NORTHERN TRUST

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GLOBAL ECONOMIC OUTLOOK

• Gear Up for Lower Gear

The global economy looks set to move into a lower gear as both advanced and emerging economies will find it hard to extend their recent robust economic performance into 2019.

The temporary (90-day) truce between the U.S. and China is a positive outcome for those directly or indirectly affected by the tit-for-tat protectionist moves. Yet the possibility of renewed escalation remains high. We expect the Trump administration to eventually hike the tariff rates to 25% on $200 billion worth of Chinese imports.

Oil has been in the news over the past few weeks. The commodity has witnessed a dramatic sell-off thanks to sanction exemptions to Iran's biggest customers, rising uncertainty about global demand and the soaring U.S. shale supply. Lower oil prices, if sustained, could boost consumers' purchasing power. It also could pose challenges for those central banks already struggling to achieve their inflation objectives. Oil producers will try to rebalance the market by reducing output.

Overall, we don't think this imminent slowdown will snowball into something more serious. But there is a long list of downside risks.

United States

- U.S. gross domestic product (GDP) growth for the third quarter was confirmed at a 3.5% annualized rate. The last revision included encouraging growth in business investment, a soft spot in the initial estimate, offset by a reduction in consumer spending. A strong holiday shopping season will support the fourth quarter, and we forecast full-year growth of more than 3%.
- Although Federal Reserve Chair Jerome Powell has downplayed the importance of forward guidance, the market has been attuned to Fed statements. Powell's most recent characterization that the Fed funds rate was "just below neutral" was interpreted as a signal that rate increases will soon end, boosting risk appetites. We expect to see a rate increase following the Federal Open Market Committee meeting on December 19, followed by two hikes in 2019.
- Labor markets remain resilient, with the unemployment rate holding at 3.7%. The prime-age (25 to 54) labor force participation rate remains below the peaks observed in past growth cycles, suggesting some slack remains in the labor market.

Eurozone

- In the eurozone, incoming data such as the eurozone Purchasing Managers' Indices (PMIs) and the German business climate index indicate that growth in the region is slowing.
- Trade tensions, Brexit uncertainty, Italy's budget stand-off, strikes in France and the possibility of snap elections in Spain next year are likely to weigh on sentiment. As a

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result, we have revised down our year-over-year real GDP growth forecast to 1.5% and 1.7% for the fourth quarters of 2018 and 2019, respectively.

- In an effort to ease market pressure, the Italian government recently softened its tone and signaled some concessions on the budget. This has raised hopes of an agreement, but the risk of an Excessive Deficit Procedure against Italy by the European Union (EU) remains high.
- These factors will likely keep the European Central Bank (ECB) from raising interest rates in 2019. Additions to the ECB balance sheet are likely to conclude by the end of the year.

United Kingdom

- After the U.K. and the EU reached agreement on the Brexit withdrawal agreement, the focus shifted to the British Parliament. The Brexit agreement is likely to be rejected in the first vote on December 11. Parliamentary arithmetic is a major hurdle for Theresa May (unless there are enough abstentions), but a modified arrangement could win a second vote. The economic consequences of a "no-deal" will be more severe than any other scenario.
- With unemployment at its lowest rate for more than four decades, U.K. wages have started to pick up, albeit not at a meaningful pace. Loosened fiscal policy announced in October will provide a boost to U.K. growth in 2019. The Bank of England will remain in a wait-and-watch mode until the Brexit date. Absent a "no deal" scenario, we expect the central bank to hike once (25 basis points) in 2019.

Japan

- Japan's GDP contracted by 0.3% in the third quarter. This outcome was not due to weak domestic fundamentals, but rather to temporary disruptions caused by a series of natural disasters and adverse weather conditions. Domestic demand will continue to underpin growth through the rest of this year and next amid a cooling external trade environment.

China

- Though China's export growth accelerated in October despite heightened trade tensions, its consumption growth weakened further, and credit growth continued to disappoint. This implies that the government will continue to implement measures (such as tax cuts and lowered reserve requirements) to underpin the economy.
- Despite a temporary truce, the risk of renewed trade escalation with the U.S. remains high. Issues related to Chinese handling of intellectual property and non-tariff barriers remain unresolved and will be difficult to negotiate in a 90-day window.

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Global Economic Forecast – December 2018

	2016	2017	2018F	2019F
United States				
Real GDP (Q4-Q4 % change)	1.8	2.6	3.2	2.3
Unemployment Rate, EOP (%)	4.7	4.1	3.7	3.7
Inflation (CPI, Q4-Q4, %)	1.8	2.1	2.2	2.5
Policy Rate (Top), EOP (%)	0.75	1.50	2.50	3.00
Eurozone				
Real GDP (Q4-Q4 % change)	2.0	2.8	1.5	1.7
Unemployment Rate EOP (%)	9.6	8.7	8.1	7.8
Inflation (CPI, Q4-Q4, %)	0.7	1.4	1.9	1.4
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	1.4	1.6
Unemployment Rate EOP (%)	4.7	4.3	4.0	3.8
Inflation (CPI, Q4-Q4, %)	1.2	3.0	2.3	1.9
Policy Rate, EOP (%)	0.25	0.50	0.75	1.00
Japan				
Real GDP (Q4-Q4 % change)	1.5	2.0	1.0	0.4
Unemployment Rate EOP (%)	3.1	2.7	2.4	2.5
Inflation (CPI, Q4-Q4, %)	0.3	0.6	0.9	1.8
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	3.9	3.9
Inflation (CPI, Q4-Q4, %)	2.2	1.8	2.4	2.3
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	1.15	1.18	1.21
GBP/USD	1.30	1.30	1.32	1.35
USD/JPY	113.7	112.0	110.0	109.0
USD/CNY	6.87	6.90	6.90	6.85

F: Forecast *EOP: End of period*