



Economic and Strategy Viewpoint

June 2018

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Forecast update: growth peaking, inflation rising



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- Global growth remains robust, but we have revised down our forecast for 2018 to 3.4% from 3.5%. This largely reflects a soft start to the year in many economies, higher oil prices and increased concerns over trade relations between the US and China. This represents the first downgrade to growth since September 2016.
- Monetary policy is expected to tighten across the developed world over the forecast period with the Fed hiking to 3% by mid next year, the ECB ending QE purchases in Q4 this year and raising rates in 2019. Some adjustment of BoJ policy can also be expected.
- The world economy is still in the expansion mode, but the forecast indicates that a more stagflationary period may lie ahead and the risks around the forecast are in this direction.

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European forecast update: a frosty start to 2018



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- The eurozone economy has experienced a largely unexpected slowdown, calling into question the durability of the recovery. While poor weather may have been to blame, leading indicators have failed to recover. Meanwhile, political risk in Italy has returned as the two biggest populist parties join forces to form a government.
- The UK appears to have suffered a similarly poor start to 2018. The good news is that a Brexit transition deal appears to have been agreed. The bad news is that uncertainty appears to be having a larger impact on confidence and house prices than previously feared.

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EM forecast update: turbulence interrupts a smooth flight



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- Broadly lower growth and higher inflation compared to our previous forecast for EM. The culprits are, in the main, a weaker than expected first quarter and much higher oil prices, though sanctions and trade tensions also weigh on activity.
- Higher inflation should close the door on further rate cuts for most of EM, though we think Russia still has space for one more. Otherwise, the next moves in Brazil and India seem likely to be hikes.

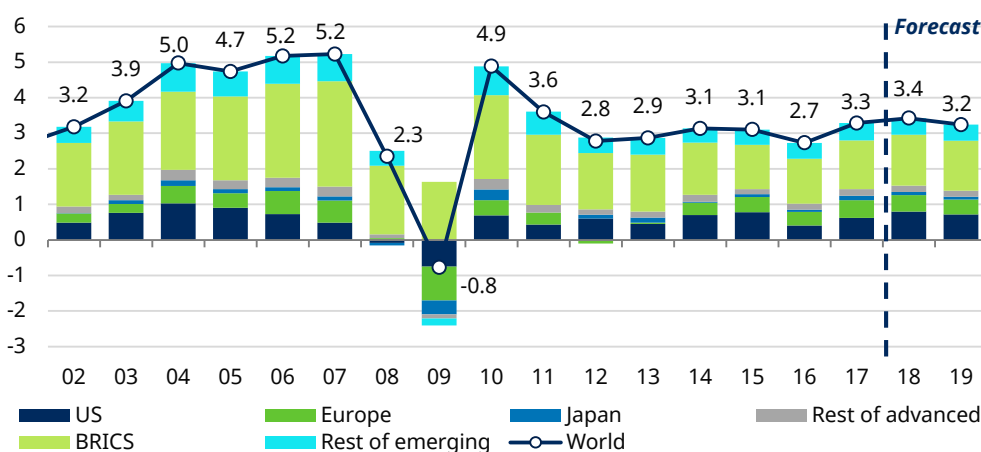
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Views at a glance

- A short summary of our main macro views and where we see the risks to the world economy.

Chart: Global growth

Contributions to World GDP growth (y/y), %



Source: Schroders Economics Group, 21 May 2018. Please note the forecast warning at the back of the document.

Forecast update: Growth peaking, inflation rising

"The good news is that the economic picture is mostly bright...But we can see darker clouds looming"

Christine Lagarde, IMF Managing Director,
11 April 2018

Summary

We have trimmed our global growth forecast for this year and next

Global growth remains robust, but we have revised down our forecast for 2018 to 3.4% from 3.5%. This largely reflects a soft start to the year in many economies, higher oil prices and increased concerns over trade relations between the US and China. The latter are expected to persist into 2019 and weigh on trade and capital investment spending even if a full trade war does not break out. We now expect 3.2% growth in 2019 (previously 3.3%) with the pace of activity cooling through the year. Meanwhile, we have revised up our inflation forecast for 2018 to 2.7% (from 2.4%) largely as a result of higher oil prices. In the US, which is approaching full capacity, we still expect core inflation to move higher over the next two years.

Led by the US Federal Reserve (Fed), developed market central banks are expected to tighten monetary policy over the forecast period. We expect three more 25 basis point rate hikes in the US this year and two next with the fed funds rate reaching 3% by the middle of 2019. The European Central Bank (ECB) is expected to end QE in Q4 this year and raise rates three times in 2019, ending the era of negative policy rates in the eurozone. The Bank of Japan (BoJ) is expected to adjust Yield Curve Control in Q4 as rising global yields put upward pressure on the 10 year JGB target of zero. In contrast lower inflation, and liquidity concerns, mean that China heads the other way with the People's Bank of China (PBoC) easing the reserve requirement ratio (RRR) and policy rates lower. The interest rate cycle is expected to turn upwards in India this year and Brazil next year. Against this backdrop the USD is expected to strengthen further in the near term before weakening in 2019 as central banks outside the US begin to tighten.

Turning point

First downward revision to growth since 2016

The latest forecast marks a turning point as it is the first time we have revised down our expectations for global growth since September 2016. The recovery in the world economy led to a series of upgrades with global growth reaching 3.3% in 2017, the strongest for six years. Alongside a benign inflation rate, this helped drive risk assets higher. The forecast for 2018 remains robust at 3.4%, so when combined with our forecast for rising inflation we would still say the world economy is in the expansion or reflation phase of the cycle. However, the outlook indicates that we are heading in a more stagflationary direction in late 2018 as growth cools and inflation rises.

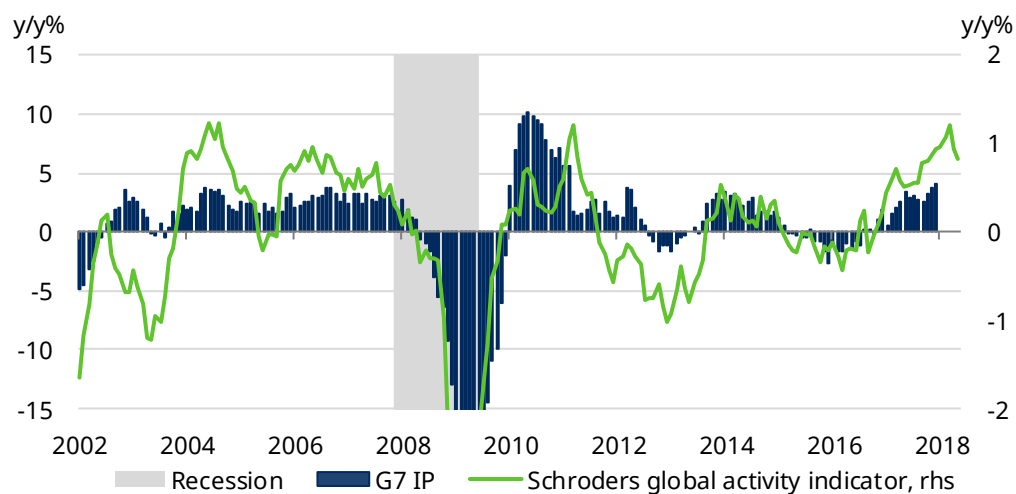
In terms of the current position, we recognise that bad weather and influenza played a part in the weak start to the year for the northern hemisphere. Faulty seasonal adjustment factors may also have depressed US official growth figures in Q1, as they have in previous years. Furthermore, US growth got a one-off boost from post-hurricane rebuilding and replacement spending at the end of last year, resulting in some payback in Q1. These factors should now fade, helping activity normalise in the current quarter.

However, whilst the world economy will always be vulnerable to the vicissitudes of the climate, there are three fundamental reasons for calling a turn in activity.

Leading indicators are rolling over

First, activity indicators are rolling over, with our global leading indicator falling in March and April (chart 1). The purchasing managers' survey, US ISM indices and national surveys have all been softer during this period, indicating a moderation in activity.

Chart 1: Global leading indicators are rolling over



Source: Thomson Datastream, Schrodgers Economics Group. 24 May 2018.

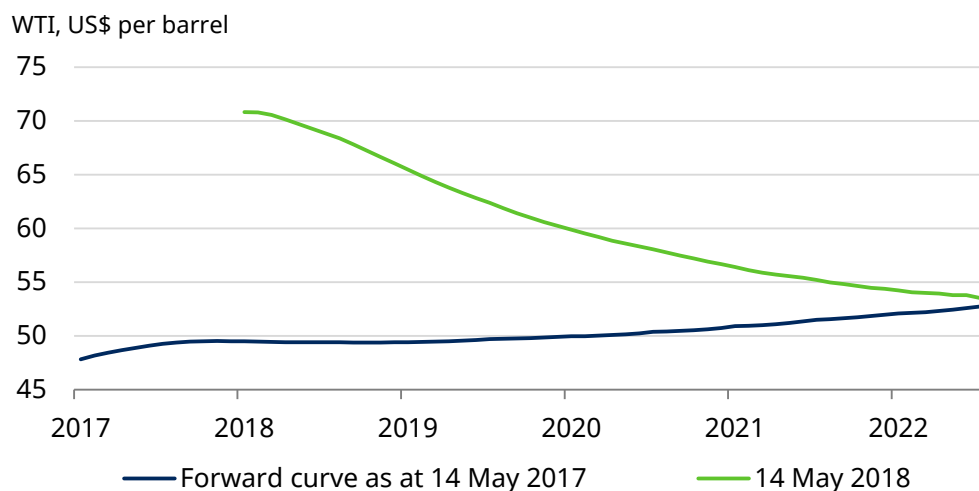
Impact of rising oil prices

Second, rising energy costs will reduce consumer spending power. The spot WTI oil price has risen 17% so far this year, driven by a combination of strong OPEC discipline and speculation (which ultimately proved correct) that President Trump would terminate the Iran nuclear deal.

Oil prices are higher although curve suggests they will ease back next year

We use the forward curve for our forecast assumptions and on this basis the oil price is expected to average some \$10 higher than in our previous forecast. For 2019 the difference is less marked as the market does not seem to expect recent price rises to be sustained as the oil curve is in backwardation (chart 2). This probably reflects expectations that other OPEC producers will step in to offset the 1 million barrels per day (mb/d) likely to be lost as a result of the re-imposition of sanctions on Iran.

Chart 2: Oil prices: spot and forward curve (today vs. one year ago)



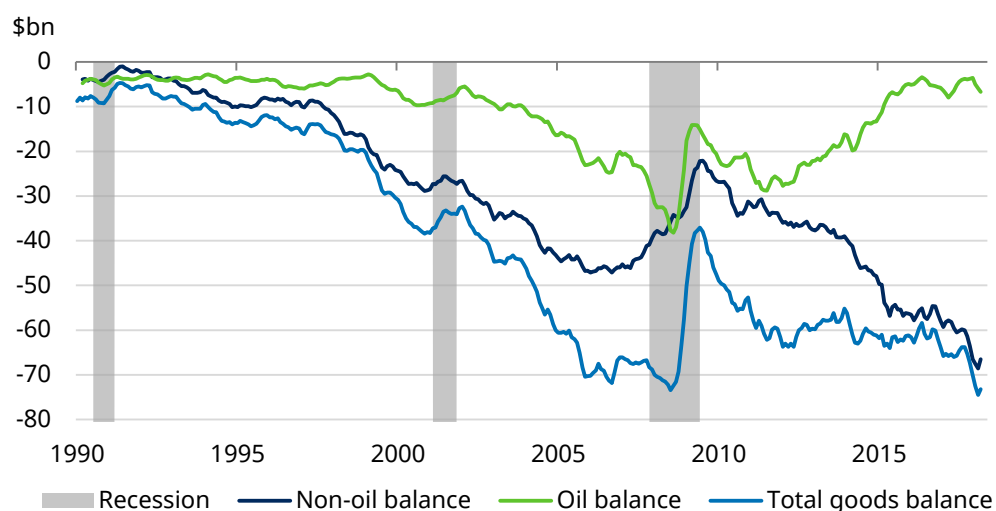
Source: Bloomberg, Schrodgers Economics Group. 14 May 2018.

Oil shocks redistribute income from consumers to producers

In terms of the macroeconomic picture, there are winners and losers as higher oil prices trigger a redistribution of income from consumers to producers. Cutbacks by consumers tend to come through more rapidly than extra spending by producers, with the result that overall growth weakens.

The impact on the US economy has changed as a result of the rise in shale gas production such that the US is now the third largest producer of oil behind Saudi Arabia and Russia¹. The US now runs a small deficit on its oil trade with the rest of the world, compared with a significant deficit only a few years ago. This has masked a more significant deterioration in the non-oil balance (chart 3). Consequently, the negative effects of higher oil prices have diminished significantly and in the near term have turned positive, as higher production tends to be the first response from shale gas producers.

Chart 3: US trade balance: with and without oil



Source: Thomson Datastream, Schroders Economics Group. 24 May 2018.

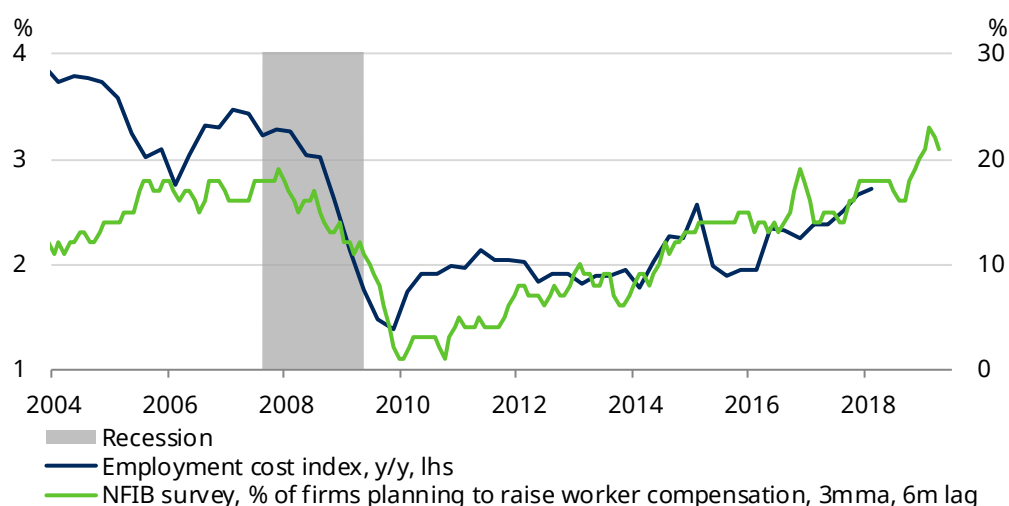
The boost may be less significant in the current environment though, as there appear to be capacity constraints in the shale industry and producers have been notably more cautious on increasing capital spending in this cycle. The boom/bust experience of the last cycle seems to be weighing on their willingness to spend, a factor reinforced by the market's view of future prices.

For the US consumer, the rise in energy prices will absorb about \$60bn. The tax cuts amount to \$120bn, so around half will go to higher gasoline prices. For those in the lowest 20% income bracket, higher gasoline prices more than offset the \$50 gain from tax cuts. Real consumer spending is likely to be lower as a result.

The key question will be whether workers can gain some of this back through higher wages. So far wages have remained remarkably subdued in this cycle but there are signs that the tight labour market is beginning to make itself felt, with anecdotal evidence and surveys pointing to higher compensation (chart 4).

¹ Source: US Energy information administration, based on 2016 figures.

Chart 4: NFIB survey points to higher compensation



Source: Thomson Datastream, Schrodgers Economics Group. 24 May 2018.

Wages and core inflation are expected to rise further

Of course, higher wages would be a double edged sword. Whilst helping consumers, they will only reinforce the Fed's resolve to tighten monetary policy and head off higher inflation. Notwithstanding the rise in oil prices, which has pushed up our inflation forecasts for 2018, we continue to expect a late cycle rise in core consumer price inflation. Our models find there are long lags in the inflation process such that changes in growth and unemployment can take a year or more to feed through into prices. On this basis higher core inflation is already in the pipeline for 2018 and, given the outlook for growth (robust) and unemployment (lower), will continue to move higher in 2019.

Trade uncertainty to weigh on activity

The third factor influencing our forecast is the trade tension generated by the Trump administration's aim of putting "America first". We had previously seen the US stance as a negotiating position tied in to the mid-term election. There is still an element of this, but the differences between the US and China on issues such as Intellectual property (IP) are such that we can see the dispute persisting into 2019 (for more on this please see the emerging markets section below).

Trade row between US and China to turn into a prolonged standoff

This is not a trade war, but a long standoff between the two largest economies in the world. In terms of impact, the uncertainty over future trade relations is likely to act as a drag on business decisions to hire and invest. The effect is akin to the drag on UK spending since the Brexit vote and accounts for some of the modest downgrade to growth in 2019.

The next US recession?

There is no US recession in our forecast which means we expect the current cycle to become the longest since the 1991–2001 period. However, whilst cause for celebration, it seems unlikely that the US expansion will go on for considerably longer as we reach the end of the decade. Tighter monetary policy and an end to fiscal stimulus will leave a hole in US demand in 2020 which makes a recession highly likely. Such a view would be consistent with a further flattening and inversion of the yield curve in 2019.

Scenarios

We have reviewed our risk scenarios and will be making two changes. Having been concerned about the risk of a "surge in bond yields" scenario from the unwinding of QE we now see this as less likely. Bond yields have risen lately, but have not reached

New scenarios are mid-cycle slowdown and oil at \$100

the levels anticipated by this scenario. The Fed is expected to continue to reduce its balance sheet and the ECB is expected to end its QE programme in Q4 this year. We would expect this to add upward pressure to yields without necessarily causing a sharp spike, so believe the risk has diminished.

This scenario is replaced by a "Mid-cycle slowdown" scenario where the soft growth in Q1 extends into Q2, with the world economy losing momentum altogether in the second half of the year. This results in a pause and some reversal in monetary tightening before activity strengthens again in 2019.

We have also dropped the "productivity revival" scenario. Whilst there were hopes of an acceleration a year ago, subsequent data releases have revealed no pick-up in output per hour, which came in at 1.3% y/y in Q1 and has been virtually unchanged over the past four quarters. This may change, but late cycle productivity revivals tend to be rare as firms hit capacity constraints and do not have the slack to easily raise output without taking on more workers. Instead they tend to raise prices, thus choking off demand and creating inflation.

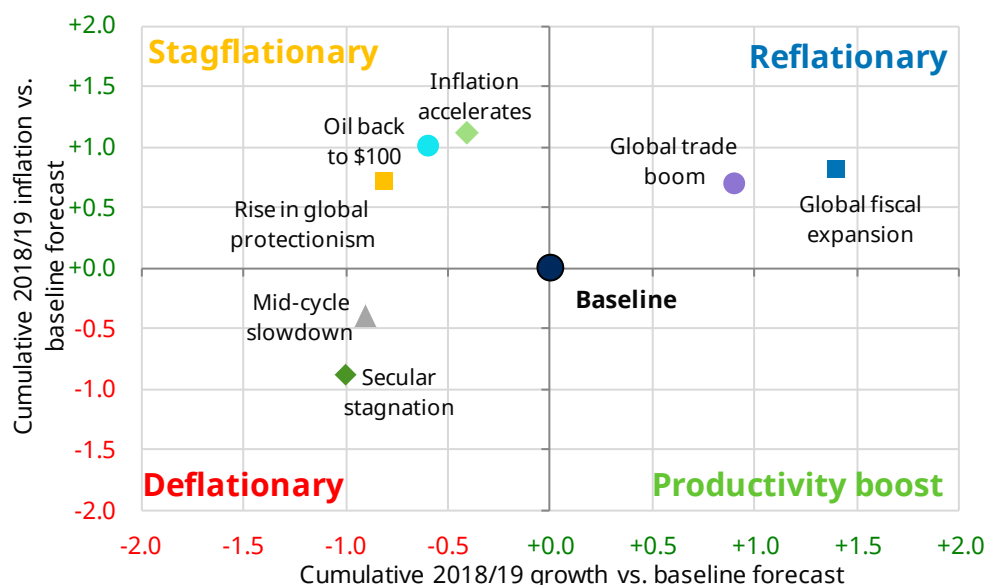
The new scenario to replace this is "oil back to \$100", where President Trump's withdrawal from the Iran nuclear deal and imposition of sanctions results in 1 mb/d being removed from oil supply as the agreement collapses. The risk premium on oil rises as the threat of conflict in the region between Iran, Saudi Arabia and Israel spreads beyond that seen in Syria. Given the tightness of the oil markets, oil prices surge to \$100 where they remain over the forecast period. This amounts to a significant oil shock for the world economy with the result that inflation is higher and growth lower.

Balance of risks lie in a stagflationary direction

We have also retained our secular stagnation scenario where, although the risks have fallen, it should not be forgotten that without the support of loose monetary and fiscal policy economic growth would be considerably weaker.

Combining our scenarios with our assessment of probabilities we see the greatest risks in a stagflationary direction with three scenarios in this quadrant: "inflation accelerates", "global protectionism" and "oil" at \$100" (see chart 5).

Chart 5: Scenario grid: growth and inflation versus baseline



Source: Schroders Economics Group, 21 May 2018. Please note the forecast warning at the back of the document.

European forecast update: a frosty start to 2018

"Among famous traitors of history, one might mention the weather"

Ilka Chase, 20th century American actress.

The eurozone economy has experienced a sudden and largely unexpected slowdown, calling into question the durability of the recovery. Severe snow storms were probably mostly to blame, but the lack of a recovery in leading activity indicators is causing growing concerns. Meanwhile, Italian political risk is back, and this time, there is no quick fix for investors.

As the eurozone sneezed, the UK caught the cold, with a more severe slowdown in the first quarter than in the continent. The weaker data was enough to persuade the Bank of England to delay its next rate hike until signs of a healthier economy return.

Why did eurozone growth slow in Q1?

The eurozone saw a sudden and unexpected slowdown in growth in Q1

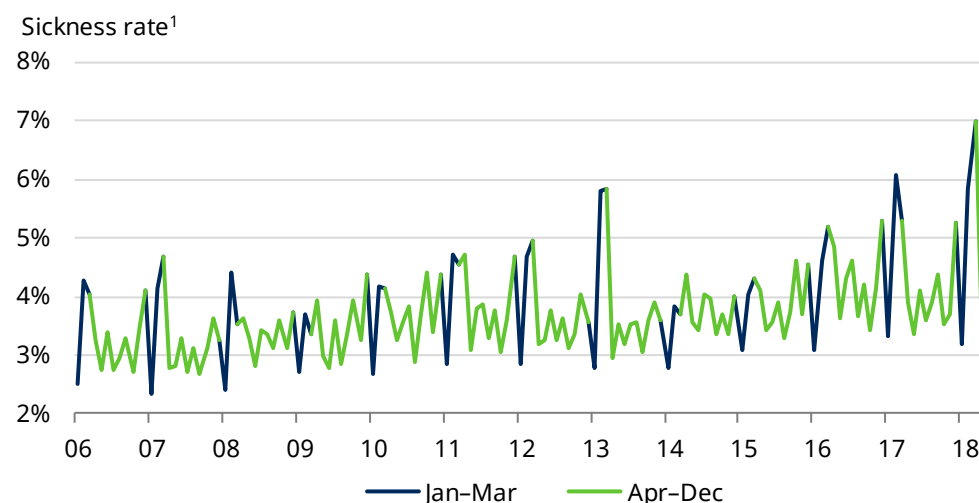
The preliminary GDP report from Eurostat shows the eurozone grew by 0.4% quarter-on-quarter in the first quarter of 2018. This is a marked slowdown compared to the upwardly-revised estimate for the fourth quarter of 0.7%.

At the time of writing, a breakdown of eurozone GDP is not yet available. However, it seems that temporary factors such as transportation strikes, the timing of Easter and cold weather may have been at fault. In particular, the unusually heavy snow storms in late February and early March, ominously dubbed the "beast from the East" by the British media, are highly likely to have played a role in the slowdown in activity.

There were reports of severe disruption to transport services, schools, hospitals, construction and some manufacturing across Northern Europe. The German Federal Ministry of Health reported a huge breakout of influenza, which caused just under 7% of the workforce covered by public health insurance to be absent from work in March – twice the usual rate of absenteeism, and far higher for seasonally than in any year since before 2006 (chart 6).

Chart 6: Germany experiences a severe flu outbreak

Severe snow storms and a flu outbreak are some of the temporary factors being blamed



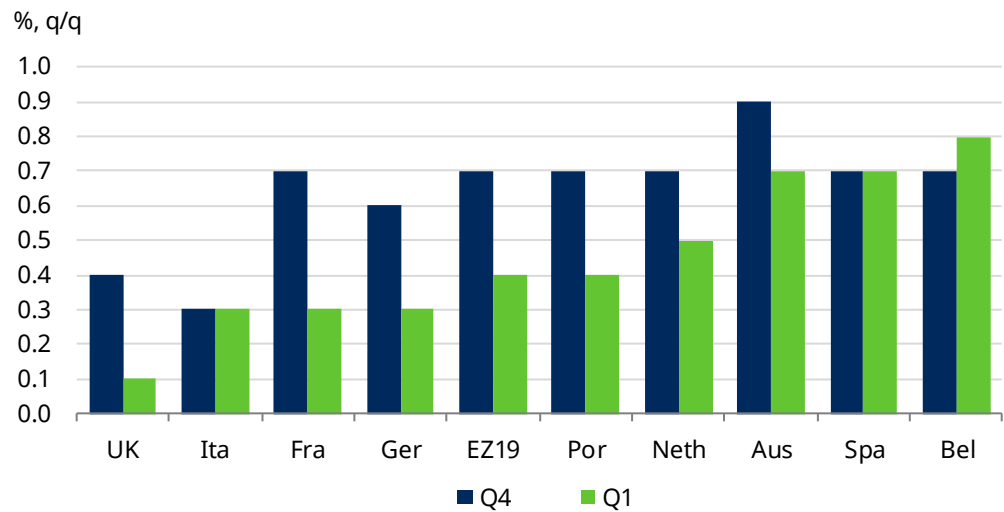
Source: German Federal Ministry of Health, UBS, Schrodgers Economics Group, 23 May 2018.

¹Persons in public health system not working due to sickness as % of all publicly insured (on 1st day of month).

Regional differences also help explain the slowdown. Northern member states such as Germany, France, the Netherlands, Austria and the UK all saw a significant drop in GDP growth. Southern member states enjoyed a better quarter, with Spain and Italy reporting no slowdown in activity (see chart 7).

Chart 7: Eurozone GDP growth slows for most

Southern Europe, which had better weather, performed as expected



Source: Eurostat, ONS, Schroders Economics Group, 21 May 2018.

Growth data from both Germany and France reported a significant decline in the external performance of the two biggest member states compared to recent quarters. Quarterly growth in German export volumes fell from a very elevated 2.6% in Q4 to -1% in Q1. Imports also fell in the latest data, but the overall trade balance went from adding 1.3 percentage points to GDP in Q4 to detracting 0.1 percentage points. Similarly in France, the quarterly net trade contribution fell from a large 0.8 percentage points to no contribution over the same time period.

Germany's and France's trade performance has weakened, but domestic demand has improved

Trade data is notoriously volatile and we would be very hesitant to call a turning point based on a single negative quarter. What is encouraging from the available data is an improvement in domestic demand. In Germany, both household consumption and investment grew at their fastest rates since Q2 2017. The only weakness in demand came from government consumption, which oddly contracted for only the second time in five years. This is unlikely to persist. In France, domestic demand also improved, but not to the same extent as in Germany.

Given the general ongoing improvement in household finances through falling unemployment and rising wage growth, domestic demand should continue to recover over the near-term. Net trade is more likely than not to rebound, though concerns over external trade wars could see Europe suffer indirectly. A hit to the confidence of exporters in say Asia would probably lead to hesitancy in committing to significant capital investment, which would in turn reduce orders to major capital goods exporters like those in Germany.

Will the eurozone rebound in Q2?

If temporary factors like the weather are to blame for the slowdown in the first quarter, then leading indicators should rebound quickly. However so far, our two favourite leading indicators have provided a mixed signal.

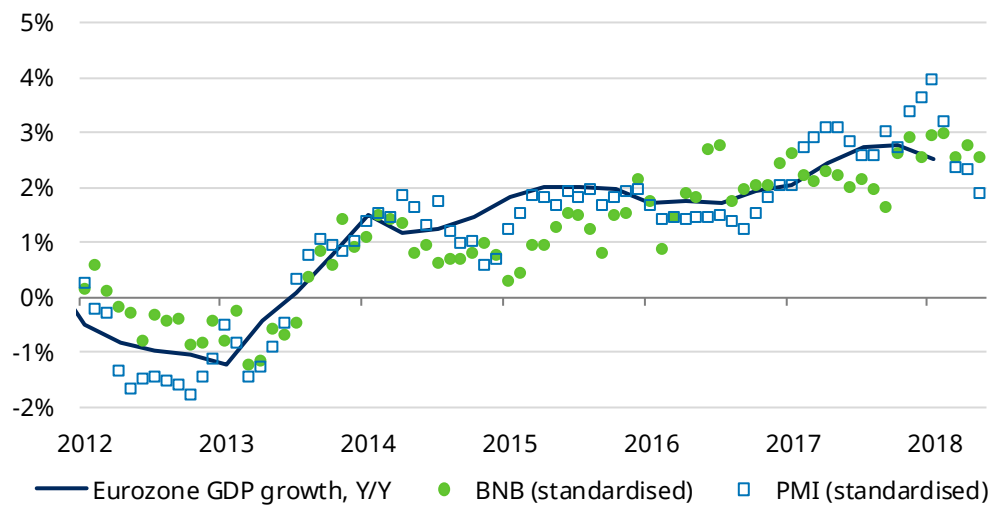
Starting with the better known and timelier of the two surveys, the Markit composite purchasing managers indices (PMIs) fell from 58.8 in January to 55.2 in March. Significantly, the indicator fell to 55.1 in April when the weather had returned to normal, and to 54.1 in May using the latest flash estimate. This suggests a more serious slowdown driven by more fundamental factors. Meanwhile, the

Belgian National Bank (BNB) confidence survey did report a rebound in activity in April, but its reading in May fell back to just above the level recorded in March.

Chart 8 shows the recent falls in these indicators plotted against real GDP growth. The surveys have been standardised to give an unbiased signal for GDP growth. Interestingly, plotting the surveys in this way shows that the PMIs were far too optimistic at the end of 2017, and the recent drop looks more like a correction to a more realistic rate of GDP growth, whereas the BNB survey was less elevated to begin with. Nevertheless, the latest reading from the PMI survey suggests that growth slowed further in the second quarter to just 0.1%. In contrast, BNB survey suggests a rebound in growth to 0.7%. For now, markets are following the better known and more pessimistic survey. However, we feel that there is some upside risk to the more pessimistic view in the markets, with the expectation that most of the temporary factors discussed above will pass.

Chart 8: Eurozone activity indicators offer mixed signals

Leading indicators are providing mixed signals as to whether activity will rebound in Q2



Source: Thomson Datastream, Eurostat, Schroders Economics Group. 24 May 2018.

Italy: Populists' palava

Italian political risk is back as a new populist government is being formed

At the time of writing, the left leaning anti-establishment party the Five Star Movement (M5S) are close to formally entering a into coalition government with the right wing populists the League party, formally known as the separatist Northern League party. Despite major differences in the two parties' views on many issues such as the redistribution of income, they have agreed on an economic policy programme and a largely unknown law professor, Giuseppe Conte, to become Italy's new prime minister. President Sergio Mattarella has approved the nomination, which is now only subject to a vote of confidence in parliament.

Investors are concerned. The economic programme outlined proposes significant tax cuts and spending increases, along with the reversal of pension reforms introduced in 2011. Tax cuts are presented in the form of two new flat income tax rates, which would replace the current five tiered marginal rate system. Doing so is likely to cost around €50 billion per year (3% of GDP), as the new tiers are far lower than the previous tax rates.

A large fiscal giveaway has been agreed, which puts Italy's fiscal sustainability at risk

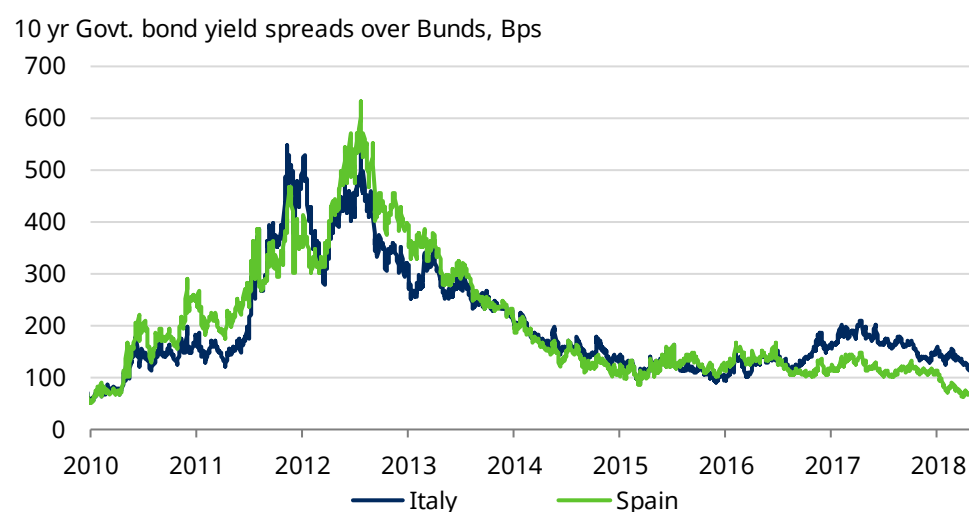
Additional spending on active labour market policies and the introduction of a €780 per month net payment to those recently made unemployment could cost another €17-19 billion (1% of GDP). Overall, the measures outlined so far, could cost a total of €100 billion per year (6% of GDP), which would put it firmly on a collision course with both the European Commission and investors.

Brussels could place Italy in an excessive deficit procedure, ultimately leading to fines and a suspension of voting rights if Italy does not stick to a sustainable budgetary path. This is unlikely to concern M5S and the League, especially as both are Eurosceptic anti-establishment parties.

Punishment from investors would be more painful, and may not only plunge Italy into a debt crisis, but also trigger a banking crisis across the eurozone. The spread of Italian 10-year bond yields relative to German bunds has already risen substantially in recent weeks, and when compared to the equivalent spread for Spain, the underperformance of Italian government bonds truly comes into focus (chart 9). The Italian-German spread has risen to just over 190 basis points, but to put the situation into perspective, it remains about 20bps lower than the peak recorded in the spring of last year in the run up to the French presidential election. It also remains far lower than the heights of the European sovereign debt crisis.

Chart 9: Markets begin to punish Italy for its political mess

Italy's bond yield is rising as investors demand a greater risk premium...



Source: Thomson Datastream, Schroders Economics Group, 24 May 2018.

Why have yields not risen further already? There are several reasons that could help explain the relative calm:

First, the European Central Bank (ECB) is still conducting quantitative easing (QE), and so there is still a large buyer in the market. We forecast QE to end in September, but many in the market think that the recent slowdown in growth and concerns over Italy could persuade the ECB to extend its programme.

Second, there is a consensus that the populist coalition government is unlikely to be effective in changing legislation, given their lack of experience in government. The complex nature of the Italian legal system, and its stubborn civil service was highlighted by Matteo Renzi's attempt to introduce structural reforms. Moreover, President Mattarella has the power to veto unconstitutional policy changes and those that go against international laws (including budgetary rules from Brussels). At best, this would only delay implementation, as his vetoes can be overruled.

Third, there is little confidence a far left and far right coalition can survive long enough to do much damage to Italy's fiscal situation. Irreconcilable differences are likely to emerge at some point, which could lead to a breakdown in the coalition, and potentially another election.

Should yields rise further, the impact on the economy is likely to be limited for some time. Households would face higher borrowing costs on unsecured loans, but mortgage debt is priced off 12-month EURIBOR rates – a euro-wide market which is largely unaffected by sovereign debt. Businesses would see higher borrowing costs through credit markets, but these remain low at present. The government's

...however, markets remain relatively calm

finances are most at risk, but even here, because average duration on Italy's debt is around seven years, total interest costs are unlikely to rise in the coming two-three years even if bond yields rise another 100 basis points from here.

For a crisis to escalate, we would need to see a failed auction, which would raise questions over Italy's ability to refinance its maturing bonds. This could certainly happen, however; Italy has already sold more than half of the bonds it planned to issue for the year. Moreover, the steep yield curve on offer in Italy for investors is very attractive when compared to other G7 markets.

For Europe more widely, the impact from an Italian debt crisis would be severe. As the third largest member state, Italy would simply be too big to bail-out for any significant period of time. Cross-border lending would be called into question, and the ECB's exposure to Italy through the Target 2 system would put its loans at risk, and may eventually require a recapitalisation if Italy was to default on its debts. It is too soon to worry about such a scenario, but it is important to note that there is no quick fix on the horizon for the current situation.

We will continue to monitor political developments in Italy, but for the time being, the Italian bond market is reasonably steady, with a small increase in risk premium being demanded by investors.

Eurozone forecast update: growth downgraded, but still strong

Turning to the forecast, we have downgraded eurozone GDP growth for 2018 from 2.6% to 2.4% (chart 10). This is our first downgrade to the year-ahead forecast since the end of 2016. The slower start to the year than anticipated is the main cause of the downgrade, though we have also nudged down growth in the second half of the year due to the negative impact we expect from the recent rise in oil prices (discussed in the previous section).

Higher oil prices and a substantially lower USD/EUR assumption have led to an upward revision to the inflation forecast. HICP inflation is now forecast to rise from 1.5% in 2017 to 1.6% in 2018, compared to our previous forecast of a fall to 1.2% (chart 11).

The outlook for 2019 is little changed, though we have downgraded growth slightly (2.2% to 2.1%) to take reflect the growing uncertainty caused by global trade talks. Overall, growth is forecast to moderate over the forecast horizon, though it remains above 1–1.5%, our estimate of trend or potential growth. This means that unemployment in the eurozone should continue to decline, helping to boost wage growth and domestic inflation.

Eurozone growth has been revised down for the first time since the end of 2016.

Chart 10: Eurozone GDP forecast

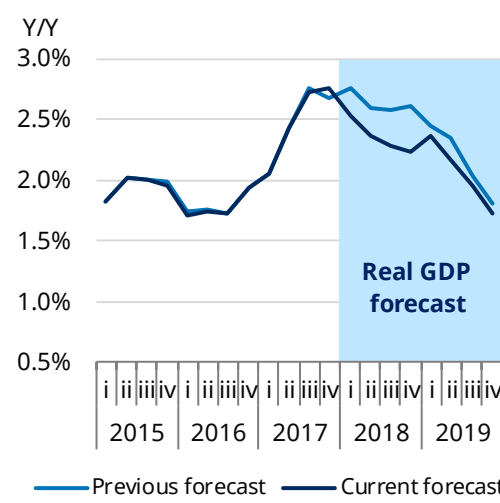
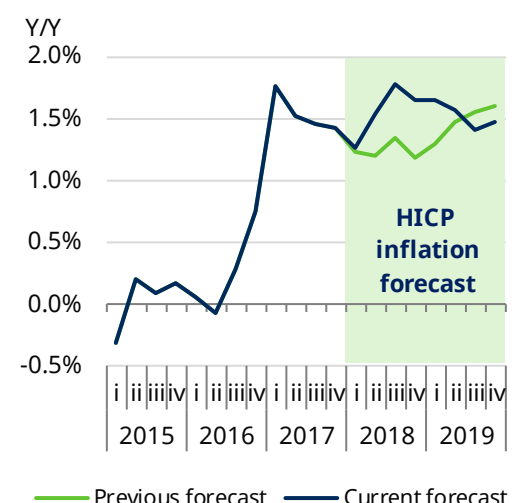


Chart 11: Eurozone inflation forecast



Source: Schroders Economics Group, 17 May 2018. Previous forecast from February 2018.

Inflation is likely to be higher in 2018 due to higher oil prices

Inflation should subside over 2019 as the oil price effect fades from the year-on-year profile. However, as inflation tends to be more sticky in the eurozone compared to other regions, our forecast only has a small fall to 1.5% for 2019 as a whole.

As for monetary policy, the ECB did not change its language in its latest meeting, and did cite temporary factors as the most likely cause for the recent slowdown. We continue to forecast QE to end in September and for interest rates to rise soon after in Q1 2019. However, if monthly official data, such as industrial production and retail sales, do not improve in the second quarter, then there is a risk that the ECB may decide to extend QE a little further beyond September, possibly to the end of the year, and potentially with a reduction in monthly purchases. This would also most likely postpone the increase in rates.

ECB president Mario Draghi is also likely to face pressure from the Germanic press to show that QE policy is not being set to bail-out his home country. The ECB has always been clear that QE was introduced to fight the risk of deflation, and not bail-out governments. The fall in bond yields was a happy side effect. Other policy tools are still available for bailing out profligate governments, though the rules state that the government in question must request the bail-out, and agree to a reforms programme, in the same way as Ireland, Portugal and Cyprus did.

UK forecast update: factoring in the Brexit transition deal

The UK also suffered from severe weather in Q1

The unenviable prize for the biggest downgrade in our forecast goes to the UK. The UK saw a collapse in growth to just 0.1% in the first quarter, largely due to "the beast from the East" – the severe snow storms that hit Northern Europe in February and March. The fact that growth fell much more in the UK highlights how ill-prepared the country is for such adverse weather.

In a similar fashion to the eurozone forecast, due to the disappointing start to the year and higher oil prices, our 2018 UK GDP growth forecast has been cut from 1.7% to 1.4% (chart 12). However, the forecast does include a recovery in the second quarter, which is supported by the rebound in retail sales recorded for the month of April.

UK GDP has been revised down in the near term, but revised higher in the second half of 2019 due to the agreement of a Brexit transition deal

Chart 12: UK GDP forecast

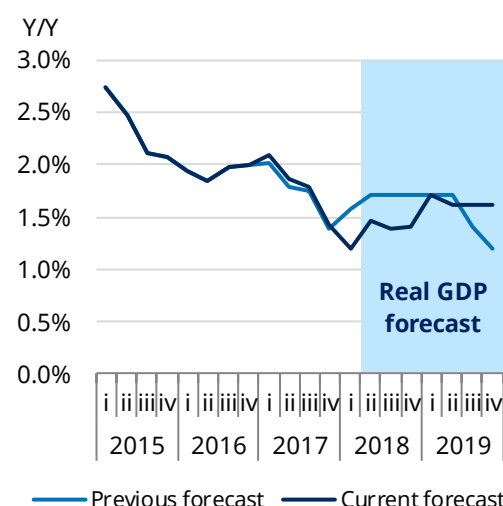
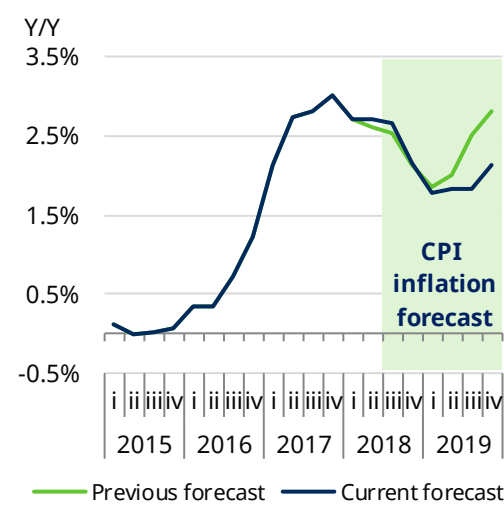


Chart 13: UK inflation forecast



Source: Schroders Economics Group, 17 May 2018. Previous forecast from February 2018. Please note the forecast warning at the back of the document.

The forecast for 2019 growth has seen a more substantial upgrade due to the recent announcement that the UK is likely to enter into a 21-month transition period immediately after Brexit in April 2019. This is expected to mean ongoing membership of both the EU single market and customs union. Previously, the

forecast had assumed a partial withdrawal from these arrangements, which would have meant impediments to trade and some tariffs being applied. Higher inflation was therefore assumed for the second half of 2019, which would have had a negative impact on real growth. With a transition likely to be in place, we have removed the mentioned stagflationary elements from the forecast (charts 12 and 13 above).

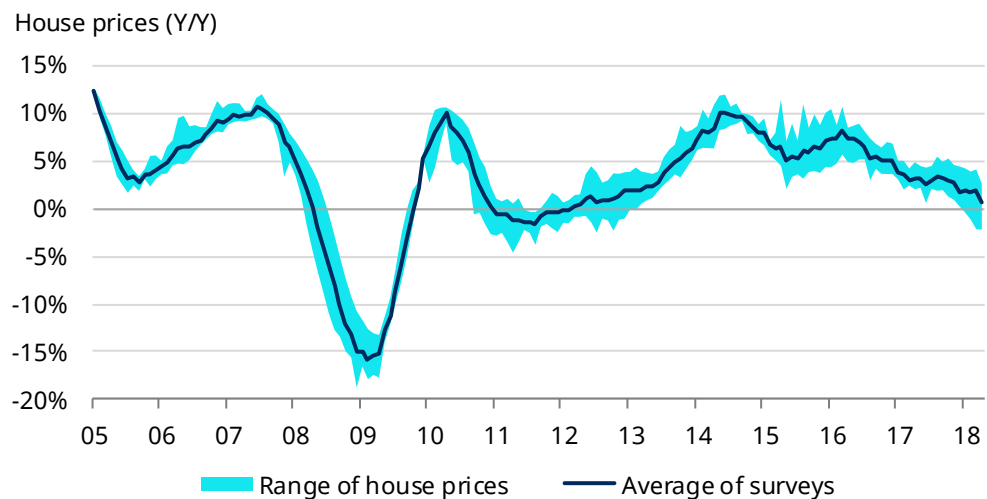
Brexit uncertainty is far from over. Indeed, as we approach the crunch point in negotiations over the summer, we expect rhetoric of hard Brexit and a cliff edge to reach a crescendo, before a final deal is agreed in September/October. Meanwhile, business and consumer confidence are likely to continue to suffer, causing decisions on large purchases or investments to be delayed if not cancelled.

The slump in house price growth is just another example of poor sentiment. While buy-to-let investors have had to endure an increase in stamp duty and a tightening of mortgage tax relief, Brexit is also cited as a major factor by most providers of house price data.

Annual growth in house prices started to turn down in the run-up to the Brexit referendum in 2016, and have since slowed dramatically to leave prices on average nationally stagnant. Most surveys that provide a regional breakdown show that London and the South-East have led the slowdown, with high-end properties, particularly in the capital, seeing significant declines in prices. This is attributed to high net wealth individuals both postponing purchases, but also many leaving the country due to Brexit uncertainty. The downturn in the upper-end of the market has now trickled down and out to other regions, with some of the national surveys reporting falls for the national average (chart 14).

Chart 14: UK house prices are trading water

Brexit uncertainty is having a negative impact on confidence, and this is spreading to the housing market



Source: Thomson Datastream, Land Registry, Halifax, Nationwide, Rightmove, LSL/Acadametrics, Schroders Economics Group, 23 May 2018.

If house prices truly start to fall, and negative momentum starts to build, history suggests that it would take years to halt the decline. This would not only be negative for consumers, but also lenders and public finances; which the latter is far too reliant on tax revenues from property transactions.

For the time being, there is plenty of liquidity in the banking system to continue to provide loans, and the proportion of risky loans is very small compared to the period before the global financial crisis. Banks have also been forced through regulations to increase their capital reserve buffers, and so should be able to withstand a small correction in house prices. However, should a correction turn into a crash, then there are very few policy tools remaining for the Bank of England to use.

BoE is expected to remain on hold until November

BoE forced to step back from a hike in May

The sharp decline in growth in Q1 forced the Bank to cancel what was seen as a near certain rate hike in May. Money markets had priced in a 100% chance of a hike in March, only for the probability to collapse following the GDP report. Regular readers will be aware that we disagreed with the market, and left our forecast unchanged last quarter, which has been proven to be the correct call.

The next BoE Inflation Report is due in August, which provides the Bank another opportunity to raise interest rates. In our view, this is still too soon to tighten policy, largely because Brexit negotiations will be reaching a head at the same time. Sentiment is likely to be particularly poor during the summer as explained above, which suggests the Bank should wait until November (in line with our forecast), when there should be much more clarity on Brexit with the end of negotiations. This time, the market is in greater agreement with our November forecast.

EM forecast update: turbulence interrupts a smooth flight

"Upon my word and honour I seem to be fated, and destined, and ordained, to live in the midst of things that I am never to hear the last of"

Charles Dickens, *Hard Times*

Growth looks softer than expected at the start of 2018

We find ourselves making some slightly less favourable revisions to our macroeconomic outlook for emerging markets this month, with broadly lower growth and higher inflation compared to our previous forecast. The culprits are, in the main, a weaker than expected first quarter and much higher oil prices, though sanctions and trade tensions also weigh on activity.

Table 1: BRIC forecast summary

% per annum	GDP		Inflation	
	2018f	2019f	2018f	2019f
China	6.6 (6.6)	6.4 ↓ (6.5)	2.4 ↑ (2.2)	2.0 ↓ (2.3)
Brazil	2.7 ↓ (2.8)	2.6 ↓ (2.8)	3.5 ↓ (4.0)	4.5 ↑ (4.4)
India	7.3 ↓ (7.4)	7.5 ↓ (7.7)	4.9 ↑ (4.7)	5.0 ↑ (4.4)
Russia	2.1 ↓ (2.7)	1.9 ↓ (2.1)	3.5 ↓ (3.6)	4.4 ↓ (4.5)

Source: Thomson Datastream, Schroders Economics Group, 15 May 2018. Numbers in parentheses refer to previous forecast from February 2018. Please note the forecast warning at the back of the document.

Hiking pressures beginning to build for some EM

Higher inflation should close the door on further rate cuts for most of emerging markets (EM), though we think Russia still has space for one more. Otherwise, the next moves in Brazil and India seem likely to be hikes; probably this year for India and 2019 for Brazil. Meanwhile, though we do not see a change in the benchmark rate in China this year, we think we will see easing via RRR cuts as the central bank attempts to maintain system liquidity. A rate cut may also be warranted in 2019 as growth slows further amid a drag on sentiment from trade tensions.

Table 2: BRIC monetary policy

% (year end)	2018(f)		2019(f)	
China RRR	15.00	(16.50)	14.00	(15.00)
China lending rate	4.35	(4.35)	4.00	(4.00)
Brazil	6.50	(6.50)	7.00	(7.00)
India	6.50	(6.00)	7.00	(7.00)
Russia	7.00	(6.75)	7.00	(7.25)

Source: Thomson Datastream, Schroders Economics Group, 15 May 2018. Numbers in parentheses refer to previous forecast from February 2018. Please note the forecast warning at the back of the document.

Policy measures still expected to weigh on Chinese growth

China: trade tensions weigh on the outlook

China had a stronger than expected start to the year, growing 6.8% in the first quarter compared to the previous year. This came despite an ongoing credit slowdown and a weaker external backdrop as developed market economies slowed. This has helped China avoid the 2018 downgrade seen in most of our forecasts, though we still expect policy tightening to weigh on growth this year and see a small deceleration to 6.6% for the year as a whole, not least because of the impact of credit on property (chart 15).

The latest evolution of credit tightening came in the form of new regulations on asset managers, implemented at the end of April. Part of the push to shrink shadow banking and bring lending back on bank balance sheets, the regulations promised to be quite disruptive, which may have prompted the last minute relaxation of some of the requirements. Nonetheless, we think that the disruption threatened by the new rules was one of the reasons for the RRR cut unveiled a few days earlier. The unexpected easing prompted theories that China was beginning to reverse its policy stance, but we see it more as a step taken to maintain liquidity as regulations took hold, and other forms of liquidity were withdrawn from the market by the central bank. Still, we think further cuts are likely as the crackdown on shadow banking continues, with the central bank unwilling to risk financial stability. We expect another 200 bps of cuts by the end of 2019.

Chart 15: Slowing credit in China dragging on property



Source: Thomson Datastream, Schroders Economics Group. 15 May 2018.

Trade tensions create concerns of a stagflationary outcome

Since our last forecast update, trade tensions have undeniably worsened. We covered the issue quite extensively in our last Viewpoint, but as a brief recap, the US and China are currently threatening one another with \$50 billion in tariffs. Though a small share of either country's trade, let alone GDP (less than half of one percent for China), the growth impact could be larger as the dispute is unlikely to end with one round of tariffs. The policy uncertainty will likely weigh on investment, particularly for exporters, and this prompts a minor downgrade of Chinese growth for 2019. We are also already seeing Chinese boycotts of some US goods, and administrative delays introduced for others, which (along with higher oil prices) drives our inflation revision for 2018. If we see more sizeable measures from the US, further revisions will be required.

Whether we can avoid an escalation of the dispute depends on what really matters to the US. China is reportedly ready to increase its imports of US goods to address the trade deficit, even if the new \$200 billion reduction demanded by the US is as implausible as China protests. If this were the only issue the US cared about, then we think a deal would likely be done. For China it does not even imply an increase in

its overall import bill, as it can substitute US goods for those currently bought from elsewhere. The US might be happy with this outcome, even as its allies protest the impact on their trade balance.

The US has also raised repeated complaints for the last decade and a half over the lack of level access to Chinese markets, and Chinese industrial policy. The forced transfer of intellectual property is part of this, but not the whole story. Given the size of China, subsidies provided to domestic industries can end up distorting global markets, as already seen in solar panels and steel. However, China is highly unlikely to bow to pressure from the US to change its domestic policies. This is partly a matter of national pride and partly, as the Chinese see it, a matter of national survival.

"Made in China 2025" (China 2025) is an initiative aimed at upgrading Chinese industry, moving the country's manufacturing up the value chain. Key goals include increasing the domestic content of core materials to 40% by 2020 and 70% by 2025. China 2025 calls for self sufficiency through technological substitution, and for China to become a manufacturing superpower that dominates the global market in high tech industries. Robotics, AI, aviation, and new energy vehicles are all target industries. This is an obvious concern for the US and others, but this opposition is viewed in China as an attempt to contain it, particularly given the use of industrial policy by the US and others during their own development stories.

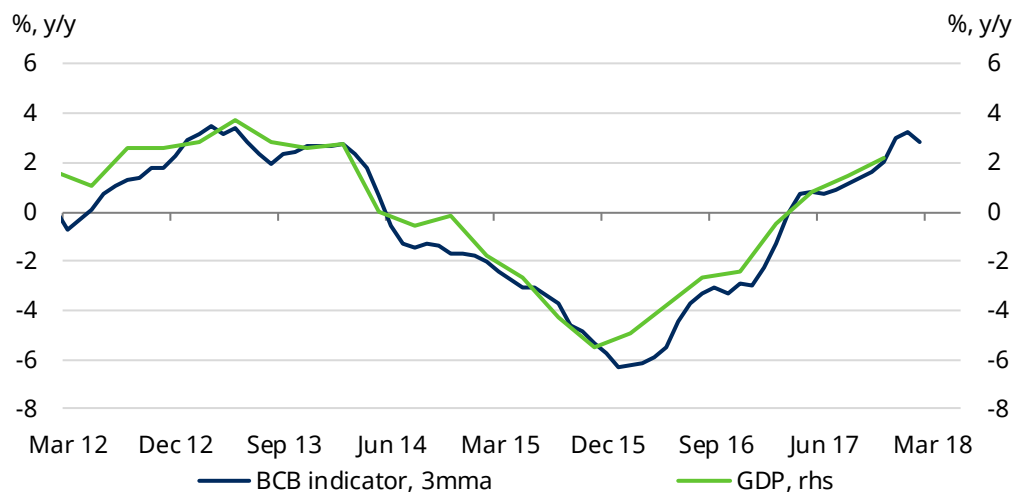
Ultimately, if the US decides that the issues of industrial policy and market access in China take precedence over the question of trade deficits, it is hard to see a compromise agreeable to both sides. China will have to hope that President Trump's desire for a win, particularly ahead of the US mid-term elections, will mean the US is happy to settle for a deficit reduction deal rather than something more fundamental.

Brazil: political headwinds

Brazil is still recovering, though political concerns mount

At the time of writing we are still waiting for Brazil's first quarter growth numbers for 2018. However, high frequency data is available for the quarter and while it suggests some moderation, particularly from a strong December, this seems similar to the slowdown globally in the first quarter rather than necessarily being a Brazil specific story. Furthermore, though weaker, the data is still stronger than seen in 2017 and so we remain fairly optimistic on the economic outlook. We have revised down expectations marginally to account for some first quarter weakness, but on the whole we think the recovery remains on track.

Chart 16: Recovery in Brazilian growth still on track despite recent weakness



Source: Thomson Datastream, Schroders Economics Group. 15 May 2018.

Reform disappointments are weighing on the currency

While beginning to climb, inflation remains very low in Brazil, around 2.8%. However, we expect an acceleration through the year with demand rising and recent currency weakness adding pressure. In this context we think it makes sense for the central bank to avoid easing rates further, but do not think a hike will be needed until late 2019, when a gradual hiking cycle will be implemented.

The outlook for 2019 has become more uncertain. Though former president Lula seems unlikely to run, given his legal troubles, there also seems little hope of a truly reformist candidate winning this year's presidential election. The current frontrunner, Jair Bolsonaro, claims to support pension reforms but at a more gradual pace than currently envisaged. This is not positive for the fiscal outlook, with a deficit at present of 7.4% of GDP, and will weigh on Brazilian assets. The currency is already showing the pressure.

On the positive side, the current government has managed to bring in some reforms, as discussed in previous Viewpoints, and commodity prices are increasingly helpful for Brazilian growth and investment. There is also the hope that a more market-friendly candidate will become competitive as campaigning begins in earnest later in the summer.

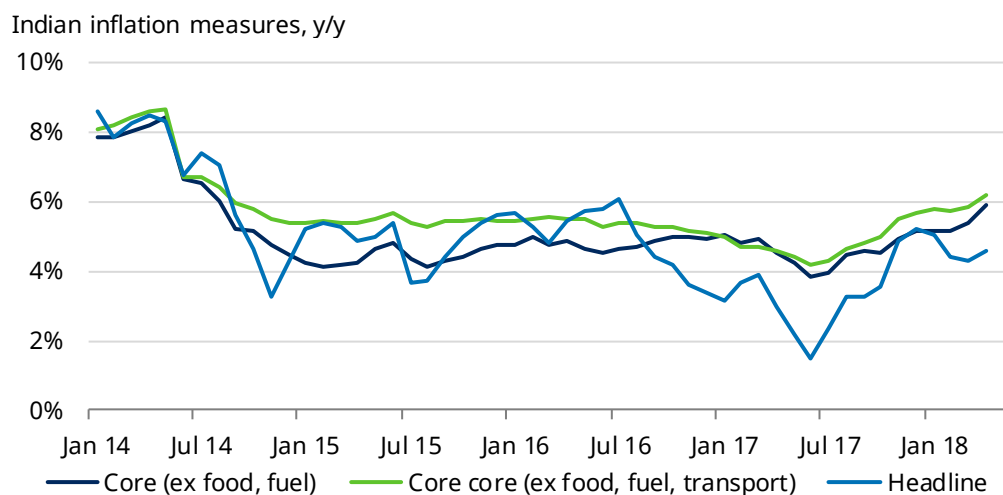
A growth recovery and rising inflation are turning doves into hawks

India: a reluctant central bank likely forced to hike

As in Brazil, first quarter GDP data is not yet available for India, but the signs are encouraging. Industrial production has been healthy, typically a good leading indicator for manufacturing sector output. Car sales, a good proxy for consumption in the absence of a retail sales index, look to have stabilised after a weak final quarter last year. Also encouraging for the year ahead is the recovery of credit, which continues to accelerate from its 2017 doldrums and is now expanding at 12.6%, year on year.

Inflation remains low by historic standards but is beginning to creep higher, with core measures particularly strong. We revise our forecasts up slightly given higher international oil prices and India's heavy reliance on imports. Against this backdrop it is unsurprising that the central bank has taken a more hawkish tone lately. We would also note that so far fuel prices domestically are not reflecting international moves in oil. The daily fuel price adjustment for petrol and diesel has been kept on hold since 24th April, and will likely recommence soon, now that the Karnataka state elections are out of the way. The inevitable increase may not be passed on to consumers (fuel excise duties could be cut, or firms could absorb the increase), but clearly this generates upside inflation risk. We now expect two hikes this year, with the first likely in June, to take rates to 6.5%, with two further hikes in 2019.

Chart 17: Inflation creeping higher



Source: Thomson Datastream, Schroders Economics Group. 15 May 2018.

A weaker start and the impact of sanctions only partly offset by oil

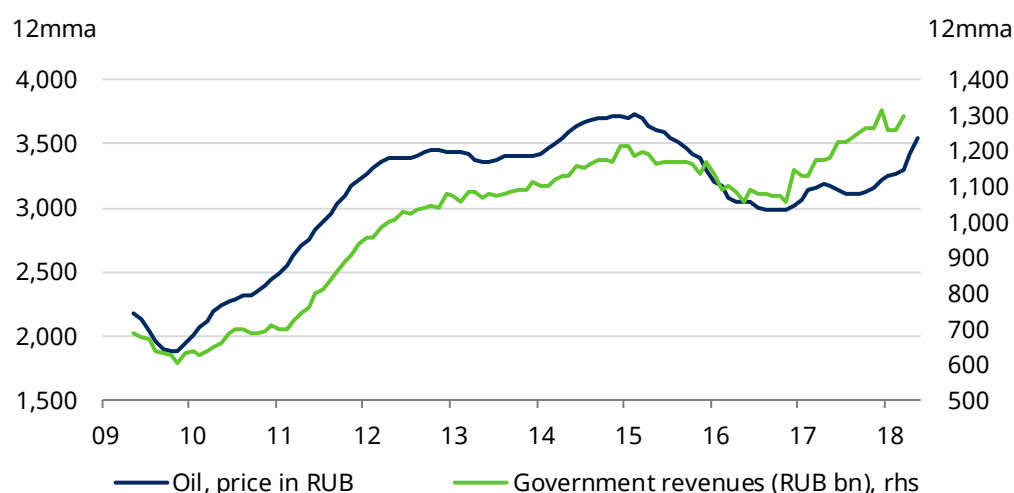
A risk to this view is that though credit growth is improving, India's banks remain shaky, stricken by recent scandal and mounting NPLs; the central bank may wish to ensure the credit recovery is entrenched before it applies the brakes. In this scenario, we still think that by 2019 it will become apparent that inflation is set to persist above its 4% target, necessitating four hikes that year to take the policy rate to 7%.

Russia: oil offers limited relief

It has been a difficult start to the year for Russia. High frequency data in the first quarter was generally to the soft side, with final quarter GDP data from 2017 also underwhelming to contribute to weaker momentum. Moving into the second quarter, the country was hit with the toughest US sanctions to date, which dealt a blow to the rouble and will likely push inflation higher, hurting private consumption. The new sanctions target both individuals and corporates, and could hit Russia's exports of aluminium given measures against its largest aluminium producer, Rusal. Finally, financing costs have also risen thanks to the increased risk premia demanded for Russian assets.

Against this, we do at least have stronger oil prices, boosted further by the weaker currency. This will benefit the fiscal balance but is unlikely to translate much into economic activity; the new fiscal rule caps spending such that all gains from oil above \$40 per barrel accrue to the government's purse. We do expect some support for industrial production, particularly if Russia is able to expand production following Iranian sanctions. But overall, we see sufficient reason for a sizeable downgrade to Russia growth expectations compared to our relative optimism previously.

Chart 18: Oil price surge will rebuild fiscal coffers



Source: Thomson Datastream, Schroders Economics Group. 15 May 2018.

In domestic politics, Vladimir Putin successfully contested the presidential elections as widely expected. As we wrote in our January Viewpoint, we saw upside policy risk from the elections, and certainly Putin's statements on policy have suggested he is leaning towards some of the reform measures proposed in the programme requested from his former finance minister Alexei Kudrin. We wait for cabinet appointments (Kudrin especially) to give further indications of policy.

Meanwhile, the inflationary impacts of the currency selloff will likely see the central bank pause, but not terminate, its easing cycle. We still expect easing this year, given the bank's view that neutral rates are 6–7%, and inflation so far has been softer than expected.

Schroder Economics Group: Views at a glance

Macro summary – June 2018

Key points

Baseline

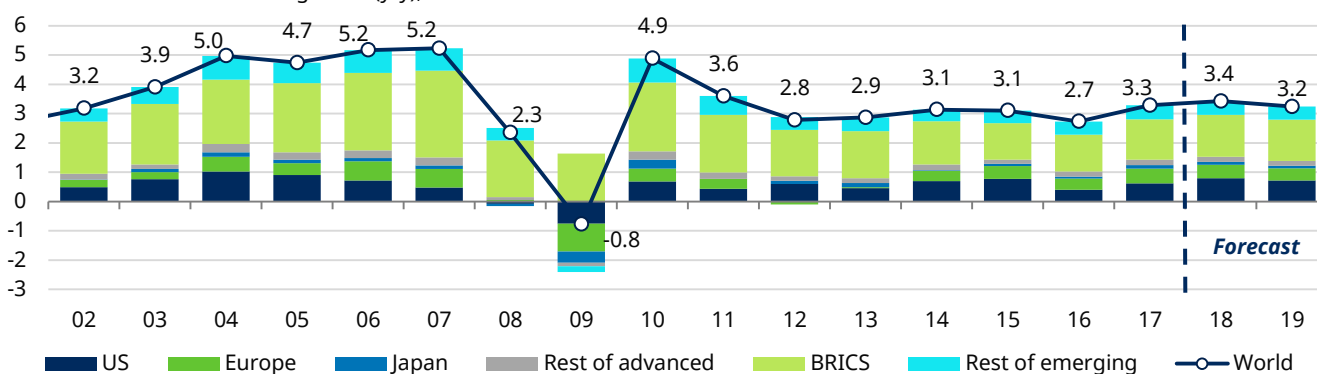
- Global growth is expected to reach 3.4% in 2018 after 3.3% in 2017, before moderating to 3.2% in 2019. Inflation is forecast to rise from 2.3% in 2017 to 2.7% in 2018, before falling back to 2.4% in 2019. Core inflation in the US is expected to rise back above 2% in 2018 and the world economy moves firmly into the expansion phase of the economic cycle.
- US growth is forecast at 2.9% in 2018 and 2.6% next, incorporating president Trump’s fiscal stimulus packages. The Fed has now started balance sheet reduction (quantitative tightening) and with core inflation rising, four hikes in total in 2018, and two more in 2019 final increase in 2019, ending the forecast at 3%.
- UK growth is likely to slow to 1.4% in 2018 as Brexit uncertainty weighs on confidence. Inflation is forecast to fall back slightly to 2.6%, as sterling depreciation effects are replaced with energy and domestically generated inflation. 2019 is very uncertain given Brexit, but we assume a transition period will be agreed that preserves the states quo of single market and customs union membership. The BoE is expected to hike once in 2018 and two more times in 2019 (to 1.25%).
- Eurozone growth is forecast to moderate to 2.4% in 2018, but remains strong overall. Italian political risk is back which will reintroduce volatility. Growth should moderate in 2019 to 2.1%, but this remains above trend. Inflation is expected to remain under 2%, with higher energy price inflation in 2018 replaced by higher core inflation in 2019. The ECB is likely to end QE in September 2018, before raising interest rates in 2019. The refinancing rate is forecast to reach 0.75%, and the deposit rate to reach 0.25%.
- Japanese growth is forecast to slow from 1.7% in 2017 to 1.3% in 2018, as inflation more than doubles to 1.2% owing to higher oil prices. We expect a change to yield curve control in Q4 this year in the form of a 10bps increase in the target yield for 10 year JGBs from zero.
- Emerging economies are forecast to see growth largely unchanged near 5% over 2018 and 2019. China’s GDP growth is forecast to continue its secular decline, but this is offset by recoveries in the rest of the BRICs.

Risks

- Risks to the baseline forecast skewed towards a more staglatory outcome. “Inflation accelerates”, “oil back to \$100” and “rise in global protectionism” are the main causes. “Mid-cycle slowdown” and “secular stagnation” make up the deflationary scenarios, but these are offset by two reflatory scenarios: “global trade boom” and “global fiscal expansion”.

Chart: World GDP forecast

Contributions to World GDP growth (y/y), %



Source: Schroders Economics Group, 21 May 2018. Please note the forecast warning at the back of the document.

Schroders Forecast Scenarios

Scenario	Summary	Macro impact	Cumulative 2018/19 global vs. baseline		
			Probability*	Growth	Inflation
Baseline	Global growth remains robust, but we have revised down our forecast for 2018 to 3.4% from 3.5%. This largely reflects a soft start to the year in many economies, higher oil prices and increased concerns over trade relations between the US and China. The latter is expected to persist into 2019 and weigh on trade and capex spending even if a full trade war does not break out. We now expect 3.2% growth in 2019 (previously 3.3%) with the pace of activity cooling through the year. Meanwhile, we have revised up our inflation forecast for 2018 to 2.7% (from 2.4%) largely as a result of higher oil prices. However, in the US which is approaching full capacity, we still expect core inflation to creep higher over the forecast period.	Led by the US Federal Reserve, DM central banks are expected to tighten monetary policy over the forecast period. We expect four rate hikes in the US this year and two next with the fed funds rate reaching 3% by the middle of 2019. The ECB is expected to end QE in Q4 this year and raise rates three times in 2019, ending the era of negative policy rates in the Eurozone. The BoJ is expected to adjust Yield Curve Control in Q4 as rising global yields put upward pressure on the zero 10 year JGB target. In contrast lower inflation, and liquidity concerns, see China to head the other way with the PBoC easing the RRR and policy rates lower. The interest rate cycle is expected to turn upwards this year in India and Brazil next year. Against this backdrop the USD is expected to strengthen further in the near term before weakening in 2019.	62%	-	-
1. Secular stagnation	Weak demand weighs on global growth as households and corporates are reluctant to spend. Animal spirits remain subdued and capex and innovation depressed. Households prefer to de-lever rather than borrow. Adjustment is slow with over capacity persisting around the world, particularly in China, with the result that commodity prices and inflation are also depressed.	Deflationary: weaker growth and inflation vs. baseline. The world economy experiences a slow grind lower in activity. As the effect from secular stagnation is more of a chronic than acute condition it takes policy makers time to identify the trend. However, as economic activity fails to accelerate, more stimulus is added. The US reverses its interest rate hikes, while the ECB and BoJ prolong their QE programmes.	1%	-1.0%	-0.9%
2. Global fiscal expansion	Following the populist expansion in fiscal policy in the US, other countries decide to follow its lead either due to changes in governments, or in response to populist movements. The G7 and BRIC economies all loosen fiscal policy significantly through a combination of tax cuts and spending increases.	Reflationary: Fiscal loosening against a backdrop of above trend growth boosts confidence further, along with GDP growth. Some economies with low rates of unemployment see wage pressures rise, causing domestically generated inflation, while other with slack remaining, still see higher inflation through commodities and higher import prices. Central banks respond by tightening monetary policy more quickly, which eventually cools activity.	5%	+1.4%	+0.8%
3. Rise in global protectionism	NAFTA talks breakdown, and the US loses patience with a lack of progress with China on trade talks. The US applies 40% tariffs on all Chinese goods in 2018 Q2. China retaliates, but starts to divert and dump its now uncompetitive goods in Europe. By the end of 2018, Europe applies selective anti-dumping tariffs of 20%, which China reciprocates.	Stagflationary: it takes time for US and Chinese consumers to substitute away from the traded goods facing tariffs. Existing supply chains also take time to break-down, which means profitability is hit and inflation rises at the same time. In Europe, dumping initially causes lower inflation, but the new tariffs cause inflation to quickly rise. Monetary policy is tightened faster to halt second round effects, causing the USD to rise against most currencies. However, the RMB falls 10%, while JPY also appreciates as growth is hit. World trade growth starts to contract and productivity weakens.	11%	-0.8%	+0.7%
4. Oil back to \$100	President Trump's withdrawal from the Iran nuclear deal and imposition of sanctions results in 1 mb/d being removed from oil supply as the agreement collapses. Risk premium on oil rises as threat of conflict in the region between Iran, Saudi Arabia and Israel spreads beyond Syria. Given the tightness of the oil markets, oil prices surge to \$100 where they remain over the forecast period.	Stagflationary: Higher oil prices feed through rapidly into inflation putting a squeeze on oil consumers world wide. Oil producers benefit but do not increase spending rapidly enough to offset cut backs elsewhere. In the US, stronger shale gas capex and output initially offset the shock, but once this fades the effect on household budgets and global trade drag on growth. Policy tightening by the Fed is more limited as the central bank weighs higher inflation against weaker growth.	5%	-0.6%	+1.0%
5. Global trade boom	After an extended period where global trade growth lagged behind global GDP, renewed global capex and a desire to rebuild inventories leads to a global trade boom, . Trade tensions ease as Trump arrives at a deal over NAFTA and with China. Stronger trade boosts growth worldwide, but also raises inflation.	Reflationary: the additional activity due to global trade boosts productivity and income, but with spare capacity in short supply, the extra demand generates inflation too. Global monetary policy is tightened by more than in the baseline, but not by enough to slow growth in 2019.	4%	+0.9%	+0.7%
6. Mid-cycle slowdown	The moderation in global growth seen at the end of Q1 becomes extended as concerns over trade wars dent business and consumer confidence. Global trade slows, capital spending plans are put on hold and consumers save the bulk of their tax cuts. The world economy hits a soft patch which extends into early 2019. Thereafter, activity begins to pick up again as relations between the US and the rest of the world improve thus lifting confidence and spending.	Deflationary: Lower oil prices and slower growth reduce inflation. After raising rates in June, the Fed reverses tack and eases at the end of the year. Rates are cut once more in 2019 before a modest recovery allows the Fed to resume hiking toward the end of the year. Rates are also lower in the UK, Eurozone and China.	5%	-0.9%	-0.4%
7. Inflation accelerates	After a considerable period where wages have been unresponsive to tightening labour markets, pay begins to accelerate in response to skill shortages. Wages accelerate around the world and economists revise their estimates of spare capacity considerably lower. Some economies such as Japan welcome the move as they seek to raise inflation expectations, others find they are facing stagflation as they effectively run out of capacity, forcing the central bank to tighten policy.	Stagflationary: US inflation rises significantly by the end of 2019 on both headline and core measures. The Fed responds by tightening more aggressively taking its target rate to 4% by end 2019. Interest rates also rise more rapidly in the Eurozone and UK whilst Japan returns rates into positive territory. Currency changes provide some cushion to the emerging markets which see a modest boost to growth alongside higher inflation in this scenario. Overall, global growth is slightly weaker and inflation considerably higher.	7%	-0.4%	+1.1%
8. Other			0%	-	-

*Scenario probabilities are based on mutually exclusive scenarios. Please note the forecast warning at the back of the document.

Schroders Baseline Forecast

Real GDP

y/y%	Wt (%)	2017	2018	Prev.	Consensus	2019	Prev.	Consensus
World	100	3.3	3.4	↓ (3.5)	3.4	3.2	↓ (3.3)	3.2
Advanced*	62.8	2.3	2.4	↓ (2.6)	2.4	2.2	↓ (2.3)	2.1
US	27.1	2.3	2.9	↓ (3.1)	2.8	2.6	↓ (2.9)	2.6
Eurozone	17.4	2.5	2.4	↓ (2.6)	2.4	2.1	↓ (2.2)	1.9
Germany	5.1	2.5	2.3	↓ (2.8)	2.4	2.2	↓ (2.4)	1.9
UK	3.8	1.8	1.4	↓ (1.7)	1.5	1.6	↑ (1.5)	1.5
Japan	7.2	1.7	1.3	↓ (1.5)	1.4	1.1	(1.1)	1.1
Total Emerging**	37.2	5.0	5.1	(5.1)	5.1	5.0	(5.0)	5.0
BRICs	24.2	5.7	5.9	↓ (6.0)	5.9	5.8	↓ (5.9)	5.8
China	16.4	6.8	6.6	(6.6)	6.6	6.4	↓ (6.5)	6.4

Inflation CPI

y/y%	Wt (%)	2017	2018	Prev.	Consensus	2019	Prev.	Consensus
World	100	2.3	2.7	↑ (2.4)	2.5	2.4	↓ (2.6)	2.4
Advanced*	62.8	1.7	2.1	↑ (1.9)	1.9	1.9	↓ (2.1)	1.8
US	27.1	2.1	2.8	↑ (2.5)	2.5	2.4	↓ (2.6)	2.1
Eurozone	17.4	1.5	1.6	↑ (1.2)	1.5	1.5	(1.5)	1.5
Germany	5.1	1.7	1.8	↑ (1.5)	1.7	1.8	(1.8)	1.8
UK	3.8	2.7	2.6	↑ (2.5)	2.6	1.9	↓ (2.3)	2.2
Japan	7.2	0.5	1.2	↑ (1.1)	1.0	1.4	↓ (1.6)	1.1
Total Emerging**	37.2	3.2	3.6	↑ (3.4)	3.5	3.3	↓ (3.5)	3.4
BRICs	24.2	2.2	3.0	↑ (2.8)	2.9	2.9	↓ (3.0)	3.0
China	16.4	1.5	2.4	↑ (2.2)	2.3	2.0	↓ (2.3)	2.3

Interest rates

% (Month of Dec)	Current	2017	2018	Prev.	Market	2019	Prev.	Market
US	1.75	1.50	2.50	(2.50)	2.61	3.00	(3.00)	2.97
UK	0.50	0.50	0.75	(0.75)	0.84	1.25	(1.25)	1.16
Eurozone (Refi)	0.00	0.00	0.00	(0.00)	-	0.75	(0.75)	-
Eurozone (Depo)	-0.40	-0.40	-0.40	(-0.40)	-0.29	0.25	(0.25)	-0.06
Japan	-0.10	-0.10	-0.10	(-0.10)	0.09	-0.10	(-0.10)	0.12
China	4.35	4.35	4.35	(4.35)	-	4.00	(4.00)	-

Other monetary policy

(Over year or by Dec)	Current	2017	2018	Prev.	Y/Y(%)	2019	Prev.	Y/Y(%)
US QE (\$Tn)	4.4	4.4	4.0	(4.0)	-9.1%	3.4	(3.4)	-15.0%
EZ QE (€Tn)	2.2	2.2	2.4	(2.4)	9.1%	2.4	(2.4)	0.0%
UK QE (£Bn)	425	445	445	(445)	0.0%	445	(445)	0.0%
JP QE (¥Tn)	529	521	551	(551)	5.7%	567	(567)	2.9%
China RRR (%)	17.00	17.00	15.00	↓ 16.00	-	14.00	↓ 16.00	-

Key variables

FX (Month of Dec)	Current	2017	2018	Prev.	Y/Y(%)	2019	Prev.	Y/Y(%)
USD/GBP	1.34	1.30	1.35	↓ (1.40)	3.8	1.35	↓ (1.36)	0.0
USD/EUR	1.17	1.15	1.18	↓ (1.28)	2.6	1.20	↓ (1.25)	1.7
JPY/USD	109.0	115.0	110	↑ (105)	-4.3	108	↓ (110)	-2.3
GBP/EUR	0.88	0.88	0.87	↓ (0.91)	-1.2	0.89	↓ (0.92)	1.7
RMB/USD	6.38	6.60	6.35	↑ (6.20)	-3.8	6.30	↓ (6.37)	-0.8
Commodities (over year)								
Brent Crude	79.1	55.6	71.6	↑ (64.0)	28.8	59.7	(59.7)	-16.6

Source: Schroders, Thomson Datastream, Consensus Economics, May 2018

Consensus inflation numbers for Emerging Markets is for end of period, and is not directly comparable.

Market data as at 24/05/2018

Previous forecast refers to February 2018

* **Advanced markets:** Australia, Canada, Denmark, Euro area, Israel, Japan, New Zealand, Singapore, Sweden, Switzerland, United Kingdom, United States.

** **Emerging markets:** Argentina, Brazil, Chile, Colombia, Mexico, Peru, China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, South Africa, Russia, Czech Rep., Hungary, Poland, Romania, Turkey, Ukraine, Bulgaria, Croatia, Latvia, Lithuania.

Updated forecast charts – Consensus Economics

For the EM, EM Asia and Pacific ex Japan, growth and inflation forecasts are GDP weighted and calculated using Consensus Economics forecasts of individual countries.

Chart A: GDP consensus forecasts

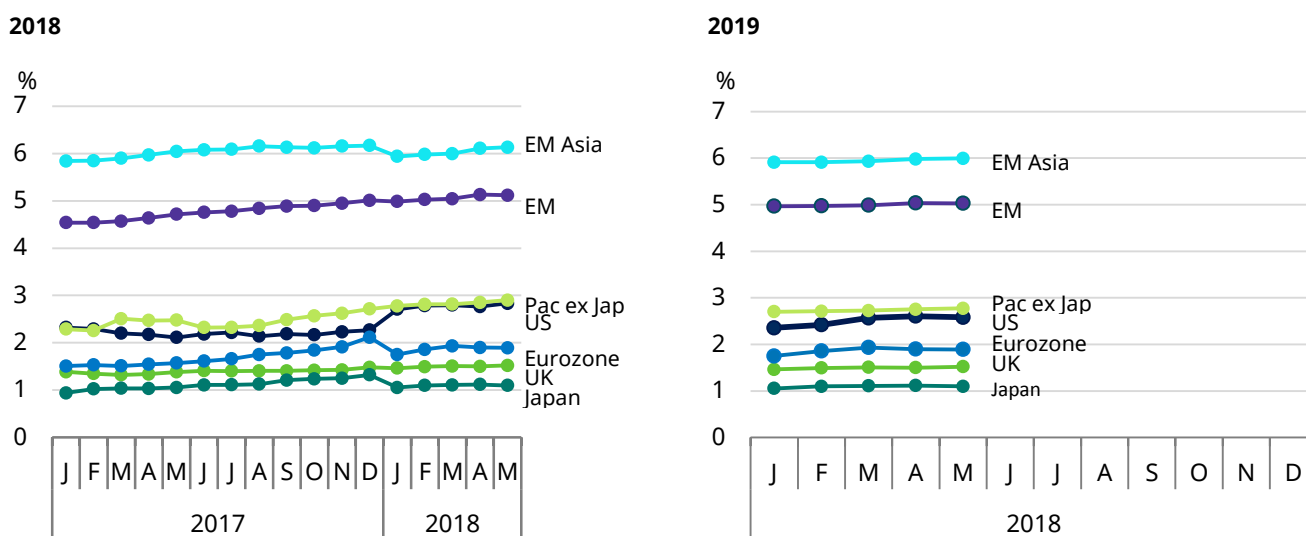
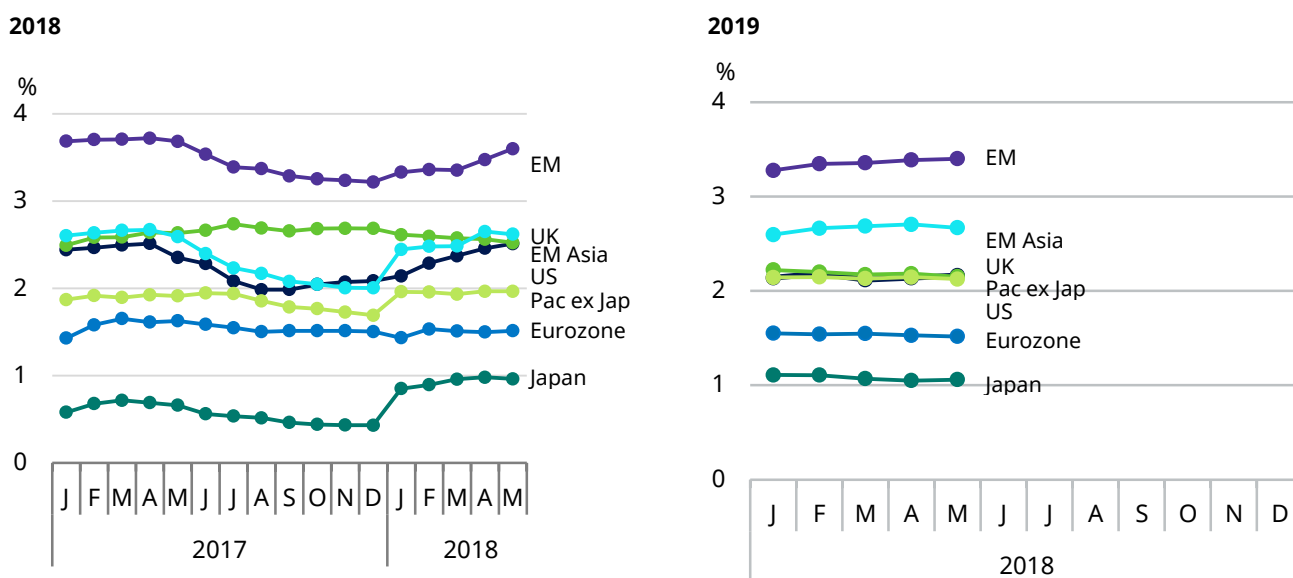


Chart B: Inflation consensus forecasts



Source: Consensus Economics (May 2018), Schroders.

Pacific ex. Japan: Australia, Hong Kong, New Zealand, Singapore.

Emerging Asia: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand.

Emerging markets: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, Argentina, Brazil, Colombia, Chile, Mexico, Peru, South Africa, Czech Republic, Hungary, Poland, Romania, Russia, Turkey, Ukraine, Bulgaria, Croatia, Estonia, Latvia, Lithuania.

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