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Global

Introducing Fathom's latest quarterly forecast: what's new?

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We shall be discussing our updated economic and financial market forecasts with clients over the coming weeks. This document lays out the major changes to our view since our previous quarterly forecast, as well as our key calls that remain unchanged.

We continue to believe that global equities are overvalued by as much as 40%, but we do not expect the bubble to burst this year. The recent correction does mark the start of a period of increased volatility, but we still expect most major equity markets to offer positive, single-digit returns in 2018.

We do not expect the equity bubble to burst this year, with global GDP growth to remain strong in 2018

Global GDP growth accelerated in 2017, and **we expect that economic activity will remain strong both this year and next**. We have nudged up our forecasts for global GDP growth from 3.7% to 3.8% in 2018, and from 3.3% to 3.4% in 2019. This includes upward revisions to growth in the US and the euro area, and a downward revision to growth in China (using our measure of Chinese economic growth, CMI 2.0). We still think that the UK will underperform other advanced economies and, if it does manage to avoid a recession, it is unlikely to grow by much more than 0.5% this year and next.

We maintain our strong conviction that the Phillips curve is not dead. With our own analysis suggesting that most major economies were already operating above potential by the end of last year, two more years of substantially above-trend growth **will cause inflation to rise faster than anticipated in many major economies**. Indeed, output gaps, particularly in the US and some core euro area economies, are likely to widen to such a degree that the odds of a sudden correction — read 'contraction' — in GDP become close to 50:50. We have revised up our inflation forecasts in the US, euro area, Japan and the UK, but revised down our inflation forecasts in China and emerging markets. The net change is a small upward revision to global inflation this year and next.

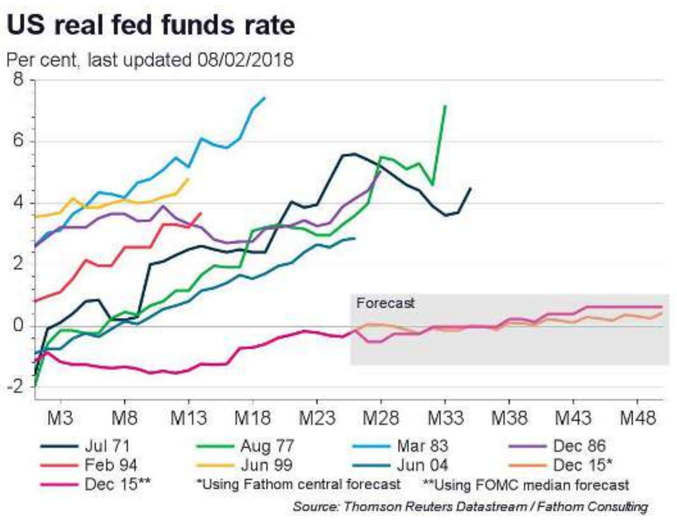
We maintain our conviction that the Phillips curve is not dead, and have revised up our inflation forecasts for most advanced economies

We think that the Fed will respond by raising nominal policy rates quicker than investors expect. We now expect to see the fed funds rate rise by 25 basis points four times this year and four times in 2019, taking it to 3.375% by the end of 2019. We had previously pencilled in three 25 basis point increases in 2018 and one 25 basis point increase in 2019. Our new figures may raise eyebrows, but it is important to remember **that US is embarking on one of its largest fiscal expansions since the second world war, at a time when the economy is already operating above capacity.** (For more on this, see 'Revisions to our key US economic forecasts'.)

This will prompt a quicker-than-currently-anticipated tightening from the Fed

In real terms, monetary policy looks set to remain extremely accommodative in nearly all of the major advanced economies. If we are right on both US inflation and US rates, the Fed's tightening cycle would be the most gradual tightening cycle in the last 50 years, by far.

But in real terms, this will almost certainly remain the most gradual tightening cycle in the last fifty years



In the euro area, we expect the ECB to stop buying new assets under its QE programme in September this year. If we are right, **an end to official purchases of government debt could see spreads in the periphery rise by as much as 100 basis points**. We expect the ECB will raise the main refinancing rate by 50 basis points next year. We had previously expected it to remain unchanged in 2019. We do not expect to see any change in policy rates in the UK or Japan over the next two years.

We expect the ECB to stop buying new assets later this year, prompting a rise in spreads in the periphery

We have identified two key risks these forecasts. The first is that China exports more deflation to advanced economies than it has been doing. This would keep a lid on inflation and policy rates in the advanced economies and be good for equities and government bonds. The second risk is CPI responding faster to labour market tightness than we anticipate and central banks hiking rates aggressively. This could cripple corporate profit margins, and stifle real GDP growth and would be consistent with the *r* - *g* gap narrowing fairly quickly, and would be likely to lead to a large correction in equities.

We will be discussing these forecasts and key themes with clients over the coming weeks. We will also be writing about the various key themes that underpin these forecasts in more detail in due course.

Continued

Overview of Fathom growth forecasts

	2016	2017	2018	2019	Trend
Annual average growth rate %		Central			
Global GDP	2.9 (3.4)	3.8 (3.8)	3.8 (3.9)	3.4 (3.5)	2.25 - 2.75
United States	1.5	2.3	3.2	2.9	1.0 - 1.5
EA	1.8	2.5	2.1	1.6	0.5 - 1.0
Germany	1.9	2.5	2.4	1.7	0.25 - 0.75
France	1.1	1.9	1.9	1.4	0.5 - 1.0
Italy	1.1	1.5	1.1	0.9	0.0 - 0.5
Spain	3.3	3.1	2.7	2.5	0.5 - 1.0
Japan	0.9	1.6	1.3	0.8	0.0 - 0.5
United Kingdom	1.9	1.8	0.7	0.5	0.5 - 1.0
China	4.4 (6.7)	6.7 (6.9)	6.2 (6.6)	5.6 (6.2)	3.75 - 4.25
EM commodity producers	1.8	2.7	3.1	2.3	2.0 - 2.5
Other EM (ex China)	5.3	5.0	5.1	4.7	3.5 - 4.0

(Using official Chinese GDP) *Source: Fathom Consulting*

Overview of Fathom inflation forecasts

	2016	2017	2018	2019
Annual average rate %			Central	
Global inflation	3.1	3.2	3.4	3.3
United States	1.3	2.1	2.7	2.7
EA	0.2	1.5	1.8	2.0
Germany	0.4	1.7	2.1	2.3
France	0.3	1.2	1.5	1.8
Italy	0.0	1.3	1.4	1.4
Spain	-0.2	2.0	2.4	2.7
Japan	-0.1	0.5	1.0	1.2
United Kingdom	0.7	2.6	2.5	2.3
China	2.0	1.5	1.4	1.6
EM commodity producers	8.1	6.0	5.8	5.6
Other EM (ex China)	4.2	5.3	5.8	5.0

Source: Fathom Consulting

Continued

Overview of Fathom financial market forecasts					
	2016	2017	Latest*	2018	2019
Year end					
Policy Rates					
United States	0.625	1.375	1.375	2.375	3.375
EA	0.00	0.00	0.00	0.00	0.50
United Kingdom	0.25	0.50	0.50	0.50	0.50
Japan	-0.10	-0.10	-0.10	-0.10	-0.10
10Y Government Bond Yields					
United States	2.43	2.41	2.84	3.30	4.20
Germany	0.21	0.42	0.75	1.35	1.75
United Kingdom	1.24	1.19	1.62	1.55	1.70
Japan	0.05	0.05	0.07	0.00	0.00
Equities - % change (LCU)					
United States - S&P 500	10	19	0	5	4
United Kingdom - FTSE 100	12	9	-7	2	4
United Kingdom - FTSE 250	4	15	-7	-4	1
Germany - DAX 30	7	13	-6	8	5
Japan - Nikkei 225	0	19	-7	11	7
Exchange Rate (vs USD)					
EURUSD - Euro	1.05	1.20	1.24	1.24	1.20
USDJPY - Yen	117	113	107	118	121
GBPUSD - Sterling	1.23	1.34	1.39	1.24	1.16
USDCNY - Chinese renminbi	6.95	6.51	6.34	6.80	7.25
Commodity Prices					
Crude Oil Brent, $ / barrel	57	67	63	63	64

Source: Fathom Consulting

** Data as of 13 February 2018*

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