

Citigold

# 2020 ANNUAL OUTLOOK



THRIVING AMID  
UNCERTAINTY



## CITI'S TOP THEMES

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## THRIVING AMID UNCERTAINTY

2019 had been the year of uncertainty, driven by trade tensions, recession risks, impeachment escalation, Brexit delays and geopolitical risks, to name just a few. Despite these, global equities rose by 25% in 2019, while global fixed income also staged a strong performance, rising 6-15%, with bond yields falling for the majority of the year.

Policy risks, both trade and monetary, were central influences to Citi analysts' economic concerns. As 2019 progressed, major central banks including the US Federal Reserve switched to easing mode and are expected to continue with their cautious policy approach. While the prospect of a trade re-escalation remains a risk, Citi analysts expect US and China to work towards avoiding further tariff escalations.

In 3Q19, strong domestic resilience helped counter weakening trade data. A snapback in global manufacturing and trade activity is expected, which may help rebuild confidence in the enduring world economic expansion and has also accounted for a rebound in cyclical equities in 4Q19.

Looking into 2020, Citi analysts expect global Gross Domestic Product (GDP) growth at 2.7% paired with inflation of 2.7%. Developed Markets may see a slowdown to below-trend growth of 1.5%, while Emerging Markets in contrast could see a moderate rebound to 4.2%.

Whilst geopolitics in 2019 was a key influencing theme on investor sentiment, Citi analysts believe that ultimately markets could refocus on economic fundamentals. There is sufficient strength in those fundamentals to help support reasonable returns on equities, leading Citi analysts to shift to overweight global equities. However, given political frictions, there is strong value in including hedges in a diversified asset allocation. Gold is overweight, and while global fixed income is underweight as an asset class, investors are likely to continue their search for yield and Citi analysts find there remains relative value in selective areas such as US-High Grade fixed income and Emerging Market Debt.

\*All returns in USD as of 29 November 2019

# 1

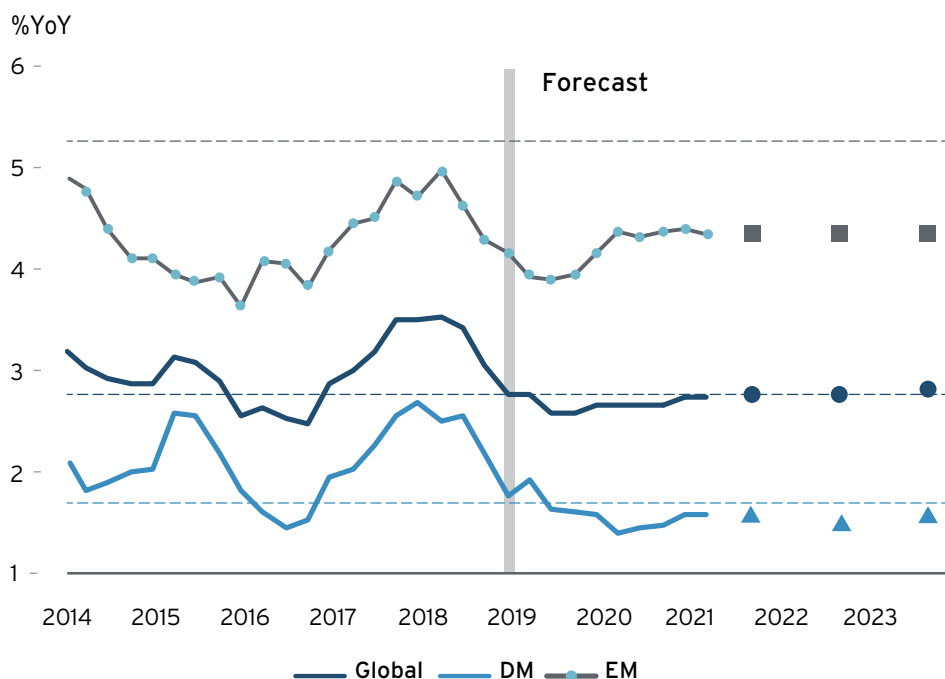
ECONOMY

## DOMESTIC RESILIENCE MAY BUOY GROWTH

### Key Takeaways

- Projections for global growth have drifted down in 2019 as a reflection of trade headwinds, though domestic resilience is showing more positive signs. Developed Market (DM) economies could slow to below-trend growth of the last 20 years, while in contrast, Emerging Market (EM) economies could see a moderate rebound.
- Citi analysts expect global growth of 2.7% in 2020 and 2021, compared with 2.6% in 2019. Inflation is targeted at 2.7% in 2020 and 2.4% in 2021, from 2.5% in 2019.
- DMs target 1.5% growth in 2020 and 2021, while EMs are anticipated to grow 4.2% in 2020 and 4.3% in 2021, reflecting the divergence between the 2 regions.

### GDP Growth forecasts



Note: Dashed lines show 2000-2017 average growth.  
Source: Citi Research. As of 23 October 2019

Uncertainties have weighed on confidence and business decision-making, and also undermined investment intentions in part because firms think that consumers may pull back. However, this has not quite been the case, and domestic resilience through strong labour markets has helped to counter slowing trade growth.

While trade policy risks may be waning, uncertainty is likely to continue clouding the global economic outlook ahead of and beyond the 2020 US presidential election. With this in mind, Citi analysts project global GDP growth of 2.7% in 2020, down from the 3.0% forecast at the start of 2019 as central banks work to offset the economic shock from the trade conflict.

## DOMESTIC RESILIENCE MAY BUOY GROWTH / 1



Growth in US GDP is expected to lower to 2.0% in 2020. US presidential elections may lead to higher volatility leading into 2021, potentially caused by economic weakness or election fallout. Differences between the Republicans and Democrats on taxation and regulation may add to trade uncertainty, which may restrain corporate activity.



Slowing GDP growth (2020 forecast at 1.2%), deteriorating economic indicators and a lack of inflation pickup saw the European Central Bank (ECB) restart its Quantitative Easing (QE) program, cutting the deposit rate by 10bps from -0.4% to -0.5% and setting monthly asset purchases of €20bn from November 2019. While these measures are likely to help, they may fall short of lifting inflation back to target, unless accompanied by meaningful fiscal policy expansion. Citi analysts think that is unlikely to happen in the near term, thus risk to growth remains skewed to the downside.



The outlook for 2020 looks challenging on the back of fiscal stimulus payback and the Olympics-related demand peaking out. However, the Bank of Japan (BoJ) is expected to maintain the policy status quo unless sharp falls are seen in USDJPY. With this, Citi analysts forecast 0.3% GDP growth in 2020.



Asia's GDP growth rate is expected at 5.2% in 2020, with a key market China, likely to see growth at 5.8%. China's domestic slowdown contributed to the growth scare that global markets experienced in mid-2019. While progress in trade talks are important, Citi analysts also see signs of improvement in China's domestic economy, which could be poised for recovery if there is a rebound in production following a sharp drop in inventories.



Central & Eastern Europe, Middle East and Africa (CEEMEA) are likely to be supported with some green shoots emerging, driven by improving domestic economic outlook, better investor sentiment globally and lower global trade risks. For Latin America (LatAm), slow growth and high fiscal deficits are structural negatives, while trade tensions and financial conditions represent the next largest risks.

1 / DOMESTIC RESILIENCE MAY BUOY GROWTH

**Risks to the global growth outlook include:**



- US recession, though not Citi analysts' base case.
- Trade policy uncertainty continuing to weigh on investment decisions.
- Fiscal policy uncertainty, given DM central banks' (excluding the Federal Reserve) limited ammunition in their toolkit to support the global economy should there be a greater slowdown than forecast.
- Rising political risks. *(See "6. Politics - Risks are Heightened")*

Core inflation has ticked up in DMs but continues to moderate in EMs. Citi analysts expect inflation of 1.6% in DMs and 4.1% in EMs in 2020.

**Two wild cards for inflation globally are:**



# 2 EQUITIES PIVOT TO GROWTH OPPORTUNITIES

## Key Takeaways

- Equity markets clocked a strong performance in 2019, with cyclical equities outperforming in 4Q19 in anticipation of a recovery in global industrial production and trade. An absence of new trade shocks could reinforce confidence in the world economic expansion.
- Overweight global equities: Equity total returns of 6-8% are forecasted in the coming twelve months, with high quality dividend growth likely to be a key contributor. All regions are overweight, with the exception of CEEMEA and LatAm.
- Growth stocks have typically outperformed in late-cycle bull markets and Citi analysts retain a growth tilt, preferring Technology and Health Care. The favored value sector is Energy, which has lagged oil price movements.

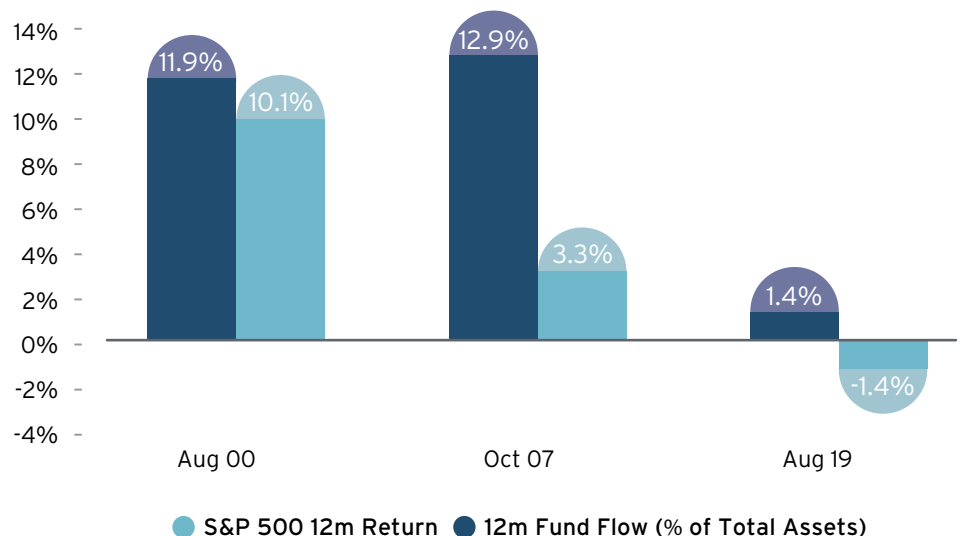
The end of a bull market is often characterized by near-euphoric risk sentiment, with strong returns and inflows into risky assets as confidence remains high. However, a closer look at monthly return and fund flows relative to prior bull market peaks shows neither a runaway rally, nor long-global equities appetite from retail and institutional investors. Citi analysts see this as a sign that the “bust” that many people expected has not been preceded by a typical “boom”.

Furthermore, Citi analysts expect a global industrial sector rebound in 2020, supported by a resilient consumer. Financial markets rallied in 4Q19 following a flat 3Q19, with cyclical equities outperforming as investors lower the probability of destructive trade actions and see diminished recession risk.

In the absence of a new, larger trade tension shock, a snapback in global manufacturing and trade activity could be expected, which is likely to rebuild confidence in the enduring world economic expansion. Monetary policy has also gone from being disruptive in the US in 2018 to turning supportive for risk assets in 2019 with many central banks following the Federal Reserve’s easing footsteps. Against this backdrop, Citi analysts have shifted from neutral to overweight global equities.

### How flows and returns compare to prior bull market peaks

12-Month Change



Source: Citi Private Bank. As of 30 October 2019.

### Higher-quality dividend growth strategies could drive equity performance

Citi analysts expect a rebound in cyclical industries' profits, forecasting global Earnings-Per-Share (EPS) to grow 7% in 2020, from a weak 2019. Full-year total equity returns are forecasted around 6-8%, reflective of the gains already registered by markets in 2019. However, rapid returns for cyclical industries may not be sustainable. Given political risks and the rebounds in markets in 4Q19, higher-quality dividend growth strategies are likely to outperform for 2020.

### Valuations not quite frothy; US looks expensive while EM, UK and Japan offer value

The MSCI AC World benchmark is trading on a trailing Price-Earnings (PE) of 18x, slightly above its long-run median of 17x. By region, US looks most expensive, while EM, UK and Japan offer best value.

Although absolute valuations may not look particularly compelling, equities still provide good value in comparison to fixed income. Global equities' dividends yield an average 2.5%, while global bonds yield just 0.6%. In particular, equities yield more than bonds in all major DM economies.



- Citi analysts anticipate modest GDP and EPS growth in 2020, while noting that significant risks remain. US elections may draw attention to potentially negative policies in the coming year. However, history shows that markets ultimately focus on economic fundamentals rather than the political process. While US equities may appear expensive relative to other markets on PEs, they look less stretched on free cash flow yield and also relative to low inflation. Consumer Price Index (CPI) readings in the 0-3% range have generally been associated with PE ratios of 17.5-18.0x, suggesting that current valuation fears may be overdone.





- Citi analysts expect European equities to grow earnings by around 5% in 2020, lower than consensus estimates of 10%. This suggests earnings downgrades may be likely in 1H20. However, on a valuation basis, European equities appear modestly cheap on an absolute basis and even more so relative to government and corporate bonds.
- As political clarity emerges in 2020, the macro data is expected to stabilize and Citi analysts have turned to a slightly more positive stance on UK equities. UK earnings have seen consistent downgrades in 3Q19 with consensus expecting 8% growth in 2020. Valuation is a key support with UK equities priced cheaply (13x PE) and offering the highest dividend yield (5%) amongst major markets. Much negative sentiment seems to be priced in.



- Consensus EPS growth of around 5% for 2020 appears achievable for Japanese equities. In particular, Citi analysts think Health Care, Technology and Consumer Staples could lead with double-digit EPS gains while Banks and Capital Goods could lag with 3-4% EPS growth. While market valuations are towards the bottom-end of the last 5-year range, a stronger yen could be a risk for equity market performance. As investors are likely to continue to pay attention to corporate governance reform and payout policies of Japanese companies, companies with strong dividend momentum and high free cash flow yield are preferred.



- In the event that trade tensions linger, attractive valuations and under-ownership of the asset class could provide some near-term downside protection. Over the longer-term, strongest potential returns are expected in EM Asia. Chinese equities offer value, trading at 12.3x forward PE, the lowest in Asia, with earnings growth also expected to rebound in 2020 from a low base in 2H19. More importantly, Chinese equities have significantly underperformed global DM equities with the greatest Chinese revenue exposure since the beginning of 2018. A trade ceasefire between the US and China could help to partially narrow that gap. Chinese equities could also benefit from increased weightage into international benchmark indices.

## 2 / PIVOT TO GROWTH OPPORTUNITIES

## Sectors to watch

Citi analysts retain a growth tilt, observing that growth stocks have typically outperformed in late-cycle bull markets. In particular, Technology and Health Care are supported by long-term trends. Energy, on the other hand, represents a value sector, with energy shares having underperformed relative to oil price movements.



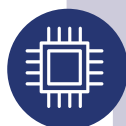
### HEALTH CARE

The Health Care sector continues to be favored due to over-arching trends of aging population and EM consumer growth. Mergers and acquisitions particularly in specialised pharmaceuticals, biotech and consumer healthcare remain an ongoing theme, with quality assets demanding high valuations. The sector is envisioned to see low double-digit earnings growth, with US and EU large-caps offering 10% and 11% 5-year earnings growth (compound annual growth rate) from 2020.



### ENERGY

Energy shares have underperformed relative to oil prices, and the sector has fallen to a record low market capitalization weighting in the S&P 500 Index. Energy, the deepest laggard cyclical industry of 2019, seems likely to rebound. Structurally, the global industry has capacity for mid to single-digit growth driven by shale and margin expansion, which translates into expanding returns for shareholders.



### TECHNOLOGY

Citi analysts are constructive on Technology with upcoming spend seen in 5G, internet-of-things / artificial intelligence / big-data, augmented reality, enterprise recovery and software security. Consensus expect earnings to grow by 10% in 2020, with valuations cheapest in EM, while Japan and US are relatively more expensive.

# 3 BONDS HUNT FOR YIELD

## Key Takeaways

- Global fixed income has had a strong year in 2019, and yields are close to record lows, but Citi analysts believe that there are still opportunities in selective markets.
- High quality longer duration bond exposures (5-10 years) are favored to balance risks, preferably in US Investment Grade (IG) corporates. Citi analysts continue to stay constructive on US financials and defensives - such as utilities - as a hedge against any potential drawdown in risk assets.
- USD-denominated Emerging Market Debt (EMD) offers some of the best relative value in global fixed income and Citi analysts see opportunities in Asian High Yield (HY) corporates, particularly in the Chinese property sector.

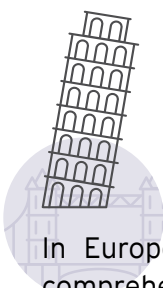
Given that more than 30 central banks around the world have cut interest rates in 2019 and core non-US rates are still near historical lows, Citi analysts believe that the hunt for yield may likely persist.



Despite solid domestic activity, downside risks from slowing global growth and trade tensions led the **Federal Reserve (Fed)** to lower policy rates by a cumulative 75bps from July through October 2019. However, it may not necessarily be the start of a full cutting cycle and Citi analysts expect no further policy easing in 2020 given an absence of a likely overshoot in inflation targets.



Citi analysts expect the **Bank of England (BoE)** to cut rates by 25bps in 2020 followed by more easing in the form of the bank rate falling to the effective lower bound (5bps) and a £50bn QE program in early 2021.



In Europe, after providing a comprehensive package of measures designed to deliver additional monetary policy stimulus over an extended period of time, Citi analysts expect the **European Central Bank (ECB)** to keep interest rates unchanged up to 2023.



Following the rate cut at the October 2019 meeting, ongoing spare capacity could bring the **Reserve Bank of Australia (RBA)** back to further policy easing, most likely in February 2020.



As the interim trade deal between US and China is priced in, the yen dollar rate is holding up well, and this does not provide compelling grounds for additional easing to fend off yen appreciation. Citi analysts believe that the **Bank of Japan (BoJ)** is likely to maintain the policy status quo unless the USDJPY rate falls below ¥100/\$.



**In Asia:** Citi analysts expect rate cuts in Malaysia, Philippines, South Korea and China.

### Selective regional markets offer value

With bond yields falling for the majority of 2019 alongside tighter credit spreads, global aggregate benchmarks have gained over 8%. Investment Grade (IG) corporates, High Yield (HY) bonds and other long-duration high quality assets have generated equity-like returns. While pleasing, this now leaves investors at a perplexing crossroad. Yields were already low at the beginning of 2019, and now that proposition has worsened. Currently, global benchmark yields (including high yield and emerging market debt) are around 1.6%, only 20bps above historical low levels. Simultaneously, global credit spreads have tightened near an 18-month low.

Global credit spreads are tight and yields are at post-crisis lows



Source: Citi Private Bank. As of 22 November 2019.

INVESTMENT GRADE (IG)

Over the last few months, 10-year US Treasury (UST) yields have followed trade optimism, as well as disappointment. In Citi analysts' view, trade uncertainties are likely to linger in 2020, not only with China, but also Europe/Japan. Therefore, to sustain higher UST yields, markets may need more confidence of deeper and long-lasting trade deals. This is why Citi analysts prefer longer duration bond exposures to balance risks, preferably in **US Investment Grade (IG) corporates**.

Credit fundamentals remain relatively healthy, while low global yields keeps refinancing risks low. If risks around trade stabilize further (or improve), spreads may tighten further. At the same time, an optimistic market outcome could imply higher yields, weighing on bond prices. Despite rate risks, Citi analysts continue to favour extending duration into intermediate maturities. The short-end (1-3 years) is one of the most over-valued segment of the US IG corporate bond market, while the belly of the curve (5-10 years) offers the largest relative spread pick-up. Citi analysts continue to stay constructive on US financials and defensives - such as utilities - as a hedge against any potential drawdown in risk assets.

BELLY OF THE CURVE  
**5-10** years  
 OFFERS THE  
 LARGEST RELATIVE  
 SPREAD PICK-UP

## 3 / HUNT FOR YIELD

USD-denominated **Emerging Market Debt (EMD)** still offers some of the best relative value in global fixed income however Citi analysts stress the importance of global diversification when investing in EM, as this region tends to be more volatile.

Asia (USD) High Yield (HY) bonds have lagged versus their US counterparts since early 2018. The weakness can be attributed to a number of factors including trade tensions and rising default rates in the region. With spreads above 700bps, Citi analysts see scope for spread narrowing, particularly in the Chinese property sector. If US-China trade tensions ease and Chinese policy makers continue to support the economy, this could bode well for risk assets and the property sector more broadly.

## EMERGING MARKET DEBT (EMD)

WITH SPREADS ABOVE

**700** bps

CITI ANALYSTS SEE SCOPE FOR SPREAD NARROWING, PARTICULARLY IN THE CHINESE PROPERTY SECTOR

## HIGH YIELD (HY) BONDS

YIELDS ON HY BANK LOANS ARE AROUND

**6.5%**

WHICH IS 100BPS HIGHER THAN HY BONDS

In contrast, Citi analysts are neutral on **High Yield (HY) bonds**. US HY valuations are expensive and it is typical for HY spreads to remain tight for long periods during economic expansions. Considering the favourable outlook on US fundamentals and low refinancing risks, Citi analysts expect spreads to remain tight.

Though HY bonds have outperformed loans in 2019, Citi analysts still prefer to use loans to supplement their US HY exposure. If risk sentiment remains positive, HY bonds may continue to outperform. However, yields on HY bank loans are around 6.5%, which is 100bps higher than HY bonds and attractive in a fixed income landscape where yield is hard to come by.

COMMODITIES

BRIGHT SPOTS IN GOLD

Key Takeaways

- The outlook for oil looks bearish in 2020 driven by the fragility of the macro outlook, combined with strong supply growth from the US, Brazil, Norway and new oil province Guyana. Citi analysts' average Brent and WTI prices for 2020 stand at US\$59/bbl and US\$56/bbl respectively.
- Lower-for-longer interest rates, global trade tensions, heightened geopolitical rifts and US election uncertainty, coupled with record central bank and investor buying activity, are all supportive of a bullish gold market environment in the medium-term. Gold as a safe haven asset tends to retain its value during times of market turbulence.
- Citi analysts' 2020 base case for industrial metals is that China eases more materially during 1Q20 and hopes of a trade deal improve such that the macroeconomic backdrop is bullish, which could be supportive of copper prices.

Commodities have remained under pressure by a slower global demand outlook even as equities have crept back up on news of tariff delays. Aside from precious metals buoyed by safe haven demand, the risk skew looks less positive for other commodities in 2020.



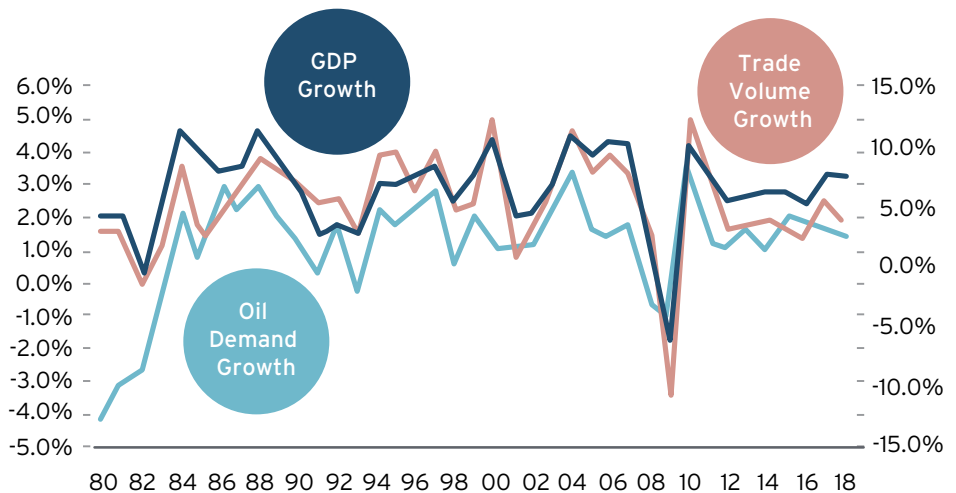
Oil: Outlook appears bearish

The September 2019 attack on oil facilities in Saudi Arabia resulted in one of the most severe disruptions ever for the oil market, in terms of volumes lost at the peak of the impact (5.7m b/d).

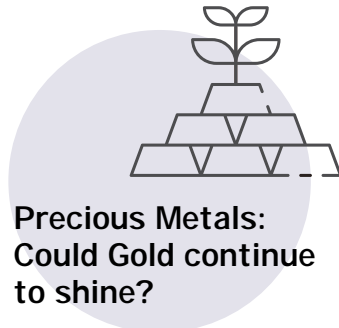
While the supply disruption led to an initial strong US\$10/bbl increase in oil prices, prices subsequently gave up most of their gains on signs that Saudi supply can return quickly. However, the events show the concentration of sensitive oil infrastructure in the region, not to mention ongoing tensions elsewhere in regions such as North Africa and Latin America.

Nevertheless, the outlook for oil looks bearish in 2020 driven by the fragility of the macro outlook, combined with strong supply growth from the US, Brazil, Norway and new oil province Guyana. Citi analysts' average Brent and WTI prices for 2020 stand at US\$59/bbl and US\$56/bbl respectively.

Oil Demand, World Trade, and World GDP growth are all very closely correlated



Source: Citi Research. As of 22 September 2019.

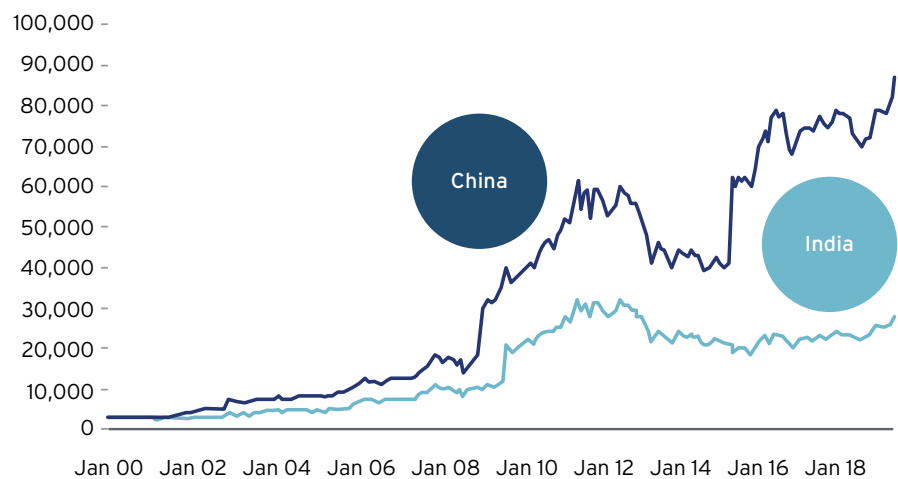


**Precious Metals:  
Could Gold continue  
to shine?**

Citi analysts expect gold prices to trade stronger for longer, possibly breaching US\$2,000/oz and posting fresh all-time highs at some point in the current cycle. Lower-for-longer interest rates, global trade tensions, heightened geopolitical rifts and 2020 US election uncertainty are potential positives for gold prices, given that it is seen as a safe haven asset that is typically uncorrelated with other financial assets in times of market stress or turmoil. Demand factors such as record central bank and investor buying activity, are also supportive of a bullish gold market environment in the medium-term.

Downside risks such as a surprise complete US-China trade deal (though not the Citi analysts' base case), coupled with a sharp upturn in global manufacturing data could probably see gold stay low at the US\$1,400-1,500/oz range for this cycle.

**US\$ (mn) value of gold reserve holdings in  
China and India**



Source: Citi Research. As of 22 September 2019.





**Industrial Metals:  
Dependent on  
de-escalation in  
trade tensions**

Zambian load shedding (where power companies reduce power availability) have also ignited fears of supply disruptions, which could also support copper prices.

Citi analysts' base case for industrial metals is that China eases more materially during 1Q20 and trade deal hopes improve such that a bullish macroeconomic backdrop is seen in 2020.

A de-escalation in trade tensions could be bullish for copper prices. Furthermore,

Zinc's fundamental outlook is unchanged; the market continues its transition to surplus, driven by anaemic demand growth and recovering smelter output in China, which has been picking up since May 2019. Much of the strong mine and refined supply growth expected for 2019 has been pushed back to 2020 and could weigh further on prices as stocks build up physically.



**Bulk Commodities: Iron  
ore prices could drop in  
2020 while coking coal  
looks set to bounce**

Citi analysts anticipate that the seaborne iron ore market may shift from a major deficit in 2019 to a surplus in 2020, driven by higher supply from Brazil and Australia. Citi analysts therefore revise down their 2020 average iron ore price forecast from US\$80/t to US\$75/t.

Separately, Citi analysts believe the market is under-appreciating the structural uplift in hard coking coal demand from China's blast furnace upsizing, as well as a lack of supply outside Australia and potential weather-related disruptions in Queensland, which may likely happen in the beginning of 2020. This demand-supply imbalance is likely to see hard coking coal price average US\$170/t in 2020.

## 5

CURRENCIES

## COULD USD BE DETHRONED?

**Key Takeaways**

- **Rising US political tensions, US-China trade dispute and risks to the US growth outlook are three main uncertainties that are likely to carry over into 2020.**
- **With 2 out of 3 key uncertainties directly impacting the US, the USD may not be the safe haven choice in 2020 and JPY and Gold appear to be more likely beneficiaries.**

G10 FX volatility remains low with ultra-low global central bank interest rates helping to compress volatility. More recently, expectations for a lessening in US-China trade tensions and improved prospects for a Brexit resolution have reduced the level of investor anxiety, which has also helped to keep FX volatility low. However, investor anxiety remains and is likely to carry over and see a more elevated FX volatility backdrop in 2020.

**3 major uncertainties likely to carry over into 2020**
**Rising US political tensions:**


Trump impeachment proceedings in a US presidential election year with a potentially divided Congress could pose a significant hurdle to implementing President Trump's domestic economic agenda (further tax cuts etc.) and re-election.

**US-China tensions**


A partial de-escalation of US-China trade tensions notwithstanding, phases two and three represent the more difficult issues and trade tensions may drag well beyond the November 2020 presidential election, perhaps morphing into more serious US-China political tensions amidst the backdrop of turbulence in Hong Kong.

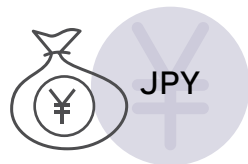
**Risks to the US growth outlook**


Citi analysts' base case is for the US economy in 2020 to slow to a moderate pace of growth with no further Fed rate cuts. However, risks are also seen to the downside with Fed rate cuts more likely than hikes and also point to US yield curve recession signals still suggesting hard landing risks.

**Safe havens: JPY and Gold more likely beneficiaries than USD**

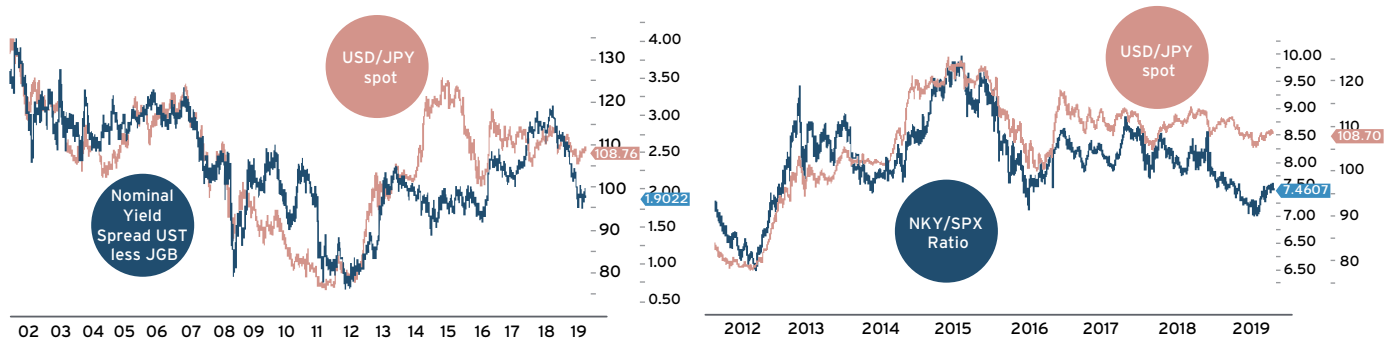


USD may not be the safe haven of choice in 2020. With 2 of 3 key uncertainties directly impacting the US (rising political tensions and risks to the US growth outlook), this may lead to USD depreciation especially if the Fed resumes its easing cycle. A broader trend towards de-dollarization by Europe and China should US-China tensions take on a more serious political overtone may also help weaken USD.

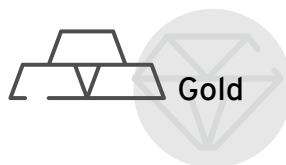


JPY has typically outperformed the G10 (including USD) and EM FX complex as a safe haven during times of heightened uncertainty. But in 2020, JPY is also likely to find support from its more positive fundamental backdrop that include, (1) a slower pace of BoJ balance sheet expansion and less rapid money growth as BoJ is unlikely to ease policy further; (2) Potentially narrower US-Japan bond yield differentials should the US economy slow more than expected.

**USDJPY Spot versus (a) Yield Spreads and (b) Equity price differentials - both charts point to a potentially stronger Yen versus USD**



Source: Citi Research. As of November 2019



Also a safe haven asset during periods of market volatility and macro risk aversion, Gold could also receive a further tailwind from (1) official sector bullion buying as there is clearer trend towards reserve diversification and de-dollarization; and (2) more broad-based buying from institutional and retail investors looking for alternatives to fiat money. Ultimately, given the backdrop of ultra-low or even negative rates across the G10, Gold could potentially find more demand as a tail hedge into the next downturn.

### Euro bloc: 2020 could be the year of the Euro bloc currencies led by GBP



Prime Minister Boris Johnson and his Conservative Party secured a landslide victory in the British general election on 12 December 2019. This is bullish for sterling as it would allow PM Johnson to push through his Brexit deal negotiated with the EU (and already passed “in principle” by the UK parliament).



ECB’s monetary easing in September 2019 has largely been countered by the 75bps of rate cuts by the US Federal Reserve across the year, while President Trump is actively trying to cap USD upside via firing warnings about FX intervention and cajoling the Fed to cut again. President Trump’s actions may gain traction should the US economy slow further in 2020. More importantly, Citi analysts now think pessimism regarding the euro zone outlook may be overdone especially if Brexit is resolved and the ECB itself appears to be signalling little appetite to ease monetary policy further with fiscal stimulus seen as the next pillar of support. Narrower US-Euro Area growth differentials in 2020 possibly supported by European Monetary Union (EMU) fiscal stimulus may see higher euro bond yields and a stronger EUR.

### Commodity Bloc: Likely to lag Euro bloc



The RBA’s policy meeting and minutes in November 2019 noted a “gentle turning point” in the Australian economy. Citi analysts expect another RBA rate cut in February 2020 with discussions about possible quantitative easing should inflation and employment not lift substantially. For now however, a lot of dovishness seems to be already priced into AUD and the partial de-escalation in US-China trade tensions could also help add a firmer floor in AUD though it is unlikely to make very significant gains in 2020.

## COULD USD BE DETHRONED? / 5



The Reserve Bank of New Zealand's (RBNZ) meeting in November 2019 was surprisingly hawkish, leaving the policy rate at 1% against consensus for a cut and with more optimistic forecasts for New Zealand's economy in 2020. This may see some upside in NZD versus USD and its commodity peers (AUD & CAD) though the upside is likely to be constrained by the domestic economy's vulnerability to global conditions as well as the 5 December 2019 bank capital changes introduced by the RBNZ.



The Bank of Canada's (BoC) statement in October 2019 was more dovish-than-expected with an emphasis placed on downside risks of trade tensions and "monitoring the extent to which the global slowing spreads beyond manufacturing and investment". But as Citi analysts point out, Governor Poloz's denial of insurance easing implies cuts may likely only come with a material worsening of the external outlook that potentially sees USD depreciation as the Federal Reserve takes the lead in cutting rates. More likely, a strong labour market and at-target inflation could keep BoC on hold in 2020 which is likely to support CAD over the longer-term.

### Asia EM: Short-term support but longer-term uncertainty



USDCNY may trade above 7.0 over the next 6-12 months given structural tensions and expected policy responses from China though downside is likely to be limited by expectations for higher China bond and equity inflows due to index inclusion. Local corporates increasing their FX conversions into CNY and seasonal demand for CNY before Chinese New Year amid a likely partial de-escalation in US-China trade tensions could also help limit USDCNY upside.



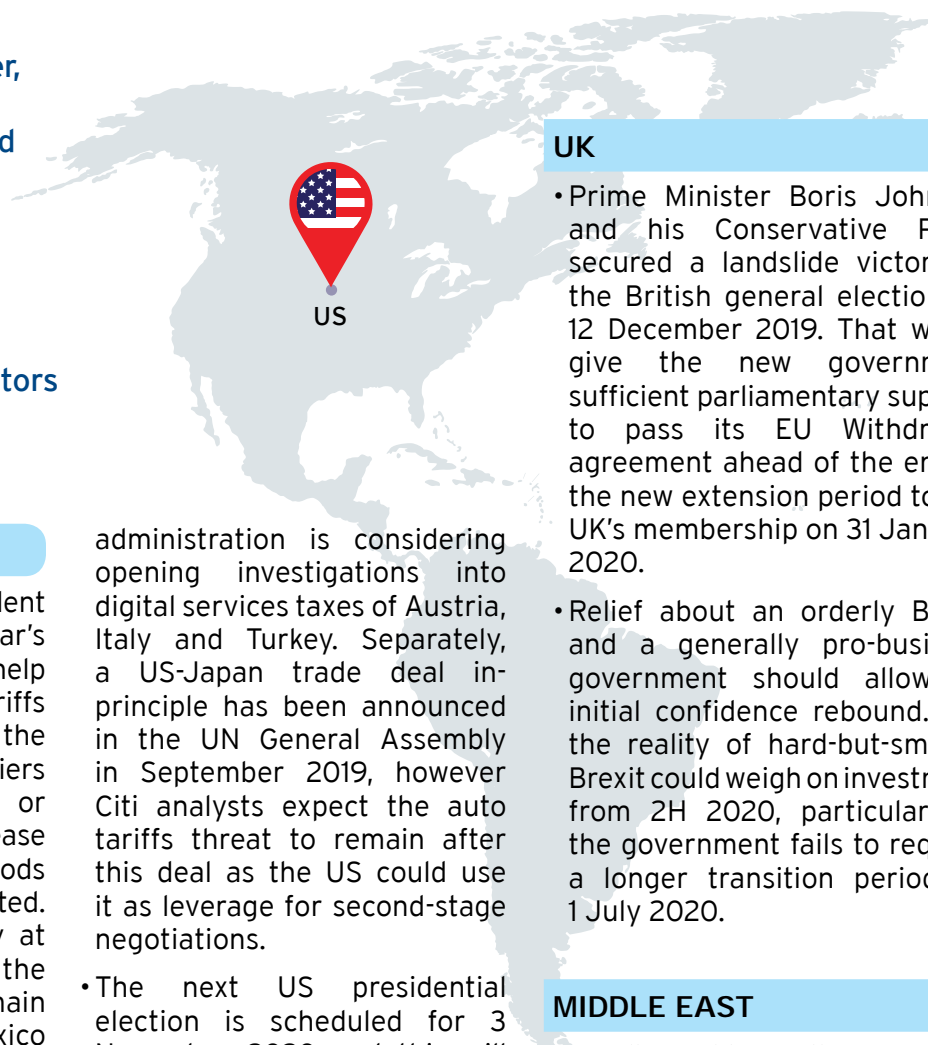
Demand for high yielding currencies is likely to support IDR, while the relatively steady economy and recovery of investment and tech cycle and supportive current account flows could support TWD and THB respectively. SGD resilience, currently dominated by a drop in resident portfolio outflows even as Singapore's current account surplus edges down to S\$22bn (2Q: S\$23bn) due to the weak external backdrop, may persist into 2020 given its safe haven characteristic within the EM complex.

# 6 POLITICS RISKS ARE HEIGHTENED

## Key Takeaways

- Over the last year or so, uncertainties have piled on: Brexit delays, trade tensions, recession chatter, impeachment escalation, oil-market disruptions, and geopolitical risks.
- Political fears are driving idiosyncratic risks in particular markets, thus Citi analysts see this as a good time for many investors to reassess the value of global diversification.

Some of the main political signposts and geopolitical risks that could move markets in 2020 include:



### US

- On 4 April 2019, President Trump gave Mexico a year's notice to stop drugs and help on immigration or face tariffs on its exports of autos to the US. Other non-tariff barriers like additional screening or regulatory checks to increase the cost of importing goods could also be implemented. As long as the emergency at the border remains active, the threat of tariffs could remain if the US judges that Mexico is not keeping its current efforts to deal with illegal immigration flows.
- Trade tensions with the EU are likely to rise, as aircraft tariffs are implemented in addition to other potential catalysts on the horizon (auto tariffs). The US has also proposed import taxes on US\$2.4bn worth of French goods in retaliation for the country's new digital services tax. Trump

administration is considering opening investigations into digital services taxes of Austria, Italy and Turkey. Separately, a US-Japan trade deal in-principle has been announced in the UN General Assembly in September 2019, however Citi analysts expect the auto tariffs threat to remain after this deal as the US could use it as leverage for second-stage negotiations.

- The next US presidential election is scheduled for 3 November 2020 and this will be the 59th election since the first in 1788. Only 3 modern US presidents have failed to secure a second term, and President Trump benefits from both incumbency advantage and the strong US economy. However, given his comparatively low approval ratings, he could be vulnerable to a Democratic ticket generating strong voter enthusiasm. The impeachment inquiry adds to further risks.

### UK

- Prime Minister Boris Johnson and his Conservative Party secured a landslide victory in the British general election on 12 December 2019. That would give the new government sufficient parliamentary support to pass its EU Withdrawal agreement ahead of the end of the new extension period to the UK's membership on 31 January 2020.
- Relief about an orderly Brexit and a generally pro-business government should allow an initial confidence rebound. But the reality of hard-but-smooth Brexit could weigh on investment from 2H 2020, particularly if the government fails to request a longer transition period by 1 July 2020.

### MIDDLE EAST

- Saudi Arabia's oil processing facilities were attacked in September 2019. The escalation coincided with President Trump's decision to pull the US out of the 2015 Joint Comprehensive Plan of Action (JCPOA nuclear agreement between Iran, the European Union and the five permanent members of the United Nations Security Council) and re-imposed economic sanctions have affected the Iranian economy.



## EUROPE

- **Italy:** Populist (M5s) and centre-left (PD) politicians in Rome recently managed to avoid a snap election which could have brought in an anti-EU, nationalist Lega-led government. But risks of snap elections in 2020 are limited unless Lega leads polls.
- **Spain:** The Socialist party PSOE again won the repeat elections on 10 November 2019, with 28.0% of the votes, but fell even shorter of a majority and failed to increase its seats in Congress. The consequences on the economy are likely to be minimal, as political developments have broadly failed to be a hindrance for the economy in the past four years. However, with the economy now slowing, and compliance with fiscal rules for Spain becoming more difficult, the lack of a formal government in Madrid may start to matter in 2020.

## CHINA

- On 12 December 2019, US and Chinese officials announced that they had finally agreed to the Phase one agreement. China agreed to billions of dollars in agricultural purchases from the US, while President Donald Trump has promised to reduce some tariffs.
- Citi analysts believe that while there is a Phase one deal, trade tensions are not over. Uncertainty on achieving the Phase two deal (mostly on technology and the potential to reduce sanctions on Chinese technology companies) and national security considerations ahead of the 2020 Presidential elections is likely to remain.

## HONG KONG

- Nearly half a year of protests have put a strain on Hong Kong's economy. 4Q GDP is likely in the third quarter of decline, after 3.6% cumulative drop in 2Q-3Q. Retail sales are down 20% from a year ago, while tourist arrivals collapsed 35%. These declines are the worst since the SARS crisis in 2003. Yet, unless a solution is found, even more is at stake, which may cause spillovers to broader regional and even global financial markets.

## NORTH KOREA

- Leaders of US and North Korea held a first, landmark summit in Singapore in June 2018 and agreed to improve relations and negotiate an end to North Korea's nuclear and missile programs. The efforts have made no substantial progress and their second summit hit an impasse in Vietnam in February 2019.

## 6 / RISKS ARE HEIGHTENED

With the many current political fears driving idiosyncratic risks in particular countries, Citi analysts see this as a good time for many investors to reassess the value of global diversification.

## Global vs. Regional Equity Market Performance During Crisis Years

Regional Crisis	Return During First Year of Crisis (%)	
Asian Crisis 1997	Asia (28.3)%	Global 15.0%
LatAm Crisis 1998	LatAm (35.1)%	Global 22.0%
EU Crisis 2011-2013	Europe (10.5)%	Global (6.9)%
Commodity Collapse 2015	LatAm (30.8)%	Global (1.8)%
US/China Trade War 2018	China (18.7)%	Global (8.9)%

Source: Citi Private Bank. As of 18 October 2019.



## ECONOMIC GROWTH &amp; INFLATION FORECASTS

	GDP			Inflation		
	2019	2020	2021	2019	2020	2021
Global	2.6%	2.7%	2.7%	2.5%	2.7%	2.4%
US	2.3%	2.0%	1.8%	1.5%	2.0%	1.8%
Europe	1.2%	1.2%	1.5%	1.2%	1.4%	1.6%
Japan	0.8%	0.3%	1.0%	0.5%	0.6%	0.6%
Latin America	0.8%	1.7%	2.2%	8.9%	7.8%	6.8%
Emerging Europe	2.2%	2.6%	3.0%	6.0%	4.9%	4.9%
Middle East & North Africa	2.1%	3.3%	3.2%	2.9%	4.3%	4.3%
Asia	5.2%	5.2%	5.2%	2.7%	3.1%	2.3%
China	6.2%	5.8%	5.6%	2.8%	3.2%	1.9%
Hong Kong	-1.3%	0.7%	1.8%	2.8%	2.6%	2.6%
India	4.9%	5.9%	6.4%	4.2%	3.7%	3.9%
Indonesia	5.0%	4.9%	5.2%	3.1%	3.8%	3.9%
Malaysia	4.6%	4.5%	4.8%	0.7%	2.3%	1.8%
Philippines	5.8%	6.2%	6.2%	2.4%	2.8%	2.8%
Singapore	0.8%	1.8%	2.2%	0.6%	1.0%	1.5%
South Korea	1.8%	2.0%	2.3%	0.4%	1.0%	1.6%
Taiwan	2.6%	2.4%	2.3%	0.7%	1.2%	1.0%
Thailand	2.6%	3.0%	3.4%	0.7%	0.6%	1.4%
Vietnam	6.9%	6.7%	6.7%	2.6%	3.0%	3.0%

Source: Forecasts from Citi Research. As of 12 December 2019.

## EXCHANGE RATE FORECASTS (VS. USD)

	1Q20	2Q20	3Q20	4Q20
Europe	1.13	1.14	1.15	1.16
Japan	106	105	103	101
UK	1.35	1.36	1.37	1.38
Australia	0.69	0.70	0.70	0.71
China	7.08	7.07	7.01	6.90
Hong Kong	7.83	7.83	7.83	7.82
India	71.7	70.9	70.7	71.2
Indonesia	13967	14116	14182	14142
Malaysia	4.14	4.13	4.09	4.03
Philippines	50.5	50.2	50.1	50.3
Singapore	1.37	1.36	1.35	1.34
South Korea	1178	1176	1173	1168
Taiwan	30.4	30.3	30.2	30.1
Thailand	29.9	29.8	29.8	30.1

Source: Forecasts from Citi Research. As of 20 November 2019.

## INTEREST RATE FORECASTS

	Current	1Q20	2Q20	3Q20	4Q20
US	1.75%	1.75%	1.75%	1.75%	1.75%
Euro Area Depo Rate	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
Japan	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%
Australia	0.75%	0.50%	0.50%	0.50%	0.50%
UK	0.75%	0.75%	0.75%	0.50%	0.50%

Source: Forecasts from Citi Research, as of 12 December 2019. Current rates as of 12 December 2019.

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