AllianceBernstein

Global Economic Outlook

Global Economic Research

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Overview

Global Economy—Our global growth estimate of 3.2% for 2014 is unchanged from last month as better trends in developed economies offset downgrades to emerging-market economies.

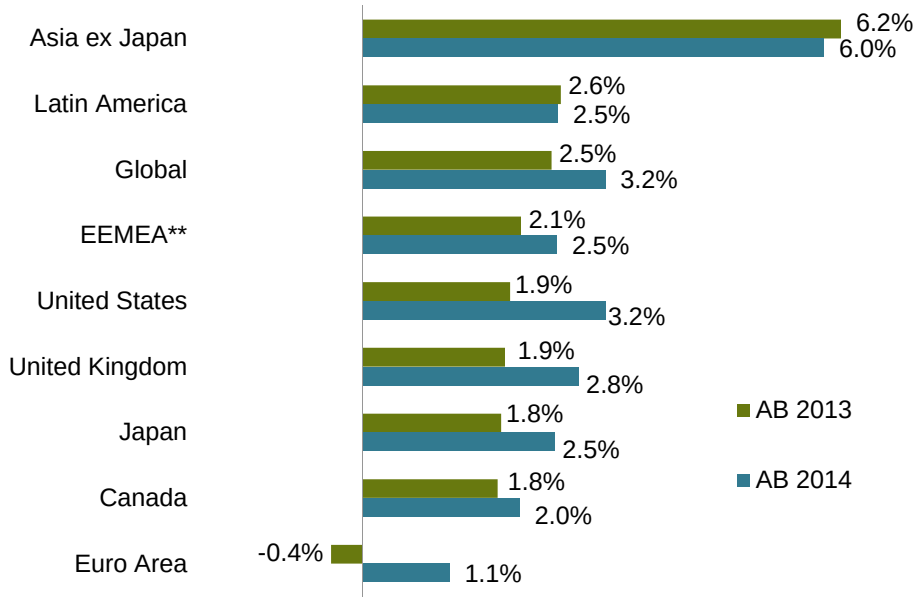
United States—Economic growth is expected to accelerate in 2014 as the drag from government spending cuts begins to diminish.

Europe—Recent data have been encouraging, but some caution is necessary, especially as the euro area would be vulnerable to a bigger-than-expected emerging-market slowdown.

Japan—Economic data continue to exceed expectations, underscoring the cyclical success (to date) of Abenomics.

China—GDP forecast is cut by 30 basis points (b.p.) to 7.1% because of tighter financial conditions and weaker demand for exports from emerging markets.

AllianceBernstein World Economic Growth Forecasts*



As of February 3, 2014
*Calendar year **Emerging Europe, Middle East and Africa
Source: AllianceBernstein

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Global Outlook

Global growth estimates unchanged

Our global economic growth projections of 3.2% for 2014 are unchanged since the start of the year, but there has been a marked shift in the composition. Growth estimates for most of the major emerging-market (EM) regions have been marked down, as the weak fundamental trends in many developing economies are colliding with a reduction in global liquidity. For example, China's GDP forecast was reduced to 7.1% from 7.4% because of tighter domestic financial conditions and weaker EM demand for Chinese exports. Growth estimates for Latin America were reduced from 2.9% to 2.5%, while EEMEA's growth forecasts were cut from 2.8% to 2.5% because of a combination of tightening domestic financial conditions and the expectations of less trade activity with other EM countries.

Improvements in developed economies helped offset weakness in EM

Countering the downgrade of EM growth prospects was a marginal upgrade to growth in the US, Europe and Canada for 2014. The shift in global leadership is most evident in business surveys for manufacturing activity. Developing economies have consistently shown better growth momentum in aggregate surveys as well as in new orders.

Monetary policy moves to include tapering in the US, aggressive quantitative easing in Japan and another rate cut in Europe

So far, the financial market turmoil in emerging markets has not altered our expectations on monetary policy decisions in the developed economies. In the US, a gradual tapering of the current asset purchase program is still taking place, and we expect the program to end later this year. In testimony before Congress, the new Federal Reserve Chair Janet L. Yellen offered an upbeat assessment of economic growth prospects and stated that there will be "continuity" with the current policy stance. Meanwhile, in Europe, we have been expecting additional monetary accommodation given the low inflation environment. Clearly, the emerging-market turmoil could add to the disinflationary pressures within the euro area, especially if it triggers an undesired appreciation of the currency. In Japan, we still expect more aggressive monetary easing, as the inflation rate is probably not going to reach policymakers' target of 2% for 2014.

All in all, we believe that the global growth outlook still looks bright for 2014. However, the financial turmoil in emerging markets must be watched closely, as it has the potential to trigger a shift in market sentiment and to significantly hurt commodity prices, which would also create a negative feedback effect on EM economies.

US Outlook

US economy forecast to expand by 3.2% in 2014

The US economy is poised for its fastest growth rate since the start of the current expansion in mid-2009. We expect real GDP growth of 3.2% in 2014, up from the average growth rate of 2.4% over the past four years. All of the growth acceleration is the result of a marked reduction in fiscal drag; Congress has delayed the budget sequester spending cuts for the next two fiscal years, while improved revenue flow should enable state and local governments to modestly lift operating budgets this year.

Private sector growth is as good as during housing boom…

Although the current economic cycle has been uneven and its sustainability constantly questioned, we think the fundamentals of US economic growth are inherently much more stable and sustainable compared to conditions 10 years ago. In particular, over the past four years, the average annual growth rate in the private

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sector has been 3.5%, which matches the pace during the first years (2002 through 2005) of the previous economic expansion.

…but today, US households have no debt overhang

Yet, there is one big difference between the two cycles. During the first four years of the last business cycle, households had added $4.2 trillion in new debt to their balance sheets. Yet, in the past four years, US household debt has shrunk by roughly $250 billion—a marked contrast to the prior cycle. At some point soon, we expect consumers to marginally increase their leverage in order to support more investment and spending. This will be a gradual process that is likely to help extend the recovery, in our view.

Although the economy is poised for faster growth, disappointing payroll gains in two consecutive months have once again raised questions about the momentum and sustainability of the recovery. In January, US payrolls increased by just 113,000, following an even smaller gain of 75,000 in December. While these gains were below consensus estimates, they were accompanied by relatively stronger growth in household employment, which rose by an average of 380,000 per month over the same period.

1Q payroll data was probably affected by bad weather

It's true that trends in payroll employment are generally more reliable indicators of labor market health. However, payroll figures can be influenced by bad weather, while the employment data in the household survey are not, as people are counted as employed even if they could not get to work because of inclement weather. So it's quite possible that the harsh winter weather in the US was a distorting influence on payroll figures, which means that we would expect to see a rebound over the next few months. It is important to note that of the 6.5 million new payroll jobs created over the past three years, roughly 2.5 million (or 37%) showed up in revisions of data, and not in the initial estimates.

Europe Outlook

Recovery slowly gaining momentum

With hard data pointing to a pickup in growth in the fourth quarter and survey data suggesting that this momentum has continued in the new year, the euro area is gradually clawing its way out of recession. This is evident in the composite Purchasing Managers' Index (PMI), which rose to 52.9 in January from 52.1 in December and is now at its highest since June 2011—just before the decision to impose losses on Greek bondholders caused financial panic and sent the region tumbling back into recession. Consumer confidence has also improved in recent months, and is now back above its long-term average.

Turnaround in the periphery

The cyclical improvement has been most pronounced in the periphery. Spain, Ireland, Portugal and Greece all exited recession in 2013, thanks mainly to easier financial conditions and less fiscal drag. In Spain, the turnaround has been particularly impressive, with the composite PMI rising to 54.8 in January from 53.9 in December. Not only is this comfortably above the euro-area average, but it is also the highest reading since July 2007.

The recovery in Spain is also apparent in official data: the economy grew by 0.1% in the third quarter of last year and 0.3% in the fourth, while the unemployment rate has been on a clear downward trend since the summer. As noted earlier, this turnaround owes much to a less restrictive policy backdrop. But it may also reflect an earlier-

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than-expected payoff from recent structural reforms. If so, Spain's experience could encourage other countries—notably France and Italy—to follow suit.

Some caution still necessary

On balance, recent data suggest that the euro area may grow more strongly than expected this year (our current forecast is for the economy to grow by 1.1% after contracting by 0.4% in 2013). But there are still reasons for caution. Indeed, the economy still faces formidable headwinds, particularly from private/public sector deleveraging and impaired monetary transmission mechanisms in the periphery. Moreover, recent turbulence in emerging markets may pose a particular risk to the euro area. Why is this? The first reason is that, unlike in the US, the recovery in the euro area is still in its infancy and therefore vulnerable to external shocks. The second is that this fragility is exacerbated by the euro area's trade links with emerging economies.

Strong trade links with emerging-market economies

Exports to emerging economies account for 47% of euro-area exports, exactly the same as in the US. But the euro area is a much more open economy than the US. This means that exports to emerging economies are much higher as a share of gross domestic product (GDP) in the euro area (8.8%) than they are in the US (4.4%). Not surprisingly, Germany is the most exposed of the large euro-area countries, with exports to emerging economies accounting for 11.2% of GDP.

In light of these factors, a broad-based slowdown in emerging-market growth would almost certainly hurt the euro area more than it would the US. However, it's also important to consider the impact that a stronger-than-expected slowdown in emerging-market growth might have on inflation in the euro area.

How low could inflation go?

Underlying inflation in the euro area has been soft for some time. This primarily reflects the amount of spare capacity in the economy together with the deflationary impact of internal adjustment in the periphery (which has put intense downward pressure on wage growth that has not been fully offset by faster wage growth in countries like Germany). Until recently, though, this weakness had not been reflected in the headline rate of inflation, which was pushed higher by rising energy prices and indirect taxes.

With these two factors fading, headline inflation has fallen sharply in recent months and now stands at just 0.7%. From this starting point, any downward pressure on commodity prices stemming from a faster-than-expected slowdown in emerging-market growth would push euro-area inflation close to, or perhaps below, zero.

ECB would respond to any signs of deflation

To some extent, this would be a double-edged sword. Lower inflation stemming from falling prices for raw materials is clearly a good thing and would, in our view, provide some breathing space for real income growth in the euro area. But such a drop would come at a time when there is growing concern about deflationary tendencies in the region. The good news is that the European Central Bank (ECB) is now very sensitive to declining rates of inflation. We already expect a reduction in the central bank's refinancing rate at its March or April meeting. Should inflation fall more sharply than we expect, a more forceful response would almost certainly follow.

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Japan Outlook

A raft of Japanese economic data over the past few weeks has underlined the degree to which the country's economic growth exceeded expectations during 2013, largely as a result of Prime Minister Shinzo Abe's economic reform program, known as Abenomics.

Strong data highlight Japan's surprisingly robust rebound and cyclical success of Abenomics

On the manufacturing front, the Purchasing Managers' Index (PMI) reached 56.6 in January, the highest reading since early 2006 and just shy of an all-time high. This strength is reflected in actual industrial production, which increased by a seasonally adjusted 1.1% in December, or 7.3% year over year. Moreover, manufacturers are expecting a sharp rise in production in January (+6.1%) as well as that level being maintained in February. If realized, that would push year-over-year industrial production growth into the low teens—the fastest pace since the late 1980s (excluding during the recoveries from the 2008 Lehman Brothers shock and the 2011 earthquake).

The strength in output is leading to a stronger labor market. Employment was up 1.5% over the year through December. And, the employment gains are happening against a backdrop of a decline in the working-age population. As a result, the unemployment rate has fallen to 3.7% in December, just a whisker above the pre–Lehman shock low.

Strong employment may prompt salary increases

This decline is occurring despite a stable-to-rising trend in labor force participation—i.e., the cyclical strength is overshadowing demographics. This labor market tightness is showing up in anecdotes about skill shortages, particularly in areas such as construction. Now the key question is whether the combination of this tightness plus political pressure will appear in higher base salary increases in the upcoming Shunto (spring wage round). We think there's a good chance of this happening.

If so, this will be a positive force for cementing the shift higher in inflation. The headline Consumer Price Index (CPI) printed at 1.6% year over year in December, while the core CPI (excluding food and energy) recorded a 0.7% year-over-year rise. Japan hasn't experienced inflation higher than this since before 1997, when the consumption tax was last increased. Even so, core inflation remains a long way shy of the Bank of Japan's 2% target, which is why we're likely to see further action by the central bank within the next three to four months, in our view.

Domestic demand drives growth surprises

All told, the magnitude of these surprises has been significant. At the end of 2012, the consensus expected 2013 GDP growth of 0.6% (or 2.0% on a 4Q/4Q basis). If our fourth-quarter GDP forecasts are close to the mark, the outcome should be close to 1.8% (or 3.6% on a 4Q/4Q basis). Most of the growth surprise has been driven by domestic demand—i.e., consumer spending, housing and public-sector capital spending. Indeed, the place where surprise has been conspicuously missing is net exports. Despite the sharp depreciation of the yen over the year, export volumes have shown only a modest recovery and have been outstripped by rising import volumes.

From a global perspective, the outlook for Japan is especially encouraging amid all the concern about risks emanating from China and emerging markets in general. In 2014, Japan is clearly close to the top of the list of countries with the potential to deliver positive surprises.

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Australasia

In recent weeks, there has been a jolt to market thinking about prospective central bank action in both Australia and New Zealand. In both countries, we think there's something of a misreading.

Despite inaction in January, RBNZ is still likely to hike in March…

In the case of the Reserve Bank of New Zealand (RBNZ), the decision to keep rates steady at the end of January generated a little disappointment. It also prompted some speculation that the bout of emerging-market volatility was behind the central bank's decision not to take action and that the RBNZ has become more dovish than previously thought.

But in our view, this view is mistaken. RBNZ Governor Graeme Wheeler made it clear that rates wouldn't stay put much longer, effectively committing to start a policy-rate normalization soon. The justification for some policy adjustment is also clear, and has been for some time. In a nutshell, recent data confirm the environment of strong growth and rising inflation risks.

The third-quarter national accounts data released late last year showed that GDP growth was already running at a 3.5% annual pace, well above trend. The RBNZ expects that pace to be maintained over the coming year, and a literal interpretation of business sentiment surveys suggests that the growth may exceed this. At the same time, inflation has exceeded expectations, with an acceleration in domestically generated inflation a key theme.

Because of these factors, a relatively aggressive tightening cycle was already fully priced into the market in the run-up to this week's RBNZ decision; 100 b.p. of rate hikes was expected by September and a further 50 b.p. by mid-2015. This still seems like a reasonable forecast to us.

…but RBA remains a long way from a tightening bias

On the other hand, there's been a tendency to infer a more hawkish stance from the Reserve Bank of Australia's behavior—particularly after the central bank removed its easing bias after the February meeting. On the domestic economy, the statement showed that the bank is marginally more upbeat than before on the recovery in interest-rate–sensitive spending, but it is still worried about the resource sector adjustment that lies ahead. So the RBA continues to hope for a return to above-trend growth, and an environment in which unemployment can start to fall. That, however, remains a forecast, not a near-term reality. In our view, the bottom line is that the prospect for a near-term policy easing (absent a dramatic turn for the worse in the EM crisis) is close to nil. And the notion that we'll see rate hikes before the year is out is well and truly wide of the mark. If there's going to be any rate action this year, we continue to think it will be easing, driven by disappointment in the speed of the recovery which the RBA currently expects.

Canada Outlook

BoC is focused on disinflation risks

Over the past month, Canada's persistently low inflation—which failed to reach 1% in 2013—and its weakening exchange rate have simultaneously moved to the forefront of the discussion about the state of the economy. This pairing has not been an accident. While the Bank of Canada (BoC) cannot explicitly promote a weaker exchange rate, it appears to be doing its part to inspire continued selling and the more rapid depreciation that has ensued.

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Easy policy is here to stay

Past emphasis on Canada's tepid expansion and household overindebtedness has recently taken a backseat to the BoC's amplified concern over a long stretch of below-target inflation. Instead of merely earning a mention toward the bottom of the monetary policy statement, inflation has taken center stage in nearly all of the bank's communiqués. Notably, emphasis on low inflation sends an important signal to the market. If feeble inflation is the bank's key concern, then policy is set to remain dovish for even longer than expected. While the probability of a rate cut remains low, the more policymakers are concerned about disinflation, the less likely they are to raise rates—thereby pushing the likely timing of a policy rate hike even later in 2015. Moreover, if low rates are here to stay, then demand for the Canadian dollar (CAD) will be further diminished and the recent sell-off in the currency is likely to continue—seemingly exactly what the BoC wants.

In the most recent Monetary Policy Statement, the BoC not only emphasized the heightened downside risk of persistently below-target inflation. It also pointed to a still-overvalued CAD as posing a continuing challenge to Canada's export markets and the investment needed to boost growth.

CAD weakness seen as a healthy development

Together, these statements reveal how the central bank views a weaker exchange rate as a crucial, albeit likely only partial, solution to two of the key issues plaguing Canada's sluggish economy. First, the eventual pass-through from a weaker exchange rate should provide a boost to flagging inflation. Additionally, a weaker exchange rate helps to make up for some of the competitive disadvantage facing Canada's exports, in part by making Canadian goods more attractive to the country's biggest trading partner, the US. Accordingly, we forecast a further depreciation of the CAD to 1.15 per USD over the next six months.

Emerging-Market Outlook

Latin America: EM assets sold off virtually across the board during the early part of the year, giving rise to heightened concerns that a systemic crisis might be unfolding. Outflows from dedicated EM funds accelerated in the beginning of 2014 to levels comparable to May 2013, when the US tapering talk began. We continue to believe that the EM shakeout is associated with investors' gradual realization that fundamentals have not improved in the past three to four years across EM credits, while global liquidity is shrinking. That combination is resulting in the repricing of EM risk, a process that started last year and that is still ongoing.

It is undeniable that a few countries in the EM universe present a mostly idiosyncratic, risky profile; Argentina, Ukraine and Venezuela are in that camp. The bulk of the EM credits, however, appear to be on far more solid footing and far from a systemic collapse, in our view. The turmoil observed in the early part of the year was due to a combination of isolated shocks that, given the fragility of investors' sentiment toward EM, had an outsize impact on asset prices. They include the decision to accelerate currency depreciation in Argentina, political unrest in Ukraine, turmoil in Turkey that prompted the central bank to tighten its monetary policy stance beyond expectations, and concerns about financial fragility and growth prospects in China. China-related worries carry a more significant weight from a global standpoint, in our view, as a sharper-than-expected deceleration in Chinese economic activity and/or negative headlines on financial stability could indeed unhinge market expectations toward EM generally. The substantial repricing that occurred in the past few weeks

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and months, however, suggests to us that pockets of value have appeared across EM regions.

Argentina: Faster depreciation and little else—for now

A substantial repricing of Argentinian risk took place after the government signaled that it wanted a weaker exchange rate while partially lifting the constraints to access foreign exchange by the public. As the currency is clearly overvalued at the official exchange rate, targeting a weaker rate is good news, in our view. Given the lack of a credible nominal anchor for inflation expectations after the currency slide, however, the ongoing strategy is risky. While the central bank raised the guideline interest rate on short-term certificates by about 10 percentage points to nearly 30%, that level still falls short of expected inflation for the year. A negative real interest rate is insufficient to stabilize the demand for dollars, which has not abated, forcing the central bank to continue intervening in the FX market. In the near term, new regulations requiring banks to reduce their foreign currency exposure provided some relief, but in order to stop the bleeding of reserves on a more permanent basis, further adjustments will be needed, including fiscal tightening, higher interest rates and a credible set of inflation statistics, which could give investors a viable alternative to take exposure in linkers. Going forward, we believe that the impact of the weaker currency on domestic prices must be monitored. Union leaders have already hinted that wage increases of up to 50% will be required to offset the devaluation. In recent days, other labor leaders had hinted that wage negotiations would have to be held more frequently (possibly quarterly) given the acceleration in inflation. We believe that wage negotiations are likely to be extremely difficult during the rest of the year, so the risk of labor conflicts should not be underestimated. In the absence of fiscal policies, it will be difficult to break the inflationary inertia, and we expect actual inflation to exceed 40% this year.

Brazil: Fiscal policy and inflation in focus

December's fiscal performance in Brazil was worse than expected. The primary surplus at the consolidated public sector level came out at BRL10.4 billion, versus the market consensus estimate of BRL11.7 billion. Therefore, the primary surplus during the year was BRL91.3 billion, or 1.9% of GDP, the lowest since 2002 when the central bank's statistical series began. The central government (treasury, social security and central bank) generated a surplus of 1.6% of GDP, while the regional government had a surplus of 0.3% of GDP. The nominal fiscal deficit came out at 3.3% of GDP, the highest in five years. Market concerns are associated with the possibility of a sovereign rating downgrade by S&P if no fiscal tightening is engineered this year, especially since the fiscal results of 2013 include a large portion of extraordinary revenues making up close to 50% of the central government's receipts. As those one-off resources are not going to be present in 2014, the primary surplus could drop to as low as 1.3% of GDP or even less in the absence of additional fiscal discipline. Gross debt/GDP ended the year at 57.2%, but it is likely to increase by at least 1% in 2014. All eyes are now on a possible announcement of fiscal tightening on the part of the government. In order to stabilize public debt ratios, an expenditure freeze of nearly BRL50 billion would be needed, a figure that appears difficult to reach given the political constraints associated with the upcoming presidential elections.

Meanwhile, last month the central bank increased the Selic overnight rate by 50 b.p. to 10.50%, with no bias toward further easing or tightening, and it released a short communiqué indicating that the decision was made by unanimous vote and "to continue with the process of adjustment of the basic interest rate." In December, the central bank hinted that the tightening cycle was close to completion, and emphasized that monetary policy acts with a lag, so that the full weight of last year's

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hikes had yet to be felt on Brazil's economic activity. But January's press release and minutes did not convey the message that the tightening cycle was over, so that the market is now anticipating another hike on February 26. Expectations for the terminal rate level in the current cycle have shifted toward 11% before the elections, depending on inflation data in early 2014. Interestingly, the minutes make reference to the need for tighter fiscal policy in order to stabilize inflation expectations, which may be interpreted as a signal that unless the fiscal program to be released in February shows restraint, the central bank may have to hike the Selic rate further. Meanwhile, January inflation was below expectations at 5.6% YoY, 32 b.p. below December's print. And industrial production contracted by a much-larger-than-expected 2.3% YoY in December, suggesting that the central bank will be able to increase the Selic by a more moderate 25 b.p. this month, in our view.

Mexico: Another rating upgrade earlier than expected

Moody's raised Mexico's sovereign credit rating by one notch to A3, with a stable outlook, higher than the ratings of S&P (which upgraded Mexico in December) and Fitch. While the decision in itself was not a surprise, the timing was, as many in the market thought the agencies would wait for implementation of the reforms before improving their ratings. The decision was made on the back of the opening up of the energy industry to private investment and the broadening of the tax base. Moody's expects that the reforms will increase potential GDP growth and strengthen fiscal fundamentals. The agency said that it does not expect further rating changes in Mexico over the next two to three years.

Meanwhile, January inflation came out at 4.5% YoY, 8 b.p. below expectations but 51 b.p. above December's print. The increase was due to the impact of the new taxes that became effective on January 1. We believe that the inflation spike will be temporary and that headline prices will converge toward the inside of the target range before midyear. Therefore, Banco de México (Banxico) will not need to adjust its monetary policy stance. Last month, the bank left the target overnight rate unchanged, as expected, and reiterated that despite the improvement in the labor market, there is still slack capacity in the job market and the economy as a whole. Banxico still projects that the slack conditions "will continue for some time." So far there has been no evidence of second-order inflation effects, and the medium-term expectations remain well anchored. For 2015, Banxico expects a sharp deceleration in inflation and average levels slightly above 3%. The bank, however, highlighted that the balance of inflation risk has deteriorated because heightened volatility in global markets could impact the currency and might eventually fuel domestic prices, while the gradual reduction in slack capacity could hit medium-term inflation expectations.

Venezuela: Policy inaction and low reserves fuel sell-off

On February 4, Venezuela's central bank reported that it had suspended the 16th Sicad auction, which was called for January 29 to distribute US$220 million among companies in the paper, wood, chemicals, health and apparel sectors. According to the bank, the auction was suspended because of "irregularities" in the dollar purchase orders. The press release provided no details about which companies or sectors presented problems or about a possible new date. Government officials, including President Nicolas Maduro, had repeatedly indicated in previous days that the government would make extra efforts to fight corruption in Sicad. The lack of details surrounding the decision, however, sent a negative signal to the market, which, coupled with the already feeble sentiment toward Venezuelan credit, prompted a sharp sell-off of the country's bonds. The government vowed to auction US$440 million during the week of February 10, but the market seems to prefer actions rather than deeds at this juncture. Meanwhile, Rafael Ramirez, the economy

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vice president and energy minister, indicated that a new "permuta-type" currency swap market will be put in place soon, something that, if confirmed, could turn the market mood around. Under the plan, Ramirez said that Sicad will work with foreign exchange bands and will apply differential exchange rates per industry. Details of the system are still scant but it appears that the official rate will be largely reserved for government imports while other flows will fall within Sicad, which will provide multiple rates. The latest Sicad auctions resulted in an exchange rate of around VEF11.60/USD, but chances are good that the authorities will gradually weaken that rate during the year. Thus, an effective devaluation could be implemented via (i) a shift of transactions to Sicad from the old Cadivi market, (ii) a weakening of the Sicad rate, and (iii) the implementation of the permuta market, with cutoff rates weaker than those of Sicad.

Downward revision of China's and Asia's growth forecast

Asia ex Japan: We have warned about the threats to growth in China and Asia over the past few months, and have now amended our forecast for 2014. Asia's total GDP growth forecast has been revised down by 20 b.p. to 6%, mainly due to the downgrade of China's growth and the associated spillover into the region. A weakening in EM demand will also act as a headwind to the recovery of Asian exports, though we believe developed-market demand may offset some of the damage in the coming year. Inflation risk will stay benign across the region and, given our view of a gradual tapering of quantitative easing in the US, we still think that policy accommodation may stay in place longer than generally expected in many Asian countries (outside of India, China and Indonesia).

China faces increased pressure on growth from domestic financial stress and tight monetary policy

In China, we have cut our GDP growth forecast for 2014 by 30 b.p. to 7.1%, which represents a more pronounced deceleration from 7.7% in full-year 2013. The downgrade was triggered by two main factors: First, China's domestic demand growth is likely to be suppressed by domestic financial stress induced by heightened credit-default risk combined with a continued tight monetary policy. We think that the chances are quite high for certain low-profile credit defaults this year in trust and wealth-management products, especially related to those borrowed by the obviously problematic mining and commodity firms. We are also concerned about some of the local government debts, especially those at the county and city levels, where the debt-to-revenue-ratio is higher than 100%. Overall, we do not see a high risk of a systemic crisis developing that would cause a hard economic landing. However, the current financial stress, plus the People's Bank of China's (PBC) maintenance of a tight policy stance to contain leveraged growth in the economy, will cause distortions in the system as 2014 unfolds, in our view.

Weaker emerging-market demand acts as headwind to exports

The second factor behind our growth downgrade of China comes from exports. In recent years, China has mainly gained market share in emerging markets, while its share in developed markets has merely been stable. Deteriorating demand from emerging markets will pose a major headwind to Chinese export growth even though shipments to the US (and, to a lesser extent, the EU) may improve.

Lower GDP target should reduce pressure on central bank to ease policy as growth slips

A key uncertainty in the economic outlook is whether the PBC will be under increasing political pressure to relax monetary policy as the economy decelerates significantly in the coming quarter or two. We think the government's annual GDP growth target for 2014 (to be officially announced at the National People's Congress in March) will be an important gauge of the chance to repeat the "stop-go" monetary policy cycle of the past. In our view, if the central bank needs to support a GDP target of, say, 7.5% for 2014 (which is the same as in 2013), the chances of some credit

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easing later in the year may be quite high as economic growth slips closer to the 7% mark in the first two quarters, according to our projection. By contrast, a 7% annual growth target will give the monetary authority more leeway to achieve its goal of containing financial leverage in the system while pushing interest-rate liberalization further to sustain China's financial reform. So far, it is reported that seven major provinces have already marked down their local GDP growth targets from last year's levels, which should increase the likelihood of a 7% national GDP target for this year.

EEMEA growth will continue gaining momentum in 2014

Emerging Europe, Middle East and Africa:

EEMEA growth should continue its gradual recovery during 2014 from what appears to have been the lowest calendar-year growth rate on record other than during the financial crises of 1998, 2001 and 2009. In sequential terms, we see the strongest recovery in Russia, but even there—as with the rest of the region—the growth rate probably won't reach more than about two-thirds of the pre-2008-crisis trend. The only economy where we see growth moderation this year is Turkey, with potential further downside risks to our forecast driven by the rise of political uncertainty, new macroprudential measures aimed at curbing consumer credit growth, and possibly further monetary tightening later this year.

Inflation should remain relatively benign…

Meanwhile, inflation is set to remain generally benign across the region, lacking strong demand- and supply-side pressures, aside from the impact of weaker exchange rates. In central Europe, we expect inflation to rise from multiyear lows, but it will stay below the official targets in Poland and Hungary as well as the Czech Republic. In Russia, inflation should finally fall to the central bank target by about midyear, helped by a planned partial freeze in administrative prices (of course, provided there are no upside surprises in food inflation, which accounts for a very large share of the Consumer Price Index). Only in Turkey and South Africa do we expect that inflation will struggle to stay within the central bank target range, owing to the exchange-rate pass-through from a cumulative depreciation of around 20% since last May. In Turkey's case, January hikes in special consumption taxes will also affect inflation.

…delaying monetary policy normalization until the fourth quarter, if at all…

Consequently, and again with the exception of Turkey and South Africa, we expect monetary policy to remain anchored at current low rates and to tighten in the last quarter of the year, at the earliest. Central banks will be looking for signs of stronger-than-expected recovery in domestic demand in order to activate the rate normalization cycle. But they could be forced to hike rates earlier if developed-market policy rate expectations become unhinged and begin to rise despite the currently flat forward guidance by the major central banks.

…except in Turkey and South Africa

In Turkey, where the central bank responded to last month's exchange-rate sell-off by announcing a surprise rate hike at an extraordinary meeting of the monetary policy committee, we see a possibility of further tightening (if needed to stabilize the exchange rate), on top of an effective hike of 300 b.p. in January. In South Africa, the central bank also delivered a surprise (albeit much more modest) hike of 50 b.p. last month, and we now think this move will be followed by two additional 50 b.p. hikes before midyear.

Hungary is the only country in the region that is likely to cut rates this year, as the ruling-party–dominated central bank chips in (with up to 35 more basis points of largely symbolic cuts) to help secure another landslide victory for the Fidesz party in April's parliamentary elections.

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AllianceBernstein Global Economic Forecast

Feb-14

	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	3.0	3.2	2.5	3.2	2.6	3.2	2.5	2.9	2.25	2.27	3.83	4.19
(PPP Weighted)	(2.8)	(3.6)	(3.0)	(3.5)	(2.9)	(2.9)	(3.0)	(2.9)				
Industrial Countries	2.1	2.3	1.2	2.3	1.2	2.1	1.3	1.8	0.34	0.30	2.48	2.84
Emerging Countries	4.7	4.8	4.7	4.7	5.1	5.1	4.7	5.0	5.68	6.05	6.51	6.90
United States	2.7	3.3	1.9	3.2	1.2	2.6	1.5	2.2	0.13	0.13	3.04	3.75
Canada	2.3	1.9	1.8	2.0	1.0	2.2	0.9	1.8	1.00	1.00	2.77	3.25
Europe	0.9	1.7	0.1	1.5	1.0	1.3	1.5	1.0	0.35	0.24	2.33	2.46
Euro Area	0.4	1.4	-0.4	1.1	0.8	1.1	1.3	0.8	0.25	0.10	2.11	2.25
United Kingdom	2.8	2.7	1.9	2.8	2.1	1.9	2.6	1.8	0.50	0.50	3.24	3.25
Sweden	1.1	2.9	0.9	2.3	0.1	1.4	0.0	0.9	0.75	1.00	2.53	2.75
Norway	1.7	2.4	1.8	2.1	2.3	1.9	2.1	2.0	1.50	1.50	3.04	3.25
Japan	3.6	1.7	1.8	2.5	1.4	3.1	0.4	2.9	0.10	0.10	0.74	0.80
Australia	2.4	1.7	2.3	1.9	2.7	1.7	2.5	2.1	2.50	2.25	4.23	4.25
New Zealand	3.3	3.7	2.8	4.2	1.6	1.8	1.1	1.7	2.50	3.50	4.71	4.75
Asia ex Japan	6.3	6.1	6.2	6.0	3.5	3.7	3.2	3.6	5.48	5.57	5.15	5.49
China[2]	7.7	7.2	7.7	7.1	2.9	2.8	2.6	2.5	6.00	6.00	4.70	5.25
Hong Kong[3]	3.1	3.1	3.0	3.3	4.3	4.1	4.3	4.0	0.50	0.50	2.35	2.30
India[4]	4.6	5.4	4.6	5.0	7.0	8.1	6.3	8.8	7.75	8.50	8.83	9.25
Indonesia[5]	5.5	5.5	5.7	5.3	8.4	5.8	7.0	6.7	7.50	7.25	8.40	7.00
Korea[6]	3.9	2.7	2.8	3.1	1.1	1.9	1.3	1.5	2.50	2.50	3.57	3.90
Thailand[7]	0.7	4.1	2.9	3.0	1.7	3.5	2.2	3.3	2.25	2.00	3.91	4.30
Latin America	2.3	2.7	2.6	2.5	6.4	8.8	6.4	8.0	6.93	7.55	9.88	9.97
Argentina	2.2	1.0	4.8	0.7								
Brazil	2.0	2.0	2.4	2.0	5.6	6.0	6.4	5.9	10.00	11.00	13.11	13.30
Chile	4.0	4.2	4.3	4.1	2.3	2.9	1.8	2.6	4.50	4.25	5.19	5.40
Colombia	4.2	4.4	4.0	4.2	1.8	3.0	2.0	2.6	3.25	3.75	6.83	7.20
Mexico	1.5	4.0	1.3	3.7	3.6	4.1	3.8	4.0	3.50	3.50	6.44	6.20
EEMEA	2.2	2.7	2.1	2.5	5.6	5.6	5.9	5.8	4.78	6.11	7.76	8.68
Hungary	2.6	1.7	1.0	2.0	0.9	2.5	1.8	1.7	3.00	3.50	5.61	7.25
Poland	2.0	2.9	1.4	2.6	0.4	2.3	0.9	1.5	2.50	2.75	4.34	4.95
Russia[8]	1.1	3.0	1.5	2.5	6.5	5.6	6.8	6.3	5.50	5.50	7.66	8.75
South Africa	1.9	3.1	1.8	2.8	5.3	6.5	5.7	6.1	5.00	6.50	8.24	9.75
Turkey[9]	5.4	2.0	4.2	2.5	7.4	7.6	7.5	7.5	4.50	10.00	10.25	10.50

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.