

May 26, 2017

Global Economic Outlook

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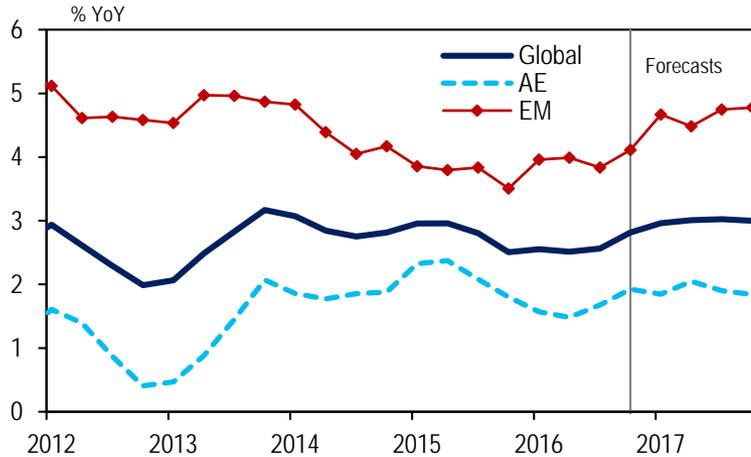
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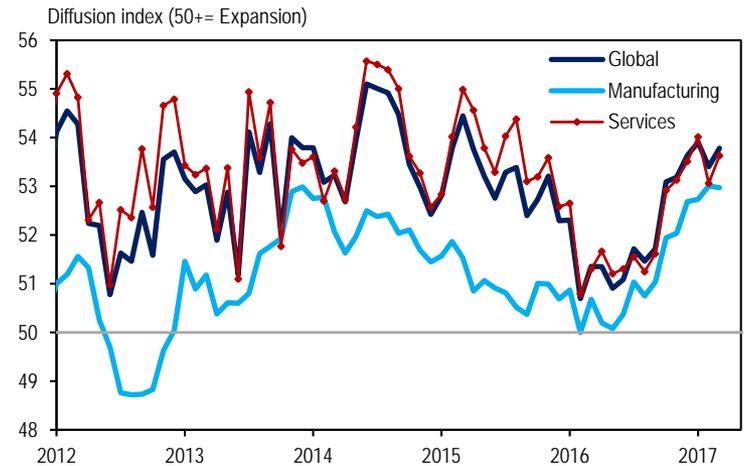
Global growth looks relatively stable with some signs of a pick up

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)



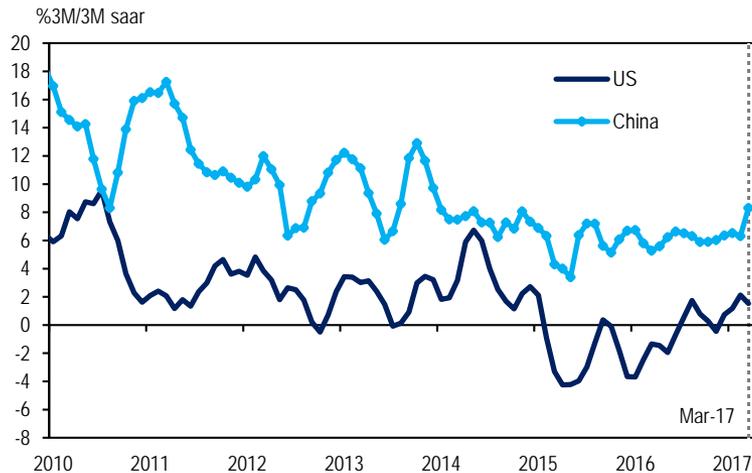
Global—Composite, Mfg and Services PMI



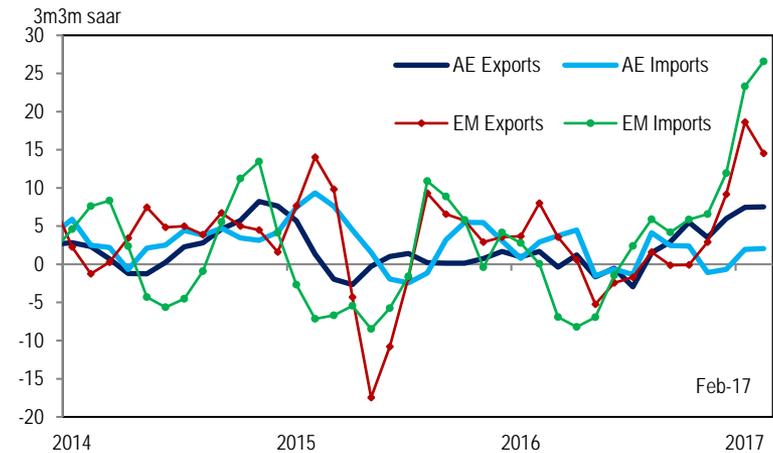
Note: Aggregates at market exchange rates. Global and EM aggregates exclude Venezuela. Source: National Statistical Offices, IMF and Citi Research

Sources: Markit and Citi Research.

US and China – Industrial Production



AE and EM – Goods Exports and Imports



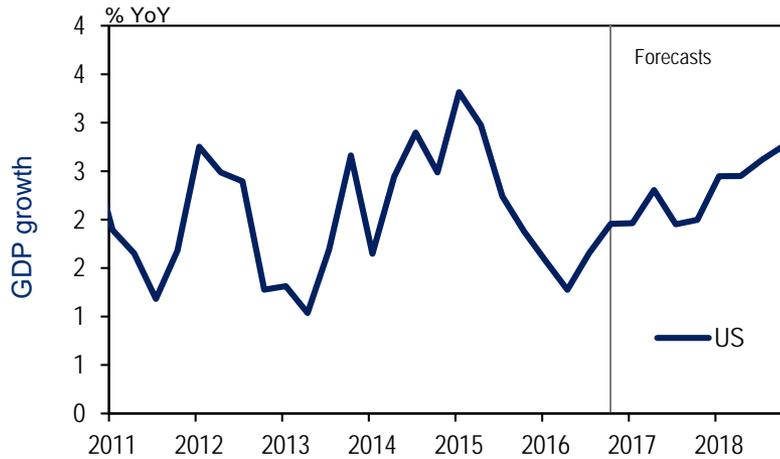
Sources: FRB, NBS and Citi Research.

Sources: CPB and Citi Research

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

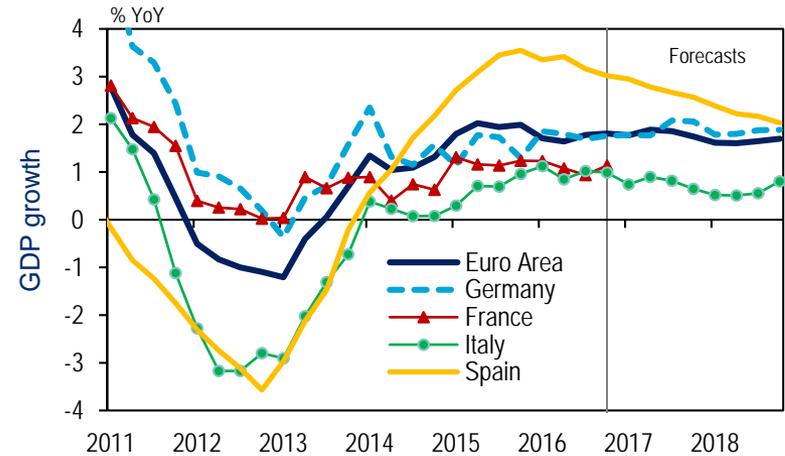
We expect growth to be solid in the euro area and to pick up in the US after a weak Q1. We expect growth to be stable in Japan and to keep moderating in China.

US



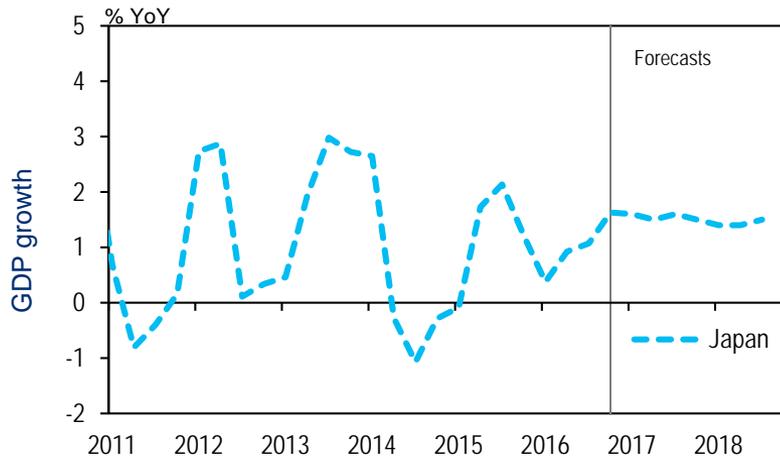
Sources: National Statistical Offices and Citi Research

Euro area and main members



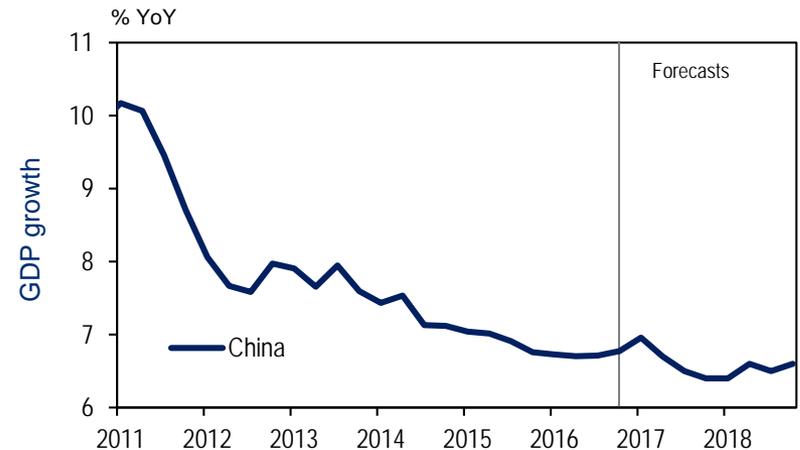
Sources: National Statistical Offices and Citi Research

Japan



Sources: National Statistical Offices and Citi Research

China



Sources: National Statistical Offices and Citi Research

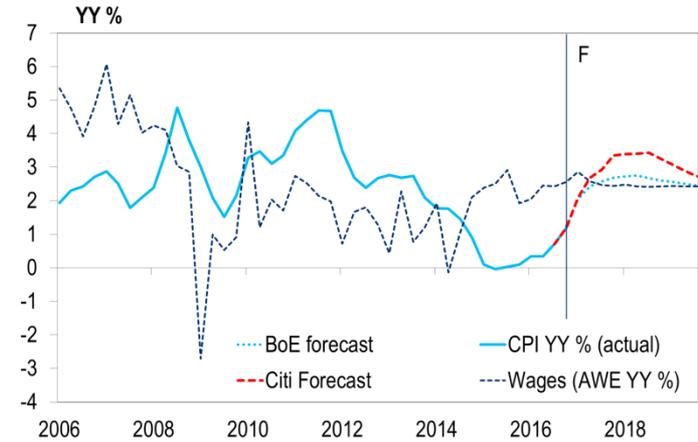
Why are markets so relaxed? The case of Brexit

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.

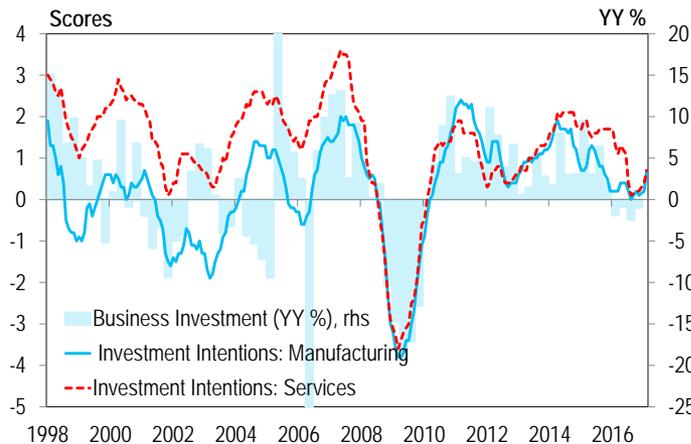
UK – Consumer Confidence



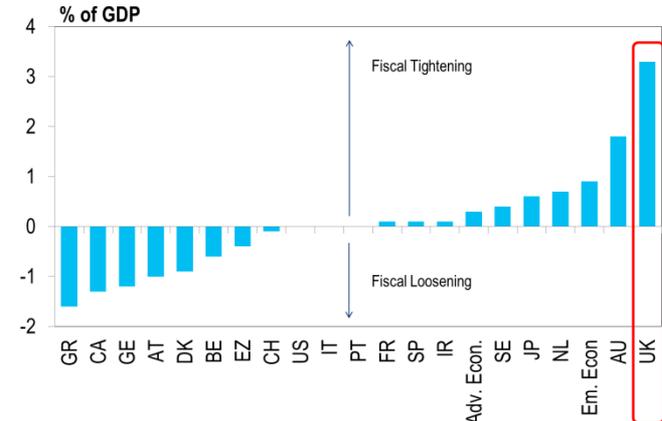
UK – CPI Actual, BoE and Citi Forecasts (YY %)



UK – Investment Intentions and Investment



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

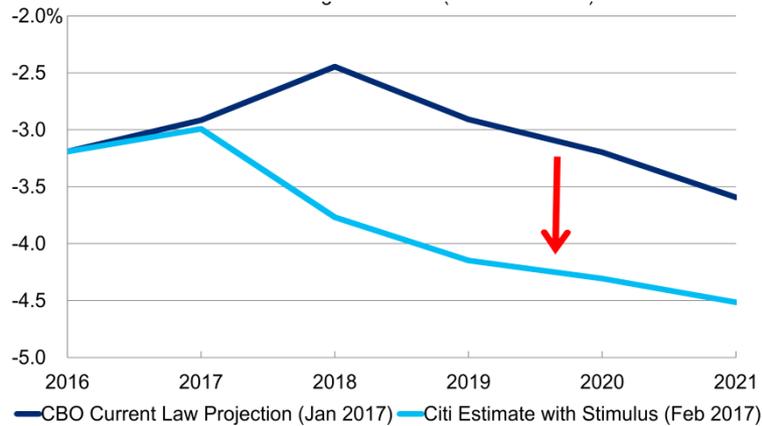


Source: BoE, Markit, ONS, Lloyds, CBI, GfK, Royal Institution of Chartered Surveyors (RICS), Halifax, Nationwide, IMF Fiscal Monitor and Citi Research

Reflation prospects boosted sentiment and market optimism

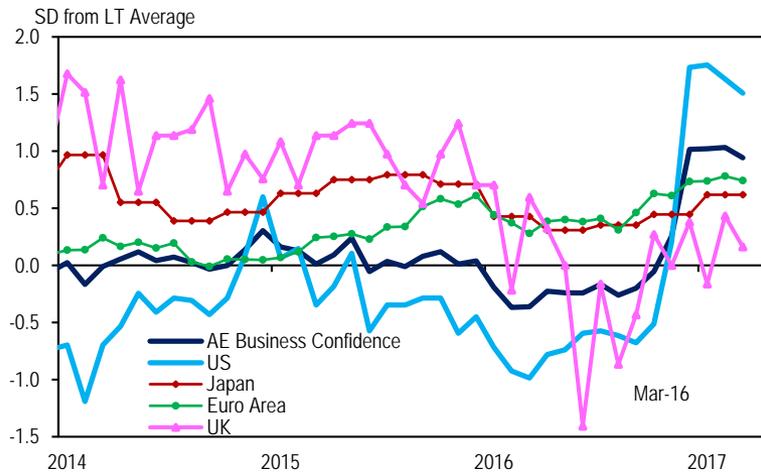
Market optimism fueled by pro-growth elements of Trump agenda, notably for small businesses (reducing regulation, reducing cost of healthcare, lowering taxes), a pick up in commodity prices and inflation.

US Federal Budget Balance (% of GDP)



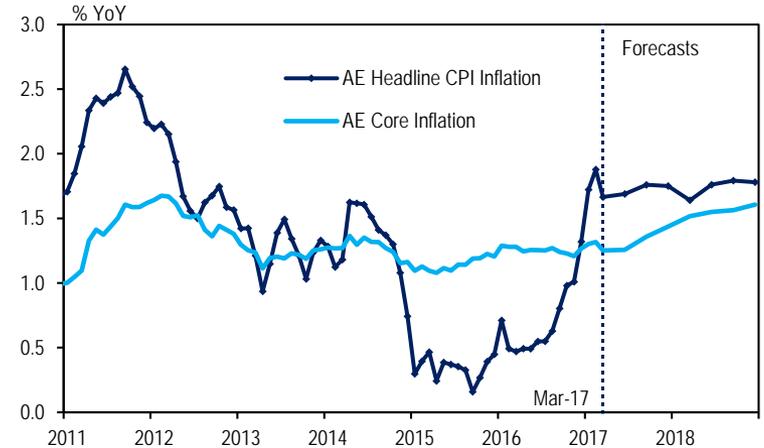
Sources: CBO and Citi Research

AE Business Confidence (SD to LT Average)



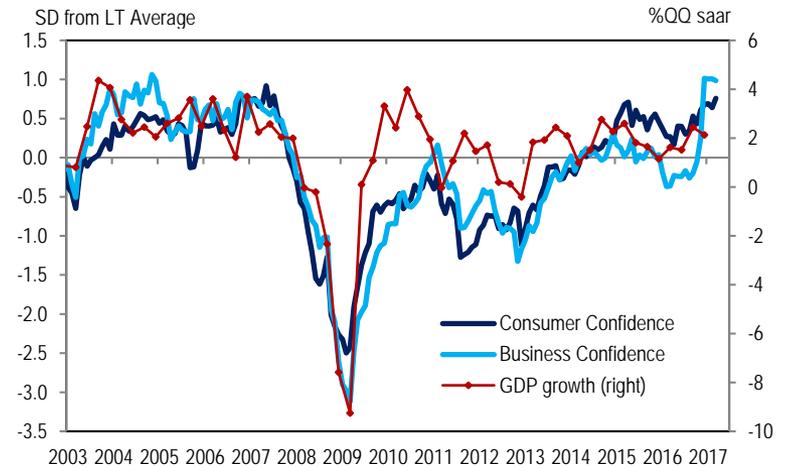
Sources: National Statistical Offices, IMF and Citi Research.

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



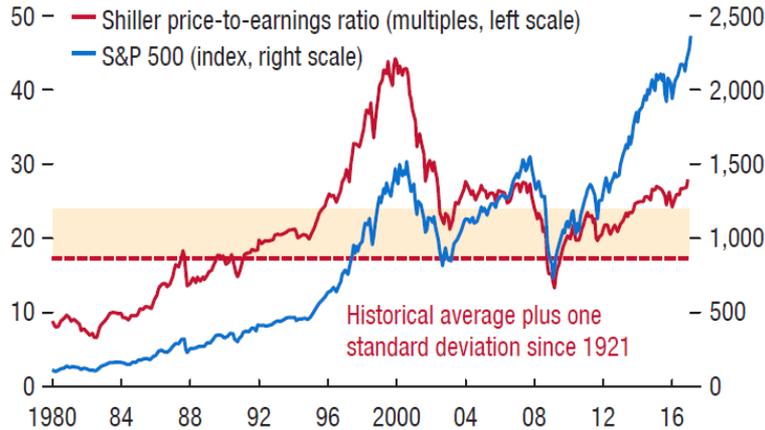
Note: GDP-weighted average of US, Japan, UK, Sweden, Switzerland, Denmark, Norway, Australia, NZ, Canada and Euro area.

Sources: National Statistical Offices, IMF and Citi Research.



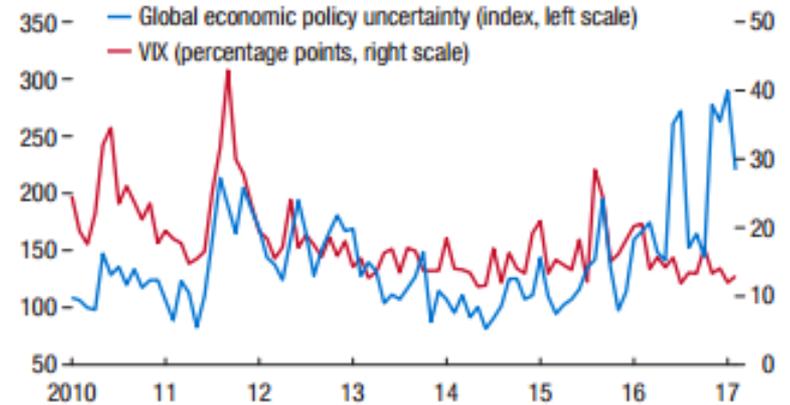
But markets appear rather complacent

US Equity Valuations



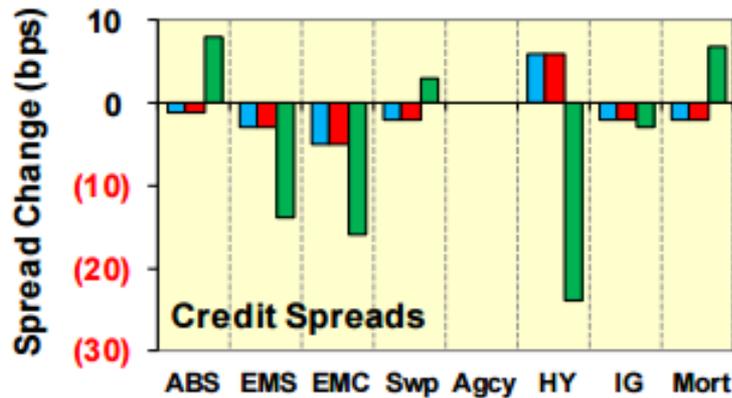
Sources: IMF Global Financial Stability Report and Citi Research

Policy Uncertainty and Equity Volatility



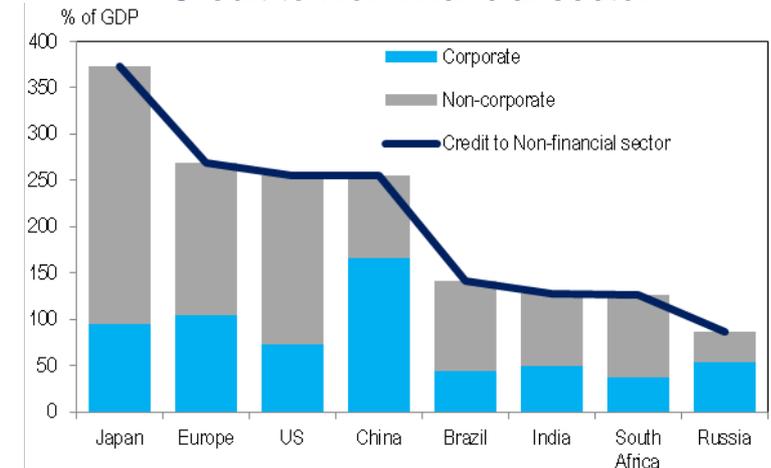
Sources: IMF Global Financial Stability Report and Citi Research

US Credit Spreads (YTD Change)



Sources: Citi Research.

Credit to Non-financial sector

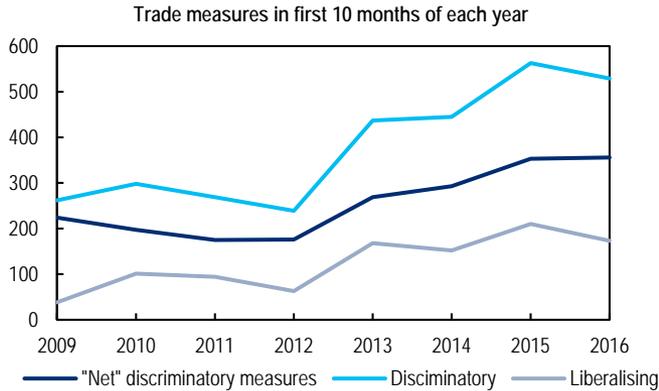


Sources: BIS and Citi Research

There are quite a few risks to the outlook

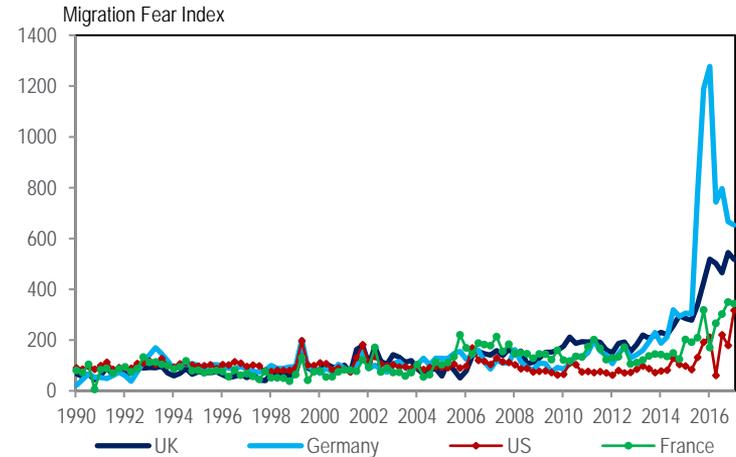
Including a rise in trade protectionism, a rise in anti-immigration sentiment, political risks in advanced economies, China cyclical risks and structural challenges and geopolitical risks. Many of these don't seem to be priced

Number of Trade Measures Implemented Globally



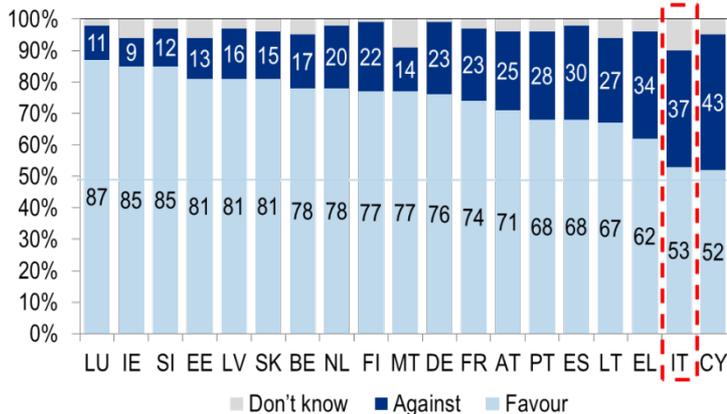
Sources: Global Trade Alert and Citi Research

Migration fear index



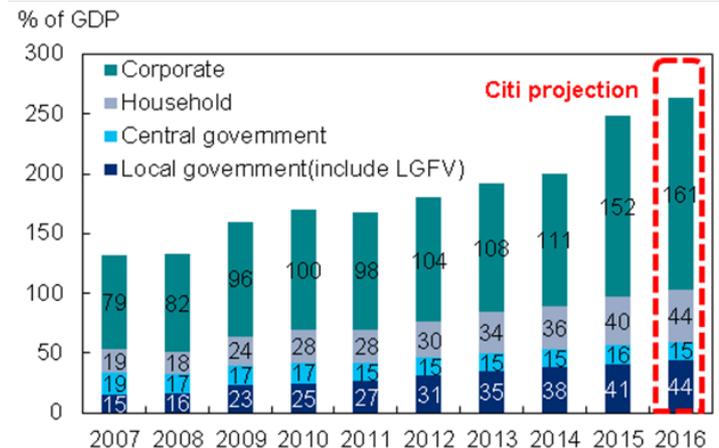
Sources: PolicyUncertainty.com and Citi Research

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.

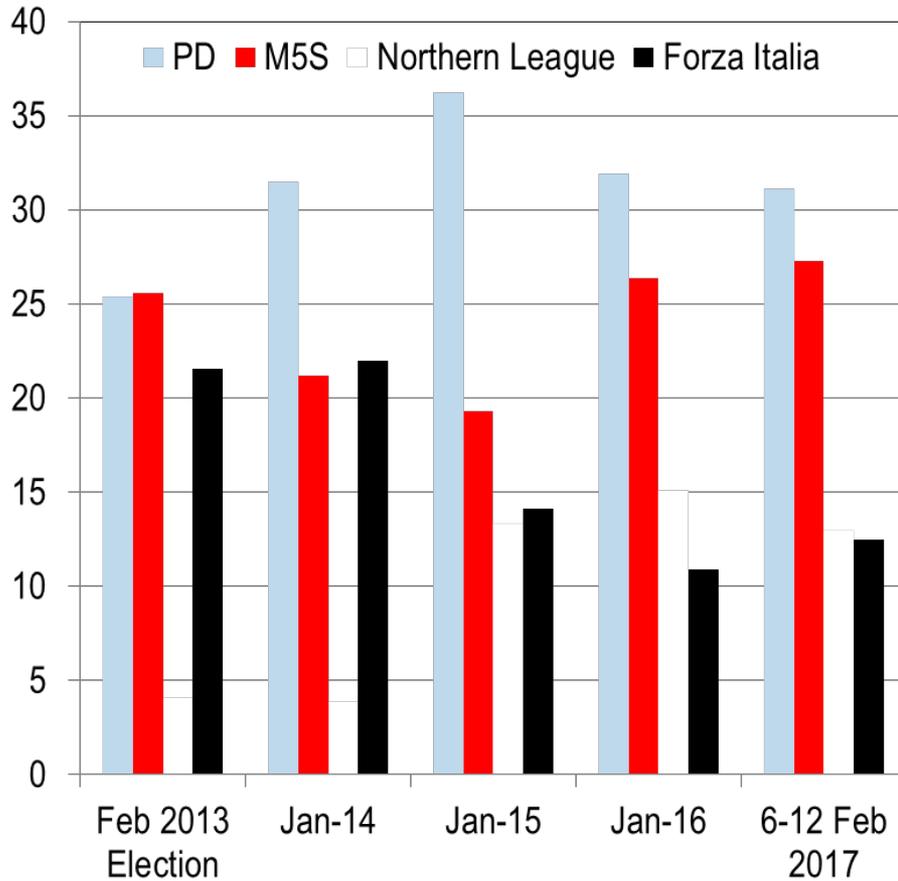


- Naming a country as 'trade manipulator' or 'currency manipulator'
- Imposing broad-based tariffs and other sanctions on specific products
- Imposing major trade remedies on China
- Introducing a broad border tax
- Withdrawing from WTO

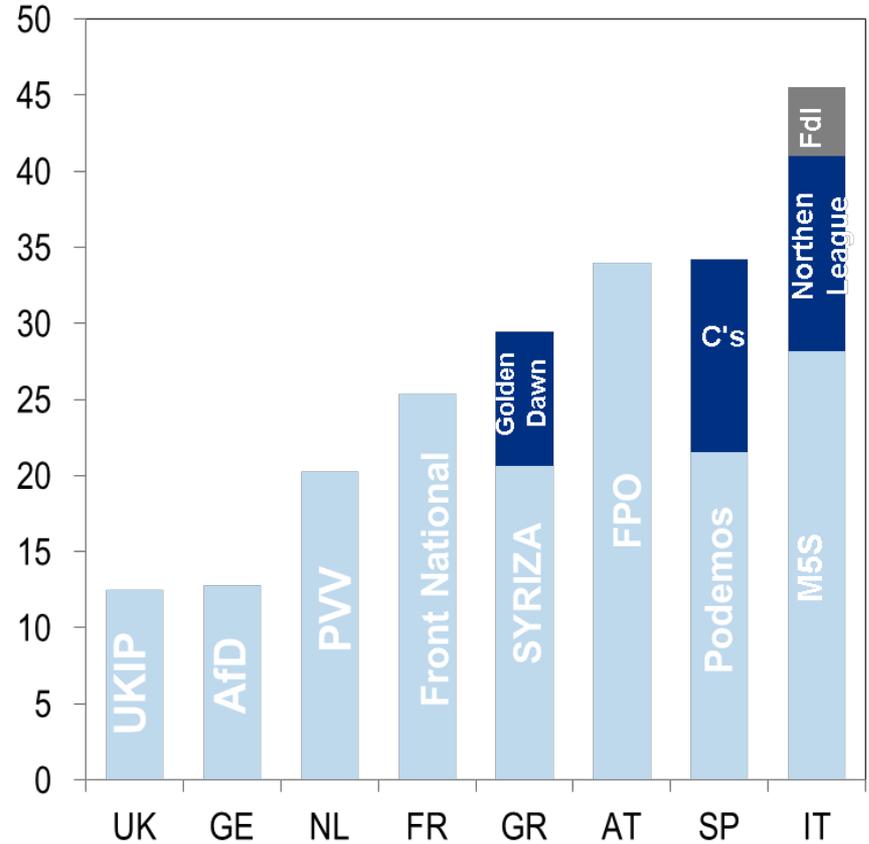
Italy: Political Fragmentation -> Lack Reform Momentum

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



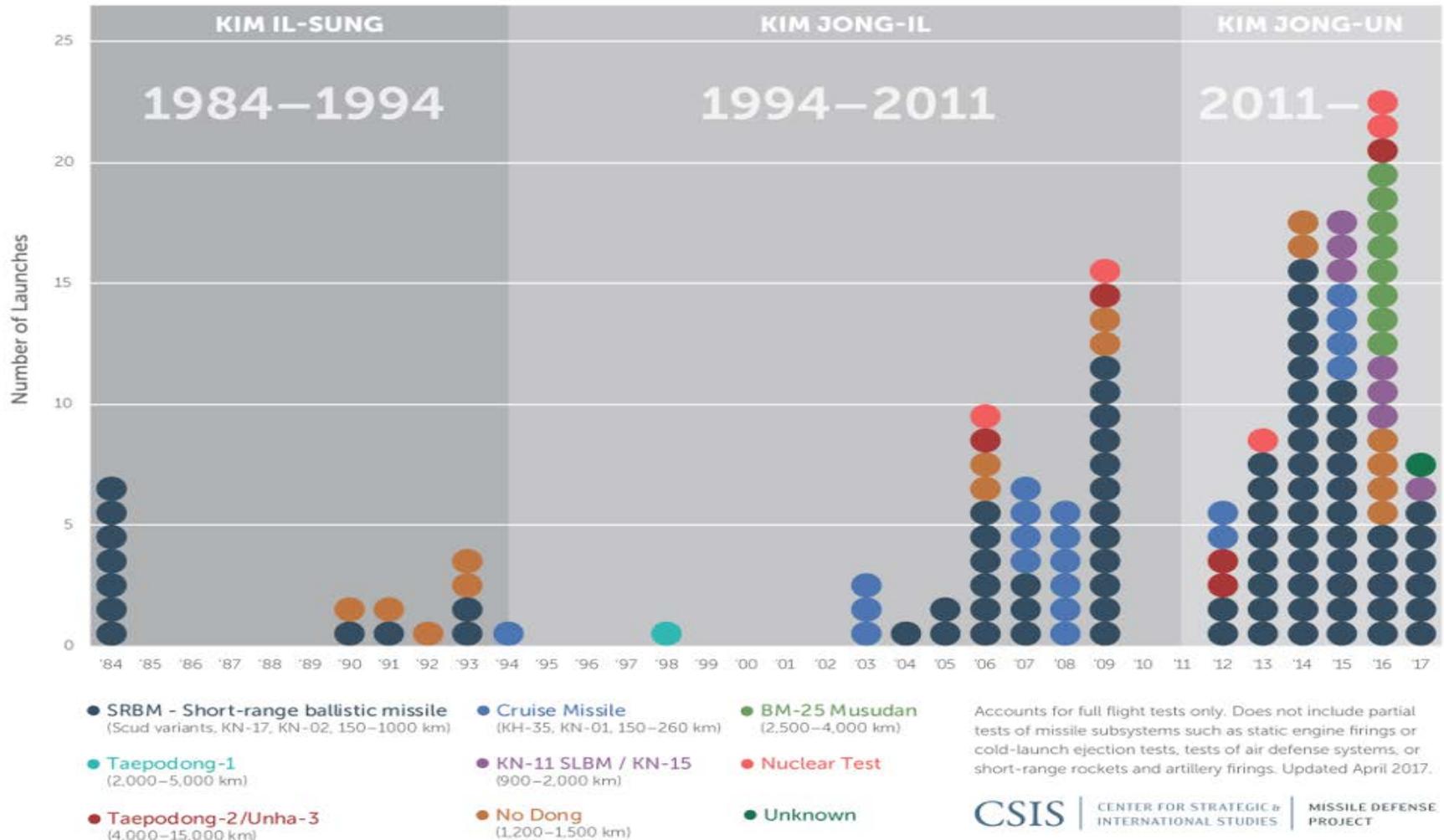
Sources: Various pollsters and Citi Research

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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

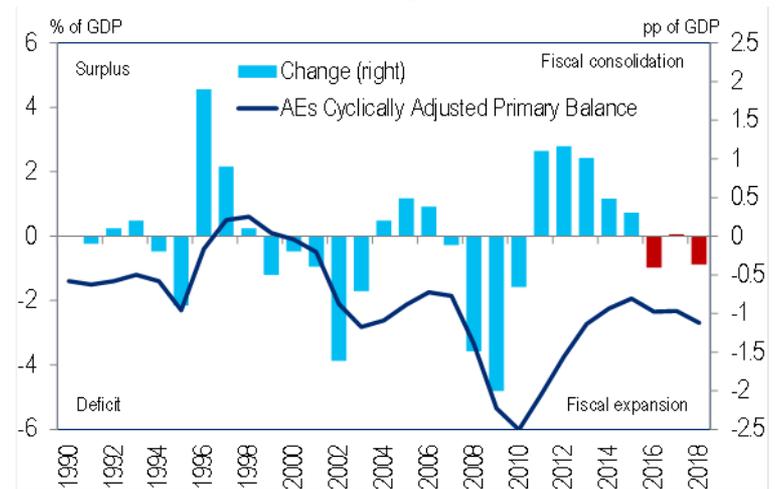
What could policy-makers do?

Time to build resilience and avoid policy mistakes.

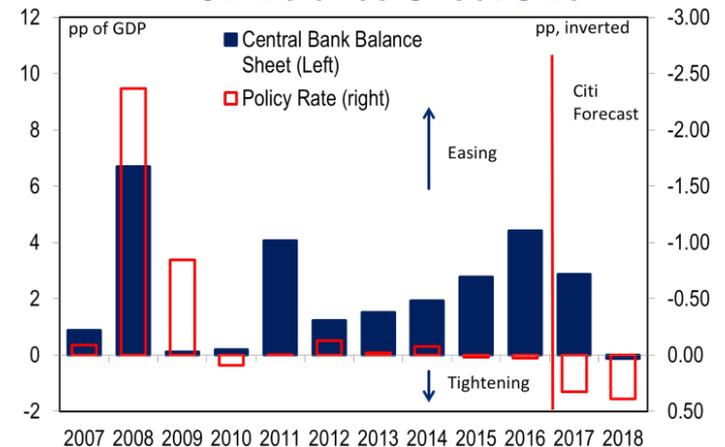
How to build resilience?

- 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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