ALLIANCEBERNSTEIN®

GLOBAL ECONOMIC RESEARCH

GLOBAL MACRO OUTLOOK

DECEMBER 2018

KEY FORECAST TRENDS

+ With 2019 approaching, the global economy is facing a less favorable mix of growth and inflation. Moreover, downside risks continue to cloud the outlook for Europe and China. If these risks materialize, recession awaits.

+ Even if tail risks are avoided, the trade war between the US and China remains a major concern. The standoff has the potential to create a permanent adverse shift in the global growth/inflation trade-off, especially if it's a harbinger of a broader schism between China and the West.

+ This drama is playing out with global debt levels elevated and central bank balance sheets starting to shrink. If growth slows more quickly than expected, investors will rightly question what's left in the monetary-policy toolbox.

+ For markets, there are three important pieces to the puzzle: the global macro cycle, global liquidity and the threat from rising populism. Together, these factors point to another volatile and challenging year for global risk assets.

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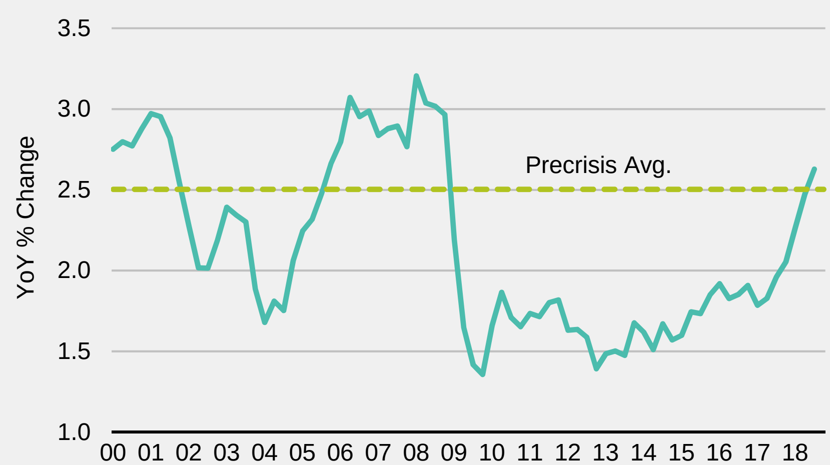
Rising Wages Point to Higher Prices or Lower Margins

G7 Wage Growth



As of September 30, 2018
Source: Haver Analytics and AB

+ A key question facing investors next year is what inflation will do as growth starts to slow. With more signs that wage growth is rising across the developed world, we think the risks to inflation are tilted to the upside.

+ But inflation won't rise if a lack of pricing power prevents companies from passing on higher wages. That's good news to the extent that it will allow central banks to slow the pace of monetary tightening. But it will also lead to a squeeze on company profit margins—hardly a positive factor for risk assets.

GLOBAL FORECASTS

Economic Growth

- Rising trade tensions and tighter financial conditions point to softer growth ahead
- But overall policy backdrop still benign, making sharp slowdown unlikely

Key Risks

- Further trade-war escalation
- China policy mistake
- European politics

Inflation

- Sharp acceleration unlikely given step-down in pace of global growth
- But capacity use is high and structural factors point to higher inflation over the medium term

Key Risks

- Can we trust the Phillips curve?
- Uncertain labor market slack

Monetary Policy

- Fed tightening to continue. Fed funds 2.38% at end 2018; 3.38% at end 2019
- ECB to end QE this year and raise rates in late 2019; BOJ to stay the course but policy "tweaks" likely

Key Risks

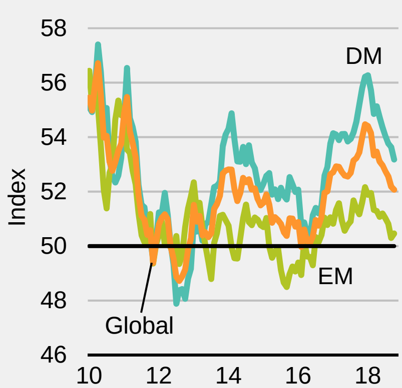
- QT more powerful than expected
- Market-driven tightening of financial conditions

OUTLOOK

- Expectations for global nominal GDP growth have not changed much in recent months at close to 6.0%, but the mix has become less favorable, with lower real growth offset by higher inflation.
- Our 2019 global growth forecast remains at 2.9% this month, but there were two noteworthy downgrades last month: we lowered the euro area to 1.4% from 1.6%, largely because of weaker Italian growth, and China to 6.2% from 6.3%, owing to concerns about the magnitude and timing of the much-needed policy response.
- Compared to consensus estimates, we are still a bit more pessimistic on the euro area (1.4% versus 1.6%) and the US (2.3% versus 2.6%), in line on China (6.2%) and more optimistic on Japan (1.3% versus 1.0%).
- We expect global inflation to be little changed at 2.9% next year. While slowing growth represents a downside risk, high capacity utilization rates and rising wage growth represent clear upside risks.

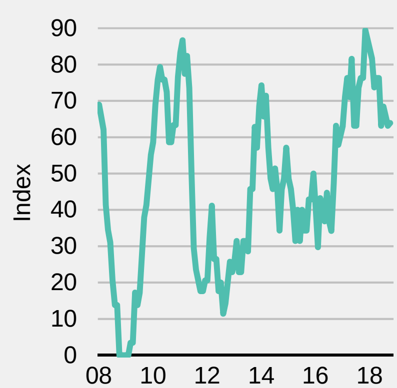
Global Cyclical Outlook: Stepping Down to a More Modest Pace of Expansion

Manufacturing PMIs



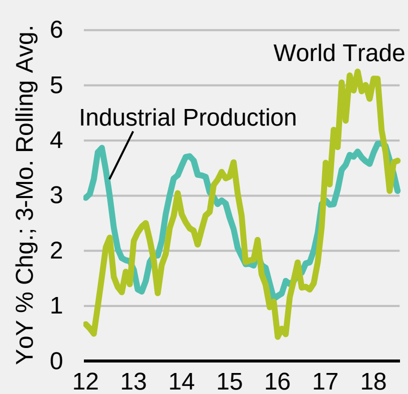
Through October 31, 2018
Source: Haver Analytics and IHS Markit

Manufacturing PMI: Diffusion Index



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

Global Trade & IP Growth



Through August 31, 2018
Source: Haver Analytics

GLOBAL MARKET OUTLOOK: YIELD CURVES

GLOBAL YIELDS

Global—Developed-market (DM) yields still expected to rise, though pace of increase now less certain

US—Solid growth, rising inflation and Fed rate hikes likely to push yields higher over the coming year

Euro Area—Bund yields still dislocated from fair value and set to rise as the European Central Bank (ECB) starts to withdraw policy stimulus; politics a downside risk

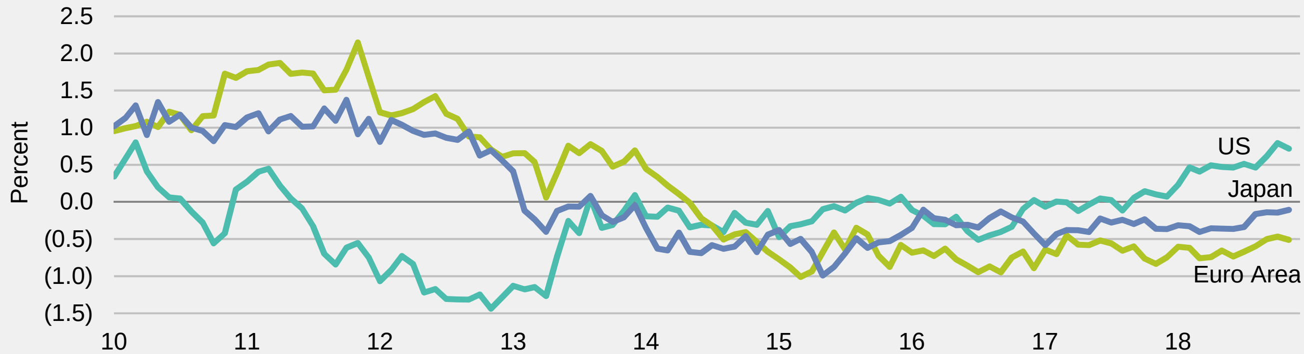
Japan—Quantitative and qualitative easing with yield curve control (QQE-YCC) policy to anchor 10-year yields close to zero, but risk of 10-year target adjustment in 2019

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

	AB		Consensus	
	2018	2019	2018	2019
US	3.25	3.75	3.20	3.44
Euro Area	0.50	1.00	0.55	0.95
Japan	0.13	0.25	0.12	0.18
China	3.50	3.30	3.48	3.38

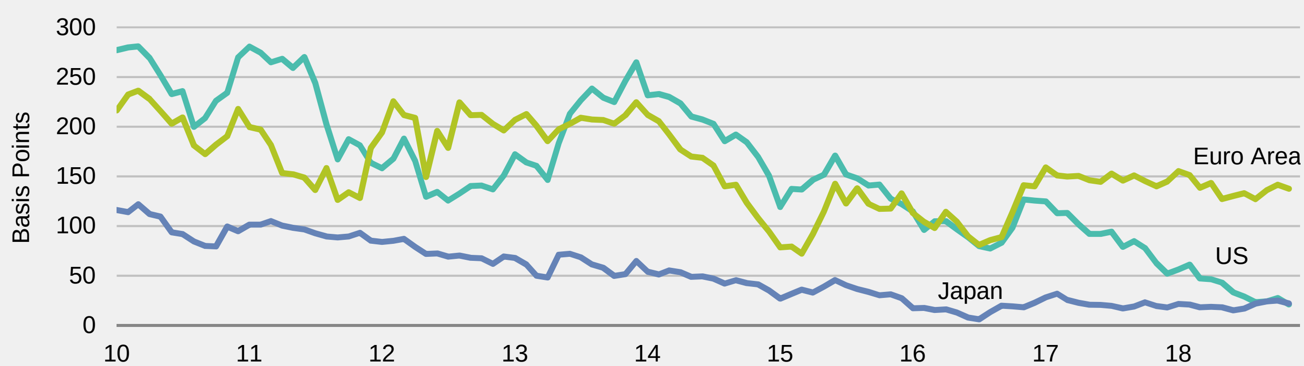
As of December 3, 2018
Source: Bloomberg and AB

Real 10-Year Bond Yields*



As of December 3, 2018
*Current 10-year bond yield less five-year/five-year forward inflation swap
Source: Bloomberg and AB

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



As of December 3, 2018
Source: Bloomberg and AB

GLOBAL MARKET OUTLOOK: CURRENCIES

FX FORECASTS

USD—USD biased to the upside, but valuations mean a sharp rise from current levels is unlikely

JPY—JPY to benefit as risk-asset headwinds intensify

EUR—EUR likely to slip toward 1.10 in coming months owing to downside risks tied to Italy and Brexit

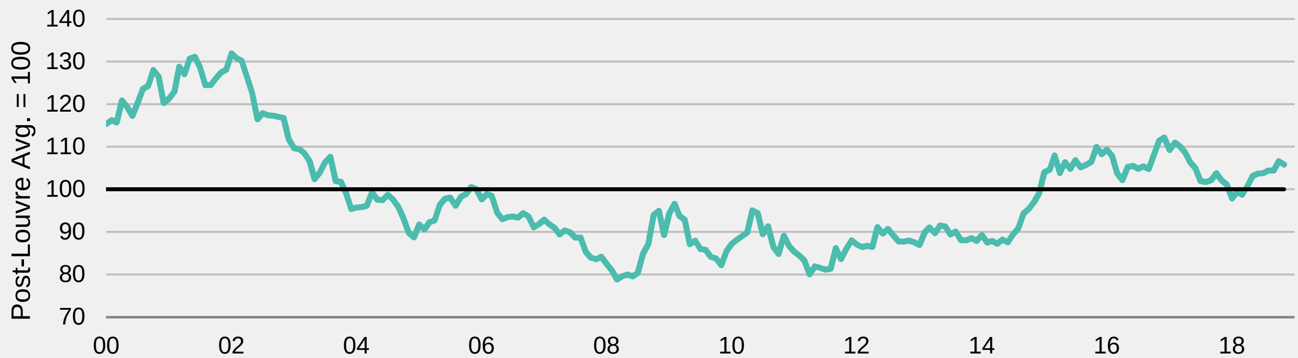
CNY—CNY already being used as a policy tool in the trade war and could fall further should tensions continue to escalate

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	114	105	113	109
USD/CNY	7.00	7.20	6.95	6.85
EUR/GBP	0.90	0.85	0.88	0.88

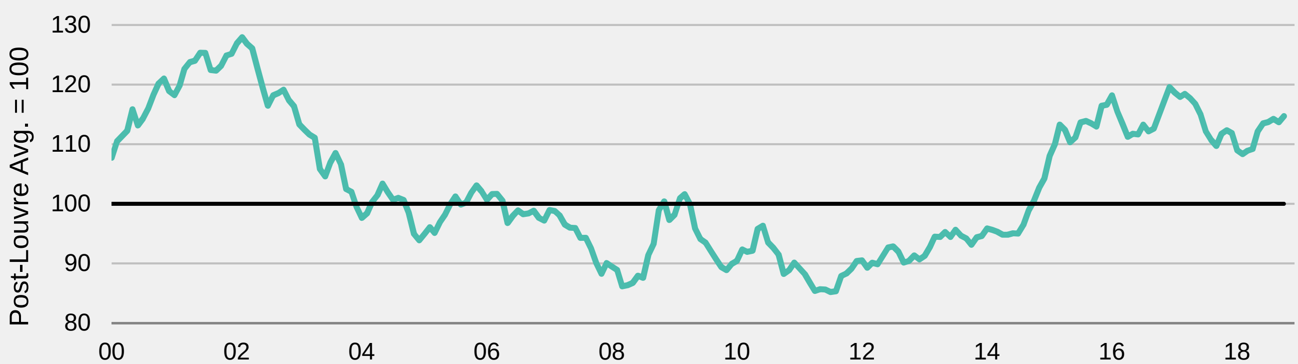
As of December 3, 2018
Source: Bloomberg and AB

Nominal USD Exchange Rate: DXY



Through December 3, 2018
Source: Bloomberg and AB

Real USD Exchange Rate



Through December 3, 2018
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	2.3	2.3	2.5	2.38	3.38	3.25	3.75

OUTLOOK

- The US economy remains fairly strong, though the pace of growth seems set to slow a bit. Nonetheless, the economy is operating at full employment, and growth is above the noninflationary potential rate, posing upside risks to wages and prices as 2019 progresses.
- Market volatility is likely to slow the economy somewhat in the coming months by tightening financial conditions. But considering how strong growth is, a modest slowdown should be welcomed for its ability to reduce the risk of eventual overheating or financial market imbalances that could jeopardize the expansion.
- Inflation has risen steadily for most of 2018 but has plateaued somewhat in recent months, which may give the Fed the opportunity to slow the pace of rate hikes in 2019.

RISK FACTORS

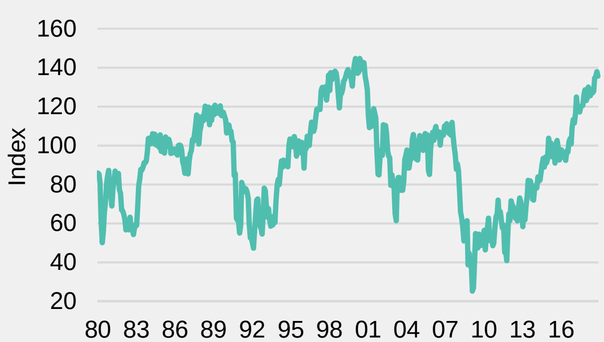
- Recent financial market turbulence highlights how difficult it will be for the Fed to move away from providing explicit forward guidance about the path of interest rates. While growth remains strong, an abrupt tightening of financial conditions could slow the economy more than currently forecast.
- Global factors, most notably the falling price of oil, pose downside risks to our inflation forecasts and thus to our expectation that the Fed will continue to raise rates throughout 2019.
- Politics remain an ever-present risk, with trade tensions and questions about the forward path of regulatory policy in focus.

OVERVIEW

There are finally some indications that growth is slowing as the effect of fiscal stimulus begins to wane. That should be viewed as good news: the economy has been operating above potential for several quarters, and a deceleration to a more trend-like growth rate reduces the risk of overheating and of financial market imbalances. The market seems concerned that a gradual deceleration will rapidly snowball into something more significant. We think those concerns are misplaced. Incoming data continue to paint a picture of a healthy economy, and we think there is plenty of forward momentum to keep growth solid for several more quarters. Another recession is inevitable, of course, but we don't think it's imminent.

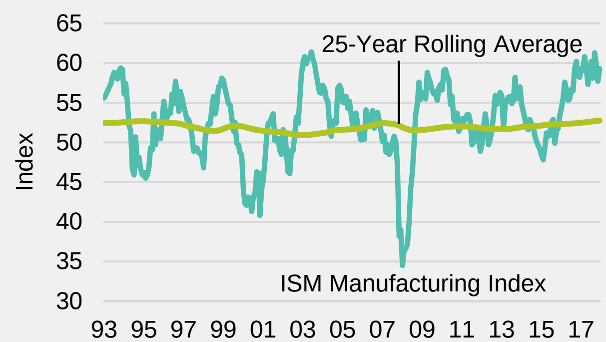
The outcome of the midterm election suggests gridlock ahead for domestic politics. We think this makes it unlikely that we will see either additional fiscal stimulus or a sea change in regulatory policy. That balance is consistent with a stable economic outlook for the time being, subject to swings in sentiment around the inevitable political noise. Trade tensions may not have a large direct impact on the domestic economy, but they are likely to impact sentiment and investment plans over the medium term. Still, for the time being, sentiment remains buoyant, which should keep the economy performing well.

Consumer Confidence



Through November 15, 2018
Source: Thomson Reuters Datastream

ISM and the Long-Term Average



Through November 15, 2018
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	2.0	1.4	1.8	1.7	0.00	0.25	0.50	1.00	1.15	1.10

OUTLOOK

+ Over the last six months we've reduced our 2019 forecast for euro-area growth from 2.1% to 1.4%, in response to rising trade tensions and signs that the Italian economy is likely to slow sharply.
+ The recent decline in the oil price has led to a slight reduction in our 2019 inflation forecast to 1.7% from 1.8%. But with wage growth picking up strongly, this is likely to mask a modest increase in core inflation to 1.3% from 1.0% this year.
+ The ECB has announced plans to phase out its net asset purchases this month. We still expect interest rates to rise next year, but softer growth means that this is likely to be a very gradual process.

RISK FACTORS

+ Risks are more evenly balanced now that we've downgraded our growth forecast. 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. The new populist government's fiscal plans have caused friction with the country's euro-area partners and led to a sharp tightening of credit conditions. Italian growth is likely to slow sharply in coming months, which could lead investors to question debt sustainability more aggressively.

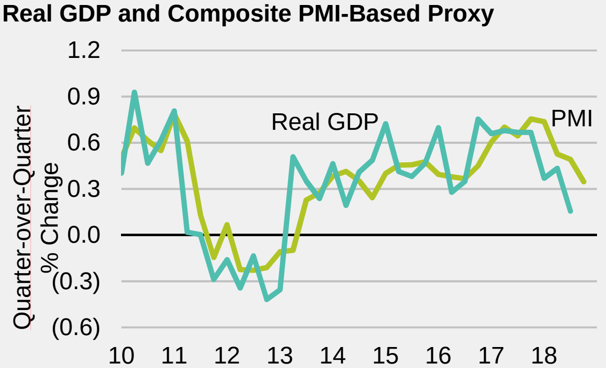
OVERVIEW

Euro-area data continue to disappoint, with the composite PMI for manufacturing and services dropping to 52.7 in November, the lowest reading since late 2014. The decline has been led by Germany and Italy; the French and Spanish PMIs have been more stable. The decline in the German PMI is partly due to temporary factors—the introduction of new auto emissions testing and the low water level on the Rhine. But the drop in the Italian PMI to 48.6 is a worrying development that suggests the economy may already be flirting with recession.

Still, many indicators suggest that tight capacity is finally feeding through to faster wage growth. In the third quarter, annual growth in compensation per employee rose to 2.5%, the fastest growth rate since 2008. At the same time, unit labor cost growth accelerated to 2.2%, above the precrisis average and the ECB's expectations. Although core inflation remains muted, there is also evidence of rising pipeline inflation, with producer price inflation for core domestic consumer goods rising to 0.8% in October, the highest since early 2012.

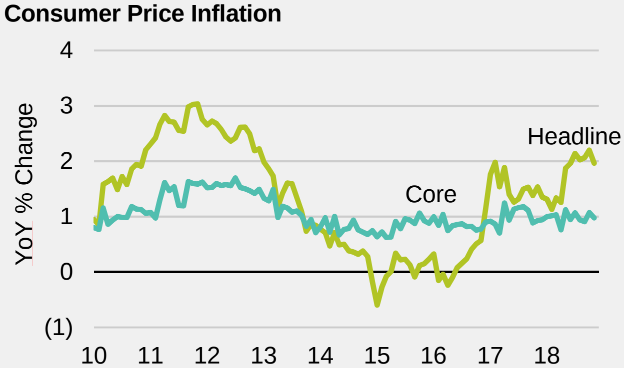
With the ECB set to end its asset purchase program this month, market attention will soon turn to the outlook for interest rates. Slowing growth and rising inflation pressures present the ECB with something of a dilemma. We still expect rates to rise by 25 basis points this year, but not until the fourth quarter, in line with the ECB's forward guidance.

Real GDP and Composite PMI-Based Proxy



Through November 30, 2018
Source: Haver Analytics and IHS Markit

Consumer Price Inflation



Through November 30, 2018
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	1.1	1.3	1.0	1.3	(0.10)	0.00	0.13	0.25	114	105

OUTLOOK

+ We still expect growth to exceed 1%, buoyed in part by further fiscal stimulus. External risks are rising, but positive factors such as income growth, supportive monetary conditions and fiscal stimulus should dominate.
+ We expect to see more concrete signs of rising inflation. Wage increases have started to move in the right direction, but CPI inflation is still far from the BOJ's 2% target.
+ The BOJ will likely stick with its QQE-YCC program, designed to cap 10-year yields, through 2019. But further tweaks are possible.

RISK FACTORS

+ External risks are front and center, including trade disruption or a sharp appreciation in the yen in a risk-off environment.

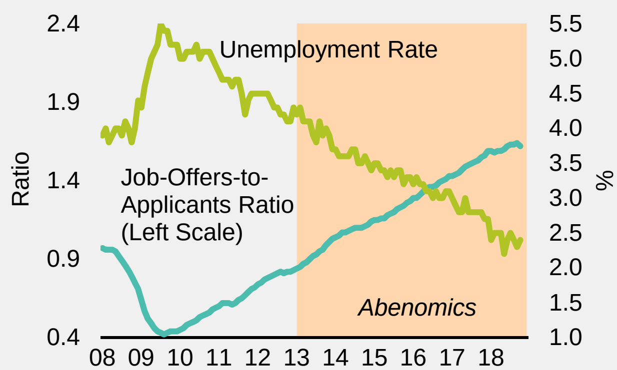
OVERVIEW

Economic data were on the soft side through September owing to natural disasters and other weather-related disruptions. But the numbers bounced in October, and the "softer" data—PMI, the Tankan survey—remain consistent with the economy continuing to expand at a reasonable pace. Next year, we expect growth to continue to run at an above-trend pace of 1% or so. Positive domestic demand drivers, such as solid household income growth and further fiscal expansion, should be more than sufficient to offset the drag coming from the external side. That should tighten the labor market and generate a further pickup in wage growth.

Even so, progress on the inflation front is still not sufficient for the BOJ to make any major adjustments to policy. But as we've argued before, experimenting with YCC is likely to continue. The size and frequency of Rinban operations have been adjusted, for example, to inject a little more volatility into the JGB market. We still think some upward adjustment in the 10-year yield target is plausible over the next 12 to 18 months.

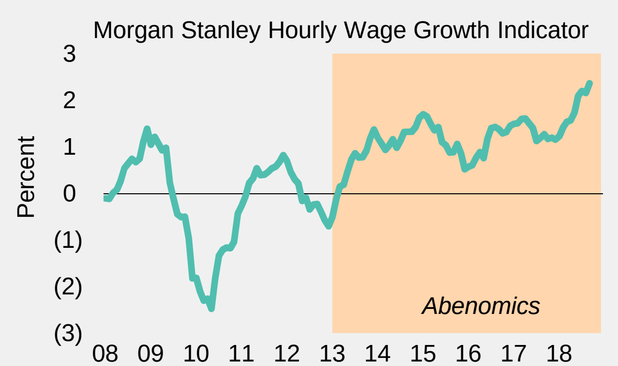
Timing that sort of adjustment is complicated, however, by the likely rise in the VAT in October 2019. There is high sensitivity around that hike: in the past, VAT hikes have had an outsize impact on GDP growth. This time around, the government will push ahead with aggressive fiscal stimulus to mitigate that risk.

Unemployment and Vacancies



Through December 3, 2018
Source: Bloomberg and Thomson Reuters Datastream

Wages



Through December 3, 2018
Source: Bloomberg and 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	6.5	6.2	2.3	2.8	4.35	4.35	3.50	3.30	7.00	7.20

OUTLOOK

- We think the official real GDP growth rate will be around 6.2% in 2019, but a likely peak in the capex cycle and decreasingly effective easing policies mean there's more downside than upside risk to that forecast.
- We expect inflation to rise to about 2.8%, 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. Big infrastructure projects and property easing are probably unavoidable, but it's possible it will be too little, too late.

RISK FACTORS

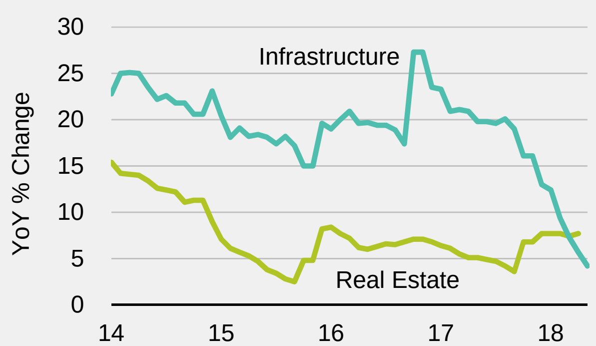
- Untimely or inefficient easing policies—or both—could make for a gloomier 2019 outlook.
- Rising inflation and slower growth risk a stagflation scenario and prevent the central bank from easing further.
- Another rise in trade tension with the US could provoke more RMB depreciation, making it a global currency and confidence destabilizer.

OVERVIEW

The most effective means of policy easing is central government–led investment in key infrastructure projects, and the time to do it is before the end of the year. Some fear this could lead to overstimulation, but we're not convinced. The deterioration of policy effectiveness and deleveraging constraints mean the economy can at best only stabilize around its current level. It's unlikely the government can resort to property easing now—that's better left until the end of the first quarter or the start of the second. If authorities delay or skimp on the size of stimulus, the outlook for the second half of 2019 will darken.

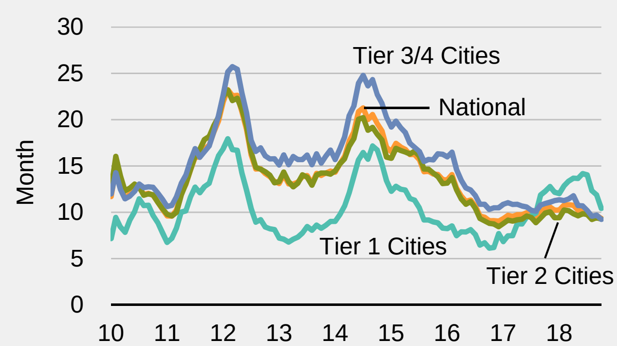
We think both interest-rate and growth differentials point to more RMB depreciation. A 90-day truce between the US and China on additional tariffs has helped stabilize the RMB. But a re-escalation of trade tensions in 2019 will add further downward pressure to the RMB, possibly causing it to break the psychologically important threshold of 7.00 per US dollar. But we don't expect it to go much further, as that would be a large depreciation and might provoke a response from Chinese policymakers.

Releveraging Up



Through October 31, 2018
Source: Bloomberg

China Property Inventory



Through December 3, 2018
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	2.2	2.1	2.3	1.75	2.75	2.60	3.25	1.32	1.37

OUTLOOK

- The domestic economy continues to perform well, which is helping the labor market. Unemployment is at a historical low, which should cause inflation to rise over time.
- The recent decline in energy prices poses downside risks to the Canadian economy, in terms of both growth and inflation.
- The Bank of Canada is likely to continue raising rates, but the pace of those increases may moderate in light of the oil price declines and the possibility that the Fed moves more slowly than expected.

RISK FACTORS

- Falling commodity prices are a clear downside risk to the economy, and while it is too early to see an impact on most domestic sectors, they merit scrutiny in the coming months.
- While near-term trade tensions with the US appear to have receded, conflict is still possible in the coming quarters.

OVERVIEW

As soon as trade tensions receded, a new risk appeared on the horizon. Falling energy prices are a threat to Canadian growth and, in contrast to trade policy, may not be resolved in one fell swoop. Should lower oil prices persist, it is likely that both growth and inflation will fall short of forecasts, leading the Bank of Canada to raise rates more gradually than previously expected. That may also reduce the risk that a heavily indebted consumer sector will face sticker shock as rates rise; a slower pace should allow a more gradual adjustment of household finances. As long as macroprudential measures to keep the housing sector from getting out of control remain effective, a more gradual rate path should not pose risks to financial stability.

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	3.2	2.3	2.0	2.0	1.50	1.50	2.65	3.00	0.72	0.68
New Zealand	2.8	2.5	1.7	2.0	1.75	1.75	2.65	3.25	0.68	0.66

AUSTRALIA

- Business sentiment remains firm, helped by the end of the mining bust, signs of a turn in nonmining capex and exposure to public sector infrastructure spending. Hiring has been strong.
- Even so, households are under pressure. Wage growth remains at record lows, undermining income growth. House prices are clearly starting to decline. Further tightening of credit availability is likely a consequence of the findings of the Banking Royal Commission. And dwelling construction activity is close to a peak.
- While this tension between good and bad economic data will be difficult to resolve clearly, and with global uncertainty increasing, we think the central bank will be on hold through the end of 2019.

NEW ZEALAND

- The growth outlook for New Zealand remains modest. Business sentiment remains weak, net migration has peaked, and house prices (in Auckland, at least) have softened. That will probably lead the central bank to relax some of its macroprudential measures.
- With inflation remaining low, wage growth relatively soft, and external risks rising, we think monetary-policy makers will keep rates unchanged through 2019.

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	1.5	2.6	2.0	0.75	1.25	1.50	1.75	1.28	1.30

OUTLOOK

+ Recent data have been mixed. While GDP growth was surprisingly strong at 0.6% in the third quarter, the composite PMI fell to 50.7 in November from 52.1 in October. Except for a temporary dip below 50 in July 2016 shortly after the Brexit referendum, this is the lowest reading since December 2012, which raises the possibility that uncertainty related to Brexit negotiations may be starting to bite.
+ If a no-deal Brexit is avoided, the British economy is likely to grow at much the same pace next year as this. Slowing global growth and Brexit-related uncertainty suggest that the risks to this forecast are on the downside, but this is likely to be offset by recently announced fiscal stimulus. With capacity use already tight and wage growth rising, we expect the Bank of England to raise interest rates by 50 basis points next year, though Brexit-related uncertainty means that the first 25-basis-point move might now come in May rather than February.

RISK FACTOR

+ 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 upon 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 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	2.2	2.4	2.0	0.75	1.25	2.25	3.00	7.90	8.26
Sweden	3.0	2.5	2.1	2.0	(0.50)	0.00	0.50	1.00	8.73	8.70

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 slightly to 2.2%.
+ Headline inflation rose to 3.4% in September, well above Norges Bank's 2.0% target. Core inflation (excluding energy and indirect tax changes) was much lower at 2.2% but is still above target and on an upward trend.
+ Norges Bank raised its key policy rate to 0.75% at its September meeting and has signaled that it is likely to raise rates by about 50 basis points per annum in coming years.

RISK FACTORS

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

SWEDEN OUTLOOK

+ Economic growth was very soft at 1.7% in the third quarter. This was much weaker than expected, but with survey data strong and Swedish data often subject to heavy revisions, we are not changing our growth forecast.
+ Core inflation (CPIF excluding energy) eased to 1.5% in October from 1.6% in September and remains roughly in line with its average over the last two or three years.
+ The Riksbank has signaled that it is likely to raise interest rates by roughly 50 basis points per annum over the next three years. The first 25-basis-point increase is likely to come at its December or February meeting.

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	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Asia ex Japan	**6.0**	**5.7**	**2.6**	**3.0**	**4.22**	**4.29**	**4.09**	**4.00**	**—**	**—**
Hong Kong	3.0	2.8	3.0	2.6	2.50	2.50	2.40	2.40	7.85	7.85
India	7.6	7.3	4.1	4.6	6.50	6.75	7.70	7.50	70.40	71.00
Indonesia	5.3	5.1	3.2	3.7	6.00	6.25	7.70	7.50	14,100	14,400
South Korea	2.7	2.3	1.7	2.0	1.50	1.50	2.30	3.10	1,130	1,175
Thailand	4.1	3.5	1.2	1.7	1.50	2.00	2.90	3.10	33.20	33.80

OUTLOOK

+ Lower oil prices should improve the external positions of energy-importing Asian economies.
+ US-China trade negotiations over the next 90 days could stoke further volatility.
+ Despite trade uncertainty, Asia's external position should remain strong compared with those of other emerging economies.

RISK FACTORS

+ Rising global yields, trade tensions 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

A sharp decline in oil prices has given current-account-deficit countries such as India, Indonesia and the Philippines some breathing room. This, along with market pricing of a more dovish Federal Reserve, sparked a recovery in risk sentiment that benefited the high-yielding assets of these three economies. As external pressure eases and inflation risk recedes temporarily, we expect the central banks to remain cautious. Policy changes are likely on hold, but expect central banks to hoard their bullets for use should sentiment worsen.

Among the risk-sensitive markets, we still prefer exposure to Indonesia and the Philippines over India. India is subject to more idiosyncratic factors, such as the upcoming local state election results and ongoing tension between the government and the central bank. Both may trigger volatility and undermine Indian assets.

Even though the US and China declared a 90-day truce on additional tariffs, the market remains skeptical that a lasting agreement is within reach. Uncertainty about trade prospects is showing up in the further deterioration in manufacturers' sentiment, with the PMIs of exporters South Korea and Taiwan dipping further below the 50 threshold that separates expansion from contraction.

Trade disputes are starting to affect growth. Net exports in the third quarter were a drag on headline GDP growth. Even so, domestic demand across the region held firm. And governments have fiscal flexibility to use as a buffer in the future. It's also important to keep in mind that the fundamentals of most Asian economies are stronger than those of other emerging markets. Most Asian economies are net savers with limited reliance on external financing, ample foreign exchange reserves, and low fiscal deficits that are being funded domestically. The large domestic savings accumulated onshore could also act as a buffer against foreign outflows and a rise in global rates.

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	**0.8**	**1.6**	**8.5**	**6.6**	**13.82**	**10.24**	**9.08**	**8.89**	**—**	**—**
Argentina	(2.1)	(0.6)	40.0	28.0	60.00	35.00	—	—	39.00	46.00
Brazil	1.5	2.4	4.0	4.1	6.50	7.50	10.00	9.10	3.78	3.70
Chile	4.0	3.9	2.9	3.0	3.00	4.00	4.95	5.25	680	690
Colombia	2.4	2.7	3.4	3.6	4.25	4.75	7.25	7.40	3,200	3,250
Mexico	2.2	2.0	4.3	4.0	8.00	7.00	9.55	10.35	20.70	21.75

OUTLOOK

+ Global growth remains robust, with the US leading the way. The expansion across G7 countries, however, appears to be somewhat weaker than initially forecasted. The environment for emerging-market assets has been challenging this year and is likely to remain complex in 2019 because of high US interest rates, a strong US dollar and protectionism out of the US.

RISK FACTORS

+ Tighter global monetary policies, heightened US protectionism, global geopolitical concerns, a strong USD, and idiosyncratic political shocks in Argentina, Mexico and Venezuela are all risks.

OVERVIEW

Economic activity in the region should improve this year, though the recovery is likely to fall short of early consensus expectations. While Mexico's pace of growth has remained steady despite the election and NAFTA-related concerns, Brazil is expected to expand more slowly than initially expected. Argentina is in the middle of a period of GDP contraction with high but declining inflation, while Venezuela is mired in hyper-stagflation. In the rest of the region, growth is soft and inflation rates remain subdued, although some pass-through from currency to domestic prices is likely in the coming months. At this point, it's fair to assume that no significant monetary easing will take place in the region for a while, with Argentina being the lone exception.

Argentina's tight policy stance is beginning to deliver results on the inflation front, although at a high cost in terms of economic activity. Monthly inflation probably peaked in October, but the contraction in GDP will likely continue until early 2019. The authorities have overdelivered on both the monetary and fiscal targets, thus securing much-needed IMF disbursements. The government hopes to see the start of a recovery around the second quarter of 2019, fueled by an expected rebound in agricultural production. Political risk remains high, and lower inflation and better activity are necessary for President Mauricio Macri to have a chance at reelection next year.

In Brazil, President-elect Jair Bolsonaro is filling his cabinet with market-friendly personnel. Bolsonaro will not have a controlling majority in Congress, so he will have to build a legislative coalition to advance much-needed reforms in Congress. The makeup of the new parliament, however, suggests that market-friendly reforms have a decent chance of approval. Pension reform remains the priority, and it appears that Bolsonaro's team will try to push reform in gradual steps in 2019.

In Mexico, markets were focused on the details of the 2019 budget plan due in mid-December. The new administration vowed a primary surplus, although the heavy burden of new social programs in President Andrés Manuel López Obrador's agenda suggests that the market will analyze the plan with extreme care to make sure the projected sources of revenue are reliable. The president's decision to cancel the original Mexico City airport project rattled the markets, and investors have challenged the government's plan to reallocate resources to the new Santa Lucia location. Meanwhile, new oil-field auctions have been suspended. Mexico's credit ratings may come under pressure in the coming quarters if the fiscal bottom line deteriorates or efforts to open the energy sector stall.

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	**2.8**	**2.4**	**6.8**	**6.2**	**10.54**	**8.29**	**10.44**	**9.62**	**—**	**—**
Hungary	3.8	3.2	2.7	3.0	0.90	1.50	3.60	3.95	283	283
Poland	4.5	3.5	2.2	2.5	1.50	1.75	3.60	4.20	4.25	4.15
Russia	1.8	1.6	3.5	4.3	7.25	6.75	8.50	8.00	70.00	65.00
South Africa	0.6	1.2	4.6	5.2	6.75	7.00	9.30	9.70	13.95	14.50
Turkey	3.0	0.0	16.6	15.6	24.00	17.00	19.00	17.00	6.30	6.30

OVERVIEW

+ Real GDP growth should remain strong in most of the region over the course of 2019, though a slowdown in Turkey may hold it back slightly from the pace set in 2018.
+ Most Central and Eastern European (CEE) economies are experiencing a rebound in headline CPI, which is likely to peak in mid-2019. After recent FX depreciation, Turkish headline inflation dynamics remain the most challenged, and CPI inflation is set to peak now at around 25% in 2019.
+ Despite the CPI rebound, central banks in several CEE countries will not tighten monetary policy significantly near term.

RISK FACTORS

+ Balance-sheet normalization at DM 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

Turkey's third-quarter GDP data showed a broad-based sequential contraction over the course of the quarter—a contraction that is likely to gather pace in the fourth quarter. This will take full-year growth to just above 2.5% year over year in 2018 (down from more than 7% in 2017) and suggests a contraction of more than 2% in 2019. This is good news in terms of inflation and the current account, as we are seeing significant demand destruction that helps to rebalance the economy following years of pump-priming. The flip side is that it will pose important challenges to corporate balance sheets over the course of 2019, necessitating government support for certain sectors.

Market reaction and asset performance will largely depend on policymakers' responses to such a sharp slowdown in activity, yet so far they have continued to make the right noises. First, the central bank signaled that it will maintain tight monetary policy. Second, the finance minister said the 2018 budget deficit will hit 1.8% of GDP, which is in line with the medium-term policy program (MTPP) announced in September.

Given the extent of the recession, we should expect policymakers to implement cautious countercyclical measures at some stage, such as interest-rate cuts and some fiscal support. With the fourth-quarter GDP data showing an even sharper contraction, the risk of a rate cut at the March 6 Monetary Policy Committee meeting (ahead of the local elections) has risen significantly. As long as cuts remain moderate (about 200 b.p.), markets shouldn't be concerned. On the fiscal front, we don't think anyone took the government at face value in its MTPP outline when it said it would keep the 2019 nominal fiscal deficit at around 1.8% of GDP, and increase the primary surplus to 0.8% of GDP—not with underlying growth assumptions of 2.3% in 2019 at the time. We believe that as long as the budget deficit doesn't balloon above 3%, the market should also be forgiving in a major recession year.

As soon as the March 2019 local elections are out of the way, the government will for the first time since early 2015 not be in election-campaign mode.

Frontier Markets

OUTLOOK

+ Approval of the tax bill in Costa Rica reduces financing risk for the rest of 2018 and unlocks multilateral financing. Authorization for external issuance should be approved in the near term, which will reduce pressure on local yields.

RISK FACTORS

+ Further fiscal adjustments are required to contain expenditure growth and comply with the fiscal rule. There's a window of opportunity for negotiations before the election cycle begins in mid-2019.

OVERVIEW

Optimism in Costa Rica rose when the tax bill was approved earlier this month, as it may create conditions for further agreements in the country's assembly. Lawmakers seem to realize that the fiscal situation is not sustainable and that changes to the expenditure structure are required to comply with the fiscal rule. The Finance Ministry has been trying to maneuver around the strict expenditure limits mandated by the constitution and other laws by broadening definitions. This is a relatively easy change, and doesn't require congressional approval, which should help to increase the discretionary portion of expenditures, estimated at just 5% of expenses for 2018. We're watching for further discussions on economic reactivation and reforms to public entities. If approved, both would have a positive fiscal impact and could spark a market rally.

Liquidity has been the primary issue affecting Costa Rican asset prices over the past few months, but the problems are mostly in the rearview mirror. Since the Constitutional Court ruled that the fiscal reform proposal could go ahead, local confidence has risen and participation in the domestic market has resumed. The fiscal reform bill also unlocked multilateral loans that had been approved by the World Bank and the Inter-American Development Bank. Authorization for external issuance is being discussed in Congress, which will help to alleviate pressure on the local market during 2019.

Last week, Moody's downgraded Costa Rica to B1 and maintained a negative outlook. Fiscal metrics have been deteriorating, and while fiscal reform was passed and is projected to help the country achieve a primary surplus by 2022, it isn't enough to stabilize the country's debt ratios. Continued pressure on spreads and pessimism from rating agencies may incentivize policymakers to pass additional reforms to contain expenditures.

AB Global Economic Forecast

December-18

	Real Growth (%)		Inflation (%)		Official Rates (%)		Long Rates (%)		FX Rates vs USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Global	3.1	2.9	2.9	2.9	3.27	3.31	3.31	3.50	-	-
Industrial Countries	2.2	1.9	1.9	2.0	1.23	1.79	1.93	2.37	-	-
Emerging Countries	4.7	4.6	4.6	4.4	7.20	6.22	6.05	5.73	-	-
United States	2.5	2.3	2.3	2.5	2.38	3.38	3.25	3.75	-	-
Canada	2.5	2.2	2.1	2.3	1.75	2.75	2.60	3.25	1.32	1.37
Europe	1.9	1.5	1.9	1.7	0.13	0.43	0.74	1.20	-	-
Euro Area	2.0	1.4	1.8	1.7	0.00	0.25	0.50	1.00	1.15	1.10
United Kingdom	1.5	1.5	2.6	2.0	0.75	1.25	1.50	1.75	1.28	1.30
Sweden	3.0	2.5	2.1	2.0	(0.50)	0.00	0.50	1.00	8.73	8.70
Norway	2.5	2.2	2.4	2.0	0.75	1.25	2.25	3.00	7.90	8.26
Japan	1.1	1.3	1.0	1.3	(0.10)	0.00	0.13	0.25	114	105
Australia	3.2	2.3	2.0	2.0	1.50	1.50	2.65	3.00	0.72	0.68
New Zealand	2.8	2.5	1.7	2.0	1.75	1.75	2.65	3.25	0.68	0.66
Asia ex Japan	6.0	5.7	2.6	3.0	4.22	4.29	4.09	4.00	-	-
China	6.5	6.2	2.3	2.8	4.35	4.35	3.50	3.30	7.00	7.20
Hong Kong	3.0	2.8	3.0	2.6	2.50	2.50	2.40	2.40	7.85	7.85
India	7.6	7.3	4.1	4.6	6.50	6.75	7.70	7.50	70.40	71.00
Indonesia	5.3	5.1	3.2	3.7	6.00	6.25	7.70	7.50	14,100	14,400
Korea	2.7	2.3	1.7	2.0	1.50	1.50	2.30	3.10	1,130	1,175
Thailand	4.1	3.5	1.2	1.7	1.50	2.00	2.90	3.10	33.20	33.80
Latin America	0.8	1.6	8.5	6.6	13.82	10.24	9.08	8.89	-	-
Argentina	(2.1)	(0.6)	40.0	28.0	60.00	35.00	-	-	38.00	46.00
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EEMEA	2.8	2.4	6.8	6.2	10.54	8.29	10.44	9.62	-	-
Hungary	3.8	3.2	2.7	3.0	0.90	1.50	3.60	3.95	283	283
Poland	4.5	3.5	2.2	2.5	1.50	1.75	3.60	4.20	4.25	4.15
Russia	1.8	1.6	3.5	4.3	7.25	6.75	8.50	8.00	70.00	65.00
South Africa	0.6	1.2	4.6	5.2	6.75	7.00	9.30	9.70	13.95	14.50
Turkey	3.0	0.0	16.6	15.6	24.00	17.00	19.00	17.00	6.30	6.30

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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