

May 26, 2017

# Global Economic Outlook

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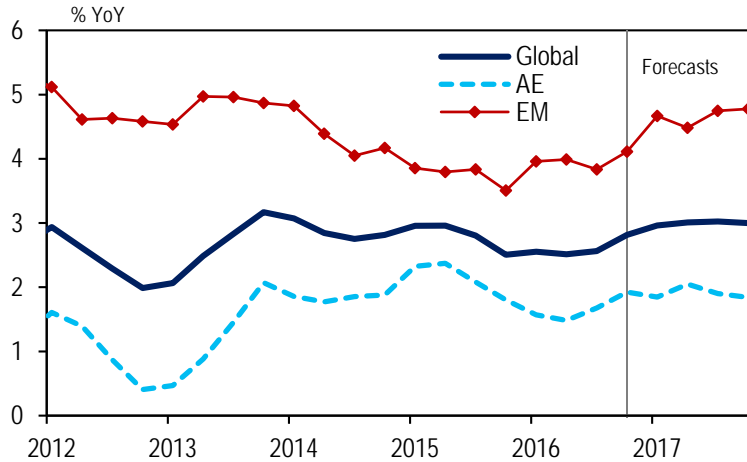
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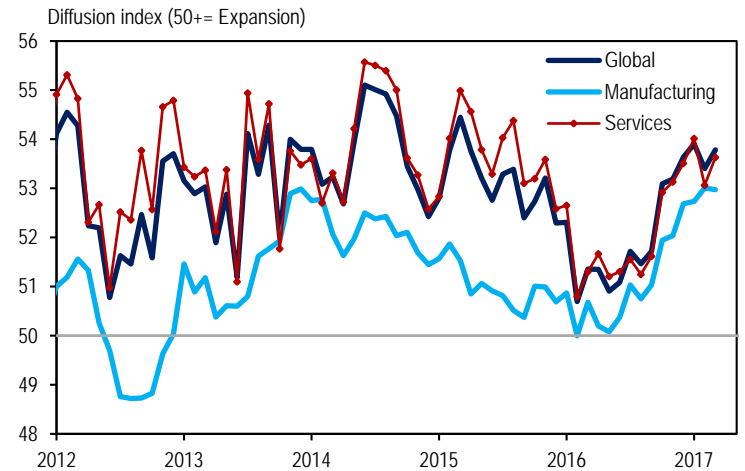
# Global growth looks relatively stable with some signs of a pick up

We see a cyclical pickup in GDP growth across AEs and EMs with industrial production and trade growth leading the way

### Global— Real GDP Growth (%YY)



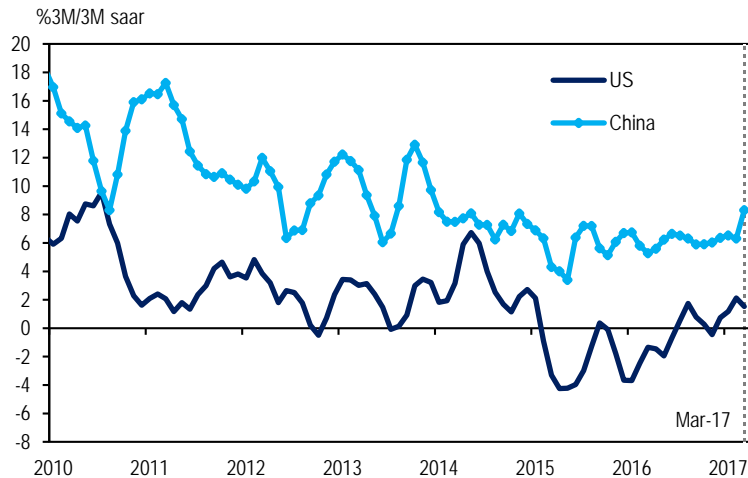
### Global—Composite, Mfg and Services PMI



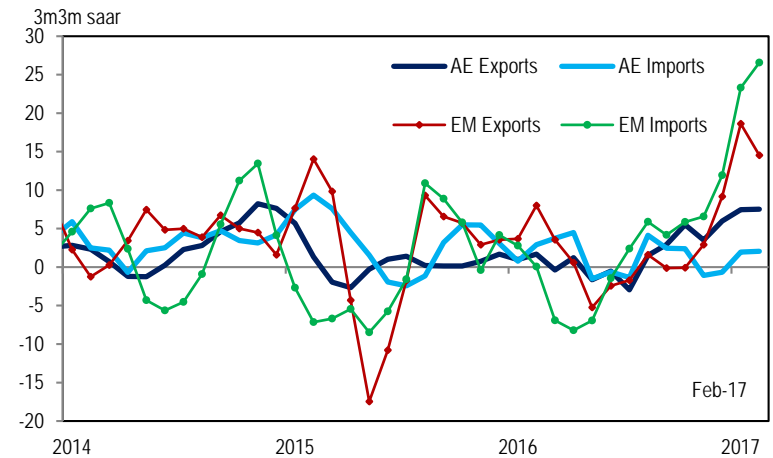
Note: Aggregates at market exchange rates. Global and EM aggregates exclude Venezuela. Source: National Statistical Offices, IMF and Citi Research

Sources: Markit and Citi Research.

### US and China – Industrial Production



### AE and EM – Goods Exports and Imports



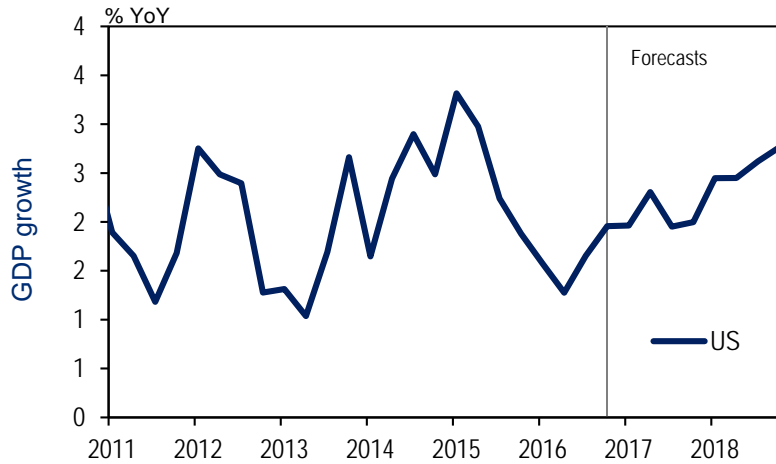
Sources: FRB, NBS and Citi Research.

Sources: CPB and Citi Research

# We See a Pickup in Growth Across AEs and Ems ex-China...

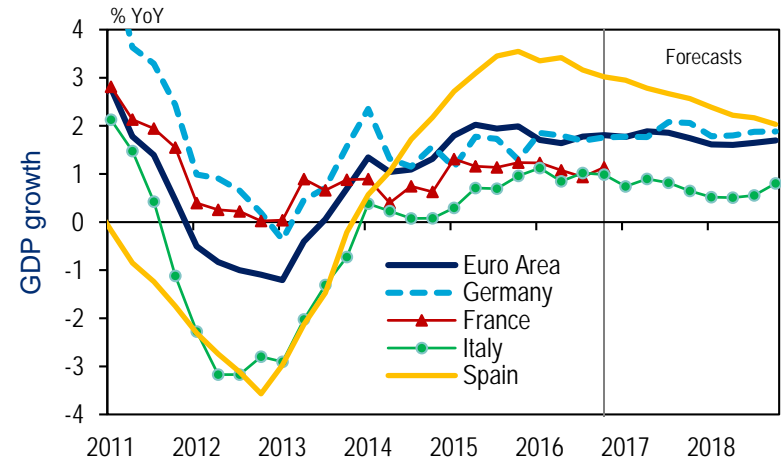
We expect growth to be solid in the euro area and to pick up in the US after a weak Q1. We expect growth to be stable in Japan and to keep moderating in China.

## US



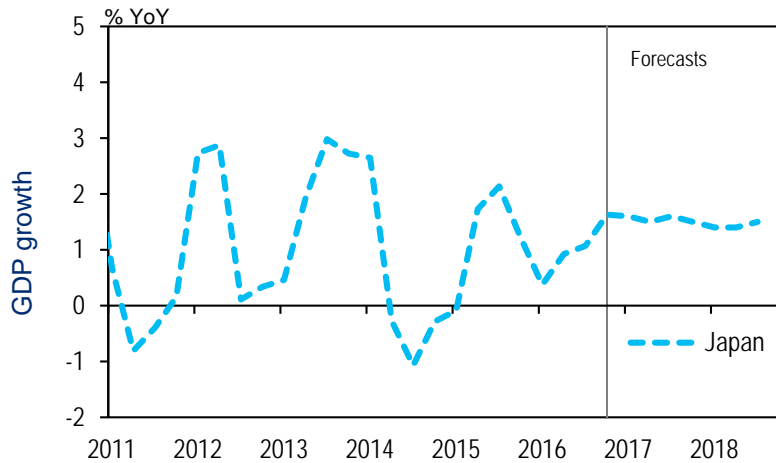
Sources: National Statistical Offices and Citi Research

## Euro area and main members



Sources: National Statistical Offices and Citi Research

## Japan



Sources: National Statistical Offices and Citi Research

## China

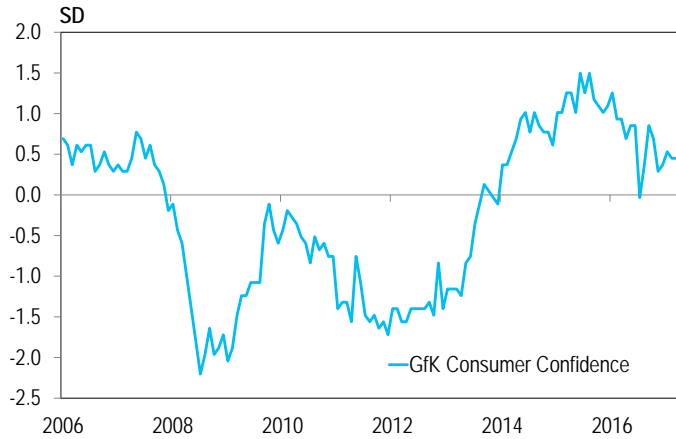


Sources: National Statistical Offices and Citi Research

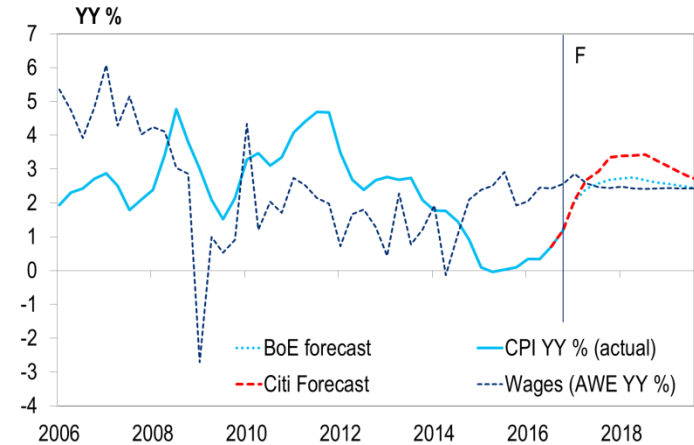
# Why are markets so relaxed? The case of Brexit

FX and monetary policy moves offset near-term effects on sentiment. But negotiations will be drawn-out and fraught with uncertainty until a likely 'hard Brexit' happens (likely by 2025, following an 'implementation period') and beyond.

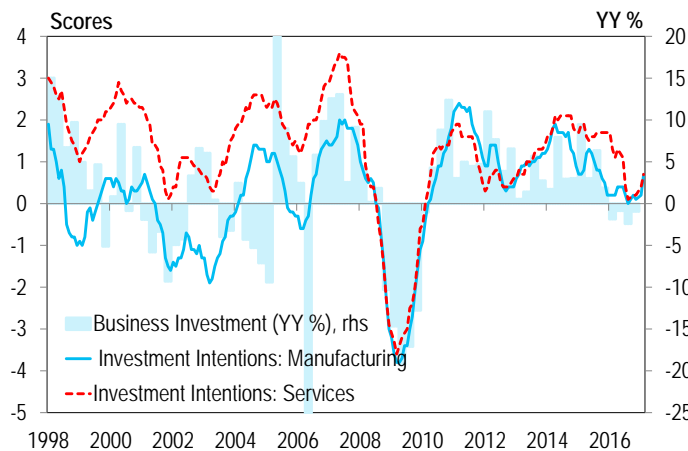
## UK – Consumer Confidence



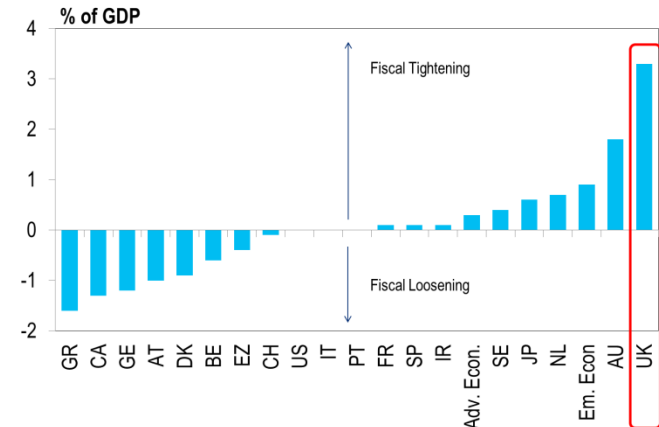
## UK – CPI Actual, BoE and Citi Forecasts (YY %)



## UK – Investment Intentions and Investment



## Advanced Economies – Change in Cyclically Adjusted Primary Fiscal Balance, 2015-2020F

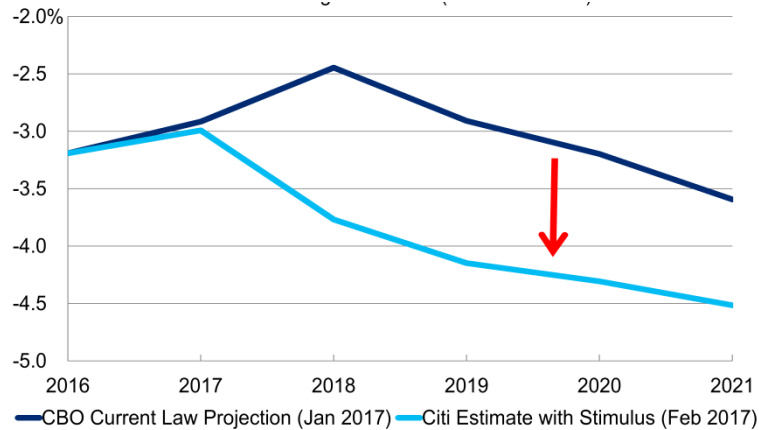


Source: BoE, Markit, ONS, Lloyds, CBI, GfK, Royal Institution of Chartered Surveyors (RICS), Halifax, Nationwide, IMF Fiscal Monitor and Citi Research

# Reflation prospects boosted sentiment and market optimism

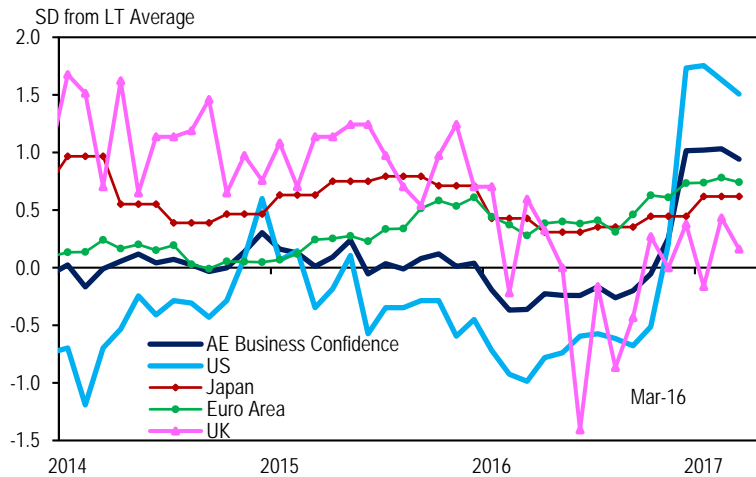
Market optimism fueled by pro-growth elements of Trump agenda, notably for small businesses (reducing regulation, reducing cost of healthcare, lowering taxes), a pick up in commodity prices and inflation.

### US Federal Budget Balance (% of GDP)



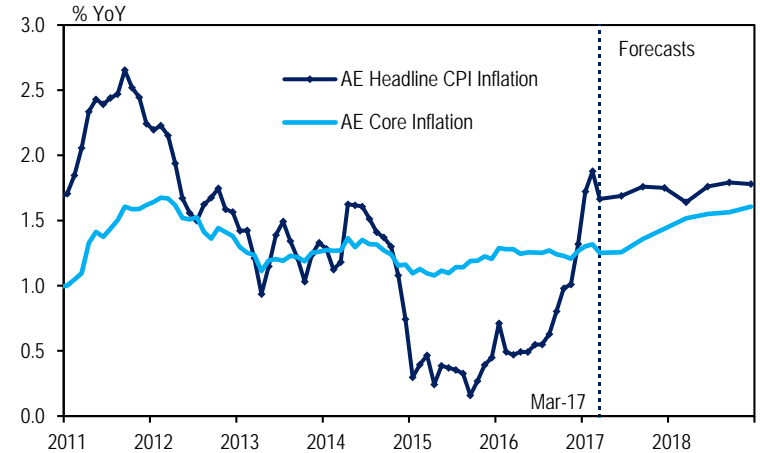
Sources: CBO and Citi Research

### AE Business Confidence (SD to LT Average)



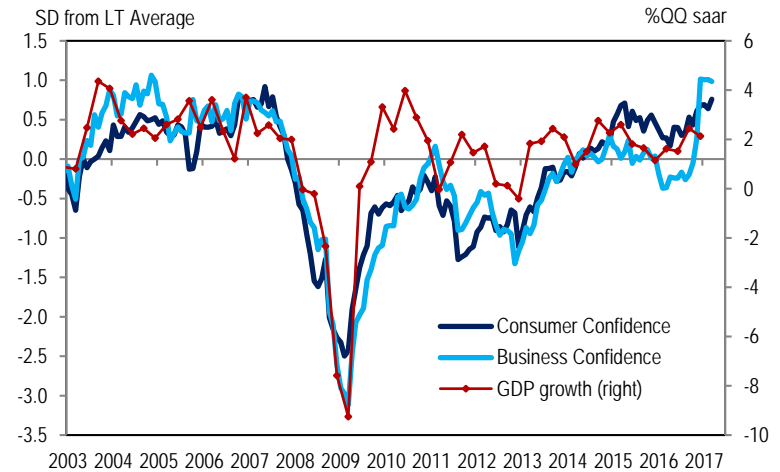
Sources: National Statistical Offices, IMF and Citi Research.

### AE – Headline and Core CPI Inflation (%YY)



Note: PCE for the US, CPI for rest. Core is CPI ex (unprocessed) food and energy. Sources: National Statistical Offices and Citi Research.

### AE – GDP Growth and Confidence measures



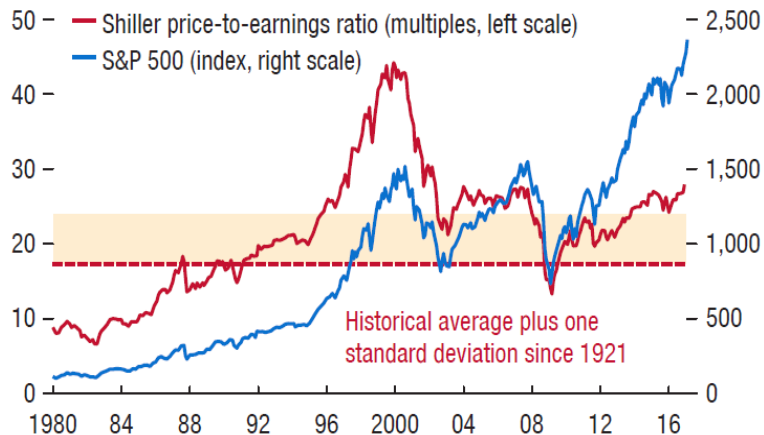
Note: GDP-weighted average of US, Japan, UK, Sweden, Switzerland, Denmark, Norway, Australia, NZ, Canada and Euro area.

Sources: National Statistical Offices, IMF and Citi Research.



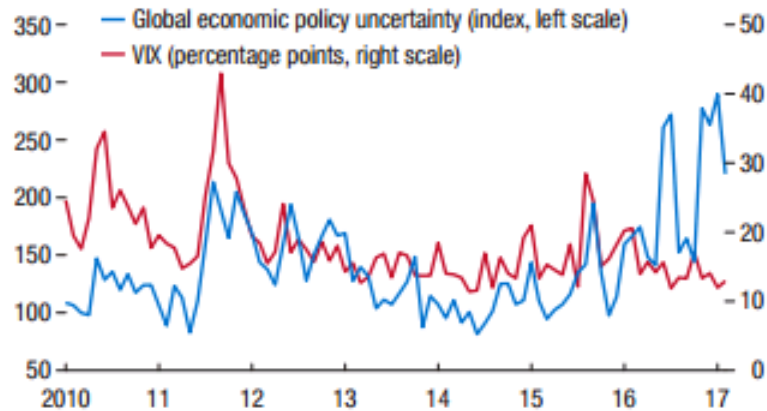
# But markets appear rather complacent

## US Equity Valuations



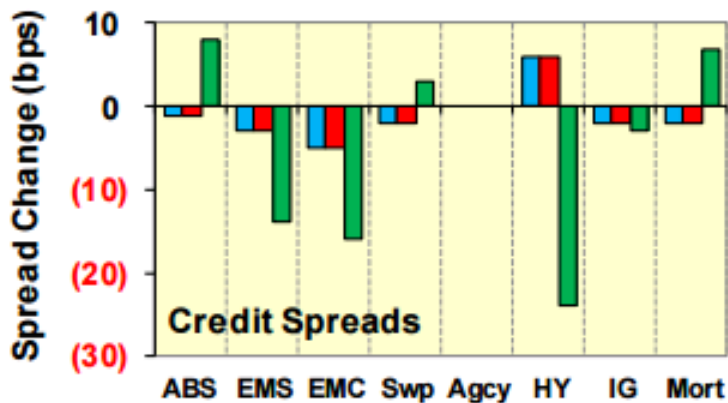
Sources: IMF Global Financial Stability Report and Citi Research

## Policy Uncertainty and Equity Volatility



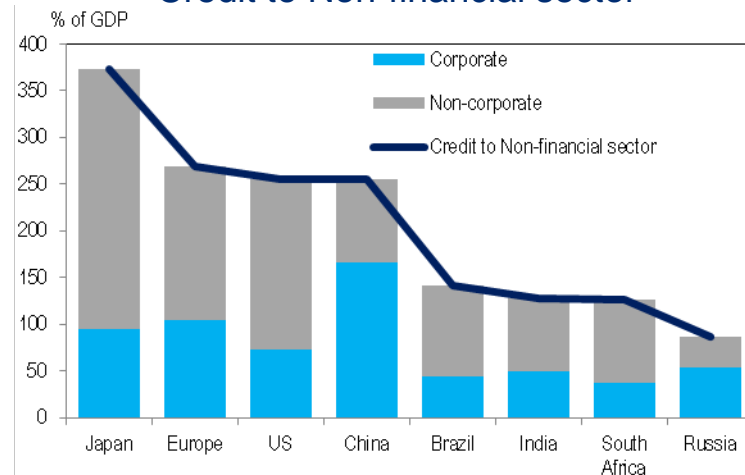
Sources: IMF Global Financial Stability Report and Citi Research

## US Credit Spreads (YTD Change)



Sources: Citi Research.

## Credit to Non-financial sector

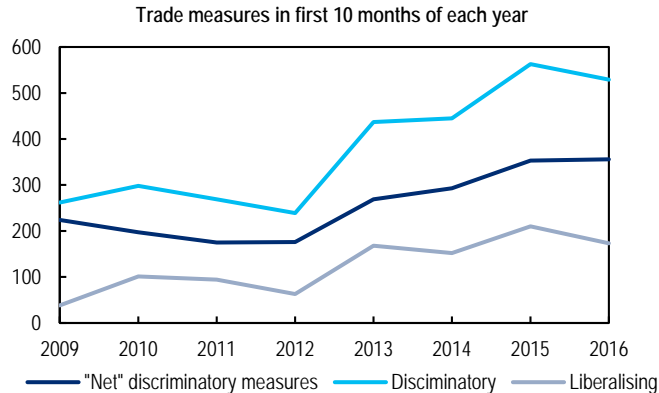


Sources: BIS and Citi Research

# There are quite a few risks to the outlook

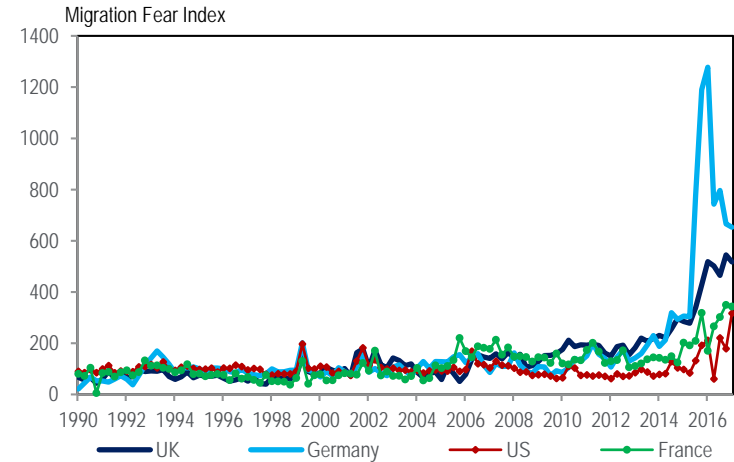
Including a rise in trade protectionism, a rise in anti-immigration sentiment, political risks in advanced economies, China cyclical risks and structural challenges and geopolitical risks. Many of these don't seem to be priced

## Number of Trade Measures Implemented Globally



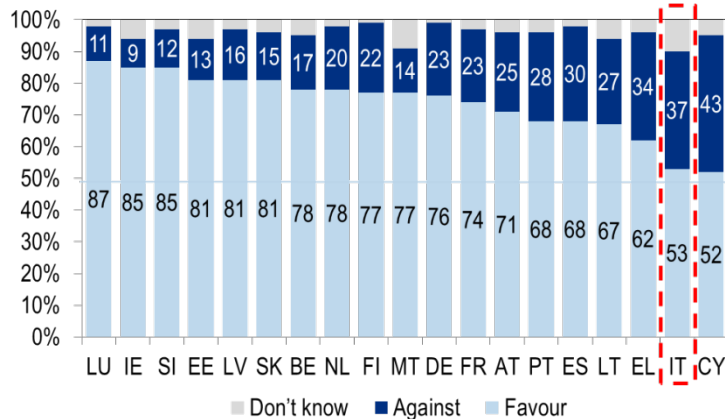
Sources: Global Trade Alert and Citi Research

## Migration fear index



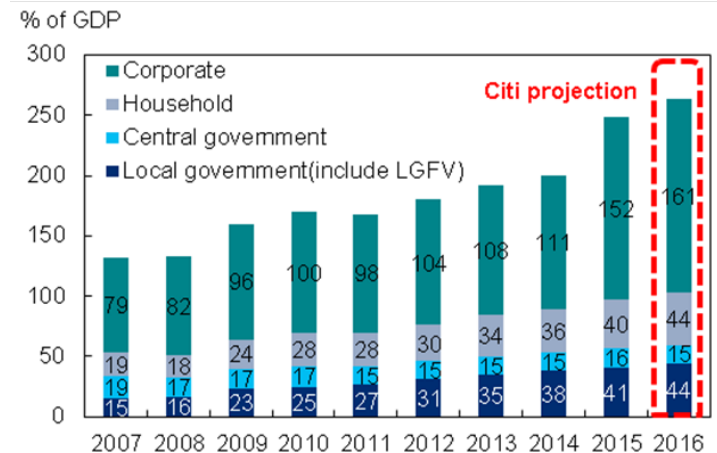
Sources: PolicyUncertainty.com and Citi Research

## Support for the Euro among euro area members



Source: Eurobarometer Survey, October 2016 and Citi Research.

## Chinese Debt overhang remains



Sources: CEIC and Citi Research

# America First: trade and protectionism remain in focus

'So far, so good', but America First still applies. Major increases in protectionism are a risk and not the base case.

## Buy and Hire American



**View – There will be more 'Buy American' clauses in public and private infrastructure initiatives.**

- Reviewing 'free trade agreements' impact on the implementation of 'Buy American' laws in Federal Government procurement.
- Reviewing (H-1B and other) visa processes.
- Cracking down on (illegal) immigration.



- Instructing Federal Agencies to stop buying imported goods.
- Reducing visa allocations sharply

## America First



**View – NAFTA renegotiation will include changes to rules of origin and dispute settlement, as well as provisions already include in the TPP (dispute settlement, labor and environment standards, IP protection).**

- Planning to renegotiate NAFTA, including US demands to 'level the playing field on tax treatment'.
- Planning to renegotiate other free-trade agreements.



- Withdrawing from NAFTA or other trade agreements
- Making major/disruptive changes to NAFTA or other FTAs (e.g. on taxation, bilateral deficit targets, reciprocal tariffs)

## Make trade fair again



**View – There will be selective investigations into specific sectors and countries but no official naming of currency or trade manipulators.**

- Preparing an Omnibus Report on Significant Trade Deficits, due by June 29.
- Launching investigations by the Commerce Department on the national security impact of core industries (steel, aluminum, vehicles, aircraft, shipbuilding, semiconductors).
- Publishing a semi-annual FX Report where the Treasury could label a country as a Currency Manipulator
- Has imposed remedial tariffs on Canadian softwood lumber imports.



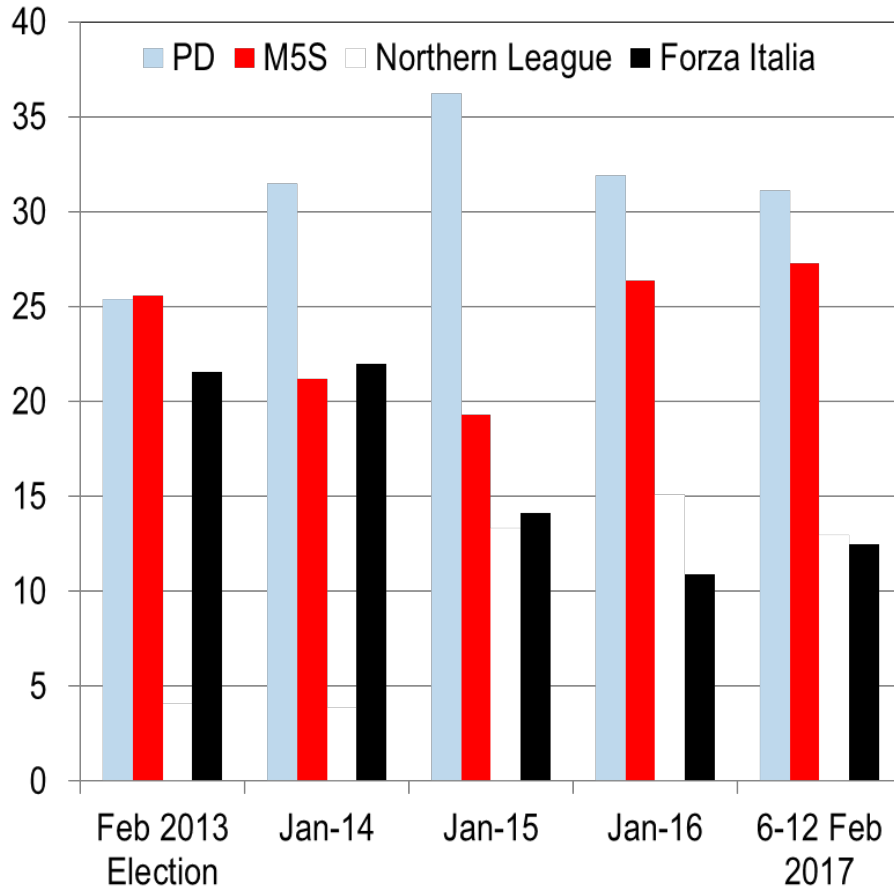
- Naming a country as 'trade manipulator' or 'currency manipulator'
- Imposing broad-based tariffs and other sanctions on specific products
- Imposing major trade remedies on China
- Introducing a broad border tax
- Withdrawing from WTO



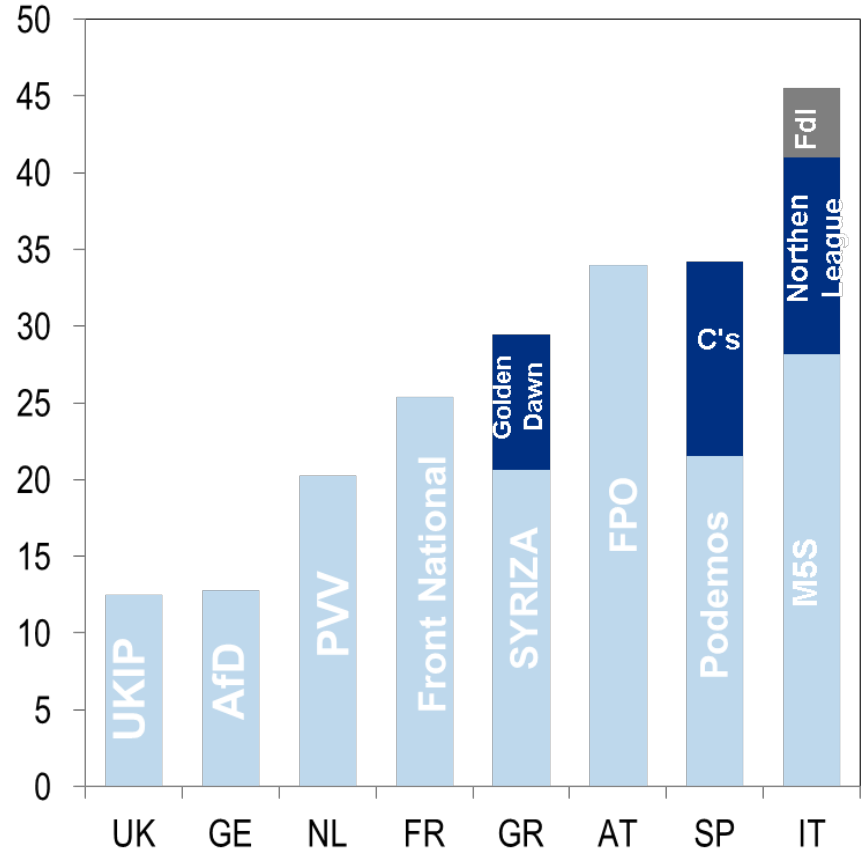
# Italy: Political Fragmentation -> Lack Reform Momentum

Anti-establishment parties poll at more than 40%, PD still polling higher than last general election in Feb-2013. Fragmented political scene will weaken future governments' stability; end of QE and retirement of Draghi in 2019.

Election Results and Opinion Polls (%). 2013 – Jan 17



Support for Alternative Parties (%), Jan 17



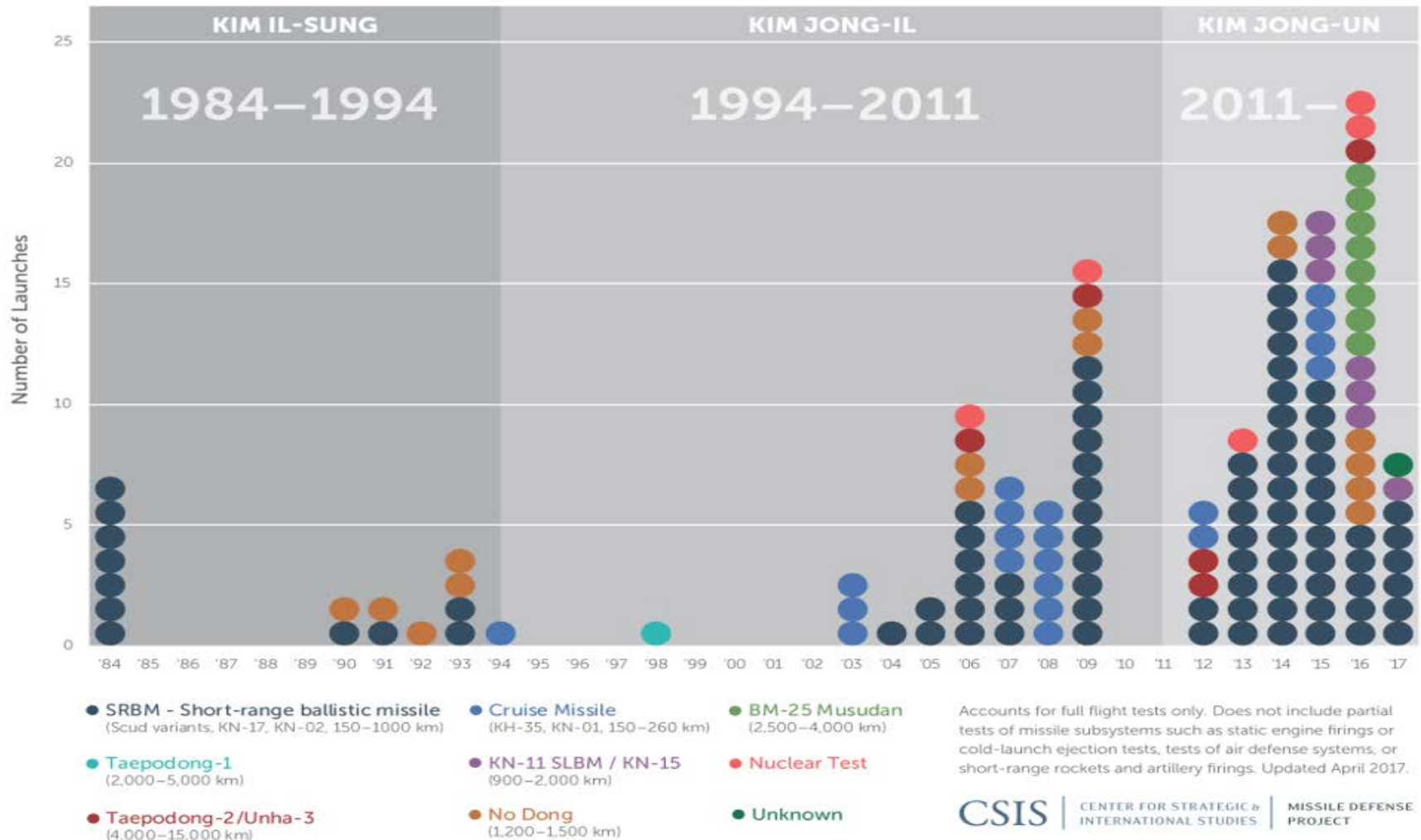
Sources: Various pollsters and Citi Research

Sources: Various pollsters and Citi Research

# Geopolitical risks are rising, too

Including in North Korea, South-China sea, Implications from Iran presidential elections

## NORTH KOREAN MISSILE LAUNCHES



Source: CSIS and Citi Research

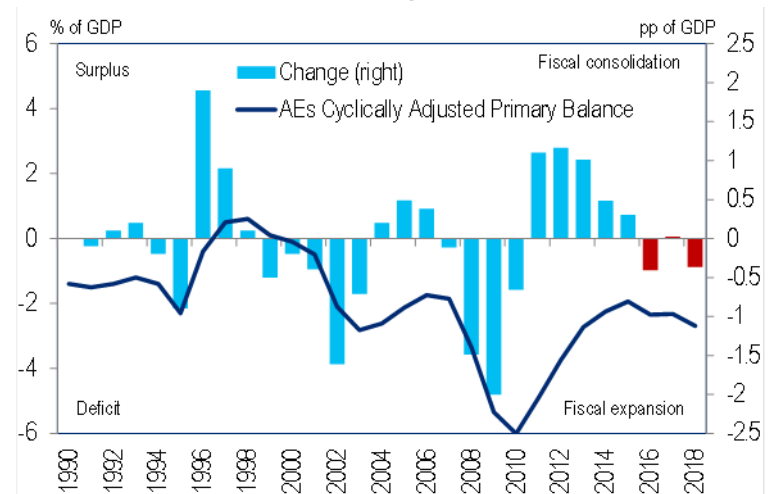
# What could policy-makers do?

Time to build resilience and avoid policy mistakes.

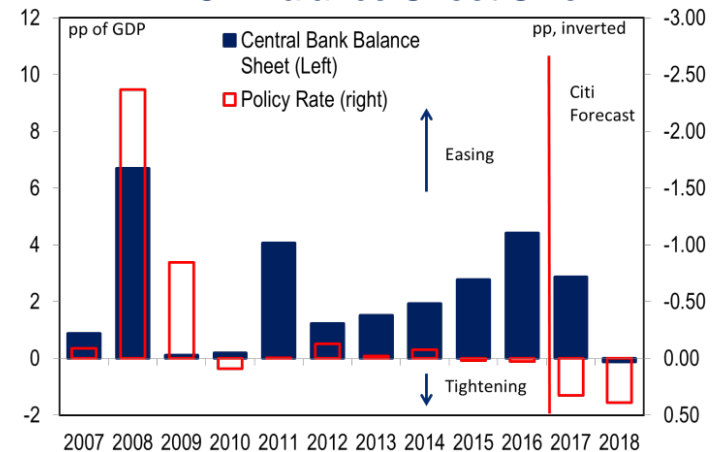
## How to build resilience?

- Implement structural reforms
- Address excessive indebtedness
- Allow a more flexible fiscal policy
- Normalize policy rates and central bank balance sheet size (although central bank balance sheet size is a political, not a technical/financial matter).

### CAPB level and Change (% and pp of GDP)



### AE – Annual Change in Policy Rate and CB Balance Sheet Size



Note: The Pension Fund Global is excluded for Norway. Sources: National Central Banks and Citi Research

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**Global Economics View**  
Rising Risk Of A Global Recession

5 February 2016 | 10 pages

**Key Points:**

- In our view, global growth is at a highly pessimistic point, after 2-3 years of relative calm.
- The imbricating together in the world economy leads to the structural and cyclical slowdown in China and its consequences elsewhere. The negative feedback loop of debt across many countries and sectors and ongoing regional and geopolitical uncertainty.
- In addition, there are now concerns about a cyclical slowdown in the advanced economies. This includes a sharp increase in the uncertainty about the outlook in the US, Euro Area, Japan and UK. Even though outright recession is unlikely in these countries, all are likely to show slower growth in 2016. In the US, between January 2015 and February 2016, we have revised our forecasts for Q2 growth in 2016 from 2.7% to 2.0% and growth could well be lower.
- Risks to the economic outlook are exacerbated by concerns that an aggressive countercyclical policy response would be leading to that the policy response would be ineffective in a number of countries, including the US. The main risks, Japan, the UK and China, to avoid a recession and to avoid a greater slowdown in potential rapid growth than is expected because of monetary tightening, the world needs a global context of what we would call "Stimulus 2.0" – monetary or countercyclical monetary policy, a fiscal stimulus and structural reform – but with more active structural reform and extended to include industrial restructuring.
- For the global economy as a whole, the monetary shock is the only one that is likely to be achieved in any major financial event. Fiscal stimulus is unlikely to meet major AE, we should view a global recession (defined as sub-2% global growth) as a real and realistic risk for 2016 and perhaps for 2017. Deleveraging global growth will likely reinforce distributional tensions and global growth could fall to near 1% a year, in the event of an even deeper AE, scenario (resulting in a US recession).

**Key Rates:**

- US Fed Rate: 0.25-0.50%
- ECB Rate: 0.00%
- Bank of Japan: 0.00%
- Bank of England: 0.50%
- China Rate: 4.25%
- India Rate: 8.00%
- South Africa Rate: 9.00%
- South Korea Rate: 3.00%
- Switzerland Rate: 0.75%
- UK Rate: 0.50%

**Global Economic Outlook and Strategy**  
May 2013

22 May 2013 | 49 pages

**Key Points:**

- Our global growth forecasts are once again this month, at 4.1% for 2013 and 5.1% for 2014 (at current exchange rates, versus 2.6% and 3.1% respectively last month). Within that roughly stable aggregate picture, we are lifting our advanced economy growth forecasts – especially for Japan and the UK in 2013, and for each area in 2014 – while again cutting growth forecasts for a range of emerging markets. Growth in investment spending is likely to replace consumer spending as a major engine of growth.
- Even with improving financial conditions and modestly better growth prospects in some cases, we believe monetary policy is likely to remain tighter in a range of advanced economies, Europe and in particular, the UK. The jobless rate remains high and the labor market continues to be weak. The jobless rate remains high and the labor market continues to be weak. The jobless rate remains high and the labor market continues to be weak.
- At the end of each area, we no longer expect a sharp 2014 recovery rate, although we still believe there is a fairly high risk of a sharp decline in some regions in coming years because of economic weakness and the resulting government debt crisis. The ECB is likely to cut rates again later this year, but we doubt that the move – and some moderate monetary tightening – will be enough to lift the euro area out of persistent weakness. China's economy is handicapped by slower growth than many observers expect, and our growth forecasts are below consensus for this year and 2014. The stimulation of lower Chinese growth and job displacement is ongoing growth prospects in many other emerging markets, restoring the bias to understate growth.
- We expect that liquidity will remain tight, leading to a tightening of credit conditions later this year. Further ahead, we still believe widespread restructuring of government and/or bank balance sheets in a range of major emerging economies, and the likely increase in restructuring of privately-owned entities as well as official exposure in some cases.

**Table 1: Summary and Global Key Rates, as of 15 May 2013**

	05/13	04/13	03/13	02/13	01/13	12/12	11/12	10/12
Global Growth	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%
Advanced Economies	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%
Emerging Markets	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%
Key Rates								
US Fed Rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
ECB Rate	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Bank of Japan	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Bank of England	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
China Rate	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%
India Rate	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
South Africa Rate	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%
South Korea Rate	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Switzerland Rate	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%
UK Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%

# Appendix A-1

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