DTZ INVESTORS

Global Economic Outlook: More of the same for 2018?

2017 was a surprisingly calm year for the global economy. Despite the economic and geopolitical concerns voiced at the beginning of the year, fears over Brexit, Chinese debt, rising populism across Europe and Trump's legislative agenda had negligible effect on world growth. Market volatility was low throughout 2017 and global growth was driven by a synchronized recovery across emerging and advanced economies.

Four months into 2018 and the new year couldn't look more different from the last. Volatility has returned; global equity markets have been rocked by concerns of an inflation scare in the US and rising trade risks between the US and China, long term bond yields have fallen breaking the upward trend that has been motion since January, and yield curves have flattened. Yet, despite the recent fluctuations in financial markets, we remain optimistic that the broad-based global recovery will be sustained through 2018. Monetary and fiscal conditions are expected to remain supportive, even as some central Banks will begin policy normalisation, which should mean that the balance between headwinds and tailwinds will remain tilted towards the latter for the rest of the year.

The late-cycle upswing to be sustained in the US. Various macro-economic indicators suggest that the current momentum has further to run. Healthy labour market conditions should support wage growth and consumer expenditure, and trade should be assisted by a weaker dollar and the buoyancy of the global economy. The implementation of new tax reforms that reduce tax rates for corporates and individuals from Q2 2018 should deliver an additional boost to business investment and private consumption. Whilst this is likely to be accompanied by a faster pick up in interest rates by the Federal Reserve to ward off inflation and prevent the economy from overheating, the expansionary fiscal measures should provide enough of an economic stimulant to offset the interest rate hikes in 2018.

EU growth to ease in 2018. The Euro-Area economy should expand at a softer pace in 2018. Generally accommodative monetary and fiscal policies will support domestic growth and healthy global economic conditions should act as a counterweight to the recent appreciation in the Euro, supporting export volumes and external trade. Business sentiment remains firm and corporate profitability high, which combined with favourable financial conditions should enable business investment to positively contribute to GDP growth in 2018. The consumer sector will remain the principal driver of growth, as improving labour market conditions and a benign inflationary environment supports household spend. However, the rate of growth in private consumption is likely to slow this year as the pressure on wages moderate from smaller declines in unemployment rates and diminishing output gaps. Overall, the Euro-area is expected to expand by 2.2% in 2018 compared to 2.4% in 2017, with Germany and Spain forecast to outperform the Euro-area average.

Japan to lose tailwinds in 2018. Japan is experiencing its strongest growth spurt since 2013, driven by strong export demand, easier fiscal measures and a recovery in domestic consumption. These factors should assist growth in 2018, but with the economy close to full capacity, (the jobless rate reached a 25 year low of 2.4% in January) GDP growth is likely to moderate. On the upside, ultra-easy monetary policy conditions should be retained in the near term given the lack of inflation, which combined with low but positive wage growth should result in the consumer economy remaining the key source of growth in 2018.

A benign growth outlook for the UK. The UK starts 2018 on a relatively good note, trade should be assisted by a competitive sterling and the positive outlook for global growth. Labour market conditions are also favourable; the unemployment rate is at a 45 year low and firms are finding it increasingly difficult to find skilled staff, with a recent Bank of England survey reporting that recruitment difficulties are at their highest level since 2004. These factors should translate into a sustained pick up in nominal earnings growth in 2018. Inflation is also expected to moderate over the course of the year as sterling's post referendum depreciation falls out of the annual rate of growth, reducing the inflationary squeeze on disposable incomes.

In view of this, the Bank of England are taking a more hawkish position on monetary policy, and have signalled that interest rates could rise 'somewhat earlier and to a somewhat greater extent' than previously anticipated. Nonetheless, interest rates are unlikely to return back to pre-crisis norms, as structural long term factors such as: ageing population, high levels of indebtedness in the consumer sector and with productivity below long term trends reduces the ability of policymakers to do so. Overall economic growth is likely to be on a par to the levels seen in 2017, on the assumption that political risks are contained, with positive contributions from net trade and household consumption generating a more balanced growth profile for 2018.

Economic growth to remain buoyant for Emerging Markets. The outlook for 2018 is generally encouraging for the Emerging Markets (EM). Rising incomes and low interest rates across most EM countries should bolster consumer spend. Higher oil and commodity prices and the upswing in global growth should assist commodity-exporting nations. India is forecast to be the fastest growing EM country in 2018 exceeding growth rates in China; with Poland, the Czech Republic and Chile also expected to outperform the EM average.

Growth to hover around the 6% mark for China in 2018. Unlike other emerging economies, China's economy is expected to slow in the near term as government reforms to address the country's existing debt burden, tackle shadow banking activities and speculative property lending come into effect. The introduction of new environmental targets will also weigh on the production industries. With China accounting for c.15% of the world's total output at the end of 2016 there is a risk that tighter monetary policies will dampen trade and impinge on world growth, but the extent to which these measures limit global growth prospects will depend on the severity of policy changes. If the government can continue to deleverage the economy without impairing growth, as per 2017, then economic growth should remain around the 6% mark for 2018.

Risks to the global growth outlook:

Upside risks: It is possible that the world economy could accelerate at a faster than expected pace in the near term if improved global economic activity and easier financial conditions reinforce one another.

Downside risks: Downside risks to global growth outlook still linger, and will be largely driven by political factors.

- Increased trade protectionism bought on by President Trump's desire to lower the US trade deficit remains a near term threat, and in a worst-case scenario has the potential to escalate into a trade war between the world's two biggest economies (US and China) disrupting trade flows and global supply chains.
- Further afield, ongoing geo-political risks could also emanate in the Middle East and North Korea.
- Meanwhile, the recent results of the Italian election could raise uncertainty across Europe over the short and medium term. The Five Star Movement and Northern League, two populist parties renowned for their anti-establishment, anti-globalist and their Eurosceptism won the lion's share of votes at the recent election. With the key leaders of both parties being political novices, an alliance between the two parties could create short term tensions while medium term risks could surface as the views of the new party clashes with the centrist, pro-European views of other European leaders. All the same, Brexit remains the main downside risk across Europe. Reaching a unanimous agreement on the terms of Brexit that is accepted by all parties will not be easy to achieve by March 2019, with the Irish border being a key area of contention for phase two of the negotiations.

Aside from politics, other risks such as the effect of monetary policy tightening by Central Banks globally could create pockets of volatility to financial markets in the near term.

Conclusion - For now the risks to the global outlook remains favourable. While the number of downside risks exceeds upside gains, the probabilities of these threats having an immediate threat to the global economy is low. At the time of writing, trade tensions between the US and China have eased, and the chances of a drawn-out trade war appear slim. As for the other political concerns, many of these issues were in existence over the last year but global growth was unresponsive to the political noise, therefore, it is quite plausible that this could be repeated in 2018.

An encouraging global economic backdrop should support financial markets in 2018 providing support to growth assets such as equities and commercial property. Even so, it would be naive to assume that continued economic growth in the global economy will lead to investment returns that match the levels seen in 2017. Rather, with the raised volatility that has surfaced in recent months likely to persist, elevated values across most asset classes and the expectations for gilt yields to gradually rise as inflation gradually rises, positive but lower asset class returns seems a more realistic outcome.

Global Growth Forecasts - Select Countries

Aggregate

	2017	2018	2019
World	3.7%	3.9%	3.9%
Advanced Economies	2.3%	2.3%	2.2%
Emerging Markets	4.7%	4.9%	5.0%
Euro-area	2.4%	2.2%	2.0%

Europe

	2017	2018	2019
Italy	1.6%	1.4%	1.1%
UK	1.7%	1.5%	1.5%
France	1.8%	1.9%	1.9%
Germany	2.5%	2.3%	2.0%
Spain	3.1%	2.4%	2.1%

Americas

	2017	2018	2019
US	2.3%	2.7%	2.5%
Canada	3.0%	2.3%	2.0%
Brazil	1.1%	1.9%	2.1%

Asia

	2017	2018	2019
Japan	1.8%	1.2%	0.9%
China	6.8%	6.6%	6.4%
India	6.7%	7.4%	7.8%

Source: IMF, January 2018 Forecasts

Authors:

Andrea White, Associate Director
Investment Strategy
Tel: 020 3349 0228
Email: andrea.white@dtzinvestors.com

Emily Brown, Junior Investment Analyst
Investment Strategy
Tel: 020 3349 0269
Email: emily.brown@dtzinvestors.com

DTZ Investors, Capital House
85 King William Street, London, EC4N 7BL, UK