AllianceBernstein

Global Economic Outlook

Global Economic Research

September 2014

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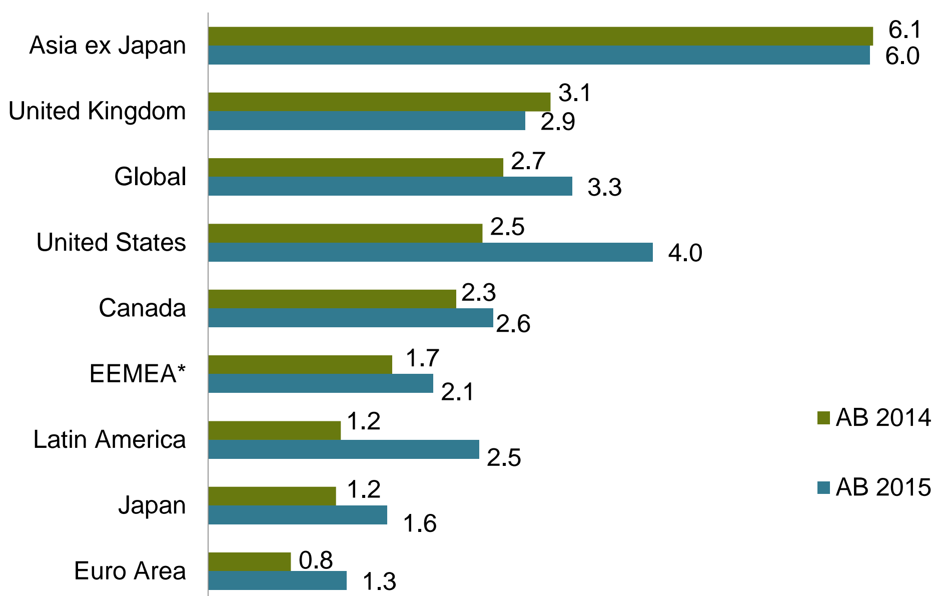
AllianceBernstein World Economic Growth Forecasts (%)



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

Global Outlook

Uneven global economy

Global economic growth remains moderate and uneven, which is likely to trigger shifts in monetary policy in a number of economies.

US growth cycle broadens

The growth cycle in the US continues to broaden and gain speed. Second-quarter real gross domestic product (GDP) growth has been revised up to 4.2%, and is likely to be revised higher; it showed very strong gains in the key cyclical sectors of manufacturing and construction. Moreover, business surveys for the manufacturing and non-manufacturing sectors indicate that growth continues to run well above trend in the third quarter, and we expect real GDP growth in the 4% range over the second half of the year. Given the underlying strength in the pace of growth and tighter labor markets, we expect the Federal Open Market Committee (FOMC) to unveil its exit strategy principles at the September 16–17 meeting.

Europe stalls

In Europe, meanwhile, economic growth and inflation conditions have deteriorated. Second-quarter growth showed no incremental gains, and inflation decelerated further. As a result, it wasn't surprising to us when the European Central Bank (ECB) not only cut its refinancing and deposit rates, but also announced that it would launch an asset-backed securities purchase program and a third covered-bond purchase program starting in October. The scale of the program hasn't been defined yet, but the intent is to increase the ECB's balance sheet toward its 2012 size.

Japan dips

In Japan, production and trade numbers continue to disappoint. The extended weakness raises the odds of another round of fiscal stimulus, and increases the pressure on the Bank of Japan to expand its balance sheet well into 2015.

The uneven pace of economic growth is even more apparent in the emerging world. Growth continues to slow in Latin America, especially in Brazil, where aggregate growth remains weak, if not stalled completely. Global sanctions have dealt a hard blow to the Russian economy and its neighboring countries in Eastern Europe. In Asia, economic growth remains moderate, but it's increasingly clear that the typical spillover of stronger US growth hasn't been felt in Asia this time around.

Growth and policy stance favor USD

From a fundamental growth and policy standpoint, the decoupling of the US growth and monetary policy cycles supports a strong US dollar against the other major currencies.

US Outlook

US growth back on solid path

Despite the small weather-related 2.1% decline in the first quarter, we still think the US economy can reach the 3%-plus 2014 GDP growth target we set at the outset of the year. Second-quarter real GDP, originally reported at 4%, was revised upward a bit to 4.2%; further upward revisions are expected when the Census Bureau issues its report on the service sector in mid-September. As things stand now, the GDP goods component rose by 10.8% in the second quarter, GDP structures rose by 9.0% and the GDP service sector rose by a mere 0.5%. We expect a relatively large upward revision to the service growth rate, which would push the final second-quarter real GDP growth number to the 5.5%–6.0% range.

Third-quarter GDP looks to be up by 4%

Third-quarter growth trends also look very strong. Institute for Supply Management surveys for July and August were impressive, suggesting broad gains in manufacturing and services. The average of the composite indices suggests that third-quarter real GDP growth could be in the 4% range, and incremental strength in

construction markets makes the case for a strong gain in real GDP growth even more credible.

Labor markets are firming

Not surprisingly, strong economic growth has been accompanied by steady gains in labor markets. However, payroll employment rose by only 142,000 in August, representing the first sub-200,000 monthly gain in eight months. Although these results are disappointing, August payroll data has been revised by an average of 90,000 jobs in each of the past three years—so the jury is still out on whether the string of payroll gains of 200,000 has actually been broken. The decline in the jobless rate to 6.1% and the rise in wages to a new cycle high of 2.5% indicate that labor markets are strengthening.

Policy shift likely ahead for FOMC

Given the broad strength in the economy and labor markets, the Federal Reserve meeting on September 16–17 could set the stage for a substantial change in forward guidance, and we think the odds are that the FOMC will announce plans to normalize policy over the next six months or more.

Europe Outlook

Growth in the region has softened

Although official data, which showed stagnant growth, probably overstated the weakness of the euro area in the second quarter, there's little doubt the recovery has lost momentum in recent months. In our view, there are two main reasons for this.

First, countries that were expected to underperform this year because they've failed to reform or take steps to improve their competitive positions (notably France and Italy, which account for almost 40% of euro-area output) have done even worse than expected. This has more than offset the positive impact of faster growth in reform countries such as Spain.

Geopolitical concerns weigh on German capital spending

Second, geopolitical uncertainty is having a bigger and earlier impact than expected. This is particularly true for Germany, where the economy is again demonstrating its vulnerability to external shocks. Of course, critics might argue that this will always be the case until the government adopts policies aimed more clearly at bolstering domestic demand.

The problem for Germany (and, to a lesser extent, the rest of the euro area) isn't just the direct hit to exports from the Russia/Ukraine crisis, which we had largely expected. Instead, the issue is the adverse impact that rising uncertainty is having on investment spending, particularly when scars from the sovereign-debt crisis remain fresh and government policy is moving in a less business-friendly direction (rising energy costs, the introduction of a minimum wage and a lower retirement age).

We see softness in German capital spending in a number of key indicators. Equipment investment, for example, which had expanded strongly in earlier quarters, fell by 0.4% in the second quarter. And despite increasing in July, the trend in domestic capital goods orders (a useful proxy for capital spending) still points down, suggesting that softness may continue into the second half of the year.

A temporary soft patch

But it's important to keep things in perspective. What we're talking about is, in all likelihood, a temporary soft patch brought on by external factors. Helped in part by a weaker currency, we expect the economy to regain traction once geopolitical risks start to fade. Unfortunately, there doesn't seem to be much hope of this happening in the very near term, and this points to a period of subdued (but positive) growth in the second half of the year.

ECB eases policy anyway

In normal times, a temporary period of soft growth wouldn't be much cause for alarm and probably wouldn't warrant an easing of monetary policy. But these aren't normal times, so the ECB responded to the recent data softness and persistently low inflation by easing at its September Council meeting. The central bank cut interest rates by 10 basis points (pushing the deposit rate to –0.20%) and announced its intention to start buying asset-backed securities and covered bonds in October. Although the ECB didn't provide any information on the size of the new programs, it did indicate that a key aim was to help push its balance sheet back toward the levels seen in early 2012. That would imply an overall increase of up to €1 trillion over the next couple of years.

Balance-sheet expansion is now the goal

Until we get further details on the size and scope of the new programs in October, it's hard to assess the implications for the economy or the likelihood of additional monetary-policy action, including sovereign-bond purchases. To the extent the new programs are seen as a substitute for sovereign-bond purchases, they clearly make this eventuality less likely. Indeed, there is now a lot of policy easing in the pipeline, especially when the recent depreciation of the exchange rate is taken into account.

Further easing still possible

The ECB's reaction function has changed quite a bit in recent months. Now that the central bank has embarked on a balance-sheet expansion program, it probably wouldn't take much for it to increase either the size or, just as important, the speed of the program. Further action, including extending the new program to sovereign bonds, is therefore still very much on the table. As ECB President Mario Draghi said recently, the risks of doing too little now outweigh the risks of doing too much in the euro area.

Japan Outlook

Wage growth finally shows some signs of acceleration

Wage growth is one of the key factors we've been looking at to determine the success—or failure—of Japanese Prime Minister Shinzo Abe's economic policy and efforts to end deflation. Will we start to see wage growth that's fast enough to be consistent with the Bank of Japan (BOJ)'s 2% inflation target on a sustainable basis?

As a rough benchmark, that level implies that labor compensation per worker needs to rise by 3.0%–3.5% year over year. Assuming labor productivity growth of 1.0%–1.5% (the pre–global financial crisis norm), this would peg unit-labor-cost growth at 2% or so, which is consistent with the inflation target. Effectively, inflation targeting has morphed into wage targeting, which is actually a common global theme.

So far, progress toward that wage-growth target has been disappointingly slow. Yes, the outcome of the traditional Shunto wage-negotiation round at the beginning of the year was positive, but that didn't seem to manifest in the aggregate wage numbers—until now. July cash-earnings numbers were unambiguously positive: Total cash earnings increased by 2.6% year over year, the highest pace since 1997. Just about every element drove the surprisingly large increase—base salaries, overtime and bonuses were all up.

There was also a tantalizing change in the jobs mix, with a greater emphasis on full-time (regular) employment. These jobs tend to have much higher average salaries compared with the non-regular equivalent, so they contribute to faster aggregate compensation growth. For most of the past 20 years, the trend has been in the opposite direction.

All tentative signs are that labor-market tightness is now revealing itself in price response. Indeed, areas where anecdotal evidence of worker shortages has been

concentrated are showing the most aggressive labor-earnings growth. These include construction (+8.2%) and real estate (+5.2%). Even in manufacturing, where production growth and export gains have been disappointing of late, labor-earnings growth is now at 5.1% year over year.

The rise in pay has been accommodated by strong corporate profit growth and widening margins—a quarterly corporate survey by the Ministry of Finance showed profit growth of 27% in 2013. But there's a caveat: this profit growth has now slowed dramatically, to just 4.5% year over year in the second quarter of 2014. The backdrop for the next Shunto round will be very different from the last.

So the question remains: Is this latest wage uptrend a one-hit wonder? Or could this become a more permanent state of affairs? The BOJ is still in the positive camp. At his Jackson Hole, Wyoming, speech, Bank governor Haruhiko Kuroda said that by anchoring inflation expectations at a higher rate and providing a basis for labor negotiations and other corporate/household financial behavior, the central bank is facilitating a "coordination mechanism" to drive a virtuous circle of mild inflation and sustained economic growth. Time will tell.

Australasia Outlook

Some progress in rebalancing Australian growth drivers

The latest Australian capex data—which provide an estimate of business capital expenditures over the next 12 months—show some progress in rebalancing growth drivers away from mining and toward non-mining sectors. But this is clearly unfinished business: greater progress is needed to create confidence that growth can rise to a level that will reduce unemployment.

Based on the latest estimates, mining-sector capital spending seems likely to fall by about 20% in the 2014–2015 fiscal year. That's not terribly surprising: a decline of that order has been in the cards for some time. It's certainly not as abrupt an adjustment to expectations as we saw during 2012. That said, this is year one of a multiyear adjustment. Mining investment peaked at 7.6% of GDP in fiscal year 2012–2013. Even after the expected decline in the fiscal year ahead, it will still be sitting north of 5%. The pre-mining-boom average was less than 2% of GDP, and we expect it to return to that level, as the continued slide in commodity prices keeps projects in the planning stage.

Non-mining is taking up some slack from the mining investment slowdown—but needs more speed and "oomph"

Given this gloomy prospect, is the non-mining sector taking up the slack? The evidence suggests that it is stepping in somewhat, but probably not fast enough—nor with enough force. Manufacturing sector investment is still retreating, and may decline by another 15%–20% next year. That would leave it at half the level of a decade ago—a stark adjustment—and the services sector would be left to do the heavy lifting. While capex is more upbeat (it may be up by 10% over the next fiscal year), there's been no incremental improvement from the last survey, and the scale of investment wouldn't be enough to offset even half the drag from mining and manufacturing.

The bottom line? "Serial disappointment"—to borrow a phrase from Bank of Canada Governor Stephen Poloz—seems likely in Australia for some time yet.

Canada Outlook

Exports have picked up…

In its latest press release, the Bank of Canada (BoC) acknowledged a recent acceleration in exports, but remained skeptical that this would translate into a pickup in business investment and hiring. The bank's concern was validated by the Labor Force Survey results for August: last month's decline of 11,000 jobs wasn't exceptional, especially for such a volatile series, but the report's details confirmed recent trends that suggest there's still substantial slack in Canadian labor markets.

…but investment and hiring are still lackluster

Helped by the continued declines in the labor force, the unemployment rate in Canada has been stagnant since the beginning of 2013. And the mix of virtually no full-time job growth and no gains in private-sector employment over the past year suggests a persistent underlying weakness in job markets.

The BoC also emphasized that a pickup in export growth doesn't mean that a desired growth rotation is fully under way. Instead, it appears that the bank is waiting for signs that business investment will pick up on the back of export growth before declaring this to be a sustainable economic growth cycle.

Increasing household debt is keeping the BoC stance neutral

While the lack of investment and hiring remain concerns, the BoC is also being forced to reconsider the risks associated with the housing market rebound and the pickup in consumption that took place in the second quarter. Canadian households once again dipped into their savings and increased their borrowing after only a short two-quarter hiatus in which debt levels were flat. Now, instead of being able to point to a constructive evolution in household imbalances, the BoC is again being forced to consider the consequences of keeping rates low for too long.

Overall, the BoC remained neutral in its latest statement, which had a slightly less dovish cast than it had in July. Given the BoC's view that inflation remains under control, we believe that as long as there's not a sharp rise in mortgage lending, the Bank won't be forced to raise rates in the near term, and these will certainly be on hold until after the US Fed initiates its own rate-hike cycle. What's more, with the manufacturing sector continuing to suffer and hiring remaining soft, we believe that the Canadian currency will weaken to around 1.12 over the next six months.

Emerging Markets Outlook

Brazil: Potential changes in the political landscape

Latin America: The August death of Eduardo Campos, a presidential candidate from the socialist PSB party, combined with the sudden emergence of former environment minister Marina Silva as a new contender for the October 5 election, has rapidly changed the Brazilian political landscape. Silva has overtaken market favorite Aecio Neves as the main contender for President Dilma Rousseff, and the latest polls show that Silva is slightly favored to win in a possible ballotage against Rousseff. According to the latest Datafolha poll, Rousseff and Silva are in a technical tie in the first round, but Silva is ahead by seven percentage points in a second round. Until Silva became the presidential candidate on the PSB ticket, Rousseff was slightly favored to win the election in the second round against Neves.

Understandably, the market's focus has turned to Silva's economic ideas. She presented her platform on August 29, and the market was receptive to her emphasis on embracing fiscal discipline—even creating a fiscal responsibility council—to lower inflation and ensure that the central bank operates independently from the executive branch. Overall, the market reaction to Silva's emergence as frontrunner has been positive, with long-term interest rates declining substantially. Silva is surrounded by a team of competent economists who are widely considered to be market-friendly and

able to improve economic management. Silva's personal story and anti-establishment image seem to appeal to young urban voters and the poor. But it's unclear whether she can build a working congressional coalition to deliver on her policy initiatives. With less than one month to go until the election and with Rousseff having a clear advantage in terms of campaign airtime, the race will be hotly contested—and can't be called with any certainty at this point.

Meanwhile, the latest activity figures confirmed that Brazil was in recession at least until the second quarter of 2014, when GDP contracted by 0.6% quarter over quarter; the first-quarter figure was revised downward to –0.2%. As expected, investment was the main culprit for the contraction, falling by 5.3% quarter over quarter during the second quarter due to political uncertainty ahead of the elections, the risk of energy rationing and overall weakness in business confidence. Investment is now running at below 17% of GDP, among the lowest levels in emerging markets, posing a significant challenge for future growth prospects. The second-quarter contraction was probably exacerbated by fewer working days due to the World Cup competition. However, even adjusting for that factor, underlying economic weakness persists.

We now believe that the Brazilian economy will expand by no more than 0.6% during 2014. July's industrial-production figures provided a small ray of hope, increasing by 0.7% month over month, a rebound possibly due to the end of the World Cup–related drop; however, it's still too early to call this the beginning of an upward trend. While the growth backdrop is disappointing, inflation remains slightly above the ceiling of the target range, preventing the central bank from lowering the target Selic interest rate. The language in the most recent communiqués from the monetary authority suggest that the Selic rate will remain at 11% for the foreseeable future. This means that potential stimulus policies could come in the form of macroprudential moves (lowering the mandatory reserve requirement on bank deposits, for example) or through more fiscal expansion.

Mexico: Energy reform moves forward

In Mexico, President Enrique Peña Nieto signed the secondary legislation of the energy reform bill into law on August 11. He also unveiled a fast-track plan toward the implementation of energy reform. The government moved the calendar of reform implementation forward by almost six months, including earlier announcements of projects to be auctioned to private companies, with the actual auctions likely to take place in early 2015. Peña Nieto vowed to immediately make available all decrees that create the new regulatory entities, and the proposals for board members for all new institutions (the National Hydrocarbons Commission, Energy Regulatory Commission, Mexican Oil Fund, Pemex and CFE). The president said that the entire new energy regulatory framework should be ready by October. We continue to believe that the energy reform is a very positive development that should contribute to gradual increases in productivity growth and higher potential growth rates. The faster implementation timeline described by Peña Nieto provides an extra sweetener.

Meanwhile, the Banco de México kept its target funding rate unchanged at 3%, as expected. The central bank indicated that economic activity recovered during the second quarter, led by export-oriented sectors, after two consecutive quarters of marked weakness. Excess capacity still persists across the economy, so Mexico continues to operate under negative output-gap conditions. This has kept inflationary pressures away from the demand side, a situation likely to continue over the coming quarters—the output gap shouldn't close until late next year or even 2016. Headline inflation has accelerated in recent months, mainly as a result of shocks to perishable goods prices; inflation is now slightly above the ceiling of the official target range. This spike is expected to be temporary. Core inflation, in turn, remains near the 3%

medium-term target, and medium-term inflation expectations remain well anchored. We believe that the Banco de México will not cut the target interest rate further, and that its next move will be an increase, possibly after the US Fed begins tightening monetary policy in 2015.

Venezuela: Cabinet changes suggest less aggressive policy adjustments

President Nicolas Maduro laid out his much-touted plan to "shake up" his administration and implement a "revolution within the revolution." The new plan rests on five pillars: 1) an economic and productivity revolution; 2) a knowledge and cultural revolution; 3) a social revolution via the "Misiones"; 4) a political revolution and reform of the state; and 5) a territorial-socialism revolution and communal development.

Maduro announced a long list that would combine some ministries and create others. The market, however, was focused on changes in the economic arena, and Maduro delivered a mixed message on that front. Energy Minister and Vice President for Economic Affairs Rafael Ramírez, who was also the acting chairman of PDVSA, became the new Vice President for Political Affairs and Foreign Affairs Minister. Ramírez was largely considered to be the main architect of more pragmatic economic ideas, including devaluation, the lifting of price controls and the consolidation of dollar assets in the central bank. After the changes, it appears that he has been separated from economic policymaking; the implicit message is that his plan may no longer be a priority. He was replaced as Vice President for Economic Affairs by Finance Minister Rodolfo Marco Torres, who also maintained his ministerial job.

It's likely that a dual currency system, rather than the unification of exchange-rate markets, will be the strategy of choice in the weeks and months to come. Executive Vice President Jorge Arreaza, who is believed to prefer a dual system, maintained his post, which also fuels the view that no foreign-exchange unification will take place at this point. Asdrúbal Chávez, former President Hugo Chávez's cousin, is the new Energy Minister, while Eulogio del Pino, until now the Vice President of Exploration and Production of PDVSA, became the new company chairman. Maduro also announced the creation of a "strategic reserve account of the Republic at the Central Bank," which will consolidate all hard-currency assets of the public sector at the central bank. The announcement is positive, although the devil is in the details, and implementation will be monitored closely by market participants.

Steady growth and inflation outlook

Asia ex Japan: The region's growth and inflation outlooks for 2015 remain stable, with aggregate GDP growth remaining at around 6% and inflation holding steady at 3.3%. We expect that the mix of growth will cause China's GDP growth to continue slowing to 6.8% next year (from 7.3% in 2014). The rest of Asia will improve steadily to 4.6% (from 3.9%) based on better export prospects.

Asia is in no hurry to tighten before the Fed—with a few exceptions

The absence of major commodity and food-price shocks, and the fact that the majority of Asian economies are still expanding at below-potential growth, means that the inflation threat should remain low in the foreseeable future. This suggests that Asian central banks aren't in a hurry to tighten policy before we expect to see interest-rate normalization by the US Federal Reserve in the second quarter of 2015. The only exceptions are the Philippines and Malaysia, where policymakers were behind the curve in reining in excess liquidity during the current cycle—they'll need further monetary tightening in 2014. India's structurally high inflation and the Reserve Bank of India will require continued monetary prudence to achieve its goal of lowering inflation to about 6% in 2016 (versus the current 8% year over year).

China's credit policy may stay volatile, but the resumption of bold monetary easing is unlikely

In China, recent swings in credit policy—from excess easing in June to abrupt tightening in July—underline the difficulty in achieving the dual objective of supporting growth while containing leverage risk in the economy. We expect that this state of affairs will continue. However, the risk of a wholesale change in policy back to the old model of a credit-fueled, investment-driven cycle should remain low overall. In fact, the intensified anti-corruption campaign will continue to curb local consumption and investment, and the present housing market consolidation will have a broader impact on the economy through slower construction, commodity demand and household spending.

Thailand, Korea and possibly Indonesia should have more room to ease rates

In contrast, we expect sluggish growth in Thailand to convince monetary authorities to further cut the policy rate this year, while disappointing growth and insufficient fiscal support will continue to increase pressure on the Bank of Korea to further trim the policy rate in coming quarters. Slackening growth in Indonesia will demand a more balanced policy mix, even though the new Jokowi administration is set to further cut the fuel subsidy (and, thus, the higher inflation induced by higher fuel prices) to prevent a fiscal blowout. As such, we expect that Bank Indonesia will likely stay put—but room for rate easing will grow, especially as the transitory inflationary effect from higher fuel prices starts to fade and real interest rates start to rise.

Geopolitics continue to dominate outlook for Russia

Emerging Europe, Middle East and Africa: Geopolitics continues to dominate and cloud the outlook for Russia's embattled economy. On the activity data front, July indicators showed a tiny pickup in output growth to 0.3% year over year from no growth in June. However, domestic demand indicators continued to weaken, as real fixed investment spending returned to negative territory (–2.0% year over year) and real wage growth (1.8%) slowed further due to an inflation uptick. According to the August survey, business confidence dipped to its lowest level since January 2010.

Will current de-escalation last?

We saw a further escalation in the Russia-Ukraine conflict in late August amid growing evidence of widespread incursions by Russian troops into eastern Ukraine and the opening of a new front in the coastal area near the economically strategic port of Mariupol. In response, the European Union (EU) gave Russia a one-week ultimatum to pull back its troops or face another round of economic and financial sanctions, while NATO decided to build a rapid-reaction force to protect eastern European members threatened by Russia. This threat seems to have spurred Russia to take part in cease-fire talks, and a truce protocol between Ukraine and pro-Russia separatists was signed on September 5. However, no agreement on a political resolution of the crises has been reached yet, which makes us very skeptical of how long the current bout of de-escalation might last. It also raises significant uncertainty about Russia's (and Ukraine's) economic outlook.

We've reduced Russia's 2015 growth forecast to 1%

The US and EU sanctions that have been imposed so far will make Russia's recovery from a first-half GDP slump even more difficult. But the sanctions' main impact will be felt in the medium term, by driving Russia into increasing international isolation and short-circuiting policymakers' ability to transform its broken growth model, which is built on the assumption of continuously rising commodity prices. As a result, we've lowered Russia's GDP forecast for next year to only 1%, which would represent only a very modest recovery from the 0.5% growth rate assumed for 2014.

CBR to remain hawkish and ready to hike further

Reacting to the prospect of intensifying sanctions and the rising risk of accelerated capital flight, the Central Bank of Russia (CBR) delivered a surprise 50-basis-point rate hike in July, taking its policy rate to 8%, and its rhetoric has been hawkish since then, despite an anemic economy. We believe that the risk to the policy rate remains to the upside, because we don't expect the Russia/Ukraine conflict to be settled any time soon. In fact, we predict further escalation as we approach the heating season.

Russia will have the greatest leverage over Western Europe and Ukraine during the late fall and winter months, and is therefore more likely to intensify its push to wrest back control over its eastern neighbor. Furthermore, Russia's retaliatory ban on European food imports that was imposed in August will have a further adverse impact on the country's stubbornly high inflation, which is set to remain above the central bank's tolerance level until the middle of next year.

South Africa's economy remains weak

In South Africa, the economy remains frail. After a small first-quarter contraction driven by the collapse in mining output and a decline in the volatile manufacturing sector, South Africa's GDP returned to growth during the second quarter. However, growth was only marginal, with all of the positive contribution coming from transportation, finance and government services. Overall, real GDP has remained broadly unchanged since the last quarter of 2013. On a positive note, the strike in the engineering and metals industries lasted only one month (July), unlike the five-month-long strike in the platinum-mining sector—the rebound in the manufacturing Purchasing Managers' Index in August reflects this. That said, the PMI readings remain in contraction territory. As a result of the disappointing second-quarter GDP numbers, we've lowered South Africa's 2014 GDP forecast by 0.2% to 1.5%, which would be its lowest growth rate since 2009.

SARB resumes a gradual tightening cycle

Lackluster economic performace and the absence of demand-side inflation pressures nonwithstanding, South Africa's central bank (SARB) felt the need to reassert that it's in a tightening cycle. In January, it delivered an unexpected symbolic 25-basis-point hike in July—the smallest rate hike in nearly 15 years. However, weak second-quarter GDP, a lower-than-expected July inflation reading and an incrementally more dovish ECB give us confidence that the SARB will continue to normalize its policy rate with great caution. This means it will most likely skip a rate hike at the next meeting during September and hike by another 25 basis points in November, for a total increase of 100 basis points this year. Next year, we expect the SARB to add another 100 basis points in hikes under the assumption that the US Fed will begin to raise rates around mid-year and South Africa's growth will begin to recover toward the 2.5%–3% mark.

Turkey's growth slowing as well

Turkey's GDP growth slowed dramatically during the second quarter after a very robust performance—by not-so-exacting regional standards—earlier this year. This reflects a combination of further domestic-demand contraction and a cyclical slowdown of demand from Western Europe as well as Ukraine, Russia (coupled with currency depreciations) and the Middle East—the latter due to the escalating military conflict in Iraq and Syria, which disrupted delivery routs for Turkish exports to the region.

Inflation remains stubbornly high

In contrast, inflation remains stubbornly high, accelerating by more than a percentage point since March and more than two percentage points since December of last year to 9.5% in August, despite the central bank's forecast of a slowdown after mid-year. The initial driver of accelerating inflation was the lira depreciation during December and January. The other key culprit has been the unprecedented rise in food inflation to nearly 15% from 10.4% in March, due to what was reportedly the most severe drought in more than a decade.

CBRT puts easing on hold

Faced with the rising inflation rate—nearly double the official 5% target—and rapidly eroding credibility, the central bank (CBRT) finally opted to pause in its easing cycle by leaving its repurchase rate unchanged at 8.25% during the Monetary Policy Committee meeting in July. However, the CBRT did reduce the overnight lending rate by 75 basis points to 11.25%, sending a message that it now feels less worried about

having to tighten liquidity dramatically (if necessary) to defend the currency—as was the case in January of this year.

Policy uncertainty subsides…

These developments may reflect the diffusion of uncertainty surrounding the outlook for macroeconomic policy direction. Ahead of last month's presidential election—Prime Minister Erdogan won in the first-round vote—many observers thought that as a part of the cabinet reshuffle, the AKP's well-respected economics team, which includes First Deputy Prime Minister Ali Babacan, might be replaced by some of Erdogan's controversial advisors. This didn't happen, in line with our own expectations, and it implies that the new cabinet will stay its course in terms of market-friendly economic policies. A smooth transition to a new prime minister (former Foreign Minister Ahmet Davutoglu, perceived as an Erdogan loyalist) and no change in the economic team significantly improve policy visibility for at least the next four quarters, and reduces many potential downside risks.

…allowing the CBRT to stay dovish

All of this will allow the CBRT to remain dovish. In fact, during the inflation-report presentation in July, Governor Basci pointed out that there may well be a structural problem with Turkey's inflation, which may require that the inflation target be revised to a (presumably) more realistic level—if inflation fails to pull closer to the target by the end of 2015. This indicates to us that the CBRT is in no rush to crack down on inflation, at least as long as the lira remains supported by markets. Herein, an increasingly more accommodative stance from the ECB will help.

AllianceBernstein Global Economic Forecast

Sep-14

	Real Growth (%)				Inflation (%)				Official Rates[1] (%)		Long Rates[1] (%)	
	4Q/4Q		Calendar		4Q/4Q		Calendar		EOP	EOP	EOP	EOP
	2014F	2015F	2014F	2015F	2014F	2015F	2014F	2015F	2014F	2015F	2014F	2015F
Global	2.8	3.2	2.7	3.3	2.7	2.7	3.1	3.1	2.04	2.41	3.38	3.83
(PPP Weighted)	(3.3)	(3.6)	(3.0)	(3.7)	(3.1)	(3.0)	(3.0)	(3.4)				
Industrial Countries	2.0	2.4	1.8	2.6	1.9	2.1	1.7	2.0	0.30	0.74	1.90	2.51
Emerging Countries	4.3	4.7	4.2	4.6	4.3	3.9	5.7	5.1	5.40	5.64	6.28	6.46
United States	3.0	3.3	2.5	4.0	2.5	2.5	2.0	2.6	0.13	1.00	2.75	3.75
Canada	2.2	3.0	2.3	2.6	2.6	2.2	2.1	2.2	1.00	1.75	2.35	4.00
Europe	1.2	1.8	1.2	1.6	0.8	1.3	0.7	1.1	0.21	0.39	1.30	1.50
Euro Area	0.7	1.6	0.8	1.3	0.6	1.2	0.5	0.9	0.10	0.10	1.00	1.25
United Kingdom	3.2	2.7	3.1	2.9	1.6	1.9	1.6	1.9	0.50	1.50	2.50	2.50
Sweden	1.3	2.5	1.8	2.4	0.7	1.5	0.2	1.3	0.25	0.50	1.50	1.75
Norway	2.4	2.5	2.3	2.4	2.1	2.1	1.9	2.1	1.50	1.75	2.50	2.50
Japan	1.4	1.2	1.2	1.6	3.0	3.0	2.8	2.3	0.10	0.10	0.55	0.90
Australia	2.1	2.0	2.7	1.8	2.3	2.4	2.7	2.4	2.50	2.50	3.45	4.00
New Zealand	3.7	2.4	4.0	2.7	1.7	1.9	1.6	1.9	3.50	4.25	4.20	4.50
Asia ex Japan	6.1	6.0	6.1	6.0	3.4	3.3	3.3	3.3	4.31	4.61	4.82	4.77
China[2]	7.2	6.7	7.3	6.8	2.5	2.7	2.4	2.5	4.00	4.50	4.30	4.20
Hong Kong[3]	2.3	3.4	2.2	3.1	3.9	4.1	3.8	4.1	0.50	1.00	1.91	2.80
India[4]	5.3	5.8	5.0	5.6	8.0	6.0	8.0	6.6	8.00	8.00	8.70	8.30
Indonesia[5]	5.6	5.8	5.3	5.6	4.5	5.3	5.8	6.0	7.50	7.00	7.80	7.25
Korea[6]	3.8	4.3	3.7	4.3	1.9	2.5	1.6	2.3	2.00	2.00	3.20	3.50
Thailand[7]	2.7	2.1	0.8	3.9	3.4	2.5	2.7	3.0	2.00	2.25	3.90	4.30
Latin America[8]	1.6	2.8	1.2	2.5	4.8	4.4	4.6	4.8	7.40	8.03	9.09	9.61
Argentina	-1.0	1.2	-1.2	1.0	29.0	25.0	32.0	25.0				
Brazil	0.8	2.0	0.6	1.5	6.5	6.3	6.3	6.5	11.00	11.75	11.90	12.50
Chile	3.1	3.9	2.6	3.7	3.0	3.0	2.9	3.0	3.25	4.00	4.80	5.50
Colombia	4.8	4.9	5.2	4.8	3.0	3.0	2.6	3.0	4.75	5.00	6.80	7.00
Mexico	3.0	3.9	2.2	3.8	3.7	3.2	3.7	3.2	3.00	3.50	6.00	6.40
EEMEA	1.5	2.3	1.7	2.1	6.8	5.3	6.5	5.7	7.15	6.77	8.54	9.16
Hungary	2.8	2.2	3.2	2.1	1.0	3.0	0.2	2.4	2.10	3.00	5.00	5.95
Poland	3.3	3.7	3.3	3.5	0.7	2.4	0.4	2.0	2.00	3.00	3.75	4.55
Russia	0.4	1.2	0.5	1.0	7.8	5.4	7.4	6.5	8.50	7.00	9.75	10.00
South Africa	1.2	2.9	1.5	2.7	6.6	5.8	6.3	5.9	6.00	7.00	8.50	9.50
Turkey	3.2	4.0	3.5	3.5	9.0	7.0	9.0	6.4	8.25	9.00	9.00	10.25

1) Official and long rates are end-of-year forecasts.
Long rates are 10-year yields unless otherwise indicated.
2) China: Official rate is considered the 7D repo rate 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) Latin American Inflation and Rates includes Brazil, Chile, Colombia, and Mexico
Note: Real growth aggregates represent 31 country forecasts, not all of which are shown.
Note: Blanks in Argentina are due to the distorted domestic financial system so we do not forecast.

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