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Global Economic Outlook

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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

US and China – Industrial Production

AE and EM – Goods Exports and Imports

Sources: Markit and Citi Research.

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.
Why are markets so relaxed? The case of Brexit

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

UK – Consumer Confidence

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)

AE – Headline and Core CPI Inflation (%YY)

AE Business Confidence (SD to LT Average)

AE – GDP Growth and Confidence measures

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

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

Policy Uncertainty and Equity Volatility

US Credit Spreads (YTD Change)

Credit to Non-financial sector

Sources: IMF Global Financial Stability Report and Citi Research.

Sources: Citi Research.

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

Migration fear index

Support for the Euro among euro area members

Chinese Debt overhang remains

Source: Eurobarometer Survey, October 2016 and Citi Research.

Source: 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
- 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.

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

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

Risk
- 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
- 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.

Risk
- 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.

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

Support for Alternative Parties (%), Jan 17

Sources: Various pollsters and Citi Research
Geopolitical risks are rising, too

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

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).

Source: Citi Research

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

Source: National Central Banks and Citi Research

**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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