Global Economy Report

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.

This report has been prepared by:

- Daniele Limonta  (daniele.limonta@alettibank.it)
- Massimiliano Marcellino  (massimiliano.marcellino@eui.eu)
- Alessandro Stanzini  (alessandro.stanzini@alettibank.it)
- Maria Eleonora Traverso  (mariaeleonora.traverso@alettibank.it)

with the collaboration of:
- Alberta Martino  (alberta.martino@eui.eu)

Report closed on June 20 2014
EXECUTIVE SUMMARY

- In June the World Bank published lower growth forecasts for 2014, in line with OECD forecasts. Total income should grow by 3.4%, caused by lower growth in major economies (+1.9%). This reflects a disappointing Q1 due to rough weather and geopolitical conditions, both phenomena now resolved. Emerging markets’ growth should be around 4.8%, restrained from some BRICS countries.

- In this issue we present a special focus on the global economy.
EXECUTIVE SUMMARY

- In the euro area, qualitative indicators confirm their levels close to several years’ highs, though with some problems in France.

- Our forecast for aggregate income growth for 2014 is at 1.4%, above consensus; for 2015 at 1.8%.

- Inflation has reached its lowest level since 2009 at 0.5%, but this should be the lower bound. Deflation risk remains definitely modest.

- European Parliamentary elections highlighted euro-scepticism growth, with 143 MPs out of 751 against the Union. The number of euro-sceptics increased by 55 compared to the previous Assembly. However, overall there should be no major problems.
US growth at the beginning of the year was penalised by adverse climate conditions and destocking after the strong accumulation in H2 2013. With Spring we should witness a positive growth payback. Furthermore, the constant decrease in Jobless Claims, the growth in Payrolls, that is returning to its trend and generally positive consumer confidence support expectations for favourable fundamentals. Forecasts: 2.8% for 2014 and 2.9% for 2015.

We expect inflation under 2% for most of the forecasting period, thanks to the output gap accumulated during the Great Recession and these four years of weak recovery. For Core CPI we expect a gradual acceleration. Forecasts: Average Headline CPI at 1.4% in 2014 and at 1.8% in 2015, average Core CPI at 1.8% in 2014 and at 2.1% in 2015.
EXECUTIVE SUMMARY

- In China the economic slowdown is significant but under control, an effect of the growth re-balancing sought by policy-makers.

- In Japan, volatility due to higher value added tax, around a persistent growth trend.
### EXECUTIVE SUMMARY

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GDP (%YoY)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>US</td>
<td>-3.1</td>
<td>2.4</td>
<td>1.8</td>
<td>2.8</td>
<td>1.9</td>
<td>2.2</td>
<td>2.9</td>
</tr>
<tr>
<td>EUROZONE</td>
<td>-4.4</td>
<td>2.0</td>
<td>1.4</td>
<td>-0.6</td>
<td>-0.4</td>
<td>1.1</td>
<td>1.8</td>
</tr>
<tr>
<td>GERMANY</td>
<td>-5.1</td>
<td>4.2</td>
<td>3.0</td>
<td>0.7</td>
<td>0.4</td>
<td>2.2</td>
<td>2.1</td>
</tr>
<tr>
<td>FRANCE</td>
<td>-3.1</td>
<td>1.7</td>
<td>2.0</td>
<td>0.0</td>
<td>0.2</td>
<td>0.6</td>
<td>1.6</td>
</tr>
<tr>
<td>ITALY</td>
<td>-5.5</td>
<td>1.8</td>
<td>0.4</td>
<td>-2.4</td>
<td>-1.8</td>
<td>0.4</td>
<td>1.4</td>
</tr>
<tr>
<td>UK</td>
<td>-5.1</td>
<td>1.7</td>
<td>1.1</td>
<td>0.1</td>
<td>1.7</td>
<td>2.7</td>
<td>2.2</td>
</tr>
<tr>
<td>JAPAN</td>
<td>-5.5</td>
<td>4.7</td>
<td>-0.6</td>
<td>2.0</td>
<td>1.6</td>
<td>2.1</td>
<td>1.7</td>
</tr>
<tr>
<td>BRASIL</td>
<td>-0.3</td>
<td>7.6</td>
<td>2.8</td>
<td>1.0</td>
<td>2.3</td>
<td>1.8</td>
<td>2.0</td>
</tr>
<tr>
<td>RUSSIA</td>
<td>-7.8</td>
<td>4.3</td>
<td>4.3</td>
<td>3.4</td>
<td>1.3</td>
<td>0.8</td>
<td>1.8</td>
</tr>
<tr>
<td>INDIA</td>
<td>6.4</td>
<td>8.9</td>
<td>7.5</td>
<td>5.1</td>
<td>4.6</td>
<td>4.7</td>
<td>5.4</td>
</tr>
<tr>
<td>CHINA</td>
<td>9.2</td>
<td>10.4</td>
<td>9.3</td>
<td>7.7</td>
<td>7.7</td>
<td>7.3</td>
<td>7.2</td>
</tr>
<tr>
<td>AUSTRALIA</td>
<td>1.4</td>
<td>2.6</td>
<td>1.4</td>
<td>3.6</td>
<td>2.4</td>
<td>2.8</td>
<td>2.9</td>
</tr>
<tr>
<td>KOREA</td>
<td>0.3</td>
<td>6.3</td>
<td>3.6</td>
<td>2.0</td>
<td>2.8</td>
<td>3.6</td>
<td>3.8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>INFLATION (%YoY)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
</tr>
<tr>
<td>EUROZONE</td>
</tr>
<tr>
<td>GERMANY</td>
</tr>
<tr>
<td>FRANCE</td>
</tr>
<tr>
<td>ITALY</td>
</tr>
<tr>
<td>UK</td>
</tr>
<tr>
<td>JAPAN</td>
</tr>
<tr>
<td>BRASIL</td>
</tr>
<tr>
<td>RUSSIA</td>
</tr>
<tr>
<td>INDIA</td>
</tr>
<tr>
<td>CHINA</td>
</tr>
<tr>
<td>AUSTRALIA</td>
</tr>
<tr>
<td>KOREA</td>
</tr>
</tbody>
</table>

Banca Aletti Forecast
Cons. Bloomberg (Jun 14)
The global economy
Global growth forecasts published in June by the World Bank feature lower growth rates this year than the IMF April forecasts. The revision in growth estimates is basically due to adverse climate conditions that hindered economic activity this winter in the US and political tensions in Eastern Europe, in particular the Ukraine-Russia conflict. The lower estimates for this year at 3.4% (from IMF’s 3.6%) are tied to higher growth rates in the following two years, with growth at 4.0% (from 3.9%) in 2015 and 4.2% (from 4.0%) in 2016.
Compared to OECD's global growth forecasts that are the same for 2014 (3.4%), the World Bank estimates a lower increase for both emerging markets at 4.8% (4.9% OECD) and for major economies at 1.9% (2.2% OECD). The greater difference is on this last figure that reflects the cut in US's growth estimate. For 2015 the World Bank foresees a greater increase, with global growth at 4%, driven by emerging economies, with a 5.4% increase, but slowed down by bland growth in major economies that grow by a mere 2.4%.
For the current two year period, the major difference among forecasts lies in the US growth forecasts. For its calculations, the World Bank used 1Q data, with its unexpected income decrease (-1% on a yearly basis).
ECONOMIC GROWTH FORECASTS

As for BRIC countries, World Bank’s forecasts on China are at 7.6% and 7.5% for these two years; India should grow by 5.5% and 6.3%; in this case estimates have been increased, while for Brazil – 1.5/2.7% - and Russia – 0.5/1.5% - there has been a further cut.
In March international trade data indicate zero increase in volumes traded compared to last year. We assume this dynamic is due to exceptional phenomena such as adverse climate conditions in the US (and Japan), slowdown in Asia due to non proactive Chinese policy and the Russia-Ukraine crisis. Thus, a decrease on a yearly basis among major economies and almost annulment among emerging economies, with a global figure that is practically flat. The leading indicator (Global Manufacturing PMI - new orders) is compatible with a positive trade evolution.
Global industrial activity increased by 3.5% in March, keeping up with levels of a certain intensity. For emerging markets, activity increased under 4.0% on a yearly basis (stable/decreasing), for major economies it grew by 3.2% (stable). Data suggests a reduction in thrust in the short term.

GLOBAL INDUSTRIAL ACTIVITY

Global industrial activity increased by 3.5% in March, keeping up with levels of a certain intensity. For emerging markets, activity increased under 4.0% on a yearly basis (stable/decreasing), for major economies it grew by 3.2% (stable). Data suggests a reduction in thrust in the short term.

GLOBAL IND. PRODUCTION AND LEADING IND.

GLOBAL INDUSTRIAL PRODUCTION
Among major countries for industrial production, activity data signal solid trend values for USA and Japan, positive for UK, Germany and Italy. France and Brazil display contracted conditions. Confidence data signals optimism for British and US businesses, while South Africa, Brazil and Russia still create scepticism.
ECONOMIC DATA AND EXPECTATIONS

Analysts’ expectations compared to published economic data confirm a majority of negative surprises in major and emerging economies. Dynamic analysis indicates the phenomenon is decreasing everywhere, with the possibility of a favourable evolution in the coming weeks.
The elections for the European Parliament highlight the growth of euro-scepticism with 143 MPs out of 751. The number of euro-sceptics increased by 55 members compared to the previous Assembly, thanks to frustration of millions of people with the economic crisis that produced business bankruptcies, income drop, destruction of jobs and high unemployment. The net victory in France of Le Pen’s right has triggered a period of political conflict with Hollande’s government. In Italy Renzi’s party’s success certainly strengthened his leadership.

**EUROPEAN ELECTIONS 2014**

Source: Il Sole 24 ore

**EMU - GDP**
Source: Eurostat - fixed prices 2008=100 (bn euro)

**UNEMPLOYMENT RATES**
Source: national statistic offices
The progressive solution to the Eurozone crisis, the consolidation of public finances in countries in deeper troubles and the improvement of Europe’s economic outlook increased rating on several of the Union’s countries and on the area as a whole. Greece, Portugal and Spain were upgraded thanks to improved public finances, inverting the trend after months of downgrading.
MONETARY POLICY AND FINANCIAL CONDITIONS

OIS SPREAD & CDS €BANKS

INTERBANK-OIS 1m differential

CDS PREMIUM EUROZONE BANKS

CREDIT INTEREST RATES

business credit under 1 mln euro

FOREIGN BANK’S ASSETS vs PERIPHERAL COUNTRIES

Aggregate banks data vs Italy, Ireland, Greece, Spain, Portugal

CREDIT INTEREST RATES

Consumer credit variable rate 1-5 years
In the June meeting, ECB adopted a strongly expansive manoeuvre. It reduced the official rate to 0.15% from previous 0.25%, marginal refinancing rate at 0.4% from previous 0.75% and, finally, interest rate on Central Bank’s deposits was lowered by 10 bp, making it negative for the first time, at -0.10%. It announced it shall interrupt liquidity sterilisation generated by the SMP programme, putting it in the system (165 bn). It has also proposed new long term loans (expiry 2018) from September and from December for banks, conditional on granting credit to the private sector. This mechanism may be renewed in 2015 and 2016 (expiry 2018), for a total amount that may be amply above 400 bn.
The operations of principal refinancing with full adjudication shall be extended to 2016. Thus, soon a programme of purchase of asset backed securities (ABS) to favour alternative financial sources for the private sector.

The package of measures has been coupled with a strengthening of “forward guidance”, announcing that rates will remain at current levels for a prolonged time period and, if necessary, there will be further unconventional measures. These strategies have been put in place to face the risks of a long period of low inflation, whose causes lie not only in downward pressure on food and energy prices, but also in the currency’s strength and in the fragility of internal demand.
After defining the first pillar of the Banking Union with the Single Supervisory Mechanism (bank surveillance under the ECB by November 2014, period necessary for the “Asset Quality Review” of the 130 banks and following “stress test”), the European Parliament has accepted, modified and approved the second pillar project proposed by Ecofin, which defines the regulatory mechanism for the unified management of banking crises. The basic framework is modified in a more federal sense and in terms of greater efficiency (sleeker and faster procedures): a bank’s failure will involve shareholders and creditors (up to 8% of the bank’s assets), with the creation of (a) a Resolution Committee that in an executive session and with a qualified weighted majority will take immediate decisions on appeal to single bank-saving fund (full session only for funds over 5 bln) and (b) a Resolution Fund, financed with private funds, i.e. the contributions on a national level for each bank…
... The fund will work with national compartments, with 40% in common starting the first year and 70% in three years, with a final endowment (after eight years) of 55 bn euro. However, for the transition period, apart from the bail-in (that doesn’t completely resolve the needs of coverage for restructuring), there’s no financial structure that may break the perverse connection between government and banks. The new regulation foresees that the Resolution Committee must agree on financial solutions to obtain immediate liquidity, even from the public sector. Thus, there’s something more than an option to seek support from a fund such as ESM. The Single Resolution Mechanism (SRM) will be in place from January 2015, while “bail in” will start in 2016.
In the June meeting, the Fed reduced by a further 10 bn USD its liquidity injections, bringing monthly asset acquisitions down to 35 bn (25 bn treasury bonds and 10 bn MBS). At the current pace, tapering will be over in Autumn, while the normalisation phase with increase in cost of money will start much later, by summer 2015. However, it has been stressed that the inversion in monetary policy will be gradual and with feasible targets. BoE confirmed stable QE (375 mln GBP) and forward guidance, i.e. if inflationary pressure is absent, before raising rates, the Committee for monetary policy will wait for further evidence of a reduction of excessive productive capacity. Among central banks, Mexico (at 3%) and Turkey (at 9.5%) have lowered rates between May and June by half a point. In April Russia raised them by the same value to 7.5% and New Zealand by 0.25% to 3%. The PBoC (China) reduced the rate of required reserves for rural credit twice. Overall, the system suffers from a significant drop in monetary and credit aggregates. Official rates are stable, while for the past weeks the exchange rate moved in the new fluctuation band (+/- 2% daily), suggesting weakness.
Global inflation stopped the fall in April returning above 3%, thanks to the increase in the major economies (1.5%). Also the decrease of emerging markets halted, consolidating the 5.5% level. Among major economies, price trend is on the rise (April data), with an intensity unseen for the past two years: production prices are at +1.4%, the general price index is at 1.9% and core at 1.4% (impulses remain on the rise).
The general index of raw materials (CRB index) confirmed values around the 2012 highs, with a correction in June driven by decrease in food and industrial goods. The inflationary impulses observed are potentially able to drive price dynamics much higher. The 10 year European *linker* index (French stock) is under 1.5% at the lowest in this phase. We expect an evolution between 1.45% and 1.75% in the coming weeks. We indicate 2.1-1.6% as normal *range*, with a *fair value* at 1.8%. For the same in USD, we consider contrasting impulses in the 2.20% area, with a progressive predominance for the growing ones that should soon bring 2.25-2.30% in the normal area, 2.6-1.9% with *fair value* 2.2/2.3%.
REAL RATES

Compared to compressed nominal rates, the real short term rates are negative in all three areas, mostly in Japan due to growth in inflation. Dynamic analysis indicates descending impulses in the coming weeks for USD and Yen, while for the euro the dynamic is forecasted to be stable/growing. Same with long term rates (those in USD are higher), thus the dominating force is downward, more for the Yen and for the USD.

REAL 3 MONTH RATES
Deflated series with CPI – periods: -3y and from 1997

REAL TEN YEAR RATES
Deflated series with CPI – periods: -3y and from 1997
Since March, the recovery trend among emerging markets and major markets is the main factor. The compartment has solid fundamentals and not unfavourable economic policies. Since the beginning of the year, the MSCI index of the seven major countries gains 5.6% while the MSCI EM. MARKETS has a 4.8% performance. The expected earnings growth in a year for the G7 is at 9.8% and 10.8% for EM.MKTS. MSCI G7 is at 15.11 times earnings, while MSCI EM.MKTS is at 10.94, decidedly relevant values in the first case, while in the second they leave room to grow. The condition, however, is not unstable, with a probable further expansion. The earning momentum is positive for the USA (on the rise) and Japan (decreasing). Eurozone and Far East are recovering, but not China.
The content of the preceding pages has been prepared by Banca Aletti&C. S.p.A. ("Banca Aletti") together with the European University Institute. Banca Aletti – belonging to the Gruppo Banco Popolare – is a broker authorized by law, listed in the Register of Banks, number 5383.

With this document Banca Aletti proposes to its customers’ evaluation information retrieved from reliable sources in the system of financial markets and – where deemed necessary – its own opinion on the matter with possible commentary (notes, observations, evaluations).

We point out that the information provided, communicated in good faith and on the basis of data available at the moment, could be inexact, incomplete or not up to date and is apt to variation, even without notice, at any given moment.

This document cannot be in any way considered to be a sales or subscription or exchange offer, nor any form of soliciting sales, subscriptions or exchange of financial instruments or of investment in general and is neither a consulting in financial investment matters.

Banca Aletti is not responsible for the effects deriving from the use of this document. The information made available through the present document must not be considered as a recommendation or invitation on Banca Aletti’s side to accomplish a particular transaction or to perform a specific operation.

Each investor should form his own independent persuasion, based exclusively on his own evaluations on the opportunity to invest. The decision to undertake any form of financial operation is at the exclusive risk of the addressees of the present disclaimer.

The source of all data and graphs is provided by Thomson Reuters where not otherwise specified.