ALLIANCEBERNSTEIN®

GLOBAL ECONOMIC RESEARCH

GLOBAL MACRO OUTLOOK

NOVEMBER 2017

KEY FORECAST TRENDS

- The global economy continues to be characterized by a combination of strong, synchronized growth—close to the pre-crisis norm—and subdued inflation. We expect both trends to continue in 2018.
- Although the Bank of England has joined the US Federal Reserve and Bank of Canada in raising interest rates, the withdrawal of monetary stimulus by developed market central banks is likely to remain gradual.
- One thing that could change this picture would be a surprisingly strong pick-up in inflation. That's because it would result in a more aggressive monetary-policy response in developed markets.
- Our analysis suggests that structural and cyclical forces are likely to weigh less heavily on inflation in coming years. But not by so much as to push it sharply higher in 2018.
- This points to a benign near-term backdrop for risk assets. In addition to inflation, key risks to this positive baseline include central bank balance sheet policy, geopolitics and how the US responds to higher interest rates.
- Our forecasts point to a stronger dollar while we continue to expect higher bond yields in the US and Europe. Even with a positive growth backdrop, this could present a less supportive environment for emerging markets.

CONTENTS

Global Forecasts 2
Global Market Outlook
Yield Curves 3
Currencies 4
Central Bank Watch....................5
US 6
Euro Area 7
Japan...8
China 9
Canada 10
Australia/New Zealand 10
UK 11
Norway/Sweden 11
Asia ex Japan 12
Latin America...............................13
Eastern Europe, Middle East and Africa (EEMEA) 14
Forecast Tables 15
Contributors.................................16

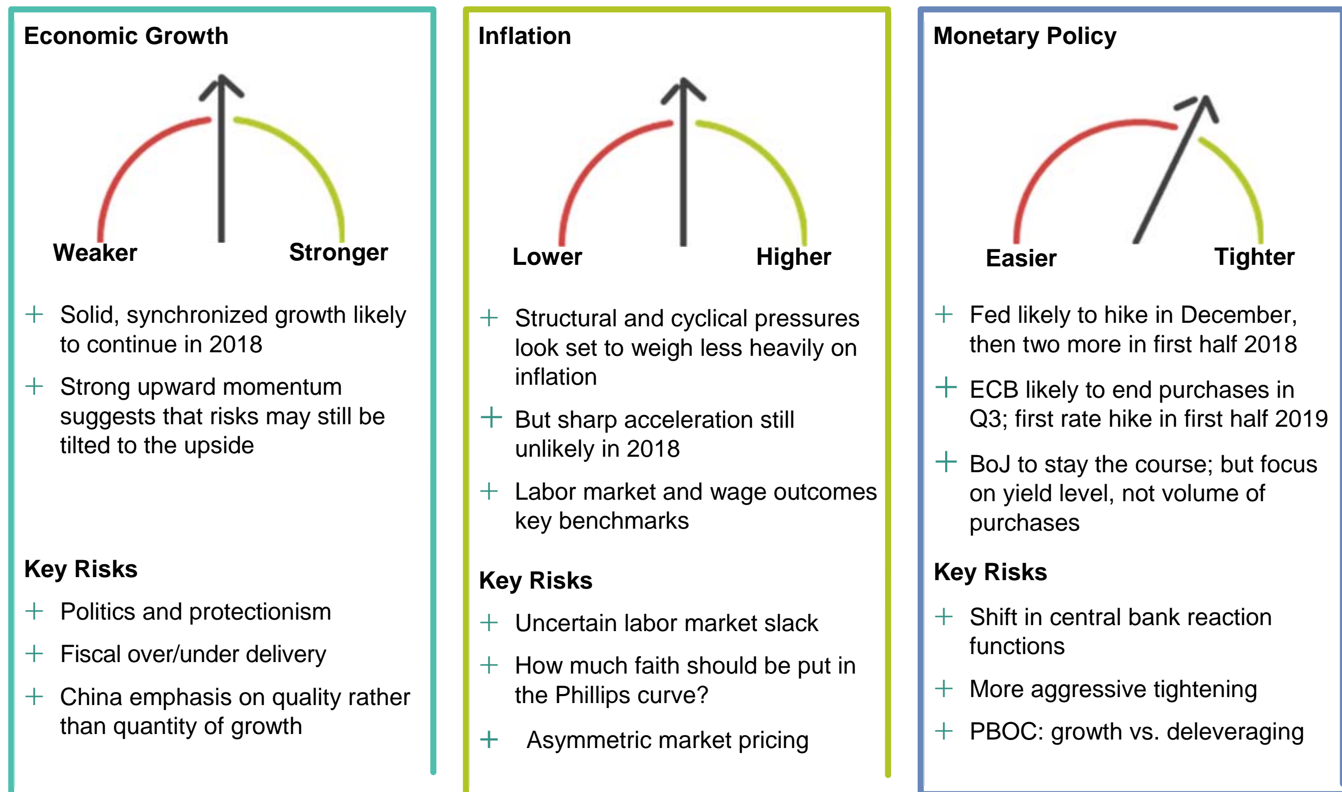
Booming Manufacturing

German Factory Orders Finally Back Above Post-Crisis Peak

As of September 30, 2017. Three-month rolling average.
Source: Haver Analytics

- German factory orders were crushed during the global financial crisis—falling by 35%. After rapid gains in recent months, though, orders are back above their 2007 peak.
- Not only does this corroborate the strong message from euro area survey data. Because Germany is a big exporter of capital goods, it also suggests that the global manufacturing cycle is in rude health.

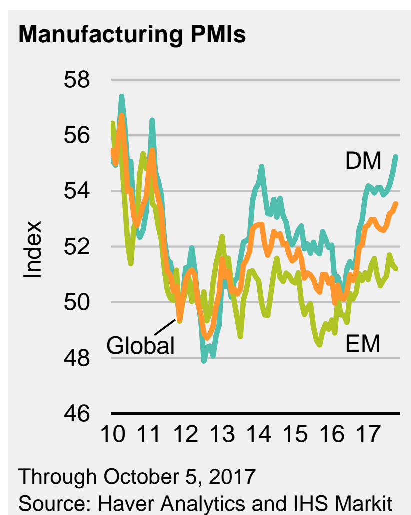
GLOBAL FORECASTS



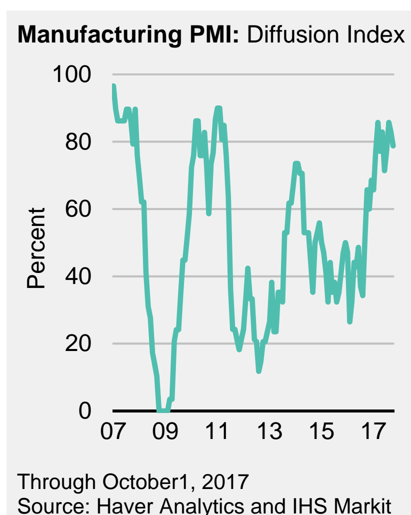
OUTLOOK

- We expect global growth of 3.0% in 2018, close to this years expected 3.1%. This stable picture is evident in both developed (2.1% versus 2.2%) and emerging economies (4.6% versus 4.5%).
- We are more optimistic than the consensus on 2018 growth in the euro area (2.2% versus 1.8% consensus) and Japan (1.6% versus 1.1%) but more cautious on the US (2.0% versus 2.4%) and China (6.0% versus 6.4%).
- We expect global inflation to average 2.5% both this year and next. Against this backdrop, central banks are likely to withdraw monetary stimulus gradually.
- Wage and inflation developments will be of particular importance next year. Any signs of a faster-than-expected increase in either would lead to a more aggressive response from central banks—something that markets are not priced for.

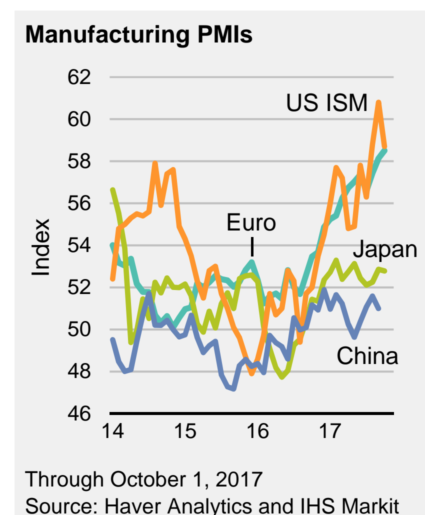
Global Manufacturing Trends: Recovery Gains Strength and Breadth



Through October 5, 2017
Source: Haver Analytics and IHS Markit



Through October1, 2017
Source: Haver Analytics and IHS Markit



Through October 1, 2017
Source: Haver Analytics and IHS Markit

GLOBAL MARKET OUTLOOK: YIELD CURVES

GLOBAL YIELDS

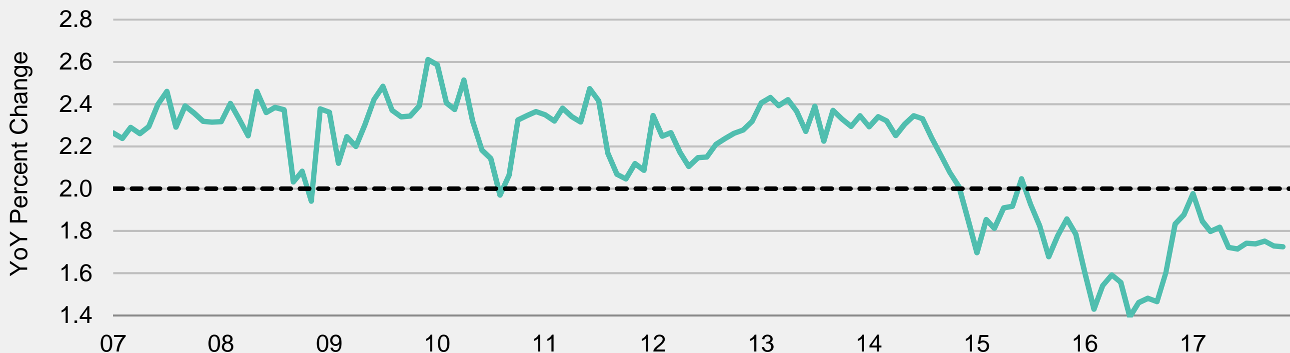
+ **Global**—Core rates still expected to trend higher; central bank balance-sheet policy a key factor
+ **US**—With the Fed likely to raise rates more aggressively than markets expect, we look for the US 10-year to rise above 3.0% next year
+ **Euro Area**—Although the ECB's communication strategy remains dovish, policy is clearly moving towards the exit door and is likely to exert upward pressure on Bund yields in coming months
+ **Japan**—QQE-YCC policy to anchor 10-year yields close to zero, but commitment to quantity target to become fuzzier
+ **UK**—Having raised rates 25bp in November, the Bank of England is likely to raise rates at least one more time in 2018

Global Rates: AB and Consensus Year-End Forecasts (%)

	AB		Consensus	
	2017	2018	2017	2018
US	2.75	3.25	2.39	2.83
Euro Area	0.75	1.50	0.58	1.02
UK	1.75	2.25	1.37	1.72
Japan	0.05	0.05	0.05	0.08

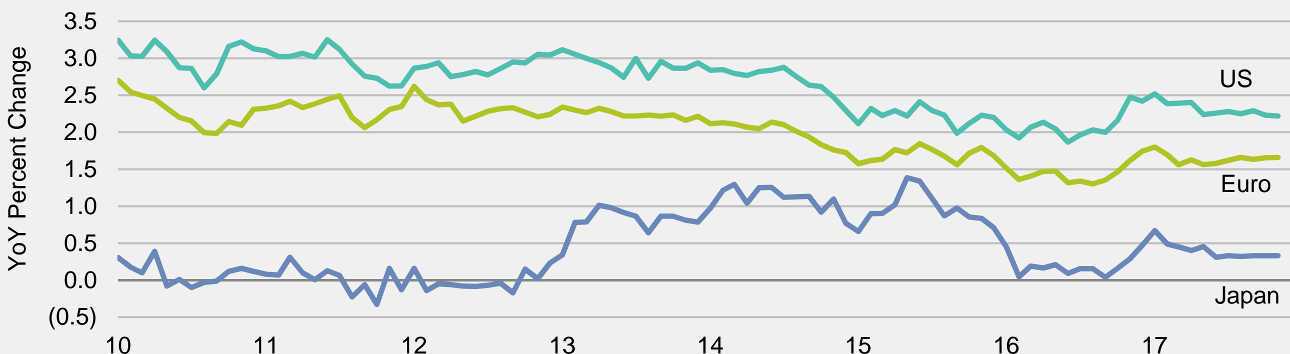
As of November 2, 2017
Source: Bloomberg and AB

G3* Medium-Term Inflation Expectations†



As of November 2, 2017
*US, euro area and Japan. †Five-year/five-year forward inflation-linked swaps
Source: Bloomberg and AB

Medium-Term Inflation Expectations*



As of November 2, 2017
*Five-year/five-year forward inflation-linked swaps
Source: Bloomberg and AB

GLOBAL MARKET OUTLOOK: CURRENCIES

FX FORECASTS

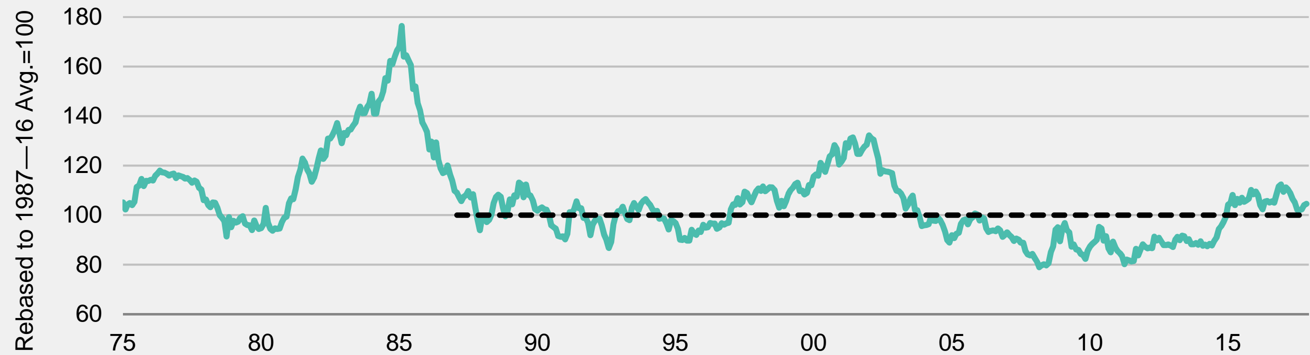
- **USD**—With the Fed likely to raise rates more than markets expect, risks have tilted back towards dollar strength
- **JPY**—Expect modest JPY weakness as BOJ lags in policy normalization process
- **EUR**—dovish ECB communication policy likely to weigh on EUR over the near term
- **GBP**—although Brexit remains a risk, more hawkish BOE likely to support GBP in coming months
- **Dollar Bloc**—AUD still vulnerable as the RBA lags in the policy normalisation process. NZD looks to have over-reacted to political shift post-election

Global FX: AB and Consensus Year-End Forecasts

	AB		Consensus	
	2017	2018	2017	2018
EUR/USD	1.15	1.10	1.18	1.22
USD/JPY	115	125	113	112
EUR/GBP	0.88	0.88	0.89	0.92
AUD/USD	0.75	0.73	0.78	0.80

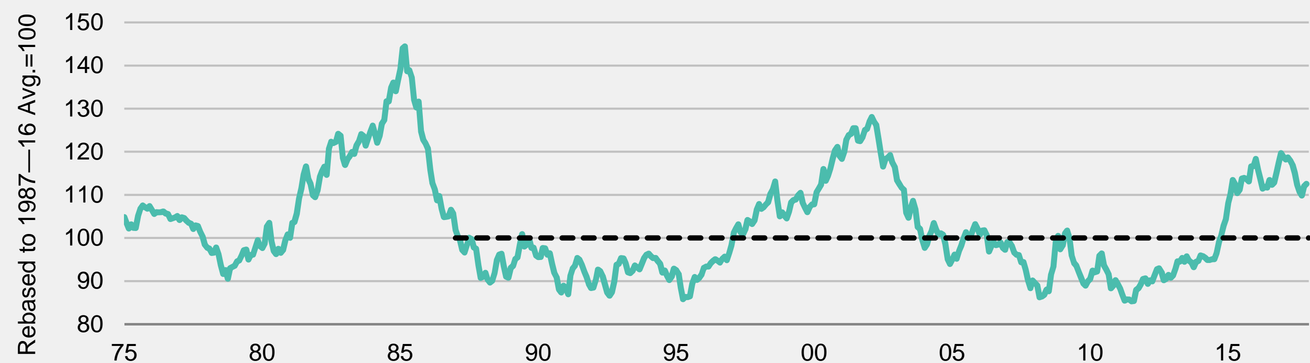
As of November 2, 2017
Source: Bloomberg and AB

USD Effective Exchange-Rate Index: Nominal



Through November 2, 2017
Source: Bloomberg and AB

USD Effective Exchange-Rate Index: Real



Through November 2, 2017
Source: Bloomberg and AB

GLOBAL MARKET OUTLOOK: CENTRAL BANK WATCH

Core/Developed Markets

	Policy Direction	Latest (%)	+6 Mo. (%)	+12 Mo. (%)	Comments/Unconventional Policy
US	⇧	1.13	1.38	1.88	The Fed's balance sheet is shrinking and we expect the program to run as scheduled unless economic conditions change dramatically
Euro Area	⇔	0.00	0.00	0.00	No movement on ECB rates until first half 2019
Japan	⇔	(0.10)	(0.10)	(0.10)	QQE-YCC policy is in play for the foreseeable future. BoJ to lag ECB and Fed in normalization process
China	⇧	2.80	2.90	3.10	Robust loan growth will offset tightening measures on shadow credits. Overtightening risk remains low
Canada	⇧	1.00	1.25	1.75	The closing output gap and strength of the labor market will likely support multiple BOC hikes
Australia	⇩	1.50	1.50	1.50	Optimism around domestic rebalancing offset by weak wages, household debt concerns and housing risk. RBA on hold through 2018
NZ	⇔	1.75	1.75	1.75	Successful macro pru negates need for rate adjustment. New government set to revise RBNZ mandate, including jobs objective
UK	⇔	0.50	0.75	1.00	Higher rates likely next year unless economy slow further
Sweden	⇔	(0.50)	(0.50)	(0.40)	Next move likely to be up, though not until 2018
Norway	⇔	0.50	0.50	0.50	

KEY DEVELOPED-MARKET THEMES

+ With the global recovery continuing to gain strength and breadth, central-bank reaction functions have started to change. There's now a less pressing need to drive inflation quickly back to target—so long as growth remains on track.
+ The market interpreted the Bank of England's November rate increase as a dovish hike. We disagree and look for two more rate increases in 2018.

Emerging Markets

	Policy Direction	Latest (%)	+6 Mo. (%)	+12 Mo. (%)	Comments/Unconventional Policy
India	⇔	6.00	6.00	6.00	Likely fiscal expansion will provide room for RBI to stay neutral after two 25-basis-point rate cuts this year
Indonesia	⇔	4.25	4.25	4.25	BI's policy easing should have come to an end with two back-to-back rate cuts over the last two meetings
S. Korea	⇔	1.25	1.50	1.50	BOK turned hawkish in the statement, expect a pre-mature hike amid weak structural growth in Korea
Brazil	⇩	7.50	7.00	7.00	Aggressive easing priced in since 4Q:2016
Mexico	⇔	7.00	7.00	6.50	Tightening cycle over; easing to start in 3Q:2018
Chile	⇔	2.50	2.50	2.50	Easing cycle over; soft growth gave room for central bank to ease
Colombia	⇔	5.00	5.00	5.00	Inflation to decline gradually; easing cycle started in December 2016
Russia	⇩	10.00	8.00	7.50	Undershooting of inflation target opens door for bigger cuts
Turkey	⇔	8.00	8.00	8.00	The CBRT will use only the upper end of the rate corridor to manage short-term lira liquidity
S. Africa	⇩	6.75	6.50	6.25	
Hungary	⇔	0.90	0.90	0.90	
Poland	⇔	1.50	1.50	1.50	

KEY EMERGING-MARKET THEMES

+ In contrast to the major developed-market central banks, most emerging-market (EM) countries are expected to either loosen monetary policy or keep it on hold in coming months.

US

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
US	2.3	2.0	2.0	2.1	1.38	1.88	2.75	3.25

OUTLOOK

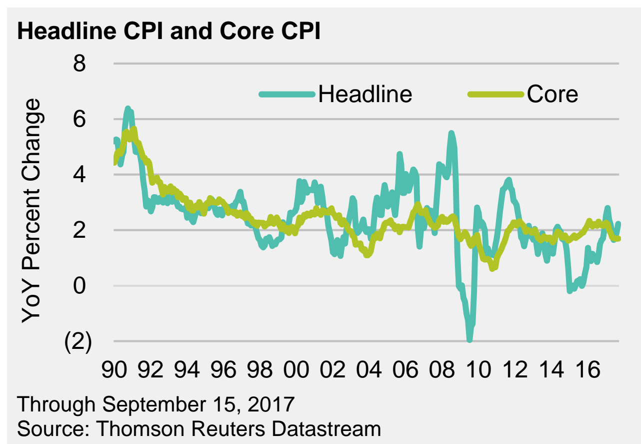
- The US economy continues to perform well, with GDP growth above potential and the labor market continuing to tighten. We expect growth to remain robust for the next few quarters, supported by accommodative monetary conditions and rebuilding activity from the late-summer hurricanes.
- Given the strong growth outlook, we expect inflation to rise gradually in the coming months. Recent increases in energy prices support that expectation, as does the possibility of fiscal stimulus.
- The nomination of Federal Reserve Governor Jerome Powell to replace Janet Yellen as Chair should assure policy continuity and should not result in any economic or market disruption.

RISK FACTORS

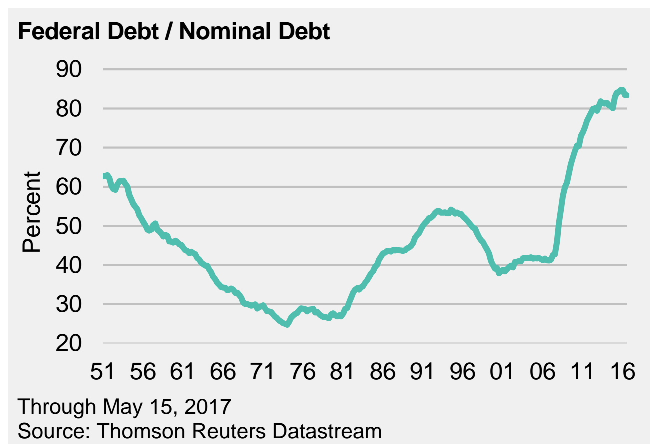
- The FOMC has begun the process of reducing its balance sheet. Our base case is that the reduction will not disrupt financial markets or the economy, but there remains some risk around the program, which has not been used previously. Should reduced central bank purchases push interest rates up more rapidly than we expect, it could slow the economy more rapidly that our current forecasts capture.
- Much of our optimism about growth in the next few quarters stems from persistently easy financial conditions. We expect conditions to tighten only gradually—driven by a combination of higher rates and a stronger dollar—into 2018. Should the pace of tightening be slower, growth could be more rapid. But should conditions tighten more rapidly, that would cause the economy to slow more than we are currently forecasting.
- Policy uncertainty in Washington remains the predominant risk, with investors unsure what changes, if any, will be made to the tax code. That uncertainty has not impeded growth this year, but if it persists it could limit the ability of businesses to plan for the future.

OVERVIEW

The US economy is enjoying a period of very solid, balanced growth, and the conditions are in place for that to continue. The global economy is improving, the labor market is strong, financial conditions are easy, and inflation is low. While an external shock could be disruptive, given the solid foundation of the economy today it would take a large shock indeed to disrupt the positive momentum. As has been the case all year, the predominant risks are in Washington, where tax cuts are the topic du jour. While tax cuts might be good for the market in the near term, the longer-term impact on the budget deficit and on government debt, as well as the high probability that the FOMC would be forced to tighten policy more rapidly in the event of a fiscal easing, could offset that positive impact. More broadly, the economy has been resilient in the face of policy uncertainty all year, and we expect that resilience to continue. Our current forecasts do not include significant changes to the tax code; as with health care, we prefer to take a wait and see approach before assessing any potential legislation. For now, the outlook remains bright and we are optimistic about the next few quarters.



Through September 15, 2017
Source: Thomson Reuters Datastream



Through May 15, 2017
Source: Thomson Reuters Datastream

Euro Area

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
Euro Area	2.3	2.2	1.6	1.4	0.0	0.0	0.75	1.50	1.15	1.10

OUTLOOK

+ We expect the euro area to grow by 2.2% next year, slightly down on this year's expected growth rate of 2.3% but still double most estimates of the economy's potential growth rate.
+ With underlying inflation set to rise only slowly and oil prices subdued, we expect headline inflation to average 1.4% next year after 1.6% in 2017.
+ The ECB is likely to end its asset purchase program in September 2018 or perhaps after some token purchases in the fourth quarter of next year. We expect the first interest rate rise in the first half of 2019.

RISK FACTORS

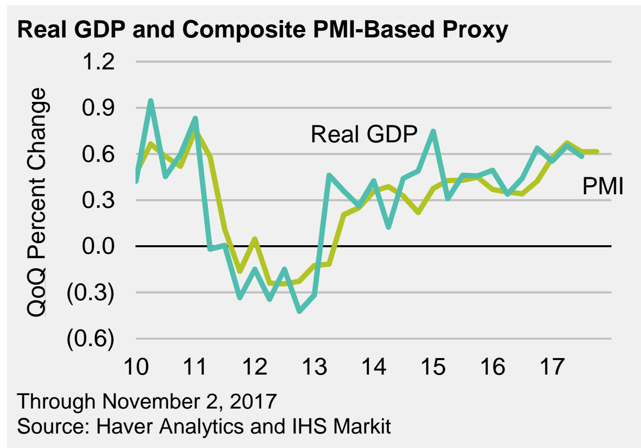
+ Risks to the growth outlook appear evenly balanced and may continue to be to the upside in the near term.
+ Our monetary policy forecasts are driven by a gradual evolution of the ECB's reaction function to place greater weight on growth rather than an expectation that inflation is likely to rise sharply. Should inflation surprise on the upside, the ECB would have to respond more aggressively and the market is clearly not priced for this.

OVERVIEW

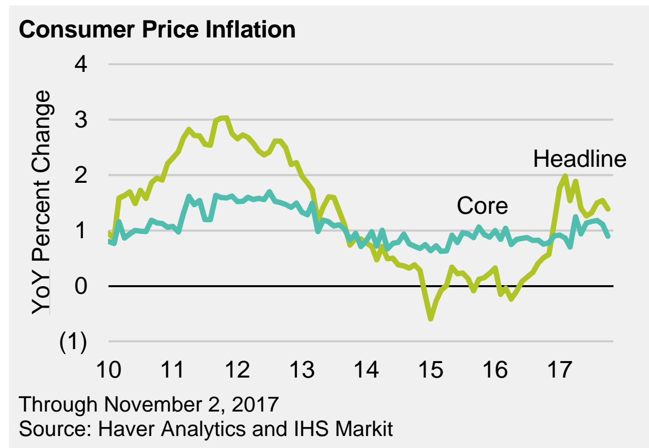
Recent data support our view that 2017 will be the best year for euro-area growth since 2007. Real GDP rose by 0.6% in the third quarter after a 0.7% gain in the second, pushing annual growth up to 2.5%. Meanwhile, survey data remain elevated and German factory orders have risen strongly in recent months. The latter were hit very hard in the aftermath of the global financial crisis, falling by 35%. The fact that they are now back at their previous cyclical peak suggests that the German and global manufacturing cycles are booming. It also suggests that the strength of the euro has, so far, had little impact.

Having surprised on the upside for much of the year, core inflation has slipped back again over the last couple of months. In spite of this, it still looks as if the underlying trend in core inflation has picked up in recent months and is now running a little above 1% rather than just below it, as was the case between the fourth quarter of 2013 and first quarter of the current year. While this is still some way short of target, it is likely to increase the ECB's confidence that inflation will eventually return to target—particularly as the economy's current and projected growth rates are consistent with a rapidly closing output gap.

The ECB will halve the volume of its monthly asset purchases to €30 billion between January and September of next year but has adopted a very dovish communication strategy. While this has helped the market digest the reduction in monthly purchases, the direction of ECB policy is clear: the question is no longer whether or not it will withdraw monetary stimulus but how quickly it is likely to do so. And the more successful the ECB is in suppressing market expectations today, the more severe the eventual reaction could be when the full extent of the policy shift becomes clear—particularly if inflation surprises on the upside.



Through November 2, 2017
Source: Haver Analytics and IHS Markit



Through November 2, 2017
Source: Haver Analytics and IHS Markit

Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
Japan	1.8	1.6	0.4	0.8	(0.10)	(0.10)	0.05	0.05	115	125

OUTLOOK

+ We still expect fiscal and monetary stimulus, along with improved private demand and a tightening labor market, to produce above-trend growth over the next couple of years. Not surprisingly, the labor market continues to tighten.
+ Despite solid activity and tight capacity, inflation has remained low. The BoJ's preferred core inflation measure (CPI ex fresh food and energy) is still near zero. Wage outcomes remain well below levels that would be consistent with the central bank's 2% inflation target.
+ In this environment, we find it difficult to see the BoJ starting the policy normalization process. Instead, the BoJ will probably maintain its QQE-YCC program designed to cap 10-year yields at zero well into 2018, and probably beyond.

RISK FACTORS

+ Any disruption of global trade caused by the Trump administration's policies is an important risk. Japan's current account surplus (4% of GDP) leaves the country vulnerable to US criticism on trade issues.
+ Political risk is another key factor. If Prime Minister Shinzo Abe were to resign, then the "Abenomics" policy architecture would be in doubt, leading to questions about whether the BoJ's QQE-YCC program could be sustained.

OVERVIEW

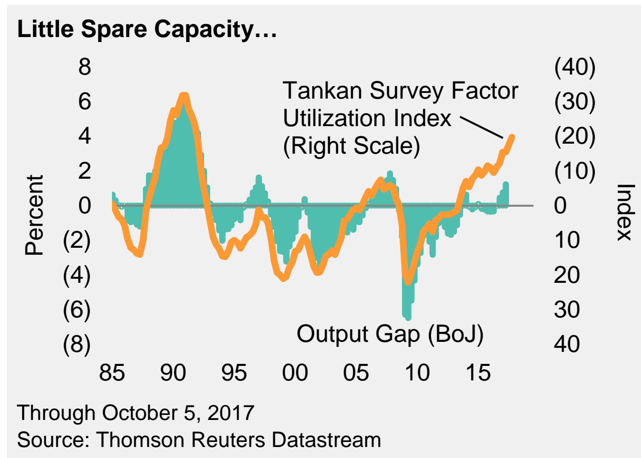
October's lower house election resulted in a resounding victory for Prime Minister Abe. His governing coalition retained their "supermajority" (>2/3 of the seats) in the Diet, leaving the path open for Mr Abe to pursue his agenda of constitutional change. The new "Party of Hope" -- founded by Tokyo Governor Koike – delivered a disappointingly small share of the vote, succeeding only in splintering the opposition parties even further.

The result will reinforce Abe's reputation within the LDP as an election winner, almost guaranteeing political continuity. At this stage, it's very difficult to paint a scenario where he is not re-elected head of the LDP at the end of 2018. Accordingly, Abe looks set to be PM through the 2020 Olympics and into 2021.

In the same vein, the political continuity generates the policy continuity – ie the broad thrust of Abenomics remains the main game. So, we expect to see more on the fiscal policy front, continued political pressure on corporates to grant wage increases and distribute excess cash on their balance sheets, and status quo for monetary policy. On the latter, this means that BOJ Governor Kuroda – or someone more dovish like former Abe adviser Etsuro Honda – is likely to head BOJ when Kuroda's first term ends next April.

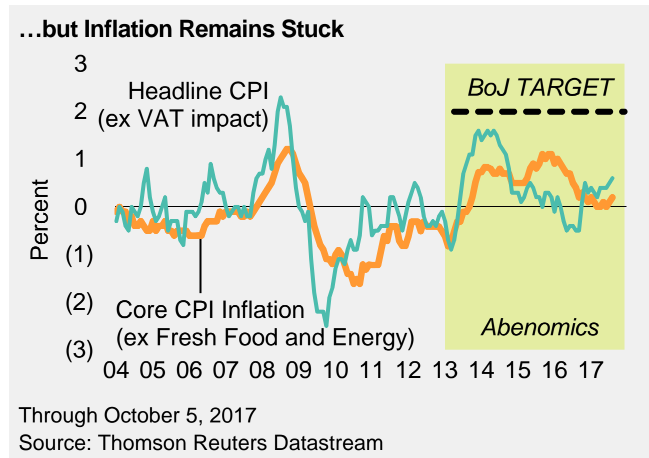
We have been emphasising political dynamics as the main tail scenario for a change in Japanese economic policy and markets. The election result effectively removes that tail risk. JGB yields seem set to stay range bound and, with policy normalisation the theme elsewhere, we'd still expect to see modest weakness in the Yen.

Little Spare Capacity…



Through October 5, 2017
Source: Thomson Reuters Datastream

…but Inflation Remains Stuck



Through October 5, 2017
Source: Thomson Reuters Datastream

China

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
China	6.7	6.0	1.6	2.3	2.80	3.00	3.70	3.60	6.55	6.50

OUTLOOK

+ Post Party Congress's economic strategy may aim to strive for a better balance between growth headline and quality.
+ Environmental protection, overcapacity cuts and financial deleveraging are expected to pose downside growth risk, while the push for tech production will be the green shoot for growth.
+ We now see limited chance of renewed capital account liberalization or greater trading flexibility for the RMB exchange rate, at least in the coming 6-12 months.

RISK FACTORS

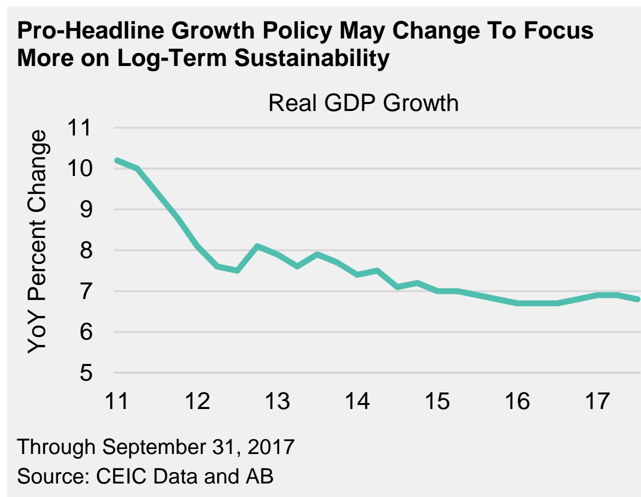
+ Rapid change in government officials' incentive system from growth headline to quality, posing more downside risk than envisaged in our base case scenario.
+ US trade sanctions against China may prove to be more widespread in products and sectors than anticipated, triggering stronger China's retaliation against US's exports and investment.

OVERVIEW

President Xi Jingpin has, as expected, gained more power at the Party Congress and the ruling regime is set to become more centralized in policy and state-directed in economic development. Within the framework of state socialism, China's reform may not necessarily mean market liberalization or opening. Instead, certain reforms which are necessarily to improve economic well-being and stability will be high on the policy agenda. The strike for a green economy is becoming more urgent as a policy to maintain social and political stability. Overcapacity cut and the push for greater private-public partnership (PPP) as the core of state-owned enterprise reform will be key to help enhance major state firms' balance sheet in order to improve their long-term competitiveness to become national champions in key strategic industries. These are likely to be the key elements of President Xi's economic strategy in his 'new era' of Chinese socialism.

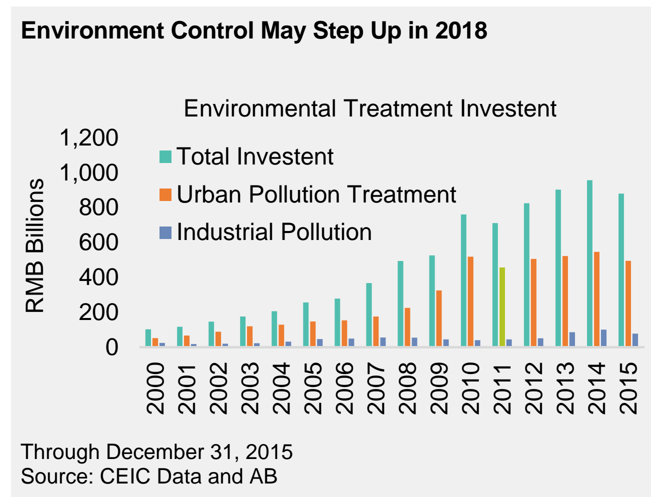
Externally, the President's key note speech at the Party Congress had little emphasis on capital account liberalization or renewed RMB internationalization. PBOC governor even said blatantly that it is yet the right time to consider a further widening of the RMB trading band currently at +/-1%. We expect that the RMB will remain a relatively stable currency class in 2018 given that the anticipated USD appreciation won't become too rapid and extreme in scale.

Pro-Headline Growth Policy May Change To Focus More on Log-Term Sustainability



Through September 31, 2017
Source: CEIC Data and AB

Environment Control May Step Up in 2018



Through December 31, 2015
Source: CEIC Data and AB

Canada

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
Canada	3.2	2.2	1.8	2.0	1.00	1.75	2.15	2.50	1.28	1.25

OUTLOOK

- Economic activity is beginning to normalize, as expected. Real GDP declined slightly in August but is still growing 3.5% year over year. We see growth slowing through year-end.
- The Bank of Canada (BoC) raised its policy rate by 25 basis points at its September meeting. We expect the BOC to stay on hold through year-end, but continue to hike rates next year, roughly on par with the US Federal Reserve.

RISK FACTORS

- Home prices are still rising in key regional markets, but macroprudential measures in Toronto appear to be temporarily cooling the market. Along with historically high household debt levels, consumers will be vulnerable if there is a labor market shock or a rapid rise in interest rates.
- Uncertainty surrounding the outcome of NAFTA re-negotiations could hurt investment. Business are unlikely to invest in their Canadian operations when there's a potential for protectionist policies to be imposed by the US.

OVERVIEW

The outlook for the economy hasn't changed, but the tone of BOC policymakers seemed to shift again this month – this time to a more dovish stance. It was widely expected that the economy would begin to slow in the 2H of 2017, and we've started to see the growth moderation begin. However, many segments of the economy are still strong – most notably, the labor market. Job gains are significantly outpacing the US, and wages have started to respond to the tightening of the labor market. But, there's still slack in the labor force and we expect job gains to continue. Importantly, a strong labor market helps to support higher home prices and rising household debt servicing costs as interest rates continue to rise. Inflation pressures are still subdued, and until prices begin to rise we should expect the BOC to maintain its accommodative monetary policy stance.

Australia/New Zealand

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
Australia	2.2	2.3	1.8	1.7	1.50	1.50	3.00	3.45	0.75	0.73
New Zealand	2.6	2.7	1.8	1.6	1.75	1.75	3.15	3.50	0.68	0.72

AUSTRALIA

- Economic data have improved, and so has the consensus outlook. The majority of analysts expected the Reserve Bank of Australia to hike rates by end 2018.
- However, macroprudential tightening is having the desired effect, leading to slower credit growth and an orderly reduction in housing price growth, including in Sydney. Elevated household debt and weak income growth are putting stress on the household sector. Confidence is only average despite a solid labor market, and spending is patchy,
- The case for tightening monetary policy against that backdrop still seems to us to be somewhat weak.

NEW ZEALAND

- Growth in New Zealand remains solid, but inflation is subdued. This partly reflects labor market dynamics, such as high levels of migration and higher participation. Both have acted as major shock absorbers and have limited wage growth to just 1.6%. It remains difficult to see the Reserve Bank of New Zealand changing course anytime soon.
- After a long wait, the populist NZ First party backed Labour to form government, rather than the incumbent National Party. Likely to see more restriction around immigration and foreign asset purchases (housing), more fiscal boost, and some changes to the RBNZ's mandate (policy committee; employment target) as a result of this shift.

UK

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
UK	1.5	1.6	2.7	2.4	0.50	0.75	1.75	2.25	1.30	1.25

OUTLOOK

- Soft real income growth and Brexit-related uncertainty have weighed on growth in recent quarters. Nonetheless, third quarter GDP data and October survey data suggest that growth has stabilized and may even be improving.
- Inflation is likely to rise further above 3.0% in coming months before moving back closer to target in 2018.
- The market regards the Bank of England's October rate rise as a dovish hike. We disagree and see a high probability of a second increase in the first half of 2018 and that another in the second half of the year is now more likely than not.

RISK FACTORS

- Despite an upward revision to the savings rate, UK household finances still look stretched. This could make the economy unusually vulnerable to higher rates.
- Brexit continues to cloud the outlook. A lengthy transition phase is still the most likely outcome but the probability attached to both tail risks—a hard Brexit or no Brexit at all—have risen.

Norway/Sweden

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
Norway	2.1	2.5	2.0	1.7	0.50	0.75	1.75	2.25	8.25	8.40
Sweden	3.1	2.9	1.9	1.8	(0.50)	(0.40)	1.00	1.50	8.25	8.50

NORWAY OUTLOOK

- The outlook is positive, with growth in the mainland economy expected at 2.1% this year and 2.5% in 2018. These forecasts, like our forecasts for the rest of Europe, are slightly more optimistic than consensus.
- Inflation remained low at 1.0%, far below the 2.5% target. Weak wage growth, lower oil prices and subdued inflation in the rest of Europe are likely to keep it below target over the forecast horizon.
- We expect Norges Bank to hold its policy rate at 0.5% at its December meeting and throughout most of 2018.

RISK FACTORS

- The main risk factor in Norway is rising household debt (currently above 210% of income). The economy would also be vulnerable to a rapid decline in the oil price.

SWEDEN OUTLOOK

- The outlook for economic growth in Sweden remains positive, with the economy still expected to expand by 3.1% this year and 2.9% in 2018.
- Inflation has been above target over the past few months, but this is partly due to special factors, and we expect it to fall back below target in 2018.
- We expect the Riksbank to hold its repo rate at (0.5)% in the near term and maintain its asset purchase program until the end of the year, barring a significant deviation in the ECB's policy stance. The re-appontment of Governor Ingves points to continuity in monetary policy in the near term.

RISK FACTORS

- High household debt and elevated house prices continue to represent a major risk to financial stability.

Asia ex Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
Asia ex Japan	**5.9**	**5.6**	**2.0**	**2.6**	**3.03**	**3.19**	**4.01**	**3.91**	**—**	**—**
Hong Kong	3.7	3.0	1.6	2.4	1.75	2.25	2.00	1.90	7.76	7.76
India	5.7	6.7	3.1	3.9	6.00	6.00	6.80	6.50	64.00	63.50
Indonesia	5.2	5.7	3.8	3.4	4.25	4.25	6.80	6.60	13,700	13,750
South Korea	3.2	2.7	2.1	2.1	1.50	1.50	2.60	2.40	1,135	1,140
Thailand	3.7	3.5	0.5	1.4	1.50	1.50	2.40	2.60	33.00	32.50

OUTLOOK

+ Despite better exports buoyed headline GDP growth, domestic demand remains mediocre and tame inflation enables Asian central banks to stay accommodative. The only exception is Philippines and Korea, but we see the latter would be a pre-mature move given structural headwinds on growth.
+ Chinese policymakers emphasized environmental protection with no specific growth target implies less a pro-growth stance.
+ Sustained export growth contributes stability of Asian currencies, provided the USD does not strengthen abruptly. A continued firm Chinese renminbi will also contribute to regional currency stability.

RISK FACTORS

+ More aggressive Fed tightening would fuel USD strength and threaten regional currencies and portfolio flows.
+ Geopolitical risk from North Korea and threats of US trade sanctions are high on the list.

OVERVIEW

Improving exports filtered in to better growth in the second half of 2017 but domestic demand remains mediocre and divergence in trade performance persists. There are more signs of peaking momentum in Taiwan's electronics exports as reflected in the moderation of leading indicators such as PMI and actual value of export orders. Meanwhile, Korea's performance remains strong as benefited from expanding demand for memory chip devices. China President Xi's speech at the Party Congress indicates less pro-growth orientation, which implies China demand may not be as strong a regional growth driver as seen over the past 12 months.

With tame inflation, Asian central banks would stay accommodative and on hold for an extended period. The exception is the Philippines, where we see BSP to start tightening to support the Peso and fend off overheating concerns by investors and rating agencies. In Korea, the central bank has turned more hawkish in its latest policy statement, but we see any potential hike be pre-mature given that the structural headwinds on growth and inflation are likely to prolong.

Market concerns on North Korea seems dissipated but upcoming development remains highly uncertain. We expect war remains a low probability but remain more concerned about the tension could disrupt US-China trade policy. Meanwhile, we expect gradual and order recovery of USD, but in case of more aggressive Fed tightening, that would threaten regional currency and portfolio flows in 2018.

Latin America

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
Latin America	**0.9**	**2.1**	**6.0**	**5.0**	**9.08**	**7.75**	**8.15**	**7.90**	**—**	**—**
Argentina	2.7	3.6	22.0	15.0	27.50	18.00	—	—	17.80	19.50
Brazil	0.6	2.4	3.1	3.9	7.00	7.00	9.60	9.00	3.27	3.50
Chile	1.3	2.7	3.2	3.0	2.50	3.00	4.45	4.70	640	665
Colombia	1.6	2.3	4.2	4.0	5.00	5.00	6.80	7.30	3,025	3,100
Mexico	2.0	2.2	5.7	3.6	7.00	6.00	7.25	7.30	19.00	19.00

OUTLOOK

+ EM assets continued to attract inflows in October, mainly directed to hard currency funds while local currency funds suffered outflows.
+ Tighter DM monetary policy remains the most significant challenge for EM countries in the months ahead.
+ Uncertainty regarding US trade policy continues, while global geopolitical concerns are on the rise.

RISK FACTORS

+ Asia–US geopolitical concerns, heightened US protectionism, uncertainty related to US tax policy, tighter global monetary policies, and idiosyncratic political shocks in Chile, Venezuela, Brazil and Mexico.

OVERVIEW

A gradual recovery is ongoing, mainly in Argentina and Brazil. Stronger commodity prices are expected to provide support for Chile and Peru. On the other hand, Mexico appears to be decelerating marginally. Inflation remains subdued in most countries, with Venezuela as the exception as the country is entering into hyperinflation. Despite the recovery, regional central banks are still either on hold or in easing mode because output gaps largely remain in negative territory.

In Brazil, President Michel Temer survived to yet another impeachment attempt and looks set to complete his presidential term through next year. Although the government has made progress with a broad swath of reforms, including changes to electoral rules, labor market deregulation and the establishment of market determination of interest rates charged by the Brazilian Development Bank, time is running out to implement changes to the social security system, much needed to ensure medium-term fiscal sustainability. Inflation is below the bottom of the central bank's target range but it may have bottomed out. The central bank has hinted that it will continue to ease policy, although less aggressively.

In Argentina, the ruling Cambiemos coalition obtained a sound victory in the October 22 legislative election, benefitting from polarization between the government and supporters of former President Cristina Kirchner. Cambiemos' strong performance is expected to unlock private investment, which has been modest so far due to uncertainty about the election outcome, and should also provide President Mauricio Macri with additional political capital to undertake reforms – labor and taxes. In the meantime, inflation remains high, preventing the central bank from easing monetary policy.

In Venezuela, the government has announced its intention to "renegotiate" sovereign debt, although in a rather ambiguous way as it also vowed to keep honoring its obligations for the time being. Although the authorities have called on international investors to meet in Caracas to discuss the terms of such negotiation, US sanctions on several government officials make said meetings illegal for US-based bondholders. At the time of printing this report, the government had paid the amortization of the PDVSA 2020 bonds but had yet to pay that on the PDVSA 2017 as well as coupons on several other securities.

Eastern Europe, Middle East and Africa (EEMEA)

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
EEMEA	**2.6**	**2.6**	**6.3**	**5.9**	**6.66**	**6.19**	**8.00**	**8.52**	**—**	**—**
Hungary	3.6	3.3	2.4	2.7	0.90	0.90	2.85	3.50	315	312
Poland	4.0	3.4	2.0	2.2	1.50	1.75	3.55	4.00	4.30	4.18
Russia	1.8	1.8	4.2	5.2	8.00	7.00	7.60	8.00	59.00	59.00
South Africa	0.5	1.0	5.4	5.3	6.75	6.75	9.25	9.50	14.50	14.50
Turkey	5.2	3.5	9.6	8.5	8.00	8.00	11.50	12.30	3.90	4.25

OUTLOOK

+ Real GDP growth should improve over the rest of this year and in 2018, thanks to strong activity in Central and Eastern Europe (CEE) and a modest recovery in Russia. In South Africa, expect weak growth and increased downside risk tied to political uncertainty.
+ Most CEE economies are experiencing a rebound in headline CPI, while Turkish inflation will peak at the end of 2017 but will remain above 9% for most of 2019. Modest disinflation should persist in Russia and South Africa.
+ Despite the CPI rebound, most CEE central banks will not tighten monetary policy in the near term. Russia has still scope to cut interest rates in 2017 and 2018, while Turkey will keep domestic liquidity conditions tight.
+ Political risks still loom large in a few EEMEA countries, especially Turkey and South Africa. Saudi-led sanctions against Qatar pose a threat to regional unity, but a mediated settlement is still likely.

RISK FACTORS

+ Balance-sheet normalization at DM central banks and the potential for higher core yields are risks for current account deficit countries such as Turkey and South Africa.

OVERVIEW

South Africa's medium-term budget policy statement (MTBPS) was certainly worse than general market expectations, with Finance Minister Gigaba not offering any remedial action on the expenditure side at all, despite the underperformance in tax collection and previously telegraphing corrective measures. The latest budget numbers do change the narrative meaningfully because they highlight Finance Minister Gigaba's clear inability (or unwillingness) to deliver fiscal consolidation, which will be even more difficult next year given the upcoming elections in 2019. The 17/18 deficit is expected to stand now at -4.3%, with the outer years at -3.9% through 20/21. This takes the gross debt to GDP ratio to above 60% by 20/21, up from 52.4% of GDP announced during the February 2017 budget. The key problem for the rating agencies is that Treasury projections offer no signs of stabilization in the gross debt numbers – the rise in the 20/21 figure does not even suggest a slowdown in the pace of increase vis-à-vis the previous year. The underlying growth assumptions are not particularly unrealistic but obviously provide little room for error going forward. In the absence of a commitment to debt stabilization, this will make it very difficult for ratings agencies not to downgrade the sovereign, potentially as early as the end of November, despite the political connotations of making such a decision ahead of the Elective Conference.

In this context, the key focus is on South Africa's local currency credit rating. The latter is key because South Africa's inclusion in Barclay's Global Aggregate Bond Index and Citi's World Government Bond Index means that between US$8-10bn are managed against these indices. Depending on the index, a loss of the local currency IG rating from Moody's and S&P could lead to forced selling and outflows. Exclusion from both indices would potentially lead to forced selling of up to US$10bn. To put this in perspective, net portfolio inflows averaged around US$10bn annually since 2015, so forced-selling could constitute just around 1 year worth of net portfolio inflows (although portfolio flows are not the only source of financial account financing). The fact that South Africa's current account deficit has been declining will likely prevent a more meaningful BoP impact, but such outflows (or expectations thereof) would nevertheless be disruptive to local markets.

The MTBPS budget and prospects of further downgrades will also likely increase market nervousness and volatility ahead of the ANC Elective Conference**.** Chances of a more market friendly outcome at the ANC conference have increased (Ramaphosa or compromise candidate Mkhize winning the conference) over the past 6 months. Yet markets will worry a lot more now what will happen under a Dlamini-Zuma ANC presidency, with the MTBPS likely being perceived of a sign of things to come.

	Real Growth (%)		Inflation (%)		Official Rates (%)		Long Rates (%)		FX Rates vs USD	
	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F	2017F	2018F
Global	3.1	3.0	2.5	2.5	2.17	2.26	3.04	3.33	-	-
Industrial Countries	2.2	2.1	1.7	1.7	0.74	1.02	1.77	2.27	-	-
Emerging Countries	4.5	4.6	3.8	3.8	4.95	4.65	5.56	5.43	-	-
United States	2.3	2.0	2.0	2.1	1.38	1.88	2.75	3.25	-	-
Canada	3.2	2.2	1.8	2.0	1.00	1.75	2.15	2.50	1.28	1.25
Europe	2.1	2.1	1.7	1.5	0.08	0.13	0.96	1.65	-	-
Euro Area	2.3	2.2	1.6	1.4	0.00	0.00	0.75	1.50	1.15	1.10
United Kingdom	1.5	1.6	2.7	2.4	0.50	0.75	1.75	2.25	1.30	1.25
Sweden	3.1	2.9	1.9	1.8	(0.50)	(0.40)	1.00	1.50	8.25	8.50
Norway	2.1	2.5	2.0	1.7	0.50	0.75	1.75	2.25	8.25	8.40
Japan	1.8	1.6	0.4	0.8	(0.10)	(0.10)	0.05	0.05	115	125
Australia	2.2	2.3	1.8	1.7	1.50	1.50	3.00	3.45	0.75	0.73
New Zealand	2.6	2.7	1.8	1.6	1.75	1.75	3.15	3.50	0.68	0.72
Asia ex Japan	5.9	5.6	2.0	2.6	3.03	3.19	4.01	3.91	-	-
China	6.7	6.0	1.6	2.3	2.80	3.00	3.70	3.60	6.55	6.50
Hong Kong	3.7	3.0	1.6	2.4	1.75	2.25	2.00	1.90	7.76	7.76
India	5.7	6.7	3.1	3.9	6.00	6.00	6.80	6.50	64.00	63.50
Indonesia	5.2	5.7	3.8	3.4	4.25	4.25	6.80	6.60	13,700	13,750
Korea	3.2	2.7	2.1	2.1	1.50	1.50	2.60	2.40	1,135	1,140
Thailand	3.7	3.5	0.5	1.4	1.50	1.50	2.40	2.60	33.00	32.50
Latin America	0.9	2.1	6.0	5.0	9.08	7.75	8.15	7.90	-	-
Argentina	2.7	3.6	22.0	15.0	27.50	18.00	-	-	17.80	19.50
Brazil	0.6	2.4	3.1	3.9	7.00	7.00	9.60	9.00	3.27	3.50
Chile	1.3	2.7	3.2	3.0	2.50	3.00	4.45	4.70	640	665
Colombia	1.6	2.3	4.2	4.0	5.00	5.00	6.80	7.30	3,025	3,100
Mexico	2.0	2.2	5.7	3.6	7.00	6.00	7.25	7.30	19.00	19.00
EEMEA	2.6	2.6	6.3	5.9	6.66	6.19	8.00	8.52	-	-
Hungary	3.6	3.3	2.4	2.7	0.90	0.90	2.85	3.50	315	312
Poland	4.0	3.4	2.0	2.2	1.50	1.75	3.55	4.00	4.30	4.18
Russia	1.8	1.8	4.2	5.2	8.00	7.00	7.60	8.00	59.00	59.00
South Africa	0.5	1.0	5.4	5.3	6.75	6.75	9.25	9.50	14.50	14.50
Turkey	5.2	3.5	9.6	8.5	8.00	8.00	11.50	12.30	3.90	4.25

Long rates are 10-year yields unless otherwise indicated.
Latin American Rates include Brazil, Chile, Colombia and Mexico
Real growth aggregates represent 48 country forecasts not all of which are shown
Blanks in Argentina are due to distorted domestic financial system so are not forecast.

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