AllianceBernstein

Global Economic Outlook

Global Economic Research

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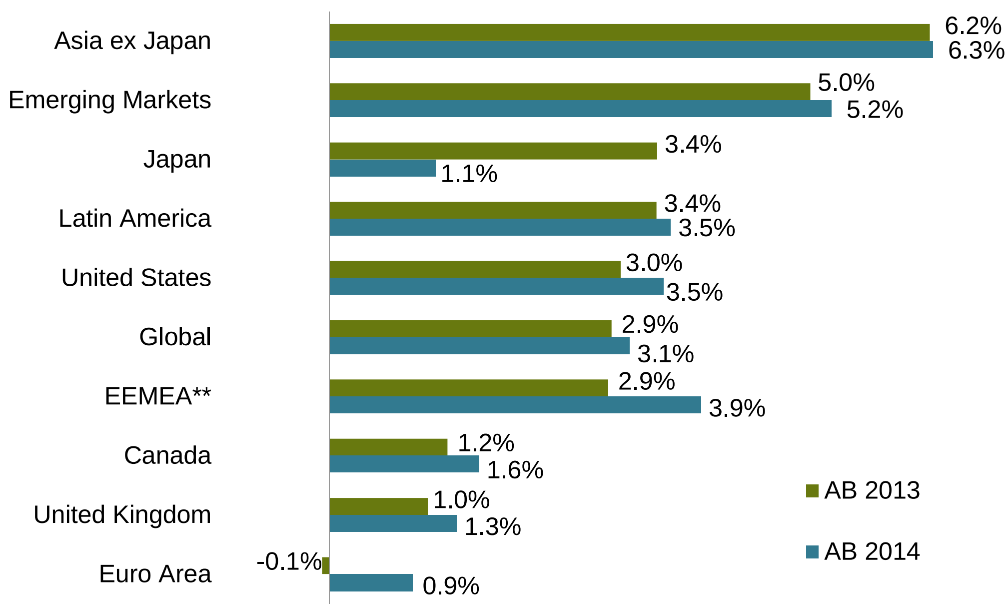
AllianceBernstein World Economic Growth Forecasts*



*4Q/4Q percentage change **Emerging Europe, Middle East and Africa
Source: AllianceBernstein

Global Outlook

Global growth remains moderate

Global growth estimates for 2013 and 2014 remain essentially unchanged at about 3% this month, although we've lowered our estimates slightly for non-Japan Asian growth. Stronger-than-expected growth in Japan and the US remain the key drivers for the acceleration in global growth in 2013, while non-Japan Asia remains the fastest-growing region. In Europe, economic recession is expected to end at about midyear, with very little growth expected in the second half. Several countries in eastern Europe have continued to post disappointing growth because of the European recession, as well as tighter lending conditions by the European banks. Growth trends in Latin American countries have been mixed, as several have been hurt by the slowdown in global trade and lower commodity prices. However, we expect the pace to improve during the second half owing to relaxed monetary conditions.

Business surveys improve recently

At this point, global business surveys are consistent with our forecast of a modest pickup over the second half of the year. Indeed, the global business surveys of manufacturing and services industries increased by over one percentage point to 53.1 in May, the highest reading since January. Most of the improvement was centered on the service sector, led by very strong gains in Japan. The service sector rebound in Japan appears to be the strongest in many years, with a lot of positive momentum in domestic demand following the fundamental change in monetary policy led by Bank of Japan governor Haruhiko Kuroda.

Manufacturing still sluggish

On the global front, the composite index of the manufacturing sector edged up as well, led by gains in new orders. However, in May, the overall reading was still below January's numbers, suggesting that global manufacturing activity is limping along, hurt by the pullback in mining activity and the weak commodity sectors.

ECB still open for more easing

On the policy front, the European Central Bank (ECB) has left the door open for more monetary accommodation—but not immediately, as there appears to be a slight recovery from depressed levels in some business surveys. Yet, the hard data on orders and sales are still decidedly weak and additional accommodation may be needed before long.

Fed ready to taper QE3

In the US, the debate on the potential tapering of the Federal Reserve's asset purchase program has had a significant impact on financial markets, evident from the rise in bond yields and the modest sell-off in equities. We expect that policymakers will communicate their intentions at the June meeting of the Federal Open Market Committee and we think they might telegraph an intent to begin tapering purchases in the third quarter, with a full wind-down of the third quantitative easing program (QE3) taking between six and 12 months.

US Outlook

Modest growth driven by private sector

The US economy continues to motor along driven by gains in the private sector. In the first quarter, real gross domestic product (GDP) growth of 2.4% masked the strength in the private sector, which increased by 4.2% annualized, the best quarterly gain in over a year. Strength was concentrated in early cyclical industries, such as consumer durables (+8.2%) and housing (+12%).

Employment data for May show continued gains in the private economy. Payroll employment rose 175,000, with private payrolls rising 178,000. Since the start of the year, monthly payroll employment has averaged 189,000 and private employment 194,000.

Service sector drives job gains

Private services industries accounted for almost all the job gains in May, led by professional and business services, leisure and hospitality and retail. Construction employment rose 7,000, while manufacturing employment fell 8,000 (concentrated in the food and printing industries). Aggregate hours worked rose 0.5% in May, led by a longer workweek in construction and services. The increase in hours worked is running close to 2% annualized in the second quarter, which suggests that real GDP growth should be in the 2.5% to 3% range for the second quarter. This implies private sector growth of about 3% to 4%.

Fed to taper asset program in 3Q

Continued improvement in the labor markets offers further confirmation that the current cycle has become self-sustaining and may no longer need all the unprecedented quantitative easing programs put in place by the Federal Reserve. At the April 30–May 1 FOMC meeting, there was a lively debate about when to start tapering the QE program. Several members thought it would be prudent to start to slow the purchase program as early as June. At the June 18–19 meeting, we think there's a good chance that the official statement will include language saying that the pace of purchases in the second half will drop from the current target of $85 billion per month.

Europe Outlook

Better survey data in May

After a disappointing start to the year, recent euro-area data have been more encouraging. This is certainly true of the May survey data which saw the composite PMI rise to 47.7, the highest reading since January, and the new orders component of the manufacturing index jump to 49.0, the highest since June 2011. There was even some brighter news from the periphery, with Spain's composite PMI rising sharply to 47.2—also its highest reading since June 2011.

Hard data are more mixed

Recent hard data have been more mixed. Based on reports from individual countries, euro-area industrial production is likely to have risen by 0.4% in April. Coming on the back of a 0.8% increase in March, this would put the level of output 1.1% higher than the first-quarter average and represent a strong start to the quarter. But consumer data have been softer, with auto sales still weak and April retail sales 0.8% lower than the first-quarter average.

Sixth straight quarter of contraction

Overall, recent data are consistent with our view that the euro-area economy in the second quarter will experience its sixth consecutive quarterly decline before stabilizing and beginning a mild recovery during the second half of the year. For the year as a whole, we expect a 0.7% contraction in economic output, slightly worse than last year's 0.5% shrinkage.

Modest recovery likely in 2014

Next year, we expect the economy to grow by 0.6%. This is based on a number of factors: a further moderation in the pace of fiscal adjustment, a gradual improvement in the monetary transmission mechanism in the periphery and the beneficial impact of lower inflation on real incomes. But it is also crucial for the euro area to avoid any further financial shocks, as this would make it difficult for business investment in the core countries to find a much-needed foothold.

ECB rates likely to stay on hold

Against this backdrop, we expect the ECB to keep interest rates on hold until at least the end of 2014. The risks to this view are, however, skewed to the downside, especially in the near term. Indeed, comments by President Mario Draghi following the ECB's June Council meeting suggest that a small minority of Council members continue to favour lower rates. Resistance of some other Council members to further easing is, however, likely to be high, especially as this may involve pushing the deposit rate into negative territory. In our view, such a controversial step would require clear evidence of renewed economic weakness.

ECB balance sheet contraction…

The ECB continues to be relaxed about the ongoing contraction in its balance sheet as banks repay surplus liquidity borrowed at the very long-term refinancing operations (VLTROs) of December 2011 and February 2012. In part, we agree with the ECB's thinking. The repayment of VLTRO money is a sign of improved funding conditions for euro-area banks, and the ECB has the means to counter any premature upward pressure on money-market interest rates should that prove necessary. Nor are we worried about the direct impact of the contraction in base money on the real economy. Indeed, while credit growth remains soft, there has been a marked improvement in monetary dynamics across the whole of the euro area in recent months. This has been led by a pickup in bank desposits in the periphery.

…may be preventing the euro from adjusting

We are more concerned about the potential impact that relative central bank balance sheet developments may have on the exchange rate. With other major central banks still expanding their balance sheets, there is a risk that the ECB's willingness to allow its own balance sheet to contract might be putting upward pressure on the euro, thus preventing it from adjusting to the lower levels warranted by its relatively poor economic fundamentals.

Japan Outlook

They say that a month is a long time in politics.

Is "Abenomics" running off track?

For the first five months of Shinzo Abe's premiership, everything was going extremely well, following the "Abenomics" script to the letter. Aggressive monetary stimulus by the Bank of Japan had helped to drive an outsized reaction in both the currency market (with the yen weakening sharply) and the equity market (with the Nikkei soaring). A more upbeat message was filtering through to business and consumer confidence, with both rising to levels not seen since the expansion in the mid-2000s. And there were signs that rising confidence was showing up in spending: for example, the 4% expansion in GDP in the first quarter, at a seasonally adjusted annualized rate (SAAR), was underpinned by solid private consumption. There was even some indication that Japan's entrenched expectations of ongoing deflation were beginning to budge.

But over the last month, events have wandered a little off-piste. Rising market volatility for Japanese Government Bonds (JGBs)—previously dismissed by the BoJ as a "bond market issue"—was starting to undermine the credibility of BoJ governor Kuroda's program. In turn, and along with talk of Fed "tapering" and weaker Chinese data, this helped to generate a sharp correction in the equity market, and a reversal in the yen. Taken together, these trends undermined critical parts of the transmission mechanism from quantitative and qualitative easing (QQE) to stronger activity.

Disappointment was expressed, too, at the failure of Mr Abe to provide more detail of his "third arrow"—the structural reform strategy to boost Japan's longer-term growth prospects.

It's premature to say the policy experiment is over

In some respects, this stall in momentum may have been inevitable. After all, markets had run a long way and expectations, which were so low at the beginning of Mr Abe's term, had been ramped considerably higher. But the response to this setback will be telling. We are focusing on three areas in the near term. First, is the BoJ able—through rhetoric and action—to dampen volatility in the JGB market? Second, will Mr Abe be able to maintain a high enough approval rating to win a majority in the Upper House elections in July? And, third, once those elections are out of the way, can Mr Abe implement the more politically difficult parts of the all-important growth strategy.

At this juncture, we're still prepared to give this experiment the benefit of the doubt, and expect to see stronger growth and higher inflation over the next 18 months.

Australia/New Zealand Outlook

We've been arguing for a long time—see, for example, our recent research paper on the commodity supercycle—that the commodity-producing economies are not all created equal. With the supply side playing a greater role in price dynamics, their vulnerabilities vary considerably. And this will be ultimately reflected in economic performance, monetary policy and currencies.

Data released this month once again underscored the stark difference between Australia and New Zealand. This is a function of commodity price behavior, as well as the transmission of commodity price dynamics to the broader economy. On the price side, nothing illustrates this gulf better than the contrast between bulk commodities and dairy—the dominant export categories for Australia and New Zealand, respectively.

As trends in key commodity prices have diverged…

Iron-ore spot prices have dropped by 25% over the past three months to about US$110 per tonne. In early 2011, before worries about excess supply began to grow, the prices stood at US$180. Coking-coal prices have fallen from above US$300 per tonne to US$135 over the same period, and thermal coal has declined from US$130 to US$80. Not surprisingly, Australia's terms of trade have slid sharply—down nearly 20% from their peak.

…economic performance and monetary policy in Australia and New Zealand are also likely to differ

In contrast, prices for dairy products have continued to climb, driven by tighter supply conditions. The global benchmark dairy price is up nearly 80% over the past year, with most of that jump occurring in April. While the rise lifted New Zealand's terms of trade by 4% in the first quarter, the bulk of the impact should show up in second-quarter numbers. We estimate that New Zealand's terms of trade will increase 10% or so in the second quarter, scaling record highs. The contrast with Australia's terms of trade is conspicuous.

The key transmission mechanisms in the two countries are very different too. Higher dairy prices are making their way through to farmers' pockets. Fonterra announced that its payout for the 2013/2014 season would be NZ$7.00 per kilogram of milk solids—up $1.20 (20%) from the previous season, providing some offset to drought-impaired production. In contrast, the ripple effects of the end of the mining sector's capital spending cycle in Australia are becoming increasingly apparent.

Unemployment in Western Australia—the epicenter of the mining boom—is now rising sharply.

There is an impact on broader business confidence, too. The National Australia Bank's business confidence index continues to slide, pointing to persistent weakness in the aggregate economy. In other words, the slack in mining is not being picked up by the non-mining sector. The Australia and New Zealand Banking Group's "Own Activity" Index for NZ businesses, on the other hand, remains buoyant.

These differences point to a divergence in monetary policy. The Reserve Bank of Australia is likely to ease more aggressively than we previously thought, given that the mining bust is playing out a little faster than our (relatively bearish) expectations. We now expect the cash rate to be cut below 2%. And while the Reserve Bank of New Zealand is unlikely to tighten imminently, preferring to implement macro-prudential measures first, a rate hike will remain a key part of the policy debate. In turn, the pressure we have seen in exchange rates, with the New Zealand dollar outperforming the Australian dollar, is likely to continue.

Canada Outlook

1Q GDP grew much faster than expected

In the first quarter, Canada's real GDP growth of 2.5% was more than double our expectations. Although we still believe the overall economy is in transition, reducing its dependence on construction and improving the support from manufacturing and external trade, the adjustment will take time.

To this point, in his opening statement to the House of Commons, newly appointed governor Stephen Poloz emphasized the limits of the country's current growth model, which is driven by increased leverage and a reliance on the housing market. Instead, the Bank of Canada hopes for a soft landing in housing to provide enough of a cushion to allow other components of GDP to pick up the slack.

Strong export growth offset weak domestic demand

First-quarter growth was fueled mainly by a spike in exports, which was directly and indirectly linked to improving demand in the US. Indeed, exports to the US increased at a 12.5% annualized rate in the first quarter, following a 10% annualized gain in the fourth quarter. Given the relatively high value of the Canadian dollar exchange rate versus the US dollar we do expect a substantial slowing in this component over the course of 2013. Domestic demand, however, increased by a mere 0.5% in the first quarter, with broad weakness in consumer spending and investment.

Even with a strong May, private jobs flat for the year

The consumer outlook remains modest at best, given the relatively high debt burdens. On the surface, the surge in household employment looks to be a very positive development. To be sure, the 94,000 gain in private jobs was the largest on record, but the gain in May follows a two-month total decline in private jobs of 105,000, and leaves private job growth only flat for the year. Furthermore, while employment increased, hours worked have actually declined since April.

Our increased growth forecast still implies a slowdown in 2Q

The payroll employment data released later this month should provide a more accurate picture of labor-market trends. Over the past six months, payroll employment has barely grown, which is one of the key reasons we had remained cautious on overall growth for all of 2013. Admittedly, the US recovery has positive spillover effects into the Canadian economy, but we still think the benefit will be modest. In light of the better-than-expected first-quarter performance, we have raised our 2013 growth estimate for Canada by 0.5 percentage point to 1.7%, but that still implies growth of about 1.5% annualized for the remaining quarters of the year.

Emerging Markets Outlook

Latin American volatility on the rise

Latin America: The indication that the US Federal Reserve was considering the gradual phasing out of its generous monetary stimulus, provided by a speech from Fed governor Ben Bernanke on May 15, elicited substantial market movements across the emerging-market universe. In Latin America, currencies have generally depreciated and market interest rates have increased. The GDP-weighted average of exchange rates in the region's eight largest countries has weakened by more than 5% since May 15, while local rates sold off across the board, regardless of credit quality. Unless some consolidation occurs at the global financial level and more clarity is achieved regarding the timing of the "tapering" in the US, emerging-market volatility is unlikely to abate, in our view.

Brazil: tighter monetary policy and phaseout of capital controls

In Brazil, on June 4, Finance Minister Guido Mantega announced the elimination of the 6% IOF tax on foreign fixed income investment. Mantega said the tax was always thought of as a temporary mechanism to offset the impact of excess global liquidity on Brazilian asset prices, and as those conditions were changing, it was no longer necessary. He did not, however, rule out reviving the tax if global conditions changed again. The 1% IOF tax on on-shore derivatives transactions remains in place, at least for now, but we think that it will also be eliminated eventually. The announcement came after the central bank surprised the market during the previous week by hiking the Selic rate (overnight rate) by 50 basis points (b.p.), versus expectations of a 25 b.p. increase.

The elimination of a barrier to entry on foreign capital is positive news. In the context of tapering talk in the US, however, it may result in increased Brazilian real volatility in the future, as the bullish signal of the IOF slashing will face the bearish signals from abroad, i.e., looming US yield increases, lower growth in China and possibly softer commodity prices. If some sense of consolidation at the global financial level is reached, the elimination on the tax on the cash transaction front should increase the attractiveness of Brazil for foreign investors, especially given the high level of local rates. It should also provide support for the currency and for local rates.

The elimination of the IOF, coupled with recent hawkish statements (and actions) by the central bank can be construed as a renewed orthodoxy on the part of the authorities. Given the recent spike in inflation and the change in international conditions, this is a welcome sign that should improve the mood of foreign investors towards the credit. On the fiscal front, however, doubts still remain, especially ahead of next year's presidential elections and given recent evidence that President Dilma Rouseff, although still comfortably in the lead, is losing some popular support. Thus, the chances are that fiscal policy will remain accommodative in the months ahead, and that inflation will remain in the upper arm of the target range. Following the disappointing economic activity figures observed during the first quarter of 2013, we have revised downwards our projections of Brazil's GDP growth for this year and next, to 2.5% and 3.0% respectively. We also maintain our view that given the deteriorating trend in the external accounts, the medium-term outlook for the currency suggests that a depreciation of the real exchange rate is likely.

S&P lowers outlook on credit rating

On June 6, S&P lowered the outlook on Brazil's sovereign credit rating to negative from neutral, still leaving it at BBB, and arguing that the combination of weak growth and excessively expansionary fiscal policy could lead to a deterioration in debt ratios. S&P also mentioned fast lending growth from state-owned banks as a reason for concern. The agency indicated that there was a one-in-three chance of a rating downgrade over a 24-month horizon. In our view, the timing of the announcement was somewhat odd, especially since in the previous two weeks the authorities had provided good news on the economic policy front. Therefore, the lowering of the outlook was probably a first step of a rather lengthy rating decision. The agency believes that Brazil is still solidly in the investment grade camp although it has lost luster relative to its peers. We believe that S&P is unlikely to downgrade the sovereign rating in the near term, and most likely no decision will be made until after the election of October 2014, although it represents a warning sign for the authorities to rebuild credibility in the country's fiscal and monetary institutions.

Colombian policy rate unchanged as expected

In Colombia, on May 31, Banco de la República decided to leave the policy rate unchanged at 3.25%, in line with consensus, and by a unanimous vote of all its board members. The bank also announced the extension of daily dollar purchases through September, although for a total of US$2.5 billion, lower than the US$3 billion that had been done during the previous four months. That is, BanRep committed to acquiring US$30.8 million per trading day through the end of September, versus US$37 million during the previous period. That reduction was also decided by unanimous vote after the currency had weakened sharply in previous days, getting closer to the level that is considered fair by the bank. BanRep governor José Darío Uribe indicated that a weaker currency was an equilibrium reaction to the expected changes in US monetary policy and to the deterioration in terms of trade. He also said the central bank "would welcome an even deeper depreciation". BanRep said that GDP had probably expanded by less than 3% year on year during the first quarter of 2013, but was expected to grow by between 3.5% and 5% this year, with 4.3% as the mean estimate.

Mexican inflation still high, policy interest rate on hold

In Mexico, consumer prices dropped by 0.33% month on month in May, three b.p. more than expected, so annual inflation is now running at 4.63%, two b.p. below April's level but still well above the 4% ceiling of the target range. Core inflation came out at 0.20% month on month, 2.88% year on year, one b.p. below expectations and seven b.p. below April's level. Noncore prices dropped by 2.05% month on month but accelerated by 20 b.p. to 10.56% year on year. We believe that annual inflation peaked in May and will begin to fall from June, although from high levels. So inflation might remains very close to the ceiling of the target range in June too.

Meanwhile, Banco de México (Banxico) maintained the tasa de fondeo (funding rate) unchanged at 4%, as expected, in its latest monetary policy meeting. The press release that accompanied the decision had a fairly neutral tone, highlighting the green shoots in the US and the turbulence created by the tapering-related talk, as well as the continued recession in Europe. All in all, Banxico sees downward risks for global growth. On the domestic front, Banxico acknowledged that both external and domestic demand were weakening, and that the risk of softer activity ahead had intensified. The recent spike in inflation is expected to be temporary, as the bank sees no evidence of domestic demand pressure. Banxico expects a slight drop in the annual inflation rate this month and then a more significant deceleration during the second half of 2013. In 2014, it expects inflation to be "very close" to the 3% medium-term target. Core inflation is expected to remain below 3% this year and next.

Until Ben Bernanke's speech on May 15, a growing number of market participants were expecting Banxico to cut the tasa de fondeo during the second half of 2013, mainly because of evidence of sluggish growth. Indeed economic activity indicators are showing that the economy is growing at well below potential levels. Since Bernanke spoke, however, the Mexican peso (MXN) has weakened by more than 6%, which represents an endogenous relaxation of the country's financial conditions without any need to lower the funding rate. Thus, we believe that the case for a cut still exists but is weaker than before. In other words, for Banxico to cut rates, we would need to see not only inflation converging to the target range but also a deeper deceleration of growth and a strengthening of the MXN. In the near term, we do not rule out the rule-based intervention mechanism, according to which Banxico sells dollars every time the currency depreciates by at least 2%, being brought back to life to reduce volatility.

Uruguay capital controls have arrived

In Uruguay, last week finance minister Fernando Lorenzo announced the enactment of 50% reserve requirements on purchases of Treasury securities by nonresidents, as well as the increase of reserve requirements on central bank debt purchases from 40% to 50%. Lorenzo said the measures were geared towards providing relief to the exchange rate, which the authorities considered to be overly strong. The timing of the announcement was somewhat puzzling, as the Uruguayan peso (UYU) has been among the worst-performing emerging-market currencies since the Bernanke speech (it had been down 8% in the previous three weeks). In addition, Uruguay is imposing restrictions at the same time that Brazil is moving in the opposite direction, and when global liquidity is no longer increasing.

The explicit message is that the authorities want to see the exchange rate at weaker levels, trying to stimulate growth, although at the expense of accepting higher inflation. Indeed, the authorities also announced the widening of the inflation target beyond July 2014 to a range of 3% to 7%, although inflation is currently above 8% and the currency slide will most likely generate additional price pressures. With currency risk hard to hedge in such a thin market, the likely scenario is that rates will go up. The authorities also announced that the main instrument of monetary policy will shift from the target interest rate to a monetary aggregate, possibly M1, with details to be unveiled during the meeting scheduled for June 27.

Venezuela: sharp deceleration in economic activity while inflation is spiraling

In Venezuela, the central bank reported that first-quarter GDP had come in at 0.9%, below expectations of 1.1%. On a quarter-on-quarter basis, activity contracted by a whopping 15.6%, with the oil sector shrinking by 1.2% and the non-oil economy collapsing by 16.6%. Meanwhile, the central bank also reported that consumer prices had risen by 6.1% month on month, 35.2% year on year in May, and way above the (already very high) expectations of a 4.1% increase. Annual inflation was 580 b.p. higher than in April and 1,730 b.p. higher than last October, suggesting that the macroeconomic imbalances are increasing. Prices of food and beverages rose by 10% month on month and 48.1% year on year. The central bank's shortage index came out at 20.5%; i.e., more than one in five products of the basic consumption basket is not available on the shelves.

The combination of low growth and spiraling inflation suggests that a rarefied social and political climate may be developing. Meanwhile, there is increasingly intense market talk about the possibility that government officials will soon travel to the US and Europe to prepare the market for a supposedly non-deal roadshow. We continue to believe that new issuance is likely, either from Petróleos de Venezuela or the republic, since the authorities have remained away from capital markets for a year and the supply of dollars to finance imports has dwindled. The high scarcity indicators suggest that unless importers are furnished with hard currency to restore supply, inflationary pressures will not abate. The government will also have to reestablish a regular mechanism to supply dollars to the domestic market, probably in the form of an upgraded "SICAD" auction expected to be in place from June.

Asia's 2013 GDP growth forecast is cut by 10 b.p. to 6.1%

Asia ex Japan: Recent trends continue to show a weak Asian growth cycle with export and industrial production growth remaining uninspiring. We have marginally nudged down our GDP growth forecast for the region to 6.1% in 2013 (from 6.2% previously) and maintain a cautious projection of 6.4% for 2014. Similarly, we now expect that the region's inflation will ease to 2.9% this year and 3.2% in 2014, which is 30 b.p. and 40 b.p. lower than our previous forecasts.

Exports remain a drag but domestic demand is not strong enough to compensate for the slack

Asia's aggregate GDP growth slowed to 6.1% year on year in the first quarter of 2013. If we exclude the exceptional V-shaped cycle in 2008–2009, the current growth rate is the slowest in 10 years. In addition, GDP growth excluding China and India eased to a mere 3.1% year on year in the first quarter—a level we haven't seen for a decade. The export cycle has been very benign by Asian standards, with year-on-year growth at a single-digit level for more than a year now, and the expansion slowing to a mere 3% in March. The cycle still lacks signs of a recovery potential, aside from a recent bounce in a select group of electronic items (specifically, semiconductors and some telecom products). We doubt the sustainability of such a tech-specific export revival. In fact, non-tech exports continue to look sluggish. Indeed, domestic demand has barely held steady in most countries and, definitely, has not been able to compensate for the slack in exports in most countries. So the deceleration in industrial production growth has extended into the second quarter of 2013. The good news is that Asia's Inflation—just below 3% year on year in April—is benign and, in fact, there are renewed signs of disinflation emerging thanks to lower commodity and food prices.

Weak growth plus benign inflation will still support policy easing in some countries.

In contrast to the US Federal Reserve's intention to scale back policy easing, Asian central banks are still erring on the easing side. The Reserve Bank of India is only halfway through its easing cycle and we expect there will be 50–75 b.p. more rate cuts to coming after last month's 25 b.p. reduction. Similarly, we have added one more 25 b.p. rate cut into our Korea forecast (following the 25 b.p. decline in May) and a 50 b.p. reduction in Thailand from "no change" previously (after a 25 b.p. reduction in May). Indonesia is likely to be the only country to buck the regional trend with a rate hike, but it all depends on whether the government cuts local fuel subsidies as promised, which, in turn, may exacerbate inflationary pressure.

The worst may be behind us…

Emerging Europe, Middle East and Africa: The data from the EEMEA region over the past two months indicates that the worst in terms of economic activity may now be behind us. In line with a similar trend in Germany (the region's main trading partner), and driven mostly by external demand, industrial output seems to have bottomed out in sequential terms around April, and the three-month seasonally adjusted momentum has now turned positive. That said, the manufacturing PMIs have been a disappointment, falling steadily across the board in the last three months, including their forward-looking components such as new orders and orders-to-inventory ratios. This undoubtedly casts a shadow over the strength of the rebound going forward.

…but, going forward, much will depend on external demand

In general, we expect that further recovery will be precariously dependent on the dynamics of external demand and will be uneven across the region. In most countries, domestic demand has slowed in recent quarters owing to slower (or, simply, no) real wage growth (especially in central Europe), continued pursuit of fiscal austerity and a slowdown in credit growth (outside Turkey).

Inflation remains well behaved, in most places…

Meanwhile, the year-over-year inflation rates continued to ease and, generally, surprised on the low side, benefiting from favorable food and energy price base effects, and evident lack of demand-side inflationary pressures. In most countries, inflation is now either well below their respective central banks' policy targets or is expected to get there during the coming quarter. Importantly, core inflation has also been easing across the region.

…allowing some central banks to ease more

This has allowed a number of central banks to continue easing policy during the past month. The rate setters in Hungary, Poland and Turkey have cut their key policy rates by 25–50 b.p. In Turkey, the cut was partly forced by the appreciation pressures on the lira exchange rate through mid-May in the wake of a credit-rating upgrade to an investment grade.

In contrast, an unexpected uptick in inflation in Russia has likely delayed the start of an easing cycle until July or August. But with the inflation rate decline we foresee in the next few months, and with growing political pressures on the central bank (CBR) to play its part in reviving the economy, we expect the CBR to deliver at least 75 b.p. of easing later this year.

Exchange rate weakness squashed chances of further cuts in Turkey and South Africa

To make things more challenging for the policymakers, a large risk sell-off across emerging markets since the second week of May—driven by expectations of the Fed tapering its securities purchases—caused a significant depreciation of most EEMEA exchange rates. While we don't expect this weakness to negatively impact near-term monetary policy decisions in Russia, Poland and Hungary, we believe the chance of any further easing in Turkey and South Africa has now been eliminated. Furthermore, in Turkey, the exchange rate of the lira will likely remain under depreciation pressure due to the rise in political uncertainty sparked by the spread of anti-government protests since the end of May. The central bank now considers the real effective exchange rate of the lira to be in undervaluation territory, not justified by fundamentals and possibly posing a threat to the inflation outlook. Hence the bank has announced plans to tighten interbank liquidity and even intervene outright in the foreign exchange market to counter "excess lira volatility."

Sub-Saharan Africa will be world's second-fastest-growing region

Frontier Markets: The second-fastest-growing region in the world will be sub-Saharan Africa, trailing developing Asia, according to the IMF's May regional outlook. The fund forecasts 5.5% growth in 2013–2014, a slight uptick from the 5% recording in 2012. Growth will continue to be driven by investment, with some countries benefiting from positive base effects due to last year's poor weather including floods in Nigeria and droughts along the Sahel. Regional inflation continues to come down, and is projected to decline into 2014, based on the IMF's assumption of moderating food prices and non-oil commodities, and central banks' greater emphasis on targeting inflation. Inflation fell to 6.6% year over-year in April, a decline from 6.9% in December, with countries benefiting from lower food inflation, tight monetary policy and positive base effects. However, as countries begin to scale back on their subsidy programs, as in Ghana or in Zambia, and as currency weakness persists, we expect upside pressures to remain on inflation.

Caribbean prospects dim under weak demand and high debt burden

Caribbean prospects are much dimmer and domestic demand remains weak as countries undertake budget austerity and current accounts remain in double-digit deficits. According to the IMF, tourism-dependent economies are likely to grow just 1.75% in 2013, but many are burdened by extremely high debt levels and some are currently in or just coming out of debt restructurings (Grenada, Jamaica). We have seen significant slowdowns in El Salvador and the Dominican Republic, raising questions about the severity of government cuts and in some cases leading to an implementation of stimulative measures. Caribbean countries are generally energy importers and, as such, they remain highly vulnerable to external oil shocks. But external accounts should be helped by the fact that oil is likely to remain at current levels, with more downside likely from a moderation of global growth.

AllianceBernstein Global Economic Forecast

Jun-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	2.9	3.1	2.4	3.1	2.4	2.8	2.3	2.8	2.06	2.27	2.96	3.41
(PPP Weighted)	(2.8)	(3.7)	(3.0)	(3.6)	(2.6)	(3.0)	(3.0)	(3.0)				
Industrial Countries	1.8	2.0	1.1	1.9	1.5	2.2	1.4	2.1	0.42	0.57	1.87	2.34
Emerging Countries	5.0	5.2	4.8	5.3	4.1	4.2	4.1	4.2	5.34	5.66	5.16	5.61
United States	3.0	3.5	2.3	3.1	2.0	2.8	1.9	2.6	0.13	0.50	2.35	3.00
Canada	1.2	1.6	1.1	1.3	1.4	2.6	1.1	2.2	1.00	1.25	2.25	2.45
Europe	0.2	1.0	-0.3	0.8	1.3	1.4	1.5	1.5	0.55	0.58	1.60	2.10
Euro Area	-0.1	0.9	-0.7	0.6	1.1	1.2	1.4	1.3	0.50	0.50	1.50	2.00
United Kingdom	1.0	1.3	0.8	1.2	2.4	2.2	2.7	2.2	0.50	0.50	2.00	2.50
Sweden	1.6	2.2	1.3	2.1	0.8	1.7	0.2	1.5	1.00	1.50	1.75	2.25
Norway	2.5	2.9	2.3	2.7	1.7	1.9	1.7	1.8	1.50	2.25	2.25	2.75
Japan	3.4	1.1	1.7	2.1	0.4	2.7	-0.1	2.4	0.10	0.10	0.90	0.90
Australia	2.1	1.8	2.2	1.9	2.2	1.7	2.4	1.9	2.25	1.75	3.30	3.75
New Zealand	2.1	3.9	2.9	2.8	1.9	2.5	1.2	2.3	2.50	3.50	3.65	4.25
Asia ex Japan	6.2	6.3	6.1	6.4	2.9	3.2	2.9	3.2	5.20	5.41	3.81	4.10
China[2]	7.5	7.4	7.6	7.5	2.5	2.6	2.4	2.7	6.00	6.00	3.30	3.50
Hong Kong[3]	3.5	3.1	3.2	3.8	2.1	3.7	3.0	3.2	0.50	1.00	1.52	2.00
India[4]	5.8	6.6	5.4	6.4	4.2	5.6	5.0	5.2	6.75	7.25	7.00	7.50
Indonesia[5]	5.8	5.4	5.8	5.6	7.4	4.8	6.4	5.6	6.00	6.50	6.00	6.25
Korea[6]	3.1	2.7	2.4	2.8	1.4	2.1	1.3	2.0	2.25	2.75	2.90	3.20
Thailand[7]	3.5	4.0	4.3	5.5	2.7	3.9	2.9	3.5	2.25	2.75	3.20	3.60
Latin America	3.4	3.5	2.9	3.7	6.2	6.4	6.2	6.2	6.53	6.94	7.95	8.63
Argentina	2.2	1.7	2.1	1.8								
Brazil	3.1	3.4	2.7	3.7	5.7	5.5	5.9	5.6	8.50	9.00	10.15	11.00
Chile	4.9	4.9	4.6	4.9	2.9	3.0	2.3	2.9	4.50	5.00	5.30	5.80
Colombia	4.5	4.5	4.1	4.5	2.8	3.0	2.6	2.9	3.25	3.75	5.15	5.90
Mexico	3.8	4.0	3.0	4.0	3.8	3.5	3.7	3.6	4.00	4.25	5.15	5.50
EEMEA	2.9	3.9	2.6	3.7	5.0	5.3	5.5	5.1	4.42	5.03	6.57	7.29
Hungary	1.1	1.7	0.3	1.5	2.7	3.0	2.4	3.2	4.00	4.50	6.00	7.50
Poland	1.7	2.9	1.0	2.6	1.5	2.3	1.3	2.2	2.75	3.25	3.50	4.25
Russia[8]	2.5	3.9	2.8	3.7	5.4	5.6	6.3	5.5	4.75	5.25	6.95	7.50
South Africa	3.1	3.4	2.6	3.3	6.1	5.8	6.0	5.8	5.00	5.50	7.35	8.25
Turkey[9]	4.9	5.0	3.4	5.1	6.0	6.5	6.4	6.0	4.50	5.50	7.35	8.25

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.