Prudential International Investments Advisers, LLC.
Global Economic Outlook 2010 – The Year Ahead

January 4, 2010
By John Praveen, Chief Investment Strategist
For Market Commentary Interviews Contact: Lisa Villareal, 973-367-2503

Summary: Steady, Sustained GDP Recovery in 2010. Benign Inflation. Low Interest Rates

John Praveen's Global Economic Outlook 2010 – The Year Ahead expects the global recovery that began in the middle of 2009 to be sustained in 2010 with a steady, sustained recovery in the Developed Economies and strong GDP growth in the Emerging Economies. GDP growth in the U.S., Europe and Japan is likely to be driven by substantial fiscal stimulus; low interest rates; inventory rebuilding; improving global trade and a modest recovery in the housing markets. GDP growth in China, India, and other Asian Emerging Markets is likely to accelerate with export recovery and strong domestic demand boosted by fiscal stimulus. Emerging Europe and Latin America are likely to benefit from strong commodity prices and recovery in exports.

Headline inflation is moving from disinflation in 2009 to low inflation in 2010 with base effects of firm oil and commodity prices, and further improvement in global growth. However, both headline and core inflation are likely to remain low due to the wide output gap, high unemployment and low capacity utilization.

Global central banks are expected to start implementing exit strategies in 2010. Some of the emerging central banks are likely to start raising interest rates in H1 2010. The developed central banks are expected to maintain current low rates through late 2010 with inflation remaining low and unemployment remaining high. We expect modest rate hikes by the Fed, the ECB, and BoE in late 2010 and no rate increase in Japan. However, global central banks are likely to start draining liquidity earlier in 2010 by unwinding some of the asset purchase programs.

Global Macro Outlook

Steady, Sustained GDP Growth. Benign Headline & Core Inflation. Rates Remain Low

Growth: Steady GDP Growth in Developed Economies. Strong GDP Growth in Emerging Economies

- The global recovery that began in the middle of 2009 is expected to be sustained in 2010 with a steady, sustained recovery in the Developed Economies and strong GDP growth in the Emerging Economies. We do not expect a W-shaped double-dip relapse into recession. In fact, GDP growth is likely to surprise on the upside.
- GDP growth in the U.S., Europe and Japan is likely to be driven by: a) substantial fiscal stimulus; b) low interest rates; c) inventory rebuilding; d) improving global trade and e) a modest recovery in the housing markets.
- We expect GDP growth in 2010 to be around 3.3% in the U.S. and around 2% in Europe and Japan. In contrast to sharp V-shaped rebound from past deep recessions, the current recovery is likely to be a more gradual, swoosh-shaped recovery with the headwinds of high unemployment and continued deleveraging by U.S. households.
- GDP growth in China, India, and other Asian Emerging Markets is likely to strengthen further with export recovery and strong domestic demand boosted by fiscal stimulus. We expect GDP growth to be over 10% in China and over 8% in India. Emerging Europe and Latin America are likely to benefit from firm oil and commodity prices and recovery in exports.

Inflation: Benign Headline & Core Inflation with Wide Output Gap, High Unemployment & Low Utilization

- Headline prices are moving from disinflation in 2009 to low inflation in 2010 with firm oil and commodity prices, and further improvement in global growth. However, both headline and core inflation are likely to remain low due to high unemployment and low capacity utilization.
- Headline inflation is likely to average around 1.8% in the U.S., around 1.3% in Eurozone and 2.5% in the U.K. However, Japan is likely to remain in deflation in 2010, with headline inflation around -1% due to strong domestic deflationary pressures.
- Core inflation in 2010 is expected to average around 1.4% in the U.S., around 1% in Eurozone and -1.5% in Japan.

Interest Rates: Central Banks Exit Strategies in Mid/Late 2010. Significant Fiscal Stimulus Still in 2010 Pipeline

- With the global recession ending in the middle of 2009, global central banks are expected to start implementing exit strategies in 2010. Some of the emerging central banks are likely to start raising rates in H1 2010. However, with inflation remaining low and unemployment remaining high, the developed central banks are expected to maintain current low rates through late 2010.

- Current U.S. unemployment rate (10%) is very high compared to the 6% average rate during past Fed tightening. Further, unemployment had been in a downtrend ahead of Fed tightening. Hence, the Fed is unlikely to begin tightening before late 2010.
- We expect modest rate hikes by the Fed, the ECB and BoE in late 2010 and no increase in Japan However, global central banks are likely to start draining liquidity earlier in 2010 by unwinding some of the asset purchase programs.
- A significant amount of fiscal stimulus remains in 2010, especially in the U.S. and China. Japan is likely to inject fresh stimulus.

Currencies: Dollar Gains against Euro, Yen, Sterling, Remains in Downtrend against Emerging Market Currencies

- The U.S. dollar is likely to rise against the euro, sterling, and yen in 2010 with relatively stronger U.S. GDP growth and the U.S. interest rates rising ahead of Europe and Japan. We expect the dollar to fall further against EM currencies.

Regional Outlook - USA, Eurozone, UK, Japan, China, Other EM

U.S.A: Solid GDP Growth in 2010. Inflation Low but Volatile. Rate Hike in Late 2010

Growth: Solid, Sustained GDP Growth in 2010 but Smaller Rebound than in Past Recoveries

- The U.S. recession deepened in early 2009 as the financial crisis escalated. U.S. GDP sunk -6.4% QoQ annualized in Q1 due to a plunge in business investment spending and housing investment. In response, the U.S. government undertook aggressive stimulus measures, while the Fed expanded its monetary stimulus through Quantitative Easing and other asset purchase programs.
- The stimulus measures helped slow the decline in Q2 with GDP falling –0.7%. U.S. GDP growth turned positive in Q3, rising 2.2% with positive contributions from consumption spending, inventory, and residential investment. U.S. GDP growth is estimated to have grown around 4% in Q4. For full year 2009, GDP is estimated to have declined –2.5%.
- ***The U.S. recovery is expected to be sustained in 2010 with GDP growth averaging around 3.3% during 2010, a much smaller rebound than in past recoveries due to the headwinds to U.S. consumers. In past U.S. recoveries, GDP surged 7% during the first year after the end of deep recessions and rose on average 5.7% after all recessions.***
- Consumer spending was the key driver of past U.S. recoveries during the last 60 years, contributing around 4% to GDP growth. However, in the current recovery, consumer spending is expected to grow just 2.6% annualized and make a smaller 2% contribution to 2010 GDP growth due to the headwinds of high unemployment and rising household savings.
- Fiscal stimulus is expected to boost spending, with over $400 billion due to be spent in 2010. With U.S. inventories at a 60-year low, inventory rebuilding is expected to contribute over 1% to GDP growth. Business investment spending and housing investment are also expected to contribute to GDP growth in 2010.

Inflation: Headline Inflation Low but Volatile Due to Base Effects. Low Core Inflation Due to Excess Capacity

- U.S. headline inflation was sharply negative through July 2009 due to base effects of high oil prices in H1 2008. Inflation sank to a low of -1.8% YoY in July from around 0% in January. With fading base effects, headline inflation rose to around 2% by late 2009. Excess capacity following the deep recession pulled down core inflation, averaging around 1.8% in 2009.
- U.S. headline inflation is expected to remain volatile during H1 2010 due to the base effects of the sharp changes in prices in H1 2009 before stabilizing in H2. Headline inflation is expected to average 2.3% in H1 and 1.4% in H2. Core inflation is expected to remain muted with low capacity utilization and high unemployment, averaging 1.4% in H1 and 1.3% in H2.

Interest Rates: Fed To Start Unwinding Asset Purchase Programs Through 2010. Rate Hike in Late 2010

- The U.S. Federal Reserve held rates at the record low range of 0 - 0.25% through 2009. However, the Fed aggressively used non-traditional monetary policy measures, purchasing Treasury bonds, MBS, and agency debt.
- The Fed is likely to hold the Fed Funds rate around zero through late 2010. This is because the current U.S. unemployment rate (~10%) is very high compared to the 6% average rate during past Fed tightening. Further, unemployment had been in a downtrend ahead of Fed tightening. Hence, the Fed is unlikely to begin tightening before late 2010. However, the Fed is likely to start draining liquidity earlier in 2010 by unwinding the Quantitative Easing measures and other asset purchase programs.

Currencies: Dollar Falls in H2 2009. Dollar Gains Against Euro, Sterling & Yen in 2010

- The U.S. dollar remained in an uptrend through early 2009. However, as financial crisis eased and risk aversion eased, the dollar fell against most global currencies, including the euro and the pound sterling. After rising above $1.50/euro in late November, the dollar strengthened sharply in December against the euro on concerns about Greek sovereign debt.
- Stronger economic growth in the U.S. and the U.S. financial system on a more stable footing is likely to lift the dollar higher against the euro, sterling and the yen. However, the dollar is likely to remain in a downtrend against Emerging Market currencies.

Europe: Modest GDP Growth in Eurozone & U.K. Low Inflation. Rate Hikes in Late 2010

Growth: Eurozone and U.K. in Deep Recession in H1 2009, Recovery in H2. Modest GDP Growth in 2010

- Eurozone GDP growth is expected to average around 2% in 2010 after the -3.9% GDP collapse in 2009. Germany and France, which led Eurozone out of recession in 2009 are expected lead the Eurozone recovery in 2010.
- Inventory rebuilding which led the recovery in mid-2009 is expected to make a strong contribution to growth in H1. Business investment spending and exports of investment goods are also expected to drive GDP growth in 2010.
- Eurozone consumption spending is expected to remain weak in H1 due to high unemployment but improve in H2 as unemployment begins to decrease. Consumer spending is expected to average around 1.2% in 2010.
- U.K. remained in recession longer than other developed economies, emerging from recession only in Q4 2009. U.K. leading economic indicators are now rising sharply, pointing to the recovery continuing in 2010. However, the U.K. recovery is also likely to be muted with fiscal policy expected to be tightened to tackle the fiscal deficit of more than 12% of GDP. Further rebalancing in the household and banking sectors is also likely to be a drag on U.K. growth. U.K. GDP is expected to average 1.6% in 2010 after the -4.6% plunge in 2009.

Inflation: Inflation Falls Sharply in 2009. Low Headline and Core Inflation in 2010 with Excess Capacity

- Eurozone headline inflation fell from 1.1% YoY in January to a trough of -0.7% in July 2009. As oil price base effects began to reverse in H2, inflation turned positive, rising to 1% in late 2009. However, core inflation has been more stable, around 1.4%.
- Eurozone headline inflation is expected to rise in early 2010, largely driven by base effects from weak oil prices in Q1 2009. Eurozone headline inflation is likely to average around 1.3% in 2010 after 0.3% in 2009. Low capacity utilization, elevated unemployment, and the impact of the overvalued Euro are likely to push down core inflation to well under 1% in H1 2010. Core inflation is expected to pick up modestly as the economy recovers to average around 1% for all of 2010.
- U.K. inflation fell sharply in 2009, hitting a trough of 1.1% in September as base effects began to unwind. Inflation trended higher to around 2% by the yearend. U.K. inflation is expected to rise further in 2010 due to the planned VAT rate reversal, and base effects of low oil prices in early 2009. Headline inflation is expected to rise to around 2.5% in 2010. However, core inflation is expected to remain benign due to the spare capacity overhang and contained wage pressures.

Interest Rates: ECB and BoE on Hold Through Late 2010 but Unwind Asset Purchase Programs Earlier in 2010

- The ECB continued to cut rates during H1 2009, lowering the repo rate from 2.5% to 1%, a new all-time low. The ECB also used non-traditional measures to ease financial conditions, including the €60bn purchase of covered bonds in a targeted effort to improve liquidity. ECB remained on hold in H2 2009.
- The ECB is expected to remain on hold through late 2010 with Eurozone GDP growth below potential and inflation remaining contained. However, the ECB is likely to start scaling back its emergency measures earlier in 2010 as it usually worries more about consumer and asset price inflation and less about unemployment than the U.S. Fed. Further, Eurozone household balance sheets are less strained and the housing market is less fragile and less interest-rate sensitive than in the U.S. and U.K.
- The BoE cut base rates from 2% to 0.5% in early 2009 and held rates at that level through the year. The BoE also undertook asset purchases, buying £200bn of long-term Gilts. The BoE is expected to remain on hold through late 2010 due to the muted recovery. However, the BoE is likely to start reversing its Quantitative Easing program by selling its Gilt holdings.

Currency: Euro and Sterling to Weaken During 2010 with Relatively Stronger U.S. Growth

- The euro and sterling weakened during early 2009 on safe haven dollar gains. However as the global recovery began to unfold, the pound and euro rose against the dollar during the rest of 2009 with European economies more cyclical than the U.S. economy.

- The pound and euro are expected to weaken against the dollar during 2010 with relatively stronger U.S. GDP growth and U.S. rates likely to rise ahead of Europe.

Japan: Modest GDP Growth in 2010. China: Solid GDP Growth After 2009 Recovery

Growth: Slower GDP Recovery in Japan during 2010. Further Solid GDP Growth in China

- Japan's GDP posted a sharp double-digit decline in Q1 due to the collapse in exports and industrial production. However, the economy rebounded out of the recession in Q2 with the recovery in exports and the government's ¥57trn fiscal stimulus package before slowing again in H2 as the fiscal stimulus petered out and domestic demand remained weak.
- Japan's GDP is expected to grow around 1.8% in 2010, after declining -5.1% in 2009, supported by solid exports due to the ongoing global GDP recovery. However, GDP growth is likely to be modest as the effects of fiscal stimulus start phasing out, while business investment spending is likely to remain soft with capex plans revised down and capacity utilization still low. Consumption is likely to get some support from fiscal stimulus, but offset by still weak consumer fundamentals.
- China's economy slowed sharply to 6.1% YoY in Q1 2009 with the global recession and high base effect. However, the economy rebounded strongly in subsequent quarters with GDP rising to above 10% by Q4 as massive fiscal stimulus boosted investment spending and consumption, offsetting the still weak external demand.GDP rose 8.6%, well above the official target, in 2009.
- China's GDP growth is on track to strengthen further in 2010 as FAI growth remains solid driven by still ample liquidity and government's commitment to support GDP growth, while consumption remains solid driven by the fiscal stimulus. About 50% of the fiscal stimulus is due to be spent in 2010. Net exports are likely to rebound with the recovery in external demand. GDP growth is expected to rise further to over 10% in 2010.

Inflation: Japanese Prices Stay in Deflation Territory During 2010. Chinese Prices Trend Modestly Higher

- Japanese prices relapsed into deflation in 2009 with headline inflation falling -1.3% YoY in 2009 driven by excess capacity and weak domestic demand. Core inflation fell to a low of -2.4% in August before moderating to -1.7% by end of 2009. Prices outside food and energy fell to a record low -1.1% in late 2009, indicating severe domestic deflationary pressures.
- Inflation is likely to remain in negative territory during 2010 as Japan's output gap remains around -6%. Japanese prices are now under strong deflationary pressures due to decline in labor earnings, elevated unemployment rate, and still very low capacity utilization. Headline inflation is still likely to remain in negative territory through 2010, around -1%.
- China's inflation fell sharply into negative territory in H1 2009 from a 12-year high of 8.7% in 2008 driven by base effects and falling food prices. However, aggressive stimulus measures to bolster consumption and the recovery in energy and commodity prices pushed prices back to positive territory in H2. Prices fell -0.5% during 2009.
- Chinese consumer inflation is likely to rise in 2010 with a rise in food and energy prices. However, the output gap remains big given that exports still remain relatively soft. Therefore, inflation is likely to remain contained in 2010, around 3%.

Interest Rates/Currency: BoJ Remains on Hold. China Starts Gradual Policy Tightening in H1 2010

- The Bank of Japan (BoJ) remained on hold at 0.1% for all of 2009 and undertook liquidity measures to stabilize the financial market and facilitate corporate financing. The BoJ is likely to keep rates around zero through 2010 and possibly undertake further QE measures amid severe domestic deflationary pressures and to support the ongoing GDP recovery.
- The People's Bank of China (PBC) remained on hold through 2009 and provided ample liquidity to boost the economy. The Bank's policy is likely to remain generally accommodative during 2010 given the early stages of the GDP recovery. However, the PBC is likely to start gradually raising interest rates in Q2-Q3 as inflationary pressures build.
- The yen fell sharply against the dollar in early 2009 with the GDP collapse, but stabilized as Japanese GDP rebounded and accelerated following the victory of the DPJ party, ending 2009 almost flat against the dollar around ¥93/dollar. The yen is likely to weaken against the dollar in 2010 with relatively stronger U.S. GDP growth and U.S. rates rising ahead of Japan.
- After remaining flat against the dollar in 2009 at RMB6.8/dollar, the Chinese RMB is likely to be revalued in 2010 due to strong GDP growth, recovery in trade, and further international pressure.

EM: Strong GDP Growth in 2010. Inflation Trending Higher. Tighter Monetary Policy

Growth: Emerging Economies on Track to Post Strong GDP Growth in 2010 After Solid Recovery in 2009

- India GDP is likely to rise above 8% in 2010 after posting a solid 7% growth in 2009. Government spending on infrastructure and services continues to support the recovery. Consumption demand remains solid, while net exports are expected to be mixed with the rise in oil prices pressuring imports while exports benefit from recovery in the global GDP growth.
- Korea GDP is on track to post a strong recovery in 2010, rising 4.5% after falling -1.2% in 2009 boosted by improving business confidence and industrial production, and as consumption recovers. Taiwan GDP is expected to rise a strong 4.5% in 2010 after a sharp -4.4% decline in 2009 as exports benefit from improving global demand and recovery in consumer confidence.
- Mexican growth is expected to rise 3.4% in 2010 with a rebound in manufacturing, capital flows, and remittances, boosted by the recovery in the U.S. economy. In 2009, the Mexican economy fell a sharp -6.2% due to fall in industrial production and consumer confidence when the recession in the U.S. growth in H1 was transmitted and magnified in Mexico by fears of the swine flu.
- Brazilian GDP is expected to rise around 5% in 2010 with domestic demand expected to recover strongly as economic conditions improve and as global demand for commodities picks up further. Interest rates also remain supportive of GDP growth. Brazil had begun to recover in early 2009 and exited the recession quicker than other economies due to the recovery in commodities prices.

Inflation: Prices Likely to Trend Higher in 2010 with Fading Base Effects & Rising Commodity Prices

- India WPI inflation is expected to trend higher, well above the RBI's comfort level, to around 8% in H1 2010 due to negative base effects from H1 2009 and upside risks to prices due to rising food prices and the firm recovery in oil and commodity prices. Solid wage growth and the government's spending plans are also likely to result in upward price pressures.
- Korean inflation is likely to remain contained around 2.7% in 2010 with excess capacity and won strength offsetting the impact of higher energy prices. Taiwan inflation is likely to rise a modest 1% in 2010 after declining -0.8% in 2009 as deflationary pressures still remain due to excess capacity. However, rising food and oil prices are putting some upward pressure on prices.
- Mexican inflation is likely to trend higher to around 4% during 2010, with VAT hike, rising fuel prices, and low base effects. Brazilian inflation is expected to rise around 4.5% in 2010 as domestic demand strengthens with wage hikes and the impact of higher credit costs on food prices.

Interest Rates: Emerging Market Central Banks to Raise Rates in 2010 After Cutting Rates Sharply in 2009

- The Reserve Bank of India is expected to start hiking interest rates in Q1 with inflation set to rise above its comfort levels and with GDP growth on solid recovery path. However, the hikes are likely to be modest in order not to derail the recovery.
- The Bank of Korea is expected to remain on hold well into 2010 given the central bank's caution about slowing growth momentum, while inflation remains well below the bank's target range. Taiwan's central bank is not expected to raise policy rates until H2 2010 and rate hikes are likely to be modest and gradual due to the low inflation and still elevated unemployment.
- The Mexican central bank (Banxico) is expected to begin to raising rates in late Q2 2010 to contain inflation arising from tax increases in the 2010 budget, but the modest recovery in domestic demand will restrain the tightening cycle. In 2009, Banxico cut rates sharply by a total of 475bps, bringing rates to 4.5% in August, and holding them during the rest of the year. The Brazilian central bank (COPOM) is likely to raise the policy rate (SELIC) as inflationary pressures rise later in 2010. In 2009, the Bank cut rates to 8.75% in August from 13.75% at the end of 2008.

Currency: Emerging Market Currencies to Appreciate Further Against Dollar in 2010

- Emerging Markets (EM) currencies depreciated sharply against the dollar in early 2009 as the financial crisis escalated. However, as EM countries began to exit the recession, their currencies began to appreciate strongly against the dollar in H2 2009.
- With Emerging Markets GDP set to grow faster than U.S. GDP, we expect further gains for EM currencies in 2009.

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