

GLOBAL ECONOMIC OUTLOOK

• Ailing Economies

A new risk, the coronavirus, is clouding the near-term outlook for the global economy. The outbreak is sending ripples through global supply chains and disrupting businesses. Those markets with strong economic linkages to China are the ones facing the biggest impairment, as the flow of goods and services has come to a virtual halt.

In the best case, the economic impact will be high but short-lived. However, if China remains in lockdown and infections continue to rise, the shock to the rest of the world could be lasting and significant. Meanwhile, other important matters (Brexit negotiations and U.S.-China trade tensions, to name two) are far from settled. The ongoing uncertainties will continue to weigh on economic prospects for a good portion of 2020. As a result, we have downgraded our growth outlook for all major economies.

Following are our thoughts on how the world's major markets will fare during the balance of the year.

United States

- Two near-term shocks are weighing on the U.S. economy. Though geographically remote from China, businesses in the U.S. will suffer from slower investment and delayed inventory growth caused by the coronavirus. In addition, the halt to production of the Boeing 737 MAX is creating a substantial disruption as workers and planes are idled. We expect growth to resume in the second half as these situations run their course.
- Fourth-quarter gross domestic product (GDP) showed continued growth with unsteady support. Previously strong consumer spending returned to normal levels, while business investment contracted for the third consecutive quarter. Net exports grew due to a sharp decline in imports, consistent with slower consumption. We believe positive consumer sentiment and supportive monetary policy will keep the economy growing, but at a slower rate than recent years.

Eurozone

- The eurozone ended the year 2019 on a disappointing note. GDP growth slowed to 0.1% quarter-over-quarter in the final three months of 2019, its slowest pace in six years, amid unexpected contractions in France and Italy. Though leading indicators and surveys are pointing towards a gradual bottoming out, the current coronavirus crisis presents a risk that could derail this stabilization. In light of the disruptions to global supply chains and trade flows from the virus, we expect eurozone GDP growth to remain weak in 2020.
- The common currency region has relatively few cushions to rely on. The European Central Bank is expected to remain on hold, maintaining its accommodative stance amid concerns about the negative side effects of negative interest rates. A much-

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needed fiscal easing policy faces political hurdles and capacity constraints.

United Kingdom

- With the U.K. formally out of the European Union, attention has turned to efforts aimed at redefining Britain's economic relationship with the world. New trade terms, customs procedures and regulations are being reconsidered across a broad range of counterparties. Considering the tough work load, we expect the negotiations to drag on beyond 2020, extending the transition period. But the possibility of a no-trade-deal Brexit cannot be ruled out; this would cause sizeable economic pain, a sharp decline in the pound's value and high inflation.
- The U.K. economy remains in a weak spot. Growth remained flat (on a quarter-over-quarter basis) in the last quarter of 2019, with the services sector slowing and manufacturing in contraction. In our view, weaker economic prospects (consistent with the Bank of England's recent GDP forecasts) will likely drive the central bank to cut interest rates by 25 basis points in the first half of this year.

Japan

- The Japanese economy continues to struggle, owing to weak domestic demand and troubling external developments. Though recent government stimulus should underpin the economy, the boost will be offset by coronavirus-related trade and supply chain disruptions. In addition, the Japanese tourism sector will suffer due to a large decline in Chinese visitors. Low growth and low inflation imply that the Bank of Japan will likely remain on hold.
- While some sporting events have already been affected by the virus outbreak, the Tokyo 2020 Olympics remain on track. In a worst case scenario, failure to contain the virus would reduce attendance at the Olympics, leading to further downward adjustments to the outlook.

China

- The Chinese economy was already struggling from elevated trade tensions and domestic imbalances before the coronavirus disrupted all sectors. The sharp reduction in economic and social activity has led to massive declines in discretionary consumption and passenger traffic, alongside factory closures. In our base case, we expect the impact to be high but short-lived, with recovery in the second half of the year. But as we discussed recently, a prolonged encounter with the virus could lead to a series of defaults and create financial instability.
- China's government has attempted to counter the economic fallout from the virus. The People's Bank of China cut a key interest rate and injected large amounts of cash into money markets to help take the pressure off banks and borrowers. Tax breaks and subsidies were also announced to help consumers as supply constraints may increase inflation. In a worst case, Beijing may pump money directly into the economy, forsaking its efforts to rein in its debt.

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Global Economic Forecast – February 2020

	2018	2019	2020F	2021F
United States				
Real GDP (Q4-Q4 % change)	2.5	2.3	1.7	1.8
Unemployment Rate, EOP (%)	3.8	3.5	3.6	3.7
Inflation (CPI, Q4-Q4, %)	2.2	2.0	2.0	2.0
Policy Rate (Top), EOP (%)	2.50	1.75	1.75	1.75
Eurozone				
Real GDP (Q4-Q4 % change)	1.2	0.9	0.8	1.1
Unemployment Rate EOP (%)	7.9	7.5	7.7	7.7
Inflation (CPI, Q4-Q4, %)	1.9	1.0	1.1	1.3
Policy Rate, EOP (%)	0.00	0.00	0.00	0.00
Deposit Rate, EOP (%)	-0.40	-0.50	-0.50	-0.40
United Kingdom				
Real GDP (Q4-Q4 % change)	1.5	1.1	1.0	1.3
Unemployment Rate EOP (%)	4.0	3.8	4.0	3.9
Inflation (CPI, Q4-Q4, %)	2.1	1.4	1.6	1.7
Policy Rate, EOP (%)	0.75	0.75	0.50	0.50
Japan				
Real GDP (Q4-Q4 % change)	-0.3	-0.4	0.5	0.9
Unemployment Rate EOP (%)	2.4	2.3	2.3	2.3
Inflation (CPI, Q4-Q4, %)	0.8	0.5	0.4	0.5
Policy Rate, EOP (%)	-0.10	-0.10	-0.10	-0.10
China				
Real GDP (Q4-Q4 % change)	6.4	6.0	5.0	5.5
Unemployment Rate EOP (%)	3.8	3.6	4.0	4.0
Inflation (CPI, Q4-Q4, %)	2.2	4.3	3.0	2.0
Policy Rate, EOP (%)	4.35	4.35	4.35	4.35
Exchange rates (EOP)				
	Mar-2020F	Jun-2020F	Sep-2020F	Dec-2020F
EUR/USD	1.11	1.13	1.15	1.16
GBP/USD	1.29	1.30	1.31	1.32
USD/JPY	109.0	108.0	107.0	106.0
USD/CNY	6.95	6.90	6.90	6.90
	<i>F: Forecast</i>	<i>EOP: End of period</i>		