Deutsche Bank
Research

The House View

Snapshot

Macro views

World

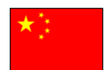
- Recent market volatility and softening in macroeconomic data suggest that the recovery has plateaued in line with our outlook for fundamentals. The global economy is still set to expand in 2019, with economic slack receding and labour markets tightening. Growth will level off in the US, recede somewhat in Europe, and hold in EM – despite a slowdown in China – over the next several quarters
- There are many potential obstructions that could derail our rosy baseline. Cyclical non-linearities could produce a faster decline in activity than anticipated or priced-in. Aggressive quantitative tightening, political risk ("crash Brexit" or Italy debt vulnerability shocks), and front loading of recession / sharp correction in financial market also pose as key downside risks

United States

- The US economy is set to continue growing at a strong and above-trend pace, albeit slightly more slowly, for the next several quarters. We forecast real GDP growth of 2.7% in 2019 and 2.1% in 2020. This is supported by strong domestic consumption and healthy capex. Tax cuts and fiscal spending acts as tailwinds and are expected to remain supportive through 2020
- A recession in 2019 does not look imminent – there are no clear investment overhangs, wage growth is rising, unemployment is at 50-year low, and productivity is set to accelerate
- The notable downside risks includes – (i) escalation of trade war resulting in higher tariffs; (ii) negative resolution of European risks (Brexit, Italy); (iii) nonlinearities in Phillips curve and rise in inflation; and (iv) flattening yield curve portending a slowdown

Eurozone

- We downgrade 2019 euro area growth forecast to 1.4% from 1.7% and see 2020 GDP growth at 1.3%. While the growth is still above trend, waning external demand is weighing on euro area growth – externally sensitive manufacturing PMIs fell to two year lows, global export orders dropped to 2016 lows, recent national survey data indicates declining business confidence in Germany, France and Italy. The ECB also noted weakness in economic activity and lowered its forecasts for 2019 GDP growth
- On the other hand, and somewhat counter-balancing, the euro area's domestic resilience remains strong – pick-up in wage growth (~2.5%), productivity growth (~0.75%) , stable corporate margins, falling unemployment rate, still-accommodative ECB policy, and easy financial conditions
- Risks are mainly on the downside and binary: "No deal" Brexit, trade war, and Italy debt crisis



China

- Expect Chinese growth to slow down from 6.6% this year to 6.3% in 2019 and 6.0% in 2020
- The US-China trade war and associated slowdown in exports are key risks. More importantly, the cooling real estate market poses the greatest risk to growth
- China's November macro activity data confirmed the negative signal in economic activity - land auctions at -2.7% yoy (-11.4% 3mma), continued weakness in auto sales, industrial production growth fell to 5.4% yoy (vs. 5.9% in October), retail sales growth lowered to 8.1% (vs. 8.6% in October)
- We expect the Chinese government to hold its policy stance in 2019 – expect further tax cuts and easing of property sector regulations early next year. Expect three RRR cuts in 2019 (100bp each cut) by the PBoC, and no change in interest rates as inflation rises only modestly

Emerging Markets

- The protraction of the global business cycle's expansion bodes well for EM economies – expect EM to grow 4.7% 2019 and 4.8% in 2020
- The liquidity fears that exposed the more vulnerable EMs in 2018 seem unlikely to repeat next year, given low chances of US recession in 2019, gradual tightening cycle, and expected dollar weakness
- Differentiation across cycles is notable. LatAm is poised to close some gap, led by Brazilian growth. Asia growth has peaked and is expected to slow through 2020, underpinned by China slowdown. EMEA economic activity is on a softening path, particularly in CE, while South Africa recovers.
- Election cycle in India, Argentina, Indonesia, and South Africa could provide election-related boost

Monetary Policy

- Fed: 3 hikes in 2019, down from our previous expectation of 4 hikes
- ECB: QE to end in Dec-2018. First 15bp depo rate hike delayed to March-2020, from Sep-2019
- BoJ: Discussion in next 2-3 years on changing policy goal from inflation to growth or price level
- BoE: One hike pencilled in for August-2019. Early Brexit resolution could mean earlier or more hikes
- PBoC: Three reserve requirement ratio cuts (100bps each in 2019)

Key downside risks

- Crash Brexit: Ongoing deadlock amongst UK MPs over the Brexit Withdrawal Agreement has intensified risks of a 'no-deal' Brexit. The UK parliamentary vote on the deal has been scheduled in the week of 14 January 2019, while both UK and EU have stepped up 'no-deal' preparations

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- Italy, France, & EP election – Confrontation between Italy and European Commission, escalation of "Yellow Vest" movement in France, or uncertainties around upcoming European Parliamentary elections could heighten volatility and harm euro area growth
- Trade conflict: Failure to secure trade deal between US-China, imposition of tariffs on EU autos or on remaining China imports, or escalation of conflicts beyond trade leading to a full-blown economic war

Key themes

- Brexit: While not our base case, Brexit deadlock is intensifying risks of a "no-deal" outcome. Iterations of the current agreement is unlikely to pass a UK parliamentary vote while the prospect of substantive changes in the existing WA seems limited. We are bullish the pound in expectation of a Brexit deal
- Italy: The European Commission recently endorsed Italy's revised budget plan – including a lower deficit target, of 2.04% of GDP in 2019. The agreement should eliminate the risk of an Excessive Deficit Procedure in the near term, though it will depend on Italy's full implementation of agreed measures over the next year. Moreover, the confrontation could likely continue as reduced deficit levels would still be too high to satisfy fiscal rules. Beside, Italy's lagging growth and high debt burden remains worrisome
- Trade war: Recent rhetoric on US-China trade conflict have somewhat softened, following a 90-day trade truce (deferring imposition of higher tariffs) being agreed in early Dec. However, subsequent developments involving Huawei and Apple case have made trade talk more difficult and signal that trade war could escalate and go beyond trade. See the probability of a trade deal on 1st March at 30%

Market views

Market sentiment

- **Higher risks:** Fundamentals are still strong, but reduced accommodation will lead to heightened risks
- Episodes of higher volatility will become more common moving forward

Equities

- **Bullish US equities**. Earnings are strong and underlying growth is robust.
- Current conditions appear oversold and inconsistent with the macro outlook

Rates

- **Strategically bearish**. We continue to expect the Fed to tighten policy further, inflation to rise, the term premium to increase from low levels
- In Europe, we expect yields to rise as ECB ends QE, though macro momentum has softened

FX

- **Dollar pressured longer term.** Near-term risks are balanced, but our strategic view is still for further dollar weakness. An exception is that we expect the dollar to rally further versus the Chinese yuan.
- **Bullish euro next year.** We still expect European growth momentum to rebound, flows to stabilize, and the current account surplus to stay high
- **Lean bullish yen**. The balance of risks for the yen are skewed toward strength versus the dollar

Credit

- **Structurally wider, but expect near term relief rally.** Expect near-term relief rally in spreads in Q1-19 and structural widening later on. EUR credit looks cheaper and should outperform the relatively expensive USD HY in 2019

EM

- **Prefer EMFX, and also EM Sovereign credit**. Solid EM growth to hold despite downward revisions. The liquidity fears that exposed vulnerable EMs in 2018 seem unlikely to repeat in 2019
- Above potential global growth, USD weakness, contained US overheating risks and gradual tightening to benefit EM FX in particular, and also HY and EM credit markets

Oil

- OPEC's production to act as stabilizing action and cancels out further sharp downswings, but 2019 balances may yet remain in small surplus and favor prices remaining below equilibrium. Lack of direction in the near-term to be influenced by negative risk and macro sentiment. Small upside likely in Q1-19

Key macro and markets forecasts

GDP growth (%)

	2017	2018	2019F	2020F
Global	3.8	3.8	3.6	3.5
US	2.2	2.9	2.7	2.1
Eurozone	2.5	1.9	1.4	1.3
Germany	2.2	1.6	1.3	1.4
Japan	1.9	0.7	0.7	0.2
UK	1.7	1.3	1.6	1.4
China	6.9	6.6	6.3	6.0

Central Bank policy rate (%)

	Current	2019F	2020F
US	2.125	3.125	3.375
Eurozone	0.00	0.00	0.25
Japan	-0.10	-0.10	-0.10
UK	0.75	1.00	1.50
China	1.50	1.50	1.50

Key market metrics

	Current	Q2-19F	Q4-19F
US 10Y yield (%)	2.76	3.40	3.30
Germany 10Y yield (%)	0.23	0.53	0.68
EUR/USD	1.145	1.18	1.25
USD/JPY	112	108	105
S&P 500	2,507		3,250
Stoxx 600	339		345
Oil WTI (USD/bbl)	47	54	54
Oil Brent (USD/bbl)	56	63	63

Current prices as of 20-Dec-2018

Recent publications

- The House View – 2019 Outlook: Growth to plateau, but not collapse, 19-December-2018
- The House View – US keeping solid global growth alive, 15-November 2018
- The House View – Markets after the recent sell-off, 16-October 2018
- The House View: Mind the (political) hurdles, 10- September-2018