



# Global Risk Outlook

## May 2016



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## About Oxford Economics

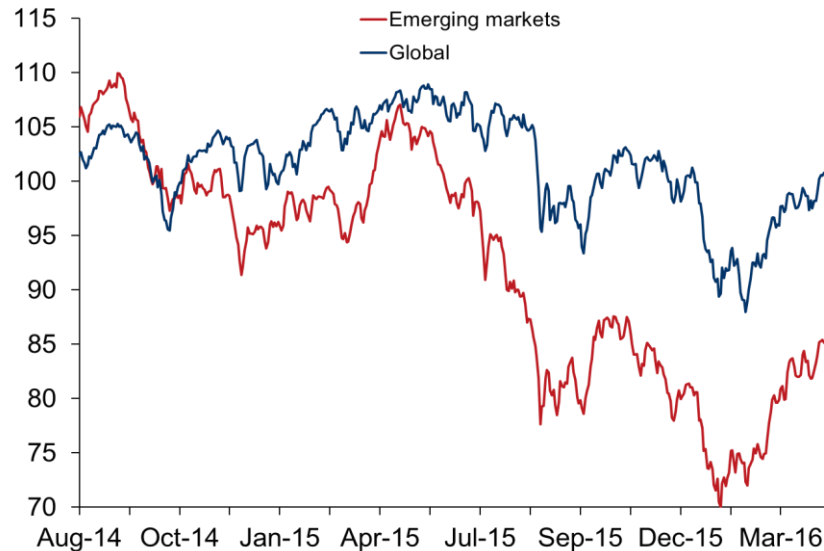
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- **Founded in 1981 as a joint venture with Oxford University,** Oxford Economics is now a leading independent economic consultancy.
- **Headquartered in Oxford, with offices around the world, we employ 250 people, including 150 economists, and a network of 500 contributing researchers.**
- The rigor of our analysis, caliber of staff and links with other leading research groups make us a trusted resource for decision makers.



# Markets have rebounded.... but stress is palpable

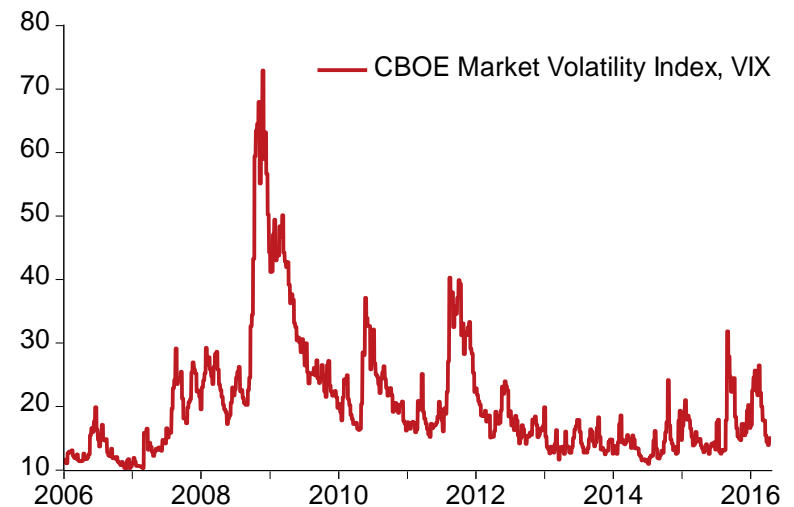
## World: Stock markets

Index August 1 2014=100



Source : Oxford Economics/Haver Analytics

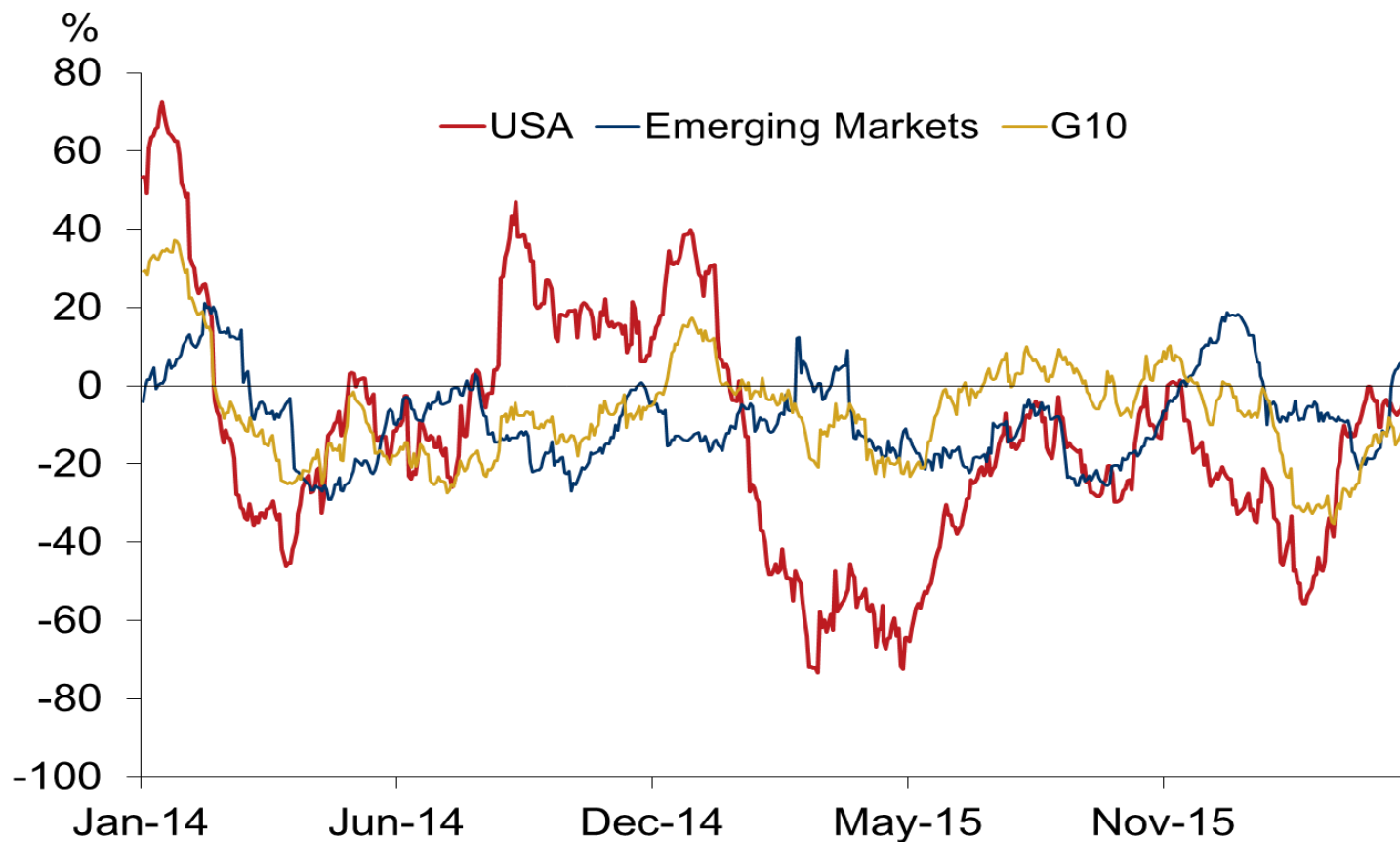
## US: Market volatility



Source: Haver Analytics

# Economic news less disappointing

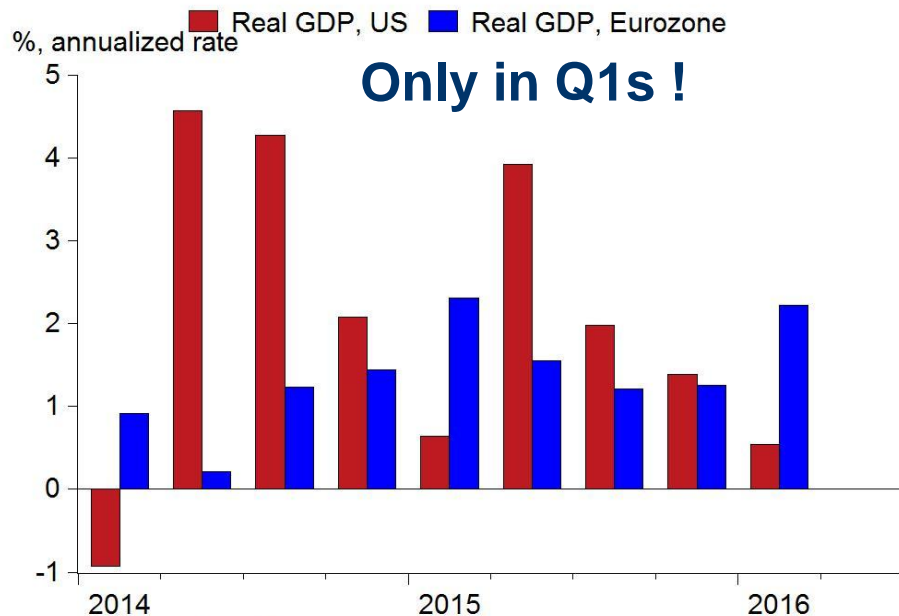
## World: Economic surprise indices



Source : Oxford Economics/Haver Analytics

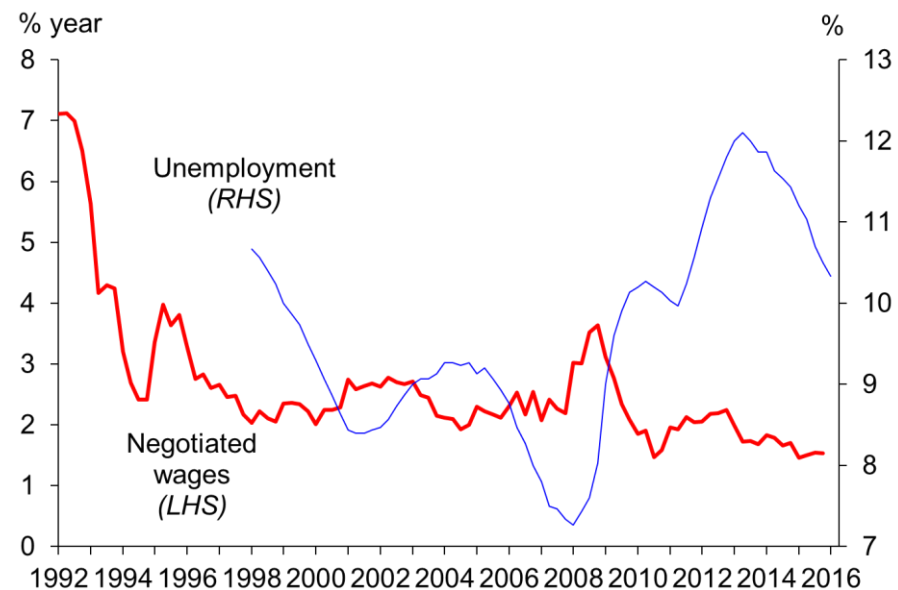
# Eurozone is fastest growing advanced economy??

## US: Real GDP growth



Source: Oxford Economics/Haver Analytics

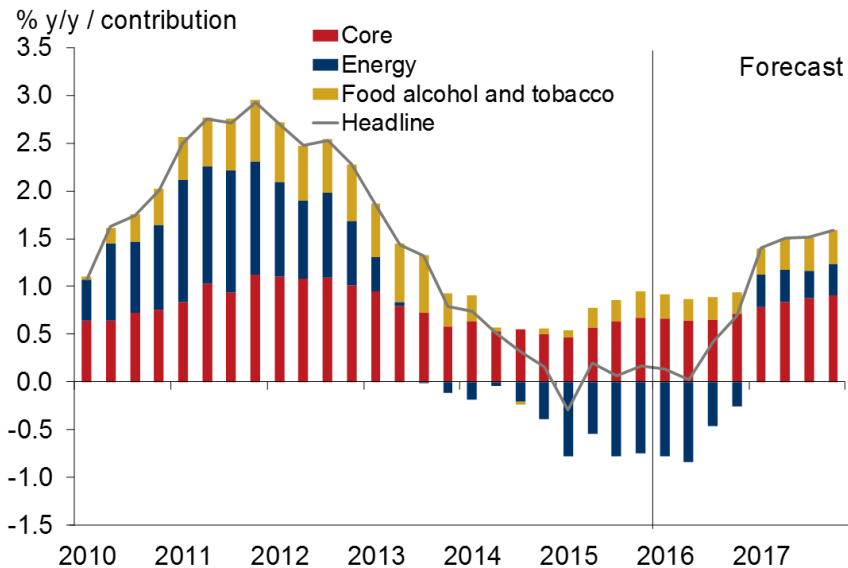
## Eurozone: Wages and unemployment



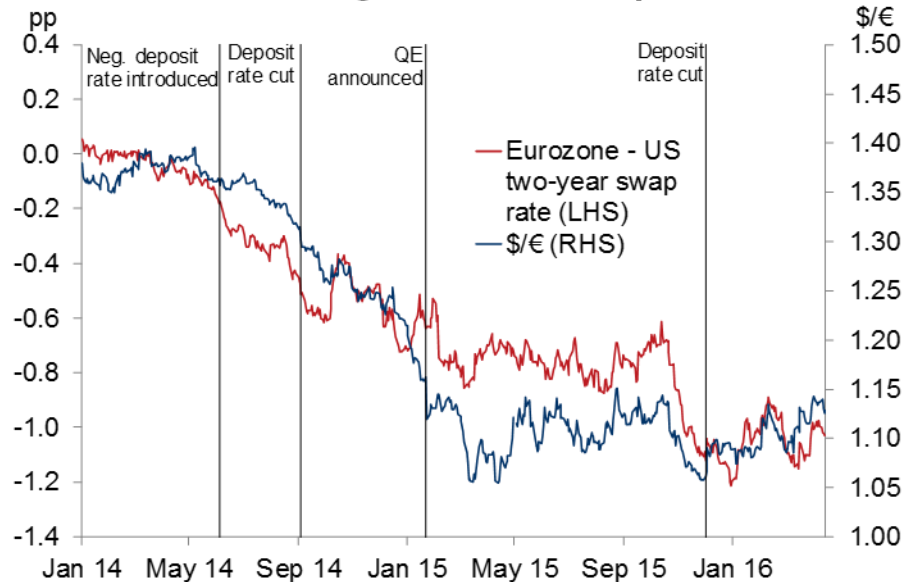
Source: Haver Analytics

# Inflation to rebound but ECB closely monitoring

## Eurozone: CPI Inflation (Bottom-up f'cast model)

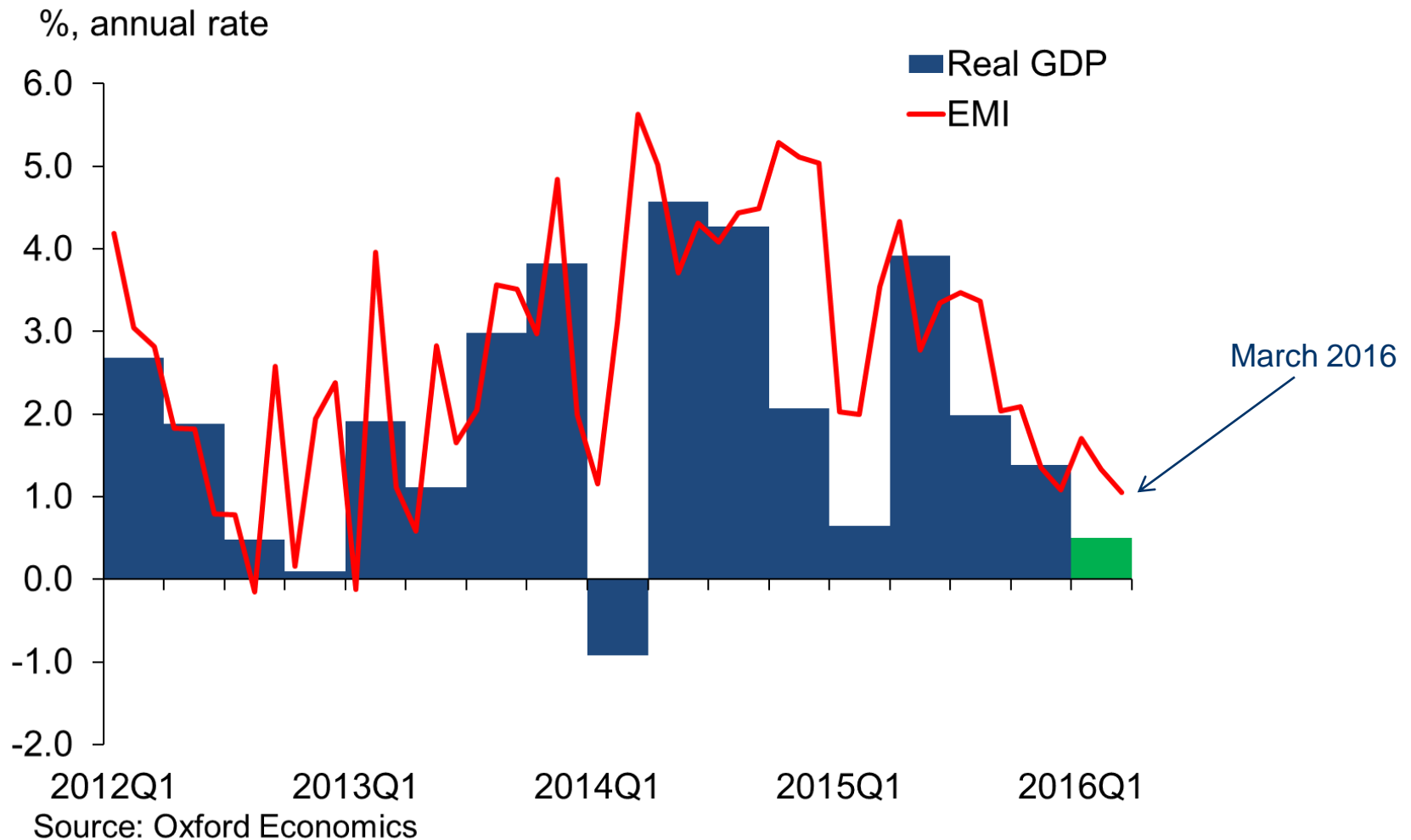


## Eurozone: Exchange rate and swap rates



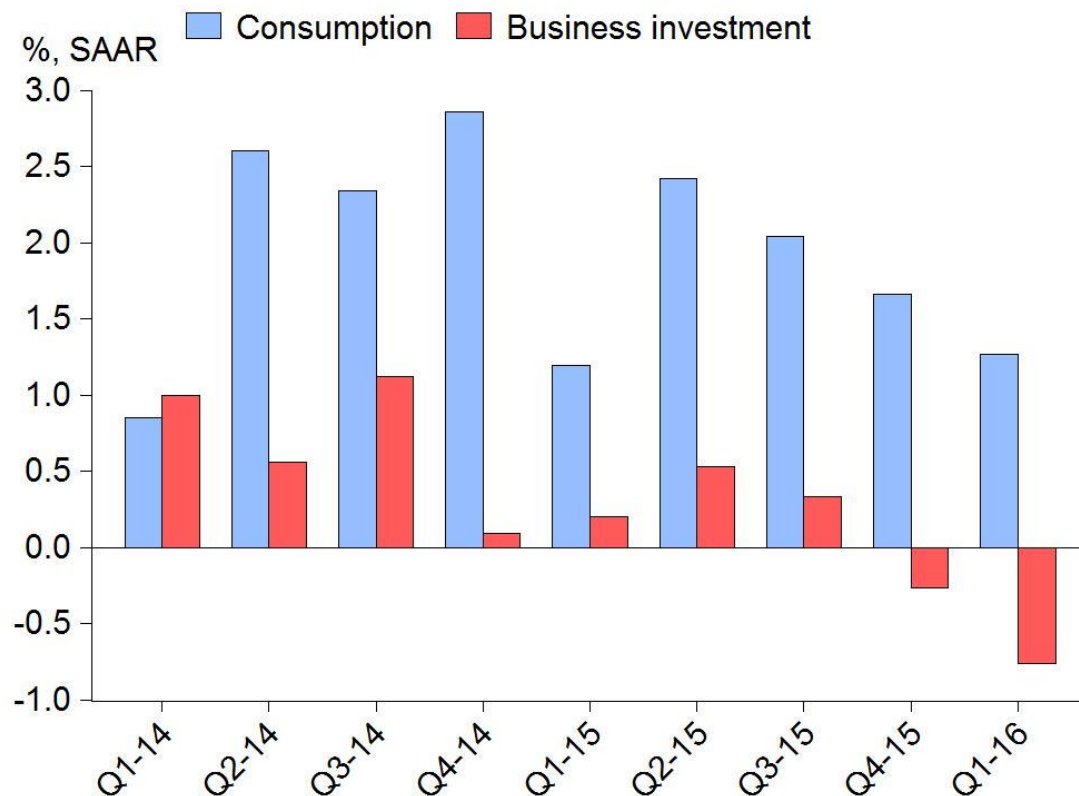
# The end of 2015 slowdown is proving to be “sticky”

## US: OE's Economic Momentum Indicator



# Usual culprits behind slowdown

## US: Contribution to real GDP growth



Source: Oxford Economics/Haver Analytics

### Culprits:

Strong US dollar

Weak global growth

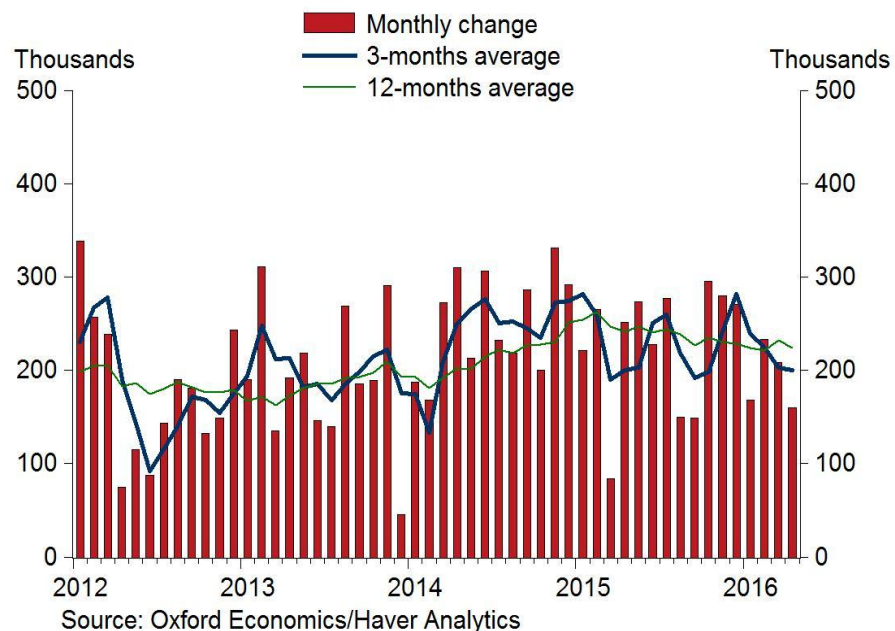
Depressed oil and gas activity

+

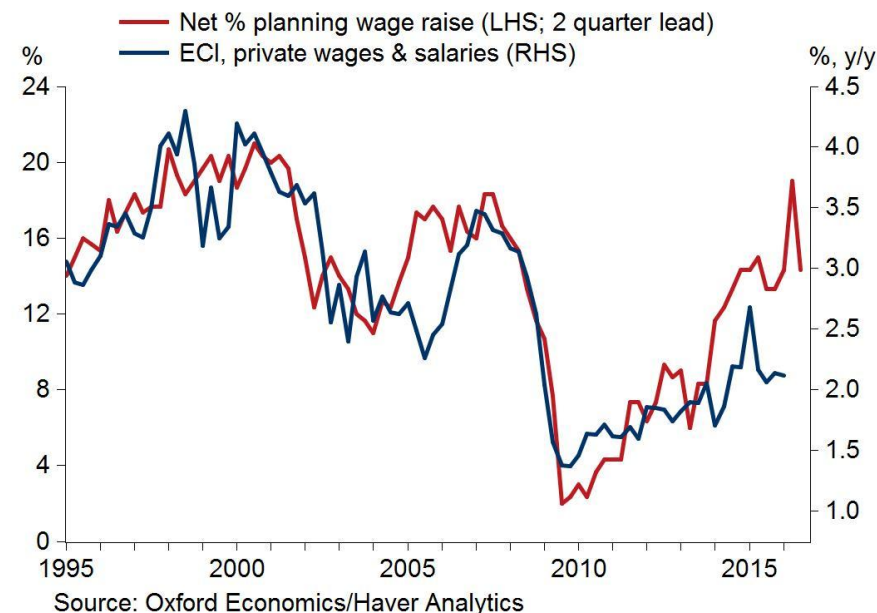
Modest consumer spending

# Employment growth is robust

## US: Nonfarm payrolls

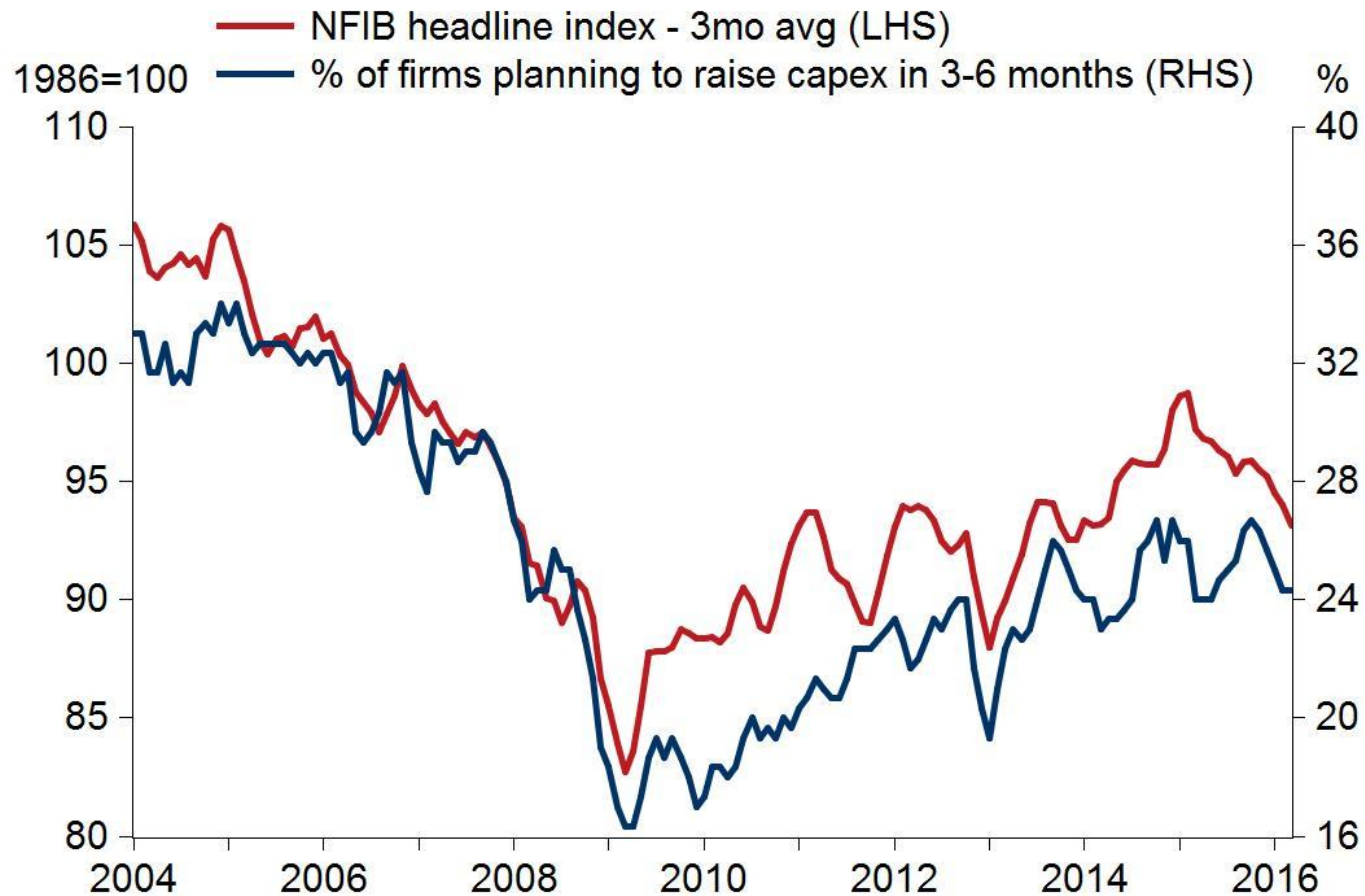


## US: Leading indicators suggest wages to rise



# Business investment to remain sluggish in 2016

## US: NFIB Small Business Optimism Index

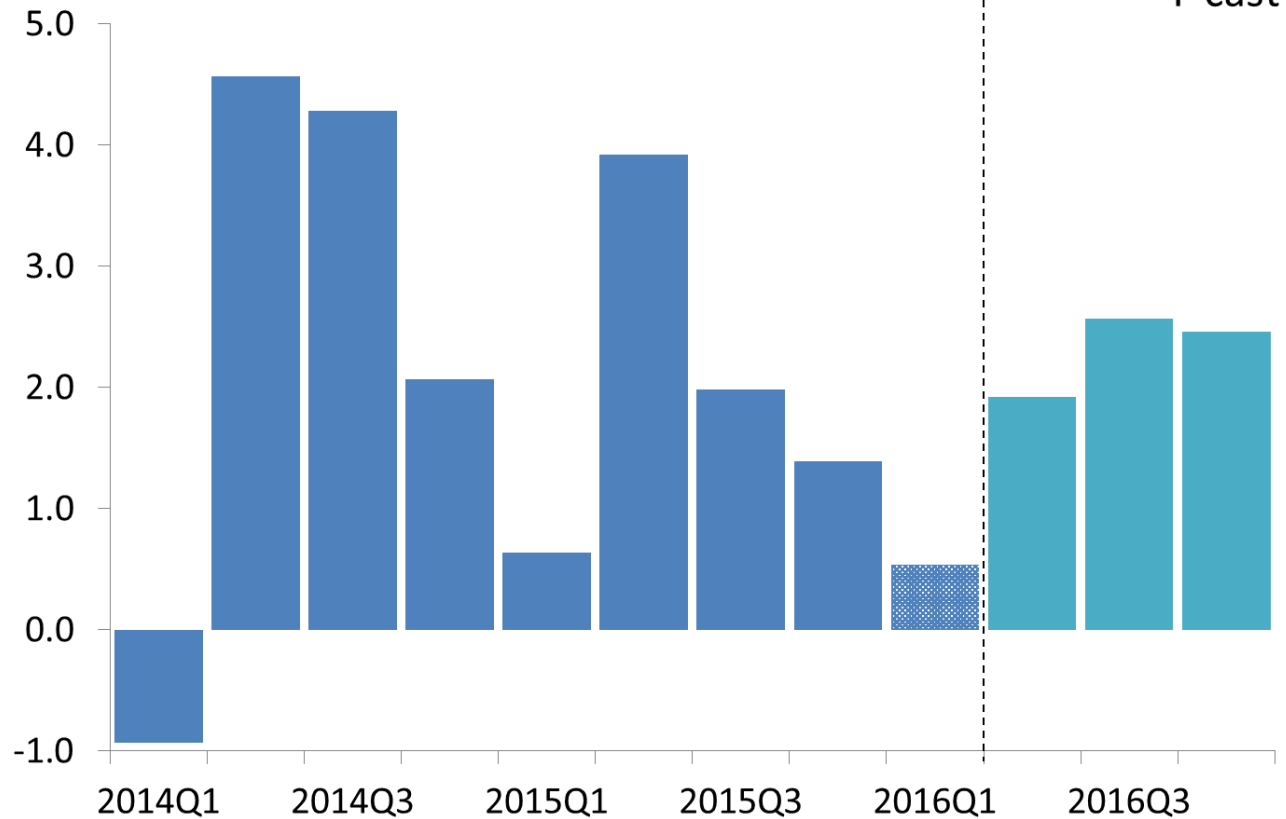


Source: Oxford Economics/Haver Analytics

# 2% growth miss is likely

## US: Real GDP growth

% annualized

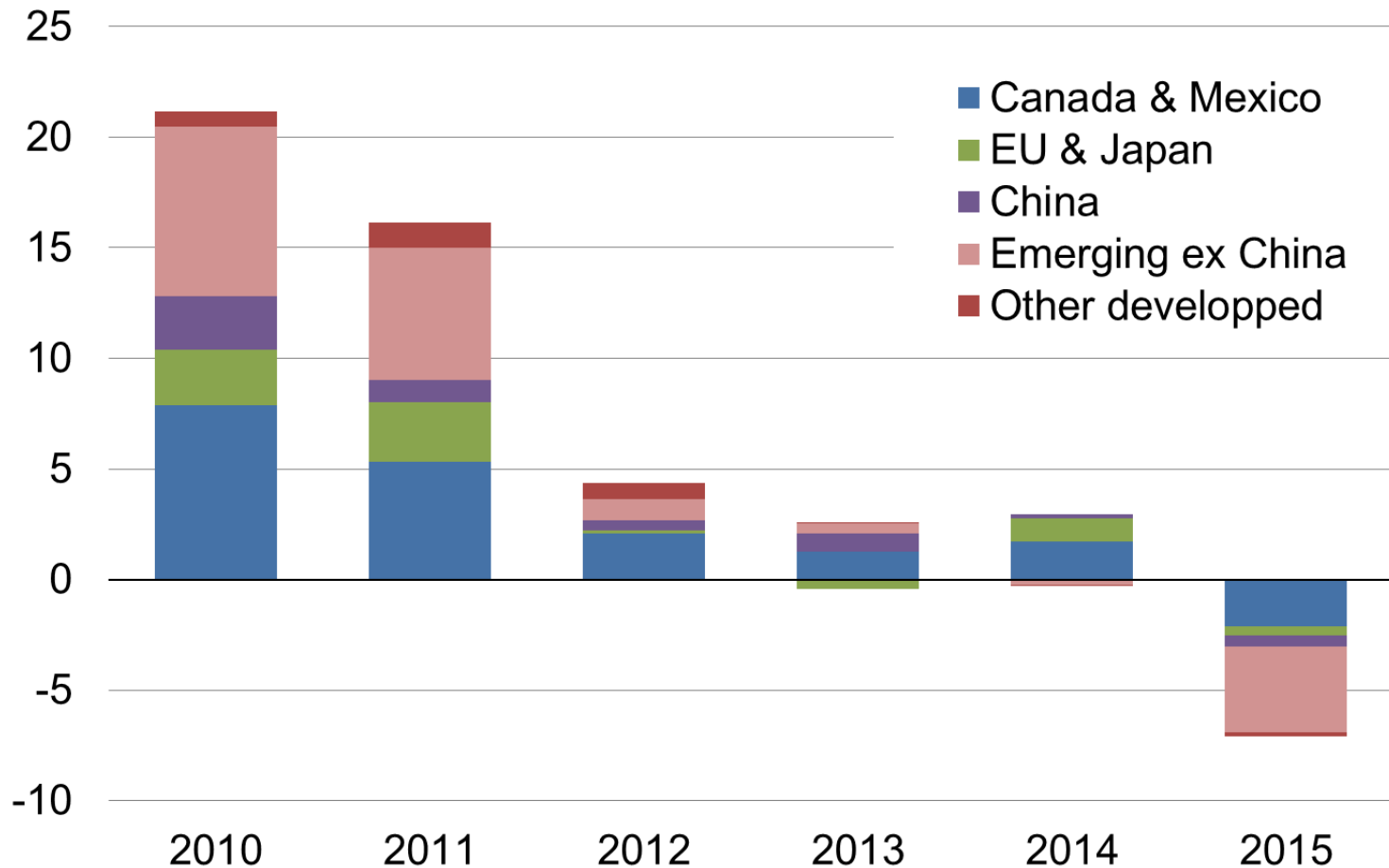


Source: Oxford Economics

# Global headwinds are restraining net exports

## US: The 'emerging markets' threat

Percentage points contribution to US merchandise export growth

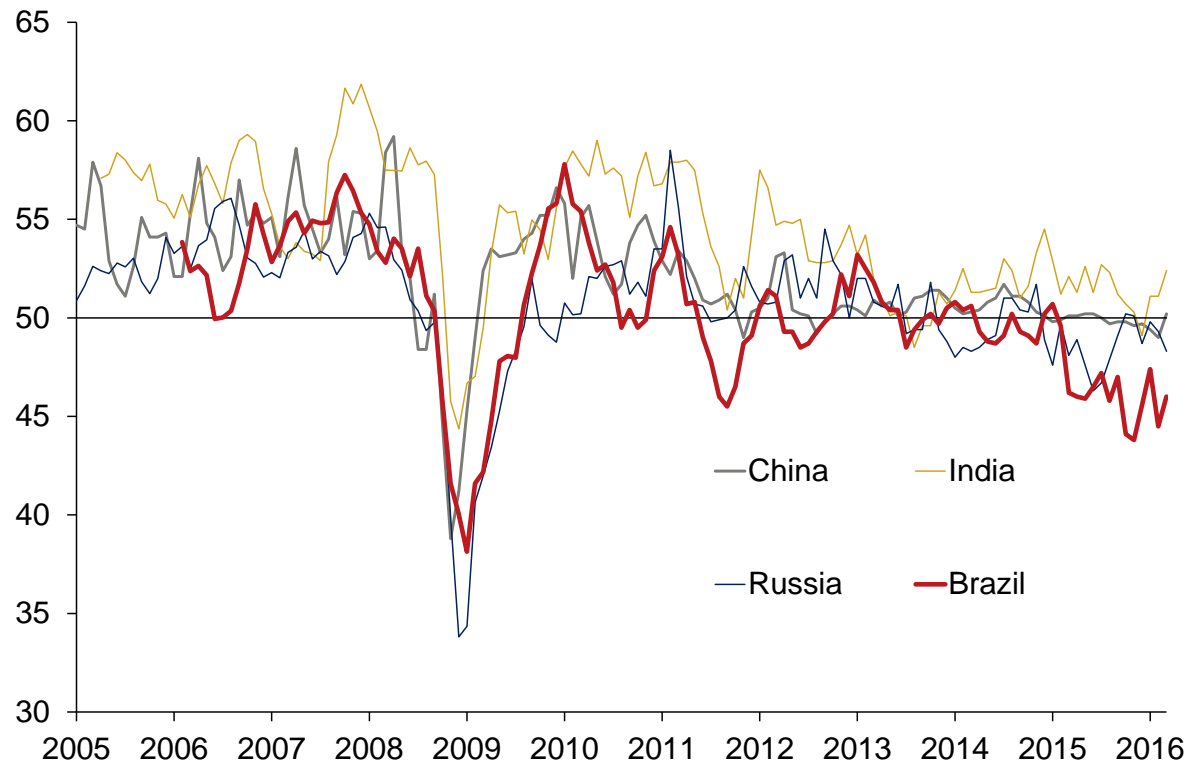


Source: Oxford Economics

# Leading indicators suggest EM weakness

## BRICs: Manufacturing Purchasing Managers' Index

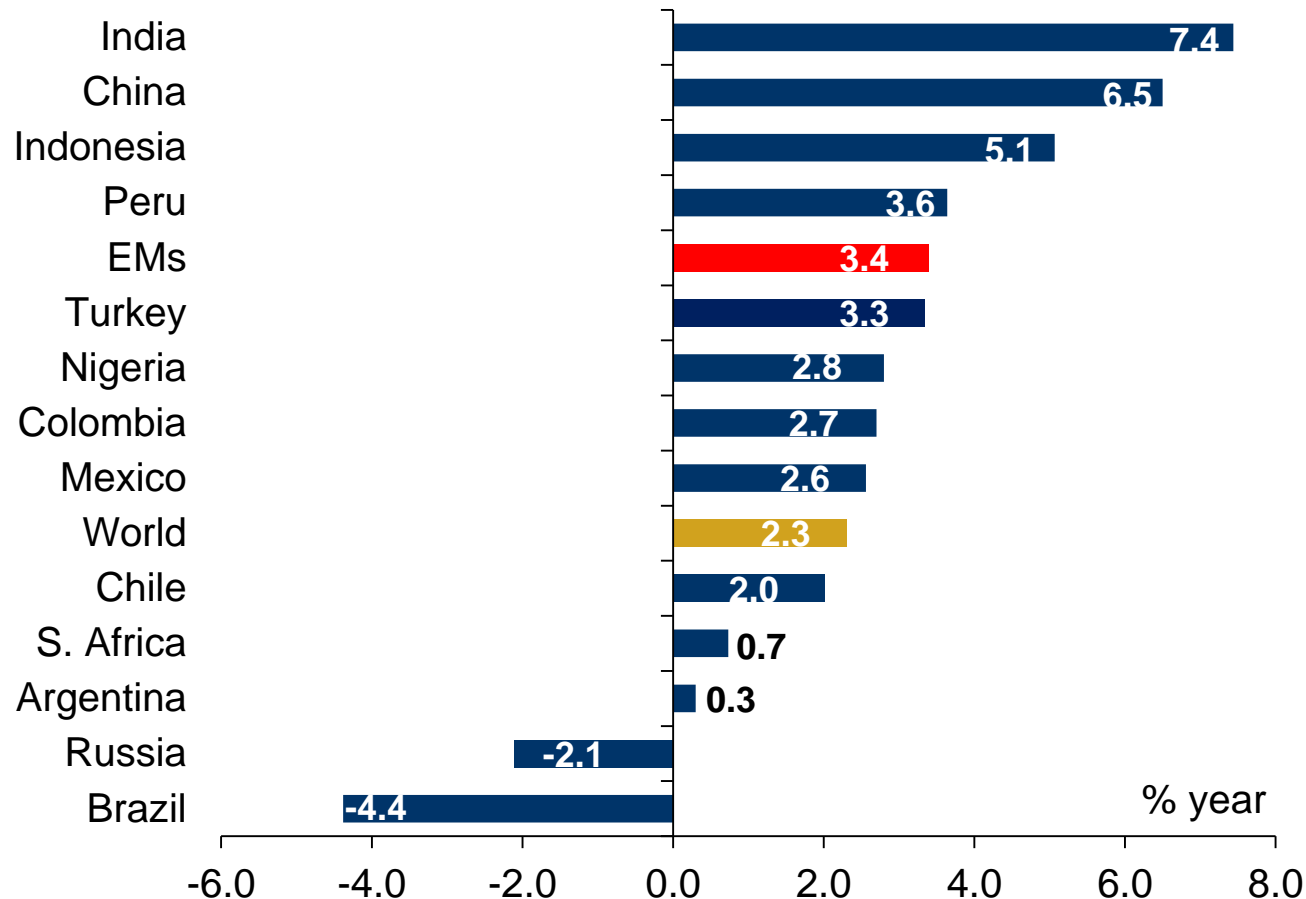
Index, breakeven level=50



Source : PMI/Markit/China NBS/Haver Analytics

# Who are the out/underperformers within EMs?

## Emerging markets: GDP growth (2016)

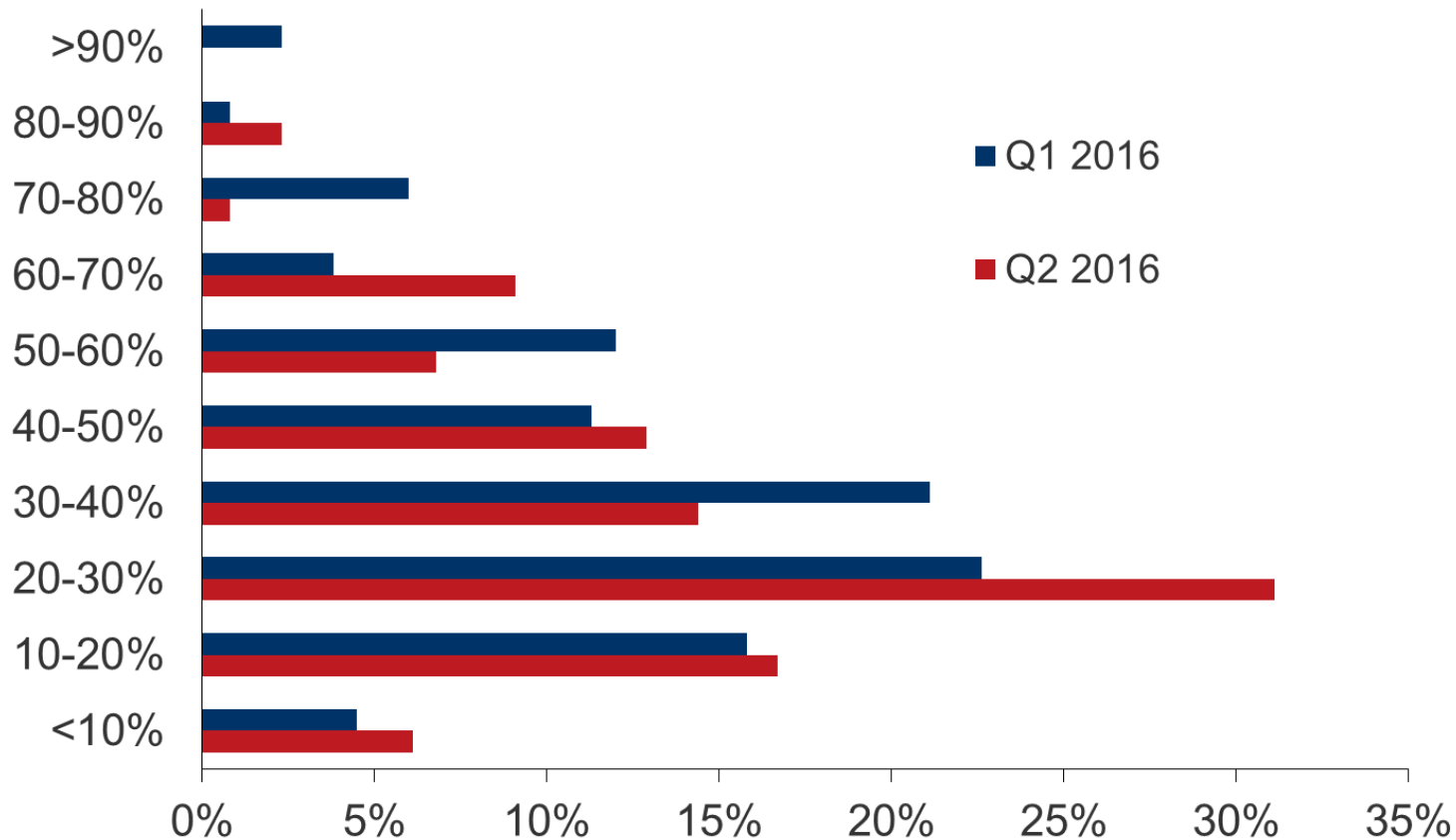


Source: Oxford Economics

# Risks remain skewed to downside...

**What probability do you place on a global downturn or recession over the next two years?**

Percentage of respondents

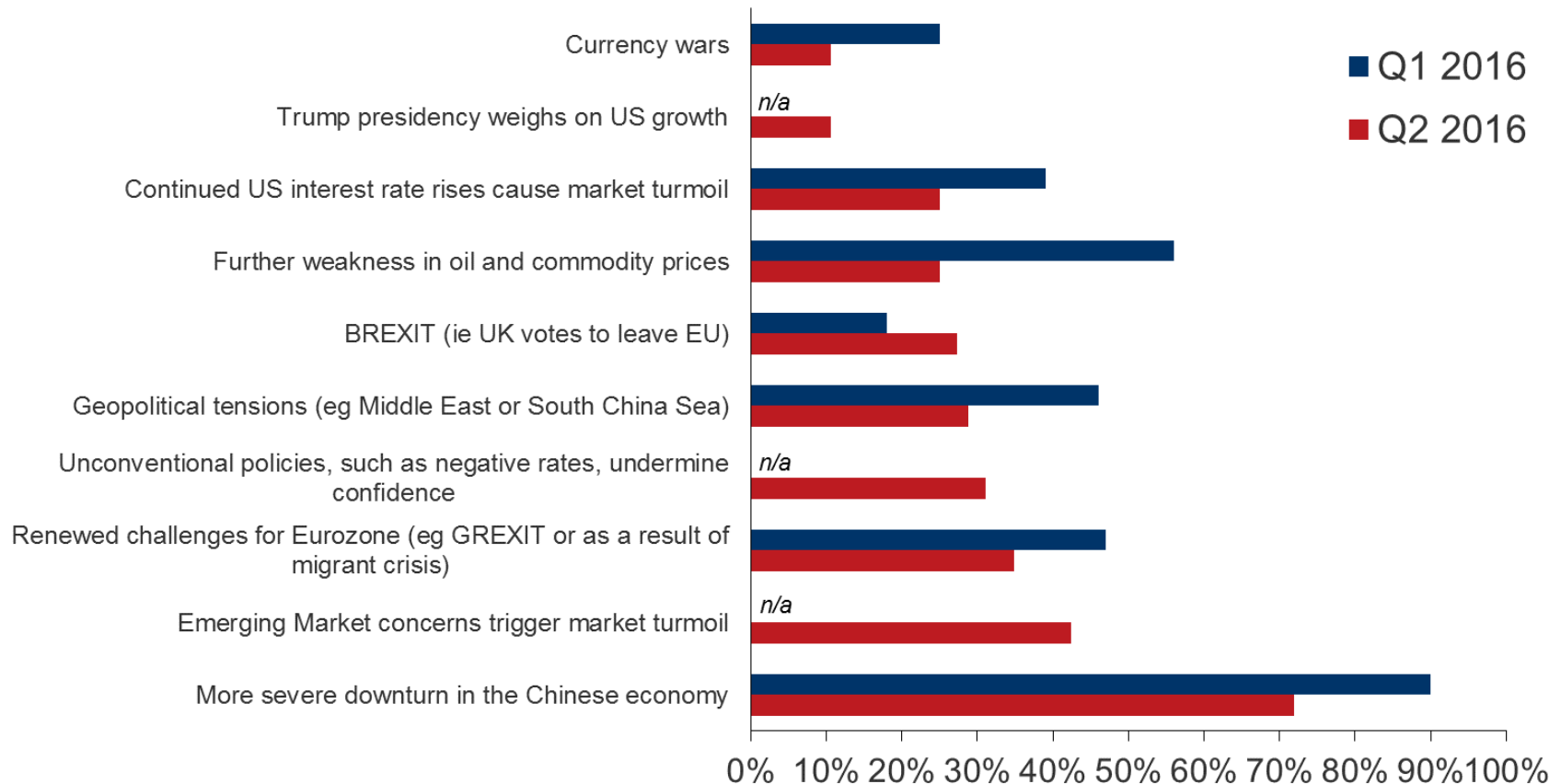


Source : Oxford Economics

# China the biggest concern

## What do you see as the top three downside global economic risks over the next two years?

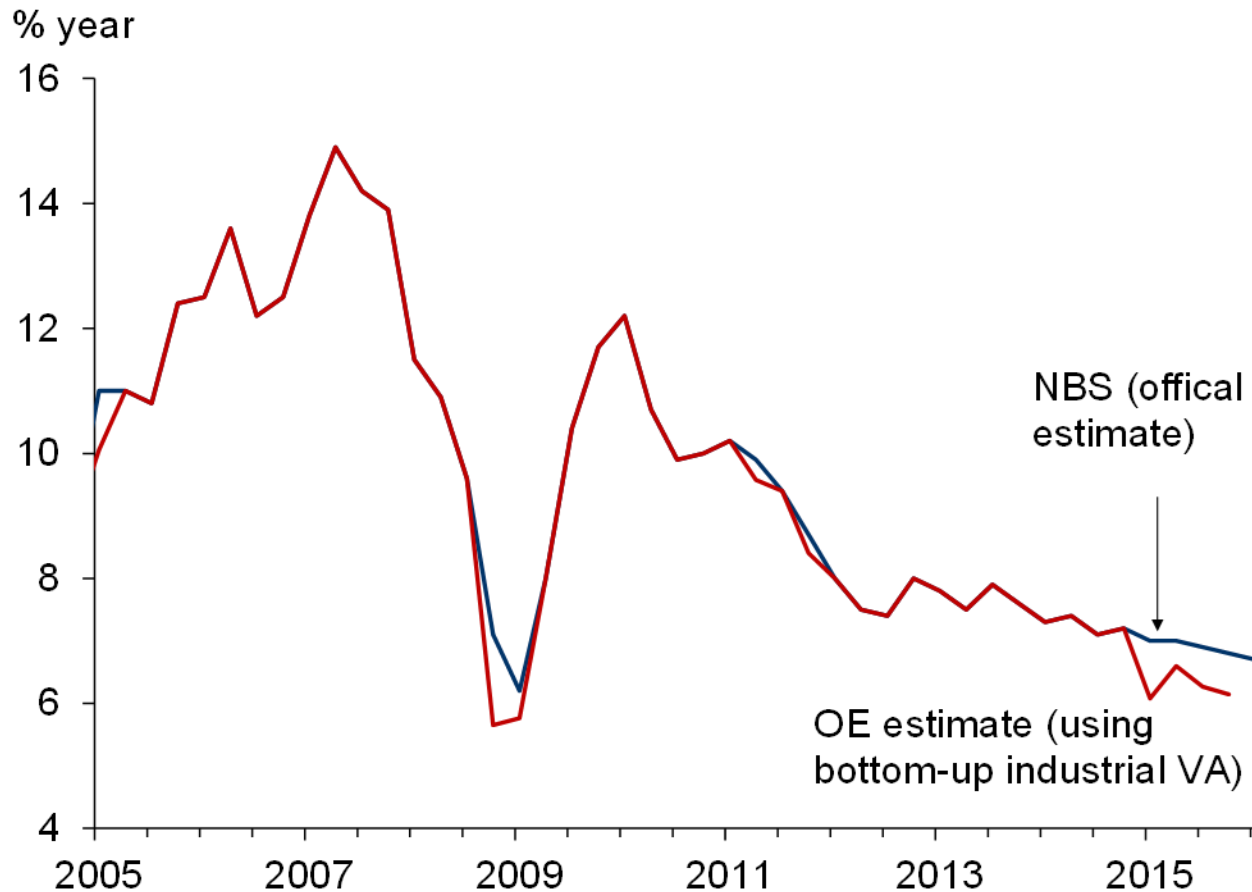
Percentage of respondents citing as a top 3 risk



Source : Oxford Economics Global Risk Survey

# Real growth slowed more than NBS data show

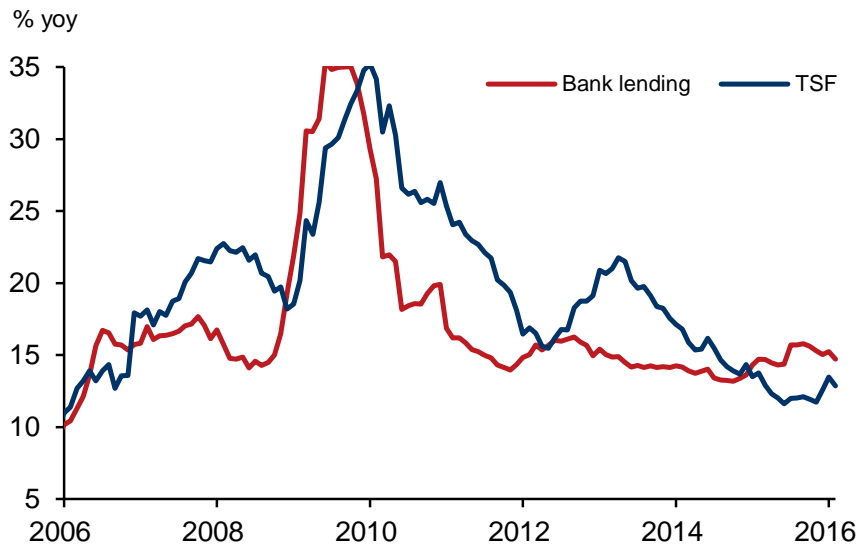
## China: GDP growth estimates



Source: Oxford Economics/Haver Analytics

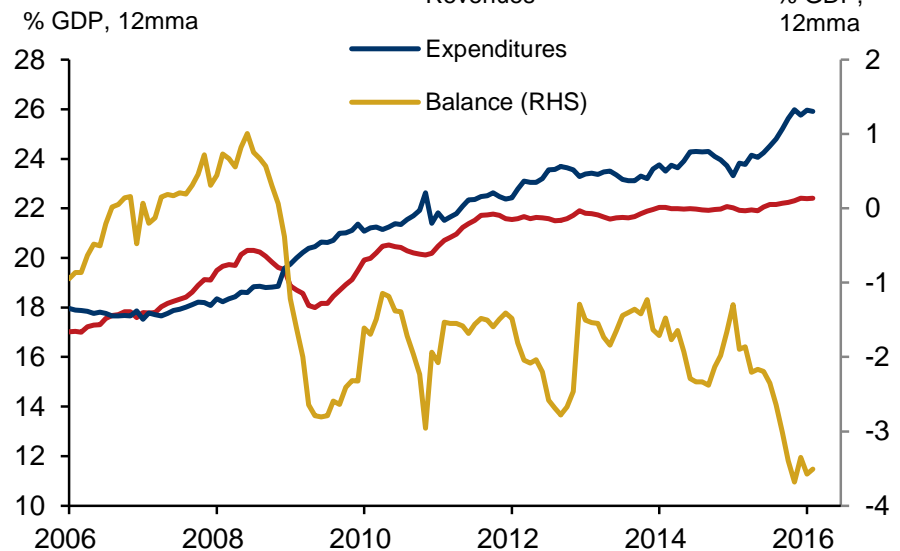
# China: Generous monetary and fiscal policy

## Bank lending and total social financing



Source: Oxford Economics, CEIC Data

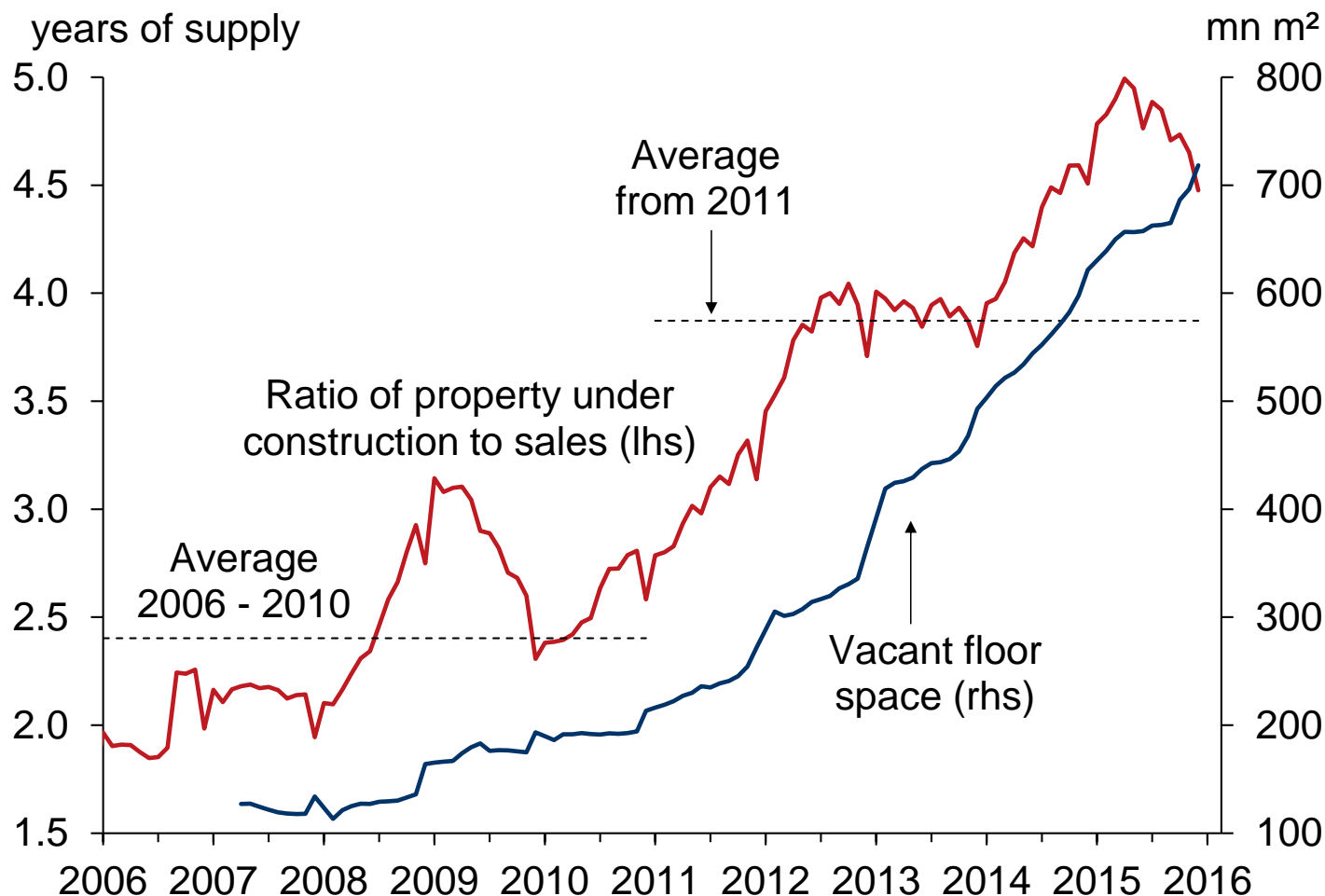
## Fiscal policy



Source: Oxford Economics, CEIC Data

# Excess supply in real estate significant...

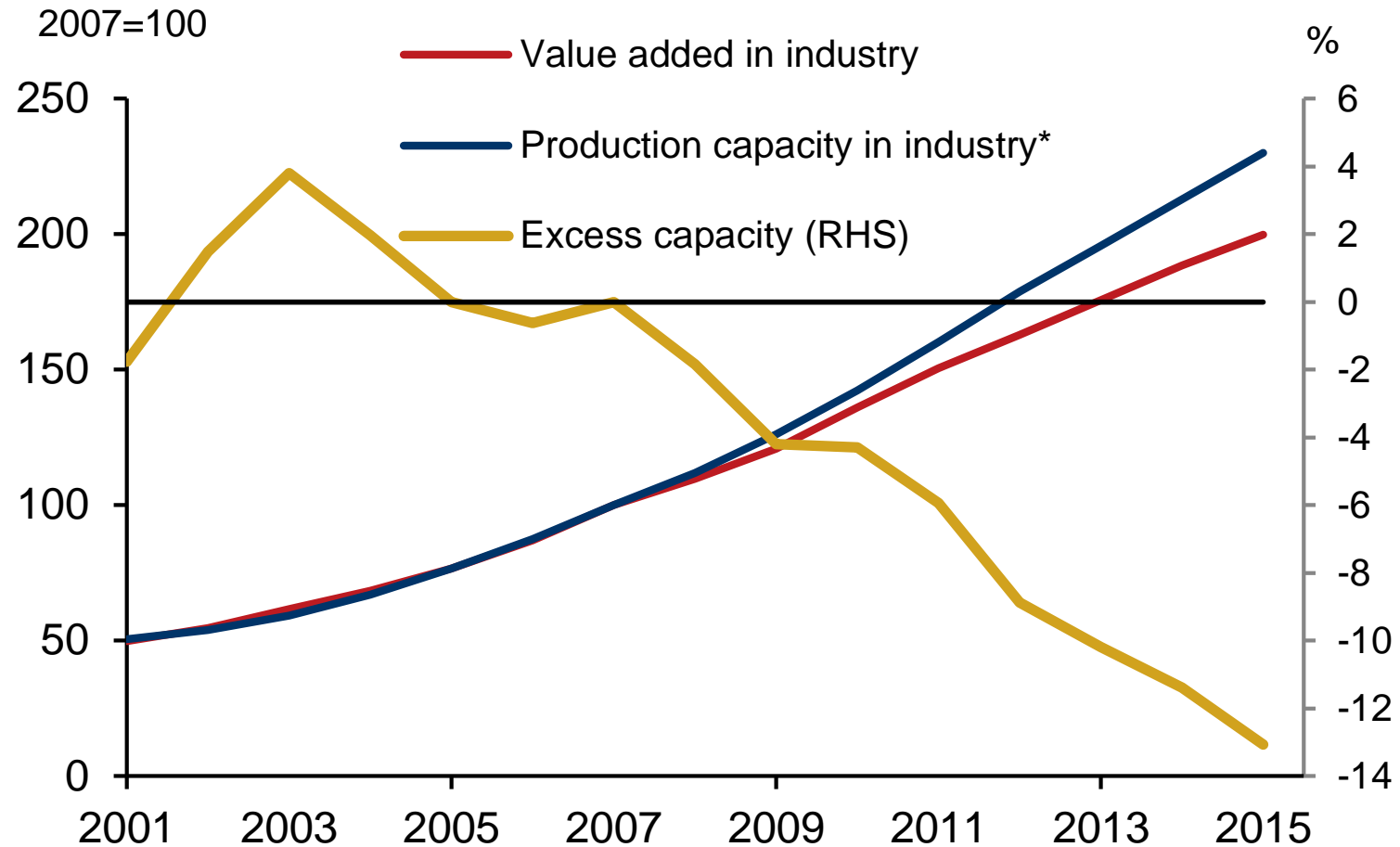
## China: Excess supply in the real estate sector



Source : Oxford Economics/Haver Analytics

# ...and excess capacity in industry still on the rise

## Production and capacity in industry



Source: Oxford Economics, CEIC Data

\* From growth accounting

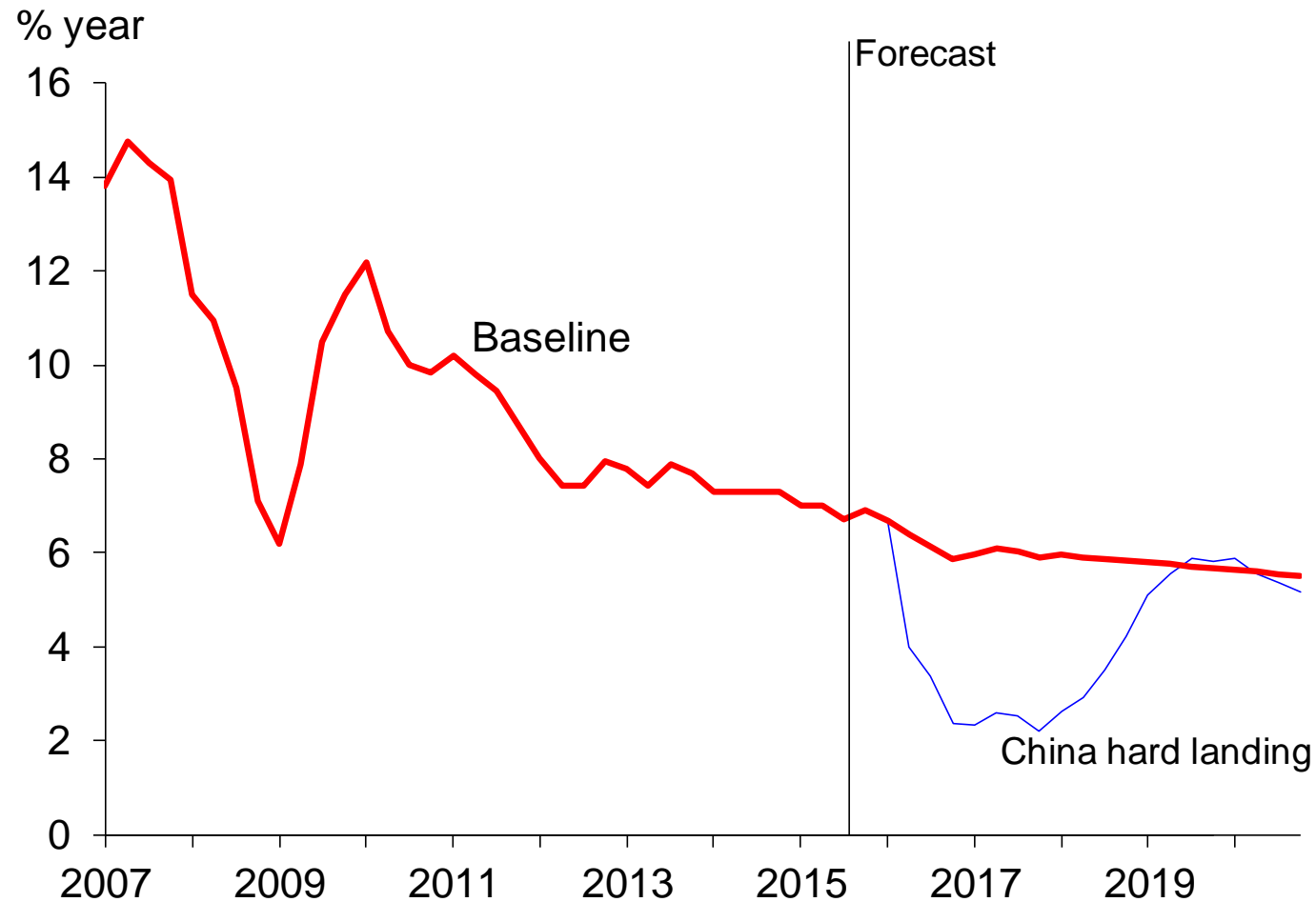
# Our modelling expertise sets us apart

- Oxford Economics has developed the world's leading globally integrated economic model, relied on by over **150 leading organisations** around the world.
- Our model replicates the world economy by interlinking **46 countries, 6 regional blocs and the Eurozone**. It is available with 5, 10 and 25-year forecasting horizon.
- **29 additional country models** being added from May.
- The global economic model feeds into a series of **industry, sub-regional and city models**. So, you can quantify the impact of global events on a consistent basis down to your industry and local markets.
- **Our team of 150 economists** set underlying global assumptions and ensure that the data, forecasts and formulas in these models are fully up-to-date.



# Chinese hard landing

## China: GDP

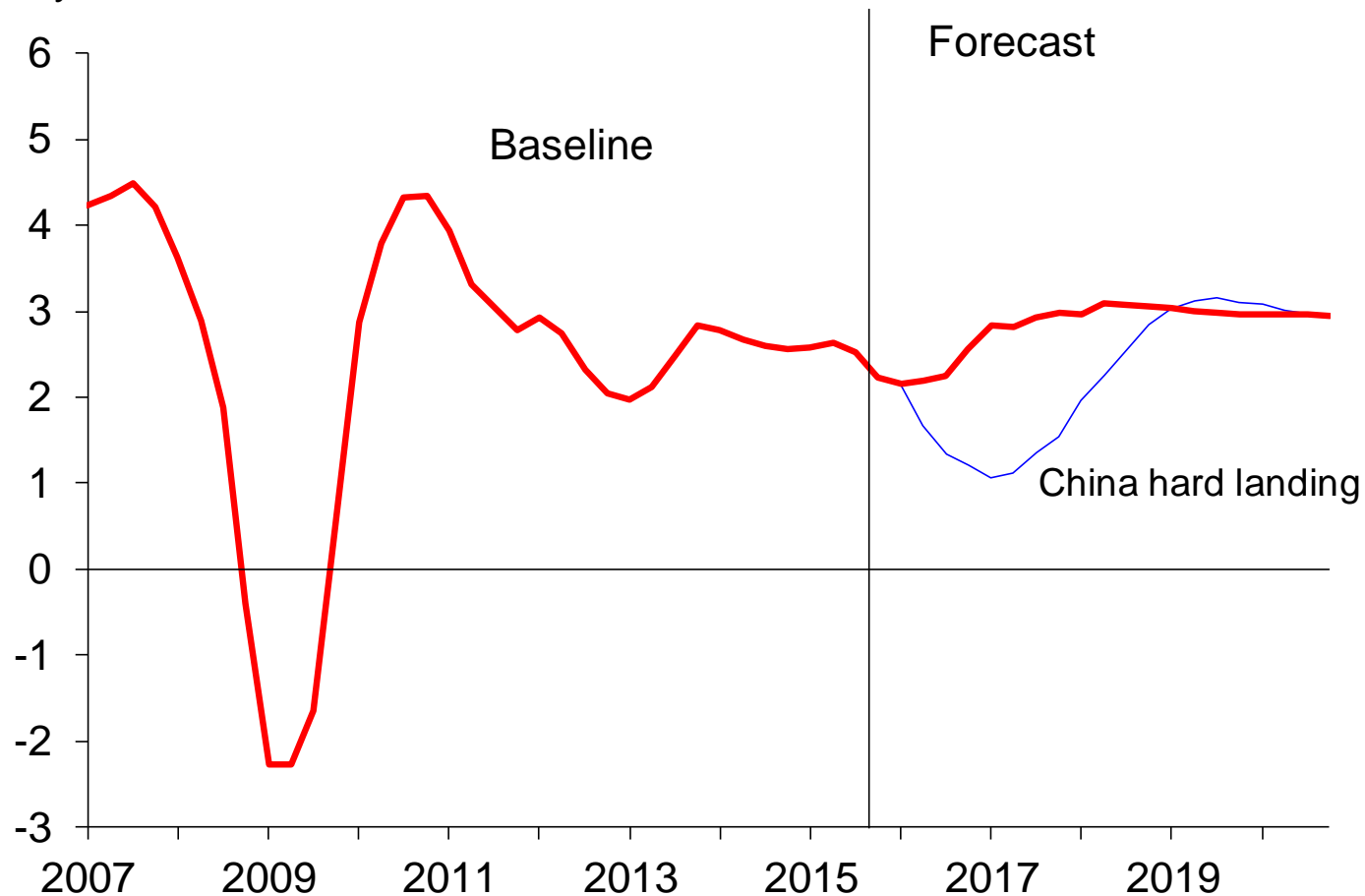


Source : Oxford Economics/Haver Analytics

# Chinese hard landing

## World: GDP

% year

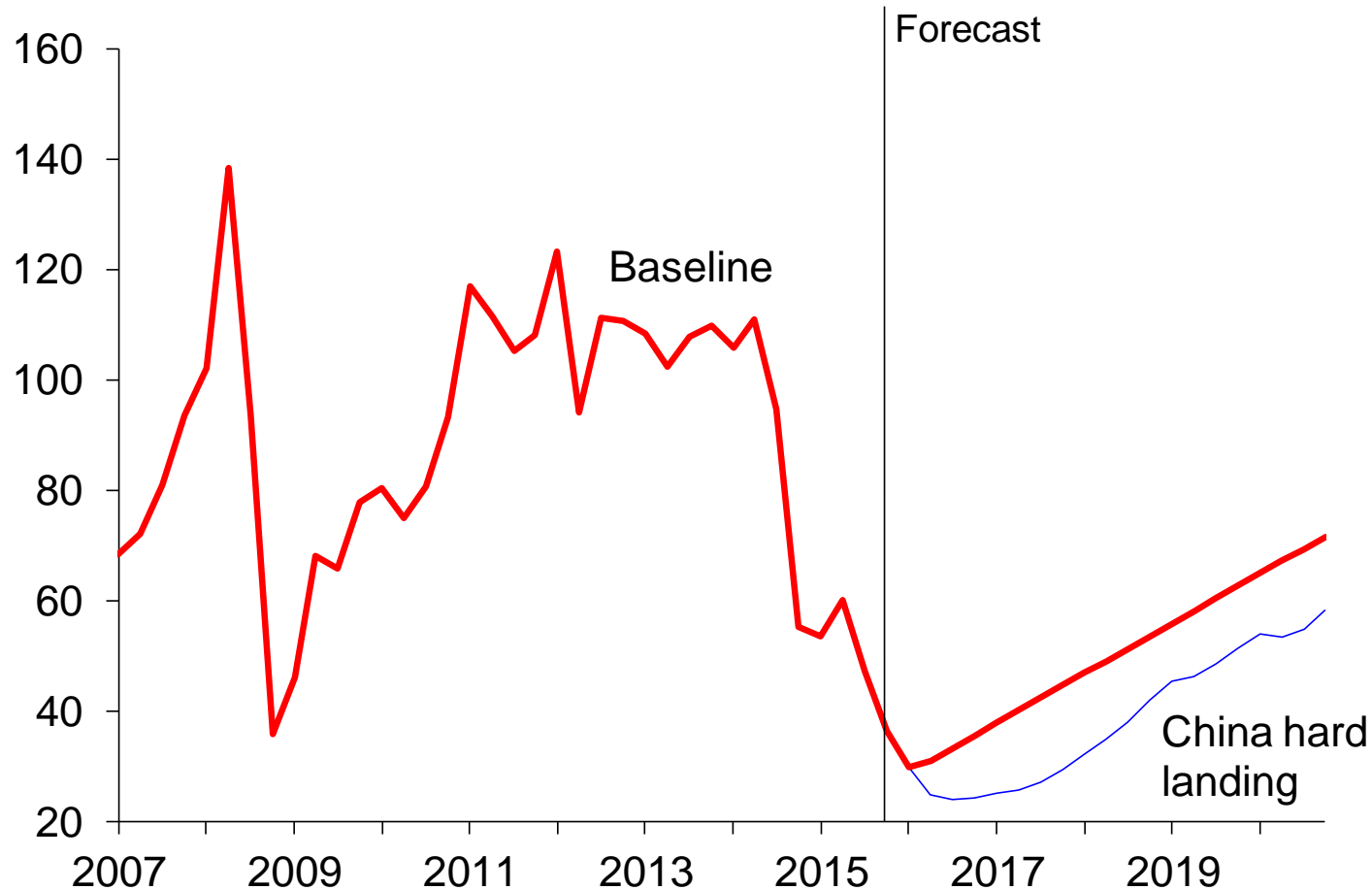


Source : Oxford Economics/Haver Analytics

# Chinese hard landing

## World oil price

\$/barrel

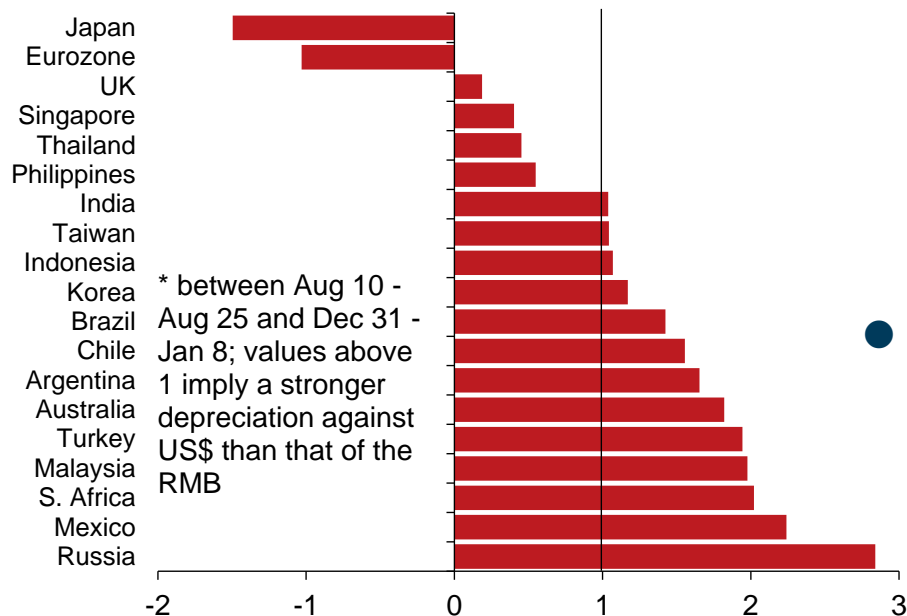


Source : Oxford Economics/Haver Analytics

# Chinese hard landing

## World: Exchange rates vs US\$

average % change relative to change in USDCNY \*



\* between Aug 10 -  
Aug 25 and Dec 31 -  
Jan 8; values above  
1 imply a stronger  
depreciation against  
US\$ than that of the  
RMB

Source : Oxford Economics / Haver Analytics

## ● The domestic policy response

- Chinese authorities embark on a range of actions, including faster policy rate cuts and currency devaluation

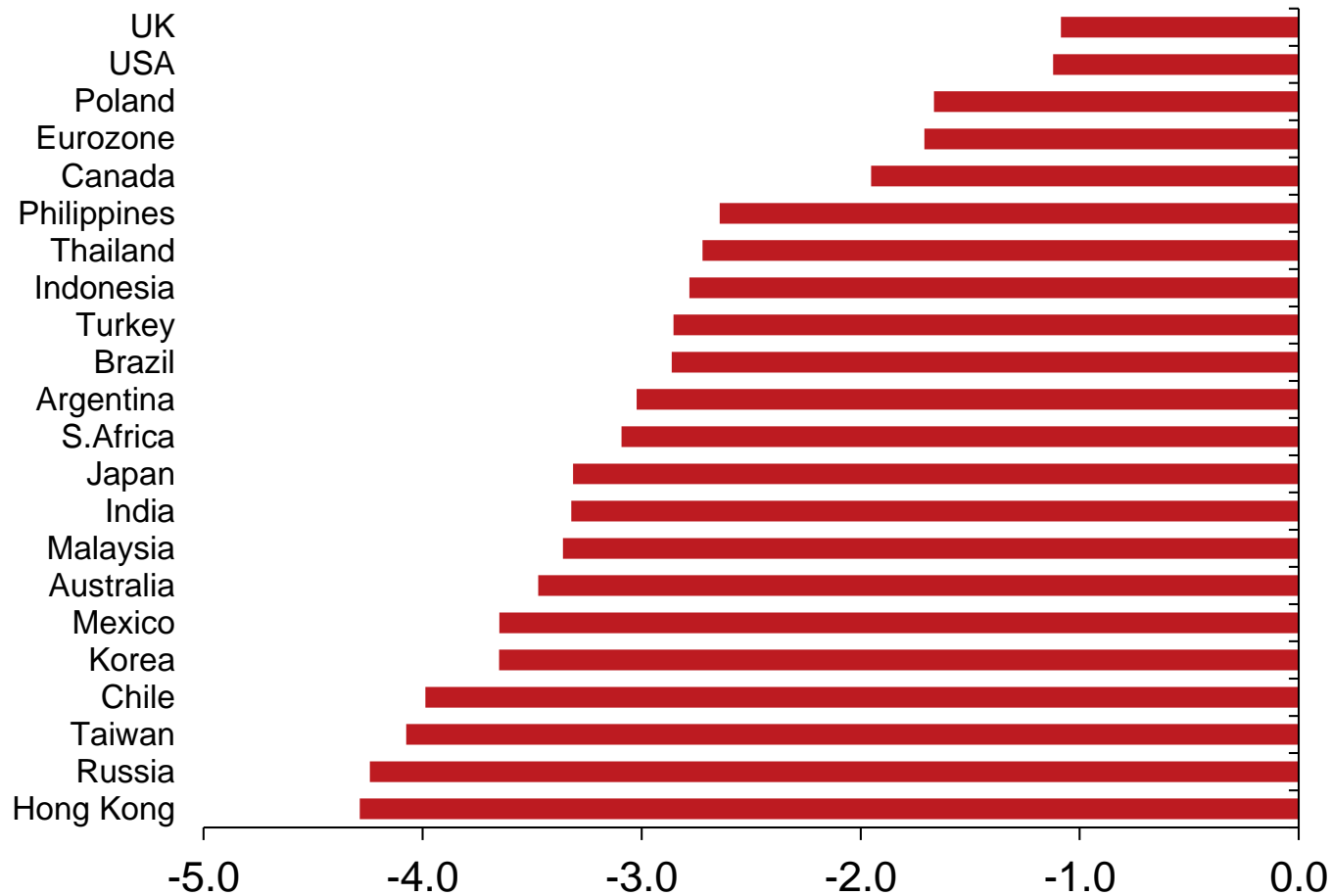
## ● Global impact and policy actions

- The slowdown weighs on world trade, commodity prices and other asset prices – and global monetary policy adjusts accordingly
- Global exchange rates adjust sharply in line with recent episodes of stronger RMB weakening

# Asia and commodity producers hit hardest

## World: GDP in downside scenario

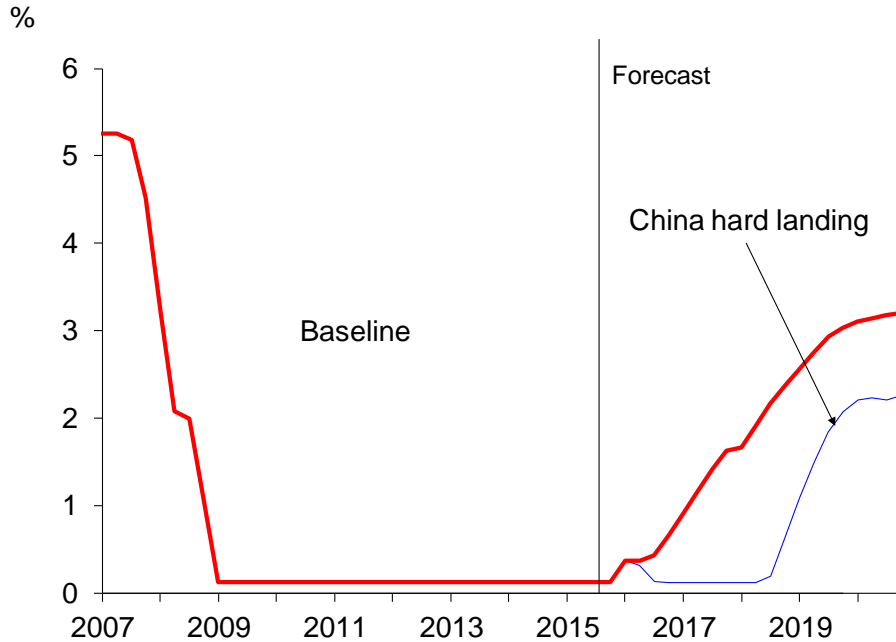
% difference in level of GDP versus baseline, 2017



Source : Oxford Economics

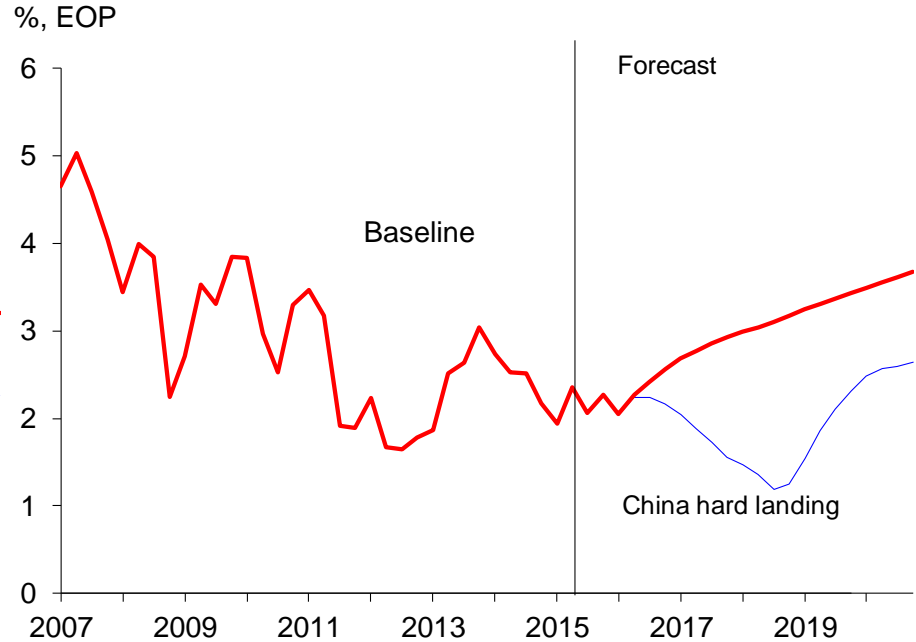
# US Treasury yields fall below 2%

## US: Federal funds rate



Source : Oxford Economics/Haver Analytics

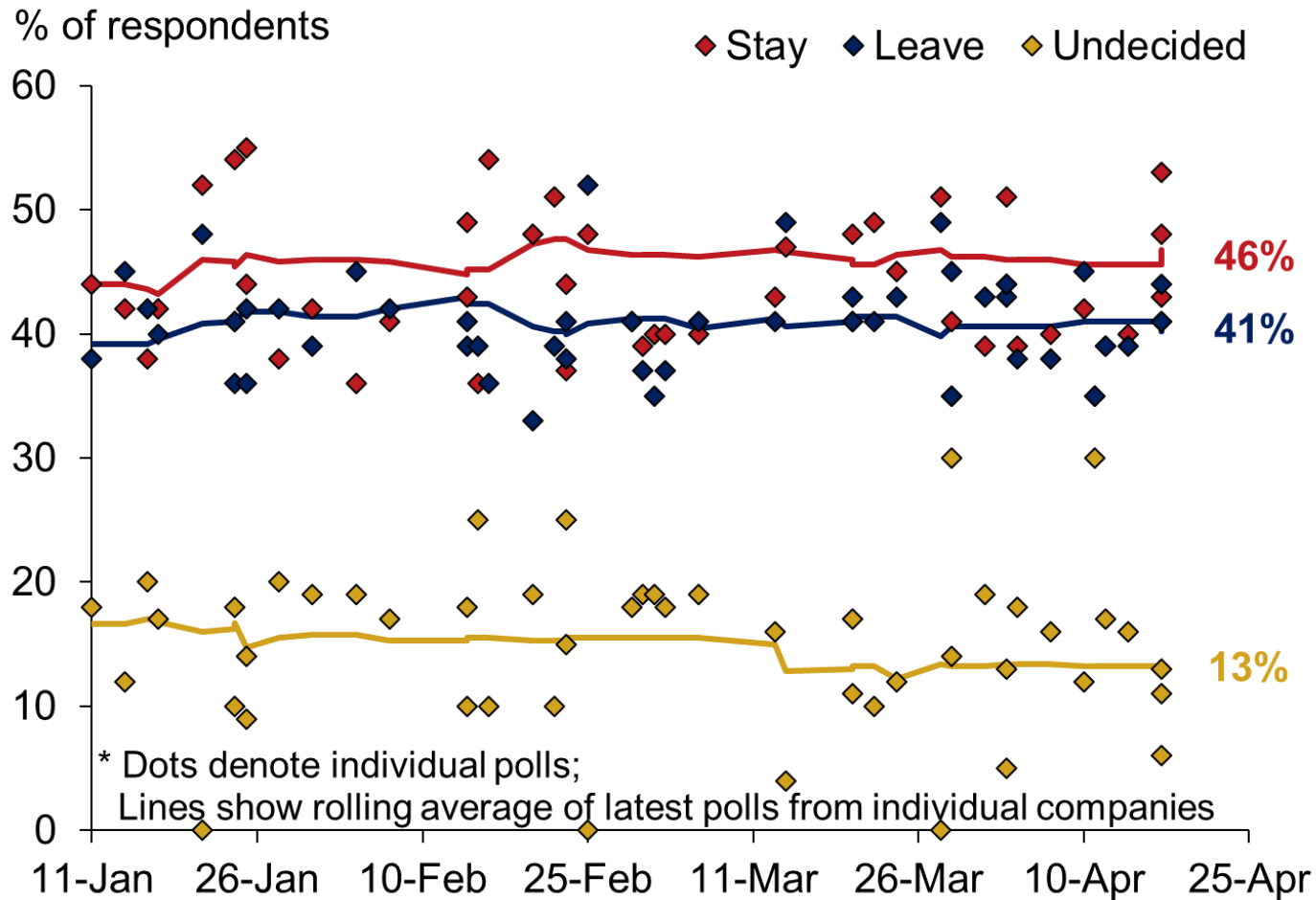
## US: 10-year government bond yields



Source : Oxford Economics/Haver Analytics

# 'Remain' enjoy a narrow lead in the polls

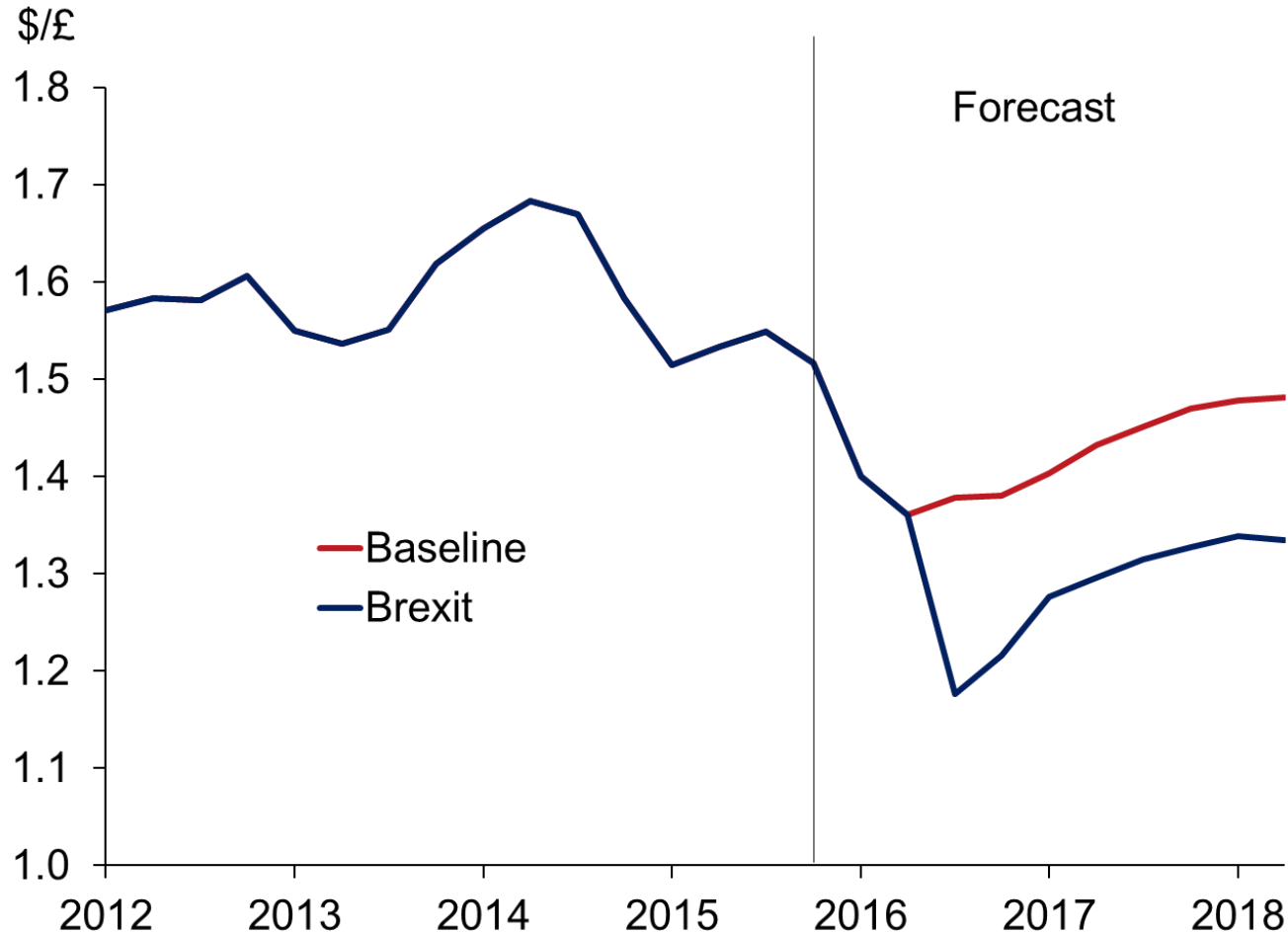
## UK: Opinion polls on Brexit\*



Source : Financial Times EU referendum poll of polls

# Option prices imply 15% depreciation post-Brexit

## UK: \$/£ exchange rate

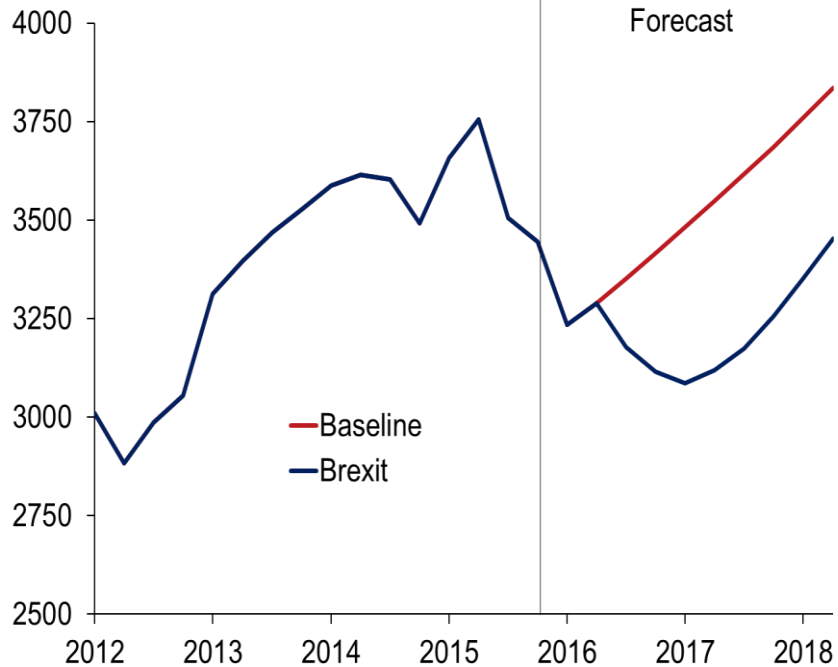


Source : Oxford Economics

# Investor & corporate confidence would be hit

## UK: FTSE all share index

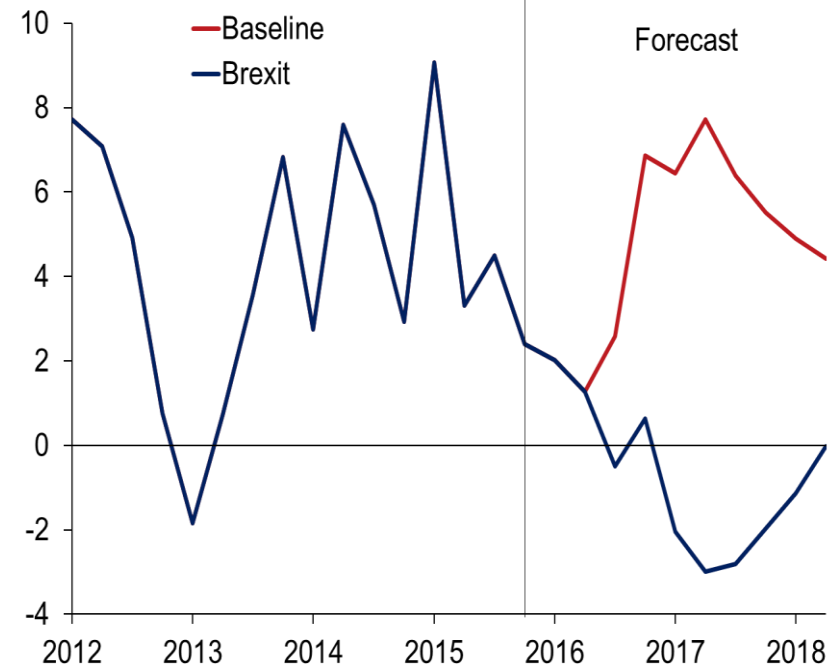
10 April 1962 = 100



Source : Oxford Economics

## UK: Business investment

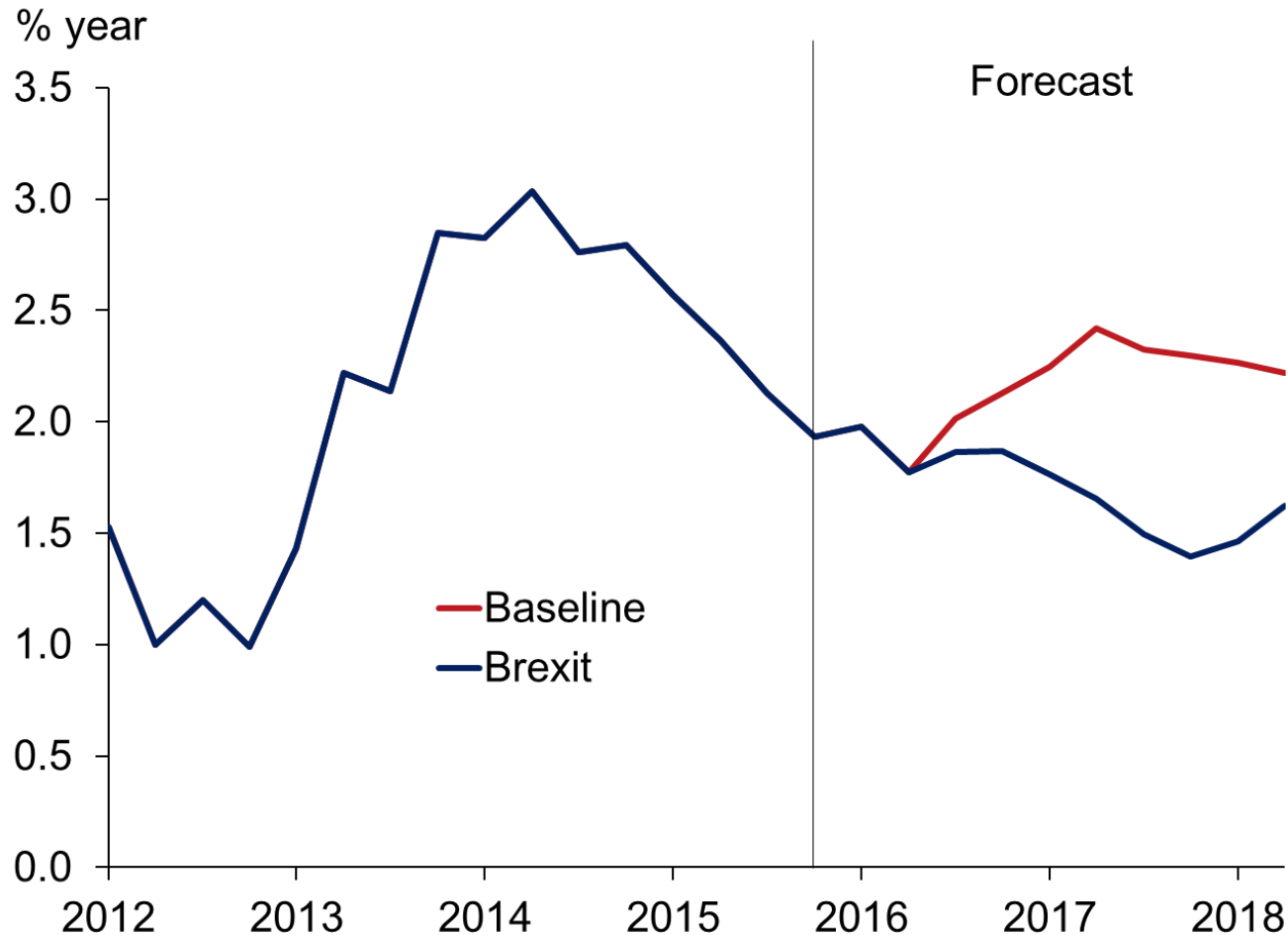
% year



Source : Oxford Economics

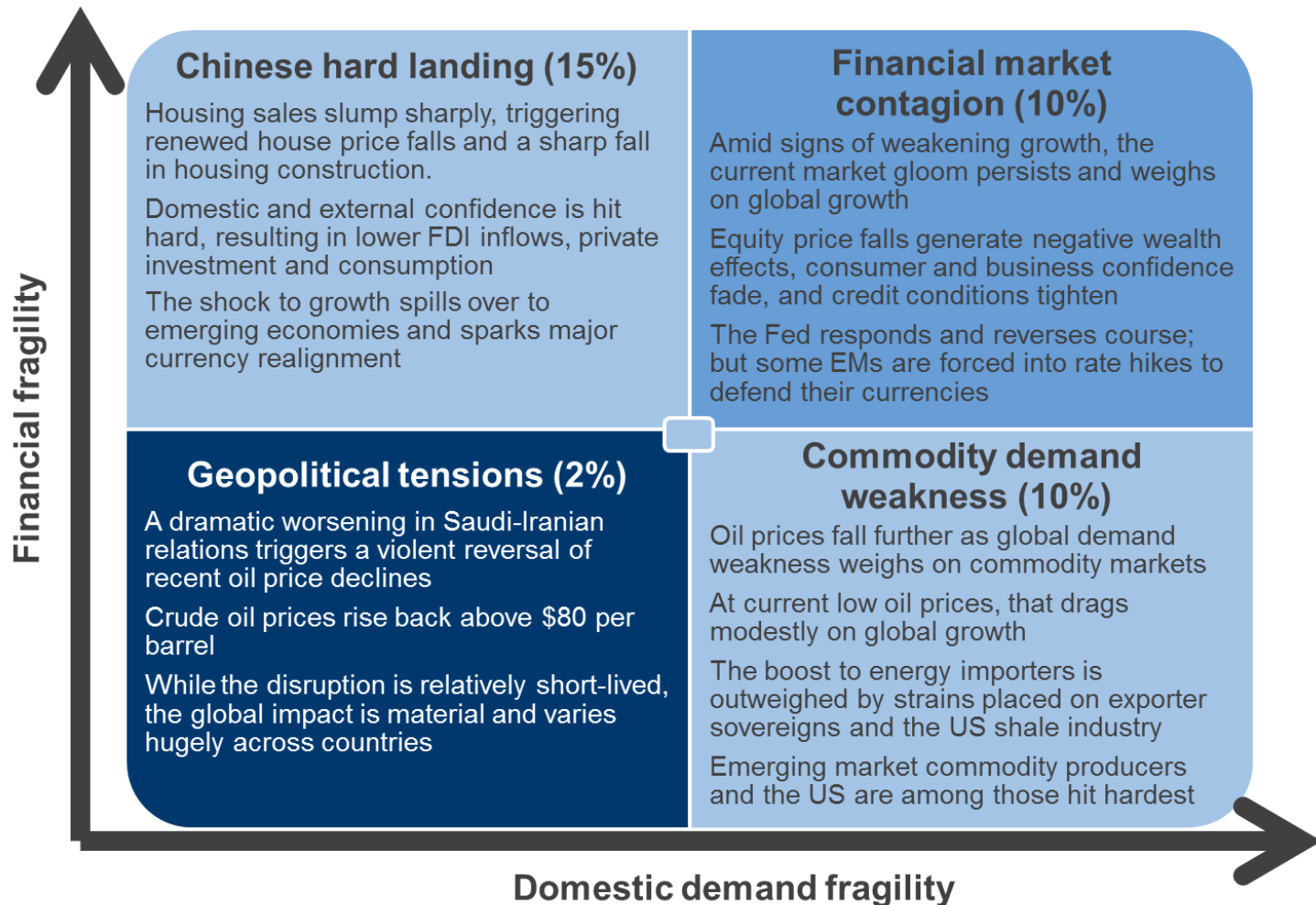
# GDP impact: noticeable but not catastrophic

## UK: GDP growth



Source : Oxford Economics

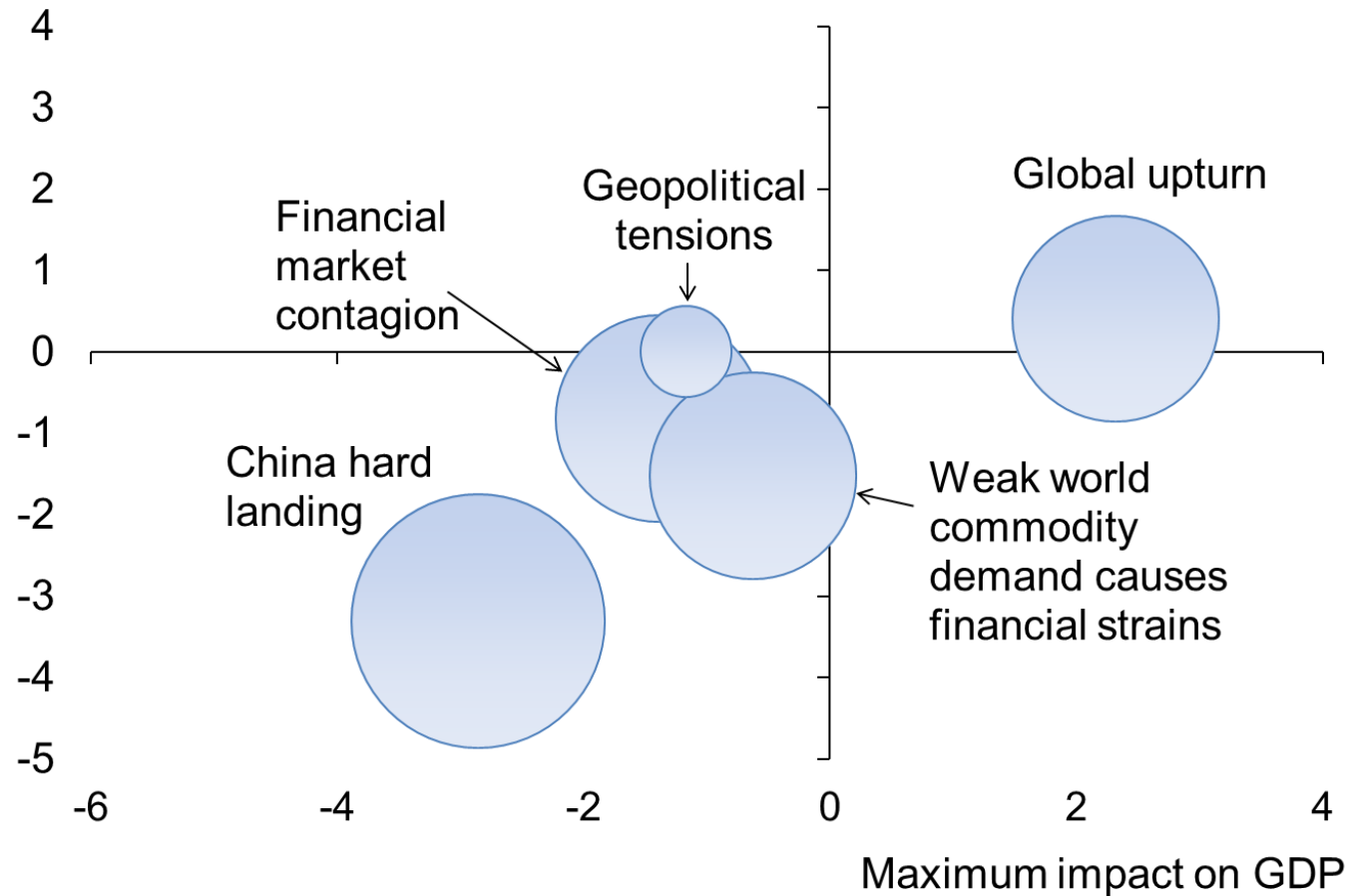
# Risks remain skewed to downside...



# ...with significant real economy implications

## Global scenarios

Maximum impact on prices

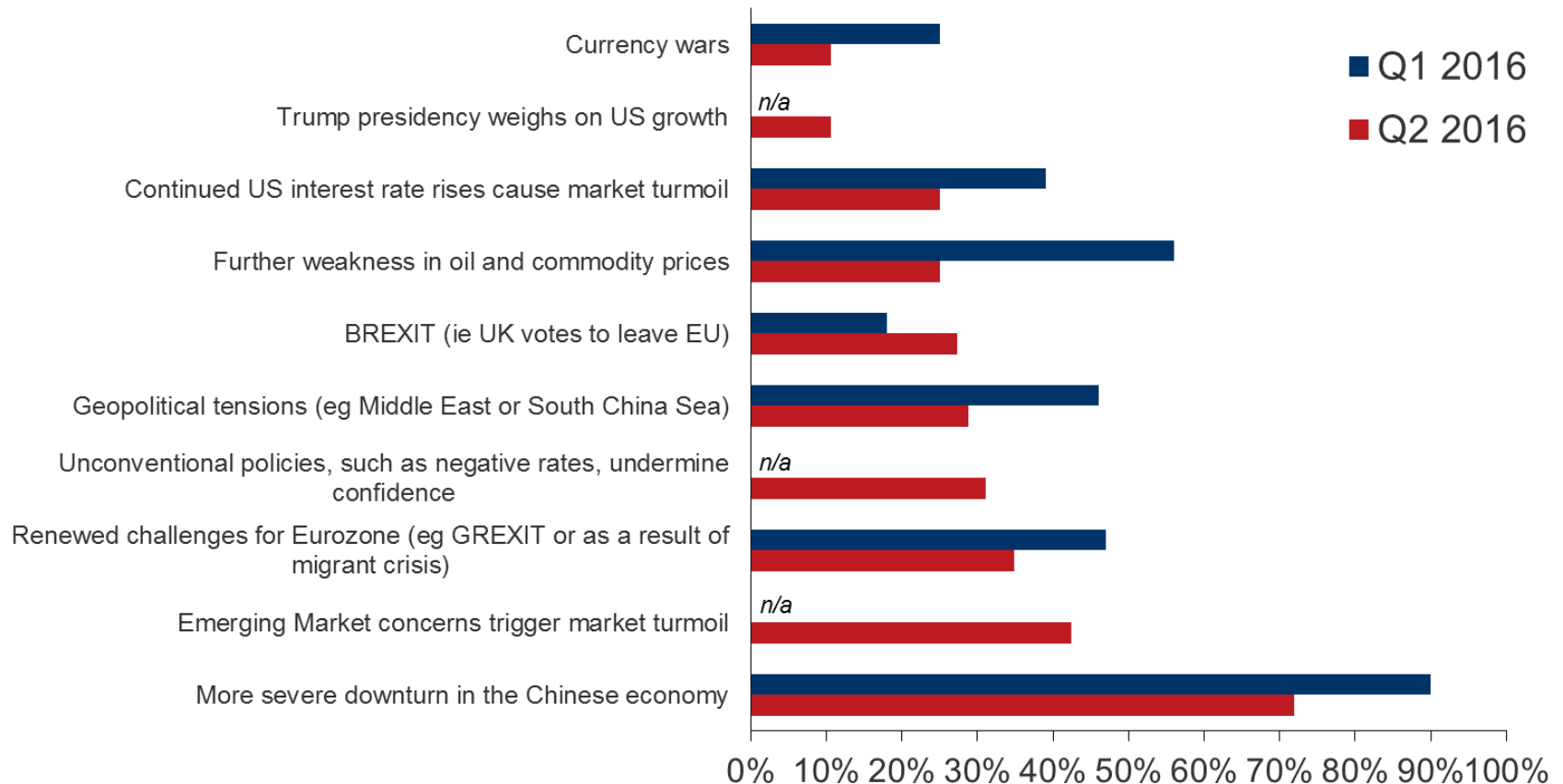


Source : Oxford Economics

# China the biggest concern

## What do you see as the top three downside global economic risks over the next two years?

Percentage of respondents citing as a top 3 risk



Source : Oxford Economics Global Risk Survey

# Trump: trade protectionism

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**Estimated negative impact from Trumps' proposed trade tariffs  
(% change in levels vs our base case of no new tariffs)**

<u>Year</u>	<u>GDP</u>	<u>Employment</u>	<u>Consumer</u> <u>Spending</u>	<u>Inflation *</u>
2020	-1.6	-0.9	-2.2	3.5

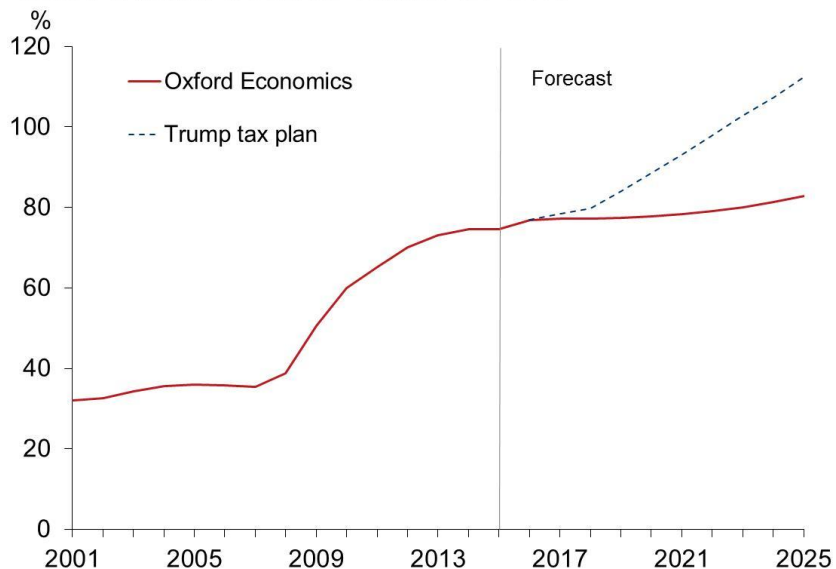
Source: Oxford Economics

\* Inflation rate under scenario (base case 2.3%)

- The risk of a global trade war would unfold, which would yield much more negative implications than our scenario illustrates.

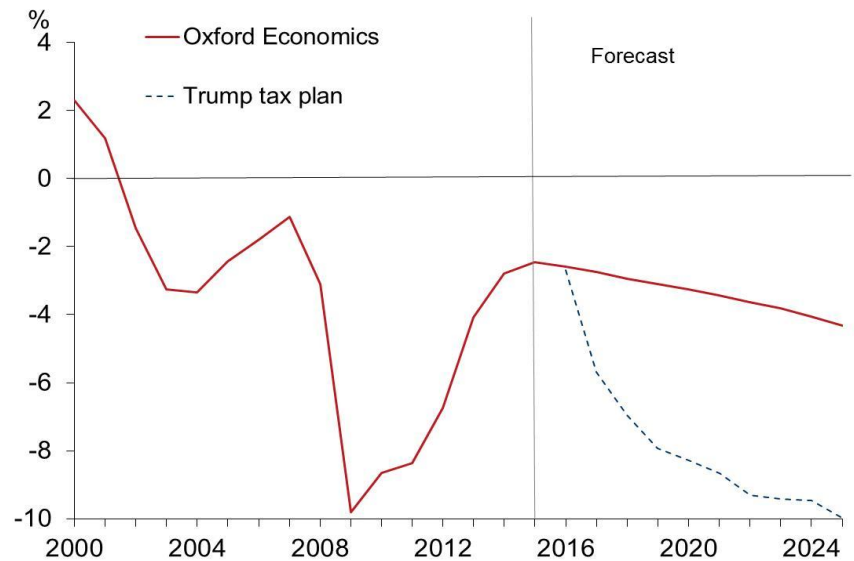
# Trump: tax

**US: Federal debt as share of GDP**



Source: Oxford Economics/Haver Analytics/Tax Policy Center

**US: Federal deficit as a share of GDP**



Source: Oxford Economics/Haver Analytics/Tax Policy Center

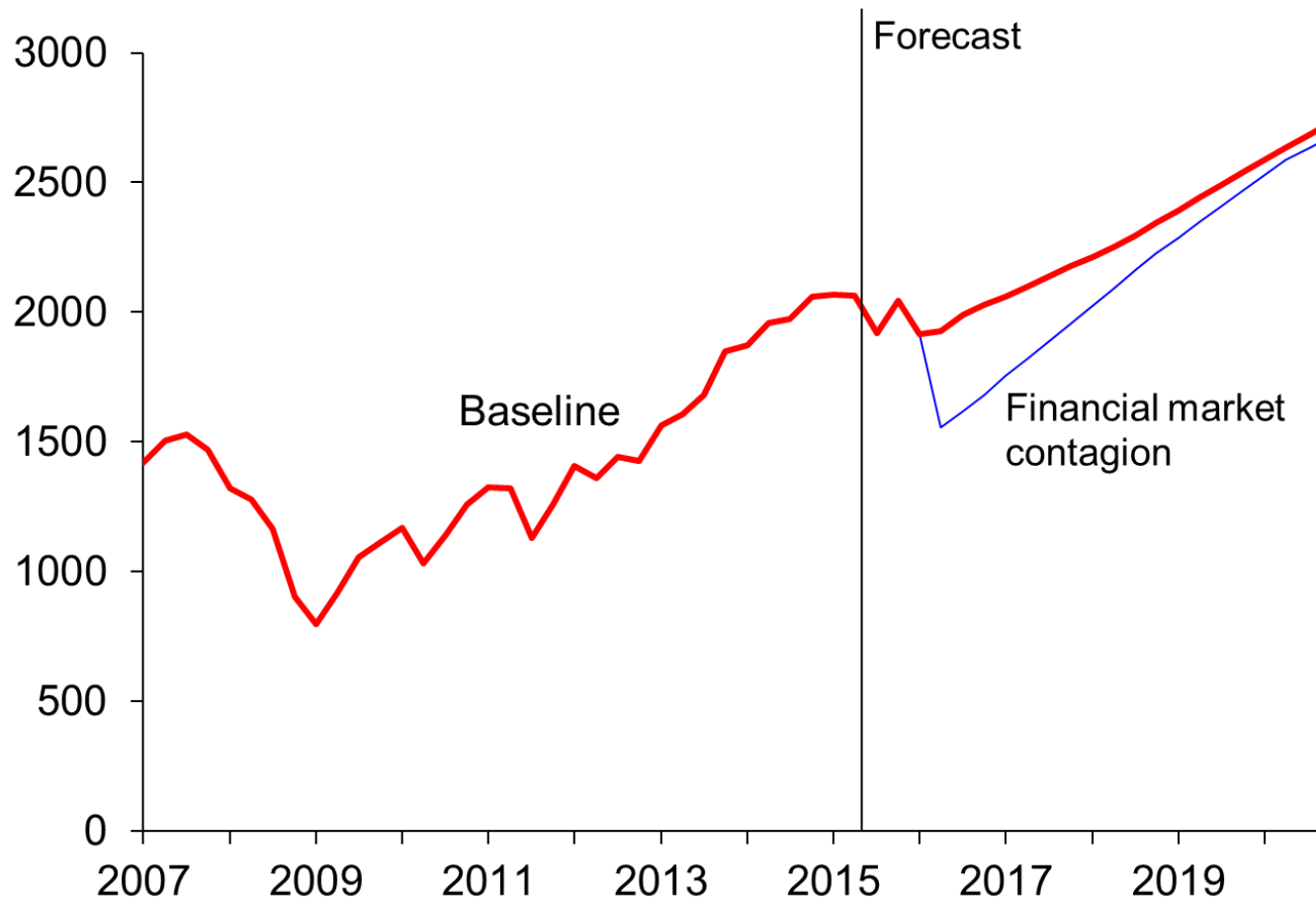
# Financial market contagion

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# Financial market contagion

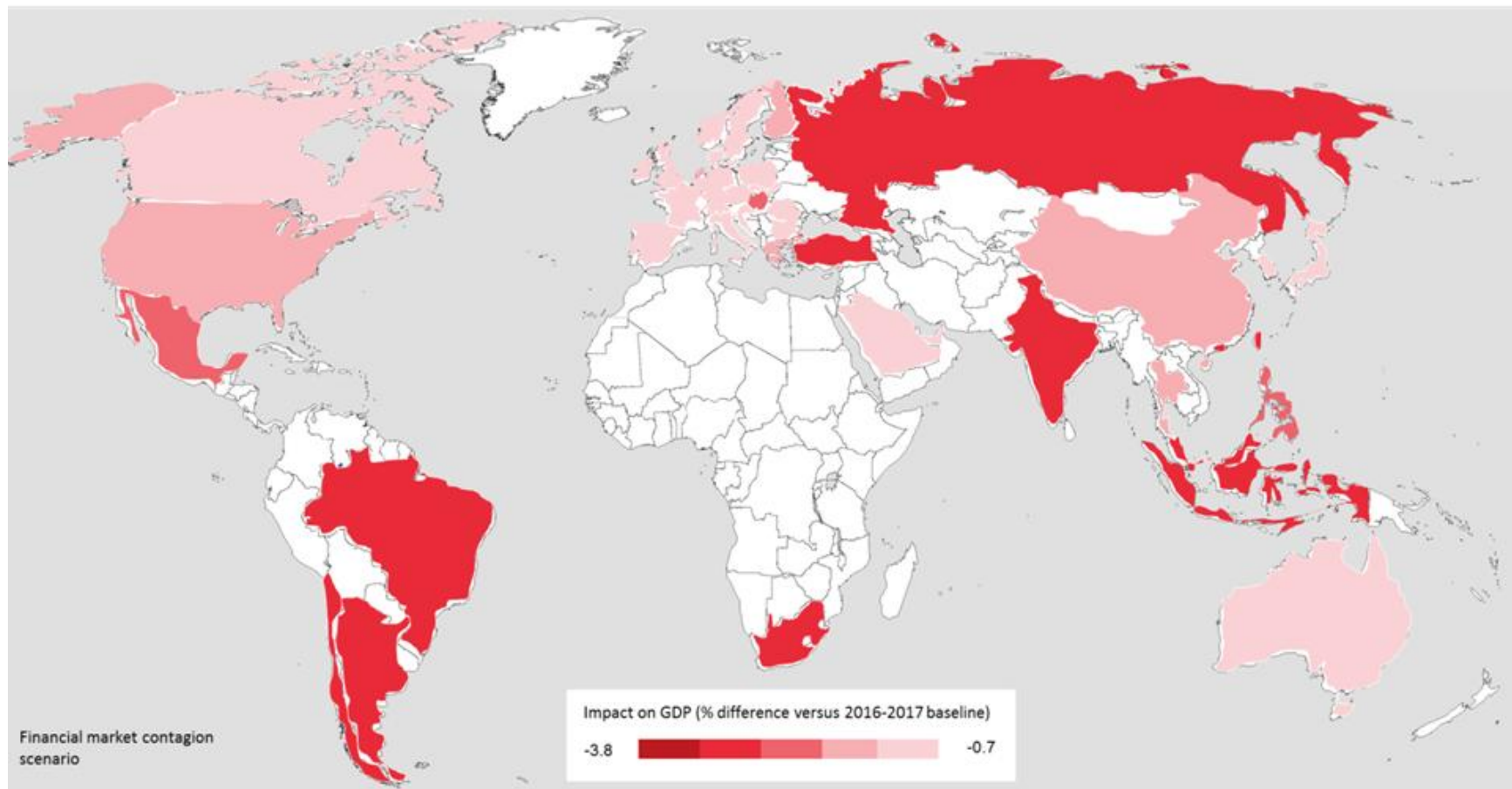
## US: Equity

S&P 500 composite index, EOP



Source : Oxford Economics/Haver Analytics

# Financial market contagion

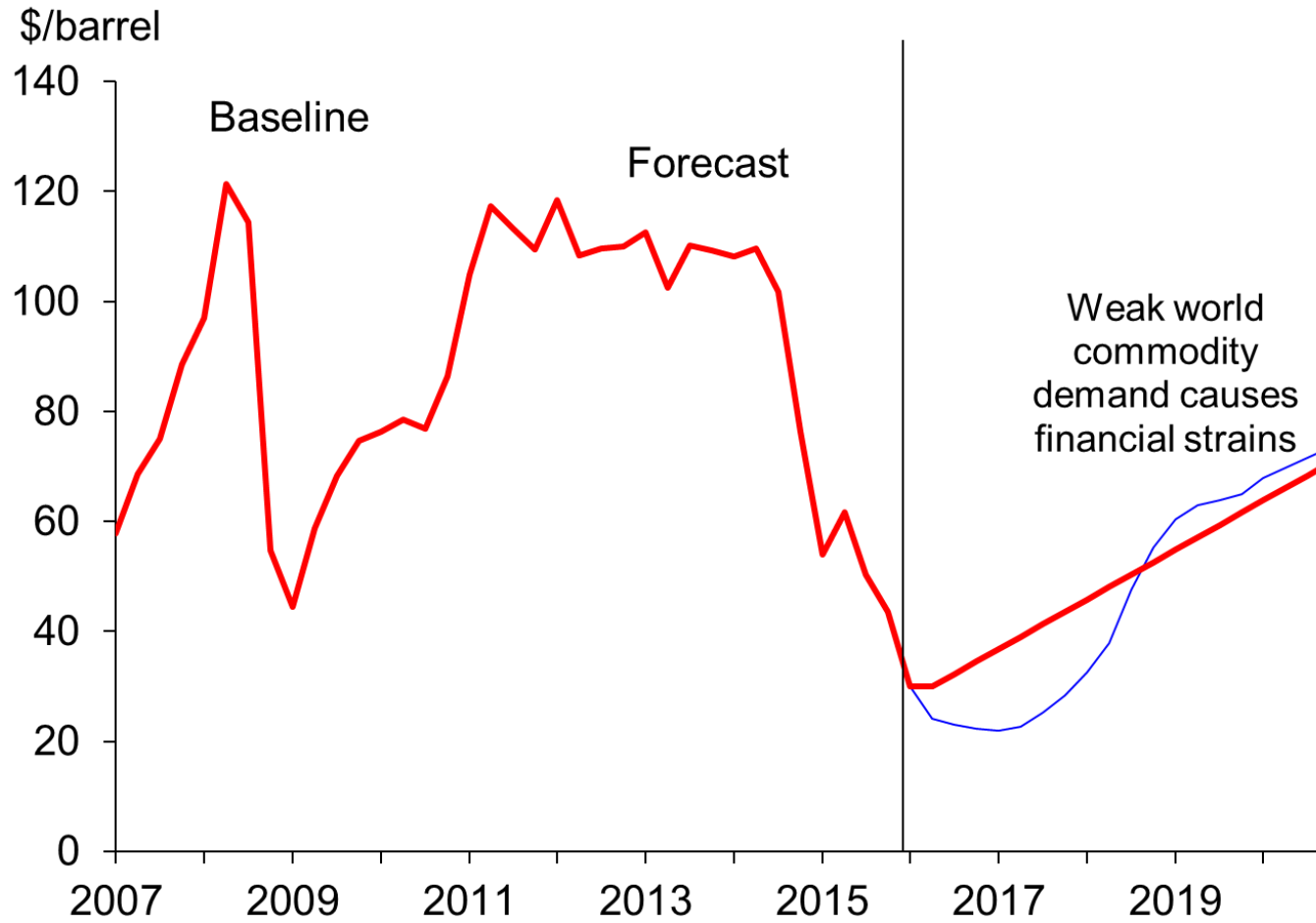


# Commodity demand weakness

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# Weak commodity demand causes financial strains

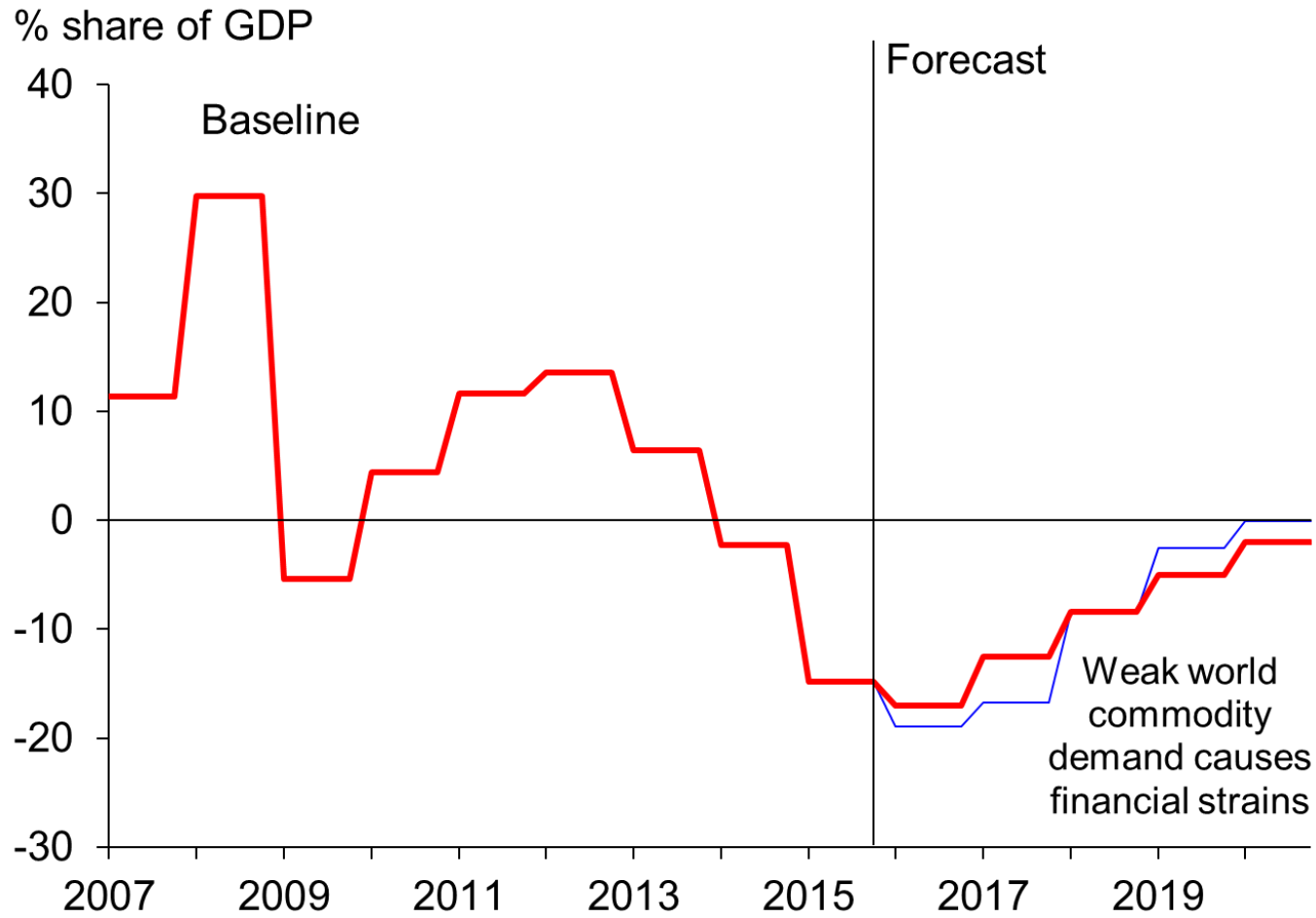
## World: Oil price



Source : Oxford Economics/Haver Analytics

# Weak commodity demand causes financial strains

## Saudi Arabia: Government balance

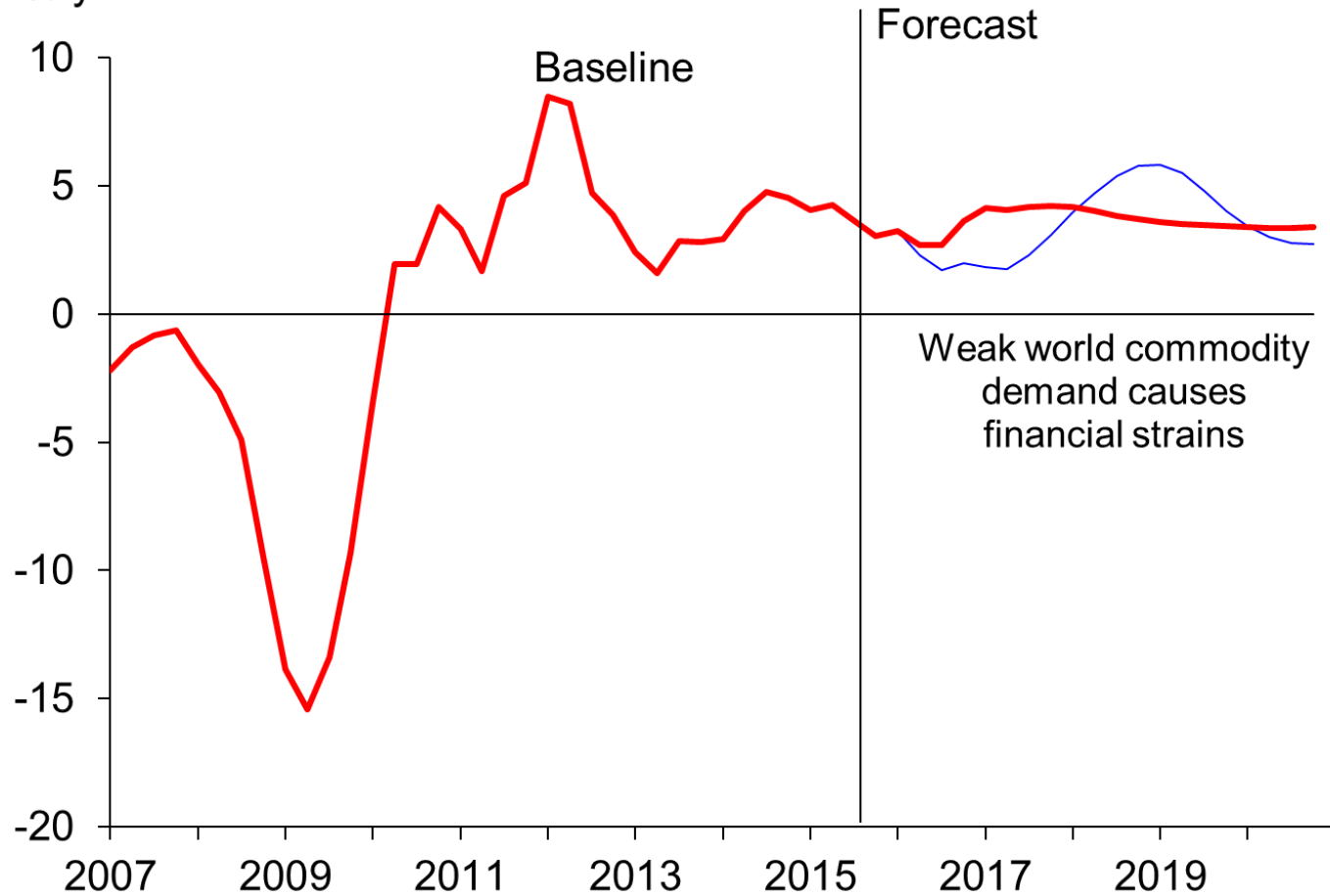


Source : Oxford Economics/Haver Analytics

# Weak commodity demand causes financial strains

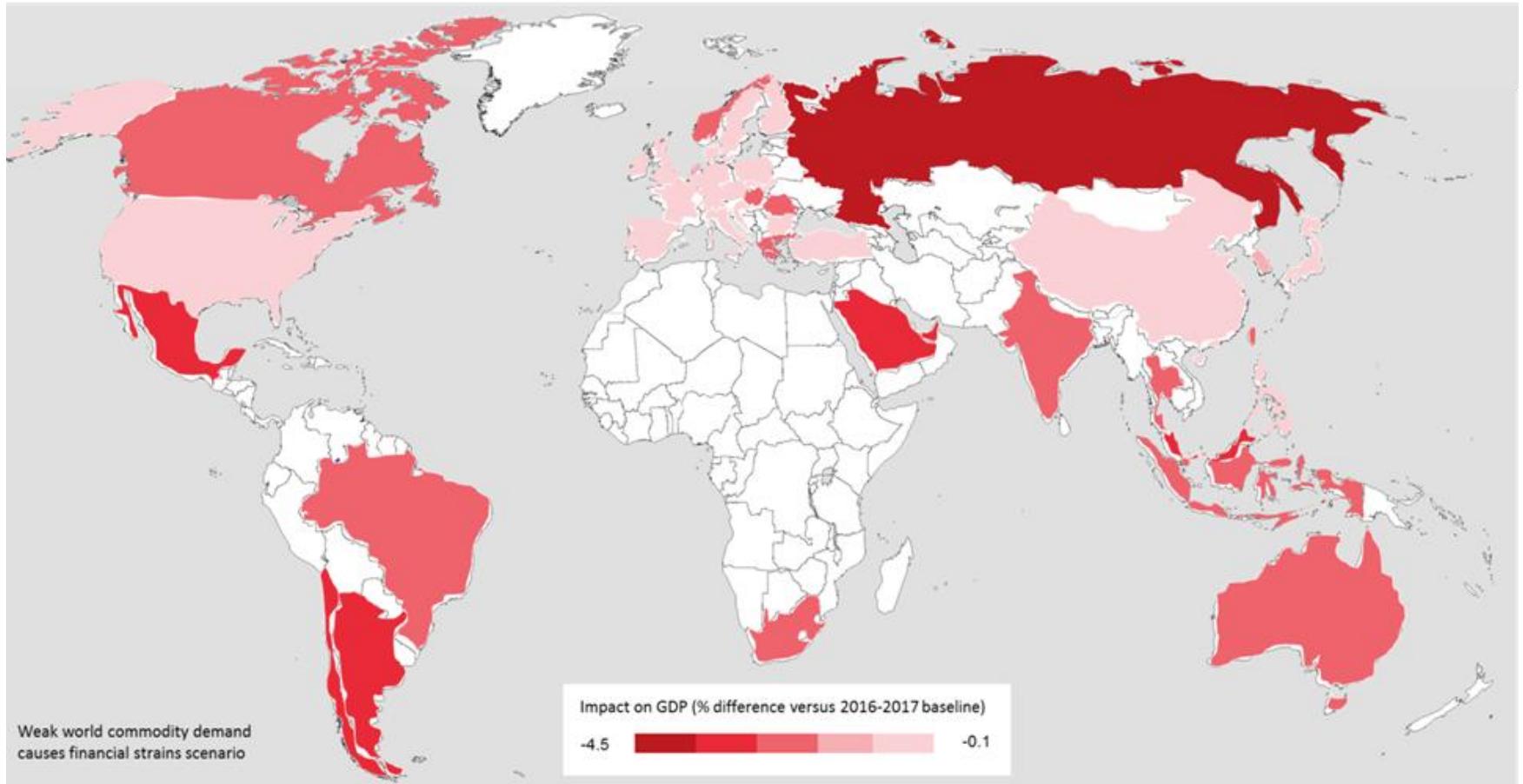
## US: Total fixed investment

% year



Source : Oxford Economics/Haver Analytics

# Weak commodity demand causes financial strains

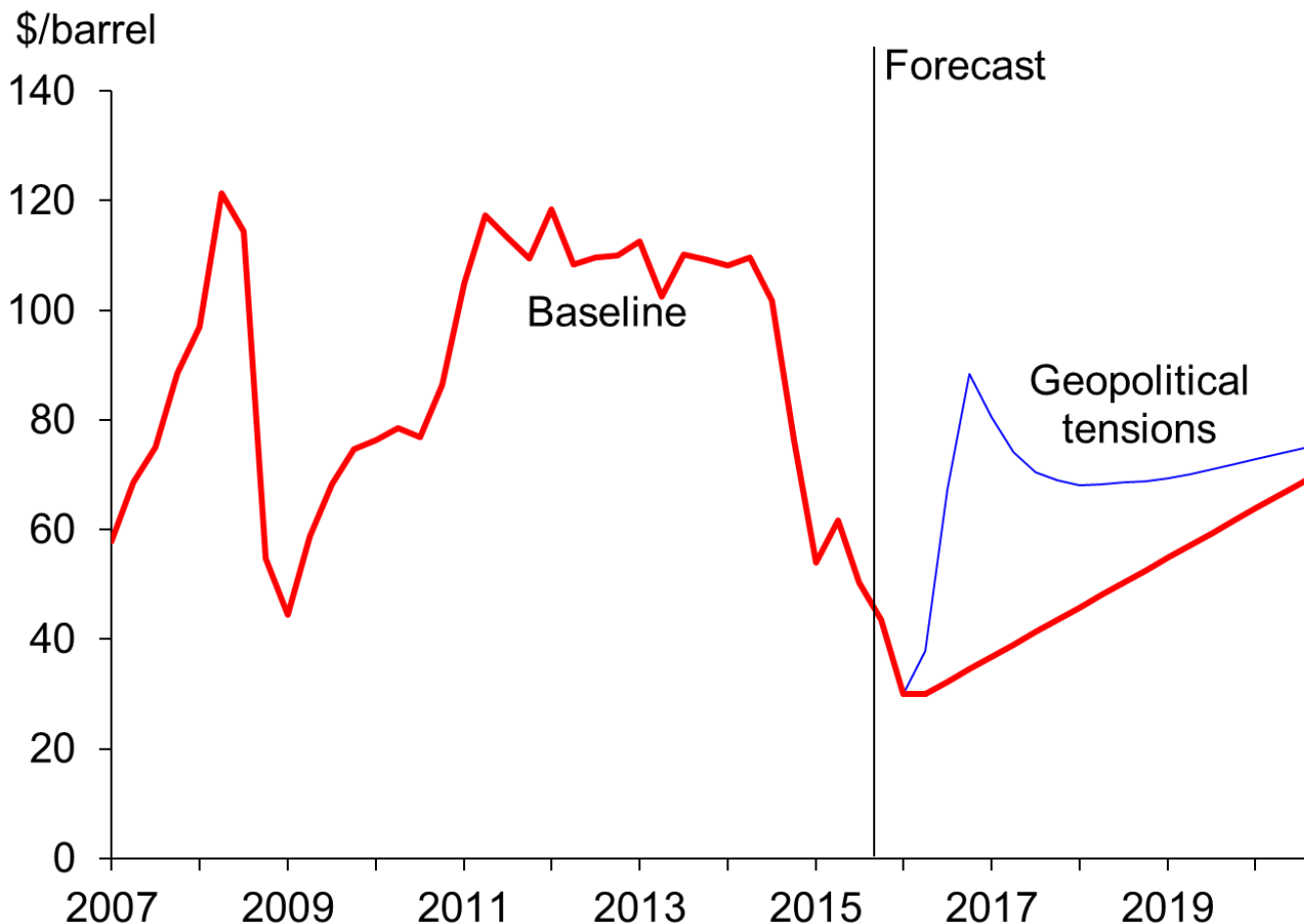


# Geopolitical tensions

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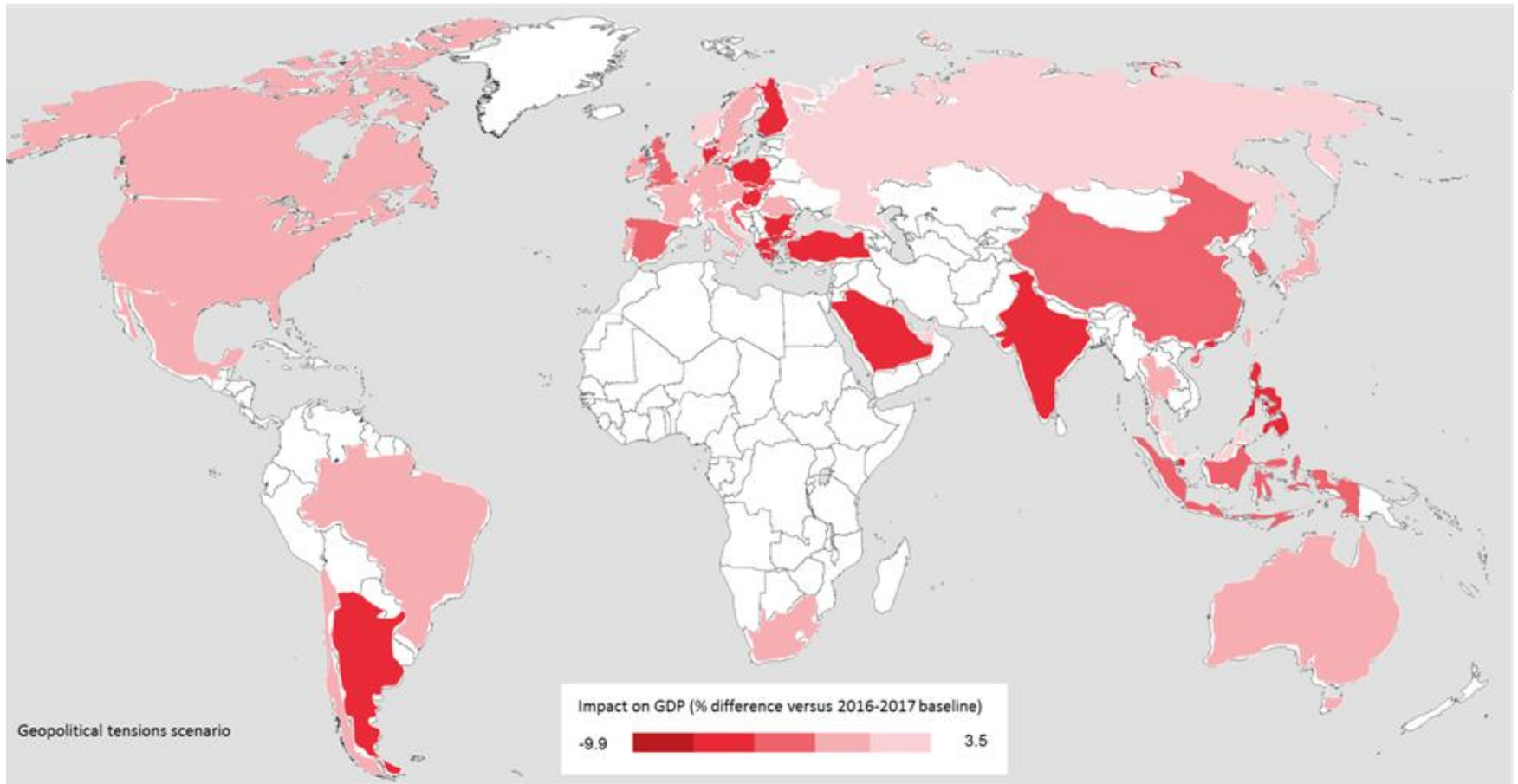
# Geopolitical tensions scenario

## World: Oil price



Source : Oxford Economics/Haver Analytics

# Geopolitical tensions scenario

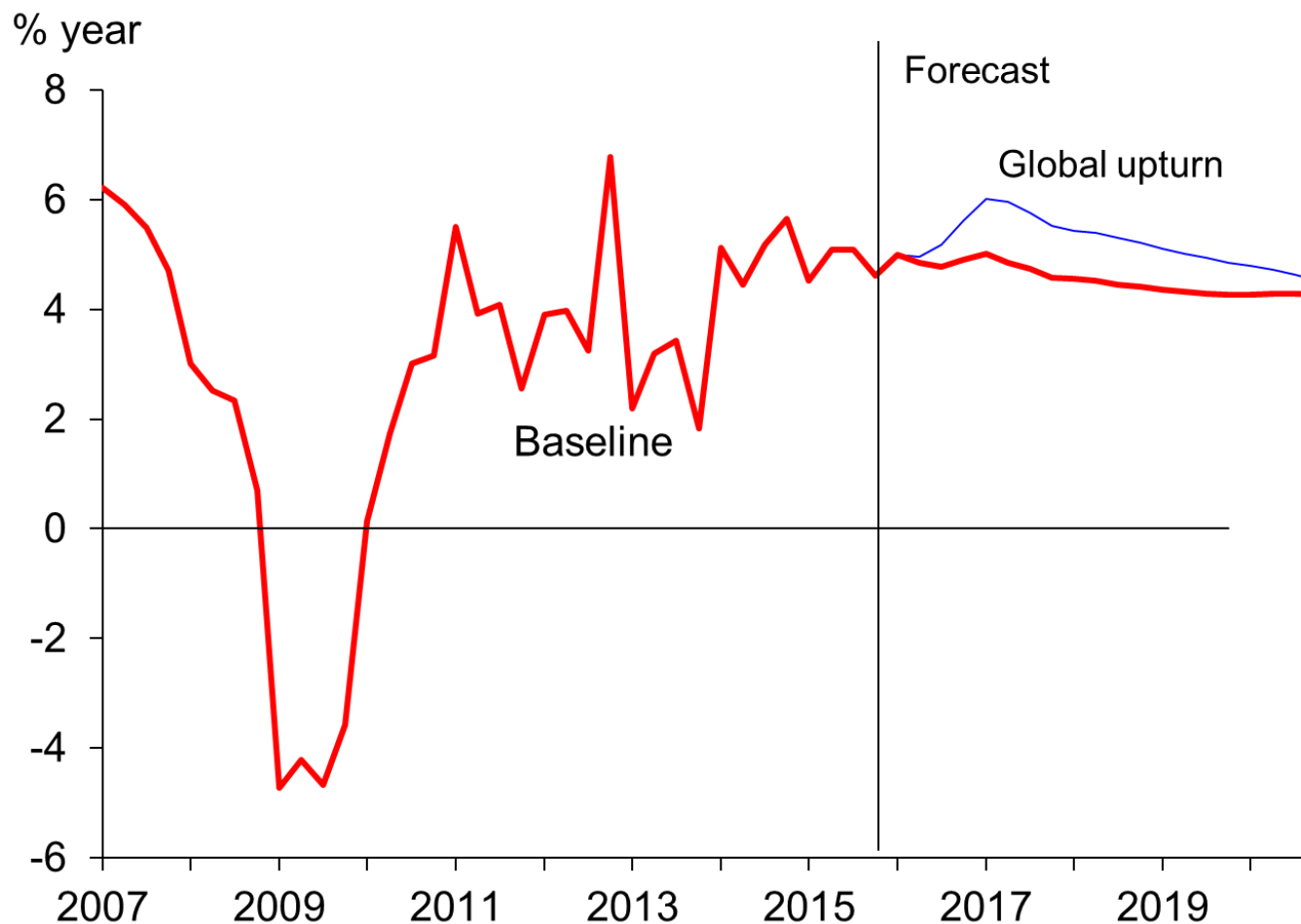


# Global upturn

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# Global upturn

## US: Wages and salaries



Source : Oxford Economics/Haver Analytics



# Global Risk Outlook

## May 2016



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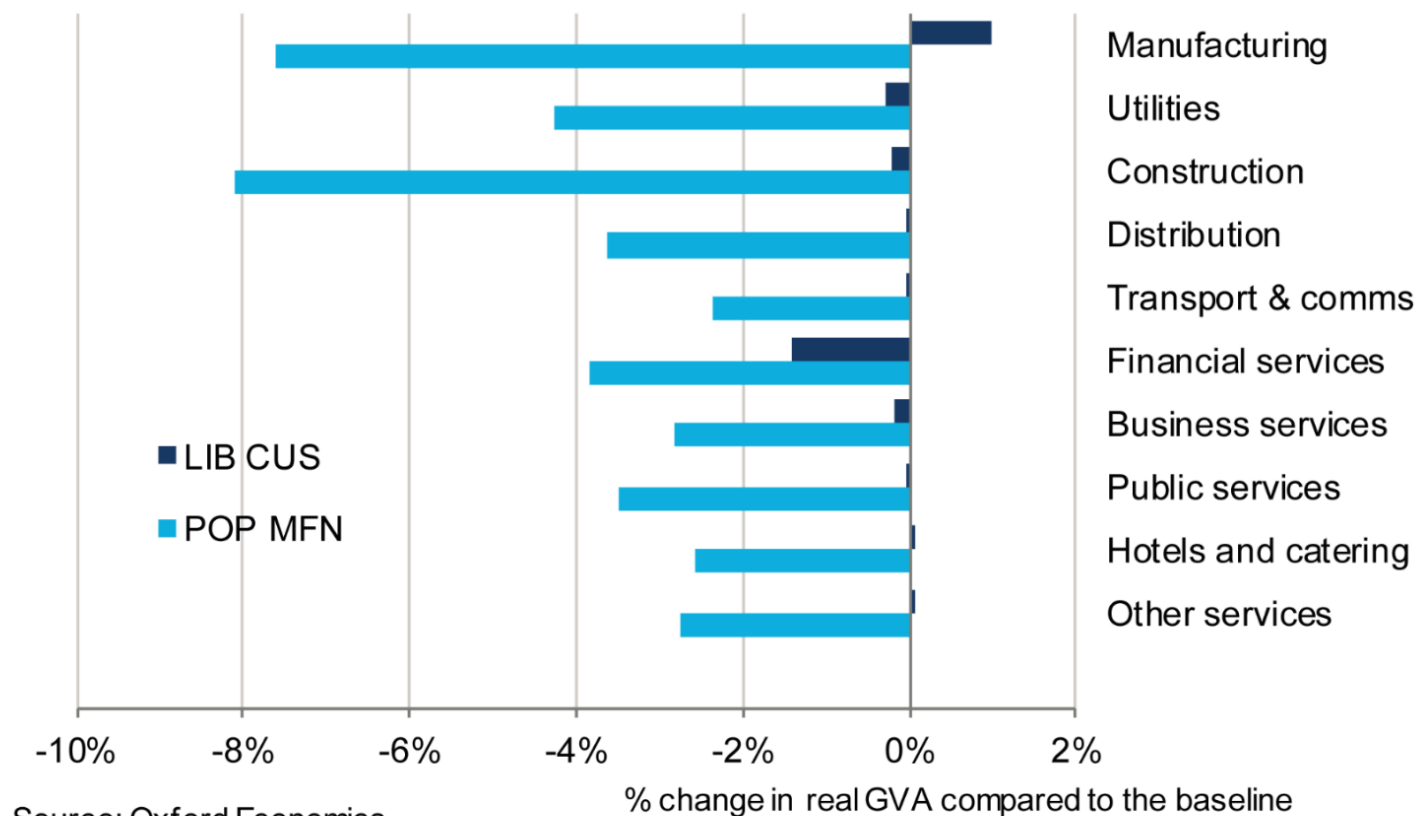
Scott Livermore

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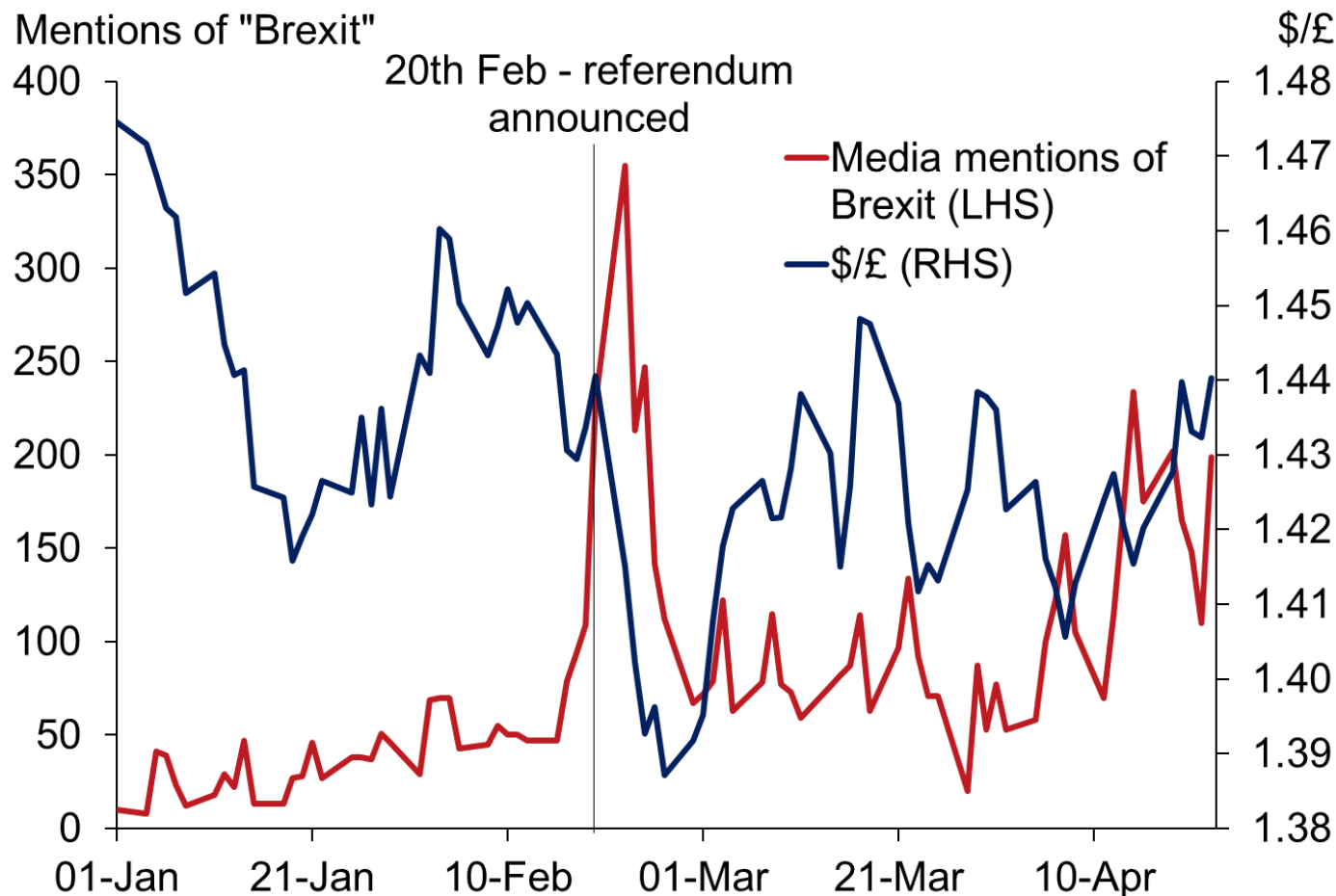
# EUROPE: BREXIT economic impacts

Fig: Implications of Brexit for the UK's economic sectors in 2030



# Markets reacted badly to the referendum

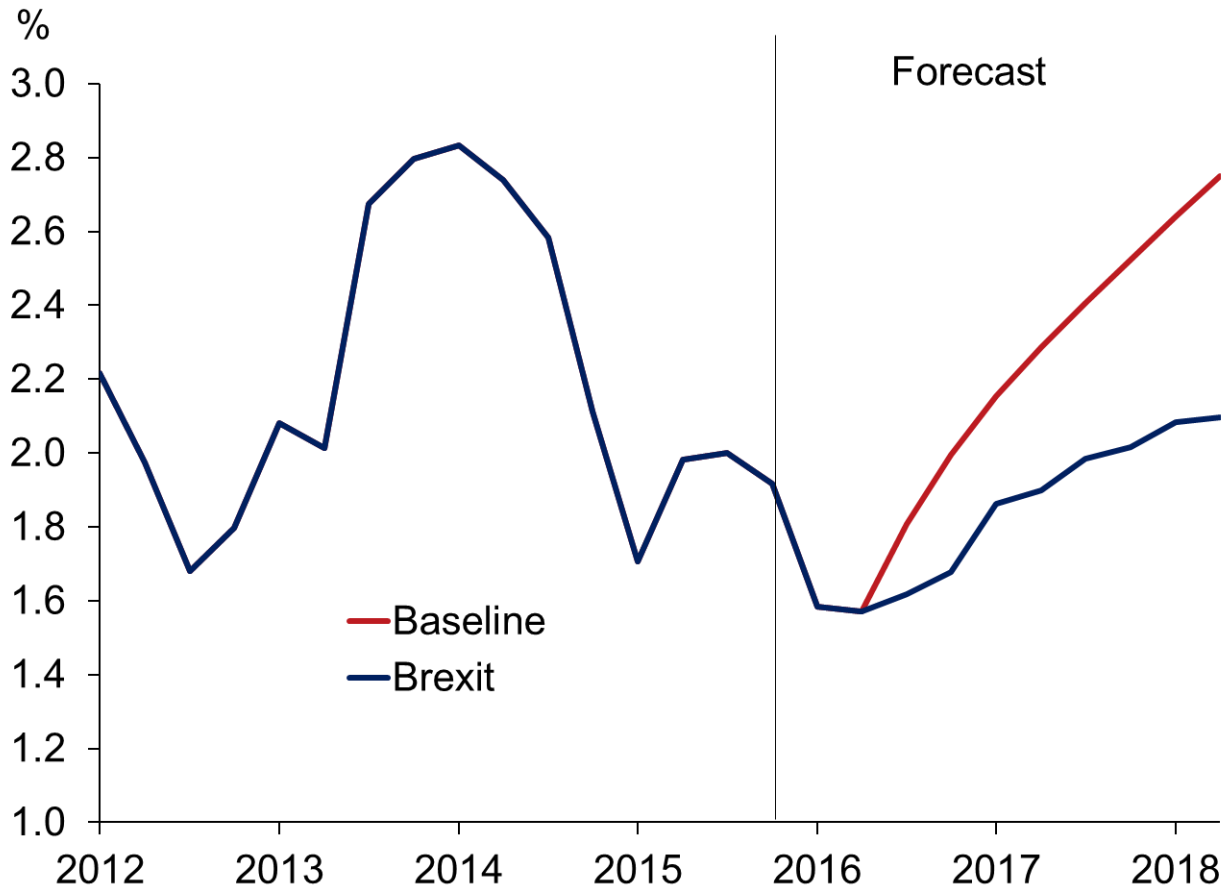
## UK: Mentions of "Brexit" & \$/£ exchange rate



Source : Oxford Economics/Bloomberg

# We would expect gilt yields to move lower

## UK: 10-year government bond yield



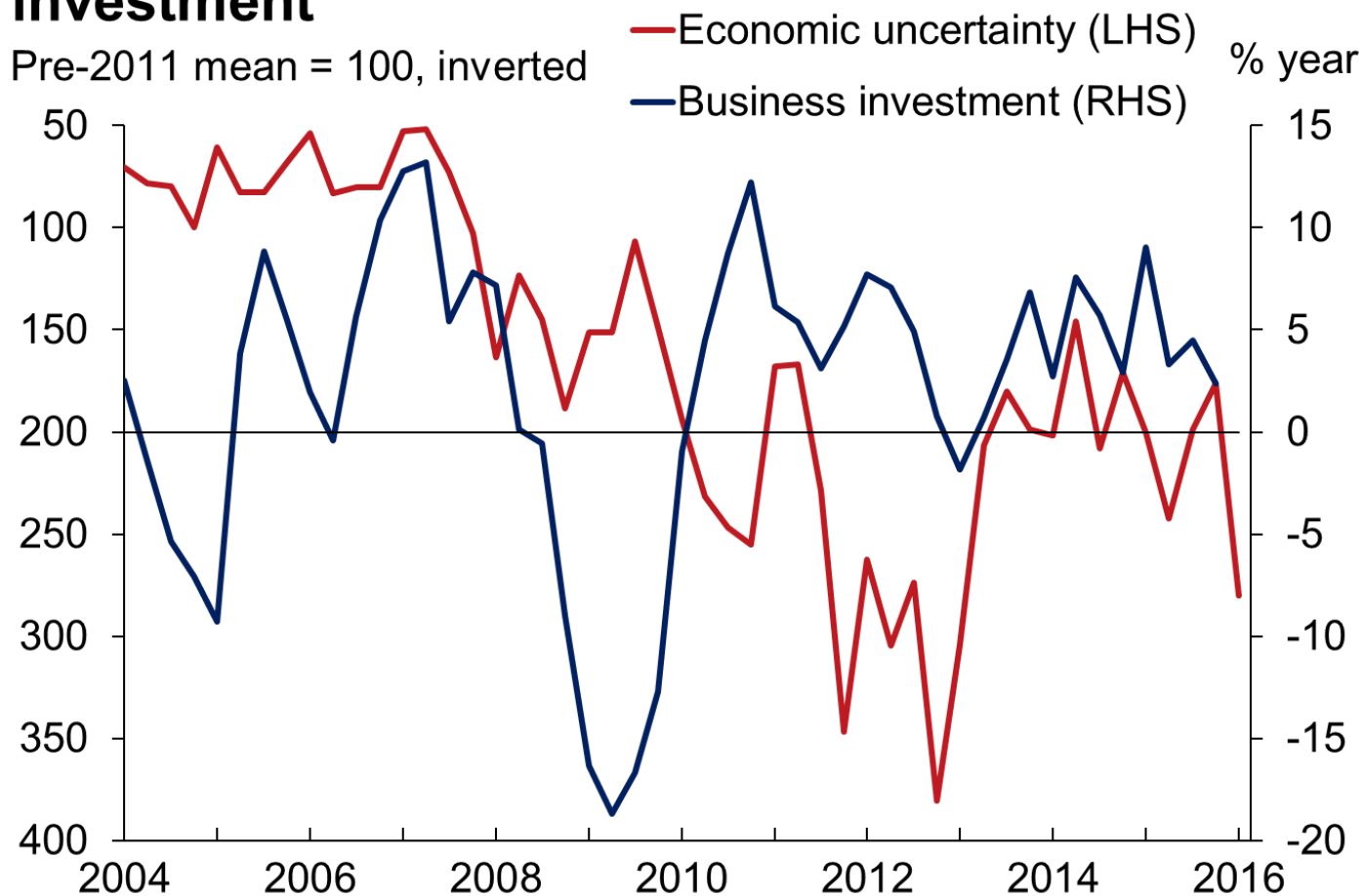
Source : Oxford Economics

## Would gilt yields rise?

- ✓ Modest increase in borrowing
- ✓ Ratings agencies likely to put UK on negative watch
- ✗ Short-term interest rates lower
- ✗ Any risk premia would soon fade if MPC demonstrated it was in control
- ✗ UK would remain a safe haven

# Uncertainty could dampen activity in short-term

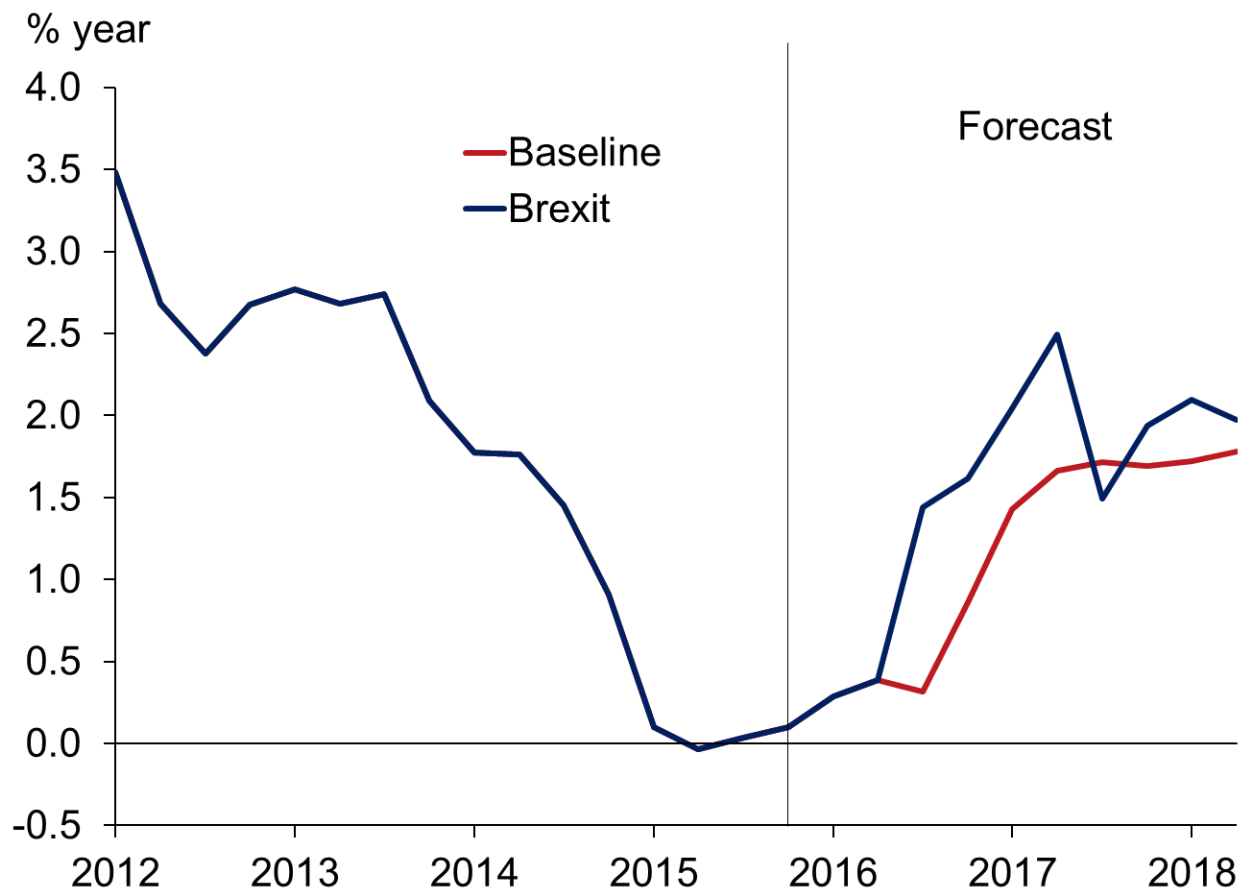
## UK: Economic policy uncertainty & business investment



Source : Haver Analytics

# A weaker £ would drive up inflation

## UK: CPI inflation



Source : Oxford Economics

...but exporters in price-sensitive sectors would benefit

# Brexit would pose a dilemma for policymakers

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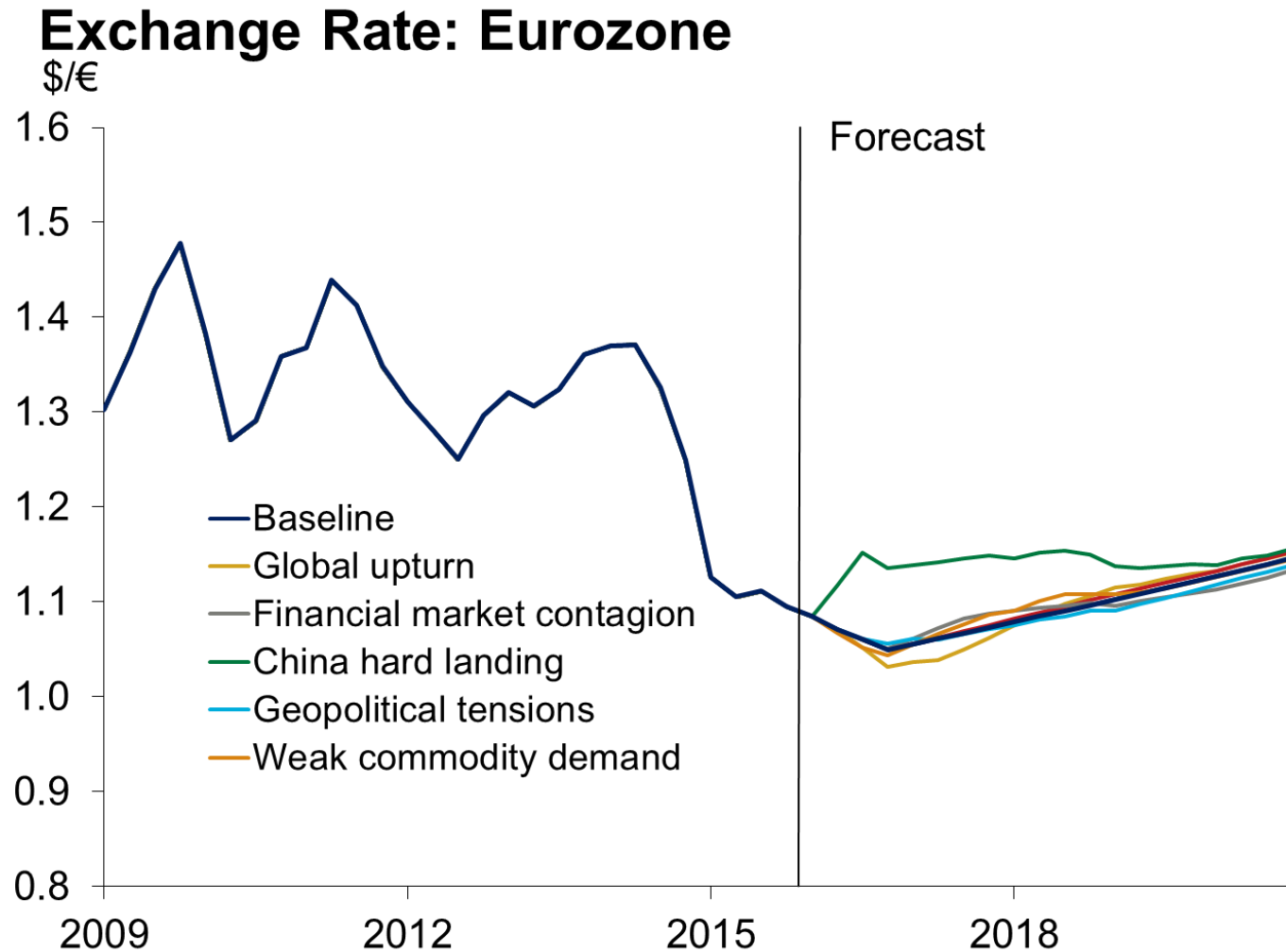
## Monetary policy

- Inflation moves above target by early-2017
- But MPC have been happy to look through temporary, sterling-generated, overshoots before
- Recent dovishness suggests rate *cut* is the most likely response given growth concerns

## Fiscal policy

- OBR would judge government in breach of fiscal mandate & growth not weak enough to trigger escape clause
- Chancellor likely to plead extenuating circumstances

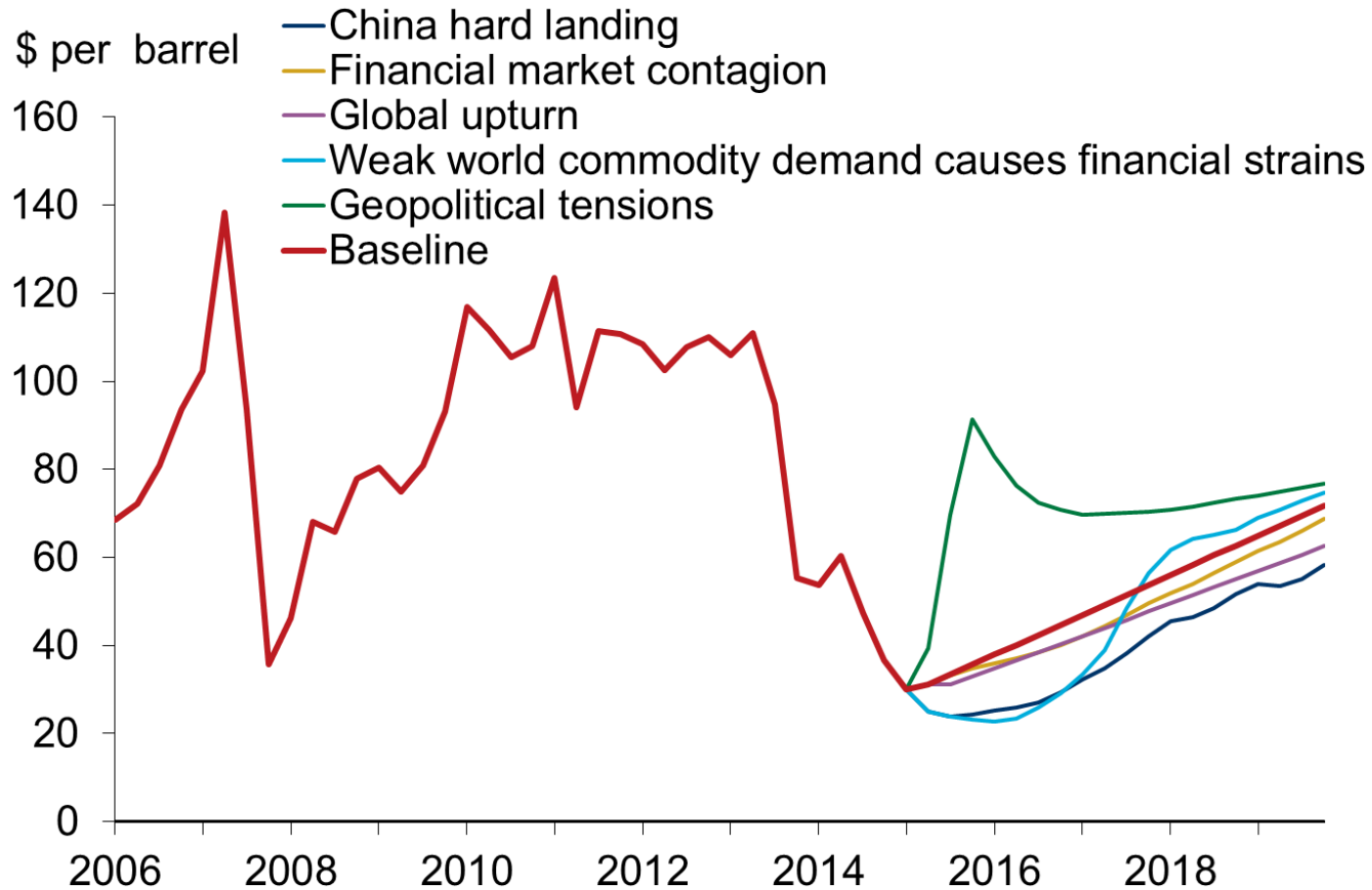
# ...with significant implications for financial markets



Source : Oxford Economics/Haver Analytics

# ...and significant implications for commodities

## World oil price

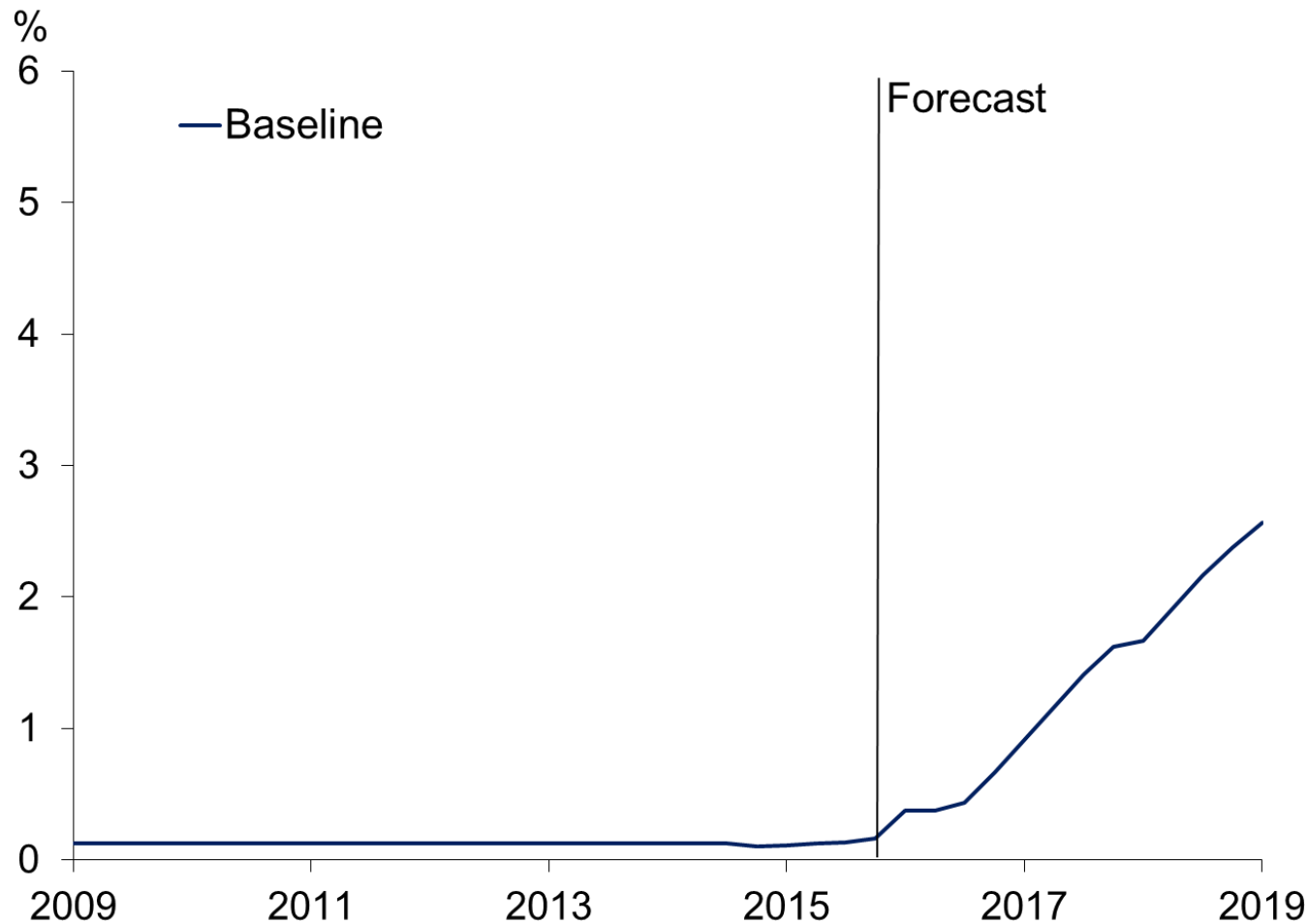


Source : Oxford Economics/Haver Analytics

# ...and significant implications for policy

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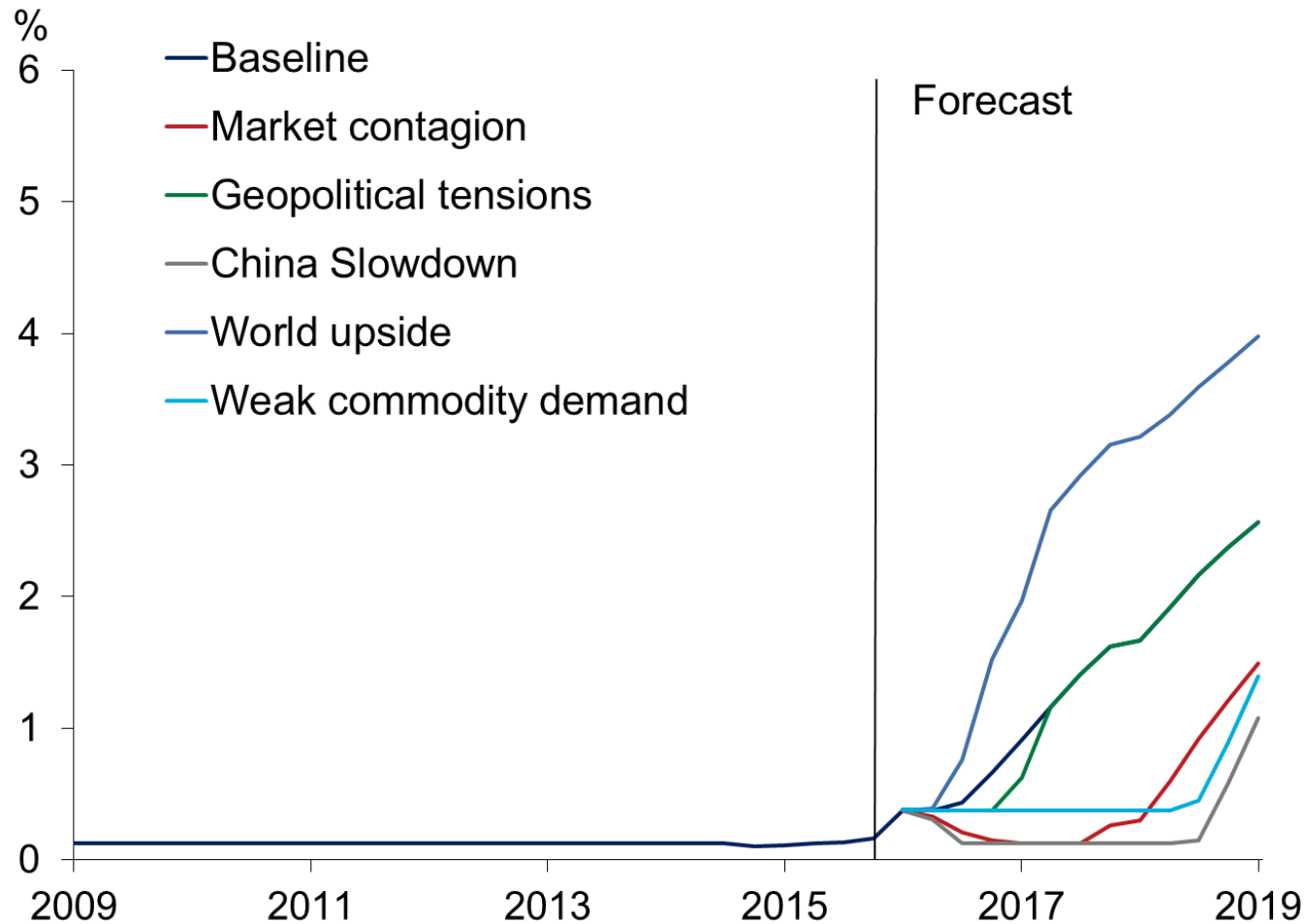
## US: Federal Funds rate



Source : Oxford Economics/Haver Analytics

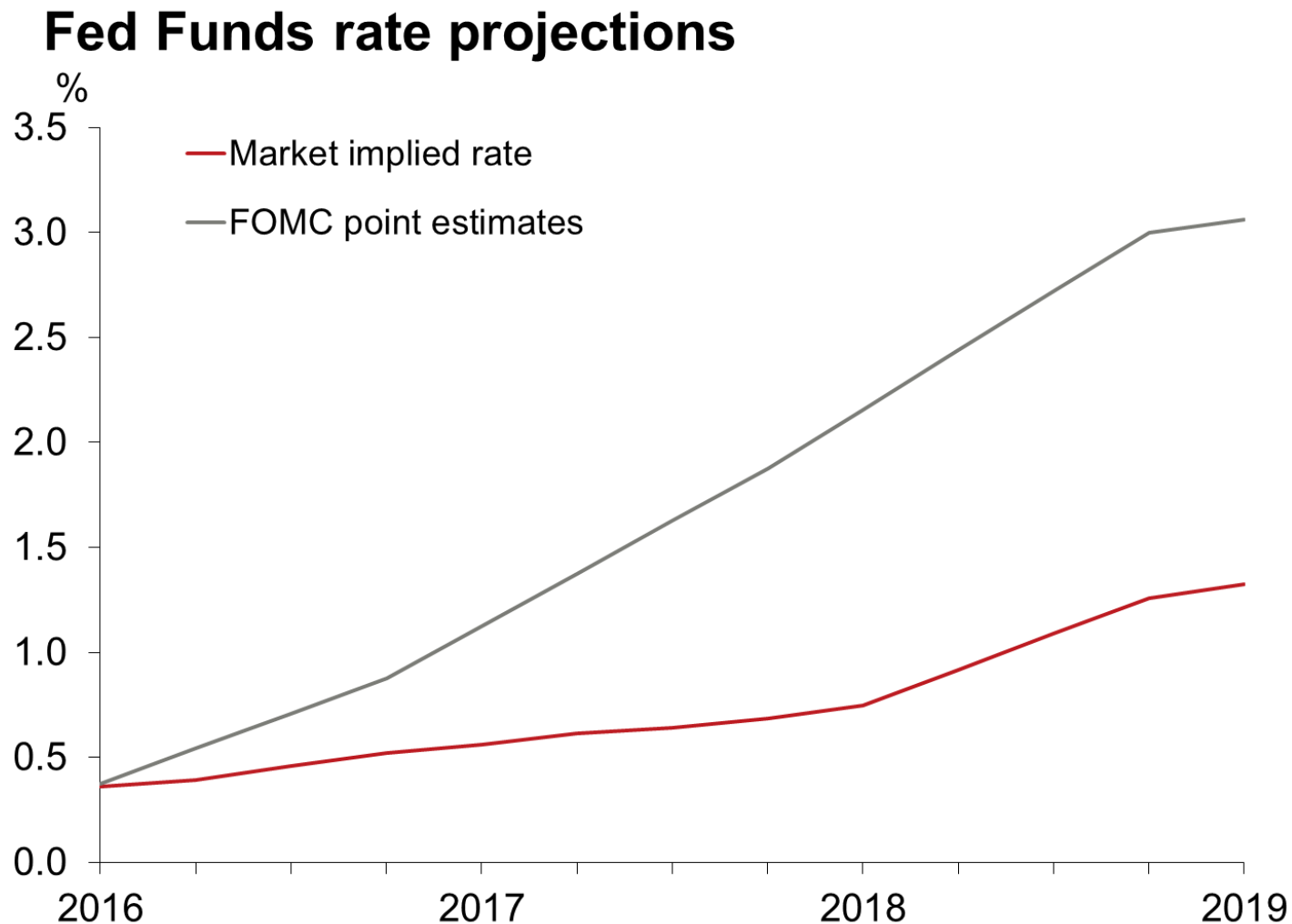
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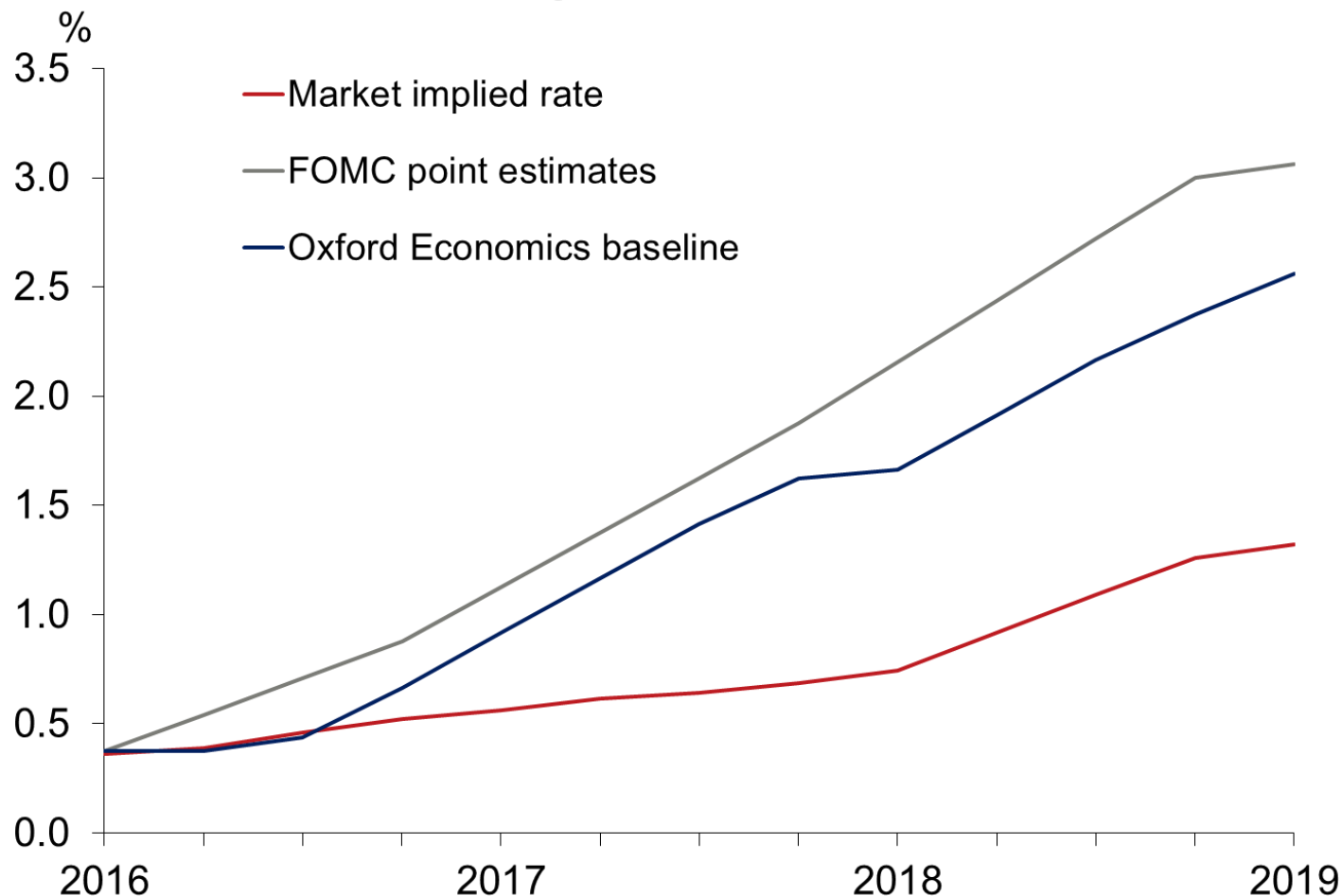
# ...and significant implications for policy



Source : Oxford Economics/Haver Analytics

# ...and significant implications for policy

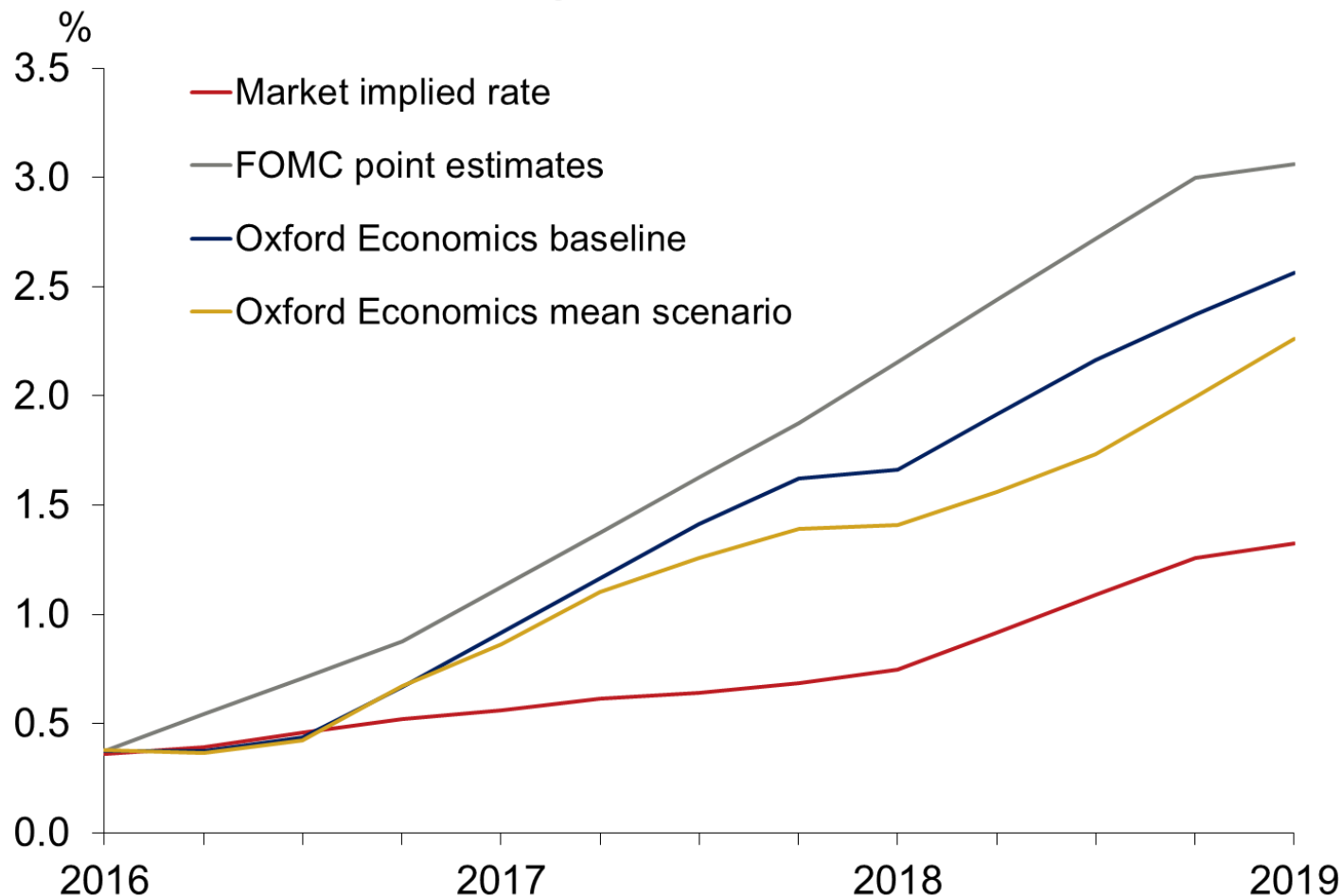
## Fed Funds rate projections



Source : Oxford Economics/Haver Analytics

# ...and significant implications for policy

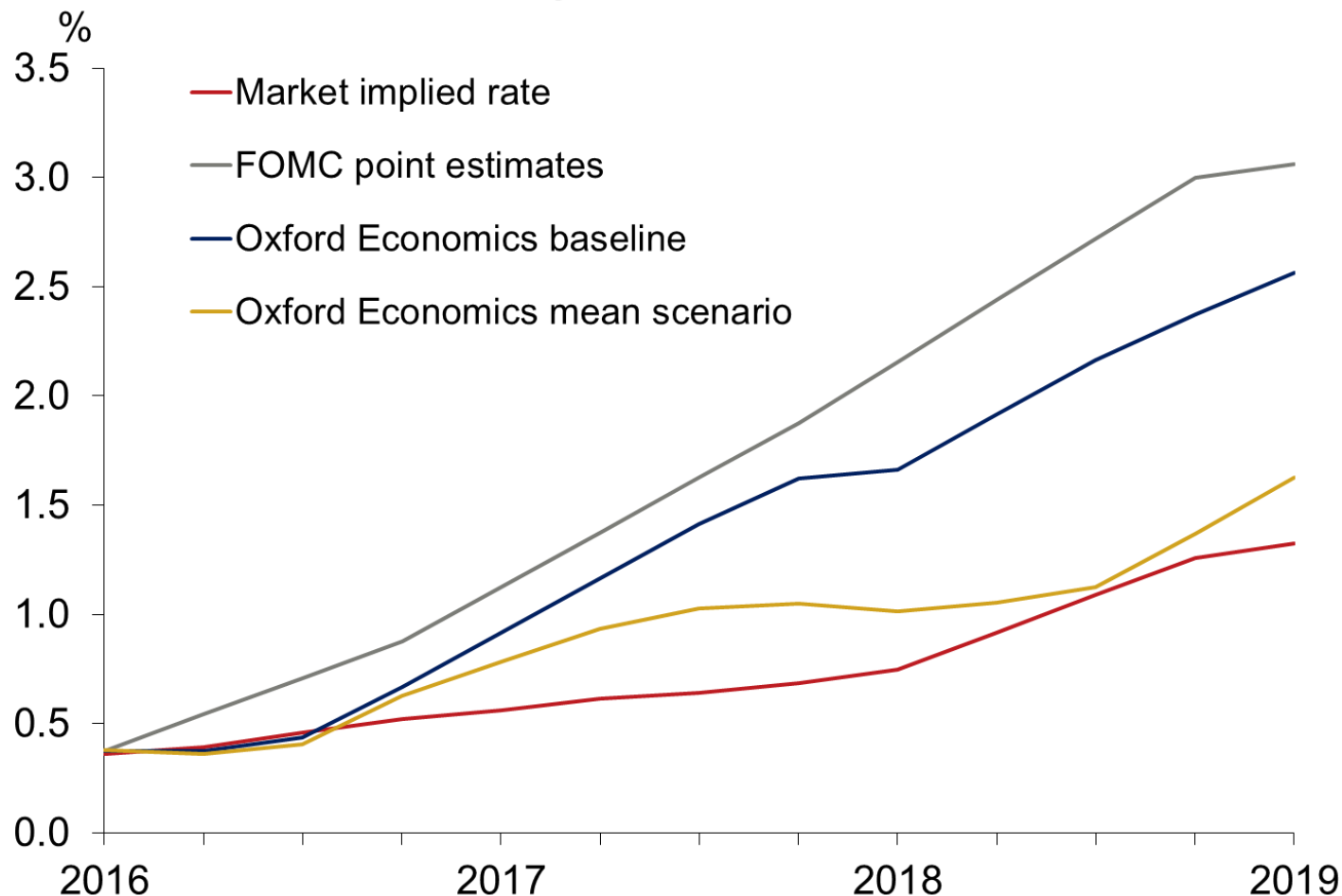
## Fed Funds rate projections



Source : Oxford Economics/Haver Analytics

# ...and significant implications for policy

## Fed Funds rate projections



Source : Oxford Economics/Haver Analytics

# Global economy: Feeble, Fickle & Fragmented

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- World GDP growth for 2016: 2.3% – slowest pace of global growth since 2009. Forecast for 2017 cut further to 2.7%.
- EMs economies expected to remain subpar.
- Strains in financial markets have abated but conditions still tighter than end-2015, and global risks are still skewed to the downside.
- Slowdown in US is proving to be “sticky”, but fundamentals remain strong.
- Central banks increased use of unconventional policy tools lends support to near-term growth (Japan, EZ), but there are questions about marginal benefits.

## Triple F: Feeble, Fickle and Fragmented

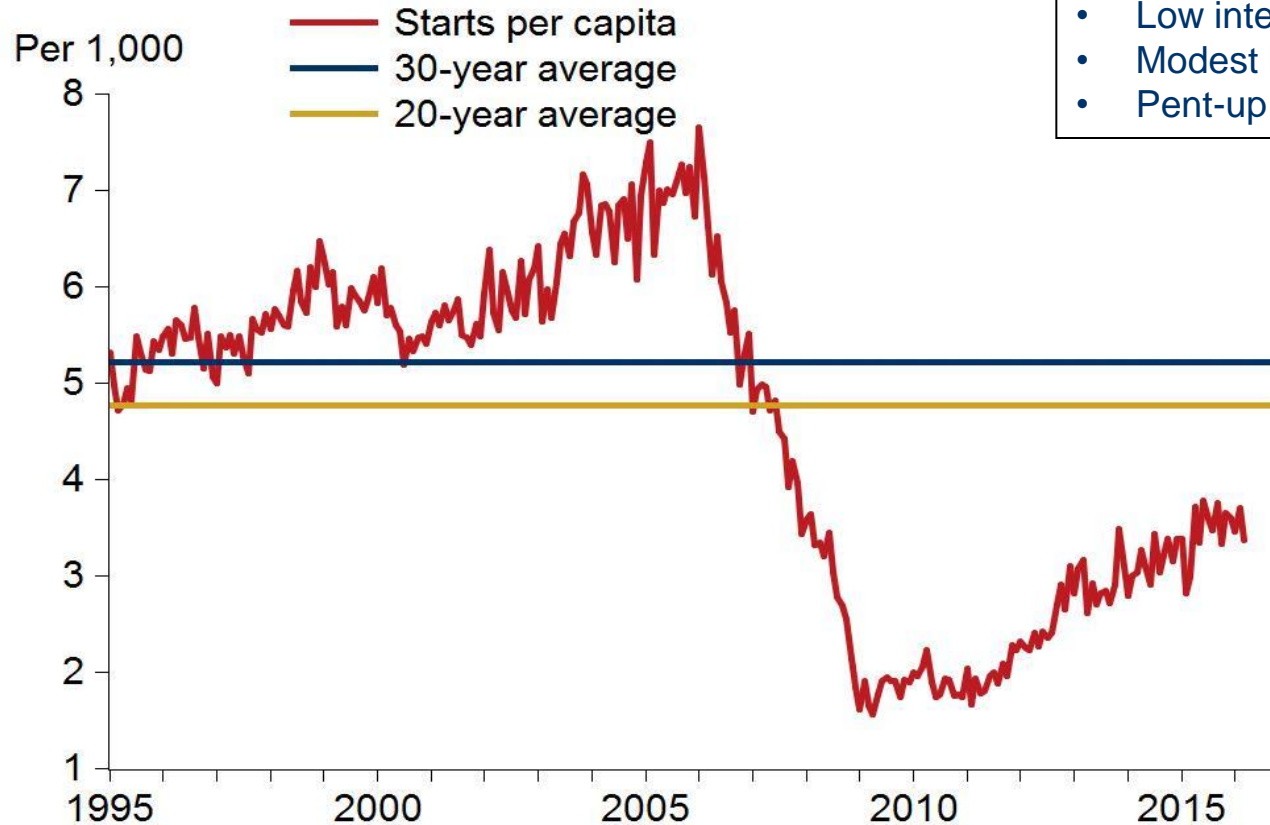
- Key risk: financial market strains:
  - confidence, wealth and credit shock
  - China & EMs
  - Geopolitical?



Ammunition?

# Housing recovery remains very gradual...

## US: Housing activity



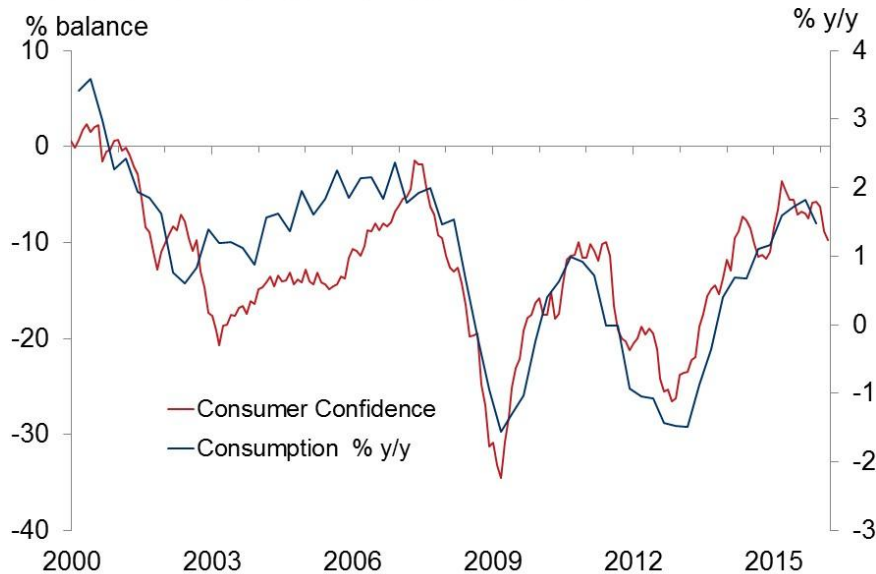
Source: Oxford Economics/Haver Analytics

### Drivers:

- Income growth
- Low interest rates
- Modest home price inflation
- Pent-up demand

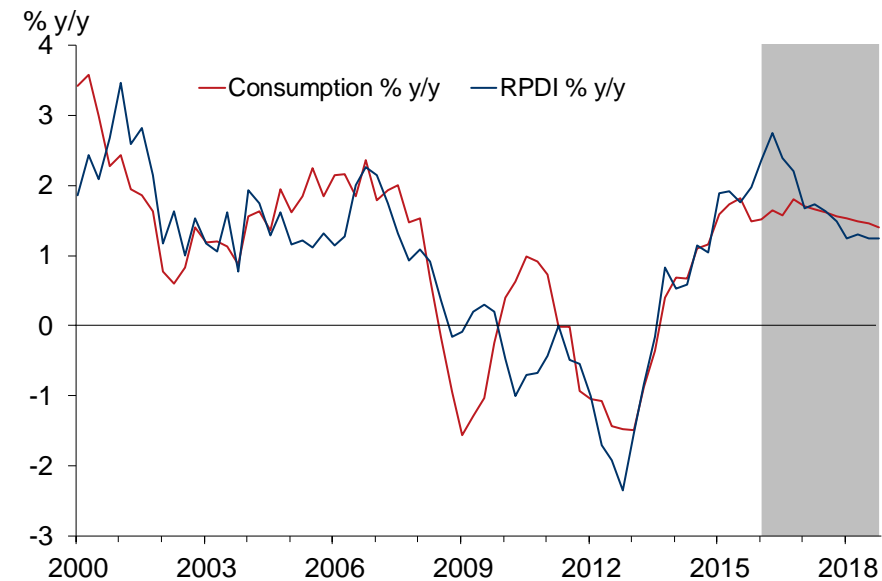
# Labor market supporting domestic demand

**Eurozone: Consumer confidence**



Source: Oxford Economics/Haver Analytics

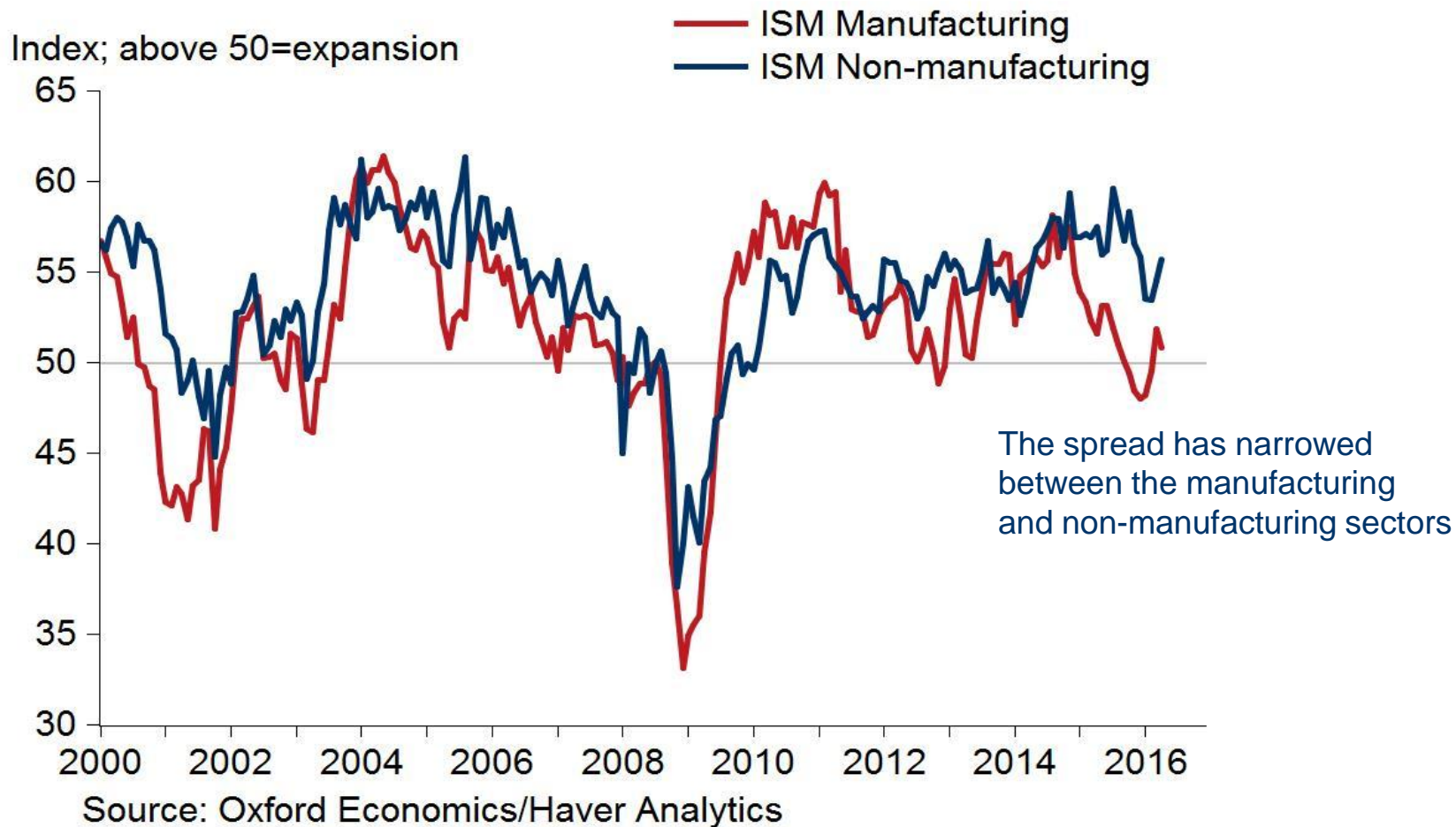
**Eurozone: consumption and real income**



Source : Oxford Economics/Haver Analytics

# ISM manufacturing has rebounded

## US: PMI Indices



# Today's Global Economic Model

- Oxford's Global Economic Model is the world's **leading globally integrated macro model**, used by over 140 clients around the world, including finance ministries, leading banks, and blue-chip companies.
- **With a 30-year track record**, the model provides a rigorous and consistent structure for forecasting, scenario analysis, stress testing and impact analysis.
- **The model covers 46 countries in detail**, plus the Eurozone, and provides headline forecasts for another 30 countries. Remaining countries are covered in trading blocs.
- Data and forecasts in the model are **updated each month**. The model is available with 5, 10 and 25-year forecast horizons.
- Oxford Economics **provides telephone and e-mail support**, and runs regular training workshops.

