



### Macro views



#### World

- Global growth remains robust. Major developed economies are growing at above-potential rates, compensating for moderation in EM growth. In 2018, we expect global growth to rise to +3.8%, but to then decelerate marginally by the end of next year
- Trade wars remain a key risk to the global economy as tensions reach levels that could weigh on global trade volumes, and potentially on global growth. Also, concerns of US-China trade war translating into a broader economic war can further dent growth prospects. The USMCA agreement diminishes one source of near-term trade uncertainty, but elevates another front against China
- A shock from either a "crash Brexit" or from Italy's debt situation would pose downside risks to euro area growth
- EM growth has moderated without collapsing, and overreaction to growth fears of the summer months has corrected. Some of the more troubled and idiosyncratic economies seem to be turning the corner



#### United States

- The outlook for the US economy remains strong over the medium-term. We expect growth to accelerate in 2018 to +2.9%, boosted by tax cuts, fiscal spending, easy financial conditions, etc. Growth momentum is also supported by rebound in consumer spending and solid capital expenditures
- The fiscal impulse is expected to stay positive until 2020, and then to slow a bit as the effects of tax reform and recent spending packages fade. On the supply side, there is scope for productivity to rise, as higher wages pressure firms to lower costs
- Residential investment spending presents slight downside risks to our near term growth forecasts. Also, downside risks remain from potentially tighter financial conditions, higher-than-expected inflation, or an external shock from China, Europe, or trade. Hence, we expect slightly lower growth in 2019 (2.8%)



#### Eurozone

- The euro area is growing at an above-trend pace despite the slowdown in 1H18, supported by easy financial conditions & solid income growth. We have reduced our 2018 euro area GDP forecast to 2.0% from 2.1%; 2019 unchanged at 1.7%
- Recent euro area macro indicators edged lower –September manufacturing PMI fell to two year low (53.2) driving composite PMI down 0.4 points (54.1). In aggregate, the euro area PMIs still point to 0.5% qoq growth, higher than our projection of 0.4% qoq. Hard data has been mixed this quarter, amid new fuel regulations which have affected auto production
- Downside risks: Italy 2019 budget leaves debt sustainability vulnerable to shocks and a "no deal" Brexit outcome would also be costly, both for the UK and the EU



#### China

- We revise down China's current account forecast to a small deficit of -0.2% of GDP in 2019. This is mainly underpinned by our expectation of lower exports due to the US tariffs. On growth front, we maintain our GDP forecasts of 6.6% for 2018 and 6.3% in 2019
- The main risk to the outlook is further trade policy escalation with the US, which could derail exports. So far, Chinese exports to the US have not fallen dramatically, but there are risks this represents front-loading ahead of tariff implementation. As tariffs phase in this fall and in the first quarter next year, there are risks that Chinese exports to the US decelerate or contract
- Monetary policy will be eased further to support growth, which will weaken yuan over the medium term. We target the Chinese currency at 7.4 for end-2019, another 6.6% depreciation from its current level



#### Emerging Markets

- EM growth has moderated, not collapsed. Overreaction to growth fears of the summer months has corrected and more troubled and idiosyncratic economies seem to be turning the corner. But the prospect of reacceleration remains elusive
- Different regions are at different cyclical stages, with Asia peaking, LatAm likely at a trough, and a dim outlook for EMEA's largest economies. EM vulnerability is still rising with LatAm (ex-Venezuela) under least stress while Asia looks most stressed. Overall, we expect 4.9% growth for EM in 2018 and 2019
- The election results in Brazil point to a more reformist government – a boost for Argentina, where persevering on tight policy is anchoring the currency. Tighter policy has also eased concerns in Turkey, while, in South Africa, market-friendly responses to set-backs contain risks

#### Monetary Policy

- Fed:** expect one more hikes in 2018 (i.e. four total this year), and four more hikes in 2019
- ECB:** QE has slowed to €15bn/m in Q4 and will end in Dec-2018. First 20bp depo rate hike in Sep-2019
- BoJ:** Discussion in next 2-3 years on changing policy goal from inflation to growth or price level target
- BoE:** No more hikes in 2018 as growth and inflation slows
- PBoC:** Three reserve requirement ratio cuts in 2019, 100bps each time

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- Key downside risks**
- **Trade conflict** as US imposes tariffs on remaining China imports, there are risks that tensions escalate into a full blown economic war causing confidence shocks, disrupting supply chains, and negatively impacting growth
  - **Crash Brexit**: We expect a deal between the UK and the EU, but the key risk is that the UK parliament rejects the final proposal. There is also risk of a near term political crisis in the UK – either through leadership challenge from Brexiteers or a breakdown in the DUP/Conservative coalition government
  - **Confrontation between Italy and European commission** over Italy's budget plan could heighten political uncertainties, increase volatility, and tighten financial conditions, weighing on the ongoing European recovery
  - **Recession**: Accentuated monetary tightening, overshooting sell-off in EM assets, and/or a sharp correction in financial assets could trigger a global slowdown/recession

- Key themes**
- **Trade wars**: No signs yet of de-escalation. The recent agreement between the US-Mexico-Canada (USMCA) vastly diminishes near-term trade uncertainties. However, trade rhetoric against China continues to intensify, signaling US's increasing resolve to confront China on unfair trade practices. The bilateral relationship between the two nations will likely stay under stress in coming quarters
  - **Brexit**: Our baseline that the UK will secure a limited withdrawal agreement with the EU 27 by the end of this year remains intact. However, the incoming newsflow over the last few weeks suggests more volatility is likely, before we see full resolution. We estimate a 50% probability that UK parliament approves the deal
  - **Italy**: Confrontation is likely between Italy and the European Commission; Italy's debt sustainability will continue to be a risk over the medium term

**Market views**

- Market sentiment**
- Markets remain supported by strong macro fundamentals
  - Episodes of higher volatility will become more common as central banks remove extraordinary accommodation

- Equities**
- **Bullish US equities**. Earnings are strong and underlying growth is robust
  - We had been cautious of near-term risks, and now expect the rally to continue

- Rates**
- **Strategically bearish**. We continue to expect the Fed to tighten policy further, the term premium to rise, pension demand to soften, and inflation to rise further
  - In Europe, we expect yields to rise as ECB ends QE and macro momentum continues

- FX**
- **Dollar pressured longer term, near-term balanced**. Our strategic view is for further dollar weakness over the next year against major currencies. However, we expect the dollar to rally further vs. Chinese yuan
  - **Neutral on euro for now**. We expect growth momentum to rebound and for the ECB to continue its tightening process by raising rates next year, which will provide a tailwind to the euro next year
  - **Bullish yen**. The Bank of Japan continues its stealth taper and flows are more supportive

- Credit**
- **Prefer EUR over USD**. Credit spreads across both the USD and EUR markets have widened recently with HY underperforming IG. USD HY in particular look expensive relative to EUR credit, and also vs. volatility implied spread levels. Volatility will likely recover but expect it to structurally move higher

- EM**
- **Neutral**. The resilience of EM flows has underpinned a relief rally in EM assets last month, but this resilience hinges on both supportive US fixed income flows and EM growth outlook. Combination of higher USD and yields, deceleration of global activity, tension with China, and DM FI outflows warrant caution.

- Oil**
- **Neutral for now**. We view supply and demand as close to balanced, as higher US and Saudi production balance out disruptions in Iran and Venezuela

**Key macro and markets forecasts**

	GDP growth (%)				Central Bank policy rate (%)					Key market metrics				
	2016	2017	2018F	2019F		Current	2017	2018F	2019F	Current	Q4-18	Q2-19	Q4-19	
Global	3.2	3.8	3.8	3.8	US	2.00-2.25	1.25-1.50	2.25-2.50	3.25-3.50	US 10Y yield (%)	3.16	3.50	3.75	3.60
US	1.6	2.2	2.9	2.8	Eurozone	0.00	0.00	0.00	0.25	EUR 10Y yield (%)	0.49	0.90	1.00	1.20
Eurozone	1.9	2.5	2.0	1.7	Japan	-0.10	-0.10	-0.10	-0.10	EUR/USD	1.16	1.17	1.25	1.30
Germany	2.2	2.2	1.9	1.7	UK	0.75	0.50	0.75	1.00	USD/JPY	112	108	103	100
Japan	1.0	1.7	0.9	0.6	China	1.50	1.50	1.50	1.50	S&P 500	2,810		0	
UK	1.8	1.7	1.3	1.6	India	6.50	6.00	6.75	7.25	Stoxx 600	365		0	
China	6.7	6.9	6.6	6.3						Gold (USD/oz)	1,225	1,210	1,220	1,200
										Oil WTI (USD/bbl)	72	72	70	68
										Oil Brent (USD/bbl)	82	80	78	76

Current prices as of 16 Oct, 2018

- Recent publications**
- [The House View – Markets after the recent sell-off](#), 16-October 2018
  - [The House View: Mind the \(political\) hurdles](#), 10- September-2018
  - [The House View: Central Bank Watch](#), 08-August-2018
  - [The House View: Tug of \(trade\) war](#), 24-July-2018