GLOBAL ECONOMIC RESEARCH

GLOBAL MACRO OUTLOOK

JANUARY 2019

KEY FORECAST TRENDS

+ When 2018 began, the global economy was in a cyclical sweet spot. But gathering headwinds—including those caused by debt, demographic trends and populism—changed that, leading to slower growth and poor risk-asset returns.

+ Investors who expected last year to be the one when conditions returned to normal were disappointed. The definition of what's "normal" needs a reset.

+ We expect global growth to continue to slow in 2019—a normalization, if you will, back towards growth rates more consistent with a soft secular backdrop.

+ To be sure, this doesn't add up to recession. But softer growth and reduced liquidity do increase vulnerability. If any one of several key risks becomes reality, it could easily push us toward a worst-case outcome.

+ If that happens, investors will rightly question what's left in the monetary-policy toolbox. We fear the answer is likely to be "not much."

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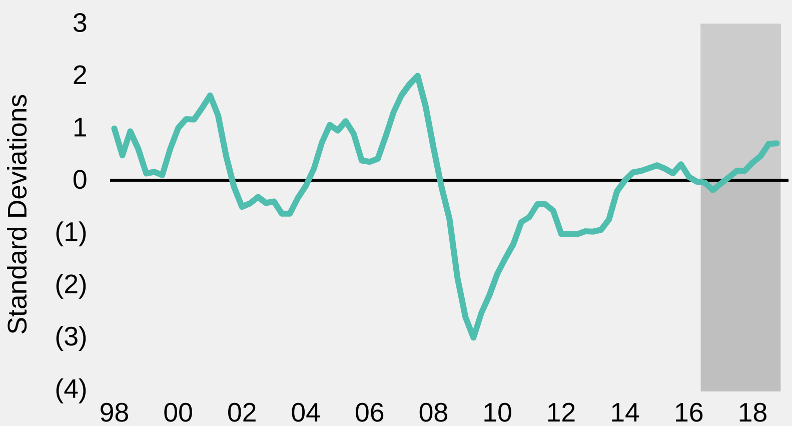
Not Just Demand Growth: Supply Matters, Too

UK Capacity Use*



Through December 31, 2018
*Weighted average of services and manufacturing
Shaded area represents the period since the Brexit vote in 2016.
Source: Haver Analytics and AB

+ Slower global growth can be attributed partly to populist policies, which have reduced demand. Global trade-volume growth is now slowing sharply. And there are signs that capital spending plans are being scaled back as a result.

+ But populism also affects the supply side of the economy. The UK is the poster child for this idea. Demand has underperformed since the Brexit vote, but capacity use and wages have continued to rise—evidence of constrained supply and a worse mix of growth and inflation.

GLOBAL FORECASTS

Economic Growth

- Rising headwinds point to softer growth ahead
- Policy response—a more dovish Fed, further easing in China—mitigates downside
- But vulnerability to crystallization of event risks remains elevated

Key Risks

- Further trade-war escalation
- China-policy mistake
- European politics (UK, Italy)

Inflation

- The secular backdrop still points to higher inflation over the medium term
- But—despite high capacity use—softer growth and falling oil prices will present a hurdle in 2019

Key Risks

- Greater non-linearity in the Phillips curve?
- Supply constraints dominate

Monetary Policy

- Fed more data-dependent; we expect two rate hikes this year
- Case for ECB hike later this year has weakened; BOJ to stay on the sidelines, anchoring JGB yields

Key Risks

- Tightening more powerful than expected
- Market-driven tightening of financial conditions

OUTLOOK

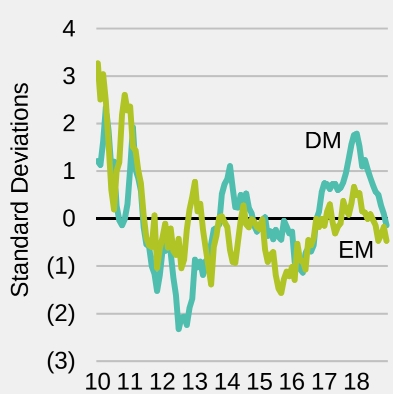
- We trimmed our 2019 global growth forecast again this month—this time, to 2.8%. Downgrades to the US (incoming activity data) and Canada (softer oil price and weaker US forecast) dominated; Japan's forecasts were also marked lower as export volume growth continued to soften.

- Compared with consensus, we are still a bit more pessimistic on the euro area (1.3% vs. 1.6%) and the US (2.0% vs. 2.6%), in line on China (6.2%), and a tad above consensus on Japan (1.2% vs. 0.9%).

- We've also trimmed our global inflation forecast for next year, to 2.8%. This largely reflects a lower oil price starting point. While slowing growth represents a downside risk, high capacity utilization rates and rising wage growth represent clear upside risks, and we do not expect a sharp deceleration of core inflation pressures.

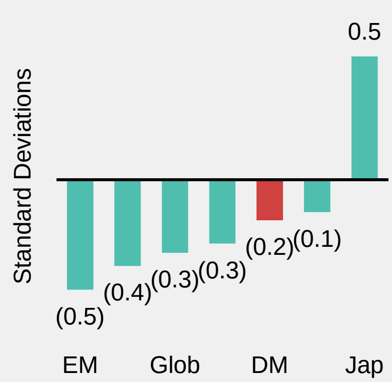
Global Cyclical Outlook: Toward a Synchronized Slowdown?

Manufacturing PMIs



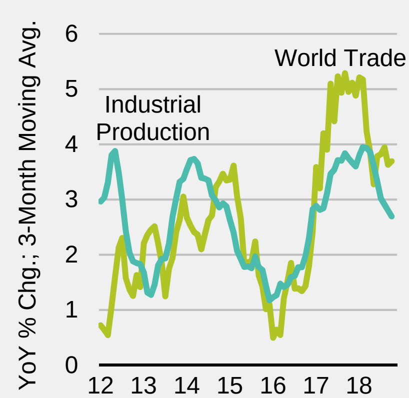
Through December 31, 2018
Source: Haver Analytics and IHS Markit

Manufacturing PMI: Dec 2018



As of December 31, 2018
Source: Haver Analytics and IHS Markit

Global Trade & IP Growth



Through October 31, 2018
Source: Haver Analytics

GLOBAL MARKET OUTLOOK: YIELD CURVES

GLOBAL YIELDS

Global—DM yields are still very low and expected to rise, but magnitude and timing less certain.

US—The market has now priced out any rate hikes in 2019; that's too big a shift, in our view, and we expect yields to rise over the coming year.

Euro Area—The case for higher Bund yields has weakened, but they remain well below our fair-value estimates and still look likely to rise; politics a downside risk.

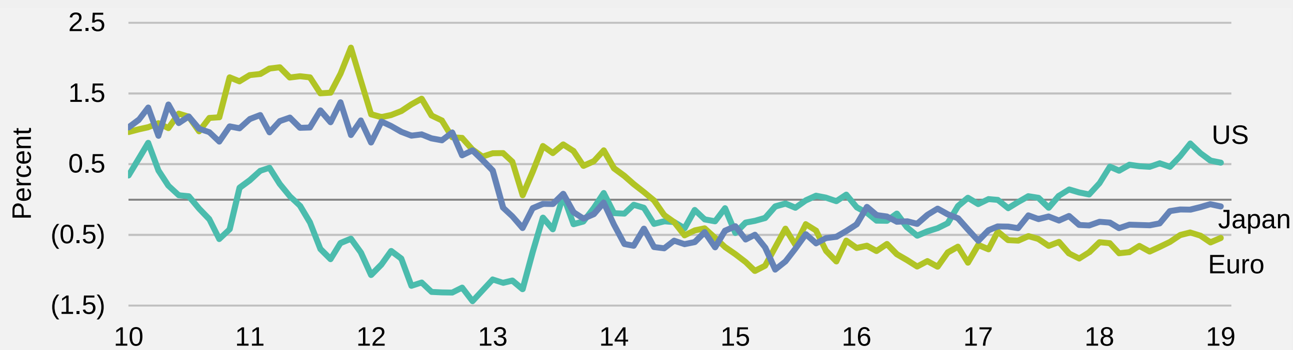
Japan—QQE-YCC policy to anchor 10-year yields close to zero; the risk of a policy tweak this year has fallen.

10-Year Yields: AB vs. Consensus Year-End Forecasts (%)

	AB		Consensus	
	2018	2019	2018	2019
US	2.69	3.50	2.69	3.29
Euro	0.24	0.75	0.24	0.89
Japan	0.00	0.15	0.00	0.17
China	3.31	3.30	3.31	3.25

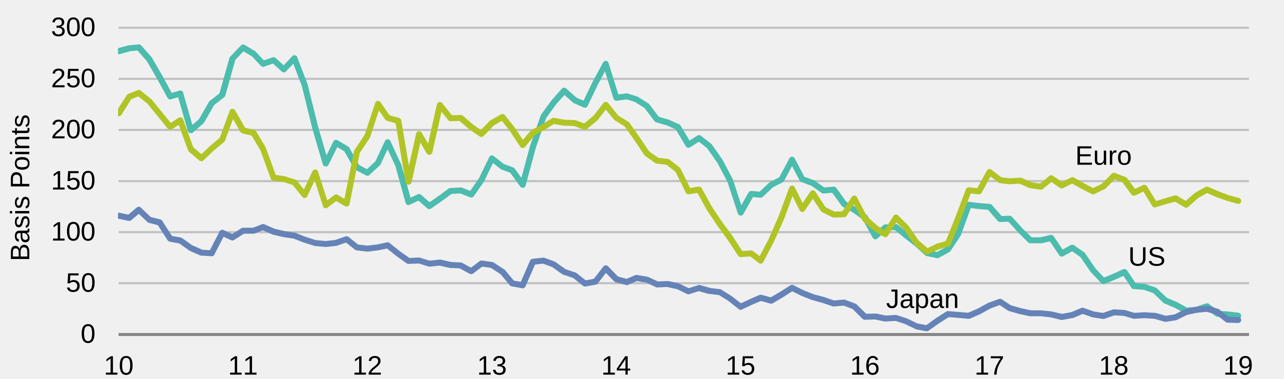
As of January 4, 2019
Source: Bloomberg and AB

Real 10-Year Bond Yields*



Through January 4, 2019
*Current 10-year bond yield less 5-year/5-year forward inflation swap
Source: Bloomberg and AB

Yield Curves: 10-Year Bond Yield Less 2-Year Bond Yield



Through January 4, 2019
Source: Bloomberg and AB

GLOBAL MARKET OUTLOOK: CURRENCIES

FX FORECASTS

USD—The US dollar has been largely range-bound over the last two years, and we see few reasons for this to change; we think that the currency has modest upside potential in the short run.

JPY—The yen should benefit if, as we expect, risk assets continue to struggle.

EUR—With the probability of a 2019 rate hike receding, we see few catalysts for a stronger euro; politics are still an important downside risk (e.g., Italy, Brexit).

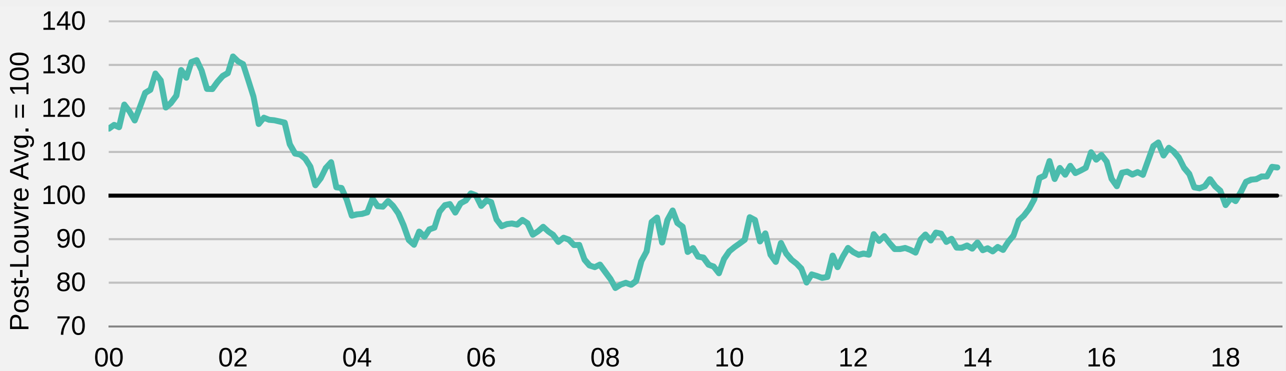
CNY—CNY is already being used as a policy tool in the trade war and could fall further, should tensions escalate further.

Global FX: AB vs. Consensus Year-End Forecasts

	AB		Consensus	
	2018	2019	2018	2019
EUR/USD	1.15	1.10	1.15	1.20
USD/JPY	110	105	110	108
USD/CNY	6.88	7.20	6.88	6.80
EUR/GBP	0.90	0.85	0.90	0.88

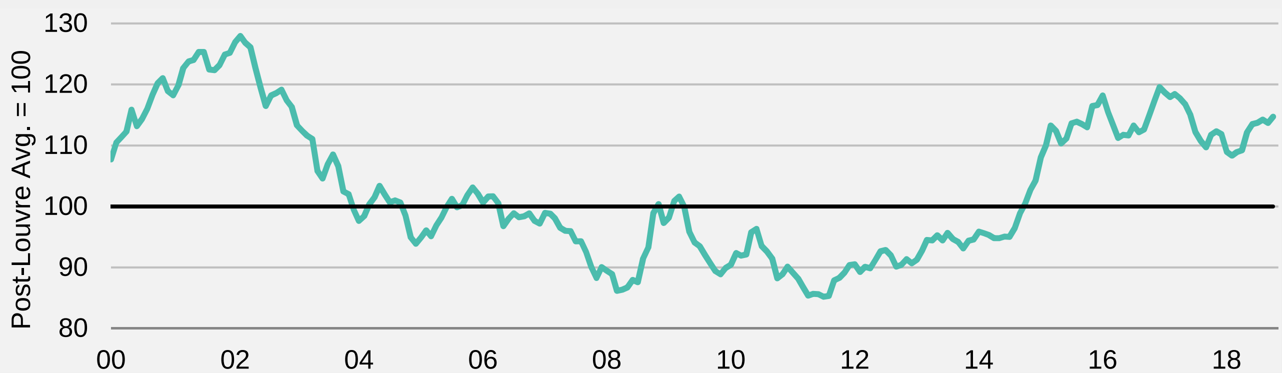
As of January 4, 2019
Source: Bloomberg and AB

Nominal USD Exchange Rate: DXY



Through January 4, 2019
Source: Bloomberg and AB

Real USD Exchange Rate



Through January 4, 2019
Source: Bloomberg and AB

US

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
US	2.5	2.0	2.3	2.3	2.38	2.88	2.69	3.50

OUTLOOK

- The US economy continued to perform well in December, but financial market turbulence suggested rising concern about the outlook. We continue to believe that a gradual slowdown is the most likely trajectory in 2019, though it is clear that downside risks to the outlook have mounted.
- When incoming data and financial markets tell different stories about the economy, it poses a challenge to central banks. The Fed continues to expect the economy to perform well, but if it sounds insensitive to market concerns, as it did at Chair Powell's December press conference, markets may perform poorly and thus slow the economy.
- With price pressures subdued and lower oil prices posing downside risks to inflation, the FOMC can afford to be patient rather than proceeding with quarterly rate hikes in a more challenging environment. Given the rise in downside risks, we now expect two rate hikes in the second half of 2019 rather than the four hikes in our previous forecast.

RISK FACTORS

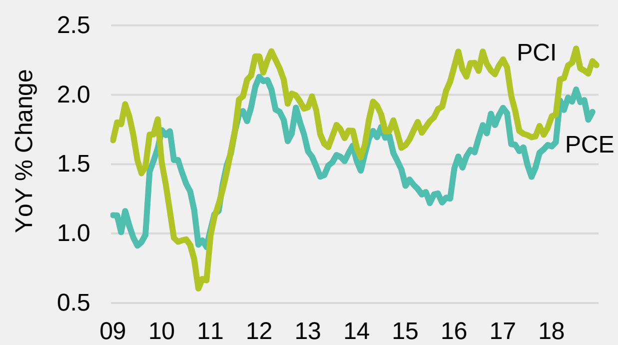
- Global growth has weakened, and downward revisions to global growth forecasts suggest that the outlook may deteriorate further. Turmoil related to Brexit and Italy and fragility in China all pose headwinds to US growth.
- Financial market sentiment remains precarious, and an unwanted tightening of financial conditions could trigger a more profound slowdown than we currently expect.
- Politics remain an ever-present risk, and the government shutdown appears poised to last long enough to have a material impact on 1Q growth. Trade tensions remain unresolved, and the very early stages of the 2020 presidential election may influence policymaking in 2019 in unpredictable ways.

OVERVIEW

While financial markets are telling us that the US outlook has deteriorated significantly, we remain more sanguine. Yes, growth is likely to slow in 2019, both in the US and globally. Still, the starting point is a strong one, and, in the end, we suspect that 2018's strong growth will look like an outlier while 2019 will be more in line with other recent years. Without significant fiscal or monetary stimulus, 2019 growth should return to more "normal" levels of about 2%. The risks around that profile are skewed to the downside, with global deterioration and financial market turbulence front of mind. The good news is that price pressures and inflation expectations remain well in check, which gives the Fed the space to accommodate these tensions by slowing the pace of rate hikes and becoming more data-dependent. If the outlook proceeds as we expect, the committee is likely to be back to raising rates in the second half of the year.

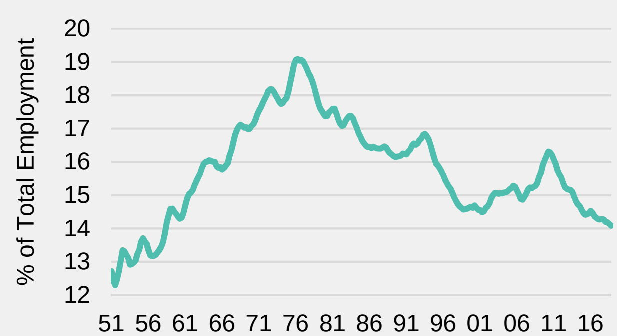
One new downside risk is the government shutdown. Government employment is a sizable chunk of total employment, and with several hundred thousand workers unoccupied for the time being, 1Q growth is likely to take a hit. Assuming that the shutdown is resolved in relatively short order, the impact should be transitory; but, of course, that assumes a particular political outcome. As we have all learned in the past few years, it isn't safe to assume anything about politics these days.

US Core Inflation Is Stable



Through December 14, 2018
Source: Thomson Reuters Datastream

Government Employment



Through October 15, 2018
Source: Thomson Reuters Datastream

Euro Area

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Euro Area	1.9	1.3	1.7	1.4	0.00	0.00	0.25	0.75	1.14	1.10

OUTLOOK

+ Since the middle of 2018, we have steadily lowered our 2019 forecast for euro-area growth, taking it from 2.1% to 1.3%. This was due, at first, to rising trade tensions and then to signs that the Italian economy was likely to slow sharply in coming quarters.
+ The recent decline in the oil price has led to a slight reduction in our 2019 inflation forecast, to 1.4% from 1.7%. Core inflation is likely to pick up this year but only very modestly, to end the year at 1.3%.
+ The European Central Bank (ECB) has terminated its asset-purchase program. With growth slowing and core inflation likely to make only limited progress, the odds have now tilted against a rate hike this year.

RISK FACTORS

+ Having downgraded our growth forecast this month, risks are now more evenly balanced. Much will depend on future developments in the trade war and political developments closer to home.
+ While euro-area economies are less vulnerable than that of the UK, a disorderly resolution to Brexit negotiations is an important downside risk.
+ Italian political uncertainty is an additional source of downside risk, particularly ahead of European elections scheduled for May. The new populist government has toned down its plans for fiscal expansion, but with growth slowing sharply in Italy, further confrontation with its euro-area partners looks likely.

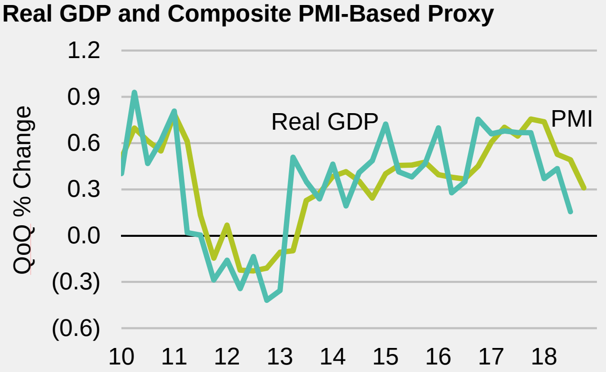
OVERVIEW

Euro-area data continue to disappoint, with the composite PMI for manufacturing and services dropping to 51.1 in December, its lowest reading since 2013. Much of the weakness in December was due to a sharp fall in the French PMI, to 48.7 from 54.2, which was probably a reaction to the *gilets jaunes* protests that have rocked the country. While the latest reading probably overstates the weakness of the French and euro-area economies, there is little doubt that growth slowed significantly over the course of 2018.

Although the economy is slowing, many indicators suggest that capacity is very tight, and this appears finally to be feeding through to faster wage growth. In the third quarter, annual growth in compensation per employee rose to 2.5%, the fastest growth rate since 2008. At the same time, unit labor-cost growth accelerated to 2.2%, above the precrisis average and the ECB's expectations. There is also evidence of rising pipeline inflation, with producer price inflation for core domestic consumer goods rising to 0.9% in November, the highest since early 2012.

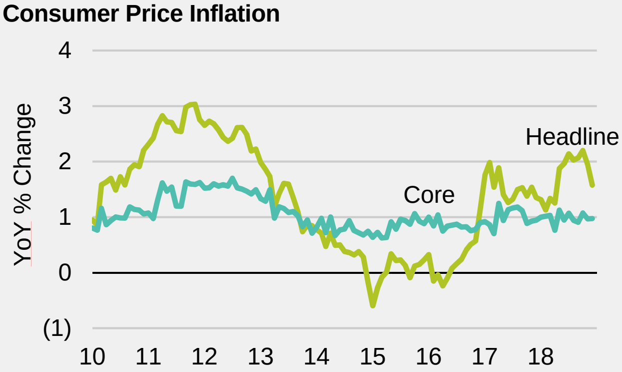
In spite of this, core CPI inflation remains muted at 1.0% and shows few signs of upward momentum. Against a backdrop of slowing growth, the ECB will need compelling evidence of rising core inflation to contemplate raising interest rates. And with this unlikely to be forthcoming, we expect rates to remain on hold (in negative territory) throughout 2019.

Real GDP and Composite PMI-Based Proxy



Through December 31, 2018
Source: Haver Analytics and IHS Markit

Consumer Price Inflation



Through December 31, 2018
Source: Haver Analytics

Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Japan	0.8	1.2	1.0	1.3	(0.05)	0.00	0.02	0.15	110	105

OUTLOOK

- We expect modest GDP growth of about 1% in 2019. Slowing global trade will drag on the economy, but fiscal stimulus, business investment and accelerated consumption ahead of October's VAT hike should offset that.
- Wage inflation is already at a 20-year high and should continue to rise, putting pressure on underlying inflation. But known one-offs, such as the VAT hike, free education and telecommunications charges, will muddy the inflation picture.
- The Bank of Japan (BOJ) is likely to stay on the sidelines in 2019. Expect the Yield Curve Control (YCC) framework to stay in place (targeting 10-year yields around zero); JGB purchases will more or less match government net issuance.

RISK FACTOR

- Potential self-inflicted risks remain—the VAT hike and possible BOJ missteps chief among them. But external risks are more important, whether they materialize through trade or via sharp appreciation in the yen in a risk-off environment.

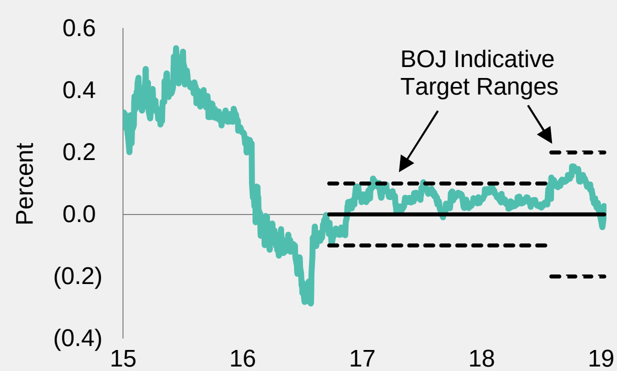
OVERVIEW

The second half of 2018 was patchier than expected for the Japanese economy, partly because of weather-related disruptions and evidence of slower export growth. The latter is likely to persist through 2019. Still, there are a number of positive offsets, including ongoing strength in capital spending (commercial property, labor-saving initiatives), fiscal stimulus and the bringing forward of consumption spending ahead of October's VAT hike. That should be enough to get growth running at about the 1% mark (above trend but close to consensus forecasts).

With capacity constraints getting tighter and wage inflation rising, we expect to see cost inflation to intensify. Whether that shows up in higher headline CPI inflation is unclear. The decline in oil prices (and a stronger yen) will flow through to domestic energy prices with a lag. And some known one-offs will muddy the picture, including the VAT hike, introduction of free education and a sharp fall in telecommunications charges.

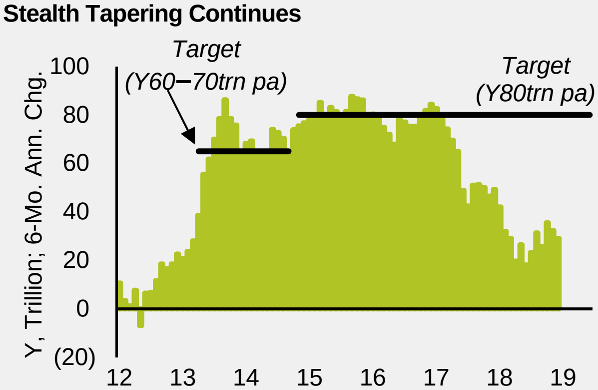
In this environment—and with external and domestic risks skewed to the downside—it seems likely that the BOJ will sit pat in 2019. This amounts to maintaining the YCC framework (targeting 10-year yields at around zero) and continuing to buy JGBs in roughly the same volume as the government's net issuance program (about Y25–30 trn per annum, recognizing that the purchases are subordinate to maintaining yield stability). The debate about how to deal with the financial stability risks of current monetary settings will continue, but with little action likely.

10-Year JGB Yield Remains Anchored



Through January 10, 2019
Source: BOJ and Bloomberg

Stealth Tapering Continues



Through December 2018
Source: Datastream

China

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
China	6.5	6.2	2.3	2.8	4.35	4.35	3.50	3.30	6.87	7.20

OUTLOOK

+ We think that the official real GDP growth rate will be about 6.2% in 2019, but a likely peak in the capex cycle and decreasingly effective easing policies mean that there's more downside than upside risk to that forecast.
+ We expect inflation to rise to about 2.8%, mostly the result of further food (grain and pork) inflation from trade tensions and currency depreciation.
+ The government should be all in when it comes to policy easing. Big infrastructure projects and property easing are probably unavoidable, but it's possible that it will be too little, too late.

RISK FACTORS

+ Untimely or inefficient easing policies—or both—could make for a gloomier 2019 outlook.
+ Rising inflation and slower growth risk a stagflation scenario and prevent the central bank from easing further.
+ Another rise in trade tension with the US could provoke more RMB depreciation, making it a global currency and confidence destabilizer.

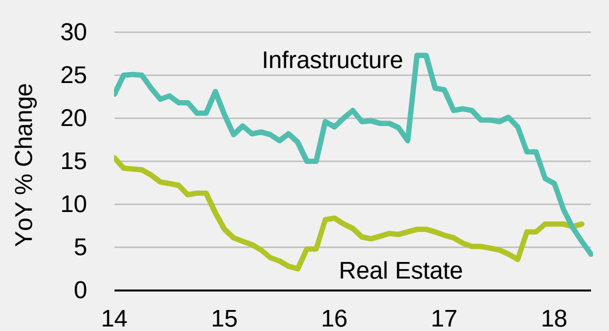
OVERVIEW

We believe that the most effective policy easing would be central-government-led investment in key infrastructure projects. The NDRC has stepped up approvals of infrastructure projects, and early January brought increased issuance of special local government bonds. Infrastructure projects are likely to focus on railway and highway construction, the electrical grid, 5G development, transportation equipment, natural gas storage and smart transportation. Big central-government projects are also likely in the Xiong An new zone in Hebei and in Olympic stadiums and venues. We estimate that the stimulus will boost GDP by 1.0%–1.5%.

Slower consumption, investment and trade are all downside growth risks, but slower consumption is the most acute of these. Fiscal stimulus will temper slower investment, while the trade-war "cease-fire" may soften the impact of the trade slowdown. But if consumers put away their wallets, it will take a rebound in stock prices to soften the blow and could raise speculation about whether the central bank will buy ETFs. Other remedies are less likely, including a rebound in property prices, an increase in leverage or wage growth.

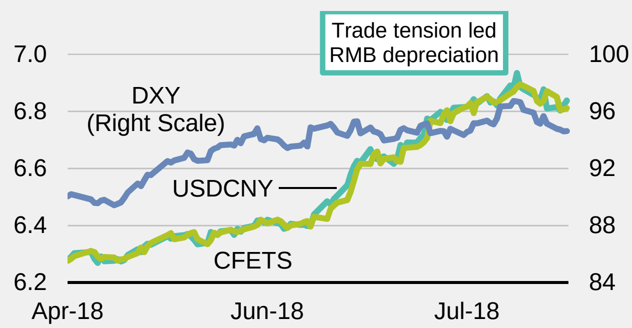
Larger monetary- and fiscal-policy easing over the near term would increase the probability of reaching 6.2% real GDP growth in 2019. If that happens, Chinese growth stabilization will keep the CNY from breaking the psychologically important threshold of 7.00 per US dollar, making it a global currency stabilizer.

Re-Leveraging Up



Through January 4, 2019
Source: Bloomberg

RMB Depreciation Slowed After Counter-Cyclical Factor Introduced



Through January 4, 2019
Source: Bloomberg

Canada

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Canada	2.5	1.8	2.1	2.1	1.75	2.25	1.96	2.75	1.37	1.35

OUTLOOK

- The domestic economy remains in strong shape, which is helping to boost the labor market. Unemployment is at a historical low, which should put upward pressure on inflation over time—though, given commodity price weakness, it is unlikely that inflation will rise sharply.
- The lower level of energy prices poses downside risks to Canadian growth that may offset some of the boost from the resolution of trade tensions with the US.
- Despite the strong economy, the Bank of Canada must contend with downside risks. As in the US, the BOC is likely to stand pat for now, until recent market and economic crosscurrents play out. The central bank is still likely to raise rates, but we don't expect policy action until later in the year.

RISK FACTORS

- Lower commodity prices are likely to pull growth down over the course of 2019.
- Should the US slowdown be more pronounced than we currently expect, the Canadian economy would suffer as well.

OVERVIEW

As with the Fed, the Bank of Canada enjoys the luxury of time. Stable price pressures mean that the BOC can wait to see how the crosscurrents evident in the economy play out. Strong labor markets pose upside risks to consumption, but weaker commodity prices pose downside risks to business investment and activity. Unless and until inflation moves decisively in one direction or another, the BOC is likely to watch and wait. We don't expect dramatic moves in the exchange rate to unduly influence the economy in 2019.

Australia/New Zealand

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Australia	2.9	2.1	1.9	1.9	1.50	1.50	2.32	2.85	0.70	0.67
New Zealand	2.8	3.2	1.6	2.2	1.75	2.00	2.34	3.25	0.68	0.71

AUSTRALIA

- The year 2018 was one of strong momentum. The end of the mining bust, a boom in state-government-led infrastructure and strong housing construction drove business confidence to record highs and underpinned a surge in jobs.
- But conditions are set to deteriorate rapidly in 2019, mainly because of housing. Home prices are already falling sharply, particularly in Sydney and Melbourne, amplifying the stress on stretched household balance sheets. A solid pipeline of activity has delayed the inevitable, but with approvals now more than 20% off their peaks, housing construction is also set to fall away rapidly. Together, these conditions represent a substantial drag.
- Central bank optimism about the outlook again looks misplaced. We expect discussion to shift from rate hikes to rate cuts, though the first cut isn't likely to come before 2020. Even so, discussion is likely to undermine the AUD.

NEW ZEALAND

- In contrast to Australia, business sentiment in New Zealand was in the doldrums in 2018. At the same time, labor market outcomes were solid, with the unemployment rate dropping below 4%.
- While inflation is relatively low, cost pressures are rising, and there are some tentative signs that wage growth is picking up. With terms-of-trade close to a record high, and with a sizable fiscal impulse to be delivered this year, we expect speculation to turn once again toward central bank tightening. We've tentatively penciled in a rate hike in 4Q.

UK

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
UK	1.5	1.5	2.5	1.8	0.75	1.00	1.33	1.75	1.27	1.30

OUTLOOK

- Recent data suggest that growth has slowed again, after a surprisingly strong third quarter. A new monthly GDP indicator shows that growth slowed to 0.4% in the three months to October from a peak of 0.7% in the three months to July. And while the composite PMI rose slightly, to 51.4 in December from 50.8 in November, these are still the lowest readings since a temporary slump below 50, following the Brexit vote in summer 2016.
- If a no-deal Brexit is avoided, the British economy is likely to grow at much the same pace this year as last. Slowing global growth and Brexit-related uncertainty suggest that the risks to this forecast are on the downside, but this is likely to be offset by recently announced fiscal stimulus. With capacity use already tight and wage growth rising, we still think that the balance of risks is skewed toward additional monetary tightening. But with the possibility that Brexit uncertainty could last longer than expected and other central banks scaling back their plans for monetary tightening, we now look for one 25-basis-point hike rather than two.

RISK FACTOR

- The outlook is still heavily contingent upon the outcome of Brexit negotiations. The most likely outcome is that the UK will either ratify the deal agreed with the European Union or choose not to leave after all. But the risks of a disruptive no-deal Brexit or domestic political and constitutional crisis should still not be dismissed.

Norway/Sweden

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Norway	2.5	2.0	2.5	1.9	0.75	1.25	1.79	2.25	8.66	8.64
Sweden	2.5	2.1	2.0	1.9	(0.50)	0.00	0.52	1.00	8.87	9.09

NORWAY OUTLOOK

- Growth in the mainland economy slipped to 2.3% in the third quarter, from 2.6% in the first half of the year. Next year, we expect growth to slow slightly, to 2.0%.
- Headline inflation was stable at 3.5% in December, well above the Norges Bank's 2.0% target. Core inflation (excluding energy and indirect tax changes) eased slightly, to 2.1% from 2.2%, but the underlying trend still appears to be upward.
- Against this backdrop, the Norges Bank has signaled that interest rates are likely to rise gradually over coming years, with the next move possibly coming as early as March, data permitting.

RISK FACTOR

- The main risk factor for Norway is rising household debt (currently well above 200% of income). The economy would also be vulnerable, should the oil price continue to decline.

SWEDEN OUTLOOK

- Economic growth was very soft, at just 1.7% in the third quarter. This was much weaker than expected, but with survey data strong and Swedish data often subject to heavy revisions, we think that this overstates the weakness of the economy.
- Core inflation (CPIF excluding energy) eased to 1.4% in November, from 1.5% in October, and remains roughly in line with its average over the last two or three years.
- The Riksbank surprised most market participants by raising interest rates by 25 basis points at its December meeting, but tempered this by signaling that the next rise was unlikely to come until the second half of 2019.

RISK FACTOR

- High household debt and elevated house prices continue to represent a major risk to financial stability.

Asia ex Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Asia ex Japan	**6.0**	**5.7**	**2.5**	**2.9**	**4.27**	**4.31**	**3.98**	**3.95**	**—**	**—**
Hong Kong	3.0	2.8	3.0	2.6	2.75	2.50	1.98	2.40	7.83	7.85
India	7.6	7.5	4.0	4.2	6.50	6.75	7.37	7.20	69.82	71.20
Indonesia	5.3	5.1	3.2	3.0	6.00	6.25	7.41	7.70	14,481	14,800
South Korea	2.6	2.2	1.3	1.9	1.75	1.75	1.96	3.00	1,116	1,150
Thailand	4.1	3.5	1.1	1.4	1.75	2.00	2.45	2.70	32.56	32.80

OUTLOOK

+ Reduced trade volume, global growth downgrades and a peaking technology cycle should slow regional growth in 2019.
+ Lower oil prices and stable exchange rates should keep inflation under control—good news for local rate markets.

RISK FACTORS

+ Uncertainty over trade and US-dollar volatility could hurt regional currencies and portfolio flows. Further continued CNY depreciation remains a key factor.
+ Any rebound in oil prices would erode fiscal and external surpluses and reverse the recent improvement in sentiment.

OVERVIEW

Recent trade indicators point to moderation in manufacturing activity. PMIs in China, Taiwan and South Korea were below 50, the level that separates expansion from contraction. This mirrors what we've seen in developed-market PMIs. Persistent trade tensions are mainly to blame for the slowdown, but so is weakening global demand and the smartphone cycle, which is reaching its peak. These headwinds should continue to hurt exports and suggest slower regional growth in 2019.

There is, however, room for a policy response. Most Asian economies' large domestic savings may act as a buffer against these trade-related headwinds. Asia has also benefited from a continued correction in oil prices. The base effect of a lower oil price will be to reduce headline CPI inflation in the months ahead and, combined with a weaker growth outlook, should allow central banks to shift to a neutral stance, particularly as currency pressure fades. Real rates in most Asian economies have returned to positive territory, the result of preemptive tightening in 2018. A benign inflation outlook should be good for Asian local rates in the months ahead.

For current account deficit economies such as India, Indonesia and the Philippines, a lower oil price improves their external accounts, which should increase demand for their currencies and local assets. We think that Indonesia will benefit most, given that real rates there have been high and fiscal consolidation was already under way in 2018. India will face more challenges from higher volatility and the possibility that policy gets more populist ahead of a general election this spring.

Latin America

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Latin America	**0.8**	**1.6**	**9.3**	**6.6**	**13.77**	**10.56**	**7.44**	**8.42**	**—**	**—**
Argentina	(1.9)	(0.3)	45.0	28.0	59.25	35.00	—	—	38.57	46.00
Brazil	1.3	2.4	4.1	4.1	6.50	7.75	7.38	8.90	3.88	3.80
Chile	4.0	3.7	2.9	3.0	2.75	3.50	4.45	4.80	696	700
Colombia	2.6	2.6	3.5	3.8	4.25	4.75	6.72	7.15	3,250	3,280
Mexico	2.1	1.8	4.7	4.0	8.25	8.00	8.75	9.30	19.69	21.20

OUTLOOK

+ Economic fundamentals are improving in much of the region, including in Brazil, Chile, Colombia and Peru. But political risks are rising in Argentina, Mexico and Venezuela, and will likely prove to be a major headwind in 2019.
+ The move toward a more dovish monetary-policy stance by central banks globally will reduce pressures on Latin American policymakers to hike rates in line with the Fed. This convergence of monetary policy will also ease pressure on EMFX.

RISK FACTOR

+ Uncertainty surrounding US trade policy will continue to weigh on LATAM economies, and not just Mexico, which is most directly affected by USMCA. The US–China trade tensions are affecting commodity-exporting economies in Latin America, and the persistence of policy uncertainty reduces demand and investment into commodity sectors.

OVERVIEW

Economic activity will be stronger in 2019 than it was last year, though the recovery has fallen short of initial expectations. Mexico has managed to maintain its growth pace despite election- and NAFTA-related uncertainties. Brazil’s economy will expand again this year, although at a slower pace than initially projected. Meanwhile, Argentina is now in the middle of a contractionary phase, and Venezuela is mired with hyperstagflation. In the rest of the region, growth is soft and inflation rates remain subdued, although currency weakness suggests that some lingering pass-through from currency to domestic prices is yet to materialize. We expect no monetary easing in most of the region in the near future.

Argentina, of course, is the exception. Monetary tightening is working there, and we believe that the economic recession is likely near its nadir. Leading indicators, including manufacturing and construction reports, were down substantially and monthly inflation probably peaked in November. The government expects to see a recovery beginning in the second quarter as the impacts of successful monetary and fiscal adjustments are realized. And the structure of the monetary adjustment allows for offsetting buffers in certain scenarios. The peso breached the lower bound of BCRA’s no-intervention range after the first central bank auction since the new monetary-policy regime began in October 2018, and BCRA responded by buying US$20 million in reserves. This move expands the monetary base, which is positive for growth. Stability of the ARS, lower inflation and a rebound in economic activity are essential for President Macri to remain competitive in his bid for reelection.

In Brazil, discussions on pension reform remain the priority in Congress and for President Bolsonaro. Recent talks have included a proposal to create a capitalized pension system, which represents a much more ambitious reform than originally proposed. Bolsonaro and his team have expressed preference for a gradual, moderate reform. He does not have a controlling majority in Congress, so negotiations may take longer than initially anticipated, but we expect that a watered-down reform proposal will eventually be passed.

Eastern Europe, Middle East and Africa (EEMEA)

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
EEMEA	**2.6**	**2.0**	**6.6**	**6.3**	**10.76**	**8.71**	**10.00**	**9.08**	**—**	**—**
Hungary	4.2	3.2	2.7	3.1	0.90	1.25	3.01	3.40	281	291
Poland	4.5	3.5	1.8	2.3	1.50	1.50	2.81	3.50	3.76	4.22
Russia	1.8	1.4	3.0	4.5	7.75	7.25	8.78	8.25	69.52	66.00
South Africa	0.6	1.2	4.6	5.2	6.75	7.00	9.44	9.40	14.39	14.50
Turkey	2.8	(2.6)	16.2	16.3	24.00	18.00	15.83	15.00	5.27	5.60

OVERVIEW

+ Real GDP growth should remain robust in most of the EEMEA region over the course of 2019, though it may slow slightly from the pace set in 2018, mainly because of a more significant slowdown seen in Turkey.
+ Headline CPI is rebounding in most Central and Eastern European (CEE) economies, but it’s likely to peak in mid-2019. Recent oil price declines are key downside risks. Turkish headline inflation dynamics remain the most challenged but are expected to ease in 2019.
+ CEE central banks are expected to remain on hold, while Russia and Turkey have room to cut interest rates.

RISK FACTOR

+ Balance-sheet normalization at developed-market central banks and the potential for higher core yields are risks for current account deficit countries such as Turkey and, to a lesser extent, South Africa.

OVERVIEW

Recent oil price swings have sparked a fair amount of volatility among the region’s oil producers, though most should be able to weather further fluctuations (barring a significant decline toward US$40/bbl for Brent crude prices). Oman is the most notable exception. A lack of reform progress and poor fiscal management (despite higher prices for most of 2018) prompted Fitch to downgrade Oman to BB+, taking the country firmly into speculative territory. S&P already had Oman at BB, and only Moody’s still considers it a Baa3 credit, albeit with a negative outlook. Fitch pointed to Oman’s large nominal fiscal deficit (9% of GDP in 2019) and signs of renewed fiscal expansion in 2018, which should widen the deficit to at least 10% in 2019. Gross government debt will rise to about 58% of GDP in 2020, from 48% of GDP this year. While Bahrain faces a similar fiscal situation (and even worse debt numbers), the main difference is that the GCC has stepped in decisively to support the it. But Oman’s government needs to raise US$6bn externally, and it remains to be seen whether international markets will be willing to finance such a large amount without more tangible fiscal reform.

Elsewhere in the region, we believe that Saudi Arabia's 2019 budget was credible and, as usual, tries to signal business as usual. Recent senior government appointments also point toward efforts to reintroduce stronger institutional checks and balances. On the budget, expenditure growth is expected to slow to about 7%, from about 12% in 2018. While cost of living and pension benefits will be maintained, the government envisages a sharp decline in defense spending. At the same time, capital expenditure is expected to increase by more than 20% in 2019 in an effort to support growth. In this context, the budget eases concerns that the government was planning to go on a renewed spending spree following recent domestic political developments. Now the government is budgeting for oil prices at roughly US$70/bbl next year, well below the current level. Along with potential capex adjustments, we would like to see an increase in the deficit to around 5.5%–6% of GDP versus the targeted 4.1% by the government. With government debt levels at around 19% at the end of 2018 and foreign reserves holding steady just shy of US$500bn, we don’t think that a bigger deficit poses a sustainability risk.

Frontier Markets

OUTLOOK

- Ukraine's new IMF program is a major step toward securing external financing.
- Foreign investor involvement in Egypt's local market is lighter than a year ago, but fiscal rebalancing is ongoing.

RISK FACTORS

- A tight race between incumbent president Poroshenko and Yulia Tymoshenko in Ukraine's presidential election is high on the list. A Tymoshenko win would introduce policy uncertainty, though she can boast a relatively conservative record of reform.
- A temporary wobble in Egyptian reserves might indicate that local commercial bank balance sheets cannot withstand more portfolio outflows.

OVERVIEW

Ukraine's government finally managed to secure a new IMF program, a key step toward securing external financing in 2019. The 14-month, US$3.9bn SBA will release an initial tranche of US$1.4bn while canceling the previous EFF, as per request. Further funds will be available upon completion of semiannual reviews. According to the IMF release, the priorities of the program will be: 1) further fiscal consolidation; 2) further reduction of inflation; 3) strengthening of financial sectors and asset recovery; and 4) structural reforms to improve tax administration, privatization and governance. These objectives effectively suggest that Ukraine will maintain its fiscal policy and monetary stance and continue with its tax reform and privatization plans. Such a framework may lead to the release of further tranches later in 2019. That will leave the country and investors to shift their focus to presidential elections in March. We expect a tight race between Poroshenko and Tymoshenko.

Egypt has been a favorite in the frontier space in recent years, thanks in part to IMF support, FX liberalization and fiscal consolidation. Foreign holdings of Egyptian T-bills surged from practically zero at the end of 2016 to a peak of about $21bn by the end of the first quarter of 2018. But investor optimism faded as last year progressed and foreign holdings fell back to about $10bn by December. Egypt's reserves held steady throughout this period of foreign liquidation, in contrast to Nigeria, where a similar foreign liquidation dynamic reduced reserves. The pressure from foreign liquidation was perhaps not as clear in Egypt as in Nigeria, but it was building nonetheless, as reflected by the decline in Egypt's commercial bank foreign assets. The US$2bn decline in Egypt's reserves in December (US$42.6bn) is thus noteworthy, even though a disbursement from the IMF that was delayed and potential near-term external issuance will soon prop reserves up again. The decline is noteworthy because it might indicate that local commercial bank balance sheets have reached the point where they can no longer cushion portfolio outflows. The revival in global risk appetite could not have come at a better time for Egypt because concerns about reserves and, in turn, FX stability would have distracted from the fiscal rebalancing that is still in motion.

	Real Growth (%)		Inflation (%)		Official Rates (%)		Long Rates (%)		FX Rates vs USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Global	3.1	2.8	2.9	2.8	3.29	3.15	2.99	3.29	-	-
Industrial Countries	2.2	1.7	1.9	1.8	1.25	1.48	1.55	2.15	-	-
Emerging Countries	4.6	4.5	4.7	4.4	7.22	6.33	5.78	5.54	-	-
United States	2.5	2.0	2.3	2.3	2.38	2.88	2.69	3.50	-	-
Canada	2.5	1.8	2.1	2.1	1.75	2.25	1.96	2.75	1.37	1.35
Europe	1.9	1.4	1.8	1.5	0.13	0.20	0.50	0.98	-	-
Euro Area	1.9	1.3	1.7	1.4	0.00	0.00	0.25	0.75	1.14	1.10
United Kingdom	1.5	1.5	2.5	1.8	0.75	1.00	1.33	1.75	1.27	1.30
Sweden	2.5	2.1	2.0	1.9	(0.50)	0.00	0.52	1.00	8.87	9.09
Norway	2.5	2.0	2.5	1.9	0.75	1.25	1.79	2.25	8.66	8.64
Japan	0.8	1.2	1.0	1.3	(0.05)	(0.10)	0.02	0.15	110	105
Australia	2.9	2.1	1.9	1.9	1.50	1.50	2.32	2.85	0.70	0.67
New Zealand	2.8	3.2	1.6	2.2	1.75	2.00	2.38	3.25	0.67	0.71
Asia ex Japan	6.0	5.7	2.5	2.9	4.27	4.31	3.98	3.95	-	-
China	6.5	6.2	2.3	2.8	4.35	4.35	3.50	3.30	6.87	7.20
Hong Kong	3.0	2.8	3.0	2.6	2.75	2.50	1.98	2.40	7.83	7.85
India	7.6	7.5	4.0	4.2	6.50	6.75	7.37	7.20	69.82	71.20
Indonesia	5.3	5.1	3.2	3.0	6.00	6.25	7.41	7.70	14,481	14,800
Korea	2.6	2.2	1.3	1.9	1.75	1.75	1.96	3.00	1,116	1,150
Thailand	4.1	3.5	1.1	1.4	1.75	2.00	2.45	2.70	32.56	32.80
Latin America	0.8	1.6	9.3	6.6	13.77	10.56	7.44	8.42	-	-
Argentina	(1.9)	(0.3)	45.0	28.0	59.25	35.00	-	-	38.57	46.00
Brazil	1.3	2.4	4.1	4.1	6.50	7.75	7.38	8.90	3.88	3.80
Chile	4.0	3.7	2.9	3.0	2.75	3.50	4.45	4.80	696	700
Colombia	2.6	2.6	3.5	3.8	4.25	4.75	6.72	7.15	3,250	3,280
Mexico	2.1	1.8	4.7	4.0	8.25	8.00	8.72	9.30	19.69	21.20
EEMEA	2.6	2.0	6.6	6.3	10.76	8.71	10.00	9.08	-	-
Hungary	4.2	3.2	2.7	3.1	0.90	1.25	3.01	3.40	281	291
Poland	4.5	3.5	1.8	2.3	1.50	1.50	2.81	3.50	3.76	4.22
Russia	1.8	1.4	3.0	4.5	7.75	7.25	8.78	8.25	69.52	66.00
South Africa	0.6	1.2	4.6	5.2	6.75	7.00	9.44	9.40	14.39	14.50
Turkey	2.8	(2.6)	16.2	16.3	24.00	18.00	15.83	15.00	5.27	5.60

Long rates are 10-year yields unless otherwise indicated.
Latin American Rates include Brazil, Chile, Colombia and Mexico
Real growth aggregates represent 48 country forecasts not all of which are shown
Blanks in Argentina are due to distorted domestic financial system so are not forecast.

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