ALLIANCEBERNSTEIN

GLOBAL ECONOMIC RESEARCH

GLOBAL MACRO OUTLOOK
FEBRUARY 2019

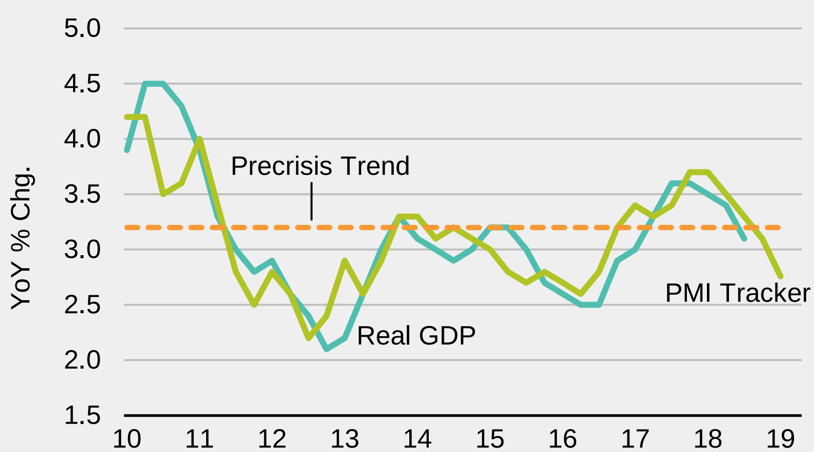
KEY FORECAST TRENDS

+ Although US data remain robust, weakness in China and Europe suggests that the global economy continued to slow in early 2019.
+ But there have been some positive developments: the Fed has made it clear it won't raise rates again until at least midyear, and aggressive policy action has reduced downside growth risks in China.
+ Still, growth risks remain skewed to the downside.
+ Another thing to keep in mind: improving financial conditions will eventually encourage the Fed to start raising interest rate again, creating a hurdle for a sustained improvement in the investment environment.
+ In other words, the current positive environment may not last that long.

CONTENTS

The Slowdown Continues

Global Real GDP Growth



Through January 31, 2019
Source: Haver Analytics and IHS Markit

+ The global manufacturing PMI has been a good coincident indicator for global economic growth. It fell again in January and is now broadly consistent with the global economy, growing at an annual rate of about 2.75%.
+ That's well below the precrisis trend (3.25%) and growth rates seen a year ago (3.5%). But, in our view, it's more consistent with the soft secular backdrop that's been in place since the global financial crisis. Seen this way, the recent slowdown might be better viewed as a normalization—with downside risks.

GLOBAL FORECASTS

Economic Growth

- Rising headwinds point to softer growth ahead
- Policy responses—a more dovish Fed, further easing in China—mitigate the downside
- But vulnerability to a crystallization of event risks remains elevated

Key Risks

- Further trade-war escalation
- China policy mistake
- European politics (UK, Italy)

Inflation

- The secular backdrop still points to higher inflation over the medium term
- But—despite high capacity use—softer growth and falling oil prices will present a hurdle in 2019

Key Risks

- Greater nonlinearity in the Phillips curve?
- Supply constraints dominate

Monetary Policy

- Fed is more data dependent; we expect two rate hikes in the second half of 2019
- The case for an ECB hike has now disappeared; BOJ to remain on the sidelines, anchoring JGB yields

Key Risks

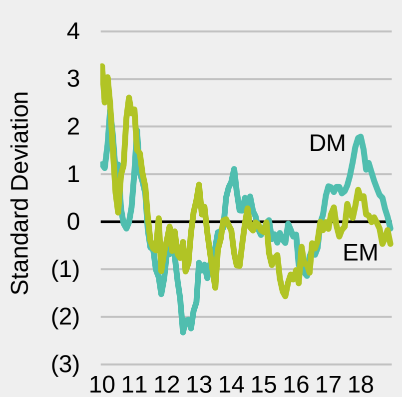
- Tightening more powerful than expected
- Market-driven tightening of financial conditions

OUTLOOK

- We trimmed our 2019 global growth forecast a little further this month, to 2.7%. That's a material downgrade from a few months ago, when we expected global growth to reach 3.1% for this year.
- Compared to consensus, we are still a bit more pessimistic on the euro area (1.1% versus 1.4%) and the US (2.0% versus 2.5%), and in line on China (6.2%) and Japan (1.2% versus 0.9%).
- We've also trimmed global inflation a touch, to 2.7% this year from 2.9% in 2018, largely because of the lower starting price for oil.
- While slowing growth represents a downside risk to inflation, high capacity utilization rates and rising wage growth represent clear upside risks. We don't expect a sharp deceleration of core inflation pressures.

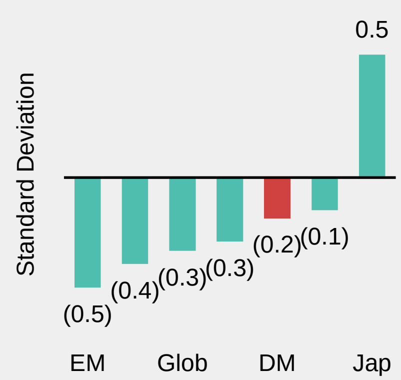
Global Cyclical Outlook: Toward a Synchronized Slowdown?

Manufacturing PMIs



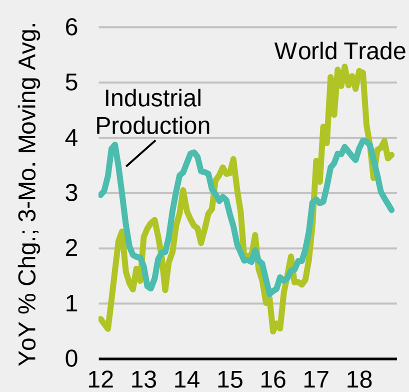
Through December 31, 2018
Source: Haver Analytics and IHS Markit

Manufacturing PMI: Dec 2018



Through December 31, 2018
Source: Haver Analytics and IHS Markit

Global Trade and IP Growth



Through October 31, 2018
Source: Haver Analytics

GLOBAL MARKET OUTLOOK: YIELD CURVES

GLOBAL YIELDS

Global—Developed-market (DM) yields are still very low and expected to rise, but magnitude and timing less certain

US—The market has now priced out any rate hikes in 2019. That's too big a shift in our view, and we expect yields to rise over the coming year

Euro Area—The case for higher Bund yields has weakened, but they remain well below our fair-value estimates and still look likely to rise; politics a downside risk

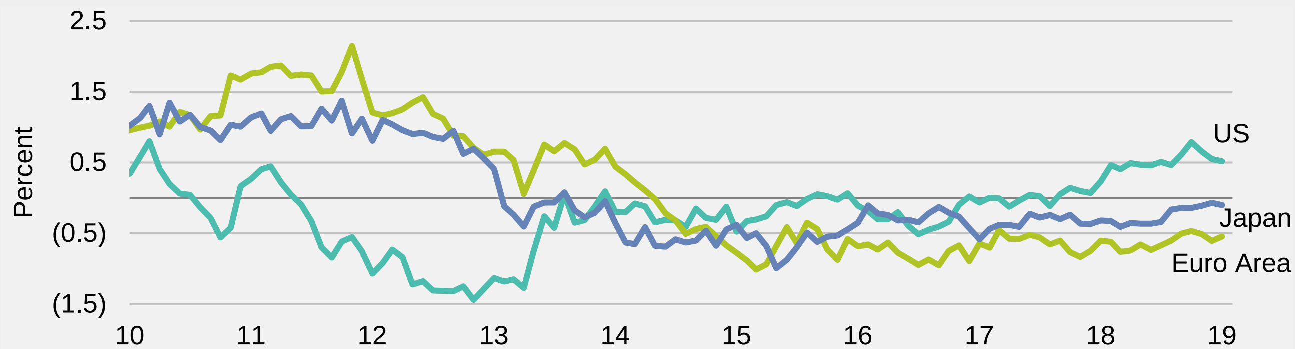
Japan—Quantitative and qualitative easing with yield curve control (QQE-YCC) policy to anchor 10-year yields close to zero; the risk of a policy "tweak" this year has fallen

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

	AB		Consensus	
	2018	**2019**	**2018**	**2019**
US	2.69	3.25	2.69	3.11
Euro Area	0.24	0.75	0.24	0.80
Japan	0.00	0.15	0.00	0.12
China	3.31	3.00	3.31	3.07

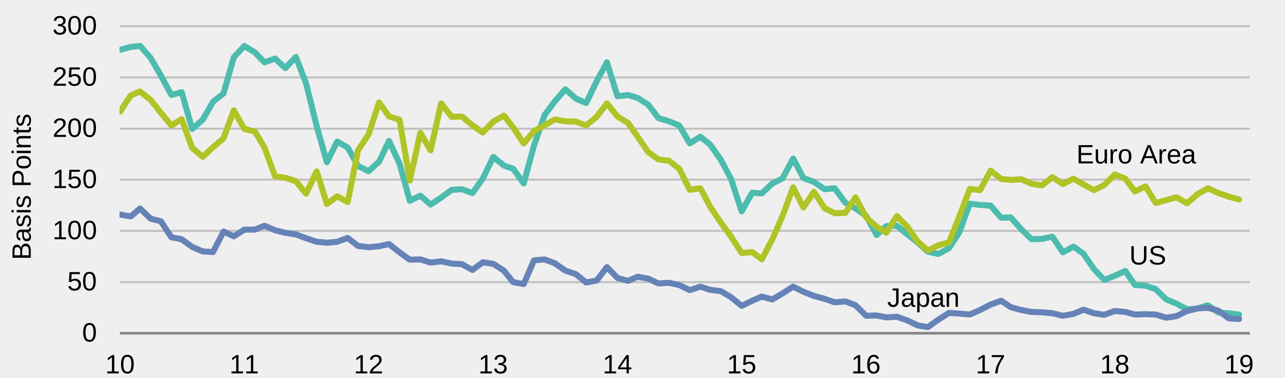
As of January 4, 2019
Source: Bloomberg and AB

Real 10-Year Bond Yields*



Through January 4, 2019
*Current 10-year bond yield less 5-year/5-year forward inflation swap
Source: Bloomberg and AB

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



Through January 4, 2019
Source: Bloomberg and AB

GLOBAL MARKET OUTLOOK: CURRENCIES

FX FORECASTS

USD—The US dollar has been largely rangebound over the last two years, and we see few reasons for this to change—especially while the Fed remains on hold

JPY—The yen should benefit if/when risk asset headwinds intensify

EUR—With rates on hold in 2019, we see few catalysts for a stronger euro; politics still an important downside risk (e.g., Italy, Brexit)

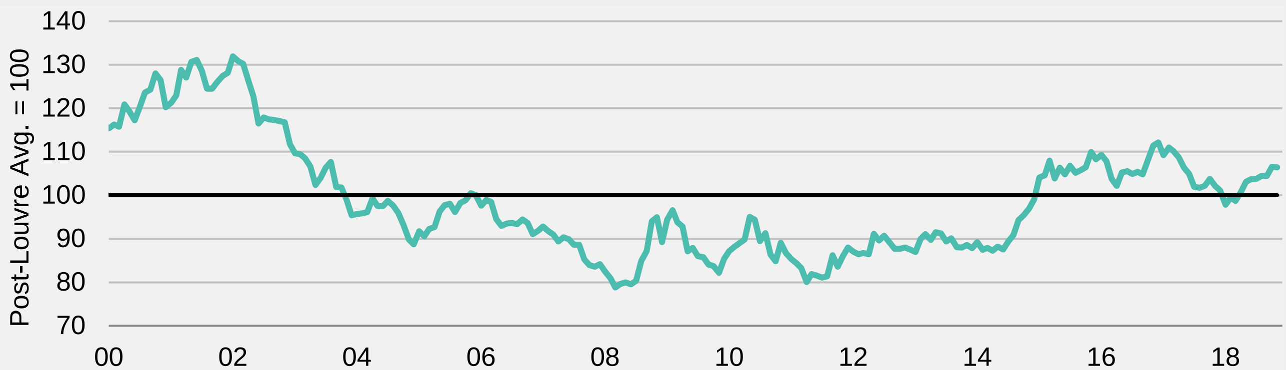
CNY—A (temporary?) truce in the trade war and receding downside growth risks point to a more stable CNY outlook

Global FX: AB vs. Consensus Year-End Forecasts

	AB		Consensus	
	2018	2019	2018	2019
EUR/USD	1.15	1.10	1.15	1.20
USD/JPY	110	105	110	108
USD/CNY	6.87	6.80	6.88	6.75
EUR/GBP	0.90	0.85	0.90	0.88

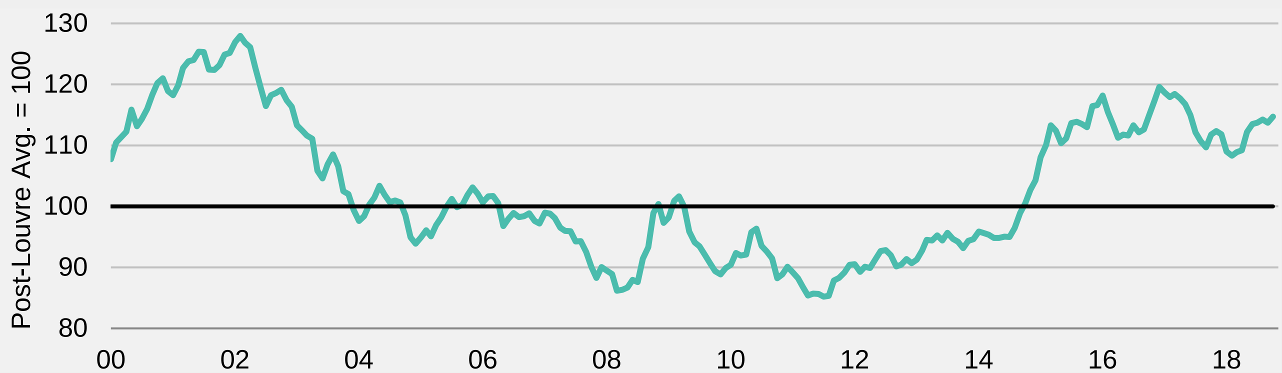
As of January 4, 2019
Source: Bloomberg and AB

Nominal USD Exchange Rate: DXY



Through January 4, 2019
Source: Bloomberg and AB

Real USD Exchange Rate



Through January 4, 2019
Source: Bloomberg and AB

US

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
US	2.5	2.0	2.3	2.3	2.38	2.88	2.69	3.25

OUTLOOK

- What one sees in the US economy depends on where one looks. The labor market paints a picture of an economy that is close to overheating. But inflation data remain tame and suggest spare capacity remains, and activity data are somewhere in between.
- With different segments of the economy apparently at different points in the business cycle, the Fed is taking a "wait and see" approach that we expect to prevail until at least midyear.
- The Fed's pivot from normalization to data dependency has contributed to a significant easing of financial conditions that should eliminate one potential headwind to growth, giving us increased confidence that the economy is likely to slow only modestly in 2019 rather than undergo the more severe downturn that the markets were pricing in in late 2018.

RISK FACTORS

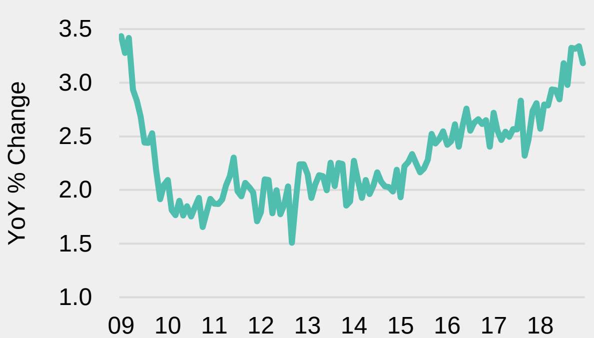
- The global economy continues to struggle, and the risk of a negative feedback loop between global activity and US markets could cause renewed stress, slowing growth more than currently expected.
- Wage pressures continue to rise. While this has not yet passed through into core inflation, should it do so more rapidly than forecast, it could impel the Fed to become more aggressive.
- The 2020 presidential election season has begun, and political risk is likely to rise over the course of the year. Another government shutdown and/or stress around the debt ceiling could weaken confidence and hurt the economy.

OVERVIEW

After a traumatic end to 2018, financial markets have relaxed considerably in early 2019. We view that as an appropriate response to the economic outlook, which remains reasonably positive. It's true that growth is likely to be slower this year than last. But slower isn't the same as slow; our 2.0% growth expectation is roughly the potential (noninflationary) growth rate of the economy and should be viewed as a good outcome, not a bad one. With the Fed less likely to raise rates aggressively now than was the case a few months ago, we have increased confidence that our basic narrative of a slower but still reasonably solid economy remains on track.

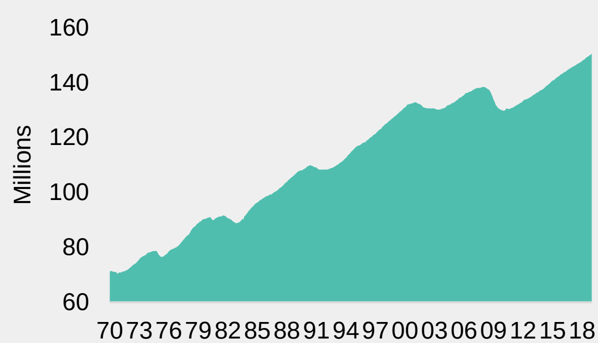
That said, the risks around our forecast are skewed to the downside. Internationally, other major economies are struggling, which could generate negative feedback loops and slow US growth. Domestically, political dysfunction is a potential source of volatility, and could damage business sentiment and investment plans. With the 2020 presidential election campaign now under way, politics are going to remain front of mind for the next several quarters.

Average Hourly Earnings



Through January 15, 2019
Source: Thomson Reuters Datastream

Total Nonfarm Employment



Through January 15, 2019
Source: Thomson Reuters Datastream

Euro Area

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Euro Area	1.9	1.1	1.7	1.4	0.00	0.00	0.25	0.50	1.14	1.10

OUTLOOK

- We've lowered our 2019 forecast for euro-area growth from 2.1% to 1.1% since mid-2018. The key drivers have been rising trade tensions, tighter Italian credit conditions and a general increase in uncertainty (e.g., Brexit).
- The recent decline in the oil price means that inflation is likely to be a little lower this year than last (1.4% versus 1.7%). Core inflation is likely to pick up, but only very modestly, to end the year at 1.3%.
- The European Central Bank (ECB) has now terminated its asset-purchase program. With growth slowing and core inflation likely to make only limited progress, the odds have now tilted against a rate hike this year. An extension of the central bank's forward guidance to push a rate hike well into 2020 now looks more likely.

RISK FACTORS

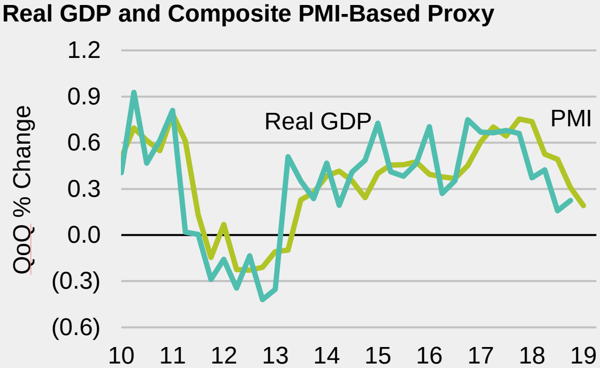
- Having downgraded our growth forecast significantly in recent months, risks are now more evenly balanced. Much will depend on future developments in the trade war and political developments closer to home.
- While the euro area is less vulnerable than the UK, a disorderly resolution to Brexit negotiations is an important downside risk for many euro-area economies.
- Italian political uncertainty is an additional source of downside risk, particularly ahead of the European elections scheduled for May. The new populist government has toned down its plans for fiscal expansion, but with growth slowing sharply in Italy, further confrontation with its euro-area partners looks likely.

OVERVIEW

The composite PMI for manufacturing and services was little changed in January (51.0 versus 51.1 in December), pointing to an economy growing at a very modest pace (i.e., about 0.2% per quarter). Moreover, some of the details of the survey make sobering reading. That's particularly true for the new orders component of the German manufacturing PMI, which slumped to 44.9, and the Italian composite PMI, which moved deeper into negative territory. The Italian economy contracted in both the third and fourth quarters of last year, and this contraction looks set to continue in the first half of this year.

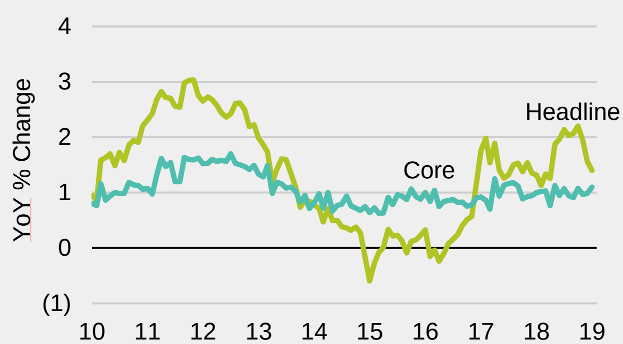
Although euro-area growth slowed last year, capacity use continued to tighten as wage growth was starting to rise: annual growth in compensation per employee rose to 2.5% in the third quarter, the fastest growth rate since 2008. Normally, this would have set the stage for higher core inflation and tighter monetary policy. But with core inflation quiescent and growth continuing to slow, that's not how things look today. Rather than raise rates this year, we now think it much more likely that the ECB will extend its forward guidance to remove any prospect of tighter policy this year and push a rate hike back into 2020. More aggressive policy easing is possible, including a resumption of quantitative easing and deeper negative interest rates, but only should recession or deflation risks start to crystallize, which we view as unlikely.

Real GDP and Composite PMI-Based Proxy



Through January 31, 2019
Source: Haver Analytics and IHS Markit

Consumer Price Inflation



Through January 31, 2019
Source: Haver Analytics

Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Japan	0.8	0.9	1.0	1.2	(0.05)	(0.10)	0.02	0.15	110	105

OUTLOOK

- We expect modest GDP growth of about 1% in 2019. Slowing global trade will drag on the economy, but fiscal stimulus, business investment and accelerated consumption ahead of October's VAT hike should offset that.
- Wage inflation is already at a 20-year high and should continue to rise, putting pressure on underlying inflation. But known one-offs, such as the VAT hike, free education and telecommunications charges, will muddy the inflation picture.
- The Bank of Japan (BOJ) is likely to stay on the sidelines in 2019. Expect the Yield Curve Control (YCC) framework to stay in place (targeting 10-year yields around zero); Japanese government bond (JGB) purchases will more or less match government net issuance.

RISK FACTORS

- Potential self-inflicted risks remain—the VAT hike and possible BOJ missteps chief among them. But external risks are more important, whether they materialize through trade or via sharp appreciation in the yen in a risk-off environment.

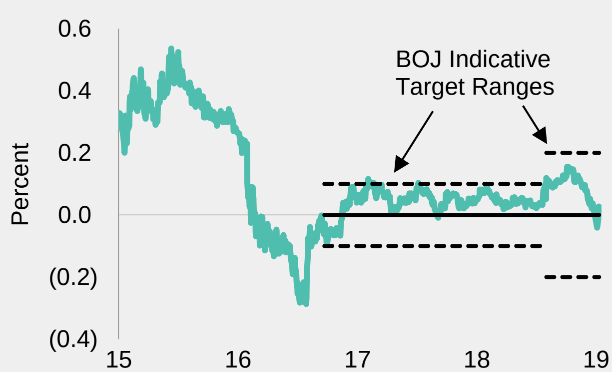
OVERVIEW

The second half of 2018 was patchier than expected for the Japanese economy, partly because of weather-related disruptions and evidence of slower export growth. The latter is likely to persist through 2019. Still, there are a number of positive offsets, including ongoing strength in capital spending (commercial property, labor-saving initiatives), fiscal stimulus and the bringing forward of consumption spending ahead of October's VAT hike. That should be enough to get growth running at about the 1% mark (above trend but close to consensus forecasts).

With capacity constraints getting tighter and wage inflation rising, we expect to see cost inflation intensify. Whether that shows up in higher headline CPI inflation is unclear. The decline in oil prices (and a stronger yen) will flow through to domestic energy prices with a lag. And some known one-offs will muddy the picture, including the VAT hike, the introduction of free education and a sharp fall in telecommunications charges.

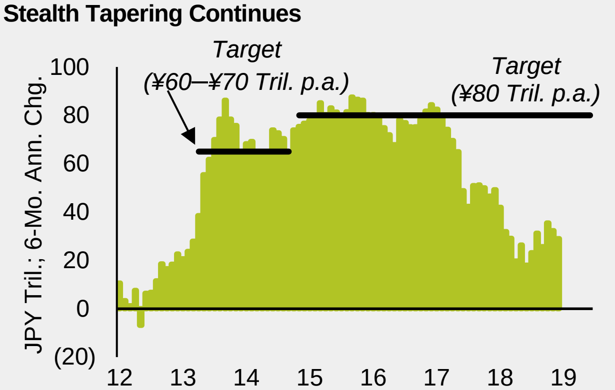
In this environment—and with external and domestic risks skewed to the downside—it seems likely that the BOJ will sit pat in 2019. This amounts to maintaining the YCC framework (targeting 10-year yields at around zero) and continuing to buy JGBs in roughly the same volume as the government's net issuance program (about ¥25–¥30 trillion per annum, recognizing that the purchases are subordinate to maintaining yield stability). The debate about how to deal with the financial stability risks of current monetary settings will continue, but with little action likely.

10-Year JGB Yield Remains Anchored



As of January 10, 2019
Source: Bloomberg and BOJ

Stealth Tapering Continues



Through December 31, 2018
Source: Thomson Reuters Datastream

China

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
China	6.6	6.2	2.1	2.4	4.35	4.35	3.31	3.00	6.87	6.80

OUTLOOK

- We think the Chinese official real GDP growth rate will be around 6.2% in 2019 as the capex cycle peaks and uncertainty about trade with the US continues to weigh on capex expansion.
- We expect inflation to rise to about 2.4%, mostly the result of further food (grain and pork) inflation from trade tensions and currency depreciation.
- The government should be all in when it comes to policy easing, and we have already seen acceleration in this area. Big infrastructure projects and property easing are probably unavoidable.

RISK FACTORS

- Untimely or inefficient easing policies—or both—could make for a gloomier 2019 outlook, though recent acceleration in concrete policy action means that the probability attached to this risk is now lower than it was.
- Rising inflation and slower growth risk a stagflation scenario and prevent the central bank from easing further.
- Another rise in trade tensions with the US could provoke more RMB depreciation, making it a global currency and confidence destabilizer.

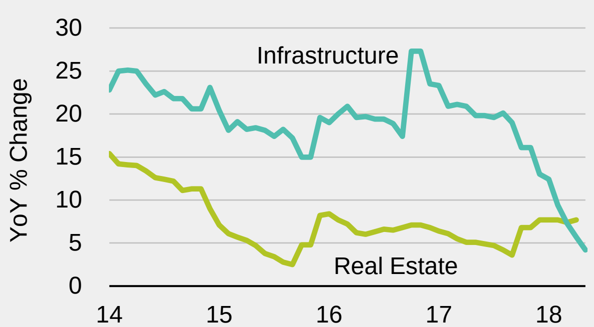
OVERVIEW

The pace of policy easing has accelerated since 2019 began. The authorities have encouraged banks to lend more to the real economy and the PBOC cut the reserve requirement ratio (RRR) by 100 basis points, injected about RMB1.5 trillion into the system and created a Central Bank Bills Swap. Infrastructure investment has also picked up, thanks in part to more issuance of special local government bonds that will be used for financing. China Railway plans to increase new investment by 45% year over year, bringing overall annual investment to a new high of RMB850 billion. Also significant: the NDRC now sees the property sector as part of the real economy rather than a source of asset bubbles. Developers have issued US$12 billion in onshore bonds and US$9.5 billion in offshore bonds. And the NDRC and 10 ministries announced plans to support domestic market targeting of autos, home appliances and agriculture.

Even so, we expect to see deceleration in some key data over the next few months, including PMI, PPI, trade and money growth, and we don't expect to see a turnaround until mid-2019. This is because it usually takes six to nine months before the effect of policy easing starts to show up in the real economy.

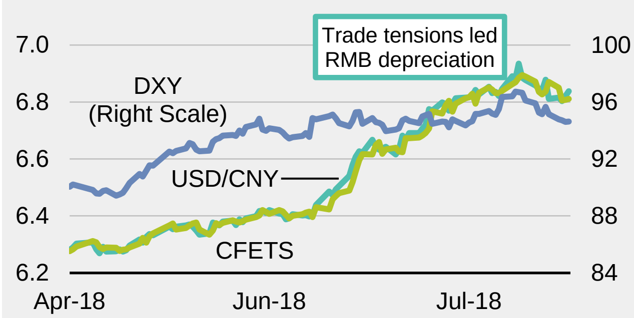
Larger monetary- and fiscal-policy easing over the near term would increase the probability of reaching 6.2% real GDP growth in 2019. If that happens, Chinese growth stabilization will keep the CNY from breaking the psychologically important threshold of 7.00 per US dollar, making it a global currency stabilizer.

Releveraging Up



Through January 4, 2019
Source: Bloomberg

RMB Depreciation Slowed After Countercyclical Factor Introduced



Through January 4, 2019
Source: Bloomberg

Canada

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Canada	2.5	1.8	2.1	2.1	1.75	2.25	1.96	2.75	1.37	1.35

OUTLOOK

- Canada's economy has settled back into a slow, steady expansion now that last year's trade tensions have faded. Growth is solid but unspectacular, and likely to remain so for the time being.
- Lower commodity prices pose a challenge to the medium-term growth outlook, but the stabilization of energy prices early this year is a relief for those who had feared a more persistent decline.
- Well-behaved inflation has allowed the Bank of Canada to pause its tightening cycle to see how the domestic economy responds to lower commodity prices and a still-decelerating housing market. We expect no change in the policy rate for at least the next several months.

RISK FACTORS

- Lower commodity prices are likely to pull growth down over the course of 2019.
- Should the US slowdown be more pronounced than we currently expect, the Canadian economy would suffer as well.

OVERVIEW

While falling commodity prices over the past few months are likely to weigh on Canadian growth to some extent, the local economy remains solid enough to continue plugging along, even with diminished terms of trade. The labor market is strong, and tame inflation allows the Bank of Canada to keep rates on hold while waiting to see the total impact of the trade tension, market turmoil and commodity price moves from last year. That means that Canada's macroeconomic environment is a dull one for now—steady growth, stable inflation and rates on hold.

Australia/New Zealand

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Australia	2.9	2.0	1.9	1.9	1.50	1.50	2.32	2.85	0.70	0.67
New Zealand	2.8	3.2	1.6	2.2	1.75	2.00	2.38	3.25	0.67	0.71

AUSTRALIA

- The year 2018 was one of strong momentum. The end of the mining bust, a boom in state-government-led infrastructure and strong housing construction drove business confidence to record highs and underpinned a surge in jobs.
- But conditions are set to deteriorate rapidly in 2019, mainly because of housing. Home prices are already falling sharply, particularly in Sydney and Melbourne, amplifying the stress on stretched household balance sheets. A solid pipeline of activity has delayed the inevitable, but with approvals now more than 20% off their peaks, housing construction is also set to fall away rapidly. Together, these conditions represent a substantial drag.
- Central bank optimism about the outlook again looks misplaced. We expect discussion to shift from rate hikes to rate cuts, though the first cut isn't likely to come before 2020. Even so, discussion is likely to undermine the AUD.

NEW ZEALAND

- In contrast to Australia, business sentiment in NZ was in the doldrums through 2018. At the same time, labor market outcomes were solid, with the unemployment rate dropping below 4%.
- While inflation is relatively low, cost pressures are rising, and there are some tentative signs that wage growth is picking up. With terms of trade close to a record high, and with a sizable fiscal impulse to be delivered this year, we expect speculation to turn once again toward central bank tightening. We've tentatively penciled in a rate hike in 4Q.

UK

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
UK	1.5	1.3	2.5	1.8	0.75	1.00	1.33	1.50	1.27	1.30

OUTLOOK

+ Recent data suggest that growth has slowed again after a surprisingly strong third quarter. A new monthly GDP indicator shows that growth slowed to 0.3% in the three months to November from a peak of 0.7% in the three months to July. Meanwhile, the composite PMI fell to 50.3 in January from 51.4 in December. Except for the reading immediately following the Brexit referendum in the summer of 2016, this is the lowest reading since December 2012.
+ If a no-deal Brexit is avoided, the British economy is likely to grow at much the same pace this year as last. However, slowing global growth and Brexit-related uncertainty suggest that risks to this forecast are on the downside. Moreover, with Brexit negotiations currently at an impasse, these risks are clearly growing.
+ With capacity use tight and wage growth rising, we continue to expect the Bank of England to raise interest rates by 25 basis points later this year. But with other central banks postponing rate hikes and Brexit uncertainty growing, the risk that this will be pushed back into 2020 is growing.

RISK FACTORS

+ The outlook is still heavily contingent upon the outcome of Brexit negotiations. The most likely outcome is that the UK will either ratify the deal agreed on with the European Union or choose not to leave after all. But the risks of a disruptive no-deal Brexit or a domestic political and constitutional crisis should still not be dismissed.

Norway/Sweden

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Norway	2.5	2.0	2.5	1.9	0.75	1.25	1.79	2.00	8.66	8.64
Sweden	3.0	2.5	2.1	2.0	(0.50)	0.00	0.52	0.75	8.87	9.09

NORWAY OUTLOOK

+ Growth in the mainland economy slipped to 2.3% in the third quarter from 2.6% in the first half of the year. Next year, we expect growth to slow further, to 2.0%.
+ Headline inflation was stable at 3.5% in December, well above the Norges Bank’s 2.0% target. Core inflation (excluding energy and indirect tax changes) eased slightly, to 2.1% from 2.2%, but the underlying trend still appears to be upward.
+ Against this backdrop, the Norges Bank has signaled that interest rates are likely to rise gradually over the coming years, with the next move possibly coming as early as March, data permitting.

RISK FACTORS

+ The main risk factor for Norway is rising household debt (currently well above 200% of income). The economy would also be vulnerable should the oil price continue to decline.

SWEDEN OUTLOOK

+ Economic growth was very soft, at just 1.7% in the third quarter. While this may overstate the weakness of the economy, survey data have also weakened, pointing to more modest growth rates ahead.
+ Core inflation (CPIF, excluding energy) rose to 1.5% in December from 1.4% in November. This is below target and roughly in line with its average over the last two or three years.
+ The Riksbank surprised most market participants by raising interest rates by 25 basis points at its December meeting, but tempered this by signaling that the next rise was unlikely to come until the second half of 2019.

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	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Asia ex Japan	**6.0**	**5.7**	**2.4**	**2.7**	**4.27**	**4.19**	**3.86**	**3.67**	**—**	**—**
Hong Kong	3.4	2.5	3.4	2.3	2.75	2.50	1.98	1.90	7.83	7.85
India	7.6	7.5	4.1	4.4	6.50	6.00	7.37	7.20	69.82	71.20
Indonesia	5.3	5.1	3.2	3.4	6.00	6.00	7.41	7.40	14,481	13,750
South Korea	2.6	2.0	1.3	1.8	1.75	1.75	1.96	2.45	1,116	1,165
Thailand	4.1	3.5	1.2	1.7	1.75	1.75	2.45	2.20	32.56	30.80

OUTLOOK

+ Risk sentiment has stabilized, but reduced trade volume, global growth downgrades and a peaking technology cycle should slow regional growth in 2019.
+ Lower oil prices and stable exchange rates should keep inflation under control—good news for local rate markets.

RISK FACTORS

+ Uncertainty over trade and US-dollar volatility could hurt regional currencies and portfolio flows. Further continued CNY depreciation remains a key factor.
+ Any rebound in oil prices would erode fiscal and external surpluses and reverse the recent improvement in sentiment.

OVERVIEW

Risk sentiment has improved, and a more dovish Fed helped Asian currencies recover in January, as did progress between the US and China on trade issues and more proactive policy in China. Even so, economic data showed continued moderation in trade as global growth slows and the technology cycle reaches its later stages. Purchasing Managers' Indices in China, South Korea and Taiwan—all major exporters—slipped below the 50 threshold that separates expansion from contraction.

Nonetheless, Asian central banks have adopted a more neutral tone, given the stabilization in risk sentiment and a benign inflation outlook. Bank Indonesia said its policy rate is now close to a cyclical peak, even though officials are still deciding when to unwind previous policy tightening. The Philippines is also studying whether to cut reserve requirements as a medium-term initiative to improve banking system efficiency. All in all, stabilized currencies, benign inflation, and a neutral or dovish turn in central banks' rhetoric would support local rates' performance in the months ahead.

Investors are now starting to focus on political events in India and Indonesia, both of which will hold general elections in 2019. We think election-related political risk is manageable in both economies. India's budget consolidation targets slipped in its recently released interim budget, but the deficit level remains modest compared with past election cycles. We don't expect any negative ratings actions. In the past we have seen policy continuity even during periods of regime shift. The election could cause a spike in near-term volatility, but the medium-term outlook of the country remains intact. For Indonesia, there is no material difference between the economic policies of the two major candidates, which suggests that the outcome shouldn't have a major impact.

For current account deficit economies such as India, Indonesia and the Philippines, a lower oil price improves their external accounts, which should increase demand for their currencies and local assets. We think that Indonesia will benefit most, given that real rates there have been high and fiscal consolidation was already under way in 2018. India will face more challenges from higher volatility ahead of the general election this spring.

Latin America

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Latin America	**0.4**	**1.8**	**9.3**	**6.6**	**13.77**	**10.58**	**7.44**	**8.42**	**—**	**—**
Argentina	(2.2)	(0.5)	45.0	28.0	59.25	35.00	—	—	38.57	46.00
Brazil	1.3	2.4	4.1	4.1	6.50	7.75	7.38	8.90	3.88	3.80
Chile	4.0	3.7	2.9	2.8	2.75	3.75	4.45	4.80	696	700
Colombia	2.6	3.0	3.2	3.5	4.25	4.75	6.72	7.15	3,250	3,280
Mexico	2.1	1.8	4.7	4.0	8.25	8.00	8.72	9.30	19.69	21.20

OUTLOOK

+ Economic growth is expected to accelerate this year, driven by cyclical expansion in Brazil and Colombia, and economic recovery in Argentina. Inflation is picking up marginally across the region, but remains contained.
+ The move toward a more dovish monetary-policy stance by central banks globally will reduce pressures on Latin American policymakers to hike rates in line with the Fed. Many central banks have said that external factors are likely to be among the most important determinants of policy decisions in the coming months.

RISK FACTORS

+ Uncertainty surrounding US trade policy will continue to weigh on LATAM economies, not just Mexico, which is most directly affected by the United States-Mexico-Canada Agreement. US-China trade tensions are affecting commodity-exporting economies in Latin America, and the persistence of policy uncertainty reduces demand and investment in commodity sectors.

OVERVIEW

Argentina's central bank adjusted its eased monetary targets for February, which should help stabilize monetary and FX dynamics. Many of the monetary restrictions the central bank set at the beginning of the year were harsher than the requirements outlined in the IMF program, but prudent, given the outlook for tighter monetary conditions in developed markets. As developed-market central banks have turned more dovish over the past few weeks though, the more favorable external environment for emerging markets has allowed policymakers to accelerate the pace of easing without creating unmanageable pressure on the peso.

In Brazil, social security reform remains a priority for policymakers. Discussions are expected to start in February, but a formal proposal has not yet been announced, and the success of pending negotiations depends largely on the outcome of speakership elections in the Senate and the lower house. The initial proposal is expected to be ambitious—including a clause for capitalization—but diluted as negotiations advance.

In Mexico, the administration continues to talk a market-friendly game. But questions remain about its willingness and ability to implement orthodox economic policies. The first test will come when the administration decides how much support to provide to PEMEX, the national oil company, and in what form. From a cyclical perspective, tighter monetary policy has started to slow growth. As long as the peso remains well behaved, inflation should begin to come down, and allow the central bank to undo some of that tightening in the next few quarters.

In Venezuela, the likelihood of a regime change is rising. On January 10, President Maduro's first term officially ended, leading to a constitutional crisis triggered by the fraudulent elections held in May 2018. The president of the National Assembly, Juan Guaidó, was named interim president and has been recognized by over two dozen nations, including the US, as the country's legitimate leader. The US Treasury imposed additional sanctions on Venezuela's state-owned oil company, Petróleos de Venezuela, which include restrictions on oil purchases by US companies, to cut off the Maduro regime from financial resources. The Venezuelan military, a key player in the political dynamics, continues to back Maduro, but support is waning. As cash-flow stress intensifies, the probability of a regime change will increase.

Eastern Europe, Middle East and Africa (EEMEA)

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
EEMEA	**2.7**	**2.0**	**6.7**	**6.2**	**10.76**	**8.46**	**10.00**	**8.93**	**—**	**—**
Hungary	4.2	3.2	2.7	3.1	0.90	1.25	3.01	3.40	281	286
Poland	5.0	3.5	1.7	2.3	1.50	1.50	2.81	3.35	3.76	4.22
Russia	1.8	1.6	3.5	4.3	7.75	6.75	8.78	8.00	69.52	65.00
South Africa	0.6	1.2	4.7	5.0	6.75	6.75	9.44	9.25	14.39	14.30
Turkey	2.8	(3.0)	16.2	16.3	24.00	18.00	15.83	15.00	5.27	5.60

OUTLOOK

+ Real GDP growth should remain robust in most of the EEMEA region over the course of 2019, though it may slow slightly from the pace set in 2018, mainly because of a more significant slowdown seen in Turkey. South Africa's growth rate is expected to be higher in 2019, but we think it will still surprise to the downside.
+ Headline CPI is rebounding in most Central and Eastern European (CEE) economies, but it's likely to peak in mid-2019. Recent oil price declines are key downside risks. Turkish headline inflation dynamics remain the most challenged, but are expected to ease in 2019.
+ CEE central banks along with the South African Reserve Bank are expected to remain on hold, while Russia and Turkey have room to cut interest rates.

RISK FACTORS

+ Balance-sheet normalization at developed-market central banks and the potential for higher core yields are risks for current account deficit countries such as Turkey and, to a lesser extent, South Africa.

OVERVIEW

Recent economic headline indicators suggest that the Turkish economy is in a significant slowdown that will likely result in a full-year recession in 2019. That will probably require more meaningful fiscal and monetary policy support as the year progresses. All major data that correlated closely with real growth, especially industrial production, retail sales and consumer credit growth, saw rolling quarter-on-quarter (QoQ) sequential contractions of –2% to –6% through November. The deceleration in activity is by no means as severe as it was during the 2008–2009 recession, however. The exception here is credit growth, which accelerated in December and shows few signs of losing momentum for now. Vehicle sales have rebounded since October, although that's due to tax cuts rather than robust consumer demand, and fourth-quarter growth is still likely to be negative.

We expect Turkey's fourth-quarter real activity is likely to contract by around –2.5% QoQ (seasonally adjusted), and that we may likely see continued (although smaller) contractions in 1Q and 2Q 2019. Full-year 2019 growth is expected to stand at –3%, down from +2.8% in 2018 and far below the consensus estimate of +0.2%). Stimulus efforts have been relatively muted so far, with the government only announcing targeted fiscal and credit support for households and businesses aimed at making it easier for companies to roll over debt. Combined with corporate deleveraging and a slowdown or even a contraction in credit growth, we see limited scope for a quick rebound in activity in the quarters ahead.

The lack of stimulus is positive from a market perspective, especially with tightly contested local elections due at the end of March. Our key concern is that despite all its hawkish rhetoric, the central bank will consider rate cuts very soon given the weak growth backdrop, especially in the case of a positive inflation surprise in March. That said, as long as the cuts are well communicated and remain measured (around 300–400 b.p.), the market fallout should be contained.

Frontier Markets

OUTLOOK

- Ecuador is likely to request a formal IMF program early this year.
- Looser monetary and fiscal policy in Ghana could keep asset prices under pressure.

RISK FACTORS

- Even with an IMF program, Ecuador will require further capital market access to bridge its 2019 financing needs and manage liabilities coming due in 2020.
- The conclusion of Ghana's IMF program in April and the risks related to next year's elections could create heightened uncertainty in the second half of 2019.

OVERVIEW

Ecuador's overall fiscal balance contracted meaningfully in 2018—an impressive feat when we consider that it had shrunk its publicly funded infrastructure investment program a year earlier and focused mainly on politically sensitive spending cuts. This year, the Finance Ministry plans more spending cuts worth another 2% of GDP, starting with ending gasoline and fuel subsidies—another politically risky move.

This fiscal adjustment has not, however, ended the decline in Ecuador's foreign-exchange reserves. That has forced it to rely on China and repo transactions with investment banks to manage its balance-of-payments imbalance and fund domestic credit expansion. Fortunately, the country's return to global capital markets this year helped it adjust its fiscal position without sparking a recession. The government has received IMF technical assistance and will likely request a financing program early this year. That should help unlock financing from other multilateral organizations and reduce Ecuador's costly financing needs.

Ghana's central bank caught the market off guard in January by cutting its policy rate by 100 b.p., to 16%. That brings the bank's cumulative rate cuts to 1,000 b.p. since late 2016. The real policy rate has come down too, from more than 12% to less than 8%. But officials still seem to think that monetary conditions are tight. The removal of weak and undercapitalized banks has eased financial stability risks and contributed to the committee's decision to cut the policy rate. Real private sector credit growth has been weak, but the combination of lower interest rates and banks' enhanced capital positions provide a springboard for credit growth in 2019. But fiscal easing will force the central bank to execute a delicate balancing act this year, as reduced foreign demand for Ghanaian debt has put pressure on the currency. We expect asset pressure to continue, given the policy mix, the April 2 conclusion of the country's IMF program, and the fiscal risks related to next year's election.

INSERT FORECAST TABLES HERE

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