January 2020

Macro Strategy

Global Risks 2020

Key Takeaways

- MetLife Investment Management sees a very modest slowdown for 2020 relative to 2019.
- Risks are balanced: an upside surprise could arise from the late-2019 stimulus by central banks globally; downside risks of an accelerated slowdown remain.
- As was the case last year, a major risk we see is trade war re-escalation, particularly although not exclusively with respect to China.
- We see several U.S. risks emerging from an election year.
- Other risks are primarily geopolitical; the widespread protests and the situation in Iran could yield additional uncertainty.

MetLife Investment Management

Our Base Case

We see the following projected growth rates for the countries in our focus.

Projected GDP growth rates

GDP Growth Rates	2019	2020
U.S.	2.3	1.8
Eurozone	1.1	0.9
U.K.	1.2	1.0
China	6.2	6.0
Japan	0.8	0.3
Mexico	0.0	1.0
Brazil	1.0	2.0

Globally, we expect economic growth to stay almost stationary, with 2020 expected at 3.1%, a small increase from 2019's expected growth of 3.0%.[1]

We expect the U.S. economy to slow down to 1.8% in 2020. Although slower, we expect to remain well away from recessionary territory.

We expect Euro area growth to slow relative to 2019, although we expect growth to improve toward the back half of 2020 as manufacturing bottoms out.

We expect China to stabilize in 2020, although slowing in line with its long-term trajectory. Negative effects of the trade war have been mitigated by considerable government intervention. Japan will weaken.

Risk #1: Trade War Re-escalation

On U.S.-China trade, we expect the somewhat weak phase 1 deal to be implemented. We expect the two sides to de-escalate but remain wary of each other.

While President Trump remains in office, we remain cognizant of the potential for the U.S. to retaliate with new or additional tariffs against countries it feels are taking advantage of it.

With China, the risks may go beyond the obvious one of a re-escalation of tariffs. In our opinion, the bigger risk would be that the two countries cease communication and engage in more political tit for tat. This is already potentially beginning with the Hong Kong Human Rights and Democracy Act and the Uighur Act. Both leaders have tried to downplay the political story and separate it from the economic, but a re-escalation could remove that inhibition. This would likely have both negative economic effects (further breaking apart supply chains) and lead to greater geopolitical uncertainty. We believe these effects would be global in nature and likely pull Europe back into another downturn.

Digital services tax—a dispute over which flared briefly at the end of 2019—is another potential flashpoint for trade. This is a relatively new development in taxation that has been proposed or implemented by a number of countries globally. The taxes appear to affect primarily U.S. companies and the U.S. has a strong interest in dissuading countries from potential adoption.

Watch for: Employment reports. If employment continues to be strong, we feel Trump may be emboldened on trade.

Risk #2: Stimulus Works (too) Well

This year, unlike last, we see potential for an upside surprise to economic conditions. Despite recent global weakness and the loss of business confidence, we see a path to a stronger 2020. We feel this path would likely involve the easing measures taken by central banks globally. A surprisingly positive resolution to U.S.-China trade tensions—beyond the phase 1 deal—would likely also be involved.

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Around the world, central banks took easing measures in 2019, in the U.S., Euro area, and China in particular. A delayed response to the stimulus is a possibility.

A U.S.-China deal that generates business confidence would likely include a substantial tariff rollback. It would also likely require much more consistent communication by both sides conveying their intention to abide by the deal.

The outcome of this could take the largely positive form of an extended business cycle. It could also lead to excesses including above-target inflation requiring Federal Reserve hikes.

Watch for: A comeback in the manufacturing sector, with higher ISMs and higher business confidence may lead to an inflationary environment.

Risk #3: Brexit

The Conservative Party's decisive win in the December 2019 U.K. election substantially reduced the likelihood of a hard Brexit event in early 2020, with the EU and U.K. on track to mutually pass a Withdrawal Agreement (WA) that will put into effect the U.K.'s legal departure from the EU around the turn of the year. However, the U.K. election result did not materially reduce the overall risk of a hard Brexit event at some point in 2020, with the issue likely to remain a source of uncertainty for global markets.

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Following passage of the WA, the U.K. will enter a transition period, during which its trading relationship with the EU will remain unchanged. The EU and U.K. will begin negotiations during this transition period to establish the trading relationship that will exist between them after the transition period ends. The transition period will initially last until end-2020 and can be extended once, up until end-2022. According to the current WA treaty, the U.K. and EU are required by end-June 2020 to have mutually agreed to an extension for the transition period if it is to last beyond end-2020.

In late-2019, the new U.K. government declared its intention to not request an extension of the transition period beyond 2020. That provides an extremely limited period of time for a trade deal to be agreed between the two parties, keeping the risk of a hard Brexit event elevated over the next year. If no deal is agreed, the U.K. will default to WTO terms in its trading relationship with the EU (the destination for ~50% of U.K. exports) and countries with which the U.K. currently enjoys preferential trading relationships via agreements with the EU (which account for a further ~20% of the U.K.'s exports). Given the Conservative Party's large parliamentary majority and the inevitable damage that a hard Brexit event would do to the U.K. economy, we still think that the U.K. government would most likely seek an extension of the transition period beyond end-2020 if no deal is done by then. However, we feel the level of uncertainty over the outlook for the trading relationship between the U.K. and EU is likely to remain high through 2020 and provoke periods of volatility in global financial markets.

Watch for: Signs that the government intends to stick to the end-2020 transition period timeline. This would raise the likelihood of a hard Brexit.

Risk #4: Election Year Uncertainty

Market volatility is to be expected in an election year, particularly one where the result is far from certain. While polling is mixed at this stage of the process, there is a strong possibility that President Trump will win office for a second term given the usual advantage an incumbent seeking re-election typically enjoys.[2] The Democrats are widely expected to retain control of the House, while Republicans appear to have an advantage in retaining the Senate as most seats up for election are in Republican leaning states.[3] In our view, an unchanged status quo will not result in any significant changes to government policy nor economic uncertainty or market volatility. A second scenario is a moderate Democratic victory, with the Senate and the House remaining unchanged. We feel markets would generally not worsen substantially if a moderate wins the election. This scenario could in fact be a positive for global trade. Although no Democrat is likely to fully roll back tariffs on China, we would expect trade policies to become more conventional and predictable.

A win for a candidate hailing from the Democratic Party's far left is another potential scenario we must consider. To date, far left candidates have publicly highlighted a number of proposed policy reforms that the markets, along with some business sectors and voters, have not digested well.[4] In our opinion, this scenario would result in greater medium- and long-term economic uncertainty. However, given the structural difficulties in changing the balance of power in the Senate—the Democrats would need to win every closely contested race, including turning over four Republican seats—we believe the anxieties around a potential far left victory are overdone.

Watch for: Rising Democratic poll results, particularly "blue wave" polling in key states (the upper Midwest and in Senate races such as Georgia, Colorado, North Carolina). This could increase the likelihood of a Democratic sweep of the Presidency, Senate, and House.

Risk #5: Nuclear Power Risk: Iran and North Korea

Iran and regional instability remain a risk. With its withdrawal from the Joint Comprehensive Plan of Action and its sanctions on Iranian oil exports, the U.S. has pushed a hard line against Iran. Sanctions have placed Iran under severe economic stress. Escalation beyond current levels remains a risk, despite U.S. reluctance to get further entangled in the Mideast. If hostilities escalate further, this would be likely to yield downside regional risks and, most importantly for the U.S., higher oil prices.

North Korea remains a wild card. Things have been quiet between the two countries, but recent sniping via Twitter between President Trump and North Korean leader Kim Jong Un shows that this tension may flare up more significantly at any time. The main concern is that an eruption of tensions could become an election year issue for President Trump if Kim Jong Un re-emerges as a threat.

Watch for: U.S. casualties at the hands of Iran which could force a stronger response from the U.S.

Risk #6: Political Upheaval Creates Another Crisis

Political disaffection and rebellion against establishment figures and political institutions are widespread. This can be seen in the recent political upheaval in countries as far flung as Chile, Lebanon, the Catalonia region of Spain, and perhaps most significantly Hong Kong. These grievances are not dissimilar to the forces that brought about the election of President Trump, or the decision for Brexit, which were also induced by a sense that the existing system was unresponsive and needed radical change.

The conduit—and perhaps the lighter fluid—for this has been social media. A generation ago, these protests may have remained isolated and obscure. Today, social media permits large scale coordination among groups that all have the same grievance—or perhaps merely the same target. Social media also behaves as an amplifier, reinforcing convictions and further motivating protestors.

Emerging markets are particularly vulnerable to big policy shifts, with some countries shifting rightward in their policies (Brazil) and others shifting leftward (Mexico). Advanced countries have also not been immune from real change, although their more robust institutions provide some protection.

Watch for: Entrenched and complacent governments and the protests they may attract, particularly in internally divided countries with uneasy coalitions. These features may indicate vulnerability to regime change.

Endnotes:

1 Our 2019 number is in line with that of the IMF (IMF World Economic Outlook, October 2019), while our forecast for 2020 implies a lower global growth rate than that forecast by the IMF: 3.1% (MIM) versus 3.4% (IMF). Most of the anticipated increase from 2019 to 2020 is due to accelerating growth by emerging markets, which grew particularly slowly in 2019.

2 As an example, one respected pollster (IBD/TIPP) polled voters on December 16 and showed Trump losing against Vice President Joe Biden by 5 points, while winning against other top tier candidates by between 1 and 4 points. Other top polls show the results in a head-to-head between Biden and Trump varying between Biden winning by 9 (Quinnipiac) and losing by 3 points (USA Today/Suffolk).

3 The toss-up Senate races, according to the Center for Politics, are North Carolina, Arizona, and Colorado. President Trump won these states in 2016 by 4%, 4%, and 5% respectively.

4 ABC News, December 12, 2019. "Warren slams moderate rivals, laying bare ideological divide." Penn Wharton Budget Model, December 12, 2019. "Senator Elizabeth Warren's Wealth Tax: Projected Budgetary and Economic Effects."

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About MetLife Investment Management

MetLife Investment Management (MIM),[1] MetLife, Inc.'s (MetLife's) institutional investment management business, serves institutional investors by combining a client-centric approach with deep and long-established asset class expertise. Focused on managing Public Fixed Income, Private Capital and Real Estate assets, we aim to deliver strong, risk-adjusted returns by building tailored portfolio solutions. We listen first, strategize second, and collaborate constantly as we strive to meet clients' long-term investment objectives. Leveraging the broader resources and 150-year history of the MetLife enterprise helps provide us with deep expertise in navigating ever changing markets. We are institutional, but far from typical.

For more information, visit: **metlife.com/investmentmanagement**

[1] MetLife Investment Management ("MIM") is MetLife, Inc.'s institutional management business and the marketing name for the following affiliates that provide investment management services to MetLife's general account, separate accounts and/or unaffiliated/third party investors: Metropolitan Life Insurance Company, MetLife Investment Management, LLC, MetLife Investment Management Limited, MetLife Investments Limited, MetLife Investments Asia Limited, MetLife Latin America Asesorias e Inversiones Limitada, MetLife Asset Management Corp. (Japan), and MIM I LLC.

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