Global Market Strategy Team

Central banks and geopolitics to shape the course of the global economy in 2020

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Key Takeaways

+ Some major central banks have become more accommodative, while geopolitical disruption continues to cast a shadow over growth.
+ All told, we forecast global economic growth of about 3% for 2020.
+ Regionally, we expect the lowest growth from Japan, the U.K., and the eurozone, and the highest from Asian emerging markets and China.

Global outlook

Economic growth forecast: About 3%

Upside opportunities include:

+ Progress toward a resolution of the U.S.-China trade war.
+ Significant fiscal stimulus from China or elsewhere.
+ Clarification on a Brexit outcome.

Downside risks include:

+ An escalation or spread of trade tensions.
+ Greater geopolitical disruption that leads to military conflict, higher oil prices, and/or increased economic policy uncertainty.
+ An increasing likelihood that trade wars could become currency wars – if the U.S. attempts to weaken the U.S. dollar and other countries react.
+ Further gridlock on Brexit.

As we look ahead to 2020, it's clear that central banks are still shouldering the burden for stimulating the economy via monetary policy, as has been the case since the Global Financial Crisis. After a nascent attempt at normalizing, some major central banks have become more accommodative as 2019 has progressed. That should bode well for 2020, as the rate cuts enacted by the U.S. Federal Reserve (Fed) in 2019 have already resulted in an acceleration in money and credit growth. However, we believe such monetary easing should be more positively impactful for asset prices than the overall economy. We do believe more fiscal stimulus is needed – although most governments are reluctant to provide it.

We note that there are longer-term implications to an overreliance on monetary policy, but that is unlikely to be an issue in the coming year. Countering the positive effects of monetary stimulus is geopolitical disruption – and the economic policy uncertainty that comes with it. Sources of policy uncertainty include:

+ The U.S.-China trade war and Brexit, which have been the most prominent creators of uncertainty in 2019.
+ The 2020 U.S. presidential election, which will kick into higher gear after the New Year.
+ The conflict between China and Hong Kong.
+ Tensions in the Middle East, including the September drone attack on Saudi oil facilities that remains to be addressed.

Economic uncertainty is likely to continue to depress capital spending, in our view, and we must watch vigilantly to ensure it doesn't spill over into diminished hiring plans.

The dichotomy between the manufacturing and service sectors of the economy continues, as we expect manufacturing to continue to experience weakness largely due to the trade wars. However, those economies with less exposure to manufacturing are likely to fare better in this environment, in our view.

We believe long-term Canadian equity underperformance could be coming to an end as Canadian stocks enjoy some advantages that may be underappreciated by investors.

U.S. outlook

Economic growth forecast: About 2%
Upside opportunities include:
+ Improving trade policy and lower policy uncertainty, which could boost business confidence, corporate spending and investment, and industrial and manufacturing activity.

Downside risks include:
+ Worsening trade policy and higher policy uncertainty, which could worsen all of the above.
+ The potential for the manufacturing sector to continue to experience weakness. The longer the uncertainty of the trade war persists, the more it is likely to weigh on business sentiment and erode business investment. The manufacturing component of the economy will likely suffer, although we expect the consumer to remain relatively strong given low unemployment. However, we will closely monitor employment and the health of the consumer.

For the U.S., we expect an environment of modest growth of approximately 2% in 2020, which exceeds consensus expectations. Our view is that growth bottoms early in the year at approximately 1%, and then accelerates as the year progresses. We expect inflation to remain relatively benign, at about 2.2%.

The growth slowdown of 2019 was driven by the lagged results of Fed tightening in 2018 and the ongoing uncertainty of the U.S.-China trade conflict. The Fed has since unwound most of the tightening, and financial conditions have eased meaningfully. The yield curve has normalized, and the dollar has weakened modestly. We believe the Fed will deliver as many interest rate cuts as necessary to support the economic expansion.

We expect the U.S.-China trade wars to continue in the short term, although there is an increasing likelihood of incremental improvements as we get closer to the presidential election in November 2020. That election could increase economic policy uncertainty in the early part of 2020, but it should decline toward the end of the year. Cycles tend to end with policy mistakes, and the risks have risen. However, it is our base case that the policy mix will continue to get modestly better.

The bottom line is that the big U.S. macro narrative has not changed. It is still an environment of relatively weak growth and benign inflation. The good news is that slow growth, benign inflation, and an easy Fed could be conducive to the economic cycle going on for far longer than most people suspect. Nonetheless, in that environment, the primary rule of policymaking is to do no harm. We believe the Fed and central banks globally will deliver more accommodation if necessary to support the economic expansion. And so we do not expect a recession in 2020. The classic signs of recession – Fed tightening, tighter financial and credit conditions – are not present at this time.

Canada outlook

Economic growth forecast: About 2%
Upside opportunities include:
+ Ratification and implementation of the United States-Mexico-Canada trade agreement (USMCA).
+ Improving trade policy between the U.S. and China.
+ Lower policy uncertainty in Canada relative to the U.S. and rest of the world.
+ A positive business and manufacturing sector outlook in Canada.
+ Early signs of improvement in global manufacturing activity, including the manufacturing recovery in China.
+ A weaker U.S. dollar and stronger U.S. economic growth.
+ Higher commodity prices.

Downside risks include:
+ Less than full ratification of the USMCA.
+ Worsening trade policy between the U.S. and China.
+ A stronger U.S. dollar.
+ Lower commodity prices.
+ Rising debt and housing weakness in Canada.

We expect Canadian gross domestic product (GDP) growth to exceed expectations at approximately 2% for 2020 versus consensus expectations of 1.6%. Canada has already shown signs of a stabilization and pickup in economic growth thanks to a number of factors, including improvements in the housing market and higher wage growth, and we expect this will continue. After a policy-induced slowdown in 2017/2018, real GDP growth bottomed at 1.4% in the first quarter of 2019 and improved to 1.6% in the second quarter, and we expect it to converge with the U.S. at 2% by the latter part of 2020. We expect inflation to pick up slightly to approximately 2.2% by the latter part of 2020.

We believe the Bank of Canada (BOC) could be one of the few central banks to raise rates in 2020 (most likely the second half of 2020). However, we do not believe this will create headwinds for the Canadian economy. The Canadian economy and stock market tend to do best in an environment of quickening global growth, rising commodity prices, and an appreciating Canadian dollar, which would be consistent with interest rate hikes. We expect the BOC to stay on hold for the rest of the year and resume raising interest rates perhaps in the second half of 2020.

We expect Canadian GDP growth to exceed expectations at approximately 2% for 2020 versus consensus expectations of 1.6%.

Eurozone outlook

Economic growth forecast: About 1%
Upside opportunities include:
+ A resolution of the U.S.-China trade war, which would likely boost Chinese and U.S. demand, as well as German fiscal stimulus.
+ Removal of tariffs targeting European goods.

Downside risks include:
+ A further global demand slowdown.
+ An unstable political environment leading to uncertainty and a no-deal Brexit, which could create a one-time shock to the system.

We expect economic growth of about 1% or less in 2020. The economy has been negatively impacted by a lack of fiscal stimulus as well as the U.S.-China trade war, and those factors are likely to be present in the coming year.

The eurozone has been having great difficulty in generating an adequate policy response. We expect the weakness in the manufacturing sector to bleed over into the services sector at a greater extent. We are starting to see initial cracks in the labour market in Germany with working hours being reduced, which is likely to carry over through 2020. The overall story is weak.

And yet the bigger issue is that the eurozone is not working as it was intended to – being a monetary union but not a fiscal one is creating enormous challenges. One challenge continues to be a significant capital imbalance between periphery and core eurozone countries.

Geopolitical risks should continue to be an issue for the eurozone. In Italy, we worry about higher political fragmentation. The reality is that, so far, the only hard number in the Italian budget law is the deficit. While the new Italian coalition is much more willing to interact in a constructive way with the European Union (EU), there is a significant chance in 2020 that the majority coalition collapses, especially in the back half of year. GDP growth expectations for Italy fall in a range of 0% to 0.4%.

We expect the European Central Bank (ECB) to remain accommodative in 2020, continuing QE purchases and possibly even cutting rates again. If governments, especially Germany, appear unwilling to provide fiscal stimulus, we could see the ECB explore more experimental monetary tools – particularly ones that could mimic fiscal stimulus. However, we're mindful that dissent against monetary easing plans by outgoing ECB President Mario Draghi may make this task more difficult for new ECB President Christine Lagarde, as she is seen as a consensus builder. Therefore, further monetary easing may not be possible in the absence of a deeper downturn or outright recession.

U.K. outlook

Economic growth forecast: About 1%
Upside opportunities include:
+ A managed EU exit.
+ The revocation of Article 50.
+ A positive turn in the global economy.

Downside risks include:
+ A no-deal Brexit.
+ Rolling EU exit deadlines, which would extend policy uncertainty.
+ Further deterioration in the global economy.
+ An early election that leads to a less business-friendly government.

We expect the U.K. economy will grow at less than 1% in 2020. The economic policy uncertainty created by Brexit has depressed business investment and business confidence. As of this writing, the Dec. 12 election looks like a three-way race with different leading parties offering quite different visions for the future of the U.K.:

+ On the right, U.K. Prime Minister Boris Johnson and the Tories envision turning London into a so-called "Singapore on Thames" that could attract foreign investment through low taxes and minimal regulations. In practice, they have been moving the U.K. closer to the U.S. model of capitalism.
+ On the left, Opposition Leader Jeremy Corbyn and the Labour Party have in mind greater protection of workers' rights, partial re-nationalization of privatized industries and education, and a more "corporatist" approach – a platform that is actually considerably further to the left than the EU model.
+ In the middle, the Liberal Democrats and others who want to remain in the EU are in effect saying that the EU model of capitalism – a strong welfare state with labour protection and regulated competition – works just fine for the U.K.

Liberal Democrats will likely campaign to remain in the EU. Labour may seek a second Brexit referendum to confirm the results of the first. And the prime minister wants to get Brexit done on the basis of the deal he negotiated in October, essentially rendering the election as a referendum on himself and his version of Brexit.

Johnson's deal (which would need to be ratified by the U.K. and EU parliaments) seeks to keep Northern Ireland aligned with the EU, with a customs border in the Irish Sea. The U.K. mainland would then be able to engage in regulatory divergence from the EU after the transition period (currently slated to expire at the end of 2020). Depending on the election result, this might simply end up moving the no-deal goal post to Dec. 31, 2020, or Jan. 31, 2021, or potentially later.

We believe the Bank of Canada could be one of the few central banks to raise rates in 2020 (most likely the second half of 2020). However, we do not believe this will create headwinds for the Canadian economy.

Japan outlook

Economic growth forecast: About 0.4%
Upside opportunities include:

+ Improvement in global demand and the end of inventory adjustments, which should normalize industrial growth.
+ A pick-up in investment demand in Asian economies (including demand for relocation), which could support capital goods exports and positively impact the Japanese economy.

Downside risks include:

+ The possibility that growth in China's capital goods demand stays low.
+ A shrinking population, which has the potential to create severe labour shortage problems and pressure consumption.

We expect the Japanese economy to stabilize in early 2020 after a fourth-quarter 2019 deceleration caused by the effects of the new consumption tax. We then expect the economy to modestly re-accelerate. Our base case expectation for GDP growth in 2020 is approximately 0.04%.

We believe the increased tax burden should slow consumption demand, although the impact should be much smaller than what we saw with the 2014 consumption tax increase. We believe the Japanese government is likely to initiate accommodative fiscal policy to help counter the headwinds created by the new consumption tax. We also believe the Tokyo Olympic Games will increase tourism and help boost economic growth.

We don't expect the Bank of Japan (BOJ) to ease policy unless the yen strengthens significantly. However, if the yen does strengthen, we expect the BOJ to consider a variety of policy tools including additional purchases of equity exchange-traded funds (ETFs), if necessary. In addition, four other potential policy easing measures mentioned by Governor Haruhiko Kuroda include:

+ Cutting the short-term policy interest rate
+ Lowering the target level of yields on 10-year Japanese government bonds
+ Expanding asset purchases
+ Accelerating the expansion of the monetary base

China outlook

Economic growth forecast: About 5.9%
Upside opportunities include:

+ The possible issuance of specialty bonds to fund local government public infrastructure investments, which could provide impactful fiscal stimulus.
+ The likelihood that capital controls, while threatened, will not actually be enacted by the U.S. against China.

Downside risks include:

+ An escalation in trade tensions between China and the U.S.
+ A continued slowdown in manufacturing growth and related capex spending.
+ High household and local government debt levels.
+ A possible deceleration in household consumption, which tends to contribute to around two-thirds of the GDP growth.

Chinese economic growth has modestly decelerated, but we believe the fundamentals remain solid as the transition continues to a consumption, services-led economy. We expect GDP growth in 2020 to be approximately 5.8% to 6%, which is around consensus expectations.

China's property market continues to be buoyant and is likely to see continued robust investment growth, in our view, which should be positive for the Chinese economy. We expect further softening of the renminbi heading into 2020 – but at a measured clip, which should also be supportive of economic growth. Other positive catalysts for the Chinese economy include fiscal stimulus measures that should boost fixed asset investments, and our expectation that there will be a stabilization in the tariff wars.

In terms of the U.S.-China trade war, we believe China will not make a deal to end the conflict if it requires any major concessions beyond narrowing the trade deficit. China appears willing to allow the trade war to continue rather than to agree to demands that it views as detrimental to the Chinese economy and its future strategic position. However, we remain positive on the Chinese economy because we believe China will utilize the fiscal and monetary tools necessary to support its economy despite headwinds created by the ongoing trade war.

Our expectations for the People's Bank of China (PBOC) in 2020 include relatively modest monetary stimulus. The PBOC could continue loosening monetary policy with potential cuts to the required reserve ratio.

We are more optimistic about capital markets than we are about economic growth. We therefore favour risk assets over non-risk assets.

Other emerging market outlooks

Economic growth forecast:
India: 5.5% to 6%
Asian EM: about 6.2%
European EM: about 2%
Latin America: about 2%

India

We expect GDP growth in India to be about 5.5% to 6% for the year. We expect growth to slow earlier in 2020 and then modestly re-accelerate, helped by the planned corporate tax cuts for next spring. We expect economic growth to slightly underperform expectations next year.

The Indian economy has been slowing sharply, with consumption recently taking major hits following weak investment. Auto sales in particular have been disappointing. We expect that weakness to continue into early next year.

However, we believe the economy will benefit from significant fiscal and monetary stimulus over the course of the year. The Reserve Bank of India appears poised to provide further accommodation, and corporate tax cuts should be very stimulative, in our view. However, there are longer-term negative implications given that the true fiscal deficit is high and some of the impending fiscal stimulus could be financed by the Reserve Bank of India (profits, capital, dividends). In addition, financial sector reform and general structural reforms are still lagging.

Asian emerging markets

Growth in Asian emerging markets remains strong, although we expect it to modestly decelerate. We expect economic growth in 2020 to be approximately 6.2%, led by Indonesia and Vietnam, which have been benefiting from trade war supply chain disruptions. Small, open economies such as Hong Kong and Singapore could experience lackluster economic growth.

European emerging markets

We expect more modest economic growth in European emerging markets in 2020 – approximately 2%.

+ We expect Poland to experience solid growth, helped by structural reforms and solid domestic demand. (One downside risk is if elections produce a shock.)
+ Meanwhile, we expect Turkey and Hungary to fare worse, as populist leaders in both countries face a hostile external economic environment. Turkey is too dependent on external financing, in our view, and Hungary is too dependent on German car manufacturing.

Latin America

Our expectations for GDP growth in 2020 are modest at 2% (versus a consensus about 2.4%).

+ We expect Brazil to fare well as its policy is pro-growth. Brazilian social security reform is making progress and raising hopes for deregulation and privatization.
+ The combination of ongoing reform efforts points to a continued recovery for Brazil, but probably at a gradual pace given the limited expected lift from commodity export prices and volumes in a still-low-growth global economic environment.
+ Brazil continues to transition from state-directed subsidized credit via the national development bank to a more market-oriented funding for corporates. Financial inclusion should also help contribute to an increase in household spending power over time given low inflation and monetary easing (in contrast to previous credit booms and busts).
+ We expect the Mexican economy to decelerate modestly on weaker investment amidst policy uncertainty, as well as relatively low U.S. growth.
+ In Argentina, the Peronist Party won the presidency as widely expected, but the margin was much smaller than feared, with former President Mauricio Macri only about 8% behind President-elect Alberto Fernandez – a much smaller differential than in the primary, which had sparked a severe sell-off across Argentinian assets and the peso. This moderate margin suggests that the new administration will need to be politically circumspect as it goes about renegotiating its IMF deal and restructuring the sovereign debt, which should limit the downside risk in the economy and markets in the short term.
+ A positive factor for Argentina's Latin trading partners is that net export effects and confidence concerns should be much less of a drag than they were in 2018-19 (thanks to reduced downside risks and reasons to expect stabilization first and then recovery – even if not a sharp rebound in activity). Among the major EMs, Brazil stands to be the main beneficiary.
+ Argentina's heavy overhang of debt, distortions from energy and other subsidies that still need to be removed, and the resulting inflationary pressure are significant, and we would not expect a v-shaped rebound in 2020.
+ In contrast, we expect Venezuela to fare worst in Latin America, given hyperinflation and continued political chaos. Neighbours and trading partners in the Andean region would continue to experience socio-economic repercussions from continued refugee migration, but we expect the economic and financial effects to be limited as this is now a long-running crisis. That said, we would not rule out an even sharper collapse of the Venezuelan state or economy.

Within fixed income, we believe that higher-yielding investments will outperform given the low rate environment.

Asset class outlooks

In addition to our regional outlooks, the Global Market Strategist Office has developed a view of various asset classes heading into 2020. We expect global economic growth to decelerate for much of 2020. Given that we expect continued monetary policy accommodation with little fiscal stimulus, we are more optimistic about capital markets than we are about economic growth. We therefore favour risk assets over non-risk assets. Details of our asset class view are below:

Equities	U.S.	Modestly bullish
	Canada	Modestly bullish
	Europe	Neutral
	U.K.	Bearish
	Japan	Modestly bullish
	Emerging markets	Bullish
Fixed income	Developed government	Bearish
	Short duration/bank loan	Neutral
	Investment grade corporate	Bullish
	High yield	Bullish
	Emerging markets (gov't and corp.)	Bullish
Alternatives	Real estate	Bullish
	Private equity	Bullish
	Hedge funds	Neutral
	Commodities	Bearish
	Gold	Bearish
Cash-like instruments	Ultra-short-duration instruments	Modestly bullish

Equities

U.S. We believe the monetary policy environment will remain supportive of equities in 2020. However, we believe investors will need to be more discerning in this environment. Valuations appear stretched for U.S. equities, in our view, but we recognize that valuations have not often been a good predictor of equity performance in the shorter term. In addition, we believe lower interest rates and low inflation make U.S. equities more attractive. Also, the dollar has weakened recently because of "quantitative easing lite" policies that are expected to be ongoing. That should be positive for U.S. equities. Therefore, we are bullish on U.S. equities, with the caveat that investors should expect more volatility in the coming year.

Canada. We are modestly bullish on Canadian equities. We believe long-term Canadian equity underperformance could be coming to an end as Canadian stocks enjoy some advantages that may be underappreciated by investors. The United States-Mexico-Canada trade agreement (USMCA) appears poised to be ratified, which would benefit Canadian stocks. In addition, the Canadian manufacturing outlook remains positive, suggesting business sentiment is positive, which should bode well for equity returns. Also, Canadian stocks could benefit from a weaker U.S. dollar and the potential for higher commodity prices.

Europe and U.K. We are neutral on European (ex-U.K.) equities. Valuations are very attractive (based on an analysis of dividend yield and cyclically adjusted price-earnings ratios), but we have not yet seen signs that the eurozone economy has reached an inflection point. We are bearish on U.K. equities. We believe it is reasonable to expect earnings declines and slower dividend growth, especially since a large portion of the U.K. market is exposed to either commodities or banks.

Japan. We are modestly bullish on Japanese equities given that we envision a moderately brighter economic picture for Asia and expect limited downside to U.S. long-term yield in our base case, which will likely result in either more stable or even weaker yen. (It has often been the case that stronger yen worked negatively for Japan equities, including this year.)

Emerging markets. Overall, we are bullish on emerging market equities. Catalysts for emerging markets include a more accommodative Fed. In particular, balance sheet normalization recently ended, which should end the liquidity suck it created for emerging markets. We also expect the search for yield to drive investors to emerging market equities. Asian emerging equities should benefit from fiscal stimulus from China and India. Chinese stocks in particular should benefit from Chinese financial liberalization and the increased weighting of Chinese A share stocks in MSCI indexes. We are bearish on Latin American equities, many of which are too closely tied to the fortunes of commodities prices and some of which we expect to suffer from policy uncertainty. We have a neutral view of emerging Europe equities given decelerating growth in the euro area.

Fixed income

Within fixed income, we believe that higher-yielding investments will outperform given the low rate environment. Therefore, we are bearish to developed government bonds with the exception of U.K. gilts, whose returns should be driven by declining yields. We prefer investment grade credit to developed sovereign credit, given the former's higher yields and better total return potential. We are positive on high yield bonds, although we prefer U.S. high yield to eurozone high yield. Even allowing for a widening of spreads and a rise in default rates, we expect returns to be better than that of lower-yielding fixed income asset classes. We are also positive on emerging market debt, also given higher yields and greater total return potential.

Alternatives

Real estate. We are most positive on real estate, given its relatively high yields and potential for outperformance in what we expect to be a relatively low return environment. We favour eurozone and emerging market real estate but favour avoiding U.K. real estate until Brexit is resolved.

Gold. We are bearish on gold. While we recognize the diversification benefits of gold as well as a lower opportunity cost given lower rates globally, we expect low returns for gold in the coming year given the rally it experienced this year. In addition, gold typically performs best in recessionary or stagflationary environments, neither of which we expect for next year.

Private equity and hedge funds. Private equity looks attractive in this environment given its risk-adjusted return potential, while we are neutral on hedge funds.

Commodities. We are bearish on commodities, as we believe valuations are much higher than historical norms for commodities in real terms. In addition, our historical analysis suggests that industrial commodities have performed poorly when the Fed is cutting rates.

Cash

We have a slight bullish view of cash-like instruments, preferring ultra-short-duration instruments. Our rationale is that such investments can offer a "safe haven" alternative to gold, and are currently more attractive than gold given the latter's stretched valuations. In addition, given the volatility markets are experiencing, having adequate cash on hand enables investors to take advantage of opportunities created by downward volatility.

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