INSTITUTE OF INTERNATIONAL FINANCE

Global Economic Monitor

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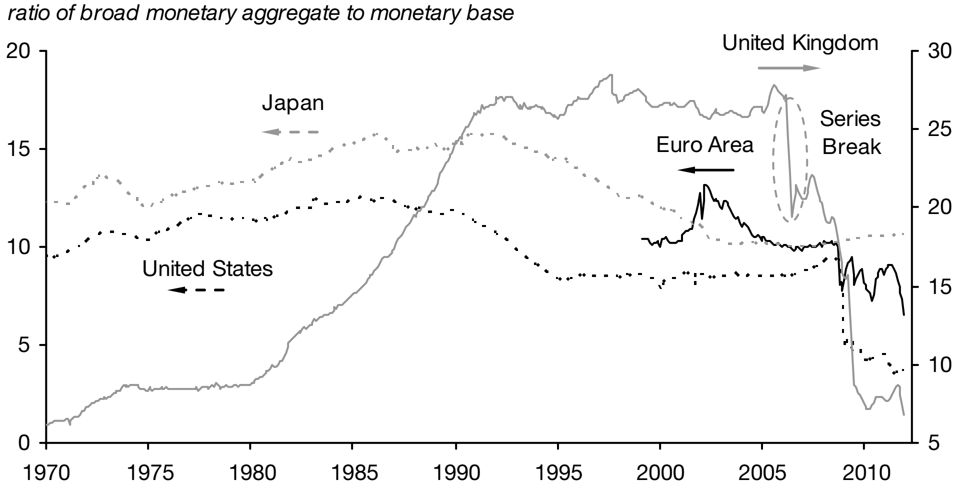
THE EEYORE ECONOMY

- The global economy is in the middle of another soft patch, although recent performance has been mixed. Current weakness is centered on Europe, which looks to have entered a mild recession in 2011Q4. Orderly resolution of the Greek debt crisis remains a key challenge. Japan also contracted in Q4. By contrast, the U.S. economy has improved somewhat in recent months, and growth in the emerging world remains quite solid.

- Near-term weakness in the Euro Area has not been quite as pronounced as we had expected, and we have revised up our GDP forecast for 2012. We now project the region to contract by 0.4% in 2012 (was 1%). We have also revised up our growth forecast for the U.S., to 2.5% (was 2.1%). These revisions have been partly offset by a cut to Japan. In the emerging world, we have trimmed our Asia forecast slightly, but lifted Latin America.

- Three years into the global expansion, much of the global economy remains in a pretty gloomy state. Unsettled Mideast politics threatens another spike in the oil price. Southern parts of the Euro Area are in depression, with unemployment rates at very worrying levels (especially youth unemployment). More generally, adjustment mechanisms within the Euro Area are not working. Monetary policy across the mature world remains unprecedentedly easy, but it is quite alarming what disappointing results we are seeing in terms of aggregate demand. Monetary extremes could be creating new excesses and imbalances not yet fully evident, in both mature and emerging economies. Finally, public debt in mature economies continues to rise at an unsustainable rate.

Chart 1
Major Economies: Money Multipliers
ratio of broad monetary aggregate to monetary base



Money multipliers have collapsed since the onset of the financial crisis. A lot has gone in at one end (central bank liquidity), but not much has come out at the other end (bank credit).

Global Overview

WHAT WORRIES US THE MOST

The table below summarizes our main worries about the global outlook. We will update this watch list for each edition of the Global Economic Monitor. Our objective is to identify issues that should be in focus for country risk managers over the next 12 months or so, and which could have global ramifications. These worries are heavily centered on Europe at the current time. Note that this list is far from exhaustive about what *could* go wrong, and does not include many concerns (including rising government debt in Japan and the U.S.) which could be major challenges over a 3 to 5-year horizon.

Issue	Key Features	What To Watch
Greece: Completion of second support package and PSI	▪ Uncertainty surrounding whether new government can keep EU/IMF program on track ▪ Risk of a subsequent debt restructuring, following pending PSI deal ▪ Growing domestic unrest	▪ Participation in bond exchange offer (early March) ▪ Composition of new government (elections in April) ▪ Progress on structural reform agenda ▪ Prospects for a recovery in latter half of 2012
Portugal: Concern about contagion from Greece	▪ Sharp increase in risk premia ▪ Concerns that the very ambitious fiscal target for 2012 will not be met given the deteriorated growth outlook	▪ Spreads on government bond yields ▪ Implementation of the promised fiscal measures ▪ Assurances from the creditor countries that assistance will be forthcoming if market access is not restored because of adverse external conditions
Middle East: Rising geopolitical risks could produce new oil price shock/ supply disruptions	▪ Potential conflict between Iran and Western powers over the country's nuclear program ▪ Conflict/incipient civil war in Syria ▪ Challenges in restoring stability to Libya ▪ Political divisions in Iraq	▪ Impact of new sanctions on Iran ▪ Risk of outright military conflict leading to disruption of oil trade through the Straits of Hormuz ▪ Willingness of Saudi Arabia to provide offset ▪ Extent of rebound in Libyan production
Egypt: Risk of currency crisis	▪ Official reserves have fallen sharply to under 3 months of imports ▪ Tourism and FDI very weak	▪ Agreement on a $3.2 billion IMF loan ▪ Presidential election scheduled for late May
Spain: Significant fiscal tightening into an already weak economy	▪ New government committed to reducing budget deficit from over 8% of GDP in 2011 to 4.4% of GDP in 2012 ▪ With economy contracting, this implies discretionary tightening of about 5-6% of GDP	▪ Full 2012 budget expected to be presented by March. ▪ Unemployment rate: 22.85% and rising (INE quarterly series); 2012Q1 data due on April 27th ▪ Success of bank restructuring program
Italy: Debt rollover risk	▪ Term debt maturities of: €53 billion in February; €45 billion in March; €45 billion in April; €19 billion in May; and €188 billion in June-December	▪ Yields on debt in secondary market ▪ Whether or not issuance is concentrated at the front end of the curve
Turkey: High external deficit	▪ Large current account deficit (10% of GDP in 2011) ▪ Insufficient net capital inflows to cover deficit ▪ Significant drawdowns from official foreign exchange reserves	▪ Net capital inflows ▪ Official foreign exchange reserves
Venezuela: October presidential elections	▪ Substantial political polarization and weak institutions have increased the country's vulnerability to domestic shocks	▪ Oil production disruption if uncertain political events result in widespread social unrest
Ukraine: Unsustainable external position	▪ Large current account deficit ▪ Significant principal repayments in 2012-13 ▪ No access to private capital markets ▪ Current IMF program suspended ▪ Banks very vulnerable to FX decline	▪ Agreement with Russia on natural gas contract ▪ Agreement with IMF on new program ▪ Major repayments due in May ($2.6 bn), June ($1 bn) and August ($1 bn)

2011Q4 WEAKNESS: POTHOLE OR ELEPHANT TRAP?

- The global economy performed poorly in 2011Q4. Although we are still relatively early in the Q4 GDP reporting season, it seems fairly clear that global growth was slower in 2011Q4 than at any time since the global recession ended in 2009Q1. Global GDP growth slowed to about 1.7%q/q, saar, down from an average of 3.1% in the previous four quarters (Table 1).

- This slowdown came despite an acceleration in U.S. growth to 2.8%q/q, saar, which was the strongest reading since 2010Q2. Global weakness was partly the result of flooding in Thailand, which disrupted global industries — especially autos and consumer electronics. Japan's March earthquake was far more traumatic to global activity, however, and global growth had averaged 2.8%, saar, in 2011H1.

- The main weakness in 2011Q4 was concentrated in the Euro Area and Japan. Most emerging economies have not yet reported GDP for Q4. Those that have are mostly from Emerging Asia, where the Thai disruption was significant among smaller, open economies. Those more dependent on large domestic markets (China, Indonesia and India) look to have maintained robust growth rates in Q4, however.

- Looking ahead, the key issue is whether Q4 weakness will be short-lived — a pothole in the global expansion — or become a more pronounced, serious downturn culminating in a global recession. Our forecast remains for the former scenario. In this context, the recent broad-based rebound in manufacturing PMIs is encouraging (Chart 2).

- The management of financial tensions in the Euro Area will be one important determinant of how the global cycle unfolds in coming quarters. Aggressive, timely support from the ECB has been integral to reducing downside risks in the Euro Area and we have trimmed our estimate of the depth of the Euro Area recession somewhat (see pages 14-17).

- Monetary easing from central banks in emerging economies will also be an important support to global growth. Indeed, monetary easing will probably do more good there, since interest and credit sensitive components of demand (such as auto sales) will be more responsive to stimulus than in mature economies (Chart 3).

Table 1
Global Real GDP Growth
percent, q/q saar

	10Q4	11Q1	11Q2	11Q3	11Q4
Mature Economies	**1.4**	**0.4**	**0.8**	**2.4**	**0.4**
United States	2.3	0.4	1.3	1.8	2.8
Euro Area	1.1	3.1	0.6	0.5	-1.3
Japan	-0.6	-6.8	-1.5	7.0	-2.3
Other Mature	1.5	1.3	1.6	3.2	0.3
Emerging Economies	**7.5**	**7.1**	**4.2**	**4.6**	**3.7**
Latin America	5.4	4.0	5.2	3.0	1.8
Emerging Europe	8.0	4.8	2.6	4.8	2.8
Asia/Pacific	8.3	9.5	4.4	5.1	4.8
World	**3.9**	**3.2**	**2.1**	**3.2**	**1.7**

Chart 2
BRIC, U.S. and Euro Area: Manufacturing PMIs
index, 50 = breakeven

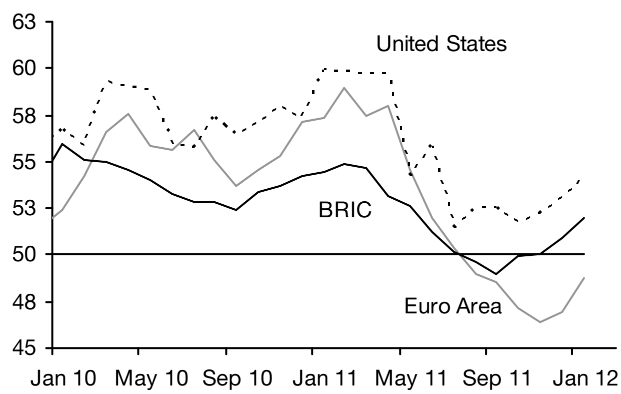
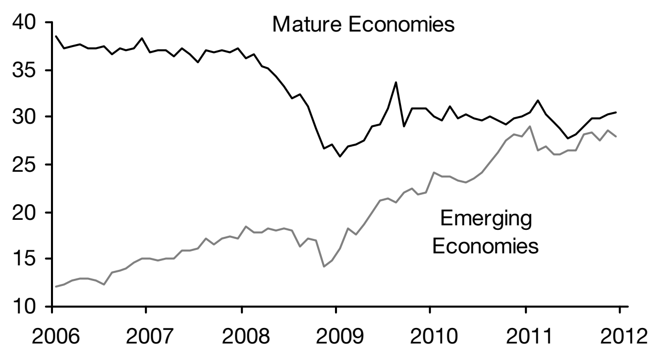


Chart 3
Auto Sales
million units, saar



THE MONETARY POLICY CAVALRY RIDES AGAIN

- The significant slowdown in global activity in the last part of 2011 elicited a substantial global monetary response. Judging from the turnaround in both global equity prices and some key global business confidence indicators from their October lows, this monetary stimulus appears to have been successful in stopping the bleeding. In aggregate, these measures should be enough to keep the global economy on a steady growth path in 2012-13.

- The most significant action has come where it was most needed: in the Euro Area, from the ECB. Official rates were reduced 50bp, back to 1%. More significantly, however, the ECB has dramatically shifted the size and composition of its balance sheet, expanding it by about 10 percentage points of GDP in recent months (Chart 4). The second three-year funding operation will occur at the end of this month and seems likely to attract bids at a level similar to, or possibly even above, the first. We also expect the ECB to cut its key lending rate by another 50bp before the end of Q2.

- The Bank of England has also expanded QE in recent months. Once the recent commitment has been completed, the stock of assets bought by the Bank under QE will total £325 billion, or 22% of GDP.

- Given the recent firming in U.S. growth, the Fed has been understandably less aggressive, but did surprise somewhat at the January FOMC meeting by committing to keeping the Fed funds rate unchanged through the end of 2014. This had a limited impact on market rates, helping lower rates the most in the intermediate part of the curve (Chart 5).

- Emerging market central banks have begun to ease, most notably in Latin America (Chart 6). The transmission mechanism between monetary policy and aggregate demand works much better in the emerging world. This easing should thus help to support EM growth in 2012.

- Despite all this monetary support, however, global credit conditions facing many end borrowers remain challenging. We investigate three aspects of this in the following pages.

Chart 4
Central Bank Balance Sheets: Total Assets
percent of GDP

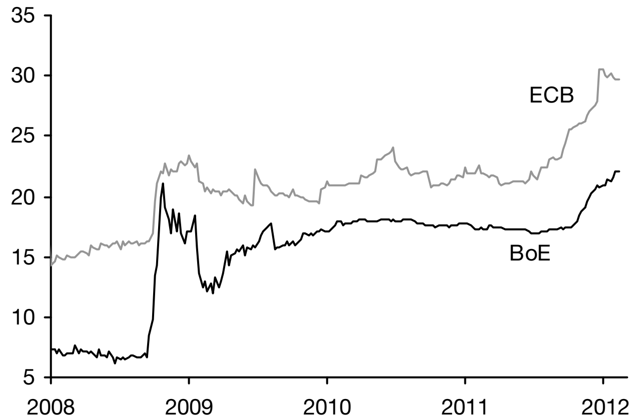


Chart 5
United States: Sovereign Bond Yields
percent, yield on generic bonds

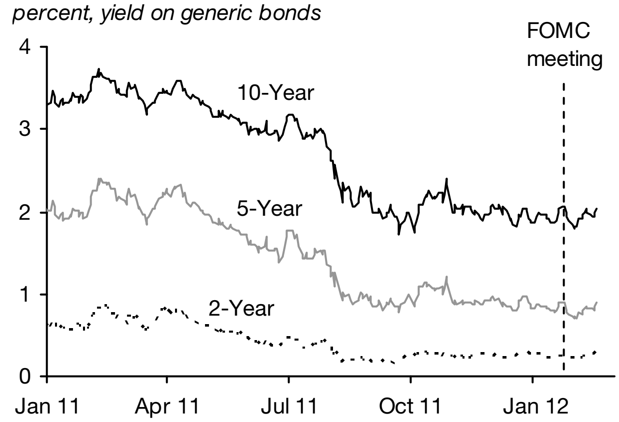
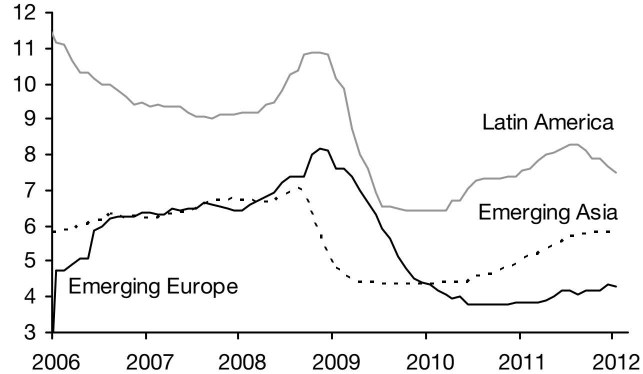


Chart 6
Trends in Official Interest Rates
percent, GDP-weighted regional averages



BANKS ARE TIGHTENING CREDIT STANDARDS

- First, the global ramifications of the European debt crisis continue to shape bank lending conditions all over the world According to recent surveys, banks in the Euro Area and emerging economies began to tighten standards again. In the US, the easing of the past few years was ended (Chart 7).

- In the Euro Area, bank lending conditions continued to tighten sharply in 2011 Q4, exacerbating concerns about the region's growth outlook. The degree of credit tightening was particularly marked in France and Italy, while there was less evidence of credit tightening in Spain. And, as expected, lending standards continued to ease in Germany, but at a slower pace.

- The Fed's Senior Loan Officer Survey indicated a slight improvement in the overall demand for credit in Q4. With business sentiment improving, the demand for corporate loans surged in the last quarter of 2011 (Chart 8). The brightest spot of the survey was the increase in mortgage demand for the second consecutive quarter, suggesting that the U.S. housing market is now on a path of gradual recovery (see page 13). Credit standards for consumer loans continued to ease whereas credit standards for corporate loans tightened slightly as U.S. banks became more cautious in their lending activities, especially towards firms with significant exposures to Europe. In Japan, lending standards continued to ease. Although the BOJ's survey pointed to almost no change in overall demand for loans, the latest hard data indicated some credit expansion, led mainly by loans for reconstruction purposes.

- Our latest EM Bank Lending Conditions Survey signaled a significant tightening in bank lending standards, reflecting a worsening in funding conditions and stricter credit standards over the past three months. The overall demand for consumer and business credit remained resilient, but the demand for residential credit fell slightly. The impact of tighter external funding conditions differed significantly among regions. It was most pronounced in Emerging Europe, where almost 50% of all credit to non-banks is accounted for by banks that form part of the Euro Area banking system (Chart 9).

Chart 7
Credit Standards
diffusion index (above 50 implies net easing)

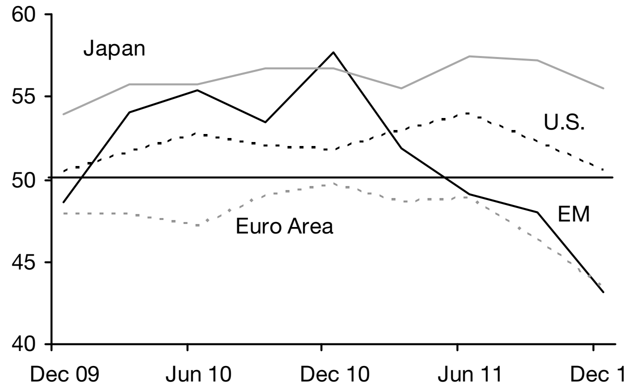


Chart 8
EM and G3 Bank Lending Surveys
diffusion index (above 50 implies net easing)

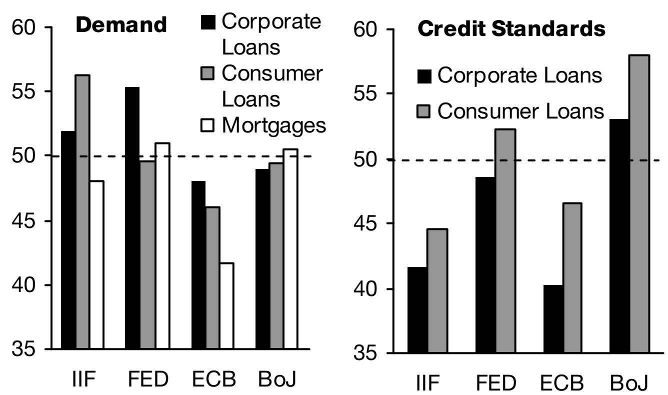
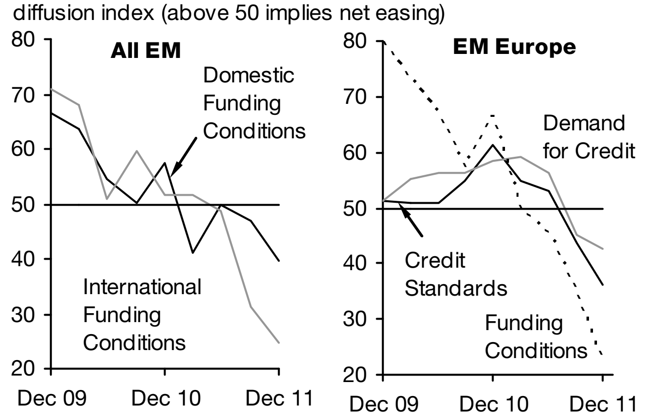


Chart 9
IIF EMLC Survey: EM Bank Funding Conditions
diffusion index (above 50 implies net easing)



Global Overview

BANK REGULATORY REFORM WEIGHS HEAVILY

- Second, we believe that the structures of regulatory reform in the financial sector-mainly on commercial banks—continue to add a significant burden to the intermediation process, hurting the economic expansion. We first warned of these problems in a major report in June 2010. Judging from data on bank lending, leading spreads and GDP outturn since, those concerns seem to be tracking.

- Bank credit growth remains lackluster. In December, bank credit to the private non-financial sector grew by only 1.2% oya in the Euro Area and 2% in the U.S., while in the U.K., bank credit contracted for a second consecutive year (Chart 10).

- Bank lending spreads are harder to measure directly. Spreads of an average of mortgage and corporate loans rates over benchmark 10-year government bond yields have remained elevated, increasing to up to 163 basis points in the U.K., 248 basis points in the U.S. and 215 basis points in the Euro Area by December (Chart 11). In 2010, the spreads averaged 44, 91 and 115 basis points in the U.K., the U.S. and the Euro Area respectively.

- Protracted weakness in macroeconomic conditions and high volatility in financial markets, both resulting from the dragging on of the European sovereign debt crisis, explain in part the continued tightening in credit conditions.

- However, credit conditions also seem to be evolving worryingly in line with the adverse scenario in the September 2011 update of our report. That scenario is increasingly turning into a central case, particularly following the EBA capital exercise, which imposes considerably more stringent capital requirements (9% CT1 in place of Basel III 7%) to be complied with by June 2012 (rather than 2019). Though the EBA has vetoed the use of deleveraging to meet the requirement, the announcement of the exercise results itself is likely to have contributed to some of the most recent credit tightening. Remarkably, our June 2010 forecast of 2011 growth, which included the effects of regulation estimated as part of our report and was significantly softer than official forecasts, has turned out to be on average correct (1.4%) (Table 2).

Chart 10
Bank Credit to the Private Non-financial Sector
percent change over a year ago

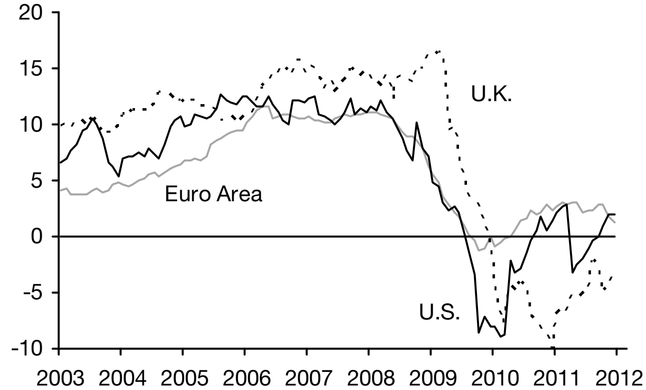
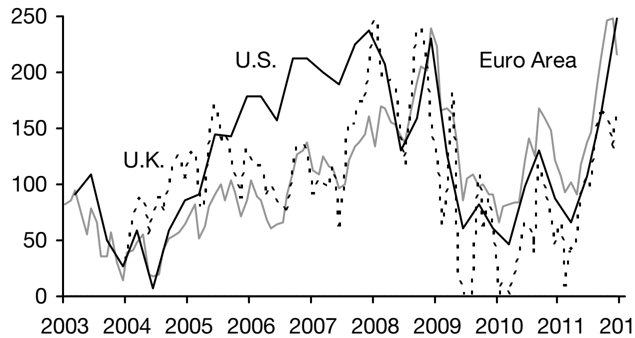


Chart 11
Bank Lending Spreads*
basis points



*Difference between average of mortgage rate and interest rate on corporates loans and 10-year government bond yields

Table 2
2011 Real GDP Forecasts
percent change Q4/Q4, unless stated

	IIF Forecast	Central Bank Forecast	Outturn
United States	2.2	3.9	1.6
Euro Area (y/y)	0.9	1.2	1.5
Q4/Q4	0.9	n.a.	0.7
United Kingdom	1.0	3.5	0.8
Average	1.4	2.7	1.4

Sources:
IIF forecast: June/July 2010 Global Economic Monitor
United States: Federal Reserve forecasts (mid-point of central tendency range).
Euro Area: ECB forecasts (mid-point of estimated range)
United Kingdom: Inflation Report (mid-point of fan chart)

CAPITAL FLOWS TO EM ECONOMIES FALTER

- The third channel of disappointment with the lack of results from easy money comes via global financial linkages, especially when it comes to capital flows to emerging economies.

- Private capital inflows to emerging markets have fallen significantly in 2011H2, largely due to intensifying financial stresses in Europe. In our January report on *Capital Flows to Emerging Market Economies*, we estimate that net private capital inflows to EMs fell to $910 billion in 2011 from $1040 billion in 2010. Although flows seem to have stabilized in recent weeks, we expect aggregate inflows this year to be only $746 billion, which would be 18% below those recorded in 2011 and 31% below our September 2011 forecast for 2012 (Chart 12).

- Tensions in Europe seem to have affected capital flows to EM economies through two main channels. First, concerns about a possible escalation of the European debt crisis have raised global risk aversion, reducing appetite for EM assets (which are perceived to be riskier than those of mature economies).

- Second, a reduction in flows by European investors and lenders accounts for a large portion of the aggregate drop. Total net capital outflows from the Euro Area averaged $1.6 trillion per year from 2004-2007, but fell to only $300 billion per year in 2008-2011 (Chart 13). Recent data suggest that in 2011H2, European investors and lenders were on net withdrawing capital from abroad.

- Bank flows appear to have been particularly affected by the ongoing debt crisis. BIS data on cross-border bank claims indicate that European banks reduced their claims on emerging market economies by a total of $233 billion in the third quarter of 2011 alone (Chart 14). Portfolio equity and debt outflows (to all economies) have also been particularly affected, contracting by $69 billion and $49 billion in 2011Q3, respectively. Foreign direct investment will probably be the only component to make a positive contribution to outward flows from the Euro Area in 2011H2.

Chart 12
Emerging Market Private Capital Inflows, Net
$ billion

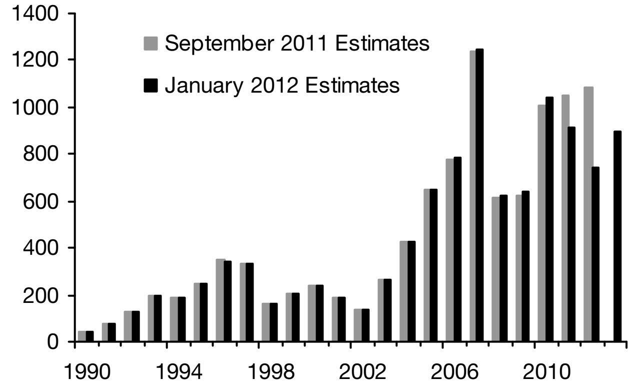


Chart 13
Net Private Capital Outflows
$ billion, net private flows by residency of investors & lenders

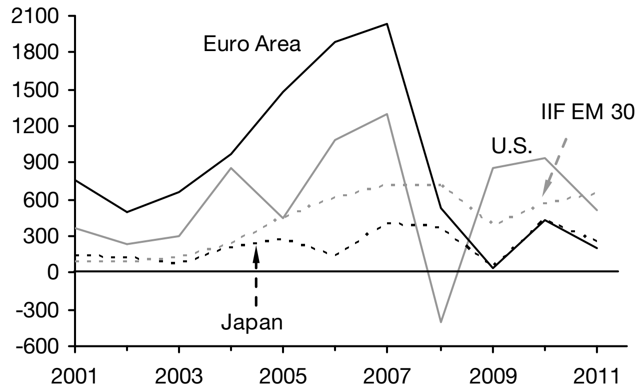
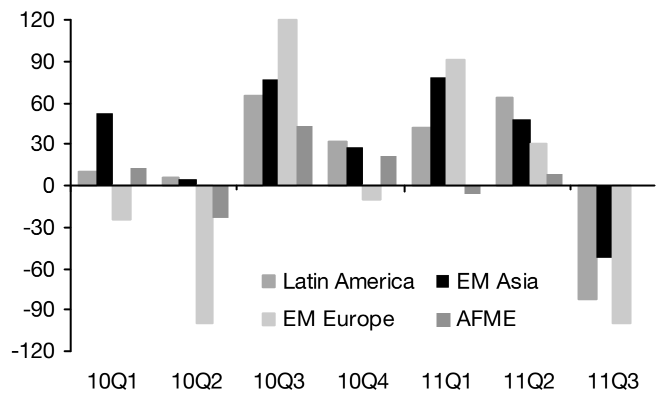


Chart 14
Claims by European Banks on EM Regions
quarterly change in $ billion, ultimate risk basis



OIL PRICES FIRM ON WEATHER AND GREATER RISK

- Brent prices, at a six-month high, have risen over 10% since early January, to $120 per barrel (pb). Prices have surged due to heightened risks in the Middle East, supply hiccups, and a severe European winter (Chart 15).

- On the supply side, geopolitical tensions in the Middle East, and supply outages, notably in the North Sea and South Sudan, have tightened the market. South Sudan stopped production of around 260,000 b/d in late January following a disagreement with Sudan. Libyan production recovered to 1 million b/d in January, suggesting that reductions elsewhere in OPEC are accommodating Libya's recovery (Table 3). We expect stronger production in the Americas to counterbalance other production declines this year.

- Europe has been experiencing colder temperatures and forecasts predict more harsh weather ahead, adding to pressures on demand. Most increases in demand in 2012 and 2013, however, will stem from emerging market growth, which will contribute around 70% of world growth in 2012.

- The Brent/WTI spread has widened again towards the $20pb level last seen in October 2011, as Brent has risen sharply, while WTI has remained at or below the $100pb level, due to continuing excess supply from continental U.S. oil (Chart 16). In early February, U.S. commercial crude oil stocks rose for the third consecutive week to 339.2 million barrels, continuing a counter-seasonal build. Overall, OECD stocks declined for the sixth consecutive month in December.

- We expect prices to remain elevated through Q1 and into Q2. In addition to a tightened demand and supply balance, market concerns continue over the uncertainty surrounding Iran. Any escalation in the situation could cause a short-term price spike that would likely push prices significantly higher. While any reduction in Iran's oil exports would likely be covered by Saudi Arabia and other producers, the market balance will remain tight. Finally, oil, like other commodities, continues to serve as a hedge against cheapened currencies, while low interest rates are likely to feed into the fundamentals-driven price firmness due to strong financial demand.

Chart 15
Oil Prices
$ per barrel

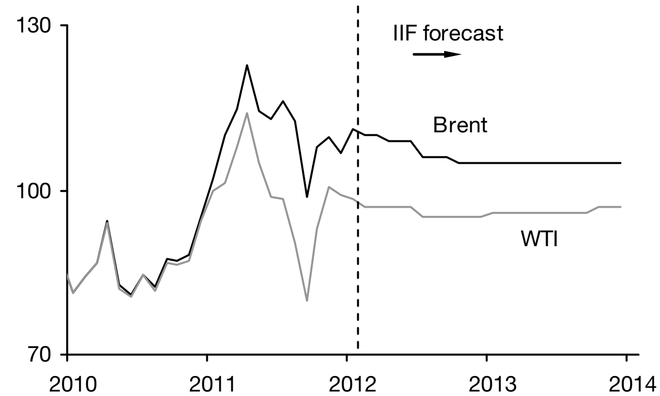
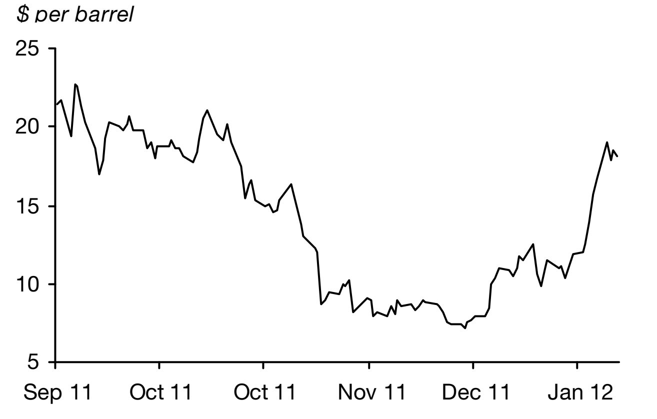


Table 3
Global Demand and Supply
million b/d

	2011	2012	12Q1	12Q2	12Q3	12Q4
Demand (million b/d)	89.1	90.1	88.9	88.8	90.7	90.9
OECD	45.6	45.3	45.9	44.3	45.6	45.6
Non-OECD	43.4	44.8	43.9	44.5	45.2	45.4
Of which: BRIC	19.3	19.9	19.3	19.7	19.9	20.5
Supply	88.5	89.9	89.9	89.2	90.1	90.3
OPEC (crude)	30.0	29.9	30.0	29.5	30.1	30.0
Saudi Arabia	9.1	9.6	9.7	9.6	9.5	9.5
Libya	0.5	1.0	0.8	0.9	1.1	1.2
OPEC NGLs	5.8	6.2	6.1	6.2	6.3	6.3
Non-OPEC	52.7	53.8	53.8	53.5	53.7	54.0
Inventory Change	-0.5	—	—	—	—	—

Source: IEA and IIF Estimates, *Reported by OECD

Chart 16
Brent/WTI Spread
$ per barrel



Global Overview

THE SHIPPING NEWS: FIRE SALE PRICES

- The benchmark measure of world shipping costs — the Baltic Dry Index (BDI) — has collapsed in recent weeks to its lowest level since 1986 (Chart 17; the BDI averages prices charged on the Baltic Exchange in London to transport bulk dry goods over 26 key routes). The variation in the BDI over recent years has been stunning: at its low in early February 2012, the BDI had fallen 95% from its peak in May 2008.

- The BDI fell like a stone from May 2008, and thus acted as a useful leading indicator of the deep global recession that followed a few months later. This raises the interesting question of what the 70% decline in the index between October 2011 and February 2012 might be telling us. The answer seems to be that the combination of an easing in world trade demand and the sudden arrival of significant new shipping capacity late in 2011 has led to a sudden glut in shipping capacity. For traders looking to move (dry) goods around the world, this represents a very welcome price break, which should support world trade and activity.

- In contrast to 2008, the sharp decline in the BDI thus seems to be supply, rather than demand driven. Other information corroborates this view. First, the tanker prices (the cost of shipping oil and other "wet" goods; as represented by the Baltic Tanker index, which we construct as the average of the "dirty" and "clean" Baltic Tanker indices) has been far more stable than the BDI in recent months. In 2008, these indices slumped together. Second, shipping traffic through the Panama and Suez Canals has held up quite well in recent months (Chart 18 again in contrast to 2008-09). Finally, inbound container traffic to West Coast ports in the U.S. has edged up steadily from lows in 2009 (Chart 19).

- There is a darker side to these fire sale prices, however. Ship owners and operators are suffering a major erosion of their operating margins. Ships that were ordered when shortages existed at the peak of the last global expansion (thus giving rise to high BDI levels of early 2008) have now been delivered and may no longer be commercially viable. In due course, this could lead to losses for lenders financing such ship purchases. At these low shipping prices, the demand for new ships is also apt to plunge. Korea, China and Japan account for about 90% of world shipbuilding.

Chart 17
Shipping Costs: Baltic Dry and Tanker Indices
index, December 2001=100

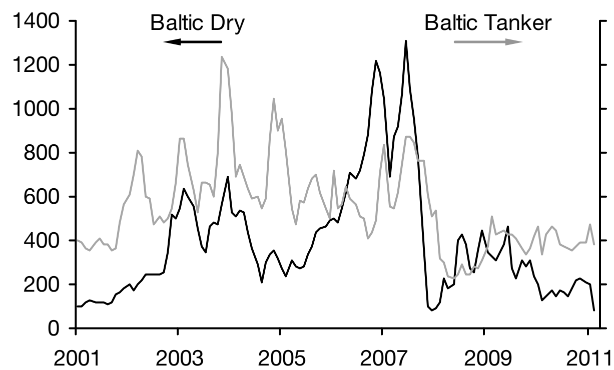


Chart 18
Shipping Volume though Panama and Suez Canals
percent change over a year ago

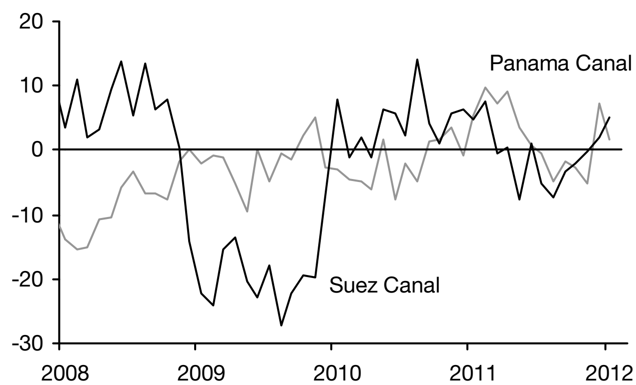
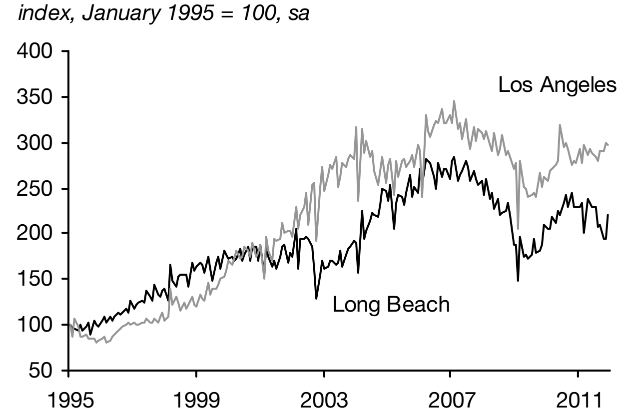


Chart 19
Inbound Container Traffic: Los Angeles and Long Beach
index, January 1995 = 100, sa



United States

U.S. OUTLOOK: HIGH HOPES, LOW EXPECTATIONS

- Recent U.S. labor market data have raised hopes that a more vigorous economic recovery may finally be taking hold. This is suggested by a healthy increase in payroll employment and continued falling jobless claims. In our view, the chances of a solid first quarter have increased, prompting us to raise our current quarter forecast to 3%, saar. However, we would caution against extrapolating too much of this strength for to rest of the year. The forces that have held back the recovery thus far, including weak household balance sheets and an ailing housing sector, are likely to fade only gradually (see page 13).

- According to the BEA's preliminary estimate, growth accelerated to 2.8%, saar, in 2011Q4 (Chart 20). Temporary effects account for a large portion of this acceleration, however. These include (1) a large boost from inventory accumulation, which may be partially reversed in Q1, and (2) a rebound in auto sales after the disruptions earlier in 2011. Trade and inventory data released in early February came in a little stronger than assumed in the BEA's estimate. The second Q4 GDP release on February 29 is thus likely to show an upward revision of around 0.5 percentage points.

- Payroll employment increased by a healthy 243k in January and monthly gains averaged just over 200k in the last 3 months (Chart 21). Hours worked through January were up 3.9%, saar, over Q4. If continued, this would be consistent with output growth exceeding 4%, even if one assumes only modest productivity growth. Expenditure-based data for early 2012 have not been as strong, however. Nominal core retail sales in January were up 2.6%q/q, saar, over 2011Q4 (Chart 22). While it is still early in the quarter, the gap between employment-based data and expenditure-based data is somewhat reminiscent of 2011Q1. In that quarter, hours worked increased at a solid pace, but negative productivity growth meant that GDP grew only 0.4%, saar.

- Policy has become a little more positive for near-term growth prospects. As assumed in our forecast, Congress is moving to extend the payroll tax cut and unemployment insurance through the whole year of 2012. In the meantime, the Fed has adopted some further easing measures, which are likely to support growth marginally (see page 12).

Chart 20
U.S.: Contributions to Growth
percentage points, saar

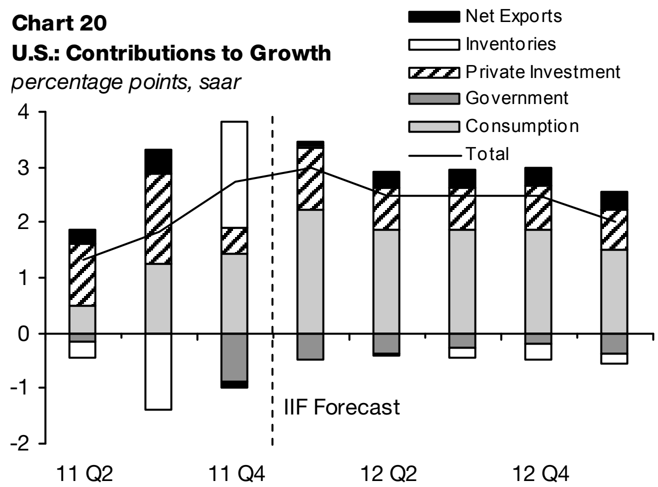


Chart 21
U.S.: Changes in Private and Public Employment
thousand, monthly data

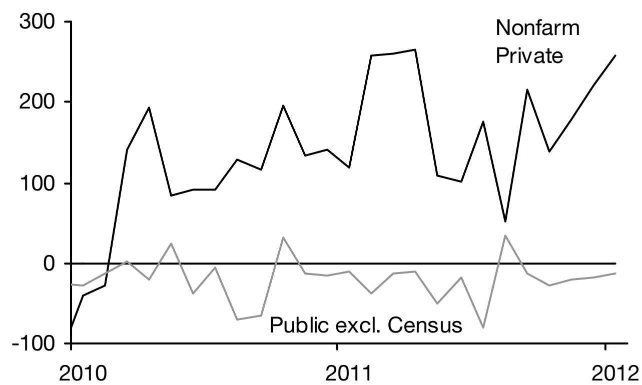
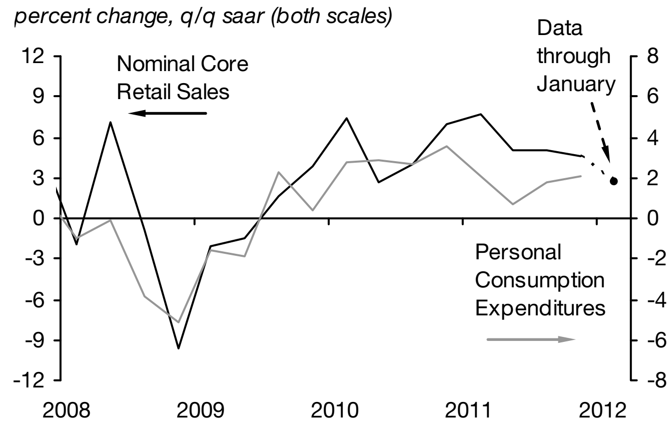


Chart 22
U.S.: Personal Consumption and Retail Sales
percent change, q/q saar (both scales)



United States

UNITED STATES FORECAST IN DETAIL

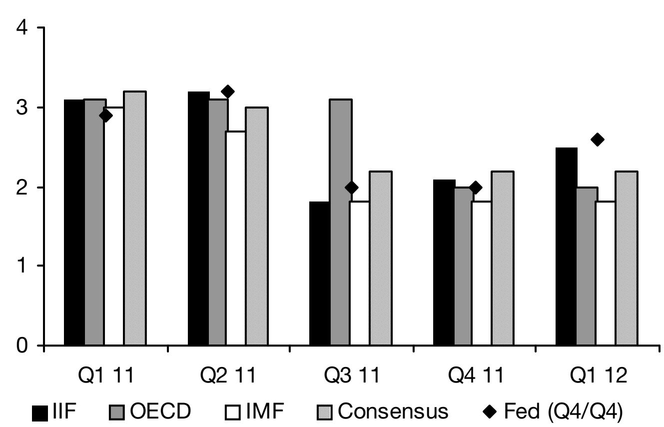
percent change over previous period, seasonally adjusted, at an annual rate, unless otherwise stated

											Q4/Q4		
	2010	**2011**	**2012**	**2013**	**11Q3**	**11Q4**	**12Q1**	**12Q2**	**12Q3**	**12Q4**	**2011**	**2012**	**2013**
Real GDP	3.0	1.7	2.5	2.5	1.8	2.8	3.0	2.5	2.5	2.5	1.6	2.6	2.6
Consumption	2.0	2.2	2.4	2.5	1.7	2.0	3.1	2.6	2.6	2.6	1.6	2.8	2.5
Government Spending	0.7	-2.1	-2.2	-1.4	-0.1	-4.6	-2.5	-2.0	-1.5	-1.0	-2.9	-1.8	-1.3
Fixed Investment	2.6	6.6	7.0	5.3	13.0	3.3	8.4	5.5	5.6	5.8	6.6	6.3	5.1
Business Equipment	14.6	10.3	7.6	5.3	16.2	5.2	8.0	6.0	6.0	6.0	9.0	6.5	4.7
Structures	-15.8	4.1	6.0	5.8	14.4	-7.2	10.0	5.0	5.0	6.0	2.7	6.5	6.0
Residential	-4.3	-1.4	6.0	4.8	1.2	10.9	8.0	4.0	4.5	4.5	3.3	5.2	5.0
Change in Inventories (*$ bn, chained 2000*)	58.8	35.5	51.0	35.9	-2.0	56.0	57.5	56.0	50.4	40.3	—	—	—
Exports of Goods and Services	11.3	6.8	5.2	6.0	4.7	4.6	5.0	6.0	6.0	6.0	5.2	5.7	6.0
Imports of Goods and Services	12.5	5.0	3.1	3.0	1.2	4.4	3.5	3.0	3.0	3.0	3.8	3.1	3.0
GDP Deflator	1.1	2.1	1.4	1.8	2.6	0.4	1.3	1.2	1.4	1.6	2.1	1.4	2.0
Nominal GDP	4.2	3.9	3.9	4.3	4.4	3.2	4.3	3.7	3.9	4.1	3.7	4.0	4.7
Contribution to Changes in Real GDP:													
Domestic Final Sales	1.9	0.0	2.2	2.3	2.8	1.0	2.9	2.2	2.4	2.5	1.4	2.5	2.3
Net Exports	-0.5	0.0	0.2	0.3	0.4	-0.1	0.1	0.3	0.3	0.3	0.1	0.3	0.3
Inventories	1.6	0.0	0.1	-0.1	-1.4	1.9	0.0	0.0	-0.2	-0.3	0.1	-0.1	0.0
Trade Balance (*$ billion*)	-646	-737	-736	-721	-181	-185	-186	-185	-184	-182	—	—	—
Current Account Balance (*$ billion*)	-471	-467	-426	-362	-110	-115	-112	-110	-103	-101	—	—	—
as percent of GDP	-3.2	-3.1	-2.7	-2.2	-2.9	-3.0	-2.9	-2.8	-2.6	-2.5	—	—	—
Consumer Prices (*percent* oya)	1.6	3.1	1.7	2.0	3.8	3.3	2.4	1.7	1.3	1.6	3.3	1.6	2.1
Core Consumer Prices (*percent oya*)	1.0	1.7	1.8	2.0	1.9	2.2	2.1	1.9	1.6	1.7	2.2	1.7	2.1
Unemployment Rate (*percent)*	9.6	8.9	8.4	8.2	9.1	8.7	8.3	8.4	8.4	8.3	—	—	—
Fed Funds Rate (*end of period*)	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	—	—	—
$ per € (*end of period*)	1.34	1.30	1.20	1.35	1.34	1.30	1.25	1.20	1.20	1.20	—	—	—
¥ per $ (*end of period*)	81.1	76.9	76.5	78.0	77.1	76.9	77.0	76.5	76.5	76.5	—	—	—
Federal Budget Balance (FY, *$ billion*)	-1294	-1297	-1211	-1002	—	—	—	—	—	—	—	—	—
as percent of GDP	-9.3	-8.9	-7.8	-6.2	—	—	—	—	—	—	—	—	—
Industrial Production - Manufacturing	5.4	4.5	3.5	3.4	5.0	3.9	4.0	3.0	3.0	3.5	4.0	3.4	3.6

Table 4
U.S.: Latest Real GDP Growth Forecasts
percent

	2012	2013	As of:
		y/y	
IMF	1.8	2.2	Jan 12
OECD	2.0	2.5	Nov 11
Bloomberg Consensus	2.2	2.5	Feb 12
IIF	2.5	2.5	Feb 12
		Q4/Q4	
Federal Reserve	2.2 to 2.7	2.8 to 3.2	Jan 12
IIF	2.6	2.6	Feb 12

Chart 23
U.S.: The Evolution of 2012 GDP Growth Forecasts
percent, y/y, forecasts as of the end of quarter



United States

MONETARY POLICY: THE POWER OF PLACEBOS

- After its January 25 policy meeting, the FOMC announced a number of measures to ease monetary policy further and improve its communication with the public (Table 5). In our view, these steps have mainly symbolic importance, reinforcing the message that the Fed is doing all it can do to support growth. This message may be of value all by itself. At this point, the only effective channel through which the Fed may be able to boost growth is probably a "placebo effect", where the perception of policy support boosts market confidence. Besides reviving animal spirits, the impact of recent measures is likely to be confined to financial markets, however, and we expect no appreciable boost to the real economy.

- The Fed announced that it expected the federal funds rate to remain "exceptionally low" through late 2014 (rather than through mid-2013). In its meeting minutes, the FOMC clarified that "exceptionally low" means 1% or less, rather than 0-0.25%. The extension seems to have helped lower medium-term interest rates further, with yields on 5-year Treasuries declining 10bp on the day of the meeting.

- In the press conference following the policy meeting, Chairman Bernanke emphasized that the FOMC is seriously considering another round of large-scale asset purchases ("QE3"). If implemented, these would likely lower yields on Treasuries further while boosting equity prices and other assets. Given how much the Fed has expanded its balance sheet already, the additional benefits of this in terms of boosting economic activity should be very small (Chart 24). At the same time, there are rising costs to this measure, including distortions to the efficient allocation of resources and incentives for investors to take undue risks.

- The Fed has also taken steps to make its policy-making process more transparent. This additional transparency serves mainly as a reminder on just how subjective, ambiguous, and challenging the nature of monetary policy making is. This point is illustrated by the interest rate forecasts of individual meeting participants (Chart 25). Participants have widely diverging views as to when the right time for the first rate hike will be, ranging from as early as this year to as late as 2016.

Table 5
Our Assessment of Recent Monetary Policy Measures

Measure	Significant Impact on Financial Markets?	Significant Impact on Real Economy?	Distortions
Extend period in which policy rate will be near zero	yes	no	misallocation of resources: excessive risk-taking, "tax" on savings
Raise possibility of QE3	yes	no	
Publish FOMC participants views on prospective rate hikes	no	no	-
Adopt explicit inflation target of 2%	no	no	-

Chart 24
Federal Reserve Assets
$ trillion

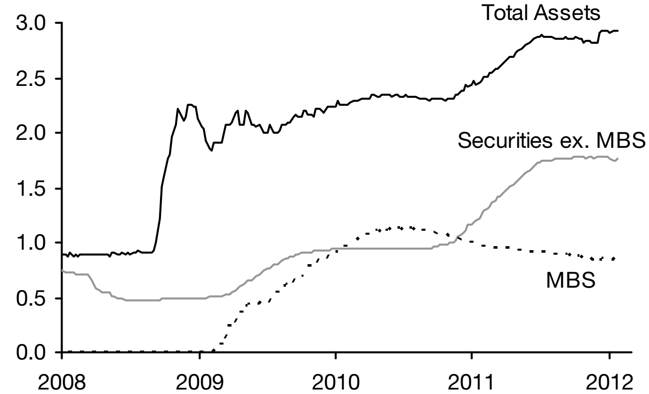
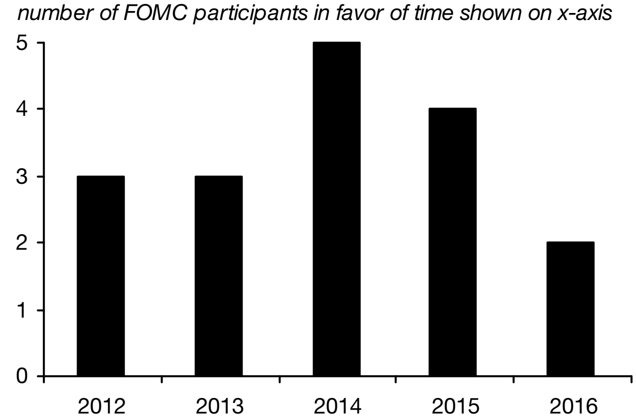


Chart 25
Appropriate Time of First Policy Rate Hike as per FOMC
number of FOMC participants in favor of time shown on x-axis



United States

HOUSING MARKET: FIRST SIGNS OF REVIVAL

- Historically, housing has been one of the first sectors to pick up after a recession, contributing an average 0.5 percentage points to growth in the first 2.5 years of a recovery (Chart 26). In the current recovery, however, the housing market has been extraordinarily weak for two main reasons. First, there is an excess supply of housing resulting from the construction boom in the 2000s. Second, mortgage lending standards are unduly tight even for credit-worthy borrowers.

- Recent indicators make us cautiously optimistic that a recovery on the housing market may finally be underway. Housing starts have increased for 8 consecutive months on a three-month moving average basis (Chart 27). They are now up 29% from the trough reached in May 2009. However, this increase occurred from a depressed level that is still far below anything seen before the crisis of 2008. In addition, headwinds remain due to the difficulty many borrowers face in obtaining mortgages and the continued influx of foreclosed homes.

- To boost the housing market, both President Obama and the Fed have offered several policy options for Congress. Obama's latest plan would extend the option to refinance to all homeowners, regardless of whether their mortgage is backed by Fannie Mae and Freddie Mac or not. So far, government refinancing programs have been limited to people with mortgages backed by Fannie and Freddie.

- The Fed has identified a number of policy options that could loosen mortgage standards and allow for easier conversion of vacant homes into rental properties. Rental vacancy rates have declined while rents have increased, suggesting that there is increasing demand for rental units (Chart 28). Thus, regulation allowing for owner-occupied properties to become rental properties would help sop up excess supply in the housing market. Further Fed suggestions include promoting alternatives to foreclosure, such as loan modifications, deeds-in-lieu or short sales, which would reduce foreclosure rates. We believe that the policy options identified by the Fed would indeed help support the housing market. At present, however, it seems unlikely that much action will be taken before the election.

Chart 26
U.S.: Residential Investment Contribution to GDP Growth
percentage pts, avg. over 10 quarters after recession, annualized

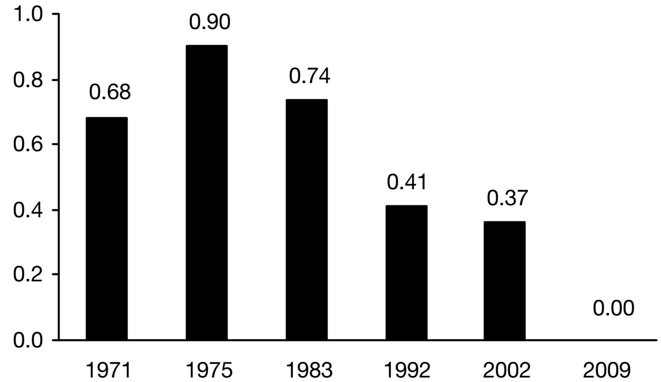


Chart 27
U.S.: Housing Starts and Permits
1000s of homes, 3-month ma

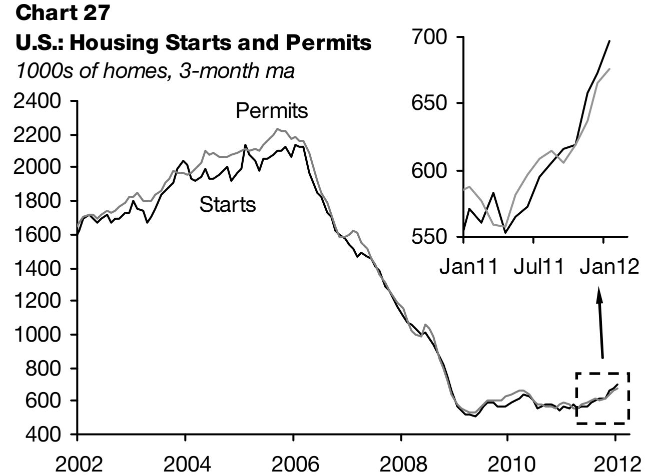
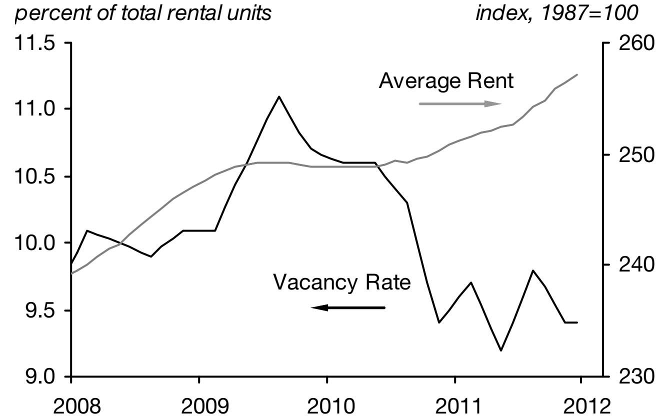


Chart 28
U.S.: Average Rental Price and Vacancy Rate
percent of total rental units *index, 1987=100*



Euro Area

EURO AREA: TENTATIVE SIGNS OF STABILIZATION

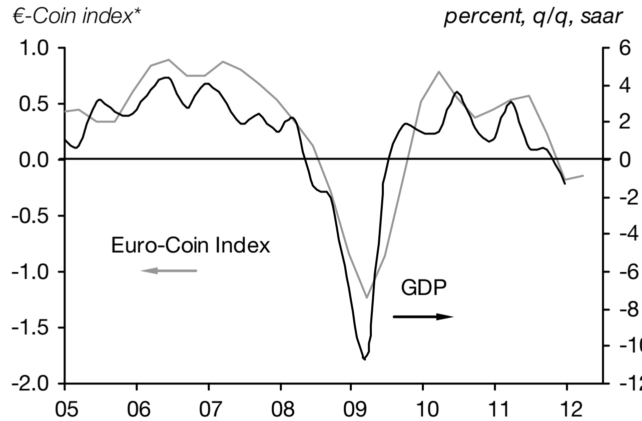
- Following a flurry of weak surveys and hard economic data, the Euro Area Q4 GDP contraction of –1.3 q/q, saar, came in better than expected (our forecast was for –2%q/q,saar; (Chart 29). With ongoing fiscal tightening, bank deleveraging, and persisting financial tensions, we view this as the onset of a mild regional recession for the region as a whole, with striking divergences among countries. The smaller peripheral economies, which have been stuck in the vicious circle of fiscal retrenchment and output contraction since 2010, are experiencing a deepening in their downturn. The slump in the core region, by contrast, is less pronounced and interrupts a period of growth since 2009Q2.

- Going forward, tentative signs of stabilization in surveys data prompted us to revise our forecast for Q1 upwards, from –2 q/q, saar to flat (Chart 30). In January, the services PMI rose to 50.4, breaking the threshold of 50 for the first time in the past five months . The manufacturing PMI ticked up for the second consecutive month, although at 48.8 it is still below the break-even level. Similarly, there was a leveling off in consumer and industrial confidence after the previous eleven months of free-fall. On a country level, PMI data suggest a rebound in German manufacturing activity and a slowing decline in Italy and Spain.

- Recent bad weather adds an extra uncertainty to near-term conditions. It seems quite likely to have damaged activity in February, with a rebound likely offset in March.

- As we proceed further into Q2 and Q3, the sovereign debt crisis continues to be the key risk to the economic outlook for the Euro Area. We believe a systemic crisis will be averted by further aggressive measures by the ECB (see page 16). The recent stabilization in confidence, however, is unlikely to be sufficient for the region to resume positive output growth any time soon, as domestic demand is constrained by fiscal contraction and tight credit conditions. Although the breakdown of GDP components is not yet available for most countries, domestic demand is expected to have been a drag across the region. In December retail sales declined for the fourth straight month, leading to a quarterly decline of –2.6q/q, saar. Retail confidence has been on a declining trend for over a year (Chart 31).

Chart 29
Euro Area: GDP Growth and €-Coin Indicator



*€- coin is a monthly estimate of the Euro Area real economic activity, computed by the Bank of Italy.

Chart 30
Euro Area: Industrial Production and Manufacturing PMI

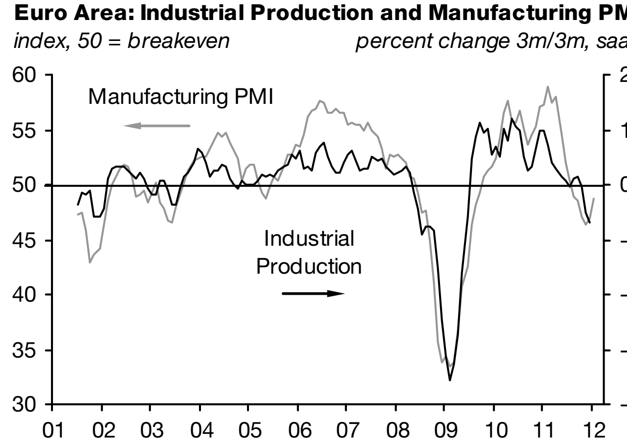


Chart 31
Euro Area: Retail Sales and Retail Confidence

Euro Area

EURO AREA FORECAST IN DETAIL

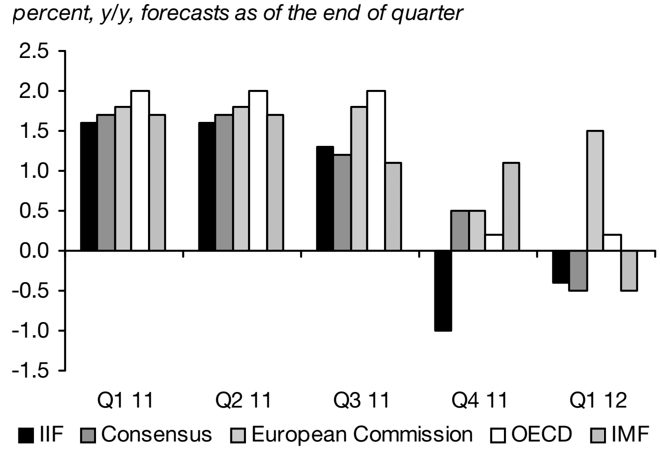
percent change over previous period, seasonally adjusted, at an annual rate, unless otherwise stated

	2010	2011	2012	2013	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4	Q4/Q4 2011	Q4/Q4 2012	Q4/Q4 2013
Real GDP	1.9	1.5	-0.4	1.2	0.5	-1.3	0.0	-2.0	0.0	1.0	0.7	-0.3	1.7
Consumption	0.8	0.8	9.4	0.1	0.9	-1.5	-1.5	-2.0	-2.0	-1.0	-0.7	-1.6	1.0
Government Spending	0.6	0.6	12.8	-0.9	-0.3	-0.5	-0.5	-1.0	-1.0	-0.5	-0.1	-0.8	-1.0
Fixed Investment	-0.8	-0.9	11.1	1.4	-0.4	-1.0	-1.0	-1.5	1.0	1.0	1.4	-0.1	2.1
Exports of Goods and Services	11.3	10.9	15.7	4.0	4.8	3.5	4.0	4.0	4.0	4.0	5.2	4.0	4.0
Imports of Goods and Services	9.5	9.3	10.0	2.0	3.2	2.0	2.0	2.0	2.0	2.0	2.9	2.0	2.0
GDP Deflator	0.7	0.9	-8.7	1.0	1.5	1.0	1.0	1.0	1.0	1.0	1.5	1.0	1.0
Nominal GDP	2.5	2.6	3.0	2.2	2.0	-0.9	1.0	-1.0	1.0	2.0	2.0	0.7	2.8
Contribution to Changes in Real GDP:													
Domestic Final Sales	0.5	0.4	9.1	0.1	0.4	-1.1	-1.1	-1.6	-1.2	-0.5	—	—	—
Net Exports	0.8	0.8	2.4	1.0	0.8	0.7	0.9	0.9	1.0	1.0	—	—	—
Inventories	0.6	0.5	-11.9	0.1	-0.6	-0.8	0.2	-1.3	0.2	0.5	—	—	—
Trade Balance (*€ billion*)	8.7	16.1	3.7	-0.2	1.9	1.5	1.3	1.1	0.8	0.6	—	—	—
Current Account Balance (*€ billion*)	-45.7	-43.2	24.9	44.2	-1.7	-1.5	5.9	4.0	3.4	-0.4	—	—	—
as percent of GDP	-0.5	-0.5	0.3	0.5	-0.1	-0.1	0.2	0.2	0.1	0.0	—	—	—
Consumer Prices (*percent* oya)	1.6	2.7	2.2	1.9	2.7	2.9	2.7	2.5	2.0	1.8	2.9	1.8	2.0
Core Consumer Prices (*percent oya*)	1.0	1.4	1.3	1.1	1.3	1.6	1.5	1.3	1.2	1.2	1.6	1.2	1.1
Unemployment Rate (*percent)*	10.1	10.1	10.8	11.0	10.2	10.4	10.5	10.7	11.0	11.0	—	—	—
ECB Refi Rate (*percent, end of period*)	1.00	1.00	1.00	0.50	1.50	1.00	0.75	0.50	0.50	0.50	—	—	—
$ per € (*end of period*)	1.34	1.30	1.20	1.35	1.34	1.30	1.25	1.20	1.20	1.20	—	—	—
Euro Area Budget Balance (*percent of GDP*)	-6.2	-6.0	-4.6	-3.8	—	—	—	—	—	—	—	—	—
Index of Manufacturing Production	7.4	3.6	-2.2	1.1	1.6	-6.7	-2.0	-2.5	-1.5	1.0	-0.2	-1.3	2.0
Index of Capital Goods Production	9.1	9.0	-0.1	3.0	9.7	-5.1	-1.0	-2.0	-1.0	4.0	3.5	0.0	4.0
Euro Area Countries Real GDP:													
Germany	3.7	3.0	0.6	1.8	2.3	-0.7	1.0	0.0	1.0	2.0	2.0	1.0	2.2
France	1.5	1.6	0.1	0.9	1.3	0.9	0.0	-1.5	0.0	0.5	1.4	-0.3	1.5
Italy	1.5	0.5	-2.4	0.4	-0.7	-2.9	-2.5	-3.0	-2.5	-1.0	-0.5	-2.3	1.9
Spain	-0.1	0.7	-1.0	1.3	0.0	-1.1	-1.5	-2.5	0.5	0.5	0.3	-0.8	2.0

Table 6
Euro Area: Latest Real GDP Growth Forecasts
percent, y/y

	2012	2013	As of:
IMF	-0.5	0.8	Jan 12
OECD	0.2	1.4	Nov 11
ECB	-0.4 to 1.0	0.3 to 2.3	Dec 11
European Commission	1.5	1.3	Nov 11
Bloomberg Consensus	-0.5	1.0	Feb 12
IIF	-0.4	1.2	Feb 12

Chart 32
Euro Area: The Evolution of 2012 GDP Growth Forecasts
percent, y/y, forecasts as of the end of quarter



Euro Area

ECB: ABUNDANT LIQUIDITY WORKS OUT (FOR NOW)

- While Euro Area leaders look for a fundamental resolution to the debt crisis, the ECB continues to play the key role in providing an effective systemic firewall. In December the ECB conducted the first of two 3-year long term refinancing operations (LTRO), with the second round scheduled for February 29. As amount of €489 billion tender replaced maturing ECB operations, net new money of about €190 billion was injected.

- The potential benefits of these longer-term loans are twofold. First, abundant and cheap liquidity eased fears of a credit crunch, as reflected in declining borrowing costs in the unsecured interbank market. Second, that long-term liquidity (the ECB hopes) will facilitate credit flows to the real economy. The latest bank lending survey pointed to a further deterioration in lending conditions to both non-financial corporations and households in December (Chart 34). As President Draghi has noted, the proceeds from the first LTRO are likely to have been used to fund banks' own maturing bonds (€230 billion due in Q1), while the second LTRO is expected to provide more free funds (Chart 35). Against the backdrop of closely intertwined solvency and liquidity problems, the announcement of the ECB measures boosted confidence, pushing down sovereign borrowing costs for the Euro Area as a whole (Chart 33).

- Apart from using the funds to roll over their own debt or lending to the real economy, banks have undoubtedly used funds to maintain or build holdings of government bonds or other high-yield securities, thus helping stabilize sovereign debt market. Euro Area banks' buying of government bonds tends to follow the risk-free term-spread (Chart 35). Except for Spain, however, the ECB data for December do not suggest an acceleration in purchases of government debt securities yet.

- Finally, LTRO money could be used to build a cash buffer and be parked at the ECB's deposit facility for a low remuneration rate of 0.25%. Increasing recourse to the deposit facility, however, is not a good measure of such behavior, as it reflects excess liquidity independently of the use of the funds. As Mr. Draghi has noted, banks that use the ECB deposit facility are usually not the same as those who participated in the 3-year LTRO.

Chart 33
Euro Area: Bond and Money Markets
basis points

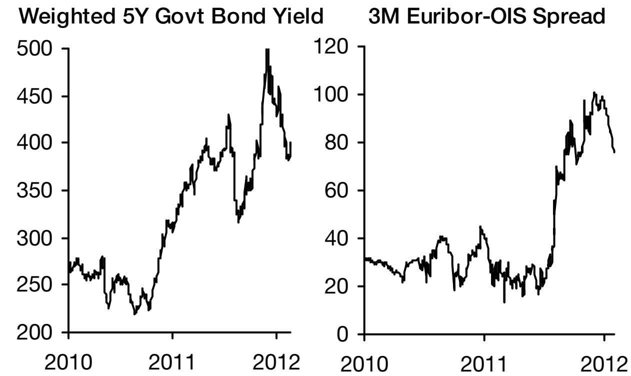


Chart 34
ECB Lending Survey
net balance, percentage points

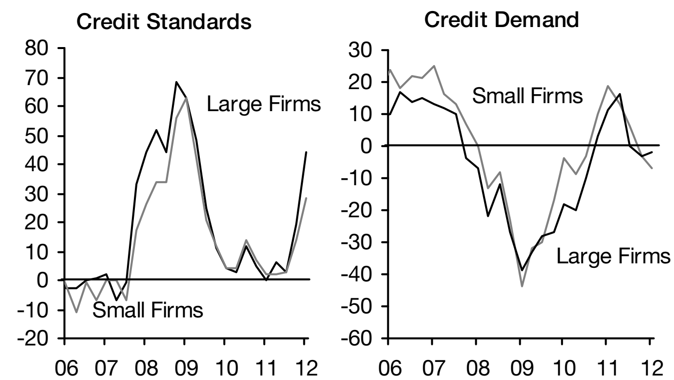
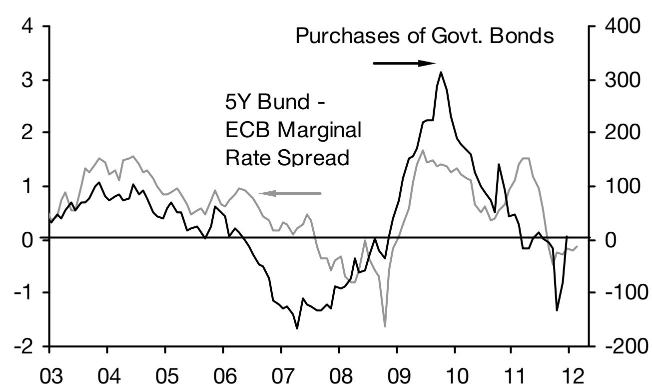


Chart 35
Euro Area: Banks' Carry Trade into Government Bonds
percentage points *€ billion, 12-month roll. sum*



Euro Area

EURO AREA PERIPHERY: STILL NOT COMPETITIVE

- Countries subject to EU-IMF financial support programs have seen their competitiveness weaken sharply since euro adoption. This reflected larger wage increases than those in their main trading partners, inflexible labor markets that have kept productivity growth slower and, at least in some of them, substantial currency appreciation (Chart 36). Even though substantial progress has been made in improving competitiveness in all three countries, thus far only half of the deterioration since euro adoption has been reversed.

- **Ireland** has made the most progress in restoring its competitiveness, but it is also the country where it had deteriorated the most (Chart 37). A substantial portion of the earlier deterioration and the recent gains reflect exchange rate movements, to which Ireland, which has a particularly large share of trade with countries outside the Euro Area, is especially susceptible. Competitiveness has also improved thanks to a rather flexible labor market, with wages and employment adjusting enough to boost exports sharply, helping shift the current account into surplus (Chart 38).

- In **Portugal** the improvement in competitiveness appears to have been the smallest, as was the earlier deterioration. The smaller improvement reflects both the more limited impact of exchange rate movements and the fact that the adjustment began only recently, but also the remaining substantial labor market rigidities, especially in the public sector. Flexibility is much larger in the tradables sector, where competitiveness gains have been bigger, helping boost exports sharply last year. The current account deficit has narrowed, but remains sizable, with further reforms needed in the sheltered segments of the labor market.

- Relative unit labor costs have declined sharply in **Greece** recently, but this was sufficient to offset only half of the earlier deterioration. The decline in labor costs, however, reflected mainly a drop in employment as inflexible wage-setting rules in the private sector have limited wage adjustment. With exports and import substitutes representing a small share in GDP, any output gains from improved competitiveness would require deeper structural reforms and are likely to be smaller and come later than in the other Euro Area periphery countries.

Chart 36
Euro Area: Nominal Effective Exchange Rate
index, 1999 Q1 = 100

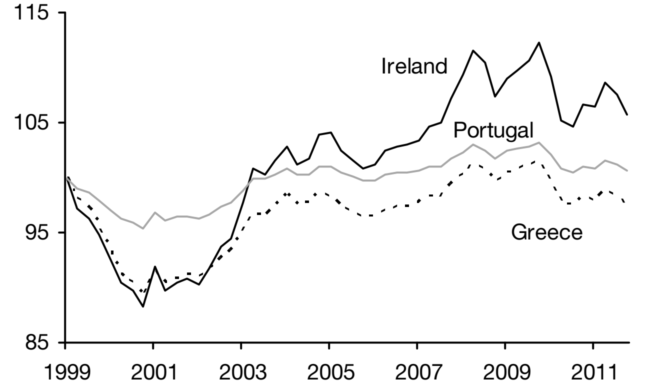


Chart 37
Euro Area: ULC-Based Competitiveness Indicators
index, 1999Q1 = 100

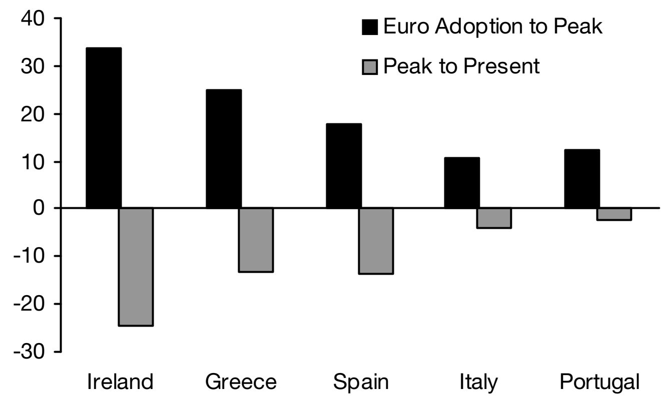
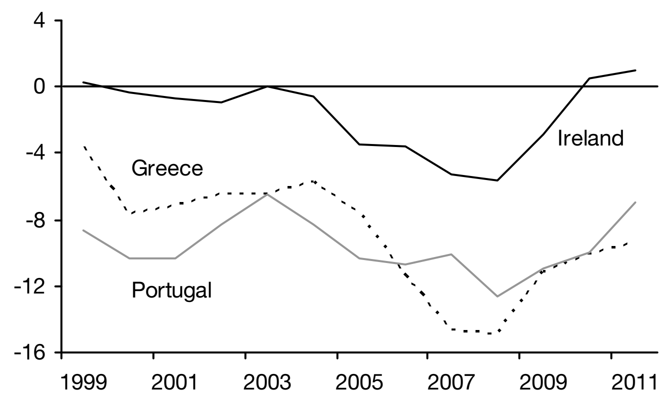


Chart 38
Euro Area: Current Account Balance
percent of GDP



Japan

A TOUGH YEAR AHEAD

- This week's release of GDP data revealed that the Japanese economy shrank more than expected by 2.3%q/q saar in Q4, reflecting a sharp decline in inventories and a large drag from the external sector (Chart 39). Net exports made a negative contribution of 2.6 percentage points as exports plunged by almost 12%. This drop was driven by (1) supply-chain disruptions caused by Thai floods, (2) the persistently strong yen and (3) faltering external demand. The increase in imports was also prominent as the demand for fossil fuel from overseas surged. Although private consumption growth decelerated significantly after surging strongly in Q3, domestic demand was firm in Q4, reflecting a rebound in private investment.

- Inventory rebuilding and the delayed public reconstruction spending should boost domestic demand in the near term. We also expect exports to rebound significantly once the supply chain disruptions from Thailand are resolved. Thus, it is most likely that Japan will resume its path of moderate economic growth in 2012. However, the uncertainty surrounding the outlook is substantial. The devastating earthquake in March reduced electricity capacity of the country sharply, which continues to weigh on business investment. Almost two thirds of the nuclear power stations have already been shut down, and rising public concerns over nuclear safety is likely to lead to more shutdowns in 2012. Japan's economy is thus becoming heavily dependent on outside supplies of energy, which will continue to adversely affect the trade balance and current account (Chart 40). With foreign demand remaining lackluster amid unsettled global financial tensions, we now project the economy to grow around 1.7% this year.

- On the monetary policy side, intensified political pressures pushed the BoJ to increase the size of its Asset Purchase Program (APP) to ¥65 trillion, reflecting a ¥10 trillion rise in government bond purchases (Chart 41). Although Governor Shirakawa declared that the BoJ did not aim to finance the fiscal deficit —which has been escalating due to the ongoing reconstruction spending— this policy change should reduce the cost of issuing JGBs. In addition, that the BoJ introduced an explicit inflation target of 1% suggests that more could be coming on the policy front.

Chart 39
Japan: Contributions to Growth
percentage points, saar

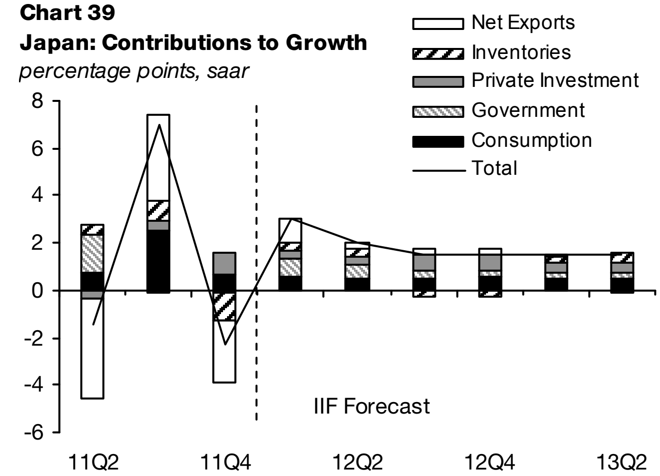


Chart 40
Japan: Trade Balance and Current Account Balance
¥ trillion

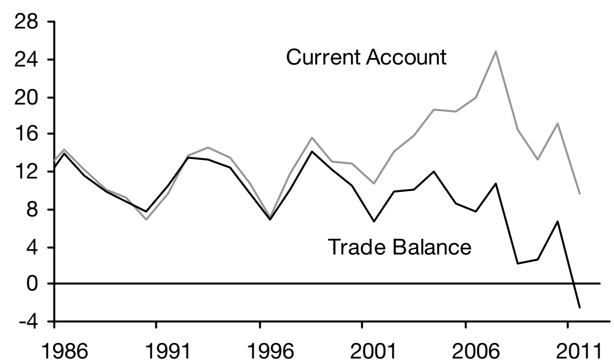
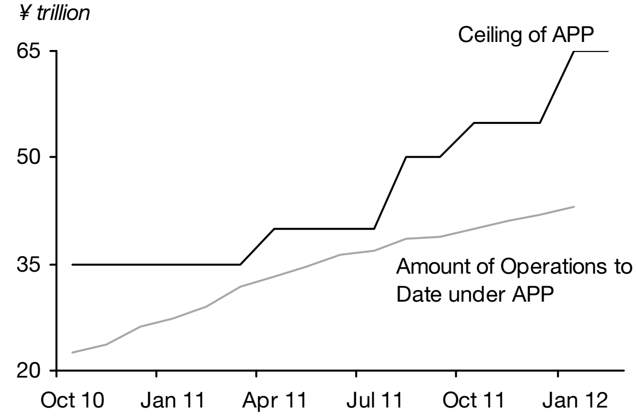


Chart 41
Japan: BoJ's Asset Purchase Program
¥ trillion



Japan

JAPAN FORECAST IN DETAIL

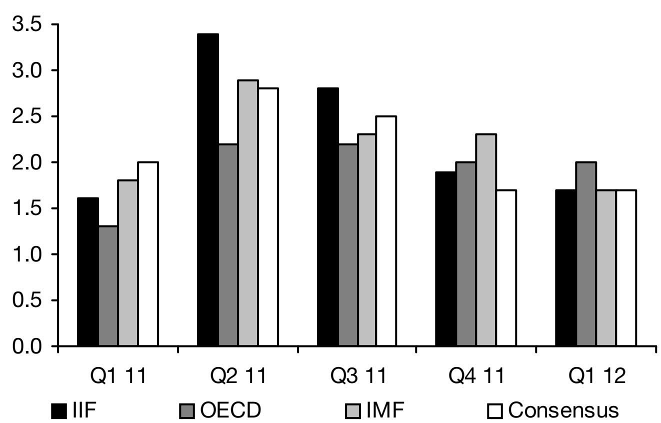
percent change over previous period, seasonally adjusted, at an annual rate, unless otherwise stated

	2010	2011	2012	2013	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4	Q4/Q4 2011	Q4/Q4 2012	Q4/Q4 2013
Real GDP	4.5	-0.9	1.7	1.5	7.0	-2.3	3.0	2.0	1.5	1.5	-1.0	2.0	1.5
Consumption	2.6	0.0	1.4	0.8	4.2	1.2	1.0	0.8	0.8	1.0	0.5	0.9	0.8
Government Spending	2.1	2.1	1.2	1.0	1.1	1.4	1.0	1.0	1.0	1.0	1.8	1.0	1.0
Fixed investment	-0.1	0.0	3.4	3.1	0.9	2.3	4.5	3.7	4.4	3.7	1.1	4.1	2.6
Business	0.8	0.2	3.2	3.6	-0.1	7.9	2.0	2.0	5.0	5.0	1.2	3.5	3.0
Government	-0.2	-3.3	4.9	2.7	-6.2	-9.5	15.0	10.0	4.0	2.0	-0.2	7.6	2.0
Residential	-4.6	5.1	2.1	1.5	19.0	-3.1	2.0	2.0	2.0	0.0	2.7	1.5	1.5
Change in Inventories *(¥ trillion, chained)*	-1.3	-3.5	-3.5	-2.8	-2.5	-3.9	-3.6	-3.1	-3.5	-3.8	—	—	—
Exports of Goods and Services	24.4	0.0	4.4	4.0	39.0	-11.9	10.0	5.0	5.0	5.0	-1.7	6.2	3.2
Imports of Goods and Services	11.1	5.9	5.1	4.0	14.2	4.1	4.0	4.0	4.0	4.0	5.8	4.0	4.0
GDP Deflator	-2.1	-1.9	-1.2	-1.0	-0.9	-0.9	-1.0	-1.0	-1.0	-1.0	-1.6	-1.0	-1.0
Nominal GDP	2.3	-2.8	0.6	0.5	6.1	-3.1	2.0	1.0	0.5	0.5	-2.7	1.0	0.5
Contribution to Changes in Real GDP:													
Domestic final sales	2.0	0.4	1.7	1.3	2.9	1.4	1.7	1.4	1.5	1.5	—	—	—
Net Exports	2.0	-0.7	0.0	0.1	3.6	-2.6	1.0	0.3	0.3	0.3	—	—	—
Inventories	0.7	-0.4	0.0	0.1	0.8	-1.1	0.3	0.4	-0.3	-0.3	—	—	—
Discrepancy	-0.2	-0.1	—	—	-0.4	0.0	—	—	—	—	—	—	—
Trade Balance *(¥ trillion)*	7.94	-1.58	-2.95	-2.36	-0.13	-1.12	-0.87	-0.78	-0.69	-0.62	—	—	—
Current Account Balance *(¥ trillion)*	17.16	9.62	9.13	9.73	2.71	1.75	2.56	2.05	2.83	1.68	—	—	—
as percent of GDP	3.6	2.1	1.9	2.1	2.3	1.5	2.2	1.7	2.4	1.4	—	—	—
Consumer Prices *(percent oya)*	-0.7	-0.3	-0.2	-0.1	0.1	-0.3	-0.3	-0.2	-0.2	-0.1	-0.3	-0.1	0.0
Core Consumer Prices *(percent oya)*	-1.2	-1.0	-0.7	-0.3	-0.4	-1.1	-1.0	-0.9	-0.9	-0.4	-1.1	-0.4	-0.3
Unemployment Rate *(percent)*	5.1	4.6	4.3	4.3	4.4	4.5	4.3	4.3	4.3	4.3	—	—	—
BoJ Overnight Call Rate *(end of period)*	0.10	0.10	0.10	0.10	0.1	0.1	0.1	0.1	0.1	0.1	—	—	—
¥ per $ *(end of period)*	81.1	76.9	76.5	78.0	77.1	76.9	77.0	76.5	76.5	76.5	—	—	—
Government General Balance *(% of GDP)*	-7.8	-9.0	-9.2	-9.5	—	—	—	—	—	—	—	—	—
Index of Manufacturing Production	16.6	-3.5	6.0	3.0	18.3	-2.1	15.0	5.0	5.0	2.5	-2.4	6.8	2.5

Table 7
Japan: Latest Real GDP Growth Forecasts
percent, y/y

	2012	2013	As of
		Calendar Year	
IMF	1.7	1.6	Jan 12
OECD	2.0	1.6	Nov 11
Bloomberg Consensus	1.7	1.7	Feb 12
IIF	1.7	1.5	Feb 12
		Fiscal Year	
Bank of Japan	2.2	1.5	Jan 12
IIF	1.7	1.5	Feb 12

Chart 42
Japan: The Evolution of 2012 GDP Growth Forecasts
percent, y/y, forecasts as of the end of quarter



Canada

REMAINING CAUTIOUS ABOUT THE OUTLOOK

- After a strong rebound in Q3, Canada's economy seems to have lost momentum in Q4. The disappointing November GDP report pointed to a drop in goods production, reflecting lower output in the energy sector amid shut downs for maintenance. GDP through November is now only 1.2%, saar, above the Q3 average (Chart 43).

- Our Canada growth forecast for 2012 looks for subpar growth of 1.9%, which would be a modest deceleration from our 2011 estimate of 2.3%. Domestic demand should continue to be the driver of growth, led by increasing business investment. We believe, however, both private consumption and government spending growth will decelerate slightly due to ongoing fiscal consolidation and weak consumer confidence. In addition, private consumption will be held back this year by weak employment and income growth as well as a possible further contraction in mortgage credit.

- The Canadian trade surplus doubled in December from November, led by a surge both in machinery and equipment exports. The trade balance recorded a surplus of C$1.4 billion in 2011, after previous year's deficit of C$8.9 billion. Although it is difficult to glean much insight about the near future based on the latest trade report, an acceleration in U.S. demand would support exports (machinery and autos) over time and lead to a stronger trade balance in 2012. On the other hand, weak terms of trade conditions and a faltering external environment would limit further improvements in the trade balance (Chart 44).

- A notable recent development is the continued increase in the unemployment rate. Driven by large private sector job losses (Chart 45), the unemployment rate edged up to 7.6% in January. With the ongoing fiscal tightening, we expect a gradual increase in public sector job losses in 2012. Moreover, deteriorating external conditions, including softer commodity prices, would continue to hamper private employment growth in the first half of 2012. It is important to note that there are large disparities between provinces. In the most populous provinces, the unemployment rate remained higher than the national average (8.1% in Ontario and 8.4% in Quebec).

Chart 43
Canada: Monthly GDP and Industrial Production
percent change, 3m/3m, saar

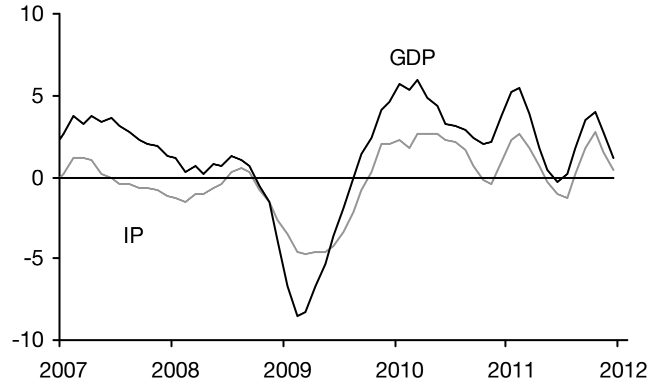


Chart 44
Canada: Trade Balance and Terms of Trade
C$ billion *index (2001 = 100)*

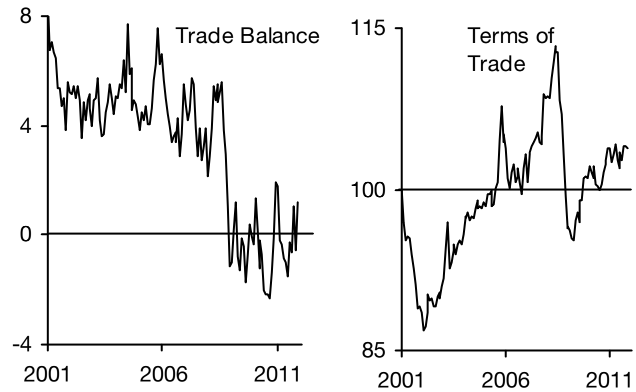
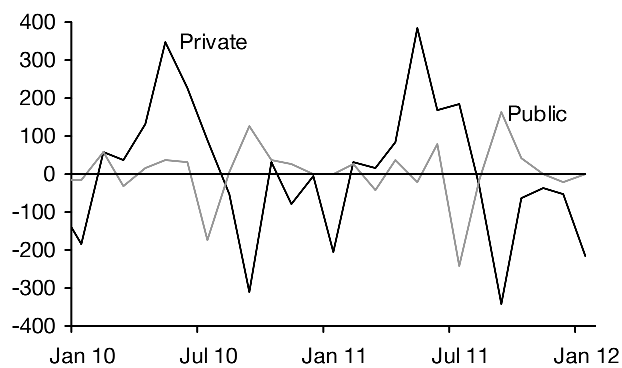


Chart 45
Canada: Changes in Private and Public Employment
thousand



Other Mature Economies

OTHER MATURE ECONOMIES FORECAST SUMMARY

percent change over previous period, seasonally adjusted, at an annual rate, unless otherwise stated

	2010	2011	2012	2013	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4	Q4/Q4 2011	Q4/Q4 2012	Q4/Q4 2013
Australia													
Real GDP	2.6	1.9	3.0	3.1	3.9	1.5	3.0	3.0	3.5	3.0	2.0	3.1	3.0
GDP Deflator (percent, oya)	5.7	4.4	3.6	2.2	3.5	4.0	4.1	3.7	3.5	3.0	4.0	3.0	2.2
Current Account Balance (%GDP)	-2.8	-2.0	-1.9	-2.0	-1.5	-1.5	-1.5	-2.0	-2.0	-2.0	—	—	—
Inflation Target	2.0 - 3.0												
Consumer Prices *(percent, oya)*	2.8	3.4	3.2	3.1	3.5	3.1	3.0	3.2	3.2	3.2	3.1	3.2	3.0
USD per AUD *(end of period)*	1.02	1.02	1.03	1.03	0.97	1.02	1.02	1.03	1.03	1.03	—	—	—
Cash Rate	4.75	4.25	4.25	4.00	4.75	4.25	4.00	3.75	3.75	3.75	—	—	—
Canada													
Real GDP	3.2	2.3	1.9	2.5	3.5	1.2	2.0	2.0	2.2	2.4	1.9	2.1	2.7
GDP Deflator (percent, oya)	2.9	3.0	2.4	2.5	3.4	2.3	2.2	2.2	2.5	2.8	2.3	2.8	2.5
Current Account Balance (%GDP)	-3.1	-3.1	-2.8	-2.7	-0.7	-0.8	-1.0	-0.6	-0.6	-0.6	—	—	—
Inflation Target	2.0 (+/-1)												
Consumer Prices *(percent, oya)*	1.8	2.9	1.4	1.8	3.0	2.6	2.0	1.2	1.2	1.5	2.6	1.5	2.0
CAD per USD	1.00	1.02	1.00	1.00	1.05	1.02	1.02	1.02	1.00	1.00	—	—	—
O/N Rate	0.99	1.00	1.00	1.25	1.00	1.00	1.00	1.00	1.00	1.00	—	—	—
Sweden													
Real GDP	5.3	4.6	0.8	1.5	6.6	-0.7	-0.7	-0.5	0.5	1.0	3.2	0.1	2.0
GDP Deflator *(percent, oya)*	1.7	2.4	8.3	5.7	0.7	6.7	9.9	9.4	7.0	7.0	6.7	7.0	5.0
Current Account Balance (%GDP)	7.0	7.3	5.0	5.0	9.0	5.0	5.0	5.0	5.0	5.0	—	—	—
Inflation Target	2.0												
Consumer Prices *(percent, oya)*	1.3	2.6	1.6	1.5	3.0	2.3	2.0	1.5	1.5	1.5	2.3	1.5	1.5
SEK per USD *(end of period)*	6.71	6.89	6.85	6.85	6.87	6.89	6.88	6.88	6.85	6.85	—	—	—
Repo Rate	1.25	1.75	1.75	1.25	2.00	1.75	1.75	1.50	1.25	1.00	—	—	—
United Kingdom													
Real GDP	2.1	0.9	0.0	1.5	2.3	-0.8	-1.0	-1.0	2.0	1.5	0.8	0.4	1.6
GDP Deflator (percent, oya)	3.0	2.3	2.3	2.4	2.4	2.3	2.0	2.3	2.4	2.4	2.3	2.4	2.4
Current Account Balance (%GDP)	-3.3	-2.4	-1.3	-0.7	-4.0	-1.5	-1.5	-1.5	-1.2	-1.2	—	—	—
Inflation Target	2.0												
Consumer Prices *(percent, oya)*	3.3	4.5	2.6	2.0	4.7	4.7	3.2	2.8	2.5	2.0	4.7	2.0	2.0
USD per £ *(end of period)*	1.56	1.55	1.58	1.58	1.56	1.55	1.56	1.56	1.58	1.58	—	—	—
Bank Rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	—	—	—

Chart 46
Other Mature Economies: Current Account Balance
percent of GDP

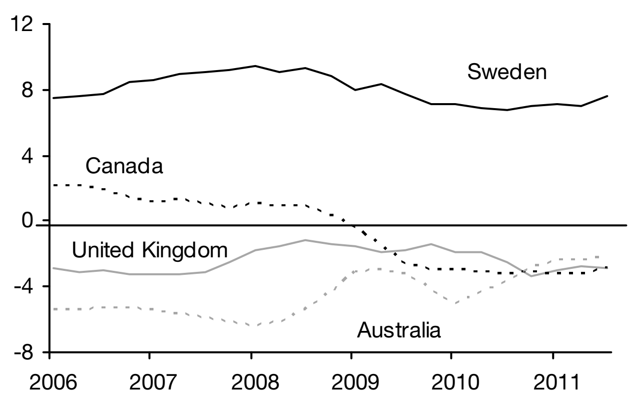
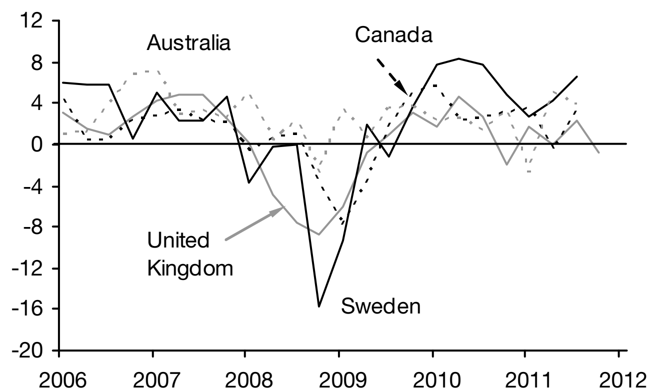


Chart 47
Other Mature Economies: Real GDP Growth
percent, q/q, saar



EMERGING ASIA: GLOBAL REVERBERATIONS

- Most of the leading emerging market economies in Asia weathered the financial crisis and have been able to cope with recurrent bouts of turmoil. Nevertheless, the reliance on export-led growth means that these economies are vulnerable to a prolonged softening in external demand. The spillover of financial turmoil to the real economy is increasingly defining the near-term outlook for the region.

- The first sign of renewed global financial turmoil emerged with the correction in equity prices last summer (Chart 48). Uncertainty about the Euro Area and the implementation of more stringent banking regulations spurred global demand for dollars reminiscent of the collapse of Lehman. As was the case at that time, Asia's ample dollar liquidity made it a prime source for funds, which has generated large capital outflows.

- The outflows put downward pressure on exchange rates across the region, but the impact was partly countered by central bank intervention. Official foreign exchange reserves held by the leading emerging markets in Asia, excluding **China**, dropped by $61 billion from a peak of $1.1 trillion in August to $1.047 trillion in December (Chart 49). Even though China has a restricted capital account, the reduction in the current account surplus, increased investment abroad and diminished inflows contributed to a reduction in reserves by almost $93 billion between October and December to $3.18 trillion (Chart 50).

- Financial conditions again changed abruptly at the turn of the year, triggered by the ECB's Long Term Refinancing Operation (LTRO). The LTRO eased global dollar liquidity pressures and helped restore market confidence. While renewed capital inflows helped replenish official foreign exchange reserves, the recovery in equity prices for the region has lagged the recovery in the mature economies. The MSCI Index for Emerging Asia has risen 17.5% from the previous low in mid-December, but is still 10% below the previous peak at the end of July. In contrast, the index for mature economies in mid-February was down 5% from its late July peak. The underperformance of equity prices suggests that investors remain concerned about the near-term outlook for the region.

Chart 48
Emerging Asia: MSCI Index
index, December 31, 2010 = 100

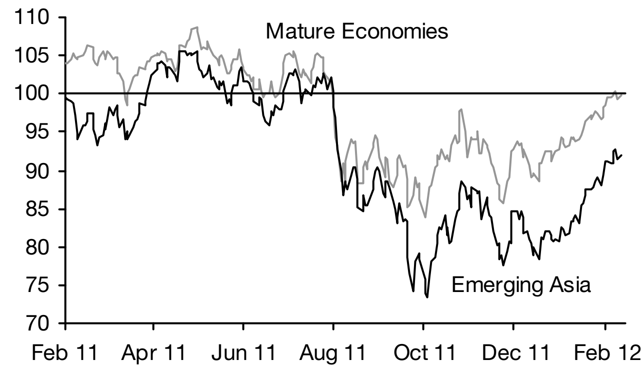


Chart 49
Emerging Asia Excl. China: Official FX Reserves
$ billion

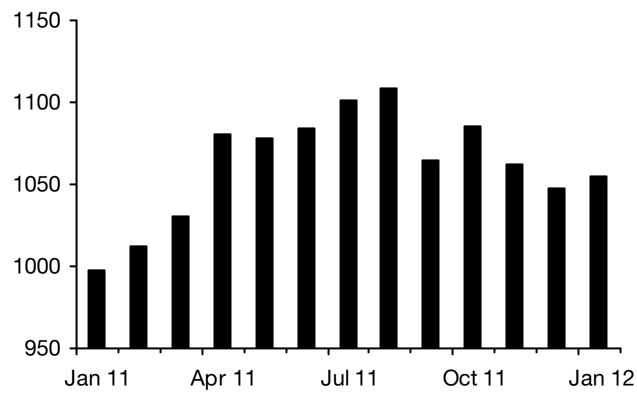
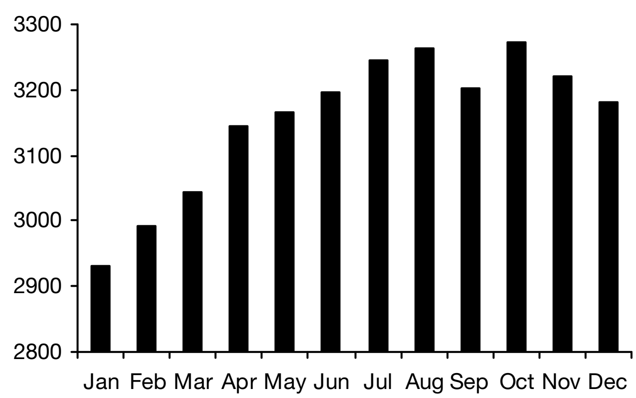


Chart 50
China: Official FX Reserves in 2011
$ billion



EMERGING ASIA (CONTINUED)

- The large current account deficit and heavy reliance on external financing made India most vulnerable to the latest bout of turmoil. The rupee dropped by 11.5% against the dollar between the end of October and mid-December to a record low of Rp54.31/$1, before rebounding with improved global market conditions to Rp49.4/$1 in mid-February 2012 (Chart 51). Official foreign exchange reserves in January 2012 were $267 billion, $24 billion less than in October.

- While the contagion from renewed global financial turmoil has once again proven to be of limited duration and magnitude, the adverse impact is now being transmitted through exports. Total merchandise exports dropped by 17% in 2009 before rebounding by 30% in 2010 and by 19% in 2011 (Chart 52).

- Last year's gain was achieved mostly in the first half and the performance weakened during the second half. Merchandise exports for the region were 9% greater in December than a year earlier, down from 18% in June. Export growth reached double-digit rates across the region in 2010 and early 2011, but slipped to single digits by the end of last year for India, Indonesia and Malaysia.

- The **Philippines** was hit hard by a softening in external demand for its electronic products, which reduced exports in the fourth quarter by 18% from the level a year earlier. The region's export powerhouses, China and **Korea**, outperformed their neighbors, but export growth in the fourth quarter of 2011 for both was lower by about ten percentage points than for the same period in 2010 (Chart 53).

- While the region has shown resilience to the transmission of adverse financial events, it is more difficult to adjust to a softening in external demand. The weakening export performance threatens growth across the region, but governments and central banks have been cautious in taking countercyclical measures. Small budget deficits, low external debt and large reserve holdings provide the wherewithal for such policy action, but more aggressive steps need to be taken to assuage the market doubts about the near-term outlook.

Chart 51
India: Exchange Rate
rupees per $

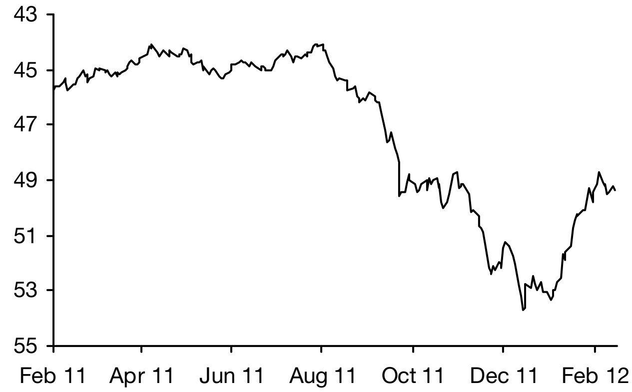


Chart 52
Emerging Asia: Exports
percent change over a year ago, 3-month moving average

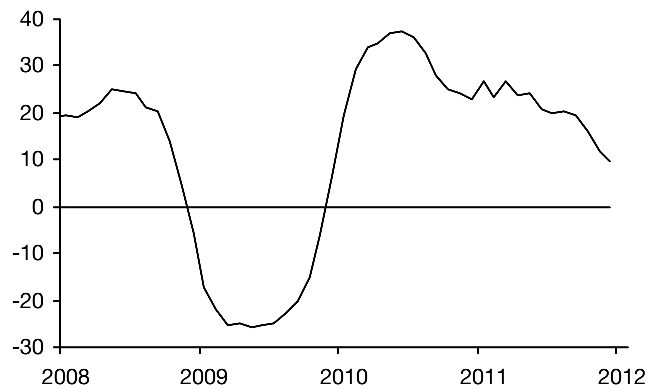
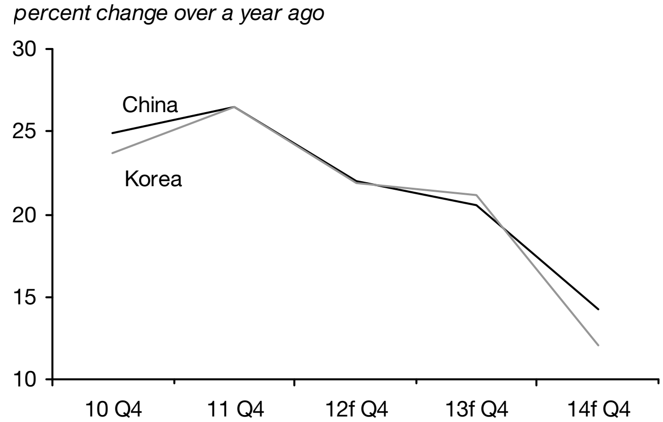


Chart 53
Emerging Asia: Merchandise Exports
percent change over a year ago



RISK APPETITE IMPROVES

- Financial markets have rebounded strongly across Emerging Europe since the start of the year. Currencies have strengthened, share prices have risen and risk premia have narrowed substantially. These gains, however, appear to be largely driven by marked improvement in market sentiment globally and renewed risk appetite rather than improved economic performance and could as swiftly reverse, in most cases, if market sentiment deteriorates again.

- A number of factors have contributed to the improvement in market sentiment. The ECB's decisions to extend long-term funding to European banks and ease collateral requirements have greatly reduced refinancing concerns and provided support to government bond markets. Growing expectations of an orderly resolution to the Greek sovereign debt crisis have contributed as well, as has the Fed's announcement that it intends to maintain near zero interest rates through 2014. Finally, somewhat better than expected data about output growth in parts of the Eurozone and especially in the U.S. has also bolstered confidence.

- Currencies in Emerging Europe have gained the most, broadly reversing the losses they suffered during the fourth quarter (Chart 54). The Hungarian forint, in particular, has gained as much as 9% against the euro since the start of the year, largely on increased expectations of renewed EU-IMF financing. Improved market sentiment and higher oil prices have helped buoy the Russian ruble by almost as much. The zloty has also appreciated strongly because of expectations that continued strong output and above-target inflation will prevent the central bank from cutting interest rates.

- Improved risk appetite has helped lower yields on local currency-denominated bonds, especially in Hungary and Turkey (Chart 55). In both countries, however, yields remain elevated, reflecting ongoing concerns about the absence of agreement with the IMF and higher cost of funding from the central bank, respectively. Credit default swap spreads have also narrowed across the board, but still remain much higher than their recent lows last June (Chart 56). Ukraine's spreads, in particular, remain especially wide on growing concerns about the sustainability of the country's external financing and the lack of progress advancing the reforms that have kept IMF lending suspended since mid-2010.

Chart 54
Emerging Europe: Bilateral Exchange Rates
index, January 2010 =100

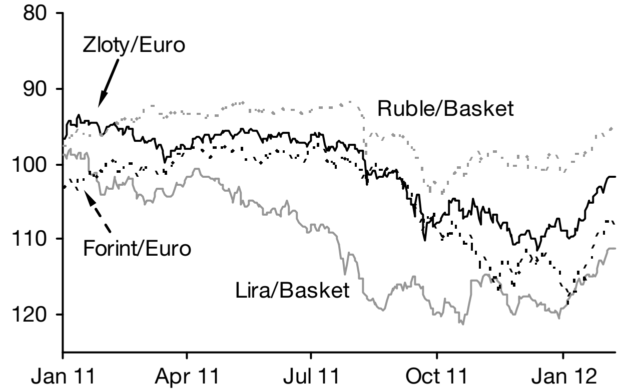


Chart 55
Emerging Europe: Benchmark Government Bond Yields
percent

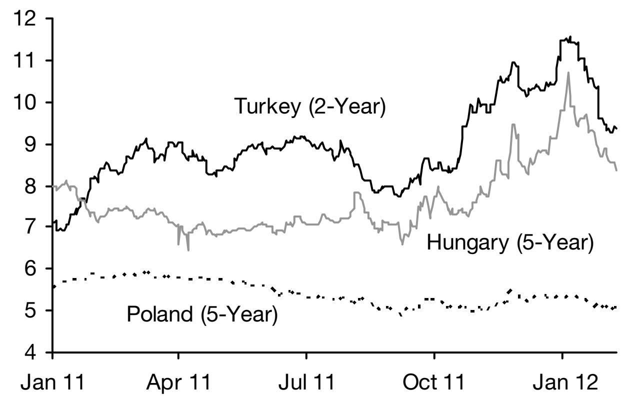
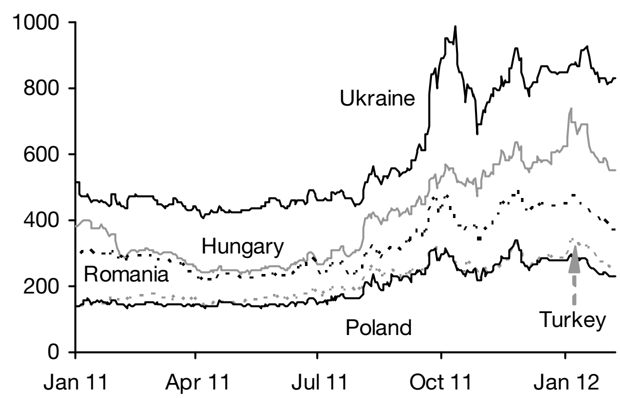


Chart 56
Emerging Europe: 5-Year CDS Spreads
basis points



Emerging Europe

EMERGING EUROPE (CONTINUED)

- In **Turkey**, the government used the improvement in market sentiment to issue $2.5 billion in Eurobonds at narrower spreads. These issues and modest net borrowing by domestic banks have been insufficient to prevent a further $2 billion drawdown on foreign exchange reserves since the start of the year (Chart 57). Despite limited inflows of foreign capital, the lira has strengthened 8% against its $/€ basket, apparently in response to an accelerated shift among residents toward lira assets. The lira's strength led the central bank to halt its foreign exchange selling auctions in late January and also reinforced the central bank's resolve to refrain from rate hikes. With the current account deficit set to remain larger than capital inflows, however, the recent appreciation could be quickly reversed, leaving Turkey vulnerable to shifts in market sentiment.
- In **Hungary**, market confidence has been buoyed by expectations that IMF-EU financing will be secured by mid-2012 given the government's apparent willingness to make concessions on disputed legislation enacted in December. The forint has appreciated 9% since early January and government bond yields have eased to 8% from a high of 11%. Forint appreciation has enabled the central bank to leave its key policy rate on hold in January. This followed hikes totaling 100 basis points to 7% since October (Chart 58). Agreement with the IMF and EU should enable the central bank, given ongoing output weakness, to reverse these hikes later in the year. Downside risks would increase, however, if the government drags its feet in modifying the disputed laws, which is a pre-condition to start official negotiations with the EU and the IMF.
- In **Poland**, the zloty's 7% appreciation since the start of 2012 appears to have been driven by stronger fundamentals. Market sentiment has been bolstered by continued solid growth with real GDP rising 0.9% in seasonally-adjusted terms in the fourth quarter of 2011 and the current account deficit set to narrow to about 2.7% of GDP from 3% a year earlier in 2010. Strong domestic demand and indirect tax increases, however, have lifted 12-month headline inflation to 4.6% in December 2011, significantly above the ±1% band around the central bank's 2.5% inflation target (Chart 59). The central bank, as a result, is unlikely to cut its key policy rate any time soon, which should provide additional support to the zloty.

Chart 57
Turkey: Gross FX Reserves and Net FX Purchases

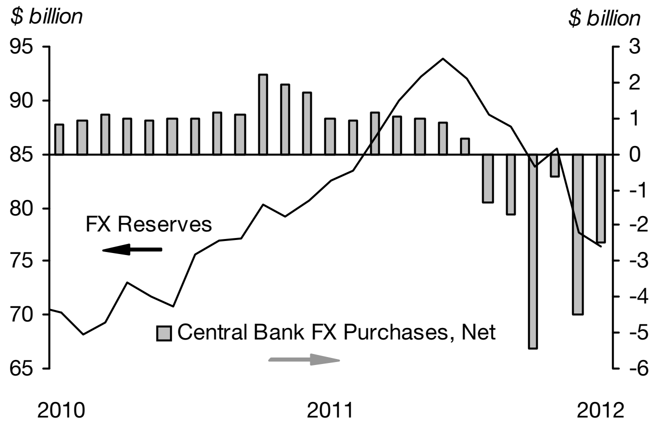


Chart 58
Hungary: Exchange Rate and Policy Interest Rate

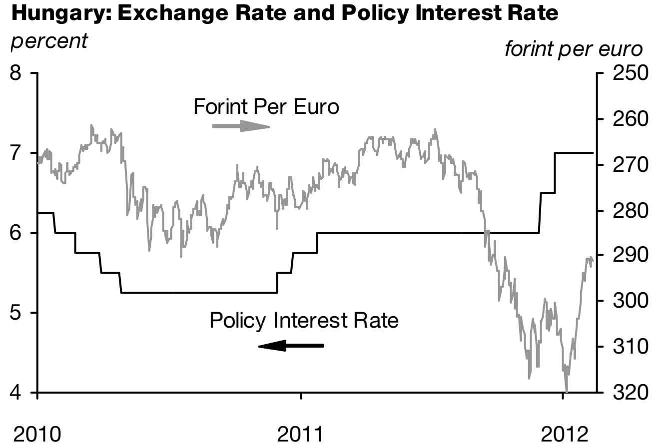
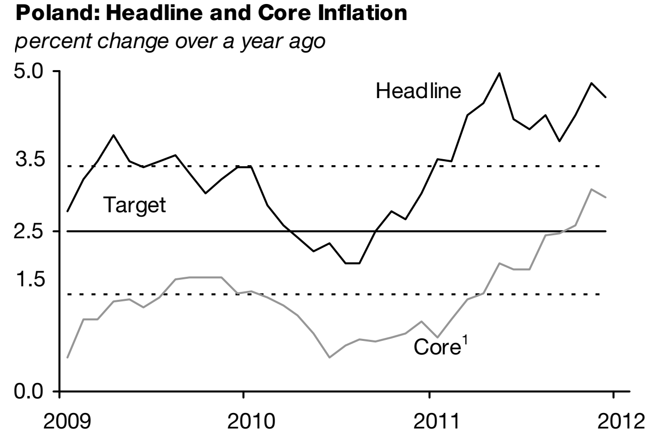


Chart 59
Poland: Headline and Core Inflation



1Net of change in taxes, food and energy prices, IIF estimation.

Latin America

GROWTH GATHERS MOMENTUM

- Europe's debt crisis has slowed real GDP growth by weakening exports and sapping confidence. Growth across the region, however, is picking up momentum on the back of monetary policy easing and a more stable world economy. Barring a global slump, we project regional growth to moderate to 3.6% in 2012 from 4.0% last year, before strengthening to 4.5% in 2013 (Chart 60). While consumer price inflation remains above target in several countries, we expect it to decline in the months ahead as below-trend growth reduces corporations' price setting power.

- In **Brazil**, high-frequency indicators suggest that the economy bottomed out during the third quarter of last year and that growth is gaining momentum, spurred by monetary easing and a sizable increase in the minimum wage. Following a 0.5% (m/m sa) contraction in October and a modest 0.2% expansion in November, industrial production increased 0.9% (m/m sa) in December. A tight labor market (the unemployment rate reached a record low of 5.2% in November) and improved consumer confidence augur well for growth, notwithstanding inflation risks. We expect economic activity to gather strength in the quarters ahead, leading to real GDP growth of 3.2% in 2012 and 5.2% next year (Chart 61).

- In **Chile**, the deceleration of the economy appears to have subsided. The seasonally adjusted IMACEC index tracking monthly economic activity rose 1.3% in December from a month earlier. Based on the IMACEC, growth momentum accelerated to 4.0% in the fourth quarter (q/q saar), up from 2.9% in the third quarter (Chart 62). Labor market indicators also point toward strengthening activity. Amidst strong employment growth, the unemployment rate declined to 6.6% in December, down from 7.1% in November. We expect real GDP growth to slow to 4.0% this year from 6.2% in 2011 but to accelerate to its trend rate of 5% next year on the easing of monetary policy and improving global conditions.

Chart 60
Latin America: Real GDP Growth
percent, y/y

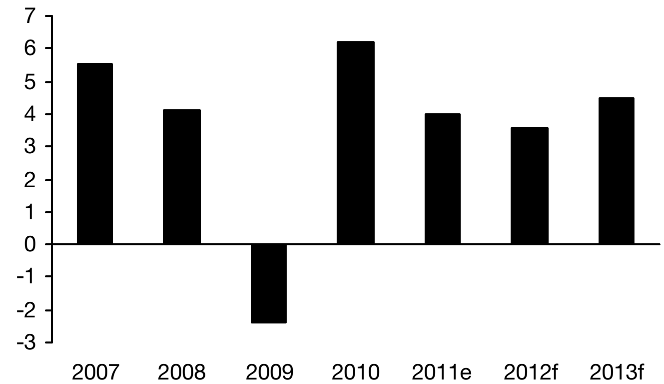


Chart 61
Brazil: Real GDP Growth
percent change, q/q, saar

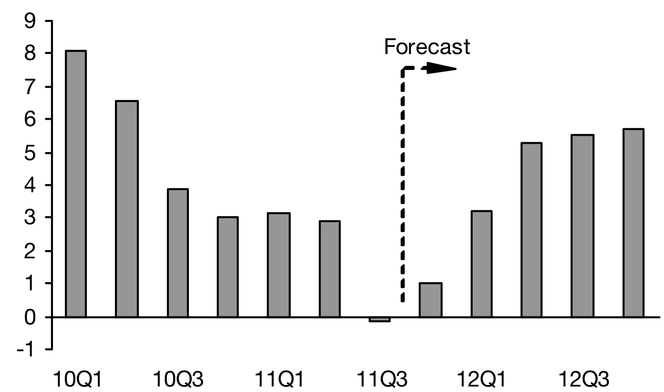
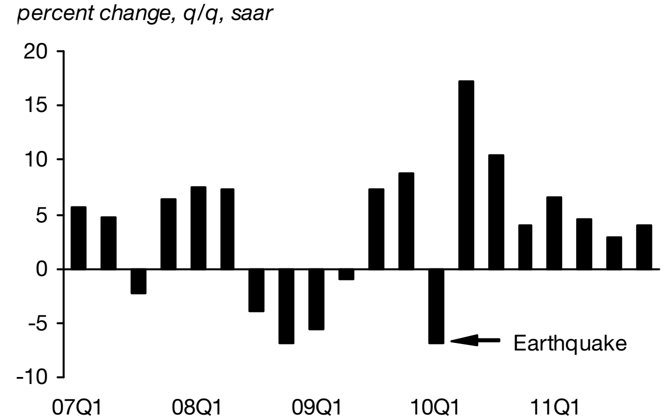


Chart 62
Chile: Economic Activity Index IMACEC
percent change, q/q, saar



LATIN AMERICA (CONTINUED)

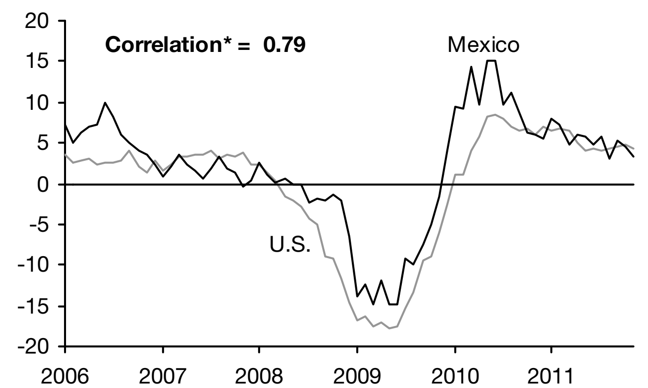
- **Venezuela's** economy climbed back from a two-year contraction in 2011, expanding an estimated 4.0% on the back of increased fiscal and quasi-fiscal spending and recovery of oil production. Spending by the central government rose 47% in the first ten months of 2011 from a year earlier, while crude oil production increased 3.4% in 2011 (Chart 63). We expect growth to strengthen to 4.4% this year, propelled by massive fiscal stimulus ahead of the October presidential election. Weak confidence and capacity constraints will hinder the impact of the fiscal impulse on growth. In the absence of a significant increase in oil prices, we expect real GDP growth to slow to 1.0% next year as public sector spending eases and the *bolivar* is devalued against the dollar in order to shore up public finances.

- In **Mexico**, the growth deceleration also appears to have ended. The Global Economic Indicator (IGAE), a monthly proxy for GDP, rose 3.8% in November oya (0.17% m/m sa), broadly unchanged from a month earlier, with fixed investment increasing 6.7% oya (1.05% m/m sa). Confidence is on the rise, underpinned by a revival of manufacturing production in the U.S., which is closely correlated with Mexican manufacturing, and renewed *peso* appreciation pressures (Chart 64). Competitiveness gains, strengthening U.S. growth and some policy stimulus ahead of the election will support the economy's quick turnaround. We expect real GDP growth of 3.6% this year and 4.0% in 2013.

- The Euro Area debt crisis has barely dented growth in **Colombia**. Several factors have combined to counteract the adverse impact of global weakness. First, global market sentiment towards the country has been favorable as a result of prudent macro policies. Second, foreign direct investment inflows have been strong, underpinning robust capital formation (Chart 65). Third, rapid growth in bank credit has fueled a strong expansion of domestic demand. The economy's buoyancy prompted the central bank to hike its policy rate in January. With global growth regaining traction, we expect growth to ease to 4.7% this year from 5.8% in 2011 and strengthen to an above-trend rate of 5.0% in 2013.

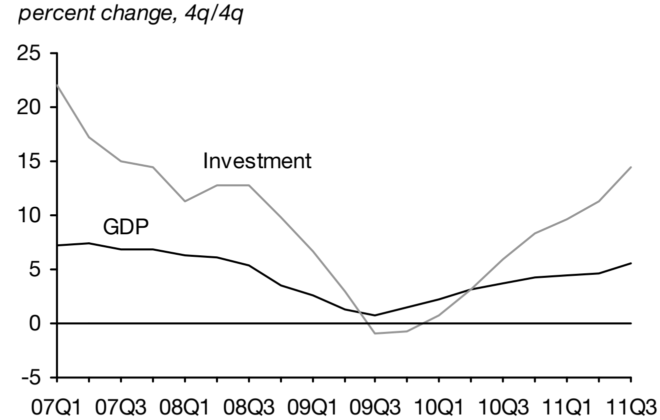
Chart 63
Venezuela: Oil Production
million barrels per day

Chart 64
Mexico and U.S.: Manufacturing Production
percent change over a year ago



*Includes IIF adjustments for a statistical break in 2011Q2

Chart 65
Colombia: Real GDP and Investment Growth
percent change, 4q/4q



Africa and Middle East

EURO AREA WEAKNESS ADDS TO MENA'S DIFFICULTIES

- The mild recession in the Euro Area will have a moderate impact on the MENA region. Most net oil-importing countries in the region face muted growth prospects due to more difficult political transitions and heightened instability. While the Euro Area's linkages with Morocco and Tunisia are significant, they are limited in the case of Egypt, Jordan, Lebanon, and Syria. The weighted average growth for the six net oil importers of the region is projected at 2.0% in 2012, well below the 4.1% registered in 2009 (Table 8). Near-term risks are to the downside due mainly to the challenging political transition and the escalating conflict in Syria. Also, a deeper recession in the Euro Area would constrain Morocco's and Tunisia's drive to achieve high growth by adversely affecting the prospects for exports, tourism income, remittances, and investment flows. Workers' remittances in Egypt, Lebanon, and Jordan are likely to remain fairly robust, as the bulk of these transfers originate in the GCC.

- The deceleration in growth in **Morocco** will be modest as compared with the 2009 global recession and financial crisis (Chart 66). A relatively large Renault car-assembly plant has recently begun its operations. This will raise FDI significantly, create new jobs for locals, and limit the decline in manufacturing related to weaker external demand. While the external and fiscal deficits will remain wide at around 5% of GDP, refinancing is not an issue and government debt sustainability is not at risk. Official reserves are projected to decline to around $19 billion by end-2012 (equivalent to 5 months of imports). The banking system remains sound and relatively resilient to the deceleration in global economic activity and the likely mild recession in the Euro Area.

- The Euro Area crisis could limit the recovery in **Tunisia's** exports and investment flows. After a contraction of about 1% in 2011, real GDP growth should rebound to around 3% in 2012, driven by a modest recovery in mining (mostly phosphates extraction) and tourism (Chart 67). The strength of the recovery is being dampened by the delays in the transition to a new political order. The fiscal deficit is expected to widen to 5.6% of GDP and official reserves to fall to 3 months of import cover. The external debt will remain manageable at 47% of GDP.

Table 8

Arab World: Real GDP Growth

	2008	2009	2010	2011e	2012f	2013f
Oil Importers	**6.4**	**4.1**	**4.6**	**1.1**	**2.0**	**3.9**
Egypt[1]	7.2	4.7	5.1	1.4	1.9	3.5
Morocco[2]	4.1	0.8	4.2	4.6	3.8	4.7
Tunisia[2]	5.0	3.1	5.6	-1.7	3.0	4.0
Syria	4.5	6.0	3.2	-6.0	-3.0	4.0
Lebanon	9.3	8.5	7.0	1.1	2.9	4.5
Jordan	7.2	5.5	2.3	2.6	2.8	4.0
Oil Exporters [3]	**6.6**	**3.9**	**4.6**	**5.3**	**4.8**	**5.1**
ow: GCC[3]	7.3	3.6	4.5	5.5	4.9	5.1
Memoranda						
World	1.4	-2.7	4.4	3.2	2.8	3.7
Euro Area	0.5	-4.2	1.7	1.5	-0.4	1.3

[1] Egypt growth rates are on fiscal year basis.
[2] Non-agricultural real growth.
[3] Non-hydrocarbon real growth.

Chart 66

Morocco: Economic Dependence on the Euro Area

percent, y/y

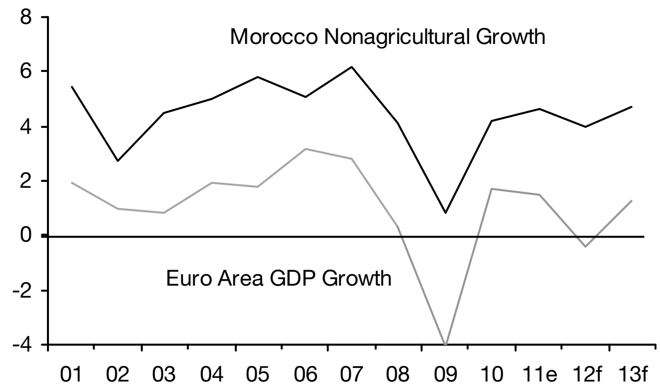
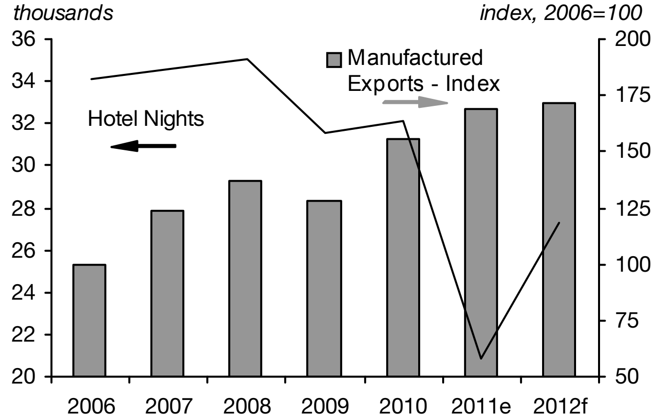


Chart 67

Tunisia: Tourism and Exports of Manufactured Goods

thousands *index, 2006=100*



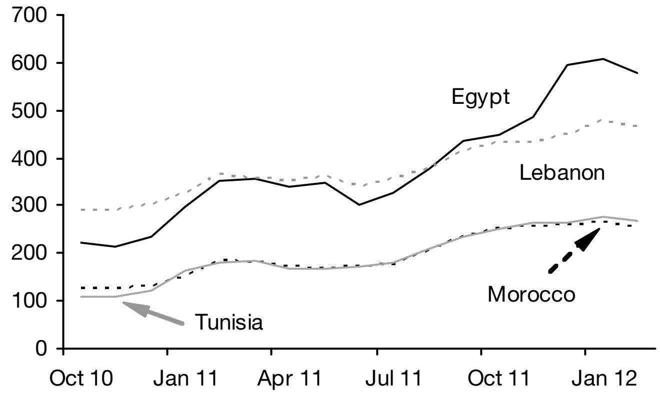
AFRICA AND MIDDLE EAST (CONTINUED)

- In **Egypt**, the recovery will be tepid, with growth of 1.9% in FY 2011/12, remaining well below pre-transition trends at about 5%. Output contracted by 1.4% in calendar year 2011, as a result of sharp decline in tourism, FDI, capital outflows, and general market uncertainty associated with the political transition. While the external current account deficit narrowed to 1.3% of GDP, the official reserves have declined steadily from a peak of $33.6 billion at end-2010 to $13.4 billion at end-January 2012 as nonresidents reduced their holdings of treasury bonds and sold equities. Sovereign bond and CDS spreads have also widened, making it more costly for Egypt to borrow (Chart 68). The fiscal deficit is expected to remain wide at about 9% of GDP in FY2011/12. External support is likely to be led by the IMF, and it may relieve but not eliminate pressures on the currency, which has depreciated by about 4% since end-2010.

- **Lebanon's** and **Jordan's** trade and financial links are mostly with the MENA countries (Table 9). The escalating uprising in Syria continues to adversely affect economic activity in both countries through lower tourism receipts and FDI, increased costs of bilateral and transit trade, and more costly access to capital markets. The fiscal deficit in Lebanon is expected to widen to about 9% of GDP in 2012. But the macroeconomic risks from the exceptionally high debt of about 140% of GDP are somewhat alleviated by the large foreign assets of the central bank and support from a highly liquid banking system. In Jordan, the 2012 budget envisages some fiscal consolidation, and we expect the deficit to narrow by one percentage point to 4.7% of GDP. The public debt is projected to rise slightly to 66% of GDP.

- Oil exporters in the region are in a better macroeconomic situation thanks to continued strength in oil prices (Table 10). Unlike 2009, downside pressure on oil prices remain limited. Banks' liquidity continues to improve, deleveraging progresses steadily, and corporate debt restructuring has reduced refinancing risk. Arab oil exporters exposure to banks in the European periphery is very small. Continued large spending and accelerating credit growth will support domestic demand. Based on continued firm oil prices (average Brent oil price of $107/barrel in 2012) the external current account balances will remain in large surpluses and foreign assets will continue to increase.

Chart 68
Africa and Middle East: Sovereign 5Y CDS Spreads*
basis points



*Monthly averages through Jan. 2012 and average for first half of February

Table 9
Economic Links between the Euro Area and MENA
percent of total

	Euro Area	MENA	Others
Jordan			
Exports	2.4	42.6	55.0
Tourism	4.6	65.4	30.0
Remittances	3.0	85.0	12.0
Lebanon			
Exports	6.3	68.6	25.1
Tourism	23.5	44.3	32.2
Remittances	3.5	75.2	21.3

Table 10
Oil Exporters: Favorable Macroeconomic Situation in 2012

	Saudi Arabia	UAE	Qatar	Kuwait	Algeria	Iraq
Real GDP Growth, %	4.7	3.0	5.7	3.1	3.9	6.3
CPI, average, % change	5	1	2	3	4	5
Current Acc. Bal., $bn	140	50	24	58	15	7
% GDP	23	13	13	34	5	6
Fiscal Balance, % GDP	10	5	2	19	-5	4
Foreign Assets, % GDP[1]	135	130	111	270	102	53
Foreign Liab., % GDP	16	32	63	39	2	52

CHANGES IN IIF FORECAST

- Relative to our December forecast, we have revised U.S. growth for 2012 up to 2.5% (from 2.1%) in light of better incoming data (Chart 69). Our 2013 call is nearly unchanged at 2.5%. Growth in the Euro Area is also projected to be higher than we previously thought. This is partly due to a smaller contraction in 2011Q4, and partly due to leading indicators signaling a less adverse outlook. In Japan, 2012 growth was revised down mainly due to the statistical carryover effect from a very weak print for 2011Q4.

- In emerging economies, growth forecasts for 2012 and 2013 are unchanged on net (Chart 71). On a regional level, moderate upward revisions to growth in Latin America were offset by small downward revisions to growth in Asia and EM Europe. Growth in the MENA region is now forecast to slow less than we previously thought.

- We have notched down our 2012 inflation forecast in the emerging economies, especially in EM Asia and EM Europe (Chart 70). Most of this downward revision is due to Russia and China.

- We have also made changes to our policy interest rate forecasts. We expect the ECB to cut rates by 25bp in its March meeting and by another 25bp in the 2012Q2 (to 0.5%), before remaining on hold through end-2013. In the U.S., do not expect any tightening through 2013, in line with the Fed's own judgment.

Chart 69
IIF Growth Forecast: Mature Economies
percent, y/y

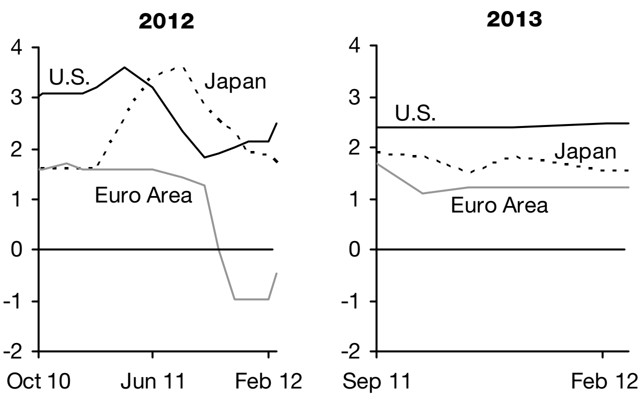


Chart 71
IIF 2012 Growth Forecast: Emerging Economies
percent, y/y

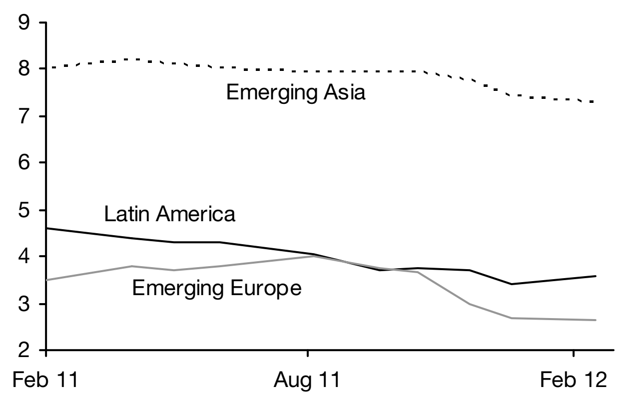


Chart 70
IIF 2012 CPI Forecast
percent change over a year ago, end of period

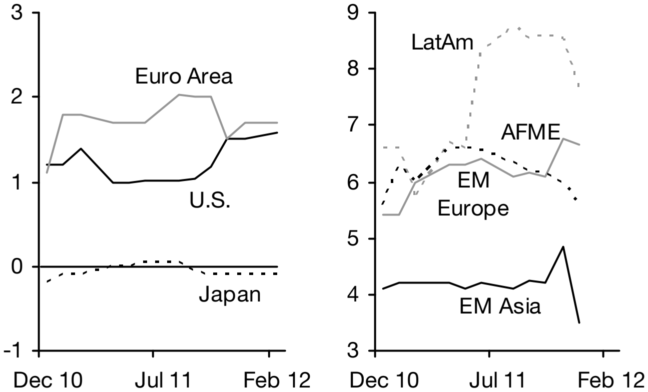
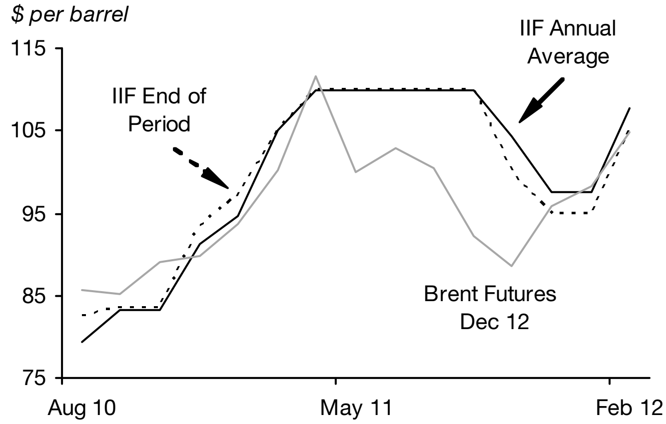


Chart 72
IIF 2012 Oil Price Forecasts
$ per barrel



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THE FORECAST IN DETAIL

Global Output Growth

percent, y/y

	2010	2011e	2012f	2013f
Mature Economies	**2.8**	**1.3**	**1.2**	**1.8**
United States	3.0	1.7	2.5	2.5
Euro Area	1.9	1.5	-0.4	1.2
Japan	4.5	-0.9	1.7	1.5
Other Mature	2.7	1.7	1.1	2.0
Emerging Economies	**7.2**	**6.1**	**5.4**	**6.1**
Latin America	6.2	4.0	3.6	4.5
Argentina	9.2	6.5	3.5	3.0
Brazil	7.5	2.8	3.2	5.2
Mexico	5.5	3.9	3.6	4.0
Emerging Europe	4.5	4.6	2.6	3.5
Russia	4.0	4.0	3.6	4.0
Turkey	9.0	8.5	3.2	4.0
Asia/Pacific	9.2	7.7	7.3	7.8
China	10.4	9.2	8.5	9.0
India	8.5	7.0	6.5	7.0
Africa/Middle East	4.3	4.7	3.9	4.0
South Africa	2.9	3.1	2.9	3.7
World	**4.5**	**3.2**	**2.9**	**3.7**

Based on market exchange rates

Consumer Prices

percent change over a year ago, end of period

	2010	2011e	2012f	2013f
Mature Economies	**1.4**	**2.7**	**1.4**	**1.8**
United States	1.2	3.3	1.6	2.1
Euro Area	2.0	2.9	1.8	2.0
Japan	-0.3	-0.3	-0.1	0.0
Other Mature	2.8	3.7	2.0	2.1
Emerging Economies	**6.2**	**5.7**	**4.9**	**5.2**
Latin America	8.1	8.2	7.7	8.7
Argentina	22.9	21.2	22.4	21.5
Brazil	5.9	6.5	5.2	5.7
Mexico	4.4	3.8	3.6	3.7
Emerging Europe	6.8	6.2	6.3	5.8
Russia	8.8	6.1	7.2	7.0
Turkey	6.4	10.4	7.7	6.7
Asia/Pacific	5.3	4.4	3.1	3.6
China	4.6	4.1	2.5	3.1
India	9.7	6.5	4.5	4.8
Africa/Middle East	5.3	5.7	5.8	5.1
South Africa	3.5	6.1	6.1	5.0
World	**3.2**	**3.9**	**2.9**	**3.2**

Exchange Rate

end of period

	17 Feb	Jun 12	Dec 12	Dec 13
¥ per $	79.5	76.5	76.5	78.0
$ per €	1.31	1.20	1.20	1.35

Official Interest Rate

end of period

	17 Feb	Jun 12	Dec 12	Dec 13
U.S. Fed Funds	0.125	0.125	0.125	0.125
BoJ Target	0.10	0.10	0.10	0.10
ECB Refi	1.00	0.50	0.50	0.50

Commodity Prices

end of period

	17 Feb	Jun 12	Dec 12	Dec 13
Oil *($ per barrel)*	120	109	105	105
Copper *(cents per lb)*	372	372	372	372
Gold *($ per ounce)*	1723	1723	1723	1723

Global Current Account Balance

$ billion

	2010	2011e	2012f	2013f
United States	-471	-467	-426	-362
Euro Area	-61	-60	-11	16
Japan	196	121	119	126
Other Mature Economies	-21	-40	-37	-35
Emerging Economies (IIF 30)	362	349	257	33
Africa / Middle East	65	180	170	140
Latin America	-47	-49	-84	-105
Emerging Europe	0	-6	-22	-83
o/w Russia	71	100	62	6
Emerging Asia	345	224	193	81
o/w China	305	200	173	81
Other Countries*	-5	97	97	222

* Includes global discrepancy

