# Global Macro Views

March 2017

By: The Standish Global Macro Committee
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**World:**

| | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 2.9% | 3.2% | – | 3.2% | – |
| Inflation | 6.0% | 6.1% | – | 4.8% | – |

Source: Standish as of March 10, 2017

In the Standish outlook, the global economy extends the pattern of the past few years in which real GDP grows at a sluggish pace with subdued volatility. The slow rate of expansion is all about the tepid progress of potential output. The aging population of most advanced economies is increasing only slowly, and productivity growth has slowed almost uniformly around the globe. We expect relatively steady expansion this year around the shallow uptrend of aggregate supply because four critical events dotting the political calendar should elicit behaviors from officials stabilizing aggregate demand.

In the United States, the Republican leadership has their eyes on the prize of the midterm elections in 2018, which will lead them to quell dissent in that ranks and push through a portion of President Trump's agenda. A trauma-free DC provides fiscal stimulus and regulatory relief this year and next, boosting household and business confidence.

In Europe, elections in France and Germany create a strong incentive for the European Central Bank to shelter in place, keeping policy accommodative so as not to insert themselves into a political debate somewhere.

The Communist party in China holds its national conference in November, which President Xi apparently intends to use to extend his control. To do so means that he is likely to use the levers of policy, which are considerable, to keep real GDP at the five-year-plan target of 6-1/2 percent.

The leadership in Saudi Arabia have set forth an ambitious agenda, Vision 2030, to reduce their dependence on energy production. The first concrete step is an initial public offering of Aramco, the state oil company. Until the closing of that deal, the timing of which has slipped into 2018, officials will put pressure on other oil producers to honor quota cutbacks so as top harden the floor to global oil prices at around $50 per barrel. Meanwhile, the technical prowess of US shale oil producers caps prices at around $60 per barrel.

Those policy incentives anchor our outlook for global real GDP at 3.2 percent this year and next. While the Fed is tightening policy, the pace of their action is torpid, at best, and its advanced economy colleagues are still full tilt into accommodation (even if sometimes they seem to be tilting at windmills). As a result, inflation in those economies picks up some this year. Global inflation, though, falls as consumer prices decelerate in a few of the double-digit-inflation outliers.

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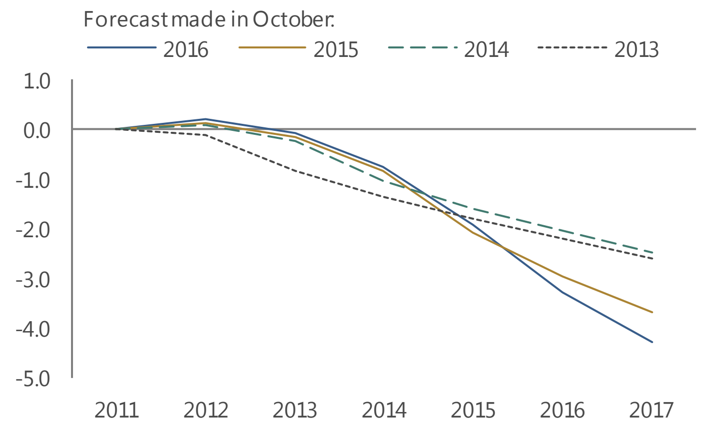
↑ positive surprise more likely over next six months. ↓ negative surprise more likely over next six months – no bias
Inflation forecasts are yearly annual averages of headline CPI.

If our expectations for 2017 and 2018 materialize, it would end the string of serial disappointment that has scarred forecasting over the past few years. By way of example, the chart plots vintages of projections of the level of global real GDP made in the October editions of the International Monetary Fund's *World Economic Outlook (WEO)* since 2012, with the starting year's expected path taken as the baseline. Each year as reality sank in further, the level of real GDP expected for 2017 was marked down relative to the 2012 expectation, cumulatively by 4-1/4 percent.

**Vintages of IMF Forecasts of World Real GDP Relative to October 2012 Outlook, Percent**




Source: International Monetary Fund, World Economic Outlook, various issues as of October 31, 2016

Why do we expect current forecasts to prove more durable? Central to this disappointment has been a gradual reassessment of the prospects for potential output around the globe, a process we think that has run its course. To demonstrate this, note that the WEO includes five-year-ahead forecasts of real GDP growth for all economies and regional aggregates. This should provide a reasonable approximation of potential output growth (or the pace of aggregate supply) because the cyclical dynamic of aggregate demand should have played out by then. As shown in the table, the latest assessments of the growth of aggregate supply are 1.7 percent for advanced economies and 5.1 percent for emerging market and developing economies. This seems both unwelcome and realistic to us, especially when compared to the view five years' ago that was about 1 percentage point higher.

**Five-Year-Ahead Forecasts of Real GDP Growth, Percent**

| Forecast as of October: | World | Advanced economies | Emerging market and developing economies |
|---|---|---|---|
| 2016 | 3.8 | 1.7 | 5.1 |
| 2015 | 4.0 | 1.9 | 5.3 |
| 2014 | 4.0 | 2.3 | 5.2 |
| 2013 | 4.1 | 2.5 | 5.5 |
| 2012 | 4.6 | 2.6 | 6.2 |

Source: International Monetary Fund, World Economic Outlook, various issues as of October 31, 2016

**Developed Markets:**

| United States | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 1.6% | 2.3% | ↑ | 2.1% | ↓ |
| Inflation | 1.3% | 2.5% | ↑ | 2.7% | ↑ |

Source: Standish as of March 10, 2017

Forecasting should not feel like flipping a coin, because the world does not often offer a stark choice of heads or tails with known probabilities. This time, though, the choice is stark as an early test of the Trump administration looms. The political quandary facing Republican leadership is that campaign promises put a hard problem—repealing and replacing the Affordable Care Act—first in the legislative queue. Because they have to use the budget reconciliation process to maneuver around a certain Senate filibuster by Democrats, the bill cannot encompass all the changes their side wants and other initiatives have to stay on hold until closure.

Their just-revealed legislative strategy is to put incomplete reform on a fast track and expect the disappointed contingent in their party to fall into line so as not to derail the new administration within its first one hundred days. If Majority Leader McConnell fails to turn any Democrats around (as is likely) and three of his Republican colleagues prove unpragmatic (as is possible), the bill fails and progress on most legislative fronts grinds to a halt.

Our forecast puts a higher probability weight on the obverse side of the coin. The American Health Care Act, warts and all, gets signed into law by April and further initiatives follow, including trimming the corporate tax rate (but not going whole hog with a border adjustment tax) and spending more on the military and infrastructure. On another track, new heads of agencies prune back the regulatory thicket, adding a regulatory dimension to the fiscal tailwind to spending.

This process, however, will probably take longer and amount to less than the expectations built into equity prices, but it will be enough to boost real GDP growth to 2-1/4 percent in 2017. This is a couple tenths faster than our prior forecast and owes to the view that a path toward meaningful change in economic policy is now more discernible.

Such growth is not gangbusters by historical standards but it is faster than that of our advanced economy trading partners and our own potential output. The former locks in the appreciated foreign exchange value of the dollar. As for the latter, tax and regulatory reform might boost longer-term growth, but such changes are uncertain and accrete slowly. For now, aggregate demand gravitates toward aggregate supply that is expanding just 1-1/2 percent per year.

This, along with the feature that the fiscal and regulatory impetus is a boost to the *level* of activity, is why we see growth slowing after this year. Resource use intensifies, and pressures on costs mount. With commodity prices moving sideways, headline inflation overshoots the Fed's 2 percent inflation goal by about ½ percentage points this year and ¾ percentage points next year.

The quarter-point increase in the fed funds rate at the March meeting was neither data dependent nor made at that meeting. The action fits our model of Chair Yellen leading her

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committee from behind: As in 2015 and 2016, acknowledge the general principle that rates should rise, mostly find reasons to put off the event, and on occasion accede to make sure that the pack does not get too far ahead. The difference this year is that three hikes (provisionally) have to be squeezed into four press-conference meetings.

There are reasons to delay, to be sure, including breaking developments on fiscal policy, looming European elections, and the snapback of the Treasury debt ceiling ten hours after the Fed announcement. Besides, for a dovish chair, a tightening delayed may never come. But too many FOMC participants saw the same sequence the prior two years and apparently wanted to take one firming to the bank when they have the chance. Yellen's reluctance to be rushed was evident in her press conference performance. They will have two more chances this year, probably September and December, and do the same in 2018. We see the funds rate target leveling off at 3 percent in early 2019. Between now and then, probably mid-2018, the Federal Open Market Committee will toggle back on its repurchase of maturing and prepaying securities in its portfolio.

| Euro Area | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 1.6% | 1.4% | ↑ | 1.3% | – |
| Inflation | 0.2% | 1.3% | – | 1.1% | – |

Source: Standish as of March 10, 2017

According to the manufacturing and services Purchasing Managers' Indices in Europe, the business cycle is roaring, rising to 55.5 and 55.4, respectively, in February. To be sure, the soft survey data is rather ubiquitously letting us know that the European economy is in a cyclical upswing right now, led by the manufacturing cycle and Germany, more specifically. However, the hard data such as industrial production and retail sales has yet to confirm this positive story. Therefore, we are reluctant to jump into a major forecast upgrade until the hard data tells us too. As is prudent, though, we are upgrading our balance of risks to the upside this month. Looking into 2H 2017, we are comfortable with our below consensus inflation forecast given that we do not believe the food and energy price trajectory justifies the consensus 2017 inflation forecast of 1.6%. To be sure, the more robust cyclical momentum could produce a higher than expected inflation path into 2018; but with core inflation sitting below 1% and real wage growth falling, we see no reason to follow the herd and upgrade our inflation trajectory. Therefore, if Mario Draghi is unable to fight the more hawkish members on the committee, we will see this as an opportunity for trades rather than a hiccup to our forecast precision. Looking forward, slowing real income growth is likely to hold back consumption, while slightly expansionary government spending from Germany should support domestic demand. Net-net the recovery should stabilize in the 1.3% quarterly pace in the second half of 2017.



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Inflation forecasts are yearly annual averages of headline CPI.

| Japan | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 1.0% | 1.0% | – | 0.8% | – |
| Inflation | -0.1% | 0.9% | – | 1.1% | ↓ |

Source: Standish as of March 10, 2017

Sentiment and activity indicators continue to point to an economy that is gradually on the mend: Labor markets tightened further, consumer confidence and corporate profits continue to improve on a trend basis, and business sentiment anticipates an upturn ahead–after some pullbacks in the last month. Meanwhile, core inflation has turned positive again, for the first time since the end of 2015; and corporate cap-ex should resume its pick-up on firming business sentiment, following from greater comfort around US-Japan relations, and improving external demand. In this backdrop, economic growth should be maintained at an above potential pace of around 1% year-on-year, and a bit lower in 2018 as the effects of the government fiscal stimulus begins to wane. For now, we expect no near-term changes in the Bank of Japan's (BoJ) monetary policy, over the next 1-2 quarters. But the widening gap between UST and JGB yields, the increasing need to begin balance sheet normalization, and the renewed risk of currency conflict with the US should pressure the BoJ to becoming less accommodative. Rising inflation in line with the BoJ's dot-plots should make the task of policy normalization a bit easier. However, a failure to sustain a regeneration of inflation would raise pressures on the policy framework. We think the risks to Japan's growth and inflation outlook are fairly balanced for now, but inflation risks are tilted lower in 2018—by which time policy normalization looks more plausible.

| United Kingdom | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 2.0% | 1.5% | ↑ | 1.3% | ↑ |
| Inflation | 0.7% | 2.5% | ↑ | 2.0% | – |

Source: Standish as of March 10, 2017

In contrast to expectations, the UK government has not softened its Brexit stance in the run-up to the triggering of Article 50 in late March. It is now our base case that the UK will exit the EU in spring 2019, exiting both the single market and the customs union as part of its 'divorce'. The UK is seeking a deep and comprehensive free trade agreement to cover both goods and services, although intentions regarding the financial services industry are less clear. It is unlikely that such an intense agreement can be fully agreed by spring 2019, so a transitional relationship is likely to be agreed first and then a framework for developing the final agreement. Recent actions within the House of Lords suggest that there will be Parliamentary votes on any new relationship before the UK exits the EU, and there are significant risks of a second independence referendum in Scotland in autumn 2018 and perhaps even a border poll in Northern Ireland.

Given French and German elections in 2017, we are unlikely to get much information until late 2017 – hence our benign Brexit outlook for 2017 and upgrades to growth. The economy has largely developed in-line with expectations, although Q4 GDP printed higher than expected at



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0.6% quarter-on-quarter, once again driven by private consumption. Inflation has risen significantly on base effects and now stands at 1.8% in January (up from 1.2% in November).

**Australia and New Zealand:**

| Australia | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 2.5% | 2.5% | ↓ | 2.2% | ↓ |
| Inflation | 1.3% | 1.9% | – | 2.0% | – |

Source: Standish as of March 10, 2017

| New Zealand | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 2.8% | 2.8% | – | 2.6% | – |
| Inflation | 0.7% | 1.4% | – | 2.0 % | – |

Source: Standish as of March 10, 2017

The lift in Australia's bulk commodity export prices has begun to flow into the economic data – pushing the trade balance into surplus and narrowing the current account deficit. A broad-based lift in Q4 GDP and encouraging business surveys puts Australia on firmer footing going into 2017. Core inflation remains below target, but some of the higher frequency leading indicators point to potential for upside surprise in the Q1 inflation data that is released in May.

However, the headwinds facing Australia's economy have not dissipated. The post-mining boom transition is ongoing, and the economy and labor market are still re-adjusting. While the unemployment rate is grinding lower, the underemployment rate remains elevated, jobs growth is concentrated in part-time work and services, and wage growth is subdued.

The rising terms of trade, which can be attributed largely to higher iron ore and metallurgical coal prices, has provided some near-term relief. That said, we question the sustainability of iron ore and coal prices at these levels. While indicators of Chinese demand for these commodities has been better than expected, it is not clear whether that demand will continue at the same pace into 2018. Therefore we are keeping a close eye on the Chinese property sector, infrastructure investment, steel production, and inventory stockpile data to better assess the price outlook for Australia's commodity exports. Australia's exports will contribute strongly to growth again this year and next, and more volumes come online from new natural gas and coal projects.

In New Zealand, strong economic performance continues – but we think that interest rate hikes from the Reserve Bank of New Zealand are not likely until 2018 due to headwinds from a high trade-weighted New Zealand dollar, housing imbalances, and low inflation backdrop.



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## Emerging Markets:

### Asia:

| China | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 6.7% | 6.4% | ↑ | 6.0% | – |
| Inflation | 1.8% | 2.1% | ↑ | 1.9% | ↓ |

Source: Standish as of March 10, 2017

The National People's Congress (NPC) was convened recently to finalize the implementation plan for this year's economic and regulatory policies. The NPC meetings confirm a shift toward ensuring more financial stability, and a bit more reform, through 2017. This was evidenced by a gradual lowering of the country's GDP growth target to "around 6.5%." In support of this objective, the authorities also mildly lowered the growth targets of M2 and Total Social Financing; whilst also advancing further cuts in excess capacity in key industrial sectors. Fiscal policy support will remain important for limiting downside risks to growth, as will a final round of debt-swaps—for easing, and terming-out, the debt servicing burden of local governments. Additional features of the authorities' countercyclical efforts will include more public-private partnership projects to boost infrastructure investment, and a growing emphasis on debt-to-equity swaps to restructure Chinese banks' exposure to questionable assets and shadow bank intermediaries. The NPC was notably silent about the run up in property prices, but given various other officials' expression of concern, we still expect property market regulations will be tightened this year. We also expect tougher regulations to limit speculative activity in commodity futures, a curtailment of excessive risk-taking through wealth-management products, and bit more official tolerance of corporate bond defaults. But we do not expect a wholesale shift in policies to bring about outright de-leveraging. The State Council's acquiescence of further increases in onshore interest rates will persist insofar as it anchors inflation expectations and stabilizes interest-rate differentials with US rates and, thereby, limits currency pressures. In view of less policy accommodation and tighter regulations, we expect GDP growth to slow to 6.4%. But we do see more upside risks to our baseline view on account of improving external demand and a socialization of funding risks which could slow the expected deceleration in the country's long-term growth path. The main tail-risk to the macro outlook arises from the outbreak of trade protectionism between the U.S. and China, under a Trump-presidency.

| South Korea | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 2.6% | 2.5% | ↓ | 2.8% | – |
| Inflation | 1.0% | 1.5% | – | 1.5% | – |

Source: Standish as of March 10, 2017

Improving external demand has spurred a sharp re-bound in exports and industrial production. The end of production setbacks at Samsung and auto strikes at Hyundai have also helped. But the country has been buffeted by a series of political shocks which continue to depress domestic sentiment and demand. First, is the political vacuum brought on by the impeachment of President Park which is expected to be resolved by subsequent elections, but

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no earlier than mid-2017. Second, are rising tensions with North Korea which has continued to provocatively test its nuclear and missile capability. Finally, Chinese restrictions on imports of South Korean goods and services, that, if implemented on an extended basis, could hit the economy quite hard. The anti-South Korean actions by the Chinese are in response to the decision by a caretaker government in Seoul to continue to deploy anti-missile defense systems with the help of the US, to safeguard against a possible North Korean offensive, but which China sees as damaging its own national security. Amidst a pick-up in domestic inflation, mainly on higher energy and commodity prices, we do not see much scope for outright monetary easing. Moreover, a meaningful fiscal support and a return to domestic political normalcy could take several more months. These domestic and external political uncertainties are the main reasons for the downward bias to our growth outlook for 2017.

| India | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 7.5% | 7.0% | – | 7.6% | – |
| Inflation | 5.3% | 5.2% | – | 5.0% | – |

Source: Standish as of March 10, 2017

The economy is undergoing a cyclical recovery from de-monetization, which should last another quarter or so. But headline rates of growth seem to have been less direly impacted than was earlier feared, reflecting a higher velocity of narrow money and a sizable shift to non-monetary transactions. The firmness in asset prices also suggests a milder than expected hit from de-monetization. That being said, we expect de-monetization will lower informal economic activity to some degree. Along with goods and services tax (GST) implementation, later in the year, it should also broaden the country's tax base and raise the share of financial savings (as % of GDP). Over the medium-term, these should also lower the risk of economic overheating. The ongoing state elections should yield mixed results for the BJP, and is unlikely to alter its governance or reform priorities. The authorities will want to ensure full recovery from de-monetization and smooth implementation of GST. We think the Modi administration will become cautious about politically risky reforms in the run up to the 2019 general elections. In the meanwhile, the authorities will strive to stay on the path of gradual fiscal consolidation and a neutral monetary policy stance. These should limit inflation, despite rising oil and commodity prices, and begin to anchor medium-term inflation expectations.



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**Latin America:**

| Brazil | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | -3.6% | 1.1% | ↓ | 1.5% | ↑ |
| Inflation | 6.3% | 4.3% | ↓ | 4.7% | ↓ |

Source: Standish as of March 10, 2017

| Mexico | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 2.3% | 1.2% | ↓ | 2.5% | ↓ |
| Inflation | 3.4% | 5.0% | ↑ | 2.9% | ↑ |

Source: Standish as of March 10, 2017

The new US administration is bringing new challenges to the global growth and trade environment, particularly for a few Latin American countries. Number one in the line of fire is Mexico, where threats of a hard renegotiation of NAFTA and limits to immigration have contributed to send the Mexican peso swooning and forced hard choices in monetary policy. Although the more recent signals are that such negotiations will be more conciliatory and will not take place until the second half of 2017, at the earliest, the damage on business confidence in Mexico has been large and economic growth is now expected to be much closer to 1% than the near 3% originally anticipated by the authorities. Broadly, the impact of these changes in direction from the US divides Latin America in two: a northern part, including Central America, the Caribbean and Mexico, which will be negatively affected by trade and immigration changes, and a southern one, where most of South American countries are expected to recover and benefit from stable commodity prices. In the second group, Argentina continues to lead with signals that the regime change will lead to a recovery with decelerating inflation and supported by capital inflows. Brazil, although it has disappointed with a deep recession in 2015 and 2016 which has erased more than 7% of GDP, has made unprecedented inroads against inflation and a turnaround in the current account. Growth in Brazil is expected to recover this year, but still at a very low rate. In contrast, Chile, Colombia and Peru should see accelerating growth, around 2.5% in the case of the first two and more than 4.5% in the case of Peru. In general, lower inflation is the success story across most of these countries, where price increases are expected to come close to the central banks' targets. The notable exception is Mexico, where devaluation pass-through and adjustments to energy prices will reverse recent gains and will cause a spike in consumer prices to levels not seen since at least 2012. In general, current account deficits are within manageable levels and moving to lower levels in countries such as Colombia and Chile, where commodity exports took a hit during the recent price decline. As the latter stabilize and recover, most of Latin America will benefit from the external sector with the exception of, again, Mexico, where oil production is dropping on account of liquidity pressures in the state oil company.



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**Russia, Turkey, South Africa, CEEMEA:**

| Russia | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | -0.5% | 1.2% | ↑ | 1.5% | – |
| Inflation | 7.1% | 4.0% | ↓ | 4.0% | – |

Source: Standish as of March 10, 2017

| Turkey | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 2.2% | 2.0% | – | 3.0% | – |
| Inflation | 7.8% | 8.0% | ↑ | 8.0% | – |

Source: Standish as of March 10, 2017

| South Africa | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 0.5% | 1.2% | ↓ | 1.5% | ↓ |
| Inflation | 6.2% | 5.5% | – | 6.0% | – |

Source: Standish as of March 10, 2017

| Poland | 2016 | 2017 | Balance of Risks | 2018 | Balance of Risks |
|---|---|---|---|---|---|
| Real GDP Growth | 2.8% | 3.2% | ↑ | 3.0% | ↑ |
| Inflation | -0.6% | 1.6% | ↑ | 2.0% | – |

Source: Standish as of March 10, 2017

Focus remains on Turkey as in late 2016, particularly as they head towards the referendum on constitutional change on April 16th. The Standish base case is for a narrow victory for the YES campaign approving the constitutional change, with a probability of 40%). This would mean snap early elections are avoided and political premium in Turkish assets declines as with no further elections until 2019, focus could return to the economy and structural reforms. Tail risks are of a strong NO vote (10% probability) which could lead to snap early elections, and a significant sell off in Turkish assets.

While nominally polls look close to 50/50, when one goes into the detail – there are clear indications that a YES vote is likely to prevail. Currently around 20% of the electorate is undecided, and using previous elections and poll movements as a guide – one can argue that 2/3 of these undecided voters will vote YES. This is due to personal concerns that a NO vote will be revealed and impact on employment prospects, a NO vote could be seen as voting against political stability, a NO vote could lead to further TRY depreciation etc. Turnout is expected to be high – around 80% – and will also be crucial to the outcome. This is especially the case for far-right MHP supporters whose votes are needed to secure a YES victory for Erdogan.

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