

Prudential International Investments Advisers, LLC.

Global Economic Outlook – May 2009

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Global Summary: Green Shoots Point to H2 Recovery After Sharp Q1 Decline

John Praveen's Global Economic Outlook – May 2009 sees the global economy continuing to show signs of improvement in April even though the U.S., Europe and Japan and many emerging economies remained deep in recession in Q1. The green shoots of recovery which first started appearing on the bleak macro landscape in March continued to spread in April across both developed and emerging economies. Leading Economic Indicators, business and consumer confidence indicators and actual activity data continue to improve in April suggesting that the pace of GDP decline in Q2 is likely to slow (or the second derivative is improving), raising confidence that the global economy is on track to recover in H2 2009.

Inflation continues to fall in both Developed and Emerging Markets. Headline inflation is already negative in the U.S., Japan and China and is likely to fall further below zero with rising slack and favorable base effects.

With the ongoing global recession, policy makers continue to keep interest rates low and have stepped up the Quantitative Easing measures that were initiated earlier. The effects of fiscal stimulus, bank rescue plans, and other measures to stabilize credit markets and support the global economy are slowly showing signs of gaining traction in halting the growth decline.

Key Changes in Macro Views

	View/ Forecast	Reasons
GDP Growth	<p>U.S., Europe and Japan remain deep in recession in Q1 2009</p> <p>However, economic data showing signs of recovery in H2</p> <p>Signs of recovery in China</p>	<ul style="list-style-type: none"> Several green shoots of recovery are appearing on the global economic landscape even though the U.S., Europe, Japan, and many emerging economies remained deep in recession in Q1. Leading Economic Indicators, business and consumer confidence indicators continue to improve suggesting that the pace of GDP declines is slowing and that global economy is on track to recover in H2 2009. In the U.S., while the pace of Q1 GDP decline at -6.1% was similar to the -6.3% decline in Q4, the composition of GDP (inventory liquidation and improved consumption) is positive for Q2 GDP outlook. GDP growth is expected to post a much smaller -0.5% decline in Q2 and remains on track for positive growth in H2 2009 but the recovery is likely to be muted. The Eurozone GDP decline accelerated as Germany (-10%) and Spain (over -7%) plunged deeper into recession. German exports continue to plunge, production is in a freefall and unemployment is rising. Spain is sinking deeper into recession with the weakest housing and labor markets in Europe. French and Italian GDP are forecast to decline over -6% in Q1. Japan's economic outlook remains bleak and in the words of the BoJ "economic conditions have deteriorated significantly and are likely to continue deteriorating for the time being." Japan's GDP is on track to another double-digit decline in Q1 after plunging -12.1% QoQ annualized in Q4 2008. In April, the Aso government announced a new fiscal stimulus package of ¥57trn with ¥15trn worth of real spending. The Chinese government has moved aggressively in implementing the stimulus package to cushion the economic slowdown. There are some signs of stabilization in economic data, though China's exports and private investment spending continue to be pressured by the bleak global growth outlook in Q1 2009. GDP growth is expected to recover in late H1 2009 as the aggressive fiscal and monetary stimulus boosts domestic demand.
Inflation	<p>Further decline in headline inflation with growing slack</p>	<ul style="list-style-type: none"> Headline inflation continues to trend lower into negative territory in the U.S. and Japan and close to zero in Eurozone. Headline inflation is likely to fall further in coming months with rising slack and favorable base effects. Core inflation remains elevated, but has begun to decline with rising economic slack as the recession deepens.
Interest Rates	<p>ECB starts QE Lite</p>	<ul style="list-style-type: none"> The ECB cut rates by 25bps to 1% at the May meeting as expected. The ECB also took the first step towards Quantitative Easing by agreeing to purchase "around €60bn" of euro-denominated covered bonds. The Bank of England expanded the target of their Quantitative Easing program by £50bn to £125bn.

Global Outlook

Sharp Decline in Q1 GDP But Green Shoots Point to H2 Recovery

Growth: Major Economies Post Sharp Decline in Q1 GDP. However, Initial Signs of Recovery Emerge

- The global economy is showing the first signs of improvement in March-April even though the U.S., Europe, Japan and many emerging economies remained deep in recession in Q1. Several green shoots of recovery are appearing around the globe.
- U.S. GDP declined -6.1% QoQ annualized in Q1 2009 after a -6.3% decline in Q4 2008. Business investment spending was the biggest drag on Q1 GDP, subtracting -4.7%. Inventories liquidation shaved -2.8% off Q1 GDP. However, consumption spending reversed in Q1, rising 2.2% QoQ annualized. The composition of Q1 GDP is positive for Q2 outlook.
- Eurozone GDP is on track for an even bigger decline in Q1, over -7% annualized, with German GDP on track to plunge over -10%, Spanish GDP set to decline over -7%, French and Italian GDP are forecast to decline over -6% in Q1. Eurozone business and consumer confidence have shown modest improvement. U.K. GDP declined -7.4% QoQ annualized in Q1 2009.
- Japan's GDP is on track to another double-digit decline in Q1 after plunging -12.1% QoQ annualized decline in Q4 2008. China's economy slowed further to 6.1% YoY in Q1. Depressed external demand remained as the biggest drag on Q1 GDP growth.
- Leading Economic Indicators, and business and consumer confidence indicators continue to improve suggesting that GDP decline in Q2 is likely to be less negative, fuelling optimism that the global economy bottomed in H1 and remains on track to recover in H2 2009.

Inflation: Headline Inflation Continues to Fall. Core Declines on Increasing Economic Slack, But Still Elevated

- Headline inflation continues to fall in the major economies, down to -0.4% YoY in the U.S., -0.3% in Japan, 0.6% in Eurozone, 2.9% in U.K., and -1.5% in China. Headline inflation is likely to fall further in coming months with rising slack and favorable base effects.
- Core inflation is also easing. U.S. core inflation held at 1.8% YoY, up 0.2% MoM. Eurozone core inflation eased to 1.5% YoY in March. Japanese Nationwide core inflation fell -0.1% in March, the first negative reading since September 2007.

Interest Rates: Fed, BoE & BoJ Continue Quantitative Easing. ECB starts Quantitative Easing Lite

- The Federal Reserve continued to hold the Funds rate in a range between 0 and 25bps at the April meeting and reiterated their open-ended commitment to keeping the Funds rate at "exceptionally low levels ... for some time." The Fed made no change to its asset purchase plans to buy up to \$1.75 trillion of agency debt, agency MBS, and Treasury securities.
- The ECB cut rates by 25bps to 1% at the May meeting as expected. The ECB also took the first step towards Quantitative Easing by agreeing to purchase "around €60bn" of euro-denominated covered bonds. President Trichet also announced a 12-month refinancing auction to complement its 3- and 6-months auctions.
- The Bank of England left rates unchanged in May after last cutting the Bank Rate by 50bps to 0.5% in March. Further, the BoE expanded the target of their Quantitative Easing program by £50bn to £125bn.
- The BoJ left its target overnight call rate unchanged at 0.1% on April 30, and maintained its bleak assessment of the economy. In March, the BoJ increased its purchase of long-term JGBs to further stabilize the financial markets.

Currencies: Dollar Mixed in April. Likely to Remain Strong in Coming Months Against Most Currencies

- The dollar was mostly unchanged against the euro in April, but fell -3.1% against the pound sterling, and edged down -0.3% against the yen. The dollar effective exchange rate fell -1.9% in April after falling -1.6% in March. Most Emerging Market currencies rose in April with declining risk aversion as equity markets rallied.
- The U.S. dollar is likely to remain strong in the near-term against most currencies with still elevated risk aversion and weaker growth outlook for Europe and Japan relative to the U.S.

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

USA: Big GDP Decline in Q1, But Composition Encouraging for Q2 GDP. Fed Sees Improvement

Growth: U.S. GDP Contracts -6.1% Annualized in Q1. GDP Composition Encouraging for Q2 GDP Outlook

- U.S. GDP declined -6.1% QoQ annualized in Q1 2009 according to the advance estimate, after a -6.3% decline in Q4 2008. The YoY pace of GDP growth decelerated to -2.6% in Q1 from -0.8% in Q4. The two GDP declines of above -6% over the past two quarters have been the worst six month period for the U.S. economy since 1957-58. Peak-to-trough, real GDP has now fallen -3.3%.
- Business investment spending was the biggest drag on Q1 GDP. Non-residential fixed investment spending sunk -37.9% QoQ annualized and subtracted -4.7% from Q1 GDP. Inventories fell -\$104bn shaving -2.8% off Q1 GDP. Government spending surprisingly declined -3.9% in Q1, after growing 1.3% in Q4, and subtracted -0.8% from Q1 growth. On the positive side, consumption spending reversed in Q1, rising 2.2% QoQ annualized, with the YoY rate moderating to -1.2%.
- While the pace of Q1 GDP was similar to the -6.3% decline in Q4, the composition of GDP (inventory liquidation and improved consumption) was more reassuring for the Q2 outlook. Further, Q1 GDP likely to be revised to a smaller decline, around -5%.

Inflation: Headline Dips Below Zero, But Core Remains Steady

- Consumer prices in the U.S. fell in March with easing energy prices. Headline inflation fell -0.1% MoM after rising 0.4% in February and 0.3% in January. The YoY rate eased to -0.4% from 0.1% in February, the weakest since 1954.
- The effects of the credit crisis, depressed energy prices, favorable base effects, and big output slack have pushed headline inflation below zero, and is likely to decline further to around -2% by July.
- Core inflation held at 1.8% YoY, but again rose 0.2% MoM with base effects holding the YoY rate steady. Core CPI rose 1.5% QoQ annualized in Q1 2009, after having shrunk to 0.6% in Q4 2008. This pace is consistent with price stability and has helped alleviate some fears of deflation. Core PCE inflation held at 1.8% YoY in March.

Interest Rates: Fed Holds Rates and Quantitative Easing Targets in April, But Sees Improvement

- The Federal Reserve continued to hold the Funds rate in a range between 0 and 25bps at the April meeting and reiterated their open-ended commitment to keeping the Funds rate at "exceptionally low levels ... for some time."
- The Fed expressed some satisfaction that recent data indicates that the pace of the economic contraction has slowed. However, the Fed made no change to its asset purchase plans through which it seeks "to provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets". In March, the Fed announced that it will purchase a total of up to \$1.75 trillion of agency debt, agency MBS, and Treasury securities.
- The Fed is expected to continue to hold rates in this range the rest of the year and continue to purchase assets as part of its QE program.

Currencies: Dollar Unchanged on Euro, Yen, Weakens Against Sterling

- The U.S. dollar was mostly unchanged against the yen and euro in April, but the sterling strengthened (3.2% against the dollar) with confidence in the BoE's QE program. Emerging Markets currencies, especially in Eastern Europe, rose sharply for the second straight month with the decline in risk aversion.
- Despite the more aggressive monetary policy stance, the U.S. dollar is likely to remain strong in the near-term against most currencies with more robust foreign demand for U.S. bonds due to still elevated risk aversion and bonds supported by Treasury buying as part of QE.

Europe: Eurozone & U.K. GDP Decline Sharply in Q1. ECB Cuts Rates, BoE Expands Quant Easing

Growth: Even Sharper Decline in Eurozone GDP in Q1 after Q4 Plunge

- In Eurozone, recent economic data has been dismal pointing to the recession continuing in H1. Eurozone leading economic indicators (LEI) were down -2.6% on a 3m/3m basis in January, still declining but better than in December. Eurozone business and consumer confidence have shown some improvement, but remain near record lows.

- Eurozone IP is off -18.4% YoY, falling on average -2.6% per month in Q1. Still weak economic activity in the Eurozone's main trading partners will likely keep the trade deficit wide and subtract from GDP growth.
- Eurozone GDP is on track for an even bigger decline in Q1, over -7% annualized, with German GDP decline accelerating to plunge over -10%, Spanish GDP on track to decline over -7%, French and Italian GDP forecast to decline over -6% in Q1.
- The U.K. economy contracted -7.4% QoQ annualized in Q1 2009, after the -6.1% decline in Q4. This was the worst decline since Q3 1979. The YoY pace slowed sharply to -4.1% in Q1 from -2% in Q4.

Inflation: Eurozone Headline Inflation Holds at Record Low. Core Falls. U.K. Headline Eases

- Eurozone headline inflation held at the record low of 0.6% YoY in April, after 1.2% in February and 1.1% in January. Excluding energy, inflation eased to 1.6% in March, but rose 0.5% MoM. Headline inflation is down in France (0.3%), Italy (1.1%), and Spain (-0.1%), but rose in Germany (0.7%). Eurozone core inflation eased to 1.5% YoY in March from 1.7% in February.
- Through July, favorable base effects, slowing global growth, and weak energy & food prices will continue to push headline inflation towards zero and even lower.
- U.K. headline inflation eased to 2.9% YoY in March after rising 3.2% in February when the Sterling depreciated. Inflation has risen MoM for two consecutive months and is the highest among G7 countries as utilities price increases from H2 2008 and stubbornly elevated food prices have kept prices elevated.

Interest Rates: ECB Cuts Rates in May, Starts Quantitative Easing Lite. BoE Expands Quantitative Easing

- The ECB cut rates by 25bps to 1% at the May meeting as expected. The ECB also took the first step towards Quantitative Easing by agreeing to purchase "around €60bn" of euro-denominated covered bonds. Covered bonds are usually backed by mortgage loans and public debt, including infrastructure finance. As a result, the ECB decision could help banks refinance additional public sector spending and mortgages without the ECB getting into the problems of having to buy public sector bonds outright.
- ECB President Trichet also announced a 12-month refinancing auction to complement its 3- and 6-months auctions.
- The Bank of England left rates unchanged in May after last cutting the Bank Rate by 50bps to 0.5% in March.
- Further, the BoE expanded the target of their Quantitative Easing program by £50bn to £125bn. The BoE expects that it will take an additional 3 months to complete their QE program.

Currency: Dollar Unchanged on Euro, but Falls Against Sterling

- The euro fell -0.2% against the dollar after rising 4.6% in March. Since the end of 2008, the euro has been quite volatile against the dollar, with little trend in one direction or another.
- The pound sterling rose 3.2% against the dollar, mostly on news that the QE program was continuing at a solid pace. The pound was quite volatile in April, rallying to near \$1.50 before easing after the Q1 GDP was weaker than anticipated.

Sharp Decline in Japan's Q1 GDP after Q4 Plunge. Signs of Recovery in China

Growth: Sharp GDP Decline in Japan after Q4 Plunge. Largest Ever Fiscal Stimulus. Signs of Recovery in China

- Japan's GDP is likely to have declined over -12% QoQ annualized in Q1 after plunging -12.1% in Q4 2008. The Q4 decline was the worst quarterly decline since Q1 1974, led by a -45% QoQ annualized plunge in exports.
- The key drags on Japan's growth are net exports and falling production. Consumption also remains weak due to poor labor market conditions. The proposed new fiscal stimulus is likely to provide some support to the economy.
- China's economy slowed further to 6.1% YoY in Q1, due to the global recession and the high base effect. Earlier, GDP slowed sharply to 6.8% in Q4 2008. Depressed external demand remained as the biggest drag in Q1 GDP growth.
- However, there are some signs of recovery in China, with improvement in business confidence, loan growth, and IP. Growth expected to recover to around 7% in Q2 and further to 8.8% in H2 with aggressive fiscal and monetary stimulus.

Inflation: Japanese Core Prices Ease Further in March. Chinese Inflation Remained Negative

- Japanese Nationwide core inflation fell -0.1% in March, the first negative reading since September 2007, while headline inflation turned further negative, falling -0.3% YoY.
- The sharp increase in Japan's economic slack and decline in energy prices is percolating into other prices in the consumer basket. This is likely to result in consumer prices declining on YoY basis over the coming months.

- Chinese consumer prices fell -1.5% YoY in April after declining -1.2% in March, the first negative reading since 2002. The YoY decline in consumer prices, especially the -1.5% decline in non-food prices has raised deflation fears. The government is likely to introduce more pro-growth measures to fight the deflation fears.

Interest Rates/Currency: BoJ on Hold in April. Continues Implementing Q.E. Explosive Credit Growth in China

- The BoJ left its target overnight call rate unchanged at 0.1% on April 30, and maintained its bleak assessment of the economy. In March, the BoJ increased its purchase of long-term JGBs to further stabilize the financial markets.
- The Peoples Bank of China (PBC) remained on hold in early 2009 after undertaking a series of policy measures in late 2008 to unfreeze the tight credit market conditions. Chinese banks increased the supply of new loans significantly in Q1 to finance the massive fiscal stimulus projects and to boost liquidity.
- The yen gained a modest 0.3% against the dollar in April after depreciating sharply by -1.4% and -7.8% in the prior two months. As the financial crisis eases, the yen is likely to weaken further due to Japan's weak growth outlook.
- RMB continued to trade flat against the dollar during Q1 2009, around 6.84 RMB/USD after gaining 7% in 2008. However, in effective exchange rate terms, RMB continued to appreciate 1.7% QoQ in Q1 after surging 7.3% in Q4 due to the currency's appreciation against the euro and yen.

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