The House View

Snapshot

Macro views

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World</td><td>

- Robust, broad-based global expansion continues, albeit at a decelerated pace. Synchronised growth across regions and economies, in many cases at above-trend levels. We expect global growth to rise to +4.0% this year, marginally above 2017, as fundamentals remain supportive.
- Europe has already begun to slow and we expect China to similarly decelerate later this year. 2018 should mark the peak of the current cyclical expansion; growth should slow down broadly from 2019.
- Attention has focused on potential trade conflicts between major economies. The situation has escalated more quickly and significantly than expected thus far, but we continue to expect cooler heads to prevail and a more acute crisis to be avoided.

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United States</td><td>

- Growth to accelerate in 2018 to an annual pace of +2.9%, the fastest since 2005, boosted around 0.7pp by the combination of tax cuts and increased government spending.
- Economic momentum remains very strong and supports our above-consensus expectations for growth this year. The latest survey data signal very robust sentiment and healthy activity in the first quarter, and financial conditions remain supportive of growth despite recent volatility.
- Recent wage and price data supports our expectation for inflation to surprise to the upside this year. Labour markets have tightened and little slack remains, so growth will become increasingly inflationary this year.
- The dollar has weakened despite reduced accommodation from the Fed. This should add a few tenths of a percentage point to both inflation and growth this year. We expect this trend to continue, as the US fiscal and current account deficits continue to widen in unison.

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Eurozone</td><td>

- Eurozone momentum has softened lately, though we still forecast +2.4% growth for 2018, marginally higher than consensus and significantly above potential.
- As we have previously highlighted, the pace of growth is far above our estimate of potential growth (around +1.0%) and is therefore unsustainable. Cyclical momentum will naturally decline as output gaps close; financial conditions will tighten as the ECB withdraws accommodation; the boost from net exports will fade as Asia decelerates; and the stronger euro will drag on growth.
- While current economic momentum remains at a high level, economic surprises have dropped to their weakest level in years. This weakness may continue in the near term, surprises should bounce back over the next few months.

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China</td><td>

- We still expect China's economic growth to slow down +6.6% this year, though the risks have become more balanced. Fiscal policy has remained robust, boosted by healthy land sale volumes which have offset planned tightening. Still, we expect policy to become less supportive through the rest of this year.
- Recent PBoC cut in the reserve requirement ratio should not be seen as a change of monetary policy stance. Its main purpose is to ease financing costs on small banks and businesses, without injecting a net increase in liquidity.
- A potential trade war remains an important downside risk. In our most bearish case, where the US imposes broad 45% tariffs on all imports from China, Chinese growth would likely slow by up to 2.5 percentage points.
- We expect CNY to stay broadly stable through 2018; tighter than expected capital controls have limited outflows.

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Emerging Markets</td><td>

- EM growth is accelerating and inflation is rising, though trade war-related disruptions remain a key downside risk, especially for Asian economies with deep supply chain linkages with China.
- With the gradual tightening of monetary policy in DM, higher rates could weigh on EM, but this does not outweigh our constructive view of fundamentals. Inflows have remained resilient.
- Political stories remain key drivers in Turkey and Russia, while upcoming elections will continue to be relevant in Colombia, Peru, Mexico, and Brazil.

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<tr><td>Monetary Policy</td><td>

- Fed: expect 3 more rate hikes this year, more than FOMC guidance and than market pricing.
- ECB: slow exit to continue. No new measures until mid-year; QE to end in 2018, first hike in mid-2019.
- BoJ: not under pressure to act; no change expected in target short rate or yield curve control policy.
- BoE: no policy change through 2018; risk is earlier tightening, with May hike possible.
- PBoC: policy tightening to curb financial risks, followed by some easing in H2-2018 if inflation allows.
- EM: rate hikes especially in Asia, while LatAm central banks have space to ease policy.

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<tr><td>Key downside risks</td><td>

- Escalation of trade restrictions: more intense and broad trade restrictions depress growth, raise prices.
- Higher than expected inflation leads central banks to raise interest rates faster, disrupting markets.
- Global growth disruption: global equity correction weighs on sentiment / wealth, triggers a recession.
- China slowdown: higher inflation, policy mistake, or financial stress leads to sharp growth slowdown.

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Key themes

- Trade wars: a full blown trade war between the US and China is the major risk facing the global economy. Rhetoric may escalate further, but we continue to believe that policymakers will avoid an economically adverse outcome
- Cyclical recovery reaches its peak: global growth will accelerate in 2018, but for many countries growth will plateau or decelerate this year. As such, 2018 should mark the peak of the current cyclical expansion, and growth should decelerate from 2019
- Slow-burning issues: focus will continue to remain on a range of slow-burning issues: trade protectionism, populism and politics, the peak of global growth, rising inflation, and tech company regulation
- Exit of ultra-loose monetary policy: major central banks clearly on exit path, Fed to continue hiking; ECB to end QE and move toward rate hikes; and BoE to likely hike rates next month
- Episodic volatility: average volatility should remain low, but volatility spikes to become more frequent as markets adapt to withdrawal of monetary stimulus
- Steady inflationary pressures: with tight labour markets and closing output gaps, price pressures will continue to build. Core inflation to grind higher toward targets in US, Eurozone. In EM, energy and food prices may rise, partially attributable to positive base effects, pressuring headline inflation
- Populism and political risk: government formation talks progress in Italy. Brexit negotiations continue ahead of the March 2019 deadline. We do not expect material macro or market impact from either

Market views

Market sentiment

- Markets remain pressured by trade and growth risks
- Fundamentals remain supportive, sell-off overdone in many cases

Equities

- Strong growth (albeit slowing), low rates (albeit gradually rising) supportive for equities. We see upside into year-end, especially in the US
- Equity correction is overdone versus fundamentals. Sentiment has been adversely impacted by trade, geopolitics, and tech-specific headlines, but these will all be transitory.

Rates

- Strategically bearish in US and Europe. Inflation to finally rise in medium-term, scope for more aggressive central bank tightening than currently priced
- More cautious near-term given extreme short positioning, high valuations

FX

- Fed's monetary policy tightening to be offset by combination of (i) US vulnerable external position and (ii) fiscal and trade policy that are dollar-negative
- Flipside of bearish dollar view; expect break above $1.30 this year
- Scope for further yen strength as external financial position improves, currency remains undervalued

Credit

- Strong economy and low volatility still supports credit fundamentals but negative technicals (ECB taper, Fed hikes, more frequent volatility spikes) to put negative pressure on credit spreads

EM

- Constructive on EM due to benign local inflation and above-trend growth, though we are alert to downside risks related to trade and global growth
- We prefer rates and credit to equities and FX, though we differentiate based on idiosyncratic details between countries

Oil

- Demand and supply looks largely balanced over the medium term, so we expect prices to retreat moderately to $65 per barrel and to remain broadly stable over the next few years

Key macro and markets forecasts

GDP growth (%)

	2016	2017F	2018F	2019F
Global	3.2	3.8	4.0	3.9
US	1.5	2.3	2.8	2.7
Eurozone	1.8	2.5	2.4	1.7
Germany	1.9	2.2	2.3	1.8
Japan	0.9	1.7	1.1	0.5
UK	1.9	1.8	1.3	1.5
China	6.7	6.9	6.6	6.3

Central Bank policy rate (%)

	Current	2017	2018F	2019F
US	1.50-1.75	1.25-1.50	2.25-2.50	3.25-3.50
Eurozone	0.00	0.00	0.00	0.50
Japan	-0.10	-0.10	-0.10	-0.10
UK	0.50	0.50	0.75	0.75
China	1.50	1.50	1.50	1.50
India	6.00	6.00	6.00	6.75

Key market metrics

	Current	Q1-18	Q2-18	Q4-18
US 10Y yield (%)	2.98	2.73	3.00	3.25
EUR 10Y yield (%)	0.63	0.49	0.75	1.25
EUR/USD	1.22	1.23	1.24	1.28
USD/JPY	108	106	102	105
S&P 500	2,674	0	0	3,000
Stoxx 600	382	0	0	395
Gold (USD/oz)	1,323	1,330	1,300	1,260
Oil WTI (USD/bbl)	67	63	62	60
Oil Brent (USD/bbl)	73	66	67	65

Current prices as of 23 Apr, 2018

Recent publications

- The House View: Trade wars and more, 16-Apr-2018
- The House View: Slow-burning issues, 13-Mar-2018
- The House View: A healthy pullback, 7-Feb-2018