Deutsche Bank
Research

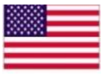
The House View

Snapshot

Macro views

World

- Robust, broad-based global expansion. Synchronised growth across regions and economies, in many cases at above-trend levels. We expect global growth to accelerate to +3.9% this year, marginally above 2017, as fundamentals remain supportive. We expect the US and eurozone to continue growing above potential, but do not anticipate any further acceleration. In China, we expect growth to slow, and are more worried about inflation and financial risks than consensus.
- 2018 should mark the peak of the current cyclical expansion; growth should decelerate from 2019.

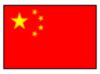


United States

- Growth to accelerate in 2018 to an annual pace of +2.9%, the fastest since 2005, boosted around 0.7pp by the combination of tax cuts and increased government spending.
- Economic momentum remains very strong and supports our above-consensus expectations for growth this year. The latest survey data signal very robust sentiment and healthy activity in the first quarter, and financial conditions remain supportive of growth despite recent volatility.
- Recent wage and price data supports our expectation for inflation to surprise to the upside this year. Labour markets have tightened, a weaker dollar supports import prices, and underlying inflation measures are near multi-year highs.
- The dollar has weakened despite reduced accommodation from the Fed. This should add a few tenths of a percentage point to both inflation and growth this year. We expect this trend to continue, as the US fiscal and current account deficits continue to widen in unison.

Eurozone

- Eurozone growth has risen to the fastest pace in a decade. We forecast +2.4% growth for 2018, marginally higher than consensus. Confidence in the self-sustainability of the recovery has risen.
- Investment spending has become more broad-based and robust, pointing to potential upside risks even with higher rates and tighter financing costs. However, the upside is capped by lack of structural reforms, and increased fiscal spending will probably be inflationary without reforms.
- The pace of growth is far above our estimate of potential growth (around +1.0%) and is therefore unsustainable. Cyclical momentum will decline from the second half of the year, as output gaps close; financial conditions will tighten as the ECB withdraws accommodation; the boost from net exports will fade as Asia decelerates; and the stronger euro will drag on growth.



China

- China's economy to continue decelerating in 2018. We forecast +6.3% growth vs. +6.9% for 2017, with risks tilted to the downside. Fiscal policy will become less expansionary for the first time since 2012, while monetary policy has also tightened. This will be partially offset by strong wage and consumer spending growth.
- If growth slows in the first half of the year as we expect, PBoC will ease monetary policy in H2 to prop up growth. But this is conditional on inflation remaining below PBoC's 3% target. Higher inflation would limit scope for easing, resulting in growth falling short of our expectations.
- The messages from the National People's Congress support our outlook: the official growth target language was softened, "stabilising macro leverage" was listed as an objective for the first time, and a new unemployment target leaves scope for reform.
- We expect CNY to stay broadly stable; tighter than expected capital controls have limited outflows.

Emerging Markets

- EM growth is accelerating and inflation is rising, albeit from a low base. Asian countries are further along in the cycle, and inflation pressures are prompting central banks to tighten policy. At the other extreme, Latin America is in a more favourable cyclical position.
- With the gradual tightening of monetary policy in DM, higher rates could weigh on EM, but this does not outweigh our constructive view of fundamentals. Inflows have remained resilient.
- Political stories have evolved positively in South Africa and Russia, though downside risks will return with elections due in Colombia, Peru, Mexico, and Brazil.

Monetary Policy

- Fed: expect 4 rate hikes in 2018, more than FOMC guidance and than market pricing (3 hikes).
- ECB: slow exit to continue. No new measures until mid-year; QE to end in 2018, first hike in mid-2019.
- BoJ: not under pressure to act; no change expected in target short rate or yield curve control policy.
- BoE: no policy change through 2018; risk is earlier tightening, with May hike possible.
- PBoC: policy tightening to curb financial risks, followed by some easing in H2-2018 if inflation allows.
- EM: rate hikes especially in Asia, while LatAm central banks have space to ease policy.

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Key downside risks	▪ Higher than expected inflation leads central banks to raise interest rates faster, disrupting markets. ▪ Global growth disruption: global equity correction weighs on sentiment / wealth, triggers a recession. ▪ Escalation of trade restrictions: more intense and broad trade restrictions depress growth, raise prices ▪ China slowdown: higher inflation, policy mistake, or financial stress leads to sharp growth slowdown.
Key themes	▪ Slow-burning issues: with immediate risks broadly abated, focus turns to a range of slow-burning issues: trade protectionism, populism and politics, the peak of global growth, and rising inflation. ▪ Exit of ultra loose monetary policy: major central banks clearly on exit path, Fed to continue hiking while ECB ends QE and moves toward rate hikes. ▪ Episodic volatility: average volatility should remain low, but volatility spikes to become more frequent as markets adapt to withdrawal of monetary stimulus ▪ Cyclical recovery reaches its peak: global growth will accelerate in 2018, but for many countries growth will plateau or decelerate later this year. As such, 2018 should mark the peak of the current cyclical expansion, and growth should decelerate from 2019. ▪ Steady inflationary pressures: with tight labour markets and closing output gaps, price pressures will continue to build. Core inflation to grind higher toward targets in US, Eurozone. In EM, energy and food prices may rise, partially attributable to positive base effects, pressuring headline inflation. ▪ Populism and political risk: government formation talks progress in Italy. Brexit negotiations continue ahead of the March 2019 deadline. We do not expect material macro or market impact from either. ▪ Trade: escalation in tensions has raised concerns over growth impact. Rhetoric is likely to escalate further, but impact should remain limited.
Market views	
Market sentiment	▪ Markets have calmed after a turbulent February ▪ Immediate risks have broadly abated and focus turns to a range of more slow-burning issues
Equities	▪ Robust albeit slowing growth, gradually rising but still low rates supportive for risk assets. 4-8% upside to Europe and US equities into year-end ▪ Biggest undervaluation of Eurostoxx50vs. S&P500 upside options in years ▪ This pricing is at odds with the fundamentally sound macroeconomic background
Rates	▪ Strategically bearish in US and Europe. Inflation to finally rise in medium-term, scope for more aggressive central banks tightening than currently priced ▪ Less conviction on higher rates in short-term, given recent rise was faster and higher than expected
FX	▪ Fed's monetary policy tightening to be offset by combination of (i) US vulnerable external position and (ii) fiscal and trade policy that are dollar-negative ▪ EUR positive. Flipside of bearish dollar view; target EURUSD at 1.30 this year. Positive flows story ▪ Near-term bullish yen. Scope for further yen strength as external financial position improves, currency remains undervalued
Credit	▪ Strong economy still supports credit fundamentals but negative technical (ECB taper, Fed hikes, higher volatility) to put negative pressure on credit spreads
EM	▪ Inflows to remain anchored by slow reflation, strengthening sentiment, benign domestic developments. Risks however higher than in 2017, as monetary policy starts tightening, China continues to slow down, trade tensions potentially escalate
Oil	▪ Short-term risk. Limited upside from current levels as higher US supply meets rising global demand

Key macro and markets forecasts

GDP growth (%)

	2017	2018	2019F
Global	3.8	3.9	3.9
US	2.3	2.9	2.7
Eurozone	2.5	2.4	1.7
Germany	2.2	2.3	1.8
Japan	1.7	1.1	0.7
UK	1.7	1.3	1.5
China	6.9	6.3	6.3

Central Bank policy rate (%)

	Current	Q4-18F	Q4-19F
US	1.38	2.38	3.13
Eurozone	0.00	0.00	0.50
Japan	-0.10	-0.10	-0.10
UK	0.50	0.50	0.75
China	1.50	1.50	1.50

Key market metrics

	Current	Q4-18F	Q4-19F
US 10Y yield (%)	2.81	3.25	
EUR 10Y yield (%)	0.59	1.25	
EUR/USD	1.237	1.28	1.35
USD/JPY	106.3	105	95
GBP/USD	1.396	1.38	1.42
S&P 500	2,755		
Stoxx 600	375		
Oil WTI (USD/bbl)	60.7	54	56
Oil Brent (USD/bbl)	64.5	60	62

Current prices as of 14-Mar-2018

Recent publications	▪ The House View: Slow-burning issues, 13-Mar-2018 ▪ The House View: A healthy pullback, 7-Feb-2018 ▪ The House View: Happy holidays, 11-Dec-2017