



Global Economic Outlook

August 2016

Contents

- Global 2
- US 2
- Europe 3
- Japan 4
- Australasia 6
- Canada 6
- Emerging Markets 7
- Global Forecasts 11

Overview

Global Economy—Growth remains subdued. While inflation should pick up somewhat next year, central bank activity is likely to exert downward pressure on yields in the near term.

United States—Growth was slower than expected in 2Q, but was still supported by strong consumer demand. GDP revisions show that expansionary monetary policy has been successful at promoting private sector growth.

Europe—Recent data suggest that Brexit will have a material impact in the UK but limited spillover in the rest of Europe.

Japan—Fiscal and monetary easing fall short, while inflation risks are still tilted to the upside.

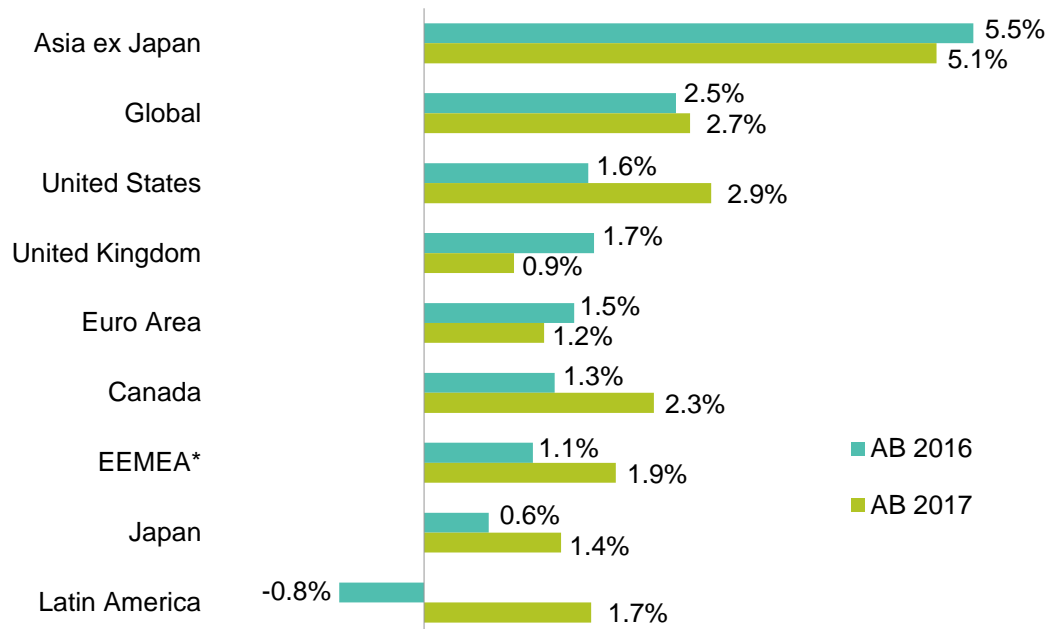
China—2Q growth holds up at 6.7%; industrial production and retail sales also suggest a stabilization of activities; but fixed-asset investment continues to slow.

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AB World Economic Growth Forecasts



As of August 1, 2016; calendar-year forecasts
Source: AB

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Global Outlook

Brexit largely a shock idiosyncratic to the UK

It's been just over a month since the UK decided to leave the European Union (EU) and the global economy seems largely unaffected. Yes, there has been a steep decline in some confidence surveys in Britain. It's also difficult to escape the conclusion that UK growth will slow sharply in the second half of the year, with the economy possibly even slipping into a mild recession. The Bank of England's relatively aggressive policy response—cutting rates and restarting QE—reflects those concerns. But, so far at least, the shock for the UK has been an idiosyncratic one. The purchasing managers' surveys and other sentiment data in Europe have barely budged. Risk assets are generally stronger than before the vote. With the Brexit having largely the effect we anticipated, we've made little change to our global growth and inflation forecasts. We still expect a modest global growth in 2017 of 2.7%, a tad above our 2.5% expected outcome for 2016.

Our conviction in Fed hikes in 2016 continues to wane

The exception, however, is global yields; they rallied strongly after the Brexit result and remain generally lower. In part, that's because central bank policy paths are responding to the rise in global political uncertainty. The Federal Reserve's assessment at its last policy meeting, for example, acknowledged that near-term risks had subsided. That's not surprising, given the Brexit aftermath and the bounce back in the labor market data. But policymakers also gave no indication that they would soon restart the normalization of interest rates. The weaker-than-expected second-quarter gross domestic product (GDP) outcome reinforced the Fed's reluctance on this score, as will uncertainty surrounding the upcoming presidential election. Even though we still think the case for higher rates in the US is strong, we are no longer convinced that we'll see a resumption of rate hikes in 2016. This is one of the reasons our global yield forecasts have been marked a little lower.

In Japan, the policy baton is passed from monetary to fiscal...

One other big factor over the past month has been the shift in the policy framework in Japan. While there was widespread disappointment in the lack of broad-based additional easing by the Bank of Japan (BoJ) in July, we're not so pessimistic. In our view, the shift confirms the notion that the QQE-NIRP policy is running out of runway and that fiscal policy is moving into the driver's seat when it comes to providing cyclical stimulus. We expect the central bank to play more of a supporting role. While Japan is not resorting to "helicopter money" in the narrow sense, it is sending the message that monetary policy and fiscal policy are becoming "joined at the hip."

...a shift we expect to see elsewhere

This shift toward a more active role for fiscal policy is something we expect to see repeated in other advanced economies over coming years. It's becoming increasingly clear that central banks are being asked to do too much and that the marginal gains from additional monetary policy stimulus are small. But monetary policy will still be needed to hold yields low while trying to generate a sustained pickup in inflation in order to aid the deleveraging process. This isn't a story for the next month or two, perhaps. But it's worth flagging as a risk as we roll into 2017.

US Outlook

2Q GDP growth slower than expected...

Real US GDP rose 1.2% on an annualized basis in the second quarter. That was just half the consensus estimate. The negative surprise was driven by an outright contraction in business inventories. According to initial estimates, business inventories contracted at an annualized rate of \$8.1 billion in the second quarter, after expanding by \$40 billion in the first three months of the year. The reduction in business inventories shaved 1.2 percentage points off the second-quarter growth rate.

There were other pockets of weakness as well. Business investment fell 3.2% annualized, as spending on structures (mainly oil rigs) and equipment decreased. Residential investment also declined 6.1%, though that reflected a “pulling forward” of construction activity that happened in the first quarter, thanks to mild weather. Defense spending also contracted again, this time by 3%.

...but consumers continue to spend

Consumers kept spending, though, and that kept the economy on a positive growth trajectory for the quarter. Real consumer spending advanced 4.2%, annualized, in the quarter, the largest quarterly expansion since the fourth quarter of 2014 and only the third quarter of the current expansion in which consumer spending topped 4%.

The strength in final consumer demand helped produce a 2.4% advance in real final sales. Reports of continued consumer spending gains in the third quarter and an expected normal pace of third-quarter inventory investment suggest that real GDP growth should be in the 2.5% to 3% range, if not higher.

Private sector has led growth for past five years

The GDP revisions for the past three years were relatively minor and did not alter the fundamental trends. The bigger story is the unprecedented gap in the private and public sector paths of growth. From 2010 to 2015, the nominal growth path of the private sector has averaged 4.6%. For the public sector, it has been less than 1%. In real terms, the private sector has posted an annual average gain of 3% while the public sector has contracted by 1.3% per year.

Positive results from unconventional monetary policy

The private sector growth trends are directly linked to monetary policy, and the nominal and real growth paths of the past six years indicate that aggressive policy easing has had some success. Yet, the overall growth rate in the real economy has been slowed by unprecedented fiscal drag.

Some may argue that the public sector can do only so much when it comes to lifting aggregate spending, especially given the amount that is being absorbed by transfer payments (social and pension benefits). That is true at the state government level. But federal spending is being dampened by the spending caps put in place by the budget sequestration process of 2013.

Both presidential candidates have focused on increasing spending on public infrastructure. But it isn't clear at this point whether they are targeting an increase in aggregate federal spending or a fundamental shift in the mix of spending. Until there is clarity on this issue, the burden of lifting aggregate growth will fall on monetary policy, and the benefits—if they exist at all—will be small.

Europe Outlook

Brexit impact appears idiosyncratic

Last month we downgraded our UK growth forecast in light of Britain's June 23 decision to leave the EU. We expected a material hit to UK growth, but only limited ramifications for the rest of Europe. So far, the data are panning out largely in line with this forecast. In the euro area, for example, there has been virtually no impact on business or consumer confidence. But in the UK, there have been some worrying drops. For example, the composite purchasing managers' index fell from 52.5 in June to 47.5 in July, the weakest reading since the first quarter of 2009 and the biggest monthly drop in the history of the series. While it is possible that this decline may be exaggerating the weakness of the economy, there is a clear risk that the UK is already flirting with recession.

Broad-based response from the Bank of England

In order to counter this risk, the Bank of England (BoE) announced a number of measures. Not only did it cut its policy rate to a record low of 0.25%, it also introduced a new Term Funding Scheme (aimed at offsetting the negative impact on bank margins from lower rates), increased its gilt purchases by £60 billion and launched a new £10 billion corporate bond purchase program. Moreover, the BoE stressed that it is ready to increase the amount of stimulus delivered through all four of these channels if necessary, and signaled the likelihood of an additional rate cut (probably to 0.10%) before year end.

Risks skewed to further easing

Beyond that, and assuming the economy develops broadly in line with our expectations (flattish growth in the second half of this year and a gradual recovery next year), we doubt there will be a pressing need for additional stimulus. Nonetheless, it's important to note that Brexit has led to a material change in the BoE's thinking and that the risks are heavily skewed in one direction. In other words, if incoming data show that the BoE overreacted, it is unlikely to reverse its actions. But if the data point to a deeper or more protracted slowdown than expected—or if the global economy stumbles—the BoE will not hesitate to ease policy further.

As to how any additional stimulus might be delivered, BoE Governor Mark Carney stressed that there was no role for negative interest rates in the UK, especially in light of the controversy they have caused in other jurisdictions. We have heard this type of claim before and are inclined to treat it with a pinch of salt. For the time being, though, it is clear that increased gilt purchases will be the preferred channel for delivering fresh monetary stimulus in the UK.

What about helicopter money?

In a press conference, Carney was asked about helicopter money. Although he called this a “flight of fancy,” it is a matter of fact that the BoE's actions will make it easier for the government to reverse course on fiscal policy later this year. Such a reversal has been well flagged ever since the Brexit referendum. And to the extent that it would not be possible without the fiscal space provided by the BoE, it can be thought of as a very mild form of helicopter money.

Could the government go further than this? In the short term, probably not; a watering down of the previous government's budget cuts, coupled with some measures to support investment, looks more likely than a Japan-style stimulus. But the political risk/reward attached to fiscal policy has changed post-referendum, and if the hit to the economy is deeper or more protracted than expected, it's worth noting that the UK's institutional setup is particularly well suited to enhanced fiscal/monetary-policy cooperation.

Japan Outlook

Fiscal plans met with disappointment...

After much anticipation, the two key policy events in Japan over the past month—Prime Minister Shinzō Abe's announcement of a “broad and bold” fiscal package and a policy meeting at the BoJ—turned out to be disappointments. In the Japanese government bond (JGB) market, yields spiked higher, while the yen strengthened and equities declined.

Were markets right to be disappointed? Certainly, expectations had been ramped up significantly ahead of the policy announcements. For example, around 80% of domestic economists were looking for the BoJ to ease further, with most anticipating something new along all three axes of the QQE-NIRP program: a further move of the overnight rate into negative territory; an expansion of the JGB purchase program; and additional risk asset purchases (equity ETFs or REITs).

Considering the expectations, it's no wonder investors were underwhelmed with what they got. A doubling of the ETF purchase program, yes. But no change to NIRP. No change to the JGB program. And not much change to the outlook.

It was a similar story on the fiscal front. Cabinet approval of a headline fiscal package exceeding ¥28 trillion, with substantial genuine fiscal stimulus, fell well short of what is required.

...but the big picture hasn't changed very much

To our way of thinking, though, there's a real risk of missing the forest for the trees. Despite this disappointment, the big picture hasn't really changed. The key elements are:

- (1) Monetary policy has run out of room to maneuver. The foray into NIRP has been ineffective and unpopular. There's limited scope to dramatically expand JGB purchases. And, after last week's move, there will not be a lot of appetite to increase the amount of equity risk on the BoJ's balance sheet. This is implicit in the BoJ's announcement that the current framework would be subject to a comprehensive review at the next monetary policy board meeting in September.
- (2) Accordingly, the central bank is passing the baton to the government, with fiscal policy expected to take the lead in generating stimulus. On the global stage, Abe has been pushing this hard all year, culminating in a green light after the G7 meeting at the end of May. He promised "bold and broad action," and now he wants to deliver on that. The upper house election result, which was framed, in part, as a referendum on the direction of Abenomics, provides a mandate to deliver on that promise. Abe considers a big fiscal expansion necessary to hit the inflation target and his ¥600 trillion GDP goal.
- (3) Fiscal policy and monetary policy are more closely intertwined. Despite speculation to the contrary, there is unlikely to be an explicit acknowledgement of so-called helicopter money. Certainly, nobody from the government or the BoJ is going to say to announce that the BoJ has decided to fund fiscal spending. But in effect, that's what's going on: fiscal expansion, facilitated by central bank purchases of bonds, with the aim of permanently increasing the money stock. That's the essence of helicopter money. As we've been arguing for a while now, monetary policy and fiscal policy are "joined at the hip." The BoJ acknowledged this need for cooperation—and the synergies it creates—in its statement.

Ultimately, we still think the scale and scope of fiscal stimulus, facilitated by central bank action, will be large enough to have a meaningful macroeconomic impact. If there's not enough juice in the package this year to make a difference, then expect more of the same next year---and so on, until it does make a difference. The commitment to fiscal consolidation (e.g., the primary balance surplus target in FY2020) is weak at best and is trumped by the need to boost the economy.

The object of all this is higher inflation. That would prove the success of Abenomics, help manage the process of public sector deleveraging and provide a positive economic backdrop for Japanese constitutional change. There's certainly no guarantee of success. But a number of boxes have been ticked: sizable fiscal expansion against the backdrop of a fully employed economy, with a compromised central bank involved in the process. That has to tilt the risks in favor of higher inflation. And that's not priced at all.

Australasia Outlook

RBA cuts policy rates, RBNZ to follow

The Reserve Bank of Australia (RBA) cut rates by another 25 b.p. at its August meeting, taking the cash rate down to 1.50%. There was not much forward guidance in the statement, and there was certainly no hint of another cut in to come.

Tame inflation data were a big reason for the rate cut. While the second-quarter inflation readings were not much different from expectations, headline inflation (1.0% year over year) and the suite of core numbers (around 1.5% year over year) are clearly running below the RBA's 2%–3% target band. The central bank expects this to persist, underpinned by “very subdued growth in labor costs and very low cost pressures elsewhere in the world.” There was also a nod to the uncertain state of the labor market (“somewhat mixed”) and the challenge of a stronger Australian dollar.

Importantly, the RBA said that macroprudential policy tightening, via supervisory efforts and a more “cautious” approach by lenders, is working and has given policymakers room to maneuver on short rates.

As an aside, this is similar to the Reserve Bank of New Zealand's (RBNZ) playbook. We expect to see a similar theme in the RBNZ's next policy review (August 11). We also expect to see a policy easing. Again, the implementation of more restrictive macroprudential measures will likely give the RBNZ room to cut.

What should we expect from the RBA from here? Probably no more action this year. Having eased monetary conditions a little in 2016, the RBA will probably watch and wait in the months ahead, especially with a new guy taking the reins in September (Deputy Governor Phil Lowe will replace retiring Governor Glenn Stevens). Further cuts are contingent upon how disorderly the housing adjustment becomes. We think there will be enough stress evident in that sector in 2017 to justify another couple of cuts. The evidence is building (no pun intended), but we're not quite there yet.

Canada Outlook

GDP weakness caused by wildfires

The impact of the Alberta wildfires has begun to appear in Canada's monthly GDP data. The May GDP report showed the largest monthly decline in economic activity since March 2009 (-0.6% month over month). The majority of this decline in output was concentrated in the oil sector, given the temporary shutdown of oil sands production facilities, but there was evidence of weakness in other sectors as well, including manufacturing. Although we still expect relatively slow economic growth for the remainder of the year, we should see a rebound in third-quarter output as the reconstruction efforts in Alberta begin and fiscal stimulus starts to have an effect.

Housing market overheated

Elsewhere, the Canadian housing market is heating up in select metropolitan areas. The home price index for the six major metro areas was up 11.1% year over year in June, and the latest resale price measure for the Greater Vancouver area, one of the largest hubs for foreign buyers, showed prices up 32% year over year in June. The Bank of Canada (BoC) expressed some muted concerns about rising home prices at its last monetary policy meeting. But weakness elsewhere in the economy is likely to keep the BoC dovish for now. The government, though, has implemented macroprudential measures aimed at slowing foreign purchases of properties in Vancouver. The measures include a new 15% property transfer tax, which only applies to foreign buyers.

The recent decline in oil prices led the Canadian dollar to peak at C\$1.322 per US dollar during July, its weakest level since late March. Following the US crude

inventory data this week, which showed lower inventory stocks, West Texas Intermediate rose above \$40 per barrel, which helped the Canadian dollar stabilize at C\$1.30. Given our expectation of continued weakness in the Canadian economy over the next six months, we have revised our exchange rate forecast to C\$1.375.

Emerging-Market Outlook

Latin America: Weekly inflows into emerging markets hit a record in July as low global interest rates and monetary stimulus boosted demand for assets. Meanwhile, regional central banks continued to focus on domestic developments and deviated from global monetary policy trends.

Brazil holds target rate steady

Brazil's monetary policy committee (Copom) left the target Selic interest rate unchanged at 14.25% in July during its first meeting with central bank President Ilan Goldfajn at the helm. Inflation expectations as per the central bank's weekly survey have fallen, but they remain well above the 4.5% medium-term target. The year-end expectation, which peaked at 7.6% in early February, is now at 7.2%, while the 12-month forward expectation has dropped from 7.2% in mid-November to 5.7% in July. Copom admitted that the ongoing contraction in economic activity should help dampen inflationary pressures, but also highlighted that current inflation at almost 9% year over year leaves no room to launch an aggressive easing cycle.

Goldfajn has been suggesting moderation when it comes to the outlook for immediate rate cuts, confounding some of the expectations for more aggressive easing that existed before he took office. By the end of May, the central bank's expectations survey called for 150 b.p of cuts to the Selic rate this year. Projections have since been cut to 100 b.p. Goldfajn's message has been that monetary policy will depend on fiscal progress. He has insisted on coordinating monetary and fiscal policy. Also, the government recently hinted at gradual fiscal improvements, which suggests that monetary easing may have to proceed more slowly.

President Michel Temer recently announced spending limits, but the policy has yet to be endorsed by congress, something that may not happen until year end. The market still thinks the policy rate will be lowered eventually, with expectations of a 11% rate by the end of 2017. But market participants have backed off on their forecast of a more front-loaded easing strategy. The central bank decision was a welcome development because it boosts its credibility and should allow for a better anchoring of inflation expectations down the road.

Mexico: The door remains open for more hikes

Minutes from the Bank of México's (Banxico) June 30 monetary policy meeting were hawkish. They revealed unanimous support for Banxico's surprise decision to hike the funding rate by 50 b.p. Although the minutes do not suggest that a hiking cycle has started, they do leave the door open for further hikes in the months to come, especially if currency volatility doesn't subside. The minutes suggest that the central bank is concerned about peso fluctuations complicating its efforts to manage inflation expectations. Headline inflation continues to behave well, and it remains below medium-term target levels, but core inflation has been edging up, and Banxico believes that peso weakness is at least partially responsible. Board members appear to be worried about possible nonlinear, surprise pass-through effects from depreciation to domestic prices. As such, they clearly prefer to act preemptively. In addition, the minutes mentioned the widening current account deficit and the stressed fiscal situation. We take this to mean that Banxico is more likely to hike again before year end than to stay on the sidelines.

Argentina: Slower rate cuts on the horizon

Having cut rates by nearly 800 b.p. in a period of two months, Argentina's central bank has taken its foot off the gas a bit. In July, it cut the yield on the 35-day Lebac, its peso-denominated debt instrument, by just 25 b.p. to 30%. The decision was made after June inflation data came in worse than expected, showing only a gradual deceleration. Private sector estimates and provincial indices show annual inflation in the upper 40% range. The City of Buenos Aires index showed inflation of 32.5% during the first six months of the year, already above the original 25% target for 2016. Although monthly and annual inflation rates are expected to moderate during the second half of the year, the figures will be well above official targets. The combination of above-target actual and expected inflation and a complex fiscal outlook following the extraordinary spending from pension fund changes suggests that the central bank's ability to continue easing at an aggressive pace in the future will be limited. We don't rule out more cuts to Lebac yields, but we'd expect them to be delivered at a slower pace.

Trade performance diverges

Asia ex Japan: Regional trade-related indicators still show uneven manufacturing activity across Asia. New export orders in key electronics exporters Taiwan and Korea improved again in July, building on a rebound in June. In China, the official and Caixin PMI surveys and their export orders components point in opposite directions. This implies divergence in performance between private and state-owned sectors (which include heavy industries). As we have argued previously, certain groups of exporters benefit from the new generation of Apple smartphones and have seen better performance. We saw a similar trend two years ago, but the impact of such concentrated orders tends to last for only a few months. Beyond electronics and telecommunication equipment, trade performance remains very sluggish.

Moreover, the actual trade data fall short of the improvement indicated in recent PMI surveys. In particular, Korea's exports relapsed, posting a double-digit year-over-year decline. Both motor vehicle and electronics exports deteriorated. China's June export growth did not improve at all, not even in the electronics sector. As such, we have yet to see signs that the export slump is near an end.

More regional central banks turn dovish

More central banks are turning dovish in the face of uncertain external developments, including Brexit. This is true even for those who have been conservative in the past. Bank Negara Malaysia surprised the market by cutting the policy rate by 25 b.p. in its first meeting under a new governor. Worsening downside risk was the main reason the bank cited for the move.

The Bank of Thailand kept rates on hold for the tenth straight meeting, though it sounded dovish in its policy statement when it expressed concerns about increasing downside risks and a stronger Baht. The bank fears currency strength may not benefit the economy and could delay inflation from rising toward the bank's target band. Such a dovish assessment makes the market think the bank may ease policy again. Overall, we expect most regional central banks, except for those in India and the Philippines, to ease in the second half of 2016.

China's 2Q growth holds up, but investment weakens

China's GDP grew 6.7% year over year in the second quarter, matching the prior quarter's rate, with a modest recovery in retail sales and industrial production. However, fixed asset investment (FAI) fell 9% year over year, year to date. Property investment fell to 6.1% from 7%. This moderation suggests sequentially fixed investments had decelerated more noticeably. Housing and infrastructure have long been two pillars of support to the economy, and a rollover of housing investment remains a risk. Meanwhile, private sector FAI fell 2.8% year over year, year to date, which affirms private investment demand remains soft.

**Seasonal surge
in new loan
growth**

Meanwhile, new loan growth accelerated in June to CN¥1.3 trillion from CN¥937 billion in May. However, this follows the seasonal pattern of the past few years that sees more loans made in June. Year-to-date new loan growth continues to moderate after the large expansion in the first quarter. Loan growth has been driven by households, the lagging effect of an acceleration in property sales in the prior months, and long-term corporate loans, which could be driven by the state-owned enterprise and infrastructure sectors. Private demand remains weak. As in the past few months, the banking channel dominated total credit expansion and shadow credit growth remained subdued. Entrusted loans, trust loans and bank acceptance bills recovered a bit compared to May, but were in line with prior months. The takeaway: not much change in domestic monetary conditions.

**Turkey's
political risks
contained, but
downgrade to
junk possible**

Emerging Europe, Middle East and Africa: Turkey's failed coup and its political and economic ramifications will dominate Central and Eastern Europe, Middle East and Africa (CEEMEA) events in the short run. We believe that near-term risks to Turkey's domestic political stability remain relatively contained, although deteriorating checks and balances and institutional quality could cause the country to lose its investment-grade credit rating. The Justice and Development Party's (AKP's) strong base of popular support has been instrumental in foiling the coup attempt and constitutes the backbone that is preventing any serious challenge to central government stability. The focus has been on how the AKP's response to the coup and the purge of security personnel (which subsequently extended to other parts of state institutions) would impact the political landscape and social stability.

**Cross-party
unity stronger
after coup...**

Only a little more than two weeks have passed since the attempted coup, and cross-party unity between the ruling AKP and the main opposition parties (especially the Republican People's Party [CHP] and National Movement Party [MHP]) appears to have reached its strongest point in years. The government withdrew the lawsuits it had filed against opposition leaders, including those that deal with personal insults against President Recep Tayyip Erdoğan. More importantly, both the MHP and CHP accepted an invitation to a first-time cross-party meeting at the presidential palace. They agreed to revive efforts to work collectively on small-scale constitutional changes that would make Erdoğan's long-sought executive presidency (EP)—or at least, a light version of it—a reality. The talks are significant because their collapse last year elevated concerns that Erdoğan might attempt a third parliamentary election to get sufficient seats to push through an EP unilaterally.

**...in part driven
by necessity...**

For sure, this sudden unity in part reflects calculated behavior: the AKP is seeking alliances at a time when it is struggling to understand the extent to which the coup plotters have infiltrated state institutions beyond the army. The MHP and CHP, possibly afraid of persecution after the recent purges, are trying to find common ground with the AKP. Exhibiting renewed commitment to the EP and constitutional changes reduces the risk of parliamentary elections, which poses greater risks for smaller parties such as the MHP, as well as the Peoples' Democratic Party (HDP). Both could fall below the 10% threshold and face parliamentary "extinction."

**...but also
possibly by a
common
purpose**

Even so, this new cooperation is not only a marriage of convenience. First, up to this point, all opposition parties—even those like the HDP, which had been excluded from cross-party talks due to alleged links to Kurdish nationalists—have vehemently denounced the coup attempt and have engaged in their own anti-coup demonstrations. This may be due to Turkey's painful past of coup d'états. Second, the cooperation may also reflect broader popular political sentiment. There is undoubtedly resentment against the AKP and Erdoğan's policies in certain quarters, but so far we have not seen a collective turn against the government. The latest flow

data showed that in the week following the coup, households sold a record amount of forex (FX) deposits during a period of FX weakness. While anecdotal, this suggests that households are not panicking. There are, of course, concerns about how long current stability can last, and much will depend on government action. A call for early elections would be negative. When it comes to foreign relations, Turkey's assertive demand for the US to extradite Fethullah Gülen have raised concerns that the failed coup will translate into an international incident, although our base case is that the Turkey-US dispute on this matter will remain in the diplomatic realm.

Structural reform concerns a key reason for a downgrade

Politics aside, the Turkish government will struggle to avert a downgrade to junk status, especially by Moody's. This is mainly because there is a gap between what the rating agency expects the government to do over the coming months and what the authorities are likely to deliver. Aside from growth and external financing concerns, Moody's expects a reversal of recent measures (recent purges, media clampdown and the SE) that raise questions about institutional checks and balances. With regards to structural reforms, Moody's emphasized that it wants concrete details about how Turkey intends to keep its structural reform program on track. Moody's has been underwhelmed by the reform process so far this year.

More importantly, the government's ability to focus on improving education and efficiency following the suspension of thousands of teachers and academics and the closure of hundreds of schools and universities is highly questionable. The government presented new initiatives to demonstrate its reform commitment. Yet some of its proposals, such as an infrastructure fund and state investment fund, lacked credible details (especially with regard to funding sources).

Tourism decline to hurt growth...

On the macro front, a sharp decline in tourism year to date is likely to shine through most clearly in the growth numbers over the coming quarters (though it's having only a small aggregate balance-of-payments effect at this stage). Improving relations with Russia may help tourism somewhat (abstaining Russian tourists have accounted for a huge decline in overall numbers), but the impact of recent declines will be felt with a lag on the economy regardless.

...but the central bank nears the end of its easing cycle

Following the recent rebound in headline inflation, we believe that the Central Bank of the Republic of Turkey (CBRT) will have no space to cut the overnight lending rate over the coming months, and may also delay the normalization process until the fourth quarter. The CBRT may yet attempt a further cut in the overnight lending rate by 25 b.p.–50 b.p., if necessary. But we still expect a token 25 b.p. hike in the one-week repo rate later in the year, which is even more likely given the latest inflation numbers. With inflation challenges unlikely to disappear in the first half of 2017, we maintain our view of additional 50 b.p. hikes in the (new) policy rate. We believe the CBRT would consider emergency rate hikes, like the ones made in 2011 and 2014, if real effective exchange rate depreciation becomes more pronounced.

Domestic uncertainties will come to the forefront

Frontier Markets: The African election season begins August 11 with elections in Zambia. We expect these elections to set the tone for other close races this year, namely in Ghana this December. Countries that rely on commodities for export earnings have turned to the International Monetary Fund (IMF) in the midst of a collapse of hard commodities like copper or oil. However, unless the IMF has a willing partner in the shape of a reformist government, it will have very little impact on reversing Africa's slowing growth and the recession in the continent's largest economy, Nigeria. In the case of Nigeria, it isn't an election but an about-turn toward orthodox policies that will likely create the turnaround. As in the developed world, frontier economies are struggling against populist rhetoric that risks adding more uncertainty to an already uncertain global environment.

	Real Growth (%)				Inflation (%)				Official Rates ¹ (%)		Long Rates ¹ (%)	
	4Q/4Q		Calendar		4Q/4Q		Calendar		EOP	EOP	EOP	EOP
	2016F	2017F	2016F	2017F	2016F	2017F	2016F	2017F	2016F	2017F	2016F	2017F
Global	2.5	2.8	2.5	2.7	2.2	2.6	2.1	2.6	2.28	2.13	2.69	2.92
(PPP Weighted)	(3.0)	(3.4)	(3.0)	(3.0)	(2.6)	(3.0)	(3.0)	(3.1)				
Industrial Countries	1.7	2.0	1.5	2.0	1.4	1.9	0.9	2.0	0.26	0.61	1.04	1.57
Emerging Countries	3.7	4.2	3.5	3.9	3.5	3.7	3.7	3.7	4.63	4.34	5.02	5.09
United States	2.2	2.9	1.6	2.9	2.0	2.6	1.4	2.7	0.63	1.50	1.90	2.65
Canada	2.1	2.0	1.3	2.3	2.0	2.5	1.7	2.3	0.50	0.75	1.60	2.50
Europe	1.4	1.4	1.6	1.2	1.1	1.5	0.5	1.5	-0.12	-0.11	0.34	0.67
Euro Area	1.4	1.3	1.5	1.2	0.9	1.2	0.3	1.3	-0.15	-0.15	0.15	0.50
United Kingdom	1.1	1.4	1.7	0.9	1.6	2.4	0.8	2.3	0.00	0.00	1.00	1.25
Sweden	3.0	2.5	3.7	2.7	1.9	2.1	1.6	2.0	-0.50	-0.25	0.50	0.75
Norway	1.2	1.6	0.8	1.5	3.1	2.2	3.4	2.3	0.50	0.50	1.25	1.50
Japan	1.3	1.5	0.6	1.4	0.3	1.1	0.3	0.9	-0.25	-0.25	-0.10	0.25
Australia	2.0	1.6	2.6	1.6	1.1	1.5	1.1	1.6	1.50	1.00	2.05	2.50
New Zealand	1.8	2.4	2.4	2.0	0.6	1.6	0.6	1.4	2.00	2.00	2.45	2.75
Asia ex Japan	5.3	5.2	5.5	5.1	2.3	2.9	2.4	2.8	2.65	2.53	3.19	3.25
China ²	6.0	5.6	6.2	5.6	2.0	2.5	2.2	2.5	2.20	2.00	2.70	2.50
Hong Kong ³	1.7	2.2	1.3	2.0	2.9	3.2	2.9	3.2	0.75	1.50	0.95	1.34
India ⁴	6.8	6.9	7.2	6.9	5.3	5.8	5.6	5.8	6.50	6.50	7.10	7.80
Indonesia ⁵	5.2	5.3	5.1	5.3	3.6	5.1	3.6	4.7	4.75	4.75	6.60	6.75
Korea ⁶	2.2	2.0	2.4	2.1	0.9	1.5	1.0	1.3	0.75	0.75	1.00	1.20
Thailand ⁷	2.7	3.1	3.0	2.8	0.9	1.5	0.4	1.3	1.00	1.00	1.80	1.90
Latin America ⁸	0.0	2.3	-0.8	1.7	5.5	5.1	6.2	5.3	9.55	8.95	9.44	9.37
Argentina	0.8	3.4	-0.3	2.3	27.0	16.0	28.0	19.0				
Brazil	-1.8	1.8	-3.5	0.9	7.0	6.6	8.3	6.8	13.50	12.00	12.20	11.80
Chile	2.5	2.9	2.3	2.8	3.6	3.2	4.3	3.7	3.50	4.00	4.80	5.10
Colombia	2.9	3.2	2.8	3.1	6.5	4.2	7.2	5.3	7.75	7.75	7.80	8.10
Mexico	2.5	2.9	2.5	2.8	3.0	3.2	2.8	3.1	4.75	5.25	6.20	6.50
EEMEA	1.4	2.3	1.1	1.9	6.5	5.3	6.2	5.9	7.50	6.83	7.84	8.14
Hungary	2.3	2.3	2.3	2.2	1.9	1.9	1.1	2.2	0.90	1.00	3.10	3.40
Poland	3.7	3.4	3.6	3.4	0.6	2.0	0.0	1.8	1.50	1.75	3.05	3.30
Russia	0.2	1.8	-0.4	1.2	7.5	5.5	7.6	6.5	9.50	8.00	8.50	8.90
South Africa	0.5	1.7	0.5	1.2	7.2	5.9	6.4	6.2	7.25	7.00	9.10	9.40
Turkey	3.0	3.1	3.2	3.0	8.4	7.3	7.9	7.5	7.75	8.25	9.70	9.80

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: AB

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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