NORTHERN TRUST

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GLOBAL ECONOMIC OUTLOOK

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From Goldilocks to Deadlocks

Until this year, the global economy had been characterized by three years of strong, synchronized growth with subdued inflation—the "not too hot, not too cold" characteristics of a "Goldilocks" economy. Though global growth is still relatively resilient, inflation risk is clearly on the rise, driven by high commodity prices and tight labor markets.

The outlook for global economy is currently clouded by a series of deadlocks on key issues. Since September's Salzburg summit, the Brexit negotiation process has turned from bad to worse. U.S. tariffs on $200 billion of Chinese imports and China's retaliatory tariffs on $60 billion of U.S. goods have contributed to elevated global trade concerns. Italy's high deficit target will lead to a face-off with the European Union (EU).

Though we are still cautiously optimistic about global prospects, there is a clear growing unease over the handling of these important issues. Hopefully, economics and politics will align to reach productive resolutions.

The following are our views on developments in the major world economies.

United States

- The Federal Open Market Committee raised the target overnight federal funds rate to a range of 2.0-2.25%. Commentary following the meeting set expectations for another 25 basis point increase in December, and more to follow in 2019.
- Labor market indicators are very strong, with unemployment well below the level considered to be non-inflationary.
- Inflation is steady. The deflator on core personal consumption expenditures (excluding energy and food) reached 2.0%, the Fed's inflation target. Anecdotal evidence of higher costs is emerging, and tariffs will be inflationary in the near term.
- Real U.S. gross domestic product (GDP) growth in the second quarter was affirmed at 4.2% (annualized). We anticipate measurements for third and fourth quarters to show slower growth, a trend that should continue through 2019.

Eurozone

- Contrary to the earlier comments by Italian Finance Minister Giovanni Tria, Italy's cabinet agreed to push the deficit target to 2.4% of GDP for 2019-2021. This not only puts Italy on a collision course with Brussels, but will also likely thwart an expected decrease in debt and lead to market volatility.
- European Central Bank President Mario Draghi recently said he expects "a relatively vigorous pick-up in underlying inflation." Though this has fueled speculation of a rate hike in the second half of 2019, we expect that below-target inflation will prevent any rate increases next year.

- Declining external demand, deteriorating sentiment amid Brexit and the threat of a trade war appear to be weighing on European manufacturers. Recent surveys indicate that Germany, the eurozone's growth engine, is feeling the heat from external uncertainties.

United Kingdom

- The imminent Brexit deadline in March 2019 raises the stakes of each round of negotiation. The recent European Commission meeting in Salzburg added to fears of a "no deal" Brexit, but we continue to expect a breakthrough in the coming weeks leading to a "softer" Brexit that preserves access to the common market.
- Real growth in the U.K. has been steady, at an annual rate of about 1.5%. Wage pressures prompted the Bank of England (BoE) to raise rates earlier this year, but Brexit risks will likely rule out any further movements for the foreseeable future. BoE Governor Mark Carney has agreed to stay at his post through 2020 to provide continuity during the Brexit transition period.

Japan

- External momentum is expected to ease after a solid first half due to tapering Chinese demand and elevated trade protection. However, there is just enough domestic momentum to underpin growth in Japan.
- Though adverse weather conditions will hinder growth in the third quarter (owing to the earthquake in northern Japan and Typhoon Jebi), higher summer bonuses boosted household spending (on cars, computers and phones) and should help offset the impact of climate events.
- Prime Minister Shinzō Abe was reelected as leader of Japan's ruling Liberal Democratic Party, putting him on course to have the longest leadership tenure since the days of the samurai.

China

- President Donald Trump's decision to impose a 10% tariff on $200 billion of Chinese imports and China's retaliation on $60 billion of American imports has scuttled the prospects of a deal between the two this year. The risk of trade tensions ratcheting up further is high.
- Against the backdrop of elevated trade conflict with the U.S. and slow credit growth, we expect China's growth to cool during the balance of 2018.
- Policymakers have taken measures to support the Chinese currency and to ease domestic credit conditions. Yet as debt levels continue to rise, financial imbalances remain a key concern for China.

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Global Economic Forecast – October 2018

	2016	2017	2018F	2019F
United States				
Real GDP (Q4-Q4 % change)	1.8	2.6	3.1	2.0
Unemployment Rate, EOP (%)	4.7	4.1	3.7	3.7
Inflation (CPI, Q4-Q4, %)	1.8	2.1	2.5	2.5
Policy Rate (Top), EOP (%)	0.75	1.50	2.50	3.00
Eurozone				
Real GDP (Q4-Q4 % change)	2.0	2.8	1.9	1.8
Unemployment Rate EOP (%)	9.6	8.7	8.1	7.8
Inflation (CPI, Q4-Q4, %)	0.7	1.4	2.1	1.6
Policy Rate, EOP (%)	0.00	0.00	0.00	0.00
Deposit Rate, EOP (%)	-0.40	-0.40	-0.40	-0.40
United Kingdom				
Real GDP (Q4-Q4 % change)	1.7	1.3	1.3	1.5
Unemployment Rate EOP (%)	4.7	4.3	3.9	3.8
Inflation (CPI, Q4-Q4, %)	1.2	3.0	2.7	2.0
Policy Rate, EOP (%)	0.25	0.50	0.75	1.00
Japan				
Real GDP (Q4-Q4 % change)	1.5	2.0	1.1	0.5
Unemployment Rate EOP (%)	3.1	2.7	2.3	2.5
Inflation (CPI, Q4-Q4, %)	0.3	0.6	1.1	1.9
Policy Rate, EOP (%)	-0.10	-0.10	-0.10	-0.10
China				
Real GDP (Q4-Q4 % change)	6.8	6.8	6.4	6.1
Unemployment Rate EOP (%)	4.0	3.9	3.8	3.8
Inflation (CPI, Q4-Q4, %)	2.2	1.8	2.3	2.4
Policy Rate, EOP (%)	4.35	4.35	4.35	4.35
Exchange rates (EOP)	**Sep-2018**	**Dec-2018F**	**Mar-2019F**	**Jun-2019F**
EUR/USD	1.16	1.19	1.20	1.21
GBP/USD	1.30	1.31	1.33	1.35
USD/JPY	113.7	112.0	110.0	109.0
USD/CNY	6.87	6.80	6.75	6.70

F: Forecast *EOP: End of period*