

GLOBAL ECONOMIC OUTLOOK

• In Choppy Waters

The synchronized slowdown witnessed around the globe in the first half of 2019 has taken hold, with no easy way back up in sight. Concerns are on the rise about the near-term growth prospects in Europe (particularly Germany) and Japan, but we do not expect these regions to slip into recession. With Prime Minister Boris Johnson now at the helm, the odds of a disorderly Brexit are rising -- yet it is still not imminent.

The resumption of U.S.-China trade talks was an encouraging development, but negotiators stumbled out of the gate. In our base case, we expect all current tariffs to remain in place at least through early 2020, sustaining downward pressure on global trade. Plus, new trade tensions flaring up between Japan and South Korea are only clouding the already bleak outlook. Against this backdrop, the major central banks have shown willingness to deploy their depleted monetary tools to fight risks of recession.

The ongoing uncertainties will continue to weigh on economic prospects for the remainder of the year and into 2020. Following are our outlooks for the major countries and regions:

United States

- Economic headlines in the U.S. have returned to a positive tone. The unemployment rate rose to 3.7% as more workers entered the labor force, while inflation rates have tempered their long decline. The trade truce with China has helped to settle markets, while the deal to lift the debt ceiling removes an important fiscal risk. Annualized gross domestic product (GDP) growth of 2.1% in the second quarter, driven by strong consumer spending, exceeded our expectations. While the decline in business investment is discouraging, the economy continues to show resilience.
- After thoroughly signaling an easier posture, the Federal Reserve has begun cutting rates. Following this week's action, we expect one additional insurance cut of 25 bps this year, and for rates to hold steady thereafter. Favorable domestic conditions call this second cut into question, but the Fed has affirmed its intent to support the economy against headwinds from trade tensions and slow global growth.

Eurozone

- Bad news continues to pile up for the region. The economy fared poorly in the second quarter, clocking a meager 0.2% quarter-over-quarter growth rate, compared to 0.4% in the first quarter. Incoming readings suggest a weak start to the third quarter, with Germany facing growing risks of recession. Worryingly, external weakness is now starting to spread to domestic demand, as services sentiment is edging lower. We do not foresee a recession yet, but uncertainties are clouding the outlook.
- The second quarter Bank Lending Survey published by the European Central Bank (ECB) showed tighter credit conditions as worries are beginning to weigh on banks' lending decisions. Against this backdrop, the ECB at its July meeting paved the way

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for an easing package in September. We expect the ECB to cut the deposit rate by 10bps and introduce a tiering system along with other monetary tools (possibly small asset purchases) at its September meeting.

United Kingdom

- Boris Johnson became the U.K.'s new prime minister and reshuffled the cabinet, promoting Brexiteers who are willing to leave the European Union on October 31 "with or without a deal." With Johnson in the driving seat, and given the limited time for negotiations and limited willingness from the EU for further concessions, all options are on the table, including fresh elections or a no-deal Brexit before October 31. Our baseline expectation is another Article 50 extension to March 2020.
- With the uncertainty expected to linger for longer, the Bank of England is likely to remain on the sidelines until next year; a no-deal Brexit could force them into action sooner. Underlying growth remains soft, as the June composite Purchasing Managers' Index recorded its first contraction since August 2016. A looser fiscal policy under Johnson is likely to produce a modest boost to economic growth in 2020. However, if the U.K. crashes out without a deal, the expansionary policy would help mitigate some of the losses.

Japan

- In its July meeting, the Bank of Japan (BoJ) kept its monetary policy unchanged, appearing to have taken a wait-and-see approach given the limited effective easing tools available. However, either a meaningful appreciation of the yen versus the dollar, or significant downside risks to economic activity (neither of which are in our base case) could force the BoJ to act.
- After securing a majority in the Upper House elections on July 21, Prime Minister Shinzo Abe looks set to implement the consumption tax hike in October 2019 that was included among the Liberal Democratic Party's election pledges. Looking ahead, we expect fiscal policy to play a bigger role in fighting the economic slowdown resulting from trade frictions, including renewed tensions with South Korea.

China

- The Chinese economy remains under considerable pressure (perhaps worse than reported owing to statistical issues) as real GDP growth slipped two-tenths to 6.2% year-over-year in the second quarter. As mentioned above, U.S.-China trade talks are off to a poor start. Despite the resumption of talks, we expect exports to remain under pressure as existing tariffs between the two countries are unlikely to be lifted any time soon.
- Chinese policymakers will likely continue to deploy supportive macro policies with an objective of stabilizing growth. That said, striking a balance between easing and containing domestic economic imbalances won't be easy.

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Global Economic Forecast – August 2019

	2017	2018	2019F	2020F
United States				
Real GDP (Q4-Q4 % change)	2.5	3.0	2.3	2.2
Unemployment Rate, EOP (%)	4.1	3.8	3.6	3.6
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	1.3
Unemployment Rate EOP (%)	8.7	7.9	7.6	7.5
Inflation (CPI, Q4-Q4, %)	1.4	1.9	1.2	1.4
Policy Rate, EOP (%)	0.00	0.00	0.00	0.00
Deposit Rate, EOP (%)	-0.40	-0.40	-0.50	-0.50
United Kingdom				
Real GDP (Q4-Q4 % change)	1.6	1.4	1.1	1.5
Unemployment Rate EOP (%)	4.4	4.0	3.9	3.8
Inflation (CPI, Q4-Q4, %)	3.0	2.3	1.7	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	1.7	0.9
Policy Rate, EOP (%)	-0.10	-0.10	-0.10	-0.10
China				
Real GDP (Q4-Q4 % change)	6.8	6.4	6.0	5.8
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	1.12	1.13	1.15	1.16
GBP/USD	1.24	1.28	1.29	1.30
USD/JPY	105.0	107.0	105.0	104.0
USD/CNY	6.87	6.84	6.82	6.79

F: Forecast

EOP: End of period