

# Schroders

## Economic and Strategy Viewpoint

### The Rocky Horror Euro Show

**Azad Zangana**

European Economist

**Craig Botham**

Emerging Markets  
Economist

- The horror show in Europe continues. Weak growth with a raised risk of recession in the near-term is not helped by very low inflation. Support from monetary policy is ongoing, but fiscal policy continues to make matters worse, despite there being room for the stronger member states to take advantage of near-record low borrowing rates. Hopefully the awakening of the zombie banks can spark the economy back to life in 2015.

#### China: No tricks up their sleeve, no treats on offer (page 7)

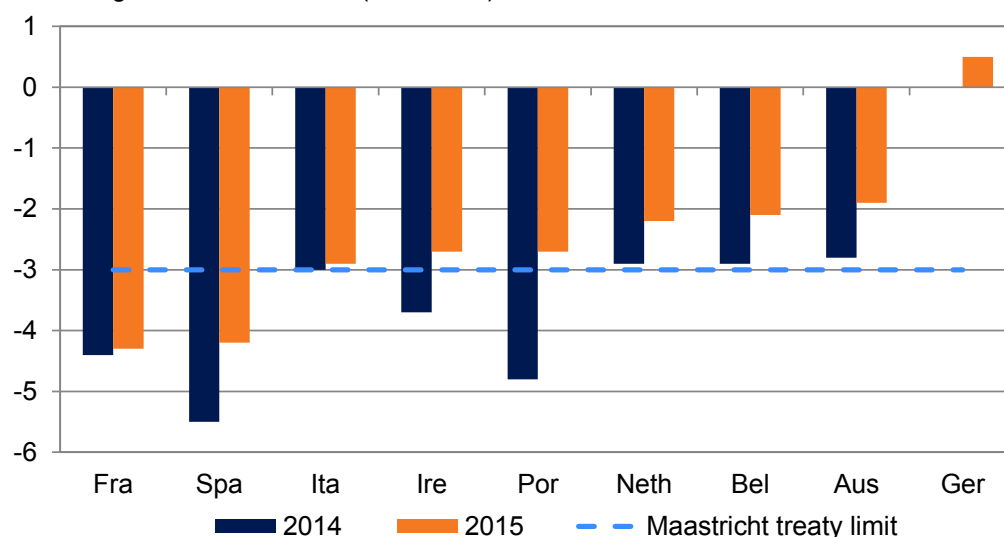
- China appears to be moving backwards on reforms while President Xi extends his power base. While China should still be able to navigate a property slowdown and potential financial crisis, the political climate makes us gloomier about its long term future.

#### Views at a glance (page 11)

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

#### Chart: Eurozone planned budgetary positions

General government balance (% of GDP)



Source: Thomson Datastream, National Draft Budgetary Plans submitted to the European Commission, Schroders. 29 October 2014.



## The Rocky Horror Euro Show

The horror show in Europe continues. The monetary union is facing weak growth with a raised risk of recession in the near-term, coupled with very low inflation, which is about to be exacerbated by the recent fall in global oil prices. Still, there are always treats on offer from fiscal and monetary policy makers. Oh wait, the European Central banks appears to be out of treats, while fiscal hawks in Brussels are only dishing out tricks this Halloween.

***Germany may be on the verge of a triple-dip recession as industrial production and net trade fall sharply***

### Ghoulish growth and devilish deflation

Germany may be in recession. The engine of European growth is spluttering, which is having a knock on impact on its trading partners. German industrial production in August fell by 4%, which means that so far in the third quarter, output for the sector is down 0.7%. Germany's external performance over the summer has also been poor. Data up to August shows that growth in the volume of goods exported is up 0.4% so far in the third quarter, compared with a rise in the volume of imports of 1.2%. This is significantly weaker than the position in the second quarter, when exports grew by 0.7%, but imports fell by 0.4%.

There are some mitigating factors behind the weaker German data. Summer school holidays started slightly later than usual, which prompted a later shut down to production than in previous years. This means that the weak data in August is likely to be overstating the slowdown and data for September should show a recovery. However, seasonal factors aside, most of the evidence available points to a weaker situation. For example, the business climate indicator from the IFO institute survey showed confidence falling to its lowest level since December 2012 - the middle of the last recession.

If it is confirmed that Germany is back in recession, we expect this to be short lived. Some of the more leading indicators such as the Markit PMIs have already started to stabilise. However, Germany's poor performance this year does lead us to question whether it can raise growth going into 2015.

***Eurozone aggregate growth may still be positive, but it is too weak to avoid the build up of deflationary pressures***

Meanwhile, the Eurozone overall will probably see some growth for the third quarter, but it's likely to be sub-trend, which means that deflationary pressures will continue to build. Most of the fall in Eurozone headline inflation has been due to three factors. The first is the strength of the euro at the start of the year which lowered import price inflation. The second factor is low food price inflation over the past year. Excess supply has caused a decline in the prices of agricultural commodities, though Russian sanctions on European food exports have not helped. Finally, the third factor has been lower energy inflation, more specifically, the sharp decline in the price of European natural gas owing to weak demand following the warm winter at the start of the year.

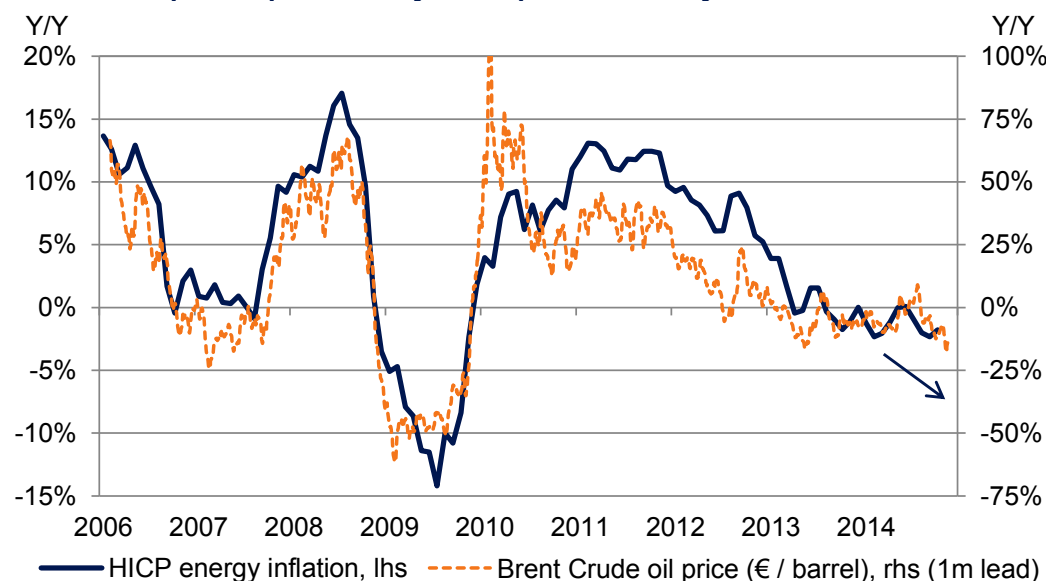
More recently, the euro has been reversing the appreciation seen in the first half of the year (which will be helpful), while agricultural commodity prices have stabilised. On the energy front, although the price of natural gas has picked up recently, global oil prices have fallen sharply in the past two months in reaction to a build-up of inventories, and OPEC's decision not to cut back supply in reaction to price falls.

The decline in oil prices is likely to weigh on global inflation over the next 6-12 months (see above). In Europe, the price of a barrel of Brent crude (€) has fallen 15% compared to a year ago, but if it remains constant, the annual fall will be about -21% by April 2015 (see chart 5). As the energy component is only 11% of the overall HICP basket, we only expect this to lower headline inflation by between 0.2-0.4 percentage points. However, with annual headline inflation at just 0.4%, small numbers can suddenly cause big worries for investors. As discussed in the above section, we do not consider the falls in energy and food prices to be a problem, or a

reflection of the economy. Supply side issues are driving prices lower, which will raise the purchasing power of households, and potentially help lift consumption.

**The drop in oil prices is likely to push inflation even lower, but this will help households**

**Chart 5: Drop in oil prices likely to keep inflation very low**



Source: Thomson Datastream, Eurostat, Schroders. 31 October 2014.

**The Eurozone needs more support...**

### **Hubble bubble, fiscal trouble**

In an ideal world, Eurozone policy makers would be preparing both fiscal and monetary policy stimulus packages. Unfortunately, reality is far from ideal. The European Central Bank (ECB) has already cut interest rates to their theoretical floor, and it is attempting to expand its balance sheet by buying various assets.

Meanwhile, fiscal policy has been contractionary for years. The governments of member states continue to be under pressure to reduce deficits, with little to no regard for the cyclical environment.

**...but policy makers are determined to ensure fiscal policy remains contractionary.**

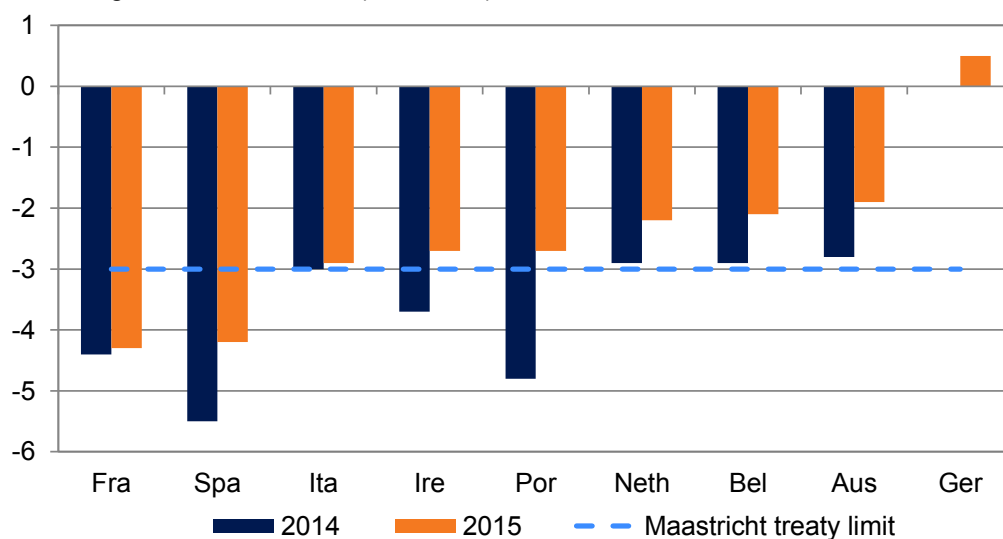
The fiscal outlook today is far better than it was in the midst of the European sovereign debt crisis. Most member states have either met the Maastricht Treaty's 3% of GDP fiscal deficit limit, or plan to next year (see chart 6 on next page). Earlier this month, member states submitted their 2015 draft budgetary plans for scrutiny by the commission. Since the introduction of the Fiscal Compact (long-term commitments from member states to meeting deficit and debt limits), additional information including the impact of planned budgetary changes are required. The process is far more geared towards ensuring member states are true to their words, with fines being applied for those that fall foul.

The draft 2015 budgets show that all of the member states expect to see their deficits fall, with the average planned reduction worth 0.8% of GDP. Spain still has one of the largest deficits in the Eurozone this year (-5.5%), but by the end of 2015, the government expects to cut its deficit to -4.2% of GDP. Spain will continue to run a deficit over the 3% limit, but remains on track with the agreed medium term adjustment. Portugal also plans to make a big adjustment, and will be within the deficit limits if successful. At the other extreme Germany is currently running a balanced budget, but plans to run a surplus of 0.5% of GDP in 2015. This seems strange given the cyclical weakness, but we will return to this later.

**All member states expect to see their budget deficits shrink in 2015**

**Chart 6: Eurozone planned budgetary positions**

General government balance (% of GDP)



Source: Thomson Datastream, National Draft Budgetary Plans submitted to the European Commission, Schroders. 29 October 2014.

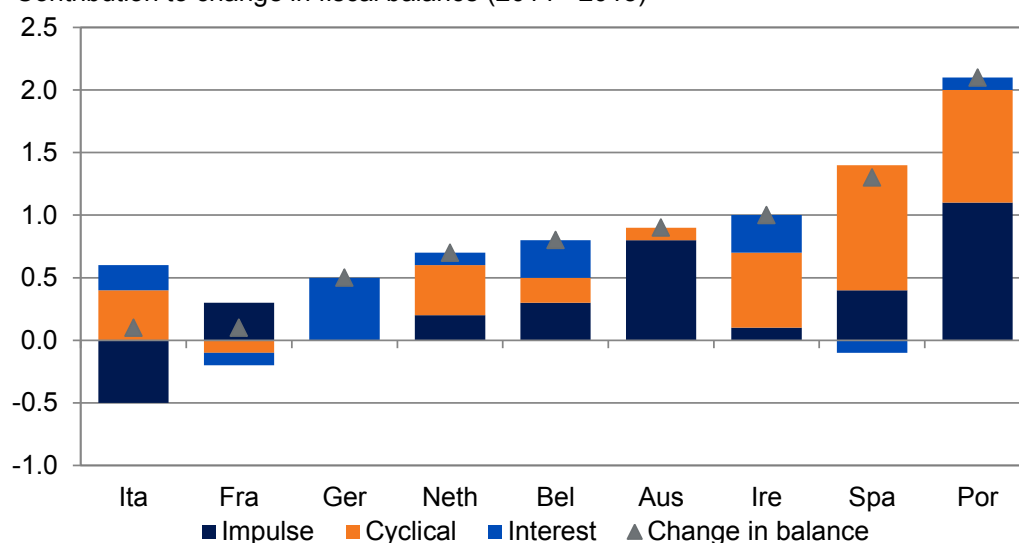
The two countries making the smallest adjustments are France and Italy, so it came as no surprise that they were forced to make last minute adjustments in order to avoid 'serious non-compliance' of EU budget rules. France and Italy are not in the clear yet as the European Commission will spend the next month evaluating all the plans in great detail before reporting their findings.

The European Commission now places greater emphasis on cyclically adjusted budget deficits, and so it is worth examining how member states expect their deficits to evolve with regards to the cyclical components, the structural component (or the fiscal impulse), and the contribution from interest payments (see chart 7). For example, Italy plans to stimulate through the fiscal impulse next year with some tax cuts, but it hopes that the stimulus will provide a boost to the cyclical budget (through stronger GDP growth). Combined with an expected reduction in interest payments, the Italian government expects to keep the overall budget deficit broadly unchanged.

**France and Italy face fines if the European Commission judges they are not sticking to past promises**

**Chart 7: Breakdown of the expected change to fiscal positions (% of GDP)**

Contribution to change in fiscal balance (2014 - 2015)



Fiscal impulse calculated as the change in the cyclically adjusted primary budget deficit. Source: Thomson Datastream, National Draft Budgetary Plans submitted to the European Commission, Schroders. 29 October 2014.

In comparison, France plans to tighten fiscal policy by 0.3% of GDP (positive contribution from the impulse to the exchequer), but the weakness from the economy and higher interest payments are expected to offset most of the gains. This has been the fundamental argument that France has used for the past three years as the government wants to avoid hurting the economy with any meaningful fiscal tightening. Tax increases and spending cuts could cause the stagnant economy to tip into recession, raise unemployment, increase the amount spent on welfare payments, and therefore lift the cyclical element of the deficit. However, fiscal hawks in Brussels argue that member states should not breach the -3% deficit limit unless the cyclical situation is very serious. France should be able to remain within the limits even during a small downturn, and should focus on the structural parts of the deficit (taxes and spending that are not linked to cyclical fluctuations - estimated to be -2.4% of GDP in 2014).

France won a two-year extension to meeting the Maastricht deficit limit in 2013, and is now at risk of being fined for not sticking to the agreed budgetary plans. In fact, France's draft budget does not include a budgetary forecast/plan beyond 2015, where as most member states are looking as far out as 2017. Essentially, not only is France planning on not meeting previous commitments, it has failed to present a plan for meeting the deficit limit at all. This is likely to not only prompt a reaction from the European Commission, but also from other member states, some of which have worked hard, and endured huge pain in order to make the required adjustments.

**Meanwhile, despite facing recession risk, Germany plans to run a budget surplus in 2015...**

Returning to Germany, the government's decision to allow its public finances to move into surplus, albeit due to potentially temporarily lower interest payments, as the economy faces the risk of recession is bordering on sadomasochism. It is like watching the heroine of a horror movie run up the stairs instead of out the front door of the spooky house. Germany has received significant criticism over its reluctance to acknowledge that twin fiscal and balance of payments surpluses can be equally damaging for the Eurozone economy.

Larry Summers, former US presidential adviser, President Emeritus and Charles W. Eliot Professor of Harvard University, recently said that *"The monolithic focus on the financial deficit to the exclusion of the investment deficit, which causes a growth deficit, has been a very substantial error."*<sup>1</sup> At the end of last year, a US Treasury report to Congress on exchange rate policies stated that *"Germany's anaemic pace of domestic demand growth and dependence on exports have hampered rebalancing at a time when many other euro-area countries have been under severe pressure to curb demand and compress imports in order to promote adjustment. The net result has been a deflationary bias for the euro area, as well as for the world economy."*<sup>2</sup>

The German government will argue that trying to reduce public debt is the responsible thing to do, especially as demographics slowly worsen, while running a current account surplus reflects Germany's strong external performance.

**...while refusing to acknowledge its role in the build-up of global imbalances.**

In our view, Germany should make room for a small fiscal expansion in order to boost domestic demand. The external position is indeed driven by the success of Germany's exporters, but it also reflects very weak domestic demand by international standards. In a world with a zero sum game, it is irresponsible to allow imbalances to build too far in either direction.

Should fiscal rules be relaxed in order to support growth? Or is weak enforcement of the rules the reason for the sovereign debt crisis in the first place? This is a difficult dilemma for a monetary union that has seen its foundations shaken, where expensive bail-outs are perceived to have been handed to the fiscally reckless, but also where bailed-out countries blame rich partners for the austerity and pain

<sup>1</sup> Larry Summers speaking at the annual IMF-World Bank meeting in Washington. 10 October 2014.

<sup>2</sup> US Treasury, Report to Congress on international Economic and Exchange Rate Policies. 30 October 2013.

endured. In thinking about this question, we have to consider the current fragile state of both the political union (loosely used) and the economic and monetary union. The Eurozone is barely getting back on its feet, with a significant risk of deflation taking hold in the meantime. Looser fiscal policy would certainly be helpful at this time, and while investors are happy to lend to governments at near record low rates, governments, especially those with better public finances like Germany, should take advantage of the situation.

### Return of the zombie banks

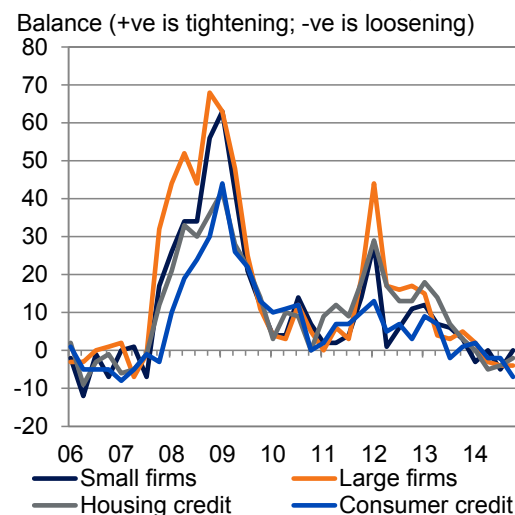
A more positive development over the past month was the long awaited unveiling of the ECB's findings from its asset quality review (AQR) and stress test which were conducted in preparation for the ECB taking over as the new single banking regulator. Overall, there were no shocks from the figures. 25 banks technically failed the process, and were required to raise €24.6 billion. However, as the analysis was conducted using a snapshot of the banks' balance sheets taken at the end of 2013, banks have been able to raise a substantial amount of capital since then. Once the new capital raised is offset, only €9.5 billion is left to raise across 13 banks. For more details see ["The Asset Quality Review and stress test: where to next?"](#) by Justin Bissek, Schroders European Banks Analyst.

European bank lending has been shocking over the past year, as banks cut back aggressively to boost their balance sheets ahead of the ECB's assessment. Looking ahead, with the AQR and stress test behind us, the banks should resume the provision of credit to support much needed business investment and economic growth. The ECB's monetary policy arm is certainly doing as much as possible to aid the banks in being more active.

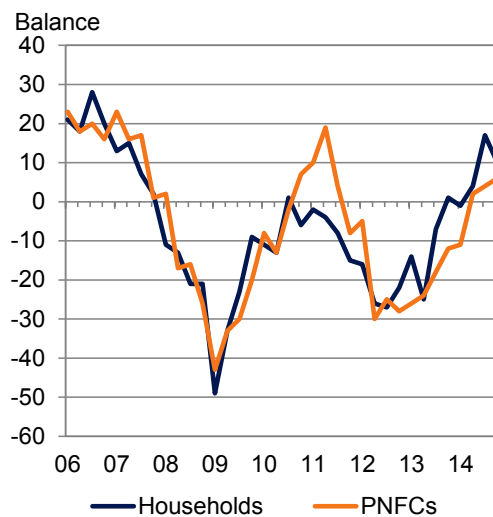
According to the ECB's credit conditions survey, lending conditions have continued to loosen across the board (chart 8) just as demand for credit is picking up, especially demand from non-financial corporates (chart 9).

**Free from the fear of further recapitalisation, banks are expected to return to lending**

**Charts 8: Credit conditions tightness**



**Charts 9: Demand for credit**



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

### Conclusion

Growth is seriously lacking in Europe, and it is threatening to push the monetary union into deflation. While monetary policy continues to provide support, fiscal policy is still contractionary, and even worse, countries that have plenty of room to provide support, are refusing to do so.

Hope for better growth comes from the unshackling of the banking sector and a return to lending. This could alleviate concerns as growth accelerates in 2015, but it certainly will not resolve the longer-term problem of a lack of competitiveness. We

will be updating our forecasts next month, but the poor run of data of late suggests the probability of full-scale sovereign quantitative easing has risen. Like a bad horror movie, there will probably be at least one more terrifying sequel in the future.

**Turning negative  
due to power grab  
and reform  
regression**

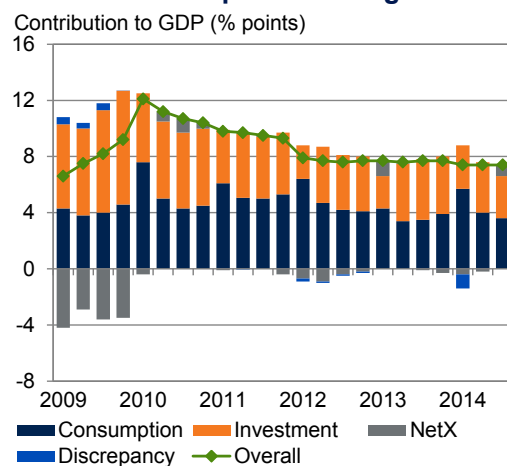
## China: No tricks up their sleeve, no treats on offer

This month's Viewpoint finds the EM economist in a renewed bout of bearishness after a visit to China. While the growth picture is much as we expected, our modest optimism over the direction of policy and politics has been firmly quashed following discussions with officials and private sector analysts. Put briefly, the Fourth Plenum's focus on the "rule of law" appears to be a continuation of a centralising power grab which will cement a move away from the apparent pro-free market stance of the Third Plenum. Meanwhile, the Communist party seems to remain sanguine about slower growth and property turmoil, and is unlikely to provide significant stimulus for some time.

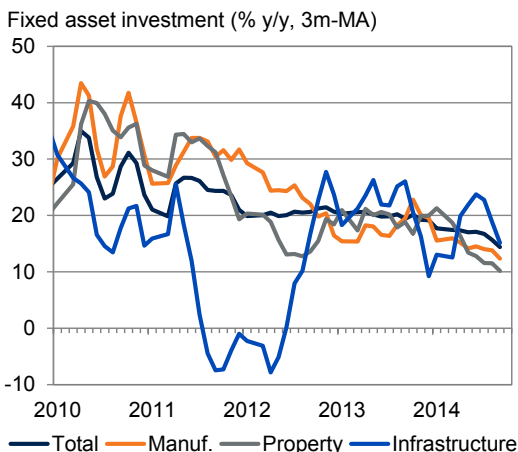
Indeed, whilst we were in China, the third quarter's GDP growth numbers were published after a morning of what looked suspiciously like expectation management by an array of economic experts on state television. The coverage was full of comments from specialists talking about how positive slower growth was for the average person, replete with remarks about quality, not quantity, of growth being important. Consequently, the growth slowdown (GDP expanded 7.3% year on year in the third quarter, in line with our forecast but slower than the second quarter reading of 7.5%) was nothing to worry about. The state seems to be priming its populace to accept lower growth in the future, and we maintain our call on a lowering of the growth target in 2015 to 7.0%.

A breakdown of GDP shows a diminished contribution of both consumption and investment, with net exports picking up the slack. The slowing of investment comes despite a government stimulus push in the middle of the year, the impact of which appears to have already worn off (see charts 10 & 11).

**Chart 10: Net exports boost growth**



**Chart 11: Investment slowdown**



Source: Thomson Datastream, Schroders. 29 October 2014

**Property  
slowdown  
continues...**

### Housing haunts China's ghost cities

In part this is because property continues to drag on the economy; investment in real estate fell to its lowest level since 2009 in September, and the bulk of this is now social housing construction. Clearly, falling prices and sales are having an impact on developers' willingness to build, as reflected in the renewed contraction of new starts in September. With excess inventories in lower tier cities now standing at up to three years' stock, a quick resolution is not on the cards.

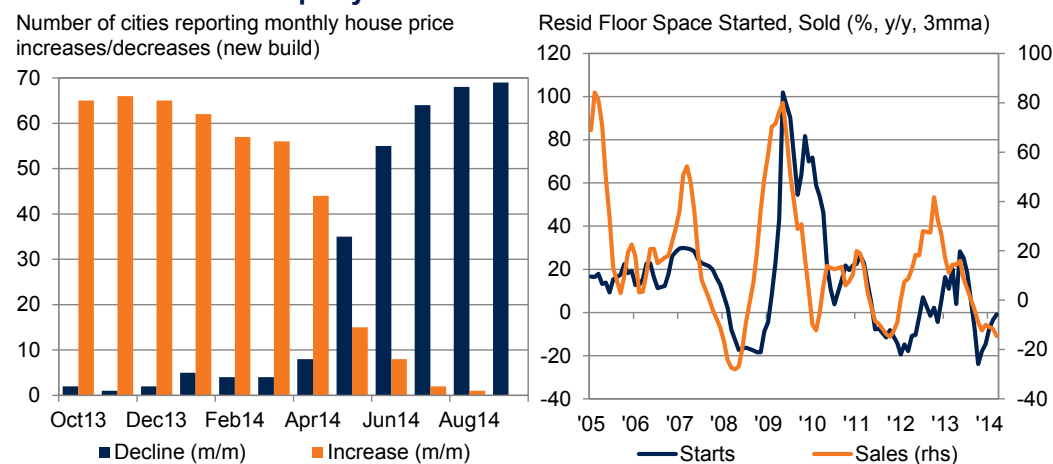
The attitude in China seems to be relatively relaxed; neither the analysts nor officials

**...but Party concern is for construction volumes, not developers**

we met voiced concern of an imminent crisis as a result of the property market. In general, the expectation is for a long downturn in the market, but that the country has the resources to manage. Compared to the West, the household sector is well positioned, debt as a share of disposable income is just 60%, leverage is low, and debt is domestically owned. A death spiral for the sector seems unlikely. Things could, however, get much worse for developers; President Xi is reportedly very comfortable with the prospect of market clearing in the sector, so policy support seems distant. The expectation is for consolidation in the sector, and a number of smaller developers are already quitting the market altogether.

The main concerns for policymakers emanating from the property market, rather than the travails of the developers themselves, are the potential for a financial crisis and the impact on growth from a reduction in construction volumes. On the latter, it is worth noting that most excess supply is in higher end housing. There remains a shortage of affordable housing, and so continued investment in social housing can serve to both maintain construction volumes (it already accounts for the bulk of real estate investment) and meet a shortfall of supply. The target for social housing construction has actually been exceeded this year, but this is unlikely to slow local governments down.

### Charts 12 and 13: Property market downturn continues



Source: Thomson Datastream, Schroders. 29 October 2014

**Property slowdown threatens government revenues**

### Fears that reform commitment is wavering

One worry might be how local governments are going to finance all this construction. Central government only provides 10% of the funds for social housing construction, with the rest provided by local governments in one form or another. But local governments have few revenue options, and the main one is land; land sales and taxes account for around 60-70% of local government revenues, and land prices have reportedly fallen 50% this year. The implication is that the local government debt problem is only going to get worse.

It seems a bad time, then, to implement fiscal reforms to limit government borrowing. From the start of next year local governments will be unable to issue new borrowing via local government financing vehicles (LGFVs) - the favoured instrument to date. Instead, they must rely on bonds (with a cap set by central government) and public private partnerships for infrastructure projects. In theory, anyway. In reality, the reforms are likely to be staggered over a few years, and restricted initially to stronger local governments. We may see a repeat of the previous two years; weak first quarter GDP due to a tighter fiscal stance, followed by an easing of restrictions as the central government becomes concerned about growth. Ultimately, as we have seen this year, reforms take a back seat to growth.

One general theme detected in our meetings was a more negative outlook for market-based reforms. Though it is difficult to get a true picture of political machinations in China, there seemed to be a broad consensus that the side-lining of



### Market reforms now an instrument, not a goal

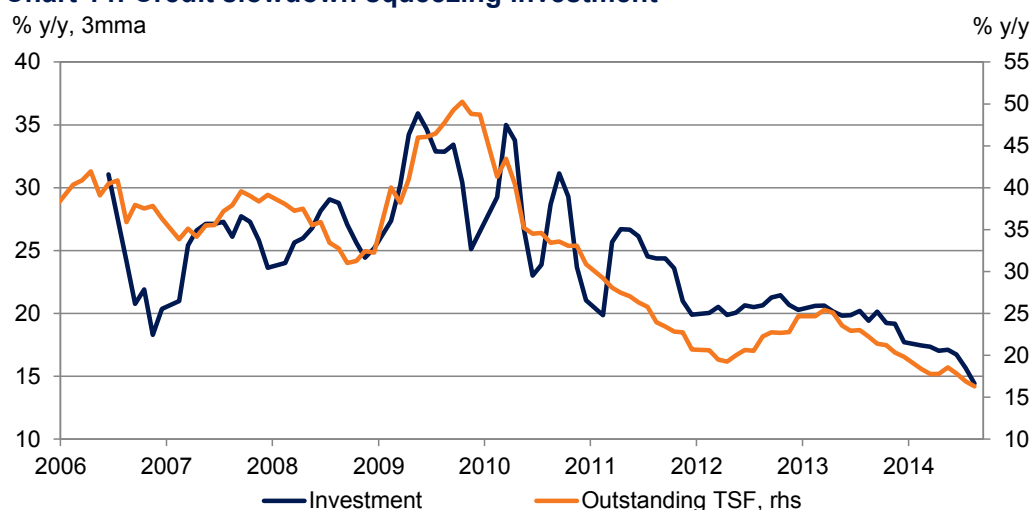
Premier Li Keqiang reflects a broader shift away from the free market stance espoused in last year's Plenum. For President Xi, the lessons to be drawn from China's performance since the crisis are that relaxing central control leads to market bubbles and a build up of debt. As a result, power is being re-centralised, away from both local governments but also from the market. Reform ideas now are very similar to the ideas of the late 1990s: a more centrally-run system with state control of a large part of the economy via strategic state-owned enterprises (SOEs), and the use of market mechanisms as instruments rather than goals. That is, market instruments will be used to make SOEs more efficient, but the SOEs will remain under state control. While a centralisation of power may increase the state's ability to respond to the property downturn and any potential financial crisis, for us it raises concerns about long term institutional quality in China, as well as longer-term growth prospects. Further, and greater, resource misallocation seems inevitable.

### Financial bogeymen lurking in the shadows

Finance is another area where reforms have, so far, disappointed. There has still been no move on deposit insurance or deposit rate liberalisation, though no two analysts we met could agree on when to expect it. Some degree of caution on financial reform is inevitable though given the twin headwinds of potential Federal Reserve tightening and China's domestic credit slowdown. While investment is particularly weak in real estate, it is slowing across the spectrum, and this is in no small part due to slowing credit growth (see chart 14).

Ongoing weakness in new total social financing (TSF) has an array of possible explanations. For one, tightened shadow banking regulations have been bringing some off-balance sheet credit back onto banks' loan books, cutting out some double counting. Meanwhile, new forms of shadow banking credit are not captured by the TSF measure, such as the increased role for securities companies. Also, as reflected by the People's Bank of China's (PBoC) third quarter survey, credit demand is likely depressed by domestic weakness and the property downturn. That is, we do not yet think this is the start of a credit crash.

**Chart 14: Credit slowdown squeezing investment**



Source: Thomson Datastream, Schroders. 29 October 2014

### Banks face large recapitalisation needs

Having said that, however, China's financial system was probably the second most discussed topic in our meetings, and not as a ray of hope. For one thing, bank profitability is falling quickly and capital buffers are eroding. Meanwhile, loan-to-deposit ratios for smaller banks are close to binding. One analyst estimated total recapitalisation needs at around 6.3 trillion RMB for the sector as a whole, related to recent regulatory crackdowns on banks' involvement in questionable shadow banking practices. There are also naturally concerns related to the property sector, though the larger developers have sufficient cash reserves to last them through to

**Poor asset quality  
prompts reform  
caution**

the end of next year.

Perhaps there can be little surprise then that lending is slowing and that there is increased macro reliance on directed lending, particularly in support of otherwise neglected sectors, suggesting a move away from market-based monetary policy. Again, this represents a backpedalling away from the more market-focused approach announced only a year ago.

One reason for caution on deposit rate liberalisation is the deterioration in asset quality; non-performing loans are reportedly 30-50% higher at some banks year-on-year, with asset management companies already being required to take some of the burden. Worse would follow if the property market downturn escalated into a financial crisis; an IMF stress test modelled on a shock akin to the 2008 crisis found that 20-25% of liabilities would end up ranked CCC or below. While the central government would intervene in such a scenario, the cost of a misstep is clearly high. Any financial crisis would face a more complicated resolution than the last one. At the time of the original debt restructuring in 2000, the "Big 4" banks accounted for 90% of lending. Now, the Big 4 are only 40% of the system, so while the PBoC and national AMC's would be involved in their bailout, the rest of the sector would likely be resolved on a province-by-province approach, utilising provincial AMC's. Question marks remain over the ability of these bodies to tackle the problem given they are backed by financially weak local governments.

Overall, China probably looks safe for now, though the likelihood of government intervention in 2015 or 2016 to prevent a crisis looks high. At a national level, the country retains sufficient resources and political will to tackle most crises, and the centralisation of power taking place should assist in this regard. On a longer-term basis, however, the change of stance on free market reforms, and the re-centralisation of power leave us uneasy about longer-term prospects for China.

## Schroder Economics Group: Views at a glance

### Macro summary

#### Key points

##### Baseline

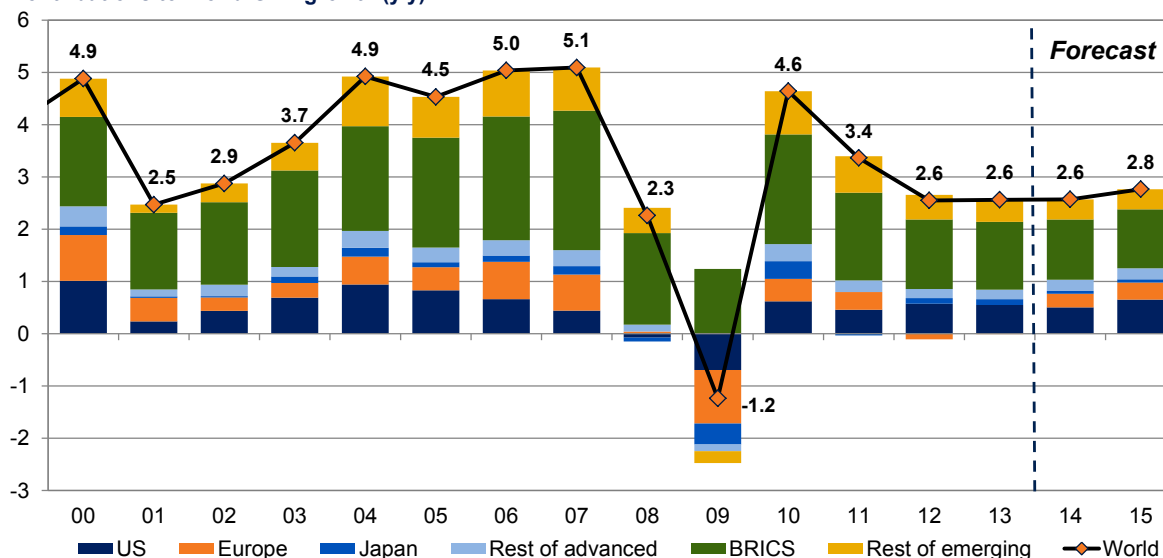
- World economy on track for modest recovery as monetary stimulus feeds through and fiscal headwinds fade in 2014. Inflation to remain well contained.
- US rebounded in Q2 and Q3 after weather related dip in Q1. Unemployment to fall faster than Fed expects, wage and price growth to pick up as productivity remains sluggish. Fed completed tapering of asset purchases in October 2014. First rate rise expected in June 2015 with rates rising 25 bps per meeting to 1.5% by year end.
- UK recovery to be sustained by robust housing and consumer demand whilst economic slack should limit the pick-up in inflation. Growth likely to moderate next year with general election and resumption of austerity. Interest rate normalisation to begin in 2015.
- Eurozone recovery becomes more established as fiscal austerity and credit conditions ease in 2014. ECB on hold after cutting rates and taking measures to reduce the cost of credit, and expand its balance sheet through ABS and covered bond purchases. Otherwise on hold through 2015. Deflation to be avoided, but a good possibility of QE in response to deflation fears.
- "Abenomics" achieving good results so far, but consumption tax has hit growth and Japan faces significant challenges to eliminate deflation and repair its fiscal position. Bank of Japan to step up asset purchases as growth and inflation fall back later in 2014.
- US leading Japan and Europe (excluding UK). De-synchronised cycle implies divergence in monetary policy with the Fed eventually tightening ahead of ECB and BoJ, resulting in a firmer USD.
- Tighter US monetary policy weighs on emerging economies. Region to benefit from advanced country cyclical upswing, but China growth downshifting as past tailwinds (strong external demand, weak USD and falling global rates) go into reverse and the authorities seek to deleverage the economy. Deflationary for world economy, especially commodity producers (e.g. Latin America).

##### Risks

- Risks are still skewed towards deflation, but are more balanced than in the past. Principal downside risks are Eurozone deflation and escalation of Russia-Ukraine crisis. Some danger of inflation if capacity proves tighter than expected, whilst upside growth risk is a return of animal spirits and a G7 boom.

##### Chart: World GDP forecast

Contributions to World GDP growth (y/y)



Source: Thomson Datastream, Schroders 27 August 2014 forecast. Previous forecast from May 2014. Please note the forecast warning at the back of the document.

## Schroders Baseline Forecast

### Real GDP

y/y%	Wt (%)	2013	2014	Prev.	Consensus	2015	Prev.	Consensus
<b>World</b>	100	2.6	2.6	↓ (2.8)	2.6	2.8	↓ (2.9)	3.1
<b>Advanced*</b>	63.0	1.3	1.6	↓ (1.9)	1.7	2.0	↓ (2.1)	2.2
<b>US</b>	24.8	2.2	2.0	↓ (2.6)	2.2	2.6	↓ (2.9)	3.1
<b>Eurozone</b>	18.8	-0.4	0.8	↓ (1.0)	0.8	1.2	↓ (1.4)	1.2
<b>Germany</b>	5.4	0.5	1.6	↓ (2.2)	1.4	2.0	↓ (2.3)	1.5
<b>UK</b>	3.7	1.7	3.0	↑ (2.9)	3.1	2.5	↑ (2.4)	2.6
<b>Japan</b>	7.2	1.5	0.8	↓ (1.2)	1.1	0.9	↓ (1.0)	1.2
<b>Total Emerging**</b>	37.0	4.7	4.2	(4.2)	4.1	4.1	↓ (4.3)	4.5
<b>BRICs</b>	22.8	5.7	5.1	(5.1)	5.1	4.9	↓ (5.1)	5.2
<b>China</b>	13.6	7.7	7.3	↑ (7.1)	7.3	6.8	(6.8)	7.1

### Inflation CPI

y/y%	Wt (%)	2013	2014	Prev.	Consensus	2015	Prev.	Consensus
<b>World</b>	100	2.7	3.1	↑ (3.0)	3.1	3.3	↑ (3.1)	3.1
<b>Advanced*</b>	63.0	1.3	1.5	(1.5)	1.5	1.7	↑ (1.6)	1.6
<b>US</b>	24.8	1.5	1.7	↓ (1.8)	1.8	2.2	↑ (1.9)	1.8
<b>Eurozone</b>	18.8	1.3	0.7	↓ (0.9)	0.5	1.1	↓ (1.2)	1.0
<b>Germany</b>	5.4	1.6	1.1	↓ (1.3)	1.0	1.8	↓ (2.0)	1.6
<b>UK</b>	3.7	2.6	1.6	↓ (1.9)	1.7	2.2	(2.2)	1.9
<b>Japan</b>	7.2	0.4	2.7	↑ (2.0)	2.8	1.5	↓ (1.6)	1.8
<b>Total Emerging**</b>	37.0	4.9	5.9	↑ (5.7)	5.8	5.9	↑ (5.6)	5.7
<b>BRICs</b>	22.8	4.6	4.4	(4.4)	4.3	4.4	(4.4)	4.2
<b>China</b>	13.6	2.6	2.3	↓ (2.7)	2.3	3.0	↓ (3.1)	2.7

### Interest rates

% (Month of Dec)	Current	2013	2014	Prev.	Market	2015	Prev.	Market
<b>US</b>	0.25	0.25	0.25	(0.25)	0.25	1.50	↑ (0.75)	0.91
<b>UK</b>	0.50	0.50	0.50	(0.50)	0.69	1.50	↑ (1.00)	1.46
<b>Eurozone</b>	0.15	0.25	0.15	↑ (0.10)	0.18	0.15	↑ (0.10)	0.20
<b>Japan</b>	0.10	0.10	0.10	(0.10)	0.19	0.10	(0.10)	0.19
<b>China</b>	6.00	6.00	6.00	(6.00)	-	6.00	(6.00)	-

### Other monetary policy

(Over year or by Dec)	Current	2013	2014	Prev.	2015	Prev.
<b>US QE (\$Bn)</b>	4368	4033	4443	(4443)	4443	(4443)
<b>UK QE (£Bn)</b>	375	375	375	(375)	375	(375)
<b>JP QE (¥Tn)</b>	258	224	295	(295)	383	(383)
<b>China RRR (%)</b>	20.00	20.00	20.00	↑ 19.50	20.00	↑ 19.50

### Key variables

FX	Current	2013	2014	Prev.	Y/Y(%)	2015	Prev.	Y/Y(%)
<b>USD/GBP</b>	1.67	1.61	1.68	(1.68)	4.3	1.63	(1.63)	-3.0
<b>USD/EUR</b>	1.34	1.34	1.32	↓ (1.35)	-1.5	1.27	↓ (1.30)	-3.8
<b>JPY/USD</b>	102.4	100.0	105.0	(105)	5.0	110.0	(110)	4.8
<b>GBP/EUR</b>	0.80	0.83	0.79	↓ (0.80)	-5.6	0.78	↓ (0.80)	-0.8
<b>RMB/USD</b>	6.15	6.10	6.12	↓ (6.18)	0.3	6.05	↓ (6.10)	-1.1
<b>Commodities</b>								
<b>Brent Crude</b>	102.0	109.0	107.1	↓ (108)	-1.7	105.5	↑ (104)	-1.5

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

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

Market data as at 15/08/2014

Previous forecast refers to May 2014

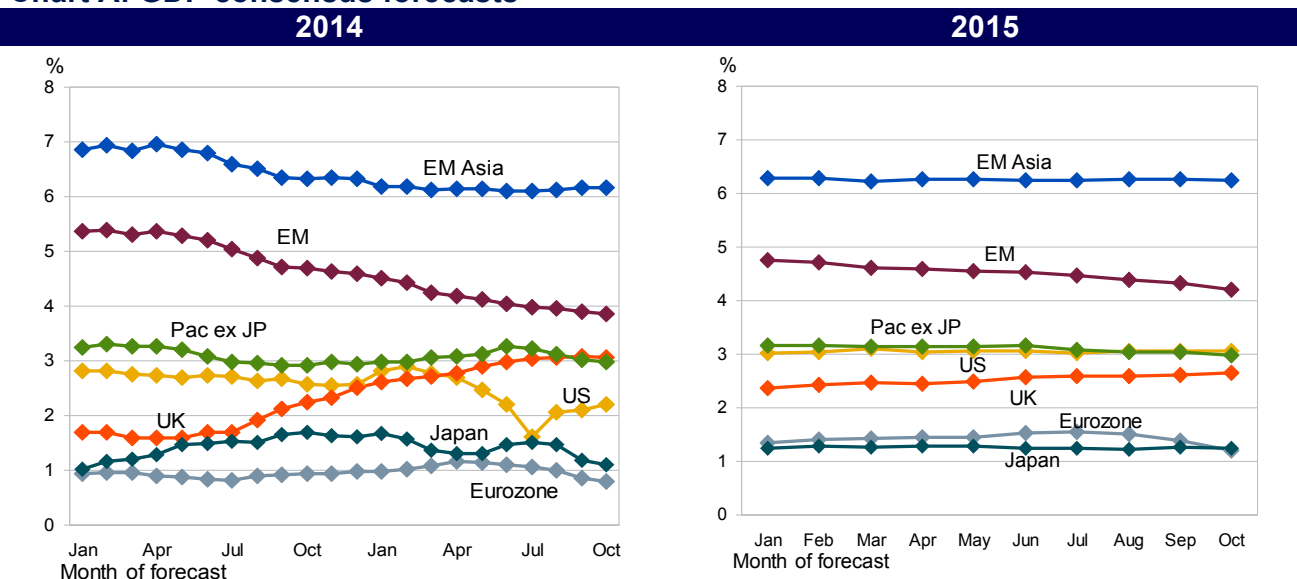
\* **Advanced markets:** Australia, Canada, Denmark, Euro area, Israel, Japan, New Zealand, Singapore, Sweden, Switzerland, Sweden, Switzerland, United Kingdom, United States.

\*\* **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.

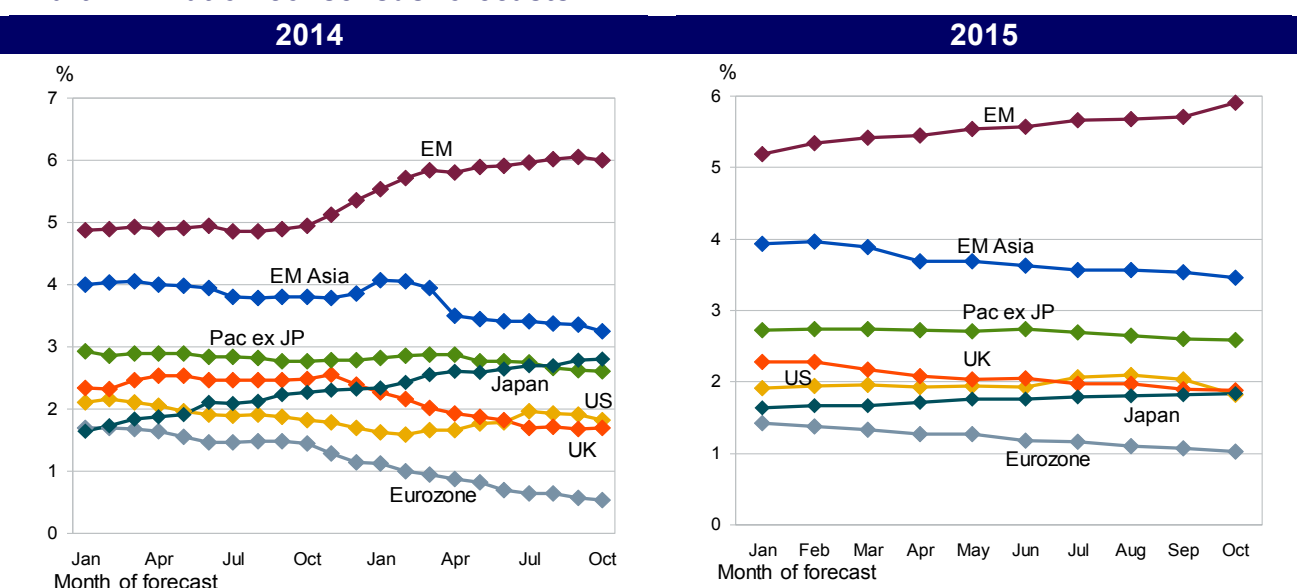
## Updated forecast charts - Consensus Economics

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

### Chart A: GDP consensus forecasts



### Chart B: Inflation consensus forecasts



Source: Consensus Economics (October 2014), Schroders

Pacific ex. Japan: Australia, Hong Kong, New Zealand, Singapore

Emerging Asia: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand

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

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