GLOBAL
ECONOMIC
RESEARCH

GLOBAL MACRO OUTLOOK

MARCH 2019

KEY FORECAST TRENDS

+ Four questions have shaped the macro debate this year: Would the Fed continue tightening? Would China's stimulus be timely and effective? Could trade tensions ease? Could Europe slip into recession?
+ Other than Europe, where we're hopeful but the jury's still out, these questions have largely been resolved. The Fed has become more data dependent, China has increased the pace of stimulus and the trade dispute has de-escalated. The result has been a major rally in risk assets.
+ Still, there's reason to be cautious. Global trade continues to decelerate, a reminder that a trade deal will not be a panacea. And it's not clear that slower growth will generate the sort of excess capacity that would relieve emerging inflation pressures.
+ Moreover, even resolution of the US-China trade war could prove a double-edged sword if Chinese concessions encourage the US to get tougher in trade negotiations with Europe.

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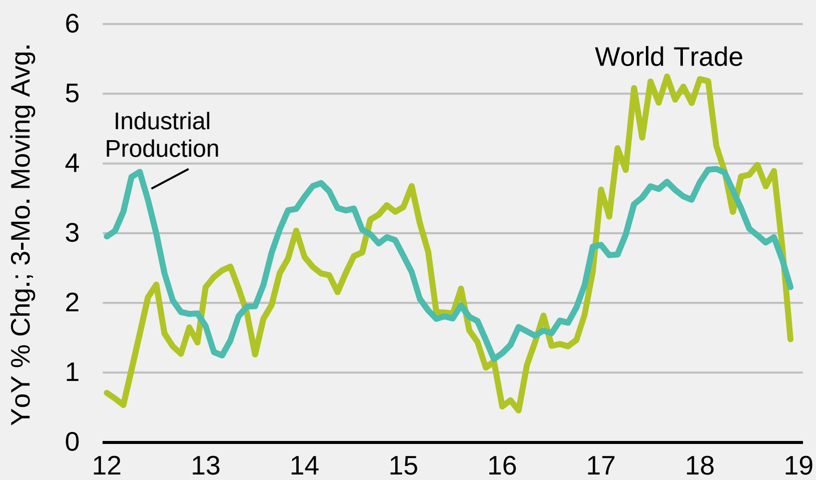
Pressure on Global Trade Continues

Global Trade and IP Growth



Through February 28, 2019
Source: Haver Analytics

+ The latest data on global trade are consistent with deceleration.
+ PMIs for bellwether exporters Korea and Taiwan, for example, slipped further in February, printing at 47.2 and 46.3, respectively.
+ There are a lot of moving parts here—from China's slowdown, to the new product cycle in tech, to excess semiconductor inventory; trade tensions are but one element.
+ Accordingly, we're skeptical that a "trade deal" is enough to generate a sharp reversal in trade growth.

GLOBAL FORECASTS

Economic Growth

- Softer growth ahead, but policy responses—a more dovish Fed, further easing in China—mitigate downside risks
- Vulnerability to event risks remains high

Key Risks

- Trade war shifts to Europe
- China policy stimulus less effective than expected

Inflation

- The secular backdrop still points to higher inflation over the medium term
- But softer growth and falling oil prices will present a high hurdle this year

Key Risks

- Greater nonlinearity in the Phillips curve?
- Supply constraints dominate

Monetary Policy

- Fed more data dependent; we forecast two rate hikes in the second half of 2019, but with much lower conviction
- The case for an ECB hike has disappeared; BOJ to remain on the sidelines

Key Risks

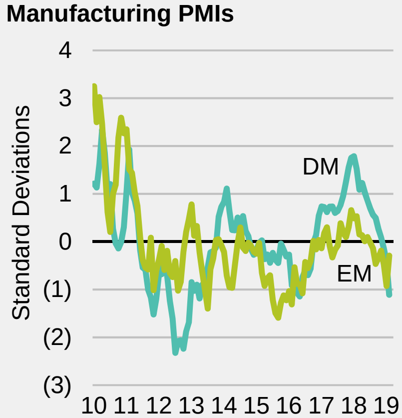
- Uncertain Fed reaction function
- Tightening more powerful than expected

OUTLOOK

- We have not changed our 2019 global growth forecast of 2.7%—a material downgrade from our global growth forecast of 3.1% just a few months ago.
- Compared to consensus, we are a bit more pessimistic on the euro area (1.1% versus 1.4%) and the US (2.0% versus 2.5%), in line on China (6.2%) and mildly optimistic on Japan (1.1% versus 0.8%).
- We expect global inflation to fall to 2.7% this year from 2.9% in 2018, largely because of the lower starting price for oil.
- While slowing growth represents a downside risk to inflation, high capacity utilization rates and rising wage growth point in the opposite direction. We don't expect a sharp deceleration of core inflation pressures.

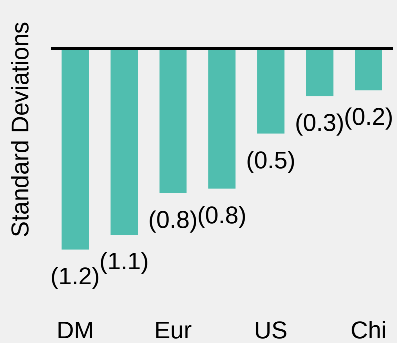
Global Cyclical Outlook: Toward a Synchronized Slowdown?

Manufacturing PMIs



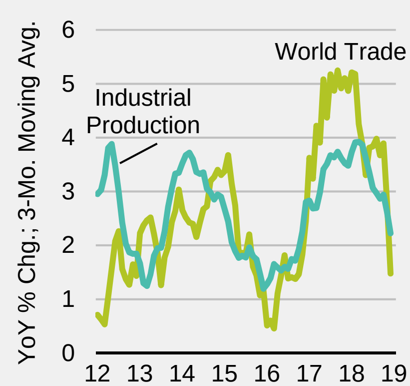
Through February 28, 2019
Source: Haver Analytics and IHS Markit

Manufacturing PMI: Feb 2019



As of February 28, 2019
Source: Haver Analytics and IHS Markit

Global Trade and IP Growth



Through February 28, 2019
Source: Haver Analytics

GLOBAL MARKET OUTLOOK: YIELD CURVES

GLOBAL YIELDS

Global—Developed-market (DM) yields are still very low and expected to rise, but magnitude and timing are less certain

US—The market has now priced out any rate hikes in 2019. That's too big a shift in our view, and we expect yields to rise over the coming year

Euro Area—The case for higher Bund yields has weakened, but the yields remain well below our fair-value estimates and still look likely to rise; politics a downside risk

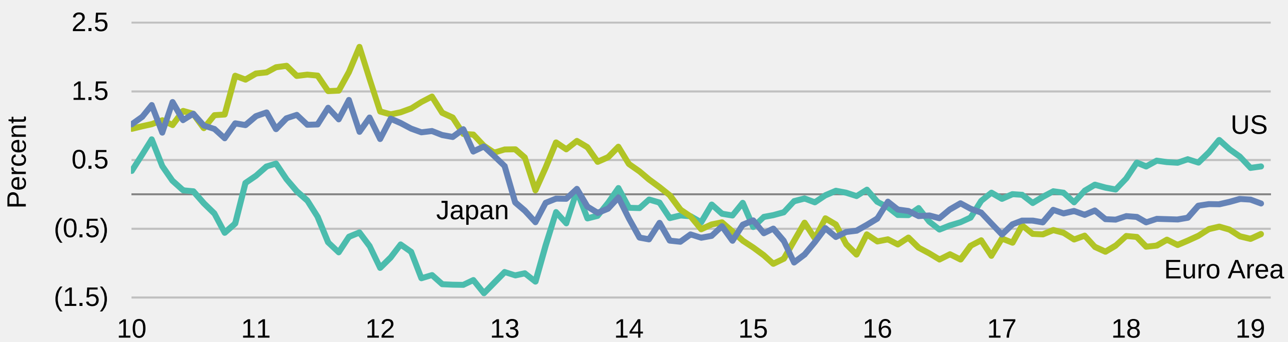
Japan—Quantitative and qualitative easing with yield curve control (QQE-YCC) policy to anchor 10-year yields close to zero; the risk of a policy "tweak" this year has fallen

10-Year Yields: AB vs. Consensus Year-End Forecasts (%)

	AB		Consensus	
	2018	2019	2018	2019
US	2.69	3.25	2.69	3.03
Euro Area	0.24	0.50	0.24	0.71
Japan	0.00	0.15	0.00	0.08
China	3.31	3.00	3.31	3.11

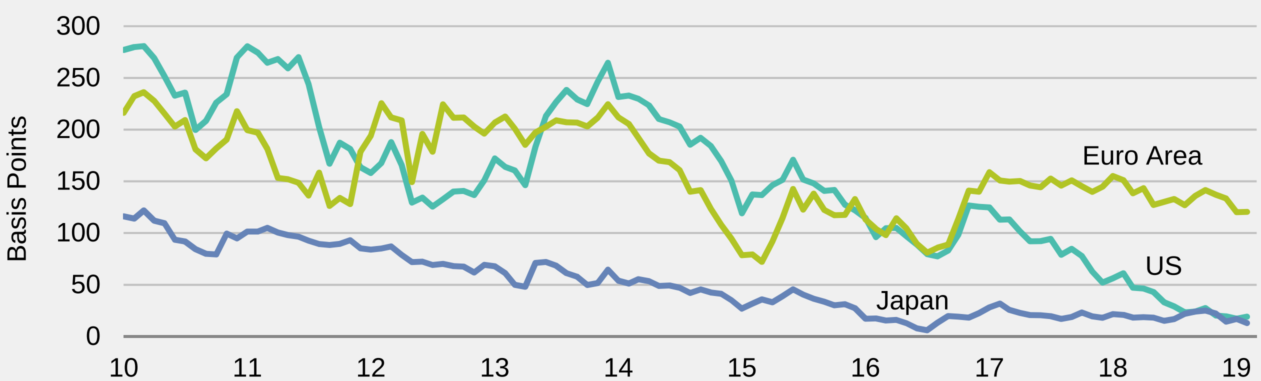
As of March 4, 2019
Source: Bloomberg and AB

Real 10-Year Bond Yields*



Through March 4, 2019
*Current 10-year bond yield less five-year/five-year forward inflation swap
Source: Bloomberg and AB

Yield Curves: 10-Year Bond Yield Less Two-Year Bond Yield



Through March 4, 2019
Source: Bloomberg and AB

GLOBAL MARKET OUTLOOK: CURRENCIES

FX FORECASTS

USD—The US dollar has been range bound over the last two years, and we don't think this will change soon—especially not while the Fed remains on hold

JPY—The yen should benefit if/when risk-asset headwinds intensify

EUR—With rates on hold for some time to come, we see few catalysts for a stronger euro; politics still an important downside risk (e.g., Italy, Brexit)

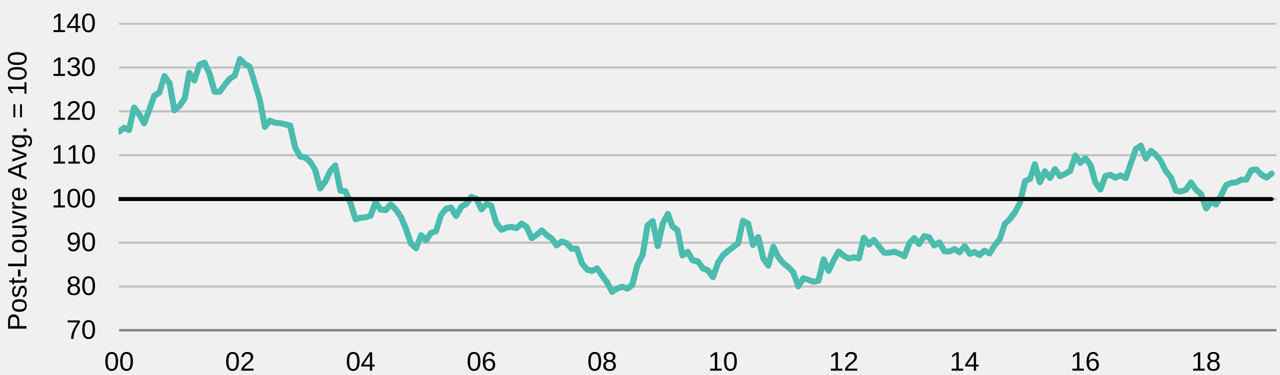
CNY—an easing of trade tension and receding downside growth risks point to a more stable CNY outlook

Global FX: AB vs. Consensus Year-End Forecasts

	AB		Consensus	
	2018	**2019**	**2018**	**2019**
EUR/USD	1.15	1.10	1.15	1.20
USD/JPY	110	110	110	108
USD/CNY	6.87	6.80	6.88	6.70
EUR/GBP	0.90	0.85	0.90	0.87

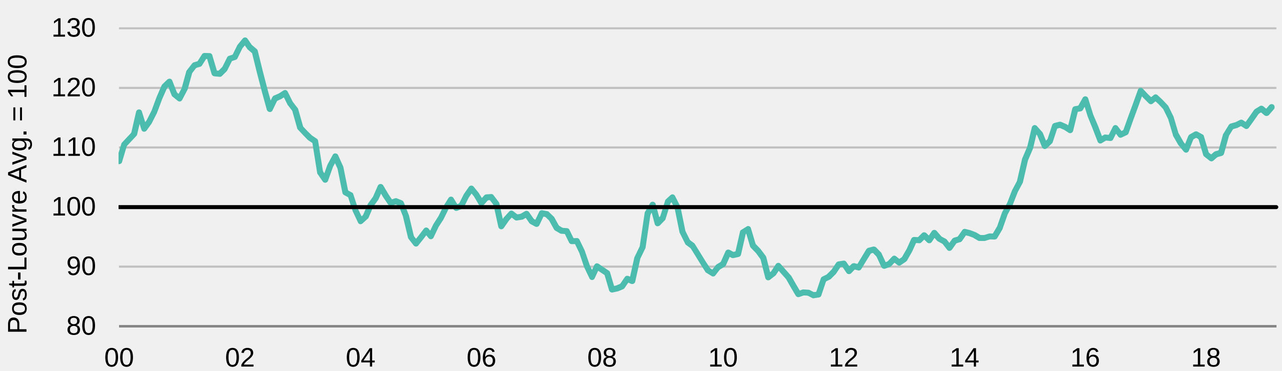
As of March 4, 2019
Source: Bloomberg and AB

Nominal USD Exchange Rate: DXY



Through March 4, 2019
Source: Bloomberg and AB

Real USD Exchange Rate



Through March 4, 2019
Source: Bloomberg and AB

US

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
US	2.9	2.0	2.4	2.3	2.38	2.88	2.69	3.25

OUTLOOK

- Incoming data paint a mixed picture of the US economy. The labor market remains strong, but the early 1Q data suggest that consumption has decelerated. We think that weather effects as well as the impact of the government shutdown are likely culprits, and we expect a rebound in the coming months.
- Inflation remains tame and is likely to stay that way for the time being. Global competition is keeping goods prices subdued and, while wages have accelerated, service price inflation does not appear to be keeping pace.
- Tame inflation and an uncertain growth outlook leave the Fed comfortably on hold for the time being. If the baseline forecast of decent growth and gradually rising inflation proves correct, we could see rate hikes later this year, but it will be several months before the Fed seriously considers changing rates again.

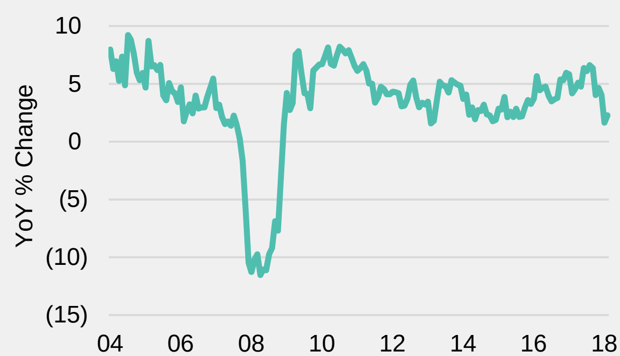
RISK FACTORS

- A weak global economy risks a negative feedback loop into the US economy, either through diminished trade or through financial market pressures.
- A divided government appears unlikely to undertake major new initiatives, but if it struggles to implement even the basics of day-to-day governing because of issues like the debt ceiling or border walls, political sclerosis could damage the economic outlook.
- The 2020 presidential election season has begun, and political risk is likely to rise over the course of the year.

OVERVIEW

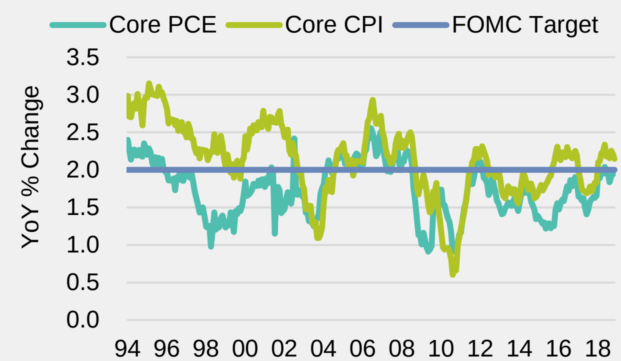
Our base case forecast for a modest slowdown appears accurate at this stage, based on incoming 1Q data. Consumers appear to have taken a break in December and January, presumably in part owing to uncertainty around the government shutdown, but we expect spending to pick up in the next few months. The strength of the labor market and improved household balance sheets provide ample support to consumption over the medium term. Muted inflationary pressures have allowed the Fed to step back from plans to raise interest rates further for the time being. The resultant easing of financial conditions, as reflected in higher equity prices and lower bond yields, will provide support for growth more broadly in the coming quarters. There is still much uncertainty, however, and we will be watching incoming data closely for confirmation that the slower growth that looks likely in 1Q is transitory rather than a more meaningful downshift.

US Retail Sales



Through January 15, 2019
Source: Thomson Reuters Datastream

US Core Inflation



Through January 15, 2019
Source: Thomson Reuters Datastream

Euro Area

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Euro Area	1.8	1.1	1.7	1.4	0.00	0.00	0.25	0.50	1.15	1.10

OUTLOOK

+ The euro area faces another challenging year in 2019, but we see a continuation of recent soft growth as being much more likely than a descent into outright recession. We forecast 1.1% growth this year, down from 1.8% in 2018.
+ Nonetheless, the outlook is materially weaker than when the European Central Bank (ECB) laid out its 2019 playbook last June. In response, the ECB has announced another targeted longer-term refinancing operation and pushed back the timing of the first rate hike into next year. We doubt this will be the last time the forward guidance is pushed back.

RISK FACTORS

+ Risks are more evenly balanced than they were in recent months, but much will depend on future developments in the trade war and political developments closer to home.
+ Superficially, the rising probability of agreement between the US and China is good news for export-dependent Europe, but not if this emboldens the US to adopt a more aggressive approach in trade negotiations with the EU.
+ A disorderly resolution to Brexit negotiations is an important downside risk for the euro area. A lack of policy flexibility means that the individual euro-area countries would not be well placed to handle the shock waves from a no-deal Brexit.

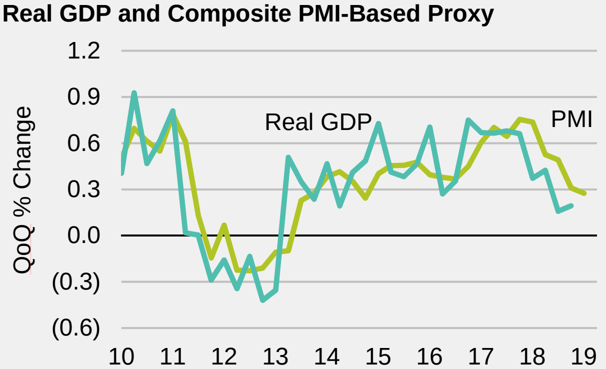
OVERVIEW

Euro-area growth has slowed sharply in recent quarters, with exports leading the way. Nonetheless, we continue to think that a recession is unlikely. The euro area should, for example, benefit from aggressive policy stimulus in China, which has significantly reduced downside growth risks there. There's likely to be a lag between policy action and impact, but we'd expect this stimulus to show up in greater support for global trade growth by the summer. The euro area is particularly sensitive to the ups, as well as the downs, of the global trade cycle.

Consumption growth also slowed last year. But real income growth remains strong and is likely to remain so over the coming year. Moreover, consumer confidence remains relatively high and has risen slightly this year. Barring a major shock, such as what happened during the global financial crisis, it would be highly unusual for the euro area to fall into recession under these circumstances.

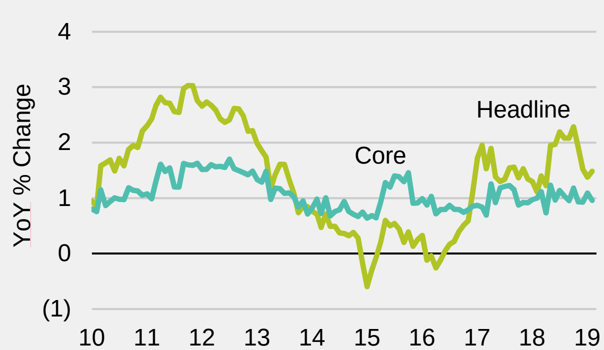
In addition to the sustained support from monetary policy, the euro is also likely to benefit from additional help from fiscal policy. Having been broadly neutral over the last year, fiscal policy is likely to turn expansionary this year in all of Germany, France, Italy and Spain. While a tightening of credit conditions means that Italy is unlikely to derive much benefit from this, that's not the case for the other countries. For the euro area as a whole, we estimate that the stimulus should be equal to roughly 0.5% of GDP this year. Hardly a game-changer, but another factor that should help to mitigate recession risks.

Real GDP and Composite PMI-Based Proxy



Through February 28, 2019
Source: Haver Analytics and IHS Markit

Consumer Price Inflation



Through February 28, 2019
Source: Haver Analytics

Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Japan	0.7	1.0	1.2	1.0	(0.06)	(0.10)	0.01	0.15	110	110

OUTLOOK

- The impact of slowing global trade is becoming more evident. But fiscal stimulus and accelerated consumption ahead of October's VAT hike should help the economy grow by about 1%.
- Wage inflation is already at a 20-year high and should continue to rise, putting pressure on underlying inflation. But known one-offs, such as the VAT hike, free education and telecommunications charges, will muddy the inflation picture.
- The Bank of Japan (BOJ) is likely to stay on the sidelines in 2019 unless the yen strengthens substantially.

RISK FACTORS

- Potential self-inflicted risks remain—the VAT hike and possible BOJ missteps chief among them. But external risks are more important, whether they materialize through trade or via sharp appreciation in the yen in a risk-off environment.

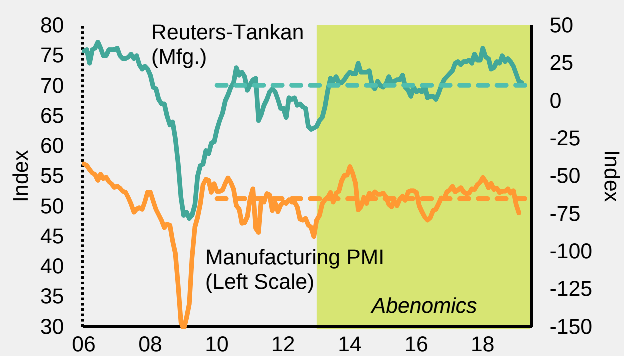
OVERVIEW

The slowdown in global trade growth is now making a bigger impression on the Japanese manufacturing sector. Export volumes and industrial production fell sharply in January, and mounting inventories in a range of companies in the electronics sector (such as chipmakers) have led to profit downgrades and production halts. And many business sentiment indicators have slipped sharply. The manufacturing sector PMI, for example, fell to 48.9 in February, the first reading below 50 since the middle of 2016.

As we discussed above, we remain skeptical about a quick turn in the trade-related pressure. Accordingly, we expect this global drag to persist. Still, there are a few positive offsets. The labor market remains solid: increases in both hourly compensation and jobs have helped household wage and salary incomes increase at a pace of more than 3% year over year. And further fiscal stimulus in the pipeline, including measures to offset the potential negative effects of October's VAT hike, should be enough to get growth running at about 1%.

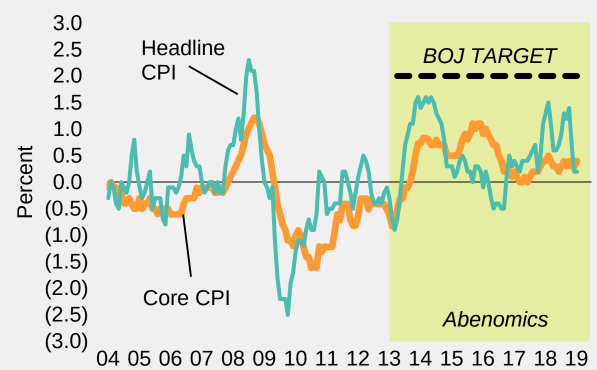
Cost pressures have clearly intensified—labor is scarce and wages are rising. But whether that shows up in higher headline CPI inflation is unclear. There are an increasing number of anecdotes about price hikes, but that's difficult to parse out of the data: core inflation remains broadly stable at around 0.4% year over year. And the energy price dynamics and some (now widely anticipated) one-offs will muddy the picture, including the VAT hike, the introduction of free education and a sharp fall in telecommunications charges. With external and domestic risks skewed to the downside, it seems likely that the BOJ will sit pat in 2019, recent chatter about further easing notwithstanding. This amounts to maintaining the YCC framework (targeting 10-year yields at around zero) and continuing to slowly taper Japanese government bond purchases. The debate about how to deal with the financial-stability risks of current monetary settings will continue, but action is unlikely.

Manufacturing Confidence Slides



Through March 8, 2019
Source: Bloomberg and Thomson Reuters Datastream

Core Inflation Steady—but Well Shy of Target



Through March 8, 2019
Source: Thomson Reuters Datastream

China

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
China	6.6	6.2	2.2	2.4	3.22	4.35	3.58	3.00	6.88	6.80

OUTLOOK

- The official Chinese real GDP growth rate will likely be around 6.2% in 2019, down from 6.6% in 2018, as weakness in capex spending persists.
- We expect continued aggressive monetary and fiscal policy easing to counter downward pressure on the economy, with a focus on infrastructure projects and property easing—the measures most likely to help stabilize the economy.
- Inflation should rise to about 2.4%, well below the government's target of 3%, as the upcoming trade deal and slower currency depreciation may reduce food prices even further.

RISK FACTORS

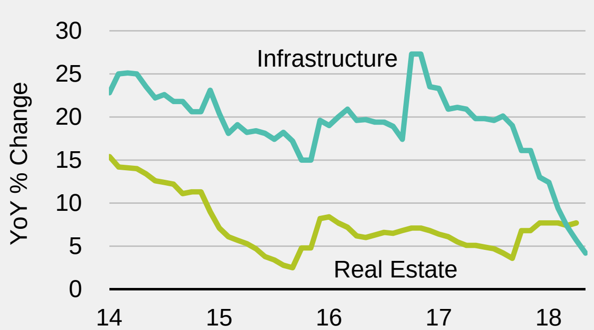
- Policy easing may be less robust than expected if economic data surprise to the upside. This would put economic stabilization this year and next at risk.
- An underwhelming US-China trade deal would also be a risk for China's economy.
- Failure to appreciate how much China has compromised to achieve a trade deal with the US may lead markets to underestimate how much other major exporters around the globe will have to compromise in future.

OVERVIEW

We think it's unrealistic to expect China's economy to grow very strongly this year. First, the capex cycle is peaking, and the future cycle is likely to be hurt by US-Chinese trade tensions. Second, these two factors will put considerable downward pressure on GDP growth in 2019 and even in 2020. Accordingly, we think the government will press ahead with aggressive monetary and fiscal easing, with a focus on infrastructure spending and property easing. But it's important to remember that policy effectiveness is declining, making it unlikely that these measures can produce much more than a 6.2% growth rate this year.

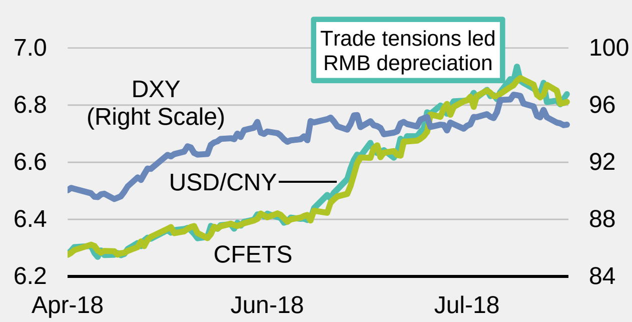
We expect to see deceleration in some key data over the next few months, including PMI, PPI, trade and money growth, and we don't expect to see a turnaround until mid-2019. This is because it usually takes six to nine months before the effect of policy easing starts to show up in the real economy. However, a few positive economic reports could prompt the government to pull back on policy easing, putting the brakes on stimulus at a time when the economy needs it desperately.

Releveraging Up



Through January 4, 2019
Source: Bloomberg

RMB Depreciation Slowed After Countercyclical Factor Introduced



Through January 4, 2019
Source: Bloomberg

Canada

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Canada	1.8	1.8	2.6	2.1	1.75	2.25	1.96	2.75	1.36	1.35

OUTLOOK

- Growth is decent and inflation has moved sideways the last few months on a core basis, signaling neither increasing dynamism nor a meaningful deterioration.
- Lower commodity prices pose a challenge to the medium-term growth outlook, but the stabilization of energy prices is a relief for those who had feared a more persistent decline.
- The Bank of Canada (BoC) has signaled a period of stable rates to come. While it appears more inclined than the Fed to resume rate hikes, we nonetheless expect any serious discussion about doing so not to begin for several months.

RISK FACTORS

- Canada's three points of potential friction are commodities, the US and China. But the domestic economy does not appear to be generating idiosyncratic risks, and that's good news.

OVERVIEW

If slow and steady wins the race, Canada should be in good shape. The domestic economy appears to be operating at something like a near-term equilibrium, with growth and inflation both keeping steady and risks of overheating in property markets having faded significantly. The BoC still likes to remind the market that only interest rates remain out of line with forecasts; the policy rate is still below what the BoC considers to be neutral. But there is no urgency to move rates higher, absent either domestic pressures or the easing of international risks. For now, that means that the macro picture is one of low-volatility stability.

Australia/New Zealand

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Australia	2.7	2.1	2.2	1.8	1.50	1.50	2.32	2.75	0.70	0.67
New Zealand	2.8	3.2	1.4	2.2	1.75	2.00	2.38	3.00	0.67	0.71

AUSTRALIA

- 4Q GDP growth was softer than expected at 0.2% (2.3% year over year). The details tell the tale: private final demand was flat in 3Q and 4Q; only public-sector spending is keeping growth in positive territory.
- This accords with our earlier view that the spillover from the housing downturn would be more pronounced than expected and would eventually result in policy easing.
- So far, though, the central bank is dragging its feet, with Governor Lowe expressing confidence that the overall economy can withstand a housing correction. We need to see more concrete evidence of a deterioration in the labor market before the central bank will be prompted to cut rates—something we don't expect to see until early 2020.
- We think there's still further currency weakness to come and wouldn't be shocked to see AUD/USD revisiting the mid-0.60s over the next three to six months.

NEW ZEALAND

- Despite softer-than-expected 4Q jobs data, we still think the labor market is in reasonable shape. And with house prices stable (flat in Auckland, still rising elsewhere), building consents (residential and non-residential) high, and a fiscal boost in the pipeline, there's plenty of support for growth.
- While inflation is relatively low, cost pressures are rising, and there are some tentative signs that wage growth is picking up. We expect speculation to turn once again toward central bank tightening in the second half of the year. We've tentatively penciled in a rate hike in 4Q.

UK

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
UK	1.4	1.2	2.5	1.8	0.75	0.75	1.33	1.50	1.28	1.30

OUTLOOK

+ Economic growth slowed to 0.2% in the final quarter of last year, with survey data pointing to a continuation of subdued growth in the opening months of 2019. Brexit uncertainty is clearly having an impact. Investment in plant and machinery has fallen for six consecutive quarters and currently stands 13% below its level in the second quarter of 2016, just before the Brexit referendum.
+ How and when Brexit uncertainty is resolved will have an important bearing on the economic outlook. We continue to think that the most likely outcome is that the UK leaves the EU with a deal. However, it is now virtually impossible for this to happen before March 29, which means that uncertainty is likely to last longer than we originally expected. This, plus the lingering threat of a disruptive no-deal Brexit, means that risks to our 1.2% growth forecast for 2019 are clearly skewed to the downside.
+ Against this backdrop, we now think it unlikely that the Bank of England will raise interest rates later this year. It's still possible, of course, but that would require the withdrawal agreement with the EU to be ratified very quickly. And, as noted above, the timetable for this is clearly slipping.

RISK FACTORS

+ While the most likely outcome is that the UK either ratifies the deal agreed on with the EU or chooses not to leave after all, the risk of a disruptive no-deal Brexit should still not be dismissed.

Norway/Sweden

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Norway	1.4	2.0	1.9	2.0	0.75	1.00	1.79	2.00	8.65	8.64
Sweden	2.3	1.8	1.9	2.0	(0.50)	0.00	0.47	0.85	8.87	9.09

NORWAY OUTLOOK

+ Growth in the mainland economy picked up slightly to 2.5% in the fourth quarter of last year. Growth was also 2.5% for 2018 as a whole, but we expect this to slow to 2.0% in 2019.
+ Headline inflation fell to 3.1% in January from 3.5% in December, well above Norges Bank's 2.0% target. However, core inflation (excluding energy and indirect tax changes) was unchanged and much closer to target at 2.1%.
+ Against this backdrop, Norges Bank has signaled that interest rates are likely to rise gradually over coming years, with the next move possibly coming as early as this month.

RISK FACTORS

+ The main risk factors for Norway are rising household debt (currently well above 200% of income) and the price of oil.

SWEDEN OUTLOOK

+ Economic growth picked up strongly to 2.4% in the fourth quarter of last year from 1.6% in the third quarter. Next year, we expect growth to slow to 1.8%.
+ Core inflation (CPIF, excluding energy) fell to 1.4% in January from 1.5% in December and continues to move in a narrow range, comfortably below the Riksbank's target.
+ The Riksbank left interest rates on hold in February but continues to forecast the next increase in the second half of the year. We think it possible that this will ultimately be pushed back into 2020.

RISK FACTORS

+ High household debt and elevated house prices continue to represent a major risk to financial stability.

Asia ex Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Asia ex Japan	**6.0**	**5.6**	**2.5**	**2.6**	**3.57**	**4.18**	**4.03**	**3.70**	**—**	**—**
Hong Kong	3.0	2.5	2.3	2.3	2.75	2.50	1.98	1.80	7.83	7.85
India	7.4	7.2	4.7	3.6	6.50	6.00	7.37	7.20	69.58	71.20
Indonesia	5.2	5.1	3.4	3.4	6.00	6.00	7.41	7.40	14,481	13,750
South Korea	2.7	2.2	1.5	1.8	1.75	1.75	1.96	2.45	1,113	1,150
Thailand	4.1	3.5	0.9	1.5	1.75	1.75	2.45	2.75	32.31	32.70

OUTLOOK

+ The drag from global trade and a peaking technology cycle should continue to weigh on growth in the more trade-exposed parts of the region (such as South Korea and Taiwan).
+ Inflation generally continues to decline across the region, and with exchange rates relatively stable, speculation has turned to policy easing.
+ Political events—including elections in India, Indonesia and Thailand—remain important risk factors to monitor.

RISK FACTORS

+ Uncertainty over the global trade cycle and the resolution of US-China trade tension remains key.

OVERVIEW

The latest data on global trade point to deceleration. PMIs for bellwether exporters South Korea and Taiwan, for example, slipped further in February, printing at 47.2 and 46.3, respectively. To be sure, there are a lot of moving parts here, from China's slowdown to the new product cycle in tech and excess semiconductor inventory. Trade tensions are but one element. Accordingly, we're skeptical that a "trade deal" will be enough to generate a sharp reversal in trade growth, and remain biased toward seeing further softness in growth in the more trade-exposed economies in the region (South Korea, Singapore, Taiwan).

In contrast, growth in India and the ASEAN economies has held up well, driven by relatively solid domestic demand. Even so, inflation has printed lower across the region. In part this reflects the pass-through from lower oil prices last year. But in general, food prices and core inflation have also been falling.

As a result, Asian central banks have adopted a more neutral tone, given the stabilization in risk sentiment and a benign inflation outlook. Bank Indonesia said its policy rate is now close to a cyclical peak. Speculation about easing in the Philippines has ramped up with the appointment of a new governor of Bangko Sentral ng Pilipinas who is perceived to be more dovish and progrowth. All in all, stabilized currencies, benign inflation and a neutral or dovish turn in central banks' rhetoric will support local rates' performance in the months ahead.

Investors are now starting to focus on political events in India and Indonesia, both of which will hold general elections in 2019. We think election-related political risk is manageable in both economies. India's budget consolidation targets slipped in its recently released interim budget, but the deficit level remains modest compared with those seen in past election cycles. We don't expect any negative ratings actions. In the past we have seen policy continuity even during periods of regime shift. The election could cause a spike in near-term volatility, but the medium-term outlook of the country remains intact.

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Latin America

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Latin America	**0.6**	**1.6**	**7.3**	**6.8**	**13.81**	**9.86**	**7.54**	**8.34**	**—**	**—**
Argentina	(2.2)	(0.5)	31.8	30.0	59.25	35.00	—	—	37.60	46.00
Brazil	1.1	2.4	3.7	4.1	6.50	6.50	7.38	8.75	3.88	3.75
Chile	4.0	3.7	2.4	2.8	2.75	3.50	4.21	4.80	696	695
Colombia	2.7	3.0	3.2	3.5	4.25	4.50	6.72	7.15	3,275	3,175
Mexico	2.0	1.8	4.8	3.8	8.25	7.50	9.11	9.30	19.64	19.50

OUTLOOK

+ Economic growth is expected to accelerate this year, driven by cyclical expansion in Brazil and Colombia and economic recovery in Argentina. Inflation is picking up marginally across the region but remains contained.
+ The move toward a more dovish monetary-policy stance by central banks globally will reduce pressures on Latin American policymakers to hike rates in line with the Fed. Many central banks have said that external factors are likely to be among the most important determinants of policy decisions in the coming months.

RISK FACTORS

+ Uncertainty may be keeping investment on the sidelines across the region. In Brazil, pension reform is a necessary precondition for economic reactivation, and approval may take longer than initially expected. Argentina’s presidential election result will produce a binary outcome for the peso and economic policies. In Mexico, uncertainty about the passage of the USMCA trade agreement may be holding investors back. And Venezuela’s challenges are affecting countries across the region.

OVERVIEW

In Argentina, the election cycle is starting to ramp up, with the first provincial election in Neuquén on March 10. Many provinces have chosen to bring forward their local vote ahead of the national presidential election on October 27 to concentrate on local issues. But the outcome of the provincial races will undoubtedly serve as a barometer for national sentiment and become part of the national conversation. Higher-than-expected inflation reduced confidence in President Macri’s economic adjustment program and the likelihood of his reelection, which sparked depreciation pressure on the peso. This rapid change in opinions contributed to volatility in the central bank’s monetary instruments during the month. The policy reference rate, Leliq, which is set endogenously within the monetary framework, fell by almost 10 percentage points and then rebounded six percentage points intramonth. This level of volatility in monetary policymaking is unusual and highlights the difficulty of monetary base targeting as an effective policy tool. Over the coming months it will become increasingly difficult for the central bank to maintain stability of the FX rate and contain inflation. Macri will try to steer away from economic issues in campaign talks, but the sluggish recovery will weigh on his popularity and rally the opposition.

In Brazil, the government announced its social security reform proposal, estimating BRL1.16 trillion in savings. The reform prioritizes equality, incorporating a progressive contribution rate structure and making changes to the pension scheme for all segments of the population, including the military and teachers. This structure should help increase buy-in from the general population, but there are many other parameters that will face opposition, including the proposed increases in minimum retirement age, rapid transition period to the new rules, and benefit changes for rural workers. The proposal will be diluted during congressional negotiations and is expected to be voted in the lower house in summer, with final approval in the Senate likely in October.

Mexico’s growth outlook continues to deteriorate. This is primarily the result of tight monetary policy and the deterioration of external trade conditions. Combining those with domestic tensions over government support for the local oil company (PEMEX), the outlook is materially weaker than it was a few months ago. The central bank has begun to shift toward easing, and we expect that shift to materialize fully in the coming months. This is an economy that needs help from policymakers to regain momentum. As long as the peso is stable, inflation should fall and allow that help to arrive.

Eastern Europe, Middle East and Africa (EEMEA)

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
EEMEA	**2.8**	**2.0**	**7.9**	**6.1**	**10.76**	**8.33**	**10.00**	**9.43**	**—**	**—**
Hungary	4.9	2.8	2.8	3.1	0.90	1.25	3.01	3.20	281	286
Poland	5.1	3.5	2.0	2.0	1.50	1.50	2.81	3.35	3.76	4.25
Russia	2.3	1.4	2.8	4.3	7.75	7.00	8.78	8.00	69.47	65.00
South Africa	0.8	1.2	4.8	4.9	6.75	6.75	9.44	9.40	14.38	14.40
Turkey	2.6	(3.0)	15.6	15.6	24.00	17.00	15.83	17.00	5.27	5.80

OUTLOOK

+ Real GDP growth should remain robust in most of the EEMEA region over the course of 2019, though it may slow slightly from the pace set in 2018, mainly because of a more significant slowdown seen in Turkey. South Africa's growth rate is expected to be higher in 2019, but we think it could still surprise to the downside.
+ Headline CPI is rebounding in most Central and Eastern European (CEE) economies, but it's likely to peak in mid-2019. Recent oil price declines are key downside risks. Turkish headline inflation dynamics remain the most challenged, but are expected to ease in 2019.
+ CEE central banks, along with the South African Reserve Bank, are expected to remain on hold, while Russia and Turkey have room to cut interest rates.

RISK FACTORS

+ Balance-sheet normalization at DM central banks and the potential for higher core yields are risks for current account deficit countries such as Turkey and, to a lesser extent, South Africa.

OVERVIEW

South Africa remains in limbo, and we are not convinced the national and provincial elections in May will alter this state. Voters vote for a political party, not an individual, but it is President Ramaphosa's popularity that will likely see the ruling African National Congress (ANC) get around 60% of the votes. That margin of victory is important because the accepted narrative (likely introduced by the Ramaphosa faction within the ANC) is that 60% or more will provide President Ramaphosa with a strong enough mandate to accelerate political and economic renewal. There is evidence of political renewal, but that has not yet translated to an improved economic prognosis. We expect GDP growth to be only slightly above 1.0% in 2019 after having increased by 0.8% in 2018. The 2019 budget proposed in February was not market friendly, as debt metrics would continue to deteriorate. But balance-sheet support for Eskom (the beleaguered power utility) and the government's plan to reconfigure the utility were positive short-term counterbalances. Some of the near-term idiosyncratic risks (Moody's credit rating review at the end of March and elections early in May) seem less daunting than thought, but the medium-term outlook remains clouded.

A recent research trip to Turkey reinforced our view that a sizeable recession is likely, with risks slightly on the downside to our growth forecast of (3)% in 2019. The Central Bank of the Republic of Turkey and independent, credible economists forecast a 4Q18 quarterly contraction of 3% quarter over quarter, above our expectations of 2% to 2.5%. If these more negative estimates materialize, we'll likely adjust our own forecast for 2019 lower too. The recession is mostly led by a significant deceleration in credit growth and very limited signs of revival so far. There has apparently been a slight uptick in credit extension year to date, but that's mostly related to credit used for working capital and rollover of existing debt, rather than to generate real growth. Given that Turkey faces a more sizeable private sector debt problem (as opposed to a public one), the deleveraging cycle among corporates and banks is likely to be a prolonged one following the spike in borrowing costs since last year. All the banks we talked to still forecast positive real growth of 1%–2% in 2019 and a doubling of aggregate nonperforming loans to 7%–8%, although risks are that this will rise into double digits given a likely weaker macro backdrop. The main caveat is that banks appear to be relatively well capitalized and do not face any USD liquidity issues at this stage.

Frontier Markets

OUTLOOK

+ The International Monetary Fund (IMF) arrangement will eliminate Ecuador's financing needs this year and will hold the government accountable to adjustment goals.

RISK FACTORS

+ Social pressure against components of the IMF program could slow the adjustment process. Specifically, opposition to the planned labor reform could catalyze public opposition to the program.
    + Ecuador's economy continues to be dependent on oil. Although the economy has diversified over the past few years away from the energy sector, much of the foreign direct investment and new investment into the country is within the energy and mining sectors. A significant decline in the oil price would have a negative impact on economic activity and the country's fiscal and external positions.

OVERVIEW

As expected, Ecuador requested a financing arrangement with the IMF to help bridge liquidity needs while the economy readjusts. The three-year program, which is expected to be approved by the IMF board in the coming week, will provide $4.6 billion in funding and unlock an additional $5.4 billion from other multilateral organizations. These funds will eliminate the need for capital market issuance during 2019.

Over the past year, the government has worked to correct the fiscal imbalances that had been created by the previous administration during a time when oil prices were high and the state received significant resources from the energy sector. The goal has been to shift the economic structure from growth driven by public sector investment to private sector activity, and reduce the size of the state. Some progress has already been made in providing incentives for private investment, reducing red tape and streamlining procedures, and moving toward a production sharing agreement (PSA) model in the energy sector. The administration has also undertaken a sizeable fiscal adjustment—reducing the fiscal deficit to close to 3% of GDP in 2018, and planning to adjust the fiscal balance by another 5% of GDP over the next three years under the new IMF program. Improving the fiscal challenges should help to normalize Ecuador's external balance as well, and reduce the country's dependence on international capital markets. If the government can execute its ambitious plans, it will achieve debt sustainability and resolve the structural issues that have been present in Ecuador for years.

	Real Growth (%)		Inflation (%)		Official Rates (%)		Long Rates (%)		FX Rates vs USD	
	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F	2018F	2019F
Global	3.1	2.7	3.0	2.7	3.14	3.04	3.01	3.11	-	-
Industrial Countries	2.2	1.6	2.0	1.8	1.25	1.46	1.54	1.93	-	-
Emerging Countries	4.6	4.5	4.7	4.2	6.74	6.05	5.83	5.42	-	-
United States	2.9	2.0	2.4	2.3	2.38	2.88	2.69	3.25	-	-
Canada	1.8	1.8	2.6	2.1	1.75	2.25	1.96	2.75	1.36	1.35
Europe	1.8	1.2	1.8	1.5	0.13	0.15	0.50	0.73	-	-
Euro Area	1.8	1.1	1.7	1.4	0.00	0.00	0.25	0.50	1.15	1.10
United Kingdom	1.4	1.2	2.5	1.8	0.75	0.75	1.33	1.50	1.28	1.30
Sweden	2.3	1.8	1.9	2.0	(0.50)	0.00	0.47	0.85	8.87	9.09
Norway	1.4	2.0	1.9	2.0	0.75	1.00	1.79	2.00	8.65	8.64
Japan	0.7	1.0	1.2	1.0	(0.06)	(0.10)	0.01	0.15	110	110
Australia	2.7	2.1	2.2	1.8	1.50	1.50	2.32	2.75	0.70	0.67
New Zealand	2.8	3.2	1.4	2.2	1.75	2.00	2.38	3.00	0.67	0.71
Asia ex Japan	6.0	5.6	2.5	2.6	3.57	4.18	4.03	3.70	-	-
China	6.6	6.2	2.2	2.4	3.22	4.35	3.58	3.00	6.88	6.80
Hong Kong	3.0	2.5	2.3	2.3	2.75	2.50	1.98	1.80	7.83	7.85
India	7.4	7.2	4.7	3.6	6.50	6.00	7.37	7.20	69.58	71.20
Indonesia	5.2	5.1	3.4	3.4	6.00	6.00	7.41	7.40	14,481	13,750
Korea	2.7	2.2	1.5	1.8	1.75	1.75	1.96	2.45	1,113	1,150
Thailand	4.1	3.5	0.9	1.5	1.75	1.75	2.45	2.75	32.31	32.70
Latin America	0.6	1.6	7.3	6.8	13.81	9.86	7.54	8.34	-	-
Argentina	(2.2)	(0.5)	31.8	30.0	59.25	35.00	-	-	37.60	46.00
Brazil	1.1	2.4	3.7	4.1	6.50	6.50	7.38	8.75	3.88	3.75
Chile	4.0	3.7	2.4	2.8	2.75	3.50	4.21	4.80	696	695
Colombia	2.7	3.0	3.2	3.5	4.25	4.50	6.72	7.15	3,275	3,175
Mexico	2.0	1.8	4.8	3.8	8.25	7.50	9.11	9.30	19.64	19.50
EEMEA	2.8	2.0	7.9	6.1	10.76	8.33	10.00	9.43	-	-
Hungary	4.9	2.8	2.8	3.1	0.90	1.25	3.01	3.20	281	286
Poland	5.1	3.5	2.0	2.0	1.50	1.50	2.81	3.35	3.76	4.25
Russia	2.3	1.4	2.8	4.3	7.75	7.00	8.78	8.00	69.47	65.00
South Africa	0.8	1.2	4.8	4.9	6.75	6.75	9.44	9.40	14.38	14.40
Turkey	2.6	(3.0)	15.0	15.6	24.00	17.00	15.83	17.00	5.27	5.80

Long rates are 10-year yields unless otherwise indicated.
Latin American Rates include Brazil, Chile, Colombia and Mexico
Real growth aggregates represent 48 country forecasts not all of which are shown
Blanks in Argentina are due to distorted domestic financial system so are not forecast.

Contributors

Guy Bruten guy.bruten@alliancebernstein.com	Mo Ji mo.ji@alliancebernstein.com	Eric Winograd eric.winograd@alliancebernstein.com
Katrina Butt katrina.butt@alliancebernstein.com	Markus Schneider markus.schneider@alliancebernstein.com	
Adriaan Du Toit adriaan.dutoit@alliancebernstein.com	Darren Williams darren.williams@alliancebernstein.com	

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