

GLOBAL ECONOMIC OUTLOOK

• The Abyss Stares Back

Instead of a calm end to summer, the past month has brought more downside risks for the global economy. The U.S. and China mutually raised tariffs, while evidence of a slowdown in the eurozone is accumulating. Brexit outcomes have become even more difficult to predict. Civil unrest in Hong Kong and a rebuilt governing coalition in Italy are the latest examples of imbalances seen around the world.

At this juncture, the best we can hope for is no further deterioration of economic conditions. The escalation of U.S. tariffs on goods from China will proceed as threatened this year, but tariffs are reaching their natural limit as a policy threat. Policymakers' comments during and after the G7 and Jackson Hole conferences failed to offer new insights or reason to expect renewed growth in any region.

The ongoing uncertainties will continue to weigh on economic prospects for the remainder of the year and into 2020. Our outlook for the world's major economies is cautious.

United States

- While parts of the U.S. economy, including business investment, are sluggish, the hale and hearty U.S. consumer is encouraging. Backed by a solid labor market, the Conference Board Consumer Confidence Index reaffirms that consumers are willing to spend. The situation could reverse if more of the cost of U.S.-China trade actions is passed on to consumers. We expect growth to remain near 2% for 2019, but as protectionist measures expand, growth will likely fall below that level in 2020.
- Federal Reserve Chair Jerome Powell acknowledged the rise in geopolitical tensions at his speech at Jackson Hole, reiterating the central bank's commitment to "act as appropriate to sustain the expansion." We expect one additional insurance cut of 25 basis points in September, and for the Fed to hold rates steady thereafter. That said, growing recession risks could force the Fed to act more decisively.

Eurozone

- Germany, the euro area's largest constituent, will be lucky to avoid recession. Second-quarter gross domestic product (GDP) growth contracted slightly, while falling results in the Ifo Business Climate and European Commission Business Surveys portend slower business investment ahead. While policymakers have long resisted fiscal intervention, they are now planning stimulus measures, such as a cut to the solidarity tax. It is unclear whether fiscal actions will be sufficient in size and speed to defer a recession.
- At its upcoming meeting on September 12, the European Central Bank (ECB) is expected to unveil a set of policy accommodations to support the sluggish European economy. Minutes of the July ECB meeting noted that "a policy package...was more effective than a series of selective actions." We expect a small cut in the deposit rate

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combined with an array of policy tools including a tiered deposit structure and an expanded long-term refinancing operation program to support bank lending and small asset purchases.

United Kingdom

- In an effort to adhere to the October 31 Brexit deadline, and place pressure on the EU for better terms, U.K. Prime Minister Boris Johnson received permission from the queen to suspend Parliament for a month. Before the recess began, however, Members of Parliament voted to take control of the legislative agenda; a bill to require further delay over a no-deal departure will be considered later this week. Should that pass, a general election might be called. Our baseline expectation is another Article 50 extension, but it will come down to the wire.
- Economic growth for the second quarter fell by 0.2%. Though this decline was a foreseeable outcome of Brexit-related accumulation of inventory in prior quarters, the slower activity is a warning worth heeding. The Bank of England's Monetary Policy Committee issued guidance that a smooth Brexit would necessitate interest rate increases, breaking with the trend set by other central banks. However, the accumulation of downside risks could require cuts. On balance, we foresee no changes to the policy rate.

Japan

- Yields on Japanese government bonds fell deeper into negative territory as a global flight to this safe-haven currency pushes down yields. The Bank of Japan has not intervened to control the yield curve, and we do not expect it will make any changes to its policy rate.
- Growth prospects for Japan remain dim, with slow growth in exports and capital spending. The consumption tax hike to come later in 2019 will weigh on consumer spending and boost inflation. An overture by the U.S. to strike a trade deal with Japan may not amount to an actual agreement, but the risk of a further slowdown due to tariffs has receded for the moment.

China

- Normally a closely managed currency, the renminbi was allowed to devalue below 7 per U.S. dollar, a symbolic threshold not crossed since 2008. Deteriorating growth conditions in China are the primary driver of the devaluation, but the ability to blunt some of the effects of tariffs is a bonus to China. We expect the value to stay depressed until a trade deal is struck.
- China fought back against the latest U.S. tariffs with retaliatory tariffs of its own, making the possibility of a deal feel more remote. The tariff battle has little remaining scope for further escalation, but we do not expect it to spread into other arenas.
- China reformed its interest rate regime by creating a new loan prime rate, giving the People's Bank of China closer control over loan rates to encourage bank lending. China will continue to look inward for stimulus measures.

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Global Economic Forecast – September 2019

	2017	2018	2019F	2020F
United States				
Real GDP (Q4-Q4 % change)	2.5	3.0	2.3	1.7
Unemployment Rate, EOP (%)	4.1	3.8	3.7	3.9
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	0.7	1.0
Unemployment Rate EOP (%)	8.7	7.9	7.8	8.0
Inflation (CPI, Q4-Q4, %)	1.4	1.9	1.0	1.1
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	1.0	1.2
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	0.5	0.8
Unemployment Rate EOP (%)	2.7	2.4	2.4	2.3
Inflation (CPI, Q4-Q4, %)	0.6	0.9	1.0	0.4
Policy Rate, EOP (%)	-0.10	-0.10	-0.10	-0.10
China				
Real GDP (Q4-Q4 % change)	6.8	6.4	5.9	5.6
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	1.11	1.12	1.14	1.15
GBP/USD	1.22	1.25	1.27	1.29
USD/JPY	105.0	107.0	105.0	104.0
USD/CNY	7.10	7.15	7.15	7.15

F: Forecast

EOP: End of period