



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
- The risk of a disruptive trade war has risen, with policymakers in the US threatening to raise tariffs even further. Foreign partners are responding with retaliatory measures. Further escalation could start to have a meaningful macro impact via higher costs, reduced sentiment, and tighter financial conditions.
- 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 +2.9%, still boosted by the combination of tax cuts and increased government spending.
- Recent US outperformance has been attributable to the lagged effect of the weaker dollar. Given recent dollar strength, it is likely that US will decelerate relative to partners
- 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. Other downside risks could stem from Italy as 2019 budget discussion with EU get underway in Q4-2018. Some upside risks from virtuous credit cycle
- The modest slowdown reflects our view that the recent pace of growth is unsustainable. Capacity constraints are already showing in the data, and adverse weather has been an additional headwind in the first half of this year
- Underlying fundamentals remain supportive of above-trend recovery in H2-2018. This is evident from recent macro data prints, recovery in survey data, capex and job cycles which implies better consumer and business confidence



China

- We expect China's economic growth to slow down +6.6% this year. Fiscal policy has softened lately, after supporting growth in the first part of the year.
- Monetary policy is likely to be deployed further to support growth, which will naturally result in a weaker currency due to interest rate differentials. The yuan will weaken further this year and in 2019
- 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.
- Several factors weigh on the growth outlook: trade tensions, heavy local election calendar, capital outflows, and limited positive spillovers from developed market investment cycle
- EM growth is becoming less synchronised. Asian economies are furthest along in the business cycle and are more exposed to trade war risks. EMEA and LatAm are more idiosyncratic, but LatAm is generally weaker, with Venezuela, Argentina, and Brazil under most stress

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 20bp depo hike in 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 barring worsening political risks
- **PBoC:** shift in stance to easing; expect one more RRR cut later in 2018 and three more in 2019
- **EM:** reflation and gradual monetary tightening on track. Increasing divergence across EM central banks

Key downside risks

- **Trade conflict escalation** between key trading partners (US, China, Canada, EU) would disrupt global growth
- **Political uncertainty** in Europe (Brexit, Italy budget) leads to increased financial market volatility
- **Stronger US dollar** forces investors to liquidate EM positions; causes overshooting selloff
- **Recession:** sharp correction in financial market will tighten liquidity and can trigger slowdown/recession

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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. Rhetoric has been intensifying recently, particularly between the US and China while EU leaders are exploring talks to avoid escalation. Further escalation will impact confidence and hurt growth more significantly. We do not expect the US to back down, and view further escalation as highly possible
 - **Currency war:** foreign exchange markets are the key asset class where trade tensions are being felt (for e.g. Chinese yuan's depreciation), and the tail risk of an outright currency war has re-emerged.
 - **Brexit:** UK seems to have made some progress towards soft Brexit, but expect no clarity on final outcome until later this year. Expect PM May to muddle through the summer.
 - **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 deceleration from 2019

Market views

- Market sentiment**
- Markets remain supported by strong macro fundamentals
 - We maintain our overarching strategic views, though downside risks from trade have intensified notably
- Equities**
- Bullish US equities. Earnings are strong, underlying growth is robust, profit margins are still rising, and buybacks are set to reach record highs this year
 - Fundamentals do not, in aggregate, signal late-cycle trend
- Rates**
- Strategically bearish. We continue to expect the Fed to tighten policy further, Treasury to raise supply, the term premium to rise, and pension demand to soften
 - In Europe, we remain bearish. QE is ending and periphery spreads could be vulnerable later this year as political risks re-emerge
- FX**
- Near-term risks are balanced, but our strategic view is still for further dollar weakness over the next year given the deteriorating flow outlook
 - Neutral euro for now. We expect growth momentum to rebound, but the ECB committed to not hiking rates for the next year
 - Neutral yen. Japanese investors look ready to increase purchases of foreign assets
- Credit**
- Dovish ECB guidance supports European credit spreads, though downside risks from trade, more aggressive Fed hiking, and European politics remain
- EM**
- Growth remains the key driver but increased differentiation is here to stay; Outlook capped by: trade conflicts, capital outflows, etc.
 - Rebound in EM assets to be on hold; Bearish bias on high-yielding EM FX and Asia FX
- Oil**
- Expect oil prices to rise in the near-term (\$80 by Year-end) before global market eventually rebalances over the next few years. Supply outlook is muted due to tepid investment over the last few years and US sanctions on Iran will further depress global supply
 - Demand will continue to grow amid healthy global growth

Key macro and markets forecasts

	GDP growth (%)					Central Bank policy rate (%)					Key market metrics			
	2016	2017	2018F	2019F		Current	2017	2018F	2019F		Current	Q3-18	Q4-18	Q2-19
Global	3.2	3.8	3.9	3.8	US	1.75-2.00	1.25-1.50	2.25-2.50	3.25-3.50	US 10Y yield (%)	2.94	3.25	3.50	3.60
US	2.3	2.9	2.8	1.7	Eurozone	0.00	0.00	0.00	0.25	EUR 10Y yield (%)	0.39	0.60	0.90	1.05
Eurozone	2.5	2.1	1.7	1.3	Japan	-0.10	-0.10	-0.10	-0.10	EUR/USD	1.17	1.17	1.20	1.25
Germany	2.2	2.0	1.8	1.2	UK	0.50	0.50	0.75	1.00	USD/JPY	111	105	102	99
Japan	1.7	0.8	0.5	0.2	China	1.50	1.50	1.50	1.50	S&P 500	2,820		3,000	
UK	1.7	1.3	1.6	1.5	India	6.25	6.00	6.50	6.75	Stoxx 600	387		395	
China	6.9	6.6	6.3	6.0						Gold (USD/oz)	1,233	1,280	1,210	1,240
										Oil WTI (USD/bbl)	69	74	74	70
										Oil Brent (USD/bbl)	74	80	80	77

Current prices as of 25 Jul, 2018

- Recent publications**
- [The House View: Tug of \(trade\) war](#), 24-July-2018
 - [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