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Alas, Kapital

The biggest puzzle in the world economy…

…is the continued weakness of capital spending…

…which may ultimately reflect the changing preferences of ageing societies

By Stephen King and James Pomeroy

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Stephen King

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Summary

A further loss of momentum

The global economy remains in relatively poor shape. Admittedly, prospects for the Eurozone as a whole haven't deteriorated and, in Spain's case, have significantly improved. Economies in most other regions of the world, however, have failed to deliver. This quarter, we have lowered our growth projections for North America, Brazil and much of Asia. Although financial markets continue to focus on developments in Greece and the Eurozone, in truth the big economic surprises are taking place elsewhere.

For those who thought lower oil prices would contribute to higher rates of economic growth, recent events will have come as a significant surprise. Yet in many ways, the latest set of disappointments mark a continuation of a longer-term trend. In the US, for example, 2015 is now likely to be the thirteenth year out of the last 16 in which the initial consensus forecast for economic growth will prove to be too high.

The investment puzzle

A key proximate reason behind these persistent growth disappointments is a lack of investment. While it's convenient to blame the global financial crisis for a dampening of Keynesian "animal spirits", we show that, at least in the US, the problems began a lot earlier. Although overall US investment held up well after the 2000 stock market crash, this was only because of the housing bubble. Non-residential investment has now been disappointingly weak for the last 15 years.

Initially, it seemed as though weakness in US capital spending would be offset by strength elsewhere, as companies looked to invest in lower-cost emerging markets. Post-financial crisis, however, that excuse no longer looks so convincing: those emerging markets that experienced investment booms are no longer quite so dynamic, suffering variously from financial instability, weak balance of payments positions and poor productivity growth.

More recent developments have only served to emphasise the investment puzzle. Even as consumer spending has either stabilised or accelerated in many parts of the world, investment spending has been a major drag. The usual "multiplier/accelerator" model of demand and investment appears to be misfiring. That's particularly surprising given the prevalence of very low interest rates and, notably in the US, very high profit levels.

A reversal of causality

Sometimes, however, it's worth reversing the causality. Instead of regarding low interest rates as a cause of stronger investment, it might make more sense to think of weak investment as a cause of lower interest rates. Consistent with ongoing disappointments on US economic growth, the long-term cost of borrowing in the US has been persistently lower than forecast over the last 15 years, thanks in part to the impact of weakening productivity growth and sluggish capital spending growth. But why have these items been so weak?

One clue comes from within the financial markets. Investors have become increasingly sceptical about the benefits of capital spending programmes, tending to punish those companies who dare to reinvest profits for the future even as they reward those who pay higher dividends in the present. The problem first emerged following the 2000 stock market collapse but it has only got worse in recent years.

Another clue comes from population ageing. Keynes once rightly stated that “in the long run, we are all dead” but, as the industrialised world’s baby boomers have matured, the “long run” has become shorter and shorter. As a consequence, long-term investment schemes begin to lose their appeal. Instead, boomers want a guaranteed income stream in retirement. It’s not so much a “global savings glut” – as Ben Bernanke, the former Chairman of the Board of Governors of the Federal Reserve once famously described it – but, instead a major shift in the preferences of savers in favour of a stable income stream. One consequence is less risk-taking. Another, by implication, is lower investment and, hence, weaker economic growth.

The forecasts

Compared with last quarter, our downward revisions relate mostly to countries outside Europe: the US had a poor first half, China has slowed down, the rest of Asia has been disappointing and Brazil’s recession has deepened. In these circumstances, we expect monetary policymakers to remain cautious, with the first tentative increase in policy rates by the Federal Reserve likely to materialise only in December, a full six months later than market expectations at the beginning of the year. China has room to ease policy further – and will almost certainly make use of that room. The ECB will remain committed to QE through to September 2016 while the BoJ may choose to deliver another slug of asset purchases in the fourth quarter.

Overall, there are few signs that the world economy is poised for lift off: progress made in one region appears only to be matched by retreat elsewhere, a likely consequence of currency wars. As such, the world economy remains in a fragile state, ill-prepared to cope with future negative shocks.

Key forecast changes

	GDP						Inflation					
% Year	2014		2015f		2016f		2014		2015f		2016f	
World	2.5	(2.5)	2.4	(2.7)	2.9	(3.0)	3.1	(3.2)	2.6	(2.7)	2.9	(2.9)
Developed	1.6	(1.6)	1.7	(2.0)	2.0	(2.1)	1.4	(1.4)	0.4	(0.2)	1.6	(1.5)
Emerging	4.3	(4.3)	4.0	(4.1)	4.6	(4.8)	4.4	(4.6)	4.3	(4.6)	3.9	(3.9)
US	2.4	(2.4)	2.2	(2.9)	2.6	(2.8)	1.6	(1.6)	0.3	(-0.1)	2.0	(1.8)
China	7.4	(7.4)	7.1	(7.3)	7.4	(7.4)	2.0	(2.0)	1.2	(1.2)	1.3	(1.3)
Japan	-0.1	(0.0)	0.8	(0.8)	1.1	(1.1)	2.7	(2.8)	0.8	(0.6)	1.1	(0.8)
India*	7.3	(7.4)	7.8	(7.8)	8.3	(8.3)	6.0	(5.9)	5.2	(5.2)	5.8	(5.8)
Eurozone	0.9	(0.9)	1.3	(1.3)	1.4	(1.4)	0.4	(0.4)	0.2	(-0.1)	0.9	(0.8)
UK	2.8	(2.6)	2.5	(2.6)	2.5	(2.5)	0.6	(1.4)	0.2	(0.3)	1.5	(1.5)
Russia	0.6	(0.6)	-3.5	(-3.5)	-1.0	(-1.5)	7.8	(7.8)	14.7	(16.1)	7.6	(7.2)
Brazil	0.1	(0.2)	-1.6	(-1.2)	1.0	(2.3)	6.3	(6.3)	8.5	(8.0)	6.1	(5.8)

Source: HSBC Estimates. Note: *India data in fiscal year (2012 = April 2012 to March 2013). GDP data from 2012 onwards is as per the new series (2011-12 prices). GDP aggregates use chain nominal GDP (USD) weights and Inflation aggregates calculated using GDP PPP (USD) weights. Parentheses show forecasts from the Global Economics Quarterly Q2 2015

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Key forecasts

Key Forecasts

	GDP			Inflation		
	2014	2015f	2016f	2014	2015f	2016f
World (nominal GDP weights)	**2.5**	**2.4**	**2.9**	**3.1**	**2.6**	**2.9**
Developed	**1.6**	**1.7**	**2.0**	**1.4**	**0.4**	**1.6**
Emerging	**4.3**	**4.0**	**4.6**	**4.4**	**4.3**	**3.9**
North America	**2.4**	**2.1**	**2.6**	**1.6**	**0.3**	**2.0**
US	2.4	2.2	2.6	1.6	0.3	2.0
Canada	2.4	1.4	2.0	1.9	0.7	1.6
Asia-Pacific	**4.0**	**4.3**	**4.6**	**3.1**	**2.1**	**2.5**
Asia Big Three	**4.1**	**4.6**	**5.0**	**3.1**	**2.2**	**2.4**
China	7.4	7.1	7.4	2.0	1.2	1.3
Japan	-0.1	0.8	1.1	2.7	0.8	1.1
India**	7.3	7.8	8.3	6.0	5.2	5.8
Asia ex Big Three	**3.5**	**3.3**	**3.6**	**2.8**	**1.9**	**2.6**
Australia	2.7	2.4	3.0	2.5	1.7	2.5
South Korea	3.3	2.8	2.8	1.3	0.8	2.1
Indonesia	5.0	4.8	5.6	6.4	6.5	4.5
Taiwan	3.8	3.5	3.5	1.2	-0.2	1.5
Thailand	0.9	3.1	3.3	1.9	-0.4	2.3
Malaysia	6.0	4.8	5.1	3.1	2.0	2.8
Singapore	2.9	2.7	3.2	1.0	-0.3	1.2
Hong Kong	2.3	2.3	2.3	4.4	2.7	3.8
Philippines	6.1	5.6	5.9	4.2	2.2	3.9
New Zealand	3.3	2.8	2.8	1.2	0.5	2.0
Western Europe	**1.3**	**1.5**	**1.6**	**0.5**	**0.3**	**1.2**
Eurozone	**0.9**	**1.3**	**1.4**	**0.4**	**0.2**	**0.9**
Germany	1.6	1.5	1.7	0.8	0.5	1.6
France	0.2	1.2	1.4	0.6	0.3	1.0
Italy	-0.4	0.5	0.8	0.2	0.3	0.8
Spain	1.4	2.9	2.2	-0.2	-0.2	1.1
Other Western Europe	**2.6**	**2.1**	**2.2**	**0.6**	**0.2**	**1.2**
UK	2.8	2.5	2.5	0.6	0.2	1.5
Switzerland	2.0	0.5	1.1	0.0	-1.0	-0.2
Sweden	2.4	2.0	1.8	-0.2	0.1	0.4
Norway***	2.3	1.6	1.7	2.0	1.6	1.7
CEEMEA	**2.3**	**1.3**	**2.1**	**5.9**	**7.8**	**5.9**
Russia	0.6	-3.5	-1.0	7.8	14.7	7.6
Turkey	2.9	2.4	3.0	8.9	7.3	7.6
Saudi Arabia	3.6	3.3	2.1	2.7	2.5	2.3
Nigeria	6.3	4.0	5.5	8.1	9.2	8.8
Poland	3.4	3.6	3.7	0.0	-0.5	1.4
South Africa	1.5	1.7	1.9	6.1	5.0	6.7
Latin America	**1.0**	**0.7**	**2.0**	**7.0**	**7.3**	**6.1**
Brazil	0.1	-1.6	1.0	6.3	8.5	6.1
Mexico	2.1	2.7	2.8	4.0	2.9	3.6
Argentina	-1.7	0.0	1.2	38.6	29.2	28.9
Colombia	4.6	3.3	3.0	2.9	4.3	3.4
Chile	1.9	2.5	3.0	4.4	4.0	3.4

Notes: *Fiscal year, **Mainland. For GDP we calculate aggregates using chain nominal GDP (USD) weights; for inflation we use PPP (USD) weights. India data in fiscal year (2012 = April 2012 - March 2013). GDP data from 2012 onwards is as per the new series (2011-12 prices)
Source: HSBC estimates

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Stephen King
Chief Economist
HSBC Bank plc
+44 20 7991 6700
stephen.king@hsbcib.com

James Pomeroy
Economist
HSBC Bank plc
+44 2- 7991 6714
james.pomeroy@hsbc.com

Out of shape

Relative to expectations at the beginning of 2014, the global economy is not in particularly good shape. Table 1 tracks changes to consensus expectations for 2015 economic growth over the last 18 months. Western Europe has performed more or less in line with initial expectations – with Spanish vim offset by Italian fatigue – but growth forecasts more or less everywhere else have suffered death by a thousand cuts. China's growth engine has misfired, Brazil has ended up in a deep recession, Canada and Australia have suffered alongside other commodity producers, Japan's recovery has stalled and, yet again, initial optimism over the pace of US economic recovery has proved to be misplaced. Of the world's largest economies, only India is doing a lot better than initially expected – but that's only because the official statistics have been conveniently recalibrated.

1. Expectations of growth have mostly come down

GDP Growth, 2015	US	Canada	UK	Eurozone	Japan	China	Brazil
January 2014	3.0	2.5	2.4	1.4	1.2	7.4	2.3
June 2014	3.1	2.5	2.6	1.5	1.2	7.1	1.8
December 2014	3.0	2.5	2.6	1.1	1.2	7.0	0.6
January 2015	3.2	2.3	2.6	1.1	1.2	7.0	0.4
June 2015	2.2	1.6	2.4	1.5	1.0	6.9	-1.2*
Total Change	**-0.8**	**-0.9**	**0.0**	**0.1**	**-0.2**	**-0.5**	**-3.5**
	India	**Germany**	**France**	**Italy**	**Spain**	**Australia**	**South Korea**
January 2014	6.8	2.0	1.2	1.0	1.2	3.0	3.7
June 2014	6.2	2.0	1.3	1.2	1.6	3.0	3.7
December 2014	6.3	1.3	0.8	0.4	1.9	2.8	3.5
January 2015	6.3	1.4	0.9	0.4	2.0	2.7	3.6
June 2015	7.8	1.9	1.2	0.7	2.9	2.5	3.0
Total Change	**1.0**	**-0.1**	**0.0**	**-0.3**	**1.7**	**-0.5**	**-0.7**

Source: Consensus Economics
*Note: For Brazil, May 2015 numbers have been used in place of June 2015 numbers

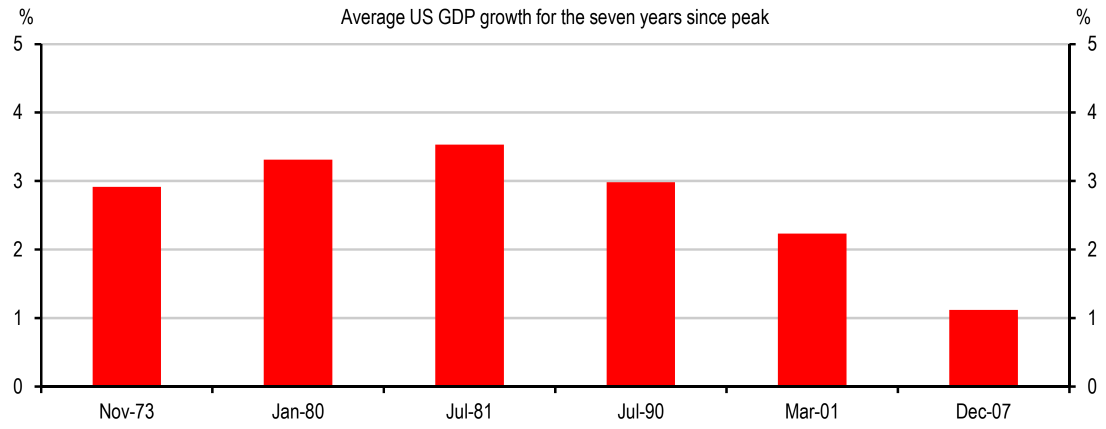
These disappointments are particularly surprising given the supposed benefits of lower oil and other commodity prices. At the beginning of 2014, the price of Brent crude stood at USD111/b. Following a bit of a rollercoaster ride, the price at the time of writing stands at around USD60/b. Conventional analysis suggested that the implied redistribution of income from oil producing nations to oil consuming nations would boost global economic activity – on the assumption that the marginal propensity to spend of oil consumers would be higher than that of producers. Yet, in the event, this has been far from obvious, for three reasons:

- First, the distinction between producers and consumers has become blurred, thanks in part to huge investment in shale energy in recent years, notably in the US.
- Second, the decline in oil prices may not have been entirely an exogenous effect associated with a change in Saudi Arabia's willingness to be the world's "swing producer" of oil: instead, part of the decline may have been an endogenous response to weakening growth in the emerging world.
- Third, in a deleveraging world, higher real incomes in response to lower oil prices might not lead to higher expenditures, particularly if interest rates are unable to fall any further to encourage people to spend rather than save (or repay debt). Indeed, since last summer, the US personal saving ratio has risen from 4.6% of personal disposable income to 5.6%: it appears that the marginal propensity to consume out of so-called "transitory income" is lower than it once was.

Beyond these near-term observations, however, there are bigger concerns. "Optimism bias" has been rife amongst US economists for many a year. It increasingly looks as though 2015 will be the thirteenth year out of the last sixteen in which the initial consensus growth forecast has proved to be too high. That's quite a remarkable result. A careful look at the data provides a clue as to what has been happening.

Chart 2 shows average GDP growth rates across all US economic cycles since the 1970s. Growth rates recorded during the last two cycles – both before and after Lehman – have been weaker than in earlier times. There is a tendency to think that US economic difficulties – and, by extension, those facing the global economy – began in 2008, thanks to the sub-prime crisis and the eventual collapse of Lehman Brothers. The data, however, suggest otherwise. Across the two economic cycles seen so far, the 21st Century has been less kind to the US economy than the late-20th Century.

2. This US economic cycle has been profoundly disappointing

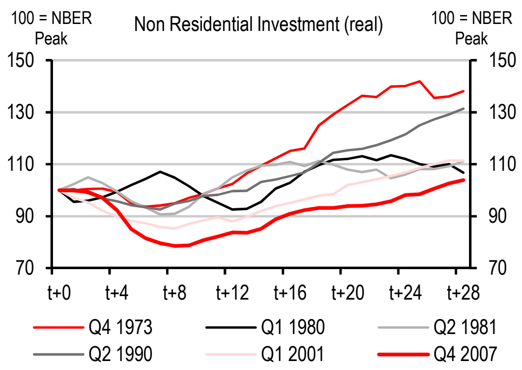


Source: Thomson Reuters Datastream, HSBC, National Bureau of Economic Research

Whatever happened to capital spending?

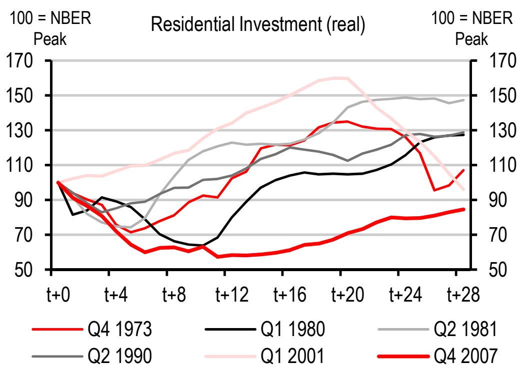
A key reason behind this disappointment is disappointment on capital spending. Charts 3 and 4 show the level of US capital spending across all cycles since the 1970s, split between residential and non-residential investment. What is immediately clear is the weakness in both areas of capital spending through the latest economic cycle. Yet for non-residential investment, this only continued a pattern already established in the previous cycle. Aggregate investment appeared to be holding up reasonably well (chart 5) only because of an unsustainable boom in residential investment. In hindsight, the US investment shortfall didn't begin with the sub-prime crisis but, instead, with the end of the tech bubble. The housing boom merely acted as fleeting camouflage.

3. US non- residential investment has been weak through two cycles



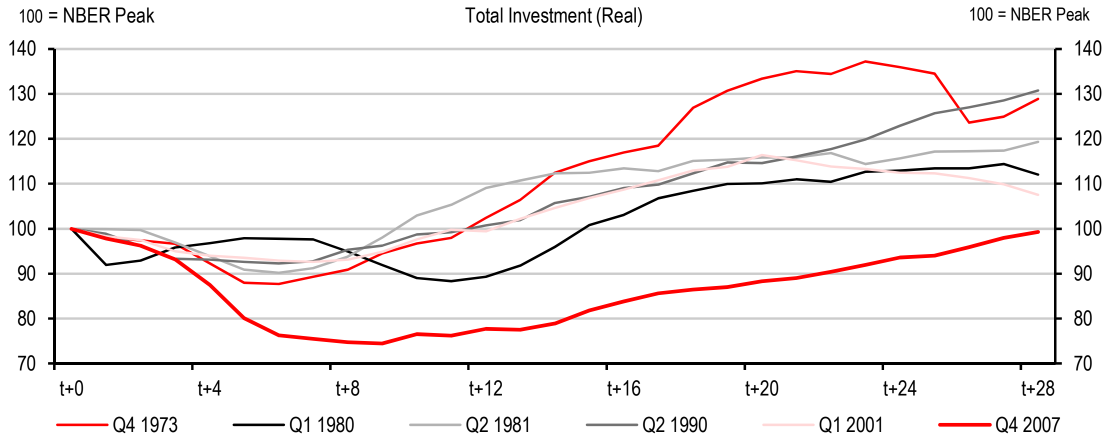
Note: t is in quarters, so t+8 is 2 years after the NBER peak
Source: HSBC, Thomson Reuters Datastream.

4. US residential investment went from bubble to bust



Note: t is in quarters, so t+8 is 2 years after the NBER peak
Source: HSBC, Thomson Reuters Datastream.

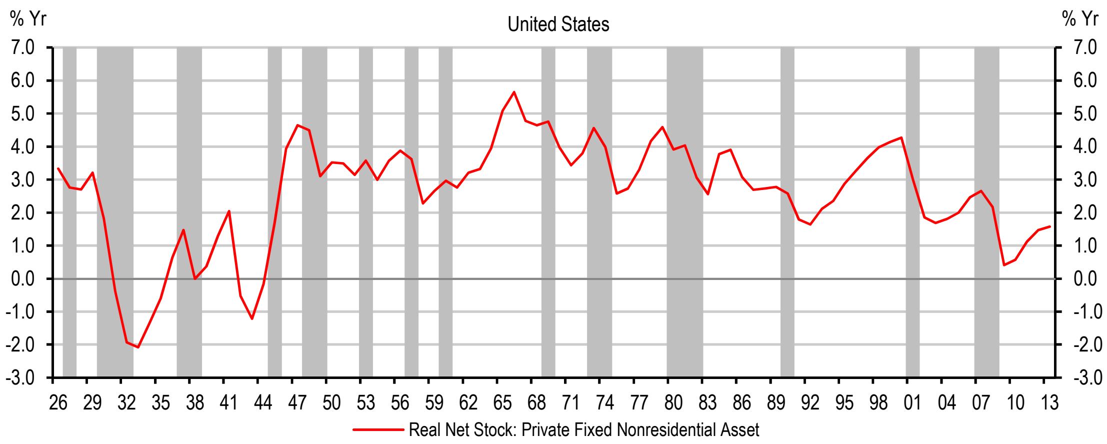
5. Total investment held up in the pre-financial crisis cycle only because of booming residential investment



Source: HSBC, Thomson Reuters Datastream

One consequence of this has been a much slower accumulation of capital stock in recent years. Chart 6, for example, shows estimates from the US Bureau of Economic Analysis of the growth of non-residential capital stock since the 1920s. Although there has been a partial rebound since the depths of the recession, the overall loss of momentum – particularly compared with the late-1990s – is striking. Simultaneously, total factor productivity has slowed.

6. A long-run history of the growth rate of the US capital stock

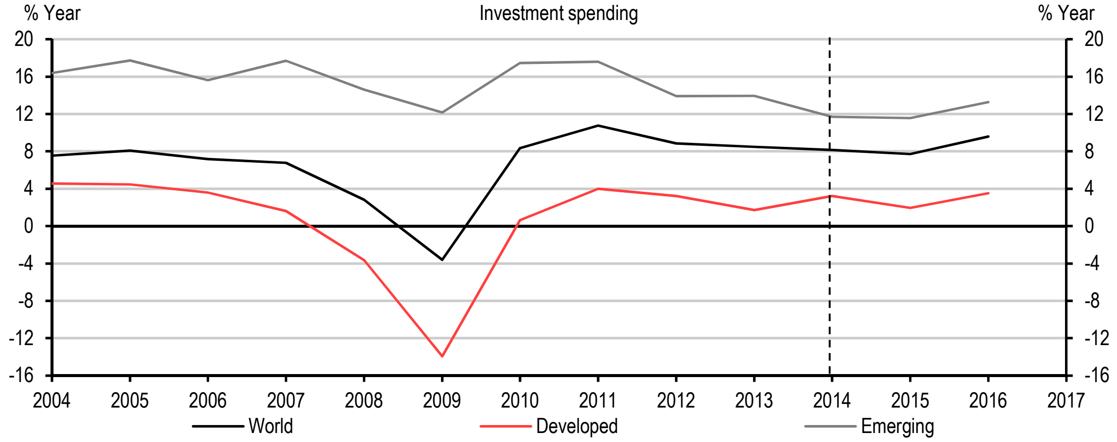


Source: HSBC, Bureau of Economic Analysis

One reason for the early-21st Century's lack of investment is doubtless a hangover after the excesses seen in the late-1990s, a period during which any hare-brained investment scheme was seen as a potential money-making opportunity. Although technology has thereafter continued to advance in leaps and bounds, it may be that the late-1990s represented the zenith of speculative technology-related capital spending.

Yet, even as non-residential investment in the US – and, by extension, the developed world – slowed, capital spending boomed in the emerging world. This was partly a process of displacement: companies that used to invest only in the developed world were faced with opportunities to invest in countries with lower labour costs and burgeoning consumer markets. The emerging market investment boom was also, of course, a reflection of accommodative monetary conditions in the West and a savings "glut" elsewhere, encouraging a global "hunt for yield" that simultaneously also contributed to the US housing boom.

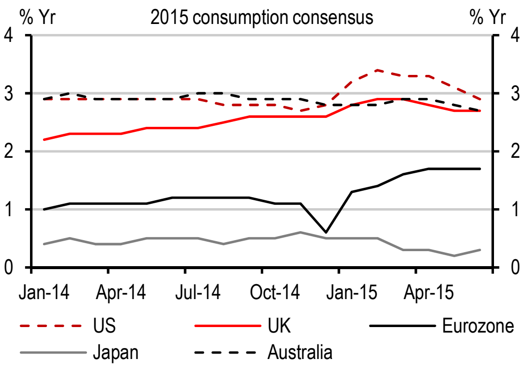
7. Even as investment softened in the developed world, it boomed in the emerging world – until more recently



Source: HSBC estimates

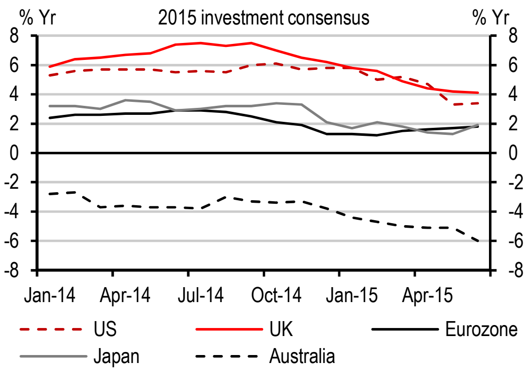
Unfortunately, weakness in investment spending has more recently become more widespread. Chart 7 shows what's been happening: in the emerging world, capital spending growth has slowed from around 17% year-on-year to around 12%. It's a process that's been accompanied by a severe slowdown in productivity and a major deterioration in competitiveness. What was once true of the developed world alone now appears to be a more widespread problem: *ex post*, returns on investment have been lower than anticipated, leaving many emerging nations with an excess of debt and a deleveraging headache. For more information on the eurozone's investment challenge please see *European Economics Quarterly, Beyond the bounce-back, Q2 2015*.

8. Earlier consumption expectations have either been met or exceeded



Source: Consensus Economics

9. Earlier investment expectations were too high almost everywhere



Source: Consensus Economics

From accelerator to decelerator: a reversed causality

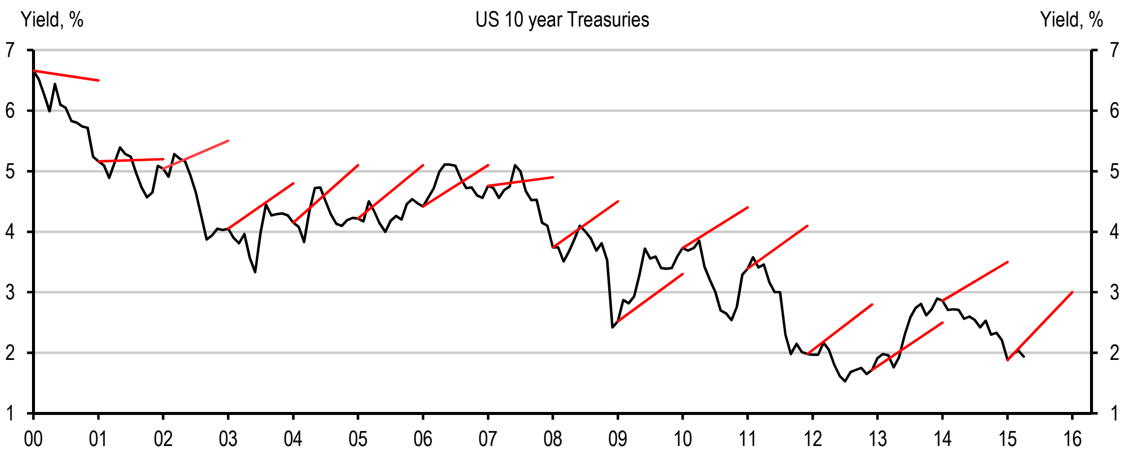
Recent developments only serve to reinforce the disappointments on capital spending. Charts 8 and 9 show revisions to the 2015 consensus for both consumption and investment growth since the beginning of 2014. For the most part, consumption has held up reasonably well, consistent with the conventional view that lower oil prices would help support demand. This is particularly true for Europe, where latest estimates are considerably higher than those published throughout 2014. Investment, however, has been hugely disappointing: latest estimates are, almost without exception, considerably weaker than originally projected. This set of outcomes is puzzling for three reasons:

- First, interest rates are remarkably low by past standards, suggesting that companies might as well invest rather than sit on low-yielding cash.
- Second, companies are, in many cases, hugely profitable.
- Third, with consumption now doing better, the most obvious excuse for underinvesting – weak final demand – no longer seems so credible. The standard multiplier-accelerator model suggests that an initial unanticipated increase in, say, consumption, should leave companies with a capital stock shortfall, triggering a rapid increase in investment to close the gap.

These "puzzles" can, however, be resolved if the usual causality is reversed. Rather than lower interest rates causing higher investment, perhaps weak investment has dragged interest rates lower. Reduced bargaining power of labour – a process that started in the 1980s but which has allowed profit shares in GDP to rise – may have encouraged companies to expand by hiring more workers rather than adding to the stock of capital, thereby changing the capital-labour ratio. Higher consumption, meanwhile, may simply be the flipside of lower investment, reflecting a shift in society's preference in favour of jam today, not jam tomorrow. It's what happens when populations age.

Chart 10 provides evidence to support the idea that interest rates have been declining structurally rather than cyclically. It shows the path for US 10-year Treasury yields alongside consensus forecasts made at the beginning of each year for the level of Treasury yields at year end (for the record, the decline in nominal interest rates shown in the chart is more or less entirely a reflection of lower real interest rates). Remarkably enough, forecasters have said the same thing more or less every year: borrowing costs are apparently always about to head higher. Occasionally, the consensus has been right. For the most part, however, it has been wrong: yields are a lot lower now than they once were, and have been trending lower for most of the last fifteen years.

10. Forecasters always think US 10-year yields are heading higher: they are normally wrong



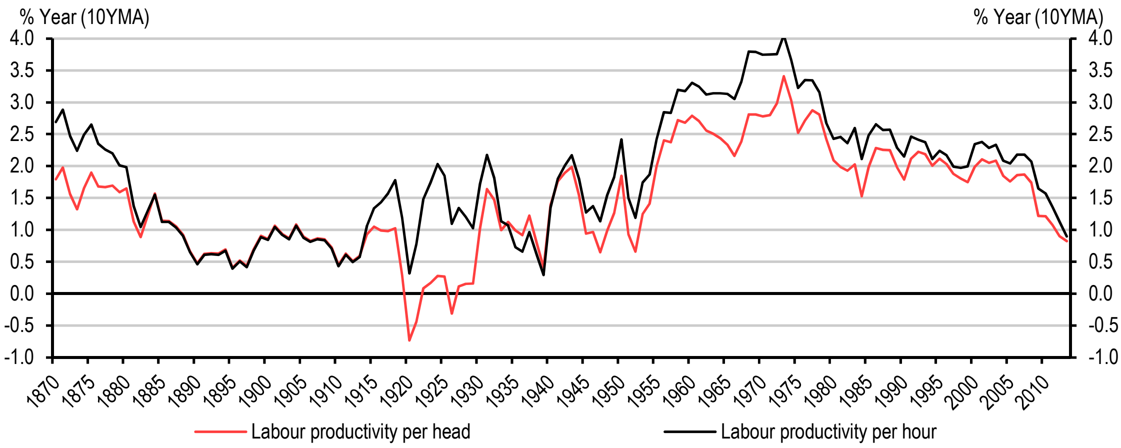
Source: Thomson Reuters Datastream, Consensus Economics. Note: red lines show consensus forecasts made in start of year for 12 months ahead.

Productivity and (dis)incentives

These persistently lower interest rates tie in with two broad themes: first, the impact of lower rates of growth in productivity and, second, the reduced incentives on offer for companies to make investments.

Chart 11 shows labour productivity in the UK – both on a per head and per hour basis – all the way back to 1870. Productivity growth slowed in the 1870s and then entered a prolonged period of relative torpor which really only came to an end in the 1950s. Over the following two decades, productivity growth rapidly accelerated. Thereafter, however, growth has decelerated, particularly since the beginning of the new Millennium.

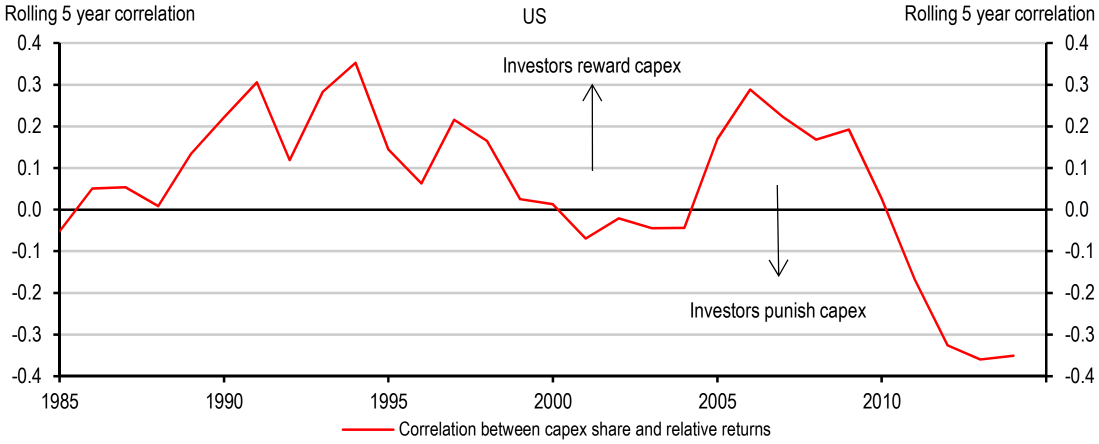
11. The UK has experienced a rapid productivity slowdown



Source: Bank of England

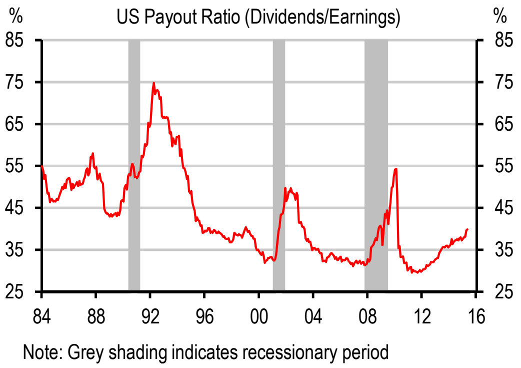
Chart 12, meanwhile, shows whether investors tend either to reward or penalise US companies on the announcement of capital spending plans. Admittedly, the chart offers only a relatively limited snapshot – back to 1985 rather than 1870 – but it suggests a sea-change in attitudes towards investment. The first hints came in the immediate aftermath of the technology bubble, when shareholders became indifferent about capital spending announcements following many years in which share prices rose strongly in response to new investment plans. Post-financial crisis, the situation has become much worse: shareholders positively recoil from companies that plan to invest for the future.

12. Do capital spending plans lead to share prices outperforming or underperforming?



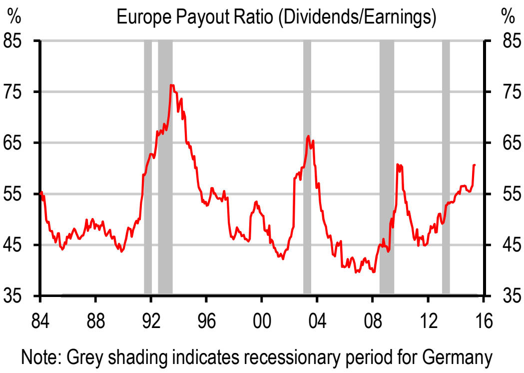
Source: HSBC, Thomson Reuters Datastream

13. The US payout ratio is on the rise



Source: HSBC, Thomson Reuters Datastream

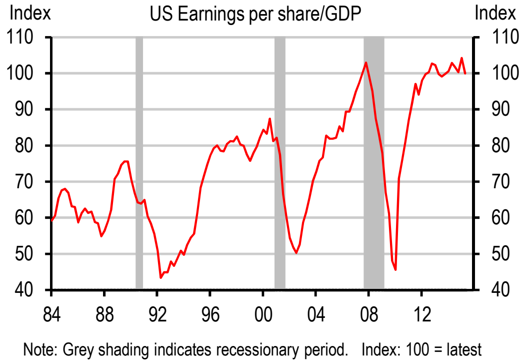
14. The same is happening in the EU



Source: HSBC, Thomson Reuters Datastream

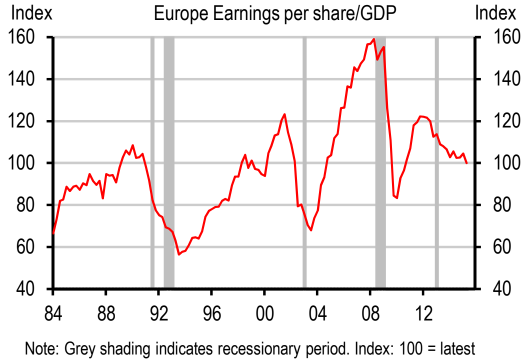
Instead, it seems, companies keep investors happy by returning money to them on an increasingly regular basis. Charts 13 and 14 show pay-out ratios – dividends divided by earnings – since the mid-1980s in both the US and Europe. For the most part, pay-out ratios spike during recessions – earnings collapse but companies attempt to maintain dividend payments – only to come straight back down during subsequent recoveries. Since the global financial crisis, however, a completely different pattern has emerged: companies are paying out, year-by-year, a bigger proportion of total earnings even though, as a share of GDP, earnings are already relatively elevated, at least in the US (charts 15 and 16).

15. US corporate profits are very high as a share of GDP



Source: HSBC, Thomson Reuters Datastream. Note: EPS for MSCI US divided by US nominal GDP. This is then rebased so that latest datapoint =100.

16. European profits are not so impressive



Source: HSBC, Thomson Reuters Datastream. Note: EPS for MSCI Europe divided by nominal GDP for Western Europe. This is then rebased so that latest datapoint =100.

Re-assembling the jigsaw

Putting these pieces of the jigsaw together, the picture that emerges has the following key characteristics:

(i) Even though global investment held up before the financial crisis, investment in the West held up only because of a boom in residential investment. Non-residential investment, particularly in the US, began to soften immediately after the technology bubble burst in 2000.

(ii) This weakening in investment coincided with a slowdown in total factor productivity on both sides of the Atlantic and with an extended period during which long-term interest rates persistently declined.

(iii) Those trends became more entrenched after the global financial crisis. Capital spending has eased in the emerging world. Interest rates have fallen further. There have been few signs of any recovery in investment even though interest rates are low and the usual "accelerator" conditions have more recently fallen into place. Productivity growth has been lacklustre – not only in the developed world but now also in the emerging world..

(iv) Where there has been economic growth, it has been employment "rich" and investment "poor", consistent with both ongoing productivity weakness and with the distinction we made in "*The monetary tug of war*" (Global Economics, Fourth Quarter 2014) between Keynesian unemployment – a reflection of weak demand – and classical unemployment – a result of wages being too high relative to the marginal productivity of the n^{th} worker. Meanwhile, companies are either choosing to reward their shareholders with higher dividend payments (or share buybacks) or their shareholders are demanding that they do so.

What might account for this prolonged period of disappointment? It is easy enough to blame the financial crisis but, to a considerable degree, the pattern of low interest rates alongside low non-residential investment had already been established, at least in the developed world, before the onset of the crisis.

Alan Greenspan, the former Chairman of the Board of Governors of the Federal Reserve, referred to a global bond market "conundrum" in testimony before Congress in February 2005 (http://www.federalreserve.gov/boarddocs/hh/2005/february/testimony.htm), with specific reference to a continued decline in long-term interest rates even as the Fed was shoving short-term interest rates higher.

Ben Bernanke – who took over from Greenspan in 2006 – offered an explanation in April 2005 in the form of the "global savings glut" – the view that excess savings particularly in Asia were lowering interest rates in the US, prompting a real estate boom (http://www.federalreserve.gov/boarddocs/speeches/2005/200503102/).

Yet the "savings glut" hypothesis has two important weaknesses.

- First, many of those nations that had "excess" savings in the form of large balance of payments surpluses in the years before the global financial crisis no longer do so: most obviously, China's surplus has collapsed and Japan's surplus is now a deficit. Yet despite the reduction of these "local savings gluts", interest rates have continued to fall.
- Second, although the Eurozone may have replaced Asia as today's provider of the global savings glut – and, according to Bernanke's later thoughts, may be responsible for subsequent further declines in interest rates (see, for example, http://www.brookings.edu/blogs/ben-bernanke/posts/2015/04/01-why-interest-rates-low-global-savings-glut) – it is no longer so obvious that the savings glut is boosting economic activity in other parts of the world in the way that Bernanke's original argument had suggested. Instead, there appears to be a growing gap between financial hope – reflected in high equity prices – and economic reality. If there is a savings glut, it appears only to be driving asset prices higher without adding significantly to economic activity.

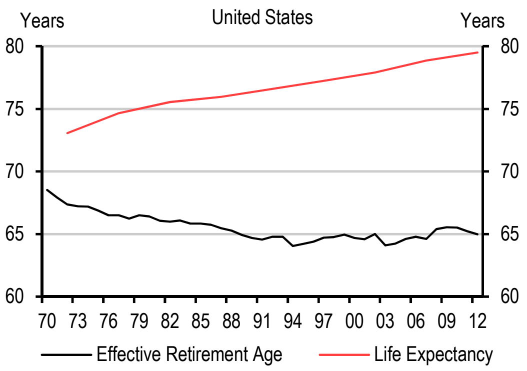
Ageing societies

There is, however, an alternative explanation for the persistent absence of investment. It relates to ways in which the savings and investment aspirations of societies change in response to population ageing. When Keynes first famously remarked that "in the long run, we are all dead", he perhaps wasn't thinking too carefully about population ageing. As the boomers mature, the "long run" for ageing societies becomes shorter and shorter. In response, savings and investment behaviours change. Most obviously, long-term investment schemes lose their appeal. Instead, ageing boomers – often increasingly risk averse - want a guaranteed stream of income in their retirement, which typically can be most easily provided by bond-like financial assets. That, in turn, implies a healthy demand for both government and corporate debt – even at historically low real and nominal interest rates – and equities that offer high dividends instead of long-run capital gains.

From a corporate perspective, the incentive is increasingly to deliver profits directly to the shareholder – in the form of dividends or share buybacks – and not to invest for the long term. The result is a combination of low interest rates and, by historical standards, low rates of investment. It's less a savings glut and more a change in savers' preferences as they age. The consequence is likely to be relatively weak economic growth where expansions are more likely to be driven by additional hiring in the labour market – often at diminishing marginal rates of productivity – and less likely to be supported by productive additions to the capital stock.

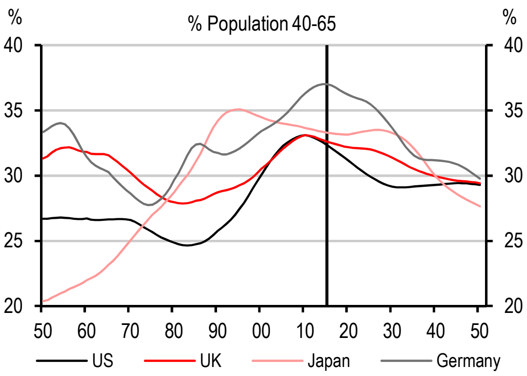
Securing incomes in the near future may have a long-term cost for younger generations. Charts 17 and 18 provide a neat way of summarising the issue. Chart 17 shows the extent to which life expectancy has increased in the US relative to retirement age. Chart 18 shows the proportion of the population in the 40-65 age group across a range of countries: in effect, once that proportion starts to shrink, the "long-run" for society as a whole becomes progressively shorter, signalling a shift in savings preferences. It happened long ago in Japan, it's already happening in Europe and it's on the cusp of happening in the US. And as the boomers age, more of society's resources are devoted to the boomers' final non-productive years: indeed, in the US, for those over 65 who contributed to the Medicare system, medical expenses are largely paid for, reducing the incentive to carry on working.

17. Americans are retiring sooner even as they're getting older



Source: HSBC, OECD, UN Population Division

18. From highly productive to increasingly needy: the ageing of developed world populations



Source: HSBC, OECD, UN Population Division

Elephants and forecasts

This quarter, we have deliberately avoided talking about the rather obvious elephant in the room, namely the uncertainty in Greece and its implications for the Eurozone more broadly. At the time of writing, the situation was still on a knife-edge, with any deal likely to be only short-term in nature. For interested observers, Janet Henry and Fabio Balboni, our European economists, are offering continuous timely updates which are available on the HSBC Research website.

Still, there are some important messages stemming from our latest forecasts – in part stemming from our concerns about capital spending. We have lowered our global GDP forecast for this year from 2.7% last quarter to 2.4%, mainly reflecting reductions in our projections for the US (down from 2.9% to 2.2%), Canada (down from 1.8% to 1.4%), China (down from 7.3% to 7.1%), Asia-Pacific (ex "Big 3") (down from 3.5% to 3.3%) and Brazil (down from -1.2% to -1.6%). There is no real evidence of decoupling between the developed and emerging worlds: growth forecasts for both regions have come down. Remarkably enough, given the uncertainties in Greece, the European outlook offers a haven of tranquillity compared with the more pessimistic tone developing in other parts of the world.

19. Key forecast changes

	GDP						Inflation					
	2014		2015f		2016f		2014		2015f		2016f	
World	2.5	(2.5)	2.4	(2.7)	2.9	(3.0)	3.1	(3.2)	2.6	(2.7)	2.9	(2.9)
Developed	1.6	(1.6)	1.7	(2.0)	2.0	(2.1)	1.4	(1.4)	0.4	(0.2)	1.6	(1.5)
Emerging	4.3	(4.3)	4.0	(4.1)	4.6	(4.8)	4.4	(4.6)	4.3	(4.6)	3.9	(3.9)
US	2.4	(2.4)	2.2	(2.9)	2.6	(2.8)	1.6	(1.6)	0.3	(-0.1)	2.0	(1.8)
China	7.4	(7.4)	7.1	(7.3)	7.4	(7.4)	2.0	(2.0)	1.2	(1.2)	1.3	(1.3)
Japan	-0.1	(0.0)	0.8	(0.8)	1.1	(1.1)	2.7	(2.8)	0.8	(0.6)	1.1	(0.8)
India*	7.3	(7.4)	7.8	(7.8)	8.3	(8.3)	6.0	(5.9)	5.2	(5.2)	5.8	(5.8)
Eurozone	0.9	(0.9)	1.3	(1.3)	1.4	(1.4)	0.4	(0.4)	0.2	(-0.1)	0.9	(0.8)
UK	2.8	(2.6)	2.5	(2.6)	2.5	(2.5)	0.6	(1.4)	0.2	(0.3)	1.5	(1.5)
Russia	0.6	(0.6)	-3.5	(-3.5)	-1.0	(-1.5)	7.8	(7.8)	14.7	(16.1)	7.6	(7.2)
Brazil	0.1	(0.2)	-1.6	(-1.2)	1.0	(2.3)	6.3	(6.3)	8.5	(8.0)	6.1	(5.8)

Source: HSBC Estimates. Note: *India data in fiscal year (2012 = April 2012 to March 2013). GDP data from 2012 onwards is as per the new series (2011-12 prices). GDP aggregates use chain nominal GDP (USD) weights and Inflation aggregates calculated using GDP PPP (USD) weights. Parenthesis show forecasts from the Global Economics Quarterly Q2 2015

These downward revisions account for changes in some of our key policy assumptions. Although the situation remains fluid, we now expect the Federal Reserve not to raise interest rates until December, a full six months later than had been expected by investors at the beginning of the year. The Chinese authorities look set to offer a lot more in the form of monetary stimulus in response not only to slowing growth but also to undesirably low inflation – although recent volatility in the various Chinese bourses may complicate matters. The Bank of Japan has held off from offering more in the way of QE but we still expect them to deliver in the fourth quarter of 2015. We think the ECB remains committed to asset purchases all the way through to 2016. Brazil may find room to cut rates by the end of the year, but only if inflation allows. The Bank of England is likely to raise rates in February 2016, two months after we think the Federal Reserve will first act.

These monetary actions may be individually sensible but they also create a global "adding up" problem through their possible currency implications. Europe's relative success in recent months is not just a reflection of the benefits stemming from lower oil prices: it also, doubtless, reflects the impact of a much softer euro, in part a reaction to – accurate – expectations that the ECB would eventually deliver quantitative easing. Europe's success, however, is arguably also the cause of failure elsewhere: a weaker euro (and yen) imply a stronger dollar (and renminbi), which in turn means that Europe and Japan have successfully exported their deflationary difficulties to their near and distant neighbours. If, in the new world order, one nation's gain is another's pain, it's hardly surprising that nascent regional recoveries always fail to kick-start the engines of global economic growth. Meanwhile, with interest rates still very low and with government debt levels still very high, there is a serious lack of ammunition with which to fight the next recession, a point we made forcibly in *"The World Economy's Titanic Problem"* (13 May 2015).

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Global economic forecasts

GDP

Annual

% Year	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
World (Nominal GDP weights)	**3.8**	**1.3**	**-2.3**	**4.0**	**2.8**	**2.3**	**2.3**	**2.5**	**2.4**	**2.9**
World (PPP Weights)	**5.4**	**2.7**	**-0.4**	**5.5**	**4.1**	**3.4**	**3.4**	**3.4**	**3.3**	**3.8**
Developed	**2.5**	**0.0**	**-3.8**	**2.6**	**1.5**	**1.3**	**1.3**	**1.6**	**1.7**	**2.0**
Emerging	**8.1**	**5.1**	**1.8**	**7.6**	**6.1**	**4.6**	**4.6**	**4.3**	**4.0**	**4.6**
North America	**1.9**	**-0.2**	**-3.0**	**2.5**	**1.9**	**2.7**	**2.2**	**2.4**	**2.1**	**2.6**
US	1.9	-0.3	-3.1	2.4	1.8	2.8	2.2	2.4	2.2	2.6
Canada	2.0	1.2	-2.7	3.4	3.0	1.9	2.0	2.4	1.4	2.0
Asia-Pacific	**6.5**	**3.1**	**1.2**	**7.1**	**4.0**	**4.4**	**4.5**	**4.0**	**4.3**	**4.6**
Asia Big Three	**6.8**	**3.1**	**1.3**	**7.6**	**4.0**	**4.6**	**4.9**	**4.1**	**4.6**	**5.0**
China	14.2	9.6	9.2	10.4	9.3	7.7	7.7	7.4	7.1	7.4
Japan	2.2	-1.0	-5.5	4.7	-0.5	1.7	1.6	-0.1	0.8	1.1
India*	9.8	3.9	8.5	10.3	4.8	5.1	6.9	7.3	7.8	8.3
Asia ex Big Three	**5.6**	**3.1**	**0.9**	**5.9**	**3.8**	**3.8**	**3.4**	**3.5**	**3.3**	**3.6**
Australia	4.5	2.7	1.6	2.3	2.7	3.6	2.1	2.7	2.4	3.0
South Korea	5.5	2.8	0.7	6.5	3.7	2.3	2.9	3.3	2.8	2.8
Indonesia	6.3	6.2	4.7	6.4	6.2	6.0	5.6	5.0	4.8	5.6
Taiwan	6.5	0.7	-1.6	10.6	3.8	2.1	2.2	3.8	3.5	3.5
Thailand	5.4	1.7	-0.7	7.5	0.8	7.3	2.8	0.9	3.1	3.3
Malaysia	6.3	4.8	-1.5	7.5	5.3	5.5	4.7	6.0	4.8	5.1
Singapore	9.1	1.9	-0.7	15.3	6.2	3.4	4.4	2.9	2.7	3.2
Hong Kong	6.5	2.1	-2.5	6.8	4.8	1.7	2.9	2.3	2.3	2.3
Philippines	6.6	4.2	1.1	7.6	3.7	6.7	7.1	6.1	5.6	5.9
New Zealand	3.4	-0.5	-1.4	1.6	1.8	2.4	2.2	3.3	2.8	2.8
Western Europe	**3.0**	**0.3**	**-4.3**	**2.0**	**1.7**	**-0.4**	**0.2**	**1.3**	**1.5**	**1.6**
Eurozone	**3.0**	**0.4**	**-4.5**	**2.0**	**1.7**	**-0.8**	**-0.3**	**0.9**	**1.3**	**1.4**
Germany	3.4	0.8	-5.6	3.9	3.7	0.6	0.2	1.6	1.5	1.7
France	2.3	0.1	-2.9	1.9	2.1	0.2	0.7	0.2	1.2	1.4
Italy	1.4	-1.1	-5.5	1.7	0.7	-2.8	-1.7	-0.4	0.5	0.8
Spain	3.6	0.9	-3.6	0.0	-0.6	-2.1	-1.2	1.4	2.9	2.2
Other Western Europe	**2.9**	**0.2**	**-3.5**	**2.3**	**1.9**	**0.9**	**1.7**	**2.6**	**2.1**	**2.2**
UK	2.2	-0.2	-3.8	1.7	1.7	0.7	1.7	2.8	2.5	2.5
Switzerland	4.1	2.2	-2.1	2.9	1.9	1.1	1.9	2.0	0.5	1.1
Sweden	3.5	-0.7	-5.1	5.7	2.7	0.0	1.3	2.4	2.0	1.8
Norway**	5.7	1.6	-1.4	1.8	1.9	3.5	2.3	2.3	1.6	1.7
CEEMEA	**6.2**	**4.3**	**-3.4**	**5.0**	**5.4**	**2.8**	**2.5**	**2.3**	**1.3**	**2.1**
Russia	8.5	5.2	-7.8	4.5	4.3	3.4	1.3	0.6	-3.5	-1.0
Turkey	4.7	0.7	-4.8	9.2	8.8	2.2	4.0	2.9	2.4	3.0
Saudi Arabia	6.0	8.4	1.8	7.4	10.0	5.4	2.7	3.6	3.3	2.1
Nigeria	6.4	6.0	7.0	8.0	4.9	4.3	5.4	6.3	4.0	5.5
Poland	7.2	3.9	2.6	3.7	4.8	1.8	1.7	3.4	3.6	3.7
South Africa	5.4	3.2	-1.5	3.0	3.2	2.2	2.2	1.5	1.7	1.9
Latin America	**5.1**	**3.3**	**-1.8**	**6.5**	**4.8**	**2.8**	**2.5**	**1.1**	**0.7**	**2.0**
Brazil	6.0	5.0	-0.2	7.6	3.9	1.8	2.7	0.1	-1.6	1.0
Mexico	3.1	1.4	-4.7	5.1	4.0	4.0	1.4	2.1	2.7	2.8
Argentina	8.0	3.1	0.1	9.1	8.7	0.8	2.4	-1.7	0.0	1.2
Colombia	6.9	3.5	1.7	4.0	6.6	4.0	4.9	4.6	3.3	3.0
Chile	5.2	3.3	-1.0	5.8	5.8	5.5	4.2	1.9	2.5	3.0

Notes: Real GDP. *India data in fiscal year (2012= April 2012 to March 2013). GDP data from 2012 onwards is as per the new series (2011-12 prices); **Mainland. We now calculate the weighting system using chain nominal GDP (USD) weights
Source: HSBC estimates

Quarterly

% Quarter & % Year		Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
North America											
US*	% Quarter	-2.1	4.6	5.0	2.2	-0.2	2.5	2.8	2.6	2.2	3.0
	% Year	1.9	2.6	2.7	2.4	2.9	2.4	1.8	1.9	2.5	2.6
Canada*	% Quarter	1.0	3.4	3.2	2.2	-0.6	0.8	1.6	2.0	2.1	2.2
	% Year	2.1	2.5	2.6	2.5	2.1	1.4	1.0	1.0	1.6	2.0
Asia-Pacific											
China	% Year	7.4	7.5	7.3	7.3	7.0	6.8	7.1	7.2	7.2	7.4
Japan	% Quarter	1.1	-1.7	-0.5	0.3	1.0	0.0	0.5	0.2	0.2	0.6
	% Year	2.4	-0.4	-1.4	-1.0	-0.9	0.8	1.8	1.7	0.9	1.4
India**	% Year	6.7	6.7	8.4	6.6	7.5	8.4	8.4	7.5	6.9	8.2
Australia	% Quarter	1.0	0.6	0.3	0.5	0.9	0.5	0.6	0.7	1.0	0.7
	% Year	2.9	2.8	2.7	2.4	2.3	2.3	2.5	2.7	2.8	3.0
South Korea	% Year	3.9	3.4	3.3	2.7	2.4	2.6	2.8	3.5	2.9	2.7
Indonesia	% Year	5.1	5.0	4.9	5.0	4.7	4.7	4.9	4.9	5.5	5.6
Taiwan	% Year	3.4	3.9	4.3	3.5	3.4	3.0	3.8	3.6	3.7	4.2
Thailand	% Year	-0.4	0.9	1.0	2.1	3.0	1.8	6.6	1.2	-1.9	4.1
Malaysia	% Year	6.3	6.5	5.6	5.7	5.6	4.7	4.9	4.2	4.4	4.9
Singapore	% Year	4.6	2.3	2.8	2.2	2.5	2.9	3.0	2.4	2.4	3.1
Hong Kong	% Year	2.7	2.0	2.9	2.4	2.1	2.8	2.9	1.5	2.4	2.5
Philippines	% Year	5.6	6.7	5.5	6.6	5.2	6.2	5.6	5.2	6.3	6.3
New Zealand	% Year	3.1	3.4	3.3	3.5	2.6	2.8	2.7	3.0	3.4	3.0
Western Europe											
Eurozone	% Quarter	0.2	0.1	0.2	0.4	0.4	0.4	0.3	0.3	0.3	0.4
	% Year	1.1	0.8	0.8	0.9	1.0	1.3	1.5	1.4	1.4	1.3
Germany	% Quarter	0.8	-0.1	0.1	0.7	0.3	0.5	0.4	0.4	0.3	0.3
	% Year	2.3	1.3	1.2	1.5	1.0	1.6	2.0	1.7	1.8	1.6
France	% Quarter	-0.2	-0.1	0.2	0.0	0.6	0.3	0.4	0.4	0.3	0.3
	% Year	0.7	-0.2	0.2	0.0	0.7	1.1	1.3	1.7	1.5	1.5
Italy	% Quarter	-0.2	-0.1	-0.1	0.0	0.3	0.2	0.2	0.2	0.2	0.2
	% Year	-0.2	-0.3	-0.5	-0.4	0.1	0.4	0.7	0.9	0.8	0.8
Spain	% Quarter	0.3	0.5	0.5	0.7	0.9	0.9	0.7	0.5	0.5	0.5
	% Year	0.6	1.2	1.6	2.0	2.7	3.0	3.1	3.0	2.6	2.2
Other Western Europe											
UK	% Quarter	0.9	0.8	0.6	0.6	0.4	0.7	0.7	0.7	0.6	0.6
	% Year	2.7	2.9	2.8	3.0	2.5	2.4	2.5	2.6	2.4	2.5
Switzerland	% Year	2.5	1.7	1.9	1.9	1.1	0.7	0.2	-0.1	0.5	1.0
Sweden	% Year	1.7	2.7	2.6	2.6	2.6	2.1	2.0	1.5	1.7	1.9
Norway***	% Year	2.1	2.7	2.2	2.0	2.0	1.0	1.2	2.0	1.8	1.9
CEEMEA											
Russia	% Year	0.6	0.7	0.9	0.4	-1.9	-3.6	-3.5	-4.9	-2.2	-1.0
Turkey	% Year	4.8	2.2	1.9	2.6	2.3	1.3	3.7	2.0	3.1	3.0
Nigeria	% Year	6.2	6.5	6.3	5.9	4.0	3.4	3.8	4.4	5.1	5.5
Poland	% Year	3.5	3.6	3.3	3.3	3.6	3.4	3.7	3.6	3.5	3.7
South Africa	% Year	1.9	1.3	1.6	1.3	2.1	1.8	2.0	1.1	1.5	1.8
Latin America											
Brazil	% Quarter	0.7	-1.4	0.2	0.3	-0.2	-1.4	-0.2	-0.3	1.0	-0.1
	% Year	2.7	-1.2	-0.6	-0.2	-1.6	-1.1	-1.5	-2.1	-1.0	0.3
Mexico	% Quarter	0.3	1.0	0.5	0.7	0.4	0.7	0.5	0.7	0.4	0.7
	% Year	1.9	1.6	2.2	2.6	2.5	2.8	2.7	2.8	2.4	2.9
Argentina	% Quarter	-0.7	0.5	0.0	0.0	2.0	-0.2	-4.0	3.0	1.7	-0.5
	% Year	0.0	-1.3	-2.7	-2.5	-1.1	0.9	0.1	0.0	0.4	1.1
Colombia	% Quarter	1.4	0.4	0.9	0.7	0.8	0.7	1.4	0.8	0.3	0.5
	% Year	6.6	4.3	4.2	3.5	2.8	3.2	3.5	3.7	3.2	3.0
Chile	% Quarter	-0.1	0.9	-0.2	0.4	0.8	2.2	-0.5	-1.1	2.9	1.6
	% Year	2.7	2.1	1.0	1.8	2.4	3.2	2.9	1.4	3.4	2.8

Notes:*Quarterly annualised rate,**Fiscal year ;***Mainland.
Source: HSBC estimates

Consumer prices

Annual

% Year	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
World	**3.7**	**5.8**	**2.4**	**3.4**	**4.5**	**3.5**	**3.2**	**3.1**	**2.6**	**2.9**
Developed	**2.2**	**3.3**	**-0.1**	**1.5**	**2.6**	**1.9**	**1.3**	**1.4**	**0.4**	**1.6**
Emerging	**5.4**	**8.3**	**4.8**	**5.3**	**6.1**	**4.9**	**4.6**	**4.4**	**4.3**	**3.9**
North America	**2.8**	**3.7**	**-0.3**	**1.7**	**3.1**	**2.0**	**1.4**	**1.6**	**0.3**	**2.0**
US	2.9	3.8	-0.4	1.6	3.2	2.1	1.5	1.6	0.3	2.0
Canada	2.1	2.4	0.3	1.8	2.9	1.5	1.0	1.9	0.7	1.6
Asia-Pacific	**3.6**	**5.8**	**2.3**	**3.8**	**4.9**	**3.8**	**3.7**	**3.1**	**2.1**	**2.5**
Asia Big Three	**3.8**	**5.5**	**2.4**	**4.1**	**5.1**	**4.1**	**4.0**	**3.1**	**2.2**	**2.4**
China	4.8	5.9	-0.7	3.3	5.4	2.7	2.6	2.0	1.2	1.3
Japan	0.1	1.4	-1.3	-0.7	-0.3	-0.0	0.4	2.7	0.8	1.1
India*	6.2	9.1	12.3	10.3	9.0	10.2	9.8	6.0	5.2	5.8
Asia ex Big Three	**3.0**	**6.1**	**1.9**	**3.0**	**4.1**	**2.9**	**2.8**	**2.8**	**1.9**	**2.6**
Australia	2.3	4.4	1.8	2.9	3.3	1.8	2.4	2.5	1.7	2.5
South Korea	2.5	4.7	2.8	2.9	4.0	2.2	1.3	1.3	0.8	2.1
Indonesia	6.7	9.8	5.0	5.1	5.3	4.0	6.4	6.4	6.5	4.5
Taiwan	1.8	3.5	-0.9	1.0	1.4	1.9	0.8	1.2	-0.2	1.5
Thailand	2.2	5.5	-0.9	3.3	3.8	3.0	2.2	1.9	-0.4	2.3
Malaysia	2.0	5.4	0.6	1.7	3.2	1.7	2.1	3.1	2.0	2.8
Singapore	0.0	6.6	0.6	2.8	5.2	4.6	2.4	1.0	-0.3	1.2
Hong Kong	2.0	4.3	0.6	2.3	5.3	4.1	4.3	4.4	2.7	3.8
Philippines	2.9	8.2	4.3	3.8	4.7	3.2	2.9	4.2	2.2	3.9
New Zealand	2.4	4.0	2.1	2.3	4.0	1.1	1.1	1.2	0.5	2.0
Western Europe	**2.1**	**3.3**	**0.6**	**1.9**	**2.8**	**2.3**	**1.5**	**0.5**	**0.3**	**1.2**
Eurozone	**2.2**	**3.3**	**0.3**	**1.6**	**2.7**	**2.5**	**1.3**	**0.4**	**0.2**	**0.9**
Germany	2.3	2.7	0.2	1.2	2.5	2.1	1.6	0.8	0.5	1.6
France	1.6	3.2	0.1	1.7	2.3	2.2	1.0	0.6	0.3	1.0
Italy	2.0	3.5	0.8	1.6	2.9	3.3	1.3	0.2	0.3	0.8
Spain	2.8	4.1	-0.2	2.0	3.1	2.4	1.5	-0.2	-0.2	1.1
Other Western Europe	**2.0**	**3.5**	**1.6**	**2.7**	**3.5**	**2.0**	**1.9**	**0.6**	**0.2**	**1.2**
UK	2.3	3.6	2.2	3.3	4.5	2.8	2.5	0.6	0.2	1.5
Switzerland	0.7	2.4	-0.5	0.7	0.2	-0.7	-0.2	0.0	-1.0	-0.2
Sweden	2.2	3.4	-0.5	1.2	3.0	0.9	-0.0	-0.2	0.1	0.4
Norway	0.7	3.8	2.2	2.4	1.3	0.7	2.1	2.0	1.6	1.7
CEEMEA	**7.4**	**11.5**	**8.6**	**6.7**	**6.8**	**5.6**	**5.1**	**5.9**	**7.8**	**5.9**
Russia	9.0	14.1	11.7	6.8	8.5	5.1	6.8	7.8	14.7	7.6
Turkey	8.8	10.4	6.3	8.6	6.5	8.9	7.5	8.9	7.3	7.6
Saudi Arabia	4.2	9.9	5.1	5.3	5.0	4.5	3.5	2.7	2.5	2.3
Nigeria	5.4	11.5	12.6	13.8	10.9	12.1	8.0	8.1	9.2	8.8
Poland	2.5	4.2	3.5	2.6	4.3	3.7	0.9	0.0	-0.5	1.4
South Africa	7.1	11.0	7.2	4.3	5.0	5.7	5.8	6.1	5.0	6.7
Latin America	**4.7**	**7.7**	**4.4**	**4.5**	**5.8**	**5.4**	**5.4**	**7.0**	**7.3**	**6.1**
Brazil	3.6	5.7	4.9	5.0	6.6	5.4	6.2	6.3	8.5	6.1
Mexico	4.0	5.1	5.3	4.2	3.4	4.1	3.8	4.0	2.9	3.6
Argentina	15.7	23.8	15.6	21.6	22.2	24.0	25.3	38.6	29.2	28.9
Colombia	5.5	7.0	4.2	2.3	3.4	3.2	2.0	2.9	4.3	3.4
Chile	4.4	8.7	1.5	1.5	3.3	3.0	1.9	4.4	4.0	3.4

Note: *India data in fiscal year (2012= April 2012 to March 2013). GDP data from 2012 onwards is as per the new series (2011-12 prices).
We now calculate the weighting system using GDP PPP (USD) weights
Source: HSBC estimates

HSBC

Quarterly

% Year	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
North America										
US*	1.4	2.1	1.8	1.2	-0.1	0.0	0.3	0.9	2.1	2.0
Canada*	1.3	2.3	2.1	1.9	1.1	0.5	0.5	0.9	1.4	1.6
Asia-Pacific										
China	2.3	2.2	2.0	1.5	1.2	1.2	1.3	1.3	1.4	1.3
Japan	1.5	3.6	3.3	2.5	2.3	0.1	0.3	0.5	1.0	1.0
India	8.2	7.8	6.7	4.1	5.3	5.0	4.5	5.6	5.6	5.8
Australia	2.9	3.0	2.3	1.7	1.3	1.6	1.8	2.2	2.5	2.5
South Korea	1.1	1.6	1.4	1.0	0.6	0.4	0.8	1.2	1.8	2.2
Indonesia	7.8	7.1	4.4	6.5	6.5	7.1	6.9	5.6	4.5	4.7
Taiwan	0.8	1.6	1.5	0.8	-0.6	-0.7	-0.2	0.5	1.6	1.5
Thailand	2.0	2.5	2.0	1.1	-0.5	-1.1	-0.5	0.5	2.0	2.3
Malaysia	3.5	3.3	3.0	2.8	0.7	2.3	2.7	2.4	4.1	2.7
Singapore	1.0	2.2	1.0	-0.0	-0.3	-0.4	-0.4	-0.2	0.3	0.9
Hong Kong	4.2	3.6	4.8	5.1	4.4	2.8	2.2	1.6	2.5	4.3
Philippines	4.1	4.4	4.7	3.6	2.4	1.8	1.7	2.9	3.5	4.4
New Zealand	1.5	1.6	1.0	0.8	0.1	0.4	0.5	1.2	1.9	1.9
Western Europe										
Eurozone	0.6	0.6	0.4	0.2	-0.3	0.2	0.2	0.5	1.1	0.8
Germany	1.0	1.0	0.8	0.4	-0.1	0.5	0.5	1.1	1.8	1.5
France	0.9	0.8	0.5	0.3	-0.2	0.3	0.5	0.6	1.1	0.9
Italy	0.5	0.4	-0.1	0.1	-0.1	0.1	0.5	0.6	0.9	0.8
Spain	0.0	0.2	-0.4	-0.6	-1.1	-0.4	0.1	0.7	1.4	1.1
Other Western Europe										
UK	1.7	1.7	1.5	0.9	0.1	0.0	0.1	0.5	1.3	1.5
Switzerland	-0.0	0.1	0.0	-0.1	-0.7	-1.1	-1.1	-0.9	-0.5	-0.3
Sweden	-0.3	0.0	-0.2	-0.2	0.0	-0.1	0.1	0.3	0.6	0.4
Norway	2.1	1.8	2.1	2.0	1.9	1.9	1.2	1.6	1.8	1.7
CEEMEA										
Russia	6.4	7.6	7.7	9.6	13.8	15.8	15.6	13.9	9.8	7.0
Turkey	8.0	9.4	9.2	8.8	7.3	6.6	6.1	6.7	7.7	8.2
Nigeria	7.8	8.0	8.4	8.0	8.4	9.2	10.2	10.0	9.6	9.0
Poland	0.6	0.3	-0.3	-0.7	-1.4	-0.6	-0.6	0.4	0.9	1.0
South Africa	5.9	6.5	6.2	5.7	4.1	4.6	5.3	5.9	7.3	6.5
Latin America										
Brazil	5.8	6.4	6.6	6.5	7.7	8.5	9.1	8.7	7.3	6.0
Mexico	4.2	3.6	4.1	4.2	3.1	2.9	2.8	3.0	3.5	3.7
Argentina	33.9	39.3	40.4	40.1	32.2	29.4	28.2	27.6	28.0	28.6
Colombia	2.3	2.8	2.9	3.5	4.2	4.7	4.3	4.0	3.6	3.1
Chile	3.2	4.5	4.7	5.3	4.4	4.0	3.9	3.7	3.7	3.5

Source: HSBC estimates, Bloomberg

Policy Rates

End period	2014		2015				2016			
	Q3 14	Q4 14	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f	Q3 16f	Q4 16f
North America										
US	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0.25-0.50	0.50-0.75	0.50-0.75	0.75-1.00	0.75-1.00
Canada	1.00	1.00	0.75	0.75	0.25	0.25	0.25	0.25	0.50	0.50
Asia-Pacific										
China	6.00	5.60	5.35	5.10	4.85	4.60	4.60	4.60	4.60	4.60
Japan	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10
India	8.00	8.00	7.50	7.25	7.25	7.25	7.25	7.25	7.25	7.25
Australia	2.50	2.50	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00
South Korea	2.25	2.00	1.75	1.50	1.25	1.25	1.25	1.25	1.25	1.25
Indonesia	7.50	7.75	7.50	7.50	7.25	7.25	7.25	7.25	7.25	7.25
Taiwan	1.88	1.88	1.88	1.75	1.63	1.63	1.63	1.63	1.63	1.63
Thailand	2.00	2.00	1.75	1.50	1.25	1.25	1.25	1.25	1.25	1.25
Malaysia	3.25	3.25	3.25	3.25	3.00	3.00	3.00	3.00	3.00	3.00
Hong Kong	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.00	1.25	1.25
Philippines	4.00	4.00	4.00	4.00	4.00	4.00	4.25	4.50	4.50	4.50
New Zealand	3.50	3.50	3.50	3.25	3.00	3.00	3.00	3.00	3.00	3.00
Western Europe										
Eurozone	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Other Western Europe										
UK	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50
Switzerland	0.00	0.00	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25
Sweden	0.25	0.00	-0.25	-0.25	-0.35	-0.50	-0.50	-0.50	-0.50	-0.50
Norway	1.50	1.25	1.25	1.00	1.00	1.00	1.00	1.00	1.00	1.00
CEEMEA										
Russia	8.00	17.00	14.00	11.50	10.50	10.00	9.00	8.50	8.00	7.50
Turkey	8.25	8.25	7.50	7.25	7.25	8.00	8.00	8.00	8.00	8.00
Poland	2.50	2.00	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
South Africa	5.75	5.75	5.75	5.75	6.00	6.25	6.50	6.75	7.00	7.00
Latin America										
Brazil	11.00	11.75	12.75	13.75	14.00	14.00	13.00	12.00	11.00	11.00
Mexico	3.00	3.00	3.00	3.00	3.00	3.25	3.50	3.75	4.00	4.00
Colombia	4.50	4.50	4.50	4.50	4.50	4.50	4.00	4.00	4.00	4.00
Chile	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.25	3.50

Source: HSBC estimates

Long rates

10-year bond yields

End period		2009	2010	2011	2012	2013	2014	2015				2016	
		Q4 09	Q4 10	Q4 11	Q4 12	Q4 13	Q4 14	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
Americas													
	US	3.7	2.8	1.9	1.8	2.7	2.1	2.1	2.4	2.3	2.5	2.6	2.7
	Canada	3.6	3.2	1.9	1.8	2.7	1.9	1.5	1.8	1.7	2.0	2.3	2.4
	Chile	6.1	5.9	5.1	5.5	5.5	4.6	4.6	4.7	4.6	4.5	4.8	5.0
Asia-Pacific													
	Japan	1.3	1.1	1.0	0.8	0.7	0.4	0.4	0.5	0.4	0.3	0.4	0.5
	Australia	5.7	5.5	3.8	3.3	4.3	2.8	2.3	3.1	2.9	2.7	2.6	2.6
	New Zealand	6.0	5.8	3.9	3.6	4.8	3.8	3.4	3.9	3.8	3.7	3.8	3.8
	India	7.7	8.0	8.5	8.2	8.8	7.9	7.8	7.8	7.6	7.3	7.0	6.8
	Hong Kong	2.6	2.9	1.5	0.6	2.3	1.9	1.7	1.8	2.0	2.2	2.4	2.5
	Indonesia	10.1	7.8	6.1	5.4	8.6	8.0	7.4	8.7	8.9	8.7	8.5	8.5
	Philippines	8.0	6.0	5.7	4.8	3.7	4.2	4.0	3.9	3.7	3.9	4.1	4.3
	Singapore	2.7	2.7	1.6	1.3	2.6	2.3	2.3	2.7	2.8	2.9	3.0	3.1
Western Europe													
Eurozone		3.6	3.8	3.7	2.7	2.9	1.2	0.6	1.4	1.1	1.4	1.6	1.6
	Germany	3.4	3.0	1.9	1.3	1.9	0.7	0.2	0.9	0.4	0.8	1.0	1.1
	France	3.6	3.3	3.0	2.0	2.6	1.0	0.5	1.2	0.6	1.1	1.4	1.5
	Italy	4.0	4.8	7.0	4.5	4.1	2.0	1.2	2.3	2.2	2.2	2.3	2.2
	Spain	3.9	5.5	5.2	5.3	4.1	1.8	1.2	2.3	2.2	2.3	2.4	2.3
Other Western Europe													
	UK	3.9	3.7	2.1	1.8	3.0	2.0	1.8	2.1	1.5	1.6	1.6	1.8
	Norway	4.1	3.7	2.2	2.1	3.0	1.9	1.5	1.7	1.7	1.8	1.8	1.8
	Sweden	3.3	3.3	1.5	1.5	2.4	1.1	0.7	1.0	1.0	1.1	1.1	1.2
	Switzerland	1.9	1.6	0.7	0.5	1.1	0.3	-0.1	0.2	0.2	0.2	0.3	0.3
CEEMEA													
	Hungary	8.0	8.0	9.8	6.1	5.8	3.6	3.5	3.8	3.7	3.7	3.6	3.5
	Poland	6.2	6.1	5.9	3.7	4.3	2.6	2.4	3.2	3.3	3.4	3.3	3.2
	Russia	8.7	7.7	8.3	6.7	7.5	13.5	11.8	11.0	11.5	11.8	11.8	11.0
	South Africa	9.0	8.9	8.1	6.8	7.9	7.7	7.9	8.4	8.6	8.9	9.1	9.0

*Weighted average of big four Eurozone economies
Source: HSBC estimates

Exchange rates vs USD

Exchange rates vs USD

End period		2012	2013			2014			2015			2016	
		Q4	Q4	Q1	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f
Americas													
	Canada (CAD)	0.99	1.06	1.10	1.07	1.12	1.16	1.27	1.26	1.30	1.30	1.30	1.30
	Mexico (MXN)	12.87	13.09	13.06	12.99	13.43	14.75	15.27	15.00	15.10	15.20	15.20	15.20
	Brazil (BRL)	2.04	2.34	2.26	2.20	2.45	2.65	3.20	3.10	3.15	3.20	3.25	3.30
	Argentina (ARS)	4.92	6.52	8.00	8.13	8.45	8.46	8.82	9.50	10.00	10.50	11.00	11.50
	Chile (CLP)	479	525	549	552	598	607	625	605	610	615	620	620
Asia/Pacific													
	Japan (JPY)	87	105	103	101	110	120	120	120	120	125	125	125
	Australia (AUD)	1.04	0.89	0.93	0.94	0.87	0.82	0.76	0.76	0.73	0.72	0.71	0.71
	New Zealand (NZD)	0.83	0.82	0.87	0.87	0.78	0.78	0.75	0.71	0.70	0.70	0.69	0.68
	China (CNY)	6.23	6.05	6.22	6.20	6.14	6.21	6.20	6.22	6.24	6.26	6.28	6.30
	Hong Kong (HKD)	7.75	7.75	7.76	7.75	7.76	7.75	7.75	7.80	7.80	7.80	7.80	7.80
	India (INR)	55.0	61.8	60.0	60.1	61.9	63.2	62.3	65.0	65.5	66.0	66.0	66.5
	Indonesia (IDR)	9638	12170	11360	11855	12175	12430	13074	13400	13700	13800	14000	14200
	Malaysia (MYR)	3.06	3.28	3.26	3.21	3.28	3.50	3.71	3.65	3.70	3.75	3.77	3.78
	Philippines (PHP)	41.1	44.4	44.8	43.7	44.9	44.7	44.7	45.0	45.2	45.4	45.6	45.7
	Singapore (SGD)	1.22	1.26	1.26	1.25	1.28	1.32	1.37	1.35	1.36	1.37	1.38	1.38
	South Korea (KRW)	1064	1056	1065	1011	1058	1093	1109	1110	1120	1130	1130	1140
	Taiwan (TWD)	29.0	29.8	30.5	29.9	30.4	31.6	31.3	30.9	31.5	31.8	31.9	31.9
	Thailand (THB)	30.6	32.8	32.4	32.5	32.4	32.9	32.6	33.5	33.6	33.7	33.8	33.9
Western Europe													
	Eurozone (EUR)	1.32	1.38	1.38	1.37	1.26	1.21	1.07	1.10	1.05	1.05	1.07	1.08
Other Western Europe													
	UK (GBP)	1.62	1.66	1.67	1.71	1.62	1.56	1.48	1.50	1.46	1.45	1.45	1.45
	Sweden (SEK)	6.50	6.43	6.48	6.69	7.22	7.80	8.63	8.45	8.57	8.57	8.41	8.33
	Norway (NOK)	5.56	6.06	5.99	6.13	6.43	7.49	8.06	7.82	8.10	8.10	7.85	7.78
	Switzerland (CHF)	0.91	0.89	0.88	0.89	0.95	0.99	0.97	0.95	0.95	0.90	0.89	0.88
CEEMEA													
	Poland (PLN)	3.10	3.01	3.02	3.04	3.31	3.54	3.80	3.78	4.14	4.14	4.07	4.03
	Russia (RUB)	30.5	32.7	35.7	33.6	39.6	58.3	58.2	55.0	60.0	65.0	66.0	67.5
	Turkey (TRY)	1.78	2.15	2.14	2.12	2.28	2.34	2.60	2.75	2.85	2.80	2.80	2.80
	South Africa (ZAR)	8.48	10.52	10.52	10.63	11.30	11.55	12.14	12.35	12.50	12.80	12.80	12.80
	Nigeria (NGN)	156.2	160.3	165.1	162.9	163.8	183.5	199.3	199.0	215.0	215.0	215.0	215.0

Source: HSBC estimates

Exchange rate vs EUR & GBP

Exchange rate vs EUR & GBP

End period		2012	2013			2014				2015		2016	
		Q4	Q4	Q1	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f
vs EUR													
Americas													
	US (USD)	1.32	1.38	1.38	1.37	1.26	1.21	1.07	1.10	1.05	1.05	1.07	1.08
	Canada (CAD)	1.31	1.47	1.52	1.46	1.42	1.41	1.36	1.39	1.37	1.37	1.39	1.40
Asia/Pacific													
	Japan (JPY)	114	145	142	139	138	145	129	132	126	131	134	135
	Australia (AUD)	1.27	1.54	1.49	1.45	1.45	1.48	1.41	1.45	1.44	1.46	1.51	1.52
	New Zealand (NZD)	1.60	1.67	1.59	1.56	1.62	1.55	1.44	1.55	1.50	1.50	1.55	1.59
Europe													
	UK (GBP)	0.81	0.83	0.83	0.80	0.78	0.78	0.72	0.73	0.72	0.72	0.74	0.74
	Sweden (SEK)	8.58	8.86	8.92	9.16	9.11	9.44	9.26	9.30	9.00	9.00	9.00	9.00
	Switzerland (CHF)	1.21	1.23	1.22	1.21	1.21	1.20	1.04	1.04	1.00	0.95	0.95	0.95
	Norway (NOK)	7.34	8.36	8.25	8.40	8.12	9.06	8.65	8.60	8.50	8.50	8.40	8.40
	Poland (PLN)	4.08	4.16	4.17	4.16	4.18	4.28	4.07	4.16	4.35	4.35	4.35	4.35
	Russia (RUB)	40.2	45.1	49.1	46.0	50.0	70.5	62.4	60.5	63.0	68.3	70.6	72.9
Africa													
	South Africa (ZAR)	11.19	14.51	14.49	14.55	14.27	13.98	13.03	13.59	13.13	13.44	13.70	13.82
vs GBP													
Americas													
	US (USD)	1.62	1.66	1.67	1.71	1.62	1.56	1.48	1.50	1.46	1.45	1.45	1.45
	Canada (CAD)	1.62	1.76	1.82	1.81	1.82	1.81	1.88	1.89	1.90	1.88	1.88	1.89
Asia/Pacific													
	Japan (JPY)	141	174	178	187	178	187	178	180	175	181	181	182
	Australia (AUD)	1.56	1.86	1.86	1.91	1.86	1.91	1.95	1.98	2.00	2.01	2.04	2.05
	New Zealand (NZD)	1.97	2.01	2.08	2.00	2.08	2.00	1.99	2.12	2.09	2.07	2.10	2.14
Europe													
	Eurozone (EUR)	0.81	0.83	0.83	0.80	0.78	0.78	0.72	0.73	0.72	0.72	0.74	0.74
	Sweden (SEK)	10.56	10.65	11.71	12.15	11.71	12.15	12.81	12.70	12.52	12.42	12.19	12.10
	Norway (NOK)	9.03	10.05	10.43	11.66	10.43	11.66	11.96	11.74	11.82	11.73	11.38	11.30
	Switzerland (CHF)	1.49	1.47	1.55	1.55	1.55	1.55	1.44	1.42	1.39	1.31	1.29	1.28
Africa													
	South Africa (ZAR)	13.77	17.44	17.55	18.18	18.32	17.99	18.02	18.55	18.25	18.55	18.56	18.59

Source: HSBC estimates

HSBC

Consumer spending

Consumer spending

% Year	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
World	**3.3**	**0.9**	**-0.6**	**2.4**	**2.6**	**2.2**	**2.3**	**2.1**	**2.4**	**2.7**
Developed	**2.2**	**-0.2**	**-1.4**	**1.7**	**1.4**	**1.2**	**1.5**	**1.6**	**2.1**	**2.1**
Emerging	**7.4**	**4.5**	**2.0**	**4.6**	**6.2**	**5.0**	**4.7**	**3.5**	**3.2**	**4.0**
North America	**2.4**	**-0.3**	**-1.8**	**1.9**	**2.5**	**2.2**	**2.4**	**2.5**	**2.7**	**2.6**
US	2.3	-0.6	-1.9	1.8	2.5	2.2	2.4	2.5	2.8	2.6
Canada	4.3	2.8	0.3	3.5	2.2	1.9	2.5	2.7	1.8	2.0
Asia-Pacific	**4.2**	**1.9**	**3.5**	**3.4**	**4.0**	**4.2**	**4.0**	**2.7**	**3.5**	**4.2**
China	8.5	4.8	16.1	0.6	10.2	8.2	7.5	7.5	7.6	7.3
Japan	0.9	-0.9	-0.7	2.8	0.3	2.3	2.1	-1.3	-0.1	1.5
India*	9.4	7.2	7.4	8.7	7.8	5.5	6.2	6.3	7.8	8.3
Australia	5.7	1.9	0.8	3.3	3.1	2.5	1.7	2.5	2.7	3.1
South Korea	5.1	1.4	0.2	4.4	2.9	1.9	1.9	1.8	1.9	2.2
Indonesia	5.0	5.6	4.6	4.3	5.1	5.5	5.4	5.1	4.8	4.9
Taiwan	2.4	-1.7	0.0	3.8	3.1	1.8	2.4	3.0	2.0	3.5
Thailand	1.2	2.8	-1.3	5.0	1.8	6.3	0.8	0.6	2.2	3.1
Malaysia	10.4	8.7	0.6	6.8	6.9	8.3	7.2	7.0	6.9	5.2
Singapore	6.1	3.5	-1.1	5.9	4.0	3.5	3.5	2.5	1.9	1.2
Hong Kong	8.6	1.9	0.2	6.1	8.4	4.1	4.6	2.7	3.1	2.7
Philippines	4.6	3.7	2.3	3.4	5.6	6.6	5.6	5.4	5.4	5.6
New Zealand	3.6	0.4	-0.8	3.1	2.0	2.9	2.9	3.2	3.2	2.5
Western Europe	**2.1**	**0.2**	**-1.3**	**0.9**	**0.3**	**-0.6**	**0.1**	**1.4**	**1.9**	**1.6**
Eurozone	**1.8**	**0.2**	**-1.0**	**0.8**	**0.2**	**-1.3**	**-0.6**	**1.0**	**1.7**	**1.3**
Germany	-0.0	0.4	0.2	0.5	2.3	0.6	0.9	1.2	2.1	1.4
France	2.4	0.4	0.3	1.8	0.4	-0.2	0.5	0.7	1.6	1.0
Italy	1.2	-1.1	-1.5	1.2	-0.0	-4.0	-2.8	0.3	0.2	0.6
Spain	3.2	-0.7	-3.7	0.2	-2.0	-3.0	-2.3	2.4	3.2	2.3
Other Western Europe	**2.9**	**-0.0**	**-2.1**	**1.0**	**0.5**	**1.5**	**1.8**	**2.3**	**2.5**	**2.5**
UK	2.6	-0.5	-3.1	0.4	0.1	1.1	1.7	2.5	2.7	2.7
Switzerland	2.3	1.4	1.2	1.6	0.9	2.8	2.2	1.3	2.0	2.0
Sweden	3.9	0.2	0.4	3.8	1.9	0.9	1.9	2.5	2.4	2.0
Norway**	5.3	1.9	-0.2	3.7	2.3	3.4	2.0	2.0	2.1	1.6
CEEMEA	**9.0**	**4.5**	**-3.8**	**4.1**	**5.0**	**3.9**	**4.3**	**1.9**	**0.1**	**2.3**
Russia	14.3	10.6	-5.1	5.5	6.8	7.8	5.0	1.3	-8.0	-0.5
Turkey	5.5	-0.3	-2.3	6.7	7.7	-0.7	4.6	1.3	3.3	3.1
Saudi Arabia	14.0	12.0	7.0	3.8	1.7	11.7	3.2	3.1	5.0	2.5
Nigeria	6.6	-34.3	6.4	-26.7	-3.1	0.0	21.1	2.0	5.7	6.2
Poland	6.4	6.1	3.3	2.5	3.0	1.0	1.2	3.1	3.4	3.6
South Africa	5.5	1.0	-1.8	4.5	4.9	3.4	2.9	1.4	1.8	1.7
Latin America	**5.4**	**4.3**	**-0.5**	**6.4**	**5.8**	**4.5**	**3.2**	**1.4**	**1.1**	**1.7**
Brazil	6.3	6.4	4.2	6.4	4.8	3.9	2.9	0.9	-1.0	0.0
Mexico	3.0	1.9	-6.5	5.7	4.8	4.9	2.5	2.0	3.1	3.1
Argentina	9.0	5.6	3.5	7.1	10.7	4.3	4.3	-0.5	0.3	2.3
Colombia	7.3	3.5	0.6	5.0	6.0	4.4	3.8	4.4	3.4	2.8
Chile	7.6	5.2	-0.8	10.8	8.9	6.1	5.9	2.2	1.4	1.5

Note: * India data in fiscal year (2012= April 2012 to March 2013). GDP data from 2012 onwards is as per the new series (2011-12 prices); **Mainland. We now calculate the weighting system using chain nominal GDP (USD) weights
Source: HSBC estimates

Investment spending

Investment spending

% Year	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
World	**6.8**	**2.8**	**-3.7**	**8.4**	**10.7**	**8.9**	**8.5**	**8.2**	**7.2**	**9.5**
Developed	**1.6**	**-3.6**	**-13.9**	**0.6**	**4.0**	**3.2**	**1.7**	**3.3**	**2.3**	**3.6**
Emerging	**17.9**	**14.6**	**12.0**	**17.5**	**17.5**	**14.0**	**14.0**	**11.7**	**10.5**	**13.1**
North America	**-1.5**	**-6.4**	**-18.3**	**1.0**	**6.4**	**7.9**	**4.2**	**4.8**	**3.4**	**5.2**
US	-1.9	-7.1	-19.0	-0.2	6.6	8.3	4.7	5.3	4.3	5.6
Canada	3.4	1.4	-11.5	11.5	4.9	4.9	0.4	0.2	-2.1	1.0
Asia-Pacific	**13.3**	**11.8**	**13.4**	**16.2**	**16.6**	**14.9**	**14.5**	**12.4**	**10.8**	**13.2**
China	24.8	25.9	30.0	24.5	23.8	20.6	19.6	16.0	13.5	16.0
Japan	0.3	-4.1	-10.6	-0.2	1.4	3.4	3.2	2.6	0.5	1.2
India*	16.2	3.5	7.7	11.0	11.3	-0.3	3.0	4.6	7.0	9.1
Australia	9.1	8.0	-1.6	4.1	7.2	8.9	-2.6	-2.7	-3.5	-0.8
South Korea	5.0	-0.9	0.3	5.5	0.8	-0.5	3.3	3.1	2.6	2.7
Indonesia	9.3	12.5	3.9	6.7	8.9	9.1	5.3	4.1	4.8	5.8
Taiwan	1.1	-11.1	-8.8	19.3	-1.1	-2.6	5.0	1.8	1.3	4.1
Thailand	1.8	2.3	-10.9	11.6	4.9	10.2	-0.8	-2.6	4.7	4.2
Malaysia	10.4	2.4	-2.7	12.1	6.4	19.0	8.2	4.8	7.9	6.0
Singapore	16.1	11.3	3.5	8.0	5.0	8.9	1.0	-2.0	4.8	4.1
Hong Kong	3.2	1.4	-3.5	7.7	10.2	6.8	2.2	-0.3	2.5	3.7
Philippines	5.2	3.2	-1.7	19.1	-1.9	10.8	12.2	6.8	6.7	5.8
New Zealand	7.6	-3.1	-11.8	0.6	5.8	7.9	8.5	8.8	3.6	5.7
Western Europe	**5.2**	**-1.2**	**-11.4**	**0.4**	**2.2**	**-2.3**	**-1.2**	**2.3**	**2.2**	**2.9**
Eurozone	**4.9**	**-0.8**	**-11.2**	**-0.6**	**1.8**	**-3.5**	**-2.3**	**1.2**	**1.7**	**2.4**
Germany	4.6	0.6	-9.9	4.6	7.5	-0.0	-0.4	3.3	2.2	3.2
France	5.5	0.7	-9.0	1.9	2.1	0.3	-0.4	-1.2	-0.2	2.2
Italy	1.3	-3.2	-10.0	-0.6	-1.7	-9.4	-5.8	-3.2	1.2	1.9
Spain	4.3	-3.9	-16.9	-4.9	-6.3	-8.1	-3.8	3.4	4.8	2.9
Other Western Europe	**5.9**	**-2.8**	**-12.0**	**3.7**	**3.7**	**2.0**	**2.3**	**5.8**	**3.6**	**4.2**
UK	4.3	-4.9	-13.1	5.3	2.8	1.2	2.8	7.3	5.2	5.7
Switzerland	5.0	0.6	-7.5	4.2	4.4	2.5	1.8	1.8	0.3	0.6
Sweden	8.3	0.3	-13.3	5.5	5.8	0.3	-0.4	7.6	4.6	3.3
Norway**	14.2	1.2	-10.7	-6.4	5.2	7.3	3.0	1.8	-1.4	1.7
CEEMEA	**18.6**	**7.0**	**-12.3**	**6.3**	**9.4**	**3.2**	**2.4**	**1.7**	**0.8**	**2.4**
Russia	21.0	10.6	-14.4	5.9	9.1	6.6	1.4	-2.0	-8.0	-5.0
Turkey	3.1	-6.2	-19.0	30.5	18.0	-2.5	4.3	-1.3	1.2	6.1
Saudi Arabia	19.4	15.1	-6.2	14.6	15.6	5.0	5.6	4.5	4.0	3.5
Nigeria	24.5	-6.8	9.1	-3.6	-8.2	2.6	7.9	13.4	11.5	8.7
Poland	19.2	8.4	-1.9	-0.4	9.3	-1.5	1.1	9.2	8.3	6.4
South Africa	13.8	12.8	-6.7	-3.9	5.7	3.6	7.6	-0.4	1.1	2.4
Latin America	**9.7**	**9.0**	**-7.1**	**10.0**	**10.2**	**1.8**	**2.5**	**-0.9**	**-0.9**	**4.4**
Brazil	12.0	12.7	-1.9	17.8	6.6	-0.6	6.1	-4.4	-7.5	3.2
Mexico	6.0	5.0	-9.3	1.3	7.8	4.5	-1.8	2.2	5.0	5.7
Argentina	13.9	7.9	-14.6	21.2	20.5	-7.0	3.1	-5.6	-4.0	4.8
Colombia	14.4	9.9	-1.3	4.9	19.0	4.7	6.0	10.9	3.6	4.0
Chile	10.8	17.9	-12.1	11.6	15.0	11.6	2.1	-6.1	1.1	2.9

Note: * India data in fiscal year (2012= April 2012 to March 2013). GDP data from 2012 onwards is as per the new series (2011-12 prices); **Mainland. We now calculate the weighting system using chain nominal GDP (USD) weights
Source: HSBC estimates

Exports

Export volume growth (GDP basis)

% Year	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
World	**9.2**	**5.2**	**-12.5**	**14.9**	**9.9**	**3.8**	**3.2**	**3.7**	**3.2**	**4.4**
Developed	**6.6**	**1.7**	**-12.2**	**11.1**	**5.6**	**2.6**	**2.1**	**3.9**	**4.0**	**4.0**
Emerging	**13.5**	**10.7**	**-13.1**	**20.3**	**15.6**	**5.3**	**4.6**	**3.6**	**2.4**	**4.9**
North America	**7.4**	**3.8**	**-9.9**	**10.3**	**6.3**	**3.4**	**2.9**	**3.6**	**2.8**	**3.8**
US	9.3	6.1	-9.1	11.1	6.7	3.5	3.0	3.2	3.0	3.3
Canada	1.1	-4.5	-13.1	6.9	4.6	2.6	2.0	5.4	2.6	4.5
Asia-Pacific	**13.7**	**9.2**	**-12.8**	**22.5**	**12.5**	**5.3**	**5.8**	**5.0**	**3.8**	**5.7**
China	25.8	17.2	-15.9	31.3	20.3	7.9	7.8	6.1	4.2	7.0
Japan	8.7	1.4	-24.2	24.8	-0.4	-0.2	1.2	8.4	7.2	5.2
India*	5.9	14.6	-4.7	19.6	14.8	6.7	7.3	-0.8	2.2	7.0
Australia	3.1	3.6	2.3	5.8	0.0	6.0	6.2	6.8	9.3	8.4
South Korea	12.7	7.5	-0.3	12.7	15.1	5.1	4.3	2.8	0.5	2.5
Indonesia	8.5	1.7	-2.0	15.3	14.8	1.6	4.2	1.0	0.8	4.3
Taiwan	10.4	0.6	-8.4	25.7	4.2	0.4	3.5	5.9	4.9	5.6
Thailand	8.9	6.3	-12.5	14.1	9.2	5.1	2.8	0.0	2.4	4.2
Malaysia	3.8	1.6	-10.9	11.5	4.2	-1.7	0.3	5.1	-1.2	1.4
Singapore	0.0	4.6	-7.6	17.4	5.9	1.7	4.4	2.1	4.7	1.9
Hong Kong	8.4	2.5	-10.0	16.8	3.9	1.9	6.2	0.9	0.4	5.0
Philippines	6.7	-2.7	-7.8	21.0	-2.5	8.6	-1.0	11.3	2.9	5.5
New Zealand	4.8	-1.3	2.1	3.3	2.6	1.9	0.9	3.3	6.4	2.5
Western Europe	**6.1**	**1.0**	**-11.8**	**10.1**	**6.4**	**2.6**	**1.9**	**3.4**	**3.9**	**3.8**
Eurozone	**7.3**	**0.8**	**-12.6**	**10.8**	**6.8**	**2.9**	**2.1**	**3.7**	**3.9**	**4.1**
Germany	9.6	1.3	-14.3	14.2	8.2	3.5	1.7	3.7	4.2	4.9
France	2.7	0.0	-11.0	8.6	7.1	2.6	1.8	2.4	4.5	2.8
Italy	5.5	-3.3	-17.9	11.3	6.1	2.0	0.7	2.4	3.5	3.6
Spain	6.6	-1.0	-11.0	9.4	7.4	1.2	4.3	4.2	5.6	5.9
Other Western Europe	**2.0**	**1.7**	**-8.7**	**7.4**	**4.9**	**1.5**	**1.0**	**2.1**	**3.6**	**2.4**
UK	-2.1	1.6	-8.2	6.2	5.6	0.7	1.5	0.6	4.4	2.6
Switzerland	10.4	2.1	-7.1	7.7	3.4	2.8	0.2	3.8	0.7	2.1
Sweden	4.7	1.6	-14.3	11.4	6.2	1.5	-0.2	3.5	3.7	3.0
Norway**	5.7	1.3	-6.0	7.4	2.5	3.0	1.6	4.0	4.6	1.5
CEEMEA	**10.2**	**11.4**	**-15.7**	**12.0**	**15.4**	**4.7**	**1.2**	**2.8**	**2.2**	**2.9**
Russia	6.3	0.6	-4.7	7.0	0.3	1.1	4.6	-0.1	-2.0	1.0
Turkey	7.3	2.7	-5.0	3.4	7.9	17.2	0.1	6.8	1.1	5.5
Saudi Arabia	10.5	34.4	-38.7	30.6	45.2	6.5	-3.2	1.0	0.0	0.0
Nigeria	2.9	-4.2	4.1	6.7	25.8	-3.6	-21.7	15.6	-6.0	1.7
Poland	10.2	7.0	-6.3	12.9	7.9	4.3	4.8	5.7	6.5	7.0
South Africa	7.8	1.5	-17.0	7.7	4.3	0.1	4.6	2.6	3.8	3.4
Latin America	**11.2**	**6.5**	**-17.0**	**24.2**	**17.0**	**2.0**	**0.7**	**0.3**	**-1.8**	**3.5**
Brazil	6.2	0.4	-9.2	11.7	4.8	0.5	2.1	-1.1	2.1	2.0
Mexico	8.9	7.2	-21.3	29.9	17.1	6.1	2.5	4.6	1.3	2.9
Argentina	20.3	25.1	-20.5	22.5	23.3	-6.0	-3.8	-10.1	-13.6	3.3
Colombia	21.4	25.9	-11.7	20.0	42.9	5.7	-2.1	-5.4	-14.6	12.4
Chile	15.5	-5.9	-14.0	28.2	14.5	-4.5	-1.7	-1.0	-1.6	3.6

Note: Real Exports of Goods & Services. * India data in fiscal year (2012= April 2012 to March 2013). GDP data from 2012 onwards is as per the new series (2011-12 prices); **Mainland. We now calculate the weighting system using chain nominal GDP (USD) weights. ***Colombian exports are in nominal USD, as provided by The Statistics Institute (DANE).
Source: HSBC estimates

Industrial production

Industrial production

% Year	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
World	**5.9**	**0.9**	**-6.1**	**11.8**	**5.1**	**2.8**	**2.6**	**3.5**	**2.6**	**3.9**
Developed	**2.6**	**-2.9**	**-13.4**	**7.1**	**2.4**	**0.9**	**1.0**	**2.8**	**1.2**	**2.3**
Emerging	**9.5**	**4.8**	**0.9**	**16.1**	**7.3**	**4.4**	**3.9**	**4.0**	**3.5**	**5.1**
North America	**2.2**	**-3.3**	**-11.3**	**5.7**	**3.4**	**3.5**	**2.8**	**4.2**	**1.1**	**1.7**
US	2.5	-3.4	-11.3	5.7	3.4	3.6	2.9	4.2	1.3	1.7
Canada	-0.8	-2.5	-11.0	6.0	4.1	1.4	1.8	4.1	-0.6	1.6
Asia-Pacific	**10.2**	**4.8**	**0.9**	**13.5**	**6.5**	**5.0**	**4.7**	**5.2**	**4.7**	**5.9**
China	16.0	12.9	12.9	15.7	13.9	10.0	9.7	8.3	6.5	7.2
Japan	2.8	-3.4	-21.8	15.6	-2.8	0.6	-0.8	2.1	0.9	3.8
India*	15.5	2.5	5.3	8.2	2.9	1.1	-0.1	2.8	6.4	7.4
Australia	3.4	2.8	-1.3	4.6	1.1	3.4	2.0	3.4	1.3	3.9
South Korea	7.0	3.5	-0.8	16.5	6.0	1.7	0.4	0.5	-0.6	-0.7
Indonesia	5.6	3.0	1.3	5.1	4.1	4.1	6.0	4.8	4.1	4.6
Taiwan	7.8	-1.1	-7.9	24.2	4.4	-0.2	0.7	6.4	3.1	6.6
Thailand	9.5	6.8	-4.1	17.4	-1.9	5.6	2.9	1.9	1.9	3.4
Malaysia	2.3	0.8	-7.6	6.2	2.4	4.2	3.4	5.1	4.9	5.1
Singapore	5.9	-4.2	-4.2	29.7	7.8	0.3	1.7	3.0	0.9	3.2
Hong Kong	-1.5	-6.7	-8.3	3.5	0.7	-0.8	0.1	-0.4	0.8	-1.0
Philippines	3.6	4.3	-4.8	11.2	4.7	5.4	10.3	8.1	8.0	8.0
New Zealand	6.1	-11.0	4.8	-4.3	0.6	-0.1	1.0	2.5	1.8	2.8
Western Europe	**2.8**	**-2.6**	**-14.3**	**6.2**	**3.1**	**-2.6**	**-0.9**	**1.0**	**1.5**	**2.5**
Eurozone	**3.8**	**-1.8**	**-15.1**	**7.3**	**3.5**	**-2.4**	**-0.7**	**0.4**	**2.6**	**2.3**
Germany	5.9	-0.0	-15.5	10.1	7.4	-0.4	0.1	1.5	2.0	4.0
France	1.2	-3.1	-13.8	4.9	2.4	-2.5	-0.5	-1.1	1.7	2.4
Italy	1.8	-3.7	-18.6	6.9	1.3	-6.2	-3.1	-0.5	0.8	2.1
Spain	1.8	-7.7	-15.6	0.8	-1.5	-6.6	-1.6	1.2	2.7	1.6
Other Western Europe	**2.0**	**-1.6**	**-10.1**	**5.2**	**2.6**	**-0.8**	**-0.7**	**2.6**	**0.8**	**1.7**
UK**	0.7	-2.9	-9.4	4.7	1.8	-1.3	-0.7	3.1	1.0	1.9
Switzerland	5.0	3.2	-10.1	6.8	8.4	-0.7	-0.5	3.4	0.4	0.4
Sweden	4.0	-2.8	-18.0	8.7	2.6	-1.2	-4.6	-1.7	-1.1	1.2
Norway	5.8	2.9	-6.4	2.8	0.9	2.7	3.8	3.3	1.7	2.5
CEEMEA	**5.9**	**2.4**	**-5.3**	**26.9**	**7.0**	**3.4**	**1.4**	**2.6**	**1.4**	**2.9**
Russia	6.3	0.6	-9.3	7.3	5.0	3.4	0.4	1.7	-2.9	-0.6
Turkey	7.0	-0.6	-9.9	12.8	10.1	2.5	3.0	3.5	1.7	2.7
Saudi Arabia	-0.2	4.4	9.0	169.2	12.0	4.9	0.2	6.0	1.0	1.0
Nigeria	-1.1	-1.3	-1.3	4.1	3.5	2.9	2.0	2.4	1.8	2.3
Poland	9.4	2.7	-3.8	11.1	6.7	1.2	2.3	3.5	4.5	4.9
South Africa	4.2	-0.4	-13.8	4.6	2.8	2.3	1.4	0.1	-0.1	1.2
Latin America	**5.3**	**1.4**	**-6.3**	**6.8**	**3.8**	**-0.1**	**0.8**	**-1.4**	**-1.3**	**3.0**
Brazil	5.9	3.1	-7.1	10.2	0.4	-2.3	2.1	-3.2	-5.0	4.0
Mexico	2.0	-0.1	-6.2	4.6	3.4	2.7	-0.7	1.8	2.2	2.6
Argentina	7.7	4.4	0.5	8.6	6.5	-1.2	-0.4	-2.5	-0.4	3.0
Colombia	9.7	-3.3	-5.1	4.2	4.9	-0.3	-1.3	1.5	2.5	4.0
Chile	4.1	0.2	-6.7	3.2	8.0	2.2	0.2	-0.8	1.2	1.5

Note: *Based on Indian fiscal year (April – March). We now calculate the weighting system using GDP PPP (USD) weights. **Manufacturing production
Source: HSBC estimates

HSBC

Wage growth

Wage growth

% Year	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
World	**6.6**	**7.1**	**3.6**	**6.0**	**6.6**	**6.4**	**5.5**	**5.6**	**4.8**	**5.1**
Developed	**2.6**	**2.8**	**1.0**	**1.8**	**1.8**	**1.6**	**1.6**	**1.8**	**1.9**	**2.1**
Emerging	**12.3**	**13.0**	**7.0**	**11.1**	**12.1**	**11.7**	**9.7**	**9.4**	**7.6**	**8.0**
North America	**3.5**	**3.0**	**1.7**	**2.0**	**2.0**	**1.9**	**1.9**	**2.1**	**2.4**	**2.4**
US	3.4	3.0	1.7	1.9	2.0	1.9	1.9	2.1	2.5	2.5
Canada	4.3	2.9	1.5	3.6	2.5	2.5	1.8	2.6	1.5	1.7
Asia-Pacific	**7.6**	**8.6**	**4.6**	**9.5**	**10.7**	**10.0**	**8.4**	**8.1**	**6.8**	**7.2**
China	16.0	15.4	9.9	15.3	18.6	13.6	11.5	10.8	10.0	10.0
Japan	-1.7	0.3	-4.8	0.6	-0.2	-0.8	-0.0	0.8	0.8	1.6
Australia	4.1	4.2	3.5	3.4	3.7	3.6	2.9	2.5	2.3	2.8
South Korea	-	-	5.0	6.4	1.7	3.8	4.4	5.0	1.7	1.7
Indonesia	4.2	7.6	5.3	12.2	3.4	20.4	14.9	13.8	6.1	5.4
Taiwan	1.8	-0.3	-9.3	8.4	2.3	0.8	0.3	3.2	3.0	3.0
Thailand	3.5	9.5	0.2	3.1	6.4	20.6	9.6	9.2	6.3	12.0
Malaysia	4.3	8.9	2.5	8.2	3.8	6.4	7.2	4.7	5.0	4.2
Singapore	6.2	5.4	-2.7	5.6	6.0	2.3	4.3	3.3	4.0	4.0
Hong Kong	2.8	0.9	0.8	3.3	9.3	5.2	4.1	4.1	4.5	4.5
Philippines	4.5	5.3	2.2	3.4	6.0	4.7	4.6	4.5	4.5	4.5
New Zealand	3.2	3.6	2.5	1.6	1.9	2.0	1.7	1.8	1.8	2.3
Western Europe	**2.9**	**3.3**	**1.9**	**1.8**	**2.0**	**1.8**	**1.6**	**1.6**	**1.6**	**1.8**
Eurozone	**2.9**	**3.5**	**2.6**	**1.6**	**2.6**	**2.4**	**1.2**	**1.2**	**1.3**	**1.3**
Germany	1.5	2.8	2.0	1.7	1.9	2.7	2.4	2.9	2.7	2.8
France	2.7	2.9	2.2	1.8	2.2	2.1	1.7	1.4	1.0	1.2
Italy	2.2	3.5	3.1	2.1	1.7	1.5	1.4	1.2	0.9	0.8
Spain	4.0	5.1	3.2	0.9	1.0	-0.6	0.0	0.0	0.4	0.6
Other Western Europe	**4.4**	**3.1**	**0.3**	**2.1**	**2.5**	**1.9**	**1.5**	**1.5**	**2.1**	**2.4**
UK	5.3	3.5	-1.1	2.0	2.4	1.4	1.2	1.2	2.5	3.0
Switzerland	1.5	2.1	2.1	1.0	1.4	1.1	0.7	0.8	0.6	0.5
Sweden	-	-	2.9	2.4	2.4	3.1	2.3	2.6	1.7	2.0
Norway	6.3	5.6	4.3	3.6	4.5	4.4	3.6	2.6	2.4	2.0
CEEMEA	**19.6**	**19.8**	**6.0**	**10.8**	**10.5**	**11.1**	**9.3**	**8.5**	**6.1**	**7.6**
Russia	27.8	27.2	7.8	12.4	11.5	13.9	11.9	9.2	4.4	7.5
Turkey	14.9	12.6	1.6	14.5	16.6	15.3	13.2	14.0	12.0	11.0
Poland	9.1	10.5	4.2	3.6	4.9	3.5	2.7	3.8	4.1	4.7
South Africa	6.7	12.8	11.8	13.6	7.2	7.6	7.6	6.7	8.0	8.0
Latin America	**6.7**	**8.3**	**7.0**	**7.9**	**8.8**	**8.6**	**7.4**	**8.7**	**7.0**	**6.8**
Brazil	7.3	9.9	8.4	9.2	9.4	9.8	8.0	9.0	6.5	6.1
Mexico	5.4	6.0	4.9	3.3	3.9	4.3	4.0	4.4	4.0	4.0
Argentina	20.0	23.4	17.3	29.3	35.8	24.8	25.2	31.5	29.2	31.4
Colombia	4.7	4.9	6.9	5.6	3.5	6.0	3.4	2.6	4.0	4.0
Chile	4.5	5.3	4.0	4.7	6.3	6.3	5.5	7.2	5.6	5.0

Note: Global and regional aggregates are calculated using GDP PPP (USD) weights
Source: HSBC estimates

HSBC

Budget balance

Budget balance

% GDP	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
North America	-1.0	-3.0	-9.6	-8.4	-8.1	-6.3	-3.7	-2.6	-2.2	-2.1
US	-1.2	-3.2	-10.1	-9.0	-8.7	-6.8	-4.1	-2.8	-2.4	-2.3
Canada	0.7	-0.4	-3.5	-2.0	-1.5	-1.0	-0.3	-0.1	0.1	0.1
Asia-Pacific	-0.6	-1.9	-4.6	-3.6	-3.4	-3.1	-3.0	-2.9	-2.7	-2.6
China	0.2	-0.8	-2.8	-2.5	-1.8	-1.5	-2.0	-2.1	-2.3	-2.6
Japan	-2.1	-4.2	-10.3	-9.3	-9.8	-8.7	-8.1	-7.1	-5.1	-4.4
India*	-2.5	-6.0	-6.5	-4.8	-5.8	-4.9	-4.4	-4.0	-3.9	-3.5
Australia	1.6	1.7	-2.1	-4.2	-3.4	-2.9	-1.2	-3.1	-2.6	-2.1
South Korea	3.3	1.6	-1.9	1.5	1.5	1.5	1.1	0.6	0.5	0.8
Indonesia	-1.3	-0.1	-1.6	-0.7	-1.1	-1.9	-2.3	-2.2	-2.3	-1.7
Taiwan	0.6	0.2	-1.2	-1.1	-0.4	-1.5	-0.8	-0.8	-0.7	-0.7
Thailand	-1.6	-0.8	-4.0	-0.9	-1.0	-2.6	-1.9	-2.7	-3.2	-3.0
Malaysia	-3.0	-4.5	-6.4	-5.3	-4.7	-4.3	-3.8	-3.4	-3.4	-3.0
Singapore	3.0	1.4	-0.9	0.2	1.2	1.9	1.4	1.1	-1.0	-0.3
Hong Kong	3.5	7.2	0.1	1.5	3.9	3.6	3.0	1.0	3.5	0.7
Philippines	-0.2	-0.9	-3.7	-3.5	-2.0	-2.3	-1.4	-0.6	-0.1	-0.4
New Zealand	3.3	3.0	-2.1	-3.2	-9.0	-4.4	-2.0	-1.3	-0.3	0.1
Western Europe	0.6	0.1	-2.4	-2.4	-1.3	-1.0	-0.8	-0.7	-0.7	-0.7
Eurozone	**-0.7**	**-2.1**	**-6.4**	**-6.2**	**-4.2**	**-3.7**	**-3.1**	**-2.4**	**-2.2**	**-2.0**
Germany	0.3	0.0	-3.1	-4.1	-0.9	0.1	0.1	0.6	0.2	0.2
France	-2.5	-3.2	-7.2	-6.8	-5.1	-4.8	-4.1	-4.0	-3.8	-3.5
Italy	-1.6	-2.7	-5.5	-4.5	-3.7	-3.0	-2.9	-3.0	-2.8	-2.3
Spain	2.0	-4.4	-11.0	-9.4	-9.4	-10.3	-7.1	-5.7	-4.9	-4.0
Other Western Europe	4.1	6.2	7.8	6.9	6.1	6.1	4.8	4.0	3.4	2.7
UK	-2.7	-6.1	-9.9	-8.5	-7.0	-7.2	-5.7	-4.8	-3.8	-2.7
Switzerland	1.5	0.6	1.8	0.3	0.3	0.1	0.2	-0.1	-0.2	-0.2
Sweden	3.6	2.2	-0.7	0.3	0.2	-0.5	-0.9	-1.1	-0.7	-0.5
Norway	17.1	18.7	10.3	11.0	13.4	13.8	11.3	9.1	9.4	9.4
CEEMEA	2.5	3.9	-6.2	-3.5	-0.3	-0.1	-1.2	-2.2	-5.0	-3.4
Russia	5.4	4.1	-6.0	-3.9	0.8	0.0	-0.5	-0.5	-1.5	0.0
Turkey	-1.6	-1.8	-5.5	-3.6	-1.4	-2.0	-1.2	-1.3	-1.6	-1.2
Saudi Arabia	11.3	29.8	-5.4	4.4	11.6	13.6	6.5	-1.9	-16.1	-11.2
Nigeria	-0.6	-0.2	-3.3	-2.0	-1.8	-1.4	-1.4	-0.7	-1.9	-1.3
Poland	-1.9	-3.6	-7.3	-7.6	-4.9	-3.7	-4.0	-3.2	-2.7	-2.3
South Africa	-0.8	-1.2	-6.3	-4.2	-3.6	-4.1	-3.8	-3.5	-3.5	-2.9
Latin America	1.5	0.8	-3.2	-1.8	-1.2	-1.1	-2.0	-3.8	-4.1	-3.5
Brazil	-2.7	-2.0	-3.2	-2.4	-2.5	-2.0	-3.1	-6.2	-6.1	-5.0
Mexico	0.0	-0.1	-2.3	-2.8	-2.4	-2.6	-2.3	-3.2	-3.5	-3.0
Argentina	0.9	1.1	-0.5	0.2	-1.3	-2.0	-1.9	-2.4	-4.2	-2.9
Colombia	-0.6	-0.1	-2.8	-3.2	-2.0	0.3	-0.9	-1.2	-2.1	-2.4
Chile	8.4	5.0	-4.2	-0.4	1.3	0.6	-0.6	-1.6	-2.0	-1.8

Note: *Fiscal year.
Global and regional aggregates are calculated using GDP PPP (USD) weights
Source: HSBC estimates

Current account

Current account

% GDP	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
North America	**-4.5**	**-4.3**	**-2.7**	**-3.0**	**-2.9**	**-2.8**	**-2.3**	**-2.2**	**-2.4**	**-2.6**
US	-5.0	-4.7	-2.7	-3.0	-3.0	-2.8	-2.2	-2.2	-2.5	-2.6
Canada	0.8	0.1	-2.9	-3.5	-2.8	-3.4	-3.0	-2.1	-2.3	-2.1
Asia-Pacific	**5.3**	**4.0**	**3.3**	**2.8**	**1.3**	**1.1**	**1.4**	**1.8**	**2.4**	**2.0**
China	10.1	9.3	4.9	4.0	1.9	2.6	1.5	2.1	2.9	2.9
Japan	4.9	3.0	2.9	4.0	2.2	1.0	0.8	0.5	3.2	1.3
India*	-1.3	-2.3	-2.8	-2.7	-4.4	-4.8	-1.7	-1.3	-1.5	-1.7
Australia	-6.7	-4.9	-4.6	-3.6	-2.9	-4.3	-3.3	-2.8	-3.1	-2.6
South Korea	1.1	0.3	3.7	2.6	1.6	4.1	6.2	6.3	8.4	8.6
Indonesia	2.3	0.0	1.8	0.7	0.2	-2.7	-3.2	-2.9	-2.6	-2.8
Taiwan	8.6	6.6	10.9	8.9	8.2	9.9	10.8	12.4	12.3	10.9
Thailand	5.5	0.7	7.8	2.9	2.4	-0.4	-0.9	3.2	3.5	3.1
Malaysia	14.9	16.5	15.1	10.1	10.9	5.2	3.5	4.3	2.5	3.3
Singapore	26.0	14.4	16.8	23.7	22.7	18.8	21.2	17.8	16.3	17.2
Hong Kong	13.0	15.0	9.9	7.0	5.6	1.6	1.5	1.9	0.4	0.6
Philippines	5.3	0.1	5.0	3.6	2.5	2.8	4.2	4.4	0.1	-0.9
New Zealand	-6.8	-7.8	-2.2	-2.3	-2.8	-4.0	-3.2	-3.3	-2.5	-2.6
Western Europe	**0.5**	**-0.4**	**0.6**	**0.6**	**0.8**	**1.5**	**1.8**	**2.0**	**1.9**	**1.8**
Eurozone	**0.1**	**-1.6**	**-0.2**	**0.1**	**0.1**	**1.2**	**1.9**	**1.9**	**2.2**	**2.2**
Germany	6.7	5.6	5.7	5.6	6.1	6.8	6.5	7.6	7.7	7.4
France	-1.0	-1.7	-1.3	-1.3	-1.7	-2.1	-1.3	-1.0	-1.1	-1.5
Italy	-1.4	-2.8	-1.9	-3.5	-3.1	-0.4	0.9	1.8	2.0	1.8
Spain	-9.6	-9.2	-4.3	-3.9	-3.2	-0.3	1.4	0.8	0.7	0.5
Other Western Europe	**1.5**	**0.2**	**0.7**	**1.7**	**1.8**	**0.8**	**0.2**	**-1.0**	**-1.0**	**-1.0**
UK	-2.7	-3.7	-2.8	-2.6	-1.7	-3.7	-4.5	-5.5	-5.5	-5.3
Switzerland	10.0	2.2	7.1	14.0	6.8	9.9	10.7	7.0	5.3	5.3
Sweden	8.9	8.5	5.9	6.0	6.9	6.6	7.3	6.8	7.3	6.7
Norway	12.3	15.7	10.6	10.9	12.4	12.4	10.0	9.4	10.3	9.9
CEEMEA	**3.4**	**3.5**	**1.3**	**1.6**	**2.8**	**3.0**	**2.0**	**2.0**	**0.3**	**1.4**
Russia	5.9	6.1	4.0	4.7	5.2	3.6	1.6	3.3	4.4	7.3
Turkey	-5.9	-5.7	-2.3	-6.5	-10.0	-5.9	-7.9	-5.8	-4.1	-4.5
Saudi Arabia	22.4	25.4	4.9	12.7	23.6	22.4	18.2	10.8	-3.3	-0.5
Nigeria	16.8	14.2	8.3	4.0	3.1	4.2	3.9	0.8	-3.1	-1.5
Poland	-6.3	-6.5	-3.9	-5.6	-5.1	-3.5	-1.3	-1.4	0.0	0.1
South Africa	-5.4	-5.5	-2.7	-1.5	-2.2	-5.0	-5.8	-5.4	-4.7	-5.0
Latin America	**1.1**	**-2.1**	**-0.1**	**-0.7**	**-1.7**	**-2.5**	**-3.3**	**-3.1**	**-2.4**	**-1.9**
Brazil	0.1	-1.7	-1.5	-2.1	-2.0	-2.3	-3.4	-4.5	-3.9	-3.1
Mexico	-1.4	-1.8	-0.9	-0.5	-1.1	-1.3	-2.4	-2.1	-2.3	-2.3
Argentina	2.2	1.7	2.9	-0.2	-0.4	0.0	-1.8	-1.7	-2.6	-4.0
Colombia	-2.9	-2.8	-2.2	-3.1	-2.9	-3.2	-3.3	-5.1	-6.0	-5.5
Chile	4.1	-3.2	2.0	1.7	-1.2	-3.6	-3.7	-1.2	0.6	1.3

Note: *Fiscal year. Global and regional aggregates are calculated using GDP PPP (USD) weights
Source: HSBC estimates

HSBC

Current account

USDbn	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
North America	**-707.2**	**-689.0**	**-424.3**	**-498.3**	**-509.5**	**-511.9**	**-430.1**	**-429.1**	**-497.2**	**-527.8**
US	-718.6	-690.8	-384.0	-442.0	-460.4	-449.7	-376.8	-389.5	-442.4	-488.1
Canada	11.4	1.8	-40.2	-56.4	-49.1	-62.3	-53.4	-39.5	-54.7	-39.6
Asia-Pacific	**444.1**	**451.0**	**353.5**	**328.4**	**192.9**	**219.3**	**261.1**	**379.7**	**479.8**	**499.9**
China	353.2	420.6	243.3	237.8	136.1	215.4	148.2	219.7	318.5	338.8
Japan	213.6	143.4	146.2	218.9	125.0	62.4	34.4	22.5	132.2	52.9
India*	-15.7	-27.9	-38.4	-46.0	-78.2	-87.8	-32.4	-27.5	-30.9	-40.2
Australia	-62.2	-53.9	-44.5	-44.8	-44.1	-65.5	-51.9	-41.0	-39.4	-31.5
South Korea	11.8	3.2	33.6	28.9	18.7	50.8	81.1	89.2	116.5	121.6
Indonesia	10.5	0.1	10.6	5.1	1.7	-24.4	-29.1	-25.4	-22.1	-25.0
Taiwan	35.2	27.5	42.9	39.9	39.9	49.0	55.3	65.4	65.7	60.3
Thailand	15.7	2.2	21.9	10.0	8.9	-1.5	-3.9	13.1	14.1	13.2
Malaysia	29.2	39.4	31.4	25.7	32.5	16.3	11.3	14.5	8.2	11.9
Singapore	46.9	27.8	32.4	56.1	62.4	53.8	63.2	53.9	46.3	50.6
Hong Kong	27.6	32.9	21.2	16.0	13.8	4.1	4.2	5.4	1.1	1.7
Philippines	8.1	0.1	8.4	7.2	5.6	6.9	11.4	12.6	0.3	-3.0
New Zealand	-9.1	-10.2	-2.7	-3.3	-4.6	-6.9	-5.8	-6.4	-4.4	-4.7
Western Europe	**-**	**-210.5**	**28.8**	**114.5**	**115.6**	**228.4**	**285.4**	**200.8**	**217.7**	**208.2**
Eurozone	**-**	**-223.5**	**-21.9**	**11.7**	**10.0**	**156.0**	**242.4**	**226.0**	**250.8**	**240.1**
Germany	249.1	226.1	198.3	211.8	247.2	255.6	266.9	282.7	245.8	250.1
France	-26.8	-50.3	-35.5	-33.2	-49.0	-57.7	-36.6	-28.3	-26.4	-36.5
Italy	-31.3	-68.1	-42.4	-73.9	-70.1	-9.2	19.6	37.4	34.8	34.1
Spain	-152.5	-158.9	-70.4	-55.7	-46.2	-4.1	19.8	10.3	8.1	6.5
Other Western Europe	**63.3**	**12.9**	**50.6**	**102.9**	**105.5**	**72.4**	**43.0**	**-25.2**	**-33.2**	**-31.9**
UK	-79.5	-112.4	-59.5	-65.5	-42.3	-95.3	-123.8	-161.8	-149.7	-148.1
Switzerland	48.2	12.4	39.0	91.0	48.2	66.7	73.7	48.1	36.0	39.4
Sweden	45.2	40.6	29.0	30.8	38.4	37.9	42.2	41.2	44.4	42.1
Norway	49.4	72.3	42.2	46.6	61.3	63.1	51.0	47.4	36.1	34.6
CEEMEA	**99.8**	**140.7**	**41.7**	**67.4**	**163.6**	**209.2**	**146.6**	**138.1**	**15.9**	**66.6**
Russia	77.2	102.3	49.0	71.1	98.9	72.0	32.8	59.5	54.3	86.4
Turkey	-37.8	-40.5	-12.2	-45.5	-75.1	-46.8	-65.0	-45.9	-28.8	-32.9
Saudi Arabia	93.3	132.3	21.0	66.8	158.5	164.7	135.4	81.2	-22.4	-3.9
Nigeria	29.5	24.7	13.8	14.2	11.9	18.9	19.6	3.0	-14.6	-7.2
Poland	-27.0	-34.9	-17.3	-26.9	-27.0	-17.6	-6.9	-7.6	0.0	0.6
South Africa	-16.0	-15.7	-8.1	-5.5	-9.1	-19.9	-21.1	-19.0	-15.1	-17.1
Latin America	**-4.7**	**-54.3**	**-23.2**	**-58.2**	**-81.0**	**-91.5**	**-144.9**	**-162.2**	**-136.6**	**-127.7**
Brazil	1.6	-28.2	-24.3	-47.3	-52.5	-54.2	-81.2	-104.8	-75.2	-59.6
Mexico	-14.7	-20.2	-8.3	-5.0	-13.3	-15.9	-30.4	-26.5	-28.2	-29.5
Argentina	7.4	6.8	11.0	-0.8	-2.3	0.1	-10.4	-8.7	-16.4	-25.8
Colombia	-6.0	-6.9	-5.1	-8.9	-9.9	-11.8	-12.7	-19.2	-18.4	-16.1
Chile	7.1	-5.8	3.5	3.8	-3.1	-9.6	-10.1	-3.0	1.5	3.3

Note: *Fiscal year.
Source: HSBC estimates

North America

US

Lower and slower for Fed rate hikes

Kevin Logan
Economist
HSBC Securities (USA) Inc.
+1 212 525 3195
kevin.r.logan@us.hsbc.com

Ryan Wang
Economist
HSBC Securities (USA) Inc.
+1 212 525 3181
ryan.wang@us.hsbc.com

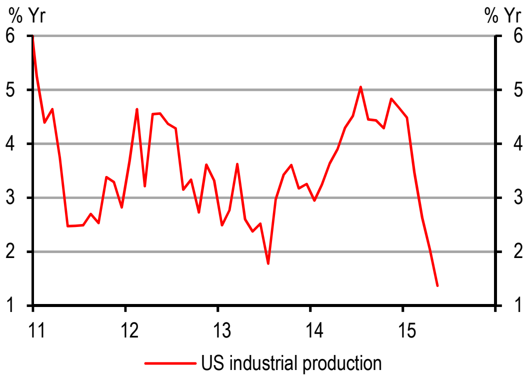
The USD's appreciation since mid-2014, along with sluggish growth in many of the world's economies, is causing a slowdown in the growth of US exports that is likely to persist for the rest of the year. The softness in external demand has impacted the manufacturing sector, and industrial production growth has slowed noticeably. A sharp fall in net exports contributed to an unexpected contraction in GDP in the first quarter this year. For 2015 as a whole, we expect that a decline in net exports will subtract about 0.6pp from the growth of GDP, compared to a 0.2pp drag in 2014.

The domestic economy appears to have regained some momentum over the course of the spring and early summer. Retail sales rose strongly in May, and construction activity has picked up since the beginning of the year. The labour market continues to show improvement. The energy sector is contracting and manufacturing job gains have slowed this year, but overall employment growth has decelerated only modestly. We expect to see a recovery in GDP growth in the second and third quarters this year, with average growth of around 2.7%.

Fed officials have indicated that, before beginning the process of policy normalisation, they would like to see further improvement in the labour market while at the same time being reasonably confident that inflation will return to 2.0% over the medium term. Core PCE inflation slowed to just 1.2% y-o-y in April, down from 1.4% a year ago, despite steady gains in employment and a decline in the unemployment rate to 5.5% from an average of 6.2% in 2014. With respect to goods, as opposed to services, the economy is experiencing deflation rather than inflation. The average price of core goods in the PCE index has fallen 0.5% in the past year.

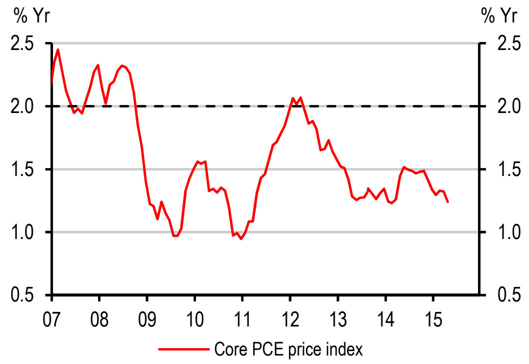
With inflation remaining low and with GDP growth decelerating from last year, we expect the FOMC to wait until December before taking its first step to raise the federal funds rate from its current 0%-0.25% range to 0.25-0.50%. We also think a continuation of slow growth will limit the number of rate hikes next year. We expect two increases of 25 basis points in 2016, lifting the federal funds range up to 0.75%-1.00% at year-end.

Industrial production growth has slowed noticeably



Source: Federal Reserve

Core PCE inflation drifting away from 2.0% target



Source: Bureau of Economic Analysis

Policy issues

Budget legislation will need to be passed for the new fiscal year by the end of September. In the past few years, budget stalemates have led to disruptive government shutdowns and near-defaults on US Treasury obligations. The chances of that happening this year are low, in our view. Although Congressional Republicans and Democrats continue to support different priorities as far as government spending is concerned, we believe the most likely outcome will be the adoption of a continuing resolution in September that keeps the mix and growth of spending broadly unchanged compared to the current fiscal year.

As far as monetary policy is concerned, many Fed officials expect to commence policy normalisation later this year. We look for the FOMC to raise the federal funds rate up from its current 0.00-0.25% target range in December. At some point after raising the policy rate, the FOMC may choose to cease making or commence phasing out reinvestments for the Fed's holdings of Treasury and mortgage-backed securities. This would gradually reverse some of the quantitative easing implemented in previous years. We expect a decision on the reinvestment policy could come at some point in 2016.

Risks

There is a risk that employment growth falls more quickly than we currently anticipate, reflecting either a more persistent slowdown in output growth or a pick-up in productivity growth from the unusually low levels of the past several years. The first scenario would be more worrisome, but in either case the slowdown in employment gains would likely lead to slower growth in household income, increasing the risks to the sustainability of the economic expansion.

A sharp increase in longer-term interest rates is another possible risk, raising potential borrowing costs for households and firms. The average 30-year fixed mortgage rate rose to about 4.0% in mid-June, up from 3.8% at the start of the year. During the 'taper tantrum' in the middle of 2013, the average 30-year mortgage rate climbed rapidly by more than 100 basis points to a peak of 4.6%, resulting in a marked slowdown in activity in the housing market. A similar outcome could be expected if longer-term interest rates were to rise sharply from current levels.

% q-o-q annualised	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP (% year)	2.4	2.2	2.6	2.9	2.4	1.8	1.9	2.5	2.6
GDP	-	-	-	-0.2	2.5	2.8	2.6	2.2	3.0
Consumer spending	2.5	2.8	2.6	2.1	2.4	2.5	2.6	2.6	2.9
Government consumption	-0.2	1.0	1.6	-0.6	2.6	2.7	0.9	1.2	1.4
Investment	5.3	4.3	5.6	-0.3	5.3	5.2	5.8	5.6	5.6
Stockbuilding (% GDP)	0.0	0.1	-0.1	0.4	-0.6	0.1	0.0	-0.4	0.4
Domestic demand	2.6	2.8	3.0	1.7	2.3	3.1	2.9	2.5	3.5
Exports	3.2	3.0	3.3	-5.9	9.8	4.0	3.5	2.0	2.9
Imports	4.0	6.3	5.0	7.1	6.3	4.9	4.4	5.1	5.1
Industrial production (% year)	4.2	1.3	1.7	3.4	1.5	0.5	-0.2	0.4	1.6
Unemployment (%)	6.2	5.4	5.0	5.6	5.4	5.3	5.2	5.2	5.0
Wage growth (% year)	2.1	2.5	2.5	2.6	2.4	2.4	2.5	2.5	2.5
Consumer prices (% year)	1.6	0.3	2.0	-0.1	0.0	0.3	0.9	2.1	2.0
Current account (USDbn)	-389.5	-442.4	-488.1	-113.3	-104.6	-109.1	-115.5	-120.3	-119.2
Current account (% GDP)	-2.2	-2.5	-2.6	-2.6	-2.3	-2.4	-2.5	-2.6	-2.6
Budget balance (% GDP)	-2.8	-2.4	-2.3	-	-	-	-	-	-
Gross external debt (% GDP)	97.3	98.1	98.2	-	-	-	-	-	-
Gross government debt (% GDP)	103.5	104.0	104.0	-	-	-	-	-	-
3-month money (%)*	0.3	0.6	1.1	0.3	0.3	0.3	0.6	0.9	0.9
10-year bond (%)*	2.1	2.5	2.8	2.1	2.4	2.3	2.5	2.6	2.7

Note: *Period-end
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, HSBC estimates

North America

Canada

Sluggishness persisting

David Watt
Chief Economist
HSBC Bank Canada
+1 416 868 8130
david.g.watt@hsbc.ca

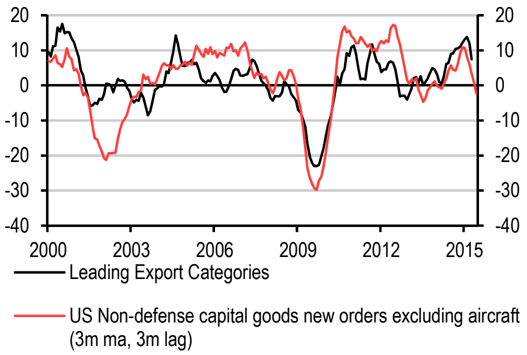
The weak Canadian dollar is expected to boost exports in H2 2015, but not enough to keep exports in line with our prior forecasts. We now look for exports to rise by 2.6% in 2015, down from 3.7% in our last outlook. The lowered forecast reflects the surprising 1.1% annualised decline in exports in Q1, a weaker than expected start to Q2, and recent indicators of demand for key Canadian exports. The Bank of Canada has identified 12 categories of goods exports believed to lead the export recovery. As shown in the left hand chart below, a slowdown in US business investment points toward moderation in the pace of expansion of these key export categories in the next few months.

We expect consumer spending to rebound from the 0.4% annualised increase in Q1, but for growth this year to only reach 1.8%, a cut from our previous 2.3% forecast. Evidence from the first quarter showed that consumers increased savings rather than boosting spending on other goods and services in response to lower oil prices. Households saved almost all of the increase in disposable income in Q1, lifting the household savings rate to 5.0% of disposable income from 3.6%. Although we do not expect a repeat in Q2, given evidence that sales of new automobiles are on pace for a record year in 2015, we nonetheless look for moderate consumption growth in coming quarters. In particular, we expect the decline in the terms of trade as reflected in the lower real effective exchange rate to limit spending growth (right-hand chart).

The decline in oil prices continues to weigh on the oil sector, in which firms face continued pressure to keep costs under control. Thus, even though oil prices are off their early 2015 lows, employment and investment in the oil sands face downside risks. Nonetheless, output in the oil sands will continue to rise in the short run given the long lead times between investment and production.

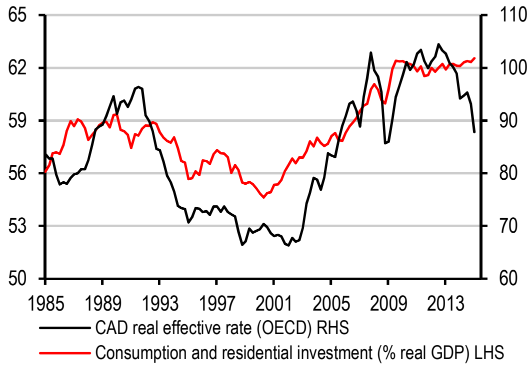
Overall, we look for the economy to grow by 1.4% in 2015, down from 1.8% in the previous outlook. In 2016, we look for GDP growth of 2.0%, down slightly from our earlier 2.2% forecast.

Leading export categories set to slow down



Source: Statistics Canada, Bureau of Economic Analysis, HSBC

No consumer response to currency decline yet



Source: Statistics Canada, OECD, HSBC

HSBC

Policy issues

We are focused on the Bank of Canada's monetary policy stance. Although the bank has indicated that the January 2015 25 basis point rate cut provided sufficient insurance to offset the decline in oil prices, we disagree. We believe that the Bank of Canada will have to cut rates again, from 0.75% to 0.25%. A key factor in this view is our more cautious outlook for the US economy. We expect the US economy to expand by 2.2% in 2015, and 2.6% in 2016, and for the Federal Reserve to raise rates in December 2015 rather than September. In the April Monetary Policy Report the bank projected that the US economy would grow by 2.7% in 2015 and 3.0% in 2016, with Governor Poloz expressing a quite optimistic view of the US economy. We think that the bank will take a more guarded view of the US economy and potential spill-over effects on Canada in mid-July. We think that more stimulus is required to close the output gap by late 2016 or early 2017. We do not expect fiscal stimulus to take the pressure off the bank to lower rates. Although an election looms (tentatively set for 19 October), the federal government has strongly indicated a preference to return to surplus while still enacting previously announced tax cuts. With federal revenues squeezed by the decline in oil prices, there is little room for meaningful stimulus in the short term.

Risks

The key risks are that the negative effects of the decline in oil prices prove more persistent, while the positive effects unfold more slowly than anticipated. There are already reasons for concern. The impact of lower oil prices on employment has not yet been fully felt, and recent news on exports and manufacturing suggests sluggishness persisting in Q2. The hand-off from energy-sensitive sectors of the economy to sectors sensitive to Canadian dollar weakness might not go as smoothly as anticipated.

The household sector also remains vulnerable. Although savings increased in Q1, debt levels are too high, leaving household balance sheets vulnerable to falling house prices, rising joblessness or higher longer-term interest rates as the first Federal Reserve rate hike nears.

% q-o-q annualised	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP (% year)	2.4	1.4	2.0	2.1	1.4	1.0	1.0	1.6	2.0
GDP	-	-	-	-0.6	0.8	1.6	2.0	2.1	2.2
Consumer spending	2.7	1.8	2.0	0.4	1.6	2.0	2.0	2.1	2.1
Government consumption	0.2	0.2	0.8	-0.8	0.2	0.5	0.8	0.8	1.0
Investment	0.2	-2.1	1.0	-7.1	-5.8	-0.8	0.9	1.7	2.0
Stockbuilding (% GDP)	0.4	0.6	0.5	0.7	0.6	0.5	0.5	0.5	0.5
Domestic demand	1.6	0.5	1.5	-1.6	-0.4	1.0	1.5	1.7	1.8
Exports	5.4	2.6	4.5	-1.1	2.2	3.5	4.2	4.8	5.0
Imports	1.8	0.8	2.5	-1.5	-2.5	1.0	2.2	3.0	3.5
Industrial production	4.1	-0.6	1.6	-4.5	-3.8	0.8	1.3	2.3	2.4
Unemployment (%)	6.9	6.8	6.7	6.7	6.7	6.9	6.8	6.8	6.8
Wage growth (% year)	2.6	1.5	1.7	2.7	1.4	0.9	1.1	0.6	1.4
Consumer prices (% year)	1.9	0.7	1.6	1.1	0.5	0.5	0.9	1.4	1.6
Current account (USDbn)	-39.5	-54.7	-39.6	-13.8	-13.0	-11.5	-10.8	-9.7	-8.6
Current account (% GDP)	-2.1	-2.3	-2.1	-3.5	-3.3	-3.0	-2.8	-2.5	-2.2
Budget balance (% GDP)	-0.1	0.1	0.1	-	-	-	-	-	-
Gross external debt (% GDP)	81.8	82.0	80.5	-	-	-	-	-	-
Gross government debt (% GDP)	86.5	87.0	85.0	-	-	-	-	-	-
CAD/USD*	1.16	1.30	1.30	1.27	1.26	1.30	1.30	1.30	1.30
3-month money (%)*	1.3	0.5	0.8	1.0	1.0	0.8	0.5	0.5	0.5
10-year bond (%)*	1.9	2.0	2.5	1.5	1.8	1.7	2.0	2.3	2.4

Note: *Period end
Source: Statistics Canada, HSBC estimates

Asia Pacific

China

Growth to pick up, but only gradually

Qu Hongbin
Economist
The Hongkong and Shanghai Banking Corporation Limited (HK)
+852 2822 2025
hongbinqu@hsbc.com.hk

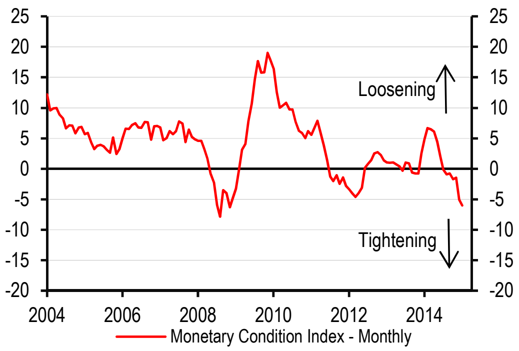
Julia Wang
Economist
The Hongkong and Shanghai Banking Corporation Limited
+852 3604 3663
juliarwang@hsbc.com.hk

Half way through 2015, economic activity remains weak. Export growth has surprised on the downside relative to our and consensus forecasts, growing by only 0.6% y-o-y in the first five months of the year. Partly this reflects weaker global demand for Asian exports as US growth turned out to be much softer than originally expected. But even though the US economy is widely expected to rebound in Q2, the boost to China's export growth will be limited given the RMB will likely remain strong versus the currencies of its trade partners. As a result, we have lowered our 2015 export forecast to 4.2% from 7.1%.

On the domestic front, the industrial deceleration continued with industrial production growth barely improving from the multi-year low reading seen in March. Weak, if not negative, profitability growth as well as deeply negative Producer Price Index (PPI) inflation suggest that conditions in the industrial sector remain challenging. Meanwhile, Fixed Asset Investment (FAI) growth slowed to an all-time low of 11.4% in May, weighed down by slower property investment. Infrastructure investment growth eased due to the tightening effect of the fiscal reforms on local government financing vehicles (LGFV). In recent weeks, the central government has approved more subways, water treatment and other major infrastructure projects while opening more channels for local governments to raise funds. However, it will take time for these measures to translate into new investment. Meanwhile, consumption growth has slowed in tandem with weaker income and wage growth, but remains on a faster growth trajectory than the investment part of the economy.

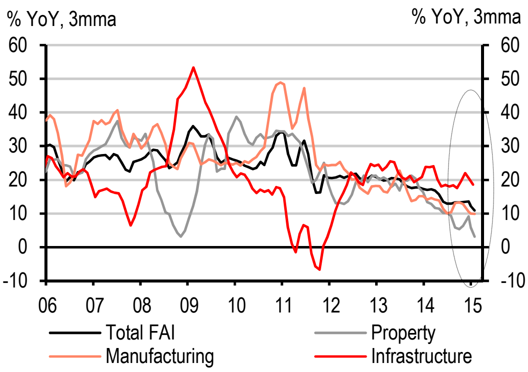
The weakness on both the external and domestic fronts has led us to trim our 2015 GDP forecast to 7.1% from 7.3%. Compared with our previous forecast, we now see a more gradual recovery as the result of belated monetary easing and the unintended fiscal tightening in the first half of the year. The slower and more uneven recovery will prompt additional monetary policy easing. We now expect an additional cumulative 250bps reserve ratio cut and 50bps policy rate cut in the rest of 2015.

Both monetary and fiscal easing measures are still needed…



Source: BIS, CEIC, Eviews, HSBC

…to anchor investment growth in the coming months



Source: CEIC, HSBC

Policy issues

With our expectations for a more gradual recovery path, we expect headline GDP growth rate to fall below 7% in Q2, prompting more aggressive policy easing. We have revised our monetary easing calls and now expect a cumulative 250bps reserve ratio cut, compared with 100bps previously. We also now expect a 50bps policy rate cut compared with 25bps previously.

Apart from monetary policy easing, we expect policy makers to roll out measures to alleviate the bottleneck on fiscal financing as well. The municipal bond issuance programme which kick-started in mid-May, is expected to accelerate in the coming months. The quota has reportedly been increased from RMB1trn to RMB2trn for 2015. We see this liability management exercise as another step in fiscal reform in order to reduce moral hazard and lower funding cost. The State Council is urging local governments to speed up the consolidation and utilisation of unspent fiscal surpluses accumulated over the years. Last but not least, policy bank lending as well as Public-Private Partnership schemes are expected to play a more prominent role.

Risks

The main downside risk to our view is that the property market fails to stabilise. Property sales have seen some sequential and year-on-year improvement, in response to the cumulative mortgage rule easing measures. The improvement is notable in first- and second-tier cities, while not yet visible in others. If the improvement in sales can be broadened and sustained, property investment growth will likely start to bottom out by year end. However, if the improvement is not sustained, then potentially even more policy easing may be needed to offset the drag from property investment.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	7.4	7.1	7.4	7.0	6.8	7.1	7.2	7.2	7.4
GDP (% quarter)	-	-	-	1.3	1.6	2.0	1.7	1.7	1.8
Primary industry	4.1	3.5	3.6	3.2	3.4	3.7	3.6	3.6	3.9
Secondary industry	7.3	6.9	7.1	6.4	6.7	7.3	7.1	7.1	7.5
Tertiary industry	8.1	7.9	7.9	7.9	7.6	8.0	7.9	7.9	8.2
Consumer spending	7.5	7.6	7.3	-	-	-	-	-	-
Government consumption	8.0	7.4	7.4	-	-	-	-	-	-
Investment	16.0	13.5	16.0	-	-	-	-	-	-
Domestic demand	-	-	-	-	-	-	-	-	-
Exports	6.1	4.2	7.0	-	-	-	-	-	-
Imports	3.5	-3.0	9.0	-	-	-	-	-	-
Industrial production	8.3	6.5	7.2	6.4	6.1	6.5	6.8	7.1	7.5
Wage growth	10.8	10.0	10.0	-	-	-	-	-	-
Consumer prices	2.0	1.2	1.3	1.2	1.2	1.3	1.3	1.4	1.3
Current account (USDbn)	219.7	318.5	338.8	-	-	-	-	-	-
Current account (% GDP)	2.1	2.9	2.9	-	-	-	-	-	-
Budget balance (% GDP)	-2.1	-2.3	-2.6	-	-	-	-	-	-
Gross external debt (% GDP)	9.5	10.1	10.4	-	-	-	-	-	-
CNY/USD*	6.21	6.26	6.32	6.20	6.22	6.24	6.26	6.28	6.30
3-month money market rate	4.2	3.0	3.0	4.9	2.9	3.0	3.0	3.0	3.0
10-year lending (%)*	4.1	3.2	3.2	4.4	3.6	3.4	3.2	3.2	3.2

Note: *Period end
Source: CEIC, HSBC estimates

Asia Pacific

Japan

Out of the woods

Izumi Devalier
Economist
The Hongkong and Shanghai Banking Corporation Limited
+852 2822 1647
izumidevalier@hsbc.com.hk

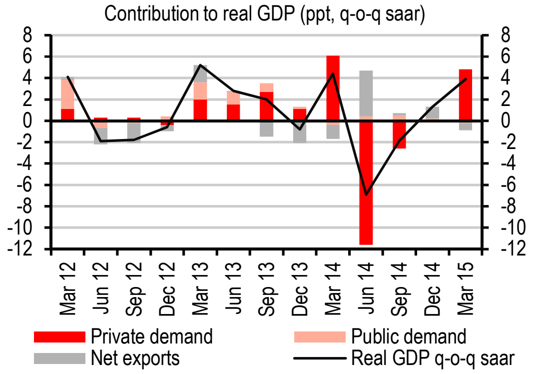
Rupali Sarkar
Economics Associate
Bangalore

The Japanese economy got off to a surprisingly strong start in 2015. Growth accelerated to 3.9% q-o-q saar in Q1 2015, up from 1.2% in Q4 2014. The improvement was driven by stronger domestic demand. Business investment surged 2.7% q-o-q sa, marking the third consecutive quarter of expansion on the back of strong corporate profits. Private consumption, though still sluggish, continued to grow. Meanwhile, external demand made a smaller contribution to growth than we had expected at the beginning of the year. Export growth remained strong, rising 2.4% q-o-q sa (versus 3.2% in Q4 2014). However, imports expanded at an even faster pace, resulting in a negative net exports contribution. Overall, Japan's growth mix is shifting towards domestic private demand sooner than anticipated.

That doesn't mean there won't be bumps along the way. Given the large contribution from inventories to Q1 2015 GDP, there is likely to be some payback in Q2 2015. The latest supply side data backs this up. IP growth has been lacklustre, and manufacturers have scaled back their production forecasts in response to inventory adjustment pressures. We therefore look for industrial production to contract in Q2 2015. Demand-side data has also been mixed. April retail sales were weaker-than-expected, suggesting that private consumption got off to a sluggish start in Q2 2015. We expect Q2 2015 GDP to slow to 0.0% q-o-q saar.

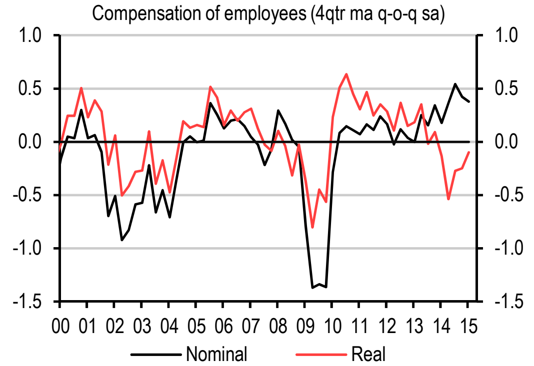
However, we remain optimistic that domestic demand will continue to expand gradually in H2 2015 and expect growth to average around 1.5% q-o-q saar for the remainder of the year. Private consumption has long been the laggard during the post-VAT-hike recovery but the picture is brightening. Sentiment has been improving since the start of the year thanks to a recovery in real spending power. Another positive is the strong recovery in nominal GDP, which surged 9.4% q-o-q saar in Q1 2015 on the back of lower oil prices. Assuming the labour share of income stays unchanged, the improvement in national income should translate into higher spending among households in H2 2015, which is crucial if Japan's economic recovery is to become self-sustaining.

Q1 GDP accelerated on the back of stronger private demand



Source: Cabinet Office, HSBC

Labour income is benefitting from a better terms of trade



Source: Cabinet Office, HSBC

Policy issues

We expect Japan-style core inflation to fluctuate around 0% through Q3 CY15 as the slowdown in energy prices offsets sluggish US-style core CPI growth. However, the slowdown in CPI inflation is not expected to prompt an immediate policy response from the Bank of Japan. In fact, at its 30 April 2015 meeting, the BoJ policy board trimmed its growth and CPI forecasts while pushing out the expected timing of hitting its 2% CPI target to H1 FY16 (ending September 2016), from "around FY15" previously. For the moment, the BoJ seems comfortable holding pat as it monitors developments in the output gap, as well as the impact of lower headline CPI on inflation expectations. Barring large external shocks to growth or a sharp strengthening of the yen, we believe the probability of near-term stimulus is low. However, it will likely be clear by late autumn whether “underlying inflation trends” are sufficiently powerful to justify the BoJ’s expectations for sustained 2% inflation. We think that the central bank will embark on one final round of easing, centring on longer-dated bond and alternative asset purchases in Q4 CY15, most likely at the 30 October 2015 one-day monetary policy meeting. However, the potential for a large-scale increase in the monetary base target is limited, given JGB liquidity issues.

Risks

We see the risks to our forecasts as balanced.

On the downside, the main risk is continued sluggishness in private consumption due to 1) a weaker-than-expected recovery in real labour income, or 2) increased saving among households, in response to uncertainties over the income outlook. Business investment may also revert to weak growth if the pick-up in the US recovery disappoints, thereby depressing exports and manufacturing sentiment.

On the upside, stronger-than-expected growth in the eurozone and the US would provide powerful tailwinds to Japanese exports. This, in turn, would support the on-going expansion in business investment. Meanwhile, there is also potential for private consumption to be boosted if wage growth accelerates more sharply than we expect.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	-0.1	0.8	1.1	-0.9	0.8	1.8	1.7	0.9	1.4
GDP (% quarter)	-	-	-	1.0	0.0	0.5	0.2	0.2	0.6
Consumer spending	-1.3	-0.1	1.5	-4.1	1.1	1.4	1.4	1.5	1.7
Government consumption	0.2	0.8	0.8	0.8	0.8	0.8	0.8	0.9	0.9
Investment	2.6	0.5	1.2	-3.1	1.8	2.2	2.1	0.6	0.5
Stockbuilding (% GDP)	-0.4	-0.5	-0.5	-0.1	-0.6	-0.5	-0.6	-0.6	-0.3
Domestic demand	-0.1	0.3	1.3	-2.0	0.4	1.4	1.6	0.7	1.6
Exports	8.4	7.2	5.2	7.4	7.9	7.7	6.0	4.8	5.6
Imports	7.4	5.9	7.5	0.0	7.3	8.1	8.4	7.2	7.4
Industrial production	2.1	0.9	3.8	-2.1	0.0	2.7	3.0	2.4	4.5
Unemployment (%)	3.6	3.4	3.2	3.5	3.4	3.3	3.3	3.2	3.2
Wage growth	0.8	0.8	1.6	-0.5	0.6	1.2	1.5	1.5	1.5
Consumer prices*	2.7	0.8	1.1	2.3	0.1	0.3	0.5	1.0	1.0
Current account (USDbn)	22.5	132.2	52.9	31.3	38.6	33.8	28.6	20.5	23.2
Current account (% GDP)	0.5	3.2	1.3	3.0	3.7	3.2	2.7	2.0	2.2
Budget balance (% GDP)	-7.1	-5.1	-4.4	-	-	-	-	-	-
Gross external debt (% GDP)	67.4	68.5	69.2	-	-	-	-	-	-
Gross government debt (% GDP)	245.2	239.0	232.1	-	-	-	-	-	-
JPY/USD**	120	125	125	120	120	120	125	125	125
3-month money (%)**	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
10-year bond (%)**	0.4	0.3	0.7	0.4	0.5	0.4	0.3	0.4	0.5

Note: We assume the next VAT hike will be implemented, as scheduled, on 1 April 2017, taking the consumption tax to 10%, from 8% currently. We also assume that the Bank of Japan announces further stimulus in Q4 CY15. *Includes the effects of the April 2014 VAT hike **Period end
Source: CEIC, Cabinet Office, MoF, BoJ, HSBC forecasts.

Asia Pacific

India

Modi's mixed bag, one year on

Pranjul Bhandari
Chief India Economist
HSBC Securities and Capital Markets (India) Private Limited
+91 22 2268 1841
pranjul.bhandari@hsbc.co.in

Prithviraj Srinivas
Economist
The Hongkong and Shanghai Banking Corporation Limited
+91 22 2268 1076
prithvirajsrinivas@hsbc.co.in

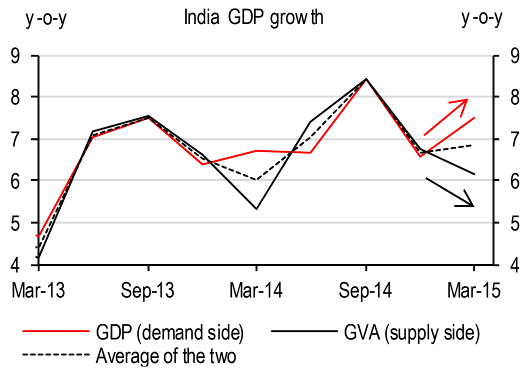
Stuti Saksena
Economics associate, Bangalore

PM Modi has been busy over the past year, with overseas travels and bilateral agreements that promise funding and investments into India. At home, a solution was devised for inactive coal mines, fuel price controls were removed, FDI norms were relaxed and by keeping agriculture support prices contained, prudent policy was chosen over populism. However, foreign investors' perception of India's tax policies has not improved, numerous projects have not got off the ground with knock-on effects on the banking system, and progress in some key bills remains stalled. To be fair, it will take time for results to show up from most of the government actions, such as restarting investments, undertaking subsidy reforms, improving ease of doing business and levying a uniform national indirect tax. Even so, the macro-economy is already much more stable with lower inflation, narrower deficits and higher foreign exchange reserves.

GDP growth in Q1 2015 improved (7.5% y-o-y vs. 6.6% in Q4 2014). However growth in GVA (a measure of activity on the supply side) slowed to 6.1% y-o-y vs. 6.8% in Q4. The divergence between the two measures of GDP is explained by the statistical artefact of higher net indirect taxes, which is likely to persist for a few quarters. While the true state of the recovery probably lies between the two figures, we prefer the supply side measure, as that gives a cleaner read on activity. The reading is also in line with our analysis of co-incident indicators, which shows that while about 40% share of GDP is improving, 60% has not yet picked up speed. The recovery is therefore still slow, but progressing steadily and is likely to gain momentum, led by higher public investments and improved urban consumption, although rural demand remains a drag. We expect headline GDP growth to improve gradually to 7.8% y-o-y in FY2015-16 from 7.3% a year earlier. Growth on the supply side (GVA) will be lower at 7.4% y-o-y in FY2015-16, up from 7.2%.

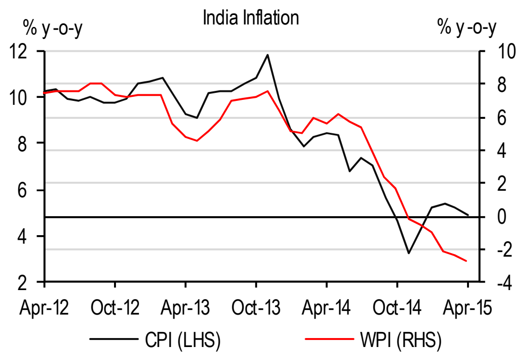
Inflation has halved in a matter of a few quarters; but with oil prices bottoming out and domestic recovery gaining ground, its dramatic decline may be over. Meanwhile, the current account deficit is likely to widen slightly due to higher oil prices and poor exports. However, it is likely to remain manageable, financed easily by stable capital inflows (FDI, ECBs and NRI deposits).

Headline GDP growth masks slow (but steady) recovery



Source: CEIC, HSBC

Inflation has fallen rapidly



Source: CEIC, HSBC

Policy issues

The budget for FY2015-16 adopted a milder fiscal consolidation path than the government had inherited, with the fiscal deficit falling to 3.9% of GDP in FY2015-16 instead of an earlier target of 3.6%. Apart from delayed consolidation in an effort to finance public investment, a transformational feature of this budget was greater devolution of untied tax income to states. Our analysis of 17 state budget documents shows that states in aggregate are illustrating signs of fiscal discipline. To match conservative revenue receipt estimates, they have slashed current expenditure much more than capex, just so as to keep fiscal deficits range-bound. We estimate a positive fiscal impulse to growth as the quality of expenditure improves.

The Reserve Bank of India delivered a 25bp rate cut in June (marking an overall of 75bp in rate cuts so far in 2015) with its forward guidance stating that policy now is neither aggressive, nor conservative, but just appropriate. Our base case forecast (of below normal but not too deficient rains through the next few months) suggest that CPI inflation would trend up to RBI's target of 6% by early 2016, leaving no space for rate cuts for the rest of the year. But, if rains turn out to be normal and economic growth, especially investment revival, remains weak, the RBI may find some space to cut rates further in 2015. However this additional space will be small, given RBI's ambitious target of 4% inflation by early 2018.

Risks

A severe drought caused by El Nino is the biggest risk to our forecasts, as it could depress rural demand further, weaken growth and stoke food prices. Key risk to our medium-term view of steady growth recovery is a slackening in the reform process and the inability of public investments to "crowd in" the private sector.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP (calendar year)	7.1	7.9	7.9	7.5	8.4	8.4	7.5	6.9	8.2
GDP (% quarter)	-	-	-	2.5	3.0	3.4	-1.6	2.0	4.3
GDP (fiscal year)	7.3	7.8	8.3	7.5	8.4	8.4	7.5	6.9	8.2
Consumer spending	6.3	7.8	8.3	7.9	8.0	6.2	9.0	8.0	8.0
Government consumption	6.6	9.3	7.6	-7.9	11.0	9.0	2.0	16.0	8.0
Investment	4.6	7.0	9.1	4.1	3.0	7.0	8.0	9.5	9.0
Stockbuilding (% GDP)	1.5	1.5	1.5	1.5	1.6	1.5	1.4	1.5	1.6
Domestic demand	6.1	7.7	8.5	5.6	6.7	6.9	8.0	9.3	8.3
Exports	-0.8	2.2	7.0	-8.2	2.0	2.0	2.0	3.0	4.0
Imports	-2.1	2.2	7.7	-8.7	2.0	2.0	2.0	3.0	5.0
Industrial production	2.8	6.4	7.4	3.4	5.4	5.5	8.2	6.5	7.1
Consumer prices	6.0	5.2	5.8	5.3	5.0	4.5	5.6	5.6	5.8
Current account (USDbn)	-27.5	-30.9	-40.2	-1.3	-1.7	-7.6	-11.3	-10.3	-6.7
Current account (% GDP)	-1.3	-1.5	-1.7	-0.2	-0.3	-1.5	-2.1	-1.8	-1.2
Budget balance (% GDP)	-4.0	-3.9	-3.5	-4.2	-4.3	-4.3	-4.1	-3.9	-3.9
Gross external debt (% GDP)	22.6	22.9	21.7	-	-	-	-	-	-
Gross government debt (% GDP)	66.5	66.4	64.0	-	-	-	-	-	-
INR/USD*	63.2	66.0	67.0	62.3	65.0	65.5	66.0	66.0	66.5
3-month money (%)*	8.3	8.0	7.5	8.3	7.9	8.0	8.0	8.0	7.9
10-year bond (%)*	7.9	7.3	6.5	7.8	7.8	7.6	7.3	7.0	6.8

Note: India annual data in fiscal year (April-March) unless indicated otherwise. For instance 2014 runs from April 2014 to March 2015. *Period end calendar year.
Source: CEIC, HSBC estimates

HSBC

Asia Pacific

Australia

Weak investment presents a challenge

Paul Bloxham
Economist
HSBC Bank Australia Limited
+612 9255 2635
paulbloxham@hsbc.com.au

Daniel Smith
Economist
HSBC Bank Australia Limited
+612 9006 5729
daniel.john.smith@hsbc.com.au

Australia's economy is in the process of rebalancing its growth as mining investment falls. Low interest rates are supporting solid growth in housing prices, which is feeding through to a strong housing construction upswing and a pick-up in durable goods sales. There is also strong growth in resources exports, as new capacity continues to come on line.

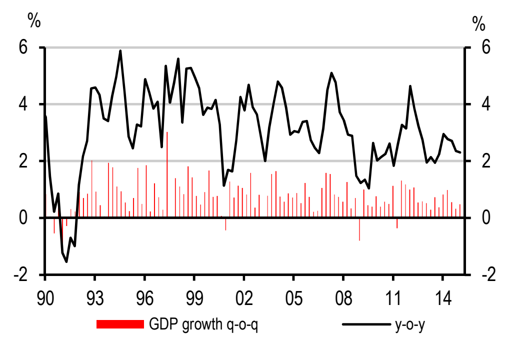
However, conditions in the non-mining business sector remain weak and public investment has continued to be a drag on growth, as state and federal governments have sought to consolidate their balance sheets. Despite strong household demand and exports growth, GDP grew at a below-trend pace of 2.3% y-o-y in the first quarter (trend is around 3.0%) as business and public investment fell.

As mining investment is expected to continue to fall over coming quarters, a pick-up in non-mining business investment and hiring will be needed for a return to trend growth. However, there is conflicting evidence on the outlook for non-mining business conditions. On the one hand, key surveys of capital expenditure intentions continue to show weak investment intentions for the coming year. On the other hand, recent labour market data have shown a solid lift in jobs growth, led by the services sector, and some stabilisation in the unemployment rate, which is a sign of improving business conditions.

To provide further support for growth, the central bank cut its cash rate by 50bp in the first half of 2015, to a new record low of 2.00%. The government also delivered a growth-supportive budget in May, which included proposals for additional spending on childcare and tax cuts for small businesses.

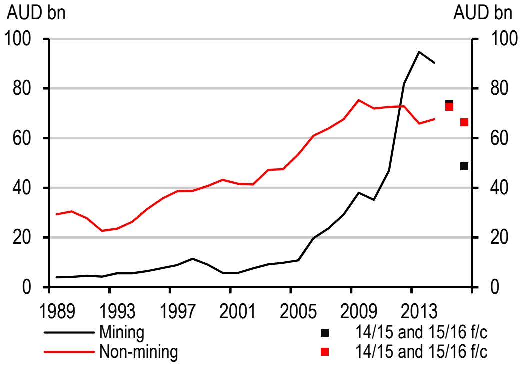
Reflecting HSBC's recent downward revision to its forecasts for China's growth in 2015 and uncertainty about local investment we revise down our Australian GDP growth forecast to 2.4% for 2015 (previously 2.6%). We retain our 3.0% GDP forecast for 2016, supported by forecasts for a solid recovery in China.

GDP growth is running at a below-trend pace



Source: ABS

Capital expenditure survey shows weak investment intentions



Source: ABS; HSBC estimates

Policy issues

For the Reserve Bank of Australia (RBA), a key challenge is to continue to provide support for domestic demand, by maintaining a low cash rate, but not over-inflate asset prices in the process. With interest rates at record lows, there is growing evidence of over-inflation of Sydney housing prices and the nationwide commercial property market. As a result, the regulator has been gradually tightening its prudential settings since late 2014. This is increasingly allowing the central bank to focus its cash rate setting on managing the real economy rather than the financial cycle.

The central bank has also continued to seek a lower AUD to help support the rebalancing of growth. Although there has been no explicit intervention, the RBA has continued to comment publicly that a lower AUD is needed for growth to return to a balanced path. We now expect the RBA to keep its cash rate on hold for the whole of 2016 (we previously had hikes in H2 2016), as we expect the RBA to keep rates lower for longer to encourage the AUD to fall further.

Risks

We judge the risks as tilted to the downside. First, there is a risk that growth in China does not pick up as much expected in 2016, dampening demand for Australia's exports. Second, there is a risk that non-mining businesses continue to lack confidence and that business investment remains weak for longer than expected. Third, there is a risk that the currency stays stubbornly high, relative to commodity prices, constraining the pace of rebalancing. Fourth, there is a risk that low interest rates inflate asset price bubbles, particularly in the major city housing markets, causing problems in coming years.

On the upside, the recent pick-up in household demand could drive a stronger pick-up in non-mining business investment and hiring than expected. In addition, the recent budget measures could be more supportive of growth than we currently anticipate.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	2.7	2.4	3.0	2.3	2.3	2.5	2.7	2.8	3.0
GDP (% quarter)	-	-	-	0.9	0.5	0.6	0.7	1.0	0.7
Consumer spending	2.5	2.7	3.1	2.6	2.6	2.9	2.8	3.1	3.2
Government consumption	2.0	1.6	1.6	1.7	1.8	1.1	1.6	1.7	1.6
Investment	-2.7	-3.5	-0.8	-3.7	-4.9	-2.3	-3.0	-1.8	-1.1
Stockbuilding (% GDP)	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Domestic demand	1.1	1.3	2.0	1.5	0.6	1.3	1.9	2.0	1.9
Exports	6.8	9.3	8.4	8.1	10.6	9.3	9.1	7.1	8.5
Imports	-1.6	3.7	4.3	3.3	1.4	3.9	6.2	3.8	4.0
Industrial production	3.4	1.3	3.9	-0.8	0.3	2.6	3.2	3.9	3.9
Unemployment (%)	6.1	6.2	5.9	6.2	6.2	6.2	6.1	6.0	5.9
Wage growth	2.5	2.3	2.8	2.3	2.3	2.3	2.3	2.5	2.6
Consumer prices	2.5	1.7	2.5	1.3	1.6	1.8	2.2	2.5	2.5
Current account (USDbn)	-41.0	-39.4	-31.5	-9.1	-10.3	-10.1	-9.9	-8.5	-8.1
Current account (% GDP)	-2.8	-3.1	-2.6	-2.7	-3.2	-3.3	-3.3	-2.8	-2.7
Budget balance (% GDP)	-3.1	-2.6	-2.1	-	-	-	-	-	-
Gross government debt (% GDP)	34.3	38.1	40.2	-	-	-	-	-	-
USD/AUD*	0.82	0.72	0.70	0.76	0.76	0.73	0.72	0.71	0.71
3-month money (%)*	4.7	2.1	2.1	2.4	2.2	2.1	2.1	2.1	2.1
10-year bond (%)*	2.8	2.7	2.6	2.3	3.1	2.9	2.7	2.6	2.6

Note: *Period end
Source: Australian Bureau of Statistics, Thomson Reuters Datastream, RBA, HSBC estimates

Asia Pacific

South Korea

Tough times

Frederic Neumann
Economist
The Hongkong and Shanghai Banking Corporation Limited, (HK)
+852 2822 4556
fredericneumann@hsbc.com.hk

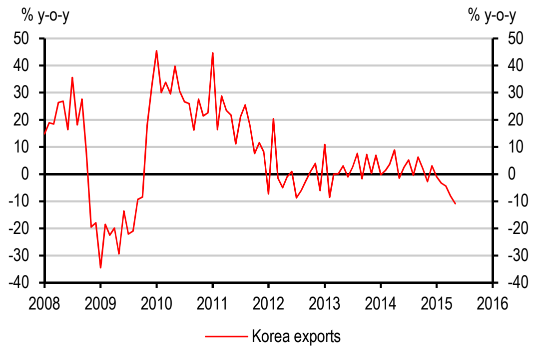
We forecast Korea's GDP to grow 2.8% in 2015, which is lower than our 3.1% forecast in the previous quarterly report. The main driver behind our downgrade is weaker-than-expected trade. Exports are likely to contract by the strongest sequential rate since early 2009. In particular, shipments to China are unlikely to recover anytime soon, as our China economists forecast lower growth in Korea's largest export market. By the type of goods, we think manufactured products will be most vulnerable to weak growth in China.

External weakness has filtered into domestic demand. Retail sales contracted on a year-on-year basis in Q1 2015, which is the first contraction since records began in 2011. Households' purchasing power is being squeezed by low wage growth, as companies cut costs to stay competitive. Furthermore, consumer sentiment may weaken due to the recent outbreak of Middle East respiratory syndrome (MERS). Meanwhile, the uncertain macroeconomic outlook and low demand environment are set to weigh on investment growth. Inventories remain elevated, especially for electronics and automobiles. The incentive for companies to increase their productive capacity over the foreseeable future is therefore limited.

An absence of demand-pull inflation means the Bank of Korea will miss its inflation target for the third consecutive year. We forecast headline CPI to average 0.8% in 2015, which would be the lowest rate since 1999. The low inflation environment means that there is room for accommodative monetary policy. We forecast the Bank of Korea to lower its policy rate by another 25bp in the third quarter.

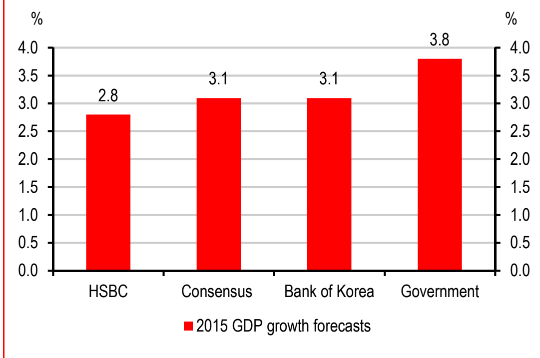
Fiscal stimulus measures cannot be ruled out. The Bank of Korea has estimated tax revenue shortfalls of KRW6trn this year, equivalent to 2% of the originally planned government expenditure. Consequently, there is a possibility of the government announcing a supplementary budget this year to meet its expenditure requirements. Moreover, with private demand set to be weaker than what was forecast at the start of the year, the government may increase its overall expenditure to support growth.

Exports have contracted sharply in recent months



Source: HSBC, CEIC

There are downside risks to public officials' growth forecasts



Source: HSBC, CEIC

Policy issues

On 20 April, Prime Minister Lee Wan-koo tendered his resignation over a bribery scandal after two months in the job. President Park Geun-hye accepted the resignation on 27 April. Since Park Geun-hye became president, two Prime Ministers have left office while three other nominees have stepped down before their National Assembly hearings. Former Justice Minister Hwang Kyo-ahn was recently appointed as Prime Minister. His background suggested greater focus on administrative and governance issues in Korea.

Korea held parliamentary by-elections on 29 April for four vacant seats. The seats were left open by the Unified Progressive Party (UPP), which had a pro-North Korea stance. The ruling Saenuri party won three of the four available seats, which gives the party a mandate to push through the Park administration's reform plans. The plans include the promotion of crowdfunding in Korea's business culture, which is relatively conservative when compared with its international counterparts. The main opposition party, the New Political Alliance for Democracy, won no seats.

Risks

Our growth projections are below consensus but downside risks remain. The uncertainty from MERS and the impact it may have on the economy is hard to quantify. At worst, the virus may be difficult to contain and cause consumer sentiment to deteriorate significantly. Thus, there is a prospect of a large contraction in private consumption in Q3 2015. This is not our base-case scenario.

The downside risks to growth mean that inflation could be lower than we currently forecast. While we do not think the average headline CPI reading for 2015 will fall into negative territory, continued subdued inflation may reduce inflation expectations. This would increase pressure on the Bank of Korea to lower its policy rate by even more than 25bp over the second half of this year and could have implications for its new inflation target, which is scheduled to be announced in September 2015.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	3.3	2.8	2.8	2.4	2.6	2.8	3.5	2.9	2.7
GDP (% quarter)	-	-	-	0.8	0.7	1.0	1.0	0.1	0.5
Consumer spending	1.8	1.9	2.2	1.5	2.4	2.0	1.9	2.0	2.2
Government consumption	2.8	3.0	2.9	3.1	4.0	2.5	2.2	3.5	3.1
Investment	3.1	2.6	2.7	2.5	2.6	2.1	3.0	1.5	1.0
Stockbuilding (% GDP)	0.4	0.8	0.5	2.2	0.6	0.2	0.5	1.8	-0.1
Domestic demand	2.4	2.8	2.2	3.0	3.7	2.3	2.1	1.8	1.2
Exports	2.8	0.5	2.5	0.0	-0.8	1.3	1.4	2.1	2.5
Imports	2.1	-0.9	0.8	1.8	-1.0	-1.5	-2.7	-2.2	0.3
Industrial production	0.5	-0.6	-0.7	-1.6	-1.3	-0.8	1.1	-0.5	-1.0
Unemployment (%)	3.5	3.7	3.4	4.1	3.8	3.5	3.5	3.4	3.4
Wage growth	5.0	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Consumer prices	1.3	0.8	2.1	0.6	0.4	0.8	1.2	1.8	2.2
Current account (USDbn)	89.2	116.5	121.6	30.5	25.7	29.6	30.8	30.1	28.8
Current account (% GDP)	6.3	8.4	8.6	8.8	7.5	8.6	8.8	8.5	8.2
Budget balance (% GDP)	0.6	0.5	0.8	0.5	0.5	0.5	0.4	0.7	0.7
Gross external debt (% GDP)	30.1	34.0	34.5	-	-	-	-	-	-
Gross government debt (% GDP)	33.9	32.2	30.0	-	-	-	-	-	-
KRW/USD*	1093	1130	1140	1109	1110	1120	1130	1130	1140
3-month money (%)*	2.1	1.5	2.2	2.0	1.7	1.6	1.5	1.7	2.0
10-year bond (%)*	2.7	2.8	3.4	2.3	2.5	2.5	2.8	2.9	3.2

Note: *Period end
Source: CEIC, HSBC estimates

Asia Pacific

Indonesia

Consumption the final engine to stall

Su Sian Lim
Economist
The Hongkong and Shanghai Banking Corporation Limited, (Singapore)
+65 6658 8783
susianlim@hsbc.com.sg

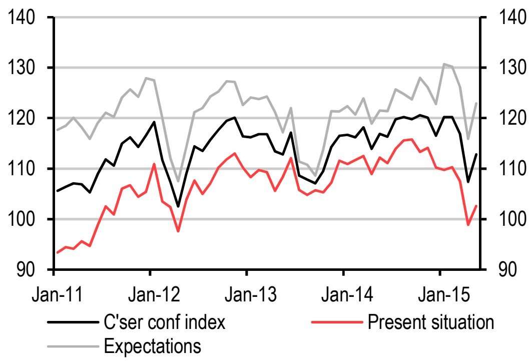
Abanti Bhaumik
Associate
Bangalore

Contrary to popular perception, the weakness in Q1 2015 GDP did not stem from a collapse in domestic demand or even net exports. Private consumption was only a touch slower than in Q4, at 1.2% q-o-q sa in line with the long-term trend. Meanwhile investment bounced 1.7% q-o-q sa following a lacklustre Q4 2014. Net exports added 0.2pp to overall q-o-q growth, as the decline in imports outpaced that of exports. In contrast, inventories and statistical errors subtracted 0.6pp from GDP growth. As a result, Q1 growth slowed to 4.7% y-o-y from 5.0%, the slowest pace since Q3 2009. This translates to an estimated expansion of just 0.8% q-o-q sa – well below potential of 1.3-1.5%, and also the slowest pace since the Global Financial Crisis.

The weak start to the year sees us downgrade our 2015 growth forecast to 4.8%, from 5.5%. For 2016, we trim our forecast to 5.6%, from 5.8%. Our 2015 forecast marks the slowest expansion since 2009. Even though we have retained our previous q-o-q headline GDP growth profile, we have lowered our consumption and import forecasts. Although domestic demand didn't collapse in Q1, the headwinds facing consumption are building. Consumer confidence in April weakened to its lowest since September 2013, and was followed by only a feeble recovery in May. Consumers are worried about business conditions, employment and incomes – and rightly so. The PMI shows that over the past year-and-a-half, employment in manufacturing – which accounts for over 13% of total employment – has contracted moderately in most months. Meanwhile wage growth across the manufacturing, hotel and non-oil mining sectors has averaged just over 6% y-o-y since 2014, down from double-digit levels in 2012 and 2013. After adjusting for inflation, which is set to average 6.5% this year, real wage growth has been close to zero or negative.

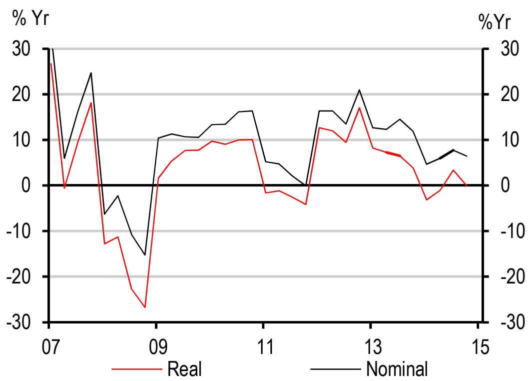
Policymakers have repeatedly pointed to the government's infrastructure plans as a bastion of hope. Until more evidence of activity on that front materialises, however, we maintain our expectation of only a moderate uptick in investment, to 4.8% (previously 4.9%) from 4.1%. As at end-April, the Public Works and Housing Ministry had spent just 2.4% of its annual IDR118trn budget, compared to 11.5% over the same period last year.

Consumer confidence lowest at eighteen-month low



Source: CEIC, HSBC

Real wage growth negative to zero since start of 2014



Source: CEIC, HSBC

Policy issues

Since unexpectedly cutting its reference rate in February, Bank Indonesia (BI) has appeared reluctant to deliver any further monetary easing. Along with the government, it has instead undertaken a number of macroprudential measures to address the slowdown. These include relaxing loan-to-value limits on mortgages and automotive loans, and encouraging banks to lend to small-medium enterprises (SMEs). More recently, the government announced that public and state-owned banks will halve their lending rates for SMEs. The luxury tax on certain goods will also be slashed or exempted, in order to spur consumption.

Perhaps BI is still smarting from the cool reception to its February rate cut (after all, the move did come on the heels of a 25bp hike – also unexpected – in November). Or maybe it fears triggering portfolio outflows, particularly ahead of an impending rate-hike cycle by the Fed. But we now expect the Fed to start hiking in December rather than September, and at a more gradual pace than initially forecast. More importantly, the macroprudential measures are not likely to be broad or potent enough to materially boost credit and economic growth. At the time of writing, none of the measures had been implemented. Furthermore, BI officials have themselves acknowledged that this year's credit growth target of 15-17% looks ambitious, when credit growth has been 11-12% y-o-y in the year to date. To this end we believe a 25bp rate cut to 7.25% will be necessary, possibly as soon as Q3 2015, lowering the cost of borrowing for all segments of the economy.

Risks

The direction of our growth forecasts in the coming quarters will hinge on whether infrastructure projects do indeed start to take off in a more material way in H2 2015. The other growth engines can no longer be relied on to propel the economy forward – external demand has been weak for the last two years, and consumption now appears to be on the cusp of heading down a similar path.

Against this backdrop of slower growth, we also worry about the government's commitment to earlier fuel subsidy reforms, particularly if global crude oil prices continue to grind higher over H2 2015.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	5.0	4.8	5.6	4.7	4.7	4.9	4.9	5.5	5.6
GDP (% quarter)	-	-	-	0.8	1.2	1.4	1.4	1.4	1.4
Consumer spending	5.1	4.8	4.9	5.0	4.9	4.7	4.6	4.6	4.8
Government consumption	2.0	3.1	6.2	2.2	2.5	2.6	4.3	5.5	6.6
Investment	4.1	4.8	5.8	4.4	4.7	4.8	5.4	5.7	5.8
Stockbuilding (% GDP)	1.9	1.8	1.9	2.6	3.5	2.1	-0.8	2.8	3.3
Domestic demand	4.7	4.5	5.4	4.3	4.4	4.7	4.5	5.3	5.2
Exports	1.0	0.8	4.3	-2.2	-0.4	2.7	1.1	3.1	4.0
Imports	2.2	0.3	4.0	1.4	0.2	0.8	0.7	1.4	0.2
Industrial production	4.8	4.1	4.6	5.1	3.7	3.9	3.9	4.5	4.6
Unemployment (%)	6.1	6.1	6.0	-	-	-	-	-	-
Wage growth	13.8	6.1	5.4	-	-	-	-	-	-
Consumer prices	6.4	6.5	4.5	6.5	7.1	6.9	5.6	4.5	4.7
Current account (USDbn)	-25.4	-22.1	-25.0	-3.8	-6.1	-5.2	-7.0	-4.7	-7.4
Current account (% GDP)	-2.9	-2.6	-2.8	-1.8	-2.8	-2.3	-3.3	-2.2	-3.3
Budget balance (% GDP)	-2.2	-2.3	-1.7	-	-	-	-	-	-
Gross external debt (% GDP)	32.9	37.0	38.4	-	-	-	-	-	-
Gross government debt (% GDP)	28.0	31.2	32.1	-	-	-	-	-	-
IDR/USD*	12430	13800	14500	13074	13400	13700	13800	14000	14200
3-month money (%)*	7.2	6.9	6.9	6.9	7.0	6.9	6.9	6.9	6.9
10-year bond (%)*	8.0	8.7	8.5	7.4	8.7	8.9	8.7	8.5	8.5

Note: *Period end
Source: CEIC, HSBC estimates

HSBC

Asia Pacific

Taiwan

John Zhu
Economist
The Hongkong and Shanghai Banking Corporation Limited
+ 852 2996 6621
john.zhu@hsbc.com.hk

Joining in the easing

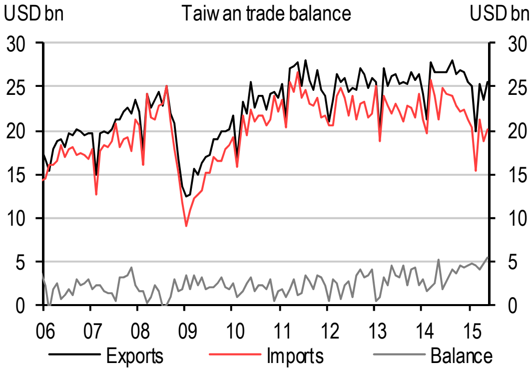
We believe Taiwan's economy will grow by 3.5% y-o-y in 2015 (versus 3.7% in 2014), which is respectable in a region where many countries are slowing down much more rapidly. We expect Taiwan's growth to remain relatively robust on the back of steadily improving domestic demand prospects. The performance of the labour market is the main driver, with the headline rate of unemployment down to its lowest since 2008. Wage growth is stable while consumer prices are falling, which should boost consumers' real spending power.

However, the external environment has been deteriorating for several months now. Export orders and exports have slowed sharply in recent months. This is partly due to the continued weakness in Mainland China, now Taiwan's largest trading partner. Exports to the Mainland and Hong Kong were down by 5.7% in the first five months of 2015 compared with in the same period a year ago. This has been partly offset by stronger exports to the US, although given the recent weakness in the US data, it is unclear whether this shift in demand will be enough to keep exports steady.

However, there has been an even more rapid decline in imports in recent months due to low commodity prices, especially for food. This has meant that Taiwan's trade surplus reached a new record high in May. This should mean that the overall contribution of net exports to GDP growth should be positive.

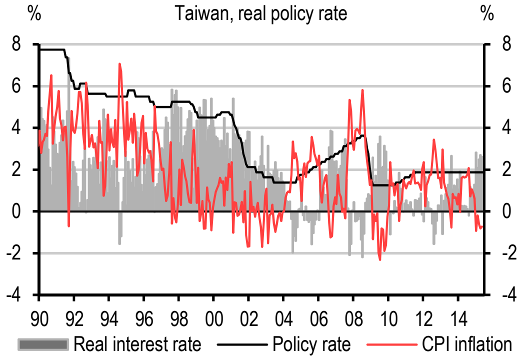
Headline CPI is likely to remain in deflation until Q4, and average significantly below the already-low official forecast of +0.1% for 2015 as a whole. This also means that real interest rates have remained relatively high for much of 2015. With core inflation (excluding food and energy prices) also falling to its lowest rate in over a year, we expect that the central bank will cut rates twice this year.

Weak exports offset by even sharper fall in imports



Source: Directorate-General of Budget, Accounting and Statistics, Executive Yuan

Real interest rates are rising due to deflation



Source: CBC, DGBAS

Policy issues

We forecast the central bank to cut the benchmark interest rate twice in 2015 to combat deflation. Growth will likely remain relatively robust driven by domestic demand. However, the risk of sustained deflation has risen in recent months. This would pose a risk to future inflation expectations as well if steps are not taken to move the economy away from deflation.

There has also been a string of policy loosening measures elsewhere in the region, including in Taiwan's major trading partners as well as its competitors – China and South Korea being the main examples. And given that the Central Bank of China (CBC) only meets every quarter, and usually only moves in 12.5bps steps, it should probably start cutting sooner rather than later.

Risks

The main risks to growth remain weaker global trade. The data from Mainland China continues to be weak, while the US economic data has also surprised more towards the downside in recent months. On the other hand, the likely later timing of the first rate hike from the Federal Reserve should ease some of the risk of capital outflows from Taiwan.

Domestically, there appear to be signs that the housing market is going into a correction. Prices are falling in y-o-y terms in the Taipei area, which is a sign that the CBC's macroprudential measures introduced previously are working. However, there is a risk that the falls will be sustained and have a knock-on impact on consumer spending and sectors such as construction.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	3.8	3.5	3.5	3.4	3.0	3.8	3.6	3.7	4.2
GDP (% quarter)	-	-	-	0.7	0.1	1.5	0.7	0.4	1.3
Consumer spending	3.0	2.0	3.5	2.5	1.5	1.8	2.2	3.6	3.5
Government consumption	3.7	-0.9	1.8	-2.2	-0.2	-0.4	-0.9	2.1	2.0
Investment	1.8	1.3	4.1	0.4	0.2	1.5	3.1	5.0	5.0
Stockbuilding (% GDP)	0.4	0.0	0.0	0.0	-0.1	0.1	0.1	-0.1	0.0
Domestic demand	3.5	1.0	3.4	0.9	0.7	0.5	1.9	3.7	3.7
Exports	5.9	4.9	5.6	5.9	4.9	4.8	4.2	5.9	6.9
Imports	5.7	1.7	5.7	2.5	1.9	0.3	2.1	6.0	6.7
Industrial production	6.4	3.1	6.6	5.8	2.8	1.4	2.7	5.2	7.0
Unemployment (%)	3.8	3.5	3.5	3.8	3.6	3.7	3.5	3.5	3.4
Wage growth	3.2	3.0	3.0	-	-	-	-	-	-
Consumer prices	1.2	-0.2	1.5	-0.6	-0.7	-0.2	0.5	1.6	1.5
Current account (USDbn)	65.4	65.7	60.3	22.0	13.2	12.8	17.7	16.7	8.6
Current account (% GDP)	12.4	12.3	10.9	16.8	10.2	9.4	12.7	12.2	6.5
Budget balance (% GDP)*	-0.8	-0.7	-0.7	-	-	-	-	-	-
Gross external debt (% GDP)*	33.7	36.9	40.4	-	-	-	-	-	-
Gross government debt (% GDP)*	40.8	39.9	38.8	-	-	-	-	-	-
TWD/USD*	31.6	31.8	32.0	31.3	30.9	31.5	31.8	31.9	31.9
3-month money (%)*	0.9	1.2	1.4	0.9	0.9	1.1	1.2	1.2	1.2
10-year bond (%)*	1.7	1.7	1.7	1.6	1.6	1.6	1.7	1.7	1.7,

Note: *Period end
Source: CEIC, HSBC estimates

HSBC

Asia Pacific

Thailand

Nalin Chutchotitham
Economist
The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch
+66 2614 4887
nalin.chutchotitham@hsbc.co.th

Uncertainties on two fronts

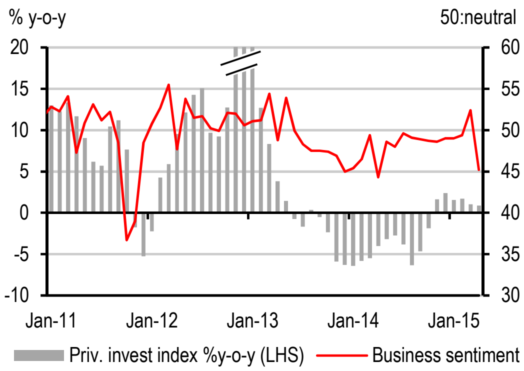
The economy grew 3% y-o-y in Q1 2015 and sustained four straight quarters of expansion in sequential terms. Nevertheless, the pace of growth remained slow, and actually decelerated to 0.3% q-o-q from 1.1% in Q4 2014 in seasonally-adjusted terms. Real exports of goods have been the main drag, given weak demand in East Asia. Private consumption and investment have also stayed sluggish despite the support from lower energy bills, mainly due to weak sentiment, high leverage, and low income growth.

Taking into consideration the weak recovery and persistent negative risks for exports, we lower our 2015 GDP growth forecast further to 3.1% from 3.6%, but raise the 2016 forecast slightly to 3.3% from 3.1%. We also lower our 2015 headline inflation forecast to -0.4% from 0.0%, due to more benign price pressure in the first five months of the year, but continue to expect inflation to rebound in 2016 because of base effects – lowering our forecast slightly to 2.3%. Given this backdrop, and to pre-empt downside risks to growth, there is a higher probability that the Bank of Thailand (BoT) will ease monetary policy further by cutting its policy rate by another 25bps to 1.25%.

There will also be more fiscal stimulus. The government announced in April a THB78bn budget (0.6% of GDP) to be spent on road construction and water-management projects that are a part of the infrastructure investment master plan. About half of this will be disbursed in 2015 and the rest in 2016 and 2017. Despite the accelerated spending plans, we still expect the budget deficits to be close to our previous forecast, due to an increase in revenues from the oil tax and the telecom-sector bandwidth auction.

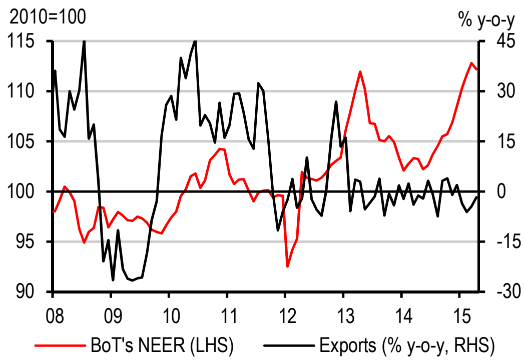
Apart from economic risks, uncertainties are also building up on the political front, especially with regards to the timing of the election, which depends on the enactment of a new constitution. The draft charter is currently being amended with suggestions from the government and the public, and it will be put to the vote in the National Reform Council and a referendum. Although we expect the economic recovery to strengthen under the 'no-unrest' assumption, prolonged political uncertainty may cap private investment growth.

Business sentiment is fragile, affecting investment spending



Source: CEIC, HSBC.

BoT changed its tone on the currency due to tepid exports



Source: CEIC, HSBC

Policy issues

The BoT has welcomed the recent weakness in the Thai baht by saying that it is positive for economic recovery. This change of tone, departing from its ‘limited interventionist’ stance, was in line with tepid exports. But apart from announcing further relaxation of FX and capital flow regulations on 30 April (the bulk of these done in 2010-13), foreign reserves do not suggest an aggressive selling of Thai baht. So far, the BoT’s Nominal Effective Exchange Rate has not risen since April. The BoT is likely to continue curbing FX volatility and ensure that the Thai baht moves in line with regional currencies.

In Q3 the Ministry of Finance (MoF) will unveil a plan to restructure THB720bn of public debt – most arising from rice subsidies. Apart from issuing new debt, the MoF will sell stakes in unprofitable businesses, but exclude listed companies. The expected outcome is a reduction of the debt servicing burden and lower leverage in a few state enterprises. The MoF said this was necessary since the new inheritance tax will not provide a big boost to fiscal revenue and property tax legislation is still underway. Also, the consumption tax rate will remain at 7% until the economy is on a firmer footing. We think that taking an active stance for long-term fiscal health management is positive, especially in the anticipation of rising spending needs for infrastructure and social welfare, and uncertainties in borrowing costs.

Risks

The nationwide THB300 daily minimum wage is due for review for adjustments to be made in 2016, and workers’ associations have proposed a 20% increase. The rate has been frozen since a 40% rise in 2013. The wage increases, if substantial, would hurt business profits, particularly among small businesses, in an environment of a tight labour market and sluggish economic recovery. However, private consumption will see stronger growth. Furthermore, the government is considering the re-adoption of a variable-wage system to better reflect costs in different regions, due to concerns about competitiveness.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	0.9	3.1	3.3	3.0	1.8	6.6	1.2	-1.9	4.1
GDP (% quarter)	-	-	-	0.3	-0.9	6.0	-4.0	-2.7	5.2
Consumer spending	0.6	2.2	3.1	2.4	2.0	1.4	3.2	3.1	2.3
Government consumption	1.7	3.4	4.3	2.5	3.3	4.1	3.7	5.9	4.1
Investment	-2.6	4.7	4.2	10.7	3.7	2.2	2.7	-1.2	4.2
Stockbuilding (% GDP)	-0.5	0.4	0.4	1.0	-0.2	-0.8	1.4	1.1	-0.2
Domestic demand	-2.7	3.0	3.1	4.0	2.2	1.2	4.9	2.2	3.5
Exports	0.0	2.4	4.2	1.0	2.1	3.8	2.6	5.0	4.0
Imports	-5.4	3.2	2.6	2.3	3.6	3.1	3.9	2.4	2.9
Industrial production	1.9	1.9	3.4	0.2	2.1	2.2	3.3	4.6	3.6
Unemployment (%)	0.6	0.8	0.8	0.9	0.8	0.8	0.8	0.8	0.8
Wage growth	9.2	6.3	12.0	6.6	6.1	6.1	6.1	12.0	12.0
Consumer prices	1.9	-0.4	2.3	-0.5	-1.1	-0.5	0.5	2.0	2.3
Current account (USDbn)	13.1	14.1	13.2	8.2	-1.7	0.2	7.3	8.9	-2.5
Current account (% GDP)	3.2	3.5	3.1	7.9	-1.7	0.2	7.2	8.8	-2.5
Budget balance (% GDP)**	-2.7	-3.2	-3.0	-	-	-	-	-	-
Gross external debt (% GDP)	34.8	35.9	35.8	-	-	-	-	-	-
Gross government debt (% GDP)	43.5	46.5	48.1	-	-	-	-	-	-
THB/USD*	32.9	33.7	34.1	32.6	33.5	33.6	33.7	33.8	33.9
3-month money (%)*	2.2	1.5	1.9	1.9	1.7	1.5	1.5	1.7	1.9
10-year bond (%)*	2.9	3.2	3.6	2.7	3.0	3.0	3.2	3.4	3.4

Note: *Period end; **on FY basis, eg. 2014 refers to October 2013 to September 2014
Source: CEIC, HSBC estimates

Asia Pacific

Malaysia

Still staring at the precipice

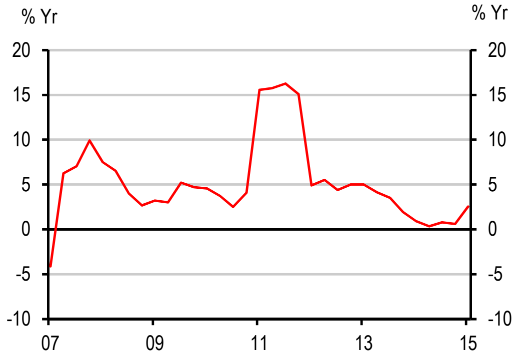
Su Sian Lim
Economist
The Hongkong and Shanghai Banking Corporation Limited, (Singapore)
+65 6658 8783
susianlim@hsbc.com.sg

Abanti Bhaumik
Associate
Bangalore

Although GDP growth moderated in Q1 2015 to 1.2% q-o-q- sa (5.6% y-o-y) in line with our forecast, it belied the distortionary effects ahead of the 6% Goods and Services Tax (GST) in April. Private consumption jumped 2.4% q-o-q, and in y-o-y terms reached a two-and-a-half year high of 8.8%. In contrast, net exports weighed more than expected on overall growth. Imports were not as weak as we had forecast, while exports moderated. Supply-side data was also very lop-sided. Construction soared 11.9% q-o-q sa from 1.2% in Q4 2014 (9.6% y-o-y versus 8.8%), supported by both non-residential and residential activity. In contrast, services momentum slowed, manufacturing was flat on the quarter, while output from mining contracted. Agricultural output was also down, after floods hurt palm oil production.

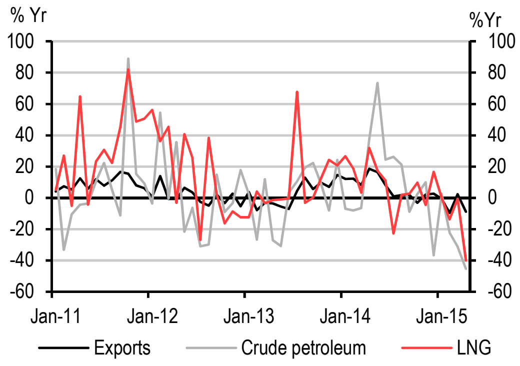
It is clear from the above that underlying growth in Q1 2015 was actually very weak. If it were not for the construction surge, the economy would have expanded just 0.7% q-o-q sa. More worryingly, in the quarters ahead, the post-GST adjustment in domestic demand could be worse than Bank Negara Malaysia (BNM) believes. Business sentiment and especially consumer sentiment have weakened noticeably. Contrary to BNM's view that incomes have been rising steadily, we also find that, after adjusting for inflation, wage growth has actually been flat at less than 1% y-o-y since Q2 2014. The GST is likely to keep y-o-y CPI inflation at the upper end of BNM's 2-3% comfort range for the rest of the year. Unless nominal wage growth accelerates more materially – unlikely, given how the economy is slowing on all fronts – then real wage growth, and in turn purchasing power, is likely to remain depressed. There is also the tricky question of rising global crude oil prices. This is positive for Malaysia's export earnings, but negative for consumers, who are no longer protected by fuel subsidies. The crude export gains may also be more than offset by LNG prices catching up with the earlier downswing in oil. History has shown that it could take as much as a year before Malaysia's gas export prices fully reflect changes in the oil price. This is an important point, considering that the bulk of Malaysia's net oil and gas balance is made up of gas, and not oil.

Flat real wage growth continues to weigh on consumption...



Source: CEIC, HSBC

... while the plunge in LNG exports is just beginning



Source: CEIC, HSBC

Policy issues

Despite the downside risks to growth, BNM has been reluctant to cut interest rates, having repeatedly said the economy remains on a steady growth path. Admittedly, with the ringgit within striking distance of its pre-float level of 3.80 against the dollar and sovereign fund 1MDB causing much fiscal and political uncertainty, it is not an easy step to take.

But there are few alternatives with which to address the slowdown, although we think a 25bp rate cut to 3.00% in Q3 2015 would help. Macroprudential loosening has been generally absent, and would be too little too late now. Fiscal stimulus is out of the question, with low oil prices already having hurt the budget. Against this backdrop, it is interesting to note how BNM's tone and behaviour has shifted ever so slightly in the last few months. In January, the monetary policy committee downgraded its 2015 inflation view; since March, reverse repos have been deployed to add liquidity to the banking system and lower elevated interbank rates. Since then, the central bank has also refrained from using the word 'appropriate' to describe its policy stance. More recently, in May, it described the risks of destabilising financial imbalances as being 'contained', indicating that it is now not as worried about elevated household debt.

Risks

We see downside risks not only to growth, but also to capital flows and ringgit-denominated assets. One source of this risk is external, that being the likelihood of the US Federal Reserve normalizing interest rates from December. Of more immediate concern, however, is how 1MDB is resolved, and what impact this will have on Malaysia's finances and Mr Najib's position as Prime Minister. In turn this raises questions about policy continuity and the future of reforms. The coming months could prove tumultuous; at the end of June the Auditor General will conclude its investigation into 1MDB. The Public Accounts Committee and BNM are also carrying out their own inquiries. The latter remains in a weak position to counter any significant outflows, with FX reserves just about covering the country's short-term external liabilities.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	6.0	4.8	5.1	5.6	4.7	4.9	4.2	4.4	4.9
GDP (% quarter)	-	-	-	1.2	0.9	1.0	1.1	1.3	1.3
Consumer spending	7.0	6.9	5.2	8.8	7.5	6.0	5.5	4.4	5.0
Government consumption	4.4	6.0	4.5	4.1	6.5	4.4	8.0	4.0	4.3
Investment	4.8	7.9	6.0	7.9	8.5	9.9	5.3	5.0	5.6
Stockbuilding (% GDP)	-0.8	-1.0	0.0	-1.0	-1.0	-1.0	-1.0	0.5	0.4
Domestic demand	5.3	6.9	6.4	7.6	7.6	6.8	6.0	6.2	6.6
Exports	5.1	-1.2	1.4	-0.6	-2.0	-0.6	-1.7	-0.8	0.9
Imports	4.2	0.8	2.9	1.0	0.9	1.3	0.1	1.0	2.9
Industrial production	5.1	4.9	5.1	6.4	4.1	5.3	3.9	4.4	4.9
Unemployment (%)	2.9	3.1	3.3	-	-	-	-	-	-
Wage growth	4.7	5.0	4.2	5.3	4.5	5.7	4.4	2.0	4.3
Consumer prices	3.1	2.0	2.8	0.7	2.3	2.7	2.4	4.1	2.7
Current account (USDbn)	14.5	8.2	11.9	2.8	0.9	2.8	1.8	3.6	1.3
Current account (% GDP)	4.3	2.5	3.3	3.6	1.1	3.2	2.0	4.1	1.4
Budget balance (% GDP)	-3.4	-3.4	-3.0	-	-	-	-	-	-
Gross external debt (% GDP)	69.9	63.3	61.4	-	-	-	-	-	-
Gross government debt (% GDP)	54.5	51.0	48.7	-	-	-	-	-	-
MYR/USD*	3.50	3.75	3.80	3.71	3.65	3.70	3.75	3.77	3.78
3-month money (%)*	3.9	3.3	3.4	3.7	3.7	3.4	3.3	3.4	3.4
10-year bond (%)*	4.1	4.2	4.2	3.9	4.1	4.1	4.2	4.2	4.2

Note: *Period end
Source: CEIC, HSBC estimates

Asia Pacific

Singapore

Joseph Incalcaterra
Economist
The Hongkong and Shanghai Banking Corporation Limited
+852 2822 4687
joseph.f.incalcaterra@hsbc.com.hk

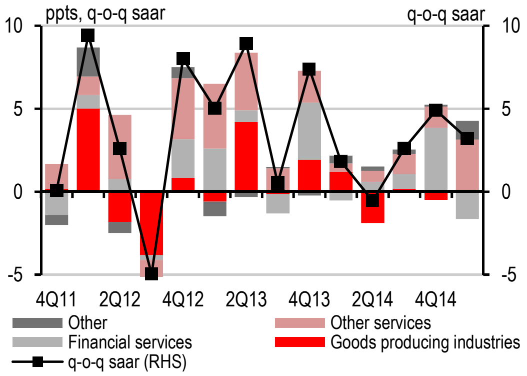
Not a bad start to 2015

Going into 2015, we predicted various headwinds that would cause growth to slow. As a small and highly open economy, Singapore is very sensitive to global conditions. Soft global trade and a fall in commodity prices posed risks to Singapore's port and domestic industries (principally petrochemicals and marine engineering). Moreover, rising interest rates suggested that Singapore's indebted consumers would need to tighten their belts again and cut down on consumption – one of the softest components of GDP as of late.

This has turned out to be mostly correct. However, growth held up better than we originally expected, as suggested by the above-consensus Q1 2015 GDP print of 3.2% q-o-q saar (which was revised upwards from the advance estimate, although down from 4.9% q-o-q saar in Q4 2014. Pharmaceutical exports, which are highly volatile and less cyclical, surged to levels unseen for years. This helped offset a plunge in petrochemical production and weak electronics output. There was also a jump in construction – particularly of private accommodation – in line with the increase in housing supply expected to come on line over the next two years. Meanwhile, services, the lion's share of the economy, were weighed down by a pullback in the finance & insurance segment following Q4's breakneck pace of growth.

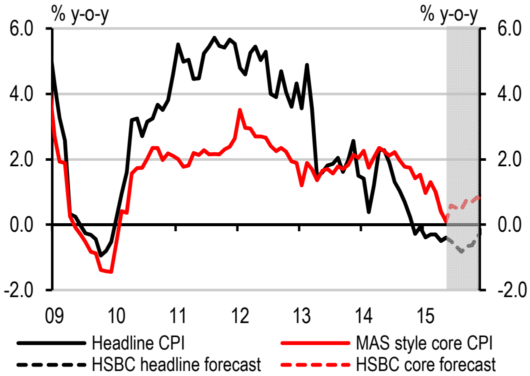
We forecast growth to slow slightly in Q2 due to a small contraction in manufacturing output and some more payback from the surge in pharmaceutical output. That said, services should keep the boat steady alongside robust government expenditure in line with the expansionary fiscal stance adopted by the government in the FY2015 budget. Following the stronger-than-expected growth in Q1, we tweak our 2015 full-year forecast up to 2.7%, while keeping the sequential profile largely unchanged. Headline CPI disinflation has intensified over the past quarter, in line with our forecast, but core is moderating more than expected due to budget measures. We maintain our headline CPI forecasts of -0.3% y-o-y and adjust core down to 0.6% for 2015, from 0.7% previously.

Growth momentum held up well in Q1 2015, thanks to a surge in construction and trade



Source: CEIC, MTI, HSBC

Headline inflation is in deflationary territory, while core has moderated substantially



Source: CEIC, MAS, HSBC

Policy issues

The direction of Singapore's unique exchange-rate policy has been the subject of a great deal of market speculation. Following the surprise monetary easing in January due to the global disinflationary shock (via a moderation of the slope), the Monetary Authority of Singapore (MAS) opted to keep policy settings on hold in its scheduled April meeting. The Monetary Policy Statement sounded relatively bullish on the improvement in global growth (our outlook is a bit more cautious), while suggesting that the central bank is focusing on the eventual pass-through of higher labour costs – even if disinflation intensifies in the short term. This leads us to think that MAS no longer has an easing bias and so we see no more change this year.

The largest policy issue – and debate – is the restructuring process intended to transition Singapore into a more productive and innovation-driven economy. An integral part is the government's immigration policy. For quite a few years now the government has increased restrictions on foreign workers (through a system of levies and quotas), while incentivising firms to invest in productivity enhancements and reduce labour intensity. After more than four years of such restructuring, productivity growth remains elusive and firms are suffering from the noxious mix of higher wages and declining productivity – thereby helping to keep growth below Singapore's trend. The MAS will likely maintain an elevated SGDREER exchange rate to guard against inflation, especially if firms pass on a larger chunk of wage costs to consumers.

Risks

As a small and open economy, Singapore is highly sensitive to global growth and trade (recall Singapore has one of the world's largest ports). Accordingly, if the weak global trade environment persists for much longer, growth in Singapore will be constrained – particularly the externally-oriented sectors. We have already baked a weak H1 trade environment into our GDP estimates, leading to our below-consensus forecast. As for the domestic economy, private consumption is already the weakest link – and this will be exacerbated by rising short-term rates (as a function of its exchange–rate based monetary policy, domestic rates are driven by the SGD and US rates). Some of this weakness, however, should be offset by a pick-up in government spending.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	2.9	2.7	3.2	2.5	2.9	3.0	2.4	2.4	3.1
GDP (% quarter)	-	-	-	0.8	0.2	0.8	0.6	0.7	1.0
Consumer spending	2.5	1.9	1.2	2.8	1.7	1.8	1.1	0.2	1.0
Government consumption	1.5	1.9	4.6	4.7	-4.7	6.2	2.5	10.0	1.0
Investment	-2.0	4.8	4.1	7.1	5.4	4.2	4.1	4.1	4.1
Stockbuilding (% GDP)	2.3	-0.9	1.3	-6.0	1.5	1.5	1.4	1.4	1.4
Domestic demand	0.4	-1.7	5.9	-10.1	2.1	4.4	2.4	16.4	2.8
Exports	2.1	4.7	1.9	4.8	4.0	5.4	4.6	0.7	1.8
Imports	1.4	2.0	3.2	-0.0	1.4	3.7	1.7	2.4	2.5
Industrial production	3.0	0.9	3.2	-5.5	-1.5	-0.6	0.5	1.0	2.7
Unemployment (%)	2.0	1.9	1.9	1.8	1.8	1.9	1.9	1.9	1.9
Wage growth	3.3	4.0	4.0	-	-	-	-	-	-
Consumer prices	1.0	-0.3	1.2	-0.3	-0.4	-0.4	-0.2	0.3	0.9
Current account (USDbn)	53.9	46.3	50.6	19.8	14.0	15.6	15.0	17.0	12.4
Current account (% GDP)	17.8	16.3	17.2	27.2	19.2	21.2	20.2	23.1	16.6
Budget balance (% GDP)	1.1	-1.0	-0.3	1.1	0.7	0.3	-0.3	-0.3	-0.1
Gross external debt (% GDP)	420.0	425.0	430.0	-	-	-	-	-	-
Gross government debt (% GDP)	102.5	114.6	117.2	-	-	-	-	-	-
SGD/USD*	1.32	1.37	1.39	1.37	1.35	1.36	1.37	1.38	1.38
3-month money (%)*	0.5	1.8	1.9	1.5	0.8	1.6	1.8	1.9	1.9
10-year bond (%)*	2.3	2.9	3.1	2.3	2.7	2.8	2.9	3.0	3.1

Source: HSBC estimates. *Note: period end

Asia Pacific

Hong Kong

Feeling the Mainland slowdown

John Zhu
Economist
The Hongkong and Shanghai Banking Corporation Limited
+852 2996 6621
john.zhu@hsbcib.com

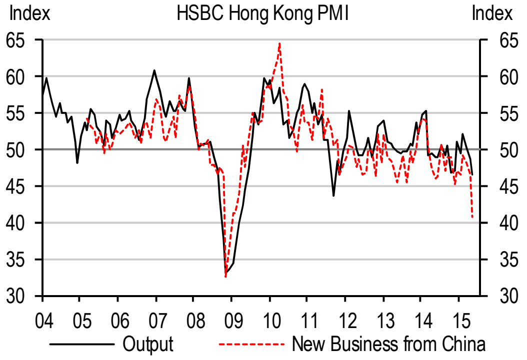
Given the slowdown in the economic data from Mainland China, it would be a surprise if Hong Kong's economy was immune. The sharp fall in new orders from the Mainland in the Hong Kong PMI, which indicates that Mainland orders are now contracting at the fastest pace since 2008, suggests that it is not. Year to date, exports to the Mainland, which accounts for over half of total Hong Kong exports, have slowed more than exports to other markets. We therefore believe the external environment will continue to be relatively weak and expect net exports to pose downside risks to growth.

Domestically, retail sales have continued to be sluggish. The total value of sales is down from last year, while volumes have held up slightly better. There has been a notable divergence between headline CPI inflation (which is falling, but still positive) and the y-o-y change in the retail price deflator (which is falling at a faster pace). This suggests that retailers are having to discount very heavily in order to protect volume growth. We therefore believe CPI inflation will continue to trend lower in the rest of the year, driven by lower food prices as well as more aggressive retail discounting.

However, lower prices may not be enough to give a large boost to demand. Growth in tourist arrivals has continued to slow and this will be a drag on both retail and exports of services such as travel and transportation, both of which had been significant contributors to Hong Kong's services trade surplus in recent years.

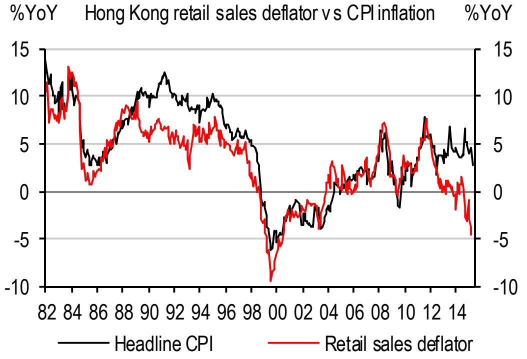
In the medium term, Hong Kong's economy still needs to transition to new sources of growth. Although tourism has been a strong growth sector in recent years, it still only contributes around 6% to GDP in total. The largest sector of Hong Kong's economy, import and export services, will come under pressure in both the short and long term due to the weakness in world trade and competition from other ports on the Mainland.

New orders from Mainland China fell sharply in May



Source: Markit, HSBC

Retailers have been discounting very heavily recently



Source: Census and Statistics Department

Policy issues

Because of the long-standing peg to the US dollar, Hong Kong does not have its own interest rate policy. So rates will go up whenever the Federal Reserve decides to begin its rate normalisation, which should be in December 2015 according to our US economists.

We believe Hong Kong can handle the normalisation of interest rates from a macroeconomic perspective. Unemployment is at a multi-year low of 3.2%, while inflation is low but unlikely to turn negative anytime soon given the relatively low pass-through from low global commodity prices to Hong Kong's CPI basket, which is dominated by housing costs.

Risks

The housing market in Hong Kong has continued to rise in recent months. We estimate that affordability is close to 17 times average annual household income, which was last seen during the height of the previous peak in 1997 just before the Asian Financial Crisis.

The HKMA is therefore likely remain vigilant over financial stability risks. Much will depend on how the market reacts to the first couple of rate hikes from the US Fed. Should the housing market continue to take those in its stride, then the HKMA could impose further macroprudential tools to rein in the housing market, which it has done on multiple occasions in recent years. These could take the form of increases in stamp duty and/or lowering the cap on mortgage loan-to-value ratios, both of which have been used in the past.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	2.3	2.3	2.3	2.1	2.8	2.9	1.5	2.4	2.5
GDP (% quarter)	-	-	-	0.4	1.6	0.8	-0.6	0.7	0.5
Consumer spending	2.7	3.1	2.7	3.5	3.4	3.1	2.5	2.2	2.6
Government consumption	3.1	4.8	4.6	3.5	4.1	5.1	6.4	5.9	5.6
Investment	-0.3	2.5	3.7	7.3	5.3	4.3	-5.2	3.4	2.5
Stockbuilding (% GDP)	0.7	-0.3	0.0	-0.5	-0.9	0.0	0.2	0.4	-0.9
Domestic demand	2.8	2.5	3.4	2.8	2.0	4.5	0.8	3.7	2.9
Exports	0.9	0.4	5.0	0.2	0.3	0.3	0.9	4.4	6.2
Imports	1.1	0.5	5.5	0.5	-0.1	0.9	0.5	5.0	6.3
Industrial production	-0.4	0.8	-1.0	-1.6	-0.6	2.4	2.7	-1.0	-1.0
Unemployment (%)	3.2	3.3	3.3	-	-	-	-	-	-
Wage growth	4.1	4.5	4.5	-	-	-	-	-	-
Consumer prices	4.4	2.7	3.8	4.4	2.8	2.2	1.6	2.5	4.3
Current account (USDbn)	5.4	1.1	1.7	-0.5	-2.0	2.0	1.6	-0.8	-1.7
Current account (% GDP)	1.9	0.4	0.6	-0.7	-2.8	2.6	2.1	-1.1	-2.3
Budget balance (% GDP)*	1.0	3.5	0.7	-	-	-	-	-	-
Gross external debt (% GDP)**	-	-	-	-	-	-	-	-	-
Gross government debt (% GDP)**	32.0	31.0	30.0	-	-	-	-	-	-
HKD/USD**	7.75	7.80	7.80	7.75	7.80	7.80	7.80	7.80	7.80
3-month money (%)**	0.4	0.8	1.2	0.4	0.4	0.6	0.8	1.0	1.2
10-year bond (%)**	1.9	2.2	2.5	1.7	1.8	2.0	2.2	2.4	2.5

Note: * Fiscal year ending March. Eg, 2013 refers to fiscal year April 2013 – March 2014. ** Period end.
Source: CEIC, IMF, HSBC estimates

HSBC

Asia Pacific

Philippines

Not immune

Trinh Nguyen
Economist
The Hongkong and Shanghai Banking Corporation Limited, (HK)
+852 2996 6975
trinhdnguyen@hsbc.com.hk

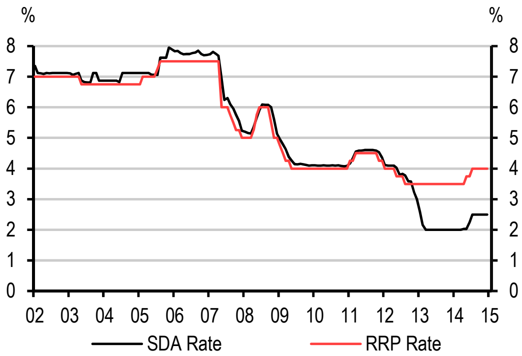
The Philippines will host and chair the Asia-Pacific Economic Cooperation (APEC) meetings this year, the first time since 1996 that it has done so. This underlines the country's remarkable comeback – it has transformed from one of the laggards of Asia into one of the region's best performing economies. In contrast to its regional counterparts, its growth has exceeded trend rates in the past three years. In Q4 2014, amidst slowing demand globally, GDP accelerated to 6.6% y-o-y from 5.5% y-o-y, thanks to strong construction spending, favourable net exports and firm private consumption. Favourable demographic transitions, lower debt interest payment, and excess liquidity will keep domestic demand firm in the years ahead.

Indeed, private consumption kicked off the year strongly – it accelerated to 5.4% y-o-y in Q1 2015 from 5.0% in Q4 2014. Investment, too, was resilient, growing 10.1% y-o-y from 8.0% in Q4 2014. But the Philippines was not immune from weak global demand – net exports contracted and subtracted almost 2pp from y-o-y GDP due to slowing exports. While imports, too, decelerated, partly thanks to savings from weaker oil prices, the headwinds from weak external demand were too strong. Slower-than-expected government spending also did not help. We forecast GDP to slow in 2015 to 5.6%, below 2014's growth rate of 6.1%.

The country's increasing consumption will be further boosted by the oil price fall. As a net importer of oil, historically, the oil trade balance has punched a large hole in the country's overall trade balance. Given the dependence on imported petroleum for domestic consumption, the fall in the total value of imports is substantial. This should lead to lower transport and household costs, easing inflationary pressures. Inflation had already decelerated to 1.6% y-o-y in May 2015 from 4.9% in August 2014. This has been a welcome respite, as the economy was beleaguered by supply shortages in 2014. We forecast CPI to average 2.2% in 2015.

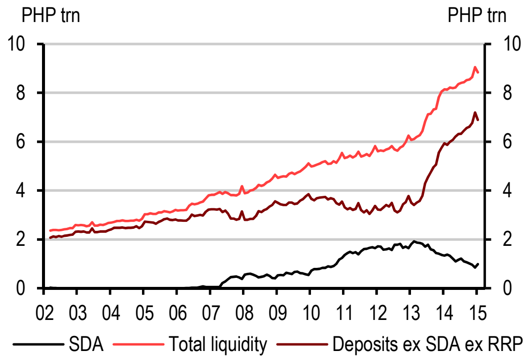
Ample liquidity in the financial system and robust economic performance will give the central bank space to keep policy rates on hold. We forecast rates to stay steady throughout 2015 and then rise gradually in 2016.

Rates are still very low and expected to stay low for longer



Source: CEIC, HSBC

The economy is awash with liquidity; credit growth is rising fast but there is plenty of scope for further growth



Source: CEIC, HSBC

Policy issues

The disbursement acceleration program (DAP), which was designed to speed up inefficient fiscal spending, was declared unconstitutional by the Supreme Court on 1 July 2014. As a result of the decision, government spending contracted sharply in Q3 2014, and expanded by only 1.8% in 2014. However, on 3 February 2015, the Supreme Court removed the prohibition on "funding of projects, activities and programs that were not covered by any appropriation in the General Appropriations Act".

Despite the reversal of the DAP decision, government spending was still disappointing, dragging down growth in Q1 2015. We expect the government to speed up spending and support growth.

President Aquino's term will end in 2016. Filipinos will go to the polls in May 2016 and the upcoming presidential elections will be on the minds of both investors and politicians this year. (Please see After Aquino, Mapping out the economic impact of the 2016 Philippine presidential election, 13 November 2014.) We expect investment will be cautious in the lead up to the presidential election while private consumption will be robust.

Risks

The low level of investment remains a concern. The private-public partnership (PPP) initiative has been sluggish at best. The administration has promised to raise infrastructure investment, but, thus far, key shortages such as electricity and air transport remain unaddressed. This will drag down the economy's competitiveness as well as output potential. Coupled with this, the rapid increase of the population means that the Philippines needs to generate new jobs to productively absorb its potential labour force. We expect public investment to slow, and private consumption and investment to pick up the slack. Should government spending slow more than expected and household expenditure weaken (not our assumption), then growth may slow sharply.

Capital outflow is also another concern. The BSP has ample foreign reserves to support the currency. That said, we believe weakness from the external factors will motivate the BSP to tolerate some PHP weakness, while keeping rates on hold.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	6.1	5.6	5.9	5.2	6.2	5.6	5.2	6.3	6.3
GDP (% quarter)	-	-	-	0.3	2.9	-0.2	2.1	1.4	2.9
Consumer spending	5.4	5.4	5.6	5.4	5.2	5.2	5.8	6.0	5.8
Government consumption	1.7	10.2	11.8	4.8	10.0	12.0	15.0	15.0	15.0
Investment	6.8	6.7	5.8	10.1	4.9	4.8	6.7	5.7	2.9
Stockbuilding (% GDP)	0.4	0.9	0.8	-0.1	-0.1	0.3	1.6	-0.1	-0.1
Domestic demand	5.0	6.6	6.2	6.7	7.6	5.7	6.5	6.9	6.2
Exports	11.3	2.9	5.5	2.2	6.0	6.0	6.5	5.0	6.0
Imports	8.7	4.7	5.5	2.0	8.5	5.0	6.5	8.0	8.0
Industrial production	8.1	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Unemployment (%)	7.1	6.8	6.7	7.3	7.3	7.3	7.3	7.3	7.3
Wage growth	4.5	4.5	4.5	-	-	-	-	-	-
Consumer prices	4.2	2.2	3.9	2.4	1.8	1.7	2.9	3.5	4.4
Current account (USDbn)	12.6	0.3	-3.0	1.1	1.7	2.7	-5.2	-0.2	1.1
Current account (% GDP)	4.4	0.1	-0.9	1.6	2.3	3.7	-6.1	-0.2	1.4
Budget balance (% GDP)	-0.6	-0.1	-0.4	-1.1	1.6	1.2	-1.9	-1.4	0.8
Gross external debt (% GDP)	27.3	25.8	23.9	-	-	-	-	-	-
Gross government debt (% GDP)	48.8	45.8	41.8	-	-	-	-	-	-
PHP/USD*	44.7	45.4	45.9	44.7	45.0	45.2	45.4	45.6	45.7
3-month money (%)*	1.4	1.6	2.0	1.6	1.6	1.6	1.6	1.8	2.0
10-year bond (%)*	4.2	3.9	4.5	4.0	3.9	3.7	3.9	4.1	4.3

Note: *Period end
Source: CEIC, HSBC estimates

HSBC

Asia Pacific

New Zealand

Paul Bloxham
Economist
HSBC Bank Australia Limited
+612 9255 2635
paulbloxham@hsbc.com.au

Daniel Smith
Economist
HSBC Bank Australia Limited
+612 9006 5729
daniel.john.smith@hsbc.com.au

Solid growth, but no inflation

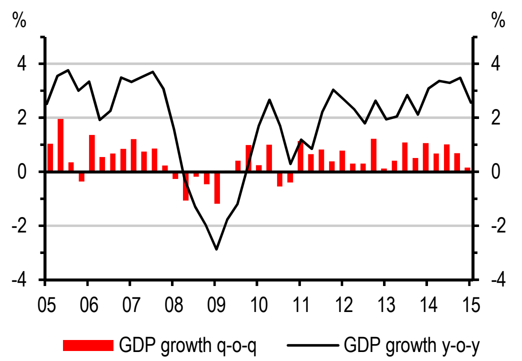
New Zealand's economy has been growing solidly for the past 18 months and it has been one of the fastest growing countries in the developed world. A key impetus for growth has been a ramp up in post-earthquake re-construction in the Canterbury region and a housing construction boom in Auckland. The construction upswing has driven strong jobs growth, which has supported a pick-up in retail sales.

However, despite strong growth, inflation has been surprisingly weak. CPI inflation fell to 0.1% y-o-y in the first quarter and timely indicators continue to suggest limited price pressures. It appears that, in the face of strong demand, New Zealand has had a collection of positive supply shocks that have kept price pressures contained. Falling oil prices and the high level of the NZD have driven a sharp fall in imported goods prices. At the same time, record high rates of inward migration and labour market participation have meant that labour supply has been strong, which has kept wages growth subdued and held down domestically produced inflation.

Very low inflation has seen the RBNZ become increasingly concerned that it may miss its mandated inflation target of '1-3% in the medium term and near the 2% midpoint'. Headline CPI inflation has been below 2% for three and a half years. As a result, the central bank cut its cash rate by 25bp to 3.25% in June. The cash rate cut came despite the central bank's own strong GDP growth forecasts, with the RBNZ remaining of the view that recent falls in dairy prices are not enough to significantly dent the growth outlook. The RBNZ also cut despite its concerns about rapidly rising housing prices in Auckland.

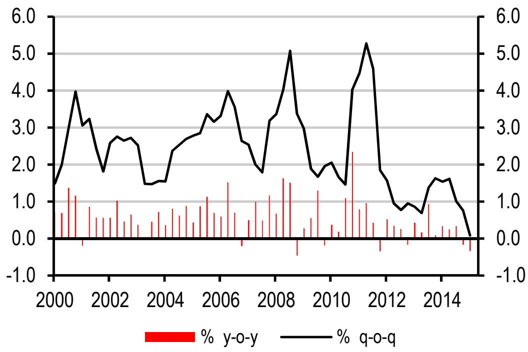
We expect GDP growth of 2.8% in 2015 (previously 3.0%) and 2.8% in 2016, and have revised down our CPI inflation forecast to 0.5% in 2015 (previously 0.8%) and 2.0% in 2016 (previously 2.1%). We expect the RBNZ to deliver a further 25bp cut in Q3 2015, taking its cash rate to 3.00%.

GDP growth has been strong, but so has supply potential



Source: Statistics New Zealand

Inflation has fallen to very low levels



Source: Statistics New Zealand

Policy issues

Authorities continue to face the challenge of managing strong housing price growth in New Zealand's major city, Auckland, while also loosening monetary policy settings to achieve the central bank's inflation targeting mandate. Auckland housing prices have risen by 19% over the past year and there are clear signs of exuberance in this market. Demand is being driven by the combination of below-neutral interest rates, strong investor interest and foreign demand.

To contain demand, the RBNZ has proposed further tightening of its macro-prudential settings. All investor purchases of Auckland properties will require a 30% down-payment from 1 October 2015, if these measures are implemented. The government has also introduced a capital gains tax for investor dwellings that are sold within two years of purchase. New laws will also tighten up controls on foreign investors, including requiring that all foreign investors have a local bank account. A key challenge for authorities is continuing to address the supply side of the Auckland housing market, where most estimates continue to suggest there is a shortfall of around 15,000-20,000 homes.

Risks

We judge that the risks to the outlook are balanced. On the downside, the recent fall in dairy prices, which is expected to weigh on the rural sector, could translate into a broader slowdown in investment than we expect. Our central case remains that most farmers should be able to smooth their spending in the face of one weak season. However, if low dairy prices persist, the financial strain could escalate further. There is also a risk that growth in China does not pick up as much as HSBC expects in 2016, dampening demand for New Zealand's exports and potentially driving commodity prices lower.

On the upside, the construction upswing is still underway and could deliver more support for growth than we currently expect. The recent RBNZ cash rate cut could help to support growth more than we are factoring in. The recent positive supply side developments could also prove to last longer than is assumed, presenting an upside risk to New Zealand's potential for further growth, though also a downside risk to the inflation outlook.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	3.3	2.8	2.8	2.6	2.8	2.7	3.0	3.4	3.0
GDP (% quarter)	-	-	-	0.2	0.9	0.9	0.9	0.6	0.6
Consumer spending	3.2	3.2	2.5	4.1	3.3	2.7	2.7	2.6	2.7
Government consumption	3.4	2.0	2.0	2.2	2.2	1.9	1.7	2.0	2.0
Investment	8.8	3.6	5.7	2.6	3.6	2.8	5.3	8.2	6.5
Stockbuilding (% GDP)	0.2	-0.3	0.0	0.2	-0.9	0.0	-0.5	-0.1	-0.1
Domestic demand	4.7	2.8	3.2	4.8	3.4	3.8	3.7	3.7	3.3
Exports	3.3	6.4	2.5	4.9	8.4	8.8	3.8	2.9	2.9
Imports	7.9	5.8	3.6	8.0	6.4	7.7	5.8	5.1	4.1
Industrial production	2.5	1.8	2.8	2.1	3.2	2.0	1.8	2.8	2.8
Unemployment (%)	5.8	5.5	5.2	5.8	5.5	5.4	5.2	5.2	5.2
Wage growth	1.8	1.8	2.3	2.0	1.9	2.0	1.8	2.1	2.3
Consumer prices	1.2	0.5	2.0	0.1	0.4	0.5	1.2	1.9	1.9
Current account (USDbn)	-6.4	-4.4	-4.7	-1.5	-1.4	-1.3	-1.3	-1.4	-1.5
Current account (% GDP)	-3.3	-2.5	-2.6	-3.0	-2.6	-2.2	-2.0	-2.4	-2.6
Budget balance (% GDP)	-1.3	-0.3	0.1	-	-	-	-	-	-
Gross government debt (% GDP)	35.0	35.0	34.9	-	-	-	-	-	-
NZD/USD*	0.78	0.70	0.68	0.75	0.71	0.70	0.70	0.69	0.68
3-month money (%)*	3.7	3.0	3.0	3.7	3.3	3.0	3.0	3.0	3.0
10-year bond (%)*	3.8	3.7	3.8	3.4	3.9	3.8	3.7	3.8	3.8

Eurozone

Eurozone

Remarkably resilient

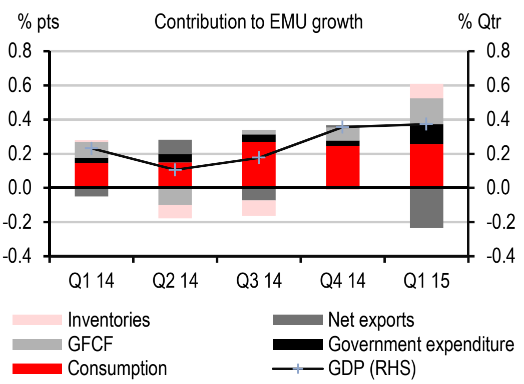
Janet Henry
Economist
HSBC Bank plc
+44 20 7991 6711
janet.henry@hsbcib.com

Against a global backdrop where the pace of growth in the US and many emerging economies disappointed, eurozone growth was unusually resilient in the first quarter. GDP expanded by 0.4% q-o-q as expected, with all of the expenditure components (see chart below) and all of the major economies registering positive growth. Consumer spending (0.5% q-o-q) accelerated, thanks to the real income boost from lower oil prices, while government spending and investment also picked up. Despite the weak euro, exports slowed modestly but imports accelerated with the result that net trade was a drag on growth.

The continued strength of consumer confidence, improving labour markets in countries such as Germany, Spain and Ireland, and the recent signs of improvement in new lending to households should support a continuation of the consumer recovery, although we suspect that the pace will slow in H2 2015 as the oil boost starts to fade. While we expect a further modest lift to investment spending, helped by the Juncker plan for strategic investment, which starts to take effect in mid-2015, a stronger investment recovery awaits a more convincing export revival – something to which the latest downward revisions to growth forecasts for major export markets, including the US and China, are not pointing.

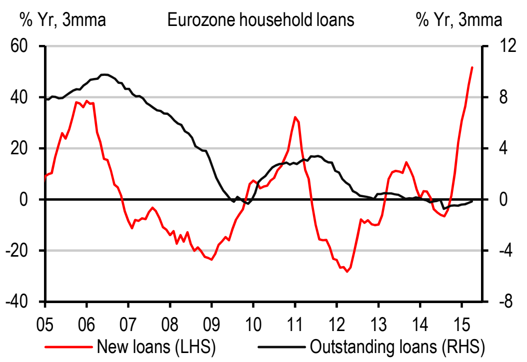
We have kept our 2015 GDP growth forecast unchanged at 1.3%, but have tweaked the details, shaving 0.1pp off Germany and raising France by 0.1pp in response to the stronger-than-expected consumer-led expansion in Q1. Spain remains the star performer while our Italy forecast is unchanged. Inflation has risen from a trough of -0.6% y-o-y in January to 0.3% in May, largely on the back of higher energy prices. We expect food and energy to be the major factors explaining monthly changes in headline inflation in the coming months while core inflation should remain low as the impact of euro depreciation on core goods prices is largely offset by a renewed weakening in service sector inflation on the back of weak wage growth.

Domestic demand drove the Q1 expansion



Source: Thomson Reuters Datastream

Ongoing deleveraging but new flow of credit is starting to recover



Source: Thomson Reuters Datastream

Policy issues

The ECB broadened its asset purchase programme in March and is currently buying EUR60bn per month of covered bonds, asset-backed securities, sovereign, institutional and agency bonds. It intends to continue at least until September 2016, or until it meets the ECB's definition of price stability (close to but below 2%). Purchases include negative-yielding assets as long as the yield is above the deposit rate (currently -0.2%) and are intended to be made according to the ECB capital key, but the ECB recognises that flexibility might be needed. These shares are not being strictly targeted every month, and central banks which do not have enough eligible bonds that they can buy can instead purchase the bonds of international/supranational institutions or even state-owned companies. We expect QE to have some impact on inflation, largely through the exchange rate channel. Monetary policy, however, cannot solve all of the eurozone's problems: fiscal policy is still needed to boost aggregate demand to prevent a further drop in inflation; further structural reforms are essential to raise potential growth; and institutional changes, including deeper fiscal integration, are critical.

Risks

The short-term boost to domestic consumer spending from lower oil prices is certainly helpful, but unemployment is still very high (11.1% in April) and most countries are striving to improve competitiveness to support export-led growth, leaving the eurozone very vulnerable to swings in the world trade cycle. Better-than-expected US and emerging-market growth could mean significantly stronger eurozone growth, but the reverse relationship also holds if growth disappoints. Other upside growth risks could come from a renewed fall in commodity prices and/or a boost to exports from sharper euro weakness. Downside risks include worsening geopolitical tensions (exports to Russia fell 15% y-o-y in 2014). Despite QE, the still worrying public debt dynamics could see debt restructuring fears resurface. Greece still poses the highest near-term risk: a four-month extension (to end-June) to the existing bailout was agreed, but at the time of writing an agreement with the IMF and European creditors on economic reforms and new fiscal targets is still awaited. With deposit withdrawals gaining momentum as the deadline approaches, the risk of capital controls having to be implemented continues to grow.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	0.9	1.3	1.4	1.0	1.3	1.5	1.4	1.4	1.3
GDP (% quarter)	-	-	-	0.4	0.4	0.3	0.3	0.3	0.4
Consumer spending	1.0	1.7	1.3	1.7	1.8	1.7	1.7	1.5	1.4
Government consumption	0.6	1.2	1.0	1.1	1.2	1.3	1.4	1.1	0.9
Investment	1.2	1.7	2.4	0.8	1.7	2.1	2.4	2.3	2.6
Stockbuilding (% GDP)	-0.7	-0.6	-0.4	-0.7	-0.6	-0.6	-0.5	-0.5	-0.4
Domestic demand	0.9	1.8	1.7	1.3	1.8	1.9	2.0	1.7	1.6
Exports	3.7	3.9	4.1	4.2	3.9	3.6	4.0	4.4	4.4
Imports	4.0	4.5	4.4	5.1	4.7	4.0	4.3	4.1	4.4
Industrial production	0.4	2.6	2.3	1.3	2.2	2.6	2.5	2.1	2.0
Unemployment (%)	12.0	11.0	10.7	11.2	11.1	10.9	10.9	10.8	10.7
Wage growth	1.2	1.3	1.3	1.2	1.4	1.3	1.2	1.3	1.3
Consumer prices	0.4	0.2	0.9	-0.3	0.2	0.2	0.5	1.1	0.8
Current account (USDbn)	226.0	250.8	240.1	53.7	51.8	62.8	79.9	47.8	51.2
Current account (% GDP)	1.9	2.2	2.2	1.9	1.8	2.3	2.9	1.7	1.8
Budget balance (% GDP)	-2.4	-2.2	-2.0	-	-	-	-	-	-
Gross external debt (% GDP)	-	-	-	-	-	-	-	-	-
Gross government debt (% GDP)	94.3	94.9	94.6	-	-	-	-	-	-
USD/EUR*	1.21	1.05	1.10	1.07	1.10	1.05	1.05	1.07	1.08
3-month money (%)*	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
10-year bond (%)*	1.2	1.4	1.7	0.6	1.4	1.1	1.4	1.6	1.6

Note: *Period end, 10-year bond is a GDP weighted average of Germany, France, Italy and Spain
Source: Thomson Reuters Datastream and HSBC estimates

Eurozone

Germany

Domestic strength

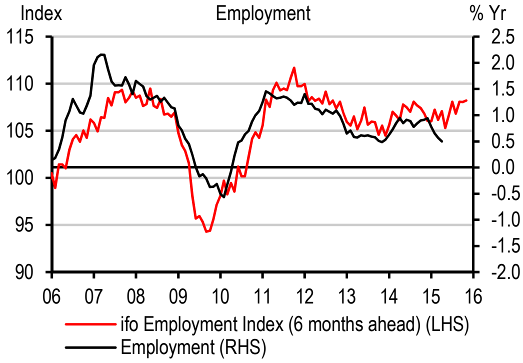
Stefan Schilbe
Economist
HSBC Trinkaus & Burkhardt AG
+49 211910 3137
stefan.schilbe@hsbc.de

Rainer Sartoris
Economist
HSBC Trinkaus & Burkhardt AG
+49 211910 2470
rainer.sartoris@hsbc.de

German GDP expanded only by 0.3% q-o-q in Q1 2015, despite a healthily growing domestic economy. Private consumption, which contributed 0.3pp to growth, should continue to perform well on the back of a tight and likely improving labour market. The ifo employment barometer points to employment growth of more than 1% y-o-y in the coming months – a marked acceleration from the current 0.5% pace. Income expectations in the GfK survey continue to reflect a strong job market, remaining near a multi-year high in May. That said, the momentum of consumption growth will fade somewhat as a result of an oil-price related pick-up in inflation. The national CPI measure increased to 0.7% y-o-y in May after hitting the trough at -0.3% in January and is expected to rise further to 1.2% at the end of this year. Construction grew by 1.7% q-o-q in Q1, but is still deep in the red in y-o-y terms (-2.3% after peaking at +10.4% in Q1 2014). Residential construction should trend upwards, as the supply side reacts to the steady rise of house and apartment prices.

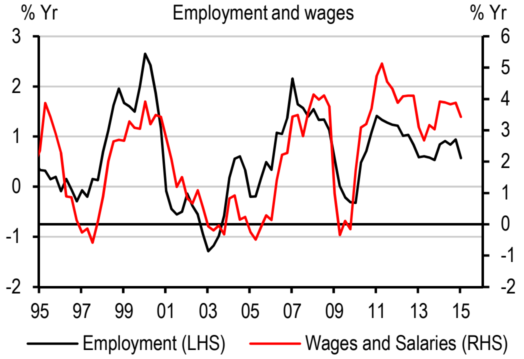
Business fixed investment expanded by 1.5% q-o-q in Q1, but some of this positive surprise can be explained by a particularly strong increase of new car registrations in the commercial sector, according to the Bundesbank. Given the recent fall in the sentiment of domestic capital goods producers to its lowest level since May 2013, the investment recovery should remain gradual for the time being, at least until external demand picks up more substantially. Still, there are signs emerging that net trade, which detracted 0.2pp from growth in Q1, will boost growth in Q2: in April the monthly nominal trade surplus reached a new record high, with new orders from the eurozone jumping sharply. Longer term, the depreciation of the euro should prove beneficial for German exporters, which sell roughly 63% of all exports outside the eurozone, but the exchange rate effect will not be a game changer as long as global demand remains sluggish. All in all, we have only slightly trimmed our forecast for 2015 GDP growth to 1.5% (from 1.6% previously) and expect a similar expansion in 2016 (1.7%).

Employment growth to pick up again...



Source: Macrobond & HSBC

... which should support wage growth



Source: Macrobond & HSBC

Policy issues

Government consumption expanded by a very strong 0.7% q-o-q, contributing 0.1pp to growth in Q1 2015. As a result, the y-o-y rate rose to 2.4% - the highest level since Q4 2009, when the German government confronted the financial crisis. And the outlook for government spending will remain favourable, since tax income in 2015 is expected to be EUR6.3bn higher than previously estimated by the "Arbeitskreis Steuerschätzung" in November 2014. This is the result of the solid economic environment, rising employment, wages and corporate profits. The government already adopted a supplementary budget for 2015, which included an increase of federal expenditure by EUR2.5bn to EUR301.6bn: EUR10bn will be used for investment spending from 2016 to 2018, with the lion's share planned for transport infrastructure and digital infrastructure and EUR1.19bn for increasing energy efficiency. Furthermore, a special fund will be created (totalling EUR3.5bn) to finance investment for financially weak local authorities. On top of that, local authorities will also receive EUR1.5bn in 2017 to create the fiscal room for investment spending.

Risks

In the short term, potentially rising uncertainty resulting from developments in Greece could weigh on companies' outlook for future demand. This could be a major obstacle to investment activity, which has just started to pick up again.

In the medium to long term, the combination of costly policy measures in the past (early retirement under certain conditions at the age of 63, and the implementation of the minimum wage) and the steady increase in unit labour costs due to wage gains exceeding productivity by a wide margin, clearly bear the risk of a loss of competitiveness of German companies. The depreciation of the euro since mid-2014 is currently a counterweight to these factors, but once the support of the euro weakness fades, companies could react by reducing employment in Germany.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	1.6	1.5	1.7	1.0	1.6	2.0	1.7	1.8	1.6
GDP (% quarter)	-	-	-	0.3	0.5	0.4	0.4	0.3	0.3
Consumer spending	1.2	2.1	1.4	2.0	2.5	2.1	1.8	1.6	1.3
Government consumption	1.2	2.0	1.5	2.4	2.0	1.8	1.9	1.6	1.4
Investment	3.3	2.2	3.2	-0.6	1.8	3.9	3.9	3.1	3.3
Stockbuilding (% GDP)	-1.5	-1.8	-2.1	-1.7	-1.8	-1.8	-2.0	-2.1	-2.2
Domestic demand	1.4	1.8	1.4	1.0	1.8	2.6	1.8	1.5	1.3
Exports	3.7	4.2	4.9	4.3	4.3	3.9	4.3	4.7	4.9
Imports	3.4	5.1	4.9	4.9	5.2	5.5	4.9	4.7	4.9
Industrial production	1.5	2.0	4.0	0.1	1.8	3.0	3.3	3.9	4.3
Unemployment (%)	6.9	6.4	6.3	6.5	6.4	6.4	6.4	6.3	6.3
Wage growth	2.9	2.7	2.8	2.2	3.0	2.8	2.8	2.8	2.8
Consumer prices	0.8	0.5	1.6	-0.1	0.5	0.5	1.1	1.8	1.5
Current account (USDbn)	282.7	245.8	250.1	64.6	59.4	56.7	65.1	64.2	58.3
Current account (% GDP)	7.6	7.7	7.4	8.1	7.2	7.2	8.2	7.8	7.0
Budget balance (% GDP)	0.6	0.2	0.2	-	-	-	-	-	-
Gross external debt (% GDP)	-	-	-	-	-	-	-	-	-
Gross government debt (% GDP)	74.7	72.0	69.0	-	-	-	-	-	-
USD/EUR*	1.21	1.05	1.10	1.07	1.10	1.05	1.05	1.07	1.08
3-month money (%)*	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
10-year bond (%)*	0.7	0.8	1.2	0.2	0.9	0.4	0.8	1.0	1.1

Note: *Period end
Source: Thomson Reuters Datastream, HSBC estimates

Eurozone

France

Green shoots

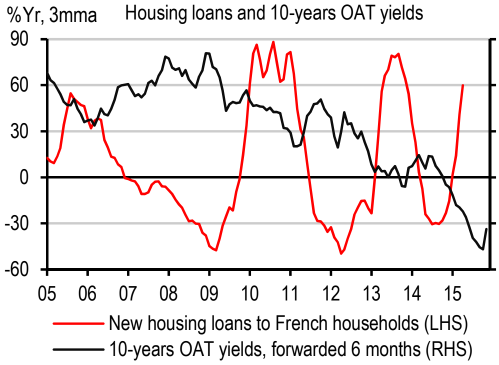
Mathilde Lemoine
Economist
HSBC France
+33 1 40 70 32 66
mathilde.lemoine@hsbc.fr

French GDP growth came in above expectations with first quarter growth of 0.6% q-o-q, up from 0.0% q-o-q in the last quarter of 2014. The positive expectations for the French economy have become more concrete. Consumer spending accelerated sharply, not only due to weather-related temporary factors, but also thanks to a sharp rebound in durable goods consumption. Moreover, stockbuilding added 0.5pp and business investment edged up. The disappointment came from the slowdown in exports despite the euro depreciation.

The French consumer is back, and should be once again the key driver of French GDP growth. Of course, the boost to disposable income from the lower oil price is set to fade. However, the income tax cut for low earners, planned for September, could offset the waning impact of the oil price decline on household income. Also the effect of the slight acceleration in inflation on household income could be offset by forthcoming wage rises. This results from the minimum wage indexation to inflation, but also arises from the low unemployment rate of highly-qualified employees, which pushes up overall wages. In addition, the first signs of housing market improvement have been confirmed. The boost to the residential investment tax credit from 1 October 2014 and the extension of the zero-interest rate mortgages from new homes to existing properties from 1 January have already pushed up housing sales. As a result, existing home prices stopped declining in the first quarter of 2015.

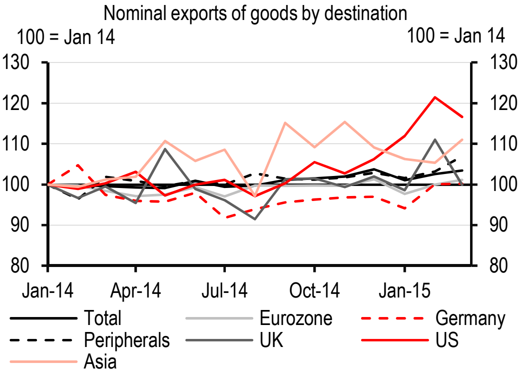
Nevertheless, the GDP growth rate will continue to be constrained by the industrial sector. Euro depreciation has mainly supported transport good exports, which are highly sensitive to price competitiveness, but has not really bolstered other types of exports. Moreover, the slowdown in US GDP growth could weigh on export growth. Finally, France's lack of competitiveness will continue to be a strong disadvantage in a weak global demand context. As a consequence, GDP growth could slow down in the second quarter of 2015 and maintain a pace of 0.4% q-o-q until the end of the year.

Housing market has already showed some signs of a revival



Source: INSEE, HSBC

Disappointing US GDP growth could weigh on exports



Source: INSEE, HSBC

Policy issues

Following the failure of the tax credit in businesses' total payroll, the French government decided to focus on supply-side measures and structural reforms. Indeed, the tax credit applied in 2013 and in 2014 was intended to improve the competitiveness of French businesses. The government expected a decline in production costs and a rise in profit margins. But the strategy backfired. Corporates' profit margins declined in 2014 to 29.5% of the value added, from 29.7% in 2013. Indeed, French businesses decided to increase wages by 1.4% in 2014, despite the disinflationary pressure. Therefore, the French Minister of the Economy, Emmanuel Macron, decided to introduce a new, but temporary, investment tax-incentive aimed at raising the return on businesses' capital and stimulating new investments. This tax credit applies to capital investments made between 15 April 2015 and 15 April 2016 and allows firms to deduct 140% of investment spending from their corporate tax base during the whole period of depreciation. The expectation is for a quicker rise in business investment than previously forecast. However, we expect the weakness in global demand and the persistent high level of public deficit, which fuels savings, to weigh on investment recovery.

Risks

The European Commission's new appreciation of French fiscal policy is a U-turn. In its latest forecast and recommendations, it judged that the French government could reach its public deficit target of 3.8% of GDP in 2015. Therefore, the main downside risk should not come from additional cuts in public spending but from increased spending. Indeed, an acceleration in public spending could require additional tax rises in the future if nominal GDP growth disappoints. This prospect could prompt a further rise in the French businesses saving rate which has already increased to 17% of value added.

The upside risk could come from a quicker-than-expected rebound in the housing market or a stronger recovery in major export markets than our current forecasts imply.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	0.2	1.2	1.4	0.7	1.1	1.3	1.7	1.5	1.5
GDP (% quarter)	-	-	-	0.6	0.3	0.4	0.4	0.3	0.3
Consumer spending	0.7	1.6	1.0	1.7	1.5	1.5	1.6	1.0	1.0
Government consumption	1.5	2.0	2.2	1.8	2.0	2.1	2.2	2.1	1.8
Investment	-1.2	-0.2	2.2	-1.7	-0.9	0.2	1.5	2.5	2.8
Stockbuilding (% GDP)	0.7	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Domestic demand	0.7	1.7	1.6	1.4	1.6	1.5	2.2	1.6	1.6
Exports	2.4	4.5	2.8	4.5	5.0	5.1	3.6	3.2	3.5
Imports	3.9	6.0	3.4	6.7	6.6	5.8	5.2	3.6	3.6
Industrial production	-1.1	1.7	2.4	1.3	1.1	1.4	3.0	2.1	2.9
Unemployment (%)	10.3	10.5	10.4	10.5	10.6	10.5	10.5	10.4	10.4
Wage growth	1.4	1.0	1.2	1.2	1.0	0.9	1.1	1.2	1.2
Consumer prices	0.6	0.3	1.0	-0.2	0.3	0.5	0.6	1.1	0.9
Current account (USDbn)	-28.3	-26.4	-36.5	-3.7	-7.4	-7.5	-7.8	-8.6	-8.6
Current account (% GDP)	-1.0	-1.1	-1.5	-0.6	-1.2	-1.3	-1.4	-1.5	-1.4
Budget balance (% GDP)	-4.0	-3.8	-3.5	-	-	-	-	-	-
Gross external debt (% GDP)	208.3	210.5	207.0	-	-	-	-	-	-
Gross government debt (% GDP)	95.6	96.7	97.3	-	-	-	-	-	-
USD/EUR*	1.21	1.05	1.10	1.07	1.10	1.05	1.05	1.07	1.08
3-month money (%)*	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
10-year bond (%)*	1.0	1.1	1.6	0.5	1.2	0.6	1.1	1.4	1.5

Note: * Period end
Source: Thomson Reuters Datastream, HSBC estimates

Eurozone

Italy

Growth, finally

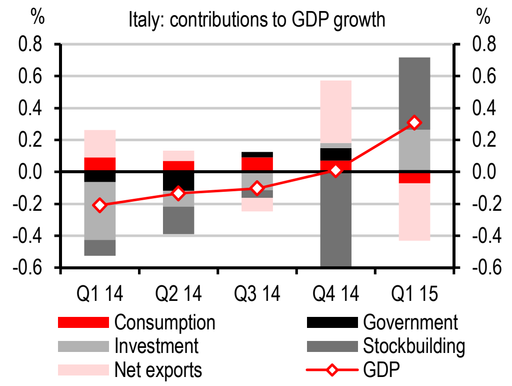
Fabio Balboni
European Economist
HSBC Bank plc
+44 20 7992 0374
fabio.balboni@hsbc.com

Italian GDP returned to growth in Q1 2015, posting the highest growth rate (0.3% q-o-q) in three years. But the detail of growth was less comforting. Household consumption fell in Q1 (-0.1% q-o-q) for the first time since Q2 2013, suggesting that the boost from lower oil prices and the extension to 2015 of the EUR80 monthly tax cut for low-income earners is being offset by high unemployment (12.8% in Q1 2015) and an higher propensity to save. Net exports detracted 0.2pp from Q1 growth, with imports rising 1.4% q-o-q and exports remaining flat. Stock-building continued its erratic path, adding 0.4pp to Q1 growth after subtracting 0.6pp in Q4 2014. Investment growth was positive (1.5% q-o-q), but largely due to transport (+29% q-o-q) whilst investment in machinery and equipment was still negative (-0.9% q-o-q).

GDP should continue to grow in Q2 and the rest of the year. Survey indicators remain strong, particularly in the manufacturing sector, with business confidence and the PMIs at the highest levels since 2011, even if industrial production made a bad start in Q2 (-0.3% q-o-q in April). The weak euro is boosting exports outside the eurozone (exports to the US rose 39% y-o-y in January-April). Household consumption should also resume growth: consumer confidence has softened slightly since the March peak, but remains at levels unseen since 2002, and the labour market is finally showing signs of improvement: the employment rate was 56.1% in April, its highest since end-2012. The banking sector is also supporting the economy: new loans to households and non-financial corporations were up 15% in Q1 2015 compared to Q1 2014.

However, so far we see little reason to raise our forecast for GDP growth in 2015 (0.5%) and 2016 (0.8%). Investment is still down over 30% in real terms from the Q1 2007 peak, which is contributing to the erosion of output potential also in light of the low quality of such investment, with one of the lowest levels of R&D spending in the EU. Rising non-performing loans and tougher regulation limit the ability of banks to lend, particularly to SMEs, the backbone of the Italian economy. Emerging skills mismatches and lack of adequate re-training policies could limit the jobs recovery (*Italy: too much growth optimism*, 14 April 2015).

Stock-building added heavily to GDP growth in Q1 2015…



Source: Italian Statistical Institute

…the labour market situation is slowly starting to improve

Source: Italian Statistical Institute * Number of employed as a share of total workforce.

Policy issues

Staying on the reform path is the clear priority in Italy. Raising the country's growth potential is key to ensure the sustainability of the high stock of debt (131.8% of GDP at the end of 2014) without creating an unbearable burden in terms of the fiscal surpluses (*Italy: QE and debt sustainability*, 16 February 2015). Reforms are also crucial to ensure Italy continues to receive the much-needed flexibility from Brussels on the fiscal targets. The labour market reform (*The Italian Job*, 28 November 2014) is starting to bear fruit in terms of job creation – particularly permanent – but the unemployment rate will fall only gradually due to the weakness of domestic demand. Re-focusing the ineffective system of unemployment benefits on re-training and active job seeking takes time. The electoral law, constitutional reform and education bill still have to go through the upper house, the very house that the constitutional reform intends to abolish, and also in which the Democratic Party (PD) does not have a majority. Next in line should be policies to lower the burden of non-performing loans for banks, but viability issues could limit their effectiveness (*Is a bad bank good for Italy?*, 12 March 2015). The list of other reforms needed is long, running from speeding up the judicial system and liberalising closed professions, to increasing the attractiveness to foreign investment.

Risks

After the small setback for the PD in the recent regional elections (*Italy regional elections: reform momentum could slow,* 1 June 2015), with the prime minister, Matteo Renzi, facing increasing opposition from within the party and having lost the support of Silvio Berlusconi's centre-right party, we could see a slowdown in the reform process, with negative consequences for growth and a need for future austerity.

Having risen some 100bps since January, yields on 10-year Italian bonds are already well above the government's projections for this year and beyond, putting pressure on the fiscal targets. And while contagion has so far been limited, a deterioration of the situation in Greece could push yields higher. With the fiscal buffer for 2015 already gone (*Italy: fiscal buffer already gone…in pensions*, 19 May 2015), there is a growing risk of an automatic VAT rise at the beginning of 2016 which could nip the recovery in the bud.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	-0.4	0.5	0.8	0.1	0.4	0.7	0.9	0.8	0.8
GDP (% quarter)	-	-	-	0.3	0.2	0.2	0.2	0.2	0.2
Consumer spending	0.3	0.2	0.6	0.3	0.3	0.2	0.3	0.5	0.6
Government consumption	-1.0	0.1	0.1	0.0	0.6	0.2	-0.3	-0.2	0.0
Investment	-3.2	1.2	1.9	0.4	0.6	1.7	1.9	1.0	2.0
Stockbuilding (% GDP)	0.0	0.0	0.0	-0.4	-0.3	-0.2	0.4	-0.1	0.0
Domestic demand	-0.6	0.4	0.7	0.2	0.4	0.5	0.4	0.4	0.7
Exports	2.4	3.5	3.6	3.5	3.4	4.0	3.3	4.1	3.6
Imports	1.7	3.2	3.6	3.8	2.8	2.9	3.2	2.8	3.6
Industrial production	-0.5	0.8	2.1	-0.5	0.4	1.5	1.8	1.9	2.0
Unemployment (%)	12.7	12.5	11.7	12.8	12.6	12.4	12.2	12.0	11.8
Wage growth	1.2	0.9	0.8	1.0	0.9	0.8	0.7	0.6	0.7
Consumer prices	0.2	0.3	0.8	-0.1	0.1	0.5	0.6	0.9	0.8
Current account (USDbn)	37.4	34.8	34.1	6.2	7.6	9.5	12.4	6.7	6.8
Current account (% GDP)	1.8	2.0	1.8	1.3	1.6	2.1	2.8	1.5	1.5
Budget balance (% GDP)	-3.0	-2.8	-2.3	-	-	-	-	-	-
Gross external debt (% GDP)	-	-	-	-	-	-	-	-	-
Gross government debt (% GDP)	132.1	133.5	133.4	-	-	-	-	-	-
USD/EUR*	1.21	1.05	1.10	1.07	1.10	1.05	1.05	1.07	1.08
3-month money (%)*	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
10-year bond (%)*	2.0	2.2	2.2	1.2	2.3	2.2	2.2	2.3	2.2

Note: *Period end
Source: Thomson Reuters Datastream, HSBC estimates

Eurozone

Spain

Still the star performer

Fabio Balboni
European Economist
HSBC Bank plc
+44 20 7992 0374
Fabio.balboni@hsbc.com

The domestic consumption boom continued in Q1 2015, with GDP growing by 0.9% q-o-q (2.7% y-o-y), up from 0.7% in Q4 2014. Once again, the main contributor to growth was household consumption (0.7% q-o-q) even if it was slightly less strong than in Q4 2014 (0.9% q-o-q). Investment grew at 1.3% q-o-q, with investment in construction (+1.5% q-o-q) growing at the highest rate since Q2 2007 (even if it remains 48% below the 2007 level in absolute terms). Net exports also contributed positively to GDP growth for the second quarter in a row in Q1 2015, with exports growing by 1% q-o-q and imports by 0.8% q-o-q. Finally, public consumption grew 1.6% q-o-q in Q1, the highest rate since Q1 2008, which was also an election year.

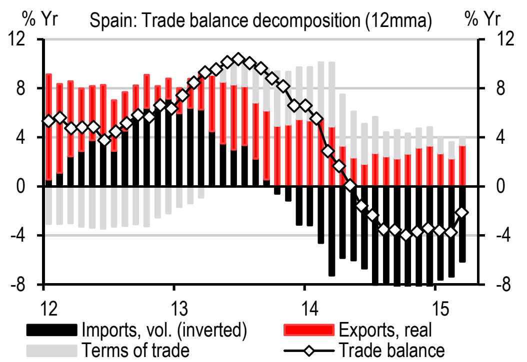
The acceleration in GDP growth in the last two quarters can be explained largely, in our view, by the fall in energy prices, which could have added some 0.6pp to growth cumulatively through consumption alone, also thanks to the higher share of energy in the CPI basket than in other eurozone countries. With energy prices up 50% since the January low and inflation edging closer to zero (-0.3% y-o-y in May), this effect should fade in the coming quarters. But job creation continues at an impressive rate: 3.6% more people were registered for social security in May compared to last year, even if most jobs (87%) are temporary and productivity growth is likely to have turned negative. This, together with the pick-up in industrial production and the ongoing strength of soft indicators, points to Q2 GDP growth broadly in line with Q1.

In the medium term, it is unlikely Spain will be able to grow by 3% consistently until 2018, as expected by the government (*Spain consumption boom: enjoy while it last*, 30 April 2015). Weak wage growth and high structural unemployment, the likely stabilisation of the household savings rate, limited growth potential of the public sector and construction, high private sector leverage and the weakness of global trade including key trade partners are all limiting factors. Given the increasingly fragmented electorate, elections at the end of the year could weigh on consumption and investment decisions. Lower energy prices have so far masked the deterioration in the external balance, but as import prices rise, the current account could revert to deficit.

Job creation has been incredibly strong so far this year...

Source: Spanish Ministry of employment and social security, Spanish statistical institute

...and favourable terms of trade helped the external balance



Source: Spanish statistical institute

HSBC

Policy issues

With the net international investment position at -94% of GDP at end-2014, rebalancing the external sector remains a key challenge. Import substitution has so far been limited, with the relationship between imports and domestic demand remaining in line with – if not stronger than – the pre-crisis period. Spanish firms' small size remains a constraint on their ability to export, and removing some of the regulatory and labour laws that form barriers to expansion would be beneficial. Liberalising closed professions (eg lawyers and pharmacists) would support growth and reduce the risk that possible wage pressures could undermine Spain's competitiveness.

On the fiscal front, the government's objective of cutting public expenditure by some 5% of GDP while also being a positive contributor to GDP growth is challenging (*Spain trip notes: 2015 boom, medium-term concerns*, 13 May 2015). The target for the social security deficit is likely to be missed and a full reform of the regional funding system would be needed to make the deficit targets achievable. Unemployment benefits might not fall as fast as the government expects, as politically it could be difficult to cut support for the long-term unemployed falling out of benefits. The government also foresees a significant reduction in interest payments, with 10-year yields projected at 1.4% in 2018, which appears unrealistic in light of recent market moves. We think that reducing the deficit would require further austerity and be a drag on growth.

Risks

The regional elections on 24 May marked the end of the bi-partisan political system in Spain, and a clear win for the anti-austerity campaign (*Spain regional elections: let the uncertainty begin*, 26 May 2015). No party was able to get an absolute majority in any of the regional parliaments and forming governments might prove hard: with the national election at the end of the year in mind, parties will not want to be seen as compromising too much on key pre-election pledges. Markets could start to worry about a possible similar scenario after the national elections, with political uncertainty making it difficult to implement further austerity and a possible U-turn on the key reforms for labour markets and pensions. Elections in Catalonia on 27 September, with the still unresolved independence issue, could add to the uncertainty.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	1.4	2.9	2.2	2.7	3.0	3.1	3.0	2.6	2.2
GDP (% quarter)	-	-	-	0.9	0.9	0.7	0.5	0.5	0.5
Consumer spending	2.4	3.2	2.3	3.5	3.3	3.2	2.8	2.6	2.3
Government consumption	0.1	1.2	-0.2	0.1	0.9	1.4	2.4	0.8	0.2
Investment	3.4	4.8	2.9	6.0	5.1	4.5	3.5	2.8	2.4
Stockbuilding (% GDP)	0.4	0.2	0.3	0.2	0.3	0.3	0.3	0.3	0.3
Domestic demand	2.2	2.9	1.9	3.3	2.9	2.8	2.6	2.0	1.9
Exports	4.2	5.6	5.9	5.7	6.7	4.3	5.9	6.2	6.0
Imports	7.6	5.9	5.7	7.4	7.1	3.6	5.7	6.1	5.7
Industrial production	1.2	2.7	1.6	1.6	2.5	3.3	3.4	2.4	1.3
Unemployment (%)	24.4	22.8	21.3	23.8	23.0	22.2	22.1	22.1	21.4
Wage growth	0.0	0.4	0.6	0.3	0.3	0.4	0.4	0.5	0.5
Consumer prices	-0.2	-0.2	1.1	-1.1	-0.4	0.1	0.7	1.4	1.1
Current account (USDbn)	10.3	8.1	6.5	-1.7	1.4	4.0	4.5	-3.6	1.3
Current account (% GDP)	0.8	0.7	0.5	-0.6	0.4	1.4	1.5	-1.2	0.4
Budget balance (% GDP)	-5.7	-4.9	-4.0	-	-	-	-	-	-
Gross external debt (% GDP)	-	-	-	-	-	-	-	-	-
Gross government debt (% GDP)	97.7	101.3	103.0	-	-	-	-	-	-
USD/EUR*	1.21	1.05	1.10	1.07	1.10	1.05	1.05	1.07	1.08
3-month money (%)*	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
10-year bond (%)*	1.8	2.3	2.3	1.2	2.3	2.2	2.3	2.4	2.3

Note: *Period-end
Source: Thomson Reuters Datastream, HSBC estimates

Other Western Europe

UK

Simon Wells
Economist
HSBC Bank plc
+44 20 7991 6718
Simon.wells@hsbcib.com

Liz Martins
Economist
HSBC Bank plc
+44 20 7991 2170
liz.martins@hsbc.com

Clearer direction post-election

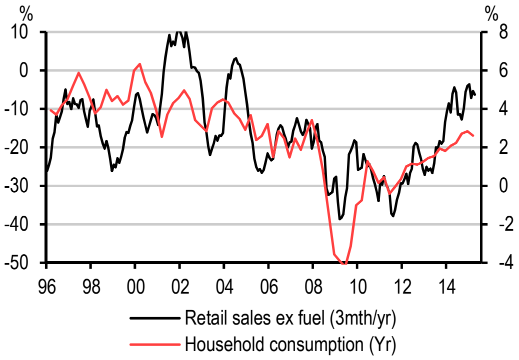
Our central forecast for the UK over the coming quarters remains relatively positive. Nominal pay growth reached 2.7% (3m/yr) in April and we expect this to grind higher through the rest of the year as falling unemployment gradually exerts higher pressure on pay. But with inflation close to zero and only expected to rise late in the year, real-terms pay is already growing at pre-crisis rates. This boost to real incomes has contributed to high consumer confidence and robust retail sales growth (chart on left). Consumer sentiment may be buoyed further by accelerating house price inflation. Leading indicators of the housing market have improved sharply and effective mortgage rates have continued to fall (chart on right).

As a result of Q1 weakness – notably a large drag from net trade – we cut our 2015 growth forecast to 2.5% from 2.6%. However, we expect the weakness seen in Q1 to prove temporary. The ONS has already said that revisions to construction output will lift Q1 GDP growth by 0.1pp to 0.4% q-o-q. And the volatile oil and gas sector has made a much stronger start to Q2. More concerning was a slowing in business and financial services growth. But there is little evidence in survey data that this will persist.

We think robust household consumption growth will persist into 2016. But the Conservative victory in the May 2015 election means we expect more front-loading of fiscal tightening and, in turn, a larger drag on economic growth from government spending cuts. The prospect of a referendum on EU membership in 2016 could also weigh on investment growth. Assuming these effects largely offset each other, we keep our 2016 growth forecast at 2.5%.

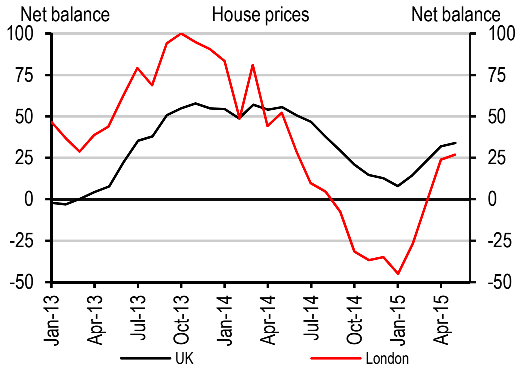
By the end of the year, with unemployment getting very close to neutral levels, wage growth rising and robust household spending supported by a hotter housing market, we expect some members of the MPC to be arguing forcefully that the gradual process of monetary tightening should begin.

Consumer confidence remains high and retail sales growth robust



Source: ONS, GfK

Leading indicators of the housing market point to a rapid turnaround



Source: RICS

Policy issues

Assuming the world economy and global monetary policy evolve broadly in line with HSBC forecasts, many of the pre-conditions for UK monetary tightening may finally be in place by Q1 next year. In February 2016, we expect the MPC to raise the Bank Rate by 25bps and cease reinvesting the proceeds of maturing gilts in its QE portfolio. We then forecast two further 25bp rate rises in 2016, in Q2 and Q4. The MPC may wish to pause tightening in Q3, particularly if this period includes the run-up to the EU referendum. We therefore expect slightly more tightening in 2016 than is currently priced in by the market, although the MPC's recent inflation forecast suggests it is not envisaging a path for the Bank Rate that is hugely different to current market expectations.

The Conservative government was elected on a platform of continued fiscal consolidation, and it aims to eliminate the budget deficit by 2018/19. With significant tax rises effectively ruled out, this requires further spending cuts of around GBP25bn. The government may choose to bring forward some of the cuts on the back of the election, implying tighter policy than was forecast in the March Budget. We should have a clearer idea on the scope and timing of the proposed cuts following the next Budget announcement scheduled for 8 July.

Risks

The main domestic risk is that the easiest public spending cuts and efficiency savings were made in the first half of the planned consolidation. If so, future cuts could exert a greater drag on overall economic growth. Otherwise the main risks are international in nature. If the Fed does not tighten policy in the US, the BoE may find it hard to raise interest rates given the upward pressure this could put on sterling and the potential for making a policy error. Similarly, if the situation in the eurozone deteriorated sharply, it would spill-over to the UK. As in 2012, this could set back plans for both fiscal and monetary tightening.

The UK also urgently needs a rise in productivity growth. With unemployment falling, the UK cannot continue to grow simply by employing more people. Without higher productivity, either wage growth could slow or aggregate demand could face supply constraints, requiring faster monetary tightening.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	2.8	2.5	2.5	2.5	2.4	2.5	2.6	2.4	2.5
GDP (% quarter)	-	-	-	0.4	0.7	0.7	0.7	0.6	0.6
Consumer spending	2.5	2.7	2.7	2.7	2.8	2.5	2.7	2.7	2.8
Government consumption	1.7	1.2	-0.5	2.5	1.0	0.6	0.5	-0.2	-0.5
Investment	7.3	5.2	5.7	3.9	4.7	4.8	7.2	6.4	6.0
Stockbuilding (% GDP)	0.3	0.0	0.0	-0.3	-0.1	-0.1	0.3	0.0	-0.1
Domestic demand	3.3	2.7	2.5	2.6	2.6	2.3	3.3	2.7	2.6
Exports	0.6	4.4	2.6	3.8	5.5	6.2	2.1	2.8	2.4
Imports	2.2	5.0	2.5	2.1	5.4	5.4	4.4	2.8	2.4
Manufacturing output	3.1	1.0	1.9	1.4	1.0	0.9	0.8	1.3	1.7
Unemployment (%)	6.2	5.3	5.0	5.5	5.3	5.2	5.1	5.1	5.1
Wage growth	1.2	2.5	3.0	1.9	2.4	3.0	2.5	3.1	2.8
Consumer prices	0.6	0.2	1.5	0.1	0.0	0.1	0.5	1.3	1.5
Current account (USDbn)	-161.8	-149.7	-148.1	-	-	-	-	-	-
Current account (% GDP)	-5.5	-5.5	-5.3	-	-	-	-	-	-
PSNB (% GDP)	4.8	3.8	2.7	-	-	-	-	-	-
USD/GBP*	1.56	1.45	1.45	1.48	1.50	1.46	1.45	1.45	1.45
GBP/EUR*	0.78	0.72	0.76	0.72	0.73	0.72	0.72	0.74	0.74
3-month money (%)*	0.6	0.8	1.8	0.6	0.6	0.6	0.8	1.1	1.4
10-year bond yield (%)*	2.0	1.6	1.9	1.8	2.1	1.5	1.6	1.6	1.8

Note: *Period end
Source: ONS, HSBC estimates

Other Western Europe

Switzerland

Plagued by the strong franc

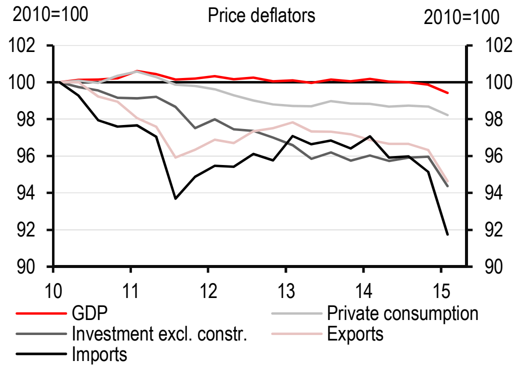
François Letondu
Economist
HSBC France
+33 1 40 70 39 33
francois.letondu@hsbc.fr

In the first quarter of 2015, Swiss GDP was hit by the sharp appreciation of the franc which followed the SNB's decision on 15 January 2015 to abandon the EUR-CHF floor. Indeed, GDP fell by 0.2% q-o-q and was weaker than expected, after 0.5% GDP growth in the fourth quarter of 2014. It was hampered by a fall in exports, while imports climbed at their fastest pace since Q2 2010. Hence, the quickening of private consumption, thanks to the fall in consumer prices, was not enough to offset the very large drag from net exports (-1.3pp).

We forecast Swiss GDP to contract at the same pace in Q2, once again because of the effects of the strong franc. Even if the contribution to GDP from external trade were to be less negative, business investment could start to decline. Indeed, firms should have had time to adjust their investment plans for the prospects for lower activity. However, public consumption is set to remain dynamic and we expect household consumption to remain strong.

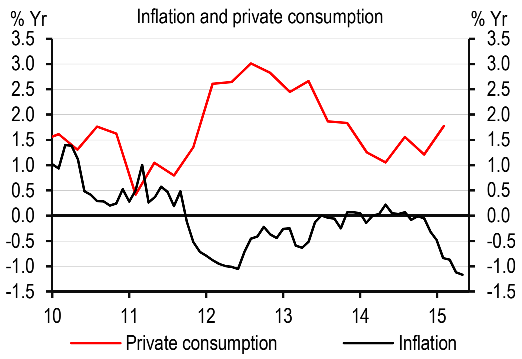
The recession should end in the second half of 2015. The stickiness of prices is set to prolong the time needed by firms to cut their selling prices, through lower margins. However, this process should be well under way by the third quarter and we expect it to lead to a progressive pick-up in exports. Indeed, in the first quarter, the deflator for goods exports (without gold and valuables) already plunged by 2.2% q-o-q, its largest fall since Q3 2011. Despite the pressure on businesses to cut costs, we anticipate that the unemployment rate will rise only moderately as the Federal Council has reactivated the partial unemployment benefit scheme in order to reduce layoffs. Wages should decelerate progressively in nominal terms, on our forecasts, but are set to remain dynamic in real terms because we expect inflation to stay negative until Q4 2016.

Falling import prices once again push down prices in the whole Swiss economy



Source: Swiss State Secretariat for Economic Affairs SECO, HSBC

We expect private consumption to remain supported by disinflation



Source: Thomson Reuters Datastream, HSBC

Policy issues

The franc has stabilised since April and the negative rate policy of the SNB should continue to limit appreciation pressures on the Swiss currency, although it is insufficient to weaken it on our forecasts. This stability points to a continuation of the status quo by the SNB. Indeed, the SNB has signalled that it has a “wait and see” attitude. Chairman Thomas Jordan stated on 31 May that the SNB has “already gone quite far” with negative rates and is “waiting to assess the effect” of this policy (in *Schweiz am Sonntag*). Hence, we forecast that the 3-month Libor target will stay at -1.25%/-0.25% and the sight deposit rate at -0.75%.

Federal elections for the National Council (lower house of parliament) and the Council of States (upper house) will be held on 18 October. In December the two houses will elect the seven members of the Federal Council, the collegial executive body. The composition of the council could influence how strictly the popular initiative “against mass immigration”, which was adopted in 2014, is applied. The Swiss People’s Party (right wing), which promoted this initiative and is asking for tight immigration quotas, seeks to regain a second seat at the Federal Council and should remain the largest political force according to opinion polls (gfs.bern). A tight quota system applying to all foreigners could mean the EU might review and nullify the 1999 bilateral agreement on the free movement of persons, which is also a trade agreement. This could weigh on the growth of exports to the EU (55% of Swiss exports).

Risks

The main downside risk for Switzerland still lies in a renewed sharp appreciation of the franc from its already very high levels as the Swiss currency remains 40% overvalued against the euro on a purchasing power parity basis. In such an event, we would expect the SNB to cut the sight deposit and the Libor target rates further. However, this would barely support domestic demand as commercial interest rates are already very low, while exports would be hit further. Thus, disinflation would last longer, increasing the risk of de-anchoring inflation expectations and of a full-scale deflation in Switzerland.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	2.0	0.5	1.1	1.1	0.7	0.2	-0.1	0.5	1.0
GDP (% quarter)	-	-	-	-0.2	-0.2	0.1	0.3	0.3	0.3
Consumer spending	1.3	2.0	2.0	1.8	2.0	1.9	2.1	2.1	2.0
Government consumption	1.4	3.1	1.9	2.6	3.8	3.8	2.3	2.7	2.0
Investment	1.8	0.3	0.6	1.3	1.0	-0.4	-0.5	-0.6	0.3
Stockbuilding (% GDP)	-0.4	-0.3	-0.3	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3
Domestic demand	0.7	1.8	1.6	1.7	0.9	2.2	2.3	1.3	1.6
Exports	3.8	0.7	2.1	2.4	2.2	-1.1	-0.8	0.4	2.1
Imports	1.5	3.4	3.3	4.1	3.0	2.6	3.8	2.1	3.4
Manufacturing production	3.4	0.4	0.4	3.7	1.4	-0.7	-2.6	-2.0	0.0
Unemployment (%)	3.2	3.3	3.6	3.2	3.3	3.4	3.5	3.6	3.6
Wage growth	0.8	0.6	0.5	0.8	0.7	0.6	0.5	0.5	0.5
Consumer prices	0.0	-1.0	-0.2	-0.7	-1.1	-1.1	-0.9	-0.5	-0.3
Current account (USDbn)	48.1	36.0	39.4	7.8	7.7	10.5	10.0	8.4	9.1
Current account (% GDP)	7.0	5.3	5.3	4.6	4.7	6.2	5.6	4.6	4.9
Budget balance (% GDP)	-0.1	-0.2	-0.2	-	-	-	-	-	-
Gross external debt (% GDP)	229.9	230.0	230.0	-	-	-	-	-	-
Gross government debt (% GDP)	34.5	34.0	33.5	-	-	-	-	-	-
CHF/USD*	0.99	0.90	0.86	0.97	0.95	0.95	0.90	0.89	0.88
CHF/EUR*	1.20	0.95	0.95	1.04	1.04	1.00	0.95	0.95	0.95
3-month money (%)*	-0.1	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
10-year bond (%)*	0.3	0.2	0.4	-0.1	0.2	0.2	0.2	0.3	0.3

Note: *Period end
Source: Thomson Reuters Datastream, HSBC estimates

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Other Western Europe

Sweden

A central banker's nightmare

James Pomeroy
Economist
HSBC Bank PLC
+44 20 7991 6714
james.pomeroy@hsbc.com

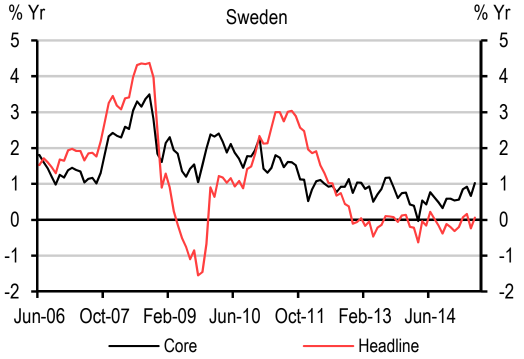
Sweden's economy continues to perform well, but that will be little consolation to the Riksbank. Inflation was 0.1% y-o-y in May, supported by food and transport costs, after a negative reading in April. We expect inflation to undershoot both the Riksbank's and consensus expectations from now until the end of the year and into 2016. We currently forecast just 0.4% inflation in 2016 (Riksbank 2.1%; Consensus 1.4%) and this sustained low inflation is expected to prompt further easing in the coming months.

However, the shape of this easing is hard to work out. A further cut to the already negative repo rate seems the most appropriate response, but the Riksbank has put its financial stability hat back on with the price of apartments in Stockholm up 17% over the past year. Given that background, we think it is more likely that further easing in the near term will come via further government bond purchases (despite the Riksbank already owning 13-15% of the government bond market) with currency intervention remaining an option should the need arise further down the line.

Bolstering the inflation rate is key for the Riksbank given the crucial wage negotiations at the start of 2016. With companies already saying that they cannot raise wages any further as they have been unable to raise output prices, if inflation expectations do not rise before the end of the year then Sweden may lose the robust wage growth that has been so supportive of consumption over the past few years.

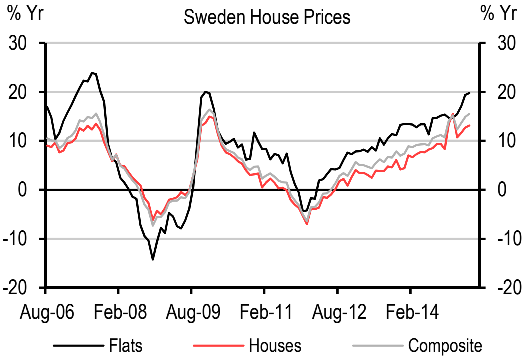
Although 2015 looks set to be another year of solid growth, the housing market also contains potential pitfalls further out. House prices cannot keep rising at these rates and we worry that possible macro-prudential measures to cool the market could put prices into reverse and lead to lower confidence, consumption and growth. This mix of robust growth, deflation, rampant house price growth and negative policy rates is certainly a headache for the Riksbank, and one that shows no sign of abating over the next quarter or so.

Swedish inflation is still very low...



Source: HSBC, Thomson Reuters Datastream

...but house prices continue to soar



Source: Thomson Reuters Datastream, OMX Nasdaq

Policy issues

The 'December Agreement', which ensured that Sweden was able to be governed by a minority government, may be at risk of breaking. The agreement says that a minority government will be allowed to have its budget passed as a result of opposition parties abstaining from voting. However, opinion polls have moved a long way since the September election, with the opposition Alliance opening up a 7-point lead in the polls over Prime Minister Lofven's coalition. The anti-immigration party, the Swedish Democrats, continue to poll strongly, with the latest surveys suggesting that they may garner 19% of the vote, up from 13% at last year's election. With such a shift in voting intentions, there may now be an incentive for opposition parties to push for a new election – bringing back some political uncertainty.

There also remains the question of which policies are left available to the Riksbank, which is still fighting deflation. How negative policy rates can go is hard to know, but it is also uncertain how many government bonds can be purchased and if direct currency intervention remains an option available to the bank.

Risks

The biggest risk for Sweden is the very frothy housing market. With prices up 17% y-o-y in some areas and a central bank that is keen to put the brakes on via macro-prudential measures, there is a substantial probability attached to falling house prices in 2016 within our forecasts. As the timing is hard to pinpoint, we nudge down consumption and investment estimates for each quarter of next year. There is of course the risk that such a shock comes sooner, or is more severe, than we expect, given the very limited arsenal left available to the Riksbank should such a problem arise.

Equally, the full impact of negative rates is yet to be seen. There have been few signs of domestic banks passing any costs across to consumers, but the longer that negative policy rates persist (we expect further rate cuts from -0.25% and then no rate rises until end-2016 at the earliest), the more likely it is that secondary effects will arise.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	2.4	2.0	1.8	2.6	2.1	2.0	1.5	1.7	1.9
GDP (% quarter)	-	-	-	0.4	0.3	0.5	0.3	0.6	0.4
Consumer spending	2.5	2.4	2.0	2.2	2.2	3.0	2.3	2.6	2.0
Government consumption	2.0	1.5	1.5	2.2	1.6	1.3	1.0	1.3	1.4
Investment	7.6	4.6	3.3	5.5	6.0	4.3	2.7	3.5	3.3
Stockbuilding (% GDP)	0.8	-0.2	0.1	0.2	-0.1	-0.1	-0.2	0.0	0.0
Domestic demand	3.7	2.4	2.3	3.2	2.6	2.3	1.6	2.2	2.3
Exports	3.5	3.7	3.0	3.7	4.4	4.5	2.3	3.6	2.8
Imports	6.8	4.8	4.1	5.5	6.0	5.5	2.5	5.0	3.9
Industrial production	-1.7	-1.1	1.2	-3.3	-1.4	0.3	0.2	1.2	1.2
Unemployment (%)*	7.8	7.4	6.9	7.8	7.8	7.6	7.4	7.3	7.2
Wage growth	2.6	1.7	2.0	1.7	1.7	1.8	1.7	2.0	1.5
Consumer prices	-0.2	0.1	0.4	0.0	-0.1	0.1	0.3	0.6	0.4
Current account (USDbn)	41.2	44.4	42.1	12.6	10.8	10.7	10.7	10.6	10.6
Current account (% GDP)	6.8	7.3	6.7	8.2	6.9	7.2	6.7	6.9	6.6
Budget balance (% GDP)	-1.1	-0.7	-0.5	-	-	-	-	-	-
Gross external debt (% GDP)	-	-	-	-	-	-	-	-	-
Gross government debt (% GDP)	42.0	41.0	41.0	-	-	-	-	-	-
SEK/USD*	7.80	8.57	8.18	8.63	8.45	8.57	8.57	8.41	8.33
SEK/ EUR*	9.40	9.00	9.00	9.26	9.30	9.00	9.00	9.00	9.00
3-month money (%)*	0.3	-0.4	-0.4	-0.1	-0.3	-0.4	-0.4	-0.4	-0.4
10-year bond (%)*	1.1	1.1	1.3	0.7	1.0	1.0	1.1	1.1	1.2

Note: *Period end
Source: Thomson Reuters Datastream, HSBC estimates

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Other Western Europe

Norway

Some signs of softness

James Pomeroy
Economist
HSBC Bank plc
+44 20 7991 6714
james.pomeroy@hsbc.com

Norway's economic performance in the first half of 2015 has been better than the very low expectations, but there are some signs that weakness may be coming through. The weakness in the oil sector is showing some signs of feeding into the rest of the economy, constraining wage growth and pushing up unemployment. Domestic demand growth was 1.4% y-o-y in Q1, much slower than the 2.4% in Q3 2014, and we expect growth to be below trend at 1.7% in 2015, held back by weak investment.

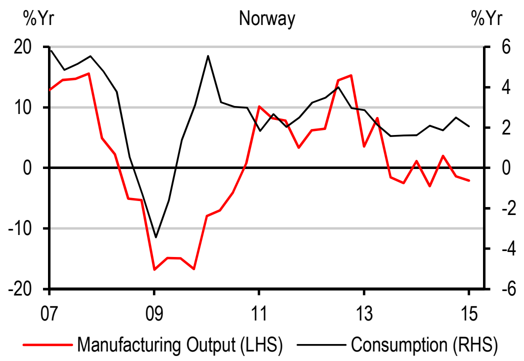
First quarter growth was 0.5% q-o-q, which on the face of it was very strong. However, a large share of this was from inventory accumulation while investment and export growth remain weak even on the mainland, which means excluding the oil industry. The signs for Q2 aren't promising on the net-trade front, with one-off imports of oil platforms pushing imports up 45% y-o-y in April, a significant drag to the net trade figures for the quarter.

On the other hand, there are signs that the consumer continues to do well. Despite slower wage growth, consumption continues to increase at roughly 2% y-o-y, and the more timely retail sales data confirm this. Credit is still growing strongly (around 6% y-o-y) and although the housing market has cooled recently, property prices were up more than 10% y-o-y in the first quarter.

This trade-off has troubled the Norges Bank. Household debt levels are extremely high, and worries about financial instability mean that the committee has a very hawkish bias. Inflation remains elevated, unlike in other European countries, and is not a concern, so the bank will not ease policy unless it really has to.

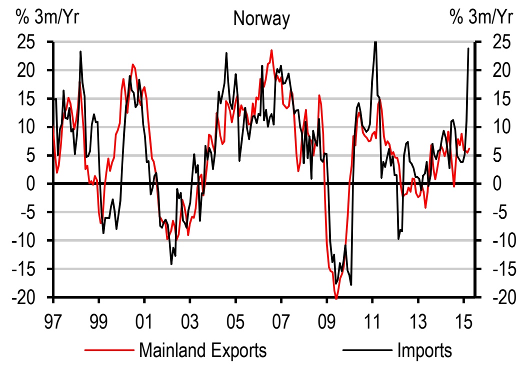
The Norges Bank's decision to cut rates at the 19 June meeting was therefore a close decision. The growth outlook may have weakened, but we still believe that Norway will avoid a severe downturn. Although we have nudged down our growth forecast, we are above consensus for 2015 and believe that this is the full extent of easing that the Norwegian economy requires, and that rates will remain at 1.00%.

Manufacturing output has been weak, but consumption has been resilient



Source: HSBC, Thomson Reuters Datastream

An anomalous spike in imports may make the Q2 GDP release appear worse than it is



Source: HSBC, Thomson Reuters Datastream

Policy issues

The value of the oil fund is now around NOK7trn (about USD850bn) and so the nominal value that the government is able to spend keeps rising sharply. The weaker NOK and strong asset markets mean that the value of the fund is now more than 200% of GDP, providing a significant buffer to any oil-related downturn. The government budget currently plans to spend 3.1% of the value of the fund, but due to the increase in value, this is equal to an additional 1.5% of GDP compared to 2014, and this can be expanded to 4% of the value of the fund should the need arise. The fund generated a greater return in Q1 than the government spent, so there are no issues regarding funding despite the lower oil price.

In terms of monetary policy, the Norges Bank remains concerned by financial imbalances. With high levels of household debt and house price and credit growth still robust, any further easing will likely be accompanied by additional macroprudential measures – concerning the countercyclical capital buffer or measures to cool the housing market. The bank prefers to tackle these imbalances with the policy rate as they are more aware of the impacts.

Risks

The oil price crash and the subsequent impact on the oil industry remain the primary risk to the Norwegian economy. There are still signs of weakness in the sector with the Norges Bank's latest regional network report suggesting a greater-than-anticipated fall in output and exploration and much lower future expectations. If this leads to a more substantial feed through to the rest of the economy, there are clearly downside risks to our forecasts.

However, there may be room for optimism. The non-oil sector is proving resilient and retail trade has been stronger than expected. The rebalancing process still needs to start, and while this will likely lead to slower growth in the medium term, a pick-up in non-oil investment in the second half of the year could mean Norway grows much more quickly than we are currently expecting.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP*	2.3	1.6	1.7	2.0	1.0	1.2	2.0	1.8	1.9
GDP (% quarter)*	-	-	-	0.5	0.1	0.2	1.1	0.3	0.3
Consumer spending	2.0	2.1	1.6	2.1	2.0	2.3	1.9	1.7	1.6
Government consumption	2.7	2.3	2.4	2.2	2.3	2.4	2.2	2.5	2.4
Investment*	1.8	-1.4	1.7	-1.4	-2.3	-2.6	0.9	2.4	0.8
Stockbuilding (% GDP)	4.8	6.5	6.4	6.8	6.8	6.0	6.5	6.5	6.4
Domestic demand	2.1	1.4	1.9	1.4	1.1	1.3	1.8	2.1	1.7
Exports*	4.0	4.6	1.5	7.0	5.4	4.3	2.0	4.0	0.3
Imports*	2.0	5.4	1.3	5.7	7.4	3.8	4.8	2.9	-1.5
Industrial production	3.3	1.7	2.5	2.5	1.8	1.4	1.3	2.2	2.4
Unemployment (%)	3.5	3.6	3.5	3.7	3.7	3.6	3.5	3.5	3.5
Wage growth	2.6	2.4	2.0	2.5	2.4	2.3	2.2	2.1	2.0
Consumer prices	2.0	1.6	1.7	1.9	1.9	1.2	1.6	1.8	1.7
Current account (USDbn)	47.4	36.1	34.6	9.1	9.1	8.9	9.0	10.6	10.8
Current account (% GDP)	9.4	10.3	9.9	10.4	10.3	10.2	10.1	10.0	9.9
Budget balance (% GDP)	9.1	9.4	9.4	-	-	-	-	-	-
Gross external debt (% GDP)	-	-	-	-	-	-	-	-	-
Gross government debt (% GDP)	26.0	25.0	26.0	-	-	-	-	-	-
NOK/EUR**	9.06	8.50	8.40	8.65	8.60	8.50	8.50	8.40	8.40
3-month money (%)**	1.5	1.0	1.0	1.1	1.0	1.0	1.0	1.0	1.0
10-year bond (%)**	1.9	1.8	1.8	1.5	1.7	1.7	1.8	1.8	1.8

Note: *Mainland, **Period end, exports and imports of travel and non-oil-related goods and services
Source: Statistics Norway, HSBC estimates

HSBC

CEEMEA

Poland

Time of change

Agata Urbanska-Giner
Economist
HSBC Bank plc
+44 20 7992 2774
agata.urbanska@hsbcib.com

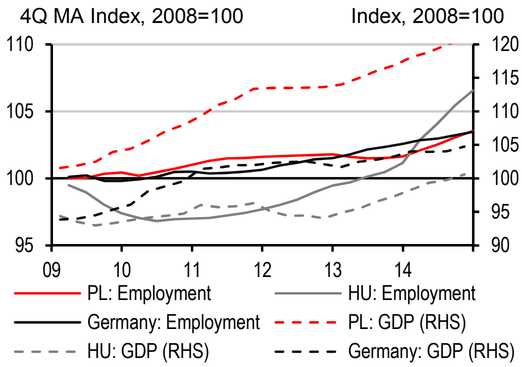
The surprise defeat of incumbent president Bronislaw Komorowski in the May elections has brought into focus the sliding popularity of the ruling Civic Platform party. This points to a much higher risk than we or the market had previously appreciated of a change in government after the parliamentary poll in October. Adding to market fears over the policy outlook, eight of the nine members of the Monetary Policy Council will see their terms end in Q1 2016. The central bank governor's mandate ends in mid-2016.

These changes are, however, occurring within a good institutional framework, which should anchor fiscal and monetary policy targets, and against a better-than-expected economic backdrop in Poland.

Activity data in the first quarter of 2015 surprised to the upside. Having moderated marginally through 2014, annual GDP growth picked up to 3.6% from 3.3% in the second half of 2014. The composition of growth has been positive. Fixed investment yet again surprised to the upside, growing in double digits on an annual basis. This came on the heels of strong y-o-y growth of over 9% in 2014. Export growth accelerated to 8% y-o-y from 5.7% y-o-y in 2014. A negative contribution from inventories – at -1.5pp in Q1 2015 – sounds a note of caution. But, on the other hand, we think consumption growth could play catch-up. The growth rate failed to pick up in the first three months of this year from 3.1% y-o-y expansion in 2014, despite progressive improvement in the labour market and consumer confidence.

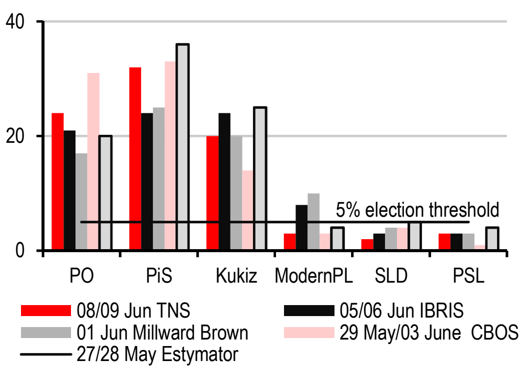
The stronger-than-expected performance in Q1 2015 continues to be balanced by a weaker global economy (the US and Asia) and Greek risks in the eurozone. We have therefore only nudged up our 2015 GDP growth forecast from 3.4% to 3.6% y-o-y.

GDP growth outperformance in Poland was not mirrored by employment data



Source: Thompson Reuters Datastream

Support for the ruling Civic Platform slides after lost presidential elections



Source: Various pollsters after CEEMarketWatch

Policy issues

The change in policy makers – a potential new government and a new Monetary Policy Council – should be viewed in the context of well-anchored policy targets within the existing regulatory framework. The appointments to the MPC, by the parliament and the president, have historically been tainted by speculation over politically-motivated choices and implied leniency towards easy monetary policy. However, that has not been borne out by experience. And it hardly seems problematic, given prolonged CPI target undershooting by the outgoing MPC. The central bank's independence is guaranteed by law and reinforced by a single, six-year term in office for MPC members. The central bank law sets price stability as the primary policy objective. And neither bank lending nor FX policy have been problematic in Poland as they were, for example, in Hungary, where the MPC followed unorthodox policy routes to address these problems. On the fiscal policy front the prudent policy is secured by the EU and the domestic public finance rules. The former caps annual budget deficits at 3% of GDP and introduces even tighter targets for the deficit in the medium term. The latter caps public expenditure growth and introduces an automatic correction mechanism based on a 3% of GDP deficit threshold, 43% and 48% of GDP public debt thresholds and the deviation from the medium-term budget target.

Risks

The Law and Justice (PiS) party, which might lead the next government, argues for an overhaul of the public finances. It values low and stable public debt but made several expensive election promises, including higher child benefits, higher tax free allowances and changes to the pension system. These will likely be financed by tax hikes so to continue to observe the sub-3% of GDP deficit targets. But better VAT collection has been mentioned which, while having proven quite successful recently in Hungary and Romania, could result in a deficit target overshooting in the short term. The PiS could also seek to scrap the expenditure rule which would be a constraint on a potential fiscal shift to higher spending financed by raising taxes. This could send the wrong signal to bond holders, even though we assume the policy target would still be to keep the public debt and budget deficits within the 3% of GDP limit.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	3.4	3.6	3.7	3.6	3.4	3.7	3.6	3.5	3.7
GDP (% quarter)	-	-	-	1.0	0.8	1.1	1.0	0.7	0.8
Consumer spending	3.1	3.4	3.6	3.1	3.6	3.5	3.5	3.6	3.7
Government consumption	4.7	2.4	2.0	3.3	2.0	3.0	1.5	2.0	2.0
Investment	9.2	8.3	6.4	11.4	8.0	7.0	8.0	5.8	6.3
Domestic demand	4.9	3.8	4.0	2.6	3.7	4.2	4.4	3.6	3.9
Exports	5.7	6.5	7.0	8.0	7.0	5.5	5.5	7.2	6.8
Imports	9.1	7.0	7.7	6.0	7.8	6.6	7.5	7.5	7.5
Industrial production	3.5	4.5	4.9	5.2	4.6	4.8	3.3	2.4	3.6
Unemployment (%)	12.3	10.8	9.9	11.9	10.8	10.1	10.2	11.1	10.1
Wage growth	3.8	4.1	4.7	3.9	3.7	4.3	4.3	4.5	4.8
Consumer prices	0.0	-0.5	1.4	-1.4	-0.6	-0.6	0.4	0.9	1.0
Current account (USDbn)	-7.6	0.0	0.6	2.5	0.7	-1.4	-1.7	1.1	-0.5
Current account (% GDP)	-1.4	0.0	0.1	2.2	0.6	-1.3	-1.4	1.0	-0.4
Budget balance (% GDP)	-3.2	-2.7	-2.3	-	-	-	-	-	-
Gross external debt (% GDP)	72.3	73.0	73.6	-	-	-	-	-	-
Gross government debt (% GDP)	50.1	50.8	50.8	-	-	-	-	-	-
PLN/EUR*	4.28	4.35	4.35	4.07	4.16	4.35	4.35	4.35	4.35
3-month money (%)*	2.1	1.7	1.7	1.6	1.7	1.7	1.7	1.7	1.7
10-year bond (%)*	2.6	3.4	3.0	2.4	3.2	3.3	3.4	3.3	3.2

Note: *Period end
Source: Thomson Reuters Datastream, HSBC estimates

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Russia

Breathing a sigh of relief

Alexander Morozov
Economist
HSBC Bank (RR), Moscow
+7 495 783 8855
alexander.morozov@hsbc.com

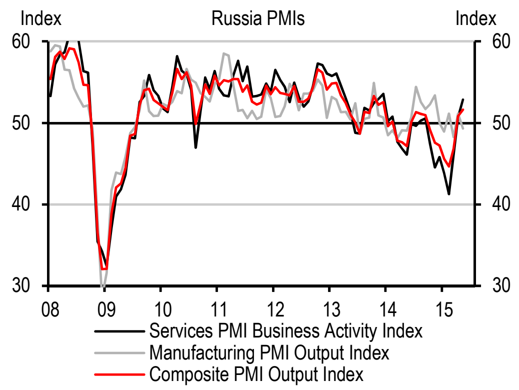
The economic downturn appears to be less severe than many had expected, with GDP contracting 1.9% year-on-year in Q1. Combined with the rebound in oil prices and the financial market rally, there is reason to be less negatively about Russia's near-term economic outlook. However, the flash April macroeconomic dataset points to an annual output contraction of around 4% y-o-y as the positive impact on the Russian economy from frontloaded budget spending disappeared. We expect a somewhat smaller GDP contraction of 1% in 2016, rather than the 1.5% fall we expected before, thinking that positive cyclical factors will partly offset negative structural factors. A return to single-digit inflation and a likely rise in public sector wages ahead of parliamentary elections positively affect our 2016 growth forecast.

As expected, inflation topped out once the strong pass-through effect from the December currency collapse faded. A rapid decline in consumer demand and the RUB appreciation have also restrained price rises since April. These developments suggest faster disinflation than we previously expected, prompting us to cut our end-2015 inflation forecast to 12% from 13%. At the same time, our concerns about next year's inflation have increased. Wage and tariff indexation will likely be in double digits in 2016, adding to inflationary pressures. Thus, we now foresee a higher, 7% rise in consumer prices by end-2016.

In the absence of strong external shocks, monetary authorities should be able to continue policy easing in both 2015 and 2016. A stronger currency and output contraction allowed the central bank (CBR) to ease policy more aggressively in January-June, utilising most of this year's rate-cut potential. As for 2016, we expect a fast easing in the first quarter when annual inflation is to drop to single digits, to be followed by incremental 25bp rate cuts at each subsequent rate setting meeting in 2016.

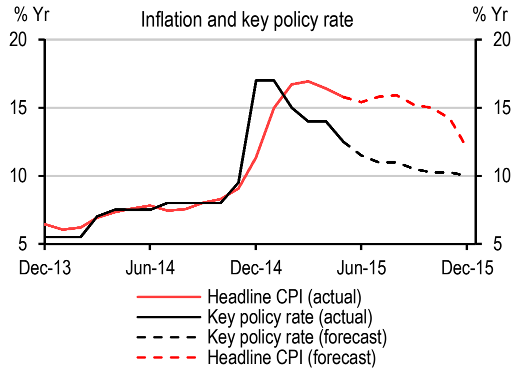
All in all, Russia can breathe a sigh of relief now, having escaped the worst. Yet, its economic outlook remains bleak, with economic stagnation and elevated inflation appearing as the most likely scenario.

HSBC Russia PMIs signal economic stabilisation



Source: Rosstat, MOED, HSBC

Key policy rate became negative in real terms



Source: Rosstat, CBR, HSBC

Policy issues

Russia's economic growth model was based on fast growth of domestic demand, propelled by rising commodity prices and high wage growth which exceeded productivity growth. This growth model has run out of steam. A new economic growth model is still elusive, but the active search for this model and development of appropriate economic policies have been postponed until 2018 as public demand for changes is low. Meanwhile, government policies focus on two things: fixing the most acute problems at a micro and sector level, and the promotion of selected policies which aim to gradually improve the business and investment climate in Russia. The latter include the promotion of non-energy exports by SMEs and a moratorium on changes in taxes. However, these positive developments are pursued in isolation from other government policies. Thus, it looks as though we shall not see much improvement in the overall investment climate in Russia any time soon.

Monetary policy has evolved from a *de facto* inflation mandate to a multifaceted policy which incorporates three mandates: inflation, growth and financial stability. We think that this evolution should slow down the medium-term disinflation trend, moving the achievement of the 4% inflation target back from 2017.

Risks

Geopolitical risks remain on investors' radar, but the overall geopolitical risk perception for Russia has improved, we think. The rebound of oil prices reduced macroeconomic risks for Russia, although this rebound might not prove sustainable. The government's political grip keeps getting tighter, with new controls and restrictions on civil rights being put in place. However, approval ratings of the political leadership are still at a very high level.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	0.6	-3.5	-1.0	-1.9	-3.6	-3.5	-4.9	-2.2	-1.0
GDP (% quarter)	-	-	-	-1.3	-1.5	0.1	-1.5	0.2	-0.3
Consumer spending	1.3	-8.0	-0.5	-8.0	-8.0	-7.0	-8.0	-4.0	0.0
Government consumption	-0.1	0.0	-1.0	3.0	0.0	0.0	-2.0	-1.0	-1.0
Investment	-2.0	-8.0	-5.0	-3.0	-6.0	-10.0	-12.5	-5.0	-5.0
Stockbuilding (% GDP)	-1.3	-0.3	0.1	-	-	-	-	-	-
Domestic demand	-0.8	-7.4	-1.4	-3.9	-4.4	-3.9	-4.8	-2.4	-0.2
Exports	-0.1	-2.0	1.0	-5.0	-2.0	-1.0	-0.5	1.0	1.0
Imports	-7.9	-28.6	0.9	-32.0	-28.0	-25.0	-30.0	1.0	0.0
Industrial production	1.7	-2.9	-0.6	-0.4	-3.5	-3.5	-4.0	-1.5	-0.3
Unemployment (%)	5.3	6.1	6.1	5.9	5.3	5.6	6.1	6.2	5.6
Wage growth	9.2	4.4	7.5	6.0	2.0	0.5	0.0	6.0	8.0
Consumer prices	7.8	14.7	7.6	13.8	15.8	15.6	13.9	9.8	7.0
Current account (USDbn)	59.5	54.3	86.4	23.5	17.8	6.0	7.5	28.7	20.5
Current account (% GDP)	3.3	4.4	7.3	8.2	5.5	1.8	2.5	10.2	7.0
Budget balance (% GDP)	-0.5	-1.5	0.0	-4.9	0.0	2.1	-3.7	-2.2	3.1
Gross external debt (% GDP)	33.5	42.5	41.7	-	-	-	-	-	-
Gross government debt (% GDP)	15.7	17.2	17.9	-	-	-	-	-	-
RUB/USD*	58.3	65.0	70.0	58.2	55.0	60.0	65.0	66.0	67.5
3-month money (%)*	23.8	11.3	7.8	15.7	12.8	11.8	11.3	10.3	9.8
10-year bond (%)*	13.5	11.8	10.5	11.8	11.0	11.5	11.8	11.8	11.0

Note: *Period end Source: Rosstat, CBR, MOF, MOE, HSBC estimates

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Turkey

Uncertainty looms

Simon Williams
Economist
HSBC plc
+44 20 7718 9563
simon.williams@hsbc.com

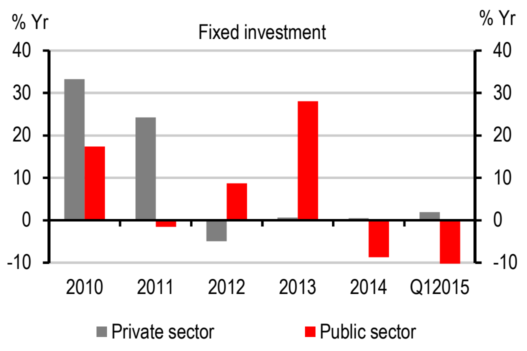
The incumbent AKP (Justice and Development Party, centre right) received 40.8% of the vote in the general election on 7 June, which left it short of the 276-seat simple majority required to form a single-party government in the 550-seat parliament. This is the first time a coalition government will have to be formed in Turkey since 2002.

As the leader of the party that received the most votes, the AKP's Ahmet Davutoglu will likely have the first attempt at forming a coalition government. It is not clear, however, who the AKP's coalition partner might be. The MHP (Nationalist Movement Party, centre right) is the closest to the AKP ideologically, but all opposition parties stated before the polls that they would refuse to enter a coalition, underscoring the depth of the political divide. If no party is able to form a coalition or minority government by the middle of the third quarter, new elections could take place, which will prolong the uncertainty.

From a macro perspective, Turkey continues to muddle through. First quarter growth was better than expected, at 2.3%, but this was primarily on the back of strong household spending. A weak currency and deteriorating consumer confidence pose downside risks to household spending growth in the remainder of the year. Fixed investment and export growth are already weak and unlikely to rebound strongly. So we have lowered our 2015 growth forecast to 2.4%, from 3.0% previously. We have made no change to our 2016 forecast of 3.0%.

Turkey's inflation is still high and its current account deficit is large, compared to most other emerging markets. But both imbalances are moderating compared with 2014, thanks to lower energy prices. That said, little has been done to address the competitiveness challenge that underlies both of these issues.

Private sector fixed investment has been weak since 2011



Source: Turkstat

Real wage growth is outpacing productivity growth

Source: Turkstat, The Conference Board

Policy issues

We do not expect to see an immediate shift in the broad outlines of monetary or fiscal policymaking in the post-election period. The CBRT is likely to remain committed to its unorthodox policy framework, while the fiscal stance should remain broadly prudent. If political uncertainty results in significant lira depreciation, the CBRT could use a number of policy tools (tightening lira liquidity by increasing the weighted average cost of funding, verbal intervention, larger FX sales, direct intervention, outright rate hikes) to defend the currency. Conversely, if headline inflation moderates in June, on the back of lower food inflation, the CBRT could consider a small cut (25-50bps) in the one-week repo rate to ensure that real rates at the policy rate level are close to zero. This was explicit policy guidance delivered early in the year. But there is no room to cut the overnight lending rate as the lira remains fundamentally vulnerable to a number of factors both external (including Fed tightening and further USD strength, rising oil prices) and domestic (such as political uncertainty, limited macro rebalancing on the inflation and current account front).

We make no change to our forecast of policy tightening in Turkey. We expect a gradual hiking cycle to start in September, and pencil in 100bps of cumulative tightening for all key rates by year-end. This would bring the one-week repo rate to 8.00% and the overnight lending rate to 11.75% by December.

Risks

Turkey's vulnerability to global factors is well known. The country has a persistently large current account deficit which is financed by portfolio flows and cross-border borrowing, while FDI coverage is low. It has high inflation, and a central bank with an unorthodox and dovish policy mix. Perhaps most importantly, Turkey needs deep-rooted, supply-side structural reforms aimed at raising productivity growth. However, given the political uncertainty that is likely to loom in the second half of the year, these economic reforms are unlikely to be implemented in the near term.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	2.9	2.4	3.0	2.3	1.3	3.7	2.0	3.1	3.0
GDP (% quarter)	-	-	-	1.3	0.2	0.0	0.2	1.0	1.0
Consumer spending	1.3	3.3	3.1	4.5	3.7	2.0	3.0	3.0	3.0
Government consumption	4.6	6.8	3.2	2.5	12.0	8.0	5.0	4.5	4.6
Investment	-1.3	1.2	6.1	0.0	2.1	1.8	1.0	4.5	5.6
Stockbuilding (% GDP)	0.1	0.4	0.5	-0.9	1.0	4.6	-3.4	-0.6	0.9
Domestic demand	1.0	3.2	3.8	3.2	4.2	2.6	2.8	3.5	3.8
Exports	6.8	1.1	5.5	-0.3	0.0	2.0	2.5	5.0	5.5
Imports	-0.2	5.3	7.8	4.1	6.5	7.0	3.5	7.0	8.0
Industrial production	3.5	1.7	2.7	1.2	1.5	2.0	2.0	2.2	2.5
Unemployment (%)	10.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0
Wage growth	14.0	12.0	11.0	13.0	12.0	12.0	12.0	11.0	11.0
Consumer prices	8.9	7.3	7.6	7.3	6.6	6.1	6.7	7.7	8.2
Current account (USDbn)	-45.9	-28.8	-32.9	-44.0	-40.0	-35.0	-28.8	-30.0	-30.5
Current account (% GDP)	-5.8	-4.1	-4.5	-6.3	-5.7	-5.0	-4.1	-4.1	-4.2
Budget balance (% GDP)	-1.3	-1.6	-1.2	-1.4	-1.5	-1.6	-1.6	-1.5	-1.3
Gross external debt (% GDP)	50.4	51.2	52.5	-	-	-	-	-	-
Gross government debt (% GDP)	33.4	33.1	31.8	-	-	-	-	-	-
TRY/USD*	2.34	2.80	2.80	2.60	2.75	2.85	2.80	2.80	2.80
3-month money (%)*	9.8	10.0	9.5	9.5	9.5	9.8	10.0	9.5	9.5
10-year bond (%)*	8.0	10.5	10.1	8.3	9.6	10.3	10.5	10.5	10.3

Note: *Period end
Source: National sources, HSBC estimates

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Saudi Arabia

Fading boost, mounting shortfall

Simon Williams
Economist
HSBC Bank PLC
+44 20 7718 9563
simon.williams@hsbc.com

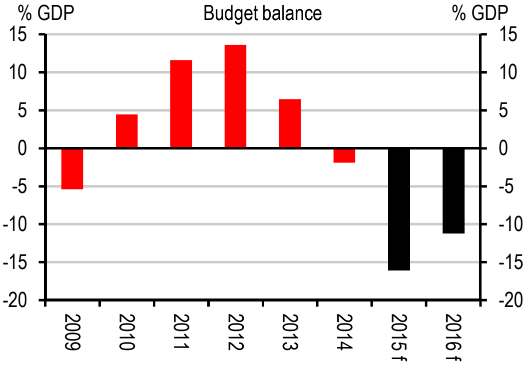
Razan Nasser
Economist
HSBC Bank Middle East
Limited, Dubai
+971 4423 6925
razan.nasser@hsbc.com

Despite weak oil prices and ongoing geopolitical risks, we remain broadly comfortable with the kingdom's near-term economic outlook. Although an oil price in the middle of the USD60-70/b range will leave Saudi Arabia with budget and current account shortfalls in both years of our forecast period, the strength of the country's balance sheet suggests that there is no fiscal or currency crisis looming. Indeed, with debt at less than 5% of GDP and reserves still sufficient to cover more than two years of spending on imported goods and services, Saudi Arabia is well placed to weather a sustained drop in its oil income. Given the kingdom's long history of managing regional turmoil, renewed political unrest – including recent conflict in Yemen – is unlikely to deal a blow to sentiment or domestic stability.

But while the kingdom can weather the storm, recent data has confirmed the heavy toll that falling oil receipts are imposing on the economy. Most obviously, reserve depletion has remained very high with total assets falling by close to USD60bn since oil prices began to weaken in Q4 2014, and by USD45bn over the first four months of 2015. The decline is even more marked than we had expected – a reflection of large spending increases implemented early in the year to mark the accession of the new king. We now expect the budget deficit to reach a record 16% of GDP in 2015, moderating to a still substantial 11% of GDP in 2016 as the impact of this year's one-off spending increases fades. We expect this to prompt the government to begin issuing debt this year for the first time this decade.

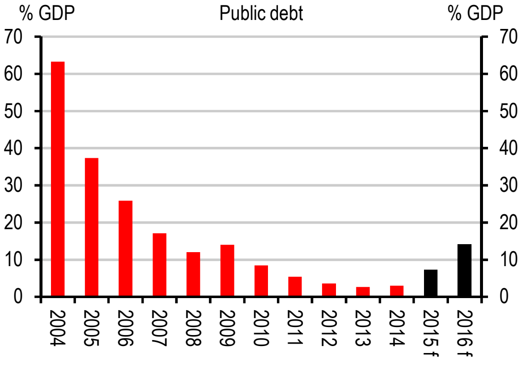
In addition to worsening domestic and external balances, we also see confirmation that lower oil receipts are weighing on economic growth. Indeed, PMI data and other proxy indicators suggest that the boost to domestic demand delivered in Q1 by the one-off spending increases had already started to fade by April and May. Our forecasts point to a further slowdown in growth over the second half of this year and into 2016 as the fiscal stance tightens. Any increase in US rates will draw Saudi rates upward with them, stiffening the headwinds the economy faces.

Additional spending will deepen the budget deficit this year...



Source: SAMA, HSBC forecasts

... although the state's balance sheets appear strong enough to take the strain



Source: SAMA, HSBC forecasts

Policy issues

The marked fall in growth rates triggered by the drop in oil receipts, together with the prospect of low energy prices leading to a prolonged period of fiscal and external account weakness, focuses the policy agenda squarely on the need for structural economic reform.

The challenges the kingdom faces are readily identifiable. For all the talk of diversification, for example, Saudi Arabia remains heavily dependent on oil which still makes up some 40% of GDP, and some 90% of fiscal receipts and export earnings. In addition to the vulnerability to swings in global commodity prices this brings, reliance on oil rent has provided few incentives for innovation and improvements in productivity, which has continued to lag, despite recent heavy investment in the capital stock. Unemployment (particularly youth unemployment) also remains high, despite years of above-trend oil-funded economic growth – a reflection of the rigidities of the local labour market and continued dependence on expatriate workers.

What a solution to those challenges looks like, however, is unclear. There has been some positive action, including the long-awaited opening of Saudi capital markets to foreign investment. There has been verbal support for change on subsidies, too, and the emergence of new leadership under the new king, Salman bin Abdulaziz al Saud, has created some optimism that the reform process may gain speed. As yet, however, no vision of what a new Saudi Arabia might look like has been articulated, and given the political and social difficulty of delivering structural change, doubts about the pace and scope of adjustment abound.

Risks

Our forecasts assume oil will continue to trade in the USD60-70/b range over the coming two years. Although the kingdom has the balance sheet strength to deal with significantly weaker prices, earnings below this level would prompt us to reduce our forecasts for real growth as the budget and current account deficits deepened. A materially higher oil price would have the opposite effect, but would weigh on our hopes for reform which is critical to the kingdom's prospects for long-term prosperity.

% Year	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
GDP	8.4	1.8	7.4	10.0	5.4	2.7	3.6	3.3	2.1
Consumer spending	12.0	7.0	3.8	1.7	11.7	3.2	3.1	5.0	2.5
Government consumption	6.7	1.0	3.2	16.6	8.1	11.1	8.2	6.0	4.5
Investment	15.1	-6.2	14.6	15.6	5.0	5.6	4.5	4.0	3.5
Stockbuilding (% GDP)	4.5	6.0	6.2	4.1	4.0	2.5	2.7	3.4	3.7
Domestic demand	12.9	0.7	38.7	8.1	7.5	4.5	5.5	5.3	3.9
Exports	34.4	-38.7	30.6	45.2	6.5	-3.2	1.0	0.0	0.0
Imports	9.7	-6.3	5.6	5.5	7.7	3.7	4.7	4.0	4.0
Industrial production	4.4	9.0	169.2	12.0	4.9	0.2	6.0	1.0	1.0
Consumer prices	9.9	5.1	5.3	5.0	4.5	3.5	2.7	2.5	2.3
Current account (USDbn)	132.3	21.0	66.8	158.5	164.7	135.4	81.2	-22.4	-3.9
Current account (% GDP)	25.4	4.9	12.7	23.6	22.4	18.2	10.8	-3.3	-0.5
Budget balance (% GDP)	29.8	-5.4	4.4	11.6	13.6	6.5	-1.9	-16.1	-11.2
Gross external debt (% GDP)	18.5	23.0	19.4	14.6	12.5	11.6	12.1	15.8	16.4
Gross government debt (% GDP)	12.1	14.0	8.5	5.4	3.6	2.7	3.0	7.3	14.2
SAR/USD*	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
3-month money (%)*	2.5	0.8	0.8	0.8	1.0	1.0	0.9	1.3	1.3

Note: *Period end
Source: National sources, HSBC estimates

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Nigeria

David Faulkner
Economist
HSBC Securities (South Africa) (Pty) Ltd
+27 11 676 4569
david.faulkner@za.hsbc.com

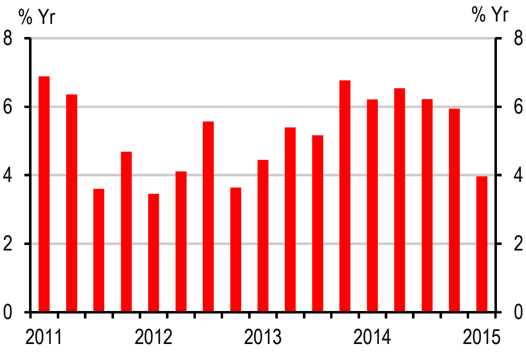
Tough task ahead for Nigeria's new president

The election of Muhammadu Buhari, who took office on 29 May 2015, represents a historic political change. It was the first time an opposition candidate has beaten the incumbent, with the relatively peaceful elections a welcome sign of Nigeria's maturing democracy. President Buhari and his All Progressive Congress (APC) party inherit a number of pressing economic challenges as well as the continuing Boko Haram insurgency in the north. Economic growth slowed to 4.0% at the start of 2015 from 5.9% y-o-y in Q4 2014, as net exports detracted substantially from headline GDP growth. The impact of lower oil prices is evidenced by the marked deceleration in nominal GDP growth, with nominal output in the oil and gas sector almost halving over the past year.

With national and state elections finished, political uncertainty in Nigeria should decline and provide an opportunity for the new government to enhance security, start to address corruption, and implement much needed growth-enhancing structural reforms. Progress in these areas will help lift growth over the medium term; however, in the near term we continue to expect subdued GDP growth, averaging 4.0% for 2015, as lower oil prices result in a negative income shock and weigh on sentiment and demand.

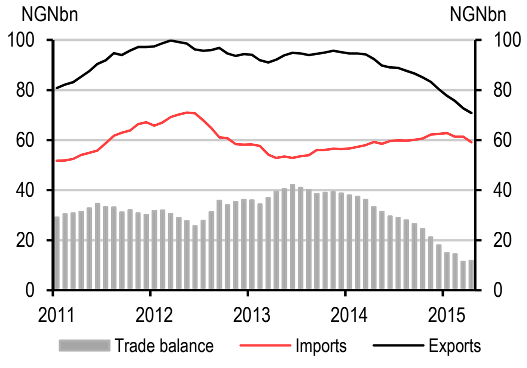
Lower international oil prices and lower oil production volumes are weighing heavily on the country's trade position. Exports fell by almost a third in the first four months of the year, reducing the trade surplus to just USD2.5bn compared with USD8.7bn in the same period last year. A significantly smaller trade surplus is likely to tip the external account into deficit (we forecast a current account deficit of 3.1% of GDP in 2015), keeping pressure on the currency. Although the naira has been stable at NGN199 since early March, this primarily reflects restrictions in the foreign exchange market. Pent-up demand for dollars, suggests that there will need to be a correction at some point and we continue to forecast a devaluation to NGN215 against the USD by the end of the year.

GDP growth slowed sharply at the start of 2015



Source: Nigeria National Bureau of Statistics, HSBC

The trade surplus has declined alongside weaker oil prices



Source: Bloomberg, HSBC

Policy issues

The Central Bank of Nigeria (CBN) left its monetary policy rate unchanged in May but harmonised the cash reserve requirement on private and public deposits at 31%. The CBN's MPC has attributed the stability of the naira to past decisions, including ending the bi-weekly official FX auctions and the array of restrictions implemented in the FX market. Yet the CBN clearly faces a deteriorating macro mix, with the economy slowing, trade surplus shrinking, and inflation rising to 9.0% in May, the top of its 6-9% target range. FX reserves are low and have been depleted further in recent weeks to about USD29bn (5-6 months of merchandise imports). We continue to expect the CBN to tighten policy in H2 2015 in tandem with a further devaluation of the naira.

The country's fiscal situation remains precarious, given the reliance on oil for government revenue. Tax data for Q1 2015 highlights that lower oil prices and weaker growth are weighing on tax revenue with overall federal tax revenues down by almost 30% y-o-y in Q1 2015. We expect the budget deficit to expand to 1.9% of GDP in 2015 from 0.7% in 2014, and continue to believe that structural fiscal reform is imperative to reduce the reliance on oil revenues and support sustainable public finances. Beyond macroeconomic policy, how the new administration approaches the oil and gas sector will be critical.

Risks

The peaceful national elections and transition in power has helped alleviate the political instability and risks that hung over Nigeria ahead of the elections. However, policy uncertainty remains elevated, with little clarity over the make-up of Buhari's cabinet or the direction of fiscal and monetary policy under the new government. Oil prices remain a key determinant of the economy's performance, while the stability of the NGN appears tenuous given restrictions in the FX market and pent-up USD demand. A move lower in the NGN could present additional inflation risks, as could the recent turn in global food prices, potentially prompting the CBN into more aggressive tightening later this year.

% Year	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
GDP	6.0	7.0	8.0	4.9	4.3	5.4	6.3	4.0	5.5
Consumer spending	-34.3	6.4	-26.7	-3.1	0.0	21.1	2.0	5.7	6.2
Government consumption	4.4	-8.1	17.8	4.6	-2.0	-10.3	5.6	5.6	5.9
Investment	-6.8	9.1	-3.6	-8.2	2.6	7.9	13.4	11.5	8.7
Stockbuilding (% GDP)	-	-	-	0.7	0.7	0.8	0.8	0.8	0.8
Domestic demand	-25.5	2.1	-13.8	-3.3	0.4	15.5	4.2	6.7	6.6
Exports	-4.2	4.1	6.7	25.8	-3.6	-21.7	15.6	-6.0	1.7
Imports	10.1	2.3	16.3	-7.8	-32.9	12.2	6.7	5.0	7.5
Industrial production	-1.3	-1.3	4.1	3.5	2.9	2.0	2.4	1.8	2.3
Unemployment (%)	14.9	19.7	21.1	23.9	24.1	24.5	24.2	25.0	24.5
Consumer prices	11.5	12.6	13.8	10.9	12.1	8.0	8.1	9.2	8.8
Current account (USDbn)	24.7	13.8	14.2	11.9	18.9	19.6	3.0	-14.6	-7.2
Current account (% GDP)	14.2	8.3	4.0	3.1	4.2	3.9	0.8	-3.1	-1.5
Budget balance (% GDP)	-0.2	-3.3	-2.0	-1.8	-1.4	-1.4	-0.7	-1.9	-1.3
Gross external debt (% GDP)	11.3	10.3	10.3	13.1	13.7	14.5	16.0	17.8	19.5
Gross government debt (% GDP)	11.7	15.4	9.7	10.3	10.6	10.6	10.9	12.5	13.7
NGN/USD*	183.5	215.0	215.0	205.0	156.2	160.3	183.5	215.0	215.0
3-month money (%)*	16.7	15.3	11.8	11.8	13.8	11.8	15.2	15.0	14.0

Source: Nigeria National Bureau of Statistics, Central Bank of Nigeria, HSBC forecasts

CEEMEA

South Africa

Growth gloom, but rate hikes loom

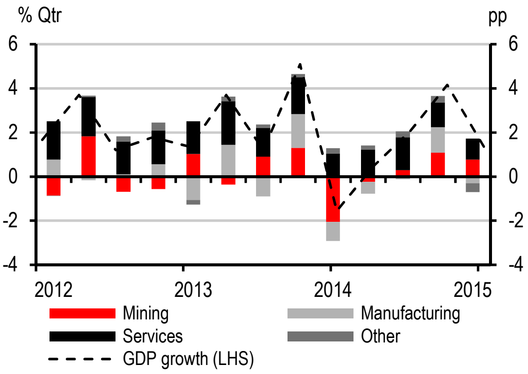
David Faulkner
Economist
HSBC Securities (South Africa) (Pty) Ltd
+27 11 676 4569
david.faulkner@za.hsbc.com

South Africa's energy crisis is weighing heavily on the country's near-term economic outlook. High levels of unplanned losses and rising planned maintenance have undermined energy availability and resulted in repeated electricity load-shedding – scheduled power outages and rationing. This is a major constraint on growth prospects with the economy expanding at an annualised pace of just 1.3% in the first quarter of 2015. Activity levels remain soft in the second quarter, as evidenced by weak PMI readings, falling vehicle sales, and contracting mining and manufacturing output. Meanwhile business and consumer confidence, which were already at low levels, are waning and dampening the prospects for strengthening consumer spending and fixed capital formation. There is little to cheer, and we expect the country's energy constraints to cap GDP growth at 1.7% in 2015 and 1.9% in 2016.

After enjoying a fleeting period of disinflation as crude oil prices collapsed, price pressures are on the rise and there are a myriad of upside risks to the inflation outlook. CPI inflation was 4.6% y-o-y in May, near the mid-point of the SARB's 3-6% target range, yet local fuel prices, food inflation, elevated wage settlements, and a weaker ZAR are likely to exert upward pressure in the coming months. The most imminent inflation risk relates to the energy regulator's decision about electricity tariffs, which will take place at the end of June. Eskom, the state-owned energy company, applied for a 25.3% tariff increase in May, almost double the 12.7% rise already granted. Inflation expectations measured by breakeven rates have risen sharply, and we now expect CPI to average 5.0% y-o-y this year and 6.7% in 2016, peaking at 7.7% in the first quarter of 2016.

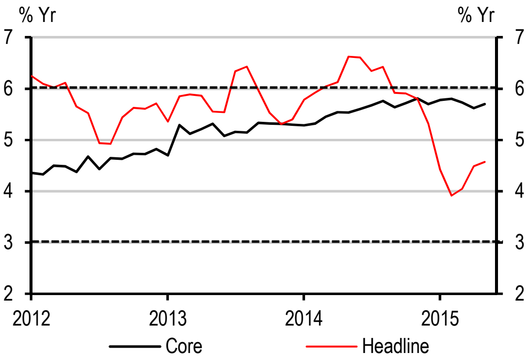
The sharp fall in crude oil imports has helped contain the size of the trade deficit and should support a narrowing in the country's current account shortfall during 2015. However, despite our forecast for the external deficit to improve to 4.7% of GDP in 2015, it remains large when compared with the deficit for other emerging market peers.

GDP growth slowed sharply at the start of 2015 as manufacturing and agriculture contracted



Source: Statistics South Africa, HSBC

Headline inflation has picked up in recent months and core inflation remains high



Source: Statistics South Africa, HSBC

Policy issues

Despite the sluggish growth environment, inflation risks are increasing and the SARB is sounding hawkish. Core inflation remains elevated at 5.7% y-o-y, highlighting the broad-based nature of underlying inflation, while the energy regulator's decision on electricity tariffs will be critical for the inflation trajectory and could prompt a significant and sustained breach of the inflation target range. The policy rate was left unchanged at 5.75% following the May MPC meeting; however, two of the six MPC members voted for a 25bp hike. We expect the SARB to raise rates by 25bp in Q3 2015, most likely at the next MPC meeting in July, to help manage and anchor inflation expectations.

Strong tax revenue collections at the end of the fiscal year helped deliver a smaller-than-forecast budget deficit of 3.5% of GDP for 2014/15. Over the next two years the government aims to consolidate the deficit and stabilise debt levels through slower spending growth and higher taxes on personal income and fuel. The improvements in fiscal policy have helped ease some of the ratings agencies' concerns over fiscal sustainability with Fitch (BBB negative) and S&P (BBB- stable) leaving their ratings and outlooks unchanged in June. However, there are still risks. Weak growth, higher debt service costs and the fiscal risks attached to several state-owned enterprises are evident in government's rising contingent liabilities. Meanwhile, the public sector wage deal signed in May has come at a substantial cost, with government estimating that the wage deal will cost an additional ZAR66bn over the next three years. Higher inflation and rising public employment could add even more to the cost of the wage settlement.

Risks

A more intensive period of load-shedding remains the greatest risk to the economic outlook and growth prospects in 2015 and 2016 through the damaging impact this would have on economy-wide output and confidence. Current wage negotiations in the gold and coal industries could result in industrial action later this year with a deleterious effect on mining output and exports, while the large external deficit is likely to remain a key vulnerability, particularly given the short-term nature of financing flows.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	1.5	1.7	1.9	2.1	1.8	2.0	1.1	1.5	1.8
GDP (% quarter)	-	-	-	0.3	0.2	0.3	0.4	0.5	0.5
Consumer spending	1.4	1.8	1.7	1.7	1.9	1.8	1.7	1.6	1.5
Government consumption	1.9	1.5	1.1	0.6	2.1	2.0	1.5	1.4	1.2
Investment	-0.4	1.1	2.4	-0.2	1.3	1.7	1.8	2.0	2.2
Stockbuilding (% GDP)	0.0	-0.0	0.0	-0.2	1.4	0.8	-2.0	-0.2	1.0
Domestic demand	1.1	1.6	1.7	1.4	1.5	1.6	1.8	1.6	1.2
Exports	2.6	3.8	3.4	5.7	3.4	3.2	2.9	2.8	3.4
Imports	-0.5	3.6	2.7	5.0	2.2	2.0	5.3	3.3	1.3
Industrial production	0.1	-0.1	1.2	0.5	-1.2	1.4	-0.7	0.8	1.3
Unemployment (%)	25.1	25.7	25.7	26.4	25.7	25.4	25.3	26.2	25.8
Wage growth	6.7	8.0	8.0	7.8	7.9	8.0	8.2	8.2	8.0
Consumer prices	6.1	5.0	6.7	4.1	4.6	5.3	5.9	7.3	6.5
Current account (USDbn)	-19.0	-15.1	-17.1	-15.5	-15.2	-14.8	-15.0	-15.6	-16.5
Current account (% GDP)	-5.4	-4.7	-5.0	-4.8	-4.7	-4.5	-4.6	-4.7	-4.9
Budget balance (% GDP)	-3.5	-3.5	-2.9	-3.9	-3.6	-3.5	-3.5	-3.4	-3.2
Gross external debt (% GDP)	43.0	44.3	46.3	-	-	-	-	-	-
Gross government debt (% GDP)	45.8	47.2	47.4	-	-	-	-	-	-
ZAR/USD*	11.55	12.80	12.80	12.14	12.35	12.50	12.80	12.80	12.80
3-month money (%)*	5.9	6.6	7.3	6.1	6.1	6.4	6.7	6.9	7.1
10-year bond (%)*	7.7	8.9	9.0	7.9	8.4	8.6	8.9	9.1	9.0

Note: *Period end
Source: CEIC, Bloomberg, HSBC estimates

Latin America

Brazil

Downgrading our growth forecasts

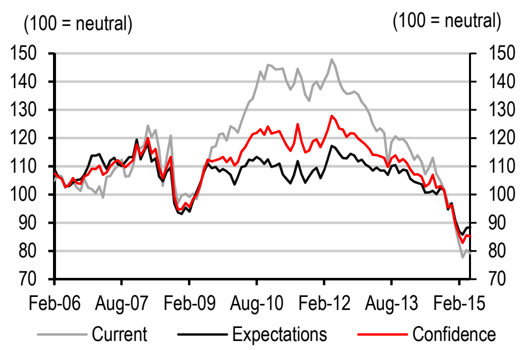
Constantin Jancsó
Economist
HSBC Bank Brasil S.A.
+55(11)3371-8183
constantin.c.jancso@hsbc.com.br

The recession gained momentum during the second quarter, and in light of different leading and coincident indicators in recent months, we are lowering our forecast for GDP growth in 2015 from -1.2% to -1.6%. We now forecast household consumption to contract by 1% on the back of rising unemployment, weak confidence, tighter credit conditions and the erosion of disposable income. We forecast that the investment component of GDP will contract by 7.5%, reflecting the combined effects of a number of factors: the adjustment in residential and commercial construction; the impact on heavy construction of the 'Operation Car Wash" investigations (into corruption allegations involving Petrobras, construction companies and political parties); and the impact of economic weakness on fixed asset investment decisions by firms as well as efforts by firms to cut inventories. Assuming also that government consumption will contract by just over 1.6% (which is consistent with the ongoing fiscal adjustment), these forecasts imply a large, 2.3% contraction in domestic demand.

These forecasts also take into account the central bank adopting a more hawkish posture than we had expected previously (see below in Policy Issues). Although we think export quantities will decline modestly in 2015, we forecast that net exports will make a positive contribution to headline GDP due to falling imports, reflecting weak domestic demand and BRL depreciation, which will also be reflected in the contraction in domestic demand. We have cut our forecast for 2016 growth, from 2.3% to 1.0%, mainly due to the weaker outlook for consumption and investment.

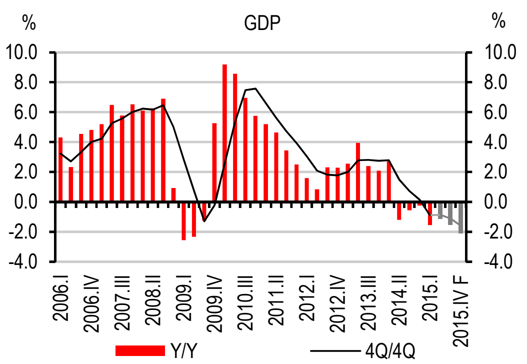
We are also revising our forecasts for 2015 inflation, from 7.8% to 8.5% y-o-y. Mostly, this revision reflects changes in our assumptions for regulated prices – especially gasoline prices. At the time of writing, domestic gasoline prices were about 15% below international prices, and we expect the government to reduce this gap relatively soon.

Consumer confidence plummets on recession concern



Source: FGV and HSBC

Recession in 2015



Source: IBGE and HSBC

Policy issues

Despite evidence that the economy is slowing down considerably, the central bank has maintained a more hawkish discourse and posture, in part because inflation was stickier than expected at the beginning of 2015. As a result, we are pencilling an additional interest rate hike of 25bps in the current tightening cycle, and now expect the central bank to raise the Selic policy rate by 25bps to 14.00% at the July monetary policy committee meeting. We still expect the central bank to begin the easing monetary policy relatively soon, but with the recent change to HSBC's view on the timing of the beginning of the tightening cycle by the US Federal Reserve to the end of 2015, we believe Brazil's policymakers will be more inclined to wait until Q1 2016 before starting to ease policy. As a result, we now forecast a Selic policy rate of 14.00% for year-end 2015. Our forecast for the year-end policy rate in 2016 remains unchanged at 11%.

Risks

A key risk, in our view, is that economic weakness affects fiscal revenues to the point that the government is unable to deliver a meaningful improvement in the fiscal accounts. Although our base-case scenario is that Brazil is able to retain its investment-grade sovereign credit rating, the difficulties in implementing fiscal austerity during the recession and the political fallout this may cause for the administration could mean that investor concern about the risks of the loss of investment grade will persist well into 2016, weighing on asset prices and confidence, even if the government implements additional measures to support the fiscal effort.

Political risk also remains an important issue in Brazil, as the government's persistent difficulties coordinating its coalition in Congress add to uncertainties about its ability to deliver the fiscal adjustment and even about the risks that Congress passes legislation that causes deterioration in the country's fiscal position.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	0.1	-1.6	1.0	-1.6	-1.1	-1.5	-2.1	-1.0	0.3
GDP (% quarter)	-	-	-	-0.2	-1.4	-0.2	-0.3	1.0	-0.1
Consumer spending	0.9	-1.0	0.0	-0.9	-0.4	-0.7	-1.8	-0.3	-0.1
Government consumption	1.3	-1.6	0.0	-1.5	-1.4	-2.1	-1.2	0.0	0.0
Investment	-4.4	-7.5	3.2	-7.8	-5.0	-8.0	-9.0	-6.0	0.0
Domestic demand	0.0	-2.3	0.6	-2.4	-1.5	-2.4	-2.9	-1.4	-0.1
Exports	-1.1	2.1	2.0	3.2	-0.3	0.8	5.3	0.5	1.5
Imports	-1.0	-3.9	-1.3	-4.7	-3.0	-6.0	-2.0	-3.1	-1.6
Industrial production	-3.2	-5.0	4.0	-5.9	-5.8	-5.1	-3.0	2.5	3.5
Unemployment (%)	4.8	6.8	7.5	5.0	5.6	6.2	6.8	7.2	7.4
Wage growth	9.0	6.5	6.1	7.3	6.4	6.4	6.0	6.1	6.1
Consumer prices (avg)	6.3	8.5	6.1	7.7	8.5	9.1	8.7	7.3	6.0
Current account (USDbn)	-104.8	-75.2	-59.6	-102.5	-94.4	-86.4	-75.2	-72.0	-68.5
Current account (% GDP)	-4.5	-3.9	-3.1	-4.6	-4.4	-4.3	-3.9	-3.8	-3.6
Budget balance (% GDP)	-6.2	-6.1	-5.0	-6.0	-5.7	-5.3	-5.0	-4.8	-4.5
Gross external debt (% GDP)	14.9	18.8	19.4	-	-	-	-	-	-
Gross government debt (% GDP)	58.9	61.6	61.8	-	-	-	-	-	-
BRL/USD*	2.65	3.20	3.30	3.20	3.10	3.15	3.20	3.25	3.30
3-month money (%)*	12.2	14.0	11.0	13.0	13.8	14.0	14.0	13.0	12.0
10-year bond (%)*	12.0	12.0	11.5	13.1	12.5	12.3	12.0	11.9	11.8

Note: *Period end
Source: IBGE, Central Bank of Brazil and HSBC

Latin America

Mexico

Rise in consumption will compensate lower investment

Lorena Dominguez
Senior economist
HSBC México, S.A
+52 55 5721 2172
lorena.dominguez@hsbc.com.mx

The Mexican economy slowed in Q1 2015, as GDP grew 0.4% in seasonally adjusted terms, but we expect a moderate pick-up in Q2 2015. We maintain our GDP growth estimate of 2.7% for 2015, but we have lowered our 2016 growth forecast to 2.8% from 3.2%, as expected government spending cuts may weigh on investment.

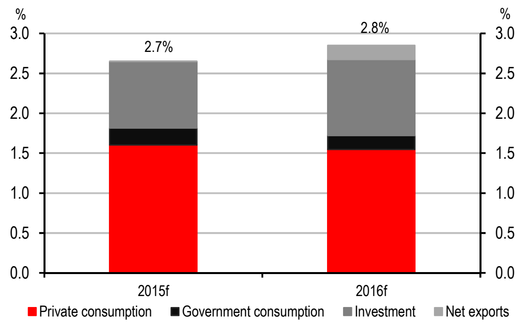
On the external front, the disruptive weather in the US combined with the reduction in that country's net exports had a negative impact on some Mexican manufactured products during Q1 2015. However, automotive exports maintained their dynamism as demand from the US continues to grow at a good pace. Thus, given that some of the factors that weighed on export dynamics in Q1 2015 were temporary and have faded, we expect a pick-up in Q2 2015, as suggested by some leading indicators.

On the domestic side, private consumption has surprised to the upside, growing 3.2% in Q1 2015, and some consumption-related leading indicators suggest that growth remains strong in Q2 2015. We have increased our expectation for private consumption growth to 3.1% this year, from 2.7%, and it will make a larger contribution to GDP (consumption is 65% of Mexican GDP). In contrast, we have reduced our estimate for investment growth to 5.0% from 6.0%, mainly due to the slowdown in residential construction.

We have fine-tuned our 2015 year-end inflation forecast to 2.9% from 3.1%, mainly due to the government's higher-than-expected reductions in electricity tariffs, which have exacerbated inflation's downward trend. In addition, the pass-through from MXN depreciation to inflation has been low so far.

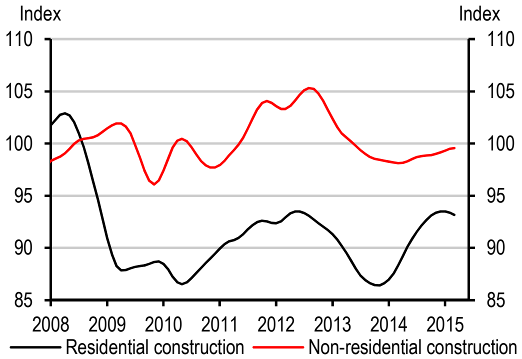
The results of June's elections indicate that the PRI ruling party will maintain its congressional majority. This may facilitate approval of the 2016 fiscal budget, which could be more complicated in light of the expected spending cuts.

Contribution to GDP growth by component



Source: HSBC with data from INEGI

Construction: pace of recovery has moderated



Source: INEGI

Policy issues

Based on our revised view that the Fed won't raise interest rates until December, we now believe that Banxico will also wait until December; we had previously expected September. In our view, with inflation below the central bank's target and a negative output gap, Mexican monetary authorities have room to hold off rates changes.

We believe that the government may face another challenging year in fiscal terms due to low oil prices and oil production levels, which we expect to result in further spending cuts in 2016. In the preliminary version of the fiscal budget sent to Congress in April, the government anticipated spending cuts of MXN135bn in 2016, in addition to the MXN124bn cuts this year. The Ministry of Finance is also considering a zero-base budget to improve the quality of spending by identifying programmes that do not work. In our view, this may be a good measure, but hard to implement.

Risks

Some upside risks for growth are related to a continuation of strong growth in consumption as well as some benefits from structural reforms. In addition, higher-than-expected growth in US exports may increase the demand for Mexican manufactured goods.

There are also downside risks. The moderation in residential construction may impact on investment, while a further decline in oil production represents a downside risk for industrial production. Finally, weaker demand of some manufactured goods from the US may continue to hurt Mexican exports.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	2.1	2.7	2.8	2.5	2.8	2.7	2.8	2.4	2.9
GDP (% quarter)	-	-	-	0.4	0.7	0.5	0.7	0.4	0.7
Consumer spending	2.0	3.1	3.1	3.2	3.3	2.9	2.7	2.9	2.9
Government consumption	2.5	2.5	2.2	3.2	2.9	2.2	2.0	2.2	2.1
Investment	2.2	5.0	5.7	5.3	6.1	4.1	4.3	5.4	5.7
Stockbuilding (% GDP)	-1.2	-1.9	-3.0	-	-	-	-	-	-
Domestic demand	2.5	3.5	3.6	-	-	-	-	-	-
Exports	4.6	1.3	2.9	-0.4	-0.7	2.9	3.1	2.9	2.9
Imports	4.9	1.4	3.4	0.6	0.6	2.1	2.3	3.4	3.4
Industrial production	1.8	2.2	2.6	1.4	1.9	2.4	3.2	1.4	3.0
Unemployment (%)	3.8	3.5	3.2	3.9	4.7	4.9	3.5	3.7	4.6
Wage growth	4.4	4.0	4.0	-	-	-	-	-	-
Consumer prices	4.0	2.9	3.6	3.1	2.9	2.8	3.0	3.5	3.7
Current account (USDbn)	-26.5	-28.2	-29.5	-9.4	-5.4	-6.7	-6.6	-7.4	-5.8
Current account (% GDP)	-2.1	-2.3	-2.3	-3.2	-1.8	-2.2	-2.1	-2.4	-1.8
Budget balance (% GDP)	-3.2	-3.5	-3.0	-0.6	-1.0	-1.0	-0.8	-0.6	-0.7
Gross external debt (% GDP)	34.2	37.0	37.5	-	-	-	-	-	-
Gross government debt (% GDP)	43.2	43.3	43.1	-	-	-	-	-	-
MXN/USD*	14.75	15.20	15.20	15.27	15.00	15.10	15.20	15.20	15.20
3-month money (%)*	3.0	3.2	4.0	3.0	3.0	3.0	3.2	3.5	3.7
10-year bond (%)*	5.8	6.6	7.2	5.9	6.4	6.5	6.6	6.7	6.9

Note: *Period end
Source: INEGI, Banxico, Ministry of Finance, HSBC estimates

HSBC

Latin America

Argentina

Gradualism as the base case scenario

Javier Finkman
Economist
HSBC Bank Argentina S.A
+54 11 4344 8144
javier.finkman@hsbc.com.ar

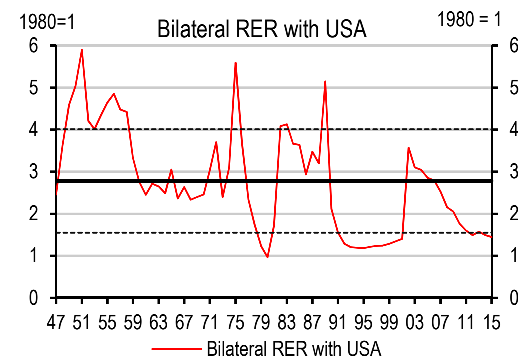
Jorge Morgenstern
Economist
HSBC Bank Argentina S.A
+54 11 4130 9229
jorge.morgenstern@hsbc.com.ar

As we expected, with the approaching primaries (9 August 2015) and the presidential election (25 October) the authorities are not addressing the macro imbalances related to tariffs and the exchange rate. Although falling, inflation is still high at 26%, helped by the anchoring of regulated prices and FX. The Argentine peso is depreciating at half the pace of inflation and therefore continues to appreciate in real terms. Output stopped falling due to an exceptional harvest, while lower inflation also helped consumption. The fiscal deficit is widening and will surpass 4% of GDP – excluding intra-public sector funding – by mid-year.

In order to postpone adjustment, the authorities have turned to non-traditional sources of funding to replenish central bank reserves. Maintaining reserves has stabilised FX expectations and contained the gap between parallel market rates and the official exchange rate. However, postponing adjustments will pass on the burden and take a toll on 2016 GDP growth that we are now forecasting at 1.2%, a cut from 3.0%.

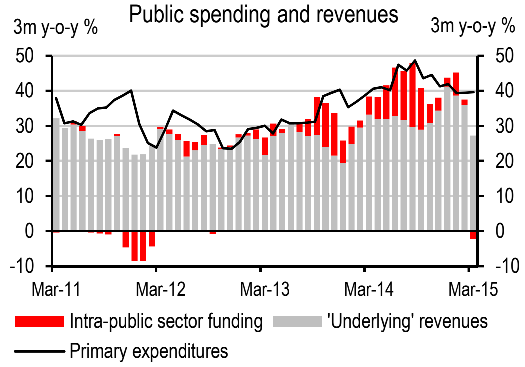
Among the economists advising frontrunner presidential candidates, Governor Scioli and Mayor Macri, a gradual correction of imbalances is emerging as the preferred strategy. Our base case scenario for 2016 is built on the premise of gradualism. We are also forecasting a faster depreciation of the currency, a minor fiscal adjustment via a reduction of energy subsidies and a wider current account deficit as import restrictions are eased. In order to finance a larger external gap, we are assuming that the government is able to tap global capital markets. This assumption is supported by our belief that the next administration – whoever wins – will have a more constructive approach towards solving the legal dispute with holdouts. A potential settlement with the holdouts – or even clear steps towards a solution – would allow the government, provinces and companies cheaper access to capital markets. Even so, we do not expect a quick agreement as it will take time to address political and operational issues. A quick resolution would imply upside risk to our base case scenario.

FX corrections usually involved sudden depreciations



Source: OJF, BCRA, HSBC. Black line is historical average, dashed lines +/- 1 std dev

Fiscal spending running high despite lower revenue growth



Source: Ministry of Finance

Policy issues

Fiscal policy is in 'election mode' with the primary outlays of the national administration growing at 40% y-o-y versus a 30% expansion of revenues in Q1 2015. We expect the same policy tone for the remainder of the year. As we have discussed, fiscal moderation would then start next year.

Monetary authorities are targeting exchange rate stability with the help of non-traditional reserves funding. This includes an FX swap with the People's Bank of China, bilateral loans and even coupons unpaid due to legal constraints that are accounted as gross reserves. FX targeting has occasionally limited the ability of the monetary authority to reduce interest rates which are an instrument needed to anchor money demand against expectations of currency depreciation – a policy reinforced by the central bank (BCRA) selling cheaper onshore NDF. The central bank is also being less aggressive in sterilising excess money issued to finance the fiscal deficit and is in this respect is being partly substituted by the Treasury, which is now issuing local debt at 12- to 18-months maturity.

Risks

Gradualism is not the historical norm in Argentina. Sizable currency misalignments – like the current one – have been corrected through sudden depreciation. Fiscal consolidation has mostly involved default on external creditors or inflating away excess public spending. Even so, there are good reasons to assign a significant probability to a gradual adjustment. First, there are little currency mismatches in both public and private sector balance sheets. Second, indebtedness within the private sector is low by historic standards, allowing for the possibility that private money will smooth the transition.

External risks to our base case scenario are related to lower commodity prices, a protracted recession in Brazil and eventually higher interest rates. Internal risks are essentially policy uncertainty – and associated defensive behaviour – and Argentina's volatile history in which gradualism has not been the norm.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	-1.7	0.0	1.2	-1.1	0.9	0.1	0.0	0.4	1.1
GDP (% quarter)	-	-	-	2.0	-0.2	-4.0	3.0	1.7	-0.5
Consumer spending	-0.5	0.3	2.3	-1.3	0.0	1.0	1.5	2.0	2.0
Government consumption	2.8	4.1	1.2	3.5	4.0	5.0	4.0	2.0	2.0
Investment	-5.6	-4.0	4.8	-5.0	-3.0	-3.0	-5.0	3.0	6.0
Stockbuilding (% GDP)	-1.0	-0.3	-0.1	-0.8	-0.8	-0.1	-0.3	-0.3	-0.3
Domestic demand	-1.3	0.5	2.8	-0.8	-0.4	3.4	-0.2	2.3	2.6
Exports	-10.1	-13.6	3.3	-13.5	-12.1	-16.4	-11.6	-5.6	-2.4
Imports	-11.5	-5.7	15.4	-15.9	-13.9	10.4	-3.0	19.9	18.1
Industrial production	-2.5	-0.4	3.0	-2.1	0.6	-0.3	-0.5	-0.1	0.8
Unemployment (%)	6.9	7.8	7.9	8.4	8.7	8.4	7.7	9.1	9.3
Wage growth	31.5	29.2	31.4	29.7	29.9	30.7	29.4	28.4	28.3
Consumer prices	38.6	29.2	28.9	32.2	29.4	28.2	27.6	28.0	28.6
Current account (USDbn)	-8.7	-16.4	-25.8	-5.5	0.0	-6.9	-4.1	-8.4	-2.8
Current account (% GDP)	-1.7	-2.6	-4.0	-1.0	0.0	-1.2	-0.7	-1.4	-0.5
Budget balance (% GDP)	-2.4	-4.2	-2.9	-1.2	-1.1	-0.9	-1.4	-0.9	-0.7
Gross external debt (% GDP)	30.1	24.8	26.7	-	-	-	-	-	-
Gross government debt (% GDP)	41.2	32.7	32.3	-	-	-	-	-	-
ARS/USD*	8.46	10.50	12.50	8.82	9.50	10.00	10.50	11.00	11.50
1-month deposit rate (%)**	20.0	22.0	22.0	20.5	21.0	21.5	22.0	22.0	22.0

Note: *Period end, ** Wholesale, private banks, average of the last month of the period
Source: INDEC, BCRA, Ministry of Finance and HSBC estimates, an average of private estimates were used for consumer prices from 2007 onwards

Latin America

Colombia

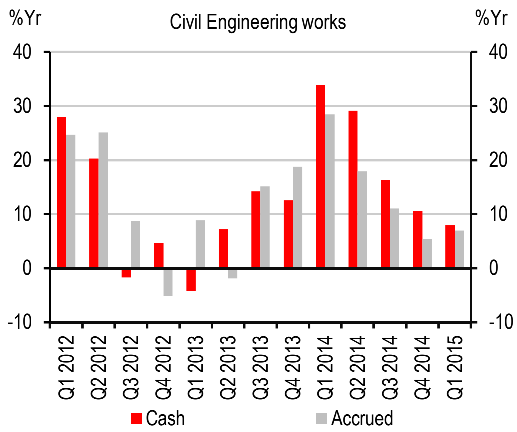
Reality bites

Ramiro Blazquez
Economist
HSBC Bank Argentina S.A.
+54 11 4348 2616
ramiro.blazquez@hsbc.com.ar

In the last few months, growth expectations have continued to converge to our expectations for 2015, with the median forecast of the Bloomberg survey now matching our own projection of 3.3%. In addition, the central bank (BanRep) has also trimmed its growth forecast from 3.6% to 3.2%. In the supply-side Q1 2015 GDP results, real GDP came in at 2.8% y-o-y, slightly below our latest forecast and also slower than in Q4 2014 (3.5% y-o-y). Some factors were a drag on growth in the first quarter, namely a decrease in mining activity due to lower coal exports as mining companies reduced inventories and also because of the impact on industrial production of the closure of the Cartagena refinery. This being said, we maintain our 3.3% forecast for 2015 as a whole. We expect activity to pick up in the remainder of the year as the government has announced that it would implement a new fiscal stimulus, similar to the one used in 2013. However, we expect only a moderate impact as the room for applying expansionary policies remains limited, and the fiscal plan is likely to focus mostly on optimising government expenditure.

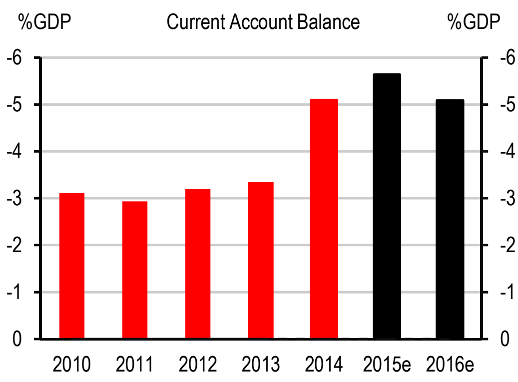
On the fiscal side, the fiscal rule states that the central government's structural deficit cannot exceed 2.2% of GDP in 2015. The authorities have calculated that the cyclical deficit should not stand above 3% of GDP to comply, only 0.2pp of GDP higher than the previous calculation that was presented at the start of the year. On the monetary policy side, we continue to see headline inflation ending 2015 near the upper bound of the 2-4% inflation band targeted by BanRep. True, this year's spike in inflation has been driven mostly by the COP weakening after the oil shock and by faster food inflation due to supply disruptions. Even so, the central bank is likely to remain on hold for the remainder of the year to keep CPI expectations within the targeted range. With growth faltering early in 2016 as the regions slow their spending following the elections in H2 2015 and inflation subsiding, we believe BanRep could ease monetary conditions slightly.

Civil engineering works



Source: DANE

Current account balance



Source: DANE, HSBC forecasts

Policy issues

The government is currently struggling to find an alternative funding source for the ‘4G’ road and highways programme, after the privatisation of the power company ISAGEN was put on hold by the local magistrates. It is unclear how this fundraising will evolve, but given the amount involved (COP5bn or USD2bn), the government could eventually explore ways it could resort to additional multilateral credit to fund the infrastructure projects. Also, fiscal accounts remain under the spotlight. The Finance Minister recently calculated a fiscal gap of around 1.2pp of GDP in 2016, which could compromise the government’s ability to attain its fiscal targets next year. The authorities expect to bridge the gap by narrowing tax loopholes and also by increasing tax collection efficiency. We think that these efforts will not suffice on their own and that raising tax pressure on individuals through tax reform is very likely to come about, despite the cost to the Santos administration’s popularity.

Risks

Despite the weaker COP, we continue to see a current account deficit of 6% of GDP in 2015 due to the surprisingly strong performance of imports in 1Q that compensates some slight increase in the average expected oil price for the year. Financing such a relatively large CAD always creates vulnerability. At barely above 10% of GDP the stock of international reserves is not that high, particularly if market sentiment were to deteriorate sharply. Also, it is unclear how the infrastructure drive will be funded, which is another reason for uncertainty and creates a downside risk to our 3% forecast in 2016. However, we do not expect this uncertainty to last for long, and that Colombia will succeed in securing the financing for its infrastructure projects, as raising the amounts involved should not be an unsurmountable problem. The authorities have repeatedly strengthened their commitment to upholding the fiscal rule, but while we believe that it is unlikely that the Santos administration will decide to relax fiscal discipline, we cannot rule out this completely.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	4.6	3.3	3.0	2.8	3.2	3.5	3.7	3.2	3.0
GDP (% quarter)	-	-	-	0.8	0.7	1.4	0.8	0.3	0.5
Consumer spending	4.4	3.4	2.8	3.9	3.0	3.2	3.5	2.8	2.7
Government consumption	6.2	1.3	-1.0	2.3	1.0	1.0	1.0	-0.5	-1.0
Investment	10.9	3.6	4.0	6.0	1.0	3.0	4.5	3.5	3.3
Stockbuilding (% GDP)	0.2	0.3	0.4	0.5	0.7	0.0	0.3	0.0	0.6
Domestic demand	6.3	3.4	3.1	4.2	2.4	2.9	3.6	2.8	3.0
Exports	-5.4	-14.6	12.4	-35.4	-25.2	-13.2	2.2	7.5	10.8
Imports	8.0	-0.1	4.0	-3.0	-3.9	-4.5	-5.0	2.1	3.5
Industrial production	1.5	2.5	4.0	-1.4	2.2	3.2	5.0	5.0	4.5
Unemployment (%)	8.7	8.5	8.5	9.9	9.1	9.3	9.0	9.5	9.3
Wage growth	2.6	4.0	4.0	4.0	4.0	4.0	4.0	3.3	3.0
Consumer prices	2.9	4.3	3.4	4.2	4.7	4.3	4.0	3.6	3.1
Current account (USDbn)	-19.2	-18.4	-16.1	-5.3	-5.8	-3.2	-3.8	-4.0	-3.5
Current account (% GDP)	-5.1	-6.0	-5.5	-7.2	-7.7	-4.3	-4.7	-5.8	-4.8
Budget balance (% GDP)	-1.2	-2.1	-2.4	-2.5	-3.0	-1.8	-1.0	-3.0	-2.2
Gross external debt (% GDP)	26.7	35.0	37.7	-	-	-	-	-	-
Gross government debt (% GDP)	40.8	45.4	47.2	-	-	-	-	-	-
COP/USD*	2377	2800	3000	2599	2700	2750	2800	2850	2900
3-month money (%)*	3.25	4.50	4.00	4.50	4.50	4.50	4.50	4.25	4.00

Note: *Period end
Source: National sources, HSBC estimates

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Latin America

Chile

Not moving forward

Jorge Morgenstern
Economist
HSBC Bank Argentina, S.A
+54 11 4130-9229
jorge.morgenstern@hsbc.com.ar

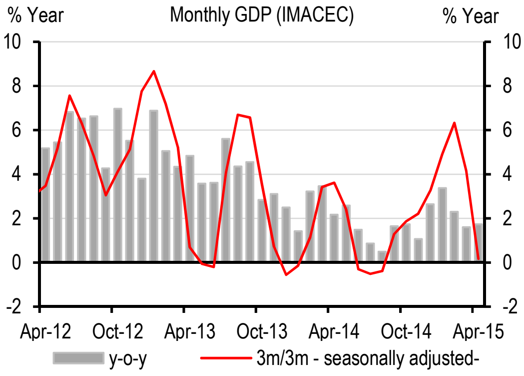
The recovery of the Chilean economy following the 2014 slowdown is proving to be a feeble one. We are not surprised, as we have held our below consensus forecast of 2.5% GDP growth in 2015 for some time. New, previously unexpected headwinds this year further support our downbeat expectations for 2016, when we see economic activity accelerating but only expanding 3.0%.

Exogenous factors are playing a negative role. The global economic outlook is less attractive, as shown by HSBC's downward revisions to GDP growth in China and the US. Also, several strikes and natural phenomena have disrupted economic activity so far this year.

Domestically, consumer and business sentiment remain in pessimist territory, responding to issues beyond economics. A sequence of corruption cases related to politics and business- related wrongdoings have been occupying the Chilean media for months now. Polls show that the popular attitude towards political institutions is at record low levels (since the restoration of democracy). In addition, the reform agenda of the Bachelet administration is negatively impacting sentiment, in our view, with labour and constitutional reform causing most concern at the moment, following tax reform last year.

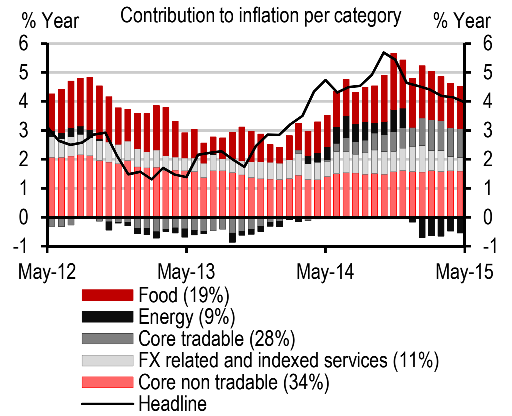
Inflation has returned to the upper bound of the central bank's target range, at 4%, after more than a year above target. We now expect inflation to end 2015 at 3.6% instead of 3.9%, with a slower convergence towards the centre of the target in 2016. The impact of FX depreciation on inflation is fading and HSBC's forecast path for the CLP-USD is also lower now. Meanwhile, measures of core non-tradable inflation are not moderating, contrary to our expectations, despite the slowdown of economic activity. Wages have only decelerated slightly, with labour demand and job creation well supported by the public sector.

The recovery has lost momentum



Source: BCCh

As the FX impact fades, core non-tradable inflation lingers



Source: INE

Policy issues

The scope for further monetary policy stimulus is limited as policymakers are coming to grips with the fact that potential growth of the economy may now be lower than expected – we estimate it to be somewhat below 4.0%. With inflation concerns beginning to ease, we believe the central bank's next move will be to raise the policy rate, but not until mid-2016.

Finance Minister Valdes warned that it will not be possible to sustain this year's expansionary fiscal stance (a budgeted increase in real spending of almost 10%) in 2016. The structural deficit measure – which would acknowledge that lower revenues in 2015 are the result of temporary low GDP growth and copper prices – will be close to 1% of GDP. The government still targets a return to structural equilibrium in 2018. We see a risk that it may have to give up this ambition, which would imply having to consolidate fiscal policy in a low growth environment.

Risks

Risks to the global outlook are always relevant due to the openness of the economy. Chile recently resorted to expansionary fiscal and monetary policy and a depreciation of the currency to absorb shocks to commodity prices. At this moment, there would be less policy flexibility for confronting a deterioration of the external environment should it arise.

Negative sentiment, if not reversed, may continue to hinder the recovery. We expect to see investment improving in H2 2015, and consumption also accelerating later in the year. However, further negative developments in the political arena or an increase in uncertainty related to the Constitutional Reform may have a negative impact on economic activity.

% Year	2014	2015f	2016f	Q1 15	Q2 15f	Q3 15f	Q4 15f	Q1 16f	Q2 16f
GDP	1.9	2.5	3.0	2.4	3.2	2.9	1.4	3.4	2.8
GDP (% quarter)	-	-	-	0.8	2.2	-0.5	-1.1	2.9	1.6
Consumer spending	2.2	1.4	1.5	1.6	1.5	1.3	1.3	1.3	1.4
Government consumption	4.4	5.9	2.2	5.6	6.0	6.0	6.0	3.0	2.0
Investment	-6.1	1.1	2.9	-1.7	1.0	2.0	3.0	2.5	2.5
Stockbuilding (% GDP)	-0.6	-0.6	-0.8	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7
Domestic demand	-0.6	3.2	1.5	1.3	3.7	2.5	5.0	0.3	1.7
Exports	-1.0	-1.6	3.6	1.4	3.2	1.4	1.4	1.5	1.8
Imports	-9.0	-1.5	1.2	-2.0	-0.2	-0.7	3.9	-3.9	-1.6
Industrial production	-0.8	1.2	1.5	-0.4	2.4	1.3	1.3	1.3	1.3
Unemployment (%)	6.4	6.5	6.7	6.1	6.6	6.8	6.4	6.3	6.8
Wage growth	7.2	5.6	5.0	7.1	6.7	6.3	5.6	5.4	5.3
Consumer prices	4.4	4.0	3.4	4.4	4.0	3.9	3.7	3.7	3.5
Current account (USDbn)	-3.0	1.5	3.3	1.2	1.3	-0.5	-0.5	1.6	1.8
Current account (% GDP)	-1.2	0.6	1.3	0.5	0.5	-0.2	-0.2	0.6	0.7
Budget balance (% GDP)	-1.6	-2.0	-1.8	-4.8	-0.7	-0.9	-0.6	-3.7	5.1
Gross external debt (% GDP)	57.4	59.2	58.6	-	-	-	-	-	-
Gross government debt (% GDP)	26.7	26.4	26.3	-	-	-	-	-	-
CLP/USD*	607	615	620	625	605	610	615	620	620
3-month money (%)**	3.1	3.1	3.6	3.1	3.1	3.1	3.1	3.1	3.1
10-year bond (%)***	4.6	4.5	5.5	4.6	4.7	4.6	4.5	4.8	5.0

Note: *Period end, ** 3-month swap, period end, *** 10-year swap, period-end
Source: BCCh, INE, Dipres, HSBC estimates

Notes

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Disclosure appendix

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HSBC

Disclaimer

Issuer of report
HSBC Bank plc
8 Canada Square, London
E14 5HQ, United Kingdom
Telephone: +44 20 7991 8888
Fax: +44 20 7992 4880
Website: www.research.hsbc.com

[466776]

Global Economics Research Team

Global

Stephen King
Global Head of Economics
+44 20 7991 6700 stephen.king@hsbcib.com

Karen Ward
Senior Global Economist
+44 20 7991 3692 karen.ward@hsbcib.com

James Pomeroy
+44 20 7991 6714 james.pomeroy@hsbc.com

Europe & United Kingdom

Janet Henry
Chief European Economist
+44 20 7991 6711 janet.henry@hsbcib.com

Fabio Balboni
European Economist
+44 20 7992 0374 fabio.balboni@hsbc.com

Simon Wells
Chief UK Economist
+44 20 7991 6718 simon.wells@hsbcib.com

Elizabeth Martins
Economist
+44 20 7991 2170 liz.martins@hsbc.com

Germany

Stefan Schilbe
+49 211910 3137 stefan.schilbe@hsbc.de

Rainer Sartoris
+49 211910 2470 rainer.sartoris@hsbc.de

France

Mathilde Lemoine
+33 1 4070 3266 mathilde.lemoine@hsbc.fr

Francois Letondu
+33 1 4070 3933 francois.letondu@hsbc.fr

North America

Kevin Logan
Chief US Economist
+1 212 525 3195 kevin.r.logan@us.hsbc.com

Ryan Wang
+1 212 525 3181 ryan.wang@us.hsbc.com

David G Watt
+1 416 868 8130 david.g.watt@hsbc.ca

Asia Pacific

Qu Hongbin
Managing Director, Co-head Asian Economics Research and Chief Economist Greater China
+852 2822 2025 hongbinqu@hsbc.com.hk

Frederic Neumann
Managing Director, Co-head Asian Economics Research
+852 2822 4556 fredericneumann@hsbc.com.hk

Paul Bloxham
Chief Economist, Australia and New Zealand
+612 9255 2635 paulbloxham@hsbc.com.au

Pranjul Bhandari
Chief Economist, India
+91 22 2268 1841 pranjul.bhandari@hsbc.co.in

Izumi Devalier
+852 2822 1647 izumidevalier@hsbc.com.hk

Su Sian Lim
+65 6658 8783 susianlim@hsbc.com.sg

Sophia Ma
+86 10 5999 8232 xiaopingma@hsbc.com.cn

Trinh Nguyen
+852 2996 6975 trinhdnguyen@hsbc.com.hk

John Zhu
+852 2996 6621 john.zhu@hsbc.com.hk

Joseph Incalcaterra
+852 2822 4687 joseph.f.incalcaterra@hsbc.com.hk

Julia Wang
+852 3604 3663 juliarwang@hsbc.com.hk

Nalin Chutchotitham
+662 614 4887 nalin.chutchotitham@hsbc.co.th

Daniel John Smith
+612 9006 5729 daniel.john.smith@hsbc.com.au

Li Jing
+86 10 5999 8240 jing.econ.li@hsbc.com.cn

Prithviraj Srinivas
+91 22 2268 1076 prithvirajsrinivas@hsbc.co.in

Global Emerging Markets

Murat Ulgen
Global Head of Emerging Markets Research
+44 20 7991 6782 muratulgen@hsbc.com

Bertrand Delgado
Senior EM Strategist
+1 212 525 0745 bertrand.j.delgado@us.hsbc.com

CEEMEA

Simon Williams
Chief Economist, CEEMEA
+44 20 7718 9563 simon.williams@hsbc.com

Alexander Morozov
Chief Economist, Russia and CIS
+7 495 783 8855 alexander.morozov@hsbc.com

Artem Biryukov
Economist, Russia and CIS
+7 495 721 1515 artem.biryukov@hsbc.com

Agata Urbanska-Giner
Economist, CEE
+44 20 7992 2774 agata.urbanska@hsbcib.com

Melis Metiner
Chief Economist, Turkey
+90 212 376 4618 melismetiner@hsbc.com.tr

David Faulkner
Economist, South Africa
+27 11 676 4569 david.faulkner@za.hsbc.com

Razan Nasser
Economist, Middle East and North Africa
+971 4 423 6928 razan.nasser@hsbc.com

Latin America

Andre Loes
Chief Economist, Latin America
+55 11 3371 8184 andre.a.loes@hsbc.com.br

Argentina

Javier Finkman
Chief Economist, South America ex-Brazil
+54 11 4344 8144 javier.finkman@hsbc.com.ar

Ramiro D Blazquez
Senior Economist
+54 11 4348 2616 ramiro.blazquez@hsbc.com.ar

Jorge Morgenstern
Senior Economist
+54 11 4130 9229 jorge.morgenstern@hsbc.com.ar

Brazil

Constantin Jancso
Senior Economist
+55 11 3371 8183 constantin.c.jancso@hsbc.com.br

Central America

Lorena Dominguez
Economist
+52 55 5721 2172 lorena.dominguez@hsbc.com.mx

Principal contributors

Stephen King
Chief Global Economist
HSBC Bank plc
+44 20 7991 6700
stephen.king@hsbcib.com

Stephen is HSBC's Chief Global Economist. He joined the company in 1988, having previously worked as an economic adviser at the UK Treasury. Stephen is a regular economics commentator on television and radio and frequently writes columns for the Financial Times and The Times. Stephen's latest book, When the Money Runs Out, was published by Yale University Press in May 2013. Stephen's first book, Losing Control: the Emerging Threats to Western Prosperity, was published in 2010 and is also available from Yale.

James Pomeroy
Economist
HSBC Bank plc
+44 20 7991 6714
james.pomeroy@hsbc.com

James is a global economist at HSBC. He joined the team in December 2013, having been an analyst within the Asset Allocation team since June 2012. He holds a BSc in economics from the University of Bath.

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