

# Global Economic Outlook

Global Economic Research

January 2014

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**United States**—Economy is poised for a strong rebound in 2014. Real GDP growth is forecast at 3.1%, up from 1.9% in 2013.

**Europe**—A subdued recovery and very low inflation point to more monetary easing in 2014.

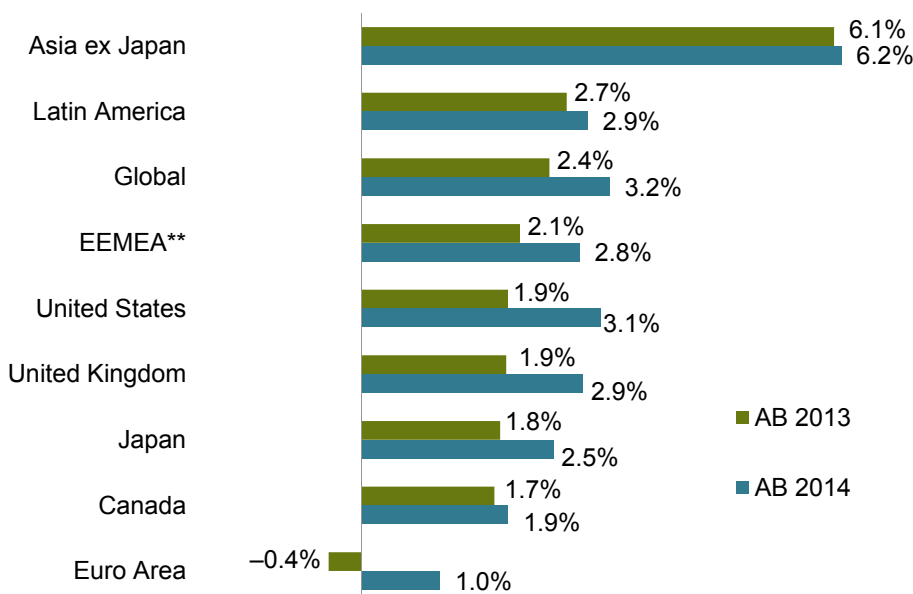
**Japan**—Consolidation of economic gains is expected this year, rather than surprises. Growth should be reasonable, with positive CPI inflation and more policy easing.

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## AllianceBernstein World Economic Growth Forecasts\*



As of January 5, 2014

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

Source: AllianceBernstein

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## Global Outlook

### Global growth set to accelerate in 2014

Global real gross domestic product is projected to grow by 3.2% in 2014, a significant acceleration from the estimated 2.4% advance in 2013. Accelerated growth in the developed economies is expected to account for the bulk of the faster growth this year, according to our research. Our analysts project that developed economies will expand by 2.3% in 2014, led by a 3.1% increase in the US. Japan's economy is expected to advance by 2.5%, while the euro-area economy should grow by 1.0%. In 2013, developed economies grew a scant 1.2%, according to preliminary estimates.

Growth in emerging economies is expected to remain relatively steady, advancing 4.9% this year, following an estimated gain of 4.7% in 2013. The strongest region will continue to be Asia ex Japan, where growth is expected to reach 6.2%, essentially matching last year's gain, followed by Latin America at 2.9% and EEMEA at 2.8%.

### Manufacturing posts strong gains, especially in developed economies

Global business surveys offer confirmation of a faster growth cycle ahead. The overall global index of manufacturing and service industries continues to post readings in the mid-50s, which is consistent with global growth in the 3%–4% range. The manufacturing sector, which is more cyclically sensitive and a harbinger of changes in growth at key turning points, continues to provide most of the lift. The gains have been driven by manufacturing sectors of developed economies—especially the US and Germany.

### Three key risks: Fed tapering, Chinese growth and European disinflation

Of course, there are some risks to our forecasts for 2014. These include the pace of tapering by the US Federal Reserve; major structural reforms under way in China and their potential impact on China's short-term growth; and how the European Central Bank (ECB) will respond to strong disinflationary trends in Europe.

We expect the Federal Open Market Committee (FOMC) to gradually reduce its asset purchase program in 2014, ending it by the end of the third quarter. Given the US economy's forward momentum, we think the tapering will not have a meaningful impact on growth, though it should lead to modestly higher market interest rates. In China, since reforms are likely to be implemented gradually, they will probably make a meaningful impact on the domestic demand growth cycle. Finally, in Europe, we do expect the ECB to lower the financing rate due to uneven growth and low inflation.

## US Outlook

### US economy posts stronger growth in 2H: 2013

The US economy's performance during 2013 improved dramatically, owing to ongoing gains in asset prices, continued monetary relaxation and reduced headwinds from fiscal policy. After expanding at less than 2% annualized in the first half, the economy more than doubled that growth performance in the third quarter, when it advanced by 4.1% annualized. Incoming data for the fourth quarter point to more strong performance, with overall growth estimated to be in the 3%–3.5% range.

### Financial conditions point to faster growth

The acceleration in economic growth is still being questioned by investors and analysts, as there have been so many fits and starts since the recovery first started in the summer of 2009. Yet, we believe that the US economy's performance reflects a dramatic turnaround in household finances, evident in record wealth positions, a solid improvement in liquidity and extremely low leverage. Meanwhile, US companies are cash rich, the monetary policy stance remains relaxed and fiscal drag is diminishing. Taken together, these factors provide a solid foundation for an acceleration in the pace of growth.

**Consumer spending is stronger...**

We currently expect real GDP growth of between 3% and 3.5% in 2014. But there is a good chance that growth may exceed these expectations because of the favorable financial conditions in place. Real consumer spending is projected to rise 2.8%, led by spending on consumer goods. New vehicle sales should top 16 million in 2014—exceeding that threshold for the first time since 2007. Housing is also poised to rebound, although housing starts of 1.1 million units are still 300,000 to 400,000 below what we consider to be a normal level.

**...while business investment is picking up**

Business investment is expected to be stronger in 2014, with spending on new structures and equipment rising between 8% and 10%. Commercial construction activity is rebounding, spurred by increased office use around the country. At the same time, a number of manufacturing firms, especially in the transportation sector, have plans to invest significantly in their domestic operations.

Government spending is expected to be up modestly, rising about 1% due to spending increases at the state and local sectors. Although the gain will be small, the government sector has been a drag on the economy for the past few years, both directly (by spending less) and indirectly (by raising taxes). The sharp reduction in fiscal drag is an important part of the accelerated US growth story in 2014.

**Monetary policy transition will be difficult**

The Fed will have a difficult time transitioning its monetary policy and managing changing market expectations related to a faster pace of economic growth. The FOMC's current forward guidance is to gradually taper the asset purchase program and to avoid official rate increases until 2016. We expect that the QE3 program will conclude by the end of the third quarter and that policymakers will start shifting their guidance on official rate increases to mid-2015.

## Europe Outlook

**Weak and unbalanced recovery**

With the pace of fiscal consolidation easing and monetary policy likely to gain some traction, we expect the euro area to remain on a gradual recovery path in 2014. But some headwinds remain and growth is likely to be anemic at just 1.0%—an improvement on the current year (−0.4%), but well below our estimates for the US (3.1%) and the UK (2.9%).

The recovery is also likely to remain unbalanced. In Germany, we expect a strong pickup in growth. And Spain may already be reaping benefits from past reforms. But France and Italy—where structural reform and wage adjustment have, so far, been disappointing—could continue to struggle. This divergence will again highlight the limitations of the euro area's "one size fits all" monetary policy.

**Inflation likely to remain low**

The recovery is unlikely to have much impact on the euro area's huge output gap, while the euro is strong and many countries are still pursuing internal devaluations (putting downward pressure on wages). These factors will probably keep inflation very low. We expect the headline rate to average just 1.0% for the year as a whole, and even less in the early part of the year.

Despite low inflation, we do not expect the euro area to slip into deflation. Still, with price rises and credit growth likely to remain muted, deflation concerns will probably linger—especially in some of the smaller peripheral economies.

**Monetary easing still likely**

Against this backdrop, we expect the ECB to move its refinancing rate (currently 0.25%) closer to zero in the near future. It is possible that the ECB will be even more

aggressive than this, pushing its deposit rate below zero or proactively inflating its balance sheet—which has shrunk rapidly in recent months. However, that would require the crystallization of region-wide deflation risks and/or a marked appreciation of the euro—neither of which are high-probability scenarios, in our view.

Based purely on our forecasts for growth, inflation and interest rates, there would seem to be little reason to expect core euro-area bond yields to rise much this year. But we also need to take account of potential developments in other markets, particularly the US, where yields are likely to rise. Such a development would almost certainly put upward pressure on German yields; the differential between US and German 10-year yields is already above 100 basis points, which is very wide in a historical context.

**Peripheral  
bonds have  
done well**

Peripheral bonds performed very well in 2013, and yield spreads with Germany are now back at levels last seen in the first half of 2011. We recognize the medium-term challenges facing these countries. But there are also visible signs of improvement in countries like Spain, and at present, it is hard to identify obvious triggers for spread widening. As long as this remains the case, and as long as the ECB continues to act as a de facto lender of last resort for these countries, the relatively high yields available in the periphery could continue to attract buyers.

**Social unrest  
and deflation  
risks remain...**

So what are the risks? Given very high rates of unemployment in most euro-area countries, social unrest will continue to linger in the background and could erupt in a number of countries. For 2014, though, we see two more specific downside risks. The first is a further strengthening of the euro, which could tip the region as a whole away from low inflation toward outright deflation. The second is the German Constitutional Court's ruling on the compatibility of the ECB's Outright Monetary Transactions (OMTs) program with the country's Basic Law. Should the court rule against OMTs, it would put in doubt the efficacy of a bond purchase program that has singlehandedly restored stability to peripheral euro-area bond markets. As such, it could plunge the region back into full-scale crisis mode.

**...but loose  
monetary policy  
and structural  
reform will  
support growth**

Nor should we ignore factors that may support growth surprises. We see two major potential sources of good news. First, monetary policy is highly expansionary and may gain traction more quickly and more strongly than expected—as happened in the UK last year, where growth was much stronger than expected. In the near term, this possibility may be limited to countries like Germany, where the monetary transmission mechanism is working properly, but over time a broader group of countries could begin to benefit. Second, recent structural reforms and labor cost adjustments could have a stronger and earlier-than-expected positive impact on growth and unemployment in countries like Spain. While this would serve only to highlight the failings of France and Italy, it would be a good thing if it forced the second- and third-largest economies in the euro area to follow a similar path.

## Japan Outlook

Last year was a year of surprise in Japan. The success of “Abenomics” in driving the yen lower and the equity market higher, a sharp recovery in growth, and a swing from deflation to inflation were clearly not part of the consensus view at the end of 2012. This year might be a little less exciting and will likely be characterized as a consolidation of 2013's gains. Still, some surprises could be in store. So what are our key themes and risks?

**2014 should be a year of consolidation, rather than surprise...**

On the macroeconomic outlook, we expect a continuation of reasonable economic growth. The pace through 2014 is likely to slow relative to the cracking pace set in 2013. We estimate that 4Q/4Q growth will reach 1.7% in 2014 versus 3.6% in 2013. In part, this reflects the spending pattern associated with the consumption tax hike (VAT) in April 2014, which dragged forward consumption and housing expenditures into late 2013/early 2014 and left a hole in the middle of the year. It also reflects some fade in the fiscal pulse. The level of public-sector investment spending in the fourth quarter of 2013 was just over 20% higher than the prior year. While the Abe administration is still increasing infrastructure spending, the pace of growth will clearly slow, in our view.

So, what could go wrong? We highlight three potential risks. First, growth could disappoint because of a lack of follow-through from policy stimulus to self-sustaining growth (watch wage growth, capital spending and export volumes). Second, the “third arrow” policies—structural reforms—are still to be implemented and their success is in question. Third, Prime Minister Abe’s focus may continue to swing toward national security and geopolitics, taking valuable political capital away from the economic reform agenda.

**...with reasonable growth, positive CPI inflation and more policy easing**

But the bottom line here is that we’re still relatively optimistic. Our calendar 2014 growth forecast of 2.5% is well above consensus (which was 1.6% in December). We’re less worried about the drag on household spending from the consumption tax hike (in part because of rising wages) and more upbeat about the prospects for an improvement in business capex. We should also see some improvement in export volumes helped by both the yen’s impact on competitiveness and the stronger global economic environment. And recall that because of a declining working-age population, Japan’s potential growth rate is not much more than 1%. So the output gap will continue to close.

The narrowing output gap should help to consolidate the rise in inflation that emerged in 2013. The headline Consumer Price Index (CPI) reached 1.5% year on year in November, while the core CPI was +0.6%—the highest reading in 15 years. An increase in wage growth—via both bonus payments and salary increases in the spring wage round—will assist in pushing inflation higher. And, of course, the consumption tax hike should add about 2 percentage points to the inflation rate.

Nevertheless, doubts about the ability of the Bank of Japan to hit its 2% inflation target will persist, which could prompt a further round of policy easing in the first half of the year via an extension or acceleration of the current JGB purchase program. As a result, we expect more downward pressure on the yen, while the BOJ should be able to cap the rise in Japanese government bond yields despite increased selling from other market participants.

## **Australasia**

**Growth, policy divergence between Australia and NZ to continue in 2014**

For Australia and New Zealand, the narrative for 2014 was well and truly set in 2013. The two big growth drivers—the mining-sector capital spending cliff in Australia and earthquake reconstruction in New Zealand—will continue to dominate through 2014 and drive a big wedge in economic performance. Domestic demand growth will be a key barometer in assessing that divergence; we expect it to run at a 1% pace in Australia (or lower) and greater than 4% in New Zealand. In turn, different trends in



unemployment should continue, with Australia's rate rising toward 7%, while New Zealand's falls toward 5%.

Economic divergence is likely to drive policy divergence. The Reserve Bank of Australia still has an easing bias. The path of the Australian dollar and the unemployment rate are key to assessing whether they will indeed loosen monetary policy, as we expect. On the other hand, the Reserve Bank of New Zealand is likely to be the first developed-market central bank to hike rates, almost certainly in March, but possibly by the end of January.

On the risk front, there is some commonality: housing and commodity prices remain central to the risks around the forecasts in both economies—and in both directions.

## Canada Outlook

**US expansion  
not having its  
usual impact**

Last year, the Bank of Canada pointed to weaker-than-expected US growth as a leading cause of the delay in Canada's export expansion. Given that trade with the US makes up nearly three-fourths of Canada's total exports, slower US growth certainly has a dampening effect on Canadian export performance. However, we have long argued that more structural factors are at play (see *Canada Perspectives: Manufacturing Export Weakness Highlights Canada's Competitiveness Issue*, November 22, 2013). This is becoming increasingly clear, as a pickup in US growth has not generated the expansion in exports that Canadian policymakers have been expecting.

**Weak export  
performance  
continues**

In November, for example, Canada posted a trade deficit of nearly C\$1 billion. Also in that report, October's marginal surplus was revised downward to C\$0.9 billion, which means that Canada's trade balance has been in deficit for 23 consecutive months. The problem for Canada is that total real exports are contracting while imports are expanding modestly. Therefore, rather than drive expansion, the external trade sector has likely been a drag on growth for the second straight quarter. And the latest trade data underscored that the long-awaited rotation to export-led growth has not yet taken place.

**Still waiting for  
a rotation in  
growth**

Recent CAD weakness is sure to help on the margin, but the move is relatively small, and it usually takes a year or more for exchange rates to show in trade flows. In the meantime, structural factors—namely a lack of investment and deteriorated competitiveness vis-à-vis US and Mexican production—are likely to continue to hinder a near-term strong Canadian export cycle.

**Monetary policy  
risks have  
shifted**

Looking ahead this year, we expect that policymakers will be forced to continue to wait for exports to drive growth, which is likely to be limited at 2.0% in 2014. Furthermore, as the Bank of Canada is waiting for drivers in the real economy to change, we expect the rate-hike cycle to be further delayed, at least until the end of 2015, and the near-term risk could actually be a cut in official rates.

## Emerging-Market Outlook

**Latin America:** A significant repricing of risk across emerging markets (EM) has taken place since the tapering-related talk began in earnest in May 2013. Both local rates and currencies adjusted markedly to expectations of less favorable global

liquidity conditions, as the EM universe saw a constant outflow of funds, particularly from fixed-income assets.

Momentum is building in the US: the combination of a reduced fiscal drag, recovering home prices and moderate energy prices suggests a positive wealth effect on consumption and improved prospects for economic activity this year. The US recovery should benefit those EM economies with significant commercial exposure, namely Mexico. It remains to be seen, however, whether the US recovery will have the same effect on regional economies as it had in the past. In recent months, US imports from EM have not reacted accordingly to the gradual improvement in activity. This is probably related to structural changes that took place in the US but also to erosion of competitiveness in many EM countries, where structural reforms have stalled. According to our calculations, potential GDP growth has dropped to an average of some 3% in Latin America, down from around 4% in the 2000–2008 period, with Brazil, Venezuela and Argentina having suffered the most significant decreases. Mexico is the most likely candidate to buck up that trend, as the recently approved energy reform is expected to gradually bear fruit, increasing competitiveness and pushing trend growth higher. For the current year, we expect regional GDP to expand by about 3%, up from some 2.7% in 2013, mainly driven by the projected recovery in Mexico.

#### **Inflation rates expected to remain stable**

Inflation rates are expected to remain fairly stable, edging only marginally upward in the region toward the 5% mark when the outliers (Venezuela and Argentina) are excluded. We expect policy rates to remain stable for the most part, with Brazil most likely implementing some residual tightening in the beginning of the year. Marginal rate cuts could take place in Chile and Peru, and small hikes could occur in Colombia and even Mexico toward year-end.

The external financing picture across Latin America looks manageable, even in the credits that have remained under pressure in recent months such as Argentina and Venezuela. We expect the average current account deficit for the region to remain just below 3% of GDP, not far from 2013 levels. In all the main countries in the region but Brazil, net foreign direct investment flows are expected to surpass the current account deficit. The thin reserve buffer in Argentina and Venezuela, hovering around 6% of GDP, warrants close monitoring.

#### **Elections scheduled in eight countries**

The 2014 political calendar in the region is packed, with elections scheduled in eight countries. The most important, potentially market-moving elections are those of Colombia (May), Brazil (October) and Uruguay (October). While it is still early in the campaigns, Presidents Juan Manuel Santos in Colombia and Dilma Rousseff in Brazil are leading the polls and look set to win reelection. In Colombia, a Santos victory will represent economic policy continuity, while a Rousseff reelection will probably be associated with policy adjustments through next year.

#### **Argentina: Price guidelines, again**

In Argentina, the government announced the establishment of a set of price guidelines for some 200 items of the basic consumption basket as a way to fight bulging inflationary pressures. Cabinet Chief Jorge Capitanich said that the accord will have to be fulfilled “with abundant supply” of the items included in the list. He added that the accord should result in an immediate drop in prices of some 7% and is expected to provide reference for up to 4,000 other prices, thus exerting deflationary pressure in the coming weeks. Commerce Secretary Augusto Costa indicated that the firms that signed the accord will be monitored every two weeks via reports from retail inspectors on price and availability of each product at the retail level. Only those

producers who meet those conditions will be welcome to discuss eventual price adjustments. Costa said that the “profit maximizing business logic conflicts with distributive equity,” so the government will intervene to limit pricemakers from appropriating an excessively large share of income. It remains to be seen, however, how this policy will affect private investment. The policy of price guidelines is not new; it was implemented several times since the 1960s. While on occasion it resulted in a temporary drop in inflation, it never proved to be a sustainable strategy. Private-sector analysts have warned that despite the price accord, January inflation is likely to be very high, possibly exceeding 3% month on month, and 27% year on year, on the back of sizable adjustments to public transportation fares, highway tolls, and the seasonal increase in services of tourism, restaurants, and hotels as well as entertainment.

**Brazil: Rating  
downgrade  
fears persist**

In Brazil, November’s tax collection reached R\$112.5 billion, slightly above expectations of R\$111 billion. The budget figures, however, were worse than expected, suggesting that spending has yet to be reined in. The primary surplus was R\$29.7 billion, versus consensus estimates of R\$32 billion, and the nominal balance showed a deficit of R\$200 million versus expectations of a R\$12.1 billion surplus. The figures were hardly reassuring, especially since continued weak fiscal performance can result in an S&P downgrade. As a result, Finance Minister Guido Mantega spoke to the media last week, anticipating the release of the fiscal numbers of 2013 by more than two weeks. He said that the primary surplus during the year was R\$75 billion, slightly above the R\$73 billion target that the authorities had set earlier in the year after a few downward revisions. He stopped short, however, of providing a solid fiscal target for the current year and even declined to indicate whether fiscal performance will be stronger in 2014, thus leaving the door open for an even more moderate primary surplus target for the year. It must be noted that the 2013 fiscal results include several one-off revenue items, which call into question whether the performance can be repeated this year. In the absence of comprehensive fiscal tightening policies—a prospect that looks unlikely during the current presidential election year—we believe that a sovereign rating downgrade during the early part of 2014 cannot be ruled out.

**Mexico: S&P  
upgrades  
sovereign rating**

On December 19, S&P upgraded Mexico’s sovereign rating by one notch to BBB+, with a stable outlook. The rating had been on positive outlook since June. Now all three major rating agencies hold Mexico at the same level, with a stable outlook. The local-currency rating was also upgraded by one notch to A by S&P. The rating action, which took place a bit before market expectations, was based on the approval of a “landmark energy reform.” S&P also highlighted that the fiscal reform will provide some flexibility to the authorities in the medium term. The neutral outlook reflects a compromise between the challenges of implementing the ambitious reforms over the next couple of years with the benefits of increased fiscal room for maneuvering and improved growth prospects.

S&P expects Mexico’s GDP growth to accelerate from 1.2% in 2013 to 3% in 2014 and 3.5% in 2015. Energy-related investment is likely to take time to materialize. Although the fiscal imbalance is expected to increase in 2014, S&P said the increase will be transitory. The general public debt/GDP ratio is poised to remain around 37% in the coming years. Although the current account deficit has remained moderate, external vulnerability has increased because of the larger foreign holdings of government securities, which S&P estimates at some US\$140 billion, more than twice as high as in 2011. Future rating actions will hinge on the speed and



effectiveness in the implementation of the reforms. We maintain a constructive view of the credit, as we expect secondary energy legislation to be approved early in 2014, thus completing the deregulation of the sector and unleashing the country's comparative advantage. Mexico's fundamentals are improving, as both the fiscal and growth outlooks are better after 2013's reforms. We expect a gradual appreciation of the real exchange rate and a gradual flattening of the peso curve in 2014.

**Mexico:**  
**Entering high**  
**inflation period**

Consumer prices rose by 0.57% month on month, 3.97% year on year in December, five basis points above expectations as per Bloomberg's survey, and 35 b.p. higher than November. Merchandise inflation was 0.36% MoM, 1.89% YoY, but services inflation accelerated significantly to 0.30% MoM, 3.54% YoY. This latter indicator is relevant as the authorities believe it best reflects the dynamics of domestic demand, so that the acceleration may be indicating that economic activity is on the mend. Producer prices rose by 2.75% MoM, 13.89% YoY, while public administered prices increased by 1.07% MoM, 8.65% YoY. We expect headline inflation to accelerate further during the first quarter of 2014, fueled by the new taxes that became effective January 1st, possibly reaching 4.4% YoY during January/February and then gradually converging back toward the inside of the target range. Inflation should remain above the 3% medium-term target level over the coming months, also because of the gradual recovery of aggregate demand, as the economy bounces from the disappointing performance of 2013, supported by a more expansive fiscal policy and more vigorous growth north of the border. We expect no policy-rate change on Banco de México's part as a consequence of the higher inflation of early 2014, as the reason behind the spike is a temporary supply shock. The inflation hump, however, bodes well for inflation-linked securities in the near term.

**Venezuela:**  
**Unstoppable**  
**inflation**

Venezuela's central bank reported that consumer prices rose by 4.8% MoM, 58.1% YoY in November, above expectations of 4% as per Bloomberg's poll. The official data were released on December 30, which was 20 days after the deadline established by the bank's bylaws, following intense media scrutiny on the reasons for the delay. Rather than reporting the figures as usual, the bank published a 10-page politically tinged report titled "Price Formation amid the Economic and Political Situation of 2013: Economic War and Government Counterattack." The report argued that "serious alterations" to the Venezuelan economy began to occur after the presidential elections of October 2012, including the "irrational depreciation" of the bolivar and speculative activity fostered by "certain opposition groups as well as the business sector." According to the bank, the government decided to take over electronics retail stores in October because of evidence of significant increases in price markups. In the absence of said intervention, the monetary authority estimated that November inflation would have been higher than 6% MoM. It should be noted that only prices of household goods declined during November, while all other item groups posted increases—some very significant, such as food and beverages, which jumped by 7.5% MoM. The bank also estimated that December inflation will probably show a significant drop toward 2.2% MoM, mainly because the impact of the October intervention measures on prices in nonmetropolitan areas will be felt with a lag. This was another unusual move, as the central bank rarely provides a monthly projection or a preliminary estimate of inflation before month-end. Even if December inflation is indeed confirmed at 2.2% MoM—i.e., well below the 3.9% MoM average observed during the first 11 months of the year—annual inflation would be 56.1% in 2013.

**Venezuela: Fuel**  
**price hike**  
**drawing near**

During a year-end speech, President Nicolás Maduro ratified the government's strategy of heavy regulation and control "of all the sectors in the economy." He

suggested that there will be more direct intervention at the sector level, similar to what took place during the fourth quarter of 2013, to regulate profit margins and lower final prices. Such a move would probably deter private investment even further. Maduro added that “a new forex system” will soon be put in place, although he stopped short of providing details. Last month, Energy Minister Rafael Ramirez said that the Sicad system would be the main vehicle to supply dollars to the private sector. But this was confusing, because he also said that “essential imports of food and medicine” will still be handled by Cadivi and that Sicad will sell only US\$5 billion this year—almost the same as last year. In addition, Ramirez said that, effective immediately, oil transactions and tourism would be channeled through the Sicad market, where the exchange rate has been hovering around 11 VEF/USD. While this would be an improvement on the existing regime, we still believe that a much stronger adjustment is needed in order to improve the fiscal bottom line and to change the mood of investors toward Venezuelan credit, including a devaluation of the Cadivi rate and a further depreciation of the Sicad rate. Moves like this would allow Petróleos de Venezuela, the state-owned energy company, to receive more VEF per dollar worth of oil exports. After some strongly worded statements from government officials late last year, Maduro said that “there is no rush” to increase fuel prices since “there is no fiscal urgency.” It must be noted, however, that the consolidated public-sector deficit as a percentage of GDP remains in double-digit territory. He mentioned that fuel price increases could be implemented at a leisurely pace “over several years.” Early in January, however, he solicited authorization to hike fuel prices to the National Assembly, which suggests that some action on the fuel price front will indeed take place. The lack of a fully fledged plan so far, however, suggests that the government is improvising and points to a lack of consensus about the policy diagnosis within the cabinet. This is complicated further by Maduro’s weak leadership, which probably is preventing him from adopting much needed but tough adjustment measures that would exact a political cost, in our view. Additional announcements will be necessary in the coming days. In the absence of more decisive action beyond the next few weeks, the risk of market disappointment and further drops in debt prices is set to increase.

#### A steady growth outlook in a diverse region

**Asia ex Japan:** Asia will remain a diverse region in 2014, but overall, GDP growth is expected to hold steady at around 6%. In our base case, China’s reform push will limit the recovery potential while India’s and Indonesia’s necessary economic consolidation will be extended as a means to rectify economic imbalances and contain high inflation. Better demand from developed markets may help a regional export recovery somewhat, though the impact will probably be modest by historical comparison. This will be a particularly significant obstacle for high export-dependent economies like Korea, Taiwan and most of the ASEAN countries. We don’t see any compelling domestic demand drivers at this juncture to compensate for the absence of a strong export recovery. Meanwhile, the tapering of quantitative easing in the US may cause further financial-market volatility, but on fundamental grounds, the lack of a major regional revival should allow policy accommodation to stay in place longer for more countries outside of India and China, in our view.

#### China’s reform push to constrain recovery potential

Our 7.4% GDP forecast for China assumes that the negative and positive effects of reforms and rebalancing will roughly balance out, causing no major disruption to underlying economic growth. In other words, new growth opportunities are likely to offset the retirement of old growth engines. Interest-rate liberalization plus a tightening of interbank lending and shadow banking regulations will continue to result in a monetary policy that is prudent to tight overall, while the need to curb local

government's leveraging risk may result in higher fiscal prudence than Beijing intends. We think that chances of small-scale and localized default risk have increased, as the development of a market-based interest-rate regime is gradually taking shape. The bigger risk is related to whether Beijing has sufficient tools and information to prevent a liquidity crunch while pursuing financial reforms simultaneously. In our base case, we don't expect a systemic banking crisis and we don't think Beijing will allow GDP growth to slip below about 6%, which would risk a hard landing.

### Mixed trends in other Asian economies

Our non-consensus view on India and Indonesia remains unchanged. We still think Indonesia has a better chance than India to recover from its respective economic woes. Indonesia should also be better shielded from any potential renewed external financing risk in 2014. We expect a few good inflation readings to provide the flexibility for Bank Indonesia to reverse the rate-hike cycle in the second half of 2014.

India's external funding position is likely to deteriorate, given the absence of further artificial catalysts to stimulate money inflows from Indians overseas. And the recent export recovery may prove short-lived, as it was triggered by manufacturers offloading inventories offshore.

In Thailand, a lingering and possibly worsening political situation is likely to threaten growth and inflation, which will provide more room for policy accommodation. Malaysia's intention to restore fiscal discipline will prompt a modest expansion in domestic demand. Similarly, in South Korea, the government's fiscal and monetary policies are expected to remain conservative based on its expectations of a stronger growth recovery—which may prove too optimistic, in our view.

### Tail risks to our base-case forecast

For the Asian forecast in general, we see one potential development that could lead to a stronger outcome than our projections against three likely downside risks to our base case. On the positive side, it is possible that exports will finally pick up and accelerate in response to sustained growth in developed markets, providing a more powerful catalyst to Asia's cyclical recovery, which was lacking in 2013. However, it is equally possible that there will be more evidence of rising labor costs in Asia, leading to a shift in the global production chain that could take manufacturing away from the region. In this worst-case scenario, Asia's long-term growth potential will be damaged and would be unlikely to return to its past economic vibrancy, in our view.

In addition, China could also become a drag on the region if Beijing pushes reform too hard (especially in the financial sector) but lacks the means to cushion a major economic downturn or systemic financial crisis. In this case, China would weigh on Asia's growth instead of being a key growth engine for the region, as in recent years. Interest rates are another area of concern. While the sharp upswing in US Treasury bond yields in 2013 on concern about the tapering of US quantitative easing pushed up local yield curves in Asia, better-than-expected US economic data could cause a similar panic in short-term interest rates across the region. This would become a particularly dangerous factor if Asian growth still lags behind the sustained improvement in developed markets while higher interest rates are imported as financial volatility resumes.

### 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 expect the strongest recovery in Russia, but even

there—as with the rest of the region—the growth rate will unlikely reach more than about two-thirds of the pre-2008-crisis trend. The only economy in which we forecast a moderation of growth this year is Turkey. In fact, we think our forecast for Turkey is susceptible to potential further downside risks because of rising political uncertainty, new macro-prudential measures aimed at curbing consumer credit growth and the likelihood of further monetary tightening later this year.

**Inflation should remain benign...**

Meanwhile, inflation is set to remain generally under control across the region, lacking both demand- and supply-side pressures. In central Europe, inflation should rise from multiyear lows but stay below official targets in Poland, Hungary and the Czech Republic. In Russia, we expect inflation to finally fall to the central bank target by about midyear, helped by a planned freeze in administrative prices (of course, only if there are no upside surprises in food price inflation, which accounts for a very large share of the index). Only in Turkey will inflation remain stubbornly high due to the foreign exchange pass-through from the steady exchange rate depreciation since last May and due to January hikes in the special consumption taxes (the latter could add up to a full percentage point to the annual headline inflation rate).

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

Consequently—and again with the exception of Turkey—we expect monetary policy to remain anchored at current low rates. Interest rates will rise only in the fourth quarter, at the earliest, if at all. Central banks will be looking for signs of a stronger-than-expected recovery in domestic demand in order to activate a rate normalization cycle. But they could be forced to hike rates earlier if developed-market policy rate expectations become unhinged and rise despite the currently flat forward guidance by the major central banks. Hungary is the only country in the region where we expect more cuts this year as the ruling party-dominated central bank chips in—with up to 50 more basis points of largely symbolic cuts—to help secure Fidesz another landslide victory in the April parliamentary elections.

**Turkey is the main exception due to the ongoing political crisis**

Turkey is the main exception here to the regional trend. We think its central bank is increasingly behind the curve and is likely to be forced to engineer further significant monetary tightening to stabilize the exchange rate and inflation before midyear. Much of the timing, however, will depend on the evolution of the current political crisis, which was triggered by large-scale corruption charges involving several cabinet ministers and businessmen close to the ruling AKP party. The crisis—arguably the most serious challenge to Prime Minister Erdoğan and his party's majority rule since 2002—has put significant further downward pressure on the Turkish lira's exchange rate. It also comes at a particularly awkward time, as the Turkish economy is among the most vulnerable emerging markets to the incipient withdrawal of global liquidity by the US Federal Reserve.

	Real Growth (%)				Inflation (%)				Official Rates <sup>1</sup> (%)		Long Rates <sup>1</sup> (%)	
	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	3.3	2.4	3.2	2.6	3.0	2.5	2.9	2.16	2.17	3.83	4.18
(PPP Weighted)	(2.8)	(3.7)	(3.0)	(3.6)	(2.9)	(2.9)	(3.0)	(2.8)				
Industrial Countries	2.1	2.3	1.2	2.3	1.3	2.1	1.4	1.9	0.34	0.30	2.48	2.84
Emerging Countries	4.7	5.1	4.7	4.9	5.0	4.7	4.6	4.8	5.65	5.78	6.51	6.85
United States	2.7	3.3	1.9	3.1	1.4	2.4	1.5	2.1	0.13	0.13	3.04	3.75
Canada	2.2	1.9	1.7	1.9	1.4	2.6	1.1	2.2	1.00	1.00	2.77	3.25
Europe	0.8	1.6	0.1	1.4	1.0	1.3	1.5	1.2	0.35	0.25	2.32	2.46
Euro Area	0.4	1.2	-0.4	1.0	0.8	1.2	1.3	1.0	0.25	0.10	2.11	2.25
United Kingdom	2.9	2.7	1.9	2.9	2.2	1.9	2.6	2.0	0.50	0.50	3.19	3.25
Sweden	1.2	2.9	0.9	2.4	0.1	1.5	0.0	1.0	0.75	1.00	2.53	2.75
Norway	1.8	2.6	1.9	2.3	2.4	1.8	2.2	2.0	1.50	1.75	3.04	3.25
Japan	3.6	1.7	1.8	2.5	1.3	3.1	0.3	2.9	0.10	0.10	0.74	0.80
Australia	2.4	1.7	2.3	1.9	2.5	1.7	2.4	2.1	2.50	2.25	4.23	4.25
New Zealand	4.2	3.4	3.0	4.4	1.9	1.8	1.2	1.9	2.50	3.50	4.71	4.75
Asia ex Japan	6.1	6.4	6.1	6.2	3.6	3.2	3.2	3.2	5.48	5.51	5.15	5.48
China <sup>2</sup>	7.6	7.6	7.6	7.4	3.0	2.5	2.7	2.6	6.00	6.00	4.70	5.25
Hong Kong <sup>3</sup>	3.1	3.1	3.0	3.5	4.6	4.1	4.4	4.2	0.50	0.50	2.35	2.42
India <sup>4</sup>	4.6	5.6	4.6	5.2	7.2	6.2	6.3	6.8	7.75	8.25	8.83	9.00
Indonesia <sup>5</sup>	5.5	5.7	5.7	5.4	8.4	4.3	7.0	4.9	7.50	6.50	8.40	6.75
Korea <sup>6</sup>	3.6	2.9	2.7	3.1	1.1	1.8	1.3	1.4	2.50	2.75	3.57	4.20
Thailand <sup>7</sup>	0.7	4.4	2.9	3.8	1.7	3.9	2.2	3.3	2.25	2.00	3.91	4.50
Latin America	2.7	3.0	2.7	2.9	6.4	8.8	6.4	7.4	7.00	7.28	9.88	9.75
Argentina	3.0	3.0	5.0	2.5								
Brazil	2.3	2.2	2.4	2.2	5.7	6.1	5.8	5.9	10.00	10.50	13.11	13.00
Chile	4.0	4.5	4.3	4.4	2.2	2.9	1.8	2.6	4.50	4.50	5.19	5.40
Colombia	4.2	4.4	4.0	4.2	2.0	3.0	2.1	2.6	3.25	3.50	6.83	7.20
Mexico	2.2	4.0	1.4	4.1	3.9	4.1	3.8	4.0	3.50	3.50	6.44	6.00
EEMEA	2.2	3.2	2.1	2.8	5.6	5.5	5.9	5.7	4.78	5.08	7.76	8.64
Hungary	2.6	1.7	1.0	2.0	0.9	2.5	1.8	1.7	3.00	3.50	5.61	7.00
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 <sup>8</sup>	1.1	3.0	1.5	2.5	6.4	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	5.7	5.7	5.4	5.00	5.50	8.24	9.50
Turkey <sup>9</sup>	5.4	4.0	4.2	4.0	7.5	7.6	7.5	7.5	4.50	5.50	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.