Economic Outlook:
Growth Without Supplements

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MACROPOLICY PERSPECTIVES

Outlook: Growth Without Supplements

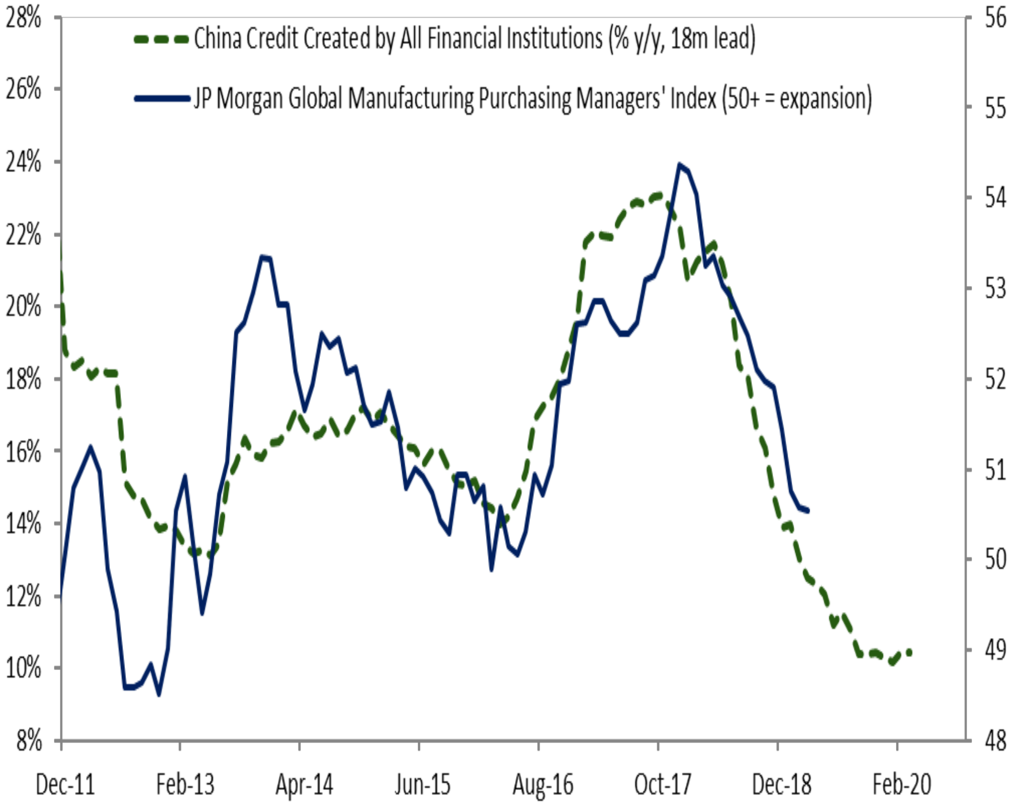
- Global momentum now moves from east to west. The Fed has been calibrating policy to ebbs and flows in Chinese credit and fiscal impulses.

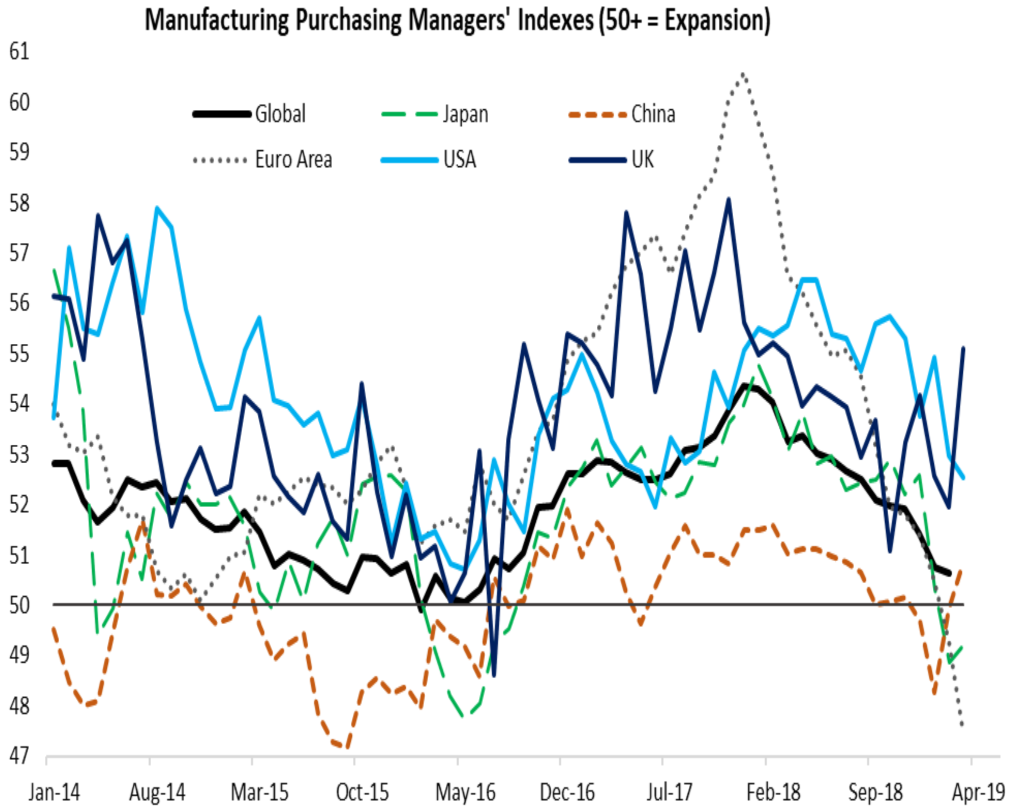
- China is aiming at stabilization not stimulation and the US fiscal impulse is fading, growth globally should continue to slow toward trend.

- We are learning from global financial markets that interest rates are neutral already, the Fed is likely done with rate hikes

- Keys to the outlook: The efficacy of Chinese stimulus/management of credit overhang (+/-), the degree to which various sources of political uncertainty slow investment and hiring (-), the ability of markets to calibrate to slower growth (-)

Global Momentum Moves From East to West





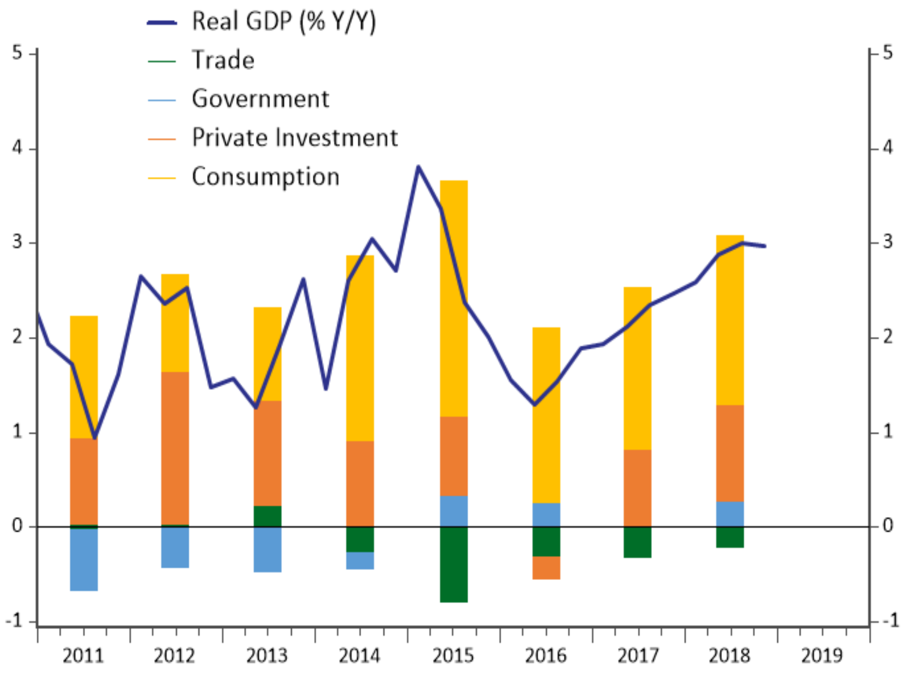
Outlook: There is slowing in the pipeline, question for H2 is whether Chinese stimulus gains traction and central bank partience keeps sentiment on track

Comparisons to Global Slowdown of 2015/2016

- Current episode does not feature the same collapse in energy/commodity prices. Better for US energy sector and EM stability but no boost to disposable income for consumers.
- Capital controls limit outflows and financial market contagion
- Greater stock of unsustainable leverage in China implies the potential for credit saturation or downside risks from deleveraging. Growth will likely be structurally slower in China rather than the 2016 bounce.
- US labor market is stronger and potentially more resilient.
- US consumption and investment are more mature cyclically, corporate sector is more leveraged suggesting greater vulnerability to shocks.
- US fiscal policy is becoming less supportive and could become restrictive
- There are greater policy uncertainties from multiple sources.
- Monetary policy is more restrictive, although financial conditions haven't tightened as much

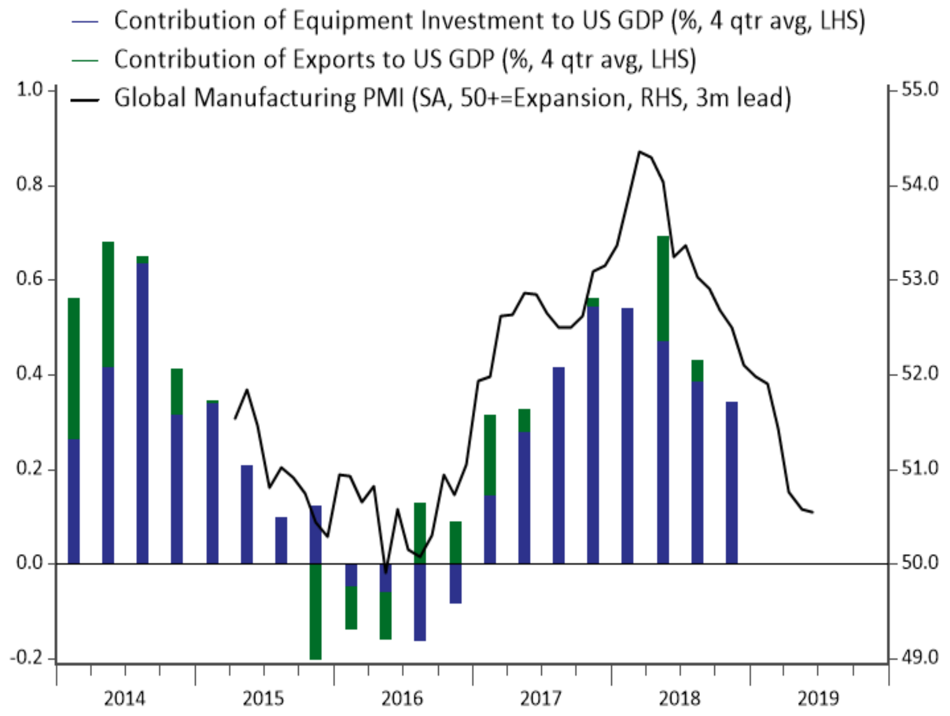
Momentum in US to Fade on Global Slowing, Fading Fiscal Impulse

Contributions to Real GDP Growth (pp)



Source: Bureau of Economic Analysis/Haver Analytics

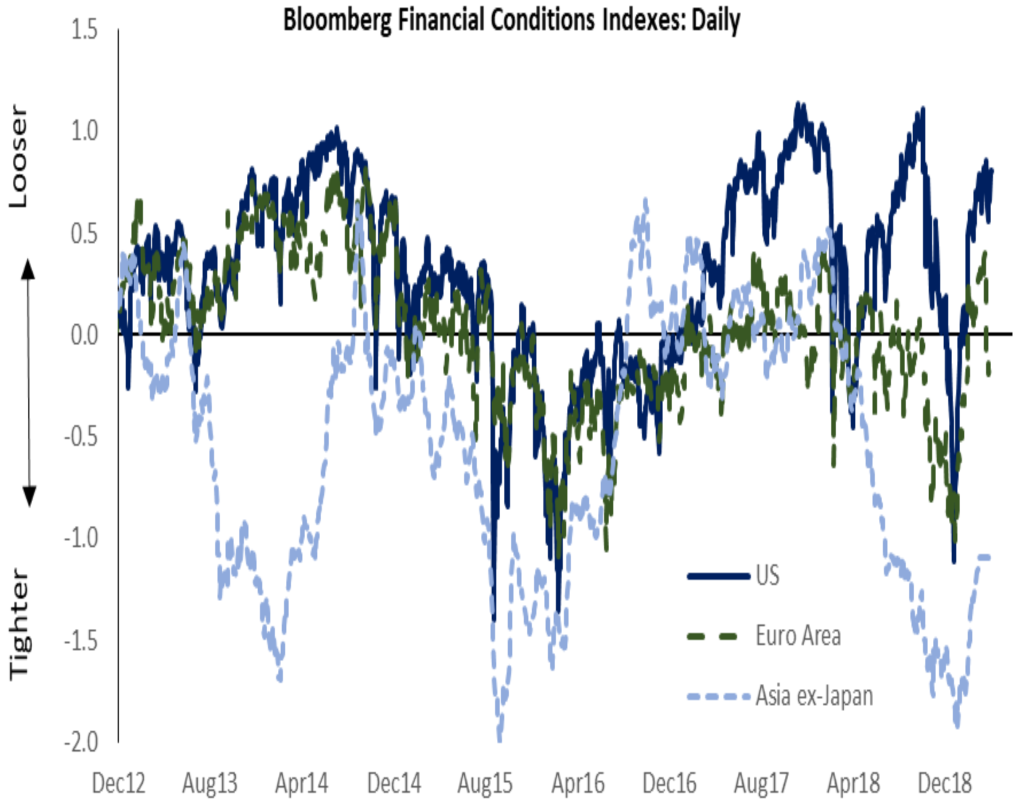
Influence of Global Economy on the US

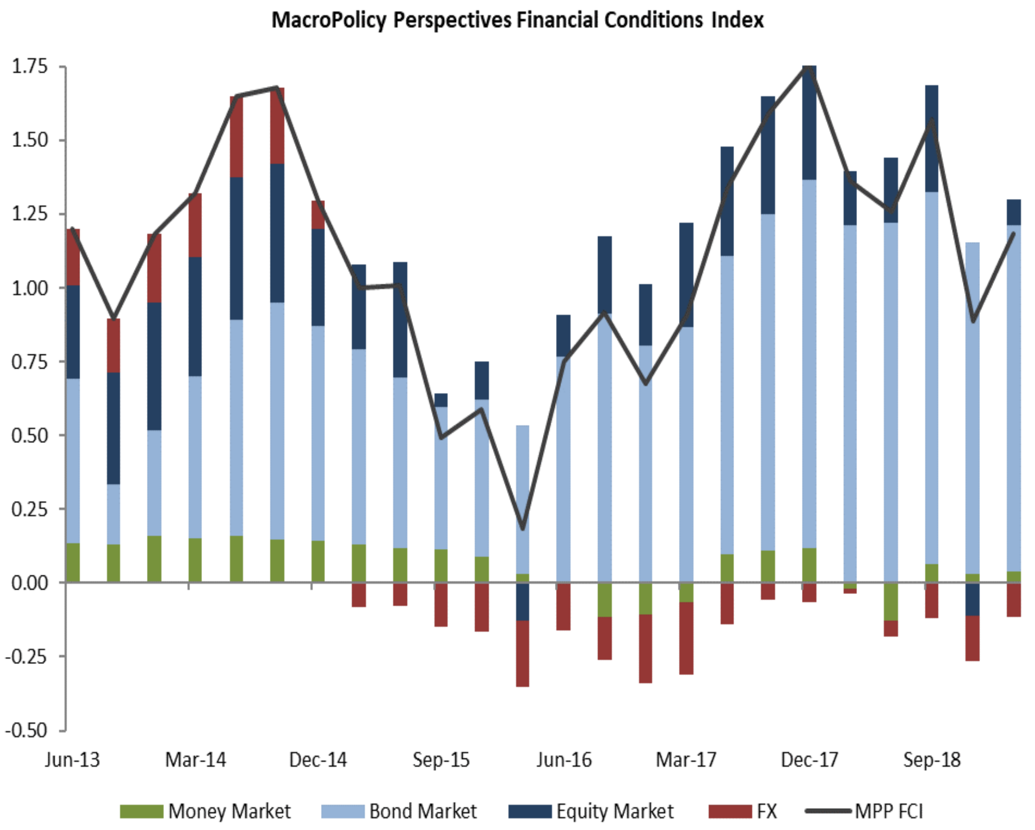


Sources: Bureau of Economic Analysis, JPMorgan/IHS Markit/Haver Analytics

- GDP pickup driven by government spending and capex
- Capex looks vulnerable to global slowdown and fiscal impulse will fade, we expect GDP growth to slow to 1.9% in 2019 from 3.0% in 2018

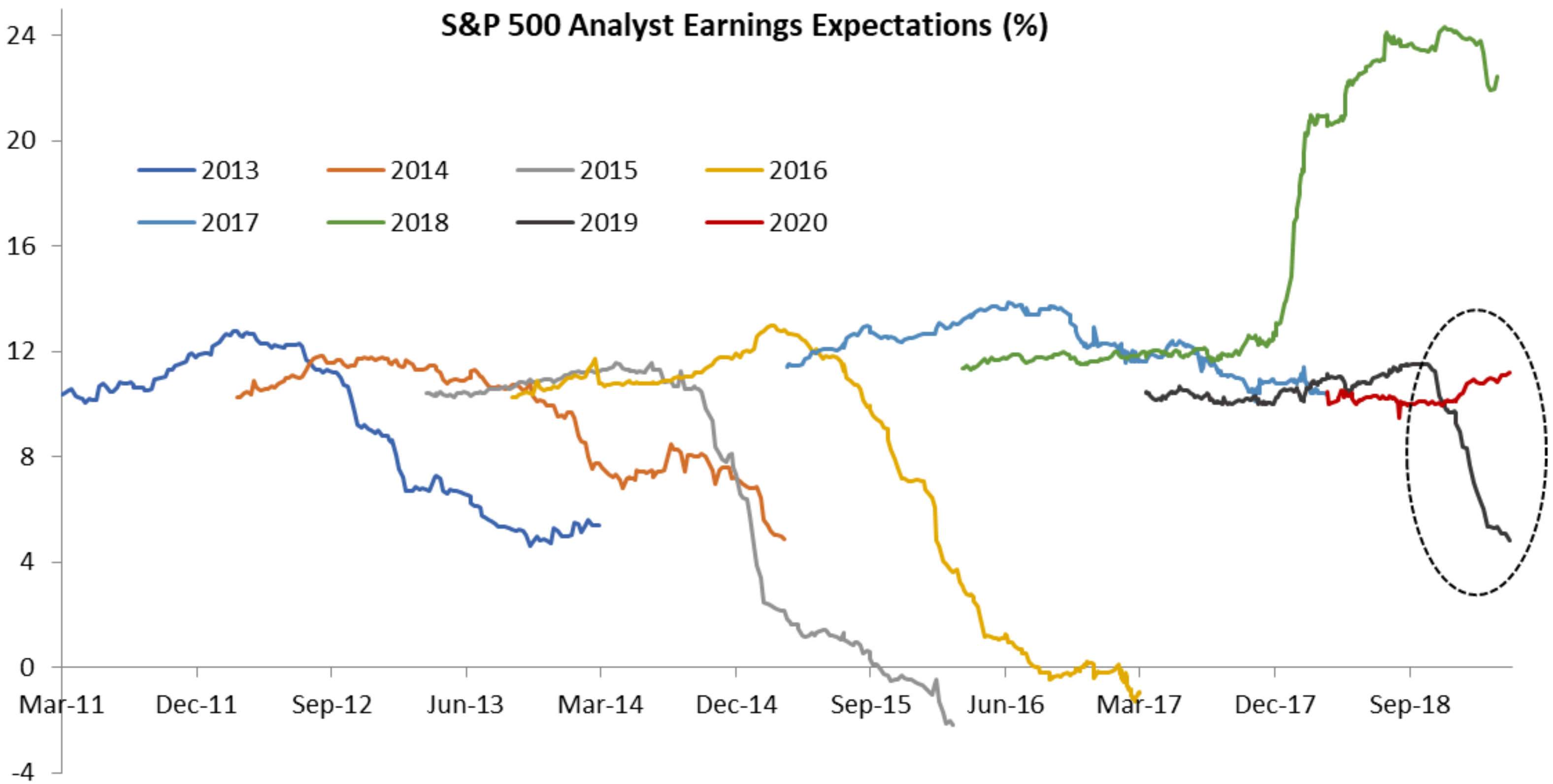
Financial Conditions Have Rebounded, Mostly in the US





- The correction started in Asia, then spread to Europe an the US. Signs of stabilization in China and central bank recalibration brought them back although they remain restrictive in Asia and neutral in Europe

US Equity Corrected on Fading Sugar Rush, Facing Global Headwinds



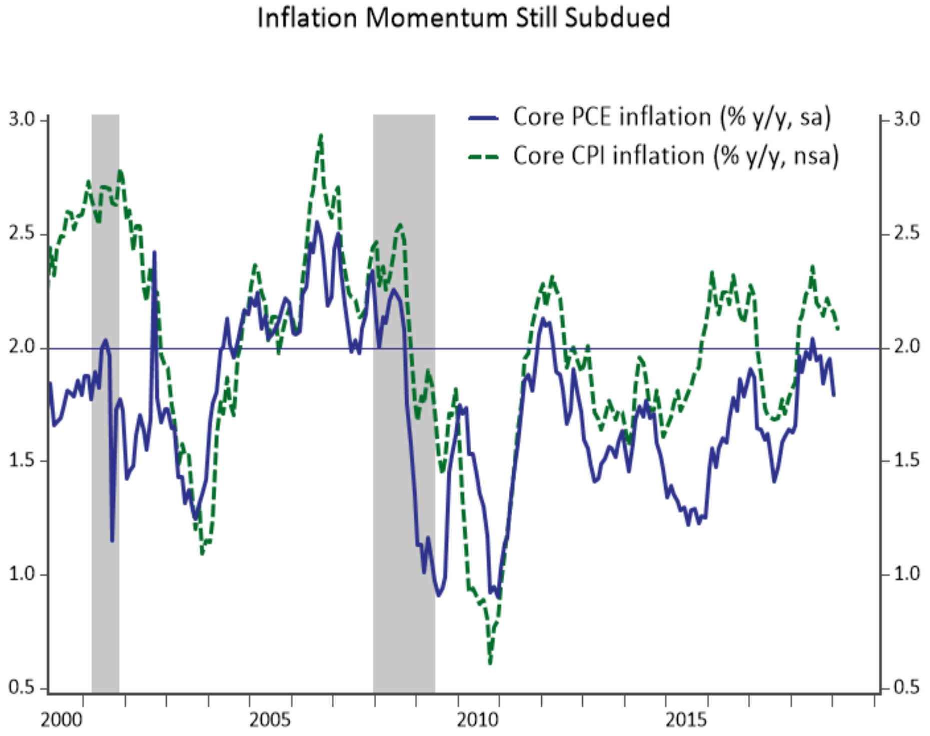
- Earnings grew at a record pace in 2018 but guidance for 2019 is moving south.
- Dynamics in downgrades look similar to last China led slowdown
- A rebound back to double digits is still expected in 2020 and 2021

Earnings Downgrades Are Broad Based

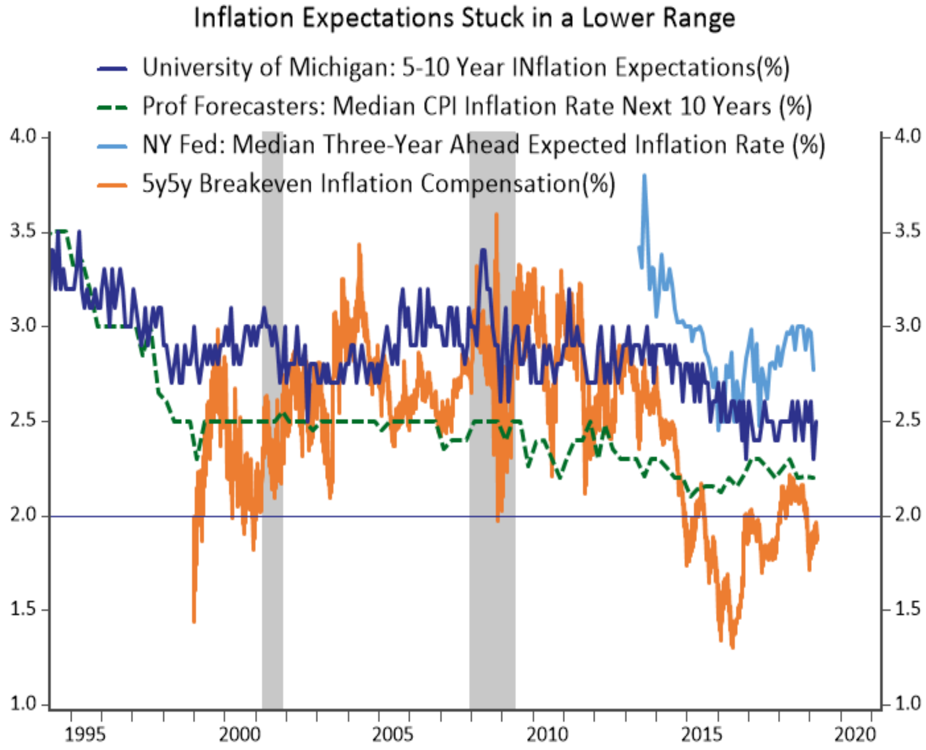
	Consumer Discretionary	Consumer Staples	Energy	Financials	Real Estate	Health Care	Industrials	Info Tech	Materials	Telecom Services	Utilities	Total
2015												
Expected Earnings Prior Oct (%)	14.6	6.5	7.8	8.4	9.7	11.6	11.2	13.0	18.7	6.4	2.9	10.5
Realized Earnings	11.5	-1.3	-59.5	-0.5	3.8	12.2	-0.1	7.4	-6.2	16.0	1.6	-2.2
% Change	-21%	-120%	-862%	-106%	-61%	5%	-101%	-43%	-133%	150%	-44%	-121%
2016												
Expected Earnings Prior Oct (%)	13.6	6.2	9.1	9.6	8.7	11.7	6.9	8.6	14.8	3.1	4.4	9.3
Realized Earnings	7.0	6.1	-76.7	-3.3	8.6	9.3	-4.8	-1.2	-5.4	7.1	17.8	-1.0
% Change	-48%	-1%	-946%	-135%	-1%	-21%	-170%	-114%	-137%	128%	301%	-111%
2019												
Expected Earnings Prior Oct (%)	14.9	4.4	25.8	10.2	6.2	8.4	12.5	14.2	6.8	12.4	4.3	11.5
Latest Earnings Expectations	11.6	2.7	-9.8	7.8	2.6	7.4	7.5	1.5	-2.7	6.0	6.9	4.8
% Change	-22%	-39%	-138%	-23%	-58%	-12%	-40%	-89%	-140%	-51%	59%	-58%

- Red indicates an absolute decline in earnings growth (more than 100% decline relative to expectations), yellow indicates a substantial decline (>5%) in expectations, blue is a performance better than initial expectations.

Inflation and Inflation Expectations Remain Subdued



Sources: BEA, BLS/Haver



Sources: UMICH, FRBPHIL, FRBNY, FRB/Haver

- If tariffs, fiscal stimulus and a strong labor market can’t raise inflation and inflation expectations this cycle, it’s hard to see what will.

Respondents to Our Shadow Survey Are Skeptical on the Inflation Outlook

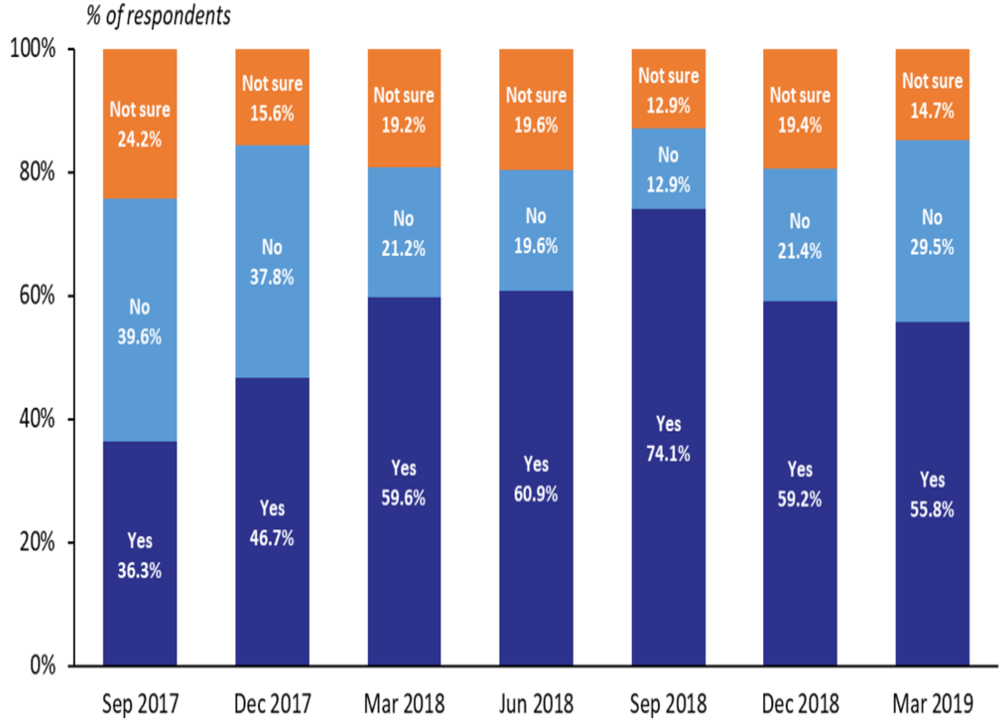
What probability do you attach to seeing a sustained* period of 2% annual core PCE inflation within the next two years?

	Total respondents			Inflation investors**		
	Median	Average	# of responses	Median	Average	# of responses
Sep 17	25%	32%	91	25%	28%	38
Dec 17	25%	31%	90	25%	35%	41
Mar 18	40%	43%	104	40%	44%	40
Jun 18	50%	46%	92	40%	41%	37
Sep 18	60%	55%	85	55%	51%	29
Dec 18	40%	44%	98	35%	40%	29
Mar 19	35%	38%	95	32%	34%	38

sustained is defined as core PCE inflation at or above 2% on a y/y basis for a period longer than 6 months.

*** "inflation investors" are those who answered "yes" to either parts of the following question: Do you invest or transact in the markets for: a) Inflation-linked securities; b) Other financial products explicitly based on your views about US inflation.*

Do you believe that current monetary policy tools are capable of generating a sustained* period of 2% core PCE inflation within the next 2 years? **core PCE inflation at or above 2% on a y/y basis for a period longer than 6 months.*



Some Additional Questions for the Policy Review

- How would a communication strategy aimed at raising inflation expectations interact with financial stability concerns?
    - How much froth in leveraged lending is the Fed willing to tolerate in exchange for 20bps on inflation?
- What are the various channels that QE and QT work and how do they interact?
    - Liquidity provision, signaling on interest rates, portfolio balance (stock versus flow)
- How does balance sheet policy interact with interest rate policy?
- Why is the focus of calibrating QE on term premia in Treasuries when the portfolio balance channel tells us it will affect financial conditions broadly?