

Global outlook: A long, hot summer...



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The next few weeks present a number of political challenges that could upset global economic growth and financial market confidence. President Trump continues to ratchet up the rhetoric on trade as he aims to squeeze maximum concessions from Europe and China, but he risks pushing too far as retaliation measures escalate. At the same time, European politics will remain in the headlines as Brexit talks go in circles and Italy potentially tests the EU's patience

US growth appears to be bouncing back sharply in 2Q18, with households and businesses seemingly brushing aside trade war fears and higher fuel and borrowing costs. The jobs market is in great shape and is supporting confidence and spending, leaving the Federal Reserve on course to hike interest rates three more times this year.

Nonetheless, how President Trump proceeds on trade will be critical for both the outlook for US growth and the US political situation. The Republicans continue to lag behind in opinion polls, which means there is a strong probability the Democrats could win control of Congress. This will make passing Trump's legislative agenda much more challenging while raising talk of his potential impeachment.

As for the Eurozone, both Italian and Spanish politics offered some drama over the last few weeks, and the current calm should not be taken for granted. On the international scene, trade tensions

are not abating yet, an important threat to Eurozone export industries. Eurozone growth is still OK, but not more than that. That means that the ECB's exit from its easy monetary policy will be extremely slow, even though inflation has picked up.

In the UK, the Bank of England is probably leaning more towards an interest rate rise in August than markets expect. But here again, the economic data risk being overshadowed by politics, as the UK debate over exiting the EU gets increasingly messy. The government is split over two proposed ways forward on trade, and in any case, the EU has already cast doubt on both.

We think that the US trade disagreement with China not only reflects a desire to reduce the trade deficit but also concerns about the rise of China and the perceived threat its "Made in China 2025" policy could spell for the US high-tech industry. As China opens up a range of markets to the world, the US risks being shut out as other countries build stronger trade ties in areas such as agriculture and energy.

In Japan, the first quarter slowdown was likely only a pause, nothing more. We anticipate activity strengthening through the second quarter – barring disasters, such as an all-out trade war.

Having been hit hard by Italian politics, the EUR is trying to make a come-back – helped by speculation over the end-point of ECB QE. Politics, global trade policy, higher core rates and idiosyncratic emerging market stories all prove risks for FX markets this summer. Given the lack of visibility, we're cutting our year-end EUR/USD forecast to 1.23 from 1.30.

As Italian fears slowly ease, and talks of ECB quantitative easing and Fed hikes restore, core rates have been able to regain some of their poise. We continue to look for the US 10-year yield to breach 3% and move towards 3.25-3.5% over coming months.

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