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 | 40% probability | Renewed escalation in trade tensions between the US and China

Analysis | US and China ceased fire after a temporary deal reached by President Trump and President Xi during G20 meetings at Argentina. The planned increase of tariff rates in January 2019 paused and the risk of an additional tranche of tariffs on the rest of US imports from China ($267bn) seems to have been also delayed, while negotiations resumed, with signs of China to deliver some of commitments before 90 days of deadline. This should at least help to reduce some downside risks in the near term, with direct impacts on trade to be less concerned, and market sentiment to recover slightly from being very downbeat. That said, this deal is still temporary, and it could take much longer to ultimately solve the problems, as many complicated topics are involved. The arrest of the CFO and daughter of the boss of Huawei, one of the most famous Chinese tech company, in Canada on the request of US reminded that the challenges between the two economies could reach beyond trade issues. As so, we could not rule out severe confrontation between the US and China to come back.

Market impact | Trade tensions have begun to weigh on business climate (especially in the manufacturing sector in Europe) and on the Chinese economy. Subsequently some private-investment projects might be postponed. Even in the absence of a large-scale trade war, global trade, which has started to slow, may thus 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 in a corner. This would cause a general rise in risk aversion (fear of a global downturn). At the end of the day, a more severe confrontation would only make losers.

Risk # 2 | 20% probability | Major European slowdown

Analysis | Eurozone GDP growth slowed down to only 0.2% QoQ in Q3, after 0.4% in Q1 and Q2 and 0.7% in Q3 and Q4 2017. While Q3 weakness was largely the result of temporary negative factors (a sharp drop in German car production due to a new emission testing regime), the underlying momentum is slower than what we anticipated a few months ago. The central scenario remains a continuation of the recovery at a slightly above-potential pace, but risks are tilted to the downside. Indeed, the combination of continuing internal political stress and external negative factors (notably a slowdown in the US and/or Chinese momentum) could cause growth to fall further. Lower oil prices are currently a supportive factor into 2019. However, a reversal of this trend would be another drag for the European economy.

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 # 3 | 15% probability | Political instability in Italy with renewed stress on sovereign spreads in the Eurozone

Analysis | The government coalition in Italy (between M5S and the League) maintained very tense relations with the EU , particularly in terms of fiscal policy and migration policy. After the announcement of an unprecedented material and significant deviation of its deficit targets far from those consistent with the correction path required by the EU commission to avoid an excessive deficit procedure, the EU Commission made the first step in November to start an Excessive Deficit Procedure for excessive debt for Italy as the projected fiscal slippage is not compatible with medium-term debt sustainability. Incoming data on contracting economic growth in Q3 and weak coincident and leading indicators for Q4 increased the risks of another dip that prompted the Government to tone down rhetoric and seek for compromise. Discussions on revising down deficit targets are currently ongoing. EDP likely will not be avoided with the revisions discussed currently, but could be less harsh.

Market impact | There is no systemic risk in our opinion. The rise in Italian bond yields has tightened local financial conditions and that weigh on the ongoing recovery in Italy. Since negotiations started to become less confrontational, spreads tightened giving some short-term relief. Yet, as the tightening concerned more the short term part of the curve rather than the long part, it looks like that the market expectations are for short-term positive developments although the long-term outlook did not change much. We perceive risks as remaining domestic. Moreover, the ECB has anti-contagion tools that it could mobilise to avoid a contagion to other peripheral markets. All of this could maintain contained contagion risk on peripheral sovereign spreads and on corporate credit spreads.

Risk # 4 | 15% probability | No-deal Brexit

Analysis | The political situation in the UK is very unstable, with a government, a majority and a parliament that are particularly divided. We identify 3 broad categories of scenarios: (1) Deal (65% probability) meaning that a deal (which can be May's deal or another one, including an EEA membership with customs union regime) can be ratified by the UK Parliament, so that the UK exits the EU in March 2019 (or a few weeks after) and enters a transition period where it remains in the Single Market at least until end 2020 (or open-ended). However, it is important to note that this probability covers very rocky paths that include a political crisis and, possibly, new elections, but nonetheless a deal in the end. (2) No deal (15% probability), although there would probably be mitigation measures meaning that the probability for EU/UK trade relations to be regulated only by the WTO regime is lower. (3) A prolonged uncertainty (20% probability) well beyond March 2019 through a granted extension or unilateral repeal of Art. 50 by the UK. This could lead to new negotiations or to a new referendum, with probably new elections in between. This category of scenarios could then lead to various outcomes in the end (including a different deal, a Brexit reversal or new risks of no deal).

Market impact | Scenario 1 should bring relief in the end, but as the road to the deal ratification will probably be difficult it will be a source of temporary stress. Scenario 2 would cause major turbulences: In the event that the outcome is ultimately unfavourable for the UK, we would see a weakening of the GBP and below-trend GDP growth. Scenario 3 includes complex paths, with probably many episodes of stress and relief.

Risk # 5 | 15% probability | Continuation of the contagion in the "emerging world"

Analysis | Emerging markets have been suffering since the start of the year, impacted by (1) the Fed's rate hikes and strong USD; (2) by the trade war rhetoric; (3) by the tightening in domestic monetary conditions (many EM central banks have risen their key rates); (4) by the deterioration of the outlook in several countries at the same time (Argentina, China, Turkey and South Africa). In fact, even though the systemic risk is lower than in the past (given the lesser vulnerability of emerging countries), most EM assets have dropped since the beginning of the year. Fears of a still strong USD, of a continuous liquidity draining by the main CB and of a renewal (after G20 agreement) of escalation in the trade war between the US and China would undoubtedly push to a larger contagion (because value chains are very integrated).

Market impact | Credit spreads and equity markets would be highly hurt; it all the more true that emerging currencies would remain under pressure with more capital outflows. However, the emerging world is not a homogeneous block, and the market will deteriorate more in the most vulnerable countries, whether due to poor external positions whether due fragile fiscal and political conditions. Some caution about emerging markets is still required at present but the risk probability has reduced. Indeed, we believe EM markets have already priced in most bad news, and at some point, they should become attractive again.

Risk # 6 | 10% probability | US Recession

Analysis | The robust performance of the US economy in 2018 has led to the supremacy of US risk assets compared to the rest of the world. Moving towards the end of the year and into 2019, global investors have started to raise questions about whether the US economy and business sector will continue to shine, how inflation will evolve, and which direction the Federal Reserve will take going forward. On the macroeconomic front, we think that US growth will continue, with some modest deceleration in 2019 that should prevent a more dangerous overheating of the economy. After the US midterm elections, two possible paths have emerged. The first path is a divided government, leading to very little meaningful legislation enacted. The second path is a constructive one where there are areas of commonality between Trump and the Democratic leadership in the House (infrastructure spending). All eyes will instead be on the Federal Reserve, as the major assumption of the outlook is for a gradual tightening in monetary policy conditions with no abrupt increase in rates amid only moderate upside pressures in wages and prices. No major imbalances are on the radar at the moment. Hence, an economic recession does not appear to be in the cards next year.

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 increasingly mixed as the cycle extends. The best choice for investors is to limit exposure to credit, diversify the portfolio smartly and to take a flexible duration management (close to neutrality at this stage. On the equity side, selection of themes, sectors and single names will be increasingly relevant, as the maturity of the cycle could eventually become a headwind.

Risk # 7 | 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 FX management, monetary and fiscal policies) so that the economy is expected to remain resilient. That being said, the country's economic model is fragile: the excess of credit is visible, 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 closely the trend in Chinese private debt, especially if the economy slows. Meanwhile, a cease of fire with US on trade tensions could gain valuable time for China to adjust their policy implementations and to better manage short-term risks. In the case of 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 burst 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..

Risk # **8** | **10%** probability | **Major political crisis in Europe**

Analysis | European politics is becoming less predictable due to the rise of various non-mainstream political forces in several countries. In September, the non-mainstream Italian government coalition announced a 2019 budget in breach of European rules, thus opening an episode of tensions with the rest of the Eurozone that is not yet resolved. In France, where the situation had been stable since the 2017 presidential election, sudden and violent social movements caught the government off guard at the end of 2018 and appeared to seriously threaten at least the continuation of its supply-side reform agenda. Although less immediately worrying, the political outlook is also uncertain in Germany (due to the leadership change at the head of Merkel's CDU party and uncertainty regarding the future of the government coalition) and in Spain (due to the lack of a proper majority in Parliament and the recent rise of a far-right party). More generally, the combination of strong anti-immigrant feelings and frustration towards European institutions seem to give a strong impetus to anti-system political forces, with the May 2019 European election seen as a major gauge of their progress.

Market impact | Given the still positive economic backdrop, we do not believe that these events will trigger a new round of systemic crisis in Europe. 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, this problematic political news flow will continue to generate market stress in 2019 while the difficulty to understand European institutions for outside investors means that European assets will continue to carry a specific political risk premium. Italian government spread vs. Bund could continue to be volatile.

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 (75% probability): global growth slows gradually but surely

- **Growth is slowing worldwide:** 2018 began based on the theme of a synchronised global recovery. But, this did not last. Since the spring, the protectionist measures taken by Donald Trump have changed the game. Emerging economies, some of which are heavily indebted in dollars, have been weakened due to the broad-based appreciation of the US currency. The depreciation of their currencies has generated local inflation and led their central banks to tighten monetary policies, which has weighed on economies already negatively affected by massive capital outflows. Advanced economies have begun to slow down. In our view, the year will end with a global economy that is evolving in a disjointed fashion, with increased downside risks. A new factor that arrived lately in the picture has been the oil price drop (well below our fair value at USD 75/br for the Brent) that should offer a much needed support to European economies and to the EM oil Importers such as India and Turkey.

- **World trade:** Global trade keeps weakening; it started 2018 at around 5% YoY and in September it has grown by 2.3% YoY. Protectionist rhetoric has pushed down business confidence, particularly in Europe. That said, uncertainty is tending to drag down investment and disrupt value chains that have developed in lock-step with the expansion in global trade over the past 15 years. In light of the above, we continue to expect the global trade to global GDP ratio to decline, with growth in trade lagging slightly behind global GDP. However, last G20 meeting in Argentina has resulted in a more positive than expected short-term scenario, where the further increase in US tariffs towards China from 10% to 25% at the 1st of January 2019 has been postponed by 90 days (1st of March 2019).

- **United States:** The economy has been driven by very accommodative fiscal policy that is likely to continue to produce effects for some time; but, the fiscal multipliers should progressively erode next year. We expect growth to decelerate to its potential, but not before late 2019/ 2020, meaning that the US economy should lose 1pp of growth by 2020. This situation will have a negative impact on corporate profits, especially if inflationary pressures intensify by then, which is possible, given the fact that the economy is operating at close to full employment. We do confirm our expectation that a recession is highly unlikely in 2019, but the cycle-end story will probably return to the fore at some point by next summer, as the fiscal multiplier impact fades and as the effects of ongoing monetary policy tightening show up. We therefore forecast a slowdown in growth by 2020, with GDP growth closer to 2% by then and we keep our scenario of a moderate hiking by the Federal Reserve.

- **Eurozone:** Last month, we revised our growth forecasts slightly downward, to 1.9% for 2018 and to 1.6% for 2019. Despite a recovery that has started well after that in the US, national economies have begun to slow in 2018. The output gap has closed in most countries, and Italy is the only one in the Eurozone (excluding Greece) where GDP has not recovered to pre-crisis levels. Several factors have contributed to the slowdown in growth in 2018: the slowdown in world trade and until recently a high oil price have been the most relevant. In addition, political uncertainties have muddied the waters (Brexit, Italian budget). The possibility of a coalition change in Germany following the defeat of the two major government coalition parties (CDU and SPD) in local elections marks the end of the Merkel era. The loss of the chancellor's leadership may hinder initiatives to strengthen the integration of the Eurozone that were under consideration. It will probably be necessary to wait for European elections in May 2019 and a new parliament, a new European Commission, a new Chancellor in Germany, and clarification regarding leadership of the institutions of the EU (Commission, ECB) to make significant progress in strengthening the financial architecture of the Eurozone. In Italy, incoming data on contracting economic growth in Q3 and weak coincident and leading indicators for Q4 increased the risks of another dip that prompted the Government to tone down rhetoric and seek for compromise. Discussions on revising down deficit targets are currently ongoing. The Excessive deficit procedure (EDP) likely will not be avoided with the revisions discussed currently, but could be less harsh.

- **United Kingdom:** The political situation in the UK is very unstable: December parliamentary vote has been postponed the day before being held. We identify 3 broad categories of scenarios:
  (1) Deal (65% probability): a deal (which can be May's deal or another one, including an EEA membership with customs union regime) can be ratified by the UK Parliament. So, the UK exits the EU in March 2019 (or a few weeks after) and enters a transition period where it remains in the Single Market at least until end 2020 (or open-ended). However, it is important to note that this probability covers very rocky paths that include a political crisis and, possibly, new elections, but nonetheless a deal in the end.
  (2) No deal (15% probability), although there would probably be mitigation measures meaning that the probability for EU/UK trade relations to be regulated only by the WTO regime is lower.
  (3) A prolonged uncertainty (20% probability) well beyond March 2019 through a granted extension or unilateral repeal of Art. 50 by the UK. This could lead to new negotiations or to a new referendum, with probably new elections in between. This category of scenarios could then lead to various outcomes in the end (including a different deal, a Brexit reversal or new risks of no deal).

- **China:** Chinese economic growth is slowing down but the authorities are working hard to stimulate the economy (through FX management, monetary and fiscal policies) so that the economy is expected to remain resilient. That being said, the country's economic model is fragile: the excess of credit is visible, 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. Meanwhile, a cease of fire with US on trade tensions could gain valuable time for China to adjust their policy implementations and to better manage short-term risks. In the case of hard landing or the bursting of the credit bubble, the Chinese authorities would be unable to avoid a stronger depreciation of the Yuan.

- **Inflation:** Core inflation remains low at this stage of the cycle in advanced economies, and should recover gradually. That said, 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. An "inflationary surprise" remains possible with rising oil prices and the pick-up in wages (United States, Eurozone) but would not last long (due to a lack of pricing power) and would drag down corporate margins more than final sale prices, all the more so if global growth slackens. Things are different in emerging economies, where inflationary pressures are greater in many countries, in reaction to which many central banks have raised their key rates.

- **Oil prices:** Oil prices have decreased sharply: from $86/bbl for Brent as of 4 October to $60 the 12th of December. The main trigger at the very beginning of the decline have been the large amount of waivers conceded by the US administration to different countries with regard to the sanctions imposed to Iran oil exports. A moderate OPEC and Non-OPEC production cut decided at the beginning of December together with fear of a more pronounced economic slowdown are keeping oil prices at low levels.

- **The main central banks will continue to remove monetary accommodation at a gradual pace.** The Fed will continue to raise its key interest rates. We expect the Fed to follow through with one more 25bp hike in December 2018 and two additional hikes in H1 2019, followed by a pause, and for it to reduce its balance sheet at the announced pace (with a gradual non-replacement of maturing securities. Meanwhile, the ECB will halt its monthly asset purchases at the end of December, as announced. However, it will continue to replace maturing securities (between €160 and 200 bn in 2019) without clarifying its reinvestment policy in order to retain some flexibility. Its first rate hike (deposit rate) is not expected until late 2019 in the best case scenario. The ECB has no room for manoeuvre to normalise its monetary policy.

Downside risk scenario (20% probability): a marked trade-war-driven economic slowdown, a geopolitical crisis or a sudden repricing of risk premiums

- The risk of further protectionist measures from the US (even after the 90 days agreed during last G20 meeting), followed by retaliation from the rest of the world, remains high. China and the EU are particularly exposed to this risk.
- Aggravation of geopolitical tensions in the Middle East with a possible oil price resurface.
- Uncertainty regarding rising trade tensions (primarily between the US and China) against a backdrop of geopolitical risks, crises in several large emerging economies (e.g., Turkey, Argentina), political risk in Brazil, a slowdown in China, and political tensions in Europe (a deterioration in the budget situation in Italy, Brexit) is encouraging companies to remain cautious.

Consequences:

- All things being equal, a trade war would drag down global trade and trigger a synchronised slowdown in growth and, in the short term, inflation. That said, a global trade war would quickly become deflationary by creating a shock to global demand.
- An abrupt repricing of risk on fixed income markets, with an across-the-board rise in government or credit spreads, for both advanced and emerging economies, and a decline in market liquidity.
- The resulting financial turbulence, the end of the cycle risk would resurface in particular in the US.
- Central banks would cease recalibrating their monetary policies and, in the worst - albeit highly unlikely - case would once again resort to unconventional tools, such as expanding their balance sheets.

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

Donald Trump makes an about turn, reducing barriers to trade and engaging in bilateral negotiations with China. 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 is reaccelerating in the Eurozone after a dip. Growth picks up again in China on the back of a stimulative policy mix in H1.
- Central banks would 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

United States: few signs of deceleration

- The overall pace of economic growth remains above potential, consistent with a gradual slowdown.
- Domestic demand remains the key driver of growth, although data started to show a change in growth composition, with a higher contribution from consumption over investments.
- Business confidence remains strong but data show a moderation in capex intentions, non-residential investments and a slowdown in durable goods orders, which point to a deceleration in business investments that bears watching.
- The labour market remains strong.
- The inflation outlook remains aligned with the Fed's projections, with modest domestic inflationary pressures as CPI remains at 2.5% YoY and Core CPI at 2.1%
- The Fed met on 8 November, leaving rates unchanged in the 2.00% to 2.25% range as expected; the Fed's rhetoric has become somewhat more dovish during the month. The next FOMC meeting will take place on 19 December.
- On the trade front, the G20 meeting reopened negotiations between China and US, suspending escalation for 90 days.

Risk factors

- Fed tightening impacting interest rate-sensitive segments (housing, consumer credit)
- Abrupt, protracted and severe tightening of financial conditions
- Tariffs and retaliation negatively impacting economic performance, both directly (prices) and indirectly (confidence)
- Geopolitical risks linked to a more hawkish shift by the US Administration

Eurozone

The recovery continues despite disappointing figures and rising political risks

- After a disappointing start to the year (GDP only rose 0.8% in H1), growth stalled again in Q3 at just +0.2%. Temporary negative factors (auto sector in Germany) played a role, but cannot be the only reason behind this weakness. Rising oil prices (until October), tension over trade and political risks also dragged down growth. The recovery will continue, but at a slower pace than previously expected (2019 growth forecast lowered from 1.8% to 1.6%).
- The Italian budget continues to fuel tensions. In France, government reforms are coming up against increasingly fierce resistance.

Risk factors

- Stronger political protest movements
- Euro appreciates
- External risks (especially of a trade war)

United Kingdom

Major uncertainty as Brexit approaches

- Growth picked up in Q3 (+0.6%) after having already rebounded in Q2. The labour market remains in good shape and real wages are trending up once again.
- However, the lack of visibility over Brexit is dragging down confidence and investment. There is great uncertainty over whether the UK Parliament will ratify November's deal struck by the UK and the EU, and many scenarios are possible, although we believe that a "no deal" situation is unlikely.

Risk factors

- "No Deal Brexit"
- The current account deficit remains very high

Japan

Buoyant domestic economy versus wobbly exports

- The economy rebounded sharply in October, as producers and retailers recovered in an attempt to recoup earlier losses in the disaster-affected third quarter. Disaster relief projects (0.2% of GDP) should boost growth in the near term.
- The government revealed a blueprint for more economic stimulus, showing a strong commitment to preventing any setback after a VAT hike in October 2019. The government has already decided on benefits to pensioners and free nursery school tuition. These plans will be included in the FY2019 plenary budget.
- Meanwhile, exports have been weakening, not because of the stepped-up US-China trade dispute but because of a synchronized economic slowdown in the non-US sphere.

Risk factors

- GM's decision to shut down factories could fuel criticism of the car industry by the Trump administration

China

- Downward risks should have eased somewhat, at least in the near term, with a temporary deal reached by the US and China during the G20 meeting.
- For now, US has agreed to pause the tariff increase planned for 1 January 2019, with negotiations to begin immediately for 90 days.
- Despite questions regarding how real this trade truce was, contrary what some suspected, China has already matched its words with deeds, by announcing some detailed measures on intellectual property protection.
- Looking ahead, we expect more structural measures to come, which the US asked for but that China also needs, in order to facilitate its own structural transition.
- Meanwhile, policymakers have made new efforts to unblock the pass-through into the private sector, which should become more visible in coming months, to help partially offset an ongoing slowdown.
- In such a case, downward pressures on RMB should also ease somewhat.

Risk factors

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

Asia (ex JP & CH)

- Notwithstanding all the noise related to the escalation of the trade issue between China and Overall growth in the area deteriorated: our GDP forecasts have been revised down throughout the region, with the contribution of external demand weaker than domestic demand.
- The region's inflation figures remained benign, with the usual exception of the Philippines, where headline inflation stayed put, at 6.7% YoY, well above the CB target. India's inflation surprised to the downside at 3.3% in October, on the back of weak Food prices.
- The BSP and BI increased their rates by 25bps once again. Despite the August announcements from the Governor the BoT is yet to change its Monetary Policy stance.
- During the last two months a clash between the RBI and the Indian Government was brought to the public's attention. In the run-up to the elections, the government would like to see the RBI more proactive in letting Public Banks ease credit conditions for SMEs.

Risk factors

- **Growth outlook revised downwards in the region**
- **Inflation still very benign with the exception of the Philippines**
- **BSP and BI continue their hiking cycle**
- **The RBI signals interferences from the Government**

Latam

- The recently released Q3 2018 GDP figures highlight a mixed macroeconomic picture in the area: Brazil and Peru accelerated more than expected, while Colombia, Chile and Mexico slowed down.
- On the inflation front, the overall environment remained benign. In Mexico, inflation finally reversed and after a 5-month long increase started to decelerate mildly in October. In Peru inflation picked up quite significantly yet remaining within the CB's target.
- The region's main Central Banks maintained monetary policy unchanged in their recent meetings, while Banxico and Chile Central Bank raised their policy rates by 25bps at 8% and 2.75% respectively.
- In the area's two main countries, fiscal policy is in the spotlight: in Brazil a very diluted Social Security reform is expected in a relatively short term and in Mexico, more details about budget implementation are expected.

Risk factors

- **Brazil still on track for recovery**
- **Inflation turning more benign in Mexico**
- **Tighter monetary policy in Chile and Mexico**
- **Contrasting signals on the fiscal side by the new Mexican administration**

EMEA (Europe Middle East & Africa)

Russia: we forecast 1.7% YoY growth for 2018 and slightly lower for 2019

- 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 the "twin surpluses" in 2018, while accumulating assets at the National Wealth Fund.
- The Central Bank may hike sometime in 2019 depending on rouble weakness and inflation expectations.

Risk factors

- **Drop in the price of oil, stepped-up US sanctions and further geopolitical tensions**

South Africa: exit of recession but no miracle

- South Africa emerged from recession in Q3 thanks to the recovery of manufacturing and services. On the expenditure side, household consumption rebounded as well as inventories while private and public investment declined. The contribution of net exports was also negative.
- In terms of policy mix, there is very little room for manoeuvre. The SARB has raised its rates and it is not excluded that it still has to do it in 2019.

Risk factors

- **Increased risk aversion, rising social demands, lack of structural reforms**

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

- The strong tightening of interest rates, the rebound in the Turkish lira, the fall in the price of oil and the implementation of discretionary measures on some goods, have provided some respite to inflation. However, it should not fall below 20% for several months.
- In this context, household purchasing power and corporate margins are at their lowest. We therefore expect a sharp drop in activity in the second half of 2018 and a GDP recession of 1% in 2019.

Risk factors

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

Macro and Market forecasts

Macroeconomic forecasts
(10 December 2018)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2018	2019	2020	2018	2019	2020
US	**2.9**	**2.7**	**2.0**	**2.5**	**2.4**	**2.3**
Japan	**0.9**	**1.2**	**0.4**	**0.9**	**1.0**	**1.5**
Eurozone	**1.9**	**1.5**	**1.5**	**1.8**	**1.7**	**1.7**
Germany	1.7	1.6	1.7	1.9	1.7	1.6
France	1.6	1.4	1.5	2.1	1.6	1.5
Italy	0.9	0.5	0.6	1.3	1.7	1.7
Spain	2.7	2.3	1.7	1.5	1.5	2.3
UK	**1.3**	**1.5**	**1.6**	**2.3**	**2.3**	**2.4**
Brazil	**1.3**	**2.2**	**2.1**	**3.7**	**4.8**	**5.2**
Russia	**1.7**	**1.5**	**1.7**	**2.9**	**4.6**	**4.1**
India	**7.8**	**6.9**	**7.1**	**4.1**	**4.1**	**5.2**
Indonesia	**5.1**	**5.3**	**5.4**	**3.2**	**3.6**	**4.3**
China	**6.6**	**6.2**	**6.1**	**2.2**	**2.2**	**2.4**
Turkey	**2.8**	**-1.0**	**1.5**	**16.3**	**17.4**	**13.0**
Developed countries	**2.2**	**2.0**	**1.6**	**2.0**	**2.0**	**2.1**
Emerging countries	**5.0**	**4.7**	**4.8**	**4.1**	**4.0**	**3.9**
World	**3.8**	**3.6**	**3.5**	**3.3**	**3.2**	**3.2**

Source: Amundi Research

Key interest rate outlook

	06/12/2018	Amundi + 6m.	Consensus Q2 2019	Amundi + 12m.	Consensus Q4 2019
US	2.25	3.0	3.0	3.0	3.0
Eurozone	0	0	0	0	0.1
Japan	-0.1	-0.1	-0.1	-0.1	-0.1
UK	0.75	1.0	1.0	1.0	1.0

Long rate outlook

2Y. Bond yield

	06/12/2018	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.76	2.9/3.0	2.83	2.8/3.0	2.83
Germany	-0.62	-0.5/-0.4	-0.56	-0.4/-0.3	-0.50
Japan	-0.14	-0.2/0.0	-0.13	-0.1/0.1	-0.13
UK	0.74	0.8/1.0	0.75	0.8/1.0	0.74

10Y. Bond yield

	06/12/2018	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.90	3.10/3.25	2.92	2.90/3.10	2.94
Germany	0.26	0.40/0.60	0.33	0.35/0.55	0.40
Japan	0.06	0.15/0.25	0.10	0.10/0.20	0.14
UK	1.30	1.40/1.60	1.36	1.40/1.60	1.41

Currency outlook

	05/12/2018	Amundi + 6m.	Consensus Q2 2019	Amundi + 12m.	Consensus Q4 2019
EUR/USD	1.13	1.18	1.17	1.20	1.20
USD/JPY	113	109	110	107	109
EUR/GBP	0.89	0.89	0.88	0.88	0.88
EUR/CHF	1.14	1.20	1.15	1.24	1.17
EUR/NOK	9.65	9.17	9.34	9.12	9.19
EUR/SEK	10.19	9.97	10.00	9.48	9.80
USD/CAD	1.34	1.28	1.29	1.25	1.26
AUD/USD	0.73	0.75	0.73	0.75	0.75
NZD/USD	0.69	0.70	0.68	0.67	0.68
USD/CNY	6.85	6.80	6.93	6.70	6.82

Amundi ASSET MANAGEMENT

Research & Macro Strategy

December 2018 #12

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

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