The fundamentals of the global economy remain strong, but the resurgent trade war has shaken markets. We believe the tariff moves announced so far will only have a small direct effect on growth and inflation in major economies. Second-order dynamics via financial markets and confidence will be more significant and less predictable. There is also the possibility of further escalation by the US or a more combustible retaliation from China, either of which would further inflame tensions and elevate risks. Apart from the trade war, economic fundamentals are actually developing more positively than many expected this year. China’s economy grew more than forecast in the first quarter, and forward-looking indicators of European activity have steadily risen from their recent troughs. The US labour market remains the envy of the world, with wages continuing to rise and the expansion set to continue at a solid pace. Meanwhile deteriorating Brexit developments are worth keeping a close eye on.

The US economy will likely continue to grow solidly over the next several quarters, but its rate of growth should fall back toward its potential around 2%. We forecast full-year growth at 2.6% this year and 1.9% in 2020. Inflation is likely to stay around the Fed’s target of 2%. The labour market continues to be very strong, with unemployment at a multi-decade low and wages rising. This should support personal income and consumer spending over the next several quarters. The notable downside risks includes – (i) escalation of trade war; (ii) sharp tightening in financial conditions and (iii) slowing China/Euro area growth dragging US growth lower too. Conversely, there are upside risks on each of these fronts as well.

Eurozone growth momentum is signaling stabilization but masks underlying risks. Q1 GDP growth came in stronger than expected rising by 0.4% q/q (versus consensus 0.3% q/q) Entering into Q2, SIREN Momentum and Surprise improved marginally on the back of upwardly revised services PMIs and mixed hard data releases - April composite PMI revised up 0.2pts to 51.5, March retail sales came in flat (vs. exp. decline of -0.1% mom), signaling resilience in consumer demand. However, economic uncertainty among manufacturers is rising and signals weaker investment spending while negative credit impulse points to easing domestic demand. Risk of outright recession has fallen but growth is likely to remain below-trend amidst slowing China PMIs and trade uncertainty.

China’s economy surprised on the upside in Q1 as the GDP growth rate stayed at 6.4% in Q1. The improvement was driven by surprisingly expansionary fiscal and monetary policies - Total government spending rose by 23% in Q1. Going into Q2, economic data has been mixed - April Manufacturing PMI came in at 50.1 (2nd consecutive monthly print of above 50) while activity data came in weaker than expected as industrial production, growth fell to 5.4% (8.7% in March) and retail sales growth fell to 7.2% (8.7% in March) On a positive note, land and property investment growth strengthened further with property sales growing 14% yoy in April (2.8% in Jan-Feb). We revise up 2019 growth forecast to 6.3% from 6.1%, but still expect growth to slow in H2- recent US tariff hike could damage growth by around -0.2% on an annualized basis. We no longer expect cuts in the benchmark interest rates and RRR in the rest of 2019.

EM growth seems to have reached the trough, but tariff threats sour EM macro backdrop and idiosyncratic developments also continue to hinder acceleration across several EM economies. EM earnings revisions suggest that a recovery of global growth might be in the making but spillovers to EM will likely remain subdued - expect EM growth at 4.5% in 2019 and slight pick up to 4.7% in 2020. In Asia, rekindled trade tensions cloud the outlook after promising exports and PMIs. In EMEA election cycles are closing, but repeat elections in Turkey pose new risks. In LatAm, disappointing activity data suggest slowdown not over while low inflation allows for less hawkish monetary policy.

**Macro views**

- **The House View**
- **Deutsche Bank AG/London**
- **The views expressed above accurately reflect the personal views of the authors. The authors have not and will not receive any compensation for providing a specific recommendation or view. Investors should consider this report as only a single factor in making their investment decision. Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors.**
- **FOR OTHER IMPORTANT DISCLOSURES PLEASE VISIT** [http://research.db.com](http://research.db.com) **MCI (P) 091/04/2018.**

**World**

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**United States**

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**Emerging Markets**

- EM growth seems to have reached the trough, but tariff threats sour EM macro backdrop and idiosyncratic developments also continue to hinder acceleration across several EM economies
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- In Asia, rekindled trade tensions cloud the outlook after promising exports and PMIs. In EMEA election cycles are closing, but repeat elections in Turkey pose new risks. In LatAm, disappointing activity data suggest slowdown not over while low inflation allows for less hawkish monetary policy.

**Monetary Policy**

- **Fed:** On hold through end-2021
- **ECB:** No policy rate tightening until end 2020
- **BoJ:** On hold, no changes in target yields on YCC, possibly well into 2020
- **BoE:** One hike penciled in for August 2019
- **PBoC:** No longer expect cut in the benchmark interest rates and RRR in the rest of 2019
Key downside risks

- **Trade war**: Further escalation of US-China trade war beyond tariffs and an extension of tariffs to Europe (auto tariff) would hit global growth hard
- **Recession**: Trade war turning into full blown economic crisis, prolonged weakness in Chinese and European growth & associated recession / sharp correction in financial markets
- **Crash Brexit**: Although not our base case, a no-deal Brexit is still possible. Delay in deal would add to uncertainty and weigh on the UK and the EU growth
- **EU elections and EM idiosyncrasies** are other risks in 2019

Key themes

- **Trade war**: Trade war has potential to imperil growth sharply. First order impact of measures announced so far look manageable, but there is room for escalation. We do not expect immediate resolution of trade war and see the June 28 G-20 meeting in Japan as the next possible date to diffuse tensions
- **Global growth**: US remain the spearhead of global growth while EU and China seek stabilization
- **Brexit**: Next vote on withdrawal bill will be held in early June. Reportedly, Labour sources have said not to back the bill without a cross-party deal. Early election this year remains our base with 40% probability of WA not ratified by or shortly after EP elections and May being replaced in leadership contest
- **EU elections**: Mainstream parties are likely to lose seats to more populists and anti-establishment politicians, making it harder to pass deeper European reforms

Market views

**Market sentiment**

- Trade war risks dominate the current narrative, but fundamentals remain strong moving forward
- Episodes of higher volatility will likely become more common moving forward

**Equities**

- Bullish US equities. Earnings have been better than expected and should remain strong
- More neutral in Europe, where equities have overshot their fundamental levels

**Rates**

- Ten-year Treasuries are near fair value based on our models and macro forecasts
- In Europe, we favour relative value trades amid few clear catalysts
- Across both major economies, inflation breakevens have scope to rise further

**FX**

- We do not have a strong view on the dollar for now, with the US current account staying flat and the Fed on hold. Longer term, we still expect dollar weakness
- The conditions are ripe for the euro to grind lower this summer, with equity inflows stagnant and low absolute level of yields. See EUR/USD potentially breaking 1.10 through the summer.
- The trade war may have further to run, and already-announced measures imply depreciation to beyond 7.0 per dollar
- The yuan is the most overvalued currency in our models

**Credit**

- Optically, single ‘B’s appear cheap across both USD and EUR credits, based on B/BB spread ratio. Trade tensions could increase credit spread volatility in the near term

**EM**

- US-centric growth and a strong USD limit upside for EM assets. EM growth seem to have reached the trough, but idiosyncratic factors continue to hinder acceleration
- EMFX valuation remains unappealing from a cyclical standpoint. EM credit spreads will likely be confined to their recent range due to trade uncertainty & idiosyncrasies

**Oil**

- Oil fundamentals remain supportive for oil prices, limiting any sharp downside. Saudi production to only moderately compensate for Iranian supply losses

Key macro and markets forecasts

<table>
<thead>
<tr>
<th>GDP growth (%)</th>
<th>2018</th>
<th>2019F</th>
<th>2020F</th>
<th>Central Bank policy rate (%)</th>
<th>Current</th>
<th>2019F</th>
<th>2020F</th>
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<td>Oil Brent (USD/bbl)</td>
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Recent publications

- **The House View – Trade war heat is on**, 16 May 2019
- **The House View – Balancing out**, 9 April 2019
- **The House View – Spring in sight?**, 12 March 2019