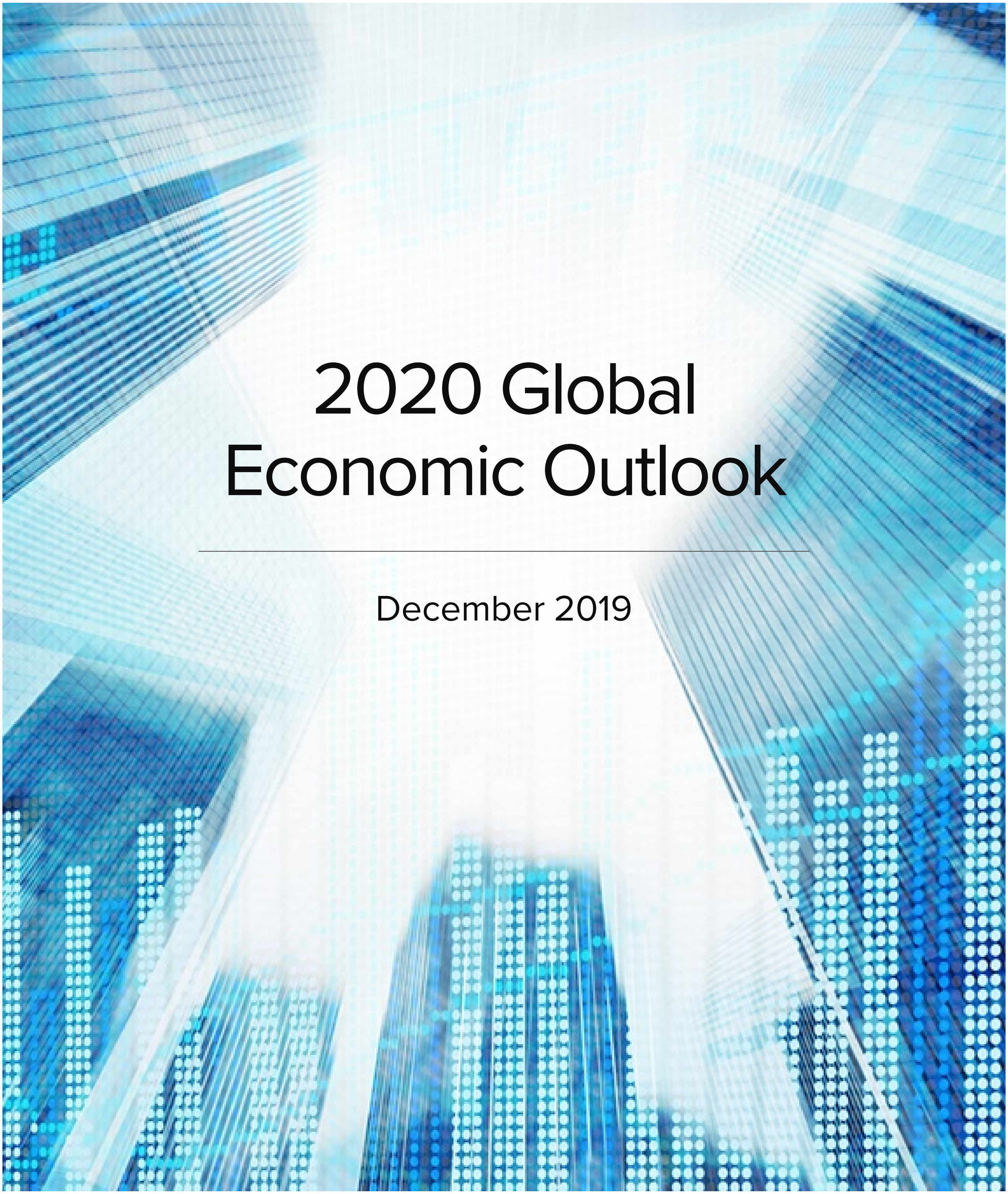


# 2020 Global Economic Outlook

December 2019

Presented by

prevedere

# 2020 Global Economic Outlook

Trade wars, Brexit, tariffs, and global manufacturing contraction are all issues causing concern regarding the current state of the global economy. This in turn is creating significant challenges for companies in their planning processes for 2020.

This report details leading macro indicators that provide a story of how the 2020 global economic landscape is likely to unfold. Key themes and economic insights that can help drive business strategy through 2020 include:

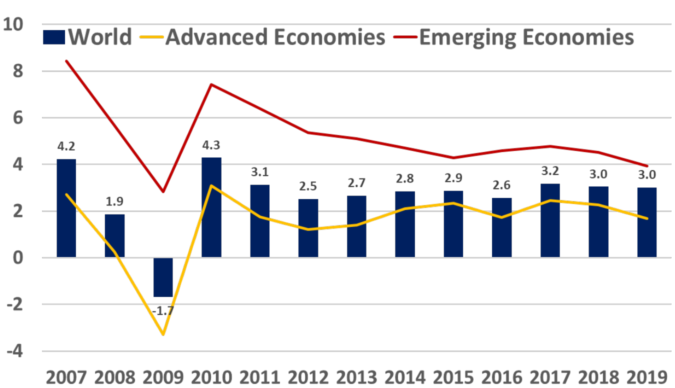
1. 2020 global economic outlook
2. Impact of rising uncertainty
3. Regions most at risk
4. Impact on the US economic outlook

Executive insights such as these are crucial in navigating a turbulent economy by both mitigating risk and identifying opportunities.

*The analysis in this report is provided by Michelle Green, Senior Economist, Prevedere. She works with businesses across a wide variety of industries, providing key economic insights to improve understanding of their external environment and how it impacts their performance.*

# 2020 GLOBAL ECONOMIC OUTLOOK

## Real GDP Growth




*Source: World Bank, IMF*

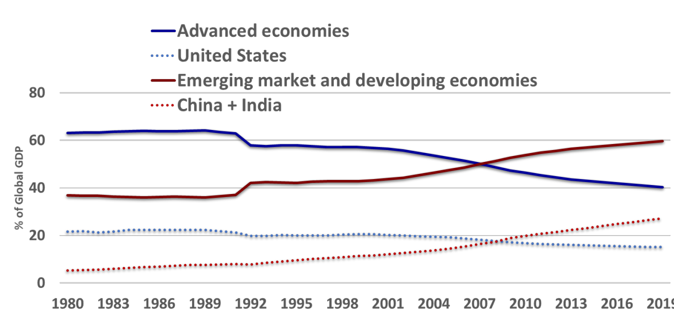
### Real Gross Domestic Product Growth

Since the 2009 recession, global GDP growth over the last decade or so has been relatively stable in the 2.5 – 3% range, with emerging economies contributing a large share of that growth. Though the most recent data shows that global GDP growth is still within that range, a trend is emerging that indicates a slowdown in growth may be forthcoming. So much so that the IMF and World Bank have both revised down their projections for 2019 and 2020. Their decision is supported by both advanced and emerging economies showing signs of slowing growth beginning around the start of 2018.

### Share of Global GDP – Advanced vs. Emerging

Emerging economies make up a larger share of global GDP growth than they have in the past, driven largely by exceptional growth rates in China and India. Therefore, any declining economic activity in emerging markets, particularly in China and/or India, will have a larger impact on global GDP growth than will slowing economic activity in developed nations like the US and Europe.

## Share of Global GDP




*Source: IMF, Prevedere*

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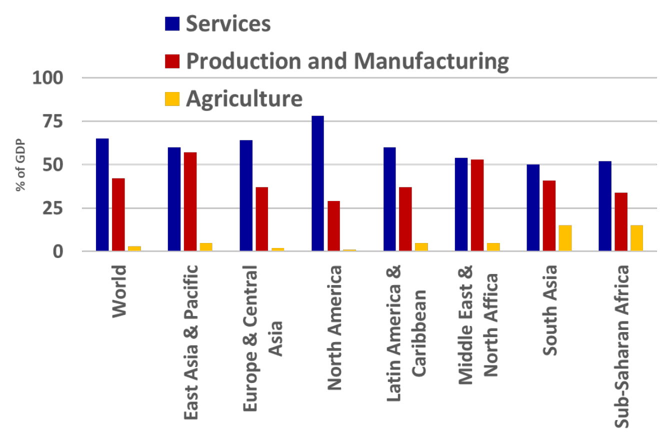
# 2020 GLOBAL ECONOMIC OUTLOOK

## Structure of Output by Region

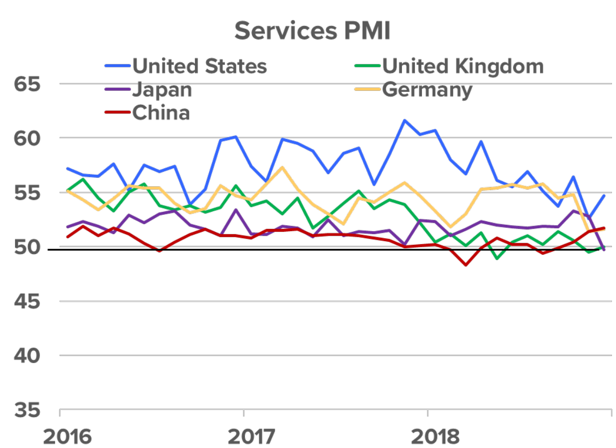


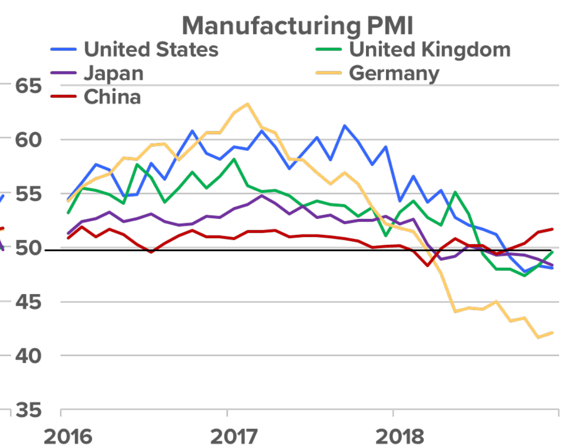

Source: *World Bank, IMF*

**Structure of Output by Region**

Production and manufacturing sectors in emerging markets have had a significant contribution on growth rates in the developing world. Globally, manufacturing and industry make up around 40% of GDP, with the share much higher in emerging markets like Asia, Latin America, and Africa. This suggests that declining activity in these sectors would have the greatest impact on emerging markets than on developed markets where the services sector makes up a larger share of GDP.

## ISM Purchasing Managers Index for Services and Manufacturing




Source: *CEIC, ISM*

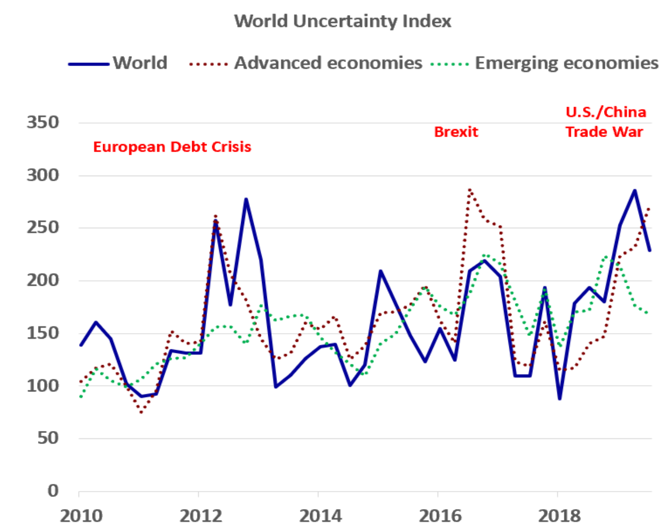
**Global Output**

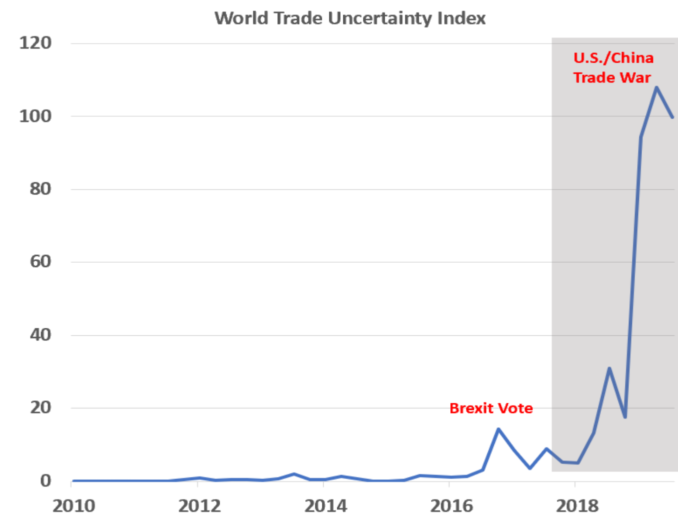
Looking at differences in production between the US, Europe, and Asia, there was weakness in manufacturing beginning around the same time that GDP growth started to decline in all markets except China. The US, Germany, Japan, and the UK are all experiencing contraction in manufacturing, but China appears to be rebounding after teetering around the 50 mark in 2018 and into 2019. Conversely, the services sector remained relatively flat for most of that same time period, where only Japan and the UK have current readings below 50.

The impact of manufacturing weakness on global output has so far been subdued by slow and steady growth in the services sector for most developed nations (especially the US) and signs of manufacturing momentum in at least some emerging markets (namely, China). Like the previous manufacturing slowdown in 2015, if the services sector remains stable, particularly in developed economies, and manufacturing continues to increase or maintain growth in emerging markets throughout next year, there is little risk that the current manufacturing slowdown will significantly drag down global GDP growth in 2020.

# IMPACT OF RISING UNCERTAINTY

## Impact of Global Uncertainty




*Source: Global Economic Policy Uncertainty Index*

**Impact of Global Uncertainty**

The outlook is conditional. All things remaining the same, we do not expect much deceleration in global GDP growth. However, the mere prospect of change is causing uncertainty. Data from the Economic Policy Uncertainty Index indicates that many people are feeling increasingly anxious about 2020 and beyond.

The World Uncertainty Index chart (above left) measures overall uncertainty over both economic and geopolitical conditions. It shows how specific events (the European Debt Crisis, Brexit, the US-China Trade War, etc.) influence our social consciousness, and possibly shape the socioeconomic choices made by businesses or consumers.

The World Trade Uncertainty Index (above right) measures the same thing – uncertainty – on the much narrower topic of trade. It clearly demonstrates that there is anxiety about global trade. Besides the US-China Trade War, the US has also threatened to or has already imposed tariffs on the EU, Japan, Brazil, Argentina, and France. These countries will (if they haven't already) likely retaliate with tariffs of their own, which could negatively impact the economy. Further, there has already been a dip in global manufacturing, although how much of that is related to trade uncertainty is not exactly clear. Additionally, there are other ramifications of this uncertainty that could be concerning.

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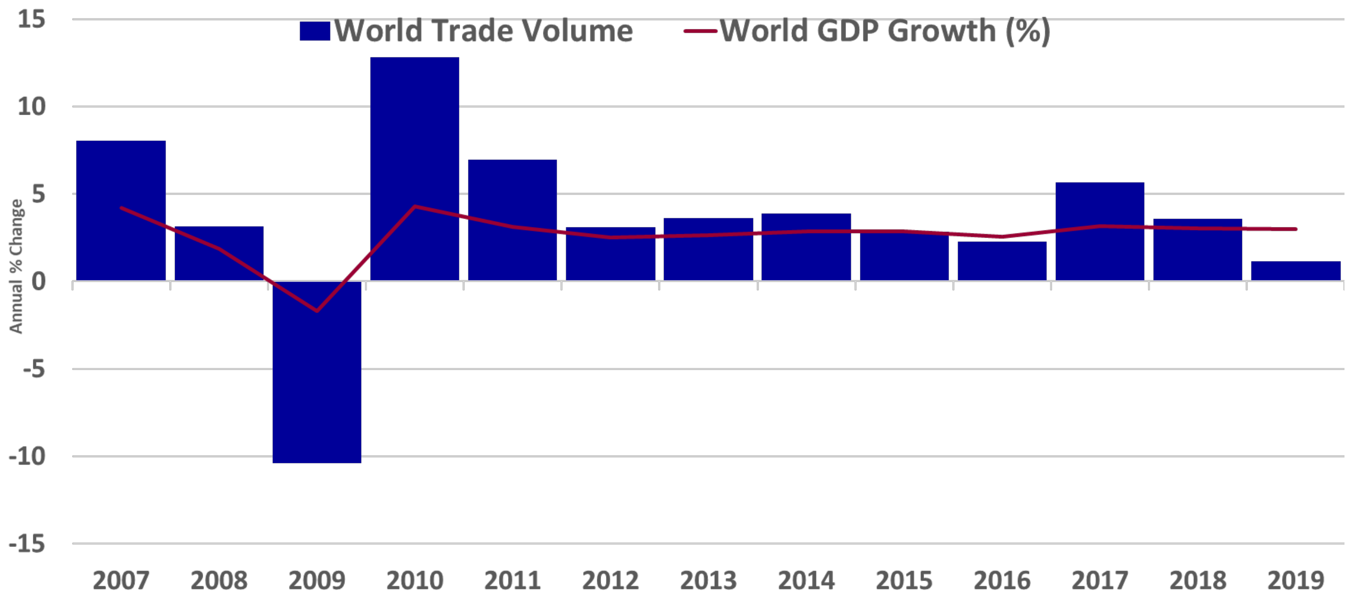
# IMPACT OF RISING UNCERTAINTY

## World Trade Volumes




*Source: IMF*

**World Trade Volumes**

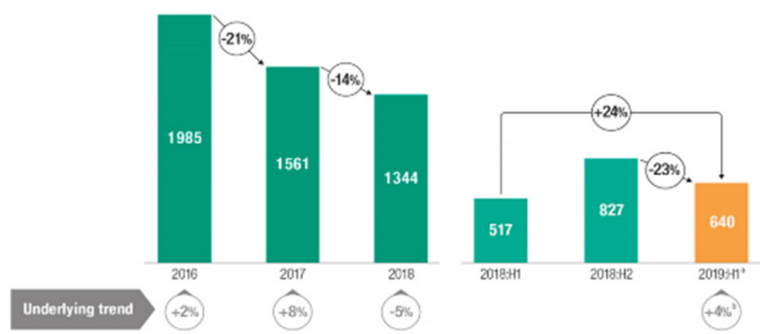
Not surprisingly there has been a definite decline in world trade volumes in 2019. Certainly, the US- China Trade War has had an impact, but other trade disputes (such as the one between Japan and South Korea), increased protectionist policies worldwide, and fundamental supply chain changes all play a part. The key takeaway here is that there are multiple barriers to international trade that are not likely to change in the short term. On the contrary, we expect these barriers to remain well into 2020. However, trade as a % of Global GDP is declining, so while we do expect global growth for 2019 to decline, the magnitude of that decline is not likely to be as steep as it will be for trade as a whole.

How well an individual country or business weathers the decline in global trade depends in large part on how connected they are to international markets and specific segments. There are some countries and industries which are more vulnerable than others. For example, Germany's Manufacturing PMI has fallen significantly in the last year. Part of that explanation is the decline in global imports of German cars, particularly from China (who recently passed new legislation curbing emissions) and from India (where consumers are having difficulty getting access to cash and credit).

# IMPACT OF RISING UNCERTAINTY

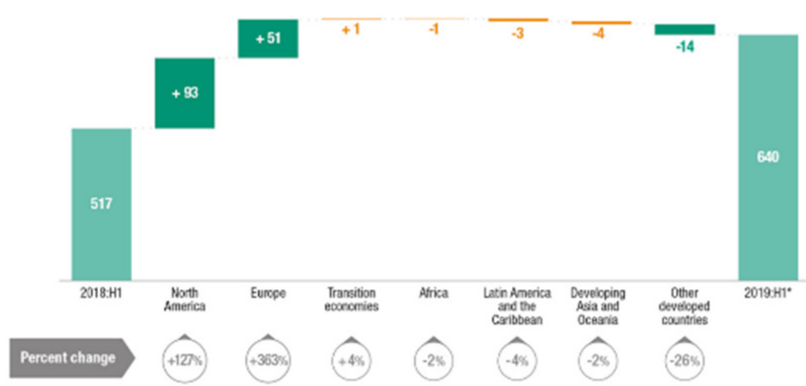
## Global Investment

**Figure 1. Global FDI flows and growth rates, 2016-2018 and 2018:H1–2019:H1**
*(Billions of US dollars and per cent)*




*Source:* UNCTAD.
[a] Estimates. [b] Annualized.
*Note:* Excluding Caribbean offshore financial centers.

**Figure 2. Regional contribution to changes in global FDI flows, 2018:H1–2019:H1**
*(Billions of US dollars)*



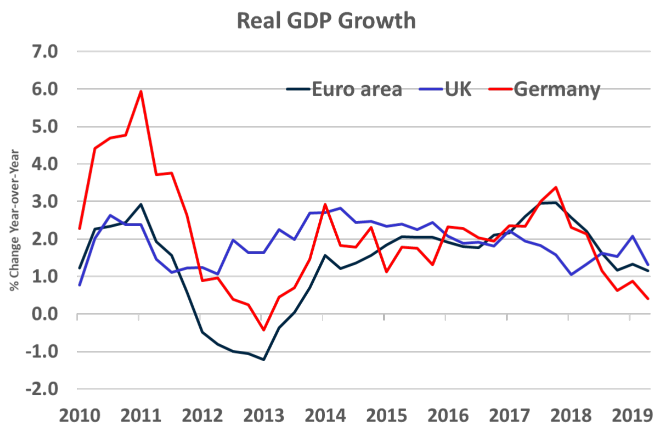

*Source:* UNCTAD.
* Preliminary estimates.
*Note:* Excludes Caribbean offshore financial centres. Percent changes are calculated for each region relative to 2018.

### Global Investments

Global business investment has been trending closely with the Uncertainty Indices and has been in decline since early 2016. We can see that as global uncertainty has risen, global business investment has fallen. Businesses do not want to invest capital when they are not guaranteed meaningful returns. The steep decline in business investment globally poses substantial risk, particularly to emerging economies who depend heavily of Foreign Direct Investment to expand output. Since emerging economies make up a larger share of global GDP growth, lack of FDI in these markets could accelerate a global slowdown in the medium term (perhaps 2021 or beyond if the trend continues).

# REGIONS MOST AT RISK

## Europe




*Source: FRED*

**Risks**

- Weak production in Germany
- Brexit

**Bright Spots**

- Fiscal policy tools in Germany
- Strong consumers

**2020 Outlook**

- **Cautiously optimistic**

**Germany** is particularly vulnerable to a decline in consumer demand (particularly for autos) from countries such as India and China. However, Germany is well positioned to combat headwinds through prudent fiscal and monetary policy should it need to. Presently, the impact of falling global demand for German exports is showing signs of stabilizing without a need for stimulus.

The German services sector (which makes up nearly 70% of its GDP) has shown steady growth despite trouble in manufacturing. The labor market is strong with record-setting low rates of unemployment and positive wage growth, which props up domestic demand. Germany is well positioned to endure an economic downturn with ample fiscal policy tools to stimulate growth if needed.

**The UK** is facing risk with the Brexit deadline approaching, as uncertainty over the outcome is still prevalent. The British economy has so far avoided a technical recession despite numerous and significant Brexit Headwinds. This is largely thanks to British consumers who have held up the overall economy with their robust spending. Although some economists have suggested the strong spending data is a result of stockpiling in anticipation of a no-deal Brexit, spending data coming out of the UK is not currently showing signs of significant weakness. Additionally, the labor market in the UK is notably healthy, with low unemployment and rising (albeit slowly) incomes.

The Brexit saga is nearing its end (or, at least, it seems like it is). That the UK economy has continued to grow throughout years of Brexit turmoil is a positive sign. Once the UK makes a final decision, global uncertainty around Brexit will likely diminish and business investment will likely pick up again.

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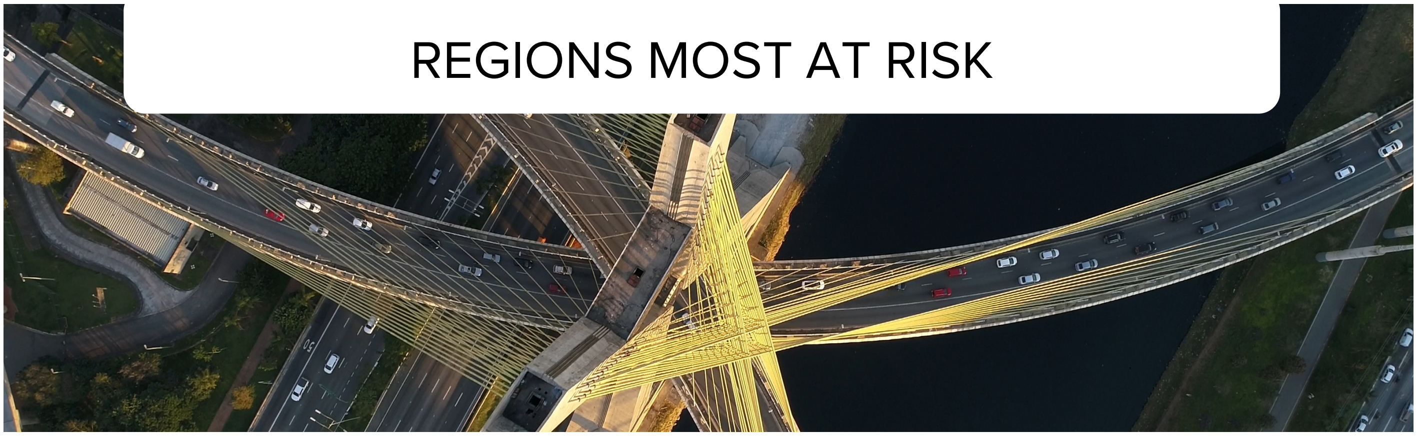
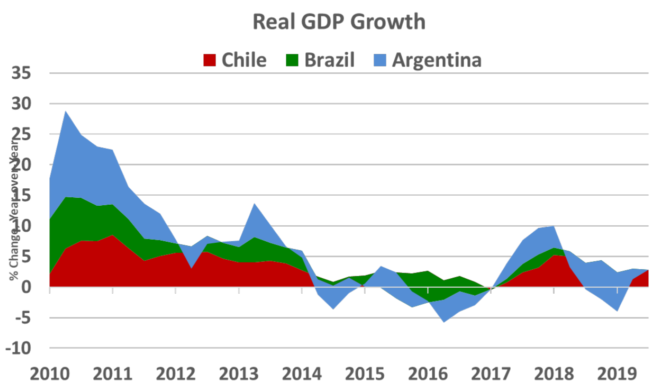
# REGIONS MOST AT RISK



## Latin America




*Source: CEIC*

**Risks**

- Geopolitical issues
- Income inequality
- Slow or negative growth across the region

**Bright Spots**

- Abundance of resources

**2020 Outlook**

- **Not-so-bright**

**Latin America** will likely be an exception to the strength of emerging markets in terms of growth in 2020. **Argentina** is currently in a recession, with no signs of recovery any time soon. **Brazil** is currently in recovery mode, with slow growth, and **Chile** (once the shining economic star of the region with an average annual GDP growth of about 2%) is in the middle of experiencing civil distress that will likely leave lasting economic impact.

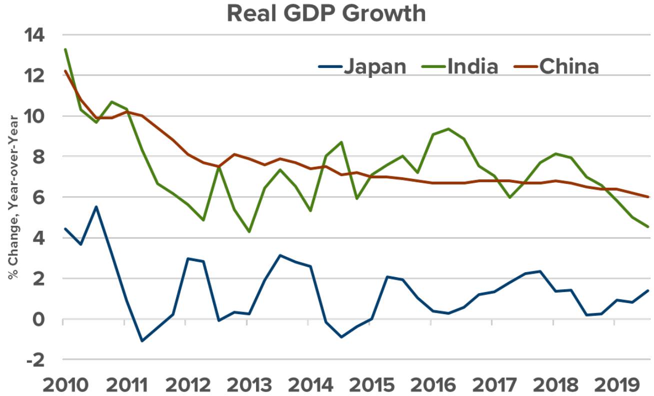
The risks in Latin America are significant. Geopolitical headwinds coming from rising populist governments and increasing social unrest, rising income inequality and slow wage growth, poor resource management, job shortages, slow or negative GDP growth, and newly announced steel tariffs on Brazil and Argentina are all dragging down the regional outlook for 2020.

There is still opportunity in resource-rich Latin America. If new governments successfully implement policies that allow for greater investment, increased employment, and perhaps more importantly – higher wages. Brazil is attempting this now with recent pension reforms and proposals for an overhaul of monetary and fiscal policy. Whether or not it will be successful remains to be seen.

When weighing the risks and opportunities across Latin America for 2020, the outlook is less than bright. We expect the risks to continue into 2020 and drag down economic growth into very slow, possibly negative growth rates across the region.

# REGIONS MOST AT RISK

## Asia




*Source: CEIC*

**Risks**

- Decelerating GDP
- Geopolitical issues
- Domestic policy

**Bright Spots**

- Strong growth
- Responsive policies

**2020 Outlook**

- **Cautiously optimistic**

**Japan** is a stable economy, but closely tied to global trade. GDP is rebounding after trade disputes and declining exports put downward pressure on growth in 2018 and early 2019. However, Japan is experiencing softening consumer spending, sending weak signals for 2020. This is not likely to change when consumers do not have a lot of incentive to increase spending. Japanese consumers are historically high savers and a recent consumption tax was put into effect in October. With negative interest rates, Japan has little room for monetary policy to ease a downturn that might arise.

**China** is facing many headwinds that are causing significant strain in GDP growth, but it remains in strongly positive territory in comparison to other markets. Trade war with the US, declining foreign investment and business confidence, weak consumerism, and unrest in Honk Kong are weighing down the outlook. China has been responsive, however, lowering key interest rates. Nevertheless, prevailing headwinds are not likely to dissipate anytime soon. We anticipate growth rates around 5%.

**India** is facing similar headwinds but much of them are homegrown, with domestic policy putting the brakes on business investment and consumer spending. Some policy implementations have led to credit and cash liquidity crises. This makes it difficult for Indian businesses and consumers to get cash and credit, causing them to turn to the Black Market where people are not engaging in traditional economic activity that leads to GDP growth. On a positive note, India has recognized this and is attempting to change course with a new policy agenda intended to increase business and consumer spending to ease cash and credit restrictions.

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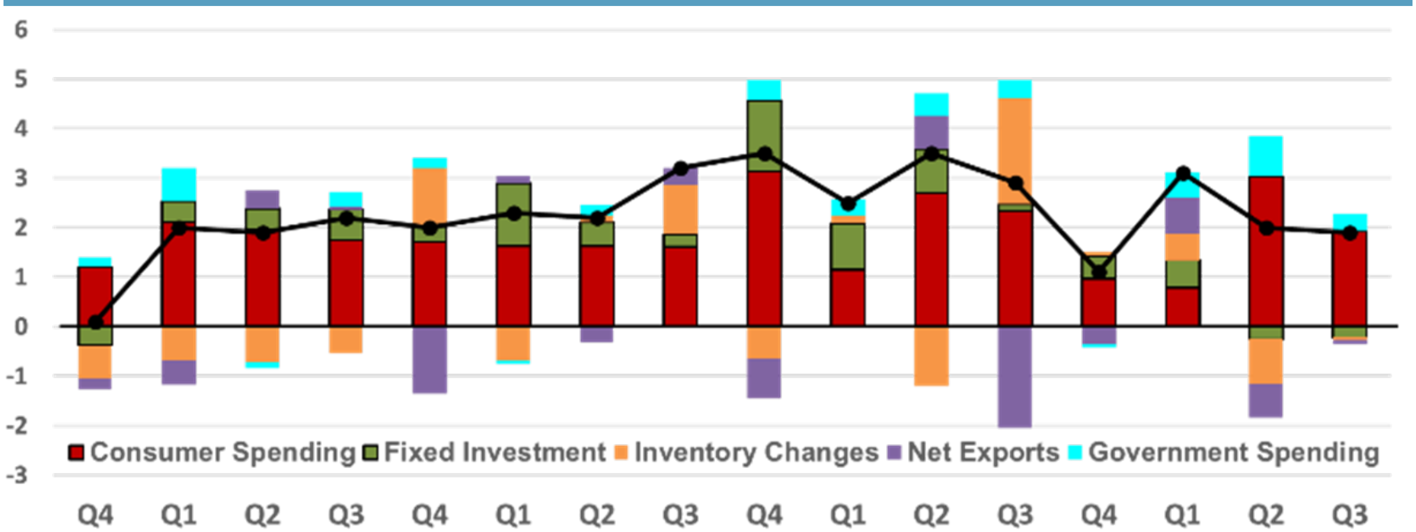
# IMPACT ON THE US OUTLOOK

**US GDP Growth**

Real GDP growth has slowed in line with an economy at (or near) full employment. Consumer spending remains the primary driver of the US economy. Government sector contribution has been positive, but investment (particularly nonresidential) has taken a hit in recent quarters, as it has across the globe.

Consumer spending and fixed investment have moved together to lead GDP growth either up or down. In Q2 2019, we see for the first time that consumer spending and fixed investment start to diverge. GDP growth declined as a result and continued into Q3. Fixed investment is something to monitor in 2020.

## US GDP Growth




*Source: Bureau of Economic Analysis*

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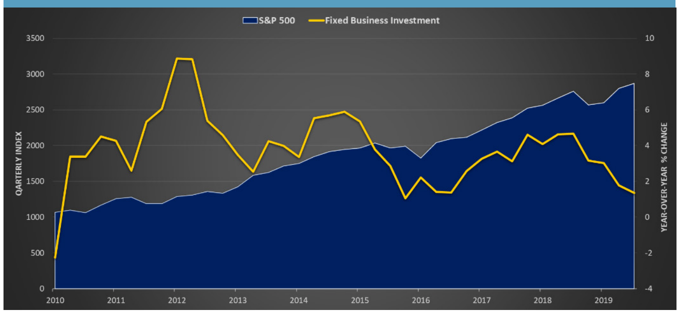
# IMPACT ON THE US OUTLOOK

## Capital Spending and Financial Data




*Source: FRED*

### Capital Spending and Financial Data

Financial markets have been strong this year, despite weak business investment. As we saw in other parts of the world, businesses are more reluctant to invest due to uncertainty over global conditions and despite higher earnings in 2019.

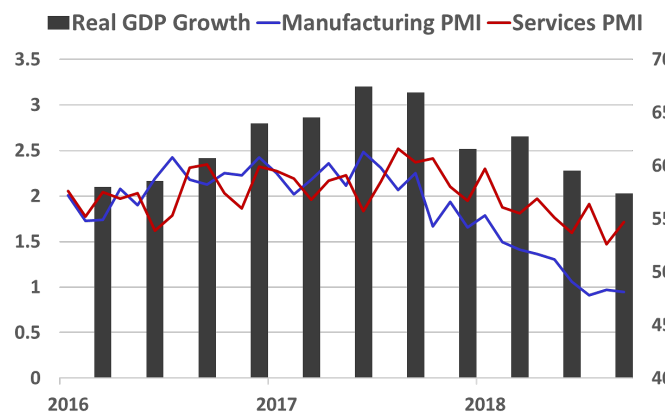
### Manufacturing vs. Services

Production and manufacturing have slowed considerably, thanks in large part to decreased export orders. However, production in the services sector is strong and growing.

Real GDP is decelerating, but remains steady between 2% and 3% annual growth, consistent with an economy operating at or near full employment.

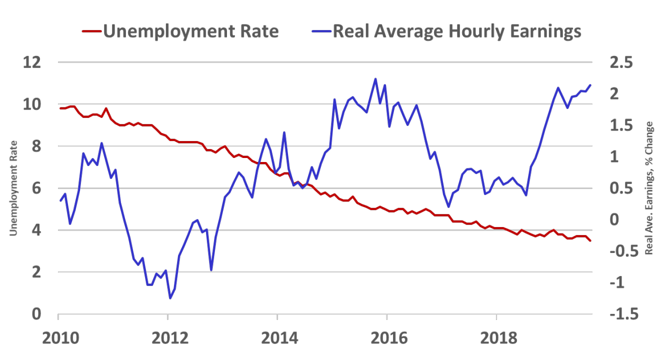
Although we are seeing a downturn in manufacturing and business investment, US outlook remains optimistic.

## Manufacturing vs. Services




*Source: CEIC, ISM*

## Healthy Labor Market




*Source: BLS*

### Healthy Labor Market

Because of a very strong labor market in the US, unemployment is at record lows – with job openings steadily growing, real wages rising, and consumer spending increasing. Since the US economy is driven by consumer spending, we expect the US economy to be sufficiently insulated from the declining manufacturing output and weakening global trade going into 2020.

# KEY INSIGHTS

There are significant headwinds facing the global economy that will likely lead to decelerating global growth in 2020, with some regions and industries more at risk than others. However, despite unprecedented global uncertainty, the underlying economic data show distinct signs of consumer and services sector strength that will likely prevent global GDP from falling into recession next year.

**What to Watch For in 2020:**

- Further industrial/manufacturing declines in Europe, Asia, and South America.
- Further signs of softening labor market in UK, as well as indicators that labor markets in advanced economies are weakening.
- Signs of a softening service sector in advanced economies.

**Bottom Line:** Geopolitical risks in 2020 outweigh economic risks. Stress signals relating to geopolitical and social unrest, such as protests in Hong Kong, Latin America, and elsewhere, impeachment proceedings in the US, and elections in the UK pose the greatest threat to the global economic outlook for the coming year.