AllianceBernstein

Global Economic Outlook

Global Economic Research

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Contents

Contributors

Joseph Carson
x1-6886

Guy Bruten
+61 3 8630 2207

Anthony Chan
+852 2918 7846

Kenneth Colangelo
x1-3619

Fernando Losada
x1-3429

Emma Matthy
x1-3055

Alexander Perjessy
x1-5986

Dennis Shen
+44 20 7173 9270

Danielle Simon
x1-3124

Vincent Tsui
+852 2918 5203

Darren Williams
+44 20 7959 4543

Overview

Global Economy—Global business surveys point to faster economic growth in 2014, led by developed economies.

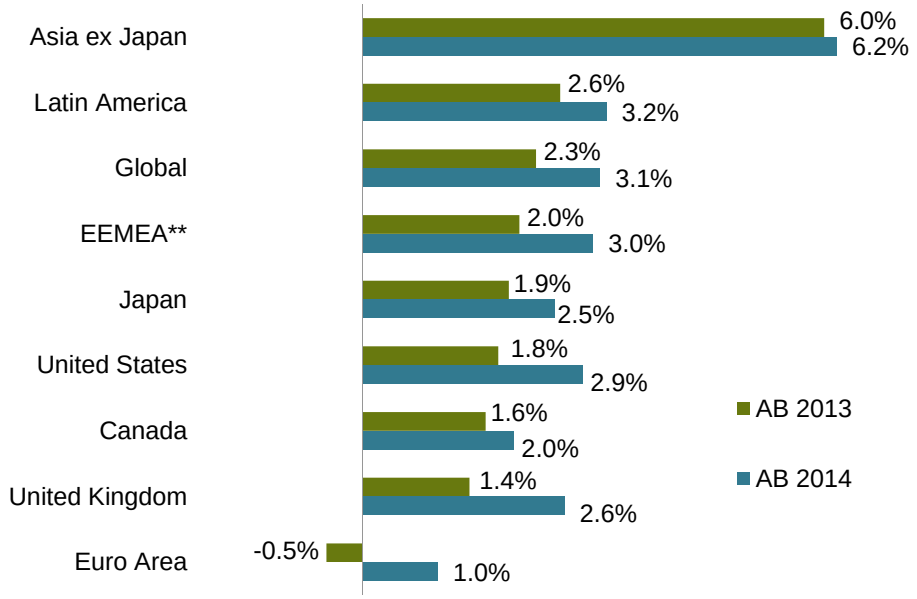
United States—US economic growth topped 3% in the third quarter, led by strong gains in cyclical sectors. This trend is expected to continue in 2014.

Europe—With growth likely to remain soft, inflation well below target and money and credit dynamics weak, we expect further monetary easing in 2014.

Japan—The yen has started to move lower again and will probably continue to weaken amid the prospect for more monetary easing, among other factors.

China—Bold reforms are needed to bolster the long-term sustainability of economic growth, although they could trigger short-term economic adjustments.

AllianceBernstein World Economic Growth Forecasts*



*Calendar year **Emerging Europe, Middle East and Africa
As of December 2, 2013
Source: AllianceBernstein

Global Outlook

Global growth is gaining speed and breadth

The global economy appears to be gaining momentum. The November survey of global manufacturing showed a strong gain, with the total index reaching its highest level in 18 months. Most importantly, solid performance of the overall index was driven by production and new orders, suggesting that the global industrial sector could be expanding at an annualized pace of 5% to 6%—twice as fast as the run rate of 2013. In our view, the rapid gains should extend well into 2014.

Leadership shifts toward developed economies

The November global manufacturing survey was led by the developed economies—particularly the US—where a broad list of industries are reporting some of the best gains in orders and production of the current cycle. Meanwhile, global manufacturing readings from emerging markets showed no net gain last month, signaling that a significant rotation in growth prospects may be in progress. It is quite possible that the global manufacturing surveys are picking up a shift in sourcing arrangements. Indeed, there have been several reports of US firms shifting back to domestic suppliers during 2013.

Worries over low inflation may trigger more easing by ECB and Japan

Although global growth prospects look brighter, inflation remains low globally. This is likely to result in more monetary accommodation in some areas. In Europe, for example, continued low inflation readings and weak growth prospects will keep pressure on the European Central Bank (ECB) to ease policy further. As a result, we expect the ECB to lower the refinancing rate further in 2014.

In Japan, inflation is likely to fall short of the Bank of Japan's (BoJ's) 2% goal for 2014, even though there is some preliminary evidence of a slight pickup in wage growth and a positive change in inflation expectations. Thus, we expect more aggressive monetary easing by the BoJ in 2014, which should weaken the yen in the process. The yen is now expected to slip toward a range of 107 to 110 versus the US dollar in the first half of 2014.

USD should gain from Fed tapering

The bigger and more important issue for global financial markets is the timing and pace of tapering by the US Federal Reserve. Policymakers are well aware that its unconventional policies could cause distortions, such as a strong asset price cycle and a misallocation of capital. Given the improvement in US labor markets since the latest quantitative easing program (QE3) began in September 2012, with the jobless rate dropping from 8.1% in August 2012 to 7.0% in November 2013, we believe that policymakers would be well advised to start tapering soon. We think that tapering QE3 would lead to a strong USD, especially against many of the major G7 currencies.

US Outlook

US growth recovery is gaining traction

During the third quarter, US real gross domestic product (GDP) growth was revised up to 3.6% from the initial estimate of 2.8%, representing the fastest quarterly gain since the first quarter of 2012. The stronger-than-expected gain in third-quarter output was driven primarily by faster gains in the private sector, as overall output in business (or nonpublic industries) is now estimated to have increased by 4% annualized, up 0.5 percentage point from the original estimate.

On the surface, some analysts may question the underlying strength of the US economy in the third quarter, since a large part of the gain was attributable to inventory investment. Based on the official data, overall final sales rose 1.9%, which

means that an accelerated pace of inventory investment accounted for 1.7 percentage points of total growth.

Strong sales gains in goods and structures

However, the final sales numbers masked the strength in demand that is ultimately linked to business inventory positions. Indeed, the final sales measure includes not only sales of goods and structures, but also of services—a sector of the economy that does not require or hold a lot of inventory. Moreover, the final sales of services have been exceptionally weak, partly because of cutbacks in government spending.

At the same time, final sales of goods and structures increased by 5.5% in the third quarter, well above the 4% gain in overall inventory positions. As a result, the ratio of total business inventories to final sales of goods and structures fell to an all-time low in the third quarter, according to the US Bureau of Economic Analysis, implying that the outsize gain in business investment was warranted.

Inventory positions remain well managed

Additional corroboration for our view that the third-quarter inventory build was intentional can be seen in the October and November surveys of manufacturing activity as reported by the Institute for Supply Management. In both months, the new orders index posted a relatively high reading, indicating that an increase in new order commitments was flowing to a wide range of industries, and that the increased demand came from both domestic and overseas customers.

Fed tapering could start soon

In our view, the US economy's strong performance in the third quarter should bolster the near-term odds that the Fed will taper QE3. That's because the GDP gain occurred despite a 1.7% contraction in spending by the federal government sector—the fourth consecutive quarterly decline. This fiscal drag is projected to diminish sharply from 2.4% of GDP in 2013 to 0.7% in 2014. A sharp reduction in the headwind from fiscal policy should result in faster GDP growth, lower unemployment and a reduction in monetary stimulus. Against this backdrop, we expect policymakers to start tapering the QE3 program relatively soon, perhaps as early as the Federal Open Market Committee meeting in December.

Europe Outlook

Growth remains positive but weak

Cyclical indicators continue to point to positive, but weak, economic growth in the euro area. For example, the composite Purchasing Managers' Index (PMI) for manufacturing and services eased slightly to 51.7 in November from 51.9 in October, but this is still consistent with GDP growth of around 0.2% per quarter. This is exactly what we should be expecting from the euro area at this stage of what is likely to be a gradual and subdued recovery in comparison with past history.

Divergence in country trends…

Moreover, aggregate economic indicators for the euro area continue to mask important differences among individual countries. This was particularly obvious in the November PMI data. These showed the German composite PMI rising to 55.4 from 53.2 in October, the highest since June 2011. There was also good news in Spain, where the PMI rose to 50.8 from 50.1, with the main impetus coming from the domestically oriented services index. But that's where the good news stops. France's composite PMI fell sharply to 48.0 from 50.5, while the Italian number also fell heavily to 48.8 from 51.3.

…with weakness in France and Italy

In our view, this configuration of readings neatly sums up the current situation in the euro area. Germany is outperforming and looks set to grow strongly in the coming quarters. Spain is starting to reap benefits from past adjustments, particularly as

fiscal pressure is starting to fade. But Italy and France—clear laggards when it comes to structural reform and labor cost adjustment—continue to struggle. However, it is one thing for France and Italy to lag during the recovery phase; it's quite another for them to move in the opposite direction. Should this continue, it will only serve to highlight the limitations of the ECB's "one size fits all" monetary policy.

More easing in the pipeline

Turning to the ECB, we expect pressure for a further easing of monetary policy to remain high in coming months. Indeed, with the recovery likely to remain subdued, inflation set to remain well below target, and money and credit dynamics soft, we now expect a further cut in the ECB's refinancing rate to 10 basis points (b.p.) during the first half of 2014. At this stage, we do not think the ECB will take the more controversial step of cutting its deposit rate into negative territory. However, this remains a distinct possibility should the economy fail to show any upward momentum over the coming year, should inflation continue to surprise on the downside or should the euro appreciate further.

A more proactive ECB?

In the past, ECB decisions to reduce interest rates have usually been driven by deteriorating economic data, like the PMIs. However, this was not the case when the ECB decided to cut interest rates in November, and this is not the reason why we expect further easing next year. Rather, we think that the ECB's reaction function has changed. The most important change, in this respect, is that the ECB now seems to be giving greater weight to current inflation in its policy decisions. However, it is also possible that the ECB is transitioning away from being a reactive central bank focused on medium-term developments, toward being a more proactive institution. If this is correct, then the ECB is unlikely to be willing to sit back and watch euro-area growth move sideways, while inflation remains at levels well below its definition of price stability as money and credit aggregates stagnate or the euro appreciates. Instead, we believe that it is likely to respond with easier policy, which can only be positive for those euro-area countries now flirting with deflation.

Japan Outlook

The yen has started moving lower again…

The USD/yen exchange rate broke through the 102 level in late November, the first foray into that area for the yen since May. The move has been fairly rapid, but in line with trends that we've seen over the past six months. After a sharp depreciation from September 2012 through last May, fueled by optimism about Abenomics—Prime Minister Shinzo Abe's aggressive economic policies—the yen has effectively been range-bound.

…and the prospect for more monetary easing, among other factors, suggests more to come

So how are we to interpret this latest move? Are we set for a reversal into the middle part of the range? Or does this represent the start of a new downtrend in the yen? In our view, there are three factors that push us toward the latter scenario.

First is the likelihood of more monetary easing. To date, the "big bang" monetary expansion delivered by BoJ governor Haruhiko Kuroda on April 4 has been paying dividends. The policy has buoyed asset prices, weakened the yen and eventually reversed a brief rise in bond yields that occurred in May/June. Thanks to the expansion combined with fiscal stimulus, GDP growth is now motoring ahead. And, in contrast to the global trend, inflation has shifted higher. But there is growing disquiet among the BoJ policy board members that the central bank will fall short of hitting its 2% inflation objective. In our view, that's a valid concern. The initial impact on inflation from the falling yen is now fading. And while rising wage growth looks likely,

that will be a mid-2014 story—not soon enough to prevent an immediate loss of inflation momentum. Considering that risk, coupled with the risks to the economy surrounding the consumption tax outlook, we believe that there's a compelling case building to deliver more monetary easing.

The second factor is the balance-of-payment dynamics. Despite the yen's depreciation, the trade balance remains firmly in deficit territory. Maybe it's the "J-curve" effect at work—trade volumes only respond with a lag. And higher energy imports as a result of the nuclear shutdown are playing a role, too. Regardless, over the last two months the deficit has averaged 2.7% of GDP—not too different from the surplus on income flows. So the current account balance is now only marginally in positive territory. Couple that with accelerating net foreign direct investment outflow, and Japan's so-called "basic balance" is now firmly in negative territory. This is a completely different balance-of-payments dynamic for Japan. At the same time, conviction is growing about the prospect for portfolio outflows thanks to the recommendations of an advisory committee for the Government Pension Investment Fund, which manages Japan's public pension funds. And note that the weekly transactions data show a pickup in purchases of foreign bonds.

Finally, there's the political dimension. Until now, there's been no particular appetite to drive the yen to an even lower level. In part, that's because the move was doing its job—boosting companies' profit margins and allowing political pressure to be applied to corporations to increase wages. But there was also a risk of "too much of a good thing"—that too steep a depreciation might end up squeezing disposable incomes, given the pass-through of energy costs. But with the initial profit boost now starting to fade and with the risks of income squeeze ameliorated to some extent by the prospect of nuclear plant restarts, the political appetite for a little more currency depreciation should soon build. This is all part of keeping the weak yen/strong Nikkei/positive approval ratings dynamic going—until more is achieved on the "Third Arrow" of Abenomics.

To these factors we would also argue that US economic fundamentals—improving growth, a move towards removing monetary stimulus, and higher interest rates—are also supportive of a stronger USD (and hence, a weaker yen). But even putting those aside, the Japanese idiosyncratic factors seem to suggest a growing prospect for further modest yen weakness. We are expecting a move in USD / JPY to the 107–110 range over the next six to nine months.

Australia/New Zealand Outlook

Exchange rate overvaluation remains a central concern for both RBA and RBNZ

Exchange rate overvaluation—and what to do about it—has been one of the big themes over recent weeks from the reserve banks of both Australia (RBA) and New Zealand (RBNZ).

A range of speeches and statements from the policymakers make it clear that they view their respective currencies as (probably) overvalued—but by how much is a difficult nut to crack. In part that's because by and large, the floating currencies have done what's been asked of them—helping to accommodate a mining boom in Australia's case, and responding to a chronic shortage of domestic savings in New Zealand's case.

So while weaker currencies could help the adjustment process in the next couple of years, the case for actively doing something to facilitate that move is not necessarily compelling. And, in any event, there's not a lot that the central banks can do about it.

On intervention, in particular, officials make the point that most of the trading in the Australian dollar (AUD) and the New Zealand dollar (NZD) occurs offshore; market volumes are large relative to likely central bank action; and large-scale intervention exposes the taxpayer to greater financial risk. So the hurdle is pretty high.

Both central banks also acknowledge that there are occasions when intervention can be effective—hence their party line that it remains part of the toolkit. Nonetheless, RBA Governor Glenn Stevens notes that intervention "can't make up for weaknesses in other policy areas, and to be effective it has to reinforce fundamentals, not work against them."

On that latter point, it's clear that the fundamental outlook for the two countries continues to diverge. Surveys assessing current business conditions, for example, show a gap that is close to the biggest on record. New Zealand conditions are about 1.5 standard deviations better than average, while Australia's are one standard deviation below. Labor-market indicators are telling a similar story, too. Job ads are up 10% year over year in New Zealand, but down 12% in Australia. The unemployment rate is falling in New Zealand in the context of rising participation, while the reverse is true in Australia. And net immigration into New Zealand is back to the high levels last seen in 2003, a great barometer of relative trans-Tasman labor-market strength.

The big-picture drivers have been clear for some time—a capital-spending upswing in New Zealand (earthquake reconstruction) versus a downturn in Australia (mining), as well as the rising terms of trade in New Zealand (dairy) versus a slide in Australia's (iron ore and coal). These contrasting factors are now revealing themselves in overall economic performance.

This divergence in fundamentals is driving the divergence in monetary policy. We still think the RBNZ is likely to tighten monetary policy in the first quarter of next year while the RBA is likely to ease. At the margin, it makes it more likely that the RBA will intervene in the currency market. As a result, we continue to favor the NZD over the AUD.

Canada Outlook

Despite Canada's relatively strong 2.7% annualized growth, the best quarterly performance in two years, the Bank of Canada's most recent policy statement exhibited an increasingly dovish tone. As expected, the bank kept rates on hold for the 25th consecutive decision, but the details of the announcement were more interesting.

Bank of Canada focused on low inflation

In October's Monetary Policy Report, there was a notable change in tone from a hawkish bias to a neutral tone, and that shift intensified in November's statement. Policymakers once again stressed greater concern about downside risks from inflation than about risks from elevated household imbalances. Furthermore, the release minimized discussion of the better-than-expected GDP number. The limited attention the release gave to the GDP report was focused on dissuading any

extrapolation from the improved quarterly expansion to enthusiasm about a sustainable rebalancing toward exports and investment.

While growth in business investment spending should be encouraging, it comes with the important caveat of a weak starting point; and net exports were still a drag on growth. Of the total 2.7% GDP expansion, inventory restocking contributed a full 1.2%.

Strong GDP headline still doesn't signal a rebalancing

And just as the Bank of Canada largely wrote off the strong GDP report, so too did the market. In the past month, the Canadian dollar (CAD) has depreciated over 2%, adding to the 4% depreciation that took place through October. We believe the currency has farther down to go. Persistently weak exports, relatively stronger US growth and an imminent tapering of the Fed's QE3 program all suggest that the recent USD/CAD rally is set to continue. Given that, we have increased our six-month USD/CAD forecast to 1.10.

Finally, while we see virtually no chance of a rate hike in 2014, we also view a rate cut as extremely unlikely. Though concerns about household imbalances are being dwarfed by low inflation, there has been little—if any—constructive evolution of household balance sheets so far this year. Additionally, given that the currency is already in the midst of accelerated depreciation, the central bank has much less incentive to try to manipulate the CAD by lowering interest rates.

CAD is set to weaken further

The bottom line is that despite some recent positive surprises in the data, we view the story as unchanged. We expect both the CAD weakness to persist and the Bank of Canada to stay on hold as we move into 2014.

Emerging-Market Outlook

Latin America: Asset prices in Latin America have remained under pressure in recent weeks because of the anticipation of an earlier-than-expected tapering by the US Federal Reserve. Currencies and long-end rates are nearing the highest levels of the year.

Argentina: New economic team, new economic policies?

In Argentina, President Cristina Fernández de Kirchner reappeared last month after her convalescence following surgery and announced several cabinet changes. The main change was the appointment of Deputy Economy Minister Axel Kicillof as the new economy minister, replacing Hernán Lorenzino, who became ambassador to the European Union and head of a new debt restructuring unit. Juan Carlos Fábrega, head of state-run Banco de la Nación Argentina, was appointed new central bank governor, replacing Mercedes Marcó del Pont. Chaco State Governor Jorge Capitanich became the new chief of cabinet, replacing Juan Abal Medina. Controversial commerce secretary Guillermo Moreno, largely considered to be one of the architects of the generalized price controls, the restrictions to international trade and the government's meddling with statistical reporting, also announced his departure from the administration. He was replaced by Augusto Costa, a foreign affairs ministry official who is close to Kicillof.

Settlement with Repsol nears

The changes conveyed the message of a gradual regime change. That perception was further reinforced by the announcement of a preliminary agreement to settle the dispute between Repsol YPF and Argentina stemming from the expropriation of 51% of the company's assets in 2012. Although there has been no official information about the Argentine offer to Repsol, Argentine and Spanish sources indicated that it

was in the order of US$5 billion, and that the payment would be made in dollar-denominated government bonds. The authorities also announced a 6% increase in fuel prices. Both the Repsol accord and the price increase suggest that the new cabinet members are zeroing in on the energy supply deficit as a priority, which is clearly a positive development. Two days after the announcement, Repsol's board of directors approved the preliminary memorandum of understanding. Despite Repsol's acceptance, details of the agreement have yet to be worked out. These include the tenor and yield of the securities, whether they will trade in open markets and whether they will have a grace period. In addition, Repsol announced that it hired an international bank to represent the company in negotiations with the republic, although Kicillof has said the discussion would have to be strictly between the firm and the republic, with no intermediaries. The management of Mexico's state oil company PEMEX, which owns a 10% stake in Repsol, was part of the negotiation, and the Argentine media are now reporting that PEMEX may establish a joint venture directly with YPF, the state-controlled oil company, to exploit the Vaca Muerta field, which is believed to contain the fourth-largest shale oil and gas reserves in the world. Despite the negative bond-supply consequences of the Repsol deal, this news is broadly positive, as it suggests that the new cabinet is moving toward normalizing the country's international financial relationships. We think there's a good chance that the agreement with Repsol will be completed soon, possibly within a few weeks. We do not believe, however, that these initiatives will result in a quick settlement with holdout investors. The appointment of Lorenzino as ambassador to the EU and head of the debt restructuring office suggests that the administration will prioritize an agreement with the Paris Club.

Brazil: Copom delivers 50 b.p. as expected

In Brazil, Copom, the central bank's monetary policy committee, did not surprise the market, and increased the Selic short-term interest rate by 50 b.p. to 10%. The press release that accompanied the decision, however, carried some news, as the committee emphasized that the hiking cycle had started in April, hinting that because of the lagged impact of monetary policy actions, the full brunt of the rate increases has yet to be felt. The communique also eliminated a sentence—which had been introduced at the time the hiking pace was accelerated to 50 b.p. from 25 b.p.—related to the contribution of rate increases to reducing inflation. Therefore, the market interpreted the message as somewhat dovish, or at least suggestive of the possibility that the next rate increase will be milder, maybe about 25 b.p. We continue to believe that the hiking cycle is nearing its end and that it will stop during the first quarter of 2014 at no more than 10.5%.

Milder-than-expected fuel price increase

Petrobras finally announced an adjustment in fuel prices, effective December 1st. Prices of fuel at the refinery level increased by 4% and those of diesel oil rose by 8%. However, fuel prices at the pump are to increase by a smaller percentage of nearly 2%, according to Fecombustiveis, a local bureau of gas station owners. In November, previous days, Petrobras CEO Graça Foster said that fuel prices were 6.5% below fair value and diesel prices were 19% lower than that benchmark. For the last two months, after Petrobras requested an October 25 deadline to implement a new price-setting mechanism, market talk had focused on the enactment of an automatic price-adjustment mechanism based on onshore/offshore differentials. However, it was believed that both President Dilma Rousseff and Finance Minister Guido Mantega opposed such a move because of its potential inflationary consequences; ultimately, the fuel price formula was not put on automatic pilot but rather remains under government control. Upon the announcement of the price adjustment, Petrobras said that "because of commercial reasons, the parameters of

the pricing methodology will remain strictly internal to the company." The announced price adjustment is a compromise between what the company requested and what the government was willing to offer, which suggests that the implicit subsidy on fuel consumption will be lower but will not disappear. The company said debt ratios are expected to return to limits established in the 2013–17 business plan "within the next 24 months," but it looks unlikely that a substantial decline from the levels reported in the third quarter of 2013 will be achieved unless further price hikes are authorized. The secrecy regarding the adjustment formula hints at the government's preference to keep all its options open for next year, although another price hike before the 2014 presidential elections looks unlikely at this juncture. Petrobras' asset prices opened lower on the news, suggesting market disappointment with the announcement. If fuel prices rise by 2%, that will result in a one-off jump in prices of nearly 10 b.p., mostly in December. We expect annual inflation to be near 5.8% by year-end, a shade below last year's rate.

Mexico: More reforms drawing near

The center-left Partido de la Revolución Democrática (PRD) announced its "definitive" withdrawal from the Pacto Por México, the multiparty agreement that was used as a framework for the design of the structural reform agenda. The ruling Partido Revolucionario Institucional (PRI) and opposition Partido Acción Nacional (PAN) remain part of the accord. The PRD had teamed up with the PRI to endorse the tax reform, but it opposes the energy sector deregulation, which is in turn backed by the PRI and the PAN. Thus, the PRD exit from the Pacto can be interpreted as a signal that the negotiations between the PRI and the PAN on energy are making progress. By withdrawing from the agreement, the PRD can have maximum flexibility to criticize the energy plan and may even try to call for an anti-reform referendum next year. In the meantime, the electoral reform was approved by Congress in general, and at the time of writing the discussion on an article-by-article basis was expected to be completed very soon. The main issues of the reform include reelection of federal legislators, mayors and local deputies, creation of a national electoral institute to oversee local elections, establishment of stricter campaign financing rules, and tougher requirements for the appointment of cabinet members. The PAN had imposed the approval of the electoral reform as a condition for it to give support to the energy reform, so that the endorsement of the former leaves the door open for a discussion of the energy bill in the coming days. We continue to believe that there is a high chance for approval before year-end of the constitutional amendment to lift the restriction on private participation in the energy sector. And secondary laws with contractual details are likely to be ready in early 2014. If so, Mexican asset prices are likely to get an initial lift by year-end, although the prospects for an earlier-than-expected tapering by the Fed remain a risk to this scenario. We maintain a positive view of the Mexican peso over the medium term, as the energy reform should contribute to lower country risk, increase productivity and attract foreign direct investment in the years to come.

China's reform drive should support long-term growth, despite possible near-term slippage

Asia ex Japan: Recent trends continue to show that Asia's growth cycle has only revived modestly in the second half of 2013 after bottoming in the second quarter. This is because export performance has been mediocre amid a lack of domestic demand recovery across the region. China's push for the next round of comprehensive social and economic reform is the most exciting policy change in the region and, if it works effectively, the country's long-term growth sustainability will be better secured. In our view, the reform should create many new growth opportunities, although economic restructuring will also retire many of the old growth engines, particularly with the aim of resolving some of China's overcapacity problems. Overall,

we think there should be some downside pressures on growth before China embarks upon a more solid new growth path. Yet we don't expect an increased risk of a hard landing; rather, we believe a slippage in growth is likely over the next few quarters when the rebalancing starts. At this juncture, we are maintaining our GDP growth forecast for China at 7.4% in 2014, modestly lower than 7.6% in 2013.

India's tight monetary policy and the need to curb public spending will suppress growth

India's third-quarter 2013 GDP growth came in at 4.8% year over year (versus 4.4% in the previous quarter)—the fifth straight month of growth below 5%. This represents a markedly slower growth environment compared with the 8–9% expansion before 2012. Hence the modest uptick in the third quarter did not signal much of a turnaround given the uneven nature of quarterly GDP growth. The mix of growth was also not too reassuring, as the marginal improvement in agricultural output (thanks to a relatively benign monsoon period) and manufacturing production was offset by moderation in services-sector output, which in itself accounts for some 70% of GDP. Meanwhile, monetary policy is expected to tighten further to curb inflation, while the ongoing robust expansion in fiscal spending will probably be reined in sharply after the general elections in the first half of 2014. Given these trends, we still expect India's GDP growth to remain benign at 5.1% in 2014.

Typhoon impact will not derail Philippines' robust growth, but central bank will stay accommodative

Although typhoon Haiyan caused vast damage and human tragedies in the Philippines, its impact on the country's economic growth and trade should be limited given the small share of the key areas of national economic activity the storm hit. Indeed, official estimates for the damage—US$568 million as of November 25—amount to just 0.2% of the Philippines' GDP. Inflation will rise but probably not add more than 0.5 percentage point to prevailing inflation (at 2.9% year over year), based on past observations of similar incidents. Overall, we expect that the typhoon's impact will not derail the Philippines' buoyant growth and the central bank will look beyond the one-off inflation impact and stay largely dovish in policy setting.

Political tension in Thailand will prompt more policy easing, helping local bond performance

In Thailand, political tension has surged with the resumption of violent protests by opposition leaders to oust Prime Minister Yingluck's administration. Crucially, and unlike previous episodes of political unrest, we think the chances of a military coup remain slim. Indeed, the prime minister has already dissolved the parliament and a general elections will be held before February 2014. This represents a better way to resolve the political stalemate, in our view. Overall, the Bank of Thailand's surprise 25 b.p. policy rate cut in response to the political tension suggests that there will be more policy accommodation if the political tension lingers. As we see more downside growth risk to the already sluggish economy, local-currency bonds are the best asset class to gain from the current politically induced economic downcycle, in our view.

EEMEA's multi-speed economic recovery

Emerging Europe, Middle East and Africa: The theme of EEMEA's multi-speed recovery continued to play out during October and November, with economic data releases (hard and soft) underscoring the disparities among central Europe, Russia, and the rest of the region. Despite weak domestic demand, industrial production continued to rebound in Poland, Hungary and the Czech Republic on the back of better core European performance. In contrast, Russia's economic data continued to disappoint, and high-frequency activity reports from Turkey and South Africa continued to display high volatility with a softening bias. In South Africa, this was partly due to production disruptions caused by the strikes in August and September that affected a number of manufacturing sectors, but most notably autos. In Turkey, the effective monetary tightening implemented by the central bank since the summer and the exchange rate depreciations have both undermined business

and consumer confidence, in turn causing a pullback in domestic demand, which had been growing at a brisk pace in the first half of the year.

Looking ahead, much will depend on whether the recovery in core Europe is sustained. On that front we are concerned about the latest production data releases in the euro area and in Germany in particular, which—despite stronger PMIs—point to a significant loss of industrial production momentum in the third quarter. Such a loss of momentum in core Europe has historically been followed (with a few months' lag) by an equivalent slowdown in central and eastern Europe due to closely integrated manufacturing production chains.

Generally benign inflation outlook…

Meanwhile, on the inflation front, the pressures in the region remain very subdued and the inflation outlook continues to be benign. Two notable exceptions here are Turkey and Russia. In Turkey, headline inflation slowed more than expected during November—courtesy of a downward surprise in food prices and an apparent petering out of the exchange rate pass-through from this summer's lira depreciation. But the run rate of core inflation remains high and above the central bank's (already fairly wide) inflation target rate of 3–7%. In Russia, the headline inflation rate remains stubborn, stuck at around 6.3%. These inflation trends have been a source of hawkishness by the Bank of Russia as well as the Central Bank of the Republic of Turkey, the latter indicating its intention to continue normalizing its unconventional monetary-policy framework.

…will keep monetary policy accommodative for some time in most countries

Elsewhere in the region, the central banks have little reason to tighten their accommodative policies. The National Bank of Hungary (NBH) continued to cut interest rates last month, encouraged by rock-bottom inflation readings, delivering another 20 b.p. cut to 3.20% last month. It also further eased monetary conditions by relaxing the terms governing bank lending under the (nonconventional) lending-for-growth scheme. We expect another policy rate reduction from the NBH before year-end, which should bring the base rate in line with the medium-term inflation target of 3.0%.

In Poland, the central bank has issued (and again reconfirmed in November) a forward guidance indicating that no rate changes should be expected before at least the middle of next year. Meanwhile, the Czech National Bank has finally thrown in the towel after months of resistance and begun easing policy through foreign exchange interventions, causing a koruna depreciation of 6.5% (versus the euro) since November 7, quite likely in response to a surprise rate cut by the ECB on the same date.

AllianceBernstein Global Economic Forecast

Dec-13

	Real Growth (%)				Inflation (%)				Official Rates[1] (%)		Long Rates[1] (%)	
	4Q/4Q		Calendar		4Q/4Q		Calendar		EOP	EOP	EOP	EOP
	2013F	2014F	2013F	2014F	2013F	2014F	2013F	2014F	2013F	2014F	2013F	2014F
Global	2.8	3.2	2.3	3.1	2.5	2.9	2.4	2.8	2.13	2.13	3.63	4.06
(PPP Weighted)	(2.8)	(3.7)	(3.0)	(3.5)	(2.8)	(3.0)	(3.0)	(3.0)				
Industrial Countries	1.8	2.3	1.1	2.1	1.4	2.2	1.4	2.0	0.34	0.30	2.17	2.68
Emerging Countries	4.6	5.0	4.5	4.9	4.7	4.2	4.5	4.4	5.72	5.80	6.63	6.91
United States	2.3	3.3	1.8	2.9	1.6	2.6	1.6	2.4	0.13	0.13	2.75	3.50
Canada	1.9	2.1	1.6	2.0	1.4	2.6	1.1	2.2	1.00	1.25	2.75	3.25
Europe	0.6	1.6	-0.1	1.3	1.0	1.5	1.5	1.2	0.34	0.24	1.94	2.40
Euro Area	0.2	1.3	-0.5	1.0	0.8	1.3	1.3	1.0	0.25	0.10	1.75	2.25
United Kingdom	2.5	2.6	1.4	2.6	2.3	2.1	2.6	2.1	0.50	0.50	2.75	3.00
Sweden	1.0	2.9	0.6	2.4	0.1	1.5	0.0	1.0	0.75	1.00	2.25	2.75
Norway	1.8	2.8	1.9	2.5	2.4	1.8	2.2	2.0	1.50	1.75	2.75	3.00
Japan	3.8	1.7	1.9	2.5	1.3	3.1	0.3	2.9	0.10	0.10	0.60	0.80
Australia	2.6	1.7	2.4	1.9	2.5	1.7	2.4	2.1	2.50	2.00	3.90	3.75
New Zealand	3.5	3.5	3.1	4.1	1.9	1.8	1.2	1.9	2.50	3.50	4.75	4.70
Asia ex Japan	6.0	6.3	6.0	6.2	3.5	3.1	3.2	3.2	5.50	5.45	5.31	5.50
China[2]	7.6	7.6	7.6	7.4	2.9	2.6	2.6	2.7	6.00	6.00	4.80	5.25
Hong Kong[3]	3.1	3.1	3.4	3.9	4.6	4.1	4.4	4.2	0.50	0.50	2.28	2.70
India[4]	4.0	5.8	4.3	5.1	6.7	4.9	6.2	5.6	8.00	7.75	9.25	8.75
Indonesia[5]	5.3	5.7	5.6	5.3	7.9	4.3	6.9	4.9	7.50	6.50	8.00	7.00
Korea[6]	3.6	2.9	2.7	3.1	0.9	1.9	1.2	1.6	2.50	2.75	3.80	4.00
Thailand[7]	2.5	4.0	3.4	5.0	1.9	3.9	2.3	3.3	2.25	2.50	4.30	4.50
Latin America	2.6	3.1	2.6	3.2	6.2	7.6	6.2	6.9	7.22	7.60	9.66	9.87
Argentina	2.8	3.0	4.3	2.5								
Brazil	2.3	2.4	2.4	2.5	5.8	6.1	5.9	6.0	10.00	10.50	12.50	12.80
Chile	4.0	4.5	4.3	4.4	2.2	2.9	1.8	2.6	4.50	4.75	5.00	5.40
Colombia	4.0	4.4	3.8	4.2	2.3	3.0	2.3	2.8	3.25	3.50	7.00	7.20
Mexico	2.2	4.0	1.4	4.1	3.5	4.0	3.7	3.8	3.50	3.75	6.00	6.00
EEMEA	2.4	3.0	2.0	3.0	5.3	5.2	5.8	5.1	4.73	4.92	7.68	8.37
Hungary	1.3	1.7	0.3	1.6	1.8	2.5	2.0	2.4	3.00	3.50	6.75	7.75
Poland	1.8	2.9	1.2	2.6	0.9	2.2	1.0	1.9	2.50	2.75	4.50	4.75
Russia[8]	1.6	2.6	1.5	2.8	5.9	5.6	6.7	5.7	5.50	5.25	7.60	8.50
South Africa	2.5	3.1	2.1	3.0	5.7	5.7	5.8	5.7	5.00	5.50	8.50	9.00
Turkey[9]	5.1	4.0	4.2	4.0	7.3	6.3	7.4	6.1	4.50	5.50	9.75	10.25

1) Official and long rates are end-of-year forecasts.
Long rates are 10-year yields unless otherwise indicated.
2) China: Official rates are 1-year benchmark lending rates and 10-year government bond yield.
3) Hong Kong: Base rate and 10-year exchange funds yield
4) India: Overnight repo rate and 10-year government bond yield
5) Indonesia: Intervention rate and 10-year government bond yield
Source: AllianceBernstein

6) Korea: Overnight call rate and 10-year government bond yield
7) Thailand: 1-day repo rate and 10-year bond yield
8) Russia: Longest fixed-rate government bond until April 11, 2011; 10-year bond thereafter.
Official rates: CBR's O/N fixed deposit rate until Oct 2011, then 1-day repo rate
9) Turkey: Since Oct 2011, the official policy rate no longer accurately reflects the central bank's monetary policy stance.
Note: Real growth aggregates represent 27 country forecasts, not all of which are shown.
Note: Blanks in Argentina are due to the distorted domestic financial system so we don't forecast.