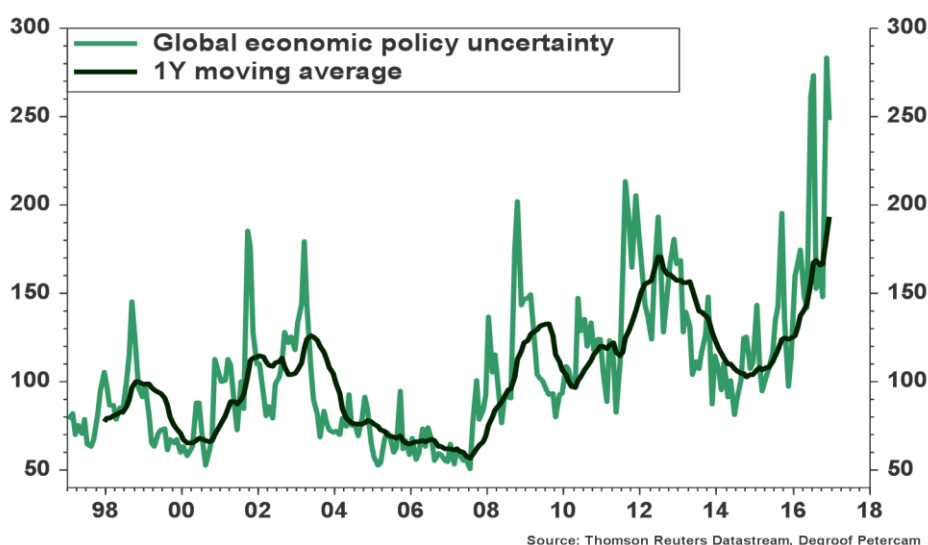


GLOBAL ECONOMIC OUTLOOK

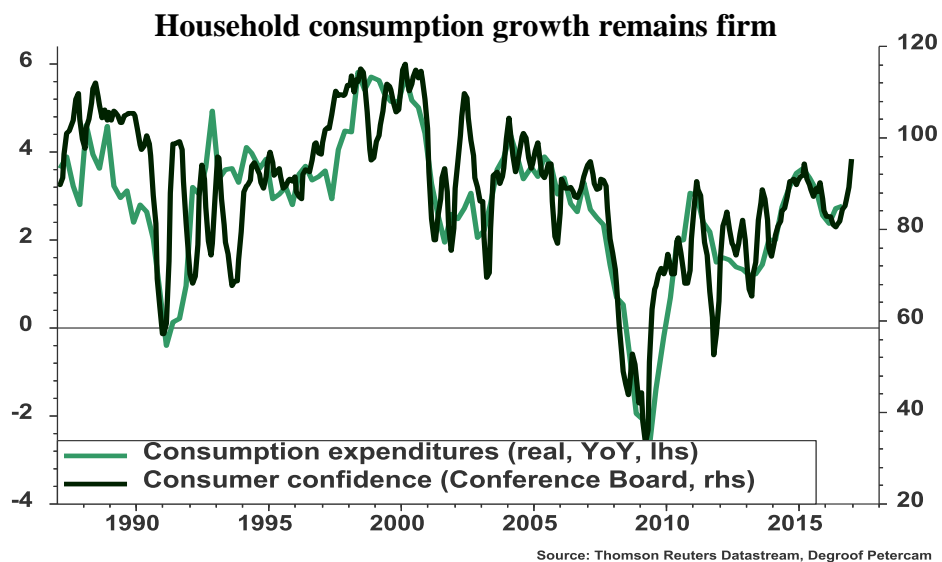
- ✓ Global economic confidence has been picking up since the Summer. Base effects linked to commodity prices are sending inflation higher, breaking the earlier disinflationary trend. Financial markets have been moving in the same direction with stock prices and interest rates seeing positive evolutions in general.
- ✓ There is a growing political awareness that budgetary policy should play a more important role in order to sustain the recovery. That said, talk is still cheap, especially in Europe entering another challenging political year. Fiscal stimulus in the US is subject to a lot of uncertainty in terms of instruments, amounts concerned and timing.
- ✓ While financial market volatility is very low, economic policy uncertainty has been increasing to very high levels. For all the talk that the fallout from both the Brexit-vote and Trump remains limited, neither have started yet.
- ✓ Recent political developments suggest the world economy could see a significant shift towards more protectionism. The USD plays an important potential catalyst role here as it makes US exports less competitive resulting in bigger trade deficits. This could create a self-fulfilling prophecy in terms of more trade protectionism with surplus countries like China and Mexico in the spotlights.
- ✓ Underlying inflation remains modest and below target in most developed markets for the time being. This implies that monetary conditions will stay loose for now even though the Fed has resumed its hiking path. Base effects linked to commodity prices are currently driving inflation higher and this effect has further to go in 2017. Textbook economics suggests that the improving cyclical momentum in combination with fiscal stimulus and trade protectionism should lead to higher inflation going forward. However, as mentioned earlier, the degree of uncertainty linked to these elements is also high.
- ✓ Risks to the current more positive growth momentum are significant in all too many ways including Trump not being able to live up to his promises, China's unsustainable credit boom or more Eurozone political instability.



Source: Thomson Reuters Datastream, Degroof Petercam

United States

- ✓ US economic activity rebounded nicely towards the end of last year following a very disappointing start. Business confidence indicators were showing signs of improvement even before Trump got elected.
- ✓ 'Trumponomics' remains subject to a lot of uncertainty at this point in time. There's a good chance we will see more fiscal stimulus (though unlikely as much as his election promise), translating in higher domestic inflation and economic growth. That said, fiscal multipliers are unlikely to prove strong for several reasons (less slack in the economy (~crowding out), big emphasis on tax cuts versus infrastructure spending, implementation risk).
- ✓ Trump has accused Mexico and China of job stealing policies. The strengthening USD puts additional pressure on the industrial sector, hence increasing the risks of protectionist measures.
- ✓ Disposable income growth, consumer sentiment and the favourable housing and labour market backdrop point to solid household consumption growth. Rising interest rates look set to provide headwind in this context.

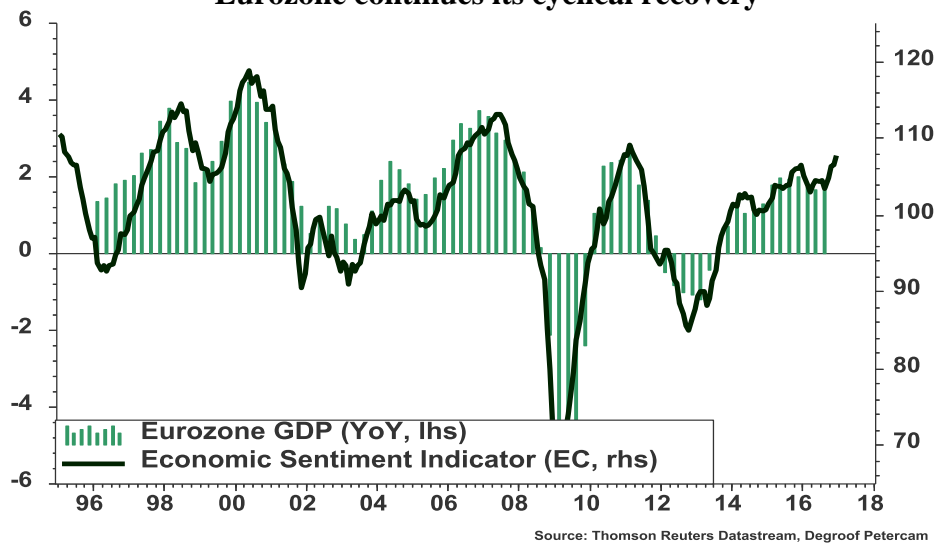


- ✓ Private investment remains disappointing against the back of modest profit growth and relatively low capacity utilization rates. Increased public spending in the years to come could attract more private investment spending, a necessary condition to get productivity growth on a higher footing.
- ✓ Inflation is picking up but remains below the Fed's target of 2% at this point. Market-based measures of inflation have been picking up considerably in recent months but remain low in historical perspective. Survey-based measures of inflation on the other hand are broadly stable in recent months.
- ✓ Monetary policy remains accommodative. The December policy rate hike, higher longer term interest rates and strengthening USD imply that monetary conditions are tightening.
- ✓ The Fed minutes published earlier this month indicate that Fed members will continue a cautious wait-, see- and react-stance depending on incoming economic data.

Europe

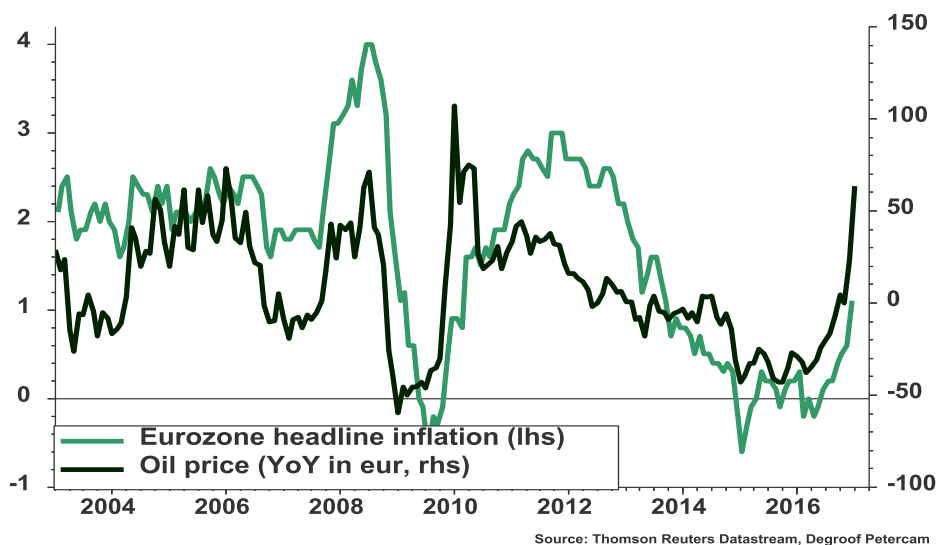
- ✓ Economic confidence indicators throughout the whole of Europe and across sectors are on the rise. While industrial production is showing signs of acceleration, household consumption growth remains firm.
- ✓ While the Eurozone is experiencing a cyclical recovery, structural headwinds in the form of ageing and insufficient progress towards a full budgetary, political and monetary union remain strongly present.

Eurozone continues its cyclical recovery



- ✓ Moreover, the easiest part of the economic recovery is probably behind us. The benefits stemming from economic tailwinds including falling interest rates, lower euro exchange rate, lower commodity prices and the lifting of earlier austerity measures are weakening. Looking forward, household real income growth will soften given that inflation is picking up.
- ✓ For the European economy to continue making sustainable progress, European governments must step up their investment policies. Unfortunately we have yet to see convincing signs in this respect.
- ✓ Elections in the Netherlands, France and Germany will make 2017 another challenging year. Given the relatively larger welfare state, the less acute refugee crisis and the recovering European economy, a large destabilizing political outcome is not the most likely for now. Nevertheless, vigilance is warranted as populism is on the rise. Meanwhile, 2017 will see the start of difficult and uncertain Brexit negotiations.

Headline inflation jumps on base effects



- ✓ Headline inflation is increasing (1.1% in December versus 0.6% in November) and base effects will send it higher over the next couple of quarters. With core inflation hovering around 1% for several years now, underlying price pressures remain weak reflecting the slack in the labour market. Although still at high levels, unemployment is coming down and surveys of employment expectations continue to paint a

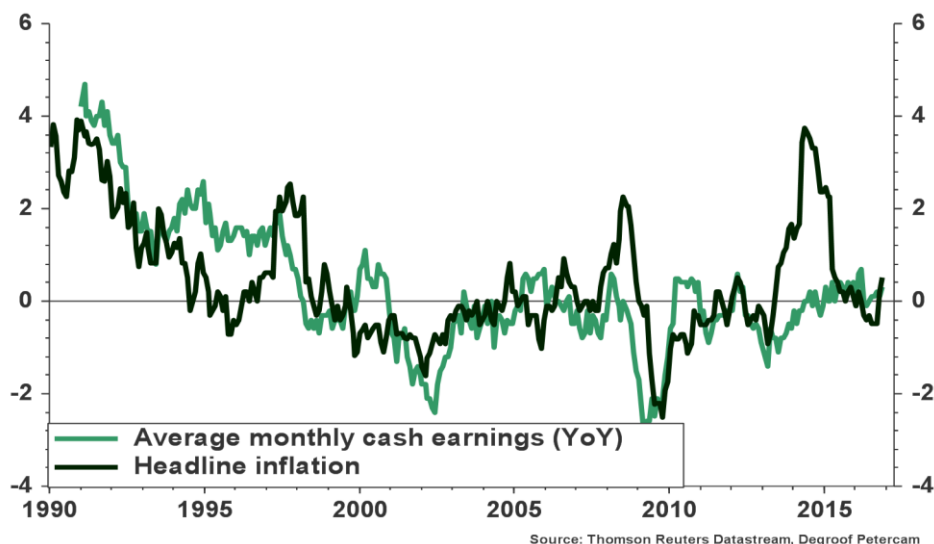
positive picture. Given the persistence of the large negative output gap, core inflationary pressures are expected to stay subdued for the time being.

- ✓ All in all, even though core price pressures should rise somewhat against the back of a more positive growth momentum, the ECB still looks to experience major difficulties in getting inflation up to its target of 2% in a sustainable way. Therefore, the ECB is in no hurry to leave its zero interest rate policy or dismantle its asset purchase program (60bn EUR each month until the end of 2017) program for now. That said, 'ECB tapering talk' will become more pronounced as the year proceeds and economic activity confirms.

Japan

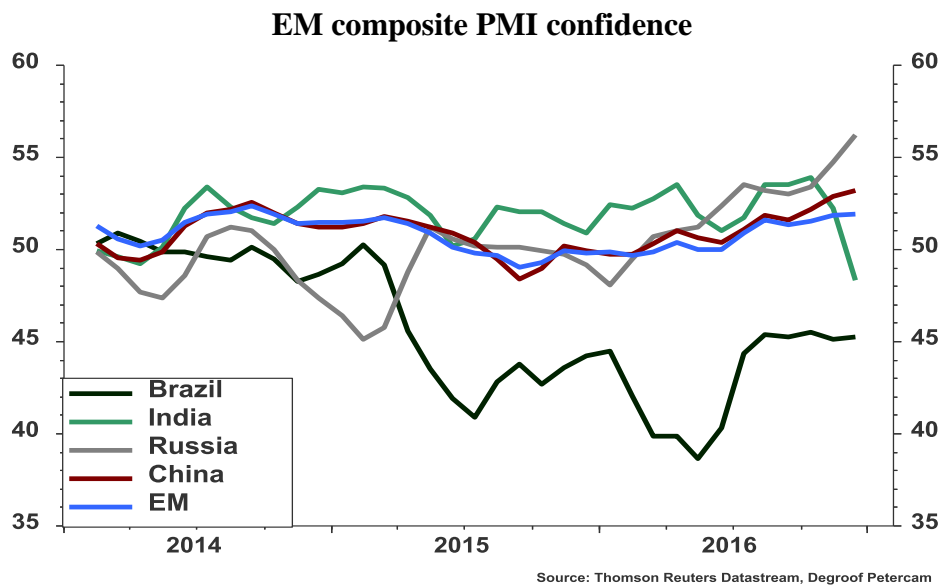
- ✓ Household consumption and industrial production growth remain subdued though the latter shows modest signs of improvement more lately.
- ✓ Although the deflationary spiral has ended since late 2013, wages and inflation fail to take off meaningfully despite the tightening labour market.
- ✓ In its September meeting, the BoJ presented its new QQE program adding yield curve control (by targeting 10y yields around 0%) and inflation overshooting. This could be interpreted as Kuroda providing more fiscal space to Abe's administration to increase fiscal spending. The idea is to stimulate inflation and lower real yields while going hand in hand with JPY depreciation. The move also gives the BoJ more flexibility to taper its asset purchase program further down the road.

Wage growth and inflation remain very modest



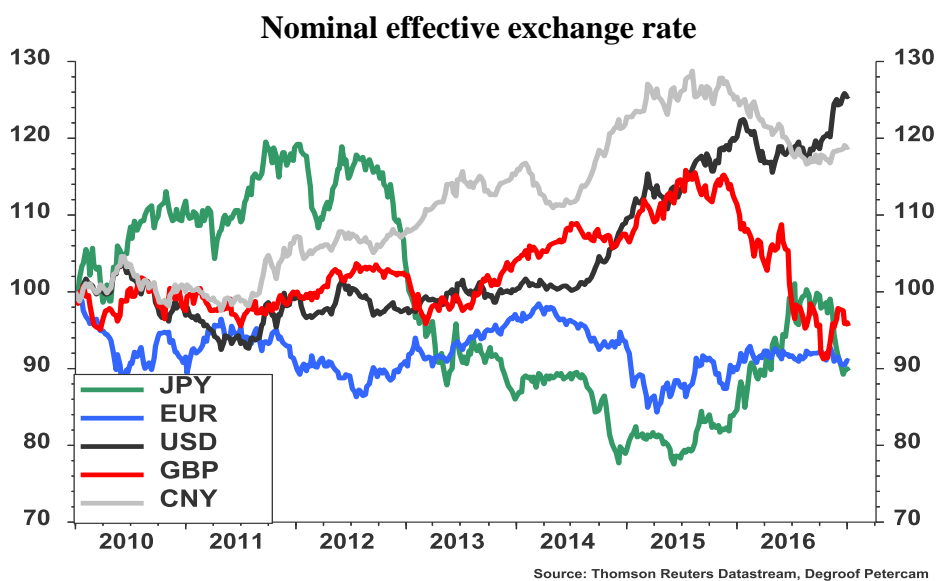
Emerging Markets

- ✓ Sentiment towards EM has improved since early 2016 against the back of a more cautious Fed, stabilization in commodity prices and reduced concerns about China's near term prospects.
- ✓ But EM are not out of the woods yet. China's challenging rebalancing exercise and uncertainties linked to monetary policy tightening in the US could expose more EM weakness. Moreover, Trump's presidency bodes risks for EM.
- ✓ Although very difficult to time, concerns about China look set for a comeback. Indeed, the background of soaring house prices and continued rapid credit growth is far from comfortable.



- ✓ From an EM wide perspective, inflation remains under control though base effects linked to commodity prices are also at play in the short term. Significant differences between countries exist. While inflation in countries like Brazil and Turkey is still at uncomfortably high levels, inflation in other countries including Korea, the Philippines, Poland or Hungary remains below target. All in all, the combination of subdued economic activity, stabilization in EM currencies and commodity prices should make sure EM inflation remains in check.

CURRENCY OUTLOOK



- ✓ The USD has become even more expensive in a long term theoretical perspective. That said, more evidence of the Fed turning more hawkish could still lead to a somewhat stronger USD in the next couple of months. Downward risks remain significant in a medium to longer term perspective.
- ✓ Following the earlier sharp depreciation linked to the risks of Brexit and the actual Brexit vote, the GBP has stabilized in real trade weighted terms since November . The currency is still trading more than 15%

below its 20-year average real effective exchange rate. Risks remain on the downside: Brexit has not started yet and the UK is running a sizeable current account deficit of around 5% of GDP.

- ✓ Following its appreciation since the start of 2016, the JPY has been weakening again since the summer. This was largely due to the BoJ's monetary policy measures (of yield curve targeting and inflation overshooting) announced in September. While the JPY looks rather cheap against the USD in a long-term perspective, the opposite seems true for its valuation against the EUR. A big depreciation versus the EUR, however, seems unlikely.
- ✓ EM currencies experienced downward pressure again since Trump got elected. Moreover, China's challenges, the subdued growth outlook and political risks warrant caution.
- ✓ Although, the RMB did not see a large one-off depreciation so far, it has faced structural downward pressure against the USD since 2014. A managed depreciation remains our base case scenario but we would not completely rule out the possibility of a big depreciation. The reason is that we remain concerned about the sustainability of China's economy.

GDP and CPI OUTLOOK

	GDP			Inflation		
	2016	2017	2018	2016	2017	2018
US	1.6	2.2	2.0	1.2	2.3	2.4
		2.3	NA		2.4	NA
Eurozone	1.7	1.5	1.3	0.2	1.3	1.4
		1.4	NA		1.3	NA
Japan	1.0	1.0	1.0	-0.2	0.4	0.7
		1.0	NA		0.5	NA
China	6.7	5.5	5.0	2.0	2.2	2.0
		6.4	NA		2.1	NA

Degroof Petercam forecasts, January 2017, Consensus forecasts

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