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Economic and Strategy Viewpoint

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Global outlook: slowdown, not recession

- We have cut our 2019 global growth projection again; however, we still believe that the US and world economy will avoid an outright recession. Consumer confidence and spending is firm and the corporate sector is not overextended to the degree that it needs a major retrenchment.
- Instead we are looking at the recent easing in US-China trade tensions, more flexible central banks and the benefits of lower oil prices to stabilise activity later this year and support an upgrade in our global growth forecast for 2020.

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Europe: rebound delayed, but still expected

- Weak external demand combined with temporary shocks to domestic supply have caused European growth to slow and disappoint investors. Signs of a rebound are emerging, but it is likely to be delayed to the middle of 2019. The growth forecast has therefore been downgraded for 2019, but upgraded for 2020. As a result of the slower recovery, we expect the European Central Bank to delay raising interest rates until the end of 2019.
- Brexit continues to haunt the UK economy as companies complain of the negative impact on their business. The delay in the ratification of the Withdrawal Agreement has led to the downgrade of the UK GDP forecast for 2019, though a smooth transition is still a key component. The next Bank of England rate rise is therefore delayed by three months to allow more time for the economy to rebound post-Brexit.

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EM forecast update: oil on troubled waters

- Minor changes to growth expectations in EM this quarter, but large downward revisions to inflation on a mix of a more favourable oil outlook and improved domestic dynamics.

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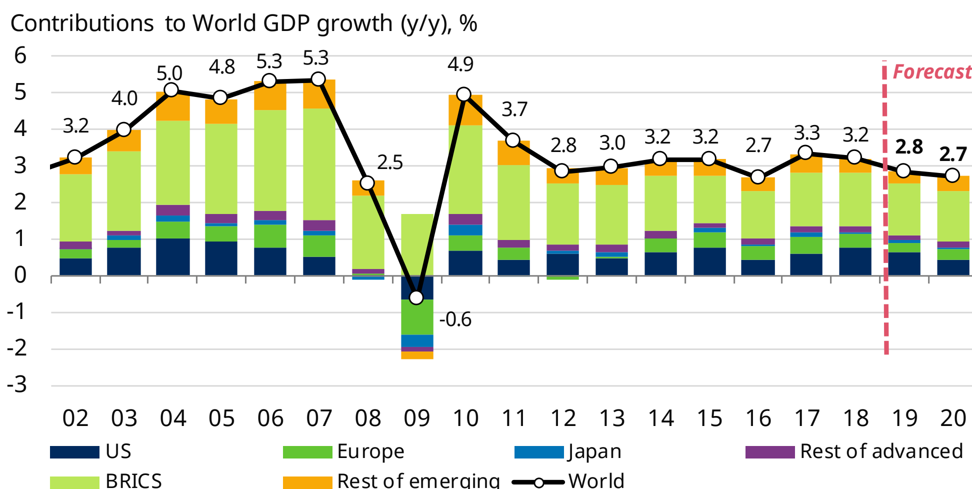
Japan: BoJ to stay on hold through VAT hike

- We downgrade our 2019 growth outlook from 1% y/y to 0.7% y/y due to disappointing growth in 2018, partly offset by infrastructure spending. A more optimistic outlook on the external environment and more infrastructure spending pushes up our 2020 growth outlook from 0% y/y to 0.4% y/y.
- The weaker global backdrop has led to a more dovish tone from the Bank of Japan. We now expect monetary policy to remain unchanged in 2019 through the VAT hike.

Chart: Global growth forecast



Source: Schroders Economics Group, 25 February 2019. Please note the forecast warning at the back of the document.

Global outlook: slowdown, not recession

Another downgrade for global growth in 2019, but we are not predicting a recession and have upgraded our forecasts for 2020.

Overview

Growth revised down for 2019 (again), but upgraded for 2020

We have revised down our forecast for global GDP growth in 2019 to 2.8% (from 2.9%), but increased our projection for 2020 to 2.7% (from 2.5%). The downgrade for this year (the fourth in consecutive quarters) is driven by cuts to our forecasts for the Eurozone, UK and Japan which offset a small increase to our China forecast. In 2020, the upward revision is across the board with, for example, the US upgraded to 1.6% (previously 1.3%), Japan to 0.4% (previously 0%) and China nudged up to 6.1% from 6%.

Meanwhile, our inflation forecasts have been reduced for this year and next with reductions across all regions except Europe. The forecast has been largely driven by the decline in oil prices which are now expected to be significantly lower over the forecast period than at the time of our last outlook in November 2018. US inflation is also lower as a result of a smaller rise in core inflation (CPI ex.food and energy) which peaks at a lower level before declining in 2020.

Weaker growth and lower inflation result in slightly easier monetary policy than in our previous forecast. The US Fed funds rate is now only expected to rise once more before falling in 2020, whilst we have pushed out rate increases in the UK and Eurozone with only one move from the European Central Bank (ECB) and Bank of England now expected this year. We also expect the Bank of Japan (BoJ) to leave policy unchanged rather than tightening its yield curve control policy further. China is expected to ease further through a lower reserve requirement ratio (RRR) which is now expected to reach 10% by end 2020 (previously 11%).

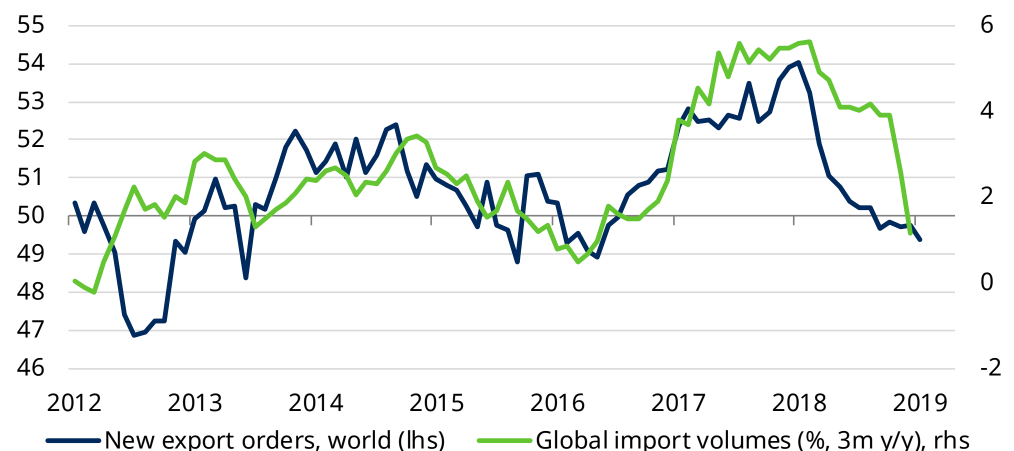
The US dollar (USD) is expected to remain firm in the near term, but to weaken later in the year as rates peak in the US whilst policy tightens in the Eurozone and UK. Sterling (GBP) is also boosted by our assumption that a deal is struck and the UK enters a transition period, rather than crashing out of the EU.

Recession risks remain high

Near term indicators remain weak, but we continue to forecast a pick-up in activity later in the year

Near term activity indicators remain weak with global trade volumes falling at the end of last year (chart 1). Industrial commodity prices, another good indicator of the industrial cycle, also continue to be soft.

Chart 1: Global trade growth and export orders



Source: Thomson Reuters Datastream, Schroders Economics Group, g0018. 27 February 2019.

There is some tentative evidence of improvement in the flash purchasing managers export orders series, but this may be distorted by the Chinese New Year. We see some of the trade weakness as being related to the unwind of front loading earlier in 2018 as companies accelerated import purchases ahead of increases in tariffs. This should lead to an inventory drawdown in the coming months which will weigh on activity and could take manufacturing purchasing managers' indices (PMI's) below the critical 50 level.

However, as long as final demand does not collapse there should be scope for recovery once inventory levels have been adjusted and the excess cleared. Corporate sector balance sheets and cash flow are not overextended to the degree that a dip in growth will prompt a major retrenchment.

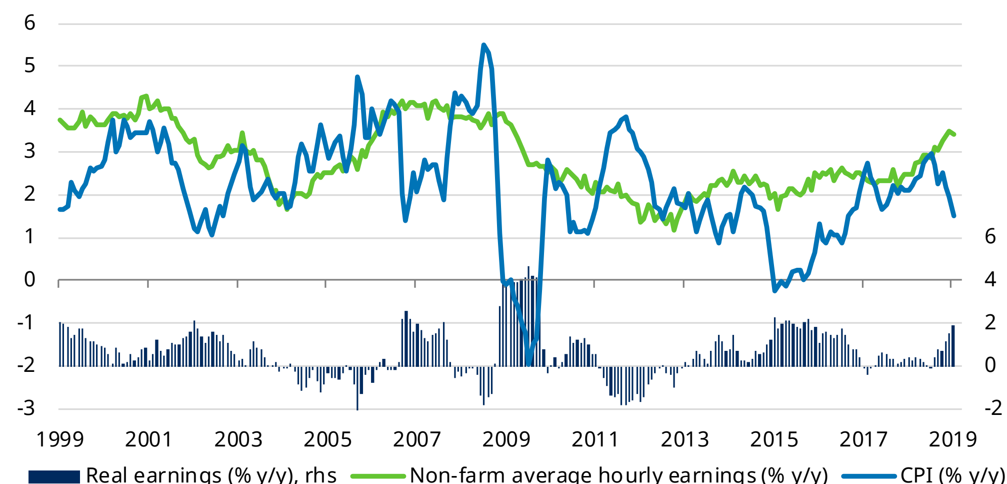
Reasons to be cheerful

Lower oil prices are boosting real incomes

Concerns over a recession will remain high in the near term, but looking further ahead we have become more optimistic on growth as a result of three factors.

First, energy prices are lower and, whilst this is in part symptomatic of weaker global demand, it is helping to bring down inflation which is boosting real incomes worldwide. The US consumer tends to see the full benefits of this due to the relatively low level of tax on gasoline and when combined with a pick up in pay, real wages are now growing at 2% in the US the fastest for three years (chart 2). The same is true in Europe and Asia and the consumer is a mainstay of growth in our forecast.

Chart 2: Real wages are rising in the US



Source: Thomson Reuters Datastream, Schroders Economics Group, g0045, 27 February 2019.

The prospect of a US-China trade deal also means lower inflation

Second, the US and China are moving closer to a trade deal with President Trump announcing that he will extend the deadline for raising tariffs on $200bn of Chinese imports from 10% to 25% beyond 1 March following 'substantial progress' in the talks with China. He is expected to meet President Xi later in March to sign a deal.

Whilst there are still hurdles to overcome, particularly on the protection of intellectual property rights, this is a marked improvement from the escalation which was part of our previous baseline forecast. Tariff increases will now be more limited helping to reduce costs, protect profit margins and contain inflation. It has been one of the factors behind our lower core inflation forecast for the US. The deal should also help reduce uncertainty and bring some clarity to businesses who have put spending plans on hold whilst reviewing the future for their international supply chains.

The deal is not all good news. Part of the agreement will involve greater purchases of US products by China of energy, agricultural and manufacturing goods ($1 trillion over the next six years) which will probably reduce sales by non-US firms. Europe and Japan may be adversely affected. Furthermore, as the trade war quietens down, the

tech war remains in full swing and we would expect the US to continue to challenge China in this area either through sanctions on Chinese companies or preventing its own companies from exporting key technology items.

Interest rates to rise less, or more slowly

Third, monetary policy is easier. This is partly a reflection of lower inflation but it also marks a shift in Fed policy making where the central bank has become more responsive to financial market conditions. Although our baseline rate forecast is only 25 basis points lower than before with a peak at 2.75% rather than 3%, long rates have declined and risk assets have rallied thus loosening monetary conditions. Furthermore, the Fed has signalled an earlier-than-expected end to quantitative tightening (QT), the process of reducing its balance sheet which is now expected to be completed by the end of the year.

These three factors are behind the forecast revisions described above. It should be added though that there are two key assumptions which remain intact from our previous forecast and play an important role in shaping the projections.

The first is that the Eurozone will rebound from its current malaise which we largely attribute to temporary factors (see Europe section below), whilst activity in China will stabilise as monetary and fiscal policy is loosened. Should the downturn deepen in these regions the risks of global recession are clearly greater.

In addition, we continue to believe that the US will slow further in 2020 as the boost from fiscal policy disappears and monetary tightening feeds through. It seems unlikely that additional fiscal stimulus will be passed by the Democrat controlled House. Given the deterioration in the budget deficit this should be welcomed and may have been a factor in progressing the trade deal with China as the president recognised he would need something else to support the economy.

A turning point?

Although we have cut our 2019 global growth projection again this forecast round marks an inflection point in that we have not extended downgrades into 2020. Instead we are looking at the easing in US-China trade tensions, more flexible central banks and the benefits of lower oil prices to stabilise activity later this year and support an upgrade in our global growth forecast for 2020.

Scenarios: skewed toward deflation

Rising risks of recession outside the US

We have updated our scenarios to capture the risks around the baseline. To reflect the concerns around growth outside the US we have introduced a Recession ex.US scenario whereby the outlook in China and Europe deteriorates significantly. This has a knock-on effect to the US and also dampens commodity prices and inflation with the result that both growth and inflation are lower than in the baseline. The US recession 2020 scenario remains and when combined with this new scenario represent the deflationary risks to the forecast (chart 3).

On the stagflationary side we still have the Italian debt crisis although the scenario is now for a later event following the agreement with the European Commission on its budget for this year. The scenario now assumes renewed tension between Rome and Brussels in the autumn as the next budget (for 2020) is formulated. The result is greater market volatility (10-year Italian government bond, BTP, yields rising to 6%) which is only quelled by a bail-out where a technocrat is installed as Italian prime minster, and the ECB's Outright Monetary Transactions (OMT) programme is activated. Quantitative Easing (QE) is also restarted in 2019 as the Eurozone faces a deep recession. Global inflation is higher although this largely reflects the impact of a large fall in the Euro on the region's inflation rate as inflation in the US, UK and Japan is actually lower, as are commodity prices.

Our trade war scenario has become the 'US vs. the rest of the world' where the US administration decides to impose tariffs on all auto imports prompting retaliation from Europe and Japan particularly and thus extending the trade conflict into new territory. Meanwhile the dispute with China worsens as trade talks fail and the US imposes further tariffs on the remainder of imports from China. The result is that higher import prices push inflation higher whilst weaker trade weighs on growth. Capital expenditure is also hit by the increase in uncertainty and the need for firms to review their supply chains. Central banks are expected to focus on the weakness of activity and ease policy by more than in the baseline.

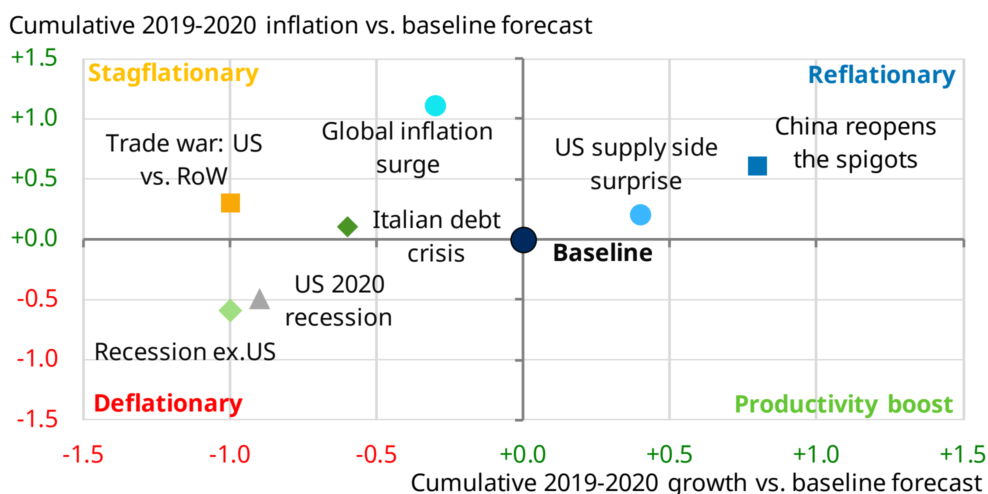
The final stagflationary scenario is 'Global inflation surge', or the Philips curve lives, where the relationship between unemployment and wages reasserts itself resulting in higher inflation and a significant tightening of monetary policy. Growth weakens creating a stagflationary outcome compared to the base.

In terms of reflation scenarios we have replaced 'Global fiscal expansion' with China reopens the spigots where China reverts to its old playbook to avert a deepening economic slowdown. Casting aside the relative timidity of current stimulus measures, policymakers embark on large scale fiscal and monetary stimulus. Commodity demand skyrockets, to the benefit of a number of emerging markets, but when combined with tight capacity constraints acts to push global inflation higher.

The US labour market could continue to surprise

Finally, we introduce a US supply side surprise scenario where the labour market proves to be more flexible than expected with supply continuing to rise through a higher participation rate as more people return to the workforce. This extends the cycle by containing wages and inflation in the US for longer than in the baseline allowing stronger growth. There is a knock-on to growth in the rest of the world though stronger US demand and higher commodity prices which raise inflation.

Chart 3: Scenarios grid



Source: Schroders Economics Group, 27 February 2019. Please note the forecast warning at the back of the document.

Risks skewed in a deflationary direction

In terms of probabilities, in our view the balance of risks has tilted in a deflationary direction over the past three months largely reflecting the introduction of the Recession ex.US scenario (see table 1). The probability on a US recession 2020 scenario is unchanged as a result of adding the new scenario which is seen as distinctly different. Meanwhile, stagflation risks remain high, but have come down reflecting lower risks on Italian debt, trade wars and inflation. The reflation probability scenario has dipped slightly meaning that the overall risks are skewed toward a weaker outcome on growth than in the baseline.

Table 1: Balance of probabilities

Scenario	Probability February 2019, %	Probability November 2018, %	Change, (Feb vs. Nov) pp
Stagflationary	14	19	-5
Deflationary	17	10	+7
Reflationary	9	11	-2
Productivity Boost	0	3	-3
Baseline	60	57	+3

Source: Schroders Economics Group, 27 February 2019. Please note the forecast warning at the back of the document.

Europe: rebound delayed, but still expected

'Incoming data have continued to be weaker than expected as a result of a slowdown in external demand compounded by some country and sector-specific factors. While the impact of some of these factors is expected to fade, the near-term growth momentum is likely to be weaker than previously anticipated. Looking ahead, the euro area expansion will continue to be supported by favourable financing conditions, further employment gains and rising wages, lower energy prices, and the ongoing – albeit somewhat slower – expansion in global activity.'

Mario Draghi, President of the ECB, speaking in Frankfurt, 24 January 2019.

European growth failed to pick up at the end of 2018

European growth continued to disappoint towards the end of 2018 and start of this year, however, there are signs that activity is due to improve. Leading indicators may have bottomed out, while a trade truce between the US and China could help boost external demand later this year. Meanwhile, the underlying fundamentals remain sound.

In the UK, Brexit uncertainty has persisted longer than had been expected, and will probably now cause a greater degree of damage to growth than previously forecast. The probability of a no-deal Brexit remains high, but even the outlook incorporating an orderly Brexit is looking less favourable due to the delays.

Weak end to 2018

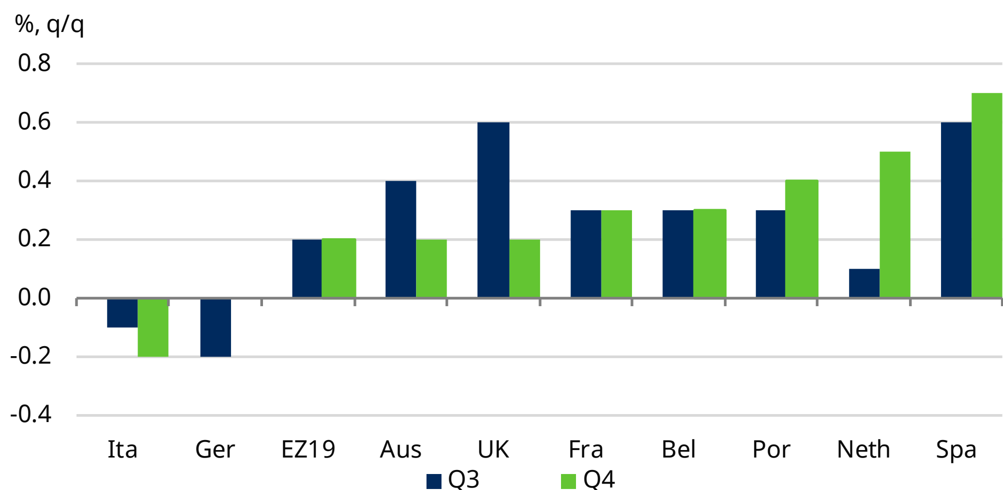
The Eurozone economy grew by just 0.2% in the final quarter of 2018, taking annual growth down from 2.5% in 2017 to 1.8% last year – the lowest annual growth rate since 2014.

It seems the same trend over most of last year persisted into the fourth quarter. Reasonable domestic demand was offset by weaker net trade, partly due to lower exports growth, but also due to higher imports.

Within the monetary union, Germany narrowly avoided a technical recession after it recorded no change in GDP in the fourth quarter compared to a 0.2% contraction in the third quarter. Italy was less fortunate as it did slip into recession, contracting by 0.2% after 0.1% in the previous quarter (chart 4).

Though Germany narrowly avoided a recession, Italy was less fortunate. Meanwhile, the Netherlands saw growth rebound

Chart 4: GDP growth fails to improve for most



Source: Eurostat, ONS, Schroders Economics Group. 25 February 2019.

We have discussed the weakness in both Germany and Italy in great detail in past editions of this publication, but here is a quick recap. Germany was

disproportionately impacted by changes to car emissions testing which caused a supply shock as the new testing regime takes longer to carry out. Sales of new vehicles across Europe slumped sharply from September 2018, but have since been recovering back towards their previous trend. Moreover, a drought towards the end of last year caused the river Rhine's water level to fall to just two feet (60cm) in certain areas, making it impossible to ship raw materials including distilled fuel. Manufacturers had no choice but to halt production for a short while.

Temporary factors have held back growth across the Eurozone which appear to be dissipating

In Italy, it appears that political uncertainty may have taken its toll on confidence and activity. At the end of last year, fears of a fiscal splurge caused bond investors to demand higher compensation, pushing Italian government bond yields higher. The 2019 budget target was in the end far more modest than initially feared, but that did not stop a very public battle between the government and the European Commission. In the end, the government backed down, and Italy's small fiscal expansion was approved. Nevertheless, the temporary rise in bond yields caused financing costs to rise across the economy, while fears of a debt crisis would have curbed demand.

Given the temporary nature of the shocks to both Germany and Italy, both should see an improvement in growth by the summer. Elsewhere, France and Belgium reported underwhelming growth of 0.3% – unchanged from the previous quarter. Portugal saw a small improvement up to 0.4% growth, but the Netherlands rebounded strongly as growth accelerated from 0.1% to 0.5%. Finally, Spain continues to show the resilience of its economy, as growth picked up from 0.6% to 0.7%.

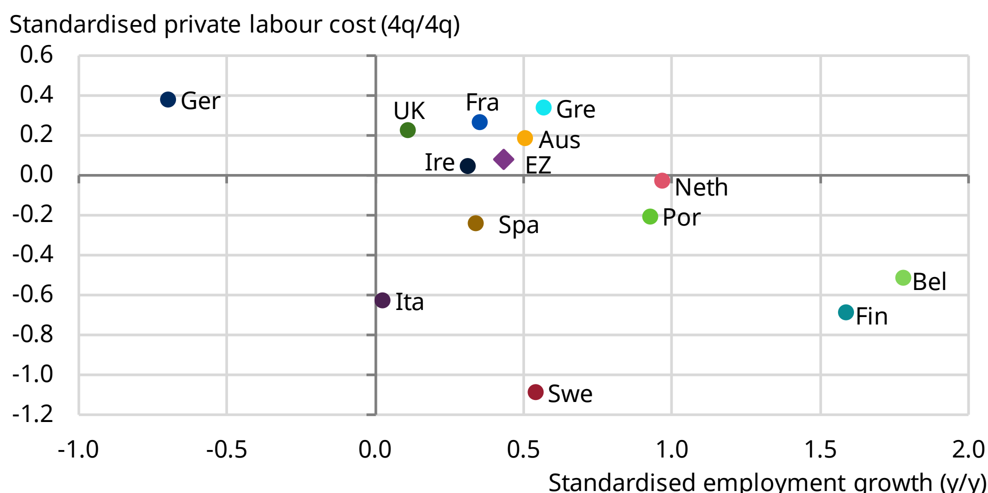
Fundamentals remains strong

Though the slowdown in GDP growth was disappointing for investors, 2018 marked the fourth consecutive year of above trend growth (~1.2%). As a result, the amount of spare capacity has been falling. For example, the unemployment rate has fallen from a peak of 12.1% in the middle of 2013 to 7.9% in December 2018. This may still seem high when compared to the US or UK, but the previous low on record (since 1998) was 7.3%, recorded at the end of 2007.

Above trend GDP growth tends to lead to above trend employment growth, which the Eurozone as a whole has enjoyed for some time. In our latest snapshot of labour market developments (chart 5), we find that almost all of the major member states are reporting above average employment growth.

Eurozone fundamentals look strong, as the labour market moves into the reflation phase of the cycle

Chart 5: Eurozone labour market enters reflation phase



Source: Thomson DataStream, Eurostat, Schroders Economics Group. 25 February 2019.

A sign of an economy approaching full capacity is wage growth rising above trend. Private sector wage growth for the Eurozone aggregate finally crossed that threshold in the third quarter of 2018 as wage growth reached 2.7% y/y.

Germany is entering the slowdown phase of the cycle as firms struggle to fill job vacancies

One member state that stands out on chart A2 is Germany, which has recently seen its employment growth slow to below trend. While employment growth is still creeping higher, momentum has clearly been lost. While that might initially appear to be caused by weaker GDP growth of late, in fact, the slow down in employment is simply caused by a scarcity of workers. Unfilled job vacancies are at a record high, and normalised wage growth is higher than any other major member state. This is typical late cycle behaviour which would normally next require tighter monetary policy to cool the labour market. Of course, Germany gave up control of its interest rates when it joined the euro, and so must now rely on trade union relations and fiscal policy to stop any overheating.

The conclusion from the above analysis is that the fundamentals look sound. Monetary policy is still very loose, and most countries have completed their austerity programmes, with many loosening fiscal policy once again. The main source of weakness has been net exports, but this is largely out of the hands of EU policy makers. If the weak external environment proves to be a permanent feature, then policy may have to be looser for longer to help transition business and workers to meet more of the needs of the domestic economy. Fortunately, it appears that progress is being made to resolve the US-China trade war, which would help boost external demand once again. Even if China promises to buy more from the US at the expense of Europe.

Eurozone forecast update

Looking ahead, growth is likely to remain weak in the first quarter of 2019, before rebounding by the middle of the year (chart 6). The disruption caused by the changes to car emissions standards should fade by then, while the above mentioned trade deal should be making a positive impact too. However, the overall forecast for 2019 GDP growth has been lowered from 1.6% to 1.3%.

The forecast for growth in 2020 has been revised a little higher (from 1.2% to 1.4%), thanks to a less negative outlook for the rest of the world, but also our lowering of the euro assumption against the US dollar (1.25 to 1.20 by end 2020). Despite the upgrade for 2020, the overall path for growth remains a deceleration towards trend by late 2020.

The Eurozone GDP growth forecast has been downgraded for 2019, but upgraded for 2020

Chart 6: Eurozone GDP forecast

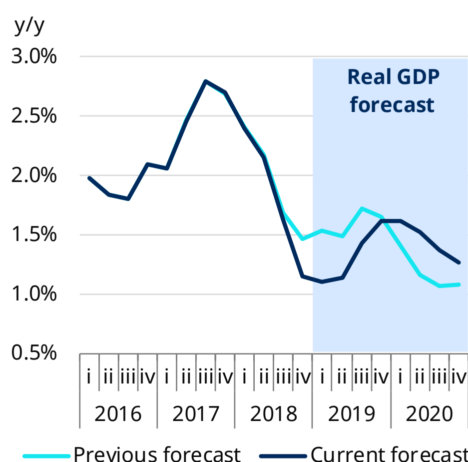
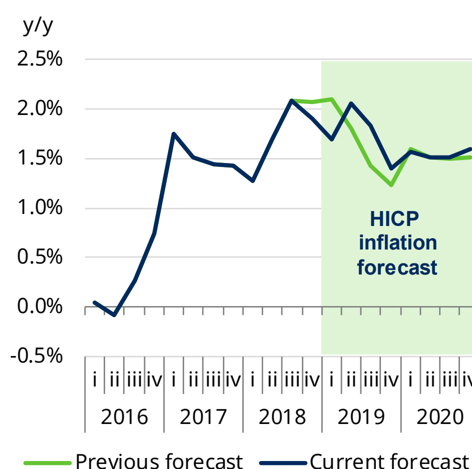


Chart 7: Eurozone inflation forecast



Source: Schroders Economics Group. 26 February 2019. Previous forecast from November 2018. Please note the forecast warning at the back of the document.

The Eurozone inflation forecast has been re-profiled slightly to remove some of the deflationary effects which were previously expected from a stronger euro. Moreover, the recent fall in global oil prices should mean lower energy inflation over most of 2019, but the impact fades by 2020. Overall, the inflation forecast has been raised from 1.6% to 1.7% for 2019, but left unchanged at 1.5% for 2020.

The ECB is likely more likely to delay its first rate rise to the end of 2019...

As for monetary policy, the European Central Bank's (ECB) language is gradually softening to acknowledge the increased downside risks to the growth outlook. Its forward guidance continues to be that interest rates remain on hold through the summer of 2019, but we suspect that given the recent weakness, the guidance may eventually be changed to extend the time frame to 'the end of the year'. This would lead us to push back the next interest rate rise to December (from September). For 2020, we still expect two more rate rises, though with the first hike in 2019 pushed out, the main refinancing rate ends 2020 at 0.75%, while the deposit rate reaches 0.25%.

With regards to quantitative easing, it is far too soon for the ECB to start reducing the stock of purchases. We do not see this occurring for at least two years. However, the ECB will soon have to decide what to do about its targeted long-term refining operation (TLTROs), as the three-year loan period matures this summer. To recap, TLTROs were temporary loans provided to banks in order to boost lending to the real economy. Banks would post collateral at the ECB (usually government bonds) in order to access the loans, but would need to see an improvement in their lending business to continue to enjoy the credit line.

...and it is likely to provide another round of TLTRO funds, albeit with less favourable terms

The scheme was originally introduced using shorter dated loans, and was designed to replace wholesale market funding at a time when the banking system was stressed. Indeed, just over three years ago, many banks were cajoled into taking as much credit as possible, so that it would appear to financial markets that the scheme was working. Most healthy banks duly unwound their arrangements soon after, but a large number of southern European banks have been left dependent on these loans.

Rather than a hard stop in June in the liquidity offered by these loans, we expect the ECB to announce another round of funding, but probably using a two-year maturity, shorter than the current three-year programme. Moreover, the interest rate due will probably be changed from fixed to floating, which will allow the ECB to raise interest rates when the time comes.

UK forecast update: Brexit uncertainty hits corporate sentiment

At the Bank of England's (BoE) February Inflation Report press conference, governor Mark Carney blamed the prolonged uncertainty surrounding Brexit for the economy's underperformance against the Bank's forecast. Indeed, GDP growth slowed dramatically in the fourth quarter (from 0.6% to 0.2%), with the December monthly reading falling to -0.4%.

UK GDP growth slowed sharply at the end of 2018 due to higher imports and falling business investment

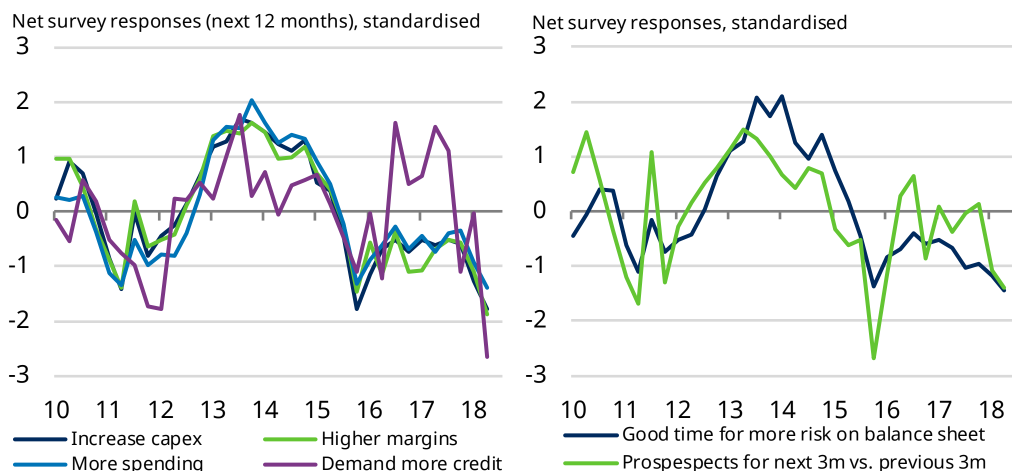
The slowdown was caused by a sharp rise in imports relative to exports, and weaker investment growth. Imports may be rising faster as firms have been warned to stockpile ahead of Brexit. A no-deal Brexit could cause trade disruption in the immediate aftermath, and so some stockpiling makes sense. The weaker investment data has been a trend for some time, with the biggest component, business investment, falling in every quarter of 2018.

Multinationals and companies that trade with the EU have been warning for some time that clarity is needed to avoid disruption. We had expected a Brexit deal to have been signed off by now, so the persistent uncertainty must be having a damaging impact on investment plans and sentiment.

The Deloitte Chief Financial Officers (CFOs) survey gives us some insight into company plans and predictions for their own outlook. Charts 8 and 9 show standardised net balance series from a range of survey questions. For example, companies surveyed plan to reduce investment spending (capex) over the next 12 months. They also expect less discretionary spending, and as a result they expect to require less financing (credit). Moreover, profit margins are expected to be squeezed, as CFOs report lower sentiment over future prospects, and suggest that now is not a good time to be adding more risk to corporate balance sheets. In fact, going though the survey, one would be hard pressed to find any indicator providing a positive signal at present.

Companies are very negative over their business prospects, with most planning to cut back capex

Chart 8 and 9: Deloitte UK CFOs survey



Source: Thomson Datastream, Schroders Economics Group. 26 February 2019.

Turning to the UK forecast, we have downgraded the growth forecast for the first and second quarter of the year due to ongoing Brexit uncertainty. We continue to expect a deal to be struck to allow the UK to enter into a transition period to facilitate a smooth Brexit. However, the delay in finalising the deal has already caused some irreversible damage. The forecast still includes a rebound in growth in the second half of 2019 as investment and household spending start to recover, which should last well into 2020 before growth starts to moderate again. Overall, the forecast for UK real GDP growth has been downgraded from 1.4% to 1.1% for 2019, and remains unchanged at 1.5% for 2020 (chart 10).

The delay to a Brexit agreement has prompted the downgrade to the UK GDP growth forecast...

Chart 10: UK GDP forecast

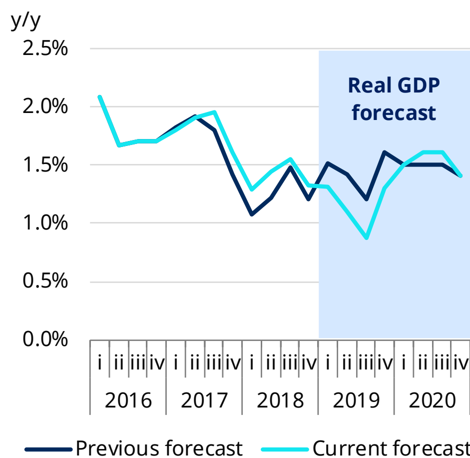
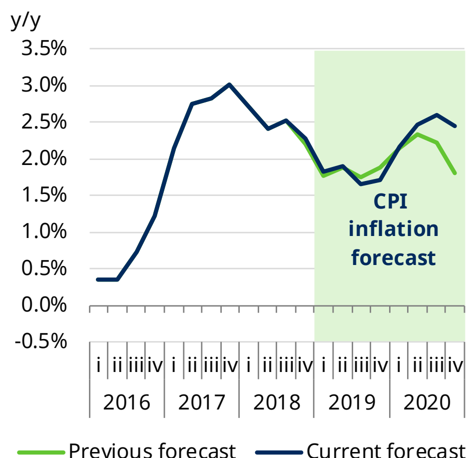


Chart 11: UK inflation forecast



Source: Schroders Economics Group. 26 February 2019. Previous forecast from November 2018. Please note the forecast warning at the back of the document.

The inflation forecast is largely unchanged as most of the recent falls in energy prices have passed through already. Energy and food price inflation is likely to be subdued over the forecast horizon, with the main driver of the rise in the path (chart 11) being underlying core inflation. With employment growth continuing to beat expectations and wage growth accelerating, companies should have plenty of room to defend their profit margins. They may have been reluctant to raise prices of late given Brexit uncertainty, but once this passes, higher core inflation is likely. The UK CPI inflation forecast is unchanged at 1.8% for 2019, but has been revised up to 2.4% for 2020 (from 2.1%).

...which should also delay the next BoE rate rise

With regards to monetary policy, we continue to expect the BoE to raise interest rates in 2019, but have pushed back the next hike by three months. This reflects the growing likelihood that a short delay may be required to facilitate Brexit. We forecast the BoE to hike in August 2019 to 1% (previously in May) then twice again in 2020 (reaching 1.50%, 25bps lower than previously forecast).

EM forecast update: oil on troubled waters

Inflation outlook improves for most of EM

Though we do make some adjustments on the growth front in this quarter's forecast update, the main changes for emerging markets come from inflation. Crude oil prices have fallen dramatically since we last updated our numbers. Combined with surprisingly low domestic inflation this sees substantial downward revisions to the inflation outlook for all BRIC economies bar Russia, for whom cheaper oil means a weaker currency and hence more imported inflation.

Table 2: BRIC GDP growth forecast summary

% per annum	GDP			Inflation		
	2018(f)	2019(f)	2020(f)	2018(f)	2019(f)	2020(f)
China	6.6 (6.6)	6.3 ↑ (6.2)	6.1 ↑ (6.0)	2.1 ↓ (2.2)	2.0 ↓ (2.6)	2.2 ↓ (2.4)
Brazil	1.2 ↓ (1.3)	2.0 ↓ (2.1)	2.4 ↑ (2.3)	3.7 ↓ (3.9)	3.9 ↓ (5.0)	4.1 ↓ (4.5)
India	7.5 ↓ (7.6)	7.3 (7.3)	7.7 (7.7)	3.9 ↓ (4.4)	2.8 ↓ (4.1)	4.0 (4.0)
Russia	1.7 (1.7)	1.4 ↓ (1.5)	1.8 (1.8)	2.9 ↑ (2.8)	5.0 ↑ (4.9)	4.3 ↑ (4.0)

Source: Thomson Reuters DataStream, Schroders Economics Group. 25 February 2019. Previous forecast from November 2018. Please note the forecast warning at the back of the document.

Lower price pressures increase the scope for easing

As might be expected, a lower inflation environment means central banks have more room to ease. We forecast an easier monetary stance, compared to our previous forecast, for three of the four BRIC economies. Only Russia, thanks to a more hawkish sounding central bank and a raised inflation profile, sees upward revisions to interest rate expectations.

Table 3: BRIC monetary policy

% (year end)	2018(f)	2019(f)	2020(f)
China RRR	14.50 (14.00)	12.00 (12.00)	10.00 (11.00)
China lending rate	4.35 (4.35)	4.00 (4.00)	3.50 (3.50)
Brazil	6.50 (6.50)	6.50 (7.00)	7.00 (7.00)
India	6.50 (6.75)	6.00 (7.00)	6.50 (7.00)
Russia	7.75 (7.50)	7.25 (7.00)	7.00 (7.00)

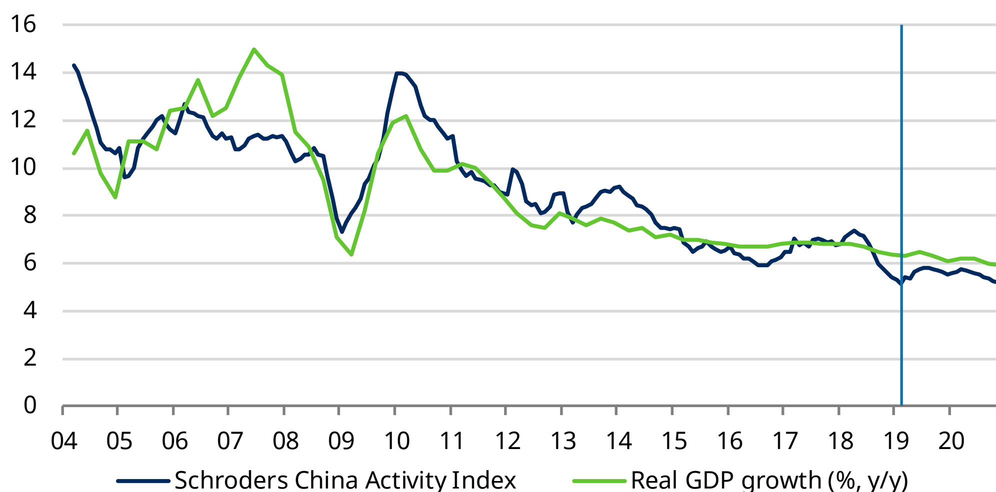
Source: Thomson Reuters DataStream, Schroders Economics Group. 25 February 2019. Previous forecast from November 2018. Please note the forecast warning at the back of the document.

China: trade truce warrants some mild optimism

Our previous forecast for China assumed that the trade war with the United States (US) would escalate further and extend to all Chinese trade with the US. The revised base case sees tariffs held at current levels and a truce in trade, which improves the outlook both for trade and investment in China. This drives our small upgrades to Chinese growth for this year and next.

Stimulus should provide some temporary relief

Chart 12: After a rebound, slowdown still on the cards



Source: Thomson Reuters DataStream, Schroders Economics Group. 26 February 2019. Previous forecast from November 2018. Please note the forecast warning at the back of the document.

While this is a positive development, we would emphasise that we still see a very similar path for Chinese growth as in our last forecast update; the economy is still set for an ongoing slowdown, trade war or no trade war (chart 12), with actual underlying activity to exhibit more weakness than headline GDP. For the time being, stimulus announcements have not been of sufficient magnitude to materially alter our view. While the January total social financing (TSF) number drew headlines for its record breaking size, if we examine the growth rate the impact is reduced, though it was still undeniably a turning point. We also think there may have been more frontloading than usual in the January reading; local governments were allowed to issue municipal bonds to support infrastructure, and this would likely have prompted some additional bank lending to be invested alongside government funds. Unless the March Congress unveils a big increase to overall infrastructure spend, the January credit data may turn out to simply have brought forward activity from later in the year. Finally, much of the new lending by banks seems to have been directed outside of the real economy, with the largest acceleration, and contribution to the overall increase, coming from portfolio investments, rather than household or corporate lending (chart 13).

Directing credit may prove difficult

Chart 13: Was new credit productive?

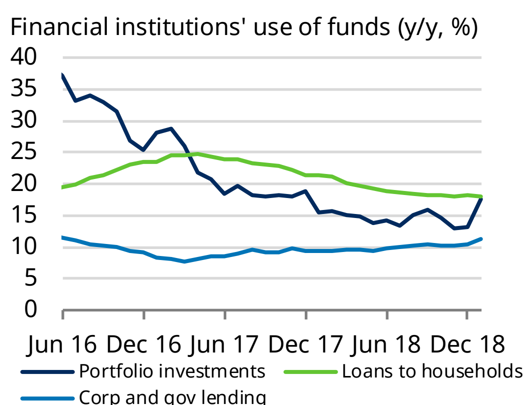


Chart 14: Growth to bottom soon

Source: Thomson Reuters DataStream, Schroders Economics Group. 26 February 2019.

These caveats serve to dampen growth expectations resulting from the surge in credit, but we should not discount them entirely. We do expect some impact on growth, and our forecast still sees growth bottoming and bouncing back in the second and third quarters. Looking at chart 14, this still seems on track; an inflection

point in credit growth has historically seen a similar inflection point in growth (as measured by our in house Schroders' China Activity Indicator) three months later, at the earliest. There is a risk that the growth takes longer to come through, especially as the relationship has seemed weaker in recent years. Still, we do expect a temporary turn around in growth within the next two quarters.

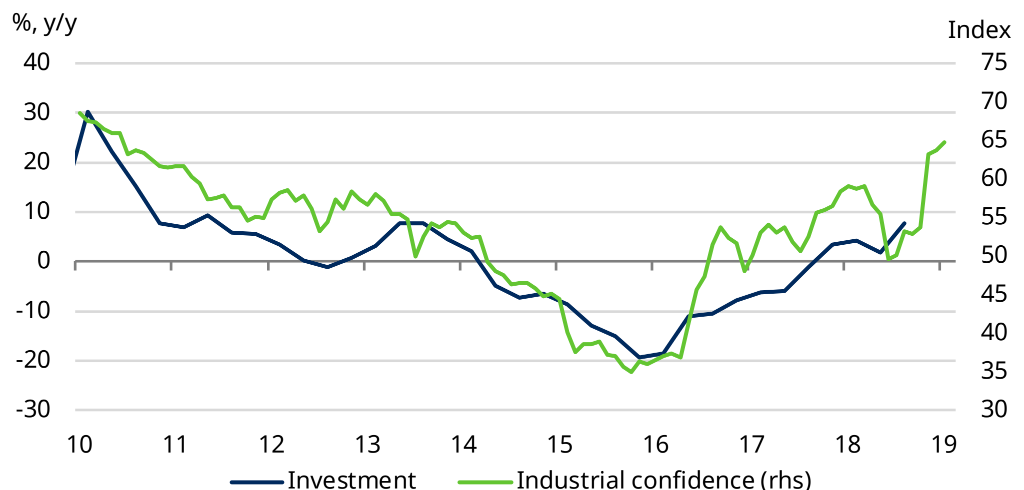
We remain of the view that policy is constrained and so we will not see explosive stimulus as in previous downturns. The central bank will continue to ease (table 3), but with currency stability now on the table in trade talks with the US the scope for a weaker renminbi (the corollary of monetary easing) is much less. There have been mixed messages recently, with one regulator declaring the end of structural deleveraging, while the People's Bank of China (PBoC) maintains it will be continuing the policy. Ultimately the PBoC sits at the top of the regulatory structure, so we would place the most weight on their words. It may be a sign however that disquiet is building over the slowdown, and so a stronger than expected stimulus is a definite risk to our view. This is reflected in our risk scenario, 'China reopens the spigots'

Brazil: Bolsonaro boost still expected but political risks have risen

President Bolsonaro is now in office, and economic confidence is high, in a promising sign for economic activity (chart 15). Investors will take further courage from the administration's proposal for pension reform, which was more ambitious than many had expected. Economy Minister Guedes is clearly being given a free rein here, and that bodes well.

Brazilian confidence remains high for now

Chart 15: Brazil's investment revival should continue



Source: Thomson Reuters DataStream, Schroders Economics Group. 26 February 2019.

Unfortunately for the minister, his hard work risks being undermined by the scandals already surfacing around Bolsonaro's government. After just 48 days, Secretary General Bebianno, accused of siphoning money from an electoral fund during last year's campaign, has been fired. The president's family have also faced allegations, with eldest son Flavio under investigation for money laundering. This is all rather inconvenient for the 'anti-corruption' candidate, and risks undoing the coalition building needed to pass a contentious pension reform. Civil servants, who see some of the largest changes, are already preparing to resist the reform. We see considerable risk that the reforms will face delay and ultimately greater dilution than the market may be expecting.

However, this was already our base case, and does not impact our outlook for growth or inflation. Growth is revised slightly lower for 2019 as 2018 looks to have been a little softer than expected in the final quarter (at the time of writing we do not have the final GDP print). More positively, inflation is also revised down thanks to cheaper oil and consistently low headline inflation prints, which leads us to forecast a more

dovish central bank. We now expect no hikes this year, from 50bps previously. This provides some additional support to growth in 2020.

India: another methodology change muddies the waters

Data changes make GDP hard to call

A problem confronting us with Indian GDP data since 2015 was the shift to a new GDP series, with a base year of 2011–2012, but with no data available for growth trends before 2012–2013. Since our last forecast, back data has been released, and in general favours the economic record of the current administration. Average growth rates under the Congress government (pre-2014) have been revised down, and underperforms the current government. A previous methodology revision made only in August of last year showed the previous government outperforming Prime Minister Modi's administration. Naturally this has prompted some controversy, and questions over the reliability of the numbers. So, while the lack of history has been addressed, the quality of the new data is still in question.

Having downgraded in our last forecast update, we see no reason to make significant changes to our growth outlook this month, given the uncertainty over the GDP numbers. There is potential upside risk: credit growth is picking up, though only very gradually, and the central bank has taken a definite dovish turn under its new governor, again provoking controversy given the circumstances surrounding the resignation of Governor Patel late last year.

Political tensions rising locally and regionally

Where we do make a change is to the inflation outlook. India is particularly sensitive to global food and oil price moves, and the latter in particular have been very favourable since our last update. Domestic food inflation has also continued to surprise to the downside, suppressing headline inflation though core inflation has remained high. Given the newly dovish bias of the central bank we expect another rate cut this year, most likely before the general elections in April and May. The outcome of these elections remains uncertain; our low conviction base case is for a Modi victory but with a reduced majority, which threatens the reform agenda. At this point, marquee reforms seem highly unlikely, and India may have to settle for gradual change rather than revolution.

Geopolitically, while India is thankfully insulated from the US-China trade war, regional tensions with Pakistan have flared once again. India's bombing of Pakistani territory, targeting alleged militants in retaliation for an attack on Indian soldiers in early February, has put some pressure on Indian assets; should matters escalate there is an obvious downside risk to growth.

Russia: oil will hit the currency but not growth

Careful budgeting limits the economic impact of weaker oil

Russia is an obvious loser from lower oil prices, but happily for the growth outlook fiscal outlays are budgeted for on the assumption of a 'break even' Brent oil price of $43 in 2019. The impact will be felt more on the currency side, resulting in a higher inflation forecast for Russia and necessitating a higher policy rate from the central bank. We do not foresee a huge increase in hawkishness, however; the link between oil and the ruble is weaker than it was, in part due to the central bank rebuilding reserves in times of higher prices. Further, the VAT increase at the start of 2019 has proved less inflationary than feared.

The VAT increase is part of the latest economic plan as laid out in the new May decree. The tax hike lays the ground for increased investment spending, and a pick up in growth in 2020. There is also an upside risk to growth from the trade truce, which should boost global activity and potentially oil prices as a result. To the downside, the threat of sanctions has still not fully receded.

Japan: BoJ to stay on hold through VAT hike

'If downside risks to economic activity and prices materialise, the Bank should be prepared to make policy responses. Since achieving the price stability target has been delayed, it is not desirable to adopt a stance of not taking actions until a serious crisis occurs'

Opinion of Bank of Japan board member, Summary of Opinions, 31 January 2019.

We revise our growth outlook for 2019 lower from 1% year-on-year (y/y) to 0.7% y/y. This is primarily due to base effects from disappointing growth in 2018, partly offset by beneficial infrastructure spending. On the plus side, a more optimistic external environment outlook, as well as more infrastructure spending, helps to push up our growth outlook for 2020 from 0% y/y to 0.4% y/y.

Our view on inflation this year remains broadly unchanged: energy and one-off factors should drive a further moderation before a VAT-led spike in October. Lower oil prices drive our downgrade to inflation in 2020.

We now expect monetary policy to remain unchanged in 2019

The weaker global backdrop has led to a more dovish tone from the Bank of Japan (BoJ). We now expect monetary policy to remain unchanged in 2019 rather than our previous expectation of another tweak to yield curve control.

Downgrade to 2019 growth reflects disappointing growth last year

A recovery in the fourth quarter confirmed temporary weakness in the third quarter, caused by a series of natural disasters, and concluded a volatile year for the Japanese economy.

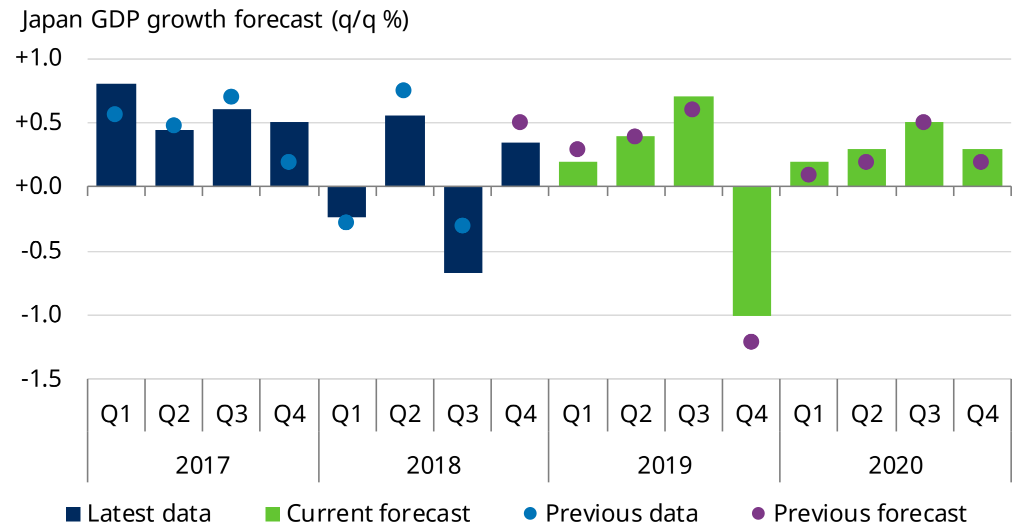
The impact of the weather disasters last summer was worse than initial Cabinet Office estimates and along with the market, we had pencilled in a slightly stronger recovery than that which materialised (chart 16). This lower growth in 2018 has a mechanical knock on impact to growth in 2019.

We also nudge down our expectation for the first quarter of 2019 as high frequency indicators, such as the Purchasing Managers Index, and the Cabinet Office composite Index continue to point to a moderation in growth. On the other hand, more infrastructure spending, recently announced by the government should support growth at the end of 2019, but more substantially in 2020 (more detail on this below).

Our growth profile continues to be shaped by the consumption tax hike

Our outlook for growth this year continues to be shaped by the upcoming rise in Value Added Tax (VAT) – otherwise known as the 'consumption tax' – from 8% to 10% in October. This has typically had a large impact on activity and we expect a subsequent sharp decline in demand as well as frontloading ahead of the tax rise.

Chart 16: Changes to Japanese quarterly growth outlook



Source: Thomson Reuters Datastream, Schroders Economics Group, 19 February 2019. Previous forecast from November 2018. Please note the forecast warning at the back of the document.

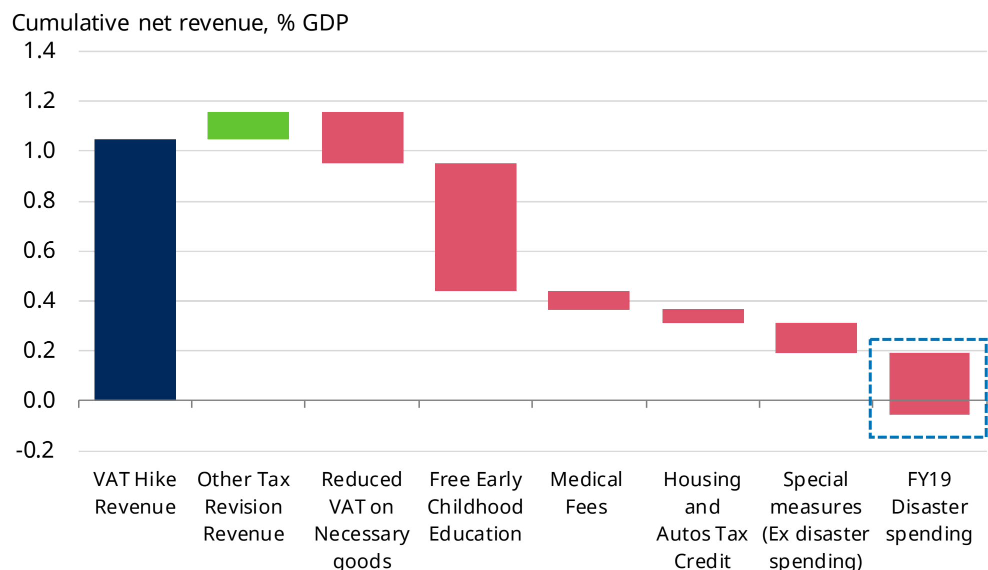
Infrastructure spending to support growth, mainly in 2020

Following the budget for Fiscal Year (FY) 2019, we have more information about how the government plans to offset the impact of the VAT hike with spending, which we incorporate into our view. As previously promised, the main offsetting measures will be free early childhood education (chart 17), which amounts to more than half the revenue of the VAT hike, once adjusted for the reduced rate on 'necessary' goods. We think the multiplier on this will be low with these households opting to save as inflation rises and sentiment remains sluggish.

Recently announced infrastructure spending should help support growth

The second largest measure is JPY1.3 trillion (0.25%) in infrastructure spending for disaster prevention. This is part of a recently announced JPY 7 trillion (1.3% GDP) spending plan over three years to FY2020, of which JPY1.1 trillion was already announced in the FY18 budget (chart 18). This spending should take time to come through, supporting growth at the end of 2019 and early 2020.

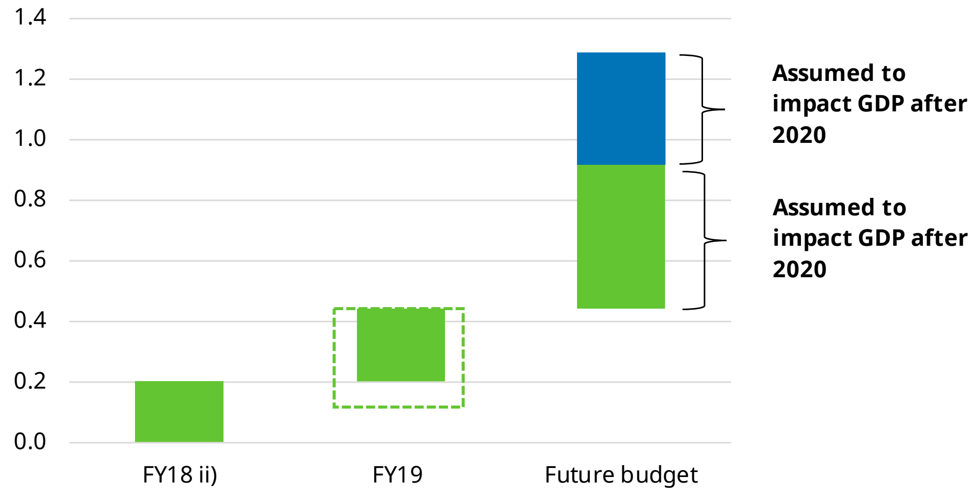
Chart 17: Spending to counteract VAT increase



Source: Ministry of Finance, Schroders Economics Group, 26 February 2019.

This leaves JPY4.6 trillion to spend up to FY2020. We factor in another JPY2.6 trillion of spending to be announced in budgets this year, leading us to revise up our outlook for 2020 growth. Note JPY2 trillion would then be left to spend in FY2020, likely supporting growth in 2021.

Chart 18: Infrastructure spending



Source: Thomson Reuters Datastream, Schroders Economics Group, 19 February 2019. Previous forecast from November 2018. Please note the forecast warning at the back of the document.

We see a moderation in employment growth in 2020

This additional spending should be an important supporting factor for growth as we still see an underlying moderation in domestic demand in 2020. This is due to slowing employment growth driving lower consumption growth. While labour shortages and still accommodative financial conditions will remain supportive for firms, the cyclical and external environment in 2020 should result in a moderation in capital expenditure, while Olympics related demand will have peaked.

Nonetheless, we become more optimistic on the external environment, also a factor which contributes to our upward revision to 2020 growth.

External headwinds bite, but outlook improves

In 2018, growth more than halved from 1.9% y/y to 0.7% y/y – just below estimates of potential growth[1]. Consumption and residential investment were drags to growth of 0.4 percentage points (pp) and 0.3pp, respectively but exports alone were responsible for 0.6pp of the fall. Net exports were also a significant drag in the fourth quarter as domestic demand itself grew by 0.6% quarter-on-quarter (q/q) – very respectable by Japanese standards. While we admit that supply side constraints had a part to play here, this also reflects the impact of a weaker global backdrop.

Our outlook for global trade suggests that external headwinds should weigh on the Japanese economy in 2019. However a more favourable outcome on the US-China trade war, along with lower oil prices, lead us to become more optimistic on the external outlook. A better outlook for net exports is another factor that plays a part in our 2020 growth upgrade.

[1] Bank of Japan estimate annual potential growth to be 0.8% as of January 2019.

Inflation to moderate further before VAT spike

A more favourable outlook for the US and China leads us to become more optimistic on the external outlook

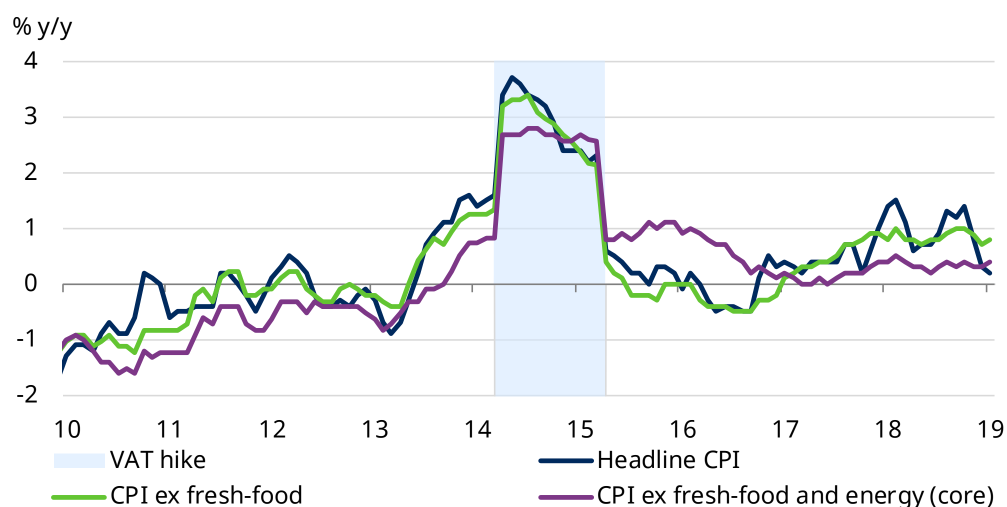
Inflation has fallen in the last few months, mainly due to developments in energy prices and the volatile fresh-food component (chart 19). However, core inflation, which excludes these factors, remains very low at 0.3% y/y. While the positive output gap points to a supportive core inflation outlook longer term, we continue to expect inflation to fall in 2019, driven by both core inflation and energy inflation.

The pessimistic outlook for core inflation continues to be due to special factors rather than a genuine return to deflation. Inflation should continue to fall in the first half of the year, helped by a one-off cut in mobile phone charges. The VAT hike itself will lead to a spike in inflation, some of which should be offset by free pre-school education.

Our inflation forecast remains at 0.5% in 2019, still picking up but now to a lower level of 1% in 2020 – reflecting lower oil prices, partly offset by stronger core inflation from stronger growth.

The pessimistic outlook for inflation continues to be driven by special factors rather than a genuine return to deflation

Chart 19: Japanese inflation cools



Source: Thomson Reuters Datastream, Schroders Economics Group, 19 February 2019.

Bank of Japan to now stay on hold until VAT hike is over

Global headwinds – the number one risk to economic activity cited by the BoJ – have caused the central bank to turn more dovish, leaving aside more hawkish concerns about the side-effects of prolonged easing.

Although policy was unchanged in the January meeting, two members became more vocal about their unease with current policy. One highlighted that it is undesirable to adopt a stance of no action until a crisis occurs (see quote). Another noted the BoJ should avoid a situation where there are embedded expectations of no policy changes amid successive downward revisions to the inflation outlook.

Global headwinds come to the forefront...

As a result of a moderation in the global backdrop and more dovish tone, we now expect BoJ policy to remain unchanged in 2019. We previously expected the side-effects of easing to drive another tweak in its yield curve control policy in the second quarter by widening the band around the 0% target of the 10-year Japanese Government Bond. An unchanged policy stance will likely be the case until the impact of the VAT hike is clear.

The short-term interest rate should be kept at -0.1% until late 2020.

...Leaving concerns about side-effects aside

Finally, despite a reluctance to ease policy, the BoJ continue to claim that they have various tools to do so. We would not rule out such actions, in the case of a further deterioration in the global backdrop, but, for now this is a risk scenario.

Schroders Economics Group: Views at a glance

Macro summary – March 2019

Key points

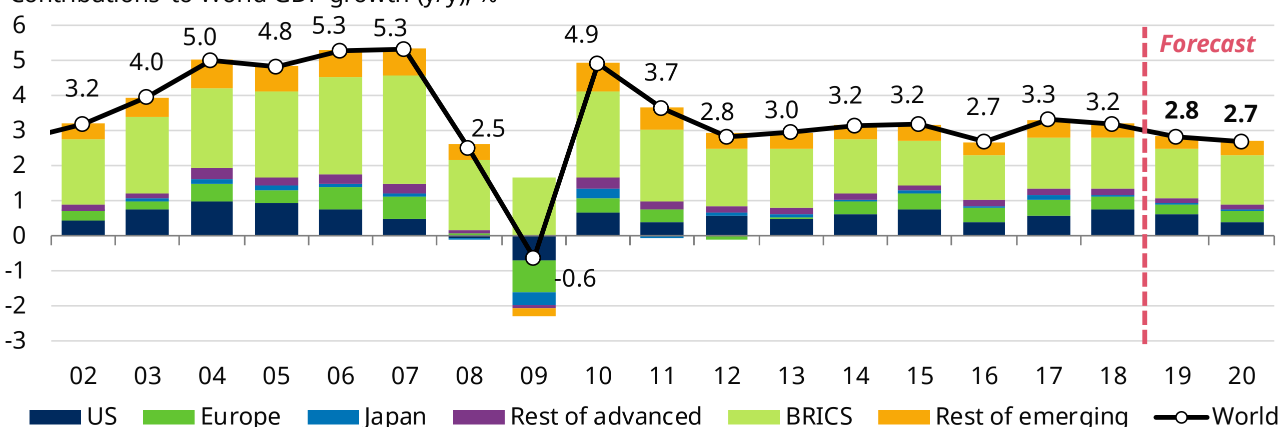
Baseline

- After expanding by 3.2% in 2018, global growth is expected to moderate to 2.8% in 2019 and 2.7% in 2020. Inflation is forecast to decline to 2.4% this year after 2.8% in 2018 and then falling to 2.5% in 2020. Meanwhile we expect the US and China to sign a trade deal in March, although the impact of actions so far will still be felt in 2019.
- US growth is forecast to slow to 2.4% in 2019 and 1.6% in 2019. With core inflation rising, we expect one more rate hike in June 2019, taking the Fed funds to 2.75%. However, as US fiscal stimulus fades and the economy slows, the Fed is forecast to cut rates twice in 2020 after ending quantitative tightening at the end of 2019.
- Eurozone growth is forecast to moderate from 1.8% in 2018 to 1.3% in 2019 as the full effects from the US–China trade war and Brexit hit European exporters. Inflation is expected to remain under 2%, with higher energy price inflation in 2018 replaced by higher core inflation in 2019. The ECB has ended QE and is expected to raise interest rates once in 2019 and twice in 2020. The refinancing rate is forecast to reach 0.75% and the deposit rate 0.25% by the end of 2020.
- UK growth is likely to slow to 1.1% this year from 1.4% in 2018. Assuming that a Brexit deal with the EU passes parliament ahead of a transition period that preserves the status quo of single market and customs union membership, growth is expected to pick up to 1.5% in 2020. Inflation is expected to fall to 1.8% in 2019 thanks to an expected rise in sterling, but stronger growth is expected to push inflation up to 2.4% in 2020. Meanwhile, the BoE is expected to hike once in 2019 and twice in 2020 (to 1.5%).
- Growth in Japan should stay steady in 2019 at 0.7%, however the path of activity should be volatile owing to the consumption tax hike in October this year. A slow recovery should follow resulting in 0.4% growth in 2020. We do not expect the BoJ to alter yield curve control, but look for rates to rise to 0% at the end of 2020 as inflation picks up.
- Emerging market economies should slow to 4.5% in 2019 after 4.8% in 2018, but pick-up slightly to 4.7% in 2020. We are optimistic that for most of the BRIC economies domestic factors can outweigh global problems in 2020. China benefits from the easing of trade tensions with the US, but against a backdrop of secular decline the PBoC should continue to ease.

Risks

- Risks are tilted toward deflation with the highest individual risk going on the US recession 2020 scenario where the economy proves more fragile than expected as fiscal stimulus is withdrawn. There is also a risk of recession outside the US given the current weakness in Europe.

Chart: World GDP forecast



Source: Schroders Economics Group, February 2019. Please note the forecast warning at the back of the document.

Schroders Forecast Scenarios

Scenario	Summary	Macro impact	Probability*	Cumulative 2019/20 global vs. baseline: Growth	Inflation
Baseline	We have revised down our forecast for global GDP growth in 2019 to 2.8%, but increased our projection for 2020 to 2.7%. The downgrade for this year (the fourth in consecutive quarters) is driven by cuts to our forecasts for the Eurozone, UK and Japan which offset a small increase to our China forecast. In 2020, the upward revision is across the board with, for example, the US upgraded to 1.6% (previously 1.3%), Japan to 0.4% (previously 0%) whilst China is nudged up to 6.1% from 6%. Meanwhile, our inflation forecasts have been reduced for this year and next with reductions across all regions except Europe where there are small upward revisions. The forecast has been largely driven by the decline in oil prices which are now expected to be significantly lower over the forecast period than at the time of our last outlook in November 2018. US inflation is also lower as a result of weaker core (CPI ex. food & energy) inflation which peaks at a lower level before declining in 2020.	Weaker growth and lower inflation result in easier monetary policy than in our previous forecast. The US Fed funds rate is now expected to rise once more before falling in 2020, whilst we have pushed out rate increases in the UK and Eurozone with only one move from the ECB and Bank of England now expected this year. We also expect the BoJ to leave policy unchanged rather than tightening its yield curve control policy further. China is expected to ease further through a lower RRR which is now expected to reach 10% by end 2020 (previously 11%). The USD is expected to remain firm in the near term but to weaken later in the year as rates peak in the US whilst beginning to rise in the Eurozone and UK. GBP is also boosted by our assumption that the economy enters a transition period rather than crashing out of the EU.	60%	-	-
1. Italian debt crisis	Although Italy has reached an agreement with the European Commission on its budget for this year, we would expect renewed tension between Rome and Brussels in the autumn as the next budget is formulated. Markets fear another more serious dispute, pushing the 10yr BTP yield up to 6%. After a couple of failed auctions, the government is forced to seek help from the rest of the EU in the form of a bail-out. There is some knock-on effect to other peripheral bond markets. A technocrat is installed as Italian PM, and the ECB's OMT programme is activated. QE is also restarted in 2019 as the Eurozone faces a deep recession. The threat of restructuring/default on Italian debt remains, but yields return to more manageable levels thanks to the ECB and change in domestic policy.	Stagflationary. The principal impact is weaker global growth with all regions affected as Italy drags Eurozone growth lower and the increase in uncertainty weighs on confidence and spending around the world. On inflation the picture is more mixed: for the eurozone, this is a stagflationary scenario due to EUR falling to 1.02. The US and Japan see their currencies appreciate, and combined with lower oil prices and a shock to financial markets, both see lower growth and inflation compared to the base. The impact on EM is more mixed. China intervenes to prop up the CNY, but Brazil, India and Russia all see FX depreciation as global risk aversion rises, making this a stagflationary scenario in EM.	5%	-0.6%	+0.1%
2. China reopens the spigots	China reverts to its old playbook to avert a deepening economic slowdown. Casting aside the relative timidity of current stimulus measures, policymakers embark on large scale fiscal and monetary stimulus, embodied in massive infrastructure spending and a resurgent property sector. Global commodity demand skyrockets, to the benefit of a number of emerging markets, and Chinese demand for manufactured goods also jumps.	Reflationary. Stronger demand from China boosts world trade and increases commodity prices with the result that both global growth and inflation are higher than in the baseline. The trade sensitive Eurozone sees a significant boost to growth in 2020 with the EM also benefitting. Interest rates are higher across the DM and in the EM (ex. China).	4%	+0.8%	+0.6%
3. Trade war: US vs. RoW	The US administration decides to impose tariffs on auto imports from the rest of the world thus extending the trade war into new territory. Meanwhile the dispute with China worsens as trade talks fail and the US imposes further tariffs on the remainder of imports from China.	Stagflationary. Higher import prices push inflation higher whilst weaker trade weighs on growth. Capex is also hit by the increase in uncertainty and the need for firms to review their supply chains. Central banks are expected to focus on the weakness of activity and ease policy by more than in the baseline.	6%	-1.0%	+0.3%
4. Global inflation surge	After a considerable period where wages have been unresponsive to tightening labour markets, pay begins to accelerate in response to skill shortages. Wages accelerate around the world and economists revise their estimates of spare capacity considerably lower. Some economies such as Japan welcome the move as they seek to raise inflation expectations, others find they are facing stagflation as they effectively run out of capacity forcing the central bank to tighten policy.	Stagflationary: US inflation rises to 3.4% by the start of 2020 on the headline measure, but core inflation reaches 3%. The Fed responds by tightening more aggressively taking its target rate to 4.00% by mid-2020. Interest rates also rise more rapidly in the Eurozone and UK whilst Japan returns rates to zero sooner than in the baseline. Currency changes provide some cushion to the emerging markets which see a modest boost to growth alongside higher inflation in this scenario. Overall, global growth is slightly weaker and inflation considerably higher.	3%	-0.3%	+1.1%
5. US supply side surprise	The US labour market proves to be more flexible than expected with labour supply continuing to rise through a higher participation rate as more people return to the workforce. This extends the cycle by containing wages and inflation in the US for longer than in the baseline allowing stronger growth. There is a knock-on to growth in the rest of the world though stronger US demand although slightly higher commodity prices raise inflation.	Reflationary. Stronger real growth allows the Fed to increase real rates slightly more in 2019 and as the economy continues to expand in 2020 the central bank does not cut rates as in the baseline. Interest rates are slightly higher elsewhere in line with stronger activity.	5%	+0.4%	+0.2%
6. US 2020 recession	The US economy proves to be more fragile than expected, as tighter monetary policy combined with the end of fiscal stimulus slow demand and cause business and households to retrench. Output begins to contract at the start of 2020 thus bringing an end to the cycle whilst commodity prices and inflation fall. The Fed eases, but markets slump on fears of a wider global recession.	Deflationary: Weaker US growth drags global trade lower, hitting the eurozone, emerging markets and Japan particularly hard. Increased market volatility also hits demand through tighter financial conditions and weaker confidence and consequently global growth slows sharply. Monetary policy is eased significantly across both the DM and EM economies in 2020.	10%	-0.9%	-0.5%
7. Recession ex.US	The slowdown in Europe, China and Japan gathers momentum as contracting export growth undermines business confidence causing capital spending to contract. Firms retrench and unemployment rises hitting consumer spending. Commodity prices weaken and inflation falls.	Deflationary: Weaker growth drags global trade lower, hitting the US which is also affected by increased market volatility and tighter financial conditions . The USD is expected to strengthen putting added pressure on EM. Monetary policy is eased around the world.	7%	-1.0%	-0.6%
8. Other			0%	-	-

*Scenario probabilities are based on mutually exclusive scenarios. Please note the forecast warning at the back of the document.

Schroders Baseline Forecast

Real GDP

y/y%	Wt (%)	2018	2019		*Prev.*	Consensus	2020		*Prev.*	Consensus
World	100	3.2	2.8	↓	*(2.9)*	2.9	2.7	↑	*(2.5)*	2.8
Advanced*	61.4	2.2	1.8	↓	*(1.9)*	1.9	1.5	↑	*(1.3)*	1.6
US	26.5	2.8	2.4		*(2.4)*	2.5	1.6	↑	*(1.3)*	1.9
Eurozone	17.2	1.8	1.3	↓	*(1.6)*	1.3	1.4	↑	*(1.2)*	1.4
Germany	5.0	1.5	1.0	↓	*(1.4)*	1.2	1.4	↑	*(1.3)*	1.5
UK	3.6	1.4	1.1	↓	*(1.4)*	1.4	1.5		*(1.5)*	1.5
Japan	6.7	0.7	0.7	↓	*(1.0)*	1.0	0.4	↑	*(0.0)*	0.4
Total Emerging**	38.6	4.8	4.5		*(4.5)*	4.5	4.7	↑	*(4.5)*	4.6
BRICs	25.3	5.7	5.5		*(5.5)*	5.5	5.5	↑	*(5.4)*	5.5
China	16.7	6.6	6.3	↑	*(6.2)*	6.2	6.1	↑	*(6.0)*	6.1

Inflation CPI

y/y%	Wt (%)	2018	2019		*Prev.*	Consensus	2020		*Prev.*	Consensus
World	100	2.8	2.4	↓	*(2.9)*	2.5	2.5	↓	*(2.7)*	2.5
Advanced*	61.4	2.0	1.7	↓	*(2.0)*	1.6	1.9		*(1.9)*	1.8
US	26.5	2.4	1.9	↓	*(2.7)*	1.9	2.3	↓	*(2.4)*	2.2
Eurozone	17.2	1.7	1.7	↑	*(1.6)*	1.4	1.5		*(1.5)*	1.5
Germany	5.0	1.8	1.8		*(1.8)*	1.7	1.7		*(1.7)*	1.7
UK	3.6	2.5	1.8		*(1.8)*	2.0	2.4	↑	*(2.1)*	2.1
Japan	6.7	1.0	0.5		*(0.5)*	0.8	1.0	↓	*(1.1)*	1.2
Total Emerging**	38.6	4.1	3.7	↓	*(4.2)*	3.8	3.5	↓	*(4.0)*	3.5
BRICs	25.3	2.6	2.6	↓	*(3.3)*	2.8	2.8	↓	*(3.0)*	2.8
China	16.7	2.1	2.0	↓	*(2.6)*	2.2	2.2	↓	*(2.4)*	2.2

Interest rates

% (Month of Dec)	Current	2018	2019		*Prev.*	Market	2020		*Prev.*	Market
US	2.50	2.50	2.75	↓	*(3.00)*	2.65	2.25	↓	*(2.50)*	2.48
UK	0.75	0.75	1.00	↓	*(1.25)*	0.95	1.50	↓	*(1.75)*	1.08
Eurozone (Refi)	0.00	0.00	0.25	↓	*(0.50)*	-0.27	0.75	↓	*(1.00)*	-0.10
Eurozone (Depo)	-0.40	-0.40	-0.20		*(0.00)*		0.25	↓	*(0.50)*	
Japan	-0.10	-0.10	-0.10		*(-0.10)*	0.03	0.00		*(0.00)*	0.03
China	4.35	4.35	4.00		*(4.00)*	-	3.50		*(3.50)*	-

Other monetary policy

(Over year or by Dec)	Current	2018	2019		*Prev.*	Y/Y(%)	2020		*Prev.*	Y/Y(%)
US QE ($Tn)	4.1	4.0	3.5	↑	*(3.4)*	-12.5%	3.4	↑	*(3.1)*	-2.9%
EZ QE (€Tn)	2.4	2.4	2.4		*(2.4)*	0.0%	2.4		*(2.4)*	0.0%
UK QE (£Bn)	435	435	445		*(445)*	2.3%	445		*(445)*	0.0%
JP QE (¥Tn)	552	552	575	↑	*(572)*	4.1%	595	↑	*(592)*	3.5%
China RRR (%)	14.50	14.50	12.00		*12.00*	-	10.00	↓	*11.00*	-

Key variables

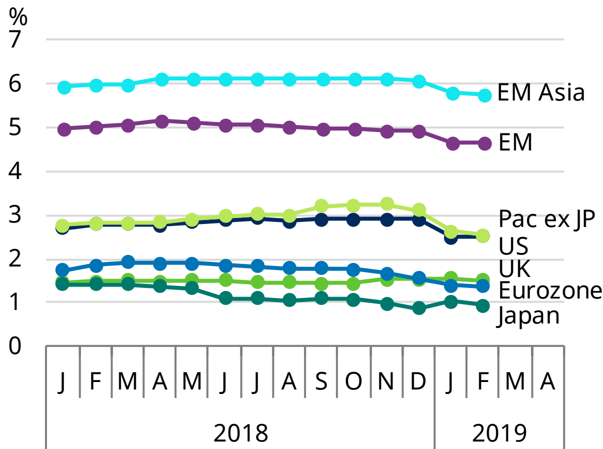
FX (Month of Dec)	Current	2018	2019		*Prev.*	Y/Y(%)	2020		*Prev.*	Y/Y(%)
USD/GBP	1.30	1.27	1.42		*(1.42)*	11.5	1.38		*(1.38)*	-2.8
USD/EUR	1.13	1.14	1.17	↓	*(1.21)*	2.3	1.20	↓	*(1.25)*	2.6
JPY/USD	110.6	109.7	110		*(110)*	0.3	108		*(108)*	-1.8
GBP/EUR	0.87	0.90	0.82	↓	*(0.85)*	-8.2	0.87	↓	*(0.91)*	5.5
RMB/USD	6.77	6.87	6.85	↓	*(7.20)*	-0.2	7.00	↓	*(7.40)*	2.2
Commodities (over year)										
Brent Crude	66.1	71.6	62.7	↓	*(71.7)*	-12.4	62.3	↓	*(68.1)*	-0.7

Source: Schroders, Thomson Datastream, Consensus Economics, February 2019
Consensus inflation numbers for Emerging Markets is for end of period, and is not directly comparable.
Market data as at 19/02/2019
Previous forecast refers to November 2018
* **Advanced markets:** Australia, Canada, Denmark, Euro area, Israel, Japan, New Zealand, Singapore, Sweden, Switzerland, United Kingdom, United States.
** **Emerging markets**: Argentina, Brazil, Chile, Colombia, Mexico, Peru, China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, South Africa, Russia, Czech Rep., Hungary, Poland, Romania, Turkey, Ukraine, Bulgaria, Croatia, Latvia, Lithuania.

Updated forecast charts – Consensus Economics

For the EM, EM Asia and Pacific ex Japan, growth and inflation forecasts are GDP weighted and calculated using Consensus Economics forecasts of individual countries.

Chart A: GDP consensus forecasts



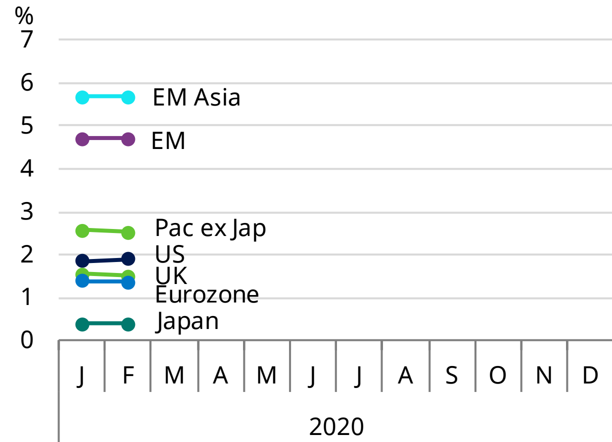
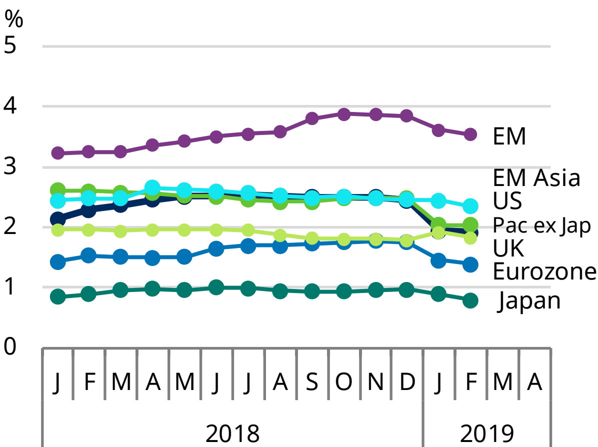
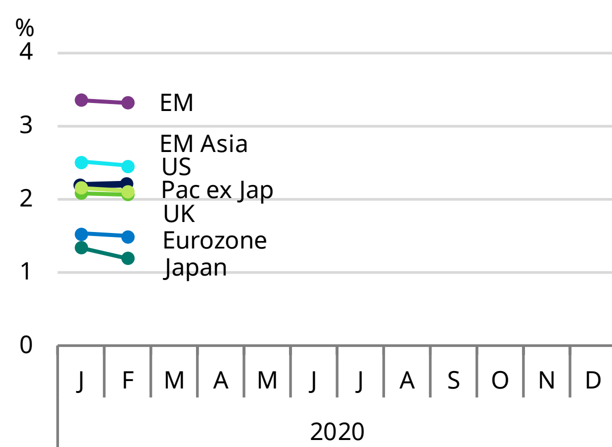


Chart B: Inflation consensus forecasts





Source: Consensus Economics (February 2019), Schroders Economics Group
Pacific ex. Japan: Australia, Hong Kong, New Zealand, Singapore.
Emerging Asia: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand.
Emerging markets: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, Argentina, Brazil, Colombia, Chile, Mexico, Peru, South Africa, Czech Republic, Hungary, Poland, Romania, Russia, Turkey, Ukraine, Bulgaria, Croatia, Estonia, Latvia, Lithuania.

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