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1. Key Themes For 2020

2. Cyclical Stabilisation In Global Growth
   1. PMI Stabilise As Policy Is Supportive
   2. Trade Dynamics To Offer Support
   3. US Economy Picking Up
   4. Eurozone Economy Stabilising
   5. German Growth To Pick Up Slightly
   6. Chinese Growth Facing Downside Risks

3. Recession Risks & Vulnerabilities
   1. Risks Easing slightly, But Challenges Remain
   2. Late-Cycle, Capacity Constraints & Inflation
   3. US-Iran Tensions & Oil Risks
   4. Wuhan Coronavirus Risks To Global Growth
   5. Equity Markets & Risk Assets Vulnerable
<table>
<thead>
<tr>
<th>Theme</th>
<th>Description</th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>1. 1990s Mid-Cycle Playbook</strong></td>
<td>US &amp; global economy looks similar to mid-to-late 1990s, which saw a mid-cycle adjustment. Growth to stabilise in 2020.</td>
<td><strong>6. Global Consumer Story To Slow Slightly</strong></td>
<td>We believe that the global consumer comes off the boil as job gains will continue to slow.</td>
</tr>
<tr>
<td><strong>2. Recession Risks To Remain Elevated</strong></td>
<td>Despite the potential for a stabilisation in cyclical indicators, there are plenty of risks and imbalances, ranging from trade to debt.</td>
<td><strong>7. Rising Structural Pressures on China</strong></td>
<td>China is facing an increasing number of structural pressures, which are being compounded by political &amp; trade risks.</td>
</tr>
<tr>
<td><strong>3. Policy Challenges &amp; Dilemmas</strong></td>
<td>Slower trend growth will exacerbate policymakers’ trade-offs and challenges. Political risk will remain an issue.</td>
<td><strong>8. UK-EU Trade Deal Uncertainty Replaces Brexit Uncertainty</strong></td>
<td>Trade negotiations could be difficult and uncertain and could result in a de-facto ‘hard’ Brexit.</td>
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<td><strong>4. Fiscal Policy To Take Over</strong></td>
<td>Monetary policy is reaching its limits as interest rates have been cut to record lows, or central banks want to retain ‘fire-power’.</td>
<td><strong>9. Potential For Unexpected Leadership Changes</strong></td>
<td>Potential for governments to collapse in Europe (eg, Spain, Italy). Carrie Lam could resign. Trump could lose election.</td>
</tr>
<tr>
<td><strong>5. US-China Tensions Persist, But Uncertainty Has Peaked</strong></td>
<td>We see bouts of escalation and de-escalation, but most of the uncertainty is behind us as we are unlikely to see a ratcheting up in trade tensions by the same degree.</td>
<td><strong>10. US Partisan Divisions To Get Worse Before They Get Better</strong></td>
<td>2020 will likely see deepening political polarisation between Republicans and Democrats as both sides prepare for the November election.</td>
</tr>
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</table>

Source: Fitch Solutions
Cyclical Stabilisation In Growth
1990s Mid-Cycle Playbook, With Global Growth Stabilising In 2020

Global Real GDP Growth To Stabilise

%  

2019 Looks Like The 1990s US Fed Rate Cutting Cycles

% & Number Of Months

Source: Bloomberg, Fitch Solutions

e/f = estimate/forecast. Source: Fitch Solutions
Global Growth Conditions Starting To Turn A Corner?

- We forecast global growth to come in at 2.7% in 2020, marking a slight uptick from the 2.6% registered in 2019.

- An increasing number of indicators point to signs of a cyclical bottoming out of the global economy.

- Global PMI composite readings have picked up from the low of 50.8 in October to 51.7 in December, with a strong pick-up in services (51.0 to 52.1) and a muted improvement in manufacturing from 49.8 to 50.1 over the same period.

- While the improvement in data is broadening, German and US manufacturing remain in contraction. Moreover, capacity constraints could limit the pace of the rebound in activity. Other risks remain in place.
**Looser Fiscal & Monetary Conditions To Support Growth**

**Fiscal & Monetary Policy Matrix**

<table>
<thead>
<tr>
<th>Monetary Policy</th>
<th>Fiscal Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tightening</td>
<td>Neutral</td>
</tr>
<tr>
<td>Neutral</td>
<td>Looseening</td>
</tr>
<tr>
<td>Looseening</td>
<td></td>
</tr>
</tbody>
</table>

- Over the past quarter there has been a continued move towards fiscal and monetary tightening, which will continue to support growth.

- Central banks around the world have less room to cut interest rates than they did in 2019, and we believe that on aggregate monetary policy will turn more neutral in 2020.

- Therefore, policymakers will increasingly lean on fiscal policy to support growth. We have seen this in Japan, South Korea, the US, Russia and India to name a few countries.

- This means that policy will remain accommodative over the coming months so long as inflationary pressures remain well behaved.

Source: Fitch Solutions
Central Bank Easing Boosted Liquidity & Lowered Borrowing Costs

Central Banks Still Loose On Balance
Diffusion Index

Source: BIS, Fitch Solutions

Tightening

Loosening

Bond Yields Still Low Globally
% Germany (RHS)

Source: Bloomberg, Fitch Solutions
Phase-One Deal Helps Global Trade Come Out Of Soft Patch

Exports Picking Up Slightly For Majors
% chg y-o-y, 3mma

South Korean Semiconductor Exports Bottoming Out?
% chg y-o-y

Note: Weighted average of major exporting markets. Source: Bloomberg, Fitch Solutions

Source: Bloomberg, Fitch Solutions
US Economic Activity Picking Up & Manufacturing Divergence To Ease

GS Activity Indicator Showing Cyclical Rebound

PMI Divergence In The US Should Start To Ease

Source: GS, Bloomberg, Fitch Solutions

Source: Bloomberg, Fitch Solutions
Asian Sentiment Indices & US Equities Could Support US Growth

Asia Rebound Could Signal A Boost To The US Economy

Equities Often Lead Growth Momentum

Source: Bloomberg, Fitch Solutions

Source: GS, Bloomberg, Fitch Solutions
Improving Confidence To Support Business Activity & Investment

Business Confidence Coming Off Its Lows In The US

Index

US Expenditure Surveys Point To Uptick In Capex Cycle

Index, % chg y-o-y

Source: Bloomberg, Fitch Solutions

Source: BEA, Bloomberg, Fitch Solutions
Falling Mortgage Rates Helping To Spur US Residential Market

Bond Yields & Mortgage Financing Costs Falling

- US 30 Year Yield
- Bankrate.com US Home Mortgage

Source: Bloomberg, Fitch Solutions

NAHB Survey Shows Strong Residential Market

- Present Sales
- Market Index
- Future Sales
- Prospective Buyer Traffic

Source: NAHB, Bloomberg, Fitch Solutions
Following a sharp deceleration since late 2017, composite PMI readings in the Eurozone are stabilizing, and in some cases such as the UK, Germany and Spain are picking up.

This suggests that the Eurozone should find some stability in 2020, and we forecast growth of 1.2% this year, similar to our estimate for 2019.

However, there remains a significant divergence between services and manufacturing, which will have to be narrowed if the EZ is to stabilize.

Services are in expansion and are rising in Spain, Germany and the UK.

Manufacturing, however remains in contraction except for in France, but is bottoming.
Services-Manufacturing Divergence, But Manufacturing Is Bottoming

Service Expansion & Picking Up In Spain, Germany & UK

Manufacturing Contraction Bottoming Out?

Source: Bloomberg, Fitch Solutions
German Manufacturing & Auto Sectors Improving

Manufacturing Bottoming Out As Services Accelerate

Index

IFO Manufacturing Surveys Point To Output Recovery

Index, %

Source: Bloomberg, Fitch Solutions

Source: IFO, Bloomberg, Fitch Solutions
German-Chinese Auto Connection Improving

German & Chinese Economies Tied At The Hip
% chg y-o-y, 3mma

Potential Upside Surprise For German Exports
%

Source: Bloomberg, Fitch Solutions
Chinese Economy Showing Greater Signs Of Stability, But Risks Mount

Structural Real GDP Growth Slowdown Still In Play

% chg y-o-y

Source: Wind, Fitch Solutions
Stimulus & Phase-One Deal Leads Manufacturing & Export Rebound

PMIs Point To Export & Manufacturing Stability

Index

Source: Bloomberg, Fitch Solutions

Sharp Pick-Up In Chinese Trade Growth

% chg y-o-y

Source: Bloomberg, Fitch Solutions
Downside Growth Risks For China Due To Coronavirus

SARS Cases Rose Quickly, But Contained In Six Months
Cumulative Cases

Chinese Retail Sales Sank & GDP Weakened
% chg y-o-y

Source: WHO, Fitch Solutions
Source: Wind, Fitch Solutions
Despite Global Stabilisation, Growth Will Be Capped To The Upside

<table>
<thead>
<tr>
<th>Country</th>
<th>Growth 2019</th>
<th>Growth 2020</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>2.2</td>
<td>1.8</td>
<td>Slight upside risks to investment, but not dramatically as election could cause some uncertainty.</td>
</tr>
<tr>
<td>Eurozone</td>
<td>1.2</td>
<td>1.2</td>
<td>Neutral, and already envisions a sharp pick-up in German growth from 0.5% to 1.1%</td>
</tr>
<tr>
<td>China</td>
<td>6.1</td>
<td>5.9</td>
<td>Large downside risks as coronavirus impacts manufacturing, transport and services.</td>
</tr>
<tr>
<td>India</td>
<td>5.1</td>
<td>5.9</td>
<td>Neutral given still-tight credit conditions.</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.0</td>
<td>2.3</td>
<td>Neutral due to structural constraints and China exposure.</td>
</tr>
<tr>
<td>Russia</td>
<td>1.2</td>
<td>1.7</td>
<td>Growth acceleration to be capped by weak oil prices and sanctions.</td>
</tr>
<tr>
<td>South Africa</td>
<td>0.4</td>
<td>1.2</td>
<td>Several structural factors will limit how fast growth will accelerate.</td>
</tr>
<tr>
<td>Turkey</td>
<td>-0.1</td>
<td>2.0</td>
<td>Deleveraging of private sector will cap any acceleration in growth.</td>
</tr>
</tbody>
</table>

2019 = estimate; 2020 = forecast. Source: Fitch Solutions

- Despite the stabilisation in global economic activity, our growth forecasts do not yet point to a sharp acceleration in growth.
- Although we will likely see some upward revisions to individual growth forecasts over the coming months, it is unlikely that we will see a sharp rebound in global growth.
- This is because some of the upside risks in some countries will likely be countered by downside risks in other parts of the world.
- For example, while investment in the US could surprise to the upside, the coronavirus could negatively impact China.
- At the same time, many emerging markets will battle with structural headwinds as well as pockets of inflation, which could limit stimulus measures.
Recession Risks Easing, But Vulnerabilities Remain
Recession Risks Easing, But Still Elevated By Historic Standards

Yield Curve Model Still Pointing To Elevated Recession Risks

Index, %

- Although we see a stabilisation in global economic momentum – as data has improved – recession risks have not dissipated altogether.
- The yield curve still points to a relatively high probability of recession in the US, despite falling in recent months.
- The global economy is late cycle, and policymakers have less policy space, making it more vulnerable to shocks.
- There are various risks to monitor including policy constraints due to late-cycle pressures, the spread of the coronavirus, potential for an escalation in trade tensions, as well as military tensions (Iran) and equity markets that look stretched.
# Recession Tracker: Risks Easing, But Not Gone

<table>
<thead>
<tr>
<th>Factor</th>
<th>Dec-19</th>
<th>Jan-20</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Policy Risks</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tariffs: Increase in China, or Mexico/Eurozone.</td>
<td>Δ</td>
<td>Δ</td>
<td>The phase-one deal between the US and China alleviates pressure.</td>
</tr>
<tr>
<td>Significant pressure on the Fed, causing a policy mistake/resignation.</td>
<td>Δ</td>
<td>Δ</td>
<td>The possibility of a policy mistake has declined, but the Fed could come under pressure again.</td>
</tr>
<tr>
<td><strong>Macro Risks</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEIs to weaken at current pace to below 2015-2016 levels and fail to stabilise by Q120.</td>
<td>Δ</td>
<td>O</td>
<td>The manufacturing sector is in contraction but is starting to rebound. Sentiment is improving and services are strong.</td>
</tr>
<tr>
<td>Steady deterioration in labour market.</td>
<td>O</td>
<td>O</td>
<td>The labour market remains robust, but NFPs and the number of new job openings are slowing, showing some incipient weaknesses.</td>
</tr>
<tr>
<td>Deterioration in lending, money supply growth.</td>
<td>O</td>
<td>O</td>
<td>Money supply growth remains robust, and bank surveys point to still reasonable lending conditions.</td>
</tr>
<tr>
<td>Rise in business and/or consumer-related NPLs.</td>
<td>O</td>
<td>O</td>
<td>General NPLs remain low given monetary easing and low interest burdens. Low-quality credit card debt is showing some stress.</td>
</tr>
<tr>
<td><strong>Market Risks</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S&amp;P declines by about 15-20% from peak, breaking support at 2,500-2,700.</td>
<td>O</td>
<td></td>
<td>S&amp;P has been hitting new highs and internals are strong, but risk of a correction has risen.</td>
</tr>
<tr>
<td>A sharp leg higher in IG and HY credit spreads towards/above 2016 highs.</td>
<td>O</td>
<td></td>
<td>IG and HY credit spreads remain tight. Germany-Italy spreads are not pointing to much stress, although risk in Italy is rising.</td>
</tr>
<tr>
<td>Rally in safe-haven assets such as the yen, treasuries, Swiss franc and gold.</td>
<td>Δ</td>
<td>Δ</td>
<td>Safe-haven assets remain bid as investors are hedging their risks.</td>
</tr>
<tr>
<td>Sharp break out in US dollar.</td>
<td>Δ</td>
<td>O</td>
<td>We are neutral on the US dollar as bullish drivers have eased.</td>
</tr>
</tbody>
</table>
Capacity Constraints Are Important To Monitor Late In The Cycle

Unemployment At Historic Lows

Output Gap Already Eroded In Many DMs

Source: Bloomberg, Fitch Solutions

Source: IMF Bloomberg, Fitch Solutions
Inflation Remains Well Behaved For Now, But Could Rise

DM Market-Based Inflation Expectations Picking Up
% Based On 5Y Forward Swaps

EM CPI Not Yet A Problem, But Could Limit Policymaking
% Based On 5Y Forward Swaps

Source: Bloomberg, Fitch Solutions
US-Iran Tensions Could Re-Escalate, Policy Misstep Is Key A Risk

Strait of Hormuz Still A Choke Point

Tensions Could See Oil Price Inflation Rise Suddenly

% chg y-o-y For Different Price Scenarios

Source: Fitch Solutions

Source: Bloomberg, Fitch Solutions
The coronavirus is spreading globally, and will have a negative impact on global growth if it is not contained.

Although the SARS virus in 2002/03 did not impact Chinese and global GDP significantly, delays to containing the virus could be more growth negative now.

China accounts for 16% of global GDP, compared with 4% in 2002 and int. aviation routes in China are much more developed than before. Chinese visitors abroad have risen to 160mn from 16mn in 2002. This could lead to a faster spread of the virus and a larger impact on GDP if not contained.

This has broad implications for global GDP through multiple channels including; transport and retail but also around investor sentiment.
Equity Markets Look Stretched Given 40% Rally In S&P Since Dec-18

Coronavirus & Equity Correction Could Spur Volatility

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S&P 500
CBOE VIX (RHS)

Valuations Looking Expensive
Case Shiller CAPE Ratio

Source: Bloomberg, Fitch Solutions
Thank You

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