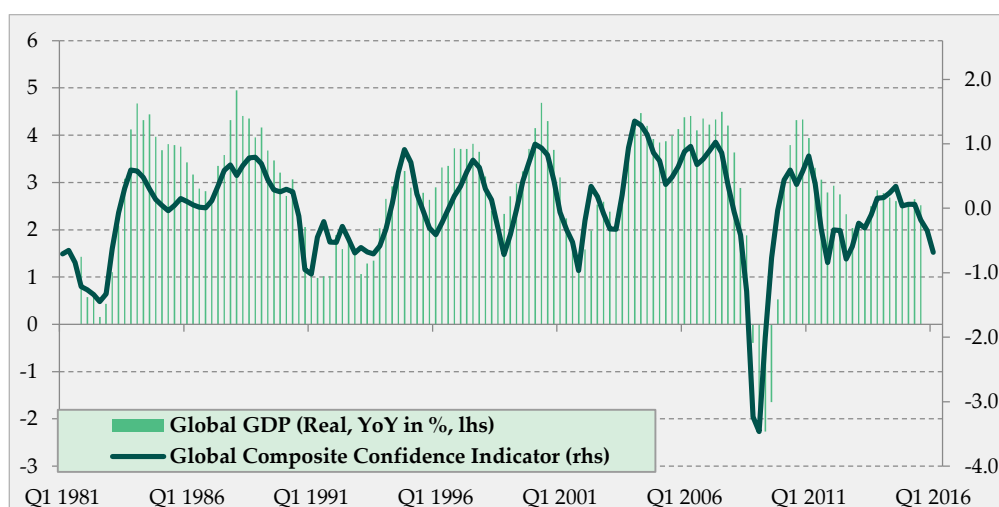


GLOBAL ECONOMIC OUTLOOK

- Our global composite confidence indicator suggests the world economy finds itself on the brink of recession. What's more, downward risks remain substantial and financial markets continue to see lots of volatility.
- Monetary policy rates are hovering near zero in the Western world. The same goes for real yields on longer term bonds. At the same time, confidence indicators suggest global economic activity is decelerating again following what has been a very lacklustre recovery since the Great Recession thus far. Meanwhile, despite huge expansions in the size of their balance sheet, most central banks are still desperately looking for higher inflation.
- Uncertainty looms large against the back of China's difficult economic rebalancing exercise, the future path of the RMB, increased realization among international investors that monetary policy can only do so much when interest rates are near zero, geopolitical risks, signs of hesitation in the US economy, disruptive effects of the earlier steep fall in oil prices, the shape of the global financial system, the risk of Brexit, the European refugee crisis and high levels of private and public debt,...

World economy on the brink of recession



Source : Datstream, Degroof Petercam

- A severe economic crisis in China is still a key risk. Our scenario that China will avoid a hard landing in 2016 remains in place even though the challenges that stem from rebalancing the economy loom large and hard landing fears are likely to continue to linger around. (<https://insights.petercam.com/emerging-markets/crossing-the-chinese-river>)
- Despite the general very low level of commodity prices, base effects will send headline inflation higher in late 2016. Core inflationary pressures look set to remain modest, implying that global monetary policy will stay very loose in the foreseeable future.
- The USD has appreciated significantly since the summer of 2014 and this has come with serious challenges. (<https://insights.petercam.com/developed-markets/more-thoughts-on-the-state-of-the->

[world-economy](#)). A further sharp appreciation from current levels, however, looks unlikely.

- Looking beyond the short-term, we think the chances of a prolonged period of relatively slow growth (in combination with interest rates around the zero lower bound) are high against the back of strengthening demographic headwinds and less scope for debt accumulation going forward. We would not agree that budgetary and monetary policymakers have lost all ammunition to fight this extremely challenging situation.
- Policy action really could make a difference and consensus is slowly building around the need for more infrastructure spending. Whereas the OECD has been (wrongly) focusing on balancing public budgets in the aftermath of the Great Recession, it now seems willing to recognize that more investment could help to spur growth. As resources are idle in a liquidity trap, a crowding-out effect from higher interest rates should not be expected, making this policy more effective. It's not entirely clear whether policymakers are ready to adopt this approach. The G20 Summit held in Shanghai last week did produce some encouraging results in this respect but remain vague at the same time.
- Our view on helicopter money going forward? If governments do spend more as we approach the ZLB, the insurance policy of helicopter money may not be needed. At the same time, even if governments want to do the right thing, lack of good projects or information delays may mean they cannot do enough. As a result, the very quick action that central banks could take with helicopter money could be a useful compliment. That said, it is not clear whether policymakers are ready to think more 'out of the box' in this respect. (<https://insights.petercam.com/developed-markets/unconventional-monetary-policy-pushing-on-a-string>).

## United States

- The US economy is facing headwinds based on most recent confidence indicators. Consensus growth estimates for 2016 (2.2%) seem too high as we have been arguing for several months now.
- Confidence in the manufacturing sector is suffering from a stronger USD and low oil prices, respectively weighing on exports and investment in the energy sector. Somewhat worryingly, confidence in the service sector has also come down since last October to a level that is slightly below its LT-average.

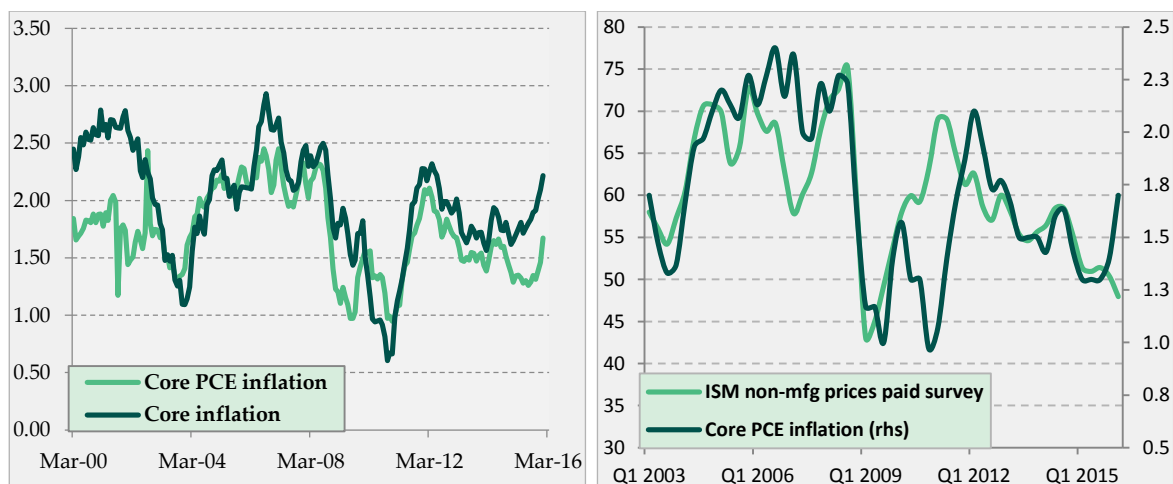
US consumer expectations softening



Source : Datstream, Degroof Petercam

- Though still in line with real consumption growth of around 2%, consumers' expectations about the future are also softening. All in all, consumer spending should hold up against the back of low energy prices, the continuing recovery in the housing market and decent job growth.
- With an average of 235K jobs created over the last 6 months, the labor market continues to perform solidly. At 4.9% the unemployment rate is in line with estimates of the NAIRU. Meanwhile the U6 unemployment rate dropped to 9.7% , down from more than 11% since the start of 2015 though still higher than the average of 8.9% seen between 1994 and 2007. Surveys measuring employment expectations have been weakening more recently. Moreover, wage growth remains lackluster.
- Headline inflation jumped up in February (to 1.3% from 0.7% in January) as the earlier sharp drop in energy prices seen earlier starts to have less of a negative impact. Base effects linked to energy prices will make sure that headline inflation will trend higher towards the end of the year. At 2.2% and 1.7% for core inflation and core PCE inflation (which is more important for Fed) respectively, underlying inflation is moving up. Looking forward, however, evidence is mixed with unit labor costs suggesting that core inflation should move up while other survey based price expectations are pointing in the opposite direction. The Fed's board of governors is also struggling with this. While Stanly Fisher sees the first "stirring" of higher inflation, Lael Brainard remains skeptic.
- Wage growth plays a key role with regard to the future path of inflation. At this point, despite the acceleration witnessed in recent quarters, wage growth is still subdued at around 2.5% yoy. NFIB survey indicators suggest wage growth should continue to pick up over the next couple of quarters. That said, this signal has been present since more than 2 years now without any meaningful realization so far.

#### Core inflation moves up but still doubtful whether acceleration will be sustained



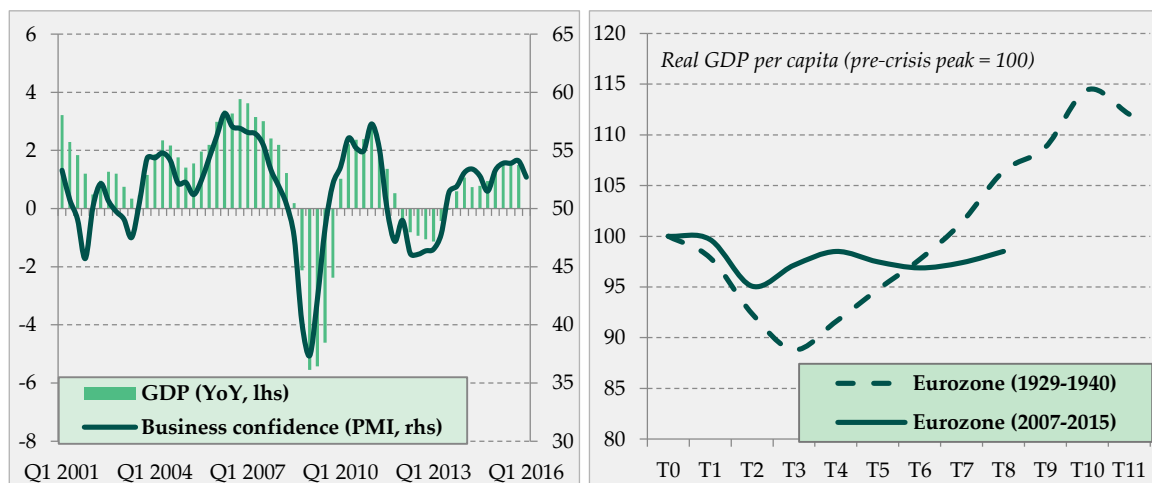
Source : Datstream, Degroof Petercam

- All in all, US policymakers are not in a hurry to raise interest rates. Clearly, recent market turmoil, signs of hesitation in the US economy and the fact that inflation remains below the Fed's target imply that it is likely to adopt a very cautious approach. The most important message is that monetary policy looks set to remain accommodative in the foreseeable future because the US economy is not doing all that great. The Fed is likely to proceed gradually and only if the underlying economic momentum remains strong enough.

**Eurozone**

- The European economy recovery remains highly disappointing against the favorable backdrop of low energy prices, the current low yield environment and EUR weakness. What’s more, leading indicators suggest economic activity is cooling against the back of a hugely disappointing post-2008 run.
- Looking ahead, household consumption should continue to increase at a modest pace supported by the slow but gradual improvement observed in the labour market and low oil prices.
- Headline inflation (-0.2 % yoy in February) is held down by the recent steep fall in energy prices but base effects will send it higher in the second half of the year. Underlying price measures on the other hand remain very weak reflecting the slack in the labor market. Given the persistence of the large negative output gap, core inflationary pressures are expected to stay very weak. All in all, the ECB is likely to experience major difficulties in getting inflation up to its target of 2%.

**Eurozone economic sentiment cools again at a time when recovery hasn’t even started for real**



Source : Datstream, Degroof Petercam

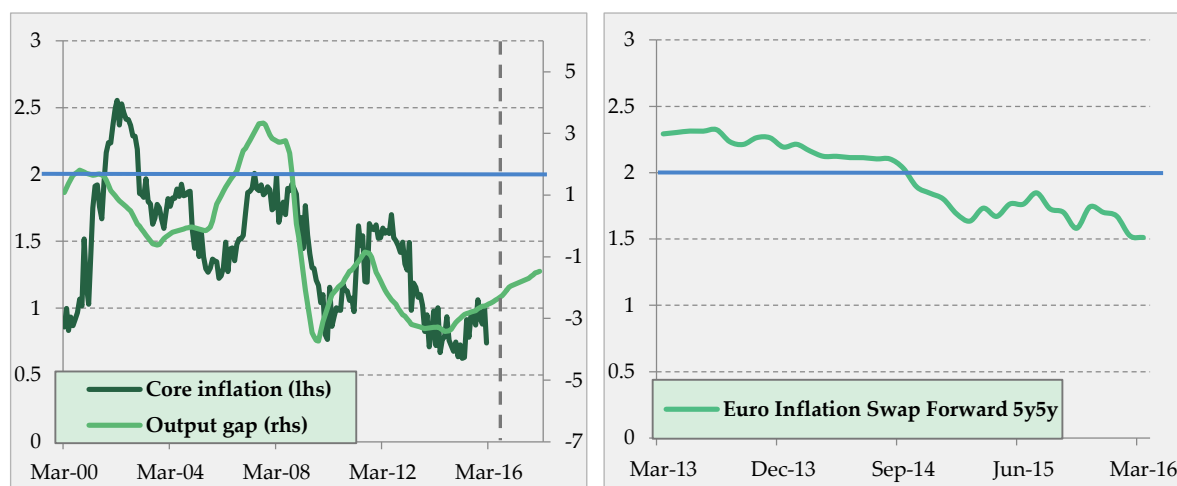
- Our long-held stance that the ECB would eventually be forced to do more has been proven right. In its December meeting, the ECB left the size of monthly asset purchases unchanged at bn 60 EUR but decided to extend its program until March 2017. In addition, the ECB decided to lower its deposit rate by 10 bp to -0.3%. In its January meeting, the ECB implicitly committed to do more in March. A further deposit rate cut to -0.4% seems the absolute minimum the ECB will have to deliver. But this will probably not be sufficient to meet financial markets’ expectations. It still has several other options including the increase in the volume of monthly purchases to bn 70-80 EUR, a further extension of the reference date to September 2017, an expansion of the TLTRO program or introducing a tiered deposit-rate system. It looks very plausible that one of these extra measures or a combination of them will be implemented.
- That said, irrespective of what will be announced, the ECB is still likely to experience major difficulties in getting inflation up to its target of 2%. A more expansive fiscal policy would probably prove far more efficient. At the same time, budgetary policymakers may not be fully convinced of this necessity so that financial markets continue to look in the direction of monetary policymakers to

do more.

- The Greek situation remains unresolved. Imposed budgetary tightening keeps Greece stuck in recession with unemployment and public debt levels at unsustainably high levels. In this context, political risks remain high.
- In a longer term perspective, European politics remain worrying in the sense that the currency union still faces existential challenges. Further integration, while still very much needed, looks far from evident at this point. Both the refugee crisis and rising popularity of extreme political parties in recent years is likely to make things only more complicated in this respect.
- The political situation in Spain is now increasingly drawing attention because, unlike in the past, no single party has an absolute majority and forming a coalition is difficult. The ECB's QE program, however, is likely to prevent that government bond spreads widen sharply. The Catalan issue should not be a major problem at least for now. First, Catalans are highly divided. Second, EU membership would not be possible without all other EU members approving it (highly unlikely).
- The Brexit risk is real and the debate is likely to intensify in the near future. All in all, our scenario is that Brexit will be ultimately avoided. That said, risks remain high. The tense situation, however, once again underlines the very challenging European political context.

<https://insights.petercam.com/developed-markets/brexit-fears-likely-to-intensify>

**Will the ECB ever hit 2% again ?**

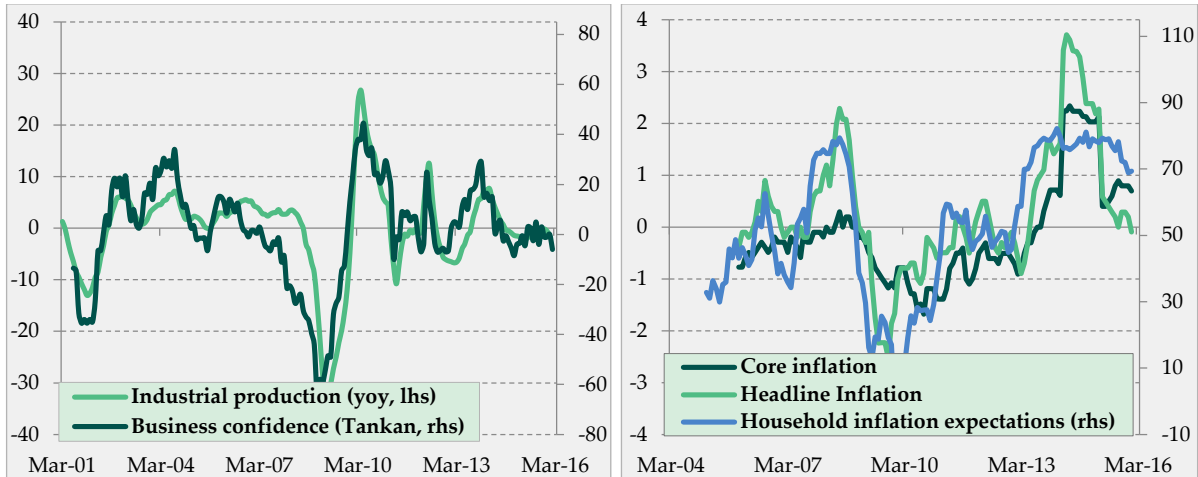


Source : Datstream, Degroof Petercam

## Japan and Emerging Markets

- Economic activity in Japan is still weak. The tightening labor market points in the direction of accelerating wage growth though other evidence paints a more nuanced picture. Inflation, meanwhile, remains significantly below the Bank of Japan's 2% target.
- The combination of weak economic activity and below target inflation, as we argued before, would eventually prompt the BoJ to expand its monetary stimulus program. Indeed, in its January policy meeting the BoJ applied a negative interest rate of -0.1% to current accounts that commercial banks hold at the BoJ (three-tier system). The BoJ also made clear that it will not hesitate to cut interest rates further into negative territory if necessary. Serious doubts remain, however, whether this can deliver the desired results.

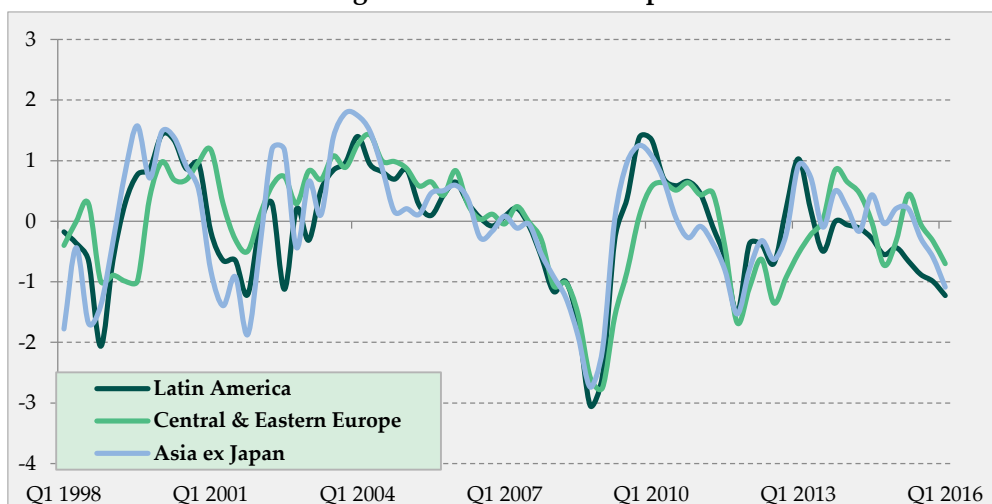
### Slow growth and lowflation keep BoJ in easing mode



Source : Datstream, Degroof Petercam

- More broadly in EM, the slowdown witnessed over the last few years reflects several factors including the negative effect of lower commodity prices, tighter external financial conditions linked to the prospect of the first rate hike in the US, economic rebalancing in China, structural bottlenecks as well as distress related to (geo)political factors.

### EM leading indicators continue to point down



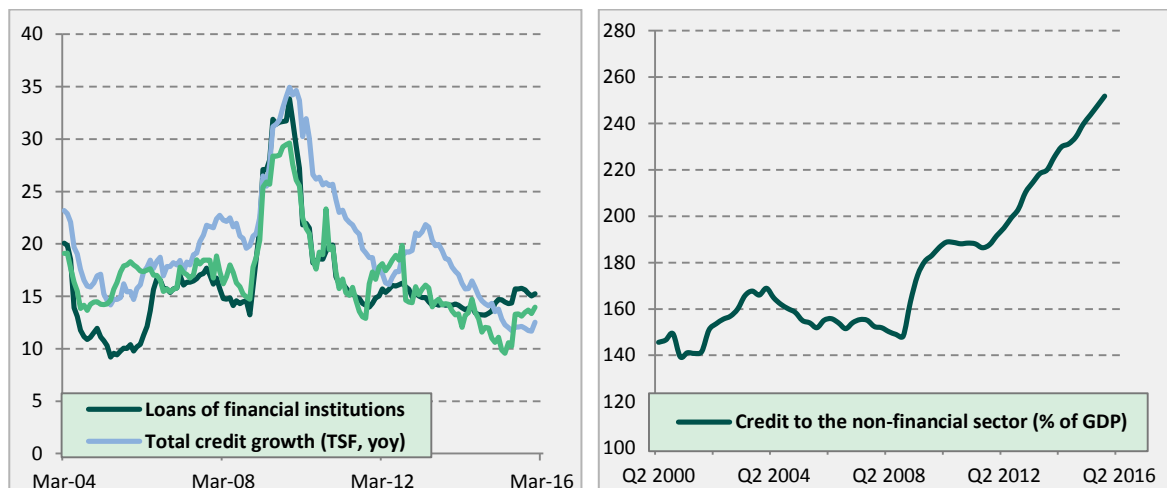
Source : Datstream, Degroof Petercam

- Economic growth in EM has slipped below the average over the past 35 years. Moreover, Brazil (!) and Russia are struggling with recession. Economic activity in EM is still very sluggish, particularly in Latin America where a weak growth momentum is accompanied with above target inflation. More flexible exchange rates, lower levels of external debt in general and significant amounts of international reserves should protect most EM against a full-blown financial crisis. Moreover, China's stimulus measures are likely to make sure that imminent hard landing fears will diminish somewhat, at least for now. Finally, the currency depreciation seen in many EM since 2013, should eventually translate in improved competitiveness when combined with further productivity

enhancing reforms. To be clear, as mentioned earlier, current financial and economic conditions as well as structural issues will make sure that EM are not up for a rapid recovery. Risks remain on the downside

- An imminent Chinese hard landing will probably be avoided as the stabilizing effect of earlier stimulus measures slowly starts to kick in. The latest confidence data show early signs of stabilization. On the other hand, the medium to longer term outlook still looks incredibly challenging against the back of the huge Chinese debt overhang, ageing population, less potential to catch up from behind and difficulties linked to further economic rebalancing. Hard landing fears, therefore, are likely to stay with us for many more years. (<https://insights.petercam.com/emerging-markets/6-graphs-illustrating-our-current-view-on-chinas-economy>). More recently Chinese policymakers have set their new growth target between 6.5% and 7% for the next 5 year. However, meeting these targets while continuing to make significant progress with regards to structural reforms looks simply impossible.

#### Credit growth accelerates again, decreasing ST hard landing risk though still very worrying trend



Source : Datstream, Degroof Petercam

- Although it's impossible to exclude the scenario of a large one-off RMB depreciation, we don't think this will happen in the coming months (<https://insights.petercam.com/developed-markets/sharp-cny-depreciation-just-around-the-corner>). A gradual managed depreciation remains our base case scenario for now.

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**GDP and CPI Outlook**


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	<b>GDP</b>			<b>Inflation</b>		
	2015	2016	2017	2015	2016	2017
<b>US</b>	2.4	<b>1.6</b>	<b>1.9</b>	0.1	<b>1.2</b>	<b>2.1</b>
		2.2	2.4		1.3	2.2
<b>Eurozone</b>	1.5	<b>1.2</b>	<b>1.4</b>	0.1	<b>0.7</b>	<b>1.4</b>
		1.6	1.7		0.5	1.5
<b>Japan</b>	0.7	<b>0.4</b>	<b>1.2</b>	0.8	<b>0.4</b>	<b>1.5</b>
		1.0	0.6		0.3	1.8
<b>China</b>	6.9	<b>5.5</b>	<b>5.0</b>	1.5	<b>1.8</b>	<b>2.1</b>
		6.5	6.3		1.5	1.7

**Degroof Petercam forecasts as of 8 March 2016, Consensus forecasts**

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