

Global Economic Outlook

December 2011

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Overview

Global Economy – European economies are expected to decline in 2012, but the US economy may play an increased leadership role in driving the global growth cycle.

United States – GDP is expected to expand by 3% in 2012, one percentage point above consensus estimates, driven by a rebound in private construction as well as capital and consumer spending.

Europe – A mild recession now looks almost unavoidable. The task for policymakers is to ensure that their actions do not lead to an even worse outcome.

Japan – Although momentum has slowed in recent months, we continue to expect solid reconstruction-led growth in 2012.

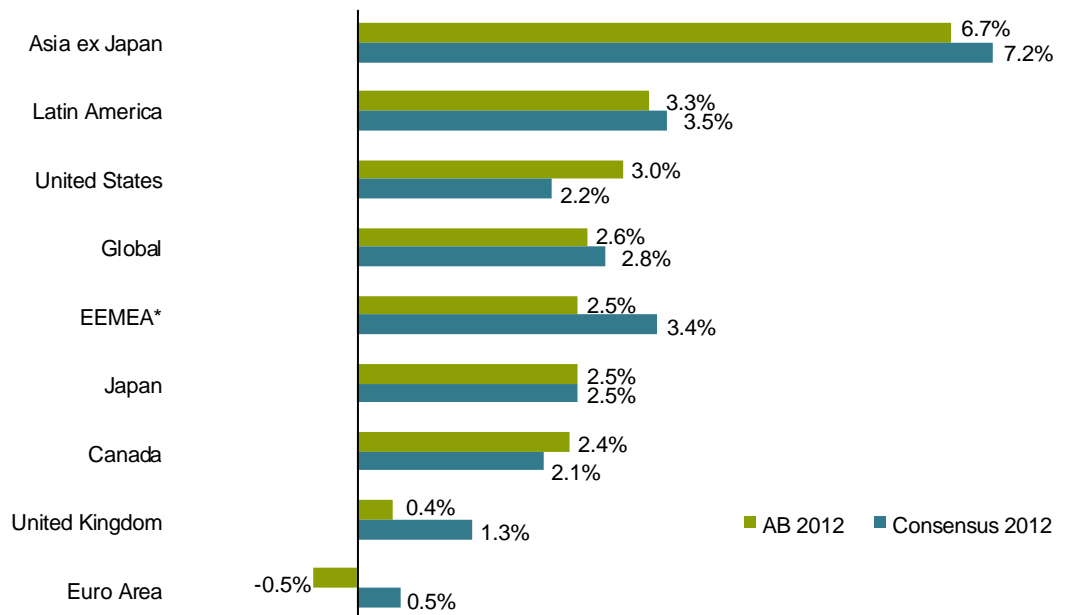
China – Lending-rate cuts are likely to be made toward the end of the first quarter of 2012 following the recent easing of the reserve requirement ratio cycle.

AllianceBernstein vs. Consensus World Economic Growth Forecasts

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Global Outlook

We have slightly lowered our estimates for global economic growth in 2012 because of a deteriorating outlook for Europe. For 2012, we now expect real gross domestic product (GDP) growth of 2.6%, down from last month's estimate of 2.8%. In Europe, we now expect real GDP to contract by 0.5% versus last month's estimate of a 0.1% decline.

In our view, the European debt crisis is now acting as a brake on the global economic recovery, though it is not triggering a global downturn. This view assumes that European Union policymakers will agree on a plan to promote and enforce greater fiscal discipline among the member countries, which in time would pave the way for the European Central Bank (ECB) to take on a more active role in the debt markets. Recently announced fiscal actions in Italy and the attendant sharp fall in bond yields is a hopeful sign that some progress is being made.

Outside Europe, the global growth cycle is continuing at a modest pace. The composite index of global purchasing managers rose 0.7 point to 52 in November, with notable strength in the US manufacturing sector.

The relative strength in the US manufacturing sector, along with a string of other positive reports on employment, retail sales, capital spending and housing, illustrates the changing character of global growth. We believe that the cycle is shifting away from an expansion led by emerging markets to one in which the US will take a leadership role. In 2012, we project US economic growth of 3%, which may not be fast by historical standards, but is above the global average for the first time since the global recovery started in mid-2009. Continued gains in capital spending and exports, along with a modest acceleration in consumer spending and the first increase in private construction spending since 2005, are the factors behind our above-consensus US forecast for 2012.

On the policy front, we expect incremental accommodation by the ECB, which should lead to a weakening of the euro versus the US dollar to about 1.25 by mid-2012. We also expect a string of monetary policy moves by several central banks in emerging-market economies. In China, the recent cut in the reserve requirement came earlier than expected, which we think is a harbinger of an official rate cut within the next three months. We expect lower official rates in Brazil as well.

US Outlook

Contrary to earlier fears, the US recovery is showing no sign of stalling. In fact, incoming data paint a picture of acceleration at year-end, with solid momentum going into the new year. At the moment, we estimate fourth-quarter real GDP growth at 3.2%, but growth may surprise on the upside. For now, our 2012 real GDP estimate of 3%—which is one percentage point over the consensus estimate—remains unchanged.

The brighter picture is most evident on the consumer side. Private nonfarm employment continues to expand at a modest pace, rising 140,000 in November, while gains from previous months have been revised up substantially. In fact, private nonfarm employment has posted average gains of 160,000 over past three months. The better-than-expected news on job creation has led to a sharp drop in the jobless rate, which fell to 8.6% in the latest month, the lowest rate in the current recovery.

The improvement in the labor market has been quickly reflected in consumer survey data and in spending patterns. The Conference Board survey of consumer confidence jumped 16 points in November, one of the largest moves on record. Although the level of the overall index remains low, the decline in unemployment in recent months is a good sign that could

Sharper decline in European economies is expected in 2012

Fiscal agreement may lead to monetary accommodation by ECB

US to take on a leadership role in 2012

Lower official rates expected in emerging markets

US economy shows resilience

Labor markets are improving

help reverse widespread pessimism on the jobs outlook.

Retail sales rebound

Not surprisingly, the brighter mood of consumers is also apparent in spending trends. Holiday sales got off to a relatively strong start, based on a number of surveys. At the same time, spending on big-ticket items has also increased. Indeed, consumer purchases of cars and trucks in November hit their highest level in four years, a clear indication that improving sentiment and finances are providing consumers with more confidence to spend again.

Capital spending is still robust

Business spending has been surprisingly firm during the ups and downs in the financial markets and the scare of contagion from the European debt crisis. Capital spending rose 15% annualized in the third quarter, and seems to be on track to post another double-digit gain in the fourth quarter. There is a risk that capital spending may slow temporarily in the first quarter of 2012, as the 100% bonus depreciation in the tax code for 2011 drops to 50% in 2012. However, with order backlogs on the rise, record new orders flowing in for US-built commercial aircraft, and nonresidential construction activity recovering, we expect another strong year for capital spending in 2012.

Unsettled fiscal issues are a key risk

All these developments are highly supportive of our US growth estimates for 2012. Of course, there are still many problems that need to be resolved, including the budget stalemate in Washington and the debt crisis in Europe. However, these issues have so far slowed the pace of recovery without stopping it. In addition, any positive developments on these fronts may inject more momentum into the economy than we currently anticipate.

Europe Outlook

Industrial output starts to contract

The euro-area economy eked out its second consecutive 0.2% expansion in the third quarter, but leading indicators suggest that economic output will start to contract in the final quarter of the year. Hard data are limited at this stage, but point in the same direction. In October, for example, industrial production was down 1.2% from the third-quarter average in Germany, 1.9% in Spain and 2.8% in Italy.

Mild recession looks unavoidable

In spite of this, the data are still consistent with only a mild recession. Indeed, important leading indicators like the composite purchasing managers' index and Germany's business climate indicator actually rose in November. In part, this may reflect the resilience of the global economy. This is apparent in German capital goods orders from countries outside the euro area, which have rebounded very strongly after a weak third quarter. In this respect, it is important to remember that while the euro area represents a considerable downside risk to the global outlook—especially if policymakers allow the sovereign-debt crisis to spiral out of control—this is just one side of the coin. The other is that a resilient global economy should help dampen recessionary forces in Europe.

The task is to prevent this turning into a much deeper downturn

Against this backdrop, the task for euro-area policymakers is to ensure that they do not turn a mild recession into something considerably worse. A couple of months ago we argued that the euro area might be in the formative stage of a credit crunch, comparable to the period just before the collapse of Lehman Brothers. Since then, tensions in bank-funding markets have risen sharply and there is a growing risk that this will spill over into the real economy, precipitating a hugely damaging feedback loop.

Onus likely to fall largely on the ECB in the near term

Euro-area governments and the European Central Bank (ECB) have key roles to play here. Ultimately, the solution to the sovereign-debt crisis must lie with governments, but there are still big ideological differences between countries, which make progress difficult. Moreover, governments have made their task far more difficult by systematically undermining the risk-free nature of sovereign obligations in the euro area—culminating in S&P's decision to put the credit ratings of all euro-area countries on review. In the near term, the spotlight is still

very much on the ECB.

The good news is that the ECB seems to be listening, at least so far as the banking system is concerned. Not only did it reduce the key refinancing rate by 25 basis points to 1.00% at its December Governing Council meeting but it also loosened the collateral requirements for access to its refinancing operations, halved the reserve requirement ratio to 1% from 2% and introduced two special 36-month longer-term refinancing operations. In conjunction, these measures represent a significant strengthening of the backstops underpinning the euro-area banking system ahead of a very challenging funding environment in 2012 and should reduce the risks of a major systemic bank running into a liquidity crisis. Unfortunately, while the ECB is willing to act as a lender of last resort for solvent but illiquid euro-area banks, it is still reluctant to do so for solvent but illiquid governments.

Japan Outlook

Since the Great East Japan Earthquake and its tsunami struck in March, we have argued that the recovery would likely consist of two broad phases. The first would involve a sharp recovery from the initial devastation, as essential infrastructure was repaired and damaged supply chains restored. The second, longer phase would be largely driven by public sector funded reconstruction and rebuilding in the areas that suffered the most.

The sharp jump in Japan's third-quarter GDP—it rose 6% in annualized terms—marks the end of the first phase. Neither the jump itself, which had been flagged in the monthly indicators, nor its composition was a surprise. The big positive drivers were consumer activity, construction and net exports. Consumer spending rose as confidence recovered and post-quake restraint faded. Auto sales improved as supply chains were restored. And TVs were in demand ahead of a shift to digital broadcasting, as were energy-efficient products from fear of electricity shortages. The housing sector was buoyed by early signs of reconstruction as well as a rush to take advantage of the “eco point” program that initially expired in July. Net exports gained as the export boost from supply-chain recovery outstripped resilient import volumes.

The positive quarter-end outcome disguises the fact that momentum was perceived to be fading as the quarter progressed. Industrial production and key business sentiment indicators such as the manufacturing Purchasing Managers' Index or the Shoko Chukin index have trended sideways from June. Most consumption-related monthly indicators drifted a little lower through the quarter. The key exception to this trend—and a reason not to succumb to the gloom—has been the behavior of the labor market.

With momentum fading, the transition from phase one to phase two is not going quite as smoothly as expected. This is compounded by a couple of factors. The first is the impact of the floods in Thailand. Over recent years Japan has been the main source of foreign direct investment into Thailand. Much of that investment was concentrated in the auto sector, and production in Thailand of both vehicles and parts now forms an important part of the supply chain. With the floods causing disruption to production facilities, there is some prospect of broader disruption to global manufacturing activity. While our base-line assumption is that normal production will most likely resume by late this year, there will be some negative impact on Japan's fourth-quarter production and GDP figures (although this should be offset by a stronger first quarter 2012).

Second, the third supplementary budget—which contains the bulk of the reconstruction spending—has only just been passed through the Diet. It now seems likely that reconstruction spending will be pushed back a quarter or so later than our earlier

Fading momentum should be temporary as reconstruction boost still expected in 2012

Transition to phase two of recovery may not be smooth

Budget delay may hold back reconstruction spending

expectations.

In addition to these factors, there is the usual list of uncertainties that have been hanging over the outlook for some time. How much impact will the European sovereign crisis have on Japan? What will be the impact on exports and domestic spending decisions of weaker global growth and the strong yen? What about the risk of electricity shortages? These risks remain.

How have we changed our GDP forecasts as a result of this analysis? We have reshuffled our quarterly profile of growth to some extent, and are now anticipating a weaker (perhaps negative) fourth quarter but a slightly stronger first half in 2012. That leaves us with a GDP growth estimate of about 2.5% for 2012, slightly below our previous forecast of 2.7%. But the broad tenor of the forecast—relatively solid activity driven by reconstruction activity—is unchanged.

Australia/New Zealand Outlook

The RBA continued to ease monetary policy in December, cutting the cash rate by another 25 basis points to 4.25%. In our view, this move was largely driven by a desire to take out some “insurance” against offshore weakness, rather than a need to actively stimulate the domestic economy. The central bank thought it had the scope to take this action in light of a better-than-expected inflation outcome. Nothing about the underlying domestic economic picture has changed dramatically: Australia remains an essentially two-speed economy.

Data released during the last month, for example, showed that private sector business capital spending increased by 12% in the third quarter, a rise of 31% over 12 months. The mining sector continues to be the primary driver of that spending, with its capital expenditure up 60% year on year. The expectations data contained in this survey are consistent with a further rise in spending through the rest of this fiscal year to June 2012. Based on the survey, we estimate that total business sector capex should be up by about 30% to 35% in the fiscal year, with the mining sector dominating growth (although not exclusively).

Retail spending and housing sector numbers, however, clearly show the economy’s other speed. Retail sales were up 0.2% in October. While this is the fourth consecutive monthly increase and is consistent with some improvement, the trend is still on the sluggish side (running at 3.5% to 4% annualized growth in nominal terms). New housing permits were also weak (down 10% month on month in October), house prices continue to drift lower (particularly in Queensland) and household credit growth remains soft, running at mid-single-digit percentages. None of this is flashing “disaster” but the data again highlight that there has not been much change in the status quo.

The aggregate picture, then, is still good, particularly in a global context. GDP growth, for example, is relatively solid, with the third quarter likely to be up 1% to 1.5%, after the 1.2% rise recorded in the second quarter. Most business surveys are consistent with an economy growing at a trend pace, as is the labor market. The unemployment rate is a tad above its lows, but unchanged versus a year ago.

Where does this leave monetary policy? The case for aggressive easing on domestic grounds is not compelling, given that it’s only been six months since the RBA was justifying a tightening bias when conditions were similar to those described above. The nub of the issue, then, is how much insurance the RBA wants to take out to protect against a potential global systemic meltdown by cutting interest rates? If Europe deteriorates further, the RBA may well decide to take out a little more insurance. However, this is not our central case, and we still consider it very unlikely that the RBA will deliver anything like the 150 basis points of

Global factors—and better inflation—saw RBA deliver rate cut

Strong mining sector drives spending

Retail and housing data are weaker

Growth remains relatively solid

RBA unlikely to lower rates

easing now priced into the bond yield curve.

Canada Outlook

A mild surge in growth

Economic activity in Canada is recovering from a sluggish summer. Part of the fall in second-quarter GDP was due to temporary energy and mining closures, so the subsequent recovery in oil export volumes in August and September was expected to pull up GDP. Otherwise, Canada's bifurcated economy rolls on. Resource booms in Alberta and Saskatchewan are pulling in jobs and bolstering wages in those regions. But in Ontario, where manufacturing costs are high by North American standards, jobs are being lost and average wages have fallen over the last year. Across Canada, existing home prices are rising faster than the effective rate of interest (about 5.5% for five-year mortgages). Amid these crosscurrents, core inflation exceeded the Bank of Canada's 2.0% annual target in September and in October.

Defending the Bank of Canada's 1.0% rate policy, Governor Mark Carney explained that the central bank targets inflation over a long and variable period, presumably implying that it's in no rush to quash inflation when the global economy is as uncertain as it is today. We think Carney's statements also imply that the Canadian dollar constrains policy from hiking rates, because the effect of higher Canadian interest rates on the currency is an important part of the monetary transmission process and the currency is too high for a broad recovery that includes manufacturing. He also said that financial stability issues in a single sector (like housing) were best treated with specific regulatory measures, which argues against raising rates to stop a housing bubble from developing. Balancing these considerations, we don't expect much change in interest-rate policy in Canada.

Emerging Markets Outlook

Brazil's economy stops growing

Latin America: Brazil's GDP was flat in the third quarter, pulling revised annual growth to 2.1%, well below the 3.0% floor that matters for local politicians and policymakers. Other information points the same way: formal job gains dipped to 126,000 in October compared with 204,000 last year. Bank lending growth slowed to 0.8% in October from rates of 2.0%–1.0% in recent months. Slowing credit growth in October might have been related to a local banking strike, but the data are still unclear. We expect GDP growth of merely 2.5% year on year in the fourth quarter, and a weak recovery to 3.3% growth by the end of 2012.

Inflation indicators are low

Reflecting weakening demand and a stabilized Brazilian real, recent inflation indicators have also been on the low side. Mid-November IPCA-15 consumer price inflation was only 6.7% compared with a year ago, and we expect lower inflation by early 2012 as very high food price gains fall out of the yearly comparison. A reduction in reported inflation due to new IPCA basket weights could cut reported inflation further, to nearly 5.0% by March–May. Brazil's target range for inflation is 2.5%–6.5%, so inflation is, at least for now, on its way back to the target band.

Central bank cuts interest rates

As expected, given slow growth and low inflation, Brazil's Central Bank Monetary Policy Committee (Copom) cut rates by a moderate 50 b.p. to 11.0%. The real question is how low rates will finally go. Global financial risks argue for cuts below 9.50% (which are now priced into forward markets). Yet arguing for caution in cutting rates is the inflationary impact of upcoming 14% minimum wage hikes on service costs and on public sector borrowing, and the expansionary effect of reduced taxes on consumer credit.

Brazil's fiscal policy had been tightened this year. Originally this was designed to slow the economy down and to increase the scope for rate cuts. Brazil's primary fiscal balance target was moved to a 3.1% surplus—a target that has been met this year, including a cumulative

3.3% in the 12 months through October. Next year, however, a higher minimum wage and rising pension costs will lift public sector spending and could damage this fiscal surplus, which helps support for a policy of rate cuts. In this situation, the Finance Ministry has initiated a package of growth-supporting fiscal measures, apparently aimed at achieving 5.0% growth in 2012. These include the elimination of the IOF tax on foreign investors, amounting to 2% on new equity and 6% on bonds, which help finance infrastructure. The ministry is also reducing the IOF tax on consumer credit, and the IPI tax on consumer goods purchases, as well as a reduction in taxes on low income housing. We think these measures will limit the slowdown in Brazil, but not enough to prevent further significant rate cuts beyond what markets now expect.

Mexico swings to dollar sales

Mexico is keeping its head above recessionary water, partly by fostering a weak currency. Growth of 4.5% in the year through the third quarter was considerably higher than expected, and it came mostly in services and manufacturing. A solid fourth quarter seems to be in the making too, because car assemblies were up in October while retail sales rose by a surprisingly high 4.7% in real terms in the year to September. Any US slowdown should have some effect in Mexico, though it should be cushioned by the low currency, which fell to 14.25 pesos per dollar at one point last month.

Mexico's Foreign Exchange Commission finally decided to swing from dollar accumulation to dollar sales, to counter the peso's long fall against the dollar from 11.5 pesos per dollar in July to 14.25 pesos in November. Official toleration of continued peso weakness appears to be ending as the sharp depreciation of the currency may have contributed to a rise in inflation from 3.2% in October to 3.4% in mid-November. The commission recently made two significant announcements: First, it plans to auction dollars for pesos if the dollar value rises more than 2% between trading sessions. For now this will be \$400 million in dollar sales a day. Second, the commission will end its long-standing dollar put auctions, which had allowed BANXICO to buy dollar reserves on dollar weakness, also in a systematic way.

These structures to buy dollars (before) or sell dollars (now) are designed to be as market-neutral as possible. But the new auctions will still be selling dollars from reserves, which have been accumulated to nearly \$140 billion, compared with \$85 billion in 2008. Back then, similar dollar auctions began as the currency weakened to 14.0 pesos per dollar in October 2008 and continued through 15.5 pesos, before the turn eventually took place in March 2010. The auctions were wound down by April 2010. We find it improbable that this statement of resistance to further currency weakness implies an early rate cut in Mexico, because 4.5% rates are another currency support—why eliminate that if the currency is much too weak? Indeed, the central bank left interest rates unchanged after its latest meeting.

Fine-tuning of growth forecasts

Asia ex Japan: The region's activity growth has continued to moderate over the past quarter, but there were still no signs of a collapse amid the lingering European debt crisis. That said, we have fine-tuned some of our GDP projections for smaller economies, particularly **Malaysia** and **Thailand**. These adjustments are not substantial enough to have affected our overall forecast for the region. For 2012, we have kept our Asia GDP forecast at 6.7% versus 7.5% in 2011.

Higher spending may boost Malaysia's growth but could worsen fiscal shortfall

For Malaysia, we have lifted our 2011 gross domestic output (GDO) growth forecast by 1.2 percentage points to 5.2%, and increased our 2012 estimates by 0.5 percentage point to 4%. The key reason is that public spending is set to accelerate in next year's general election and we also expect Bank Negara Malaysia to trim interest rates in order to provide an additional boost to economic growth. However, the flip side of policy stimulation is likely to be a worsening of the fiscal deficit beyond the official target of 4.7% of GDP.

We have cut Thailand's GDP growth forecast by 1.1 points to 1.5% for 2011, on the back of

Thailand's recovery will depend on banks' lending attitude

the devastating impact of the recent flooding on the economy. October manufacturing production plunged 36% year on year (or 38.9% month on month), and capacity utilization has dropped significantly to 46.4 from 65.5 in the previous month. Both trends reflected the massive scale of disruption, and we expect a significant slowdown in exports in the months ahead as the correction in October had been mitigated by inventory de-stocking. For 2012, we have lifted our GDP forecast by 1.5 points to 4% (short of the government's forecast of 4.6%) in light of pent-up demand thanks to reconstruction activity. Recent official reports showed that Bangkok would be free from flooding by the end of December, and floodwaters have already receded at five out of seven industrial estates north of Bangkok. The two remaining industrial zones are expected to dry up soon.

While factories have gradually resumed production activities, local media reported that commercial banks on the ground would extend the repayment period for businesses affected, while withholding new loan approvals as many borrowers lack adequate collateral or guarantors. This may delay efforts by local manufacturers to restore full capacity and could justify further monetary easing by the Bank of Thailand to provide some relief to local firms.

India may dip into sub-7% GDP growth next year

In addition, while we have not changed our GDP forecast for **India** at 7% in 2012, our projection is likely subject to downside risk in light of the faster-than-expected pace of economic slowdown in the past quarter. Third-quarter GDP growth slowed to 6.9% year on year (from 7.7% in the previous quarter), which represents the first sub-7% growth in three years.

All sectors have slowed except exports, which picked up surprisingly to 27.4% year on year from 24% in the second quarter. The acceleration in exports should be hard to sustain given slowing global demand, and we expect a marked decline in shipments will emerge in early 2012. Import growth plummeted to 10.9% year on year (from 24% in the second quarter), reflecting a slackening in domestic demand. Indeed, private consumption growth has slowed to 5.9% year on year (from 6.3%) and the outcome reinforced our long-held view that India's services sector has not performed as well as the services PMI trend has suggested. The Reserve Bank of India's aggressive policy tightening over the past year has started to filter through the system, with fixed investment contracting by 0.6% on the year following an 8% year-on-year expansion in the second quarter. However, weaker growth will help to shape a more positive inflation picture next year, and, at this juncture, we expect the central bank will start cutting interest rates by the second quarter of 2012 with a total 75 b.p. reduction in the full year.

China starts outright, rather than selective, monetary easing

In **China**, officials have been talking about policy fine-tuning, but a series of moves over the past month or so looked more like outright monetary easing than policy adjustments. These included selective credit easing to small- and medium-size enterprises, an unwinding of open market operations and a lowering of short-term bills. In addition, the Reserve Requirement Ratio (RRR) reduction was extended to more local rural credit cooperatives, and the latest 50 basis points RRR was cut for commercial banks.

In our view, the RRR cut for banks has marked a change in the People's Bank of China's (PBOC) monetary policy stance, and there will be at least three or four more reductions in 2012. We still expect a lending rate cut will come three to six months from now, although Beijing does not want an outright reduction to confuse market expectation that its current tight housing policy will soon change. We disagree with some of the market views that expect the PBOC to hike lending rates while cutting the RRR. There is no precedent for this monetary policy mix and we do not know what this will mean as an overall policy.

EEMEA GDP reports were mixed in 3Q

Emerging Europe, Middle East and Africa: Third-quarter GDP reports from across the region were mixed, indicating a broadly unchanged growth picture compared with the second quarter in [Poland](#) and [South Africa](#), and a sharp growth rebound in [Hungary](#) and [Russia](#) (largely due to a bumper harvest). Owing to the large weight of the harvest, we estimate that the aggregate growth rate for the region as a whole accelerated to 3.8% (seasonally adjusted annualized rate) from 2.5%. This is in spite of our assumption that growth in Turkey, to be reported next week, slowed further in response to credit tightening and weaker domestic demand. Detailed GDP releases in the coming weeks should help explain the sources of the intra-regional divergence and hence the sustainability of the third-quarter developments.

Regional surveys beat expectations, but growth is slowing in 4Q

Meanwhile, the high-frequency activity and survey indicators released over the past month came out generally better than expected. In most countries that have reported so far, industrial production momentum firmed up in October, as did the momentum in retail sales (surprisingly, despite sagging consumer confidence). Finally, November PMIs remained unchanged in the aggregate as a decline in the [Czech Republic](#), Hungary and Poland (currently in the contraction territory) was offset by an increase in South Africa and Russia. This would seem to paint a relatively upbeat picture for the fourth quarter, but we suspect that the damage caused to global consumer and business confidence by the escalation of the euro-area crisis should weigh on both production plans and household consumption during the rest of the year. We therefore expect that EEMEA GDP growth will have slowed to a seasonally adjusted annualized pace of less than 1.5% in the current quarter, the slowest growth since the first quarter of 2009.

Inflation deteriorates amid exchange rate weakness

On the inflation front, the picture has deteriorated during October and November as the exchange rate weakness across the region continued to feed through to consumer prices. The acceleration has been especially sharp in [Turkey](#) where the headline inflation rate rose to 9.5% year over year in November from an average of 6.5% during the summer. It will probably end the year more than four percentage points above the 5.5% inflation target.

Inflation rates across EEMEA are now almost uniformly above central bank targets. The only exception is Russia, where the central bank has had a rather unambitious informal inflation target of 6%–7% this year. Against this backdrop, EEMEA's major central banks have decoupled from the rest of the world in that they see only a very limited scope for monetary easing despite the specter of a global slowdown. During the past month, EEMEA policy rates were therefore kept on hold.

EEMEA rates are on hold, except in Hungary

Hungary was an exception, as its central bank began a hiking cycle in response to the large sell-off in the forint and its implications for financial stability and inflation. A downgrade of Hungary's sovereign credit rating to below investment grade by Moody's has also added to the country's rising risk premium, which is something that the central bank has traditionally monitored. We think there's a good chance of another 50 basis point hike this month, but next year the onus will be on the Hungarian authorities and their ability and willingness to negotiate a financing and confidence backstop with the IMF. The government made another surprise U-turn last month by announcing that it would seek an IMF-sponsored program after turning its back on such an option since the previous stand-by arrangement expired in late 2010. Despite its ambitious fiscal consolidation and debt reduction plan under way, Hungary is unlikely to be able to finance itself exclusively from the markets if the current market stress persists into 2012. Moreover, some of the recent government moves to address the household foreign exchange mortgage overhang at the expense of the banks have undermined market confidence and, critically, hurt the country's medium-term growth and hence fiscal consolidation prospects. A large foreign ownership of the local bond market

adds further pressure in this respect. We think that last month's market volatility, a rating downgrade and the central bank's reaction have now significantly increased the government's awareness of these vulnerabilities and we would therefore expect it to seek common ground with the IMF in the form of a precautionary stand-by arrangement by the end of February. The latter is also a self-imposed deadline for the S&P to decide whether to follow Moody's and to become the second critical agency to downgrade Hungary to non-investment grade.

Turkey squeezes domestic liquidity

In Turkey, the central bank stuck to its policy of squeezing domestic liquidity which has kept the overnight market rates in the range of 9.0%–12.5% or up to 600 basis points above their level at the end of September. This was done without moving the key policy rate, which has remained at 5.75% since the August cut and has become irrelevant as an indicator of the central bank's monetary policy stance.

	Real Growth ¹ (%)			Inflation ¹ (%)			Official Rates ² (%)			Long Rates ² (%)		
	2010	2011F	2012F	2010	2011F	2012F	2010	2011F	2012F	2010	2011F	2012F
Global	4.2%	2.8%	2.6%	2.4%	3.7%	2.7%	1.96%	2.13%	1.84%	3.90%	3.18%	3.59%
(PPP Weighted)	(5.1%)	(3.7%)	(3.3%)	(3%)	(4.3%)	(3.2%)	(2.6%)	(2.9%)	(2.6%)	(4.3%)	(3.7%)	(4%)
Industrial Countries	2.7%	1.4%	1.6%	1.5%	2.8%	2.0%	0.63%	0.63%	0.46%	3.04%	2.16%	2.84%
Emerging Countries	8.0%	6.3%	5.3%	4.7%	5.9%	4.7%	5.34%	6.07%	5.46%	6.22%	5.91%	5.60%
United States	3.0%	1.8%	3.0%	1.6%	3.7%	2.6%	0.13%	0.13%	0.13%	3.30%	2.25%	3.50%
Canada	3.2%	2.4%	2.4%	1.8%	2.2%	2.0%	1.00%	1.00%	1.00%	3.11%	2.25%	3.00%
Europe	1.9%	1.6%	-0.3%	1.9%	2.9%	2.0%	0.96%	0.99%	0.57%	3.25%	2.26%	2.54%
Euro Area	1.8%	1.6%	-0.5%	1.6%	2.7%	1.9%	1.00%	1.00%	0.50%	3.19%	2.25%	2.50%
United Kingdom	1.8%	0.9%	0.4%	3.3%	4.5%	2.5%	0.50%	0.50%	0.50%	3.49%	2.35%	2.75%
Sweden	5.3%	4.5%	1.0%	1.3%	3.0%	1.9%	1.25%	2.00%	1.50%	3.28%	2.00%	2.35%
Norway	1.8%	2.5%	2.0%	2.4%	1.6%	1.5%	2.00%	2.25%	2.25%	3.68%	2.50%	3.00%
Japan	4.5%	-0.4%	2.5%	-0.7%	-0.3%	-0.1%	0.05%	0.10%	0.10%	1.13%	1.10%	1.40%
Australia	2.6%	2.1%	4.0%	2.9%	3.5%	3.1%	4.75%	4.25%	4.25%	5.51%	4.20%	5.00%
New Zealand	1.7%	2.1%	3.4%	2.3%	4.2%	2.4%	3.00%	2.50%	2.75%	5.87%	4.20%	5.10%
Asia ex Japan	9.3%	7.5%	6.7%	4.1%	5.6%	3.7%	4.98%	5.81%	5.29%	4.63%	4.32%	3.98%
China ³	10.3%	9.3%	8.3%	3.3%	5.5%	3.4%	5.81%	6.56%	6.06%	3.91%	3.50%	3.25%
Hong Kong ⁴	6.8%	5.1%	3.6%	2.4%	5.3%	4.2%	0.50%	0.50%	0.50%	2.86%	1.35%	1.60%
India ⁵	8.6%	7.5%	7.0%	9.5%	9.5%	6.5%	6.25%	8.50%	7.75%	7.91%	8.80%	8.30%
Indonesia ⁶	6.1%	6.4%	5.1%	5.1%	5.4%	3.6%	6.50%	6.00%	5.50%	7.61%	6.70%	5.75%
Korea ⁷	6.2%	3.6%	3.0%	3.0%	4.3%	3.0%	2.50%	3.25%	2.75%	4.47%	3.80%	3.25%
Thailand ⁸	7.8%	1.5%	4.0%	3.3%	3.9%	3.5%	2.00%	3.00%	2.50%	3.71%	3.40%	3.00%
Latin America	7.1%	4.0%	3.3%	5.4%	5.9%	6.5%	7.62%	8.70%	7.08%	10.50%	9.40%	8.76%
Argentina	9.2%	8.7%	2.9%	10.5%	13.0%	17.0%						
Brazil	7.5%	3.1%	3.3%	5.1%	6.0%	6.2%	10.75%	11.00%	8.50%	12.44%	11.00%	10.00%
Mexico	5.4%	3.9%	3.4%	4.2%	3.1%	3.4%	4.50%	4.50%	4.50%	6.96%	6.50%	6.50%
EEMEA	4.9%	4.4%	2.5%	6.2%	6.7%	6.2%	4.17%	4.51%	4.51%	7.62%	8.04%	8.13%
Hungary	1.3%	1.2%	-1.0%	4.9%	3.8%	4.8%	5.75%	7.00%	6.00%	7.97%	8.25%	7.00%
Poland	3.9%	4.1%	3.1%	2.7%	4.1%	2.8%	3.50%	4.50%	4.50%	6.06%	5.75%	5.00%
Russia ⁹	4.0%	3.8%	3.1%	6.8%	8.5%	7.0%	2.75%	3.50%	3.50%	7.48%	8.10%	8.50%
South Africa	2.9%	3.0%	1.5%	4.1%	5.1%	5.6%	5.50%	5.50%	5.50%	8.28%	8.00%	8.25%
Turkey ¹⁰	9.0%	7.2%	2.0%	8.6%	6.3%	7.5%	6.50%	5.75%	5.75%	8.61%	9.50%	9.75%

1) Growth and inflation forecasts are reported on a calendar-year basis.

2) Official and long rates are end-of-year forecasts. Long rates are 10-year yields unless otherwise indicated.

3) China: Official rates are 1-year benchmark lending rates and 10-year government bond yield.

4) Hong Kong: Base rate and 10-year exchange funds yield.

5) India: Overnight repo rate and 10-year government bond yield

6) Indonesia: Intervention rate and 10-year government bond yield

7) Korea: Overnight call rate and 10-year government bond yield.

8) Thailand: 1-day repo rate and 10-year bond yield

9) Russia: Longest fixed-rate government bond until April 11, 2011. 10-Year bond thereafter
Official Rates: CBR's O/N Fixed Deposit Rate

10) Turkey: Since Oct 2011, the official policy rate no longer accurately reflects the central bank's monetary policy stance.

Note: Real Growth aggregates represent 27 country forecasts, not all of which are shown.