The House View

Snapshot

Macro views

World

- Growth has slowed over the last several months, but it remains broad-based and the latest data suggests the trend has stabilized. In most major cases, economies are growing at above-potential rates. We expect global growth to rise to +3.9% this year, marginally above 2017, as fundamentals remain supportive, but to decelerate over the medium term back to trend levels
- Downside risks, including trade conflict and geopolitics, have returned to prominence. While positive recent political developments in Italy have eased concerns about immediate stress, the risk of a disruptive trade war has risen. Measures announced so far will likely have a small macroeconomic impact, but further escalation may negatively impact confidence, tighten financial conditions, raise prices, and weigh on growth
- Europe and the US have renewed their economic divergence for now. While European growth has decelerated notably this year, the US remains supported by fiscal stimulus and strong fundamentals

United States

- Growth to accelerate in 2018 to an annual pace of +3.0%, the fastest since 2005, still boosted by the combination of tax cuts and increased government spending. There are risks that this fiscal boost takes longer to impact the economy than we originally expected, in which case some of the boost may occur in 2019
- Economic momentum remains very strong and supports our above-consensus expectations for growth this year. Financial conditions remain accommodative despite recent volatility and dollar strength
- Recent wage and price data supports our expectation of upside surprise to inflation this year. Labour markets have tightened and little slack remains, so growth will be increasingly inflationary this year and next

Eurozone

- We expect the Eurozone economy to grow +2.1% this year, a modest slowdown after 2017's impressive performance. Momentum has softened over the last several months, but remains comfortably above our estimate of potential growth (which is around +1.0%). There are risks of a more disruptive trade war, including proposals by the US to raise tariffs on EU car exports, which would weigh on sentiment and growth
- The modest slowdown reflects our view that the recent pace of growth is unsustainable. Cyclical momentum will naturally decline as output gaps close; financial conditions will tighten as the ECB withdraws accommodation; and the boost from net exports will fade as Asia decelerates
- The new Italian government has softened its rhetoric on potentially disruptive issues like the euro, and Italian fundamentals have improved post-crisis. Financial conditions should not tighten enough to derail the ECB's existing policy path, though pressure could resume later this year surrounding the 2019 budget discussions

China

- We expect China's economic growth to slow down +6.6% this year. Fiscal policy has remained supportive, boosted by healthy land sale volumes which have offset planned tightening. This fiscal boost will likely fade later this year, and monetary policy is likely to continue being deployed to support growth
- The outlook regarding trade conflict with the US has deteriorated. Measures already announced will shave only a small percentage off of growth this year, but proposals to expand tariffs to cover more exports will have a notable negative macro impact. Authorities would likely respond by easing policy more aggressively

Emerging Markets

- EM growth is accelerating and inflation is rising, though risks are elevated from the strong dollar, higher US rates, potential trade conflict, and withdrawal of major central bank accommodation. Thus far, EMs have remained resilient in the face of market pressure headwinds.
- In Turkey, with incumbent President Erdogan winning the first round of electcion, political uncertainity is over, but markets will now await clarity on the future economic path
- Inflation dynamics will dictate policy, though trends are diverging across regions and countries. EM performance and flows are being more differentiated and this will continue

Monetary Policy

- Fed: expect 2 more hikes in 2018, i.e. total 4 hikes this year, and 4 hikes in 2019
- ECB: QE to slow to €15bn per month in Q4 and end in Dec 2018; first hike not before Sep 2019
- BoJ: no changes in target yields on YCC this year, continued reduction in pace of JGB purchases
- BoE: opportunistic one-off rate hike in August assuming some rebound in data
- PBoC: shift in stance to easing; recent RRR cut to be effective July 5th; expect one more cut later in 2018
- EM: increasing CB divergence; expect hikes in Asia, and hold in most EMEA & LatAm

Key downside risks

- Rising trade tensions between key trading partners (US, China, Canada, EU) would disrupt global growth
- Political uncertainty in Europe (Brexit, Italy, Germany, Spain) leads to increased financial market volatility
- Policy divergence between major Central Banks for a prolonged period could lead to currency war and further impact trade balances
- Stronger US dollar forces investors to liquidate EM positions; causes overshooting selloff

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Key themes

- Trade wars: increase in trade tensions over the last month the key focus for markets. US administration has implemented several protectionist measures and seems intent on imposing even broader ones in the near-term. While the direct macro impact of the existing measures will likely be small for now, further escalation may impact confidence and hurt growth more significantly. We view substantive escalation of trade disputes, leading to unilateral imposition of further tariff and non-tariff barriers as a real possibility
- US overheating: with the US economy growing already above potential, range of US policies (tariffs, tax-cuts etc) risks sending inflation higher and can cause overheating in the economy
- Easing growth momentum: global macro momentum has eased this year, but it still remains strong and is consistent with still robust GDP growth. We expect 2018 to mark peak cycle
- Political risks in Europe: EU political landscape looks busy with multiple issues on hand – migration crisis, trade conflict with US, Brexit negotiations, dispute within German coalition, new populist govt in Italy – all of which have potential to inject volatility into financial markets
- Return of central bank policy divergence: renewed divergence between Fed and ECB. The Fed is tightening policy to avert overheating risks while the ECB has shifted in a dovish direction. A prolonged period of divergence could lead to currency wars and further weigh on trade balances

Market views

Market sentiment

- Risk assets ultra sensitive to trade rhetoric
- Markets remain supported by strong macro fundamentals. We maintain our overarching strategic views, though downside risks from trade and politics have intensified

Equities

- Bullish US equities. Underlying growth is robust, profit margins are still rising, buybacks are set to reach record highs this year
- In Europe - we remain underweight European equities versus US equities, as our projections for relative macro surprises and the euro imply around 5% relative downside over the coming months. We prefer Swiss equities to France, and banks to non-financial cyclicals and defensives
- Higher real rates are not a problem for equities as long as inflation remains under control

Rates

- Strategically bearish. We revised up our year-end US10Y yield forecasts to 3.5% on higher supply, stronger growth, more Fed tightening, and expected softer pension demand
- In Europe, we remain bearish but have moderated our year-end forecasts for Bunds to 90bps, on softer growth and expected low volatility

FX

- Near-term risks are balanced for dollar, but our strategic view is still for further dollar weakness over the next year given the deteriorating flow outlook
- Neutral for Euro as we expect growth momentum to rebound
- Bullish yen as external financial position improves, currency remains undervalued

Credit

- Cautious and selective. Dovish ECB guidance supports European credit spreads, though downside risks from trade, more aggressive Fed hiking, and European politics remain

EM

- Fundamental driver of EM remains growth, and the outlook remains strong
- Near-term upside limited by risk from trade war, higher US rates, stronger dollar, fear of outflows

Key macro and markets forecasts

GDP growth (%)

	2016	2017	2018F	2019F
Global	3.2	3.8	3.9	3.9
US	1.5	2.3	3.0	2.8
Eurozone	1.8	2.6	2.1	1.7
Germany	1.9	2.2	2.0	1.8
Japan	1.0	1.7	0.8	0.5
UK	1.9	1.8	1.3	1.6
China	6.7	6.9	6.6	6.3

Central Bank policy rate (%)

	Current	2017	2018F	2019F
US	1.25-1.50	1.25-1.50	2.25-2.50	3.00-3.25
Eurozone	0.00	0.00	0.00	0.25
Japan	-0.10	-0.10	-0.10	-0.10
UK	0.50	0.50	0.75	0.75
China	1.50	1.50	1.50	1.50
India	6.25	6.00	6.50	6.75

Key market metrics

	Current	Q4-18	Q2-19	Q4-19
US 10Y yield (%)	2.85	3.50	3.60	
EUR 10Y yield (%)	0.33	0.90	1.05	
EUR/USD	1.16	1.20	1.25	1.30
USD/JPY	110	102	99	95
S&P 500	2,742	3,000		
Stoxx 600	382	395		
Gold (USD/oz)	1,257	1,260	1,300	1,300
Oil WTI (USD/bbl)	72	60	59	59
Oil Brent (USD/bbl)	78	65	64	64

Current prices as of 27 Jun, 2018

Recent publications

- The House View: Trade war tensions, 26-June-2018
- The House View: Infographic – Risk of US policy-driven overheating, 18- June-2018
- The House View: Infographic – Italy: relax, at least for now, 06-June-2018
- The House View: Supported global growth, 22-May-2018