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Global Economic Outlook:
Which way now?

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IHS Markit growth forecasts

GDP (% y/y)	2017	2018	2019	2020	2021	vs consensus
World	3.4	3.2	2.7	2.7	2.8	In line
US	2.4	2.9	2.3	2.3	2.1	Above
China	6.7	6.6	6.2	5.8	5.7	Below
Japan	1.9	0.8	1.1	0.3	0.6	In line
Eurozone	2.7	1.9	1.1	0.9	1.2	Below
Germany	2.8	1.5	0.6	0.8	1.2	Below
France	2.4	1.7	1.2	0.9	1.1	Below
Italy	1.8	0.7	-0.1	-0.2	0.4	Below
UK	1.8	1.4	1.0	0.6	1.2	Below
India	7.1	6.8	6.6	6.8	6.8	In line
Brazil	1.1	1.1	0.8	1.4	1.5	Below
Russia	1.7	2.2	1.3	1.7	1.8	In line

Source: IHS Markit

- Global GDP growth is forecast to slow in 2019-21, but with divergence across regions and countries.
- IHS Markit forecasts in line with consensus: World, Japan, India, Russia
- IHS Markit forecasts above market consensus: US
- IHS Markit forecasts below market consensus: China, Europe (particularly Germany and UK), Brazil

Key risks

To the downside…

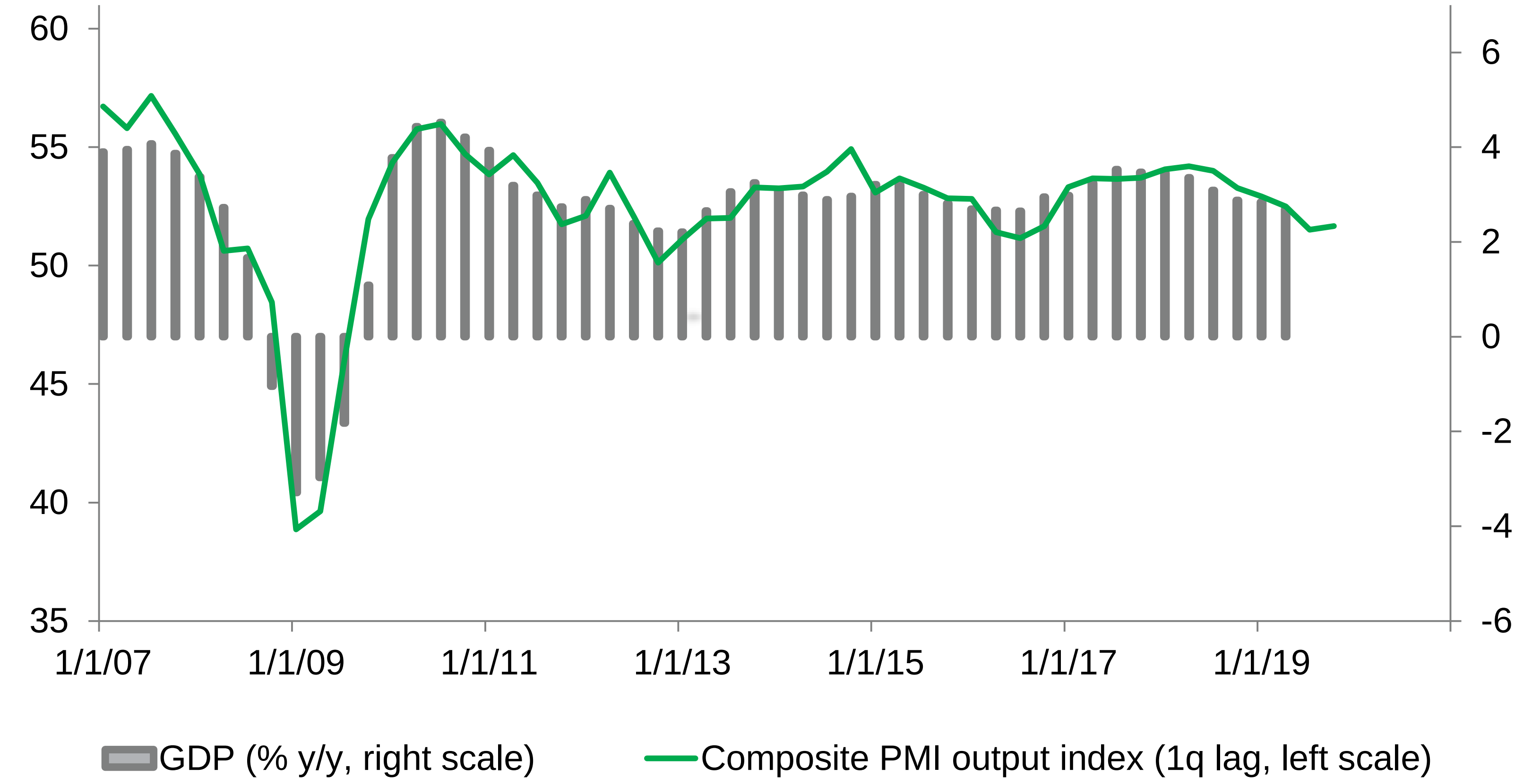
- Intensification of protectionism, further weakness in global trade
- Contagion from weak exports/manufacturing to consumer/services
- Political events: e.g. “no deal” Brexit, Middle East conflict
- Increased precautionary saving, by households and corporates
- Market turmoil, lower asset prices, adverse wealth effects

To the upside…

- Looser monetary policy given low inflation and inflation expectations
- Additional fiscal space due to low sovereign yields
- Change of US presidency (with caveats)

PMI points to global growth moderation, so far

PMI a good leading indicator of global growth momentum



Source: IHS Markit

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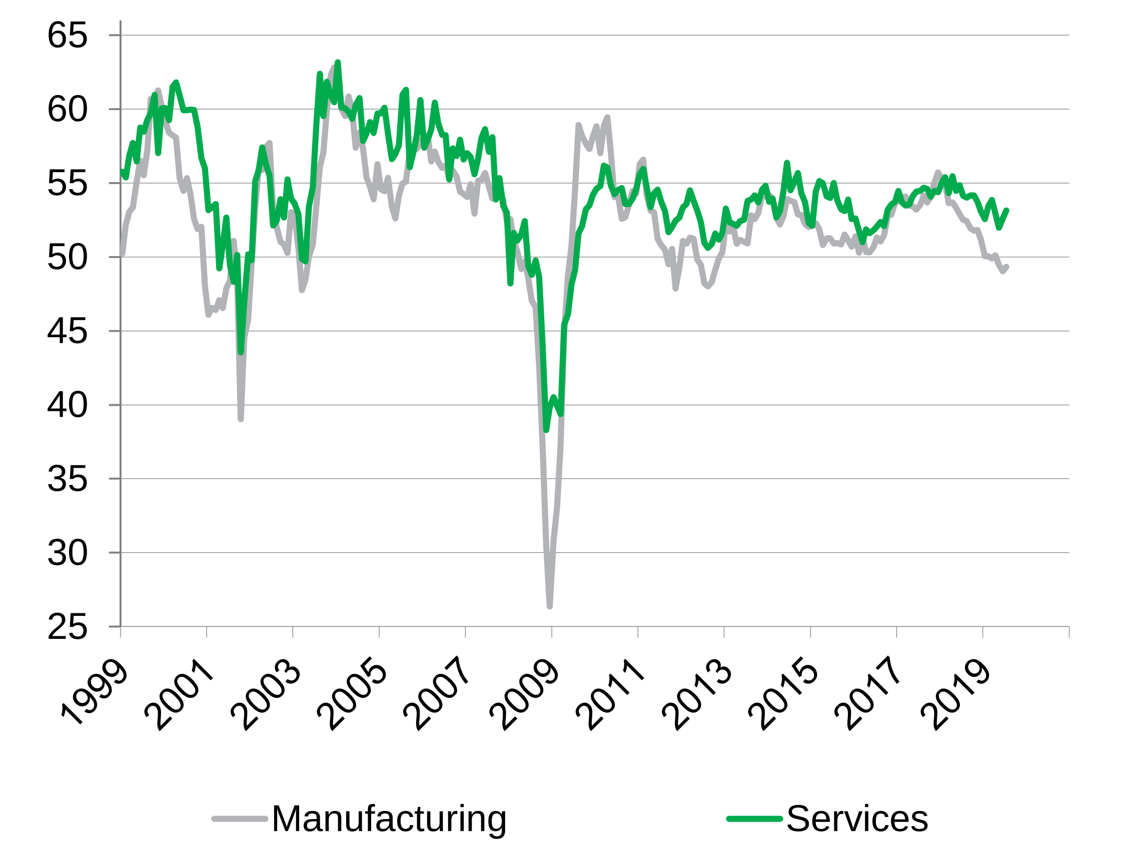
- IHS Markit's global PMI figures are updated shortly after the end of each calendar month.
- They cover countries accounting for over 85% of global GDP.
- Latest PMIs indicative of global growth of 2½-2¾%, broadly in line with our baseline forecast.
- The indications vary by region and sector, however.

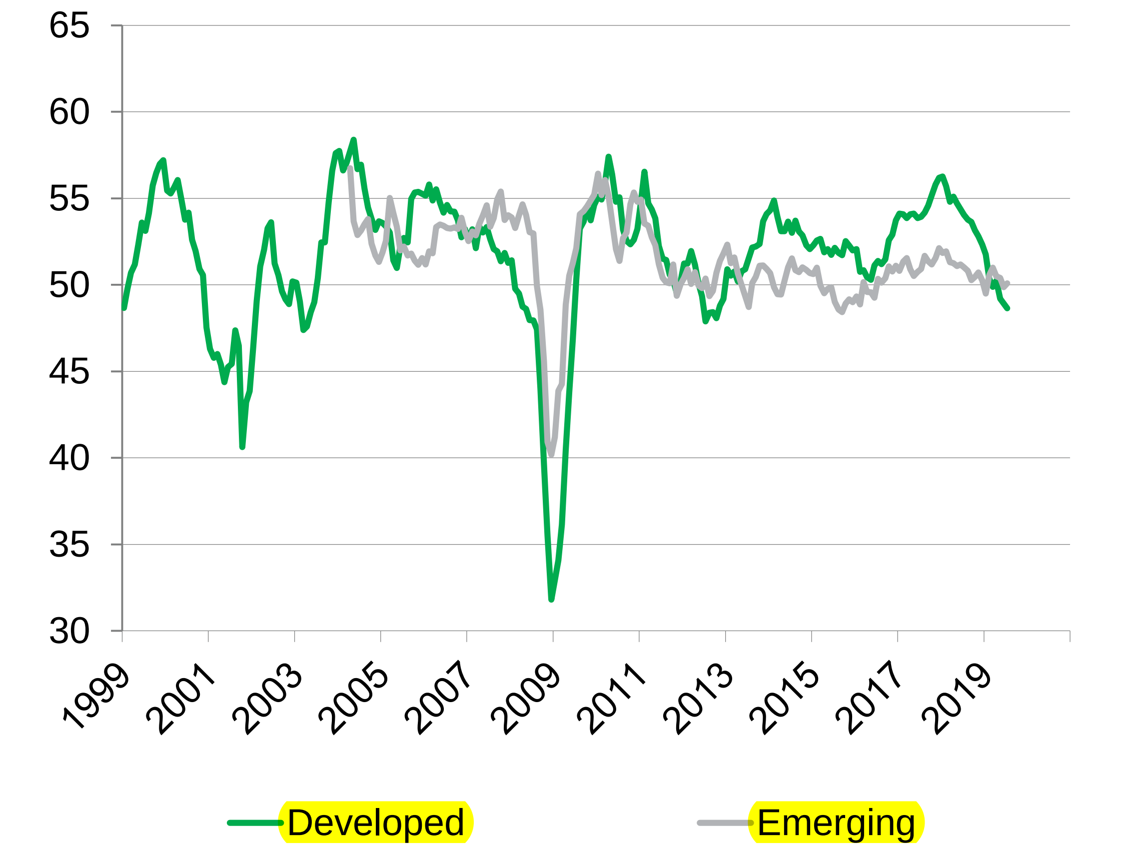
PMIs diverging across sectors and economies

Manufacturing in recession, services less affected



Source: IHS Markit © 2019 IHS Markit

Manufacturing slump led by developed markets



Source: IHS Markit © 2019 IHS Markit

Typical recession triggers

Supply shocks

- Supply curbs drive up oil and other commodity prices
- Adverse impact on production costs
- Hit to household real incomes

Financial stress

- Bubbles burst, asset prices correct
- Adverse wealth effects
- Tightening of banks' credit conditions

Policy tightening

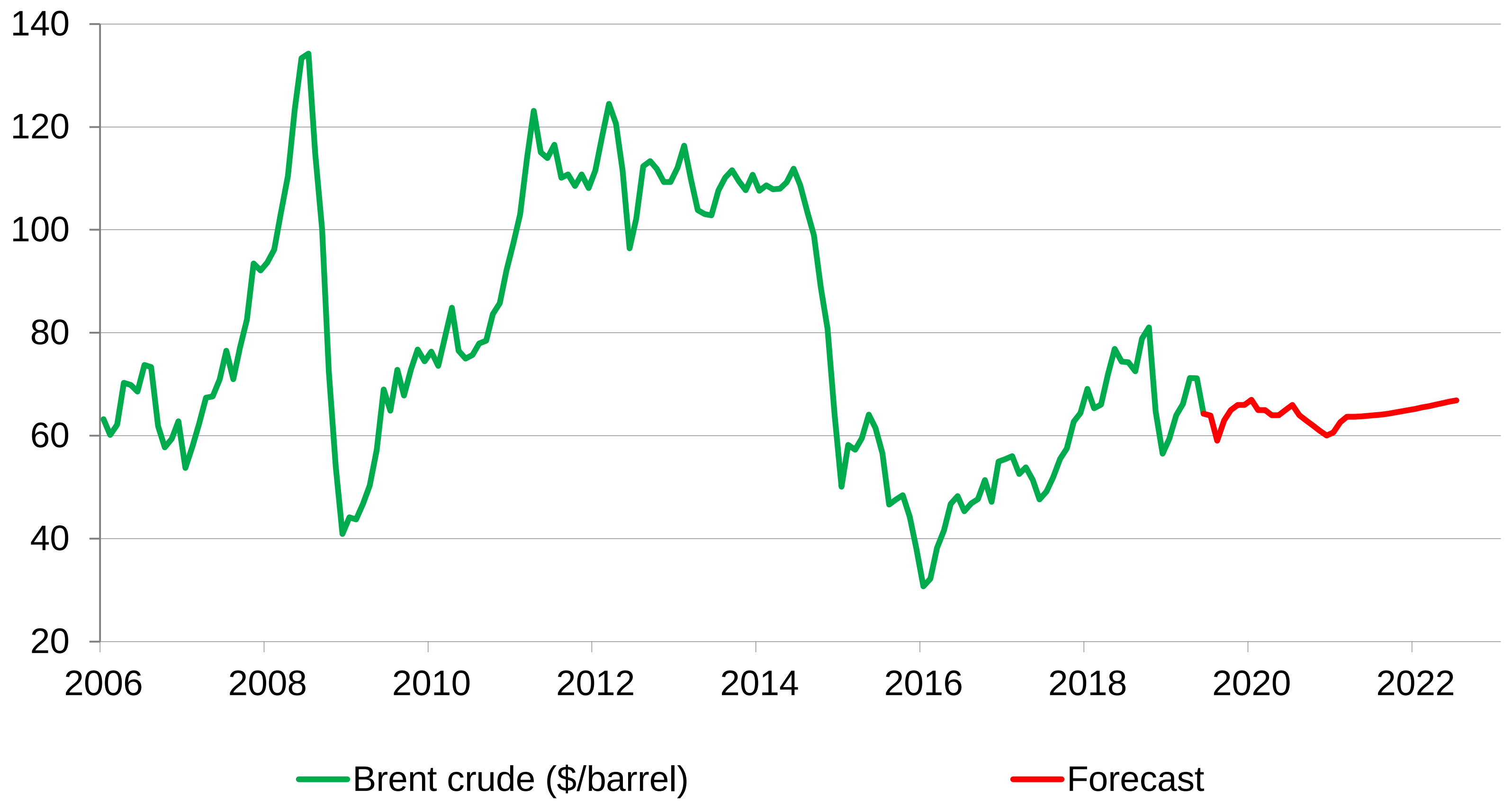
- Central banks bear down on inflation and expectations
- Real short- and long-term rates rise
- Pro-cyclical fiscal contraction during a downturn

Geopolitical factors

- Military conflicts, political upheaval
- Populism, protectionism
- Persistent high uncertainty

Weaker global demand dampening oil prices

Ups and downs but within a relatively narrow range

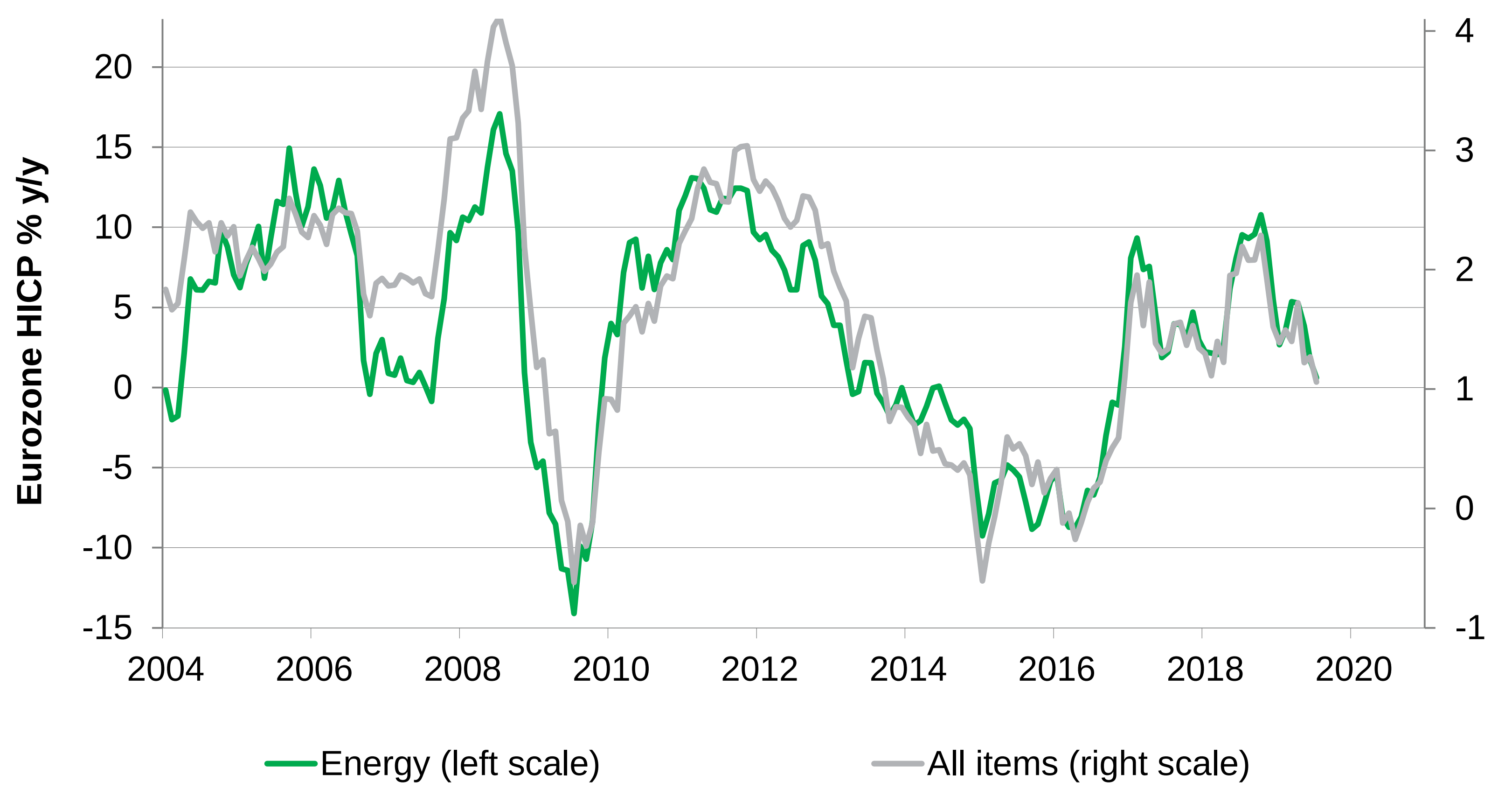


Source: IHS Markit

- Baseline for Brent crude: average of $65/barrel in 2019 and $64/barrel in 2020-21.
- Demand weakness leaning down near-term. Temporarily interrupted in Q4 2019 as refiners gear up to supply low-sulphur fuel ahead of January 2020's IMO deadline.
- Downside risk? Global industrial slump deepens.
- Upside risks? Output cut by Vienna alliance (but beyond Saudi, few candidates). Escalation of Iran conflict, blocking transit.

Low energy inflation a boost for consumers

Low inflation supporting real incomes and spending



Source: Eurostat

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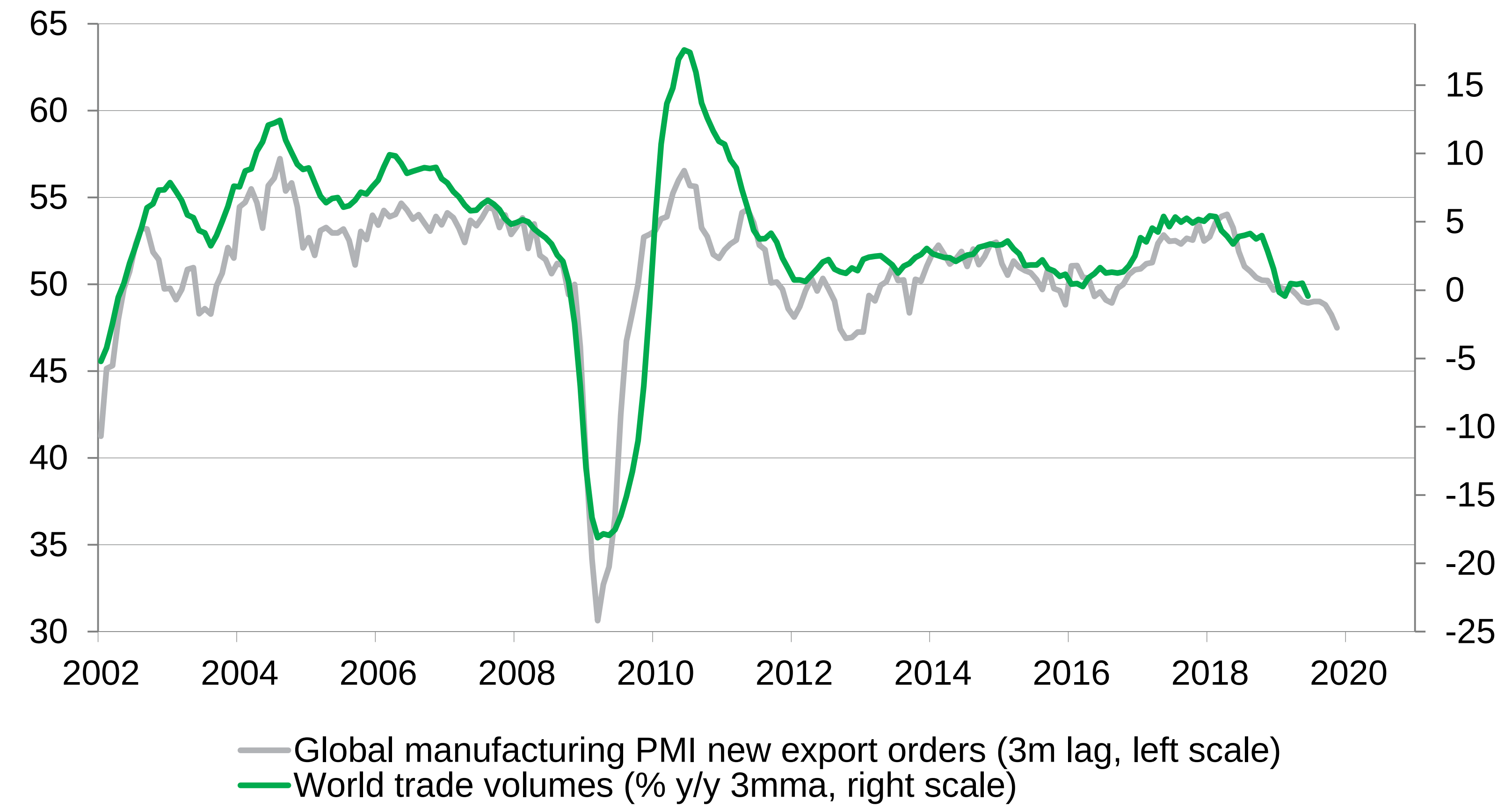
- Lower energy inflation has been driving down inflation rates across western Europe, boosting household real incomes.
- The boost to consumer spending is helping to cushion the effects of weaker exports.
- Eurozone inflation, for example, has more than halved versus its peak in October 2018 (down to just 1.0% in July).

Global trade & APAC: tariffs take a toll

Weakness in global trade to continue

PMI new exports orders a leading indicator of world trade dynamics



Source: IHS Markit, CPB

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- IHS Markit's global manufacturing PMI sub-index of new export orders is a good guide to how world trade will evolve.
- The new export orders sub-index has been below the 50 expansion-contraction threshold for almost a year and has recently shown signs of further weakness.

US tariff timeline

January 2018:
30% tariff on imported solar panels (most of which come from China) and large residential washing machines (starting at 20%).

March 2018:
25% and 10% tariffs on steel and aluminum imports, respectively.

May 2018:
Commerce department investigation into tariffs on auto and parts imports, concluding in May 2019 (decision on possible 25% tariff then delayed to November 2019).

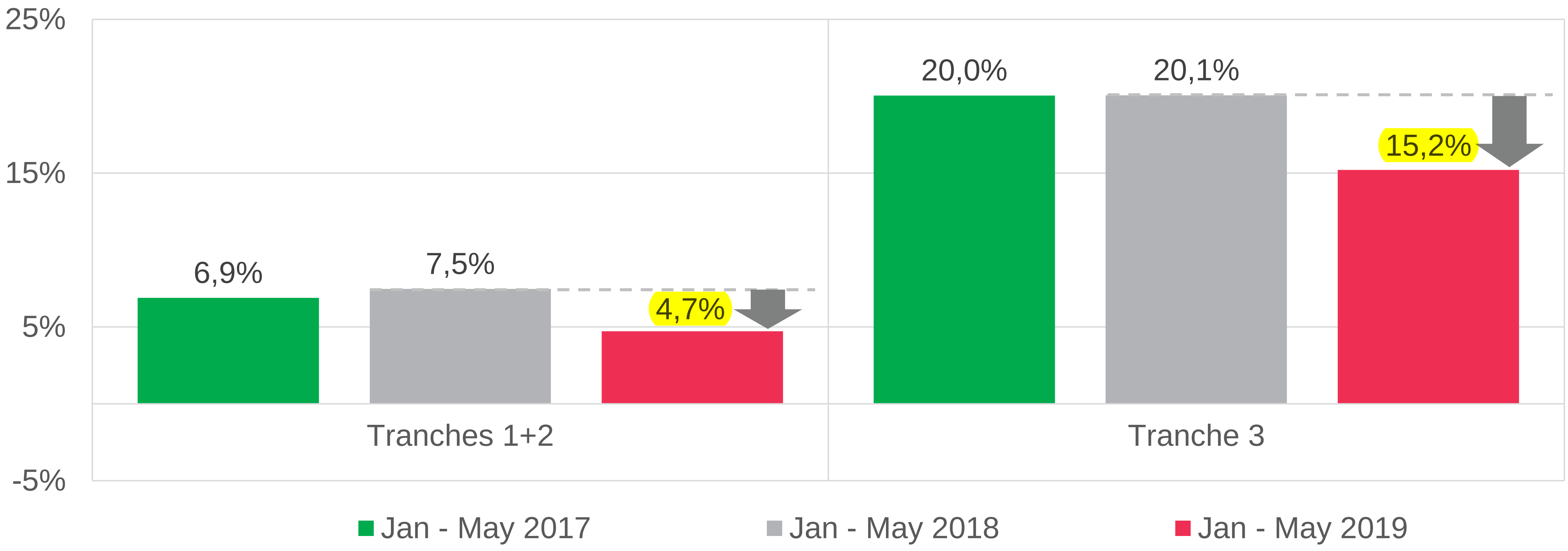
June 2018:
(Tranches 1 & 2)
25% tariff on $50 bn of imported Chinese goods under Section 301 of the Trade Act, to be introduced in two phases (July and August 2018)

July 2018:
(Tranche 3)
10% tariff on additional $200 bn of Chinese imports from September 2018 (subsequently raised to 25% in May 2019, with further rise to 30% proposed from October 2019).

July 2019:
(Tranche 4)
10% tariff on remaining $269 bn of Chinese imports in September and December 2019 (subsequently raised to 15%, with threat of further increases).

US tariffs imposed so far have led to a shift away from China…

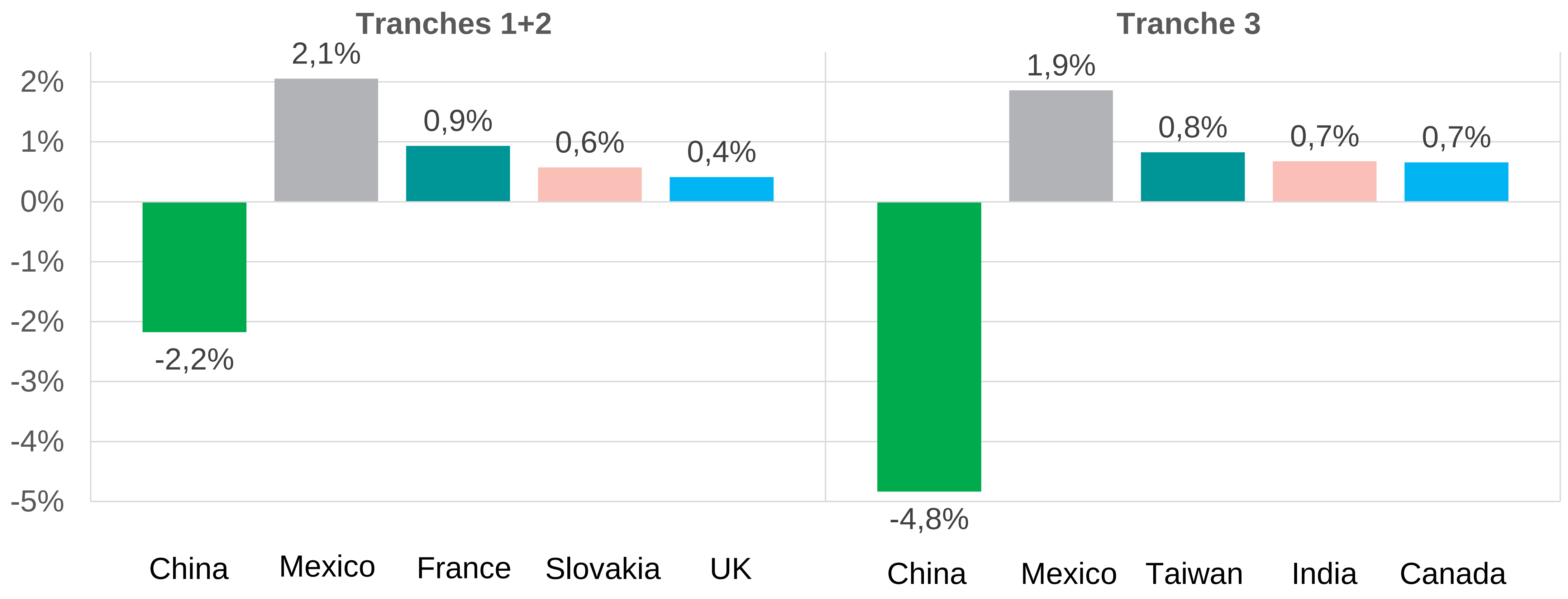
Chinese share of US imports



Source: IHS Markit, US Census

…with Mexico a key beneficiary

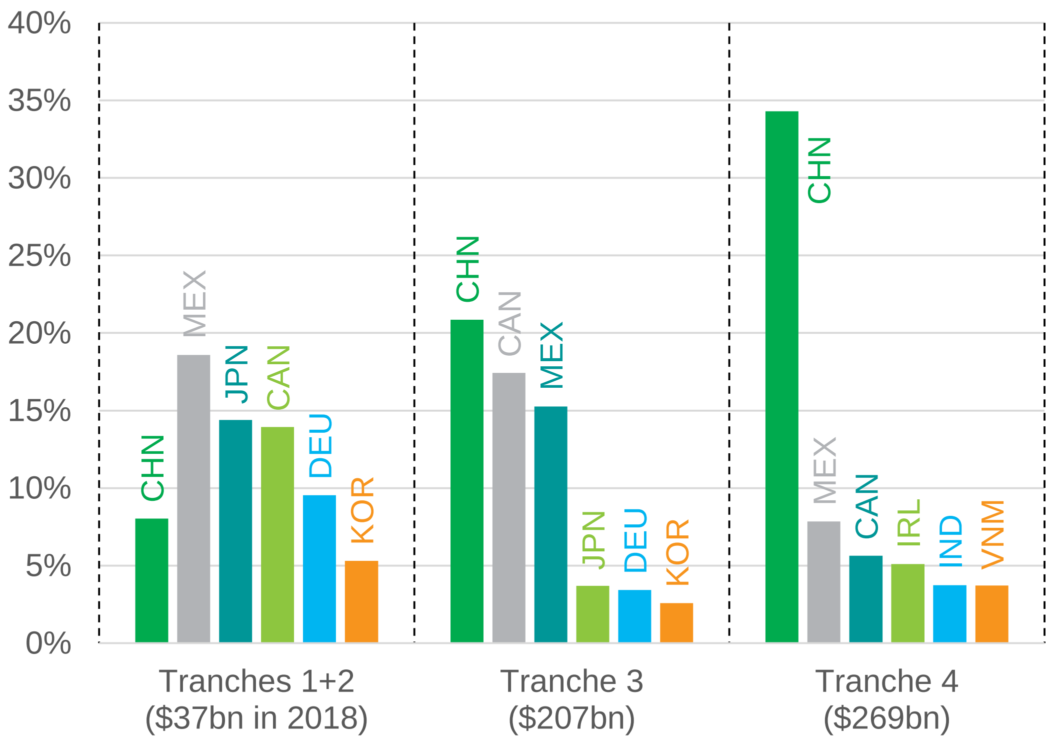
Changes in shares of US imports



Source: IHS Markit, US Census

Tranche 4 includes more consumer products, with fewer substitutes

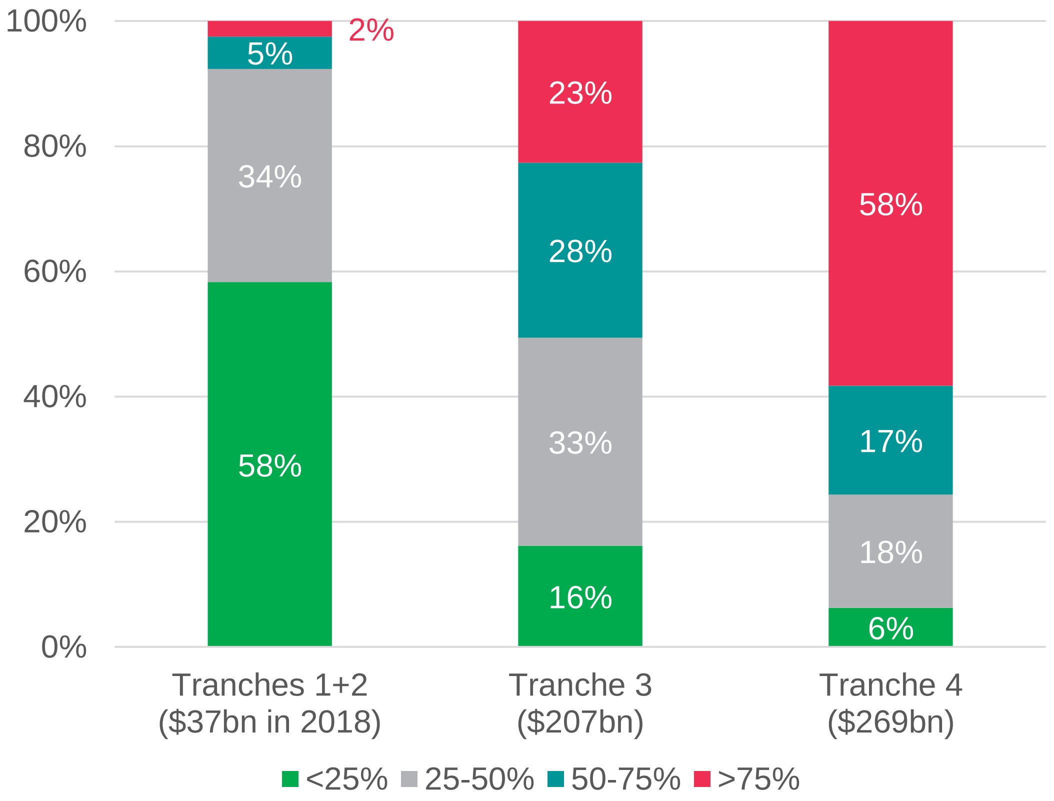
Share of US imports (2017)



The US could find substitutes in Canada and Mexico for the goods contained in the three lists, but probably not for the rest

Source: IHS Markit

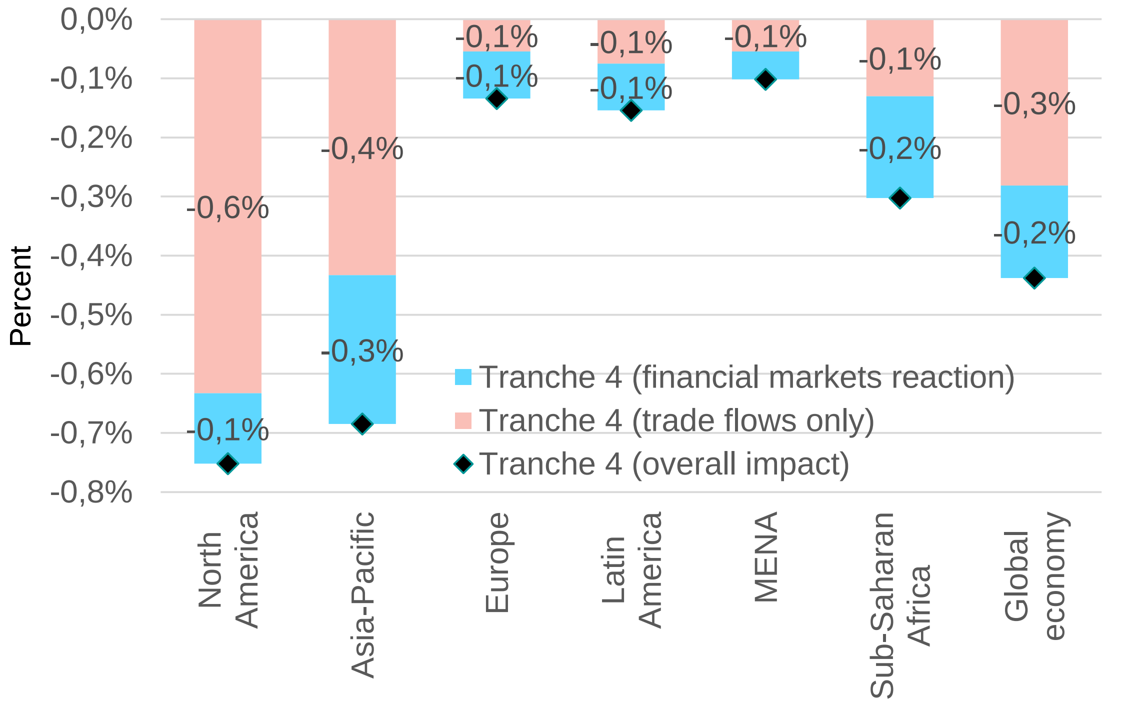
Breakdown of Chinese market shares in US imports (2017)



Source: IHS Markit

Protectionism damages growth across all regions

Real manufacturing exports, deviation from baseline, 2021



Source: IHS Markit

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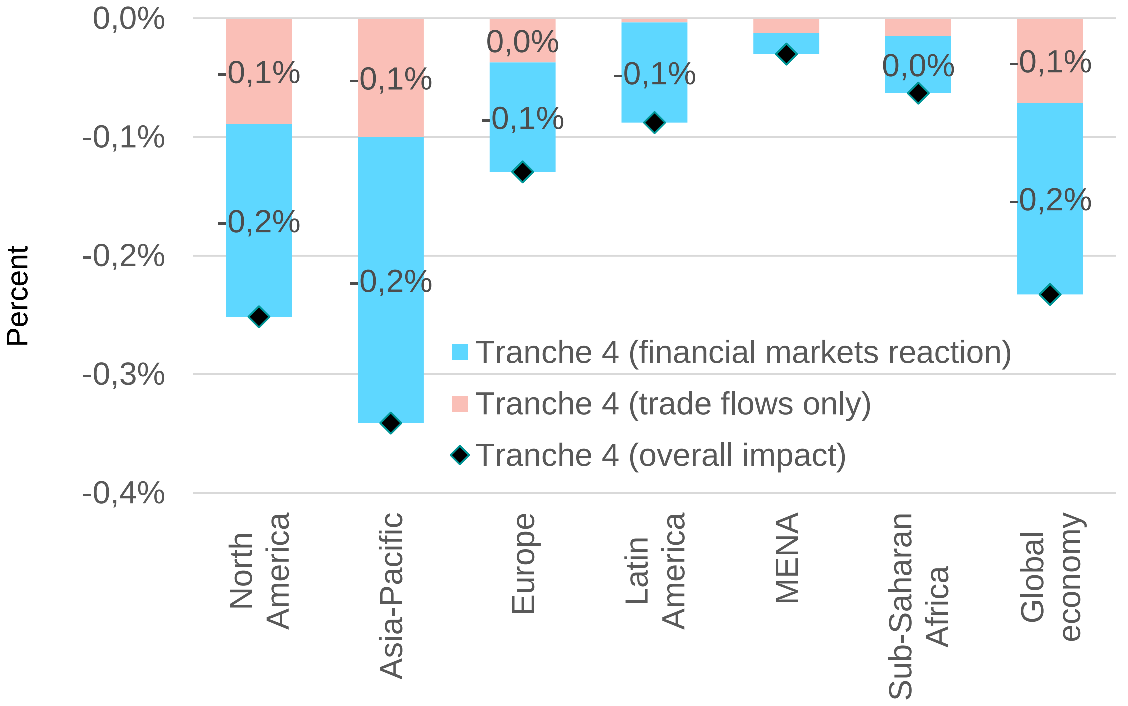
Real GDP, deviation from baseline, 2021



Source: IHS Markit

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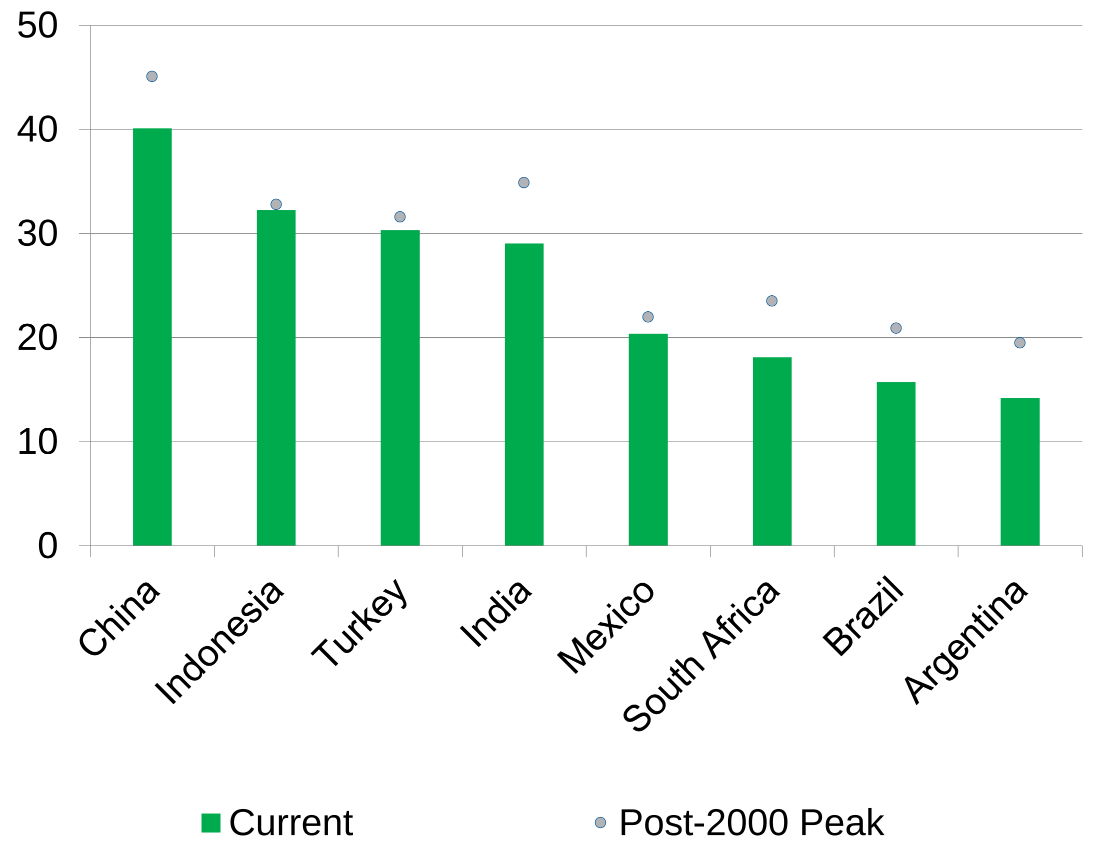
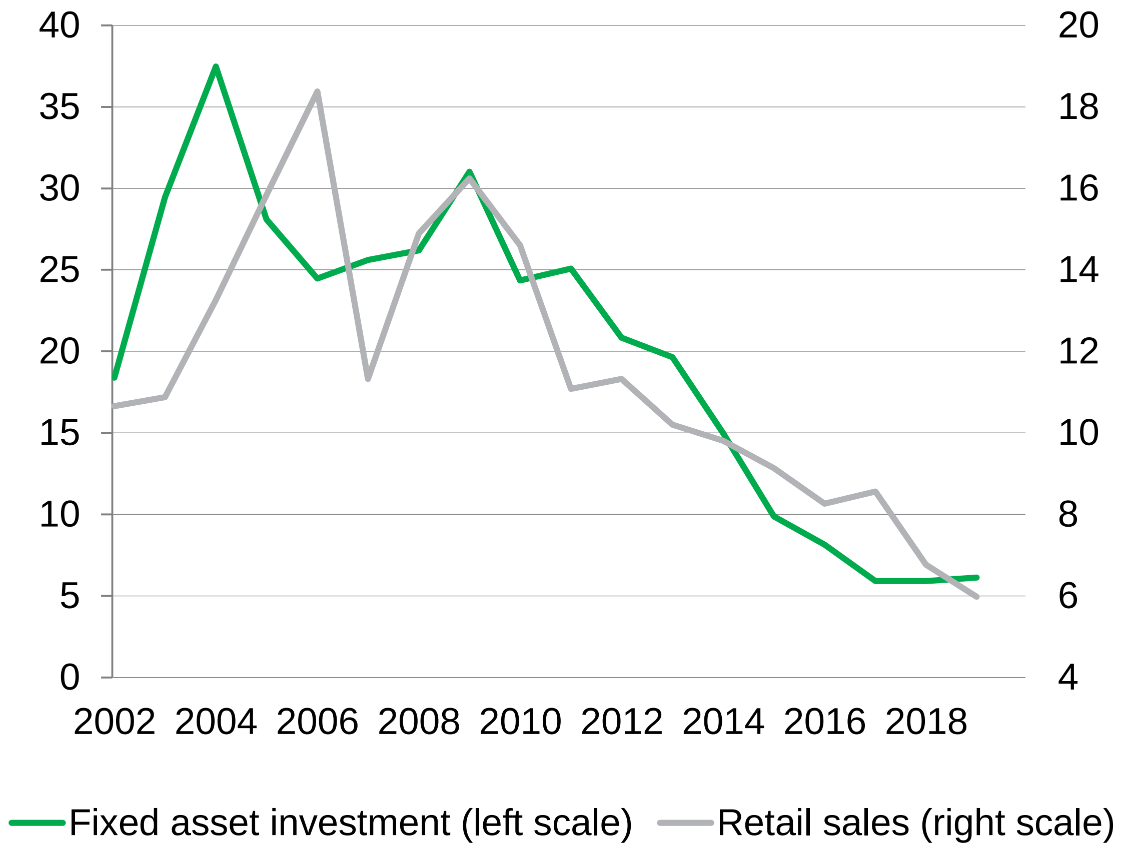
China’s rebalancing results in lower growth

Gross fixed capital formation (% GDP)



Source: IHS Markit

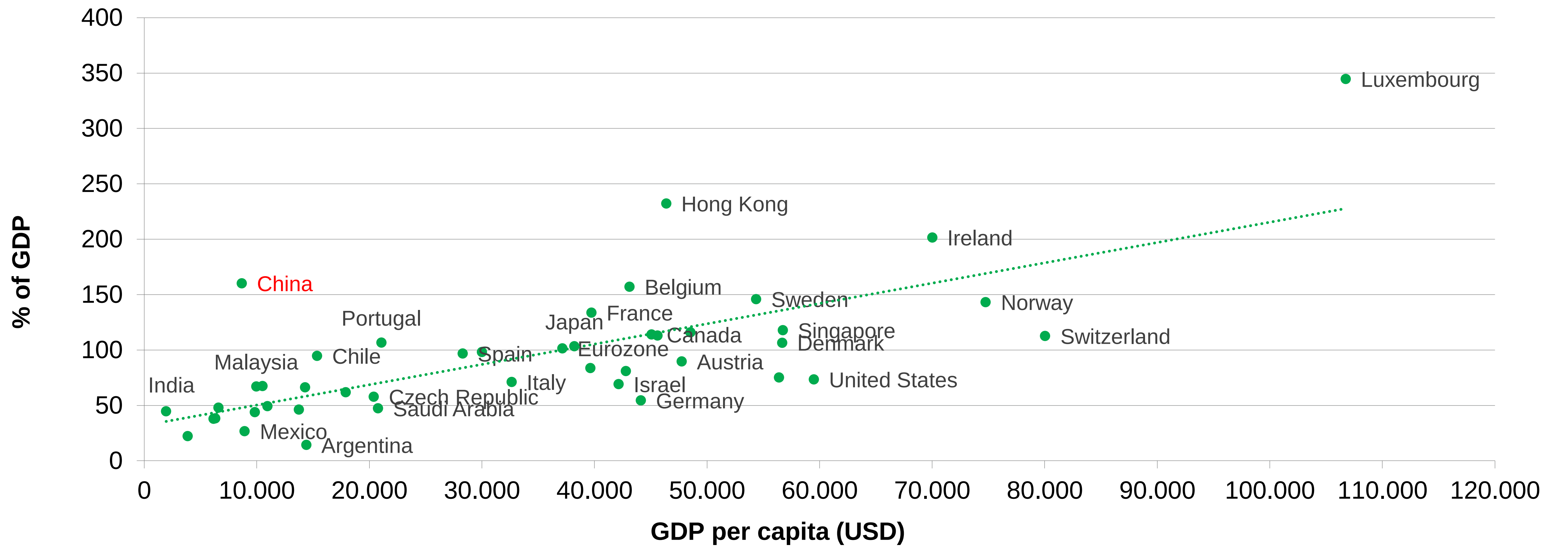
Chinese domestic demand slowdown (% y/y)



Source: IHS Markit

Corporate debt in China unusually high

Non-financial corporate debt ratios compared

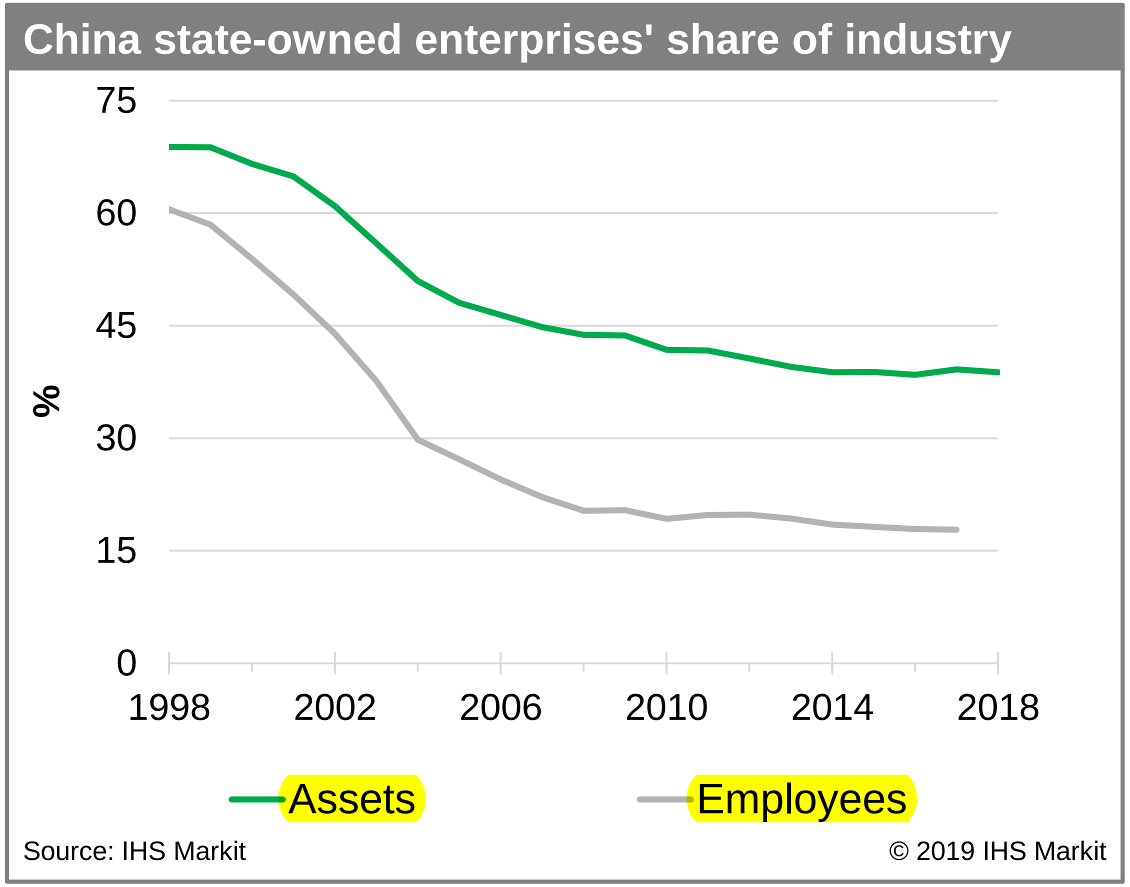


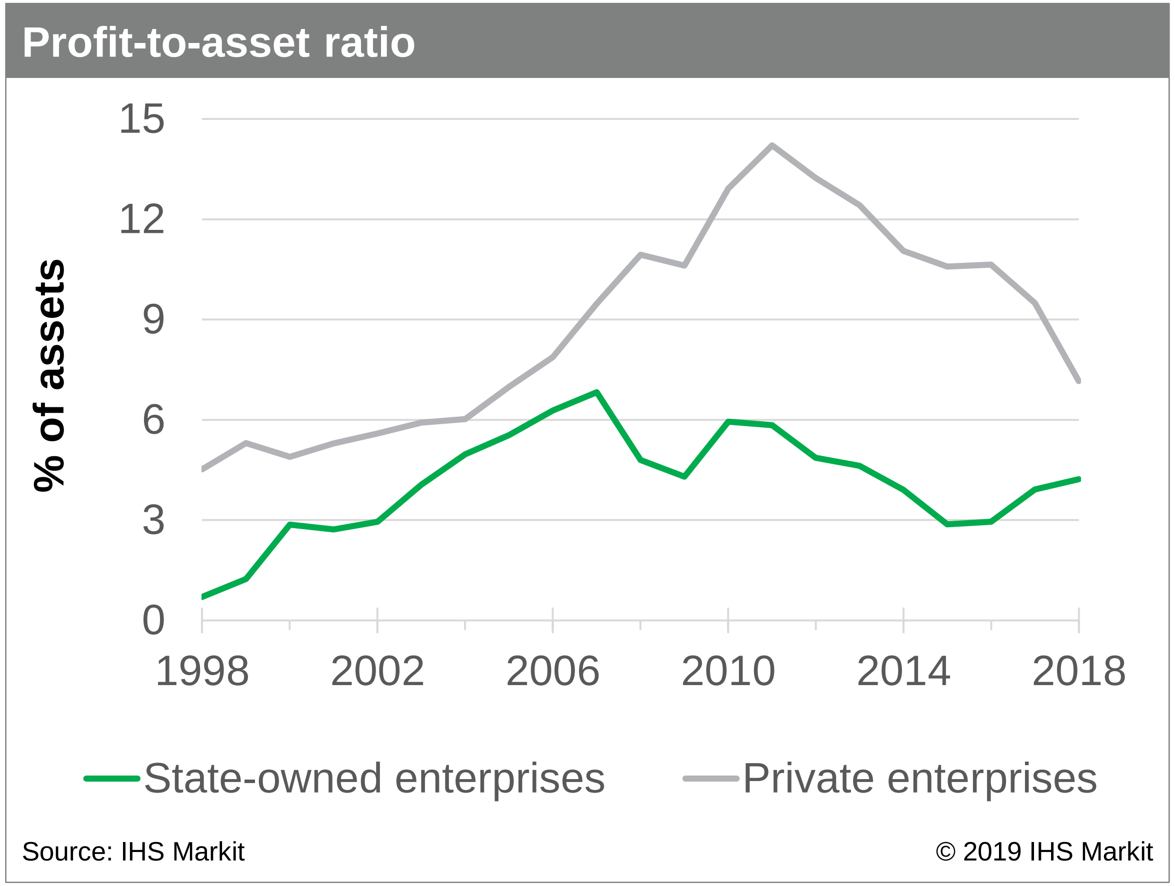
Source: IHS Markit

China’s state-owned enterprises still dominant

High share of industry still….

….but with lower efficiency than private sector





China: debt, real estate and lending

- Real estate-related loans account for approximately 25% of Chinese banks' assets.
    - Around 60% are in typical real estate-related lending (split 33% to 27% between mortgages and loans to real estate developers, respectively).
    - Around 40% are loans to Chinese corporations and local governments, collateralised by real estate holdings.
- From 2000–2015, China's publicly listed firms (excluding financial, real estate and construction sectors) allocated almost one-fifth of their capital expenditure to acquiring land, including commercial and residential land for speculative investment and collateralised bank borrowing.
- Post-GFC, the central government removed the borrowing ban on local governments, allowing their LGFVs to obtain bank loans by using land reserves as collateral. According to China's National Audit Office, almost 40% of local government debt is collateralised by those governments' revenue from future land sales.
- Around 33% of local government revenue is derived from land sales, meaning revenue streams are sensitive to real estate boom-bust cycles and such development is incentivised.

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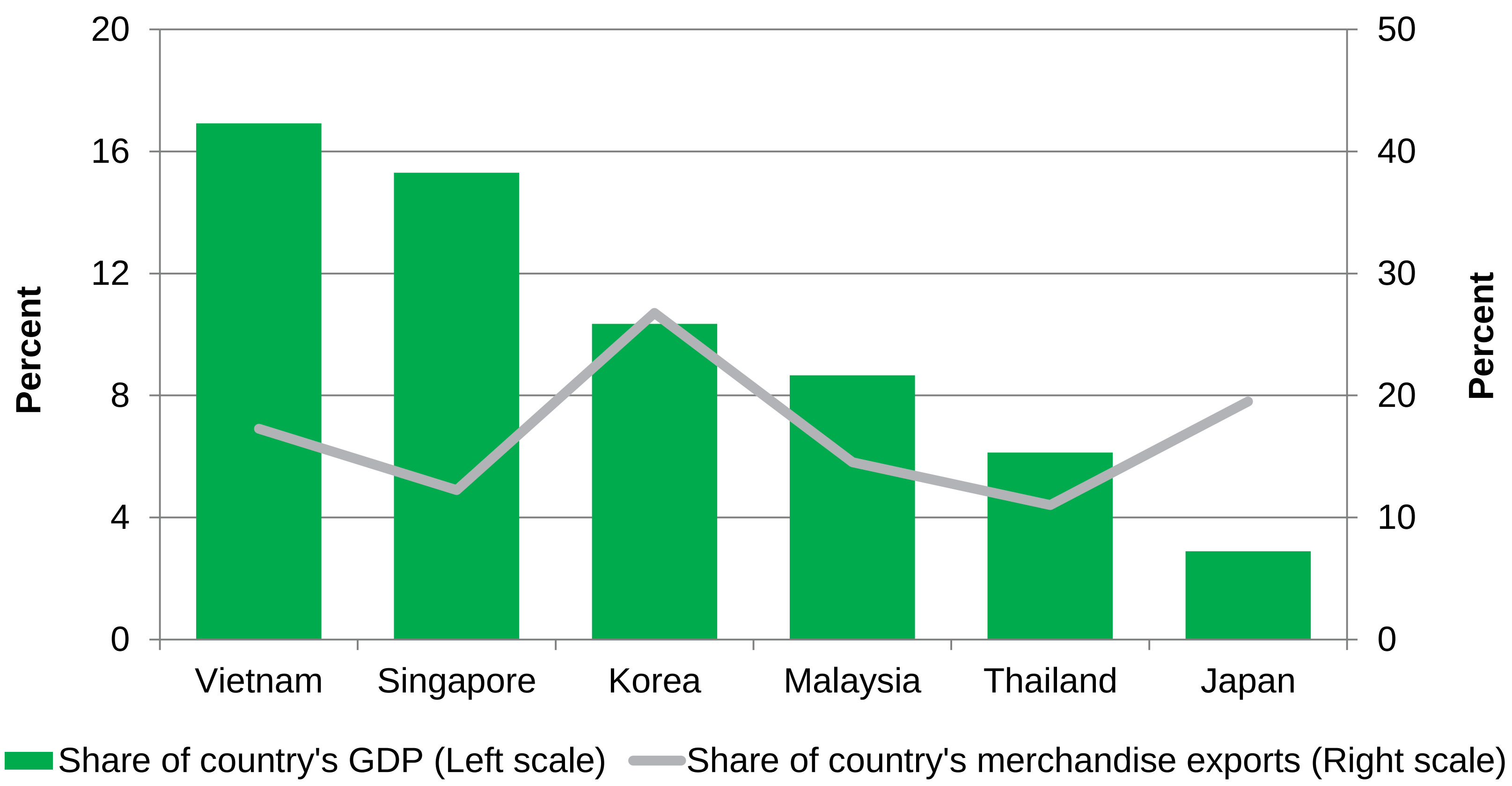
Trade exposure to China varies across Asia

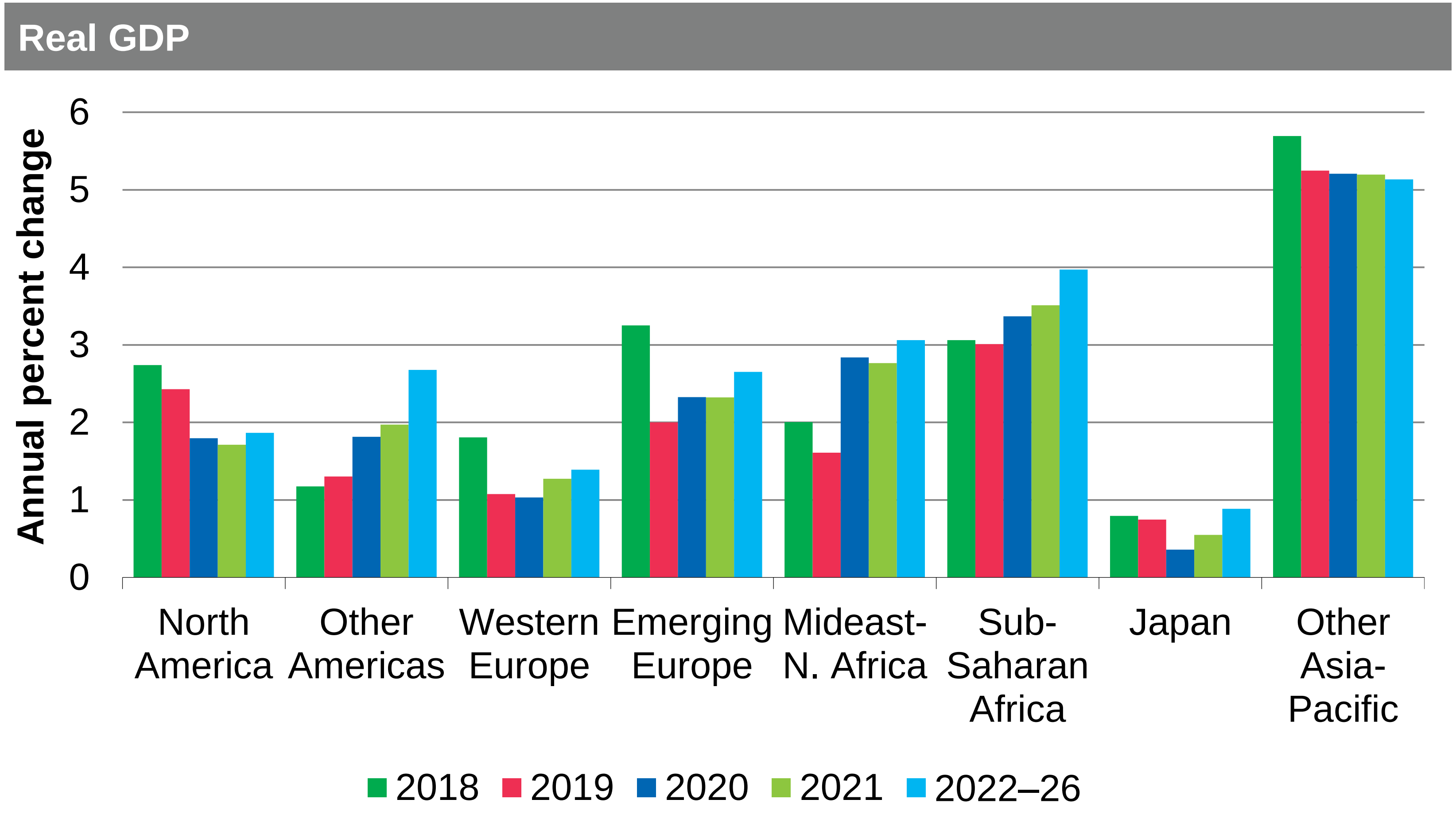
Merchandise exports to China (2018)



Source: IMF Direction of Trade database, National sources

- Across Asia, there are variations in both trade exposure to China and openness to trade.
- Vietnam and Singapore have the highest trade linkages: exports to China account for over 15% of GDP in both economies.
- Vietnam is benefiting from production relocation, however, leading to criticism from the US (added to the US Treasury's currency monitoring list in May 2019).

Growth forecasts by region

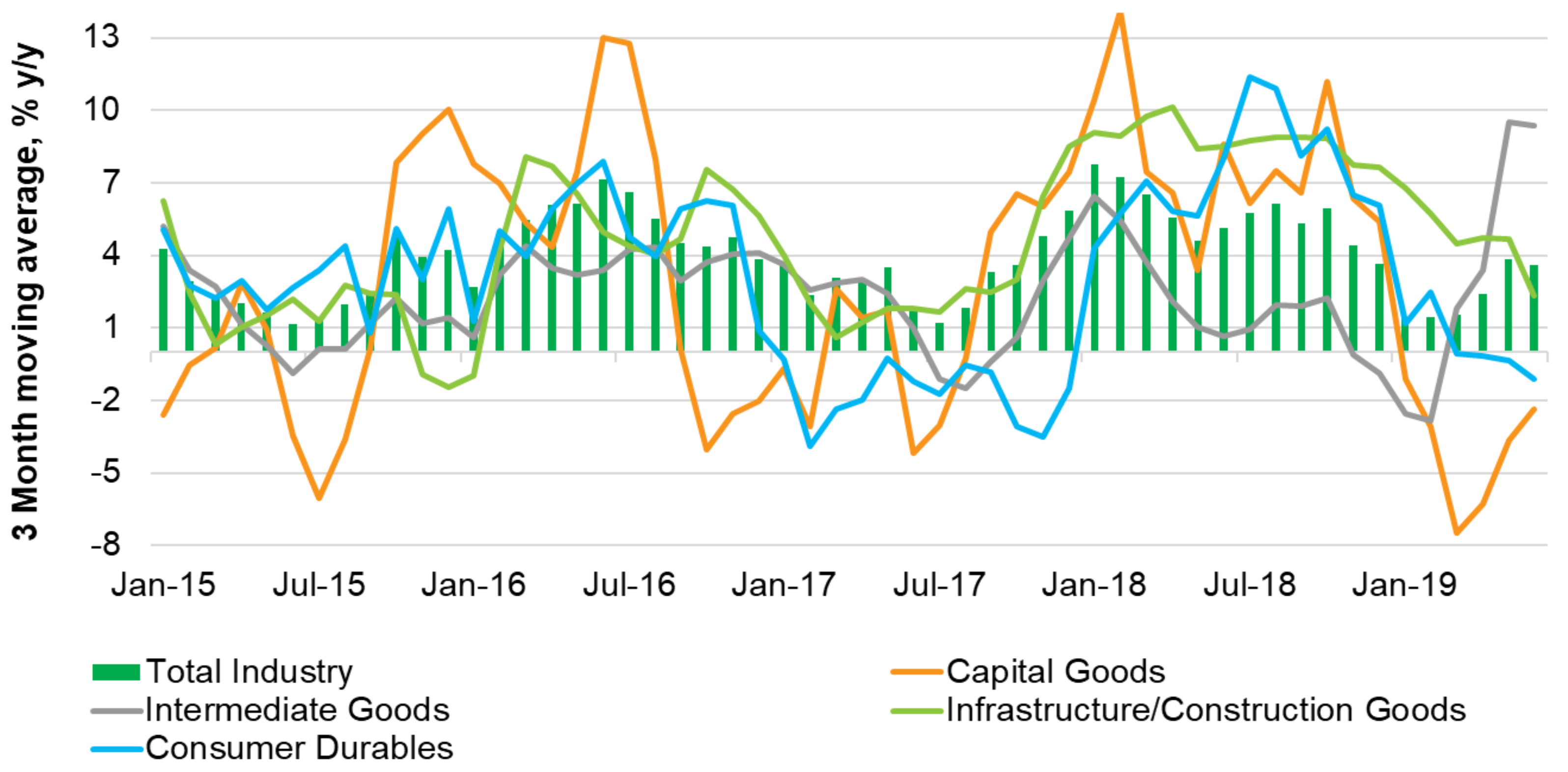


Source: IHS Markit

- China’s rebalancing and the imposition of tariffs are headwinds to APAC growth but the region is still forecast to outperform growth-wise.
- Advanced economies face challenging demographics, poor productivity trends and large debt burdens.
- This is particularly the case for western Europe.

Mixed picture for India

Industrial output: Weakness in infrastructure/construction and capital goods



Source: Ministry of Statistics and Program Implementation, India

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- **Short-term (FY2019-20):**

  Further relaxation of corporate and banking regulation.

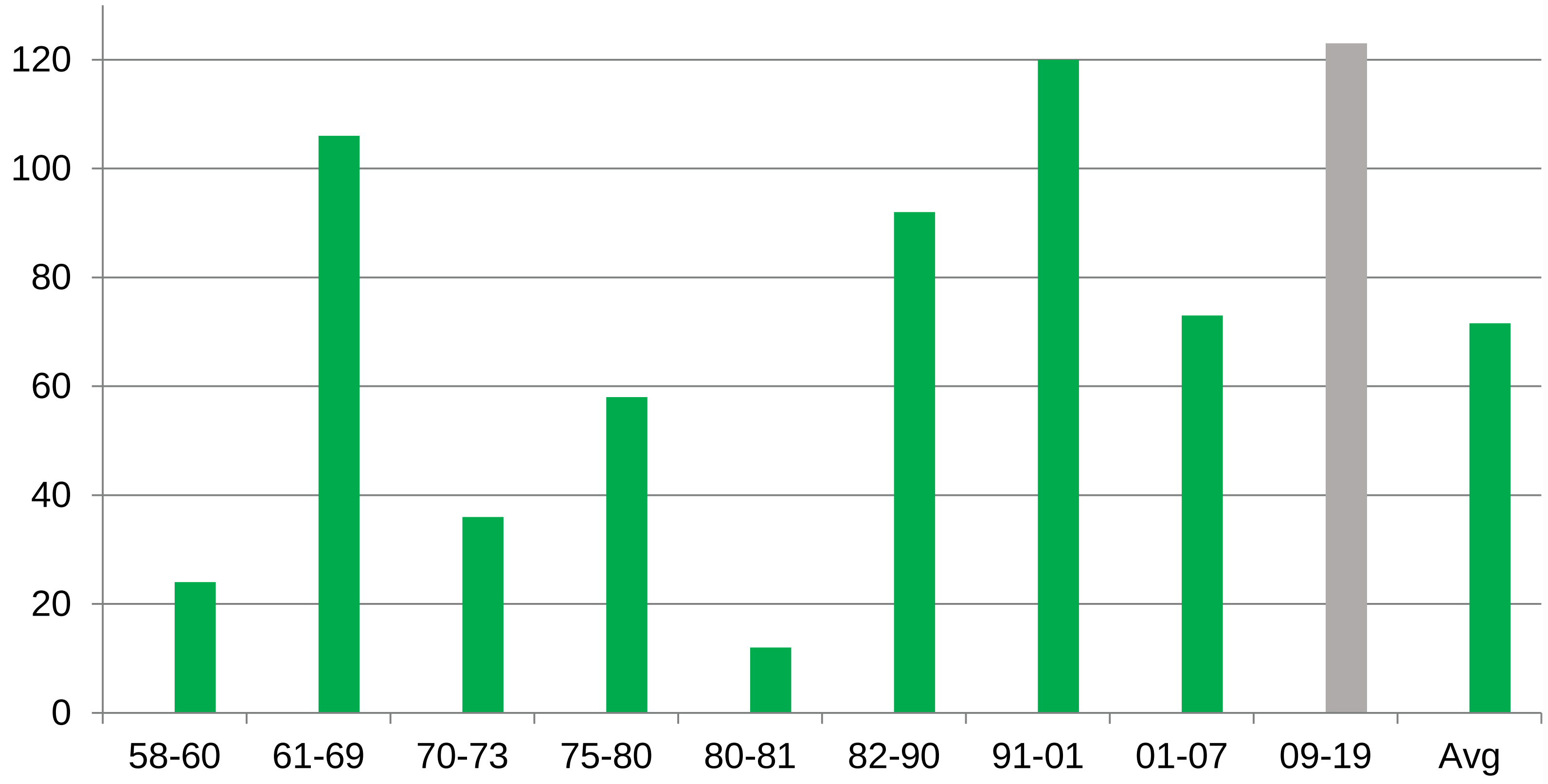
  Additional support for agriculture and rural economy.

- **Medium-term (FY2020-2023):**
  - Government focus on infrastructure investment, especially digital, and manufacturing revival.
  - But fixed investment dampened by unresolved banking sector problems. Ground-breaking structural reforms unlikely.

US: Stronger for longer

Current US expansion unusually long

Length of expansions in US real GDP (months)



Source: National Bureau of Economic Research, IHS Markit

- The prior US recession ended in June 2009, according to the NBER's estimates.
- The length of the expansion since is exceptional – it is the longest since the 1950s.
- Late-cycle fiscal stimulus is a key reason why.
- The recent Bipartisan Budget Act 2019, signed in August, raises defence and non-defence spending caps for two years.

Low US unemployment rate usually a harbinger of recession

'Soft landing from below' historically difficult to achieve

Source: NBER, IHS Markit

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- In prior decades, when the US unemployment rate has been sub-NAIRU for a long period, recessions have *always* followed.
- Restrictive monetary policy, set to rein in inflation and inflation expectations, has been a frequent cause.
- Comparatively muted inflation and inflation expectations currently suggest this time may be different.

Fed takes out some policy "insurance"

"The Committee will be patient as it determines what future adjustments to the target rate for the federal funds rate may be appropriate."

FOMC statement, 1 May 2018

"Uncertainties about [the] outlook have increased. In light of these…and muted inflation pressures, the committee will closely monitor the implications of incoming information…and act as appropriate to sustain the expansion."

FOMC statement, 19 June 2019

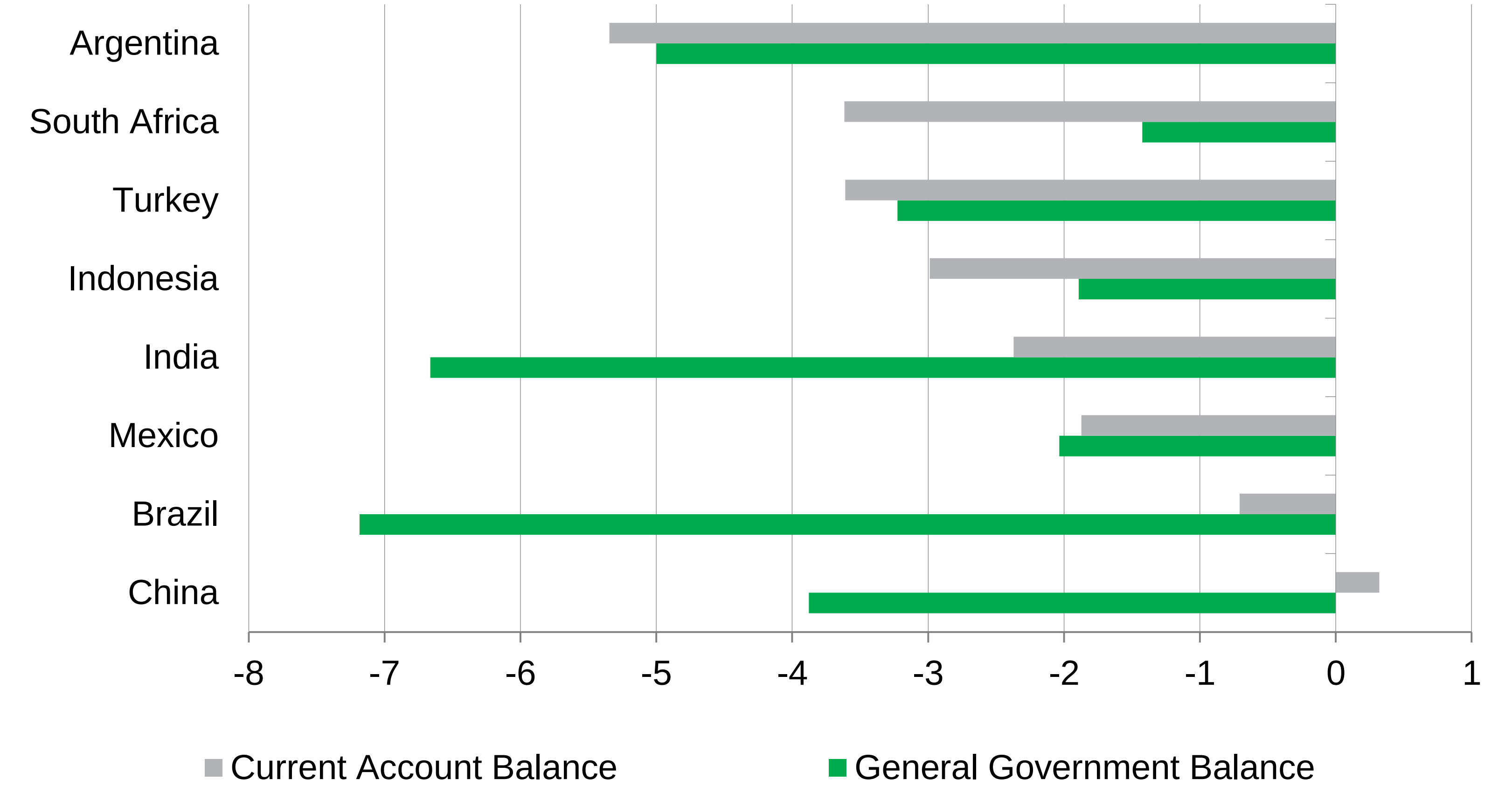
Source: Getty Images

"Strong labor market conditions and inflation near the symmetric 2% objective are the most likely outcomes but uncertainties about this outlook remain."

FOMC statement, 31 July 2019

Emerging market imbalances still a concern

Fiscal and Current Account Balances (% of GDP, 2018)



Source: IHS Markit

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- Imbalances across emerging markets remain a source of potential financial market stress and economic spillovers.
- “Twin” deficits have been particularly worrisome in Argentina, Turkey and Indonesia.
- The switch from Fed policy tightening to easing relieves one potential source of pressure.

Next US presidential election: state of play

Trump's ratings

- 43% approval even with sub-4% unemployment
- 40-45% of public "strongly" disapproves
- Most polls put him behind Biden and Sanders…
- …but running close to other candidates

Trump's advantages

- Strong economy: longest expansion in decades
- Incumbency advantage
- Democrats divided (25 candidates)
- Democrats may campaign to the left

Trade policy

- Democrats generally more protectionist than previous US presidents
- Anti-Chinese sentiment is bipartisan
- Don't bank on a swift reversal therefore
- Approach to historic allies would change

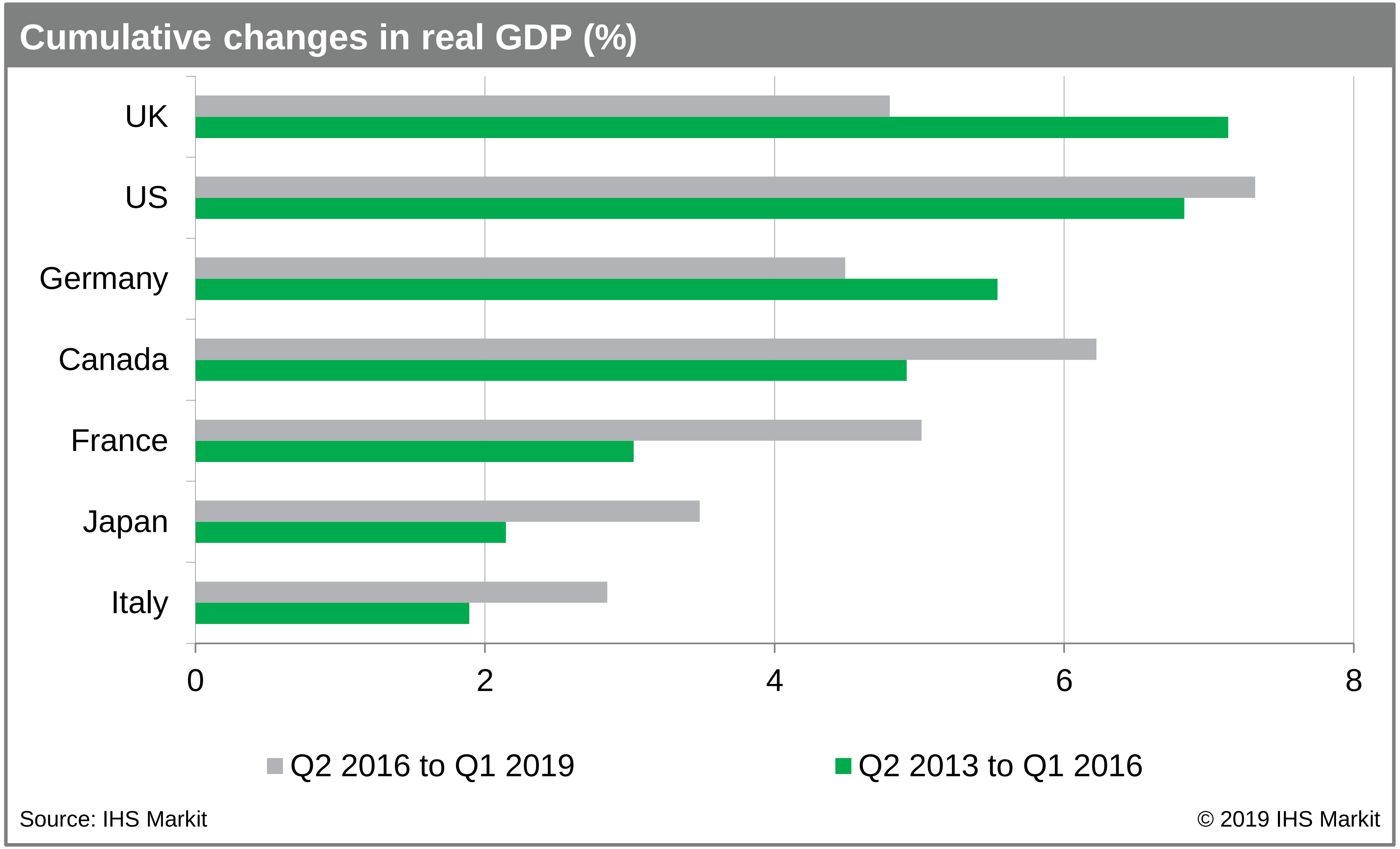
Europe: Recession risk

“No deal” Brexit blocked, for now

Source: Getty Images

- UK PM Boris Johnson had committed to take the UK out of the EU by 31 October “do or die”.
- But parliament has legislated against “no deal” on 31 October, while the government has now lost its majority in the House of Commons.
- “No deal” risk is not fully extinguished. Opinion polls suggest the outcome of the next general election is difficult to call.

Post-referendum UK growth slowdown



- The cumulative rise in UK GDP was the highest of the G7 economies in the three years prior to the EU referendum in June 2016.
- In the three subsequent years, the UK is one of just two G7 economies to have experienced a lower increase in GDP compared to the three years prior - the other is Germany.
- UK GDP fell by 0.2% q/q in Q2, the first contraction since 2012. The PMI signals further weakness.

What if? "No deal" impact on UK

For UK corporate sector

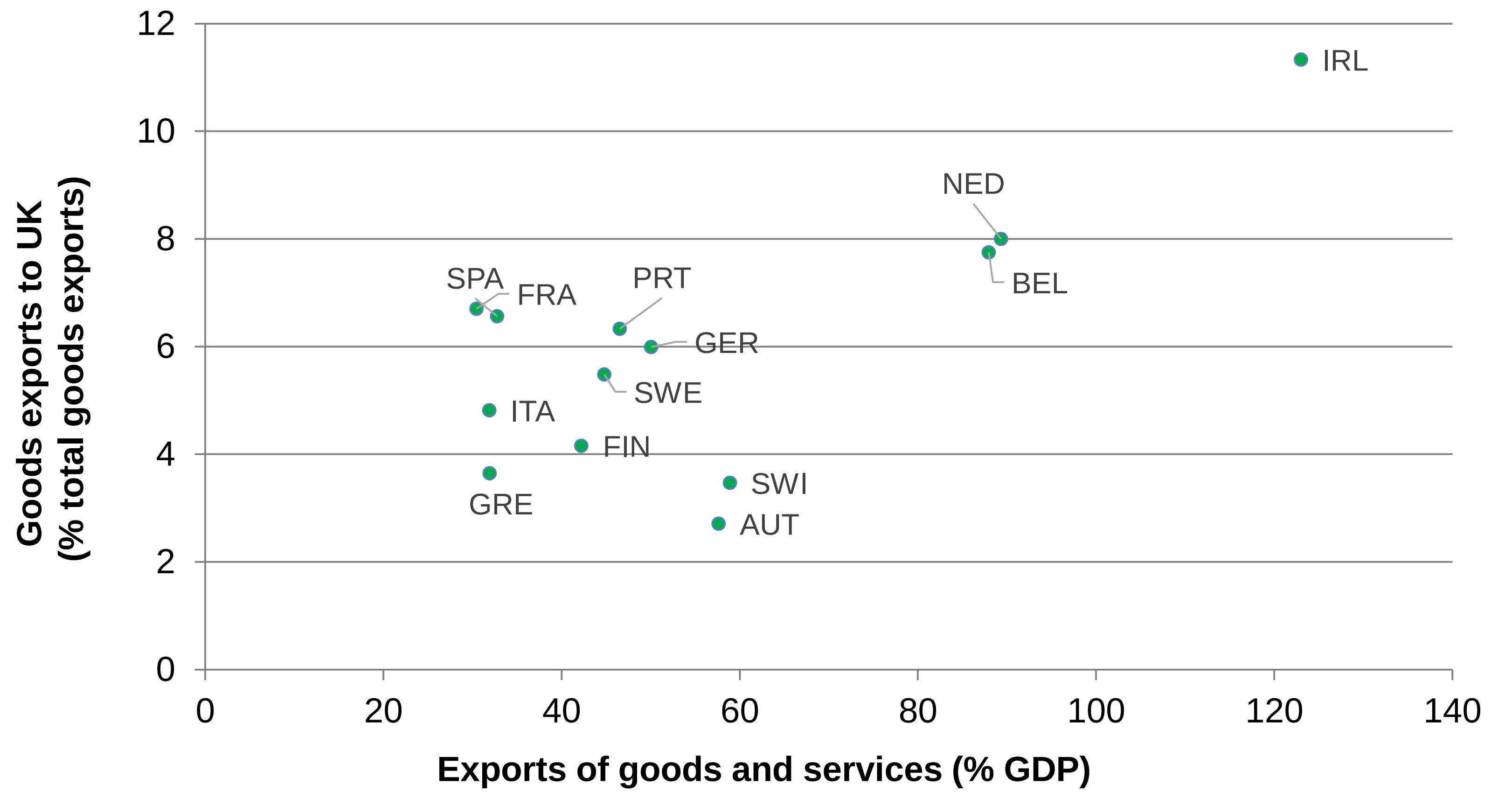
- Weaker export growth
  - *Tariffs on UK's exports to EU (average of 4%)*
  - *Lower EU demand, partially offset by weaker GBP*
- Disruption to supply chains
  - *Customs backlogs*
  - *Product shortages, just-in-time*
- High uncertainty
  - *Defer or cancel investment projects*
- Tighter financial conditions
  - *Access to credit*
  - *Market issuance*

For UK household sector

- Weaker household real income
  - *Tariffs on UK's imports from EU (65% of manufactured goods imports)*
  - *Import prices surge due to GBP weakness, plus goods shortages*
  - *High pass-through to CPI inflation*
  - *Contraction in employment*
  - *No bargaining power for compensatory rise in pay growth*
- Adverse wealth effects
  - *Lower equity and house prices*
  - *Household savings rate already near historic lows*
  - *High household debt*

What if? "No deal" impact on Europe

EU economies' trade linkages to the UK



Source: Eurostat, IMF

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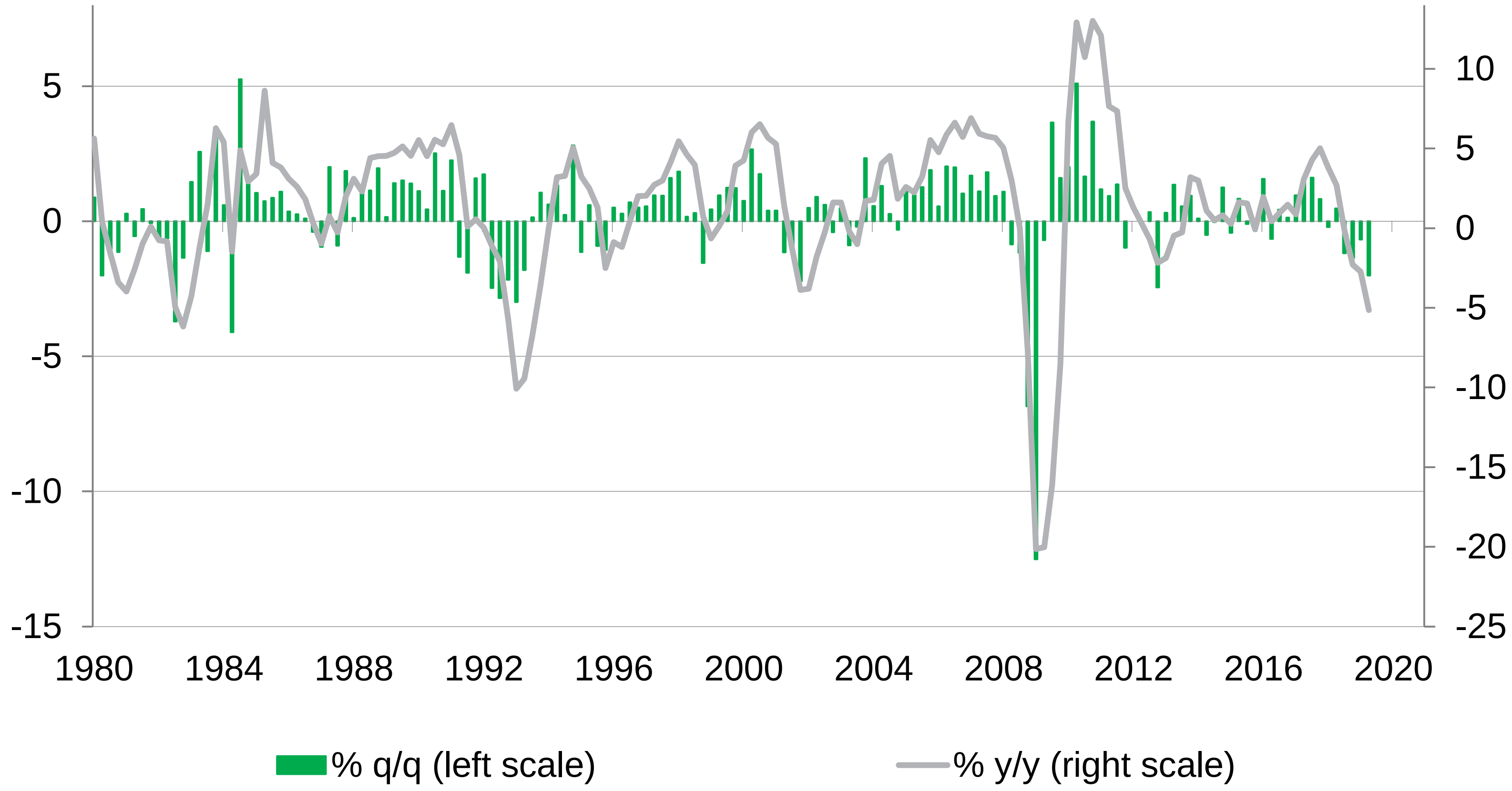
- Trade exposure to the UK economy varies widely across the EU.
- Ireland has much the highest share of total goods exports going to the UK and is very open to trade.
- The Netherlands and Belgium are similar in terms of trade structure.
- Types of goods exported also matter: German autos are particularly vulnerable to a severe adverse shock to the UK household sector.

German industrial sector already in a deep recession

Recession already worse than during the early 2000s



Source: Eurostat

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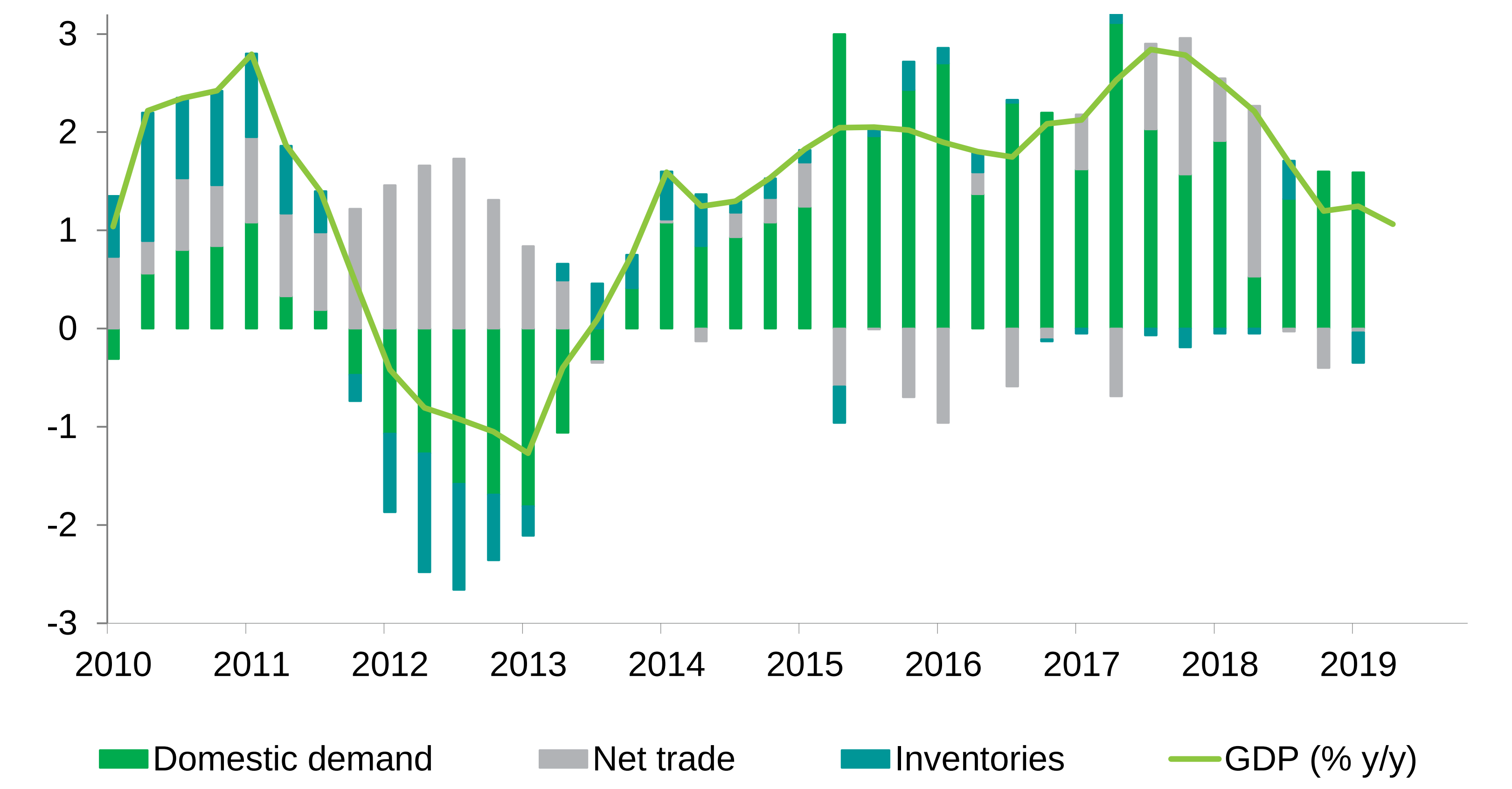
- German industrial output has fallen for four straight quarters and is down by over 6% from 2017's peak.
- The post-GFC collapse in 2008-9 makes other downturns look trivial but this is a severe downturn.
- Germany accounts for the highest share of UK imports (around 13%) and a "no deal" Brexit would deepen and broaden the recession.

Eurozone slowdown export-driven, so far

Eurozone GDP growth and contributions (y/y, p/points)

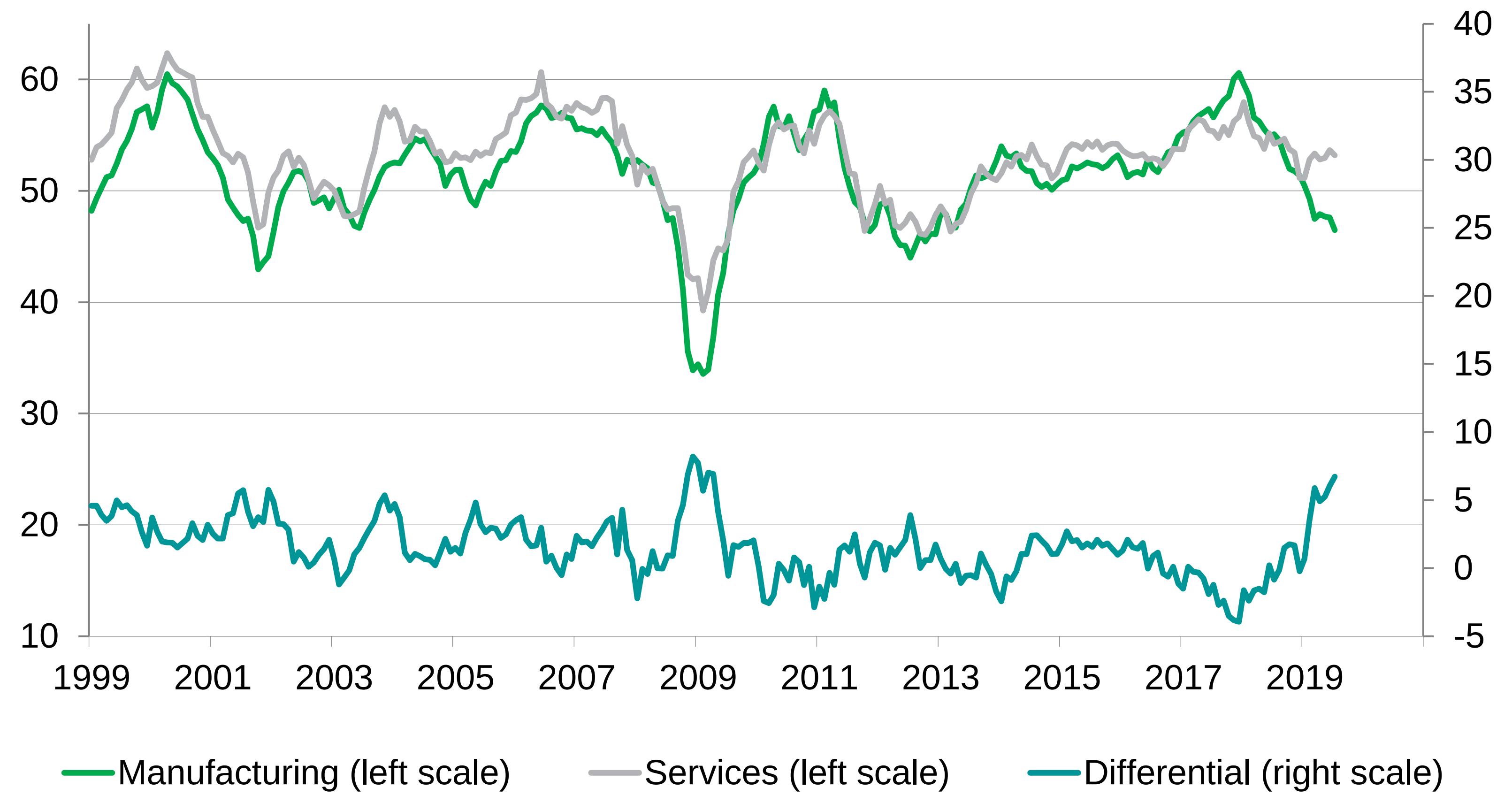


Source: Eurostat

- Eurozone Q2 GDP growth of 1.1% y/y was the lowest since Q4 2013.
- Net trade contributions drove the growth spurt in 2016-17 and have driven the slowdown since.
- Domestic demand has held up so far, with private consumption supported by real income gains.
- Business investment has also been resilient to date but looks vulnerable given manufacturing weakness.

Eurozone sector divergence is exceptional

Services-manufacturing PMI gap has surged to near-record highs

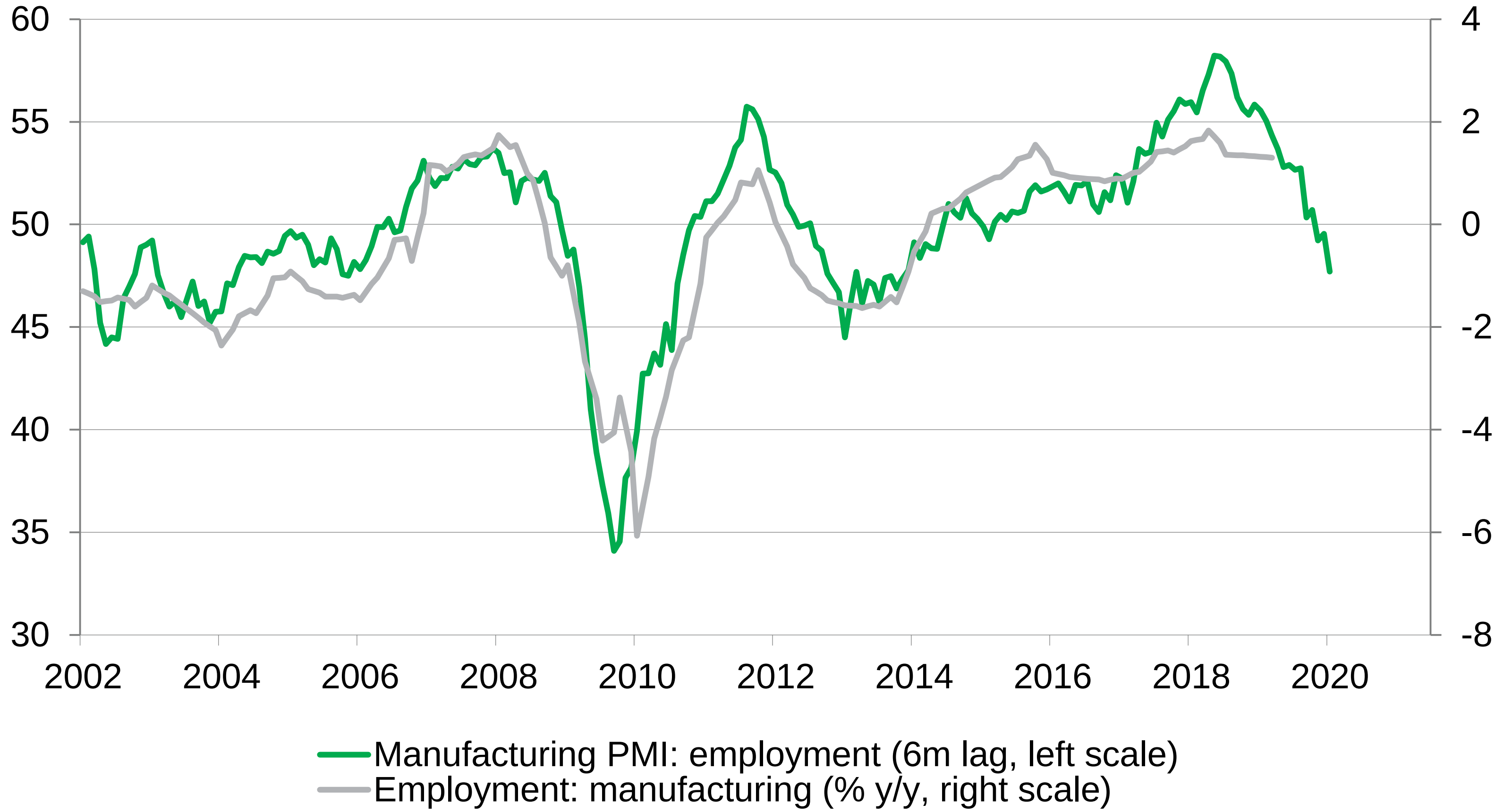


Source: IHS Markit

- The services to manufacturing PMI differential has surged as the manufacturing sector has weakened.
- Historically, the differential does not stay wide for long.
- Either manufacturing recovers, which looks unlikely near-term, or negative spillovers to the service sector build.
- Weaker employment is a key transmission channel to monitor.

Weaker eurozone employment could hit consumer demand

PMI signals contraction in manufacturing employment



Source: Eurostat, IHS Markit

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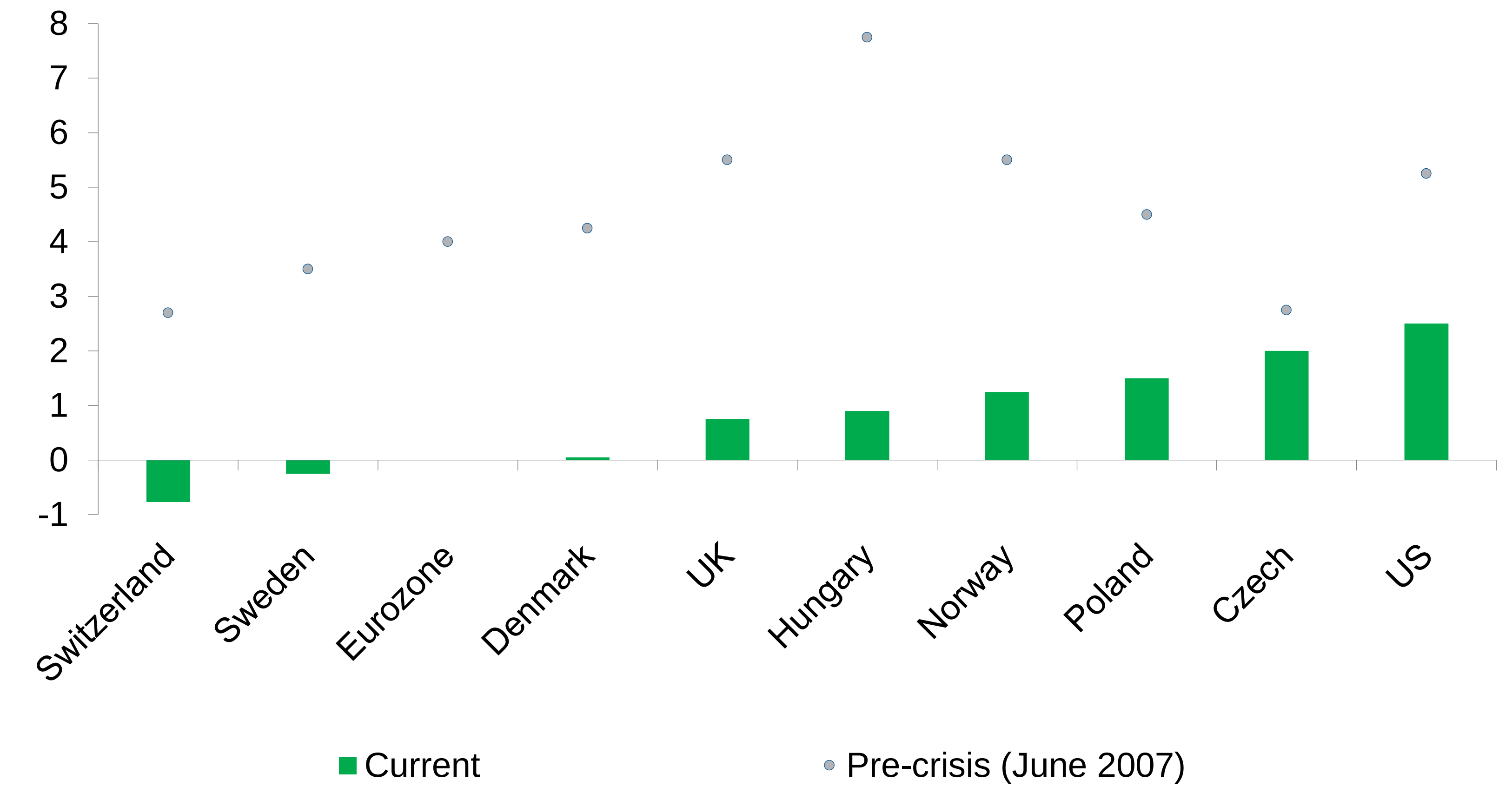
- Persistent weakness in manufacturing activity points to job losses, as signaled by IHS Markit's PMI employment sub-index.
- Employment growth has already slowed: Q2's 0.2% q/q increase was the weakest for over four years.
- This is a key issue as labour market conditions have been pivotal to the relative strength of domestic demand to date.

European monetary policy constraints

Little room to lower central bank policy rates in Europe

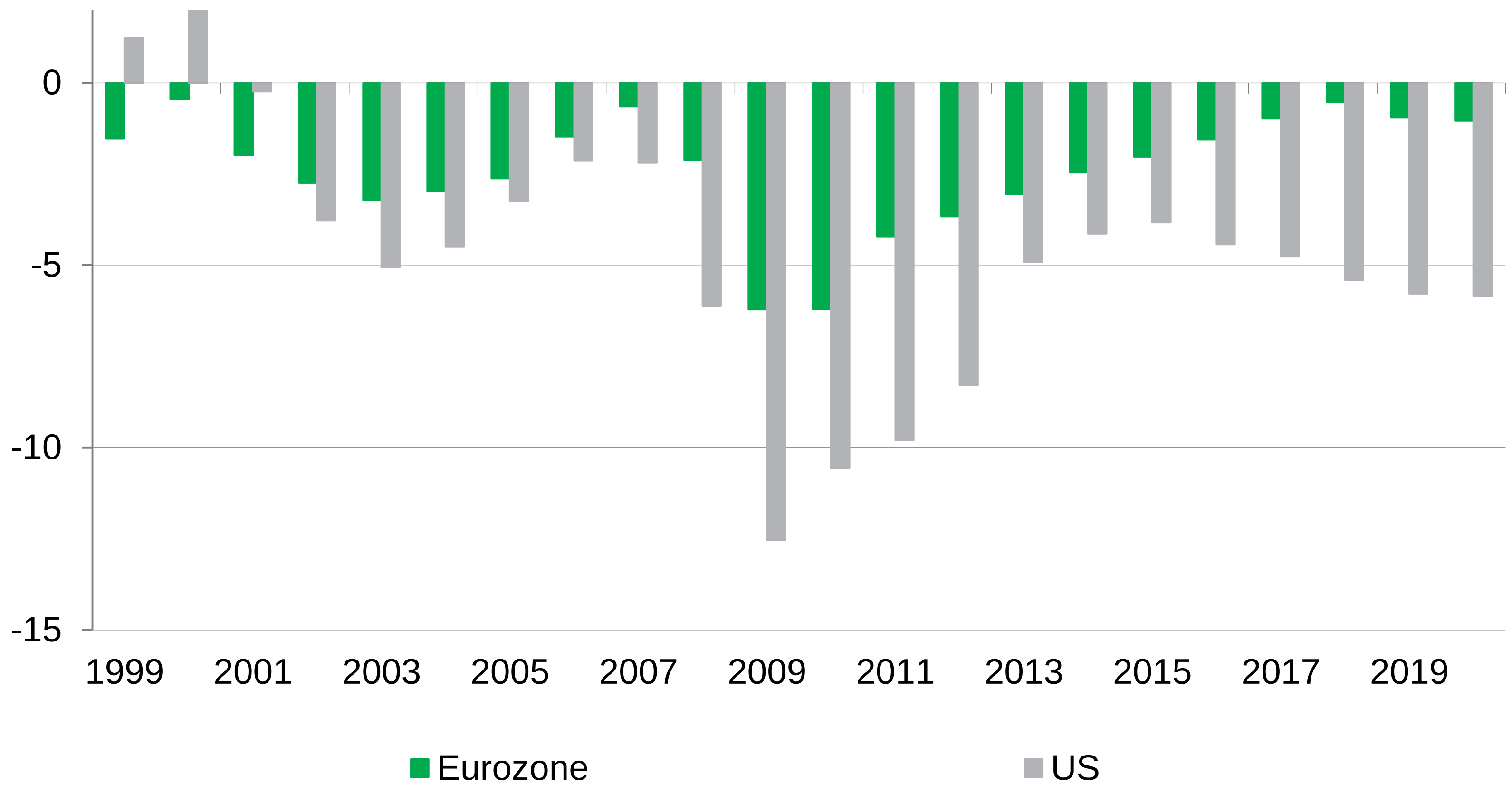


Source: IHS Markit

- Europe has limited policy ammunition to respond to an adverse shock.
- In western Europe, there is little room for manouevre to lower policy rates.
- Emerging Europe is less constrained, though relative to pre-crisis levels, policy rates are still rather low.
- Unconventional measures are possible (e.g. more QE) but they are likely to have diminishing returns.

Contrasting eurozone and US fiscal positions

General government budget balances (% GDP)



Source: IHS Markit

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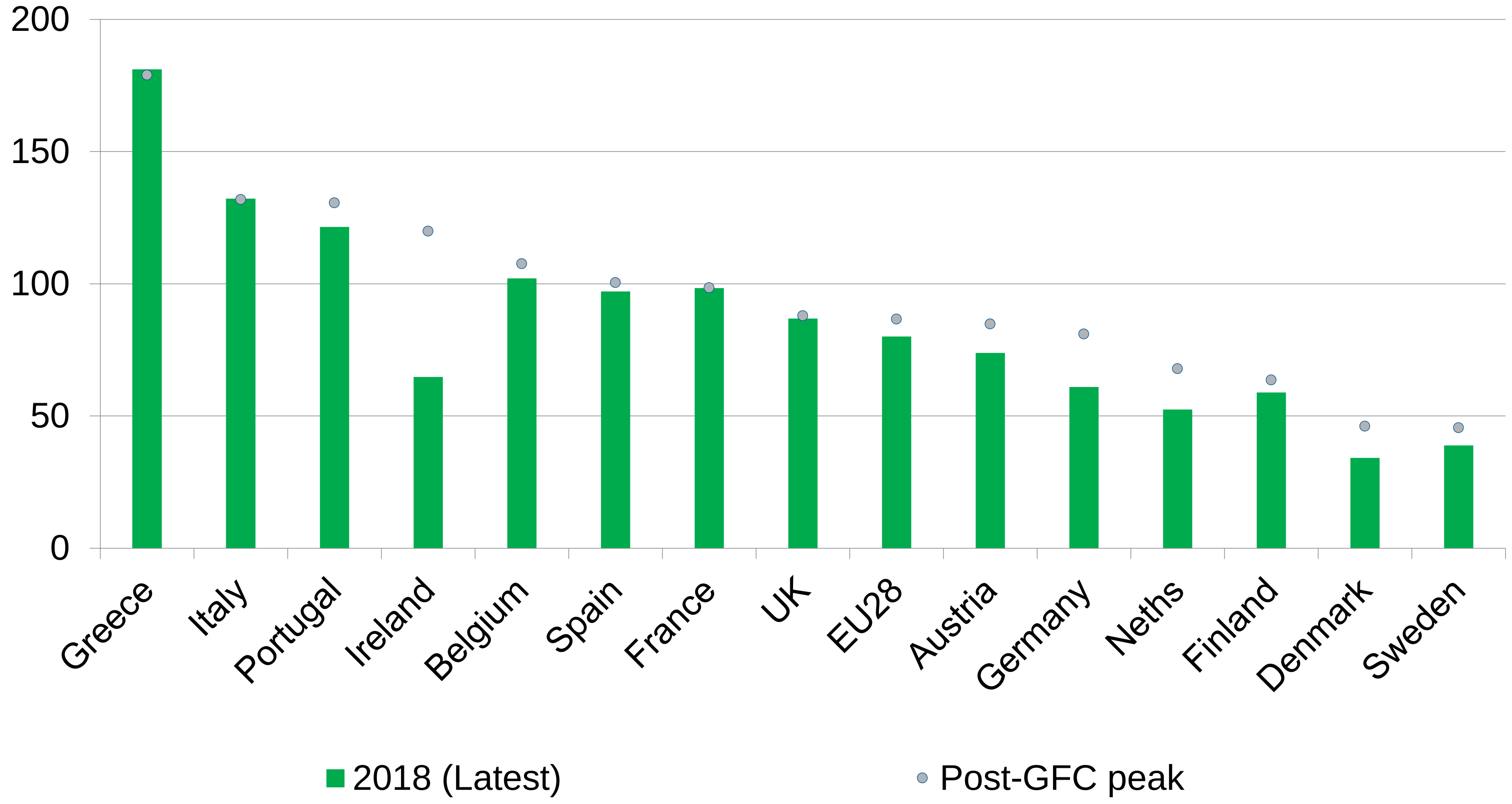
- The eurozone's aggregate fiscal position is relatively positive: the budget deficit is less than 1% of GDP.
- But effective policy co-ordination is a problem for the eurozone.
- The US fiscal position merits more attention than it is receiving.
- Revenues are low relative to GDP which will be a problem in a severe downturn, absent expenditure restraint.

Variations in fiscal space across Europe

General government debt to GDP ratios (%)

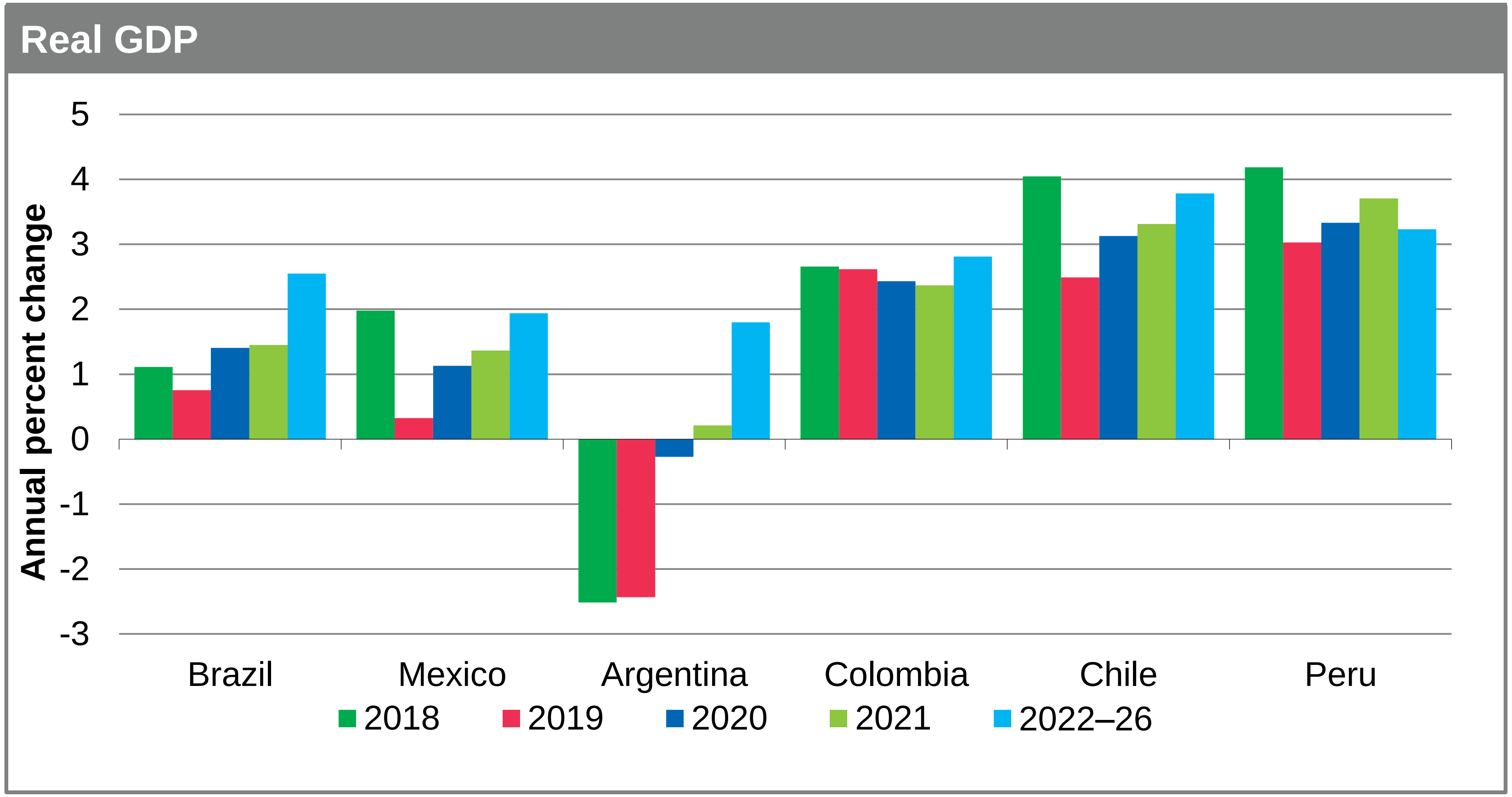


Source: Eurostat

- Fiscal policy will have to play a more prominent role in supporting demand given monetary policy constraints.
- High debt burdens remain a problem in the "periphery", given limited post-crisis deleverage.
- Still, there is plenty of fiscal space in "core" countries, including Germany where there is limited political appetite to deploy it pre-emptively.

Latin America: Policy problems

Latin America growth forecasts



Source: IHS Markit

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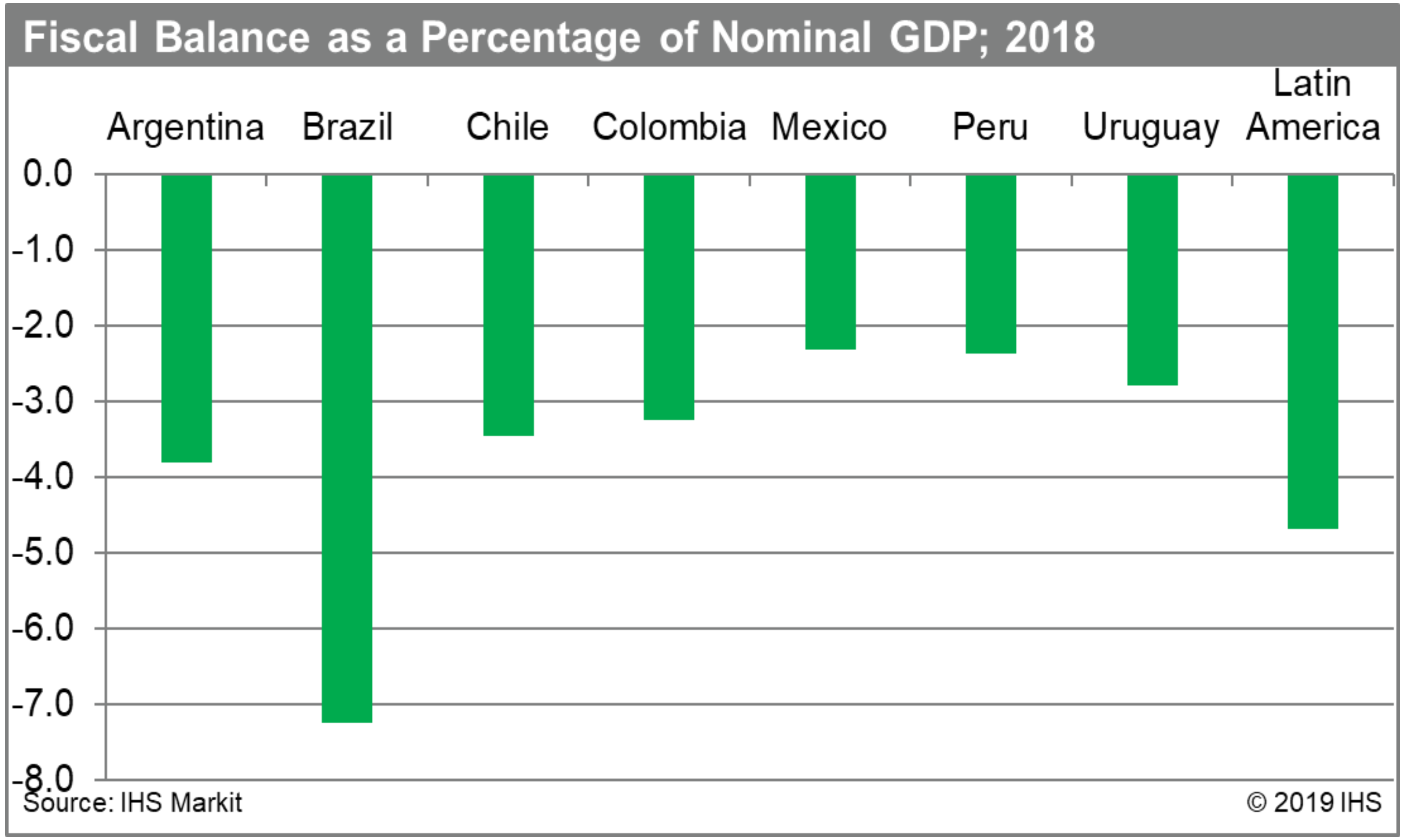
- The period of above-trend economic growth is ending.
- Financial conditions are tightening and volatility has increased. This is hurting business sentiment and investment.
- Latin America's GDP growth is forecast to accelerate to 1.7% in 2020 from 1.2% in 2019 but this is still low by EM standards.

Fiscal fragility



- Governments cannot increase public spending to boost aggregate demand given already high budget deficits.
- Fiscal policy in some countries has had to become restrictive: i.e. spending cuts and/or higher tax receipts are required to avoid crowding out the private sector.
- Debt to GDP ratios are also rising quickly in some countries, including Brazil.

Political and policy outlook pivotal

Mexico: AMLO-related uncertainty but solid policy framework

- Cancellation of Mexico City Airport.
- Suspension of oil and electricity auction rounds.
- Consultations of local communities on projects considered of public interest pose legal/contractual risks.
- Centralisation of presidential power limits check and balances.
- Still, the well established policy framework is a big plus.
- Credible inflation targeting regime.
- Flexible exchange rate regime.
- Financial system well capitalized with relatively good asset quality.

Brazil: Pro-reform agenda from Bolsonaro but delivery uncertain

- Ambitious infrastructure programme (private concessions for airports, highways, railways and ports).
- Easing of licensing and environmental regulations favour mining and agri-business.
- Oil and gas sectors attracting oil majors, output to rise sharply.
- Reduced role for state-run banks.
- But the government is inexperienced and there is a lack of coordination between the president and his economic team.
- Approval of pension reform key test; fractured Congress main hurdle.

Argentina: Macri re-election risk deepens economic distress

- Austerity secures IMF support but exacerbates recession.
- As does tight monetary policy.
- Macri's chances of re-election very low after August primary election (general election on 27 October).
- CDS nearly doubled in reaction to the result.
- Peso collapse raises risk of sharp economic deterioration.
- Immediate impact of devaluation on consumer prices and expenditure.
- Uncertainty, higher prices for intermediate inputs from abroad and wage adjustments will hit industry.

Summary

- Global GDP growth forecast to slow from 3¼-3½% in 2017-2018 to around 2½-¾% in 2019–21. Downside risks have risen but not sufficiently to trigger a global recession in our baseline.
- However, note that some key near-term downside risks are not included in the baseline:
  - Fourth tranche of US tariffs on China (effective from 1 September 2019).
  - US tariffs on imports of autos and parts (announcement due in November 2019).
  - A "no deal" Brexit (watch this space!).
- Low interest rates and persistent fiscal deficits in many countries implies that there will be less scope for counter-cyclical stimulus in the event of another recession.
- The Asia-Pacific region is again expected to make the strongest contribution to global growth, though China's economy has entered a long-term slowdown.
- The US is benefiting from late-cycle fiscal stimulus and the Fed's monetary policy easing but the business cycle is already exceptionally long.

What to watch: potential game changers

Risk	Drivers
China hard landing	• Trade conflicts hit exports and foreign direct investment. • Prior over-investment and debt reduces impact of policy stimulus. • Housing and banking sector vulnerabilities.
European recession	• “No deal” Brexit pushes the UK into a deep recession. • Weaker exports to UK broadens Germany’s recession. • US tariffs on EU autos and parts deepen the downturns.
Stalled US expansion	• High uncertainty and weaker trade hit exports and equity markets. • Tariffs on consumer goods also raise inflation, hitting consumption. • Households and businesses behave more cautiously.
Oil shock	• Conflict in the Middle East escalates. • Oil production and transportation are disrupted. • Price spike hits advanced economies’ real disposable income.

Good luck!

Source: Getty Images

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