



# UBS House View

Monthly Base **January 2020**

**Chief Investment Office GWM**

This report was prepared by UBS AG.

All forecasts in this publication are as of 12 December 2019 at 09:00 a.m. CET and might change after that. This publication will only be updated intra-monthly to reflect changes in our TAA positions or thematic views. To get our most recent forecasts, please refer to our publication called "Global forecasts."

Please see the important disclaimer at the end of the document.

This document is a snapshot view. We update the tactical asset allocation as changes occur and resend it to subscribers. For all other forecasts and information, we advise you to check the Investment Views section in your E-Banking or in Quotes.

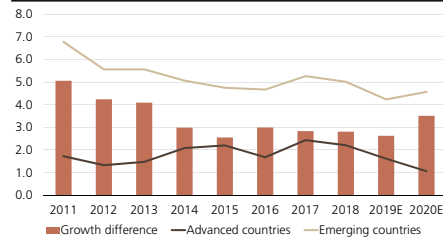
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Dec 12 2019

# Financial Market Outlook – short term

## Global Tactical Asset Allocation

### EM vs. DM growth difference to widen in 2020

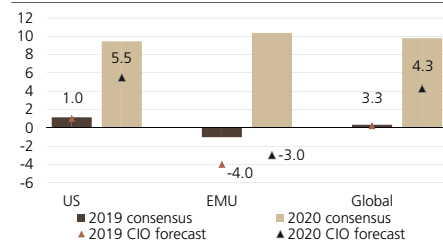
Annual real GDP growth in % including UBS forecasts



Note: EM = emerging markets; DM = developed markets.  
Source: Haver, CEIC, national statistics, UBS, as of December 2019

### US equities offer better earnings outlook than Eurozone

Consensus earnings-per-share (EPS) vs. UBS CIO forecast



Source: Thomson Reuters, UBS, as of December 2019

### Asset allocation

Some back and forth between China and the US regarding a potential Phase 1 trade deal has kept investors busy over the past month and caused some market volatility. As the December 15 deadline approaches and the outcome can be binary, we think a neutral allocation to equities is warranted. We remain skeptical on the prospect of a meaningful trade deal anytime soon, but our base case is an agreement that avoids further escalation. Economic data is tentatively suggesting a stabilization of global growth, but no acceleration yet. We keep our overweight positions in EM sovereign bonds and a basket of EM currencies, as the environment remains supportive of carry trades, with global central banks providing strong monetary stimulus. To become more positive, we are looking for signs of a sustainable economic recovery and a significant trade agreement. On the flip side, a breakdown in trade negotiations would cause our outlook to deteriorate again.

### Equities

We overweight US over Eurozone stocks. Should economic data weaken, we think the Federal Reserve has more leeway to act than the European Central Bank (ECB). Consensus expectations for earnings growth look more realistic in the US than in the Eurozone. We also overweight Japanese over Eurozone equities. While both regions are geared toward global growth and exports, Eurozone stocks have outperformed and are already pricing in a significantly better outcome compared to the Japanese market.

### Bonds

After very strong returns in 2019, the outlook for 2020 is more muted, as bond yields have fallen. Still, against a backdrop of very easy monetary policy globally and mediocre economic growth, selecting the right carry assets remains a promising strategy. We hold an overweight position in EM sovereign bonds in USD over high grade bonds. The current yield of 5% remains attractive, as central banks keep interest rates low and the growth differential between emerging and developed markets is likely to widen in the quarters ahead. Recent idiosyncratic risks (e.g. from Ecuador) have not spilled over into the broader asset class, highlighting its current resilience and well-diversified nature.

### Foreign exchange

We keep an overweight in the US dollar against the Australian dollar (AUD) as deteriorating economic conditions in Australia are likely to keep the country's central bank on an easing path, while the AUD remains exposed to US-China trade tensions. Our EM currency basket (overweight Indian rupee and Indonesian rupiah versus the AUD and Taiwan dollar) aims to earn the interest rate advantage without being too strongly exposed to US-China trade tensions.

### Longer-term asset allocation (1–4 years)

While we generally recommend to hedge the currency risk of non-domestic equity positions, we have removed these hedges for UK and Japanese equities. The British pound and the Japanese yen are substantially undervalued and thus offer significant appreciation potential over the coming years, outweighing the benefits of currency hedging.

# Cross-asset preferences

## Equities

## Bonds

## Foreign exchange

## Hedge Funds

## Precious Metals & Commodities

### We like...

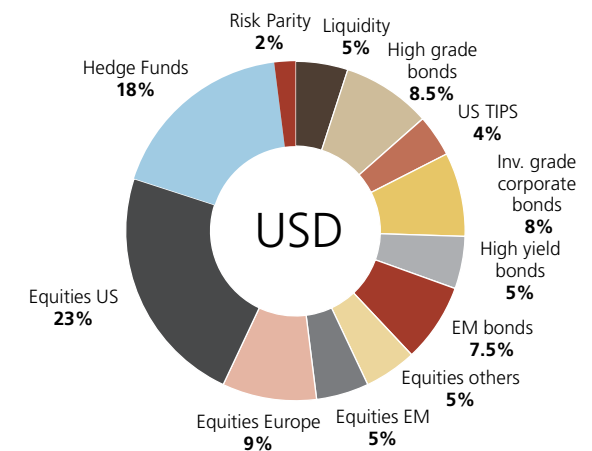
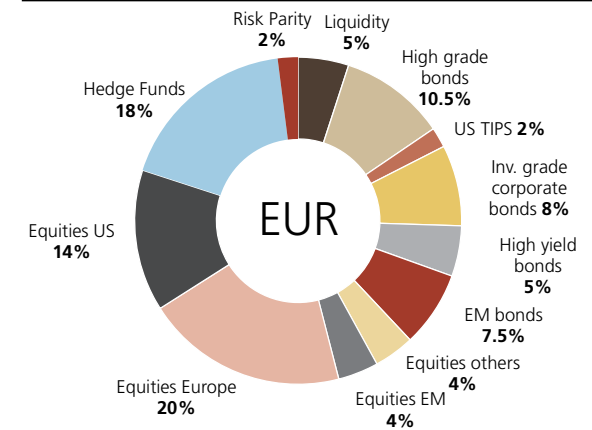
- Japanese equities
  - US equities
  - Global quality stocks
  - "Buy-write" strategy on US equities
  - US smart beta
- 
- Emerging market sovereign bonds in USD
  - Global green bonds
  - Mind the gap: Corporate "rising star" candidates
  - Time to be more selective in EM credit
- 
- US dollar versus...
  - EM FX (INR, IDR) versus...
  - Japanese yen (1–4-year horizon) versus...
  - British pound (1–4-year horizon) versus...

### We don't like...

- Eurozone equities
- 
- Developed market high grade bonds
  - Mind the gap: Corporate "fallen angel" candidates
- 
- ...Australian dollar
  - ...DM FX (AUD, TWD)
  - ...base currency
  - ...base currency

↗ Recent upgrades   ↘ Recent downgrades

### Model portfolios (EUR & USD)

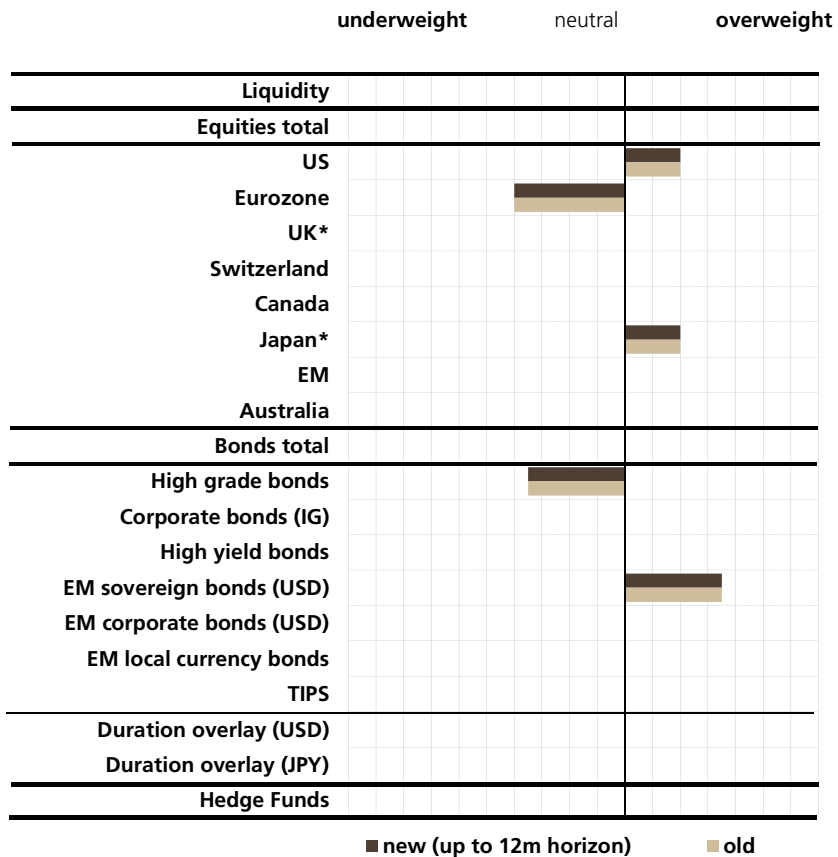


Source: UBS, as of 12 December 2019

Note: Portfolio weightings are for a EUR model portfolio and a USD model portfolio, with a balanced risk profile (including TAA). We expect the EUR balanced portfolio (excluding TAA) to have an average total return of 2.8% p.a. and a volatility of 7.9% p.a. over the next seven years. We expect the USD balanced portfolio (excluding TAA) to have an average total return of 5.1% p.a. and a volatility of 7.9% p.a. over the next seven years.

# Global tactical asset allocation

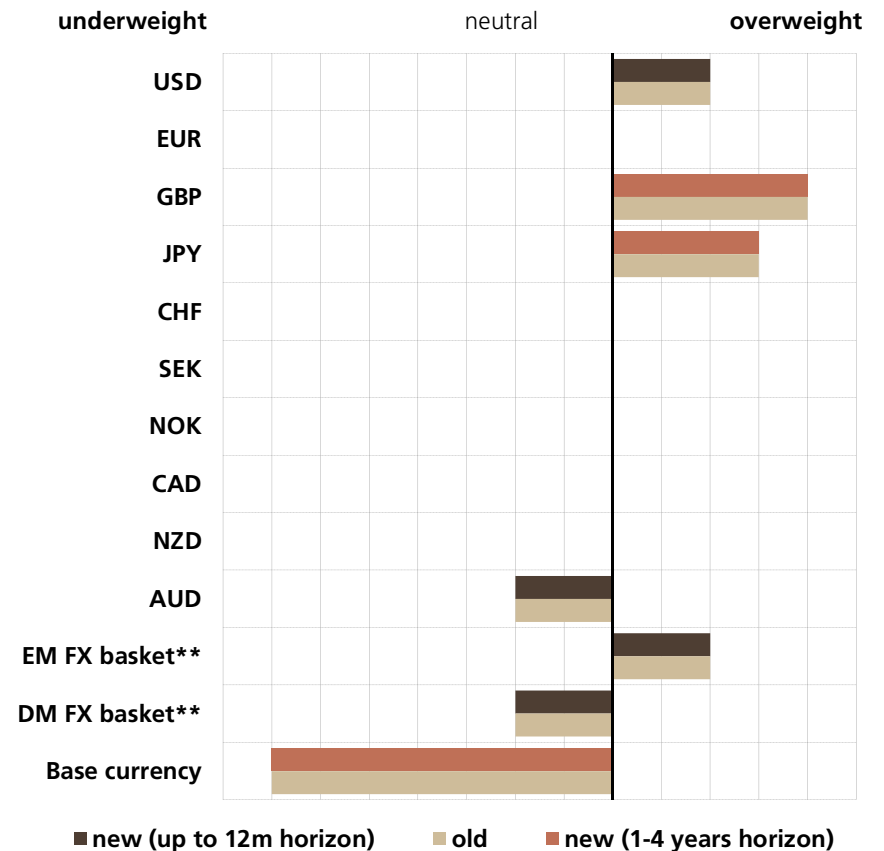
## Tactical asset allocation deviations from benchmark



Source: UBS, as of 12 December 2019

Please note that the bar charts show total portfolio preferences, which can be interpreted as the recommended deviation from the relevant portfolio benchmark for any given asset class and sub-asset class.  
\*Currency exposure of Japanese and UK equities is not hedged.

## Currency allocation



Source: UBS, as of 12 December 2019

\*\* EM FX basket contains Indian rupee and Indonesian rupiah. DM FX basket contains Australian dollar and Taiwanese dollar (all equally weighted).

# CIO themes in focus

## Equities

- **US smart beta**

Certain stock characteristics (momentum, quality, small capitalization, risk-weighting, value, and yield) have been shown to deliver long-term investment outperformance relative to a market-capitalization-weighted index. Combining these characteristics, known in the industry as smart beta, makes the investment less cyclical and creates a "passive-plus" solution. Smart beta's compelling value proposition has resulted in considerable growth in assets. Smart beta ETF assets have risen to over USD 750bn and are growing by more than 30% a year.

- **Generate yield: "Buy-write" on US equities**

An equity buy-write strategy involves buying equities (the "buy" part) while selling (or "writing") call options that cover the position, typically on a monthly schedule. In exchange for giving a counterparty the right, but not the obligation, to buy the underlying asset at a predetermined price, the buy-writer receives a premium. Over an economic cycle, equity buy-write strategies generate attractive risk-adjusted returns as they capture both the equity and volatility risk premium. They are most appealing when equity returns moderate and market momentum eases.

- **Global quality matters**

The quality factor aims to reflect the performance of companies with durable business models and sustainable competitive advantages. It therefore targets companies with a high return on equity, stable earnings, and low financial leverage. In the late stages of the business cycle, when economic growth slows down and volatility rises, quality matters. As trade uncertainties remain, a global sector-neutral quality strategy can also offer added downside protection in a relative context.

## Bonds

- **Green bonds: Sustainability meets late-cycle stability** 🌱

We view green bonds as a sound, sustainable alternative to global investment grade (IG) bonds. While an individual green bond usually performs in line with an otherwise identical non-green one, the green bond market has a more conservative sector and risk profile and benefits from demand for sustainable investments outgrowing supply. This should lead to outperformance during times when credit risk premiums rise, making green bonds an appealing late-cycle investment, following the recent recovery in credit risk premiums globally. To benefit from green bonds' less cyclical profile, investors should diversify broadly and in particular avoid issuer concentration risk.

- **Mind the gap: Investing in the crossover zone**

Investors able and willing to stomach the potential volatility of "crossover credit" investments can earn potentially significant alpha if key rating agency action is anticipated correctly. While we emphasize that investments in BBB or lower quality bonds are not suitable for risk-averse investors, we provide credit views on the issuers trading in the crossover area. We also offer long and short bond baskets to help investors navigate the crossover zone.

- **Time to be more selective in EM credit**

With this theme, we provide advice on how to build diversified exposure to emerging market (EM) credit, drawing from our top-down view on the asset class, as well as the bottom-up insights of our credit analysts. Emerging market credit should benefit from accommodative global liquidity conditions, resilient (though slowing) global economic growth, and sound credit fundamentals, as well as the relative attractiveness of the asset class versus other credit market segments. That said, as we move toward a later stage of the global business cycle, selectivity will remain paramount in 2020. We expect risks to remain two-sided, providing opportunities for active investors to adjust their exposure toward the most promising opportunities.

This selection of themes is a subset of a larger theme universe. It represents the highest conviction themes of the UBS Chief Investment Office GWM, taking into account the current market environment and risk-return characteristics.

# CIO longer-term investment themes in focus

## Equities

- **Obesity** 🌱

Urbanization and rising per capita GDP in emerging markets will contribute to the prevalence of obesity globally in the coming decades. Western economies are most associated with the obesity epidemic, but it is no longer just a rich-world problem. Based on current trends, the combined population of obese and overweight adults globally could exceed 40% by 2030.

- **Medical devices** 🌱

The world's aging population and the growth of the over-65 age group will create more opportunities for companies selling medical products and devices. Other drivers of the medical device industry include better penetration in emerging markets due to improved infrastructure, new innovative treatments, increased affordability due to rising per-capita GDP, and a growing prevalence of "lifestyle diseases" like obesity due to urbanization. We expect sustainable mid-single-digit revenue growth.

- **Emerging market infrastructure** 🌱

Growing urbanization and the expansion of megacities in emerging markets are driving demand for infrastructure investment. Spending on EM infrastructure is expected to grow to USD 5.5 trillion from the current USD 3 trillion, bringing its share of global spending to two-thirds by 2025 from the current half. Inadequate urban and nationwide infrastructure acts as a bottleneck to economic growth, making infrastructure investment a national priority.

- **Space**

The sharp decline in launch costs is lowering entry barriers to space. We forecast the space economy will grow from USD 340 billion currently to almost USD 1 trillion in the next couple of decades, catalyzed by sustained capital investment by new-economy billionaires. Investment exposure at this early stage is best gained via existing listed companies in the aerospace, satellite, and communications segments. New space startups may offer investment opportunities in private markets.

- **Water scarcity** 🌱

Water is essential to life and represents a key driver of economic growth. Unfortunately, fresh water is distributed unequally worldwide. As the world's population grows, the planet's limited natural resources are subject to increasing strain, which in turn can detract from social and economic prosperity. Population growth alone is a problem, but how and where it takes place can make resource management that much more of a challenge. While urbanization provides a major boost to GDP growth, it also requires vast amounts of scarce water. Many countries confront the increasing challenge of water scarcity while some face overabundance. We see attractive long-term investment opportunities in water that are likely to remain valid for decades.

This selection of themes is a subset of a larger theme universe. It represents the highest conviction themes of the UBS Chief Investment Office GWM, taking into account the current market environment and risk-return characteristics. The Longer Term Investments (LTI) theme series focuses on inevitable global trends, such as population growth, aging, and urbanization, that create a variety of opportunities, with certain companies and subsectors experiencing a higher-than-GDP rate of revenue growth. Here, we include a subset of a larger universe of LTI themes expected to offer good entry points for theme-oriented investors in the coming months, and highlight our preference for a diversified approach to themes.

# Key Investment Risks

Selected scenario		Scenario description	Expected market performance for select asset classes		
Base case	Managed slowdown	Global growth stabilizes around 3%. Major central banks retain an easing bias. The global economy remains in "late-cycle" territory for at least another six to 12 months.	↑	<b>Global equities</b> 0% to +5% as we expect global earnings to remain low next year	
			↑	<b>US rates</b> to remain low as the Fed maintains the optionality to keep easing	
			↑	<b>EURUSD</b> rises toward 1.15 as Fed easing option and no additional tariffs help exports	
Key downside scenarios	New breakdown in trade talks with tariff increase	Trade talks break down. Tariffs on USD 160bn of Chinese goods come into effect on 15 December and China retaliates. US growth falls below trend and the risk of a US recession rises significantly.	↓	<b>Global equities</b> - 15% to - 20% as earnings deteriorate and pressure on profit margins rises	
			↓	<b>US rates</b> potentially fall to new historical lows	
				↔	<b>EURUSD</b> at 1.10, assuming that tariffs would hurt European growth (else 1.15-1.20)
	European economic slowdown	The Eurozone economy tips into recession, driven by a further deterioration in the Sino-US trade dispute beyond announced tariffs or a tit-for-tat tariff escalation between the US and the EU.	↓	<b>EMU equities</b> -10% to - 15% as weakness in manufacturing spill over to services	
↓			<b>EUR HY</b> spread reaches 800bps amid higher default risk		
			↓	<b>EURUSD</b> below 1.05 driven by further ECB stimulus	
Key upside scenarios	Trade talks momentum builds with tariff removal	The US and China agree on a phase I deal and rollback of tariffs, and resolve core structural issues such as forced technology transfer and Chinese subsidies. Growth outlook in both countries improves considerably as uncertainty fades.	↑	<b>Global equities</b> +5 to +10% with countries exposed to the global cycle leading up	
				↑	<b>US rates</b> Short-term rates reprice higher while the long end hits a lower high, absent structural reforms
			↑	<b>EURUSD</b> 1.15-1.20 assuming Europe profits from improving global growth.	
European growth re-accelerates	External headwinds fade and European growth recovers faster than expected, given the Eurozone economy's high reliance on global trade. Growth is supported by improving domestic demand, improved outlook in the manufacturing sector, and continued ECB stimulus.	↑	<b>EMU equities</b> +5% to +10% with positive earnings growth in 2020		
		↑	<b>EUR HY</b> spread tighten to 300bps but rising government yields weigh on total returns		
			↑	<b>EURUSD</b> at 1.20 as investors start pricing ECB policy tightening	

Expected total returns over a 6-month horizon. FX and spread levels as of end of Q2 2020.

Note: Upside and downside scenarios are possible events outside of CIO's base case expectations.

Please refer to the last published Global Risk Radar edition for further details on the risk scenarios and investment implications

For further information please contact CIO strategist Dirk Effenberger, dirk.effenberger@ubs.com



# Key financial market driver 1 - *Central bank policy*

## Key points

- Faced with rising risk premiums as a result of trade uncertainty, central banks have tended to keep policy accommodative in 2019. This is acting as an insurance policy to maintain existing levels of activity.
- A debate seems to be starting in central bank circles about the merits of prolonged periods of negative interest rates. The decision of Sweden's Riksbank around negative rates and any subsequent policy reaction will be watched by markets. The Swiss National Bank remains a fan of keeping rates below zero.
- The major central banks are signalling a pause in policy moves in the near term. Having taken out insurance, policymakers seem unwilling to add further stimulus when underlying economies remain strong.

## CIO view (Probability: 60%\*)

### Remaining accommodative, no significant policy shifts

- The Federal Reserve has eased policy this year despite extremely low unemployment rates. Economic growth, while slowing, is not exceptionally weak. It seems that the interest rate cuts to date have been an insurance to manage uncertainties created by the current trade conflict.
- Any significant escalation of the trade conflict (impacting the real economy) may force additional easing in the US and elsewhere. The Fed seems unlikely to reverse the 2019 rate cuts quickly, even if there is some resolution to the dispute with China.
- The European Central Bank is clearly divided over recent policy moves. However, there does not seem to be a consensus to change policy in the near term.

## ➤ Positive scenario (Probability: 20%\*)

### More aggressive policy easing as macro backdrop worsens

- Political policy errors threaten economic growth either through more aggressive trade disruption or weaker US or European growth. Central banks respond to the changing economic outlook with easing that goes beyond our base case forecasts.

## ➤ Negative scenario (Probability: 20%\*)

### Policy breakthroughs reduce uncertainty

- A comprehensive US-China deal on trade reduces real economic risk. Investment spending and business confidence recover more than expected. Central banks focus on the economic cycle, and hint at or move toward policy normalization.

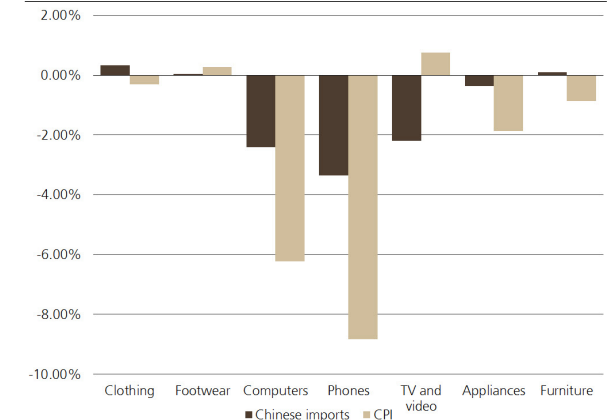
\*Scenario probabilities are based on qualitative assessment.

## Key dates

Jan 3	US Federal Reserve minutes
Jan 23	ECB policy decision
Jan 29	US Federal Reserve policy decision
Jan 30	Bank of England policy decision

## Chinese import prices seem to have little to do with US consumer prices

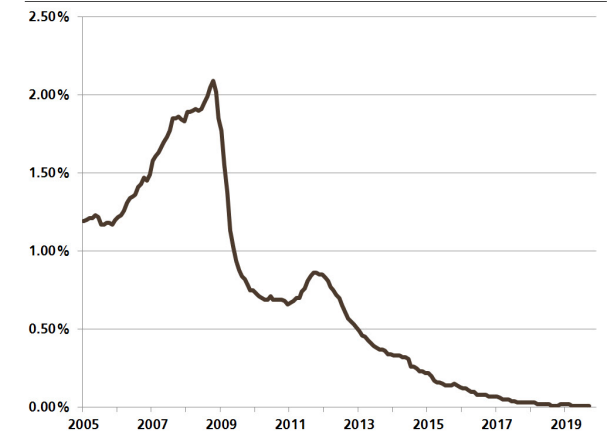
Average (2014-2019) import price inflation from China versus domestic US consumer price inflation, % y/y rates



Source: Haver, UBS, as of 4 December 2019

## German retail savers may pay the negative interest rate tax

German overnight bank retail deposit rates – which may now go below 0%



Source: Haver, UBS, as of 4 December 2019



# Key financial market driver 2 - *Earnings growth should improve*

## Key points

- Corporate profit growth remains sluggish.
- But headwinds should begin to fade.
- Leading to better growth in 2020.

## CIO view (Probability: 60%\*)

### Earnings soft patch poised to improve

- US earnings growth has been pressured this year due to fading fiscal stimulus, slower global growth, rising tariffs, lower commodity prices, and a stronger US dollar. Still, a material decline in profits looks unlikely. Leading indicators such as access to capital remain supportive, suggesting that profit growth should improve in 2020.
- At a sector level, 2019 profits are down sharply in the energy and materials sectors. Tech (especially semis) and industrials earnings are also lower. But with signs that the global industrial and commodity cycles are bottoming, along with lower semiconductor inventories, these sectors will not likely be a drag in 2020.
- We continue to expect S&P 500 EPS of USD 164 (+1% y/y) in 2019 and USD 173 (+5% y/y) in 2020, and await greater clarity on US-China trade policy and its impact on the global economy.
- In the fourth quarter, we expect earnings growth to be flattish to slightly positive. The energy, materials, and industrials sectors will continue to be weak but the tech and financials sectors should see some improvements relative to prior quarters.
- We expect profit margins to fall 0.4% in 2019. Still, we don't expect a sustained margin decline. The weakness is due to slow revenue growth and idiosyncratic factors such as investment spending in communication services and currency headwinds in consumer staples and tech. Most of the pressure is not due to rising wages. Labor-intensive consumer discretionary companies are the most exposed to higher wage costs but, outside of this sector, the average company should be able to offset higher wages through greater productivity and targeted price increases. Also, bear in mind that higher wages typically translate into faster consumer spending.

## ➤ Positive scenario (Probability: 20%\*)

### Central bank stimulus and trade dispute resolution

- Aggressive global central bank stimulus and a resolution to the trade dispute between the US and China drive a reacceleration in growth.

## ➤ Negative scenario (Probability: 20%\*)

### Downturn in sentiment

- Trade and geopolitical tensions flare up, depressing business and consumer sentiment. Wage pressures, without improving consumer and business demand, crimp profit margins and earnings growth rates. Declines in long-term interest rates pressure financial sector earnings.

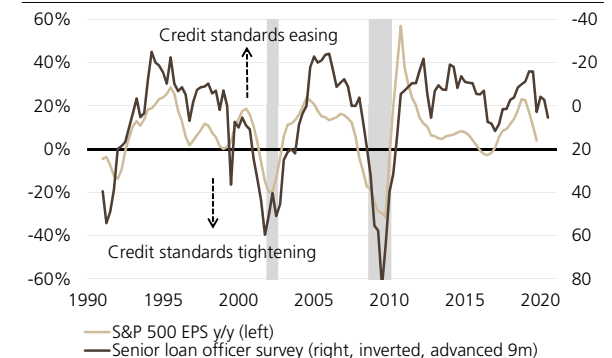
\*Scenario probabilities are based on qualitative assessment.

## Key dates

Jan 15 4Q earnings season kicks off with banks

## Credit standards remain supportive for further EPS growth

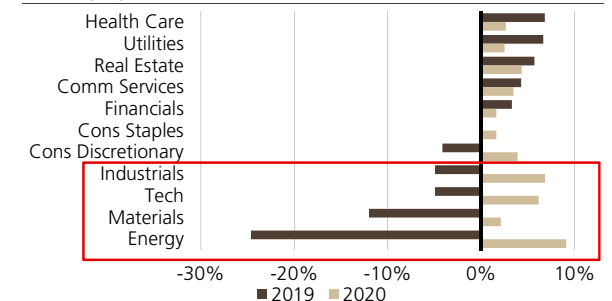
### Fed loan officer survey and S&P 500 EPS growth



Source: Bloomberg, UBS, as of 5 December 2019

## Anticipate improvement in global cyclical sectors

### Earnings growth, UBS CIO estimates



Source: FactSet, UBS, as of 5 December 2019

# Global economic outlook - *Summary*

## Key points

- Slowing investment has slowed global growth, to a level somewhat below trend. The lack of significant imbalances in the global economy means that a more significant slowdown remains low probability.
- Consumer demand remains firm in most major economies. In particular, consumers remain willing to purchase more expensive items, which suggests a degree of confidence in their future employment, and the overall economic outlook.
- While a US-China trade deal would be positive economically, it is unlikely to restore trust in the world trade order. Re-imposing tariffs on Argentina and Brazil reminds companies that any trade deal can be reversed.

## CIO view (Probability: 50%\*)

### Global growth below trend for now

- Trade uncertainty continues to be felt via weaker investment spending. Trade matters more to equity markets than it does to the real economy. A partial trade deal between China and the US would have a positive but limited impact on this. Avoidance of existing trade taxes through supply-chain shifts has increased and should continue to blunt their negative impact. There is some evidence of a stabilization or modest improvement in global trade volumes.
- Manufacturing-sensitive, investment-focused economies like Germany have already felt the consequences of trade tensions. However, recent Asian and European data offer some signs of more stable growth.
- Labor market strength is continuing in most major economies, supporting consumers' income (via increased employment, increased wages, or both). Global unemployment is near a 40-year low. Domestic demand should limit the drag from the export and investment weakness.
- However, the longer the downturn in investment continues, the greater the risk it will spill into labor markets and weaken domestic demand.
- Underlying inflation trends remain relatively benign, with companies absorbing trade taxes rather than passing them on. The effect of strong labor markets should be monitored.

## ↗ Positive scenario (Probability: 25%\*)

### Faster return to trend growth

- Trade uncertainty recedes after a breakthrough in US-China negotiations, triggering a recovery in investment spending. Labor markets continue to support consumer demand.
- The fiscal and monetary stimulus measures in Europe and Asia support economic growth.

## ↘ Negative scenario (Probability: 25%\*)

### Trade escalation pushes the world economy toward a severe downturn

- Trade tensions escalate, unsettling business confidence further. Companies decide to retrench, meaning not only lower investment, but also attempts to cut labor costs. This weakens consumer spending.
- Limited monetary and fiscal-policy measures are insufficient to counter a fast global downturn.

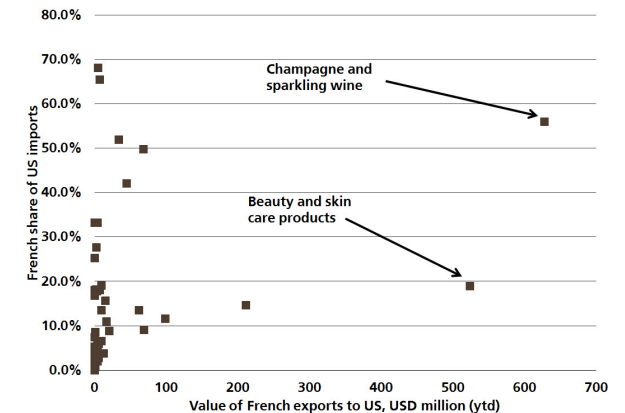
\*Scenario probabilities are based on qualitative assessment.

## Key dates

Jan 10	US employment report
Jan 29	US Federal Reserve meeting

## Proposed taxes on US consumers of French product - Champagne and skincare matter most

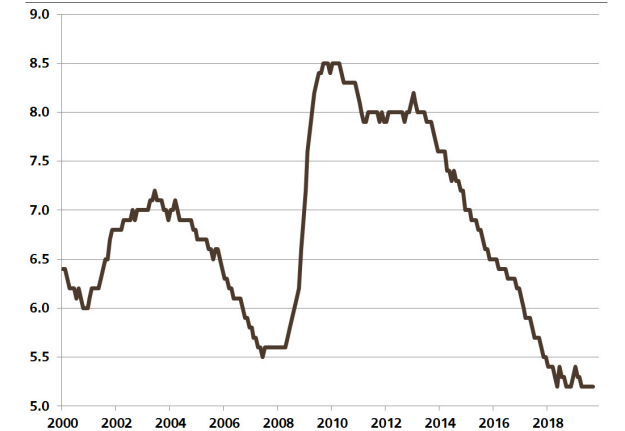
Comparison of French share of US imports and value of French exports to the US



Source: UBS calculations from US Census Bureau data, as of 4 December 2019

## Global labour markets remain very strong

The OECD unemployment rate is at the lows for this millennium



Source: Haver, UBS, as of 4 December 2019

# US economy - *Slower growth amid trade disputes*

## Key points

- Economic growth is likely to remain at or below trend.
- Core inflation should hit the Fed's 2% target in 2020.
- The Fed remains on hold for now.

## CIO view (Probability: 50%\*)

### Moderate expansion

- GDP is likely to expand at or below the 2% potential growth rate in the quarters ahead.
- Job growth has slowed and the number of job openings has declined, suggesting that demand for labor has softened. However, the labor market remains very tight, with the unemployment rate near a 50-year low.
- Rising wage income should continue to support consumer spending, which is the main driver of overall economic growth.
- Strong profits and labor shortages provide an incentive for businesses to invest. However, political uncertainty is acting as a constraint. Further escalation of trade disputes would pose a serious threat to the recovery, while a solid US-China agreement could boost growth.
- The manufacturing sector is struggling amid the trade disputes, with the purchasing managers' index below 50 since August, and manufacturing output is down year-to-date. Domestic demand should provide enough support to prevent a severe downturn.
- Residential investment turned positive in 3Q19 and should trend higher. Mortgage rates have declined, and demand for housing should be supported by the strong labor market.
- We expect core PCE inflation, which excludes food and energy prices, to reach the Fed's 2% target in 2020.
- The Fed cut rates by a total of 75 basis points between July and October, and is now signalling a neutral stance. The Fed still has room to cut further if economic conditions deteriorate.

## ↗ Positive scenario (Probability: 20%\*)

### Growth rebound

- A breakthrough in trade negotiations removes uncertainty, allowing business investment to strengthen and GDP growth to rebound. The Fed refrains from further rate cuts, but rate hikes remain unlikely within the next 12 months unless inflation surprises to the upside.

## ↘ Negative scenario (Probability: 30%\*)

### More severe slowdown

- Trade disputes, political uncertainty, and tighter financial conditions weigh on business investment. Weaker demand for labor undermines consumer spending. The Fed cuts rates further, potentially to zero if the economy enters recession.

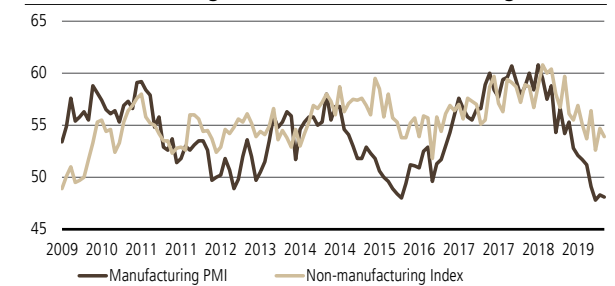
\*Scenario probabilities are based on qualitative assessment.

## Key dates

<b>Dec 13</b>	Retail sales for November
<b>Dec 17</b>	Industrial production for November
<b>Dec 20</b>	Personal income and spending, PCE inflation for November
<b>Jan 3</b>	ISM PMI for December

## PMIs have moved lower

### ISM manufacturing PMI and non-manufacturing index



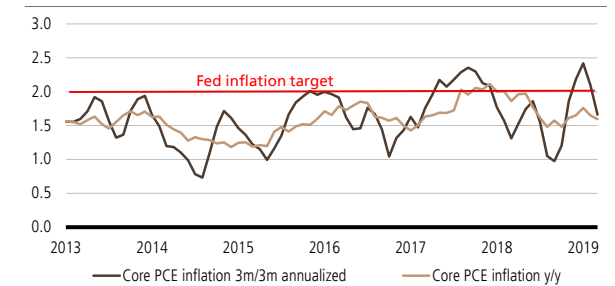
Source: Bloomberg, UBS, as of 4 December 2019

ISM = Institute for Supply Management

PMI = Purchasing Managers' Index

## Inflation is below the Fed's target

### Core PCE inflation



Source: Bloomberg, UBS, as of 4 December 2019

PCE = Personal Consumption Expenditures

# Eurozone economy - *Economic growth with upside risks*

## Key points

- Improved momentum in trade talks underpins our Eurozone growth outlook.
- Inflation is set to move slowly higher, driven by energy-related base effects.
- Should current trade talks succeed, the probability is high that the ECB won't have to cut anymore.

## CIO view (Probability: 50%\*)

### Growth outlook with upside risks

- The Eurozone economy may see better growth momentum in 2020 on the back of substantial progress in trade talks. Meanwhile, energy-related base effects are set to push inflation moderately higher. The ECB is expected to decrease the deposit rate by 0.1% in March, but successful trade talks would clearly reduce the probability of further rate cuts.
- In Germany, moderate fiscal measures and better world trade should stabilize its manufacturing sector. In France, the waning yellow-vest protests, reforms, and fiscal stimulus should help safeguard robust economic growth.
- Growth in Italy should continue to stabilize following the compression in bond risk premiums. Spanish growth is set to remain solid, but the political stalemate is capping its growth upside.

## ➤ Positive scenario (Probability: 30%\*)

### Better-than-expected growth

- The global economy accelerates again and the euro strengthens. Eurozone loan demand and the economy recover faster than envisaged. Political risks fade.

## ⚠ Negative scenario (Probability: 20%\*)

### Economic slowdown

- The Eurozone falls into recession as trade tensions escalate sharply, markets lose faith in Italy's debt sustainability, Brexit talks fail, or the Chinese economy suffers a severe downturn.

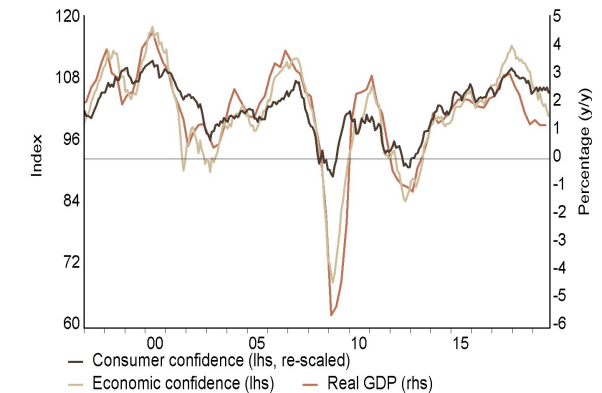
\*Scenario probabilities are based on qualitative assessment.

## Key dates

<b>Dec 16</b>	Flash PMI for December
<b>Jan 7</b>	Inflation estimate for December
<b>Jan 9</b>	Unemployment for November
<b>Jan 23</b>	ECB press conference

## Eurozone growth consolidating

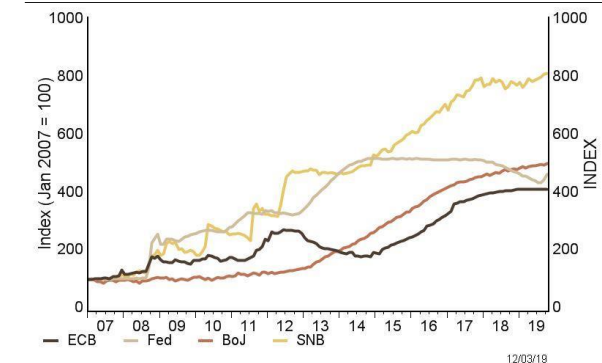
### Business and consumer surveys



Source: Haver Analytics, UBS, as of November 2019

## ECB balance sheet topping out

### Total assets in national currency (index: 2007=100)



Source: Haver, UBS, as of November 2019 (SNB data as of October 2019)

# Chinese economy - *Slower economy, continued easing*

## Key points

- GDP growth should continue its orderly deceleration in 2020.
- We expect both monetary and fiscal policy to remain supportive.
- The Sino-US trade tension remains a key risk.

## CIO view (Probability: 70%\*)

### Continued easing to cushion slowdown

- October data weakened with slower investment and softer consumption. Full-year GDP growth is likely to decelerate to 6.1% from 6.6% in 2018, and moderate to just below 6% in 2020 on ongoing structural reforms and lingering trade tensions.
- October CPI inflation surged to a seven-year high of 3.8% y/y, driven by pork prices which went up by over 100%, and we expect the pressure to continue in 1Q20. The core CPI inflation stayed subdued at 1.5%. PPI deflation widened further to -1.6% y/y due to weak manufacturing and base effects. We see the average 2020 CPI inflation below 3% and PPI inflation around 0%.
- Both monetary and fiscal policy are supportive. The central bank cut banks' reserve requirement ratio by 150bps in November, releasing about CNY 2.4 trillion of liquidity. We expect another 100–200bps of cuts before end-2020, with a possible cut of 50bps before Chinese New Year in mid-January. Interest rates have trended down with more stable credit growth. On the fiscal side, local government bond (LGB) issuance reached over CNY 3 trillion as of November, and could reach CNY 4 trillion in 2020.
- The Sino-US trade tension remains a key risk. China and the US continue to talk and may reach an interim deal. The US suspended the 5% tariff hike on USD 250 billion of Chinese exports planned on 15 October, while China agreed to increase purchases of US agricultural products with lower tariffs. The Sino-US relation is entering a new paradigm with long-lasting cycles of talk-fight-talk.

## ↗ Positive scenario (Probability: 5%\*)

### Growth acceleration

- Annual GDP growth accelerates above 6.5% in 2019 on easing trade tensions and a global cyclical growth upswing. Aggregate debt-to-GDP ratio stabilizes. Annual current account surplus increases over USD 100bn.

## ↘ Negative scenario (Probability: 25%\*)

### Escalating China-US trade tension

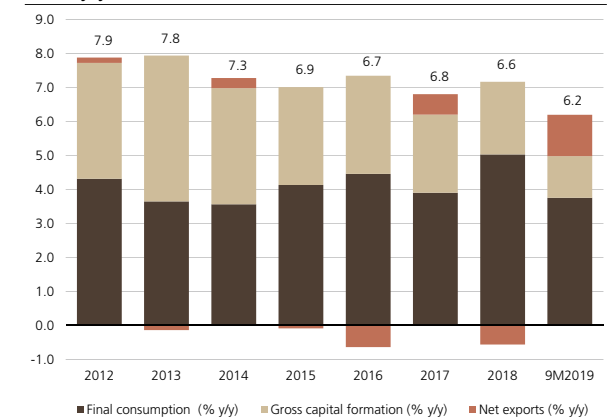
- The US makes good on its threats to impose investment restrictions and tariffs on most Chinese products, introducing a sweeping tariff of 25% on USD 300bn worth of annual Chinese imports before 2020.
- In 2019, Chinese GDP growth experiences a sharp slowdown below 5.5% for two consecutive quarters and a faster deterioration of its current account into annual deficit.
- The CNY slides to 7.5 per USD or weaker within a quarter, while FX reserves fall dramatically and capital controls are tightened up.

\* Scenario probabilities are based on qualitative assessments.

## Key dates

<b>Dec 16</b>	November fixed-asset investment, retail sales, industrial production
<b>Dec 31</b>	November manufacturing and nonmanufacturing PMI

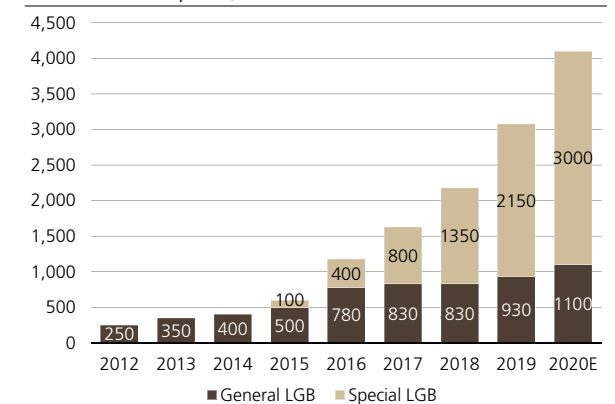
## 2020 GDP growth to slow to "around 6%" in % y/y



Source: CEIC, UBS, as of November 2019

## Local government bond issuance quota to be lifted further in 2020

New issuance quota, in CNY bn



Source: CEIC, UBS, as of November 2019

# Swiss economy - *Clouded outlook despite solid GDP growth*

## Key points

- Swiss GDP surprised to the upside and grew 0.4% q/q in 3Q19. On the back of the stronger figures, we revised up our GDP forecasts for 2019 to 0.8% and for 2020 to 1.1%.
- Due to the subdued outlook for the global economy and political uncertainties, we continue to see muted GDP growth in the coming quarters.
- Given these risks, we expect the Swiss National Bank to cut rates by 25 basis points in March 2020.

## CIO view (Probability: 50%\*)

### Solid Swiss GDP growth in Q319

- Swiss GDP grew by 0.4% q/q in 3Q19, outpacing our and consensus forecasts. GDP growth on a year-on-year basis accelerated to 1% (1.1% as reported by the SECO – not seasonal-adjusted). Nearly all GDP components contributed to the robust growth environment. Foreign trade was boosted by strong exports from the pharmaceutical industry, but most other export sectors increasingly felt the slowdown of the global economy.
- On the back of the stronger-than-expected 3Q19 GDP data, we revise up our forecasts for 2019 and 2020. We now expect 2019 GDP growth at 0.8% and see 2020 GDP growth at 1.1%.
- The trade tensions between the US and China are likely to weigh on global growth in the coming quarters. Despite the robust 3Q GDP numbers, we continue to see muted Swiss growth in 4Q19 and 1H20 on the back of the subdued outlook for the global economy. A sustainable rebound of Swiss growth before 2H20 is unlikely. Swiss growth is too export-dependent to decouple from the global cycle.
- The subdued sentiment seen in Swiss export industries is reflected in the Swiss manufacturing PMI which fell below 50 in spring and has remained below this threshold ever since. This implies that today's upbeat GDP numbers are not the start of a sustainable recovery but rather a one-off.
- The strengthening Swiss franc and lower oil prices (compared to last year) will have a dampening effect on inflation this year. We expect consumer prices to grow 0.4%, after last year's 0.9%. For next year, we expect an inflation rate of 0.5%.
- The SNB is currently refraining from intervening in the currency market. That said, we see more monetary easing by the ECB next year on the back of political uncertainty and the subdued economic picture in the Eurozone, which could put appreciation pressure on the Swiss franc and force the SNB to lower interest rates as well. We expect the SNB to cut rates from -0.75% to -1% next March.

## ➤ Positive scenario (Probability: 20%\*)

### US und China strike trade deal

- A further drop in Eurozone unemployment leads to a rebound in Europe and shores up domestic demand, which in turn supports Swiss exports.

## ➤ Negative scenario (Probability: 30%\*)

### Trade disruption sends Switzerland into recession

- More protectionist measures by the Trump administration (especially against European car makers) leads to a global downturn, which would hurt Swiss exports.

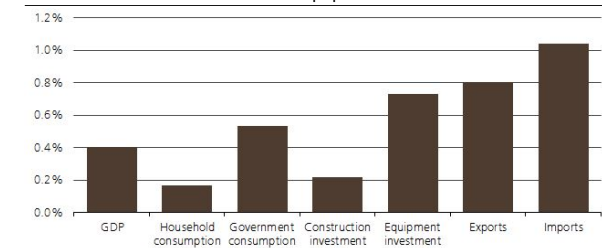
\* Scenario probabilities are based on qualitative assessment.

## Key dates

Jan 2	Manufacturing PMI for December
Jan 7	CPI for December
Jan 28	Trade balance December

## All GDP components contributed to Swiss growth

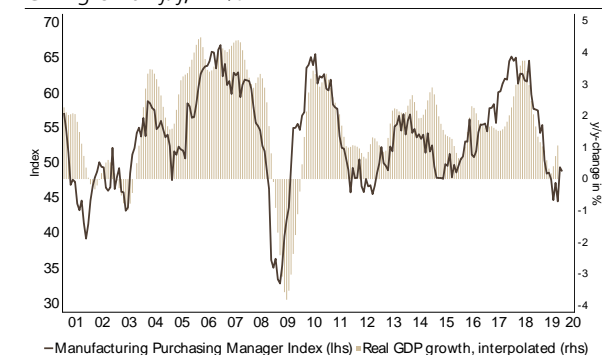
Contribution to Swiss GDP q/q in %



Source: Macrobond, UBS, as of 4 December 2019

## Manufacturing PMI does not imply any recovery in the near future

Manufacturing purchasing manager index and Swiss GDP growth y/y, in %



Source: SNB, UBS, as of 4 December 2019

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