Global Economic Outlook – September 2015

Philippe WAECHTER Head of Economic Research
My twitter account @phil_waechter or http://twitter.com/phil_waechter
My blog http://philippewaechter.en.nam.natixis.com

Synthesis

I. World trade is growing at a slow pace since summer 2011.
   - This reflects the absence of a real growth driver at the global scale.
   - Neither the US, nor China or Europe are potential drivers of global growth.
   - Their momentum is not strong enough to push the world expansion on a higher trajectory

II. This means that each country or zone will have to focus on its own internal demand to grow rapidly. The possibility of waiting an impulse from outside, as it was done in the past, is no longer available

III. Therefore, economic policies will have to remain very accommodative .

IV. That's why I don't think that a Fed's lift off of its interest rates could be a good idea

V. The ECB will have to maintain its QE at least until September 2016 and fiscal policies will not constrain private behaviors. There is a need for more coordination in economic policies.

VI. In China, the situation is still complicated. The change in the growth model leads to balance of strength between those who currently have the power (regional governments and State Owned Enterprises) and those who will be the future of China (services) – China will follow the same pace than Japan and South Korea before it.

VII. One main consequence will be a low oil price for long. It will be a catalyst for a stronger dynamics in industrialized countries (remember the end of the 90's)

VIII. This is not a good moment for emerging countries – China is no longer a key driver for than and commodity prices are low.

What about monetary policies?

The current growth momentum is low, inflation rates are close to zero and core inflation rates are below central banks' target of 2%.

The business cycle is not back to normal even with very accommodative monetary policies.

Central banks in the USA and in the Euro Area said that they prefer to act a bit too late than too early. In the current context, they do not want to take any risks as they think that a negative shock could have a persistent effect on the business cycle.

As far as inflation is muted, central banks will not act in a hurry.

That's why the ECB quantitative operation will be extended after September 2016.

At the last Fed's meeting it was clear that

The US central bankers were afraid of the long lasting effect that an external shock could have on the business cycle profile. This shock could come from China and the Fed doesn't want to add a interest rate shock

The US central bank is expecting a slow convergence to its 2% inflation rate (2018)

Therefore, the Fed has decided not to move in September and will probably not move in December.

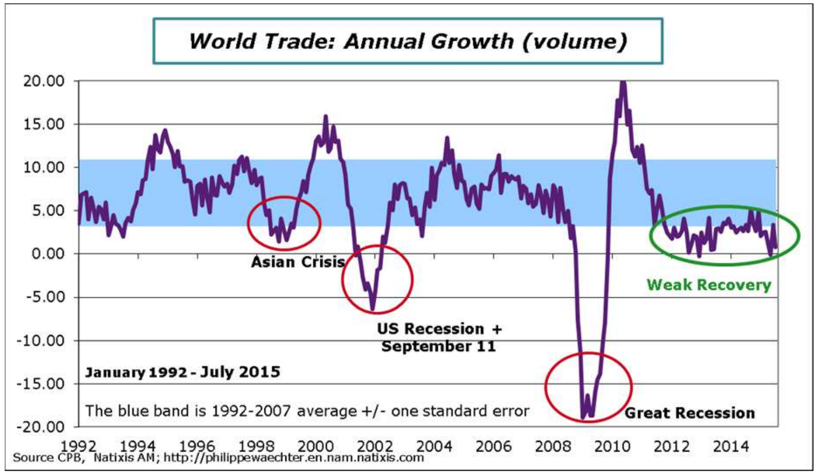
The Fed think that the monitoring of its policy is asymmetric. If it is too accommodative, the convergence to the 2% target will be more rapid and it's not an issue. If it is too tight, the risk is on growth and on the postpone convergence to the inflation target.

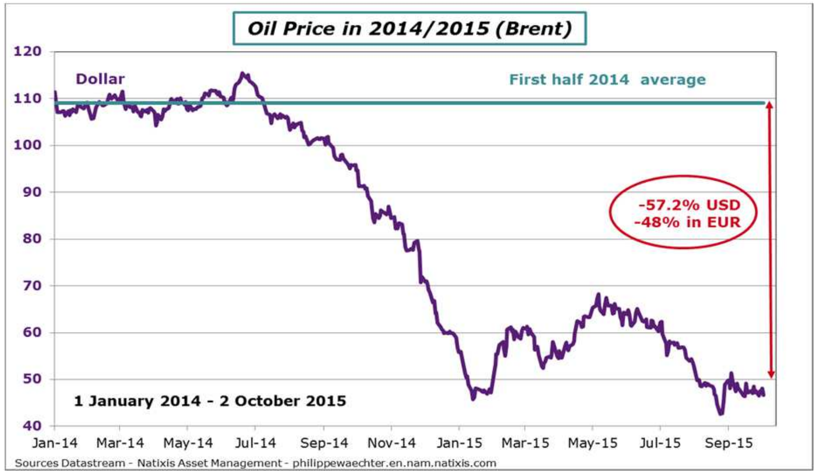
They will continue with this in mind: it's better to act later than too early

NATIXIS ASSET MANAGEMENT

Global Economic Momentum

- The global economy can be characterized by two elements:
  The first is the low dynamics seen in world trade
  The second is the rapid drop in the oil price
- On the first graph, the world trade yearly change lacks of momentum as it is below the blue band which is its pre-crisis growth rate +/- a standard error.
- This reflects the absence of strong growth driver for the world economy. In the past, the USA and more recently China played this role.
- Growth is these two countries are not strong enough to put the world economy on a higher trajectory.
- This means that there is no strong impulse from world trade to push growth on the upside. Therefore, growth momentum will depend mainly on internal demand dynamics. That's why economic policies must remain accommodative
- One consequence of this sluggish growth is lower commodity prices. This can be seen on oil price. This will be positive for oil consumer countries as the transfer from producers to consumers will be 2 trillion dollars. This will be a source of stronger consumer expenditures in developed countries

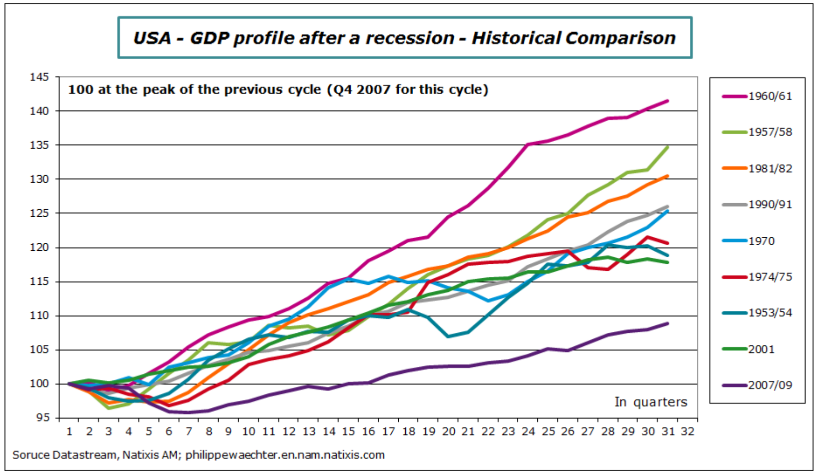




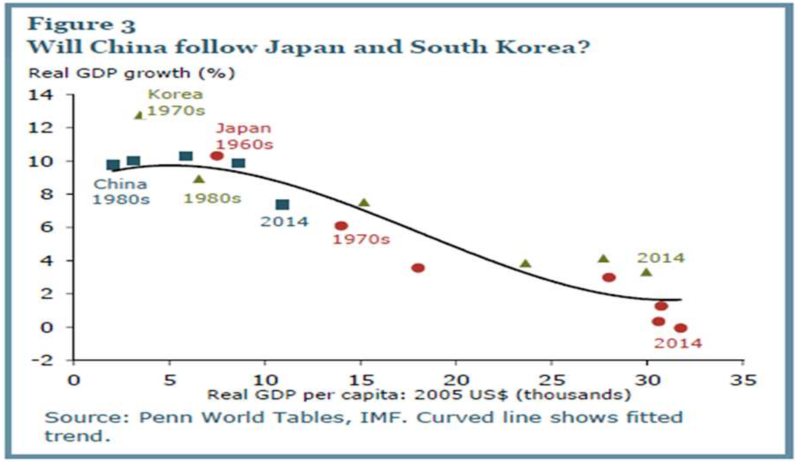
NATIXIS ASSET MANAGEMENT

USA and China follow a new model

- The USA follow a weak trajectory during this business cycle. That's what is seen on the first graph.
  It shows GDP profile during and after each recession since WWII. The current profile is the lowest for the last 60 years.
- The US economic model has changed. It can support its internal demand but has no longer the ability to create an impulse that will drive the world economy on the upside.
- At the same time the US economy is more dependent on the global dynamics. That can explain the Fed's behavior. The monetary policy determinants are no longer linked to the internal situation only.
- In China, the transition between an industrial led growth economy to a service led growth economy implies lower growth profile. This dynamics will converge to a 2 to 5% GDP growth in 5 to 10 years from now.
- The Chinese situation can be compared to Japan from the 1960's and South Korea from the 1970's. Both have had a transition that is of the same kind than China. The Chinese economic structure will change dramatically in the years ahead.

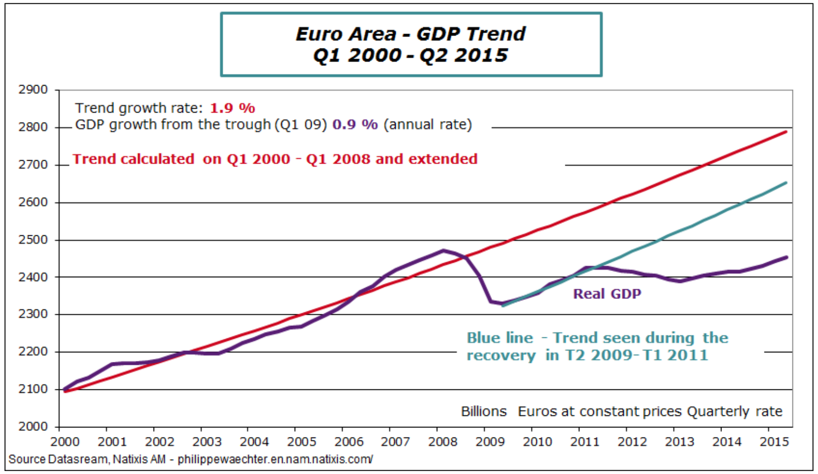


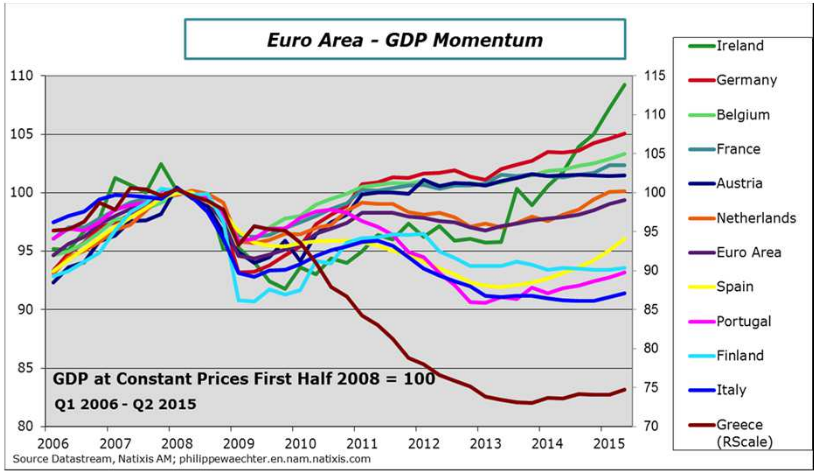
Soruce Datastream, Natixis AM; philippewaechter.en.nam.natixis.com



The Euro Area economic trend

- The challenge in the Euro Area is to converge to a stronger growth profile. The first graph shows that since the first quarter of 2011 the average growth rate has been close to 0+.
- One explicit reason of the situation is the austerity policy that has been put in place in 2011/2012. This has lowered demand addressed to companies leading to a GDP decline. The trough of the recession was during the first quarter of 2013. Since then the recovery follows a slow pace.
- This means that the Eurozone has not the capacity to create an impulse for the world economy. But as the impulse from outside will be limited due to the low world trade momentum, expansion will only come from the internal demand and from more accommodative economic policies.
- The ECB monetary policy wants to improve the current business cycle. It wants to reduce the financial fragmentation to create a more homogenous financial environment. The ECB also wants to create a competitiveness shock with low interest rates and a low euro.
  On the second chart GDP trajectories are still too heterogeneous.





NATIXIS ASSET MANAGEMENT

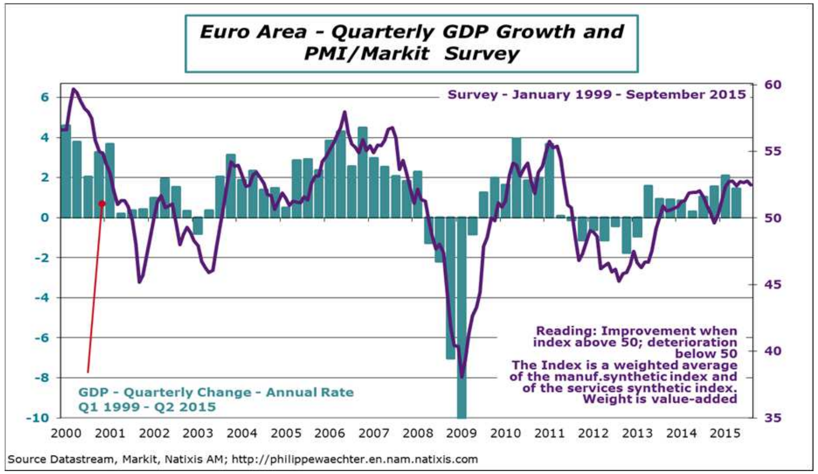
Short-term prospects in the Euro Area

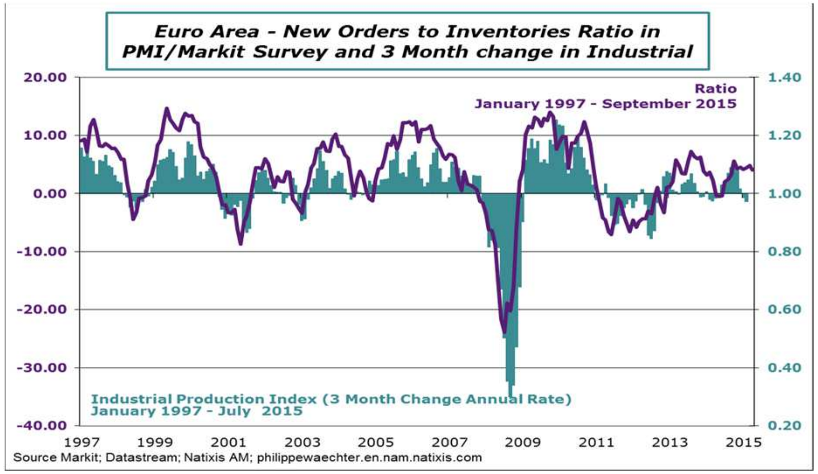
- To converge to a more homogenous business cycle, the ECB has provoked a competitiveness shock for every country of the Euro Area with low interest rates for an extended period.
  Every country trades a lot with of others countries of the region. Then an impulse due to a competitive shock can generate a contagion effect. At this moment, the stronger demand momentum will lead to a stronger investment dynamics. This will induce a more robust business cycle.
  A low oil price will also be very helpful at this stage. We expect it to stay low for an extended period.

- In the past, a more consistent business cycle had positive effects on growth momentum.

- The current recovery can be seen on the first graph at the top right of this page. GDP quarterly growth figures are positive but the Markit synthetic index doesn't show a strong acceleration. It is at almost the same level since last February. This reflects a transitory lack of homogeneity in the business cycle.

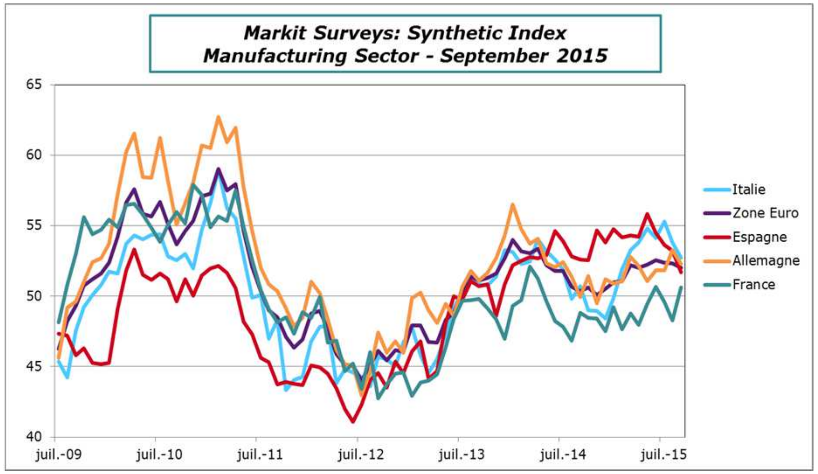
- In the second graph we see that new orders are feeding the recovery. We expect that with the process explained the momentum will be stronger in a foreseeable future

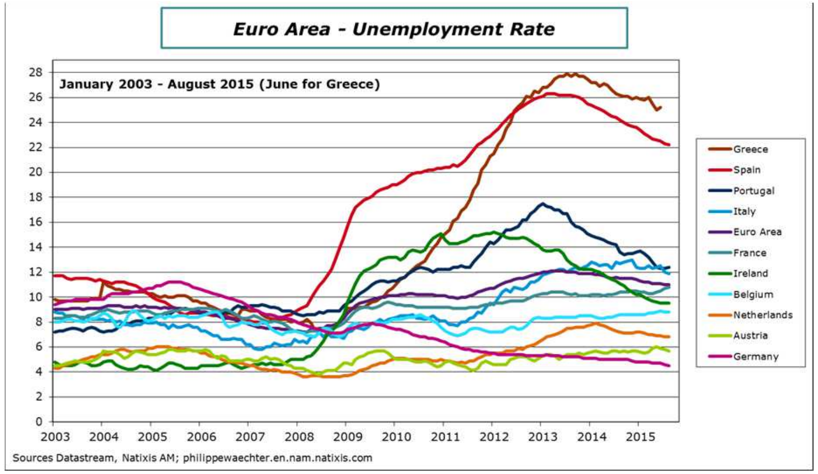




The role of Economic Policy

- In the short run, we see on the first graph (top right) that in the manufacturing sector there is no strong acceleration.
- This is a mix of the low world trade momentum and the necessity to have stronger support inside the Euro Area.
- This will not come from an already very accommodative monetary policy. There is a need for a more proactive fiscal policy even if it is associated with a higher public debt.
- Households' debt, as a percentage of disposable income, is still very high, at a level comparable to its pre crisis level. Fiscal policy must help by transferring part of this debt to the future through a higher public debt.
- This would imply lower unemployment rates and the possibility of a more autonomous business cycle. That's what is currently needed as there is an strong uncertainty on the moment when world trade will be a strong support fro growth in the future.

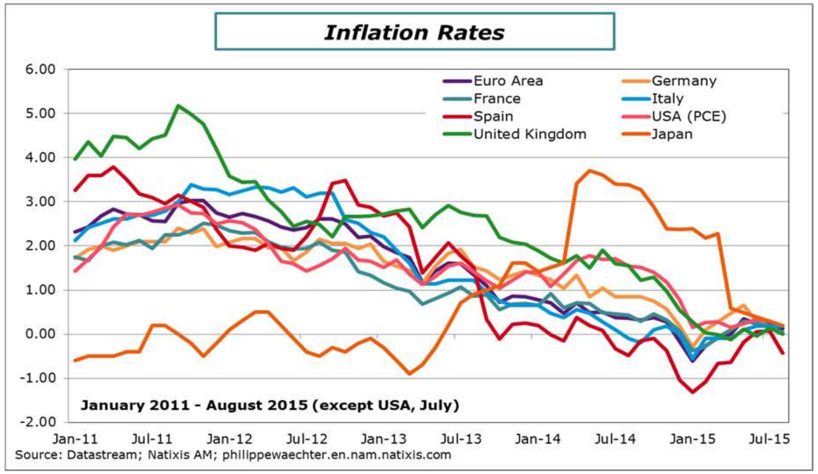


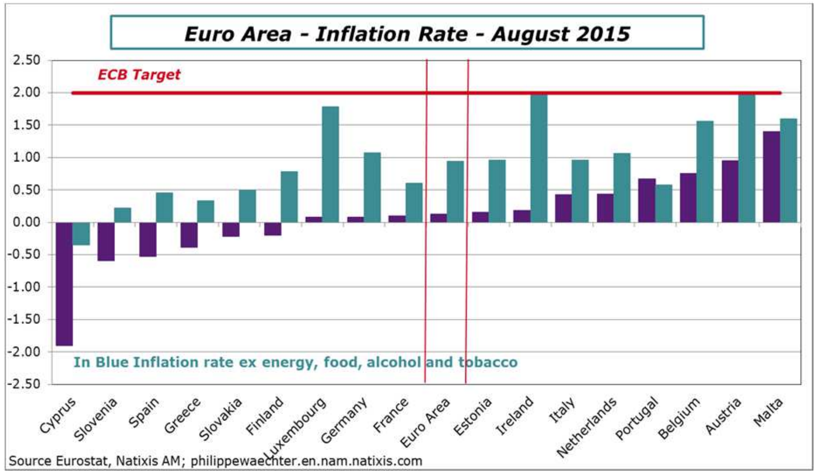


NATIXIS ASSET MANAGEMENT

Inflation rates are close to 0%

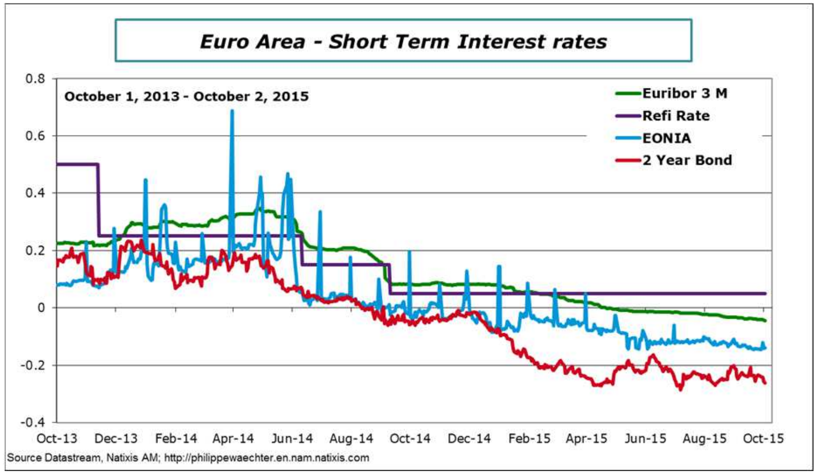
- Another strong characteristic of the current period is the absence of inflation (graph on the top right)
- Core inflation rates are close to 1%. The lower oil price pulls down the inflation rate but the internal price dynamics is not that strong pushing core inflation rates below the 2% central banks' target.
- In most countries, the lack of pressures on the labor market leads to a low wage momentum that doesn't feed internal price dynamics.
- Central bankers want to converge to a 2% inflation rate. They consider this target as consistent with stable prices.
- As far as inflation rates are way below 2% they will maintain accommodative monetary policies, even in the USA.
- The risk with a close to 0% inflation rate is a close to 0% wage indexation. The absence of nominal illusion can then limit households expenditures even if purchasing power is stable. In that case it would be a drag for the internal demand and for growth.

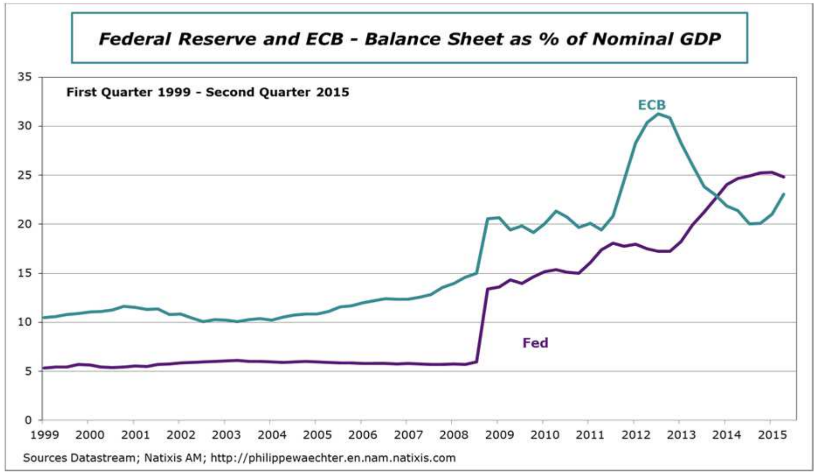




Accommodative Monetary Policies

- In the Euro Area, the ECB has decided to maintain low interest rates for an extended period.
- The refi rate is currently at 0.05% and is expected to remain at this level until at least the end of 2016
  The ECB has also put in place a quantitative operation. It purchases EUR 60bn of assets every month. It is mainly sovereign debt but also agencies, covered bonds and ABS.
- We see and the second graph (bottom right) the impact the QE has on the ECB balance sheet.
- As the ECB will continue, the ECB's line will cross the Fed's line. The difference with the 2012/2013 episode of larger balance sheet is that the current purchases are definitive. In 2012/2013 it was just a temporary operation. That's a huge difference.
- Mario Draghi during his press conference following the last monetary policy committee said that the QE could be extended. Its characteristics are the amount of assets purchased (EUR 60bn every month) and its length: it is supposed to stop at the end of September 2016 if long term inflation expectations converge to 2%. The QE operation could be extended beyond September 2016.

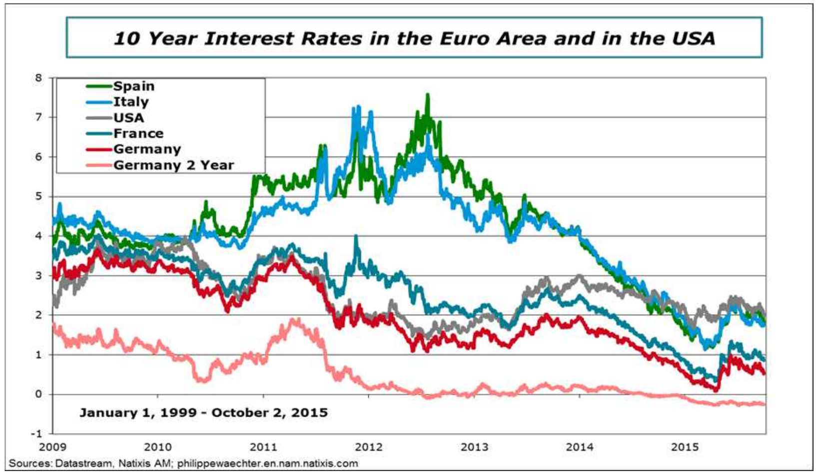




NATIXIS
ASSET MANAGEMENT

Fragmentation and the Euro exchange rate

- One important issue for the ECB monetary policy is to reduce financial fragmentation.
- In other words, financial conditions were not homogenous within the Euro Area. Interests rates were at very different levels between countries. This was a drag for a strong recovery on the credit market. Companies didn't face the same financial conditions even if they had the same characteristics.
- The ECB monetary policy has helped to reduced these distortions and it has been a source of recovery on the credit market. This is clearly the case in Spain.
- We see on the second graph (bottom right) that current expectations on monetary policies on both side of the Atlantic are consistent with a Euro/dollar exchange rate between 1 and 1.15.
- This reflects on one side the ECB accommodative monetary policy and on the other side the doubt that market operators have on a change of the Fed's monetary policy.



Forecasts

	Avergage growth					Average Inflation				
	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016
USA	2.3	2.2	2.4	2.5	2.4	2.1	1.5	1.6	0.2	1.5
Japan	1.7	1.6	-0.1	0.8	1.4	0.0	0.4	2.7	0.6	0.6
Euro Area	-0.7	-0.4	0.9	1.5	1.9	2.5	1.4	0.4	0.1	0.8
U.Kingdom	0.7	1.7	2.8	2.6	2.5	2.8	2.6	1.5	0.1	1.3
China	7.8	7.5	7.4	6.8	6.4	2.6	2.6	2.0	1.3	1.3
France	0.4	0.4	0.4	1.1	1.6	2.0	0.9	0.5	0.1	0.7

Year end	Monetary Policy					Long Term Interest Rates (10 year)				
	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016
USA	0-0.25	0-0.25	0-0.25	0-0.25	0.75-1	1.7	3	2.2	2.2-2.5	2.2-2.6
Japan	0.1	0.1	0.1	0.1	0.1	0.8	0.7	0.3	0.2-0.5	0.3-0.6
Euro Area	0.75	0.25	0.05	0.05	0.05	1.2	1.95	0.5	0.4-0.8	0.7-1.3
U.Kingdom	0.5	0.5	0.5	0.5	0.50-0.75	1.8	3.1	1.8	1.6-2.2	1.8-2.2

Source Economic Research
Natixis Asset Management

Legal information

Natixis Asset Management
Registered Office: 21 quai d'Austerlitz – 75 634 Paris Cedex 13 – Tel. +33 1 78 40 80 00
Limited Liability Company - Share Capital of 50 434 604,76 euro
Regulated by AMF under n° GP 90-009
RCS number 329 450 738 Paris

This document is destined for professional clients. It may not be used for any purpose other than that for which it was conceived and may not be copied, diffused or communicated to third parties in part or in whole without the prior written authorization of Natixis Asset Management.
None of the information contained in this document should be interpreted as having any contractual value. This document is produced purely for the purposes of providing indicative information. It constitutes a presentation conceived and created by Natixis Asset Management from sources that it regards as reliable.
Natixis Asset Management reserves the right to modify the information presented in this document at any time without notice and particularly the information concerning the description of the management processes which does not in any way constitute a commitment on behalf of Natixis Asset Management.
Natixis Asset Management will not be held responsible for any decision taken or not taken on the basis of information contained in this document, nor in the use that a third-party may make of it.
Figures mentioned refer to previous years. Past performance does not guarantee future results. Reference to a ranking and/or a price does not indicate the future performance of the UCITS or the fund manager.
The funds mentioned in this document have received the approval of the French Financial Market Authority (AMF) or have received authorization to be marketed in France. The risks and costs related to investment in a fund are described in the fund's prospectus. The prospectus and the periodical reports are available on request from Natixis Asset Management. Potential subscribers must be in possession of a copy of the prospectus before making any subscription.
In the case of funds that qualify for a special tax status, we remind potential investors that the special tax conditions depend on the individual situation of each clients and that such conditions may be subject to future modification.
Under Natixis Asset Management's social responsibility policy, and in accordance with the treaties signed by the French government, the funds directly managed by Natixis Asset Management do not invest in any company that manufactures sells or stocks anti-personnel mines and cluster bombs.
The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material.

This material is provided only to investment service providers or other Professional Clients or Qualified Investors and, when required by local regulation, only at their written request. • **In the EU (ex UK)** Distributed by NGAM S.A., a Luxembourg management company authorized by the CSSF, or one of its branch offices. NGAM S.A., 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. • **In the UK** Provided and approved for use by NGAM UK Limited, which is authorized and regulated by the Financial Conduct Authority. • **In Switzerland** Provided by NGAM, Switzerland Sàrl. • **In and from the DIFC** Distributed in and from the DIFC financial district to Professional Clients only by NGAM Middle East, a branch of NGAM UK Limited, which is regulated by the DFSA. Office 603 – Level 6, Currency House Tower 2, P.O. Box 118257, DIFC, Dubai, United Arab Emirates. • **In Singapore** Provided by NGAM Singapore (name registration no. 5310272FD), a division of Absolute Asia Asset Management Limited, to Institutional Investors and Accredited Investors for information only. Absolute Asia Asset Management Limited is authorized by the Monetary Authority of Singapore (Company registration No.199801044D) and holds a Capital Markets Services License to provide investment management services in Singapore. Registered office: 10 Collyer Quay, #14-07/08 Ocean Financial Centre. Singapore 049315. • **In Hong Kong** Issued by NGAM Hong Kong Limited. • **In Taiwan:** This material is provided by NGAM Securities Investment Consulting Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C and a business development unit of Natixis Global Asset Management. Registered address: 16F-1, No. 76, Section 2, Tun Hwa South Road, Taipei, Taiwan, Da-An District, 106 (Ruentex Financial Building I), R.O.C., license number 2012 FSC SICE No. 039, Tel. +886 2 2784 5777. • **In Japan** Provided by Natixis Asset Management Japan Co., Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No. 425. Content of Business: The Company conducts discretionary asset management business and investment advisory and agency business as a Financial Instruments Business Operator. Registered address: 2-2-3 Uchisaiwaicho, Chiyoda-ku, Tokyo. • **In Latin America (outside Mexico)** This material is provided by NGAM S.A. • **In Mexico** This material is provided by NGAM Mexico, S. de R.L. de C.V., which is not a regulated financial entity or an investment advisor and is not regulated by the Comisión Nacional Bancaria y de Valores or any other Mexican authority. This material should not be considered investment advice of any type and does not represent the performance of any regulated financial activities. Any products, services or investments referred to herein are rendered or offered in a jurisdiction other than Mexico. In order to request the products or services mentioned in these materials it will be necessary to contact Natixis Global Asset Management outside Mexican territory.
The above referenced entities are business development units of Natixis Global Asset Management, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. Although Natixis Global Asset Management believes the information provided in this material to be reliable, it does not guarantee the accuracy, adequacy or completeness of such information.

> Further information: www.nam.natixis.com