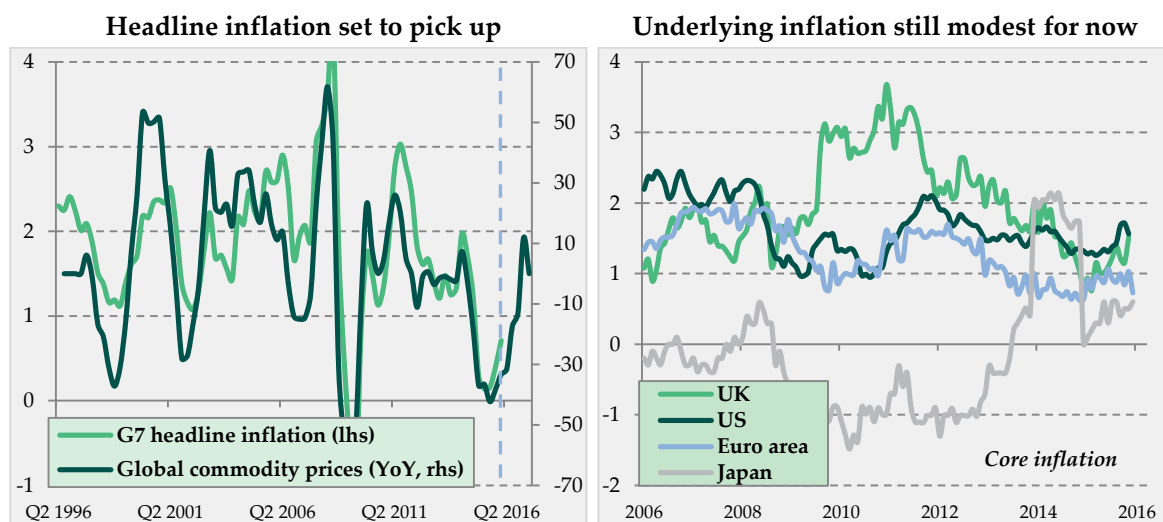


GLOBAL ECONOMIC OUTLOOK

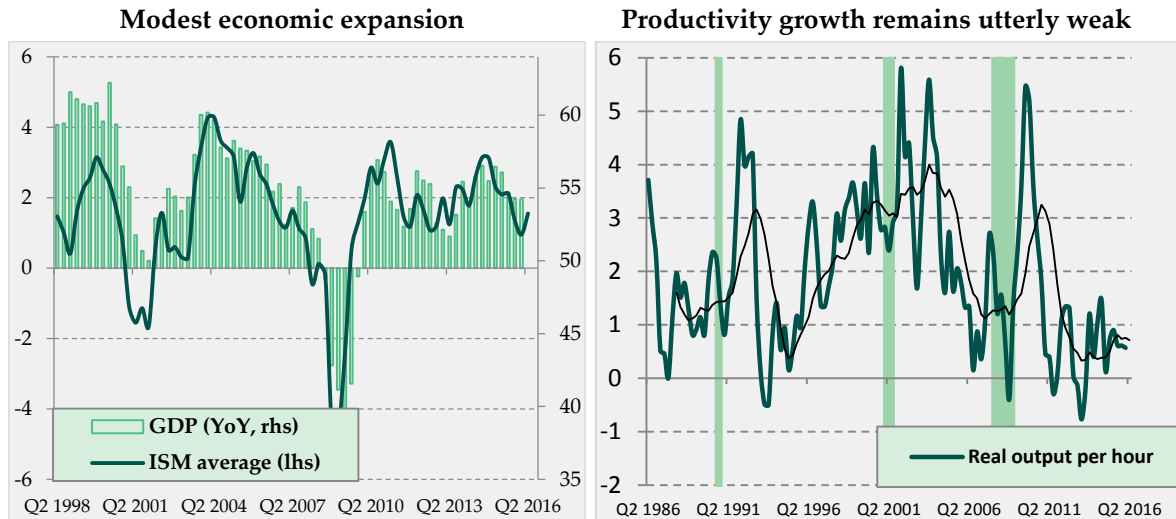
- Global recession fears have eased over the last two months. That said, our global composite confidence indicator still suggests that global economic activity remains weak. What's more, downward risks remain substantial against the back of China's difficult economic rebalancing exercise, increased awareness 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,...
- 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 remains weak following what has been a very lacklustre recovery since the Great Recession thus far.
- 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. That said, budgetary and monetary policymakers have not lost all ammunition to fight this extremely challenging situation. There is still room to do more (see [here](#) for example). Encouragingly, there is a growing awareness about the need for more expansive budgetary policies. At the same time, statements remain vague implying that actual implementation might take some time.
- Meanwhile, despite record low policy rates and huge expansions in the size of their balance sheet, most central banks are still desperately looking for higher inflation prints.



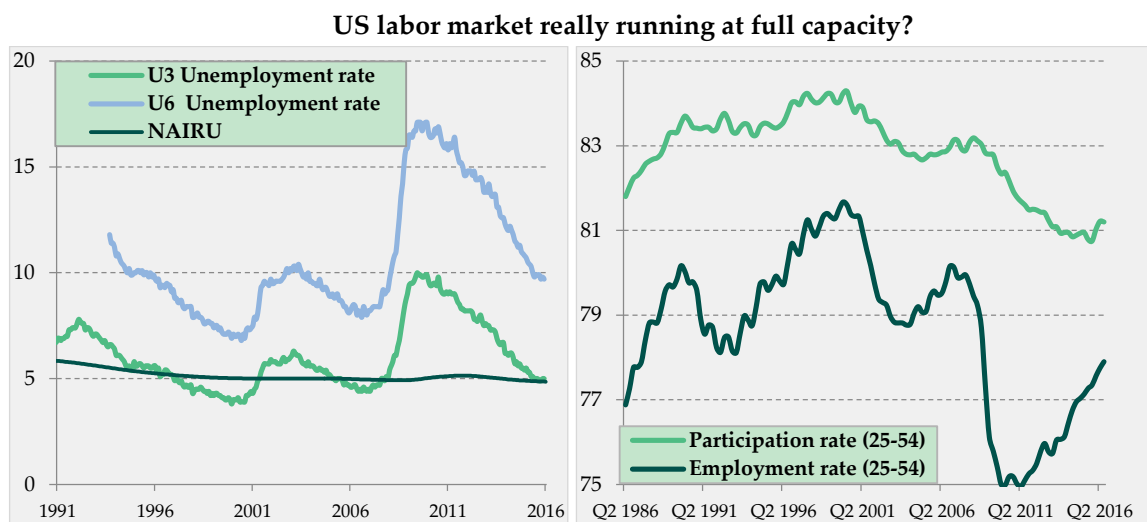
- Despite the general very low level of commodity prices, base effects will send headline inflation higher in late 2016. Core inflationary pressures look set to remain fairly modest for now, implying that global monetary policy will stay very loose for the time being. The outlook for inflation in a medium to longer-term perspective, on the other hand, is still subject to major uncertainty.

United States

- Even though most important confidence indicators improved since the start of the year, the US economy is only expanding at a modest pace. In line with the evolution seen over the past years, overall productivity growth remains very disappointing. The manufacturing sector still struggles from the stronger USD and problems in the energy sector. Confidence in the service sector, on the other hand, holds up at fairly high levels.



- Though still in line with real consumption growth of around 2%, consumers' expectations about the future are softening a touch. 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 almost 220K jobs created over the last 6 months, the labor market continues to perform solidly. At 5.0% the unemployment rate is in line with estimates of the NAIRU. Meanwhile the U6 unemployment rate stands at 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. Encouragingly, the employment and participation rate have been picking up in recent quarters. At the same time though they have not yet reached pre-crisis levels.

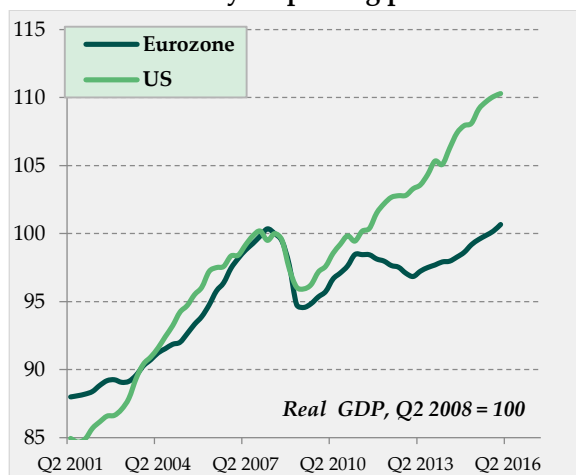


- Wage growth plays a key role with regard to the future path of inflation and is slowly picking up. At 2.5%, however, the level remains below its 30-year average of around 3%.
- Base effects linked to energy prices will make sure that headline inflation (now at 0.9%) will trend higher towards the end 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 is moving up.
- Looking forward, however, evidence is mixed 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 paint a much more modest outlook.
- All in all, 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 approach for now. The recent stabilization in commodity prices, the recent USD depreciation and decreased worries about China could provide a window of opportunity to hike interest rates in June but this has become a very close call. More importantly, however, the Fed is likely to proceed gradually and only if the underlying growth momentum remains strong enough.

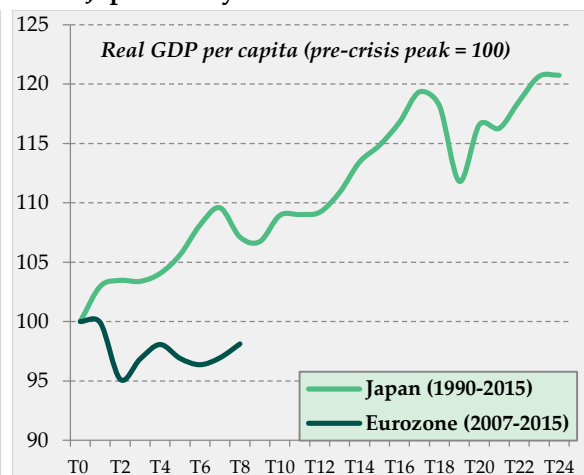
Eurozone

- The eurozone economy expanded solidly at the start of the year according to the preliminary Q1 GDP release (2.2% QoQa, 1.6% YoY). In doing so economic activity has now just passed its pre-crisis peak level, a disappointing run so far. On a GDP per capita level, the situation is obviously even worse. Much has been written about the threat of a Japanese style scenario for the eurozone but many observers ignore the fact that Japan has actually done reasonably ok when demographics are taken into account. European policymakers can only hope they can achieve this performance.
- Looking forward, economic activity should hold up against the favorable backdrop of low energy prices, the current low yield environment and EUR weakness. That said, this is still far from spectacular. What's more, confidence indicators are not pointing to further growth acceleration.
- In line with the improvement witnessed in economic activity, the labor market is also recovering. Unemployment rates are coming down throughout the region. Importantly, youth unemployment remains worryingly high and the downward trend in Greece and Italy for example seems to be stalling.

Economic activity surpassing pre-crisis level

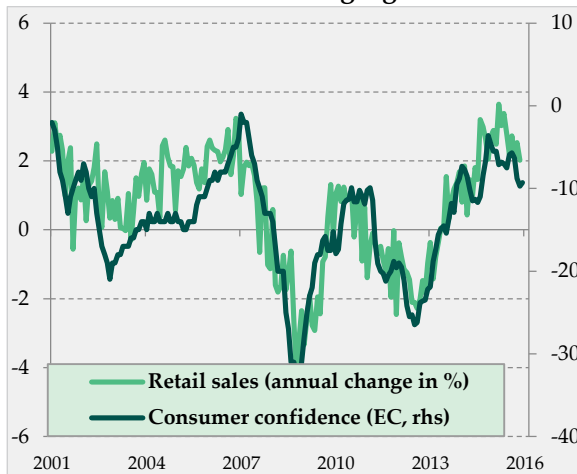


A Japanese style scenario for the eurozone?

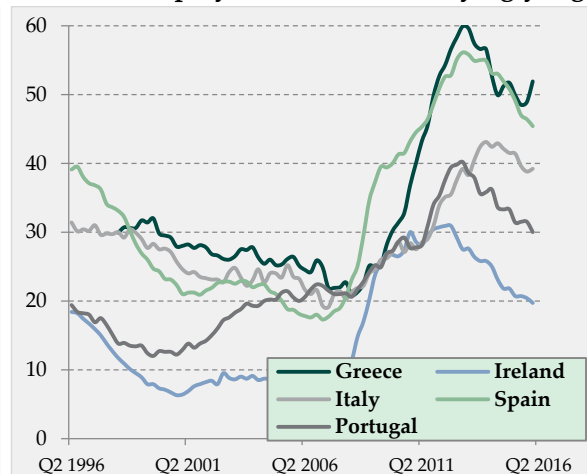


Source : Datastream, Degroof Petercam

Consumer confidence showing signs of hesitation



Youth unemployment remains worryingly high



Source : Datastream, Degroof Petercam

- European politics remain worrying in the sense that the currency union still faces existential challenges against the back of rising populism and waning appetite for further fiscal integration.
- The Greek situation remains unresolved. Imposed budgetary tightening keeps Greece stuck in recession with unemployment and public debt levels at unsustainably high levels. The economic and social situation remains unsustainably weak. Therefore, political risks remain high. A debt restructuring/forgiveness is needed but less budgetary tightening is more important in the short run.
- The political situation in Spain remains uncertain. Unlike in the past, no single party has an absolute majority and coalition formation has failed in previous months. New elections will be held in late June. The ECB's QE program, however, is likely to prevent that government bond spreads widen sharply.
- The Brexit risk is real and the debate has intensified in recent months. Our scenario is that Brexit will ultimately be avoided (see [here](#) for example). That said, risks remain high. In case Brexit were to happen, the immediate market reaction could prove very negative. Afterwards, the reaction will be more path dependent. In a short to medium term perspective, the market reaction will depend on how hostile or friendly the exit from the EU would be organized. In a medium to longer-term perspective, the critical factor is whether BREXIT would lead to further EU integration or disintegration.

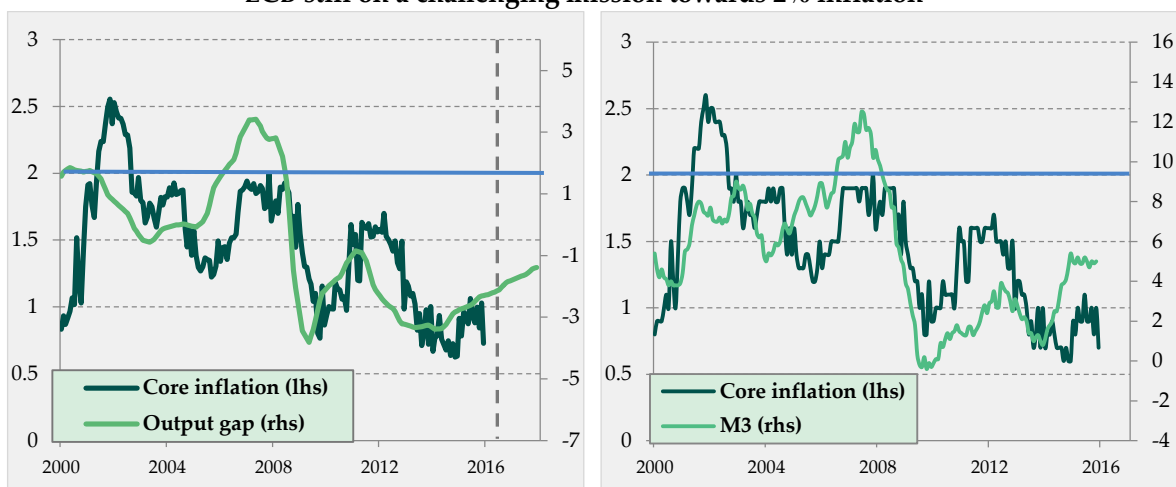
Greek society experiencing severe pressure



Source : Datastream, Degroof Petercam

- Headline inflation (-0.2 % yoy in April) is held down by the earlier steep fall in energy prices but base effects will send it higher in the second half of the year. Underlying price measures 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, 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% anytime soon. In a medium to longer term perspective, provided that the eurozone can escape the liquidity trap, from a pure monetary point of view, the outlook for inflation could be firmly up. That said, the Japanese example shows that this is far from guaranteed.

ECB still on a challenging mission towards 2% inflation

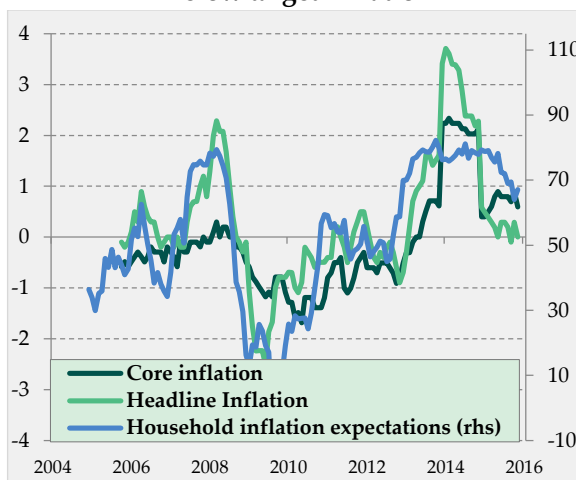


Source : Datastream, Degroof Petercam

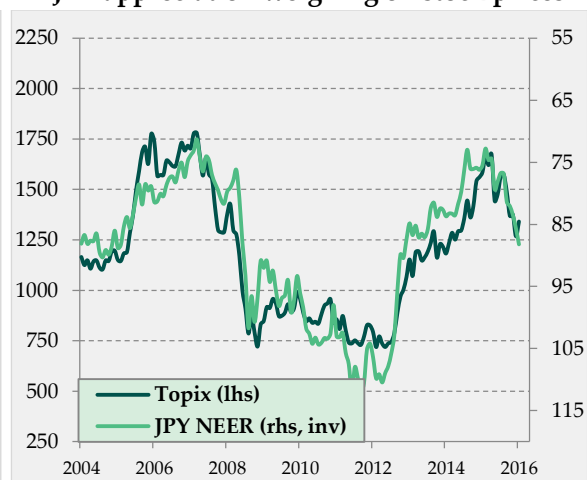
Japan and Emerging Markets

- Economic activity in Japan is still weak. Wage growth remains subdued despite the tightening labor market. Inflation, meanwhile, remains significantly below the Bank of Japan's 2% target. What's more, JPY has seen substantial appreciation in recent months, in turn weighing Japanese stock prices. All this implies that the BoJ firmly keeps its bias towards further monetary easing.

Below target inflation

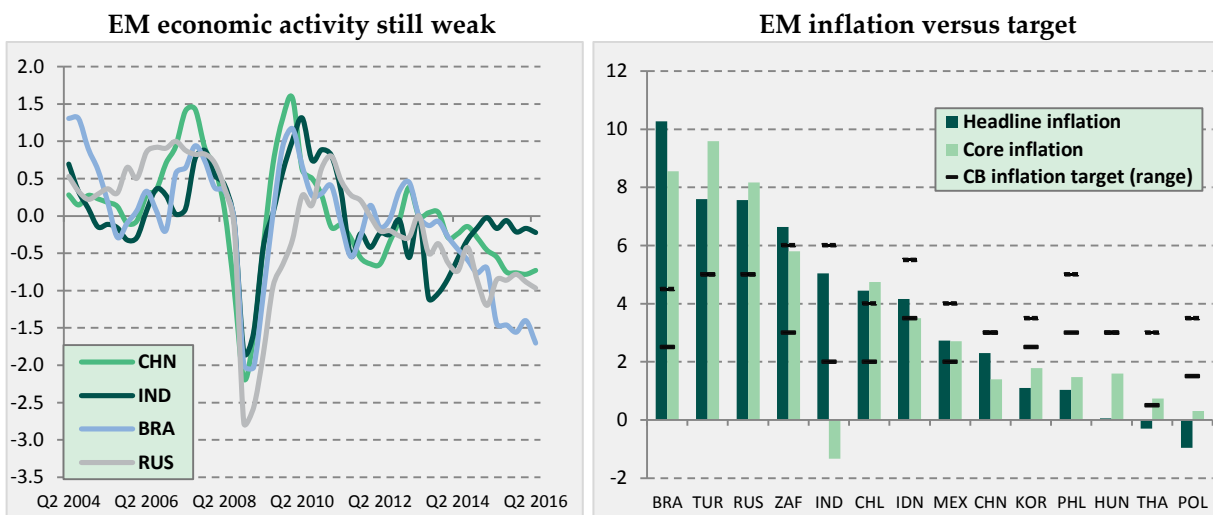


JPY appreciation weighing on stock prices



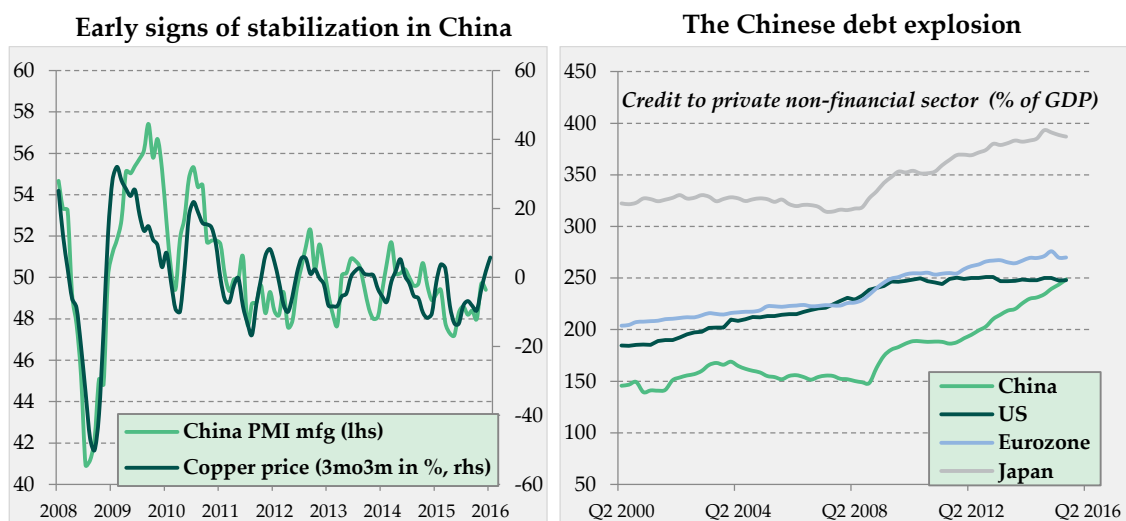
Source : Datastream, Degroof Petercam

- 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.



Source : Datastream, Degroof Petercam

- Despite early signs of stabilization, economic activity in EM is still weak. 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. 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. Downward risks prevail against the back of China's difficult rebalancing process.

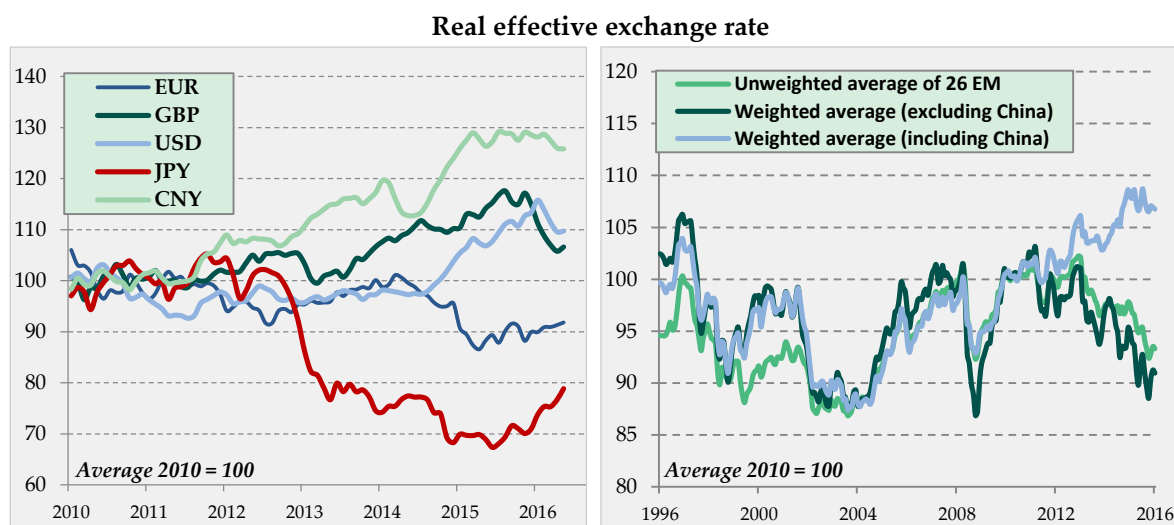


Source : Datastream, Degroof Petercam

- Chinese hard landing fears have been receding over the last couple of weeks 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, budgetary and relaxation measures with regards to housing are 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 remains 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 fake 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.
- From a wide EM perspective, inflation remains under control. That said, significant differences between countries exist. While inflation in countries like Brazil, Turkey or Russia 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



Source : Datastream, Degroof Petercam

- 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. 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 from a long term theoretical perspective. That said, more evidence of the Fed moving towards another rate hike could lead to a slightly stronger USD in the next couple of months.
- With inflation pressures still modest and growth prospects weakening significantly, the BoE is not in a hurry to hike interest rates. The risk surrounding "Brexit", an issue that has gained more attention in recent months, poses downward risks for the GBP. That said, the GBP has already depreciated significantly since late 2015. A "remain vote" is likely to result in some GBP appreciation albeit to a limited extent given the weaker growth outlook and large current account deficit.
- The JPY has been strengthening in recent months. From a LT-perspective, it seems that the JPY has now become a little bit too expensive versus the EUR. A further sharp appreciation from current

levels looks unlikely. That said, this will largely depend on upcoming central bank moves from both sides.

- EM currencies experienced serious downward pressure since the May 2013 taper tantrum but entered calmer waters more recently. Investor appetite for EM assets has waned and sustained EM currency weakness is likely given the subdued growth outlook. That said, given the depreciation already seen since the spring of 2013 and the recent stabilization in leading indicators, the risk of another sharp hit now looks smaller. Indeed, in real effective exchange rate terms, EM currencies (weighted by GDP ex China) have depreciated around 10% since May 2013 on average (strong difference from country to country).

GDP and CPI Outlook

	GDP			Inflation		
	2015	2016	2017	2015	2016	2017
US	2.4	1.5	1.8	0.1	1.2	2.0
		2.0	2.4		1.3	2.2
Eurozone	1.5	1.5	1.4	0.0	0.5	1.3
		1.5	1.6		0.3	1.4
Japan	0.5	0.3	1.0	0.8	0.2	1.5
		0.6	0.5		0.0	1.6
China	6.9	5.5	5.0	1.5	2.1	2.1
		6.5	6.3		1.9	1.9

Degroof Petercam forecasts as of 10 May 2016, *Consensus forecasts*

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