Global Economic Outlook

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Overview

Global Economy—Three issues dominate the short-term outlook: the Fed's rate hike plans, Greece's future in the euro and a Chinese slowdown.

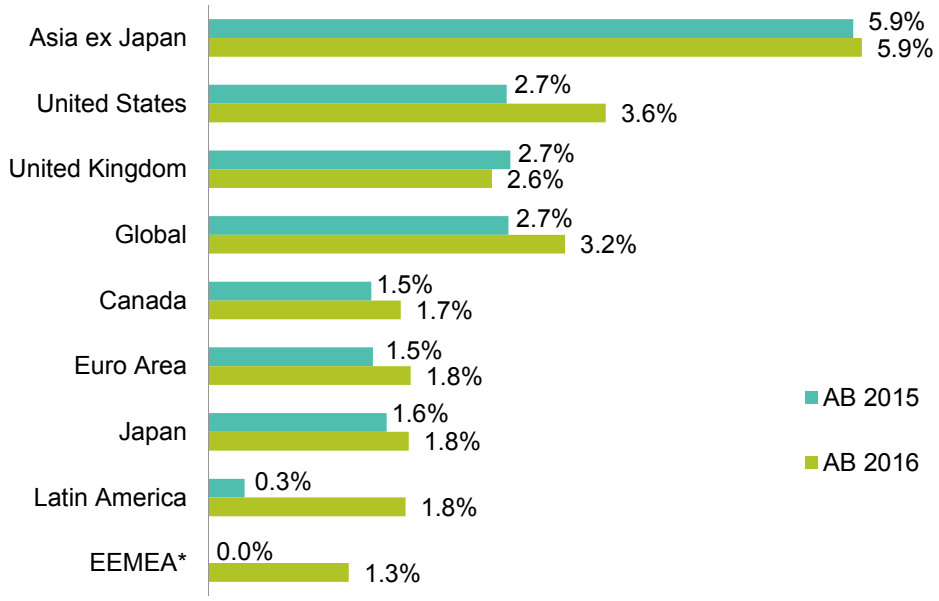
United States—US growth is rebounding and a September rate hike remains on the table.

Europe—The probability of Greece leaving the euro is rising. This would be a big step into the unknown, but we think the impact on other countries can be contained.

Japan—Bank of Japan easing expectations fade as tapering speculation starts.

China— Stock market selloff forces central bank to act.

AB World Economic Growth Forecasts



As of July 1, 2015; calendar-year forecasts
*Emerging Europe, Middle East and Africa
Source: AB

Global Outlook

Global growth outlook faces three issues

The global economy continues to expand at a moderate pace and our growth forecast of 2.7% for 2015 is unchanged from last month. A modest acceleration to 3.2% is expected for 2016.

World financial markets have been grappling with three big issues over the past few months: the timing of an initial rate hike by the US Federal Reserve; the discussion surrounding Greece and whether or not the country will stay in the euro area; and the slowdown in China and the policy accommodation that is likely to follow.

FOMC plans for interest-rate lift-off

The Fed has been laying the groundwork for a midyear rate hike since the March Federal Open Market Committee (FOMC) meeting at which policymakers removed "patience" from the official statement. Unexpected weakness in the economy in 1Q, driven in part by bad weather and a ports strike on the West Coast, compelled the Fed to delay the initial hike. We still think the economy's growth trajectory, strengthening labor markets and a modest increase in core inflation will force the Fed to raise official rates in September.

Europe and Greece negotiations

In Europe, negotiations between Greece and its official creditors reached a critical phase after Greek citizens rejected measures required to unlock fresh bailout funding. The gap between Greece and its creditors may already be too big to bridge, especially in the short time frame required to avoid a July 20 default on the European Central Bank (ECB). We think the probability of a Greek exit is rising rapidly. Our base case is that any spillover to other countries would be contained. Even so, a Greek exit would be a big step into the unknown with unpredictable consequences.

China slowdown and financial-market volatility

Slower growth and recent financial-market volatility have forced China's central bank to cut lending rates and reserve requirements again. So far, the Bank of China has lowered lending rates by 115 basis points and reserve requirements by 150 basis points since the start of the year. We expect lending rates to be reduced by another 25 to 50 basis points and reserve requirements by 100 to 150 basis points before year-end. The continued relaxation of monetary policy is consistent with a normalization of growth to around 6.6% for 2015 and 6.5% in 2016.

US Outlook

US on track for nearly 3% growth in 2015

We still see real GDP growth near the 3% mark for 2015 even after a weak start to the year. The 0.2% annualized decline in 1Q real GDP looks to us like a one-time event, driven in part by bad weather and disruptions to commerce due to the ports strike on the West Coast. Subsequent revisions to core data, such as construction spending, already suggest that the first-quarter decline will prove to be a mirage that may dissipate entirely when the benchmark revisions are released later this month.

The pace of economic growth looks to have accelerated broadly in 2Q. At this writing, we put the 2Q annualized advance in the 3%–4% range, with a number of key cyclical sectors driving the acceleration.

Stronger consumer…

Real consumer spending looks lkely to be in the 3%–3.5% range, with exceptionally strong gains in big-ticket durable goods (led by vehicle sales). Real construction spending looks likely to post one of its strongest quarterly gains in the cycle. Based on the April and May data, nominal construction spending is running at more than 17% annualized in the period.

…and construction markets

To date, the manufacturing sector has been lagging, due to the lagged effects of cutbacks in the energy sector and external trade, which may be linked to recent US-dollar strength. However, the June manufacturing survey from the Institute for Supply Management suggests that the industrial sector will soon contribute more to the overall growth. The composite index reading of 53.5 for June was the highest since January, and readings on new orders and employment were the highest levels of the year, suggesting a strong second half.

September rate hike still on the table

Fed policymakers have had the luxury of waiting to see if the 1Q GDP weakness was a one-time event or something more systemic. We think a broad array of data—including retail sales, home sales, and manufacturing and service industry surveys—makes it fairly clear the economy is operating with a full head of steam and the window to start normalizing monetary policy has arrived. We expect liftoff at the September FOMC meeting.

Europe Outlook

Recovery firmly on track

As we approach the midpoint of the year, the euro-area recovery remains firmly on track. That's certainly the message from key survey data like the composite Purchasing Managers' Index, which rose to 54.2 in June from 53.6 in May. That's the best reading since May 2011 and is consistent with economic growth of about 0.4% a quarter (similar to the first-quarter reading). Consumer confidence has fared less well, falling in May and in June. However, the decline has been modest and the latest reading is still well above the long-term average for this series. This is a resilient performance—particularly given the deteriorating situation in Greece and the resultant stream of negative headlines.

The recovery has, of course, benefited from several important tailwinds, notably a lower oil price that has given a significant, if temporary, boost to real-income and consumer spending growth. Underlying all this, though, has been a slow but steady improvement in money and credit dynamics. It's vital that this continues if the recovery is to be sustained once temporary tailwinds start to fade.

Improved money and credit dynamics

Until recently, the improvement in money and credit dynamics in the euro area was most visible in rapid money-supply growth—narrow money, M1, is currently growing at an annual rate of 11.3%—and declining bank-lending rates in the periphery. Now, it's beginning to show up in bank lending, currently growing at its fastest pace since the beginning of the credit crunch in 2011. To put this in perspective, net new lending to euro-area households and firms rose to €61.2 billion in the first five months of this year compared with a contraction of €20.8 billion in the same period last year.

A closer look at the data shows that the improvement in bank lending is being driven by loans to households—up €46.2 billion in the first five months of the year compared with a €15.0 billion increase in loans to nonfinancial companies (NFCs). At first glance, the relative weakness of NFC lending might seem disappointing. However, there are two important caveats.

Strong corporate bond issuance…

First, it's not unusual for household lending to lead NFC lending during the recovery phase of the business cycle. Second, the bank-lending data understate the overall strength of credit provision to NFCs. That's because issuance of debt securities (corporate bonds) by euro-area NFCs has been very strong in recent months. In the first four months of the year (May data are not yet available), net corporate bond issuance in the euro area rose to €38.2 billion. As a result, overall borrowing by NFCs—bank lending plus net bond issuance—grew at its fastest pace since 2011.

…boosts overall credit growth

This also means that total credit supplied to households and firms is growing more quickly than bank lending alone indicates. Including debt securities, overall borrowing by euro-area households and firms rose by €87.8 billion in the first four months of the year. This compares with a contraction of €0.6 billion a year ago and has lifted the annual growth rate to 1.3% from a low of (0.5)% in March 2014. The strength of the recent upturn is even more apparent in the three-month annualized growth rate, now running at 2.9%, the highest since February 2011.

These growth rates are still well below precrisis levels (average credit growth between 2004 and 2007 was 8.1% in the euro area). Nonetheless, the recent recovery does suggest that easy money and measures to support bank lending are starting to bear fruit, which augurs well for the sustainability of the recovery. And to the extent that past deflationary episodes have often been associated with weak money and credit dynamics, it also suggests that deflation risks in the euro area are starting to recede.

Greek risks continue to rise

On the political front, negotiations between Greece and its official creditors have reached a critical phase following a referendum in which Greek citizens rejected measures required to unlock fresh bailout funding. There is a clear risk that the gap between the two sides is now too big to bridge, especially in the short time frame required to avoid defaulting on the ECB on July 20. As a result, we think the probability of a Greek exit is now rising rapidly. And while our base case is that the impact on other countries would be contained, this would also represent a step into uncharted waters with unpredictable consequences.

Japan Outlook

Expectations of further BoJ easing have cooled…

Since the Bank of Japan (BoJ) expanded its quantitative/qualitative easing program last October, the central bank has been growing its balance sheet to the tune of ¥80 trillion a year, largely through the purchase of Japanese government bonds (JGBs). Its balance sheet is now equivalent to 70% of GDP, and the BoJ owns one-quarter of the stock of JGBs outstanding. If the current program were to be continued through the end of 2016, those figures would come close to 100% and 40%, respectively. Those are huge numbers by any measure.

Is such a status quo scenario the most likely outcome? Probably. But it's worthwhile considering a range of scenarios, including (1) further easing, (2) status quo, (3) technical tapering and (4) tapering as a form of tightening.

For most of this year, the debate has centered on (1) and (2). Would the BoJ be compelled to respond to signs of falling inflation, which is in part driven by energy prices, by expanding the program further? Or would the BoJ tough it out, arguing that there were sufficient signs of progress elsewhere (in wages, for example) to back the view that things were still on track? We've been in the latter camp, and that's roughly where market consensus has now converged.

But in recent months, there has been a bit more chatter about the possibility of tapering, or a reduction in the pace of the asset purchases. In large part, that has been driven by technical considerations—concerns that the BoJ may not be able to continue implementing the current program. Over the past two years, the amount of JGBs outstanding has increased by ¥76 trillion, but the BoJ has increased its holdings by ¥130 trillion. The purchases have been accommodated by a sell-down by banks, pension funds and other domestic holders.

…but could tapering actually start in early 2016?

As we look toward the end of this year and into 2016, however, it becomes more difficult to see how this stacks up. Net issuance is slowing as the government's budget position improves. The public pension system will have largely accomplished its stated asset reallocation from JGBs to equities and other riskier assets. And there's a limit to how much further banks can reduce their JGB holdings. It could be increasingly difficult for the BoJ to find willing sellers.

Under this scenario, the central bank faces a communication quandary. Is it better to try to implement the current program and risk a series of failed JGB-purchasing *rinban* operations? Or does it make more sense to reduce the size of the program and argue that it's not really a tightening but merely a technical adjustment? Both options are challenging and difficult to telegraph to the market.

That brings us to our fourth scenario: tapering as the beginning of a tightening process. This is an easier communication exercise, as it amounts to aligning a policy change with macroeconomic success. The preconditions for that scenario are not yet in place, but they could be by the time we roll into 2016.

Three elements would need to come together: clear signs that the economy is still growing at an above-trend pace and that this is forcing a change in pricing behavior; some realignment or reinterpretation of the inflation target; and more credibility put around the government's fiscal consolidation plan.

A tapering-as-tightening scenario is far from a done deal. The odds on the BoJ maintaining the status quo for the next 12 months are probably still close to 50%. But the probability of the fourth scenario is rising and now likely exceeds the odds of a further easing.

Australasia Outlook

Housing has been a bright spot…

Amid all the commodity-related gloom, the housing sector has been the one bright spot in the Australian growth story. While much of the attention has been focused on the sharp rise in house prices, particularly in Sydney, there has been a sizable upswing in construction activity, too.

In 2011 and 2012, before capital spending in the mining sector started to peak, total housing starts were running at around 150,000 units per year. In 2014, construction of close to 200,000 new dwellings was commenced. And that looks set to be surpassed in 2015—perhaps reaching as high as 225,000 units, based on the run rate implied by building approvals data.

As a result, dwelling construction has added half a percentage point to GDP growth over the past year, offsetting part of the one-percentage-point drag from weaker business investment. In turn, that's helped to cushion the employment impact of the mining capex bust. Construction jobs are up 7% from the end of 2012 despite the 20% fall in nonresidential construction.

But our suspicion is that this might be as good as it gets for housing. A 40%-plus increase in the number of dwelling starts represents a meaningful swing in the supply picture for housing, particularly since this is occurring against the backdrop of slowing population growth, reflecting a sharp slowing in net immigration.

…but supply/demand balance is shifting…

This swing in the supply/demand balance is already starting to have an impact on pricing. Growth in average rents, for example, has slowed sharply. Nationwide, rental growth has slowed from mid-to-high single digits in 2008 and 2009 to just 2% now. House price growth outside Sydney has slowed sharply, too. Price growth in Perth and Brisbane, two cities at the heart of the mining boom-and-bust saga, is now negative.

It's not necessarily the case that the endgame here is a housing collapse and carnage, as it was in the US, Spain and Ireland. That seems too alarmist, particularly as the price boom and the construction upswing have not been accompanied by rampant growth in credit.

Still, it's almost inevitable, in our view, that we end up with some sharp falls in housing construction activity from the middle of next year (with some fallout on employment). And this may accompany a prolonged period of flat or lower home prices. In turn, that will ramp up pressure on households to do a bit more deleveraging—and put more international focus on risks in the Australian banking system.

…providing reasons to remain gloomy

In short, even as some of the negativity surrounding commodities starts to fade, there are still plenty of reasons to be gloomy about Australia's growth prospects over the next couple of years.

Canada Outlook

Real GDP continues to disappoint

Canadian real GDP fell again in April, to (0.1)%, its fourth consecutive monthly decline. The Bank of Canada (BoC) warned of underperformance in the beginning of the year, predicting that the impact from the oil-price shock would be felt more quickly than expected. However, the recent data suggest the impact of that shock will be bigger than the BoC initially assumed. If growth doesn't recover, additional easing or a weaker currency could become a reality. But given high consumer-debt levels, we think the BoC will hold off on cutting the policy rate for fear that doing so would encourage even more debt use.

The BoC is counting on a stronger US economy to help the export sector. The poor competitiveness of Canada's manufacturing sector has weakened the trade linkage—one of the fundamental reasons we expect a weaker Canadian dollar.

BoC remain on hold for now

The economic contraction in April shows that the weakness in 1Q is spilling over into 2Q. The goods sector was the biggest drag on growth, contracting 0.8%. While a contraction in the mining and oil and gas sectors, which was (2.6)%, was expected, the struggle in the construction and manufacturing sectors—at (0.1)% and (0.2)%, respectively—was not anticipated.

The weakness in manufacturing is troubling. Competition problems and poor productivity suggest it's not likely to improve anytime soon. The April output data also reveal that a stronger US economy hasn't sparked the desired turnaround. As a result, the BoC's prediction of a rebound in 2Q (expansion of 1.8%) looks shaky. The BoC may face pressure to respond at some point, but we expect policymakers to hold their fire for now.

Emerging-Market Outlook

Latin America: Last month was a difficult one for many emerging economies. The sell-off in the Chinese equity market, the political turbulence in Greece and the drop in commodity prices created headwinds for emerging-market (EM) assets. That has pushed some spreads wider and weakened some currencies.

Brazil: in the eye of the political storm

The consolidated public sector showed a primary deficit of R$6.9 billion in May, equivalent to 0.7% of GDP. The number suggests the government's fiscal adjustment exercise has yet to gain traction. The authorities are very far from the 1.2% primary surplus target established for this year (or 1.1% after the GDP revision), and local media reports suggest that a downward revision to the target is imminent.

The internal government discussion appears to be related to the magnitude of the downward revision, with ruling Workers' Party legislators looking at 0.6% and Finance Minister Joaquim Levy expecting 0.8%. In any event, the downward revision should not come as a major surprise, but its confirmation will still have important consequences.

First, it will probably prompt downgrades by Moody's and Fitch, which will leave the sovereign rating at the lowest level of investment-grade status. It is not clear whether the downgrades will come with a negative outlook. Our base-case scenario is that they won't.

Second, a softer fiscal adjustment could in principle mean that more aggressive monetary policy will be needed to bring inflation down. That is a more difficult call, as the reduction in the primary target is directly related to much weaker activity growth. So far this year, the fiscal tightening is being weakened by the recession and by the rigidity in current spending. This means the bulk of the adjustment is falling on investment outlays, which is compromising future growth prospects. Although industrial production surprised on the upside in May, showing a small 0.6% month-over-month increase, the trend continues to be negative. The interannual contraction was 8.8%.

Market consensus expectations for this year's GDP point to a 1.5% month-over-month contraction, with risks of an even larger decline. Meanwhile, headline inflation remains well above the target range and is expected to surpass the 9% year-over-year mark during the third quarter before starting to fall in January.

The domestic political scenario remains volatile. The local media have reported that individuals currently under arrest because of the Car Wash investigation hinted that illegal funds were used to finance the campaign of the ruling Workers' Party candidates. If those allegations are proven true, they could compromise President Dilma Rousseff and bring the country closer to impeachment proceedings.

Opposition leaders admitted to having conversations about "parliamentary alternatives," a cryptic way of suggesting that Rousseff's impeachment is being discussed. The president's popularity continues to test new lows, making it more difficult for the administration to gather support from Congress for the implementation of tough adjustment policies. Our base-case scenario sees Rousseff surviving any impeachment attempts, but politically induced volatility will increase in the weeks ahead.

Of course, Rousseff's low approval numbers and her inability to run for reelection mean she's probably not a political threat to the opposition. That's not so when it comes to former President Luiz Inácio Lula da Silva, the main contender from the ruling coalition ahead of the 2018 presidential election. Neutralizing Lula would probably put the Workers' Party out of contention for the next presidential race. Thus, keeping Rousseff in office to oversee policy adjustments while neutralizing the Lula threat would be a suitable strategy for the opposition. In fact, it's likely preferable to impeachment.

Mexico: Getting ready to follow in the Fed's footsteps

Banco de México (Banxico) announced a new calendar of monetary policy meetings for the remainder of the year and postponed four upcoming meetings by a few days.. Banxico's meetings are now scheduled to follow each of the FOMC meetings this year, a move clearly devised to coordinate policy decisions with the US. This way, if the Fed raises the fed funds rate, Banxico can react accordingly. If the Fed were to hike and Banxico to stand pat, the peso would probably depreciate sharply and give rise to unwanted market volatility. The implicit message is that Banxico will likely adjust its monetary policy stance immediately after the Fed, should the US tightening cycle start this year.

Meanwhile, consumer prices are increasing by less than the 3% medium-term target, both in headline and core terms. In its latest quarterly inflation report, Banxico revised its inflation expectations downward, and it now projects both headline and core rates to remain below 3% this year. Banxico is in a comfortable position, still with no evidence of pass-through inflation from a weaker currency, so it doesn't need to preempt the Fed as long as economic activity is recovering slowly. The output gap will probably remain in negative territory until well into 2016.

Argentina: presidential tickets confirmed

The candidates for all the different posts in the upcoming national elections have been confirmed. Presidential candidate and Buenos Aires state Governor Daniel Scioli announced that his running mate for the October elections will be Carlos Zannini, the current legal secretary of the presidency. Zannini is arguably the politiican closest to President Cristina Fernández de Kirchner, so the signal was even more powerful than choosing Economy Minister Axel Kicillof as a running mate.

Zannini has been a key political operator of the *kirchnerismo* since former President Néstor Kirchner took office in 2003. His appointment suggests that President Fernández will remain influential during Scioli's government and that a settlement with holdouts is less likely to occur in the near term if Scioli wins the election.

If the anti-holdout rhetoric and the lack of negotiation don't change, the chance that Judge Thomas Griesa will eventually include local-law, non-exchange dollar-denominated bonds in the pari passu injunction will increase. Scioli's main challenger is Buenos Aires Mayor Mauricio Macri from the PRO party, who announced that Senator Gabriela Michetti will be his running mate.

Meanwhile, official statistics office INDEC reported that GDP expanded by 0.2% quarter over quarter and 1.1% year over year during 1Q. The figures were a shade below expectations in a Bloomberg poll, but were much higher than private estimates in the country, which pointed to a small contraction during the period. Government spending led the increases at 8.0% year over year, followed by consumer spending at 0.8% and investment at 0.5%. Both exports and imports shrank year over year, by 1.4% and 6.1%, respectively. On a quarter-over-quarter basis, all demand-side components of GDP expanded with the exception of exports, which dropped marginally. According to official data, the economy has expanded by 0.8% year over year during the past two quarters, and April's economic activity index also showed a

1.7% expansion, which suggests that output will grow again during 2Q. Although reservations about the accuracy of the official data remain, chances are that these figures will result in an upward revision to GDP growth projections for this year.

Asia's trade data remain weak

Asia ex Japan: The latest trade data continue to show soft export demand across Asia. Electronics exports, once the sole driver of foreign sales, have slackened in recent months while the US market has remained the only supporting destination amid continued weak global trade. With oil prices showing signs of a retracement and general commodity prices (especially copper and iron ore) having slackened further, we see little risk of inflation picking up in the foreseeable future. As such, we maintain our forecast for more interest-rate easing by Asian central banks in the next few quarters despite the well-anticipated interest-rate normalization by the US Federal Reserve before the end of 2015.

China's stock market sell-off a worry

In China, the recent equity sell-off has send the Shanghai A-Share Index down some 30% from its mid-June peak. The correction still isn't too extreme given the 150% rally from the low a year ago. Still, Beijing responded swiftly with an all-out market support program that includes unprecedented heavy-handed directives. It is obvious that the fear of social discontent is a key driver behind the prompt response. The economic impact on the already weak consumption and investment in the current growth cycle must be adding to the government's concerns.

Policy response has been heavy-handed

The current policy responses—including the suspension of IPOs, the provision of liquidity and share buybacks by state firms—are all pretty standard market support measures. However, it is the way local financial institutions are being coerced to purchase stock, with a set holding period, and the restriction on short selling that have set a controversial precedent. In our view, they look like orders from top politicians without much consideration for their potential to distort a normal market correction.

Moreover, the money pulled so far from various institutional sectors (asset management, local brokerages, etc.) to support the market amount to just a few hundred billion yuan. That's but a fraction of the market's RMB¥47 trillion combined tradeable market capitalization. It's also well short of the RMB¥5 trillion of leveraged financing (margin lending plus other stock-purchasing funding) that has fueled the frenzy.

Beijing should have strong firepower in the worst-case scenario

The bureaucratic flight against market headwinds may linger for a while. But worries about whether China will have the ability to stabilize growth actually emerged well before the stock market correction began. In our view, China isn't running out of policy options, though we don't think it is likely to follow the US, Europe and Japan on the path to quantitative easing (QE).

The key question is what Beijing will do if a genuine financial crisis develops and the economy looks headed for a hard landing. Will it abandon its reform, restructuring and deleveraging initiatives and revert to the type of all-out fiscal and monetary reflation we saw in 2009? In our view, we think that, even now, the People's Bank of China will have to stick to a prudent course of gradual monetary policy easing to cushion the economic pain caused by the reforms.

China can unleash liquidity without resorting to QE

Of course, China doesn't need to impelment QE because interest rates are not yet at rock bottom. If we imagine a worst-case situation in which the government gives up on reform and turns to total reflation, we think China would have enough firepower to inject massive amounts of liquidity into the system (though doing so would have negative economic consequences).

It's worth recalling that China's reserve requirement ratio (RRR) went from 6% in 2000 to a peak of 21% in 2011 in an attempt to sterilize excess foreign capital inflows and avoid a monetary overhang situation. Given that the net inflow has now turned into a net outflow and that the domestic sterilization measures are no longer needed, the easing of the RRR will release a lot of liquidity into the system. If RRR is cut swiftly from the current 18% to, say, 5%, a total of RMB¥17 trillion (US$2 trillion) of fresh liquidity can be pumped back into the system.

Similarly, if the recent relaxation of banks' loan-to-deposit ratio (LDR) is pushed to the extreme—for instance, from the current 68% to 90%—about RMB¥29 trillion (US$4.6 trillion) of extra credit can be made available to the economy. The combined total of the two moves—RRR cuts and LDR expansion—will add a staggering US$6.6 trillion to China's US$10 trillion economy. This is a significant amount in terms of economic lift—but it's also releveraging.

Moreover, China can make massive fiscal injections. Past underspending/ overbudgeting at the local government level has left China with a cumulative RMB¥3.4 trillion (US$550 billion) worth of fiscal deposits. This money should be liquid and flexible in an emergency. On a wider scale, the deposits of broader government agencies and organizations summed up to some RMB¥19 trillion (US$3 trillion), but they probably aren't as easy to use as a policy tool.

Russia's recession deepens, inflation slows in 2Q…

Emerging Europe, Middle East and Africa: In Russia, monthly indicators showed a further deepening of the recession during the second quarter. According to the estimate by the Economy Ministry, the decline in real GDP accelerated in year-over-year terms to 4.9% in May from 4.2% in April and 3.2% in March. It follows a downwardly revised GDP contraction of 2.2% in 1Q. Investment spending and the collapse in household consumption were the key expenditure drivers behind this bleak picture of the real economy. Meanwhile, inflation continued to stabilize in June, easing to 15.3% year over year from 15.8% in May, although in sequential terms inflation actually turned negative due to the food components of the CPI basket.

…creating more room for rate cuts

All of this allowed the Central Bank of Russia (CBR) to continue easing monetary policy last month. The bank board decided to cut the key policy rate by 100 basis points to 11.50%, as was expected. While the accompanying statement did mention that easing in the coming months will be constrained by upside inflation risks, it went on to paint a fairly benign inflation outlook, with the headline inflation rate falling below 7% year over year by mid-2016 and to 4% in 2017. The near-term inflation headwinds are expected to come from the 7.5% regulated utility price hike starting on July 1, but this has long been expected. Disinflation should resume in September, thanks to strong favorable base effects associated with last year's imposition of the food import ban. We expect the CBR to keep cutting the policy rate for the remainder of the year, although the pace of the cuts is likely to be reduced to 50-basis-point clips starting at the next policy meeting.

Meanwhile, western sanctions are extended until 2016…but with little tangible effect of the regime in Moscow

The situation in eastern Ukraine remained unchanged, with little progress on the implementation of the Minsk cease-fire agreement from February. If anything, the level of violent incidents in the Russian rebel-occupied areas increased over the past month. In response, and in line with expectations, the European Union agreed to an extension of the set of economic and financial sanctions against Russian entities until January 31, 2016. Yet neither this nor the deepening recession seems to have had much impact on President Vladimir Putin's approval ratings, which reached an all-time high of 89% in June, as reported by the Moscow-based research center Levada. This dashes any hope that a regime change could be under way as a result of the "costs" imposed by the West on Russia for its foreign policy.

According to the published survey, Putin remains the most trusted politician, and his approval ratings increased by four points since January and by 24 points since before the annexation of the Crimea. The findings were confirmed independently by the Washington-based Pew Research Center. The sanctions just don't seem to be working the way they were intended to—at least for now.

…and Turkey's elections produced a hung parliament…

In Turkey, last month's parliamentary election produced a hung parliament and stripped the Justice and Development Party (AKP) of its ruling majority after 12 consecutive years in power. Coalition negotiations among the four parliamentary parties have so far produced no results. It appears that a coalition without the AKP will be impossible, since the nationalist MHP party refuses to participate in any government that would include the pro-Kurdish HDP party.

…plus difficult coalition negotiations begin

This leaves only four possibilities. The first is an AKP-MHP coalition, which we consider the most likely outcome. This would be the most market-friendly outcome, in our view, especially if the well-respected ex–central bank governor Durmuş Yilmaz, a newly elected MHP member of parliament, is included on the new economic team. The key downside of this scenario would be the freezing of the Kurdish peace process, which the MHP pledged to derail.

The second possibility is an AKP-CHP coalition, i.e., a coalition between the incumbent ruling party and the largest opposition group. But this would be a motley concoction of a socially conservative AKP and a socially liberal CHP. It would also match the economically conservative AKP and economically populist CHP. Despite its generally pro-business and pro-European rhetoric, the CHP is a leftist party. The key priority of its economic policy agenda is a fiscal spending increase worth 2.9% of GDP. Such a coalition might help ease the polarization in Turkish society, but it would be very unstable and would likely lead to policy paralysis.

The third possibility would be an AKP minority government with external support from the MHP. Again, the stability of such an arrangement would be an issue, and the AKP leaders have spoken against it in recent weeks.

The fourth possibility would be early elections. These could be called by the president should the parliamentary parties fail to form a workable coalition within 45 days after the first mandate is given, presumably to AKP leader Ahmet Davutoğlu. Such elections would then take place in about three months (i.e., by early December). Judging from the available postelection opinion polls, there is little evidence yet that the voter preferences have shifted, so it would make little sense at this point to go this route. This is the outcome with the lowest probability.

Reflecting the high degree of political and policy uncertainty and unfavorable core inflation dynamics, the Central Bank of the Republic of Turkey had very little choice last month but to remain on hold despite the wobbly real economy and expected disinflation during the summer months. The MPC continues to describe its monetary policy stance as cautious (i.e., keeping a flat yield curve and tight liquidity), and we now expect that the next move, later this year, will be a hike. The timing and the size of it is uncertain and will depend on both domestic political developments and the timing of the policy normalization by the Fed.

In South Africa, energy regulator's decision provides relief for the SARB

In South Africa, the National Energy Regulator (NERSA) unexpectedly rejected the request by state-owned utility Eskom to hike electricity tariffs by an additional 12.6% (a total of 25.3% over the next 12 months). It was expected that NERSA would award at least some portion of the increase requested. There are three key implications of this decision. First, the central bank will be able to relax a bit over the next six

months, as the inflation path will not be pushed up by an additional supply-side shock. Such a shock could have raised the inflation rate above the target range for more than two quarters next year. This has somewhat diminished the probability of this month's rate hike by the South African Reserve Bank (SARB), although it will still be a close call—more so given the uncertain global environment due to developments in Greece.

Second, while the decision by the regulator will benefit the manufacturing and the mining complex in South Africa, by deferring another large cost increase, the decision will hurt Eskom's financials and potentially force it into more electricity load-shedding at some point. This in turn will constrain the ability of the entire economy to grow.

Third, a failure to improve Eskom's financials through a tariff hike will increase the amount of financing that the government will have to provide to the utility from the budget or through further guarantees. The bottom line is that the NERSA announcement is marginally negative for sovereign credit (due to potential growth, fiscal and public debt implications) and slightly dovish for monetary policy (which currently has a hawkish bias due to rising inflation and asymmetric upside inflation risk). As for the local bond market, the announcement would imply a curve steepening: lower front-end yields and higher yields at the back end.

Hungary's central bank indicates more easing

In Hungary, the central bank (MNB) delivered another 15-basis-point cut last month, as expected, reducing the policy rate to 1.50%. Surprisingly, however, the statement said that achieving the medium-term inflation target would be supported by "further slight easing," indicating that more rate cuts may still be in the pipeline. This openness to further easing was not expected and somewhat contradicts the bank's upward revision of the 2015 inflation forecast to 0.3% from 0.0% published in the 1Q Inflation Report. On balance, it seems that the MNB is ready to deliver some more "symbolic" easing, perhaps taking the policy rate down to 1.25% over the summer. It's also clear that the time for tightening monetary conditions is far away. Tightening would require a substantial deterioration in the inflation outlook. According to the MNB's latest forecast, inflation will rise to 2.4% in 2016.

Separately, Hungary's parliament approved a 2016 budget, which according to EU methodology should have a deficit of 2.0% of GDP, down from the 2015 plan of 2.4%. Headline fiscal discipline remains the key feature of the ruling Fidesz party's macro policy framework and should, over the next 12 months, deliver a credit rating upgrade for Hungary, especially if growth momentum is maintained.

AllianceBernstein Global Economic Forecast

July-15

	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	3.0	3.1	2.7	3.2	2.1	2.5	1.8	2.5	2.06	2.30	3.23	3.61
(PPP Weighted)	(3.5)	(3.6)	(3.0)	(4.4)	(2.6)	(3.0)	(2.4)	(2.8)				
Industrial Countries	2.5	2.3	2.1	2.6	1.1	2.0	0.5	1.9	0.43	0.94	1.87	2.35
Emerging Countries	3.9	4.4	3.8	4.3	3.9	3.4	4.1	3.4	4.97	4.78	5.74	5.94
United States	2.9	3.1	2.7	3.6	1.3	2.7	0.4	2.7	0.63	1.75	2.75	3.25
Canada	1.1	2.3	1.5	1.7	1.4	2.5	1.0	2.2	0.75	0.75	2.00	2.75
Europe	2.1	1.9	1.7	2.0	0.9	1.4	0.3	1.4	0.14	0.28	1.25	1.74
Euro Area	1.8	1.8	1.5	1.8	1.0	1.3	0.3	1.3	0.05	0.05	1.00	1.50
United Kingdom	3.0	2.1	2.7	2.6	0.6	1.5	0.2	1.5	0.50	1.25	2.35	2.75
Sweden	2.4	2.4	2.5	2.5	0.4	2.0	0.1	1.4	-0.35	0.00	1.15	1.75
Norway	1.8	2.4	1.6	2.1	1.7	2.0	1.8	2.1	1.00	1.50	2.00	2.50
Japan	3.0	1.4	1.6	1.8	0.6	1.5	0.8	1.2	0.10	0.10	0.55	0.90
Australia	2.6	2.1	2.4	2.2	1.6	2.0	1.4	2.0	2.00	2.00	3.00	3.25
New Zealand	1.5	1.3	2.3	1.5	0.7	1.7	0.2	1.6	3.25	2.50	3.50	3.50
Asia ex Japan	5.9	6.0	5.9	5.9	1.9	2.6	2.1	2.4	3.15	3.16	3.85	4.11
China[2]	6.6	6.5	6.6	6.5	1.5	1.9	1.6	1.8	2.50	2.50	3.30	3.60
Hong Kong[3]	2.2	3.2	2.0	2.8	2.4	2.5	3.0	2.3	0.75	1.25	1.81	1.41
India[4]	7.9	7.4	7.2	7.3	5.7	6.2	5.3	5.9	7.25	7.25	7.90	8.30
Indonesia[5]	5.1	5.3	4.8	5.1	5.4	4.1	6.3	4.3	7.00	6.50	6.50	6.80
Korea[6]	3.0	3.0	2.7	3.1	-0.9	1.9	0.0	1.0	1.25	1.25	2.10	2.00
Thailand[7]	3.3	3.9	3.3	3.9	0.0	2.6	-0.6	2.0	1.25	1.25	2.70	3.00
Latin America[8]	0.9	2.3	0.3	1.8	6.1	4.3	6.1	4.5	9.04	8.33	9.56	9.31
Argentina	0.1	1.3	0.4	0.7	20.0	25.0	21.0	28.0				
Brazil	-0.6	1.5	-1.5	1.0	8.9	5.3	8.6	5.7	14.00	12.00	12.40	11.75
Chile	3.5	4.0	2.9	3.6	3.0	3.0	3.0	3.0	3.00	3.75	4.80	5.10
Colombia	3.0	3.0	2.9	3.1	3.5	3.3	4.0	3.5	4.50	5.25	7.40	7.65
Mexico	3.1	3.7	2.7	3.3	2.9	3.2	3.0	3.1	3.25	4.00	6.40	6.60
EEMEA	0.1	1.2	0.0	1.3	8.9	5.8	10.2	5.9	7.53	7.14	8.83	9.35
Hungary	2.8	3.0	3.0	2.9	1.9	2.5	0.0	2.4	1.25	2.00	4.25	4.75
Poland	3.9	3.5	3.4	3.7	0.5	1.8	-0.6	1.5	1.50	2.25	3.75	4.25
Russia	-2.6	-0.5	-2.5	-0.5	12.4	6.5	15.7	7.2	9.50	8.00	10.25	10.50
South Africa	2.2	2.2	2.4	2.3	6.0	5.7	4.9	5.8	6.25	7.00	8.75	9.25
Turkey	3.3	3.5	2.6	3.5	8.0	7.0	7.5	6.1	8.00	9.00	9.25	10.50

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: AllianceBernstein

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.