

Schroders

Economic and Strategy Viewpoint

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US: Why worry about rising wages? (page 2)

- Wage growth in the US looks set to accelerate judging from recent surveys, but should we worry about rising pay, which after all means better living standards for many? Any concern seems particularly misplaced as empirical surveys find little evidence of a link from wages to inflation.
- The link from wages to prices may be weak, but there is a strong correlation between unit labour costs and prices. Wage increases have little price impact if matched by productivity gains. The problem for the US is that productivity growth has dropped in the wake of the global financial crisis. Stronger wage growth is set to translate into higher labour costs and increased inflation, bringing pressure for tighter monetary policy from the Fed.

Eurozone: Making progress (page 6)

- Recent softer data have raised fears of a potential slump in Eurozone activity. However, in comparison to our more subdued forecast, this is not a surprise given the still restrictive credit conditions.
- In order to unlock higher growth, the ECB must build on the improvements seen in credit conditions and the increase in the demand for credit. Higher growth is essential to reduce the Eurozone's vulnerability to any future macro or political shocks.

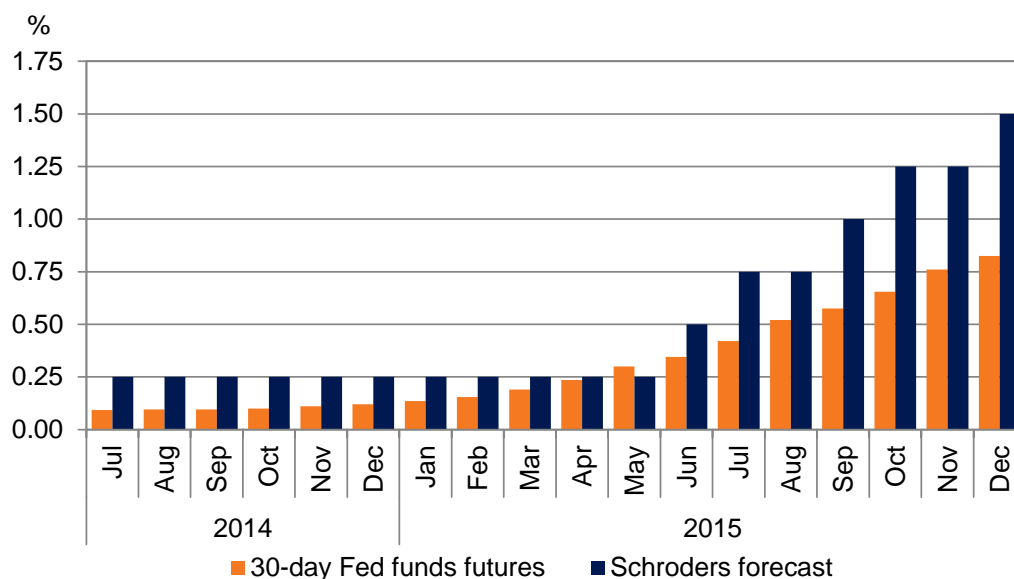
The EM export recovery: are we nearly there yet? (page 9)

- The emerging market export recovery is seemingly always on the horizon, never arriving. But there are signs of a modest pick up in some EM economies. We find evidence that this time around, the export recovery will be more selective than in the past.

Views at a glance (page 18)

- A short summary of our main macro views and where we see the risks to the world economy.

Chart: Markets continue to look for a dovish Fed



Source: Bloomberg, Schroders forecast. 30 July 2014. Please note the forecast warning at the back of the document.

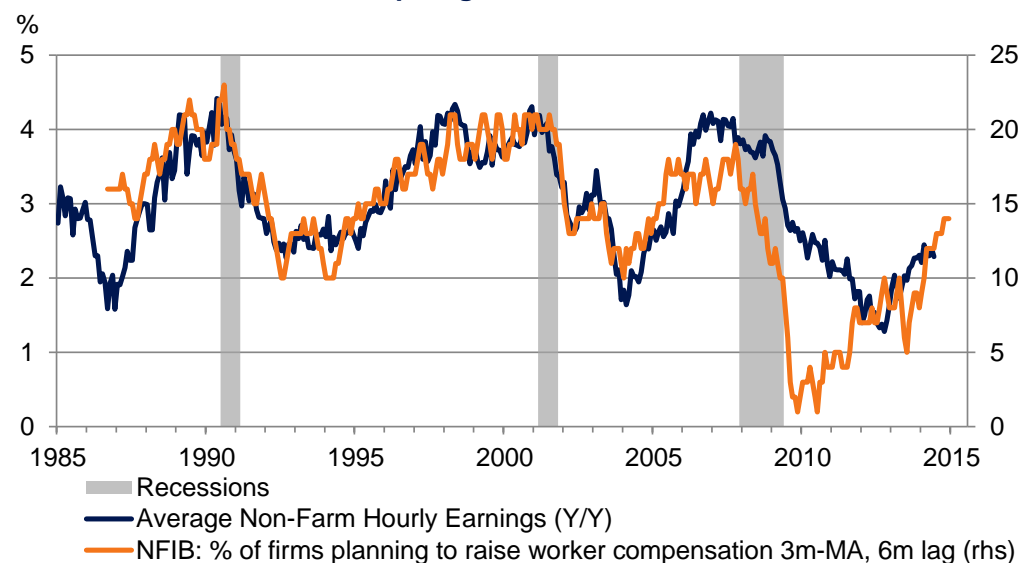


US: Why worry about rising wages?

Labour market is key to US rate outlook

In the last Viewpoint we argued that US unemployment would fall significantly further and that wages were likely to accelerate, an outcome that would turn the Fed in a more hawkish direction. The labour market remains key and in her recent Q&A session following Congressional testimony Fed chair Janet Yellen said that if the labour market "continues to" improve more quickly than anticipated by the FOMC, rate hikes would probably occur "sooner" and be "more rapid" than currently envisioned. Such comment supports our baseline forecast that US interest rates will rise ahead of market expectations to 1.5% by the end of next year and move higher in 2016 (see chart on front page). Recent survey evidence from the National Federation of Independent Business (NFIB) points toward an acceleration in wages over the next six months with the number of firms planning to increase worker compensation rising significantly (chart 1).

Chart 1: US firms set to bid up wages



Source: Thomson Datastream, Schroders. 30 July 2014.

Rising wages, rising inflation?

Whilst these developments increase our conviction, the question has been asked as to why economists seem so worried about wage growth at the present time. After all, a key aim of economic activity is to deliver a rising level of income, thus boosting living standards and the welfare of the household sector. Higher wages might also help arrest the trend toward increasing income inequality. Indeed, given the squeeze on real wages in the US and UK in recent years, should we not welcome a rise in worker pay as good news?

The frequent answer is that higher wages will result in higher inflation, forcing central banks to tighten policy and bring activity back down. Yet such concern on wages seems misplaced when looking at the link with inflation. Empirical analysis finds little evidence that higher wages cause higher prices and if anything the link runs from inflation to wages¹.

In our view there is a link, but we need the right perspective on wages. Higher wages are undoubtedly good for all if backed by higher productivity. It is unit wage costs, not wages per se which influence inflation in the near term. When higher real wages are not matched by increased productivity, unit wage costs rise and force businesses to raise prices, or face a squeeze on their profit margins. Consequently, we need to look at the combination of wages and productivity to gauge the effect on inflation through unit wage costs. The close correlation between unit labour costs and

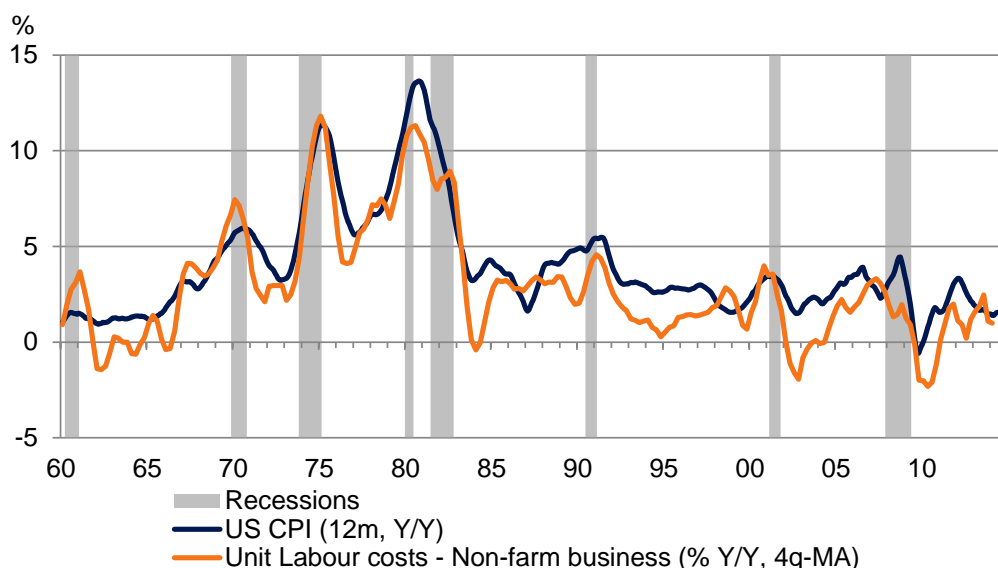
¹ For example, see "Does wage inflation cause price inflation?" Hess and Schweitzer, April 2000 Federal Reserve Bank of Cleveland.

2

inflation can be seen in chart 2 and suggests that firms generally will pass on increased costs through price increases.

Chart 2: US CPI and unit labour costs

Unit wage costs drive inflation, not wages



Source: Thomson Datastream, Schroders. 30 July 2014.

However, this is not the end of the story: wages play an important role in the so-called second round effects which determine whether inflation shocks can become ingrained. For example, a pick up in inflation from an oil shock can lead to higher wage demands as workers seek compensation for the loss of purchasing power. If wages then rise, consumers can maintain expenditure thus accommodating the shock into the price level on a permanent basis. Alternatively, if wages do not rise, demand falls and inflation will drop back as the shock passes through the system.

Rising wages can accommodate higher prices

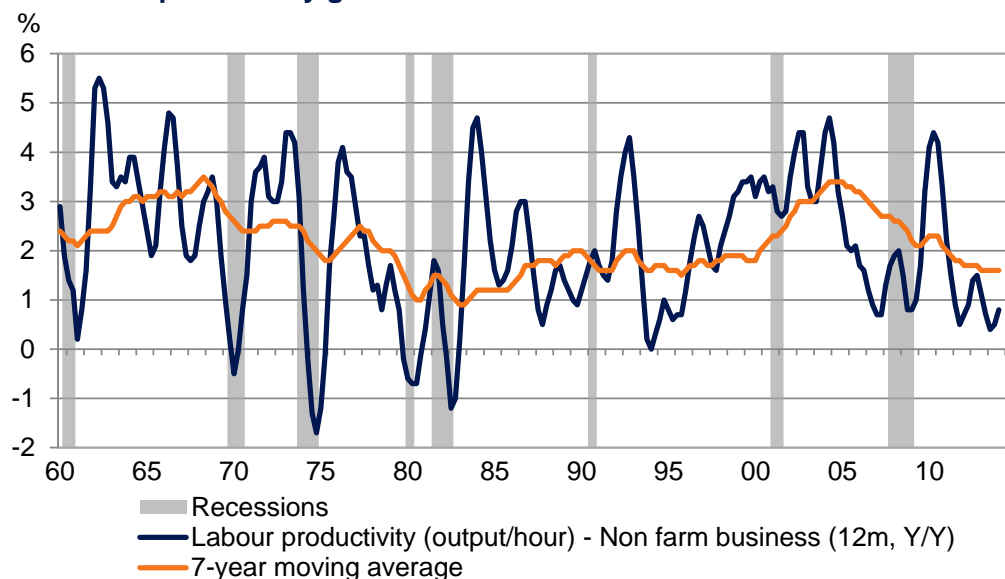
It is the ability of the economy to reject or absorb and propagate price changes which determines its vulnerability to shocks and tendency toward inflation. Wages are clearly the key conduit in this mechanism, with the ability of workers to obtain higher pay dependent on factors such as the tightness of the labour market and institutional arrangements such as contractual inflation linking and the degree of unionisation. The stance of the central bank is also vital as an authority credibly committed to keeping price inflation on target can contain price expectations in the wake of a shock.

There is interplay between the first and second effects making it difficult to entirely disentangle the direction of causation. However, in the absence of shocks it is the first effect from rising unit wage costs that is likely to kick off the inflationary process. The question then is with wages likely to accelerate, will productivity rise sufficiently to keep unit wage costs and inflation under control?

Productivity has slowed significantly over the past decade

Productivity trends have not been encouraging in recent years, with output per hour decelerating to less than 1% per annum in the past three years. The seven year trend (used to eliminate the effect of the cycle) has slowed to around 1.6% p.a. from a peak of 3.4% p.a. in 2004 (chart 3 on next page).

Chart 3: US productivity growth has slowed



Source: Thomson Datastream, Schroders. 30 July 2014.

This is a worry as ultimately productivity determines the ability of an economy to deliver rising real wages and living standards. There is an industry of economists looking at why we have seen a slowdown and we cannot do justice to the debate here, but two explanations seem important.

"New economy" benefits are fading, global financial crisis destroyed capital

First, it would seem that the boost from the "new economy" as the internet took off in the 1990s has now faded and the current shift toward smart phones and tablets does not seem to be reaping the same benefits. These may come through later as it takes time for businesses to learn the best means of exploiting new technology, but recent developments may not prove as ground breaking as the introduction and dissemination of the internet in the 1990s.

Second, much capital was wasted during the housing boom of the last decade, fuelled by sub-prime borrowing and financial "innovation" (bank leverage). Rather than creating worthwhile, productive assets, much capital was simply written off and lost in the global financial crisis. The legacy of the boom was an excess of housing, rather than a set of innovations and increased capital investment. In this way the second bubble in the banking system will prove more damaging than the first in tech.

Arguably this effect will now work its way through and as companies begin to invest again, productivity will pick up, enhanced by the latest new technology. Alternatively, a more cautious banking sector will inhibit the funding of new investment and/or companies will remain risk averse such that capex does not pick up sufficiently to boost output-per-worker. We look for capex to recover in the second half of the year alongside employment growth, although the recovery may disappoint as firms continue to prioritise payments to shareholders and/or prefer to take over rivals rather than invest in new capacity.

On balance, the outlook over the next one to two years is for productivity growth to remain relatively subdued, such that a pick-up in wages and worker compensation will result in a pick up in unit labour costs thus adding to inflationary pressure. Given our assumptions on output, employment and productivity, we would see wages rising to a 3% rate with unit labour costs running at 2% rate next year. Unemployment is likely to fall to 5%, below most estimates of the NAIRU. Overall CPI inflation will then depend on factors such as the strength of the housing market (primarily through rents) and commodity prices such as food and energy. However, on this outlook, core CPI inflation is set to accelerate to 2.5% next year and higher in 2016.

Cost pressures likely to intensify unless Fed acts

The Fed may well be able to tolerate some pick up in inflation and may not see this as particularly alarming, but of course the longer it leaves policy loose and the labour market tightens, the more likely it is that costs and prices accelerate further in 2016. The only way higher costs would not feed through into prices would be if companies were prepared to allow margins to absorb the increase. Profits would then bear the burden with adverse consequences for the equity market. This could happen if demand was soft, but it would subsequently be followed by higher unemployment as firms restructured to bring costs back under control.

Eurozone: Making progress

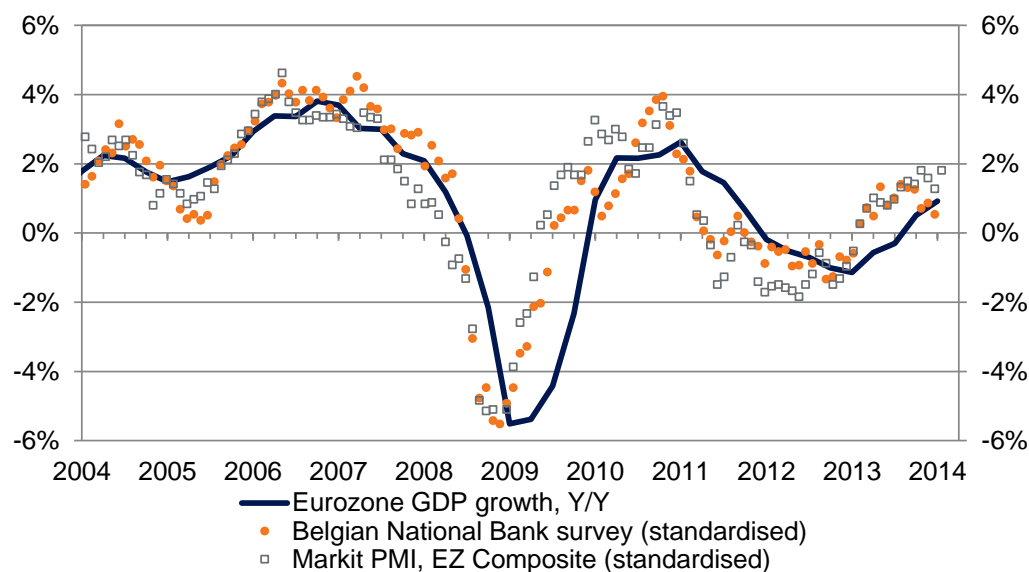
The recovery in the Eurozone remains slow but the monetary union is making progress in emerging from the sovereign debt crisis. Institutional change has followed to improve the resilience of the banking sector, while safety nets were introduced in order to protect sovereigns. While the economy is improving, it remains vulnerable to shocks, especially as growth has not accelerated to more healthy levels.

Recent weaker data

Over the past few months, investors' fears over the Eurozone's recovery have been re-emerging as a number of leading business surveys have been falling. The macro composite of the Markit purchasing managers' indices (PMIs) had fallen in both May and June, while the Belgian National Bank survey has also been coming down.

Moreover, the most recent industrial production data has been weaker than expected. For example, Germany's industrial output is down 1.5% in the first two months of the second quarter compared to the first quarter. Over the same period, France's industrial production has fallen by 0.9%, while Italy has also seen a fall of 0.5%. Only Spain has seen gains so far in the second quarter (1.1%), with the early estimate for Q2 GDP surprising on the upside at 0.6%. The industrial production figures out so far suggest Eurozone GDP could be negative in the second quarter, but could this be the start of yet another recession?

Chart 4: Leading indicators remain firm



Source: Thomson Datastream, Eurostat, Markit, Belgian National Bank, Schroders. 30 July 2014.

...although the moderation in leading indicators from high levels is not a surprise

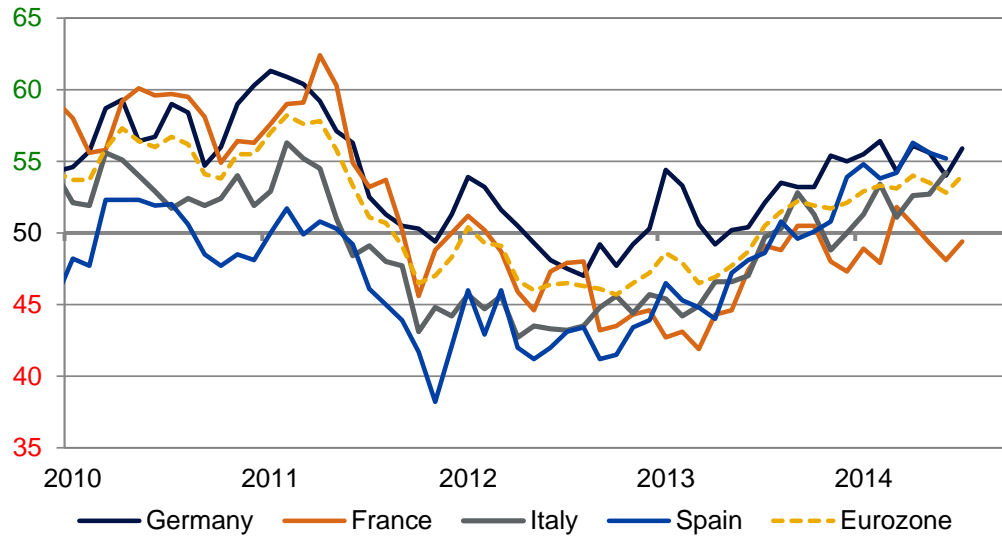
At this stage, the falls in the above-mentioned leading indicators are not yet a concern, as prior to these falls, the indicators had been very strong compared to consensus and our own GDP forecast (see chart 4 above). The surveys had been consistent with between 1.5-2% year-on-year GDP growth - considerably higher than our 1% forecast for 2014. The moderation in activity is therefore not too surprising. More recently, the advanced print for the July PMI showed a bounce back, which if confirmed when the full release is published, should help dispel fears of the Eurozone slipping back towards recession.

Of the four largest member states, France has been the laggard over the past three to four months. The French macro composite PMI has been below the neutral 50 mark since May, although the latest print did show a small pick up. Germany, Italy and Spain have all remained above the neutral mark, and have recently been making steady gains (see chart 5 on next page).

Chart 5: PMIs highlight France's difficulties

Survey balance

France continues to be the laggard amongst the largest four member states

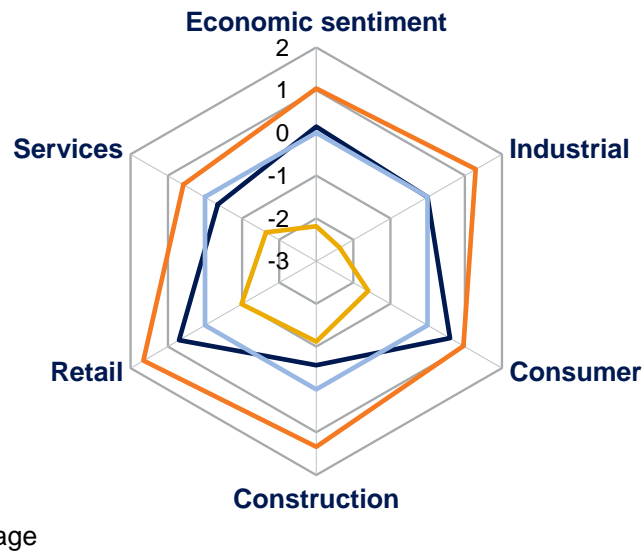


Source: Thomson Datastream, Markit, Schroders. 30 July 2014.

Taking a closer look at the available leading indicators by sector, the European Commission's survey shows that most of the improvement in the Eurozone economy has been seen in the retail sector, boosted by stronger consumer confidence (see chart 6 below). This has been helped by two factors. The first has been low price inflation, and in some countries even mild deflation. This has helped boost disposable income in real terms, and therefore lifted the purchasing power of households. The second has been an improvement in labour markets, especially rises in hiring and recent falls in the unemployment rate.

Chart 6: Improved consumer confidence boosting retail activity

Within sectors, the retail sector is doing very well on the back of stronger consumer confidence



The axis on the spider chart shows the readings on a standardised scale, where zero is the long-run average (since 1996). Source: Thomson Datastream, European Commission, Schroders. 30 July 2014.

Other sectors are struggling to reach post-recession levels of activity

Other than the retail sector, the industrial/manufacturing sector is now back to normal levels of activity; the services sector is still below its long-run average, while the construction sector is still in a dire situation. Following a recession, we would expect most if not all of these sectors to be reporting activity running at above average levels, yet this is only coming through on the retail side. This may be explained by a missing key ingredient vital for a fast recovery - credit availability.

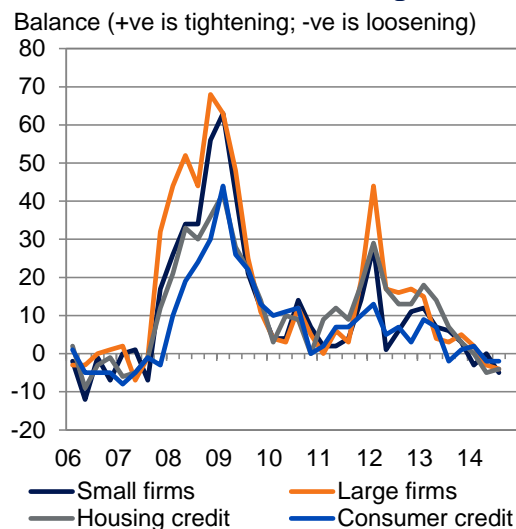
Credit channel is key

As we have discussed in the past, the reason for our forecast for a subdued recovery is the ongoing reform and repair of the banking system. As the ECB became the new single EU wide regulatory supervisor, it began a process to harmonise banking capital rules. The ECB should publish the results of the asset quality review (AQR) at the end of the summer, but the change in rules and additional scrutiny may have prompted banks on average to reduce the size of their loan books. This process should now be reaching an end, and along with the additional liquidity from the ECB in the form of the targeted long-term refinancing operations (LTROs) being introduced in the second half of the year, we should see some improvement in lending and economic activity towards the end of the year and 2015.²

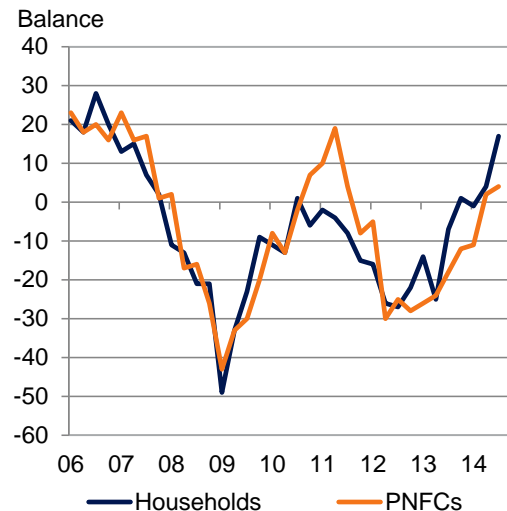
Greater credit availability is the key to unlocking more investment and demand, and to making the economy more resilient.

Meanwhile, the ECB's credit conditions survey shows that credit conditions are loosening across the board (chart 7), while demand for credit is picking up sharply (chart 8). The Eurozone now needs to see a pick-up in lending in order to raise business investment and consumer spending, which will have a multiplier effect through the economy. More lending is the key to unlocking stronger growth and reducing the vulnerability of the Eurozone economy. The ECB must ensure that it continues to aid the early improvements in credit conditions, while at the same time building its own credibility as a banking regulator.

Charts 7: Credit conditions tightness



Charts 8: Demand for credit



Source: Thomson Datastream, ECB Credit Conditions Survey, Schroders. 30 July 2014.

² See Schroders Quickview: "ECB acts to head off deflation risk".

The EM export recovery: are we nearly there yet?

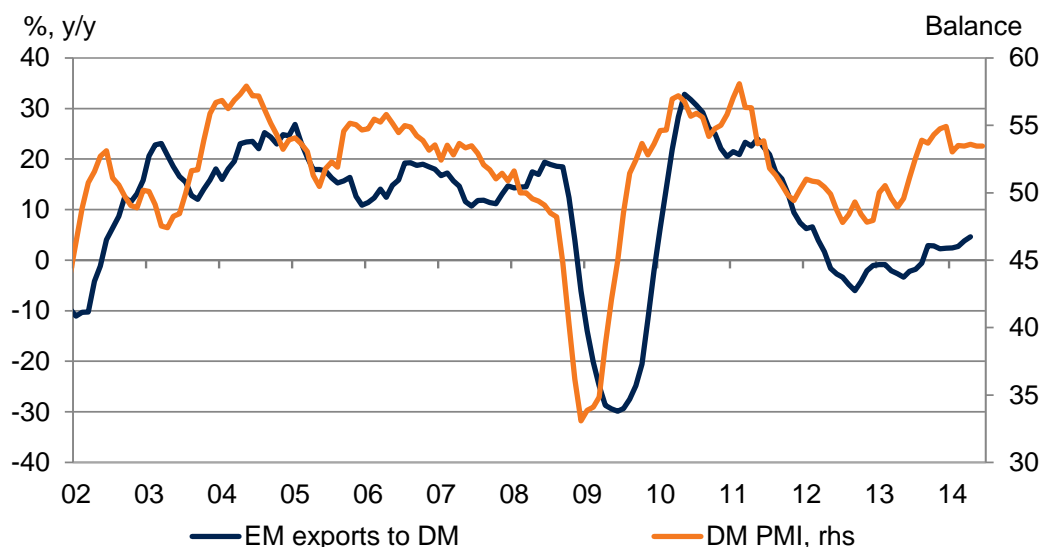
EM exports have stubbornly refused to track DM activity...

The de-coupling of EM exports and DM growth

We have written on more than one occasion about the emerging market (EM) export recovery we expect to see on the back of improved growth in developed markets. Of course, it is yet to arrive, which is slightly embarrassing. As a face-saving exercise, can we at least explain why EM exports are lagging so much?

As a reminder, a recovery in developed market (DM) growth has historically seen a revival of EM exports as manufacturing and consumer spending ramp up and draw in a range of inputs and goods (chart 9). This time, however, while activity surveys have picked up in DM, EM exports have not followed nearly as closely.

Chart 9: EM exports usually track DM activity



Source: Thomson Datastream, IMF, Schroders. 23 July 2014. DM PMI is a GDP weighted series of Eurozone, Japan and US PMI/ISM. EM sample consists of nineteen countries³. Exports calculated using DM imports to address data quality issues.

...though we can find European exceptions

In an attempt to explain this perhaps the first step to take is to examine whether the same is universally true across EM, or whether certain economies are distorting the picture.

As it turns out, on an individual country level export performance varies quite widely (chart 10 on next page). The Central and Eastern Europe, Middle East and Africa (CEEMEA)⁴ region looks to be the clear outperformer, while Latin America⁵ is the definite laggard. Asia⁶ is somewhere in the middle, but has only really distinguished itself from Latin America in recent months.

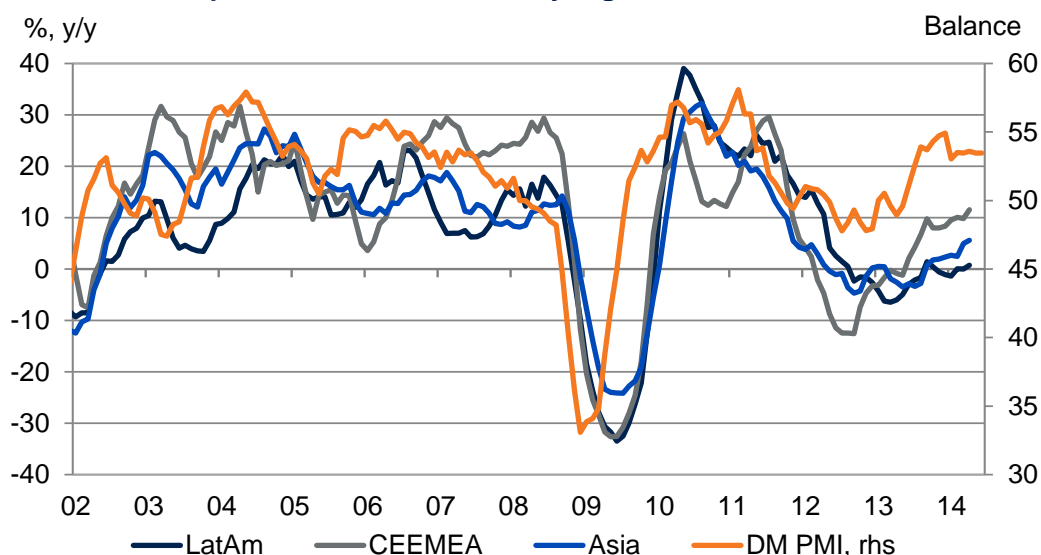
³ Brazil, Chile, China, Colombia, Czech Republic, Hungary, India, Indonesia, South Korea, Malaysia, Mexico, Peru, Philippines, Poland, Russia, South Africa, Thailand, Turkey, Taiwan

⁴ Represented here by Hungary, Czech Republic, Poland, Turkey and South Africa

⁵ Brazil, Mexico, Chile, Colombia, Peru

⁶ China, India, Indonesia, Malaysia, Philippines, South Korea, Thailand, Taiwan

Chart 10: Trade performance has varied by region



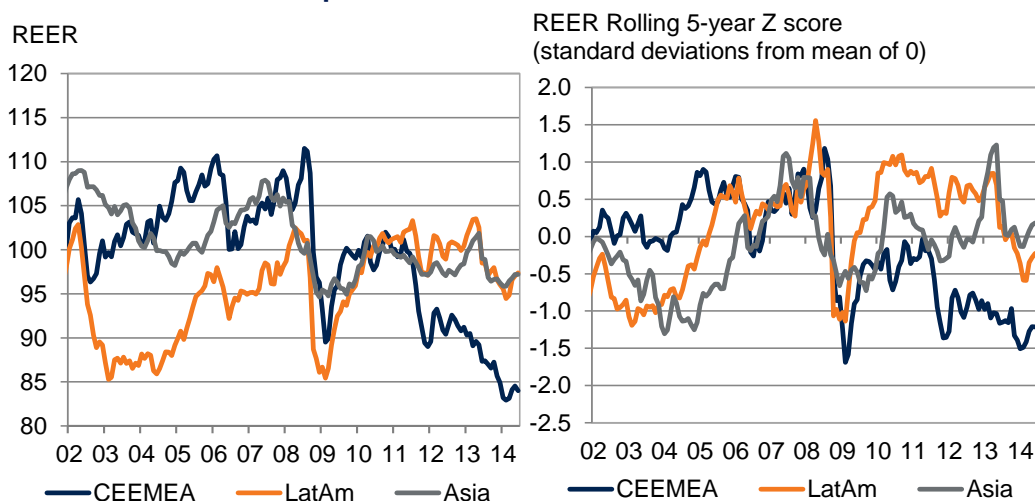
Source: Thomson Datastream, IMF, Schroders. 23 July 2014

What is it about the CEEMEA countries that has led them to outperform the rest of the emerging markets? A few possibilities present themselves; perhaps Europe is proving a better trade partner than the US, with a greater demand for imports; Germany in particular is a key driver for eastern European economies. Alternatively, perhaps the CEEMEA countries export goods more suited to the current DM recovery than their counterparts in LatAm or Asia, or perhaps they are simply more competitive.

Competitiveness helps explain CEEMEA outperformance

One way to assess the competitiveness of these regions is to look at the real effective exchange rate (REER), a trade weighted exchange rate that also accounts for relative inflation. A real depreciation renders a country more competitive as its goods become relatively cheaper. As charts 11 and 12 show, the CEEMEA region has become more competitive relative to LatAm and Asia since roughly mid-2011, and this is true whether we look at the REER in levels or relative to its own history. This then could explain some of CEEMEA's relative outperformance. Note, however, that neither Asia nor Latin America look, on this measure, to have become especially uncompetitive. Both look to be around historical norms, levels which did not prevent strong export cycles in the past.

Charts 11 & 12: EM competitiveness based on the REER



Source: Thomson Datastream, Schroders. 25 July 2014. Regions are calculated as a simple average of representative countries' REERs and REER Z scores.

If the difference can be not fully explained by competitiveness, perhaps the choice of trade partner matters. Japan appears to constitute a relatively minor trade partner when compared to the US and Eurozone (table A), so our focus is likely to be on the latter two.

Table A: EM exports to DM as a share of total merchandise exports

Europe seems to be driving stronger export growth

	Japan	US	Eurozone
LatAm	3%	45%	10%
Asia	7%	14%	10%
CEEMEA	1%	3%	45%

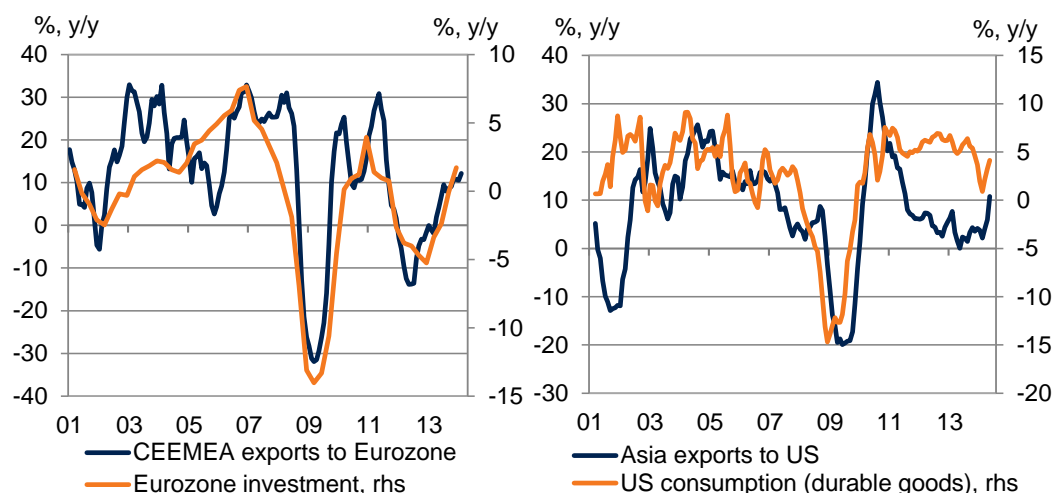
Source: UNComtrade 2013 data, Schroders calculations. 28 July 2014

One conclusion we might immediately draw from the table is that the Eurozone is driving a stronger trade recovery for its trade partners than is the US. However, it is worth noting that the US share for LatAm is pulled upwards by Mexico and to an extent Colombia; for Peru, Chile, and Brazil the share is 15% or less. Mexico has been outperforming the rest of LatAm in exports to the US, as well as in aggregate (performing more like an Asian exporter). LatAm has also underperformed both CEEMEA and Asia in export performance to the US, so we need to go deeper than simply looking at trade partners.

It might be more helpful to look at what the different regions are exporting to their DM trade partners. Looking at total exports, it is notable that Asia and CEEMEA export more manufactured goods⁷ than LatAm, which is more reliant on commodities. This is especially true when we look at exports to the Eurozone and US (after excluding Mexico). For Asia and CEEMEA, manufactured goods account for easily over half of total goods exports to the US and the Eurozone; for LatAm exc. Mexico, the figure is less than 20%. A focus on manufactured goods, then, could be helping Asia and CEEMEA outperform LatAm. As for CEEMEA's outperformance of Asia, it looks as though this might be linked to the sources of demand within their major trading partner; for CEEMEA, Europe seems to draw in imports to feed capital expenditure (capex) requirements, while for the US, it is consumption, particularly of consumer durables, driving the flow (charts 13 and 14). Asia then looks dependent on a revival of the US consumer, while CEEMEA needs continued capex growth in Europe.

Charts 13 & 14: Different drivers for US and Eurozone trade

Holding out for capex in Europe, consumers in the US



Source: Thomson Datastream, Schroders. 29 July 2014.

⁷ Based on SITC revision 1 classifications, "manufactured goods" here refers to "Miscellaneous manufactured articles" and "Machinery and transport equipment".

Meanwhile, for Latin America (excluding Mexico), a return to old glories seems unlikely. Commodity demand, particularly for energy, is greatly reduced in the US following the shale revolution. The slowdown and rebalancing in China has also seen softer commodity prices generally, harming the earning power of LatAm's chief exports. The continent will have to look to new industries to re-couple to US growth.

Developed market differences

Still, no region is recording the kind of export growth we saw in previous recoveries or that we typically see associated with the current PMI readings in DM. While competitiveness might explain CEEMEA's stronger showing relative to other EM regions, it can not be the explanation for the poor performance of EM compared to history. As we noted, LatAm and Asia do not look less competitive than during previous periods of export strength. Is it perhaps the case that this time is different? That the recovery in the US, Europe and Japan is less import-intensive than in the past?

Perhaps "this time is different" in DM?

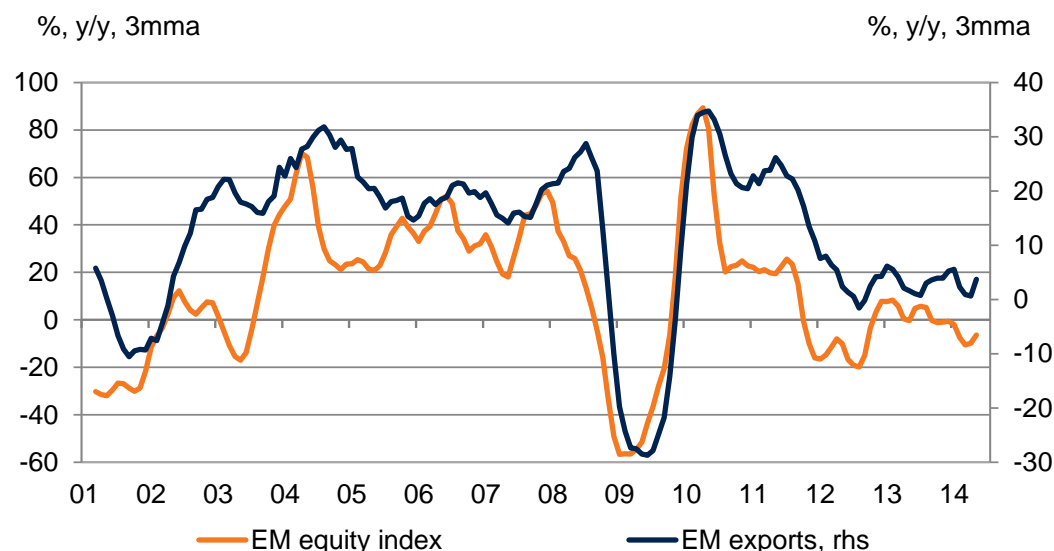
We do not have the space here to go into a full examination of the three large developed market economies, but in each we can see reasons for a more lacklustre boost to EM than witnessed historically. In the Eurozone, the asset quality review, alongside the well documented woes of banks, has hindered credit growth and hence capex spend. In the US, wage growth has been anaemic, which will have suppressed consumer spending across the board, and the shale revolution has greatly reduced its demand for energy imports. Finally, in Japan, the recovery has been driven by Abenomics and heavily dependent thus far on a weaker currency - hardly conducive to imports.

Why does this matter?

This issue is not purely academic, but has significant macroeconomic and financial ramifications. One reason to look for an EM export recovery is what it implies for earnings and, by extension, emerging market equities. The underperformance of the asset class could finally reverse if we saw a strong export recovery in EM (chart 15).

Chart 15: Emerging market exports and equities

An EM export recovery could be the catalyst for equity outperformance



Source: Thomson Datastream, Schroders. 29 July 2014

A trade recovery is important for earnings and the equity market, but also for addressing external imbalances, which came into focus in the wake of last year's "taper tantrum", and which remain an issue for some economies today.

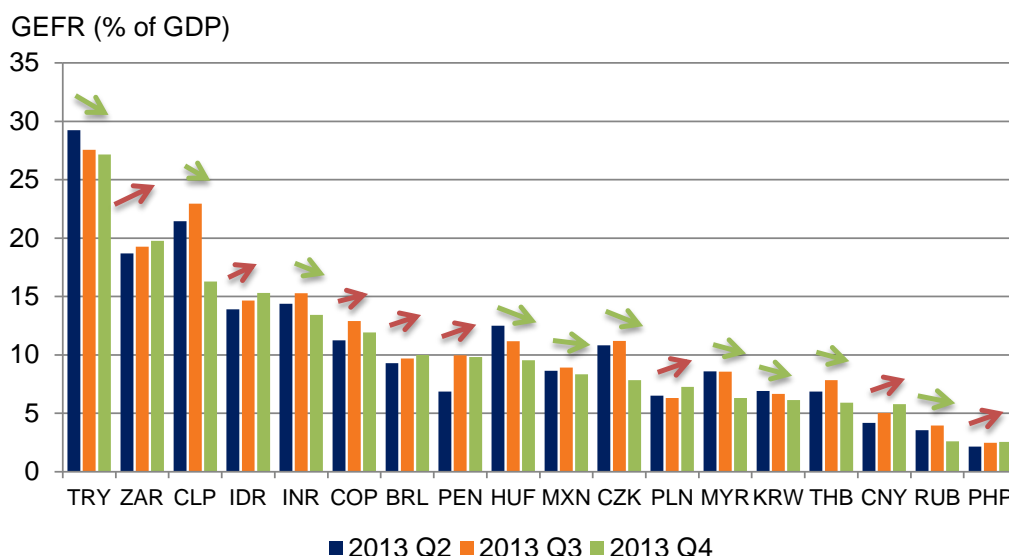
Concerns over the external balance sheet are driven in particular by the threat posed by a potential "sudden stop" of financing flows. One useful measure is the gross external financing requirement (GEFR), the combination of short-term external

debt and the current account deficit. This is shown as a share of GDP for selected EM economies in chart H. There has been a mixed performance since attention was drawn to external balances last May, but even where countries have reduced GEFR as a share of GDP it often remains high enough to cause problems in the event of a "sudden stop". In Turkey's case, for example, if all external financing was withdrawn, funding equivalent to 26% of annual nominal economic activity would disappear.

Better exports could also address external imbalances

One of the biggest improvements since May has been made by India, which has seen a large increase in net exports, driven by both higher exports and lower imports. Other economies have struggled to emulate the Indian experience, and have improved by less and largely on the back of import contraction (and hence a domestic demand slowdown). An export recovery would be immensely helpful therefore in addressing these external vulnerabilities.

Chart 16: EM vulnerability to external financing shocks over time



Source: JEDH, Bloomberg, Schroders. 29 July 2014

Optimism for CEEMEA and Asia, pessimism for LatAm

Overall, EM's poor export performance to date in this recovery depends on the region in question (yet another strand in the recurrent theme of EM differentiation). For Latin America, the situation is perhaps the worst; simply put, it is not exporting the goods likely to benefit from growth in Europe (capital goods) or the US (consumer goods). Asia's prospects look better, despite a weak performance so far, as a recovery in US wages should help a revival in US consumer spending which appear to be a key driver in US imports from the region. Finally, CEEMEA, which has outperformed the rest of EM, has done so thanks in part to an increase in competitiveness, but also due to its reliance on Europe has a trading partner, and Europe's very modest recovery in capex spending. With the AQR removed as a headwind to European credit, and an increasingly accommodative ECB, we could be well positioned for further growth here too.

Schroder Economics Group: Views at a glance

Macro summary – July 2014

Key points

Baseline

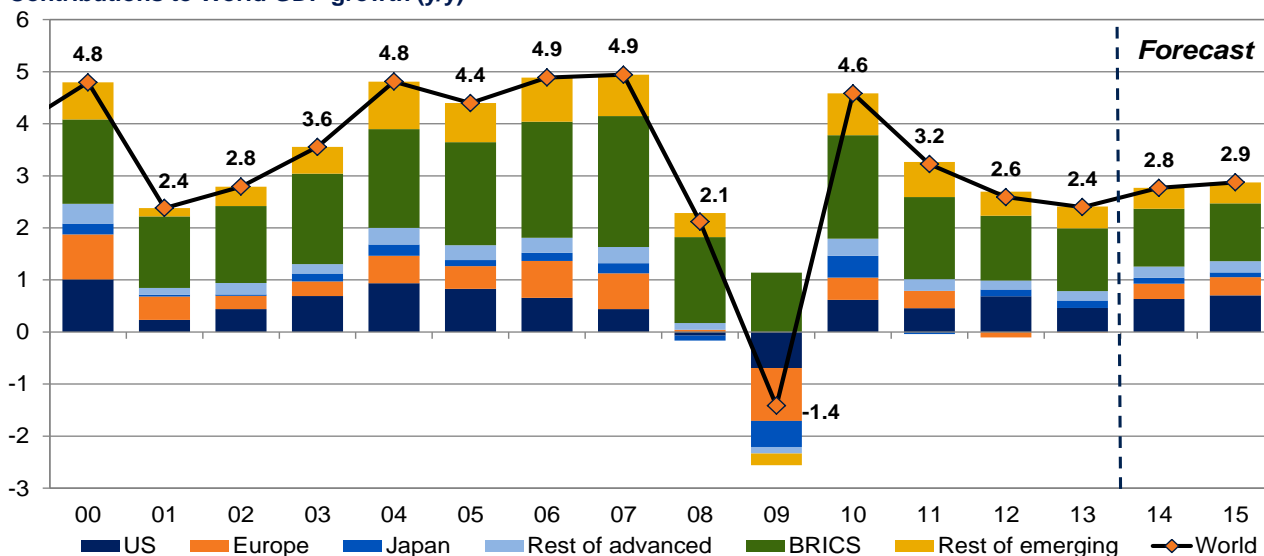
- World economy on track for modest recovery as monetary stimulus feeds through and fiscal headwinds fade in 2014. Inflation to remain well contained.
- US to rebound in q2 after weather related dip in q1. Economy beginning to normalise as banks return to health and the pace of de-leveraging eases. Unemployment to fall faster than Fed expects and central bank to complete tapering of asset purchases by October 2014. First rate rise expected in June 2015 with rates rising 25 bps per meeting to 1.5% by year end.
- UK recovery to be sustained by robust housing and consumer demand whilst economic slack should limit the pick up in inflation. Growth likely to moderate next year with general election and resumption of austerity. Interest rates to rise in February 2015 and reach 1.5% by year end.
- Eurozone recovery becomes more established as fiscal austerity and credit conditions ease in 2014. ECB on hold after cutting rates and taking measures to reduce the cost of credit, otherwise on hold through 2015. Deflation to be avoided, but strong possibility of QE (purchases of asset backed securities) in response to deflation fears.
- "Abenomics" achieving good results so far, but Japan faces significant challenges to eliminate deflation and repair its fiscal position. Bank of Japan to step up asset purchases as growth and inflation fall back later in 2014.
- US leading Japan and Europe (excluding UK). De-synchronised cycle implies divergence in monetary policy with the Fed eventually tightening ahead of ECB and BoJ, resulting in a firmer USD.
- Tighter US monetary policy weighs on emerging economies. Region to benefit from advanced country cyclical upswing, but China growth downshifting as past tailwinds (strong external demand, weak USD and falling global rates) go into reverse and the authorities seek to deleverage the economy. Deflationary for world economy, especially commodity producers (e.g. Latin America).

Risks

- Risks are still skewed towards deflation, but are more balanced than in the past. Principal downside risk is a China financial crisis triggered by defaults in the shadow banking system. Some danger of inflation if capacity proves tighter than expected whilst upside risk is a return of animal spirits and a G7 boom.

Chart: World GDP forecast

Contributions to World GDP growth (y/y)



Source: Thomson Datastream, Schrodgers 28 May 2014 forecast. Previous forecast from February 2014. Please note the forecast warning at the back of the document.

Schroders Baseline Forecast

Real GDP

y/y%	Wt (%)	2013	2014	Prev.	Consensus	2015	Prev.	Consensus
World	100	2.4	2.8	↓ (3.0)	2.6	2.9	↓ (3.1)	3.1
Advanced*	64.4	1.2	1.9	↓ (2.1)	1.6	2.1	↓ (2.2)	2.3
US	24.7	1.9	2.6	↓ (3.0)	1.6	2.9	↓ (3.0)	3.0
Eurozone	18.6	-0.4	1.0	↓ (1.1)	1.1	1.4	(1.4)	1.6
Germany	5.2	0.5	2.2	↑ (1.9)	2.0	2.3	↑ (2.2)	2.0
UK	3.8	1.7	2.9	↑ (2.6)	3.0	2.4	↑ (2.1)	2.6
Japan	9.1	1.6	1.2	↓ (1.4)	1.5	1.0	↓ (1.3)	1.3
Total Emerging**	35.6	4.6	4.2	↓ (4.4)	4.2	4.3	↓ (4.6)	4.7
BRICs	21.8	5.5	5.1	↓ (5.3)	5.1	5.1	↓ (5.6)	5.3
China	12.5	7.7	7.1	(7.1)	7.3	6.8	↓ (7.3)	7.2

Inflation CPI

y/y%	Wt (%)	2013	2014	Prev.	Consensus	2015	Prev.	Consensus
World	100	2.6	3.0	↑ (2.8)	3.1	3.1	↑ (2.8)	3.1
Advanced*	64.4	1.3	1.5	↑ (1.4)	1.6	1.6	↑ (1.5)	1.7
US	24.7	1.5	1.8	↑ (1.5)	2.0	1.9	↑ (1.4)	2.1
Eurozone	18.6	1.3	0.9	↑ (0.8)	0.7	1.2	(1.2)	1.2
Germany	5.2	1.6	1.3	(1.3)	1.1	2.0	↑ (1.7)	1.8
UK	3.8	2.6	1.9	↓ (2.3)	1.7	2.2	↓ (2.7)	2.0
Japan	9.1	0.1	2.0	↑ (1.9)	2.7	1.6	↑ (1.5)	1.8
Total Emerging**	35.6	4.9	5.7	↑ (5.4)	5.7	5.6	↑ (5.3)	5.4
BRICs	21.8	4.7	4.4	↑ (4.3)	4.4	4.4	↑ (4.1)	4.2
China	12.5	2.6	2.7	(2.7)	2.4	3.1	↑ (2.9)	2.9

Interest rates

% (Month of Dec)	Current	2013	2014	Prev.	Market	2015	Prev.	Market
US	0.25	0.25	0.25	(0.25)	0.26	1.50	↑ (0.50)	0.92
UK	0.50	0.50	0.50	(0.50)	0.72	1.50	↑ (0.50)	1.58
Eurozone	0.25	0.25	0.10	(0.10)	0.21	0.10	(0.10)	0.30
Japan	0.10	0.10	0.10	(0.10)	0.19	0.10	(0.10)	0.19
China	6.00	6.00	6.00	(6.00)	-	6.00	(6.00)	-

Other monetary policy

(Over year or by Dec)	Current	2013	2014	Prev.	2015	Prev.
US QE (\$Bn)	4227	4033	4443	(4443)	4443	(4443)
UK QE (£Bn)	375	375	375	(375)	375	(375)
JP QE (¥Tn)	241	224	295	-	383	-
China RRR (%)	20.00	20.00	19.50	↓ 20.00	19.50	↓ 20.00

Key variables

FX	Current	2013	2014	Prev.	Y/Y(%)	2015	Prev.	Y/Y(%)
USD/GBP	1.68	1.61	1.68	↑ (1.63)	4.3	1.63	↑ (1.55)	-3.0
USD/EUR	1.37	1.34	1.35	↑ (1.34)	0.7	1.30	↑ (1.27)	-3.7
JPY/USD	101.5	100.0	105.0	↓ (110)	5.0	110.0	↓ (120)	4.8
GBP/EUR	0.81	0.83	0.80	↓ (0.82)	-3.5	0.80	↓ (0.82)	-0.7
RMB/USD	6.23	6.10	6.18	↑ (6.00)	1.3	6.10	↑ (5.95)	-1.3
Commodities								
Brent Crude	111.1	109.0	108.3	↑ (108)	-0.7	103.7	↑ (103)	-4.3

Source: Schroders, Thomson Datastream, Consensus Economics, July 2014

Consensus inflation numbers for Emerging Markets is for end of period, and is not directly comparable.

Please note the forecast warning at the back of the document.

Market data as at 16/05/2014

The current forecast refers to May 2014 and the previous refers to February 2014.

The US and UK interest rate forecasts were updated this month.

* **Advanced markets:** Australia, Canada, Denmark, Euro area, Israel, Japan, New Zealand, Singapore, Sweden, Switzerland, Switzerland, United Kingdom, United States.

** **Emerging markets:** Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela, China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, South Africa, Russia, Czech Rep., Hungary, Poland, Romania, Turkey, Ukraine, Bulgaria, Croatia, Latvia, Lithuania.

I. Updated forecast charts - Consensus Economics

For the EM, EM Asia and Pacific ex Japan, growth and inflation forecasts are GDP weighted and calculated using Consensus Economics forecasts of individual countries.

Chart A: GDP consensus forecasts

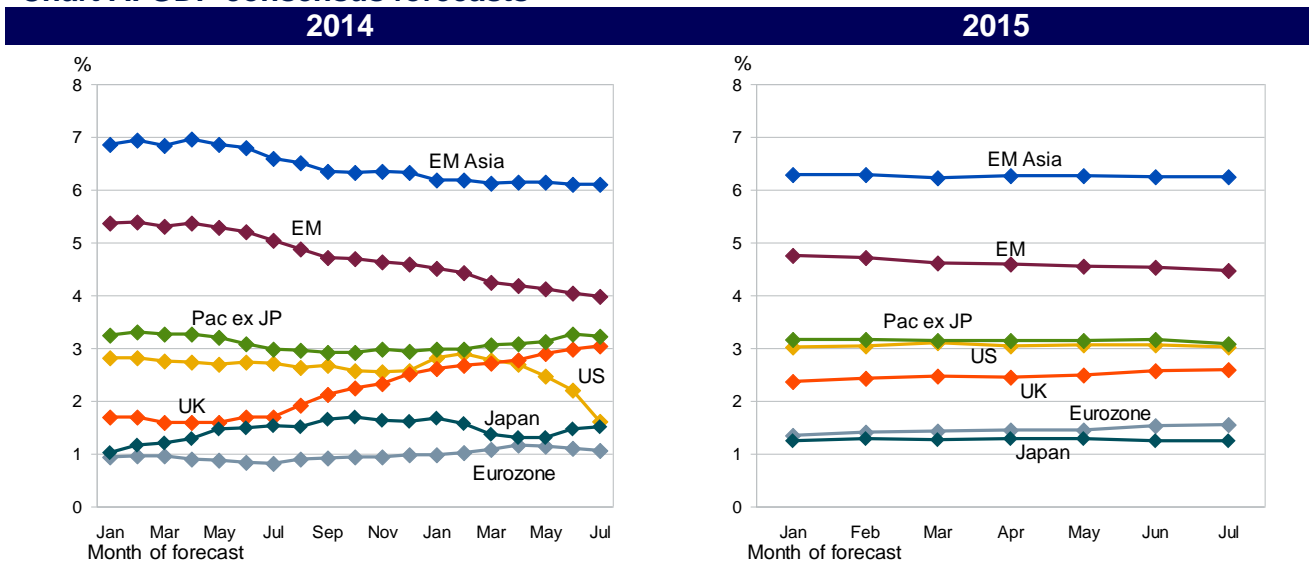
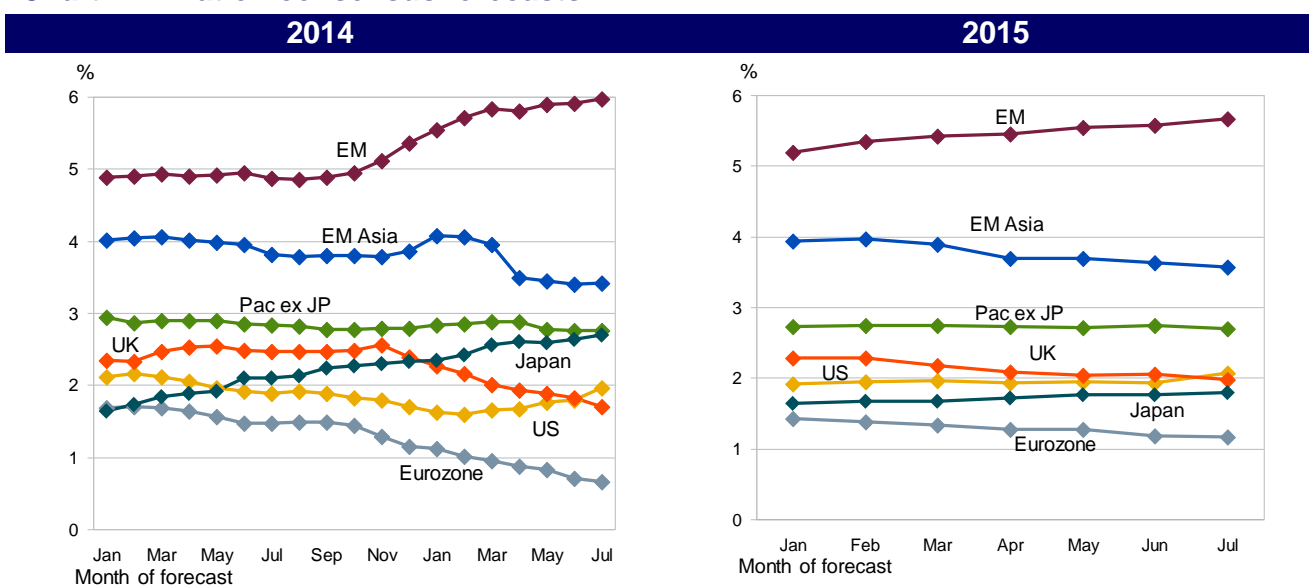


Chart B: Inflation consensus forecasts



Source: Consensus Economics (July 2014), Schroders
 Pacific ex. Japan: Australia, Hong Kong, New Zealand, Singapore
 Emerging Asia: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand
 Emerging markets: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, Argentina, Brazil, Colombia, Chile, Mexico, Peru, Venezuela, South Africa, Czech Republic, Hungary, Poland, Romania, Russia, Turkey, Ukraine, Bulgaria, Croatia, Estonia, Latvia, Lithuania

The forecasts included should not be relied upon, are not guaranteed and are provided only as at the date of issue. Our forecasts are based on our own assumptions which may change. We accept no responsibility for any errors of fact or opinion and assume no obligation to provide you with any changes to our assumptions or forecasts. Forecasts and assumptions may be affected by external economic or other factors. The views and opinions contained herein are those of Schroder Investments Management's Economics team, and may not necessarily represent views expressed or reflected in other Schroders communications, strategies or funds. This document does not constitute an offer to sell or any solicitation of any offer to buy securities or any other instrument described in this document. The information and opinions contained in this document have been obtained from sources we consider to be reliable. No responsibility can be accepted for errors of fact or opinion. This does not exclude or restrict any duty or liability that Schroders has to its customers under the Financial Services and Markets Act 2000 (as amended from time to time) or any other regulatory system. Reliance should not be placed on the views and information in the document when taking individual investment and/or strategic decisions. For your security, communications may be taped or monitored.