Global Macroeconomic Outlook
June 2019

Global Economic Outlook

The IMF continues to reduce their growth projections as the global economic expansion slows, trade tensions escalate, and uncertainty related to Brexit continues.

- The IMF now forecasts global growth to be 3.2% in 2019 and 3.5% in 2020 (both revised down by 0.1%).
- In advanced economies, growth is projected to slow from the 2.2% 2018 level to 1.9% in 2019 and 1.7% in 2020. While the forecast for growth in the U.S. was revised up in 2019 (2.6% versus 2.3%) given strong exports and an increase in inventories, expectations for a slowdown to 1.9% in 2020 remains due to the reduction in fiscal stimulus. Growth in the euro area and Japan are both projected to be lower than the U.S. this year and next.
- In emerging and developing economies, growth is forecasted to be 4.1% in 2019 and 4.7% in 2020, but both estimates were revised down as tariffs continue to impact investment and trade. China's growth is expected to slow even further given the escalation in trade tensions with the U.S. and overall slower growth globally. Fiscal stimulus will likely offset only part of the impact of the trade dispute.
- Overall, inflation is projected to remain level over the coming years, close to long-term averages.

	Real GDP (%)[1]				Inflation (%)[1]			
	IMF 2018 Actual	IMF 2019 Forecast	IMF 2020 Forecast	Actual 10 Year Average	IMF 2018 Actual	IMF 2019 Forecast	IMF 2020 Forecast	Actual 10 Year Average
World	3.6	3.2	3.5	3.4	3.6	3.6	3.6	3.5
U.S.	2.9	2.6	1.9	1.7	2.4	2.0	2.7	1.6
Euro Area	1.9	1.3	1.6	0.8	1.8	1.3	1.6	1.3
Japan	0.8	0.9	0.4	0.7	1.0	1.1	1.5	0.3
China	6.6	6.2	6.0	7.9	2.1	2.3	2.5	2.2
Emerging Markets (ex. China)	3.5	3.7	4.1	3.7	6.4	6.6	6.2	6.5

[1] Source: IMF. World Economic Outlook. Real GDP: July 2019 Update. Inflation: April 2019 Update. "Actual 10 Year Average" represents data from 2009 to 2018.

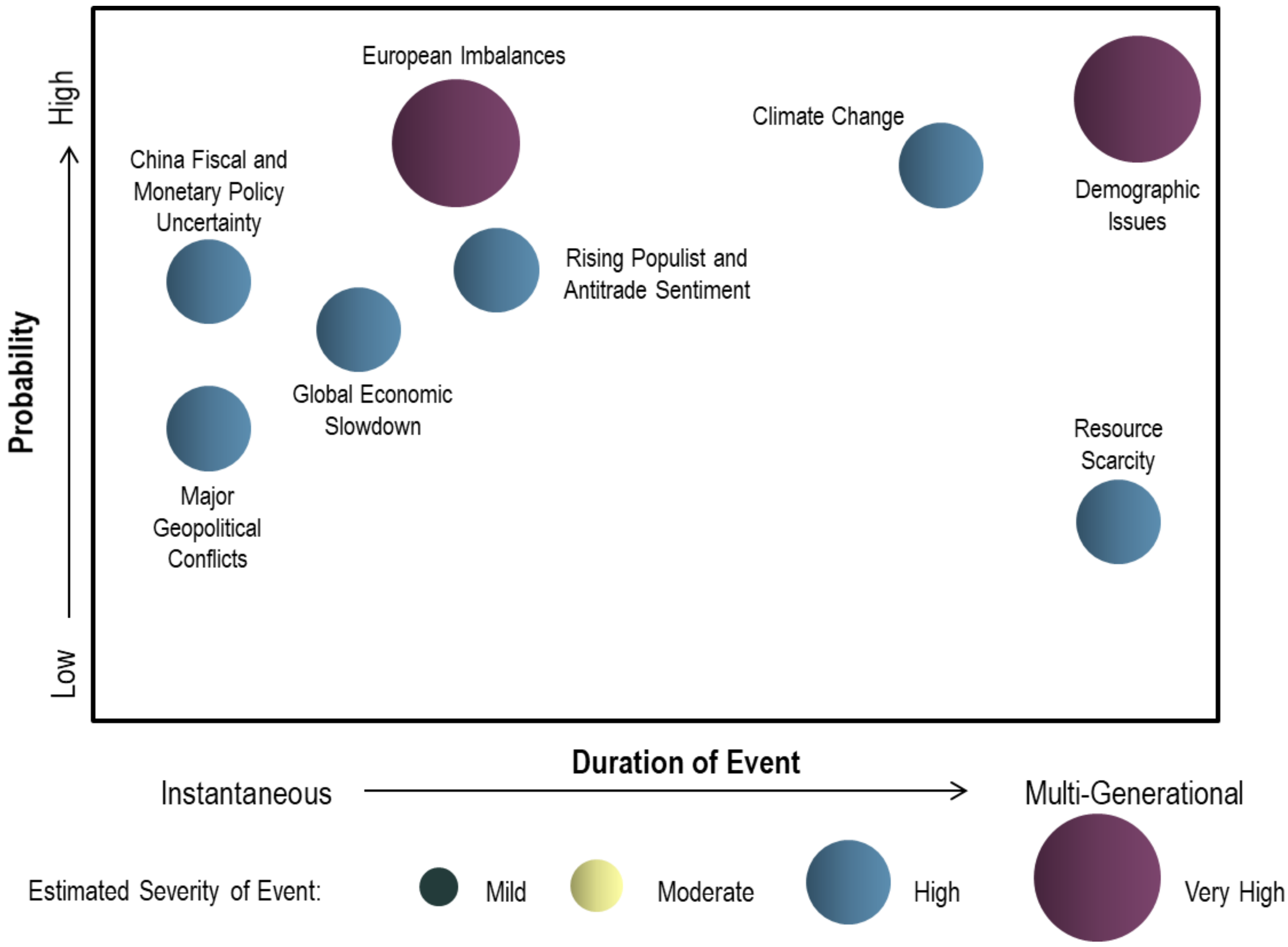
Global Economic Outlook (continued)

With global growth slowing, compounded by trade tensions, major central banks are pivoting toward more accommodative policies.

- The Federal Reserve held the federal funds rate at 2.25%-2.50% at their June meeting, but we expect they will start cutting rates. Questions remain regarding how long the rally in risk assets can last and how this easing cycle will look given the already low interest rate levels.
- The Bank of Japan (BOJ) is showing no signs of pulling back from its unprecedented monetary stimulus, as inflation remains well below target, growth is slowing globally, and the consumption tax increase planned for later this year may further dampen growth. At their June meeting the BOJ made no changes to their stimulative efforts, keeping bank deposit rates negative (-0.1%), and continuing to target a 0% yield on the 10-year government bond.
- The European Central Bank held low rates steady at their June meeting and signaled that they could restart quantitative easing and rate cuts given slowing economic conditions. Later this year former head of the IMF, Christine Lagarde, will take over the helm of the ECB from Mario Draghi with expectations for her to continue to do “whatever it takes” to support the economic region.
- The People’s Bank of China (PBOC) continues to cut bank reserve requirements in an effort to stimulate growth as the trade war with the U.S. weighs on the slowing economy. Recently, fiscal stimulus was added as a further step to support the economy, but additional stimulus increases concerns given the already high debt levels.

Several issues are of primary concern: 1) uncertainty related to the U.S. economy and policies; 2) declining growth in China, along with uncertain fiscal and monetary policies; and 3) political uncertainty in Europe and risks related to the U.K.’s exit from the European Union.

Macroeconomic Risk Matrix



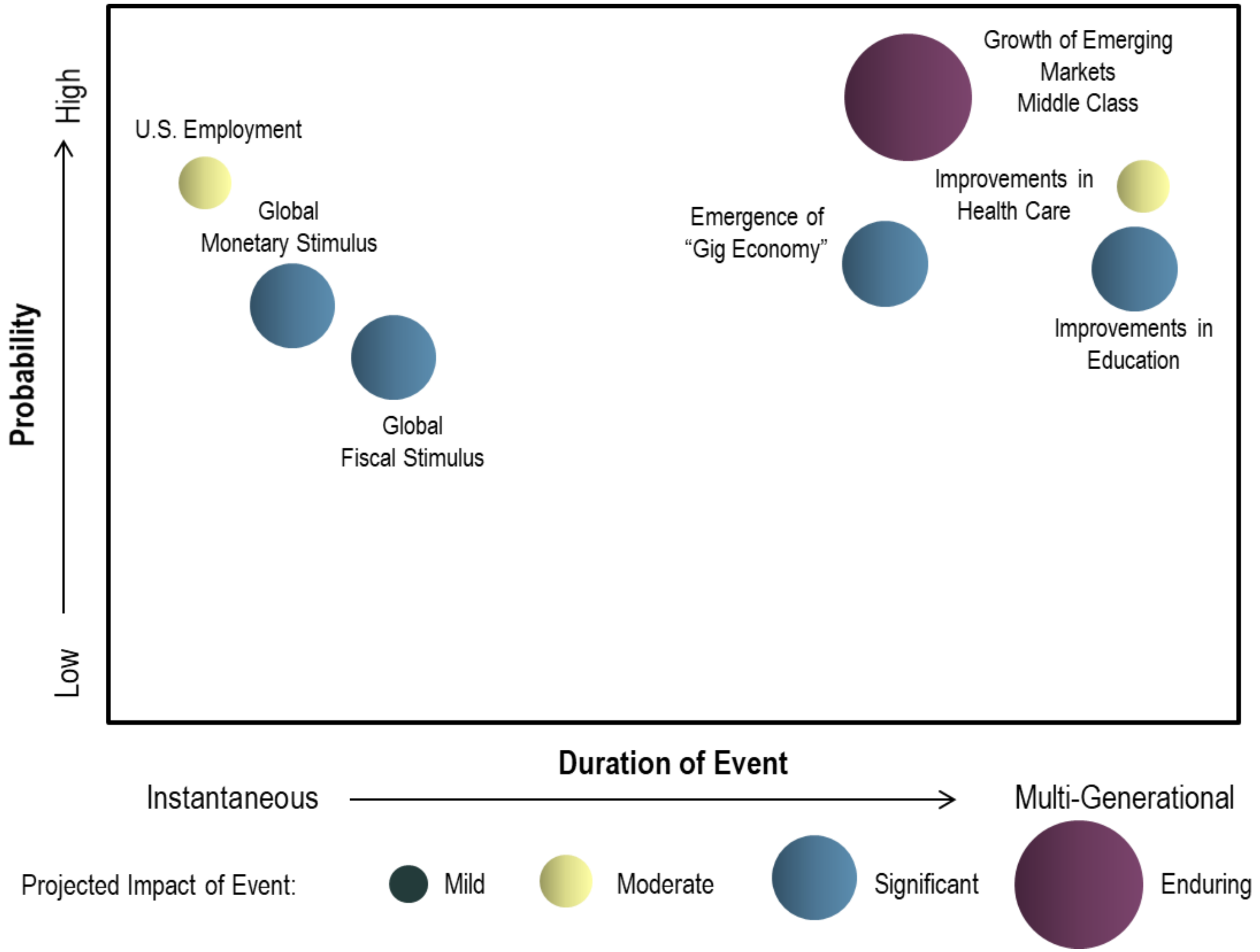
Macroeconomic Risk Overviews

China Fiscal and Monetary Policy Uncertainty	The process of transitioning from a growth model based on fixed asset investment by the government to a model of consumption-based growth will be difficult. Trade tensions between the U.S. and China could further weigh on the already slowing growth, as the U.S. is the largest destination for China's exports. The management of capital outflows is another key issue in China with officials tightening regulations to stem outflows. The hot property market and the growing mountain of debt in the corporate sector remain other key risks. As China tries to manage a smooth economic transition through fiscal and monetary policies, heightened financial risks exist.
Climate Change	The earth's average temperature has been increasing since preindustrial times with the pace accelerating over the last 35 years. Increased levels of greenhouse gases like carbon dioxide have been the main cause of higher temperatures as they trap heat in the atmosphere. Warmer temperatures have led to the melting of glaciers and polar ice and increased precipitation in wet regions and reduced it in dry regions. The economic impacts of climate change are many, including declining crop yields, effects on livestock health, shifts in tourism, damage to infrastructure (rising sea levels and more extreme weather), and higher levels of disease and malnutrition.
Demographic Issues	In Japan and Europe, birth rates have declined for decades, resulting in populations becoming older and smaller relative to the rest of the world. In China, their so-called "one child" policy helped to reduce population growth, but has created other issues for the government. As life expectancy increases, the prior policy creates complications with a low working base left to support a relatively large and aging population. These demographic trends will have negative long-term impacts on GDP growth and fiscal budgets, amplifying debt problems.
European Imbalances	The crisis is rooted in structural issues in the Eurozone related to the combination of a single currency and monetary authority combined with 17 fiscal authorities. Within the European Union, tensions exist, as highlighted by political changes in Italy and the prior U.K. referendum, related to policies on immigration, laws, and budgetary issues. Given the size of Italy's bond market and economy within the euro area, a sovereign debt crisis or departure from the euro would have significant consequences. The "Brexit" deadline has been pushed back, but in the meantime companies continue to leave the area and investment has been delayed, both weighing on growth. A departure of the U.K. from the European Union without a deal would be particularly impactful to businesses. The odds of a no deal Brexit have increased with the election of Boris Johnson.

Macroeconomic Risk Overviews (continued)

Global Economic Slowdown	After a long period of synchronized global growth a slowdown has started given late cycle dynamics compounded by trade tensions and uncertainties related to Brexit. Recessions are not forecasted in the short-term for most major economies, but the risk remains. The pivot of major central banks to an easing focus in response could support growth and markets in the short-term but could also fan risk taking and increase systemic risk.
Major Geopolitical Conflicts	Tensions with Iran increased due to U.S. sanctions and Iran's recent seizure of a British oil tanker. The potential for escalation exists which could affect oil prices and ultimately growth. Other outstanding issues include the ongoing conflict between Russia and the Ukraine, trade and military tensions in the South China Sea between the U.S. and China, and North Korea's nuclear aspirations.
Resource Scarcity	The growing world population, urbanization, and a growing middle class, particularly in emerging economies, could all lead to a scarcity of resources, including food, water, land, energy, and minerals. As demand continues to grow and supply declines, rising commodity prices may hurt the living standards of many and increase the risk of geopolitical conflicts.
Rising Populist and Antitrade Sentiment	Tariffs started by the U.S. against China and some of its allies, along with elections/votes in the U.S., Europe, U.K., and Mexico highlight the growing populist/antitrade sentiment. The recent "yellow vest" protests in France is yet another example of unrest related to social inequality and ultimately led to President Macron promising tax reforms. Stagnant wages, growing inequality, and the perception of jobs being lost abroad are key contributors. Reducing trade and imposing tariffs will likely lead to higher inflation, reduced efficiencies, and heightened tensions between countries.

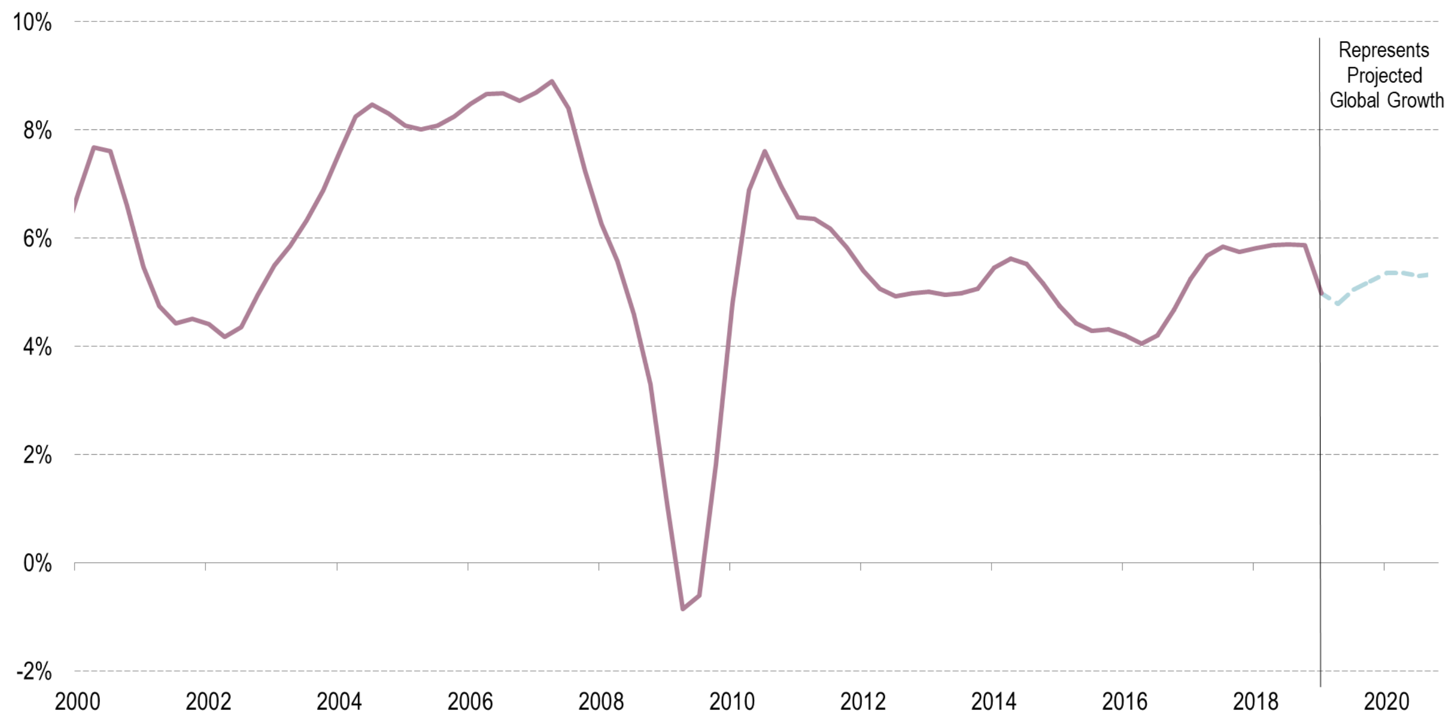
Positive Macroeconomic Trends Matrix



Positive Macroeconomic Trends Overviews

Emergence of "Gig Economy"	The "gig economy" continues to grow with over a third of workers considering themselves working independently. The new structure allows workers flexibility in the jobs they take, their schedules, and offers the ability to work outside of a traditional office. For companies, it has led to lower labor and overhead costs (more employees are working remotely), flexibility in hiring workers temporarily, and lower recruiting and training costs.
Global Monetary Stimulus	Given slowing global growth, compounded by trade tensions, major central banks have pivoted to a more dovish tone. The U.S. and ECB are expected to start cutting rates and could move back to quantitative easing, while the BOJ maintains its massive monetary support. These policies have been a major boost to the markets and could support global growth. The key questions remain whether or not they are pivoting too early and if this rally in risk assets is short-lived or more sustainable.
Global Fiscal Stimulus	Given the slowing growth globally, there could be an increase in fiscal stimulus. U.S. tax cuts should help growth domestically and abroad, particularly for key trading partners barring any overwhelming headwinds from tariffs. China has also recently reduced bank reserve requirements and announced fiscal stimulus policies. With interest rates still relatively low, borrowing for infrastructure investments is affordable. Increased fiscal stimulus could help growth while reducing the reliance on monetary policy.
Growth of Emerging Markets Middle Class	In emerging economies, the middle class is projected to grow significantly over the next twenty years. This growing middle class should increase consumption globally, which in turn will drive GDP growth and create jobs.
Improvements in Education/Healthcare	Literacy rates and average life spans have increased globally, particularly in emerging economies. Higher literacy rates will drive future growth, helping people learn new skills and improve existing skills. Longer lives increase incentives for long-term investments in education and training, resulting in a more productive work force and ultimately more growth.
U.S. Employment	The U.S. unemployment rate has steadily declined since its post Global Financial Crisis peak. Hourly earnings growth has not reached levels that it has in prior recoveries, but has increased from its lows. Improvements in the U.S. labor market, along with the tax cuts, should stimulate consumption and growth for both U.S. and foreign goods. A lower unemployment rate and higher consumption will also lead to higher tax revenue that should partly offset the deficit pressures from tax reforms.

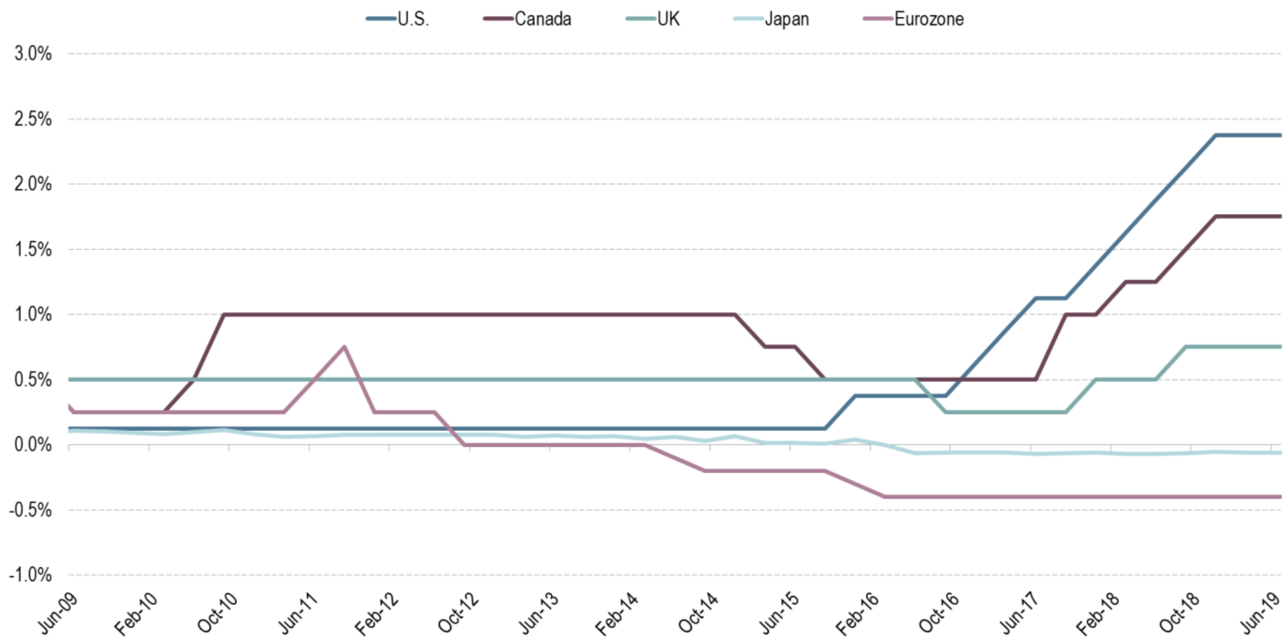
Global Nominal Gross Domestic Product (GDP) Growth[1]



- After the recent period of synchronized global economic growth, economic activity has declined due to continued trade tensions, a slowing Europe and uncertainties related to Brexit, and a slowing China.
- Growth is forecasted to slow in 2019, before picking up in 2020, with key risks to the downside including trade tensions heating-up again, the UK exiting the European Union without a deal, and disinflationary impacts on debt servicing.

[1] Source: Oxford Economics. Updated July 2019. GDP data after Q4 2018 are estimates.

Central Bank Interest Rates[1]



- After increasing rates over the last several years from record lows, major central banks are shifting to a more accommodative stance given slowing global growth.
- Of all the central banks, the U.S. has the most room to lower rates, while Japan and Europe are already in negative territory.
- Given the limited ability to reduce rates, there is speculation that we could see a return to other policies like quantitative easing or increased fiscal support if the global slowdown escalates.

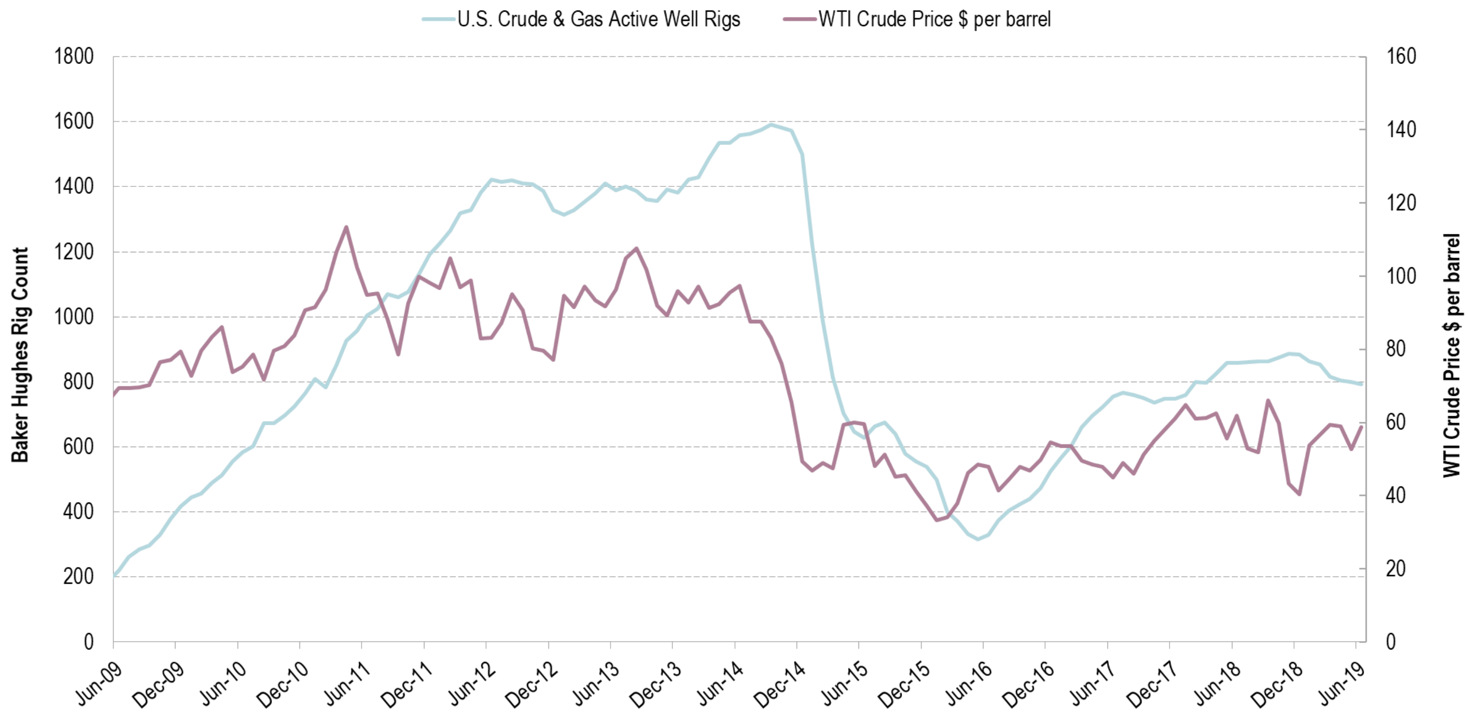
[1] Bloomberg. Data is as of June 30, 2019.

U.S. Dollar versus Major Currencies[1]

- The U.S. dollar rose 0.8% in the second quarter, recovering from a decline in the first quarter.
- Since 2011, the dollar has significantly increased in value, helped by the relative strength of the U.S. economy and higher interest rates.
- Due to frustrations with the strength of the dollar, there is speculation that the U.S. government could intervene in an effort to weaken it.
- If U.S. growth slows and the trade deficit continues to rise, the dollar could weaken further.

1 Source: Federal Reserve Bank of St. Louis. Data is as of June 30, 2019.

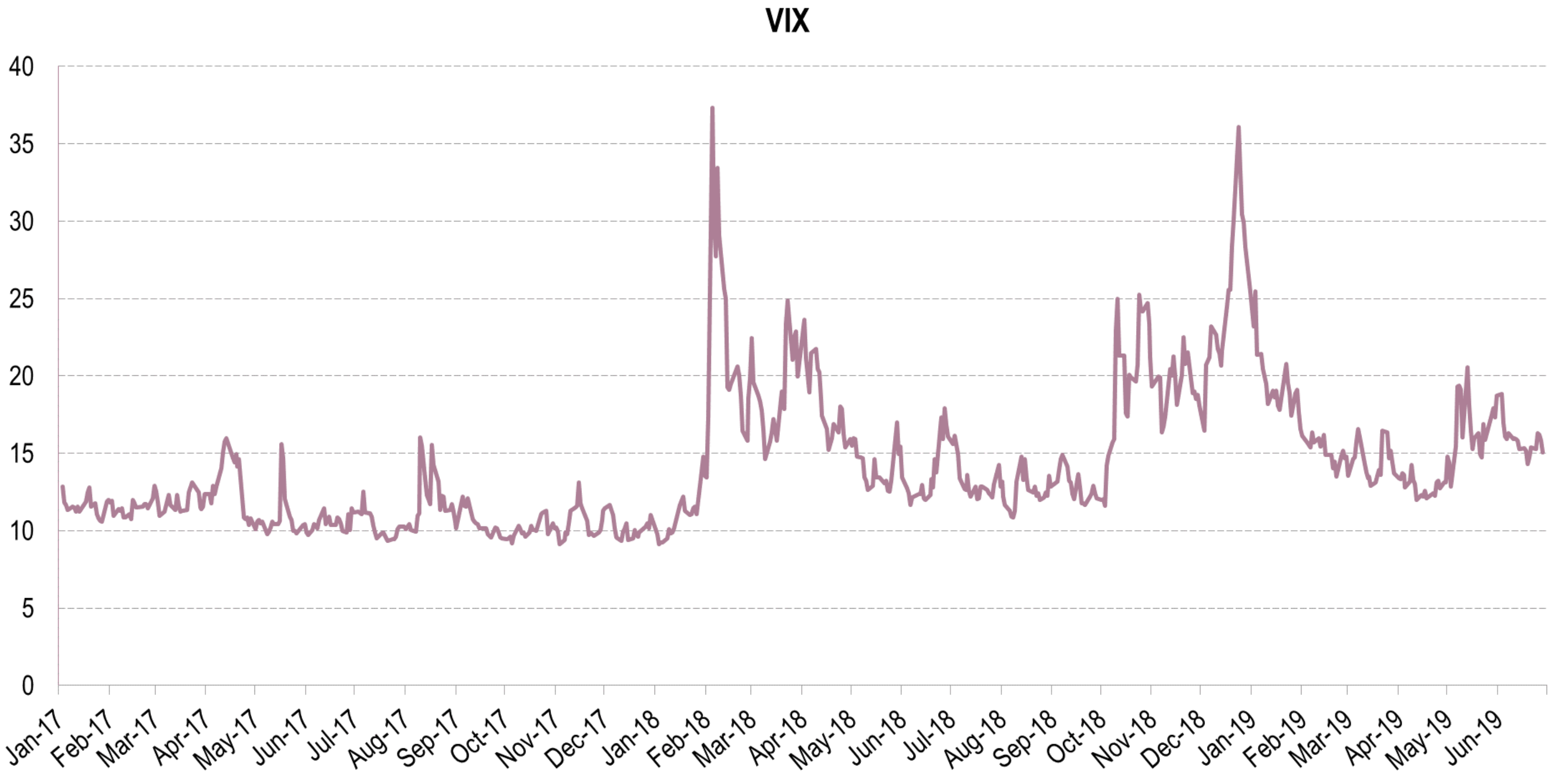
Oil Price and Rig Activity[1]



- Oil prices finished the quarter at $58.72, a level slightly below the prior quarter but well above the 2018 year-end value of $40.41.
- Pledged cuts from OPEC countries, and allies like Russia, along with sanctions on Iran and Venezuela from the U.S., contributed to the recovery in prices this year. After quarter-end, an escalation in tensions between Iran and the West drove prices higher.
- Acting as a counterforce to higher prices are the slowing global economy, continued growth in U.S. shale production, and the persistently strong U.S. dollar.

[1] Source: Bloomberg. Data is as of June 30, 2019.

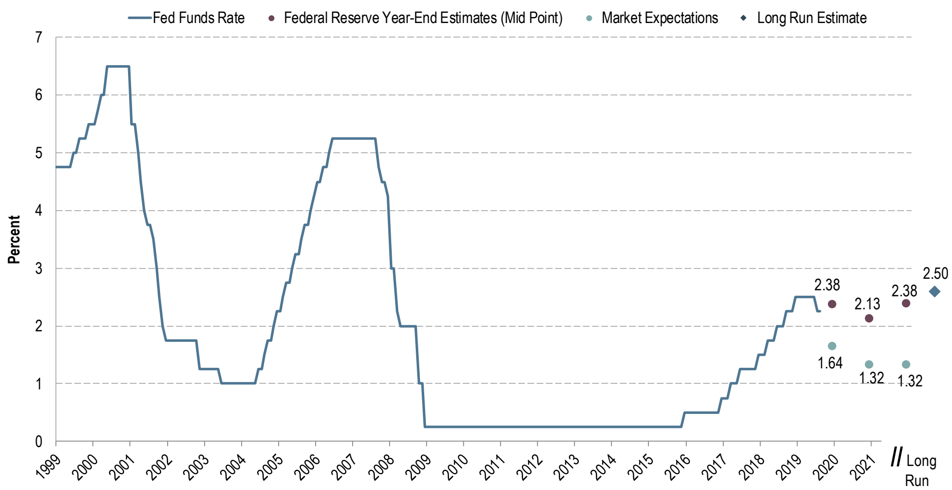
Volatility[1]

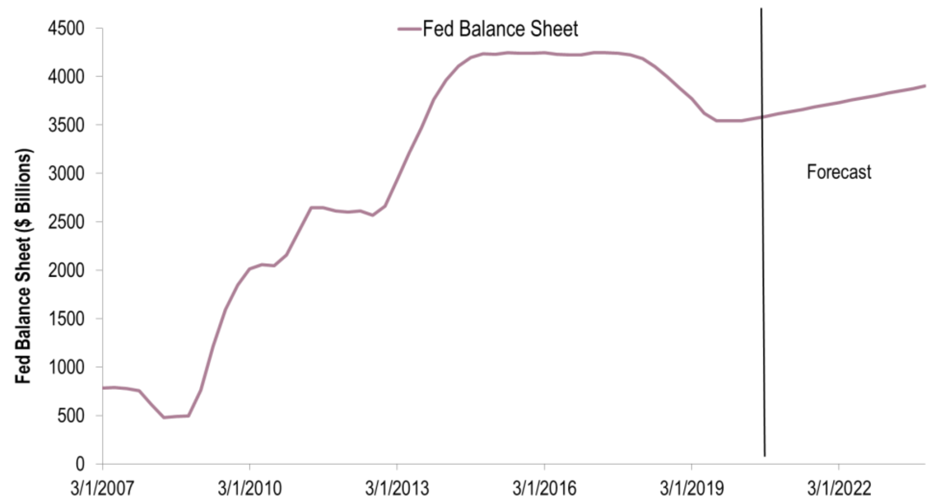


- Given the escalation in trade tensions and corresponding global growth concerns, volatility picked up in the second quarter but remained below levels seen late last year.
- The potential for renewed volatility remains given the late cycle dynamics in the U.S., the long equity market expansion, and the many unresolved political and trade issues globally.

1 Bloomberg. Represents daily VIX data and is as of June 30, 2019.

U.S. Monetary Policy[1, 2]

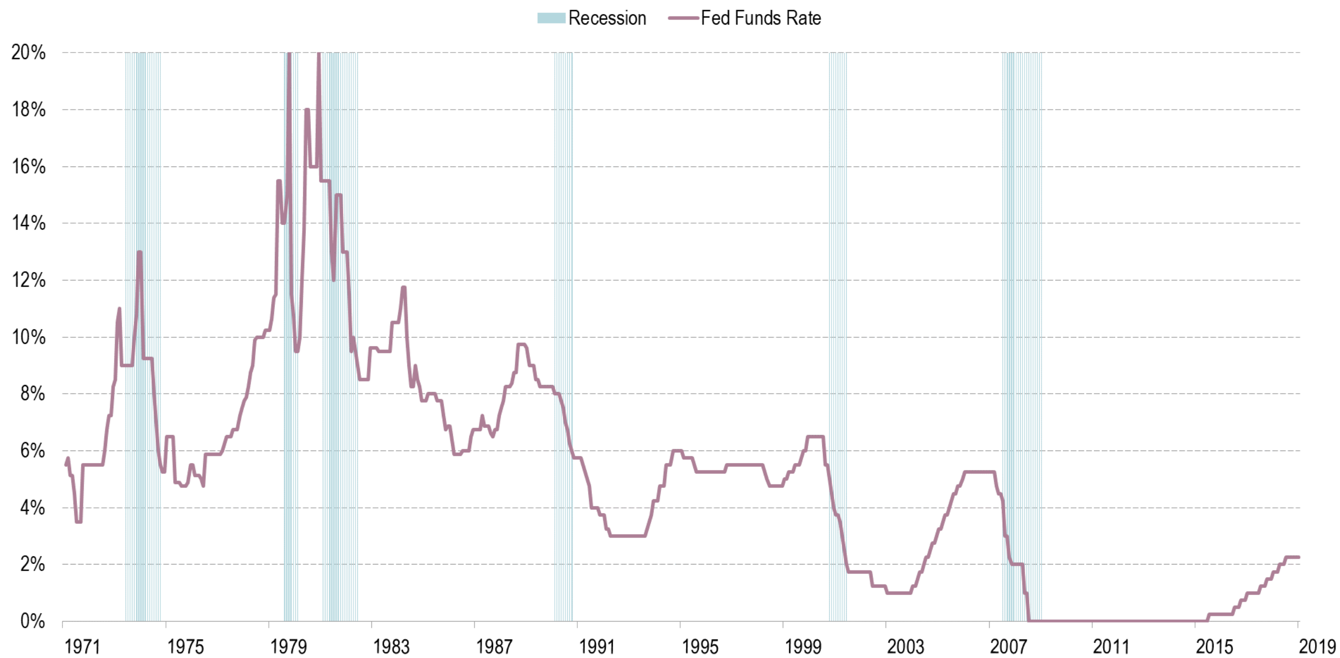




- Investors are expecting the Federal Reserve to start lowering interest rates. The Fed also indicated that balance sheet reductions would end later this year, with expectations for an increase going forward.
- Slowing global growth, stubbornly low inflation, and continued trade tensions drove the pivot to a more accommodative policy and was a large contributor to the recent rally in risk assets.
- The risk remains that cutting interest rates now could lead to borrowers taking on more risk and ultimately deepening the next recession leaving the Fed with limited policy tools.

1 Source for Monetary Policy: Bloomberg. Data is as of June 30, 2019.
2 Source for Balance Sheet: Oxford Economics.

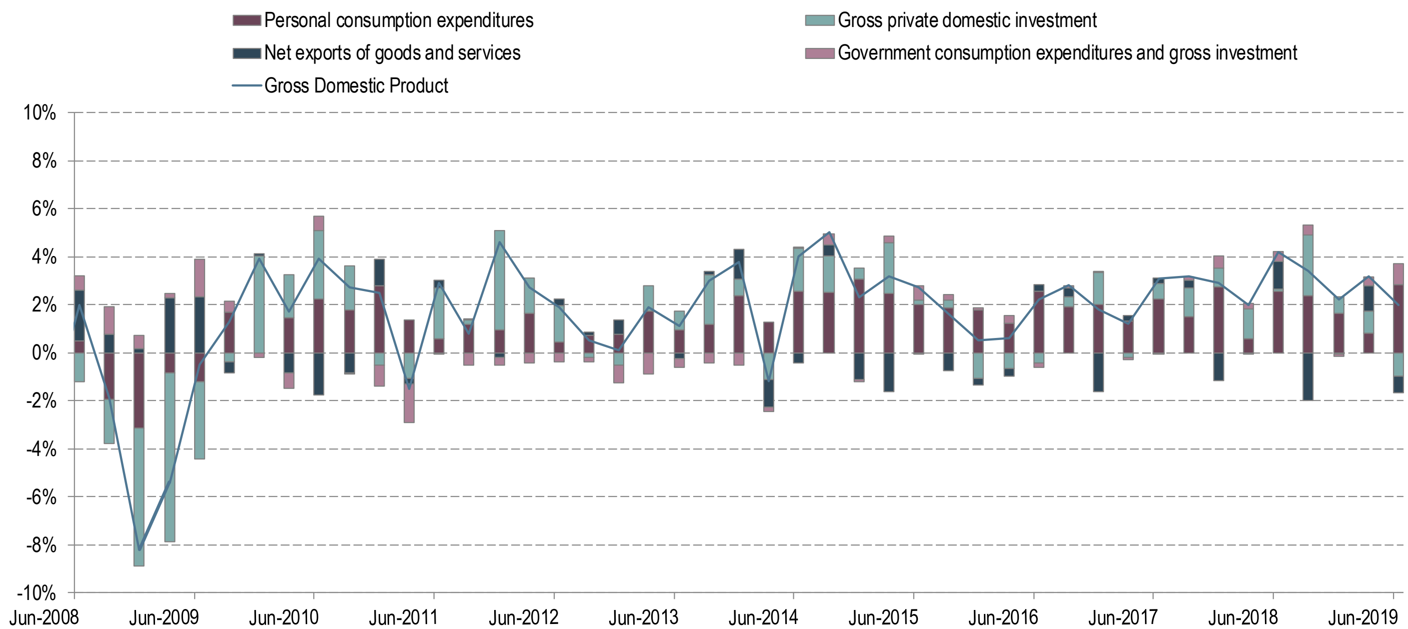
Historical Rate Easing Cycles[1]



- In prior periods where the Federal Reserve reduced interest rates to support growth, they cut rates on average by 5% to 6%.
- Given the current level of rates, they do not have that luxury this time, meaning they need to make each rate cut count.
- Some are speculating given the low level of rates that the Fed will have to resort to quantitative easing again or other policies to support the economy or that fiscal stimulus will play a larger role.
- A key difference in prior easing periods was that inflation and rates were much higher.

[1] Source: Bloomberg. Data is as of June 30, 2019.

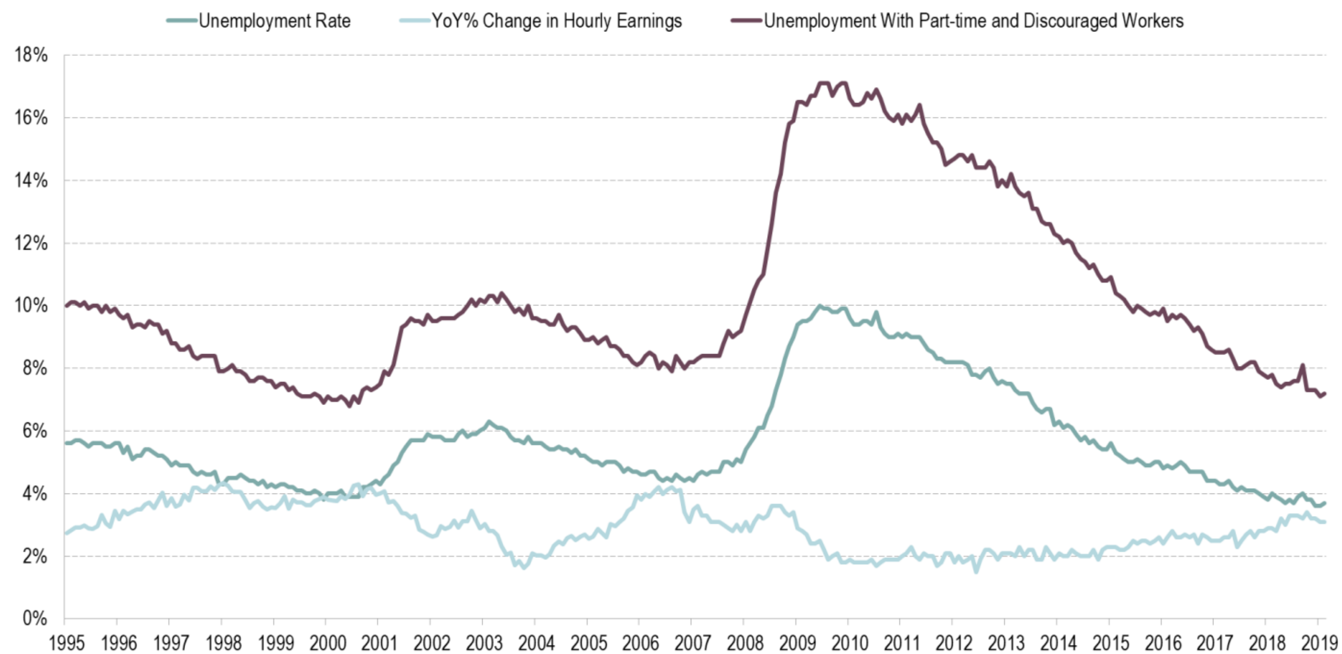
U.S. Real Gross Domestic Product (GDP) Growth[1]



- The third estimate of GDP for the second quarter in the U.S. came in at an annualized rate of 2.0%, below the initial estimate of 2.1% and the 3.1% level of the prior quarter. Over the last year, GDP grew by 2.3%.
- The slowdown in the global economy, along with trade tensions, led to the lower results in the second quarter, but the results did not support the recession fears of many.
- A slowdown in manufacturing has weighed on parts of the economy, but it has been counterbalanced by a strong U.S. consumer. Consumer spending was the largest contributor to second quarter growth with government spending also helping, while business investment was the largest detractor.

1 Source: U.S. Bureau of Economic Analysis. Data is as of the second quarter of 2019 and represents the third estimate.

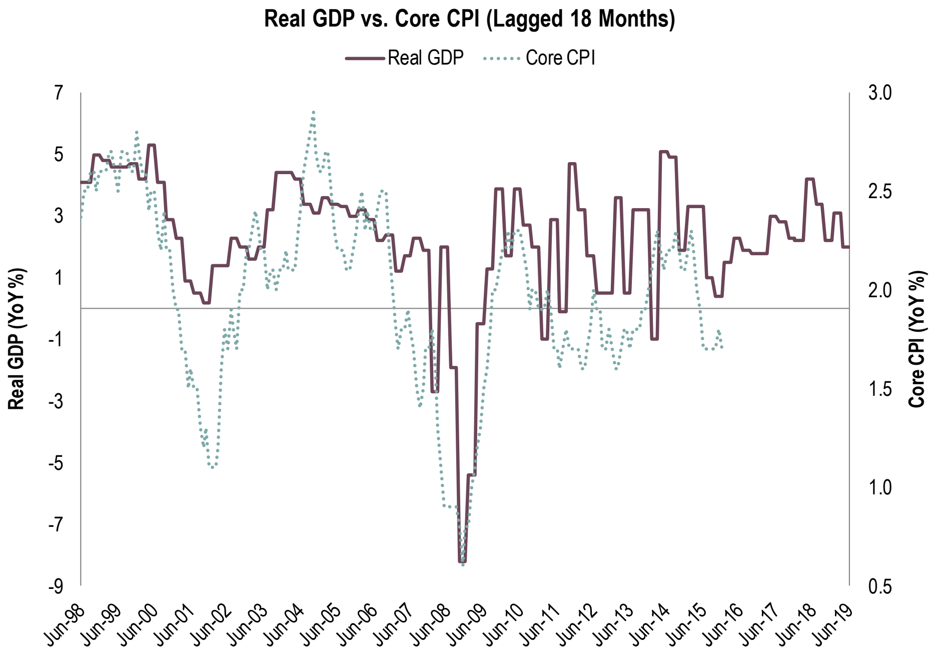
U.S. Employment & Wages[1]

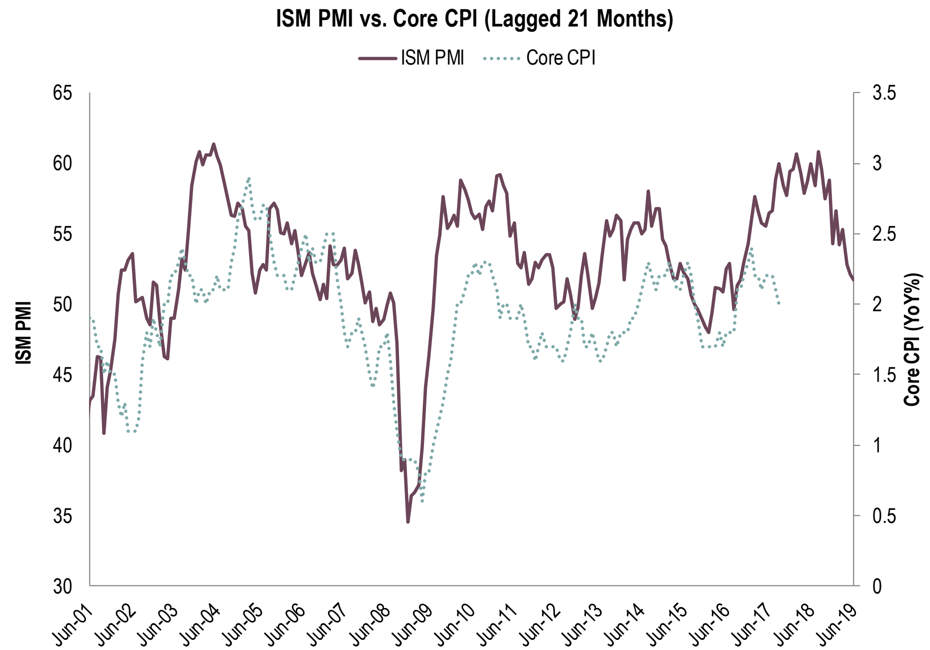


- The unemployment rate ticked down further in the second quarter declining 0.1% to 3.7%, a level close to 50-year lows.
- The broader measure of unemployment (U6) that includes discouraged and underemployed workers also continued to fall, reaching 7.2% at quarter-end.
- Given the late cycle dynamics, wage growth has improved with the tighter labor markets, supporting an increase in consumer spending.

[1] Source: Bureau of Labor Statistics. Data is as on June 30, 2019.

U.S. Inflation[1]



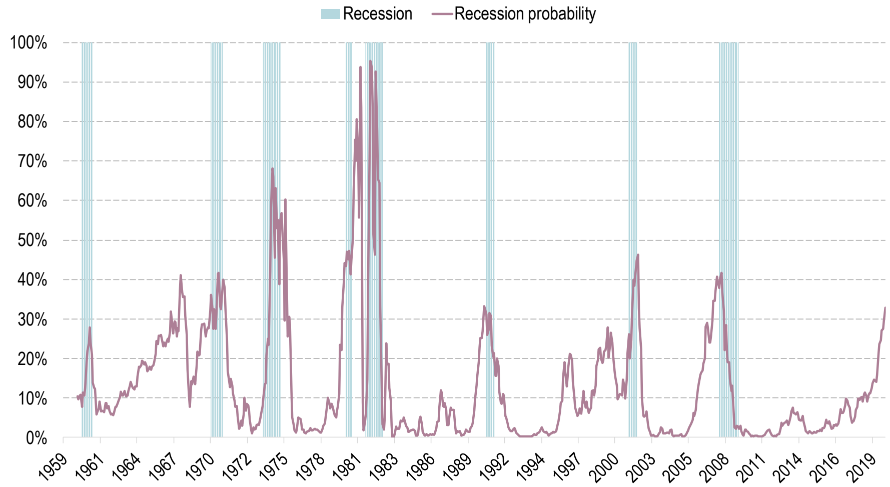


- Inflation is considered a lagging indicator, representing past economic conditions.
- This leads to economic conditions today being a means of forecasting future inflation levels.
- Real GDP and manufacturing indicators, like the ISM Purchasing Managers Index, have historically been reasonable indicators of future inflation.
- Recently, manufacturing data and GDP declined from their peaks. Lower economic activity and slowing manufacturing could all lead to a decline in inflation and support the Fed's decision to lower rates.

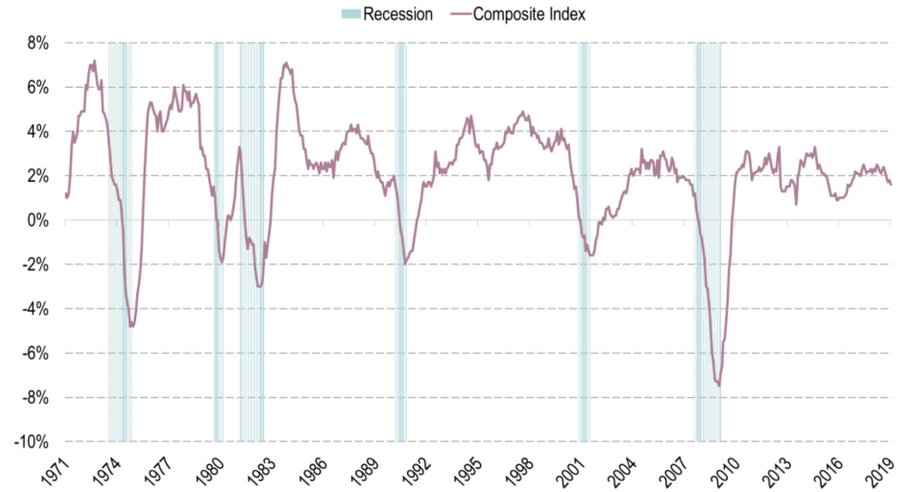
1 Source: Bloomberg. Data is as of June 30, 2019 for ISM PMI and as of the second quarter (third estimate) for U.S. Real GDP.

Recession Watch in the U.S.

Probability of U.S. Recession 12-mo (%)[1]



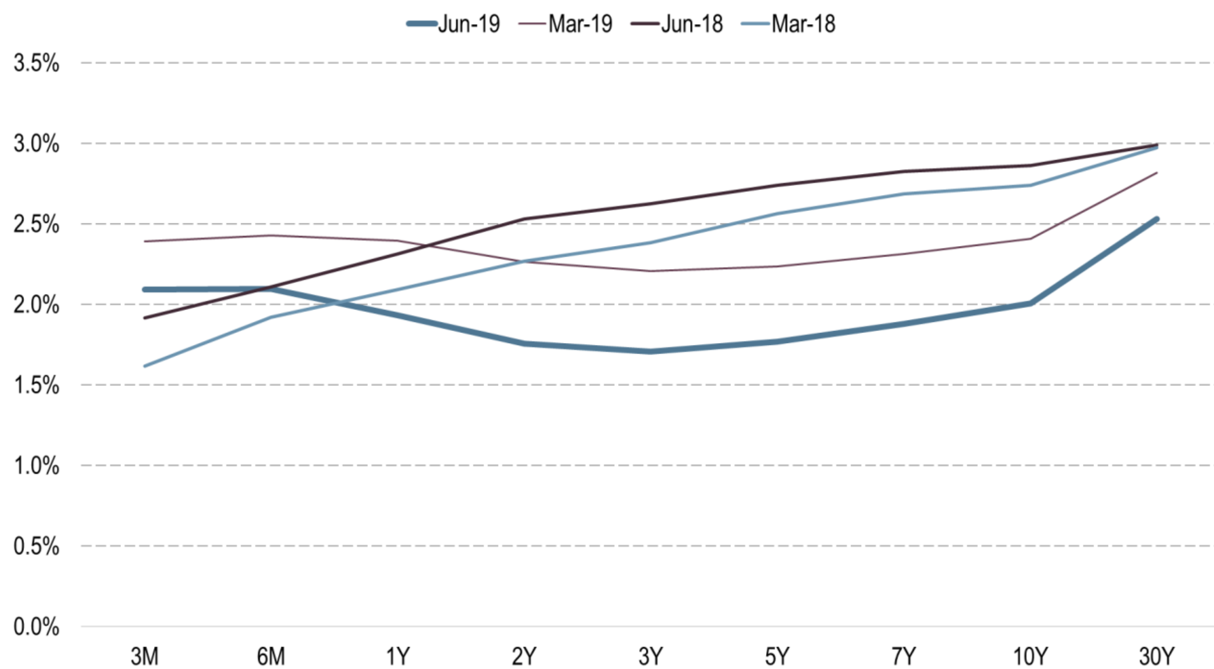
Composite of Four Coincident Indicators[2]



- Coincidental indicators, which provide a strong perspective of the current state of the economy, are signaling that the U.S. is not in a recession.
- Going forward, economic conditions are expected to slow in the U.S., but the risk of entering a recession in the short-term appears low.

[1] Source: New York Federal Reserve. The NY Fed's model uses the spread between 10-year and 3-month Treasury rates to calculate the probability of a recession in the U.S. twelve months ahead. Data is as of June 30, 2019.
[2] Source: Conference Board. Consists of employees on nonagricultural payrolls, personal income less transfer payments, industrial production, manufacturing, and trade sales. Data is as of June 30, 2019.

U.S. Yield Curve[1]

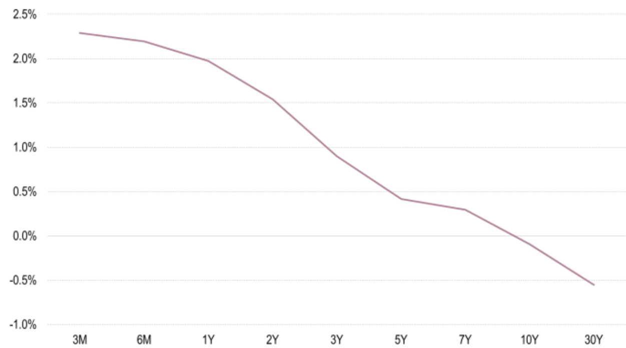


- Rates have decreased across maturities in the U.S. and the front-end of the yield curve is inverted (i.e., yields are higher for shorter-term bonds).
- The yield curve has long been looked to as a barometer of economic strength and one useful potential recession indicator.
- Inversions in the yield curve have historically preceded recessions, with a few exceptions, but the time between the inversion and recession has varied.

1 Source: Bloomberg. Data is as of June 30, 2019. Numbers represent month-end values.

Government Bond Yield Curves[1]

U.S./Italy Rate Differential



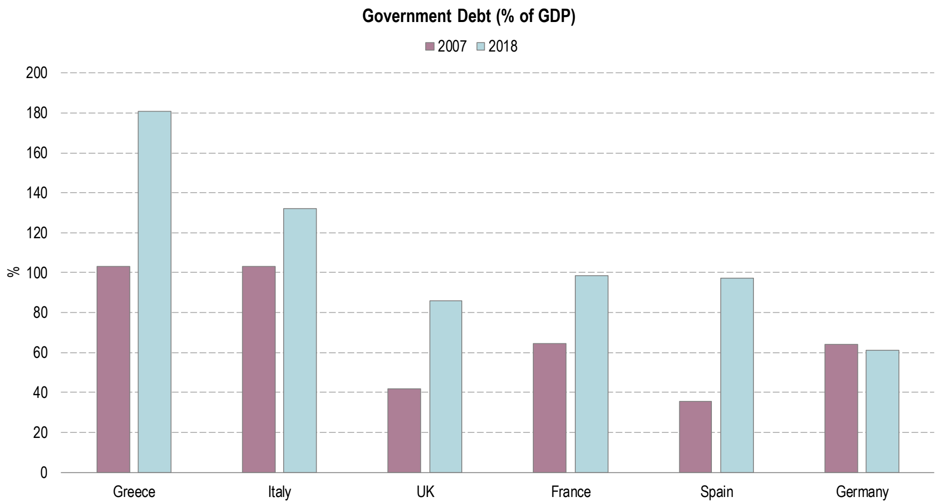
U.S./Japan Rate Differential

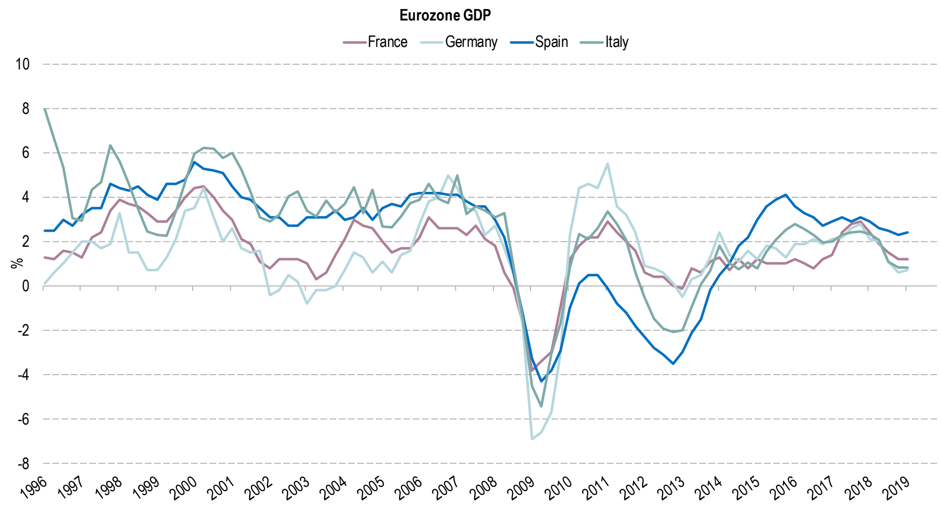
U.S./Germany Rate Differential

- Rates continue to be higher in the U.S. across the yield curve compared to Germany and Japan, and for most of Italy. Higher rates in the U.S. have been a contributing factor to the strength of the U.S. dollar.
- Given concerns over slowing growth, government bonds have attracted capital due to their safe-haven quality leaving large parts of the yield curves in Italy, Japan, and Germany in negative territory.

[1] Source: Bloomberg. Data is as of June 30, 2019. Rate differential data represents the differences in the yield for a U.S. Treasury at each maturity versus the respective similar bond for each country.

European Economic Conditions[1]

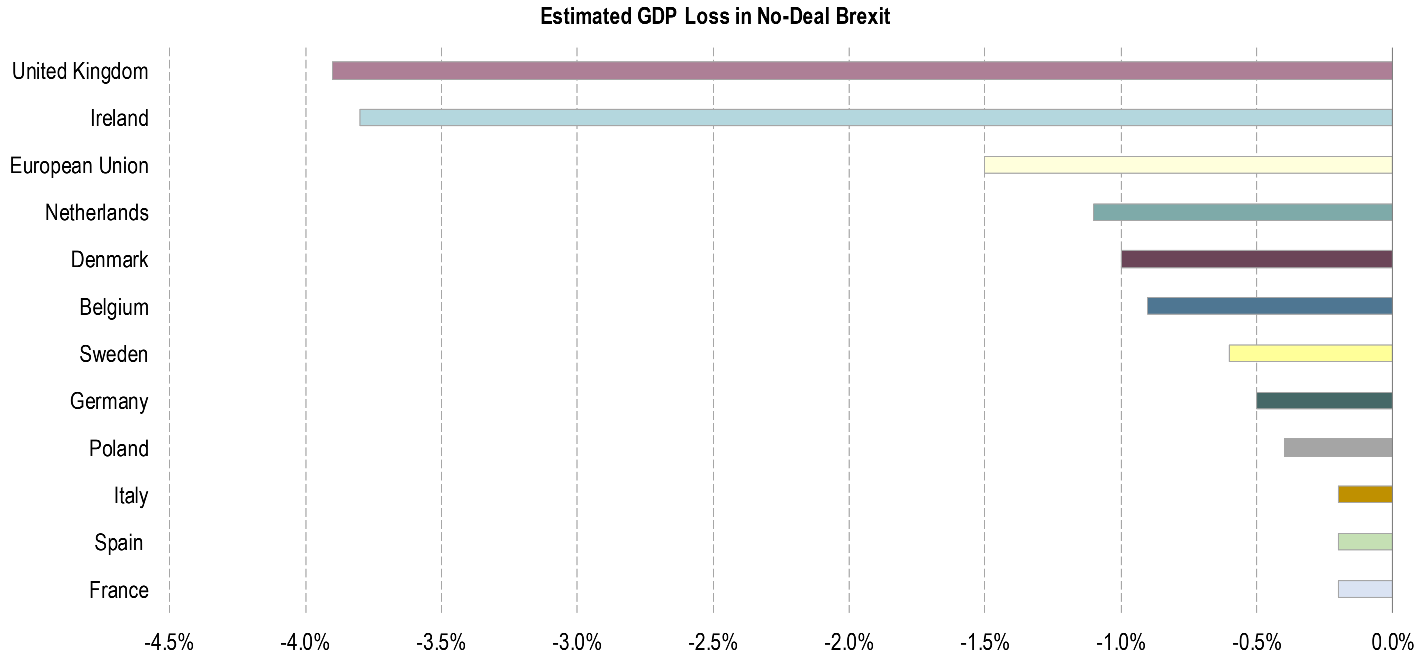




- Overall growth has declined in Europe given the slowdown in Germany, uncertainties related to Brexit, and trade tensions.
- Growth has been uneven in Europe with Germany experiencing much stronger growth after the Global Financial Crisis, and lower lows in 2012 and 2013, compared to Italy and Spain.
- High debt burdens have weighed on Italy and Greece's economies given their inability to devalue their currencies and the limits on fiscal expansion.
- Going forward, Italy's populist government's strategy to stimulate growth in the face of the high debt levels will be a key issue and could lead to continued clashes with the European Commission.

[1] Source: Bloomberg. Data for government debt as a percent of GDP is as of December 31, 2018. Eurozone GDP data is as of March 31, 2019.

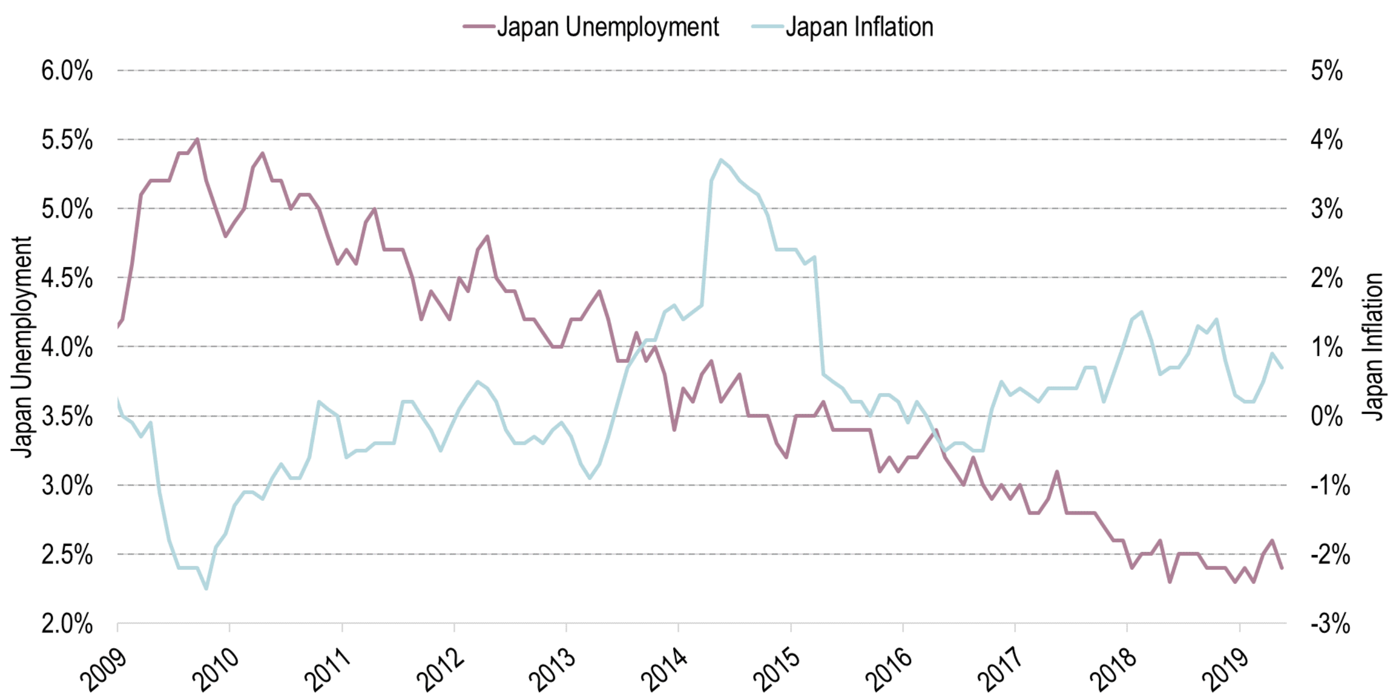
Brexit[1]



- The United Kingdom (UK) received an extension to the end of October of this year to finalize a deal with the European Union (EU) related to the terms of Brexit.
- Several options remain going forward with varied implications including approval of the deal Theresa May negotiated with the EU, Brexit being canceled, and an exit from the EU without a deal.
- A no-deal Brexit would be particularly impactful, weighing most on the UK and Irish economies, but with varied impacts across other countries too.
- After quarter-end, former London mayor and Eurosceptic, Boris Johnson, became prime minister and inherited the task of resolving prior differences and delivering Brexit.

[1] Source: IMF via The Guardian.

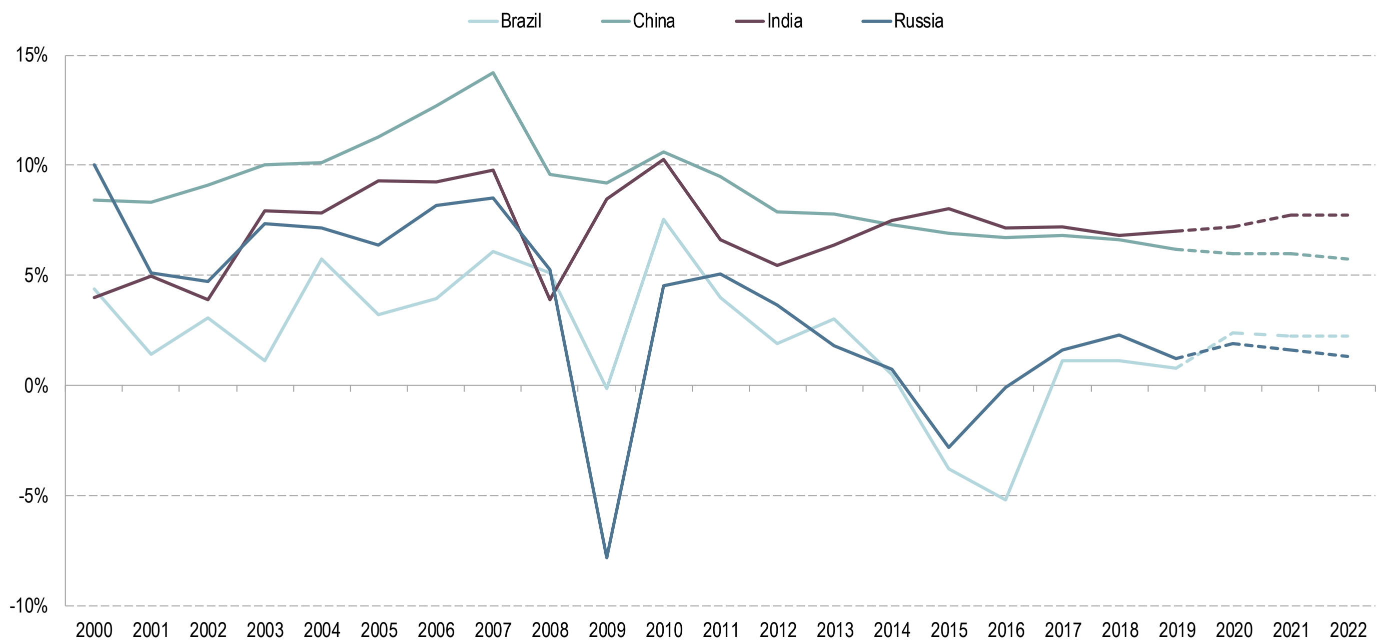
Japanese Economic Conditions[1]



- Inflation in Japan remains well below the central bank's 2% target and very low unemployment levels persist given the ageing workforce.
- Of all the major economies, Japan's central bank maintains the largest simulative effort particularly given below target inflation levels.
- Looking forward, the consumption tax increase scheduled for later in 2019, along with slowing global growth, could weigh on Japan's growth.

1 Source: Bloomberg. Data is as of May 31, 2019.

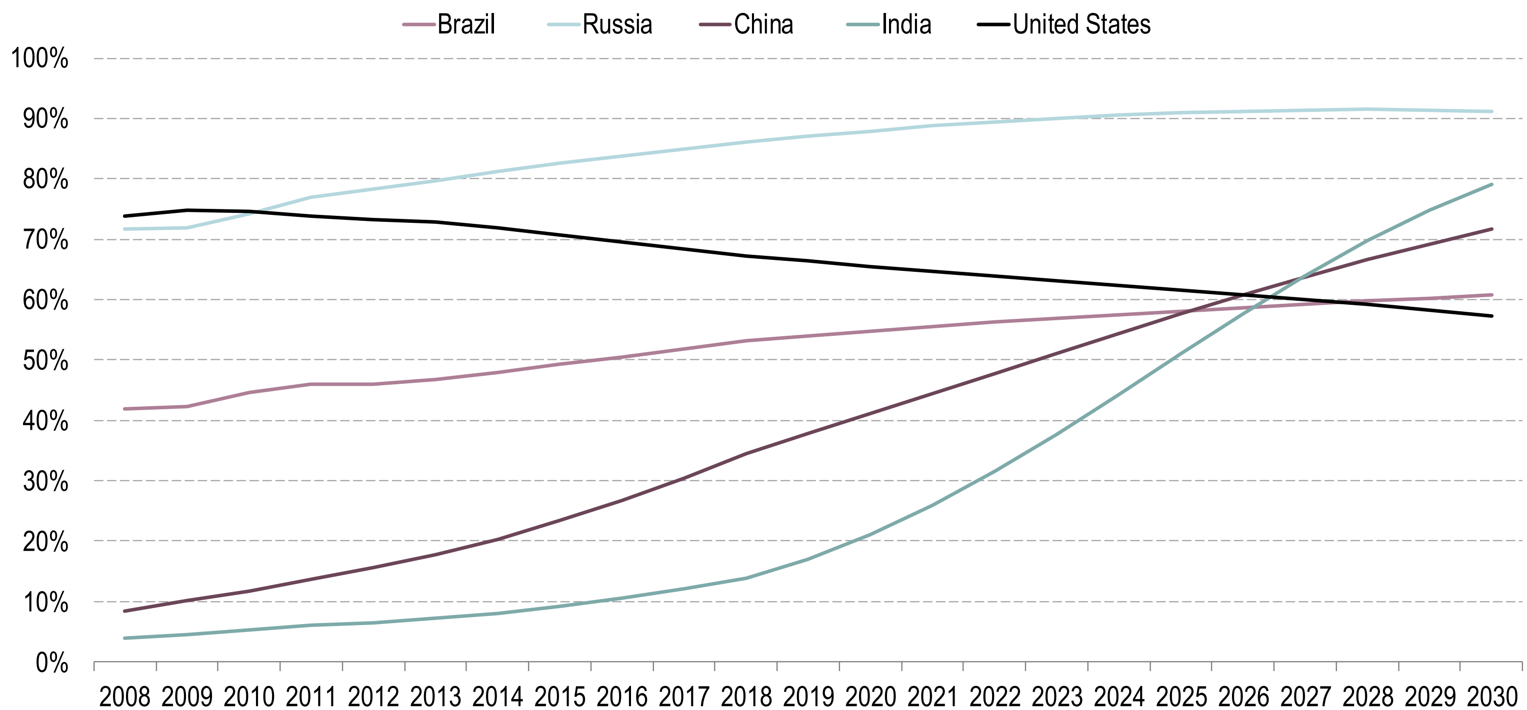
Emerging Market GDP[1]



- Growth in emerging economies generally remains higher than developed economies but uneven, with tariffs, debt levels, and slowing developed economies remaining key risks.
- Increased trade tensions with the U.S. added to the pressures of an already slowing China leading to predictions for growth to slow further, while India remains a bright spot with growth forecasted to pick-up to over 7%.
- The IMF projects growth from Russia and Brazil, an improvement from the contraction in 2015 and 2016. Forecast for Brazil's 2019 growth were reduced by over 1% given lingering uncertainties about fiscal reforms.

1 Source: IMF. World Economic Outlook. July update. Estimates start after 2018.

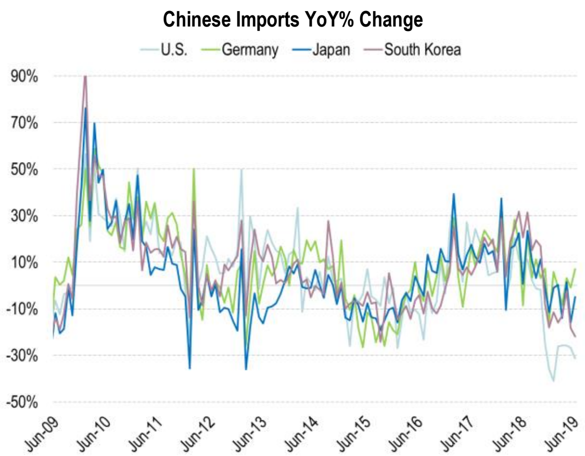
Growth of the Middle Class[1]
(% of Total Population)

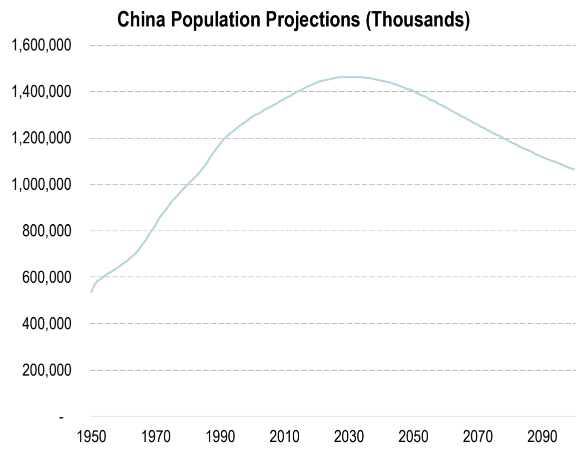


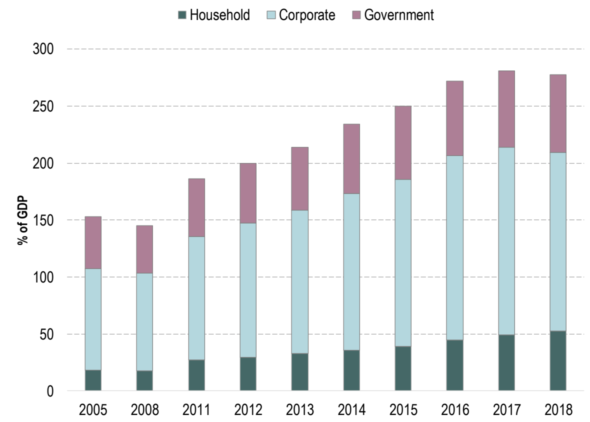
- A large part of the long-term emerging market story is the growth of the middle class.
- In advanced economies like the U.S., the middle class segment has matured, while in emerging markets it is expected to grow rapidly.
- The expanding middle class, particularly in China and India, is projected to lead to much higher consumption, and should help the global economy.

[1] Source: Brookings Institute.

China[1, 2, 3]







- In the coming years, China will need to manage the process of transitioning to an economy based more on consumption than investment, while continuing to reduce debt levels and dealing with financial risks. A prolonged trade fight with the U.S. could make this process difficult and further weigh on growth.
- Recently, trade has become sluggish in China due to the slowing economy and escalating trade tensions. Imports (above) declined on lower domestic demand, while exports fell given the U.S. trade tensions.
- Given sluggish economic conditions, policymakers increased stimulus recently by aggressively cutting taxes. This is a departure from the previous investment approach to stimulate growth.
- China's population is projected to decline given the impact of the "one child" policy. This creates further issues going forward as a relatively smaller work force needs to support a large retirement age population.

[1] Source for China Imports: Bloomberg. Data as of June 30, 2019.
[2] Source for China Population: United Nations "World Population Prospects 2019."
[3] Source for China Debt: Oxford Economics/CEIC data.

Summary

Three primary concerns face the global economy: 1) uncertainty related to the U.S. economy and policies; 2) declining growth in China, along with uncertain fiscal and monetary policies; and 3) political uncertainty in Europe and risks related to the U.K.'s exit from the European Union.

- The U.S. has experienced largely stable growth since the end of the financial crisis, but at levels below prior recoveries. The economic expansion has been long and it is inevitable that growth will eventually slow in the U.S., particularly as the impact of the tax cuts wane. The markets have largely cheered the Fed's recent pivot in monetary policy, but questions remain including whether this will lead to borrowers taking on more risk, is it too early to stop tightening policy, and how long is the rally in risk assets sustainable. Gridlock remains in Washington as seen by the government shutdown last year with uncertainty related to policies on tariffs, immigration, and strategic alliances remaining.
- China continues to manage a repositioning and slowing of its economy, which could have a meaningful impact on countries that depend on its trade. High debt, particularly in the corporate sector, and the escalation of the trade dispute with the U.S. remain key issues. Trade tensions and overall slowing global demand has already started to affect China as seen through recent trade data. The additional policy support could help the economy in the short-term, but may undermine efforts to reduce debt.
- Elections in Italy and recent protests in France show that unrest remains in Europe. Conflict has already materialized between Italy and the European Commission over Italy's budget proposal. Given that Italy is the world's fourth largest bond market and the third largest economy in Europe, what happens there matters, with a debt crisis or departure from the euro having far-reaching effects. The on-going negotiations of the U.K. to leave the EU is another key issue with recently elected Boris Johnson committing to deliver a Brexit one way or another by the October deadline.

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