Economic Outlook

World | Q3 2016*

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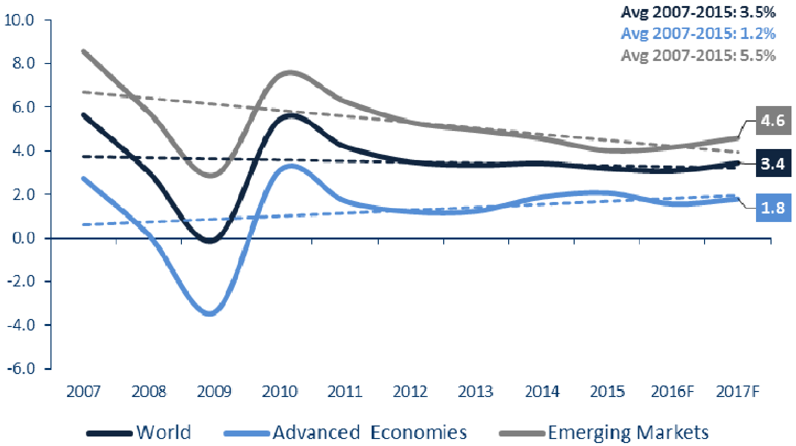
*As of 04 October 2016

Summary

- **Global growth** is expected to **slowly ameliorate** in 2017, although slightly **underperforming** w/ respect to historical record. Growth in **Advanced Economies** (AE) is **above average**, while still **subdued** in **Emerging Markets** (EM).
- **Global saving glut** generated in the past decades by the **increase** in the **desired stock of savings**, also due to **aging** population and **inequality**, seemed to **stop** in the past two years, along with the **current account reversal** in AE and EM.
- Is the World economy going through a **secular stagnation**? On the back of **sluggish global demand**, **investment** did **not pick up** in OECD countries, showing the **slowest recovery** in 40 years. Long-run factors also contributed to **declining productivity**, i.e. shifts in **demography**, **technology** and **propensity to save**.
- In Q2 2016 **US GDP rebounded**, but **growth** was still **disappointing**, despite **falling unemployment** and **increasing real earnings**. The **4th longest expansion** of US economy since WWII is raising fears of **approaching downturn**.
- In H1 2016 **China** continued to **decelerate**, along w/ ongoing **shift** from **investment-** to **consumption-based** economy. **Capital outflows subsided** and **yuan** exchange rate stabilized vis-à-vis US dollar. However, **reduction** in **foreign reserves** and prolonged **credit expansion** continued to amplify the **vulnerability** of Chinese economy.
- **US$** real effective **appreciation** and **excess** of global **supply** in the past two years **depressed oil prices**, which in turn put **downward pressures** on **price dynamics** and inflation **expectations**. Both factors showed **signs of stabilization** in H2 2016. Global **stock markets ended** their **rally**, negatively affected also by **declining earnings**.
- The **Fed rate hike** in Q4 2015 gave rise to a **diverging pattern** in **monetary policies**, although further increases did not materialize yet. The **effectiveness** of expansionary monetary policies (i.e. QE and NIRP) was **undermined** by **zero lower bound** and **low natural rate of interest**.
- In Q2 2016 the global amount of **govt bonds** trading at **negative yields** reached the record level of $10tn, while **inflation expectations** showed signs of **de-anchoring**.

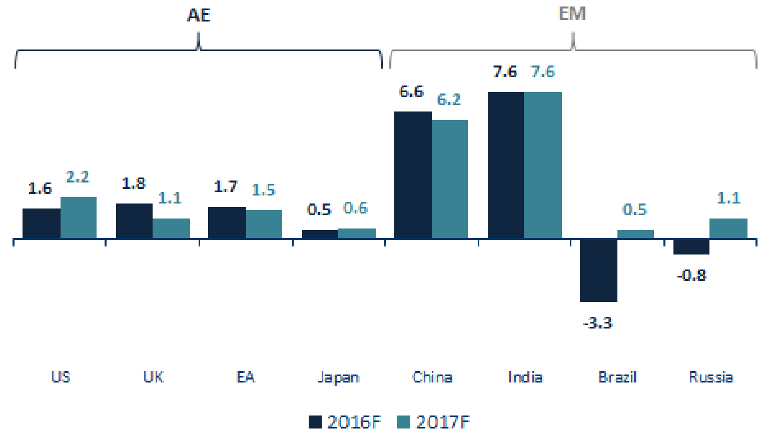
Global Growth> Ameliorating, But Slowly

Global Growth: World Regions
(Real GDP; Δ% YoY)



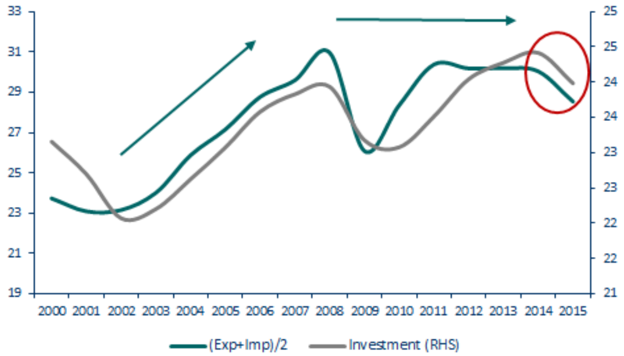
Source: IMF, CDP.

Advanced vs Emerging Economies
(Real GDP; Δ% YoY)



Source: IMF, CDP.

Global Trade and Investment
(% of GDP)

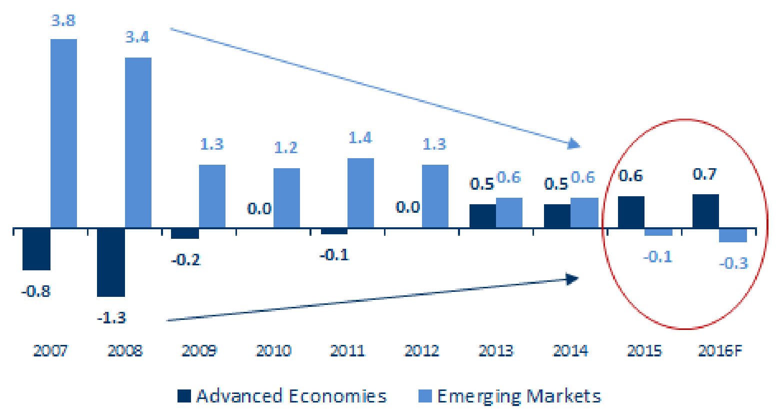


Source: World Bank, CDP.

- **World growth** will slowly **ameliorate** in 2017, in line w/ **expectations** but slightly **underperforming** w/ respect to **historical record**.
- Growth in **Advanced Economies** (AE) is **above average**, while growth in **Emerging Markets** (EM) is **improving**, but still **subdued** when compared to past figures.
- **Trade-** and **investment-to-GDP** ratios **interrupted** their **upward pattern**, **flattening** in the last 5 years.

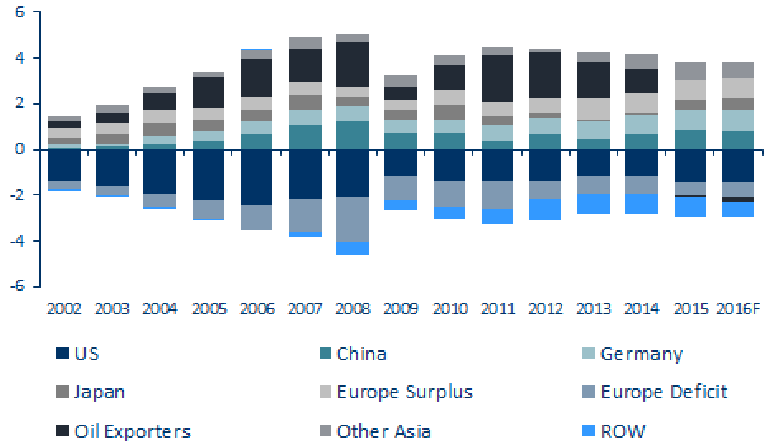
Current Account> Reversal Dynamics

Current Account Dynamics
(% of GDP)



Source: IMF, CDP.

Global Imbalances
(% of World GDP)

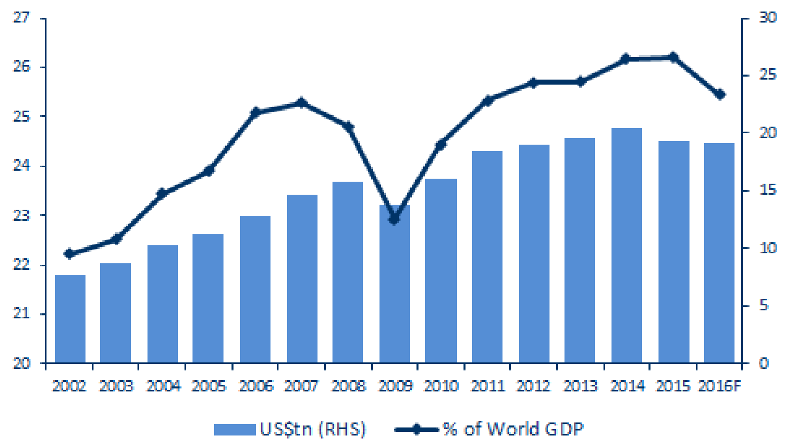


Source: IMF, CDP.

- **Current account** (CA) dynamics between AE and EM have been progressively **reverting**. **AE** became **net creditors**, improving their **external wealth**, while **EM** turned into **net debtors**, deteriorating their **foreign positions**.
- **Global imbalances** seem **no longer** a **threat** to world economy, given the **stabilization path** followed to the crisis. **Macro imbalances** have been therefore **reduced** worldwide in the past decade, also due to **decrease** in world **trade flows**.
- **US** is still **major contributor** to **CA deficit** at world level, while in 2015 **European surplus** countries replaced **China** as main responsible for **CA surplus**. Due to low energy and commodity prices, **oil producers** shifted from CA surplus to **deficit**.

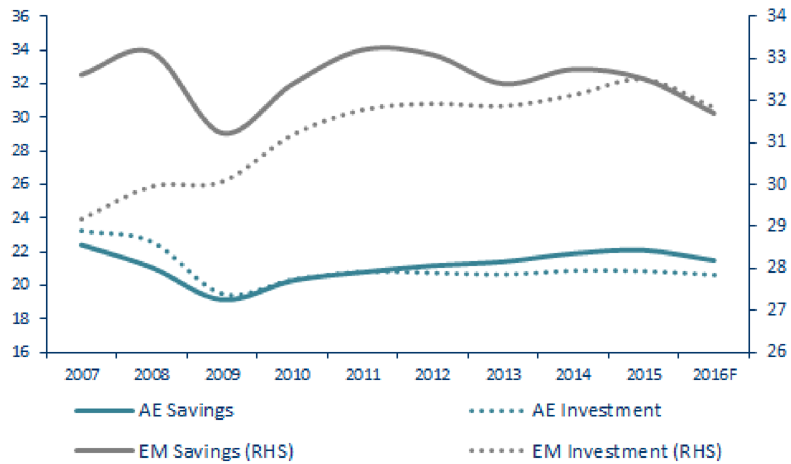
Savings & Investment> Global Glut: Coming to a Halt?

World Savings
(Gross)



Source: IMF, CDP.

Savings vs Investment
(% of GDP)

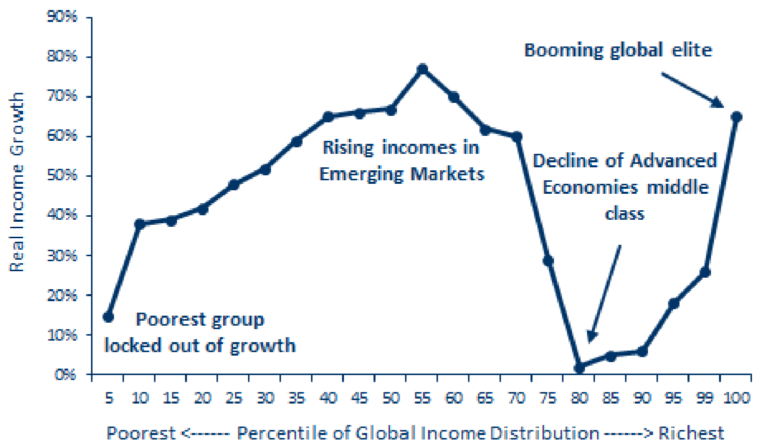


Source: IMF, CDP.

- A **global saving glut** (Bernanke, 2005) emerged in the **world economy** in the past decades. World savings reached a **peak** of about $20tn in 2014, i.e. 26% of world GDP, and **declined** thereafter both in absolute and relative terms.
- The **global glut**, mainly fueled by **savings** generated in **EM** after the financial crises at the end of 1990s, **increased** by about $10tn since the beginning of 2000s, despite the remarkable **contraction** occurred in **2009**.
- In the past decade **EM reduced** the **propensity to save** and **increased** the **investment rate**. **AE** progressively **reduced** their **investment rate**, while after the crisis they **increased** the **propensity to save**, contributing to generate the **CA reversal** observed in the previous slide.

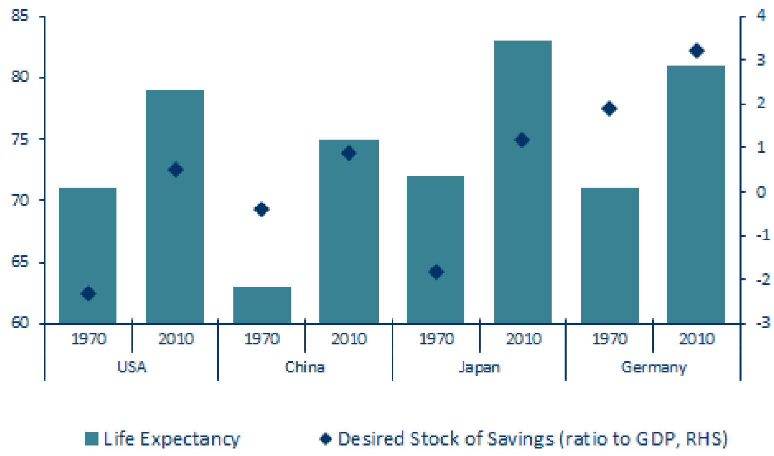
Inequality and Aging> Elephant (Chart) in (Wealthy) Room

Household Income Growth
(1988-2008; 2005 US$ PPP)



Source: Lakner and Milanovic (2013), CDP.

Aging and Savings
(Years)



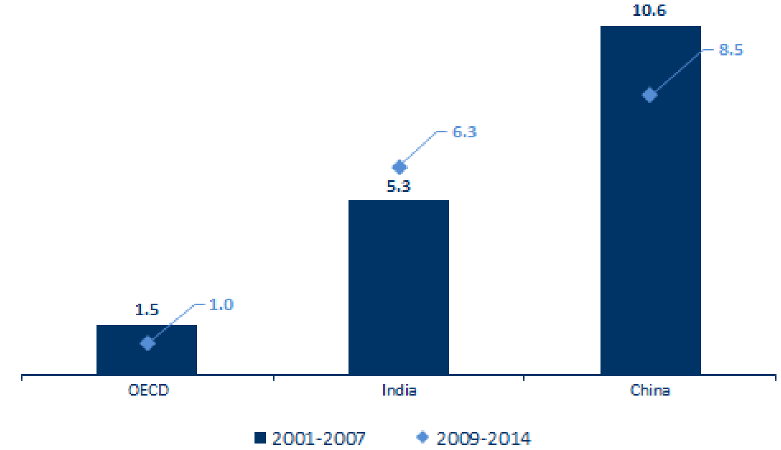
Source: Gottfries and Teulings (2015), CDP.

- **Globalization** exacerbated **inequality** within **AE,** but global inequality decreased due to **rising incomes** in **EM**, namely Asian countries (i.e. China). AE's **middle class stagnated** (losers), while **global elite boomed** (winners): top 5% of distribution accounted for 44% of increase in global income.
- **Inequality** and **aging population** are two main causes of **saving glut**: the boom of global elite **increased** the **share of income** devoted to **savings**, while a **longer life** induced people to **save more** for **retirement**. Higher life expectancy, **low population growth** and **constant retirement age** increased the stock of **desired savings**.
- Inequality and aging reinforced the **anti-globalization backlash** spurred by **populist movements** in the **rich world**.

Productivity> Secular Stagnation

Productivity Growth

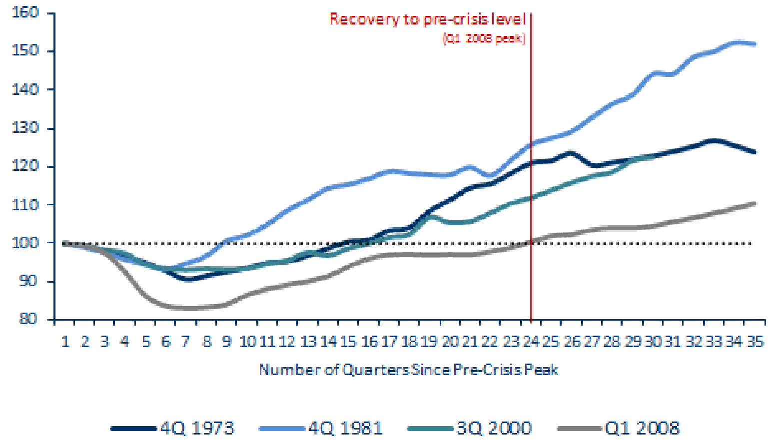
(Real GDP per Person Employed; % Annual Average)



Source: OECD, CDP.

Investment Cycle

(OECD Countries' Real Business Investments; Peak =100)

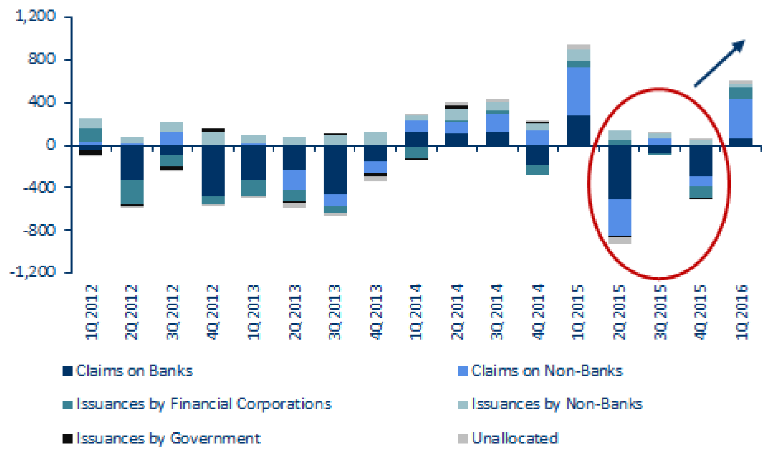


Source: OECD, CDP.

- **Productivity growth** in **OECD** countries is at **historical low.** On average, in the **post-crisis** period (i.e. 2009-2014), labor productivity growth **lost** 0.5% per year compared to the **pre-crisis** period (i.e. 2001-2007).
- Productivity in **EM** is growing at a **faster** rate. However, **India** is **accelerating**, while **China** is **slowing down**, having **lost** about **2%** per year in productivity growth since 2009.
- The current **investment cycle** recovery in **OECD** countries is the **slowest** in 40 years. **Secular stagnation** induced by the shifts in **demography**, **technology**, **propensity to save** and **inequality** is a main factor behind the **lack of aggregate demand** in AE (Summers, 2013 and 2014).

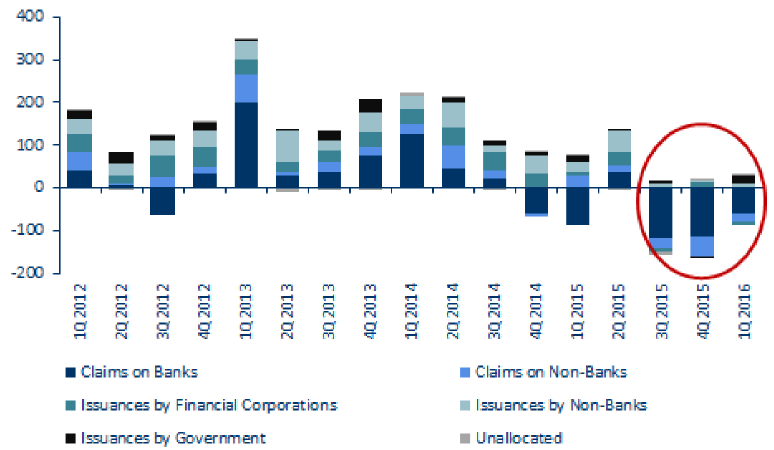
International Credit> Turning Point in Global Liquidity?

Credit and Securities: AE*
(Claims: Exch. Rate Adj. Changes; Issuances: Net Flows; US$bn)



Source: Bank for International Settlements, CDP.

Credit and Securities: EM*
(Claims: Exch. Rate Adj. Changes; Issuances: Net Flows; US$bn)



Source: Bank for International Settlements, CDP.

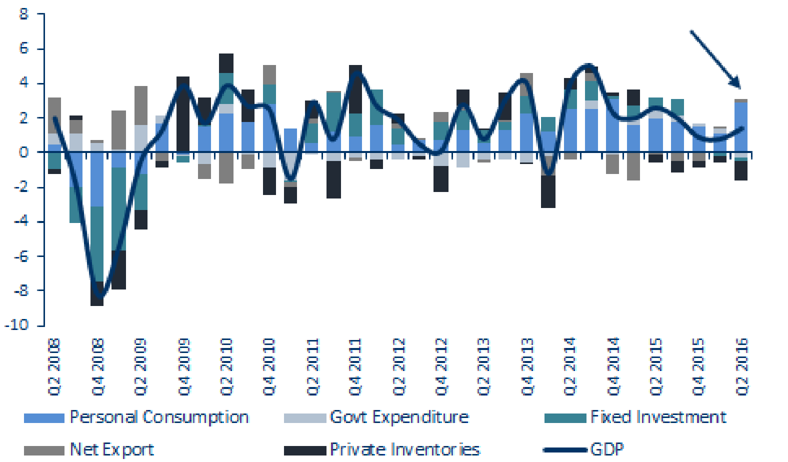
- After **slowing down** in H2 2015, in Q1 2016 **international credit dynamics** became **positive** in **AE** and **ameliorated** – although still **negative** – in **EM**. In Q4 2015 **global credit flows** to AE and EM **contracted by about** $458bn and $163bn, respectively. In Q1 2016 credit flows increased by $584bn in AE and decreased by $49bn in EM.
- Increased **market volatility**, **dollar strength** and **slowdown in China** tightened external **financial conditions** in **EM** in H2 2015. However, the dynamics eased in Q1 2016, while in Q2 2016 data on **international debt securities** showed a **revival** of **net issuance** in **EM** by 128U$bn.
- These dynamics could signal a **turning point** in **global liquidity conditions** (Cohen, Koch and Parise, 2016).

** Cross-border positions and international debt securities. Local positions in foreign currecy have been excluded.*

US Economy> Rebounding, but Losing Momentum

Contributions to Real GDP Growth

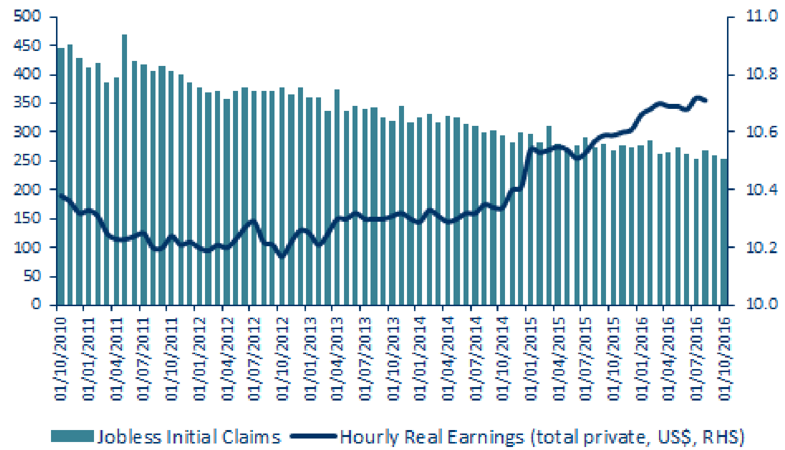
(% Annualized Rate; QoQ)



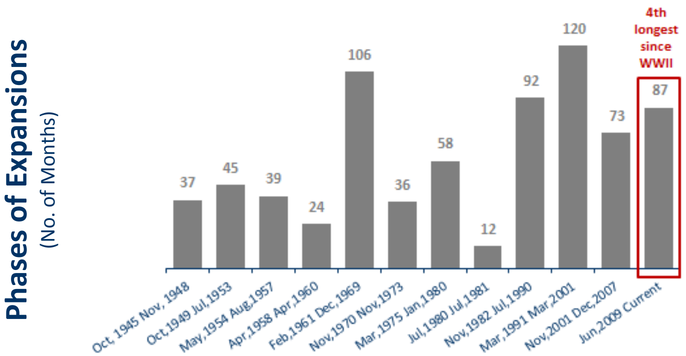
Source: Bureau of Economic Analysis, CDP.

Unemployment vs Earnings

('000 Persons)



Source: Bureau of Labor Statistics, CDP.

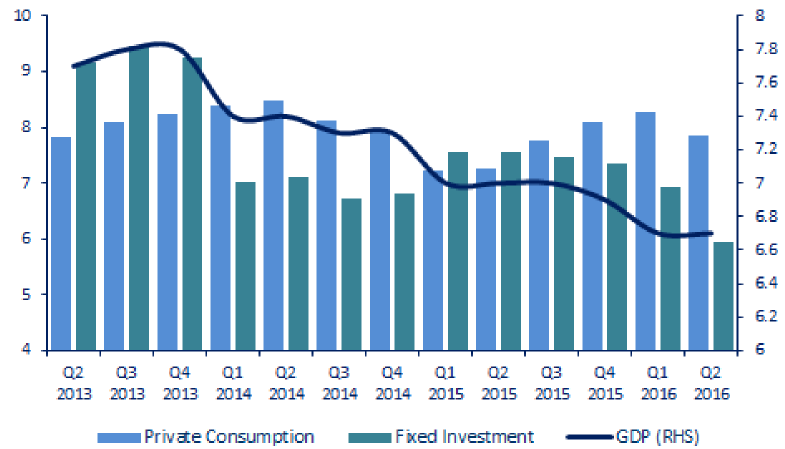


Source: NBER, CDP.

- In Q2 2016 US **GDP rebounded** at annualized rate of 1.4% w/ respect to Q1 2016 (0.8%). Growth was slightly **better-than-expected**, but still **disappointing**.
- **Positive signals** came from the **job market**, with **declining jobless claims** and **increasing real earnings**.
- **US economy** is in its **4th longest expansion** since WWII, raising fears of **approaching downturn**.

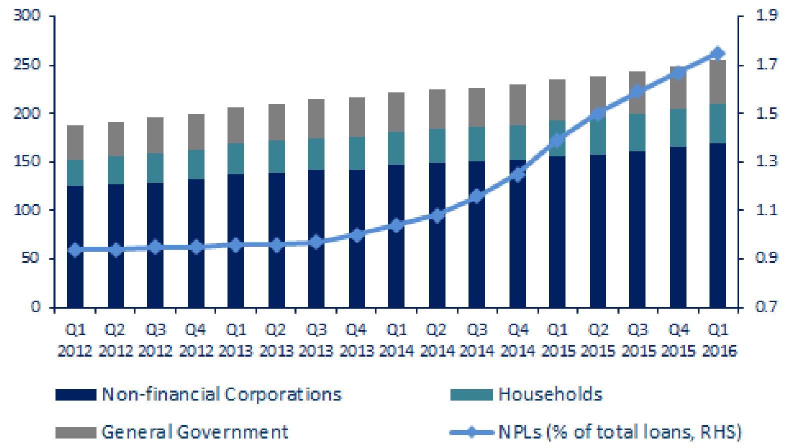
China> Tiger or Tortoise?

Real GDP, Consumption and Investment
(Δ% Quarterly; YoY)



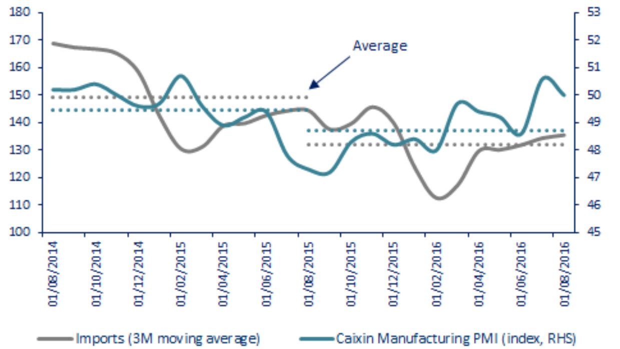
Source: National Bureau of Statistics of China, Oxford Economics, CDP.

Credit Breakdown by Sector
(% of GDP)



Source: Bank for International Settlements, China Banking Regulatory Commission, CDP.

Imports vs Manufacturing
(US$bn)

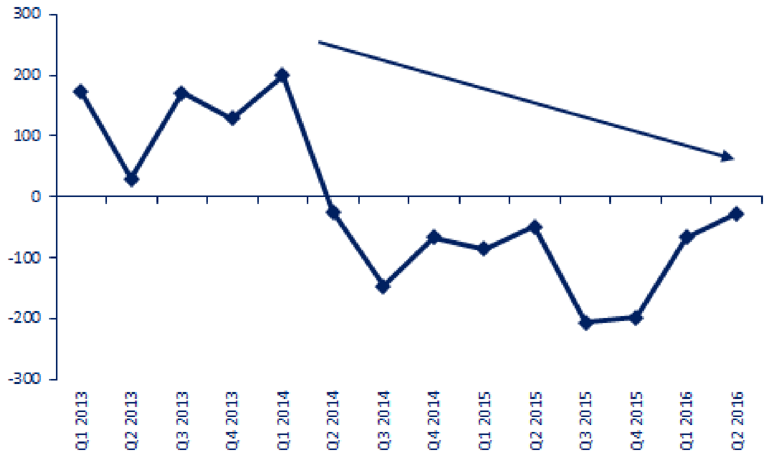


Source: Chia Customs, Markit Economics

- **China** is shifting from **investment-** to **consumption-based** economy, w/ a **deceleration** of its **growth rate**.
- **Credit expansion** coupled with **economic slowdown** led to an increase in **debt** of **corporations** and banks' **NPL ratio**.
- **Manufacturing index** and **imports** have been both **decreasing**, although rebounding in H1 2016.

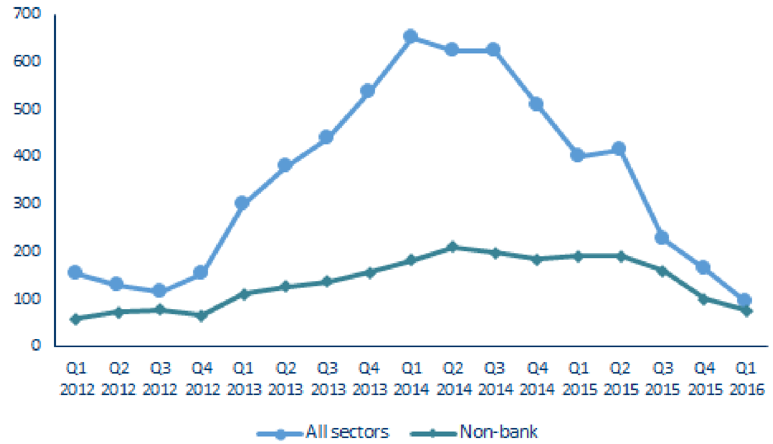
China's Capital Outflows> The Drivers Behind

Capital Flows* (US$bn)



Source: China Customs, People's Bank of China, CDP.

Foreign Claims (Net; US$bn)



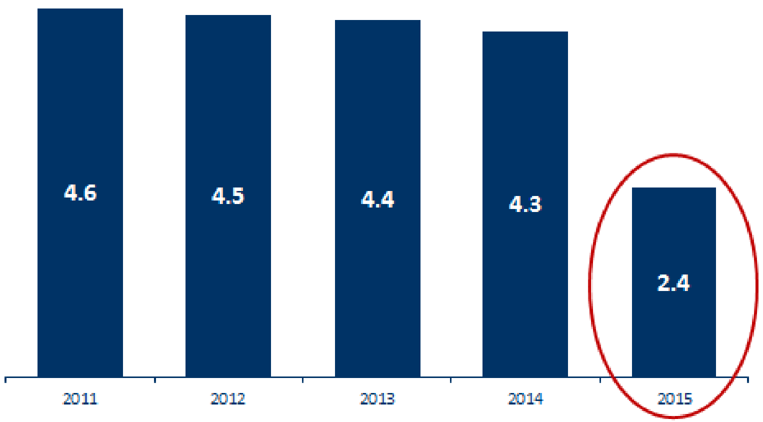
Source: Bank for International Settlements, CDP.

- After experiencing a **record outflow** of capital in 2015 (i.e. > $500bn), in H1 2016 these **negative dynamics** seemed to **improve**, **reducing** the **capital outflows** from China at about $90bn.
- The **reduction** in **outflows** followed the **renminbi stabilization** by Chinese authorities, in order to prevent **excessive depreciation** vis-à-vis the dollar.
- Chinese banks **reduced** their **net external exposure**, also fearing a **cost increase** in **foreign debt** due to **renminbi depreciation**. **Net foreign claims** against Chinese companies **decreased** from the peak of $650bn in 1Q2014 to $95bn in Q1 2016.

** Calculated as the change in foreign reserves plus the negative of the change in trade balance.*

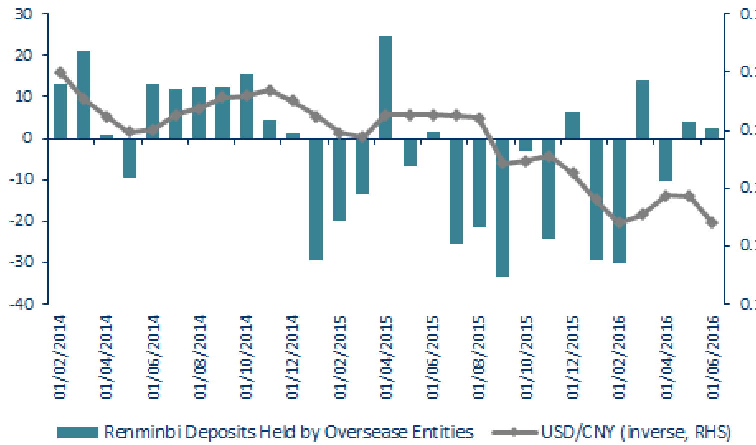
Chinese External Position> Increasing Vulnerability

Foreign Reserves vs External Debt
(Ratio)



Source: People's Bank of China, State Administration of Foreign Exchange, CDP.

Renminbi Deposits and FX Rate
(Δ MoM, US$bn)

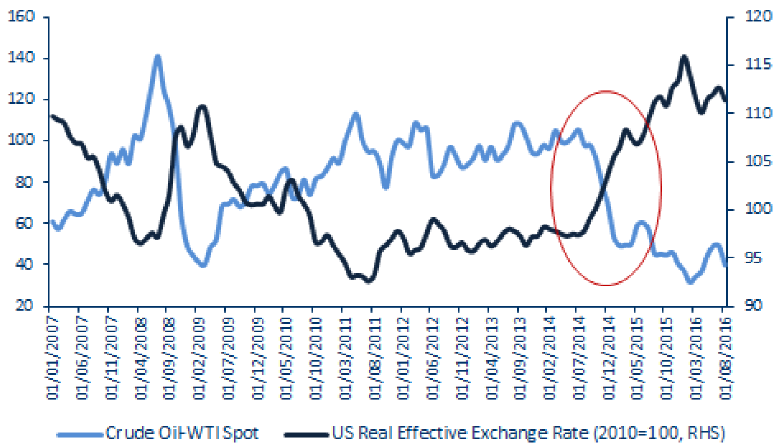


Source: Thomson Reuters, People's Bank of China, CDP.

- Chinese **external debt** is still **sustainable**, considering the amount of **gold and foreign reserves** owned by the PBoC. However, the **ratio** foreign reserves / external debt **decreased** almost by a half between 2014 and 2015, showing signals of **increasing vulnerability**.
- A **lower demand** for **renminbi deposits** in China by **overseas entities** (a change of -$145bn and -$50bn in 2015 and H1 2016, respectively), coupled with other **capital outflows**, put **pressures** on the **FX rate** vis-à-vis the US dollar.
- Shorting renmimbi deposits **drove down** the yuan to dollar **exchange rate** (i.e. inverse of USD/CNY), inducing a **6% depreciation** of Chinese currency from January 2015 to June 2016, although it appeared to **stabilize** in H1 2016.

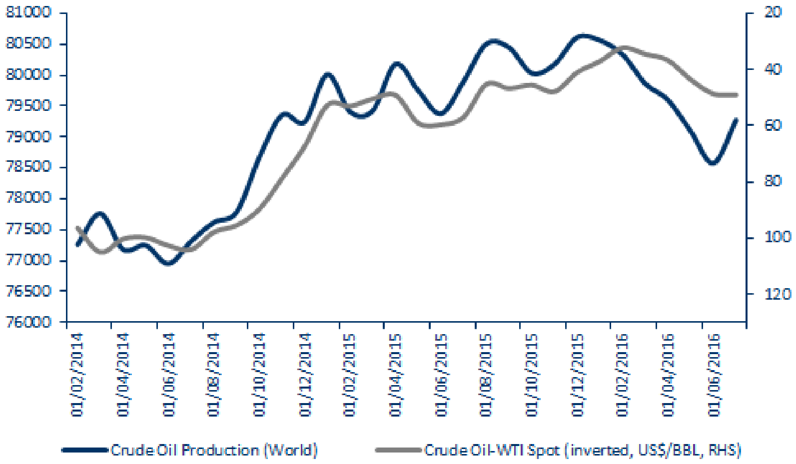
Oil Prices> Downward Pressures... Still at Work

Oil Prices vs US Exchange Rate
(US$/BBL)



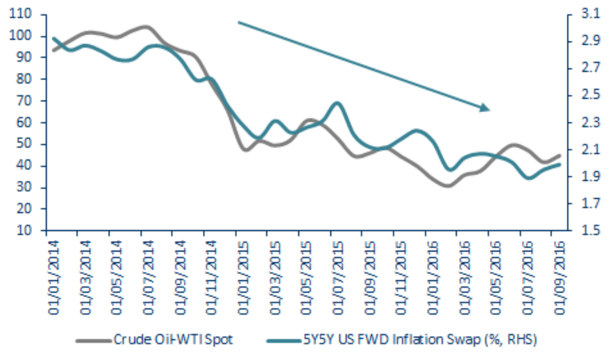
Source: Thomson Reuters, JP Morgan, CDP.

Oil Prices and Supply
(MMBBL/Day)



Source: Thomson Reuters, Energy Information Administration, CDP .

Oil Prices and Inflation Expectations
(US$/BBL)

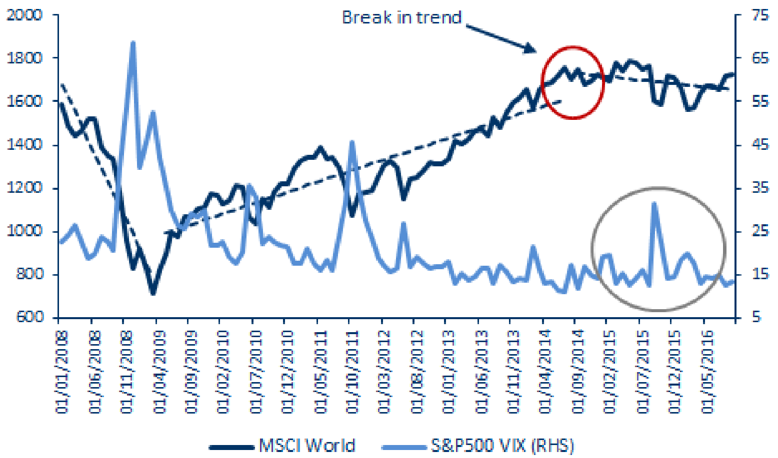


Source: Thomson Reuters, CDP.

- **US$** real effective **appreciation** => **higher oil price** in **local currencies** => **lower global demand** => **reduction** in **dollar price** (De Schryder and Peersman, 2015) w/ **increase in global supply**.
- **Low oil prices** remain **bullish factor** for **US economy** (i.e. increased households consumption), but induce **downward pressures** on **inflation expectations**.

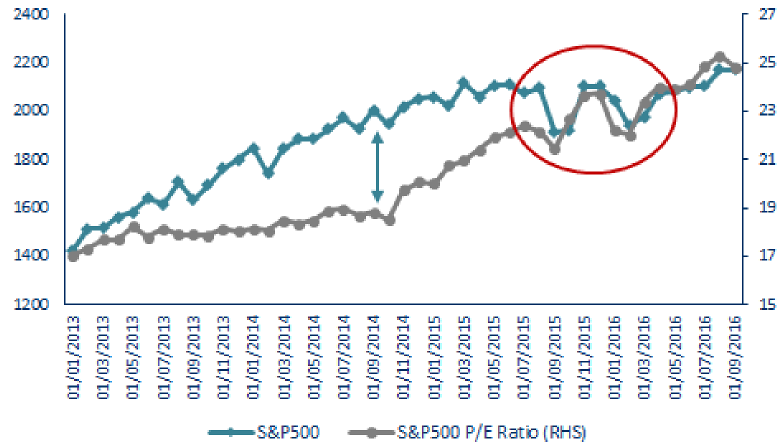
Stock Markets> From Bulls to Bears?

Performance vs Uncertainty
(Price Index; US$)



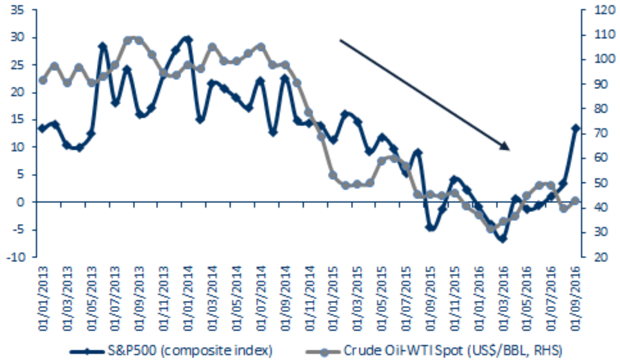
Source: MSCI, Chicago Board Options Exchange, CDP.

Market Multiples
(Composite Index; US$)



Source: Standard & Poors, www.multipl.com, CDP.

Stock Market Returns and Oil Prices
(Δ%, YoY)

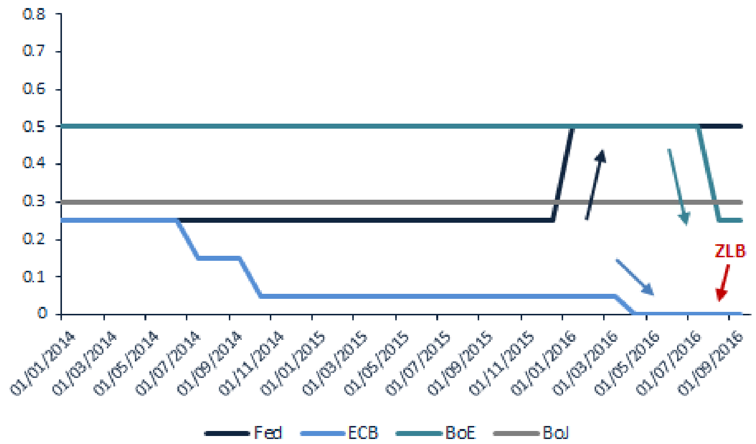


Source: Standard & Poors, Thomson Reuters, CDP.

- The **bullish trend** in world stocks due to **profit-seeking** behavior seems to be **ended** in H2 2014, incorporating **renewed volatility** over the course of 2015.
- In contrast, **market multiples** started to **increase**, w/ some **turbulences**, because of **negative earnings** of US **companies** from Q2 2015 to Q2 2016.
- **Returns** in US stock market was **negatively influenced** by declining **oil prices**. (i.e. oil as a financial asset)

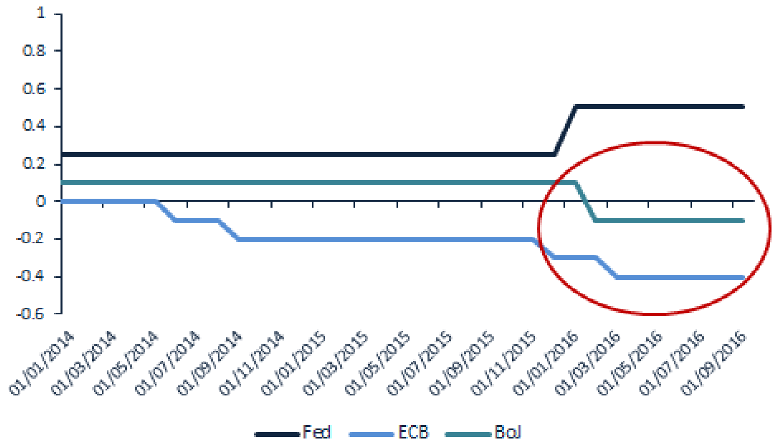
Monetary Policies> Diverging Patterns

Main Policy Rates*
(%)

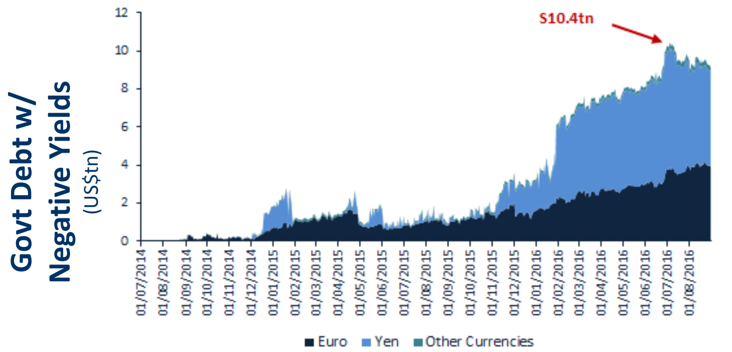


Source: Central Banks, CDP.

Deposit Facility Rates**
(%)



Source: Central Banks, CDP.



Source: Bank for International Settlements, CDP.

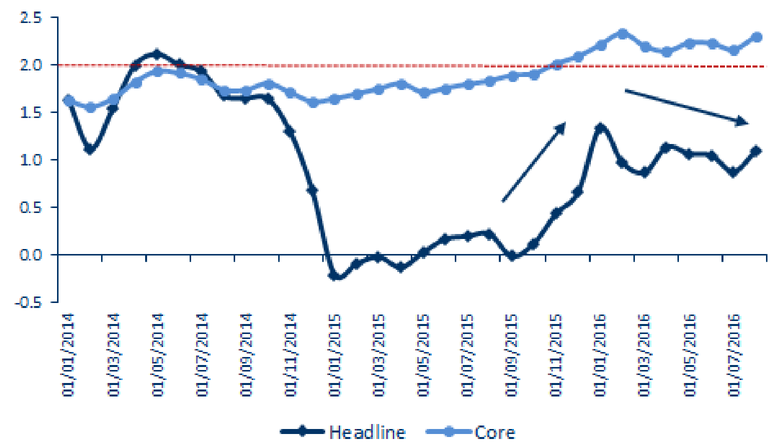
- **Monetary policies** became **more expansionary** worldwide (i.e. **QE** and **NIRP**) to push inflation to target level, but w/ increasing limits due to **zero lower bound** (ZLB). **Fed** started a **diverging pattern** in Q4 2015, but w/ more **uncertainty** about timing of further **rate hike**.
- **Zero** or **negative interest rates** (NIRP) increased the global amount of **govt bonds** trading at **negative yields** to a record level of $10tn.

** Fed: Federal Funds Rate; ECB: Main Refinancing Rate; BoE: Base Rate; BoJ: Basic Discount Rate.*

*** Fed: Required Reserve Balance Rate; ECB: Deposit Facility Rate; BoJ: Policy Rate Balance (former Main Policy Rate).*

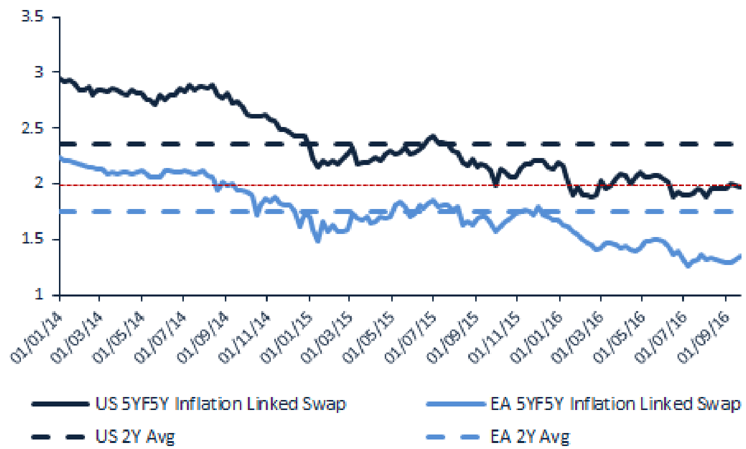
Inflation> (Dis-)Inflationary Forces

US Inflation
(%)



Source: Bureau of Labor Statistics CDP.

Inflation Expectations: US vs EA
(%)



Source: Thomson Reuters, CDP.

- In H2 2014 the dramatic **reduction** in **oil prices** pulled US **headline** inflation **below zero**. **Core inflation** progressively increased to **exceed** the 2% target. Since H2 2015 headline inflation **rebounded**, but in H1 2016 it followed a **downward pattern** once again.
- **Inflation expectations** both in US and Euro Area are at **historical low** and seem to be **not very sensitive** to **inflation targeting** policies by central banks, showing signs of **de-anchoring**. (particularly in EA)
- **Efficiency** of **monetary policy** in targeting inflation is reduced by **natural rate of interest** below its long-run level and persistently **lower than zero**, i.e. **liquidity trap**. (Cúrdia, 2015; Curdia, Ferrero, Ng and Tambalotti, 2015)

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