



2013 Global Economic Outlook



BNP PARIBAS | The bank for a changing world

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- **Global and China**

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Central Banks are changing

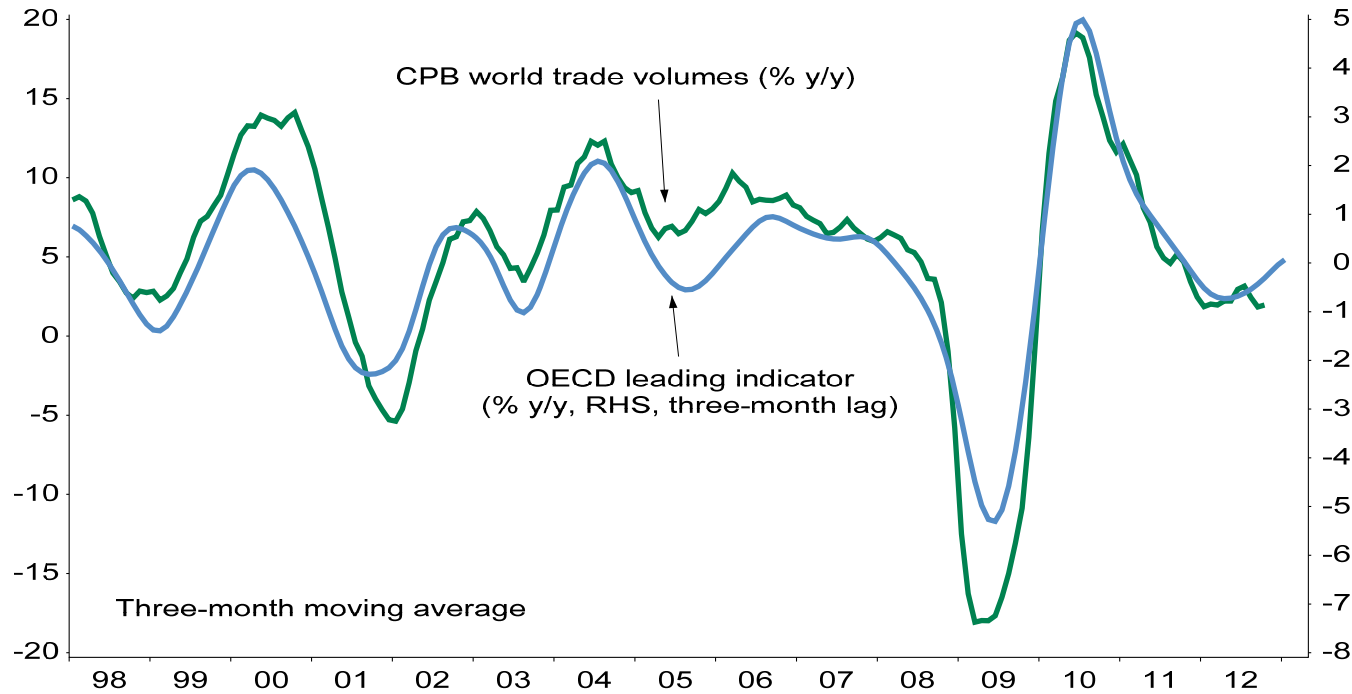
- Central banks were not originally set up to fight inflation
- Inflation targeting came because inflation was the main concern in the 1980s
- Now the main concern now is financial stability, government funding and growth
- Fed has adopted an unemployment target and is expanding its balance sheet
- Bank of England through funding for lending is on credit easing tack
- Bank of England may adopt nominal GDP target
- Bank of Japan under pressure to ease strongly to aid government
- ECB has agreed to be a lender of last resort to governments



All change – to more expansionary policies



Global trade & OECD leading indicator



Source: Reuters EcoWin Pro

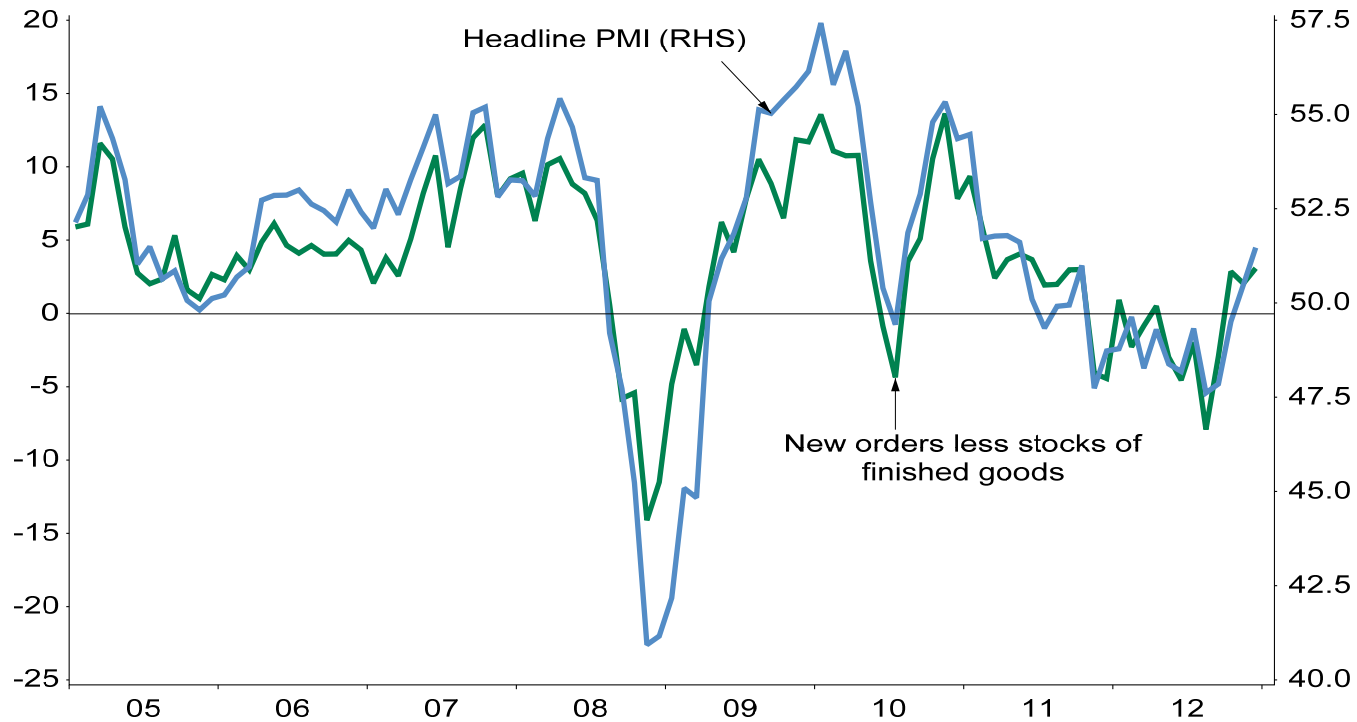
- 2012 has seen a big slowdown in global manufacturing
- The OECD's composite leading indicator is starting to improve ...
- ... albeit at a relatively gradual pace to date
- This has been a good indicator of turning points in global trade dynamics, again with a lead of a few months



Point of inflection



China: Manufacturing PMI - positive signs



Source: Reuters EcoWin Pro

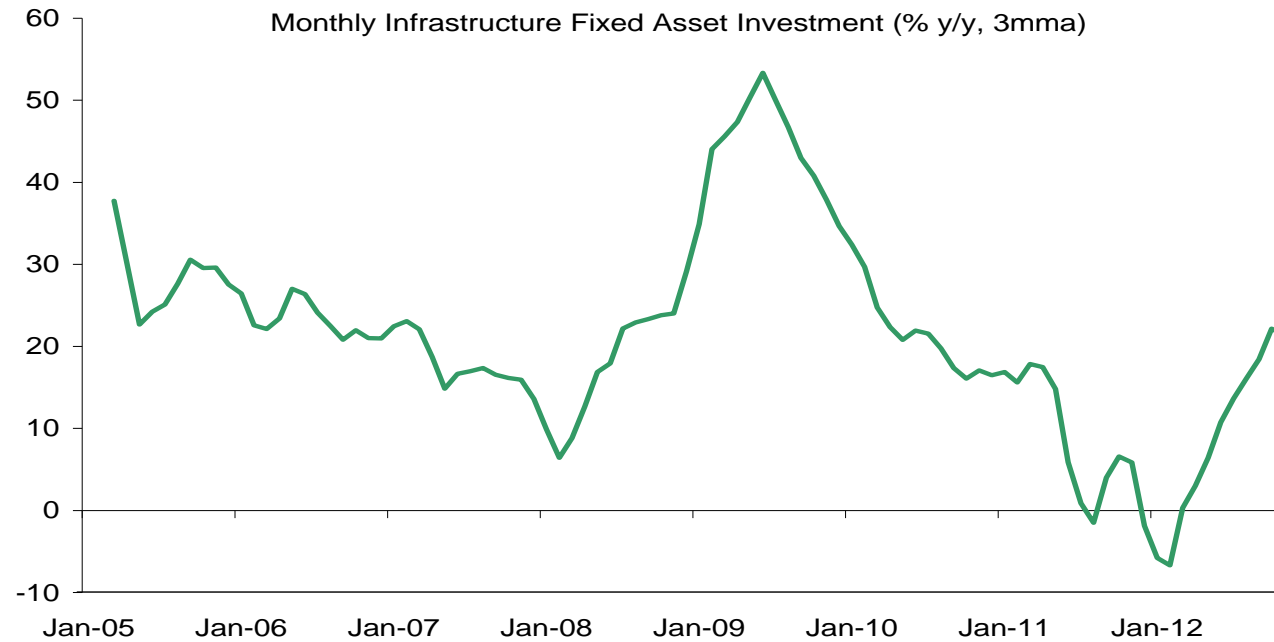
- Within the manufacturing PMI data, the gap between new orders and inventories tends to be a good leading indicator ...
- ... of the underlying momentum in the sector
- The new orders-to-inventory gap in the Chinese manufacturing PMI has picked up markedly since August



Leading indicator of the leading indicator



China – More of the same



MH/DB

Source: Reuters Ecowin Pro, BNP Paribas

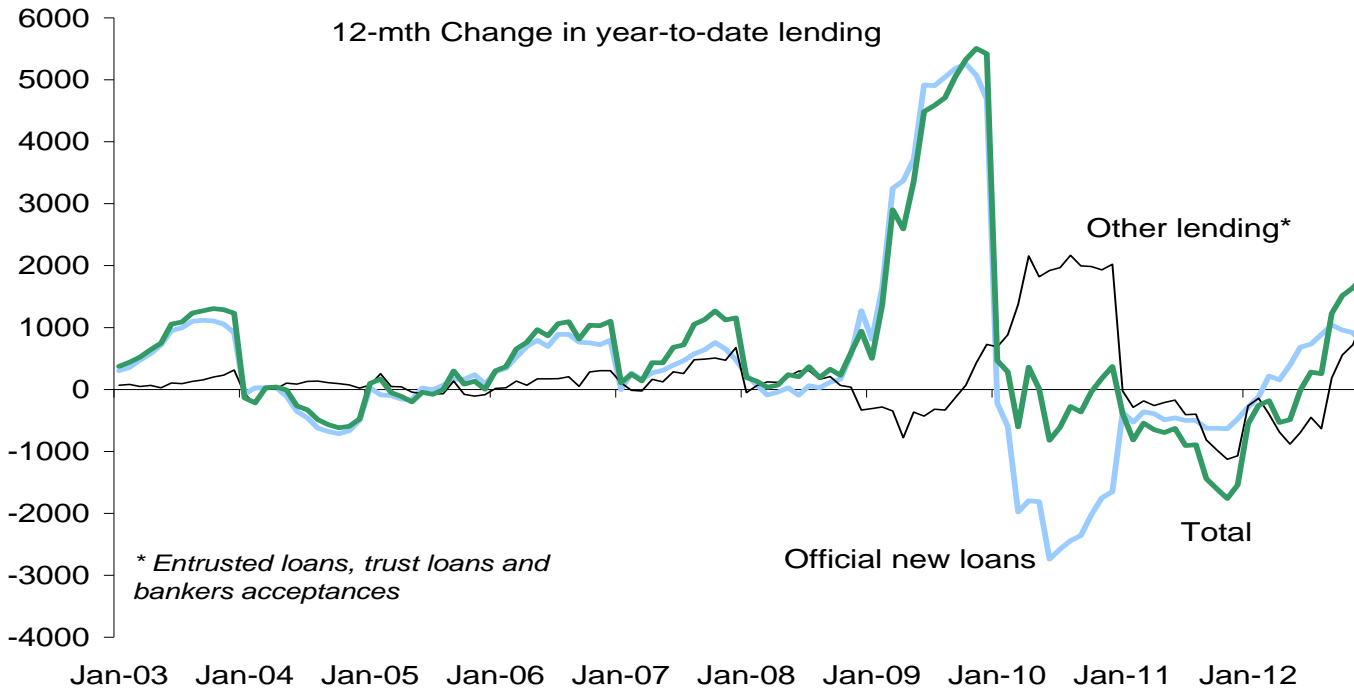
- Drilling down into sectoral detail on the capex side a rebound in infrastructure capex...
- ...partially fuelled by a rapid re-acceleration in railway investment has been key...
- ...as project approvals were accelerated from mid-year onwards
- Swings in investment still driving the cycle



On the right track



China – Money & credit key



MH / DB

Source: Reuters Ecowin Pro, CEIC, BNP Paribas

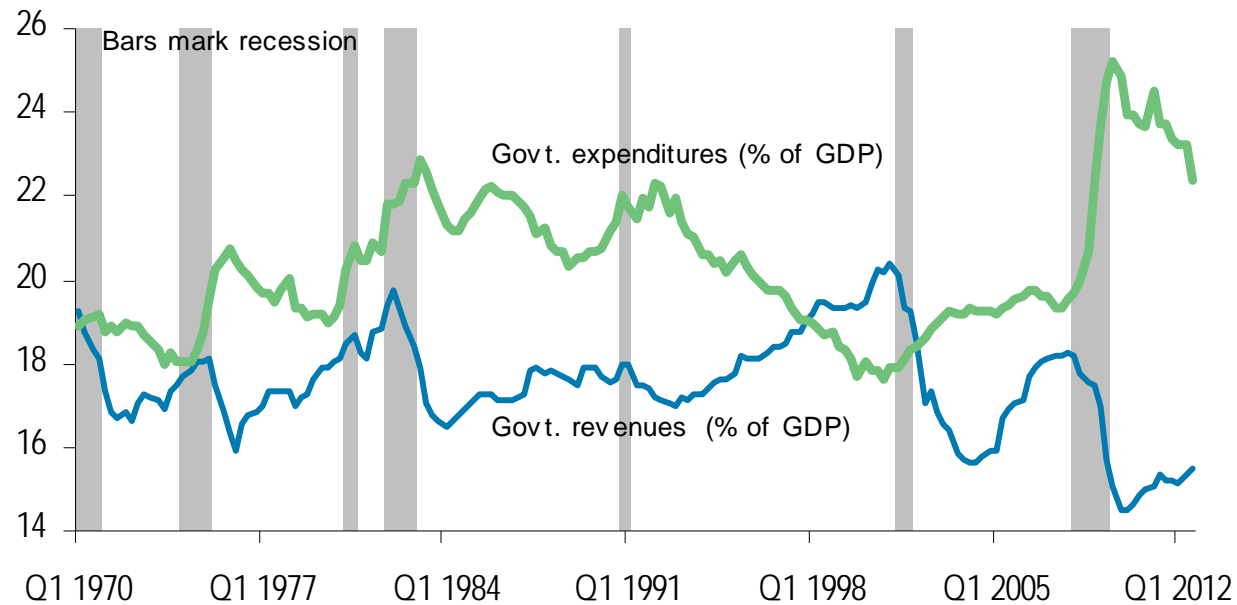
- Money growth is turning, although remains constrained for now
- Bank lending has picked up notably...
- ... especially when 'other' types of lending are included
- This loosening of credit conditions is key to believing the economy is picking up



Expansion under way



US: The fiscal outlook is the key uncertainty



Source: Reuters EcoWin Pro, BNP Paribas

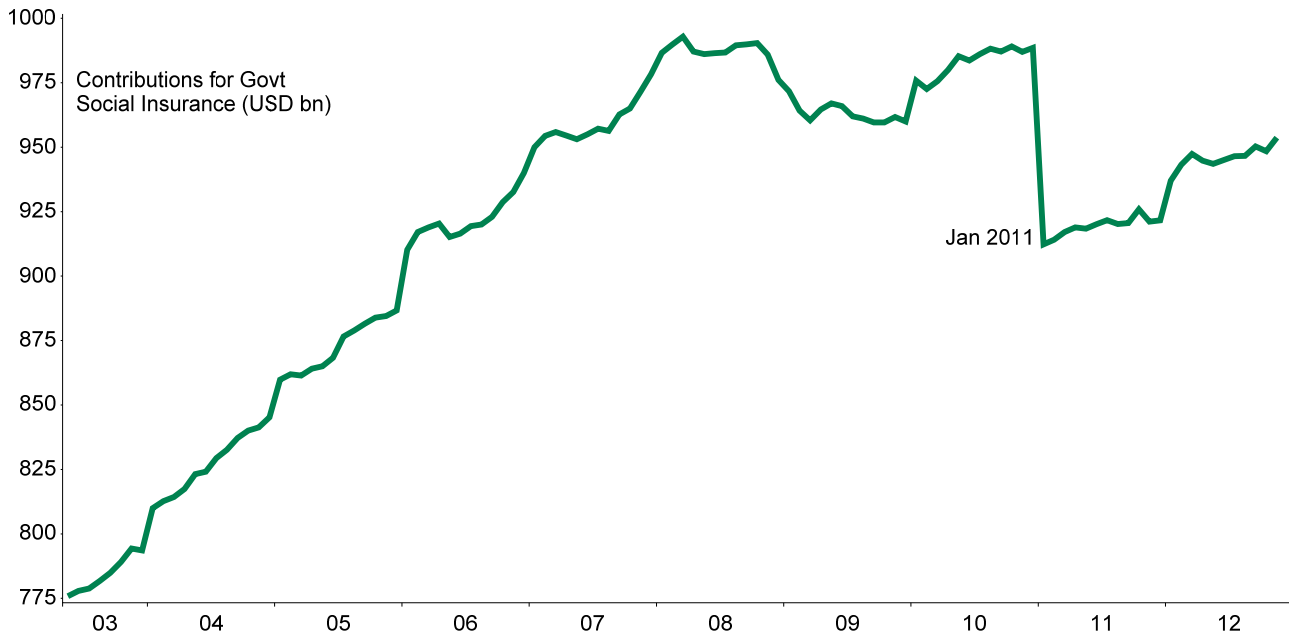
- The US fiscal problem is that revenues rose to record highs
- So far consolidation has been slow
- Massive gap explains massive disagreements



Ultimately, they have to raise taxes and cut expenditures



US: January will feature a sizable decline in take home pay



Source: Reuters EcoWin Pro

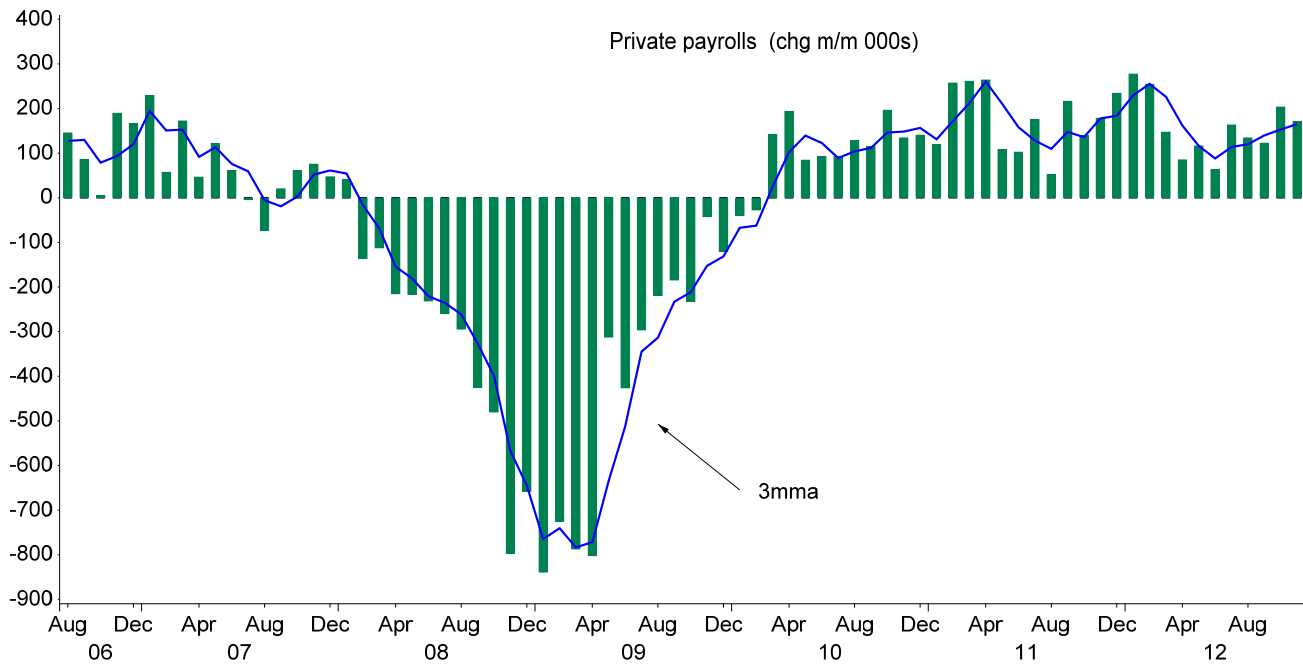
- Payroll tax hike is equivalent to 2% of disposable pay
- Will bite in first few months of year



Confidence and retail sales to take a hit



US: Hiring has held up, but has not accelerated



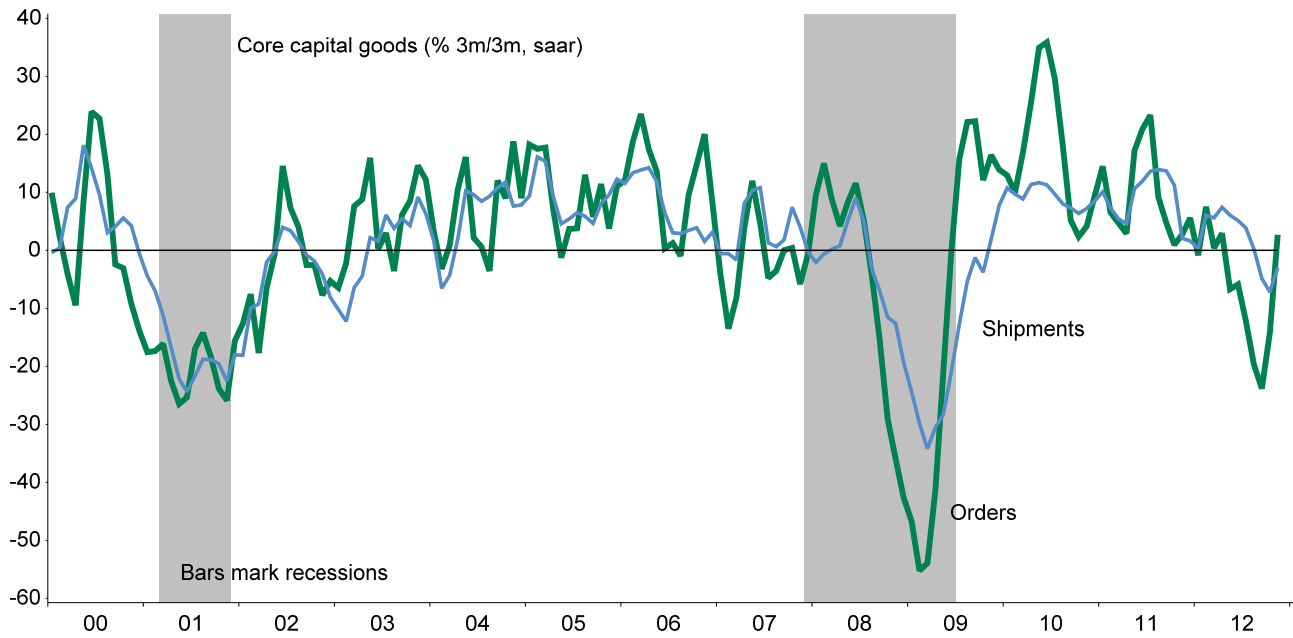
- Payrolls have been decent for three years
- But we've never reached levels seen in previous recoveries
- Trend growth has dropped?



Have never reached take off velocity



US: Capital spending volatile



Source: Reuters EcoWin Pro

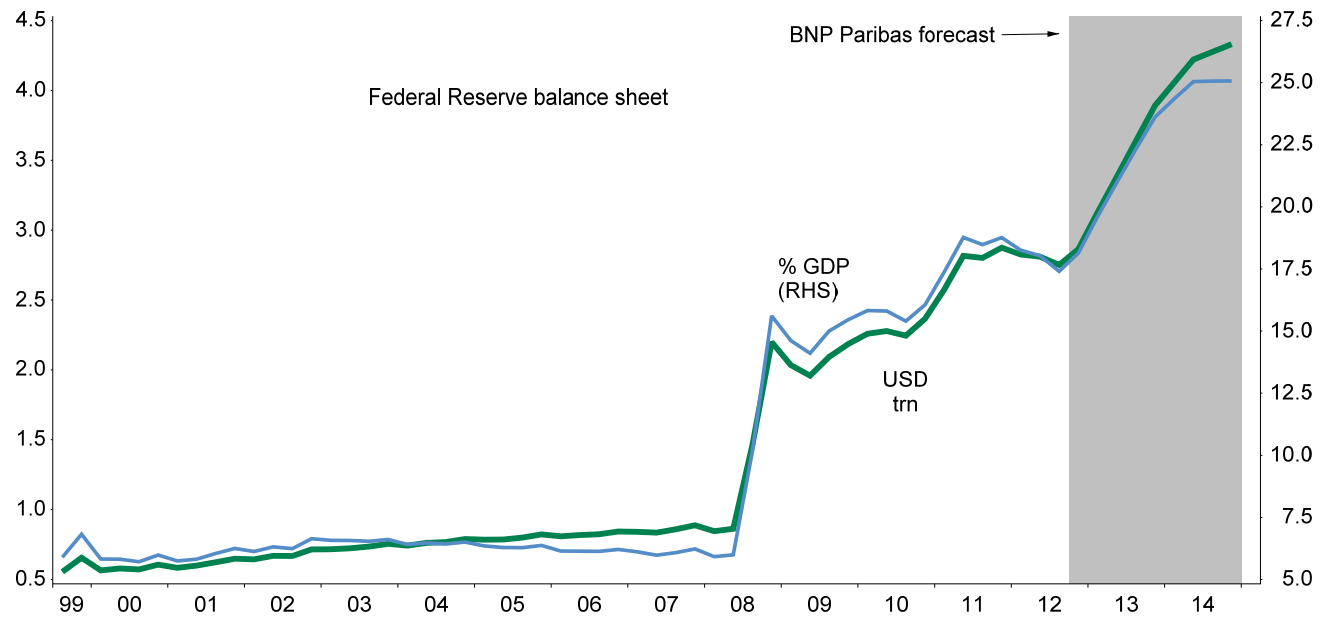
- Global manufacturing slowdown, fiscal cliff all weighed on capex in 2012
- Stabilisation at year end



Worst is over?



US: Trend-like growth will keep the Fed easing



Source: Reuters EcoWin Pro

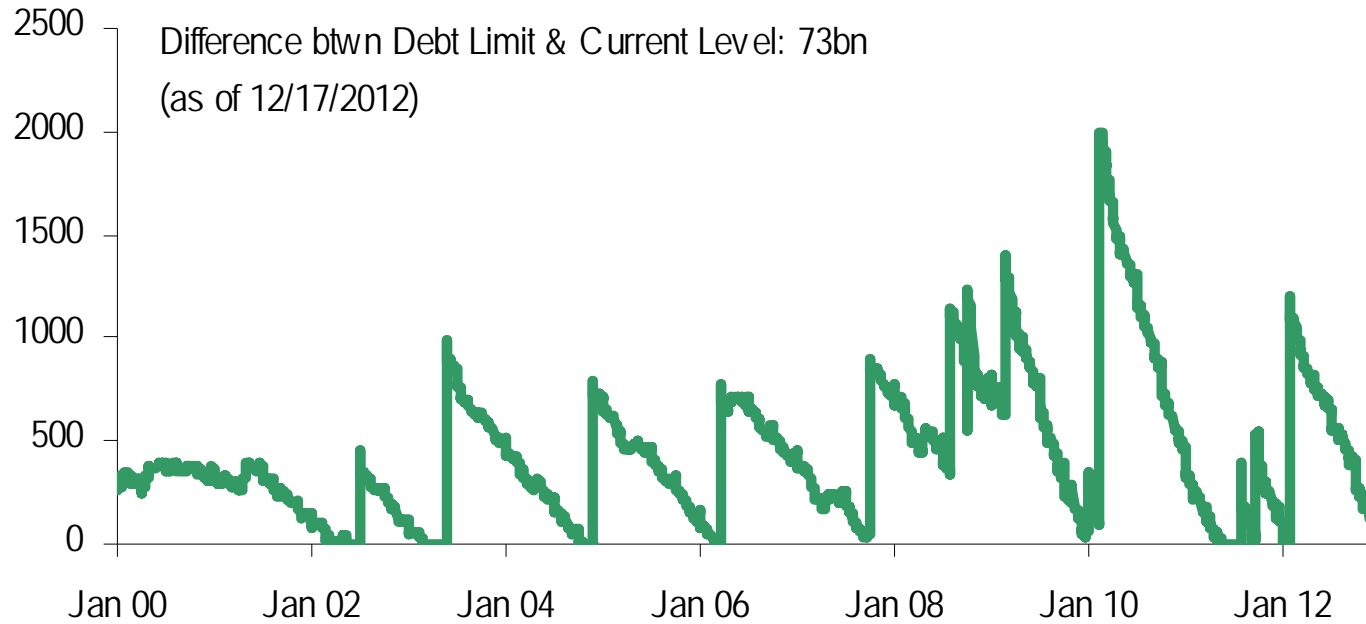
- We expect fed to keep easing at USD85bn a month this year .. And to scale back in 2014
- Latest minutes have made us more nervous but bigger than expected fiscal tightening tempered that



After balance sheet stability under twist, we no get expansion



US: Difference between debt limit and current level (USD bn)



Source: Haver Analytics, BNP Paribas

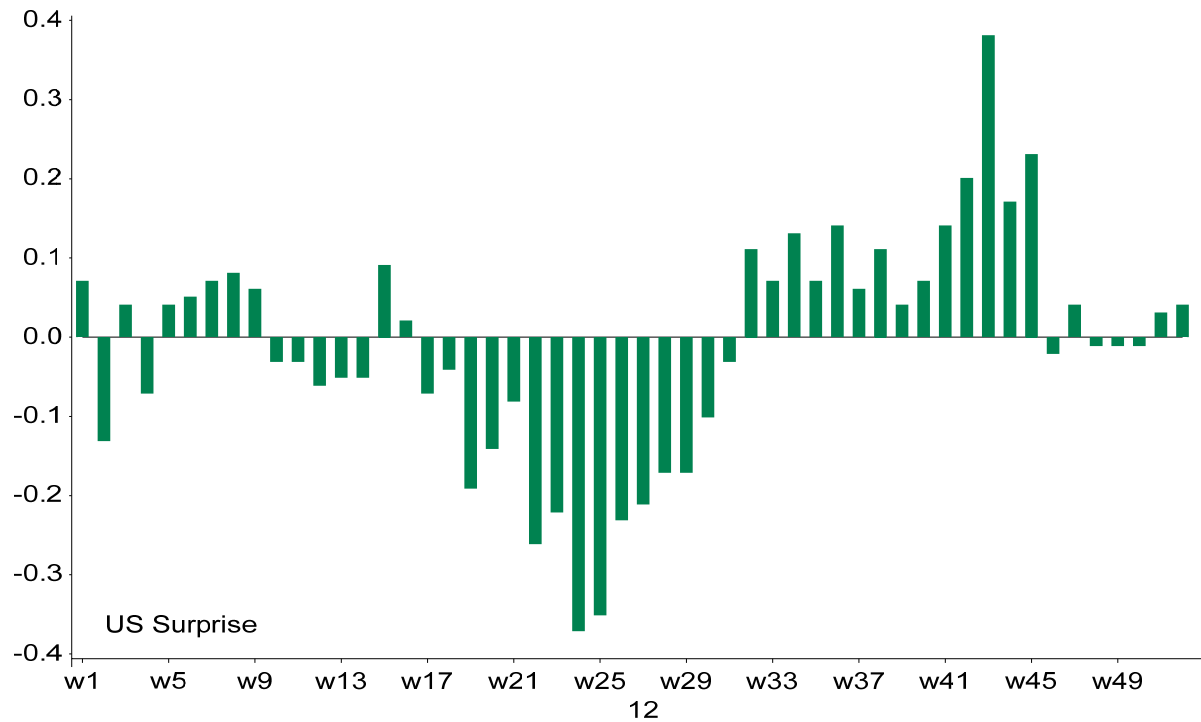
- Treasury is running accounting “tricks” to get us through to late Feb/early March
- What we need is a big increase in the debt limit
- Worst would be temporary increase and repeat of crisis



No permanent fix



US surprise indicator



Source: Reuters EcoWin Pro

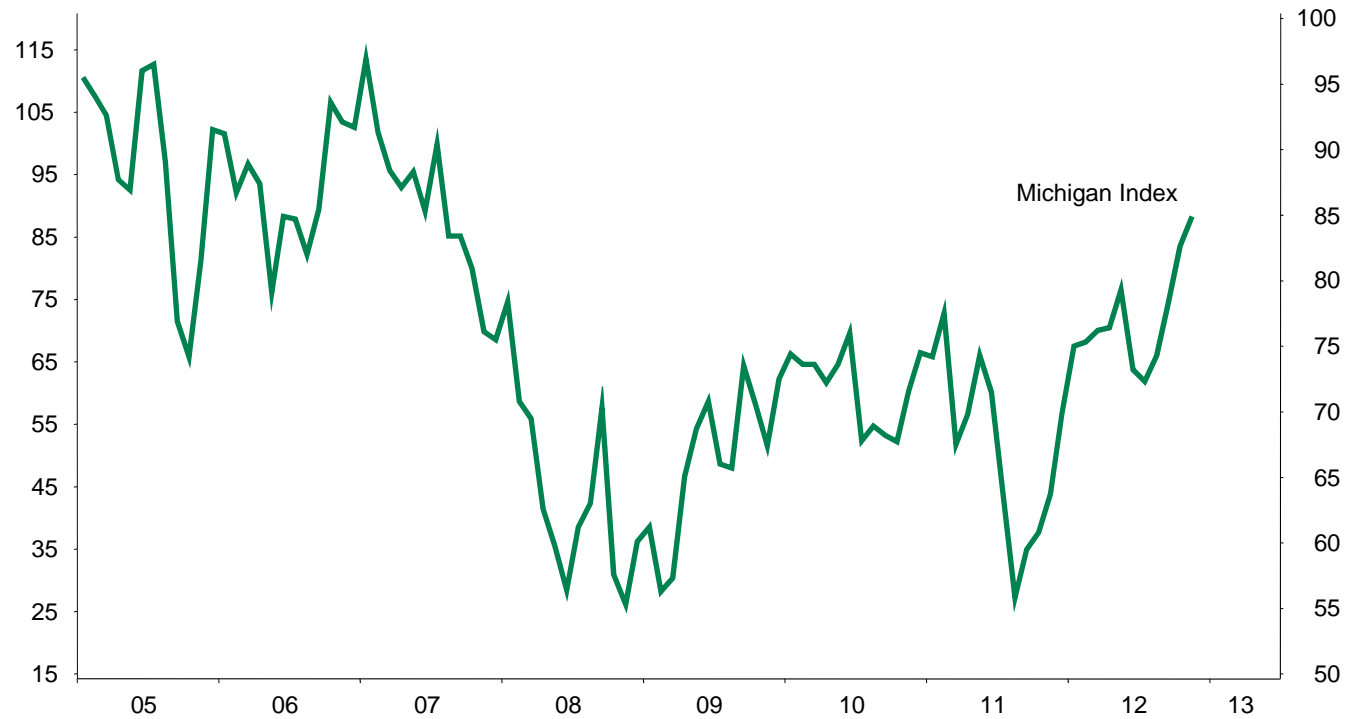
- US data failed to meet market expectations in the spring ...
- ... then improved ...
- ... but have died out recently – fiscal cliff?



Have the favourable surprises ended?



US: Consumer sentiment



Source: Reuters EcoWin Pro

- Consumer confidence in the US has been benefiting from improving wealth effects ...
- ... related to the improvement in the stock market
- The labour market is also improving, albeit gradually

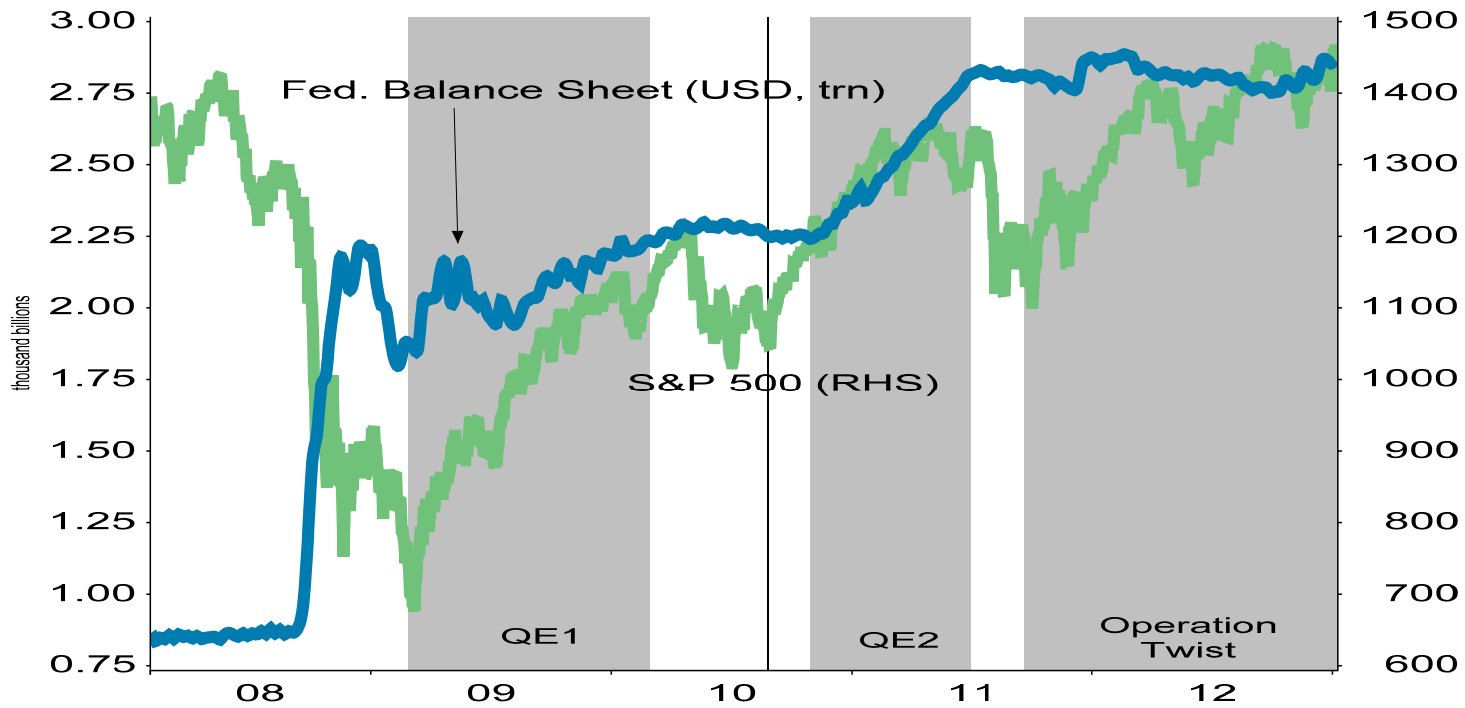


On the rebound



QE has been successful in boosting risk assets

SPX v. Fed Balance sheet



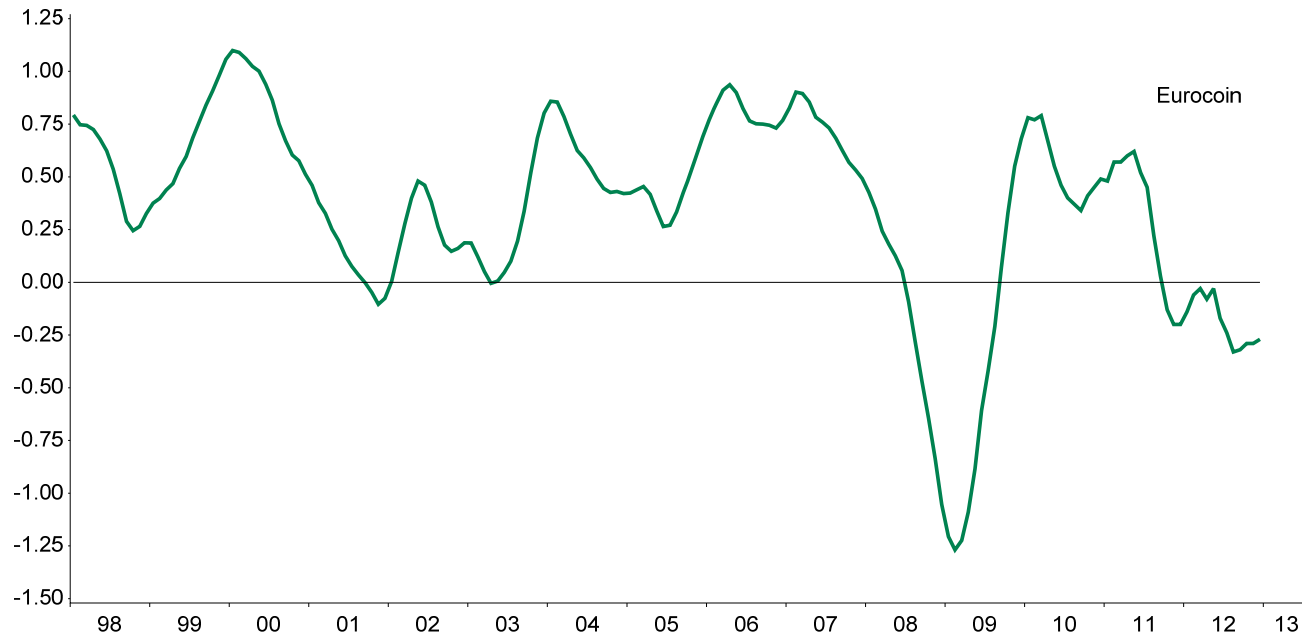
Source : Ecowin Reuters, Bloomberg, BNP Paribas



Risk assets draw significant support from Fed QE



Eurocoin indicators



Source: Reuters EcoWin Pro

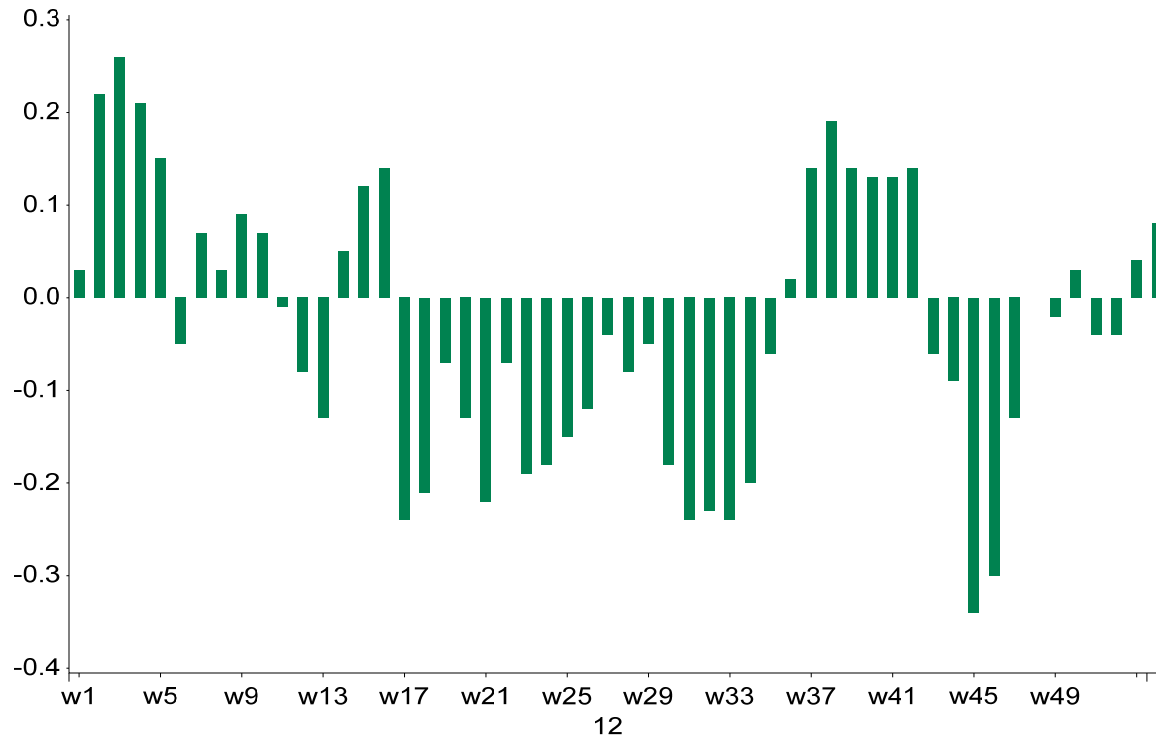
- Eurocoin is signalling a contraction at about a ½% annualised rate
- Some sign of flattening off but no great improvement



Mild recession



Eurozone surprise indicator



Source: BNP Paribas

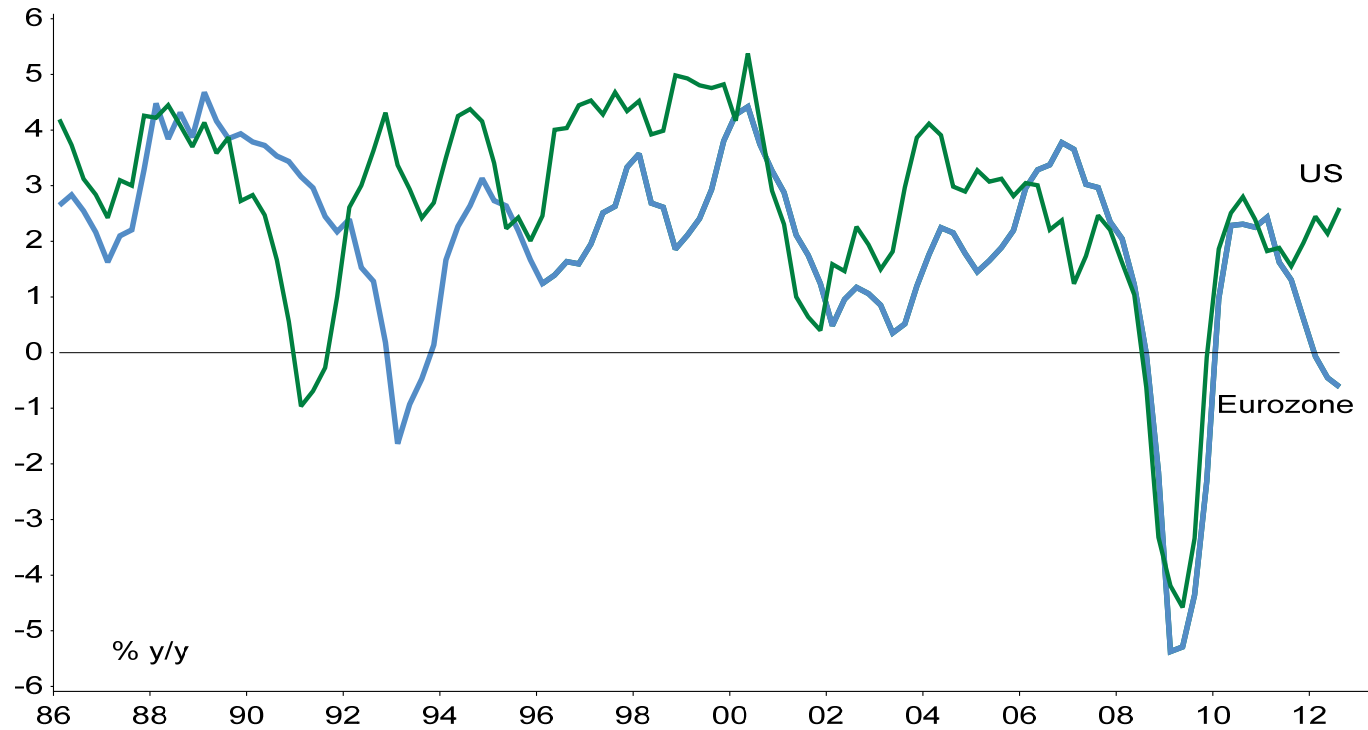
- Eurozone data have continued to surprise to the downside since April
- First positive surprises for a long time ...
- ... but they haven't lasted



It's gotten worse again



Divergence: GDP growth



Source: Reuters EcoWin Pro

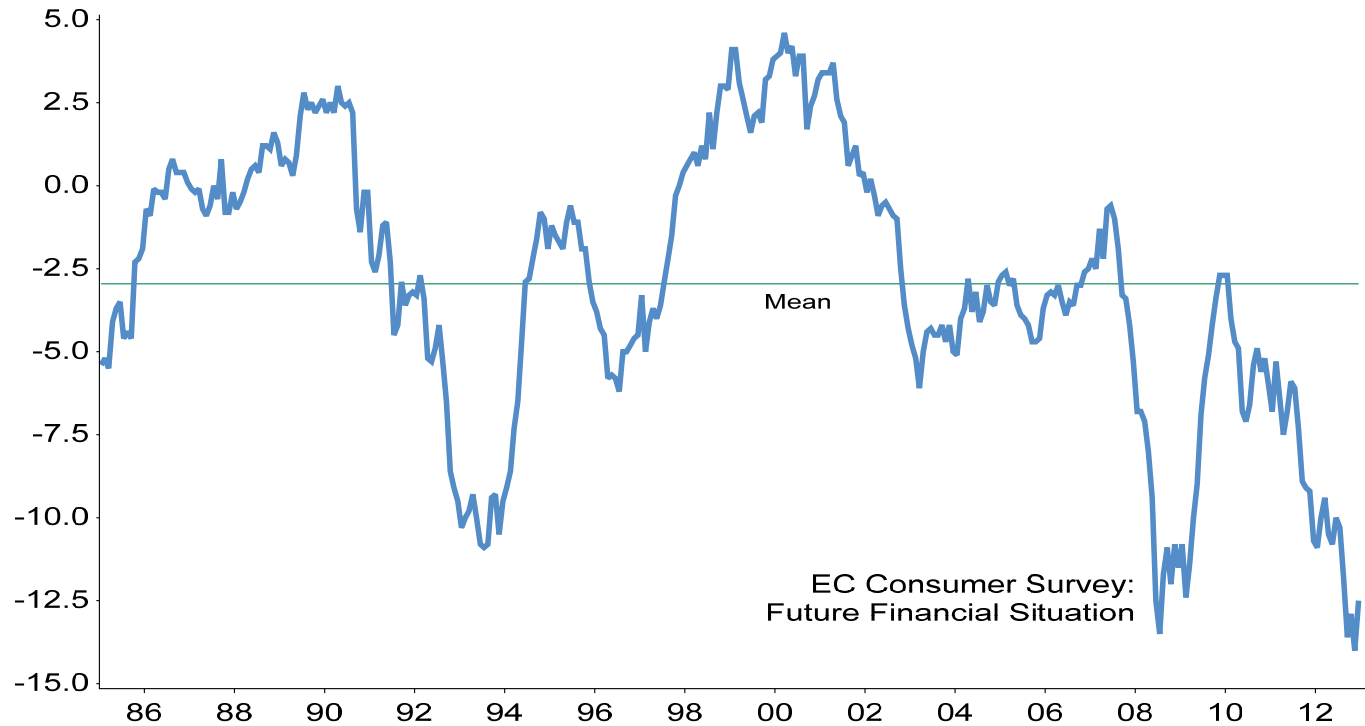
- The US economy has been enjoying steady, if unspectacular, growth of around 2% since 2010
- GDP in the eurozone, in contrast, is contracting
- Fiscal policy is a key reason for the divergence of growth dynamics



Mind the gap



Eurozone: Consumer sentiment



Source: Reuters EcoWin Pro

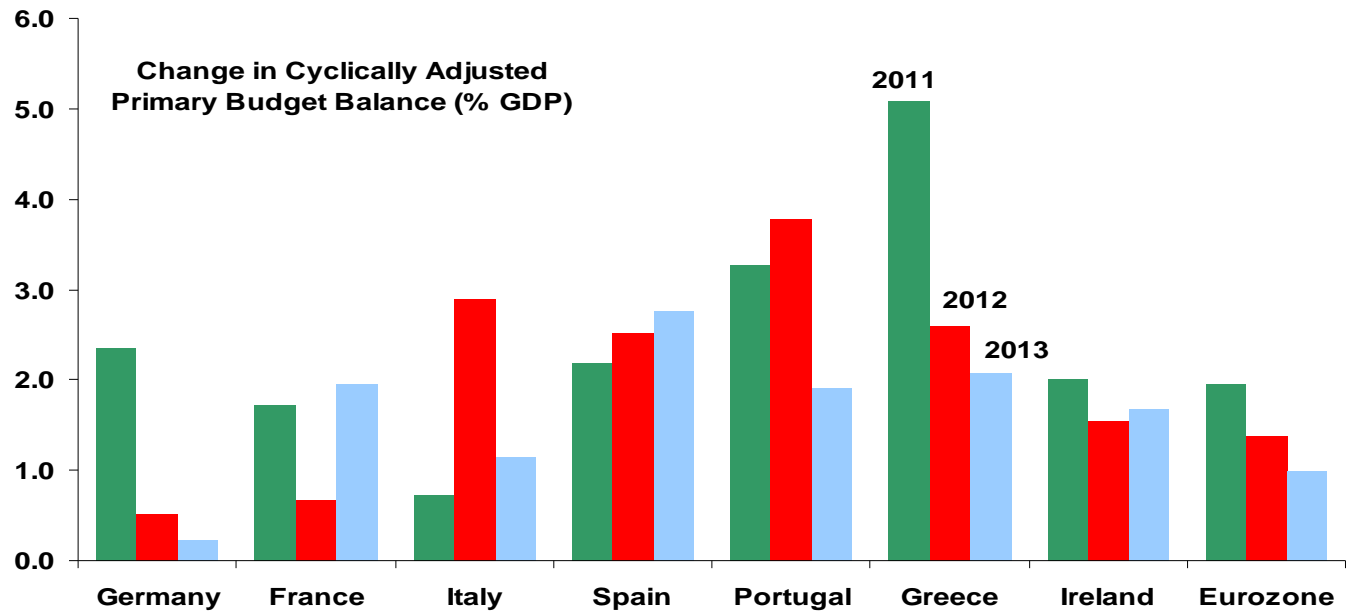
- The EC consumer survey of future financial conditions is as weak currently as it was after the Lehman collapse
- High unemployment, fiscal tightening, a squeeze on household incomes – all point to consumer weakness
- The eurozone recovery will remain highly dependent on external economic conditions



Domestic doom and gloom



Eurozone: Fiscal adjustment



GK/ML

Source: Reuters EcoWin Pro, BNP Paribas

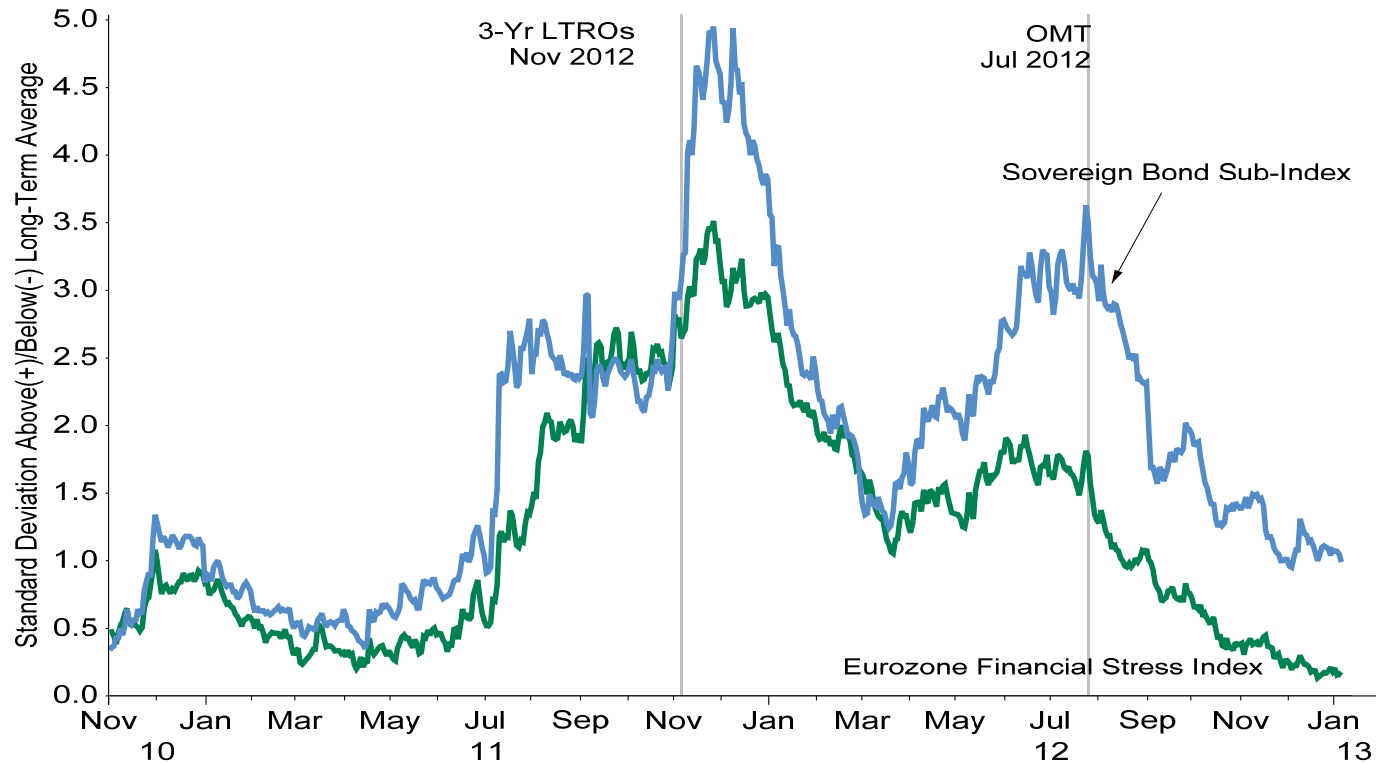
- The 'peripheral' eurozone member states are undergoing a period of concerted fiscal tightening
- The change in the underlying fiscal stance is exceptionally large in 2012 in a number of countries
- The adjustment is consistent with large output declines this year, even with a conservative 'multiplier' assumption



Concerted tightening



Eurozone: BNP Paribas financial stress index



Source: Reuters EcoWin Pro

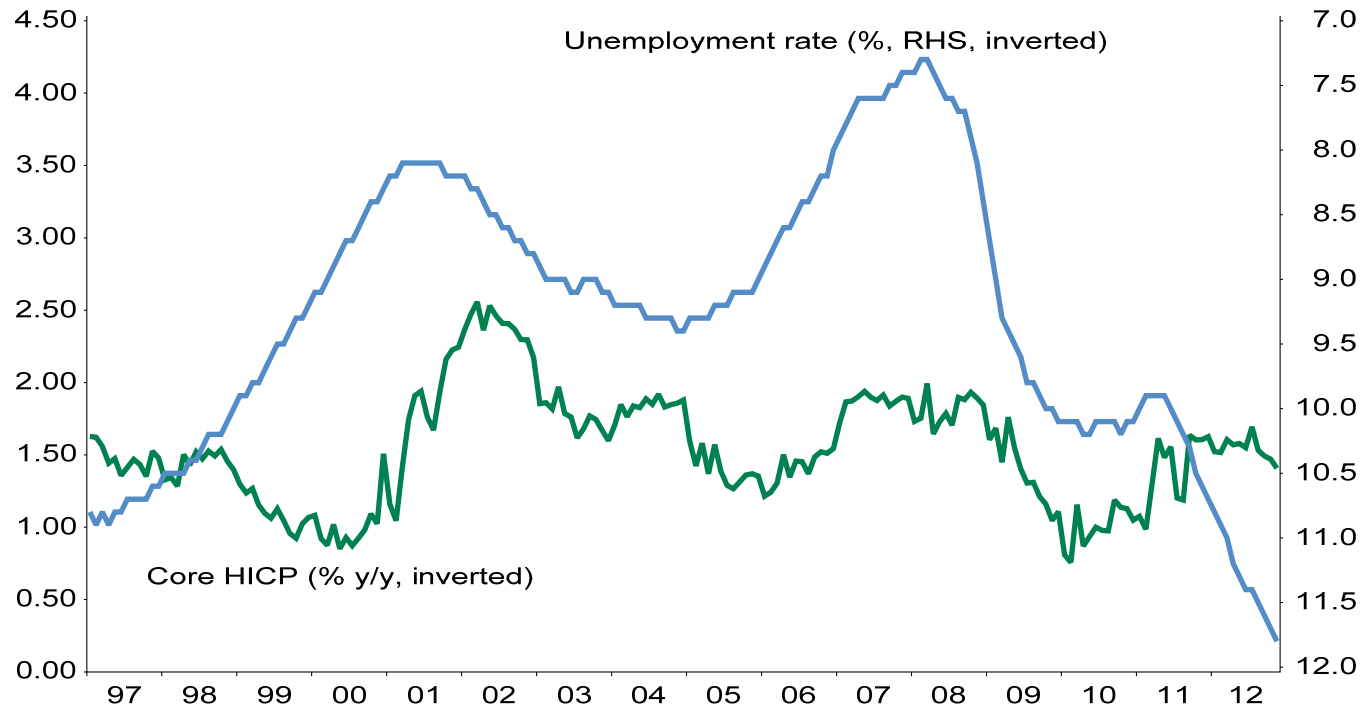
- Measured by our stress indicator, the ECB's OMT announcements have had a pronounced effect
- The indicator includes a range of financial variables: sovereign yield spreads, stock market volatility, cross-currency basis
- Tail risk has diminished considerably



Something was wrong in the neighbourhood... who you gonna call?



Eurozone: Inflation drivers



Source: Reuters Ecowin Pro

- Unemployment leads compensation
- Compensation leads wage negotiations and core inflation
- Yet to see the effects of the recession on core inflation

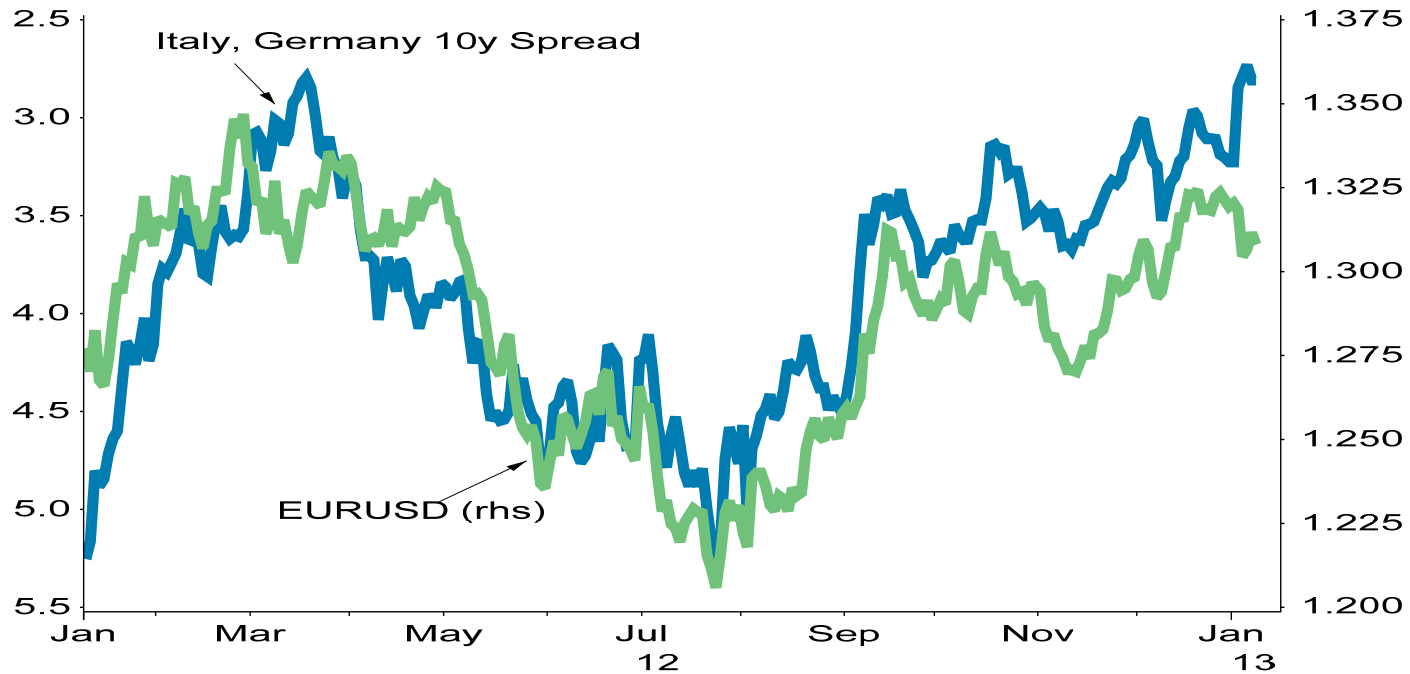


Inflation should be held in check by output gap



LTRO and Mr Draghi have calmed EZ peripheral bond markets

EURUSD and Italian-German 10-year yield spread



Source: BNP Paribas



The easing of eurozone peripheral stress has supported EUR



Draghi's list

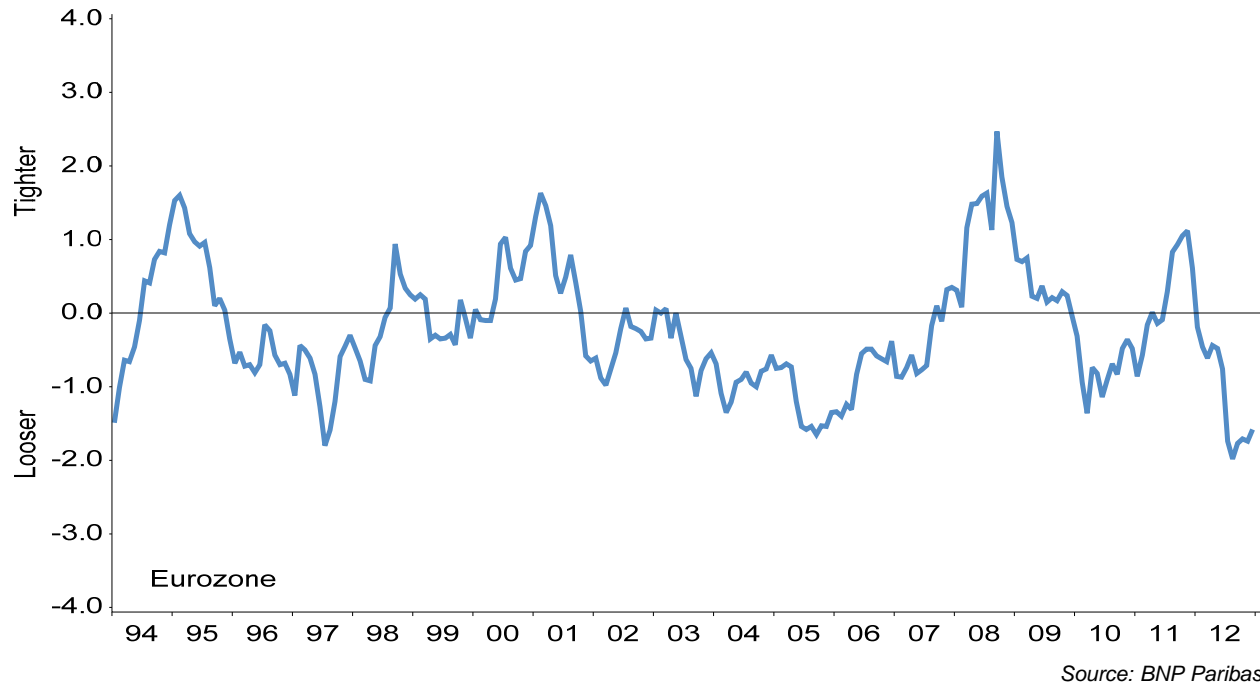
- **Significantly lower bond yields and Credit Default Swaps**
- **Higher stock market prices**
- **Lower stock market volatility**
- **Strong capital inflows in the eurozone**
- **Higher bank deposits in peripheral countries**
- **Lower net redemptions in loans to non-financial corporations**
- **Lower Target2 balances**
- **Reduced size of ECB balance sheet**



Significant improvement in financial market conditions – no need to ease rates



Eurozone: Financial and monetary conditions



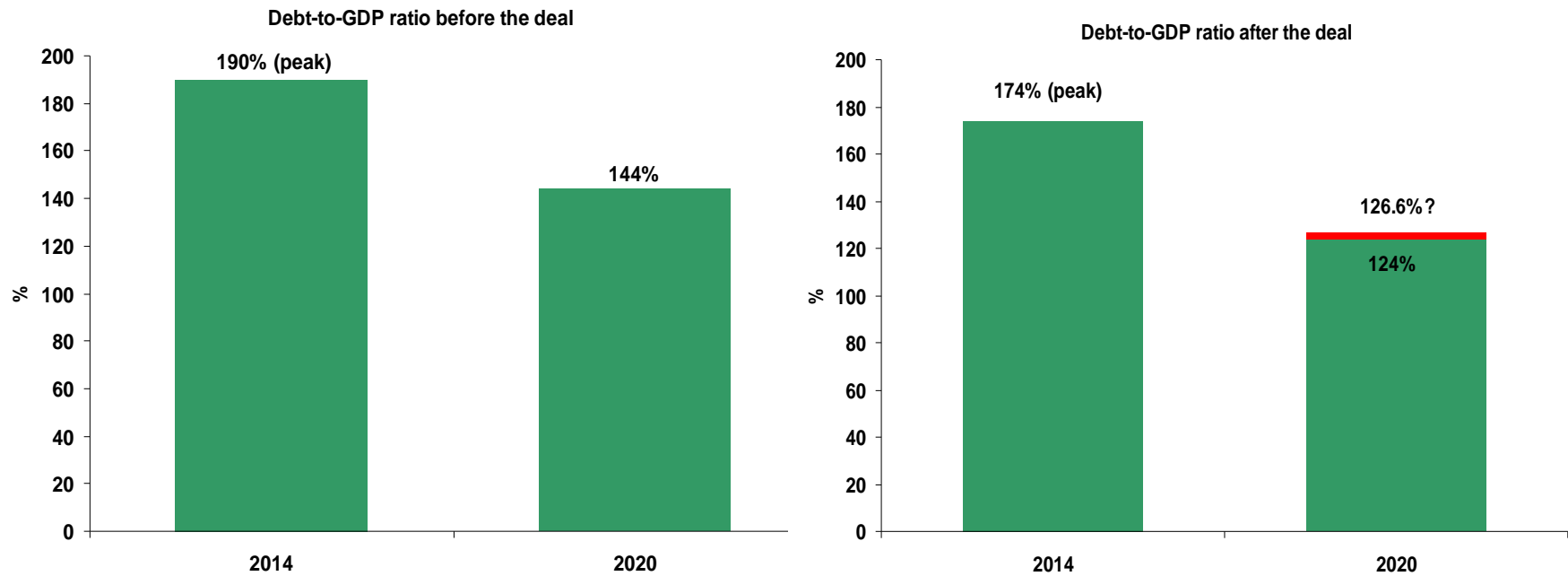
- After the two 3-year LTROs, financial and monetary conditions have eased significantly in the eurozone
- The eurozone FMCI currently stands at its lowest level since 2005
- Such an improvement should help to boost activity



Financial conditions remain loose



Greece: Is it enough?



GK

Source: European Commission, BNP Paribas

- The Troika now targets the debt-to-GDP ratio to fall to 124% in 2020
- But the 'announced' measures will only lower Greece's debt levels to around 127% of GDP by 2020
- Our forecast is for Greece's debt-to-GDP ratio to fall to around 130% in 2020
- This suggests further concessions, most probably a writedown on loans to Greece, will be needed in the period ahead



More help needed?



Greece in a nutshell



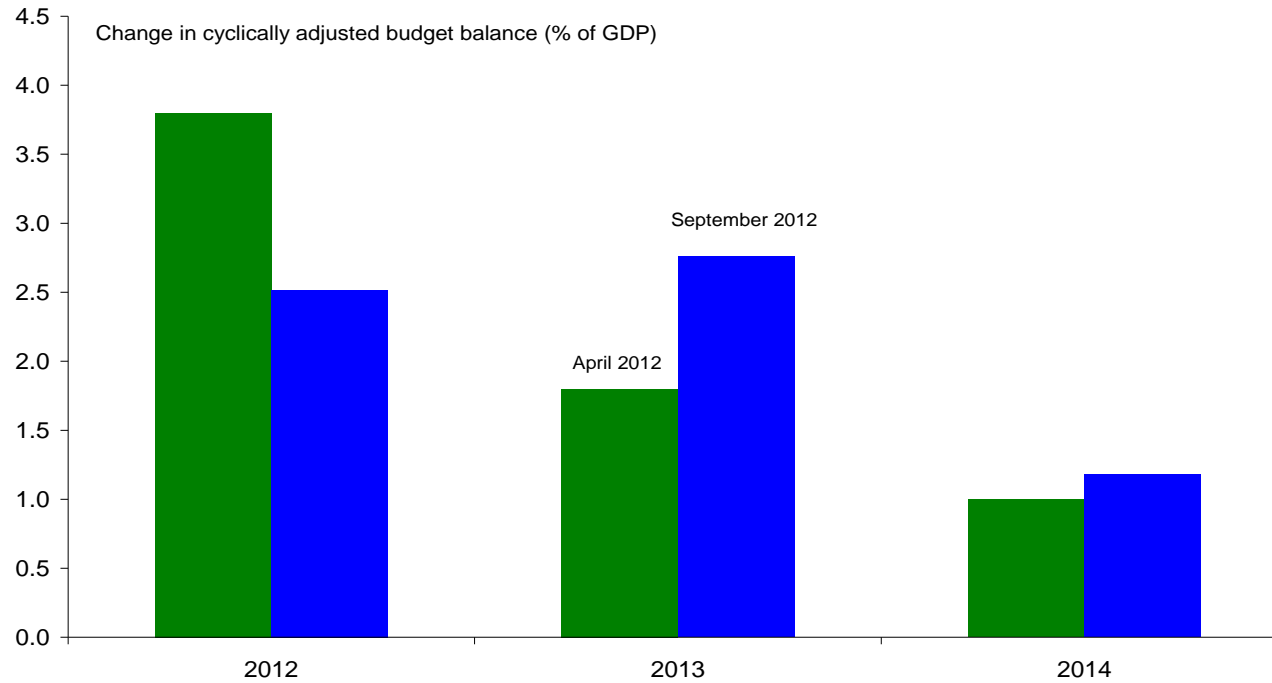
- Greece cannot take an exit from the euro at the moment
- Eurozone cannot take a Greek exit until firewalls are complete
- Draghi's line that the euro is indissoluble can't stand up to a Greek exit



We know the Greek deal is a fudge but we are “condemned to success”



Spain: Fiscal tightening



RS

Source: Reuters EcoWin Pro, Ministry of Finance, BNP Paribas

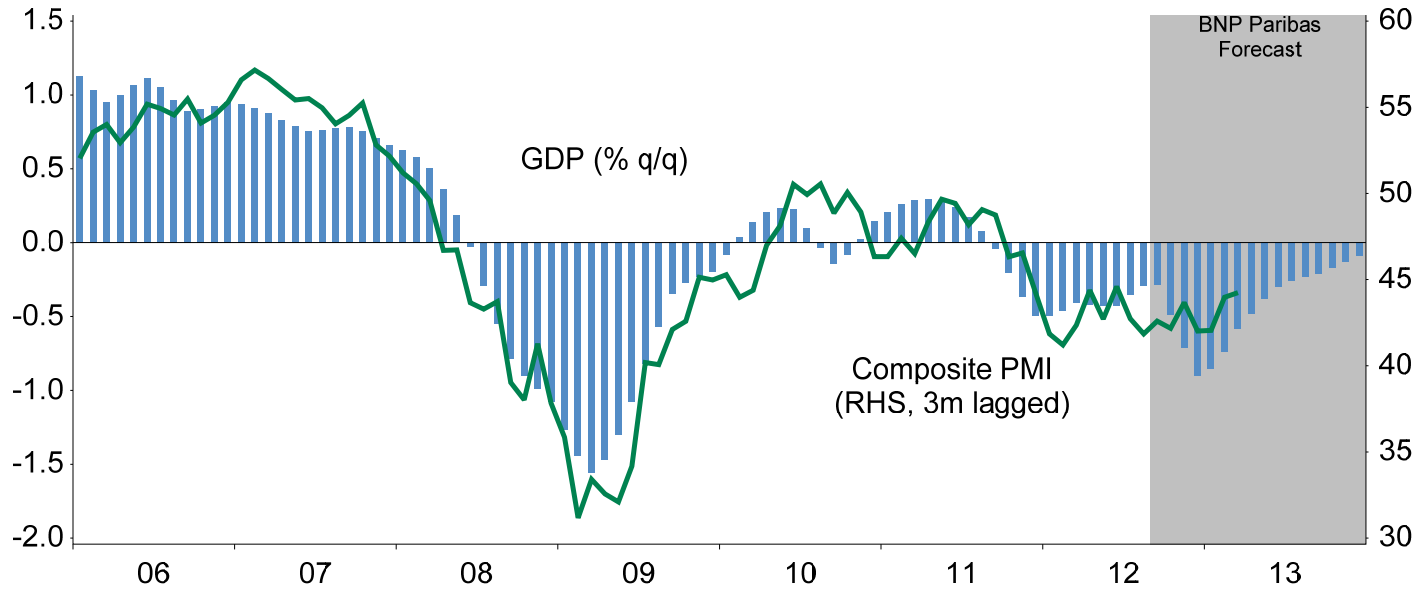
- Spain will consolidate its public finances more slowly than first expected ...
- ... leading to greater tightening later on



Slippage in 2012 means more tightening in 2013



Spain: Surveys and GDP growth



Source: Reuters EcoWin Pro

- Spain briefly moved out of recession ...
- ... but is now back in it
- Though not with the same severity as in 2008-09



Double dip



Waiting for Rajoy



- “We’re **waiting for Godot**”
- “Ah! Are you sure it was here?””
- “What?”
- “That we were to wait”

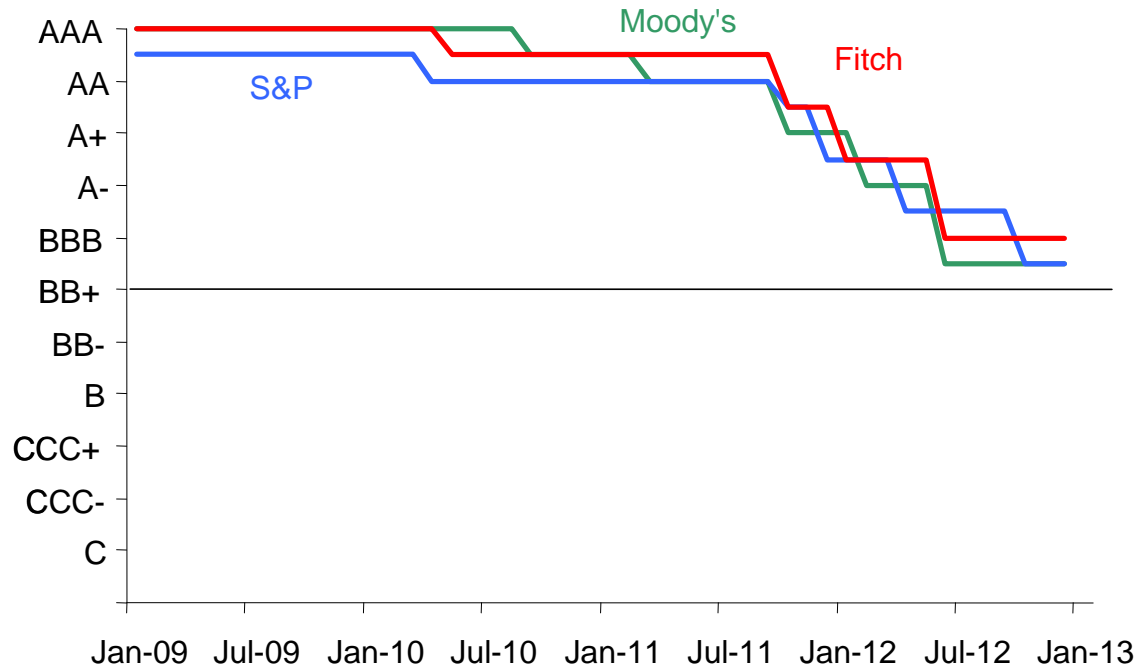


Will Rajoy, unlike Godot, ever show up?



Spain approaching the sub-investment grade threshold

Spanish credit ratings



RS

Source: BNP Paribas

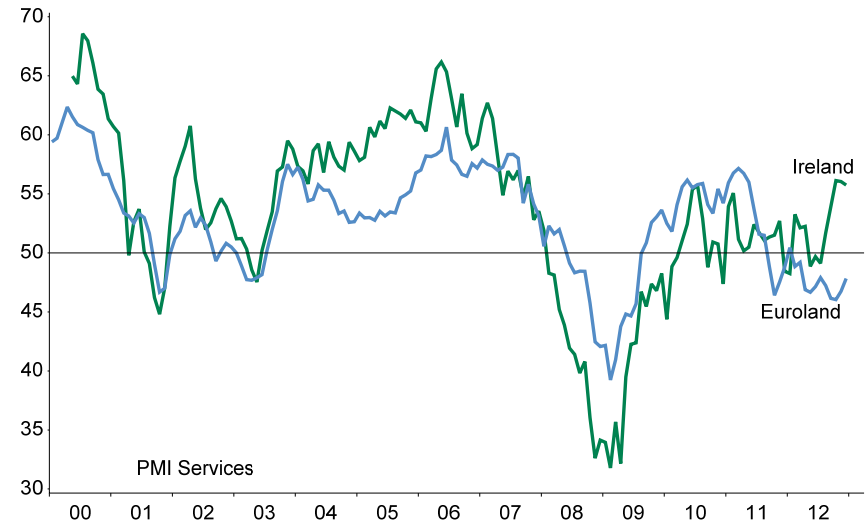
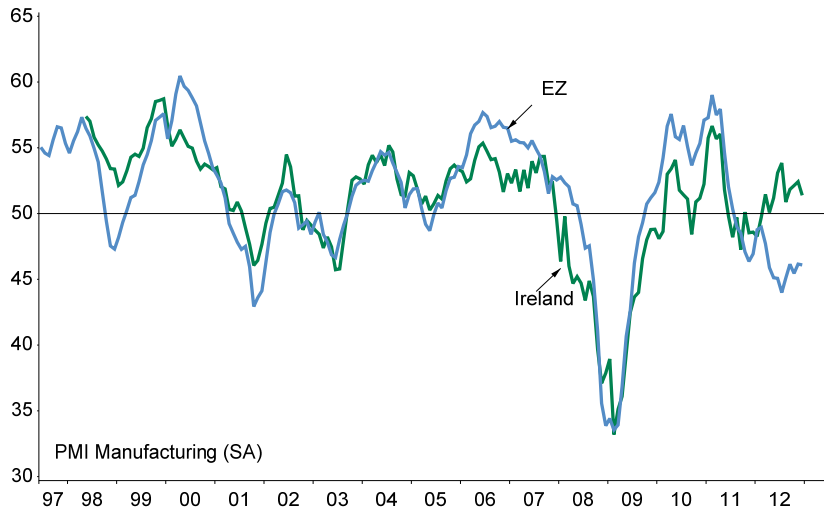


Spain its investment-grade on expectation of ESM and OMT. Market access key



Ireland: Surveys stronger than eurozone

PMI surveys



Source: Reuters EcoWin Pro, BNP Paribas

- Both the manufacturing and service PMI indices are well above 50, in stark contrast to the eurozone.
- Manufacturing momentum has cooled, though new orders and export orders are still rising.

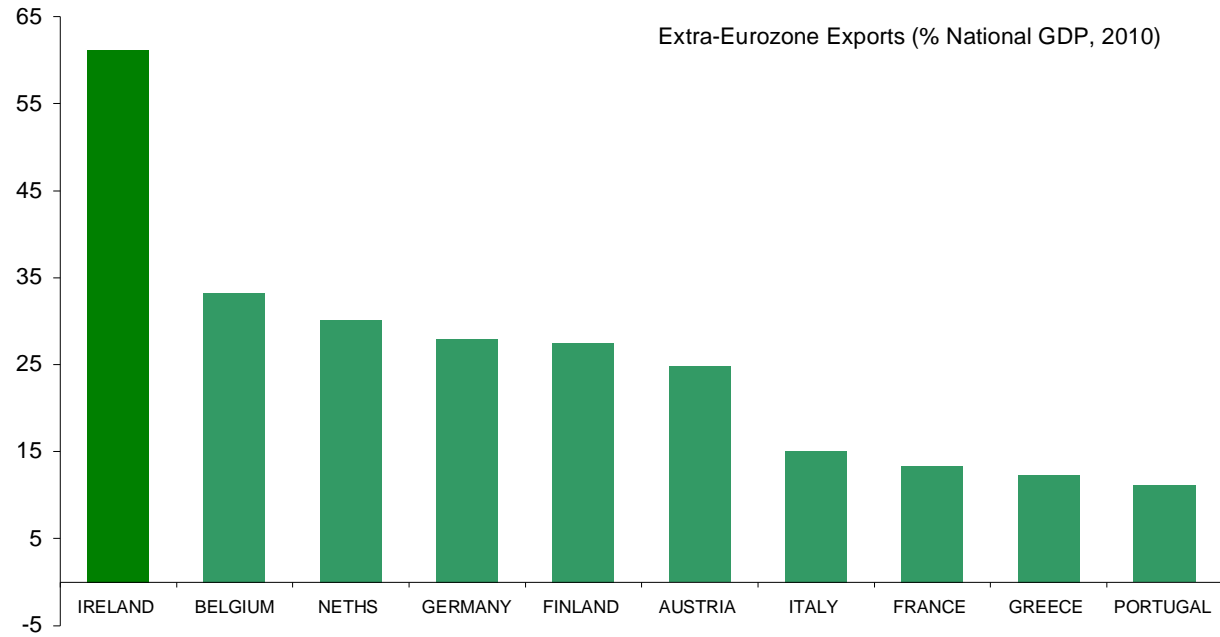


Outperforming the eurozone



Ireland: Open to the world

Openness to external eurozone exports



DT

Source: Reuters EcoWin Pro, BNP Paribas

- Irish is very sensitive to external developments...
- ...with exports around 100% to GDP

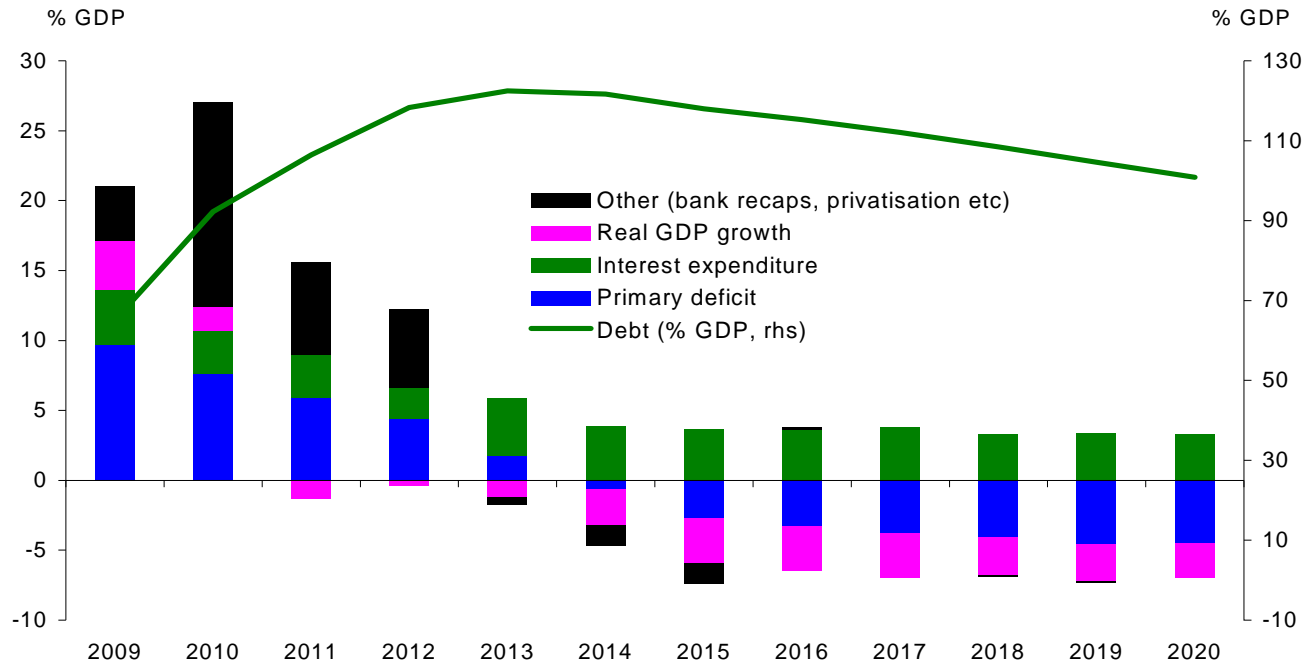


Not a typical eurozone economy



Ireland: Debt sustainability is still a stretch

Irish Debt Dynamics



DT

Source: IMF Eighth Review

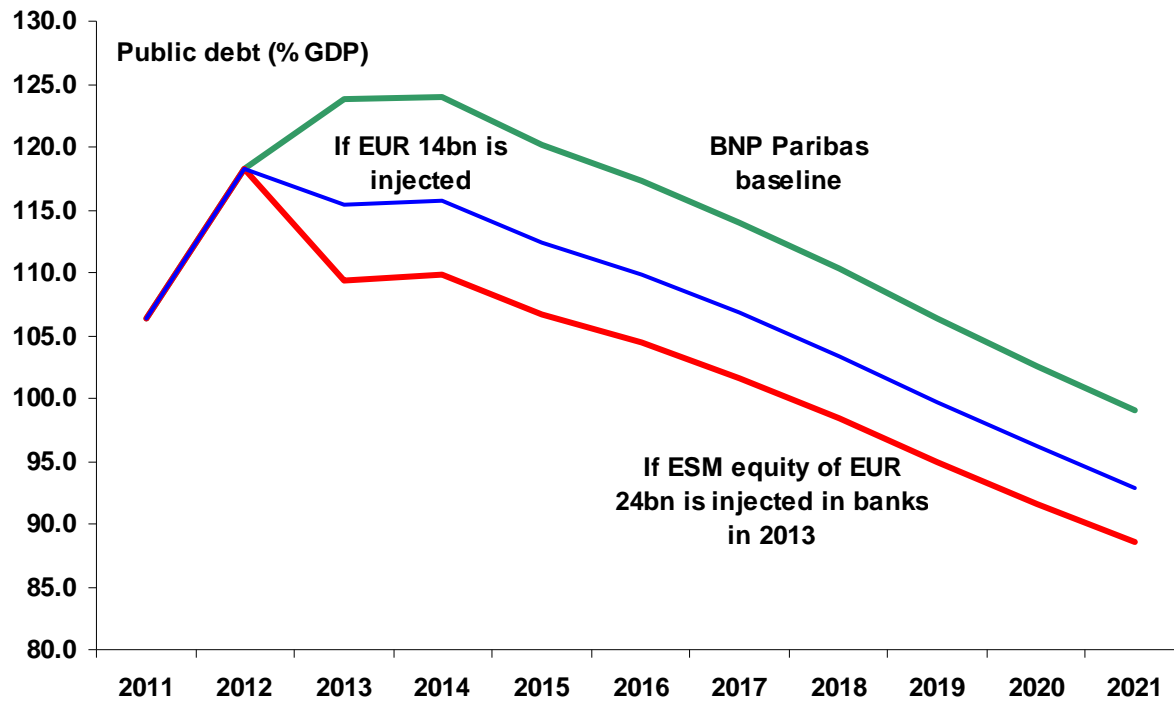
- Debt peaks at 123% under current plans
- Program sees primary balance in surplus in 2014 (0.6% GDP)
- The DSA sees nominal growth at 4.5% in 2015-17 (cf 2.1% in 2012). Could still be difficult



Sustainability is still a stretch



Ireland: ESM equity injections could move debt towards 100%



DT

Source: BNP Paribas

- If the ESM invested EUR 24bn (the full value of the bank equity increase under the programme) in the banks...
- ...and the government used the proceeds towards debt reduction...
- ...government debt would drop to around 109% in 2013 according to our calculations, compared to a base case of 123.8% of GDP

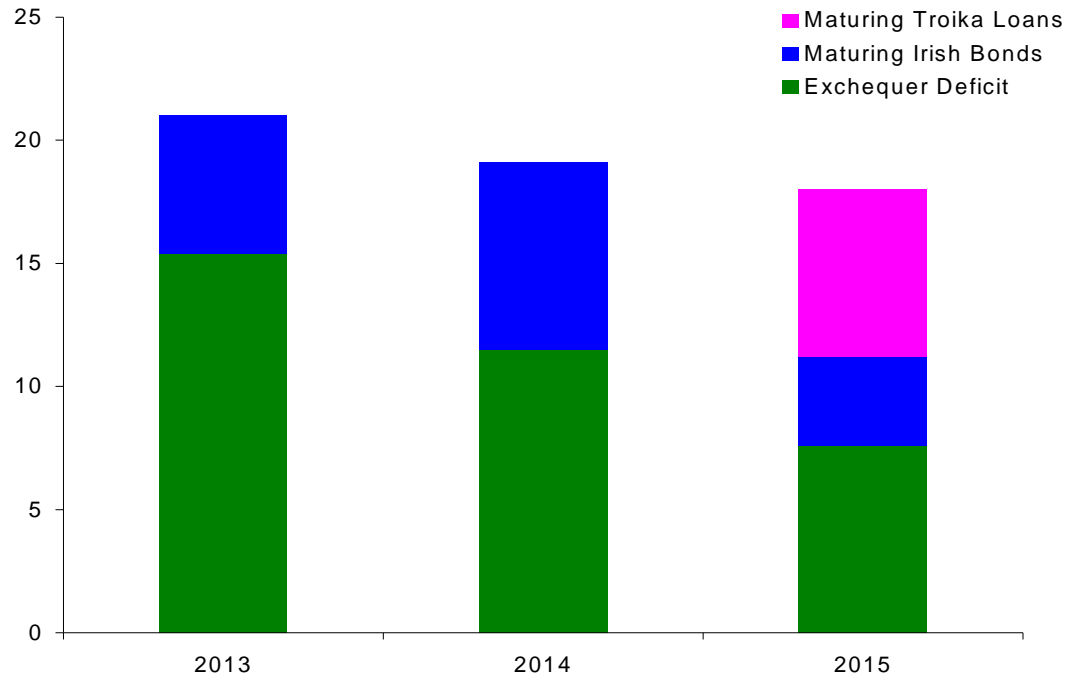


A deal could move the sovereign towards sustainability



Ireland: Is 2014 too soon?

Funding profile (EUR bn)



DT

Source: NTMA, Department of Finance

- Without a deal it may still be possible to exit the programme at the end of 2013, esp given half of 2014 is pre-funded.
- But removing the EUR 3.1bn of promissory note payments, along with possible support from OMT, could make full re-engagement possible



Programme exit in 2014 with OMT support possible



Summary

- **Slow recovery in global growth**
- **We feel more upbeat on**
 - US
 - China
 - LatAm
- **Europe is lagging**
 - No positive growth until H2
 - But financial stress reduced
 - Greece 'condemned to success'
 - Spain will go to ESM – but when?
 - Big issues put off until after German election
- **Global policy to remain very soft**
 - Norway, Canada and some Latam to hike this year
 - But some others cutting
 - And ECB on permahold



Economic forecasts

Economic Forecasts (% y/y)								
	2011	2012	2013	2014	2012		2013	
					Q3	Q4	Q1	Q1
US								
GDP	1.8	2.3	1.8	2.6	2.6	1.9	1.7	1.8
CPI	1.6	3.2	2.1	1.8	1.9	1.6	2.0	1.8
Core CPI	1.0	1.7	2.1	1.8	2.0	1.9	1.7	1.8
Eurozone								
GDP	1.5	-0.5	-0.4	1.0	-0.6	-0.7	-0.8	-0.6
Germany	3.1	0.9	0.5	2.2	0.9	0.7	0.3	0.2
France	1.7	0.1	0.0	0.9	0.1	0.0	-0.1	0.0
Italy	0.6	-2.1	-0.7	0.7	-2.4	-2.2	-1.6	-0.8
Spain	0.4	-1.4	-1.8	0.0	-1.6	-2.0	-2.2	-2.1
CPI	2.7	2.5	1.8	1.5	2.3	1.9	1.7	1.7
Core CPI	1.4	1.5	1.3	1.3	1.4	1.3	1.2	1.3
Japan								
GDP	-0.6	2.1	0.3	0.0	0.5	0.5	-0.7	-0.3
Core CPI	-0.3	-0.1	-0.2	0.2	-0.1	-0.4	-0.3	0.0
US-Like Core CPI	-0.9	-0.6	-0.3	0.7	-0.6	-0.4	-0.7	-0.5
UK								
GDP	0.9	-0.1	0.9	1.6	0.0	0.3	0.7	1.3
HICP	4.5	2.8	2.6	2.6	2.7	2.6	2.8	2.7
Core CPI	3.2	2.4	2.2	1.8	2.2	2.7	2.4	2.4

Source: BNP Paribas (Market Economics)



Interest rate and FX forecasts

Interest-rate forecasts (%)*

	Spot**	Q1 '13	Q2 '13	Q3 '13	Q4 '13	Q1 '14
US						
Fed Funds	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25
2-year	0.25	0.20	0.20	0.25	0.25	0.25
10-year	1.87	1.75	2.00	2.20	2.40	2.50
Germany						
Refi	0.75	0.75	0.75	0.75	0.75	0.75
2-year	0.13	0.00	0.10	0.15	0.20	0.20
10-year	1.58	1.20	1.30	1.50	1.75	1.85
Italy						
10-year vs Bund	2.55	4.05	3.10	3.05	2.75	2.70
Spain						
10-year vs Bund	3.31	5.05	3.85	3.90	3.75	3.50
Japan						
Call Rate	0.10	0.10	0.10	0.10	0.10	0.10
2-year	0.09	0.10	0.10	0.10	0.10	0.10
10-year	0.82	0.75	0.80	0.80	0.85	0.85
UK						
Base Rate	0.50	0.50	0.50	0.50	0.50	0.50
2-year	0.41	0.20	0.30	0.45	0.60	0.70
10-year	2.08	1.90	1.95	2.10	2.25	2.30

Source: BNP Paribas (Market Economics, Interest Rate Strategy)

*End Period **Spot Rates as at 14 January

FX forecasts*

	Spot**	Q1 '13	Q2 '13	Q3 '13	Q4 '13	Q1 '14
EUR/USD	1.34	1.35	1.32	1.35	1.32	1.31
USD/JPY	89	83	80	78	76	78
GBP/USD	1.61	1.73	1.74	1.82	1.78	1.82

Source: BNP Paribas (FX Strategy) *End Period **Spot Rates as at 14 January



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