

Prudential International Investments Advisers, LLC.

Global Economic Outlook – March 2009

By John Praveen, Chief Investment Strategist

For Market Commentary Interviews Contact: Lisa Villareal, 973-367-2503/lisa.villareal@prudential.com

Global Summary: Financial Crisis Pushes Global Economy into Recession

John Praveen's Global Economic Outlook – March 2009 sees the global recession continuing in H1 2009 with the developed economies remaining deep in recession and several emerging economies falling into recession as global trade collapsed and labor markets deteriorated. Recent U.S. economic data points to the recession continuing in H1 2009. The sharp loss of momentum in major components during Q4 2008 has increased the downside risk to GDP growth in Q1. In Eurozone, depressed business and consumer confidence, declining leading economic indicators, slowing global growth, falling exports and rising unemployment point to another sharp decline in Q1 GDP after a plunge in Q4. Japan has fallen into the most severe recession since WW-II and the economy is expected to remain deep in recession through late 2009.

Inflation continues to fall in both Developed and Emerging Markets. Headline inflation is likely to fall further below zero, with lower oil prices and favorable base effects.

As the global recession deepened and spread to emerging economies, policy makers responded aggressively with rate cuts, fiscal stimulus, bank rescue plans and other measures to stabilize credit markets and support the global economy. However, these measures are yet to gain traction in halting the growth decline.

	View/ Forecast	Reasons
GDP Growth	<p>U.S., Europe and Japan remain deep in recession during H1 2009</p> <p>Sharply slower growth in Emerging Markets</p>	<ul style="list-style-type: none"> The global recession continues in H1 2009 with the developed economies remaining deep in recession in Q1 and several emerging economies falling into recession as global trade collapsed and labor markets deteriorated. Further, a negative feedback loop between financial market stress and the real economy is also depressing GDP growth. Recent U.S. economic data points to the recession continuing in H1 2009. The loss of momentum in major components (with GDP contracting -6.2%) increases the downside risk to GDP growth in Q1 2009. Labor market remains weak and consumer confidence has fallen to record lows. Business confidence languishes in recessionary territory. In Eurozone, recent economic data has been dismal pointing to the recession continuing in H1 2009. Eurozone business confidence remains near record lows in France, Italy, and Germany. Consumer confidence remains near historically low levels. Depressed business and consumer confidence, declining leading economic indicators, slowing global growth, falling exports and rising unemployment point to another sharp decline in Q1 GDP after a -6% decline in Q4. U.K. growth continues to slow in Q1 due to the significant headwinds to consumer spending, investment activity, and export growth. After the steep -6% annualized decline in Q4 growth, the U.K. economy is set to fall again in Q1 with the tailwinds from aggressive rate cuts and the VAT reduction not sufficient to outweigh the headwinds of the global recession. Japan has fallen into the most severe recession since WW-II and the economy is expected to remain deep in recession through late 2009. Net Exports, the main driver of growth remains very weak in Q1 2009. Decline in IP and capex are likely to accelerate. Consumption spending remains weak. GDP growth is expected to post another double-digit decline in Q1. The deepening global recession and collapse in trade has pushed several emerging economies into recession and sharply slowed growth in others. China's GDP growth is likely to slow to around 7% in H1 2009. India is likely to slow to around 5% in H1 2009. Brazil's GDP is expected to be slower around 1.6% in H1 2009.
Interest Rates & Currencies	ECB, BoE cuts rates in March	<ul style="list-style-type: none"> The ECB cut rates by 50bps to 1.5% in March. Following the -6% plunge in Eurozone Q4 GDP, the ECB is likely to cut rates further closer to zero as well as use other unconventional measures to arrest the decline in Eurozone GDP and stabilize markets. The BoE cut rates in March by 50 bps to 0.5%. The Bank also started implementation of Quantitative Easing through an initial £75bn of asset purchases, financed by the creation of central bank money.
	BoJ restarts QE to ease credit markets	<ul style="list-style-type: none"> The BoJ is expected to keep interest rates at very low levels with the sharp plunge in Q4 GDP growth and bleak outlook for H1 2009. With fresh signs of dislocation in local credit markets, the bank is also likely to pursue Quantitative Easing policy as a means of jump starting the credit markets and supporting the economy. These actions are more likely given the uncertainties in the implementation of fiscal stimulus measures.

Global Outlook

Recession Deepens & Spreads. Deflation Fears. Aggressive Policy Response

Growth: Developed Economies Remain Deep in Recession. Recession Spreads to Emerging Markets as Exports Collapse

- The recession in U.S., Eurozone, U.K. and Japan deepened in Q4 2008 with each posting sharply negative GDP growth. The deepening recession in the developed economies engulfed several emerging economies and sharply slowing GDP in others.
- U.S. GDP fell sharply in Q4, down -6.2% QoQ annualized, -0.8% YoY, with a big decline in consumption and investment spending. Japan's Q4 GDP plunged -12.7% QoQ annualized with a collapse in exports and its knock-on effects on domestic demand.
- The Eurozone economies fell deeper into recession with a collapse in global trade and implosion in domestic demand. Eurozone GDP declined -6% QoQ annualized, -1.3% YoY in Q4. The GDP decline was led by Germany (-8.2%) followed by Italy (-7.2%), France (-4.6%) and Spain (-4%). The U.K. economy contracted -5.9% QoQ annualized in Q4.
- The global recession continues in H1 2009 with the developed economies remaining deep in recession in Q1 and several emerging economies falling into recession as global trade collapsed and labor markets deteriorated. Also, a negative feedback loop between financial market stress and the real economy is further depressing GDP growth.

Inflation: Deflation Fears as Headline Inflation Continues to Fall. Core Follows on Increasing Economic Slack

- Headline inflation continues to fall in both Developed and Emerging Markets. Headline inflation fell in January to -0.2% YoY in the U.S. and 0% in Japan, while continuing to ease in Eurozone to 1.1%. Chinese consumer prices fell to 1% in January. Headline inflation is likely to fall further below zero, with lower oil prices and favorable base effects.
- Core inflation remains elevated, but has begun to decline with rising economic slack as the recession deepens. U.S. core held at 1.7% YoY, while Eurozone and U.K. core were 1.6% YoY and 1.3%, respectively. Japanese core eased to 0% in January.

Interest Rates: Aggressive Rate Cuts and Unconventional Measures with Recession & Deflation Fears

- As the global recession deepened and spread to emerging economies, policy makers responded aggressively with rate cuts, fiscal stimulus, bank rescue plans and other measures to stabilize credit markets and support the global economy. However, these measures are yet to gain traction in halting the growth decline.
- The U.S. Fed left the Funds rate between 0 and 25bps in January and made an open ended commitment to keeping the rates at "exceptionally low levels ... for some time." The Fed also reiterated that it "will employ all available tools to promote the resumption of sustainable economic growth." The Fed is open to purchasing Treasuries to improve credit markets.
- The ECB cut its key rate by 50bps to 1.5% in March as expected, the lowest since the ECB's founding in 1998. Following the -6% plunge in Eurozone Q4 GDP, the ECB is likely to cut rates further and use other unconventional measures to halt the decline in Eurozone GDP and stabilize markets.
- The BoE cut its base rate by 50 bps to 0.5% in March. The Bank began implementation of Quantitative Easing through an initial £75bn of asset purchases, financed by the creation of central bank money.
- The BoJ remained on hold in February at 0.1%. In addition, the BoJ announced measures to ease the credit markets by extending its special lending program and commercial paper purchase program, and detailed its plan for corporate bonds purchase.

Currencies: Dollar Posts Solid Gains in February. Further Dollar Gains Likely Against Most Currencies

- The U.S. dollar posted solid gains in February on expectations that the U.S. will be the first to recover from recession. The dollar was unchanged against the euro, but rose 1.3% against the sterling and 7.4% against the yen. Emerging Markets currencies, especially in Eastern Europe, fell sharply on increased risk aversion, export collapse and concerns about sovereign risk.
- The U.S. dollar is likely to remain strong in H1 against most currencies with elevated risk aversion and weaker growth outlook for Europe and Japan relative to the U.S.

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

USA: U.S. GDP Falls –6 percent in Q4. Recession Continues in H1. Fed Implements Quant Easing

Growth: U.S. GDP Contracts –6% Annualized in Q4. Recession Continues in H1 2009

- The U.S. recession deepened in late 2008 as Q4 GDP plunged –6.2% QoQ annualized, much bigger decline than the –0.5% decline in Q3. The biggest drag on Q4 GDP was consumption spending which fell –4.3% QoQ annualized. Non-residential fixed investment spending tumbled –21% and housing investment extended its decline, down –22.2%. Net exports subtracted –0.5% from GDP growth. Inventories added just 0.2% to Q4 GDP and government spending added 0.3% to growth.
- Recent U.S. economic data points to the recession continuing in H1 2009. The loss of momentum in the major components of demand - consumption, investment spending & housing - in Q4 2008 increases the downside risk to GDP growth in Q1 2009. Further, a negative feedback loop between financial market stress and the real economy is taking a toll on GDP growth.
- Following the –6.2% annualized decline in Q4 GDP, GDP growth is expected to post another –4.8% decline in Q1. GDP growth is expected to show signs of recovery in H2 2009 but the recovery will be muted.

Inflation: Headline Continues to Fall to Zero with Base Effects. Core Inflation Positive but Subdued

- The effects of the credit crisis, falling energy prices, favorable base effects, and economic slack have helped drive headline inflation close to zero and to the edge of deflation in H1 2009.
- The YoY rate of headline inflation edged down to –0.2% in January from –0.1% in December, the weakest since 1954. Headline inflation rose 0.3% MoM after the –0.8% decline in December and –1.7% fall in November.
- Core inflation rose 0.2% MoM in January, but the YoY pace held steady at 1.7% due to base effects. Core PCE eased to 1.6% YoY in January.
- Given the favorable base effects, widening output slack, and oil prices down more than –70% from the peak, headline CPI is likely to stay below 0% in the coming months and fall closer to around –2% by July.

Interest Rates: Fed Holds Interest Rates at 0-25bps range. Fed Undertakes Quantitative Easing

- The Fed left the Funds rate in a range between 0 and 25 bps at the January meeting, and made an open ended commitment to keeping the Funds rate at "exceptionally low levels ... for some time."
- Fed continues its quantitative easing program by targeting liquidity programs through the Term Asset-Backed Securities Loan Facility (TALF), expanding the quantity and duration of their purchases of agency debt and mortgage-backed securities.
- However, after expanding its balance sheet dramatically in Q4 2008, the Federal Reserve let its balance sheet contract marginally as some programs were not renewed.

Currencies: Dollar Continues to Gain. Further Dollar Gains Likely Against Sterling, Euro, Yen

- The U.S. dollar posted solid gains against most currencies in February. The dollar was unchanged against the euro, but rose 1.3% against the pound sterling. The dollar rose 7.4% against the yen as global trade slowed dramatically and the Japanese economy fell off a cliff with exports collapsing. Renewed dollar gains against Emerging Market currencies as risk aversion rises.
- The dollar is likely to remain strong against the major currencies with the U.S. likely to recover from recession ahead of the others. Elevated risk aversion is likely to keep the dollar strong against Emerging Market currencies.

Europe: Eurozone & U.K. GDP Fall Sharply in Q4, Further Decline in Q1. ECB & BoE Cut Rates

Growth: Slowing Global Growth Pulls Eurozone & U.K. Deeper in Recession

- The Eurozone economies fell deeper into recession with a collapse in global trade and implosion in domestic demand. Eurozone GDP declined –6% QoQ annualized, –1.3% YoY in Q4. GDP declined sharply in all major Eurozone economies in Q4, but the decline was especially steep in Germany (–8.2%), followed by Italy (–7.2%), France (–4.8%), and Spain (–4%).
- Depressed business and consumer confidence, declining leading economic indicators, slowing global growth, falling exports and rising unemployment point to another sharp decline in Q1 GDP.
- The U.K. economy contracted –6% QoQ annualized in Q4, after the –2.8% decline in Q3. The YoY pace slowed sharply to –1.9% in Q4 from 0.2% in Q3. U.K. growth continues to slow due to the significant headwinds to consumer spending, investment activity, and export growth.

Inflation: Eurozone Headline Inflation in a Downtrend. Core Falls. U.K. Headline Eases

- Eurozone headline inflation remains in a downtrend, but edged higher in February to 1.2% YoY from 1.1% YoY in January, likely due to stronger oil prices. Meanwhile, Eurozone core inflation fell to 1.6% YoY in January. Headline inflation is down in France (0.8%) and Spain (0.7%), but edged up in Germany (1%) and Italy (1.5%).
- During H1 2009, favorable base effects, slowing global growth, and falling energy & food prices will continue to push headline inflation towards zero and even lower.
- U.K. headline inflation was marginally lower in January to 3% YoY from 3.1% in December. Core inflation actually rose to 1.3% from 1.2%, though the December decline was likely excessive and this rise was a payback.

Interest Rates: Both ECB & BoE Cut Rates in March. BoE Announces Implementation of QE

- The ECB cut its base rate by 50bps to 1.5% in March as expected after remaining on hold at 2% in February. Following the -6% plunge in Eurozone Q4 GDP, the ECB is likely to cut rates by another 50bps by May and use other unconventional measures to halt the decline in Eurozone GDP and stabilize markets.
- The BoE cut UK base rates by 50 bps to 0.5% in March. More importantly, the BoE announced the implementation of Quantitative Easing through the Asset Purchase Facility (APF), by purchasing £75bn of assets financed by an increase in central bank reserves.

Currency: Dollar Gains Further in February. European Depreciation to Slow with Rate Cuts Priced in

- The pound continued to fall against the dollar in February due to the weaker U.K. growth outlook, but the euro was unchanged against the dollar. The euro fell to a low of \$1.25/euro before recovering, while the pound dropped to \$1.43/pound.
- The sterling and euro are likely to remain weak against the dollar in coming months due to the weaker growth outlook in Europe as global trade slows. The pace of currency depreciation should slow due to interest rate cuts being already priced in.

Japan GDP Plunge in Q4, Big Decline in Q1. China Slows Sharply in Q4

Growth: Japan GDP Plunges in Q4 2008. Further Sharp Decline in Q1 2009. Sharp Slowdown in China

- The Japanese economy fell off a cliff in Q4 falling into the worst recession since WW-II. GDP plunged -12.7% QoQ annualized, -4.6% YoY in Q4, the worst quarterly decline since Q1 1974, led by a -45% annualized plunge in exports.
- Japan's recession is likely to continue well into H2 2009. GDP growth is on track to another double-digit decline in Q1 with exports plunging -46% in January and Q1 IP set to decline -20% QoQ. Consumption spending remains very weak.
- China's growth slowed sharply to 6.8% YoY in Q4 from 9% in Q3, pushing the 2008 average GDP growth down to 9% in 2008 after 13% in 2007 as Chinese exports collapsed with global economy in recession.
- China's GDP growth in Q1 is likely to remain weak as developed economies remain deep in recession, dragging down China's exports. However, ongoing fiscal stimulus and aggressive PBC rate cuts should support Chinese growth.

Inflation: Japanese Core Prices Ease Further in January. Chinese Inflation Continues to Moderate

- Japanese headline inflation continued to fall with both core and headline down to 0% in January. Nationwide core inflation fell to 0% YoY from 0.2% in December, while nationwide headline inflation fell to 0% from 0.4% in December.
- The sharp increase in Japan's economic slack and decline in energy prices is filtering further to prices in the consumer basket. This is likely to result in consumer prices declining on a YoY basis over the coming months.
- Chinese inflation continued to ease, down to 1% in January 2009 from 1.2% in December and a 12-year high of 8.7% in February 2008 due to favorable base effects. Excess capacity has emerged as the key deflationary force after the exports collapsed in late 2008.

Interest Rates/Currency: BoJ on Hold in February. PBC Eases Aggressively to Support Growth

- The BoJ remained on hold in February after lowering its target overnight call rate to 0.1% from 0.3% in December. In addition, the BoJ announced measures to ease the credit markets by extending its special lending program and commercial paper purchase program, and detailed its plan for corporate bonds purchase.
- The PBC has remained on hold in the first two months of 2009 after undertaking a series of policy measures to ease the tight credit market conditions by easing the availability and cost of credit.

- The yen appreciated sharply in January, gaining 1% against the dollar after appreciating 23% in 2008. However, much weaker-than-expected macro data led to a sharp depreciation in February. Once the financial crisis eases, the yen is likely to weaken further due to Japan's weak growth outlook.
- RMB continues to trade flat against the dollar in January-February around 6.84 RMB/USD after gaining 7% in 2008. The RMB continued to appreciate against a basket of currencies in January, up 0.8% in effective exchange rate terms, after gaining 12.9% in 2008, as RMB appreciated 9.2% against the euro the past two months.

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