

Global Economic Viewpoint

October 2003



- World growth is now clearly recovering, led by the US and Asia. Europe is the laggard.
- Much of this reflects the stimulus from lower interest rates. The recent rise in long term interest rates, coupled with higher oil prices, could limit the economic upswing.
- Central banks have been able to cut interest rates because inflation is so low. We expect them to keep rates low for an extended period.
- China has shrugged off deflation and faces overheating as credit demand soars.

		Growth		Inflation		Fiscal Deficit	Central Bank Rates		
		GDP, Q4 on year ago (%)		CPI, Q4 on year ago (%)		% of GDP	Now	In 3 months	In 12 months
		2003	2004	2003	2004	2003			
United States	The market expects...	3.5	3.8	1.8	1.3	4.0	1.0	1.0	1.50
	We expect...	Growth is surging. Even if demand eases in 2004, the newsflow remains strong		Inflation is still trickling down		Net stimulus is ½-1% GDP in 2003 and 2004	-	1.0	0.75
		The Fed is on hold for now but would ease again if growth falters							
Euroland	The market expects...	0.7	2.4	2.0	1.6	2.7	2.0	1.9	2.25
	We expect...	Any pick-up is anaemic and externally-led		Inflation is stuck at 2% despite the weak economy		France and Germany ignore the GSP 3% limit	-	1.75	1.75
		Rates could yet fall further							
Japan	The market expects...	2.2	1.6	-0.2	-0.5	7.7	0	0	0
	We expect...	Steady growth to continue		Deflation has eased but CPI could weaken again in 2004		JGB market vulnerable	-	0	0
		No change							
UK	The market expects...	1.8	2.9	2.7	2.7	2.8	3.5	3.6	4.5
	We expect...	Dip in domestic demand is now over		Switch from RPIX to HICP implies lower recorded numbers		Overshoot likely: fiscal problems lie ahead	-	3.75	4.0
		HICP must stay low to stop MPC raising rates							



Global Economic Viewpoint - continued

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United States



- The economy gathered momentum over the summer and looks set for robust growth in the second half of this year.
- Nonetheless, we estimate that the disinflationary output gap will persist well into 2004. We also have concerns over how long substantially above-trend growth will last.
- Company profits are rising, investment is recovering but companies are reluctant to rehire. The "job-less" recovery is seen as a key threat to Bush's chances of re-election in November 2004. We expect unemployment to edge lower over the next 6 months.

Japan



- Production has rebounded and inventories are lean so Japan has the prospect of continued steady growth.
- Deflation seems to have eased both at the consumer level and in terms of basic materials.
- The G7 initiative to strengthen Asian currencies will probably limit but not prevent intervention by the BoJ to weaken the yen.
- Koizumi has consolidated his position as PM and, by re-appointing Takenaka, reaffirmed his reformist agenda.

Euroland



- The ECB has redefined its monetary target implying an easier stance. Inflation is right on target but should be lower given a strong euro and high unemployment.
- The ECB have cut rates three times since end-2002. We think the markets may be premature in assuming the next move in rates is upward.
- France and Germany look set to breach the Growth and Stability Pact 3% fiscal deficit limit both this year and next.
- Ten new countries will join the EU in time for the European parliamentary elections next June. They should all benefit from interest rate convergence.

UK



- The slowdown in consumer spending and the housing market may have run its course.
- Survey data suggest a broad-based economic recovery lies ahead.
- Fiscal policy has been a bright spot but things may be darkening as tax revenues decline and borrowing rises at a time when spending on public services is rising rapidly.
- HICP, the new index for the Bank of England's inflation target, is below-target. It must stay there to prevent a rate rise.

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