Global Economic Weekly

Cold comfort from hot labor markets

Bank of America Merrill Lynch

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Global Letter: cold comfort from hot labor markets

We develop a measure of the contribution of GDP components to variations in the business cycle. Consumption is the largest part of all DM economies, but it is less important to the cycle than investment and exports. Therefore, we put less focus on labor markets and consumption and more focus on capex, PMIs and trade flows.

Key calls

We summarize our key calls that are either out of consensus or not priced into the markets, and our important forecast changes.

United States: assessing the stockpile story

Inventory growth boosted GDP growth in both 3Q and 4Q 2018. This was due to elevated auto inventories, which may persist in 1Q. In our view, pre-tariff stockpiling was not a major driver decreasing the probability of a major inventory pullback. We are tracking 1.4% for 1Q GDP growth, but there is high uncertainty given all the distortions.

Euro Area: mostly pain no gain from Brexit scenarios

A Brexit deal remains our base case, but no-deal remains a possibility. We quantify potential Euro area effects. A spike in uncertainty, lower UK growth, GBP depreciation and higher tariffs could put 70-100bp of Euro area growth at risk. A short, or even a long extension would look similar to our base case, not creating much growth upside.

Asia: India – 6 events to track

With policy and polls around the corner we advise investors to track 6 upcoming events- (1) RBI's FX swap; (2) A liquidity injection calendar; (3) RBI Policy; (4) Jalan committee report on economic framework; (5) Opinion polls; (6) Rains.

Emerging EMEA: South Africa – trip notes

Electricity shortages, weak confidence and agricultural production, and slowing global growth should weigh on growth. Reforms should continue post elections, albeit at a slow pace. Eskom is everyone's concern.

Latin America: Mexico – consumers' dilemma

Consumer confidence is at all-time highs in Mexico yet private consumption is falling. We believe high consumer confidence echoes AMLO's high approval ratings and consumers' hopes of higher social expenditures.

Economics
Global

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Global Letter

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Cold comfort from hot labor markets

In the past few weeks we have been focused on the global growth slowdown and the offsetting policy stimulus in China. Here we focus on the developed economies:

- We develop a measure of the contribution of GDP components to variations in the business cycle.
- Consumption is the largest part of all DM economies, but it is less important to the cycle than investment and exports.
- Therefore, we put less focus on labor markets and consumption and more focus on capex, PMIs and trade flows.

Mixed macro signals

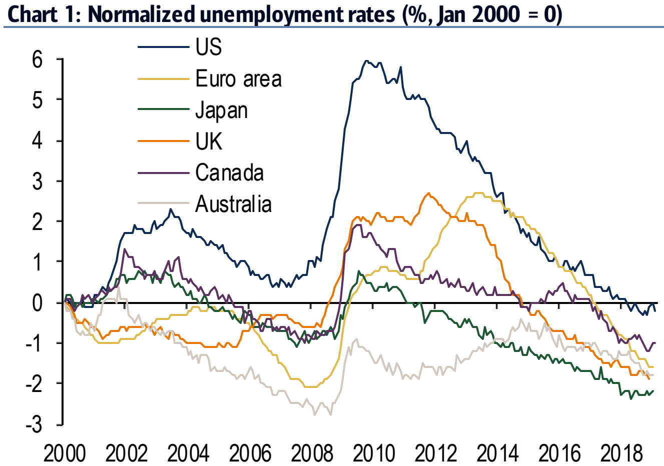
Across the developed economies we are seeing a dichotomy between strong labor markets (Chart 1) and slowing growth (Chart 2). Although investment has slowed only modestly, the weakness in export growth has been stark (Chart 3). And PMIs have declined substantially across the board, suggesting that there could be trouble ahead (Chart 4).

On the one hand, consumer spending accounts for more than 50% of GDP in all of the G6 economies. Therefore, low unemployment, combined with decent wage growth, might provide a buffer for the rest of the economy. On the other hand, investment and exports tend to be much more volatile, so they might drive the swings in the business cycle despite their relatively small share of overall spending (Table 1).

So how worried should we be? To answer this question, we develop a metric that quantifies the contribution of the components of GDP to its variation. Table 2 shows our results. For interested readers we describe our methodology in the paragraph below; others are welcome to skip ahead to the next section.

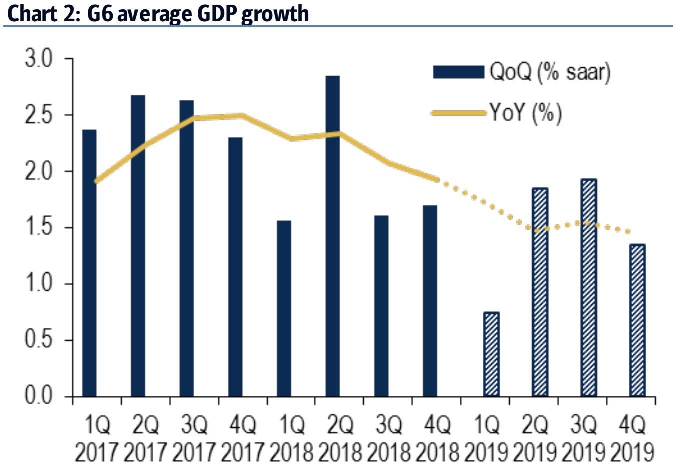
Our metric is an adapted version of the "risk contribution" measure that is used in portfolio analysis to calculate the contribution of each asset in a portfolio to its overall

Chart 1: Normalized unemployment rates (%, Jan 2000 = 0)



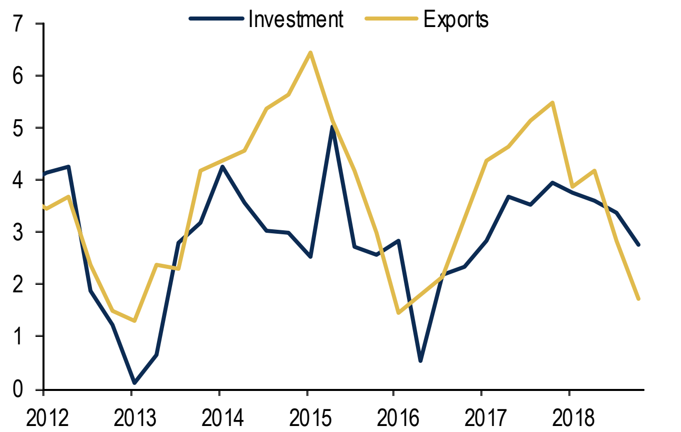
Source: BofA Merrill Lynch Global Research, Haver Analytics

Chart 2: G6 average GDP growth



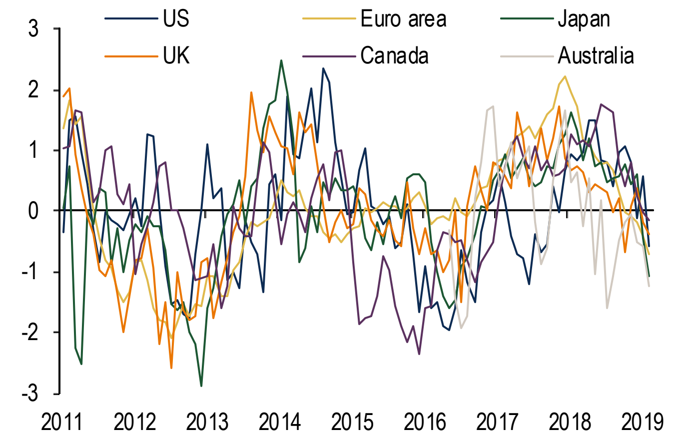
Note: Growth is aggregated using IMF PPP weights.
Source: BofA Merrill Lynch Global Research, IMF

Chart 3: G6 average investment and export growth



Note: Growth rates are aggregated using IMF PPP weights and the GDP shares of investment/exports in each economy. Investment includes private and public gross fixed capital formation, but excludes inventories.
Source: BofA Merrill Lynch Global Research, Haver Analytics, IMF

Chart 4: Standardized manufacturing PMIs (z-scores)



Note: The PMI for Australia is only available from May 2016 onwards.
Source: BofA Merrill Lynch Global Research, Haver Analytics, IHS Markit

risk (i.e., its standard deviation). We find that the contribution of a component to the variation in overall growth equals the correlation of its growth contribution with total GDP growth, times the ratio of the standard deviation of the growth contribution to the standard deviation of total growth. Note that this measure captures three aspects of the role of a GDP component in cyclical variations: (1) the share of the component in total output, which impacts its growth contribution; (2) the volatility of the component, which impacts the standard deviation of the growth contribution; and (3) the co-movement of the component with the rest of the economy, which impacts the correlation term.

What drives the cycle?

We find that consumer spending is not nearly as important a driver of the business cycle in the G6 economies as its spending shares would suggest. The reason is that consumption is much smoother than the rest of GDP, which in turn is because it has a large nondiscretionary component that does not vary much with the business cycle. There is a limit beyond which consumers cannot cut their spending on housing services, clothing, food and medical care during economic downturns.[1]

By contrast investment and exports drive business cycles in developed economies by a disproportionately large degree relative to their share of output. This is true even though we only account for gross fixed capital formation and leave out the most volatile component of total investment—inventories. Investment is highly cyclical because businesses typically adjust their capital spending in response to fluctuations in demand or uncertainty shocks. Residential investment also tends to move with, and drive, the cycle.

Table 1: Shares and volatility of the components of GDP

	Consumption		Investment		Exports	
	GDP share	Volatility (pp)	GDP share	Volatility (pp)	GDP share	Volatility (pp)
US	69%	1.8	21%	6.0	14%	8.7
Euro area	54%	1.4	21%	6.7	49%	7.1
Japan	56%	3.6	24%	6.1	17%	16.8
UK	66%	2.7	17%	11.5	29%	12.0
Canada	57%	1.8	21%	7.9	32%	9.0
Australia	57%	2.2	24%	10.4	22%	8.5

Note: GDP shares are for 2018. Volatility is calculated as the standard deviation of QoQ saar growth from 1Q 2000 to 2Q 2019. The shares shown can add up to more than 100% because imports contribute negatively to GDP. Investment includes private and public gross fixed capital formation, but excludes inventories.
Source: BofA Merrill Lynch Global Research, Haver Analytics

Table 2: Contributions to GDP growth volatility

	Consumption	Investment	Exports
US	33%	40%	27%
Euro area	23%	41%	104%
Japan	33%	20%	50%
UK	45%	27%	45%
Canada	18%	48%	88%
Australia	24%	64%	31%

Note: The contributions shown can add up to more than 100% because imports contribute negatively to GDP. Investment includes private and public gross fixed capital formation, but excludes inventories.
Source: BofA Merrill Lynch Global Research, Haver Analytics

[1] Officially the US Census Bureau designates housing, clothing and food as nondiscretionary spending.

Exports are often determined more by external demand and FX fluctuations than by domestic fundamentals (which would influence supply). But they are so volatile that they nonetheless tend to have a substantial impact on overall growth. The role of exports in the cycle varies substantially across the developed economies, with exports playing a huge role in the Euro area and Canada, and a relatively small role in the US. In the Euro area, it is not an exaggeration to say that exports are the business cycle, a point that our Europe economists often emphasize. Our estimates understate the normal role of exports in Japan because the period includes the volatility created by the consumption tax increase.

Uncertainty is certainly a concern

Our takeaway is that the consumer will probably not save the day. Consumer spending has always been a buffer during economic slowdowns but it has not prevented them. For example during the 2001 recession, consumption growth did not turn negative for even a single quarter in either the US or the Euro area. During the soft patch of 2015-16 it ran at around 2.7% in the US and 1.8% in the Euro area.

If anything we are concerned that in a deeper-than-expected slowdown, labor markets will eventually deteriorate across DM, causing consumer spending to slow. Most labor-market indicators are either coincident with the broader cycle or lagging (particularly wage growth). Our call for a bounce back in global (and DM) growth in the second half of this year is therefore not premised on the undeniable strength in G6 labor markets. Rather we are expecting some of the uncertainty shocks that have hit the global economy and markets in recent months to fade.

Most importantly, we think a US-China trade deal is likely in the next few months. This should help business confidence in both the US and China. Add in the big stimulus efforts, and we expect Chinese growth to pick up a bit in the second half of the year. Stronger domestic demand out of China, and stronger US demand for Chinese products, would be supportive for the external sectors in the Euro area, Japan and Australia.

Other sources of macro/market uncertainty also appear to be easing. The big three central banks—the Fed, BoJ and ECB—have all turned dovish. On the fiscal side, we expect some modest stimulus out of Germany this year. US fiscal stimulus is fading, but at least the government shutdown is now behind us. On Brexit we expect some sort of deal, although we have low conviction on the timing and nature of the agreement. Italy remains on the backburner for now, although its budget discord with the EU could resume after the European Parliament elections in May. In terms of oil prices, we are not expecting a major shock when the Iran sanction waivers expire in May.

It's all about China

In terms of the outlook we will be watching China, first and foremost. We will also be looking for signs of bottoming out in measures of developed-market business confidence, such as the forward-looking new orders and new export orders components of PMIs. The surge in PMIs in 2017 was an overshoot in retrospect: the actual pickup in investment was relatively modest. We are holding out hope that the same will be true on the way down. Developed markets will not be able to consume their way out of the ongoing slowdown. They will have to invest and trade their way out instead.

Key calls

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Below we summarize our key calls that are either out of consensus or not priced into the markets, and our important forecast changes.

US: Opportunistic reflation

We believe the patient Fed will only hike once more, likely in December. The Fed is being patient in order to assess downside risks to global growth, determine how last year's confidence shock and tightness in financial conditions will impact growth and, importantly, allow inflation to accelerate. In the coming months, we think the Fed will indicate that it is comfortable with core PCE inflation in the 1.5%-2.5% range. This would allow an overshoot at the peak of the business cycle, which is necessary for inflation to average 2% in the long run.

See US Economic Weekly: One and done, Ethanomics: Why the Fed will try to overshoot its inflation target

China: soft landing

We expect the Chinese economy to bottom out early this year and then bounce back in the second half. Policymakers have responded to the US-China trade war with a "do-whatever-it-takes" approach to supporting growth. Earlier policy tightening created room for accommodation, and financial conditions have already started to ease. Economic activity should follow suit in a few months' time.

See Asia 2019 Year Ahead: Policy to be held hostage by growth headwinds and trade uncertainty

Euro area: deflated expectations

Despite the better-than-expected 4Q 2018 GDP print, we continue to forecast below-consensus growth of just 1.1% in the Euro area this year. Italy is already in a technical recession. Moreover, the risks to our view are skewed to the downside: we are concerned about external demand, particularly out of China, and the spillover effects of a possible (though still unlikely) no-deal Brexit. We also expect headline and core inflation to come in below consensus in 2019 and 2020.

See Europe Economic Weekly: Always look on the bright side of life; Europe Economic Weekly: 2019 Year Ahead: Find time to pick the right time

Mexico: slicing growth in half

We have halved our 2019 growth forecast to 1.0%, which is well below consensus (2.0%). Slower global and US growth will weigh on external demand. Uncertainty about domestic policy and approval of the USMCA has been a drag on investment. Moreover, fiscal policy and monetary policy remain tight. Given the large revision, however, the risks to our forecast are now skewed to the upside.

See Mexico Watch: 1% growth in 2019

Changes to our key calls

We have revised down our 2019 growth forecast for Brazil to 2.4%, in line with consensus. There are three reasons. First is the handoff effect from weaker-than-expected growth last year. Second, credit and investment have been slow to adjust to a series of shocks (the deepest and longest recession in 2015-16, structural change in lending rates, 2018 presidential elections). Finally, weakness in the external sector has had a greater impact on the economy than expected.

Global economic calendar

The week ahead

Next week, attention will be on the US GDP data, core PCE, housing data, consumer confidence and trade balance. RBNZ Official Cash Rate will be announced in the New Zealand. CPI inflation across the Euro area. CPI and IP data in Japan. In emerging markets, there are monetary policy meetings in South Africa, Mexico, Chile, Hungary and Czech Republic.

Key events in the week ahead

NYT	Country	Data/Event	For	BofAMLe	Cons.	Previous
Monday, 25 March						
5:00	Germany	IFO Business Climate	Mar	98.9	--	98.5
9:30	Brazil	Current Account Balance	Feb	-$2000m	--	-$6548m
Tuesday, 26 March						
3:45	France	GDP (yoy, F)	4Q	0.90%	--	0.90%
7:00	Brazil	COPOM Meeting Minutes				
8:30	US	Housing Starts	Feb	1240k	1210k	1230k
8:30	US	Building Permits	Feb	1270k	1320k	1317k
9:00	Hungary	NBH decision – base rate	-	0.90%	0.90%	0.90%
10:00	US	Consumer Confidence	Mar	132.0	132	131.4
21:00	New Zealand	RBNZ Official Cash Rate	Mar	1.75%	1.75%	1.75%
8:30	US	Trade Balance	Jan	-$57.8bn	-$57.3bn	-$59.8bn
10:00	US	Current Account Balance	4Q	-$131.0bn	-$130.0bn	-$124.8bn
Wednesday, 27 March						
8:30	US	Trade Balance	Jan	-$57.8bn	-$57.3bn	-$59.8bn
10:00	US	Current Account Balance	4Q	-$131.0bn	-$130.0bn	-$124.8bn
Thursday, 28 March						
4:00	Spain	CPI EU Harmonised (mom, P)	Mar	1.90%	--	0.20%
6:00	Euro area	Consumer Confidence (F)	Mar	n.a.	--	--
8:00	Czech Rep.	CNB rate decision	-	1.75%	1.75-2.00%	1.75%
8:30	US	Initial Jobless Claims	23-Mar	225k	—	221k
8:30	US	GDP qoq (Annualized)	4Q T	2.1%	2.3%	2.6%
8:30	US	Personal consumption (qoq, Annualized)	4Q T	2.6%	—	2.8%
8:30	US	GDP Price Index	4Q T	1.8%	1.8%	1.8%
8:30	US	Core PCE (qoq)	4Q T	1.7%	—	1.7%
9:00	Germany	CPI EU Harmonized (mom, P)	Mar	0.70%	--	0.50%
10:00	US	Pending Home Sales	Feb	-0.5%	0.5%	4.6%
15:00	Mexico	Overnight Rate	28-Mar	8.25%	8.25%	8.25%
19:30	Japan	Tokyo CPI Ex Fresh Food YoY	Mar	1.00%		1.10%
19:50	Japan	Industrial Production MoM SA	Feb	0.30%		-3.40%
-	South Africa	SARB Announce Interest Rate	Mar	6.75%	n.a.	6.75%
Friday, 29 March						
3:45	France	CPI EU Harmonized (mom, P)	Mar	1.10%	--	0.10%
4:55	Germany	Unemployment Claims Rate (sa)	Mar	5.00%	--	5.00%
5:30	UK	GDP (qoq, F)	4Q	0.20%	--	0.20%
6:00	Euro area	CPI Core (yoy, A)	Mar	0.90%	--	1.00%
6:00	Italy	CPI EU Harmonized (yoy, P)	Mar	1.20%	--	1.10%
8:30	Canada	GDP MoM	Jan	0.00%		-0.10%
8:30	US	PCE Headline Prices (mom)	Jan	0.0%	0.1%	0.1%
8:30	US	PCE Core Prices (mom)	Jan	0.1%	0.2%	0.2%
10:00	US	New Home Sales	Feb	615k	622k	607k
17:00	Chile	Overnight Rate Target	31-Mar	3.00%	--	3.00%

Source: Bloomberg, BofA Merrill Lynch Global Research

For the full-week calendar, see here.

United States

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Assessing the stockpile story

- Inventory growth was robust in both 3Q and 4Q of 2018. We expect normalization going forward.
- Inventories may only exert a modest drag in the first quarter owing to elevated autos. We do not believe pre-tariff stockpiling was a major driver.
- We are tracking 1.4% for 1Q GDP growth, but there is high uncertainty given all the distortions.

First quarter noise

The Fed clearly is in a very dovish frame of mind. Fed officials are concerned about market volatility, persistently low inflation and a slowing economy. Here we focus on the later. In particular, we address two of the noisiest parts of the GDP accounts: inventories and trade. We find that inventories were bloated at the end of last year due to sector-specific stories around autos. There may have been some inventory stockpiling ahead of tariffs, but our assessment of the data suggests it was a secondary factor at best. Thus, we do not expect a major reversal of inventories in 1Q. Meanwhile, trade flows can accelerate. With both of these "unknown", 1Q GDP growth is tracking 1.4%, but with a particularly large confidence band.

Vroom vroom

Real change in private inventories (CIPI) reached elevated levels in the second half of last year, jumping from -$36.8 bn 2Q to $89.9bn in 3Q and then rising further to $97.1bn in 4Q. This boosted 3Q GDP growth by a huge 2.3pp and 4Q by 0.1pp. Remember that inventory investment is the difference between production and sales during a quarter, capturing whatever was unsold during the quarter. While businesses have gotten better at inventory management, it is still difficult to precisely forecast sales leading to periods of underbuild and overbuild. The gains in 2H likely reflected a positive payback after the contraction in 2Q.

Digging into the details of 4Q inventories, we find that two of the top three contributors to strong inventory growth were related to the motor vehicle supply chain: retail inventories surged by $22.4bn in 4Q, and wholesale inventories climbed $11.5bn (Table 3). Together the auto sector accounted for 35% of the inventory increase. Our Auto analysts noted that total unit auto inventories were 3% above the 5yr average from a days' supply perspective at the end of last year, which had increased slightly from 2% above in September. This is still a reasonable level, and auto manufacturers have been somewhat disciplined in adjusting production to demand, although the creep higher may reflect some unintentional build—it is hard to be perfect. Notably, there has been a significant shift in the inventory mix (Chart 5). Excess supply in trucks has emerged, while cars have gotten leaner. The uptick in total inventories and change in the mix helps to explain the 4Q growth in real inventories.

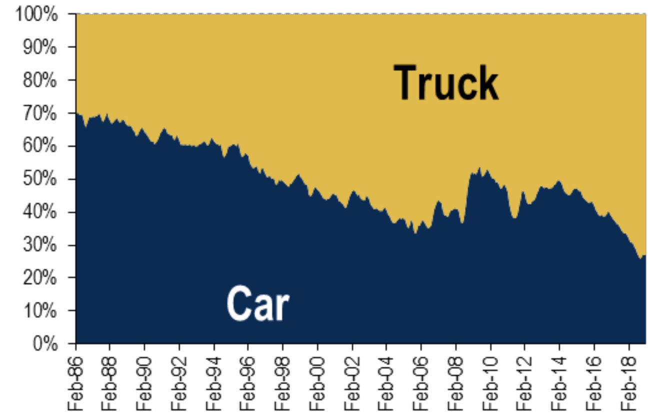
Looking ahead to 1Q, we think auto inventories may remain elevated, limiting the normalization in broader inventory growth. Auto sales have been more subdued, averaging 16.6mn saar in January and February versus 17.5mn in 4Q. Our Auto analysts noted that this has led to inventory creeping up to now about 4% above the 5yr average. It may take until 2Q for real auto inventories to normalize, either as a function of sales recovering (not our Auto analysts' view) or manufacturers taking production down to address the lower sales levels. With this in mind, our Auto analysts believe production

Table 3: Top 10 drivers of real CIPI strength in 4Q 2018 (real $bn saar)

	4Q 2018
Real CIPI	**97.1**
Retail: Motor Vehicle/Parts Dlrs	22.4
Wholesale: Machinery Equip	13.3
Wholesalers: Motor Vehicles	11.5
Retail: Other Retail Stores	8.3
Wholesale: Electrical Gds	8.1
Wholesale: Apparel/Piece Gds	7.8
Wholesale: Metals & Minerals	7.6
Other Industries Inventories	6.3
Wholesale: Misc Nondurables	6.1
Mfg: Chemicals	5.1

Source: BofA Merrill Lynch Global Research, Bureau of Economic Analysis

Chart 5: US inventory mix (% of total inventory)



Source: Ward's AutoInfoBank

discipline could be tested this year if sales deteriorate as they expect. In this scenario, we would see greater unintentional inventory build this year.

Could it be pre-tariff stockpiling?

Recent news reports have argued that businesses stockpiled goods ahead of the threat of higher tariffs in January. This would translate into a boost to imports and inventories, followed by a payback in 1Q. However, we believe the evidence suggests it was a secondary driver. Table 4 shows the top 10 categories exposed to the second round of tariffs, calculated as the nominal value of affected Chinese imports as a share of total US imports and the % yoy nominal import growth trajectory for affected Chinese goods. There is some supporting evidence of stockpiling in Machinery (except electrical), as it was the second most exposed category to the tariffs with 62% of US imports affected. It saw a pop in % yoy imports at the end of the year, and wholesale machinery was one of the drivers of inventory strength ($13.3bn).

Table 4: Top 10 import categories exposed to the second round of Chinese tariffs

Category (2018 nominal US imports)	Affected goods % of US imports	Affected nominal Chinese imports (% yoy) 4Q	3Q	2Q	1Q
Furniture & fixtures ($45.6bn)	74%	2%	-7%	-2%	9%
Machinery, except electrical ($188.6bn)	62%	26%	13%	-3%	-5%
Fabricated metal products, NESOI ($78.1bn)	44%	10%	6%	11%	14%
Apparel & accessories ($87.8bn)	20%	0%	-5%	2%	6%
Electrical equipment, appliances & components ($125.9bn)	15%	14%	5%	5%	9%
Fish, fresh/chilled/frozen & other marine products ($16.5bn)	11%	22%	-26%	2%	23%
Minerals & ores ($5.5bn)	11%	37%	-12%	-14%	-50%
Computer & electronic products ($414.0bn)	11%	13%	-1%	1%	-10%
Beverages & tobacco products ($25.8bn)	9%	56%	60%	72%	32%
Forestry products, NESOI ($2.6bn)	8%	-3%	20%	8%	28%

Source: BofA Merrill Lynch Global Research, Census Bureau

However, aside from that there are reasons for skepticism. Notably, 3 of the top 4 most exposed import categories did not see meaningful import growth acceleration in 4Q. The only other categories where imports accelerated were electrical equipment, appliances & components and computer & electronic products. However, both account for 15% or less of US imports, and the latter was not a major driver of real CIPI in 4Q.

Moreover, our colleagues Aditya Bhave and Stephen Juneau found that tariffs led to a sharp decline in % yoy growth of affected imported goods. This suggests that, if anything, the risk to 4Q imports and inventories should have been to the downside following the initial 10% tariff at the end of September. Their findings are consistent with recent literature on the US-China trade war from Amiti, Mary et al. (2019) and

Fajgelbaum, Pablo D. et al (2019): both papers found the pull-forward effect of tariffs to be mild relative to the steep declines in imports after the tariffs were enacted. Retaliatory tariffs also worked in the same way, with foreign demand falling and therefore weighing on US exports. These data are more obvious, as nominal US exports to China plunged 11.7% qoq sa in 3Q and 23.2% in 4Q.

Inventories will still be a drag, trade flows can grow further

In summary, while we expect inventories to see a pullback from elevated levels in the first quarter of 2019, we do not expect a major reversal. Auto inventories are likely to see continued growth given the soft sales environment in January and February, and we do not believe pre-tariff inventory build was a major driver that would have argued for a negative reversal lower in both inventories and trade flows. That said, there is high uncertainty around gauging all of these crosswinds, particularly with the two most volatile components of real GDP. We are tracking 1.4% for 1Q GDP growth but with a large confidence band.

Euro Area

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Mostly pain no gain from Brexit scenarios

- While a Brexit deal remains our base case, we cannot rule out a no-deal scenario. Hence we quantify Euro area effects.
- A spike in uncertainty, lower UK growth, GBP depreciation and higher tariffs could put 70-100bp of Euro area growth at risk.
- A short or even a long extension would look similar to our base case, hence not creating much growth upside for Europe.

We are one week away from the Brexit deadline and we are no wiser than we were a few months ago. True, the risk of a no-deal Brexit is lower now, we think, but it can't be ruled out. And we potentially face the risk of a long extension that would also have an uncertain outcome. In this context, we are again being asked about the potential downside risks for the Euro area outlook in those scenarios. Our answers are the same as before.

From an economic shock point of view, even if that scenario now has a lower probability, our main concern is a no-deal Brexit next week. We still think we would be looking at a short-term hit to Eurozone GDP of 0.7% to 1.0% with the potential to push the Euro area into a short technical recession. In other words, a no-deal Brexit could bring EU growth well below potential and just slightly above zero. And it could be even worse given potential logistical difficulties.

We are less concerned about a scenario with a short extension that leads to a deal, since that would not be very different from our central scenario. And if we were to see a long extension, we think that, even if there were some persistent uncertainty and the risk of a future harder Brexit were still there, the short-term impact should be fairly contained. It could even be a marginal positive given the (small) improved outlook we would expect for the UK economy, the currency, and at least stabilisation in the amount of Brexit-induced policy uncertainty.

The cost of no deal, revisited

We remind our readers of what we have argued before. Rob Wood still expects the UK to exit the single market but stay in the customs union in the long run, with many different paths for getting there. The risk of a no-deal Brexit is now lower, but it is still the default option if nothing else is agreed. Europe is taking a tough stance and the UK will need to give in to avoid a no-deal Brexit.

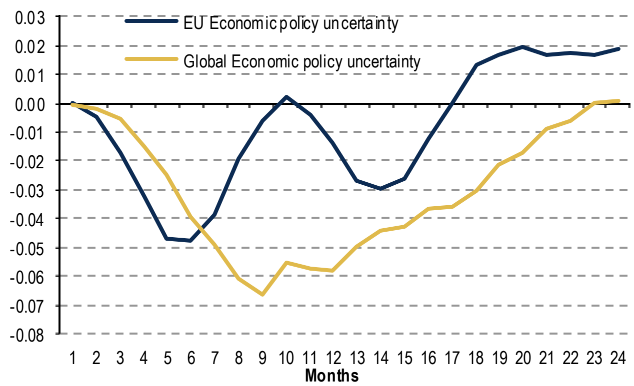
Either the UK chooses an alternative plan next week, or heads to elections, with then a long extension conditional on the results of that political process. Or it could go for something close to the existing withdrawal agreement and we would then see a short extension. But a decision needs to be made to avoid an accident.

In this context, what short-term costs could the Euro area face at the end of next week if a no-deal Brexit were to materialise (see here for a detailed discussion on the long-term costs)?

The first obvious one is an uncertainty shock. Remember from our previous work that uncertainty can act as an important drag on growth. Our econometric framework (see here for details) suggests that a policy uncertainty shock of one standard deviation that lasts for a quarter would incrementally hit growth for at least half a year, with a maximum impact of -5bps of growth, before starting to fade shortly after and pretty much disappearing after one year. The cumulative impact on GDP would be around -20bps (Chart 6).

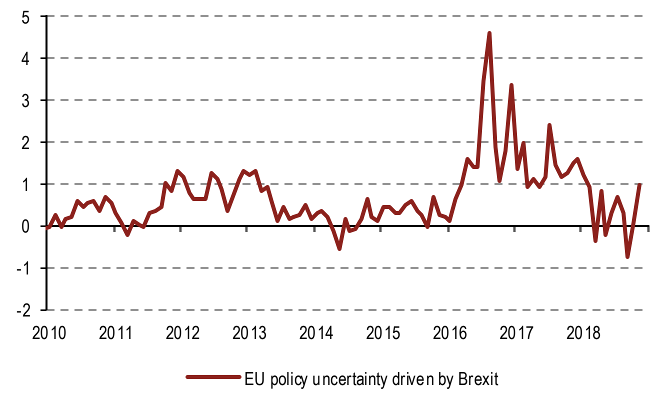
Chart 7 shows the Brexit vote led to an increase in policy uncertainty in Europe of more than three standard deviations, although it was very short-lived. A similar shock, if it were to persist and we think it would if we had a no-deal Brexit, could easily impact GDP by 30-60bps.

Chart 6: Response of EA GDP tracker to a one standard deviation shock in uncertainty



Source: BofA Merrill Lynch Global Research. For policy uncertainty indexes see "Measuring Economic Policy Uncertainty" by Scott Baker, Nicholas Bloom and Steven J. Davis at www.policyuncertainty.com

Chart 7: EU policy uncertainty driven by Brexit



Source: BofA Merrill Lynch Global Research. For policy uncertainty indexes see "Measuring Economic Policy Uncertainty" by Scott Baker, Nicholas Bloom and Steven J. Davis at.
Note: standardized series

Additionally, we would expect a slowdown in the UK economy of at least 1%, according to Rob Wood, potentially larger. Let's take, for the sake of argument, a 2.5% growth shock in the UK, which would typically lower imports by around 5%. We then increase that effect by 75% to account for the fall in sterling we would expect to follow and the potential hit to other non-Eurozone economies (e.g., Switzerland/Sweden). That would translate into a direct hit to EU GDP of about 0.4% after one year.

We can look at the impact beyond the uncertainty shock from just the trade angle. A no-deal Brexit would introduce immediate tariffs for trade between the UK and the rest of the EU. The size of the shock depends on the specific assumptions, but most estimates in the case of goods suggest an average tariff rate in the 3-4% range. That excludes non-tariff barriers (NTBs). But, according to recent research, a no-deal Brexit could easily bring non-tariff costs (the equivalent in tariff terms of NTBs) of more than 5% in a pessimistic case. We can apply these tariffs and non-tariff costs to total trade flows between the UK and the EU, but for that we need price elasticity of exports and imports. If we take 0.5%, not far off what empirical evidence suggests in response to FX changes, the cost in GDP terms of higher tariffs would be close to 20bps. An elasticity of 1 would bring the cost in excess of 30bps, not far from the macro approach we discussed above. The impact could be worse, even: tariff-specific research from French think tank CEPII suggests that every 1% rise in tariffs could affect demand by 1.4-2%[2]. If correct, the impact on Euro area GDP from tariffs alone could be close to 60bp.

In sum, we would look for a short-term hit to Eurozone GDP of 0.7% to 1.0%. In other words, a no-deal Brexit could bring EU growth well below potential and just slightly above zero. Of course this excludes many other channels and impacts that are hard to quantify. Beyond an increase in costs, there are many threats to commercial flows, including goods and services.

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[2] Fontagne, Martin & Orefice "The International Elasticity Puzzle Is Worse Than You Think", CEPII Working Paper 2017-03-February
Bénassy-Quéré, Bussière & Wibaux "Trade and currency weapons", CEPII Working Paper N°2018-08, June 2018

The EU exports 2.5% of GDP to the UK (Table 5), and most of these exports would need to go through enhanced border checks. Would the infrastructure be in place for speedy controls? There is a risk of impairment from physically shipping exports to the UK when we adjust to the new customs system. This is particularly relevant and goes beyond the tariff and non-tariff increase in costs described above. In other words, the final impact on trade (and GDP) could be much larger than suggested above if the infrastructure required for speedy border controls is not in place.

Should we worry about a long extension?

A short extension should not make a difference to our current forecasts. But under a long extension it could be argued that some tail risks to our 2019 could fade, at least temporarily (a new, more EU-sceptic UK prime minister could lead to higher uncertainty at a later stage, pushing the negative growth impact into the latter part of 2019)

First, we would expect slightly better growth in the UK (1.3% vs 1.1%). Rob Wood argues a long extension would seem, at least initially, like cancelling Brexit. Second, it would potentially also come with a weaker EUR against GBP, an additional tailwind for Euro area external demand from the UK.

Finally it would at least help to contain the level of Brexit-induced uncertainty for a while. This is very relevant. As we have argued before, we have seen a massive increase in policy uncertainty in the Euro area. But while we showed that trade policy uncertainty could easily explain a drag on growth of around 15bps so far, Brexit-related uncertainty does not seem to have been a significant drag on growth throughout 2018. In fact, Brexit-related uncertainty (once everything else is stripped out from policy uncertainty, Chart 7) does not seem to have been a significant drag on growth throughout 2018. If a long extension at least helps to contain further increases in uncertainty, that would stop the Euro area outlook from deteriorating further, at least in the short run.

Table 5: EU trade exposure to UK

	Exports to UK in % of GDP (2017 data)		
	Goods	Serv ices	Total
Germany	2.6	0.8	3.4
France	1.4	1.3	2.7
Italy	1.3	0.5	1.8
Spain	1.7	1.6	3.3
Netherlands	6.9	3.1	10.0
Belgium	7.3	2.1	9.4
Ireland	5.5	8.9	14.5
Euro area	2.5	1.5	4.0
EU-27	2.5	1.5	3.9

Source: Eurostat, BofA Merrill Lynch Global Research

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India – 6 events to track

- Investors should watch for the next steps that RBI takes to infuse durable liquidity – OMO purchases or FX swaps. RBI to cut in April and that should bring lending rates lower.

- Opinion polls and party manifestos should become the talk of town as general elections begin in April through May. Rains are also critical to track with chances of El Nino rising

We advise investors to track 6 key upcoming events, which will likely shape the markets over the next few weeks. Starting from as early as March 26th is the RBI FX swap needs to be monitored to gauge the interest of banks to park their dollars with the RBI. Improved FPI inflows clearly aid the favorable seasonality that INR sees during Feb-March. We expect this to be followed up with a calendar of durable liquidity injection for the June quarter (via OMO and/or FX) that assures markets of adequate liquidity and facilitates further monetary policy transmission into lower lending rates. Moving on to April, we expect the RBI MPC to cut rates by 25bps as inflation continues to stay low. April 7 should see the Jalan committee submitting their recommendations on the RBI's economic capital framework; we estimate RBI's excess capital to be anywhere between Rs1000bn and Rs3000bn that could potentially go the public exchequer. Preparing for the polling season, we look out for more opinion polls and party manifestos as India heads into general elections starting April 11. Lastly, the first forecast by the IMD for this year's monsoon is critical to track as the southern oscillation index swings the *El Nino* way.

As we set into the policy and polls season, we list the key events to keep an eye on.

#1 March 26: The RBI USD/INR Buy/Sell FX swap

Markets were positively surprised by the RBI announcing a USD/INR Buy/Sell swap for US$5bn that will take place on March 26. While this is being branded as a 'new' instrument in the RBI liquidity management toolkit, in our assessment, RBI has traditionally met higher liquidity demand in the 'busy' industrial season in Feb-March by buying FX. This exploits favorable trade seasonality (Chart 8). Also, the recent revival of FPI (foreign portfolio investment) equity inflows (Chart 9) has helped the RBI to use the FX route to inject durable liquidity in the system, the need for which is especially higher near March-end. This auction is only formalizing what has been happening since late 2011.

#2 March 29: OMO Calendar for June quarter?

We expect the RBI to issue a durable liquidity calendar injecting US$2-3bn a month in the June quarter by end-March. This could be via RBI OMO or FX purchases. One cannot underestimate the role sufficient liquidity plays in aiding monetary policy transmission. Since the Feb repo cut by the RBI MPC, many banks (both public and private) have cut their MCLR (marginal cost of funding based lending rate) by 5-10bps. While this is still incomplete, we expect more banks to follow suit and up the game by cutting lending rates by 10-15bps this time. Overall we expect lending rates to come off by 50bps by March 2020 (see RBI: 3 reasons for OMO calendar for June quarter 18 March 2019).

#3 April 4: RBI policy- expect 25bps rate cut

We expect the RBI MPC to cut rates by 25bps on April 4, while recognizing the chance of a 50bps cut (but that's not our base case). We would ideally want to wait and see what happens to rains and expect another 25bps cut in June/August. FY19 on an average should see inflation at 3.4%, lower than the RBI's target of 4%. FY20 CPI inflation is estimated to average at 4.7%, largely on base effects. We expect the RBI MPC to look through that (learning from 2017) and go ahead with lower rates. The re-evaluation of monetary policy by the Fed also raises chances of coordinated monetary easing (see 2.6% CPI: Could the RBI MPC cut 50bp on April 4? 13 March 2019).

#4 April 7: Jalan committee report on adequacy of RBI reserves

We await the recommendations of Jalan committee, which are due on April 7, regarding the RBI's economic capital framework. We opine that RBI's Contingency reserves (CR), at 6.2% of book, are far higher than the BRICs (Brazil, Russia, India and China, ex India) average of 2%. Revaluation reserves are also on the higher side relative to BRICs' central banks. Overall reserves, at 26.7% of RBI book, are well above the 18% proposed by the RBI's 2004 Usha Thorat group. Accordingly, we estimate Rs1000-3000bn/US$14-42bn/0.5-1.6% of GDP at Rs70/USD as RBI's excess capital (see Jalan committee: We see Rs1-3trn of excess RBI capital 27 December 2018).

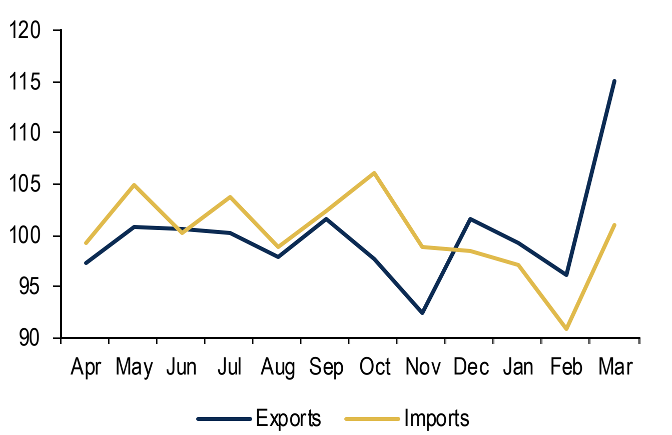
#5 April 7 onwards: Polling season- opinion polls and party manifesto

India will go into national elections starting April 11 in 7 phases through May 19, and results will be declared on May 23. With the model code of conduct now on, the deadline for parties to release their manifestos is 48 hours before polling. We advise investors to track both the opinion polls and the party manifestos as cues to market action The last round of opinion polls showed some improvement for the Mr. Modi-led NDA; while some of this could be attributed to the diplomatic victory post the recent Indo-Pak tussle, some of this is also on account of newly stitched alliances. We have long argued that 2019 general elections will again bring the importance of regional party alliances to forefront (see 2019 polls: All eyes on May 23 11 March 2019).

#6 April 5-15: IMD monsoon forecast

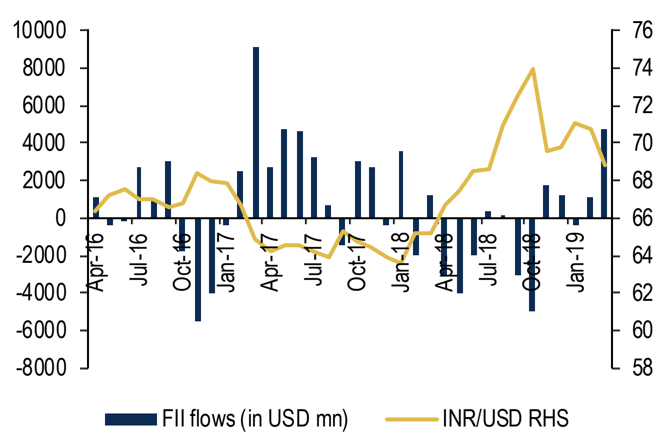
We await the first forecast by the IMD (India Meteorological Department) for the south-west monsoon in India this year. Early indicators, such as the southern oscillation index hint at rising chances (80%) of an *El Nino* in March- May, which is likely to decrease to 60% during June- August. For India, July- August make up for more than 50% of total monsoon rains, and thus the situation is not worrisome yet. So far, Skymet (a private forecasting agency) has assigned a 50% chance of a normal monsoon in 2019.

Chart 8: Seasonality favors INR in Feb- March



Source: BofA Merrill Lynch Global Research estimates, RBI

Chart 9: Add to this FPI flows have revived too



Source: BofA Merrill Lynch Global Research estimates, Bloomberg

Emerging EMEA

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South Africa – Trip notes

- Electricity shortages, weak confidence and agricultural production, and slowing global growth should weigh on growth

- Reforms should continue post elections, albeit at a slow pace. Eskom is everyone's concern. Local investors are comfortable with the risk premium over inflation. They believe Moody's negative outlook is in the price.

Full report: Trip notes – status quo to prevail

Reform should continue post elections, albeit at the current slow pace
National elections are scheduled for May 8th. Discussions on land reform, load shedding, nationalization of the SARB and prescribed assets dominate the election rhetoric. However, we think these concerns are overdone as a comfortable win by the ANC should continue to support reform albeit at a slow pace. The ANC has advanced in the polls in the six weeks leading up to elections since 1994. The ANC is currently leading the polls with a 55% majority, followed by DA at 24% and EFF at 11%. However, recent polls also suggest that ANC may lose majority in Gauteng and Western Cape.

SARB also focuses on risks to inflation, which are to the upside
The favorable backdrop and the output gap (which should prevail until end-2020) have helped the inflation profile. We see inflation at 4.6% in 2019E and 4.8% in 2020E. Higher electricity tariffs should add about 0.1-0.2ppt to headline inflation this year. The decline in inflation has given the SARB headroom to drive expectations to the mid-point of the inflation target range.

However, risks to inflation remain to the upside, e.g. administered price increases, rand volatility, risks to oil prices, and inflation expectations hovering above 5% (although declining). The SARB sees food prices to have consistently surprised to the downside, however, they are likely to normalize. Risks should urge the SARB to err on the side of caution. Nevertheless, we do not see the monetary authority overreacting to short-term movements in the exchange rate and oil prices.

Growth is subdued due to setbacks from structural rigidities
Lower global growth, low business and consumer confidence, load shedding and a decline in agricultural production likely will weigh on growth in 2019E. We see growth at 1.3% with risks to the downside. The lack of adjustment in income tax brackets is also regressive and would reduce disposable incomes. This, in turn, would constrain the fiscal space. Moreover, the funding needs of Eskom, health schemes and tertiary education could put pressure on expenditures. Reform is needed in state-owned enterprises, in particular Eskom.

Quick wins on reform could be in the areas of visa regulation, upgrading internet/cellular infrastructure, reducing the cost of doing business, and investment to close the skills gap. These reforms should add to South Africa's growth potential and help reverse the deterioration of per capita income growth.

Land reform is unlikely to undermine protection of property rights
Land reform continues to be a highly publicized debate as it is a proxy for inequality. However, opinion polls suggest that the general population still ranks jobs/employment and corruption as the priority policy areas. The President’s position is that reform will be carried out in an orderly fashion (i.e. no land grabs) and should focus on state-owned land.

Despite ongoing uncertainty, we think a loss of property rights in South Africa is unlikely, even if constitutional changes are recommended. It is not certain that the necessary political consensus (of at least a two-thirds majority in parliament) would be achieved to implement any changes. We believe South Africa has a robust legal and constitutional system that will limit the likelihood of explicit land grabs, with private land tenureship likely to be protected. Any proposed legislative changes are unlikely to be finalized before 4Q19 given a lengthy and complex parliamentary process and risks of legal challenges.

No quick wins on Eskom

We estimate that Eskom's FY19 cash deficit is about R53bn (based on a 9.4% base tariff increase). The National Treasury's R23bn cash injection and about R13bn in already secured borrowing will help ease Eskom's financial constraints. Eskom still needs to finance the remaining R17bn. Given the R14bn unutilized space in government guarantees, we think FY19 should be easily funded. Additional space could also be generated through the R38bn maturing debt (under government guarantees).

Structural adjustment on the expenditure side of Eskom's balance sheet is still required. This should necessitate efficiency improvements in power generation (especially in Kusile and Medupi), consolidation in the labor force, and renegotiation of supply contracts. We think reform on these fronts would require a big effort and compromise from all stakeholders (including unions) to implement.

Moody's to change the outlook on March 29th

Our baseline is for Moody's to move to negative outlook on March 29th and to sub-investment grade after the October mid-term budget. However, we acknowledge that the March 29th decision will be a close call with scope for Moody's to assess progress on growth and Eskom reforms despite fiscal weakness.

Local investors see slow pace of reforms and dismiss noise into elections

We think the local investor base will continue to backstop SAGBs. Some of the local investors that we met see government bond yields trading in the 8.75-9.5% range. These yields provide a good real rate of return as inflation is well anchored around 4.5%. They tend to dismiss the election rhetoric around "prescribed assets" but believe that it would be used as a last resort if conditions warrant.

Local investors see Eskom as a slow-moving process. Unbundling of the company should be a five-year plan with debt structuring a separate process. In this regard, they see things moving in the right direction but at a slower pace. Also, governance changes across policy makers and Zonda commission hearings are perceived positively as improving sentiment on the margin.

They are concerned about the outlook for China growth and agree with us that a slowdown will weigh on South African growth. They believe that Moody's change of outlook to negative is already in the price so no change should move spreads by 20-30bp.

Some of the banks are more cautious and differentiate on who they lend to. Relative to the past they are likely to ask for more collateral and reluctantly engage with new clients.

Latin America

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Mexico – consumer confidence at records high

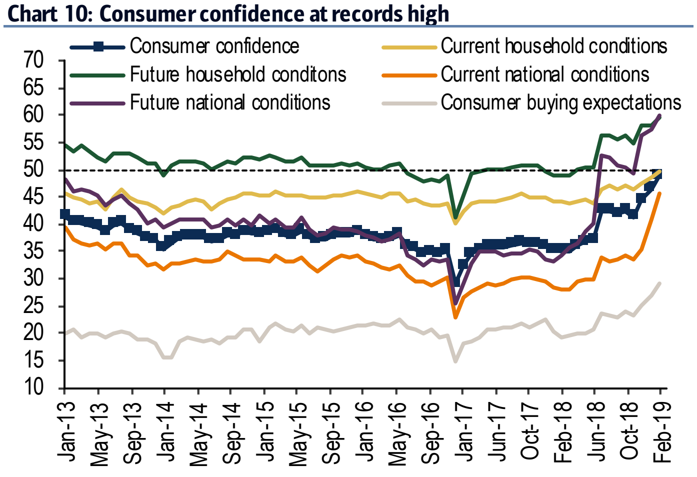
- Consumer confidence is at all-time highs in Mexico yet private consumption is falling.
- We believe high consumer confidence echoes AMLO's high approval ratings and consumers' hopes of higher social expenditures. We do not expect high consumer confidence to outdo fundamentals and expect consumption growth to remain around 2% as in 2018.

Consumer confidence is at record highs and has been trending up since AMLO won the presidential election in July 2018. The indicator is still below 50 so, in principle, Mexican consumers are still bearish, as a print below 50 indicates that consumers see the economic situation worse now or in the future than in the past, but it has never been above 50, and it is at its historical high at 48.8 (February, using seasonally adjusted data). Looking at the indicator's components, all are trending up and two are already above 50 (Chart 10). The component that has increased the most since the election is future national conditions, which is currently at 59.9. The only other component above 50 is future household conditions at 59.6. So consumers believe that Mexico's economic situation and their own household economic situation will be better in the next twelve months than in the previous year.

High consumer confidence echoes AMLO's high approval…

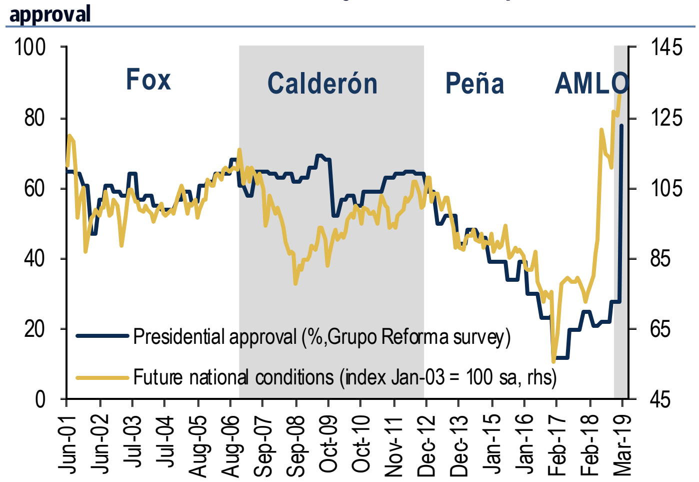
We believe that consumer confidence, and in particular the future national conditions, in part echo AMLO's sky-high approval rates (Chart 11). AMLO won the presidential election with 53% of the votes and his approval has increased since he took office on December 2018. Even though business leaders and investors disapprove of some of his decisions, such as cancelling the New Mexico City Airport or canceling oil and energy auctions, many Mexicans see these actions as a fight against corruption and hence approve them. So, many people in Mexico believe that economic conditions in the country will be better in the next twelve months because they believe that AMLO will reduce corruption (and increase security), which will help the economy. AMLO has also promised to rescue the south and Pemex, to reduce inequality and to grow the economy by 4%. AMLO feeds the expectation of better economic conditions with daily morning

Chart 10: Consumer confidence at records high



Source: BofA Merrill Lynch Global Research, INEGI, Banxico

Chart 11: Consumer confidence very correlated with president's approval



Source: BofA Merrill Lynch Global Research, INEGI, *El Reforma* newspaper press conferences (on weekdays) that can last more than an hour and a half. But those expectations have yet to be met. Hard data on economic growth, oil production and insecurity have not improved.

... and also the hope of social transfers

Consumer confidence could also be high because consumers have high hopes that someone in their households could receive a transfer as a result of one of AMLO's social programs. AMLO has an explicit populist bias and his first budget contains new social programs that increase transfers to consumers, such as universal pension to senior people and scholarships for young people. However, despite all the publicity about the new transfers, the 2019 budget has government expenditure falling with respect to 2018 as a percentage of GDP (23.2% in 2019 vs. 23.7% in 2018). Furthermore, as financing costs increase, expenditure ex-financing cost drops even more (20.2% in 2019 vs 21.1% in 2018). So any rise in consumption will come from re-directing resources to people with high propensity to consume rather than from more government expenditure.

Meanwhile, consumption is decelerating...

While consumption confidence soars, actual consumption has decelerated. Aggregate consumption contracted 0.1% mom sa in December 2018, which puts annual consumption growth at only 0.4% yoy in real terms. Other consumption measures are also weak: retail sales contracted 3.2% mom and 1.3% yoy in December while department stores' (ANTAD) same-store sales fell 0.6% in February, in real terms.

... and consumption fundamentals are mixed

The fundamentals that determine consumption are mixed, at best. Real wages have increased recently as a result of lower inflation (which has decelerated from 5.8% yoy at the end of 2018 to slightly below 4% in February) and also as a result of large increases in the minimum wage (16% yoy nationwide and 100% in municipalities next to the US border). We expect real wage growth to continue this year. But job creation has already decelerated. And the unemployment rate is rising (from 3.4% in June 2018 to 3.5% in January 2019). We expect job creation to continue decelerating as the economy slows Remittances for now retain solid growth, but we expect them to decelerate as US GDP growth decelerates and the US labor market softens. Finally, credit for consumption has also decelerated (1.8% yoy in real terms in January 2019 vs. 2.6% yoy in January 2018), and we do not expect credit to accelerate, as Banxico is likely to keep real rates above its neutral rate for some time.

We expect consumption growth to remain around 2%

We expect consumption to be the best performing domestic sector of the Mexican economy in 2019, but we do not expect consumption growth to accelerate from its 2018 pace. High consumer confidence will help aggregate consumption to perform better than what fundamentals would predict, but it will not be enough to accelerate consumption growth by itself, in our view. Although the evidence is mixed, several academic studies find that consumer confidence indicators do not help predict consumption expenditures beyond fundamentals, except perhaps when the change in confidence is large (Dees and Soares (2001)). And when confidence helps, it does so mostly for non-durable goods, not for durables or services. Overall, we expect private consumption growth to remain around 2% in 2019, after decelerating to 2.1% in 2018 from 3.3% in 2017, with upside risks given high consumer hopes. Consumption will likely grow more in real terms than with government spending and investment, in our view.

Global Economic forecasts

Global economic forecasts

	GDP growth, %				CPI inflation*, %				Short term interest rates**, %			
	2017	2018F	2019F	2020F	2017	2018F	2019F	2020F	Current	2018F	2019F	2020F
Global and Regional Aggregates												
Global	**3.8**	**3.8**	**3.4**	**3.6**	**3.0**	**3.2**	**3.1**	**3.1**	**4.45**	**4.42**	**4.23**	**4.13**
Global ex US	**4.2**	**4.0**	**3.6**	**4.0**	**3.1**	**3.4**	**3.3**	**3.3**	**4.88**	**4.86**	**4.56**	**4.43**
Developed Markets	2.2	2.2	1.6	1.6	1.8	2.0	1.4	1.6	1.18	1.17	1.30	1.45
G5	2.2	2.1	1.5	1.6	1.7	2.0	1.4	1.6	1.16	1.15	1.29	1.44
Emerging Markets	4.9	4.9	4.5	4.9	3.8	4.1	4.1	4.1	6.61	6.63	6.16	5.84
Emerging Markets ex China	3.9	3.9	3.7	4.2	5.0	5.1	5.6	5.1	7.92	7.92	7.21	6.72
Europe, Middle East and Africa (EMEA)	2.6	2.3	1.5	2.1	4.1	4.4	4.3	3.9	4.45	4.52	4.29	4.18
European Union	2.6	2.1	1.3	1.7	1.8	1.9	1.4	1.5	0.30	0.30	0.33	0.60
Emerging EMEA	2.9	3.0	1.9	2.8	6.9	7.4	7.8	7.0	9.64	9.82	9.24	8.60
PacRim	5.6	5.5	5.3	5.4	2.0	2.3	2.2	2.7	4.05	4.02	3.95	4.00
PacRim ex Japan	6.1	6.1	5.8	5.9	2.2	2.4	2.4	2.9	4.52	4.50	4.41	4.43
Emerging Asia	6.2	6.2	5.9	6.0	2.2	2.4	2.4	2.9	4.60	4.59	4.49	4.51
Americas	2.1	2.4	2.0	2.0	3.4	3.7	3.4	3.1	5.15	5.02	4.65	4.30
Latin America	1.7	1.4	1.7	2.3	6.5	6.9	7.5	5.8	12.56	12.09	10.14	8.72
G5												
US	2.2	2.9	2.2	1.8	2.1	2.4	1.8	2.1	2.38	2.38	2.63	2.63
Euro area	2.4	1.8	1.1	1.5	1.5	1.8	1.2	1.2	0.00	0.00	0.00	0.25
Japan	1.7	0.8	0.4	0.6	0.5	1.0	0.3	0.7	-0.10	-0.10	-0.10	0.00
UK	1.7	1.4	1.1	1.6	2.7	2.5	1.8	1.8	0.75	0.75	1.00	1.50
Canada	3.0	1.8	1.5	1.8	1.6	2.3	1.7	1.9	1.75	1.75	1.75	2.25
Euro area												
Germany	2.5	1.5	1.0	1.5	1.7	1.9	1.2	1.3	0.00	0.00	0.00	0.25
France	2.3	1.5	1.1	1.5	1.2	2.1	1.2	1.2	0.00	0.00	0.00	0.25
Italy	1.5	0.8	0.2	0.9	1.3	1.2	1.1	1.3	0.00	0.00	0.00	0.25
Spain	3.0	2.5	2.0	1.8	2.0	1.7	1.1	1.3	0.00	0.00	0.00	0.25
Netherlands	2.9	2.5	1.5	1.8	1.3	1.6	1.9	1.5	0.00	0.00	0.00	0.25
Belgium	1.7	1.4	1.2	1.4	2.2	2.3	1.3	1.4	0.00	0.00	0.00	0.25
Austria	3.0	2.8	1.5	1.7	2.2	2.1	1.6	1.8	0.00	0.00	0.00	0.25
Greece	1.4	2.1	1.8	1.7	1.1	0.8	0.7	1.2	0.00	0.00	0.00	0.25
Portugal	2.7	2.1	1.4	1.6	1.6	1.2	1.0	1.3	0.00	0.00	0.00	0.25
Ireland	7.2	6.5	2.3	2.6	0.3	1.1	1.1	1.1	0.00	0.00	0.00	0.25
Finland	2.8	2.2	1.6	1.8	0.8	1.2	0.5	0.9	0.00	0.00	0.00	0.25
Asia Pacific												
China	6.9	6.6	6.1	6.2	1.6	2.1	1.6	2.2	4.35	4.35	4.35	4.35
India	6.7	7.2	7.4	7.6	3.6	3.5	4.7	5.0	6.25	6.25	6.00	6.00
Indonesia	5.1	5.2	5.2	5.4	3.8	3.2	3.0	3.5	6.00	6.00	5.25	5.25
Korea	3.1	2.7	2.6	2.5	1.9	1.5	1.5	1.6	1.75	1.75	1.75	1.75
Australia	2.2	2.8	2.5	2.7	2.0	1.9	1.8	2.2	1.50	1.50	1.50	1.50
Taiwan	2.9	2.7	2.0	2.3	1.1	1.4	1.1	1.4	1.38	1.38	1.38	1.63
Thailand	3.9	4.1	3.7	3.6	0.7	1.1	0.9	1.1	1.75	1.75	1.75	2.00
Malaysia	5.9	4.7	4.5	4.7	3.8	1.0	1.4	2.5	3.25	3.25	3.25	3.25
Philippines	6.7	6.2	6.0	5.9	2.9	5.2	3.2	3.0	4.75	4.75	4.50	4.25
Singapore	3.6	3.3	2.8	2.5	0.6	0.4	0.8	1.6				
Hong Kong	3.8	3.3	2.2	2.7	1.5	2.4	2.1	2.3	1.80	2.10	2.50	2.50

Global economic forecasts

	GDP growth, %				CPI inflation*, %				Short term interest rates**, %			
	2017	2018F	2019F	2020F	2017	2018F	2019F	2020F	Current	2018F	2019F	2020F
Latin America												
Brazil	1.0	1.1	2.4	3.0	3.4	3.7	3.7	4.1	6.50	6.50	6.50	7.25
Mexico	2.0	2.0	1.0	1.5	6.0	4.9	3.9	3.6	8.27	8.25	8.25	6.50
Argentina	2.9	-2.6	-1.0	1.0	25.6	33.7	43.6	25.7	65.76	59.30	42.00	30.00
Colombia	1.8	2.6	2.6	3.2	4.3	3.2	3.3	3.3	4.25	4.25	4.25	4.50
Chile	1.5	4.0	3.4	2.9	2.2	2.3	2.1	3.1	3.00	2.75	3.75	4.25
Peru	2.5	4.0	3.3	3.5	2.8	1.5	2.4	2.5	2.75	2.75	2.75	3.25
Ecuador	2.4	0.5	-1.0	0.0	0.4	0.2	-0.5	0.0				
Uruguay	2.7	2.4	1.5	1.5	6.2	8.0	7.5	7.0				
EEMEA												
Russia	1.5	2.3	1.2	2.1	3.7	3.0	5.0	3.9	7.75	7.75	7.00	6.50
Turkey	7.4	3.3	-0.5	3.0	11.1	16.2	19.5	18.1	24.00	24.00	22.00	20.00
Nigeria	0.8	1.8	2.4	2.8	16.5	12.1	13.0	13.0	14.00	14.00	14.00	14.00
Egypt	4.2	5.3	5.5	5.7	23.5	21.6	14.9	10.8	15.75	16.75	16.75	15.00
Poland	4.7	5.1	3.6	3.3	2.0	1.7	1.7	2.8	1.50	1.50	1.50	1.50
South Africa	1.3	0.7	1.3	1.7	5.3	4.6	4.6	4.8	6.75	6.50	6.75	6.75
Romania	6.9	4.0	2.5	2.2	1.3	4.6	3.4	3.4	2.50	2.50	2.50	2.50
Ukraine	2.5	3.3	3.2	3.2	14.4	11.3	8.0	6.0	18.00	18.00	14.00	11.00
Czech Republic	4.3	2.8	2.6	2.7	2.4	2.1	2.5	2.3	1.75	1.75	2.00	2.25
Israel	3.3	3.4	3.0	3.0	0.2	0.8	1.3	1.5	0.25	0.25	0.50	0.50
Hungary	4.0	5.0	3.3	2.9	2.4	2.8	2.8	3.2	0.90	0.90	0.10-1.10	0.35-1.35
Saudi Arabia	-0.9	2.3	1.6	1.9	-0.9	2.6	2.0	2.0	2.50	3.00	3.50	3.50

Notes: Global and regional aggregates are based on the IMF PPP weights unless stated otherwise. Countries within each region are ordered according to these weights.

* Annual averages. The HICP measure of inflation is used for Euro area economies. ** Central bank target rate, year-end, where available, short-term rates elsewhere.

Source: BofA Merrill Lynch Global Research

Real GDP growth, qoq annualized %

	1Q 2018	2Q 2018	3Q 2018	4Q 2018	1Q 2019	2Q 2019	3Q 2019	4Q 2019	2018	2019	2020
Developed Markets											
United States	2.2	4.2	3.4	2.6	1.0	2.5	1.9	1.9	2.9	2.2	1.8
Euro Area	1.4	1.7	0.6	0.9	0.8	1.3	1.6	1.6	1.8	1.1	1.5
Japan	-0.4	1.9	-2.4	1.9	-0.8	1.1	2.8	-2.4	0.8	0.4	0.6
United Kingdom	0.4	1.7	2.5	0.7	0.4	0.8	1.6	2.0	1.4	1.1	1.6
Canada	1.3	2.6	2.0	0.4	1.1	2.1	1.8	1.7	1.8	1.5	1.8
Australia	4.3	3.3	1.1	0.7	3.2	3.2	3.6	3.2	2.8	2.5	2.7
G6 Aggregate	**1.6**	**2.8**	**1.6**	**1.7**	**0.7**	**1.9**	**1.9**	**1.3**	**2.2**	**1.6**	**1.6**
Emerging Markets											
China	6.1	7.0	6.6	6.1	5.9	6.1	6.3	6.3	6.6	6.1	6.2
India	10.1	7.8	3.3	3.9	11.4	8.7	4.4	4.9	7.2	7.4	7.6
Indonesia	4.4	6.2	4.7	5.5	5.0	5.5	4.1	6.9	5.2	5.2	5.4
Korea, Republic Of	4.1	2.4	2.3	3.9	2.1	2.4	2.2	3.7	2.7	2.6	2.5
Taiwan	3.0	1.1	1.5	2.6	3.2	3.3	3.6	1.7	2.7	2.0	2.3
Thailand	8.6	4.5	-1.3	3.3	4.7	4.9	2.0	2.6	4.1	3.7	3.6
Singapore	2.4	1.0	3.0	3.2	2.3	2.7	3.3	4.6	3.3	2.8	2.5
Hong Kong	8.7	-0.8	0.4	1.2	3.0	3.5	3.3	2.7	3.3	2.2	2.7
Brazil	1.7	0.2	2.2	0.5	0.5	5.5	3.4	2.9	1.1	2.4	3.0
Mexico	4.2	-0.6	2.4	1.0	-1.5	2.3	2.6	2.3	2.0	1.0	1.5
Colombia	3.6	2.4	0.9	3.6	2.6	2.6	2.6	2.6	2.6	2.6	3.2
Chile	4.9	2.7	1.1	2.8	5.7	4.3	5.1	0.0	4.0	3.4	2.9
Peru	3.6	9.6	-3.1	10.0	1.2	2.8	2.8	2.8	4.0	3.3	3.5
Russia	2.7	6.2	-1.1	-2.1	1.2	6.7	-0.6	-1.0	2.3	1.2	2.1
Turkey	6.9	2.6	-4.3	-11.5	0.0	2.0	8.2	13.6	3.3	-0.5	3.0
South Africa	-2.6	-0.4	2.2	2.6	-1.9	1.9	0.8	3.6	0.7	1.3	1.7

Source: BofA Merrill Lynch Global Research

Monetary policy forecasts

Key meeting dates and expected rate change (bp)

	Current	18-Dec	19-Jan	19-Feb	19-Mar	19-Apr
Developed Markets						
Fed	2.25	+25bp	unch	-	unch	-
ECB	0.00	unch	unch	-	unch	10th
BoJ	-0.10	unch	unch	-	unch	25th
BoE	0.75	unch	-	unch	unch	-
BoC	1.75	unch	unch	-	unch	24th
Riksbank	-0.25	+25bp	-	unch	-	25th
SNB	-0.75	unch	-	-	unch	-
Norges Bank	1.00	unch	unch	-	+25bp	-
RBA	1.50	unch	-	unch	unch	2nd
RBNZ	1.75	unch	-	unch	26th	-
Emerging Asia						
China (lending rate)	4.35	-	-			
Req. res. ratio*	13.50					
India**	6.50					
Repo rate	6.25	unch	-	-25bp	-	
Cash res. ratio	4.00	unch	-	unch	-	
Korea	1.75	-	unch	unch	-	18th
Indonesia	6.00	unch	unch	unch	unch	25th
Taiwan	1.38	unch	-	-	unch	-
Thailand	1.75	+25bp	-	unch	unch	-
Malaysia	3.25	-	unch	-	unch	-
Philippines	4.75	unch	-	unch	unch	-
Latin America						
Brazil	6.50	unch	—	unch	unch	—
Chile	3.00	unch	+25bp	-	**29th(+25)**	-
Colombia	4.25	unch	unch			
Mexico	8.25	+25bp	-	unch	28th	-
Peru	2.75	unch	unch			
Emerging EMEA						
Czech Republic	1.75	20th	-	unch	28th	-
Hungary	0.90	18th	unch	unch	26th	30th
Israel	0.25	-	unch	unch	-	11th
Poland	1.50	unch	unch	unch	unch	2nd
Romania	2.50	-	unch	unch	-	
Russia	7.75	-	-	unch	22nd	26th
South Africa	6.75	-	unch	-	26th	-
Turkey	24.00	unch	unch	-	unch	25th

Note: Bolded data are expectations in basis points. "—" denotes no meeting. TBA: MPC meeting not yet set. *Major five banks. **Reverse repo rate.

Source: BofA Merrill Lynch Global Research, Central Banks

FX forecasts

	Spot	19-Mar	19-Jun	19-Sep	19-Dec	20-Mar	20-Jun	20-Sep	20-Dec
G3									
EUR-USD	1.14	1.16	1.20	1.22	1.25	1.25	1.27	1.30	1.30
USD-JPY	111	106	107	103	101	105	105	105	105
EUR-JPY	126	123	128	126	126	131	133	137	137
Dollar Bloc									
USD-CAD	1.34	1.33	1.35	1.36	1.35	1.35	1.35	1.35	1.35
AUD-USD	0.71	0.72	0.74	0.76	0.78	0.78	0.79	0.80	0.81
NZD-USD	0.69	0.69	0.70	0.71	0.72	0.72	0.73	0.73	0.74
Europe									
EUR-GBP	0.87	0.87	0.86	0.86	0.86	0.87	0.87	0.88	0.88
GBP-USD	1.31	1.33	1.40	1.42	1.45	1.44	1.46	1.48	1.48
EUR-CHF	1.13	1.17	1.18	1.20	1.22	1.23	1.24	1.25	1.25
USD-CHF	0.99	0.98	0.97	0.98	0.98	0.98	0.98	0.96	0.96
EUR-SEK	10.43	10.55	10.45	10.37	10.30	10.25	10.20	10.15	10.10
USD-SEK	9.17	9.09	8.71	8.50	8.24	8.20	8.03	7.81	7.77
EUR-NOK	9.62	9.70	9.60	9.50	9.40	9.30	9.20	9.10	9.00
USD-NOK	8.45	8.08	7.87	7.79	7.52	7.44	7.24	7.00	6.92

	Spot	19-Mar	19-Jun	19-Sep	19-Dec	20-Mar	20-Jun	20-Sep	20-Dec
Latin America									
USD-BRL	3.79	3.62	3.60	3.60	3.60	3.62	3.64	3.66	3.68
USD-MXN	18.86	19.50	19.85	20.20	20.50	20.60	20.70	20.80	20.90
USD-CLP	670	662	664	666	668	669	670	671	672
USD-COP	3082	3155	3170	3185	3200	3306	3314	3322	3330
USD-ARS	41.02	39.20	42.00	45.80	50.60	52.80	55.40	57.90	60.70
USD-PEN	3.29	3.31	3.32	3.33	3.34	3.34	3.34	3.34	3.34
Emerging Europe									
EUR-PLN	4.28	4.30	4.30	4.30	4.30	4.30	4.30	4.30	4.30
EUR-HUF	315	317	315	313	310	310	310	310	310
EUR-CZK	25.67	25.50	25.50	25.00	24.70	24.70	24.70	24.70	24.70
USD-UAH	27.09	26.50	27.00	28.00	28.50	28.50	28.50	28.50	28.50
USD-RUB	63.86	64.00	62.00	62.00	62.00	62.00	62.00	62.00	62.00
USD-ZAR	14.21	14.30	14.20	14.30	14.10	14.10	14.10	14.10	14.10
USD-TRY	5.47	5.60	5.80	6.10	6.30	6.60	6.80	7.00	7.30
EUR-RON	4.76	4.75	4.75	4.80	4.80	4.80	4.80	4.80	4.80
USD-EGP	17.29	17.90	17.90	17.90	17.90	17.90	17.90	17.90	17.90
USD-ILS	3.60	3.60	3.50	3.50	3.50	3.50	3.50	3.50	3.50
USD-AED	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67	3.67
USD-KWD	0.30	0.28	0.28	0.29	0.28	0.28	0.28	0.28	0.28
USD-SAR	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
USD-QAR	3.64	3.64	3.64	3.64	3.64	3.64	3.64	3.64	3.64
Asian Bloc									
USD-KRW	1128	1,125	1,140	1,125	1,110	1,100	1,090	1,080	1,070
USD-TWD	30.81	30.90	31.00	30.90	30.70	30.60	30.50	30.40	30.30
USD-SGD	1.35	1.37	1.37	1.37	1.36	1.35	1.34	1.33	1.32
USD-THB	31.67	31.00	30.80	30.50	30.50	30.20	30.00	30.00	29.80
USD-HKD	7.85	7.85	7.85	7.85	7.85	7.85	7.85	7.85	7.85
USD-CNY	6.70	6.85	6.90	6.95	7.00	6.90	6.80	6.80	6.70
USD-IDR	14,140	14,200	14,100	14,000	14,000	13,800	13,700	13,600	13,500
USD-PHP	52.75	51.00	51.50	51.25	51.25	51.00	51.00	50.00	50.00
USD-MYR	4.06	4.07	4.10	4.13	4.15	4.10	4.05	4.00	4.00
USD-INR	68.83	70.00	73.50	72.50	71.00	70.00	69.00	68.00	67.00

Source: BofA Merrill Lynch Global Research

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