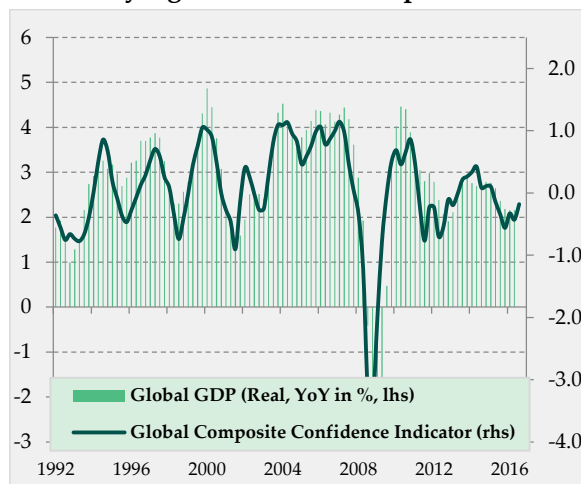


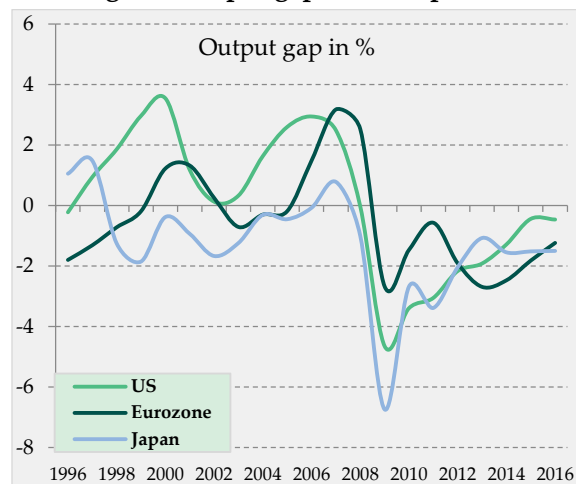
GLOBAL ECONOMIC OUTLOOK

- ✓ Our global economic activity indicator suggests that growth remains subdued, in line with the IMF’s latest outlook report. That said, we are witnessing early but encouraging signs of acceleration in recent months.
- ✓ The risk of a prolonged period of subdued growth and low interest rates is real against the back of strengthening demographic headwinds and less scope for debt accumulation. ([More here](#)).
- ✓ Encouragingly, there is a [growing awareness](#) about the need for more expansive budgetary policies. In a liquidity trap situation this will prove far more efficient to close the output gap, especially in Europe and Japan. If followed up by concrete and sizeable policy action this could translate in stronger economic activity and higher inflation prints. For now at least, statements still remain vague implying that actual implementation might take time and the amounts concerned limited.
- ✓ On a positive note, there seems to be consensus that monetary policy can only do so much in the current near zero interest rate environment. Moreover, monetary policymakers look set to attach more weight to the financial sector’s concerns (cfr flat yield curve).
- ✓ Even with the low level of commodity prices in place, base effects will send headline inflation higher in the next couple of quarters. The prospect of a late November Opec deal to cut production tends to strengthen this effect.
- ✓ Underlying inflation remains modest and below target in most DM for the time being. This implies that monetary conditions will stay loose for now even though a second rate hike in the US is becoming more likely.

Early signs of economic improvement



Negative output gaps remain present



Source: Datastream, Degroof Petercam

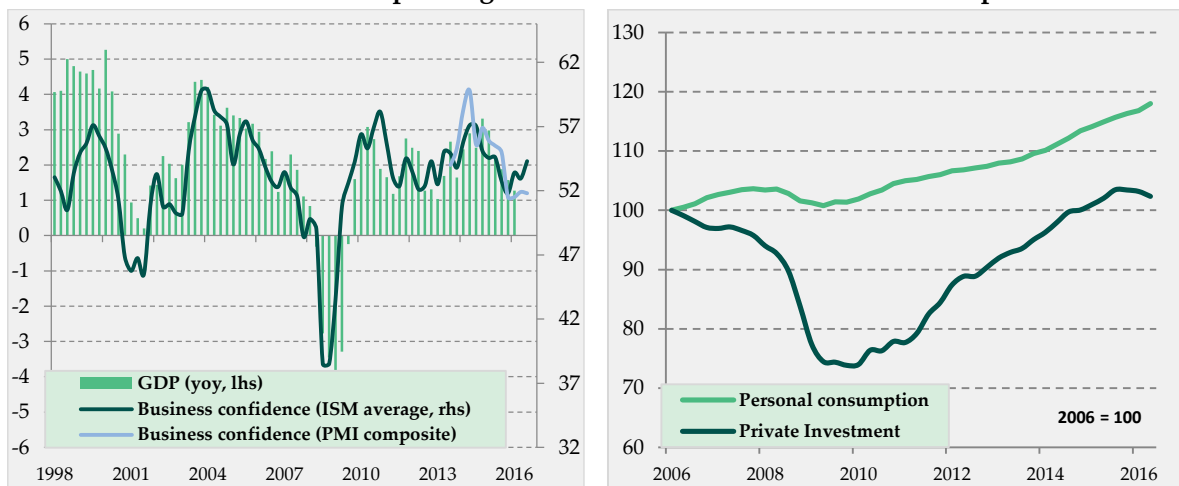
United States

- ✓ US economic activity disappointed strongly in the first half of the year. The manufacturing sector still suffers from the stronger USD and problems in the energy sector. Service sector confidence, on the other hand, recovered strongly in September following the sharp drop in August. All in all, according to leading

indicators, growth is now hovering between 1-2%.

- ✓ Overall productivity growth remains very disappointing and the outlook for investment remains weak against the back of negative profit growth and relatively low capacity utilization rates. This is a key risk factor for the US economy. That said, increased public spending after the US elections could attract more private investment.
- ✓ Household consumer spending is growing at around 2% in year-on-year terms and several factors, including disposable income growth, consumer sentiment and the relatively favorable housing and labor market backdrop, suggest consumption growth should hold up.

Solid US consumer spending versus weak investment and industrial production



Source: Datastream, Degroof Petercam

- ✓ Adding 204K jobs on average over the past 12 months, the labor market has been performing solidly. Leading indicators suggest future job gains will come in a touch lower. Initial jobless claims, meanwhile, remain at very low levels, indicating that the labor market is doing fine overall.
- ✓ Wage growth plays a key role with regard to the future path of inflation and is slowly picking up. At around 2.5%, however, the level nevertheless remains below its 30-year average of around 3%.
- ✓ Base effects linked to energy prices will make sure that headline inflation (now around 1%) will trend higher towards the end of the year. At 2.2% and 1.6% for core inflation and core PCE inflation (which is more important for Fed) respectively, underlying inflation has been stabilizing over the last 3 months. Looking forward, however, leading indicators paint a mixed picture with the evolution in unit labor costs suggesting that core inflation should pick up further (accelerating wage growth in combination with slow productivity growth) while price surveys point to only very modest upward price pressure.
- ✓ US policymakers are not in a hurry to raise interest rates. Modest growth in combination with below target inflation means that the Fed continues to adopt a very cautious wait-and-see approach as has been the case for several years now. December now looks like the most likely candidate to see a second rate hike. All in all, the Fed's own estimates, the so-called dots, still look too bullish.
- ✓ The November Presidential elections are drawing lots of attention. As things stand, according to election polls, Mrs Clinton is leading the race to the White House ([more here](#)).

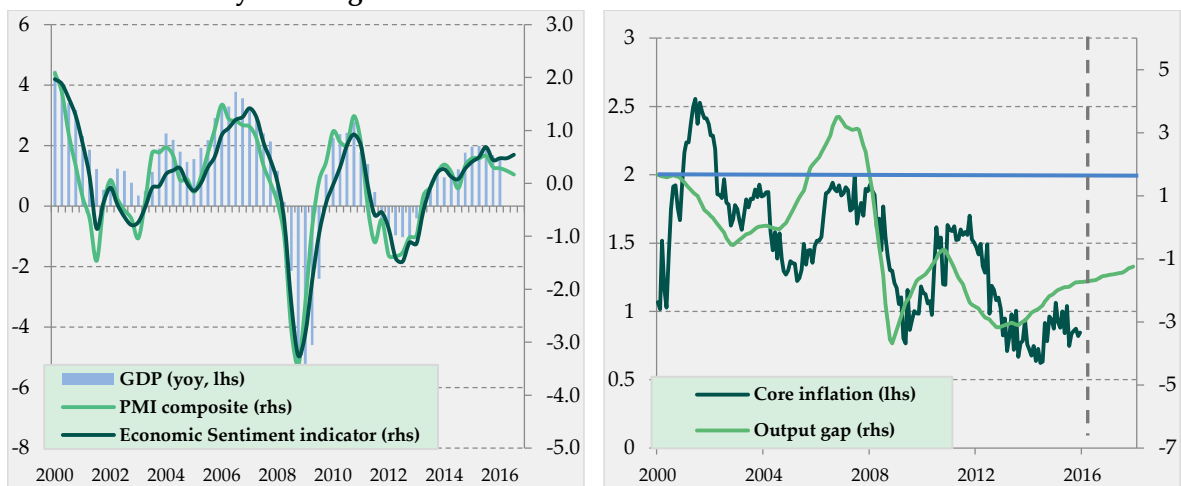
Europe

- ✓ Encouragingly, most confidence indicators in the immediate aftermath of the Brexit vote are holding up.

This suggests that the fallout on Eurozone economic activity remains limited so far. Note, however, that the European Commission's confidence indicator shows a somewhat more upbeat picture than the Eurozone composite PMI.

- ✓ The Eurozone cyclical recovery is still far from spectacular. Consumer spending is holding up nicely while investment is still sluggish. What's more, confidence indicators are not pointing to further growth acceleration and structural headwinds remain strong (more [here](#)). The Eurozone still faces major challenges beyond the short-term.
- ✓ Trade negotiations between the UK and the EU still need to start and this looks set to be a complex and prolonged negotiation process. Most recent headlines suggest that the likelihood of a confrontational Brexit is increasing. This has been reflected in recent further GBP depreciation.
- ✓ The upcoming constitutional referendum (about reducing the power of the Senate) in Italy also seems challenging. A yes vote is far from assured. The 2017 European political calendar remains challenging (Austrian, Dutch, French, German elections) and poses risk to economic financial market sentiment.

Eurozone economy showing resilience in Brexit aftermath while inflation remains downbeat



Source : Datastream, Degroof Petercam

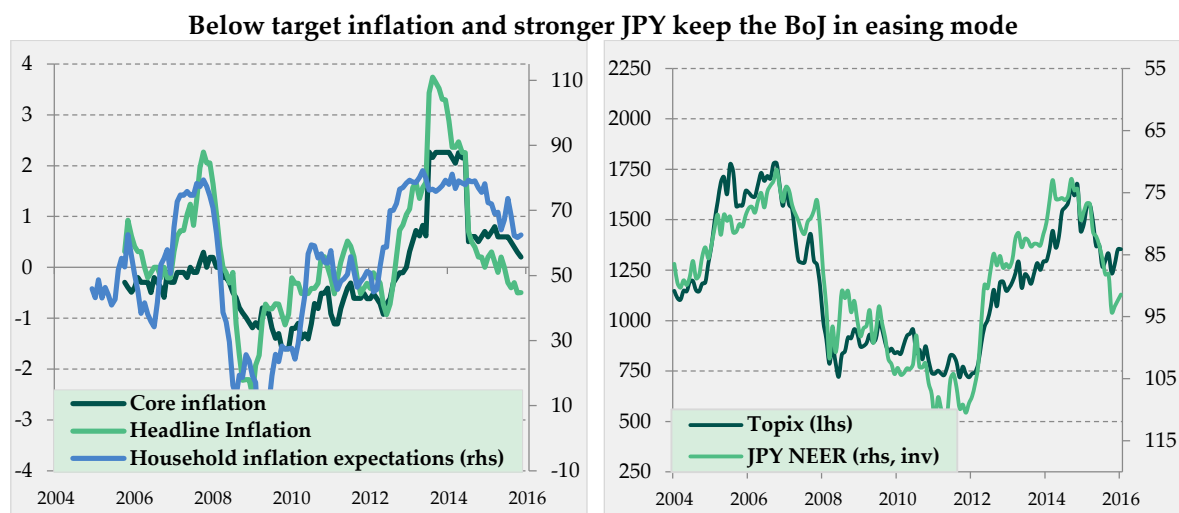
- ✓ Headline inflation (0.4 % yoy in September) is held down by the earlier steep fall in energy prices but base effects will send it higher over the next couple of quarters. With core inflation hovering around 1% for several years, underlying price measures remain weak reflecting the slack in the labour market.
- ✓ Given the persistence of the large negative output gap, core inflationary pressures are expected to stay subdued. All in all, despite the latest easing measures taken in March, the ECB still looks to experience major difficulties in getting inflation up to its target of 2% in a sustainable way (see [here](#) for more information), keeping monetary policy in easing mode for longer. All talk about the ECB going in tapering mode seems premature at this stage. As things stand, the ECB will first announce an extension of its current (€80bn per month) asset purchase program, perhaps until September next year.
- ✓ It should be clear, however, that opposition to more monetary easing is rising and also that it is no panacea in a liquidity trap situation. Indeed, a more expansive budgetary stance is likely to prove more helpful in this respect. The ECB has also been hinting in this direction more in recent months.

Japan

- ✓ In Japan, despite sluggish economic activity, JPY appreciation and falling stock prices, the BoJ basically refrained from adding stimulus in its late July meeting. Meanwhile the Abe government announced a new

fiscal stimulus package of 28.1 trillion JPY (around 5.6% of GDP). That said, only a fraction of that constitutes fresh public spending (7.5 trillion JPY of which 4.6 JPY in 2016), so that all talk of big fiscal stimulus is vastly exaggerated. It should nevertheless translate in somewhat higher GDP numbers next year.

- ✓ In its September meeting, on the other hand, 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 writing a blank check to Abe's administration to increase fiscal spending further while rates would interest rates would remain in check. The intention would be to stimulate inflation and lower real yields. It would probably go hand in hand with JPY depreciation. This move also gives the BoJ more flexibility to taper its asset purchase program further down the road if the strategy would prove succesful.

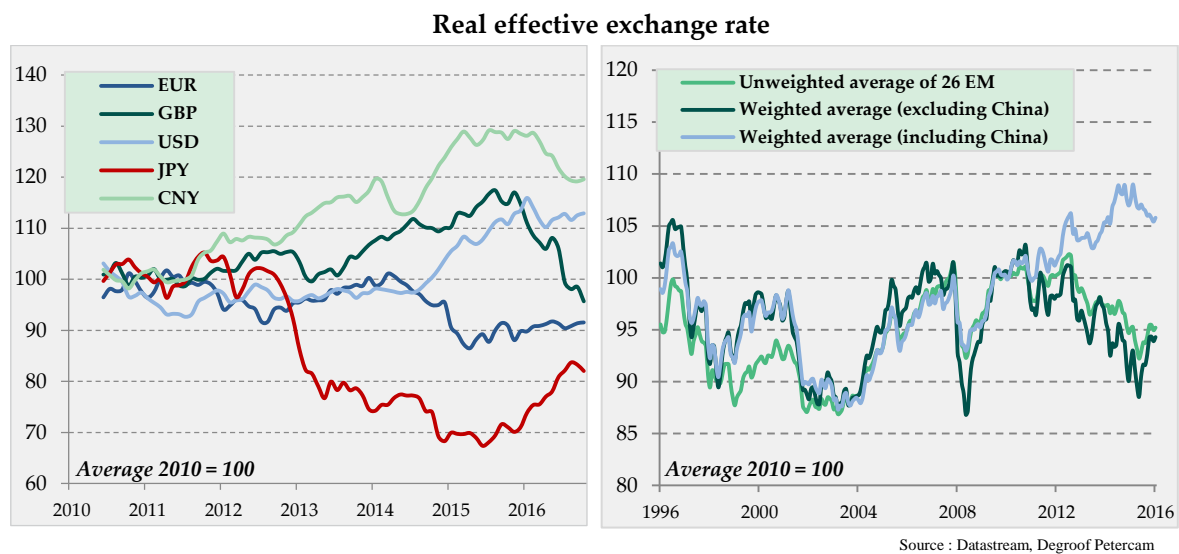


Emerging Markets

- ✓ More broadly in EM, the slowdown witnessed over the past few years reflects several factors including the negative effect of lower commodity prices, tighter external financial conditions linked to the prospect of the hiking cycle in the US, the private sector debt overhang, economic rebalancing in China, structural bottlenecks as well as distress related to (geo)political factors. Moreover, there are signs of premature deindustrialization in several important EM which is worrying in a medium to longer term perspective.
- ✓ Sentiment towards EM has improved in recent months against the back of a reduced USD outlook, stabilization in commodity prices and reduced concern about China's near term prospects following policy support to growth. 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 easily expose more EM weakness ([see here](#) for more information). Additionally, prospects differ sharply across countries and regions, with emerging Asia in general and India in particular showing resilient growth and sub-Saharan Africa and economies of the Middle-East experiencing a sharp slowdown.
- ✓ Chinese hard landing fears have been receding over the past months and a large one-off depreciation has been avoided, at least for now. This is completely in line with the scenario we described earlier (see [here](#) and [here](#) for example). The combination of monetary and budgetary measures is driving a cyclical recovery. But while we were right on this call, we are still convinced that the medium to longer term outlook for China will prove extremely challenging.

- ✓ Moreover, it would not be surprising that worries about the sustainability of the current recovery soon pop up again. Indeed, the background of inaccurate growth figures, soaring house prices and continued rapid credit growth is far from comfortable and will give rise to more and more concerns about the state of China's economy. How will Chinese policymakers reconcile the ambition of strong growth and the need for further economic rebalancing while at the same time avoiding the stop-and-go policies seen in recent years? The short answer is that this will prove close to impossible. That's why, despite the recent calmness, concerns about China look set for a comeback in the not so distant future as also explained [here](#).
- ✓ Among other large EM, growth prospects are relatively stronger in commodity importers such as India, China or the Philippines. For commodity dependent EM, adjusting to lower commodity prices remains a challenge. This adjustment can take the form of an exchange rate depreciation for countries not relying on an exchange rate peg (Russia), the use of reserves to cushion the income shock (S. Arabia) or a fiscal consolidation that is as growth friendly as possible.
- ✓ From an EM wide perspective, inflation remains under control. That said, 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.

Currencies (more details [here](#))



- ✓ Our long-held stance that the consensus view of a continued USD appreciation should not be taken for granted, has been proven right so far (more [here](#)). We continue to think that a sharp appreciation from current levels should not be expected. Despite the latest depreciation the USD still looks rather expensive in a long term theoretical perspective. That said, more evidence of the Fed moving towards another rate hike could lead to a somewhat stronger USD in the next couple of months. Therefore, we see upward risks for the USD.
- ✓ The BoE loosened monetary policy after its August meeting in response to the effects of Brexit. GBP is currently trading more than 18% below its 20-year average real effective exchange rate, although there is still some room left for depreciation towards its PPP-level. Moreover, at 6% of GDP the current account deficit remains pretty big. Another rate cut is still likely over the coming months. Given the lack of

visibility on the future for the UK, the downward risks for the GBP continue to prevail. More details on the GBP can be found [here](#).

- ✓ Until recently, the BoJ has been underwhelming expectations of policy easing, leading to a stronger JPY. From a LT-perspective, it seems that the JPY has now become a little too expensive versus the EUR. A further sharp appreciation from current levels looks unlikely. That said, this will largely depend on upcoming central bank actions from the BoJ and ECB.
- ✓ EM currencies experienced serious downward pressure since the May 2013 taper tantrum. Since February this year, however, appetite for EM currencies has been improving as investor's expectations about higher policy rates in the US have been tempered. This intensified the search for yield and benefited EM assets. The subdued growth outlook and political risks warrant caution.
- ✓ In contrast to what many observers have feared since the summer of 2015, the RMB has not seen a large one-off depreciation so far just like we had expected (see [here](#) for more details). Following the G20 meeting in Shanghai in February, there seems to be more consensus on this call. Chinese policymakers have been making numerous initiatives in recent months to enhance the flexibility of the exchange rate and the opening up of the capital account. These efforts are rewarded by the inclusion of the RMB in the basket of SDR currencies of the IMF as of October. We would not rule out the possibility of a big depreciation. The reason is that we have become more concerned about the sustainability of China's economy. Moreover, a great deal of the capital flight witnessed in recent years was linked to Chinese companies paying down dollar debt.

GDP and CPI Outlook

	GDP			Inflation		
	2015	2016	2017	2015	2016	2017
US	2.6	1.3	1.6	0.1	1.2	2.2
		1.5	2.3		1.2	2.2
Eurozone	1.9	1.5	1.1	0.0	0.2	1.3
		1.5	1.3		0.2	1.3
Japan	0.6	0.6	1.0	0.8	-0.1	0.8
		0.6	0.8		-0.2	0.4
China	6.9	5.5	5.0	1.5	2.1	2.3
		6.6	6.3		2.0	2.0

Degroof Petercam forecasts, October 2016, Consensus forecasts

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