

2019: The best of times, the worst of times

As we look ahead to 2019, we're hoping for the best and preparing for the worst. Our base case calls for a slowdown in economic growth. But with so much being driven by political posturing, we'll admit, anything is possible. So here's a look at some of the best- and worst-case scenarios for the global economy next year



In this list, we look at some possible outcomes-- both positive and negative-- for the most important themes of the year, including Brexit, the US expansion, global trade problems and the eurozone economy. While we don't consider these to be the most likely outcomes, they're not farfetched either and we can't afford to ignore them. P.S. if this isn't bleak enough for you, we also did a piece with [some pitch-black scenarios just for the eurozone](#).

📌 UK: A 'no deal Brexit'

Fears are growing that the UK could crash out of Europe on WTO terms – and it's not hard to see why. With 29 March enshrined in UK law as the Brexit date, 'no deal' is the default position unless a

majority can be found for an alternative in Parliament, be that an election/second referendum (which would require the exit date to be pushed back), or some kind of tweaked deal. If no alternative can be found, the UK will abruptly leave the EU's single market and customs arrangements, and **a UK recession would be highly likely**. Lengthy queues would likely form at major ports, with or without fresh checks being implemented at European ports, given the British logistics industry is already operating at full capacity. Given that the UK imports 40% of its food, the worst case scenario could see shortages of produce. Britain won't quite starve but in this 'no deal' scenario, the Bank of England has indicated that policy rates could go either way – although the likely sharp hit to confidence makes a cut (or more QE) in our view, much more likely than a hike.

↑ UK: Changes its mind after all

With no majority for any kind of Brexit in Parliament, calls for a second referendum are growing, although it will inevitably face challenges. Firstly, the bulk of Conservative MPs are unlikely to vote in favour of one, and there's no guarantee many opposition Labour MPs would either. But if enough support is found for a second vote, then the legislative process means it could take several months to arrange (the [LSE estimates](#) at least five to six months, if everything goes smoothly). This would almost certainly require the two-year Article 50 period to be extended. There is also a lot of debate about what the question would be – would it be May's deal vs. No deal, or May's deal vs Remain, or a combination of all three? That debate could take some time, and either way, it's worth noting that the polls are still fairly neck-and-neck, with Remain slightly out in front.

↓ US: Debt doomsday

Higher US interest rates are already starting to bite with housing activity slowing. There are also worries about the investment backdrop while intensifying trade worries could hurt sentiment even further. Should US-China relations worsen markedly there is the possibility that China could use the US's deteriorating fiscal position and the fact the Federal Reserve is running down its balance sheet as a way of fighting back against the Trump administration. China holds 20% of US Treasuries and while it won't sell those Treasuries, it could choose not to turn up at future Treasury auctions. Given that China is typically such a huge buyer, this could mean a failed auction. The result could be a spike in yields, which would have ramifications for US equities and by extension, the US economy. Escalating geopolitical tensions would be bad news for everyone, and safe havens such as gold, the Swiss Franc and the US dollar would be sought after.

↑ US: The long boom

The US economy has had a fantastic 2018 and while there are clearly headwinds from tighter monetary conditions and protectionism, there is still a fair chance the US can maintain its momentum. The upside would most likely come from an acceleration in wage increases. Surveys suggest firms are struggling to recruit staff with the right skill sets and compensation is consequently rising. Average hourly earnings are already running above 3% year-on-year and are set to rise further. With more money in their pockets, consumers would continue spending and if President Trump succeeds with a bi-partisan push on infrastructure investment spending, growth could confound expectations. In addition, any thawing of trade tensions would be a major boon. This would support equity markets and keep the Federal Reserve hiking interest rates for longer, meaning additional gains for the dollar.

⬇️ Global trade: End of the ceasefire

Following the G20 meetings, China has joined the EU in negotiating with the US to try to avoid further tariff increases. In China's case, the deadline for reaching results in the talks is 1 March. By then, negotiators are tasked with finding some common ground on issues which have remained some of the most intractable in international trade, including technology transfer. If the negotiations fail, tariffs will increase by a further 15 percentage points on the \$200 billion package of Chinese goods that has already seen 10 percentage point increases. The remainder of US-China trade will then also become subject to tariffs. At the same time, trade negotiations between the US and EU officially begin in January, after the EU Council has given its formal agreement. Alongside negotiations on tariffs, the talks aim to enhance regulatory co-operation in selected industries and reduce trade barriers more generally. The talks, however, are overshadowed by a Section 232 investigation report finding that imports of cars and parts present a threat to US national security. This would clear the way for tariff increases on these products, ramping up the pressure on the EU-US talks.

⬆️ Global trade: Agreements and access

The threat of trade barriers has prompted firms to re-assess their supply chains during 2018. Both the US and the EU are pressing for better market access for their firms in China in different ways. In contrast to the looming deadline in the US-China talks, negotiations on an EU China investment agreement have been ongoing since 2014, and this year, they dealt with the crucial issue of market access for the first time. Reaching an agreement in 2019 will be challenging, but should be possible given the political will to signal both parties' commitment to openness, as well as the increased appeal of investing outside the US. Physical and digital infrastructure facilitating trade between the EU and China is also being improved under the Belt and Road Initiative. Firms in the EU can engage more confidently with the BRI now that the EU has finalised its own complementary strategy for connecting Europe and Asia.

⬇️ Eurozone: European elections cause a new vacuum

The European Elections in May could bring bigger gains for the anti-EU parties than expected. If 2019 marks more losses for parties in the political centre, this would reduce the appetite for further integration or reforms.

Investors were relieved in 2017 after the election of French President Emmanuel Macron, with a long lull in the markets with regards to euro-risk. But with Macron's popularity now at rock-bottom levels, German Chancellor Angela Merkel stepping down and the Italian government continuing its collision course with the European Commission, the entire eurozone could get caught in a new wave of uncertainty. It is not unimaginable that concerns about the strength of the monetary union return with a vengeance and weigh on investment and consumption as the economy slows more significantly than already thought.

⬆️ Eurozone: A second wind

While all the focus is on limiting the impact from downside risks, it could well be that none of these actually materialise. If the Withdrawal Agreement for Brexit is signed, a transition period will follow in which trade is not impacted. A fudge over the Italian budget could be found, with Italy reducing spending and the Commission therefore not starting an excessive deficit procedure. The truce between the EU and US on trade could continue, which would make for a much sunnier scenario

that boosts confidence. This would then result in higher investment, given that capacity utilisation is still high and new hires are hard to get. The eurozone economy could then see growth rates of above 2% again as some delayed investment and spending boosts growth materially. As a consequence, wage growth would accelerate in the first half of 2019, pushing core inflation closer to 2% and forcing the ECB to hike the deposit and refi rate in September and the refi rate once again in December. With possibly a more hawkish ECB president in place – dare we say Germany's Jens Weidmann? – this would result in a swift shift towards monetary policy normalisation, causing 10-year yields to rise above 1.5% before year-end.

The list does not end here, there are many global factors likely to have a decisive impact on 2019 global growth. A slowing growth path seems logical given that many major economies are now late cycle, but it does not require an extraordinary scenario for growth to slow much more severely, as can be seen above. Equally, as many of the 2019 risks have not yet materialised, matters could well be resolved, with upside potential for global growth. With our crystal ball hazier than usual this year, it's best to be prepared for all scenarios.

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