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Daily Observations

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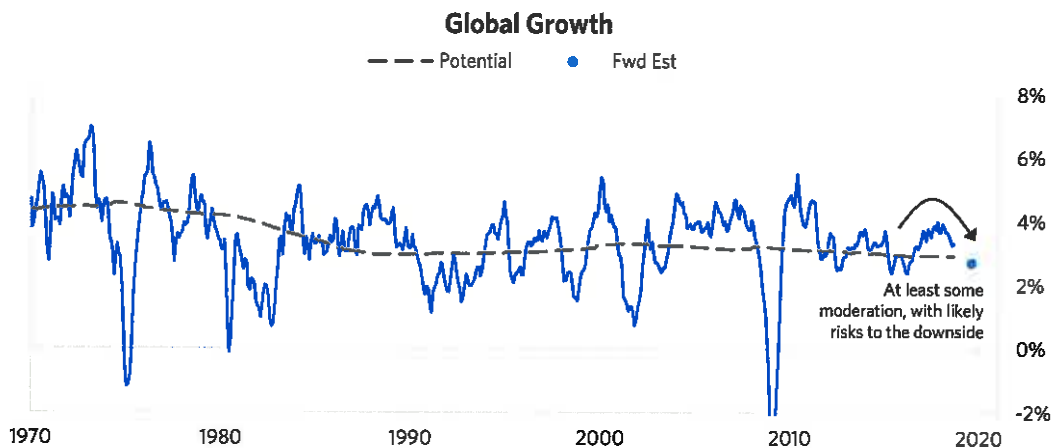
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Global Expansion Is Likely to Moderate, and Most of the Risks Tilt to the Downside

On a global basis, we are transitioning from a period of extraordinarily easy monetary policy, rising asset prices, and strong global growth to one of somewhat tighter monetary policy, flatter asset prices, and slower growth. The pullback in central bank stimulation so far plus the amount of tightening discounted going forward is moderate at this point, and the flow-through to asset prices and growth has been limited. But over time, we expect to see this tightening flow through more, with the most likely outcome being a modest, broad-based slowing of growth over the next year. That said, we think the risks are tilted to the downside. Any positive growth surprises are more likely to be met by tightening and so would be less sustainable. And, as we look at current conditions, we think it is more likely than not that central banks will tighten faster than discounted, posing downside risks to both asset prices and economic growth. We assess the risks today, particularly the political ones, as appearing larger than usual at a time when an extremely long period of steady growth has contributed to both low realized and discounted volatility. The implications if any of these risks materialize are different for different economies and regions, and if monetary easing proves to be needed, it is likely to be less effective than usual, and global policy coordination may prove to be more challenging as well. The clearest risks include:

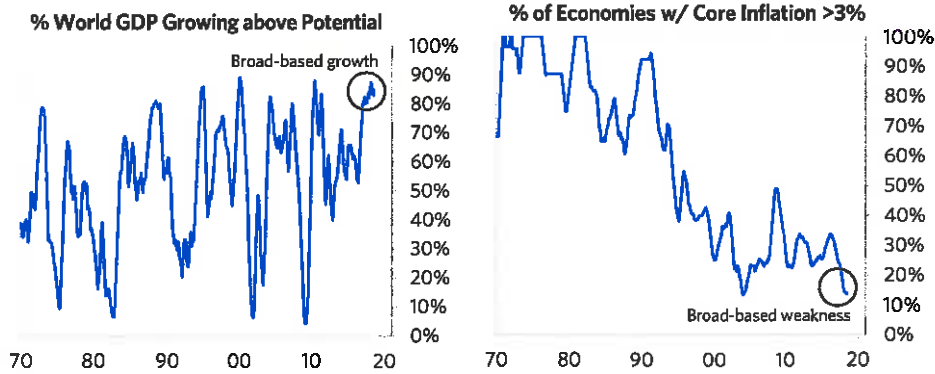
- In the US, the combination of tightening, ebbing fiscal supports, and risks around trade. The US is furthest in its expansion, and dollar tightening is a bearish pressure for dollar-reliant economies.
- In Europe, divergent conditions leading to political risks, as well as Brexit, are potential sources of instability.
- In China, there is an ongoing economic slowing as domestic tightening has begun to bite, and trade tensions have picked up. We expect the Chinese economy to slow further over the next year.
- In a few isolated emerging economies (Turkey in particular), balance of payments crises are forcing harsh trade-offs that are likely to further hurt domestic growth.

The chart below shows our timely read on global growth relative to potential, as well as our base case forward estimate based on current conditions and pressures. Growth is likely to moderate somewhat over the next year, with additional slowing possible if the risks turn out to be bigger than currently discounted.



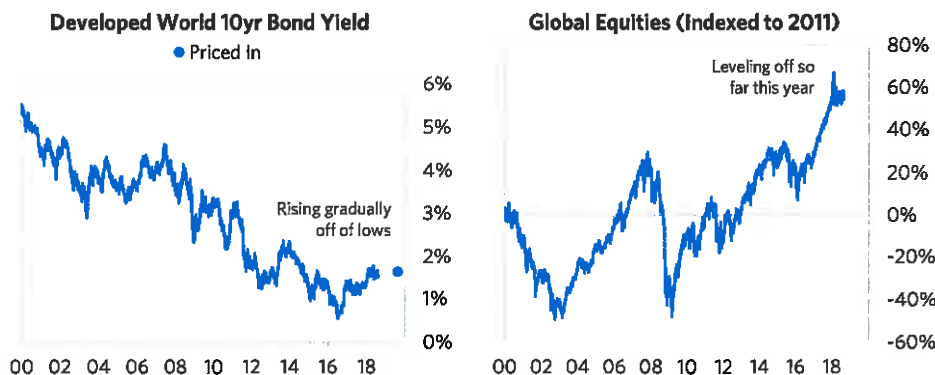
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On a backward-looking basis, actual conditions are still largely consistent with the “Goldilocks” expansion of the past few years: remarkably widespread growth paired with secularly low core inflation. The economic impact of tightening (both the flow-through of tightening that has already occurred and the impact of tightening faster than priced in going forward) is still largely ahead of us.



Financial Conditions Have Turned Less Stimulative

Looking ahead, the likely slowdown is based in the ongoing shift away from extremely easy monetary policy, which has been a key support to both asset prices and economic conditions. The moderate tightening we’ve seen, plus what is discounted going forward, is gradually removing that support and manifesting in the leveling off of asset prices—though the flow-through to growth has so far been limited.



For now, growth is strong almost everywhere and similar to what most economies have experienced over the last few years. Financial conditions, however—and equity prices in particular—have gone from significant annual gains to losses almost everywhere. While the rise in bond yields has been more muted, rates have gone from low and falling to modest increases in most places.

	Real Growth			Equity Returns (Ann)		Level of Bond Yield		
	Today	Avg: Prev 3yrs	Fwd Est	YTD	Prev 3yrs	Today	Avg: Prev 3yrs	YTD Chg
United States	2.7%	2.4%	1.8%	10.7%	9.0%	2.8%	2.1%	0.4%
China	6.8%	6.6%	6.0%	-15.4%	1.0%	3.5%	3.1%	-0.4%
Euroland	2.0%	2.1%	1.1%	-2.7%	6.5%	0.5%	0.3%	-0.1%
Exposed to US Demand	2.3%	2.2%	1.3%	-6.5%	6.4%	2.2%	1.9%	0.1%
Significant Ties to China	3.6%	3.2%	2.1%	-6.0%	6.7%	2.4%	2.1%	0.1%
EM Europe ex-Russia & Turkey	3.6%	3.4%	1.9%	-8.8%	5.7%	2.6%	2.3%	0.2%
Most Reliant on USD	2.9%	1.7%	2.4%	-14.7%	10.1%	8.5%	8.8%	2.3%
Commodity Producers	2.4%	0.8%	2.5%	-4.0%	8.6%	7.1%	7.9%	0.8%

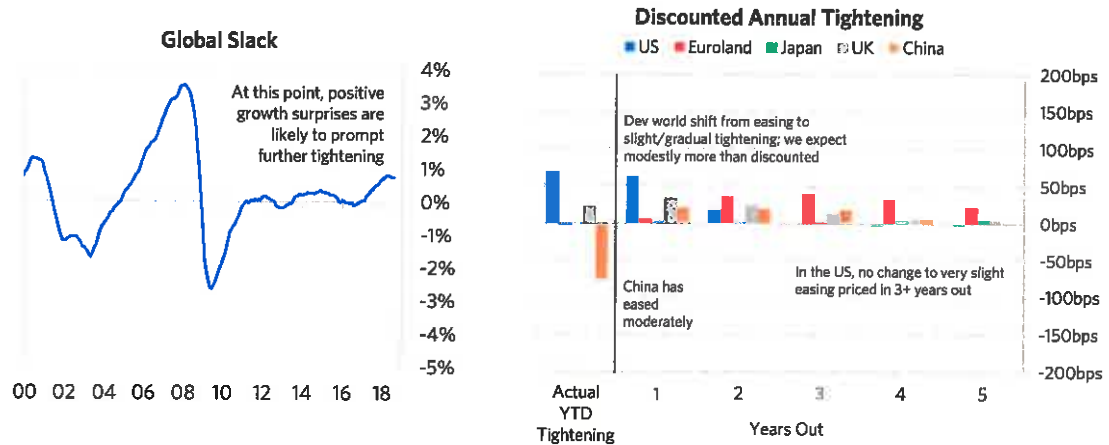
Outside of US, asset markets are weaker now

Current growth rates similar to those in recent years

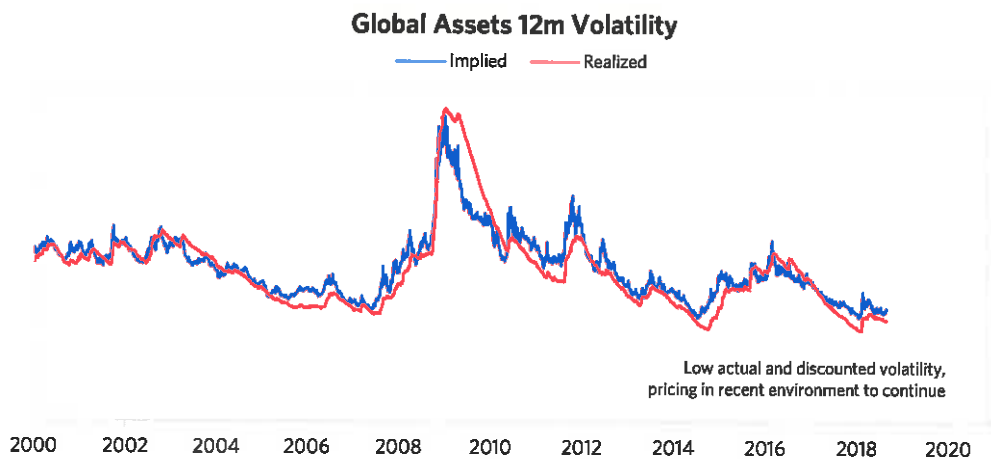
Broad-based; modest slowing likely

Level of rates still pretty low; starting to rise a bit in most places

Looking ahead, both the tightening to date (including asset sales and slowing of QE) and the very modest tightening discounted going forward are likely to continue flowing through to weaker asset returns and slower growth. In our view, central banks are more likely than not to tighten faster than the little that is discounted, which would be a further negative pressure on assets and growth.



Markets are also pricing in a continuation of very low volatility in asset markets, despite the likelihood of tightening faster than the very little that is currently priced in, as well as the economic implications of a gradually slowing global economy.

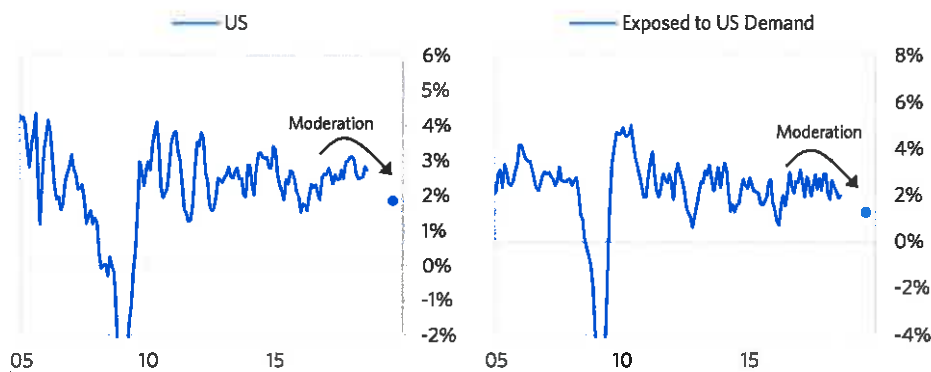


Scanning across Individual Economies, a Few Key Dynamics Are Behind the Broad-Based Moderation

Breaking down the underlying drivers a bit more allows us to see how dynamics emanating from a few major economic spheres are driving the shift in global conditions and to roughly size their impact—as well as assess what’s likely to occur going forward. It also allows us to see how some of the downside risks could spill over to affect more economies than just those directly affected. Below, we scan across major regions and group economies by the drivers they are exposed to. A couple of key dynamics stand out.

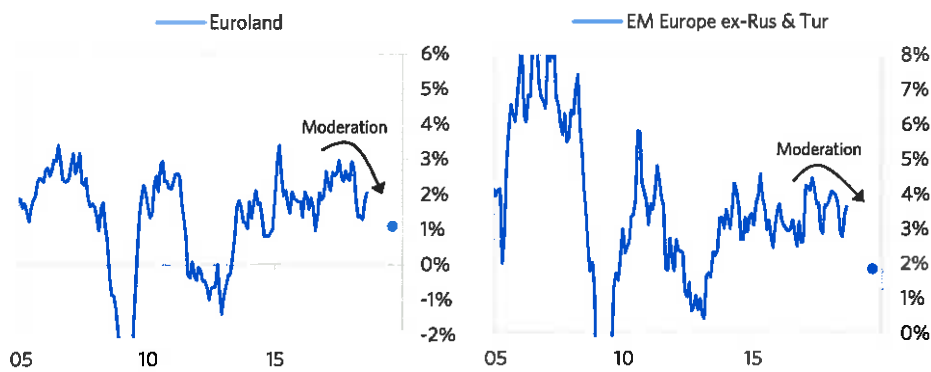
The US has been very strong over the past six months, as the fiscal stimulus and global strength have more than offset the Fed’s tightening. Looking ahead, we’d expect US growth to slow and drag down its major trading partners (e.g., Canada and Mexico) as well as some of the economies most reliant on dollar funding.

Real GDP Growth

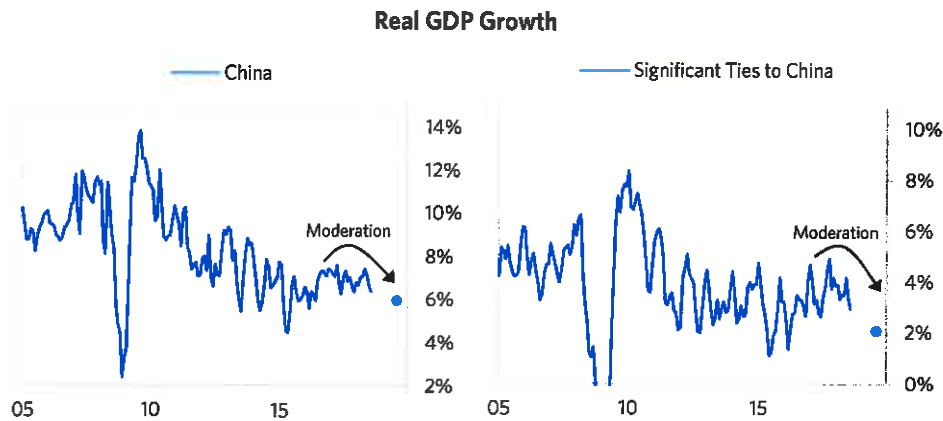


European growth has also slowed over the course of this year, and we expect somewhat more cooling as stimulation gets pulled back and as the results of widening spreads in some countries like Italy flow through. There are likely to be some knock-on effects for economies with significant trade ties to the Eurozone.

Real GDP Growth

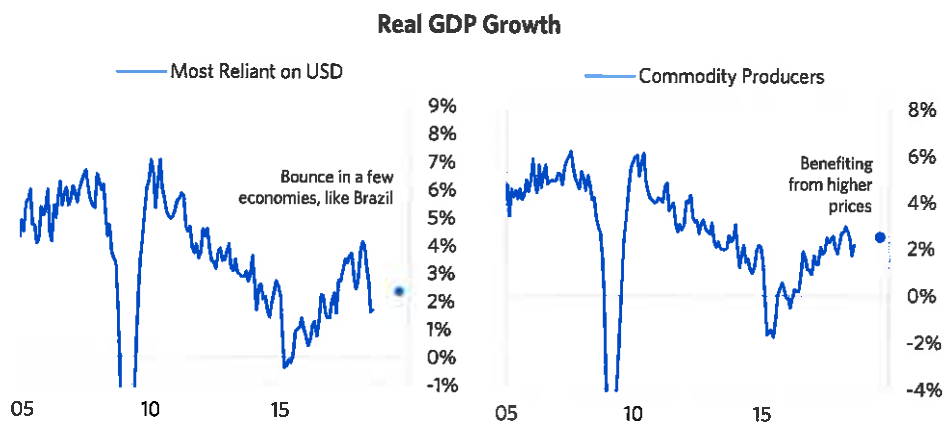


Chinese growth has also cooled over the course of this year, and we expect a bit more slowing going forward even with recent easing moves by Chinese policy makers. Economies most closely linked to China are likely to slow as well.

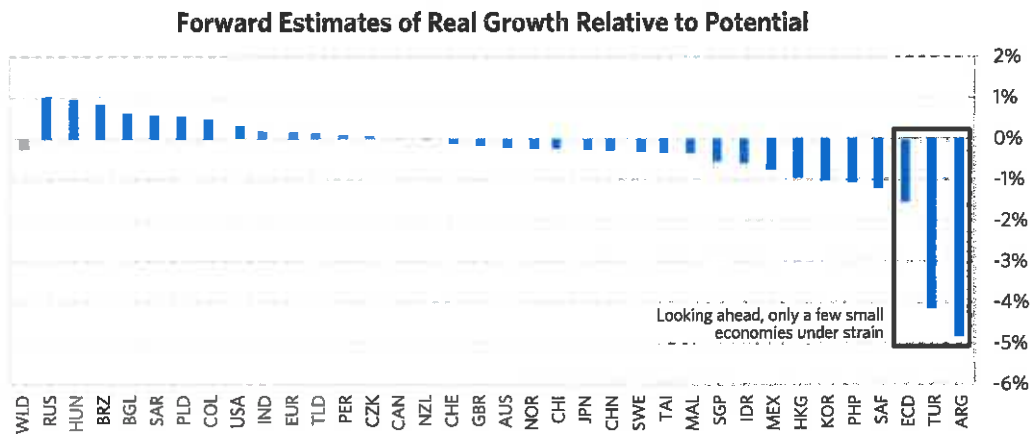


The chart below on the left shows an aggregation of growth in dollar-reliant emerging market economies. Among these economies, pockets of weakness (e.g., in Turkey and Argentina) have been a drag recently, but looking ahead the strength of the cyclical upswing in some of the larger dollar-reliant places (like Russia and Brazil) is likely to overwhelm that headwind.

Growth in commodity-producing economies more broadly, shown in the right-hand chart below, has accelerated over the last year or so, in line with rising commodity prices. Looking ahead, we'd expect the pace of their growth to moderate as commodity prices have leveled off, though our leading estimates still have them as one of the few places in the world that aren't slowing.



The last chart below shows our growth estimates across all major economies. Our base case is that, outside of a few economies experiencing severe strains, growth will remain at or near potential across the world. Of course, some economies are more sensitive than others to the array of risks we outlined earlier, so if downside risks do come to pass we would expect growth in the most exposed economies to diverge more than shown below.



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