GLOBAL OUTLOOK

Global Risk Insights

- Euroland growth forecast for 2012 cut to below 1%; softening global activity foretells a weak Q4.
- Downside risks include capital losses due to European sovereign debt woes, threatening banks' viability and the possibility of further fiscal burdens; the exhaustion of policy options amid concerns about economic growth; and volatility from deflating asset bubbles in financial markets.
- Debt dilemmas weaken the economic outlook and raise the risk of new global financial crises.
- ***Currently deteriorating:*** Belgium, China, France, Germany, Greece, Italy, Portugal, Spain.
- ***Currently improving:*** Angola, Chile, Estonia, Gabon, Libya, Sierra Leone, UAE, Zambia.

Global Economic Outlook: Divergence in the Global Economy

IMPACT: the main economies are showing increasing signs of divergence…

The main economies are increasingly showing signs of divergence. Asian growth led by China, India and Japan (as it recovers from the tsunami in Q2 2011) will underpin global growth in 2012, as will the US, which we expect to continue its weak recovery. However, there is a high risk of recession in the euro area on the back of the instability caused by the failure to address the debt crisis in Greece and Italy. Furthermore, the situation in Europe, with weak demand and a sovereign debt crisis threatening to spill over into the global financial system, threatens the recovery outside Europe.

…and risks remain on the downside

As has been the case for some months, other downside risks remain high: these include the high level of household debt in the US; possible policy errors as governments and central banks try to counterbalance dealing with sovereign debt while promoting growth; volatility and potential asset bubbles in the financial markets; and the renewed threat of currency wars and attendant protectionism. As such 2012 promises to be another year of high uncertainty.

Key Risk: Multiple Sovereign Debt Crises Threaten Financial Stability

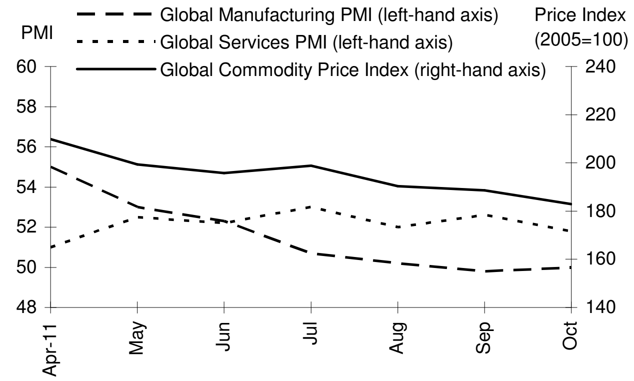
IMPACT: the threat from Italian sovereign debt potentially outranks that from Greece by an order of magnitude

The European financial system and global investor confidence are confronted with two dangers, the first here and now, the second imminent. Greek sovereign debt has already clawed at European financial institutions' balance sheets via a precipitous collapse in value, as the political consensus behind the course of the EU-led and IMF-assisted bail-out to Athens has wavered. Now, the much larger edifice of Italian sovereign debt (total EUR1,787bn) is threatening capital losses in new parts of the financial system, such as for insurers who avoided risky peripheral sovereign debt but not Italian sovereign debt.

IMPACT: the debt crisis will reduce economic growth forecasts both inside and outside Europe

A repeat of Italian 10-year government bond yields' surge past 7% in November could undo efforts to build banks' capital up into safer territory. The transmission channels run into French banks' balance sheets. Moreover, the shock could depress peripheral European debt further and initiate a pull-back of European bank credit from emerging markets, bringing a credit crunch to parts of the world economy so far spared economic stagnation. The political consensus and emergency liquidity required to remedy this do not exist: we expect slowing economic growth in the eurozone and linked economies.

Key Global Growth Indicators



Real GDP Growth (%)

	2010	2011f	2012f
World	**4.0**	**2.6**	**2.5**
Advanced economies	2.9	1.4	1.2
US	3.0	1.5	1.0
Euroland	1.8	1.3	0.6
Japan	4.0	-0.5	2.2
UK	1.8	0.9	0.8
Emerging economies	6.7	5.6	5.6
Brazil	7.5	4.0	5.0
Russia	4.0	3.8	3.2
India	9.7	7.2	7.4
China	10.3	8.9	8.5

Notes: 'PMI' is the Purchasing Managers Index – a reading above 50 denotes an expansion in sectoral activity, and one below 50 a contraction; the Global Commodity Price Index is the IMF's price index for all primary commodities (2005=100). Sources: IMF; JPMorgan; D&B

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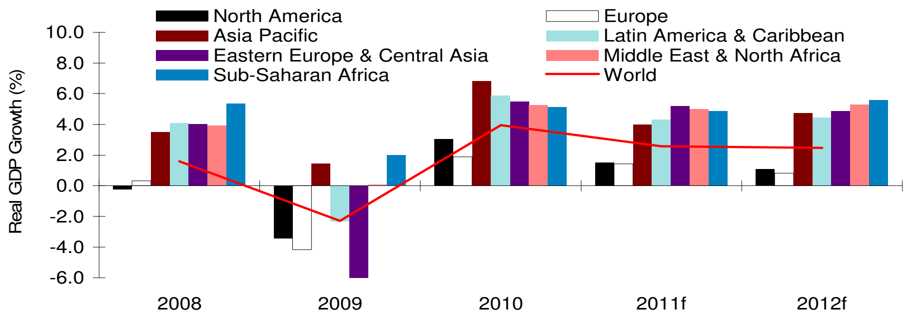
IMPACT: Europe is emerging as the greatest threat to global business confidence by far, as sovereign debt concerns in Europe escalate; inflation persists in Asia Pacific and Latin America; Russia suffers capital outflows; growth outlook for the Middle East and Africa still positive.

Growth Outlook by Region



Source: D&B

North America: The latest economic indicators (including encouraging manufacturing and labour market activity) underline that the risk of recession has fallen, although we expect only low-level, below-trend growth. Worryingly, the lack of a credible medium-term fiscal consolidation plan creates uncertainty about future consumption and investment.

Europe (EU + Iceland, Norway and Switzerland): A surprising interest rate cut by the ECB in early November will provide some limited monetary stimulus. However, with the situation in Greece and questions over Italy escalating, economic activity in and outside the euro area will slow further and financial sector stability in some countries will remain fragile.

Asia Pacific: Slowing export growth and the credit shortage in the private sector in China threaten to bring out bad loans in the financial sector, while non-performing loans are growing in India. With European banks responsible for extending a fifth of bank credit in Asia outside Japan, the channels for a negative shock from a European credit crunch are multiplying.

Latin America & Caribbean: The likelihood of turmoil in developing countries affecting Latin America has increased and as a consequence we expect a deceleration in key economies. Inflationary pressure continues to be felt despite this in Brazil, Argentina and Venezuela, reducing competitiveness. We cannot rule out protectionist measures ahead.

Eastern Europe & Central Asia: Growth prospects in Russia remain moderate at best, as sluggish external demand and rising capital outflows offset partly the positive impact of high commodity prices. The economic outlook in the rest of the region will be stronger, supported by robust government spending.

Middle East & North Africa: The downturn in Europe and political instability in the region are likely to soften growth prospects and raise external economic risks in the non-oil producing countries, such as Egypt and Tunisia. The hydrocarbon-rich economies will continue to record strong growth rates, owing to high commodity prices and government spending.

Sub-Saharan Africa: Exchange rate volatility has increased in sub-Saharan Africa, amid ongoing uncertainty over the EU's debt crisis. This has added to business uncertainty in the region, compounding rising inflation and credit risks, particularly in South Africa, Kenya and Tanzania. Nonetheless, the region will continue to post relatively strong growth.

IMPACT: Safe haven flows are likely to support the US dollar and sterling over the short term into Q1 2012; but uncertainty over the composition of the euro area in coming years makes predictions of euro strength or weakness less meaningful.

Exchange Rates (period average), US / Euro-Zone Interest Rates (end-period)

	Aug-11	Sep-11	Oct-11	Latest	2010	2011f	2012f
EUR:USD	0.70	0.73	0.73	**0.74**	0.75	0.72	0.75
JPY:USD	76.97	76.80	76.64	**76.90**	87.78	79.60	77.80
GBP:USD	0.61	0.63	0.63	**0.63**	0.65	0.62	0.63
BRL:USD	1.60	1.75	1.77	**1.78**	1.76	1.60	1.60
Key US interest rate	0-0.25	0-0.25	0-0.25	**0-0.25**	0-0.25	0-0.25	0-0.25
Key ECB interest rate	1.50	1.50	1.50	**1.25**	1.00	1.25	1.00

Sources: Haver Analytics; D&B

IMPACT: Oil prices are stable, but downside risks are significant; non-oil commodity prices soften further, but emerging-market demand and the recently weak dollar should sustain prices; gold price still high amid systemic uncertainty.

Commodity Prices (period average)

	Aug-11	Sep-11	Oct-11	Latest	2010	2011f	2012f
Aluminium (USD/tonne)	2,392	2,296	2,172	**2,085**	2,173	2,450	2,200
Copper (USD/tonne)	9,041	8,314	7,347	**7,582**	7,539	9,000	6,700
Gold (USD/ounce)	1,756	1,772	1,665	**1,719**	1,226	1,545	1,650
Oil (USD/barrel)	110.2	112.7	109.6	**108.1**	79.6	111.6	115.6
Cocoa (USD/tonne)	3,286	3,176	2,960	**2,731**	3,484	3,450	2,900
Coffee (US cents/lb)	285	289	258	**258**	225	290	280

Sources: Haver Analytics; D&B