Schroders

Economic and Strategy Viewpoint

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Global Forecast update: Groundhog day (Page 2)

- **Global growth is likely to continue to struggle in 2013 given the headwind from fiscal policy in the advanced economies. We expect the US to avoid the fiscal cliff, but still tighten by 1.5% of GDP whilst Europe continues to pursue austerity.**
- **As a consequence, monetary policy is set to remain loose with the US Federal Reserve, Bank of Japan and Bank of England all printing money to varying degrees. The main change to the forecast is that we now expect Greece to remain within the Euro having previously forecast a Grexit in 2013. It is a close call, but greater political commitment suggests that the Euro will hold together.**

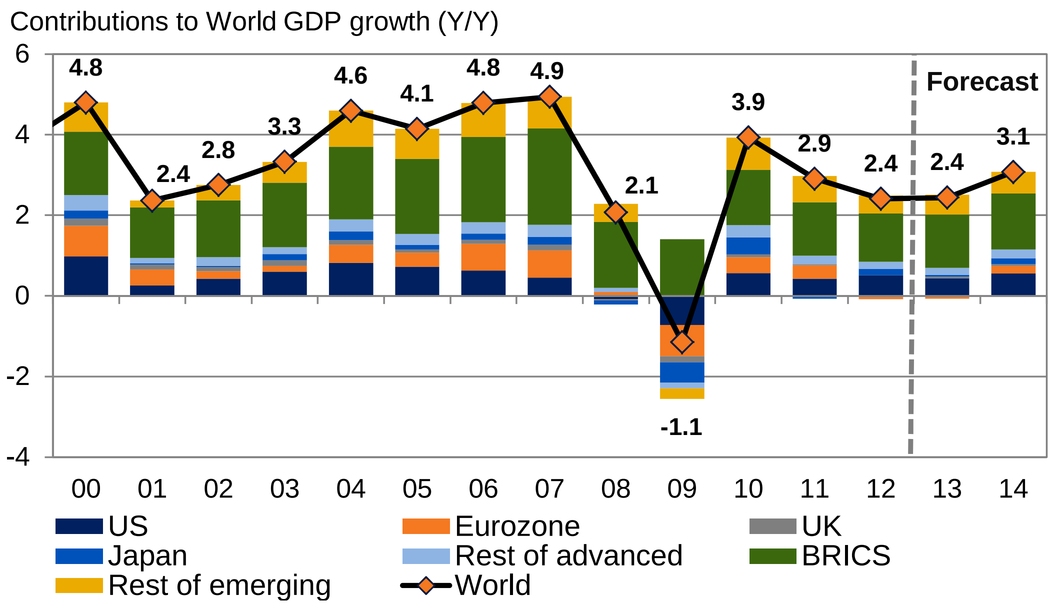
Eurozone double-dips, but 'Grexit' risk eases (Page 6)

- **The recession in the Eurozone overall has finally been confirmed as Germany and France failed to keep the monetary union in aggregate from double dipping.**
- **Looking ahead, although there are few signs of improvement on the cyclical front, the tail-risks are now less skewed to the downside. We have removed the 'Grexit' from our baseline scenario after signs that Europe is preparing yet another deal for Greece. This helps lift our forecast for 2013 growth, and in the absence of a country leaving, we see growth gaining momentum into 2014.**

BRICs building towards recovery? (Page 9)

- **We believe the recent rebound in activity in the emerging world, particularly China, has enough momentum to generate a bright start to 2013; but we remain cautious that much of this is down to the global inventory cycle, and that final demand remains weak. We believe 2013 will be a stronger year than 2012 in the emerging world, but growth is likely to remain below potential.**

Chart: Global growth forecast breakdown



Source: Schroders. 23 November 2012.

Forecast update: Groundhog day

This month we have updated our forecasts for the world economy and take an initial look at 2014. First we look back on 2012 and compare performance with the consensus forecasts of last year.

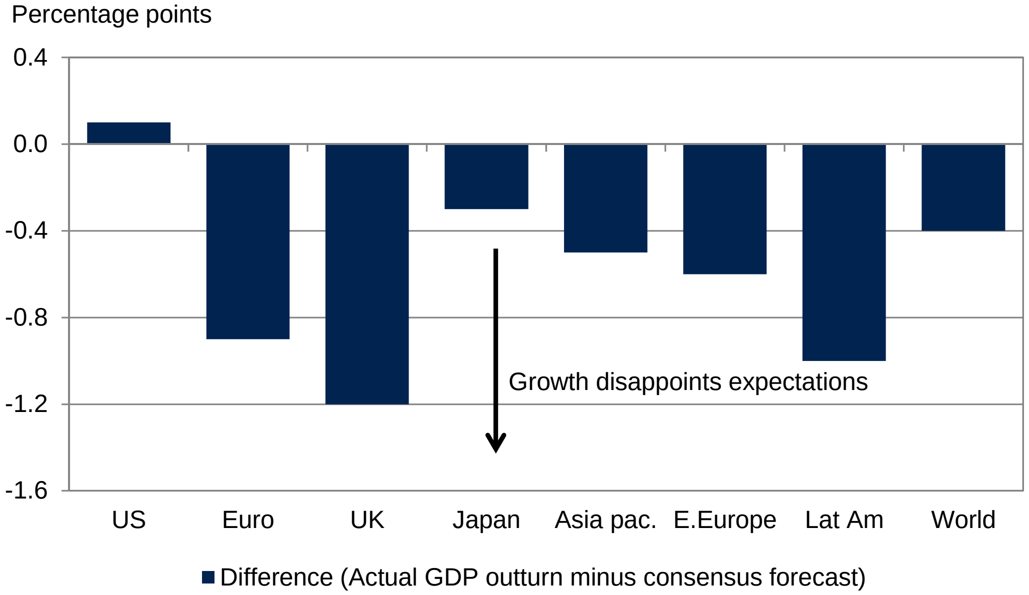
Looking back at 2012

Global growth disappointed in 2012

The world economy is likely to have achieved growth of 2.4% in 2012, about 0.5% below the consensus expectations of a year ago and worse than the 3% achieved in 2011. The swing factor has been the Eurozone which has managed to disappoint even modest forecasts by going back into recession. Inflation also proved higher than expected in the single currency area as taxes rose. Euro woes weighed on activity elsewhere through weaker trade growth, hitting not just neighbouring economies like the UK, but also those further afield. The emerging markets undershot expectations as they proved less resilient to the downturn in the West than might have been expected. De-coupling proved elusive in 2012.

The one country which did perform in line with expectations in 2012 was the US, which looks like achieving 2.2% growth, close to the forecast of a year ago. Such an outcome can only be described as subdued by the standards of an economy which is used to growing at nearer to 3%. However, the fact that the US did not disappoint on the growth front helped the S&P500 outperform global equity markets for much of 2012. By contrast, as growth expectations fell in Europe, the DJ Eurostoxx underperformed and only recovered after the ECB increased its commitment to holding the Euro together.

Chart 1. Underwhelming: 2012 growth vs. expectations



Source: Consensus Economics, November 2012 vs November 2011.

Looking forward to 2013

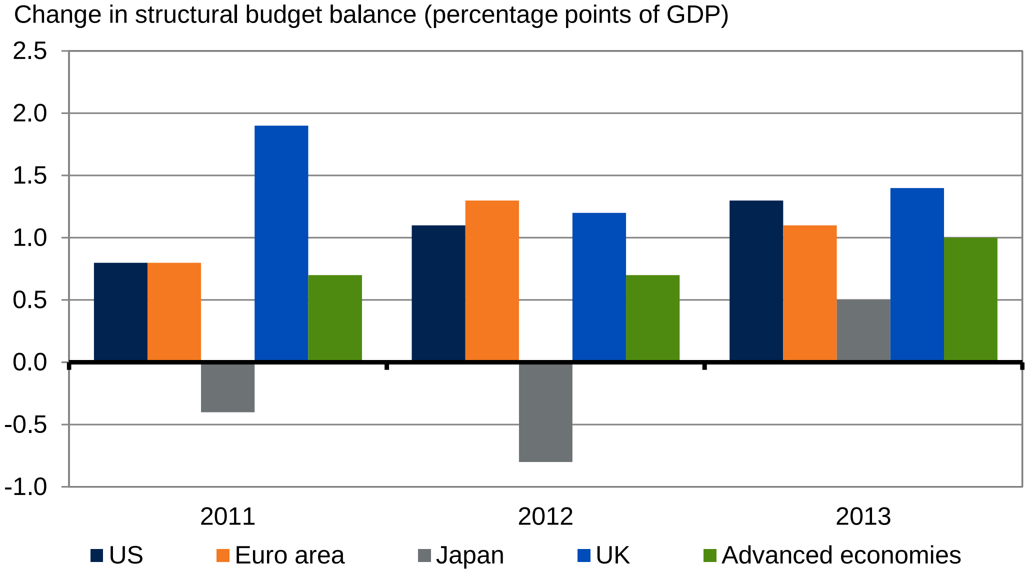
Fiscal policy will continue to weigh on growth next year

Looking into 2013, it is difficult to see a major improvement in global activity. As discussed in last month's *Viewpoint*, one of the factors which has weighed on growth has been fiscal policy which has had more impact than might have been expected over the past couple of years as fiscal multipliers have proven to be greater than in the past. In the absence of an offsetting monetary response and with several countries tightening policy simultaneously, higher taxes and cuts to public spending have hit growth more significantly than in more normal times, such as when the banking system is functioning and global trade is expanding rapidly.

Based on current plans, fiscal policy looks set to tighten further in 2013 with figures from the IMF suggesting a tightening of 1% of GDP for the advanced economies (see chart 2). Our assessment differs by country with slightly more tightening in the US (1.5%

GDP) and less in the UK (1% GDP), but on balance the overall picture is the same. Japan is set to swing from fiscal stimulus to contraction as the authorities address the deficit. Critically, we are assuming that the US avoids the "fiscal cliff" through a temporary agreement, setting the scene for more tortured negotiations over a "Grand bargain" later in the year. Note that whilst all the focus is on 2013, US fiscal policy has been slowly tightening for the past two years as state and local governments cut spending.

Chart 2: Fiscal policy to tighten further in 2013



Source: IMF Fiscal Monitor, November 2012.

Monetary policy is expected to continue to have some positive, albeit limited effect in 2013, through Quantitative Easing with the Federal Reserve, Bank of England and Bank of Japan all printing money. Strictly speaking the ECB will not be joining them, but we do expect a programme of bond purchases to start following a request from Spain for assistance in early 2013. The difference, however, is that these purchases will be sterilised through sales of Treasury bills by the ECB so as to offset the impact on the money supply.

Greece to remain within the Euro

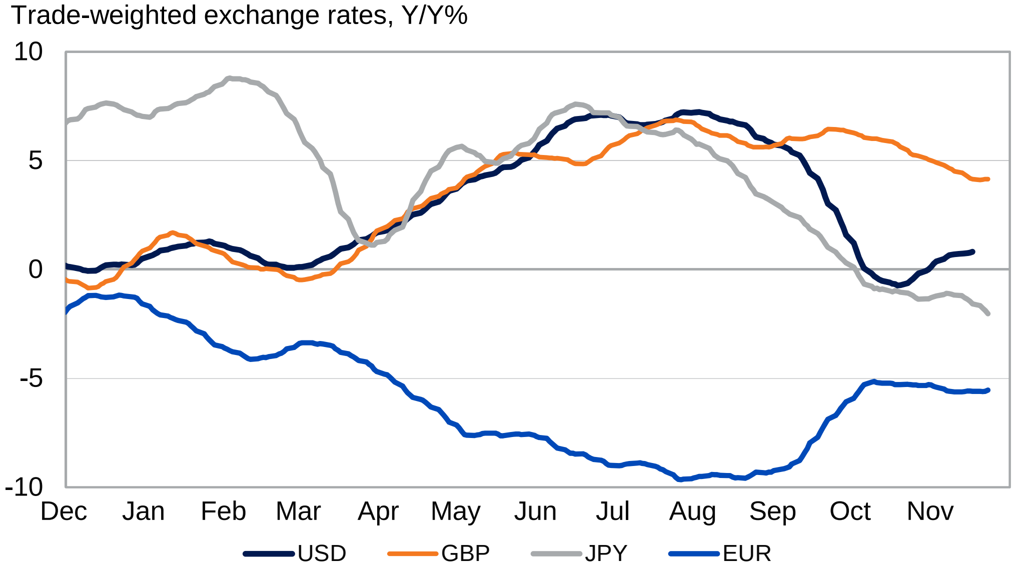
Increased support from the ECB and politicians has been an important factor in improving our optimism on the Eurozone and consequently we are now assuming that Greece stays within the Euro. This is a close call as the current negotiations within the Troika indicate that Greece has some way to go to fiscal redemption.

Nonetheless, if Angela Merkel and Mario Draghi are serious about saving the Euro then that means Greece stays in. We do believe, however, that a sustainable package will involve the official sector taking a haircut on its holdings of Greek debt and loans (OSI). Some way will be found around German objections although this will need to be done sooner rather than later if OSI is not to become an election issue in 2013. More likely it will be after the election.

From a forecast perspective, removing "Grexit" has led us to upgrade our growth forecast for the Eurozone as the region will no longer be hit by the fallout from losing a member. We would still ascribe a relatively high probability to Grexit, but not enough to make it the central case (see Europe section for more details).

Coming back to monetary policy, we also need to consider the impact of exchange rate changes. After interest rate changes and QE the only other source of monetary stimulus available to the authorities is the exchange rate. In many ways this becomes a race to the bottom as central banks compete with each other to print money. Somewhat surprising then that the currency which has fallen the most in trade-weighted terms over the past year has been the one where the central bank has not been printing – the Euro (chart 3). Concerns over a possible break-up of the currency have taken a toll.

Chart 3: EUR weaker, GBP stronger, JPY softening



Source: Thomson Datastream, Schroders, 23rd November 2012

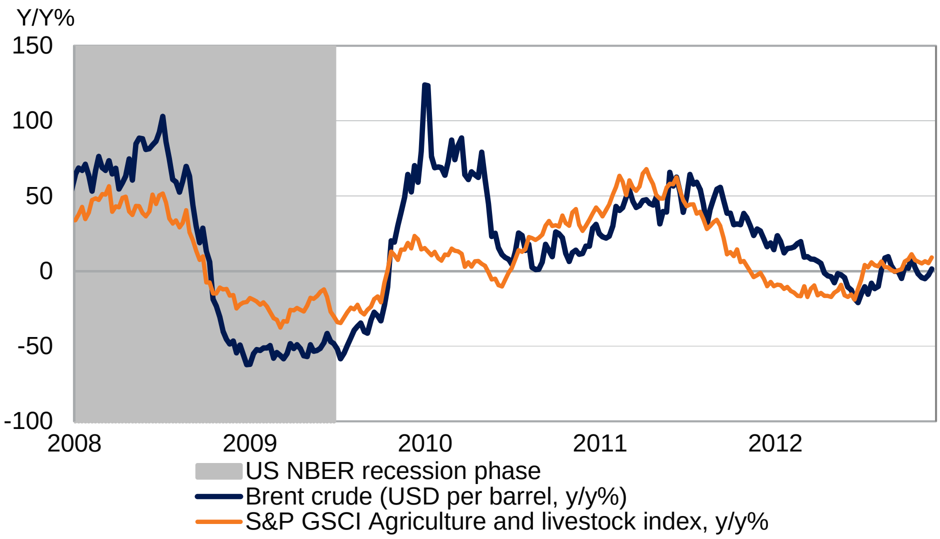
Japan has run into a brick wall

Using official indices, the trade weighted Euro is down some 5% over the past year, a move which will provide some support to the region's embattled exporters. By contrast the GBP is up about 5%, an outcome which will not help efforts to rebalance the UK economy (chart). The USD is now roughly flat whilst the JPY is now weaker in trade weighted terms following the recent move in Japan where the government is taking more control of the Bank of Japan (BoJ).

The Japanese economy appears to have hit a brick wall recently with big falls in industrial production and retail sales in September. The latter can be explained by the ending of the car incentive scheme whilst industrial production is more to do with the trade slowdown and dispute with China. The BoJ announced another JPY 11trillion of asset purchases (QE), a new scheme to boost bank lending and made a joint statement with the Ministry of Finance on how they would step up the fight against deflation.

Finally, in assessing the global outlook we need to take account of commodity prices. Following the slowdown in global growth post the global financial crisis, commodity prices have played a greater role in driving activity by acting as a tax (or subsidy) on consumer incomes and spending. Going into 2013, commodity prices look like being a neutral factor for the first time in four years with oil and food prices roughly stable over the past year (chart 4).

Chart 4: Commodity prices have stabilised



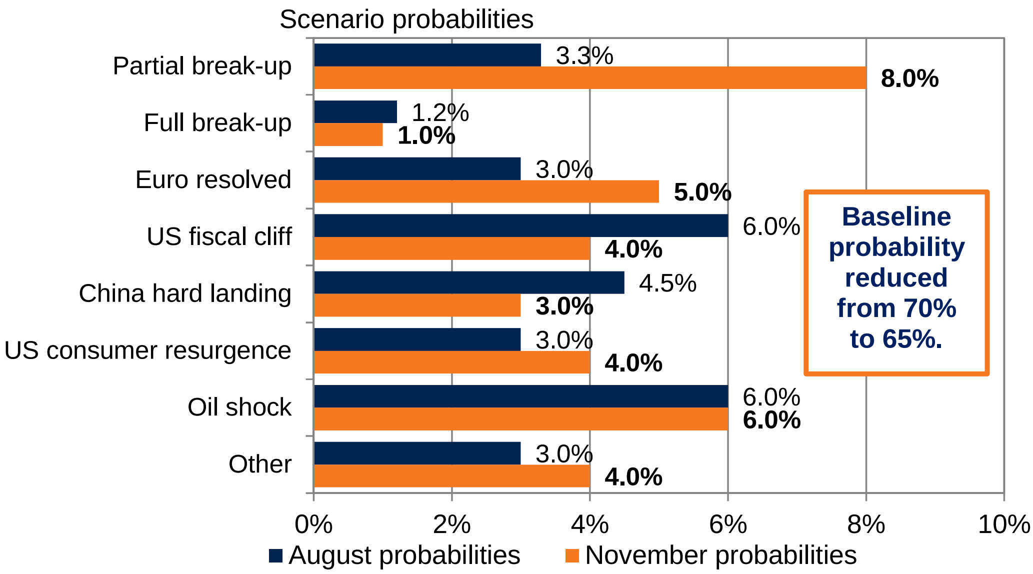
Source: Thomson Datastream, Schroders, US National Bureau of Economic Research (NBER), 23rd November 2012.

Risks

The balance of risks remains skewed in a deflationary direction, but less so than last quarter

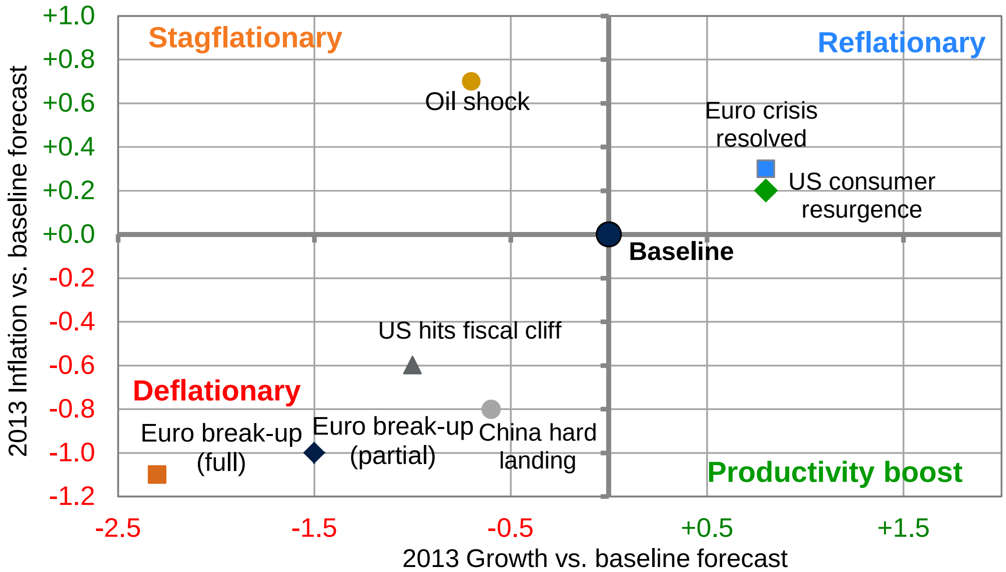
The balance of risks has been affected by dropping Grexit from our baseline forecast. Consequently, the probability on the baseline has been reduced from 70% to 65% and the risk of partial breakup (which now includes Grexit) increased to 8% (previously 3.3%). Other noteworthy changes in probability are: an increase in the likelihood of the Euro crisis being resolved to 5% (previously 3%), a reduction in the probability of the US fiscal cliff (from 6% to 4%) following recent signs that talks between Democrats and Republicans have been constructive and a lower probability of a hard landing in China given recent signs of a turnaround (see below). The net result of these changes is to marginally increase the probability of a reflationary outcome for the world economy in 2013. See chart 5 for full details on the changes in probabilities attached to different scenarios whilst chart 6 classifies the different risks in terms of their impact on global growth and inflation.

Chart 5: Scenario probabilities



Source: Schroders Economics Group, November 2012

Chart 6: Global growth and inflation risks vs. baseline



Source: Schroders, 23rd November 2012

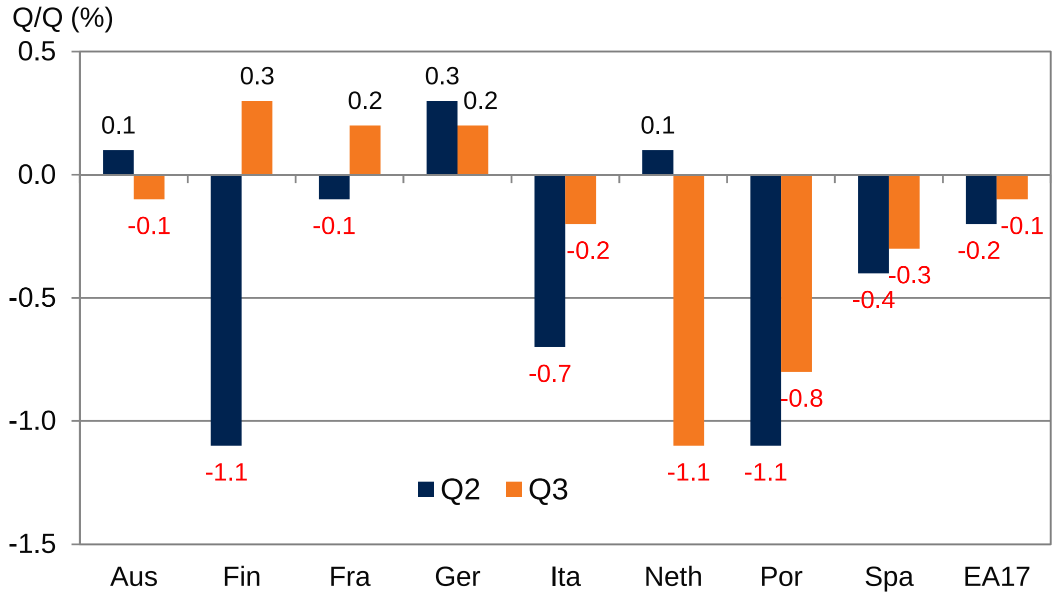
Eurozone double-dips, but 'Grexit' risk eases

The Eurozone is back in recession…….

The Eurozone is officially back in recession. Despite most of the south struggling with austerity for most of 2011 and 2012, the aggregate of the monetary union has only recently double-dipped. Germany and France, which have not re-entered recessions, failed to keep the rest of the Eurozone afloat in the second and third quarters. Surprisingly, some of the worst results were not in the periphery, but in the core, with Austria recording a slight dip in activity, while the Netherlands contracted by a huge 1.1% (see chart 7). In fact, though the headline numbers are poor overall, the good news is that the latest set of GDP figures are better than expected. For example, the Bloomberg consensus for Italian GDP was -0.5%, against a turnout of -0.2. Similarly, the Spanish, German and French numbers all beat expectations.

….though the numbers were better than expected

Chart 7: Quarterly real GDP growth



Source: Thomson Datastream, Eurostat, Schroders. 23 November 2012.

The better than expected numbers are likely to have been a result of the stronger industrial production numbers we highlighted in last month's *Economic and Strategy Viewpoint.* However, we also mentioned that more leading indicators were pointing to further weakness ahead. Indeed, at the time of writing, our favourite two indicators-the Markit PMI composite and the Belgian National Bank survey-both ticked up, but remain indicative of a further contraction in the fourth quarter.

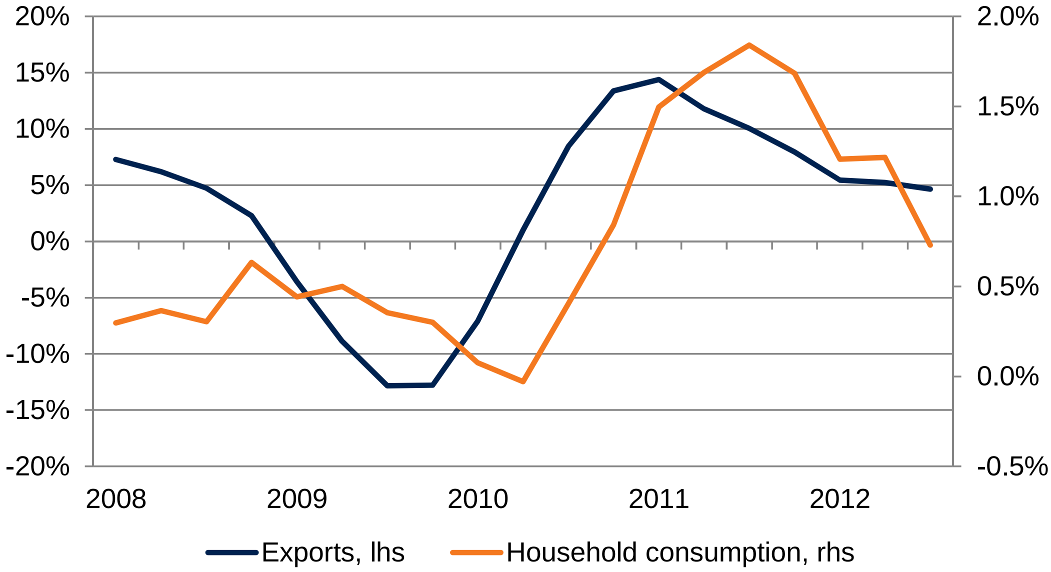
The picture in Germany is similar to that of the rest of Europe. The IFO survey for November showed a small improvement across the board, but not enough to give sufficient confidence in a substantial turn around.

The breakdown of the German GDP data provides some clue of the malfunction in what was one of the strongest economies in the G7. Germany is going through a normal cyclical downturn as corporates reduce output in order to clear a build-up of inventories. We estimate destocking to have reduced Q3 GDP growth (+0.2%) by 0.3 percentage points. The normal reaction of policy makers in such a situation would be to provide either fiscal or monetary stimulus, however, Germany is clearly different. Not only does it reside in a monetary union where it has no control over its own interest rates, but fiscal policy is also constrained by the need to lead the rest of Europe by example - to show the apparent benefits of fiscal discipline.

Though Germany would benefit from stimulus it really needs stronger demand for exports

While monetary and fiscal policy expansion would benefit Germany, the real cause of the downturn began with the external environment. Like most open export-orientated economies, external demand is the key driver of activity in Germany. Indeed, German export growth tends to lead German household consumption, due to the direct impact on domestic finances (see chart 8).

Chart 8: German exports leading consumption (4Q, Y/Y)



Source: Thomson Datastream, Schroders. 23 November 2012.

Germany could do with some rebalancing towards domestic demand. This would certainly make the economy less susceptible to international demand shocks. Such rebalancing may be slowly underway, but in the near-term, Germany is unlikely to see strong growth return unless there is a pick up in its export markets, namely, the US, China, and the rest of the Eurozone.

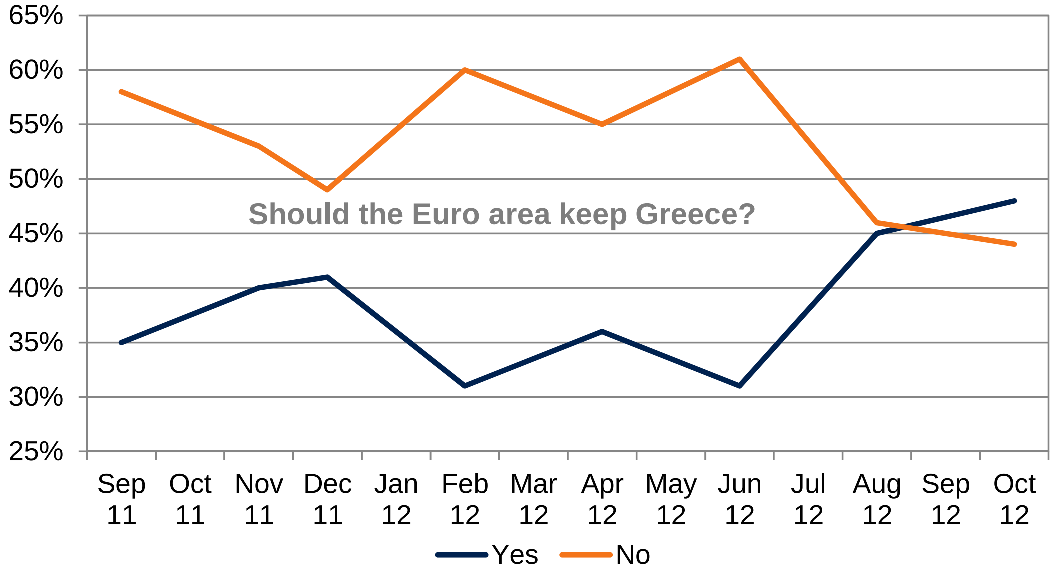
'Grelief' as 'grexit' less likely

Despite Greece still waiting for its overdue €31.5 billion bail-out tranche from September, developments in recent weeks have been more positive for Greece's long term prospects in the Eurozone. The first development was the positive

Merkel's visit to Athens helped boost sentiment towards Greece…..

reaction in Germany following Chancellor Angela Merkel's visit to Athens last month. Although the mood in Athens was nothing short of hostile, Merkel's words of support have shifted opinions back home. A poll conducted by ZDF politbarometer in Germany has for the first time shown more Germans in favour of Greece remaining in the Euro than against (see chart 9). In addition, Merkel's own polling as leader has been boosted after the visit.

Chart 9: German sentiment turns in favour of keeping Greece



Source: ZDF Politbarometer, Schroders. 8 November 2012.

It seems that Merkel has finally caught up with the wider sentiment in Germany. Over the past year, regional elections have been swinging to the left, to parties that are more supportive of European solidarity, including towards Greece. It seems that Merkel is now ready to lean to the left, in order to capture the centre ground ahead of the election in September 2013. This makes a Grexit very difficult for Merkel next year - which was our previous assumption.

In addition to the change in German sentiment, it appears that Greek Prime Minister Antonis Samaras has successfully persuaded the Troika that Greece's current bail-out plan is unlikely to succeed. We highlighted the unrealistic Greek plan after the restructuring of privately held Greek debt. As most of the debt was held by official institutions, the 75% net present value haircut barely put a dent in Greece's government debt mountain.

Greece has agreed to the €13.5 billion of cuts that the Troika had requested, however, in order to make the adjustment process more realistic, European partners are considering a two year extension for Greece's deadline to lower debt-to-GDP back to 120% of GDP.

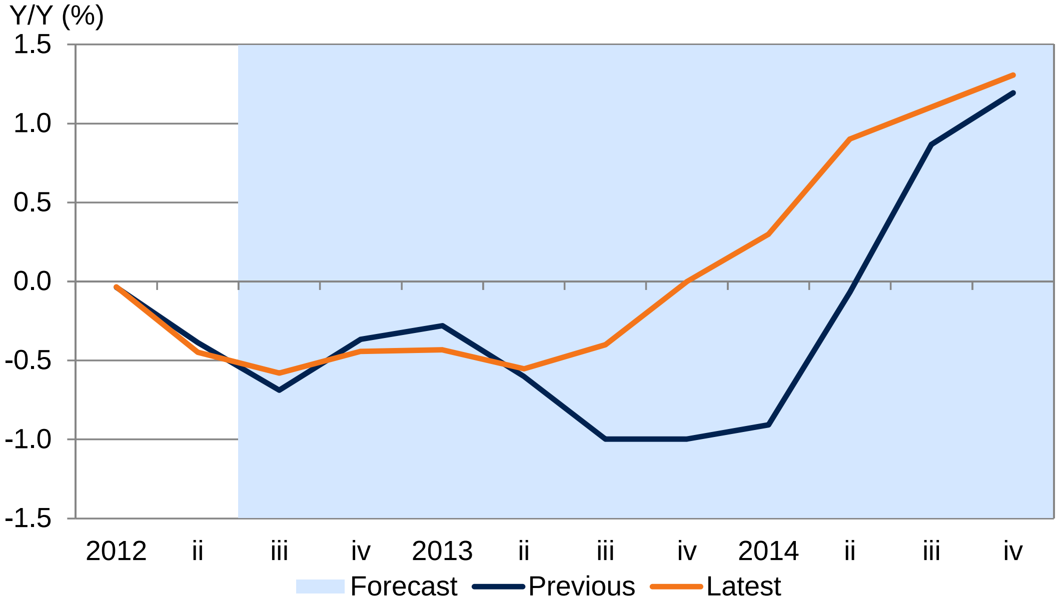
…and with a bail-out deal in the pipeline, a Grexit is now less likely

The current stumbling block is the IMF, which openly disagreed with the European Commission and ECB on what should happen next. The IMF believe that the only solution going forward is for official loans to be restructured (excluding the IMF). For the moment, European leaders are against the idea as it would amount to a fiscal transfer, along with a default on European taxpayers, during a delicate time when Europe is offering loans to other countries. However, some politicians are more open to the idea, suggesting that interest payment re-profiling, and the recycling of profits, could be used to help reduce Greek debt.

We expect a deal to be struck amongst the Troika over the next few months. In the meantime, Greece will probably be given some of its overdue tranche from the European Union. The risk is that the IMF continues to disagree, and pulls out from the Greek bail-out all together. However, given the large European contingent on the IMF's executive board, a deal is more likely to be found than not.

Given the change in German public sentiment, along with the willingness of European partners to renegotiate the Greek bailout, we feel that the probability of a Grexit has now fallen to below 50%. As a result, we have removed the Grexit from the baseline scenario, which lifts our Eurozone growth forecast, and removes the wider negative impact on the rest of the regions for the global forecast (see chart 10).

Charts 10: Removing the Grexit - Eurozone GDP forecast



Source: Schroders. 23 November 2012.

It is worth noting that because of the poor signal from leading indicators mentioned earlier, we have downgraded the near-term forecast for the Eurozone. We expect the turn-around in activity to be delayed until the 2nd quarter of 2013, as general external weakness from the US weighs on exporters.

However, because of the upgrade to the forecast for Eurozone growth in 2013 overall, we have removed the 25 basis point interest rate cut from the forecast, which was previously assumed to follow the Grexit. We now forecast ECB rates to remain on hold until 2015.

BRICs building towards recovery?

While we expect to see stronger activity next year than this across all four BRIC economies, particularly Brazil, we remain below-consensus given the moribund growth seen in the developing world and the continued weakness of final demand. By 2014 we expect all four to be growing at close to their trend rate.

The boost to growth from removing the Grexit is mitigated by the abandonment of the expected policy response

Our forecasts for 2013 have been adjusted for the removal of the "Grexit" as our baseline scenario; which *ceteris paribus* is positive for growth. Our modelling, however, suggests that the growth benefit of this will be smaller in the emerging markets than in the Eurozone itself. This is simply a reflection of the greater ammunition, especially on the monetary front, available to policymakers in the emerging world; which we had expected would be quickly deployed to mitigate the fallout from the Grexit and deepening Eurozone recession. Thus, the boost to emerging growth as a result of the removal of this event is somewhat reduced as the policy response is not enacted. Moreover, the cyclical outlook in the Eurozone remains very weak for 2013, despite Greece retaining its membership, and this will continue to stymie activity in emerging markets.

We expect the positive momentum in China to continue into 2013, but retain concerns over final demand

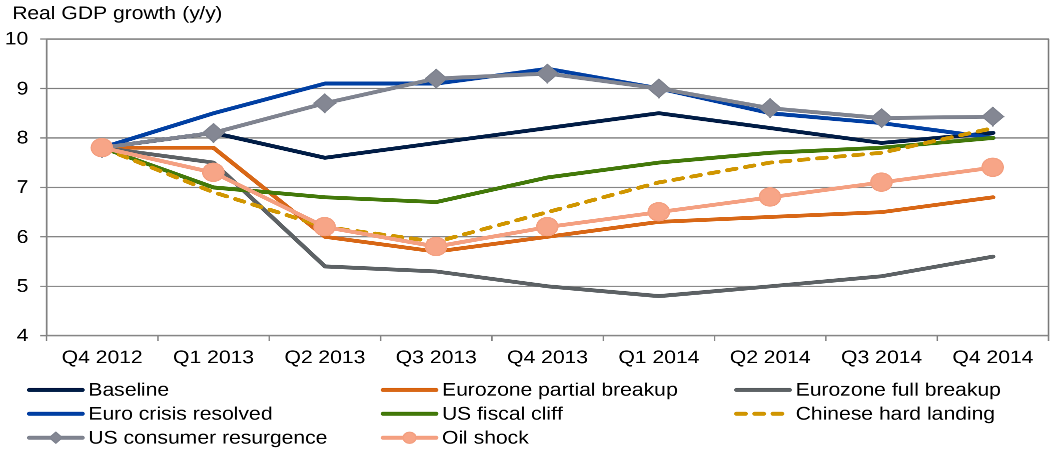
We have written previously about the turnaround in activity in **China** and we believe this momentum has a little further in it, leading to around 7.8% growth in the fourth quarter (implying full-year growth of around 7.7% in 2012). We remain concerned, however, that a significant part of this rebound is driven by a favourable stage of the global inventory cycle; and that final demand remains weak. Given this, we expect growth momentum to plateau in the first quarter of next year (exactly when is complicated by the heavy seasonal distortion of the Chinese New Year, occurring on 10th February). We envisage signs of a slowdown to be met by further monetary easing, with a 25bp lending rate cut and a 100bp cut to the required reserve ratio (RRR), which would spur a mild pickup in activity into the second half of the year. The People's Bank of China (PBoC) will be assisted in their decision making by an inflation outlook that continues to be benign.

Additionally, it seems that the official growth target of the Chinese government has become a more reliable indicator of policy measures. In previous years, it was not unusual for the target to be exceeded by several percentage points, but it seems the new target of 7.5% per annum reflects a more realistic assessment of the Chinese economy, and this has implications for the likelihood of stimulus measures being enacted to maintain the target growth rate. Though it seems highly likely that growth will continue to be above its target level, it seems less likely that policy will be loosened to generate significant overshoots. Much will be made of the impact of the recent leadership transition, but we feel any reforms will be focused on the long run, with little material impact over the next 12-18 months.

This, and the relatively circumspect response to the slowdown earlier this year, suggests that fractionally reducing our forecast for next year is merited. Overall, therefore, our 2013 growth figure has been softened to a below-consensus 8%. Though it is difficult to get too much clarity of vision looking into 2014, we see a slight improvement from 2013 to around 8.2%, which we estimate is close to the current trend rate of growth.

The risks to this forecast seem skewed to the downside, with the potential for both internal and external shocks to destabilise the Chinese economy. Of our seven alternative scenarios mentioned in the previous section only two, 'US consumer resurgence' and 'Euro crisis resolved', generate growth in excess of our baseline scenario in the following two years (chart 11). The sensitivity of Chinese growth numbers to external events highlights how far the de-coupling process has to go, even for an economy with the domestic demand potential of China.

Chart 11: Chinese economy still sensitive to external outcomes



Source: Schroders, November 2012

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Chinese authorities retain significant firepower at their disposal to deal with a slowing economy should they see fit. Though the size of the 2009 stimulus was anomalous, there seems little doubt that this firepower would likely be deployed in the form of investment and infrastructure spending in the event of an adverse scenario. Thus, while the world may initially receive a disinflationary shock from the cooling Chinese economy, it is unlikely this would be a lasting consequence.

Huge monetary easing has helped drive recovery in Brazil, which should continue into next year

In **Brazil**, we have seen a recovery in the macro data in the second half of the year, thanks largely to some extremely accommodative behaviour from the central bank (BCB) after very weak activity at the tail end of 2011 and in the first half of this year. We expect growth of at least 1% q/q in both the third and fourth quarters, with this momentum continuing into early next year. Though we should see growth nudge down a tick as 2013 wears on, it should remain robust throughout the year. Our forecast of 3.6% for next year is a sizable uplift from an estimated 1.5% this year. Looking ahead to 2014, we expect continued improvement to a shade over 4%. The FIFA World Cup, held across Brazil in June-July 2014, should also boost activity[1].

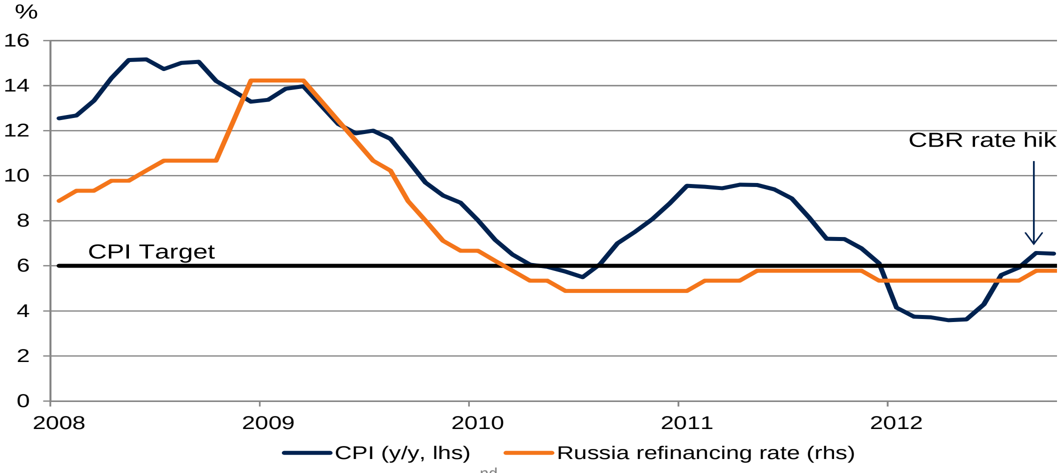
With so much easing having taken place, we expect the BCB to maintain the current policy rate at 7.25% for some time, unless outside shocks create significant deterioration in the macro outlook. It is likely, however, that the strengthening of activity and the depreciation of the Real earlier this year will put upward pressure on inflation throughout 2013. If this is realised, we believe the BCB will use the exchange rate as the anti-inflation policy instrument of choice, reducing intervention to allow the Real to break from its tightly managed 2.00-2.10 BRL/USD range, as opposed to interest rate hikes.

Moving eastwards, we have seen the **Russian** economy slow somewhat in the second half of the year, after a strong end to 2011 and start of 2012, thanks in large part to elevated oil prices in 2011 and some pre-election fiscal stimulus. Recent signs suggest that this slowing may have stabilised, and we expect 2012 GDP to come in at a reasonable 3.5%. We expect the Eurozone macro outlook, on which Russian exporters are so dependent, and the lack of an oil price tailwind to weigh on growth going into 2013, where we expect a further softening of the data after a bright start to the New Year.

The Russian central bank appear willing to sacrifice activity for inflation targeting credibility

Activity is unlikely to be helped by the Russian Central Bank (CBR), arguably the most hawkish in the world at this time, having raised rates in September just prior to inflation breaching its official target (chart 12), citing the importance of retaining credibility as an anti-inflation institution.

Chart 12: Low inflation tolerance from the CBR



Source: Thomson Datastream, Schroders. 22nd November 2012.

[1] Isolating and quantifying this boost is not easy, but the last three World Cup hosts (Japan/Korea, Germany and South Africa) all saw a material pickup in growth in the first two quarters of the year they hosted it.

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Though softer recent data on this front has reduced the likelihood of further rate rises (our baseline forecast is for no further hikes), it is clear that they view inflation risks as skewed to the upside. With this attitude, significant softening of both realised and expected inflation will be required before more accommodative policy is enacted, and the effects of the earlier rise will continue to weigh on activity.

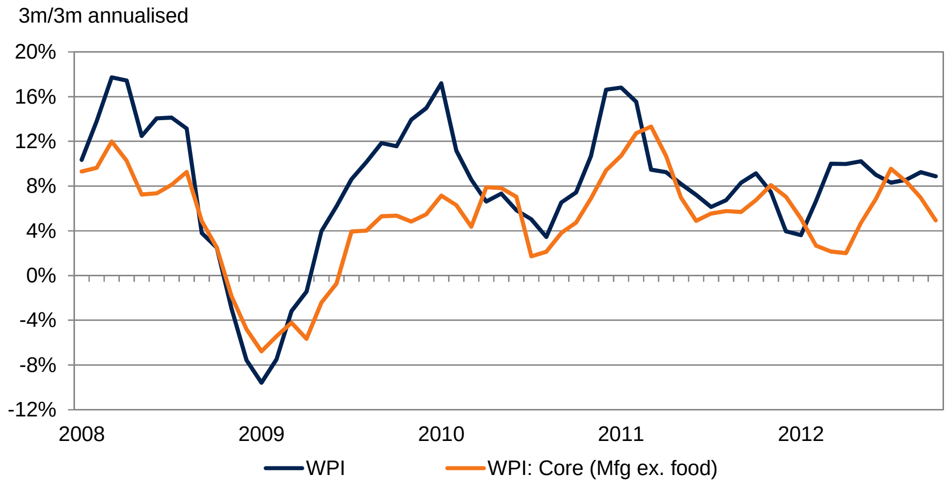
Finally, we believe that activity in **India** will continue to be muted and disappointing. Getting a strong grasp on the Indian economy can be challenging, as data is often poor and subject to very large revisions. It is clear, however, that the global slowdown has affected India, with growth so far this year slowing below 6% for the first time since 2008-9. We expect this disappointment to continue for the remainder of 2012, with survey data such as the PMI suggesting that activity remains weak, generating calendar year GDP growth of around 5.6%.

Structural and cyclical headwinds to Indian growth remain, but recent reform proposals are positive

Though we expect a pickup in 2013 and 2014, India faces an unpleasant cocktail of institutional, structural and cyclical headwinds to growth. A range of reforms have been proposed, however, which may alleviate some of these difficulties, such as allowing greater foreign entry into the supermarket industry and reducing fuel subsidies. Though the politics is likely to prove tricky, if these reforms are implemented they would undoubtedly remove some of the structural barriers to growth in India.

One major barrier to an improvement in the cyclical outlook for India has been the persistence of high inflation, and the reluctance of the Reserve Bank of India (RBI) to ease policy as a result. With the weakness of activity, we would have expected to see inflation, particularly core (non-food manufacturing) ease gradually to allow the RBI scope to act; and its failure to do so is indicative of structural issues in the supply chain of the Indian economy. But with recent signs that inflation is finally cooling, particularly core (chart 13), the RBI is soon likely to feel able to ease monetary policy, which will provide a support for activity in 2013. Of course, a victim of this could well be the Rupee.

Chart 13: Core inflation falling should allow RBI to ease



Source: Thomson Datastream, Schroders, Schroders, 22nd November 2012

Schroders Baseline Forecast

Real GDP

y/y%	Wt (%)	2011	2012		Prev.	2013		Prev.	Consensus	2014	Consensus
World	100	2.9	2.4	↓	(2.5)	2.4	↓	(2.5)	2.6	3.1	N/A
Advanced*	65.2	1.4	1.2	↓	(1.3)	1.0	↑	(0.9)	1.2	1.8	N/A
US	23.6	1.8	2.2		(2.2)	1.9	↑	(1.8)	1.9	2.4	N/A
Eurozone	20.4	1.6	-0.4		(-0.4)	-0.3	↑	(-0.7)	0.0	0.9	N/A
Germany	5.6	3.1	1.0	↑	(0.9)	0.7	↑	(0.4)	0.8	2.0	N/A
UK	3.8	0.9	-0.1	↑	(-0.4)	1.0	↑	(0.5)	1.3	1.3	N/A
Japan	9.2	-0.7	1.7	↓	(2.8)	0.4	↓	(1.2)	0.8	1.6	N/A
Total Emerging**	34.8	5.7	4.7	↓	(4.8)	5.2	↓	(5.4)	5.3	5.5	N/A
BRICs	21.1	6.3	5.7	↓	(5.8)	6.3	↓	(6.4)	6.5	6.6	N/A
China	11.4	8.1	7.7	↓	(7.8)	8.0	↓	(8.1)	8.1	8.2	N/A

Inflation CPI

y/y%	Wt (%)	2011	2012		Prev.	2013		Prev.	Consensus	2014	Consensus
World	100	3.3	2.8		(2.8)	2.7	↑	(2.5)	2.8	2.6	N/A
Advanced*	65.2	2.5	1.9		(1.9)	1.6	↑	(1.5)	1.7	1.5	N/A
US	23.6	3.2	2.2		(2.2)	1.6	↓	(1.7)	2.0	1.6	N/A
Eurozone	20.4	2.7	2.6	↑	(2.4)	2.0	↑	(1.6)	1.9	1.7	N/A
Germany	5.6	2.5	2.1		(2.1)	2.1	↑	(1.6)	1.9	1.8	N/A
UK	3.8	4.5	2.9	↑	(2.6)	2.8	↑	(2.1)	2.7	2.8	N/A
Japan	9.2	-0.5	-0.5	↓	(-0.3)	-0.6	↓	(-0.4)	-0.2	-0.4	N/A
Total Emerging**	34.8	4.8	4.5		(4.5)	4.9	↑	(4.5)	4.8	4.7	N/A
BRICs	21.1	4.6	4.3	↑	(4.2)	4.8	↑	(4.2)	4.6	4.4	N/A
China	11.4	3.0	2.8	↓	(2.9)	3.6	↑	(3.2)	3.3	3.6	N/A

Interest rates

% (Month of Dec)	Current	2011	2012		Prev.	Market	2013		Prev.	Market	2014	Market
US	0.25	0.25	0.25		(0.25)	0.31	0.25		(0.25)	0.36	0.25	0.52
UK	0.50	0.50	0.50		(0.50)	0.51	0.50		(0.50)	0.50	0.50	0.68
Eurozone	0.75	1.00	0.75		(0.75)	0.18	0.75	↑	(0.50)	0.22	0.75	0.47
Japan	0.09	0.08	0.08		(0.08)	0.31	0.08		(0.08)	0.27	0.08	0.28
China	6.00	6.56	6.00	↑	(5.75)	-	5.75	↓	(6.00)	-	6.00	-

Other monetary policy

(Over year or by Dec)	Current	2011	2012		Prev.		2013		Prev.		2014
US QE ($Bn)	1660	1663	1915	↓	(2000)		2935	↑	(2000)		3955
UK QE (£Bn)	325	249	375	↓	(400)		450	↓	(475)		450
Eurozone LTRO	NO	YES	YES		YES		YES		YES		YES
China RRR (%)	20.00	21.00	20.00	↑	19.00		19.00		19.00		19.00

Key variables

FX	Current	2011	2012		Prev.	Y/Y(%)	2013		Prev.	Y/Y(%)	2014	Y/Y(%)
USD/GBP	1.58	1.55	1.60	↑	(1.55)	3.0	1.52	↓	(1.55)	-5.0	1.50	-1.3
USD/EUR	1.27	1.30	1.25	↑	(1.20)	-3.7	1.20		(1.20)	-4.0	1.15	-4.2
JPY/USD	80.2	76.9	82.0	↑	(76.0)	6.6	84.0	↑	(83.0)	2.4	90.0	7.1
GBP/EUR	0.80	0.84	0.78	↑	(0.77)	-6.5	0.79	↑	(0.77)	1.1	0.77	-2.9
RMB/USD	6.23	6.29	6.20		-	-1.5	6.10		-	-1.6	6.00	-1.6
Commodities												
Brent Crude	109.5	108	111.6	↑	(108)	3.0	106.0	↑	(103)	-5.0	101.5	-4.2

Source: Schroders, Thomson Datastream, Consensus Economics, November 2012
Market data as at 14/11/2012

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

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Schroders Forecast Scenarios

Scenario	Summary	Macro impact	Probability*	Global vs. 2013 baseline Growth	Inflation
Baseline	Tightening of fiscal policy in 2013 and 2014 leaves the macro environment weak. Grexit is avoided as the Eurozone manages to muddle through, although the OMT is activated by Spain. US avoids fiscal cliff, but not austerity all together.	Growth remains fairly flat in 2013 before picking up in 2014. The biggest drivers of the 2014 rise in growth are Japan, the BRICs and the Eurozone. Inflation to remain subdued, keeping monetary policy in stimulus mode.	65%	-	-
1. Euro break up (partial)	Grexit triggers severe contagion to peripheral economies. Germany holds line on no QE. Leaders unable to muster external support. Capital flight. Peripheral countries exit in 2013H2, but core countries unite to save the Euro.	Default by periphery hits banks and deepens Eurozone recession. Euro rump appreciates, new peripheral currencies fall. Deflationary impact on rest of world as trade and finance dry up.	8%	-1.5%	-1.0%
2. Euro break up (full)	Grexit results in severe contagion and break-up of Euro in 2013H2. Sequence of exits as firewall is insufficient to save Italy and Spain. Political fall out results in core countries also reinstating their original currencies.	Financial chaos, widespread nationalisation of banking systems causes significant economic slump in Europe. Sharp appreciation of new Deutschmark, new peripheral currencies collapse. Knock on effects through trade and financial links pushes rest of world into recession. Collapse in commodity prices and inflation. Significant policy easing. Social unrest/ political upheaval.	1%	-2.3%	-1.1%
3. Euro crisis resolved	Policymakers pull together. Germany agrees to collective financing and beefed up support for Euro leads to return of investor confidence, peripheral yields fall and growth resumes alongside measures to rebalance world economy.	Eurozone growth picks up as confidence and spending revive. Global growth strengthens. Monetary policy tighter than in base but loose by historical standards to accommodate fiscal consolidation.	5%	+0.9%	+0.3%
4. US economy hits fiscal cliff	US politicians fail to agree compromise on tax and expenditure programs, fiscal policy tightens by 4% GDP from January 2013.	US economy falls into recession in 2013. World economy weakens as US demand falls, emerging markets are most affected. Commodity prices fall, inflation is lower. More QE from the Fed and easing elsewhere.	4%	-1.1%	-0.6%
5. China hard landing	Downturn in housing sector combines with weakness of external demand to push GDP growth below 6.5%. Fear of 2009 style surge in money growth means policymakers react too slowly to reflate the economy.	Sharp fall in commodity prices pushes down inflation. Growth in rest of world initially slows as demand weakens, but then recovers as benefit of lower inflation feeds through to consumers. Monetary policy eases.	3%	-0.7%	-0.8%
6. The return of the US consumer	US households start to borrow and spend again buoyed by rising house prices and easier lending standards from banks.	US growth picks up supporting activity around the world. USD strengthens as Fed begins to unwind emergency policy and normalise interest rates.	4%	+0.8%	+0.2%
7. Oil shock	Increasing tension between Iran and the west culminates in a US-Israeli strike on Iran's nuclear facilities in 2013. Oil price rises, peaking at $200 in 2013q2.	Inflation rises sharply squeezing real incomes and expenditure. International tension causes business to delay hiring and investment plans resulting in global recession. Stagflation, but policy makers focus on growth and ease.	6%	-0.7%	+0.8%
8. Other			4%	-	-

*Scenario probabilities are based on mutually exclusive scenarios.

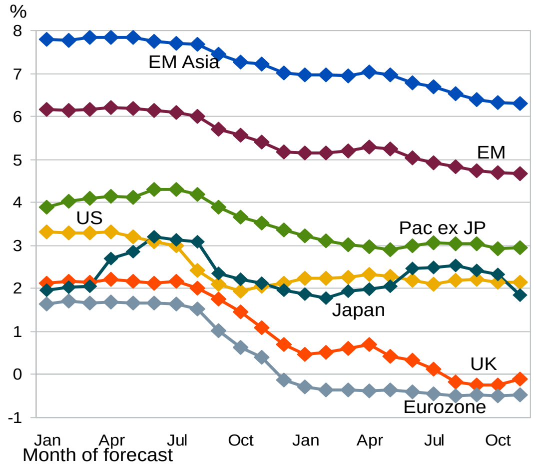
Schroders

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

2012	2013



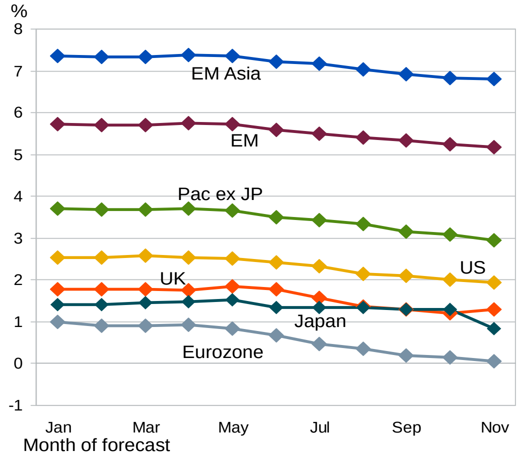
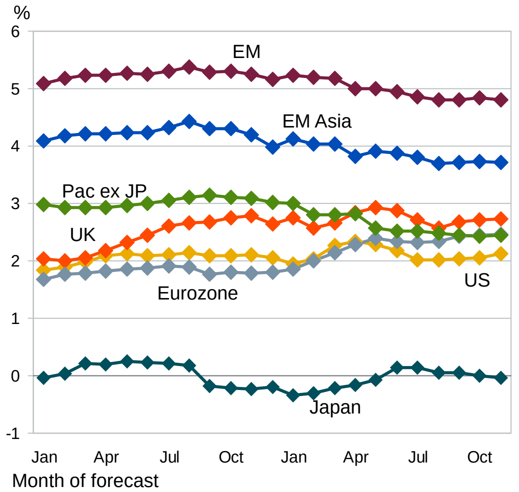
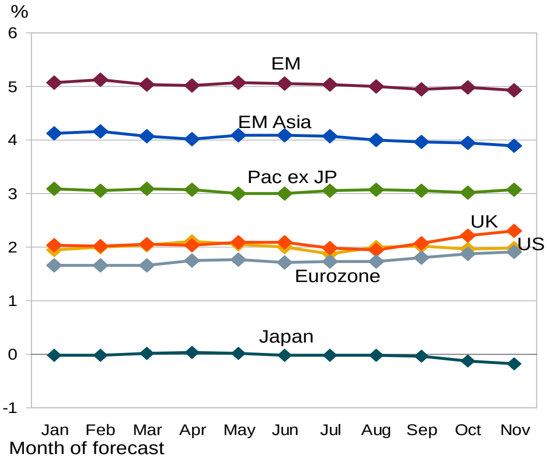


Chart B: Inflation consensus forecasts

2012	2013





Source: Consensus Economics (November 2012), 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

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