

March 2013

Global Economic Outlook

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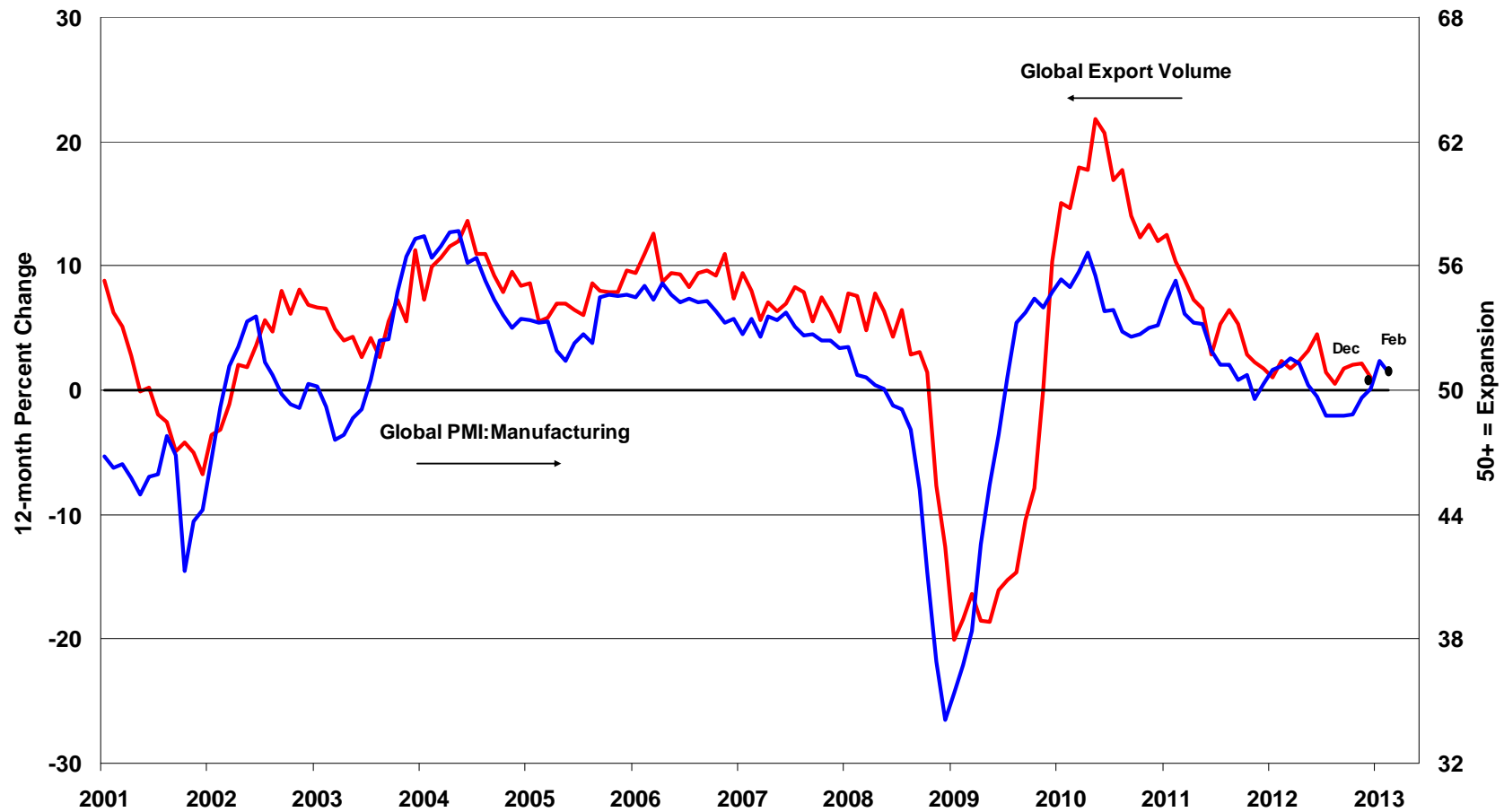
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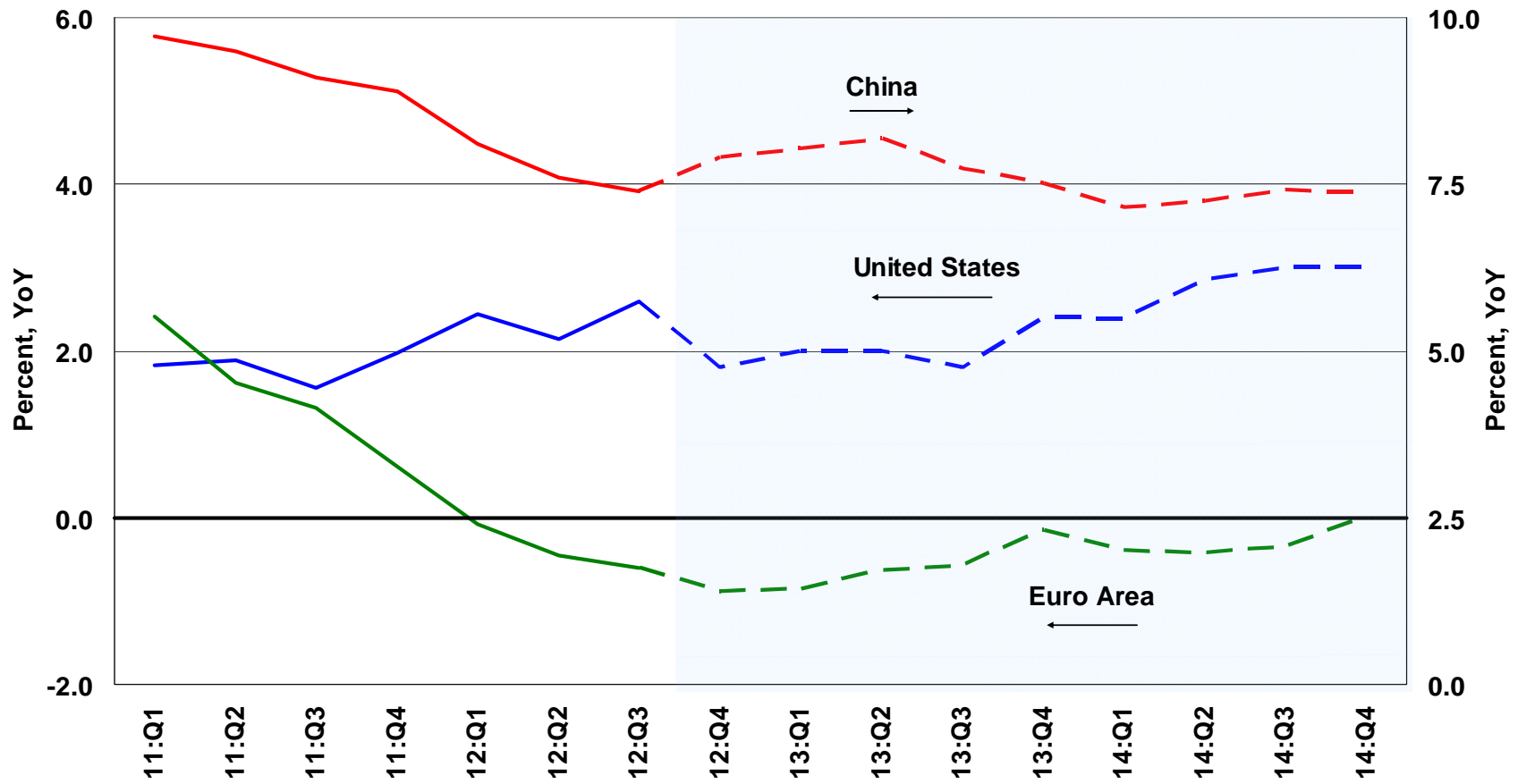
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Global Growth Indicators



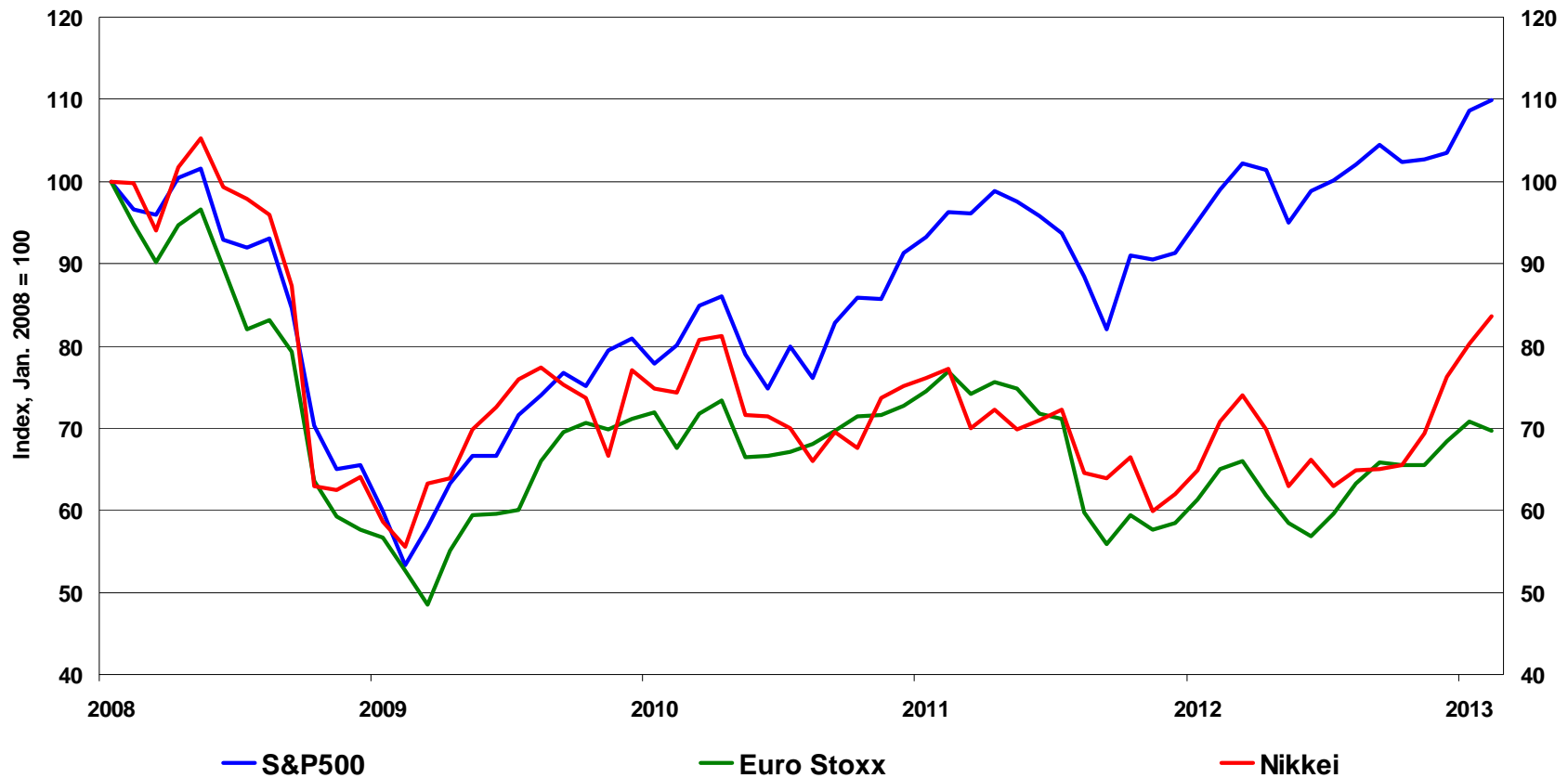
Sources: Netherlands Bureau for Economic Policy Analysis, Markit, and Citi Research.

Real GDP Growth



Source: Citi Research.

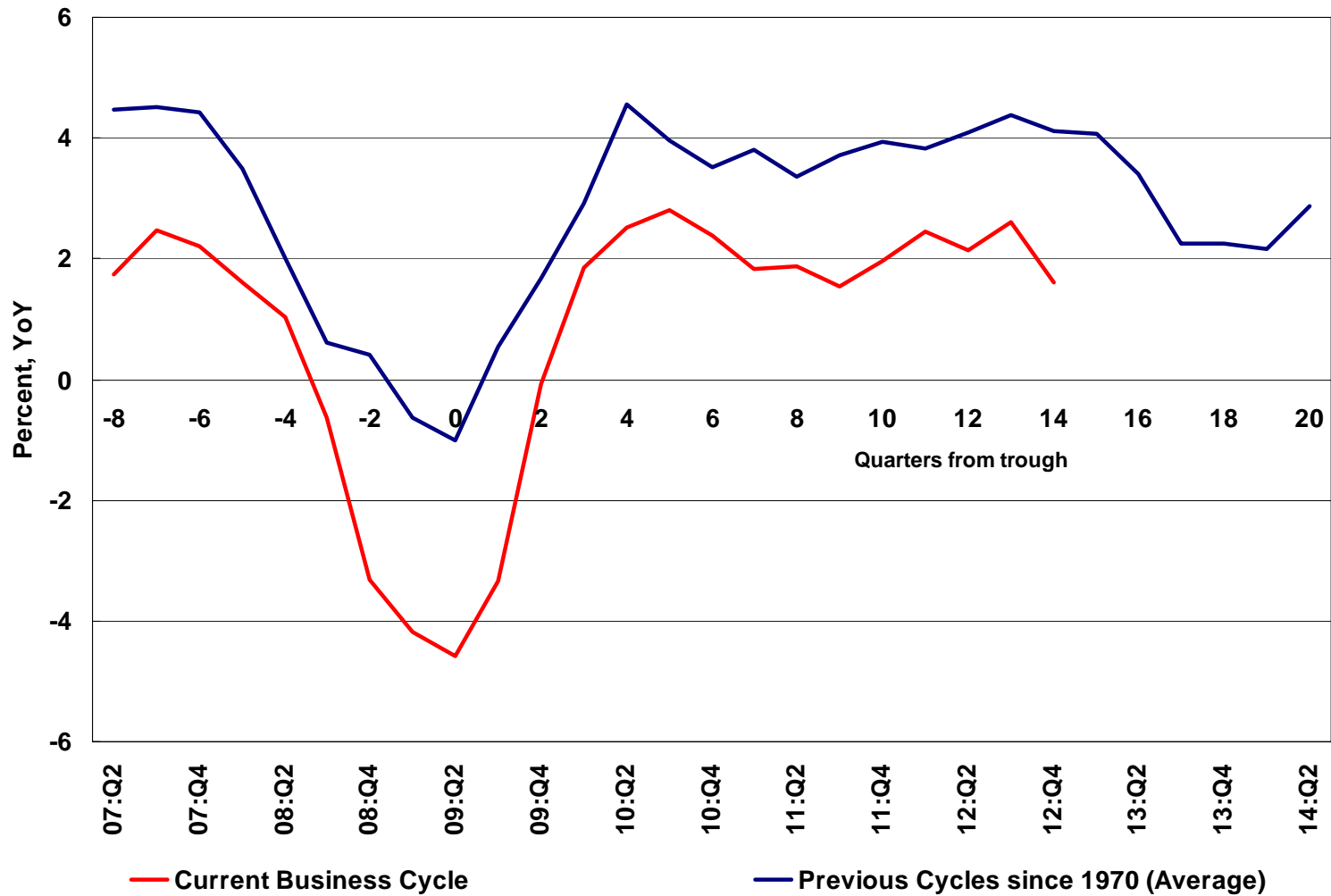
Global Equity Markets



Sources: Haver Analytics and Citi Research.

The United States

U.S. Real GDP Growth



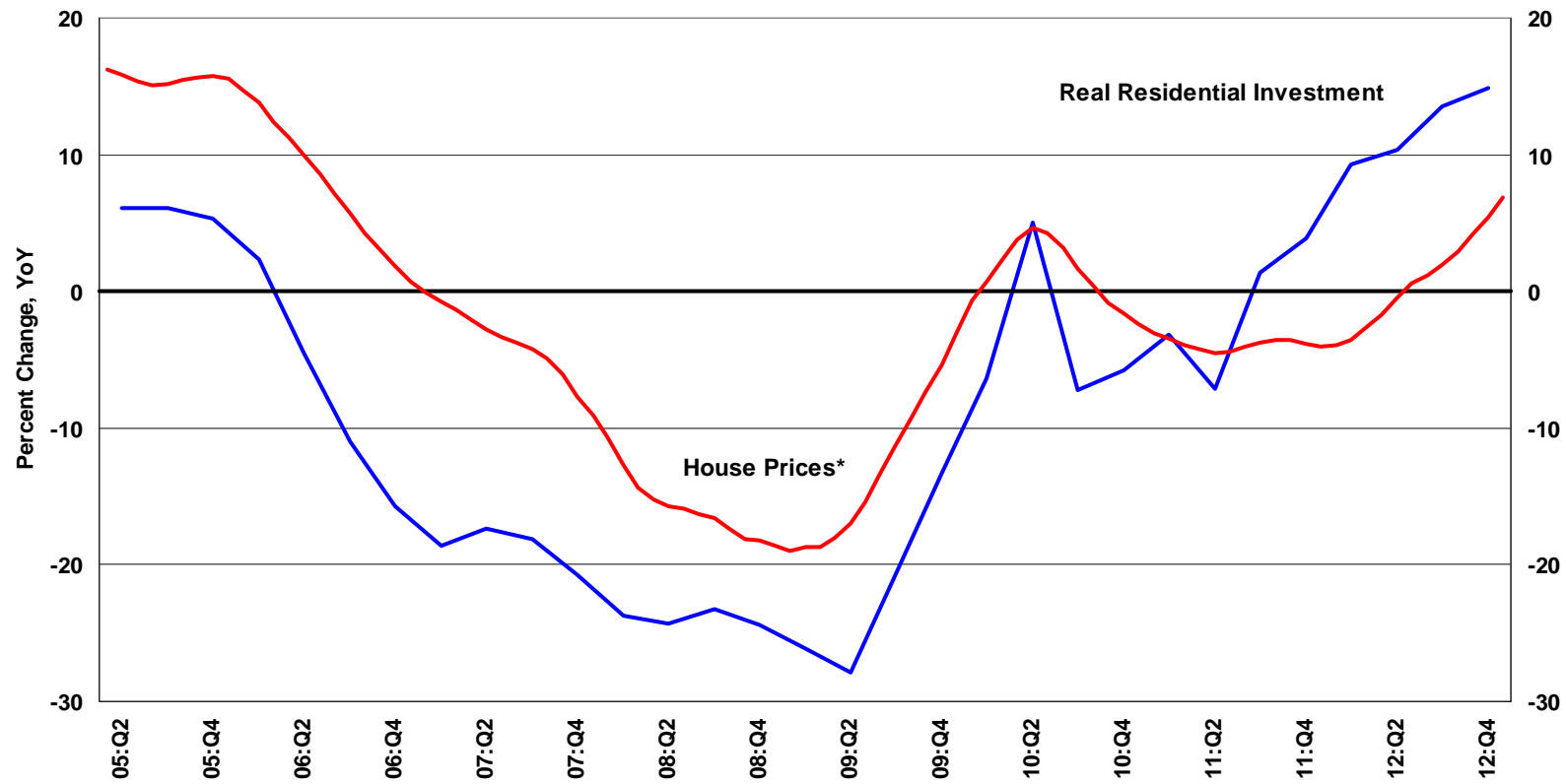
Sources: Bureau of Economic Analysis and Citi Research.

What Explains the Disappointing U.S. Recovery?

- The headwinds restraining *demand*—particularly consumer spending—proved stronger than most observers expected.
 - Stresses in the housing market.
 - Balance sheet deleveraging by households.
 - Credit availability, especially for households.
 - Severe labor market weakness.

- The good news is that many of these headwinds are now diminishing.

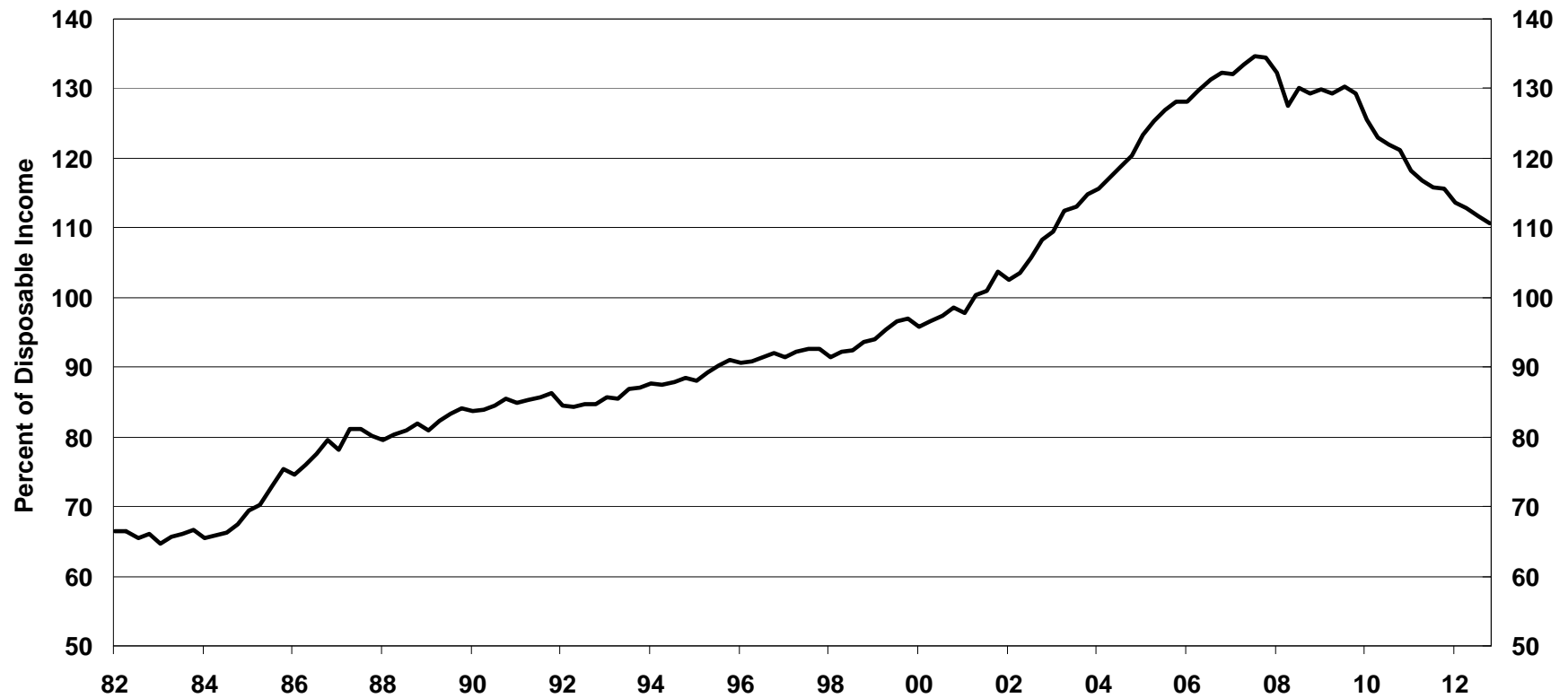
U.S. Housing Market



*S&P/Case-Shiller Composite 20 Index.

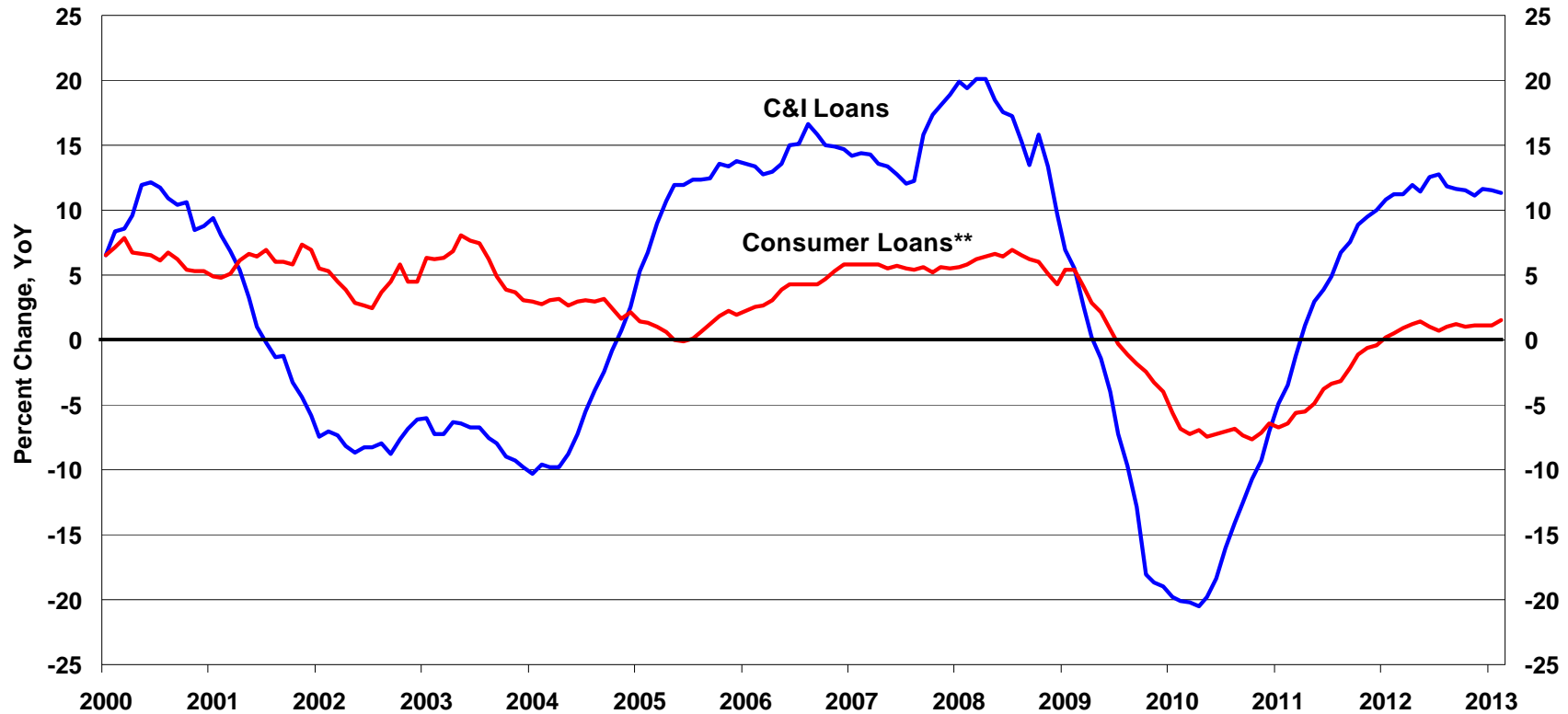
Sources: Bureau of Economic Analysis, Standard and Poor's, and Citi Research.

U.S. Household Debt



Sources: Federal Reserve Board and Citi Research.

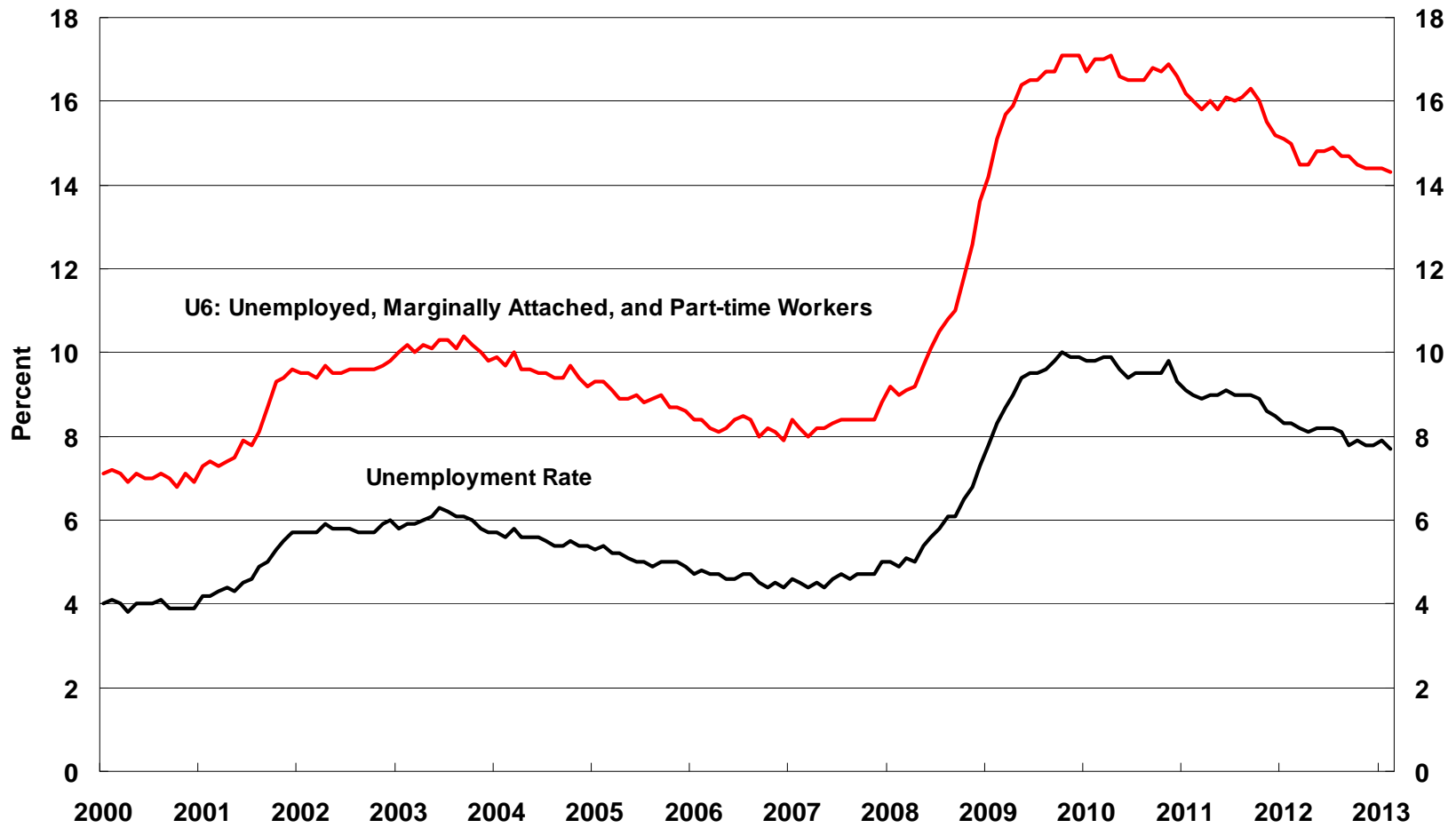
Bank Lending*



*All commercial banks; break-adjusted. **Non-mortgage loans.

Sources: Federal Reserve Board and Citi Research.

Labor Market Conditions

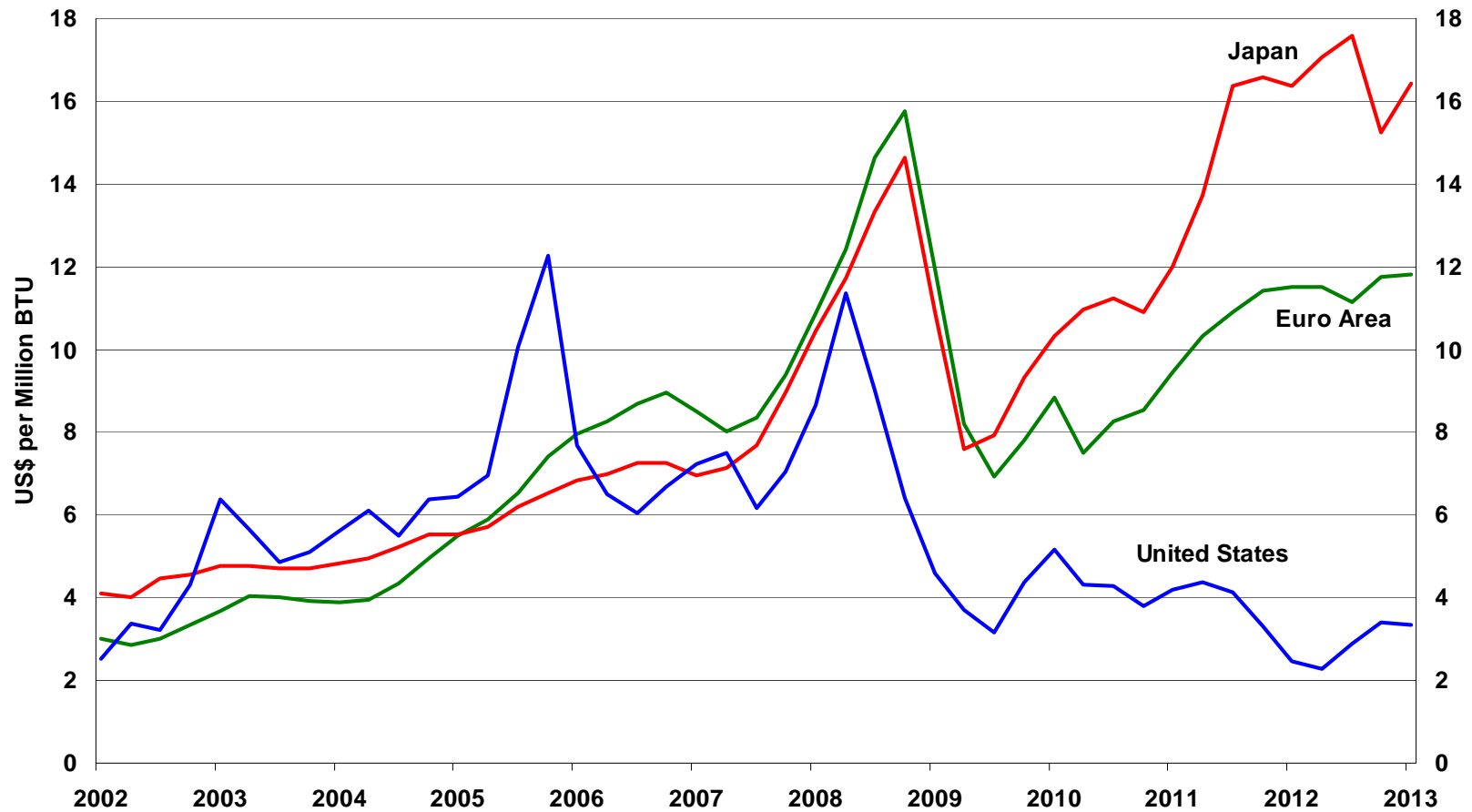


Source: Bureau of Labor Statistics.

Corporate Sector

- Corporates are in strong financial and competitive position.
- But firms are constrained by
 - *Economic Uncertainty*: Aggregate demand has been soft—firms want some confidence that there is demand for increased production.
 - *Policy Uncertainty*:
 - Regulatory Structure?
 - Level of taxes and features of the tax structure?
 - Outlook for fiscal policy?

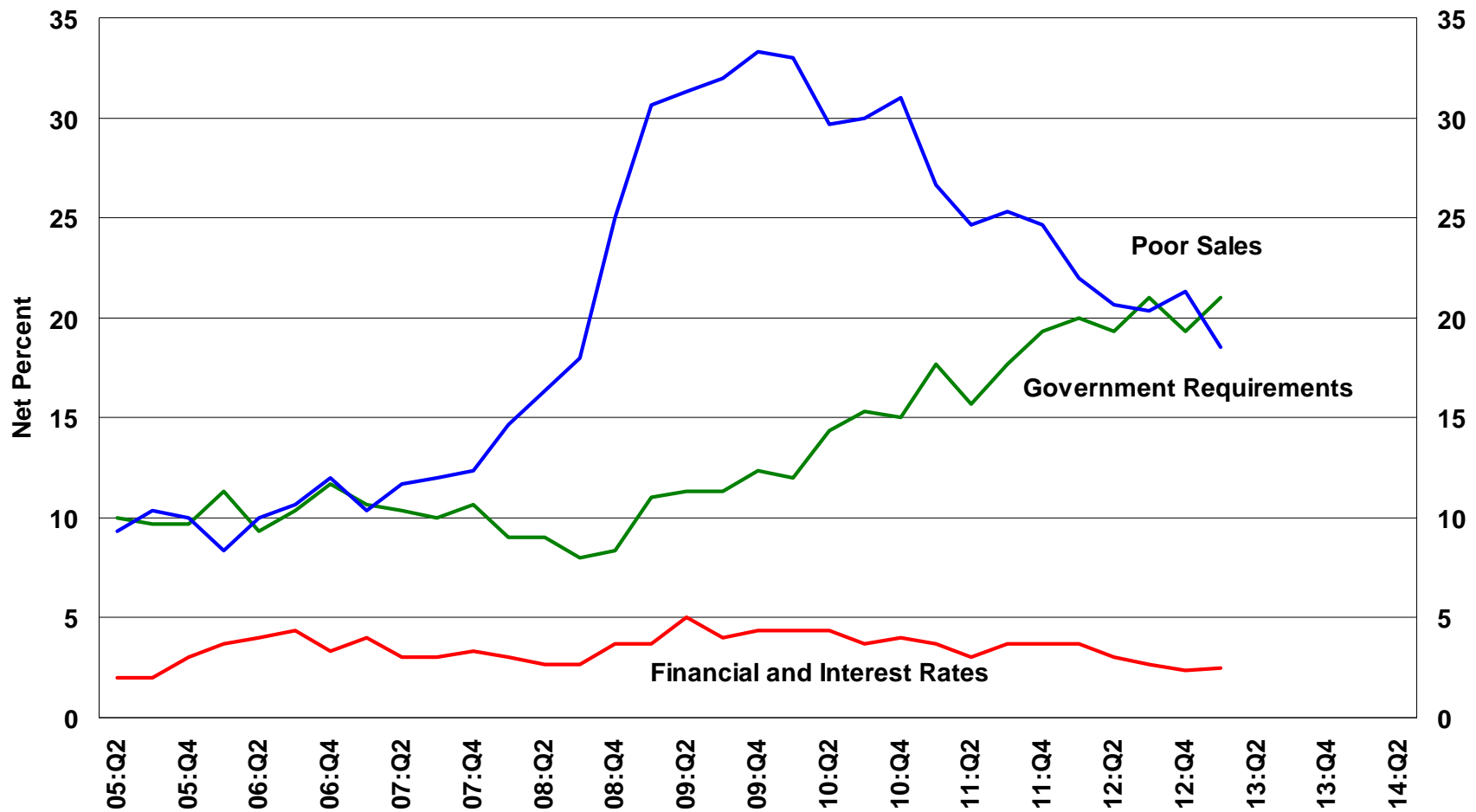
Natural Gas Prices – A Revolution



Note: 2013:Q1 data are for January and February.

Sources: World Bank and Citi Research.

U.S. Small Business Sentiment: Most Important Problem



Note: 2013:Q1 data are for January and February.

Source: National Federation of Independent Business.

Status of Fiscal Negotiations

- Fiscal cliff avoided—but *just barely*.
 - Increased tax rates for high-income earners.
 - Payroll tax cut expires.
 - . . . *These measures will exert roughly 1% of drag in 2013.*

- Sets up further debates: Debt Ceiling, Continuing Resolution, and Sequester.
 - *Sequester will subtract (as much as) another 0.5% from growth this year.*

- Much more needs to be done to address entitlements and debt sustainability!

Trajectory of QE3: If the Economy Picks Up in H2. . .

- September 2013: Reduce pace of purchases (e.g., to \$50 billion per month).
 - *Economy*: Sustained 200,000+ payrolls
Supportive wealth effects from housing and equities
 - *Communication*: Hints in July HH testimony
Stronger signaling in August minutes

- April/May 2014: End QE3.
 - *Economy*: Growth somewhat over 3 percent
Mounting concerns about “overheating” in asset markets
 - *Communication*: Broadly as above--February HH testimony and March minutes

- Fall 2014: Cease reinvestment of maturing securities.

- Mid-2015: Start hiking policy rates.
 - *Economy*: Unemployment rate at or below 6.5 percent
Inflation still at or below 2 percent--not a pressing concern
 - *Communication*: Likely to emphasize that rate hikes will be gradual

- Fall 2015: Begin selling securities (e.g., \$200 billion per year).

U.S. Economic Outlook

- Working hypothesis is that the underlying engine of growth is still solid:
 - Potential growth at 2¼ to 2½ percent annually.
 - Output gap roughly 4 to 4½ percent of GDP.

- Consumer sector is healing.

- Key question: When will corporate confidence recover?

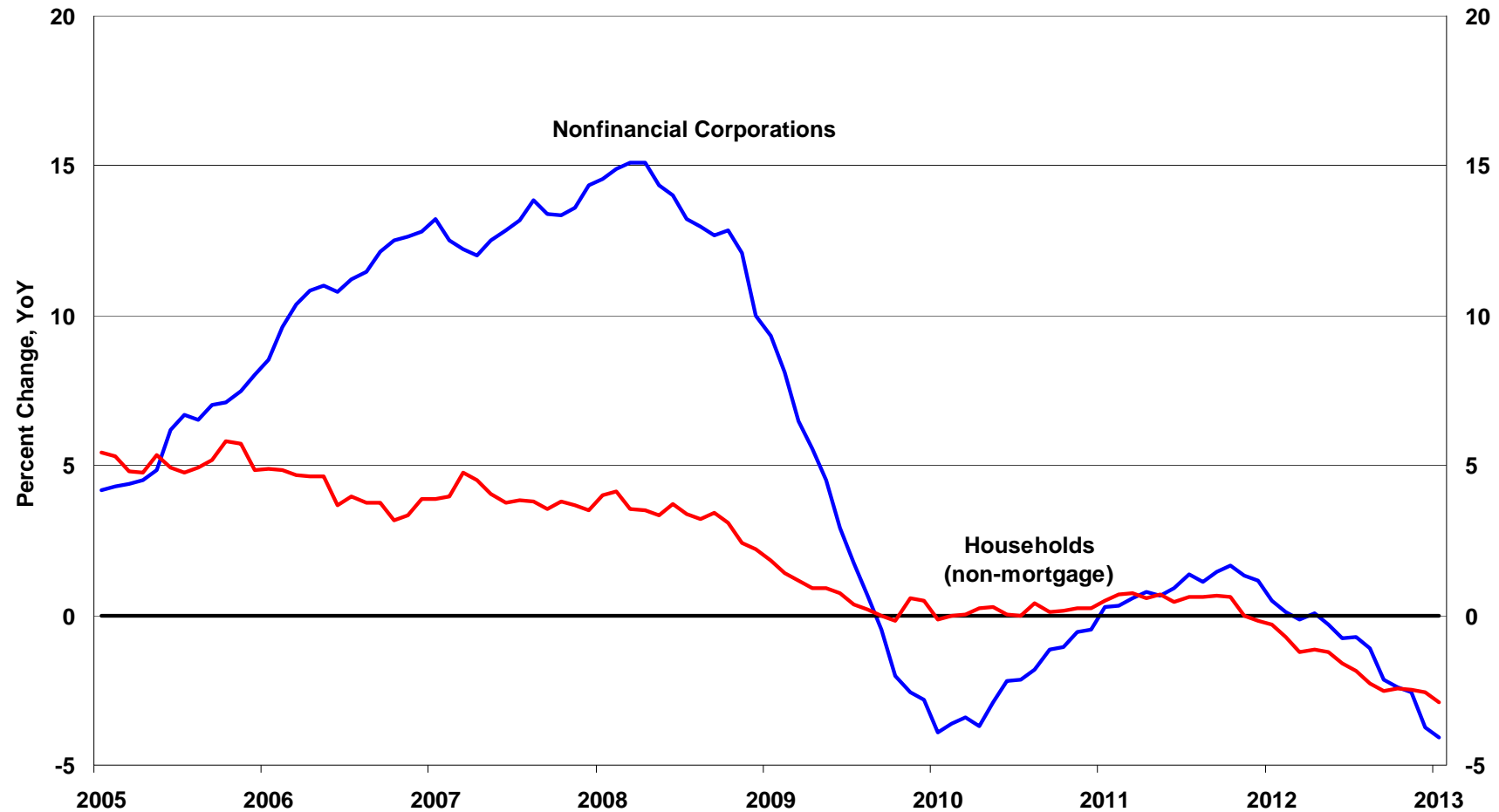
- Debt ceiling—and fiscal uncertainties more generally—remain major risks.

Europe

Euro-Area Policy Challenges: Overview

- *Acute Challenges.* Financial stability risks and other problems that could erupt into crisis:
 - Greek exit.
 - Fiscal funding for Spain and Italy.
 - Banking sector stresses: Liquidity.
... *Recent policy actions very helpful.*
- *Chronic Challenges.* Deep problems that left unaddressed could lead to disruptions over time:
 - Growth/competitiveness imbalances.
 - Fiscal imbalances—debt sustainability.
 - Bank capitalization.
 - Lack of necessary surveillance and crisis management architecture.

Euro-Area Bank Lending



Note: Loans to households adjusted for methodological changes in June 2010.

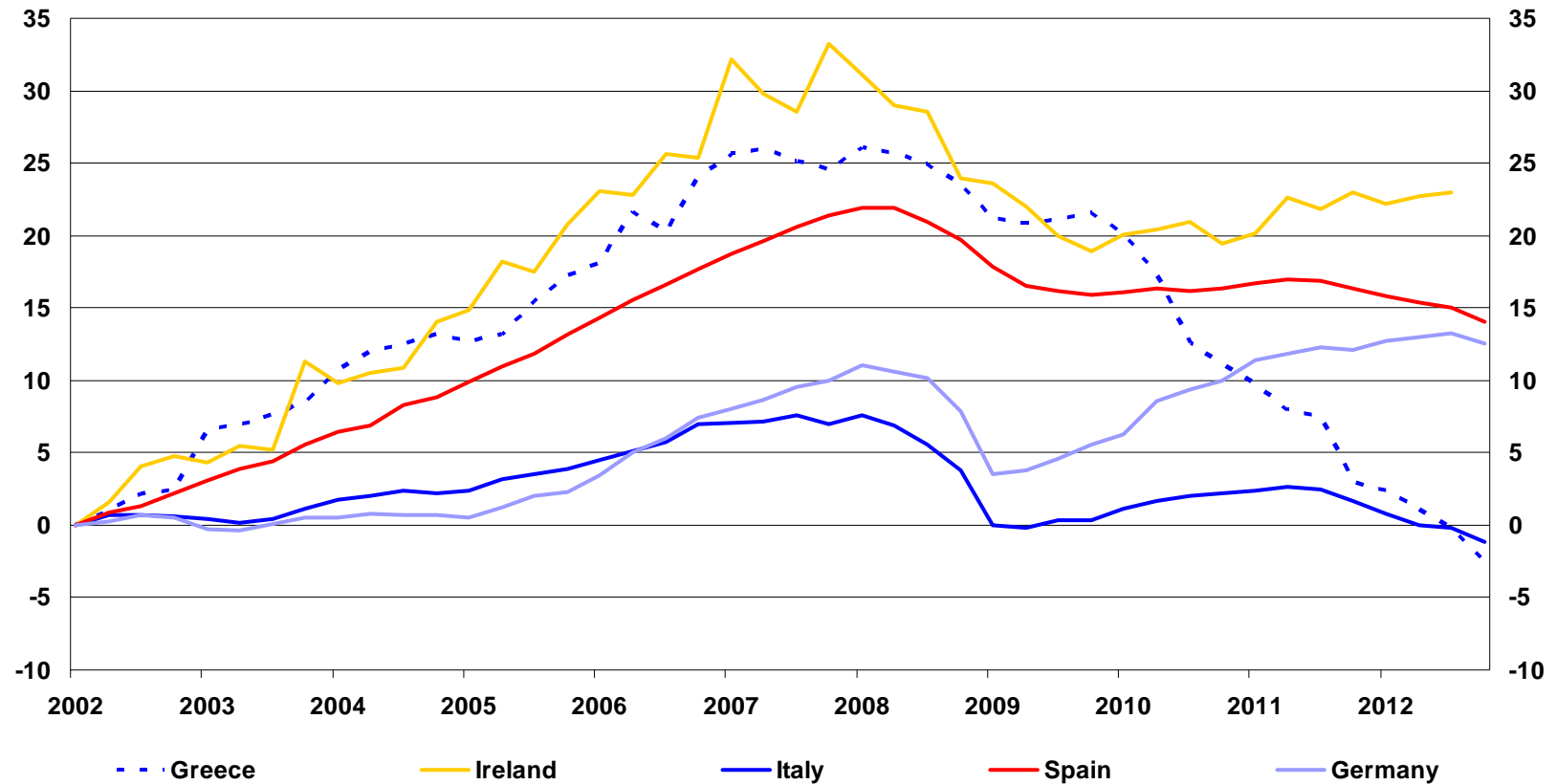
Sources: ECB and Citi Research.

Outlook for Euro-Area Activity

- GDP is likely to continue to contract through the next couple of years. . .
- Key restraining factors:
 - Credit crunch – bank deleveraging.
 - Fiscal challenges in some countries.
 - Political uncertainties.
 - Structural imbalances: Growth and competitiveness.

Economic Divergence Within EMU

Percent Change in Real GDP Since 2002:Q1



Sources: Eurostat, Haver Analytics, and Citi Research.

Japan

Outlook for BoJ Policy

- Prime Minister Abe is pressuring the BoJ to be more stimulative.
- In tandem, the ¥ has declined more than 15 percent against the U.S. dollar since early October.
- Governor Kuroda:
 - Is bringing a new tone and rhetoric to the BoJ.
 - Will be more aggressive in implementing the BoJ's asset purchase program (e.g., more long-duration assets).
- But an abrupt discontinuity in BoJ's policies seems unlikely . . . *Indeed, ¥ depreciation to date may be about as stimulative as it gets!*

Canada

Implications for Canada

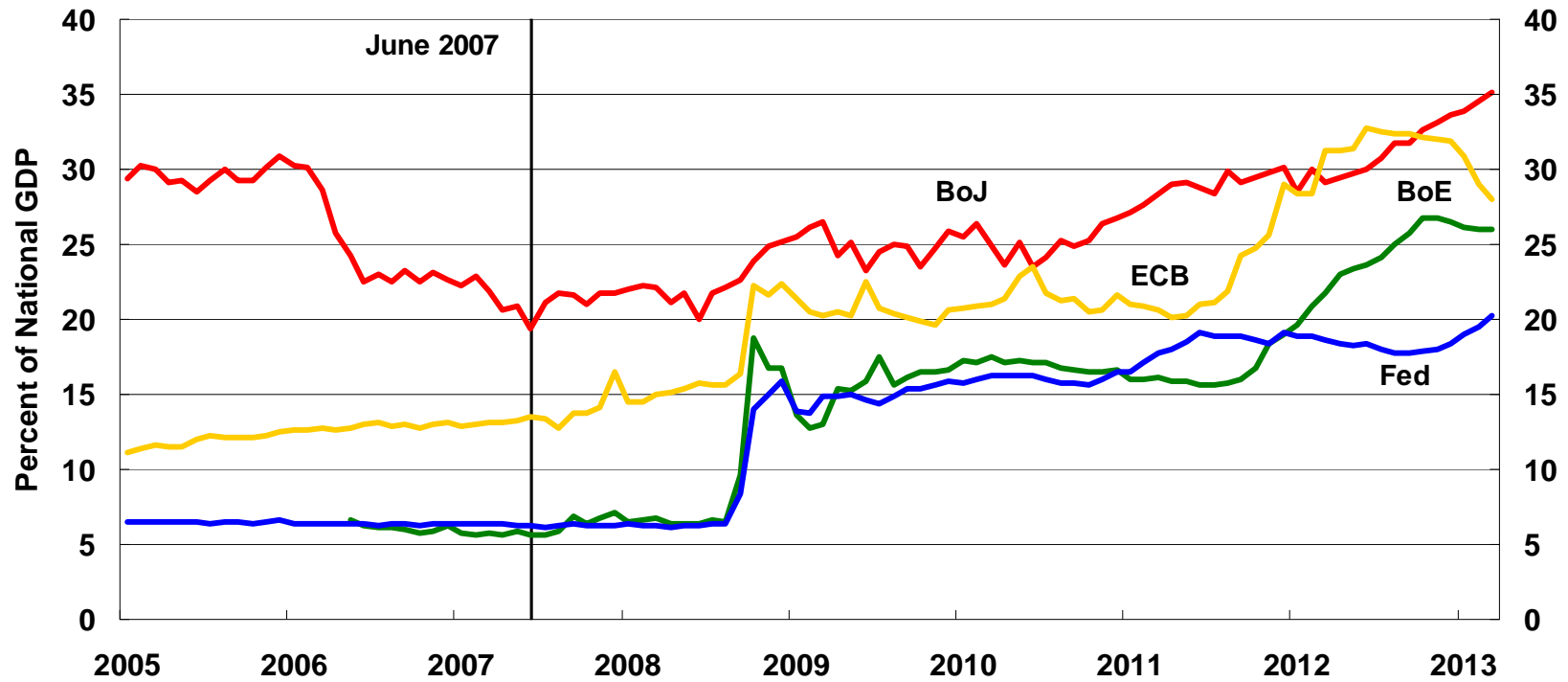
- Reduced inflows from China into Canadian housing market?
- Prospective strengthening of U.S. economy:
 - Likely to bring appreciation of U.S. dollar.
 - Good news for Canadian manufacturing sector.
 - Normalizing of the interest rate environment.
- Overall global performance means commodity prices likely to move sideways.

Global Risks

Global Risks

- Political uncertainties in Europe.
- A policy mistake by the Chinese authorities.
- A loss of investor confidence in U.S. fiscal discipline, with consequent stresses in Treasury markets and other sovereign debt markets.
- Spike in global oil prices, reflecting disrupted supplies from the Middle East.
- Possible concerns about central banks' ability to manage sizable balance sheets?

Central Bank Assets



Sources: National Central Banks and Statistical Agencies, Haver Analytics, and Citi Research.

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