* As the global economy enters its tenth year of expansion following the global financial crisis, concerns are growing that a recession may be imminent. Although several factors will raise the risk of recession in 2019, a slowdown in growth—led by the United States and China— with periodic “growth scares” is the most likely outcome. In short, economic growth should shift down but not out.
* Previous Vanguard outlooks anticipated that the secular forces of globalization and technological disruption would make achieving 2% inflation in the United States, Europe, Japan, and elsewhere more difficult. In 2018, we rightly anticipated a cyclical firming in core inflation across various economies. In 2019, we do not see a material risk of further strong rises in core inflation despite lower unemployment rates and higher wages. This is because higher wages are not likely to funnel through to higher consumer prices, as inflation expectations remain well-anchored.
* As inflation moves toward target, financial stability risks rise, and unemployment rates continue to approach or drop below estimates of full employment, global central banks will stay on their gradual normalization paths. In the United States, we still expect the Federal Reserve to reach terminal rate for this cycle in the summer of 2019, bringing the policy rate range to 2.75%–3% before halting further increases in the face of nonaccelerating inflation and decelerating top-line growth. Other developed-market central banks, though, will only begin to lift interest rates from postcrisis lows.
* With slowing growth, disparate rates of inflation, and continued policy normalization, volatility in financial markets is likely to accelerate. Long term, our ten-year outlook for investment returns remains guarded, given the backdrop of high valuations and depressed risk-free rates across major markets.

Global Outlook Summary

Global economy: *Down but not out*

As the global economic expansion enters its tenth year, concerns are growing that a recession may be imminent. Although several factors will raise the risk of recession in 2019, a slowdown in growth—led by the United States and China—is the most likely outcome. In short, economic growth should shift down but not out.

We expect the global economy to continue to grow, albeit at a slightly slower pace, over the next two years, leading at times to so-called growth scares. In 2019, U.S. economic growth should drop back toward a more sustainable 2% as the benefits of expansionary fiscal and monetary policy abate. Europe and Japan are at an earlier stage of the business cycle, though we expect growth there to remain modest.

In emerging markets, China’s growth will remain near 6%, with increasing policy stimulus applied to help maintain that trajectory. Unresolved U.S.-China trade tensions remain one of the largest risk factors to our view, in addition to stronger-than-expected tightening by the Federal Reserve should the U.S. unemployment rate approach 3%.

Global inflation: *Unlikely to shoot past 2%*

Previous Vanguard outlooks anticipated that the secular forces of globalization and technological disruption would make achieving 2% inflation in the United States, Europe, Japan, and elsewhere more difficult. In 2018, we rightly anticipated a cyclical firming in core inflation across various economies. In 2019, we do not see a material risk of further strong rises in core inflation despite lower unemployment rates and higher wages, as inflation expectations remain well-anchored.

In the U.S., we expect core inflation to remain near or below 2% throughout 2019; an escalation in tariffs would only temporarily affect U.S. core inflation. In Europe and Japan, price pressures will increase gradually as labor market slack erodes, though core inflation is likely to stay well below 2%. Higher wages are likely, yes, but higher inflation is not.

Monetary policy: *Convergence commences, with the Fed stopping near 3%*

As inflation moves toward target, financial-stability risks rise, and unemployment rates approach full employment, global central banks will stay on their gradual normalization paths.

In the United States, we still expect the Fed to reach terminal rate for this cycle in the summer of 2019, bringing the policy rate range to 2.75%–3% before halting further increases in the face of nonaccelerating inflation and decelerating growth. Other developed- market central banks will only begin to lift interest rates from postcrisis lows. We expect the first rate increase from the European Central Bank in late 2019, followed by a very gradual hiking path thereafter. Japan is late to the party and we do not expect any rate increases in 2019, though some fine-tuning of its policy framework is likely to ease growing financial-stability risk. Emerging- market countries don’t control their own destiny and will be proactively forced to tighten along with the Fed, while further modest currency depreciation, tempered by tightened capital controls, is the most likely outcome in China.

Investment outlook: *No pain, no gain*

With slowing growth, disparate rates of inflation, and continued policy normalization, volatility in financial markets is likely to accelerate. Long term, our ten-year outlook for investment returns remains guarded, given the backdrop of high valuations and depressed risk-free rates across major markets.

U.S. fixed income returns are most likely to be in the 2.5%–4.5% range, driven by rising policy rates and higher yields across the maturity curve as policy normalizes. This results in a modestly higher outlook compared with last year’s outlook of 1.5%–3.5%—albeit still more muted than the historical precedent of 4.7%.

Returns in global equity markets are likely to be about 4.5%–6.5% for U.S.-dollar-based investors. This remains significantly lower than the experience of previous decades and of the postcrisis years, when global equities have risen 12.6% a year since the trough of the market downturn. We do, however, foresee improving return prospects in non-U.S. developed markets, building on slightly more attractive valuations (a key driver of the equity risk premiums) combined with higher expected risk-free rates.

As was the case last year, the risk of a correction for equities and other high-beta assets is projected to be considerably higher than for high-quality fixed income portfolios.