Risk factors

DIDIER BOROWSKI, Head of Macroeconomic Research
PHILIPPE ITHURBIDE, Global Head of Research

The table below presents risk factors with judgmental probabilities (i.e. not market based). It also develops the possible market impacts.

Risk # 1 | 25% probability | Uninterrupted escalation in trade tensions between the US and China

Analysis | US/China negotiations had a surprising turnaround, with tariff raised on $200bn in Chinese goods from 10% to 25%, adding new downward pressures to global trade. Uncertainty increased in near term following the US announcement to restrict Huawei's purchases from US suppliers. There is a need for caution in the near term. On the other hand, the current tariff increase still looks manageable for China. Chinese policymakers are better prepared than last year, with policy effects on the way. Looking ahead, the window for US/China to reach a deal is still open. Two sides have made concrete progress, with several major issues left to be decided by President Trump and President XI. Both sides should feel more pressures and greater pains to come. The US should be careful about raising tariffs on the rest of $300bn Chinese products, as most of them will be consumer goods, unlike previous tranches.

Market impact | Tariffs have started to hit trade again, and have uncertainty been weighing on the business climate (especially in the manufacturing sector) and on the Chinese economy. As a result, some private investment projects have probably been postponed. Even in the absence of a large-scale trade war, global trade, which has started to slow, may therefore slow down further. A chain reaction would cause a fall in global trade of goods while exacerbating local inflationary pressures in the short run (mainly in the US), putting central banks into a corner. This would cause a general rise in risk aversion (due to fear of a global downturn). At the end of the day, a more severe confrontation would only make losers.

Risk # 2 | 25% probability | No-deal Brexit

Analysis | The UK is in the midst of a deep political crisis. Conservatives and Labour were sanctioned by voters. Nigel Farage's Brexit party is the big winner. Consequently, Boris Johnson has the wind in his sails to succeed Theresa May. But nothing is done yet. Theresa May's resignation will be effective on 7 June. From 10 June, the procedure to find a successor will begin. Theresa May will remain in office until the end of the procedure. There is no shortage of candidates. We should be fixed by the end of July at the latest. It should be noted that staunchly pro-Bremain parties (such as the Liberal Democrats) also scored well in the election, making the political situation even more polarised and, possibly, bringing more impulse to those demanding a second referendum. It should be remembered that the 27 EU countries must be unanimous on 31 October for a further extension of the deadline, which is not a foregone conclusion. Against this backdrop, the likelihood of the UK leaving the EU without an agreement has increased and it is therefore necessary to continue to prepare for it both at national and company level. However at the end of the day, everything remains possible: no-deal Brexit, new elections, new referendum, new Article 50 extension, not to mention that it cannot be ruled out that the British Government could simply revoke Article 50. The only good news is that fewer and fewer protesting/populist parties in Europe are calling for the exit of the euro (which would require an exit from the EU). It is likely that they are being vaccinated by the British turmoil.

Market impact | In the short run, uncertainty is likely to stay elevated as long as the new Prime Minister is not designated and it may even rise further if the next government adopts a confrontational approach with the EU-27. -In the face of uncertainty, the risk premium on UK assets must be sufficient - with a weak currency and lower prices for risky assets - to attract foreign investors. Is this enough today? Nothing is less sure! In the event that the outcome is unfavourable for the UK, we would see a weakening of the GBP and below-trend GDP growth. But should a deal be approved or the article 50 be revoked, we would see the opposite, The situation remains very binary and thus not very conducive to strong portfolio recommendations.

Risk # **3** | **25%** probability | **Political instability in Italy with renewed stress on sovereign spreads in the Eurozone**

Analysis | In early April the Italian Government released its latest economic blueprint (SGP), embedding the new economic forecasts for the 2020 budget and beyond. Projections are now more aligned with the consensus, implying weaker growth and a worsened state of public finances. Growth projections now expect the Italian economy to grow at 0.2% YoY in 2019, followed by a modest recovery to 0.6% in 2020. The deficit is expected to reach 2.4% of GDP in 2019, declining gradually to 1.5% in 2022. Yet, due to the combination of a worsening growth profile and a reduction in the primary surplus, debt is expected to increase further from 132.2% of GDP in 2018 to 132.6% in 2019. The target for 2022 is set at 128.9%. Due to the 2018 increase in the debt profile, compared with previous agreed targets, on May 29th the EU commission sent a letter notifying the breach and asking for clarification of the special factors that forced the deviation. To add further tension to the Italian economy, the EU election results have completely changed the balance of power within the governing coalition, with the League almost doubling the Five Star Movement's votes. This came with a high voter turnout. Confrontational tones within the government and with the EU on the Commission's budget rules resurfaced immediately, with increased risks of new elections. Although political incentives may not be absolutely in favour of this outcome, we cannot completely rule out the possibility of early elections, the earliest date possible being September (although this could fall very close to the start of the 2020 budget discussion, and would therefore not be the best political outcome).

Market impact | Notwithstanding the better than expected Q1 GDP, which marked an exit from the technical recession suffered by the Italian economy in H2 2018, markets remain nervous about the Italian government's new confrontational tones with regards to EU budget rules. Moreover, heightened tensions within the government coalition have increased the risk of snap elections and the uncertainty on how Italy would deal with the daunting task of addressing the 2020 budget, which should sterilise relevant VAT hikes while revamping a challenging spending review. At the moment, there is no systemic risk in our opinion. We perceive risks as remaining domestic. Keep in mind that the ECB has anti-contagion tools that it could call on to avoid a spread to other peripheral markets. In addition, the ECB has announced new TLTROs to alleviate the banking system. All of this should contain the contagion risk on peripheral sovereign spreads and on corporate credit spreads.

Risk # **4** | **20%** probability | **Major European slowdown**

Analysis | Q1 GDP growth figures (+0.4% QoQ for the entire Eurozone) came as a relief after high frequency indicators had signalled more weakness at the beginning of the year. For the moment, at least in core countries, economic difficulties are largely contained within the manufacturing sector. Moreover, the risk of US tariffs on the European car sector is now less imminent (D. Trump has postponed his decision by 90 days). However, there are risks that manufacturing remains under pressure, notably due the effect of renewed US-China tensions on international supply chains, while new US trade action against Europe cannot be fully ruled out. Domestic political risk is also present, first and foremost in Italy, whose 2020 budget negotiation with the new EU Commission will be difficult. Finally, the "no-deal" Brexit risk, although postponed, is rising again following the resignation of T. May. Such problematic events could occur against a backdrop where the key supporting factors of 2019, the still buoyant labour market and the significant easing of fiscal policies in large countries, gradually lose some of their strength due to cyclical and political causes.

Market impact | As the ECB would be left with few tools to face a slowdown, and as a coordinated fiscal stimulus would be very difficult to decide due to the complex European institutional and political environment, a major slowdown would clearly be negative for European assets and the Euro.

Risk # **5** | **15%** probability | **US recession**

Analysis | The US economy was stronger than expected in Q1 (+3.2%), although the composition of growth was somewhat volatile and sent out mixed signals, as almost half of the boost was in inventory growth and net trade. Incoming data related to Q1 this year, although more mixed, tend to confirm our outlook, pointing to a gradual convergence towards potential growth. Keep an eye, however, on the performance of the manufacturing sector, which soft data seem to describe in some difficulty.

Renewed tensions on the trade front with China, with the step up in tariffs, the still open risk of imported cars tariffs from Europe (postponed by six months), and uncertainty in the very important process of ratifying the USMCA (aka NAFTA 2.0) add uncertainty to the risks in our outlook. Yet, in our central scenario, US growth will slow, driven by slower domestic demand, which we anyhow expect to remain resilient, consumption in particular, given the strength of the job market and a benign inflation outlook. Against this backdrop, the probability of recession remains low in the foreseeable future, and we expect the Federal Reserve to remain on hold.

Market impact | Markets are likely to become more circumspect with regard to 2020 growth expectations as the deceleration could become more pronounced, and economic signals are likely to become increasingly mixed as the cycle extends. At the time of the writing, the markets have begun pricing in two and half rate cuts by the Fed by end of 2020, the first one occurring by the end of 2019. As the cycle matures, the best choice for investors is to limit exposure to credit. On the equity side, selection of themes, sectors and single names will be increasingly relevant.

Risk # 6 | 15% probability | Major geopolitical crisis in the Middle-East

Analysis | While there are always geopolitical risks centred in the Middle-East, US-Iran tensions have increased in recent weeks after D. Trump 1/ cancelled the waivers that enabled some countries to import Iranian oil 2/decided new sanctions on Iran. Recent security incidents (attacks on tankers in the Persian gulf) and aggressive declarations by both sides have only worsened the situation. An important factor is that Trump's team for foreign and security affairs is now considerably more hawkish than at the beginning of his mandate, with the appointment of personalities such as Mike Pompeo at the State Department and, even more so, John Bolton as National Security Advisor. However, Trump appears to be a lot more pragmatic than the latter. On the Iranian side, the risk of a military confrontation with the US is made larger by internal divisions, and the possibility that the IGRC could conduct operations without the full approval of the country's leaders.

Market impact | Oil prices would be the main item to watch, while a US-Iran open confrontation could be detrimental to most risky asset classes and cause a surge in safe-haven flows to the USD. However, at this point, we expect no durable upside shock on oil prices, given the high level of US shale gas production and declarations by Saudi Arabia and the UAE that they can make up for the shortfall in Iranian exports.

Risk # 7 | 10% probability | Major political crisis in Europe

Analysis | The European Election results were broadly in line with what opinion polls had indicated, although with a slight "pro-institution" surprise. Key takeaways are, first, a decline in the votes for the two large political groups which are the social-democrats and the Christian-democrats or moderate right; these two parties had, since 1979, commanded a combined majority in the European Parliament, and this is now over. Second, a rise in other so-called "mainstream" forces, the pro-market liberal centre including the Party of French President Macron, and, even more notably, the Greens. Together, all these pro-institution, pro-European forces command roughly 67% of MP vs. 70% before the elections. Then the other major take-away is that far-right (or right-wing Eurosceptic) parties see their share increasing from roughly 20% to 25%, with prominent cases being France, where the far-right national front comes first before the President's party, and Italy. However, far-right parties also scored a bit short of expectations in other key countries such as Germany and the Netherlands, while far-left party have seen their share diminish from 10% to 7%. All in all, while combined radical parties, Eurosceptic parties see their total share increasing from 30% to 32%, this is not the tsunami that could really have been a shock to institutions. The two historic mainstream parties which can build a majority through a coalition either with the liberal centre, or with the Greens will find it a bit more difficult than it used to be, yet it should still be manageable. Radical parties will have a bit more power, especially through parliamentary committees, they could try to propose amendments but they should not be able to block key legislation except on topics where mainstream forces could be very divided. What is also remarkable is the rise in the participation rate at the vote. Turnouts at the European election had been historically low and falling and this time it rose from 43% to around 50%, which shows a rising interest in European affairs.

Market impact | Given the still positive economic backdrop, we do not believe that a new round of systemic crisis in Europe is possible. Non-mainstream political forces that are in a position to rule countries (such as in Italy) have shown that they want to blame European political institutions and try to modify them, but not exit the Eurozone. However, we cannot rule out some market stress while the difficulty to understand European institutions for outside investors means that European assets may continue to carry a specific political risk premium. Italian government spread vs. Bund should continue to be volatile.

Risk # 8 | 10% probability | Major slowdown in the "emerging world"

Analysis | Emerging markets asset classes started 2019 buoyantly, thanks to (1) the Fed's U-turn in communication ("wait and see" attitude on interest rates revising the dots, stabilisation of its balance sheet by Q3 2019); (2) a more negative news-flow concentrated in DM (Europe in particular); and (3) a less likely escalation in the trade war between the US and China with likely a deal between the two. Having said that, the contagion risk in the EM world remains well alive whether through real economy spillovers (overall weaker global growth will reflect in weaker global trade and less external demand for EM economies) or through financial markets spillovers. The Federal Reserve stance shift has been quite earlier and stronger than anticipated in our 2019 outlook and the risk of a monetary policy mistake by the main central banks remains non negligible. Indeed, today we do see the risk of contagion through financial market higher than through the chain trade. As long as the global financial environment remains dovish, the contagion risk coming from the usual fragile suspects like Turkey and Argentina remains limited; however, should the global environment change towards a tighter one, the contagion risk would increase.

Market impact | Spreads and equity markets would once again be highly hurt; it is all the truer that emerging currencies would be again under pressure with capital outflows. However, the emerging world is far from being a homogeneous block, and markets would deteriorate more in the most vulnerable countries, whether due to poor external positions or fragile fiscal and political conditions. Some caution on emerging markets is still required at present.

Risk # 9 | 10% probability | A Chinese "hard landing"/ a bursting of the credit bubble

Analysis | Chinese economic growth is slowing down, but the authorities are working hard to stimulate the economy (through monetary and fiscal policies) so that the economy will remain resilient. Recent data tend to indicate that the policy mix has a noticeable positive impact on the economy. That being said, the country's economic model is fragile: the excess of credit is visible, and non-financial corporate debt has surged since the GFC. The good news is that the NFC debt-to-GDP ratio had started to drop since late 2017. We will continue to monitor the trend in Chinese private debt closely, especially if the economy slows. Meanwhile, the de-escalation in trade tensions should give China policymakers time to adjust their policy implementations and to better manage short-term risks. In the event of a hard landing or the bursting of the credit bubble, the Chinese authorities would be unable to avoid a stronger depreciation of the yuan.

Market impact | A hard landing linked to a bursting of the credit bubble would have a very negative impact, and its cascading effects would be particularly disastrous: vulnerability of banking systems (in China and elsewhere), vulnerability of the global financial system, vulnerability linked to China's public and private debt, negative impact on regional and global trade, and thus on commodities and emerging countries, impacts on the currencies of commodity-exporting countries, advanced countries and emerging countries, etc.

MACROECONOMIC CONTEXT
Our convictions and our scenarios

DIDIER BOROWSKI, Head of Macroeconomic Research
PHILIPPE ITHURBIDE, Global Head of Research

This section provides a reminder of our central scenario and alternative scenarios.

Central scenario (70% probability): domestic demand and services to remain resilent despite rising uncertainty on trade

- **Growth has slowed worldwide:** 2018 had begun based on the theme of a synchronised global recovery. But this did not last. Since spring 2018, the protectionist measures taken by Donald Trump have changed the game. Emerging economies, some of which are heavily indebted in dollars, were weakened last year by the broad-based appreciation of the USD. Moreover, economic activity has weakened markedly in the Eurozone since Q4 2018. Hence, 2019 has begun with a global synchronised slowdown. They are signs of stabilisation but with risks being increasingly tilted to the downside.
- **Global trade** is under pressure but its importance must not be overestimated: Global trade has fallen over the past 18 months; it started 2018 at around 5% yoy but fell sharply in Q4 2018, zigzag over the last few months and should face challenge again given recent increase of tariff for Chinese imports to US. The economic slowdown in China probably played a role in late 2018. But most importantly, the protectionist rhetoric has pushed uncertainty to an all-time high (with a peak in Jan), dragging down investment. Re-escalation on trade between China and the US doesn't bode well such as the one between the US and Mexico and, on the other hand, a trade war between the EU and the US remains a distinct possibility. At this stage, we however continue to expect global trade growth to stabilise at around the level of global GDP growth (i.e. we would expect global trade to return to around 3% yoy by mid-2020). And in addition, we believe that the resilience of domestic demand is underestimated. True global trade strongly contributed to global growth over the past decades, but that's less and less the case: global growth is primarily driven by domestic demand. Services are increasingly becoming decoupled from industry, which can be explained by the relative strength of consumption vs investment and trade since the global financial crisis.
- **United States:** The US economy has been driven by a very accommodative fiscal policy; its impact should progressively erode this year. True, real GDP growth was well above expectations in Q1 19 (3.1% qoq at annual rate after 2.2% in Q4 18). This was the third quarter the US economy grows at a rate above 3% in the last 5 quarters. GDP growth also picked-up on a year on year basis from 3.0% in Q4 18 to 3.2% in Q1 19. Yet, nominal GDP growth slowed from 5.2% YoY in Q4 to 5.0% in Q1. Looking at the composition of quarterly growth, domestic demand slowed notably (both household consumption - especially in durables goods - and investment in equipment decelerated). Due to very accommodative monetary and financial conditions, we however think that growth should be able to gradually decelerate to its potential in 2020, barring any major shock on financial conditions or major confidence corrections from businesses and consumers. Corporate profits will remain under pressure, especially if inflation re-accelerates, which is still possible, given that the economy is operating at close to full employment and tariffs may get at least partially passed through. We do believe that a recession is unlikely in 2019 and in 2020 (as household consumption should continue to benefit from higher disposable income). However, doubts about the extension of this cycle are likely to rise in the coming quarters (less support from fiscal policy, domestic demand under pressure, mixed signals from sentiment and hard data) if trade and geo-politic tensions do not ease. And we must keep in mind that sub-par growth may trigger a profit recession.
- **Eurozone:** Growth rebounded 0.4% QoQ in Q1, which came as a relief after a very weak H2 2018. Importantly, the figure for Germany, the Eurozone's economic powerhouse, was also 0.4% after two quarters of quasi-recession. Strong spending by German consumers showed that the spill-

overs of manufacturing weakness to the overall economy had remained, so far, limited. However, Eurozone data for Q2 was mixed: Manufacturing indicators have stabilised, but some of them continue to show a contraction in activity. Indicators for services continue to show an expansion, although at a moderate pace. The labour market remains generally strong, although some minor cracks are visible in Germany. In terms of risks, the Eurozone economy remains exposed to trade tensions. While there was a reprieve concerning the threat of higher US tariffs on European autos, as D. Trump postponed his decision to mid-August, European corporations can nonetheless be hit by US-China tensions through global value chains. Brexit also came back to the spotlight, after the April lull, as T. May's resignation seemed to increase again the probability of a UK exit from the EU without a deal. Finally, regarding the domestic political agenda, the European elections' result were a relief as anti-system parties, while achieving some gains, did not obtain more votes than announced by the polls. Nonetheless, the confrontation could flare up again between the anti-system ruling coalition in Italy (as the Lega Nord may feel bolstered by its gains at the European election) and European authorities over the 2020 Italian budget. In Germany, following the poor showing of the two ruling coalition party at the European election, the risks that it could break up has also slightly increased.

- **United Kingdom:** Political visibility in the UK is very limited after PM Theresa May announced she would resign as leader of the Conservative party (and therefore, subsequently, as PM). The Conservative party will elect a new leader over the Summer with a significant probability that she or he, as PM, could have a tougher approach on Brexit, increasing the risk of a no-deal exit from the EU. However, as Parliament remains strongly opposed to a no-deal, and may have the ability to prevent it, many Brexit scenarios remain possible, all the more so that a political gridlock leading to new elections cannot be ruled out.

- **China:** The surprising turnaround in US/China negotiations and tariff increases on $200bn Chinese goods are adding new downward pressures to China's economy. Uncertainty increased in near term following US announcement to restrict Huawei's purchases from US suppliers. That said, we think the window for US/China to reach a deal is still open, as concrete works have been done with several major issues left to be decided by President Trump and President XI, while both sides are set to feel more pains. The current tariff increase still looks manageable for China, as policymakers are better prepared than last year, and policy supports since H2 last year are taking effects.

- **Inflation:** Core inflation remains low in advanced economies. The slowdown in inflation in recent years is primarily structural in nature, as it is tied to supply-side factors, while the cyclical component of inflation has weakened (with a flattening of the Phillips curve). Core inflation is likely to pick up only slightly in advanced economies. In theory, an "inflationary surprise" remains possible with the pick-up in wages (in the US and the Eurozone) but it is striking to see that inflation slowed in the US in Q1 19 just as real GDP growth accelerated! In the Eurozone, in a low inflation environment, we consider that corporates have almost no pricing power (i.e., corporate margins more at risk than final sale prices). At the end of the day, with low inflation and subdued growth, most central banks have turned more dovish since the start of the year.

- **Oil prices:** Oil prices have unexpectedly dropped over the past weeks due to the trade war escalation (with the Brent falling close to US$ 60 pb). Economic stabilisation remains supportive but geopolitical tensions can change dramatically the overall picture eroding demand projections in the next 12 months. OPEC and supply disruption concerns in Venezuela, Libya, Iran and recently in all middle East are here to stay. At the end of the day, oil prices will probably continue to move within a wide range, with some volatility. On the one hand, supply-side pressures will continue to push prices up while, on the other hand, fears about the evolution of aggregate demand should keep them under pressure. All in all, we are sticking to our range target of $60-70 (Brent).

- **Most central banks on the dovish side:** The Fed is in a "wait and see" mode; we expect neither rate hike nor rate cut in 2019 except in the latest case if downside risks materialise, if financial conditions tighten, or if inflation surprises on the downside. Risks have clearly become asymmetric. For the ECB, we expect a status quo (regarding interest rates) in 2019 and 2020. The ECB has no room for manoeuvre to normalise its monetary policy, given the economic slowdown and the absence of inflation. The ECB announced new TLTROs in March (to come in September); the technicalities are expected to be very accommodative: The ECB may ease further if growth slows further, with a new QE. A two-tiered system is being seriously considered for the deposit rate, to alleviate the burden on banks that have very large excess reserves (Germany).

Downside risk scenario (25% probability): a marked trade-war-driven economic slowdown, a geopolitical crisis or a sudden repricing of risk premiums

- Rising trade tensions with no compromise between the US and China
- Risk of further protectionist measures from the US, followed by retaliation from the rest of the world.
- Repeated uncertainty shocks (global trade, Brexit, Italy) may weigh heavily on global demand.

Consequences:

- All things being equal, a trade war would drag down global trade and trigger a synchronised and sustained slowdown in growth and, in the short term, some inflation. That said, a global trade war would quickly become disinflationary by creating a shock to global demand. Counter cyclical fiscal and monetary policies would be rapidly put in place (but with a lag).
- An abrupt repricing of risk on fixed income markets and a decline in market liquidity.
- Recession fears in the US.
- CBs could once again resort to unconventional tools, such as expanding their balance sheets (particularly true for the ECB).

Upside risk scenario (5% probability): a pick-up in global growth in 2019

Donald Trump makes an about-turn, reducing barriers to trade. Domestically, the theme of increasing infrastructure spending could return to centre stage and extend the cycle in the United States.

- Acceleration driven by business investment and a rebound in global growth.
- Pro-cyclical US fiscal policy generating a greater-than-expected acceleration in domestic growth. Growth reaccelerates in the Eurozone after a pronounced soft patch. Growth picks up again in China on the back of a stimulative policy mix.
- Central banks react late, initially maintaining accommodative monetary conditions.

Consequences:

- An acceleration in global growth would boost inflation expectations, forcing central banks to consider normalising their monetary policies more rapidly.
- An increase in real key rates, particularly in the US.

Macroeconomic picture by area

United States

Normalisation progresses

- As the fiscal boost fades, key drivers of domestic demand are slowing progressively and getting closer to long-term trends, as monetary policy and financial conditions smooth and accompany this normalisation.
- Still-dynamic labour demand and wage growth, coupled with contained inflationary pressures, support resiliency in personal consumption, expected to be the main driver of domestic demand. Q1 personal consumption was weaker than expected but may be temporary (government shutdown, Q4 market correction).
- Business confidence has moderated appreciably compared to last year and this translates into a moderation in capex intentions and investments.
- Moderate domestic and external inflationary pressures are keeping both core and headline CPI in check, composing a benign inflation outlook until expectations remain stable. The Federal Reserve is expected to remain on hold this year, ending QT, and remaining alert to any changes in financial conditions, economic outlook and inflation dynamics

Risk factors

- **Tariffs risks may negatively impact economic performance, both directly (in prices and orders) and indirectly (in confidence). The longer the list of good included in tariffs, the higher the impact on U.S. domestic demand**
- **Renewed policy uncertainty may hold back new capex plans more than expected**
- **Geopolitical risks (Iran, Venezuela) could represent an upside risk to oil prices and our inflation outlook**

Eurozone

A gradual improvement expected despite significant risks.

- After a highly disappointing year in 2018, growth rebounded in Q1. However, despite robust domestic demand and a solid job market, industrial indicators remain very poor. We forecast a gradual improvement during the rest of 2019 but with lots of risks.
- The euro zone is still heavily exposed to international trade tensions, although the direct threat of US customs tariffs on European vehicles is less imminent. After a lull in April, the risk of a no-deal Brexit has also risen.

Risk factors

- **Rise in protest political movements**
- **External risks, including the trade war and a slowdown in the US and China**

United Kingdom

Lots of uncertainty in the run-up to Brexit

- Growth rebounded in Q1, but thanks in part to Brexit-related precautionary spending. The UK obtained an extension in the deadline from the EU until 31 October, but Prime Minister Theresa May was unable to reach an agreement with Labour to ratify the EU Withdrawal Agreement. The political situation is still highly volatile, with uncertainty regarding who will take over from May and a greater risk of a hard Brexit.
- Despite political uncertainties, the job market is still strong, and wages have risen in real terms, driven by the receding in inflation.

Risk factors

- **A non-deal Brexit**
- **The current account deficit is still very high**

Japan

Remains precarious

- Q1 GDP soared by 2.1% qq. However, this was due only to weak imports and inventory accumulation, both of which derive from ephemeral private demand. Both consumer spending and business investment retreated from Q4/18 levels.
- Industrial production remains lacklustre, with inventories climbing to their highest level in six years. Stalwart exports to the U.S. have not fully offset weak shipments to Asia.
- Investment in structure is buoyant on the back of urban development and office refurbishment. In contrast, spending on machines remains weak, as a green shoot in the Chinese economy has yet to stimulate manufacturers.
- Steady wage increases underscore consumption, whereas galloping prices of daily necessities are discouraging households. The transition to a new era under the new emperor should partly encourage consumers.

Risk factors

- **Capital spending plan for this year is subject to reduction**
- **Companies may stop, downsize or postpone business investment on anaemic corporate earnings and the escalating US-China trade dispute**

China

- The surprising turnaround in US/China negotiations and tariff increases on $200bn Chinese goods are adding new downward pressures to China's economy.
- Uncertainty increased in near term following the US announcement to restrict Huawei's purchases from US suppliers, but the window is still open for a trade deal ahead. Keep a close eye on the next steps by US and China in the run-up to the G20 in Japan in late June.
- Exports are expected to be hit again, but perhaps less so than in Q4, with less distortion.
- Policymakers look better prepared than last year, with all measures on the table ready to use if and when necessary.
- Meanwhile, there are signs that policy supports since Q3 are starting to pass through into real economy and are becoming more visible.
- RMB should be able to avoid large depreciation barring any further major escalations, helped by policy supports and capital control.

Risk factors

- **Uncertainty in US/China relationship**
- **Policy mistakes in managing near-term risks and the structural transition**
- **Geopolitical noise regarding North Korea**

Asia (ex JP & CH)

- Q1 2019 growth figures have been broadly disappointing in the region, with few exceptions (China and Taiwan). Overall, the negative momentum has been confirmed by hard data, with very weak export figures and softening domestic demand, too.
- The region's inflation figures have remained very benign. Oil and food prices reverted their contribution from negative to positive, pushing inflation levels up mildly. CB targets are not at risk for the time being.
- Finally, we saw two central banks in the region (Philippines and Malaysia) cut their policy rates by 25bps on weaker economic conditions and low inflation. More easing is in the pipeline.
- Three important election outcomes have been officialised, in Thailand, Indonesia and India. In all three cases, the status quo prevailed with the victory of the incumbent president/ coalition. Modi's victory in India was much stronger than expected.

Risk factors

- **Q1 2019 GDP generally weaker than expected**
- **Inflation still very benign. Oil and food prices are driving inflation up**
- **Central banks in the region start to move on the easing side**
- **Election outcomes in Thailand, Indonesia and India confirm the status-quo**

Latam

- Overall, Q1 GDP in the region has shown a broad based weakness in several countries (Mexico, Chile and Colombia to name few). Domestic demand has been impacted by specific temporary factors.
- On the inflation front, the overall environment remains benign. However, in the region's main economies inflation went up: in Mexico to 4.4% YoY (above Banxico's target) and in Argentina to the worrisome level of 55.1% YoY.
- The region's main central banks left their monetary policy rates unchanged. The Argentina central bank has made its no-intervention zone to defend the peso more flexible.
- The approval ratings of the presidents of the two main countries (Brazil and Mexico) are on very different paths. Bolsonaro's is sliding fast while AMLO's is holding high. Recently, AMLO announced a halt in tax breaks for many companies. These kinds of decisions will add little to revenues but they'll work in term of popularity.

Risk factors

- **Overall poor Q1 GDP figures released so far**
- **Inflation is benign overall, but higher than wanted in Mexico and Argentina**
- **BCRA makes the no-intervention zone more flexible**
- **Brazilian President Bolsonaro's popularity is sliding**

EMEA (Europe Middle East & Africa)

Russia: Real GDP growth was 2,2% in 2018 and should be slightly lower in 2019. However, growth is expected to accelerate over the medium-term, thanks to a significant infrastructure spending programme from 2019 to 2024.

- Despite the threat of potential US sanctions down the road, the macroeconomic scenario remains supportive. Russia will be among the few emerging market sovereigns with "twin surpluses" in 2019, while accumulating assets in the National Wealth Fund.
- The central bank has kept its key rates on hold, but we expect a rate cut in Q4.

Risk factors

- **Drop in oil prices, stepped-up US sanctions and further geopolitical tensions**

South Africa: exit from recession, but no miracle

- High-frequency indicators are still very weak, and recent currency pressures due to a weak external environment for emerging countries and a cabinet reshuffle are only making things more complicated. With a null Q1 GDP figure, we have revised our forecast for 2019 from 1.4% yoy down to 0.8% yoy.
- Despite a weak economic and subdued inflation environment and a dovish Fed, we expect the SARB to remain cautious and to keep a neutral stance at least for the first half of the year.

Risk factors

- **Increased risk aversion, risk of sovereign rating downgrading, rising social demands in the run-up to elections and risk of fiscal slippage**

Turkey: we expect double-digit inflation and a recession in 2019

- Turkey's GDP decreased by 2.7% yoy in Q1-19, slightly less than in the previous quarter (-3% yoy). While private consumption slowed down less than in Q4-18, investment fell again by 13% yoy. As expected, the Government's expenditure increased sharply (+ 7.2% yoy).
- The CBRT is still under pressure, with CPI inflation set to remain high and pressures on the currency to continue in an unfavourable political environment.

Risk factors

- **A too rapid easing of the central bank, a cooling of budgetary policy, and a slowdown in activity in the Eurozone**

Macro and Market forecasts

Macroeconomic forecasts
(4 June 2019)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2018	2019	2020	2018	2019	2020
US	**2.9**	**2.4**	**2.0**	**2.4**	**2.0**	**2.4**
Japan	**0.8**	**0.9**	**0.7**	**1.0**	**0.9**	**1.3**
Eurozone	**1.8**	**1.0**	**1.5**	**1.8**	**1.2**	**1.5**
Germany	1.4	0.8	1.5	1.7	1.5	1.5
France	1.5	1.3	1.5	2.1	1.3	1.5
Italy	0.8	0.1	0.6	1.1	1.0	1.5
Spain	2.5	2.0	1.8	1.7	1.6	1.9
UK	**1.4**	**1.1**	**1.4**	**2.4**	**2.2**	**2.2**
Brazil	1.1	1.3	2.1	3.7	4.3	4.7
Russia	2.2	1.5	1.7	2.9	4.8	4.0
India	7.4	6.2	6.6	4.0	3.4	4.6
Indonesia	5.2	5.0	5.3	3.2	3.5	4.2
China	6.6	6.2	6.1	2.1	2.2	2.5
Turkey	2.9	-1.5	1.5	16.2	15.6	12.9
Developed countries	**2.2**	**1.7**	**1.7**	**2.0**	**1.6**	**2.0**
Emerging countries	**4.9**	**4.4**	**4.7**	**4.0**	**3.9**	**3.9**
World	**3.8**	**3.3**	**3.5**	**3.2**	**3.0**	**3.1**

Source: Amundi Research

Key interest rate outlook

	24/05/2019	Amundi + 6m.	Consensus Q4 2019	Amundi + 12m.	Consensus Q2 2020
US	2.50	2.50	2.50	2.50	2.50
Eurozone	0	0	0	0	0
Japan	-0.1	-0.1	-0.1	-0.1	-0.1
UK	0.75	0.75	0.75	1.00	1.00

Long rate outlook

2Y. Bond yield

	24/05/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.16	2.20/2.40	2.05	2.20/2.40	1.99
Germany	-0.63	-0.60/-0.40	-0.67	-0.60/-0.40	-0.66
Japan	-0.15	-0.20/0.00	-0.17	-0.20/0.00	-0.18
UK	0.66	0.60/0.80	0.61	0.70/0.90	0.62

10Y. Bond yield

	24/05/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.32	2.40/2.60	2.35	2.40/2.60	2.39
Germany	-0.12	0.05/0.20	-0.02	0.05/0.20	0.05
Japan	-0.07	0.00/0.10	-0.03	0.00/0.10	0.01
UK	0.97	1.10/1.30	1.05	1.15/1.35	1.10

Currency outlook

	23/05/2019	Amundi + 6m.	Consensus Q3 2019	Amundi + 12m.	Consensus Q1 2020
EUR/USD	1.12	1.13	1.14	1.17	1.17
USD/JPY	110	109	110	107	108
EUR/GBP	0.88	0.87	0.86	0.86	0.85
EUR/CHF	1.12	1.14	1.13	1.15	1.15
EUR/NOK	9.80	9.40	9.54	9.30	9.43
EUR/SEK	10.75	10.40	10.50	10.20	10.35
USD/CAD	1.35	1.32	1.32	1.30	1.31
AUD/USD	0.69	0.70	0.72	0.69	0.74
NZD/USD	0.65	0.66	0.67	0.66	0.68
USD/CNY	6.91	6.70	6.72	6.70	6.70

Amundi ASSET MANAGEMENT

Research & Macro Strategy

June 2019 #06

Amundi Research Center

Top-down

Asset Allocation

Bottom-up

Corporate Bonds

Fixed Income

Foreign Exchange

Money Markets

Equities

Find out more about Amundi research team

research-center.amundi.com

Monetary Policies

Forecasts

Investment Strategies

Quant

Emerging Markets

Sovereign Bonds

Private Equity

Real Estate

High Yield

Document issued by Amundi, “société par actions simplifiée”- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com

Photo credit: iStock/Getty Images Plus - adamkaz - Tetra Images

Chief editor

BLANQUÉ Pascal, Group Chief Investment Officer

Editor

ITHURBIDE Philippe, Global Head of Research

Deputy-Editors

BOROWSKI Didier, Head of Macroeconomic Research

DEFEND Monica, Head of Strategy, Deputy Head of Research

Conception & production

BERGER Pia, Research and Macro Strategy

PONCET Benoit, Research and Macro Strategy