

Global Economic Outlook

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Key calls

-   Trade war: to last indefinitely
-  Fed: “mid-cycle adjustment”
-  China: getting more concerned
-  Euro area: quantitative easing in small quantities
-  Mexico: growth even lower
-  Brazil: historic lows in policy rates

A tariff on optimism

- Global outlook
 - Steady deterioration
 - Many lingering policy risks
- Trade war
 - Two steps back, one step forward
 - “No pain, no deal”
- US outlook
 - Consumer still strong
 - Fiscal stimulus fading
- Fed
 - “Mid-cycle adjustment”
 - Inflation stuck in neutral

Forecast summary

	2019 (%)		2020 (%)		Cumulative revision (pp, 2019+2020)
	Old	New	Old	New	
Global	3.2	3.1	3.2	3.1	-0.2
US	2.3	2.3	1.7	1.5	-0.2
China	6.1	6.1	6.0	5.7	-0.3
Euro area	1.1	1.1	1.0	1.0	0.0
Japan	1.0	1.0	0.2	0.2	0.0
UK	1.1	1.1	0.8	0.8	0.0
Canada	1.3	1.2	1.3	1.1	-0.3
Australia	2.2	2.2	2.6	2.6	0.0
Brazil	0.7	0.7	1.9	1.9	0.0
India	6.7	6.5	7.0	6.8	-0.4
Mexico	0.5	0.5	1.2	1.0	-0.2

Salami-slicing our growth forecasts

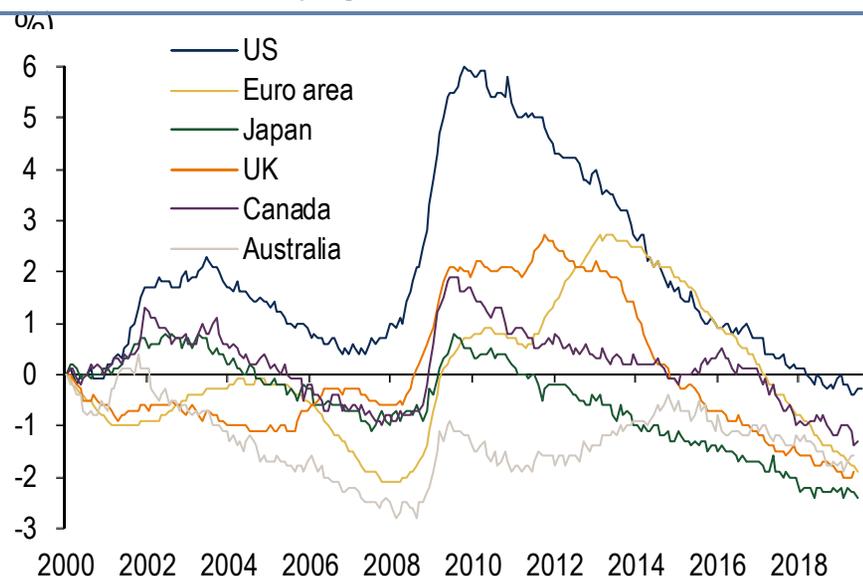
- Trade war is the main story
- Other bad news
 - US fiscal stimulus fading
 - Brexit, Italy unresolved
 - Downturn in semiconductor cycle
 - Various idiosyncratic EM stories (e.g. Turkey, Argentina, India, Brazil)
- Good news
 - Big China easing
 - Modest global central bank easing (although policy space limited)

Forecasts in free fall
(annual growth)



Cold comfort from hot labor markets

Labor markets are historically strong ...
(Normalized unemployment rates, Jan 2000 = 0,



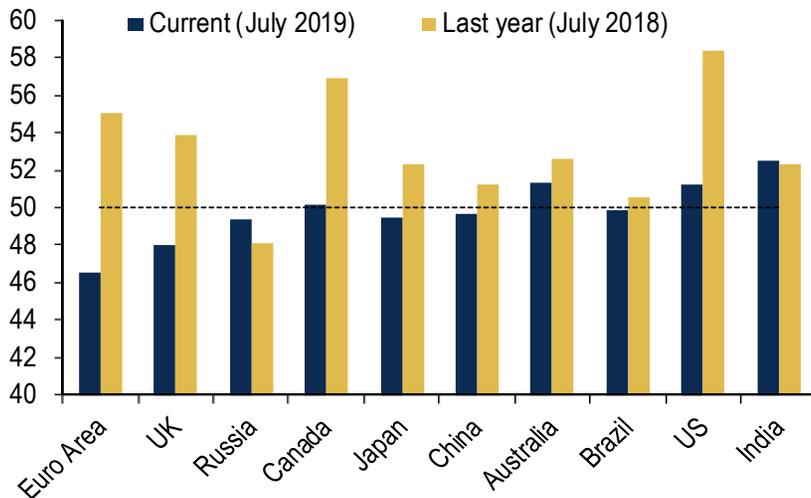
... But investment, trade drive the business cycle
(contributions to GDP growth volatility)

	Consumption	Investment	Exports
US	33%	40%	27%
Euro area	23%	41%	104%
Japan	33%	20%	50%
UK	45%	27%	45%
Canada	18%	48%	88%
Australia	24%	64%	31%

Note: The contributions shown can add up to more than 100% because imports contribute negatively to GDP. Investment includes private and public gross fixed capital formation, but excludes inventories. Source: BofA Merrill Lynch Global Research

Broad-based manufacturing slowdown

Global manufacturing slowdown
(PMIs, 50+= expansion)



Global manufacturing and US jobs



Source: BofA Merrill Lynch Global Research, Haver Analytics, Bureau of Labor Statistics

China: For each trade action, a policy reaction

- Double whammy from credit tightening, trade war
- Focus shifts back to growth: want to negotiate from strength
- Credit easing: “social financing”
- VAT tax cuts, personal income tax cuts, import tariff cuts, R&D rebates, etc.
- Infrastructure spending
- So far not effective: more to come
- **Baseline: 5.7% growth in 2020**

Hard landing risks rising, but we are not there yet

Indicator	Current level	“Hard landing” threshold
BofAML China ACT indicator (% yoy)	3.3%	<3%
IP (% yoy)	4.8%	<4%
PPI inflation (% yoy)	-0.3%	<-5%
Exports (% yoy)	3.3%	<-15%
Imports (% yoy)	-5.3%	<-10%
PMI	49.7%	<45
Surveyed unemployment rate	5.3%	>6%

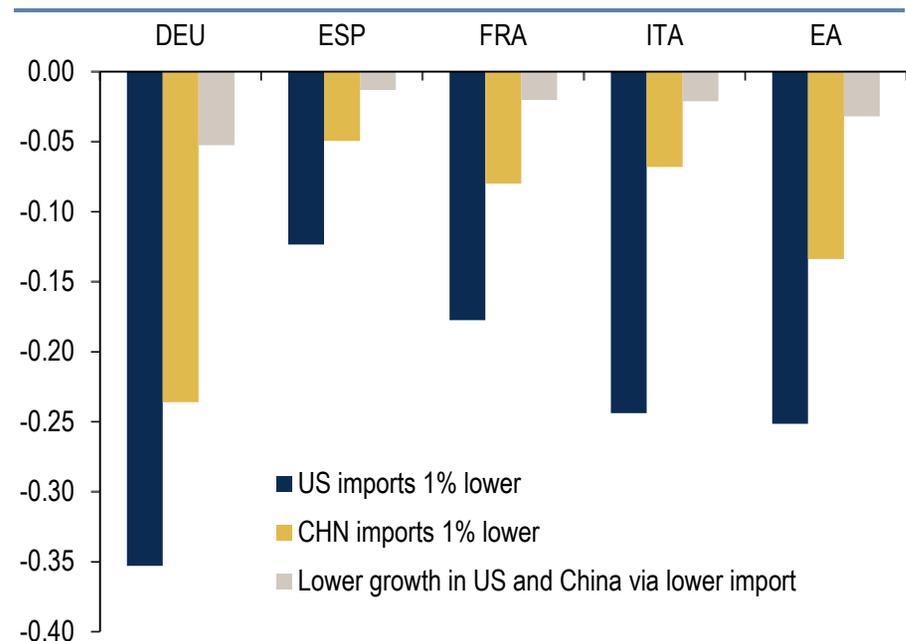
Note: The indicator identified as BofAML China ACT above is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Merrill Lynch Global Research. This indicator was not created to act as a benchmark.

Source: BofA Merrill Lynch Global Research

Euro area: deer in headlights

- 1.0% forecast for 2020 growth
 - Trade war uncertainty, Brexit
 - Importer of growth
 - Germany contracted in 2Q
- Risks still to the downside
 - Trade: Full-blown US-China trade war, auto tariffs, FX
 - Politics: Quitaly, Brexit, oil
- **ECB to cut depo rate 20bp in Sep, restart QE**
 - Rate cut likely to come with tiering
 - QE to be small: 9-12 months of EUR30bn
 - Symmetry added to inflation target

Impact on GDP growth of US or China slowdown (pp)



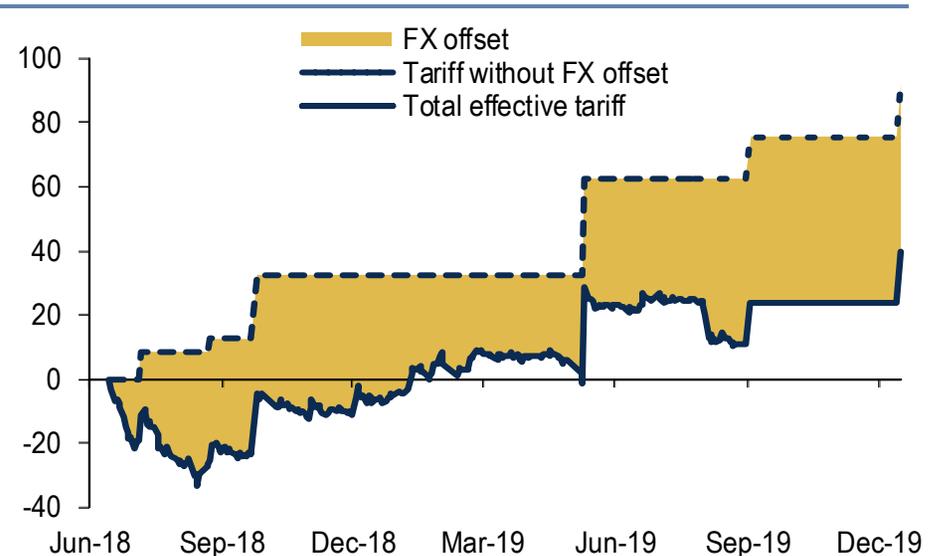
Brexit: can't escape gravity

- **Bottom line: Brexit is a negative for the UK economy**
 1. Gravity: FTAs with other countries cannot offset loss of EU membership
 2. Extended uncertainty shocks have irreversible consequences
- No deal becoming more likely
 - Default outcome
 - But, opposed by majority in Parliament
 - Could cause recession. Very negative for sterling
 - BoE worried about sterling impact on inflation
 - Cut likely but not guaranteed if no deal

Trade war: two steps back

- Recent escalation crossed two “red lines”
- **Consumer tariffs**
 - Until now, pattern of avoidance: China list revisions, auto tariff delays
 - Impending tariffs a game changer
 - Now everything on the table: 25% tariffs on all Chinese goods, autos, Vietnam
- **Currency “war”**
 - Renminbi breaks 7: major offset to US tariffs
 - US declares China a “currency manipulator” on the same day

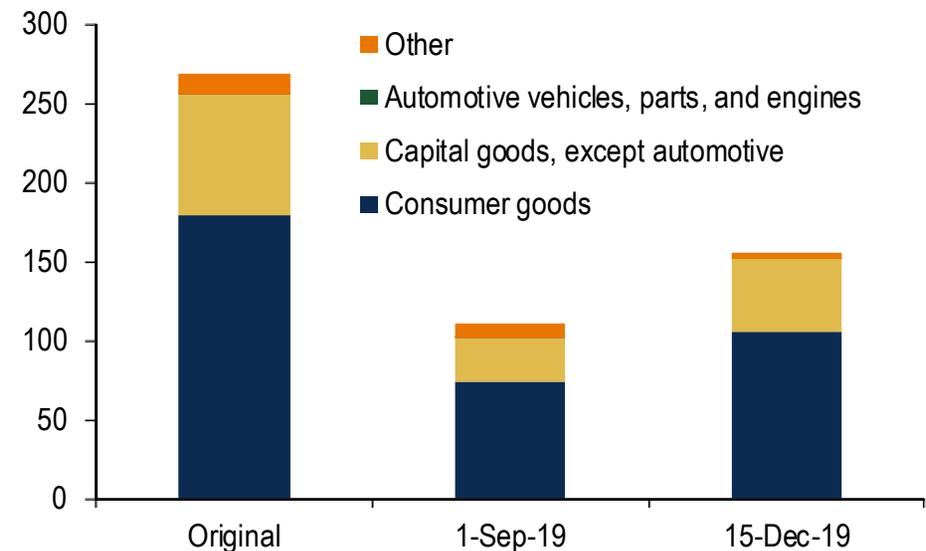
Impact of FX on effective US tariffs on Chinese goods (\$bn)



...One step forward

- Partial delay is a positive
 - Delays consumer pain until after holiday shopping season
 - Reduces risk of additional consumer tariffs
- **Baseline view: trade war lasts indefinitely**
 - Bipartisan support to get tough on China
 - Americans see unfair trade
 - Geopolitical concerns
 - Further escalation more likely than de-escalation

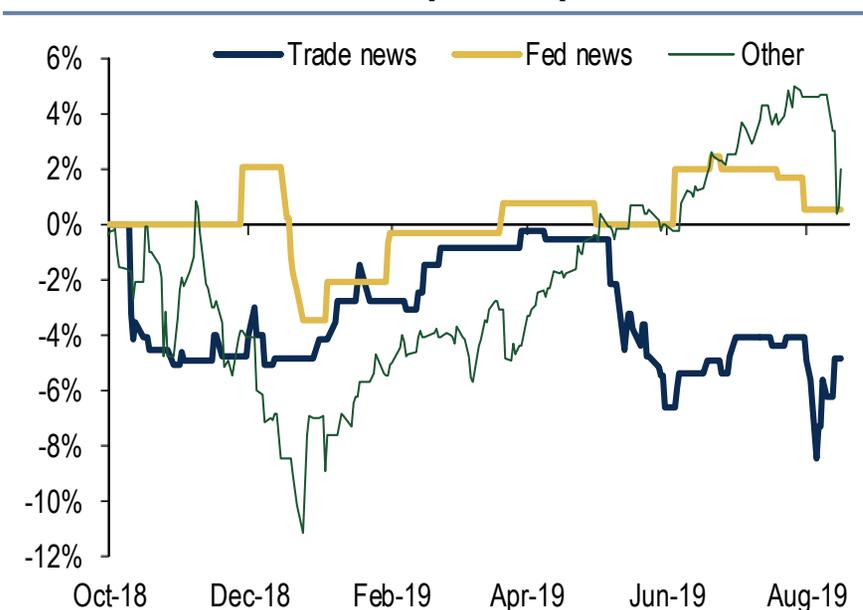
Consumption goods benefit most from the tariff delay
(\$bn)



Policy collared?

- The “Powell put”
 - The Fed wants to raise inflation
 - Requires a continued hot labor market
 - Also wants to “sustain the expansion”
- The “Trump call”
 - Absent pain, trade war escalates
 - Three kinds: market, economic and political
 - Pressuring Fed to support “war”
- Perverse feedback loop playing out
 - Trade war repeatedly returns
 - Fed repeatedly eases
 - Markets range bound, economy stays soft

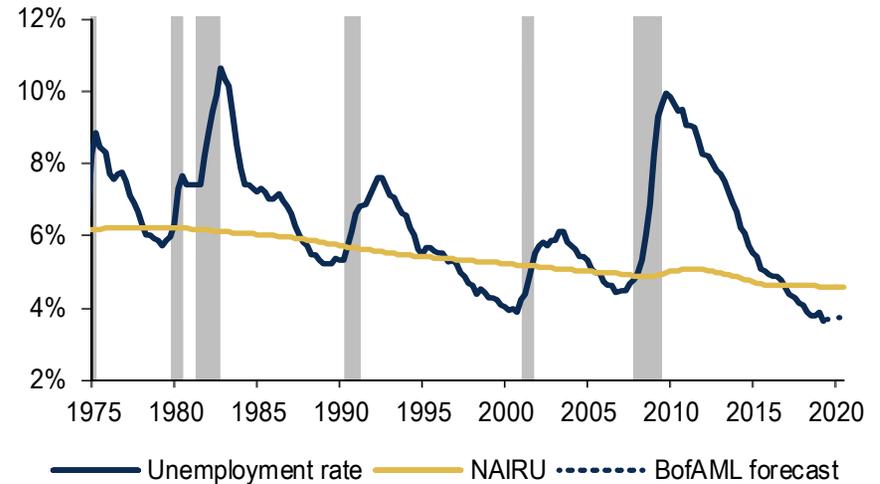
Market drivers since Sep 2018 peak in S&P 500



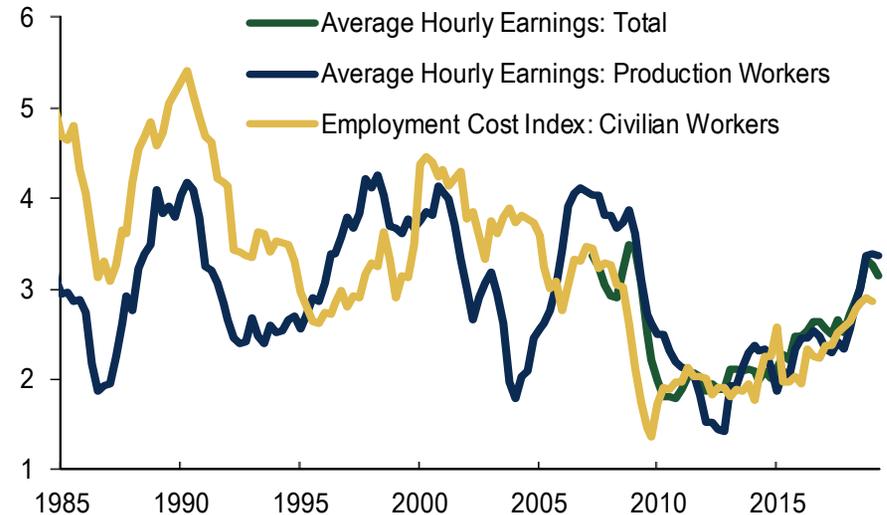
US: labor market still solid

- Many labor market indicators very strong
- Trend job growth above breakeven
- Prime-age workers returning
- Wage Phillips curve back to life

Unemployment rate still falling...



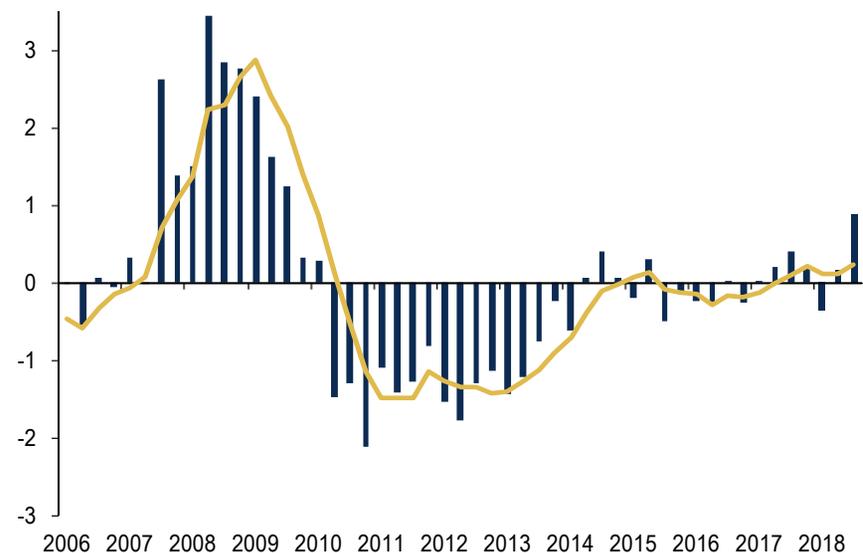
...Putting pressure on wage growth (%, yoy)



US: fading fiscal caffeine

- Fiscal double espresso
 - 10-year \$1.5tn tax cut
 - Two-year \$300bn spending increase
- Already fading?
 - Growth peaked in 2Q 2018
 - To return to trend by 2020
- New tax cut: very unlikely
- Infrastructure: doubtful
 - R's: private-public partnerships
 - D's: corporate tax increases
- Small positive: spending caps raised
- Overall: from easy to neutral

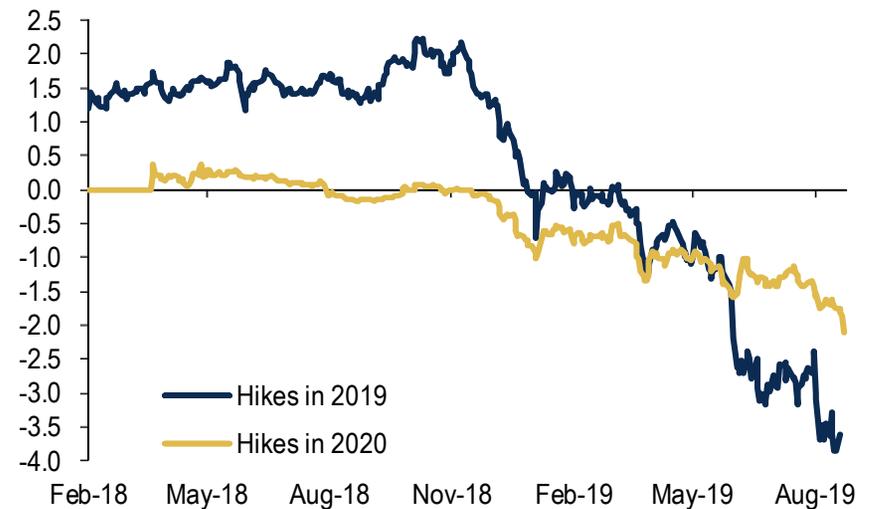
Fading stimulus
(% contribution to GDP growth)



Fed: mid-cycle adjustment

- The Fed has said it will act preemptively to “sustain the expansion” ...
- ... And it has not pushed back against market pricing
- **We expect three more rate cuts this year**
 - Sep, Oct, Dec, 25bp each
 - On hold thereafter
 - Will the Fed be able to resist market pressure?
 - Risk: underwriting trade war

No. of hikes / cuts priced



Brazil: historic lows in policy rates

GROWTH



0.7% 2019
1.9% 2020

Labor market and activity recovery should be more gradual than expected.

INFLATION



3.4% 2019
3.8% 2020

Inflationary pressures faded in the short term and expectations are anchored.

MONETARY POLICY



4.75% 2019
4.75% 2020

Dovish central banks, progress on reform agenda, inflation under target and weak activity.

FX



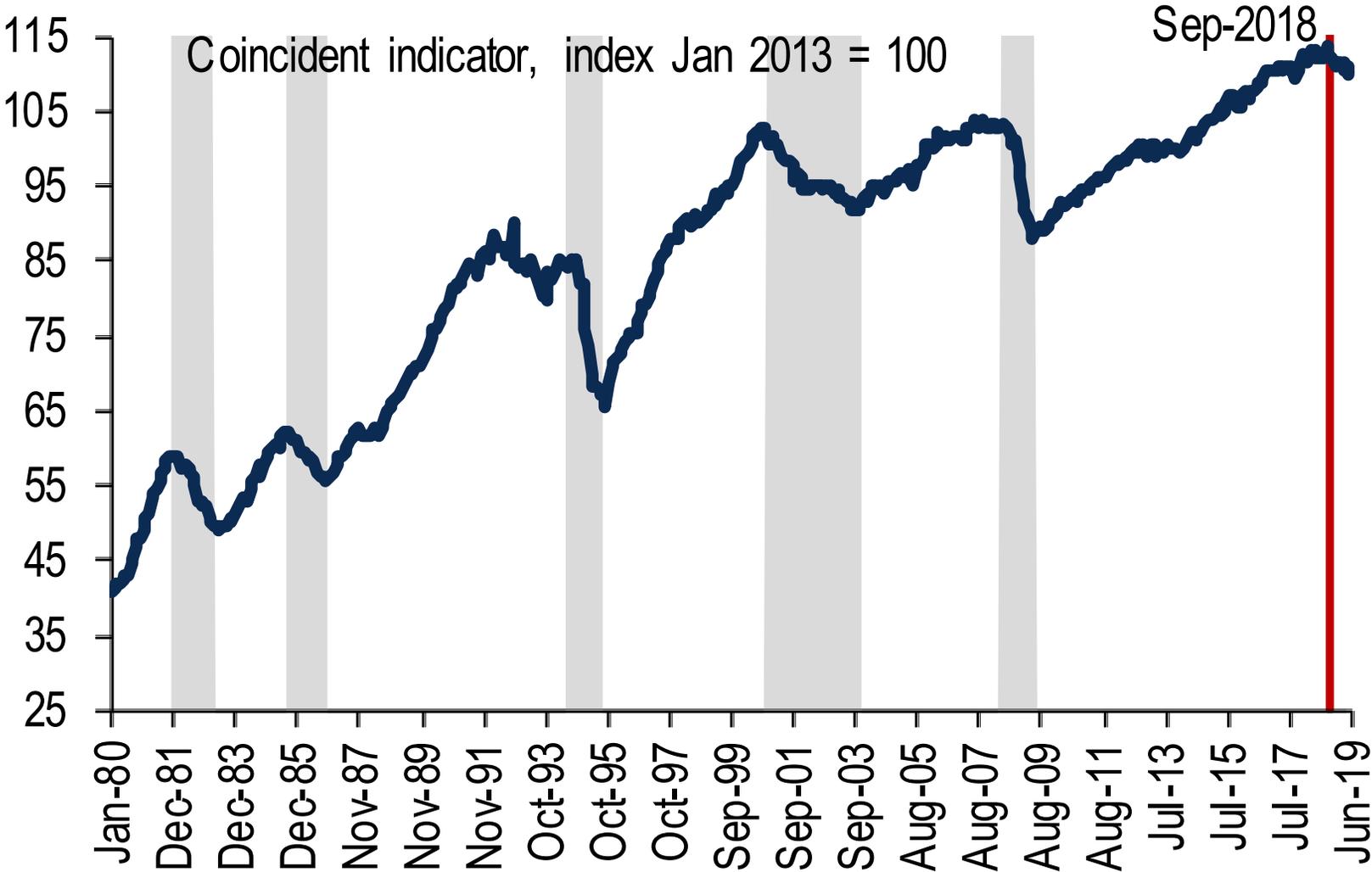
4.00 2019
3.70 2020

Less uncertain domestic scenario and robust equities pipeline.

FISCAL

Better mandatory spending control + pre-payments to Treasury → cushioned debt/GDP increase. Pension reform full approval still pending.

Is Mexico in a recession since Sept 2018?



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