

GLOBAL MACRO OUTLOOK

DECEMBER 2019

KEY FORECAST TRENDS

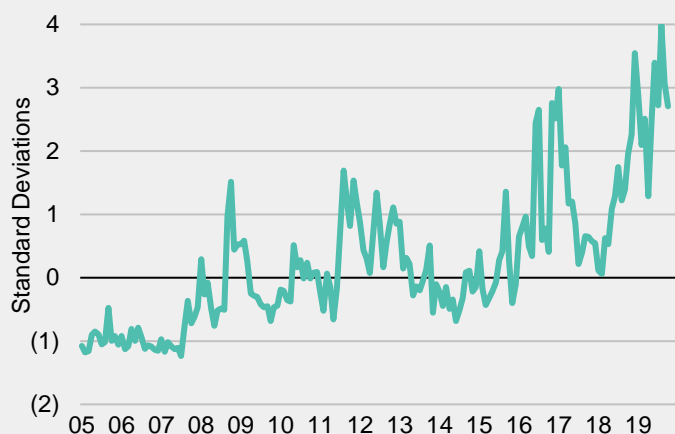
- + Financial markets continue to be buoyed by signs of an extended truce in the US-China trade war and tentative signs that manufacturing—a sector that has single-handedly dragged global growth lower—may finally be starting to stabilize.
- + But stabilization is not the same as recovery, and it's important to note that the most recent survey data, including the closely watched manufacturing PMIs, still point to contracting industrial output. It would be premature to rule out a spillover into rising unemployment, falling investment and a deterioration in the broader economy.
- + Nor are we convinced that recent developments on the trade front will lead to a spontaneous recovery in output. That's partly because of the lingering risk of failure but also because it will take more than a fragile truce to lift the cloud of uncertainty weighing on global output—particularly with new populist risks forming on the horizon (including the US presidential election).
- + While the outlook may have brightened in recent weeks, it has not done so sufficiently for us to change our baseline view. We expect global growth to remain weak, inflation to remain subdued, policy rates to remain at record lows (or move even lower) and bond yields to trade in a narrow range around current levels.
- + With monetary policy having reached the end of the road, fiscal policy offers the best hope of breaking out of this low-growth and interest-rate regime. But while there are emerging signs of a shift in this direction, we're still a long way from the large-scale, proactive fiscal stimulus needed to transform the outlook.

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Uncertainty Remains High

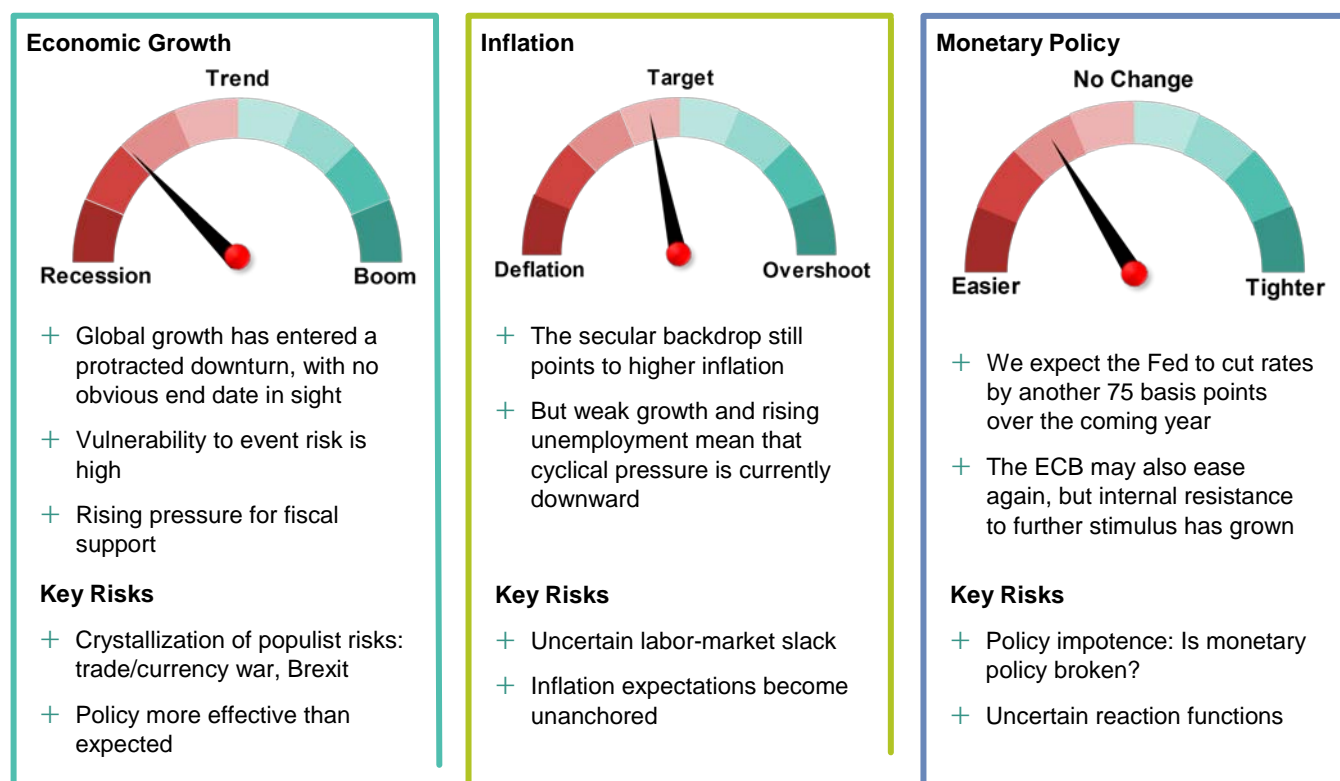
Global Economic-Policy Uncertainty



As of October 31, 2019
Source: Haver Analytics

- + Policy uncertainty has played a key role in driving the global business cycle in recent years. The thawing in trade relationships between the US and China is therefore a very welcome development.
- + But there's a long way to go. As the graph opposite indicates, policy uncertainty remains elevated and is much higher than in 2014 and 2017, when a big reduction in uncertainty set the stage for a rebound in global activity.

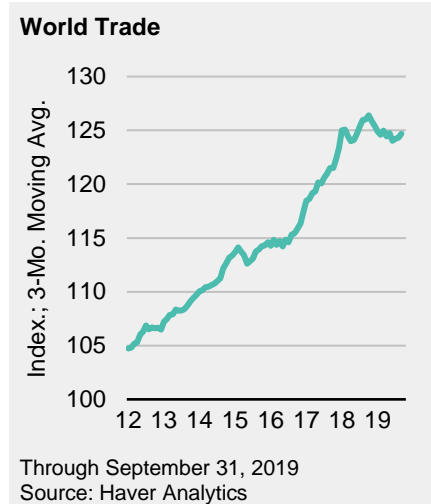
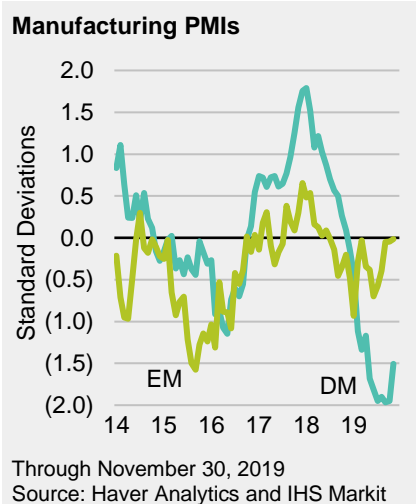
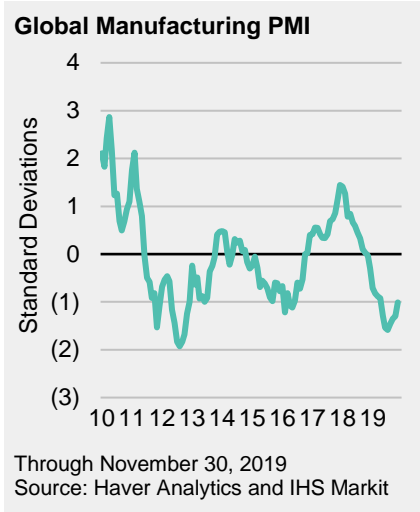
GLOBAL FORECASTS



OUTLOOK

- + Our baseline forecast is for global growth to remain weak, inflation to move sideways, and policy interest rates to remain at current ultralow levels or move even lower.
- + We expect the global economy to grow by just 2.2% in 2020, which would be the weakest growth since 2009. Compared with consensus, we're a bit more pessimistic on the US (1.5% growth next year vs. 1.8%) and China (5.8% vs. 5.9%) but much more pessimistic on the euro area (0.3% vs. 1.0%) and Japan (-0.4% vs. 0.3%). This reflects our continued concerns about trade-sensitive economies with limited policy flexibility.
- + The secular backdrop still points to higher inflation. But cyclical developments point in the opposite direction; we expect global inflation to fall to 2.7% in 2020, from 2.8% this year.
- + We expect the Fed to cut interest rates by another 75 basis points (b.p.) and the ECB to announce an additional rate cut and more aggressive asset purchases. But uncertain reaction functions mean our conviction level is lower than it was.

Global Cyclical Outlook: Tentative Signs of Stabilization



GLOBAL MARKET OUTLOOK: YIELD CURVES

GLOBAL YIELDS

Global—Growing optimism on US-China trade and a scaling back of monetary-stimulus expectations in the US and Europe have helped global bond yields to rebound somewhat from record lows. But with the global economy entering a protracted downturn and the Fed and ECB likely to lower interest rates further, the case for a sustained increase in bond yields is weak.

US—The recent backup in US yields is consistent with our view that bond yields are set to move modestly higher over the medium term. But with the Fed likely to cut rates by more than the market expects, the recent rise may be premature.

Euro Area—We expect economic growth to fall short of the ECB's expectations and core inflation to remain stuck well below target. That means there is a strong case for additional monetary stimulus. The case for higher bond yields is weak.

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

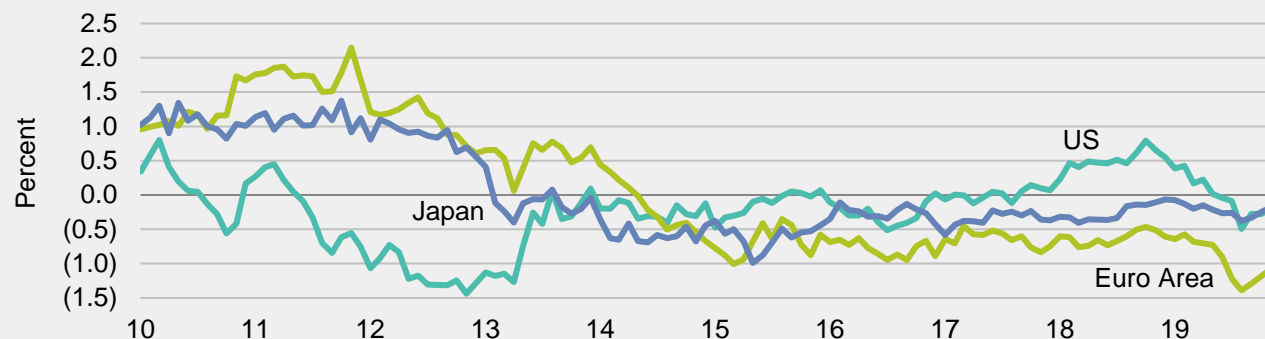
10-Year Yields: AB vs. Consensus Year-End Forecasts (%)

	AB		Consensus	
	2019	2020	2019	2020
US	1.75	1.75	1.71	1.93
Euro Area	(0.35)	(0.25)	(0.50)	(0.33)
Japan	(0.10)	(0.20)	(0.17)	(0.05)
China	3.20	3.00	3.10	2.90

As of December 2, 2019

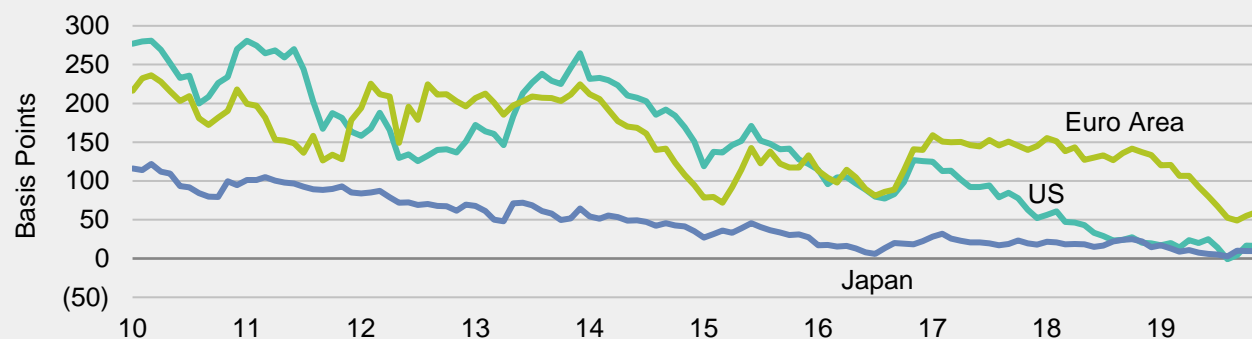
Source: Bloomberg and AB

Real 10-Year Bond Yields*



*Current 10-year bond yield less five-year/five-year forward inflation swap
Through November 29, 2019; Source: Bloomberg and AB

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



Through November 29, 2019
Source: Bloomberg and AB

GLOBAL MARKET OUTLOOK: CURRENCIES

FX FORECASTS

USD—The dollar has strengthened modestly in 2019 as growth has slowed more abruptly overseas than in the US. But we still expect the Fed to cut rates aggressively, making it hard to see the dollar adding much to its recent gains.

JPY—The yen is likely to benefit as global growth slows further and risk-asset headwinds intensify.

EUR—Weak growth, the prospect of more monetary stimulus and populist risks mean that there are few reasons to buy the euro.

CNY—The CNY has benefited from signs of a cease-fire in the US-China trade war, and developments in that sphere will continue to set the tone for the Chinese currency.

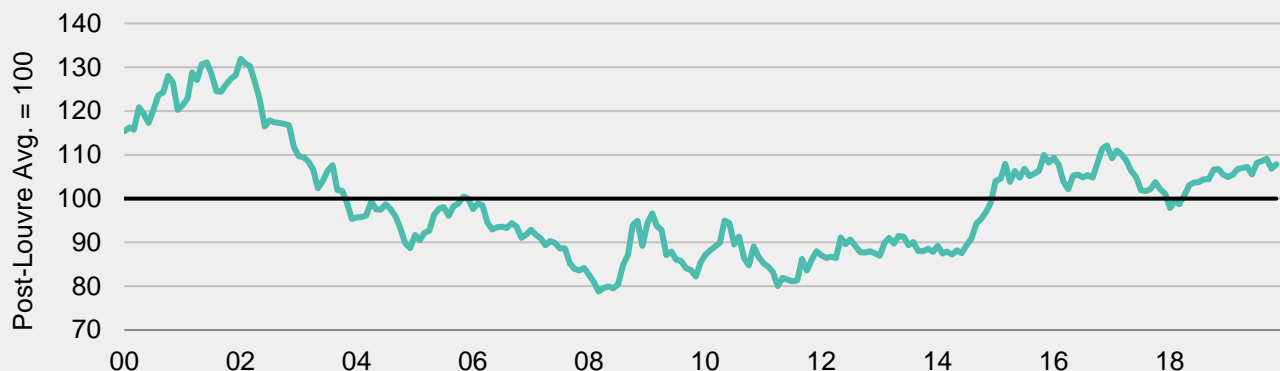
Global FX: AB vs. Consensus Year-End Forecasts (%)

	AB		Consensus	
	2019	2020	2019	2020
EUR/USD	1.13	1.13	1.11	1.15
USD/JPY	107	95	108	105
USD/CNY	7.10	7.20	7.08	7.10
EUR/GBP	0.87	0.88	0.86	0.86

As of December 2, 2019

Source: Bloomberg and AB

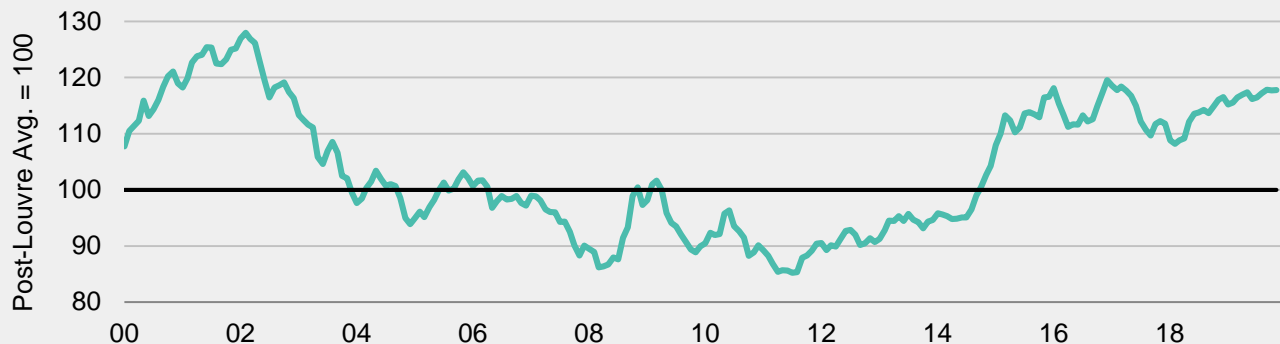
Nominal USD Exchange Rate: US Dollar Index



Through November 29, 2019

Source: Bloomberg and AB

Real USD Exchange Rate



Through November 29, 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	1.5	2.3	2.3	1.63	0.88	1.75	1.75

OUTLOOK

- + The US economy remains a study in divergence. Manufacturing and other externally exposed sectors are extremely weak because of the trade war, while the labor market and domestic consumption, which are less vulnerable to trade frictions, remain strong. How long the divergence can last is an open question, as is the direction in which it is eventually resolved. Our expectation is that the domestic economy will begin to weaken further over time but will retain enough strength to avoid a sharp contraction.
- + Inflation remains missing, which has allowed the Fed to offset some of the weakness that the trade war has engendered, and we expect it to remain low. With debt burdens rising, however, the real cost of servicing debt in a low-inflation world is a significant headwind to future growth.
- + The Federal Open Market Committee is on hold for the time being; but given our expectation that the labor market and domestic consumption will slow over time, we continue to expect rate cuts in 2020.

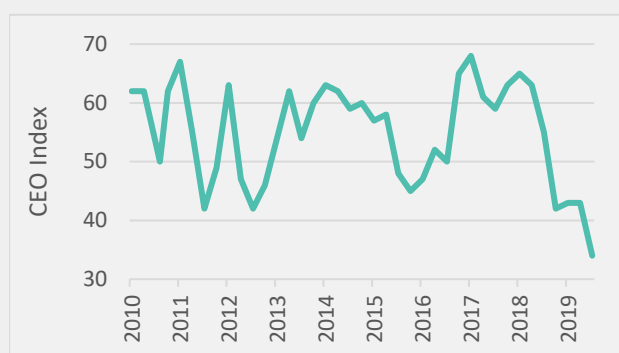
RISK FACTORS

- + Trade uncertainty remains persistent, and we don't believe that even an initial deal between the US and China—should one be reached—will be enough to lift the cloud hanging over manufacturing and capital expenditures.
- + Equity markets appear already to have priced in a significant bounce-back in growth that is at odds with our forecast. If growth doesn't bounce, financial market volatility could resurface.

OVERVIEW

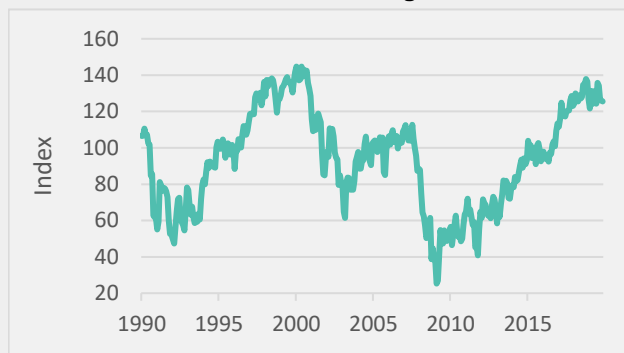
The US economy is perched on a knife's edge, precariously balanced between weak manufacturing and capital investment, on the one side, and strong labor markets and domestic consumption, on the other. The magnitude of the divergence is large by historical standards, and the gap has been persistent. The divergence is an obvious result of the trade war, which has imposed a negative shock on manufacturing but has yet to materially weigh on the domestic consumer. While we take no view on if or when a trade deal will be reached, our view is that enough damage has already been done to limit growth in the coming year. With political uncertainty piled atop trade uncertainty, the environment for business investment is weak, and we expect that weakness eventually to spill over to the labor market. That said, the consumer is in good shape, the savings rate has risen, and financial conditions are accommodative. We view the Fed as likely to do what needs to be done in order to keep financial conditions accommodative. As a result, we expect a deterioration in growth that leaves the economy running below potential in 2020.

Total Measure of US CEO Confidence



Through September 30, 2019
Source: Refinitiv Datastream

Consumer Confidence Is Still Strong



Through November 15, 2019
Source: Refinitiv 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	1.1	0.3	1.2	1.2	(0.50)	(0.60)	(0.35)	(0.25)	1.13	1.13

OUTLOOK

- + The euro-area outlook remains challenging, and we expect growth to slip to 0.3% in 2020, down from 1.1% this year. That's well below the ECB's 1.2% projection for next year, reflecting our concerns about the region's vulnerability to weak global growth and lack of effective policy tools.
- + Core inflation rose to 1.3% in November. But with growth weak and unemployment set to rise, we don't expect it to rise much further, let alone move close to the ECB's target.

RISK FACTORS

- + Risks to growth are evenly balanced. But it is still much easier to see growth surprising materially to the downside than the upside.
- + Our forecasts assume that recessionary conditions in manufacturing gradually spill over into weaker employment and capital spending growth and that policy will be ineffective in stimulating growth and inflation. If these assumptions are wrong—perhaps because of a more aggressive fiscal response than expected—growth could surprise on the upside.
- + Brexit is still an important downside risk, particularly given our concerns about policy flexibility and effectiveness in the euro area.

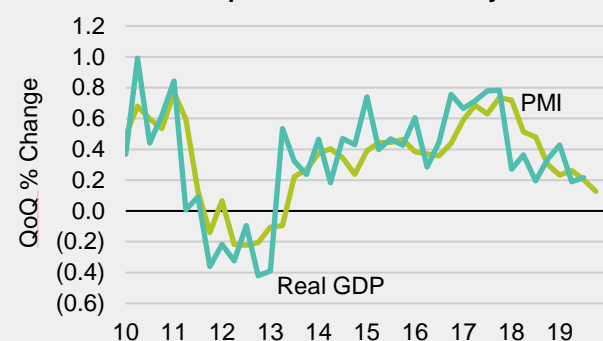
OVERVIEW

There are tentative signs that euro-area growth is stabilizing at a low level. For example, the composite PMI was stable at 50.6 in November, above September's cyclical low of 50.1. And, the manufacturing PMI rose for the second consecutive month, a sign that the worst might be over for a sector that has single-handedly dragged overall growth lower. Stabilization is not, however, recovery, and the euro area will remain vulnerable to adverse global developments for the foreseeable future.

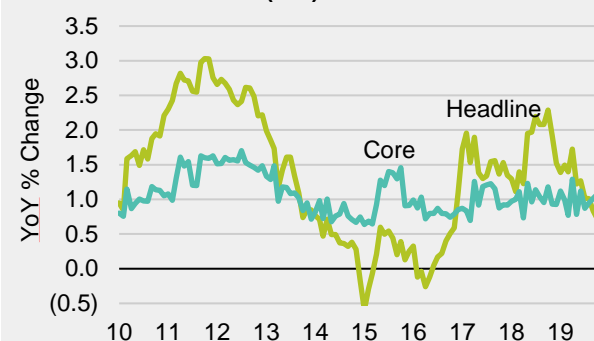
One way of reducing the euro area's vulnerability to external developments would be greater use of fiscal policy. By forcing bond yields (and government financing costs) to record lows, the ECB is certainly doing its bit to provide governments with fiscal space. And there are signs that they are slowly stepping up to the plate: we estimate a fiscal boost equal to 0.4% of GDP in 2020, compared with 0.2% this year. While that will be helpful, it won't be big enough, in our view, to shift the euro area out of its current low-growth regime.

Core inflation rose to 1.3% in November, a four-year high. Yet this was partly due to temporary factors, and, with growth weak and unemployment set to rise, it is difficult to see underlying inflation maintain this upward momentum in coming quarters. There is still a strong case for the ECB to deliver additional monetary-policy stimulus, but a change of leadership and internal resistance make this less certain than it was.

Real GDP and Composite PMI-Based Proxy



Consumer Price Index (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	1.1	(0.4)	0.8	0.9	(0.10)	(0.15)	(0.10)	(0.20)	107	95

OUTLOOK

- + The global trade conflict continues to undermine Japan's manufacturing sector.
- + The labor market remains tight, but there are tentative signs of a turning point.
- + The Bank of Japan's (BOJ) options to ease in an effective manner remain limited.
- + A prolonged downturn in the global economy should lead to further yen strength.

RISK FACTORS

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

OVERVIEW

The implementation of the second VAT hike under the "Abenomics" banner took place in early October. As expected, the tax change has had a material impact on the pattern of spending. Retail sales jumped sharply in August and September, before falling back sharply in October (see chart).

The devastation delivered by Typhoon Hagibis, the costliest natural disaster since the 2011 earthquake and tsunami, is an additional factor to consider. The disruption adds further downside risk to the 4Q GDP.

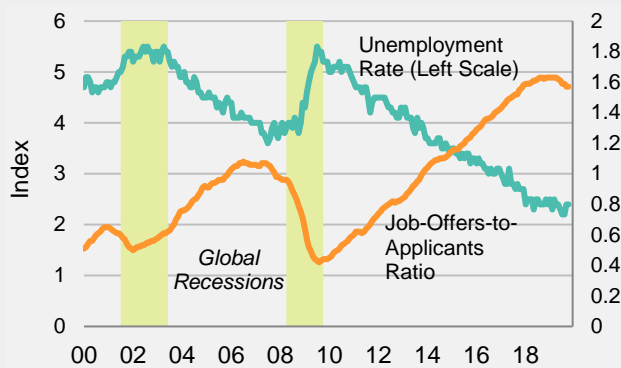
These three sources of uncertainty—global trade, ramifications of the VAT hike and natural disaster vulnerability—are driving the prospect of substantial fiscal stimulus via a supplementary budget. At more than Y25trn, the headline numbers are huge. But history teaches us that the actual fiscal impulse ("real water," in Japanese parlance) will be materially smaller than that. Reconstruction spending and other fiscal measures should add a tick or two to growth in 2020, without materially changing the narrative about the outlook. We still expect a persistent slowdown in growth over the year ahead.

Despite the growing uncertainty about the economic outlook, the BOJ is unlikely to do anything more than tweak policy. Its main policy role now is to support fiscal implementation via capping any rise in JGB yields (via its yield-curve control program).

Retail Spending Jumps Ahead of VAT Hike, Then Falls



A Turn in the Labor Market?



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	5.8	2.5	2.4	4.35	4.10	3.20	3.00	7.10	7.20

OUTLOOK

- + The official Chinese real GDP growth rate will likely be about 6.2% in 2019, down from 6.6% in 2018, as weakness in capex spending persists. And we expect that 2020 China's real GDP growth rate may come down to around 5.8% level.
- + 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 don't think that the increase will limit the central bank's policy easing.

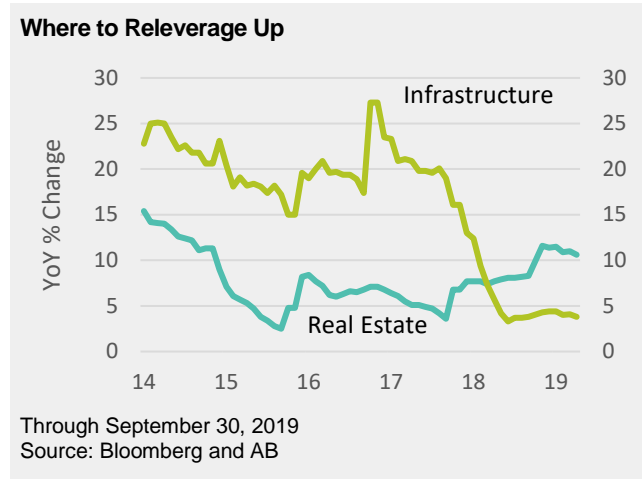
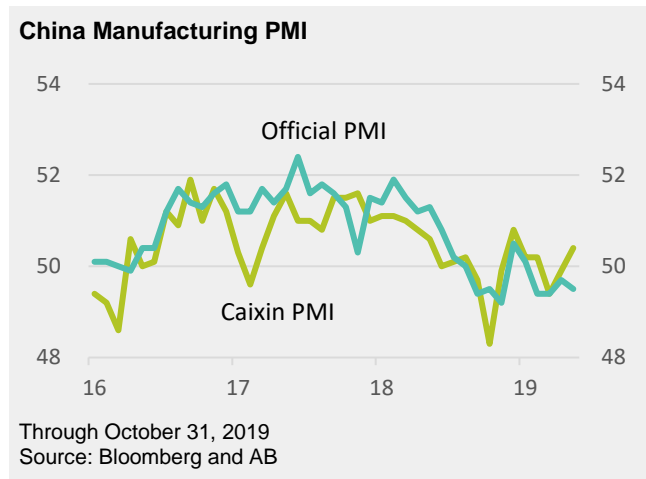
RISK FACTORS

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

OVERVIEW

Premier Li is reviewing his list of strategically important big infrastructure projects. This sends a clear signal that Li will accelerate infrastructure spending soon, most likely in early January. Accordingly, China is set to issue CNY 1 trillion of local government debt—the first batch of a quota—around the same time.

Meanwhile, Changsha, the capital city of Hunan province is lifting a ban on home purchases. This sends a clear signal of property easing, implying an underlying slower economy with inventory pressure that needs to be destocked. More cities are likely to follow in 2020. Infrastructure investment and property investment are key pillars that can stabilize the economy and we are now seeing signs accelerated easing in both areas. We still think increased downward pressure on growth will require more easing in 2020. Turning to inflation, we expect a peak at around 5% in the first quarter of 2020 allowing the PBOC to act on quantitative easing and deliver more RRR cuts, social financing and open market operations. Until then, we think the PBOC will conduct price actions by cutting interest rates in small steps.



Canada

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
Canada	1.8	1.5	2.1	2.1	1.75	1.00	1.50	1.50	1.30	1.35

OUTLOOK

- + Canada's economy remains in a sort of equilibrium, with both growth and inflation stable. Until the global environment changes materially, this is likely to continue.
- + The stable economic environment means that the Bank of Canada does not face undue pressure to act on interest rates. While we expect rate cuts next year, in line with our expectation of global economic deterioration, the BOC is more likely to be reactive than proactive, and it will take evidence of weakness to prompt significant easing.

RISK FACTOR

- + A resumption of trade tension globally would be unwelcome for the local economy, which remains quite exposed to global factors.

OVERVIEW

Canada remains an oasis of calm in a stormy global environment. It is not immune to global trends—quite the contrary—but with the global environment stable for the last couple of months, there has been little of note on the Canadian economic front. The Bank of Canada has a clear easing bias, as policymakers recognize the downside risks around the world. But until those risks materialize, the BOC seems most likely to stand pat—and the stable domestic economy allows it to do just that.

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
Australia	1.7	1.3	1.3	1.6	0.75	0.50	1.10	1.25	0.67	0.62
New Zealand	2.2	1.8	1.7	1.9	1.00	0.50	1.25	1.15	0.64	0.62

AUSTRALIA

- + Amid concerns about global growth and domestic economic stagnation, the Reserve Bank of Australia (RBA) has taken the cash rate to 0.75% and has discussed QE. This easing and some relaxation of macro-prudential policy have prompted a rebound in home prices and, perhaps, a bit more of a positive outlook.
- + We're inclined to fade that optimism. Despite this postelection relief, we still expect the housing downturn to have a material impact on overall growth, driving the unemployment rate back through the sixes. The 3Q GDP numbers reinforce this more pessimistic viewpoint.
- + Accordingly, the RBA is likely to deliver a little more easing, and we wouldn't be shocked to see further weakness in the Australian dollar.

NEW ZEALAND

- + The slide in New Zealand business confidence has started to make its presence felt in the labor market, with job growth slowing and the unemployment rate ticking higher, to 4.2%.
- + Along with persistently lower-than-expected inflation, a policy rethink by the central bank (including a dovish 50-b.p. cut in August) has also driven a further shift lower in the policy-rate outlook. We expect the overnight cash rate to hit 0.50% in 2020.

UK

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
UK	1.0	0.5	1.9	1.7	0.75	0.50	0.65	0.75	1.30	1.28

OUTLOOK

- + Politics still dominates the outlook ahead of the December 12 general election. Although the Conservative Party's poll lead has narrowed somewhat in recent weeks, this process may be coming to an end, and it retains a healthy advantage over the Labour Party: a 10-point lead, according to an average of each polling organization's latest survey. There is still time for this to change; but as things stand, the most likely outcome is still a Conservative majority government and EU exit at the end of January. Were the election to result in a hung Parliament, however, there would almost certainly be a second referendum, and it is likely that voters would choose to remain in the EU.
- + If the UK does leave the EU with a deal early next year, this would not be the end of the Brexit process. The government would then have to enter trade negotiations with the EU. If it wasn't able to reach agreement by the end of next year, or agree to extend the transition period, there would be a hard Brexit in December 2020. The bottom line is that uncertainty with respect to Brexit is likely to remain high, making a rebound in the economy next year unlikely.

RISK FACTORS

- + A no-deal Brexit, while highly unlikely at this stage, would push the economy into recession.
- + A Labour government would lead to considerable volatility. While the UK would probably end up remaining in the EU under this scenario, a sharp lurch to the left on domestic policy would have a very damaging impact on business and investment confidence.

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
Norway	2.5	1.5	2.2	1.8	1.50	1.50	1.40	1.50	10.15	10.00
Sweden	1.4	1.0	1.9	1.7	(0.25)	(0.25)	(0.10)	0.10	10.65	10.50

NORWAY OUTLOOK

- + Growth in the mainland economy rose to 2.9% in the second quarter, far stronger than in the rest of Europe. Looking ahead, we doubt that Norway will be able to buck the regional trend. We expect economic growth to slow to 1.5% in 2020.
- + Core inflation (adjusted for tax changes and energy prices) was again slightly above target, at 2.2% in September. We expect Norges Bank to keep interest rates unchanged, but the risk is clearly tilted toward a further increase.

RISK FACTORS

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

SWEDEN OUTLOOK

- + Survey and hard data paint very different pictures of the Swedish economy. While economic growth was stronger than expected, at 1.7% in the third quarter, recent survey data have again been weak, with the composite PMI dropping to a fresh cyclical low of 47.2 in November.
- + Core inflation (consumer price index with a fixed interest rate, excluding energy) was unchanged, at 1.7% in September, and has now been below Sveriges Riksbank's 2.0% target for two years.
- + The Riksbank has scaled back its projections for its policy rates but continues to point to another move in December. This would take its key rate back to zero and end Sweden's experiment with negative rates—for the time being, at least.

RISK FACTOR

- + 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	5.4	5.1	2.4	2.4	3.93	3.67	3.54	3.39	—	—
Hong Kong	0.1	(1.0)	2.5	2.3	2.00	1.50	1.50	1.40	7.83	7.85
India	6.2	6.0	3.2	3.0	5.15	4.65	6.50	6.30	70.00	68.00
Indonesia	5.0	5.0	3.2	3.0	5.00	4.75	7.00	6.85	14,000	13,950
South Korea	1.8	1.5	0.5	1.1	1.25	1.00	1.45	1.35	1,200	1,275
Thailand	2.7	2.5	1.2	1.2	1.25	1.00	1.50	1.50	30.50	33.00

OUTLOOK

- + The drag from global trade, uncertainty about the technology cycle and geopolitical risks continue to weigh on growth in the more trade-exposed parts of the region.
- + With inflation low and exchange rates relatively stable, slowing growth is driving a broad-based easing in monetary policy across the region. The debate around the potential for fiscal stimulus is also picking up steam.

RISK FACTORS

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

OVERVIEW

GDP growth in trade-exposed Asia has slowed sharply, a reflection of the continuing drag from the trade conflict, the tech cycle and its spillover to global growth more broadly. We expect that downward pressure to persist, given the chance of protracted weakness in the global economy. This is reflected in our below-consensus view for growth across the region.

The most recent data on trade across the region point to some stabilization in exports and have generated some optimism about the outlook. But there's a world of difference between "stability" and "recovery." At this juncture, there's little evidence of the latter. Expect trade conflict, geopolitical pressure and populist politics to continue to exert a drag in 2020.

Disappointing growth performance in the post-GFC period has helped to underpin a very subdued inflation picture. The combination of soft growth, minimal price pressure and downside risks tied to the global economic environment has allowed central banks to embrace policy easing. Expectations have been pared back a little, but markets still expect further cuts in policy interest rates over the next year.

Apart from growth and inflation, several other factors are complicating the monetary-policy outlook. In Thailand, for example, persistent currency strength continues to cause concern for policymakers. Similarly, financial-stability risks tied to household debt are also feeding into monetary-policy decision-making. Macro-prudential policy is here to stay.

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
Latin America	0.4	1.6	9.3	7.2	12.11	9.93	6.13	6.53	—	—
Argentina	(2.5)	0.0	50.0	35.0	60.00	45.00	—	—	65.00	80.00
Brazil	0.6	2.0	3.3	3.8	4.50	5.00	6.50	7.00	4.15	3.80
Chile	1.0	1.5	2.3	3.5	1.75	1.75	3.50	3.25	780	770
Colombia	3.2	3.2	3.6	3.5	4.25	4.50	5.80	6.00	3,420	3,500
Mexico	0.0	0.9	3.6	3.5	7.25	7.00	6.80	7.20	19.60	20.25

OUTLOOK

- + Political upheaval took center stage in the past month in several Latin American countries. Large protests in Chile and Colombia, as well as Ecuador's failed attempt to pass a tax reform, put downward pressure on valuations across asset classes. Authorities have addressed some of the population's demands, reducing the extent of the protests; but the possibility of fiscal slippage due to more spending and lower taxes is still likely to affect valuations.
- + In Brazil, 3Q economic activity data were better than expected. We expect growth to rebound as we head into 2020, ending a protracted period of low growth. Reduced political uncertainty and loose monetary policy translate into credit growth, and the passage of key structural reforms further improves confidence.
- + Data releases in Mexico show an economy struggling to grow and have contributed to a weaker 2020 outlook. And policymakers have limited countercyclical tools to use. The government's spending cuts—part of its austerity pledge—are worsening the slump in activity, while monetary policy is cautious, with core inflation near the top of its target range.

RISK FACTORS

- + Political uncertainty could erode business and consumer confidence, which would weigh on already-low growth estimates for 2020. A worsening in the global trade outlook is also a key risk for the region.

OVERVIEW

Protests that turned violent, social unrest and a political crisis took center stage in Chile and Colombia last month. In both countries, protesters struggling in the low-growth, politically fragmented environment were demanding more and better social spending and reduced inequality.

In Chile, the government and most of the political parties represented in Congress unveiled a road map to a new constitution after announcements of increases in social expenditure failed to placate demonstrators' demands. The government announced a nearly \$5.5 billion fiscal stimulus package (almost 2% of GDP) to be delivered in 2020, which would increase the overall fiscal deficit to 4.4% of GDP. Monetary policy was expansionary before the unrest started, and the central bank was forced to announce a foreign exchange reserves sales program to stem the currency from depreciating at a rapid pace. President Piñera's position is weak, as reflected by record-low approval numbers. All eyes will be on the constitutional reform process that will start with a plebiscite in April 2020 to define whether voters want a new constitution and how the members of the Constituent Assembly would be elected.

In Colombia, the intensity of the protests was lower than in Chile but also showed a large discontent with current political and economic conditions. The government's response has been focused on delivering tax cuts for the poor and vulnerable population. The government estimates the cost of these measures to be about 0.3% of GDP. While the size of the fiscal package is smaller than Chile's, the government's fiscal situation is more fragile, which may limit its ability to respond again if the protests continue and demands from the population increase.

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
EEMEA	1.0	2.2	7.3	7.1	6.72	5.85	7.38	7.41	—	—
Hungary	3.8	2.3	3.1	3.2	0.90	1.25	1.80	1.80	330	325
Poland	3.9	3.1	1.9	2.5	1.50	1.50	2.10	2.20	4.30	4.30
Russia	1.2	1.7	4.3	3.7	6.25	5.75	6.30	6.15	65.0	63.00
South Africa	0.5	0.9	4.2	4.6	6.50	6.00	9.00	9.20	14.90	16.00
Turkey	(1.0)	1.5	16.5	13.0	12.00	10.00	13.00	14.00	6.00	6.25

OUTLOOK

- + Real GDP growth is expected to pick up in 2020, particularly in Turkey.
- + 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, South Africa and Turkey have room to cut interest rates.

RISK FACTOR

- + 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

There are still no green shoots in the South African economy. The multiyear contraction in GDP per capita is set to continue in 2020, and there are no natural catalysts to lift depressed consumer and business sentiment. The Medium-Term Budget Policy Statement (MTBPS) that had been tabled at the end of October showed that government debt is likely to rise from around 60% of GDP to 70% in three years' time, and to keep rising for at least the following five years. The dire debt outlook is credible, but we think that Finance Minister Mboweni also deliberately laid out the fiscal facts to prioritize a debate about remedial action. Two key obstacles to fiscal consolidation: high and sticky growth in the public-service wage bill; and recurring bailouts of state-owned companies. Addressing these spending pressures will require political support, and we don't see much evidence suggesting that sufficient support will be forthcoming.

We suspect that there will be reactive changes in the 2020 budget in February. But we do not think that this will be enough to prevent South Africa from losing its last investment-grade rating. Moody's has been more patient than S&P and Fitch, but following the MTBPS, the ratings agency changed the outlook on South Africa's Baa3 rating to negative. A downgrade by Moody's will result in South Africa's expulsion from the WGBI. We think that a credit downgrade/WGBI expulsion is largely discounted, but we remain concerned about the medium-term asset-price trajectory. We are concerned because there is not a lot of monetary-policy space and practically zero fiscal space to support the economy.

Frontier Markets

OUTLOOK

- + Sri Lanka's sovereign-debt sustainability is not under threat yet, compared with other sovereign credits such as Argentina or Lebanon.
- + But the government needs to focus on consolidating public finances and generating a consistent primary balance surplus to achieve debt sustainability over the medium term.

RISK FACTOR

- + Given large and growing interest-cost obligations, Sri Lanka's external financing needs for 2020 remain large. Uncertainty over future IMF cooperation would make it more difficult for the country to access international bond markets, in our view.

OVERVIEW

Following Gotabaya Rajapaksa's presidential victory on November 16, the new administration wasted little time implementing nearly all the promises that it had made about fiscal loosening. Markets reacted negatively to this—and to the resignation of the central bank governor—in light of Sri Lanka's fiscal vulnerabilities and questions about ongoing IMF cooperation. The latter doesn't matter much from an external financing perspective in US dollar terms. But IMF support has been an important factor supporting policy and overall confidence. Against significant tax cuts and Rajapaksa's ambivalence toward the IMF, future cooperation appears to be hanging in the balance.

We believe that a balanced primary budget for next year is unlikely, following the announcement of these measures, and we now pencil in a 0.5% of GDP primary deficit, which would leave the nominal deficit just above 7% of GDP. Given Sri Lanka's large and growing interest-rate burden, a much better primary balance performance is required at this juncture to improve the nominal balance, as compared with four or five years ago.

Even under relatively aggressive fiscal deficit assumptions over the coming years, we believe that Sri Lanka's debt sustainability is not yet under threat. That said, the margin for error is thin. Potential shocks to the currency (given the central bank governor's resignation), as well as real growth, remain risks. The government needs to focus on consolidating public finances and to generate a consistent primary balance surplus to achieve debt sustainability over the medium term. Sri Lanka's external eurobond financing needs for 2020 to cover fiscal and interest obligations remain large, at around US\$3.5–\$4bn. And it's uncertain how quickly the government will be able to tap international markets without the policy anchor such as the IMF provides. Eurobond financing needs could be smaller if the government manages to place debt more domestically than we currently expect.

	Real Growth (%)		Inflation (%)		Official Rates (%)		Long Rates (%)		FX Rates vs USD	
	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
Global	2.4	2.2	2.8	2.7	2.58	2.09	2.16	2.18	-	-
Industrial Countries	1.6	0.9	1.7	1.7	0.75	0.35	0.85	0.88	-	-
Emerging Countries	3.9	4.3	4.8	4.4	6.09	5.34	4.75	4.66	-	-
United States	2.0	1.5	2.3	2.3	1.63	0.88	1.75	1.75	-	-
Canada	1.8	1.5	2.1	2.1	1.75	1.00	1.50	1.50	1.30	1.35
Europe	1.1	0.4	1.3	1.3	(0.21)	(0.33)	(0.11)	(0.01)	-	-
Euro Area	1.1	0.3	1.2	1.2	(0.50)	(0.60)	(0.35)	(0.25)	1.13	1.13
United Kingdom	1.0	0.5	1.9	1.7	0.75	0.50	0.65	0.75	1.30	1.28
Sweden	1.4	1.0	1.9	1.7	(0.25)	(0.25)	(0.10)	0.10	10.65	10.50
Norway	2.5	1.5	2.2	1.8	1.50	1.50	1.40	1.50	10.15	10.00
Japan	1.1	(0.4)	0.8	0.9	(0.10)	(0.15)	(0.10)	(0.20)	107	95
Australia	1.7	1.3	1.3	1.6	0.75	0.50	1.10	1.25	0.67	0.62
New Zealand	2.2	1.8	1.7	1.9	1.00	0.50	1.25	1.15	0.64	0.62
Asia ex Japan	5.4	5.1	2.4	2.4	3.93	3.67	3.54	3.39	-	-
China	6.2	5.8	2.5	2.4	4.35	4.10	3.20	3.00	7.10	7.20
Hong Kong	0.1	(1.0)	2.5	2.3	2.00	1.50	1.50	1.40	7.83	7.85
India	6.0	6.0	3.2	3.4	5.15	4.65	6.50	6.30	70.00	68.00
Indonesia	5.0	5.0	3.2	3.0	5.00	4.75	7.00	6.85	14,000	13,950
Korea	1.8	1.5	0.5	1.1	1.25	1.00	1.45	1.35	1,200	1,275
Thailand	2.7	2.5	1.2	1.2	1.25	1.00	1.50	1.50	30.50	33.00
Latin America	0.4	1.6	9.3	7.2	12.11	9.93	6.13	6.53	-	-
Argentina	(2.5)	0.0	50.0	35.0	60.00	45.00	-	-	65.00	80.00
Brazil	0.6	2.0	3.3	3.8	4.50	5.00	6.50	7.00	4.15	3.80
Chile	2.0	2.5	2.2	2.6	1.75	2.00	2.50	2.75	780	770
Colombia	3.2	3.2	3.6	3.5	4.25	4.50	5.80	6.00	3,420	3,500
Mexico	0.0	0.9	3.6	3.5	7.25	7.00	6.80	7.20	19.60	20.25
EEMEA	1.0	2.2	7.3	7.1	6.72	5.85	7.38	7.41	-	-
Hungary	3.8	2.3	3.1	3.2	0.90	1.25	1.80	1.80	330	325
Poland	3.9	3.1	1.9	2.5	1.50	1.50	2.10	2.20	4.30	4.30
Russia	1.2	1.7	4.3	3.7	6.25	5.75	6.30	6.15	65.00	63.00
South Africa	0.5	0.9	4.2	4.6	6.50	6.00	9.00	9.20	14.90	16.00
Turkey	(1.0)	1.5	16.5	13.0	12.00	10.00	13.00	14.00	6.00	6.25

Growth and inflation forecasts are calendar year averages.

Interest rate and FX rates are year end forecasts.

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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