

P I M C O

Global Economic Outlook

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# Synching Lower

*CalPERS Offsite, January 22, 2019*

*Joachim Fels*

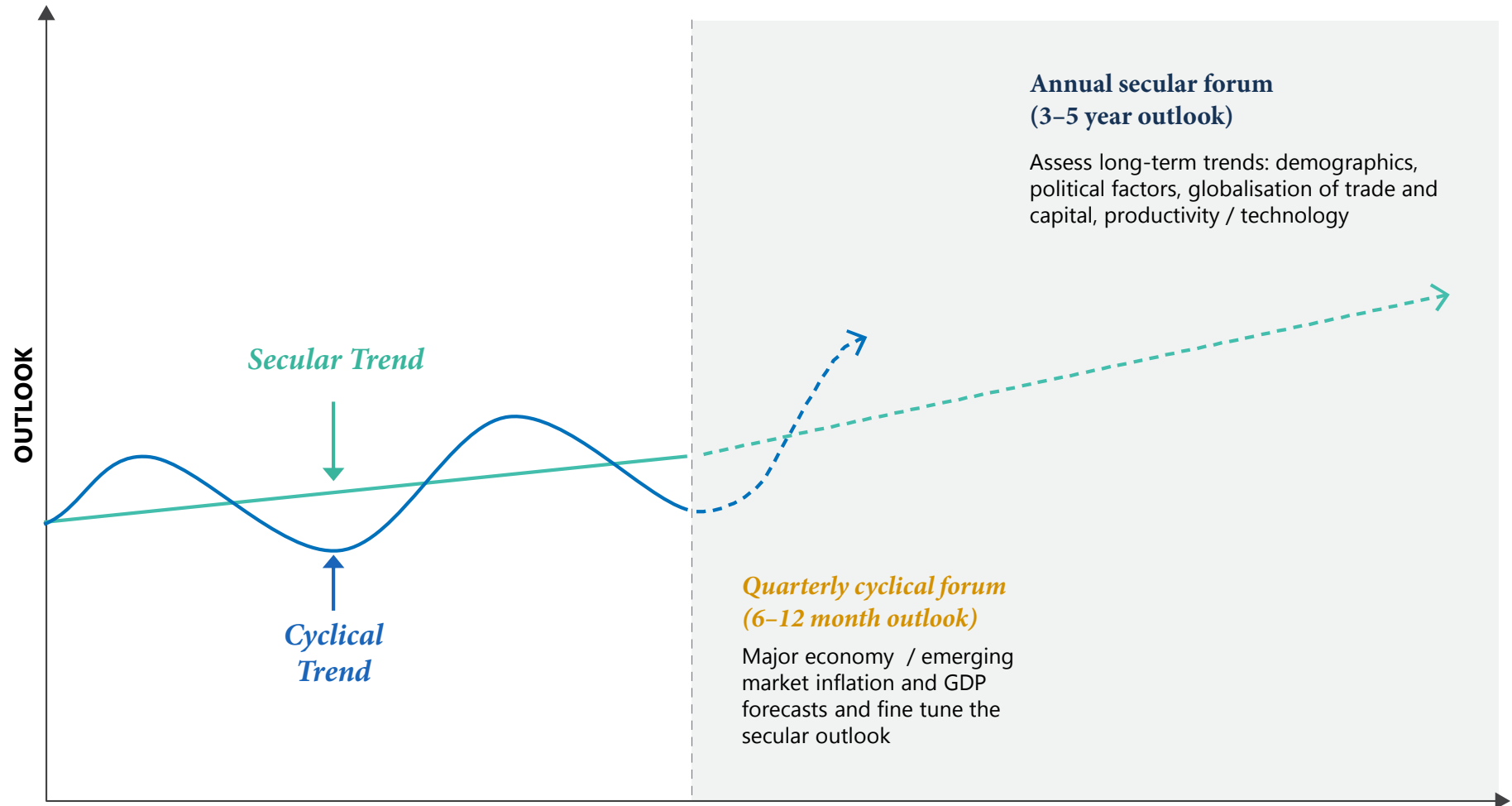
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A company of Allianz 



# PIMCO's investment process

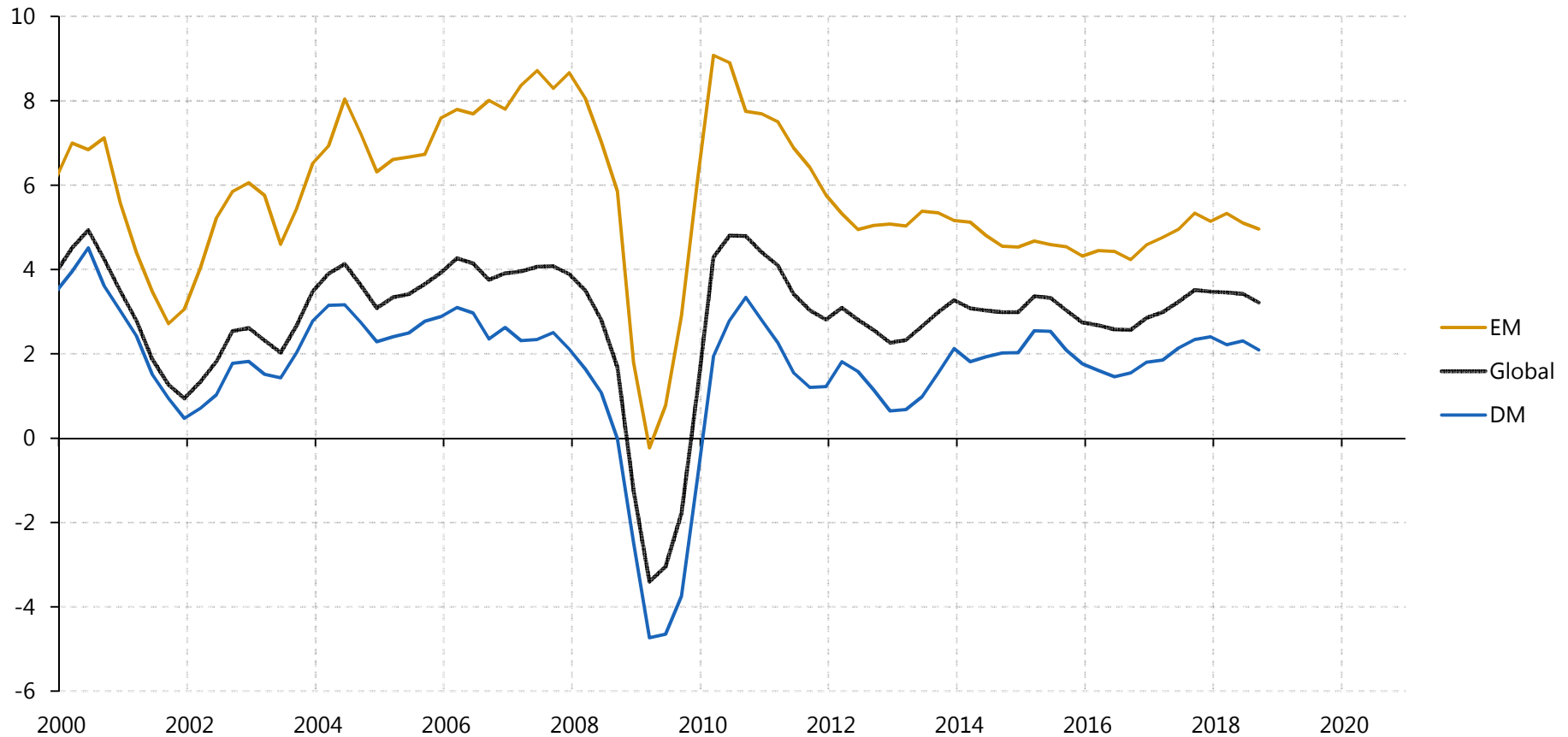
## *Forums: Themes that anchor portfolio construction*



SOURCE: PIMCO  
Refer to Appendix for additional investment strategy, outlook and risk information.

# Global GDP growth: The peak is behind us

## Real GDP Growth (y/y, %)



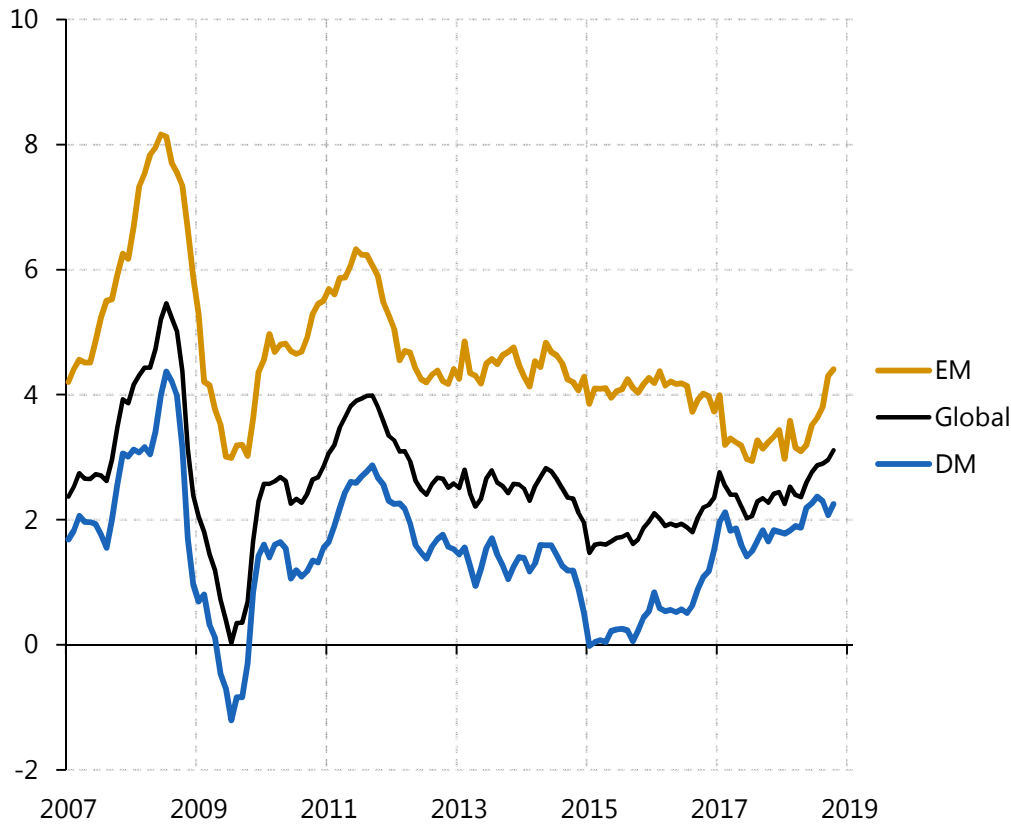
As of September 2018.

SOURCE: Haver Analytics, PIMCO calculations.

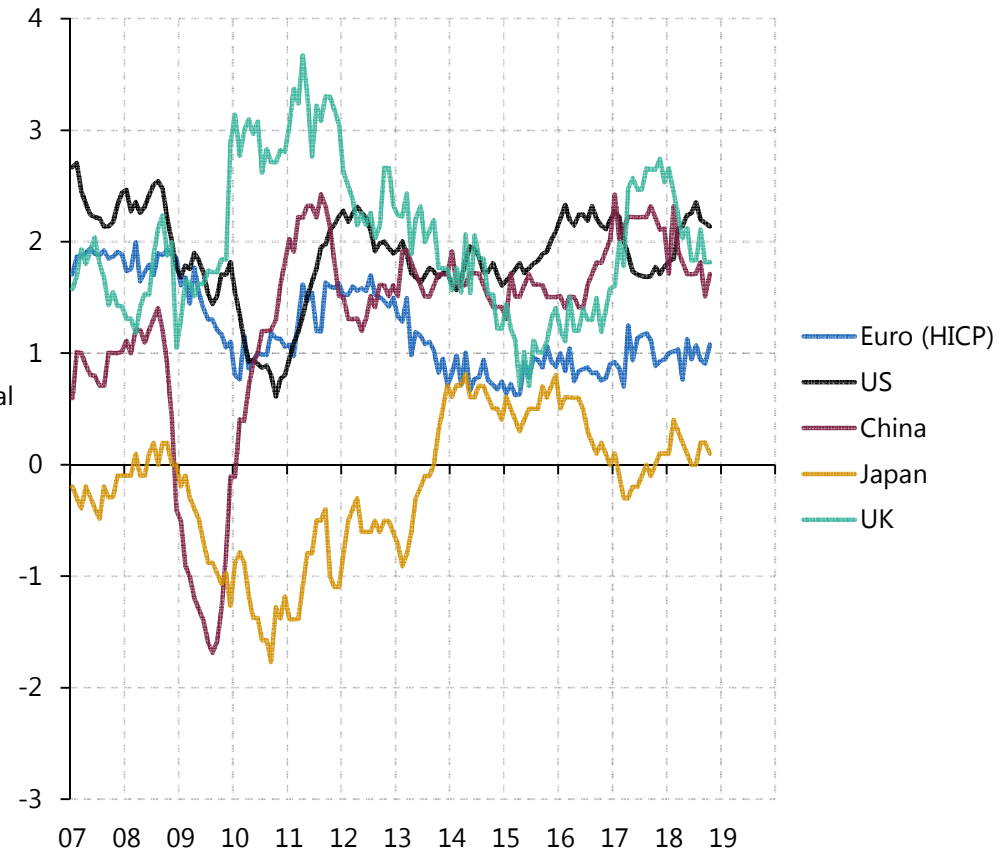
DM = Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, UK, US. EM = Argentina, Brazil, Chile, China, Colombia, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Poland, Russia, Singapore, South Africa, Taiwan, Thailand, Turkey. Global = EM + DM. Aggregates are GDP-weighted averages using market exchange rates. Note: Australia, Argentina, South Africa and Turkey are excluded for 3Q 2018.

# Headline inflation has peaked, core inflation flat like a pancake

## Headline CPI Inflation (%y/y)



## Major Economy Core CPI Inflation (%y/y)



As of November 2018.

SOURCE: Haver Analytics, PIMCO calculations.

DM = Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, UK, US. EM = Argentina, Brazil, Chile, China, Colombia, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Poland, Russia, Singapore, South Africa, Taiwan, Thailand, Turkey. Global = EM + DM. Aggregates are GDP-weighted averages using market exchange rates.

# Global policy rate higher, but real rates still historically low

## Central Bank Policy Rates (%)



## Major Economy Central Bank Real Policy Rates (%)



As of November 2018.

SOURCE: Haver Analytics, PIMCO calculations.

DM = Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, UK, US. EM = Argentina, Brazil, Chile, China, Colombia, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Poland, Russia, Singapore, South Africa, Taiwan, Thailand, Turkey. Global = EM + DM. Aggregates are GDP-weighted averages using market exchange rates.

# Wobbly markets have tightened financial conditions

## U.S. Dollar



## U.S. 10 year Treasury Yield



## U.S. Equities

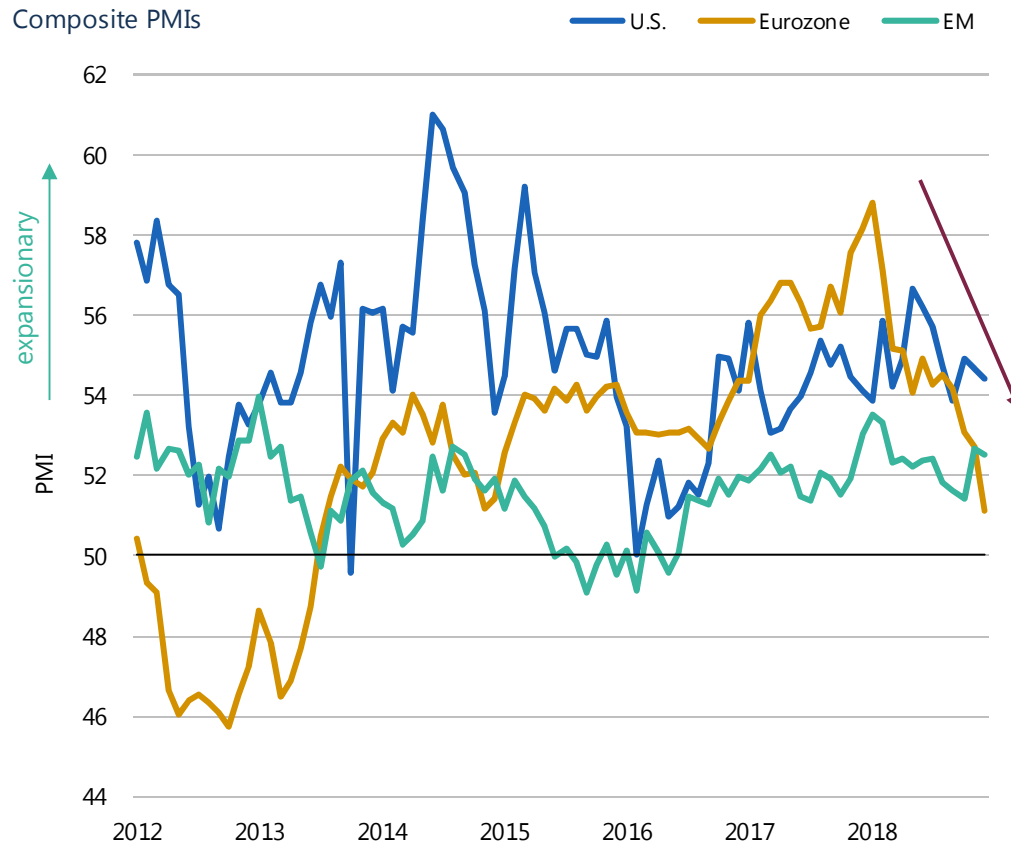


## 10 year BTP – Bund Spread



As of 3 January 2019  
SOURCE: Bloomberg

# 2019 Cyclical Outlook: *Synching Lower*

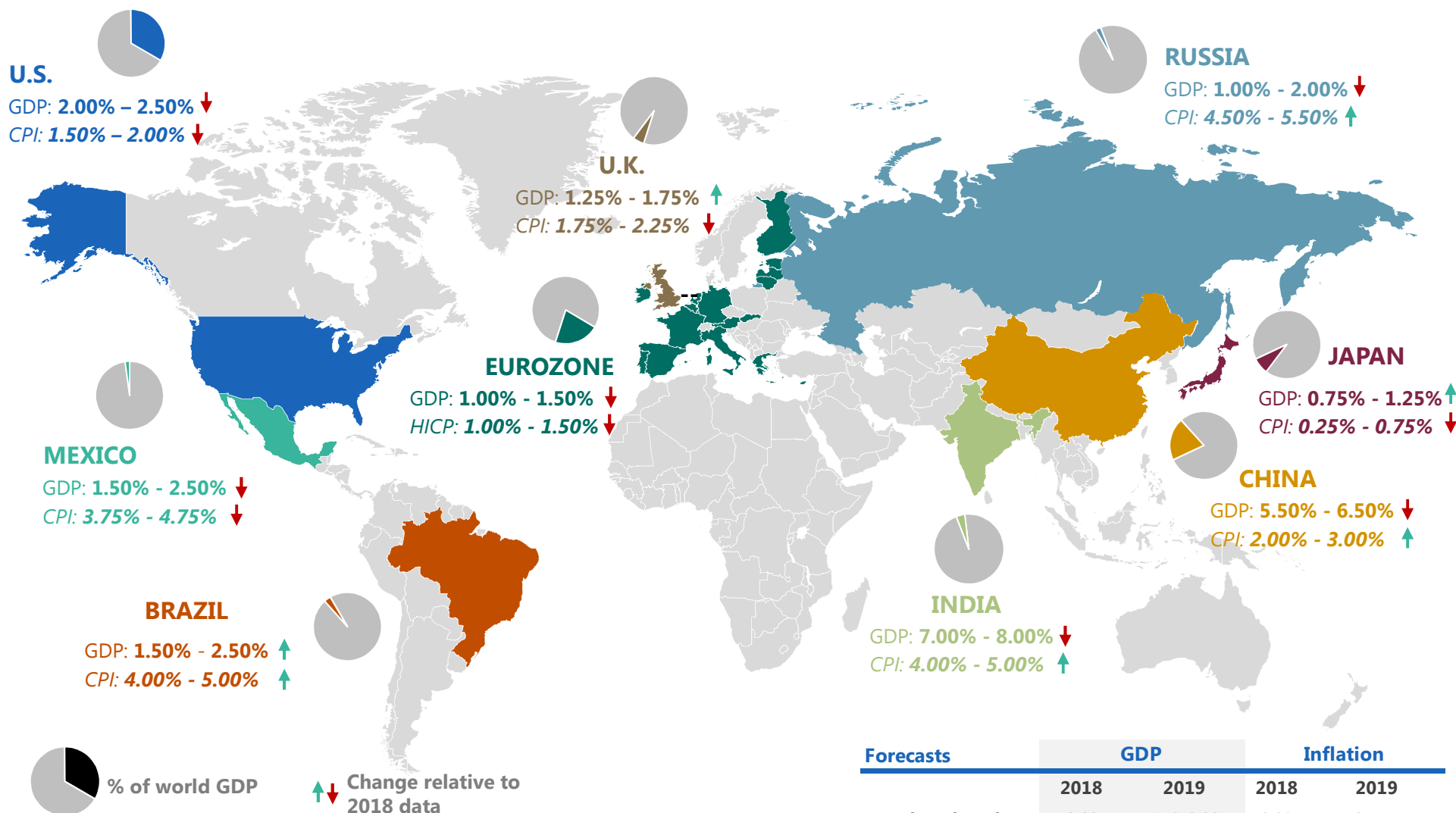


## ***Debates shaping the outlook for 2019:***

1. *How late is it in the cycle?*
2. *The end of U.S. economic exceptionalism?*
3. *Will inflation ever return?*
4. *The Fed pauses, then what?*
5. *U.S. versus China: truce or peace?*

As of December 2018  
SOURCE: Haver Analytics

# 2019 Cyclical Outlook: *Synching Lower*



For illustrative purposes only.  
PIMCO forecast ranges as of December 2018  
Real GDP and inflation projections reflect the midpoints of PIMCO's forecast ranges.  
Refer to Appendix for additional forecast, outlook, and risk information.

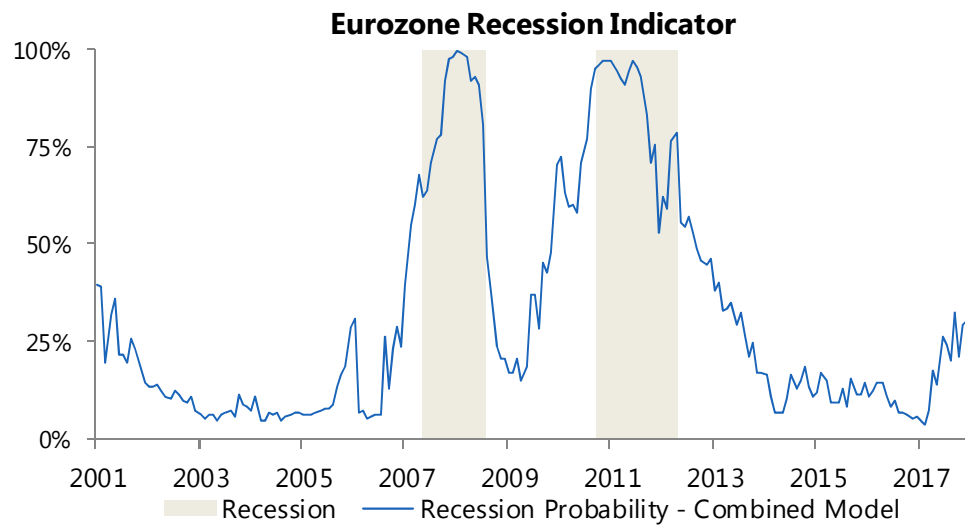
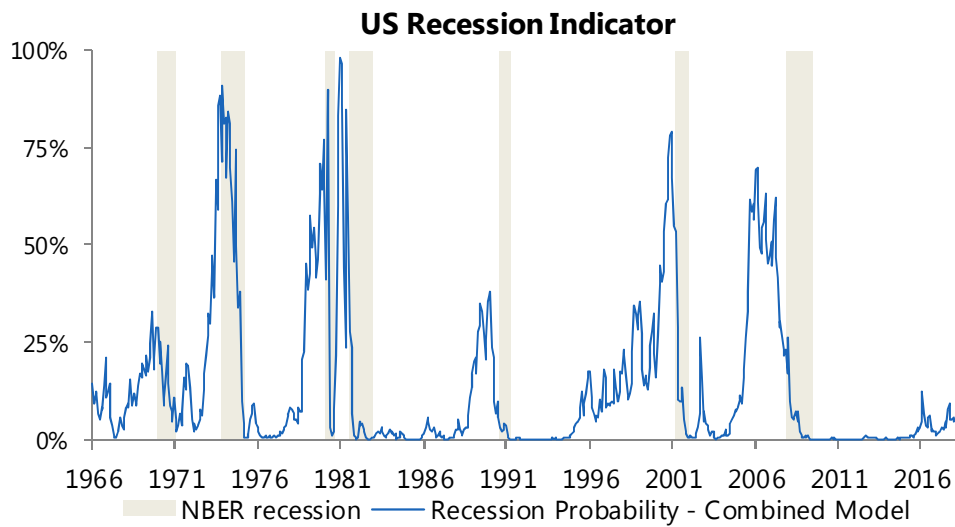
Forecasts	GDP		Inflation	
	2018	2019	2018	2019
Developed Markets	2.20	1.50-2.00	2.00	1.25-1.75
Emerging Markets	5.40	4.75-5.75	2.90	2.75-3.75
<b>World</b>	<b>3.30</b>	<b>2.75-3.25</b>	<b>2.30</b>	<b>1.75-2.25</b>



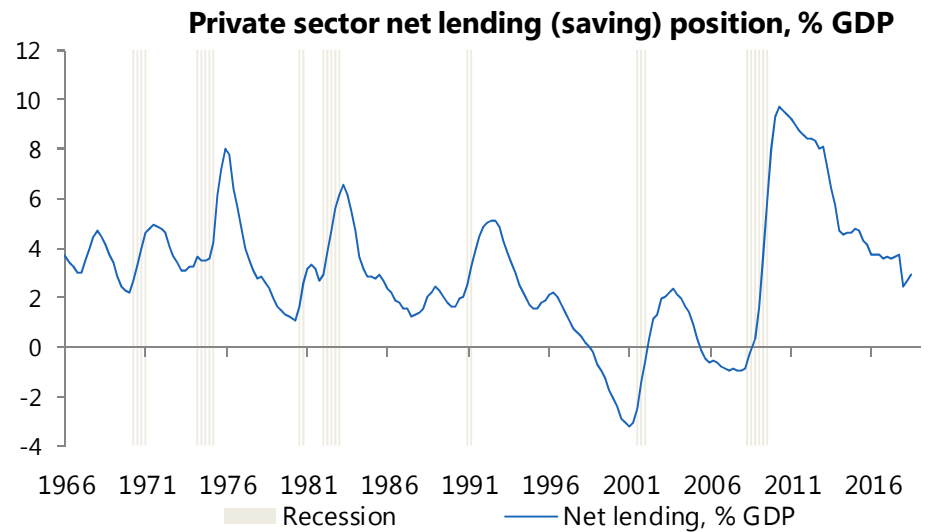
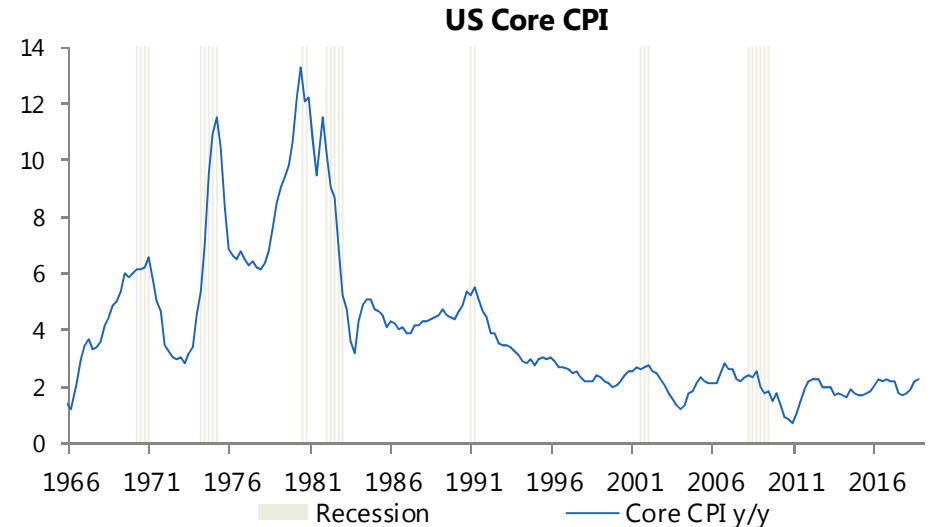
# Debate #1: How late is it in the cycle?

## Recession models are flashing orange, but few traditional signs of overheating

Recession models show above average probabilities



No signs of overheating or overspending



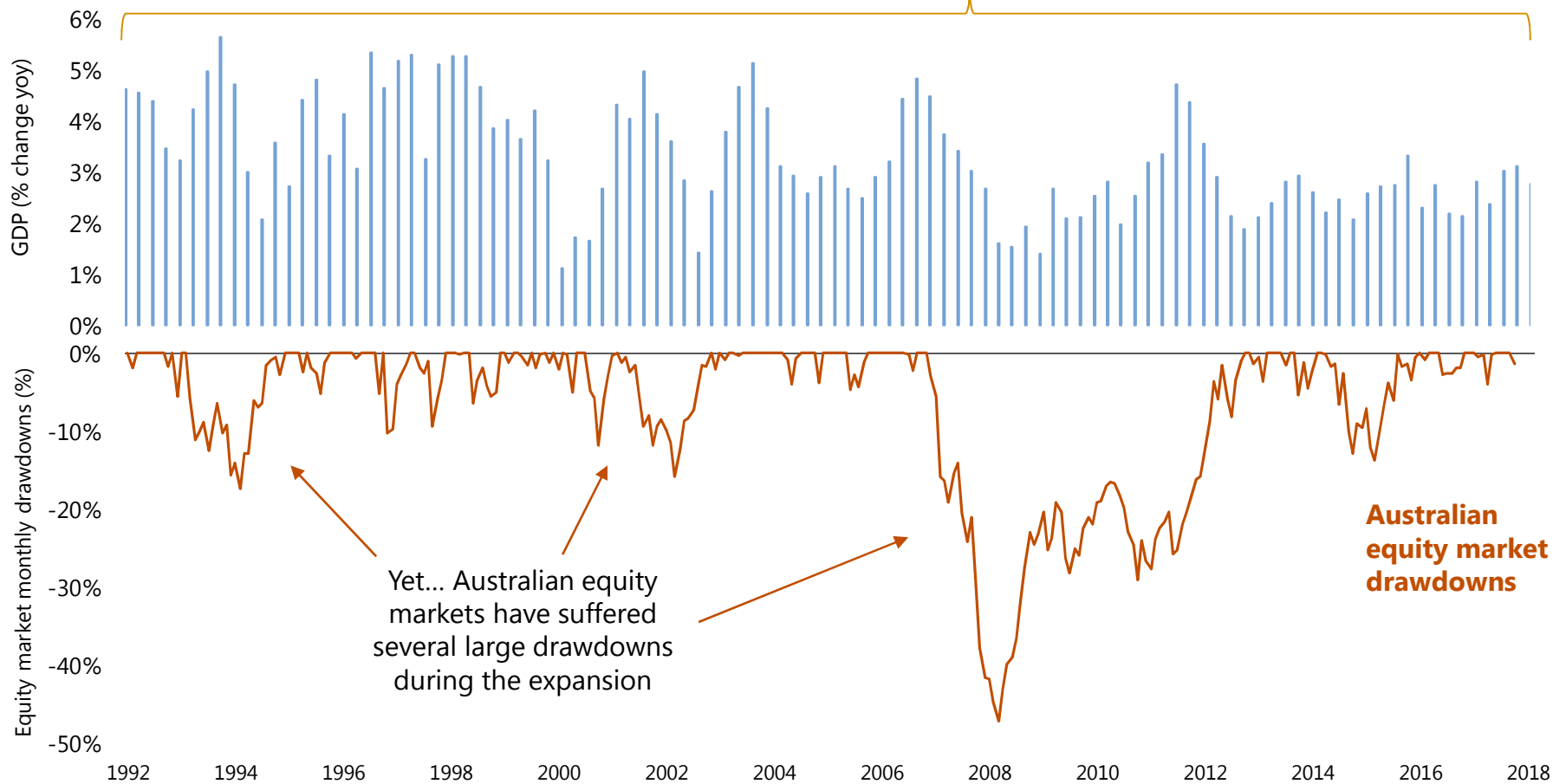
As of December 2018. SOURCE: PIMCO, Bloomberg, NBER, Haver. Note: Model-based recession probabilities are only one input into PIMCO's overall assessment of recession risks

# Debate #1: How late is it in the cycle?

Note: It doesn't take a recession for turmoil to roil financial markets

## Case Study: Australia

Australia: NO GDP recession for 27 years

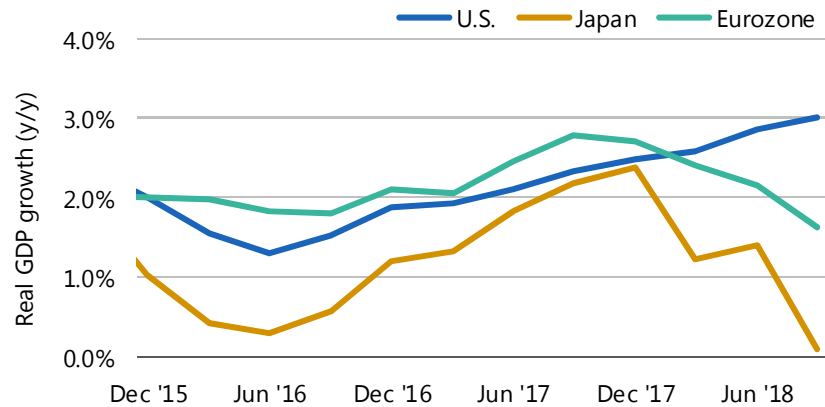


As of December 2018  
SOURCE: Bloomberg, Haver Analytics

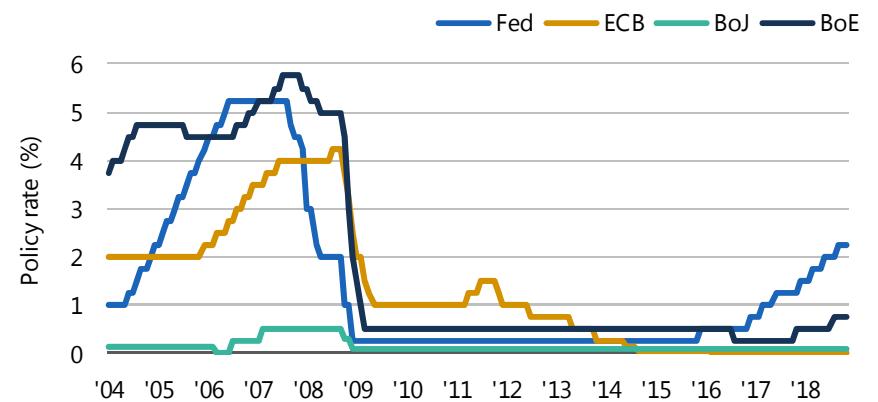
# Debate #2: Is U.S. economic exceptionalism coming to an end?

## US economy and policy was exceptional in 2018

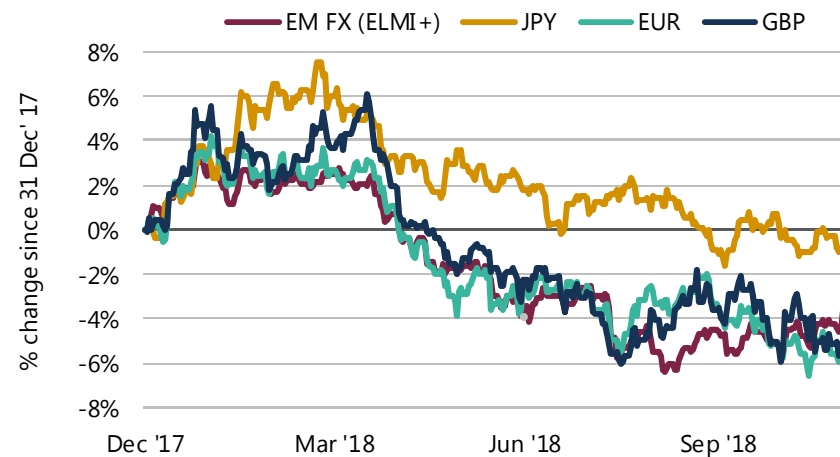
### U.S. growth has outpaced others



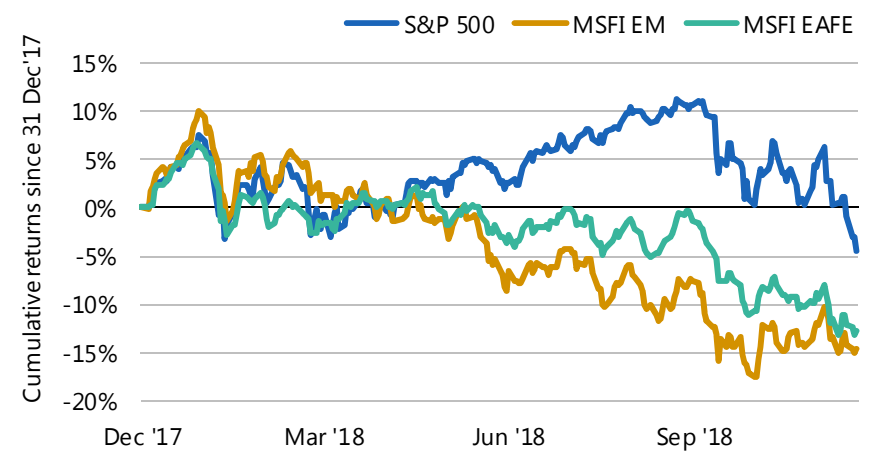
### More normalization in U.S. policy rates



### The dollar has rallied against most counterparts

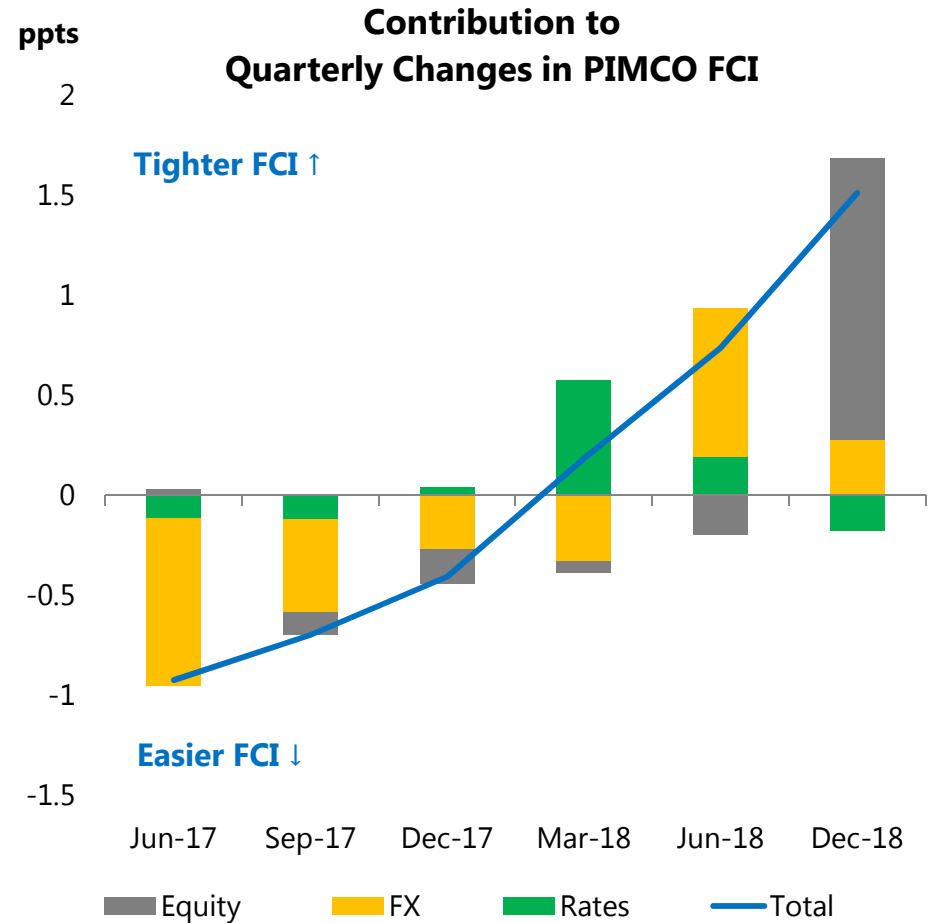
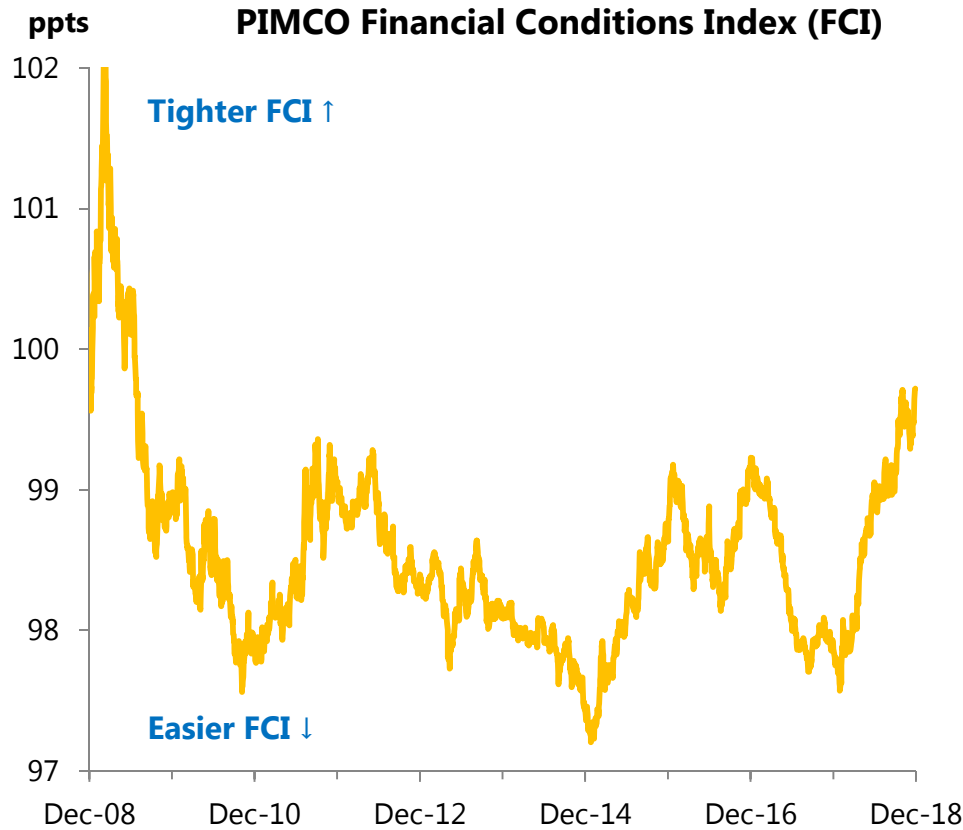


### U.S. equities have outperformed others



As of December 2018  
SOURCE: Bloomberg, Haver Analytics

# Debate #2: Is U.S. economic exceptionalism coming to an end? Tighter financial conditions will start to bite soon

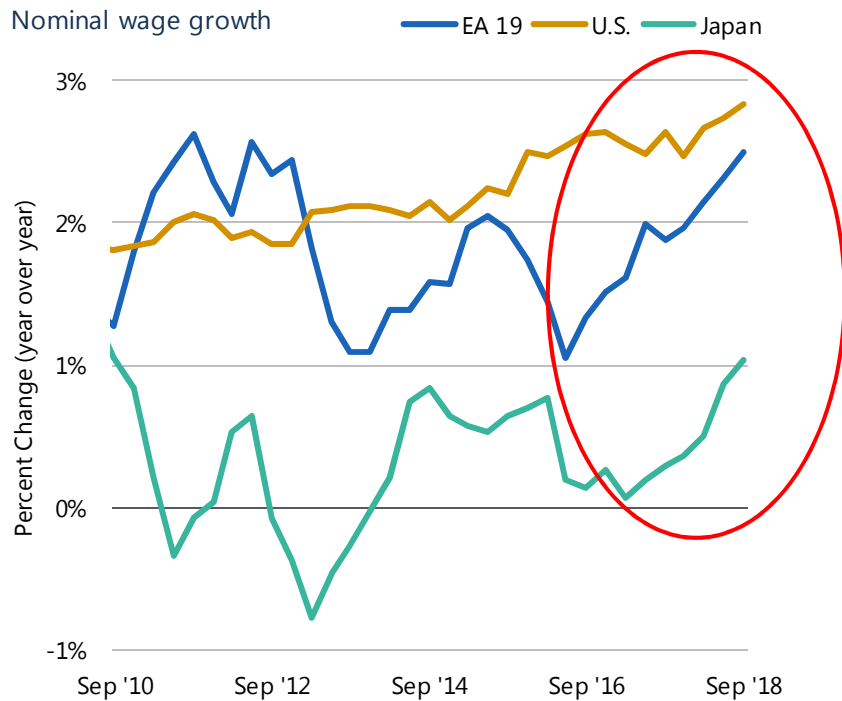


As of December 2018  
Source: Haver, FRBUS, PIMCO Calculations

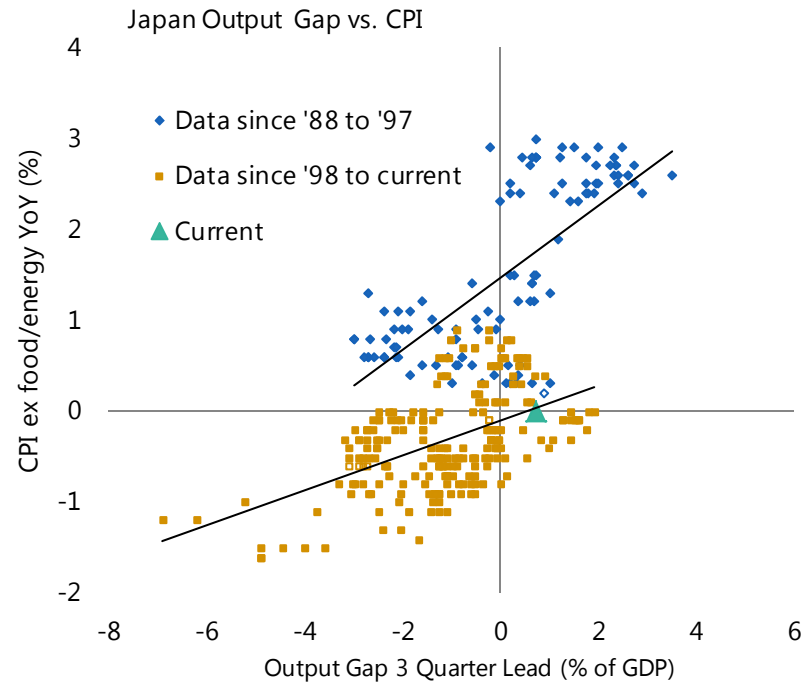
# Debate #3: Will inflation ever return?

## Wages are picking up, but inflation more likely to remain tame

### Nominal wages are showing signs of life...



### ...But Phillips Curves are flat and inflation expectations remain well-anchored



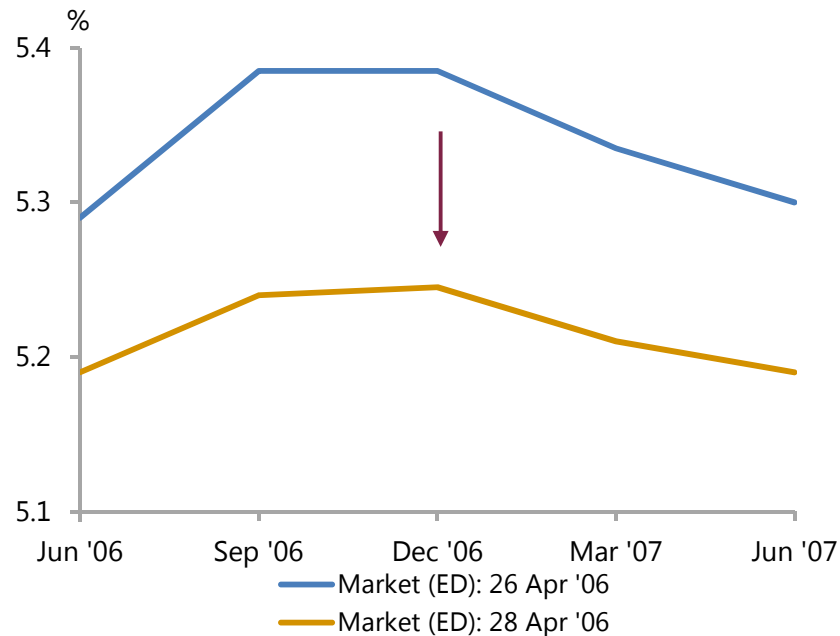
As of 30 November 2018 or latest available.  
SOURCE: Eurostat, BEA, MHLW, Haver, PIMCO

# Debate #4: The Fed pauses, then what?

## Fed has arrived in PIMCO's New Neutral Range, no need to overshoot

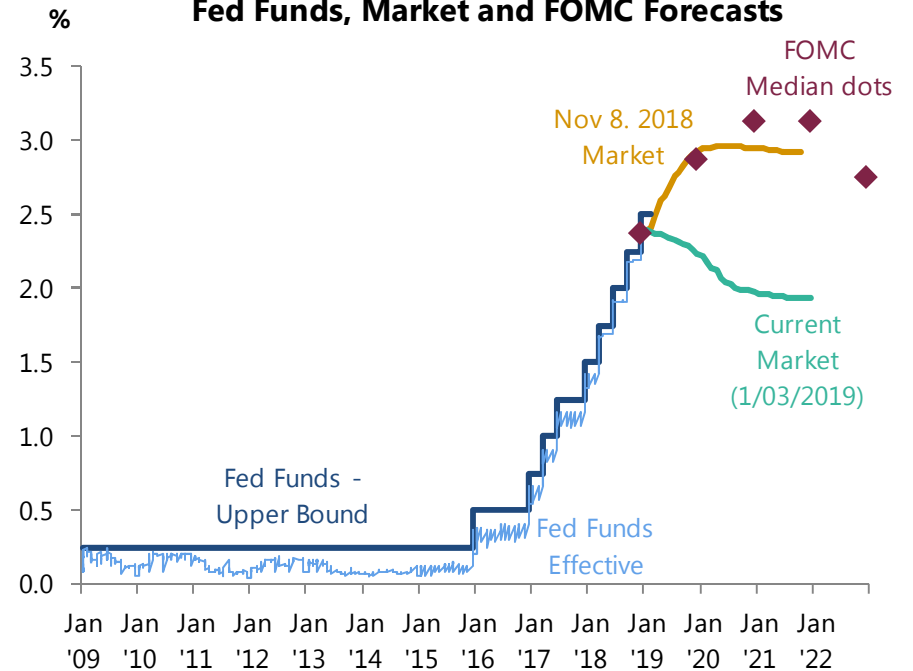
### History shows a pause can be difficult to communicate

Change in Eurodollar Futures after Chair Bernanke suggested the Fed might "pause" on April 27<sup>th</sup>, 2006



### Markets now think the Fed is done hiking

Fed Funds, Market and FOMC Forecasts



As of 3 January 2019

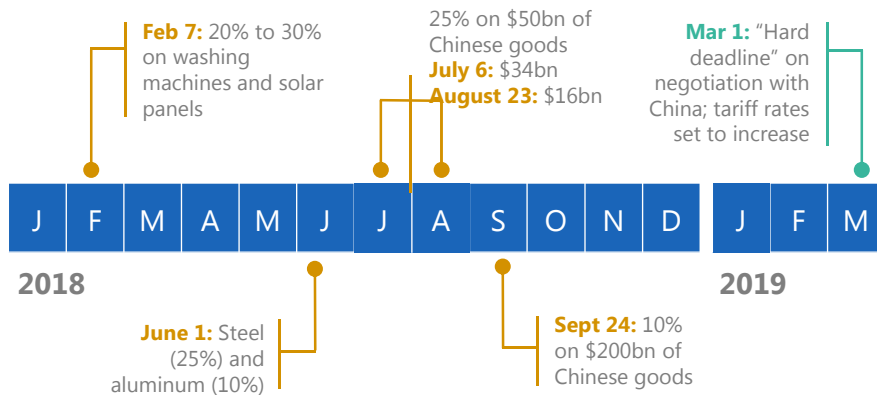
SOURCE: PIMCO, Bloomberg, Minack Advisors. Bernanke, Ben. "The courage to act : a memoir of a crisis and its aftermath." New York : W.W. Norton & Company, 2015.

# Debate #5: U.S. versus China – truce or lasting peace?

## A deal on trade looks likely, but the underlying conflict won't be resolved

### 90 day pause in trade escalations: is the worst behind us?

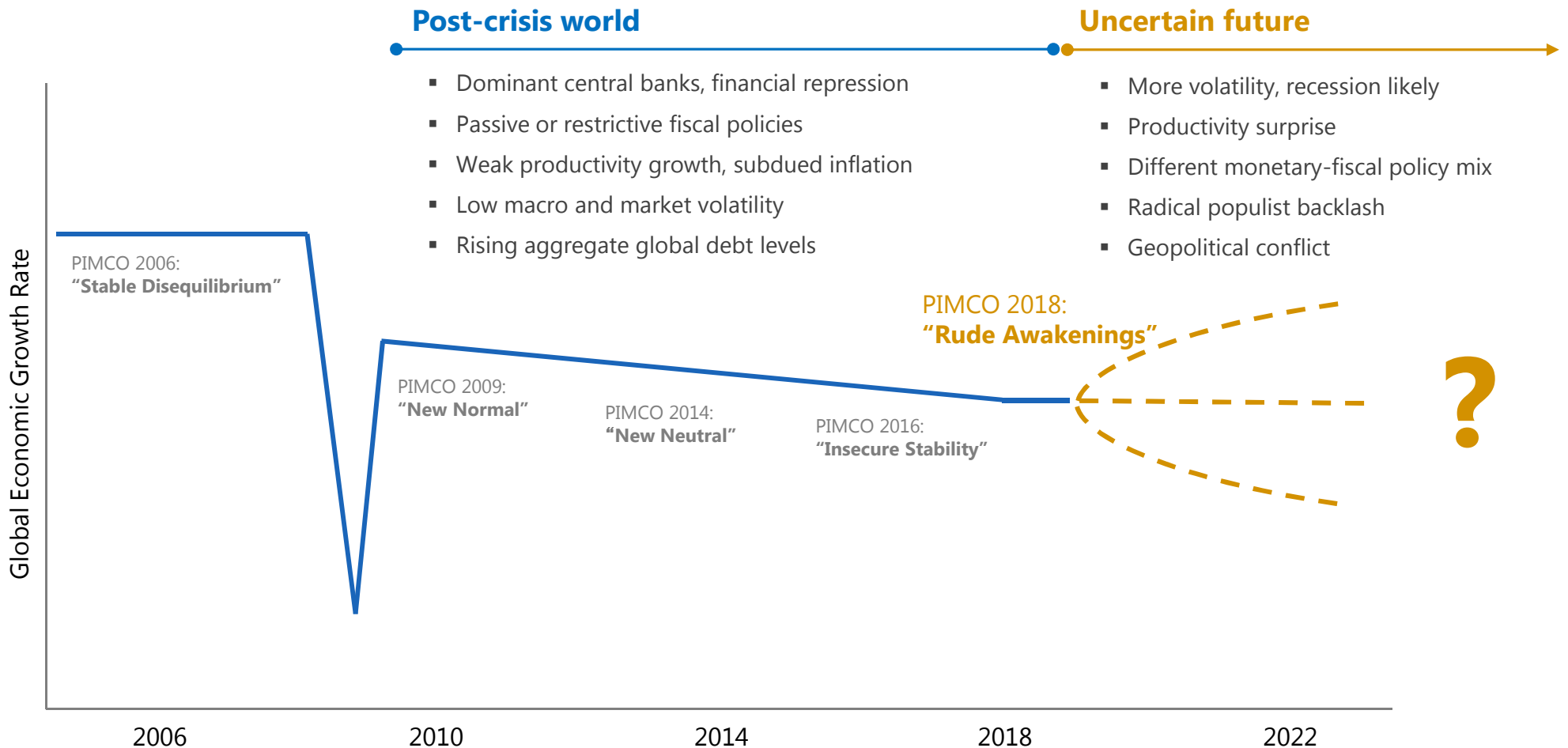
#### U.S. tariff announcements



### ...But conflict between the U.S. and China is more deep-rooted and not only about trade



# The next five years could be radically different, prepare for ‘Rude Awakenings’

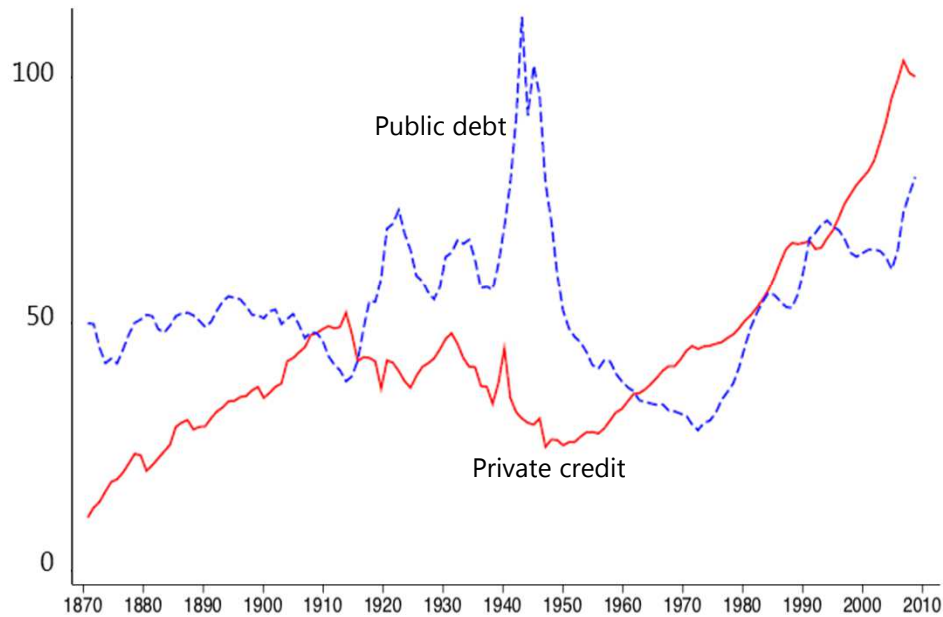


As of June 2018. SOURCE: PIMCO  
Refer to Appendix for additional outlook and risk information.

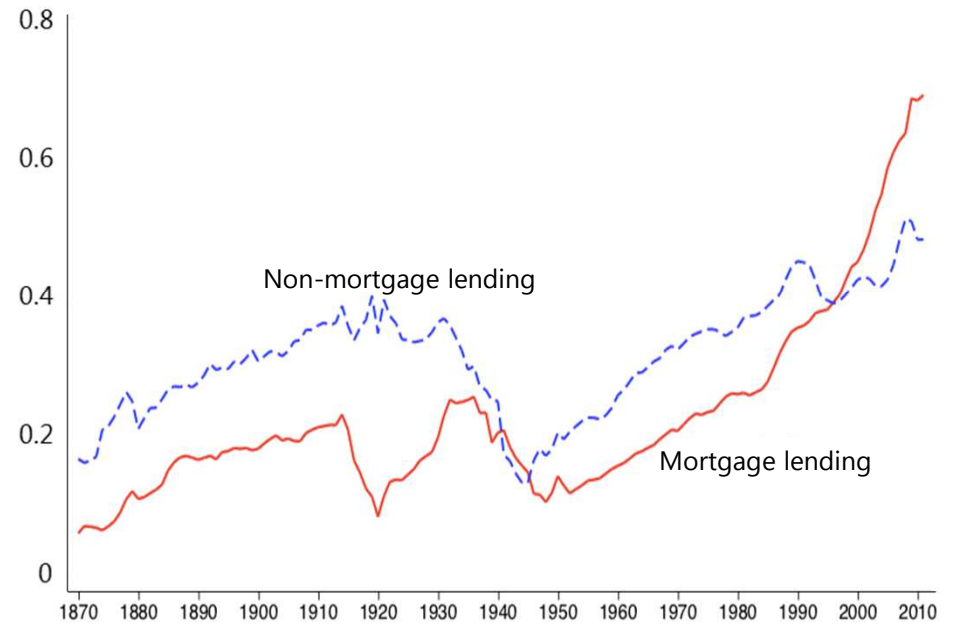


# The elephant in the room: The debt hockey stick

**Global Private and Public debt, Percent of GDP**



**Mortgage and Non-mortgage bank lending to GDP**



Source: Òscar Jordà, Moritz Schularick, and Alan M. Taylor. 2017. "Macrofinancial History and the New Business Cycle Facts." in *NBER Macroeconomics Annual 2016*, volume 31, edited by Martin Eichenbaum and Jonathan A. Parker. Chicago: University of Chicago Press.

# Appendix

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## FORECAST

Forecasts, estimates and certain information contained herein are based upon proprietary research and should not be interpreted as investment advice, as an offer or solicitation, nor as the purchase or sale of any financial instrument. Forecasts and estimates have certain inherent limitations, and unlike an actual performance record, do not reflect actual trading, liquidity constraints, fees, and/or other costs. In addition, references to future results should not be construed as an estimate or promise of results that a client portfolio may achieve.

## INVESTMENT STRATEGY

There is no guarantee that these investment strategies will work under all market conditions or are suitable for all investors and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market.

## OUTLOOK

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## RISK

Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and the current low interest rate environment increases this risk. Current reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. Investing in **foreign denominated and/or domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. **Equities** may decline in value due to both real and perceived general market, economic, and industry conditions.

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