GLOBAL ECONOMIC FORECASTS: Q3 2019

August 19, 2019

Report closing date: August 10, 2019
Global Outlook

- Global Baseline Outlook
- Global Forecasts: GDP Growth, Inflation, Interest Rate
- Global Risks

The US
China
India
Japan
The Eurozone
The UK
Russia
Brazil

Notes
Global Baseline Outlook

- The first half of 2019 has seen downgrades to the global outlook especially in emerging and developing economies.
- Global GDP growth is expected to be 3.1% in 2019, rebounding to 3.3% annually in 2020-2021.
- The overwhelming contribution to global growth will continue to come from developing and emerging economies (EM), with their output expected to rise by 4.3% in 2019, improving to 4.7% growth annually in 2020-2021.
- Advanced economies (AE) growth is expected to be 1.7% in 2019, declining to 1.5% annually in 2020-2021.
- Overall global downside risks have increased, with rising trade tensions and financial markets volatility since May 2019.
The global monetary policy stance has become significantly more accommodative since May 2019, supporting equity markets and business investment. The US Federal Reserve has cut its policy rate by 0.25 percentage points in July, with another cut expected by the end of 2019. The ECB has also signaled further potential easing either by interest rates cuts or an expansion of its long-term lending programme for banks.

Global stock markets have rallied in the first half of 2019, completely erasing the end of 2018 market correction. Emerging markets risk premia declined a little in the first half of 2019, and stock market volatility remains low.

The China-US trade war has escalated with the US planning to impose new tariffs on Chinese imports despite the restart of trade negotiations. Global trade volume growth has declined, constraining growth for export-dependent EM and the Eurozone.

Stock markets remain fragile and below their 2018 peaks. The recent announcements of new US trade tariffs on China have caused new stock price declines and an increase in financial markets volatility. Stock markets are likely to be fairly priced according to fundamentals, but they remain highly vulnerable to rising trade or geopolitical tensions and may reflect excessive optimism about central bank interest rate cuts.

Large declines in long-term AE interest rates, with segments of the US yield curve inverting (longer-term rates below the short-term rates), signal heightened global downturn risks.

Global financial crisis recovery dynamics have essentially played themselves out in AE’s, leaving mainly long-term trend growth in 2020 and beyond. AE labour productivity and wage growth rates continue to remain significantly below previous historical trends at 0.5-1.5% annually.

EM economic convergence trends have mainly disappeared outside China and India, with labour productivity growth declining close to the low AE growth rates.
## Real GDP Annual Growth Forecasts and Revisions from Last Quarter (1) (%, percentage points)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advanced Economies</strong></td>
<td>2.2</td>
<td>1.7</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>-0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>USA</td>
<td>2.9</td>
<td>2.4</td>
<td>1.7</td>
<td>1.5</td>
<td>1.6</td>
<td>0.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>Canada</td>
<td>1.9</td>
<td>1.2</td>
<td>1.5</td>
<td>1.7</td>
<td>1.7</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Eurozone</td>
<td>1.9</td>
<td>1.2</td>
<td>1.3</td>
<td>1.3</td>
<td>1.2</td>
<td>0.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>Germany</td>
<td>1.5</td>
<td>0.8</td>
<td>1.2</td>
<td>1.3</td>
<td>1.1</td>
<td>-0.1</td>
<td>-0.1</td>
</tr>
<tr>
<td>France</td>
<td>1.6</td>
<td>1.2</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Italy</td>
<td>0.7</td>
<td>-0.1</td>
<td>0.3</td>
<td>0.5</td>
<td>0.8</td>
<td>0.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>Spain</td>
<td>2.6</td>
<td>2.3</td>
<td>1.9</td>
<td>1.7</td>
<td>1.3</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>UK</td>
<td>1.4</td>
<td>1.2</td>
<td>1.3</td>
<td>1.5</td>
<td>1.6</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Japan</td>
<td>0.8</td>
<td>0.8</td>
<td>0.4</td>
<td>0.6</td>
<td>0.6</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>South Korea</td>
<td>2.7</td>
<td>1.9</td>
<td>2.2</td>
<td>2.2</td>
<td>2.2</td>
<td>-0.5</td>
<td>-0.2</td>
</tr>
</tbody>
</table>
### Real GDP Annual Growth Forecasts and Revisions from Last Quarter (2) (%, percentage points)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Emerging and Developing Economies</td>
<td>4.6</td>
<td>4.3</td>
<td>4.6</td>
<td>4.6</td>
<td>4.5</td>
<td>-0.2</td>
<td>-0.1</td>
</tr>
<tr>
<td>China</td>
<td>6.6</td>
<td>6.1</td>
<td>5.9</td>
<td>5.7</td>
<td>5.1</td>
<td>-0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>India</td>
<td>7.3</td>
<td>6.7</td>
<td>7.1</td>
<td>7.2</td>
<td>6.6</td>
<td>-0.6</td>
<td>-0.2</td>
</tr>
<tr>
<td>Indonesia</td>
<td>5.2</td>
<td>5.1</td>
<td>5.2</td>
<td>5.2</td>
<td>5.0</td>
<td>-0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.1</td>
<td>1.0</td>
<td>2.0</td>
<td>2.3</td>
<td>2.4</td>
<td>-1.2</td>
<td>-0.3</td>
</tr>
<tr>
<td>Mexico</td>
<td>2.0</td>
<td>1.0</td>
<td>1.7</td>
<td>1.9</td>
<td>2.4</td>
<td>-0.7</td>
<td>-0.3</td>
</tr>
<tr>
<td>Russia</td>
<td>2.2</td>
<td>1.1</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>-0.4</td>
<td>-0.1</td>
</tr>
<tr>
<td>Turkey</td>
<td>2.7</td>
<td>-1.5</td>
<td>1.7</td>
<td>2.9</td>
<td>3.3</td>
<td>-0.5</td>
<td>-0.2</td>
</tr>
</tbody>
</table>
Inflation Forecasts

**Advanced Economies**

- US
- Eurozone

**Developing and Emerging Countries**

- Brazil
- Russia
- India
- China

Source: Euromonitor International Macro Model
Central Bank Interest Rate Forecasts

**Advanced Economies**

- **US**
- **Eurozone**

**Developing and Emerging Countries**

- **Brazil**
- **Russia**
- **India**
- **China**

*Source: Euromonitor International Macro Model*
Global Risks

- The announcement of new US tariffs on Chinese imports has significantly increased the likelihood of our US-China All Out Trade War scenario.
- Rising trade tensions and a worsening slowdown in global trade and manufacturing, together with more negative signals from financial markets have increased global downturn and emerging markets slowdown risks.
- The selection of Boris Johnson as the UK’s PM and his appointment of a pro-hard Brexit cabinet have raised the risks of the UK exiting the EU without a deal after October 2019. No-Deal Brexit scenario probabilities have increased.

* Impact is measured as world GDP change over 3 years compared to baseline scenario, in percentage points.
## Global Risk Index Scores and Rankings

### Euromonitor International Global Risk Index, August 2019

<table>
<thead>
<tr>
<th>SCENARIO</th>
<th>GLOBAL RISK INDEX</th>
<th>GLOBAL GDP IMPACT</th>
<th>PROBABILITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Downturn</td>
<td>2.2</td>
<td>4.9</td>
<td>13.5</td>
</tr>
<tr>
<td>Emerging Markets Slowdown</td>
<td>1.3</td>
<td>2.8</td>
<td>14.3</td>
</tr>
<tr>
<td>Global Crisis</td>
<td>1.1</td>
<td>10.4</td>
<td>3.3</td>
</tr>
<tr>
<td>China Hard Landing</td>
<td>0.7</td>
<td>2.3</td>
<td>9.8</td>
</tr>
<tr>
<td>Eurozone Recession</td>
<td>0.6</td>
<td>2.3</td>
<td>8.3</td>
</tr>
<tr>
<td>Disorderly No-Deal Brexit</td>
<td>0.6</td>
<td>1.2</td>
<td>15.0</td>
</tr>
<tr>
<td>US-China All-Out Trade War</td>
<td>0.6</td>
<td>0.6</td>
<td>31.0</td>
</tr>
<tr>
<td>Global Trade War</td>
<td>0.3</td>
<td>1.3</td>
<td>8.3</td>
</tr>
<tr>
<td>Eurozone Crisis</td>
<td>0.3</td>
<td>3.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Trump Adverse Policies</td>
<td>0.3</td>
<td>3.3</td>
<td>3.0</td>
</tr>
<tr>
<td>No-Deal Brexit</td>
<td>0.3</td>
<td>0.3</td>
<td>25.0</td>
</tr>
<tr>
<td>Korean Conflict</td>
<td>0.2</td>
<td>4.7</td>
<td>1.3</td>
</tr>
</tbody>
</table>

*Source: Euromonitor International Macro Model*

*Note: Global Risk Index ranks scenarios by the expected global GDP impact, calculated as the 3-year cumulative global real GDP impact of the scenario multiplied by its 1-year probability, relative to the average global downside shock probability. The Index is based on 58 world’s major economies (representing 90% of global GDP at PPP).*
The US economy has continued to grow faster than its long-term trend in 2019. According to the preliminary estimate GDP growth was 2.3% year-on-year in the second quarter of 2019.

Private sector confidence remains above average. Strong labour markets are sustaining robust consumer disposable income and spending growth rates.

However, the worsening global trade outlook and escalating trade tensions with China are hurting manufacturing and business investment.

Downside risks have increased, leading us to increase probabilities on all pessimistic scenarios, and reduce the probability of our main optimistic scenario.

In our baseline scenario, US GDP is expected to increase by 2.2-2.6% in 2019 and by 1.3-2.1% in 2020. Afterwards, growth is forecast to stabilize at 1-2% annually, due to low long-term labour productivity and employment growth rates. Baseline scenario one-year ahead probability: 20-30%.
Forecast Risks

- On 1 August, US President Donald Trump announced a 10% tariff on an additional USD300 billion in Chinese imports, on top of the USD250 billion in imports already subject to a 25% tariff. The Chinese have promised to retaliate proportionately, through a mix of trade tariffs and other restrictions on US products and businesses in China.

- The direct macroeconomic impact of these extra tariffs on US 2019-2020 annual GDP growth is on the order of 0-0.2 percentage points. However, risks of a major all-out US China trade war with much higher tariffs on all imports have increased.

- We now estimate the one-year ahead probability of an all-out trade war with another comprehensive 15-25 percentage points rise in tariffs at 26-36%. Such a scenario starting in Q4 2019 would cut US GDP growth to 1-1.7% in 2020.

- The more pessimistic signals from bond markets and the renewed tensions between the US and China have also caused an increase in the estimated probability of a global downturn to 11-16% over a 1-year horizon. A global downturn starting in Q4 2019 would lead to a GDP decline of 0-1.3% in 2020.
Pessimistic and Optimistic Scenarios

**US Real GDP Growth Forecast**

- **Pessimistic scenario**
  - In the most likely pessimistic scenario, rising trade tensions with China and increasing risk aversion in financial markets reduce business confidence and investment.
  - US GDP growth declines to 2-2.5% in 2019 and 0.4-1.3% in 2020.
  - Probability: 20-25% over a one-year horizon.

- In a major downturn, the factors driving the pessimistic scenario are also accompanied by a significant decline in consumer confidence and spending and substantial increases in financial market risk premia. GDP growth falls to 1.8-2.5% in 2019, and ranges from -0.5 to 0.4% in 2020.
  - Probability: 15-20% over a one-year horizon.

- **Optimistic scenario**
  - In the optimistic scenario, the US and China reach a trade agreement, stock markets continue rising and private sector sentiment improves.
  - US GDP growth improves to 2.3-2.7% in 2019 and 2.1-3% in 2020.
  - Probability: 15-20% over a one-year horizon.
Consumer Spending, Labour Markets and Private Sector Sentiment

• Consumption has increased at around 2.5% year-on-year in recent quarters, above long-term potential growth. This robust performance is backed by high disposable income growth and strong labour markets, with historically low 3.7% unemployment rates.

• Most of the rise in real disposable income continues to come from employment growth. Real labour compensation per hour has grown at just around 0-1% (depending on inclusion of benefits or just wages) so far in 2019. Labour productivity growth has picked up to around 2% in recent quarters, but this has yet to fully show up in labour compensation growth.

• Consumer sentiment has declined but remains moderately above the historic average. Small business owner sentiment has been stable, significantly above long-term average. The CEO economic outlook (reflecting large business sentiment) has declined in the first half of 2019, though remaining above historic averages.
Business Investment and Financial Markets

- **Business investment growth has slowed down in 2019, with a contraction in Q2 according to preliminary estimates.** The decline in growth is driven by a worsening trade outlook, worsening trade tensions and rising global uncertainty.

- **US stock markets have rebounded strongly in H1 2019, recovering from the market correction in late 2018, though declining in early August by around 4% in response to news in new tariffs on Chinese imports.** Corporate bond yield spreads relative to treasuries have declined slightly in H1 2019 and are at around the median of their historic distribution.

- **Overall, financial markets outside government debt do not exhibit any major financial stresses in mid-2019.** However, the announcement in the beginning of August of fresh US tariffs on Chinese imports has caused some turbulence, and ongoing escalation in the US-China trade war could significantly increase financial stress.

- **Recent declines in interest rates have played a major role in supporting stock prices and business investment.** Private sector external financing conditions remain relatively loose except for some high risk borrowing segments.
The Federal Reserve cut the Fed funds rate by 0.25 percentage points in July, in line with expectations. The Fed highlighted strong labour market and consumer spending conditions, but it justified the interest rate cut as insurance against downside risks from weaker global growth and higher trade policy uncertainty. Core inflation at around 1.6%, moderately below the 2% target, is another justification given by the Fed for cutting interest rates, even though they are still below the long-term neutral rates.

A second 0.25 percentage points interest rate cut is expected in 2019, with the Fed funds rate expected to stay at around 1.9% until the beginning of 2022, rising gradually towards 2.5% afterwards.

US medium/long-term interest rates have declined by around 1 percentage points since the end of 2018, along with falling Fed funds rate expectations. This suggests significant investor concerns about slower growth or a recession, despite the good overall financial stability signals from stock valuations and credit spreads.
CHINA

General Outlook

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth (%)</td>
<td>6.6</td>
<td>6.1</td>
<td>5.9</td>
<td>5.7</td>
<td>5.1</td>
<td>-0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Inflation (%)</td>
<td>2.1</td>
<td>2.2</td>
<td>2.3</td>
<td>2.4</td>
<td>2.5</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>1-Year Lending Rate (%)</td>
<td>4.4</td>
<td>4.4</td>
<td>4.4</td>
<td>4.4</td>
<td>4.8</td>
<td>0.0</td>
<td>0.1</td>
</tr>
</tbody>
</table>

• China's growth is declining smoothly, with 6.3% year-on-year growth in the first half of 2019, according to the official statistics. Rebalancing towards consumption and services is also continuing, with service sector and private consumption growth rates of around 7%. However, the trade war with the US and a more general worsening of global exports demand caused a contraction in merchandise exports in Q2.

• GDP growth is expected at 5.8-6.3% in 2019, followed by 5.4%-6.3% growth in 2020.

• The economy has become mainly domestically driven in recent years, and the government has launched a moderate fiscal stimulus package. However, growth remains vulnerable.

• Debt is continuing to pile up faster than income levels, and recent months have seen some turbulence in interbank markets. Consumer spending growth has slowed down compared to 2018, due to higher uncertainty and pessimism about future income prospects.

• State owned enterprises (SOEs) are continuing to drag down productivity growth with excessive and inefficient investment. And the official statistics may be severely overestimating the economy’s strength, with actual output growth closer to 4-5% according to independent academic estimates.

• Baseline scenario one-year ahead probability: 25-30%.
Forecast Risks

• On 1 August, US President Donald Trump announced a 10% tariff on an additional USD300 billion in Chinese imports, on top of the 250 billion USD in Chinese imports already subject to a 25% tariff. The direct macroeconomic impact of these extra tariffs on China’s 2019-2020 annual GDP growth are on the order of 0.1-0.3 percentage points.

• The one-year ahead probability of an all-out US China trade war, with another 15-25 percentage points rise in tariffs on all bilateral trade, has increased to 26-36%. In this scenario, Chinese GDP growth would decline to 4.8%-5.6% in 2020.

• The more pessimistic signals from bond markets and the renewed tensions between the US and China have also caused an increase in the estimated probability of a global downturn to 11-16% over a 1-year horizon. A global downturn starting in Q4 2019 would cause Chinese GDP Growth in 2020 to crash towards 0.6-1.9%.

• China also remains highly more vulnerable to a more domestically driven hard landing scenario, due to its dangerously high debt levels and complexities of the ongoing economic rebalancing. A hard landing would push China’s GDP growth in 2020 towards 1.7-3.0%. We estimate the one-year ahead probability of this scenario at 7-13%.
Pessimistic and Optimistic Scenarios

In the most likely pessimistic scenario, rising trade tensions with the US and falling private sector confidence cause a faster slowdown in growth. GDP growth declines to 5.6-6.1% in 2019 and to 4.2-5.1% in 2020.

- Probability: 20-25% over a one-year horizon.

In the most likely optimistic scenario, China and the US reach a trade deal, fiscal stimulus effects are stronger than expected, and private sector confidence improves. GDP growth reaches 6.1 -6.5% in 2019, rising to 6.4-7.2% in 2020.

- Probability: 15-20% over a one-year horizon.

In a major downturn, the worsening trade environment and decline in private sector confidence is accompanied by a significant decline in real estate prices and tightening of credit market conditions. China’s GDP growth is 5.5-6% in 2019 and just 2.9-3.9% in 2020.

- Probability: 15-20% over a one-year horizon.
Economic Activity and Private Sector Sentiment

- China GDP H1 2019 year-on-year growth was 6.3%, in part due to falling exports growth, but the overall slowdown in growth is mostly domestically driven. Despite the headlines about the slowest growth in almost 30 years, the result is in line with expectations and the baseline forecast for a gradual slowdown in China’s growth.

- Growth was 5.8% in construction and manufacturing sectors, compared to 7% in services. The Services sector now accounts for 54.9% of GDP (compared to 39.9% for manufacturing and construction) and over 60% of GDP growth. Nominal investment growth was 5.8% year-on-year in H1 2019 (around 5.5% in real terms using the producer price index).

- Per capita disposable income growth in H1 2019 was 6.5%, supporting a shift towards higher consumption/GDP. Real retail sales year-on-year growth in H1 2019 was 6.7%.

- Industrial production growth has settled back at around 6% after a brief upturn in early 2019. Real retail sales are still rising moderately faster than GDP growth, but they have also slowed down to below 7% in recent quarters.

- Year-on-year total social financing growth (China’s most comprehensive measure of external financing) was 10.7% in July, significantly above nominal GDP growth rate of around 8%. RMB loans growth (accounting for 68% of total social financing) increased by 12.7% year-on-year.

- These numbers imply that China’s current pace of growth remains reliant on an unsustainable rate of credit creation.
• India’s economy continues to slow down. Real GDP growth declined from 6.6% in Q4 2018 to 6% in Q1 2019, the lowest figure for the last seven quarters.

• The slowdown in Q1 2019 was due to decreased investment and lower exports. While economic growth was prompted by higher government spending and slightly increasing private consumption.

• Despite the economic slowdown, the outlook looks optimistic. It is expected that the economy will pick up gradually and real GDP will grow by 6.7% in 2019 and 7.1% in 2020.

• Political uncertainty before general election at the beginning of 2019 highly decreased investment growth, from 11% in Q4 2018 to 4% in Q1 2019. Looking ahead, these figures should increase in subsequent quarters as the second round elected government has a guaranteed majority of seats in India’s parliament and lowered the interest rate.

• It is expected that Prime Minister Modi’s government reforms related to labour laws, income tax and household provision with electricity and cooking gas will increase general private consumption, which will contribute to economic growth and raise inflation.
Pessimistic and Optimistic Scenarios

In the pessimistic scenario, the slowdown of India’s economy would be the result of lower consumption, and cooling in the manufacturing and agriculture sectors. Actions and reforms of the second round elected government present a major risk to economic performance.

- India’s annual real GDP growth could drop to 6.1% in 2019 and 3.6% in 2020. We assign this scenario a 10-20% probability over a one-year horizon.

In an optimistic scenario, the elected government will make bolder reforms in changing labour codes, tax policies, easing the privatisation process and ensuring availability of land for industrial development. These changes would increase capital inflows and boost economic growth.

- Under this scenario, India’s annual real GDP growth could accelerate to 6.9% in 2019 and 8.8% in 2020. We assign this scenario a 15-25% probability over a one-year horizon.
Inflation and Monetary Policy

• The Reserve Bank of India (RBI) cut interest rates by 25 basis points to 5.75% in June, due to a slowdown in investment activity and still moderate private consumption growth. It is expected that the rate will be cut again during the next policy meeting in August.

• During the third quarter of 2019, the pricing power of producers in India was growing especially in the food sector. In June, annual price growth was 3%, compared to 2.5% in April, and was closing on the average of the RBI’s 2-6% target.

• The Indian rupee reached its lowest level since July 2018. This fall was mainly due to China’s central bank consenting to currency depreciation as a response to the continuing China-US trade war. The sensitive response to other currency fluctuations has raised concerns about India’s ability to pay off its debt should the government agree to issue foreign currency denominated bonds.
Foreign Direct Investment and Business Dynamics

• With a strong majority, the re-elected Prime Minister of India is aiming for the second term to restore moderate economic growth with inflows from foreign investors.

• However, foreign direct investment in 2018 showed only moderate growth compared to previous years. Business confidence index growth plunged due to uncertainty around the election results, but it is expected that more stability in the government and clear reforms will increase these figures in the future.

• At the same time, a difficult regulatory environment remains an obstacle for business development. Despite a significant jump in position in the World Bank’s Ease of Doing Business ranking (from 134th in 2014 to 100th in 2018), India stands lower than other regional countries in the business environment rankings. India pushed forward due to reforms related to expanding access to electricity and trading across borders, but the labour market and allocation of construction permits remain key obstacles for new businesses.
Economic Activity

- Japan’s economy appears to have resisted the worsening global demand environment better than expected in the first half of 2019. Business and consumer confidence have been declining, but business investment has been stronger than expected.

- According to the preliminary estimate, Q2 output increased 1.8% year-on-year, significantly beating expectations. Nevertheless, due to the worsening global conditions, we have made only modest upgrades of forecasts to 0.8% in 2019 and 0.4% in 2020.

- Slowing external demand has already resulted in contracting industrial output and is likely to push down capital investment as uncertainty about future economic conditions makes investors weary.

- Paired with the expected consumer spending decrease following the tax hike (from 8% to 10%, scheduled for October this year), the economy is likely to lack any sustainable growth momentum over a 1-year horizon.

Source: Euromonitor International from national statistics

Source: Euromonitor International from cabinet Office, Bank of Japan
Pessimistic and Optimistic Scenarios

Pessimistic scenario:
- The most immediate risks to Japan’s growth are related to the US protectionist policies and China-US trade war, as well as a lack of momentum in private spending.
- In case the economic conditions worsen, exports are expected to decline further, inflation remains slow and consumption continues to be weak. GDP would decline by 0.4% in 2020.
- We assign a probability of around 10-15% to such a scenario over a one-year horizon.

Optimistic scenario:
- Our optimistic scenario assumes that the foreign trade conditions normalise, while on the domestic front, the government’s measures successfully translate into reforming the labour market, restoring wage growth and reviving inflation.
- This would provide a boost to consumer spending and investments. Under this scenario, annual real GDP growth would improve to 1.2% in 2020.
- We assign a probability of around 10-15% for optimistic growth scenario over a one-year horizon.
Foreign Trade

- In the last few months, exports have suffered from a slowdown in global economy and uncertainty over trade conditions. Lack of trade deal between China and the US as well as cooling Chinese economy continue to weigh on Japanese exports, with trade balance stuck in the negative territory. In addition, as a result of a diplomatic dispute with South Korea, the country’s third-largest export destination, Japan has recently imposed export restrictions on some materials for South Korea’s tech sector, adding more concerns over the trade outlook.

- Japanese Yen has strengthened over the last few months, which bodes ill for the country’s exports; in addition, a risk of further exchange rate rally is present. The US Federal Reserve has recently lowered short-term interest rates for the first time in over a decade, and European Central Bank is signaling a possible cut as well. South Korea, Indonesia, South Africa and Turkey are among the countries who have already cut interest rates in July this year. Lower yields increase the relative attractiveness of Japan’s sovereign bonds to investors, pushing the currency up and making exports less profitable. As a result, there are speculations that the Bank of Japan might roll out additional stimulus sometime soon to support the currency and foreign trade.
THE EUROZONE

General Outlook

- Eurozone GDP is expected to increase by 1.1-1.4% in 2019 and by 0.8-1.7% in 2020. Q1 2019 output growth was better than expected at 0.4% quarter-on-quarter, but this mainly reflected temporary factors such as a mild winter and a rebound in car production. Growth slowed down again in Q2 to 0.2% quarter-on-quarter.

- The growth outlook remains below the long-term average, mainly due to the worsening in global trade and manufacturing sector conditions. Manufacturing output in particular has contracted in 2019.

- Domestic demand and service sector conditions have been stronger. Consumption and fixed investment growth remain slightly above long-term trends, with supporting factors including above average consumer confidence, continuing employment and income growth.

- However, business investment growth is expected to decline more significantly due to the worsening global demand/trade outlook.

- Baseline scenario one-year ahead probability: 20-30%.

---

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth (%)</td>
<td>1.9</td>
<td>1.2</td>
<td>1.3</td>
<td>1.3</td>
<td>1.2</td>
<td>0.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>Inflation (%)</td>
<td>1.8</td>
<td>1.3</td>
<td>1.5</td>
<td>1.6</td>
<td>1.8</td>
<td>-0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>ECB Refinancing Rate</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
<td>0.9</td>
<td>0.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

---
Forecast Risks

- Forecast risks have increased substantially since May 2019, due to a combination of worsening global uncertainty and higher no-deal Brexit risks.
- The Eurozone is vulnerable to increasing global downturn risks, just like other regions. In a global downturn Eurozone GDP would decline by 0.6-1.9% in 2020. We assign this scenario an 11-16% probability over a 1-year horizon.
- The selection of Boris Johnson as the new Conservative UK Prime Minister and his appointment of a pro-hard Brexit cabinet have significantly raised the probability of the UK exiting the EU without a deal in October 2019, to around 40%. In the more likely moderate No-Deal scenario the impact on the Eurozone would modest with 2020 GDP growth declining by 0.1-0.5 percentage points relative to the baseline forecast.
- However, there is a 10-20% probability of a more extreme disorderly No-Deal scenario with significantly worse declines in bilateral UK-Eurozone trade volumes and significant financial markets turbulence. In this scenario Eurozone GDP would contract by 0.1-0.9% in 2020.

- The Eurozone remains vulnerable to regional factors such as weak bank balance sheets and tensions in Italian debt markets. These more regional risk factors have remained stable and have even improved slightly, for example with a lower estimated Italexit risk. Nevertheless, the probability of a deep Eurozone recession with GDP contracting by more than 2% in 2020 remain 6-10% over a 1-year horizon.
THE EUROZONE

Pessimistic and Optimistic Scenarios

**Eurozone Real GDP Growth Forecast**

- **Pessimistic scenario**
  - In the most likely pessimistic scenario, a worsening global trade outlook and declining private sector sentiment cause a stronger than expected growth slowdown in the Eurozone.
  - Eurozone GDP growth is 0.8-1.3% in 2019 and ranges from -0.3 to 0.7% in 2020.
  - We assign this scenario a 20-25% probability over a 1-year horizon.

- **Optimistic scenario**
  - In the most likely optimistic scenario, an improving global trade outlook and rising private sector sentiment boost economic activity.
  - Eurozone GDP growth improves to 1.1-1.5% in 2019 and 1.5-2.3% in 2020.
  - We assign this scenario a 15-20% probability over a 1-year horizon.

**Source:** Euromonitor International Macro Model
Private Sector Sentiment and Investment

- The Eurozone economic sentiment index declined to 102.7 in July (from 103.3 in June), its lowest level in three years. The decline was especially strong in industrial sector confidence. Overall Eurozone Economic sentiment has declined since mid-2018 and is now barely above the historic average.

- Eurozone fixed investment growth has held up surprisingly well despite the recent slowdown, though this partly reflects a recovery in residential investment growth. Business fixed investment has slowed down despite low external financing costs, due to lower global exports demand, higher uncertainty and worsening domestic Eurozone private demand and profit expectations.
Consumption, Labour Markets and Consumer Confidence

• Consumption growth in the Eurozone has fallen below the average of the last 5 years, similar to overall GDP growth.

• Consumer confidence indices have remained above the historic average in most key EUZ economies, though they’re mainly stable or declining.

• Employment rates have recovered to pre GFC levels, but real wage growth remains weak.

• The Eurozone unemployment rate declined to 7.5% in June, down from 8.2% year-on-year and the lowest rate since July 2008. The unemployment rate ranged from 3.1% in Germany and 8.7% in France, to 9.7% in Italy and 14% in Spain.

• Beyond 2020, employment growth should slow down close to zero, meaning that further increases in disposable income will have to come mainly from rising worker compensation growth. Real compensation growth is expected to remain at just 0.5-1% annually in 2019-2021.
The European Central Bank (ECB) maintained policy rates unchanged in July but hinted at further monetary policy easing in upcoming meetings.

Monetary policymakers are concerned about the weak global trade environment and annual inflation at 1-1.5%, significantly below the 2% target. This justifies a relatively loose monetary policy with interest rates moderately below our estimate of the long-term neutral rate of 1.25-1.75%. However, this level of inflation and the current 1.2% real GDP growth probably do not justify the current low rates of around zero.

There is strong pressure from financial markets on the ECB to maintain interest rates close to zero for longer and even reduce them further below zero. Long-term Eurozone interest rates in August 2019 are around 1 percentage point lower than a year ago, with investors in German 10-year government bonds (the benchmark risk-free investment in the Eurozone) now effectively paying almost 0.6% annually to fund the German government.

Our current forecast is for a gradual rise in the ECB refinancing rate from zero after 2020, but there are significant downside risks to this forecast, such as a global downturn, no-deal Brexit or a more Eurozone specific recession. All these scenarios could delay interest rates rising above zero until 2022-2023.
General Outlook

On 25 July, Boris Johnson became the new Conservative Prime Minister, following Theresa May’s resignation. The new PM has installed a pro Hard Brexit cabinet and has promised to leave the EU by 31 October 2019 under all circumstances.

With little chance of negotiating a new deal on the Conservative Hard Brexiteers’ terms by October, the UK would appear to be headed towards a costly No-Deal Brexit. However, the majority of Members of Parliament are opposed to a No-Deal Brexit, and the Conservative government is vulnerable to a no-confidence vote, which would block Conservative plans to exit the EU by 31 October.

The UK economy has been surprisingly resilient until recently, with the unemployment rate at 3.8% in mid-2019 and private sector confidence only moderately below historic averages.

However, significant strains have started showing up around the original March 2019 Brexit deadline. UK output declined in Q2 by 0.2% quarter-on-quarter, after the robust 0.5% quarter-on-quarter growth of Q1. This was the first contraction since 2012. Year-on-year GDP growth in Q2 was 1.2%

The main factors in the decline were a big drop in fixed investment and declining inventories, following the build-up in anticipation of the Brexit deadline in Q1.
Forecast Risks

• Under the baseline scenario of a new government and an eventual EU-UK Brexit deal centred on a currency union, we expect UK GDP to increase by around 0.9-1.4% in 2019 and by 0.5-1.9% in 2020. This baseline forecast is only assigned a 26-36% probability. The wide intervals for 2020 reflect normal business cycle shocks interacting with uncertainty about the outcome of UK elections and ongoing negotiations with the EU.

• We now assign a 20-30% probability to a relatively well managed moderate no-deal Brexit scenario. In this case, UK GDP growth would range from -0.7% to 0.8% in 2020. In a Disorderly No-Deal Brexit scenario, GDP in 2020 would contract by 3-5%. We assign this more extreme scenario a 10-20% probability.

• On the upside, if the current pro-hard Brexit conservative government collapses, the UK could end up with a new government committed to a lighter Brexit or holding a second referendum between any deal and remaining in the EU. In this Light/No Brexit scenario, we would expect UK output growth to rise to 1.4-2.8% in 2020. We assign the light/no Brexit scenario a 24-34% probability.
Labour Markets, Inflation and Economic Activity

- The labour market remains strong with a 3.8% unemployment rate and 3.6% nominal year-on-year wage growth in June (around 1.6% after inflation), despite all the Brexit uncertainty. Inflation remains close to target at 2% year-on-year in June, (though core inflation excluding food and energy was lower at 1.7%).

- Industrial production has been extremely volatile in anticipation of the UK potentially exiting the EU in March 2019. Growth has increased since April, but it remains vulnerable. Retail sales accelerated in anticipation of potential stock outs after Brexit in March and have since declined towards 1.5-2% year-on-year growth.

- Business confidence has rebounded from its March low just before the UK was due to exit the EU. However, it remains moderately below the historic average, and the increase in no-deal Brexit risks after Boris Johnson became PM is likely to cause a new decline. Consumer sentiment has remained moderately below the historic average in 2019 and would decline significantly under no-deal Brexit scenarios.
GDP Growth

- In our baseline, in 2019 we expect real GDP to grow by about 1.1% and further increase to around 1.5% year on year over the next two years.
- According to Rosstat’s first estimate, annual GDP growth slowed down significantly in Q1 2019 to 0.5% from 2.7% year on year in the previous quarter.
- As before, among the growth factors, the main role is played by expansion of private final consumption and exports. However, the contribution of both these factors noticeably decreased relative to previous periods. In addition, the contribution of fixed capital formation became negative, which, generally speaking, may turn out to be the first sign of stagnation.
- The weakening of consumer and investment activity was caused by several factors: VAT rate increase from 1 January 2019 and related acceleration in price growth; weak dynamics of real disposable household income; tightening of monetary conditions in H2 2018; adjustment of inventories (mainly due to accelerated year-end increase in inventories potentially related to the forthcoming VAT hike); slowdown of government investments; base effect, when in Q1 2018, annual GDP growth accelerated to 1.9% from 0.3% in the previous quarter.

- Export dynamics was mainly affected by weaker external demand, restriction of oil production according to OPEC+ agreement and partly a disruption in oil supplies through the Druzhba pipeline because of oil pollution.

Source: Euromonitor International from national statistics
Note: Real GDP growth split by spending components is provided before the recent Rosstat revision of construction and total annual GDP statistics
Pessimistic and Optimistic Scenarios

### Pessimistic scenario
- The pessimistic scenario assumes a decline in oil prices to USD35 a barrel level at the end of 2019/beginning of 2020 due to lower global demand for energy commodities.
- Deterioration of external conditions will become the reason for a short-term economic recession amid acceleration of capital outflow, ruble depreciation, decline in business confidence and contraction of domestic demand.
- Under this scenario, we expect real GDP to decrease by 0.7% in 2020 and return to positive growth of 0.4% in 2021. We assign a 10% probability to this scenario over a one-year horizon.

### Optimistic scenario
- An optimistic scenario assumes the oil price to reach USD80-90 a barrel over the 2-year forecast horizon. Though fiscal rule is expected to smooth over the influence of oil price growth, high prices will definitely provide additional support to business sentiment, and consumer and investment activity.
- Under the stated conditions, real GDP is expected to grow by 3.7% in 2020 and 2.6% in 2021. This scenario is assigned a probability of 5-10% over a one-year horizon.

**Russia Real GDP Growth Forecast**

- **2018**: Euromonitor baseline
- **2019**: Optimistic scenario, Pessimistic scenario
- **2020**: Euromonitor baseline

*Source: Euromonitor International Macro Model*
Production and Investment

- Revised industrial statistics shows that production continued to grow in Q2 2019 and even slightly accelerated relative to the previous quarter (+2.9% year-on-year growth in Q2 2019 compared to +2.3% in Q1 2019).

- As before, the main driver of industrial production growth remains mining and quarrying dynamics (+3.1% in Q2 2019), however the sector’s growth rates slowed down, ie growth was contained by weak external demand for gas due to warm weather in Europe and restrictions imposed on oil production under the OPEC+ agreement.

- In manufacturing, the situation is rather unstable. After promising acceleration in April (+4.7% annual growth), a downward correction by -1% was recorded in May followed by +3.4% increase in June.

- The slowdown in investment dynamics is also in the construction sector. The volume of construction works shows almost zero annual growth already two quarters in a row. For that reason, it would be premature to speak about the growth of investment activity. Positivity is related to the shift in implementation of some major public national projects to the second half of 2019, which could give support to overall investment activity in the economy.
Inflation, Income and Consumption

- Inflation in Q2 2019 continued to decline slowly. In March, it reached 5.3% in annual terms, but in June it dropped to 4.7%. Lowering inflation is a result of the completion of the VAT increase effect on prices, stable exchange rate dynamics as well as rather tight monetary and credit policy amid moderate dynamics of domestic demand.

- The downward trend shown by inflation underpins expectations of 4.5% consumer price growth in 2019 with subsequent inflation slowdown to around 4.1% in 2020-2021.

- Retail trade turnover dynamics continued to slow down reaching 1.4% annual growth in June, which is the lowest level since mid-2017, which is in general a reflection of real wages and income dynamics.

- Q2 2019 consolidated the trend of minimal expansion of real wages and, accordingly, stagnation of real disposable incomes of the population (+0.5% annual growth in Q2 2019), which became the basis for the gradual inhibition of private consumption.
Economic Activity (1)

- **Brazil’s economic recovery is slower than previously expected.** Real GDP growth reached only 0.5% year on year in Q1 2019. Growth was mainly influenced by private consumption and foreign trade. However, the effect of the former is shrinking. The share of investment and public consumption is almost negligible, depicting ongoing uncertainty regarding the government’s efficiency and fiscal sustainability.

- **Despite some reforms already taking place, the economy is still lacking long-awaited momentum to catch up.** Therefore we have downgraded our real GDP projections to 1% for 2019 and 2% for 2020 (from 2.1% and 2.3%, respectively, in the May 2019 forecast).

![Brazil Real GDP Growth by Expenditure Component](source: Euromonitor International from OECD)
Economic Activity (2)

- As pension reform is successfully making its way through Congress, it is positively affecting inflation outlook. The government has cut inflation targets in upcoming years. However, the main reason for lower than expected inflation is economic slack.

- The growth of Index of Economic Activity has recently picked up sharply, rising for the first time in 2019 and reducing the fear of the economy moving into a recession. However, this upturn could be just transitory. As the economic outlook remains highly unstable, the government faces a challenge to take action against still possible economic downturn.

Source: Euromonitor International from IBGE, Central Bank of Brazil
Pessimistic and Optimistic Scenarios

**Brazil Real GDP Growth Forecast**

- **Pessimistic scenario**
  - Brazil’s economy is falling behind growth forecasts despite the breakthrough of pension reform in the lower house of Congress.
  - Surging budget deficit, lower consumer and business expectations regarding the reforms might slow down the growth even further.
  - Under this scenario, real GDP growth could reach 0.8% in 2019 and 0.2% in 2020. We assign a probability of 10-15% to this scenario over a one-year horizon.

- **Optimistic scenario**
  - If the government succeeds in taking the necessary reforms aimed at productivity increases, efficiency gains, greater flexibility of the economy, and improvements in the business environment, it would help reverse the stagnation of the economy.
  - In this case, real GDP growth could reach 1.1% in 2019 and 3.8% in 2020. We assign a 10-15% probability to this scenario over a one-year horizon.

*Source: Euromonitor International Macro Model*
Budget Deficit and Access to Workers Guarantee Funds

• Despite positive expectations from reforms such as tax burden reduction and pension reforms, Brazil’s weak economic growth is compromising the budget. Revenues from tax collection are falling behind expectations, forcing significant government spending cuts. The first spending freeze in March affected almost BRL30 billion, while the current proposal is said to impact another BRL1.5 billion. Reform of the expensive social security system is expected to stabilise the fiscal balance and eliminate the need for further spending reductions.

• Another proposed measure to deal with austerity is releasing more than BRL42 billion in cash from workers’ severance funds. This is expected to boost GDP growth by 0.3 percentage points in the coming year and revive the economy as employees will be able to withdraw certain amounts of money annually. The ability to access the workers’ fund is expected to further lower the unemployment rate as employees will be encouraged to stay employed while employers will be more willing to create jobs. Additionally, the government believes it will boost consumption and help reduce household debt which has been steadily growing.
Scope and Objectives

- Global Economic Forecasts quarterly Global Outlook is a partner piece to Euromonitor Macro Model, which is represented in Macro Model dashboard.

- The Global Outlook is an explainer of quarterly forecast updates of Macro Model. The analysis is focused on quarterly macro changes and what these mean to our view of the likely, optimistic and pessimistic scenarios for the global economy.

- Euromonitor International’s Macro Model (EMM) is a quarterly forecast model for the global economy.

- EMM is a global model, with countries simultaneously interacting through trade and aggregate demand spillovers. It currently produces GDP, Unemployment, Inflation and Interest Rate forecasts for 58 countries.

- The EMM forecasts are revised quarterly, with some inter-quarter revisions for key economies.

- Global Economic Forecasts quarterly Global Outlook focuses on world’s key economies and explains the latest macroeconomic changes in them, as well as the most up-to-date baseline, optimistic and pessimistic scenarios for these economies.
# Global Risk Scenario Descriptions

<table>
<thead>
<tr>
<th>Scenarios</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Downturn</td>
<td>Fears of escalating protectionist and populist policies and growing geopolitical tensions raise uncertainty levels and worsen sentiment in global financial markets and the private sector.</td>
</tr>
<tr>
<td>Global Crisis</td>
<td>The global crisis scenario combines a severe global downturn with a Chinese hard landing and a Eurozone recession.</td>
</tr>
<tr>
<td>Eurozone Recession</td>
<td>Growing geopolitical and EU break-up risks raise uncertainty and reduce investment. Significant deterioration in Eurozone credit markets and confidence indicators. Italy and Greece exit the Eurozone.</td>
</tr>
<tr>
<td>China Hard Landing</td>
<td>Lower private sector confidence, declining exports, a rising proportion of non-performing loans and greater than expected costs of rebalancing from investment to consumption cause a sharp downturn in China’s economy.</td>
</tr>
<tr>
<td>No-Deal Brexit</td>
<td>UK-EU negotiations break down, and the UK leaves the EU in 2019 without making a trade deal.</td>
</tr>
<tr>
<td>Disorderly No-Deal Brexit</td>
<td>This is a worst-case No-Deal Brexit scenario. Trade sensitivity and disruptions are more severe and long lasting.</td>
</tr>
<tr>
<td>Korean Conflict</td>
<td>Nuclear fears lead to a US strike on North Korea. North Korea invades South Korea and strikes Japan. Fears of strikes on the US or other Asian countries lead to a sell-off in financial markets and a slowdown.</td>
</tr>
<tr>
<td>Global Trade War</td>
<td>US-China Trade War tariff increases and bilateral tariff increases between the US, Asia Pacific, the EU, Canada and Mexico.</td>
</tr>
<tr>
<td>Trump Adverse Policies</td>
<td>Global Trade War and stricter US immigration policies cause big decline in employment growth.</td>
</tr>
</tbody>
</table>
Definitions

- Forecast closing date: August 5 2019
- All baseline forecasts (expected or most likely outcomes) are assigned a 20-30% probability unless stated otherwise.
- All most likely Pessimistic and Optimistic Scenarios are assigned a probability of 15-25% unless stated otherwise.
- All GDP and GDP components growth rates are in real (inflation adjusted) terms unless stated otherwise.
- All annual GDP and GDP component growth rates are for January-December calendar year unless stated otherwise.
- All quarterly GDP and GDP components growth rates are year-on-year unless stated otherwise.
CONTACT DETAILS

Aiste Navaityte  
Senior Data Analyst  
Aiste.Navaityte@Euromonitor.com

Aleksej Baksajev, PhD  
Data Scientist  
Aleksej.Baksajev@Euromonitor.com

Daniel Solomon, PhD  
Senior Economist  
Daniel.Solomon@Euromonitor.com

Marija Aciene  
Data Analyst  
Marija.Aciene@Euromonitor.com