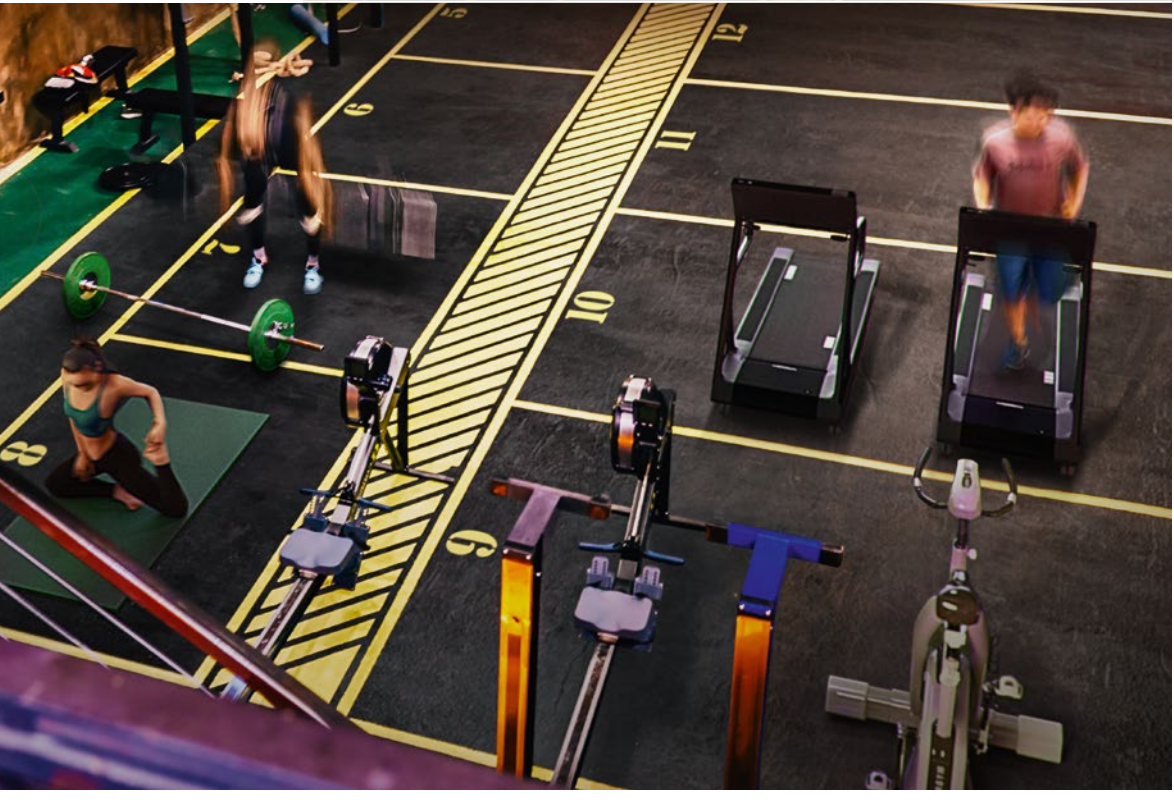


Helaba

Markets and Trends 2019

Global economy in the gym

Research, December 2018



Values with impact.



Global economy in the gym

Helaba Research
December 2018

Helaba



Dr. Gertrud R. Traud

Chief Economist /
Head of Research

Editorial

2019 will be an exhausting year, so fitness will be essential. The challenges can only be met with a certain level of performance. That's why we are sending the global economy to the gym.

> *Sport can play a role in improving the lives of individuals, not only individuals, I might add, but whole communities.*
>
> Kofi Annan

Dear readers,

I belong to the generation of baby boomers. In terms of numbers, we make up the largest population cohort – at least in developed countries. We feel young and do not want to be associated with the concept of senior citizens. We are all too happy to follow the slogan of "50 is the new 40". Some even subtract another decade from it. But how fit are we really?

A person's fitness results from the interaction of several workout goals. Just lifting weights is not enough. Instead, a balance between the following **five factors** is needed: Endurance, strength, speed, coordination and flexibility. This is especially important for us "best agers" because, according to numerous studies, people who do sports live longer than couch potatoes.

Modern gyms have identified us as a target group. The original place where you **pumped iron** has evolved into one that focuses on all aspects of fitness. In addition to cardio and muscle training, it also offers back-strengthening and yoga courses, myofascial release and Pilates. So you can easily test for yourself how fit you are. But how fit is the global economy and how are the individual countries getting themselves into shape?

Baseline scenario: global economy in the gym

In this year's baseline scenario, the global economy faces up to the challenges of the gym in 2019. What almost all countries have in common is limited **flexibility**. A decade after the financial crisis, indebtedness in developed countries remains high. Total debt in developing countries has also risen significantly in recent years. Private sector debt is currently higher than before the financial crisis almost everywhere – Germany is an exception, despite the real estate boom.

Although many nations are active in sports, they are concentrating their training routines on achieving short-term success. **Speed**, i. e. high growth rates, is the be-all and end-all. Expansionary fiscal policy increases the pace of growth while soaring indebtedness is tolerated, restricting flexibility. This seems to

be Donald Trump's approach to working out so far. For the **strongest** economy on earth, we recommend an adjustment to their fitness routine, because more is not always better – sometimes it is not even good at all.

Coordination and endurance are the greatest challenges for most countries. The trick of mastering the former is to strike a balance between individual economic policy instruments. Even more difficult is the art of **perseverance**, i. e. pursuing a policy geared to sustainability. Unfortunately, it does not produce immediate results. On the contrary, oftentimes they only become apparent when another government has long since taken the reins. This is what policymakers must learn to endure.

> *Since progress in a workout routine only comes with time, but muscle ache sets in immediately, a certain tolerance for frustration is required.*

Besides high levels of debt and a more restrictive monetary policy and rising interest rates in many countries, political uncertainty, a simmering trade war and a slowdown in some economies are currently leading to signs of fatigue. To start working out in this environment requires enormous mental fortitude. For this reason, a **personal fitness coach** is advisable for some countries. He or she provides strict guidelines and makes sure that you hang in there, even if your motivation drops off or if it becomes painful. The EU Commission probably feels like such a coach with Italy at the moment.

Workout to yield first positive results as early as 2019

The moderate price of crude oil is helping to sustain economic growth in buyer countries. In combination with a higher euro exchange rate, this will particularly benefit the euro area. Some emerging countries will be given a workout routine by the IMF, while others will motivate themselves and push ahead with reforms. Precisely because some countries will start to sweat, initial results will already be seen in the course of 2019. Economic momentum in the euro area and emerging markets will pick up somewhat. This will benefit their respective **stock markets** and **currencies**.

To raise your fitness level, you don't necessarily have to go to a gym. Most activities can also be carried out at home, in the park or in



fields, woods and meadows. The countries we have selected have very special **fitness techniques**. In the United States, many are passionate about wrestling, while Russia is focusing on cognitive training with chess. The Chinese are using tai chi to slow things down. In our publication you will find additional countries and their corresponding sporting activities.

I wish you the best of success with your fitness training in 2019.

Yours

Chief Economist / Head of Research

This publication represents a summary of the most important subjects and findings of the 2019 annual outlook. This document as well as the complete version (only in German) can be found at:

helaba.com/de/research

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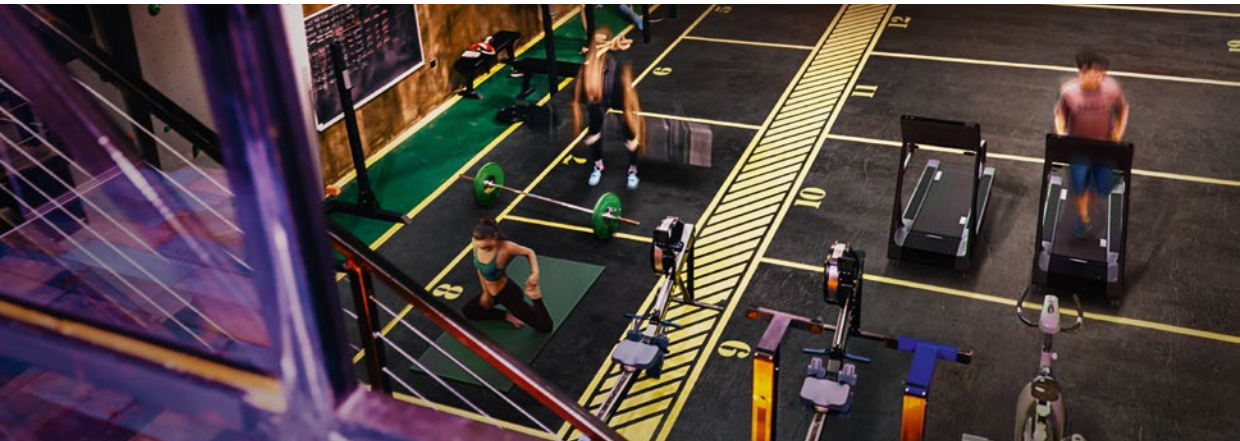
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1 Gym (70%)

Baseline scenario

Gym (70 %)

2019 is going to be an exhausting year. The better the fitness of a country is, the easier it will be able to cope with the challenges. That's why we are sending the global economy to the gym.

Precisely because some countries will work up a sweat, they will chalk up their first successes as early as 2019: the euro area economy and emerging markets will begin to gather steam again. This will have a positive effect on their respective stock markets and currencies. We attribute a probability of 70 % to this scenario.

Fiscal policy to set the pace

In cyclical terms, the most important economic regions will move in **different directions** in 2019: while momentum in the United States and China is likely to weaken, we expect the euro area and Germany to pick up over the course of the year. For emerging markets, we anticipate that conditions will stabilise. Global economic growth will not quite be able to sustain the pace of 2018.

The **Chinese** economy has already shifted down a gear and will continue to lose momentum in 2019 – in part because of barriers to trade being erected by the United States.

In contrast, though, the **US economy** is still booming. However, this is mainly due to the substantial fiscal stimulus provided by tax cuts and sizeable increases in public spending. Since this stimulus will run its course, growth on the other side of the Atlantic will also decelerate. As early as 2019, tailwinds from US fiscal policy will weaken significantly.

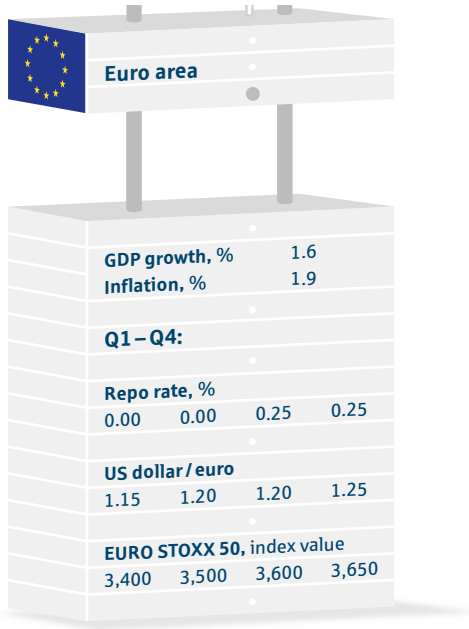
> *New Economic Records being set on a daily basis – and it is not by accident!*
>
> Donald Trump

In the euro area and Germany, the current deterioration in sentiment indicators is likely to come to an end before long and the economic **situation will recover in 2019**. While there will be a tendency towards more fiscal stimulus in the euro area (and China), it will taper off in the United States. We believe that a successful outcome to negotiations on the trade dispute will provide relief, especially for the German automotive industry.

We also see steps towards **détente** in other key economic conflicts, albeit without solving underlying structural problems or settling fundamental differences of opinion. Squabbles over the Italian budget should ultimately

Selected forecasts 2019

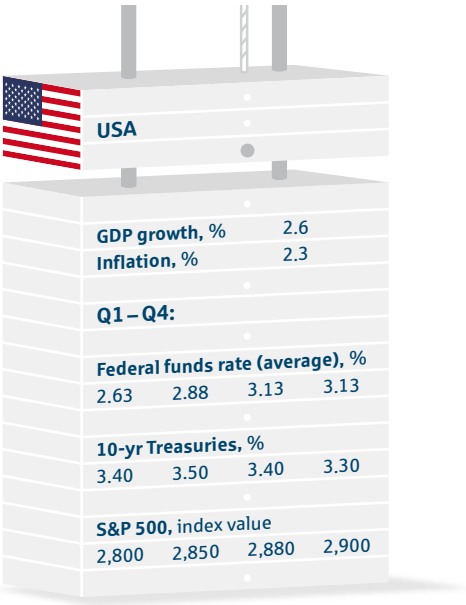




Source: Helaba Research

culminate in a compromise that will allow both the government and the EU Commission to save face – neither side has an interest in escalating the conflict. A negotiated solution is also emerging for Brexit. The chaotic cliff-edge scenario that many had feared will fail to materialise. However, we do not expect any indications that the EU and the euro area will undergo a process of renewal in 2019 – the muddling through will continue and institutional stagnation will remain the norm in Europe.

> *It is hard to imagine jobs that do not exist yet.*



The revival in productivity growth in the United States and the euro area that has been eagerly anticipated for years will probably not manifest itself in 2019, either. However, we do not share the sense of pessimism about technology on the part of many doomsayers – **digitisation** will inject **positive momentum** into the global economy for a considerable period of time.

Wages to rise more strongly

While we assume oil prices will move largely sideways, core inflation in the US economy, which is running at full capacity, should continue to rise, reaching a new cyclical high of around 2.5 %. **Wage pressures** will slowly but surely increase. Trade tariffs will tend to drive up prices. Germany and the euro area are likely to post an average annual inflation rate of around 2 %. Due to increasingly tight

labour markets, as in Central European countries, wages will see stronger rises here as well.

Fed takes a break, ECB gets warmed up

The **US Federal Reserve** has already travelled a fair distance along the path of monetary policy normalisation. In view of full employment and rising core inflation, the Fed is likely to hike the key interest rate further in 2019. In the autumn, however, with a target corridor of 3 % to 3.25 %, it will probably **interrupt the tightening cycle** in order to assess the extent to which less expansionary fiscal and monetary policies are slowing the economy.

The **ECB**, however, will be in a position to push ahead with its strategy of exiting its monetary policy crisis mode by raising interest rates thanks to an accelerating euro economy and inflation close to its target. The refinancing rate is expected to rise to 0.25 % and the deposit rate to –0.2 % in the second half of 2019.

> *China, the European Union and others have been manipulating their currencies and interest rates lower, while the U.S. is raising rates while the dollars gets stronger and stronger with each passing day – taking away our big competitive edge. As usual, not a level playing field…*
> Donald Trump

The strength of the **US dollar** will recede. With weaker cyclical tailwinds for the US currency, its yield advantage over the euro will diminish as a result of the ECB's interest rate turnaround. On balance, Trump's fiscal and trade policies are proving to be a burden on the greenback. The euro-dollar exchange rate will rise to 1.25.

Financial markets place their faith in the fitness of the euro

The **turnaround in euro interest rates**, higher US yields and mounting inflation expectations should then propel 10-year Bund yields to around 1 %. The yield on US Treasuries of the same duration will also pick up, but will remain well below the 4 % mark. The spread

between US and German government bond yields will narrow, having diverged sharply in 2018.

Credit defaults at banks will stay below their long-term average and corporate debt ratios will remain low. Covered bonds, which will continue to be resilient, will face reduced demand from the ECB. Overall, we expect a moderate increase in risk premiums on **debt markets**.

Following the end of quantitative easing by the major central banks, competition will intensify both between and within asset classes.

A switch of favourites for equities

In the case of **equities**, US stocks are not well placed to add to their relatively high valuation. Euro equities, in contrast, are only moderately valued. In the course of 2019, they are once again likely to benefit from an economic tailwind. This will result in a fundamentally derived range of 10,500 to 14,000 points for the DAX. Towards the end of the year, it should reach 13,200 points.

> *Investing on the stock markets means keeping your head when all about you are losing theirs.*
> Erhard Blanck

On many **real estate** markets, low interest rates, solid economic growth and moderate construction activity will ensure a sustained upward trend in rents and purchase prices. However, the existing overvaluation on certain submarkets will continue to increase.

Gold should fluctuate between 1,200 and 1,400 US dollars per troy ounce.

Overall, the success of an investment strategy not only depends on the choice of asset class but also of region. Demand for risky assets is likely to be somewhat higher in 2019 as political uncertainties subside.

Interest rates and bonds

Adding some more weights

A recovery of the euro area economy over the course of 2019, falling unemployment, rising wages and normalised inflation rates will pave the way for the ECB to exit its monetary policy crisis mode. The turnaround in interest rates, higher US yields and rising inflation expectations should lead to yields on 10-year German government bonds climbing to around 1 %.

In 2018, German government bonds have performed below average due to the persistently low, in some cases even negative yield levels. On a real basis, things look even worse. As inflation has risen to over 2 %, adjusted for the rise in prices the interest rate on German government bonds has fallen to a historic low. Bonds will carry this **burden** into the coming year.

Initial rate hike in the third quarter

The key anchor for investors is the ECB's goal of **hiking key interest rates** in the second half of 2019. Mario Draghi will probably announce this change of direction himself. It would be just before the end of his term in office, which has been marked by a stance of monetary easing that is unparalleled in its breadth. Otherwise, the **new president of the ECB** would be responsible for this decision, which from Germany's point of view is long overdue – although it remains to be seen whether a "hawk" with a tendency to raise interest rates or a monetary policy "dove" will be in charge of the ECB in November. Investors have been relatively relaxed about this issue so far. The experience of recent years has given them a sense of security that the central bank will act prudently when in doubt.

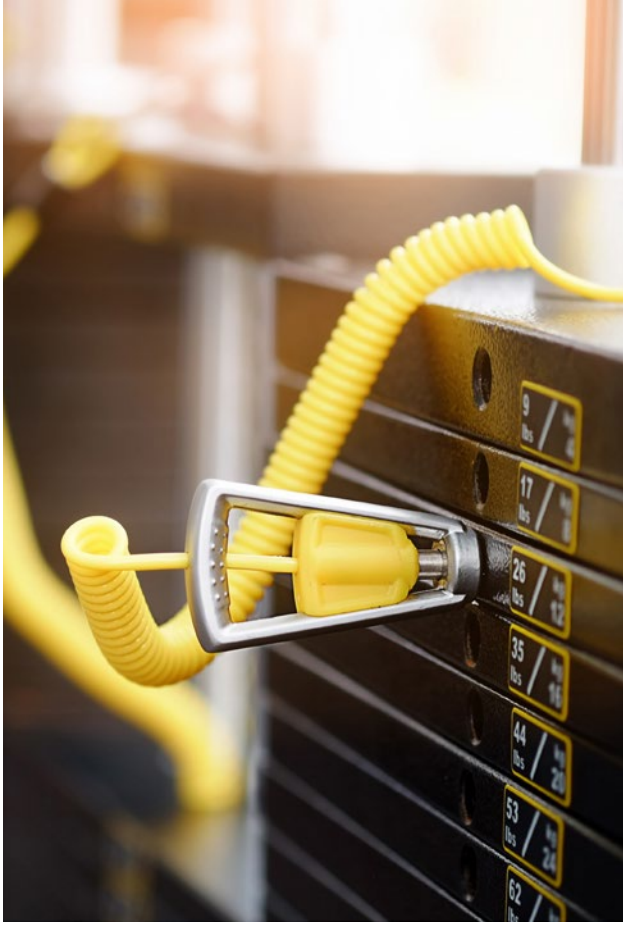
Faced with a number of **uncertainties**, such as the dispute over the Italian budget, the risk of a chaotic Brexit or the continuation of the trade conflict, the envisaged turnaround in interest rates will in any case face a certain scepticism on the part of investors. Our baseline scenario – premised on an improvement

in the underlying economic environment over the course of 2019 – therefore offers the potential for a surprise in the form of rising yields. In addition, comments from ECB members suggest that the ECB could act more decisively than in recent years, meaning that "perfect" conditions would not be required to justify an initial rate hike.

> *Rising yields in Germany would reflect a more efficient and resilient monetary union.*

Apart from euro area policy tightening, the impact of rising US yields is likely to continue to be felt for the time being. Yields on 10-year US government bonds finally broke through the 3 % barrier and **thus ended a long-term downward trend**. Three further key interest rate hikes in 2019, the shrinking of the Fed's balance sheet and increasing public debt in the United States are expected to create a degree of upward pressure on yields. However, an end to the cyclical rise in US yields is in sight. This should ultimately cap the increase in 10-year yields at a level well below 4 %.

Yet Bunds are burdened by their **record spread against US Treasuries**. Significant catch-up potential has developed here, especially if inflation expectations in the euro area should rise. As a result, the yield curve of German government bonds is likely to become steeper.



Equities

Switching favourites

It's not age that counts most, but fitness – and this applies to bull markets too. In 2018, equities throughout the world have already shown clear signs of fatigue. More and more indices have slipped into the red.

The comparatively high valuation of equities worldwide combined with a pronounced insouciance had made stock markets vulnerable. Less favourable fundamental factors, such as a global deterioration in economic indicators and a gradual withdrawal from ultra-loose monetary policy by the major central banks, were therefore able to make their mark, as were recurring geopolitical tensions and trade disputes.

Some of the overvaluation has now been corrected, but **not all indices are in shape again** for the next rally. Moreover, with monetary policy becoming noticeably less easy in the future, competition will intensify both between and within asset classes.

US equities with weight issues

Despite high valuations, the **leading US indices** had reached one record high after another until early October. Deregulation fantasies and "America First" aroused unrealistic expectations. The downsides of US economic policy, on the other hand, have long been played down by market participants.

In the wake of price corrections for US equities, the acute overheating has subsided. Despite an emerging cyclical slowdown, the US economy will continue to grow slightly above potential. At the very least, this suggests that there will be moderate growth in corporate profits. However, some of this will be used to reduce the valuation, which is still too high. On aggregate, this points to a fair price range of 2,400 to 3,000 for the S&P 500.

Like many other global stock market barometers, the **DAX and EURO STOXX 50** peaked in January 2018. They thus almost perfectly mirrored the cyclical pattern of earlier phases with declining economic indicators. Euro shares have now reached a fair level on the basis of the most common analytical ratios.

In the past, however, pronounced corrective movements usually only ended when there were also indications of an end to the downward trend in important leading economic indicators. In view of the fact that these indicators are still at a comparatively high level, it is unlikely that there will be a reversal to the upside until spring 2019.



DAX fit for 2019

In our baseline scenario, the fair valuation for the DAX lies within a P/E band of between 10.5 and 13. In recent years, this corridor has proven to be a reliable indicator for upper and lower turning points. Potential for higher prices will emerge in the course of 2019 as prospects for corporate profits improve and valuations expand moderately. This translates into a DAX price range of 10,500 to 14,000 points. Towards the end of the year, the German benchmark index should be trading at 13,200 points. The risk/return profile is thus significantly more attractive than that of its US counterparts.



Crude oil and gold

Largely in equilibrium

Brent crude to remain stable

There will be a more or less sideways movement in oil prices in 2019 as supply risks diminish. The shift in perception from the supply to the demand side on oil markets is likely to continue next year, and not only because of possible negative fallout from the trade conflict. As such, there appears to be **ample supply on physical markets**. It seems that additional supply from non-OPEC countries is alleviating the market situation. At the same time, global crude oil consumption probably reached an interim peak in July 2018.

Price volatility is also likely to remain marked in 2019 in the wake of OPEC's expectation management and China's shifting demand patterns. However, the geopolitical premium will not be as pronounced as it was in 2018, especially as there will be a tendency for various OPEC countries to reduce their supply shortfalls.

Gold with limited potential

Gold should be well hedged in 2019 **in a range of between 1,200 and 1,400 US dollars** per troy ounce. This is supported by persistently modest real interest rates in the United States, a weaker US dollar as well as market psychology. Thus, bets by non-commercial market participants against gold have remained at an extremely high level to date. Finally, a more favourable technical picture suggests a recovery in prices.

Impeding factors such as the weakness of various emerging market currencies and a reluctance to buy gold will lose their effect in 2019. However, further US interest rate hikes and the ECB's turnaround in monetary policy are likely to continue to weigh on gold prices. Above all, however, a resurgence in the opportunities offered by risky securities, such as equities and corporate bonds, suggests that a significant recovery in gold prices is unlikely.

Real estate

Mature, but not weakened by age



The boom on the real estate market is entering its tenth year and is thus in a **mature phase**. But real estate cycles do not succumb to old age. Low interest rates and robust economic growth will keep the sector fit in 2019. A modest rise in interest rates will not choke off the upswing. This means that property values in many European countries should continue to rise. The situation looks less favourable in the US, where higher yields on the bond market already offer investment alternatives.

On the German office market, rising employment is fuelling strong demand for space. The situation is more difficult on the retail market, which is burdened by increasing e-commerce. With buoyant demand and moderate construction activity, **rents** in many segments of the commercial real estate market will **continue to rise** and **vacancy rates** will **fall** in 2019. The valuation of many properties, which has already reached a high level, will continue to climb.

For German **open-ended real estate funds**, we expect an almost unchanged average annual return of around 2 ½ % in 2019. This would mean that the difference to bond yields would be sufficiently high as to guarantee a continued inflow of funds.

The broad range of housing policy activities will not stop the rise in prices on the **German residential market** in 2019. In particular, the high level of capacity utilisation in the construction industry and a shortage of land for development will act as obstacles to significantly higher construction activity.

Currencies

US dollar and Swiss franc

The **US dollar** is **flagging**. The dollar environment, which has so far been rosy, will gradually deteriorate; "America First" no longer applies to the currency markets. Economic growth in the United States is slowing, while the euro area is recovering from its downturn. The declining growth advantage of the United States will be reflected in monetary policy. The Federal Reserve will interrupt its cycle of interest rate hikes and the ECB will start to raise key rates. The unusually high US yield advantage over the euro will therefore probably recede.

In the longer term, the downside potential of the US dollar will predominate. The rising budget deficit and the chronic current account shortfall in the United States favour a weaker currency. Moreover, trade policy does not only entail risks of an economic nature. President **Trump's protectionist policies** and his desire for a weaker US dollar are at least indirectly **weighing on** the latter, especially since the greenback is still considered overvalued. In the course of 2019, the euro-dollar exchange rate is likely to hover in a range of between 1.10 and 1.30, rising to 1.25 by the end of the year.



> *The greater the impression that Trump is using the dollar to push through foreign policy goals, the more international investors will look around for an alternative currency.*
>
> Economist Barry Eichengreen

The **Swiss franc** will weaken slightly against the euro. In comparison to the ECB, the Swiss central bank will further delay its interest rate turnaround and the Swiss yield disadvantage will increase. Declining political uncertainty will reduce demand for the safe investment haven. Consequently, the euro-franc exchange rate should climb to 1.20.



2 Emergency room (20%)

Alternative scenario

Emergency room (20 %)

In our negative alternative scenario, above-average political risks are accompanied by a growing number of purely cyclical arguments. Historically high debt levels and an already very expansionary monetary policy limit the scope to stimulate the economy.

Diagnosis: Multiple risks

There are more than enough potential triggers for a global recession in 2019. The slowdown in **China** may be surprisingly more pronounced. In the **United States**, the Fed's interest rate hikes could be sufficient to stall economic growth. Finally, it does not take much imagination to extend the downward trajectory of economic indicators in the **euro area**.

Investors look for safety and shift out of risky assets and into the safe havens of **US Treasuries and Bunds.** The yield on 10-year German government bonds tests new historic lows towards the –1 % mark, as other European government bonds are shunned.

The **US dollar** lives up to its reputation as a crisis currency, especially as problems in the single currency area weigh on the euro. The euro-dollar exchange rate plummets to 0.95.

Gold is in demand and reaches a level of 1,600 to 1,800 US dollars per troy ounce.

The economic slump triggers a correction in **real estate prices,** especially in heavily overvalued segments.

A sharp drop in sales and pressure on margins lead to substantial declines in corporate profits. Increasing risk aversion results in significant valuation discounts. The **DAX** plunges to 9,000-point territory.



3 Relaxing spa (10 %)

Alternative scenario

Relaxing spa (10 %)

In our positive alternative scenario, the economic environment resembles a relaxing spa. Everything feels very laid-back and a sense of ease spreads throughout the world. Sentiment improves and risk premiums fall.

The global economy simply re-accelerates. Previous symptoms of weakness in China and the euro area turn out to have been a temporary dip. The **United States** experiences sustained growth of 3 % to 4 %. With the global industrial cycle picking up speed again, stimulus measures in **China** have a procyclical effect, pushing economic growth towards 7 % and more.

Germany and its EU neighbours also benefit from the global industrial upturn. The German and euro area economies expand by around 3 %. Higher growth flushes revenues into state coffers and thus promotes a compromise solution in the dispute over appropriate fiscal policy.

Inflation spurs central banks into action

The good economic situation leads to rising inflation. Monetary policy on both sides of the Atlantic is tightened by more. The interest rate on 10-year Treasuries climbs to around 5 %, while yields of **German government bonds** of the same maturity move towards the 2 % mark. The euro benefits from the political strengthening of the monetary union. The **euro-dollar exchange rate** climbs to 1.35.

Real estate becomes more expensive despite higher interest rates. In more and more market segments, the valuation situation comes to a head. Companies use their scope for price hikes to expand profit margins. In view of the increasing risk appetite of investors, there is an explosion in valuations. The **DAX** surpasses the 15,000-point mark.

4 Countries in the baseline scenario




Forecasts 2019
GDP
1.2 %
GDP
2.4 %
GDP
2.4 %
GDP
4.0 %
GDP
1.0 %
GDP
6.0 %
GDP
7.2 %
GDP
2.3 %

Germany

Still going strong

The German economy is expected to accelerate from mid-2019 onwards. At 1.5 %, economic growth will remain above the employment threshold in 2019.

In 2019, **consumption** will be the main factor contributing to economic growth. At 1.6 %, consumer spending should increase more strongly than in the previous year. The rise in employment and increases in collective bargaining settlements will have a positive effect. Consumers will also benefit from the return to the equal funding of contributions to statutory health insurance and the "mothers' pension".

The sharp drop in new orders in the manufacturing sector and the high degree of uncertainty regarding trade policy are still holding back capital formation. **Equipment spending** will pick up speed again in the course of 2019 but is expected to be up only 3 % on the year (2018: 4.5 %).

Investment in construction is also continuing to grow: demand for residential housing remains high and financing conditions are favourable, with real income rising and interest rates still low. The public sector is increasingly investing in infrastructure and demand for office buildings, in particular, is buoyant.

Foreign trade is not expected to make a positive contribution to growth in 2019, either. Exports to the EU are likely to be further hampered by the UK due to Brexit uncertainties. However, China will remain a bright spot despite somewhat slower economic growth, while exports to the United States will only increase at a below-average rate.



France

Macron the fitness instructor needs more time



After years of below-average economic growth, gross domestic product (GDP) is set to grow by 1.5 % in 2019, the same rate as for the euro area as a whole.

The population expects to see swift results. But **patience** is called for, because there will be a time lag before President Macron's structural reforms take effect. This is true for changes to employment law and the incremental reduction in corporation tax, which should gradually translate into higher investment.

Consumer spending held back economic growth in 2018. The hike in the social security tax reduced net income growth in the first half of the year, while relief from changes to social security contributions did not take effect until the second half. In addition to an expansion in employment and higher wages in 2019, this should have a positive effect on private consumption.

In France, the **government deficit** is expected to rise again in 2019. It is planned to reach a level of 2.8 % of GDP, up from 2.6 % in 2018. One-off effects, such as the assumption of the debt of SNCF, the state-owned railway company, are a reason for this.

Investment in equipment is also expected to increase in 2019. However, as economic recovery will only gradually take hold, the pace of capital formation will scarcely be higher than in the previous year. Construction activity will continue to provide a modest impetus, while foreign trade should have a somewhat negative effect on growth.



Italy

A risky race

Italy's new populist government wants to significantly expand the budget **deficit in 2019**. In so doing, it is provoking a **conflict with the EU Commission**. The financial markets have reacted nervously to this. The spread to German government bond yields has widened significantly as a result.

In Italy in particular, there is an urgent need for sound fiscal policy, as the country has the second-highest public debt in the euro area after Greece at over 130 % of gross domestic product. Under pressure from the financial markets, the government is likely to find a compromise with Brussels. Nevertheless, fiscal policy will be more expansionary than previously assumed. In the short term, this could generate positive growth impulses. However, the higher interest rate spread is already putting a heavy strain on **Italian banks**. The net effect of a more expansionary policy will be rather small. Nevertheless, economic growth is expected to rise slightly to 1.3 % in 2019.

Since 2001, the Italian economy has been growing at a consistently slower pace than the average of the euro area as a whole. This indicates that, rather than a temporary weakness in demand, there are concrete **structural problems**. The planned measures will not help in this respect. In particular, the reversal of the pension reform with the option of earlier retirement is likely to have a counterproductive effect. The collapse of the Morandi Bridge in Genoa has put the need to modernise and expand infrastructure into sharp relief.

Spain

A little less momentum

Thanks to years of above-average growth rates, Spain has long since returned to its pre-crisis income level. Nevertheless, the country has **become poorer** compared to the rest of the euro area. Gross domestic product (GDP) per capita in 2018 is about 77 % of the average in the single currency area, compared with a little over 84 % in 2007. After three years of growth rates of 3 % and more, Spain will only expand by 2.5 % in 2018. This is expected to fall to 2.3 % in 2019.



In this environment, the Spanish government also intends to relax its **fiscal policy stance** somewhat. Nevertheless, with a budget deficit of 2.7 % of GDP, the Maastricht ceiling of 3 % is likely to be observed for the first time in ten years. It is doubtful as to whether the target of 1.8 % will be achieved in 2019. Despite strong economic growth, government debt is barely declining and still stands at 98 % of GDP.

Consumption will grow at roughly the same rate as GDP in 2019, stimulated by higher employment, a slight increase in wages and economic policy measures.

Equipment spending and **construction** activity should continue to expand. Additional government support for social housing will have a positive impact. Foreign trade is not expected to make a positive contribution for the year as a whole.

In order to continue to expand at an above-average rate and thus reach the income level of the euro area in the medium term, Spain would have to tackle its **structural weaknesses** in a more systematic way. However, the extent to which these problems are being addressed is inadequate.

Sweden

Riksbank dares turnaround

The Swedish economy excelled in 2018 with solid growth rates and this will continue. It seems to be the appropriate time for **interest rate hikes**, as consumer price inflation has been hovering above the central bank's target of 2 % since August. In 2019, it is expected to be slightly higher at 2.2 %. In this respect, we expect the Riksbank to start raising interest rates and to finally abandon the record low key rate of –0.5 %.

Real estate price a key factor

In addition to consumer prices the Swedish central bank also considers developments in the real estate market as well as the external value of the krona. For this reason, **extreme caution** is likely when raising interest rates in order to avoid a rapid slowdown on the housing market and an excessive appreciation of the currency. With this in mind, the key interest rate is not expected to reach positive territory until 2020 at the earliest.

Sentiment in industry is good and the sector is projected to grow at 4 %. Public-sector consumption should increase by 2 % next year and also contribute to economic growth.

However, the real estate market is a **load factor**. In the major cities, house prices have fallen by 6 % since the beginning of 2018. Accordingly, the **construction** sector is likely to make a negative contribution to growth next year.

Overall, economic growth, at 2.4 %, should be slightly lower in 2019 than in the previous year.



United Kingdom

Brexit gets rolling



Brexit will formally enter into force on 29 March 2019 at 23.00 GMT. A withdrawal agreement has virtually been negotiated. It provides for a **transition phase** until the end of 2020, during which the relationship between the United Kingdom and the EU will remain almost unchanged. This phase will provide an opportunity to settle unresolved issues regarding the future relationship from 2021 onwards.

This future relationship will likely include **restrictions** on **trade in services** and on the **free movement of workers**, but trade in goods will probably remain largely intact. Regular customs controls are not in the economic interest of the EU, either. Despite the risks involved in the negotiations and subsequent ratification – especially in the British parliament – the United Kingdom is likely to leave the EU with a well-defined agreement. After all, a "no deal" Brexit would entail massive economic upheaval.

Modest economic growth

Thanks to the transition phase, Britain's formal exit from the EU will have little impact on its economy. In general, however, **Brexit will be a burden** on growth. Consumer spending should stabilise. However, investment will presumably increase more slowly. Overall, gross domestic product is expected to grow at a marginally lower rate of 1.2 % in 2019 than in 2018. Inflation will decline slightly to 2.2 %. The Bank of England will continue its process of monetary policy normalisation and tentatively raise its key interest rate to 1.0 %. As uncertainties recede, the pound sterling will benefit.

Russia

Not enough work-outs for structural transformation

After his re-election in March 2018, President Vladimir Putin **set the bar** very high for the new government: he has demanded that the government deliver a better education and health system, nationwide poverty reduction, higher infrastructure investment, rising salaries in the public sector and an increase in pensions above the inflation rate.



Financing these projects is a **feat of strength**, even for resource-rich Russia. They will not automatically boost economic growth of 1.7 % in 2019. No expansionary fiscal and monetary policy impulses are to be expected. **Consumer spending** – the mainstay of economic growth – will temporarily weaken as a result of the increase in the VAT rate from 18 % to 20 % at the beginning of 2019.

The relatively **independent central bank** will react with higher key interest rates in the event of increasing inflationary pressure following the VAT increase and if the rouble depreciates.

The solid set of data (public finances, current account, currency reserves) ensures **a high level of macroeconomic stability**. However, structural disadvantages are hampering economic growth. The investment ratio is therefore below average at 21 % of gross domestic product.

The government is reluctant to implement **economic reforms** because they would be accompanied by domestic political changes. Only with more commitment and additional workouts will the Russian economy become more independent of the energy sector and develop a greater momentum of its own.



2019, but will more than halve. Accordingly, economic growth in 2019 should slow from around 3 % to 2.6 %.

> *Trade wars are good and easy to win.*
> Donald Trump

The negative impact of the **trade dispute**, on the other hand, should be manageable, as Donald Trump chose to pick a fight at a time when the US economy was showing considerable momentum. At least in the medium and long term, US consumers and companies are also likely to be among the losers.

United States

Trump's economic miracle: fake news?!

The US economy is booming. Donald Trump regards this as the result of his successful economic policies. The **immediate surge in demand** is primarily due to very loose fiscal policy. The tax cut at the end of 2017 has considerably reduced the tax burden on households and companies. At the same time, government spending is increasing at a rate not seen since 2009. The IMF estimates that the direct fiscal stimulus accounted for one percentage point of gross domestic product in 2018. On a "current law" basis, this effect will not turn negative in

Further interest rate hikes … and then a hiatus

The Fed will initially push ahead with its policy of gradual interest rate hikes as core inflation continues to rise. The target range for the key interest rate should reach 3.00 % to 3.25 % in the summer. This would be at the lower end of what we would consider a neutral interest rate level. In view of the slowdown in economic growth, however, a **longer hiatus** in the cycle of interest-rate hikes should be on the cards from autumn onwards.



China

Slowdown

Economic policy doping enabled China to largely maintain its pace of growth into 2018. In 2019, though, the dragon will tend to lose speed **despite an increased dose of stimulus**. Growth is likely to slow from an annual average of 6.6 % in 2018 to 6 % in 2019. This reflects a combination of an ongoing structural weakening and an acute cyclical dip.

More stimulus

The leadership in Beijing will continue to pursue on the course of a **more expansionary fiscal policy and a loosening of monetary and credit policy**. It will put reforms on the back burner that are sensible in the medium term, but will be a burden in the short term. This will stabilise growth. However, it will ultimately put the country's medium to long-term prosperity at risk as it does not address underlying structural problems – high levels of corporate debt and the excessive shares of investment and industry in the economy.

At the same time, relations with the United States and other advanced Western economies will become more difficult, even if, as expected, the **trade dispute with the United States** does not escalate further. The government will probably want to avoid a noticeable depreciation of the yuan. It could get out of hand, create additional conflict potential with the United States and bring less economic benefit than it used to, because exports are no longer China's main driver of growth today.

> *There are no winners in a trade war.*
>
> Xi Jinping

Brazil

All just for show?

Higher investment and a recovery in consumer spending to offset negative impact of fiscal consolidation on growth.

Investors reacted with relief to the victory of right-wing populist Jair Bolsonaro in the presidential elections in October 2018. The **ambitious reform plans** of his designated minister, Paulo Guedes, include privatisations and an urgently needed reform of the pension system. The implementation of these projects, however, depends on approval by the highly fragmented Congress.

Turning public finances around remains the greatest challenge. Government debt has literally exploded since 2014 and is expected to exceed 80 % of gross domestic product (GDP) in 2019. Without decisive consolidation, the country is heading for a debt crisis.

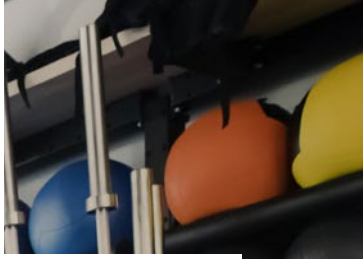
The previous government had therefore already inserted a spending cap into the constitution. But even that is probably not enough to slow the rise in government debt. The new government plans a smaller deficit of 5.7 % of GDP in 2019.

Due to **high currency reserves** and moderate current account deficits, Brazil is in good shape on the external front. Liberal economic reforms will ensure that investment picks up soon. Together with a slight recovery in consumer spending thanks to lower unemployment figures, economic growth could therefore rise to 2.3 % in 2019.



5 Tables of forecasts in the baseline scenario





Financial market forecasts

	Change since 31.12.2017	Current*	Forecast horizon at end … Q1/2019	Q2/2019	Q3/2019	Q4/2019
	in basis points	interest rate in %				
ECB deposit facility rate	0	–0.40	–0.40	–0.40	–0.20	–0.20
Repo rate	0	0.00	0.00	0.00	0.25	0.25
Overnight rate Eonia	–2	–0.36	–0.35	–0.35	–0.20	–0.20
3M Euribor	1	–0.32	–0.30	–0.25	–0.10	–0.10
6M Euribor	1	–0.26	–0.25	–0.20	–0.05	0.00
12M Euribor	4	–0.15	–0.15	–0.10	0.10	0.20
2-yr Bunds	6	–0.57	–0.50	–0.40	–0.25	–0.20
5-yr Bunds	2	–0.18	–0.05	0.10	0.25	0.30
10-yr Bunds	–2	0.41	0.60	0.80	0.90	1.00
2-yr swap rate	3	–0.12	0.00	0.10	0.25	0.30
5-yr swap rate	2	0.34	0.45	0.60	0.70	0.75
10-yr swap rate	7	0.96	1.05	1.15	1.25	1.30
30-yr swap rate	2	1.51	1.60	1.70	1.80	1.85
Federal funds rate**	75	2.13	2.63	2.88	3.13	3.13
3M USD Libor	92	2.61	2.90	3.10	3.30	3.25
10-yr US-Treasuries	73	3.14	3.40	3.50	3.40	3.30
	in local currency, %	index				
DAX	–11.2	11,472	12,300	12,700	13,000	13,200
EURO STOXX 50	–8.0	3,225	3,400	3,500	3,600	3,650
Dow Jones	2.3	25,286	26,000	26,500	26,800	27,000
S&P 500	1.8	2,722	2,800	2,850	2,880	2,900
Nikkei 225	–4.2	21,811	22,500	23,000	23,500	24,000
	%	price in $				
Brent crude $/bbl	–2.1	65	73	75	72	74
Gold $/oz	–7.7	1,202	1,280	1,300	1,320	1,280

*13.11.2018 **target range, mid point Sources: Bloomberg, Helaba Research



Currency forecasts

	Change since 31.12.2017	Current*	Forecast horizon at end … Q1/2019	Q2/2019	Q3/2019	Q4/2019
vs. Euro	**vs. Euro, %**	**exchange rate**				
US dollar	6.3	1.13	1.15	1.20	1.20	1.25
Japanese yen	5.3	128	125	128	128	132
British pound	2.1	0.87	0.85	0.85	0.80	0.80
Swiss franc	2.9	1.14	1.15	1.15	1.20	1.20
Canadian dollar	–0.9	1.49	1.48	1.52	1.52	1.58
Australian dollar	1.7	1.56	1.55	1.60	1.58	1.58
Swedish krona	4.0	10.22	9.90	9.80	9.60	9.50
Norwegian krone	–2.5	9.59	9.30	9.10	8.90	8.80
Chinese yuan	0.5	7.84	8.05	8.28	8.28	8.50
vs. US-Dollar	**vs. USD. %**	**exchange rate**				
Japanese yen	1.0	114	109	107	107	106
Swiss franc	3.4	1.01	1.00	0.96	1.00	0.96
Canadian dollar	5.3	1.32	1.29	1.27	1.27	1.26
Swedish krona	10.7	9.06	8.61	8.17	8.00	7.60
Norwegian krone	3.6	8.50	8.09	7.58	7.42	7.04
Chinese yuan	6.9	6.96	7.00	6.90	6.90	6.80
US-Dollar vs. …	**vs. USD. %**	**exchange rate**				
British pound	–4.0	1.30	1.35	1.41	1.50	1.56
Australian dollar	–7.6	0.72	0.74	0.75	0.76	0.79

*13.11.2018

Sources: Bloomberg, Helaba Research

Gross domestic product, inflation, budget deficit

	Gross domestic product Real change, % yoy				Consumer prices Change, % yoy				Budget deficit % of GDP			
	2017	2018e	2019f	2020f	2017	2018e	2019f	2020f	2017	2018e	2019f	2020f
Euro area	**2.5**	**1.9**	**1.6**	**1.8**	**1.5**	**1.8**	**1.9**	**1.8**	**–1.0**	**–0.6**	**–0.7**	**–0.6**
Germany	2.5	1.6	1.5	1.8	1.8	2.0	2.1	2.0	1.0	1.4	1.2	1.2
France	2.3	1.6	1.5	1.8	1.2	2.1	2.0	1.8	–2.7	–2.6	–2.8	–2.2
Italy	1.6	1.0	1.3	1.6	1.3	1.3	1.4	1.3	–2.4	–1.9	–2.3	–2.2
Spain	3.0	2.5	2.3	2.1	2.0	1.8	1.7	1.6	–3.1	–2.7	–2.4	–1.8
Netherlands	3.0	2.6	2.2	1.8	1.3	1.7	2.2	1.8	1.1	1.3	1.1	0.9
Austria	2.7	2.8	2.0	2.0	2.1	2.0	2.0	2.1	–0.8	–0.3	–0.2	0.0
Greece	1.5	2.0	1.9	2.0	1.1	0.8	1.2	1.2	0.8	0.6	0.5	0.5
Portugal	2.8	2.0	1.8	1.7	1.6	1.5	1.6	1.6	–3.0	–0.8	–0.6	–0.3
Ireland	7.2	4.5	3.0	3.5	0.3	0.8	1.5	1.8	–0.3	–0.2	–0.1	0.2
United Kingdom	**1.7**	**1.3**	**1.2**	**1.5**	**2.7**	**2.5**	**2.2**	**2.2**	**–1.8**	**–1.4**	**–1.7**	**–2.0**
Switzerland	**1.7**	**3.1**	**2.0**	**1.5**	**0.5**	**1.0**	**1.4**	**1.4**	**0.8**	**0.6**	**0.4**	**0.4**
Sweden	**2.4**	**2.8**	**2.4**	**2.4**	**1.8**	**1.9**	**2.2**	**2.0**	**1.4**	**1.2**	**1.0**	**1.0**
Norway	**2.4**	**1.9**	**2.4**	**2.4**	**1.9**	**2.6**	**2.8**	**2.8**	**4.4**	**4.8**	**4.2**	**4.8**
Poland	**4.7**	**5.0**	**4.0**	**3.3**	**2.0**	**1.9**	**2.2**	**1.8**	**–1.4**	**–1.1**	**–1.4**	**–1.5**
Hungary	**4.4**	**4.7**	**3.4**	**2.5**	**2.3**	**3.0**	**3.4**	**2.8**	**–2.2**	**–2.6**	**–2.2**	**–2.2**
Czech Republic	**4.5**	**2.8**	**2.6**	**2.5**	**2.5**	**2.2**	**2.2**	**2.0**	**1.5**	**1.3**	**1.0**	**0.8**
Russia	**1.5**	**1.8**	**1.7**	**1.7**	**3.7**	**3.0**	**4.3**	**4.0**	**–1.4**	**0.6**	**0.7**	**0.7**
United States	**2.2**	**2.9**	**2.6**	**1.8**	**2.1**	**2.4**	**2.3**	**2.2**	**–3.7**	**–4.8**	**–5.1**	**–4.6**
Japan	**1.7**	**0.9**	**1.0**	**0.3**	**0.5**	**1.0**	**1.5**	**2.0**	**–3.5**	**–3.7**	**–3.8**	**–3.4**
Asia ex Japan	**5.8**	**5.7**	**5.2**	**5.0**	**2.3**	**3.0**	**3.4**	**3.1**	**–2.8**	**–2.9**	**–3.0**	**–3.0**
China	6.8	6.6	6.0	5.8	1.6	2.2	2.2	2.0	–3.9	–4.1	–4.5	–4.5
India	6.7	7.4	7.2	7.2	3.3	4.5	4.9	4.8	–3.5	–3.6	–3.3	–3.2
Latin America	**0.8**	**0.8**	**1.8**	**2.0**	**6.2**	**6.8**	**6.8**	**5.2**	**–3.3**	**–2.9**	**–1.8**	**–1.7**
Brazil	1.0	1.6	2.3	2.2	3.4	4.1	4.0	3.9	–8.0	–7.0	–5.7	–5.6
World	**3.6**	**3.6**	**3.4**	**3.2**	**2.5**	**2.9**	**3.1**	**2.8**	–	–	–	–

GDP growth working day adjusted if available; e=estimate, f=forecast

Sources: EIU, Macrobond, Datastream, Helaba Research

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