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Disinflation and Divergence

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Big Picture Themes

Moderately stronger global growth, EM divergence



Disinflationary growth to continue

- The US economy is to continue growing at above trend, with moderate acceleration likely in the Euro area, Japan and parts of EM
- The sharp drop in commodity prices should benefit consumers globally while keeping inflation at bay, allowing central banks to remain accommodative



Monetary policy to diverge slowly

- As the BoJ continues easing and the ECB embarks on further easing programmes, global financial conditions should stay loose
- While the Fed might be getting closer to tightening, a stronger USD should act as an equilibrating mechanism, preventing significant divergence in monetary policy trajectories



Emerging Market differentiation to grow

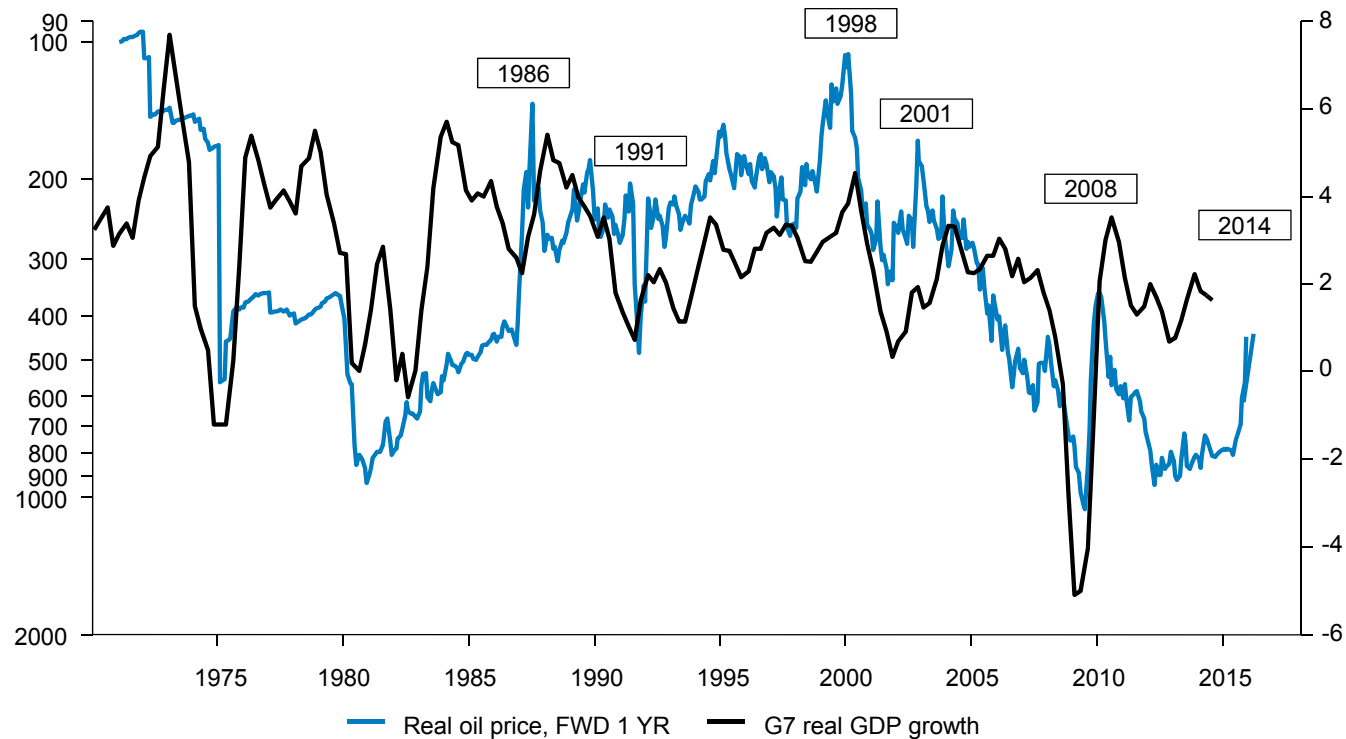
- EM growth outcomes will become increasingly diverse based on: (1) exposure to China and US, (2) dependency on commodities, (3) effort on structural reform
- While easy global financial conditions and a moderate rebound in DM should be generally supportive to the overall growth picture in EM, a country-specific shock (e.g. from Russia, Venezuela) could be quite disruptive

Source: Fidelity Worldwide Investment, February 2015.

Real Oil Price Collapse is a Stimulus for Consumers

One of the largest and fastest oil price falls in history

Real Oil Price (inverted and pushed forward 1 year) versus Global GDP Growth

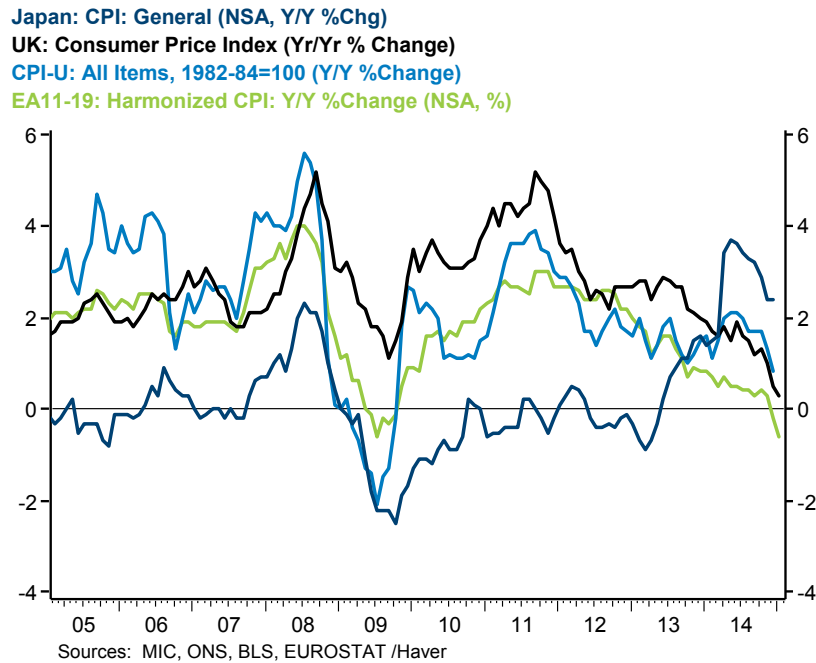


Source: Datastream, February 2015. WTI crude oil price deflated by US CPI. G7 Real GDP Growth R.H scale

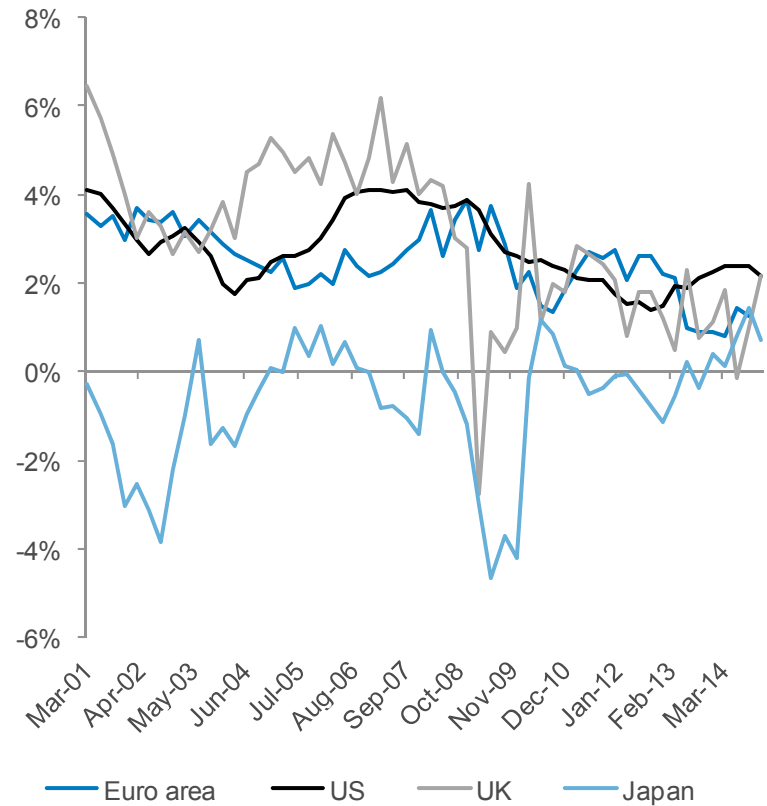
DM Inflation and Wage Growth Remain Suppressed

The drop in the oil price adds to downward pressure

DM headline inflation trends



DM wage growth

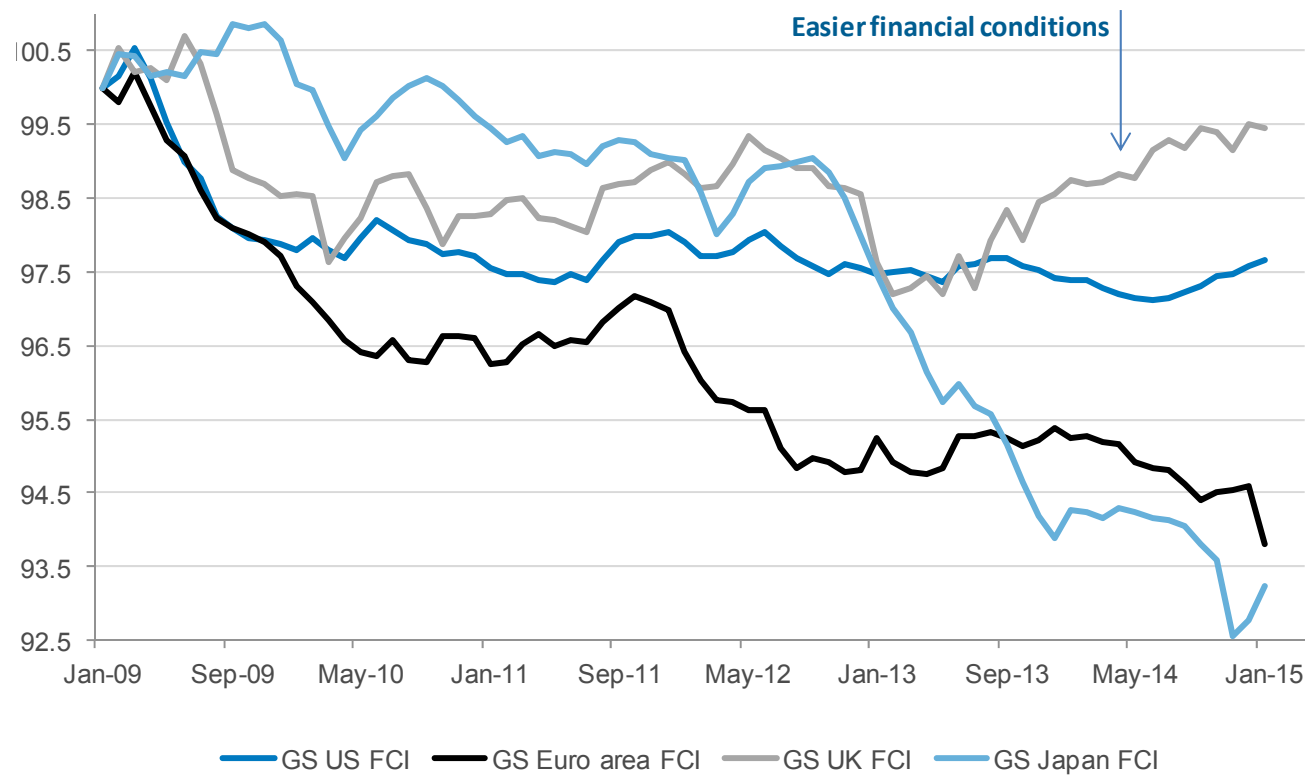


Source: Haver Analytics, February 2015.

DM Financial Conditions Diverge Slowly

Japan has seen the most easing recently

DM Financial Condition Indices (Index, Jan 2009=100)

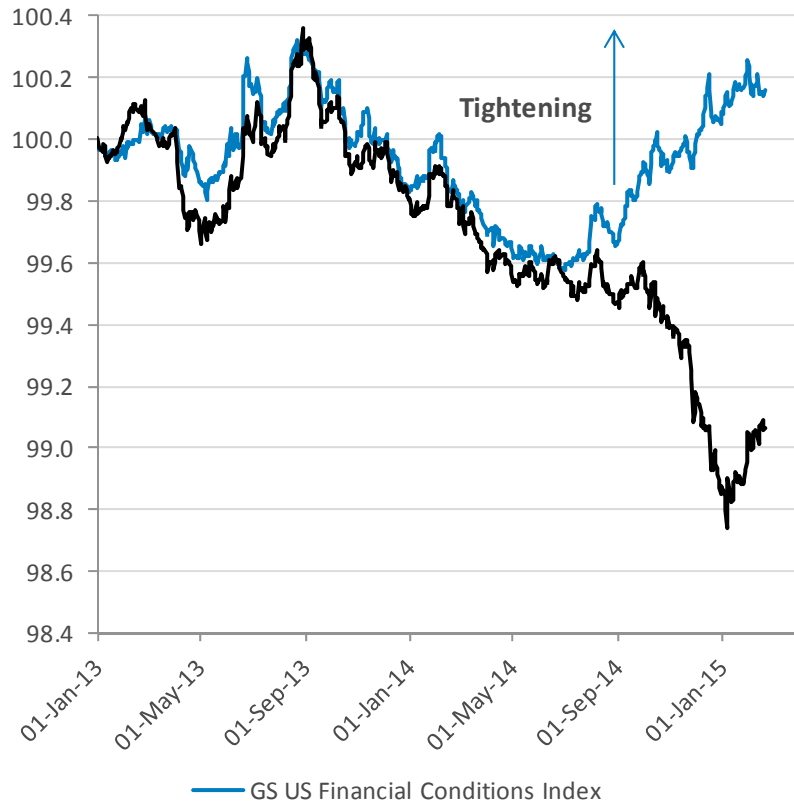


Source: Goldman Sachs Economics Research, February 2015.

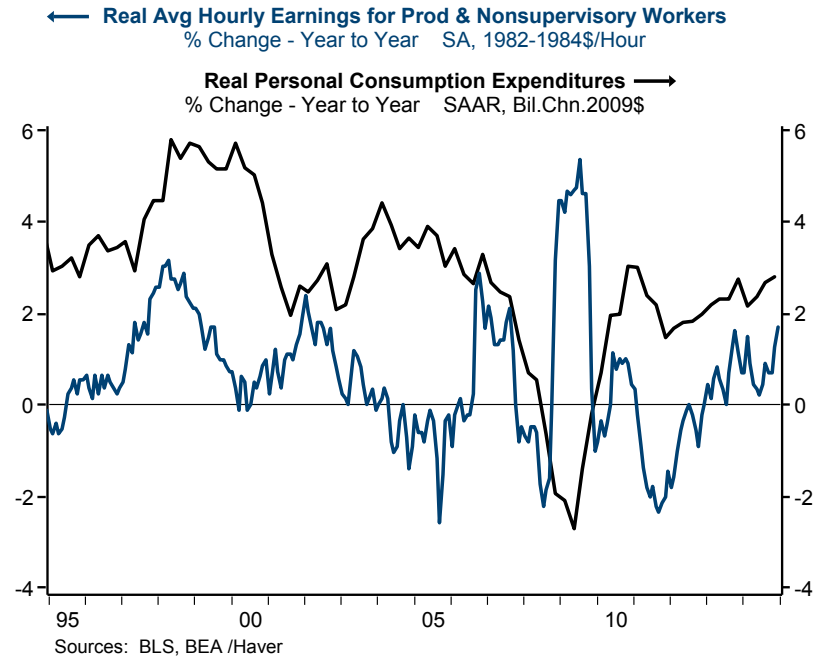
US Consumption Boost from Lower Oil

The benefit of lower oil prices will be significant

US financial conditions index (FCI)



Real wages and consumption

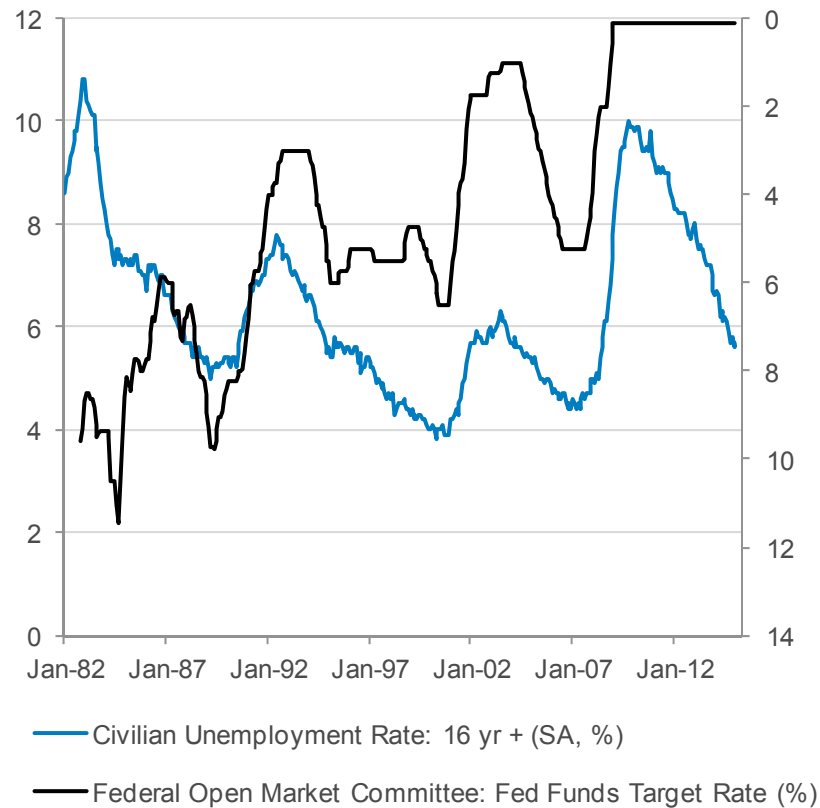


Source: Haver Analytics, Datastream, February 2015.

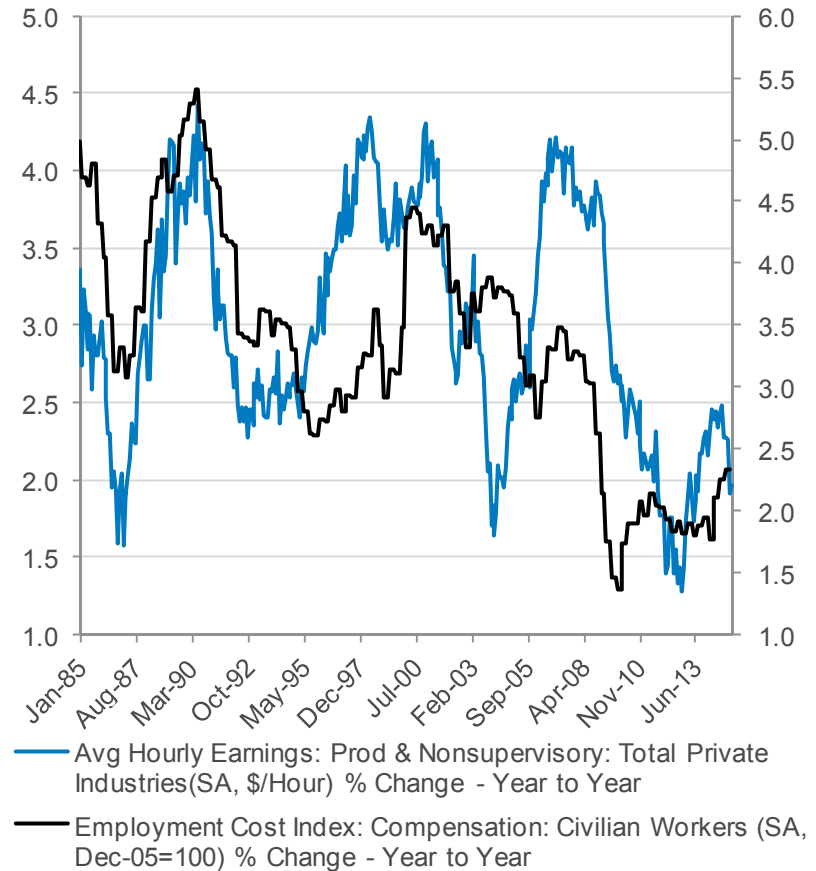
All Eyes on US Labour Market and Wages

No pressure on the Fed yet

US unemployment rate vs Fed funds



US wage growth

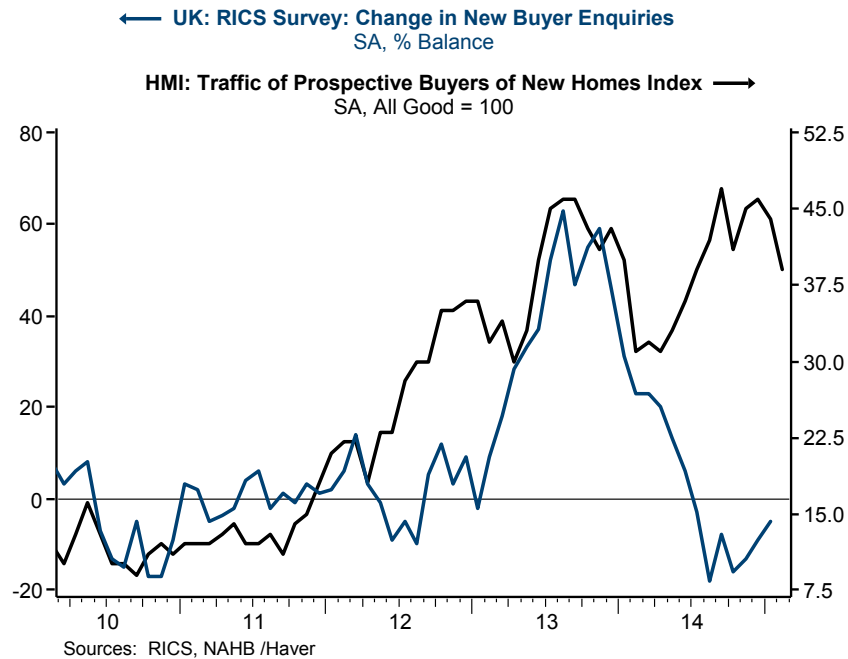


Source: Bureau of Labor Statistics, Federal Reserve Board, Haver Analytics, February 2015.

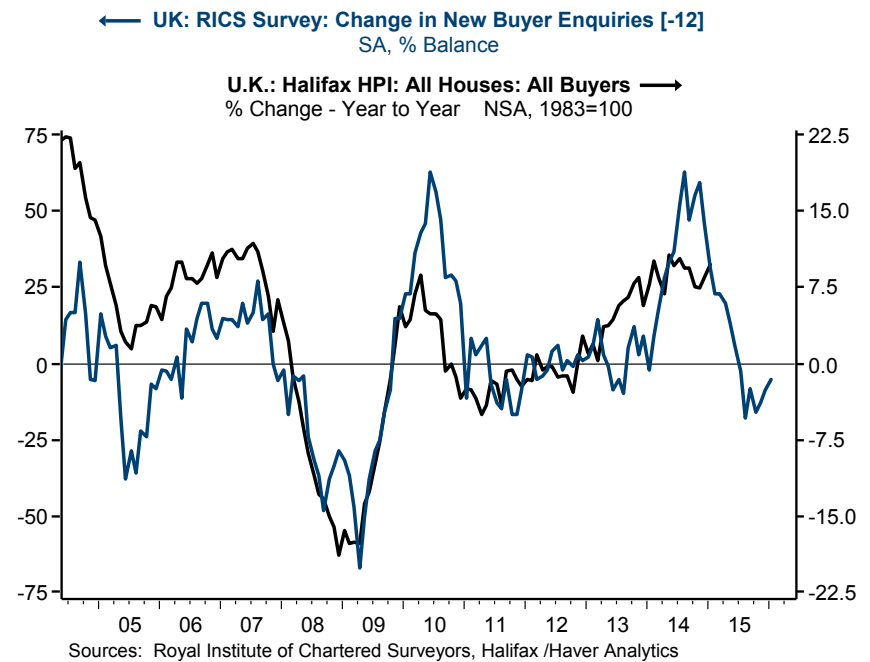
UK Housing-Driven Slowdown

Weakness continues

UK vs US housing surveys



UK house prices and RICS housing survey

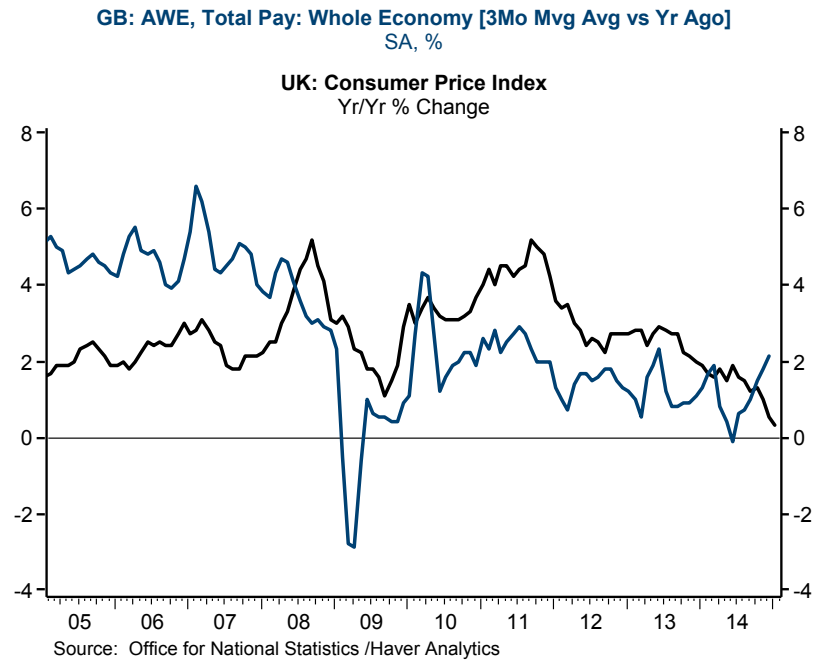


Source: Haver Analytics, February 2015.

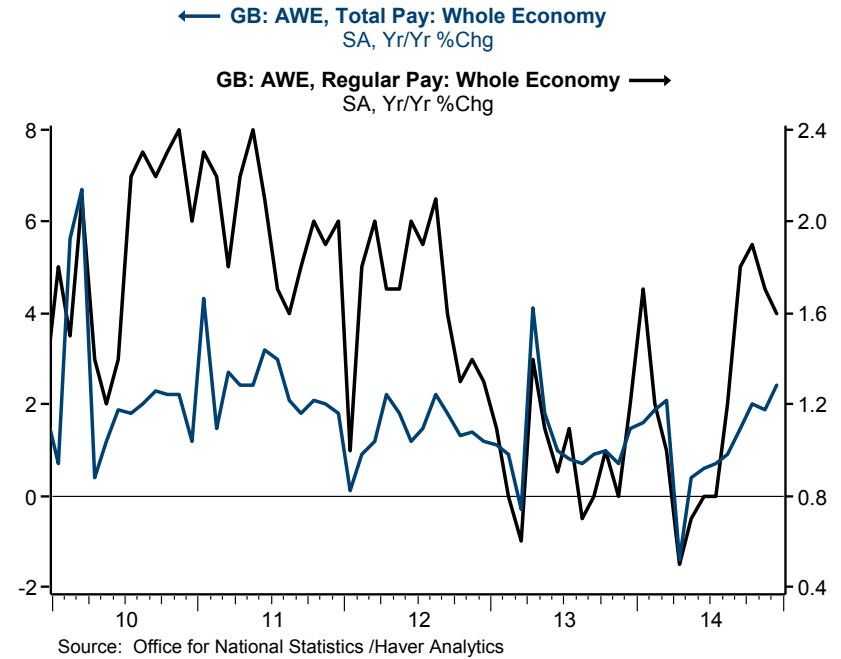
UK Labour Market

Real wages are picking up

Nominal wages vs CPI



Total and regular wage growth (excl bonuses)

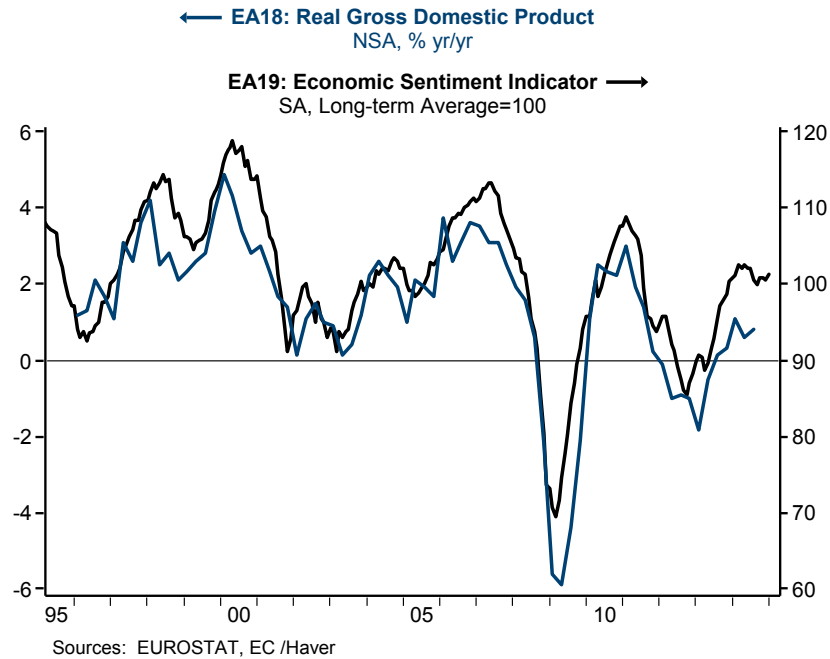


Source: Haver Analytics, February 2015.

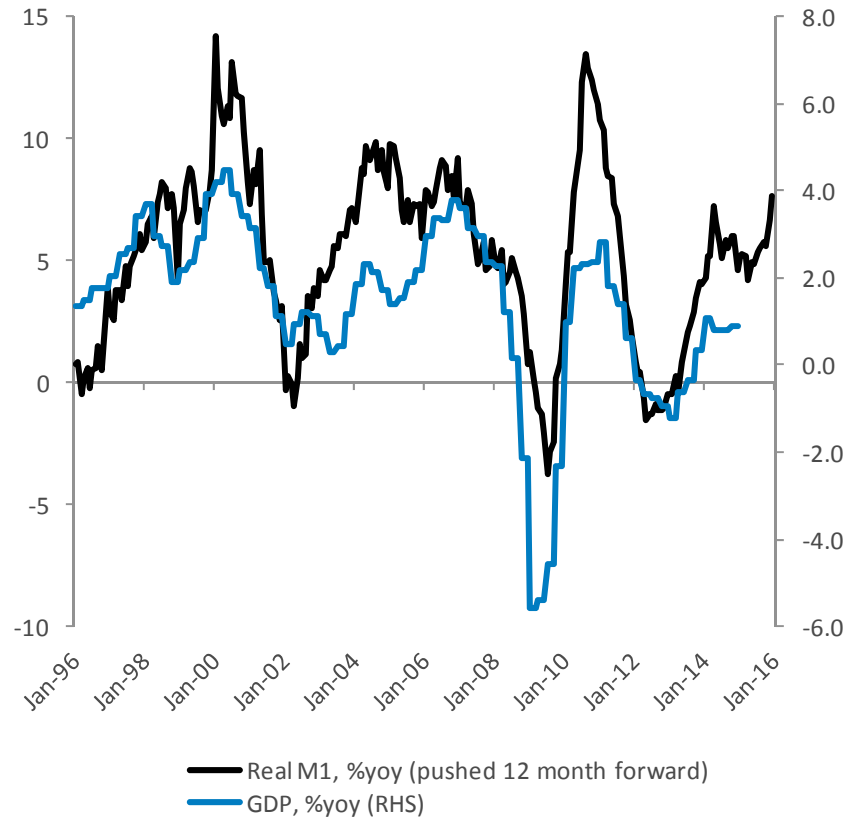
Euro Area Outlook Remains Challenging

But leading indicators point to a moderate turnaround

Euro area sentiment vs GDP



Euro area real M1 growth vs GDP

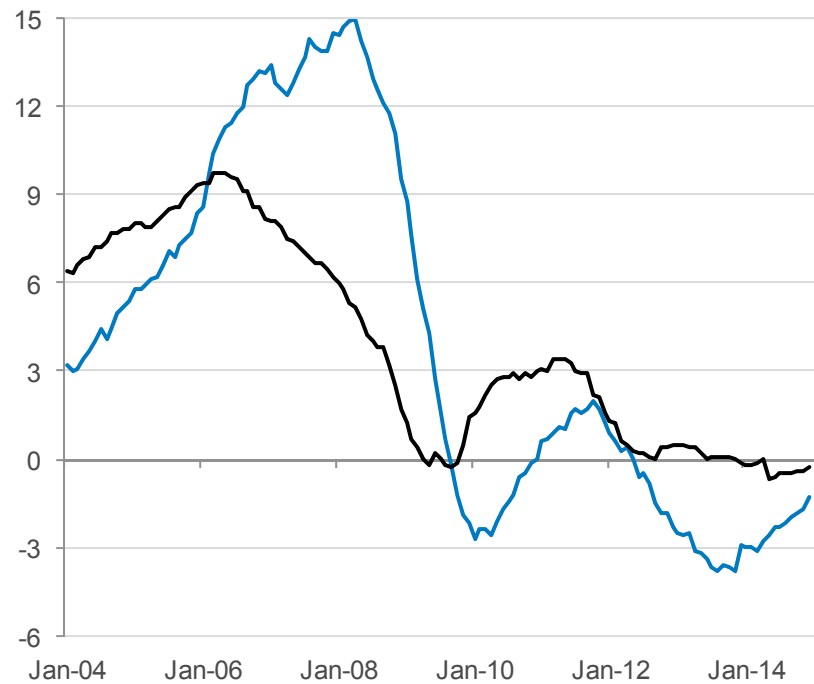


Source: Haver Analytics, February 2015.

Credit Easing Continues

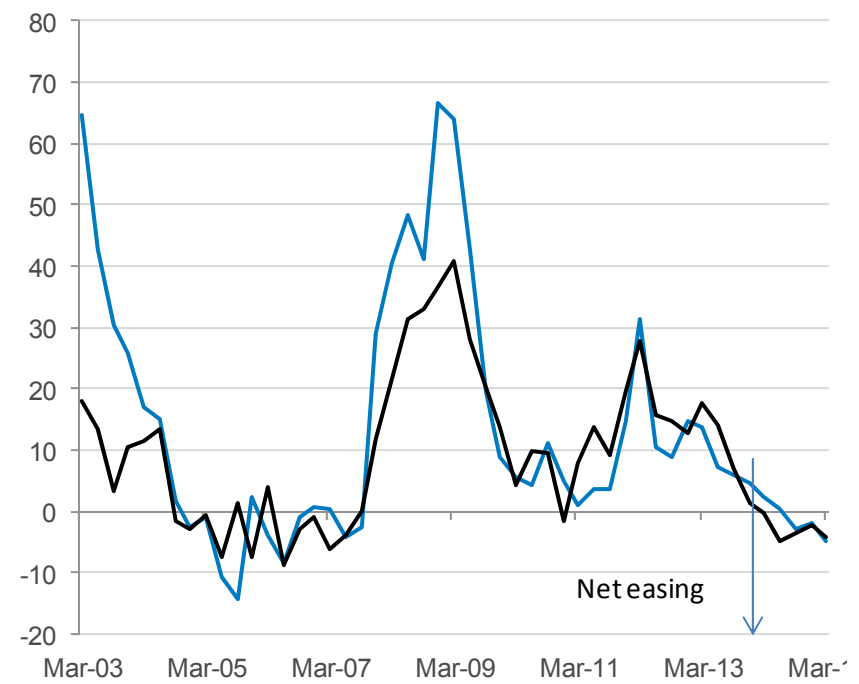
ECB policies should help ease credit standards further

Euro area credit growth



— Credit to non-financial corporations — Credit to households

ECB bank lending survey



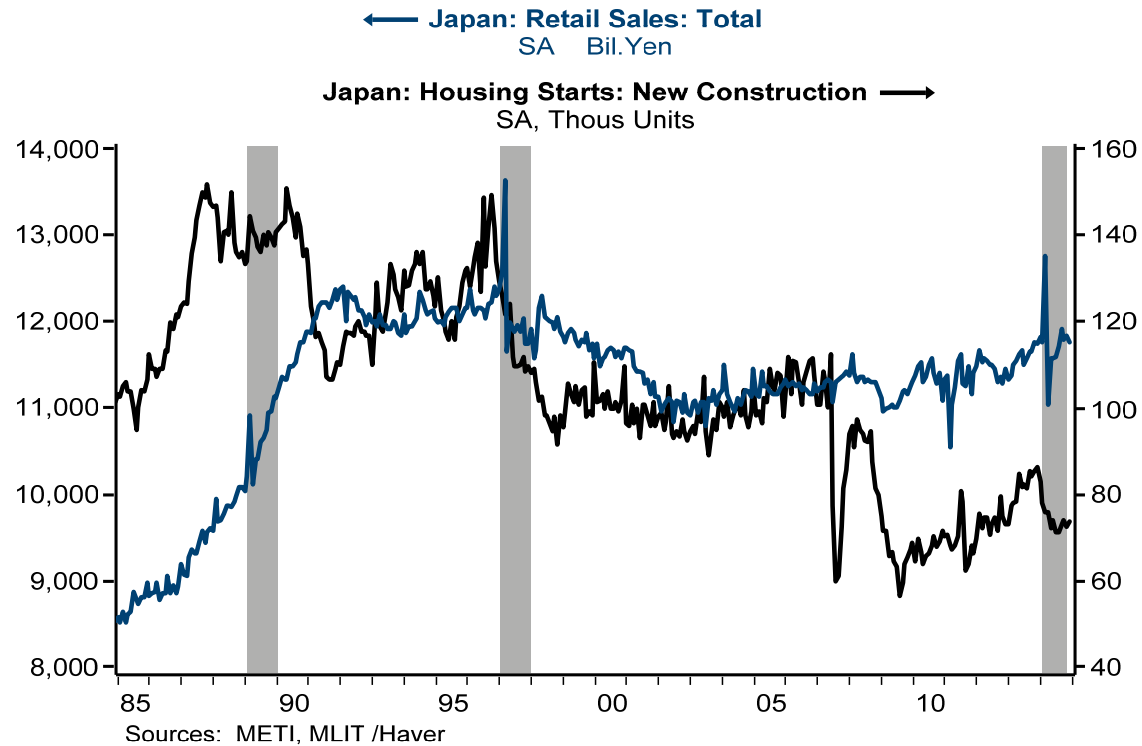
— Business loans — Approval for house purchase loans

Source: Haver Analytics, February 2015.

Japan is in Recession

The impact of the consumption tax hike is still felt

Japan Retail Sales and Housing Construction Starts

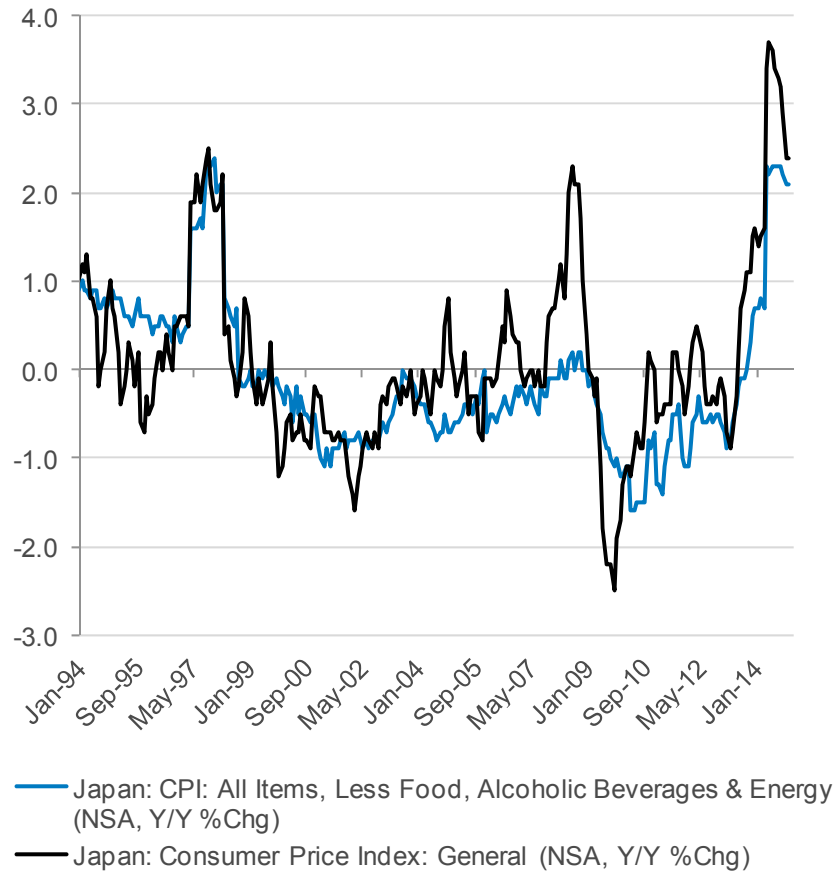


Source: Haver Analytics, February 2015.

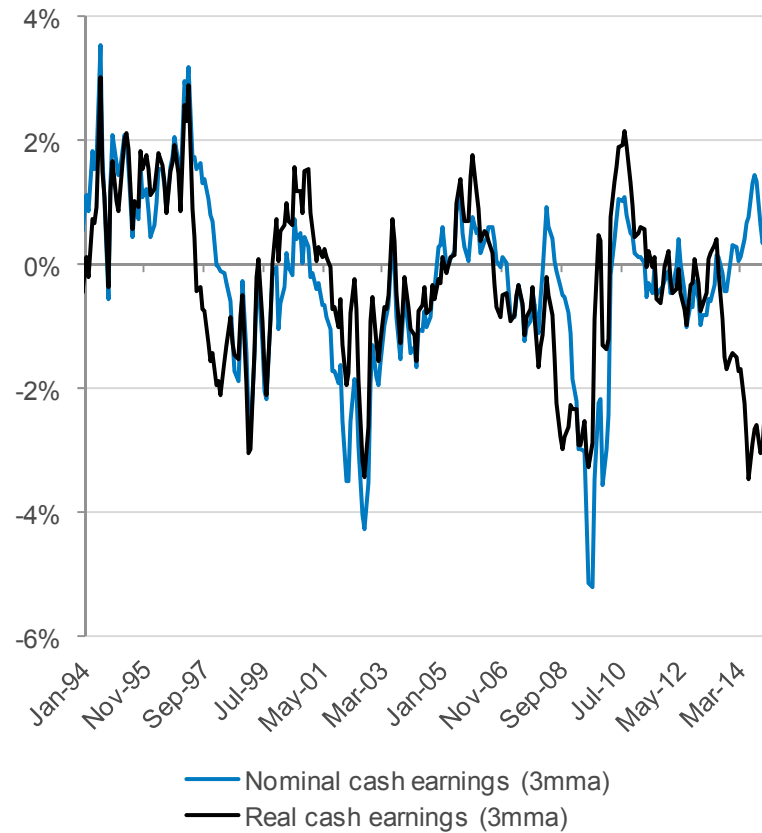
Japan Real Wages Declining

Nominal wage growth is not keeping pace with inflation

Japan headline and core inflation



Japan cash earnings

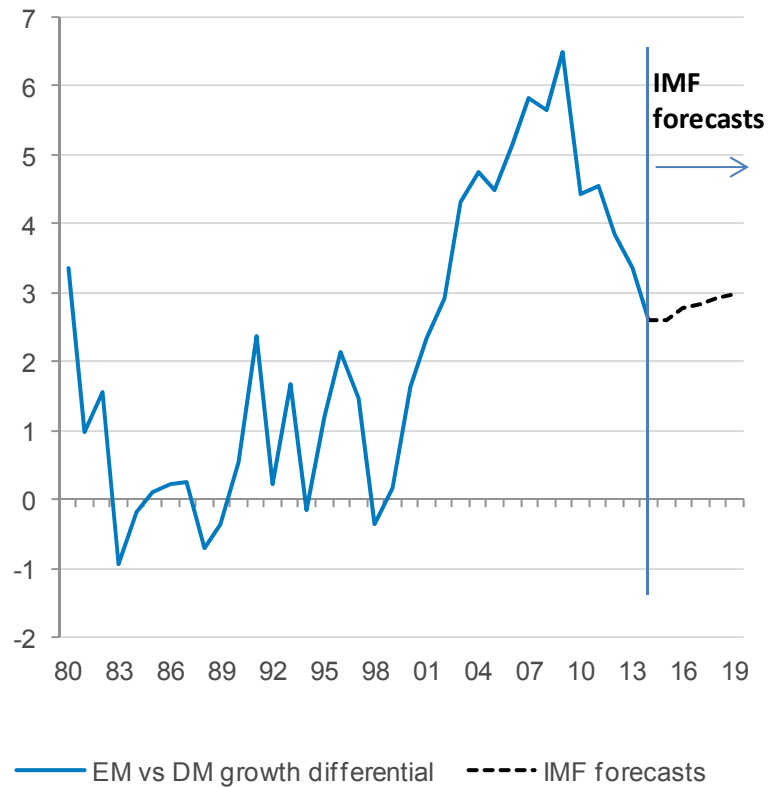


Source: Haver Analytics, February 2015.

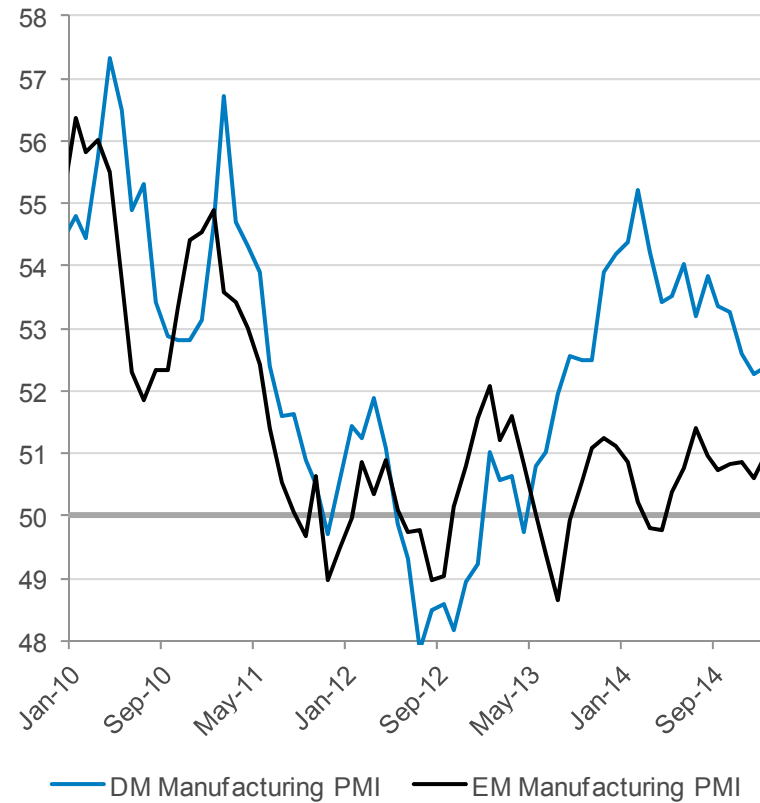
Sluggish EM recovery

Growth headwinds intensify

EM vs DM growth rate



EM vs DM PMIs

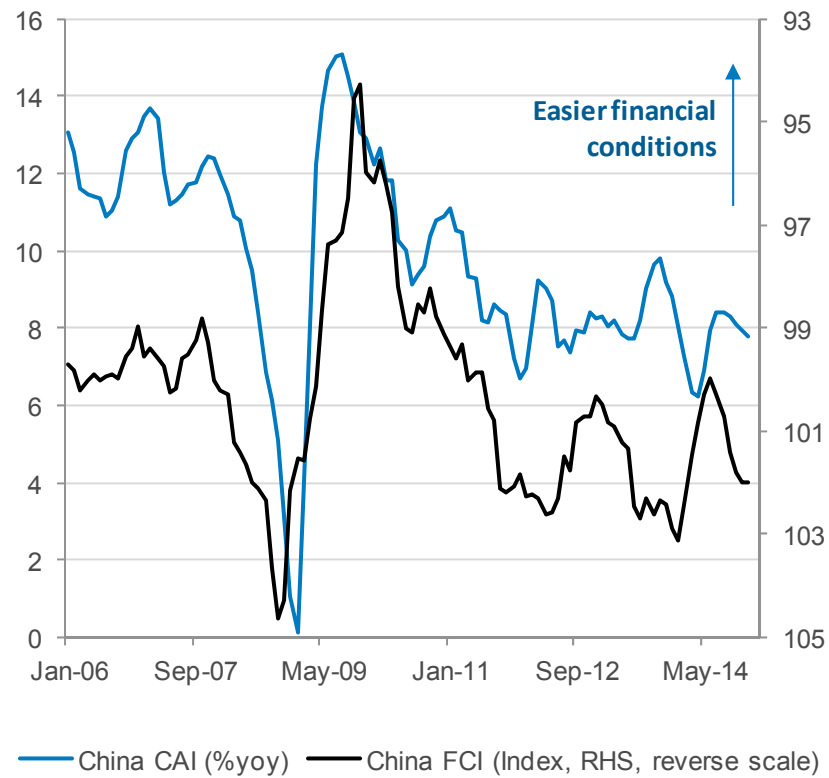


Source: IMF, Haver Analytics, February 2015.

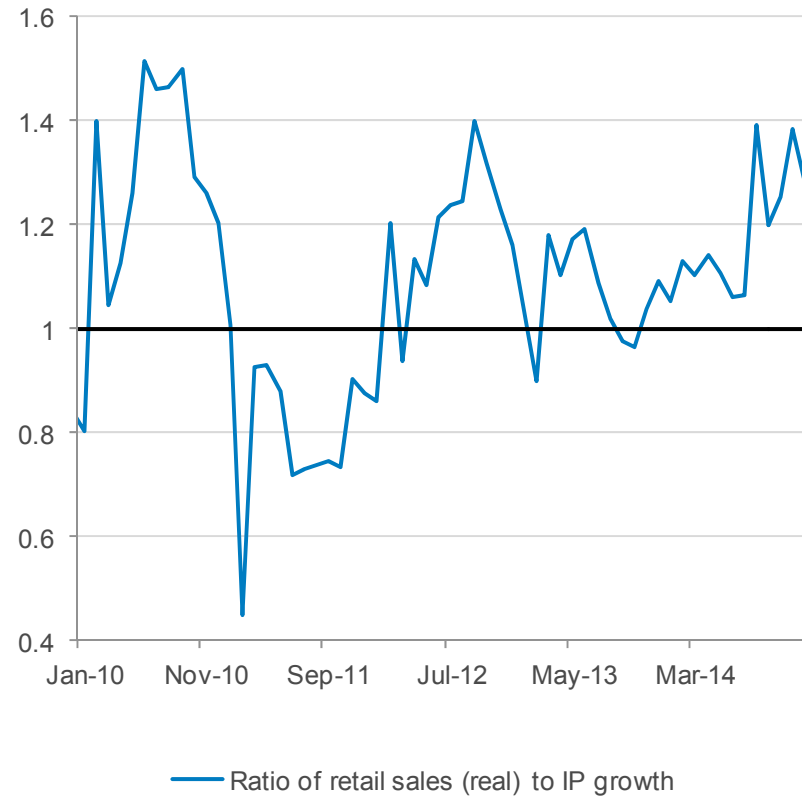
China's Structural Slowdown

Cyclical stabilisation in sight

China activity vs financial conditions



China 'rebalancing' indicator

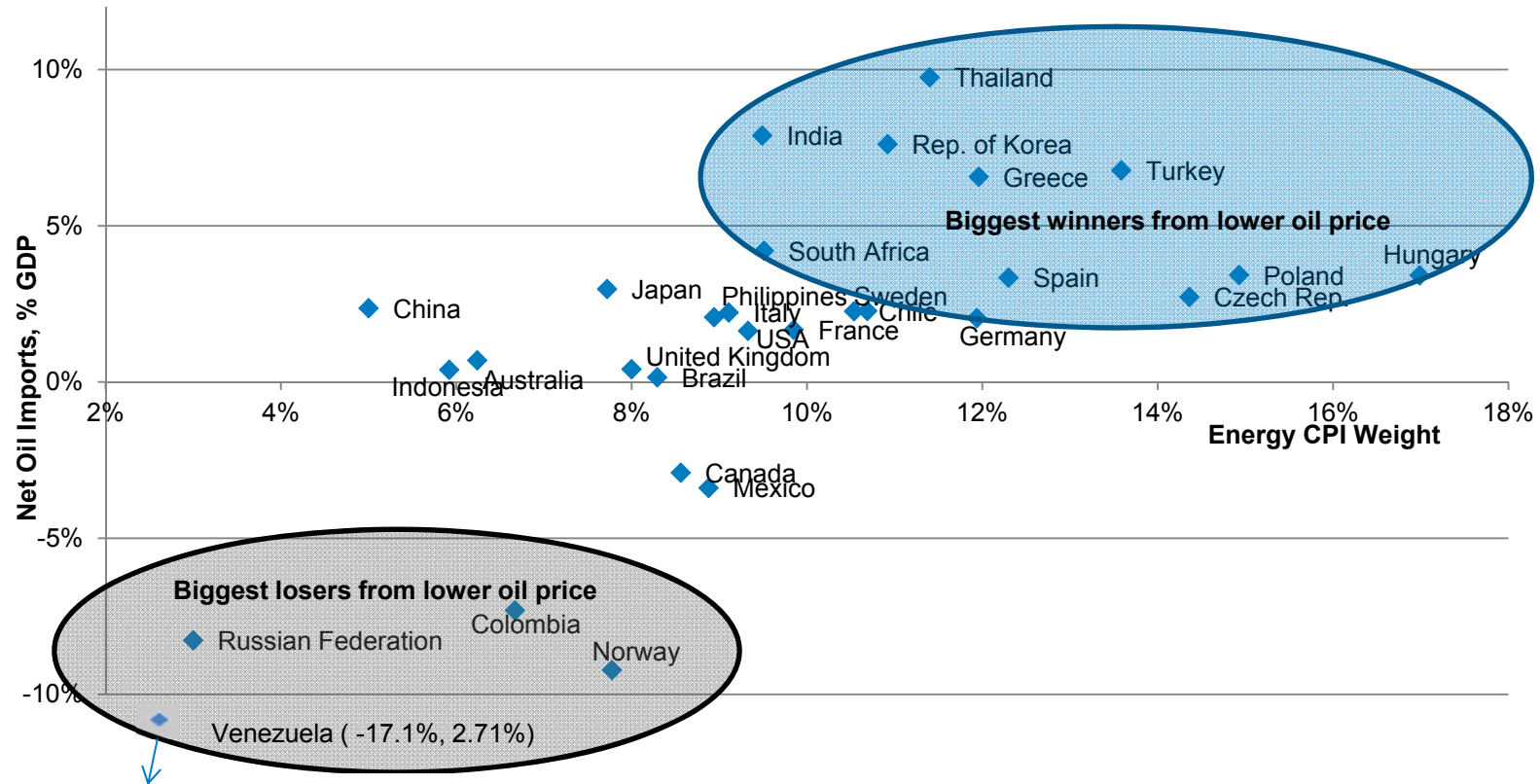


Source: Goldman Sachs Economics Research, Haver Analytics, Fidelity calculations, February 2015.

Winners and Losers from Lower Oil Prices

Gauging relative exposure to oil prices across EM

Energy CPI weight vs net oil imports



Source: Haver Analytics, Comtrade, Fidelity calculations, December 2014.

Quantifying Structural Reform

GS Growth Environment Score (GES)

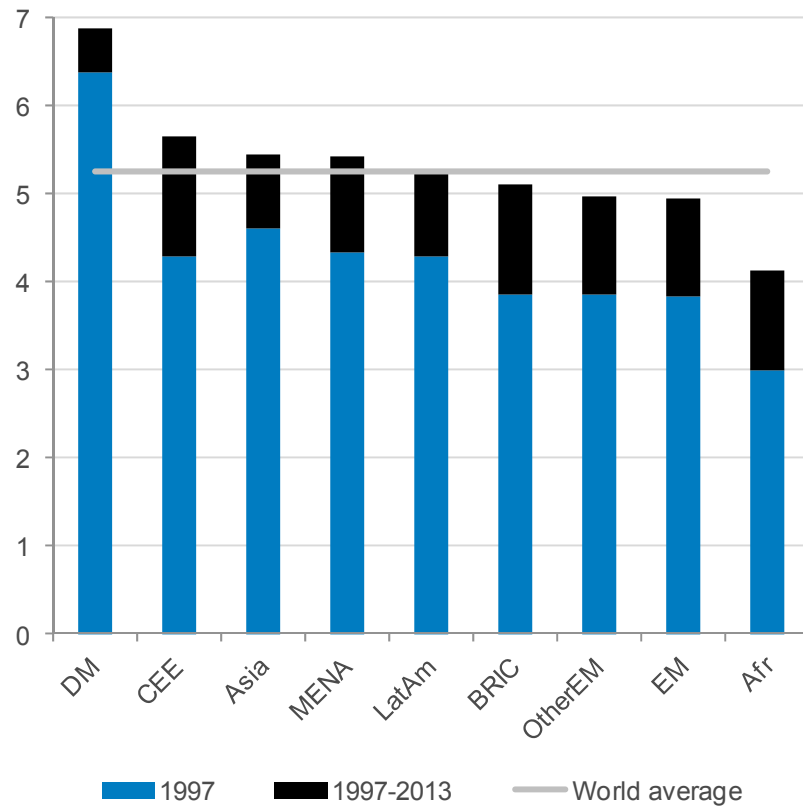
- **Political conditions:** rule of law, corruption, political stability
- **Macroeconomic stability:** government deficit, inflation, public debt
- **Macroeconomic conditions:** investment, openness
- **Human capital:** life expectancy, schooling
- **Technology:** mobiles, computers, internet, internet servers
- **Microeconomic environment:** patents, R&D, cost of business, urbanisation

Source: Goldman Sachs Economics Research, February 2015.

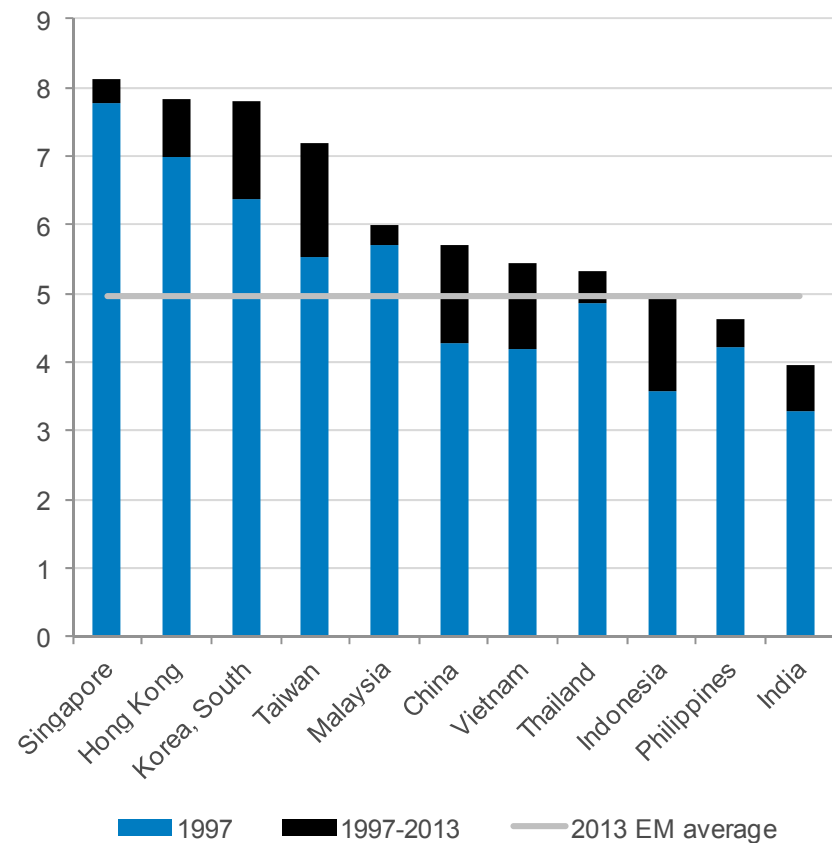
Structural Reform is Key

CEE and Asia stand out in EM, but more progress is needed

2013 Growth Environment Score and progress



GES across Emerging Asia

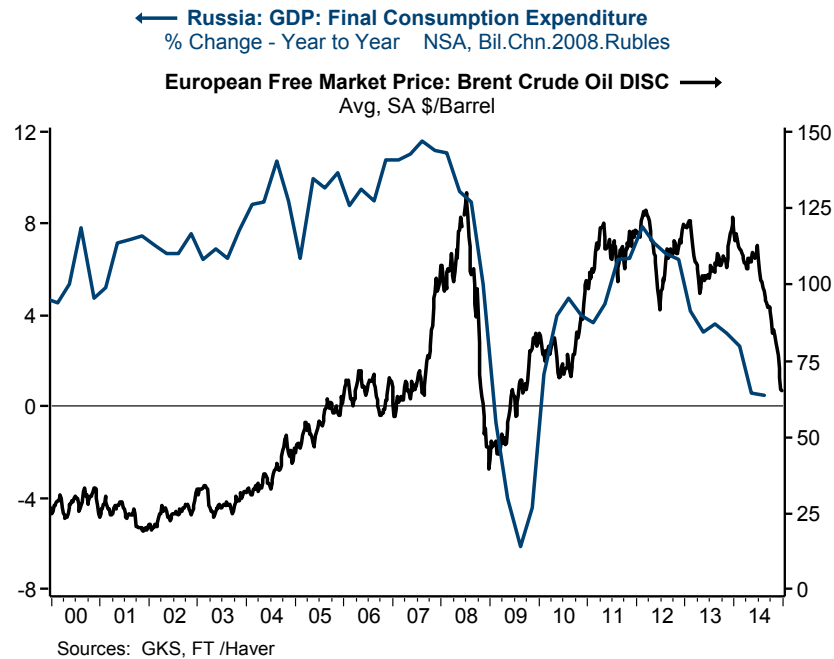


Source: Goldman Sachs Economics Research, February 2015.

Key Risks: EM Shock

Russian crisis could be the source of disruption

Russia's real consumption vs oil price



Russia's CPI vs Ruble

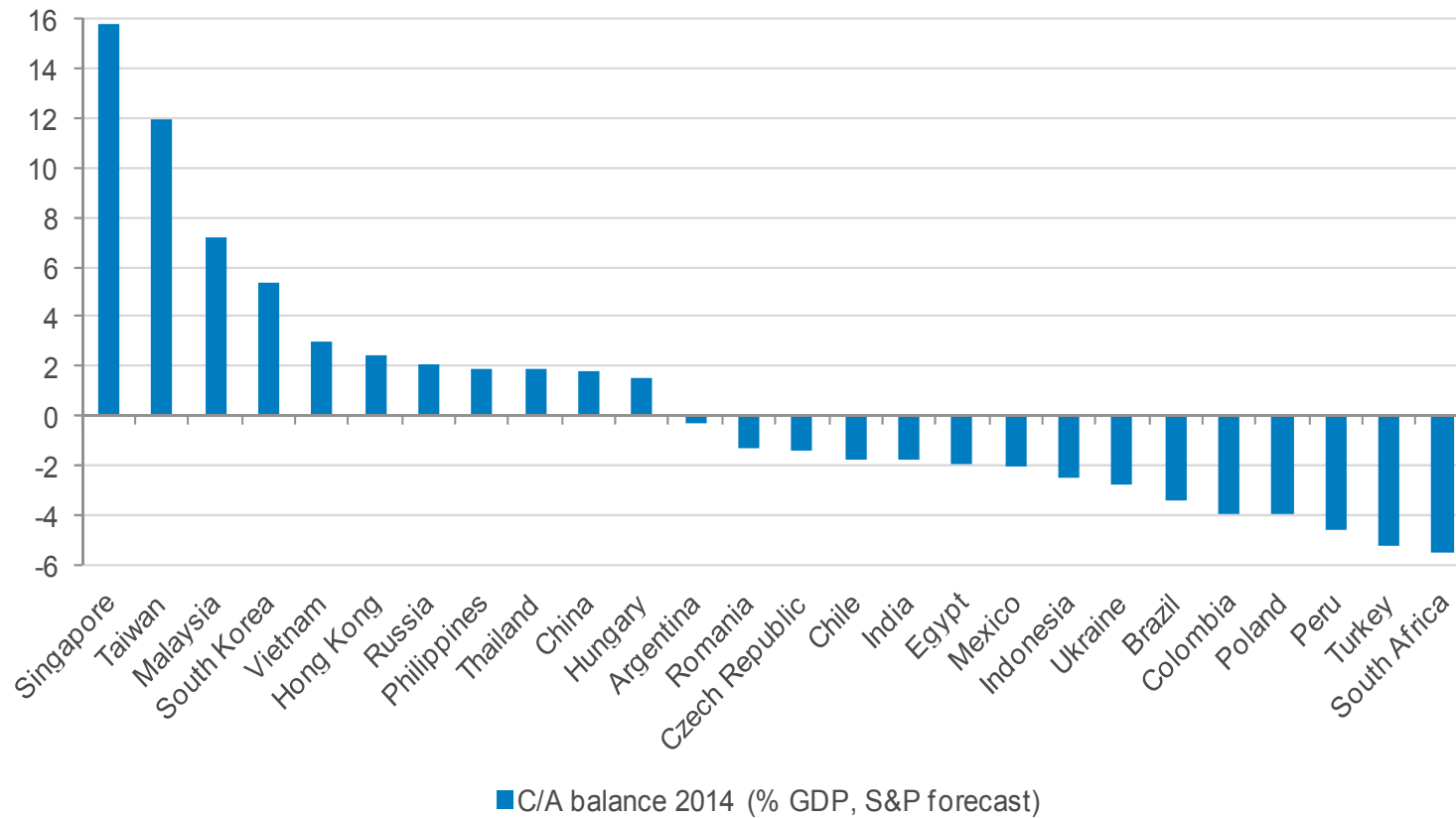


Source: Haver Analytics, February 2015.

Key Risks: Rising Global Yields

EM vulnerabilities could resurface

2014 current account balances



Source: S&P, December 2014.

Investment Implications

Moderately overweight equities and USD

	++	+	=	-	--
Multi Asset	Equities		Property Bonds	Commodities	
Equity Regions	Japan	Europe ex UK	USA UK Asia Pacific	Emerging Markets	
Equity Sectors	Discretionary	Healthcare Tech	Financials Industrials Utilities	Energy Materials Staples	
Currencies	US Dollar		Pound Sterling Swiss Franc	Japanese Yen Euro Canadian Dollar Australian Dollar	

Source: Fidelity Worldwide Investment, this represents the opinion of Fidelity Solutions. Positions for principal multi asset institutional and retail funds are as of February 2015. Individual fund positions may vary.

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