

Prudential International Investments Advisers, LLC.

Global Economic Outlook – July 2009

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Global Summary: Smaller GDP Decline in Q2. GDP Expected to Turn Positive in H2. Rates on Hold

[John Praveen's Global Economic Outlook – July 2009](#) sees global growth outlook continuing to improve with Leading Economic Indicators (LEIs) and business and consumer confidence indicators pointing to a smaller decline in Q2 and growth turning positive in H2. U.S. GDP is on track to a much smaller -1% QoQ annualized decline in Q2 with LEI, ISM manufacturing and service indexes, and consumer confidence indicators continuing to improve in June/July. Eurozone economies appear to be on recovery track with a smaller -2% GDP decline in Q2 after the Q1 collapse, led by a turnaround in Germany and France. GDP growth is expected to turn positive in the U.S. and Europe in Q3. In Japan, with the fiscal stimulus boosting production and consumption, and a modest recovery in net exports, GDP is rebounding in Q2 to a 1% QoQ annualized rise after the Q1 collapse. China's economy rebounded strongly in Q2 with GDP rising 7.9% YoY after slowing sharply to 6.1% in Q1 driven by a significant pickup in investment spending and consumption boosted by the massive fiscal stimulus.

Headline inflation fell further into negative territory in the U.S., Eurozone and Japan with increasing slack and base effects of the surge in oil prices in Q2 2008. Headline inflation is likely to turn more negative in the near-term before turning positive in late 2009. However, increasing slack in the output and labor markets are likely to dampen inflationary pressures. Core inflation remains stable easing concerns about deflation. The Fed, ECB, BoE, and BoJ are expected to remain on hold through the remainder of the year and continue with their Quantitative Easing policies.

Key Changes in Macro Views

	View/ Forecast	Reasons
GDP Growth	<p>Smaller Q2 GDP decline in U.S. and Europe.</p> <p>Positive Q2 GDP growth in Japan.</p> <p>China Q2 GDP Rebounds</p> <p>GDP on track to turn positive in H2.</p>	<ul style="list-style-type: none"> The global growth outlook continues to improve. Leading Economic Indicators (LEIs) and business and consumer confidence indicators point to a smaller decline in Q2 and growth turning positive in H2. Leading Economic Indicators (LEI) in many countries have shown sustained improvements from their lows in early Q1. U.S., Eurozone, and U.K. leading indicators have all turned positive recently. Japanese indicators are still depressed, but are beginning to turn around. U.S. GDP is on track to a much smaller -1% QoQ annualized decline in Q2 with LEI, ISM manufacturing and service indexes, and consumer confidence indicators continuing to improve in June/July. The early reading is for Q3 GDP to rise around 2%. Eurozone economies appear to be on recovery track with a smaller -2% GDP decline in Q2 after the Q1 collapse, and growth turning positive in H2 2009. The Eurozone recovery is being led by a turnaround in Germany and France. The improvement in U.K. business confidence and stabilization in industrial activity points to a smaller decline in Q2 GDP, around -1% QoQ annualized. In Japan, with the fiscal stimulus boosting production and consumption and a modest recovery in net exports, GDP is rebounding in Q2 to a 1% QoQ annualized rise after the Q1 collapse. China's economy rebounded strongly in Q2 with GDP rising 7.9% YoY after slowing sharply to 6.1% in Q1. The rebound was driven by a significant pickup in investment spending and consumption boosted by the massive fiscal stimulus.
Inflation	<p>Headline Negative with Slack & Favorable Base Effects</p>	<ul style="list-style-type: none"> Headline inflation in negative territory in the U.S., Eurozone and Japan with increasing slack and base effects of the surge in oil prices in 2008. Headline inflation is likely to turn more negative in the near-term before turning positive in late 2009. However, increasing slack in the output and labor markets are likely to dampen inflationary pressures. However, core inflation remains stable easing concerns about deflation.
Interest Rates	<p>Rates on Hold for Rest of 2009</p>	<ul style="list-style-type: none"> The Fed, ECB, BoE, and BoJ are expected to remain on hold through the remainder of the year and continue with their Quantitative Easing policies.

Global Outlook

Smaller Q2 GDP Decline. Positive GDP in H2. Headline Inflation Negative. Interest Rates on Hold

Growth: Smaller Q2 GDP Decline, Positive Growth in H2 in Developed Economies, Stronger Growth in EM

- The global growth outlook continues to improve with GDP. Leading Economic Indicators (LEIs), business and consumer confidence indicators remain in an uptrend pointing to a smaller decline in Q2 and growth turning positive in H2.
- U.S. Leading Economic Indicators (LEI), ISM manufacturing and service indexes, and consumer confidence indicators continue to improve in June/July. U.S. GDP on track to a much smaller -1% QoQ annualized decline in Q2. GDP growth on track to turn positive in H2 as the fiscal stimulus boosts consumption and government spending. Q3 GDP is expected to rise around 2% annualized.
- Eurozone economies recovering after Q1 collapse. IP, retail sales and trade lifting Q2 GDP to a smaller decline of around -2% QoQ annualized. In the U.K., the improvement business confidence and stabilization in industrial activity points to a smaller decline in Q2 GDP, around -1% QoQ annualized.
- Japan's GDP appears on track to a sharp rebound in Q2. The fiscal stimulus is boosting production and consumption, while net exports are posting a modest recovery. This points to Q2 GDP rebounding to around 1% QoQ annualized growth. China's economy rebounded strongly in Q2 with GDP rising 7.9% YoY after slowing sharply to 6.1% in Q1. The rebound was driven by a significant pickup in investment spending and consumption boosted by the massive fiscal stimulus.

Inflation: Headline Negative With Economic Slack & Favorable Base Effects. Core Remains Stable

- U.S. consumer prices rose at its fastest MoM pace since July 2008 due to rising energy prices. Headline prices jumped 0.7% MoM with the YoY rate easing to -1.2% from -1% in May, the weakest since 1950. Headline CPI is on track to decline further, bottoming around -2 % YoY in July 2009, before turning positive in Q4 2009.
- Eurozone headline inflation edged down to -0.1% YoY in June from 0% in May and 0.6% in March and April. U.K. headline inflation edged down to 1.8% due to base effects as prices still rose MoM. Japanese nationwide core inflation (excluding fresh food) fell at its sharpest pace on record, falling -1.1% YoY in May after holding at -0.1% in April.

Interest Rates: Central Banks on Hold, Continue QE. To Remain on Hold Through Year End

- The Fed, ECB, BoE, and BoJ remained on hold in June/early July. These central banks continue to undertake various forms of "Quantitative Easing" through asset purchase programs to pump liquidity into the financial system.
- The Federal Reserve continued to hold the Funds rate in a range between 0 and 25bps at the June meeting. On balance, the Fed's cautious outlook for the economic recovery and its confidence of inflation suggest that the Fed is unlikely to start tightening policy until well into 2010, despite market expectations of tightening in late 2009.
- The ECB held rates at their record low 1% at the July 2nd ECB Council meeting after cutting rates by 25bps in May and April. Further, the ECB has begun purchasing bonds as part of its €60bn program. In the U.K., the BoE again held the bank rate at 0.5% at their July meeting. In addition, the BoE decided to hold the size of their Quantitative Easing program at £125bn.
- The BoJ left its target overnight call rate unchanged at 0.1% in July. The bank raised its assessment of the economy for the second month in June, but said it won't rush to wind down the unorthodox measures it adopted to counter Japan's recession.

Currencies: Dollar Weakness on Economic Recovery, Increase in Risk Appetite & Growing Twin Deficits

- The U.S. dollar was mostly unchanged against the euro in June, but the sterling strengthened (1.7% against the dollar) for the third consecutive month. In addition, the yen weakened (-1% against the dollar) with the stock market correction in June and rising concerns over the outlook for global growth.
- The dollar is likely to weaken against most currencies given the increase in risk appetite, economic recovery and the ballooning U.S. fiscal and current account deficit. However, there could be some near-term volatility due to questions about the strength of the economic recovery.

Regional Outlook - USA, Eurozone, UK, Japan, China

USA: Smaller Q2 GDP Decline. Inflation Turns More Negative. Fed Keeps Rates Near Zero

Growth: Smaller Q2 GDP Decline, Positive GDP Growth in H2 After Sharp Decline in Q1

- U.S. Leading Economic Indicators (LEI), ISM manufacturing and service indexes, and consumer confidence indicators continue to improve in May/June indicating that the U.S. economy is bottoming. U.S. GDP is on track to a much smaller -1% QoQ annualized decline in Q2.
- U.S. GDP growth is likely to turn positive in H2 as the fiscal stimulus boosts consumption and government spending. However, the GDP rebound is likely to remain anemic with rising unemployment and rising household savings dampening consumption spending while continued weakness in the housing market is likely to remain a drag on growth. The early reading is for Q3 GDP to rise around 2% annualized.
- U.S. Q1 GDP was revised to a smaller decline of -5.5% QoQ annualized in the final estimate from the -5.7% decline in the preliminary estimate, after a -6.3% decline in Q4 2008. Business investment spending was the largest negative contributor, sinking -37.3% QoQ annualized and subtracting -4.6% from Q1 GDP.

Inflation: Headline Inflation Turns More Negative, But Core Still Positive and Steady

- Consumer prices rose at its fastest MoM pace since July 2008 fuelled by a rise in energy prices. U.S. consumer prices jumped 0.7% MoM, but the YoY rate eased to -1.2% from -1% in May, the weakest since 1950.
- Headline CPI is on track to decline further, bottoming around -2% YoY in July 2009 (held down by base effect of the \$145 peak in oil prices in 2008). Headline CPI is expected to turn positive in late Q3 and Q4 2009 with oil prices expected around \$70/bbl in Q4 2009 versus \$60/bbl in Q4 2008.
- U.S. core inflation also rose 0.2% MoM in June, after rising 0.1% in May. The YoY rate of core CPI eased to 1.7% in June from 1.8%. This pace of core prices should ease deflation fears. Core PCE inflation eased to 1.8% YoY in May.

Interest Rates: Fed Keeps Rates Near Zero, No Change in Asset Purchase Program. Rates on Hold into 2010

- The Federal Reserve continued to hold the Funds rate in a range between 0 and 25bps at the June meeting and reiterated their open-ended commitment to keeping the Funds rate at "exceptionally low levels ... for an extended period." The Fed opted not to alter the size or structure of the asset purchase programs at its June meeting.
- The Fed expressed cautious optimism that "the pace of economic contraction is slowing" ... and continues expect "... a gradual resumption of sustainable economic growth." The Fed continues to "expect that inflation will remain subdued for some time.
- On balance, the Fed's cautious outlook for the economic recovery and its confidence of inflation suggest that the Fed is unlikely to start tightening policy until well into 2010, despite market expectations of tightening in late 2009.

Currencies: Dollar Weakness on Economic Recovery, Increase in Risk Appetite & Growing Twin Deficits

- The U.S. dollar was mostly unchanged against the euro in June, but the sterling strengthened (1.7% against the dollar) for the third consecutive month. In addition, the yen weakened (-1% against the dollar) with the stock market correction in June and raising some concerns over the outlook for global growth.
- The dollar is likely to weaken against most currencies given the increase in risk appetite, economic recovery and the ballooning U.S. fiscal and current account deficit. However, there could be some near-term volatility due to questions about the strength of the economic recovery.

Europe: Eurozone & U.K. GDP to Post Smaller Decline in H2. ECB& BoE on Hold

Growth: European Indicators Point to Smaller Decline in Q2, Recovery in H2

- Eurozone economies appear to be on recovery track with a smaller GDP decline in Q2 after the Q1 collapse and growth turning positive in H2 2009.
- The rebound in IP, improvement in retail sales and trade are lifting Q2 GDP to a smaller decline of around -2% QoQ annualized. GDP is expected to rise around 1% in Q3.
- In the U.K., the improvement in business confidence and stabilization in industrial activity points to a smaller decline in Q2 GDP, around -1% QoQ annualized.
- Earlier, U.K. GDP was revised lower to decline -9.3% QoQ annualized in Q1 2009 (from -7.3% originally), after the -6.1% decline in Q4 2008.

Inflation: Eurozone Headline Inflation Edges Below Zero. Core Falls. U.K. Headline Edges Down

- Eurozone headline inflation edged down to -0.1% YoY in June from 0% in May and 0.6% in March and April. Meanwhile, Eurozone core inflation eased to 1.4% in June. Headline inflation is easing in Germany (0%), France (-0.6%), Italy (0.6%), and Spain (-1%). Favorable base effects, a large output gap, and still weak global growth are likely to keep inflation depressed in the coming months. However, as base effects reverse there will be near-term volatility in headline inflation.
- U.K. headline inflation edged down to 1.8% due to base effects as prices still rose MoM. Core inflation eased to 1.5% YoY. Inflation has risen MoM for five consecutive months and is the highest among the G7 countries as utilities price increases from H2 2008 and stubbornly elevated food prices have kept prices elevated.

Interest Rates: ECB and BoE on Hold. ECB Begins Purchasing Bonds, BoE Almost Finishes Initial Program

- The ECB held rates at their record low 1% at the July 2nd ECB Council meeting after cutting rates by 25bps in May and April. At the press conference, President Trichet refused to say whether the ECB would cut rates even lower. However, we currently expect them to remain on hold through the end of the year unless the economic recovery unravels. Further, the ECB has begun purchasing bonds as part of its €60bn program.
- The BoE again held the bank rate at 0.5% at their July 10th meeting. In addition, the BoE decided to hold the size of their Quantitative Easing program at £125bn after increasing it last by £50bn in May. The bank reported that £112bn in assets, or 90% of the overall program, had been purchased already. Since the pace of purchases seems to have speeded up from the May meeting, the program is likely going to reach its target shortly.

Currency: Dollar Unchanged on Euro, but Falls Against Sterling

- The euro fell a modest -0.6% against the dollar in June after gaining a sharp 6.9% in May. After rallying for three straight months with broad gains in risk appetite and global equities, the euro took a breather during June as investors took profits on stocks.
- The pound sterling gained 1.9% against the dollar in June after surging 9.4% during May. Although the pound was weak against the dollar earlier in the month with the lingering political uncertainties and demand for the dollar by cautious investors, the improvement in financial market sentiment as the month progressed led the sterling to post solid gains for the month.

Japanese Q2 GDP Rebound after Q1 Collapse. Sharp Q2 Rebound in China

Growth: First Positive GDP Growth in Five Quarters in Japan after Record Plunge. Strong Recovery in China

- Japan's GDP appears on track to a sharp rebound in Q2. The fiscal stimulus is boosting production and consumption, while net exports are posting a modest recovery. These points to Q2 GDP rebounding to around 1% QoQ annualized growth. However, consumption and capex remains sluggish, raising concerns about the sustainability of the recovery.
- Japan's Q1 GDP decline was revised up to -3.8% QoQ, -14.2% annualized. From the peak in Q1 2008, the Japanese GDP has declined by -9.1%, compared with average peak-to-trough decline during post-war recessions of just -2%.
- China's economy recovered strongly in Q2, rising 7.9% YoY after slowing to 6.1% in Q1 and 6.8% in Q4 2008. There was significant pickup in investment spending and consumption boosted by the massive fiscal stimulus. However, although external demand stabilized, it remained weak and was the largest drag on GDP growth.
- GDP growth is expected to recover further to around 9% YoY in H2 2009 due to the aggressive fiscal and monetary stimulus. Investment spending and consumption are likely to continue to lead the Chinese economic recovery in the coming quarters, while external demand is expected to improve more gradually as developed economies recover.

Inflation: Japanese Core Prices Ease Further in May. Chinese Inflation Still Negative, But Set to Recover

- Japanese nationwide core inflation (excluding fresh food) fell at its sharpest pace on record, down -1.1% YoY in May after holding at -0.1% in April due to lower energy prices and downward pressure from economic slack. Headline inflation also fell -1.1% YoY after -0.1% in April. The sharp increase in Japan's economic slack and decline in energy prices are likely to keep inflation deep in negative territory over the coming months.
- Chinese consumer prices fell deeper into negative territory during June. Although the decline in food prices has moderated, the decline in non-food prices intensified with excess capacity. However, the fiscal and monetary stimulus should push consumer prices back to positive territory later in the year.

Interest Rates/Currency: BoJ Remains on Hold in July. Credit Growth Remains Strong in China

- The Bank of Japan (BoJ) remained on hold as expected in July, leaving its target overnight call rate unchanged at 0.1%. The BoJ extended the expiration date for its Quantitative Easing and liquidity measures to December.
- In China, the PBC in its Q2 monetary policy meeting cautious about the sustainability of the recovery and indicated that it will continue its “relatively loose” monetary policy. Credit expansion continued in June at an explosive pace, with new loans surging RMB1.5trn taking the H1 total new loans up to a record high of RMB7.4trn.
- The yen fell -0.8% against the dollar in June after gaining 3.5% in May. As the financial crisis eases, the yen is likely to weaken further with rising risk appetite reviving the carry trade.
- The RMB continued to trade flat against the dollar in H1 2009 and early July, around 6.84 RMB/USD after gaining 7% in 2008. In effective exchange rate terms, the RMB fell -1.2% in June after -2.6% in May.

Disclosure:

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