Global Economy Report

February 2014
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The Global Economy Report is prepared in cooperation by the Macroeconomic Research Division of Banca Aletti and the Global Governance Programme of the Robert Schuman Centre for Advanced Studies of the European University Institute.

The objective of the Report is to provide an analysis of the current and expected macroeconomic and financial conditions at the global level, with also a focus on key economic areas such as Europe, the USA and ASIA.

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January IMF forecasts depict favourable conditions for major economies in 2014, with upward revisions for several previous forecasts, in particular for advanced economies.

Among BRIC countries, forecasts for China (7.5%) and India (5.4%) have been raised, although fractionally. Russia (2%), Brazil (2.3%) and South Africa (2.8%) see lower growth forecasts for this year due to endogenous conditions of disequilibrium and exogenous reasons connected to uncertainty on the Fed’s exit strategy.

After the 3% growth estimate for 2013, the global economy this year will grow by 3.7% according to the IMF, accelerating to 3.9% in 2015.
US growth in Q4 was in line with our forecasts, but the composition was mixed at the end of 2013. We continue to foresee a good growth both in the housing and the manufacturing sectors. Growth forecasts are at 2.7% for 2014 and at 2.9% for 2015. Unemployment rate is expected to decrease below the 6.5% threshold around mid year and continue under 6% at the end of 2015.

We expect inflation below 2% for most of the forecasting period, thanks to the output gap accumulated during the Great Recession and these years of weak recovery. After the October cyclical low at 0.9% yoy, Headline CPI trend growth has gradually accelerated to 1.5% yoy in December. Our Forecasts are for average headline CPI at 1.5% in 2014 and at 2.0% in 2015, while average core CPI is seen at 1.8% in 2014 and at 2.1% in 2015.
The Fed has decided to continue Tapering (its purchases reduction) in January, cutting monthly purchases by a further 10 bln to 65 bln USD per month. As long as data will support the Fed’s outlook, we expect a continued gradual reduction during this year, to completely halt the program in Q4 2014 (October or December). The first increase in Fed Funds should be around mid 2015.

Congress approved the Omnibus Spending Bill for Fiscal Year 2014, thus approving all spending for the current fiscal year and avoiding the risk of further shutdowns and incorporating the 10 December Budget agreement that reduces Sequester’s cuts for 2014-2015. Earlier this month, Congress also passed a bill to raise the Debt Ceiling.
The modest inversion in global economic expectations, due to turbulence in emerging markets, has not seriously impacted the qualitative indicators that lead the Eurozone’s economic cycle. Most of them reached new highs in the first survey for 2014, confirming our forecast for above consensus growth in Eurozone for the current year.

Aggregate income should therefore increase by 1.4% in 2014, accelerating to 1.8% in 2015, led by Germany, with above 2% growth both this year and next year. There are signals that Italy, after exiting the recessive phase, will gradually consolidate its growth in the course of the year, while also France is overcoming its unexpected negative growth of the second half of 2013. The key point comes from improvement in the periphery of the area.

Inflation was at +0.7% in January. We expect it may reach even further lows in February (+0.6%), stabilising on modest levels (below 1%) for most of the year. The average inflation rate is seen at 1%, but is expected to increase in 2015 to 1.5%.

In this report we present a special focus on the euro area.
After over a year of stagnation, the UK recovery accelerated in 2013 and since Q2 we registered an above potential growth. Growth comes mainly from Private Consumption, supported by an improved job market, by increased housing prices and by low interest rates, causing thus a further accumulation of private debt. Our forecasts for real growth are at 2.7% in 2014 and at 2.1% in 2015.

Inflation in the past year has been supported by a series of one-off shocks (increased taxes, university fees and utility tariffs) and by particularly low labour productivity that pushes up ULC, while more recently the pound appreciation is limiting the impact of raw materials’ price increases. In January Headline CPI fell to 1.9% yoy, below the BOE’s target for the first time since November 2009. After this number, we forecast a mild acceleration and CPI to get back above target for most of the forecasting period. Our forecasts for average headline CPI are at 2.1% in 2014 and at 2.3% in 2015.

Monetary Policy: the February MPC meeting didn’t change neither rates (at 0.5%) nor the asset Purchases programme (stuck at 375 bln pounds). The Inflation Report introduced a new Forward Guidance phase, that refers to spare capacity and different job market indicators.
EXECUTIVE SUMMARY

- China: the system is finding an equilibrium on more modest growth trajectories compared to the recent past. 2013 ended with an income increase limited to 7.7%, value that could decrease to 7.3% in the current year. There are no data for January on industrial production and sales, but December values indicate an increase in production of 9.7% and in sales of 13.6%, overall in line with the average values for the previous two years.

- Japan: persistence of an expansive impulse with uniform intensity in the 2014-2015 period, with average income increases between 1.5%-2%. The unemployment rate decreased to 3.7% in December, while the inflation value confirms the end of the deflation, with an yoy rate of 1.6% and a positive value also for the core inflation (0.7%). CPI inflation could reach 2.9% by the end of 2014, partly due to the increase in the consumption tax.
Weakness in Australian economy is evident from GDP’s fluctuation in the third quarter, at 0.6% qoq, in line with Q1 results. Also signals from labour market are not encouraging, with rising unemployment rate and declining participation rate. Growth forecasts incorporate a partial recovery in 2014 and 2015 (Oxford Economics forecasts are at 2.74% for 2014 and 2.9% in 2015), supported by RBA’s accommodative monetary policy stance.

Korea: National accounts highlight a slowdown in the second semester, with Q4 2013 growth at 0.9% qoq, down from 1.0% in Q3. The trend remains positive, benefitting from a consumption recovery sustained by government policies and low interest rates. Growth forecasts for this year are modest, around 3.02%, mainly led by consumption and supported by the Central Bank’s and Government’s policies. For 2015 we foresee an impulse in growth that should bring it back to 2011 levels.
# EXECUTIVE SUMMARY

## GENERAL MACRO SUMMARY

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|       |      |      |      |      |       |       |       |
| **INFLATION (%Y/Y)** |      |      |      |      |       |       |       |
| US    | -0.4 | 1.6  | 3.2  | 2.1  | 1.5   | 1.8   | 2.1   |
| EUROZONE | 0.3  | 1.6  | 2.7  | 2.5  | 1.4   | 1.0   | 1.5   |
| GERMANY | 0.2  | 1.2  | 2.5  | 2.1  | 1.6   | 1.5   | 1.9   |
| FRANCE | 0.1  | 1.7  | 2.3  | 2.2  | 1.0   | 1.2   | 1.3   |
| ITALY | 0.8  | 1.6  | 2.9  | 3.3  | 1.3   | 1.0   | 1.3   |
| UK    | 2.2  | 3.3  | 4.5  | 2.8  | 2.6   | 2.1   | 2.3   |
| JAPAN | -1.3 | -0.7 | -0.3 | 0.0  | 0.4   | 2.7   | 1.8   |
| BRASIL | 4.9  | 5.0  | 6.6  | 5.4  | 6.2   | 5.9   | 5.6   |
| RUSSIA | 11.7 | 6.9  | 6.5  | 5.1  | 6.8   | 5.5   | 4.9   |
| INDIA | 10.8 | 12.1 | 8.9  | 10.4 | 10.9  | 9.6   | 8.4   |
| CHINA | -0.7 | 3.3  | 5.4  | 2.7  | 2.6   | 3.1   | 3.3   |
| AUSTRALIA | 1.8 | 2.9  | 3.3  | 1.8  | 2.4   | 2.6   | 2.5   |
| KOREA | 2.8  | 3.0  | 4.0  | 2.2  | 1.3   | 2.2   | 2.8   |

*Banca Aletti Forecast
Cons. Bloomberg (Feb 14)*
FOCUS ON THE EURO AREA
In Q4 we still had positive dynamics. The income level is still significantly below pre-crisis levels, but is highest since mid 2012.
For the first time since the beginning of 2011, the four major Eurozone economies have registered positive variations of output simultaneously. Germany is still the strongest economy, with a 0.4% qoq increase and 1.4% on a yearly basis. France recovered from its summer drop and is growing at +0.3% qoq, +0.8% yearly. Italy and Spain registered +0.1% and +0.3% GDP growth respectively, with a still negative trend.
Also the minor economies of the area register improving levels and dynamic output trends. The highest growth was in the Netherlands (+0.7%), while Portugal marked the strongest trend change (+1.6%).
Only Estonia, Finland and Cyprus registered negative variations. Latvia is number one in trend terms, while among major economies Portugal beat Germany.

Ireland, Luxembourg, Malta, Slovenia and Greece have not published the data yet. Greek National Statistics Office doesn't publish GDP quarterly growth.
The modest decline in global confidence due to the current crisis in emerging markets has smouldered but not stopped the expansive trait of the global economic cycle. Economic activity, although with stronger downward risks, keeps improving, especially in developed economies. The expectations of progressive strengthening of growth trajectories for Eurozone’s main macroeconomic variables is thus confirmed, in line with aggregate industrial production dynamics already seen in the Union.
With the January 2014 survey, Eurozone Manufacturing PMI index was higher figure than the global PMI index for the first time in past three years, as the Chinese index touched its six-month low and the US index its eight-month low, though we believe the deterioration is only temporary. The European gap compared to world levels has been closed and the difference has inverted into positive territory.

**EUROZONE - GENERAL ECONOMIC ACTIVITY**

**EUROPE AND WORLD CYCLE**
PMI Manufacturing index comparison

**EUROPE AND WORLD CYCLE**
PMI Manufacturing index comparison
Eurozone recovery pace grew in January, bringing confidence to its two and a half year high. In the first survey for 2014, the Composite PMI index (that measures the general economic climate), accelerated from 52.9 to 52.1 in December, remaining above the 50 threshold for the seventh month in a row. The Manufacturing index accelerated to 54.0, its highest since May 2011, triggered by recovery of new orders (55.7, highest since April 2011). The Services index is at a four-month high at 51.6, confirming itself in expansion area.
During our forecasting horizon, Eurozone’s economy will see a) Germany’s constantly above average performance, with quarterly increases in GDP around 0.4%/0.5% in 2014-2015; b) France’s near-recessive evolution that will persist till the middle of this year (risk decreasing); c) gradual consolidation in Italy.
We expect Germany to grow by 2.2% in 2014 and 2.1% in 2015, while growth for 2014 will be at 0.6% in Italy and 0.7% in France. In 2015 the gap between Eurozone’s major economies is expected to reduce (France +1.5% and Italy +1.3%).
2013 ended with a 0.4% reduction of aggregate income. We confirm our 2014 growth forecast for Eurozone at 1.4%, sensibly above consensus or major international organisations forecasts. For 2015 we foresee a further acceleration in income up to 1.8%, still above consensus, strongest growth since 2010.
The latest available data on exports (November 2013, 0.2% mom), confirm Eurozone exports stagnation, with an average increase for 2013 at 0.6%, compared to an average 10% growth in 2011-2012 and 20% in 2010. The trend of the leading indicator is compatible with an acceleration of exports in the current year.
Accelerating exports in 2014 is a common feature for the main Eurozone economies, particularly Germany and the Netherlands. Greatest difficulties in France, that is recovering anyway.
Despite export stagnation, in the past year the trade balance registered a surplus, thanks to the simultaneous decline in import volumes (-3.9% yoy November 2013). Balance is currently at 17.1 bln euro, close to its March 2013 peak data (21.1 bln).
US and UK, both enjoying brilliant growth perspectives for 2014, represent the principal markets for Eurozone exports, counting together for slightly less than 24% of exports. Trade toward emerging Asian economies excluding China, centre of the current turbulence, represent a little over 7% of total. The persistence of critical conditions in these areas is in any case insufficient to deteriorate the EMU’s competitive position in the current year.
China is instead Eurozone main import market (over 11% of total). US and UK combined share is about 18%, while Russia is gaining importance, over 7%. Around one fifth of imported goods come from emerging Asian economies.
At the beginning of 2014, the manufacturing leading indicator recorded its highest level in the last three years at 52.2, supporting the recent acceleration of industrial production. The manufacturing cycle in Spain finally signals an expansive phase.
The first survey for 2014 also records expansive data for Greece. It's the first time since the great recession of 2008-2009. The Manufacturing PMI index in January was at 51.2, its highest since July 2008, with dynamics that anticipate a strengthening of industrial activity, currently still markedly recessive.
Irish business confidence, although decreasing in the past three surveys, remains on levels close to the past three years’ highs, in expansive territory (52.8). The figure is consistent with the great acceleration of industrial activity generated in the final months of 2013. The December 2013 fluctuation seems temporary and reversible, due to extreme volatility.
In Portugal the industrial cycle is in a phase of rapid acceleration. At 99.6, business confidence for the manufacturing sector is at its five-year high, while production registered an exceptional trend increase in December 2013 at 9.1%, marking its record since 2006.
The consolidation of macroeconomic conditions in the Union’s periphery is a central element in Eurozone’s growth acceleration in 2014.
In December industrial activity registered declines in all major economies of the area, that we assume temporary and not problematic for the strengthening production trend.
Eurozone’s industrial production closed 2013 with a -0.7% change, corresponding to a +0.5% trend change. The leading indicator is consistent with the foreseen improvement of aggregate industrial activity.
December marked a surprising weakness in private consumption in the Monetary Union. The major surprise came from the strong drop in retail sales in Germany (-2.5% mom), but decreases have been observed in Austria (-1.8%), Spain (-3.6%) and Portugal (-5.8%) as well. France is the only exception.
Retail sales in Eurozone, on average, recorded a -1.5% decrease in December 2013. The Q4 average was negative by seven tenths of a point compared to the previous quarter.
Weakness in private consumption at the end of 2013 is in contrast with the evident improvement in consumer confidence, which grew even further at the beginning of the year. For households, the economic outlook for the coming months is at a three-year high. We expect a significant recovery in retail sales already in January.
In December 2013, the job market recorded a 129K unemployment decline. In the past three months the number of unemployed decreased by 244K units overall. Such an evident improvement in occupation was not seen since 2010.
January 2014 preliminary figure for Eurozone Headline CPI was +0.7% yoy, fourth consecutive data below 1%, twelfth under ECB’s target 2%. It represents a 47-month low, previously recorded last October and it implies a -1.1% mom change. The average inflation rate for 2014 was +1.4%, down from +2.5% in 2012 and +2.7% in 2011. This is the lowest yearly rate since 2009 (+0.3%). In December (latest available Eurostat official surveys for all countries), harmonised inflation was below its long-term averages in almost all countries (except Austria and Finland), was negative in Greece and Cyprus and just positive in Portugal, Spain and Slovakia.
With preliminary January reading, Eurozone inflation rate, net of its volatile components (ex Energy, Food, Alcohol, Tobacco), is at +0.8% yoy, up by one tenth compared to its all-time low recorded in December (+0.7%). Core inflation is thus higher than headline inflation, with a one pp difference. On average in 2013 core inflation was at 1.1% (lowest since 2010), down from +1.5% in 2012 and +1.4% in 2011.
The decline in inflation in January is mainly due to energy prices (Energy CPI at -1.2% from 0% in December), but was also supported by a modest slowdown in food prices (+1.7% from +1.8) and industrial goods (+0.2% from +0.3%). Instead services inflation (over 42% of the basket) increased by one tenth, at +1.1%. 

**EUROZONE - INFLATION**

**INFLATION BY MACROSECTORS**

The decline in inflation in January is mainly due to energy prices (Energy CPI at -1.2% from 0% in December), but was also supported by a modest slowdown in food prices (+1.7% from +1.8) and industrial goods (+0.2% from +0.3%). Instead services inflation (over 42% of the basket) increased by one tenth, at +1.1%.
Excluding the energy component, that is now in deflation, the January inflation rate would be three tenths higher at 1.0%.
Inflation tends to follow the economic cycle with a two-quarters lag. The sudden slowdown of consumer prices in the fall months is largely due to the delayed effects of recession. Industrial activity’s and private consumption’s modest recovery perspectives and the improving confidence will have a positive effect on price dynamics only in a couple of months.
Looking at the charts, we notice overshooting of retail prices vs production prices, considering the existing correlation. The qualitative indexes, which remain close to their past year highs, signal that downward pressures in wholesale prices should be gradually fading.
December data signalled smaller disinflationary pressures on inputs of the production chain.
Deflation risks are negligible in the Eurozone as an aggregate. Risks may be higher in the periphery. For February, we forecast a new low at 0.6% for the headline inflation rate. Up to September 2014 general inflation will remain around 1%, compressed by high spare capacity in goods and labour markets, with a modest economic recovery. Only in October it will return around 1.5%, thanks to stabilising input and energy prices. Inflation will accelerate in 2015, but the persistent negative output gap will still bind price dynamics, keeping it far from 2%. Average rate will be at +1.0% in 2014 and at +1.5% in 2015. For core inflation we foresee a declining profile for the first three quarters of the year, with a minimum at +0.3% in September 2014 and then a gradual increase to 1% in 2015. Average rate at +0.5% in 2014, +1.0% in 2015.
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