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International Economic Outlook

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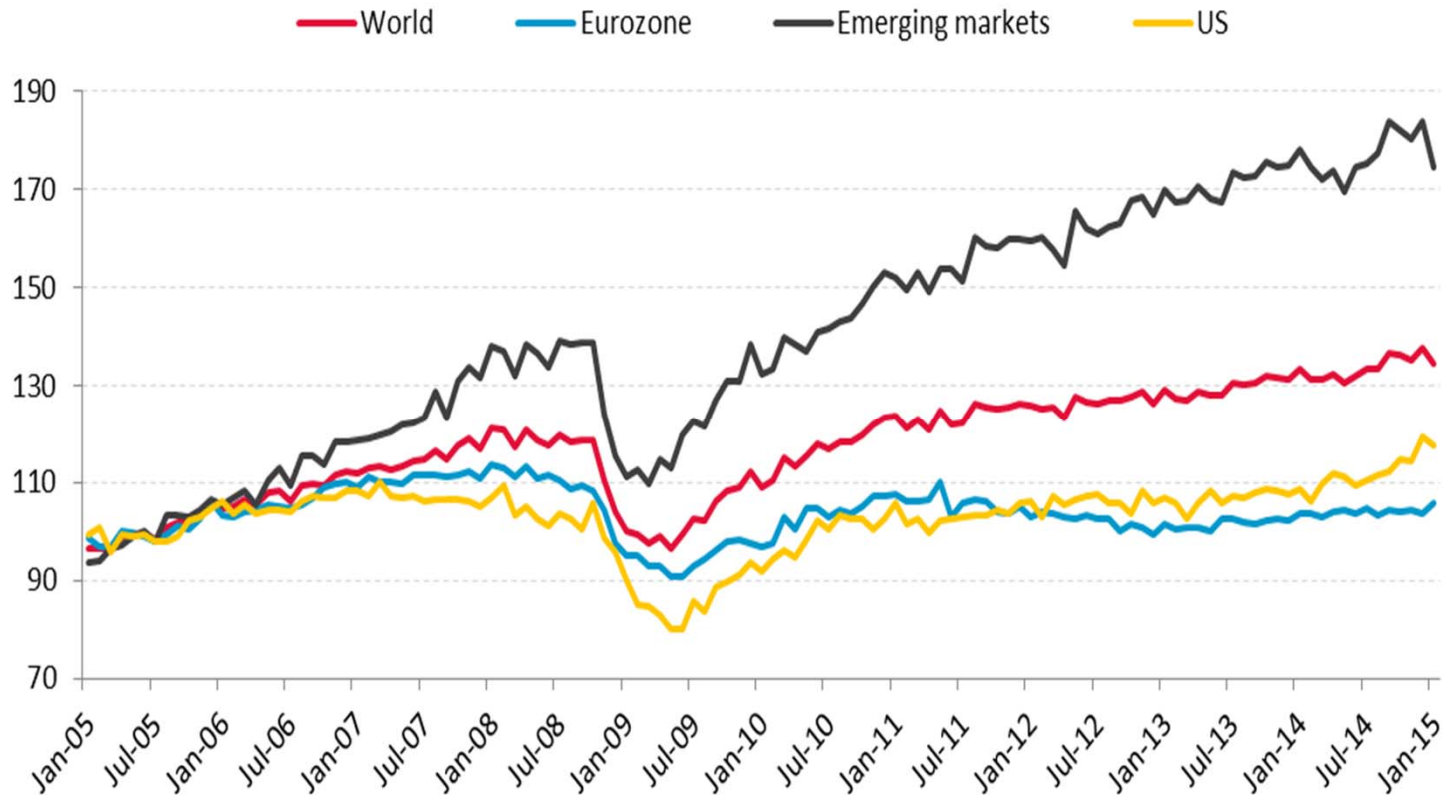
April 2015



Key Macroeconomic Themes for 2015/16

- Global growth rebalancing from developing markets to developed markets well under way:
 - ✓ Growth steadily accelerating in the US, steady in UK
 - ✓ Structural slowdown in China: 7% is the new norm. Important implications for other EM's, especially commodity producers
- Assessing the effects of lower oil, weaker euro and stronger growth in the US on EZ growth:
 - ✓ Lower oil prices: +0.4pc on Household consumption growth, +0.2 to 0.4pc on GDP growth
 - ✓ Weaker euro FX: +0.3pc on EZ exports; Italy will benefit the most, given strong price elasticity of exports
 - ✓ Stronger US GDP growth: +0.1pc on EZ GDP
- ECB has its credibility at stake: €1 trillion QE will take time before material effects become visible
- Despite some positive developments we still anticipate sub-par growth in Eurozone, especially France, Italy, as investment recovery remains elusive.

World Trade Growth Remains Soft (Volume Import Indices)

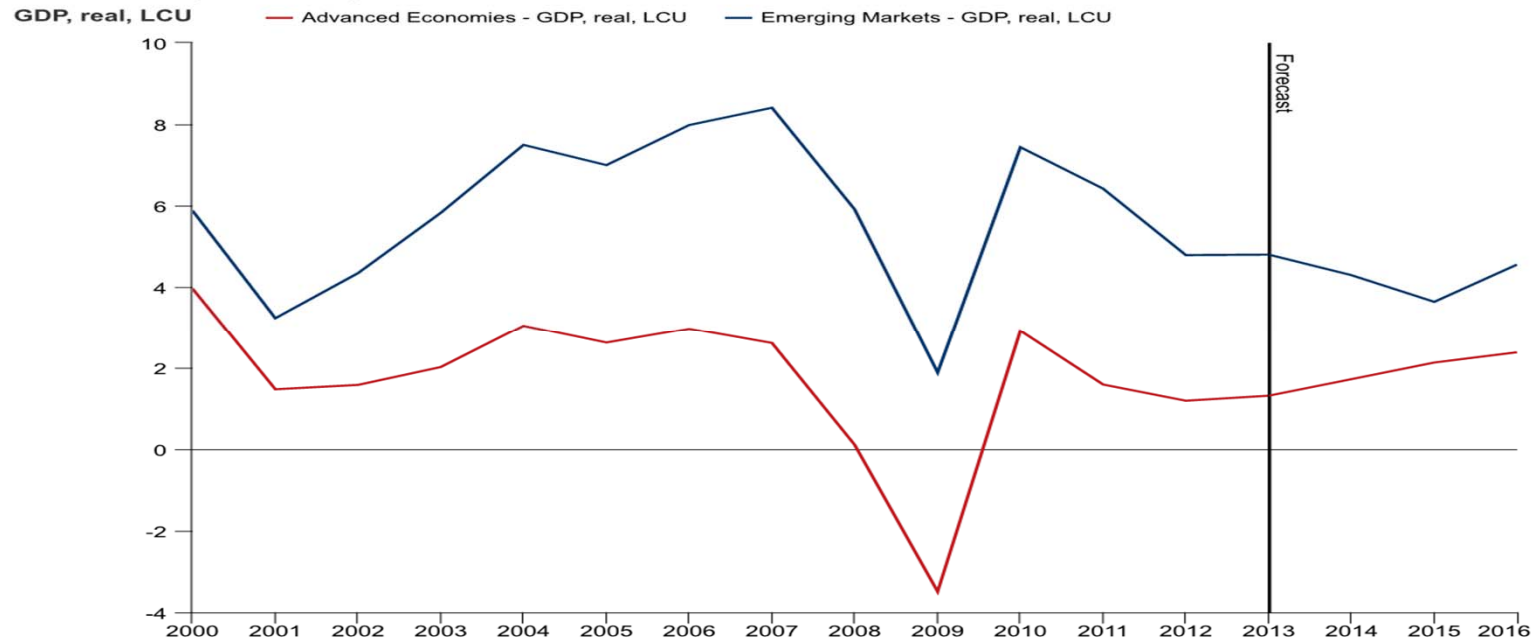


Source: Netherland Bureau of Economic Research: latest data point January 2015

Diverging Performances

The global economy is characterized by a major gap in relative performance between the developed and emerging economies. To the extent that global growth has lifted since the height of the EMU debt crisis in 2012, it has been focused in the DM, where GDP gains have moved above potential. By contrast, EM growth has weakened and fallen even further below trend. This growth divergence is expected to persist in 2015

Real GDP (%ch Y/Y)

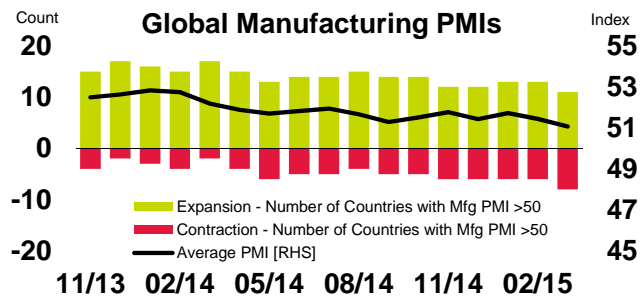


Source: IMF, S&P Forecast

Global Manufacturing PMI Heatmap

	11/13	12/13	01/14	02/14	03/14	04/14	05/14	06/14	07/14	08/14	09/14	10/14	11/14	12/14	01/15	02/15	03/15
Europe	52.6	53.3	54.5	53.8	53.4	53.8	52.8	52.4	52.2	51	50.6	51.1	50.8	51	51.6	51.7	52.7
Euro Zone	51.6	52.7	54	53.2	53	53.4	52.2	51.8	51.8	50.7	50.3	50.6	50.1	50.6	51	51	52.2
France	48.4	47	49.3	49.7	52.1	51.2	49.6	48.2	47.8	46.9	48.8	48.5	48.4	47.5	49.2	47.6	48.8
Germany	52.7	54.3	56.5	54.8	53.7	54.1	52.3	52	52.4	51.4	49.9	51.4	49.5	51.2	50.9	51.1	52.8
Italy	51.4	53.3	53.1	52.3	52.4	54	53.2	52.6	51.9	49.8	50.7	49	49	48.4	49.9	51.9	53.3
Netherlands	56.8	57	54.8	55.2	53.7	53.4	53.6	52.3	53.5	51.7	52.2	53	54.6	53.5	54.1	52.2	52.5
Spain	48.6	50.8	52.2	52.5	52.8	52.7	52.9	54.6	53.9	52.8	52.6	52.6	54.7	53.8	54.7	54.2	54.3
UK	57.8	57.3	56.7	56.1	55.4	56.9	56.5	56.7	54.9	52.9	51.4	53.3	53.4	52.8	53	54	54.4
Poland	54.4	53.2	55.4	55.9	54	52	50.8	50.3	49.4	49	49.5	51.2	53.2	52.8	55.2	55.1	54.8
Russia	49.4	48.8	48	48.5	48.3	48.5	48.9	49.1	51	51	50.4	50.3	51.7	48.9	47.6	49.7	48.1
Turkey	55	53.5	52.7	53.4	51.7	51.1	50.1	48.8	48.5	50.3	50.4	51.5	52.2	51.4	49.8	49.6	48
Canada	55.3	53.5	51.7	52.9	53.3	52.9	52.2	53.5	54.3	54.8	53.5	55.3	55.3	53.9	51	48.7	48.9
US	54.7	55	53.7	57.1	55.5	55.4	56.4	57.3	55.8	57.9	57.5	55.9	54.8	53.9	53.9	55.1	55.7
Brazil	49.7	50.5	50.8	50.4	50.6	49.3	48.8	48.7	49.1	50.2	49.3	49.1	48.7	50.2	50.7	49.6	46.2
Mexico	51.9	52.6	54	52	51.7	51.8	51.9	51.8	51.5	52.1	52.6	53.3	54.3	55.3	56.6	54.4	53.8
China	50.8	50.5	49.5	48.5	48	48.1	49.4	50.7	51.7	50.2	50.2	50.4	50	49.6	49.7	50.7	49.6
India	51.3	50.7	51.4	52.5	51.3	51.3	51.4	51.5	53	52.4	51	51.6	53.3	54.5	52.9	51.2	52.1
Indonesia	50.3	50.9	51	50.5	50.1	51.1	52.4	52.7	52.7	49.5	50.7	49.2	48	47.6	48.5	47.5	46.4
Japan	55.1	55.2	56.6	55.5	53.9	49.4	49.9	51.5	50.5	52.2	51.7	52.4	52	52	52.2	51.6	50.3
S.Korea	50.4	50.8	50.9	49.8	50.4	50.2	49.5	48.4	49.3	50.3	48.8	48.7	49	49.9	51.1	51.1	49.2
Taiwan	53.4	55.2	55.5	54.7	52.7	52.3	52.4	54	55.8	56.1	53.3	52	51.4	50	51.7	52.1	51

Source: Markit, Thomson Reuters Datastream, S&P Ratings

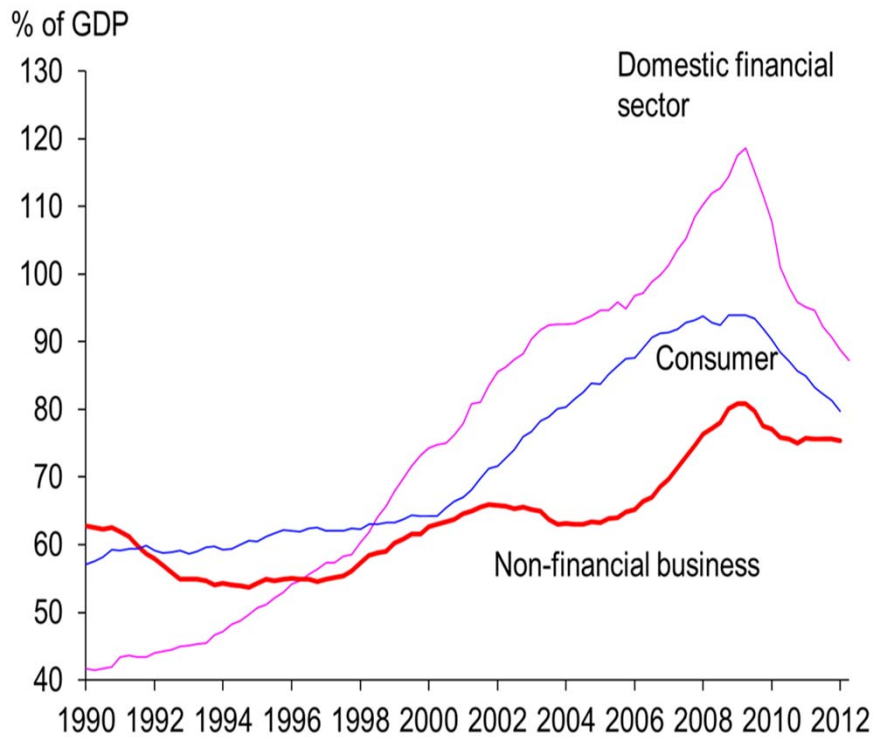


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The US Locomotive Is Back On Track

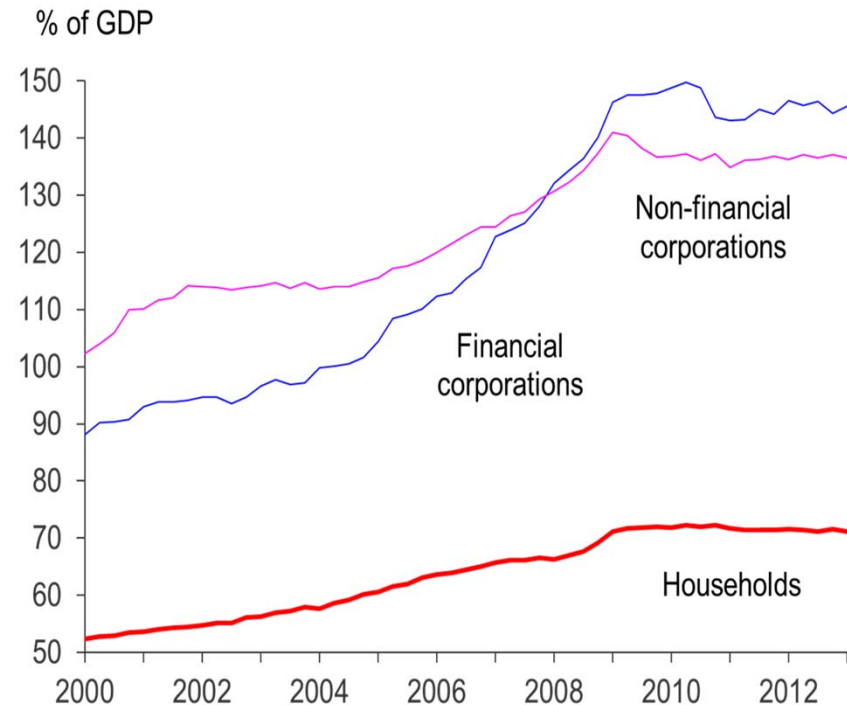
US Economy Is Most Advanced Among G7 In Deleveraging

US: Sectoral indebtedness



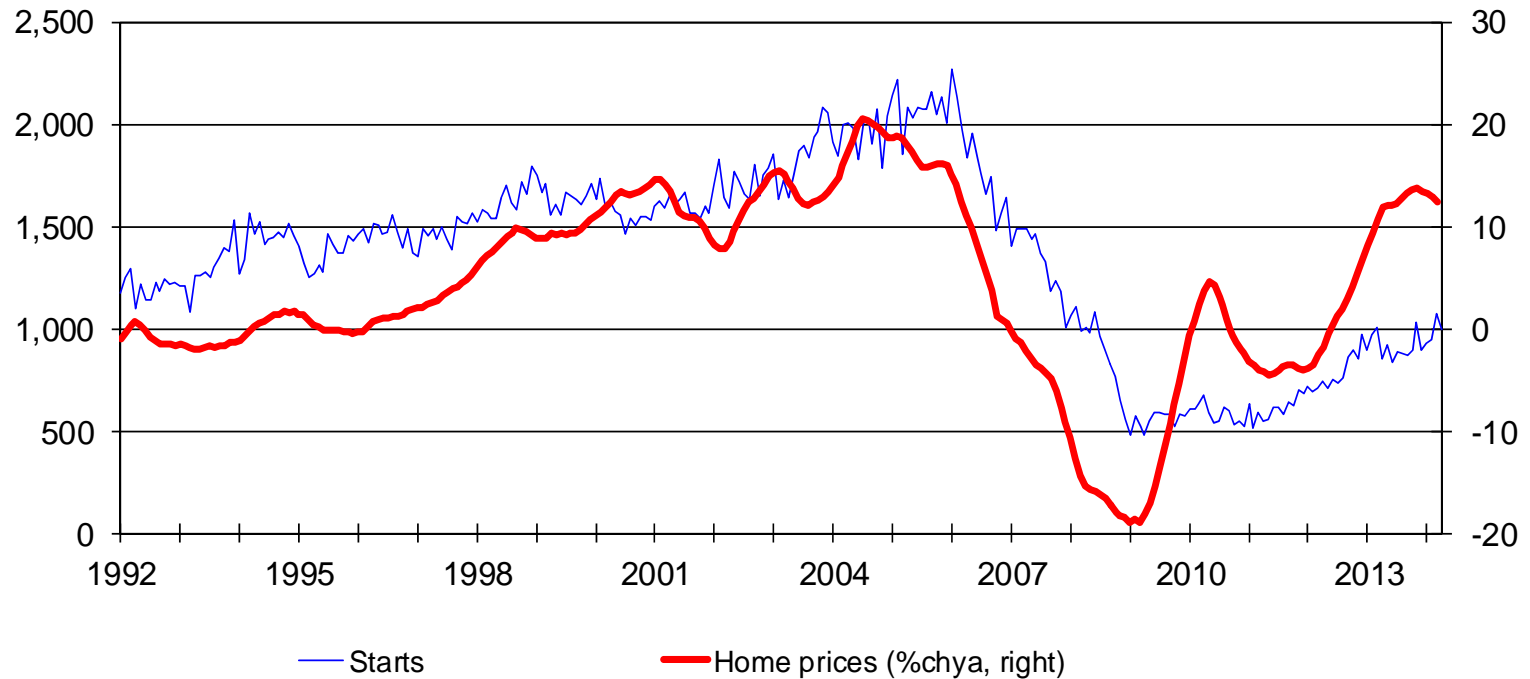
Source: Haver Analytics

Eurozone: Financial balances



Source: Haver Analytics

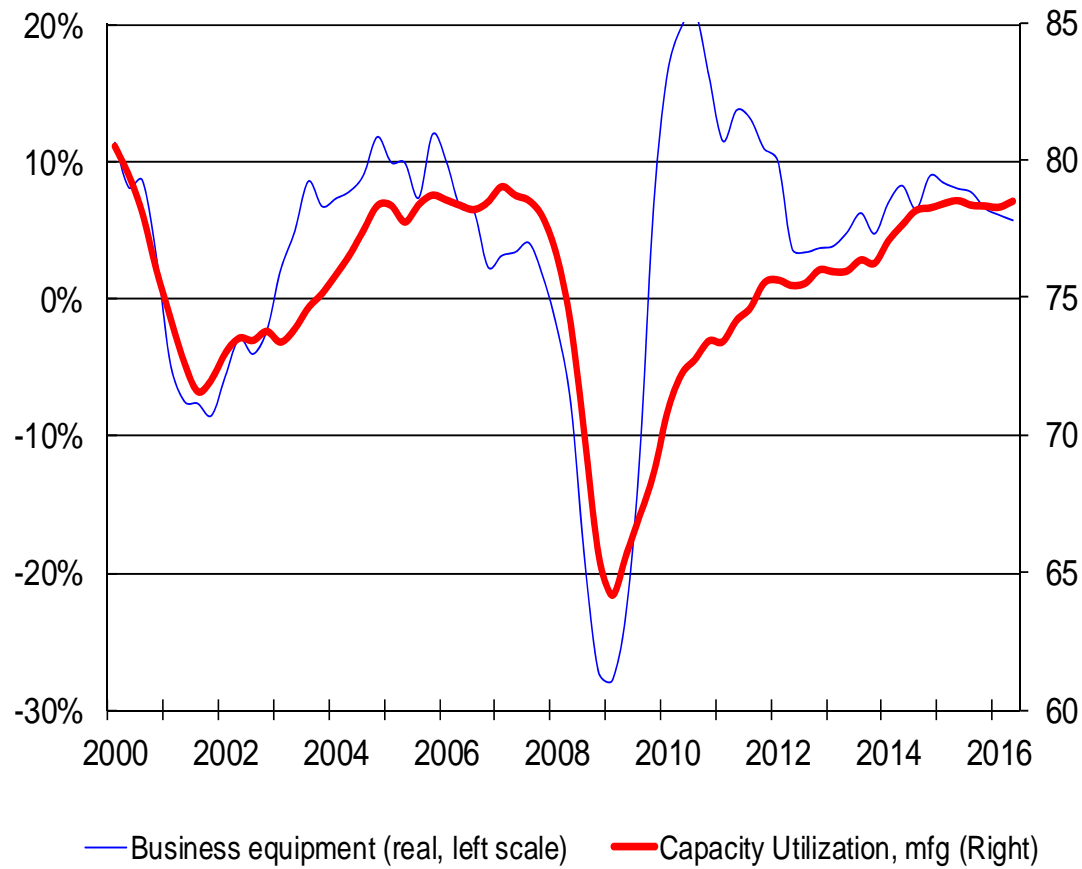
US: Housing Bounces Back, Despite Dips



- Recovering from an historic drop

Source: S&P/Case-Shiller, October 2013; Census Bureau

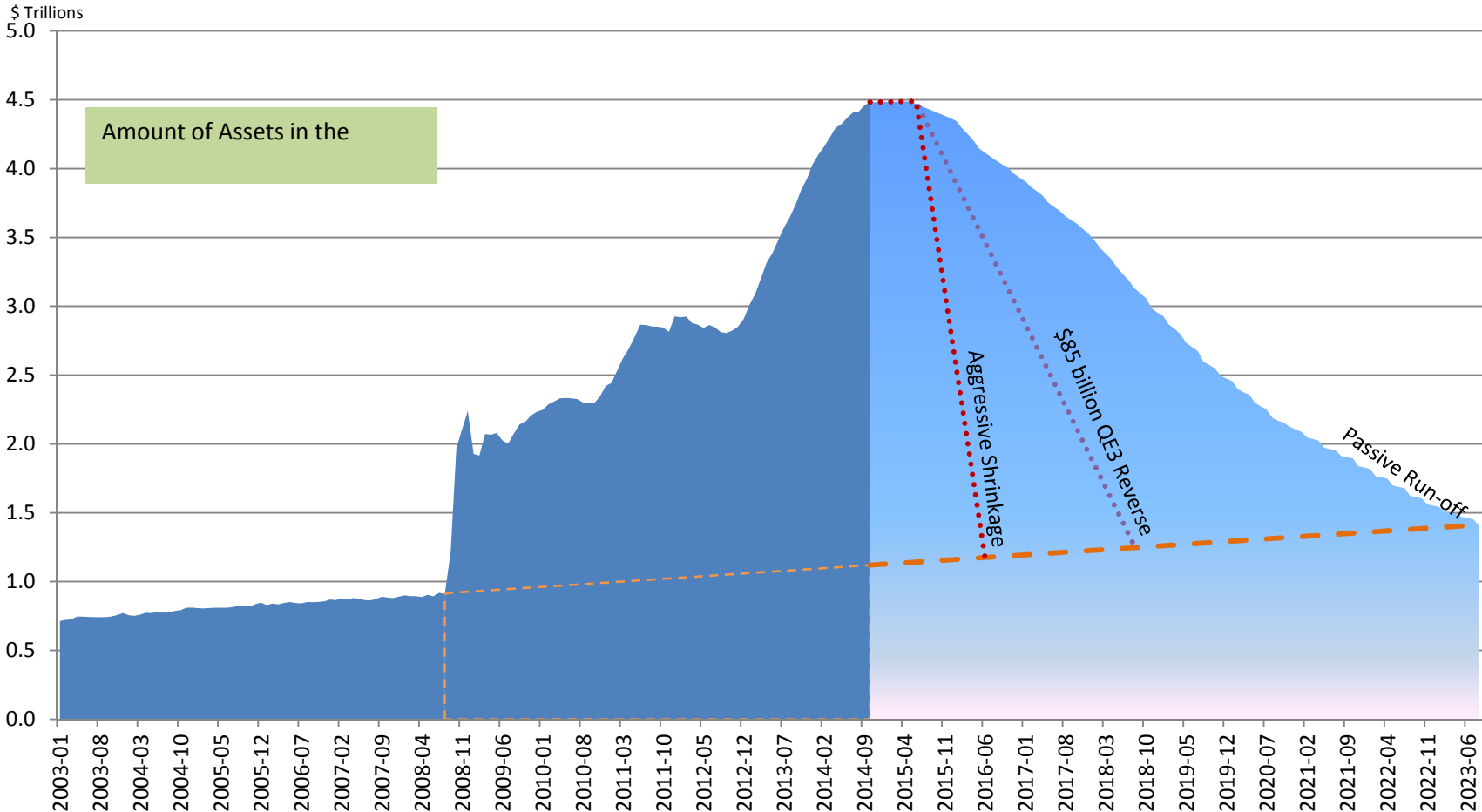
Manufacturing Returns to U.S.



- Cheap energy attracts manufacturers
- Equipment production largely recovered
- Capacity utilization has improved

Source: Federal Reserve; Bureau of Economic Analysis; Standard & Poor's Ratings Services Projections

Quantitative Easing: Coming Down The Mountain



Source: The Federal Reserve and S&P Calculations.

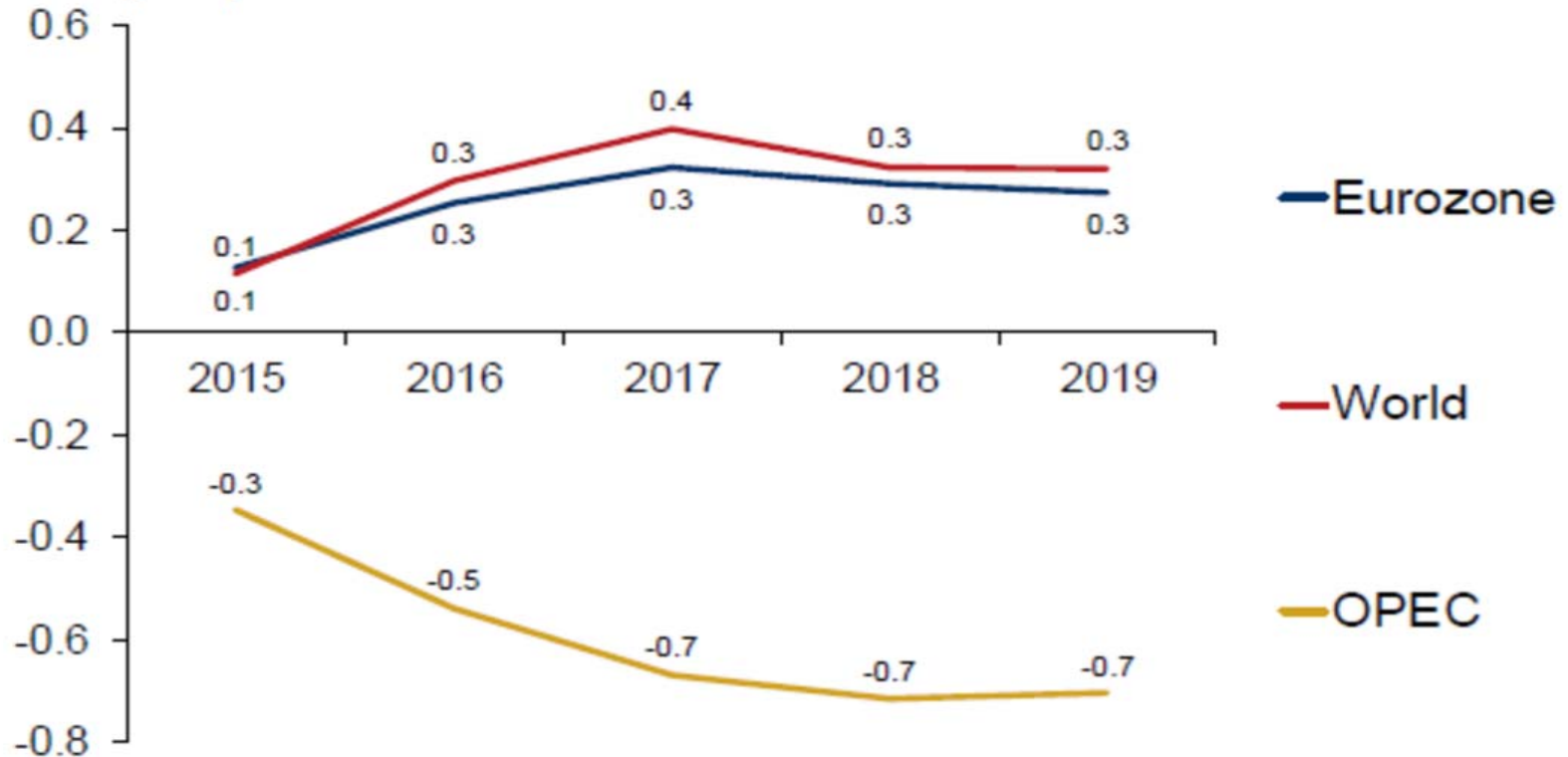
Note: (1) Balance sheet's shrinkage to normal size starts on June of 2015 in all scenarios. The future "normal size" is based off pre-crisis linear trend. (2) In the passive run-off case, U.S. Treasury Securities are allowed to run-off as they mature and MBS pre-payments are assumed to be an average of \$250 billion per year till mid-2018, \$150 billion per year the next 2 years, and \$100 billion per year then on. In this scenario, balance sheet reaches normal size by 8/23. (3) In the Aggressive Shrinkage scenario, securities worth \$3.3 trillion are aggressively

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A New Oil Shock

A US\$20pb fall boosts world GDP by around 0.3%

GDP impact of \$20 oil price decline average impact on level of GDP



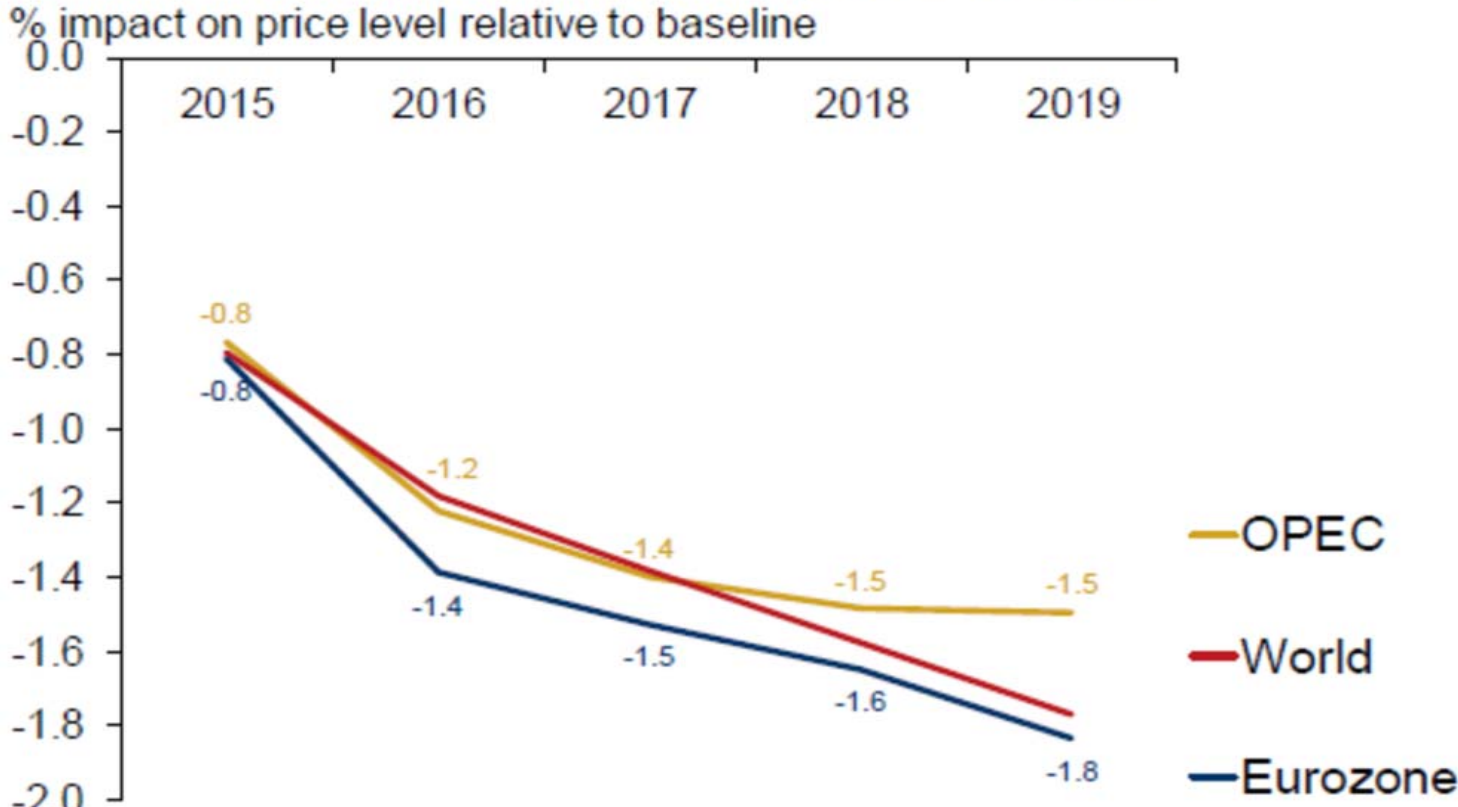
Source : Oxford Economics/Haver Analytics

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And reduces consumer prices by about 1.2%

Price level impact of \$20 oil price decline

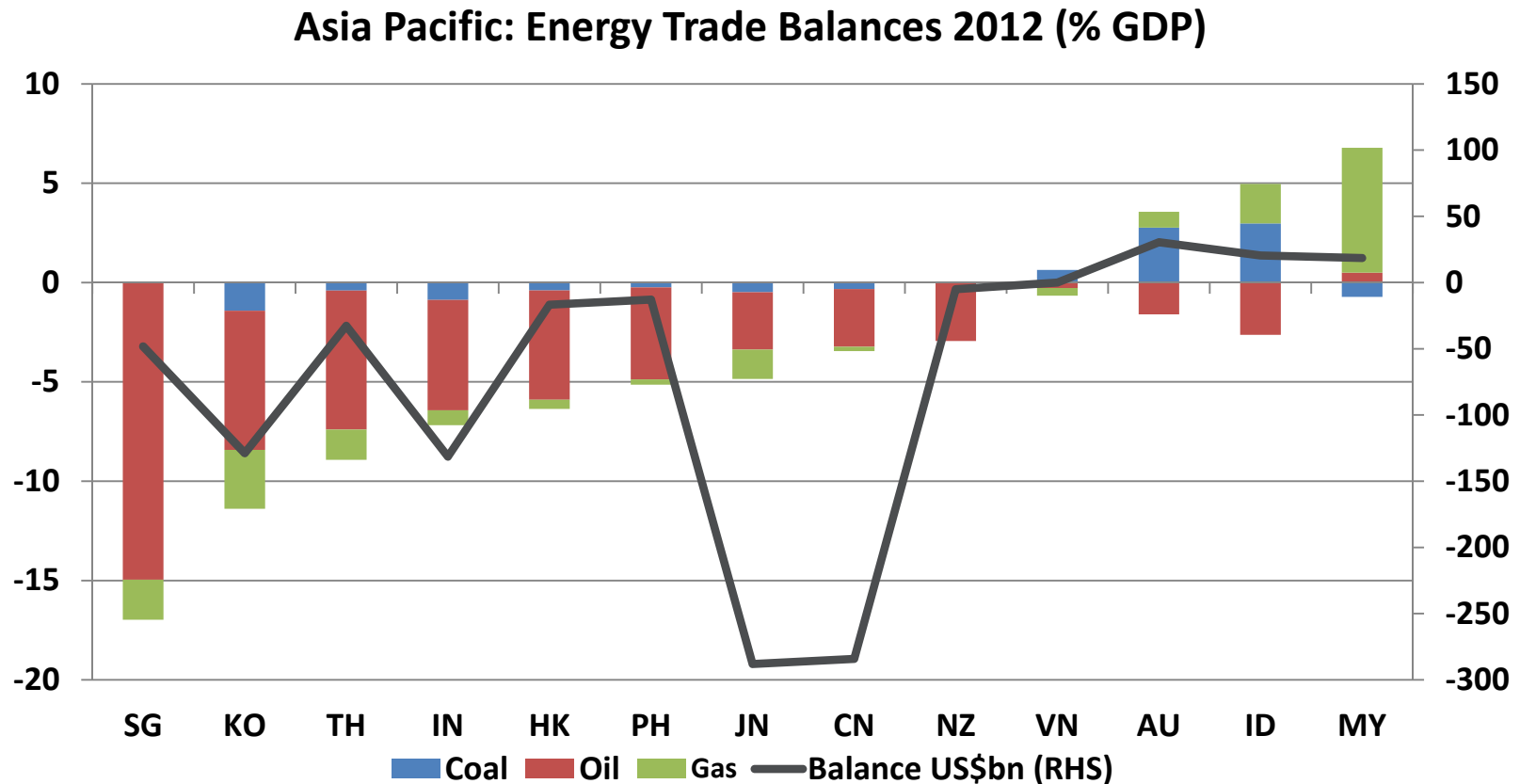


Source : Oxford Economics/Haver Analytics

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The Steep Drop in Oil Prices Is A Windfall To Asia Pacific

Most of APAC Is Running A Sizeable Energy Trade Deficit



Source: COMTRADE, Standard & Poor's

China Status Report
Slower Growth Is Good, But Risks Remain

China: Slower Growth Is Actually A Good Thing But Risks Remain In The Property Sector (and its financing)

We think missing the 2014 growth target was a positive development:

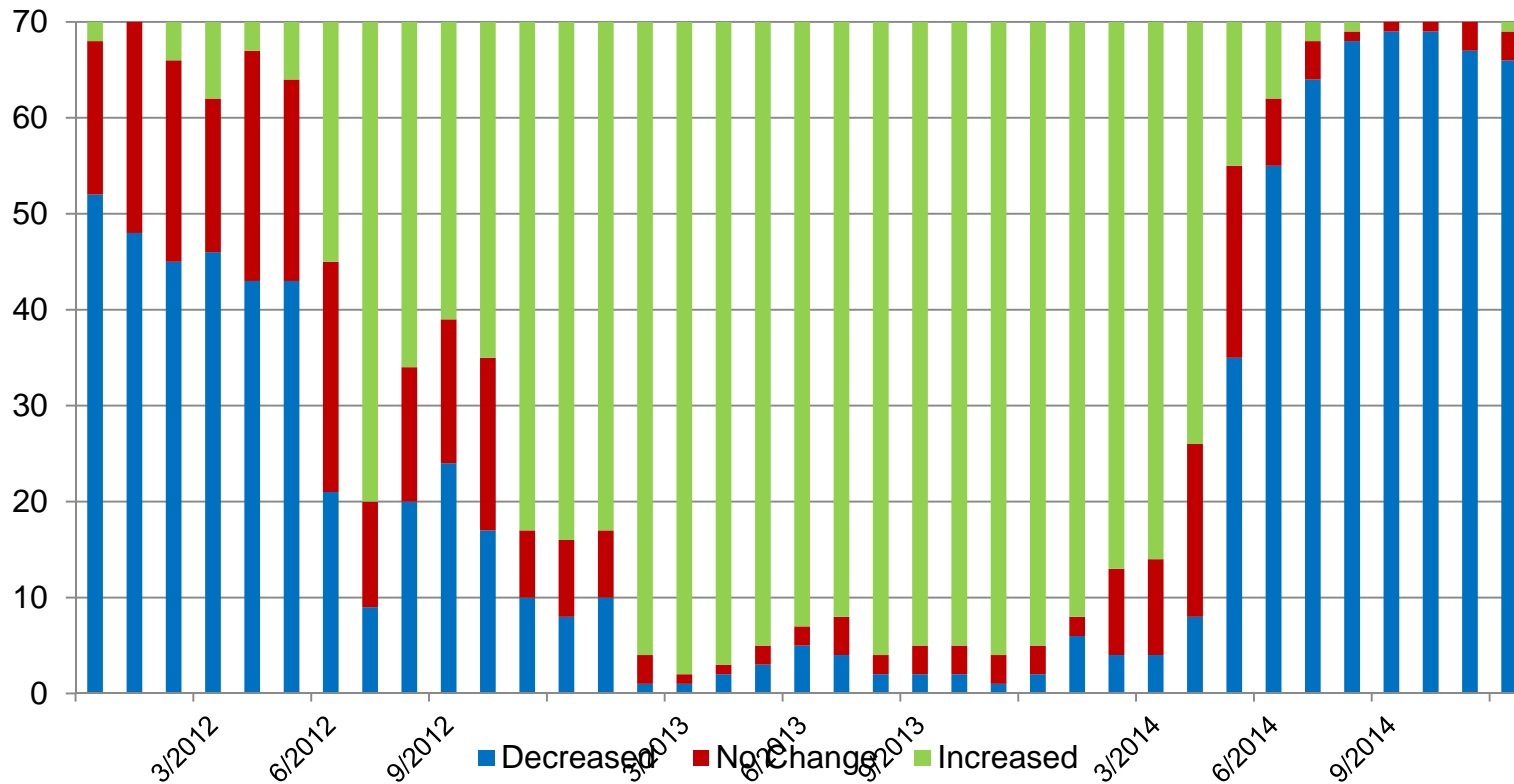
- ✓ Credit growth (and GDP growth) since the GFC has been too fast
- ✓ The government needs to break the growth target psychology
- ✓ (Does the difference between 7.4% and 7.5% really matter?)

But the downside risks are still there. How might things play out?

- ✓ Credit discipline requires defaults to reduce moral hazard
- ✓ Default(s) might cause a “Chinese-style run” on shadow banks
- ✓ Funding could dry up for a swath of investment projects
- ✓ Strong systemic banks and external surplus shore up system
- ✓ Policy response is likely to be swift and decisive
- ✓ Hit would be investment-heavy, sharply lower growth momentum

Chinese Property Prices Continue to Decline The Size Of The Inventory Overhang Is Unknown

Newly Constructed Price m/m Change, number of cities

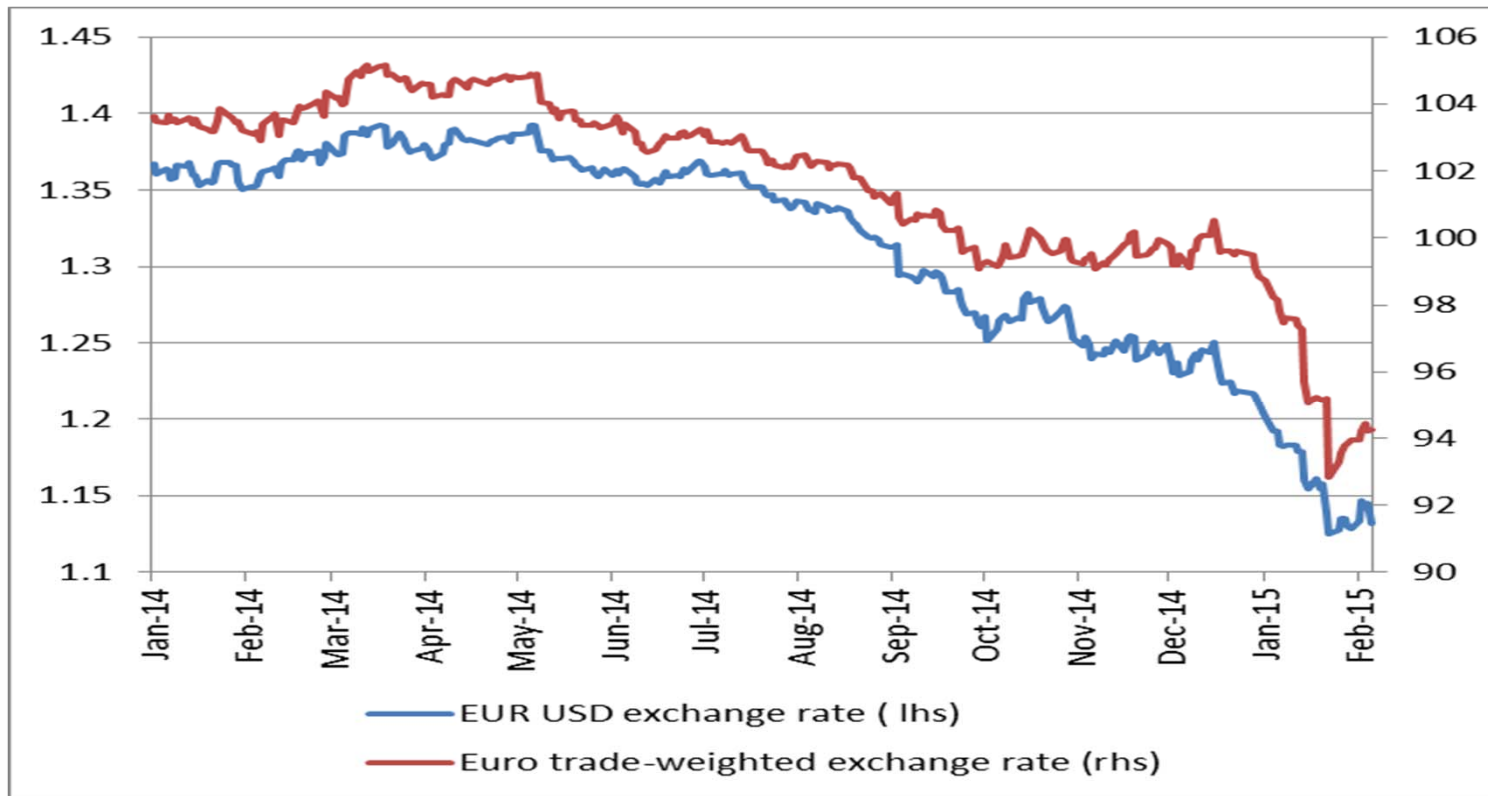


Source: CEIC

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Europe: Gathering Speed

The Weaker Euro FX Rate Will Boost Exports Growth

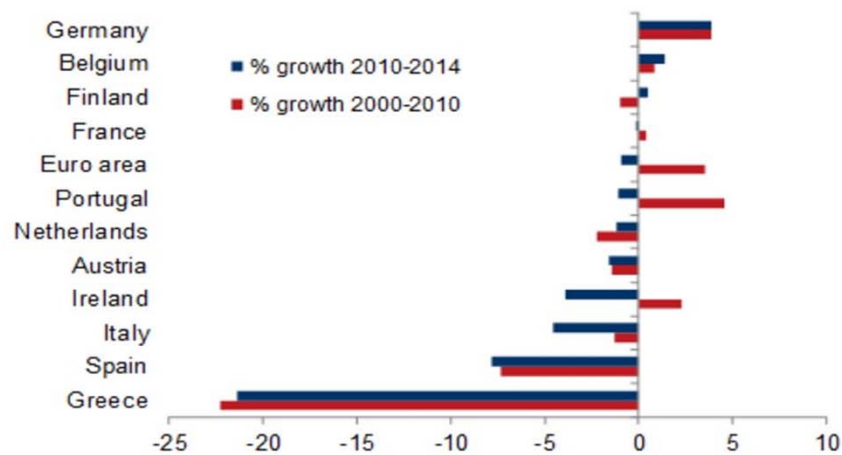


Source: Bloomberg

Low inflation rates also a positive for incomes

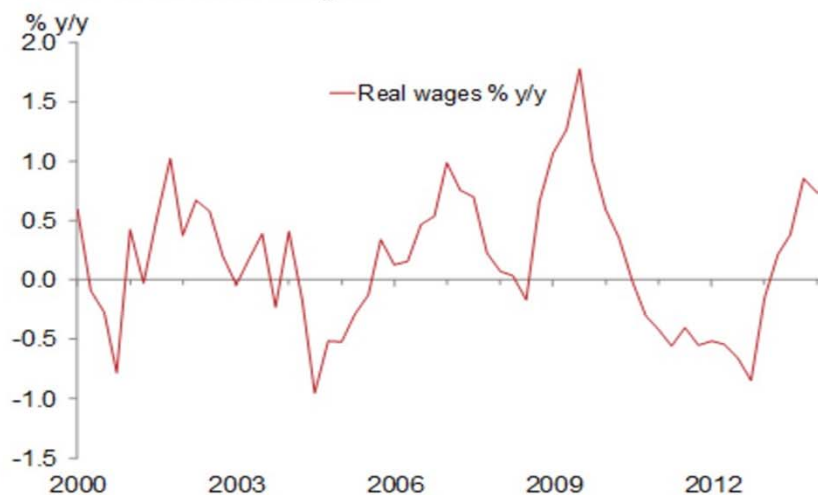
- In aggregate real wage growth since 2010 has been muted reflecting the weakness of demand and high unemployment
- Falling inflation however is now providing a significant boost to real wages

Euro area real wage growth



Source : Oxford Economics/Haver Analytics

Euro area real wages

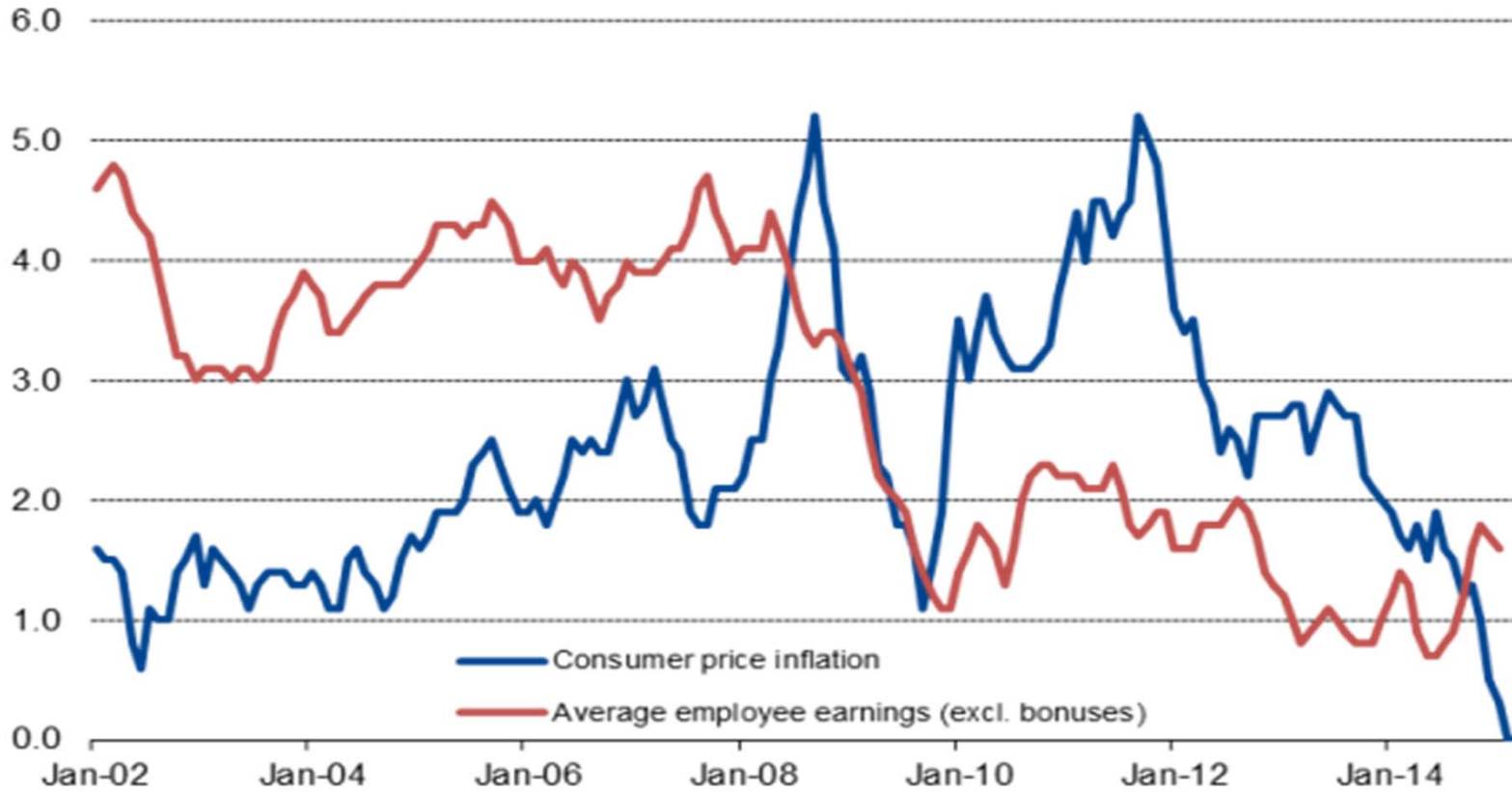


Source : Oxford Economics/Haver Analytics

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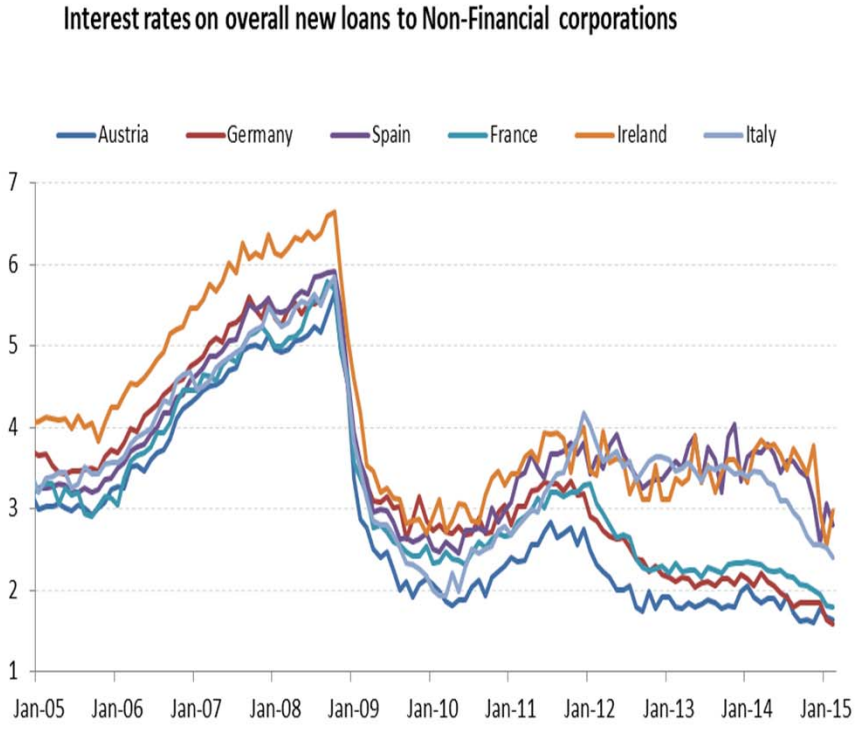
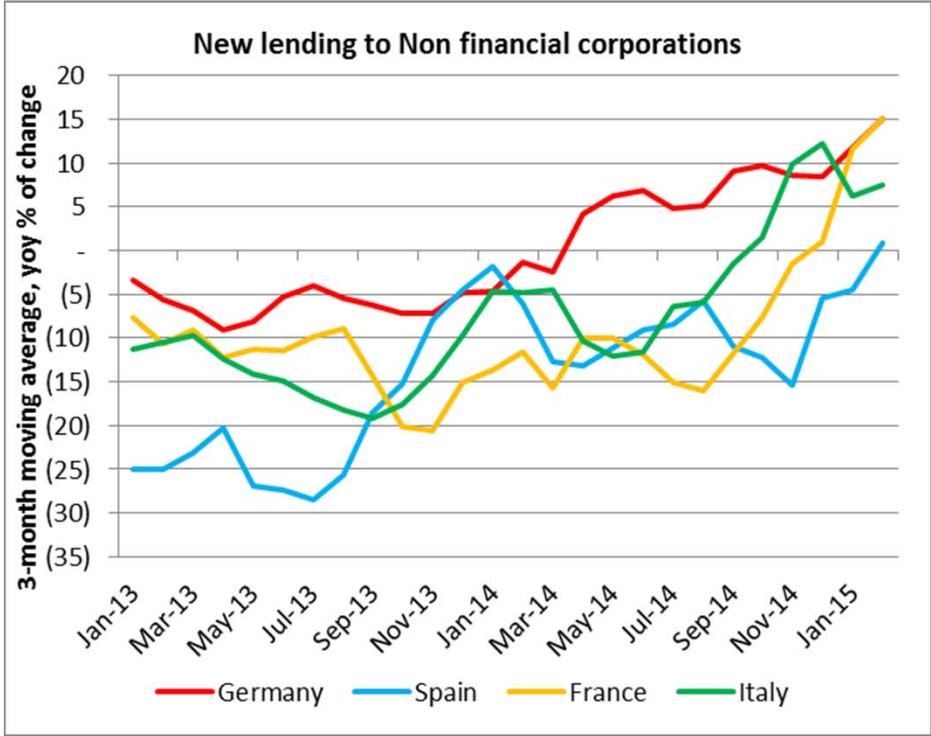
UK inflation and pay

Annual % change



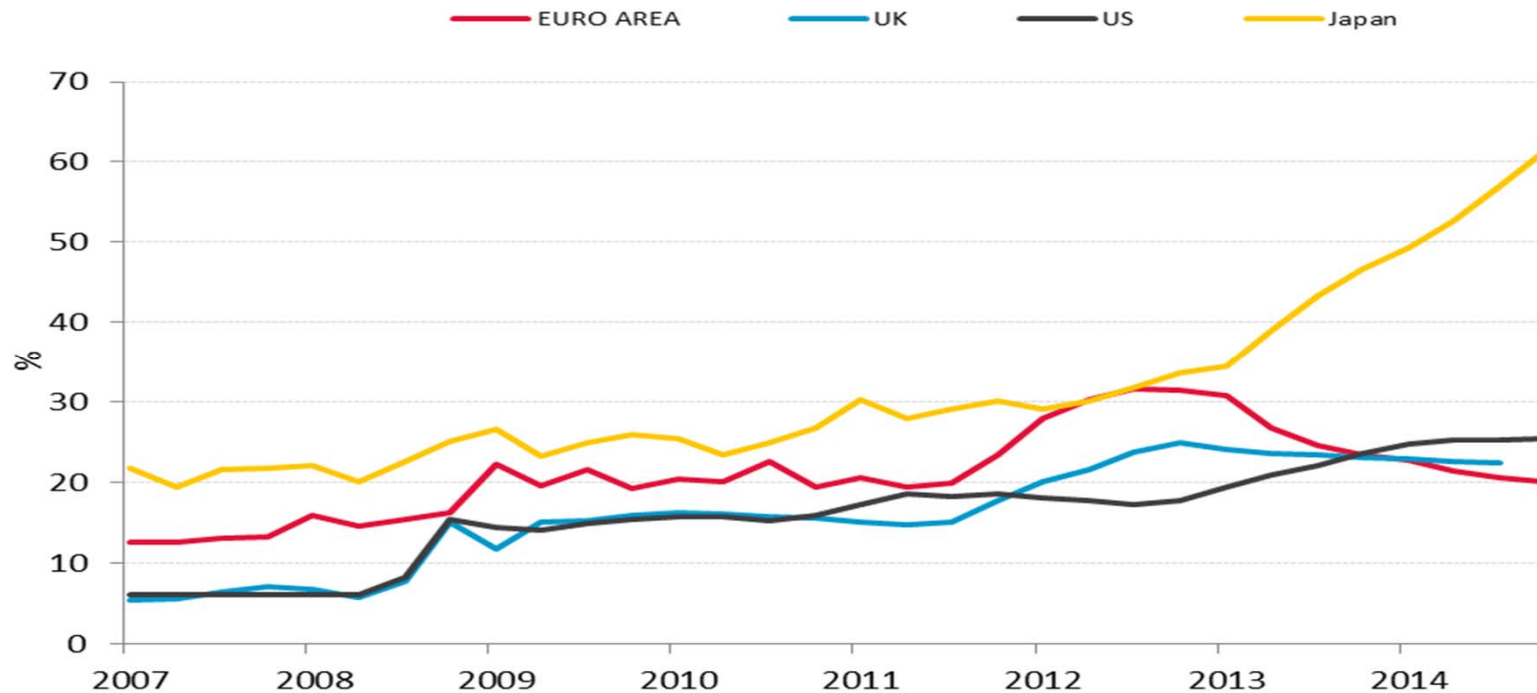
Sources: Markit, Office for National Statistics

Monetary Policy: How To Kick Credit Growth Back To Life?



The ECB Balance Sheet Has Actually Been Shrinking Since 2012

Central Banks balance sheet as a % of Nominal GDP



Source: ECB, Bank of England, Federal Reserve, Bank of Japan, Q4 2014

QE Aims At Boosting Asset Prices

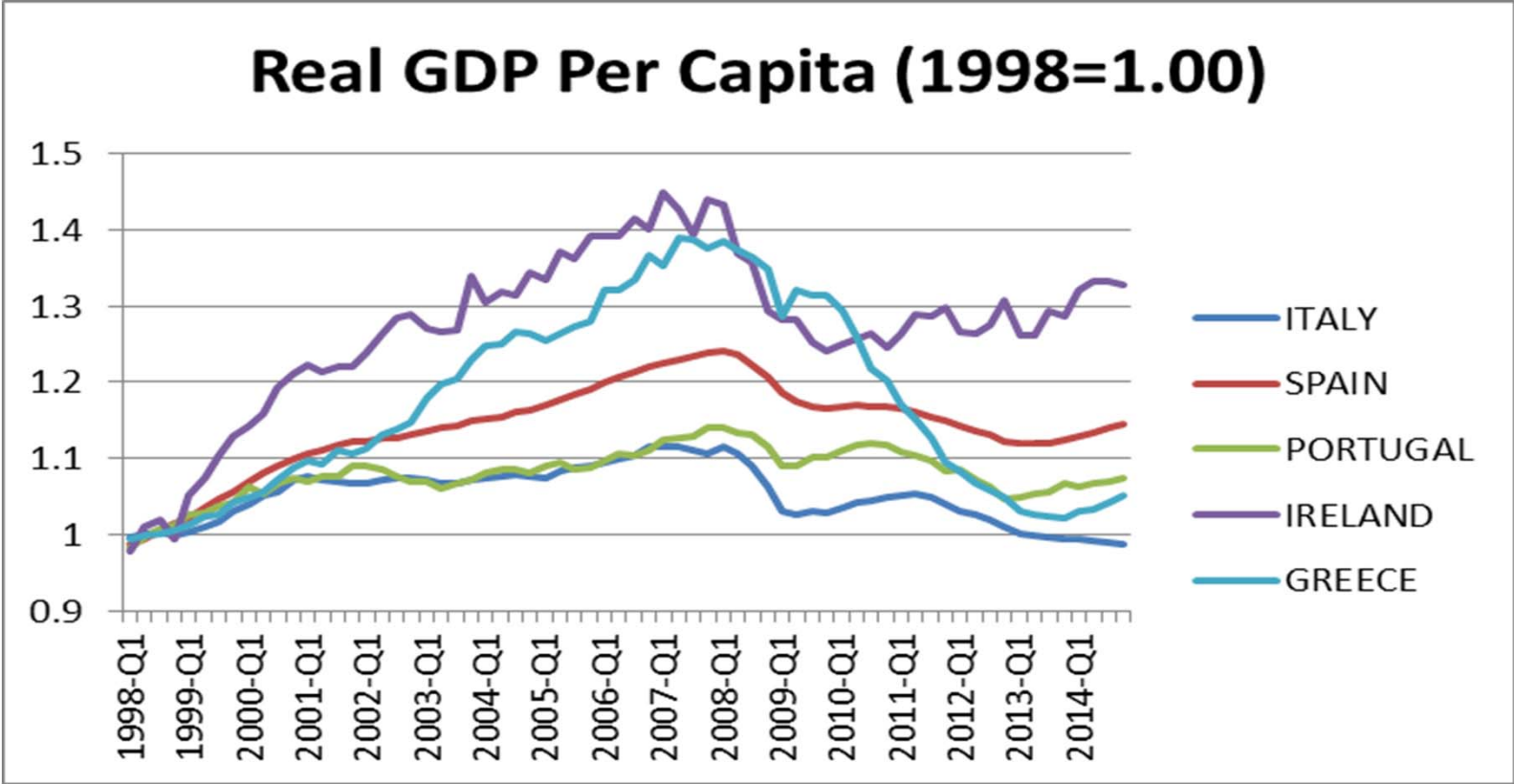
	Effects of QE on the day it was announced		
	FX	Stock indices	10-year yield (bps)
QE1 Fed	-1%	0.70%	-22
QE2 Fed	0.10%	0.40%	-2
QE3 Fed	-0.20%	1.60%	-4
QE BoE *	-0.40%	0.20%	-1
QE BoJ 2013	-3.60%	2.20%	-11
QE ECB	-1.20%	1.60%	-7
* Average of the 7 announcements by the BoE re: introducing or reinforcing QE			
Source Bloomberg			

European Housing Market Forecasts

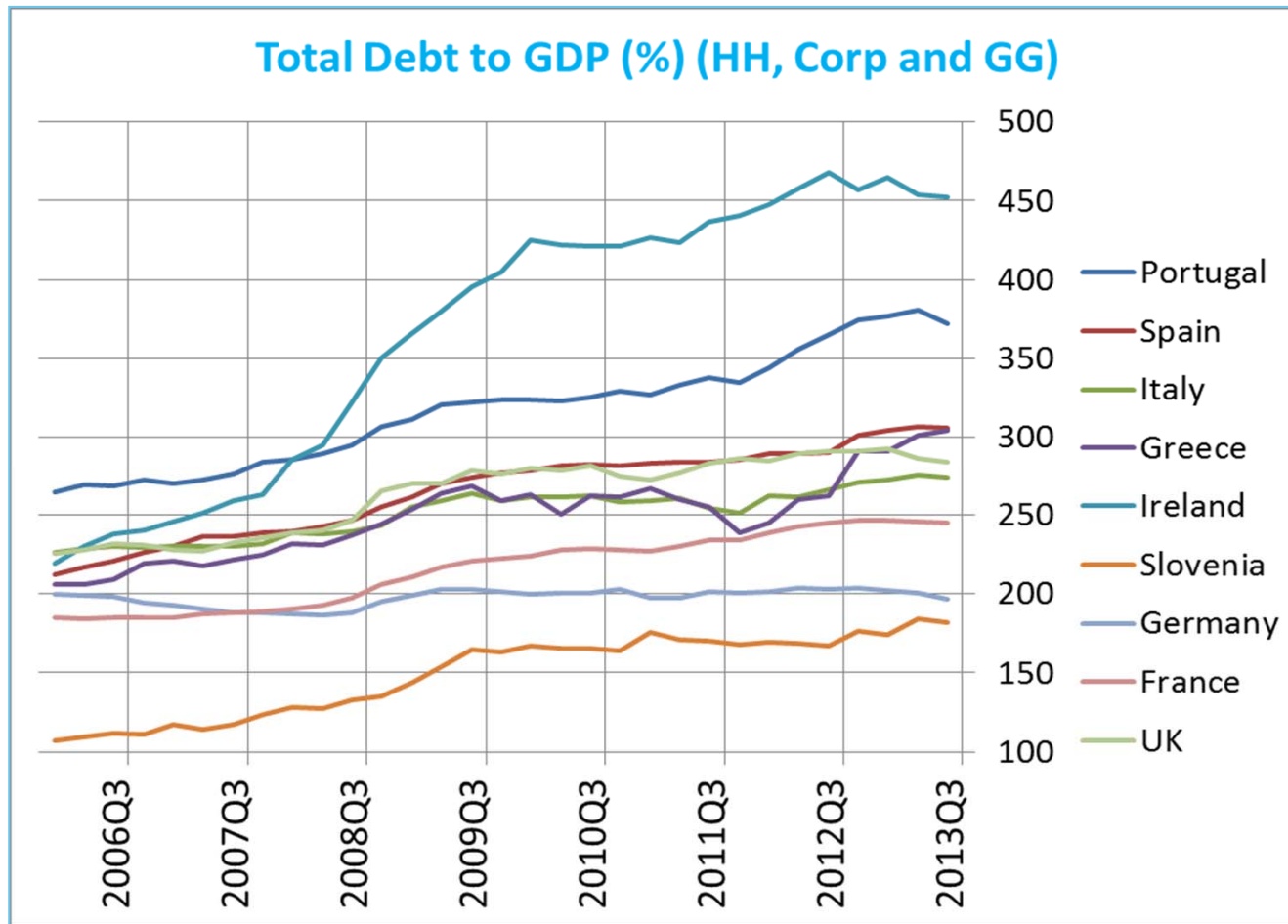
Nominal House Prices, % change Y/Y	2012	2013	2014-e	2015-f	2016-f
Belgium	1.5	1.2	0.5	-3.5	-2.5
France	-2.0	-1.9	-4.0	-3.0	0.0
Germany	4.6	3.2	3.0	5.0	3.5
Ireland	-6.2	6.0	16.0	9.0	5.0
Italy	-5.2	-5.3	-3.5	-2.0	1.0
Netherlands	-7.6	-4.3	2.2	1.5	2.5
Portugal	-2.7	-3.0	-1.0	1.0	1.5
Spain	-10.4	-4.6	-2.0	0.0	2.0
Switzerland	3.6	4.6	0.5	-1.0	1.0
United Kingdom	2.3	5.4	7.0	4.0	3.0

Sources: S&P, OECD, Hypoport

But The Eurozone Economies Remain Weak

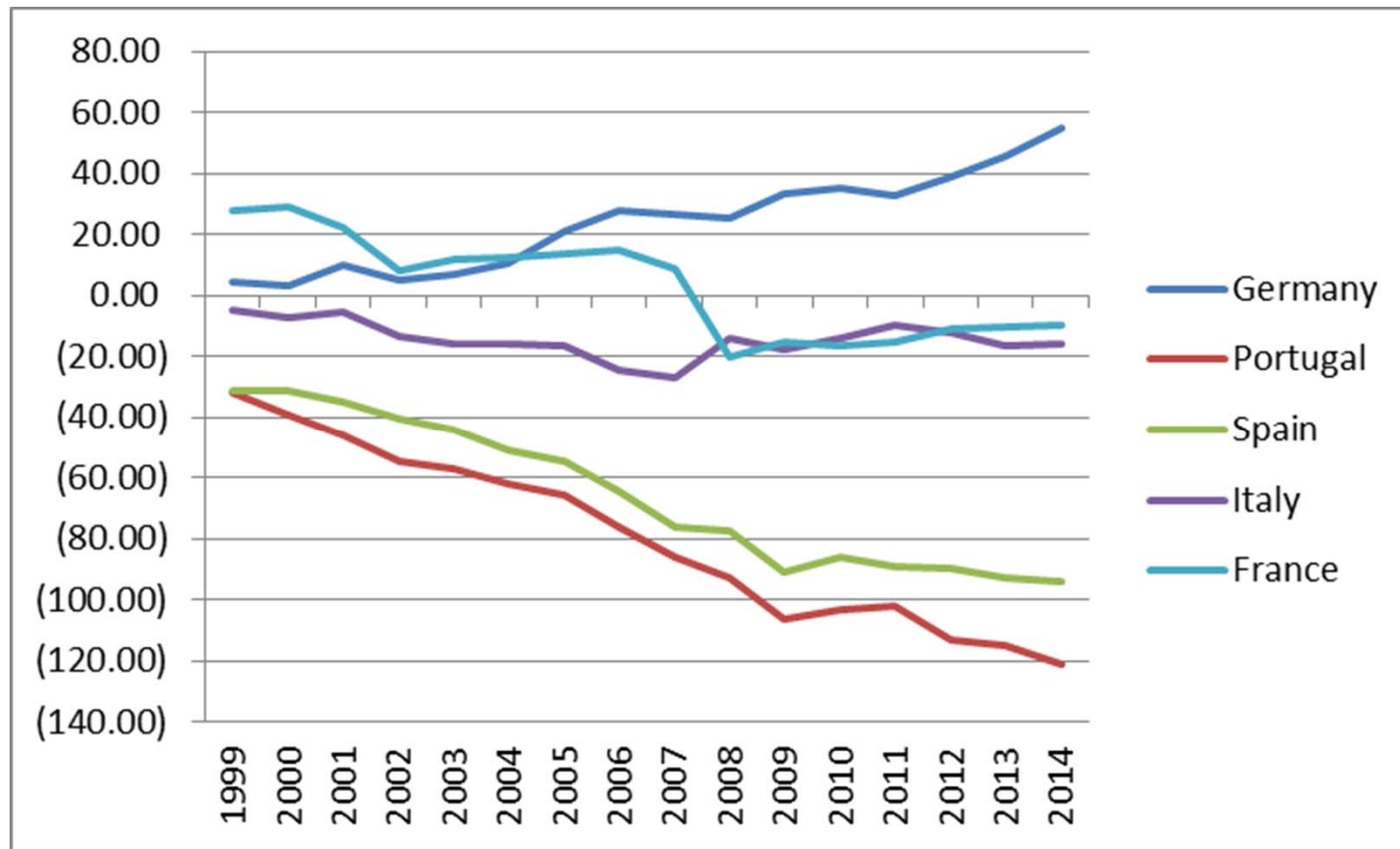


The Deleveraging Has Only Just Begun

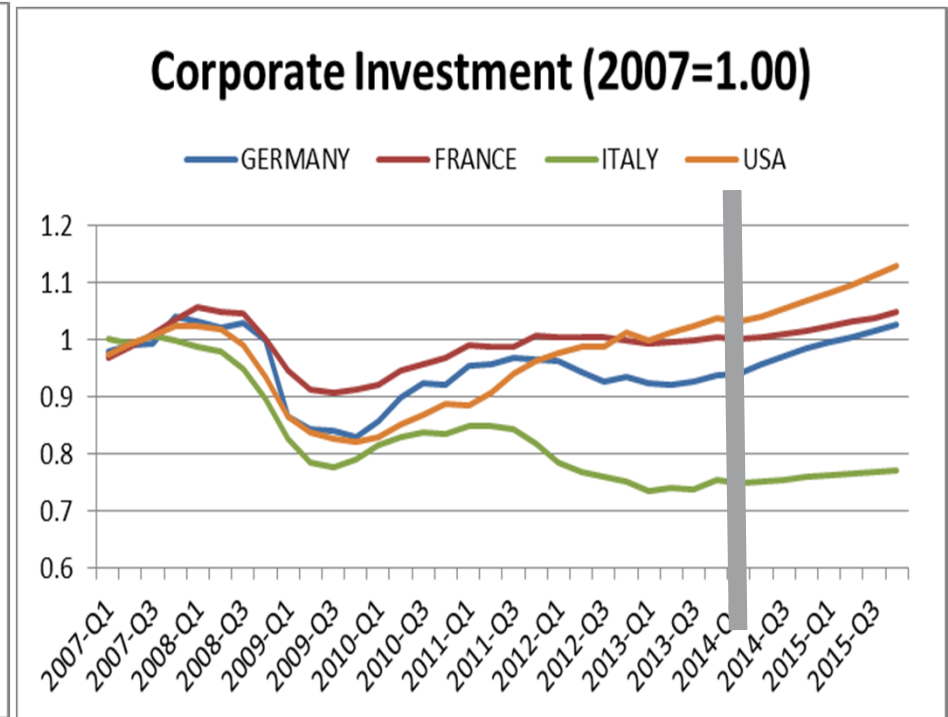
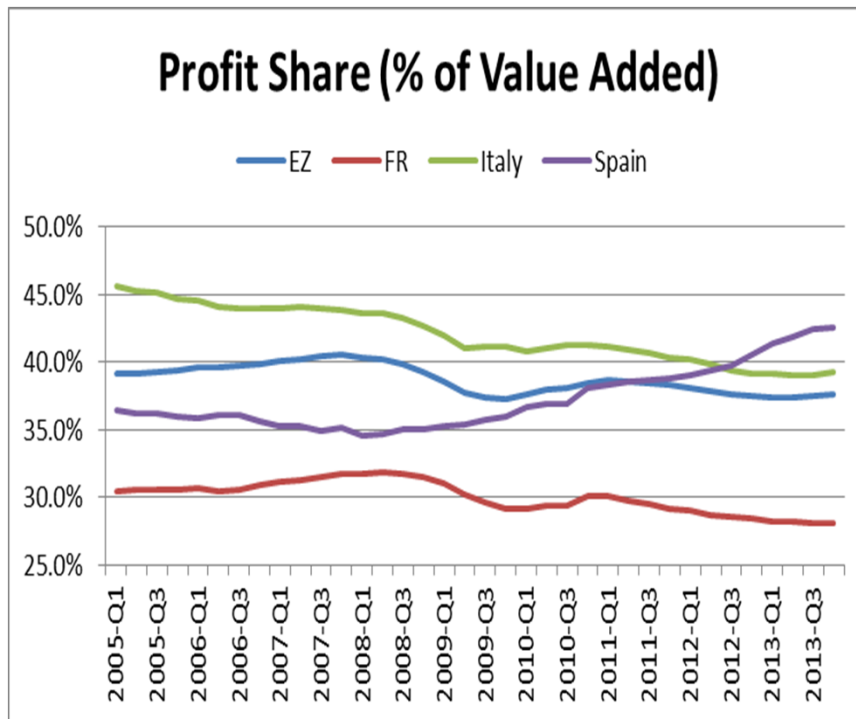


Source: Eurostat.

International Investment Position (% of GDP)



The Recovery in Corporate Investment Lags That In The US

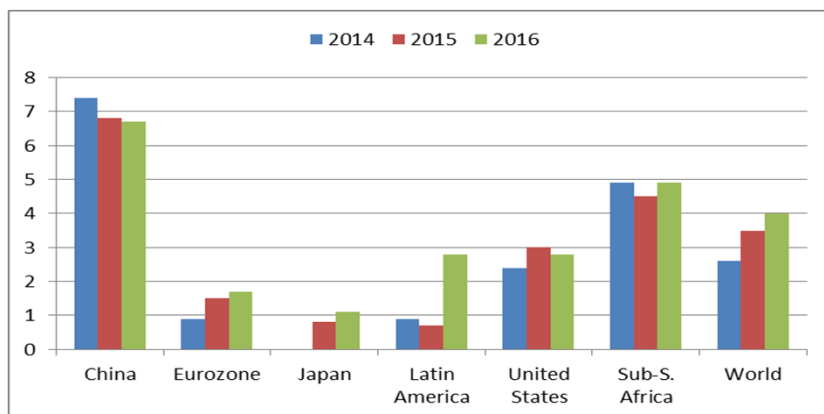


Source: Eurostat, S&P calculations and forecasts

Wrapping up: Global Macro Outlook

GDP Growth Rate Forecasts (%)

	2014	2015	2016
China	7.4	6.8	6.7
Eurozone	0.9	1.5	1.7
Japan	0.0	0.8	1.1
Latin America	0.9	0.7	2.8
United States	2.4	3.0	2.8
Sub-Saharan Africa	4.9	4.5	4.9
World	2.6	3.5	4.0



- ✓ We expect global growth to be a bit stronger this year and next, despite a continuing China slowdown, as the US, the eurozone, Japan, and India all grow faster.
- ✓ The shale revolution-driven decline in the oil price is positive for global growth; as post-crisis headwinds taper off and the IT revolution permeates economies, “secular stagnation” seems like a misnomer.
- ✓ The ECB’s QE program is a significant policy shift that should help to underpin a surprisingly robust cyclical upswing; the Fed’s cautious normalization of monetary policy should support a continued move of the US economy back to full employment.
- ✓ After a self-inflicted recession, Japan looks likely to record reasonable growth, as the BOJ continues its concerted efforts to end deflation. Success on that front could involve a reflationary tipping point.
- ✓ The Chinese economy is likely to keep gradually slowing. The credit and investment overhang remains a downside risk, but should it start to become manifest policymakers would likely counter it strongly.

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