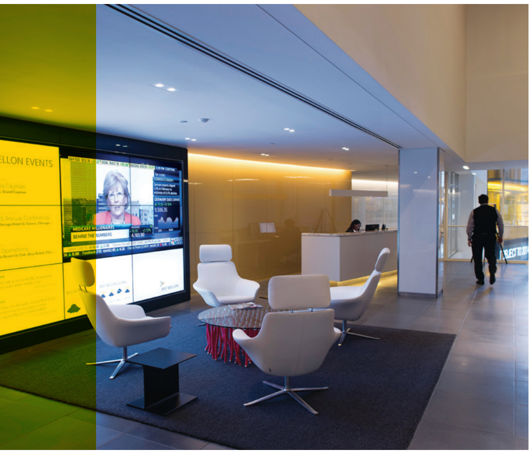

MAY 2015

Global Macro Views

By The Standish Global Macro Committee

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The global economy appears to be experiencing a bit of déjà vu at the beginning of 2015 with US GDP growth disappointing due to what we believe are mostly transitory factors. However, with the Federal Reserve contemplating hikes in short-term interest, the weakness in the data has received increased scrutiny from investors. We continue to expect the Fed to begin the normalization process no later than its September policy meeting. The data on the labor market and inflation remain supportive of the Fed's medium-term view and suggest that a zero-interest rate policy may no longer be appropriate. Furthermore, we are less concerned about growth in Europe and Japan where quantitative and qualitative monetary easing will likely continue to benefit the growth and inflation outlook.

We continue to expect the Fed to begin the normalization process no later than its September policy meeting.

Yet, our view is not without risks. Political wrangling over Greece's high debt levels and threats of an exit from the euro remain. In addition, the Conservative Party's victory in the UK suggests a referendum on European Union (EU) membership in 2016 or 2017, which has the potential to disrupt markets. There are also concerns about growth in China where capital outflows and fiscal consolidation at the local government level are restraining economic activity. Nevertheless, we believe these issues are more likely to influence the pace of tightening in the US rather than the timing of the first rate hike.

WORLD	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	3.2%	–	3.6%	–
Inflation	3.6%	–	3.5%	–

Source: Standish as of May 5, 2015

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

STANDISH

BNY MELLON

UNITED STATES	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	2.4%	–	2.7%	–
Inflation	1.5%	–	2.2%	↑

Source: Standish as of May 5, 2015

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

We still anticipate that consumer spending will be a key driver of the US economy in the coming months.

The US economy expanded at an annual rate of 0.2% in the first quarter, which disappointed our expectations and prompted us to lower our forecast for full-year 2015 GDP growth to 2.4% down from 2.7%. As we mentioned previously, we believe Q1 output was held back by a combination of weather and the West Coast port shutdowns, but we expect the stronger dollar will be a drag on exports and the manufacturing sector going forward. We still anticipate that consumer spending will be a key driver of the US economy in the coming months as wage growth improves and households begin to spend some of the cash they have saved at the gas pump. We are also hopeful that residential investment in housing will play a greater role in the growth outlook as home sales pick-up in the spring and summer.

The Fed acknowledged the poor first quarter GDP print in its April policy statement, but they agreed it was partly transitory. They also stated that even though inflation is anticipated to remain near its recent low level in the short-term, they expect it "to rise gradually toward 2% over the medium-term as the labor market improves further and the transitory effects of declines in energy and import prices dissipate." Therefore, we continue to expect the first rate hike no later than the Fed's September policy meeting, provided the employment figures recover and the unemployment rate moves lower. With lift-off still likely in September, we anticipate a language change from the Fed to prepare investors no later than the July policy meeting.

EURO AREA	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	1.5%	–	1.6%	↑
Inflation	0.5%	–	1.5%	–

Source: Standish as of May 5, 2015

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

The PMI survey points to ongoing expansion in both the services and manufacturing sectors through the second quarter of 2015. As we await the first quarter flash estimate of GDP – due on the 13th of May – we are confident that this recovery is quite sustainable throughout 2015 and 2016. The reason is that the recovery is more domestically generated with investment and consumption both likely to play a part rather than wholly dependent on the global economy. On the external front, risks have somewhat abated with the US economy expected to bounce-back from some of the transitory factors restraining growth and the Chinese authorities supporting growth through stimulus. On balance the risks have slightly turned to the upside amid the European Central Bank's (ECB) determination to see their asset purchase programs through.

JAPAN	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	1.1%	–	1.5%	↑
Inflation	0.5%	–	1.5%	↑

Source: Standish as of May 5, 2015

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

As a result of the Conservative majority, the UK will now have a binding referendum on its EU membership.

In Japan, the data has slightly lagged, as the Japanese exporters suffered the effects of their two largest trading partners, the US and China, posting downbeat economic statistics in the first quarter of the year. Despite this and the low probability that inflation hits their target by the end of fiscal year 2015, the Bank of Japan (BoJ) did not announce a further extension of their Quantitative and Qualitative Easing program in April 2015. Instead, they lengthened the time frame with which the markets should expect the BoJ to meet its 2% objective, now the first half of fiscal 2016. In our view, this is consistent with no new stimulus over the medium-term and a slightly lower inflation forecast. We agree with the BoJ, given the supply/demand conditions in the Japanese government bond market and the tight labor market which should produce robust wage gains starting in the second half of this year.

UNITED KINGDOM	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	2.5%	–	2.3%	–
Inflation	1.0%	↓	1.8%	↓

Source: Standish as of May 5, 2015

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

The UK general election on 7th May produced a shock result, with the Conservatives unexpectedly achieving a slim majority of seats – the base case scenario was for a hung Parliament and a coalition government. Although this outcome was clearly missed by the polls and analysts (likely due to the increased fragmentation of the UK on a geographical basis), it is logical in the sense that the Conservatives have produced a decent UK economic recovery during the last five years in government. As a result of the Conservative majority, the UK will now have a binding IN/OUT referendum on its EU membership during 2016 or 2017. Current polls suggest that voters would marginally vote to stay in the EU, although in reality it really is far too close to call and thus open to high levels of political, economic and financial market uncertainty.

More immediately a Conservative majority government will mean the tightest fiscal policy of all the potential government outcomes, and thus a pick-up in austerity in the next five years with a focus on reductions in government spending and perhaps even allowing for some taxation reductions. This may have a negative impact on growth, although it really is too soon to tell given the lack of Conservative budget plans. Tighter fiscal policy and the potentially negative pressure upon GDP relative to current expectations, implies this election outcome could potentially set the path for slightly looser monetary policy than had been expected by the market. While we still expect the Bank of England (BoE) to begin to raise rates around March/April 2016, which is earlier than the June 2016 currently priced in by the futures market, it will mean that policy rate increases could be slower than had been expected during 2016 and 2017.

The promise of further monetary easing and the tolerance of buoyant equity market prices will anchor domestic sentiment in China.

In other news, GDP grew by 0.3% quarter-on-quarter (q/q) in Q1 compared with growth of 0.6% q/q in Q4. Services outperformed the average (0.5% q/q), while manufacturing (-0.1% q/q) and construction (-1.6% q/q) disappointed. We expected manufacturing to be weak and the slowdown in the housing market is likely to have hit construction. Having said this, we didn't have a bad winter in the UK, so there is some chance of upwards revisions to these volatile early construction numbers and thus Q1 GDP overall.

CHINA	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	6.7%	↓	6.3%	–
Inflation	1.9%	↓	2.0%	–

Source: Standish as of May 5, 2015

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

We continue to believe that the authorities will struggle to avoid a sub-7% GDP growth rate this year as the economy grapples with overcapacity in key industrial sectors and the property market. Ongoing reductions in the banks' reserve requirements – and lower interest rates – will help. But it will not offset the structural down-trend. One reason for our skepticism is that ongoing monetary easing has to also contend with capital outflows which are slowing money supply growth. Another reason is that the fiscal drag from lower local government spending is unlikely to be resolved anytime soon. This is because recent measures for re-profiling local government obligations through a finance-ministry-backed debt swap have found few initial takers. Meanwhile, land sales revenues continue to shrivel, and shadow bank financing channels remain closed. The promise of further monetary easing and the tolerance of buoyant equity market prices will anchor domestic sentiment. However, these are unlikely to offset tightening monetary conditions brought on by high real interest rates and a strengthening real exchange rate. China's growth and inflation prospects continue facing downside risks over the near term. What could alter these risks is if continued monetary easing is accompanied by much larger quasi-fiscal spending by the policy banks who would have to step in to fill the activity void left by the local governments. But this is not in evidence as yet, or could come too late.

China's strategic goal of including the RMB in the Special Drawing Rights is backed by official rhetoric about speeding up exchange rate liberalization. But until this materializes later in the year, the authorities seem committed to an interventionist stance in the interim to limit currency weakness. Such FX intervention, in turn, could result in further erosion of the People's Bank of China foreign exchange reserves as well as weigh on export competitiveness. However, a strong external balance sheet should allow the authorities to focus on continuing to lower nominal, and ultimately, real, domestic interest rates.

SOUTH KOREA	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	3.0%	–	3.3%	–
Inflation	1.0%	–	1.6%	–

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

Source: Standish as of May 5, 2015

Korea's economy continues to be beset by slowing exports and sluggish domestic demand.

Korea's economy continues to be beset by slowing exports and sluggish domestic demand. Although the Bank of Korea (BoK) has lowered its policy rate by 75 bps (basis points) since July 2014, it has not been able to shake off the economic torpor from excess capacity in the corporate sector and high household leverage. These structural headwinds alongside persistent competitive pressures from a weak yen are the main reasons for the lowering of our full year GDP forecasts for this year and the next by 30 bps and 10 bps, respectively, to 3% and 3.3% year-over-year. The finance ministry is trying to push ahead with restructuring household debt on the back of low/flat yield curves and a growing MBS market. But this is likely to lower the vulnerability of the (predominantly floating/bullet) household debt stock against rate shocks or external upheavals, and not boost domestic demand anytime soon. Headline inflation is also likely to remain restrained to just 1% this year, rising to only 1.6% in 2016 –considerably, and persistently, below the BoK's inflation target of 3% year-over-year. As core inflation is also losing momentum, we continue to expect monetary authorities to lower the policy rate by an additional 25 to 50 bps in the remainder of this year. Improved global demand, lagged effects of policy easing and firmer commodity prices keep the balance of risks to our current projection of Korean growth and inflation stable.

INDIA	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	7.5%	–	7.9%	–
Inflation	5.8%	↑	5.5%	↑

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

Source: Standish as of May 5, 2015

India's growth recovery should remain underpinned by the terms of trade windfall of lower commodity prices, declining inflation, a mildly positive fiscal impulse, and gradual monetary easing. A recovery in European growth should also prove beneficial, as India is more heavily exposed to trade with Europe in comparison to other Asian emerging markets. The ongoing budget session of the Parliament has implemented several reforms, but big-ticket reforms such as the land acquisition bill is facing stiff political opposition and the goods and services tax bill could face procedural delays. A recent circular to impose a Minimum Alternative Tax on foreign portfolio investors has also weighed reignited investors' concern about retroactive taxation and –if not resolved speedily– could weigh on flows, even though the overall external position is much improved relative to mid-2013, when the economy and the currency proved especially vulnerable to the 'taper tantrum.' As reforms and the investment environment face greater challenges, we are removing the upward bias to our GDP growth projection for 2015, and highlighting higher inflation risk on account of weather-related disruptions which could adversely impact food prices later this year and the next.

A key theme has been the continued strength of Polish, Hungarian and Romanian currencies versus the euro.

LATIN AMERICA

BRAZIL	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	–1.0%	↓	1.0%	–
Inflation	8.0%	–	6.5%	↓

MEXICO	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	3.2%	↓	3.8%	↓
Inflation	3.2%	↓	3.4%	–

Source: Standish as of May 5, 2015

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

The timely release of financial statements by Petrobras, the oil company, has removed a major source of uncertainty for Brazil. From now on, confidence and macro performance will likely depend solely on political developments and their influence on the execution of ongoing economic adjustments. So far, the central bank remains keen on controlling inflation via monetary tightening, while fiscal spending is being reigned in. All important business confidence is expected to recover in the second half, but a recession is almost a certainty this year, followed by a moderate recovery in 2016. Mexico is also slowing down, although expectations of a stronger US economy later in the year should help to improve growth in 2016. Chile, Colombia and Peru will likely grow moderately and below potential, but stabilization of commodity prices should help to improve the outlook for next year. With the exception of Brazil, where inflation remains significantly above the official target, consumer prices remain well behaved in the other economies (except Argentina and Venezuela), allowing central banks to maintain a neutral stance on monetary policy.

CENTRAL AND EASTERN EUROPE (EXCLUDING TURKEY)	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	2.6%	↑	2.8%	–
Inflation	0.7%	↓	1.8%	↓

Source: Standish as of May 5, 2015

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

A key theme during April has been the continued strength of CEE3 (Poland, Hungary and Romania) currencies versus the euro. This has been made all the more interesting by the fact that local bond markets are not reporting particularly elevated ECB quantitative easing related inflows. We are currently approaching or have surpassed key levels in the Polish zloty, Hungarian forint, and Romanian leu. This may prompt some central bank action should it continue. For example, in Poland verbal communications by the central bank are expected – although no FX interventions at the current juncture (some implicit manipulation has been happening through the absorption of EU funds already). In Hungary, we are also expecting the monetary policy easing cycle to continue in-line with lower than target inflation. In Romania, the most recent developments have focused on the fiscal easing which Prime Minister Ponta recently announced (particularly the lower rates of valued added tax). While fiscal easing does provide a positive impulse to growth and means that inflation is going to rise significantly more slowly during 2015 than had been anticipated, it is likely to attract some negative comments from both the EU as there is a greater risk that some fiscal targets will be missed. It also means that the relationship with the IMF is unlikely to improve in the near-term.

TURKEY	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	3.5%	↓	4.0%	–
Inflation	6.0%	↑	6.5%	–

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

Source: Standish as of May 5, 2015

Recently, the macro data has been disappointing with sluggish growth numbers and inflation not falling as much as was hoped due to food prices and Turkish lira weakness. Industrial production numbers for Q1 2015 was extremely weak, the current account deficit is not improving, and the political outlook remains clouded. Recent communications make it clear that President Erdogan is calling the shots within the Justice and Development Party (AKP) – and despite the Kurds standing as a single party at the June election – this increases the risk of further political noise and negative shifts in economic policy post the election. Thus, negative sentiment is likely to ensure that Turkish assets (particularly the currency) remain weak and under pressure until post the June election.

SOUTH AFRICA	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	2.0%	↑	2.5%	–
Inflation	4.5%	–	6.0%	–

↑ positive surprise more likely over next six months ↓ negative surprise more likely over next six months – no bias

Source: Standish as of May 5, 2015

Looking into the second half of 2015, we expect the South African economy to accelerate, but only modestly. Favorable base effects in the mining and manufacturing sectors will be largely offset by still depressed household consumption, fiscal consolidation, and the inability of electricity supplier ESKOM to provide a consistent and uninterrupted supply of energy. We believe growth in 2015 will be faster than in 2014, but a sustained run of above trend growth does not seem likely over the near future. Having troughed early in the spring, inflation is set to accelerate steadily into the end of the year. Headline inflation will likely breach the top of the South African Reserve Bank's (SARB) target band early in 2016 as the prices of fuel, food, and electricity accelerate in unison. Depending on the evolution of core inflation, shifting inflation expectations and the impact of policy normalization in the US, the SARB is likely to resume its hiking cycle as we approach year-end. However, given the underlying weakness of the South African economy, we believe that, while the SARB will communicate hawkishly, it will tighten monetary policy as slowly and as little as possible.

We expect the South African economy to accelerate in the second half of 2015, but only modestly.

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