Growth Prospects and Challenges Ahead for the U.S., U.K., Eurozone, China, and Japan

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The economic slowdown that began in late 2018 has started to stabilize. Trade tensions and policy uncertainty took a toll on confidence and financial markets late last year, but both seem less threatening today. Financial conditions have eased as major central banks (including the U.S. Federal Reserve) maintain a fairly accommodative stance amid a subdued inflation outlook.

A U.S.-China trade agreement is likely in the coming months, but wider tensions remain in other U.S. trade relationships. Amid other threats, the U.S. has moved toward imposing $11 billion in tariffs on Europe, putting the global automotive market at risk. And the roads to United States-Mexico-Canada Agreement and Brexit ratification won't be easy.

We continue to see risks to our outlook as weighted to the downside.

United States

- The U.S. economy has delayed this year's expected slowdown, with real first-quarter gross domestic product (GDP) estimated to have grown by 3.2% on an annualized basis. However, much of the strength was explained by transient increases to inventories and net trade. We expect the momentum to fade in the coming quarters but not to an extent that warrants a rate cut by the Fed. As long as economic performance persists, we expect one hike in 2020.
- The labor market remains strong, as reflected in the March employment report. Weekly jobless claims touched 50-year record lows, providing assurance of continued economic momentum.

Eurozone

- According to the flash estimate, the eurozone's quarter-over-quarter real GDP growth improved in the first quarter, driven by strong domestic demand. But external headwinds continue to weigh on industrial performance. Increasing evidence of a stabilizing Chinese economy and global manufacturing should bode well for Europe's exporters in the second half of the year. That said, risks remain tilted to the downside as Brexit and U.S. car tariff threats loom large.
- Higher oil prices should boost the headline inflation but won't be enough for the European Central Bank to move interest rates higher. A subdued economic outlook (including core inflation) suggests rate increases are a long way off.
- May elections for the European Parliament will remain in focus as they might challenge confidence and create policy uncertainty for the years ahead.

United Kingdom

- While the risk of a disruptive Brexit at the end of March was averted by the six-month Article 50 extension, the political class remains highly divided. Brexit has brought the government and policymaking to a standstill. Lingering uncertainty continues to take a toll on businesses and their investment decisions. Yet, the economy remains largely resilient thanks to the support provided by the consumer sector.
- The U.K. is set to participate in the upcoming European parliamentary elections, as exit deal ratification by the British parliament beforehand looks practically impossible. We continue to expect an agreement later this year that largely preserves the existing provisions of business and finance. That said, all other scenarios – such as a second referendum, another extension and no-deal – are still on the table. The Bank of England will remain on the sidelines and isn't likely to move rates until further clarity emerges on Brexit, with no hikes in 2019 and one in 2020.

Japan

- The Japanese economy continues to struggle amid an unfavorable external environment. Growth will remain constrained by relatively weak external demand, particularly from China, and deceleration in capital spending.

- With China trade negotiations in the final lap, the U.S. administration's focus has shifted to Japan. In our base case, we expect a bilateral trade deal to emerge this year, but considering Japan's desire for reciprocal concessions from the U.S., the process will be slow.
- The Bank of Japan in its April meeting tweaked forward guidance by adding "at least through around spring 2020" to the monetary policy statement, providing further clarification that it would examine the impact of the "scheduled consumption tax hike" around spring 2020.

China

- China's economy surprised on the upside as year-over-year real first-quarter GDP growth held steady at 6.4% as the impact of policy easing continues to feed through. There are signs momentum is firming up, and a temporary trade peace between China and the United States will only add to the momentum. We expect Chinese growth to moderate to 6.2% by end of this year and 5.9% by end of 2020.
- Policymakers will continue to deploy easing measures without moving the benchmark rates to underpin growth. Excessive leverage remains a key concern that constrains policy easing.

	2017	2018	2019F	2020F
United States				
Real GDP (Q4-Q4 % change)	2.5	3.0	2.2	1.8
Unemployment Rate, EOP (%)	4.1	3.8	3.7	3.8
Inflation (CPI, Q4-Q4, %)	2.1	2.2	2.5	2.0
Policy Rate (Top), EOP (%)	1.50	2.50	2.50	2.75
Eurozone				
Real GDP (Q4-Q4 % change)	2.7	1.2	1.3	1.5
Unemployment Rate EOP (%)	8.7	7.9	7.8	7.5
Inflation (CPI, Q4-Q4, %)	1.4	1.9	1.7	1.7
Policy Rate, EOP (%)	0.00	0.00	0.00	0.00
Deposit Rate, EOP (%)	-0.40	-0.40	-0.40	-0.40
United Kingdom				
Real GDP (Q4-Q4 % change)	1.6	1.4	1.3	1.5
Unemployment Rate EOP (%)	4.4	4.0	3.9	3.8
Inflation (CPI, Q4-Q4, %)	3.0	2.3	2.0	1.8
Policy Rate, EOP (%)	0.50	0.75	0.75	1.00
Japan				
Real GDP (Q4-Q4 % change)	2.4	0.3	0.2	0.8
Unemployment Rate EOP (%)	2.7	2.4	2.4	2.3
Inflation (CPI, Q4-Q4, %)	0.6	0.9	2.1	1.3
Policy Rate, EOP (%)	-0.10	-0.10	-0.10	-0.10
China				
Real GDP (Q4-Q4 % change)	6.8	6.4	6.2	5.9
Unemployment Rate EOP (%)	3.9	3.8	4.0	4.0
Inflation (CPI, Q4-Q4, %)	1.8	2.2	2.8	2.7
Policy Rate, EOP (%)	4.35	4.35	4.35	4.35
Exchange rates (EOP)	**Jun-2019F**	**Sep-2019F**	**Dec-2019F**	**Mar-2020F**
EUR/USD	1.13	1.14	1.16	1.17
GBP/USD	1.31	1.33	1.36	1.37
USD/JPY	110.0	109.0	108.0	108.0
USD/CNY	6.71	6.69	6.67	6.65

F: Forecast *EOP: End of period*