

# GLOBAL MACRO OUTLOOK

## AUGUST 2019

### KEY FORECAST TRENDS

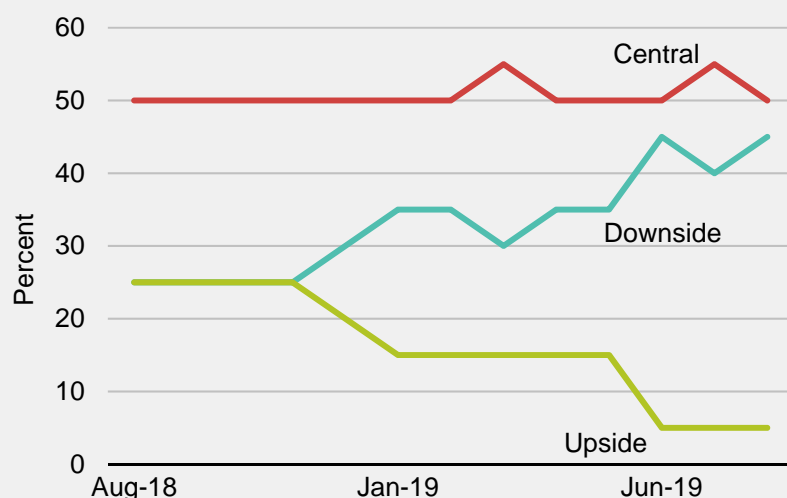
- + President Trump's surprise decision to impose additional tariffs on China adds to our conviction that markets are too sanguine about trade tension, broader populist risks and, ultimately, the probability of global recession—which remains uncomfortably high, in our view.
- + The net result is likely to be more monetary stimulus: higher tariffs on China means more easing in the US and China, while (possible) tariffs on European goods would mean more easing from the European Central Bank (ECB).
- + But investors should take little comfort from this at a time when monetary-policy effectiveness is declining across the globe. Indeed, monetary policy may already be broken in Europe and Japan.
- + We see additional risks in coming months. The probability of a no-deal Brexit has risen. And with the US poised to take steps to weaken the dollar, so has the risk of a currency war. Rising conflict between policymakers within and across borders represents a major threat to global economic and financial stability.

### CONTENTS

<b>Global Forecasts</b> .....	<b>2</b>
Global Market Outlook	
Yield Curves .....	3
Currencies .....	4
US .....	5
Euro Area .....	6
Japan .....	7
China .....	8
Canada .....	9
Australia/New Zealand .....	9
UK .....	10
Norway/Sweden .....	10
Asia ex Japan .....	11
Latin America .....	12
Eastern Europe, Middle East and Africa (EEMEA) .....	13
Frontier Markets .....	14
<b>Forecast Tables</b> .....	<b>15</b>
<b>Contributors</b> .....	<b>16</b>

### Risks Heavily Skewed to the Downside

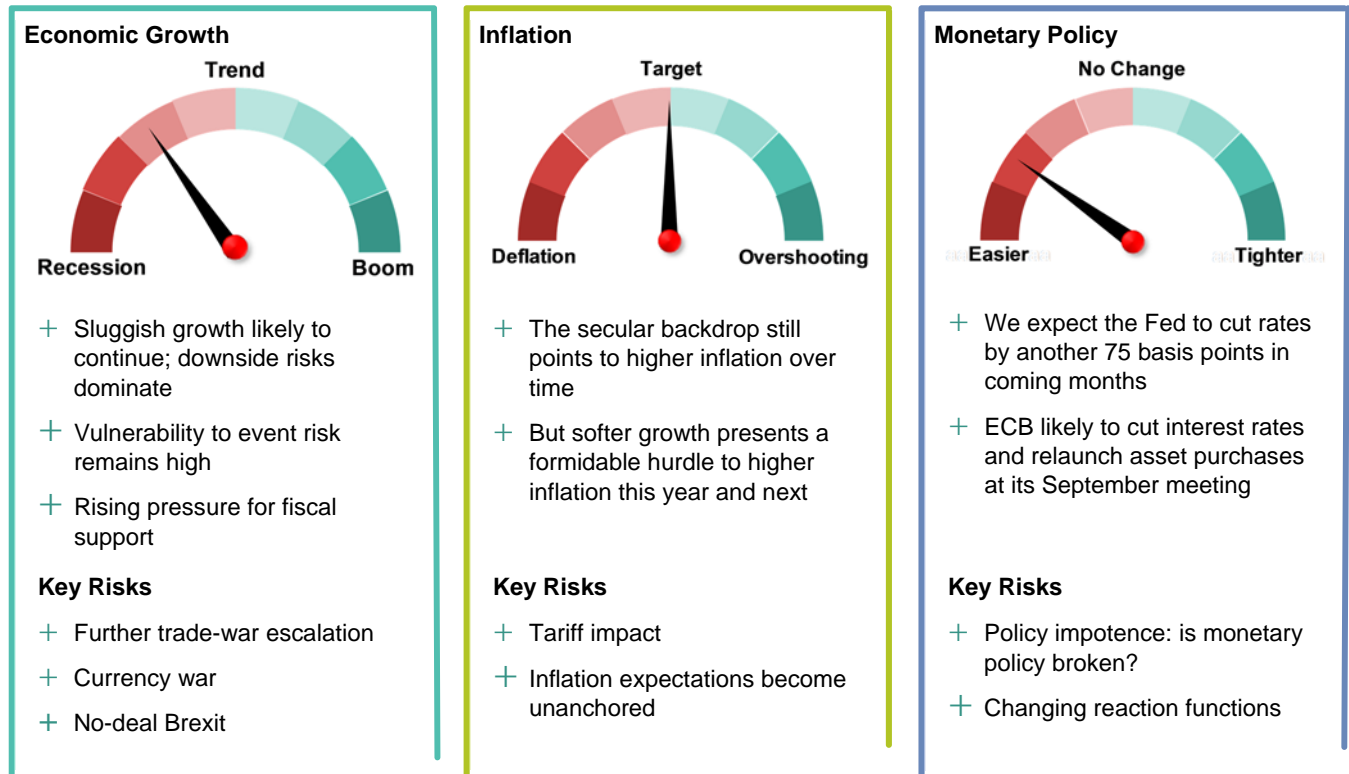
#### AB Scenario Probabilities



As of July 31, 2019  
Source: AB

- + Our central case is for soft global growth at around 2.5% both this year and next. But risks to this forecast are heavily skewed to the downside.
- + Downside risks have risen steadily in recent months and the probability of a much weaker growth trajectory now stands at 45%, in our view.
- + That's an unusually high number given that growth is already quite weak. It would not take much to tip the global economy into recession.

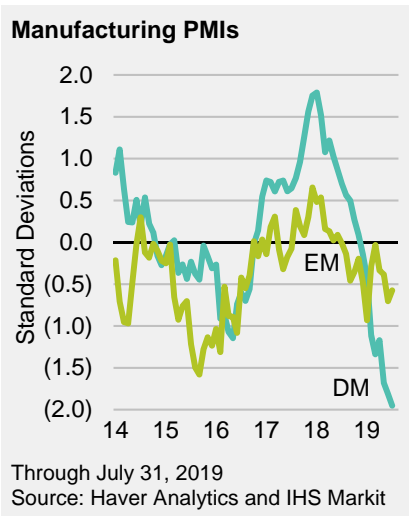
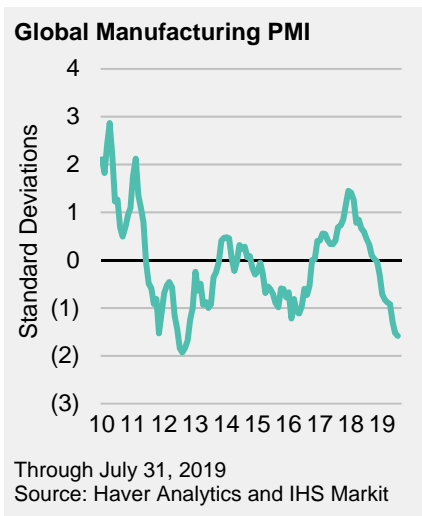
## GLOBAL FORECASTS



## OUTLOOK

- + We expect the global economy to grow by 2.6% this year and next. This soft performance reflects a weak secular backdrop and rising cyclical headwinds.
- + Risks to this outlook are heavily skewed to the downside. We're most concerned about open economies with limited policy flexibility. That puts the spotlight firmly on the euro area, which we expect to grow by just 1.0% next year.
- + The secular backdrop continues to point to higher inflation. But cyclical developments point in the opposite direction. We expect global inflation to fall to 2.7% in 2019 from 2.9% this year. That's despite an acceleration to 2.5% in the US.
- + Central banks have abandoned their plans for policy normalization. We expect the Fed to cut rates by another 75 basis points (b.p.) and the ECB to couple modest rate cuts with additional bond purchases. Policy effectiveness will be key.

## Global Cyclical Outlook: Close to Postcrisis Lows



## GLOBAL MARKET OUTLOOK: YIELD CURVES

### GLOBAL YIELDS

**Global**—Bond yields in many markets have fallen to record lows. But with growth weak, risks to the downside and central banks around the world likely to inject more monetary stimulus, the case for a near-term increase in yields is weak.

**US**—US yields have pushed even lower as concern about low inflation and poor global growth has mounted. We remain cautiously optimistic that the worst outcomes will be avoided and thus expect a modest rise in yields over the medium term. But a near-term trigger is hard to find, so it may well be some time before the move higher begins.

**Euro Area**—With the ECB likely to cut rates and announce additional bond purchases at its September Council meeting, the case for higher Bund yields has disappeared.

**Japan**—Quantitative and qualitative easing with yield-curve control (QQE-YCC) to anchor 10-year yields close to zero over the forecast horizon.

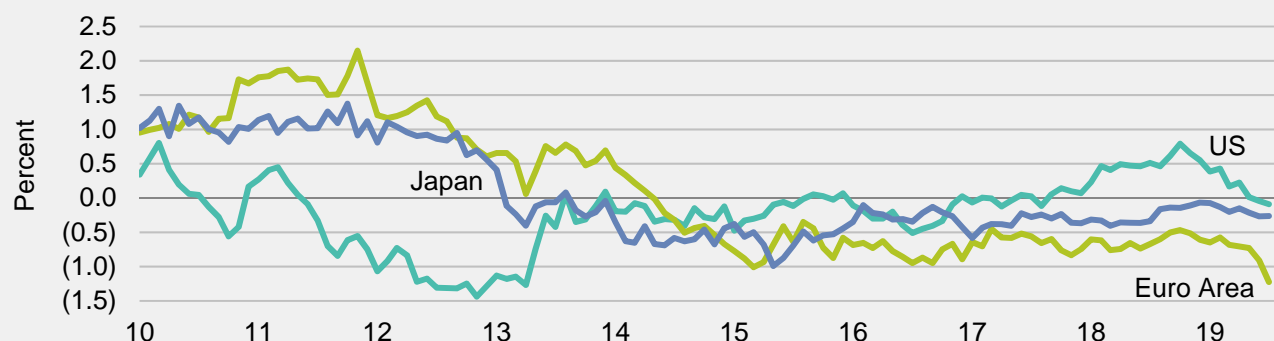
#### 10-Year Yields: AB vs. Consensus Year-End Forecasts (%)

	AB		Consensus	
	2019	2020	2019	2020
<b>US</b>	2.30	2.50	2.15	2.27
<b>Euro Area</b>	(0.25)	(0.25)	(0.16)	0.18
<b>Japan</b>	(0.10)	0.00	(0.10)	(0.01)
<b>China</b>	3.10	3.00	3.02	2.87

As of July 31, 2019

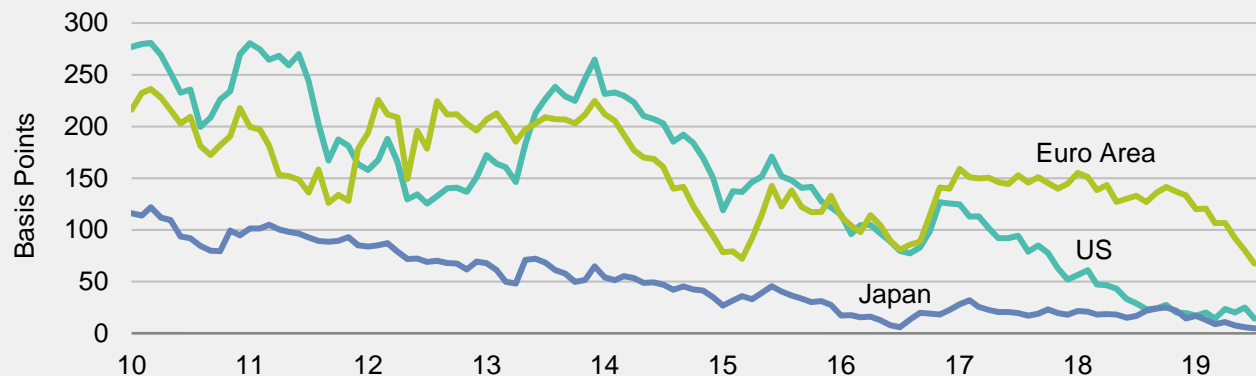
Source: Bloomberg and AB

#### Real 10-Year Bond Yields\*



\*Current 10-year bond yield less five-year/five-year forward inflation swap

#### Yield Curves: 10-Year Bond Yield Less Two-Year Bond Yield



Source: Bloomberg and AB

## GLOBAL MARKET OUTLOOK: CURRENCIES

### FX FORECASTS

**USD**—Fed rate cuts and possible currency intervention point to a softer dollar. But other central banks are also likely to ease policy in coming months, and the prospect of a currency war clouds the outlook.

**JPY**—The yen should benefit as risk-asset headwinds intensify.

**EUR**—Weak growth, a new round of ECB asset purchases and the rising risk of a no-deal Brexit means there are few reasons to buy the euro.

**CNY**—The CNY outlook remains heavily dependent on the US/China trade war.

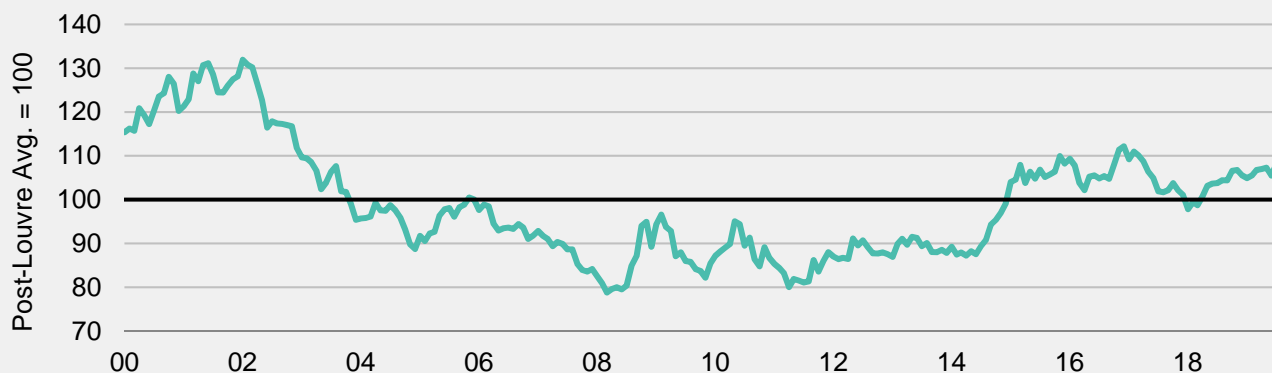
**Global FX: AB vs. Consensus Year-End Forecasts (%)**

	AB		Consensus	
	2019	2020	2019	2020
EUR/USD	1.13	1.13	1.15	1.18
USD/JPY	102	100	105	105
USD/CNY	6.90	6.90	6.90	6.75
EUR/GBP	0.90	0.90	0.88	0.87

As of July 31, 2019

Source: Bloomberg and AB

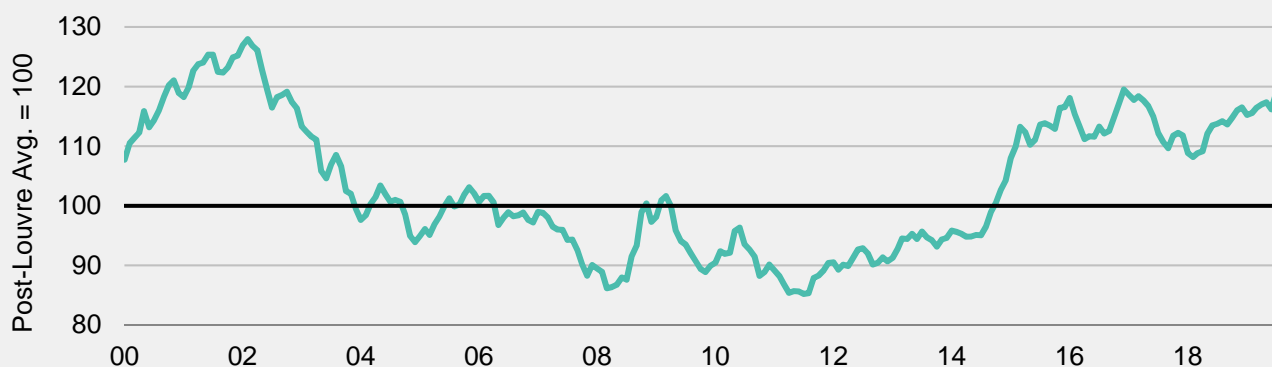
**Nominal USD Exchange Rate: DXY**



Through July 31, 2019

Source: Bloomberg and AB

**Real USD Exchange Rate**



Through July 31, 2019

Source: Bloomberg and AB

## US

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
US	2.0	1.8	2.3	2.5	1.88	1.38	2.30	2.50

### OUTLOOK

- + The economy slowed modestly in the second quarter and looks likely to do more of the same in the coming months. Still, the growth picture remains relatively solid all in all, with the labor market robust and consumption remaining strong.
- + Inflation remains subdued, and inflation expectations have fallen such that they are no longer consistent with the Fed's 2.0% target. We believe that falling inflation expectations are the foremost threat to the long-term health of the economy.
- + Persistent trade tensions and a challenging global environment mean that the balance of risks around the outlook is decisively negative. That, combined with the decline in inflation expectations, prompted the Federal Open Market Committee FOMC to cut interest rates in July. We expect more easing in the coming months, though Fed Chair Jerome Powell went to great lengths to emphasize that the easing we expect should be thought of as a midcycle adjustment rather than signaling the end of the expansion.

### RISK FACTORS

- + Trade policy remains unpredictable and is already weighing on business investment decisions. Further escalation of tensions between the US and China, spreading of the trade war to include Europe or Japan, and even the onset of a currency war all remain very real possibilities, and all would be disruptive to the economy.
- + We view the Fed's rate cut as appropriate and expect more easing. We remain skeptical that monetary policy easing will be enough to offset the headwinds from trade policy and the weak global economy over the longer term.

### OVERVIEW

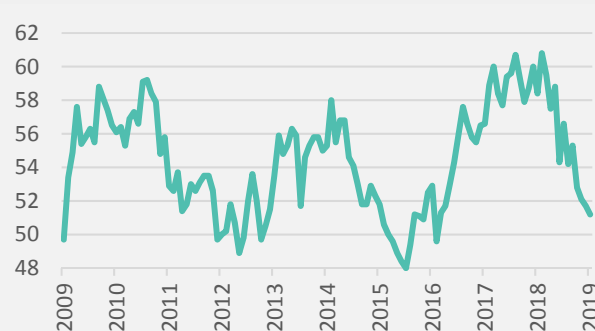
The last few months have been volatile, with policy-induced headwinds to growth only partially offset by the tailwind from more accommodative monetary policy. The balance between those variables remains a difficult one to strike, and the success or failure of policymakers to strike that balance will define the next several quarters. The good news is that the economy is for now in a solid position, underpinned by robust labor markets and strong consumption. The bad news is that business investment and sentiment are suffering at the hands of unpredictable policymaking. Financial markets seem to be operating on the assumption that monetary policy will succeed in offsetting the negative risks. We think that it is a much closer call than the market seems to appreciate. We view trade policy as only one part of a broader shift toward populism, and we expect that populism will drive politics and the political economy for the next several years at least. With interest rates already low by historical standards, the firepower available to the Fed is more limited than in past cycles. It will take no small amount of skill to navigate the choppy waters ahead and the Fed's recent communication foibles give us reason to worry that they may not be up to the task. For now, the slowdown remains manageable, but we think the economy is more fragile than the data alone would suggest.

**US Domestic Private Fixed Investment**



Through May 15, 2019  
Source: Refinity Datastream

**ISM Manufacturing Index**



Through July 15, 2019  
Source: Refinity Datastream

## Euro Area

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
Euro Area	1.3	1.1	1.3	1.3	(0.65)	(0.65)	(0.25)	(0.25)	1.13	1.13

### OUTLOOK

- + The euro-area outlook remains challenging. We expect the economy to grow by 1.0% next year, significantly less than the ECB's latest forecast of 1.4%, with risks heavily skewed to the downside.
- + The ECB has abandoned its plans to normalize monetary policy and is likely to ease policy at its September Council meeting. We expect a 10-15 basis point reduction in the deposit rate and a new quantitative easing program at a monthly purchase pace of at least €30 billion until at least the end of 2020.

### RISK FACTORS

- + Risks are heavily skewed to the downside. While the domestic economy remains resilient, it's not clear how long this would last in the face of sustained external weakness.
- + The euro-area countries are open economies with low policy flexibility. As such, they are particularly vulnerable to a sustained slowdown in global trade growth due to a prolonged period of trade tension.
- + The risk of a no-deal Brexit is an important downside risk for the euro area.

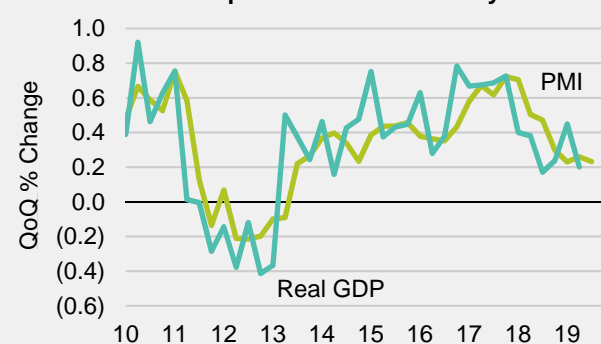
### OVERVIEW

The ECB left policy on hold at its July press conference but altered its forward guidance to reintroduce an easing bias—rates will now remain at present or “lower” levels until at least the middle of next year—and tasked the relevant committees to look at the best ways of adding fresh stimulus, including new asset purchases. We expect a 10-15 basis point reduction in the key deposit rate, pushing it deeper into negative territory, and a new QE program at a monthly pace of €30bn or slightly more until at least the end of next year.

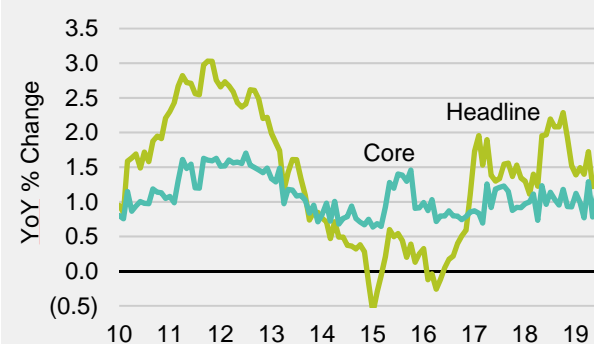
In addition to signaling that policy easing is in the pipeline, the ECB committed itself to a symmetrical inflation target for the first time. This change comes after core inflation has been below target for over a decade, and President Draghi confirmed that this was meant to highlight the ECB's dissatisfaction with persistently low inflation and the complete lack of progress towards target. This is probably the first step toward a formal change in the inflation target itself, which would cement the case for substantial policy stimulus.

We remain skeptical that additional monetary easing will deliver a material lift to either growth or inflation in the euro area. But the ECB doesn't have any choice; the alternative would be to admit that it doesn't possess the tools needed to hit its inflation target, and that's simply not an option. Moreover, the ECB's asset purchases reduce interest rates on government debt and therefore provide more scope for fiscal expansion in the euro area, something that the ECB is keen to encourage. The problem is that most governments are still unwilling or unable to exploit this opportunity—perhaps the ECB's next president, Christine Lagarde, will have the skills to exploit.

**Real GDP and Composite PMI-Based Proxy**



**CPI Inflation**



## Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
Japan	0.6	0.5	0.8	1.2	(0.10)	(0.10)	(0.10)	0.00	102	10

### OUTLOOK

- + The slowdown in global trade has hit Japan's export sector, but the domestic economy is holding up.
- + The labor market remains tight. Even so, progress toward the 2% inflation target has been slow.
- + As other global central banks ease, the Bank of Japan's (BOJ) options remain limited.
- + The prospect of a "currency war" in addition to broadening "trade war" could see a sharply stronger yen.

### RISK FACTORS

- + Apart from October's VAT hike, most of the key risks are external and will likely materialize through a sharp appreciation of the yen.

### OVERVIEW

One of the changes in this month's forecast pack is our incorporation of further strength in the yen. We now have USDJPY at 102 in six months (from 105), and 100 in 2020 (from 105).

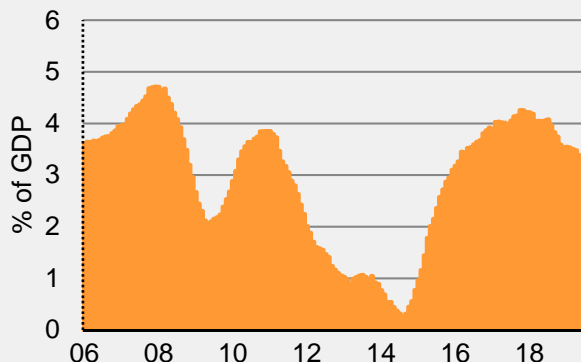
There are three key factors driving that change.

First, it has become clear that there is nothing left in the BOJ's monetary policy toolbox. Despite all the talk of easing policy "without hesitation" – the new BOJ buzz phrase -- it remains unclear what policy initiatives would be effective. Indeed, if easing is just a "tweak," rather than being something substantive, then the risk of it delivering a perverse outcome is relatively high: pushing rates further into negative territory, for example, is likely to accentuate fears around the banking system, with the prospect of undermining growth.

Second, the prospect of currency intervention by the US administration has risen significantly. While there's little doubt that aggressive action could weaken the USD over a short horizon – hours, or days – there has to be a question mark over whether that weakness will be sustained at a time when the world's major central banks are engaged in a race to the bottom. Yes, the dollar screens expensive on many metrics. But it's not clear that positioning is one-sided. And the prospect of a globally cooperative and coordinated approach (as we saw in the Plaza Accord) is close to zero. Indeed, retaliatory action of some sort seems more likely. And so "currency war" ends up triggering a risk-off episode. In that scenario, the yen strengthens.

Third, continuing the risk-off theme, we've raised the odds of a key populist risks – hard Brexit – coming to pass. We are more worried about its consequences (particularly for Europe, against a backdrop of an economy that continues to slow). Once again, the yen is a clear beneficiary in that scenario.

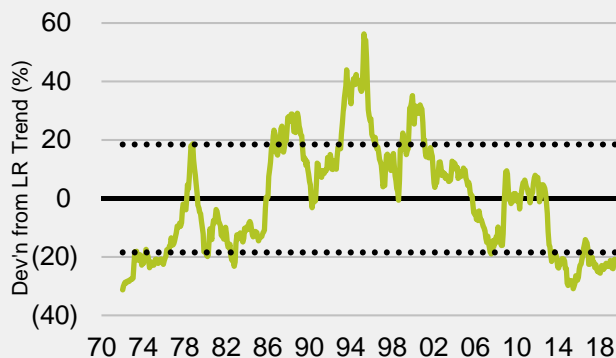
**Current Account Surplus Remains High**



Through August 1, 2019

Source: Bloomberg and Thomson Reuters Datastream

**Japan Real Effective Exchange Rate**



Through August 1, 2019

Source: Thomson Reuters Datastream

## China

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
China	6.2	6.0	2.5	2.4	4.35	4.10	3.10	3.00	6.90	6.90

### OUTLOOKS

- + The official Chinese real GDP growth rate will likely be around 6.2% in 2019, down from 6.6% in 2018, as weakness in capex spending persists.
- + We expect continued monetary and fiscal policy easing to counter downward pressure on the economy. The focus will likely be on infrastructure projects and property easing—the measures most likely to help stabilize the economy.
- + Rising pork prices may push up inflation, but we think that the increase will not constrain the central bank's monetary policy easing.

### RISK FACTORS

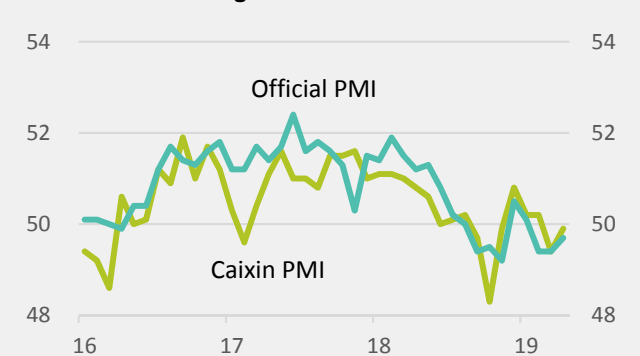
- + Policy easing may be less effective than expected if economic data surprise significantly to the downside. This would put sustained economic stabilization this year and next at risk.
- + An underwhelming US-China trade deal—if one comes at all—would be another risk for China's economy.

### OVERVIEW

Trade-related uncertainty has made Chinese capex expansion less likely. We still think that China has enough ammunition when it comes to easing policy. On the monetary side, that includes the ability to cut the reserve requirement ratio (RRR), or the benchmark interest rate equivalent, such as Medium Lending Facility Rate (MLF) or the Prime Lending Rate. On the fiscal side, the government can issue more special local government bonds. The official target is CNY 2.1 trillion for 2019, but we think that the government can do more, as infrastructure projects are most effective in stabilizing growth.

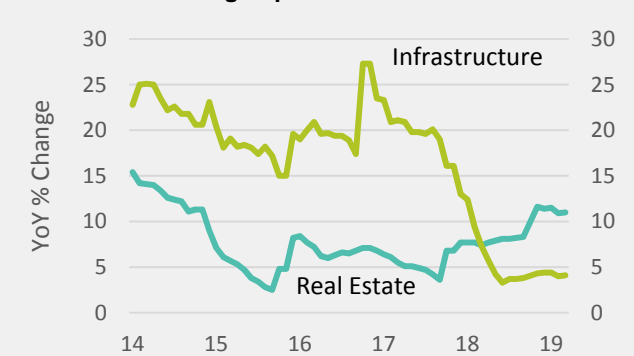
If the Chinese economy stabilizes this year—and we think that it will—China's currency should become a global currency stabilizer. Even so, we cannot ignore the ongoing trade tensions between China and the US. With an escalation of a 10% additional tariff on the remaining US\$300bn in Chinese goods, we think that the USD/CNY exchange rate could break above 7.0, en route to 7.2. RMB depreciation will help Chinese exporters weather the impact of tariffs, to some extent. Further escalation of a 25% additional tariff on the remaining US\$300bn would pose a bigger risk to China and the global economy.

**China Manufacturing PMI**



Through July 31, 2019  
Source: Bloomberg and AB

**Where to Re-Leverage Up**



Through June 30, 2019  
Source: Bloomberg and AB

## Canada

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
<b>Canada</b>	1.8	1.8	2.1	2.2	1.50	1.25	1.75	2.00	1.30	1.28

### OUTLOOK

- + Canada remains on the sidelines in the global trade war, generating no headlines and little market attention. This has allowed the domestic economy to remain in balance, with both growth and inflation close to target.
- + With central banks around the world, most notably the Fed, cutting interest rates, the Bank of Canada has the scope, if perhaps not the urgency, to do the same. We think they are more likely than not to go with the prevailing wind and cut rates later this year.

### RISK FACTORS

- + As has been the case all year, an escalation in the trade war would hurt Canada even if that escalation does not directly involve it. The economy also remains sensitive to global commodity prices, which could suffer if the global economy performs poorly.

### OVERVIEW

Canada is exposed to the global economy, to its detriment just now. Poor global performance has capped Canadian growth, though it has not yet pushed growth lower largely because the US economy remains on relatively good footing. Risks abound, and the question for the Bank of Canada is whether to act preemptively or to wait for something bad to happen first. We expect it to opt for the latter and to move in line with other major central banks. Will it work? That depends on just how bad things get globally. For now, Canada is left to watch and wait since events are largely beyond its influence.

## Australia/New Zealand

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
<b>Australia</b>	1.7	1.7	1.3	1.6	0.50	0.50	1.25	1.35	0.65	0.63
<b>New Zealand</b>	2.7	2.7	1.7	2.0	1.25	1.25	1.55	1.70	0.67	0.65

### AUSTRALIA

- + The Reserve Bank of Australia (RBA) delivered back-to-back cuts in June and July, taking the cash rate down to 1.0%. Forward guidance is clear – rates will remain low (or lower) for an extended period.
- + What happens to unemployment is critical. Despite some post-election relief, we still expect the housing downturn to have a material impact on overall growth, driving the unemployment rate back through the 6s. So expect more rate cuts in the months ahead.
- + We think that there's still further currency weakness to come, and we wouldn't be shocked to see AUD/USD revisiting the 0.63-0.65 region, particularly as iron ore prices pull back from recent highs.

### NEW ZEALAND

- + We continue to think that there is a clear divergence in fundamentals between the Australian and New Zealand economies, with the latter on much firmer footing (in part, a reflection of the housing-sector outlook).
- + Still, persistently lower-than-expected inflation has driven a policy rethink by the central bank, and is likely to see at least one more easing from the central bank.

## UK

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
<b>UK</b>	1.2	1.2	1.8	1.7	0.75	0.75	0.90	0.75	1.25	1.25

### OUTLOOK

- + Brexit continues to dominate the headlines. New Prime Minister Boris Johnson has promised to leave the European Union (EU) on October 31, even if that means leaving without a deal. With the EU unlikely to compromise on the withdrawal agreement reached with Theresa May, the risk of a disruptive Brexit has risen—though Johnson's weak position in Parliament means that a further postponement of the Article 50 withdrawal date still looks more likely.
- + What, though, would a no-deal scenario look like? Although various contingency plans have been made, changing the nature of the UK's trading relationship with the EU overnight would inevitably be disruptive, pushing the economy into recession. The magnitude of the downturn would, however, be limited by an aggressive policy response. We expect the Bank of England to cut interest rates to zero and restart its bond-purchase program in a no-deal Brexit scenario, and that would be accompanied by a significant fiscal stimulus.
- + From a market perspective, the most obvious casualty of a no-deal Brexit would be the pound, which we expect to fall toward parity against the dollar. Aggressive monetary easing would also put downward pressure on gilt yields, though the ECB would probably respond to a no-deal Brexit by stepping up the pace of its (expected) future bond purchases, limiting the extent to which the gilt market would outperform.

### RISK FACTORS

- + In addition to the risk of a no-deal Brexit, domestic political risk is now very high.

## Norway/Sweden

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
<b>Norway</b>	2.2	1.7	2.2	1.8	1.50	1.50	1.50	1.50	8.44	8.22
<b>Sweden</b>	1.8	1.6	1.9	1.8	(0.25)	(0.25)	0.00	0.00	9.33	9.33

### NORWAY OUTLOOK

- + Growth in the mainland economy eased to 2.4% in the first quarter, from 2.7% in the final quarter of last year, but is close to the average of recent quarters and remains above trend. Core inflation was unchanged at 2.3% in May, still slightly above target.
- + The Norges Bank raised rates by 25 basis points, to 1.25%, at its June meeting and indicated a rising probability of an additional rate increase before year-end. The rationale is simple: Inflation is above target, growth is above trend, the output gap is now positive, the krone is weak and interest rates are still in expansionary territory. The Norges Bank is aware of global risks, but until some part of this narrative changes, it is likely to continue gradually raising interest rates.

### RISK FACTORS

- + High household debt (currently 220% of income) and oil-price fluctuations are key risk factors.

### SWEDEN OUTLOOK

- + Economic growth slowed to 1.4% in the second quarter, and domestic demand growth is now negative. This is consistent with the message from recent survey data, with the Economic Tendency Indicator currently at its lowest since the middle of 2013.
- + Core inflation (CPIF, excluding energy) rose to 1.9% in April, the closest it has been to the Riksbank's 2.0% target since August 2017.
- + The Riksbank has scaled back its projections for the key policy rate, indicating a move back to zero around the turn of the year. Even this might prove difficult at a time when the Fed and ECB are easing monetary policy.

### RISK FACTORS

- + High household debt and elevated house prices continue to represent a major risk to financial stability.

## Asia ex Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
Asia ex Japan	5.6	5.4	2.5	2.5	4.04	3.84	3.58	3.51	—	—
Hong Kong	2.2	2.0	2.2	2.2	2.75	2.50	1.40	1.35	7.83	7.85
India	7.2	7.0	3.6	3.8	5.50	5.25	6.90	6.80	69.00	68.00
Indonesia	5.1	5.1	3.2	3.0	5.75	5.50	7.30	7.20	14,000	13,950
South Korea	1.8	1.8	0.9	1.1	1.25	1.25	1.45	1.55	1,250	1,275
Thailand	3.0	3.0	1.2	1.2	1.25	1.25	2.00	2.00	32.00	33.50

## OUTLOOK

- + The drag from global trade and uncertainty around the technology cycle should continue to weigh on growth in the more trade-exposed parts of the region.
- + Inflation generally continues to decline across the region, and with exchange rates relatively stable, most Asian central banks have pivoted to an easing stance and have started to act upon that.

## RISK FACTORS

- + Uncertainty over the global trade cycle and US-China trade tensions remain concerns.

## OVERVIEW

Export data and PMIs for bellwether exporters like South Korea, Singapore and Taiwan remain patchy. The pace of deterioration may have eased to some extent, but we remain very circumspect about the prospects for a robust—or even a tepid—recovery. Why? Because there are a lot of moving parts to consider, and the likely path of the trade war is but one. China's growth outlook, the new product cycle in tech and excess semiconductor inventory are important, too. Accordingly, we remain biased toward weak growth in the more trade-exposed economies in the region.

To date, the spillover of external weakness and geopolitical shocks to domestic economies has been limited. But there are signs of that now happening. In Korea, for example, capital spending has collapsed, and the labor market has started to weaken (the recent escalation in the Japan-Korea spat won't help). In Singapore, retail spending has softened. Hong Kong's GDP report for 2Q was particularly weak (and we are watching development in the demonstrations very closely).

At the same time, inflation has been lower than expected across the region – both headline and core. Along with the Fed's pivot, this has helped drive a broad reassessment of the policy outlook across the region. Central banks have started to deliver on the easing that markets have priced – with cuts in Korea, Malaysia, Indonesia, India and the Philippines. We expect more easing to come --- including interest rate cuts in Thailand and an adjustment in the nominal effective exchange rate (NEER) slope in Singapore.

## Latin America

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
<b>Latin America</b>	<b>1.2</b>	<b>2.3</b>	<b>9.3</b>	<b>6.1</b>	<b>11.50</b>	<b>9.41</b>	<b>6.66</b>	<b>6.87</b>	—	—
Argentina	(1.3)	1.5	48.0	25.0	50.00	35.00	—	—	48.00	56.00
Brazil	0.8	2.5	3.9	4.0	5.75	6.50	7.20	7.75	3.80	3.60
Chile	3.0	3.3	2.3	3.0	2.25	2.25	3.00	3.25	700	680
Colombia	2.9	3.3	3.3	3.3	4.25	4.25	6.00	6.50	3,250	3,200
Mexico	1.8	1.5	3.8	3.2	7.75	7.00	7.25	6.75	19.10	21.00

### OUTLOOK

- + Brazilian policymakers are on the brink of approving an overhaul of the social security system, a change that will likely prompt the central bank to cut rates further and cause consumers and businesses to regain confidence. The upshot should be a broad recovery in growth.
- + Global central banks' more dovish bent gives regional counterparts the room to cut rates to offset external headwinds. Chile began the trend with a surprise 50-bp cut in its policy rate, Brazil cut rates by 50 bps in July, and many other regional central banks have become more dovish and are likely to cut rates later this year.

### RISK FACTORS

- + Concerns about global growth and other external risks, specifically regarding trade, may be keeping investment on the sidelines across the region. Growth expectations are likewise slowing in much of the region.

### OVERVIEW

In Argentina, risks ahead of the primary election on August 11 are rising, and asset volatility has started to rise. The ARS depreciated 4.5% in June after enjoying relative stability in May and appreciating in June. The central bank has responded to currency pressures by tightening the monetary base and increasing the Leliq rate for the first time since April. Although peso deposits in the local banking system have been relatively stable so far, households may look to convert savings to dollars closer to the election if Frente de Todos candidate Alberto Fernandez, who is viewed as a risk to peso stability, starts rising in the polls. Tightening monetary policy helps to incentivize investors to stay in the carry trade and maintain peso investments. As the election approaches, pressure on the peso will continue to rise. But the central bank can combat some of this pressure through purchases of US dollar futures, USD spot-market intervention and drawing on its \$20 billion swap line with China. Maintaining currency stability is essential for President Macri's reelection prospects and is something the government – and the market – is watching closely.

In Brazil, social security reform passed the first vote in the Lower House. Only small changes to the bill were made during negotiations, preserving most of the expected fiscal savings over the next 10 years. The second vote in the Lower House is expected in early August when Congress returns from its midyear recess, with minimal changes to the proposal. The bill then goes to the Senate for approval. There are some signs that changes to the state and municipal social security system could be added back into the proposal, which would add another R\$500 billion in savings to the consolidated public sector's fiscal accounts. Progress on the social security reform contributed to the central bank cutting rates by 50 bps in July. Expectations for inflation to continue to trend below target and sluggishness of economic activity indicators should lead the central bank to ease monetary policy further this year.

Mexico is teetering on the brink of a recession, with very high real interest rates and a challenging global environment combining to push growth close to zero. Unemployment has started to rise and inflation to fall, which should open the door to rate cuts soon, particularly with central banks both north and south of Mexico easing policy already. The longer Banxico waits to cut, the more it is eventually going to have to do so. We think rate cuts should start immediately, particularly with the peso having been stable for the last six months.

## Eastern Europe, Middle East and Africa (EEMEA)

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
<b>EEMEA</b>	<b>1.3</b>	<b>2.5</b>	<b>7.9</b>	<b>7.4</b>	<b>7.90</b>	<b>7.21</b>	<b>8.83</b>	<b>8.88</b>	—	—
Hungary	3.8	2.8	3.1	3.2	1.25	1.25	2.15	2.15	320	318
Poland	3.9	3.6	1.9	2.5	1.50	1.50	2.20	2.30	4.25	4.20
Russia	1.2	1.7	4.3	4.0	6.75	6.50	7.25	7.15	64.50	65.50
South Africa	0.5	1.2	4.4	4.9	6.50	6.25	9.00	9.20	14.75	15.10
Turkey	(3.0)	0.5	16.5	14.3	15.75	14.50	17.00	18.50	6.10	6.25

### OUTLOOK

- + Real GDP growth is expected to pick up in 2020, particularly in Turkey and South Africa, although downside surprises are possible in the latter.
- + While headline CPI is rebounding in most Central and Eastern European (CEE) economies, price pressures are expected to ease in Russia and Turkey, following fading tax and exchange-rate pass-throughs. Inflation in South Africa is expected to remain close to the midpoint of the target band.
- + CEE central banks are mostly expected to remain on hold, while Russia and Turkey have room to cut interest rates in 2019 and potentially into 2020.

### RISK FACTORS

- + The potential for higher core yields is a risk for current account deficit countries such as Turkey and, to a lesser extent, South Africa.

### OVERVIEW

The Turkish Central Bank (CBRT) surprised with a larger-than-expected 425-bp cut at its July monetary policy committee (MPC) meeting, with further significant easing likely this year. The CBRT's relatively neutral MPC statement suggests a possibly more cautious approach going forward. We believe however that political pressure will remain substantial to continue decreasing borrowing rates. The government has already signaled its desire for the central bank to play a more active role in Turkey's macroeconomic recovery. That's mainly because the government's fiscal pace for further expansion remains relatively limited, especially from a funding perspective. The 2019 fiscal deficit target was already hit during the first six months of the year, and the government has to largely rely on extraordinary central bank profits to be able to finance the fiscal shortfall during the second half of the year. Against this backdrop, we expect an additional 400 bps of cuts between now and year-end, with risks skewed toward more aggressive easing. The main concern is that this will again rapidly reduce Turkey real interest rate differential to levels when the currency is much more vulnerable.

Elsewhere, the Russian Central Bank (CBR) also cut interest rates, although at a much slower pace (25bps), and the outlook is much more predictable than in Turkey. The MPC statement remained largely unchanged and, on balance, equally dovish. Key sentences such as "the Bank of Russia admits the possibility of further key rate reduction at one of the upcoming Board of Directors' meetings and a transition to neutral monetary policy in the first half of 2020" remained in place and point toward further easing. The fact that "disinflationary risks exceed pro-inflationary risks over the short-term horizon" made the statement a little more dovish, but was counterbalanced by warnings that a potential increase in fiscal spending in 2H 2019 could have inflationary impacts further down the line. With the "neutral" policy rate at 6%-7%, we can expect another 50-75bps of cuts by June 2020 to take the policy rate to 6.50%, of which 50bps may be delivered during the remainder of 2H 2019 depending on fiscal policy. We believe these dynamics remain supportive of local assets over the coming quarters.

South Africa's fiscal woes continue as government had to step up yet again to provide financial support to the state-owned power utility, Eskom. The result is a 37% increase in weekly government bond issuance and mounting credit rating pressure. Fitch (BB+) responded first by changing the outlook to negative from stable, but S&P (BB) and Moody's (Baa3) also highlighted risks to South Africa's credit ratings. We think Moody's could also change to a negative outlook before the end of the year, which would push local bonds to the cusp of exclusion from the World Government Bond Index (WGBI). The SARB cut the policy rate by 25 bps in July, as expected, but we think the Bank could choose to stay on the sidelines for the rest of the year to provide cover for the ZAR. A lot of South Africa's fiscal woes are, in our view, already reflected in ZAR asset prices, but weak local and global economic growth stands in the way of meaningful price appreciation.

## Frontier Markets

### OUTLOOK

- + With lingering fiscal uncertainty, the International Monetary Fund (IMF) out of the picture and presidential elections in 2020, Ghanaian dollar bonds could remain range-bound for the foreseeable future.
- + El Salvador's plan to combat insecurity and boost private investment is ambitious and is estimated to boost growth to 3%. However, execution risk is high.

### RISK FACTORS

- + Hard-line US immigration policies toward Central America could begin to be directed toward El Salvador. These types of policies typically generate significant fiscal costs.

### OVERVIEW

Ghana's Finance Minister, Ken Ofori-Atta, presented the midyear fiscal policy review at the end of July. The revised budget deficit for 2019 (-4.3% of GDP from -4.0%) was not unexpected, and the change was not large enough to unsettle investors too much. Investors, including ourselves, are generally comforted by government's commitment to keep the fiscal deficit at less than five percent of GDP (and maintain a primary balance) as stipulated by the Fiscal Responsibility Act of 2018. But, the details of the updated budget show a familiar trend — that is, crystallization of contingent liabilities that is reflected below-the-line. With lingering fiscal uncertainty, the IMF out of the picture and presidential elections in 2020, Ghanaian dollar bonds could remain range-bound for the foreseeable future.

El Salvador's new president, Nayib Bukele, is trying to change his country's reputation. He has an idealistic vision for his country: reduce insecurity, attract private investment and increase growth. His plan includes more specific details than those of new administrations typically do, and he has packaged his proposals in a way that appeals to both the Salvadoran people and his diplomatic counterparts from the US. As a result, local optimism about the future is high, Bukele's popularity has increased from its already high level since the election, and relations with the US are better than they've been in years. Growth in the coming years is expected to come from large-scale investment projects, including an \$850 million power plant and natural gas pipeline, expected to begin construction in 2020. This project, and others, is expected to boost growth to 2.5-3%, which should help to improve the country's fiscal profile. The plan is good, and confidence is high, but execution risk is equally high. Bukele's New Ideas party doesn't have representation in Congress, so he will have to gain support from traditional parties, at least until the 2021 legislative elections. His popularity is ~80%, so traditional party deputies may have an incentive to support him, but it's not guaranteed. The 2020 budget discussions start toward the end of August and should give more clarity into Bukele's vision and the willingness of Congress to give him the external financing he will likely need next year.

	Real Growth (%)		Inflation (%)		Official Rates (%)		Long Rates (%)		FX Rates vs USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
<b>Global</b>	2.6	2.6	2.9	2.7	2.66	2.32	2.46	2.53	-	-
<b>Industrial Countries</b>	1.6	1.4	1.7	1.8	0.80	0.59	1.13	1.24	-	-
<b>Emerging Countries</b>	4.2	4.6	5.0	4.3	6.21	5.54	5.05	5.00	-	-
<b>United States</b>	2.0	1.8	2.3	2.5	1.88	1.38	2.30	2.50	-	-
<b>Canada</b>	1.8	1.8	2.1	2.2	1.50	1.25	1.75	2.00	1.30	1.28
<b>Europe</b>	1.3	1.1	1.3	1.3	(0.32)	(0.32)	0.01	(0.02)	-	-
Euro Area	1.2	1.0	1.2	1.2	(0.65)	(0.65)	(0.25)	(0.25)	1.13	1.13
United Kingdom	1.2	1.2	1.8	1.7	0.75	0.75	0.90	0.75	1.25	1.25
Sweden	1.8	1.6	1.9	1.8	(0.25)	(0.25)	0.00	0.00	9.33	9.33
Norway	2.2	1.7	2.2	1.8	1.50	1.50	1.50	1.50	8.44	8.22
<b>Japan</b>	0.6	0.5	0.8	1.2	(0.10)	(0.10)	(0.10)	0.00	102	100
<b>Australia</b>	1.7	1.7	1.3	1.6	0.50	0.50	1.25	1.35	0.65	0.63
<b>New Zealand</b>	2.7	2.7	1.7	2.0	1.25	1.25	1.55	1.70	0.67	0.65
<b>Asia ex Japan</b>	5.6	5.4	2.5	2.5	4.04	3.84	3.58	3.51	-	-
China	6.2	6.0	2.5	2.4	4.35	4.10	3.10	3.00	6.90	6.90
Hong Kong	2.2	2.0	2.2	2.2	2.75	2.50	1.40	1.35	7.83	7.85
India	7.2	7.0	3.6	3.8	5.50	5.25	6.90	6.80	69.00	68.00
Indonesia	5.1	5.1	3.2	3.0	5.75	5.50	7.30	7.20	14,000	13,950
Korea	1.8	1.8	0.9	1.1	1.25	1.25	1.45	1.55	1,250	1,275
Thailand	3.0	3.0	1.2	1.2	1.25	1.25	2.00	2.00	32.00	33.50
<b>Latin America</b>	1.2	2.3	9.3	6.1	11.50	9.41	6.66	6.87	-	-
Argentina	(1.3)	1.5	48.0	25.0	50.00	35.00	-	-	48.00	56.00
Brazil	0.8	2.5	3.9	4.0	5.75	6.50	7.20	7.75	3.80	3.60
Chile	3.0	3.3	2.3	3.0	2.25	2.25	3.00	3.25	700	680
Colombia	2.9	3.3	3.3	3.3	4.25	4.25	6.00	6.50	3,250	3,200
Mexico	1.8	1.5	3.8	3.2	7.75	7.00	7.25	6.75	19.10	21.00
<b>EEMEA</b>	1.3	2.5	7.9	7.4	7.90	7.21	8.83	8.88	-	-
Hungary	3.8	2.8	3.1	3.2	1.25	1.25	2.15	2.15	320	318
Poland	3.9	3.6	1.9	2.5	1.50	1.50	2.20	2.30	4.25	4.20
Russia	1.2	1.7	4.3	4.0	6.75	6.50	7.25	7.15	64.50	65.50
South Africa	0.5	1.2	4.4	4.9	6.50	6.25	9.00	9.20	14.75	15.10
Turkey	(3.0)	0.5	16.5	14.3	15.75	14.50	17.00	18.50	6.10	6.25

Long rates are 10-year yields unless otherwise indicated.

Latin American Rates include Brazil, Chile, Colombia and Mexico

Real growth aggregates represent 48 country forecasts not all of which are shown

Blanks in Argentina are due to distorted domestic financial system so are not forecast.

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