The Macro-Economic Outlook and the Challenges for the World

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### The Financial Fallout from Global Political Turmoil

1. Its risk on as investor confidence is rising faster than economic growth.
2. A few bright spots are appearing in the developed economies, but their growth will be well below normal.
3. The emerging economies will lead world growth again in 2013, by the same pace than in 2012.
4. Political turmoil will increase uncertainty and asset price volatility, lessen global economic growth and create an investment tail risk.
5. Globalization’s effect on the business cycle is increasing equity synchronization.
6. Some key long term investment themes.
Risk Has Fallen to its lowest level in 5 Years

ViX S&P 500, Chicago Board of Trade; logarithmic scale
US: Equities Still Look Cheap

P/E average 18.1

S&P 500

P/E Operating Earnings
Real Rates Turned Negative

-6.00
-4.00
-2.00
0.00
2.00
4.00
6.00
8.00
10.00
12.00

Real 10 yr. Treasury

real money market rates
US: Debt and Equity Relative to GDP

- Debt/NGDP
- S&P/NGDP

Key Episodes:
- Dot com bubble
- Credit fueled bubble
Global Growth in 2013 Led by Emerging Economies
US: Bank Loans to Consumers and RE
Stagnate only Business Borrows
(Seasonally adjusted annual rates)
US: New Housing Starts Adding to GDP Growth

Historical average
US: Employment Increases Averaging 200k per month but UR Still too high
US: Profit’s Percent of National Income Rises to New Peak
US: Corporate Cash Flow Exceeds Capital Expenditure (bn $)
EU: Region In Recession Only Two Countries Have Positive GDPY/Y
EU: UR at Socially Unacceptable Levels
EU: Sovereign Rates are still too High

- Greece
- Portugal
- Spain
- Italy
- France
- UK
- Netherlands
- Germany
Central Bank’s Lowered Rates to near Zero
Japan: December Tankan Survey Weak

Manufacturing

Nonmanufacturing

(Diffusion index, % points)

Large Enterprises
Medium-sized Enterprises
Small Enterprises

“Favorable”
“Unfavorable”

Forecast

CY
Japan: Weak Yen Strong Equity Market

Yen right
S&P Japan left
China: Manufacturing PMI index is Improving
Asean: Per Capita Income in Asian Economies in 2011($)

ASEAN 5 Indonesia, Malaysia, Philippines, Thailand, Vietnam
Asean: Developing Economies Should Keep Growing Rapidly

Average growth rates of selected Asian economies, 2000-2013

Note: Adv. Asia = Japan, Australia and New Zealand; CHN = China, IND = India; Actual rates for the period of 2000-2007, and estimates for the period of 2012-13. Source: IMF
US: Improvement in Consumer Confidence Slumped at Year-end
US: Fiscal Cliff vs CBO Alternative
EU: Budget Deficits Improve in 2011

Blue 2011, Red 2010

Ireland | Greece | Spain | UK | France | Netherlands | Portugal | Italy | Belgium
EU: Current Borrowing Rates Are Greater than Present Growth Rates
EU: Countries with Debt/GDP ratio above 100% are Vulnerable
Japan and China Potential Conflict

Senkaku Islands and vicinity

- Dividing line between Japan’s and China’s exclusive economic zones
- Kubajima island
- Senkaku Islands
- Okinawa Island
- Taiwan
- Ishigakijima island

200 km
For Chinese 2013 is the year of the Snake

According to the Chinese mythology the year of the snake implies opportunity and caution for investors. Therefore, volatility should rise and create some interesting and potentially risky investment opportunities in 2013.
Interconnectedness: US and Asian Stock markets

Stock Performance Indexed to 100 in 2007
Some Differentiation: US vs EU Returns

Stock Performance Indexed to 100 in 2007
The World’s Population is Aging Rapidly
The Old are overtaking the young

The world’s population is aging and, in developed countries, the size of the elderly population has already surpassed that of the 12–24 age group.

(billions)

More developed countries (12–24)

Less developed countries (12–24)

Less developed countries (60+)

More developed countries (60+)
Conclusion

1. Investors are confident and are choosing risk, pouring funds into equities and away from bonds.
2. Central banks are creating liquidity, keeping borrowing rates at minimum levels, and pursuing aggressive monetary ease.
3. Economic forecasts for 2013 are less sanguine than equity market performance is:
   - Emerging markets should grow faster than developed ones.
   - The US economy is vibrant but faces more political fiscal hurdles.
   - The EU, UK and Japan are in recession and only Japan seems to be stimulating its economy.
   - China, India and Asean should grow about as fast as last year with more internal demand developing.
4. There are 4 political risks that could lead to a large tail risk for investors.
5. There are 4 powerful investment themes that provide long term opportunities for investors.