Global Macro Views

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By: The Standish Global Macro Committee

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World:

	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	3.0%	–	3.2%	↓
Inflation	4.1%	–	4.0%	↓

Source: Standish as of January 5, 2016

Global growth is likely to advance in 2016 at a rate near current levels while continuing declines in commodity prices present downside risks to inflation outlooks. In the U.S., Europe, and Japan, ongoing accommodative monetary policies should support at or above potential rates of growth driven primarily by consumer demand in the services sector. However, recent tightening of financial conditions may pose downside risks to consumer behavior, particularly in the U.S. In China, the structural slowdown is expected to continue in 2016, weighed down by the slowdown in global manufacturing and trade, though we continue to believe that a hard landing in China will be avoided. Economies dependent on commodity exports will continue to face increasing pressure which poses risks for more widespread weakness in emerging markets with further price declines. Weakness in demand from emerging markets increases the downside risks for developed markets. Global inflation trends are expected to moderate somewhat, though we expect positive base effects to lead to higher average inflation in 2016.

Developed Markets:

United States	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	2.4%	↓	2.4%	–
Inflation	0.2%	–	1.7%	–

Source: Standish as of January 5, 2016

The latest revision to Q3 GDP showed real growth advancing at 2% for the quarter. Tracking estimates for Q4 are currently in the 1.0%-1.5% range. Personal consumption which has been the driver of U.S. growth has moderated somewhat in recent data, as households have demonstrated increased levels of savings perhaps in response to elevated concerns over global growth and financial market volatility that characterized late summer. Moving into 2016, consumption will likely continue to be supported by a strong labor market, energy savings and healthy household balance sheets. Net exports are likely to continue to be a modest drag, though the effects of the strong dollar in 2015 should begin to abate somewhat. Government spending which has been a drag on growth over the last several years should be a modest positive.

Headline inflation figures in the U.S. should be on the rise in the first quarter of 2016 on base effects from the late 2014 decline in commodity prices, though core measures are likely to show only modest increases. The most recent readings show core PCE prices expanding at a steady 1.3% while core CPI prices ticked up modestly to a 1.9% rise YoY. The increasing gap between CPI and PCE measures is largely driven by the larger weight of shelter related expenditures in the CPI based calculation as well as differences in the methodology for accounting for medical expenses.

↑ positive surprise more likely over next six months. ↓ negative surprise more likely over next six months – no bias
Inflation forecasts are yearly annual averages of headline CPI.

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We expect the Federal Reserve to continue their process of policy normalization by raising the target for Fed Funds by 0.75% in 2016 to 1.25% by year end which is somewhat higher than current market expectations. Continued above trend growth and a tightening labor market are likely to support the Fed's medium term forecasts for inflation rising to their target level though persistent uncertainty on growth globally will likely cause them to be a bit more cautious then their current projections for rate increases.

Euro Area	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	1.5%	—	1.7%	↑
Inflation	0.1%	—	0.9%	↓

Source: Standish as of January 5, 2016

December's main event was the market's disappointment with the European Central Bank (ECB). While the ECB did announce some easing in their monetary policy in their meeting on the 3rd December, they disappointed the market who were expecting more (given the extremely dovish communications which have built up since September). The ECB cut the deposit rate by 10bps to 0.3%, and while several changes were made to the QE purchases, only really the six month extension in the purchase timing (extended from September 2016 to March 2017, EUR360bn in extra purchases) was really material. The other changes include: a) buying of regional debt (mainly reduces the risk of bottlenecks in buying German assets, other countries less affected); b) reinvestment of maturities (as per other central banks QE programs); and c) continuation of LTRO. Draghi did maintain a dovish rhetoric in light of continued downside risks to inflation, although it now appears that the potential for further ECB easing is much lower – and will be closely tied to inflation prints. In the macroeconomic space, leading indicators continue to point to a 0.4% q/q Q4 GDP print for the Eurozone.

Japan	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	0.7%	—	1.2%	↓
Inflation	0.8%	—	1.1%	↓

Source: Standish as of January 5, 2016

Despite significant, and growing, risks to its growth and inflation forecasts, the Bank of Japan remains confident that growth will remain above potential and inflation will continue to trend towards its 2% goal. Given an extremely low potential growth rate and a shrinking labor force, 'above trend' is a low bar to clear and even our low growth forecasts should be sufficient to keep downward pressure on the unemployment rate and, hopefully, upward pressure on wages. There are, however, significant downside risks to our forecasts. The outlook for regional growth is weak and should non-Japan Asian currencies remain under-pressure, an appreciating trade-weighted yen could erode the profitability of the external sector and reduce domestic hiring and investment. On the upside, a material fiscal stimulus could push growth higher and push the unemployment rate down more rapidly. Assuming external risks do not materialize, it is not clear that the economic outlook warrants further monetary policy stimulus from the Bank of the Japan.

United Kingdom	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	2.3%	—	2.3%	—
Inflation	0.2%	—	1.3%	↓

Source: Standish as of January 5, 2016

As we move into 2016, we continue to expect the Bank of England (BoE) to raise rates in H1 2016 following the Fed's initial rate hike in December. We expect the BoE to signal a rate rise in their February 2016 quarterly inflation report, and then to proceed with an initial 25bps increase in the base rate in Q2 2016. While inflation continues to remain below target, we do expect significant increases in the headline rate in Q1 2016 as food and energy deflation pressures ease. November 2015 is expected to have marked a turning point in the inflation cycle in the UK. Labor market data also supports a normalization in monetary policy. While November's labor market data was mixed, it had several stands of underlying strength – with the data highlighting strong employment dynamics but also slight headwinds to further wage growth. Unemployment now stands at 5.2% – its lowest level since pre-crisis April 2008.

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Australia	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	2.2%	—	2.4%	↓
Inflation	1.5%	—	1.8%	↓

Source: Standish as of January 5, 2016

We believe that Australia will grow at a 2.4% pace in 2016, below estimated potential output of 2.75%. We will be keeping a close eye on the Q4 inflation print which is released at the end of January, as we feel that a significant enough downside disappointment could prompt the "glass half full" Reserve Bank of Australia to step up their easing bias. Momentum in core inflation slowed markedly in the second half of last year, and we see few new sources of inflation. Many, including ourselves, highly question the recent jumbo gains in the labor market, with much of the growth difference being attributed to measurement factors.

Emerging Markets:

Asia:

China	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	6.8%	—	6.2%	—
Inflation	1.9%	—	1.6%	↓

Source: Standish as of January 5, 2016

We expect full year real GDP growth to slow to 6.2% year-on-year this year, from 6.8% in 2015 and 7.3% in 2014, but the economy will avoid a hard landing. A gradually weakening of currency to around USDCNY 7.0 by the end of 2016 should provide more policy flexibility to sustain countercyclical support for the economy. Monetary easing and heightened local government spending (on infrastructure) is struggling to firm industrial activity, but services are holding up quite well. Excess capacity in the country's manufacturing and housing sectors, amid tepid external demand, will remain a drag on industrial and construction investment and, likely, sustain producer price deflation. The base effects of the large run up in the stock market, from a year ago, should also have a dampening effect on financial services and reported GDP growth in H1 '16.

Modest SOE reforms will likely be started in the year ahead. This is needed for cutting excess capacity and lowering structural headwinds to the effectiveness of ongoing policy easing. Real sector reforms – though, without weakening labor markets in a big way – are also needed to complement financial liberalization which has progressed faster; and thereby lower any further build-up of macro-financial risks. The inclusion of the CNY in the IMF's SDR basket could become the segue for modest SOE reforms, but is unlikely to prompt any large, near-term upturn in foreign portfolio capital inflows. As a result, onshore hedging and resident portfolio diversification will continue to exert balance of payments pressure. A shift in the currency regime to a "clean float" is not foreseen as yet, but gradual depreciation will ease monetary conditions and help cut producer price deflation.

South Korea	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	2.6%	—	2.8%	↓
Inflation	0.8%	—	1.4%	↓

Source: Standish as of January 5, 2016

We believe the Korean economy will struggle to pick-up from a sub-3% real GDP growth rate. The cyclical momentum of the last two quarters seems to be losing some momentum, highlighting the dominance of structural headwinds over countercyclical policy easing. Aging demographics and high household debt – though with improving rate and maturity structure – look set to limit domestic consumption. Meanwhile, the export sector's vulnerability to both Chinese demand and competitive pressure from the JPY and CNY seem certain to keep a lid on any sustained recovery in exports or investment. The authorities' efforts to 'recycle' Korea's current account surplus will take more time to weaken the Won. The authorities' hesitance to use fiscal policy more forcefully will keep up pressure on the central bank to maintain a stable-to-easing bias in monetary policy.

India	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	7.5%	—	7.6%	—
Inflation	5.6%	—	5.3%	—

Source: Standish as of January 5, 2016

We expect India's cyclical economic upturn will remain sluggish and weighed down by weak external demand, fractious domestic politics and limited policy space. Growth will remain stuck in a mid-7% range, though, with stable-to-gradually easing inflation. Contentious domestic politics has slowed reform legislation, postponed – though not

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derailed – GST implementation, and weighed on domestic sentiment. Public sector wage rigidities from a decennial wage revision process look set to weigh on both more productive fiscal spending as well as the overall level of the general government deficit. Banks' Nonperforming Loan (NPL) and capital adequacy pressures have limited lending appetite, curbed a larger corporate cap-ex pickup and generated a "credit-less" and sluggish growth recovery. However, better food stock management, low energy and commodity prices and improving inflation expectations, alongside ongoing efforts to improve the business environment and prospects for reform implementation – albeit with delays – should prompt gradual monetary easing.

Latin America:

Brazil	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	-3.5%	↓	-2.4%	↓
Inflation	10.8%	↑	6.5%	↑

Source: Standish as of January 5, 2016

Mexico	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	2.5%	↓	2.8%	↓
Inflation	2.8%	↓	3.2%	↓

Source: Standish as of January 5, 2016

The year 2015 ends with one of the worst economic performances in a while for Latin America, with a near recession at the aggregate level and the weakest growth among all economic regions. The growing disparity between capital formation – still around 20% of GDP – and domestic savings – at least 3% of GDP lower – also meant that current account and fiscal deficits widened to levels not seen since the crisis-prone 1990s. All this is happening in an environment of potentially tighter financing conditions if US policy rate normalization discourages investment flows and raises the cost of capital. The challenge for 2016 is therefore enormous, as poor growth may fail to attract capital, which in turn may extend the length of economic sluggishness and continue to put pressure on currencies and inflation. The global environment is not very supportive on that basis, with Chinese growth continuing its decelerating path, with a poor start of the year for the growth outlook in the developed world, and with commodity prices revisiting low levels last seen ten years ago. Among the bright points in the regional outlook, Argentina's new administration and its early achievements in regime change could present interesting opportunities as the country works its way back to the voluntary global capital markets. Also, economic policy remains largely predictable and orthodox, with notable exceptions in countries such as Venezuela – where low oil prices could portend a payments crisis this year – and Brazil. The latter will remain immersed into a political crisis which more than dominates any attempt to rectify the fiscal situation. In fact, Brazil and Venezuela will be the two major regional economies where another recession may take place this year. Mexico could present another investment opportunity if – finally – the US economy were to grow at a faster pace and bring economic activity in that country to higher levels. In general, the current outlook for 2016 suggests that the main macro indicators will repeat the figures recorded in 2015 and that much of a positive surprise in those regional countries with disciplined macro policy will still be dependent on an improvement in the global economic environment.

Central and Eastern Europe:

	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	3.4%	—	3.1%	↑
Inflation	-0.1%	—	1.0%	↑

Source: Standish as of January 5, 2016

All in all, Central and Eastern Europe looks rather robust as we head into 2016. We continue to expect growth to remain robust across the region, supported primarily by private consumption (which in Poland and Romania will be supported by fiscal loosening). While public investment will take a dip in 2016 as the new EU structural and cohesion funds take time to get disbursed, continued recovery in the Eurozone will continue to provide export opportunities. Inflation will begin to rise across the region, although is unlikely to reach central bank targets before the end of 2016. Monetary policy actions will continue to be led by the ECB, although the new Polish MPC will present an increased likelihood of an independent rate cut. Hungary will also continue to ease policy, albeit through unorthodox central bank measures. In the political space, political risk premium in Poland should decrease and Romania's technocrat government will continue until Parliamentary elections are held in Q4 2016.

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

Russia and Commonwealth of Independent States:

Russia	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	-3.8%	—	-0.3%	↓
Inflation	15.5%	—	7.5%	—

Source: Standish as of January 5, 2016

CIS	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	-3.5%	—	0.2%	↓
Inflation	15.4%	—	8.9%	↑

Source: Standish as of January 5, 2016

As we head into 2016, we expect that economic conditions will improve. While some were previously expecting a return to growth in 2016, this appears unlikely given the most recent declines in oil prices – which will require the government to engage in further fiscal consolidation measures than those already outlined. Domestic demand – both consumption and investment – will continue to drag on growth, only partially offset by stronger net exports. Moderating drag from deleveraging should support the recovery as we move through 2016, but fiscal policy will weigh on growth throughout the year. Inflation will decline as we move through 2016, as base effects related to the EU food import ban and RUB depreciation ease, providing the central bank with opportunities to loosen monetary policy further (albeit at a far slower rate). Finally, we believe Russia will continue to remain very sensitive to oil prices in 2016.

Turkey	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	3.2%	—	3.3%	↓
Inflation	8.0%	—	7.4%	↑

Source: Standish as of January 5, 2016

Turkey and its assets will likely continue to be volatile as we head into 2016. While economic data may be robust, we expect there will continue to be political headwinds (both internally and externally) which will continue to capture the headlines. The failure of the central bank to hike in December 2015, despite previously communicating they would, means that Turkey is not starting off 2016 in a particularly positive view of international investors.

Despite an almost year-long election cycle in 2015, growth has defied expectations and remained robust. We expect this to continue as we move into 2016, supported primarily by private consumption. Inflation will continue to remain above the central bank target. A change in central bank governor by April 2016 will also complicate matters, with the risk that President Erdogan chooses a non-market friendly governor. Fiscal finances will deteriorate slightly as the government engages in some mild fiscal loosening, although this is from a previously high quality base.

Political developments will likely be difficult. Internally, President Erdogan is likely to continue to engage in continued pursuit of a de-facto executive presidency, increasing control over the central bank as well as separatist rhetoric towards the Kurdish minority/PKK. Externally, tensions with Russia and other Middle East countries are likely to continue as long as the conflict in Syria is occurring. Turkey will also continue to play a pivotal role in reducing the flow of refugees/migrants from Syria to Western Europe.

South Africa	2015	Balance of Risks	2016	Balance of Risks
Real GDP Growth	1.5%	—	1.0%	—
Inflation	6.2%	—	6.0%	—

Source: Standish as of January 5, 2016

The outlook for the South African economy continues to deteriorate. Forward looking indicators of demand remain weak and point towards a further deceleration in growth in 2016. Unfortunately, due to second order effects of a weakening rand and spiking food prices, the South African Reserve Bank (SARB) will be forced to continue to adjust to monetary policy in a procyclical manner. Fiscal policy is more of a question mark. Following the dismissal of Finance Minister Nene, David van Rooyen's four day tenure in the position and the reappointment of former Finance Minister Pravin Gordon, the outlook for fiscal policy is highly uncertain. At the margin, we believe the appointment of Gordon, not to mention key regional elections scheduled for next year, will lead to less procyclical, or possibly even counter cyclical fiscal policy. While this might be a positive development in the near term, it would also certainly hasten South Africa's descent into sub-investment grade ratings. Aside from expansionary fiscal policy, we see little change of the South African economy accelerating in 2016 as the economy is only in the early stages of adjusting to 2015's terms of trade shock.

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Inflation forecasts are yearly annual averages of headline CPI.

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