NORTHERN TRUST

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GLOBAL ECONOMIC OUTLOOK

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• Truce, Not Peace

As announced at the G20 Osaka summit last weekend, trade talks between the United States and China will resume after a seven-week hiatus. This is a welcome development for Asian and European economies, which find themselves in the middle of the impasse. But turning this into something more permanent requires a concrete settlement on key issues, not a temporary truce. Experience shows this will not be easy.

In our base case, economic activity will remain subdued in major economies as tariffs will likely remain in place through 2019, maintaining downward pressure on global trade. In addition, geo-political tensions (most recently in Iran) are expected to remain elevated, limiting any rebound in sentiment. As a result, the world's major central banks are likely to ease their policy stances to provide insurance against recession.

Overall, while downside risks to the global outlook have not increased, they haven't declined, either. Following are our outlooks for the major countries/centers:

United States

- Economic circumstances are slowing but not yet contracting. The June manufacturing Purchasing Managers Index fell to 51.7, still expanding but not by a strong margin. Retail sales have yet to grow any faster than 3.8% year-over-year in any month thus far in 2019, a slower pace than was observed throughout 2017 and 2018. We expect economic growth to return to a more balanced pace of 1.9% year-over-year, near its long-run potential rate. Unemployment is likely to remain below 4%, while inflation should fall no further.
- The Federal Reserve has continued its rapid change in tone. In 2018, it raised overnight rates four times and ended the year by setting expectations for more. The Fed has since rescinded those forecasts and most recently set the stage for a cut. We expect to see two insurance cuts of 25 basis points each to the federal funds rate, in July and September, holding steady thereafter.

Eurozone

- The region appears to be flirting with recession, with Germany and Italy under particular stress. In view of persistently weak incoming data, we have revised our growth projections down for this year and next. We think recession can be avoided, if global trade tensions cool. A no-deal Brexit, U.S. car tariff threats and budget disputes between member states and the European Commission are the key downside risks.
- Continued industrial sector woes amid external exposures have reinforced European Central Bank (ECB) President Mario Draghi's case for easing monetary policy. We expect the ECB to embark on an easing path using tools other than interest rates.
- Though EU leaders are likely to slowly inch towards a deal on the bloc's top jobs, the difficult negotiations give a glimpse into how consensus on important legislation will be

hard to achieve in the coming years, particularly on matters of fiscal policy and immigration.

United Kingdom

- After a strong first quarter owing to Brexit-related distortions (stockpiling before the March deadline), evidence of a slow second quarter is emerging. Retail sales declined in May while the CBI industrial survey and manufacturing PMI survey both disappointed. Though the other major central banks have taken a dovish turn, the Bank of England (BoE) has not. The Monetary Policy Committee (MPC) continues to expect a gradual and limited increase in interest rates over the next few years.
- With Boris Johnson almost certain to become the next prime minister, "the perceived likelihood of a no-deal Brexit has risen" (from the June MPC minutes). The chances of an agreement between the U.K. and the EU before the October 31 deadline have probably diminished; another Article 50 extension is becoming increasingly likely. New U.K. elections, which might return a different government, are also a possibility.

Japan

- According to the latest Bank of Japan's (BoJ) Tankan results, business and overall sentiment dropped in June, particularly among manufacturers. External prospects remain cloudy given global trade frictions (which have hindered Japan in several ways) and advancing restrictions covering the telecommunications sector. These factors are likely to continue to weigh on Japanese sentiment, despite the recent trade truce at the G20 summit.
- At its June meeting, the BoJ left monetary policy unchanged, but signaled its readiness to increase stimulus. A meaningful appreciation of the yen versus the dollar (not our base case) would add pressure for the BoJ to act. We expect fiscal policy to play a bigger role in fighting Japan's economic slowdown.
- We expect the government to stick to the October 2019 timeline for the implementation of a consumption tax hike, but deteriorating economic conditions could lead to yet another delay.

China

- The U.S. decision to loosen some restrictions on Huawei and China's agreement to restart agricultural purchases paved the way for the temporary trade truce at the G20 meeting. Resumption of talks is a positive step, but Chinese growth and exports will remain under pressure as a series of tariffs and other trade barriers remain in place. Our growth outlook for China remains unchanged.
- Against this backdrop, Chinese authorities will continue to focus on stabilizing domestic growth through policy easing while keeping a close eye on economic imbalances in credit and selected asset markets.

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Global Economic Forecast – July 2019

	2017	2018	2019F	2020F
United States				
Real GDP (Q4-Q4 % change)	2.5	3.0	1.9	1.9
Unemployment Rate, EOP (%)	4.1	3.8	3.7	3.8
Inflation (CPI, Q4-Q4, %)	2.1	2.2	2.1	2.0
Policy Rate (Top), EOP (%)	1.50	2.50	2.00	2.00
Eurozone				
Real GDP (Q4-Q4 % change)	2.7	1.2	0.9	1.2
Unemployment Rate EOP (%)	8.7	7.9	7.7	7.5
Inflation (CPI, Q4-Q4, %)	1.4	1.9	1.2	1.3
Policy Rate, EOP (%)	0.00	0.00	0.00	0.00
Deposit Rate, EOP (%)	-0.40	-0.40	-0.40	-0.40
United Kingdom				
Real GDP (Q4-Q4 % change)	1.6	1.4	1.3	1.5
Unemployment Rate EOP (%)	4.4	4.0	3.9	3.8
Inflation (CPI, Q4-Q4, %)	3.0	2.3	1.8	1.7
Policy Rate, EOP (%)	0.50	0.75	0.75	0.75
Japan				
Real GDP (Q4-Q4 % change)	2.4	0.2	0.1	0.8
Unemployment Rate EOP (%)	2.7	2.4	2.4	2.3
Inflation (CPI, Q4-Q4, %)	0.6	0.9	1.8	1.0
Policy Rate, EOP (%)	-0.10	-0.10	-0.10	-0.10
China				
Real GDP (Q4-Q4 % change)	6.8	6.4	6.1	5.9
Unemployment Rate EOP (%)	3.9	3.8	4.0	4.0
Inflation (CPI, Q4-Q4, %)	1.8	2.2	2.6	2.5
Policy Rate, EOP (%)	4.35	4.35	4.35	4.35
Exchange rates (EOP)	**Sep-2019F**	**Dec-2019F**	**Mar-2020F**	**Jun-2020F**
EUR/USD	1.15	1.16	1.17	1.18
GBP/USD	1.28	1.29	1.31	1.33
USD/JPY	107.0	106.0	106.0	105.0
USD/CNY	6.85	6.82	6.80	6.77

F: Forecast *EOP: End of period*