Risk factors

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The table below presents risk factors with judgmental probabilities (i.e. not market based). It also develops the possible market impacts.

Risk # 1 | 25% probability | No-deal Brexit

Analysis | Following PM May's failure to obtain parliamentary ratification of the Brexit Withdrawal Agreement and her resignation as head of the Conservative Party, the UK is in the midst of a deep political crisis. Members of the Conservative party now have to choose between the two candidates, Boris Johnson and Jeremy Hunt, that Conservative MPs have shortlisted to become party head and therefore PM. Both say that, while they would prefer to renegotiate the Withdrawal Agreement with the EU (something that the EU says it will not do), they will go for a no-deal Brexit on October 31 if renegotiation proves impossible. While this risk of no-deal is very real, the future PM will also face an unchanged parliament that remains opposed to such an outcome. The capacity of parliament to block no-deal (which is the default legal solution) is unclear but another possibility could be a no-confidence vote, which would lead to new elections. Another extension of the Art. 50 deadline cannot be ruled out: although this would require unanimous approval from EU member countries (with some currently very reluctant), it could become necessary in case of new UK elections or if the UK opts for a new referendum. Finally, the UK also has the possibility to revoke Art. 50 unilaterally. There are therefore still many possible outcomes (deal, no-deal, new delay, elections, Art. 50 revocation…) and political stress will be very high after the summer recess. The European election has shown how polarised the country is (hard Brexit parties scored well, but so did staunchly Bremain parties). The only good news is that fewer and fewer protesting/populist parties in Europe are calling for exit from the Eurozone (which would require an exit from the EU). It is likely that they are being vaccinated by the British turmoil.

Market impact | In the short run, uncertainty is likely to stay elevated as long as the new Prime Minister is not designated and it may even rise further when the next government adopts a confrontational approach with the EU-27. -In the face of uncertainty, the risk premium on UK assets must be sufficient - with a weak currency and lower prices for risky assets - to attract foreign investors. Is this enough today? Nothing is less sure! In the event that the outcome is unfavourable for the UK, we would see a weakening of the GBP and below-trend GDP growth. But should a deal be approved or the article 50 be revoked, we would see the opposite, The situation remains very binary and thus not very conducive to strong portfolio recommendations.

Risk # 2 | 25% probability | Political instability in Italy with renewed stress on BTP

Analysis | Due to the breach of the Debt rule in 2018, the EU Commission considers that an Excessive Deficit Procedure is warranted for Italy. More worryingly, official estimates project the Debt to GDP ratio to increase from 132.2% in 2018 to 132.6% in 2019, before declining to 128.9% in 2022. The Italian government is reportedly negotiating and working hard to find not only additional resources for 2019 to compensate for the past breach, but also to address the most challenging task, which is the 2020 budget. Although political incentives may not be absolutely in favour of this outcome, we cannot completely rule out the possibility of a government crisis and snap elections, the earliest date possible being September (although this could fall very close to the start of the 2020 budget discussion).

Market impact | Notwithstanding the better-than-expected Q1 GDP, which marked an exit from the technical recession seen in the Italian economy in H2 2018, the markets remain nervous about the Italian government's new confrontational tones with regard to EU budget rules. Moreover, heightened tensions within the government coalition have increased the risk of snap elections and the uncertainty about how

Italy will deal with the daunting task of addressing the 2020 budget, which should eliminate relevant VAT hikes while revamping a challenging spending review. At the moment, there is no systemic risk in our opinion. We perceive the risks as remaining domestic. Keep in mind that the ECB has anti-contagion tools that it can call on to avoid a spread to other peripheral markets. In addition, the ECB has announced new TLTROs to alleviate the banking system. All of this should contain the contagion risk on peripheral sovereign spreads and on corporate credit spreads.

Risk # **3** | **20%** probability | **Major European slowdown**

Analysis | After Q1 GDP growth figures (+0.4% QoQ for the entire Eurozone), which came as a relief but were partly due to positive temporary factors (strong precautionary imports from the UK and mild weather which supported construction), Q2 indicators showed much more moderate growth. Moreover, manufacturing surveys have stabilised, but have barely improved from the low levels reached after a series of domestic and external shocks in recent quarters (specific sectoral issues in the car industry and rising US-China tensions). Should they remain depressed for long, more contagion to the rest of the economy will occur. A number of risks could worsen the situation after the summer, notably an escalation in US-China tensions (to which European manufacturing is heavily exposed through global value chains), US tariffs on the European auto sector (a decision could come in November), a no-deal Brexit (at the end of October) or a worsening of the political crisis between Italy and the rest of the EU. Such problematic events could occur against a backdrop where the key supporting factors of 2019, the still buoyant labour market and the significant easing of fiscal policies in large countries, gradually lose some of their strength due to cyclical and political causes.

Market impact | The ECB has signalled that it stands ready to deploy new tools to face a slowdown, however its room for further stimulus is limited. A coordinated fiscal stimulus would be also be very difficult to decide due to the complex European institutional and political environment. Therefore, a major slowdown would clearly be negative for European assets and the Euro.

Risk # **4** | **20%** probability | **Re-escalation in trade tensions between the US and China**

Analysis | At first glance, the outcome of the G20 is encouraging. Trump bought time. But in substance, the truce reached does not change much. The most complex issues (intellectual property rights, technology transfers) were not addressed at the G20. The confrontation between the US and China will therefore return to the forefront sooner or later. It should not be forgotten that the US is entering a pre-election period. The opposition to China goes far beyond the Republicans. Whoever the US President is next year, the opposition between the two countries on strategic issues could worsen their relations in the coming years. It is therefore important not to misunderstand the context. The protectionist rhetoric will not disappear from the radar screens. The likelihood of a global trade agreement is very low. And in the end, there is still a great risk that Donald Trump will impose a tariff increase on an additional $300bn of imports from China, even if not immediately, and at a lower rate (more likely 10% than 25%). Tariff uncertainty is long-lasting, which is clearly not good news for investment and trade..

Market impact | There was some market relief after the G20 meeting rather than a strong rally, as some progress in the trade disputes were somehow already priced in and the expectations for a full deal are still very low. Global trade and the global manufacturing sector will likely remain under pressure in H2 2019. Uncertainty remains high.

Risk # **5** | **15%** probability | **US recession**

Analysis | The US economy was stronger than expected in Q1, although the composition of growth was somewhat volatile and sent out mixed signals, as almost half of the boost came from inventory growth and net trade. Incoming data related to H1 are more mixed and point to a gradual convergence towards the potential growth rate. Signs of a somewhat more pronounced deceleration in investments and capex require monitoring, while the still strong, albeit decelerating labour market, points to moderating yet resilient consumption. Keep an eye, however, on both hard and soft data, as soft data may give leading signals but can sometimes be misleading; we are watchful of the protracted weakness in the manufacturing sector,

which represents a small part of the US economy but may spill over to the service sector. Renewed tensions on the trade front with China with the step-up in tariffs, the still open risk of tariffs on cars imported from Europe (postponed by six months), and uncertainty surrounding the very important process of ratifying the USMCA (aka NAFTA 2.0) add uncertainty to the risks in our outlook. The probability of recession remains contained in the near future, as the Fed has turned more dovish with a risk management approach designed to prevent negative spill-overs from the trade front into the domestic economy by opening the door for rate cuts.

Market impact | The markets are likely to become more circumspect with regard to 2020 growth expectations as the deceleration could become more pronounced, and economic signals are likely to become increasingly mixed as the cycle extends. At the time of writing, the markets have begun pricing in up to 4 rate cuts by the Fed by end of 2020, the first one occurring as soon as July 2019.

Risk # 6 | 15% probability | Major geopolitical crisis in the Middle-East

Analysis | While there are always geopolitical risks centered in the Middle- East, US -Iran tensions have increased in recent weeks after D. Trump 1/ cancelled the waivers that enabled some countries to import Iranian oil 2/decided new sanctions on Iran. Recent security incidents (attacks on tankers in the Persian gulf and the shooting down of a US drone by Iran) and aggressive declarations by both sides have only worsened the situation. An important factor is that Trump's team for foreign and security affairs is now considerably more hawkish than at the beginning of his mandate, with the appointment of personalities such as Mike Pompeo at the State Department and, even more so, John Bolton as National Security Advisor. However, Trump appears to be a lot more pragmatic than the latter. On the Iranian side, the risk of a military confrontation with the US is made larger by internal divisions, and the possibility that the IGRC could conduct operations without the full approval of the country's leaders.

Market impact | Oil prices would be the main item to watch, while a US-Iran open confrontation could be detrimental to most risky asset classes and cause a surge in safe-haven flows to the USD. However, at this point, we expect no durable upside shock on oil prices, given the high level of US shale gas production and declarations by Saudi Arabia and the UAE that they can make up for the shortfall in Iranian exports.

Risk # 7 | 10% probability | Major political crisis in Europe

Analysis | Aside from the Italian situation (see risk#3) there are few identifiable triggers for short-term systemic political risk in the Eurozone, in particular as the European election results were broadly in line with what opinion polls had indicated, even producing a slight "pro-institution" surprise. While the European Parliament is more fragmented, and European governments and institutions are having a harder time than usual negotiating appointments to the EU's top jobs (European Commission, Council, Parliament and Central Bank), this should not trigger a major crisis. However, it is far from clear that voters' support for "anti-system" parties has peaked and the presence of these parties in national parliaments is complicating the building of government majorities. Politics is therefore becoming less predictable, notably in large countries where it used to be stable (Germany and Spain). While this is manageable in good times, it may become problematic should a deterioration of the economic situation (or other emergencies) require a strong political hand. Moreover, other changes only complicate European political life further: "Pro-system" forces other than traditional political parties are also making progress (notably the Greens and the economic Liberals), while recent events in France have indicated the possibility of protest movements not led by political parties or trade unions. On the positive side, it should be mentioned that appetite for leaving the euro is diminishing, and is no longer on the agenda of major protest parties in France and Italy.

Market impact | Given the still positive economic backdrop, we do not believe that a new round of systemic crisis in Europe is possible. Non-mainstream political forces that are in a position to rule countries (such as in Italy) have shown that they want to blame European political institutions and try to modify them, but not exit the Eurozone. However, we cannot rule out some market stress while the difficulty to understand European institutions for outside investors means that European assets may continue to carry a specific political risk premium. Italian government spread vs. Bund should continue to be volatile.

Risk # **8** | **10%** probability | **Major slowdown in the "emerging world"**

Analysis | The renewed wave of dovishness among the main central banks (namely the Federal Reserve and the ECB) is making the global financial environment easier for the emerging markets. A more pronounced USD depreciation is the missing factor in this environment, though it has partly started. The rosier financial picture will only spoil following an abrupt re-adjustment to the much more dovish market expectations of a more cautious monetary policy pursued by the Fed. Having said that, the amount of dovishness announced and realistically followed through should prevent idiosyncratic risks from becoming systemic risks. On the real economy side, spillovers from shocked external demand to domestic demand (mainly via capex) have been considerable in Asia, more so than in other regions. In order to see the expected stabilisation in growth and not a major slowdown, an orderly solution to the trade dispute is needed in the next few months.

Market impact | In the risk case, spreads and equity markets would once again be significantly impacted. This particularly true as emerging currencies would once again be under pressure due to capital outflows. However, the emerging world is far from being a homogeneous block, and the markets would deteriorate more in the weakest and most vulnerable countries, due to their poor external positions or fragile fiscal and political conditions.

Risk # **9** | **10%** probability | **A Chinese "hard landing"/ a bursting of the credit bubble**

Analysis | Chinese economic growth is slowing down, but the authorities are working hard to stimulate the economy (through monetary and fiscal policies) so that the economy will remain resilient. Recent data tend to indicate that the policy mix has a positive impact on the economy. That being said, the country's economic model is fragile: the excess of credit is visible, and non-financial corporate debt has surged since the GFC. The good news is that the NFC debt-to-GDP ratio had started to drop since late 2017. We will continue to monitor the trend in Chinese private debt closely, especially if the economy slows. Meanwhile, the de-escalation in trade tensions should give China policymakers time to adjust their policy implementations and to better manage short-term risks. In the event of a hard landing or the bursting of the credit bubble, the Chinese authorities would be unable to avoid a stronger depreciation of the yuan.

Market impact | A hard landing linked to a bursting of the credit bubble would have a very negative impact, and its cascading effects would be particularly disastrous: vulnerability of banking systems (in China and elsewhere), vulnerability of the global financial system, vulnerability linked to China's public and private debt, negative impact on regional and global trade, and thus on commodities and emerging countries, impacts on the currencies of commodity-exporting countries, advanced countries and emerging countries, etc...

MACROECONOMIC CONTEXT

Our convictions and our scenarios

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This section provides a reminder of our central scenario and alternative scenarios.

Central scenario (65% probability): resilient domestic demand and services despite the uncertainty adversely affecting trade

- **Slower global growth:** after rebounding in Q1, growth slowed significantly in Q2 in the United States and Europe. Industrial surveys show that the global manufacturing sector is in recession. However, domestic demand remains resilient due primarily to household consumption which continues to be buoyed by the labour market. In these conditions, the services sector has proved resilient.

- **Global trade is under pressure, but its importance must not be overestimated:** global trade has plummeted over the last 18 months. Protectionist rhetoric has increased the level of uncertainty and caused investments to plunge in numerous trade-sensitive countries. Trade is expected to remain under pressure in H2 and grow at a lower pace than global GDP. That said, we believe that domestic demand's resilience is underestimated. While global trade has effectively made a strong contribution to global growth over the last few decades, this is increasingly less so, with global growth being driven primarily by domestic demand. And the services sector is increasingly less correlated to industry, which can be attributed to the relative importance of consumption in relation to investments and trade since the 2008 crisis.

- **United States: gradual return to its potential.** The US economy has been boosted by a very accommodative fiscal policy, whose impact is expected to gradually diminish in H2. Real GDP growth significantly exceeded expectations in Q1 2019 (3.1% quarter-on-quarter on an annualised basis after 2.2% in Q4 2018) but growth slowed sharply in Q2. However, given the very accommodative monetary and financial conditions, we believe that in the absence of a major shock affecting these conditions or significant change in corporate and consumer confidence, the slowdown should remain contained. Investment looks set to slow. However, we think it unlikely that there will be a recession in 2019 or 2020, as household consumption is expected to continue to benefit from the increase in disposable income. Nevertheless, if trade and geopolitical tensions persist, doubts concerning the extension of the current cycle could intensify over the next few quarters (less support from fiscal policy, domestic demand under pressure with contagion from industry to the services sector). Moreover, it is important to bear in mind that below normal growth could trigger a contraction in profits.

- **Eurozone:** growth rebounded by 0.4% quarter-on-quarter in Q1, which was a relief after a very weak H2 2018. In Germany, the main economic power in the eurozone, growth also came out at 0.4% after two quarters of virtual recession. The high level of German consumer spending demonstrated that the repercussions of the weaknesses in the manufacturing sector on the economy as a whole had, hitherto, remained limited. However, there was a fairly significant deterioration in the eurozone's Q2 data, particularly with regard to manufacturing indicators. The services sector continues to expand, albeit at a moderate pace and the unemployment rate continues to decline. In terms of risk, the eurozone economy remains exposed to trade tensions. Despite the deferment of increased US customs duties on European cars, Donald Trump having postponed his decision to mid-August, European companies may nevertheless be affected by China-US tensions via the global value chains. Brexit has also returned to centre stage since, with the arrival of a new Prime Minister, the probability of the United Kingdom withdrawing from the EU with no deal has increased. Finally, with regard to domestic policy, the result of the European elections was a relief since anti-system parties did not obtain more votes than the polls anticipated, despite making progress. However,

confrontation could resume between the anti-system coalition in power in Italy (the Northern League feeling strengthened by its gains in the elections) and the European authorities over the 2020 Italian budget issue. In Germany, following the poor performance in the European elections of the two coalition parties in power, the risk of rupture has also slightly increased.

- **United Kingdom:** political visibility in the United Kingdom is very limited. Boris Johnson will probably succeed Theresa May and adopt a tougher approach on Brexit, increasing the risk of the country withdrawing with no deal. However, given that Parliament remains firmly opposed to a no deal, a number of Brexit scenarios remain possible. There are likely to be heightened tensions between the UK government and the EU with the approach of the deadline (31 October). A no deal withdrawal from the EU remains the default option if the two parties fail to reach an agreement. Therefore, uncertainty will continue to adversely affect the economy over the coming months.

- **China:** the authorities have multiplied monetary and fiscal stimulus measures over the last year, which has helped cushion the shock related to the slowdown in global trade. Negotiations between China and the United States will resume following the G20 summit in Osaka. There is some good news (absence of a deadline, suspension of the prohibition on US companies continuing to provide Huawei). The pressure on global value chains should therefore subside, particularly in the technology sector. However, tensions look set to return to centre stage sooner or later with regard to strategic issues (intellectual property rights, technology transfer), on which no progress has been made. We cannot rule out renewed tensions between the United States and China. Therefore, the Chinese authorities cannot let down their guard.

- **Inflation:** underlying inflation remains low in the advanced economies. The slowdown in inflation over recent years is primarily structural, since it is tied to supply factors, while the cyclical component of inflation has weakened (with the flattening of the Phillips curve). Underlying inflation is only expected to accelerate slightly in the advanced economies. In theory, an “inflationary surprise” remains possible with the pick-up in wages (in the Unites States and eurozone) but it is striking to see that inflation has slowed in the United States, whereas real GDP growth has accelerated! In the eurozone, against a backdrop of low inflation, we believe that companies have virtually no power to fix prices (margins under pressure). Ultimately, in view of low inflation and the increase in downside risks, the majority of central banks have done a U-turn in terms of communication, since the beginning of the year.

- **Oil price:** fears of a global slowdown and the increase in US production are exerting downward pressure on oil prices which is creating concern among Middle Eastern countries. In response, OPEC countries and 10 other countries including Russia signed a cooperation agreement at the beginning of July, which de facto creates enlarged OPEC. All these countries (OPEC+) – which account for 50% of global production (vs. 30% for OPEC) - have renewed (for nine months) their agreement of last December aimed at reducing their cumulative supply by 1.2 million barrels/day in relation to their production in October 2018. Ultimately, we believe that supply pressures will continue to drive prices upwards, whereas fears concerning the trend in global demand should keep them under pressure. Therefore, all things considered, we maintain our target of $60-70/barrel (Brent).

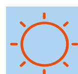
- **Central banks durably accommodative:** the Fed is in “wait-and-see” mode. We expect a preventive cut in its rates of 25bp in 2019 (as an “insurance policy”), but barely more in the case of our central scenario in which consumption proves resilient. We consider market expectations (decline of 100bp in 12 months) to be excessive unless, naturally, downside risks were to materialise. In terms of the ECB, Mario Draghi clearly opened the door at Sintra to a cut in its rates and/or a securities purchase programme (QE) if the situation does not improve. We do not expect a cut in the deposit rate (unless the Fed aggressively lowers its rates and/or the euro appreciates significantly above $1.15). However, we expect the announcement of a new corporate bond purchase programme in September. A two-tier system is seriously being considered for deposit rates, in order to reduce the charge on banks that have substantial surplus reserves (Germany).

Downside risk scenario (30% probability): marked economic slowdown due to the trade conflict, geopolitical crisis or sudden revaluation of risk premiums

- The G20 truce is not lasting: new escalation in trade tensions between the United States and China, or between the United States and Europe.
- Series of uncertainty shocks (global trade, Brexit, Italy) that could cause global demand to plummet.

Consequences:

- All other things being equal, a trade war would lead to global trade plunging, triggering a synchronised and durable slowdown in growth and, in the short term, inflation. That said, a global trade war would rapidly become deflationary by creating a shock on global demand. Counter-cyclical fiscal and monetary policies would be rapidly implemented.
- Sudden revaluation of risk on bond markets and decline in market liquidity. Fears of recession in the United States.



Upside risk scenario (5% probability): recovery in global growth in 2020

Donald Trump does a U-turn, reducing the obstacles to trade. On the domestic front, the subject of the increase in infrastructure spending could return to the forefront and help extend the cycle in the United States.

- Acceleration driven by corporate investment and the recovery in global growth. The United States' pro-cyclical fiscal policy leading to a stronger than expected acceleration in domestic demand. Acceleration of growth in Europe after a marked decline. Recovery of growth in China due to a stimulating policy mix.
- Belated reaction by central banks which, initially, are likely to maintain accommodative monetary conditions.

Consequences:

- An acceleration in global growth that would increase inflation expectations, obliging central banks to consider normalising their monetary policy more quickly.
- Rise in real key interest rates, particularly in the United States.

Macroeconomic picture by area

United States

The Fed shifts to a risk management approach in order to engineer a soft landing

- Key drivers of domestic demand are decelerating progressively, especially on the investment side, while fundamentals remain more supportive for the US consumer; we expect monetary policy to smooth financial conditions and accompany this normalisation.
- Labour market and wage growth, albeit starting to convey more mixed data, coupled with contained inflationary pressures, are supporting resilience in personal consumption; expectations also remain broadly upbeat, while retail sales are normalising around their longer term trends.
- Business confidence has moderated appreciably compared to last year, and this is translating into a moderation in capex intentions and investments, which are expected to slow going forward.
- Moderate domestic and external inflationary pressures are keeping both core and headline CPI in check, although the Federal Reserve may start being concerned by the persistence of low inflation and the risk of a downward shift in inflation expectations, for the effectiveness of its monetary policy transmission. The central bank conveyed a dovish message at its June meeting, anticipating possible cuts in response to heightened risks to the outlook from trade issues. We are now pencilling in three rate cuts in the next 12 months, linked to the Fed's "risk management approach", rather than to increased recessionary risks. A soft landing remains the target.

Risk factors

- **Tariffs risks may negatively impact economic performance, both directly (in prices and orders) and indirectly (in confidence). The longer the list of goods included in tariffs, the higher the impact on U.S. domestic demand**
- **Renewed policy uncertainty may hold back new capex plans more than expected**
- **Geopolitical risks (Iran, Venezuela) and tariffs, could represent an upside risk to oil prices and to our inflation outlook**

Eurozone

Moderate growth expected. Risks are considerable

- After the rebound in Q1 growth (+0.4%) Q2 indicators are pointing to a slowdown. Activity remains robust in services but the manufacturing sector is sluggish. Things are returning to normal in the automotive sector after the shocks of 2018, but rising trade tensions are dragging down confidence and investment.S
- A no-deal Brexit in October would have an economic cost to the euro zone (albeit less so than for the UK itself). Tense fiscal negotiations are expected between Italy and the European Commission.

Risk factors

- **Trade war and threat of US tariffs on the European automotive industry**
- **A no-deal Brexit**
- **Political tensions in Italy**

United Kingdom

The possibility of a no-deal Brexit cannot be ruled out.

- After the rebound in growth in Q1 (+0.5%, driven mainly by precautionary spending), the economy is likely to slow down, as the risk of a no-deal Brexit and trade tensions weigh on confidence.
- Boris Johnson and Jeremy Hunt, the two remain candidates in the race to replace Theresa May as prime minister, say they would be willing to accept a no-deal Brexit if the EU refuses to make new concessions. Parliament, however, is opposed to this, which points to a very tense political situation in autumn 2019.

Risk factors

- **A no-deal Brexit**
- **The current account deficit remains very high**

Japan

Get there, but hurdles remain

- The Ministry of Economy and Industry upgraded its assessment of production to "stabilization" from "weakening", due to modest progress in inventory adjustments. Machinery orders rose in April for the third straight month, suggesting that spending on equipment will be sanguine in the next few quarters. An official corporate survey shows that companies plan to boost capital spending by 9% this year.
- However, the corporate sector is vulnerable to escalation in the US-Sino trade conflicts. Export volume plunged in May to its lowest level in three years as US President Trump hinted at imposing higher levies on a wider range of Chinese products.
- Wage growth has levelled off, reflecting a somewhat eased labour market. As a consequence, households have started saving more and consuming less, and retail sales were therefore slightly less strong.

Risk factors

- **Supply chain disruption on the back of the intensified trade dispute between the US and China**
- **Global economic deceleration dampens companies' capital expenditure motivations**
- **A consumption tax hike in October 2019 could exacerbate the economic downturn**

China

- The surprising turnaround in US/China negotiations and tariff increases on $200bn of Chinese goods have been adding new downward pressures to China's economy.
- A new truce was achieved at the G20 in Osaka in late June, providing that no further tariffs would be imposed on the remaining US imports from China and talks between the two countries would resume. In addition, a partial relaxation on the Huawei ban was announced. This is an overall positive outcome for the time being.
- Exports in May were hit again (0.5% YoY), but less so than in Q4.
- Policymakers look better prepared than last year, with all measures on the table ready to use if and when necessary.
- Meanwhile, there are signs that policy supports since Q3 are starting to pass through into real economy and are becoming more visible.
- RMB should be able to avoid large depreciation, barring any further major escalations, helped by policy supports and capital control.

Risk factors

- **Uncertainty in the US/China relationship**
- **Policy mistakes in managing near-term risks and the structural transition**
- **Geopolitical noise regarding North Korea**

Asia (ex JP & CH)

- In Q2 2019, the region (with regard to emerging countries) experienced the weakest macro momentum in terms of spillover from the external demand shock to domestic demand. In relative terms, the strongest deterioration was in Malaysia, Thailand and South Korea.
- The region's inflation figures have remained very benign. Food prices have been pushing up the cost of living quite broadly on the back of agro prices, which have increased lately. Having said that, CB targets are not at risk for the time being.
- In June, we saw central banks in the region in wait-and-see mode even though we keep expecting more easing to come. BoT and BoK showed more dovishness in their rhetoric.
- On 27 June, two months after the national elections, the Constitutional Court in Jakarta declared Jokowi as the Indonesia president, dismissing Prabowo Subianto's appeal.

Risk factors

- **Still weak macro momentum in the region**
- **Inflation still very benign. Food prices have been driving inflation up**
- **Central banks in the region in a wait-and-see mode. More easing to come**
- **Jokowi officially confirmed as President of Indonesia for a second term**

Latam

- Based on second-quarter readings, we do see some persistent weakness in the two main countries in the region: Mexico and Brazil. These poor macroeconomic figures relate more to domestic than external demand.
- On the inflation front, the overall environment remains benign. Mexican inflation has resumed converging towards the target, with its latest figure at 4.3% YoY, down from 4.4% YoY. Argentina inflation disappointed, at 57% YoY in May.
- The region's main central banks left their monetary policy rates unchanged. On 8 June, Chile's central bank cut its Policy Rate by 50bps, from 3.0% to 2.5%.
- During the month of June, the pension reform discussion in Brazil gathered some positive momentum. Votes are expected soon from the Special Committee and the Lower House (in a plenary session).
- Moody's and Fitch downgraded Mexico sovereign and Pemex.

Risk factors

- **Economic conditions continued to weaken in the second quarter of the year**
- **Inflation is benign overall. Argentine inflation in May disappointed on the high side**
- **Chile's central bank cut its Policy Rate by 50bps.**
- **Mexican sovereign rating and Pemex downgraded**

EMEA (Europe Middle East & Africa)

Russia: Real GDP growth was 2,2% in 2018 and should be close to 1.5% in 2019. However, growth is expected to accelerate over the medium-term, thanks to a significant infrastructure spending programme from 2019 to 2024.

- Despite the threat of potential US sanctions down the road, the macroeconomic scenario remains supportive. Russia is among the few emerging market sovereigns with "twin surpluses" in 2019, while accumulating assets in the National Wealth Fund.
- As expected, the CBR cut its policy rate in June by 25bps. We expect more cuts given decelerating inflation.

South Africa: exit from recession, but no miracle

- High-frequency indicators are still very weak, and recent currency pressures due to a weak external environment for emerging countries and a cabinet reshuffle are only making things more complicated. With a null Q1 GDP figure, we have revised our forecast for 2019 from 1.4% yoy down to 0.8% yoy.
- Despite a weak economic and subdued inflation environment and a dovish Fed, we expect the SARB to remain cautious and to keep a neutral stance at least for the first half of the year.

Turkey: we expect double-digit inflation and a recession in 2019

- Turkey's GDP decreased by 2.7% yoy in Q1-19, slightly less than in the previous quarter (-3% yoy). While private consumption slowed down less than in Q4-18, investment fell again by 13% yoy. As expected, the Government's expenditure increased sharply (+ 7.2% yoy).
- The CBRT is still under pressure, with CPI inflation set to remain high and pressures on the currency to continue in an unfavourable political environment.

Risk factors

- **Drop in oil prices, stepped-up US sanctions and further geopolitical tensions**
- **Increased risk aversion, risk of sovereign rating downgrading, rising social demands in the run-up to elections and risk of fiscal slippage**
- **A too rapid easing of the central bank, a cooling of budgetary policy, and a slowdown in activity in the Eurozone**

Macro and Market forecasts

Macroeconomic forecasts
(18 June 2019)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2018	2019	2020	2018	2019	2020
US	**2.9**	**2.4**	**2.0**	**2.4**	**2.0**	**2.5**
Japan	**0.8**	**0.9**	**0.7**	**1.0**	**0.9**	**1.3**
Eurozone	**1.9**	**1.0**	**1.3**	**1.8**	**1.2**	**1.4**
Germany	1.4	0.8	1.4	1.7	1.4	1.6
France	1.7	1.3	1.4	2.1	1.2	1.5
Italy	0.7	0.1	0.5	1.1	0.8	1.3
Spain	2.6	2.3	2.0	1.7	1.1	1.4
UK	**1.4**	**1.4**	**1.4**	**2.5**	**1.8**	**1.9**
Brazil	1.1	1.3	2.1	3.7	4.3	4.7
Russia	2.2	1.5	1.7	2.9	4.8	4.0
India	7.4	6.2	6.6	4.0	3.4	4.6
Indonesia	5.2	5.0	5.3	3.2	3.5	4.2
China	6.6	6.2	6.1	2.1	2.2	2.5
Turkey	2.9	-1.5	1.5	16.2	15.6	12.9
Developed countries	**2.2**	**1.7**	**1.6**	**2.0**	**1.6**	**1.9**
Emerging countries	**4.9**	**4.4**	**4.7**	**4.0**	**3.9**	**3.9**
World	**3.8**	**3.3**	**3.5**	**3.2**	**3.0**	**3.1**

Source: Amundi Research

Key interest rate outlook

	28/06/2019	Amundi + 6m.	Consensus Q4 2019	Amundi + 12m.	Consensus Q2 2020
US	2,50	2,25	2,15	2,25	2,05
Eurozone	0	0	-0,34	0	-0,34
Japan	-0,1	-0,1	-0,1	-0,1	-0,1
UK	0,75	0,75	0,80	0,75	0,90

Long rate outlook

2Y. Bond yield

	01/07/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	1.75	1.50/1.70	1.62	1.40/1.60	1.59
Germany	-0.732	-0.80/-0.70	-0.78	-0.80/-0.70	-0.77
Japan	-0.215	-0.30/-0.20	-0.24	-0.30/-0.20	-0.25
UK	0.617	0.55/0.75	0.51	0.45/0.65	0.49

10Y. Bond yield

	01/07/2019	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	2.03	1.95/2.15	2.06	1.90/2.10	2.12
Germany	-0.31	-0.20/-0.30	-0.24	-0.15/-0.25	-0.18
Japan	-0.16	-0.20/0.00	-0.11	-0.20/0.00	-0.07
UK	0.84	0.90/1.10	0.91	0.80/1.00	0.96

Currency outlook

	28/06/2019	Amundi + 6m.	Consensus Q4 2019	Amundi + 12m.	Consensus Q2 2020
EUR/USD	1.14	1.16	1.15	1.14	1.17
USD/JPY	108	108	108	105	107
EUR/GBP	0.90	0.90	0.89	0.89	0.88
EUR/CHF	1.11	1.13	1.12	1.12	1.15
EUR/NOK	9.70	9.50	9.54	9.43	9.40
EUR/SEK	10.56	10.40	10.60	10.45	10.50
USD/CAD	1.31	10.30	1.32	1.30	1.30
AUD/USD	0.70	0.71	0.70	0.69	0.72
NZD/USD	0.67	0.68	0.66	0.67	0.67
USD/CNY	6.87	6.80	6.90	6.75	6.85

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