

# Global Economic Outlook

March 2014

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## Overview

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**United States**—In 2014, private and public sector gains are expected to produce growth of 3.2%, the fastest annual advance of the current cycle.

**Europe**—The ECB now seems more confident in the recovery and has raised the hurdle for future policy action.

**Japan**—A swing in inflation from negative to positive has been a key marker of policy success in Japan. The upcoming consumption tax hike will see the headline inflation rate ramp up further still.

**China**—The growing importance of containing credit and default risk is likely to preclude major monetary stimulation.

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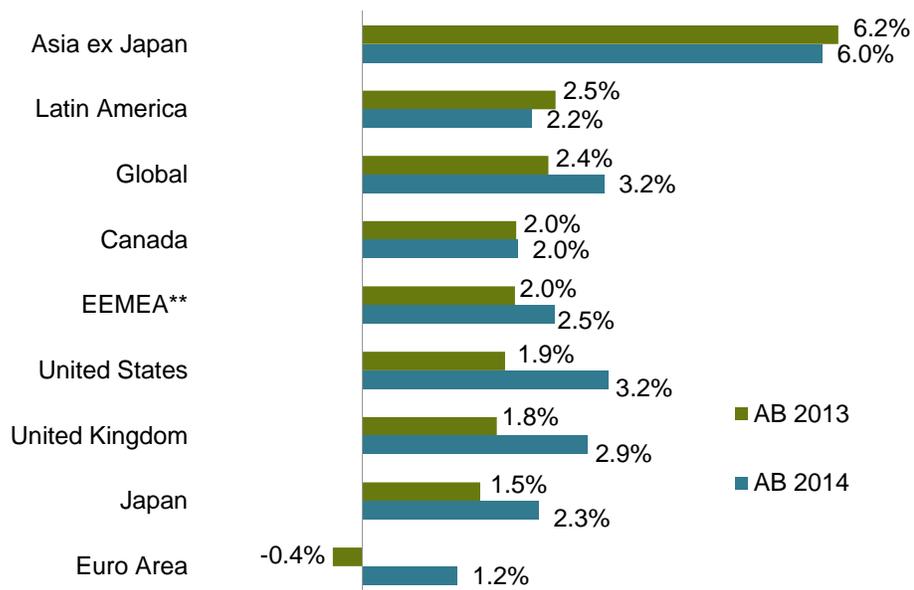
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## AllianceBernstein World Economic Growth Forecasts\*



As of March 3, 2014

\*Calendar year \*\*Emerging Europe, Middle East and Africa

Source: AllianceBernstein

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## Global Outlook

**Global growth forecasts show stronger developed economies**

Our forecasts for global economic growth of 3.2% in 2014 remain unchanged since the start of the year. Better business survey data in the developed economies (mainly Europe) have led to a marginal upgrade of growth estimates, offsetting the slight downward adjustments to growth forecasts for emerging-market economies. Our growth estimates of 3.2% for the US, 2.3% for Japan and 1.6% for Europe in 2014 all show a sharp acceleration from last year's performances. In the emerging economies, Asia continues to lead the way with growth of 6% (versus 6.2% in 2013), followed by 2.2% in Latin America and 2.5% in EEMEA.

At this time, business surveys show that the global economy is moving forward at a modest pace, even though bad weather has clearly disrupted activity in the US and parts of Europe during the early months of 2014. The J.P. Morgan Global All-Industry Index slipped one point to 53 in February, mainly because of a sharp decline in the US service sector. The overall index has been running close to 54 for the previous three months.

**Business surveys are broadly consistent with global outlook**

Although global service activity appears to have slowed in February, the manufacturing sector remains fairly robust, with the global index running close to 55 for the past four months. Once again, stronger gains in the developed economies—especially the US and Germany—were responsible for the solid manufacturing reading in February.

**Policy outlooks differ in the developed economies**

On the policy front, the Federal Open Market Committee (FOMC) is expected to continue its program of reducing the scale of asset purchases at each regularly scheduled meeting. During her congressional testimony in February, newly appointed Fed Chair Janet Yellen indicated that tapering will continue at a modest pace, which suggests an incremental reduction of \$10 billion per month at the March meeting. We still think there is a good chance that the European Central Bank (ECB) will ease further in 2014, but the hurdle for a shift towards a more accommodating policy seems higher than we initially thought. Meanwhile, we would expect a more aggressive pace of asset purchases by the Bank of Japan in order to reach the 2% inflation target later in 2014 or in early 2015.

## US Outlook

**US growth of 3.2% in 2014**

The US economy is expected to post real gross domestic product (GDP) growth of 3.2% in 2014 according to our estimates, up from 1.9% in 2013. At first glance, our growth estimate may seem rather aggressive after the economy underperformed our expectations last year.

**Public sector rebound will buoy growth**

However, the faster pace of economic growth this year is largely attributed to the turnaround in the government sector, as federal cutbacks end while state and local governments marginally increase spending thanks to much-improved fiscal finances. In 2013, the overall government sector contracted 2.3%, the third consecutive annual decline. Almost all of last year's decline was centered in the federal sector, which declined 5.5%. The budget agreement reached in Congress last October not only eliminates the budget sequester cuts for 2014 but, at the margin, adds a little more to defense spending. Meanwhile, several state and local governments have increased spending plans, so we expect that the government sector in aggregate will add to the overall growth rate.

## Private sector remains solid

In the private sector, growth has been running at a rate of about 3.5% for the past few years, reaching nearly 4% last year. Of course, the rate of growth is not evenly distributed among all sectors each year. For example, while last year's private sector growth was driven by increased purchases of consumer durables and housing, we expect 2014 growth to be driven more by business investment.

## FOMC may be compelled to lift rates earlier than forecasted

In our view, the faster pace of growth will compel monetary policymakers to continue tapering their asset purchase program as planned. And we would not be surprised to see unemployment falling beneath the 6.5% threshold by the middle of the year. If that occurs, the financial markets could price in a rate hike for the middle of 2015.

## Europe Outlook

### Recovery gains ground

Data released this week confirmed that the euro-area economy grew by 0.3% in the final quarter of last year. This was the third consecutive quarter of modest expansion and the first time that annual GDP growth turned positive since the final quarter of 2011. The breakdown of the data showed a tiny gain in private consumption (+0.1%), a small drop in government consumption (−0.2%) and a strong gain in fixed investment (+1.1%). The latter is particularly encouraging, suggesting that rising business confidence is now starting to have a positive impact on capital spending in the euro area.

### Employment starts to rise

Labor market developments have also been encouraging. Although official figures are not yet available, data from individual countries suggest that employment grew by 0.1% in the final quarter of last year. This would be the first increase since the second quarter of 2011. With one notable exception—Italy, where employment contracted by 0.4% in the fourth quarter—the improvement in labor market conditions is broadly based; it is particularly apparent in Spain (+0.4% in the fourth quarter) and, to an even greater extent, Portugal (+0.9%). This may be another indication that structural reforms are beginning to pay off more quickly and more strongly than expected in these countries.

### But still a long way to go

But while the euro-area economy and labor market seem now to be clearly on the mend, it is important to put the recent performance of the economy in context. For example, the level of output is still 2.7% below the peak of the last business cycle in the first quarter of 2008, and this shortfall rises to 4.4% for domestic demand and a massive 19.1% for fixed investment (which is currently at the same level as it was all the way back in 1999 when the euro was launched). The same is also true for the labor market, where the recent rise in employment has barely put a dent in the unemployment rate, which at 12.0% is still very close to its recent record high.

### Huge amount of excess capacity

All of this means there is likely to be an enormous amount of spare capacity in the euro-area economy. And, with the recovery likely to continue at a gradual pace, this is likely to exert downward pressure on inflation for the foreseeable future. This is a point that the ECB made at its March press conference, when it said that a high degree of spare capacity would allow it to keep policy accommodative even as the economy continues to recover, while publishing a forecast showing inflation below its target (of below but close to 2%) for at least the next three years.

## Higher hurdle for monetary easing

In spite of this, the ECB did not lower interest rates at its March meeting and gave no real indication that it is likely to do so in the near future. Indeed, the whole tone of the March press conference was hawkish, and it seems that the ECB is now more confident that the recovery will gradually push inflation back toward target and therefore feels no compulsion to hasten this process. This does not mean the ECB has closed the door on further easing—disinflationary forces are still too powerful for that—but it does suggest that the hurdle for future action is higher than we had assumed.

## Shift from deflation to inflation has been successful so far

### Japan Outlook

One of the key themes in Japan over the past year has been the accelerated pace of inflation. In March 2013, just before the dramatic policy easing announced by incoming Bank of Japan (BOJ) Governor Haruhiko Kuroda, the headline Consumer Price Index (CPI) was running at 0.9% below year-earlier levels. The core CPI (excluding food and energy) was also running at a similar pace. Deflation remained well entrenched, as was Japan's position at the bottom of the industrial economies' inflation league table.

Twelve months on, the story has changed dramatically. Based on the Tokyo CPI outcome for February, we estimate that the nationwide headline CPI will be running at 1.7% year over year (YoY), with core inflation at 0.7%—the highest since April 1998. Only a handful of industrial countries—Australia, the UK and Norway—are recording higher rates of headline inflation. Indeed, the debate about the global economy continues to focus on concerns about tipping into deflation.

To be sure, the drivers of the rise in inflation to date are to some extent transitory—the pass-through of a weaker yen, electricity tariff hikes and so on. In the absence of further one-off factors, the acceleration in inflation might be expected to fade. After all, the lion's share of the yen depreciation occurred over the six months through mid-May last year, while an institutional change in wage- and price-setting behaviors is only in its formative stages.

Yes, bonuses were up in December, and many employees at large companies appear poised to win base salary increases for the first time in many years during this current *shunto* negotiation round. So, aggregate wages are almost certain to break into positive territory after being persistently flat to negative. That said, wage growth is still likely to fall well short of the 3%-plus rate that's necessary for consistency with a 2% inflation goal.

## Consumption tax hike will reinforce inflation gains...

But the one-offs aren't absent. Of them, the biggest one is just about to hit—an increase in the consumption tax rate from 5% to 8% on April 1 will add around 2 percentage points to headline inflation. So it's quite conceivable that, all other things being equal, Japan's inflation rate might accelerate to at least 3% by the middle of the year.

Not all businesses will be able to pass the consumption tax increase through to their customers. And a hangover from the pre-hike shopping frenzy may dampen demand in April and beyond. But, on balance, the tax hike is still likely to generate headlines about increasing prices, entrenching the rise in inflation expectations.

**...but provides a range of additional challenges**

So just as the BOJ actions in April last year were pivotal for the course of Abenomics, the response to the consumption tax hike this April will be crucial, too. But there are a host of questions that arise, cutting across several areas. For example: Will the downside risks to growth stemming from the squeeze in purchasing power drive a further round of BOJ easing? Will realization of the highest inflation rate since the early 1990s prompt more aggressive wage claims, particularly given the tightness of the labor market? Will the squeeze on retirees' income prompt a political backlash against Prime Minister Shinzo Abe? Will households accelerate their asset allocation from bank deposits to higher-return assets? Along with the pending announcement of the next phase of the growth strategy (the third "arrow" of Abe's "Three Arrows" policy) in June, these are key questions for the success of Abenomics.

**Capex survey confirms that rebalancing remains a hope rather than a reality**

## **Australasia**

One of the key questions about the Australian economic outlook has been whether the transition from mining-driven growth to nonmining growth would occur smoothly. We've been arguing that the poor employment outcomes over the past year suggest that it won't be easy. The latest capital spending survey from the Australian Bureau of Statistics, which showed a sharp fall in both actual capex in the fourth quarter and planned investment spending in the fiscal year ending June 2015 (FY2015), confirms that a smooth transition remains a hope, not a reality.

Actual spending on plant and equipment investment fell 8.6% quarter over quarter in the fourth quarter—or down 16% year over year, the first double-digit annual fall since the early 1990s recession. In addition, capital spending expectations for 2014–2015 were very gloomy. The survey suggested a decline consistent with a sharp fall in mining capex of about 25% in 2015, or around 1.5% of GDP.

This continues the downshift in expectations that's been under way since the end of 2011. At the same time, there's little evidence that nonmining capex is about to surge to offset this drop. At best, the survey suggests that nonmining capex will remain flat for the next 18 months. And within that, manufacturing spending is once again being decimated—a fall of at least 20% is plausible, which would leave the level of manufacturing sector capex half of what it was in 2012.

In sum, the capex survey confirms that: (1) the decline in mining capital spending is only just beginning, and the cliff-like falls are still to come; and (2) those looking for a sharp recovery in nonmining capex to assist in the rebalancing of the economy are going to have to wait for a while—it's not just around the corner. These developments reinforce our bearish baseline view about Australia. Yes, housing is recovering. But it's not enough to offset the headwinds coming from the mining capex downcycle, or the other structural negative factors—job losses announced over recent weeks are yet another manifestation of that.

**Forecasts for RBA hikes look well off the mark**

Against this backdrop, we continue to think that rate cuts by the Reserve Bank of Australia are more likely than not before the end of the year and that any talk of rate hikes is well and truly off the mark.

## Canada Outlook

**4Q acceleration is unlikely to continue**

In 2013, Canada's economy expanded 2.0%, better than expected and up from 1.7% in 2012. The GDP report released last week revealed a 2.9% annualized acceleration in the fourth quarter. This strong fourth-quarter headline, combined with upward revisions to growth in the first half, makes the Canadian economy look much rosier than it seemed through much of the year.

However, given the composition of 2013 growth—especially in the fourth quarter—we do not expect that momentum to continue into 2014. First, we expect a correction in the recently robust contribution from inventory build. Over the last two quarters, inventory expansion was responsible for nearly half of the economy's total growth.

Furthermore, most of the remaining growth was driven by the consumer. In fact, household consumption grew 3.3% in 2013, far outpacing average weekly income growth of only 2%. Despite the Bank of Canada's (BoC) continued calls for a rotation in growth away from household consumption, the consumer continued to prop up the economy throughout 2013. Given relatively weak employment data and already stretched balance sheets, we do not think this support will persist in the year to come.

**Rotation to investment remains elusive**

Finally, the segments that the BoC hoped would generate the most growth have failed to contribute. Nonresidential investment actually contracted in the fourth quarter, and recent survey data suggest that the slowdown is likely to continue. On the positive side, net exports contributed a small gain, accelerating into the end of the year as export sectors benefited from growing US demand. However, Canada's lack of competitiveness is likely hindering the export sector's ability to take advantage of US growth to the same extent that it has in the past.

**Expect 2.0% growth again in 2014**

Consequently, we expect further delays to the "great rotation" and another year of 2.0% growth in 2014.

## Emerging-Market Outlook

**Argentina: The Repsol settlement and the new CPI**

**Latin America:** On February 25, Repsol's board of directors approved the Argentine government's proposal to pay for the 51% stake in YPF, the state-owned energy company, that was expropriated in early 2012. The agreement calls for the issuance of USD5 billion worth of dollar-denominated government bonds. In the event that the bonds fail to maintain an average market value of at least USD4.67 billion during 90 days after the payment date, Argentina will have to issue up to an additional USD1 billion of bonds. The accord has to be ratified by the Argentine Congress, where it is not expected to suffer any delay. The agreement includes "guarantees for effective payment" by Argentina as well as the reciprocal withdrawal of all judicial and arbitral claims against each party and the waiver of any future claim. Any future dispute regarding the settlement will have to be submitted to UNCITRAL, the UN international conflict resolution tribunal.

Repsol's sources have already indicated that the Spanish company will sell the bonds "quickly" to finance investment projects in Spain and abroad with the proceeds. This means that the increase in bond supply and its impact on valuation will probably result in Argentina having to issue an extra amount of securities, beyond the initial US\$5 billion—and maybe even close to the US\$6 billion ceiling. Despite the negative impact on debt technicals, the settlement with Repsol is likely to be

beneficial for investor sentiment toward Argentina, as it represents a step in the right direction toward normalizing the financial relationships of the Republic with the international financial community. It will probably also be helpful in easing the dialogue with the IMF and the Paris Club. And, in what is probably the government's main hope, the accord could unlock foreign direct investment directed to new shale oil and gas projects in the western part of the country.

**Brazil: Copom delivers after announcement of fiscal adjustment**

In Brazil, the Copom by unanimous vote hiked the target Selic rate by 25 b.p. to 10.75%, broadly in line with market expectations. Also as expected, no commitment was made to any fixed future policy path; i.e. the Copom left the door open to a further residual hike depending on the evolution of inflation and economic activity in the next few months. The minutes of the meeting, released a week after the interest-rate decision, had a slightly more hawkish tone than expected, suggesting that a final 25 b.p. hike may be in the pipeline for the April 2 meeting. Meanwhile, the government announced that during the fourth quarter of 2013, GDP expanded by 0.7% quarter over quarter (QoQ), well above expectations of 0.3% and more than offsetting the 0.5% contraction in the third quarter. The figure resulted in an expansion of 2.3% during the entire year.

While the numbers exceeded expectations, we expect GDP growth this year to underperform the growth rate in 2013. According to our estimates, Brazil's GDP will expand by about 1.7% this year, on the back of tighter fiscal and monetary policies, coupled with looming energy rationing as well as a minor negative impact from exports to Argentina.

All things considered, however, the better-than-expected fourth-quarter figures suggest that the Selic tightening cycle will end after a likely final 25 b.p. increase next month. In our view, this scenario has become more likely after late last month, when the government announced a primary fiscal surplus target for 2014 of 1.9% of GDP, in line with expectations. Some 1.6% will be generated by the central government and 0.4% by the states. The figure is similar to 2013's, although last year's performance was masked by one-off revenues that are unlikely to be repeated in 2014. As a result, the authorities have announced a program of spending cuts worth BRL44 billion. Although uncertainty still exists regarding the execution of the cuts and the possible adjustment to electricity prices, the announcement is likely to stabilize expectations in the short term because it could delay a possible S&P downgrade until after the October presidential election. The announced fiscal effort, however, is not enough to stabilize the debt/GDP ratio, which suggests that it should be interpreted as a down payment and that more tightening will be necessary after October. In addition, the fiscal projections have become a moving target, as downward revisions to growth mean that additional tightening will be necessary to achieve a given surplus goal; this will be a difficult prospect during a presidential election year with an incumbent running for reelection.

**Mexico: Low growth, low inflation**

In Mexico, headline prices rose by 0.3% MoM, 4.2% YoY during February, 25 b.p. below January's print. Core prices rose by 0.3% MoM, 3.0% YoY, so they remain below the medium-term target level. Non-core inflation is at 8.2% YoY. The moderate February figures provide some early evidence that the inflationary shock in January as a result of the new taxes was temporary and rather short lived. We expect headline inflation to drop slightly below the 4% ceiling of the target range before mid-year, although seasonal factors could push it marginally above that level at times during the second half of 2014. Meanwhile, the government's statistical office Inegi

## Venezuela: Waiting for Sicad 2

also reported last year's GDP figures. In the fourth quarter of 2013, GDP expanded by 0.7% YoY and 0.2% QoQ on a seasonally adjusted basis, some 30 b.p. below expectations. For the full year, GDP expanded by 1.1%, also at the lower end of expectations. There was a clear deceleration of growth during the fourth quarter, which casts some doubt on the vigor of this year's recovery, as industrial activities actually contracted during the period. In fact, it's quite possible that actual performance will undershoot the official 3.9% GDP growth forecast for the year. In our view, the combination of moderate inflation and low growth suggests that Banco de México will remain on the sidelines with a fairly dovish message for the time being; indeed, we expect no changes to the tasa de fondeo rate during 2014.

Venezuela's extended carnival holidays ended on March 4. Since then, the clock has been ticking again for the government to launch the new Sicad 2 currency mechanism. Rafael Ramírez, the energy minister and economy vice president, said it would be inaugurated on March 10. In the meantime, local media reports have suggested that the Sicad 2 rate could be much weaker than market expectations. *El Nacional* newspaper, for instance, said that it could be as high as VEF50/USD.

We expect that the Sicad rate will be much weaker than under the previous exchange mechanisms, Cadivi (6.30) and Sicad 1 (11.00)—but not as depreciated as reported. Indeed, a Sicad 2 rate weaker than 25 would be a positive surprise. While the implementation of Sicad 2 will not mean that Venezuela as a whole will generate more dollars, a weaker exchange rate will help reduce the sharp imbalances between dollar supply and demand, and will provide dollars to the private sector that in turn should contribute toward reducing shortages of basic goods. On the flip side, official recognition of a weaker exchange rate should result in further pressure on domestic prices, although it can be argued that local prices already reflect, at least partially, a parity weaker than Cadivi's. The success of Sicad 2, therefore, is important to determine whether the wave of mostly middle-class protests wanes or becomes exacerbated. Meanwhile, Ramírez traveled to China and Russia, where he reached "multiple and sizable financial agreements," according to President Nicolás Maduro, who didn't provide any further details. Local economic consultants reported that dollar assets outside the central bank reached almost US\$17 billion in January, up some US\$6 billion since December, reportedly on the back of disbursements from China and because of limited authorizations to import goods and services, possibly in anticipation of Sicad 2.

On the political front, protests continued during the holidays, although with somewhat less intensity. At the time of writing, the tally of casualties had reached 20. The Organization of American States (OAS) is expected to hold special sessions to discuss Venezuela, although Maduro said that he won't pay any attention to a possible OAS resolution and that "he wants the OAS out of Venezuela." He also announced the stoppage of diplomatic and commercial relations with Panama, accusing President Ricardo Martinelli of trying to meddle in Venezuelan politics and being a "lackey" of the US. The opposition claims that the police and armed forces continue to arrest demonstrators illegally, violating human rights. It has rejected Maduro's call for national peace talks until several conditions are met, including the freeing of all political prisoners, the purge of Cuban personnel from the armed forces and the disarming of the so-called "colectivos," i.e. the chavista militias. As those conditions are unlikely to be fulfilled, social tensions will probably continue over the coming days and weeks.

**Steady growth with tame inflation**

**Asia ex Japan:** There's been no change to our GDP forecast for Asia after our growth downgrade last month. We still expect an essentially steady growth outlook this year, with little underlying inflation risk across the region (with the exceptions of India, Indonesia and, to a lesser extent, Malaysia and the Philippines). In 2014, Asia will probably still lack a major export-led recovery, given the growing divergence of weakening emerging-market demand and a growing recovery in the developed world. Domestic demand will also lack stimulation owing to the need of many Asian countries to maintain a sound fiscal discipline or engage in fiscal consolidation. The only positive aspect for the region is tame inflation, which should allow monetary policy to stay accommodative for longer in many countries, thereby providing some support for domestic demand growth in the coming year.

**Uncertainty to cloud China's financial sector**

China's increasing need to contain credit and default risk is still expected to dictate a more hawkish monetary policy, while the pressure to control local government's default risk means that fiscal policy may end up tighter than the government planned. For China's financial sector, 2014 will be a year of changes and uncertainties. Banks are being asked to bring shadow banking assets back on balance sheet, and markets are still not sure how to price the write-offs and provisioning of these moves. China is also launching its first onshore corporate bond default this month (Chaori Solar Energy), and there may be more to come—not just corporate bonds and trust securities, but possibly even some high-risk debt from local government (such as small cities or counties).

People's Bank of China is also evolving from a credit, quota-based monetary policy framework to an interest-rate, market-based system (with increasing interbank rate-based pricing of loans). So volatility of short-term interest rates and liquidity will continue, as will uncertainty about banks' net interest margins—especially with the soon-to-be-announced deposit interest rate liberalization.

**Systemic risk remains low, but market takes time to distinguish relative risk**

That said, we are beginning to see China's credit market learning to distinguish relative risk. Risk premiums on low-rated onshore corporate bonds (BBB and below) have increased against the backdrop of a big rally in local government bonds, driven by the safe-haven trade. Shadow banking assets still account for a small share (0.8% to 4%) of the big five state banks' total assets (which account for 70% of the system's total assets). Small local or regional banks' share of shadow banking credits account for about 20–30% of total assets. We still think the systemic risk in China is low, but it will take time for the financial market to truly distinguish the relative risk between assets.

**EEMEA outlook marked by political uncertainty**

**Emerging Europe, Middle East and Africa:**

After a rather turbulent start to the year—when a generalized emerging-market risk sell-off triggered unprecedented policy responses from a number of EEMEA central banks—the outlook for much of the region remains shrouded in uncertainty. Despite the output recovery that we had penciled in for 2014, the pace of GDP growth is likely to remain significantly below the region's long-term potential. In addition, the outlook is subject to threats from external factors such as China and stagnant commodity prices, and—more importantly—from several political crises simmering within the region's borders.

**The crisis over Crimea...**

The most serious of these has begun to unfold in Ukraine, where the ouster of the corrupt and increasingly unpopular regime of President Viktor Yanukovich (in what could be described as a popular uprising) has given an excuse to Russia to intervene militarily in Ukraine's autonomous region of Crimea. Officially, the intervention had

been framed as an operation to protect the local ethnic Russian population from an alleged rising wave of Ukrainian nationalism. But it is being seen by most observers as a rather blatant and calculated move by the Kremlin to destabilize Russia's westerly neighbor in order to prevent its new government from moving the country into the Western orbit and away from its historical geopolitical and economic partnership with (and its dependence on) Russia. The conflict has the potential to spill over into the rest of the region—especially now that Ukraine's territorial integrity has driven a wedge between President Putin's openly expansionist Russia and the West—as well as medium-term implications for Russia's economy, the largest in the region.

**...could spark a tit-for-tat financial and economic warfare...**

An open military clash between Russia and the West (NATO) over Crimea is very unlikely in our view. We think having nuclear powers on both sides of the equation will be enough of a deterrent. The real risk, however, is that the conflict could escalate into economic and financial “warfare” with the use of (reciprocal) financial sanctions, trade restrictions and embargoes. From the Western perspective, the fact that Russia's oligarchic class has significant financial assets in the US and in European banks potentially provides some leverage over the Kremlin. So does the need of the large Russian corporations to access international capital markets, credit lines and their own offshore assets. On the other hand, Europe's dependence on Russia's exports of natural gas (accounting for close to 30% of the EU's total imports and anywhere from 40% to 100% of total consumption, depending on country) gives important leverage to Russia.

**...and will permanently dent Russia's investment climate and growth outlook**

The situation in Crimea remains very fluid and could easily escalate further, especially after the referendum set for March 16 in which Crimeans will vote on whether to remain a part of Ukraine (perhaps with a greater degree of autonomy) or to join the Russian Federation. The latter is the most likely outcome, even after adjusting for the fact that the actual vote may not be entirely fair and free. Regardless of the outcome, however, we believe the crisis will push Russia into greater isolation and set back any progress that the economy has made over the past two years in improving its business and investment climate and in stabilizing rampant private capital flight. As a result, we will be looking to make further downward revisions to Russia's growth outlook, the severity of which will depend on the extent of the sanctions that may be imposed.

**Turkey is heading into important municipal elections...**

Meanwhile, in Turkey, political noise continues to intensify ahead of the municipal elections scheduled for the end of March. After corruption revelations against several ruling Justice and Development Party (AKP) politicians, their relatives and their business associates in December, Prime Minister Erdogan took a very firm and combative stance against what he sees as an effort to overthrow his government by a clandestine movement headed by an exiled (moderate) cleric. Indeed, the government has taken measures to thoroughly purge the ranks of the police and the judiciary, believed to be infiltrated by the alleged plotters. It also pushed a very controversial bill through parliament to give the government tighter control over the board that appoints judges and prosecutors, and passed legislation that will allow the authorities to censor websites that may carry alleged evidence of the government's wrongdoing. This, in turn, has triggered even more Internet leaks of supposed evidence, including some that claim to directly implicate the prime minister, although the authenticity of these is being disputed. All this, in turn, has had a further dampening impact on business and consumer sentiment, above and beyond the Turkish lira weakness (nearly 25% since last May), monetary policy tightening (more

than 550 b.p. during the same time frame), and the implementation of macroprudential measures targeting consumer credit.

**...although we  
continue to see  
a favorable  
outcome**

Critically, this month's municipal elections are seen as the first real test of the AKP's and Erdogan's popularity since the mass anti-government protests last summer and the corruption probe that began late last year. Hence, we believe that political noise is likely to increase in the next few weeks. Nevertheless, the most recent opinion polls indicate that, despite increased polarization in the society, there has been little noticeable shift in voter preferences so far; the AKP has not lost much of its popularity relative to the 2011 parliamentary elections, and its candidates should have no problem winning the two main cities (Istanbul and Ankara). This means that the Goldilocks political scenario is still the most likely one, in which Erdogan moves to the (largely ceremonial) role of a president this summer and President Abdullah Gül becomes the next prime minister, leaving the government's generally market-friendly policy framework intact. In a more problematic scenario, the AKP's loss of preference would force Erdogan to remain at the helm of the party and take it to elections in 2015 (or later this year should the AKP decide to call snap early elections), with much sharper and even more controversial rhetoric, possibly combined with some economic populism. In our view, this scenario is less likely to play out.

	Real Growth (%)				Inflation (%)				Official Rates <sup>1</sup> (%)		Long Rates <sup>1</sup> (%)	
	4Q/4Q		Calendar		4Q/4Q		Calendar		EOP	EOP	EOP	EOP
	2013	2014F	2013	2014F	2013	2014F	2013	2014F	2013	2014F	2013	2014F
<b>Global</b>	3.0	3.3	2.4	3.2	2.5	3.2	2.5	2.9	2.25	2.28	3.83	4.14
(PPP Weighted)	(2.8)	(3.7)	(3.0)	(3.5)	(2.8)	(2.8)	(3.0)	(2.8)				
<b>Industrial Countries</b>	2.0	2.6	1.2	2.4	1.2	2.1	1.3	1.8	0.34	0.30	2.48	2.84
<b>Emerging Countries</b>	4.7	4.7	4.7	4.6	4.9	5.2	4.6	5.1	5.68	6.09	6.51	6.73
<b>United States</b>	2.5	3.7	1.9	3.2	1.2	2.6	1.5	2.1	0.13	0.13	3.04	3.75
<b>Canada</b>	2.7	1.7	2.0	2.0	1.0	2.2	1.0	1.8	1.00	1.00	2.77	3.25
<b>Europe</b>	1.0	1.8	0.1	1.6	1.0	1.3	1.5	1.0	0.35	0.24	2.33	2.46
Euro Area	0.5	1.5	-0.4	1.2	0.8	1.1	1.3	0.9	0.25	0.10	2.11	2.25
United Kingdom	2.7	2.9	1.8	2.9	2.1	1.7	2.6	1.7	0.50	0.50	3.24	3.25
Sweden	3.1	2.2	1.5	2.7	0.1	1.1	0.0	0.5	0.75	1.00	2.53	2.75
Norway	1.9	2.4	2.1	2.2	2.3	2.0	2.1	2.1	1.50	1.50	3.04	3.25
<b>Japan</b>	2.6	2.4	1.5	2.3	1.4	3.1	0.4	2.9	0.10	0.10	0.74	0.80
<b>Australia</b>	2.8	1.7	2.4	1.9	2.7	1.7	2.5	2.1	2.50	2.25	4.23	4.25
<b>New Zealand</b>	3.3	3.7	2.8	4.2	1.6	1.8	1.1	1.7	2.50	3.50	4.71	4.75
<b>Asia ex Japan</b>	6.3	6.1	6.2	6.0	3.5	3.6	3.2	3.6	5.48	5.57	5.15	5.20
China <sup>2</sup>	7.7	7.2	7.7	7.1	2.9	2.8	2.6	2.5	6.00	6.00	4.70	4.80
Hong Kong <sup>3</sup>	3.0	3.4	2.9	3.1	4.3	4.1	4.3	4.0	0.50	0.50	2.35	2.34
India <sup>4</sup>	4.7	5.4	4.6	5.0	7.0	8.1	6.3	8.8	7.75	8.50	8.83	9.25
Indonesia <sup>5</sup>	5.7	5.5	5.8	5.5	8.0	5.8	6.4	6.7	7.50	7.25	8.40	7.00
Korea <sup>6</sup>	3.9	2.7	2.8	3.1	1.1	1.9	1.3	1.5	2.50	2.50	3.57	3.80
Thailand <sup>7</sup>	0.6	3.7	2.9	2.6	1.7	3.4	2.2	3.3	2.25	2.00	3.91	4.00
<b>Latin America</b>	2.1	2.4	2.5	2.2	6.0	8.6	6.0	7.8	6.93	7.56	9.88	9.86
Argentina	3.0	0.0	5.0	-0.3								
Brazil	1.9	1.6	2.3	1.7	5.6	6.0	6.4	5.9	10.00	11.00	13.11	13.10
Chile	4.0	4.1	4.3	4.0	2.3	2.9	1.9	2.6	4.50	4.00	5.19	5.10
Colombia	4.2	4.4	4.0	4.2	1.8	3.0	2.0	2.6	3.25	4.00	6.83	7.25
Mexico	0.7	3.8	1.1	3.5	3.7	4.0	3.8	4.0	3.50	3.50	6.44	6.20
<b>EEMEA</b>	2.3	2.7	2.0	2.5	5.6	5.4	5.9	5.5	4.78	6.33	7.74	8.85
Hungary	2.7	1.7	1.1	2.0	0.7	2.7	1.6	1.3	3.00	3.00	5.61	7.00
Poland	2.3	2.9	1.6	2.6	0.9	2.1	1.2	1.4	2.50	3.00	4.34	4.95
Russia <sup>8</sup>	1.1	3.0	1.3	2.5	6.4	5.3	6.8	5.8	5.50	5.50	7.66	9.00
South Africa	2.1	2.7	1.9	2.7	5.4	6.5	5.8	6.1	5.00	6.50	8.24	9.75
Turkey <sup>9</sup>	5.4	1.7	4.2	2.5	7.5	7.6	7.5	7.5	4.50	11.00	10.15	10.75

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.