SIGNATURE

Research
27 June 2019

Global Outlook

Monetary tide keeps markets afloat

The bond rally does not signal a dire economic outlook; it is partly due to investors recalibrating their neutral rate estimate lower. The global economy should temporarily slow in the coming months, but the business cycle is set to endure. We expect central bank easing to support markets and recommend global equities over bonds.

Ajay Rajadhyaksha
+1 212 412 7669
ajay.rajadhyaksha@barclays.com
BCI, US

Completed: 26-Jun-19, 21:25 GMT Released: 27-Jun-19, 04:00 GMT Restricted - External

This document is intended for institutional investors and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors under U.S. FINRA Rule 2242. Barclays trades the securities covered in this report for its own account and on a discretionary basis on behalf of certain clients. Such trading interests may be contrary to the recommendations offered in this report.

Please see analyst certifications and important disclosures beginning on page 56.

FOREWORD

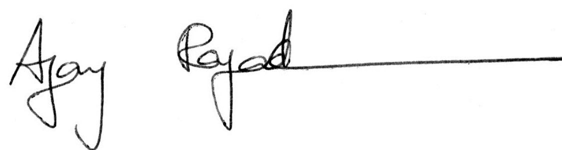
Arguably the biggest development in financial markets in Q2 19 is the breath-taking rally across global rates. 10y US Treasuries have rallied 50bp in the past three months, the front end of the US curve is now pricing in over 100bp of easing by end-2020, and ever larger parts of the world's bond markets keep sliding into negative yield territory. Central bank rhetoric has affirmed market pricing, with the June FOMC strongly hinting that rate cuts are coming and ECB President Draghi stating that "in the absence of improvement" in inflation data, "additional stimulus will be required." Trade tensions between the US and China remain elevated ahead of a critical G-20 meeting, and sentiment indicators on global trade and manufacturing are under pressure. All seems as it should be: the global business cycle might be turning over in part thanks to trade tensions, central banks are going to ease accordingly, and bond markets are pricing this in.

But if this explanation is correct, someone forgot to tell the world's risk markets. US equities just hit all-time highs, global stocks are up over 15% on the year, and credit spreads in the US and Europe are well below the levels of December 2018, let alone the more serious widening in January 2016. What gives? How does one reconcile the gloom in bond markets with the cheery disposition of risk assets?

One explanation is that equity investors have convinced themselves that central banks will ease quickly enough to offset trade-related drags such that global economies escape unscathed. But that argument assigns to central banks an almost magical ability to fine-tune policy and assumes that any cuts will immediately support economies. This is not supported by history: when business cycles turn, equities decline, even as central banks are easing aggressively. Instead, we believe a major reason for the bond rally is that investors have revised downward their assessment of "neutral" policy rates in the world's major economies, most notably in the US. If this is correct and bonds are rallying because investors expect easing due to a recalibration of monetary policy, rather than purely for cyclical reasons, then the stock market move is more consistent with the bond rally. This argument is supported by the fact that long-dated rates have fallen in lockstep with the front end for much of 2019 and by the Fed's recently marking down its long-term neutral rate significantly. The persistent weakness in inflation and market expectations in most major economies also supports this theory.

We do not mean to downplay the economic effect of trade tensions. There *is* an industrial/manufacturing slowdown playing out, and the June payroll report suggested some spill-over into the broader US labor market. And the Fed *has* expressed caution about rising economic uncertainty and weak inflation. But one employment report does not a recession make. The global services economy remains in reasonable shape, job markets across the US and Europe are still healthy and the US consumer is still spending on big-ticket items, such as autos. The world economy should slow for the next few quarters, but we think this is not the end of the business cycle, but a lull in growth.

The second half of the year promises to be very eventful, with central banks on the move, uncertainty on trade negotiations, and many bond and stock markets at the year's highs. Few assets strike us as compellingly cheap; investors will need to be nimble to eke out returns. It is our hope that this publication assists you, our clients, in your investment process for the rest of 2019.



Ajay Rajadhyaksha
Head of Macro Research

CONTENTS

Overview 4

Monetary tide keeps markets afloat

The bond rally does not signal a dire economic outlook; it is partly due to investors recalibrating their neutral rate estimate lower. The global economy should temporarily slow in coming months, but the business cycle is set to endure. We expect central bank easing to support markets and recommend global equities over bonds.

Economic Outlook 13

A tense lull

Global growth prospects have softened, as earlier signals of a modest rebound led by China have fallen victim to protracted uncertainties about global trade relations. We now project global growth at just 3.3% in both 2019 and 2020. Thus far, consumption, supported by healthy labor markets, remains robust across regions, limiting recession risk. However, a continued slump in manufacturing and trade could eventually spill over, especially if global trade tensions escalate further. Citing increased downside risks, declining inflation expectations and lower 'neutral' rates, central banks have signaled renewed easing. We expect the Fed to cut 75bp and the ECB to lower its depo rate 30bp (to -70bp) over the next 12 months.

Special Topic 30

The Fed mulls easing amid confluence of risks

In the weeks leading into the June FOMC meeting, we revised our outlook for Federal Reserve policy and now expect 75bp of rate cuts this year, beginning with a 50bp reduction in July, followed by 25bp in September. Here, we revisit the rationales for a mini-easing cycle from the Fed in light of communications from the June FOMC meeting and discuss scenarios in which our outlook for the policy rate could be proven incorrect.

Special Topic 40

Trade war: Effects across Equities

As the multi-front trade war continues to escalate, technology, national security and the race to control the next wave of the tech revolution have emerged as some of the key issues. Because of the disparity in global and domestic exposures across industries and regions and the range of potential salvos each trading partner can launch against the others, we believe the recent developments imply a high dispersion between the winners and the losers. The global equity markets, however, remain relatively sanguine, which seems to indicate that investors may either be optimistic about a near-term resolution or expect the Fed to cut rates enough to cushion these headwinds.

Global Forecasts 51

SUMMARY OF ASSET ALLOCATION THEMES

	KEY FORECASTS	KEY RECOMMENDATIONS
Equities	• We think US equities are overvalued in our central scenario of escalation of US-China trade tensions. However, we cannot rule out an equity melt-up scenario which would require aggressive Fed easing despite a trade truce. • For Europe, we expect low-single-digit upside for the remainder of 2019. Valuations are not excessive but we expect EPS growth to be subdued. The region remains under-owned, so any reduction in geopolitical and macro risks could help unlock latent demand.	• For the US, we are Overweight healthcare, infotech, and materials; Underweight utilities, consumer discretionary, and industrials; and Market Weight financials, comm services, energy, and consumer staples. • For Europe, we are Overweight Energy, Materials, and Healthcare and Underweight Tech, Industrials and Staples. We have Market Weight ratings on Financials, Discretionary, Telecom, and Utilities.
Bonds	• Amid risks to growth and muted inflation, short rates are likely to move lower as major DM central banks ease. • Long-term yields have an asymmetric profile, with room for larger rallies on markets pricing for "lower for longer," while contained inflation makes a material sell-off unlikely.	• In the US, we continue to recommend far-forward starting steepeners and long-end swap spread tighteners. • In Europe, we are bullish on duration and keep 10s/30s swap curve-flatteners. We also favour semi-core and maintain our long 30y Belgium vs. Germany recommendation.
Commodities	• Oil prices came under pressure in Q2, on demand concerns emerging from escalating trade tensions, but we think prices overshot to the downside. • We forecast OPEC+ to extend their output cuts into the second half, largely offsetting weak demand growth.	• We expect Brent and WTI prices to average $74/b and $67/b in Q3, respectively.
Inflation	• US: Breakevens are cheap to underlying inflation, but sentiment remains poor despite expected Fed cuts. • UK: Overall bearish, but Brexit news could be a significant driver of short-dated breakevens in the coming quarter. • EUR: Breakevens beyond the short end to be range bound but volatile in the near term. ECB rhetoric likely puts a floor under breakevens, but scope for inflation hedging demand is further reduced following the nominal rally.	• We recommend 2y energy-hedged breakeven longs. • EUR: BTP€i21/SPGB€i27 breakeven flattener. • UK: Sell the 1y in 2y RPI swap if the forward reaches 4.0%..
Credit	• Our base case is modestly wider spreads at year-end, but if central banks are aggressive in the short term, we believe spreads should be stable or even tighter. • We prefer down in quality within markets based on the outperformance of lower beta year-to-date. BBBs look attractive, considering the recent rally in BBs and strength all year of As.	• Financials have outperformed industrials; as a result, we prefer industrials. • We are more neutral on the US vs. Europe. On a hedged basis, Europe was cheap for most of the year, but has outperformed recently and we believe the relationship is closer to fair today.
Emerging Markets	• The global macro backdrop for EM assets has materially deteriorated, amid a re-escalation of trade tensions and weak global and EM growth momentum. • But central banks appear ready to proactively lean against the tide. This should provide a strong anchor for EM credit and opportunities for select longs in EM rates, likely resulting in further outperformance of these two relative to the more cyclical EM FX.	• In EM FX/local markets, we recommend long the Jan 22 DI future in Brazil, long a 1x1 EURHUF call spread and positioning for an escalation in US-China tensions through long USDTWD and USDPHP NDFs. We remain long 5y and 10y IGBs, received 2s5s COP IBR and received 5y5y vs. 1y1y ZAR IRS, FX-hedged via a long 1x2 USDZAR call spread. Finally, we recommend a long 1x2 USDMXN call spread and receiving 1s5s TRY CCS. • In EM credit, demand for IG will likely remain solid, but the outlook for HY is more mixed. Our OWs in the latter include Ecuador and El Salvador. We downgraded Turkey to UW (and suggest buying the 5y CDS-cash basis) and upgraded Ukraine to MW on political balance of risk considerations; EEMEA/ LatAm corporates have further room to outperform sovereigns, but we are more cautious on Asia credit.
Foreign Exchange	• Proactive Fed rate cuts are expected to dent the USD in Q3 but lay the groundwork for a later rebound as the US economy bottoms and rebounds. • We expect EURUSD to descend to cycle lows by mid-2020, reflecting higher risk premia as the economy continues to deteriorate amid limited policy degrees of freedom. • The yen, however, is likely to be the top performer as yield differentials narrow and it benefits from diversification as an alternative risk hedge to the USD.	• GBP will likely continue to plumb the bottom of longer-term ranges as Brexit and election uncertainty linger. • Commodity currencies suffer from falling commodity prices and EM continues to underperform amid weak global growth, but differentiation should increase. • USDCNY is expected to breach 7.00 in a controlled manner, but this forecast is highly conditional on the outcome of the G20, an uncertainty (among others) that hangs heavily over all of our FX forecasts.

Note: Equities views published in *Complacency is gone but caution still warranted - June Chart Pack*, 5 June 2019, and *Can Equities Melt-up?* 25 June 2019. Rates views published in *Global Rates Weekly: No longer patient*, 20 June 2019. Commodities views published in *The Blue Drum: Summer is coming*, 9 May 2019 and *Oil market outlook: Torn between uncertainties*. Inflation market views published in the *Global Inflation-Linked Monthly: Patience is a virtue, until it is neglect,* 14 June 2019. Credit views published in *Tuesday Credit Call*, 25 June 2019; *Global Credit Outlook*, 30 November 2019; *Preferred shorts for the summer*, 14 June 2019; and *EUR versus HY bonds: 1-Nil*, 24 May 2019. Emerging market views published in the *Emerging Markets Quarterly: Another lifeline from central banks*, 26 June 2019. Foreign Exchange views published in *FX & EM Macro Forecast Update*, 25 June 2019.

OVERVIEW

Monetary tide keeps markets afloat

Ajay Rajadhyaksha
+1 212 412 7669
ajay.rajadhyaksha@barclays.com
BCI, US

Michael Gavin
+1 212 412 5915
michael.gavin@barclays.com
BCI, US

The economic outlook has dimmed somewhat, due to intensifying US-China trade tensions. We now expect the ongoing soft patch in global activity to extend through the remainder of the year. But we believe that the weakness in trade and manufacturing will not broaden enough to end the ongoing global expansion, given healthy labour markets and consumption in most major economies.

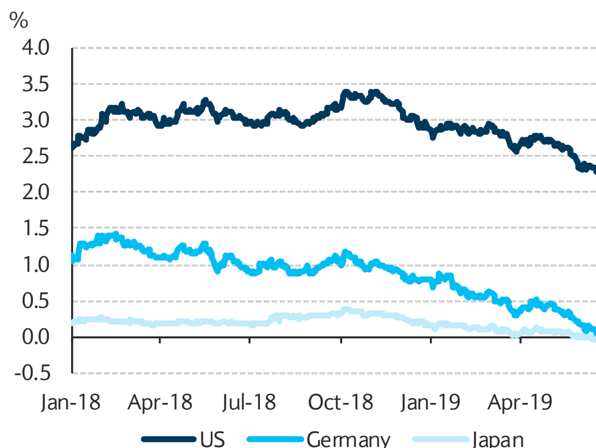
In our view, the rally in core rates is not just due to trade frictions and does not signal an overly gloomy view of the world economy. Instead, some of it is due to investors' recalibrating lower what they believe to be the long-run, cyclically neutral policy rate in the US and the euro area, and central banks agreeing with this recalibration by signalling a move to rate cuts. We do not see a major disconnect between ultra-low bond yields and resurgent stock markets.

We expect risk assets to remain resilient as long as relative valuations strongly favour equities over bonds; central banks retain the willingness to ease in the face of news that poses economic risks; and the ongoing soft patch in trade and manufacturing does not threaten the global expansion.

While equity valuations are modestly above our fair value estimates, we continue to recommend overweight allocations to equity risk and underweight to safe bond markets. This is due mainly to the extremely low yields on offer in core bond markets. We do not expect a sharp unwind of the bond rally even if there is good news on trade, given persistent weakness in inflation data and expectations and our view that markets are unlikely suddenly to re-assess long-term neutral rates higher.

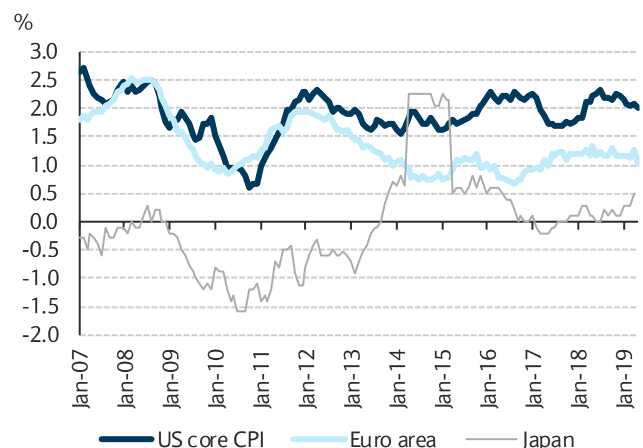
EM markets are likely to be caught between two opposing forces: a weaker macro backdrop and Fed rate cuts. We would avoid growth-sensitive cyclical assets such as EM equities in favour of EM fixed income. The USD could be a mixed bag over the next few quarters, but should weaken against most currencies in Q3, on expected Fed cuts.

FIGURE 1
Bond market projections of longer-dated interest rates have been falling since late 2018



Note: 5y5y forward rates from government bond markets. Source: Barclays Research

FIGURE 2
Measures of US and euro area underlying inflation have been falling since late 2018 and remain very low in Japan



Note: CPI excluding food and energy. Source: Haver Analytics

The chief risk to our stance is the global business cycle. If investment and trade are sufficiently dislocated, perhaps due to new tariffs between the US and other major economies, labour markets and domestic demand could eventually capitulate. This is not our base case, but a risk well worth monitoring.

What just happened?

It is natural to assume that dramatic market movements like those of Q2 are a result of the most noteworthy headlines of the period. In the present context, this narrative assigns a dominant role to the confrontational turn in US-China trade talks that startled much of the world beginning in early May and that is believed to have increased downside risks to the global economy. According to this, financial market participants concluded that monetary authorities – most notably the Fed – would respond proactively to intensified risks with a substantial easing of monetary policy. This anticipated ease in monetary conditions drove market rates down and, by convincing investors that economies would be thus insulated, insulated equity and credit markets as well.

This is a coherent way to account for the moves in financial markets this quarter, and we partly subscribe to it. But we think it is incomplete and in some ways misleading. For example, the tariff-centered approach to understanding market developments seems hard to square with the fact that long-dated interest rates have fallen in near lockstep with short rates throughout 2019, including in May and early June, when trade policy shocks were the dominant disrupter of the financial peace. This is not what one might expect of a precautionary response to offset essentially cyclical effects of a non-monetary policy shock.

The bond rally is not just a response to tariff-centered economic anxiety

It is theoretically possible that a precautionary monetary response to a disruptive policy shock could leave the world economy – and therefore equity and corporate credit markets – largely unscathed. But this attributes to monetary authorities a capacity for fine-tuning that is not supported by history. It is difficult to imagine that an economic shock large enough to elicit the bond market moves that have occurred, and the monetary policy easing that we now anticipate, will have little to no negative consequences for equity and corporate bond fundamentals. The tariff-centered explanation thus leaves us with an uncomfortable sense of disconnect between bond and equity markets.

Finally, if one adopts a somewhat longer perspective, the Q2 downdraft in global interest rates looks more like a continuation of a trend that began in late 2018, well before President Trump's trade policy grabbed the headlines and became the dominant focus of investors' anxieties. In the US, the 5y5y forward Treasury rate has fallen from an early November peak of 3.40% to 2.25%, with the majority of the move occurring before May 2019. Over the same period, the 5y5y rate on bunds has fallen a bit more than 100bp (to within a couple basis points of zero), and for JGBs it has fallen roughly 40bp.

What are financial markets telling us?

If we view this forward rate as an (admittedly imperfect[1]) proxy for the market's estimate of a long-run, cyclically neutral policy rate, the interpretation would be that market participants have revised downward their estimate of the US neutral rate by 115bp, with a similar downward revision in the euro area and a smaller but still substantial one in Japan (where the scope for downward revision was limited by the initially much lower forward rate).

These are very large reassessments, but it is possible to rationalize them, at least directionally. Measures of US and euro area inflation have stubbornly refused to gather momentum and have in fact eased in the past year, despite strong labor market recoveries. Japanese inflation has shown signs of life in recent months, but remains far below the 2%

[1] Since even forward rates can be pulled down for cyclical reasons.

target. In the US, some interest-sensitive sectors – most notably residential construction – have struggled as the Fed has tightened monetary conditions. Counter-arguments can be made, and we do not necessarily endorse the market's apparent reassessment of the neutral interest rate. Our point is that such a reassessment can definitely be explained and it seems unlikely that data will force a change in the market's view of the neutral rate, at least in the next couple of quarters.

This has important implications for investors' views of the Fed's monetary policy stance. In late 2018, bond pricing suggested that markets felt that US monetary policy was more expansionary than the neutral rate. But the US curve now implies a view that monetary policy is (only a little) contractionary relative to the greatly reduced estimate of the neutral policy rate. In light of still weak inflationary momentum, a case for reversing a few of the FOMC's most recent rate hikes would be easy to make, even in the absence of risks from the weak global backdrop and trade policy uncertainties. In short, we believe that core bond yields are at current levels partly because investors have revised downward their assessment of neutral policy rates, and only secondarily due to a flight from trade-related economic risks.

What, no disconnect?

This perspective sharply reduces the sense of disconnect between bond and equity markets. The perception of disconnect arises for those who think that bond markets are expressing anxieties about the economic and financial backdrop that most equity markets are ignoring. But if rates are low in part because bond investors expect a reset of monetary policy, rather than only due to economic anxiety, then it is perfectly natural for equity markets to remain well supported, as long as the Fed delivers the rate cuts that investors are now expecting.

We do not think there is a major disconnect between the equity and bond rallies and expect the Fed to ease 75bp

Moreover, it does not much matter whether the Fed is easing because of its assessment of downside economic risks or because it agrees that the neutral rate is lower than previously thought. If market participants are right about the long-term neutral rate, the Fed will struggle to move it higher in the years ahead. If markets are wrong and the neutral rate is meaningfully higher than bond market pricing now implies, inflation will sooner or later force policy rates higher. This scenario could be major news someday, but is highly unlikely to be a market theme for the remainder of 2019.

At this point, we expect the Fed to deliver what bond markets are clamouring for and forecast 75bp in total cuts this year. In "The Fed mulls easing amid confluence of risks", we discuss ways in which our Fed call could be wrong in either direction, either because the Fed defies bond markets and stands pat or because data push it into a full-fledged easing cycle.

What to do?

In other words, as investors make asset allocation decisions for the second half of the year, they have to choose between two very different lenses through which to see the world:

1. The world just became a much riskier place because of the intensification of the US-China trade conflict and the possibility of new trade frictions between the US and other major economies. The Fed and the ECB are telegraphing this gloomier outlook, as are bond markets. Meanwhile, equity markets are whistling past the graveyard, as though the anticipated easing of policy (especially in the US) will be enough to offset weaker fundamentals. Investors should stay away from equities until valuations reflect this deterioration in the economic fundamentals.

2. The 2019 plunge in key interest rates is not mainly telegraphing a dire assessment of the world economy. Bond markets are expressing a view that has been developing since late 2018 that the neutral policy rate in key currency areas is (even) lower than previously thought. As long as the Fed (in particular) accommodates this view, there is an argument for risk assets to stay resilient, especially with competition from core rates even lower than at the beginning of Q2.

Forced to choose between these alternative views of the world, we would align ourselves with the second.

A familiar context

As a result, the investment backdrop looks to us much like it did last quarter, when our key theme was that risk assets would be resilient to bad news because safe asset yields were so low and central banks' willingness to respond to shocks was high. We did not expect the more confrontational turn in the US-China trade war or the continued rally in core bond markets. But risk assets did display resilience to the bad news that materialized in May, as we had forecast. The poster child for this resilience is the US equity market, which rose nearly 5% QTD and is now at a record high. But other advanced equity markets advanced almost as much, and some emerging equity markets rose even more sharply, with the obvious exception of China and other Asian economies directly affected by the trade war.

We think this Teflon-like response to bad news depends on a valuation gap that is strongly in favour of risky assets, a reliably dovish response to negative news by key central banks, and a limited risk of a global recession. All three elements are likely to remain intact in the remainder of the year.

- US and European equities are not cheap, and we expect a gradual return to more normal valuations, which should put a damper on prospective returns over the medium term. But the situation is far more extreme in safe bond markets, where nominal yields to maturity have fallen below zero on trillions of dollars of assets and expected real yields are even more negative.
- If there was room for doubt about major central banks' willingness to act pre-emptively to offset economic (and therefore financial) risks, the Fed's and ECB's recent responses should have eliminated it. The key question is not willingness, but whether there is policy space. The answer for Japan and the euro area may be: 'not much'. But for the US, rates markets are pricing only a partial and temporary reversal of the Fed's tightening to date. In the event that some element of the outlook deteriorates further, there is room for the Fed to ease substantially more than rates markets are now pricing. In light of the dollar's central role in global markets, we consider this a reassuring monetary policy safety net against further bad news.
- Monetary policy puts are a powerful tonic for financial markets, but policy easing would not insulate equity and other growth-sensitive assets from a recession in the US or another major economy. It would be reckless to ignore the risks of such a recession ten years into the global expansion, with world trade and manufacturing activity under evident pressure. However, our view is that the ongoing weakness in trade and manufacturing is, like 2015, a soft patch in the world expansion that will not become a more broad-based downturn.

We continue to recommend equities over safe bond markets

Like last quarter, and for fundamentally similar reasons, we continue to recommend that investors maintain an overweight position in equity markets and underweight position in safe bond markets. The case for equities is as uncomfortable as the one we made last quarter. The global economic expansion looks to us more tepid than it did three months ago; the economic backdrop, thus, provides limited support for growth-sensitive assets. At the same time, equity valuations are elevated by historical standards and above our strategists' assessments of fair value. But while equities are not cheap, they are still at levels where further multiple expansion or increases in valuation (however muted) are consistent with the range of normal historical experience. This contrasts with the situation in safe bond markets, where yield levels make owning the assets hard to justify on any but the most tactical of rationales, or in anticipation of a global recession.

We still recommend global equities over core bond markets, given rock-bottom bond yields and our belief that the economic slowdown is temporary.

This does not mean that equities will not reprice downward if there is a clear deterioration in their fundamentals, such as because of a slowdown deep enough to slash corporate earnings, an unfriendly shift in tax policy, or the emergence of a more hostile regulatory environment. In our view, though, the unattractiveness of the main alternative asset class limits the extent and duration of sentiment-driven sell-offs, just like the moves this quarter. In such an environment, we think that it makes sense for investors to bear the equity risk they are still compensated to own, rather than retreating to an asset class that offers the near-certainty of negligible or (in the euro area and Japan) negative real returns. We are likely to maintain that view until the risk of a recession appears meaningfully higher.

Although we think that the 2019 plunge in yields makes safe bonds unappealing, bond markets are not precariously positioned, at least in our view. Some investors have expressed the concern that bond valuations are highly vulnerable to good news on US trade policy; if concerns about trade vanish, so does the prospect of the monetary easing that has propelled rates higher, and so does the flight from risk that some consider a dominant part of the 2019 bond rally. We find scenarios like this of limited concern because the recent recalibration of the neutral policy rate should not reverse even if trade frictions ease. Admittedly, there is a cyclical as well as a long-term structural component to the monetary ease that has been priced into rates markets in the past seven months, and if monetary authorities disappoint in the short run, bonds will react to some degree.

But we expect any such reaction to be limited until some particularly persuasive central banker or (more likely) data convince investors that inflation will eventually respond to easier monetary policy in the major economies. This may well happen one day. But in light of the stubborn failure of inflation to push higher, and the number of false alarms through which investors have lived in recent years, we feel pretty confident that higher expectations of inflation pose a limited risk to bond markets in the months ahead. We would limit exposure to safe bond markets simply because we see a very high probability of very low returns, not because we are worried about an abrupt reversal of the bond rally.

Key risks: Manufacturing recession spill-over and/or a multi-front trade war

The easiest way for an economist to darken a page or ten with ink is to list the risks that surround pretty much any forecast. Some of these have reasonably high probability but limited global effect, while others are of high effect but low probability. In the first category, we include the long-running drama of Brexit, Italian fiscal fights with the EC, and a victory by populists in the upcoming Argentine presidential elections. We will not talk about these because, important as they are for the economies directly affected, they are unlikely to affect our global investment thesis. In the second category, we might include a sudden resurgence of inflationary pressures in the major economies: high effect but low probability. There is little point in dwelling on such risks, either. The risks worth discussing are those that would seriously undermine our investment thesis and are at the same time probable enough to warrant serious thought. Over the three- to six-month focus of this *Outlook*, the main risk is that the ongoing trade and industrial deceleration deepens and spills over such that it brings about an end to the global business cycle.

Could the industrial recession bring an end to the business cycle?

This risk is not negligible, especially in the context of the main pressure points in the world economy. The Chinese authorities' struggle to rein in leverage while supporting growth targets (especially as frictions with the US rise); supply chain dislocations and business uncertainties created by the Trump administration's trade policy agenda; questions for European businesses about the rules of the game after the UK leaves the European Union – each of these involves enormous uncertainties and economic consequences that are more

than a rounding error for the global economy. Moreover, the world economy has been in expansion for over a decade, and while these do not die of old age, some sources of momentum do fade as economies recover. It is reasonable for investors to believe that the expansion may be more vulnerable now than several years ago.

Our view is that the risk of recession has risen, but nevertheless remains a low-probability scenario – not negligible, but too low to position for. In the advanced economies that still comprise most of the world economy, industry and international trade are important. But these sectors are small relative to domestic demand. In particular, household demand predominantly falls upon locally produced services and is determined mainly by the evolution of labour income. Domestic labour markets remain robust in most advanced economies, and the outlook for overall domestic demand remains correspondingly resilient to a softening of manufacturing and trade. For example, the US consumer is still not shying away from big ticket purchases such as autos, real disposable income continues to rise in the euro area at a healthy pace, and Chinese consumption of services (such as healthcare) has kept rising in H1 19.

Having said that, if investment and trade are sufficiently dislocated, labour markets and domestic demand will eventually capitulate. If our market call for Q3 is wrong, one possible reason is that advanced economy labour markets and domestic demand are undermined by uncertainties and risks created by their own policymakers.

A multi-front trade war that draws Europe in

A related risk is that the US imposes new tariffs on other major economies, even as US-China trade negotiations continue. A few months ago, when the US postponed a decision on tariffs on European autos primarily to focus on talks with China, markets heaved a sigh of relief. But since then, the president's threat to impose tariffs on Mexico (even though it did not come to pass) has renewed the risk that the US administration is open to a multi-front trade war. The Mexico tariff episode also suggested that the US was willing to use tariffs as leverage for reasons unrelated to trade, another unnerving factor for markets.

A multi-front trade war that includes tariffs on European auto exports would increase the odds of a recession, but this is a risk, not our base case

In particular, there is a risk that the administration might use the results of its Section 232 investigation as leverage against Europe by claiming that a bilateral trade deficit in goods presents a national security risk to the US. And if this were to lead to 25% tariffs on auto exports from Europe, the economic hit would be significant, especially for Germany. This is not an academic argument for far into the future; European Commissioner for Trade Cecilia Malmström warned EU's trade ministers recently that tariffs could be imposed as early as July. This would be a material negative; Europe remains the most vulnerable large economy (relative to the US, China or Japan), with limited policy tools and a host of downside risks, especially in Southern Europe.

It is possible, then, to create a plausible (if still distant) narrative in which Europe flirts with a recession, nominal GDP contracts materially in economies such as Italy, periphery bond yields rise, investors start worrying about the possibility of Italy's going into a 'program', and markets suddenly wake up to the idea of a possible haircut in the world's third-largest sovereign bond market. This is not our base case, though. We feel there is far more political resistance in Congress (including from the Republicans) to imposing tariffs on Europe than on China. A solution also seems more clear-cut, in the form of additional US defence exports to Europe that would increase European defence spending (a repeated US demand) while lowering the US trade deficit in goods with the euro area. But this is a risk that we will monitor closely in the months ahead.

Asset class summary: Risk still well supported

Equities and credit: overweight for now

As at the beginning of last quarter, equity markets look generously valued in the US and close to neutral in Europe. Our equity strategists are forecasting flat to slightly negative 2019 earnings for the S&P500 and roughly flat earnings in Europe. There is also some risk that if the trade war worsens, China could retaliate using non-tariff measures (see "Trade War: Effects across Equities," one of the two thematic pieces in this GO). On the face of it, not much to get excited about. But equity markets do not exist in a vacuum, and investors moving out of stocks will face the problem of what to buy instead. As we noted before, current valuations make safe bonds an almost untenable investment; this should keep investors in equities and other risky assets, as indeed has been the case since the start of June. In this historically abnormal context, past valuation benchmarks may temporarily fade in significance.

Moreover, as we noted in *Can equities melt up?*, stocks have a history of rallying if the Fed is easing in what subsequently proves to be a soft patch rather than an outright recession. From a sector selection standpoint, we are market weight across advanced equity markets. Within US equities, we recommend US companies with low reliance on international sales and higher beta to the domestic economy.

The valuation picture in developed market corporate credit is less extreme. Despite a fierce rally in June, spreads remain wide of levels seen as recently as last fall and a considerable distance from all-time records. Even if central banks ease, we believe that tightening is likely to be limited by the lower overall yields that limit the participation of yield-sensitive buyers. Our medium-term view is for modestly wider spreads. But here again, the call for the next quarter is more positive, and the path of least resistance is further spread tightening; over the next few months, we recommend going down in credit quality with an emphasis on BBBs but not further (in part because BB-BBB spreads are now at post-crisis tights). Across sectors, we recommend industrials over financials. Across geographies, European credit still screens a little cheaper than the US, but given that Europe has led the credit rally, we are market weight across geographies.

Rates: The Q2 bond rally is here to stay

In the US, we expect 2y yields to decline to 1.5% and 10s to stabilize just below 2% over the coming quarters. Our yield forecasts reflect our base case of a shallow cutting cycle by the Fed and a temporary slowdown in US growth. As a result, even as 2y yields fall along with the spot FF rate, we expect the 2s/10s yield curve to steepen. Risks to the forecasts are likely skewed to the downside. If the economic slowdown is deeper and longer lasting than our base case, the Fed could move more aggressively, given that the policy rate is much closer to the zero lower bound than at the start of previous easing cycles.

We do not expect a sharp bond sell-off even if there is a near-term truce on trade

Further, were the Fed to adopt a strong form of forward guidance (such as average inflation targeting), markets would likely expect the policy rate to stay at the zero lower bound for long. Such an outcome could push yields well below current seemingly low levels, even in the absence of an actual recession. As for yields, as the economy recovers from this soft patch, yields might rise a little higher than our base case. For instance, in the 1998 cutting cycle, the low in 10y yields was right around when the Fed cut first. But given how disappointing inflation data have been and how muted inflation expectations are, a significant sell-off remains unlikely.

The path for European yields, especially bunds, is likely to depend on how low the depo rate can go and on the nature of any new QE by the ECB. The bond market is pricing in a lower bound for the depo rate at -70/-80bp, which looks reasonable to us. On the QE front, any

additional asset purchases from the ECB are likely to be of an open-ended nature, spread in a balanced way across sovereign debt/credit/spread products. We think the bar is high for bunds to rally further and see 10y Bund yields at -25bp by end of Q4, only 5bp below forwards. On the other hand, persistent weakness in euro area inflation data and a collapse in medium-term inflation break-evens make a material bund sell-off unlikely.

The clearer opportunity in Europe is in sovereign spreads, which we feel do not yet price in QE prospects or further ECB easing and have room to tighten further. Italy is the clear stand-out here, with 10-year BTPs still above 2%, thanks to continued concerns about political stability. We believe that snap elections in September cannot be ruled out, especially if ECOFIN decides to execute the Excessive Deficit Procedure at its July 8-9 meeting (not our base case). But the window for September snap elections remains tight, and a new government could well be a center-right coalition, which may be seen as market friendly. Ironically, if the existing government were to stay in place, there would be greater risk of friction with the EC. But such concerns are likely to be swept aside if expectations of ECB QE do build. We still like sovereign spreads in Spain and Belgium, but for investors willing to stomach mark-to-market volatility, Italian debt is now an intriguing opportunity.

FX: Fed easing does not mean a decisive turn to USD weakness

For much of this year, even as the Fed staged a remarkable about-turn on monetary policy, the USD stayed resilient, defying the expectations of many investors. That is likely to be tested as the Fed now approaches an (admittedly shallow) easing cycle. With major central banks such as the ECB and BoJ near their effective lower bounds for rates, Fed cuts compress the large US carry advantage. All else equal, this should depress the relative price of the USD, and indeed we forecast USD depreciation versus most G10 currencies in Q3.

But all else is not equal. In particular, the risk profile of the euro area is arguably worse than that of the US, with risks – Italian politics, Brexit, a spiral down in inflation expectations, or the threat of US tariffs on European auto exports – tilted to the downside. The contrast in risks between the US and euro area could become impossible to ignore by year-end as Fed cuts start to cushion US growth; hence, we expect any USD/EUR weakness to be limited to the next few months and to reverse starting in Q4. In contrast, Japan's stable risk profile provides the opposite: diversification in a world where global concentration in USD financial assets has increased. We foresee increased upward pressure on the JPY, with the USDJPY getting to a low of 102 at the end of the year before backing off a bit next year.

In Asian currencies, we expect little movement on the RMB ahead of the G20 meeting as Chinese authorities hold the line to preserve their optionality. But if the US imposes broader tariffs in Q3, as is our base case, we would expect Chinese authorities to allow USDCNY to rise to just above 7.00 but fight any further rise to break the psychological focus on that level. Once market pressure subsides, however, we expect further depreciation to be allowed. By mid-2020, we forecast USDCNY at 7.25. However, this forecast is highly dependent on trade negotiations. News that Presidents Trump and Xi will meet at the G20 raises sharply the likelihood of a ceasefire that delays the imposition of tariffs and could consequently delay a move above 7.00. Other EM currencies are likely to have mixed performance, with BRL and INR doing well, while Asia EM, as well as commodity currencies, still pressured from the upcoming growth slowdown. In sum, this is not a usual Fed easing cycle and is, hence, not likely to be accompanied by a decisive turn to USD weakness.

EM fixed income: Rescued by the bond rally

At first glance, EM assets face a more challenging macro backdrop than three months ago. Global trade tensions have re-escalated, growth momentum has weakened, and oil just went through a short-lived bear market. But from a total return perspective, the sharp rally in core rates has already compensated for the pressure on risk premia in EM fixed income.

Total returns in EM credit and local markets have been positive in Q2, which has helped stabilize flows into EM funds. While there were several consecutive weeks of outflows from EM equity and bond funds in May, flow momentum has turned positive recently, especially for hard-currency bond funds.

We would avoid cyclical, growth-sensitive EM assets like equities, but expect EM fixed income to do well

EM assets should be boosted by the turn towards easing by the world's major central banks. This should provide an important anchor for EM credit and EM local debt (FX hedged). We expect EM fixed income to extend its outperformance against more growth-sensitive asset classes, such as EM FX and EM equities. Country-specific factors will, of course, remain important, given the plethora of political risk events across a series of EM countries over the next few months. For example, cyclically sensitive financial assets in EM Asia are likely to be held hostage to every new headline on US-China trade. On the other hand, markets in relatively closed large economies such as Brazil and India should outperform.

With lower risk of durable tariffs, and as a potential beneficiary of near-shoring, Mexican local currency assets could benefit. Conversely, the potential for EU car tariff threats later in the year likely implies CEE underperformance (even though we do not expect auto tariffs actually to be imposed on Europe). Our main message: while the mediocre macro backdrop is unlikely to improve, it should be offset by central bank policy and the rally in core bonds for the less cyclical assets. EM fixed income should be the primary beneficiary, as ample risk premia leave room for the EM-DM spread to compress.

Oil: Heading upwards

After a strong start to the year, oil prices have struggled in recent months, with Brent down a few percent for Q2, despite a rebound in June. The weakness is largely a function of concerns about demand growth, rather than supply overshooting estimates, led by US tight oil, as has been the case over the past five years. This explanation is supported by below-average OECD total oil stocks (on a days of demand basis), the backwardated curve structure, and seasonally low product crack spreads. Over the past month or so, our economists have softened their global growth outlook for this year, and the revisions imply a 400 kb/d reduction in our global oil demand outlook of 1.3 mb/d y/y for this year (see *The Blue Drum: Summer is coming*, 9 May 2019). All else equal, this should imply a $5/b downward revision to our $73/b Brent forecast for H2 19.

However, we see several supply-side risks likely offsetting slower demand growth. First, tighter US sanctions have caused a greater-than-expected reduction in Iranian supplies. We had expected Iranian crude production to average 2.1 mb/d, but it averaged 1.9 mb/d last month. We also forecast Venezuelan crude production to average 0.9 mb/d in the second half. But the odds of a prolonged crisis, in which Venezuela's output drops to as low as 0.5 mb/d by year-end, are rising, in our view. Third, US crude production in recent months reflects a continued slowdown in y/y growth as capital discipline and accumulating base declines take hold and the oil-directed rig count continues to move lower. At the same time, we expect OPEC and its partners to roll over their production agreement next week, with no material increase in production targets. We are bullish on oil prices and expect Brent and WTI to average 73 and 66 dollars per barrel, respectively, in H2 19.

ECONOMIC OUTLOOK

A tense lull

Christian Keller
+44 (0) 20 7773 2031
christian.keller@barclays.com
Barclays, UK

- **Global growth prospects have softened, as earlier signals of a modest rebound led by China have fallen victim to protracted uncertainties about global trade relations. We now project global growth at just 3.3% in both 2019 and 2020.**
- **Thus far, consumption, supported by healthy labor markets, remains robust across regions, limiting recession risk. However, a continued slump in manufacturing and trade could eventually spill over, especially if global trade tensions escalate further.**
- **Citing increased downside risks, declining inflation expectations and lower 'neutral' rates, central banks have signaled renewed easing. We expect the Fed to cut 75bp and the ECB to lower its depo rate 30bp (to -70bp) over the next 12 months.**

The authoring research analysts would like to thank Akash Utsav for his assistance in connection with the preparation of this report

Global economy: Slower and lower for longer

Activity affected by uncertainty

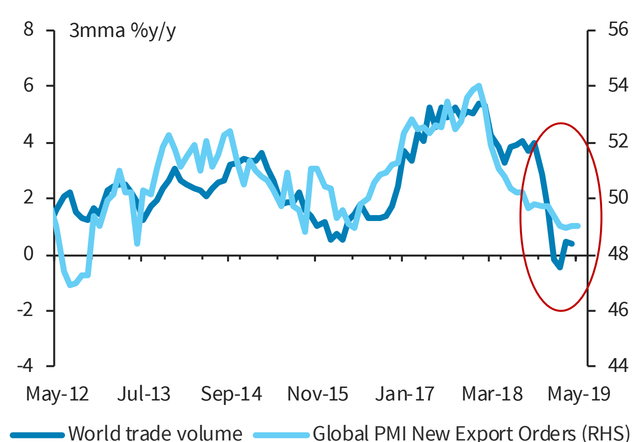
The global economy has not improved as we had expected in the March *Global Outlook* ("Economic Outlook: Delayed, not derailed"). Signs of a policy-induced rebound in China and expectations of upcoming resolutions to some of the main political uncertainties had suggested that after a the sharper-than-expected slowdown during 2018, global activity would modestly re-accelerate from Q2 onwards. In the event, the uncertainties about global trade – caused by US-China tensions – and Europe – caused by Brexit deadlines, EU elections and Italy – have not abated but, if anything, increased. There is still hope that some of these conflicts could still be settled, eg, through potential US-China agreements at the forthcoming G20 summit or a final passage of a Brexit transition agreement after the summer. For now, however, it may be more realistic to assume that these tensions are here to stay, as they reflect underlying geopolitical and societal shifts that will likely play out over a longer period.

This protracted uncertainty has in itself become the materialization of an economic risk, as it weighs on sentiment and affects business decisions. Faced with not only the actual higher US-China tariffs but also the ambiguity about potential tariffs and non-tariff barriers worldwide, businesses have become concerned about their existing supply chains and

FIGURE 1
Global activity has continued to soften, as manufacturing …

Source: IHS Markit, Haver Analytics, Barclays Research

FIGURE 2
…and global trade sharply slowed against the backdrop…



Source: CPB, IHS Markit, Haver Analytics, Barclays Research

related investment plans. As a consequence, global business sentiment has remained weak and the manufacturing-trade-investment nexus has not recovered as earlier expected. Certainly, to the extent that inventory cycles also play a role, some of the weakness could fade; moreover, new trade barriers may also create opportunities through trade diversion for individual companies and countries. But, in aggregate, the effect on the global economy is negative.

A protracted manufacturing slump could spill over into services and the labor market

At the same time, economies' consumption-driven service sectors have held up well thus far across regions. Given the dominance of consumption in overall demand and the typically larger share of services over manufacturing in modern economies, the risk of outright growth recessions thus appears contained. Instead, the continued absence of price pressures despite very low unemployment, combined with still-favorable financial conditions, paints a picture of a slower but sustained global expansion.

Adjusting to lower neutral interest rates

In contrast, falling bond yields globally, most notably an inverted 3m-10y US yield curve, suggest a much higher risk of a recession. One explanation could be that the apparent resilience in the domestic economy is a temporary delusion. After all, labor markets typically are lagging indicators, and the 'service-ification' of today's economies may be exaggerated: ultimately, many of the businesses categorized as services remain linked to manufacturing; ie, they 'service' the manufacturing industries. Hence, if the ongoing industrial recession persists – unlike in 2015-16, when global manufacturing was revived by China's massive stimulus – the robustness in labor markets and domestic service sectors may not last much longer.

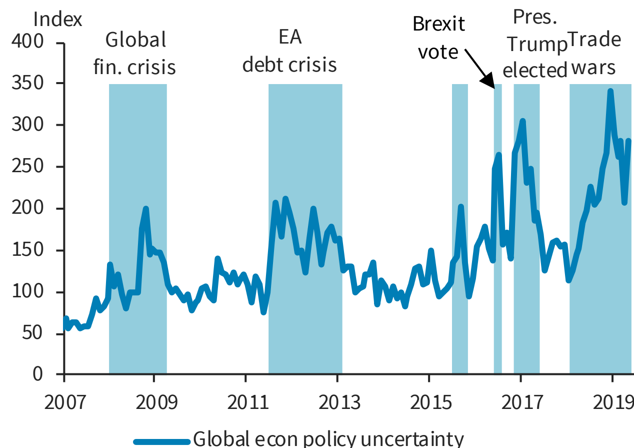
*Although lower yields could reflect recession risks, they could also reflect a lower r**

A more benign explanation could be that lower bond yields reflect an acknowledgment that long-run, cyclically 'neutral' interest rates (r*) have shifted lower. As central banks recalibrate their policies accordingly, markets price generally lower policy rates. This, rather than fears of an imminent economic contraction, contributes to the flattening or even inversion of yield curves. Certainly, the strong predictive power of yield curve inversions for US recessions in the past does suggest caution. But much empirical research suggests that a combination of factors – including demographics, potential growth, global savings and income distribution – has contributed to significant declines in neutral interest rates over past decades.

Monetary policies seem to reflect this interpretation. Over the past 12 months alone, the Fed's FOMC dot plot shows a 50bp decline in what the median voter expects to be the longer-run policy rate, thus implying that past policy hikes may have created more tightening than desired (when the longer-run rate was still thought to be higher). Led by the

FIGURE 3

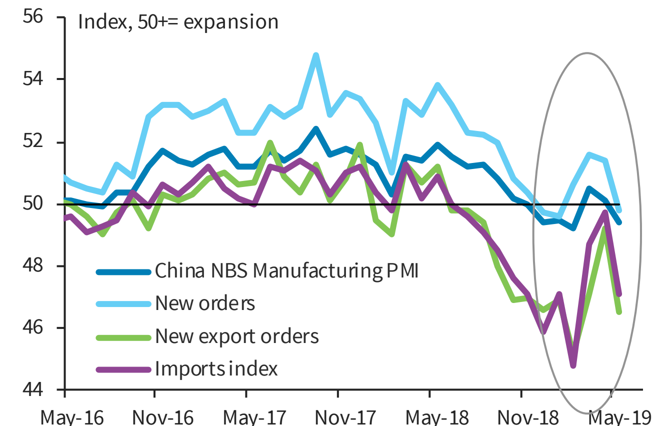
… of protracted high policy uncertainty, mainly from trade…



Source: PolicyUncertainty.com, Haver Analytics, Barclays Research

FIGURE 4

…causing an initial China rebound to be short-lived



Source: CFLP/NBS, Haver Analytics, Barclays Research

Fed, the ECB and others, central banks have signaled their readiness to move from the previous stage of pausing their normalization efforts to providing some fresh stimulus. However, the messages are not for the start of full-fledged rate cutting cycles, but rather limited doses of easing to provide insurance in the face of rising risks to growth and softening inflation expectations.

Assumptions matter more than usual

Overall, the narrative is one of a policy-insured global economy in a prolonged soft patch, rather than at the onset of recession. We now forecast the global economy will expand 3.3% in both 2019 and 2020. This is a 30-40bp sharper slowdown from the 3.9% growth in 2018 than we forecast in March, but still implies core economies to grow broadly around trend, rather than risking contractions. We reduced our growth projections for all of the G-3 economies – the US, the euro area and Japan – for both 2019 and 2020, but the most notable downward revision has been for China. Caused mainly by increased trade and commercial tensions with the US, we no longer expect any rebound in H2 and forecast China's growth will slow to just 5.5% in 2020. The last time China reported sub-6% annual growth was in 1989-90, when its share of the global economy was only a fraction of what it is today. This implies additional risks to our global projections.

A US-China trade deal would raise China growth forecast…

However, given the very high policy uncertainty, underlying assumptions matter more than usual. Most importantly, our China forecast is predicated on a baseline where the US eventually imposes 25% taxes on all Chinese imports – a step that is under preparation by the US administration but that could be averted if Presidents Trump and Xi can reach some sort of deal at the upcoming G20 summit. Hence, in such an event, our forecasts of China growth forecasts would appear too gloomy (by roughly 0.5pp for 2020). At the same time, our forecasts also assume that a no-deal Brexit is avoided and the US will not impose tariffs on EU car imports. Otherwise, each event would shave 0.4pp off the EU's 2020 growth, bringing it to about zero (with Germany possibly in recession). For the UK, we expect a fall back on WTO rules in a no deal to reduce growth about 100bp in 2020.

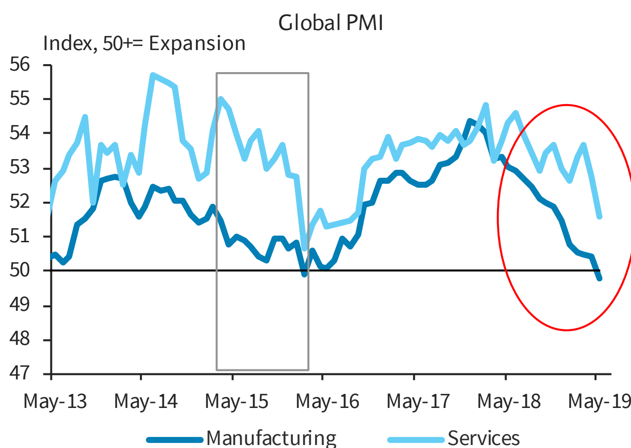
…while US tariffs on EU cars or a no-deal Brexit would cut European growth further

We expect constrained supply to help oil prices to rise in H2

Finally, our forecast for rising oil prices in H2 19 (to $/b 73 average for Brent) are based on not only demand holding up relatively well under our growth assumptions, but also developments in Iran, Venezuela and OPEC decisions to continue to constrain supply. These are reasonable assumptions, but involve geopolitics, which are difficult to predict. Hence, beyond the usual assumptions about fiscal and monetary policies, there is additional need to make assumptions about trade and geopolitical disputes, which creates higher variance around forecasts.

FIGURE 5

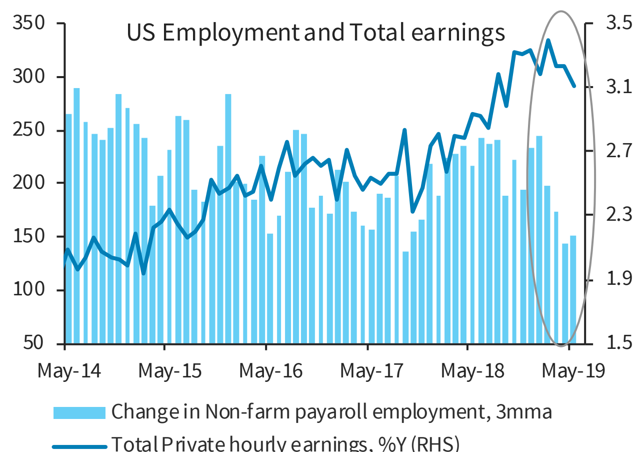
A persistent manufacturing slump would drag down services…



Source: IHS Markit, Haver Analytics, Barclays Research

FIGURE 6

…and eventually also hit the labor market with a lag



Source: BLS, NBER, Haver Analytics, Barclays Research

FIGURE 7

Barclays global growth and inflation forecasts

	* Real GDP (% change)											Inflation (% annual change)					
	Barclays								vs. Mar. GO			Barclays			vs. Mar. GO		
	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	2018	2019	2020	2018	2019	2020	2018	2019	2020	2018	2019	2020
Global#	**3.4**	**3.3**	**3.1**	**3.0**	**3.4**	**3.9**	**3.3**	**3.3**	**0.0**	**-0.3**	**-0.4**	**2.4**	**2.0**	**2.1**	**0.0**	**-0.1**	**-0.2**
United States	3.1	2.0	1.5	1.0	1.5	2.9	2.5	1.6	0.0	-0.2	-0.5	2.4	1.6	2.0	0.0	-0.1	-0.3
Japan	2.2	-0.4	1.0	-3.3	0.8	0.8	0.4	0.4	0.0	-0.2	-0.1	0.9	0.7	0.9	0.0	0.1	-0.1
United Kingdom	2.0	-0.7	1.0	0.5	1.0	1.4	1.1	0.9	0.0	0.0	-0.4	2.5	1.9	1.8	0.0	-0.1	0.0
Euro area	1.6	1.0	0.8	0.6	1.1	1.9	1.1	1.0	0.1	-0.1	-0.4	1.8	1.2	1.1	0.0	-0.2	-0.3
Germany	1.7	0.1	0.4	0.3	1.3	1.5	0.5	1.0	0.0	-0.3	-0.6	1.9	1.5	1.5	0.0	0.1	-0.2
France	1.4	1.4	1.1	1.0	1.2	1.7	1.3	1.2	0.2	0.1	-0.2	2.1	1.2	1.1	0.0	0.0	0.0
Italy	0.5	0.2	0.1	0.0	0.0	0.7	0.0	0.2	-0.1	0.0	-0.4	1.2	0.9	0.9	0.0	-0.4	-0.4
Advanced	**2.4**	**1.2**	**1.2**	**0.3**	**1.3**	**2.2**	**1.7**	**1.3**	**0.0**	**-0.1**	**-0.4**	**2.0**	**1.4**	**1.6**	**0.0**	**-0.1**	**-0.2**
Emerging#	**4.2**	**4.7**	**4.4**	**4.7**	**4.8**	**5.1**	**4.4**	**4.6**	**0.0**	**-0.4**	**-0.4**	**2.9**	**3.0**	**2.9**	**0.0**	**0.1**	**0.0**
EM ex China#	**2.4**	**4.1**	**3.9**	**4.5**	**4.1**	**4.1**	**3.2**	**4.1**	**0.0**	**-0.6**	**-0.3**	**3.7**	**3.5**	**3.6**	**0.1**	**-0.1**	**-0.1**
Brazil	-0.6	1.4	2.1	2.0	1.3	1.1	1.0	2.1	0.0	-1.2	-0.5	3.7	3.9	3.8	0.0	-0.1	-0.2
Mexico	-0.7	1.2	-1.2	0.8	2.8	2.0	0.5	1.5	0.0	-1.3	-0.5	4.9	4.0	4.0	0.0	0.3	-0.2
China	6.9	5.6	5.2	5.1	5.9	6.6	6.0	5.5	0.0	-0.2	-0.5	2.1	2.3	2.0	0.0	0.3	0.0
India	4.1	7.5	8.2	9.0	7.0	7.4	6.5	7.4	0.1	-0.9	-0.1	3.9	3.1	4.3	0.0	-0.4	-0.1
South Korea	-1.5	4.9	3.4	2.2	1.2	2.7	2.2	2.2	0.0	-0.3	-0.3	1.5	0.9	1.3	0.0	-0.4	-0.3
Indonesia	4.3	5.0	5.5	4.5	5.3	5.2	5.0	5.0	0.0	0.0	-0.3	3.2	3.0	3.5	0.0	0.0	0.0
Poland	4.1	5.3	6.1	4.9	2.4	5.1	4.2	3.5	0.0	0.0	0.0	1.8	1.9	3.1	0.0	0.0	0.0
Russia	1.5	-2.2	2.9	2.0	-0.1	2.3	1.0	2.0	0.0	0.0	0.0	2.9	5.0	3.8	0.0	-0.3	0.0
Turkey	5.2	1.2	-6.7	-1.7	11.2	2.7	-2.1	1.6	0.0	-1.5	-0.8	16.2	16.8	12.9	0.0	0.0	0.0
South Africa	-3.2	1.5	1.0	1.6	1.7	0.8	0.2	1.7	0.0	-1.0	-0.5	4.6	4.5	5.3	0.0	-0.3	-0.3
Brent, US$/bbl	64	73	74	73	78	72	71	75									
Fed policy rate, %	2.25-2.5	2.25-2.5	1.5-1.75	1.5-1.75	1.5-1.75	2.25-2.5	1.5-1.75	1.5-1.75									
US treasuries (10Y)	2.41	2.02^	1.95	1.95	1.95	2.69	1.95	-									

Note: * Quarterly data are % over previous period, saar; # Aggregates for CPI exclude Argentina and Venezuela inflation rates and Real GDP excludes Venezuela; ^ Q2 datapoint is as of 24th June (EoP). Source: Haver Analytics, Barclays Research

Regional outlooks: Framed by trade policy and political risks

US: More pronounced deceleration ahead

We have long expected the US economy to gradually decelerate toward trend this year, led by the waning boost from 2018's double dose of fiscal stimulus, a weaker external backdrop, and the lagged effects of the Fed's tightening cycle. Although disruptions from the extended federal government shutdown and financial market turbulence left an adverse imprint on activity in the early portion of the year, the Fed's dovish turn in the new year, combined with the improved data in March, seemingly put the economy on course for a soft landing at the time of our last *Global Outlook*.

Since our March publication, a number of adverse influences on production have become evident, much (but perhaps not all) of which appears to derive from trade tensions and weakness in interest-sensitive components of demand. Revised estimates now show sizeable net declines in manufacturing activity since the turn of the year, driven in part by reduced production of industrial equipment and durable goods more broadly. This weakness has been accompanied by a notable softening of business fixed investment, fed in part by firms putting off capital purchase decisions as they evaluate the viability of existing

global supply chains in light of escalating trade tensions. Finally, with inventory investment having contributed more than 1.0pp, on average, to annualized quarterly GDP growth from Q3 18 to Q1 19, there are also signs that manufacturing will need to contract further in coming quarters as producers grapple with unintended stockpiling.

Inventory build-up and weak business investment suggest more rapid slowdown ahead

With these influences in mind, our baseline now expects a more pronounced deceleration in activity in 2019, with GDP growth dipping below potential growth in the second half of 2019 before returning to trend in Q2 20. However, this projection is clearly accompanied with substantial downside risks – most notably the risk that weakness in the trade-exposed manufacturing sector – which represents just 10-12% of overall US activity – will spill over into the broader economy. With available data still showing household spending on a steady upward march, fueled by the resilient cycle of hiring, gains in household income, additional spending and further hiring that has helped to fuel much of the recovery, we do not view this to be the most likely outcome. As we assess the relative likelihood of a more forceful downturn in coming months, we will be looking for influences that would interrupt the chains of this cycle, such as a drop in consumer confidence, or apprehension about hiring by businesses in non-trade exposed sectors (such as most services). Although it represents only one month of data, the sizeable deceleration of growth in nonfarm payrolls in May (to 75K from 224K in April) seemingly highlights these downside risks, as much of this slowing was focused on the service sector.

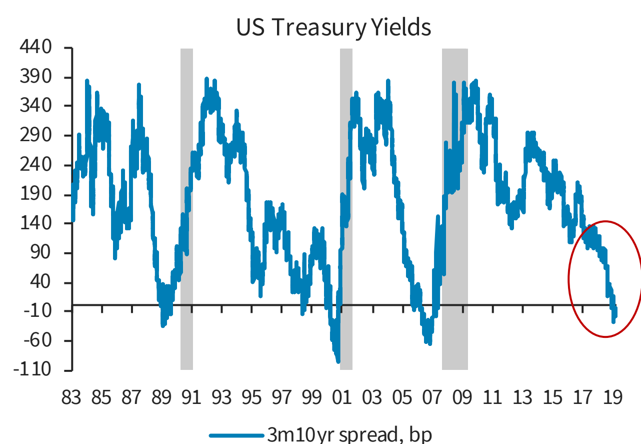
China: Less than 6

Escalation of US tariffs to push Chinese growth to below 6%

Our view of a Chinese re-acceleration from the sharp slowdown in H2 18 was initially supported by improving hard and soft data in late Q1. However, that momentum proved short lived, as China's activity indicators generally moderated again in April-May, pointing to weaker domestic demand amid a deteriorating external environment. Instead of the widely anticipated trade deal, China's relations with the US deteriorated, as the US added further tariffs. In addition, the conflict also widened to include individual companies on the grounds of security and technology concerns. This has significantly changed the outlook for China and thereby also the global growth profile. Although the upcoming G20 summit still offers an opportunity for the Presidents Trump and Xi to find an agreement, at the time of writing we find the most probable scenario one of a controlled deterioration, where the US follows up on the threat to impose tariffs on the remaining USD300bn of Chinese imports and China will retaliates through various channels (as it has less US imports on which it can impose tariffs).

FIGURE 8

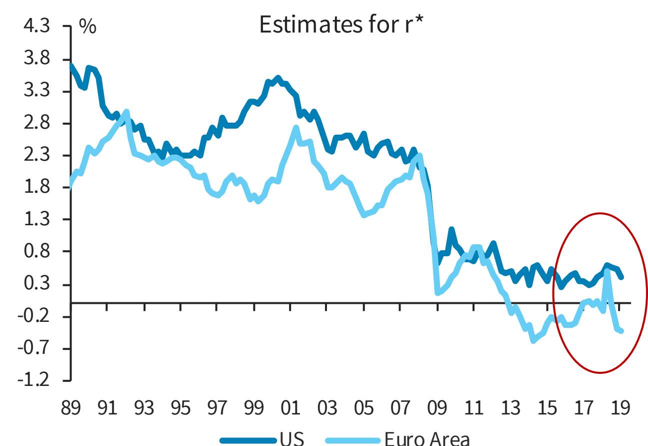
Yield curve inversion has been a good recession predictor…



Source: FRB, Haver Analytics, Barclays Research

FIGURE 9

…but lower bonds yields also reflect lower neutral rates



Source: FRBSF, Haver Analytics, Barclays Research

We believe the deterioration in the trade situation is already showing its effects. Although the additional tariff hikes on USD200bn of Chinese imports were not effective until 15 June, May data – including the PMI, industrial production, investment, imports, export orders and core inflation – already showed deterioration. A better-than-expected rebound in retail sales, benefiting from holiday distortion, provided the only bright spot in May, although the average for April-May is still slower than Q1.

Our growth forecasts assume US tariff on all Chinese goods

Consequently, we lowered our 2019 GDP growth forecast to 6.0%, implying a weakening of momentum during Q2-Q4 from the robust 6.9% q/q saar expansion in Q1. According to our analysis, our assumption of all Chinese imports to the US being subject to a 25% tariff, will reduce full-year growth by about 100bp. Assuming some policy domestic response, we still believe annual growth in 2020 will slow to just 5.5%. By the same token, a US-China agreement at the G20 that keeps existing tariffs, but avoids the additional tariffs on USD300bn of imports could prop up our 2019 growth forecast to c.6.2% and c.5.8-6.0% in 2020. Under even more optimistic de-escalation scenarios, where existing tariffs are reduced again, growth projection could improve further.

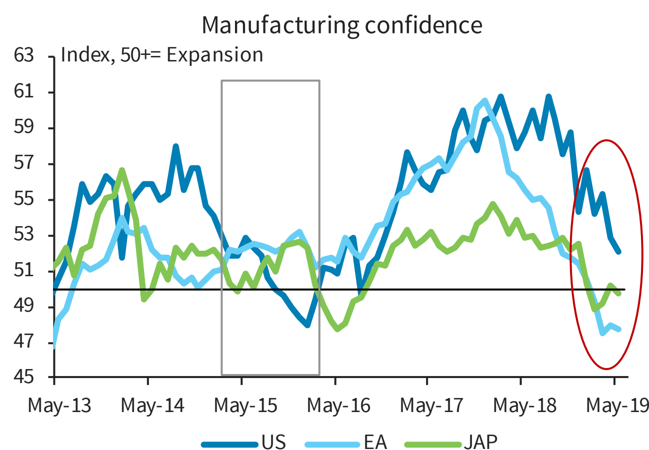
Our current forecast assumes the government to accept lower growth. It would refrain from aggressive easing and large credit-driven stimulus, using more targeted easing instead to support growth and employment. Although monetary easing will likely play a role (more below), we think fiscal policy will be the main pillar by: 1) stepping up financing for still-weak infrastructure investment, including likely increasing 2019 quota for local-government special bonds and relaunching the special construction fund; 2) more targeted fiscal support (eg, tax exemptions) for industries hit by tariffs and general employment; and 3) follow-through on the earlier committed sizable tax cuts and ensure implementation at the local level.

Euro area: Suffering from openness

As the most open among the advanced economic regions, the euro area suffers most from the deterioration in the external environment. With manufacturing PMIs having stabilized below the expansionary 50 threshold in Q2, it is now clear that the positive growth surprise in Q1 was not the beginning of a notable rebound after the marked slowdown in activity during 2018. In light of the ongoing trade tensions between the US and China and the looming threat of tariffs on EU exports into the US, prospects for the tradable sector remain bleak, leaving net exports to remain a drag on euro area growth in coming quarters.

FIGURE 10

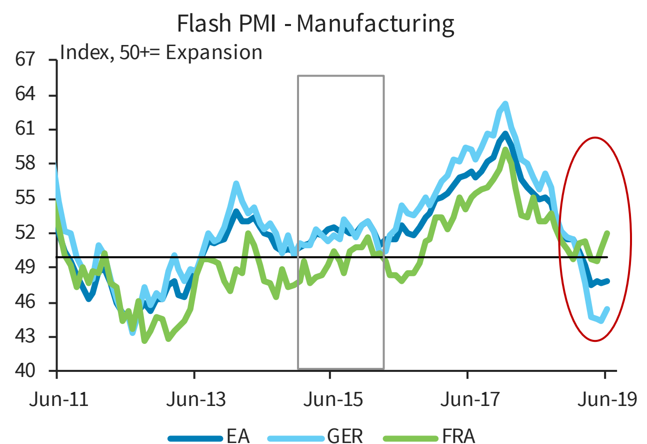
US growth dynamics remain stronger than in the rest of G3



Source: ISM, IHS Markit, Haver Analytics, Barclays Research

FIGURE 11

… while in the euro area, France pulled ahead of Germany



Source: IHS Markit, Haver analytics, Barclays Research

In contrast, domestic demand, and especially private consumption, should remain resilient this year. Labor markets are still on a solid footing, as the euro area unemployment rate has been on a steady declining trend (to 7.8% in Q1 19), while labor force participation has been rising and wage growth improving in parallel. Despite some preliminary signs that hiring intentions might have begun to slow, we expect this healthy labor market momentum to hold for coming quarters, continuing to support consumption. Moreover, the euro area also looks set to experience the largest fiscal easing in a decade – our estimates suggest the aggregate structural budget balance will decline by 0.4pp in 2019, adding c.0.2pp to GDP growth this year. As discussed in more detail below, the ECB seems ready to act again, determined to maintain the very favorable borrowing conditions and ample liquidity to accommodate the still fairly stable credit demand for investment coming from the real economy.

France is expected to grow at twice the rate than Germany this year, while Italy stagnates

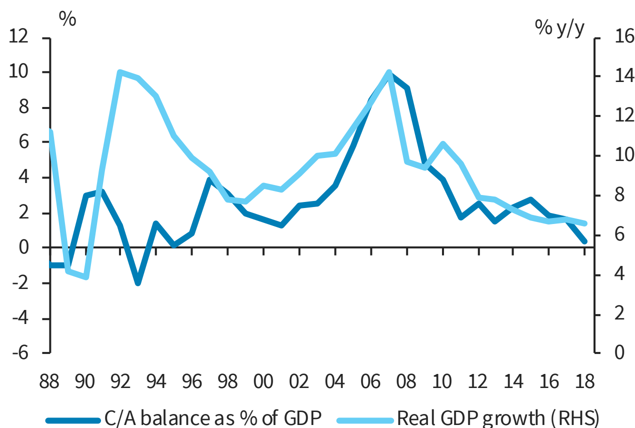
Taken together, this should prevent the weakness in trade and investment from translating into a hard landing. Thus, although we downgraded our euro area growth forecasts further since the March *GO*, we still expect a soft landing toward potential, averaging 1.1% in 2019 and 1.0% in 2020. However, within the euro area the adjustments varied, reflecting the different structures of the economies. While we still expect France's more service-driven economy to grow 1.3% in 2019 and 1.2% in 2020, Germany's reliance on manufacturing and exports has led us to reduce our forecasts to just 0.5% and 1.0%, respectively for the same years. While Italy's protracted political uncertainty, possibly culminating in another budget stand-off with the EU this fall, suggests economic growth will remain broadly flat in 2019-20. On the other hand, Spain continues to perform well (2.2% in 2019 and 1.6% in 2020), even if at a slower pace than in previous years.

No-deal Brexit and US tariffs biggest deal for Q4

The risks to euro area growth remain tilted to the downside, however. In addition to the uncertainties around demand from China and many other EM economies so relevant for Europe, the potential imposition of US tariffs on EU car imports and a potential no-deal Brexit loom large over the growth outlook. Those two events could shave off 0.4pp each of euro area growth in 2020, which would drive the euro area close to stagnation (and Germany likely into recession). Further out, fresh EU reform momentum regarding banking and capital markets union, as well as fiscal and/or infrastructure initiatives could boost sentiment and activity. However, the ongoing negotiations around the EU leadership positions at the Commission, Council and ECB, and the political challenges not only in Italy but also within Germany's grand coalition, do not bide well for any such reform drive.

FIGURE 12

China's GDP growth and external balances are changing…



Source: CNBS, Haver Analytics, Barclays Research

FIGURE 13

…as consumption replaces investment as driver of growth

Source: CNBS, Haver Analytics, Barclays Research

Japan: Slowing below potential

Given its relative openness, manufacturing focus and close commercial relations with China, Japan's economy feels the consequences from the global developments. Given that we lowered our expectation for net exports and factored in the likely resulting drag on corporate earnings and private capex, we cut our forecast of Japan's GDP growth to 0.4% for both 2019 and 2020. This would be half the 0.8% achieved in 2018, significantly below the average 1.4% annual growth Japan has achieved since the 2008-09 GFC and also below the BoJ's estimate of potential growth (0.7%).

Consumption tax hike could create contraction in Q4

Upside risks to this scenario stem not only from a potentially less pronounced slowdown in China as a consequence of some trade deal with the US, but also from some possible upside by better-than-expected corporate investment and/or more expansionary fiscal policies. First, an acceleration of the recent trend of labor-saving/rationalization investment through capital deepening (higher capital equipment ratios to boost labor productivity) could be a secular growth driver. Second, there still could be a switch to expansionary fiscal policy through increased expenditure backed by supplementary budgets or, though it appears unlikely at this stage, a delay or suspension of the October consumption tax hike, depending on economic and political developments.

UK: In search of direction… a no-deal exit not excluded

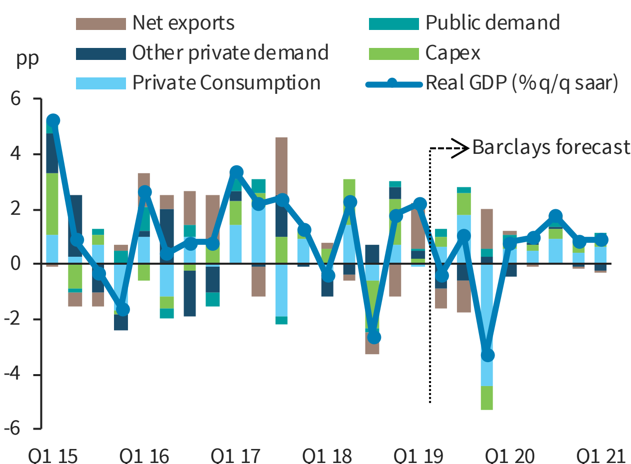
The UK economy is experiencing the headwinds of the persistent political uncertainty and the perception of increased risks of a no-deal Brexit under a prospective new Tory PM. Combined with the unwind of the Brexit-related inventory build in Q1, this weighs on the outlook for activity. April GDP contracted 0.4% m/m, providing a very poor start to Q2 activity. Much of the downturn in manufacturing was caused by car factory closures, as auto makers brought forward production stoppages that normally take place over the summer. However, weakness extended beyond manufacturing, with construction and services sector also subdued, thus implying a mild contraction in Q2.

A sharp inventory unwind, with indications that labor markets will soften

A temporary period of weakness had been widely expected; however, PMI surveys highlighted difficulties securing new contracts, while survey respondents also flagged that supply chains had started to be diverted away from the UK. This implies that beyond the temporary inventory unwind, longer-term shifts in client demand are at play. The labor market has held up well, with the unemployment rate at 3.8%, a multi-decade low. However, as recruitment agents continue to signal permanent job placements declining steadily since March, labor market conditions look to soften in coming quarters, in our view.

FIGURE 14

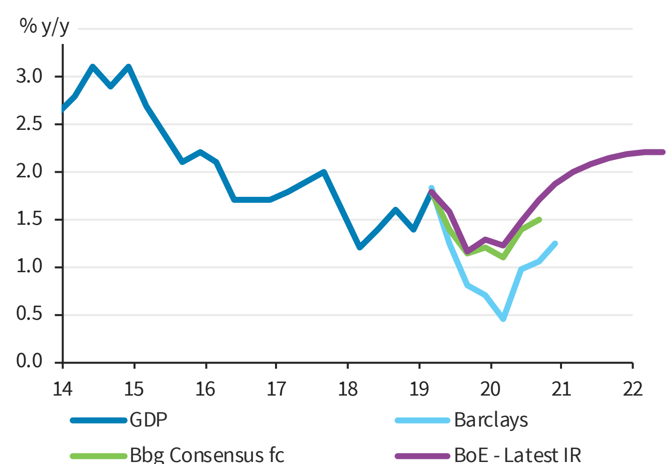
Japan's consumption tax could cause contraction in Q4



Source: CAO, Haver Analytics, Barclays Research

FIGURE 15

On UK growth, we project a sharper slowdown



Source: Bloomberg, BoE, Barclays Research

Therefore, we downgraded our growth outlook over the coming quarters to reflect the backdrop of increased domestic and global uncertainty. We now expect 2019 GDP growth of 1.1% y/y (-0.1pp) and 0.9% y/y (-0.3pp) in 2020. We adjust the profile for Q3 and Q4, which straddle the October Brexit deadline, to reflect another inventory-led fluctuation and also weaker global trade. Our growth profile is far weaker than the BoE's May Inflation Report growth forecast. However, following the downgrade of its Q2 GDP forecast in the June MPC minutes, we expect downward risks to the MPC's annual growth forecasts over the coming months.

EM: Pressures from global trade, relief from easy money

EM economies are feeling the pressure, and some relief, at the same time. The weakness in global manufacturing and trade clearly adversely affects EM economies, while the US-China trade tensions also fuel deeper concerns about the future of the multilateral trading order. A shift toward less liberal trade regimes and bilateral tariff negotiations would have negative the implications for many the small, open EM economies that are integrated into global value chains and dependent on trade. Moreover, regardless of the recent geopolitical-driven rebound in oil prices, commodities are unlikely to provide the support they did in the past. That said, this is in part offset by the monetary accommodation in the core economies. In the absence of inflation pressure, the Fed, the ECB and others have signaled renewed easing, easing concerns held not long ago that policy normalization in the core could dry up USD liquidity and lead to capital reversals from EM.

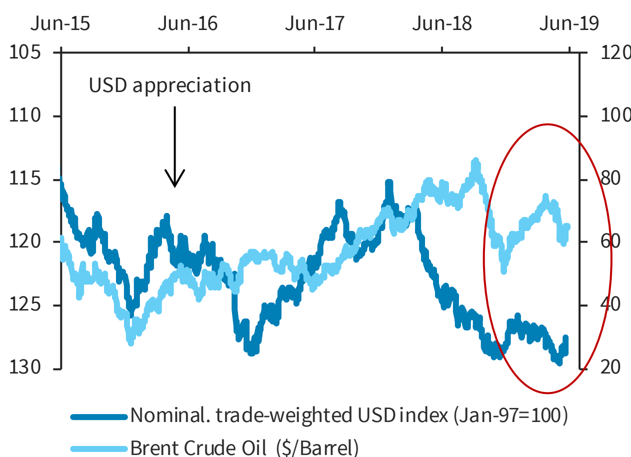
EM Asia broadly weaker, while more closed economies (India) in better position

Against this backdrop, the economic outlook for EM Asia has darkened considerably. The region's most open economies – Taiwan, Korea and Singapore – are likely to be hit first, as growth in major economies slows and the tech cycle droops. Others, such as Malaysia, the Philippines and Thailand, look similarly exposed. The larger, more closed economies of India and Indonesia are likely to be least affected. We have lowered our GDP growth forecasts for the EM Asia region (ex-China) to 5.0% for 2019 and 5.5% for 2020.

South Africa and Turkey also suffer from domestic issues

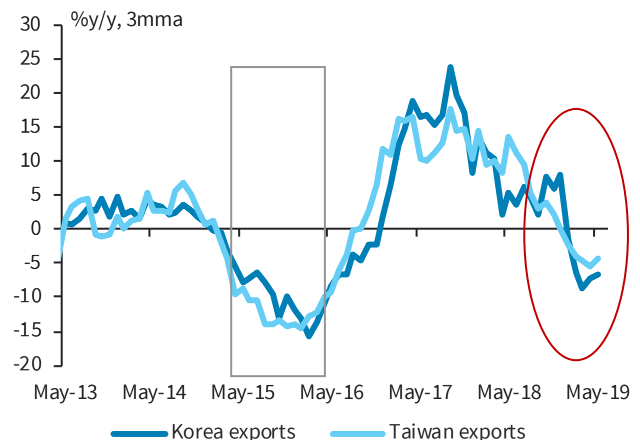
In the EEMEA region, some of the larger economies, especially South Africa and Turkey, continue to be heavily affected by idiosyncratic factors. The exceptionally weak Q1 growth in South Africa highlighted the economy's fundamental structural weaknesses, as well as its vulnerability global trade tensions. We revised our 2019 growth forecast downward to just 0.2% and see only a modest acceleration to 1.7% in 2020. In Turkey, we expect a deeper economic contraction this year (-2.1%) than we forecast in March, followed by a modest rebound in 2020 (+1.6%). These revisions are driven by extended FX pressures, delayed policy easing, and lingering uncertainty, especially the risks of US sanctions related to Turkey's purchase of Russian air defense missiles.

FIGURE 16
Oil should re-strengthen and USD weaken in coming months



Source: FRB, FT, Haver Analytics, Barclays Research

FIGURE 17
EM Asia's manufacturers suffer most from trade tensions



Source: KCS, MoF, Haver Analytics, Barclays Research

Central European economies' robust growth stands out

The Russian economy slowed sharply at the start of the year, to just 0.5% y/y for Q1, as the increase in the VAT hit consumption and a number of investment projects came to an end. However, recent high-frequency data suggest a recovery in activity, which would support our forecast of a modest GDP expansion of 1.0% this year. As is often the case, central Europe's economies stand out in the region. Activity surprised on the upside in both Poland and Hungary, as domestic demand accelerated further, more than offsetting weakness in export-oriented sectors. We keep our growth forecast for 2019 unchanged for Poland at 4.2%, and after a very strong Q1, we raise our 2019 growth forecast for Hungary to 4.0%.

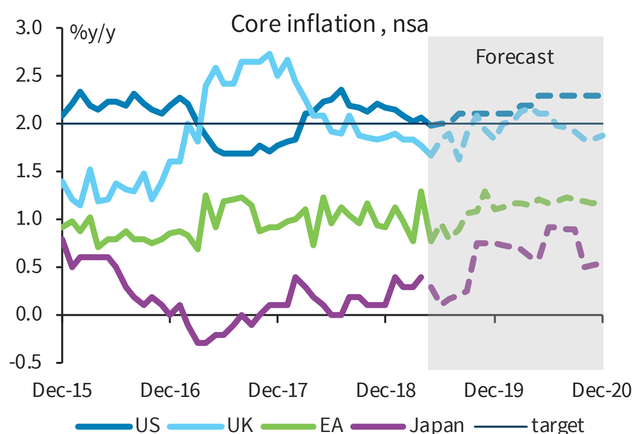
Political uncertainty weighs on LatAm region

In LatAm, heightened political uncertainty has become an important common theme. In Brazil it remains unclear whether political conditions will allow the reform agenda to advance, especially sufficiently ambitious pension reform. In Mexico, doubts are mounting about the new government's policy intentions, with Pemex debt sustainability lingering as a major risk. In Argentina, the future of the IMF program could become dependent on the outcome of the presidential election, which itself has become key determinant of peso stability and, thereby, inflation and growth dynamics.

As a consequence, we continue to see Argentina's economy contracting (-0.7) for another year in 2019, and we again lowered our growth forecasts for the largest economies Brazil and Mexico. In Brazil, we forecast growth will reach only 1.0% this year, based on the available data for Q2 and our view that the recovery in H2 will be softer than we earlier expected. Assuming only gradual improvement in domestic sentiment and softer Chinese demand, we expect growth to pick up to only 2.1% in 2020. Mexico's economy is quickly losing steam, worse than our expectation of a short-lived deceleration. We expect the private sector to remain cautious, slowing employment creation and investment activity. We expect Mexico's economy to expand just 0.5% in 2019 and 1.5% y/y in 2020. The upside risk to our forecast is a faster-than-expected resolution of the Pemex situation, leading to quicker recovery in confidence.

FIGURE 18

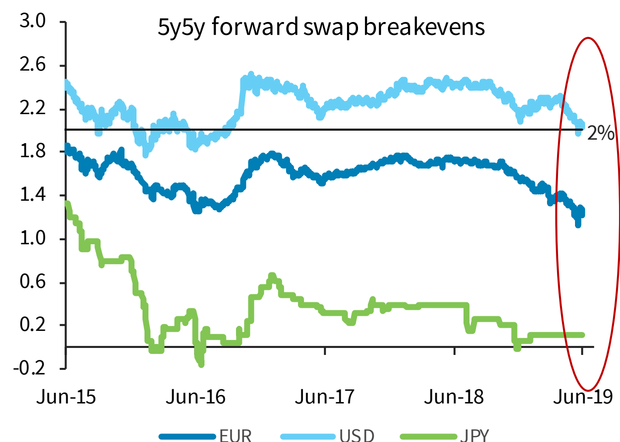
Core inflation has softened recently and is projected to rise only modestly …



Source: BLS, ONS, MIC, Eurostat, Haver Analytics, Barclays Research

FIGURE 19

… but market expectations are painting a gloomier picture of further weakening inflation dynamics



Source: Bloomberg, Barclays Research

Monetary policy: Back to easing

Fed: Taking out insurance

Just when the Fed seemed to be settling into the patient policy stance it had adopted with its dovish turn early this year, the FOMC shifted course again in June by signaling a high likelihood of cuts to its policy rate. The decision to not cut rates in June was seemingly a close call: although the median dot showed no expected change in the policy rate this year, 8 of the 17 participants on the plot expected at least one cut in 2019 and 7 of these showed two cuts. This was a distinct change from its March meeting, when no participants expected cuts this year, and six expected tightening in 2019. In light of incoming data since March and the outcome of the June meeting, we now forecast a 50bp cut in the funds rate at the July FOMC meeting followed by another 25bp cut in September.

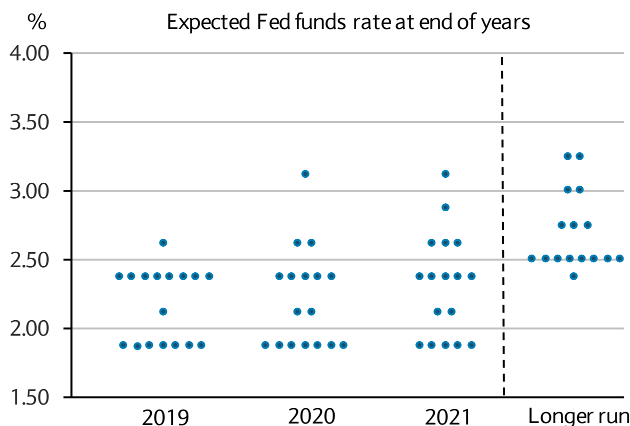
We expect the Fed to cut 75bp, starting in July

The FOMC's desire to provide policy support apparently has two broad motivations. The first is a desire to act pre-emptively against recessionary risks brought on by escalating trade tensions, a risk that is magnified by the relative proximity of the zero lower bound and the feared loss in policy traction once it is hit. Although Chair Powell was careful to point out that the economy was likely to remain in expansion, he communicated that weakness in global demand and business fixed investment had skewed risks to the downside, making the expansion more fragile.

The second motivation is soft inflation, which has been running persistently below the Fed's 2% target. The committee took a larger-than-expected signal from this weakness in the June projections, projecting that core PCE inflation would continue to run short of the target in 2019 and 2020. Persistent inflation softness also seemingly led participants to conclude that the policy stance was tighter than previously thought, with the median assumption about the neutral policy rate down 0.3pp relative to March. This marked a notable shift, with most participants earlier in the year having dismissed much of the lingering inflation shortfall to transitory factors. In our view, this shift would be sufficient to prompt cuts to the policy rate this year even in the event of a significant de-escalation in US-China trade tensions.

FIGURE 20

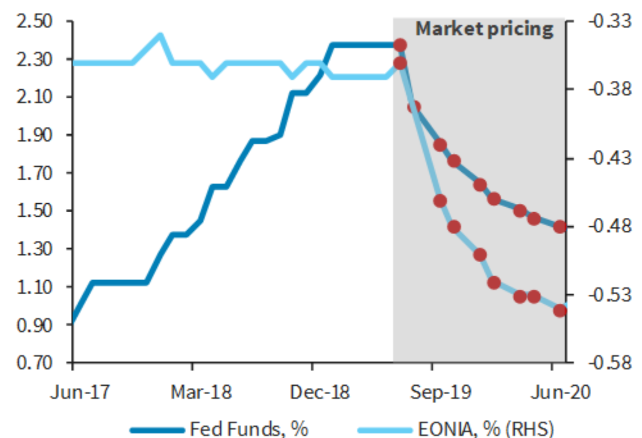
Eight FOMC members project rate cut(s) by year-end …



Source: Federal Reserve, Barclays Research

FIGURE 21

… and markets are pricing cuts by the Fed and the ECB



Source: Barclays Live, Barclays Research

ECB: Whatever… is needed

We now predict ECB's depo rate to be reduced to -70bp by Q2 2020…

ECB President Draghi used his speech at the ECB's annual Sintra Forum to send a forceful message. Against the backdrop of persistent below-target inflation and a steady decline in inflation expectations over the past six months or so, Draghi stressed that the ECB was not resigned to accepting inflation settling significantly below its 2% target, that it still had sufficient policy ammunition, and that it was ready to use it. The notable emphasis on "symmetry" around the 2% target, on downside risks, on policy action being triggered by an "absence of improvements" (which are baked into the ECB's current projections), on policy rate cuts *and* "mitigating measures," but also on remaining headroom in asset purchases all suggest to us a forthcoming policy effort.

Design of 'mitigating measures' for banks to be crucial

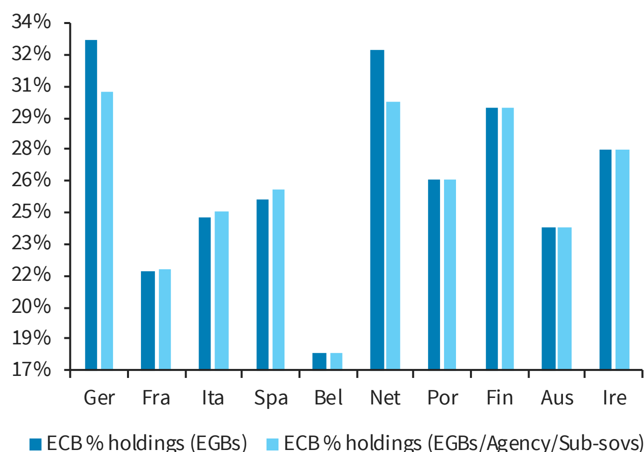
Although incoming data and events over the coming weeks could alter this outlook, we expect the following path of ECB action: 1) at the July meeting, make explicit the downward bias in rates in its forward guidance (ie, "at current rates *or lower*"); 2) at the September meeting, present downward revisions in the ECB's macro projections for the euro, which then trigger 3) the first 10bp deposit rate cut in September, followed by cuts in December and March, bringing the deposit rate to -70bp by Q2 20; 4) accompanied by mitigating measures (ie, tiering of deposits) for banks; and eventually, 5) restart the asset purchase program (APP) in January 2020 on a limited scale (eg, EUR30bn per month).

BoJ: No reversal on reversal rate

In a week when both the Fed and ECB sent dovish signals, the BoJ Policy Board wrapped up its two-day monetary policy meeting (19-20 June) without any such surprise. While maintaining its current policy stance in a 7-2 majority decision, it gave no indications that it was contemplating any additional easing measures. However, potential Fed and ECB actions in coming months could result in further yen strength and add to the market's expectation for the BoJ to respond with further easing as well. In such a situation, the BoJ seems more constrained than even the ECB. In particular, it has been highlighting regularly the negative side effects of its NIRP policy, starting with a speech by BoJ Governor Kuroda in November 2017 that made explicit reference to the "reversal rate": the tipping point after which negative interest rates would no longer be expansionary but become contractionary due its negative effects on financial institutions' profitability. In contrast, the ECB acknowledged the theoretical concept of a reversal rate early on, but has consistently emphasized that such effects were not (yet) discernible in the European banking system.

FIGURE 22

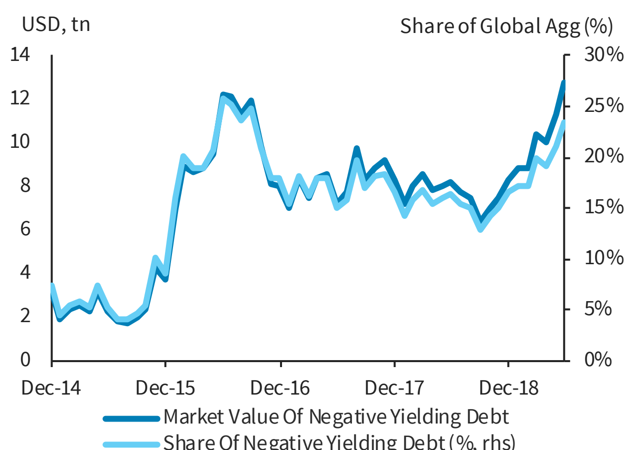
ECB's Draghi is also not excluding renewed asset purchases, possibly beyond the existing self-imposed restrictions



Source: Bloomberg, ECB, National Treasuries, Barclays Research

FIGURE 23

Expectations of further central bank easing have driven the global share of negative yielding bonds to record highs



Source: Bloomberg, Barclays Research

Therefore, it could be very difficult now for the BoJ to revise its view on the reversal rate. Instead, we believe it would react to a tightening of financial conditions by: 1) further strengthening its forward guidance on policy rates; an 2) expanding its qualitative easing (QE), for example, by lifting its guideline for annual ETF purchases to JPY8-10trn from the current JPY6trn, which has relatively fewer side effects.

BoE: Mixed message

Recent weakness in UK activity data and dovish Fed and ECB messages put pressure on the BoE to explain its guidance that policy tightening at a "gradual pace and to a limited extent" would be required to deliver inflation to target. Speeches by MPC members expressed different views, with the majority still reiterating the need for a gradual pace of rate hikes (Broadbent, Haldane and Saunders), and others highlighting the increase in downside risks to the global and domestic outlook (Vlieghe).

BoE's guidance for rate hikes not credible to market

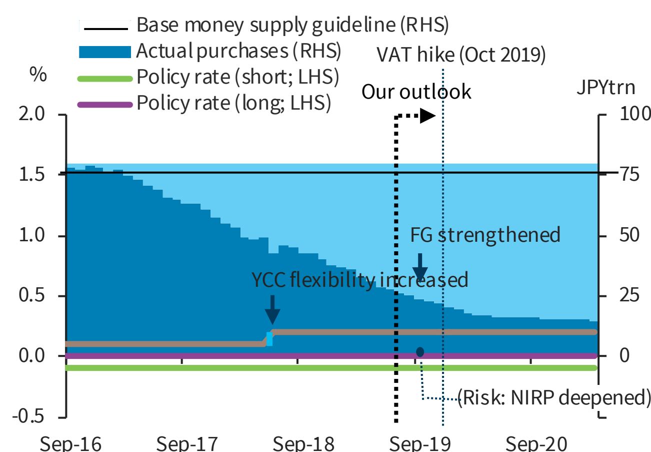
Although the BoE left the established language of a tightening bias in place at its June meeting, it did highlight downside risks to the economy from both domestic and international sources and Bank staff cut its growth "nowcast" for Q2. Notably, the Bank acknowledged the clear difference of view between its assumption of a smooth and orderly Brexit and the more pessimistic assumption embodied in market pricing. Against this backdrop it will be difficult for the BoE to manage shifting market pricing back toward pricing in hikes over the forecast horizon. We maintain our view of unchanged rates through 2019 and 2020, as even with an orderly Brexit, the macro backdrop does not currently appear to justify a move in rates in either direction.

PBoC: Beyond 7.0

The escalating trade tensions with the US have further complicated the PBoC's life, as it searches the right balance between its goals of supporting economic activity and maintaining stability. Following the sharp slowdown in 2018, which was driven in large part by its earlier intentional tightening (including through regulations) to promote deleveraging, the PBoC clearly shifted toward a more accommodative stance, also expressed in part by the across-the-board RRR cuts in January. At the same time, it was clear that the PBoC remained concerned about well-identified debt and financial risks, avoiding any suggestion that a large monetary stimulus was underway. Instead, it has continued to employ targeted measures to ensure sufficient liquidity in the interbank market and to repair the credit channels hurt by a city commercial bank takeover,

FIGURE 24

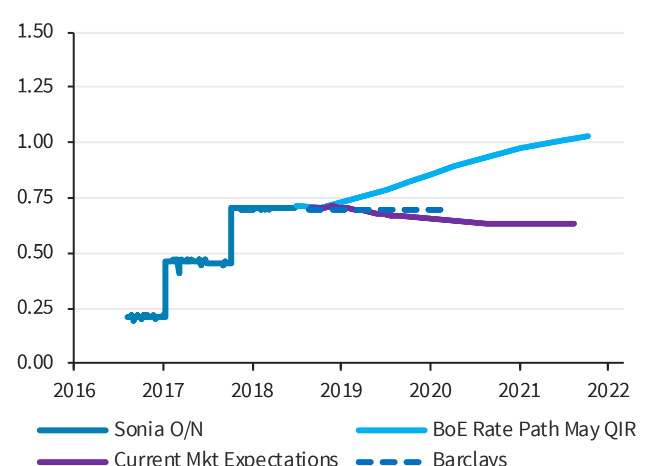
Japan's BoJ may prefer increased QQE over deeper NIRP



Source: BoJ, Barclays Research

FIGURE 25

Market expectations unfazed by BoE's forward guidance



Source: Bloomberg, BoE, Barclays Research

Faced with lower growth, a deteriorating current account and US tariffs, the PBoC will not resist CNY to break '7.0'

Importantly, by keeping the CNY exchange rate versus the USD stable – and even letting it appreciate it somewhat during a period of poor data from November to January, the PBoC signaled to the US its willingness to cooperate on the bilateral trade issues. This changed after the prospects of a trade deal with the US deteriorated, and the CNY weakened sharply during May – albeit not beyond the unofficial threshold of 7.0/USD. At the time of writing, some of the recent appreciation of the CNY seems to reflect a perceived increase in the likelihood of a deal still to be reached between the US and China at the upcoming G20 summit. By the same token, however, it raises the question whether the PBoC would still try to maintain this de facto "upper limit" on CNY against USD if no deal is reached. In a scenario where China's growth slows further, inflation pressures remain well contained and large current account surpluses are a thing of the past, it would make less and less sense to stand in the way of a market-driven adjustment toward a weaker CNY. At the same time, the PBoC also seems able to avoid the seemingly large, uncontrolled depreciations that generated stability concerns in 2015-16.

Hence, depending on the outcome of US-China negotiations at the G20 summit, the PBoC may adopt more aggressive easing measures, facilitated by the Fed's dovish turn. While China's monetary policy will still be more reactive (data- and risk-dependent) than pre-emptive, our baseline scenario of a further escalation in US tariffs on Chinese imports assumes the PBoC will respond to the weakened growth outlook. We expect it to guide interest rates lower via increased liquidity injections, targeted and broad-based RRR cuts (by additional 100bp or more), and policy rate cuts (including guiding lower the loan prime rate) – likely following the Fed – and also by allowing the CNY to depreciate to 7.20 against the USD over the next 12 months.

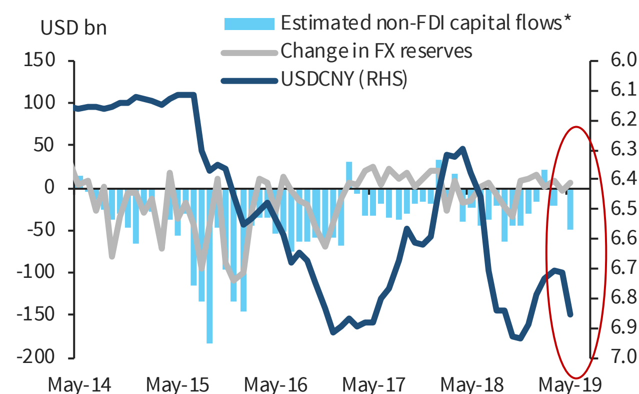
EM: Cut if you can

With softer growth, limited inflation pressures globally, and with advanced markets' central banks – led by the Fed and with very few exceptions (UK, Norway) – having signaled monetary easing ahead, EM central banks are largely following the same script.

In most EM Asia economies, weaker growth means that output gaps will turn or remain negative over the next 6-12 months, creating room for monetary policy support. We now expect more monetary easing in Indonesia, Korea, Malaysia, the Philippines, Singapore and Taiwan, while flagging risks of further easing in India and Thailand. In India, where the RBI has already delivered 75bp of rate cuts, we see another 25bp reduction in the repo rate in August, with risks of an extended easing cycle, dependent on the extent of the growth

FIGURE 26

PBoC could let the CNY depreciate against the USD past 7

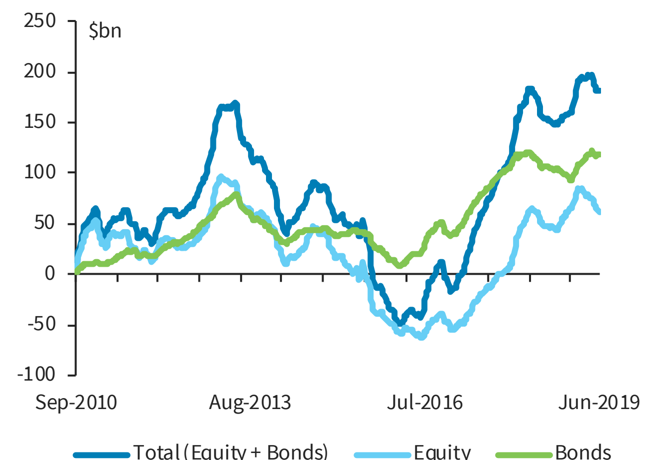


* Estimated capital flows = change in FX purchase position - trade balance - net direct investment + change in FX deposits

Source: Barclays Research

FIGURE 27

Risk of large scale capital flow reversals from EM has faded

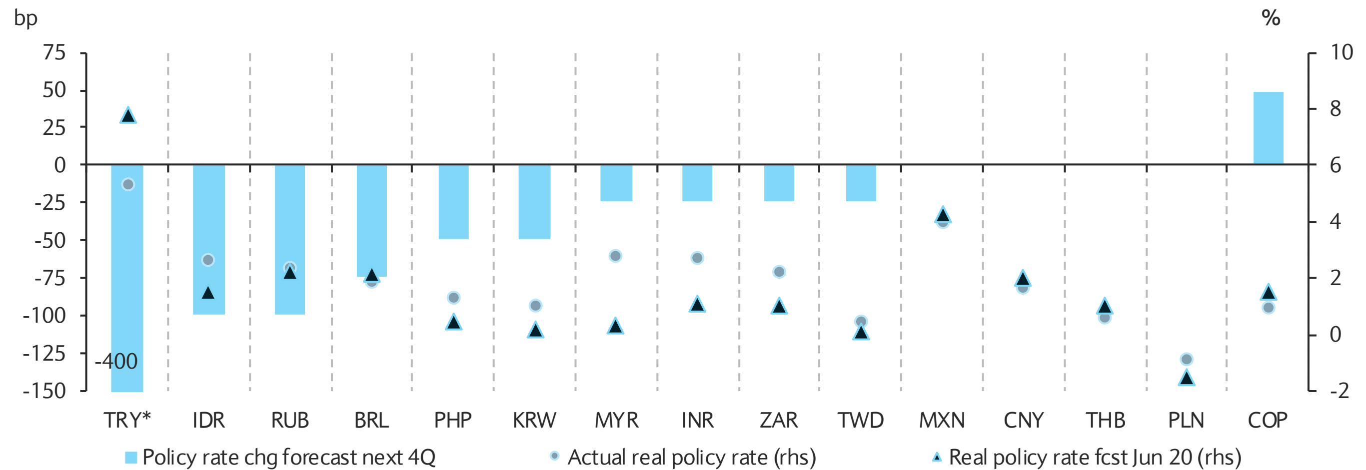


Source: EPFR, Barclays Research

weakness. They will be followed by Indonesia, which is expected to cut rates 100bp by Q1 20, and the Philippines, where we expect another 50bp of easing. In Malaysia, we expect a cumulative 50bp of cuts through 2019, while Singapore will likely also reduce the pace of gradual appreciation in its SGD NEER in October. Korea is also expected to deliver 50bp of cuts through 2020, starting next meeting in July.

FIGURE 28

EM central banks are forecasted to follow the Fed and reduce policy rates in coming quarters



Source: Bloomberg, Barclays Research

In EEMEA, we have brought forward our forecast for interest rate cuts in Russia, as fears of currency depreciation from new US sanctions have eased and inflation has consistently come in below expectations. We now expect Russia's key rate to end the year at 7.00%. In South Africa, inflation has remained within the SARB's 3-6% target range since April 2017, and we now expect it to remain there over the next two years. With two of five MPC members having already called for a rate cut at the May meeting, we expect the SARB to take advantage of the window of opportunity and ease rates 25bp, to 6.50%, at its 18 July MPC meeting and then stay on hold through 2020. In Turkey, inflation has been in line with the midpoint of the central bank's forecast range so far this year, despite the TRY's depreciating 15% against the basket. A favorable base should accelerate disinflation in Q3 19, before it rebounds in Q4 19. We expect the central bank to feel increasingly comfortable with the level of headline inflation and deliver the first rate cut of 200bp in July, followed by another 200bp in September, lowering the one-week repo rate to 20% by year-end.

In Central Europe, the ECB's recent dovish shift provide further support for central banks in Poland and Hungary to keep policy loose despite robust growth. We still expect the NBH to reduce the outstanding stock of FX swaps further in the coming months, thus withdrawing some of the previously injected monetary stimulus, but we now expect interest rate hikes to come only in 2020. The domestic pressures are less pronounced in Poland and we do not expect any change in monetary policy there until next year.

In LatAm, the largest change in our policy rate forecasts is in Brazil. We now expect the BCB to reduce the Selic rate 75bp by year-end, to 5.75%. This is driven by the large negative surprises on domestic growth and an external backdrop favorable for monetary easing, both of which have filtered into the BCB's inflation forecasts. In Mexico, however, Banxico is likely to keep the reference rate steady at 8.25% for the rest of the year. The board has made clear that the stickiness of core inflation is a main concern and rate cuts should not be expected in the short term, as the economy still faces significant risks, particularly a potential downgrade to Pemex, with consequences for financial markets.

FIGURE 29

Global Forecasts (1): GDP and CPI inflation: Barclays Research projections

		Real GDP					Real GDP			Consumer prices				Consumer prices		
		% over previous period, saar					% annual change			% over a year ago				% annual change		
	Weight[#]	1Q19	2Q19	3Q19	4Q19	1Q20	2018	2019	2020	1Q19	2Q19	3Q19	4Q19	2018	2019	2020
Global*	*100.0*	3.4	3.3	3.1	3.0	3.4	3.9	3.3	3.3	2.0	2.2	1.9	1.9	2.4	2.0	2.1
Advanced	*41.5*	2.4	1.2	1.2	0.3	1.3	2.2	1.7	1.3	1.5	1.5	1.2	1.3	2.0	1.4	1.6
Emerging*	*58.5*	4.2	4.7	4.4	4.7	4.8	5.1	4.4	4.6	2.8	3.2	2.9	2.9	2.9	3.0	2.9
BRIC	*39.8*	5.2	5.0	5.5	5.5	5.3	5.9	5.3	5.4	2.4	3.1	2.9	2.9	2.6	2.8	2.6
Americas*	*26.2*	1.9	2.2	1.5	1.3	1.5	2.4	2.0	1.8	2.0	2.2	1.7	1.7	2.7	1.9	2.3
United States	*18.7*	3.1	2.0	1.5	1.0	1.5	2.9	2.5	1.6	1.6	1.8	1.4	1.4	2.4	1.6	2.0
Latin America*	*7.4*	-0.9	2.7	1.6	2.3	1.5	1.3	1.0	2.2	3.9	4.1	3.4	3.6	3.9	3.8	3.8
Argentina	*0.8*	-0.9	7.0	1.6	3.2	2.0	-2.5	-0.7	2.2	51.8	56.2	50.8	40.1	34.3	49.1	27.9
Brazil	*3.1*	-0.6	1.4	2.1	2.0	1.3	1.1	1.0	2.1	4.1	4.3	3.4	3.7	3.7	3.9	3.8
Colombia	*0.7*	0.0	6.5	5.0	4.0	2.0	2.6	3.2	3.7	3.4	3.2	3.3	3.3	3.3	3.2	3.3
Mexico	*2.4*	-0.7	1.2	-1.2	0.8	2.8	2.0	0.5	1.5	4.1	4.3	3.8	3.9	4.9	4.0	4.0
Peru	*0.4*	-5.3	5.4	7.9	8.1	-6.7	4.0	2.8	3.5	2.1	2.6	2.3	2.3	1.3	2.3	2.3
Venezuela	*0.3*	-	-	-	-	-	-20.1	-32.0	10.5	-	-	-	-	-	-	-
Asia/Pacific	*49.4*	5.0	5.1	5.0	4.7	5.1	5.5	5.0	4.9	1.6	2.1	1.9	2.1	2.0	1.9	2.0
Japan	*5.1*	2.2	-0.4	1.0	-3.3	0.8	0.8	0.4	0.4	0.8	0.6	0.3	1.0	0.9	0.7	0.9
Australia	*1.2*	1.6	2.6	3.0	2.6	2.0	2.8	2.0	2.4	1.3	1.5	1.3	1.3	1.9	1.4	1.8
Emerging Asia	*43.1*	5.4	5.8	5.5	5.7	5.6	6.2	5.6	5.5	1.8	2.4	2.3	2.4	2.3	2.2	2.3
China	*23.1*	6.9	5.6	5.2	5.1	5.9	6.6	6.0	5.5	1.8	2.7	2.5	2.4	2.1	2.3	2.0
Hong Kong	*0.4*	5.4	4.9	2.4	-2.4	3.6	3.0	2.0	1.5	2.2	2.6	1.9	2.2	2.4	2.2	2.1
India	*9.7*	4.1	7.5	8.2	9.0	7.0	7.4	6.5	7.4	2.5	3.0	3.1	3.6	3.9	3.1	4.3
Indonesia	*3.2*	4.3	5.0	5.5	4.5	5.3	5.2	5.0	5.0	2.6	3.0	3.1	3.4	3.2	3.0	3.5
South Korea	*2.0*	-1.5	4.9	3.4	2.2	1.2	2.7	2.2	2.2	0.5	0.7	1.0	1.4	1.5	0.9	1.3
Malaysia	*0.9*	4.4	7.5	0.4	1.3	4.6	4.7	4.5	4.2	-0.3	0.6	1.8	1.8	1.0	1.0	1.7
Philippines	*0.9*	3.9	5.3	7.6	7.2	4.9	6.2	5.8	6.1	3.8	3.0	2.2	2.4	5.2	2.9	3.4
Singapore	*0.5*	3.8	-1.3	4.5	6.4	3.4	3.1	1.6	1.2	0.5	0.7	0.5	0.9	0.4	0.7	0.7
Taiwan	*1.1*	2.3	2.0	2.8	2.4	0.4	2.6	2.0	1.8	0.3	0.9	0.5	1.0	1.3	0.7	1.3
Thailand	*1.2*	4.1	6.5	0.1	7.1	3.3	4.1	3.5	3.2	0.7	1.1	0.8	1.0	1.1	0.9	0.8
Europe and Africa	*24.5*	1.9	0.6	0.8	0.9	1.9	2.1	0.9	1.4	2.7	2.5	2.1	2.0	2.6	2.3	2.1
Euro area	*13.7*	1.6	1.0	0.8	0.6	1.1	1.9	1.1	1.0	1.4	1.4	1.1	1.1	1.8	1.2	1.1
Belgium	*0.5*	1.1	0.7	0.5	0.4	0.8	1.4	1.0	0.8	2.0	1.6	1.1	0.7	2.3	1.3	1.0
France	*2.7*	1.4	1.4	1.1	1.0	1.2	1.7	1.3	1.2	1.4	1.2	1.0	1.1	2.1	1.2	1.1
Germany	*4.0*	1.7	0.1	0.4	0.3	1.3	1.5	0.5	1.0	1.6	1.7	1.4	1.4	1.9	1.5	1.5
Greece	*0.3*	0.9	1.3	1.2	1.6	2.0	1.9	1.1	1.8	0.8	0.7	0.4	0.4	0.8	0.6	0.6
Ireland	*0.3*	4.6	3.4	3.5	2.2	1.9	6.8	3.4	2.2	0.9	1.1	0.4	0.7	0.7	0.8	0.8
Italy	*2.2*	0.5	0.2	0.1	0.0	0.0	0.7	0.0	0.2	1.0	1.0	0.9	0.8	1.2	0.9	0.9
Netherlands	*0.9*	1.9	1.7	0.9	0.6	0.8	2.5	1.6	1.0	2.5	2.7	2.4	2.5	1.6	2.5	1.9
Portugal	*0.3*	2.1	1.4	1.1	1.1	1.4	2.1	1.6	1.3	0.8	0.5	0.0	0.4	1.2	0.4	0.3
Spain	*1.7*	2.9	1.8	1.4	1.4	1.7	2.6	2.2	1.6	1.1	1.1	0.7	0.7	1.7	0.9	1.1
United Kingdom	*2.8*	2.0	-0.7	1.0	0.5	1.0	1.4	1.1	0.9	1.9	2.1	1.9	1.8	2.5	1.9	1.8
EM Europe & Africa	*8.0*	2.5	0.3	0.8	1.5	3.4	2.7	0.7	2.1	7.6	7.0	6.0	5.3	5.6	6.6	5.5
Poland	*1.1*	4.1	5.3	6.1	4.9	2.4	5.1	4.2	3.5	1.3	2.0	1.9	2.4	1.8	1.9	3.1
Russia	*3.9*	1.5	-2.2	2.9	2.0	-0.1	2.3	1.0	2.0	5.2	5.1	5.2	4.8	2.9	5.0	3.8
Turkey	*2.0*	5.2	1.2	-6.7	-1.7	11.2	2.7	-2.1	1.6	21.4	18.4	13.7	10.8	16.2	16.8	12.9
Israel	*0.3*	3.5	3.7	4.0	4.2	3.2	3.7	3.5	3.3	0.9	0.8	1.0	1.1	0.8	1.0	1.5
South Africa	*0.7*	-3.2	1.5	1.0	1.6	1.7	0.8	0.2	1.7	4.2	4.4	4.6	4.6	4.6	4.5	5.3

Note: Weights used for real GDP are based on IMF PPP based GDP, and weights used for consumer prices are based on IMF nominal GDP (5yr centered moving average). (#) IMF PPP-based GDP weights for 2018. (*) Aggregates for CPI exclude Argentina and Venezuela inflation rates and Aggregates for Real GDP exclude Venezuela. Source: Barclays Research

FIGURE 30

Global Forecasts (2): External and government balances, and Barclays Research projections

	Current account (% GDP)							Government Balance (% GDP)						
	2014	2015	2016	2017	2018	2019F	2020F	2014	2015	2016	2017	2018	2019F	2020F
Global	0.1	0.5	0.5	0.6	0.3	-0.1	-0.3	-3.7	-3.8	-3.9	-3.2	-3.2	-3.5	-3.4
Advanced	-0.5	-0.3	-0.1	0.1	0.0	-0.3	-0.6	-4.4	-3.8	-3.8	-2.9	-2.9	-3.3	-3.2
Emerging	1.1	1.7	1.4	1.3	0.7	0.3	0.1	-2.6	-4.0	-3.9	-3.7	-3.6	-3.8	-3.8
BRIC	0.9	1.8	1.1	1.0	0.4	-0.2	-0.3	-2.6	-4.6	-4.7	-4.4	-4.3	-4.5	-4.5
Americas	-2.4	-2.7	-2.3	-2.2	-2.3	-2.3	-2.6	-5.4	-5.3	-5.7	-4.6	-4.6	-5.1	-5.1
United States	-2.1	-2.2	-2.3	-2.3	-2.4	-2.4	-2.7	-5.2	-4.7	-5.4	-4.2	-4.3	-5.1	-5.1
Latin America	-3.7	-4.9	-2.5	-1.6	-2.1	-1.9	-2.6	-6.0	-8.4	-7.6	-6.8	-6.3	-5.6	-4.9
Argentina	-1.6	-2.8	-2.8	-4.9	-5.4	-2.6	-3.9	-3.9	-5.2	-5.9	-5.9	-5.0	-4.1	-3.3
Brazil	-4.2	-3.0	-1.3	-0.4	-0.8	-1.0	-1.7	-6.0	-10.2	-9.0	-7.8	-7.1	-6.8	-6.3
Colombia	-5.2	-6.4	-4.3	-3.4	-3.8	-3.6	-3.0	-2.4	-3.0	-4.0	-3.7	-3.1	-2.6	-2.3
Mexico	-1.9	-2.6	-2.3	-1.7	-1.8	-1.6	-1.7	-3.1	-3.4	-2.5	-1.1	-2.1	-2.1	-1.8
Peru	-4.4	-5.0	-2.6	-1.2	-1.6	-2.2	-2.5	-0.3	-2.1	-2.6	-3.1	-2.5	-2.2	-2.1
Venezuela	2.9	-18.4	-2.7	5.1	3.9	-0.8	-10.3	-13.6	-8.8	-10.3	-17.0	-20.4	-17.4	-11.4
Asia/Pacific	1.7	2.7	2.4	2.2	1.3	0.9	0.8	-3.0	-3.6	-3.6	-3.4	-3.7	-3.9	-3.7
Japan	0.8	3.1	3.9	4.1	3.5	3.3	3.4	-5.4	-4.4	-4.5	-3.6	-4.1	-4.0	-2.9
Australia	-3.1	-4.6	-3.3	-2.6	-2.1	-1.2	-2.2	-3.1	-2.4	-2.2	-2.0	-1.9	-0.5	0.2
Emerging Asia	2.4	3.1	2.5	2.1	1.0	0.5	0.4	-2.3	-3.4	-3.5	-3.5	-3.8	-4.1	-4.1
China	2.1	2.8	1.7	1.5	0.5	-0.4	-0.4	-1.8	-3.4	-3.8	-3.7	-4.2	-4.5	-4.5
Hong Kong	1.4	3.3	4.0	4.7	3.6	3.4	3.3	3.6	0.6	4.4	2.2	1.4	1.3	1.3
India	-1.4	-1.1	-0.5	-1.5	-2.4	-1.8	-1.8	-6.7	-6.9	-6.5	-6.5	-6.5	-6.5	-6.3
Indonesia	-3.1	-2.0	-1.8	-1.6	-3.0	-2.5	-2.4	-2.1	-2.6	-2.5	-2.5	-1.8	-1.8	-2.0
South Korea	5.6	7.2	6.5	4.7	4.4	3.8	3.5	-1.9	-2.3	-1.3	-1.0	-0.6	-1.8	-2.2
Malaysia	4.3	3.0	2.4	2.8	2.1	2.1	2.1	-3.3	-3.2	-3.1	-2.9	-3.7	-3.4	-3.4
Philippines	3.8	2.5	-0.4	-0.7	-2.4	-2.2	-2.5	-0.6	-0.9	-2.4	-2.2	-3.2	-3.0	-3.0
Singapore	18.0	17.2	17.5	16.4	17.9	18.0	17.0	0.1	-1.0	1.4	2.0	0.4	-0.7	-0.7
Taiwan	11.4	14.0	13.4	14.6	12.2	11.0	10.6	-0.8	0.1	-0.3	-0.1	-0.9	-1.5	-1.5
Thailand	3.8	8.0	11.7	11.0	6.9	7.0	5.5	-2.9	-2.9	-2.8	-3.5	-3.0	-3.0	-3.0
Europe and Africa	1.0	1.4	1.3	1.6	1.9	1.3	1.0	-2.4	-2.3	-1.8	-1.3	-0.5	-0.8	-0.9
Euro area	2.5	2.7	3.1	3.2	3.3	2.7	2.3	-2.5	-2.0	-1.6	-1.0	-0.5	-1.0	-0.9
Belgium	-0.9	-1.0	-0.6	0.7	-1.3	-2.4	-3.0	-3.1	-2.4	-2.4	-0.8	-0.7	-1.3	-1.5
France	-1.0	-0.4	-0.8	-0.6	-0.3	-0.4	-0.6	-3.9	-3.6	-3.5	-2.8	-2.5	-3.1	-2.1
Germany	7.2	8.6	8.4	8.0	7.4	7.2	6.9	0.6	0.8	0.9	1.0	1.7	0.9	0.3
Greece	-1.6	-0.8	-1.7	-1.8	-2.9	-2.8	-2.8	-3.6	-5.6	0.5	0.7	1.1	0.8	0.7
Ireland	1.2	4.6	-4.1	8.2	9.6	5.0	3.5	-3.6	-1.9	-0.7	-0.3	0.0	0.0	0.3
Italy	1.9	1.3	2.5	2.6	2.5	2.6	2.0	-3.0	-2.6	-2.5	-2.4	-2.1	-2.6	-2.5
Netherlands	8.4	6.3	8.0	10.8	10.9	9.4	9.2	-2.2	-2.0	0.0	1.2	1.5	1.4	0.8
Portugal	0.1	0.1	0.6	0.4	-0.6	-2.2	-2.4	-7.2	-4.4	-2.0	-3.0	-0.5	-0.4	-0.1
Spain	1.4	0.9	0.9	1.0	1.1	0.7	0.7	-6.0	-5.3	-4.5	-3.1	-2.5	-2.3	-2.2
United Kingdom*	-4.9	-4.9	-5.2	-3.3	-3.9	-5.9	-6.0	-4.8	-3.8	-2.3	-2.0	-1.2	-1.3	-1.5
EM Europe & Africa	0.3	1.8	0.3	0.0	1.5	1.8	1.4	-0.5	-1.9	-2.4	-1.8	0.0	-0.1	-0.5
Poland	-2.0	-0.6	-0.3	0.2	-1.3	-1.8	-2.0	-3.5	-2.6	-2.3	-1.7	-1.0	-1.2	-1.4
Russia	2.8	5.2	2.0	2.3	6.0	5.5	5.2	0.9	-2.4	-3.7	-2.2	2.0	2.5	1.3
Turkey	-4.7	-3.7	-3.8	-5.6	-5.5	-2.9	-3.5	-1.0	-1.0	-1.1	-1.6	-2.0	-3.4	-2.3
Israel	3.8	5.1	3.7	3.0	2.9	3.1	2.9	-2.9	-2.1	-2.3	-2.2	-2.8	-2.8	-2.8
South Africa	-5.1	-4.6	-2.9	-2.5	-3.6	-3.3	-3.4	-3.5	-3.7	-3.6	-4.0	-4.3	-4.8	-4.4

Note: Weights used are based on IMF nominal GDP (5yr centered moving average). (*) Government balance is fiscal year forecasts, e.g., 2017 = FY 17/18, and defined as public sector net borrowing excluding financial interventions. (**) South Africa government balance (% GDP) is a consolidated budget figure representing financial years (i.e., FY 09/10 = 2010). Venezuela numbers are forecasts for 2016. Source: Barclays Research

SPECIAL TOPICS

The Fed mulls easing amid confluence of risks

Michael Gapen
+1 212 526 8536
michael.gapen@barclays.com
BCI, US

Jonathan Millar
+1 212 526 4876
jonathan.millar@barclays.com
BCI, US

In the weeks leading into the June FOMC meeting, we revised our outlook for Federal Reserve policy and now expect 75bp of rate cuts this year, beginning with a 50bp reduction in July, followed by 25bp in September.[2] Here, we revisit the rationales for a mini-easing cycle from the Fed in light of communications from the June FOMC meeting and discuss scenarios in which our outlook for the policy rate could be proven incorrect.

Although the FOMC did not make cuts to its policy rate in June, it delivered a number of strong signals that seemingly pave the way for the limited easing cycle that we anticipate: dropping the "patient" language it had adopted in January, highlighting downside risks to the expansion, making unusually large downward revisions to its inflation outlook, and slashing its estimates of the long-run neutral rate of interest.

Heightened uncertainty about trade is one factor pushing the Fed to ease...

…but it's not the whole story by any means

We see a number of broad influences pushing the Fed toward rate cuts: a desire for insurance against weaker economic outcomes; evidence that the current monetary policy setting is too restrictive in the context of low inflation; and elevated trade policy uncertainty. A fourth influence – concerns about the efficacy of monetary policy at the effective lower bound – leads us to believe the Federal Reserve will act earlier and more aggressively than it might if there were more space to reduce the policy rate. Although developments in US trade policy have garnered headlines in recent months, we emphasize that our expectation for monetary easing is based on a confluence of influences that extend beyond trade policy; trade is part of the story, but it is certainly not the whole story.

That said, while we have a high level of conviction that some monetary policy easing from the Fed will be forthcoming, the domestic and international economic and political situation remains fluid and alternative outcomes to our baseline warrant attention and discussion. These include potential outcomes that could lead to no change in the target range for the federal funds rate and other outcomes that could lead to more rate cuts than we envision.

The confluence of forces pushing the Fed into action

We begin by discussing the rationale behind our outlook for rate cuts from the Federal Reserve beginning in July, driven by a combination of forces.

Renewed weakness in the industrial sector

Our previous outlook was a Fed on hold

Our outlook for the US economy in the previous GO had growth in economic activity slowing from 3.0% y/y in Q4 18 to 2.4% y/y in Q4 19. Thereafter, we had expected it to continue to grow at 2.0% in 2020. The main contributors to this deceleration were a weaker external backdrop, fading fiscal stimulus, and lagged effects of past monetary policy tightening. Our assumption was that the Fed would stay on the sidelines through the end of 2020, particularly in light of favourable prospects for a US-China trade deal taking shape in early 2019. We looked for modest growth in business spending and solid labor market fundamentals to support household spending and underpin ongoing economic expansion.

Incoming data initially seemed to confirm this view. Although volatility in financial markets and the elongated federal government shutdown suppressed domestic spending early in the year, March data on durables orders and personal spending pointed to a rebound in domestic demand.

[2] See *2019-2020 US Outlook: Industrial slowdown and inventory drawdown* and *Trade tensions and weak business spending likely point to Fed rate cuts*, We originally projected Federal Reserve rate cuts to begin in September and *moved our expectations forward to July* following the release of the May employment report, which showed weaker employment growth than we expected.

Our revised US outlook has a more abrupt slowing in business spending…

But the tide seemingly turned with the incoming data for April. Although April estimates for personal spending and auto sales gave us comfort that private consumption remained fairly healthy, data on industrial production (IP) and durable goods orders pointed to broad-based weakness in the manufacturing sector that could not be explained solely by one-offs from the government shutdown or the grounding of the Boeing 737 MAX. The weakness in the April estimates for these sectors was telling: the manufacturing component of IP showed outright declines in production on a year-on-year basis for the first time since 2016, reversing the strong gains through last summer that had been propelled by fiscal stimulus. Meanwhile, indicators of business investment showed notable deterioration, with core capital goods orders down 1.0% on the month and capital goods imports down 3.2% from a year-earlier levels. Although IP rebounded modestly in May, the gains were supported by a weather-related swing in utilities production and gains in the volatile auto assemblies category. Manufacturing ex-autos, which accounts for nearly 70% of total industrial production, was flat on the month and up only 0.3% y/y.

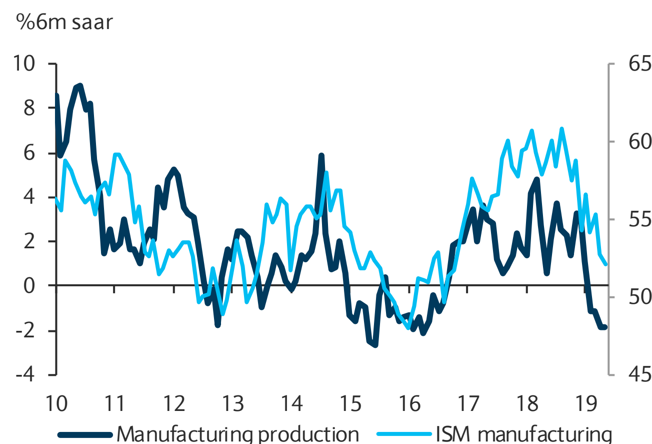
…as another industrial recession looks possible

These data have had a noticeable effect on our Q2 US GDP tracking estimate, particularly for nonresidential fixed investment. Our tracking estimate for equipment spending now shows a decline of 3.1% q/q saar, while that for structures (which is sensitive to energy drilling activity) shows a decline of 2.6%. Although the deterioration in these categories suggested by these two months of data is, by itself, not conclusive, it has been accompanied by dismal forward-looking indicators for manufacturing, including the ISM manufacturing index and similar indices from the regional Feds. Similarly, rig counts indicate that drilling activity remains on a steady downward track. Our revised US outlook incorporates the assumption that the combination of weak global growth, a strong USD, deteriorating profitability and margins, and elevated uncertainty from ongoing trade tensions is causing goods-producing sectors to retreat.[3] In other words, the burst of goods demand and production following last year's double dose of fiscal stimulus appears to have given way to an industrial slowdown.

Altogether, we have factored in more subdued rates of business spending and hiring over the forecast horizon. We expect a lull in goods sector activity to slow real GDP growth to 1.9% y/y in Q4 19, where we expect it to remain in 2020. Relative to the previous GO, these growth forecasts are down 0.5pp in 2019 and 0.1pp in 2020. However, our outlook for

FIGURE 1

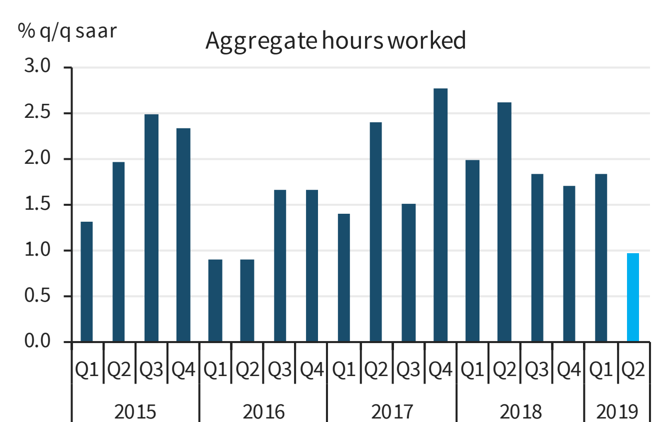
Manufacturing production is contracting for the first time since the 2015-16 industrial recession



Source: Federal Reserve, Haver Analytics, Barclays Research

FIGURE 2

Aggregate hours worked has slowed as both hours and employment have softened



Note: Q2 2019 is April and May over the Q1 average. Source: BLS, Haver Analytics, Barclays Research

[3] We have long highlighted the role that increased uncertainty can play in weighing on hiring and investment decisions, as well as what the resolution of uncertainty can do to boost investment and hiring prospects. See *Uncertainty shocks and recessionary risks*, 14 September 2011, and *Watch out below! Causes and consequences of a falling US unemployment rate*, 4 May 2012.

growth in private consumption is little changed, as we expect moderate growth in services production and consumption to keep the US economy from slipping into recession, with some additional support from more accommodative monetary policy.

High inventory-to-sales ratio points to a risk of inventory drawdown

High inventories may be weighing on production…

In our view, downward pressure on manufacturing activity from soft global demand and deteriorating demand for durable goods is being intensified by an undesired accumulation of inventories. To be sure, trade and inventory data tend to be volatile, so extracting information from their movements can be difficult. Nevertheless, nonfarm inventories grew 5.3% q/q saar in Q1 19 after registering 4.1% annualized growth in Q4, leaving the level of inventories at $2.6trn (in chained 2012 dollars). As shown in Figures 3 and 4, the recent pace of inventory accumulation has driven inventory investment well above levels needed to keep the inventory-to-sales ratio constant, with inventories making sizeable positive contributions to growth in three consecutive quarters (and in four of the last five quarters).

…but firms may also be front-running tariffs and trade policy uncertainty

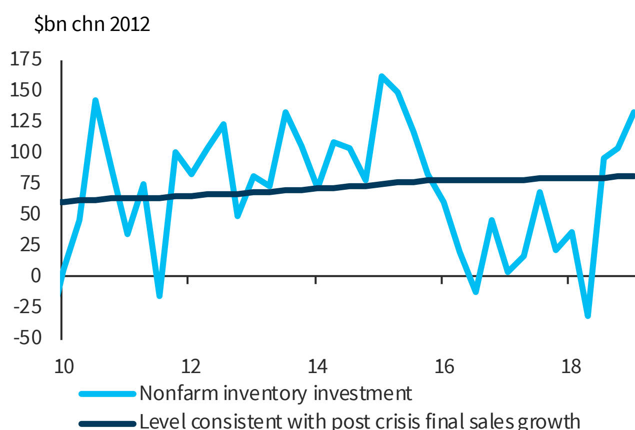
The gap between current inventories and the level needed to keep the ratio of inventories to sales near recent levels is as large as it has been since mid-2015. Perhaps not coincidentally, that was in the midst of the industrial recession, when a marked slowdown in industrial production eliminated several years of modestly excessive inventories. Even if final sales of goods and structures were to grow at 3.5% (about its average pace in recent years), the annualized level of inventory investment would need to fall c.$40bn just to keep the inventory-to-sales ratio near current levels. The timing of any inventory drawdown will be a key factor in assessing when manufacturing production may have reached a trough.

Inventory accumulation may be a rational response to protectionism

While we characterize the accumulation of inventories in recent quarters as unwanted or undesired, there are risks that this could reflect factors other than excess production. Our UK economics team recently suggested that the private sector in the UK is intentionally accumulating inventories to maintain operations to protect against "Brexit risk." Similar risk management behavior could be occurring in the US, with the private sector actively accumulating inventories in advance of an escalation in protectionism and disrupted supply chains. If so, this would also be consistent with running a higher inventory-to-sales ratio, suggesting that the risk of an immediate inventory drawdown may be overstated.

FIGURE 3

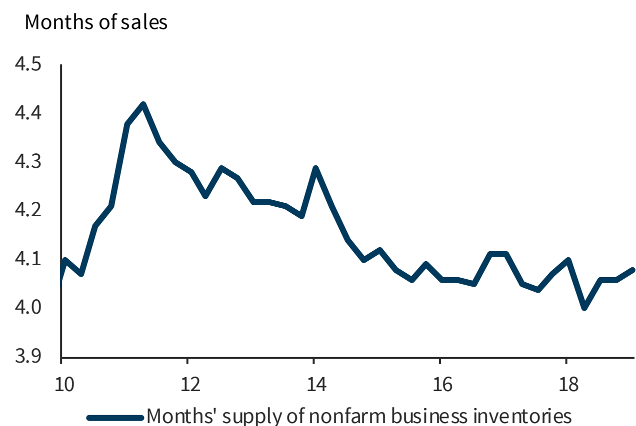
A rebound in inventory accumulation…



Note: Final sales of goods and structures. Source: BEA, Haver Analytics, Barclays Research

FIGURE 4

…has pushed the inventory-to-sales ratio near recent peaks



Note: Months of sales is calculated by dividing the stock of inventories by final sales of goods and structures. Source: BEA, Haver Analytics, Barclays Research

To account for this very real possibility, our projection assumes a gradual slowdown of inventory investment, rather than a rapid one. While this limits the negative effects on growth in any one quarter, it also elongates the slowdown of industrial production in our outlook. Given our assumptions, we project that the trough in year-on-year IP growth will occur in late Q3 19 or early Q4 19.

The Fed wants to take out insurance against recession risk

Our revised outlook calls for precautionary easing from the Fed…

At the June FOMC meeting, the committee appeared to agree with our assessment of slowing manufacturing output and sluggish business spending and saw a more accommodative policy stance as the appropriate way to obtain insurance against downside risks to the outlook. Chair Powell cited weaker-than-expected global growth, alongside softness in domestic manufacturing, trade, and business investment, as pointing to a more fragile outlook relative to when the FOMC last convened. That said, Powell was careful to say FOMC members see the economy as likely to remain in expansion, supported by growth of household spending and the still-healthy labor market.

…and the Fed seems to be in agreement

While the baseline is one of continued expansion, a sizeable number of FOMC members appear receptive to the argument that increased uncertainties about the outlook warrant temporary accommodation. For example, in public remarks following the June meeting, Vice Chair Clarida seemingly supported this view, saying in an interview that "the case for providing accommodation has increased…especially in the last six or eight weeks, there has been elevated uncertainty about the outlook." Our analysis indicates that the desire to take out insurance against increased downside risks was a hallmark of the precautionary rate cuts that the Greenspan Fed undertook in the 1990s.[4]

Elevated trade policy uncertainty

Our view, as well as that of the FOMC, is that uncertainty has picked up substantially since the GO we published in March. The main source is US trade policy, with the US-China trade deal that appeared to be in train in March giving way to further escalation of the dispute.

Trade policy uncertainty has risen

But this sense of uncertainty goes much deeper than the twists and turns of the storyline of the US-China dispute. Following the outcome of the 2016 presidential election, we have assumed that the US would gradually place restrictions on its trade with China, but refrain from a significant escalation in protectionism against other important trading partners. After all, if the administration's primary concern is national security risks from trade in dual-use technology (and China's industrial policies more broadly), then the US was likely to enlist help from its historical allies. Such help would be difficult to obtain if the US were simultaneously threatening these allies with tariffs. But developments in recent months have called this assumption into question, with the Trump administration showing that it is willing to threaten tariffs on its allies in the pursuit of even non-economic policy aims, as demonstrated by the recently averted threat of escalating tariffs on Mexican imports over immigration policy. This suggests that uncertainty about the course of US trade policy is substantially higher than we had thought a few months ago.

In the current outlook, we make the following assumptions:

- We expect tariffs on the remaining c.$300bn of imports from China to be implemented, but with sizeable exemptions (either in the amount of imports subject to tariffs or the tariff rate itself). Whereas corporations may not have taken the administration at face value when it threatened tariffs previously, we believe they do now, and the public comment period is likely to result in numerous exemptions that will reduce some of the

[4] The current environment has many similarities to 1995, when the Fed reduced its policy rate as 'insurance' against further weakening in the economy, even though the FOMC did not believe a recession was likely. See *Greenbook*, 28 June 1995. Also see the *transcript* for the July 5-6 1995 Meeting of the Federal Open Market Committee. For additional discussion, see our *June FOMC Preview*.

adverse economic consequences.[5] The Office of the US Trade Representative held public hearings during June 17-21 and again on June 24-25. Results of the hearings are expected to be reported shortly.

- We also expect non-tariff barriers to affect other elements of trade with China in H2 19, including efforts to "blacklist" Chinese firms that deal in sensitive technologies. We intend to examine the impact of such efforts on a case-by-case basis. At present, several US technology firms are lobbying the administration for less restrictive policies that could slow down the process and reduce any immediate direct effects.
- We lean toward passage of the USMCA trade agreement later this year, albeit with low conviction. The approval is likely to have limited economic effect relative to NAFTA, and we think upside to the US economy is limited. Although passage would provide more certainty, the administration has already shown a willingness to threaten and impose tariffs on NAFTA members, which go against the spirit and the letter of the new agreement. We would only take a more negative view on developments should a failed USMCA agreement lead the administration to attempt a withdrawal from NAFTA. We see this as a distinct possibility.
- The recent tariff threat on Mexico suggests to us that the US administration has taken a different – and more aggressive – approach. It seems willing to inflict economic pain to bring trading partners to the negotiating table. We expect a threat of tariffs on European auto imports later this year, following the expiration of the six-month delay that was offered in Q2. While we do not see these tariffs as likely to be implemented, we have concerns the risk of tariffs alone will weigh further on activity. If the administration confronts Europe, it does not seem much of a stretch to think it will also take an adversarial position toward Japanese auto imports.

Altogether, our baseline assumes that trade policy uncertainty will remain elevated, contributing not only to ongoing weakness of business investment and domestic manufacturing, but also to elevated risks that this could spill into activity more broadly. We have long highlighted the role that increased uncertainty can play in weighing on hiring and investment decisions, as well as what the resolution of uncertainty can do to boost investment and hiring prospects.[6]

More than trade policy uncertainty is weighing on the outlook

Trade policy forms just one part of a larger taxonomy of risks that are monitored when the FOMC assesses its policy stance. The committee is seemingly prepared to reduce the target range for the federal funds rate even if US-China trade discussions at the G20 meeting produce a favorable outcome. Indeed, Chair Powell was careful to say in the June press conference that the committee's concerns about the outlook extend beyond restrictive trade policies and trade policy uncertainty. He also noted that the committee sees weakness in domestic and international manufacturing and trade data, which could be related to China's efforts to reduce leverage and the recent oil price slide. It is also fair to say that the committee is uncertain about how quickly the lift from fiscal stimulus may be fading from consumer or business spending, and the imprint this has left on incoming data.

A need to recalibrate the policy stance in light of persistently low inflation

The Fed remains preoccupied with low inflation

Beyond these other non-trade sources of uncertainty, the committee emphasized that low inflation was a primary concern that warranted immediate attention. Headline PCE and CPI inflation are running well below their pace at year-end, prompting many on the committee

[5] In addition, remaining imports from China not currently subject to new tariffs are skewed toward consumer goods. That the administration has avoided placing tariffs on these imports to date suggests they may be more willing to permit exemptions to limit any drag on household spending.
[6] See *Uncertainty shocks and recessionary risks*, 14 September 2011, and *Watch out below! Causes and consequences of a falling US unemployment rate*, 4 May 2012.

to re-evaluate their outlook for inflation. In the updated Summary of Economic Projections, the median forecast for both headline and core PCE inflation was revised lower in 2019 and 2020, with the committee not foreseeing the 2.0% target being met until 2021 – about a year later than in its March projections. This is a marked shift from previous FOMC meetings where Chairman Powell attributed inflation shortfalls to transitory forces.

The June FOMC statement and opening remarks during the press conference also referenced the decline in market-based measures of inflation compensation during the intermeeting period and the drop in some survey-based measures of inflation expectations, with Powell emphasizing that both "are near the bottom of their historic ranges." Escalating disinflation concerns likely contributed to the 0.3pp reduction in the median estimate of the longer-run neutral rate, to 2.5%.

The zero lower bound also looms large

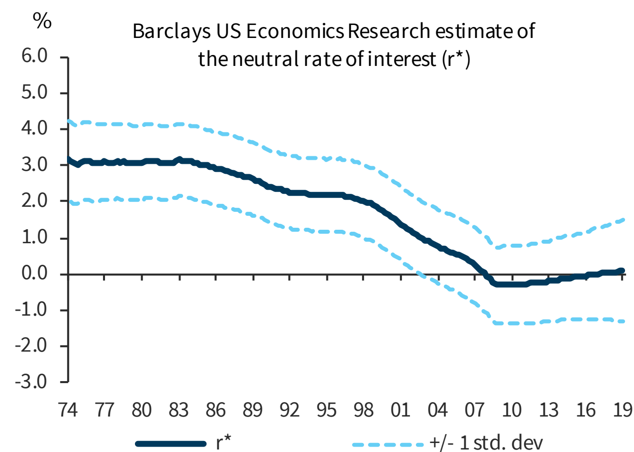
These developments, combined with observed weakness in interest-rate sensitive sectors such as housing, all seem consistent with an inference that the current policy stance is too tight. We agree with this inference, which is aligned with estimates of the neutral policy rate from our state-space model (Figure 5), which remains at the lower end of the Fed's range of estimates. On these grounds alone, we think that the committee will view a recalibration of its policy stance to be justified in July, even if the US and China de-escalate trade tensions.

The zero lower bound means acting earlier and forcefully

A final factor leading the Fed to reassess its policy stance is the limitation on policy posed by the zero (or effective) lower bound. In our view, concerns about the costliness of reaching the zero bound imply that the hurdle for initiating rate cuts – for whatever reason – is lower today than it was in the past. Solid theoretical considerations suggest that acting early and more forcefully is the best way to avoid zero lower bound outcomes. After all, the current level of the federal funds rate allows the committee only 225-250bp of rate cuts, well short of the 500bp or more it has undertaken in the previous three easing cycles. Similarly, the fact that long-term Treasury yields are already so low also seemingly limits the additional support that could be provided through forward guidance and asset purchases. If the FOMC believes that it does not have enough monetary policy bullets to respond to a deep recession, then it would be sensible to spend them in a way that might prevent a strong recessionary dynamic from taking shape.

FIGURE 5

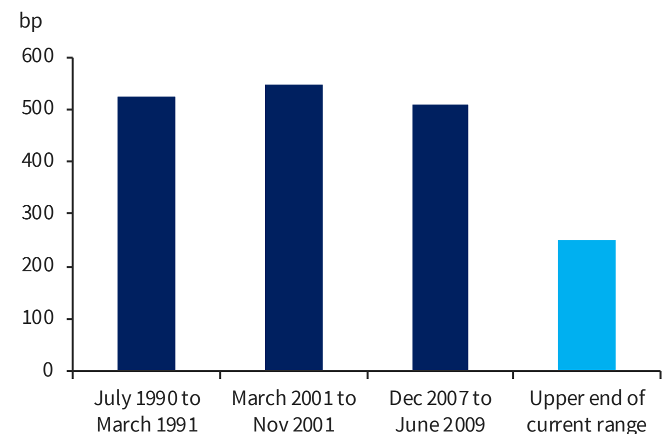
Our estimate of the real neutral policy rate remains near zero



Source: Barclays Research

FIGURE 6

Limited policy space encourages early and aggressive action



Note: Maximum funds rate change beginning six months before start of NBER-defined recession and ending two years after end of recession.
Source: Federal Reserve, Haver Analytics, Barclays Research

In July, we expect an initial rate move of 50bp

We think the Fed will open with a 50bp cut in July…

We think the FOMC will conclude that it needs an aggressive rate cut at the July FOMC meeting, given our baseline assumptions, which include an outcome of the G20 meeting that leads to the imposition of additional tariffs and a scenario in which financial markets are pricing in at least one rate cut at the July meeting, as they are currently. We see several reasons to look for a large initial move, including:

- **The last two rate cut cycles began with 50bp cuts**. The Fed cut the policy rate by 50bp in September 2007 and January 2001. While these turned out to be full easing cycles from higher initial interest rate levels, not "insurance" episodes, we think these experiences are still indicative of the Fed's willingness to ease more rapidly than it hikes.
- **The Fed is more willing to surprise on cuts than hikes.** In our view, the Fed judges the success of rate cuts based on the level of surprise versus expectations, whereas in hiking cycles it tends to be comfortable meeting expectations. Investors are already pricing in a bit more than one full 25bp cut at the July meeting. The FOMC risks leaving markets wanting more if it falls short of that expectation.
- **Markets are pricing in significant action in the coming year.** While we understand that the Fed will be wary about validating the extent to which markets are pricing in rate cuts over the coming year, the sheer magnitude of the cuts expected by markets risks disappointment if the committee moves too cautiously.
- **The proximity of the effective lower bound will influence the reaction function.** As mentioned above, Chair Powell has repeatedly emphasized a desire to support the expansion while avoiding an encounter with the zero lower bound. We think the committee would be prepared to take a larger initial step – even though that step represented a non-trivial portion of the current funds rate – if it felt that doing so would meaningfully reduce the likelihood of a lower bound outcome.
- **Low inflation and risk management.** With inflation running below the 2% target, the risk of an aggressive move producing a material overshoot of the inflation target is relatively low. The committee has emphasized that it sees the risk of low inflation as outweighing the risk of high inflation. Given where inflation trends and expectations are at present, the committee would seemingly infer high confidence that an aggressive move would support its inflation mandate, rather than fuelling an overshoot that might prove costly to unwind later.
- **Financial stability risks are still low.** With the committee assessing financial stability risks to be low, it will likely view any increase in stability risks from an aggressive rate cut to be modest.
- **The Fed does not "hold bullets" or "keep powder dry."** The Fed's historical tendency is to act quickly and decisively, as opposed to keeping policy easing in reserve for a later date. Given that it is already undertaking a policy framework review, it is readily evident that the committee already believes it does not have enough policy space to respond to the next downturn solely through interest rate policy; keeping interest rate cuts in reserve will not change that picture.

Some thoughts on alternative outcomes

…but we see the situation as fluid, and other possible outcomes warrant attention

As always, we do our best to arrive at what we think is the most likely outcome and why, with the understanding that one should give weight to alternative outcomes. Sometimes these alternatives involve outcomes that occur with low probability and involve high risks, while others materialize from risks that lie closer to our baseline assumptions and yield

smaller deviations from our baseline. We provide a list of a few such alternatives and, in each case, discuss timelines that may occur as the Fed considers whether easing is needed to support the outlook and how much.

1. The FOMC may fear political risks from an aggressive move

The Fed faces political constraints

One argument against moving early, more forcefully, or both in the current context is political risk. Although the committee may see a rationale to avoiding the effective lower bound, the Federal Reserve may fear that such a move would be viewed as capitulating to ongoing pressure from the Trump administration, which favors a more accommodative policy stance. A forceful move to ease rates, in the current context, could also be viewed as enabling the administration to take an even more aggressive trade posture toward China. To be sure, criticism of monetary policy decisions by the executive branch is not new – other administrations have done the same – but the current degree of political polarization is unusually high. Many FOMC members – as well as Fed staff – are already uncomfortable with how politicized the institution has become following the 2008-09 financial crisis[7] and would prefer to avoid a potential loss in credibility from being seen as responding directly to political pressure or favouring one political party.

We see this as a risk that is close to our baseline, particularly in light of the outcome of the June FOMC meeting, where seven participants submitted forecasts with 50bp in rate cuts by year-end and an eighth forecast a 25bp reduction. It is not unreasonable to suspect that the committee would have cut the funds rate in June were it not for the optics of doing so directly on the heels of administration criticism.[8]

With the committee seemingly so close to pulling the trigger in June, how plausible is it that political risks might forestall rate cuts? Our view is that political risk may well affect *when* the Fed decides to act (eg, September instead of July), but not *whether* it will act or how it will act when it does. Political risk means the committee could prefer to wait for additional evidence that the economy is slowing or that vulnerabilities are rising before taking action. Indeed, this seems to be one reason why financial markets were pricing a relatively low chance of the Fed's cutting its policy rate in June – ahead of the G20 meeting – and focusing most of its attention on July and September for rate reductions. But any diminution in political risks from delaying action must rightly be weighed against potential losses from being perceived as wilfully undermining the administration – or, worse, responding too late to developments and failing to fulfil its dual Congressional mandate. At the end of the day, it is not obvious that delaying action to avoid accusations of political bias is viable long term.

Even if the political risk element does carry considerable weight within the committee, there is reason to believe that the G20 outcome will provide a temporary opening that helps attenuate that risk. Specifically, our baseline assumption for the G20 is one in which relations between US and China remain frayed, leading the US to impose additional tariffs on Chinese imports. In our view, this outcome would provide ample cover for an aggressive Fed rate cut in July.

2. A reduction in trade uncertainty at the G20

Our baseline assumption that the US will follow through with its tariff threats seemed like a likely outcome following the breakdown of trade talks in April and the lack of substantive discussions between the two countries since. However, the announcement that Presidents Xi and Trump will indeed meet to discuss trade and other issues on the sidelines of the G20

[7] Binder, Sarah and Mark Spindel, *The Myth of Independence: How Congress Governs the Federal Reserve*, Princeton, NJ: Princeton University Press, 2017.
[8] Indeed, outgoing Vice Chairman Stanley Fischer has recently argued that there is a good chance that the Fed would not have raised the funds rate in December if Trump had not been advocating against an increase (*Bloomberg*, 16 June, 2019).

meeting raises risks of more positive outcomes. News reports leading up to the G20 have highlighted the possibility of a resumption of trade negotiations.[9]

A ceasefire at the G20 between the US and China is a real possibility

In our view, the announcement of a meeting is not enough to cause us to adjust our baseline assumptions. But it does highlight the risk of the several alternative outcomes (see *China-US trade talks: Fine tuning post-G20 scenarios*, 24 June):

- **Ceasefire**. We think it is possible that a temporary "ceasefire" may be announced in which both sides agree to halt further escalation of tariffs and non-tariff barriers while high-level negotiations take place. In this outcome, the US administration would suspend the next round of tariffs for several months or more and, in addition, could delay non-tariff barriers and further "blacklisting" of Chinese corporations. China would refrain from countermeasures. Should this alternative materialize, it could cause the Fed to ease by less than we expect, at a later date, or both. That said, we do not think "kicking the can" down the road for several months will alleviate trade policy uncertainty, and the Fed was explicit in identifying non-trade factors as supporting a case for easing. Hence, even though such a ceasefire might affect the timing of FOMC action, it would not likely cause it to backpedal much from its June messaging.

- **Grand bargain**. In this scenario, on which we place a low probability, the sides return to the deal that was apparently nearing completion in April, delivering a trade agreement that prevents tariff escalation, includes commitments by the Chinese to purchase US imports, sets benchmarks for the reduction of existing tariffs, includes provisions to restrict intellectual property theft, and provides a resolution process whereby US firms can file claims against perceived wrongdoing. A "grand bargain" would likely pose upside risk to the US and global outlook and could lead to a rebound in confidence. Even though there is much to like about this scenario, we would still have a hard time not seeing the Fed easing, given persistent disinflationary pressures. But if an agreement is quickly agreed and implemented at the G20, the Fed could conceivably retreat to its patient policy stance and look for the strengthened outlook to support inflation.

3. Greater-than-expected escalation in trade tensions

There are also several scenarios that could lead to even more protectionism and trade policy uncertainty than we envision in our baseline, which need not be mutually exclusive.

- **A breakdown at the G20 and few domestic tariff exemptions.** Our baseline assumes sizeable domestic exemptions from tariffs following the conclusion of the usual public comment period. With the Chinese fresh off of meetings with the North Korean government prior to the G20, perhaps the US and China find themselves even further apart on outstanding issues and the US concludes that more economic pressure is needed. In this outcome, the administration refuses many of the exemptions being sought by domestic importers and moves to implement 25% tariffs on the remaining c.$300bn in imports. In this case, the more widely implemented tariffs could weaken consumer spending, hobble retailers that rely on imports, and amplify the risk of recession. If so, the FOMC would likely deliver on our baseline expectation of 75bp in rate cuts this year and consider further easing if it sees evidence of US households moving into precautionary saving mode or businesses becoming reluctant to hire.

- **A widening of the trade war.** Even if the discussions go reasonably well at the G20 and a ceasefire results, there are other avenues for protectionism that could reinforce a global slowdown. These include failure to pass the USMCA and the administration moving to withdraw from NAFTA, or a move to slap tariffs on auto imports from Europe,

[9] Leonard, Jenny, Shawn Donnan and Haze Fan, "US, China near tariff cease-fire as deal optimism lifts stocks," *Bloomberg*, June 26, 2019.

Japan, or both. Even if the USMCA manages to pass, the US could opt to impose tariffs on Mexico if it feels the country is not delivering on its promise to stem the flow of asylum seekers at the US-Mexico border. A broadening of protectionism to other trading partners and to durables imports (through tariffs on autos) could very well increase recession risks and jeopardize the longest expansion on record. Reciprocal measures in each of these cases would likely amplify economic costs to the global economy. Although we see each of these scenarios as lower risk outcomes, they cannot be fully discounted. If one or more of them materializes, the Fed may be forced to ease much more than it currently anticipates, with the lower bound likely coming into play.

There are ways in which the lull in activity can get worse

Beyond the aforementioned trade policy related scenarios, we also present the following scenarios posed by the existing industrial recession.

4. The slowdown in industrial production is a prelude to a recession

Our baseline assumes that a largely closed US economy remains resilient to many of the factors slowing global growth. This reflects the fact that the incoming data appear to have bifurcated, with manufacturing output and business spending having slowed but domestic services output and private consumption remaining resilient. Yet it may simply be the case that employment is in the process of slowing and that this will weaken private consumption over the course of the year. In this scenario, the weak May employment report is a precursor to further weakness, and initial Fed cuts are followed by more. To be sure, we find little to suggest that this is the case beyond the May employment report, and we view it as a low-probability outcome for now. We remain watchful for signs hiring continues to slow and for indications via initial claims data that firings have accelerated.

5. The slowdown in industrial production is 'much ado about nothing'

The flipside of the above scenario is that we – and the Fed – have overplayed the weakness in the industrial sector and the risks that it poses with regard to the Fed's dual mandate. A potential ceasefire at the G20, combined with positive data surprises that reveal an earlier trough to manufacturing production, could cause the Fed to initiate fewer hikes or none at all. But at the risk of sounding redundant, we believe the Fed has largely committed itself to 50bp of easing on the grounds of below-target inflation alone. That said, sustained evidence of a stronger economy and firmer inflation outcomes could prompt it to take back such rate cuts later in the projection (perhaps in the first half of 2020, or in 2021).

SPECIAL TOPICS

Trade war: effects across equities

Equity Strategy
Maneesh S. Deshpande
+1 212 526 2953
maneesh.deshpande@
barclays.com
BCI, US

Emmanuel Cau, CFA
+44 (0)20 3134 0475
emmanuel.cau@barclays.com
Barclays, UK

Macro Research
Ajay Rajadhyaksha
+1 212 412 7669
ajay.rajadhyaksha@barclays.com
BCI, US

This chapter is a Special Report that is not an equity or a debt research report under U.S. FINRA Rules 2241-2242.

Although the effect of the multi-front trade war on aggregate equities indices is not significant, the effect on some pockets is likely to be substantial

As the multi-front trade war continues to escalate, technology, national security and the race to control the next wave of the tech revolution have emerged as some of the key issues. Because of the disparity in global and domestic exposures across industries and regions and the range of potential salvos each trading partner can launch against the others, we believe the recent developments imply a high dispersion between the winners and the losers. The global equity markets, however, remain relatively sanguine, which seems to indicate that investors may either be optimistic about a near-term resolution or expect the Fed to cut rates enough to cushion these headwinds.

The US launches a multi-pronged trade war

The developments in geopolitical risks, with rising trade tensions between the US and its major trading partners (China, Mexico and Europe), have led to uncertainty in the outlook for equities, and risky assets broadly. Because of the disparity in global and domestic exposures across industries and regions and the range of potential salvos each trading partner can launch against the others, we believe the recent developments imply a high dispersion between the winners and the losers for the rest of the year.

Technology, national security and the race to control the next wave of the tech revolution have emerged as some of the key issues underpinning the trade war. The US blacklisting of Huawei and China's announced plans to set up an Unreliable Entities List have the potential to disrupt global semiconductor and telecom supply chains. The recent but short-lived Mexican tariff threat also shows the emergence of tariffs not just as a tool to demand better terms of trade, but also to coerce other countries to make internal policy changes. Europe's large, open economy is already feeling the effects of the trade war, and the threat of further tariffs looms large.

Equity markets remain relatively sanguine, however, which seems to indicate that investors may be optimistic about either a near-term resolution (the two country leaders plan to meet at the G20 at the end of June) or expect the Fed to cut rates enough to cushion these headwinds. In fact, given the Fed commentary on weak global growth and the decline in business sentiment, it is quite probable that the Fed is prepared to cut rates even if US-China trade discussions at the G20 meeting produce favourable outcomes.

In the next few sections, we provide our views on the effects of the trade war on different equity sectors and industries around the globe. Figure 1 summarizes the likely effect of the various prongs of the trade war.

FIGURE 1
Effect of the various prongs of the trade war across equity indices, sectors and assets

Battle Front	Asset	Impact
US-China tariffs	US Equities (SPX)	EPS -2.2%
US-China tariffs	Most affected US sectors: COND EPS -7.5%, INFT EPS -5.8%, INDU EPS -3.1%	
US-China tariffs	Chinese equities and currency	Negative
Huawei Ban	US Telecom	Neutral
Huawei Ban	US Comm Equipment	Positive
Huawei Ban	US Semiconductors	Negative
Huawei Ban	European Comm Equipment	Positive
Huawei Ban	European Telecom	Mixed likely Negative
Huawei Ban	European Semiconductors	Mixed likely Negative
Unreliable Entities List	US Equities (SPX)	Negative
China Retaliation (Apple Ban*)	US Information Technology	EPS -3.7%
US-Mexico tariffs	US Equities (SPX)	SPX EPS -2.6%
US-Mexico tariffs	Most affected US sectors: ENER EPS -8.4%, COND EPS -7.3%, INDU EPS -6.4%	
US-Mexico tariffs	Mexican equities and currency	Negative
US-Europe tariffs	European Autos & Components	Negative
US-Europe tariffs	European Chemicals	Negative
US-Europe tariffs	German Equities	Negative

Source: Barclays Research

Effect of US-China tariffs on US equities

Hopes for a resolution of the US-China trade war were dashed in early May after the US increased tariffs from 10% to 25% on $200bn of Chinese imports (effective June 1, 2019), over China's resistance to US demands for legal changes addressing intellectual property theft and its disagreement over the corresponding enforcement mechanisms. The US also threatened to impose tariffs on the remaining $300bn of Chinese imports. The public comment period that commenced on June 10 ended with the seven-day public hearing through June 25. The tariffs could be imposed after a rebuttal period that ends July 2.

China retaliated by increasing duties from 10% to 25% for $60bn of U.S. imports on May 13; more importantly, the rhetoric from Chinese policymakers and local press has become more nationalist relative to the previous measured tone. Given the limited scope for tariff-related measures, any further Chinese retaliation will likely come via non-tariff measures.

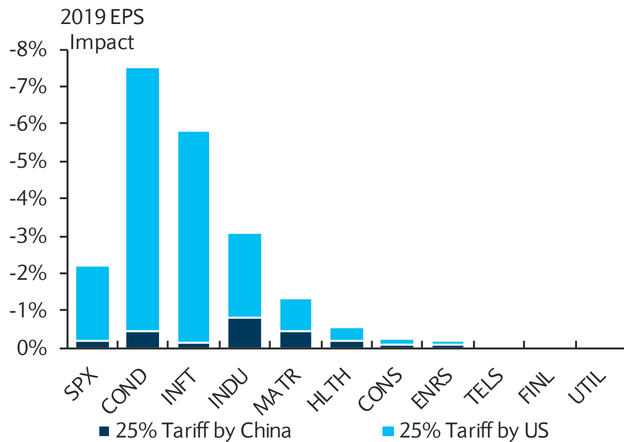
Any rapprochement will likely now emerge only in the G20 conference on June 28-29, when Presidents Trump and Xi are scheduled to sit down for an “extended meeting”. However, given the continued hardening of stances, our base case is now that the US-China trade war will continue to escalate and tariffs on $300bn (but probably with substantial exemptions) will go into effect. In fact, the US administration put five more Chinese tech entities on the trade blacklist a week ahead of the summit.

Our economists estimate direct net economic losses of 25% tariffs on all Chinese imports to the US at 0.2-0.3% of GDP for the US economy over the long run. Indirect effects from a loss in business or consumer confidence and an escalation in financial market volatility, which could lead to larger declines in output and employment (*US-China trade tensions: When giants collide: A re-escalation*, May 13, 2019).

As for the effect on US corporate profits, the level of international sales is not a good proxy to estimate the effect of tariffs imposed by China on US goods, as what really matters is the level of actual exports and imports. Since individual companies do not

FIGURE 2

Effect of US-China tariff is not significant, but some sectors are affected



Source: US Census Bureau, BEA,10-K filings of S&P 500 companies, Bloomberg, Barclays Research

FIGURE 3

Stocks most exposed have sold off significantly

Source: Bloomberg, Barclays Research

typically report actual imports and exports, we estimate these as a percentage of sales for each S&P 500 company by leveraging trade and input-output data for its five-digit level NAICS industry classification for the entire US economy from the US Census Bureau and Bureau of Economic Analysis, respectively.

A key assumption of our methodology is that US companies bear the entire brunt of the tariffs on imports and exports. These are first-order effects and, although conservative, do not take into account second-order effects such as potential declines in capex due to increased uncertainty and valuations, which could be a major driver of price moves.

Based on this methodology, we estimate that while the effect on S&P 500 earnings is relatively modest at ~2% (Figure 2), there is substantial variation across sectors, with Consumer Discretionary, Information Technology and Industrials the most affected. Our US-China trade war basket that comprises names that we expect to be affected negatively by the trade war has significantly underperformed recently (Figure 3). More importantly, despite the increased optimism about a potential truce during the G20 meeting, these stocks have not substantially outperformed over the past week.

Effect of US-China non-tariff measures: Huawei ban

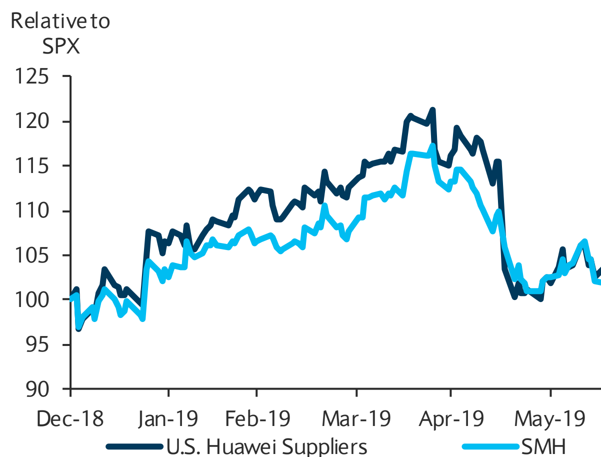
The US ratcheted up measures beyond tariffs by blacklisting leading Chinese telecom giant Huawei Technologies on May 15, based on cyber security concerns, and put five more Chinese tech entities on the trade blacklist a week ahead of the G20 summit. In this section, we examine the direct effect on suppliers to Huawei and knock-on effects on other sectors.

Direct effect on Huawei suppliers

Huawei is a major customer for a range of US suppliers for all parts of the microprocessor supply chain, from design to finished chips. Although US semiconductor companies that are major suppliers to Huawei have sold off substantially (Figure 4), we estimate the worst-case effect on their earnings to be even higher. These high-value components entail very large research and development costs and significant capital outlays for their manufacture, which means that profit comes from volume, and losing a customer such as Huawei hurts that profit even more because of operational leverage. We estimate that the earnings effect from the Huawei ban is likely to be 2-3x higher than the sales effect due to this. The price under-reaction indicates that the market expects either the ban to be temporary or Huawei's competitors to pick up the slack.

FIGURE 4

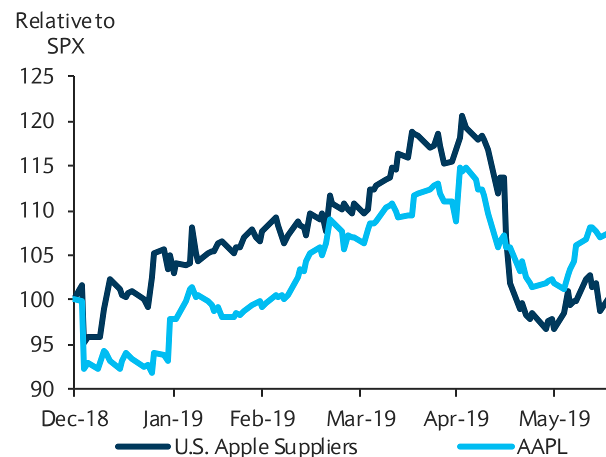
Suppliers to Huawei have sold off significantly…



Source: Bloomberg, Barclays Research

FIGURE 5

… as has Apple and its suppliers



Source: Bloomberg, Barclays Research

Knock-on effects of Huawei ban

- **US Telecom sector (Neutral effect)**: US telecoms use Huawei for less than 1% of their wireless needs, so the Huawei ban should not really affect them.
- **US Telecom Equipment Manufacturers (Positive effect):** Huawei has challenged the leadership of US networking suppliers over the last few years. For example, while US manufacturers had 95% market share in global IP routing in 2002, this dwindled to only 65% in 2018, with Huawei taking 31% (*TMT: 5G Leadership: Huawei In Context*, June 5, 2019). If the Huawei ban remains in place, these companies could regain market share as telecom carriers redirect new purchases to these manufacturers.
- **European Telecom Equipment sector (Positive effect):** If the Huawei ban becomes permanent, Telecom equipment manufacturers could be beneficiaries from decreased competition and more orders if European Telecom firms are forced to exclude Huawei from their 5G rollout.
- **European Telecom firms (Mixed, likely negative effect):** Telecom firms may have to delay or prolong their planned 5G rollout, given higher potential costs. A worse outcome for European Telecoms would be if they would need to remove existing Huawei components from their networks. This would involve substantial extra capital expenditure.
- **European Semiconductor companies (Mixed, likely negative effect):** At the margin, some European names in Semis & Tech Hardware may win market share from US peers as Chinese tech looks to diversify their supplier base away from the US. However, if Huawei cannot get critical components from US, it may also need to stop buying components from European suppliers. Some European Tech companies make goods that incorporate US patented technology and may therefore be directly affected. Overall, the complex picture argues for a mixed to negative result for European firms. Profit warnings thus far have been larger than expected, perhaps showing the depth of the interconnectedness in supply chains.

- Meanwhile, European Tech names are not cheap, trading near one standard deviation expensive on P/E. Furthermore, this elevated valuation is based on peak earnings that have not yet begun to price in a slowdown meaningfully. We have had Semis underweight since early May and moved the overall Tech sector to underweight in June, as we expect reverberations from the Huawei situation to dent global Tech spending, on top of the broader economic slowdown.

Effect of US-China non-tariff measures: China retaliation

While China has reacted proportionately to the tariffs imposed by the US, it has not retaliated in a meaningful manner to the Huawei ban. In this section, we examine the potential retaliation channels, which include export restrictions (eg, on rare earth metals), restrictions on sales of US goods and services, financial tools such as devaluing the CNY and selling US Treasuries and other non-tariff restrictions targeting US companies trading with or operating in China.

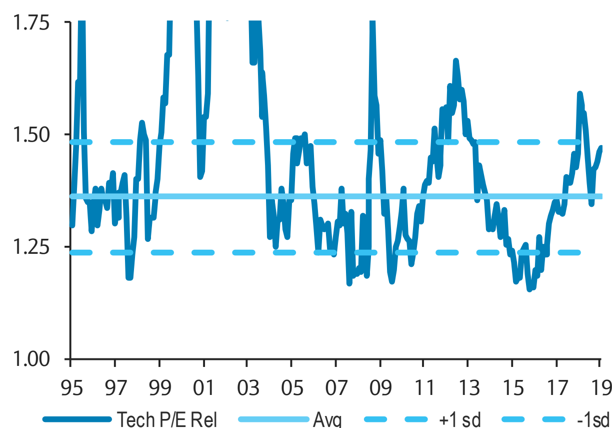
Retaliate against US companies' operations in China

On 31 May, China's Ministry of Commerce (MOFCOM) announced plans to set up an Unreliable Entities List (UEL) that would target any foreign company, organization, or individual that damaged the interests of Chinese companies or threatened China's national security. MOFCOM emphasized that firms that had taken discriminatory actions against Chinese companies could be part of this blacklist. While it is not clear what entities MOFCOM might add to the list, US firms such as Qualcomm, Intel, Microsoft and Google that have followed the US directive to stop providing key components to Huawei might come under scrutiny. Similarly, non-US companies that have cut off Huawei (eg, UK's ARM and Japan's Toshiba) risk being added to this list. While China has already imposed bans on a number of social media US companies over the last decade, like Google, Facebook and Twitter, the recent action is more deliberate to mirror the actions of the US against Huawei.

China has not yet made clear what being on this list entails, but recent actions provide some clues. For example, in early June, China opened a probe into FedEx for its potential violation of Chinese laws and regulations, because four packages containing documents being shipped to Huawei in China were diverted to the US without authorization. Similarly, on June 4, China's market regulator fined Ford Motor's main joint venture ~CNY160mn in China for violating anti-monopoly laws. It seems likely that companies on China's UEL will be subject to restrictions in trade and sales, and possibly also investments and business. It is also possible that individuals' travel, activities, and employment applications could be rejected.

FIGURE 6

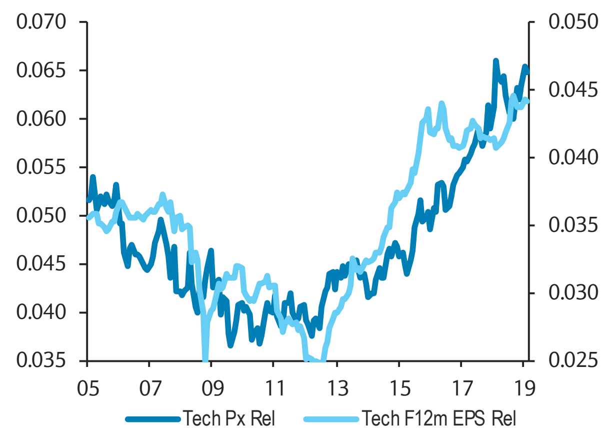
MSCI Europe Technology sector P/E relative to MSCI Europe



Source: Refinitiv, IBES, MSCI, Barclays Research

FIGURE 7

MSCI Europe Technology sector price and earnings relative to MSCI Europe



Source: Refinitiv, IBES, MSCI, Barclays Research

Chinese authorities could also make life difficult for US firms operating in China, in other less official ways. The government could raise the hurdles to doing business by intensifying shipping inspections and prolonging customs checks, applying greater scrutiny or delaying approvals of licenses, tightening regulatory discretion of investment by US companies, and launching investigations into company practices. The American Chamber of Commerce of China noted recently that nearly half of its members were facing non-tariff barriers as retaliation after the US-China trade war took a turn for the worse a couple of months ago. Finally, China is a very large and important consumer market for many American brands, from Starbucks and McDonald's to Apple. For now, we do not expect a voluntary or government-sponsored consumer boycott of US brand names, but it remains a risk that we are watching closely.

Among US companies, Apple Inc. is most exposed to China on two fronts: first, the company manufactures most of it products in China and is, thus, exposed to an escalation of import tariffs by the US; second is the importance of the Chinese consumer market to the iPhone, which China could disrupt through non-tariff measures. If the company's products were hit by tariffs, Apple would be forced either to raise prices or to cut margins, or some combination of the two. It could squeeze its suppliers to preserve margins. If China retaliates to the Huawei ban by banning sales of Apple products, we estimate that a total Apple ban for example would negatively affect the Information Technology sector earnings and hurt S&P 500 earnings by 0.8%. The price effect on the stocks in the Apple supplier basket has also been quite substantial (Figure 5).

More broadly, we estimate that a 10% effect on Chinese revenue for all US companies operating in China will hurt S&P 500 earnings by 2.9%, higher than that due to tariffs.

Allow the CNH to depreciate

Several investors have raised the prospect that China might retaliate against US tariffs by weakening its currency. We do believe that the Chinese authorities will allow the RMB to depreciate past 7 (for the first time in over a decade) after the G20, assuming that the US imposes 25% tariffs on all Chinese exports. However, we do not expect depreciation of a magnitude that materially offsets 25% tariffs. In other words, we are looking for the RMB to depreciate a few percent; our year-end forecast for the USD/CNH is 7.25.

On the one hand, there are plenty of reasons for China to depreciate its currency. Over the past couple of decades, it has arguably resisted the trend depreciation that many EM currencies have had against the USD (for example, Asia's second-largest EM economy India; the INR has depreciated from 45 to about 70 against the USD since 2000, even as the RMB has moved from 8 to below 7). China no longer runs a massive aggregate current account surplus. Market conditions seem to be pushing in the direction of RMB weakness as trade war concerns accelerate. And China has done a good job of choking off capital flight after learning lessons from the second half of 2015.

Yet we think the authorities will be at pains to emphasize that any CNY depreciation is controlled and not drastic. China wants to 'internationalize' its currency over the next several years and presumably will not want the RMB to be seen as vulnerable to massive swings. And while there are no signs of capital flight, the country has $900bn fewer in FX reserves than at the start of 2015. Moreover, its domestic financial system is much bigger, meaning that the percentage of local liquidity that needs to 'run' or leak out before FX reserves drop sharply is lower and, thus, (at the margin) more likely. If we are wrong and capital flight does pick up, China is arguably less prepared than in the 2015 episode. For all these reasons, we believe that China will not brandish currency weakness as a weapon through a sharp depreciation, even as it allows steady and controlled weakness in the RMB over the next several months.

Sell US Treasury Holdings

Worsening trade rhetoric has again brought to the fore the possibility of China's selling its US Treasury holdings. While it is very possible that it could be forced to liquidate US Treasuries to defend its currency should there be a capital flight, choosing to do so as a negotiating tool seems unlikely, in our view.

Central banks typically hold a significant portion of their FX reserves in US Treasuries because the Treasury market is deep and liquid. In a capital flight, Treasuries can be readily sold. China is no exception. China's US Treasury holdings have largely mimicked its FX reserves. It was forced to reduce its FX reserves from about $4trn at the end of 2014 to $3trn by the end of 2016 to offset the capital flight. Not surprisingly, it reduced its Treasury holdings as well. Absent a capital flight, the key question is what would China do with the USD proceeds if it sells USTs. Converting into yuan (or even another currency) would likely strengthen the currency and tighten domestic financial conditions. Leaving them in USD would serve no political purpose. Further, reducing the share of the most liquid asset class in FX reserves in favour of other asset classes/currencies would not be prudent from a risk management perspective, in our view.

Meanwhile, US Treasuries are likely to take cues from the worsening global and economic backdrop rather than sales, given their safe haven status. The 2015-16 experience shows that even as China sold $400-500bn of US Treasuries, yields fell dramatically, suggesting the global backdrop matters far more for outright yields. Further, China's US Treasury holdings (if they are like a typical central bank) are likely front-loaded, limiting the duration effect of sales. Having said that, should China sell USTs, they would cheapen versus, for example, matched-maturity swaps. Such sales are likely to lead to a build-up of dealer inventory of Treasuries, which are already bloated and would need to be financed.

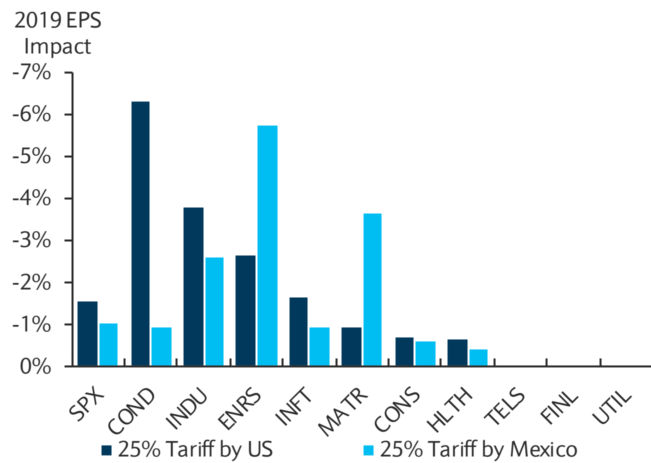
Effect of US-Mexico Tariffs

On May 30, 2019, President Trump unexpectedly announced plans to impose a 5% tariff on Mexican imports and raise these gradually to 25% by October 1, 2019, unless Mexico takes action to halt the flow of mostly Central American migrants through Mexico to the southern US border. However, on June 7, he announced that the planned tariffs will be suspended after Mexico agreed to adopt stronger measures to control immigration. Still, the nations agreed to reconvene after 90 days if the measures do not produce "expected results". For now, our base case is that the truce between the two countries will last, but there is a non-trivial possibility of a resurgence on this front.

Our Mexican economist expects a very significant effect on the Mexican economy if the tariffs are actually implemented (*Mexico and FX & EM Strategy: Threat on tariffs and risks of escalation*, 31 May, 2019). We estimate that a 25% tariff on all US-Mexico trade would affect S&P 500 earnings by ~2.5%, with more significant effects on the Consumer Discretionary (especially autos) and Energy sectors (Figure 8). The price reaction of risky assets most exposed to a potential US-Mexico trade war (Mexican peso, Mexican equities, US automakers) indicates that the market believes that the truce between the two countries is permanent (Figure 9).

FIGURE 8

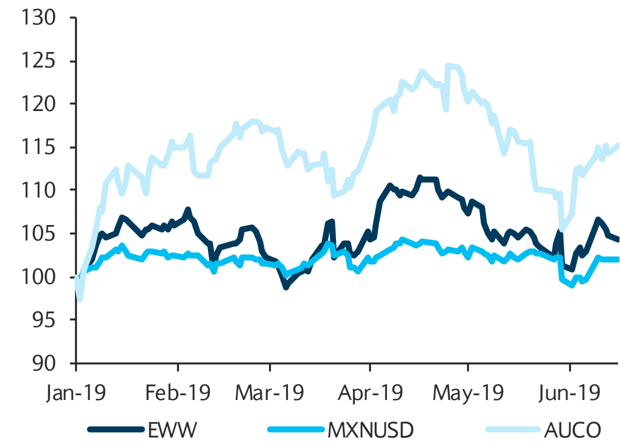
US-Mexico tariffs would affect some sectors substantially



Source: US Census Bureau, BEA,10-K filings of S&P 500 companies, Bloomberg, Barclays Research

FIGURE 9

However, risky assets are not pricing a substantial escalation



Source: Bloomberg, Barclays Research

Effect of US-Europe tariffs

The US Department of Commerce has concluded a review of whether automobile imports threaten national security under Section 232 of the Trade Expansion Act of 1962. While the results of the review are not publicly known, implementation would, in our view, have a substantial effect on the European economy. Our economists estimate the imposition of autos tariffs on Europe could cause a hit of as much as 40bp to European GDP, 60bp in Germany alone (see EU-US trade: *Car tariff hike – getting under the hood* from 29 November 2018). Certainly, there could be some mitigating factors (a fall in the EUR, potential ECB or fiscal response), but regardless, we would expect the effect to be negative. As we discuss below, in our opinion, the European auto sector is not pricing in these higher risks. While this sector has underperformed the broader European equity indices, it has more or less performed in line with US autos on both a price and a valuation basis.

What is priced into European autos?

The global auto industry is already facing significant and costly secular headwinds: the shift to electric drivetrains, autonomous vehicles and ride-hailing. Volumes in China, the industry's growth engine, collapsed from July 2018 and are running at nearly -18% y/y (Figure 10). As yet, they show little sign of recovery, although comps ease as H2 begins. US and European volumes also went negative in H2 18 and have barely made it back to flat y/y thus far.

The European auto industry is also facing self-made headwinds related to "Diesel-gate" and the consequent increased emissions and testing costs.

FIGURE 10

Car Sales y/y for China, the US and Europe

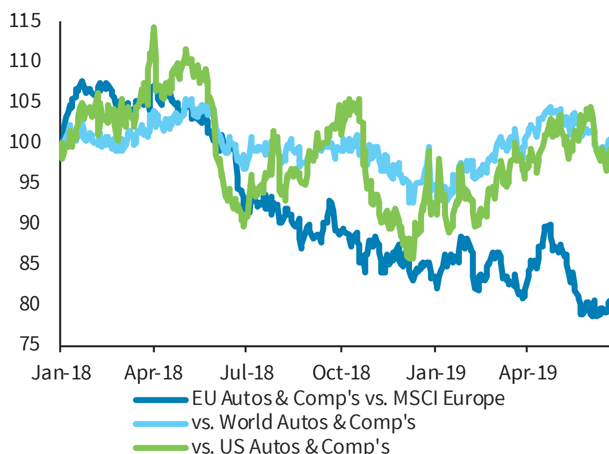
Source: Bloomberg, Barclays Research

As a result, the European Autos & Components sector has significantly underperformed the broader European equity indices, we note four distinct periods. The sector had its first significant underperformance in June 2018, as China volumes went negative and tariff noise emerged. WLTP-related volume distortions were most paramount in Q3 18, but at the same time underlying economic weakness was emerging. This helped cause the sector underperformance in Q4 18, as the global equity risk-off event took hold and tariff threats continued. The sector then enjoyed a period of outperformance in early 2019, as bad news was felt to be priced in, sentiment toward the sector improved, and a US-China trade resolution looked to be within reach. However, when the US-China trade war re-escalated in early May, the underperformance re-emerged. The recent Mexico skirmish is unlikely to provide reassurance: Mexico was seen as a medium-term coping strategy for the European names, where they could have shifted production should tariffs have been introduced on European exports.

However, European autos have not substantially lagged their US counterparts. Thus, the Autos & Components sectors in the US and Europe are trading near trough valuations (Figure 11 and Figure 12), and earnings have been correcting since mid-2018.

FIGURE 11

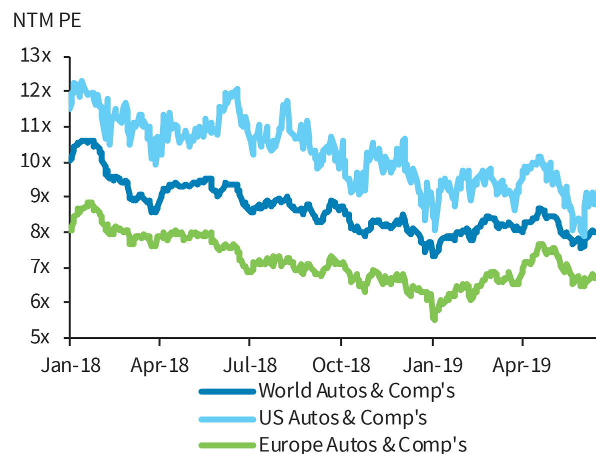
MSCI Europe Autos & Components Sector Performance Relative to MSCI Europe and MSCI World and US Autos & Components



Source: Bloomberg, Barclays Research

FIGURE 12

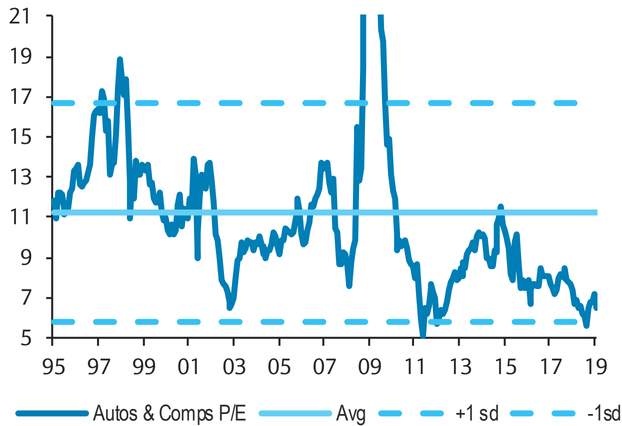
MSCI World, US and Europe Autos & Components Sector Valuations Are Trading Near Trough Levels



Source: Bloomberg, Barclays Research

FIGURE 13

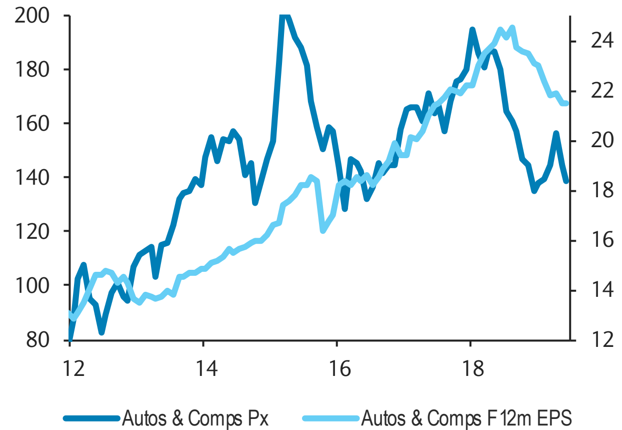
MSCI Autos & Components sector F12m P/E at cycle lows…



Source: Refinitiv, IBES, MSCI, Barclays Research

FIGURE 14

… and earnings have come down some, but do not include the potential effect from tariffs



Source: Refinitiv, IBES, MSCI, Barclays Research

The imposition of tariffs between the US and EU would likely cause a further correction to earnings of European names. Our sector analysts estimate 12-25% of earnings could be lost at the German OEMs. Parts/components companies are not immune either, and autos supply chains would also see a reduction in volumes. Based on the above risks, we would argue that while European Autos & Components have de-rated vs. the equity market overall, they have not particularly underperformed their global peers, especially US Autos & Components, which are subject to many of the same secular forces, but not the EU-US tariff threat.

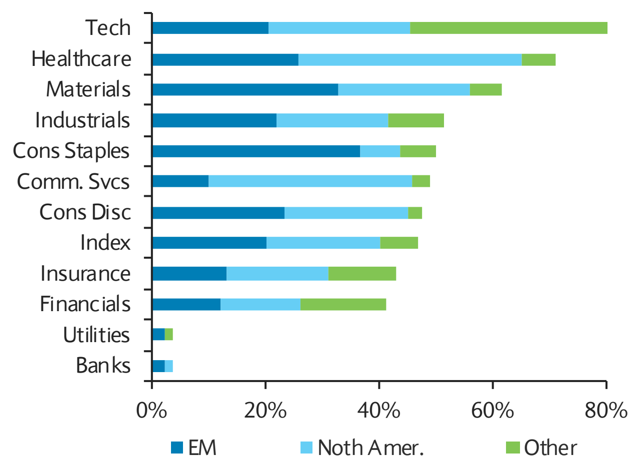
European Chemicals derive on average 10-15% of revenue from the Autos & Components sector, with some companies as high as 30-40% and, hence, could also be exposed to downside risk.

German Equities could be affected more significantly

Within Europe, Germany is the most exposed to the global trade slowdown, specifically the threat of autos tariffs, and has a higher-than-average exposure to Tech. At c.40% of GDP, exports account for a larger proportion of the German economy than any other European

FIGURE 15

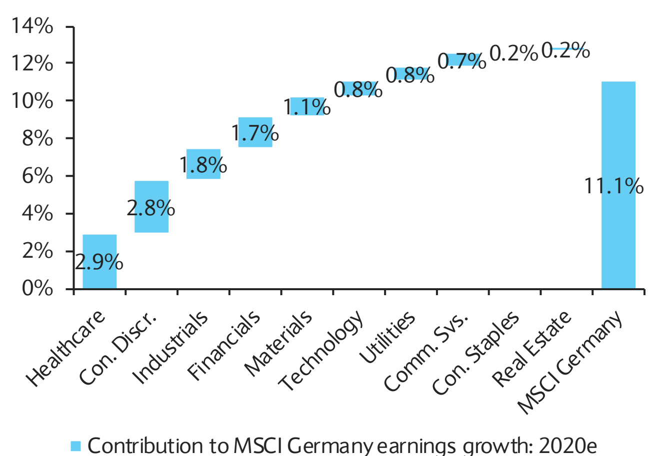
German equities export sales exposure: Emerging markets and North America dominate



Source: Worldscope, Bloomberg, Barclays Research

FIGURE 16

Contribution to 2020 consensus earnings growth for MSCI Germany by sector



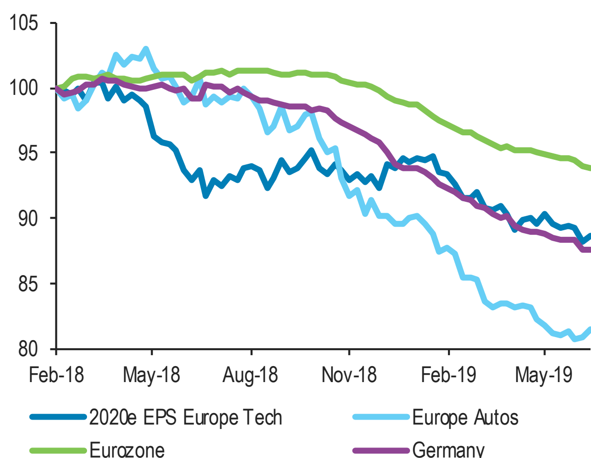
Source: Refinitiv, IBES, Barclays Research

country, and it is the third-largest exporter in the world, behind China and the US. Moreover, exports to the US and China represent about 3% of GDP each, while car exports alone (to countries outside the EU) account for more than 2% of GDP. Consequently, the German equity market is highly cyclical (55% of market cap in cyclical sectors), which is mostly exposed to mature industries such as Chemicals (8%), Industrials (13%), and Autos (14%).

For 2020, the bulk of EPS growth for Germany is expected to come from five sectors: Healthcare, Financials, Consumer Disc (75% Autos), Industrials, and Materials (Chemicals). The latter three are clearly at risk from a further global/trade slowdown. The consensus estimates 9% eurozone EPS growth for 2020 and 11% for Germany, which look optimistic in the current climate and would not include any further hit to GDP from auto tariffs. While new tariffs could lead the EUR lower, the benefit to European earnings would likely be marginal compared with the overall growth decline. We recently moved German equities back to UW (*European Equity Strategy: Complacency is gone but caution still warranted*) as the tariff war re-escalated and continue to recommend caution on trade and tariff-exposed equities more broadly.

FIGURE 17

2020 EPS numbers for Europe tech, autos, MSCI eurozone and MSCI germany are being cut…



Source: Refinitiv, IBES, Barclays Research

FIGURE 18

…but larger cuts to 2019 EPS numbers mean 2020 EPS growth rates are rising

EPS y/y	Latest		end-18	Latest		end-18
	2020e		2020e	2019e		2019e
Europe Tech	19.2%	▲	14.0%	10.0%	▼	17.3%
Europe Autos	7.8%	▲	6.0%	2.9%	▼	10.2%
MSCI Eurozone	10.0%	▲	9.0%	4.7%	▼	9.2%
MSCI Germany	11.1%	▲	9.4%	5.0%	▼	10.3%

Source: Refinitiv, IBES, Barclays Research

GLOBAL FORECASTS

Interest Rates

Rajiv Setia +1 212 412 5507, rajiv.setia@barclays.com, BCI, US

FIGURE 1
Global bond yield forecasts

10y Global Bond Yields				
	Q319	Q419	Q1 20	Q2 20
US Treasuries	1.95	1.95	1.95	1.95
Euro Government Bonds	-0.25	-0.25	-0.20	-0.20
UK Government Bonds	0.80	0.85	0.85	0.90
Japan Government Bonds	-0.15	-0.10	-0.10	-0.10

Source: Barclays Research

Commodities

Amarpreet Singh +1 212 526 1672, amarpreet.x.singh@barclays.com, BCI, US

FIGURE 2
Commodities Forecasts

	Units	Q4 18	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
WTI	US$/bbl	59	55	65	67	66	71	70	67	63
Brent	US$/bbl	69	64	73	74	73	78	77	74	70

Source: Bloomberg, Barclays Research

Equities

Maneesh Deshpande +1 212 526 2953, maneesh.deshpande@barclays.com, BCI, US
Emmanuel Cau +44 (0)20 3134 0475, emmanuel.cau@barclays.com, Barclays, UK

FIGURE 3
Global Equity Indices year-end targets

Index	1Q (March 29, 2019)	Spot(June 25, 2019)	2019 End Forecast
S&P 500 (SPX)	2834	2917	2750
Euro Stoxx (SXXE)	367	373	390
FTSE 100 (UKX)	7279	7422	7700

Source: Barclays Research

FX & EM Macro Strategy

Marvin Barth + 44 (0) 20 3134 3355, marvin.barth@barclays.com, Barclays, UK

FIGURE 4

FX & EM Macro Strategy forecasts

	Forecasts					Forecast vs Outright Forward			
	Spot	End Q3 19	End Q4 19	End Q1 20	End Q2 20	End Q3 19	End Q4 19	End Q1 20	End Q2 20
G10 countries									
EURUSD	1.14	1.14	1.11	1.08	1.06	-0.5%	-3.7%	-6.9%	-9.2%
USDJPY	107	105	102	102	103	-1.3%	-3.6%	-3.0%	-1.4%
GBPUSD	1.27	1.27	1.25	1.23	1.20	-0.6%	-2.5%	-4.3%	-6.3%
USDCHF	0.98	0.96	0.98	1.00	1.01	-0.2%	2.3%	5.0%	6.8%
USDCAD	1.32	1.34	1.35	1.35	1.35	1.5%	2.7%	2.8%	2.8%
AUDUSD	0.70	0.68	0.67	0.67	0.67	-2.9%	-3.8%	-4.7%	-5.2%
NZDUSD	0.66	0.65	0.64	0.63	0.63	-2.3%	-3.9%	-5.5%	-6.3%
EURJPY	122	120	113	110	109	-1.8%	-7.2%	-9.7%	-10.5%
EURGBP	0.90	0.90	0.89	0.88	0.88	0.2%	-1.3%	-2.8%	-3.1%
EURCHF	1.11	1.10	1.09	1.08	1.07	-0.7%	-1.5%	-2.3%	-3.1%
EURSEK	10.55	10.75	10.80	10.90	10.90	1.9%	2.2%	3.1%	3.0%
EURNOK	9.71	9.50	9.60	9.75	9.85	-2.7%	-2.2%	-1.2%	-0.8%
Emerging Asia									
USDCNY	6.88	7.05	7.15	7.15	7.20	2.4%	3.6%	3.4%	3.8%
USDHKD	7.81	7.80	7.80	7.80	7.80	-0.1%	0.0%	0.0%	0.1%
USDINR	69.35	68.50	69.25	68.50	69.50	-2.3%	-2.1%	-3.1%	-3.5%
USDIDR	14,125	14,500	14,700	14,800	14,900	1.4%	1.5%	0.9%	0.4%
USDKRW	1,156	1,200	1,210	1,220	1,225	4.2%	5.4%	6.6%	7.4%
USDMYR	4.14	4.17	4.22	4.23	4.24	0.9%	2.0%	2.1%	2.1%
USDPHP	51.38	52.25	53.00	53.25	53.50	1.0%	1.9%	1.8%	1.7%
USDSGD	1.35	1.38	1.39	1.40	1.41	2.0%	3.2%	3.7%	4.4%
USDTHB	30.77	31.60	32.00	32.00	32.00	3.0%	4.5%	4.7%	5.0%
USDTWD	31.06	31.70	32.05	32.00	32.00	2.7%	4.2%	4.6%	5.1%
Latin America									
USDBRL	3.85	3.95	3.90	3.90	3.90	1.7%	-0.3%	-1.1%	-1.9%
USDCOP	3,191	3,325	3,350	3,375	3,375	3.7%	4.0%	4.2%	3.6%
USDMXN	19.22	19.50	19.75	20.00	19.75	-0.1%	-0.4%	-0.7%	-3.4%
EMEA									
EURHUF	323	328	330	332	334	1.3%	1.7%	2.1%	2.5%
EURPLN	4.26	4.30	4.32	4.34	4.36	0.5%	0.4%	0.3%	0.2%
USDRUB	62.96	64.50	66.00	66.50	67.00	1.1%	2.1%	1.6%	1.1%
USDTRY	5.80	6.00	6.20	6.40	6.50	-1.8%	-2.9%	-3.8%	-6.0%
USDILS	3.60	3.60	3.60	3.62	3.62	0.7%	1.2%	2.2%	2.7%
USDZAR	14.34	14.75	15.00	15.25	15.50	1.6%	2.1%	2.6%	3.0%

Note: Spot and forwards as of 25 June 2019. Source: Barclays Research

Economics

Christian Keller +44 (0)20 7773 2031, christian.keller@barclays.com, Barclays, UK

FIGURE 5

Official interest rates and Barclays Research projections

	Current	Start of cycle date	Start of cycle level	Last move	Next move expected	Forecasts Q2 19	Q3 19	Q4 19	Q1 20	Q2 20
Advanced										
Fed funds rate	2.25-2.50	Tightening:16 Dec 15	0-0.25	Dec 18 (+25)	Q3 19 (-75)	2.25-2.50	1.50-1.75	1.50-1.75	1.50-1.75	1.50-1.75
BoJ rate of policy-rate balances	-0.10	Easing: 30 Oct 08	0.50	Jan 16 (-20-0)	Beyond 2020	-0.10	-0.10	-0.10	-0.10	-0.10
BoJ target of 10y JCB yields	0.00	Easing: 21 Sep 16	-	Sep 16 (0)	Beyond 2020	0.00	0.00	0.00	0.00	0.00
ECB main refinancing rate	0.00	Easing: 3 Nov 11	1.50	Mar 16 (-5)	Beyond 2020	0.00	0.00	0.00	0.00	0.00
ECB deposit facility rate	-0.40	Easing: 3 Nov 11	0.75	Mar 16 (-10)	Sep 19 (-10)	-0.40	-0.50	-0.60	-0.70	-0.70
BOE bank rate	0.75	Tightening 2 Nov 17	0.25	Aug 18 (+25)	Beyond 2020	0.75	0.75	0.75	0.75	0.75
RBA cash rate	1.25	Easing: 4 Jun 19	1.50	Jun 19 (-25)	Aug 19 (-25)	1.25	1.00	1.00	1.00	1.00
RBNZ cash rate	1.50	Easing: 8 May 19	1.75	May 19 (-25)	Aug 19 (-25)	1.50	1.25	1.25	1.25	1.25
Swiss National Bank: policy rate	-0.75	Easing: 8 Oct 08*	2.25 to 3.25*	Jan 15 (-50)*	Beyond H1 2020	-0.75	-0.75	-0.75	-0.75	-0.75
Norges Bank: Deposit rate	1.25	Tightening: 20 Sep 18	0.50	Jun 19 (+25)	Dec 19 (+25)	1.25	1.25	1.50	1.50	1.50
Riksbank: Repo rate	-0.25	Tightening: 20 Dec 18	-0.50	Dec 18 (+25)	Beyond H1 2020	-0.25	-0.25	-0.25	-0.25	-0.25
Bank of Canada	1.75	Tightening: 12 Jul 17	0.50	Oct 18 (+25)	Beyond Q2 2020	1.75	1.75	1.75	1.75	1.75
Emerging Asia										
China: 1y bench. lending rate	4.35	Easing: 21 Nov 14	6.00	Oct 15 (-25)	Beyond 2020	4.35	4.35	4.35	4.35	4.35
Hong Kong: Base rate	2.75	Tightening: 17 Dec 15	0.50	Dec 18 (+25)	Q3 19 (-75)	2.75	2.00	2.00	2.00	2.00
India: Repo rate	5.75	Easing: 07 Feb 19	6.50	Jun 19 (-25)	Aug 19 (-25)	5.75	5.50	5.50	5.50	5.50
Indonesia: 7 day reverse repo	6.00	Tightening: 17 May 18	4.25	Nov 18 (+25)	Q3 19 (-25)	6.00	5.50	5.25	5.00	5.00
Korea: Base rate	1.75	Tightening: 30 Nov 17	1.25	Nov 18 (+25)	July 19 (-25)	1.75	1.50	1.50	1.50	1.25
Malaysia: O/N policy rate	3.00	Easing: 07 May 19	3.00	May 19 (-25)	Q3 19 (-25)	3.00	2.75	2.75	2.75	2.75
Philippines: O/N lending#	4.50	Easing: 09 May 19	4.75	May 19 (-25)	Q3 19 (-25)	4.50	4.25	4.00	4.00	4.00
Taiwan: Rediscount rate	1.375	Easing: 24 Sep 15	1.875	Jun 16 (-12.5)	Q1 20 (-12.5)	1.375	1.375	1.375	1.250	1.125
Thailand: O/N repo rate	1.75	Easing: 30 Nov 11	3.50	Dec 18 (+25)	Beyond Q2 2020	1.75	1.75	1.75	1.75	1.75
Emerging Europe, Middle East & Africa										
Hungary: 2w deposit rate	0.90	Easing: 22 Mar 16	1.35	May 16 (-15)	Q4 19 (+10)	0.90	0.90	0.90	1.00	1.20
Israel: Discount rate	0.25	Tightening: 26 Nov 18	0.10	Nov 18 (+15)	Beyond Q2 2020	0.25	0.25	0.25	0.25	0.25
Poland: 2w repo rate	1.50	Easing: 4 Mar 15	2.00	Feb 15 (-50)	Beyond Q2 2020	1.50	1.50	1.50	1.50	1.50
Russia: One-week repo rate	7.50	Easing: 30 Jan 15	17.00	Jun 19 (-25)	Q3 19 (-25)	7.50	7.25	7.00	6.75	6.50
South Africa: Repo rate	6.75	Tightening: 22 Nov 18	6.50	Nov 18 (+25)	Jul 19 (-25)	6.75	6.50	6.50	6.50	6.50
Turkey: One-week repo rate	24.00	Tightening: 24 Nov 16	7.50	Sep 18 (+625)	Q3 19 (-400)	24.00	20.00	20.00	20.00	20.00
Latin America										
Argentina: LELIQ 7 day rate	65.00	Tightening: 27 Apr 18	27.25	Mar 19 (+1500)	Q4 19 (-1000)	65.00	65.00	55.00	45.00	40.00
Brazil: SELIC rate	6.50	Easing: 19 Oct 16	14.25	Mar 18(-25)	Sep 19 (-25)	6.50	6.25	5.75	5.75	5.75
Colombia: Repo rate	4.25	Easing: 16 Dec 16	7.75	Apr 18 (-25)	Nov 19 (+25)	4.25	4.25	4.25	4.50	4.75
Mexico: Overnight rate	8.25	Tightening: 17 Dec 15	3.00	Dec 18 (+25)	Beyond Q2 2020	8.25	8.25	8.25	8.25	8.25
Peru: Reference rate	2.75	Easing: 11 May 17	4.25	Mar 18 (-25)	Beyond Q2 2020	2.75	2.75	2.75	2.75	2.75

Note: Rates as of COB 25 June 2019 in % per annum (unless stated). *Referring to the previous target range of the 3-month Libor.

Source: Barclays Research

FIGURE 6

General government gross debt/GDP ratios and Barclays Research projections

Gross government debt ratio (% GDP)

	2014	2015	2016	2017	2018	2019F	2020F
Americas							
United States	103.5	103.9	106.8	105.2	107.2	107.3	108.5
Latin America							
Argentina	44.7	52.6	53.3	56.6	86.1	76.1	69.8
Brazil	56.3	65.5	70.0	74.1	77.2	79.7	80.9
Colombia	46.2	51.2	51.9	52.8	52.6	51.9	50.8
Mexico	41.3	45.4	49.4	47.0	46.9	47.0	45.9
Peru	19.3	22.3	23.3	25.0	25.8	26.3	26.8
Venezuela	81.5	127.8	75.6	90.8	97.6	129.6	98.2
Asia/Pacific							
Japan	186.2	186.1	188.8	189.5	192.3	193.6	193.7
Australia	34.2	37.6	41.3	43.2	42.0	41.0	41.0
Emerging Asia							
China*	14.9	15.5	16.2	16.4	16.6	17.1	17.4
Hong Kong	0.1	0.1	0.1	0.1	0.1	0.1	0.1
India**	66.6	68.6	68.2	68.9	68.3	68.0	67.0
Indonesia	25.8	29.4	30.2	32.6	34.1	34.2	33.8
South Korea	32.2	37.8	38.3	38.2	38.6	39.4	40.2
Malaysia	51.9	53.6	51.9	50.1	51.2	52.3	53.1
Philippines	45.3	44.4	41.7	40.8	40.9	41.0	41.0
Singapore	97.1	99.5	105.4	107.4	111.3	115.1	119.4
Taiwan	35.8	34.5	33.3	32.1	32.0	31.9	31.9
Thailand	42.5	43.7	40.7	41.2	41.9	42.4	44.3

	2014	2015	2016	2017	2018	2019F	2020F
Europe and Africa							
Euro area	94.4	92.3	91.4	89.1	87.1	86.5	85.4
Belgium	107.5	106.4	106.1	103.4	102.0	101.3	100.7
France	94.9	95.6	98.0	98.4	98.4	99.1	99.0
Germany	75.3	71.6	68.5	64.5	60.9	58.5	56.6
Greece	178.9	175.8	178.5	176.2	181.1	177.3	172.4
Ireland	104.2	76.8	73.5	68.5	64.7	61.3	55.9
Italy	131.8	131.6	131.4	131.4	132.2	133.8	135.0
Netherlands	67.9	64.7	61.9	57.0	52.4	49.1	46.7
Portugal	130.6	128.7	129.2	124.8	121.5	119.5	116.6
Spain	100.4	99.3	99.0	98.1	97.1	96.7	96.6
United Kingdom#	82.6	82.3	85.1	84.6	83.1	82.8	81.7
EM Europe & Africa							
Poland	50.0	51.2	54.2	50.2	48.0	46.2	44.8
Russia	15.9	16.4	17.1	17.8	17.5	16.5	15.0
Turkey	28.8	27.6	28.3	28.3	32.2	33.7	33.8
Israel	66.1	64.0	62.3	60.8	59.8	59.0	58.6
South Africa	46.5	48.9	50.6	52.7	55.6	56.8	58.0

Note: (*) Central government debt ratio is reported for China; (**) Corresponds to FY for India (i.e., FY 17/18 = 2017); (#) Corresponds to FY for UK (i.e., FY 17/18 = 2017), and is defined as Public Sector Net Debt. Source: Barclays Research

FIGURE 7

Global Key Events Calendar

	2019							2020				
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Key policy meetings/Publications												
North America												
FOMC meeting	19	31	-	18	30	-	11	29	-	18	29	-
Summary of Economic Projections	19	-	-	18	-	-	11	-	-	18	-	-
FOMC minutes	-	10	21	-	9	20	-	2	19	-	8	20
Fed's Beige Book	5	17	28	-	16	27	-	8	26	-	15	27
Bank of Canada	-	10	-	4	30	-	4	…	…	…	…	…
Europe												
EU Summit	20-21,30	-	-	-	17-18	-	12-13	-	-	26-27	-	-
EU General Affairs Council	18,25	23	-	16	15	19	10	…	…	…	…	…
ECOFIN	14	9,24	-	13-14#	10	8,15	5	…	…	…	…	…
Eurogroup	13	8	-	13	9	7	4	…	…	…	…	…
ECB "policy" meeting	6	25	-	12	24	-	12	23	-	12	30	-
ECB minutes	-	4	22	-	10	21	-	9	20	-	9	28
ECB economic bulletin	20	-	8	26	-	7	26	-	6	26	-	14
ECB "non-policy" meeting	26	10	7	25	9	6,20	4	-	19	-	1	20
EU deadline for draft budget submission	-	-	-	-	TBD	-	-	-	-	-	-	-
BoE - MPC policy meeting	20	-	1	19	-	7	19	30	-	26	-	7
BoE Inflation Report	-	-	1	-	-	7	-	30	-	-	-	7
BoE minutes	20	-	1	19	-	7	19	30	-	26	-	7
Brexit*	-	-	-	-	31	-	-	-	-	-	-	-
Riksbank	-	3	-	5	24	-	19	…	…	…	…	…
SNB	13	-	-	19	-	-	12	-	-	19	-	-
Norges Bank	20	-	15	19	24	-	19	…	…	…	…	…
Asia/Africa/RoW												
Bank of Japan	19-20	29-30	-	18-19	30-31	-	18-19	…	…	…	…	…
BoJ minutes	25	-	2	25	-	6	24	…	…	…	…	…
Reserve Bank of Australia	4	2	6	3	1	5	3	…	…	…	…	…
RBNZ	26	-	7	25	-	13	-	-	12	25	-	-
South African Reserve Bank	-	18	-	19	-	21	-	…	…	…	…	…
Key international meetings												
IMF/IBRD	-	-	-	-	18-20	-	-	-	-	-	17-19	-
G20	28-29	-	-	-	-	-	-	…	…	…	…	…
G7	-	-	25-27	-	-	-	-	…	…	…	…	…
Elections/Key political meetings												
Portugal (General)	-	-	-	-	6	-	-	-	-	-	-	-
Argentina (Presidential, 1st round)	-	-	-	-	27	-	-	-	-	-	-	-
Japan (Parliament, upper house)	-	21 TBC	-	-	-	-	-	-	-	-	-	-

(-) No event, (…) Event yet to be confirmed. (#) Informal meetings of ministers in Helsinki. (*) 31 Oct.: New exit deadline

Source: Central banks, IMF, European Commission, Reuters, Bloomberg, Market News, Barclays Research

RESEARCH CONTACTS

Jeff Meli
Head of Research
+1 212 412 2127
jeff.meli@barclays.com
BCI, US

Ajay Rajadhyaksha
Head of Macro Research
+1 212 412 7669
ajay.rajadhyaksha@barclays.com
BCI, US

Marvin Barth
Head of FX Strategy
+ 44 (0) 20 3134 3355
marvin.barth@barclays.com
Barclays, UK

Christian Keller
Head of Economics Research
+44 (0)20 7773 2031
christian.keller@barclays.com
Barclays, UK

Andreas Kolbe
Head of EM Credit Research
+ 44 (0) 20 3134 3134
andreas.kolbe@barclays.com
Barclays, UK

Michael Pond
Head of Inflation-Linked Research
+1 212 412 5051
michael.pond@barclays.com
BCI, US

Daniel Rekrut
Head of Developed Markets Fundamental Credit Research
+44 (0)20 777 35980
daniel.rekrut@barclays.com
Barclays, UK

Bradley Rogoff
Head of Credit Research and Strategy
+1 212 412 7921
bradley.rogoff@barclays.com
BCI, US

Rajiv Setia
Head of Rates Research
+1 212 412 5507
rajiv.setia@barclays.com
BCI, US

Michael Gavin
Global Macro Strategist
+1 212 412 5915
michael.gavin@barclays.com
BCI, US

US

Aroop Chatterjee
Head of FX Strategy, North America
+1 212 526 9617
aroop.chatterjee@barclays.com
BCI, US

Michael Gapen
Head of US Economics Research
+1 212 526 8536
michael.gapen@barclays.com
BCI, US

Shobhit Gupta
Head of US Credit Strategy
+1 212 412 2056
shobhit.gupta@barclays.com
BCI, US

Marco Oviedo
Head of LatAm Economics
Mexico and Central America
+1 212 526 6840
marco.oviedo@barclays.com
BCI, US

Anshul Pradhan
US Fixed Income Strategy
+ 212 412 3681
anshul.pradhan@barclays.com
BCI, US

Rob Rouse
Head of US Equity Research
+1 212 526 6156
rob.rouse@barclays.com
BCI, US

Maneesh S. Deshpande
Head of US Equity Strategy &
Global Equity Derivatives Strategy
+1 212 526 2953
maneesh.deshpande@barclays.com
BCI, US

Europe

Rupert Jones
Head of EMEA Equity Research
+ 44 (0) 20 7773 2755
rupert.x.jones@barclays.com
Barclays, UK

Søren Willemann
Head of European Credit Strategy
+ 44 (0)20 7773 9983
soren.willemann@barclays.com
Barclays, UK

Emmanuel Cau, CFA
Head of European Equity Strategy
+44 (0)20 3134 0475
emmanual.cau@barclays.com
Barclays, UK

Cagdas Aksu
European Rates Strategy
+44 (0)20 777 35788
cagdas.aksu@barclays.com
Barclays, UK

Moyeen Islam
UK Rates Strategy
+44 (0)20 7773 4675
moyeen.islam@barclays.com
Barclays, UK

Brahim Razgallah
Economist – MENA
+ 44 (0) 20 3555 4762
brahim.razgallah@ barclays.com
Barclays, UK

Asia Pacific

Sudeep Sarma
Head of Asia Pacific Research
+ 65 90125360
sudeep.sarma@barclays.com
Barclays Bank, Singapore

Tetsufumi Yamakawa
Head of Research, Japan
+81 3 4530 1130
tetsufumi.yamakawa @barclays.com
BSJL, Japan

Yoshio Takahashi
Head of Non-Yen Strategy, Japan
+81 3 4530 1686
yoshio.takahashi@barclays.com
BSJL, Japan

Analyst Certification

We, Ajay Rajadhyaksha, Michael Gavin, Christian Keller, Michael Gapen, Jonathan Millar, Emmanuel Cau, CFA and Maneesh S. Deshpande, hereby certify (1) that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

Each research report excerpted herein was certified under SEC Regulation AC by the analyst primarily responsible for such report as follows: I hereby certify that: 1) the views expressed in this research report accurately reflect my personal views about any or all of the subject securities referred to in this report and; 2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Important Disclosures:

Barclays Research is produced by the Investment Bank of Barclays Bank PLC and its affiliates (collectively and each individually, "Barclays").

All authors contributing to this research report are Research Analysts unless otherwise indicated. The publication date at the top of the report reflects the local time where the report was produced and may differ from the release date provided in GMT.

Availability of Disclosures:

For current important disclosures regarding any issuers which are the subject of this research report please refer to https://publicresearch.barclays.com or alternatively send a written request to: Barclays Research Compliance, 745 Seventh Avenue, 13th Floor, New York, NY 10019 or call +1-212-526-1072.

Barclays Capital Inc. and/or one of its affiliates does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that Barclays may have a conflict of interest that could affect the objectivity of this report. Barclays Capital Inc. and/or one of its affiliates regularly trades, generally deals as principal and generally provides liquidity (as market maker or otherwise) in the debt securities that are the subject of this research report (and related derivatives thereof). Barclays trading desks may have either a long and / or short position in such securities, other financial instruments and / or derivatives, which may pose a conflict with the interests of investing customers. Where permitted and subject to appropriate information barrier restrictions, Barclays fixed income research analysts regularly interact with its trading desk personnel regarding current market conditions and prices. Barclays fixed income research analysts receive compensation based on various factors including, but not limited to, the quality of their work, the overall performance of the firm (including the profitability of the Investment Banking Department), the profitability and revenues of the Markets business and the potential interest of the firm's investing clients in research with respect to the asset class covered by the analyst. To the extent that any historical pricing information was obtained from Barclays trading desks, the firm makes no representation that it is accurate or complete. All levels, prices and spreads are historical and do not necessarily represent current market levels, prices or spreads, some or all of which may have changed since the publication of this document. Barclays Research Department produces various types of research including, but not limited to, fundamental analysis, equity-linked analysis, quantitative analysis, and trade ideas. Recommendations and trade ideas contained in one type of Barclays Research may differ from those contained in other types of Barclays Research, whether as a result of differing time horizons, methodologies, or otherwise. In order to access Barclays Statement regarding Research Dissemination Policies and Procedures, please refer to *https://publicresearch.barcap.com/S/RD.htm*. In order to access Barclays Research Conflict Management Policy Statement, please refer to: *https://publicresearch.barcap.com/S/CM.htm*.

Includes content supplied by IHS Global Inc. and its affiliates ("IHS") [2019]. The use of this content was authorized in advance by IHS. Any further use or redistribution of this content is strictly prohibited without written permission by IHS. All rights reserved.

All pricing information is indicative only. Prices are sourced from Refinitiv as of the last available closing price at the time of production of the research report, unless another time and source is indicated.

Types of investment recommendations produced by Barclays FICC Research:

In addition to any ratings assigned under Barclays' formal rating systems, this publication may contain investment recommendations in the form of trade ideas, thematic screens, scorecards or portfolio recommendations that have been produced by analysts in FICC Research. Any such investment recommendations produced by non-Credit Research teams shall remain open until they are subsequently amended, rebalanced or closed in a future research report. Any such investment recommendations produced by the Credit Research teams are valid at current market conditions and may not be otherwise relied upon.

Disclosure of other investment recommendations produced by Barclays FICC Research:

Barclays FICC Research may have published other investment recommendations in respect of the same securities/instruments recommended in this research report during the preceding 12 months. To view all investment recommendations published by Barclays FICC Research in the preceding 12 months please refer to *https://live.barcap.com/go/research/Recommendations*.

The MSCI sourced information is the exclusive property of MSCI Inc. (MSCI). Without prior written permission of MSCI, this information and any other MSCI intellectual property may not be reproduced, redisseminated or used to create any financial products, including any indices. This information is provided on an "as is" basis. The user assumes the entire risk of any use made of this information. MSCI, its affiliates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. MSCI and the MSCI indexes are services marks of MSCI and its affiliates.

Legal entities involved in producing Barclays Research:

Barclays Bank PLC (Barclays, UK)

Barclays Capital Inc. (BCI, US)

Barclays Bank Ireland PLC, Frankfurt Branch (BBI, Frankfurt)
Barclays Bank Ireland PLC, Paris Branch (BBI, Paris)
Barclays Bank Ireland PLC, Milan Branch (BBI, Milan)
Barclays Securities Japan Limited (BSJL, Japan)
Barclays Bank PLC, Hong Kong branch (Barclays Bank, Hong Kong)
Barclays Capital Canada Inc. (BCCI, Canada)
Barclays Bank Mexico, S.A. (BBMX, Mexico)
Barclays Securities (India) Private Limited (BSIPL, India)
Barclays Bank PLC, India branch (Barclays Bank, India)
Barclays Bank PLC, Singapore branch (Barclays Bank, Singapore)

Disclaimer:
This publication has been produced by Barclays Research Department in the Investment Bank of Barclays Bank PLC and/or one or more of its affiliates (collectively and each individually, "Barclays"). It has been prepared for institutional investors only and not for retail investors. It has been distributed by one or more Barclays affiliated legal entities listed below. It is provided to our clients for information purposes only, and Barclays makes no express or implied warranties, and expressly disclaims all warranties of merchantability or fitness for a particular purpose or use with respect to any data included in this publication. To the extent that this publication states on the front page that it is intended for institutional investors and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors under U.S. FINRA Rule 2242, it is an “institutional debt research report” and distribution to retail investors is strictly prohibited. Barclays also distributes such institutional debt research reports to various issuers, media, regulatory and academic organisations for their own internal informational news gathering, regulatory or academic purposes and not for the purpose of making investment decisions regarding any debt securities. Media organisations are prohibited from re-publishing any opinion or recommendation concerning a debt issuer or debt security contained in any Barclays institutional debt research report. Any such recipients that do not want to continue receiving Barclays institutional debt research reports should contact debtresearch@barclays.com. Barclays will not treat unauthorized recipients of this report as its clients and accepts no liability for use by them of the contents which may not be suitable for their personal use. Prices shown are indicative and Barclays is not offering to buy or sell or soliciting offers to buy or sell any financial instrument.
Without limiting any of the foregoing and to the extent permitted by law, in no event shall Barclays, nor any affiliate, nor any of their respective officers, directors, partners, or employees have any liability for (a) any special, punitive, indirect, or consequential damages; or (b) any lost profits, lost revenue, loss of anticipated savings or loss of opportunity or other financial loss, even if notified of the possibility of such damages, arising from any use of this publication or its contents.
Other than disclosures relating to Barclays, the information contained in this publication has been obtained from sources that Barclays Research believes to be reliable, but Barclays does not represent or warrant that it is accurate or complete. Barclays is not responsible for, and makes no warranties whatsoever as to, the information or opinions contained in any written, electronic, audio or video presentations of third parties that are accessible via a direct hyperlink in this publication or via a hyperlink to a third-party web site (‘Third-Party Content’). Any such Third-Party Content has not been adopted or endorsed by Barclays, does not represent the views or opinions of Barclays, and is not incorporated by reference into this publication. Third-Party Content is provided for information purposes only and Barclays has not independently verified its accuracy or completeness.
The views in this publication are solely and exclusively those of the authoring analyst(s) and are subject to change, and Barclays Research has no obligation to update its opinions or the information in this publication. Unless otherwise disclosed herein, the analysts who authored this report have not received any compensation from the subject companies in the past 12 months. If this publication contains recommendations, they are general recommendations that were prepared independently of any other interests, including those of Barclays and/or its affiliates, and/or the subject companies. This publication does not contain personal investment recommendations or investment advice or take into account the individual financial circumstances or investment objectives of the clients who receive it. The securities and other investments discussed herein may not be suitable for all investors. Barclays is not a fiduciary to any recipient of this publication. Investors must independently evaluate the merits and risks of the investments discussed herein, consult any independent advisors they believe necessary, and exercise independent judgment with regard to any investment decision. The value of and income from any investment may fluctuate from day to day as a result of changes in relevant economic markets (including changes in market liquidity). The information herein is not intended to predict actual results, which may differ substantially from those reflected. Past performance is not necessarily indicative of future results. The information provided does not constitute a financial benchmark and should not be used as a submission or contribution of input data for the purposes of determining a financial benchmark.
United Kingdom: This document is being distributed (1) only by or with the approval of an authorised person (Barclays Bank PLC) or (2) to, and is directed at (a) persons in the United Kingdom having professional experience in matters relating to investments and who fall within the definition of "investment professionals" in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order"); or (b) high net worth companies, unincorporated associations and partnerships and trustees of high value trusts as described in Article 49(2) of the Order; or (c) other persons to whom it may otherwise lawfully be communicated (all such persons being "Relevant Persons"). Any investment or investment activity to which this communication relates is only available to and will only be engaged in with Relevant Persons. Any other persons who receive this communication should not rely on or act upon it. Barclays Bank PLC is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority and is a member of the London Stock Exchange.
European Economic Area (“EEA”): This material is being distributed in the EEA by Barclays Bank PLC. Barclays Bank PLC is not registered in France with the Autorité des marchés financiers or the Autorité de contrôle prudentiel.
Americas: The Investment Bank of Barclays Bank PLC undertakes U.S. securities business in the name of its wholly owned subsidiary Barclays Capital Inc., a FINRA and SIPC member. Barclays Capital Inc., a U.S. registered broker/dealer, is distributing this material in the United States and, in connection therewith accepts responsibility for its contents. Any U.S. person wishing to effect a transaction in any security discussed herein should do so only by contacting a representative of Barclays Capital Inc. in the U.S. at 745 Seventh Avenue, New York, New York 10019.
Non-U.S. persons should contact and execute transactions through a Barclays Bank PLC branch or affiliate in their home jurisdiction unless local regulations permit otherwise.
This material is distributed in Canada by Barclays Capital Canada Inc., a registered investment dealer, a Dealer Member of IIROC (www.iiroc.ca), and a Member of the Canadian Investor Protection Fund (CIPF).

This material is distributed in Mexico by Barclays Bank Mexico, S.A.

Japan: This material is being distributed to institutional investors in Japan by Barclays Securities Japan Limited. Barclays Securities Japan Limited is a joint-stock company incorporated in Japan with registered office of 6-10-1 Roppongi, Minato-ku, Tokyo 106-6131, Japan. It is a subsidiary of Barclays Bank PLC and a registered financial instruments firm regulated by the Financial Services Agency of Japan. Registered Number: Kanto Zaimukyokucho (kinsho) No. 143.

Asia Pacific (excluding Japan): Barclays Bank PLC, Hong Kong Branch is distributing this material in Hong Kong as an authorised institution regulated by the Hong Kong Monetary Authority. Registered Office: 41/F, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

All Indian securities-related research and other equity research produced by Barclays' Investment Bank are distributed in India by Barclays Securities (India) Private Limited (BSIPL). BSIPL is a company incorporated under the Companies Act, 1956 having CIN U67120MH2006PTC161063. BSIPL is registered and regulated by the Securities and Exchange Board of India (SEBI) as a Research Analyst: INH000001519; Portfolio Manager INP000002585; Stock Broker/Trading and Clearing Member: National Stock Exchange of India Limited (NSE) Capital Market INB231292732, NSE Futures & Options INF231292732, NSE Currency derivatives INE231450334, Bombay Stock Exchange Limited (BSE) Capital Market INB011292738, BSE Futures & Options INF011292738; Depository Participant (DP) with the National Securities & Depositories Limited (NSDL): DP ID: IN-DP-NSDL-299-2008; Investment Adviser: INA000000391. The registered office of BSIPL is at 208, Ceejay House, Shivsagar Estate, Dr. A. Besant Road, Worli, Mumbai – 400 018, India. Telephone No: +91 2267196000. Fax number: +91 22 67196100. Any other reports produced by Barclays' Investment Bank are distributed in India by Barclays Bank PLC, India Branch, an associate of BSIPL in India that is registered with Reserve Bank of India (RBI) as a Banking Company under the provisions of The Banking Regulation Act, 1949 (Regn No BOM43) and registered with SEBI as Merchant Banker (Regn No INM000002129) and also as Banker to the Issue (Regn No INBI00000950). Barclays Investments and Loans (India) Limited, registered with RBI as Non Banking Financial Company (Regn No RBI CoR-07-00258), and Barclays Wealth Trustees (India) Private Limited, registered with Registrar of Companies (CIN U93000MH2008PTC188438), are associates of BSIPL in India that are not authorised to distribute any reports produced by Barclays' Investment Bank.

This material is distributed in Singapore by the Singapore branch of Barclays Bank PLC, a bank licensed in Singapore by the Monetary Authority of Singapore. For matters in connection with this material, recipients in Singapore may contact the Singapore branch of Barclays Bank PLC, whose registered address is 10 Marina Boulevard, #23-01 Marina Bay Financial Centre Tower 2, Singapore 018983.

This material is distributed to persons in Australia by Barclays Bank PLC. None of Barclays Bank PLC, nor any other Barclays group entity, holds an Australian financial services licence and instead relies on an exemption from the requirement to hold such a licence. This material is intended to only be distributed to "wholesale clients" as defined by the Australian Corporations Act 2001.

Middle East: Nothing herein should be considered investment advice as defined in the Israeli Regulation of Investment Advisory, Investment Marketing and Portfolio Management Law, 1995 ("Advisory Law"). This document is being made to eligible clients (as defined under the Advisory Law) only. Barclays Israeli branch previously held an investment marketing license with the Israel Securities Authority but it cancelled such license on 30/11/2014 as it solely provides its services to eligible clients pursuant to available exemptions under the Advisory Law, therefore a license with the Israel Securities Authority is not required. Accordingly, Barclays does not maintain an insurance coverage pursuant to the Advisory Law.

This material is distributed in the United Arab Emirates (including the Dubai International Financial Centre) and Qatar by Barclays Bank PLC. Barclays Bank PLC in the Dubai International Financial Centre (Registered No. 0060) is regulated by the Dubai Financial Services Authority (DFSA). Principal place of business in the Dubai International Financial Centre: The Gate Village, Building 4, Level 4, PO Box 506504, Dubai, United Arab Emirates. Barclays Bank PLC-DIFC Branch, may only undertake the financial services activities that fall within the scope of its existing DFSA licence. Related financial products or services are only available to Professional Clients, as defined by the Dubai Financial Services Authority. Barclays Bank PLC in the UAE is regulated by the Central Bank of the UAE and is licensed to conduct business activities as a branch of a commercial bank incorporated outside the UAE in Dubai (Licence No.: 13/1844/2008, Registered Office: Building No. 6, Burj Dubai Business Hub, Sheikh Zayed Road, Dubai City) and Abu Dhabi (Licence No.: 13/952/2008, Registered Office: Al Jazira Towers, Hamdan Street, PO Box 2734, Abu Dhabi). Barclays Bank PLC in the Qatar Financial Centre (Registered No. 00018) is authorised by the Qatar Financial Centre Regulatory Authority (QFCRA). Barclays Bank PLC-QFC Branch may only undertake the regulated activities that fall within the scope of its existing QFCRA licence. Principal place of business in Qatar: Qatar Financial Centre, Office 1002, 10th Floor, QFC Tower, Diplomatic Area, West Bay, PO Box 15891, Doha, Qatar. Related financial products or services are only available to Business Customers as defined by the Qatar Financial Centre Regulatory Authority.

Russia: This material is not intended for investors who are not Qualified Investors according to the laws of the Russian Federation as it might contain information about or description of the features of financial instruments not admitted for public offering and/or circulation in the Russian Federation and thus not eligible for non-Qualified Investors. If you are not a Qualified Investor according to the laws of the Russian Federation, please dispose of any copy of this material in your possession.

IRS Circular 230 Prepared Materials Disclaimer: Barclays does not provide tax advice and nothing contained herein should be construed to be tax advice. Please be advised that any discussion of U.S. tax matters contained herein (including any attachments) (i) is not intended or written to be used, and cannot be used, by you for the purpose of avoiding U.S. tax-related penalties; and (ii) was written to support the promotion or marketing of the transactions or other matters addressed herein. Accordingly, you should seek advice based on your particular circumstances from an independent tax advisor.

© Copyright Barclays Bank PLC (2019). All rights reserved. No part of this publication may be reproduced or redistributed in any manner without the prior written permission of Barclays. Barclays Bank PLC is registered in England No. 1026167. Registered office 1 Churchill Place, London, E14 5HP. Additional information regarding this publication will be furnished upon request.

BRCF2242