

Global Economic Outlook

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Overview

Global Economy – Global GDP forecasts for 2010 and 2011 are little changed, but concern that growth may falter has pushed the likelihood of official rate hikes into 2011.

United States – Revised data show that new recovery drivers such as exports and investment provided a bigger boost to GDP in the past year than initially estimated.

Europe – Euro-area data continue to surprise on the upside. This is especially true for Germany, but developments in the periphery have also been encouraging.

Japan – Currency strength has become a headwind to a cyclical recovery.

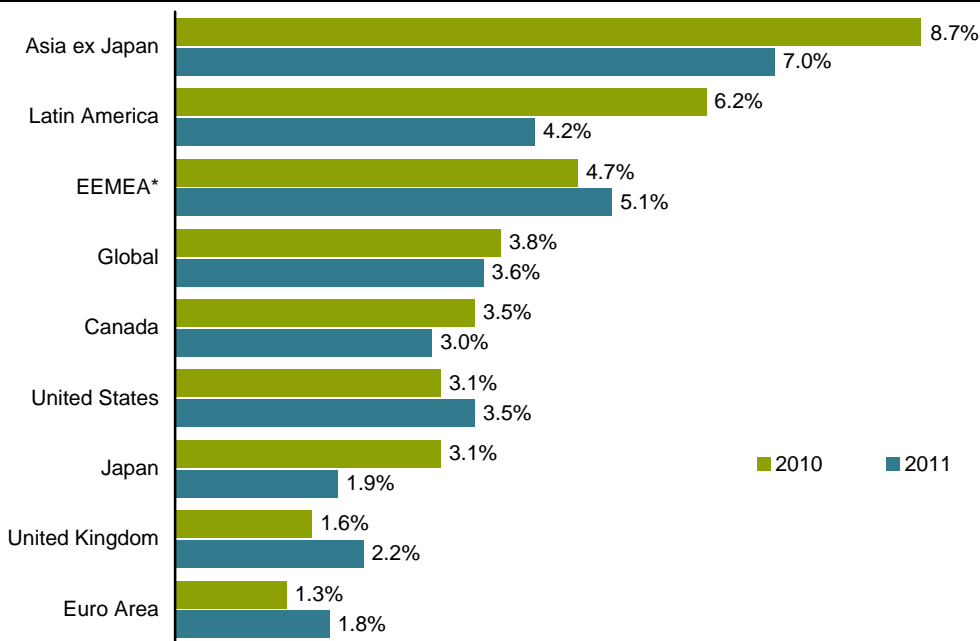
China – Although the July PMI suggests production expansion has slowed, a hard landing is unlikely and there is little risk of too much monetary policy tightening.

Global Economic Research

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AllianceBernstein World Economic Growth Forecasts



*Eastern Europe, Middle East and Africa
 Source: AllianceBernstein

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Global Outlook

Global GDP cycle to continue through 2011

Global GDP forecasts remain little changed from last month, with overall growth pegged at 3.8% for 2010, and 3.6% for 2011. However, there is a growing sense that the global economy is vulnerable to a broad slowing trend, especially in the manufacturing sector. In historical perspective, a slowdown in the rate of manufacturing growth is a normal part of the recovery cycle, which happens when the big swing from liquidating stock to rebuilding inventories begins to wane.

Manufacturing activity has slowed a bit

In July, the overall global manufacturing purchasing managers' index slipped 0.7 points to 54.3, about 3.5 points below the high point reached back in April. This level is still consistent with relatively strong growth in the manufacturing sector, but the softer readings have created some concern about the global GDP recovery, especially as some countries have started to tighten fiscal policy.

US manufacturing is still being driven by exports

It's worth noting that the global purchasing manager's country indices have declined in almost all countries, but emerging-market economies have posted weaker readings. While central banks in several emerging-market countries have been increasing interest rates, we don't think these policy adjustments alone were large enough to trigger such a quick decline in manufacturing activity. In addition, the correlation between the level of composite manufacturing indices and production growth is not as high as in the industrialized world.

The reasons for this lower correlation are not quite clear. It may be because emerging markets are a smaller sample size than developed economies. But whatever the reason for the gap, we believe that the slowdown in emerging-market purchasing indices may not translate into as much weakness in manufacturing production as is generally feared. In fact, the strong rebound in sensitive material prices, such as copper and oil, appears to support the view that manufacturing in emerging markets is more resilient than perceived.

In the industrial economies, the US manufacturing index is still running higher than the global average, but the gap has narrowed from several points to only one point in July. The US manufacturing sector continues to drive the US economy, and support from export markets remains crucial to the sector's strength. In July, the overall manufacturing composite index stood at 55.5, off only 0.7 from the previous month, while export orders rebounded a bit.

Germany's strong manufacturing rebound boosts Europe

In Europe the manufacturing index has exceeded the global average for three consecutive months. All of the outperformance is centered in Germany, where the composite index has reached 61.2, nearly seven points above the global average. In other European countries, such as France and Italy, manufacturing performance has been fairly steady, while weaker economies including Spain and Greece are showing early signs of improvement.

Fed unlikely to raise interest rates until 2011

On the policy front, expectations of official interest rate hikes in the US have been delayed due to growth and inflation concerns expressed by Federal Reserve Chairman Ben Bernanke in his testimony last month before Congress. As a result, we have raised our six month target on the EUR/USD to 1.25 from 1.20. Emerging-market currencies and commodity currencies like the Australian dollar are still expected to appreciate modestly.

US Outlook

US GDP hasn't rebounded strongly...

The current US economic recovery doesn't fit the historical mold. GDP has not rebounded strongly, as it usually does following a very deep recession, and the composition of economic growth is radically different than the first year of any other recovery downturn in modern times. These two key differences have made it harder for analysts and policymakers to forecast the economy's path, since many features of the current cycle are unique.

...But new mix of growth drivers has helped economy get back on track

However, we believe the distinguishing features of the US recovery that began in mid-2009 do not necessarily undermine the economy's ability to secure long-term growth. In fact, our analysis of the recent preliminary second-quarter GDP figures and revised data for the past three years suggests that a new mix of growth drivers is helping the US economy get even closer to a sustainable and balanced recovery than widely perceived.

The below-average pace of the current recovery is particularly noteworthy because it has diverged from the historical pattern in which the severity of a recession is often an indicator harbinger of the pace of recovery that follows. Indeed, deep downturns in the past have generally been followed by sharp upturns, while shallow recessions have been followed by weaker recoveries.

According to revised data, GDP recorded a record peak-to-trough decline of 4.1% during the Great Recession of 2008–2009, or 0.5 percentage points worse than initial estimates. Although this was a record economic slump in the postwar period, the rebound during the first year of the recovery proved to be modest by historical standards, as real GDP advanced by just 3.2% in its first year—well below the historical average of 4.7%. The rebound still ranks higher than the weak GDP recoveries of 1991–1992 and 2002, when the economy advanced by 1.9% and 2.6% respectively. But following deep downturns, recoveries of economic growth tend to exceed the recessionary decline by a factor of two or more. That's what happened following the deep downturns of 1973–1975 and 1981–1982, when first year gains of 6.2% and 7.7% respectively more than doubled the output decline of the recession.

In the past, no matter how fast or slow the economy rebounded after a recession, the first year of recovery was always driven by the early cyclical sectors of consumer spending and housing. Not this time. For the first time in the postwar period, exports and investment drove an economic recovery, with a combined contribution to real GDP from both sectors that exceeded the overall gain in real GDP. According to the revised data, growth in exports and business investment added four percentage points to real GDP growth over the past year. That's almost one percentage point more than the total gain and nearly 2.5 times more than the average contributions from these two important sectors in previous economic recoveries.

These new drivers of economic growth came at an opportune time because the traditional engines of growth—consumption and housing—were providing little support for the recovery. These two sectors added 1.3 percentage points to GDP growth in the first year of recovery, roughly a third of the typical contribution during the postwar period. The weak contribution was expected because consumer spending power and psychology was hit hard during the recession, through a combination of record job losses and wealth destruction. As a result, many people chose to delay big ticket purchases, reduce debt positions to more manageable levels and increase savings in the process.

The good news is that consumers have accomplished this much faster than anyone had expected. According to the GDP revisions, personal income was revised up by \$170 billion at the end of 2009, reflecting higher employee compensation, as well as upward revisions to dividends, interest payments and proprietors (or small business income). The income revision is noteworthy because the Bureau of Economic Analysis now has complete information on wage and salary income through the fourth quarter of 2009, which was found to have been understated by nearly \$50 billion. In our view, personal income is probably still being understated, because the upturn in federal withheld income tax receipts started in April 2010, four months after the point up to which the government has hard income data.

Importantly, the revision to personal saving was even larger than the income revision, as the government also lowered spending and tax numbers a bit. Personal saving in the fourth quarter of 2009 reached \$623.4 billion, roughly \$220 billion more than the earlier estimates, according to the revised GDP data. The personal saving rate was revised by nearly two percentage points

Revised data show recession was deeper than estimated

Progress in consumer deleveraging process

to 5.9% in 2009 and is estimated to have risen to 6.2% in the second quarter. For the past year and a half, the personal saving rate has averaged close to 6%. The last time it was near 6% for that length of time was in the early 1990s.

Solid income and savings data support sustainable recovery

Upward revisions to personal income and saving data indicate that the US economy is getting much closer to the point in the cycle at which the consumer will support the recovery with additional spending and investment. Of course, confidence in the sustainability of the cycle is still lacking and labor markets remain weak, so it may take time before consumers are eager to take additional risk. Yet we think concern about the pace and sustainability of the recovery is unwarranted, as the underlying data are showing signs of better balance.

Some analysts argue that heavy reliance on overseas demand is unhealthy and unsustainable, and risks triggering a quick and sharp setback in the GDP cycle. We believe the transition of US economic growth toward a new mix of growth drivers, with exports and investment leading the way, injected a much-needed spark into the recovery.

Labor market improvements still needed to restore consumer confidence

Yet we have also consistently argued that the new drivers of US growth must eventually filter back into domestic consumption and housing, via wealth creation and household income and saving flows, in order to foster long-term sustainable economic growth. We are starting to see many of the fundamental adjustments needed for the cycle to become more sustainable. But more improvements must unfold before consumers gain enough confidence to spend more, and that is only likely to come when news from labor markets improves.

Europe Outlook

A couple of months ago we lowered our euro-area growth forecast for 2010 to 1.3% for two reasons. First, hard data for the early part of the year were weaker than expected. Although we had some reservations about the accuracy of the data, it was starting to require implausible assumptions for the remainder of 2010 to achieve our target of 2.0% at the time. Second, we thought the protracted nature of the sovereign debt crisis was likely to weigh on consumer and business confidence in the second half of 2010, leading to some moderation in the pace of expansion.

Data continue to surprise on the upside

When we lowered our numbers, we argued that the risks were balanced. On the downside, it was possible that the sovereign debt crisis could escalate further, spilling over into a full-scale banking crisis. Against this, we felt that momentum in the core euro-area economies was so strong and the global environment so favorable, that growth could easily surprise on the upside. Since we cut our forecasts, economic and financial-market developments have suggested that conditions are improving. Not only has the sovereign debt crisis started to ease, but recent data have been unambiguously positive.

Second-quarter GDP likely to rise strongly

Importantly, hard data in the euro area have moved in line with the persistently upbeat survey data. Second-quarter GDP data will not be available until the middle of August, but our monthly GDP indicator—based on industrial output, retail sales, auto registrations and unemployment—shows a 0.8% gain in the three months to May. This suggests that the risks to our 0.7% second-quarter forecast may be slightly on the upside. Moreover, recent survey data suggest that momentum remained firm at the beginning of the third quarter, with the composite purchasing managers' index (PMI) rising from 56.0 in June to 56.7 in July. This is close to the second-quarter average and is consistent with quarter-on-quarter GDP growth of around 0.7%. The rise was driven by particularly strong performance from Germany, where the PMI rose to a near-record 59.0. However, our calculations suggest that the composite PMI for the rest of the euro area declined only marginally in July, to 55.5 from 55.7. It is early days, but so far the data suggest that any slowdown in the third quarter is likely to be modest.

Consumer confidence resilient

Although we normally regard consumer confidence as a less useful indicator than business confidence, it is encouraging to see that it, too, has not been adversely affected by the sovereign debt crisis. July's reading of -14 represents a marked improvement on -17 in June and is the highest reading since the first half of 2008. Again, this improvement has been driven by the core euro-area countries, especially Germany. But even in the periphery, there are signs that consumer confidence is starting to stabilize.

Little evidence of a credit crunch

Nor is there any evidence to suggest that the sovereign debt crisis has significantly impaired the bank-lending channel. The European Central Bank's latest survey of credit conditions, taken at the height of the sovereign debt crisis, did show some tightening, driven by market-access and liquidity problems in the periphery. But for the euro area as a whole, the tightening of lending standards was modest. Moreover, actual data now point to a steady, if unspectacular, improvement in bank lending.

Risks to growth shift to the upside

Nevertheless, it is still too early to conclude that downside growth risks have been eliminated. Financial markets remain fragile and the periphery still faces an uphill struggle. It would therefore be premature to lift our 2010 growth forecast. However, we take considerable comfort from recent data and continue to believe that markets are too pessimistic on the outlook for euro-area growth. The likelihood of a double dip recession has also receded—which is crucial for the euro area's chances of steering through the sovereign debt crisis.

Japan Outlook

Easing of cyclical recovery

The cyclical recovery of the Japanese economy seems to have lost steam, as June's industrial production slowed to 17% year on year from 20.4% in May (or -1.5% month on month, seasonally adjusted). Export growth has also eased to 27% year on year in June from the peak of 45% in February. Unlike the continued strength in Korea and, to a lesser extent, Taiwan, we think the strong yen was the major headwind to Japan's export competitiveness. This is also the main reason that Japan's export recovery has lagged Korea's and Taiwan's.

Deflation lingers

On the domestic front, the unemployment rate rose for the fourth consecutive month to 5.2% in June, although the rise came from a larger jump in labor force than in jobs. The good news is that the new job-to-applicant ratio (a leading indicator) rebounded to 0.88 in June from 0.83 in May. If this improvement continues, it will at least provide some support to household spending in the near term. Meanwhile, deflation remains severe with the June core CPI staying flat over the month but still down by 0.7% on the year (versus a decline of 0.9% in May). We expect Japan's GDP growth will ease back to about 1.9% in 2011, from 3.1% in 2010, with CPI deflation staying at around -0.4% next year.

We think that the JPY/USD exchange rate should be much weaker than the current 86 level on fundamental grounds. However, we have scaled back our six-month forecast for JPY/USD to 92, from 95 previously, given the lingering reduction in global risk appetite. Accordingly, we have also slightly revised our six-month forecast for 10-year JGB yield to 1.2% from 1.3%.

Australia Outlook

Is Australian consumer spending weakening?

Australian retail sales figures over the past couple of months have surprised to the downside, rising by just 0.2% in each of May and June. The year-on-year growth rate has slipped back to the 1%–2% range from the 7%–8% recorded through 2009. It's certainly the case that a rising debt servicing burden is starting to bite as the Reserve Bank of Australia (RBA) hikes rates. But are the latest data signaling a more fundamental weakening of the Aussie consumer? We think not—or at least not yet—for a number of reasons.

First, the slowdown is partly illusory. There were significant fiscal handouts to consumers in late 2008 and the first half of 2009. Not surprisingly, this provided a big boost to retail

Technical factors skew data

spending volumes in the first and second quarters of 2009. Year-on-year comparisons are still challenging because of that base effect. Hence it should not have been surprising to see a marked deceleration in nominal retail spending over the past year. Those base effects have now largely run their course, and should not be a big influence from here on.

Income generation remains robust

Fundamentals of income generation remain positive. Recent trends in employment growth have been stellar. The number of jobs has risen by more than 350,000 over the last 12 months (that is, a pace exceeding 3%). The breadth of the recovery has improved, too, with full-time jobs growth outpacing part-time over the past six months, and the number of average hours worked rising. Leading indicators suggest solid employment growth will continue in the months ahead. With average weekly earnings now growing at more than 5%, underlying labor income growth is pushing 9%. Add the impact of the income tax cuts delivered at the start of July and it's hard to get pessimistic about underlying fundamentals.

Consumer sentiment remains buoyant. After taking a hit earlier this year when the RBA was delivering back-to-back rate hikes, consumer sentiment has bounced back strongly. At 119.2, the latest reading is once again close to all-time highs. This is not really consistent with a household sector under stress: declining unemployment and the 20%-plus rise in house prices seem to have offset any worries about rising interest rates.

Spending outlook looks promising

The combination of solid income fundamentals, tax cuts, buoyant confidence, an RBA on hold (for now) and technical factors bolster our expectations of surprisingly firm consumption spending readings through the second half of 2010 and into 2011. With other areas of private spending also likely to be strong, this underpins our view that domestic demand should run in the 4%–5% range over the next 12–18 months. In turn, this reinforces our bias towards rising rates, a flattening of the Australian government yield curve and a firm Australian dollar.

Canada Outlook

Canada is slowing with the US

Growth is slowing in Canada, amid a deceleration of US economic activity and in response to impending fiscal and monetary tightening. The establishment survey of jobs and Canada's global survey of monthly GDP show a rapid slowdown through May, concentrated in real estate activities. By contrast, the household survey of jobs was more buoyant, finding more jobs in the service sector in Ontario and Quebec. Different currents are clearly in play here, including a likely pickup in oil sector activity in Western Canada with higher oil prices, and a broad housing slowdown elsewhere in the country with the tightening of lending terms and borrowing costs. On balance, due to weak establishment numbers, we forecast a slowing pace of growth in the second quarter, down from a 6.1% annual pace to around 2%. This is in line with the relatively sharp slowdown predicted by the central bank in its latest inflation report.

Looser credit may boost economic activity

Surveys show elements of the momentum that had built up in Canada before the latest slowdown. Both input and output prices are widely expected to rise, and companies are also beginning to report very early signs of capacity pressure, although there is no sign of difficulty finding workers yet. Still, inflation expectations overall are firmly anchored at around 2%, at the center of the Bank of Canada's inflation target range. In the medium term, however, the bank may be more worried about the possibility that easier bank credit conditions now could boost sustained economic activity. Credit terms have clearly eased, with rates until recently at exceptionally low levels and the beginning of a home price bubble becoming visible. In response, the central bank is in the process of hiking rates, but we think it will probably pause to reconsider as softer local and global economic news accumulates.

Emerging Markets Outlook

Brazilian car
assemblies are slowing

Latin America: Brazil: We knew that a dip in car sales in Brazil was coming after tax reductions ended at the end of March, but the decline has gone on longer than expected and has caught producers more off balance than we had expected. Industrial production was down in April, and again in June, from levels close to their peak before the crisis. We assume sales, and then production, will recover in a few months, however, because of widespread gains in formal jobs and no sign of a pause in domestic credit to households.

Adding to the soft economic news, food prices have fallen for several months—the same items that were soaring in price earlier in the year. In June, inflation was zero, although underlying service sector inflation was running at around 5.0%, which should soon feed through again to the headline figures. On balance, softer activity and price pressures led the Brazilian central bank to slow its pace of rate hikes to 50 b.p. As a result, market participants have lowered their expectations for the end point of this Brazilian rate hiking cycle from around 13.0% to 11.5%.

Mexico's central bank
holds off declaring
victory over inflation

Mexico: Car assembly activity is booming in Mexico, but not much else. Vehicle exports to the US market surged through May and June, pushing up industrial production and manufacturing reports. Car assemblies are now almost back to pre-crisis levels, although local sales remain down. Although this will help generate strong GDP in the second quarter, Mexico's expansion is only slowly developing any broader momentum. Indeed, according to the latest available official government estimates, real investment spending declined in April.

According to the central bank's inflation report, actual inflation in Mexico has been lower than expected, and may fall short of the central bank's forecast of 4.75%–5.25% at year-end. But the bank left its forecast unchanged because of risks of higher prices due to unusually severe rainfall that may damage crops as well as the potential for a currency disruption. The central bank ended its report with a plea for fundamental supply-side change in Mexico to reduce the underlying bottlenecks that have kept inflation high, even after a severe recession and despite the existence of significant unused capacity. Interest rates were left unchanged at 4.50%.

Chile: Chilean officials were in New York for the last few weeks talking up their new bond issue, to meet part of the reconstruction costs from the February earthquake. High savings from windfall copper earnings put Chile in a strong position to pay for a big fiscal push in 2009 and to finance part of the rebuilding efforts. A crash rebuilding program will get fully underway in the second half of 2010, helping to provide further support to an already recovering economy. Ahead of the predictable jolt upwards in activity, the Banco de Chile raised rates by 50 b.p. this week, to 1.50%. Enrique Marshall from the central bank board, said at a presentation that a forward rate at 4.0% in one year are the central bank's best expectation.

Foreign exchange
reserves surge in
Argentina

Argentina: Dollar reserves at the central bank are climbing, due to the country's potential to normalize its debt situation and surging soy sales. As the wave of extra soy harvests in Argentina and Brazil depressed prices through the normal first-half sales period, exporters may have held back sales until prices recovered. The central bank is now reporting higher foreign exchange reserves, rising to \$50.7 billion on July 16—or \$2.7 billion higher than at the end of 2009. Net reserves may have risen even more, as the authorities take the opportunity to pay down loans from the Bank for International Settlements. Some of these reserves may be used to pay down Paris Club official debt later this year.

Venezuela: Local newspapers claim Venezuela is planning to issue \$10 billion in new bonds to finance imports. According to reports from foreign investors familiar with the plans, \$6 billion is under consideration by the central bank, but other authorities have implied that Chinese credits will be used instead. After choking off the last source of gray-market foreign exchange, officials seem surprised by the economy's deep dive. Now, they appear to be

attempting to reverse the declines by providing foreign exchange. However, officials have suggested that the implied yield must be “reasonable”, which in turn means they will only be able to do it in a situation of very strong global risk appetite.

Moderate economic recovery in Central America and the Caribbean

In Central America and the Caribbean, data continue to signal a moderate economic recovery. Monthly activity indices in El Salvador and Costa Rica grew at a slightly weaker pace over April to May, but these signs appear short-term with early June indications pointing back up. We moved up our GDP forecast on El Salvador to an above-consensus 2.0% in 2010 due to signs of an export-led recovery. The Dominican economy remains strong with growth above 7.0%. Inflation risks are moderate with countries such as Jamaica still easing monetary policy on relatively stable prices amid an early recovery and benign commodity prices.

Fine-tuning our growth and inflation forecasts

Asia ex Japan: Our GDP forecast for the region has been fine-tuned to 8.7% in 2010 (from 8.8% previously) and 7% in 2011 (from 7.1%), largely due to the adjustment in our growth forecast for China. In the second quarter, GDP came in a touch softer than expected at 10.3% year on year, versus our forecast of 10.8%, and we have slightly lowered our projection for year-on-year growth in the third and fourth quarters to 9.6% and 8.7% respectively. We have also lowered our full-year 2010 forecast to 10%, from 10.4% previously. However, our forecast for 2011 remains unchanged at 9.1%. Moreover, China’s GDP growth in 2009 was revised up substantially to 9.1%, from an initial estimate of 8.7%, which has also acted as a higher base for comparison for our 2010 forecast.

Meanwhile, inflation across Asia has been tamer than our already bullish assessment. We have also slightly lowered our inflation forecast for the region to 3.8% in 2010, from 4%, while maintaining our forecast at about 3% next year. We continue to expect a gradual and measured pace of interest rate policy normalization in Asian economies, which will lead to only modest pickups in bond yields and a general flattening of yield curves.

India will probably hike interest rates further and Indonesia is likely to start hiking in the fourth quarter

The only exception is **India**, where strong growth and a tightening of capacity will keep inflation sticky in double-digits over the next few months. This will require a continued proactive tightening stance by the Reserve Bank of India. We expect that the overnight repo rate, which has already been raised by a total of 100 b.p. this year, will increase a further 75–100 b.p. in the next 12 months. Similarly, but to a lesser extent, continued resilient growth in Indonesia, where year-on-year GDP jumped by 6.3% in the second quarter, together with the recent surge of inflation to 6.3% year on year in July, should be enough to convince the central bank to start normalizing interest rates before the end of this year. In our view, Bank Indonesia is likely to increase policy rates by 25 b.p. to 6.5% in the September’s policy meeting.

China’s PMI suggests slower production expansion but little risk of a hard landing

In **China**, the official PMI for July was similar to that reported in June, with the overall index easing slightly to 51.2, from 52.1 in June. New orders fell by another 1.2 points to 50.9, but the decline in new export orders eased by 0.5 point (to 51.2 in July) compared with a decrease of 2.1 points in the previous month. This suggests that domestic orders have softened more than export orders last month and, in the former, the decline was mainly the result of policy tightening on property as well as a peaking of infrastructure investment. In addition, the continued sharp fall in input costs to 50.4, from a peak of 72.6 in April, was another indication of weakening demand for commodity and raw materials. The flip side of the lowering of input prices is a sharp easing of China’s inflationary pressure.

In our view, the outcome is not too alarming, as China’s monetary policy tightening during the first half of 2010 was aimed at preventing an overheating of manufacturing—particularly by curbing overinvestment in heavy industries. Overall, the manufacturing sector is still expanding but at a more moderate pace, which has sharply reduced inflationary pressure in the economy. Moreover, we think that there is no evidence in these numbers to suggest a risk of

overtightening or a hard landing and the need for an imminent policy turnaround by Beijing. We expect that policymakers will hold lending rates unchanged for the rest of this year and maintain a very modest RMB appreciation policy. The only area which may see faster policy relaxation is on property but only when top-end market prices correct meaningfully, by perhaps 20%–30% from the peak in early 2010.

Eastern Europe, Middle East and Africa: May and June production data across EEMEA confirmed that the annualized pace of industrial expansion had remained firmly in double digits during the second quarter of 2010. Meanwhile, purchasing managers' indices (PMIs) were broadly unchanged in July, and—having declined from the peak in April—are now painting a picture of more moderate yet still fairly robust growth in the months ahead. Much of the decline in PMIs has been due to weaker new orders and, most recently, export orders, reflecting greater uncertainty about the future pace of global recovery. The only country in the region bucking this general trend has been **South Africa**, where recovery in manufacturing had been more sluggish this year and PMIs are back in contraction territory. Part of the explanation probably lies with the World Cup, but it's also likely due to the strength of the local currency which has outperformed the rest of the region over the past 18 months.

Domestic demand in EEMEA has so far lagged the recovery in manufacturing which had been driven chiefly by exports. Recent data releases indicate that consumer demand is reviving, but at a growth rate that is a fraction of pre-crisis levels. A notable exception is **Turkey** where historically unparalleled real interest rates combined with a healthy banking sector are fueling strong credit expansion to households.

Due to weak domestic demand (pressures) and still negative output gaps (even in Turkey), inflationary pressures remain contained across the region. July inflation releases showed a further deceleration on both headline and core measures, which—with the exception of Hungary—are all inside central banks' target ranges.

Benign inflation developments and uncertainty about global growth kept all major central banks in EEMEA on hold this month. Statements from central banks—and newly released inflation reports in Turkey and the Czech Republic—confirm our view that the normalization of interest rates in EEMEA will not start before the second quarter of 2011. The exception to this was the Bank of **Israel**, the only central bank in the region that has already begun a tightening cycle. The Israeli central bank once again surprised us and the markets with a rate increase of 25 b.p. to 1.75%, citing local housing market pressures (a regional outlier) and a rise in inflation expectations.

Meanwhile, in mid-July, the IMF mission left **Hungary** without reaching a staff agreement on the ongoing standby arrangement (SBA) review, reflecting the new Fidesz-led government's unwillingness to push forward unpopular fiscal measures ahead of October 3 municipal elections. We still think the Hungarian authorities will find a compromise with the IMF/EU once political obstacles are out of the way, but we are increasingly uncomfortable with the new government's push for a medium-term fiscal consolidation plan without IMF involvement. Even though Hungary does not need IMF funding in the near term, as it has built some fiscal reserves and can tap markets in the current risk-friendly environment, the new government needs to boost its credibility and establish a track record of fiscal prudence. In our view, an IMF-sponsored program that provides a financial backstop for when the markets turn risk averse is the best way to do it. Clearly, this approach was chosen by the authorities in **Romania** and **Ukraine**, who—unencumbered by the election calendar—opted to stick with unpopular measures to afford themselves financial breathing room under an IMF-backed arrangement. Romania successfully completed its fourth SBA review this month, while Ukraine agreed to a new SBA worth \$15 billion over the next 2½ years.

Manufacturing activity remained strong in 2Q

Domestic demand drivers still weak but tentatively improving

Inflation continues to moderate but nearing a cyclical trough

Monetary policy on hold except in Israel

IMF/EU program hits a roadblock in Hungary but is on track in Romania

Ukraine agrees on a new IMF stand-by arrangement

| | Real Growth ¹ | | | Inflation ¹ | | | Official Rates ² | | | Long Rates ² | | |
|-----------------------------|--------------------------|-------|-------|------------------------|-------|-------|-----------------------------|--------|--------|-------------------------|--------|--------|
| | 2009 | 2010F | 2011F | 2009 | 2010F | 2011F | 2009 | 2010F | 2011F | 2009 | 2010F | 2011F |
| Global | -2.1% | 3.8% | 3.6% | 0.9% | 2.3% | 2.3% | 1.95% | 2.11% | 2.86% | 4.37% | 4.03% | 4.48% |
| (PPP Wtd) | -0.7% | 4.7% | 4.3% | | | | | | | | | |
| Industrial Countries | -3.4% | 2.4% | 2.6% | 0.1% | 1.5% | 1.6% | 0.63% | 0.72% | 1.53% | 3.43% | 3.20% | 3.81% |
| Emerging Countries | 1.5% | 7.4% | 6.2% | 3.3% | 4.8% | 4.1% | 5.72% | 6.10% | 6.65% | 7.04% | 6.38% | 6.40% |
| United States | -2.4% | 3.1% | 3.5% | -0.3% | 1.7% | 2.0% | 0.25% | 0.25% | 1.50% | 3.85% | 3.75% | 4.75% |
| Canada | -2.6% | 3.5% | 3.0% | 0.3% | 1.8% | 2.0% | 0.25% | 1.50% | 2.00% | 3.60% | 3.00% | 3.50% |
| Europe | -4.2% | 1.4% | 1.9% | 0.6% | 1.6% | 1.8% | 0.92% | 0.96% | 1.59% | 3.50% | 3.14% | 3.64% |
| Euro Area | -4.1% | 1.3% | 1.8% | 0.3% | 1.3% | 1.6% | 1.00% | 1.00% | 1.50% | 3.39% | 3.00% | 3.50% |
| United Kingdom | -4.9% | 1.6% | 2.2% | 2.2% | 3.2% | 2.6% | 0.50% | 0.50% | 1.50% | 4.02% | 3.75% | 4.25% |
| Sweden | -5.1% | 3.7% | 3.2% | -0.3% | 1.3% | 2.0% | 0.25% | 1.25% | 3.00% | 3.29% | 3.10% | 3.65% |
| Norway | -1.5% | 2.1% | 2.9% | 2.2% | 2.5% | 2.0% | 1.75% | 2.25% | 3.25% | 4.14% | 3.75% | 4.25% |
| Japan | -5.2% | 3.1% | 1.9% | -1.4% | -0.3% | -0.4% | 0.10% | 0.10% | 0.10% | 1.30% | 1.20% | 1.10% |
| Australia | 1.3% | 3.3% | 4.5% | 1.8% | 3.1% | 3.0% | 3.75% | 4.50% | 6.50% | 5.80% | 6.00% | 6.50% |
| New Zealand | -1.7% | 2.9% | 3.5% | 2.1% | 2.9% | 4.5% | 2.50% | 3.25% | 4.50% | 5.81% | 5.85% | 6.25% |
| Non-Japan Asia | 5.2% | 8.7% | 7.0% | 0.5% | 3.8% | 3.0% | - | - | - | - | - | - |
| China ³ | 9.1% | 10.0% | 9.1% | -0.7% | 2.8% | 2.5% | 5.31% | 5.31% | 5.85% | 3.65% | 3.40% | 3.25% |
| Hong Kong ⁴ | -2.8% | 6.8% | 5.2% | 0.5% | 2.6% | 2.2% | 0.50% | 0.50% | 1.00% | 2.65% | 2.40% | 2.75% |
| India ⁵ | 6.7% | 8.3% | 7.1% | 1.3% | 9.8% | 6.0% | 4.75% | 6.50% | 6.75% | 7.56% | 7.75% | 8.00% |
| Indonesia ⁶ | 4.5% | 5.7% | 5.0% | 4.8% | 5.0% | 4.0% | 6.50% | 6.75% | 7.25% | 9.05% | 7.60% | 7.40% |
| Korea ⁷ | 0.2% | 6.5% | 4.5% | 2.7% | 2.5% | 2.2% | 2.00% | 2.75% | 3.00% | 4.90% | 4.60% | 4.50% |
| Thailand ⁸ | -2.2% | 6.4% | 2.8% | -1.0% | 3.3% | 2.8% | 1.25% | 1.75% | 2.00% | 3.63% | 2.90% | 2.75% |
| Latin America | -2.7% | 6.2% | 4.2% | 5.1% | 5.4% | 4.4% | - | - | - | - | - | - |
| Argentina ⁹ | 0.8% | 8.0% | 6.5% | 6.3% | 12.0% | 13.0% | - | - | - | - | - | - |
| Brazil ¹⁰ | -0.2% | 7.8% | 5.0% | 4.9% | 5.6% | 5.0% | 8.75% | 11.25% | 12.50% | 13.31% | 12.41% | 13.00% |
| Mexico | -6.5% | 4.6% | 3.1% | 5.3% | 5.0% | 3.5% | 4.50% | 4.50% | 4.75% | 8.01% | 6.50% | 7.00% |
| EEMEA | -5.2% | 4.7% | 5.1% | 8.5% | 6.1% | 5.9% | 7.17% | 6.57% | 7.13% | 8.89% | 7.78% | 7.55% |
| Hungary | -6.2% | 0.8% | 2.1% | 4.2% | 4.7% | 3.0% | 6.25% | 5.25% | 5.25% | 8.03% | 7.50% | 7.25% |
| Poland | 1.7% | 2.9% | 4.0% | 3.5% | 2.4% | 2.6% | 3.50% | 3.50% | 4.00% | 6.26% | 6.00% | 5.50% |
| Russia | -7.9% | 5.5% | 6.3% | 11.7% | 6.6% | 7.0% | 8.75% | 7.50% | 7.50% | 9.08% | 7.50% | 7.00% |
| South Africa | -1.8% | 3.2% | 3.6% | 7.2% | 5.2% | 5.7% | 7.00% | 6.50% | 7.00% | 9.17% | 8.50% | 8.50% |
| Turkey ¹¹ | -4.9% | 5.7% | 4.5% | 6.3% | 8.5% | 6.5% | 6.50% | 7.00% | 9.00% | 10.44% | 9.50% | 10.00% |

1) Growth and inflation forecasts are reported on a calendar year basis.

2) Official and long rates are end-of-year forecasts. Long rates are 10-year yields unless otherwise indicated.

3) China: Official rates are 1-year benchmark lending rates and 10-year government bond yield.

4) Hong Kong: Base rate and 10-year exchange funds yield

5) India: Overnight repo rate and 10-year government bond yield

6) Indonesia: Intervention rate and 5-year government bond yield

Source: AllianceBernstein

7) Korea: Overnight call rate and 5-year government bond yield

8) Thailand: 1-day repo rate and 5-year bond yield

9) Turkey: Long-term rates are 5-year rates. As of May 18, 2010, 1-week repo auction rate replaced the overnight borrowing rate as the new policy rate, leading a purely technical policy rate adjustment to 7.00% from 6.50%.