



Global Economic Outlook

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United States—The US economy should grow 3.2%, thanks to strength in the consumer and housing markets.

Europe—Recovery should continue, but growth likely won't be strong enough to generate a sustained increase in core inflation, making more policy easing likely.

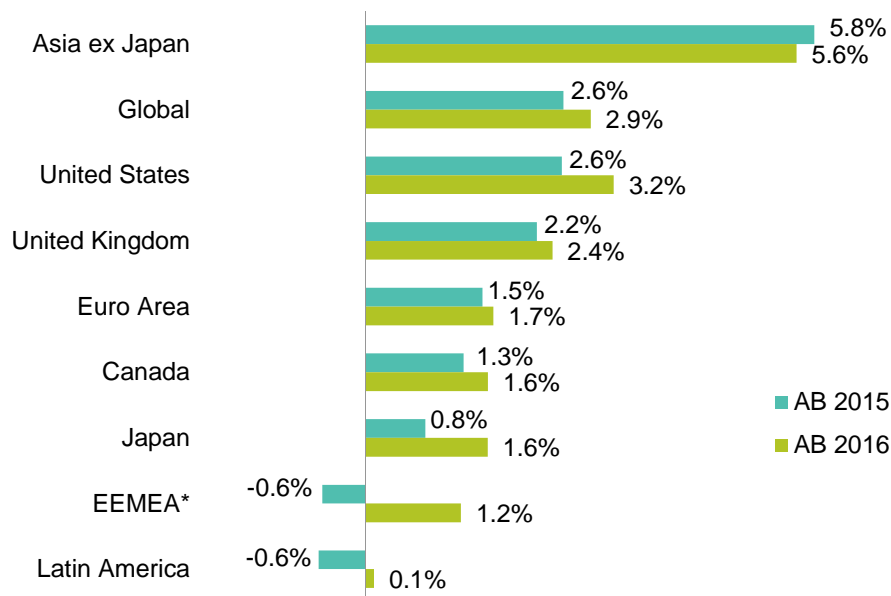
Japan—There are three critical things to watch in 2016: wages, politics and a turn in BoJ policy.

China—Challenges remain, but economic rebalancing is under way.

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AB World Economic Growth Forecasts



As of January 5, 2016; calendar-year forecasts
 *Emerging Europe, Middle East and Africa
 Source: AB

Global Outlook

Global growth remains moderate

We expect the global economy to grow by 2.9% in 2016, marginally higher than our 2015 estimate of 2.6%. Overall growth conditions are moderate. The risks are probably evenly balanced in the developed economies, but skewed toward weaker-than-expected performance for many developing ones.

Sluggish export markets and weak commodity prices are dominant macro factors as 2016 begins. This can be seen most clearly in the performance of the emerging-market (EM) economies. Central banks in many EM countries may have to ease monetary policy to support the domestic economy or to spur further currency weakness and realignment.

Worries on China

At the top of the list is the People's Bank of China. China's ongoing transition from an investment- and export-dominated economy to one that relies more on consumption and services has been more disruptive than many expected. A change in the currency regime that would involve pegging the yuan renminbi to a basket of currencies instead of to the US dollar looks like a way to support the domestic economy and boost exporters' competitiveness. But we still see the need for a series of monetary easing steps in 2016 as well.

Developed economies decoupling

EM policy decisions will have big implications for the global economy and could influence the decisions of many developed-market central banks. For now, though, the economic news and trends in the developed economies, especially the US and Europe, remain positive, and we still expect the Federal Reserve to raise official interest rates gradually in 2016.

US Outlook

US growth performance in 2015 was spurred by consumer spending and housing

The US economy turned in a mixed performance in 2015. Overall economic growth is likely to be in the 2.25%-to-2.5% range, with stronger consumer and housing markets accounting for most of the growth. Real consumer spending is estimated to have increased 3.1%, the best gain in a decade. A near-record year for motor vehicle sales (17.3 million units) drove consumer spending. Consumers spent their energy savings on new vehicles, travel, and eating and drinking.

Investment in the housing market was a large contributor to overall growth as well. Spending on new housing and remodeling rose 9%, and housing starts jumped to their highest level since 2007. Strong employment growth (2.6 million jobs) and a sharp jump in household formation helped spur these strong gains.

Business investment, meanwhile, was held back by a substantial cutback in energy capital expenditures. New spending on nonresidential structures declined 1% as spending on mining and oil rigs plunged. Business spending on durable equipment and software (excluding purchases of new vehicles) posted a small gain, as investment in machinery used in the energy sector declined as well. Foreign demand was a weak spot in 2015 given the strength in the US currency and uneven growth in many major trading partners.

In 2016, we expect continued gains in consumer spending and housing to drive real gross domestic product (GDP) growth of 3.2%. The drag from the energy sector should fade over the course of the year, and government spending should post its largest increase in the current recovery, given the increase in discretionary defense and nondefense spending.

We expect headline inflation to increase to about 2%. This is dependent largely on a modest rebound in energy prices. We see the federal funds rate ending 2016 at 1.5%.

Europe Outlook

Solid end to 2015

December survey data suggest that the euro-area economy ended 2015 on firm footing. Shaking off weakness in France (partly related to the November terrorist attacks), the composite Purchasing Managers' Index (PMI) matched its high for the year, while the broadly based economic sentiment indicator (ESI) reached its highest level since April 2011. Indeed, the services component of the ESI was at its highest since October 2007, testifying to the domestic nature of the recovery.

Recovery likely to continue

With help from low oil prices and an increasingly supportive monetary/fiscal policy mix, we expect the recovery to continue. Indeed, our latest forecast (1.7%) is for growth to be a little higher in 2016 than it was last year (1.5%). There are arguments for stronger growth than this, especially with fiscal policy turning more overtly expansionary across the region. But the recovery continues to face important headwinds, not least in the form of weak EM growth. Until the external backdrop improves, it's difficult to see a material acceleration in the pace of euro-area growth.

Unlike the economy, inflation ended 2015 on a soft note, with the headline rate unchanged at 0.2%. There are two main reasons for this. First, renewed weakness in the oil price means that energy prices continue to exert significant downward pressure on inflation (knocking 0.6 percentage points off the headline rate in December). Second, while the economy is recovering, growth is clearly not yet strong enough to generate sustained upward pressure on core inflation.

For the European Central Bank (ECB), weak headline and core inflation are equally problematic. That's because the headline rate has been below 0.5% for 18 months now; the longer it stays there, the more worried the ECB will become about a possible "unanchoring" of inflation expectations. And in order for the ECB to feel confident that headline inflation is moving back to target and likely to stay there—a key condition for ending its quantitative easing program—there needs to be a decisive pickup in core inflation.

Core inflation likely to remain soft, leading to more monetary easing

Unless the oil price continues to fall, base effects should push headline inflation higher over the coming year. But with the recovery eating only slowly into spare capacity and global price pressures weak, lifting core inflation won't be easy—especially with the temporary boost from euro weakness starting to fade and service-price inflation anchored at historical lows. Barring an unexpectedly strong pickup in growth or another sharp drop in the euro, we therefore expect core inflation to remain close to 1.0% for much of 2016. And given the ECB's well-voiced concerns about persistently low inflation, this is likely to lead to more monetary easing, helping anchor Bund yields and providing further support for peripheral bond markets. This should also give a downside bias to the euro, though the bulk of the currency's move may now be over.

External growth risks, domestic political risks

Our base case for 2016 is therefore for the economy to continue to recover—but not enough to generate a sustained increase in core inflation. We think the ECB will respond to this by easing policy further. As usual, there are a number of risks that need to be closely monitored. Perhaps the most important of these is the possibility that economic and financial developments in emerging markets could deteriorate further, leading to weaker-than-expected euro-area growth. Domestically, the main

risks are political. While no major elections are scheduled this year, political fragmentation is now a fact of life in most euro-area countries and is causing governance problems in Spain, Portugal and Greece. Added to this is a likely referendum on the UK's membership in the European Union and a possible repeat of last year's migrant/refugee crisis.

Japan Outlook

As we roll into the first half of 2016, we think there are three things worth watching in Japan.

Three critical things to watch in 2016: wages, politics, and a turn in BoJ policy

First, on the data front, a few areas remain critical. Will we see a revival in domestic capital spending? Will consumer price inflation—particularly the BoJ's new core measure—continue to drift higher? And, most important in the near term, what will be the outcome of the annual wage bargaining round (Shunto) in the first quarter? These factors will shape perceptions about the path the economy is on.

Second, there's politics. After a year of no national elections in 2015, domestic politics come back onto the agenda, with an election for the Upper House of the Diet to be held by July. There's some talk that Prime Minister Shinzo Abe might also dissolve the Lower House and shoot for a double election (although he was keen to dismiss that prospect in his New Year speech).

In any case, this means we shouldn't expect anything too controversial on the policy front in the first half of the year. Yes, there'll be a bit more fiscal stimulus (on top of the already announced Supplementary Budget). And Abe will continue to pivot the agenda away from the old Three Arrows campaign and toward the new priorities. Implicit in that pivot is a need to declare that Japan has “exited deflation.”

That declaration will have some implications for BoJ policy, the third thing to watch in 2016. In this context, the decision to tweak the QQE program in December was telling. The main action of the policy “adjustment” (the BoJ governor was keen to avoid calling it additional “easing”) was to lengthen the duration of the Japanese government bond (JGB) purchase program and underpin the bull flattening of the JGB curve over the last few weeks.

But the more substantive implication for the next six months is that the declaration will narrow the range of potential outcomes. It makes it more likely that the BoJ will continue with the current program rather than decide to ease policy aggressively or to taper. However, this is mostly an issue of timing. We still expect the debate over “what's next” for BoJ policy to heat up by the second half of the year. The discussion could favor tapering, but we're also seeing more discussion of the prospect of interest-rate targeting (e.g., capping the level of 30-year JGB yields). That uncertainty should increase JGB volatility and will probably strengthen the yen.

Australasia Outlook

Focus of downside risks in Australia swing to housing

In both Australia and New Zealand, many of the themes that were prominent in 2015 look likely to remain in play in 2016. How much more of a drag will the commodity price downturn be? What's the end game for overextended housing markets? And how much of a pick-up is occurring outside those two sectors?

New Zealand is in a better position to navigate those challenges. In Australia, the risk of a disorderly adjustment in the country's property market looks set to dominate the debate over the next six months. House prices were already softening as 2015 ended, and the leading indicators of construction activity seem to have rolled over.

In turn, the greater downside risks for Australia leave us somewhat gloomier on the prospects for the Australian currency. While our base case is for no policy change from either of the antipodean central banks, the Reserve Bank of Australia is more likely to ease than the Reserve Bank of New Zealand.

Canada Outlook

Disappointing economic data in September and October support our view that the Canadian rebound in the third quarter is not sustainable. We revised our fourth-quarter real GDP growth forecast down to 1.6%, annualized, from 2.2%. The energy and manufacturing sectors remain weak, with low commodity prices hurting manufacturers' competitiveness. Consumer debt remains high as well.

We think real GDP growth in 2016 will be slightly better than it was last year (1.6% vs. 1.3%), but it still depends on the price of oil and the US recovery. The economy is starting to adjust to its terms-of-trade shock, thanks to the US recovery, a weaker Canadian dollar and monetary policy easing.

We still expect the Bank of Canada (BoC) to leave the overnight rate at 0.50%, though risks have been skewed toward further easing in 2016 since BoC Governor Stephen Poloz mentioned the possibility of zero interest rates. Still, with the currency depreciating further, we think the BoC will wait to act. We expect the Canadian dollar to trade in a range of C\$1.40 to C\$1.45 per US dollar over the next several months and the federal government to provide some fiscal stimulus before the year is out.

Emerging-Market Outlook

Latin America: This year's election calendar is light (just Peru and the Dominican Republic have presidential votes scheduled). Still, we expect political developments to dominate economic policy design and execution.

In Brazil, inflation exceeds 10%, even though the economy contracted more than expected last year. The central bank left the door open to further interest-rate hikes when it acknowledged that it wouldn't get inflation back down to its target levels until 2018. Whether it will be possible, politically, to raise rates during a deep recession remains to be seen. President Dilma Rousseff recently replaced Finance Minister Joaquim Levy with Planning Minister Nelson Barbosa. Levy's standing in the administration had weakened after Brazil lost its investment-grade status and the economy fell into a deep recession. Levy's plans to streamline public spending never materialized in full because of political gridlock in Congress. Revenues suffered because of the economic contraction.

Barbosa reportedly prefers to tighten fiscal policy more slowly to prevent hurting economic activity even more. He settled for a 0.5% primary fiscal surplus projection for 2016, compared to Levy's 0.7%. But since GDP will likely shrink again in 2016, it's not clear Barbosa can make good on his surplus projection. We expect a smaller primary result this year—close to zero or even slightly negative. Sovereign debt ratios are likely to deteriorate further, and Brazil could suffer at least one more

4Q real growth
will disappoint

BoC to remain
on hold and
CAD to weaken

Brazil: Stuck
in a bad
equilibrium

downgrade early in 2016. Meanwhile, the threat of presidential impeachment hasn't disappeared; the investigation into alleged bribes involving state oil company Petrobras is ongoing. If these political uncertainties persist, business and consumer confidence probably won't recover, making it hard to overcome the slump in activity.

**Argentina:
Macri starts on
a high note**

In Argentina, the new government of President Mauricio Macri didn't waste time implementing deep economic changes, including the elimination of currency market restrictions. The bold political move paid off, as the exchange rate didn't overshoot as Macri's opponents said it would. The government has also increased interest rates and rekindled negotiations with foreign creditors via the special mediator designated by US courts. It has also moved toward overhauling the statistical office, Indec.

These market-friendly decisions have boosted investor spirits, although the administration still faces important challenges, including the risk of high pass-through from the depreciation to domestic prices, the lack of access to international financing and a majority opposition in the Senate that will make carrying out reforms more difficult.

**Venezuela:
Government
and opposition
in collision
course**

In Venezuela, the opposition won a significant victory in December's midterm elections, reaching a controlling majority for the first time in 16 years. The Chavista government, however, has made it clear that it is willing to defy the opposition majority by appointing several new Supreme Court judges before the inauguration of the new parliament. President Nicolas Maduro reshuffled his cabinet, appointing a new radical finance minister, suggesting he has no intention to implement much-needed market reforms. At this point, it looks as though political volatility could get worse in the months ahead. In addition, the government may have trouble servicing its debt with oil prices as low as they are.

**Low inflation
will ensure more
policy easing**

Asia ex Japan: The growth outlook will remain challenging as a result of sluggish foreign and domestic demand. The only bright spot is that weaker commodity prices should keep inflation under control. Food inflation has remained quite well behaved as well despite worries about potential El Niño effects. Against this backdrop, most Asian central banks will retain room to ease monetary policy, including those in China, Taiwan, Indonesia, Thailand and South Korea.

Worries about growth mean there's also room for more expansionary fiscal policy. This is especially true in China. The government there may be more willing to accelerate public projects to offset weakness in export demand. Indonesia and Malaysia may be the exceptions here, as fiscal discipline will still be needed to restore policy credibility.

**RMB under
pressure but
new currency
basket key to
RMB outlook**

The People's Bank of China (PBC) changed its foreign exchange policy after the yuan RMB's admission to the SDR currency basket in late November. Recent trends suggest the central bank will peg the yuan more closely to a basket of currencies and allow more volatility in the exchange rate. This may lead to more RMB weakness in the near term, as the move has added to capital outflows. We expect the authority will still try to maintain a stable currency basket, so the direction of the US dollar will be a crucial factor in assessing the RMB outlook in the coming year.

**China's
economic
rebalancing
underway**

Domestically, the Chinese economy is undergoing a steady structural rebalancing aimed at making it more of a consumption-led and services-driven economy. While the "old economy" of heavy and low-value-added manufacturing has continued to decelerate, services-sector growth—especially in e-commerce and financial services—has continued to progress. That's why we think it's unlikely that Beijing will find itself under too much pressure to go for a "big bang"—type policy stimulation to

rescue growth. Instead, we expect authorities to continue reducing the reserve requirement ratio and interest rates at a measured pace. We also expect them to embrace a slightly more expansionary fiscal policy in 2016.

Lower oil prices positive for CEE growth but lower inflation a potential challenge

Emerging Europe, Middle East and Africa: The accelerated decline in oil prices since the end of 2015 will continue to accentuate near-term divergences in growth, inflation and monetary policy across the region. Real activity in Central & Eastern Europe (CEE), especially in the Czech Republic, Hungary, Poland and Romania, will benefit from lower commodity prices and steady eurozone growth. Most CEE central banks will struggle to meet their inflation targets against even lower energy prices, which should increase the scope of further monetary policy easing and support for growth. Lower inflation does, however, pose a risk to public finances. Countries such as Poland may be forced to revise the overoptimistic inflation assumptions in their latest budget projections, which may lead to potential upward revisions in fiscal deficit forecasts for 2016.

Russia expected to maintain policy prudence...

Elsewhere, Russian real activity will struggle as a result of the renewed decline in oil prices, leaving the risks to our 2016 growth forecast somewhat skewed to the downside. This is partly because Russian policymakers are likely to maintain a prudent approach in the face of lower oil prices, which will not support growth in the short run. We believe the finance ministry will amend public expenditure projections to ensure that the fiscal deficit will remain close to 3% of GDP in 2016. In this context, the possible return of former Finance Minister Alexei Kudrin would bode well for policy credibility. The central bank will probably still ease monetary policy in 2016, but it is likely to proceed with caution in the first quarter, given recent ruble depreciation and ongoing elevated inflation expectations.

...while Turkey and South Africa will struggle with monetary and fiscal policy credibility

Turkey and South Africa will remain in focus this year, especially when it comes to policy credibility. The former undoubtedly benefits from lower commodity prices and greater political stability. Yet confidence has been undermined again by the Turkish central bank's (CBRT's) refusal to begin its promised normalization process. Its attempts to obscure its own forward guidance by focusing explicitly on short-term market volatility have also unnerved investors. With domestic inflation rising, Turkey needs tighter monetary policy, although it seems the CBRT is prepared to risk falling further behind the curve amid intensifying political pressures. In South Africa, monetary policy credibility remains strong, although the sudden dismissal of Finance Minister Nhlanelo Nene in December caused a severe blow to confidence in fiscal public finances. The reappointment of Pravin Gordhan should help to restore credibility, although South Africa's weak growth dynamics (driven, in part, by tighter monetary policy) will pose a challenge to the fiscal trajectory and South Africa's investment-grade status.

Middle Eastern fiscal adjustments and Saudi/Iran relations remain key themes

In the Middle East, public finances and Saudi-Iranian relations will remain in the spotlight, along with lower oil prices. Saudi Arabia remains one of the countries in the region most vulnerable to the mostly self-inflicted decline in oil prices, given the ongoing large fiscal outlays since the 2011 Arab Spring. Yet the Saudi government's recent announcement of more far-reaching fiscal reforms indicates that it is preparing more seriously for a long period of low oil prices. The kingdom's strategy to suppress oil prices is also aimed at depriving Iran of oil revenues once sanctions are lifted. The execution of Sheikh Nimr al-Nimr and the cessation of diplomatic relations with Iran represent another step in the growing rivalry between the two countries and worsening Sunni-Shiite polarization.

The commodity rout has required countries to devalue currencies, maintain tight monetary policies, and pass amended 2016 budgets

Frontier Markets: A number of African commodity exporters have begun to preemptively take action to offset low prices and weak consensus forecasts. In Angola, the central bank decided to devalue the local currency by 15% at the beginning of the year. That follows two other devaluations since oil began its descent. The bank also continued raising its policy rate to combat rising inflation, and it maintains tight control of its FX market, which has helped to preserve substantial reserves. Calls for Nigeria to follow suit and devalue its currency have grown louder, and the black market exchange rate suggests the currency should be 30% weaker. So far the administration has resisted a one-off devaluation, but we expect devaluation in the coming months. The 2016 budget calls for an increase in spending to boost growth and infrastructure development. The government will likely have to tap external sources of capital to do that, and it makes more sense to wait until after a currency devaluation. The administration recently decided to scrap fuel subsidies, marking a reversal by President Muhammadu Buhari. So we believe a similar understanding will come with regard to currency management. Countries across the sub-Saharan region have begun to pass addenda to their 2016 budgets that call for increased expenditure cuts. But with infrastructure gaps being a primary concern for future growth, the International Monetary Fund has suggested a greater push for structural reforms, specifically ones focused on expanding the tax base and combating tax evasion (especially in the economy's gray areas).

	Real Growth (%)				Inflation (%)				Official Rates ¹ (%)		Long Rates ¹ (%)	
	4Q/4Q		Calendar		4Q/4Q		Calendar		EOP	EOP	EOP	EOP
	2015E	2016F	2015E	2016F	2015E	2016F	2015E	2016F	2015E	2016F	2015E	2016F
Global	2.5	3.1	2.6	2.9	1.7	2.5	1.6	2.2	1.99	2.22	3.06	3.31
(PPP Weighted)	(2.9)	(3.6)	(3.0)	(3.4)	(2.3)	(3.0)	(2.3)	(2.6)				
Industrial Countries	2.0	2.4	1.9	2.4	0.4	2.0	0.3	1.5	0.31	0.80	1.50	1.91
Emerging Countries	3.3	4.2	3.6	3.9	4.0	3.3	3.9	3.4	4.90	4.71	5.83	5.81
United States	2.5	3.3	2.6	3.2	0.5	2.9	0.1	2.3	0.38	1.50	2.27	2.90
Canada	0.7	1.8	1.3	1.6	1.4	2.5	1.1	2.1	0.50	0.50	1.39	1.95
Europe	1.8	1.9	1.7	1.8	0.2	1.4	0.1	0.9	0.13	0.21	0.94	1.13
Euro Area	1.6	1.8	1.5	1.7	0.2	1.3	0.0	0.9	0.05	0.05	0.68	0.85
United Kingdom	2.1	2.5	2.2	2.4	0.1	1.4	0.0	1.0	0.50	1.00	2.02	2.25
Sweden	3.1	2.7	3.2	2.8	0.2	1.8	0.0	1.3	-0.35	-0.35	0.97	1.25
Norway	1.2	1.8	1.4	1.5	2.1	2.2	2.1	2.3	0.75	0.50	1.52	1.75
Japan	1.8	1.6	0.8	1.6	0.2	1.2	0.8	0.7	0.07	0.10	0.27	0.75
Australia	2.6	1.9	2.3	2.1	1.8	2.0	1.5	2.0	2.00	2.00	2.88	3.00
New Zealand	1.2	1.3	2.2	1.2	1.0	1.7	0.5	1.6	2.50	2.50	3.58	3.50
Asia ex Japan	5.5	5.8	5.8	5.6	1.9	2.0	1.9	1.9	3.06	2.70	3.70	3.55
China ²	6.5	6.4	6.8	6.3	1.6	1.4	1.4	1.6	2.41	2.00	2.93	2.75
Hong Kong ³	2.0	2.8	2.4	2.3	2.2	2.1	3.0	1.9	0.75	1.25	1.59	1.55
India ⁴	6.8	6.9	6.8	7.0	4.1	5.4	4.6	4.7	6.75	6.50	7.76	7.90
Indonesia ⁵	4.6	5.4	4.7	4.9	4.8	3.9	6.4	3.4	7.50	6.50	8.79	7.60
Korea ⁶	2.3	3.0	2.4	2.6	1.1	0.9	0.7	0.8	1.50	1.25	2.09	2.00
Thailand ⁷	2.2	3.2	2.7	2.9	-0.9	1.6	-0.9	0.8	1.50	1.00	2.55	2.70
Latin America⁸	-1.1	1.0	-0.6	0.1	7.2	5.7	6.5	6.1	9.26	9.71	11.73	11.77
Argentina	1.0	1.3	1.5	1.2	20.0	23.0	21.0	30.0				
Brazil	-4.8	-1.0	-3.6	-2.6	10.7	7.9	9.3	8.4	14.25	14.50	16.46	16.25
Chile	3.0	3.8	2.5	3.4	4.4	3.2	4.3	3.7	3.50	4.00	4.60	5.00
Colombia	2.9	3.0	2.9	3.0	6.4	4.0	5.0	5.1	5.75	6.25	8.31	8.75
Mexico	2.4	3.7	2.5	3.2	2.3	3.2	2.7	3.1	3.25	4.00	6.25	6.50
EEMEA	-0.5	1.7	-0.6	1.2	9.7	6.3	9.8	6.7	8.03	7.82	8.38	8.90
Hungary	2.6	2.4	2.9	2.7	2.0	2.6	0.2	2.2	1.35	1.35	3.33	3.75
Poland	3.6	3.6	3.4	3.7	0.4	1.7	-0.7	1.1	1.50	1.50	2.95	3.20
Russia	-3.6	0.8	-3.9	-0.3	14.5	7.5	15.5	8.3	11.00	9.00	9.54	10.00
South Africa	0.6	1.2	1.3	1.0	5.0	6.3	4.7	6.2	6.25	7.25	9.74	9.70
Turkey	2.8	2.5	3.1	3.0	8.2	7.4	7.7	7.9	7.50	10.75	9.70	10.80

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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