

GLOBAL MACRO VIEWS

NOVEMBER 2014

By: The Standish Global Macro Committee

Rebecca Braeu, PhD, CFA; Cathy Elmore; Thomas Higgins, PhD;
Nathaniel Hyde, CFA; Rowena Macfarlane; Aninda Mitra;
Javier Murcio

World:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	3.0%	–	3.5%	–
Inflation	3.7%	↓	3.5%	–

Source: Standish as of November 4, 2014

This month, we have further downgraded our world GDP forecast for 2014 from 3.2% to 3.0% primarily due to weaker growth in emerging markets (EM). Specifically, we have become more pessimistic on the outlook for growth in the Commonwealth of Independent States, Latin America, the Middle East, and Sub Saharan Africa. Part of the weakness is the result of cyclical factors such as lower commodity prices and slower growth in Europe and Japan. However, some of it is likely structural in nature and will persist even as the economic cycle picks-up. The good news is that the U.S. economy continues to perform well, which should aid the recovery in some of these markets. Moreover, the Bank of Japan (BoJ) and European Central Bank (ECB) continue to increase the level of accommodation in order to stimulate their flagging economies. Most recently, the BoJ surprised the markets with a further expansion of their balance sheet. We anticipate that the ECB will likely follow suit in the coming months. Therefore, we still expect an acceleration in world GDP growth to 3.5% in 2015.

↑ positive surprise more likely over next six months.

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

CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute

United States:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	2.2%	–	2.5%	–
Inflation	1.7%	↓	2.5%	–

Source: Standish as of November 4, 2014

The U.S. economy expanded at an annual rate of 3.5% in Q3 2014, but recent data on trade and inventories suggests this is likely to be revised down to around 3%. A large increase in federal defense spending contributed 0.7 percentage points to the headline GDP increase. While this is unlikely to be repeated, there are other reasons to be optimistic that the economy can sustain a 2.5% to 3% pace into next year. First, the composition of growth remains healthy. Indeed, all of the major sectors of the economy contributed positively to the Q3 gain. Second, while growth in consumer spending was modest, increasing at an annual rate of just 1.8% in Q3, the 70 cent/gallon decline in regular unleaded gasoline prices since June should give households a boost as we head into the holiday shopping season. Third, private inventories, which subtracted from Q3 growth, now appear to be better aligned with demand and should be neutral for growth going forward. Given this backdrop, the Federal Reserve ended its asset purchase program as expected at the conclusion of its October meeting. Overall, the policy statement had a more hawkish tone than the market had anticipated with no mention of the recent slowdown in global economic activity. Instead, the Fed focused on domestic indicators, stating that the “underutilization of labor resources is gradually diminishing.” The Fed also added language that made its forward guidance data dependent rather than time dependent. Thus, if the incoming information indicates faster progress toward the Fed’s employment and inflation objectives than anticipated, then increases in the fed funds rate would occur sooner. We continue to expect the Fed to begin hiking short-term interest rates around the middle of next year.

Euro Area:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	0.7%	–	1.0%	–
Inflation	0.5%	↓	0.8%	–

Source: Standish as of November 4, 2014

We are shifting our view on near-term European Central Bank (ECB) policy. Specifically, we believe that the odds that the ECB announces measures aimed at further balance sheet expansion have increased materially over our investment horizon. What has changed? First, the outlook for the German economy has deteriorated significantly, as a 25% year-over-year drop in Russian exports continues to weigh in on industrial confidence. We expect German growth to increase at an annual rate of around 1% in Q4, which is not sufficient to ease disinflationary pressures quickly. Second, the recent drop in global commodity prices is likely to weigh on the inflation outlook. Consequently, we revised down our forecast for inflation to just 0.5% through year-end with a negative balance of risks. Money supply and lending dynamics have improved but this takes time to feed through to inflation. Third, the targeted longer-term refinancing operations take-up in September was a disappointment and inflation expectations have weakened recently. Indeed, the ECB's inflation profile is the most positive predictor of inflation expectations and this has been consistently revised downward. Finally, as the Bank of Japan (BoJ) demonstrated, central banks still have room to surprise markets – this is likely the biggest card the ECB has to play. Going forward, the timing of the ECB's reaction function is quite uncertain. However, the outlook for the economy is poor enough that the inflation profile is more likely to deteriorate than improve. This is cause for further easing.

Japan:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	0.9%	–	1.7%	↓
Inflation	2.9%	–	2.7%	–

Source: Standish as of November 4, 2014

Two major and unexpected announcements occurred within days of each other. First, the Nikkei newspaper reported that the Government Pension Investment Fund (GPIF) would shift its target allocations to increase risk within its portfolio. Second, the Bank of Japan (BoJ) increased the size of its Quantitative and Qualitative Monetary Easing (QQE) program. The goal of the asset allocation shift by the GPIF is to raise domestic consumption through positive wealth effects and to increase expected returns of the pension system. The goal of the BoJ announcement was to shore up inflation expectations, ease the drag from the value added tax (VAT) hike next year, flatten the government yield curve, and ensure demand for GPIF bonds that may be sold. Under the second QQE program, the BoJ increased the size of their monetary base targets by roughly 3% of GDP (10-20 trillion yen) to 80 trillion yen per year by accumulating more risk assets such as exchange traded funds and real estate investment trusts. The BoJ also substantially increased its purchase of Japanese government bonds to offset a decline in holdings by GPIF. The BoJ will be moving out the curve “with a view to encouraging a decline in interest rates across the yield curve”. In contrast to the first QQE program, which was scheduled to end in April 2015, the second QQE program will continue as long as “it is necessary for maintaining that [2%] target in a stable manner.” In sum, this was a material shift in policy and one backed by just a slim majority on the board, so highly contentious. On the back of both measures, we have increased our forecast for inflation and growth for 2015. The offset to the positive economic momentum is that Abe will very likely move forward with his scheduled VAT hike from 8%-10% next year.

United Kingdom:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	3.0%	↑	2.5%	↑
Inflation	1.8%	↓	2.0%	↑

Source: Standish as of November 4, 2014

Third quarter UK GDP was estimated at a robust 0.7% quarter-on-quarter earlier this month, in-line with our expectations and just slightly down from the 0.9% quarter-on-quarter growth seen in Q2. A modest slowdown in growth was expected given the continued poor economic performance of the eurozone, the UK's key trading partner. Growth continued to be driven by services, particularly those related to leisure activities, communications and business/finance. Looking forward, expectations are for growth to slow slightly into Q4 given a variety of external headwinds. Nevertheless, the UK will continue to outpace the eurozone in its economic recovery. Headline CPI inflation came in unexpectedly weak at 1.2% year-over-year in September, down from 1.5% in August. Core CPI excluding energy, food, alcohol and tobacco was also down to 1.5% year-over-year, from 1.9% previously. While some softening in the data was expected due to lower petrol prices, the slowdown was larger than anticipated as a result of broad based weakness across sectors. We await confirmation of a continuation in this trend before changing our forecast given that some of the volatility was attributable to large moves in air and sea fares.

China:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	7.3%	–	7.0%	↓
Inflation	2.4%	–	2.5%	↓

Source: Standish as of November 4, 2014

Chinese authorities have continued to keep up a steady dose of accommodation through targeted monetary policies, while avoiding a broader, untargeted easing. This, alongside the firming of net exports, limits the risks to headline GDP growth this year. However, the scale of the easing, though supportive, will be insufficient for turning around China's growth prospects in 2015. In particular, the property sector, which is undergoing a multi-year adjustment, will continue weighing on the economic outlook. Moreover, although both credit and economic activity have decelerated, the growth of nominal credit continues to outpace that of nominal GDP, thereby underscoring the lengthy de-leveraging process which still lies ahead. Amidst this backdrop, the Chinese yuan (CNY) continues to appreciate gradually against the US dollar, as monthly trade surpluses have recently surprised on the upside. A firmer CNY has also been an important backstop for other Asian currencies, amid the strengthening value of the dollar. However, capital outflows and valuation losses on the People's Bank of China's (PBOC) foreign exchange reserves have been substantial. Although we don't expect the authorities' currency management policy to undergo an imminent shift, recent capital outflows have curtailed the pace of foreign exchange reserve accumulation. As increases in net foreign assets are a key component of the PBOC's base money creation, slower sales of foreign exchange to the central bank have prompted additional liquidity easing – such as the extension of 'standing facilities' to the country's larger banks, and ensuring ample interbank liquidity – so as to limit the risk of a broader credit crunch. Nonetheless, as China's 'basic balance' (current account + foreign direct investment) remains at a relatively healthy 3-4% of GDP, we doubt if capital account developments are likely to mount a large or imminent challenge to the policy framework.

ASEAN-5 Emerging Markets:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	4.9%	–	5.3%	↓
Inflation	4.4%	–	4.3%	↓

Source: Standish as of November 4, 2014

China's ongoing slowdown, sharply weaker commodity prices and idiosyncratic country developments are beginning to cloud the outlook for ASEAN-5 emerging markets—Indonesia, Malaysia, the Philippines, Thailand and Vietnam. Most ASEAN economies are increasingly reliant on Chinese demand for commodities and intermediate goods. We continue to think that the drag from weaker Chinese demand and lower prices of commodity exports will be offset, to some degree, by stronger G-3 demand in 2015. However, country specific growth risks are rising. For instance, despite the forthcoming implementation of a long-delayed fuel subsidy reform, Indonesia's parliamentary politics have turned for the worse. This could prove inimical to the broader outlook for supply-side reforms and the overall business outlook. Malaysia is expected to undertake tax reforms and tighten monetary policy in coming months. But the authorities have begun signaling a dilution of structural and policy adjustments amid rising concerns about a larger than expected adverse economic impact from falling commodity (export) prices. Even Thailand, widely expected to sustain a strong rebound, and benefit from falling commodity prices, has witnessed -at best- only an anaemic recovery, since the army-backed government took over. The feeble Thai recovery could reflect continuing doubts about political and policy stability, and growing leverage in the private sector. Meanwhile, activity remains reasonably healthy in the Philippines and in Vietnam, both of which should also gain from the drop in fuel and commodity prices. However, as these two economies account for only around 18% of the region's GDP, we see growing downside risks to the ASEAN-5 aggregate outlook for 2015.

South Korea:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	3.7%	–	3.8%	–
Inflation	1.6%	–	2.1%	↓

Source: Standish as of November 4, 2014

Low inflation, a slow cyclical recovery in domestic demand and weakening commodity prices induced the Bank of Korea (BoK) to cut its policy rate yet again by 0.25% to 2.0%, at its October meeting. The lagged impact of the BoK easing and the Korean government's recent supplementary budget should place a floor beneath growth risks in the remainder of this year and in 2015. However, inflation continues to ease and it is running well below the BoK's inflation target. Lower prices of oil imports are likely to intensify downward pressures on the headline inflation rate. Meanwhile, Korea's trade weighted exchange rate has become expensive and its export growth has remained sub-par relative to the rest of the region, fuelling the authorities' concern about growth risks from external channels should the Japanese yen or the euro weaken even further. This is likely to prolong the maintenance of a very accommodative policy stance, and it could heighten South Korean won volatility and weakness. Additional rate cuts, however, will have to take into account the systemic risks of high household debt, which continues to ease only slowly.

Latin America:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	1.6%	↓	2.9%	↑
Inflation	6.4%	–	5.7%	–

Source: Standish as of November 4, 2014

The re-election of Brazil's incumbent president, Dilma Rousseff, has removed a major source of uncertainty in that country. Her margin of victory was narrow, which seems to create confidence that she will introduce some reforms to the current economic model in order to improve business sentiment and stimulate private investment. Nonetheless, Brazil is unlikely to grow by more than 2% in 2015, following growth below 1% this year. Meanwhile, the ongoing recovery in the U.S. is helping to fuel a rebound in industrial production in Mexico, though we believe next year will still be relatively weak. Beyond that, structural reforms should begin to translate into faster growth. In other countries in the region, Colombia remains on track for growth close to potential, while base effects should help Peru accelerate next year to about twice the growth rate expected in 2014. Nonetheless, the overall theme of global sluggishness and soft commodity prices will remain a limitation to faster growth in most countries. While no recession is predicted at this point, it will prevent Latin American economies from returning to the average growth rate experienced over the last ten years.

Central and Eastern Europe (excluding Turkey):

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	2.2%	↓	2.8%	↓
Inflation	1.2%	↓	2.2%	–

Source: Standish as of November 4, 2014

While Poland surprised the market with a larger-than-expected 50 basis point (bp) reduction in the policy rate in October, a restarting of the easing cycle was expected before the end of 2014. A longer than anticipated period of deflation, increasing risks of a slowdown in growth related to both the eurozone manufacturing cycle and Russia, and the prospect of further easing by the ECB provided the National Bank of Poland with a suitable and justified opportunity to reduce the policy rate. We expect to see a further 25bps cut in November, though 50bps is also a possibility. However, that should mark the end of the brief easing cycle. Romania is also expected to reduce its key policy rate by another 25 bps prior to the end of 2014.

Russia and Commonwealth of Independent States:

Russia	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	0.0%	↓	0.5%	↓
Inflation	8.0%	↓	6.0%	↓

Source: Standish as of November 4, 2014

CIS	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	-0.4%	↓	0.6%	↓
Inflation	8.9%	–	6.1%	–

Source: Standish as of November 4, 2014

The situation between Russia and Ukraine has not changed materially over the last month, though an agreement on gas transit is reported to have been made with the help of the European Union. The ruble has been weak throughout the month, and the central bank had to resume intervention, spending almost \$27 billion and culminating in a rate hike of 150 bps on October 31st. While the weaker ruble will support exports and boost oil revenues in local currency, the sharp drop in oil prices and higher rates will have an impact on overall activity. Thus, GDP forecasts for both 2014 and 2015 have been scaled back and inflation will likely remain elevated over the coming months. With parliamentary elections completed on 26th October in Ukraine, the two main parties of the President and the Finance Minister are expected to form a coalition and continue reform implementation as per the IMF. However, the economic situation remains extremely weak given the ongoing impasse in the Donbas region. If oil prices remain at current levels, Kazakhstan will also see an impact on activity and fiscal accounts, and may push through another devaluation of the Kazakhstani tenge.

Turkey:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	3.0%	↓	4.0%	–
Inflation	9.0%	↓	6.3%	↓

Source: Standish as of November 4, 2014

Inflation expectations have declined thanks to lower food and oil prices. Nonetheless, inflationary pressures persist in 2015 and this will continue to complicate the policy mix. The government puts pressure on the central bank to cut interest rates in order to stimulate the economy, despite inflation remaining above the target. This, in turn, has removed an important support to the currency, which therefore feeds back on expectations. Growth, in the meantime, is suffering from weakness in the agricultural sector, despite better performance in industries. Geopolitical risk is another factor negatively influencing the outlook, as Middle East conflicts coincide with euro area weakness and pressures on Russia. Having said this, growth should be faster in 2015 than this year, as some of the imbalances in the external and fiscal side begin to improve and the negative influence of local politics fades.

South Africa:

	2014	Balance of Risks	2015	Balance of Risks
Real GDP Growth	1.4%	–	2.7%	–
Inflation	6.0%	↓	5.8%	–

Source: Standish as of November 4, 2014

Continuing the trend seen last month, the South African economy is showing signs of stabilization and, in some areas, outright improvement. PMI's are comfortably above 50 and various measures of confidence are trending gradually higher. In general, coincident data remains mixed with the manufacturing sector showing signs of improvement, but the mining sector continuing to underperform. The pace of economic activity will almost certainly accelerate over the coming quarters, though growth is unlikely to exceed potential on a sustained basis. Over the next six months, inflation will likely continue to moderate as falling fuel and food prices put downward pressure on the headline rate. High wage growth and administered price hikes will likely keep core CPI elevated. We believe that this will give new South African Reserve Bank Governor Lesetja Kgahnyago cover to leave rates on hold. Further tightening over the near term cannot be rule out, but given the fragility of the underlying economy and the projected decline in the headline inflation rate, we do not believe it is likely.

BNY Mellon Investment Management is one of the world's leading investment management organizations and one of the top U.S. wealth managers, encompassing BNY Mellon's affiliated investment management firms, wealth management organization and global distribution companies. BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may also be used as a generic term to reference the Corporation as a whole or its various subsidiaries generally. The information in this document is not intended to be investment advice, and it may be deemed a financial promotion in non-U.S. jurisdictions. Accordingly, where this document is used or distributed in any non-U.S. jurisdiction, the information provided is for Professional Clients only. This material is not for onward distribution to, or to be relied upon by, retail investors. Any statements and opinions expressed in this document are as of the date of the article, are subject to change as economic and market conditions dictate, and do not necessarily represent the views of BNY Mellon or any of its affiliates. The information contained in this document has been provided as a general market commentary only and does not constitute legal, tax, accounting, other professional counsel or investment advice, is not predictive of future performance, and should not be construed as an offer to sell or a solicitation to buy any security or make an offer where otherwise unlawful. The information has been provided without taking into account the investment objective, financial situation or needs of any particular person. BNY Mellon and its affiliates are not responsible for any subsequent investment advice given based on the information supplied. This document is not investment research or a research recommendation for regulatory purposes as it does not constitute substantive research or analysis. To the extent that these materials contain statements about future performance, such statements are forward looking and are subject to a number of risks and uncertainties. Information and opinions presented in this material have been obtained or derived from sources which BNY Mellon believed to be reliable, but BNY Mellon makes no representation to its accuracy and completeness. BNY Mellon accepts no liability for loss arising from use of this material. If nothing is indicated to the contrary, all figures are unaudited. Any indication of past performance is not a guide to future performance. The value of investments can fall as well as rise, so you may get back less than you originally invested. This document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country in which such distribution or use would be contrary to local law or regulation. This document may not be distributed or used for the purpose of offers or solicitations in any jurisdiction or in any circumstances in which such offers or solicitations are unlawful or not authorized, or where there would be, by virtue of such distribution, new or additional registration requirements. Persons into whose possession this document comes are required to inform themselves about and to observe any restrictions that apply to the distribution of this document in their jurisdiction. **The investment products and services mentioned here are not insured by the FDIC (or any other state or federal agency), are not deposits of or guaranteed by any bank, and may lose value.** This document should not be published in hard copy, electronic form, via the web or in any other medium accessible to the public, unless authorized by BNY Mellon Investment Management. Issuing entities This document is approved for Global distribution and is issued in the following jurisdictions by the named local entities or divisions: UK and in mainland Europe (excluding Germany): BNY Mellon EMEA, BNY Mellon Centre, 160 Queen Victoria Street, London EC4V 4LA. Registered in England No. 1118580. Authorised and regulated by the Financial Conduct Authority. • Germany: Meriten Investment Management GmbH which is regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht. • Dubai, United Arab Emirates: Dubai branch of The Bank of New York Mellon, which is regulated by the Dubai Financial Services Authority. This material is intended for Professional Clients only and no other person should act upon it. • Singapore: BNY Mellon Investment Management Singapore Pte. Limited Co. Reg. 201230427E. Regulated by the Monetary Authority of Singapore. • Hong Kong: BNY Mellon Investment Management Hong Kong Limited. Regulated by the Hong Kong Securities and Futures Commission. • Japan: BNY Mellon Asset Management Japan Limited. BNY Mellon Asset Management Japan Limited is a Financial Instruments Business Operator with license no 406 (Kinsho) at the Commissioner of Kanto Local Finance Bureau and is a Member of the Investment Trusts Association, Japan and Japan Securities Investment Advisers Association. • Australia: BNY Mellon Investment Management Australia Ltd (ABN 56 102 482 815, AFS License No. 227865). Authorized and regulated by the Australian Securities & Investments Commission. • United States: BNY Mellon Investment Management. • Canada: Securities are offered through BNY Mellon Asset Management Canada Ltd., registered as a Portfolio Manager and Exempt Market Dealer in all provinces and territories of Canada, and as an Investment Fund Manager and Commodity Trading Manager in Ontario. • Brazil: this document is issued by ARX Investimentos Ltda., Av. Borges de Medeiros, 633, 4th floor, Rio de Janeiro, RJ, Brazil, CEP 22430-041. Authorized and regulated by the Brazilian Securities and Exchange Commission (CVM).

The issuing entities above are BNY Mellon entities ultimately owned by The Bank of New York Mellon Corporation.

BNY Mellon Company information

BNY Mellon Cash Investment Strategies is a division of The Dreyfus Corporation. • BNY Mellon Western FMC, Insight Investment Management Limited and Meriten Investment Management GmbH do not offer services in the U.S. This presentation does not constitute an offer to sell, or a solicitation of an offer to purchase, any of the firms' services or funds to any U.S. investor, or where otherwise unlawful. • BNY Mellon Western Fund Management Company Limited is a joint venture between BNY Mellon (49%) and China based Western Securities Company Ltd. (51%). The firm does not offer services outside of the People's Republic of China. • BNY Mellon owns 90% of The Boston Company Asset Management, LLC and the remainder is owned by employees of the firm. • BNY Mellon owns a 19.9% minority interest in The Hamon Investment Group Pte Limited, the parent company of Blackfriars Asset Management Limited and Hamon Asian Advisors Limited both of which offer investment services in the U.S. • The Newton Group ("Newton") is comprised of the following affiliated companies: Newton Investment Management Limited, Newton Capital Management Limited (NCM Ltd), Newton Capital Management LLC (NCM LLC), Newton International Investment Management Limited and Newton Fund Managers (C.I.) Limited. NCM LLC personnel are supervised persons of NCM Ltd and NCM LLC does not provide investment advice, all of which is conducted by NCM Ltd. Only NCM LLC and NCM Ltd offer services in the U.S. • BNY Mellon owns a 20% interest in Siguler Guff & Company, LP and certain related entities (including Siguler Guff Advisers LLC). MIC003-13-11-2014 (1M). Issued as at October 2014. T1291 11/14.

本情報提供資料は、BNY メロン・グループ（BNY メロンを最終親会社とするグループの総称です）の資産運用会社が提供する情報について、BNY メロン・アセット・マネジメント・ジャパン株式会社が審査の上、掲載したものです。当資料は情報の提供を目的としたもので、勧誘を目的としたものではありません。当資料は信頼できると思われる情報に基づき作成されていますが、その正確性、完全性を保証するものではありません。ここに示された意見などは、作成時点での見解であり、事前の連絡無しに変更される事もあります。

BNY メロン・アセット・マネジメント・ジャパン株式会社
BNY Mellon Asset Management Japan Limited

金融商品取引業者：関東財務局長（金商）第 406 号
〔加入協会〕 一般社団法人 投資信託協会
一般社団法人 日本投資顧問業協会