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Policy Tipping Points

- The current US expansion is now the longest on record, spanning over a decade, but is running on a single consumer engine and we see several headwinds in 2020 with (1) a less favourable fiscal impulse; (2) pressure on corporate balance sheets slowing hiring, (3) a new order of trade bilateralism marking a structural headwind and (4) still high policy uncertainty with the approach of the presidential election in November. Moreover, while the Fed still enjoys room to ease policy, we expect monetary policy to be less effective at current low interest rates.
- Concerns on room for monetary policy to deliver further stimulus are particularly acute in Japan and the euro area, leading to calls for more fiscal stimulus. Prime Minister Abe has taken the plunge, and the new stimulus package should help keep at bay recession. The euro area is set to enjoy moderate fiscal stimulus, but building political consensus for a more determined effort, be it on the fiscal front or to reduce fragmentation, is set to remain slow on progress.
- The debate on rebalancing monetary and fiscal policy mix is not the only policy tipping point on the horizon. On trade, bilateralism as opposed to multilateralism is becoming more prevalent. Climate change and digitalisation, moreover, bring their own policy challenges on not least in terms of social inequality.
- For emerging markets, these global policy tipping points present important challenges and not least as China starts to face the well-known challenges of middle income. Hunt for yield continues to underpin emerging markets, but vulnerabilities remain to a reversal of risk sentiment, not least given high volumes of corporate debt roll-over.

THE FUTURE IS YOU SOCIETE GENERALE

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EXECUTIVE SUMMARY

World economy

Global economic activity continues to slow, reflecting stagnant global trade and a broad-based slowdown in real investment, especially in the manufacturing sector. Global manufacturing PMI has inched up for three consecutive months but remains at a modest 50.3 (close to 50, which marks the line between expansion and contraction) in November. These improvements may signal that the sector is turning the corner, following a steady weakening since early 2018, although we do not expect any sharp rebound. The service sector, which had showed resilience, is now beginning to buckle. And, looking ahead, we see several headwinds.

On the cyclical-side, we note a maturing profit cycle in the US and in several major euro area economies. Efforts to rebuild margins are expected to weigh on investment and employment, with negative consequences on domestic demand.

The outlook will be highly influenced by the responses of governments to several major policy challenges. These include defining an appropriate policy mix to face low structural growth and high indebtedness; the approach to global governance, from trade arrangements to policies to cope with climate change, and how to address the challenges of digital transformation, not least reskilling of workers.

Central banks will continue to provide stimulus, but monetary policy accommodation is becoming less effective. Consensus is to our minds too upbeat on the potential for further monetary policy easing to boost growth; not least given that the «financial leverage » cycle is looking streched and that macroprudential authorities, not least in Europe, are responding hereto with tightening. This reality has triggered calls for a more aggressive use of fiscal policy. Japan announced a stimulus package that will bring a fresh fiscal impulse keeping recession at bay. The euro area should also enjoy some policy accommodation but building political consensus for a more determined effort is set to remain challenging. Across the Atlantic, we see a modest fiscal drag with little scope to build political agreement on a new stimulus package ahead of the November elections. Finally, in China, the authorities are managing a delicate balancing act which will allow for modest easing only. In sum, we expect the fiscal impulse contribution to the G5 GDP growth to be just short of 0.2% of GDP in 2020 and to withdraw more than 0.1% of GDP growth in 2021.

While the US-China trade deal takes away the short-term risk of additional tariffs, the move to bilateralism in trade negotiations marks a structural headwind. The Trump administration has been holding back the recruitment of new judges for WTO trade-dispute settlement, blocking the WTO functioning and has been using trade policies as a threat in international relations with partners (China, Turkey, Brazil, Argentina, etc). The risk of a less integrated global economy is very real (see focus below). Apart

from trade, the increased tensions in 2019 in high-tech sectors between the US and China is undoubtedly the most worrying. And, a growing number of countries are using national security arguments to filter and sometimes block cross-border operations.

The UK is now set to leave the European Union at the end of January 2020 in divorce that also points to lower economic cooperation. Negotiations now turn to forging the future economic relationship between the UK and the EU27, that will come into force when the transition period ends on 31 December 2020 (or longer if agreed by common accord). During the transition, the relationship between the UK and the EU27 will still function as today, but risks of a hard Brexit at the end of the transition period remain present, albeit now with an Irish backstop in place.

The world economy faces also challenges coming form the need to address climate change and the industry transormation to adopt to new digital technoogies and automation, with the risk of further accentuating the gap between high-skilled and low-skilled workers and “uberisation”. Climate change has already had a major impact on the auto industry, which is adjusting to new country regulations and regulation and changes in consumer’s preferences. While we see the business response to tackle climate change as good news over the medium to long term, it will likely to be a headwind short-term, and not least if government fails to adopt mitigating policies, such as reskilling of labour and infrastructure investments.

In sum, we see continued uncertainty over major policy and industry challenges and expect growth in the advanced economies to decelerate to 1.2% in 2020 and 0.8% in 2021, from 1.7% in 2019. Global GDP growth will remain overall stable in 2020 and 2021, with several large emerging-market countries still delivering rapid growth, including India, and other getting out of the doldrums, like Turkey or Brazil. China remains in “soft-landing” mode but will continue to increase its share of global GDP over the forecast horizon.

Socio-political developments in many countries are a source of risks. Several countries face or recently faced civil unrest, including Bolivia, Chile, Hong Kong, and Lebanon, where a fiscal crisis looks unavoidable. Tensions in the Middle East have intensified. Social tensions in the euro area remain an additional risk.

Advanced economies

Growth in the US remained firm in 2019, but the support of the past fiscal easing is fading, and with little opportinuty for renewed stimulus ahead of the elections in November, we expect fiscal plicy to turn to a moderate drag in 2020. US unemployment stands at its lowest level in nearly five decades, however, the corporate profit cycle is maturing, and we expect efforts to rebuild margins to weigh on investment and employment looking ahead. Impeachment proceedings will impact the political debate into 2020 and policy uncertainty is set to remain high. We

expect the US economy to grow at 2.3% in 2019, decelerating to 1.5% in 2020 and to 0.8% in 2021.

The pace of activity in the euro area is slowing, in part due to the concurrent deceleration of exports and the industrial sector. Private demand has so far been resilient, but there are indications of more modest growth in the service sector. The risk of US protectionist policies is set to reverberate across global supply chains, weighing on global corporations including those located in the euro area. Growth is set to decelerate towards 0.7% in 2020 and 0.4% 2021, from 1.2% this year. The French economy remains relatively resilient and is expected to outperform Germany over the downturn, but with notably weaker public finances and the ongoing challenge of addressing structural rigidities. Local elections dynamics in Italy could raise further concerns on the stability of the current coalition

The UK is expected to formally leave the European Union by 31 January 2020 and enter the transition period which is due to end on 31 December 2020. Bremain is now discarded and the risk now is that we could reach 31 December 2020 without a deal. Corporate investment is likely to remain subdued due both to continued uncertainty as to the future trade relations and due to the reality of Brexit. We forecast UK GDP growth at 1.2% in 2019 and only 0.2% in 2020 and 0.5% in 2021.

In Japan, the government announced a new fiscal stimulus package to counter a slowdown in activity, partly driven by lower household consumption following the increase in the consumption tax, among other factors. Activity is nonetheless expected to slow down over the next two years.

Emerging markets

In China, past policy tightening and trade tensions with the US have adverse impact on growth. Given bourgeoning debt levels, the Chinese authorities are taking a cautious approach to policy easing to support activity (and avoid a hard landing), but with an eye on future stability. We expect GDP growth in China to slow to 5.8% and 5.5% in 2020 and 2021, from 6.1% in 2019.

The headwinds coming from slower trade are dampening growth in emerging Asia, albeit still the fastest-growing region in the world. The expansion is set to moderate in emerging Europe, except in Turkey, where growth will rebound after the recession of 2018/19. Turning to Latin America, activity in Brazil accelerating, and in Sub-Saharan Africa should also enjoy steady expansion, albeit it at a lacklustre rate. Middle East and North Africa will post higher growth in 2020 compared to 2019, but stagnant oil revenues coupled with geopolitical uncertainties will cap the possibility of any rapid expansion.

While financial conditions remain benign, especially following US monetary easing, emerging markets face large corporate debt repayments in 2019-2021 and are still vulnerable to changing market sentiment. Argentina faced significant currency volatility in 4Q 2019 and has introduced restrictions on capital outflows, which are

likely to be maintained all over the public debt restructuring process that will be launched by the new administration.

Central banks

Major central banks have turned more accomodative amid low global inflation and a deterioration of the growth outlook. The Federal Reserve has cut rates three times since July 2019 to a target of 1.50-1.75% and ended its balance sheet reduction. We expect the Fed to progressively lower rates down to 0%-0.25% in 2021. The Fed has been injecting liquidity into the short-term money market to avoid a liquidity squeeze, due to excess reserve frictions and shortages in the system.

ECB policy is undergoing a strategic, which could eventually alter the way the institution conducts its monetary policy, and not least with an added "green" dimension. Overall, the ECB remains in accommodation mode and as the Fed pursue easing, we see room for an additional 10bp cut to the deposit rate largely aimed at offsetting any upward pressure on the euro. The modalities of the tiered rate system for the remuneration of banks' reserves will be adapted to counter potential side effects of negative rates on monetary policy transmission to the economy.

The Bank of Japan is likely to keep ultra-low interest rates and maintain its quantitative easing programme until at least 2021, given the higher priority given to stimulate growth over "normalising" monetary policy.

Financial markets

Market risk appetite has been given a boost since October, lifting both stocks and bond yields. The recent surge in equity valuations appears to be driven more by liquidity rather than economic fundamentals.

Several headwinds remain with ongoing challenges to the multilateral trade order, the short-term impact of the digital and climate transition, low productivity and high debt levels. Low policy ammunition is a concern. In both Japan and the euro area, there are mounting concerns that negative interest rates have started hurting savings and bank intermediation, and are aggravating financial stability risks, not least in non-banks.

While supporting parts of the economy in near term, easy financial conditions will also push investment portfolio further out the risk curve and/or into less liquid assets. This is set to cause additional build-up of vulnerabilities, and not least in emerging and frontier market economies borrowing in USD. The low rate environment is also creating challenges for bank intermediation and pension and insurance companies in advanced economies.

FINANCIAL GLOBALISATION AT A TIPPING POINT

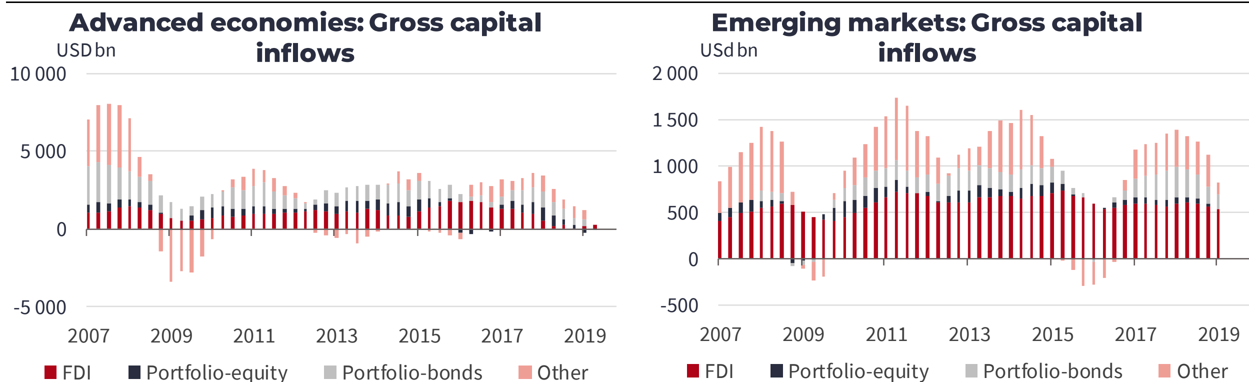
- **Capital flows have declined significantly since the 2009 crisis. Protectionism, among other factors, have contributed hereto.**
- **FDI to emerging countries is also slowing for structural reasons.**
- **It is too soon to confirm that we have reached a "globalisation peak", but the risk of a gradual "disintegration" is very real.**

Global activity is slowing, with a further loss of momentum forecast for 2020-2021. The decline in interest rates should encourage financial flows to emerging markets, but they are being hampered by structural trends.

THE SLOWDOWN IN FINANCIAL GLOBALISATION

Financial globalisation has slowed significantly since 2008. Annual cross-border capital flows have decreased by more than 60% compared to the peak in 2007 (c.f. charts below). A large part of this adjustment was the result of the reduction in European banks' cross-border exposure during the eurozone crisis. Foreign direct investment (FDI) flows are less volatile and generally proved to be fairly resilient until 2017, but have since collapsed.

Slowing financial globalisation



Source: IMF, SG Economic and Sector Research

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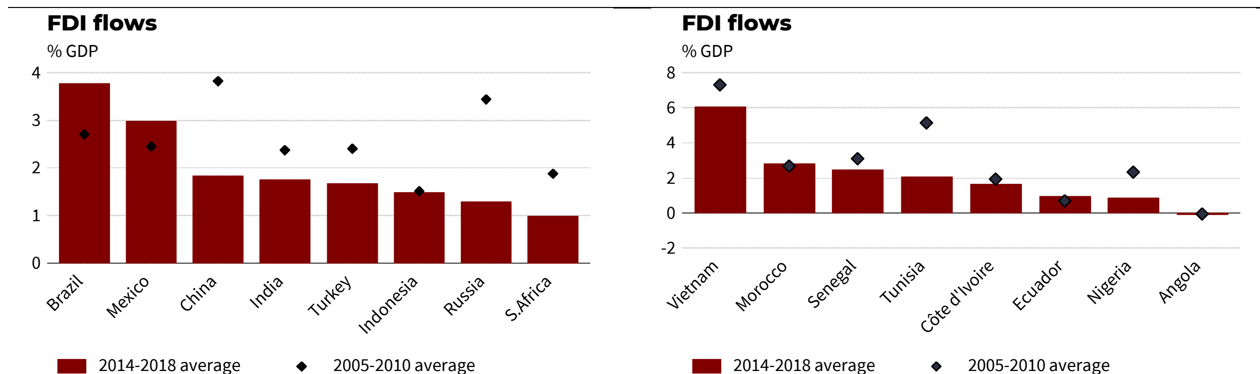
The main reason for this recent decline is the 2018 tax refrom by the Trump administration, relating to income held abroad by US multinational companies. This draove repatriation of dividends to the US, along with the reduction of structured financial arrangements in the form of SPVs, domiciled primarily in Luxembourg and the Netherlands. A recent IMF study[1] estimates that this reduction explains most of the collapse of advanced countries' FDI in 2018. The good news is that these accounting movements in the books of multinational companies do not directly

[1] IMF (2019), « The rise of phantom investments", *Finance and Development,* September 2019.

affect the real economy of recipient countries. However, the fact that 38% of the global stock of FDI reportedly consists of this “phantom” FDI, whose purpose is tax optimisation, suggests that this movement is far from over. The same IMF study further advocates a reduction in this tax optimisation, reiterating that in 2017 Luxembourg was the leading recipient country of FDI globally, with a stock of $5.1tn, ahead of the US and well ahead of China.

However, it is also noticeable that there has been a slight trend towards the erosion of FDI to emerging countries after a peak in 2011 (cf chart). We reassess this same trend in all the countries.

FDI inflows to EM have declined



Source: IMF, SG Economic and Sector Research

Source: IMF, SG Economic and Sector Research

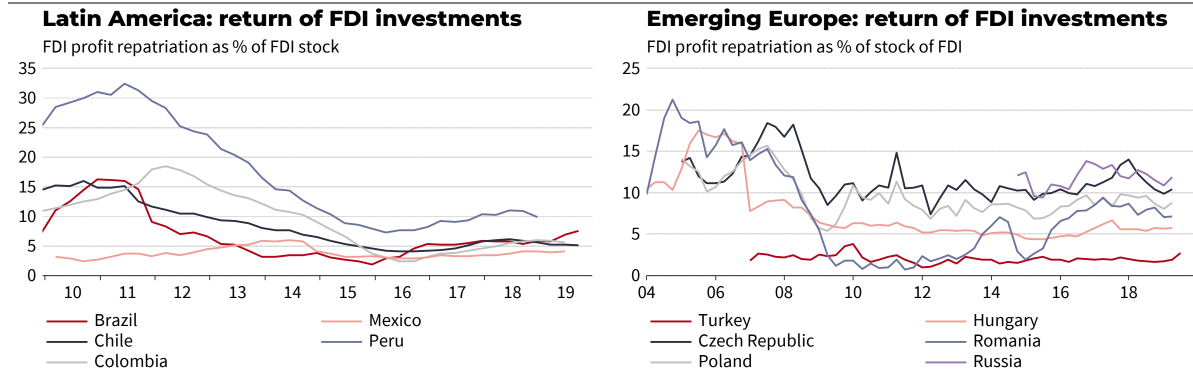
THE STRUCTURAL SLOWDOWN IN FDI TO EMERGING COUNTRIES

This erosion is tenuous in nominal value, but it is more evident when it is expressed as a percentage of the GDP of the countries concerned (cf chart). There are several contributory factors: decline in the growth outlook of major emerging countries; plummeting commodity prices compared with the beginning of the decade; decline in incentives for value chain fragmentation. Finally, new national investment policies have become more critical with regard to foreign investment.

The most mobile FDI targets global export markets and primarily seeks efficiency. It is affected not only by the slowdown in international trade and the rise in protectionist policies, but also by the decline in incentives for the fragmentation of production processes. The rising risks associated with this fragmentation, such as geopolitical or climate risks, the increased adoption of policies on local content requirements, are prompting the refocusing or even contraction of value chains. Labour costs therefore seem to have less influence on location decisions. At the same time, there are new incentives to relocate to smaller, more flexible production units closer to end markets, due also to the trend towards sustainable consumption methods. Consequently, multinational companies are rethinking their location strategies in order to adapt to these changes in the global economy.

It is difficult, however, because of a lack of statistics, to distinguish FDI aimed at global export markets, by nature sensitive to the growth in international trade, to local productions costs and exposed to protectionist measures, from FDI aimed at domestic markets, more sensitive to the growth of local markets and whose profitability can, in contrast, benefit from protectionist measures.

A mixed picture on FDI profitability



Source: FMI, SG Economic and Sector Research

For this second category of FDI, aimed at domestic markets, the environment is also becoming more complex. The average domestic demand rate of the major emerging countries has decelerated throughout the last decade. This is particularly true of Latin America. However, the profitability of FDI there seems to be resilient (see graph). It is even high in Brazil despite several years of recession or very low growth over the last five years. Moreover, Brazil is the major emerging country that attracts the most FDI as a proportion of its GDP. Paradoxically, the high level of entry barriers protects the profitability of FDI in Brazil. However, the environment is also becoming more complex in Central Europe, in this case for opposite reasons: growth in domestic demand is high but the significant position of FDI in the economies of these countries at the end of the transition years encouraged several governments in the region (especially Hungary and Poland), to indirectly tax them more or attempt to reduce their market share. Efforts to reduce what was perceived to be a form of foreign economic dependency affected in particular the non-tradable sectors, energy and financial services.

THE RISK OF A LESS INTEGRATED GLOBAL ECONOMY IS REAL

Among the recent developments, the increased tensions in 2019 in high-tech sectors between the US and China is undoubtedly the most worrying. If confirmed, it points to a sustainable decoupling in these sectors and probably beyond. Moreover, the risk of new tariff measures by the Trump administration and the affirmation by several countries of more nationalist policies are fuelling uncertainty. A growing number of countries are using national security arguments to filter and sometimes block cross-border operations. Finally, with the new Silk Road, China is supporting massive infrastructure investment projects whose governance will remain hybrid, combining

the logic of FDI with that of bilateral agreements between States. In this environment, countries supporting trade multilateralism have become less numerous. Moreover, financial markets are taking more account of the environment, social and governance issues, which involves more vigilance on the part of multinational companies. There is therefore the possibility of stagnation and even a slow decline in production links between economies. The decoupling in terms of technological standards between major regions could accentuate. The composition of FDI flows is also likely to be affected by doubts over the advantages of export-oriented FDI. In a nutshell, financial globalisation has reached a new tippong point.

ECONOMIC FORECASTS

Real GDP growth (annual, %)	2018	2019e	2020f	2021f	2022f
Advanced economies	***2.2***	***1.7***	***1.2***	***0.8***	***1.3***
United States	2.9	2.3	1.5	0.8	1.4
Japan	0.3	1.0	0.7	0.5	0.7
United Kingdom	1.4	1.2	0.2	0.5	1.5
Euro area	1.9	1.2	0.7	0.4	1.0
Germany	1.5	0.6	0.5	0.2	0.9
France	1.7	1.4	0.8	0.7	1.1
Italy	0.7	0.2	-0.1	0.0	0.7
Spain	2.4	2.0	1.1	0.7	1.2
Emerging Markets	***4.4***	***3.9***	***4.3***	***4.3***	***4.4***
Asia	6.0	5.4	5.4	5.3	5.3
China	6.6	6.1	5.8	5.5	5.2
India	6.8	6.0	6.4	6.3	6.6
Central and Eastern Europe	3.1	2.0	2.3	2.2	2.2
Russian Federation	2.2	1.5	1.5	1.5	1.5
Turkey	2.8	0.2	3.0	3.0	3.0
Latin America	1.0	1.1	2.0	2.5	2.6
Brazil	1.1	1.3	2.0	2.2	2.1
Middle East & Central Asia	0.5	-0.5	2.4	2.7	2.3
Africa	3.4	3.2	3.8	3.8	4.1
World	***3.6***	***3.1***	***3.2***	***3.1***	***3.3***

All averages (regional, economic classification) are computed using GDP expressed at Purchasing Power Parity (PPP) exchange rate. PPP exchange rates are used to equalise the cost of a standardised basket of goods between different countries

Consumer prices index (annual, % ch)	2018	2019e	2020f	2021f	2022f
United States	2.5	1.9	2.0	1.7	2.1
Japan	1.0	0.4	0.5	0.6	0.5
United Kingdom	2.5	1.8	1.3	1.7	2.1
Euro area	1.8	1.2	1.5	1.1	1.2
Germany	1.9	1.4	1.5	1.2	1.2
France	2.1	1.3	1.4	1.1	1.1
Italy	1.2	0.7	0.9	0.8	1.0
Spain	1.7	0.8	1.4	1.1	1.3
China	2.1	2.9	3.1	1.4	2.1

end of period	13/12/2019	2020f	2021f	2022f
Interest rates, %				
United States				
Fed Funds target rate (high range)	1.75	1.00	0.25	0.25
10y government bonds	1.82	1.15	1.30	1.90
Euro area				
Refinancing rate	0.00	0.00	0.00	0.00
Deposit facility rate	-0.50	-0.60	-0.60	-0.60
10y government bonds				
Germany	-0.29	-0.60	-0.40	0.20
France	0.00	-0.20	0.05	0.60
Italy	1.26	1.90	2.10	2.70
Spain	0.42	0.35	0.60	1.10
United Kingdom				
Bank rate	0.75	0.50	0.50	0.50
10y government rate	0.79	0.80	0.95	1.50
Japan				
Complementary Deposit Facility rate	-0.10	-0.07	-0.07	-0.07
10y government bonds	-0.02	0.00	0.00	0.00
Exchange rates				
EUR / USD	1.11	1.10	1.10	1.15
EUR / GBP	0.83	0.90	0.90	0.90
GBP / USD	1.34	1.22	1.22	1.28
EUR / JPY	121	121	121	127
USD / JPY	109	110	110	110
USD / CNY	6.98	7.20	7.30	7.30
Oil price (Brent), USD/barrel	**65.0**	**65.0**	**65.0**	**65.0**

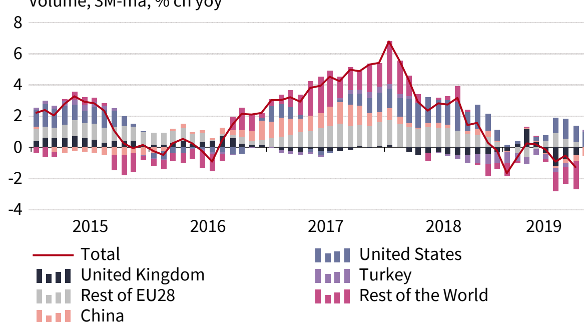
EURO AREA

- **Growth dipped to 1.2% in 2019 and is set to slow further in 2020-2021 before recovering in 2022.**
- **The ECB's monetary stance will remain very accommodative and interest rates are set to stay low over the forecast horizon.**
- **Risks are primarily tilted to the downside. Coordinated fiscal stimulus offers upside, but presently seems unlikely.**

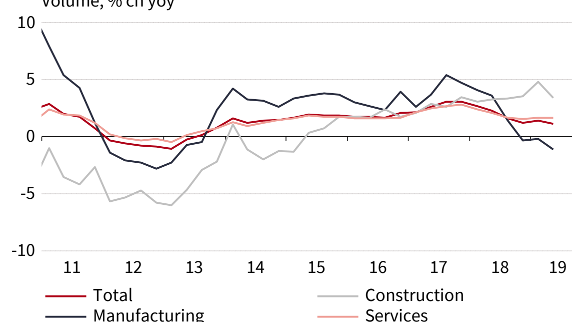
Growth slowed again in 2019, to 1.2%, hampered by the concurrent deceleration of exports and the industrial sector. The impact on the domestic economy appears limited for now, but will be felt more acutely in 2020-2021, leading to a further weakening of growth (which we expect to fall to 0.4% in 2021) and a rise in the unemployment rate.

The slowdown in exports will continue in 2020-2021 in light of Brexit, moderating growth in China and the expected cyclical downturn in the US. Exports should enjoy some recovery as of 2022 with fading Brexit uncertainty and policy support.

Declines in exports and the industrial sector will impact the rest of the economy in 2020-2021



Source: Refinitiv, SG Economic and Sector Research



Source: Refinitiv, SG Economic and Sector Research

Domestic demand is set to slow in 2020-2021, after holding up well in 2019 thanks to the robust labour market, a slightly expansionary fiscal policy and solid credit growth. It will recover only slightly in 2022. Businesses and households will postpone their spending plans due to the decline in income and persistent uncertainty. On the back of the rise in unemployment, consumption will continue to slow in 2020-2021, following on from the trend that began in 2019. Public demand is expected to remain stable overall over our forecast horizon, reflecting a moderately expansionary fiscal policy.

Investment growth will slow down over the horizon, following an exceptional performance in 2019, mainly due to the relocation of a multinational corporation in Ireland.

With global demand weakening, businesses will pass on the slowdown in unit labour costs to their prices. As a result, core inflation is set to slow over our forecast horizon.

Monetary policy will remain very accommodative over the forecast horizon. The ECB will undergo a strategic review soon, which could eventually alter the way the institution conducts its monetary policy. In the meantime, the central bank will react to low growth and subdued inflation by further cutting its deposit rate by 10bp to −0.6% in 2020. Asset purchases will continue for as long as necessary. Their technicalities and composition may be reviewed, if necessary, to guarantee their smooth implementation. In parallel, the modalities of the tiered rate system for the remuneration of banks' excess reserves will be adapted to counter potential side effects of negative rates on monetary policy transmission to the economy.

Against this backdrop, long term interest rates are set to remain very low over the forecast horizon.

The risks to our scenario are primarily tilted to the downside. Top of the list, significant uncertainty continues over Brexit. In Italy, snap elections in 2020 would likely revive investors' concern about the sustainability of public finances. The industrial sector (especially in Germany) would be hit hard by an increase in US tariffs on vehicle imports. In contrast, coordinated fiscal stimulus within the euro area and determined progress on the euro area architecture would improve the growth outlook. However, whether this will happen remains very uncertain.

Euro Area	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	1.9	1.2	0.7	0.4	1.0
Household consumption	1.4	1.3	1.1	0.7	0.8
Public consumption	1.1	1.6	1.2	1.2	1.2
Investment	2.4	7.0	1.9	0.1	0.9
Exports of goods & services	3.3	2.4	1.3	0.3	2.1
Imports of goods & services	2.7	4.6	2.5	0.9	2.0
Inflation, %	1.8	1.2	1.5	1.1	1.2
Core inflation, %	1.0	1.1	1.2	0.8	0.7
Real gross disposable income (GDI), % ch	1.7	2.4	1.5	1.1	1.1
Households saving rate, % of GDI	12.2	13.4	13.8	14.1	14.3
Unemployment, % of labour force	8.2	7.6	7.7	8.0	8.1
Fiscal balance, % of GDP	-0.5	-0.3	-0.6	-1.0	-1.1
Public debt, % of GDP	86.1	85.0	84.5	85.0	85.3
Current account balance, % of GDP	3.1	2.7	2.5	2.2	2.2

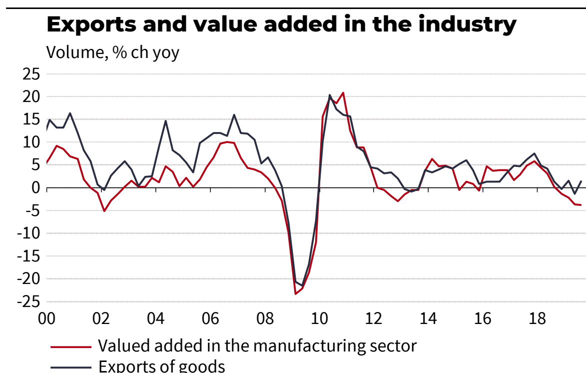
GERMANY

- **Growth will stay subdued in 2020-2021, before picking up in 2022.**
- **Given weaker global demand, core inflation is set to decline over our forecast horizon.**
- **Large-scale fiscal stimulus offers upside risk but seems unlikely for now.**

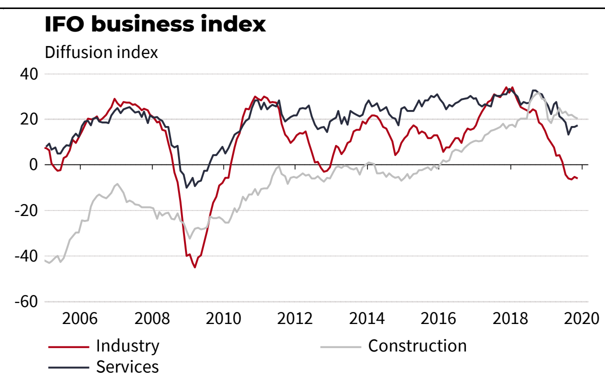
Growth has slowed again in 2019. Expected at 0.6 % this year, it has dipped below its potential, hurt by a further deceleration of exports and inventory reduction by auto manufacturers. Despite stabilisation in the manufacturing sector, the knock-on effect of the global slowdown onto the domestic economy will foster a low growth environment and trigger an increase in the unemployment rate in 2020-2021.

Brexit, moderating growth in China and the cyclical downturn expected in the US in 2021 will hamper any sustained recovery in global trade in 2020-2021. Against this backdrop, exports, which slowed sharply in 2019, will contract over 2020-21 before rebounding again in 2022, on the back of expected US stimulus.

Difficulties in the industry, which is highly export-oriented, are spilling over the domestic economy



Source: Refinitiv, SG Economic and Sector Research



Source: Refinitiv SG Economic and Sector Research

Domestic demand is set to slow 2020-2021. The economy boasts full employment, and the income split has favoured of households. As such, private consumption has been well supported in 2019. However, the decline in exports and the difficulties that the industrial sector is experiencing will gradually trickle down to the domestic economy, via employment. With the rise in unemployment and slowing household income, private consumption is expected to lose steam in 2020-2021.

After a stable showing in 2019, investment growth will slow sharply in 2020 before contracting in 2021. Declines in profitability and weaker demand, against a backdrop of significant uncertainty, will lead companies to postpone spending.

For households, the shift in the labour market is expected to curb private investment. Finally, although public investment will remain firm, it will only partly

offset the decline in private investment, which is not set to recover before 2022. Indeed, the fiscal impulse planned by the government in 2020-2021 will be limited.

With the slowdown in global demand, it will be difficult for companies to increase their prices, even though wage pressure will remain acute until 2019-2020. As a result, core inflation is forecast to slow over our forecast horizon and companies will seek to rebuild margins on the cost side.

Our scenario comes with multiple risks. The reality of Brexit marks an ongoing headwind and comes with uncertainty. Moreover, any increases in tariffs on vehicle imports by the United States would have a major impact on the automotive sector, which has been struggling since 2018. In contrast, a significant fiscal stimulus would improve the growth outlook. Whether this happens, however, remains highly uncertain.

Germany	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	1.5	0.6	0.5	0.2	0.9
Household consumption	1.2	1.6	1.0	0.4	0.7
Public consumption	1.4	2.1	1.7	1.3	1.2
Investment	3.5	2.8	0.2	0.0	1.0
Exports of goods & services	2.3	0.9	-0.1	-0.1	1.8
Imports of goods & services	3.7	2.2	0.2	0.5	1.9
Inflation, %	1.9	1.4	1.5	1.2	1.2
Core inflation, %	1.3	1.3	1.2	0.9	0.8
Real gross disposable income (GDI), % ch	1.9	1.6	1.3	-0.1	0.2
Households saving rate, % of GDI	11.0	11.0	11.2	10.7	10.4
Unemployment, % of labour force	5.2	5.1	5.6	6.2	6.6
Fiscal balance, % of GDP	1.5	1.0	0.5	-0.4	-0.6
Public debt, % of GDP	61.9	59.5	58.1	58.1	58.0
Current account balance, % of GDP	7.6	7.2	6.3	5.7	5.2

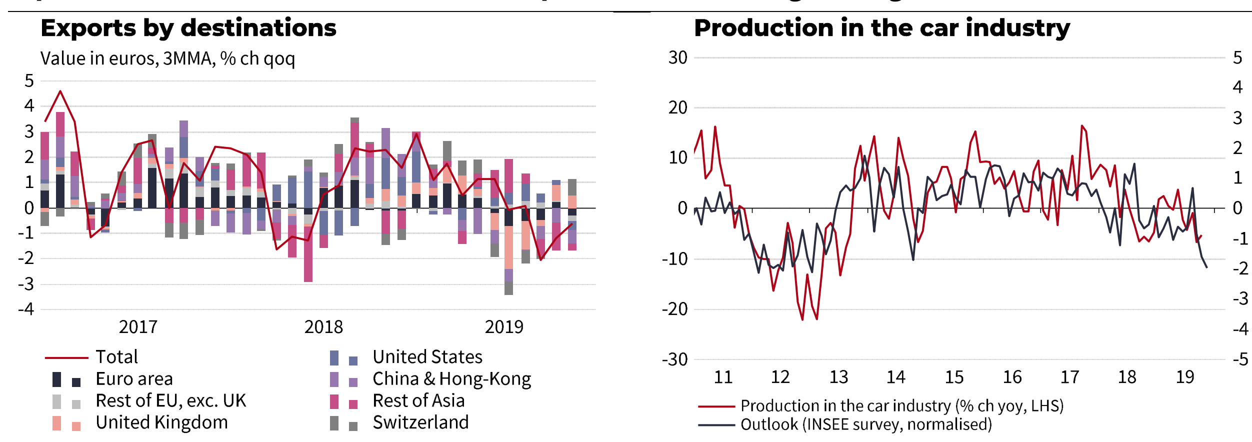
FRANCE

- **Growth will slow further in 2020-2021 before some rebound in 2022.**
- **Core inflation will drop over the forecast horizon, reflecting the deceleration in unit labour costs.**
- **Social tensions in reaction to the reforms risk curbing domestic demand around year-end.**

Growth slowed again in 2019, to 1.4%, due to less robust export figures and curbs on household investment. In 2020-2021, the impact of the global slowdown on the domestic economy and outsourcing in the automotive sector will further hamper growth, which is set to fall to 0.7% in 2021. Activity will slightly pick up in 2022 on the back of a recovery in the US and will be driven by a rebound in exports and investment.

The trend in foreign trade is set to deteriorate until 2021. Exports are expected to slow in 2020-2021, in the wake of Brexit, the weakness of the German economy and the cyclical downturn in the US. At the same time, French manufacturers halting domestic production of several vehicle models will boost automobile imports in 2020. Exports are only expected to rebound in 2022.

Dips in external demand and automotive production will drag down growth in 2020-2021



Source: Refinitiv, SG Economic and Sector Research

Source: Refinitiv, SG Economic and Sector Research

The dip in external demand will impact the domestic economy as early as 2020, via employment and investment. The latter will stagnate quickly, especially on the business side, and is set to contract in 2021. Housing investment will remain sluggish, especially if public support measures such as the Pinel law and interest-free loans continue to be phased out.

Employment will also slow as of 2020, contributing to a rise in unemployment. However, household consumption will hold up initially, underpinned by the social and fiscal measures adopted in the wake of the Yellow Vest movement. However, with labour market conditions expected to deteriorate (unemployment will hit around 9.5% in 2022), households will curb spending in 2021-2022. Nonetheless,

public expenditures will partly offset this slide, with the government taking advantage of very favourable lending conditions to support activity in 2021-2022.

With global demand weakening, businesses will seek to rebuild margins on the cost side. Core inflation will therefore remain subdued over our forecast horizon.

With fiscal stimulus expected in 2020-2021 and automatic stabilisers set to kick in due to the lower growth outlook, the public deficit will widen to 3.5% in the trough of the cycle. As such, the public debt ratio is expected to rise above 100% over the forecast horizon.

The risks to our scenario are primarily tilted to the downside. Domestic demand could suffer again from renewed social discontent over pension and unemployment insurance reforms. Additionally, the automotive industry would certainly suffer from any US protectionist measures targeting the sector. However, consumption may surprise to the upside, given that households have been saving a portion of the income freed up by the government's social and fiscal measures.

France	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	1.7	1.4	0.8	0.7	1.1
Household consumption	0.9	1.3	1.2	0.9	1.0
Public consumption	0.8	1.3	1.1	1.7	1.9
Investment	2.8	3.6	1.8	0.4	1.0
Exports of goods & services	3.5	2.0	1.1	0.6	2.8
Imports of goods & services	1.2	2.4	1.9	1.4	2.9
Inflation, %	2.1	1.3	1.4	1.1	1.1
Core inflation, %	0.9	0.6	1.0	0.8	0.8
Real gross disposable income (GDI), % ch	1.2	2.2	1.3	0.2	0.4
Households saving rate, % of GDI	14.2	14.9	15.0	14.5	14.0
Unemployment, % of labour force	8.7	8.3	8.6	9.1	9.5
Fiscal balance, % of GDP	-2.5	-3.2	-2.5	-3.0	-3.5
Public debt, % of GDP	98.4	98.9	99.4	100.8	102.3
Current account balance, % of GDP	-0.7	-1.0	-1.3	-1.4	-1.3

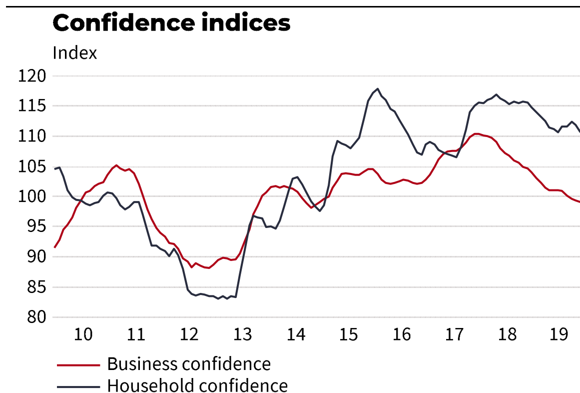
ITALY

- **Activity is likely to contract slightly in 2020 and to stagnate in 2021 on the back of political uncertainty and the global slowdown.**
- **The budget deficit, which held stable in 2019, is set to deteriorate in 2020 due to expansionary fiscal measures and a weak economy.**
- **The political situation is still uncertain and fresh elections remain a possibility in 2020.**

The Italian economy has experienced very low growth since 1Q18 and is expected to contract slightly next year. In line with global trends, manufacturing weakened further this year and inventories fell sharply while external trade held up well. In 2020 and 2021, external demand is set to be weaker alongside with the downturn in global growth. Italy's GDP should improve in 2022 to 0.7% on the back of the recovery in the European cycle.

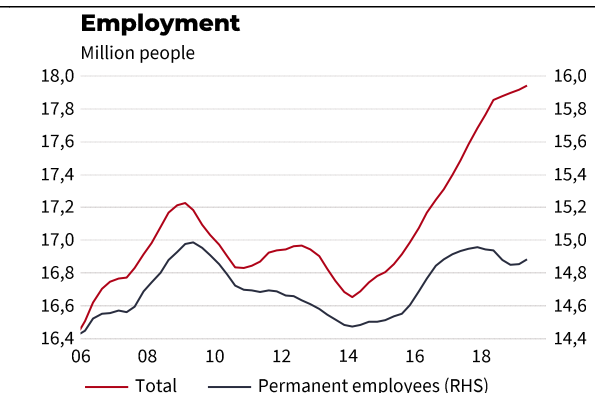
Domestic demand is likely to remain sluggish over the next two years. Subdued demand prospects and recurrent global policy uncertainty will continue to weigh on firms' confidence and private investment is expected to contract. Profit margins have been falling sharply due to decreasing productivity and rising wages. They should recover somewhat helped by fiscal incentives and employment contraction as of next year, but investment is not expected to rise again before 2022. Activity in the construction industry is expected to remain sluggish.

Lower confidence for firms and households



Source: Istat, Refinitiv, SG Economic and Sector Research

Job creation mainly on short term contracts



Source: Istat, Refinitiv, SG Economic and Sector Research

In 2020 and 2021, household consumption is set to remain positive but will only offer a modest support for growth. Households are set to suffer from an increase in unemployment (from 10% in 2019 to 11.8% in 2022), but disposable income should continue to increase thanks to a slight increase in wages. Due to persistent uncertainty regarding both the economic and political situation, households are set to remain cautious and the savings rate is set to slightly increase.

In terms of public finances, improved tax receipts following the switch to electronic invoicing for VAT on 1 January and a lower interest burden with the easing of sovereign bond yields in 2H19 will ease budget pressures. Yet, the budgetary deficit is likely to increase from 2.3% in 2019 to 2.8% in 2020 and should come out close to 3% in 2021 and 2022 as the economic downturn adversely weighs on public finances. Fiscal policy is set to remain expansionary in 2020, but to a lesser degree than we had previously anticipated. Public debt is set to increase further and reach 140% of GDP in 2021 versus 135% in 2018. Italy remains at risk of noncompliance with European fiscal rules according to the European Commission opinion published in November and is invited to use any windfall gains to accelerate the reduction of the government debt-to-GDP ratio.

The debate on the reform of the ESM treaty has created new tensions within the coalition and regional elections in 2020 could accelerate the end of the Italian coalition. Tensions are also possible over the deterioration of the growth outlook which will weigh on public receipts and complicate the government's task. While the spread on Italian yields fell below 150bp in September, we anticipate a return to 250bp during 2020 because of deteriorating public finances and renewed political uncertainty. The risk of a populist government with a strong Eurosceptic component coming into power at the next elections (2023 at the latest) remains high.

Italy	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	0.7	0.2	-0.1	0.0	0.7
Household consumption	0.8	0.6	0.5	0.3	0.5
Public consumption	0.4	0.5	0.4	0.1	0.1
Investment	3.0	2.2	-2.1	-0.9	0.7
Exports of goods & services	1.3	1.7	1.4	0.1	1.6
Imports of goods & services	2.4	1.0	2.1	0.3	1.0
Inflation, %	1.2	0.7	0.9	0.8	1.0
Real gross disposable income (GDI), % ch	0.9	0.6	0.9	0.3	0.6
Households saving rate, % of GDI	9.8	9.8	10.1	10.1	10.2
Unemployment, % of labour force	10.6	10.0	10.9	11.6	11.8
Fiscal balance, % of GDP	-2.2	-2.3	-2.8	-3.0	-3.0
Public debt, % of GDP	134.8	136.2	137.9	140.0	140.9
Current account balance, % of GDP	2.6	3.3	3.4	3.3	3.5

SPAIN

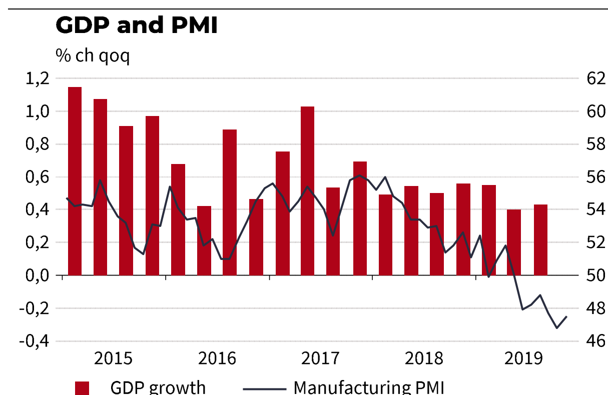
- **After five dynamic years, growth is expected to slow to 1.1% in 2020 and 0.7% in 2021.**
- **Inflation will remain subdued despite the increase in the minimum wage and unemployment is set to increase as of 2020.**
- **Without the support of *Podemos* and a deal with the Catalans, the PSOE cannot form a government, leading to new elections.**

The Spanish economy kept growing at a good pace until Q3 thanks to solid domestic demand. Both household consumption and investment in equipment proved robust. GDP growth is nevertheless expected to slow sharply to 1.1% in 2020 and 0.7% in 2021, due to the slowdown of growth in the rest of the euro area and Brexit uncertainties, notably in the tourism sector, before rebounding to 1.2% in 2022.

Domestic demand should continue to be the main driver of the Spanish economy while trade tensions will keep weighing on exports. Household consumption should start to slow in 2020 after several years of strong growth, despite the increase in the minimum wage. Spanish households have dipped significantly into savings in recent years – notably to finance the purchase of cars and other durable goods – and should take advantage of a recovery in purchasing power to restore their savings.

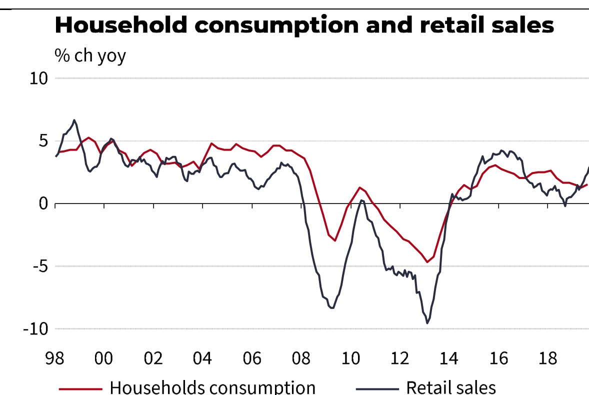
The unemployment rate is set to reach a low of 14.2% in 2019, close to its structural level, before increasing from 2020 in line with the downturn in the growth cycle. It is forecast to surpass 15% in 2022.

Manufacturing PMI in contraction zone



Source: Refinitiv, SG Economic and Sector Research

Retail sales on the rise



Source: Refinitiv, SG Economic and Sector Research

Investment is expected to slow significantly from 2020 after six years of strong growth, due to uncertainty around Brexit. The increase in wages around the minimum wage will continue to erode companies' margins and weigh on their capacity for self-funding. Activity in the construction sector should also lose momentum after two years of strong investment growth. The delivery of new building permits has already come to a halt.

Brexit is likely to have a significant impact on the peninsula's economy. The UK is the fourth largest export market for Spanish products, primarily in the transport sector (cars, trains, aeronautics) and in food (fruit and vegetables). The stakes are also high for the tourism sector as Spain had 16 million visitors from the UK (its leading market) last year. Finally, there could be a significant migratory impact: it is estimated that between 800,000 and one million UK citizens live at least part of the year in Spain. These are mainly retired persons who would be particularly sensitive to the issue of access to medical care, which could become very difficult after the Brexit transition period.

The elections of 10 November resulted in a fragmented parliament, with a severe setback for *Ciudadanos* (from 57 to 10 seats) and a rise of right-wing parties (Vox and Partido Popular). The PSOE remains the first parliamentary force with 120 seats out of 350 but falls short of an outright majority by 55 seats. Even with the support of Podemos (35 seats) and some regionalist parties, it will be difficult for Pedro Sanchez to form a government as he needs the approval of the Catalans of ERC. Failing to reach a deal with ERC would lead Spain to a third round of elections in spring 2020.

The public deficit returned below 3% of GDP in 2018, after reaching 10.5% in 2012. Fiscal policy is likely to remain neutral overall due to the lack of major stimulus measures, and the deficit should stabilise at around 2.5% of GDP over our forecast horizon. Public debt should fall slightly in 2019 and 2020 to 96% of GDP before returning to its 2018 level of 97% of GDP in 2022.

Spain	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	2.4	2.0	1.1	0.7	1.2
Household consumption	1.8	1.2	1.5	0.9	1.1
Public consumption	1.9	2.3	1.7	1.2	1.2
Investment	5.3	2.6	1.0	0.2	1.0
Exports of goods & services	2.2	1.7	1.1	0.3	1.9
Imports of goods & services	3.3	1.0	2.2	0.5	1.5
Inflation, %	1.7	0.8	1.4	1.1	1.3
Real gross disposable income (GDI), % ch	1.9	2.4	1.7	1.0	1.3
Households saving rate, % of GDI	6.3	7.4	7.5	7.6	7.9
Unemployment, % of labour force	15.3	14.2	14.5	15.2	15.5
Fiscal balance, % of GDP	-2.5	-2.2	-2.2	-2.5	-2.6
Public debt, % of GDP	97.6	96.5	96.4	97.2	97.4
Current account balance, % of GDP	1.9	1.6	1.4	1.3	1.5

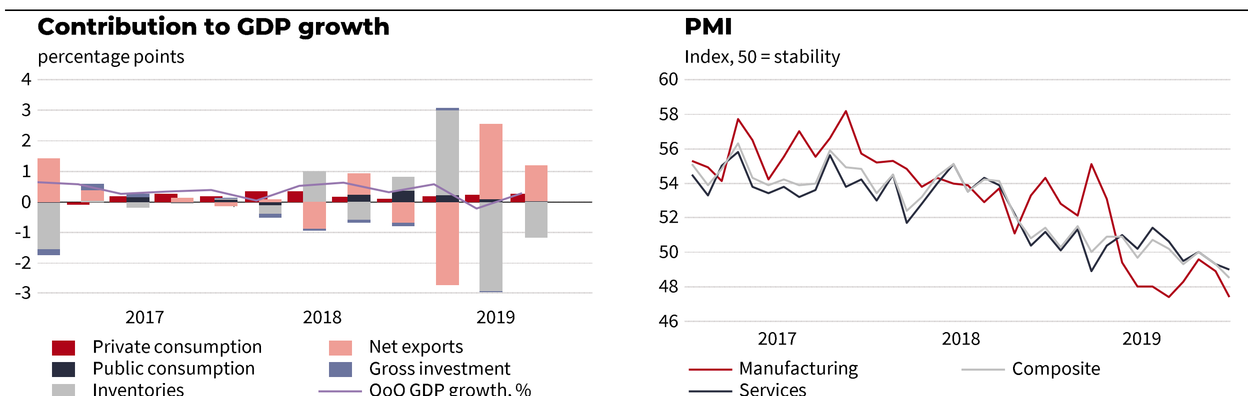
UNITED KINGDOM

- **The UK is expected to formally leave the EU by 31 January 2020.**
- **It opens a transition period during which the future relationship between the UK and the EU27 will be discussed.**
- **Because of the uncertainties on the outcome and because Bremain is now discarded, corporate investment is likely to remain subdued.**

The newly elected Parliament is expected to approve the withdrawal agreement and the political declaration clarifying the framework for the future relationship between the UK and the EU27. While this political declaration provides for an ambitious free trade agreement, similar to the one between Canada and the EU (CETA), to be implemented at the end of the transition period (currently set for 31 December 2020), the forthcoming negotiations are likely to prolong a climate of uncertainty that is expected to significantly affect investment and household confidence in 2020. Moreover, it is worth note that the fact that Bremain is now almost certainly off the table could trigger relocation of firms that have so far frozen major relocation decisions, awaiting clarity.

Under the October Brexit agreement, the European Commission is expected to present a draft mandate in early February 2020 to allow negotiations to start quickly. However, experts agree that the 11 months allotted time to reach an agreement will probably not be enough; free trade agreements require an average of 48 months of negotiation. Discussions could also stumble over the significant regulatory divergences with the EU that the Conservative majority want to secure. The withdrawal agreement negotiated by Boris Johnson provides that the UK may request an extension of the transition period (until the end of 2022) before 1 July 2020. Boris Johnson has already stated that he *"absolutely does not see the need to do so"*. This transition phase is particularly uncomfortable for the UK because, during this period, the country is bound by EU regulations and decisions without a voice and because it entails a financial contribution from the UK to the EU budget. However, in the absence of an agreement at the end of the transition period, trade relations between the UK and the EU will be governed by WTO rules.

In 3Q19, despite the global slowdown and the dynamism of imports in the run-up to Brexit, external demand made a positive contribution (+1.2%) to GDP in the UK, which grew by 0.3% sequentially, after -0.2% in Q2. This contribution must be put in perspective with the weakness of Sterling. The real effective exchange rate was on average 3% lower in Q3 than in Q2. The increase in the GBP following the postponement of the Brexit in October should mitigate or even reverse this effect in 4Q19. Business cycle leading indicators in the services and construction sector also point to a deterioration in activity in 4Q19.



Source: NSO, SG Economic and Sector Studies

Source: IHS Markit, SG Economic and Sectoral Studies

In this context, political and monetary authorities should use their room for manoeuvre. We are currently factoring in fiscal policy support in 2020 and 2021 corresponding to Chancellor Javid's September announcements, +£13.4 bn for the fiscal year 2020-21 compared to the previous version of the budget, as part of the spending review. We also expect the BoE's main rate to fall to 0.5% in 1Q20.

United Kingdom	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	1.4	1.2	0.2	0.5	1.5
Household consumption	1.6	1.2	1.2	0.6	0.8
Public consumption	0.6	3.2	2.2	2.0	1.6
Investment	-0.1	0.1	0.4	1.2	3.9
Exports of goods & services	-0.9	-0.1	-6.2	-0.5	-0.6
Imports of goods & services	0.7	2.6	-6.6	1.2	-0.5
Inflation, %	2.5	1.8	1.3	1.7	2.1
Core inflation, %	2.1	1.6	0.7	1.4	1.9
Real gross disposable income (GDI), % ch	5.1	3.2	1.9	2.0	3.4
Households saving rate, % of GDI	6.1	6.5	6.1	5.7	6.0
Unemployment, % of labour force	4.0	4.0	4.7	4.7	4.3
Fiscal balance, % of GDP	-2.2	-1.6	-2.3	-2.8	-2.2
Public debt, % of GDP	85.9	85.2	85.8	86.4	85.1
Current account balance, % of GDP	-4.3	-4.6	-5.0	-5.5	-5.1

UNITED STATES

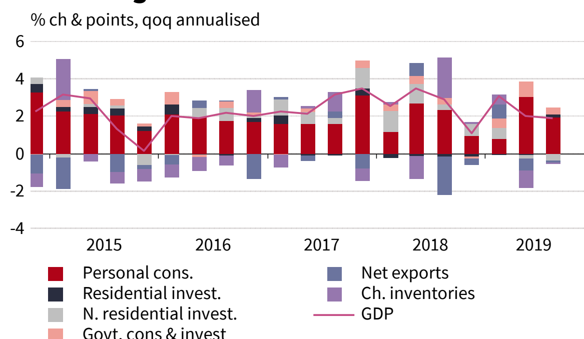
- **Economic growth is set to progressively moderate on the back of lower fiscal support and eroding corporate profits.**
- **The Fed started an easing cycle of monetary policy in an environment of higher trade uncertainties and slowing global growth.**
- **The main risks for the economy are a further escalation of trade tensions and a tightening of financials conditions for corporates.**

Economic activity continues to progressively decelerate. Real GDP growth expanded by 1.9% qoq ar with non residential fixed investment still under performing. Indeed, the latter posted a second consecutive quarter of contraction (-0.4% qoq ar) dragged among other things by the prolonged strike in the automotive sector and the uncertainties linked to trade tensions. On the other side, private consumption remains solid (1.9% qoq ar) underpinned by a robust job market and moderate earnings growth. Finally, public expenditures continue to support growth driven by federal current expenditures.

The economy is set to continue to decelerate in the coming quarters on the back of the downturn of the corporate profit cycle. Corporate profits are set to deteriorate further due to higher higher labour and inputs cost, hence hindering private investment outlook. Futhermore, persistent policies uncertainties linked to trade tension and the November general election are also expected to weigh on investment prospects.Fiscal policy is also expected to remain neutral in the coming two years, as discretionnary expenditures are set to remain stable in real terms while tax rates will not change, withdrawing hence an element of support. Private consumption is expected to remain resilient in the coming quarters, supported by the easing of the Federal reserve, but to progressively decelerate as the job market conditions become less favorable. Economic activity is likely to decelerate further in 2021 and recover thereafter.

US: GDP growth & contributions

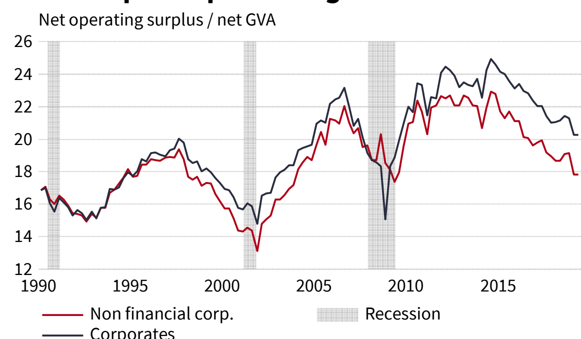
% ch & points, qoq annualised



Source: Refinitiv, SG Economics & Sector Studies

US: Corporate profit margins

Net operating surplus / net GVA



Source: Refinitiv, SG Economics & Sector Studies

The inflation outlook remains benign. Despite a tight labour market and higher import tariffs, core PCE inflation increased by 1.6% in September, still below the symmetric 2% target of the monetary authorities. Core inflation is expected to remain under the Fed target in the coming quarters as demand pressures are likely to remain contained and the strong USD environment is likely to erode eventual import tariff increases.

In the context of softening growth and low inflation, the Federal Reserve pursued the easing cycle of monetary policy by reducing its policy target range by 25bp both in October to 1.50-1.75%. The Fed also decided to maintain its Treasury bills purchases at least into the Q2-20 to reduce the tensions of the repo market. Finally, they kept the decision to change the composition of its balance sheet by re-investing monthly up to USD 20bn MBS arriving at maturity into Treasury securities. In announcing these measures, the FOMC stated that they see "*the current stance as likely to remain appropriate*", signalling an effective pause of interest rate cuts in the coming months. All in all, we expect that the Fed will proceed to three more rate cuts in 2020 as the economy softens further.

The main risk for the economy remains a further trade tension escalation. New tariffs on imported goods or an increase of current tariffs rates would weigh further on corporate profits, especially for corporate relying on value-chains, hampering capital expenditures prospects. Surging trade tensions could translate into tighter financial conditions in an environment where corporate debt has significantly increased during past years.

United States	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	2.9	2.3	1.5	0.8	1.4
Household consumption	3.0	2.4	1.7	0.9	1.5
Public consumption & investment	1.7	3.3	1.5	1.8	2.1
Private investment	4.6	2.1	1.2	-1.3	2.1
Exports of goods & services	3.0	0.5	0.8	-2.0	2.3
Imports of goods & services	4.4	2.5	1.5	-1.0	3.0
Inflation, %	2.5	1.9	2.0	1.7	2.1
Core inflation, %	2.2	2.4	1.6	1.6	2.1
Real gross disposable income (GDI), % ch	3.6	2.5	1.0	-0.6	0.9
Households saving rate, % of GDI	8.9	9.1	8.4	7.3	6.9
Unemployment, % of labour force	3.8	3.6	4.3	5.0	5.3
Fiscal balance, % of GDP	-6.6	-7.3	-7.4	-7.7	-7.8
Public debt, % of GDP	78.4	77.9	80.0	82.9	85.3
Current account balance, % of GDP	-2.4	-2.5	-2.6	-2.4	-2.8

JAPAN

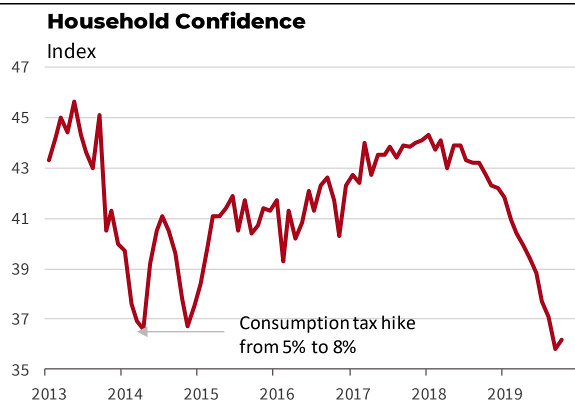
- **The risk of an economic slowdown increases...**
- **... and will be partially offset by a fiscal stimulus plan**

The 4Q GDP numbers are likely to confirm a loss of growth momentum, as obstacles multiply to weigh on domestic and external demand. Faced with such a risk, the Abe government announced a stimulus program that is expected to counteract downside risk in 2020.

Household confidence remains low despite a very slight recent recovery. The consumption tax was hiked in October 2019 from 8% to 10% and compensatory measures have been contemplated to mitigate its negative effect on purchasing power, and food products have been exempted. This should prevent an excessively negative shock to consumer demand. Indeed, household consumption fell by 0.9% in 2014, when the tax rate increased from 5% to 8% in April 2014. Despite these compensatory measures, household spending is expected to be affected given the low level of confidence, but on a smaller scale than in 2014.

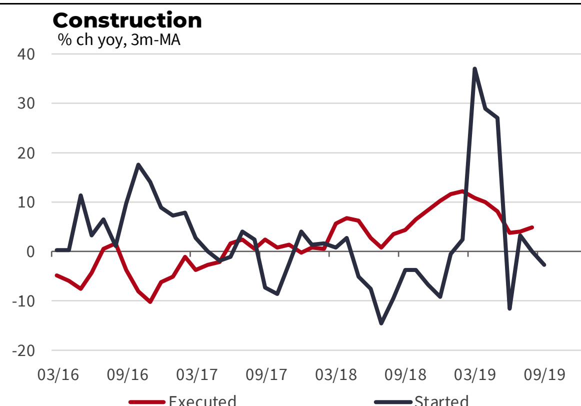
The investment slowdown that is due once preparations for the Tokyo Olympic Games are complete marks an addtional domestic headwind. Construction has been booming since 2018, but this trend is expected to subside after the summer of 2020.

Household confidence at its lowest level



Source: Cabinet Office

Construction activity peaked



Source: Ministry of Land, Infrastrucrture, Transport and Tourism.

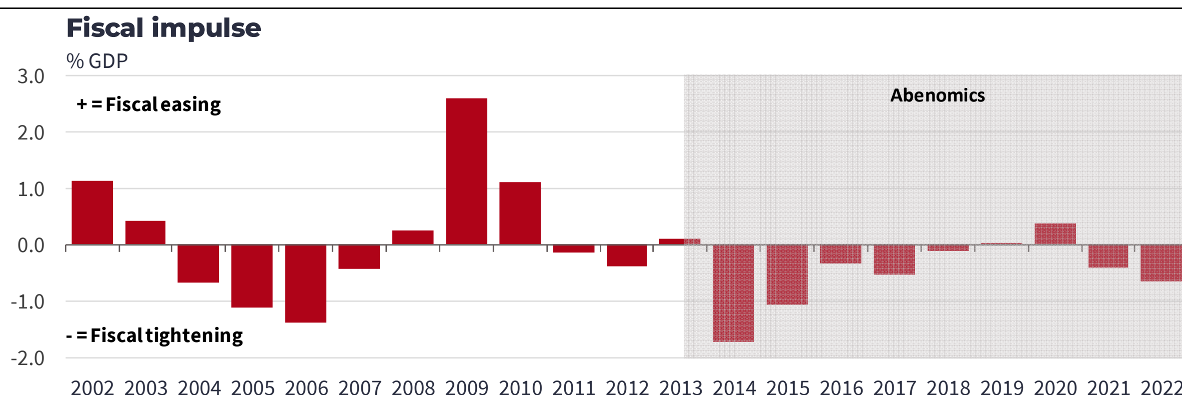
Inflation is stubbornly low, despite the consumption tax hike in October. Non-food inflation rose only 0.4% for the month year-on-year.

Against this backdrop, Prime Minister Abe announced a new stimulus of JPY 13.2 trillion (2.4% of nominal GDP), including JPY 9.4 trillion in fresh local and central government spending (1.7% of nominal GDP). Government spending aims to protect against the risk of an economic slowdown and in particular through the reconstruction in areas affected by natural desasters. They should start in the first quarter of 2020 and end in the first quarter of 2021. However, the execution risk of fiscal expenditure may comprome the magnitude and the effectiveness of the

stimulus. The lack of manpower is an important cause. Thus, the stimulus would counteract the risk of a slowdown in 2020, but 2021 will again face a negative fiscal impulse and will therefore experience a slowdown in growth.

At the same time, the central bank has strengthened forward guidance by extending the current monetary policy to an indefinite period. For the first time under Abenomics, monetary and fiscal policy would be coordinated, leaving behind the risk of increased debt service charge pressure on public debt.

Fiscal impulse to become positive in 2020



Source: IMF, SG Economics and Sector Studies

Japan	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	0.3	1.0	0.7	0.5	0.7
Household consumption	0.0	0.5	-0.1	0.5	0.4
Public consumption	0.9	2.0	2.0	0.6	0.7
Investment	1.1	2.7	2.2	0.6	0.7
Exports of goods & services	3.4	-1.8	1.1	0.4	1.5
Imports of goods & services	3.3	0.0	1.6	0.5	0.4
Inflation, %	1.0	0.4	0.5	0.6	0.5
Core inflation, %	0.8	0.6	0.6	0.6	0.5
Real gross disposable income (GDI), % ch	1.1	0.8	-0.1	0.7	0.7
Households saving rate, % of GDI	3.9	4.2	4.2	4.4	4.7
Unemployment, % of labour force	2.4	2.4	2.3	2.4	2.4
Fiscal balance, % of GDP	-3.2	-3.0	-3.1	-2.2	-1.8
Public debt, % of GDP	237.1	237.7	237.6	238.4	238.1
Current account balance, % of GDP	3.5	3.0	2.9	2.9	2.8

CHINA

- **The pace of the slowdown is expected to stabilise in 2020, particularly for domestic demand.**
- **Inflation, which is climbing along with pork prices, is expected to ease in the second half of 2020.**
- **Financial risk is still under control, despite a few areas of tension.**

The slowdown is expected to continue, but its pace will likely stabilise in 2020 before the economy's resilience is tested yet again by the anticipated US deceleration in 2021.

Indeed, there are several factors suggesting a moderate improvement in the Chinese economy. Firstly, the semiconductor industry is expected to recover early 2020. Secondly, the automotive industry cycle has probably bottomed out in 2018-2019. And lastly, the conclusion of a phase 1 trade deal between the US and China, opens up for some tariff relief, albeit modest.

In addition, economic policy, especially on the monetary side, turned more accomodative in November. The interest rate on MLFs (medium-term lending facilities) was lowered by 5 basis points (bp), so the LPR (loan prime rate), which is meant to reflect the decline in the MLF rate, also dropped 5bp for the 1- and 5-year maturities. The PBoC also reduced the seven-day reverse repo rate by 5 bp for the first time in four years. These multiple easing measures in a single month are boosting demand, though they still fit with the prudent policy mix approach, namely to avoid massive stimulus. Indeed, the 5 bp rate cut, whether in the cost of financing the banks or the economy, is still moderate. The decrease in the reserve requirement ratio seems poised to round out this easing phase.

Fiscal support is expected to be based more on off-balance-sheet measures, specifically the issuance of special local government bonds. The issuance quota for 2020 is likely to be increased.

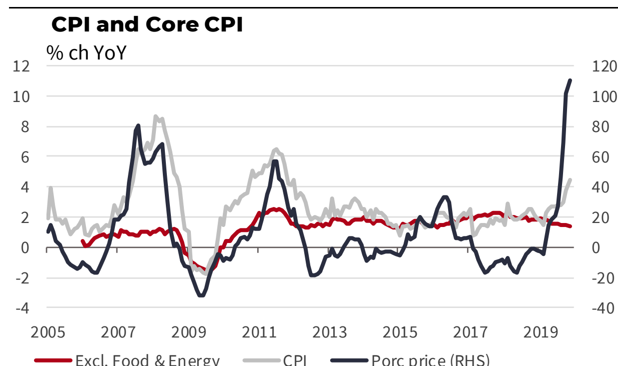
Inflation – which has risen sharply due to the jump in pork prices – is expected to peak in 1H20 before declining again. The lack of an increase in core inflation allows monetary policy easing some leeway, contrary to previous episodes of inflation linked to pork prices.

Consequently, investment should pick up the pace slightly while consumption would continue to play the role of key growth booster. However, the contribution to external demand will become less positive due to increasing imports.

Meanwhile, financial stability risk is fairly well under control despite a few areas of tension. Bond defaults continue, but they amount to 0.5% of total outstanding value of the market. Non-bank financing (especially shadow banking) is losing out to bank financing. Even though the small rural banks are grappling with worsening asset

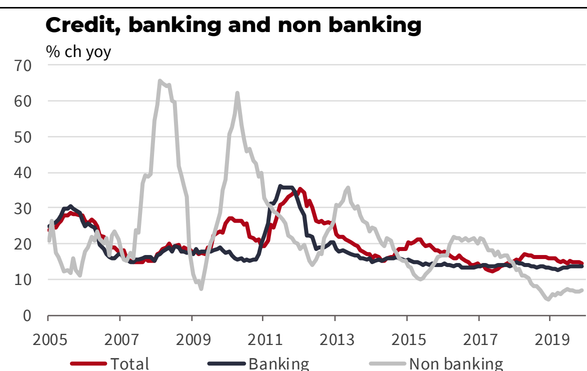
quality, the systemic impact is low due to their small size and their very regional nature.

Rising headline due to pork prices, but low core



Source: NBS, PBoC

Sharp decline in non-bank financing



Source: PBoC

Trade tensions – or, more broadly, China's rivalry with the US – will persist, no matter how negotiations between the world's top two economies play out. The RMB, which is tolerated to fluctuate more, is expected to suffer less downward pressure than in 2019 (when its exchange rate hit 7.2 against the dollar after consecutive tariff hikes). In fact, the current account surplus is likely to stabilise around 1%-2% of GDP after flirting with 0% in 4Q18 and 1Q19. Measures to open the domestic financial markets are positive for capital inflows. Moreover, controls on certain capital outflows are still in place.

China	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	6.6	6.1	5.8	5.5	5.2
Household consumption	9.6	7.1	6.9	6.7	6.3
Public consumption	9.8	7.4	7.7	7.0	6.4
Investment	4.7	3.0	4.5	4.4	4.0
Exports of goods & services	3.8	2.0	1.3	1.0	2.4
Imports of goods & services	8.2	-4.1	0.4	0.5	1.4
Inflation, %	2.1	2.9	3.1	1.4	2.1
Fiscal balance, % of GDP	-2.6	-2.8	-3.0	-3.0	-3.0
Public debt, % of GDP	36.5	36.8	37.0	37.2	37.5
External debt, % of GDP	14.6	14.0	14.0	14.1	14.2
Current account balance, % of GDP	0.4	1.5	1.4	1.2	1.1

INDIA

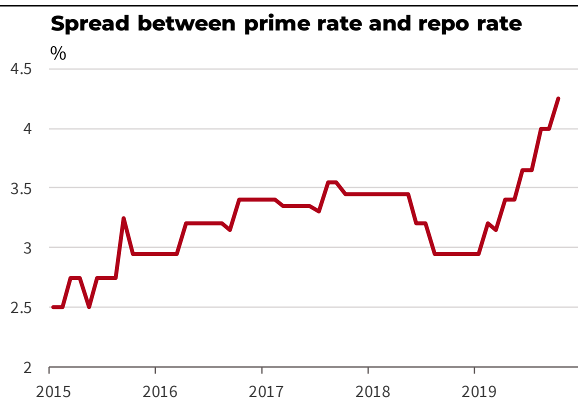
- **Growth reached a low point in 3Q19 and is expected to recover only very gradually.**
- **Leeway for the policy mix is becoming limited.**
- **To watch: inflationary risk, weakness of the financial system, and the health of public finances.**

GDP growth is expected to recover from 4.5% yoy in 3Q19, its lowest point since 2012. Monetary and fiscal policy actions have been very responsive, but are struggling to be sufficiently effective. This will limit the scope of the recovery.

The central bank has cut rates five times in 2019, a series marked by its scale and speed. The key rate has dropped from 6.5% to 5.15%. However, these rate cuts have not been entirely passed onto cost of financing the economy. Still, the gap between the RBI rate and the commercial banks' rate to their best clients has widened since early 2019, when the monetary easing cycle began. Consequently, the increase in bank lending to the non-government sector has been slowing steadily.

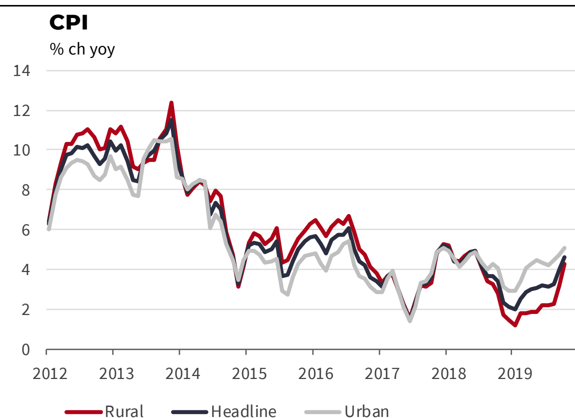
On the fiscal policy side, India has little leeway. Public debt makes up more than 65% of GDP, and the government's budget deficit stands at 6.5% of GDP. However, the finance minister has announced a stimulus plan that essentially involves removing taxes, equiping administrations with new vehicles, smoothing the reimbursement of GST (consumer tax), and infrastructure investment facilities.

Transmission (very partial) of monetary easing



Source: RBI

Surge in inflation, especially in rural area



Source: Central Statistics Office

The recent rise in inflation due to the increase in food prices is yet another constraint on any easing of the policy mix. Even though non-food inflation remains very low at 2.5%, in a country with an inflationary past and with inflation sensitive to harvests and imported oil prices (both of which are external factors), the risk that inflation will close in on the RBI's upper target (+/-2% around 4%) is to the upside. In addition, with food prices representing 40% of the consumer price basket, its increase would erode household purchasing power and heighten the distress of rural demand.

The financial system is also vulnerable. State banks have a non-performing loan ratio above 14%, whereas it is less than 5% for private banks. Indeed, the need for recapitalisation is the reason for a portion of the RBI's transfer to the government. Likewise, the default by IL&FS and other non-banking financial institutions illustrates the sector's cash shortage. State-owned banks are encouraged to finance these non-banking financial institutions. This interconnected vulnerability between the state banks and the shadow banking system is partly compromising monetary easing efforts and is likely to continue weighing on the financing of the economy, and in turn on economic growth.

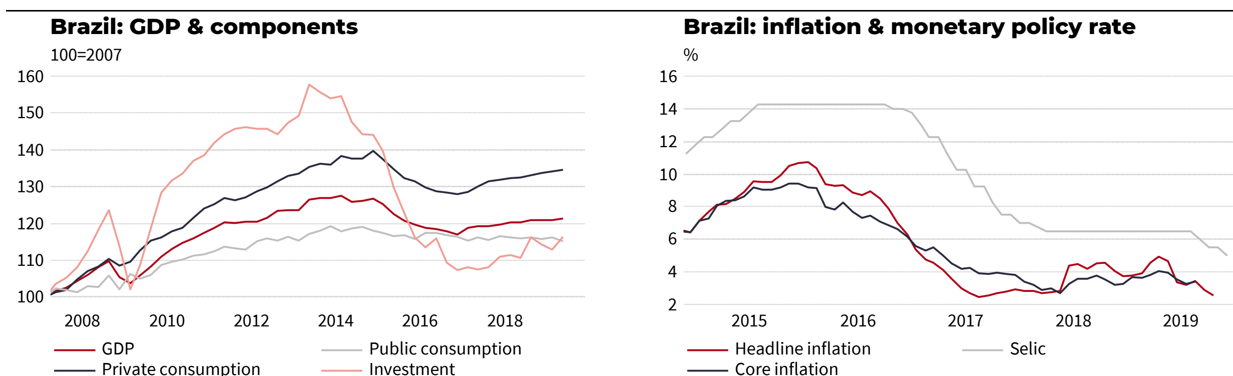
India	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	6.8	6.0	6.4	6.3	6.6
Household consumption	8.1	5.6	6.2	5.7	6.1
Public consumption	9.2	7.6	11.1	9.5	9.6
Investment	10.0	4.9	5.4	6.2	6.1
Exports of goods & services	12.5	3.5	2.7	3.7	5.1
Imports of goods & services	15.4	6.4	4.2	2.8	4.8
Inflation, %	3.4	3.4	4.1	4.1	4.0
Fiscal balance, % of GDP	-6.4	-7.5	-7.2	-7.0	-6.9
Public debt, % of GDP	68.1	69.0	68.5	67.7	66.9
External debt, % of GDP	19.6	20.3	19.8	18.3	17.6
Current account balance, % of GDP	-2.1	-2.0	-2.3	-2.3	-2.4

BRAZIL

- **Economic growth remains on a moderate trend.**
- **Low inflation is giving authorities the opportunity to ease lending conditions.**
- **The main risk to growth is deteriorating external trade.**

Overall, economic growth remains moderate. Real GDP grew by 0.6% qoq in 2Q19 (1.1% yoy). Investment continues to grow moderately (2% qoq). Private consumption also grew modestly (0.8% qoq), due to a sluggish labour market (the unemployment rate reached 11% in July).

GDP is expected to grow only by 2% in 2020 after two consecutive year of 1% growth. The weakness of growth mainly reflects the subdued investment dynamics since the 2015-16 recession. The latter is still constrained by restrictive financial conditions for corporate (BNDES keeps reducing its balance sheet and interest rates level for corporate are still high), significant underutilization of current capacities, ongoing fiscal adjustment and persistent political noise. Consumption is recovering progressively as the labour market is improving slowly (although some of the improvement is on the informal market) and easier financial conditions for households. Finally, external demand is expected to lose traction as demand from Argentina which is the country's biggest trading partner for manufactured products, is also likely to stay in recession in 2020.



Source: Refinitv, SG Economics & Sector Studies

Source: Refinitiv, SG Economics & Sector Studies

The inflation outlook remains favourable and well below the central bank's 2019 target of 4.25%. Indeed, inflation reached 2.5% in October as regulated prices inflation has significantly slow downed to 2% and services prices inflation remain stable at 3.5%. Furthermore, inflation expectations for 2020 are also declining, 3.6%, and are also under the 4% for 2020. Overall, with no pressure coming from domestic demand and a lower pass-through from exchange rate variations, the risk of inflationary pressures in the coming quarters is low. Given the weak growth and

inflation environment, the BCB reduced its policy rate in November to 5%, its lowest historical level and is likely to continue the easing cycle

The pension reform was finally approved by the Congress (lower house and Senate) in October. Under the voted reform, the retirement age will be raised and indexing of pension pay-outs will be decreased, generating savings of eight GDP points over the next decade. This adoption of this reform was essential for fiscal sustainability and to reduce the economic policy uncertainties. Pension expenditures currently represent 8% of GDP and 44% of primary expenditures and are the main driver of the primary fiscal deficit. The reform will create fiscal space as the government will more easily comply with the fiscal rule that limits growth in public expenditures to last year inflation. The approval of this reform, which needed a large majority in Congress, showed that the government was able to implement economic reform, reducing hence policy uncertainties. The main risks are still a deterioration in the international environment, a more acute slowdown in China or a worsening of the Argentine crisis and, domestically, a return of political impasse.

Brazil	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	1.1	1.3	2.0	2.2	2.1
Household consumption	1.9	1.3	2.2	2.7	2.5
Public consumption	0.0	0.0	0.0	0.1	0.1
Investment	4.1	1.8	3.5	3.8	3.8
Exports of goods & services	4.1	4.0	2.8	2.5	2.5
Imports of goods & services	8.5	3.0	3.0	3.8	3.8
Inflation, %	3.7	3.6	3.7	3.8	3.5
Fiscal balance, % of GDP	-7.3	-6.7	-6.7	-6.4	-6.3
Public debt, % of GDP	77.2	79.0	81.0	82.0	81.0
External debt, % of GDP	22.6	24.0	25.0	25.0	25.0
Current account balance, % of GDP	-2.2	-2.6	-3.0	-3.2	-3.2

RUSSIA

- **Despite the ongoing fiscal policy easing, GDP growth will remain sluggish amid weak investment and slow external demand.**
- **Inflation has peaked, and monetary policy has been eased since June 2019.**
- **Uncertainties over Western sanctions weigh on the access to long-term funding and on potential growth.**

GDP growth remained sluggish in 2019 and is projected to remain weak in 2020-2021 in a less supportive external environment and amid structural bottlenecks, low investment and lagging productivity gains.

GDP accelerated slightly from 0.7% yoy in 1H19 to 1.7% yoy in 3Q19. This is mainly based on stock building and government spending (+13 % yoy in 3Q19 for the consolidated budget). The VAT hike from 18% to 20% in January 2019 had an adverse impact on private consumption. Manufacturing PMI figures released in November also point to further deceleration of activity.

Despite the slight easing in fiscal policy that started end-2019, GDP will remain subdued in the coming years. Investment should remain weak amid low corporate margins, limited access to foreign financing and lingering uncertainties around Western sanctions. External demand is expected to be sluggish amid trade war uncertainties, a cyclical slowdown in international trade, and stable oil prices (65 USD/barrel expected in 2020-21). Private consumption should also post weak performances as wages and disposable incomes growth have continued to decelerate. Besides, the pension reform (increase in retirement age from 60 to 65 for men and from 55 to 60 for women) will have a negative impact on disposable income by delaying the first pensions paid, as retired people in Russia traditionally continue to work and combine their former wages and their pension.

Inflation peaked in April 2019 at 5.2% and reached 3.5% yoy in November 2019. Weak consumer demand did not allow companies to adjust prices to the VAT rate increase in full scale. In this context, the CBR started to ease monetary policy in June 2019 and lowered again the key rate by 50bp to 6.25% in December 2019.

Russia's external and fiscal metrics have significantly improved in the past years.

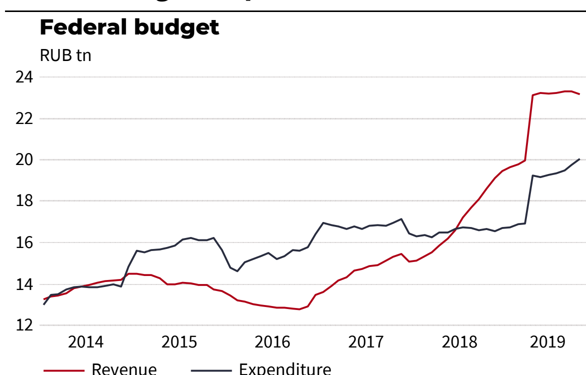
Public finances have indeed posted better performances: the federal budget was in surplus in 2019 (the first time since 2014) and 5Y CDS reached its historical low at 69 bp in November 2019.

The external situation is also stronger. The flexible exchange rate provides an important cushion for the economy against volatile commodity markets. The sensitivity of the exchange rate to the oil price dynamics has significantly decreased thanks to the fiscal rule. External debt has sharply decreased from USD 732 bn in

2014 to USD 471 bn in October 2019 (around 30% of GDP). FX reserves have increased to reach USD 541 bn in October 2019, the highest level since 2014.

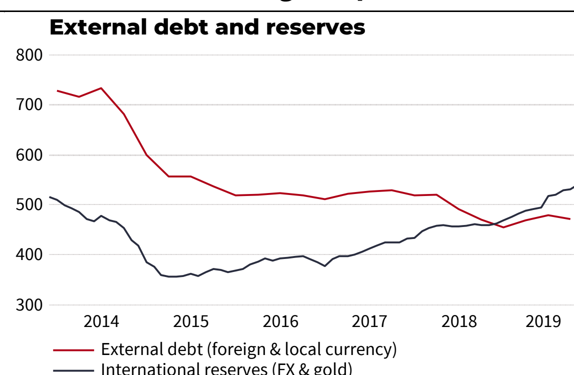
Besides, banks have managed to decrease their external leverage and remain net external creditors. Retail lending dynamics have slightly slowed down following the two rounds of macroprudential measures implemented by the CBR in September 2018 and March 2019.

Public finances have improved and posted a federal budget surplus in 2019



Source: Refinitiv, SG Economics & Sector Studies

External debt decreased whereas FX reserves have reached their highest point since 2008



Source: Refinitiv, SG Economics & Sector Studies

Sanctions remain a persistent risk factor. A second round of sanctions for the alleged breach of the Chemical and Biological Weapons Control and Warfare Elimination Act of 1991 was implemented in August 2019. Several bills that would impose stiff new sanctions have been pushed in the US Congress and could come on the forefront.

While the short-term impact of sanctions seems rather marginal, they may leave a negative footprint over long-term potential growth through confidence channels and by reducing access to foreign financing.

Russia	2018	2019f	2020f	2021f	2022f
Real GDP, % ch	2.2	1.5	1.5	1.5	1.5
Household consumption	2.3	1.0	1.5	1.5	1.5
Public consumption	0.3	0.2	0.4	0.3	0.3
Investment	2.5	0.2	0.5	1.0	1.2
Exports of goods & services	6.0	1.0	0.6	3.0	3.4
Imports of goods & services	4.0	-0.3	-1.0	2.8	3.5
Inflation, %	2.9	5.0	4.0	4.0	4.0
Fiscal balance, % of GDP	2.9	1.0	0.1	-0.3	-0.6
Public debt, % of GDP	14.6	16.5	17.7	18.3	19.0
External debt, % of GDP	27.5	27.2	26.8	27.0	27.4
Current account balance, % of GDP	6.8	5.7	3.9	3.4	3.3

AFRICA

- **Regional growth for 2019 continue to be revised downward, and is now expected to dip below 2018 levels.**
- **This is primarily due to disappointing economic performances in Nigeria, South Africa, Algeria and Angola.**
- **Despite projections for renewed growth in 2020, regional growth is still not high enough to ease socio-economic fragility.**

Regional growth for 2019 is now expected to slow slightly compared to 2018 (3.2% vs. 3.4% the previous year), following the downgrade of growth estimates in several countries. Despite a few, generally marginal and “low-impact” revisions (specifically **Ghana**, **Senegal** and **Morocco**), diversified and non-resource intensive (oil and metals) economies remain robust, with growth rates often topping 5%-6%.

Conversely, these downward adjustments are more problematic in the region's major economies (Nigeria, South Africa, Algeria and Angola, which account for about 17%, 16%, 8% and 5% of Africa's GDP, respectively).

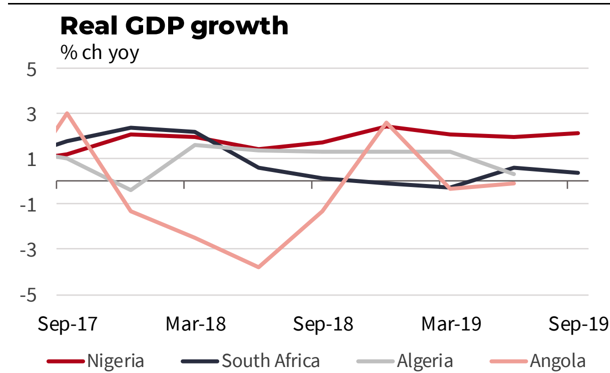
In **Nigeria**, the expected rebound is not materialising, and growth is stagnating at a much lower level than historical performance (about 2% yoy since the start of 2018, vs. nearly 7% on average between 2005 and 2014), as it remains hampered by the same structural problems, including weak domestic and foreign investment; faulty public policies and business environment; a persistently difficult security situation; and (to a lesser extent) a vulnerable, inefficient banking sector.

In **South Africa**, (business and household) confidence continues to decline, reflecting persistent structural problems (weak investment, inefficiency of state-owned entities – particularly the power company Eskom) and cyclical problems (widespread social discontent, worsening trade terms, etc.). In spite of a (limited) rebound since 2Q19, growth is still under 1% yoy.

In **Algeria**, the slowdown that began when oil prices started to decline in mid-2014 worsened in 2Q19, with growth coming out at 0.3% (vs. 1.3% in 1Q18). While hydrocarbon production continues to contract because of major structural constraints (ageing oil fields, lack of investment, etc.), the other sectors continue to suffer from the current political and social unrest.

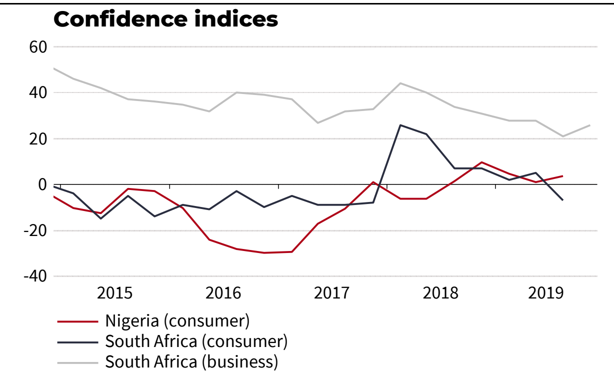
In **Angola**, GDP contracted in 1Q and again in 2Q19. The reforms begun as part of the IMF programme signed in December 2018 have yet to re-energise non-oil sectors (for now, the effects of a substantial decline in public demand are outweighing the ongoing economic liberalisation), whereas recurring technical problems continue to affect oil production (currently 1.4 million barrels/day, vs. 1.6 million at the end of 2018).

Disappointing growth in several of the region's major countries



Source: Refinitiv, SG Economic and Sector Research

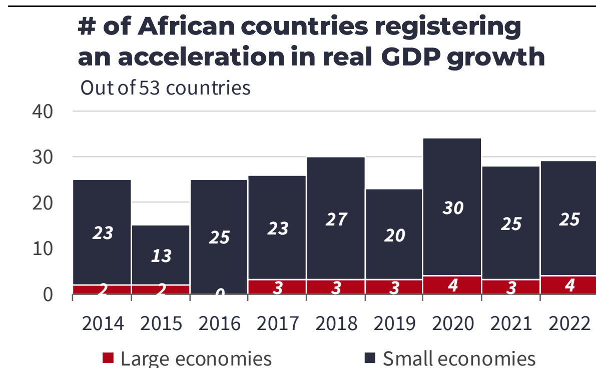
Nigeria and South Africa: confidence at half-mast



Source: Refinitiv, SG Economic and Sector Research

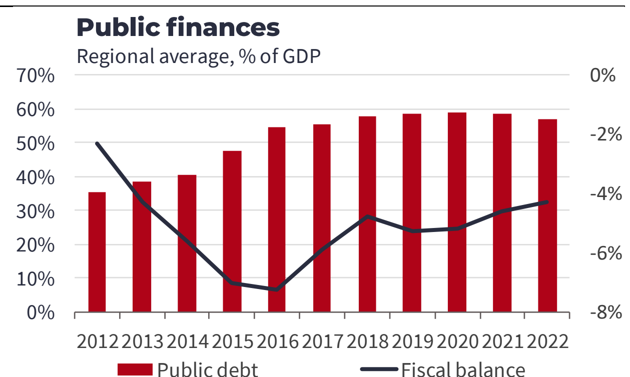
In 2020, regional growth is expected to pick up again slightly, and is now forecast to come out under 4%. As such, 34 out of 53 countries should see higher growth in 2020 than in 2019. While external growth drivers are now less supportive (in line with the worldwide economic slowdown), internal drivers are gradually gaining momentum, as illustrated by i) a recovery in lending to the private sector (thanks to bank balance sheets becoming increasingly robust, albeit slowly) facilitating the rebound in private-sector demand; and ii) the continued vigour of public demand (the average public deficit in Africa is expected to remain stable in 2020). Africa's growth in 2020 will remain very mixed, and will not be sufficient to reduce economic frailty (specifically, increasing concerns over the region's public debt susatinability), or social discontent (grass-roots movements in North Africa, South Africa, Guinea, and Ethiopia; security problems in Central Africa and the Sahel).

Africa: growth regaining momentum in the majority of countries



Source: Refinitiv, SG Economic and Sector Research The "major economies" are those whose GDP represents more than 5% of regional GDP: Algeria, Egypt, Morocco, Nigeria and South Africa).

Africa: significant increase in public debt ratios

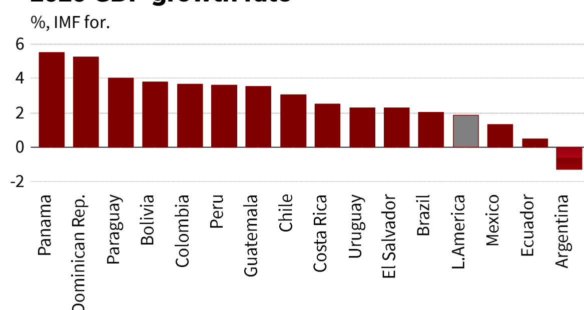


Source: Refinitiv, SG Economic and Sector Research

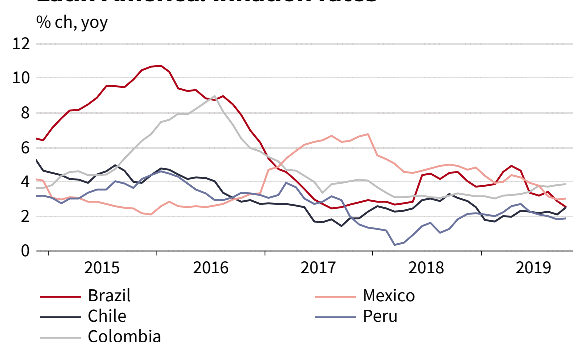
LATIN AMERICA

- **The sluggish growth of the major economies continues to adversely affect the momentum in the region.**
- **With the exception of Argentina, inflation remains under control, facilitating a decline in rates by central banks.**
- **Stagnant growth over the last three years has contributed to rising social tensions in several countries in the region.**

In the region's main economies, activity remains at best sluggish due to various internal adjustments and an unfavourable external environment.



Source: Refinitiv, SG Economic and Sector Research



Source: Refinitiv, SG Economic and Sector Research

In Brazil, activity remains weak, reflecting still flagging investor sentiment. However, the adoption of the pension reform in October, which is supposed to generate a saving of 8% in respect of GDP over the next ten years, could boost investment.

In **Mexico**, weak growth in manufacturing output and contractions in the oil and construction sectors continue to drag down growth. Moreover, a 6-week strike in the automotive sector in the United States in Q3 2019 had a substantial impact on the Mexican economy, which is highly integrated in the American production value chain. This event contributed to the deterioration in investment, also weakened by restrictive financial conditions. Lastly, the decline in business confidence points to weak investment in the coming quarters. Inflation remains under control at 3.6% year-on-year in September, reflecting weak domestic demand and a stable exchange rate. Accordingly, the central bank has been gradually reducing its key rate since July, which nevertheless remains at a very high level (7.5% in November). Considerable uncertainty regarding the government's economic policy and the external environment (ratification of the USMCA trade agreement) are preventing the central bank from reducing its key rate more rapidly.

In **Argentina**, President Alberto Fernandez, who assumed office on 10 December, will face a recessive economic environment, high inflation and balance of payments

pressures. Capital controls (maximum withdrawal of USD 200 per person per month, applying to residents) will remain in place. The new government will have to contemplate negotiations in order to restructure its public debt. Debt servicing amounts to USD 50bn in 2020 (almost half in local currency) and concerns primarily securities governed by local law.

The smallest economies are enjoying robust growth. However, this remains well below the growth achieved during the last rising commodity price cycle.

In **Chile, Colombia and Peru**, social tensions have erupted against the backdrop of a slowdown in growth and halt in the reduction of income inequality, which remains among the highest in the world. Although growth remains higher than 3% year-on-year in 3Q19 in the three countries, it is lower than the figure between 2003 and 2013 (5% on average). Contrary to the major economies in the region, Chile, Colombia and Peru have considerable leeway to implement counter-cyclical policies. Colombia and Peru have primary budget surpluses. Chile has a moderate primary budget deficit and all three countries have low public debt ratios. Moreover, they also have low inflation rates, which has enabled central banks to pursue their rate cutting cycle.

EMERGING ASIA

- **A less negative external environment in 2020.**
- **A responsive policy mix to underpin domestic demand.**
- **Redeploying the global value chain is creating disparity in export momentum.**

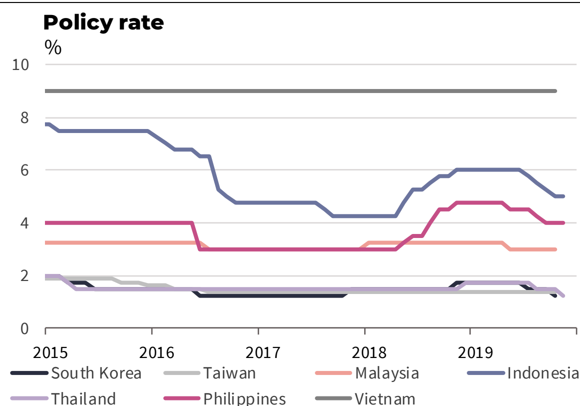
Growth in emerging Asia, excluding China and India, will stay resilient in 2020 – above 3% – due to a less-negative external environment and a responsive policy mix.

In terms of external demand, negative factors should ease compared to 2019. First, the room for US tariff hike on Chinese exports now seems limited, even if uncertainties persist given the rivalry between the world's two largest economies. Next, the downward cycle in the semiconductor industry is expected to bottom out no later than early 2020.

In fact, *World Semiconductor Trade Statistics* show that on average it takes six quarters for the downward adjustment period to reach its lowest point. If history offers a good guide, this suggests that the downward cycle that began in 2Q18 could last until the end of 2019.

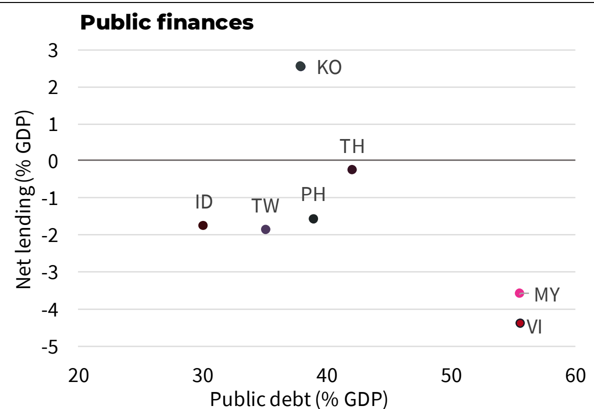
Although a future rebound in export orders is hard to see clearly from here, the most negative shock to foreign demand is now likely behind, albeit that we see no fast track rebound.

Almost generalised monetary easing



Source: Refinitiv

Relatively healthy public finances



Source: IMF

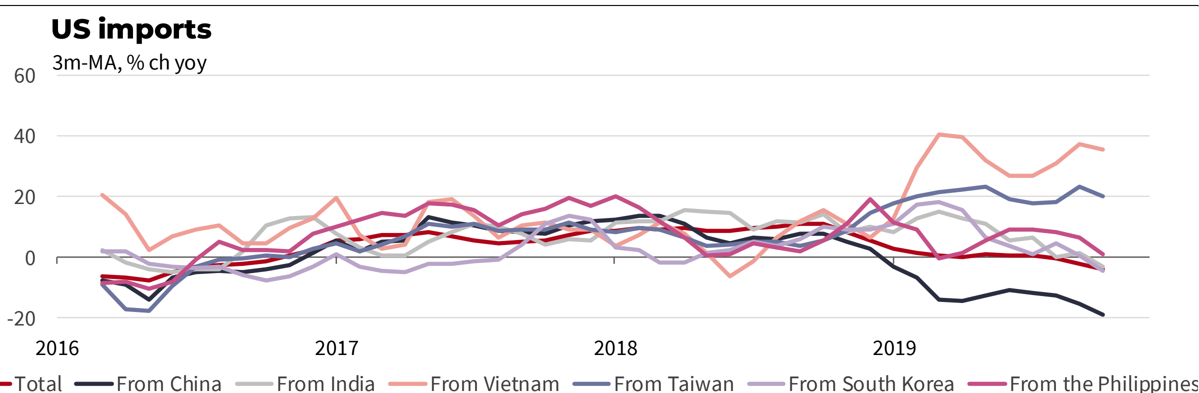
As for supporting economic policy, most countries in the region have been very responsive, especially since they have a certain amount of leeway. In 2019, monetary policy rates were lowered in South Korea (from 1.75% to 1.25%), Malaysia (from 3.25% to 3%), Indonesia (from 6% to 5%), Thailand (from 1.75% to 1.25%), and the Philippines (from 4.75% to 4%). Several economies have also announced fiscal support measures. Take Thailand ($10bn stimulus package, i.e. 2% of GDP) and South Korea (public spending up 8% in 2020). Other countries are expected to see their expenses rise (the Philippine Congress has already approved the 2020 budget

with a catch-up on spending). Remember, most Asian economies have relatively healthy public finances – public deficits and/or public debt are fairly low. This is the case in South Korea (budget surplus), Taiwan, the Philippines, and Thailand, with a public debt-to-GDP ratios of 40% or less and deficits of less than 2% of GDP. Even Indonesia, which is relatively more restricted in terms of external financing, should be able to draw on a widening of its public deficit in the first year of Joko Widodo's second presidential term. The resilience of the Indonesian rupiah illustrates the impressive level of credibility the country has acquired among international investors.

On the external front, central banks in the region hold comfortable FX reserves, protecting from international capital flow volatility. In case of reversal of global risk appetite, India and Indonesia, which have external borrowing needs, remain the most vulnerable.

Lastly, trade tensions between China and the US have also led to an acceleration in the redeployment of the global value chain, with production being relocated from China to other regions. Vietnam and Taiwan seem to be the winners, with much greater momentum in investments and exports. In Vietnam, low cost of production is a key reason behind the growth in FDI ($2.1bn from China over the first 10 months of 2019, a year-on-year increase of 170%). Meanwhile, Taiwan is being highly proactive in encouraging the return of relocated Taiwanese capital, with its three-year plan that includes advantageous loan terms. Such action is likely to continue to create disparity in the region's export situations.

Trade flows are redirected to Taiwan and Vietnam



Source: US Census Bureau

GULF STATES

- **Stagnant oil revenues limit growth prospects.**
- **Budget deficits look set to become a structural feature.**
- **Geopolitical concerns are a source of uncertainty.**

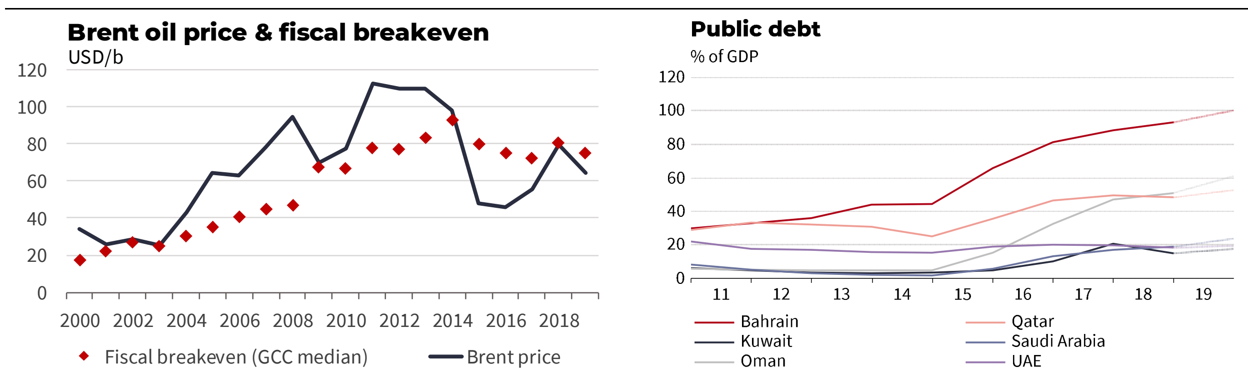
The economic prospects of the region are clouded by stagnant oil revenues, precarious growth prospects for key trading partners (China, Europe) and high levels of geopolitical uncertainty.

Non-hydrocarbon GDP growth in the region has slowed down significantly and is expected at 2.2% in 2019 and 2.9% in 2020 well below the 7.5% average of the period 2000-2015. National economic development long-term plans envisioned by GCC governments focus on the modernisation of the economy and on efforts to insulate countries from oil price volatility. Over the last few years, however, policy efforts have been concentrated in adjusting the budgets to lower oil revenues. Such efforts have translated into a lower expansion in public infrastructure spending, freezing public wage bills and a decline in subsidies and social transfers, which in turn slowed down private spending. Workforce nationalization measures on the Gulf labour market also conduced to an exit flow of migrant workers from Gulf countries, which hurt consumption expenditures locally.

In late 2018, **Saudi Arabia** and the **United Arab Emirates** both announced stimulus programmes of $14bn and $13.6bn respectively (i.e. 1.7% and 3% of their GDP), opening the door to a new series of public-sector investments in 2019. Still, revenues sensitive to the distribution of the oil rent are stagnant and overall non-oil growth is expected to remain modest.

Central banks in the region followed the US Federal Reserve and cut their key policy rates, given their pegged exchange rates to the USD. Lower interest rates will encourage borrowing and bring some support to the real estate market, which has contracted since 2015.

Budget deficits look set to become a structural feature. Fiscal breakeven oil prices have generally declined since 2014, but they are still too high to balance national budgets. The loss of government revenues with respect to pre-2015 levels has been partially offset by debt flows. The GCC governments have been highly active on the international debt markets. They issued $38bn in 2016, $49bn in 2017 and $34bn in 2018. Year-to-date Eurobond issues stand at $41bn (Saudi Arabia issued $13bn, Qatar $12bn, and the UAE $10.5bn). Saudi Arabia also launched the to sell up to 1.5% of shares of Aramco, the giant oil company, to raise funds to modernise the economy. According to the company's statement, the amount raised totalled $25.6bn, making it the world's biggest IPO in history. The IPO still fells short of Saudi Arabia's initial lofty expectations with little participation from foreign investors.



Source: IMF Regional Economic Outlook, various issues

Source: IMF Regional Economic Outlook, April 2019

Fiscal breakeven oil price, $/b

	2014	2015	2016	2017	2018	2019
Bahrain	103	119	106	113	118	95
Kuwait	54	47	43	45	54	54
Oman	94	102	101	91	99	87
Qatar	58	54	54	50	50	49
Saudi Arabia	106	94	96	84	89	86
UAE	91	65	51	61	66	70

Source: IMF Regional Economic Outlook, April 2019

Forward exchange rates point to no significant pressure on the GCC currencies' peg to the dollar. The current account deficit in **Oman** and **Bahrain** remains large and further adjustment in the growth of domestic demand will be necessary over the medium term to support the currency peg. However, Oman is dragging its feet when it comes to implementing fiscal consolidation measures, and the country's external assets are dwindling. As a result, its bond yields are now the highest in the region. In October 2018, Bahrain received $10bn in financial aid from its neighbours (Saudi Arabia, UAE, Kuwait) that helped ease pressures on its currency, but the fragilities remain.

Geopolitical concerns seem set to remain a source of uncertainty. The Abqaiq–Khurais attack targeting Saudi's oil facilities in September 2019 adds to worries, against a backdrop of relentless tensions between the US-Iran and regional rivalries. A growth in military spending, already high in GCC countries, will continue weighing on budget expenditures and fiscal sustainability. The blockade of **Qatar** by its closest neighbours does not seem to have inordinately disrupted the country's economic performances. Yet, the diplomatic rift has entered the third year with little signs of easing, reducing economic cooperation within the region and business prospects for firms with activity in all GCC economies.

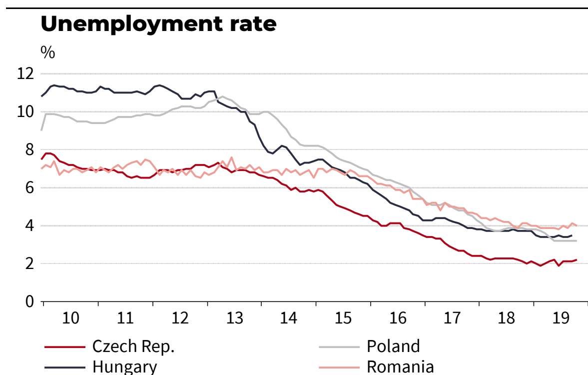
CENTRAL AND EASTERN EUROPE

- **Growth has so far decoupled from the downturn in the Euro Area but is set to decelerate in 2020-2021.**
- **Inflation has passed its peak but remains fuelled by wage pressures and resilient domestic demand.**
- **On the longer term, a major risk for the region would be a cut in European structural funds for the 2021-2027 period.**

GDP growth in Central and Eastern Europe (CEE) has so far decoupled from the downturn in the euro area thanks to sound domestic demand. In the past 4 years, private consumption has been supported by robust wage growth (ranging from 8% to 14% yoy in the region). Public investment has benefited from large inflows of EU structural funds. Private investment has also rebounded amid high level of capacity utilization. Fiscal policy has also been supportive. In Poland, a pre-election package extended the 500+ child benefit program to all first children, introduced a one-off bonus for pensioners in 2019, lowered the personal income tax rate and abolished personal income tax for employees up to age 26. Romania has also implemented an expansionary fiscal policy with several VAT cuts, increases in public wages and pensions since 2016.

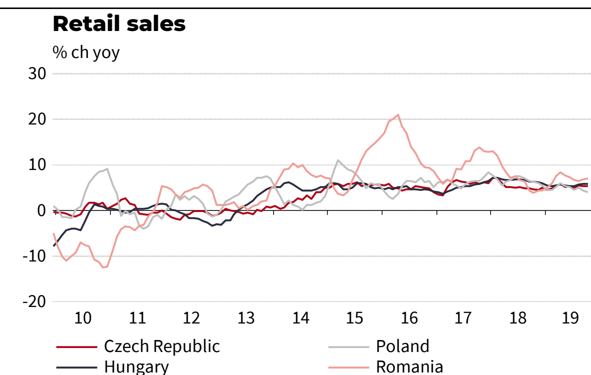
In 2019, Hungary, Poland and Romania will remain the top performers in Europe with GDP growing around 4% on average. The Czech Republic will keep up fair momentum, expanding at around 2.5%.

Significant improvement in labour markets in the region has supported private consumption



Source: Refinitiv, SG Economics & Sector Studies

In this context, retail sales have posted dynamic growth in the region



Source: Refinitiv, SG Economics & Sector Studies

The outlook for 2020-2021 is however less bright. Further deterioration in the external environment – notably with the slowdown of the euro area, the CEE's key trading partner – and increased capacity constraints would eventually weigh on activity. For now, tight labour markets keep fuelling wage pressures and supporting demand, but the overall effect might turn negative. Job vacancy rates have now reached historical heights and corporate profit margins are declining.

The region keeps some fiscal space to support growth in case of a more abrupt slowdown and several countries have already announced expansionary measures for 2020. In **Czech Republic**, the 2020 state budget incorporates an increase in pensions, parental allowances, sickness benefits and public wages (+10% for teachers and +7% for other public servants). The newly elected government in Poland has also announced a minimum wage increase that would double the minimum wage in 2023 and the implementation of a regular bonus for pensioners (13th payment per year).

Regional inflation peaked in May 2019 and remains above 2%, still fuelled by dynamic wage growth, resilient domestic demand and rising food prices. Against the background of soft external demand and the ECB's loose monetary policy stance, central banks in Czech Republic, Hungary, Poland and Romania stood pat at their November meetings marking a pause in the previous tightening or normalisation stance. Central banks will have to deal with a weak external environment, but inflationary pressures will prevent any significant easing cycle.

Looking forward, several risks must be monitored in the region.

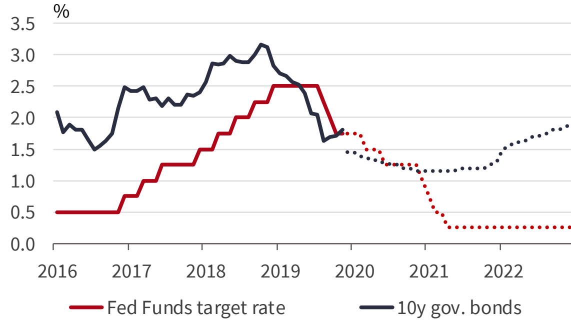
Macroeconomic imbalances in **Romania** are deepening. The current account deficit will surpass 5% of GDP in 2019 while the budget deficit could reach up to 3.5% of GDP according to the European Commission. The new pension law paved the way for large pension increases (+15% already implemented in Sept. 2019 and +40% planned in Sept. 2020) that will put further stress on public finances and on the external situation. In this context, there are mounting risks on the FX side and a higher probability of a growth steep downturn.

Turkey has exited recession and market sentiment has improved. Part of this progress is due to benign international markets conditions and some issues remain below the surface. Despite current-account rebalancing, overall external financing requirements remain high. The New Economic Program for 2020-2022 targeting 5% growth is not realistic in a context where large corporates have to adapt to higher foreign debt servicing costs after the sharp FX depreciation of 2018. The need for banks to set aside provisions for NPLs is likely to obstruct the growth of bank credit.

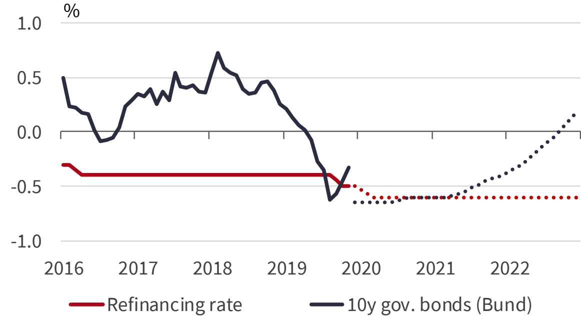
Finally, a decrease in European structural funds for the 2021-2027 period would have a negative impact on growth in the medium term in all the region that already suffers from a decline in active population. In this context, several European countries signed a declaration in Prague in November 2019 to discuss the EU draft budget published in 2018 that reduce structural funds for the next multiannual financial framework 2021-2027. The countries that signed the declaration claimed that the amount of European structural funds should be the same in 2021-2027 as in 2014-2020, considering that European funds are the main engine of investment in Central and Eastern Europe and also ask for more flexibility in the fund absorption mechanism.

ECONOMIC AND FINANCIAL DATA

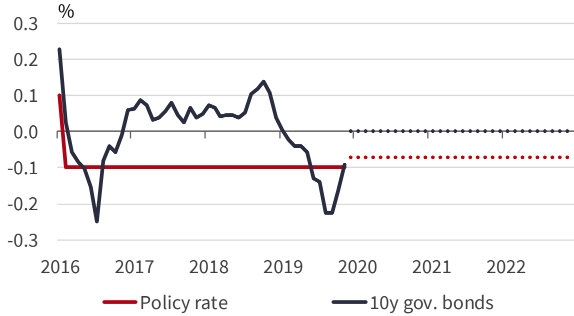
United States: interest rates



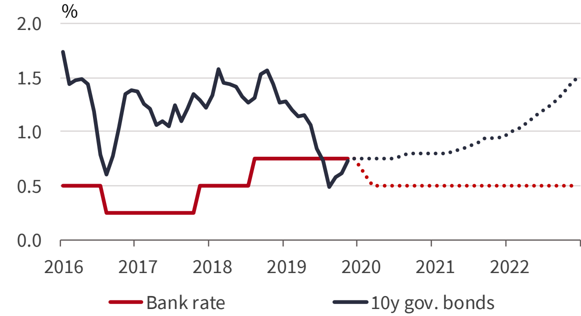
Euro area: interest rates



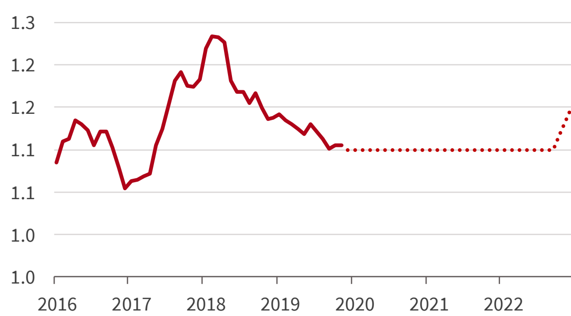
Japan: interest rates



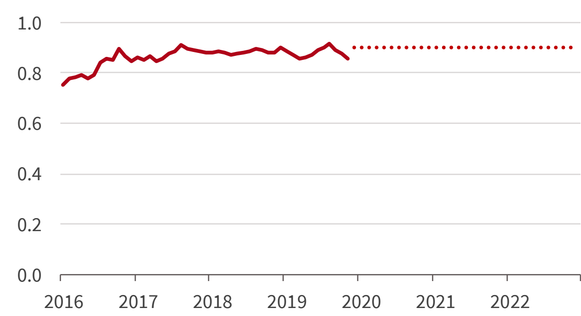
United Kingdom: interest rates



EUR/USD: exchange rate



EUR/GBP: exchange rate



USD/JPY: exchange rate

USD/RMB: exchange rate

Real GDP, % ch	2014	2015	2016	2017	2018	2019f	2020f	2021f	2022f
United States	2.5	2.9	1.6	2.4	2.9	2.3	1.5	0.8	1.4
Japan	0.3	1.3	0.5	2.2	0.3	1.0	0.7	0.5	0.7
United Kingdom	2.6	2.4	1.9	1.9	1.4	1.2	0.2	0.5	1.5
Euro area	1.4	2.0	1.9	2.7	1.9	1.2	0.7	0.4	1.0
Germany	2.2	1.5	2.1	2.8	1.5	0.6	0.5	0.2	0.9
France	1.0	1.0	1.0	2.4	1.7	1.4	0.8	0.7	1.1
Italy	0.1	0.7	1.4	1.8	0.7	0.2	-0.1	0.0	0.7
Spain	1.4	3.8	3.0	2.9	2.4	2.0	1.1	0.7	1.2
China	7.3	6.9	6.7	6.8	6.6	6.1	5.8	5.5	5.2
India	7.4	8.0	8.2	7.2	6.8	6.0	6.4	6.3	6.6
Brazil	0.5	-3.5	-3.3	1.1	1.1	1.3	2.0	2.2	2.1
Russia	-0.2	-2.3	0.3	1.6	2.2	1.5	1.5	1.5	1.5

Inflation, %	2014	2015	2016	2017	2018	2019f	2020f	2021f	2022f
United States	1.7	0.2	1.3	2.0	2.5	1.9	2.0	1.7	2.1
Japan	2.8	0.8	-0.1	0.5	1.0	0.4	0.5	0.6	0.5
United Kingdom	1.5	0.1	0.6	2.7	2.5	1.8	1.3	1.7	2.1
Euro area	0.4	0.2	0.2	1.5	1.8	1.2	1.5	1.1	1.2
Germany	0.8	0.7	0.4	1.7	1.9	1.4	1.5	1.2	1.2
France	0.7	0.0	0.3	1.2	2.1	1.3	1.4	1.1	1.1
Italy	0.2	0.1	-0.1	1.3	1.2	0.7	0.9	0.8	1.0
Spain	-0.2	-0.6	-0.3	2.0	1.7	0.8	1.4	1.1	1.3
China	2.0	1.4	2.0	1.6	2.1	2.9	3.1	1.4	2.1
India	5.8	4.9	4.5	3.6	3.4	3.4	4.1	4.1	4.0
Brazil	6.3	9.0	8.8	3.5	3.7	3.6	3.7	3.8	3.5
Russia	7.8	15.5	7.1	3.7	2.9	5.0	4.0	4.0	4.0

Investment, % ch	2014	2015	2016	2017	2018	2019f	2020f	2021f	2022f
United States	6.6	3.4	1.9	4.2	4.6	2.1	1.2	-1.3	2.1
Japan	2.9	1.7	-0.3	4.3	1.1	2.7	2.2	0.6	0.7
United Kingdom	6.6	3.7	3.6	1.6	-0.1	0.1	0.4	1.2	3.9
Euro area	1.4	4.5	4.0	3.7	2.4	7.0	1.9	0.1	0.9
Germany	3.2	1.2	3.6	3.1	3.5	2.8	0.2	0.0	1.0
France	0.0	0.9	2.5	5.0	2.8	3.6	1.8	0.4	1.0
Italy	-2.1	1.6	4.2	3.5	3.0	2.2	-2.1	-0.9	0.7
Spain	4.1	4.9	2.4	5.9	5.3	2.6	1.0	0.2	1.0
China	6.9	7.3	6.4	5.0	4.7	3.0	4.5	4.4	4.0
India	2.6	6.5	8.3	9.3	10.0	4.9	5.4	6.2	6.1
Brazil	-4.2	-13.9	-12.1	-2.5	4.1	1.8	3.5	3.8	3.8
Russia	-0.7	-10.0	1.0	5.1	2.5	0.2	0.5	1.0	1.2

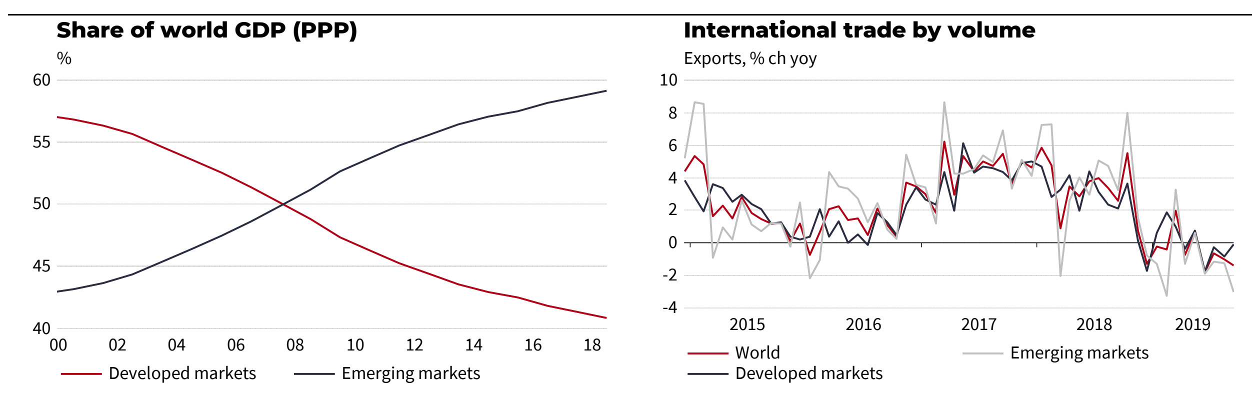
Current account balance, % of GDP	2014	2015	2016	2017	2018	2019f	2020f	2021f	2022f
United States	-2.1	-2.2	-2.3	-2.3	-2.4	-2.5	-2.6	-2.4	-2.8
Japan	0.8	3.1	3.9	4.2	3.5	3.0	2.9	2.9	2.8
United Kingdom	-4.8	-4.9	-5.2	-3.5	-4.3	-4.6	-5.0	-5.5	-5.1
Euro area	2.4	2.8	3.2	3.1	3.1	2.7	2.5	2.2	2.2
Germany	7.0	8.5	8.4	7.9	7.6	7.2	6.3	5.7	5.2
France	-1.0	-0.4	-0.6	-0.7	-0.7	-1.0	-1.3	-1.4	-1.3
Italy	1.9	1.4	2.6	2.6	2.6	3.3	3.4	3.3	3.5
Spain	1.7	2.0	3.2	2.7	1.9	1.6	1.4	1.3	1.5
China	2.2	2.7	1.8	1.6	0.4	1.5	1.4	1.2	1.1
India	-1.3	-1.1	-0.6	-1.8	-2.1	-2.0	-2.3	-2.3	-2.4
Brazil	-4.1	-3.0	-1.3	-0.7	-2.2	-2.6	-3.0	-3.2	-3.2
Russia	2.8	5.0	1.9	2.1	6.8	5.7	3.9	3.4	3.3

Fiscal balance, % of GDP	2014	2015	2016	2017	2018	2019f	2020f	2021f	2022f
United States	-5.3	-4.7	-5.4	-4.3	-6.6	-7.3	-7.4	-7.7	-7.8
Japan	-5.6	-3.8	-3.7	-3.2	-3.2	-3.0	-3.1	-2.2	-1.8
United Kingdom	-5.6	-4.5	-3.2	-2.4	-2.2	-1.6	-2.3	-2.8	-2.2
Euro area	-2.5	-2.0	-1.5	-0.9	-0.5	-0.3	-0.6	-1.0	-1.1
Germany	0.3	0.7	0.8	1.2	1.5	1.0	0.5	-0.4	-0.6
France	-3.9	-3.6	-3.5	-2.8	-2.5	-3.2	-2.5	-3.0	-3.5
Italy	-3.0	-2.6	-2.4	-2.4	-2.2	-2.3	-2.8	-3.0	-3.0
Spain	-5.9	-5.2	-4.3	-3.0	-2.5	-2.2	-2.2	-2.5	-2.6
China	-0.9	-2.8	-3.1	-3.1	-2.6	-2.8	-3.0	-3.0	-3.0
India	-7.1	-7.2	-7.1	-7.0	-6.4	-7.5	-7.2	-7.0	-6.9
Brazil	-6.1	-10.3	-9.1	-7.9	-7.3	-6.7	-6.7	-6.4	-6.3
Russia	-1.1	-3.4	-3.7	-1.5	2.9	1.0	0.1	-0.3	-0.6

Public debt, % of GDP	2014	2015	2016	2017	2018	2019f	2020f	2021f	2022f
United States	74	75	77	76	78	78	80	83	85
Japan	236	232	236	235	237	238	238	238	238
United Kingdom	86	87	87	86	86	85	86	86	85
Euro area	93	91	90	88	86	85	84	85	85
Germany	76	72	69	65	62	59	58	58	58
France	95	96	98	98	98	99	99	101	102
Italy	135	135	135	134	135	136	138	140	141
Spain	101	99	99	99	98	96	96	97	97
China	40	41	37	37	37	37	37	37	38
India	67	69	68	68	68	69	69	68	67
Brazil	56	66	70	74	77	79	81	82	81
Russia	16	16	16	15	15	16	18	18	19

All data as of end-2018	GDP, current	GDP per capita	Indebtness			Internat. Invest. Position (IIP), net
			Public	Private, non-fin. corp.	Private, hholds.	
	USD billions	USD, PPP terms	% of GDP	% of GDP	% of GDP	% of GDP
Advanced markets						
United States	20,580	62,869	99	47	76	-46
Japan	4,972	44,246	215	91	58	62
United Kingdom	2,829	45,741	108	65	84	-10
Euro area	13,639	39,614	96	61	58	-4
Germany	3,951	52,386	67	40	54	60
France	2,780	45,893	110	73	60	-16
Italy	2,076	39,676	142	65	41	-5
Spain	1,428	40,172	108	65	59	-77
Emerging markets						
China	13,368	18,116	51	152	53	16
India	2,719	7,859	68	45	11	-16
Brazil	1,868	16,146	88	42	28	-33
Russian Federation	1,657	28,797	15	46	17	22
Turkey	771	28,044	30	69	15	-48
Czech Republic	245	37,340	33	57	32	-23
Romania	240	26,448	37	-	-	-43
Morocco	119	8,931	65	-	-	-65

Source: SG Economics & Sector Studies, IMF, Banque de France, BIS
IIP = total external financial assets minus total external liabilities



Source: SG Economics & Sector Studies, Refinitiv Datastream

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