Global Economic Outlook:

A tale of two recoveries: Strong recovery in most of EM but a shallow one in developed world

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A Tale of Two Recoveries

The aftermath of the crisis should constrain the developed world recovery, but, led by a booming China, emerging markets look set for strong growth.

Moving up a gear

European economies are shifting up a gear, although cruising at too speed still seems some way off. The strong policy response has done more than just interrupt a free-fall, and foreign demand, especially from Asia, should be an important driver of recovery. We are also less negative on credit in the euro area, while the UK economy should benefit from a weaker exchange rate. In most countries, the labour market has been relatively resilient as well. However, deleveraging remains a powerful headwind and the strong euro may prevent the euro area from benefiting fully from increased foreign demand. Moreover, monetary conditions are likely to tighten more rapidly in the euro area than in the UK. So we are not exactly cheerful yet.
Our Global View in a Nutshell

- The developed-world recovery looks set to be weak given de-leveraging forces and other legacies of the crisis.

- With good fundamentals and a lack of aftermath issues, the emerging world, particularly Asia, looks set to grow strongly.

- Developed-world inflation should stay low amid ample spare capacity, but exchange-rate-targeting central banks risk bubbles.

- The main downside risks include a re-eruption of financial distress, a commodity price bubble and premature fiscal tightening.

- A possible upside surprise: animal spirits stir and, with monetary conditions super-loose, help release pent-up demand.
The worst recession since the Great Depression

Forecast real GDP growth rates of major regions/countries, 2009 (% y-o-y)

Source: Nomura Global Economics
Emerging Asia set to lead the way in 2010 recovery

Forecast real GDP growth of major regions/countries, 2010 (% y-o-y)

Source: Nomura Global Economics
In the notes - something awry in the expected Japan growth rate: 1.40 7%
Global GDP growth forecast

2010 and 2011 projections

Source: Nomura Global Economics
Deflation averted, but little risk of high inflation

Consumer price index (% y-o-y)

Source: Nomura Global Economics.
Monetary stimulus: Policy rates near zero

Main policy interest rates (%)

Source: Nomura Global Economics.
Monetary stimulus: Quantitative easing

Central bank balance sheets (Index, January 2007 = 100)

Note: Bank of England data available through mid-August; Source: Central Bank websites and Nomura Global Economics.
Fiscal stimulus: Unprecedented deficits

Central government budget balance (% GDP)

Source: Nomura Global Economics.
United States: Deleveraging under way

Change in consumer credit outstanding, by type ($bn)

Source: Federal Reserve, Haver Analytics.
De-leveraging consumer likely to crimp US recovery

US household consumption and debt as percentage of GDP

Source: Nomura Global Economics.
Japan back in deflation and heading for double dip

Real GDP growth and core inflation

% q-o-q ar

% y-o-y

Source: Nomura Global Economics.
source for actuals?
saintcym, 05/01/2010
Booming investment-driven Chinese economy

Fixed asset investment growth and investment share of GDP

% y-o-y

Source: Nomura Global Economics
China: Credit-fuelled Investment Boom

Bank lending (% y-o-y)

Note: CEIC, Nomura Global Economics.
Europe: Our view in a nutshell

- The euro-area economy exited recession in Q3 2009, the UK probably did so in Q4.
- We expect sub-par growth given household de-leveraging in the UK and feeble domestic momentum in the euro area.
- The fiscal policy challenge: deliver short-term stimulus within a credible framework of medium-term consolidation.
- Headline inflation looks set to rise in the UK and euro area, but underlying inflation is likely to stay very weak.
- We expect the ECB to start gradually removing exceptional liquidity measures but not to start hiking rates until October 2010.
- The BoE MPC faces uncertainties on both sides and we do not expect rate hikes until November 2010.
Euro area: Shape of our forecast

Source: Nomura Global Economics.
United Kingdom: Shape of our forecast

GDP growth (% y-o-y)
CPI (% y-o-y)
Fiscal balance (% GDP)
Current account (% GDP)

Source: Nomura Global Economics.
Europe: Key themes

- Credit crunch and deleveraging?
- Unemployment performance
- Net trade and exchange rates
- Monetary policy and exit strategies
- Euro area periphery issues
Europe: Still playing catch-up
Real private consumption (Index, Q1 2005 = 100)

Source: Nomura Global Economics.
Europe: Key role of banks in credit provision

Source of credit in Europe vs US

Europe: Balance sheet burden
Total government aid to banking sector since 1997

By country (€bn)

- Spain
- Sweden
- Austria
- Netherlands
- Belgium
- France
- Ireland
- Germany
- Denmark
- UK

By type (%)

- Impaired assets
- Capital injection
- Liquidity & funding
- Liability guarantee

Source: Bloomberg and Nomura Global Economics.
Europe: Access to credit may not be too bad

Credit obtained against credit needed

% of firms that applied for a loan and got all the financing requested

Circles= SMEs and Diamonds-large firms, 2009H1

Source: ECB and Nomura Global Economics.
UK credit flow to households has collapsed

UK consumer credit and Home equity withdrawal

as % of disposable income

Source: ONS and BoE
Employment resilience

The rise in unemployment has been surprisingly moderate in Europe, except for Spain.
Pro-active government policies dampened rise in unemployment

Note: The fitted line is a standard Okun's law linking unemployment to the GDP growth rate
Source: Eurostat, German Labour agency, Nomura Global Economics
Labour adjustment: Hours, not headcount

Source: Eurostat, Nomura Global Economics
World trade rebound

Euro-area foreign demand, surprise since July 2009

Source: Nomura Global Economics
Euro strength

Trade-weighted euro

FX contribution to GDP and inflation revisions

Source: ECB and Nomura Global Economics
Net trade major contribution to UK growth

Net trade share of GDP vs effective exchange rate

Source: ONS, OECD, Nomura Global Economics
Why QE is necessary

- Bank rate
- Nomura forecast
- Fitted

% vs. intended QE effect

Bank of England balance sheet has expanded

Bank of England consolidated balance sheet: liabilities

- Other liabilities
- Short-term open market operations
- Reserve Balances
- Foreign currency public securities issued
- Cash ratio deposits
- Notes in circulation

Bank of England consolidated balance sheet: assets

- Other assets
- Longer-term sterling reverse repo
- Short-term open market operations
- Ways and Means advances to HM Government
- Bonds and other securities acquired via market transactions

(a) Excludes loans and associated deposits in course of settlement.

Source: Bank of England
charts need source
saintcym, 05/01/2010
Gilt yields have been driven down

Sources: Bank of England and Nomura Global Economics

Lines show 5-year government bond yields less OIS rates.
Bank Rate: Nomura forecast v BoE conditioning assumption


The BoE November curve is estimated using overnight index swap (OIS) rates in the fifteen working days to 4 November 2009.
GDP growth forecast: Nomura v BoE

Source: ONS, BoE and Nomura Global Economics.
BoE’s GDP level forecast

(based on market interest rate expectations and £200 billion asset purchases)

Source: Bank of England
Do recessions destroy productive potential?

Per capita GDP following banking crises (logarithmic level)

<table>
<thead>
<tr>
<th>1987</th>
<th>1989</th>
<th>1991</th>
<th>1993</th>
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<th>2001</th>
<th>2003</th>
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<td>Korea 1997</td>
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<td>Thailand 1997</td>
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<td>Japan 1997</td>
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<td>Sweden 1991</td>
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Source: IMF World Economic Outlook, Nomura Global Economics.
Alternative UK output gaps depending on what happens to potential output

Source: Nomura Global Economics
CPI inflation forecast: Nomura v BoE

Actual
BoE Nov 09 Inflation Report
Nomura forecast

% y-o-y

2007 2008 2009 2010 2011 2012
Inflation outlook

Euro-area HICP inflation

Source: Eurostat, Nomura Global Economics
Monetary conditions

Nomura index of monetary conditions in the euro area

Source: Nomura Global Economics
ECB outlook

We expect normalisation of ECB operations in Q3 2010, first rate hike in October 2010

Source: Bloomberg, Nomura Global Economics
Fiscal outlook

Consolidation will likely be slow

<table>
<thead>
<tr>
<th>% GDP</th>
<th>Budget balance</th>
<th>Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Euro area</td>
<td>-6.4</td>
<td>-6.9</td>
</tr>
<tr>
<td>Germany</td>
<td>-3.3</td>
<td>-5.3</td>
</tr>
<tr>
<td>UK</td>
<td>-12.6</td>
<td>-12.7</td>
</tr>
<tr>
<td>France</td>
<td>-8.4</td>
<td>-9.0</td>
</tr>
<tr>
<td>Italy</td>
<td>-5.3</td>
<td>-5.1</td>
</tr>
<tr>
<td>Spain</td>
<td>-11.7</td>
<td>-9.7</td>
</tr>
<tr>
<td>Netherlands</td>
<td>-4.9</td>
<td>-5.6</td>
</tr>
</tbody>
</table>

Source: Eurostat and Nomura Global Economics
Euro-area periphery: Public-sector debt forecasts

Note: 2009-2011 data are European Commission forecasts
Source: European Commission, Nomura Global Economics
Euro area: Public-sector interest payments

Greece and Italy

Note: 2009-2011 data are European Commission forecasts
Source: European Commission, Nomura Global Economics
## None defaulted

Historical highs in interest payments as percentage of GDP
(Our 2011 forecast for Greece: 5%)

<table>
<thead>
<tr>
<th>Country</th>
<th>% GDP</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>10.1</td>
<td>1994</td>
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<tr>
<td>Italy</td>
<td>10.7</td>
<td>1993</td>
</tr>
<tr>
<td>Denmark</td>
<td>6.8</td>
<td>1985</td>
</tr>
<tr>
<td>Portugal</td>
<td>6.1</td>
<td>1986</td>
</tr>
<tr>
<td>Sweden</td>
<td>4.7</td>
<td>1994</td>
</tr>
<tr>
<td>US</td>
<td>4.6</td>
<td>1991</td>
</tr>
<tr>
<td>UK</td>
<td>4.2</td>
<td>1982</td>
</tr>
</tbody>
</table>

Source: European Commission, Nomura Global Economics
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