# Risk factors

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

Finalised on 30/09/2019

| Risk # 1 | 30% probability | No-deal Brexit |
|---|---|---|

**Analysis |** Events accelerated in the first week of September. After taking control of its own agenda, Parliament passed a motion instructing the PM to request from the EU an extension of the Brexit deadline (to 31 January 2020) on October 19 if no deal has been agreed by then with the EU or if the Commons has not given its assent to a no-deal Brexit. After excluding 21 Tory MPs who had voted for the above motions (thereby losing his parliamentary majority), Boris Johnson proposed snap elections for 15 October. However, his bid failed as opposition parties either voted against or abstained (a 2/3 majority is required). Moreover, the Supreme Court ruled that Johnson's decision to suspend Parliament until Oct 14 was unlawful, which allowed MPs to reconvene. Even though there remains a small risk that Johnson could find a constitutional backdoor to force elections before 31 October, an extension followed by snap elections or (less likely) a second referendum now seems the most likely scenario. Current polls indicate that Tories may win an outright majority in snap elections, but the political dynamics could change very rapidly depending on what happens by 31 October. An alliance with the Brexit Party would be disliked by many moderate Tory voters. On the other hand, opposition parties would find it difficult to campaign on any common platform, barring a second referendum, which is a divisive issue among Labour voters. Moreover, Jeremy Corbyn is a difficult figure to rally around for moderate voters. The risk of no-deal in 2020 remains real.

**Market impact |** The risk of a no-deal on 31 October has receded, but uncertainty remains on the 2020 horizon. 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? Not by a long shot! In the event that the outcome is unfavourable for the UK, we would see a weaker GBP and below-trend GDP growth. But should a deal be approved or Article 50 be revoked, we would see the opposite. The situation remains very binary and thus not very conducive to strong portfolio recommendations.

| Risk # 2 | 20% probability | Major European slowdown |
|---|---|---|

**Analysis |** After Q1 GDP growth figures (+0.4% QoQ for the entire Eurozone), which came as a relief but were partly due to positive temporary factors (strong precautionary imports from the UK and mild weather, which supported construction), growth slowed in Q2 (+0.2%) and it is posed to be weak in Q3, as well. In particular, risks of a technical recession in Germany are not negligible. Manufacturing surveys keep signalling weakness in the sector and the extent of the weakness poses risks of contagion to other sectors of the economy, which so far have remained resilient. A number of risks could worsen the situation, notably a further escalation in US-China tensions (to which European manufacturing is heavily exposed through global value chains), US tariffs on the European auto sector (a decision could come in November), and Brexit. At the political level, some degree of uncertainty persists (including the stability of Italy's new government and the likelihood of a no-deal Brexit). On the upside, deployment of fiscal plans (at national and/or EU levels) may help stabilise the Eurozone economy's domestic demand against external uncertainties. Yet, appetite for a coordinated effort still seems modest. In this context, a significant pickup in growth in 2020 is unlikely, and risks remain prominent and significantly tilted to the downside.

**Market impact |** A major slowdown would clearly be bad news for European assets and the euro. But, in that case, the policy mix would become even more accommodative in both monetary and fiscal terms, and this should help anchor growth expectations. We would therefore expect any negative market impact (related to a stronger slowdown than expected) to be short-lived, as investors would want to price in the positive impact on the economy of the policy mix.

## Risk # 3 | 20% probability | US recession

**Analysis |** The US economy is gradually slowing. Recent revised data show that the peak of growth had already been reached in Q2 2018 and that, since then, the US economy has been gradually decelerating towards the trend. Incoming data have begun to support the view that domestic demand is also gradually decelerating, due to weakening investments and capex and a labour market shifting into lower gear. Looking forward, we therefore expect muted growth in investments and moderating US consumer spending (as total labour income is decelerating somewhat and confidence in the future is worsening). Persistent uncertainty on the trade front, with risks of step-up in tariffs and persistent geopolitical issues represent key risks to our outlook, which is tilted to the downside. According to the most recent updates, we are seeing signs of an increased probability of recession from both the macro and financial data we monitor, over a 12-month horizon. From the current low probability of having a recession in the short term (below 5%), the likelihood increases over time to above 20%.

**Market impact |** The markets are likely to become more circumspect with regard to 2020 growth expectations as deceleration could become more pronounced, and economic signals align to point to slower domestic demand. In this context, the Federal Reserve will keep attempting to facilitate a macroeconomic soft landing by contrasting the forces that could drag down US growth and we expect protracted dovishness, with the possible return to balance sheet expansion, in order to keep rates in the targeted range, through a higher level of liquidity in the system. The markets are pricing in two and half cuts over the next 12 months.

## Risk # 4 | 15% probability | US & China: negotiations resume

**Analysis |** As far as we know, the most complex issues (intellectual property rights, technology transfers, tariffs already in place, and the Huawei case) are still on the table, and the Sino-US confrontation returned to the forefront early in September, with tariffs from both sides increasing. On a more positive note, talks have resumed at a lower-level delegation and are expected to continue in early October at a higher level. The two sides have approached the ongoing talks with a more constructive tone, with China's making some exceptions to its tariffs regime (including sensitive sectors for the US) and the US's postponing the increase of current tariffs rate from 25% to 30% to 15 of October, showing some goodwill during the Chinese Golden Week and the ongoing talks. Keep in mind that the US is entering a pre-election period, and opposition to China goes far beyond the Republicans. Regardless of whoever is elected US President next year, opposition between the two countries on strategic issues could worsen their relations in the coming years. It is therefore important not to misunderstand the context. Protectionist rhetoric will not disappear from the radar screens. The likelihood of a comprehensive agreement is very low.

**Market impact |** Along with the tit-for-tat, the most relevant implication on the markets soon after the recent events has been the CNY depreciations above the psychological threshold of 7 against the USD. The trade-weighted dollar is now historically high, and EM currencies had a short period of instability in the aftermath of the CNY depreciation. That instability should accentuate in the event that the CNY depreciates much further

## Risk # 5 | 15% probability | Major geopolitical crisis in the Middle-East

**Analysis |** While there are always geopolitical risks centred in the Middle East, US-Iranian tensions have increased in recent months after Donald Trump: 1/ cancelled the waivers that enabled some countries to import Iranian oil; and 2/ decided on new sanctions on Iran. Recent security incidents (notably the attack on a major Saudi oil facility) and aggressive statements by both sides have only worsened the situation.

At this date, it is unclear whether the departure of John Bolton, Donald Trump's very hawkish national security advisor, will lead to any softening of the US stance. Indeed, Trump already appeared a lot more pragmatic than him. On the Iranian side, the risk of a military confrontation with the US is made larger by internal divisions, and the possibility that the IRGC could conduct operations without the full support 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 sustained upside shock to oil prices, given the high level of US shale gas production and statements by Saudi Arabia and the UAE that they can make up for the shortfall in Iranian exports.

Risk # **6** | **10%** probability | **Political instability in Italy with renewed stress on BTP**

**Analysis |** The new government is now facing its first difficult task, setting the challenging 2020 budget, with the stated goal of avoiding a VAT rate hike and keeping public finances in check while avoiding fiscal consolidation. Its goal, actually, would be to even include a few limited fiscal expansionary measures (e.g., higher financial support and protection to workers, lower labour and incomes taxes, less administration, and a new wave of investment plans). All this would clearly be very difficult to achieve. Despite the sharp reduction in near-term risks relating to a potential debt crisis or a long-lasting political confrontation with the European authorities, structural issues, which are a medium-term concern (public debt burden and limited fiscal space) remain unresolved. As a matter of fact, the government has pledged to comply with EU rules for the 2020 budget, potentially relying on the greater flexibility that may be granted by the European Commission.

**Market impact |** Italian financial markets welcomed the avoidance of further uncertainties that would have been inevitable in the case of a snap election. As a result, BTP vs. Bund spreads tightened strongly, falling back to mid-May 2018 levels. Moreover, the flattening of the Italian curve confirmed that easing political uncertainties support the attractiveness of longer Italian bonds, one of the few remaining oases in the European desert of yield. In order to see further yield compression, the markets are likely waiting for the publication of the 2020 budget. While a small premium for political risks is likely to remain priced in, given the latent fragility of the coalition, there is still room for yields to decline, especially in the longer end of the curve.

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

**Analysis |** The European Parliament is more fragmented, although European Elections introduced a slightly "pro-institution" surprise (in reaction to fears of a euro-sceptic wave). European governments and institutions are facing a harder time than usual negotiating appointments to the EU's top jobs (European Commission, Council, Parliament and Central Bank), and this could mirror future complexity in negotiations aimed at further integration. However, this should not be able to trigger any major crisis at the European level. Yet, it is far from clear that voters' support for "anti-system" parties has peaked and the presence of these parties in national parliaments is complicating the building of government majorities. Politics is therefore becoming less predictable, notably in large countries where it used to be stable (in Germany and Spain). While this is manageable in good times, it may become problematic should a worsening of the economic situation (or other emergencies) require a strong political hand. Moreover, other changes are only complicating European political life further: "Pro-system" forces other than traditional political parties are also making progress (notably the Greens and the economic Liberals), while recent events in France have indicated the possibility of protest movements not led by political parties or trade unions. On the positive side, it should be mentioned that appetite for leaving the euro is diminishing and is no longer on the agenda of major protest parties in France and Italy.

**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 for outside investors of understanding European institutions means that European assets may continue to carry a specific political risk premium.

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

**Analysis |** The recent trade war escalation has triggered a renewed wave of growth deceleration within the EM universe and not only. However, the incrementally dovishness by the main central banks (namely the Federal Reserve and the ECB) is making the global financial environment easier for the emerging markets. A more pronounced USD depreciation is the missing factor in this environment. The rosier financial picture will only worsen if there is any abrupt re-adjustment in the very dovish market expectations following a more cautious monetary policy pursued by the Fed/ECB. Having said that, the amount of dovishness announced and realistically put through should prevent idiosyncratic risks from becoming systemic risks, as happened per Argentina in August. On the real economy side, spillover from the external demand shock to domestic demand (mainly via capex) has been considerable in Asia, more so than in other regions. In order to see the expected stabilisation in growth and not a major slowdown, an orderly solution to the trade dispute is needed sooner than later.

**Market impact |** In the risk case, spreads and equity markets would once again be significantly impacted. This is particularly true as the emerging currencies would once again be under pressure due to capital outflows. However, emerging markets are far from being a homogeneous block, and the markets would worsen more in the weakest and most vulnerable countries, due to their poor external positions or fragile fiscal and political conditions.

## 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 on a manageable slowdown path. Recent data indicate that the trade war is biting and a supportive policy mix is necessary. The country's economic model is fragile: signs of excessive credit are 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 (although it has mildly increased lately). We will continue to monitor the trend in Chinese private debt closely, especially if the economy slows. If any harder landing approaches, the Chinese authorities still have enough ammunition to offset the shocks, including more depreciation, an expansion of credit in the property market, and more expansionary fiscal and easier monetary policy.

**Market impact |** A hard landing triggered by a bursting of the credit bubble would have a very negative impact, and its cascading effects would be particularly disastrous, including 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, and so on.

# MACROECONOMIC CONTEXT
## Our convictions and our scenarios

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

### CENTRAL SCENARIO (60% probability): resilient domestic demand and services despite the uncertainty adversely affecting trade

- **Slower global growth:** the economic weakness seen worldwide during the summer has continued into the fall with very few exceptions. Industrial surveys and data continue to show that the global manufacturing sector is in recession. However, domestic demand remains more resilient, due primarily to household consumption, which continues to be buoyed by very low inflation and in certain economies by a vibrant labour market. Still, services have proved more resilient than manufacturing.

- **Global trade remains under heavy pressure:** global trade has plummeted over the last 18 months. Protectionist rhetoric and measures have increased again recently, with the US imposing new tariffs on 1 September and China retaliating immediately. The level of uncertainty on a trade deal is still higher, although talks have resumed. Approaching the new round of negotiations, both sides have shown a more constructive attitude, with China's announcing some exceptions lasting one year on some items under tariffs since 2018 (sensitive sectors included) and Washington's postponing the tariffs rate increase to 15 October from 1 October. An interim deal looks like more likely. Having said that, trade is expected to remain under pressure for the time being, and it will grow at a slower pace than global GDP. That said, we must not underestimate the resilience of the domestic demand. While global trade has indeed made a strong contribution to global growth over the last few decades, this is less and less so, as global growth is now being driven primarily by domestic demand. And the services sector is less and less correlated to industry, which can be attributed to the relative importance of consumption in relation to investments and trade since the 2008 crisis.

- **United States:** a gradual return to potential, with slightly higher downside risks. The US economy, boosted by very accommodative fiscal policy in 2018, began decelerating in H2 2018 and continued to do so in the following quarters. After peaking at 3.2% YoY in Q2 2018, GDP growth gradually decelerated and stood at 2.3% YoY in Q2 2019, recently revised data show. Fixed investments have been trending down markedly since the second half of 2019, while personal consumption expenditures have remained resilient overall. The protracted weakness in global trade and manufacturing, coupled with uncertainty over the implementation of tariffs, may have played a role in discouraging investments, partially offsetting the benefits of fiscal policy. Corporate and consumer confidence indeed worsened recently, raising concerns of a sharper deceleration in domestic demand. At this stage, while probabilities of recession have risen, we don't think a recession is likely in 2019 or 2020. And yet, signals are starting to appear that the labour market is decelerating and perhaps turning, with a slower pace of growth in payrolls and new hiring intentions, supporting the view that domestic demand will keep decelerating as we go into 2020. Even so, risks remain tilted to the downside: if trade and geopolitical tensions persist, doubts on the extension of the current cycle could intensify over the next few quarters (less support from fiscal policy, and domestic demand under pressure with a contagion from manufacturing to services). Moreover, it is important to bear in mind that below-normal growth and tighter financial conditions could trigger a contraction in profits. With this in mind, the Federal Reserve should stick to its dovish stance, signalling reasonable pragmatism and cautiousness in using its "policy ammunition": however, recent trends in trade disputes and risks to financial conditions (mostly driven by the strong USD) make an additional rate cut likely before the end of 2019.

- **Eurozone:** the Eurozone economy expanded by 1.2% YoY (0.2% QoQ), denoting softening momentum as manufacturing weakness persisted and uncertainty remained high on the trade and political fronts, as a result of the continued risks of escalation with new tariffs, weak data on global trade, and political developments (e.g., Italy and the UK). The Eurozone economy's declining trend is the result of different growth patterns from one country to another. Germany and Italy weakened further in Q2, and signs point to persistent weakness in Q3. No sharp reacceleration is in sight for now and risks of technical recession are still looming. Other economies remain broadly resilient, like Spain, France, and Portugal, albeit with moderating growth and other, more minor economies are keeping their fundamentals overall on track. The unemployment rate remains on a downward path but has stopped declining in a few member-states (e.g. Germany and the Netherlands), yet remains below its long-term average and at historically low levels. Risks remain tilted to the downside. Uncertainties are likely to persist in the coming months as potential further escalations in the trade war are possible, Brexit remains unresolved, with still open the possibility of a very disruptive no-deal Brexit. Some signs that member-states with fiscal room may be willing to engage in some fiscal expansion now appear more supported by news (e.g. Germany and the Netherlands), although a more coordinated fiscal effort at the EU level seems still far from reaching a consensus at this stage. At its September meeting the ECB delivered a comprehensive package, managing not to disappointing markets expectations. On the one hand, the 10bps deposit rate cut and EUR 20bn per month of QE were lower than the markets' expectations. On the other hand, the improvement in TLTRO III conditions and the length of the QE passing from "date"- to "state"- contingent (meaning dependent on inflation projections) were the dovish surprises. Another 10bps depo rate cut in the next 12 months is possible, although in a context that offers very limited room for further cuts and with the need to compensate additional negative effects to the banking system. The next meeting is on 24 October.

- **United Kingdom:** Another extension of the Brexit deadline now seems the most likely scenario. Indeed, Parliament has tied the hands of PM Boris Johnson by 1/ passing a motion instructing him to request an extension from the EU by 19 October (if no deal has been ratified); and 2/ refusing his request for a snap election before 31 October. Snap elections are probable (although not certain) after the extension. Their outcome would be very uncertain. Should the Tories win a clean mandate, the probability of a no-deal Brexit would increase although: 1/ concessions from the EU making room for a deal cannot be completely ruled out; and 2/ a no-deal could be accompanied by mitigation measures (for instance, a limited transition period or sectoral agreements to be negotiated with the WTO). On the other hand, should the Tories fail to obtain a majority, many possibilities would open up, such as a new referendum, new negotiations leading to a softer Brexit (e.g., 'Norway+'), or even a unilateral repeal of Art. 50. However, unless Labour obtains an outright majority, forming a government coalition of "Bremainer" parties will be difficult, as they are opposed on most other issues. The risk of a hung Parliament's only prolonging the uncertainty cannot be completely ruled out.

- **China:** August's string of data (released in September) has confirmed and, in a way, has accentuated the perception of the economic slowdown seen in July. At this point, we confirm our view of a GDP decelerating at the range floor at 6% YoY in H2 2019 and below 6% YoY in 2020 (at 5.8% YoY). Chinese authorities have signalled their determination to maintain growth above 6%. However, the latest data haven't shown a uniformly dark picture. Housing, retail sales ex-auto, and infrastructure investments have been resilient in their weakness if not moderately growing as in the case below (supported by the special bonds issues). We expect the authorities will ramp up their stimulus to accommodate the deceleration mentioned above. More stimulus has to come in the form of monetary policy easing (RRR and LPR), front-loading of local government special bonds, support for the auto sector (relaxing or removing purchase restrictions) and the budget fund. More concessions to the US on the trade front should help to alleviate the short-term pain from the external side.

- **Inflation:** underlying inflation remains low in the advanced economies (despite a recent advance in the US). The slowdown in inflation in recent years has a structural component, related to supply factors, while the cyclical component of inflation has weakened (with the flattening of the Phillips curve). Underlying inflation is only expected to accelerate slightly in the advanced economies. In theory, an "inflationary surprise" remains possible with the pick-up in wages (in the Unites States and the Eurozone), but it is striking to see that the 2018 acceleration in GDP growth was not accompanied by higher inflation. In the Eurozone, against a backdrop of slowing growth, we believe that companies have virtually no pricing power (with margins under pressure). Ultimately, in view of low inflation and the increase in downside risks, most central banks have made a U-turn in terms of communication since the beginning of the year. Under an adverse, recessionary scenario (not our central scenario), upside pressure on wages would not last long, anyway.

- **Oil prices:** While the attack on major Saudi oil installations on September 14 generated a very sharp spike in oil prices, most of the effect was short-lived, as reports indicated that the country could rapidly restore most of the lost supply. Beyond this short term volatility, fears of a global slowdown and increased US production continue to exert downward pressure on prices (indeed, oil faltered in August on downward revisions in demand, while there was a surprise jump in OPEC production). On the other hand, continued OPEC+ coordination (following the July agreements to reduce production) will continue to manage supply. Therefore, all things considered, we reiterate our target of $60-70/barrel (Brent) and $55-65 (WTI).

- **Central banks' incremental dovishness in September and more to come:** As expected, the Federal Reserve lowered its target range for the Federal Funds rate by 25 basis points to 1.75%-2.00% at its September meeting. The policy decision was in response to slowing global growth, lingering uncertainty about trade policy, and muted inflation pressures. Going forward, we see more easing coming but we do expect fewer rate cuts (50bps) than the market. In a much-awaited meeting, the ECB announced an easing package, including a 10bps deposit rate cut, an open-ended QE program, a two-tiered reserve system, and improved TLTRO terms. As per the Fed, we expect a lower ECB deposit rate. On the EM side, we had the same incremental dovishness: Central banks cut their policy rates by 325bps (Turkey), 50bps (Brazil), and by 25bps (Russia and Indonesia), to name a few.

## DOWNSIDE RISK SCENARIO (30%): full-blown contagion to domestic demand

**Two "families" of risks with different conclusions on monetary policies and scenarios**

**1. Trade-related risks:** global trade takes longer to "normalise", additional escalation on trade war, and full-blown contagion into consumption:

- **Growth falls further, profit recession** / the global recession comes back to the forefront
- **Central banks:** even more accommodative monetary policies than what are currently priced in by markets
- **Fiscal policies:** would gradually take over from monetary policy to support growth

**2. Market-related risks:** sudden repricing of risk premia with a large impact on financial conditions, exacerbated by low liquidity (various triggers: wars (e.g., Middle East), crisis in HK, credit event (HY) etc.)

- **The policy mix** (fiscal & monetary) would become much more proactive (i.e. pre-emptive) in that case, while it would likely come somewhat later with trade tensions alone..

## UPSIDE RISK SCENARIO (10%): modest reacceleration of global growth in 2020

**We are raising the probability of the upside risk scenario (and lowering the probability of the central to 60%)**

- Actually, we have substantially revised down our central scenario, by embedding part of the downside risk scenario into the central scenario. By definition, this means that it's now much easier to be "positively surprised". For instance, on the political level the most recent news flow is more positive (pro-European coalition in Italy, possible trade de-escalation).
- Subsequently, going forward, we may see at the same time lower (political) risks and a more expansionist policy mix worldwide, which would pave the way for a rebound in confidence and a quicker normalisation of global trade.
- A modest reacceleration of growth (slightly above potential) – vs. subpar growth in the base case – is a distinct possibility.

# **Macroeconomic picture** by area

Macroeconomic Research Team

Finalised on 29/09/2019

## United States

### US growth gradually decelerates amid trade war concerns and geopolitical uncertainty

- The drivers of domestic demand keep slowing, with investment spending hit worse than private consumption. Business climate surveys are showing a weak spot in manufacturing and services.
- Consumer confidence signals are mixed, but, on average, suggest that confidence is worsening in the future. Some signals point to a moderating pace of labour income with softening growth in payrolls and weaker new-hiring intentions, and wages and salary growth moderating. On the investment front, spending plans are tending to decline. Inflation is low (1.7% overall, 2.4% for core inflation) but remains close to the Federal Reserve's target.
- The Fed delivered a second 25 bps cut at its September FOMC. It remains open to act again in case of need. The Fed signalled reasonable pragmatism and cautiousness in using its "policy ammunition", but recent trends in trade disputes and risks to financial conditions (mostly driven by a strong USD) make an additional rate cut likely by the end of 2019

**Risk factors**

- Tariffs risks may negatively impact economic performance, both directly (in prices and orders) and indirectly (in confidence). The longer the list of goods 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 and tariffs could pose an upside risk to oil prices and to our inflation outlook

## Eurozone

### Weaker industrial activity is adversely affecting the economy

- The majority of business climate indicators saw a further deterioration in September. The situation is particularly bad in industry (especially in Germany), due to both specific difficulties (automotive sector) and external causes (trade war and risk of a no-deal Brexit).
- While, for the moment, the spreading of industrial difficulties to the service sector and the labour market remains limited, it is an increasing risk.

**Risk factors**

- Trade war and the threat of US tariffs on the European automotive sector
- No-deal Brexit

## United Kingdom

### Increased risk of no-deal Brexit

- After the contraction in Q2 (+0.5%, largely due to precautionary spending), the data showed an improvement at the beginning of Q2. The labour market is strong and wages rise significantly. Political uncertainty, however, continues to weigh on investment.
- Uncertainty about Brexit is extremely high. PM Boris Johnson continues to state that Brexit will happen on 31 October, even without a withdrawal agreement. However, Parliament has passed a motion instructing him to request an extension of the Brexit deadline from the EU, should there be no deal approved by 19 October.

**Risk factors**

- A no-deal Brexit

# **Macroeconomic picture** by area

Finalised on 29/09/2019

## Japan

**External threats gradually impair the corporate sector**

- Corporate revenues have become anaemic and profits have plunged markedly, although exports show signs of stabilization. Private machinery orders lack strength, reflecting companies' reluctance to boost capacity and/or renew plant and equipment amid growing uncertainties surrounding global trade.
- So far resiliency in the service sector is keeping capital spending afloat as the MOF's corporate survey shows a massive 8.3% increase in capex plans this year. However, business morale of non-manufacturers fell to a 3-year low, though much better than the case of manufacturers, which hit a 6-1/2-year low. Job vacancy dropped for the third month in a row, mirroring slower domestic economic growth.
- In light of the above, consumption could be another source of pain for the economy. Real household spending is being affected by weaker earnings and fears of a consumption tax hike.

### Risk factors

- Economic package will not sufficiently alleviate the pain of consumption tax hike, as expected
- Companies will accelerate suspension or cancellation of capital investment as the global economy weakens farther

## China

- Approaching the new round of negotiations, China has announced some exceptions for some items placed under tariffs in 2018. These exceptions will last one year and will involve some sensitive sectors for the US (like agriculture). Moreover, China has announced and started larger purchases of farm goods from the US.
- Chinese macroeconomic data continue to decelerate on a broad basis, including in manufacturing, consumer goods and fixed capital investments.
- The policy mix continues to support the economy in a limited way, through both the monetary and fiscal levers. The LPR fell by another 5bps on 20 August.
- In a recent speech, the PBoC Governor, Yi Gang, said that, unlike other central banks, the PBoC will not slash its policy rates or introduce any quantitative easing. The PBoC wants to pursue an orthodox monetary policy.

### Risk factors

- A likely interim deal between China and the US after the October talks
- China's economy is decelerating more than expected.
- Policy mix still mildly supportive

## Asia (ex JP & CH)

- Economic conditions in the region keep worsening, driven by a further decline in external demand and soft domestic demand. The outlook for exports is poor, due to a re-escalation in trade tensions. The new round of negotiations between China and the US could offer some relief if an interim deal is achieved.
- The region's inflation figures have remained very benign. Inflation in August picked up mildly, except in South Korea (0% YoY from 0.6% YoY) and the Philippines (1.7% YoY from 2.4% YoY).
- In September, Bank of Indonesia resumed its easing with a 25bp rate cut, while the Bank of Thailand remained on hold. We expect more easing in the area.
- In September, the Indian government surprisingly cut the corporate income tax rate from its current level from 35% to 25% for companies already operating, and to 17% for companies set up after 1 of November 2019 in an attempt to revive domestic investments and attract foreign investments.

### Risk factors

- Still weak macro momentum in the region. A trade deal is crucial.
- Inflation still very benign, with a mild pick up in August.
- Central banks in the region still accommodative.
- India lowered the corporate tax rate for existing and new companies significantly.

# **Macroeconomic picture** by area

Finalised on 29/09/2019

## Latam

- The growth outlook has worsened significantly in all countries. However, macro momentum has improved very slightly in Chile and Brazil. Mexico is in recession, while Brazil's growth outlook looks more resilient.
- On the inflation front, the overall environment remains benign. Mexican inflation has converged nicely towards the central value of the target, with its latest figure at 3.2% YoY, down from 3.8% YoY. Argentina inflation is still above 50%, stable around 54% YoY in August, and will not converge soon.
- The central bank of Brazil cut its policy rate again by 50bps and left the door open to a further significant easing.
- Pension reform deliberations have been postponed to mid-October, while the economy minister is trying to form a consensus on fiscal reform, starting with the introduction of a new VAT system at the federal level. The $5.4bn tranche of disbursement by the IMF to Argentina has been postponed until there is more clarity on the new government's intentions

### Risk factors

- **Economic conditions continued to weaken; Mexico is in a recession.**
- **Inflation is benign overall. Argentine inflation in August remained above 50%.**
- **BCB once cut again the Selic rate by 50bps.**
- **The $5.4bn tranche of disbursement by the IMF to Argentina has been postponed.**

## EMEA (Europe Middle East & Africa)

**Russia: Real GDP growth was 2.2% in 2018 and is expected to slow down to 1.2% in 2019. However, growth is expected to accelerate over the medium term on the back of 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 is one of the few emerging market sovereigns with "twin surpluses" in 2019, while accumulating assets in its National Wealth Fund.
- As expected, the CBR cut its policy rate in August by 25bps. We expect another 25bp cut in the next few months, given decelerating inflation.

**South Africa: exit from recession, but no miracle**

- Recently released Q2 GDP showed more resilience than the market was expecting mainly thanks to post strike recovery in mining. We confirm our 2019 GDP forecast of 0.8% YoY with downside risks.
- Given deteriorating fiscal dynamics, creeping inflation and Rand weakness the SARB is likely to remain on hold.

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

- The growth report for the second quarter of the year showed only a marginal improvement in the recessionary phase that Turkey is going through. We do confirm our GDP forecasts at -1.8% over 2019, and +1.5 for 2020.
- The Central Bank of Turkey cut its policy rates significantly in September, by 325bps to 16.5%. We expect some more easing to come in support of very weak economic conditions.

### Risk factors

- **Drop in oil prices, stepped-up US sanctions and further geopolitical tensions**
- **Increased risk aversion, risk of sovereign rating downgrades, rising social demands in the run-up to elections and the risk of fiscal slippage**
- **A too rapid easing of the central bank, a cooling of budgetary policy, and a slowdown in Eurozone activity.**

# Macro and Market forecasts

## Macroeconomic forecasts
(27 September 2019)

| Annual averages (%) | Real GDP growth % | | | Inflation (CPI, yoy, %) | | |
|---|---|---|---|---|---|---|
| | 2018 | 2019 | 2020 | 2018 | 2019 | 2020 |
| **US** | **2.9** | **2.3** | **1.7** | **2.4** | **1.8** | **2.3** |
| **Japan** | **0.8** | **1.0** | **0.5** | **1.0** | **0.8** | **1.0** |
| **Eurozone** | **1.9** | **1.0** | **1.0** | **1.8** | **1.3** | **1.5** |
| Germany | 1.5 | 0.6 | 0.7 | 1.7 | 1.5 | 1.7 |
| France | 1.7 | 1.3 | 1.2 | 2.1 | 1.3 | 1.4 |
| Italy | 0.7 | 0.1 | 0.4 | 1.1 | 0.6 | 1.0 |
| Spain | 2.4 | 2.2 | 1.9 | 1.7 | 0.8 | 1.1 |
| **UK** | **1.4** | **1.2** | **1.1** | **2.5** | **1.9** | **2.0** |
| **Brazil** | 1.1 | 0.9 | 1.6 | 3.7 | 4.0 | 4.4 |
| **Russia** | 2.2 | 1.2 | 1.7 | 2.9 | 4.8 | 4.0 |
| **India** | 7.4 | 5.7 | 6.5 | 4.0 | 3.3 | 4.2 |
| **Indonesia** | 5.2 | 5.1 | 5.2 | 3.2 | 3.5 | 3.8 |
| **China** | 6.6 | 6.2 | 5.8 | 2.1 | 2.4 | 2.5 |
| **Turkey** | 2.9 | -1.8 | 1.5 | 16.2 | 15.6 | 12.9 |
| **Developed countries** | **2.2** | **1.7** | **1.4** | **2.0** | **1.6** | **1.8** |
| **Emerging countries** | **4.9** | **4.2** | **4.4** | **4.0** | **4.0** | **3.9** |
| **World** | **3.8** | **3.2** | **3.2** | **3.2** | **3.0** | **3.1** |

*Source: Amundi Research*

## Key interest rate outlook

| | 27/09/2019 | Amundi + 6m. | Consensus Q1 2020 | Amundi + 12m. | Consensus Q3 2020 |
|---|---|---|---|---|---|
| **US** | 2.00 | 1.50 | 1.75 | 1.50 | 1.75 |
| **Eurozone** | -0.50 | -0.60 | -0.60 | -0.60 | -0.60 |
| **Japan** | -0.1 | -0.2 | -0.1 | -0.2 | -0.1 |
| **UK** | 0.75 | 0.75 | 0.70 | 0.50 | 0.75 |

## Long rate outlook

### 2Y. Bond yield

| | 27/09/2019 | Amundi + 6m. | Forward + 6m. | Amundi + 12m. | Forward + 12m. |
|---|---|---|---|---|---|
| **US** | 1,65 | 1.20/1.40 | 1,56 | 1.30/1.50 | 1,51 |
| **Germany** | -0,756 | -0.90/-0.70 | -0,81 | -0.90/-0.70 | -0,85 |
| **Japan** | -0,313 | -0.30/-0.20 | -0,35 | -0.30/-0.20 | -0,38 |
| **UK** | 0,405 | 0.20/0.40 | 0,30 | 0.20/0.40 | 0,27 |

### 10Y. Bond yield

| | 27/09/2019 | Amundi + 6m. | Forward + 6m. | Amundi + 12m. | Forward + 12m. |
|---|---|---|---|---|---|
| **US** | 1.69 | 1.40/1.60 | 1.74 | 1.60/1.80 | 1.78 |
| **Germany** | -0.59 | -0.50/-0.70 | -0.55 | -0.50/-0.70 | -0.51 |
| **Japan** | -0.24 | -0.20/0.00 | -0.18 | -0.20/0.00 | 0.14 |
| **UK** | 0.48 | 0.50/0.70 | 0.54 | 0.50/0.70 | 0.58 |

## Currency outlook

| | 26/09/2019 | Amundi + 6m. | Consensus Q1 2020 | Amundi + 12m. | Consensus Q3 2020 |
|---|---|---|---|---|---|
| **EUR/USD** | 1.09 | 1.10 | 1.12 | 1.13 | 1.14 |
| **USD/JPY** | 108 | 105 | 105 | 104 | 105 |
| **EUR/GBP** | 0.89 | 0.89 | 0.90 | 0.89 | 0.89 |
| **EUR/CHF** | 1.09 | 1.08 | 1.10 | 1.12 | 1.11 |
| **EUR/NOK** | 9.92 | 9.70 | 9.80 | 9.42 | 9.68 |
| **EUR/SEK** | 10.67 | 10.60 | 10.65 | 10.36 | 10.59 |
| **USD/CAD** | 1.33 | 1.31 | 1.32 | 1.28 | 1.30 |
| **AUD/USD** | 0.67 | 0.69 | 0.68 | 0.72 | 0.70 |
| **NZD/USD** | 0.63 | 0.64 | 0.64 | 0.67 | 0.66 |
| **USD/CNY** | 7.13 | 7.25 | 7.20 | 7.15 | 7.20 |

Amundi ASSET MANAGEMENT

Research & Macro Strategy

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