BOC Research Institute

Global Economic and Financial Outlook

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Highlights

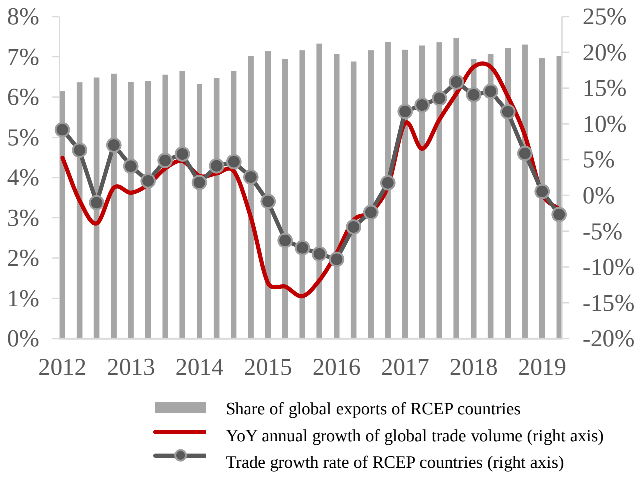
● The global economy in 2019 witnessed an apparent downward trend, and the growth rate is expected to reach 2.6%, a new record low in recent years. The global economy has become highly financialized, mainly characterized by high liquidity, low growth rate, low inflation and high bubbles.

● Looking ahead to 2020, given the interwoven political and economic risk factors, the global economy is expected to further decline in the first half and bottom out in the latter half of the year, with the annual growth rate expected to decrease by 0.1 percentage point.

● The changing global trade circumstances urge new ways of regional cooperation, and RCEP aims to establish a framework-oriented free trade agreement, which is expected to become a model for international economic and trade cooperation.

● Technological development and new economic industries represent the future development direction of the global economy, which call for strengthened global cooperation in innovation and investments to drive the real economy out of the trough.

Trade Growth of RCEP Countries



Sources: CEIC, BOCHK

BOC Research Institute
Global Economic and Financial Research Team

Team leader: Chen Weidong

Deputy leader: Zhong Hong

Team members: Liao Shuping
Wang Youxin
Zhao Xueqing
Xie Feng
Liu Jinhan
Wang Ruolan
E Zhihuan (Hong Kong)
Ding Meng (Macao)
Huang Xiaojun (New York)
Lu Xiaoming (New York)
Qu Kang (London)
Lin Lihong (Singapore)
Zhang Mingjie (Frankfurt)

Contact: Liao Shuping

Telephone: 010-66594052

Email: liaoshuping@bankofchina.com

The Global Economy is Bottoming Out: Gaining New Momentum

——Global Economic and Financial Outlook (2020)

In 2019, due to the rising global trade protectionism, confidence in international trade, manufacturing and consumer investment fell to recent lows. Facing the downward pressure on the economy, central banks of major economies cut interest rates successively, and the easing monetary policy was adopted again across the world. The financial markets were highly liquid and frothy, and the global economy became highly financialized. Resolving the predicament of real economy growth requires the joint efforts of all countries. In the Asia-Pacific region, significant progress has been made in RCEP negotiations, which provides a model for establishing mutually-beneficial economic and trade partnerships to bring win-win results. Meanwhile, strengthening cooperation concerning innovation and investments as well as accelerating the development of the new economy will effectively boost the global economy. All the above efforts are expected to build up new momentum for the global economic recovery and hence deserve special attention.

I. Global Economic and Financial Outlook for 2020

I.1 Global economy is expected to bottom out

The global economy in 2019 is gloomy, registering a QoQ decline of economic growth. The annual GDP growth is estimated at around 2.6%, recording the lowest level since the outbreak of the financial crisis. The global economy mainly showed the following characteristics: **firstly, regional differentiation occurred amid the overall downturn**. The manufacturing industry suffered the most significant impact from the recurring global trade frictions, and JPMorgan Global Manufacturing PMI was below the expansion-contraction line for six months consecutively. The global economy shifted from the “potential downward trend” to the “actual downward trend”, and about 90% of all economies saw lowered GDP growth. However, developed economies and emerging economies diverged in the depth of their downturn. In 2019, the GDP growth rate of the US and the euro area registered a YoY decline of more than 0.6 percentage point, while the GDP growth of some countries in the Asia Pacific, Central Asia and Africa only decreased slightly, and the GDP growth rates of several countries were even rising instead of falling. **Secondly, easy monetary policies were adopted on the whole**. Over 30 countries and regions announced interest rate cuts successively. Specifically, the Fed cut interest rates three times in a row in 2019, the European Central Bank cut its negative interest rate for another time, and Bank of Japan amended its perspective guidelines. India, Russia and the Philippines also trimmed their interest rates several times. The global monetary policy exhibited easing once again. **Thirdly, economic operations became increasingly financialized**. Given the slack demand of the real economy, high liquidity hasn’t pushed up inflation of major countries. Instead, money flows to the capital market, resulting in record-high major stock indexes, high level of government and private debts as well as a gradual build-up of systematic financial risks.

Looking into 2020, the global economy may continue its downward trend in the first half of 2020 and then bottom out in the latter half. The annual economic growth rate is estimated at around 2.5%, down 0.1 percentage point from the 2019 level. This estimate is mainly based on the following judgments:

First, overall economic growth lacks momentum. On the one hand, the recovery of large economies remains sluggish, with weakening growth momentum observed in the four major economies, namely the US, Europe, Japan and China, which together contribute over 50% of global

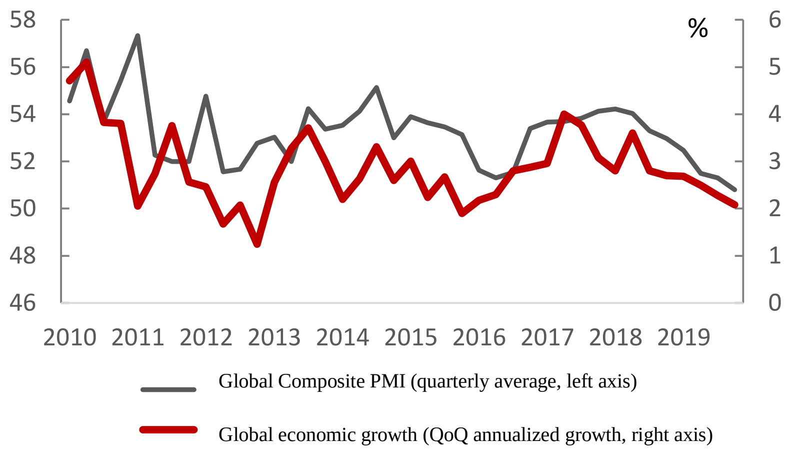
GDP growth. On the other hand, countries such as Argentina, Iran, Turkey, Venezuela, India, Brazil, Mexico and Russia which suffered from severe political conflicts or dire economic situations are expected to resume growth from historical lows. However, the internal and external environment confronted by these countries is still fragile, restricting their potential for growth and rebound. Consequently, even if the global economy would recover in the latter half of 2020, it would be a weak one.

Second, global trade frictions have not achieved a turnaround. So far, the Sino-US trade negotiations have made positive progress, and technical consultations over part of the texts have been completed. Trade war arises from additional tariffs. Both sides are likely to remove the additional tariffs gradually during several phases as the agreement progress, which might significantly boost market confidence and reduce the uncertainty of economic operation. However, due to the uncertainties in the Sino-US trade negotiations, any setback may affect market expectations and lead to market turmoil. In addition, trade frictions between the US and Europe, between the US and Japan and between Japan and South Korea have remained, and the multi-lateral coordination mechanism for global trade is on the verge of failing.

Third, international direct investment has remained sluggish. Under the influence of protectionism, global foreign direct investment has witnessed a decline for three straight years since 2016. The global FDI in 2018 decreased by 13%, and the global FDI in the first half of 2019 shrank further by 23% from that of the latter half of 2018. Since the US tax reform impact has faded away and capital flowing back to the US has declined, the direct investment from developed nations may pick up slightly, but the overall scale is expected at below decade average. Given the slowdown of the global economy, trade tensions and decline in return on investment, the global direct investment situations are still unoptimistic.

Fourth, the space for global policy adjustments is limited. We expect that major central banks in the world will continue to adopt the “low interest rate + quantitative easing” policy for a period of time. After a round of unconventional monetary policy cycle which narrows down space for further monetary policy, strengthening fiscal policy has become a dominant choice. Nonetheless, high level of government debts have restrained the expansion space of fiscal policies in developed nations. In 2019, government debts as a share of GDP in advanced economies averaged 104.1% and is expected to rise to 104.8% in 2020. For emerging economies, countries with strong domestic demand, less vulnerability to trade conflicts and low fiscal deficits, such as the ASEAN nations, will be more resilient to an economic slowdown. On the contrary, countries with twin deficits such as India and countries in the Middle East and Latin America with heavy dependence on commodities exports can hardly cope with the downward pressure with fiscal incentives.

Figure 1: Global GDP Growth V.S. Global Composite PMI



Sources: Wind, BOC Research Institute

I.2 Risk factors buildup in the global financial market

In 2019, the global financial market presents evident periodical characteristics as it fluctuates with changes in trade situations, global economic outlook and monetary policies of central banks. In Q1, the risk indicators of many fields registered improvement, investor confidence and risk preference rallied, risk premium declined, and the fluctuations in the stock markets, debt markets, foreign exchange markets and energy markets in major economies were mitigated significantly. From the end of Q2 to Q3, international trade situations worsened, and the uncertainty index of global economic policies rose to an all-time high. The yield curve of developed economies was inverted, and the risks of global economic slowdown or even recession were increasing, which led to rising risk aversion and renewed turmoil in financial markets. The monthly average of Risk of Financial Crisis Index (ROFCI) of the US once reached 45, entering the unstable zone. Since Q4, with the gradual relaxing of global monetary policies, the central banks of the US, Europe and Japan started to expand their balance sheets, and the Sino-US trade frictions have eased, which have enhanced risk preference and boosted investor confidence to a certain extent, and eased the credit and liquidity crunch. Generally speaking, the global financial market has remained relatively stable amid fluctuations in 2019.

Looking into 2020, we anticipate that the global financial market will suffer from high uncertainty. The significant financial risks include the following: **firstly, low interest rate drives investors into high-risk investments.** Presently, the outstanding negative interest rate debts account for 20% of total government debts in developed economies. Lingering low interest rate and even negative rate are expected to urge investors to pursue returns by investing in assets with higher risks and poorer liquidity. **Secondly, the debt risks of non-financial enterprises in developed markets continue to rise.** Due to the mounting debts and weakening of debt servicing capabilities, the enterprises in several systematically-important economies become highly vulnerable, and the quality of leveraged loans and their derivative assets has started to deteriorate. **Thirdly, some financial markets are overvalued.** Thanks to monetary stimulus, most stock markets around the world have been rising fast. By November 2019, the MSCI World Index, MSCI Developed Markets Index, MSCI Emerging Markets Index had increased by 19.2%, 20.4% and 10.3% respectively from the beginning of the year. The stock prices are overvalued relative to economic fundamentals and corporate earnings and show signs of “bubbles”, leading to downward correction risks.

I.3 Intertwined political and economic risks will affect the trend and judgment of 2020

The biggest uncertainty in the 2020 outlook may lie in the US, and political factors are expected to become critical disturbing factors. The presidential election of the US and the Middle East geopolitics will get intertwined with trade frictions and debt risks, making the global economic and financial trend more volatile.

The first is the downside risks of the US economy. Since the US contributes 24% of the world's GDP, its economic trend will largely affect the global growth landscape and market confidence. Since 2019, there have been growing concerns over economic recession risk in the US, as the yield inversion of Treasury bonds widened and extended. The US economy is expected to the remain in a downward trend due to the unstable consumer performance, declining private investment, deteriorating trade deficits and lackluster fiscal spending in the election year.

The second is the risk of escalating trade frictions between China and the US. Presently, the Sino-US trade frictions show signs of alleviation, and both nations are expected to reach an agreement for the first phase. Nonetheless, this only serves as a "ceasefire agreement", since the two sides remain far apart in crucial areas which involve their core interests. As a result, the possibility of setbacks can't be ruled out, and the battlefield may be expanded from bilateral to multilateral relations, involving the WTO reform agenda for instance. Therefore, it's not advisable to be overly optimistic about the Sino-US trade negotiations in 2020, and it's recommended to get prepared for the prolonged and complicated conflicts.

The third is the US election and geopolitical risks. In 2019, there has already been a major dispute between candidates from the Democratic Party and the Republican Party, which has caused sharp fluctuations in the financial markets. As the election campaign will be formally started in 2020, both parties are expected to attack each other more intensively, inevitably bringing shocks to the global market sentiments. Besides, the major powers continue to fight in the Middle East region over the Iran and Syria issues, which is expected to produce significant impact on prices of crude oil etc., affecting developing nations which heavily depend on imports and exports of commodities.

II. Review and Outlook for Key Regions and Key Fields

II.1 US economic outlook for 2020 and impact on Latin American countries

The US economy has entered the second half of this round of economic expansion and witnessed a continuous decline in the first three quarters of 2019. The annual GDP growth rate is estimated at 2.3%, a remarkable drop from 2.9% of 2018. Looking ahead to 2020, the growth rate of the US economy may fall to 1.9%, and the possibility of a recession continues to rise.

1. Demand in the US economy may remain sluggish

Firstly, private investment may continue to decline. In Q2 and Q3 of 2019, enterprise investment growth fell from the peak value of 13.7% in Q3 2018 to -6.1% and -1.5% respectively, dragging down the GDP growth for two quarters consecutively. The PMI of the manufacturing industry fell below the expansion-contraction line for several months, and the PMI in September was merely 47.8, the lowest level in the past decade. According to estimates, private investment growth excluding real estate project in 2019 would decline from 6.4% in 2018 to 2.3%. In 2020, given the impact of private enterprise debts and the presidential election, private investment growth is expected to further decline to around 1%.

Secondly, net exports can hardly become a key driving factor for US economic growth. Due to the characteristics of the US in the macro-economic structure, the trade protectionism policy adopted by the US hasn't improved its overall trade deficits. Net exports in Q2 and Q3 2019 dragged down GDP by 0.7 and 0.1 percentage point respectively, so net exports are negative factors for economic growth. In addition, given the low proportion of trade in the overall GDP, even if a trade agreement is reached to a certain extent between China and the US, trade can hardly become a key driving factor for the US economy in 2020.

Thirdly, government spending expansion is confronted with increasing political pressure. The government spending growth in the first ten months of 2019 was substantially higher than the same period of 2017 and 2018 and became the second most important driving force for the economic growth of the US in 2019. However, since the two political parties of the US will become more polarized in the election year, and Trump is under pressure of impeachment, it is difficult to introduce any large fiscal spending plan in 2020, which will further affect the sustainability of economic growth of the US.

Fourthly, the growth rate of household consumption is uncertain. Robust labor market and compensation growth, and wealth effects backed by the capital market have contributed to the relatively stable growth in consumer spending, which accounts for 70% of the US economy and serves as the foundation for the growth of US economy. However, the growth rate of disposable income of the US residents and household consumption stood at roughly 3.0% and 2.6%, representing a modest decline from 4.0% and 3.0% in 2018. Moreover, recently several consumer confidence indexes have declined successively. In the future, the limited labor market improvement space, weakening compensation growth and lag effects of trade frictions are expected to cause some negative impacts, and household consumption growth may fall to around 2.0%.

2. The US monetary policy will most likely remain relaxed

Based on inflation and labor market statistics, firstly, the inflation indexes based on market transactions and surveys of economists all indicate that the trend of "low inflation" will continue. The average PCE inflation has risen by only 1.4% in the past three months. According to the yield of TIPS, the CPI inflation level for the upcoming five years is only around 1.5%. However, given the gap of 20 to 30 basis points between CPI inflation and PCE inflation, the average PCE inflation in the coming five years will be as low as around 1.3%. Secondly, stable labor market situations serve as the biggest support for the Fed to remain confident in the economy. The adjusted monthly average of incremental non-agricultural employment population in August-October is 176,000. The unemployment rate in October is 3.6%, still quite close to the 50-year low of 3.5%, but the potential for continuous improvement in the labor market is expected to be limited in 2020.

In terms of the benchmark interest rate, the Treasury yield curve (the difference between the yield on the 10-year Treasury bonds and that on the 3-month Treasury bonds) was inverted for about four months in 2019. The three rate cuts introduced by the Fed will play a certain part in extending the current cycle, but will once again reduce its monetary policy space to address recessions. Notably, with its "Not QE" program, the Fed took only two months to regain about 40% of the scale shrunk by quantitative tightening in the past 21 months. The Fed would rather resort to the non-conventional quantitative easing than allow its benchmark interest rate to fall into the trap of negative interest rate prematurely.

With respect to the financial system, the "intensified regulation" in the past few years has significantly improved the stability of the US financial system, which is much better than that before the financial crisis in 2008. However, the overall level of corporate debts of the US have reached a record high. Debts are more and more held directly in the form of bonds, and the mounting corporate debts are increasingly concentrated in enterprises with high risks, which bring potential risks for all kinds of non-banking financial intermediaries that offer debts or leveraged financing for enterprises. Based on the current economic and financial situations, we expect 2-3 interest rate cuts by the Fed in 2020.

Table 1: Forecast for the Fed's Benchmark Interest Rate

	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	2021Q1
"Hawkish"	1.7	1.7	1.7	1.7	1.7	1.9

scenario						
“Dovish” scenario	1.5	1.3	1.2	1.0	0.9	0.9
Fed dot plot, Sept. 2019	1.9	1.9	1.9	1.9	1.9	2.1

Note: Forecast values are quarterly averages with implied probability distribution.

Sources: The Fed, BOC New York Branch

3. Latin America is exposed to both internal and external pressures

Since 2019, deteriorating internal and external environments have put the economy of Latin America under considerable downside pressure. In Q3, 17 out of 20 economies in the region registered a slowdown, and the economic growth for the whole year may be as low as around 0.1%. We expect that Latin America can hardly go out of the economic difficulties for some time to come.

Internally, this region already showed signs of economic sluggishness in the latter half of 2018, which extended to 2019, resulting in lackluster exports and investments as well as decline in public spending and personal consumption. Although small and medium-sized countries such as Dominica and Panama have maintained economic growth, the two major Latin American economies, namely Mexico and Brazil, suffered from faltering growth, while Venezuela and Cuba were trapped in sanctions crisis.

Externally, the rising trade protectionism cast a shadow on trade and investment in this region, and the political and economic interference of the US with Latin America increased geopolitical tensions.

With respect to trade, the unilateral trade protectionism of the US severely affected the economic development of Latin America. Presently, the US remains the largest trading partner of Latin America, accounting for 35% of its total trade. China is the second-largest trading partner of Latin America, taking up 27% of its total trade. With the escalation of unilateral trade protectionism of the US and the intensified Sino-US trade frictions, Latin American countries which rely on resource exports and external markets are exposed to heightened pressure. On the one hand, as it directly affected Latin America’s exports to the US, Central American countries and Caribbean countries, as well as South American countries which have Free Trade Agreement (FTA) with the US have been walloped. In the first three quarters of 2019, Latin America’s exports to the US shrank by 9.4% year on year, while imports increased by 0.5% from the same period of last year. On the other hand, the Sino-US trade frictions have hindered the expansion of the global value chain, which increased the uncertainty of Latin America’s imports and exports.

In terms of investment, the US is the most important source of foreign investments for Latin America. However, as the US cut aids to Latin America and intensified sanctions on some countries, investment and development in the region slowed down. In 2018, the Trump Administration proposed to the Congress to cut 35% aids for Latin America from the 2016 level, and only provided a meager USD1.2 billion, the least aid received by the region since 2001. Given the unfavorable international environment and rising geopolitical risks, Latin America’s foreign investment inflow may slip again after ending the five consecutive years of decline. Latin America received foreign direct investment (FDI) of USD184.287 billion in 2018, up 13.2% from the previous year. However, FDI is estimated to decline further by 5% in 2019 from the 2018 level.

II.2 Economic outlook for Asia Pacific and Belt and Road region in 2020

Due to the global economic downturn and sluggish external demand since 2019, the Asia Pacific region and Belt and Road region have been affected to a certain extent, registering slower overall economic growth than 2018 and remarkable regional gaps. According to estimates, the economic growth rate of Asia Pacific region will reach 4.4%, down 0.5 percentage point from the previous year; Caucasus and Central Asian region 4.4%, up 0.2 percentage point year on year; Central Europe 4.1%, down one percentage point from the previous year; East Europe 1.3%, down 1.1 percentage points year on year.

1. Belt and Road region shows differentiated growth

Asia will become the engine to drive global economic growth. Due to the global economic downturn, trade frictions and other uncertainties, Asia's economic growth has slowed down by some degree. However, Asia remains a vital driving force for global economic growth. In the first three quarters of 2019, the actual GDP growth rate of Asia (excluding Japan) reached 5.4%, 5.2% and 5.2% respectively, far higher than the global average. The launch of the Belt and Road infrastructure connectivity and the promotion of regional trade and investment by the RCEP agreement are expected to inject new momentum for economic growth in this region. On the whole, the emerging Asian economies are expected to register a growth rate of 6% in 2020, increasing modestly from that of 2019.

Despite the global economic downturn, the Caucasus and the Central Asian region saw rising growth, which may be mainly attributed to the expansionary fiscal policies. Affected by global trade tensions and economic growth slowdown of major trading partners, the Caucasus and the Central Asian region experienced a dramatic decline in the growth of crude oil exports. To cope with the impact of slower crude oil revenue growth, Kazakhstan, Turkmenistan and Uzbekistan have adopted expansionary fiscal policies and intensified countercyclical adjustments. The economic growth rate of Caucasus and Central Asia region is expected to reach 4.4% in 2019, up 0.2 percentage point from the previous year, while the growth rate in 2020 will be at par with that of 2019.

The economic growth of Central and Eastern Europe declines, while the Belt and Road will become a key driving force. According to forecasts of the IMF, the GDP growth of emerging European economies is estimated at 1.8% in 2019, 0.5 percentage point higher than that of advanced European economies. Specifically, the economic growth of Central and Eastern Europe is 4.1% and 1.3% respectively. In the future, with the steady advancing of connectivity enabled by Belt and Road infrastructure construction, the investment growth in Central and Eastern Europe is expected to rise further. Besides, the increase in disposable income in this region will further unleash its private consumption potential. It's expected that the growth rate of emerging European economies will reach 2.5% in 2020, while that of Eastern Europe can hopefully rise to 1.9%.

2. Key focus: the ten ASEAN countries have maintained robust growth momentum

In recent years, the ASEAN countries have maintained fast economic growth, which is quite outstanding amid the global economic downturn. In September 2019, the Asian Development Bank gave its most recent estimates for GDP growth of the ten ASEAN countries, which was 4.5%, down 0.6 percentage point from 2018. The country-by-country breakdown shows that the YoY growth of Indonesia, Thailand, Malaysia, Singapore, the Philippines and Vietnam in 2019 H1 is 5.1%, 2.6%, 4.7%, 0.6%, 5.5% and 6.8% respectively. According to IMF statistics, the ASEAN countries' contribution to global economic growth has reached 10% in 2019.

Looking ahead to 2020, thanks to the brisk internal consumption and investments, the economic growth of the ASEAN countries can hopefully firm up to around 4.8%, mainly for the following three reasons: **Firstly, the ASEAN has enjoyed robust internal demand and investment, attracting continuous inflow of foreign investments.** In 2000-2018, the foreign investments in the ten ASEAN countries grew at an average annual rate of 10%. The constant inflow of foreign investments is expected to drive the development of the manufacturing industry and industrial upgrade of the ASEAN. **Secondly, the low inflation will provide space for further relaxation of**

monetary policies. Thanks to low oil prices, the ASEAN member countries all register an inflation rate lower than the target of their respective central bank. In 2019, the central banks of Indonesia, Thailand, Malaysia, the Philippines and Vietnam cut interest rates in succession to spur internal demand with loose monetary policies. **Thirdly, the formal implementation of the RCEP Agreement and the infrastructure connectivity along the Belt and Road are expected to inject lasting impetus to ASEAN's economic development.** In 2019, the ASEAN overtook the US and became the second-largest trading partner of China. In the future, the implementation of the RCEP Agreement and the infrastructure connectivity in the Belt and Road region will provide an institutional platform and real foundation for economic and trade cooperation between the ASEAN and other countries.

II.3 The economic outlook of Europe for 2020

The economy in Europe was gloomy in 2019, as all members recorded economic slowdown. In Q3, the EU (including the UK) registered a QoQ increase of 0.3% and a YoY increase of 1.3%. According to estimates, the economy of euro area and EU grows at 1.1% and 1.4% respectively in 2019, down 0.8 percentage point and 0.6 percentage point from the prior year, registering the lowest growth since 2014. Notably, European member states ended their diverging performance and started to slow down together, and the mutual spillover between peripheral and core member states generated adverse effects. Manufacturing and export-oriented countries were hit hard, with Germany recording an economic growth decline by 1.1 percentage points. The Southern economies are still exposed to double pressures of economic downturn and mounting debts, as evidenced by Italy, which registered a GDP decline of 0.7 percentage point to 0.1%. Countries with close ties with the UK were beset by uncertainties, with Ireland recording a sharp drop of 2.6 percentage points in economic growth.

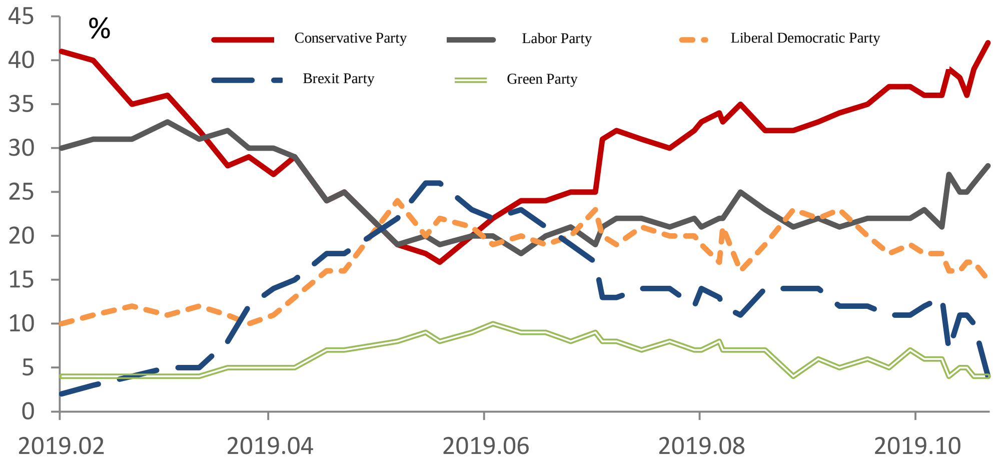
Looking ahead to 2020, Europe is expected to remain at the L-shaped lows, building a bottom and gathering momentum. On the positive side, the international trade has picked up slightly, the EU's new leadership team has been in place, employment growth is back to the pre-crisis level, and the wage income index and the labor costs growth are at a 24-year and 10-year high respectively. All of these are conducive to the shoring up of the service industry, the construction industry and consumption, and supporting the economic growth of Europe. However, the complex and volatile internal and external situations and the intertwined political and economic risks will bring many uncertainties to the development of Europe. The GDP of the euro area and the EU is expected to grow at 1.0% and 1.4% respectively in 2020, continuing to hover around the L-shaped bottom. In 2020, Europe will strive to balance the internal and external situations, reconcile differences of all parties and build up momentum for a steady recovery. On the whole, three challenges lie ahead for Europe.

First of all, can Europe stimulate internal momentum and cope with changes in external situations? Presently, the sluggishness of Europe can be attributed to uncertain geopolitical relations, fragmented politics, and weakening economic competitiveness. In 2020, two issues have to be properly dealt with for the new leaders to lead Europe out of its political and economic difficulties. **The first is to promote reform by internal reconciliation.** The newly-elected leadership team of the European Commission needs to harmonize the relations between political parties and between western and eastern Europe, properly solve the immigration problem, lead its member states to promote legislation reform and new structural policies actively, promote the modernization of industrial policies, and effectively improve Europe's productivity and core competitiveness. **The second is to maintain a balance through external adjustment**. In its European Economic Forecast for Autumn 2019, the European Commission cited trade frictions between China and the US as an important cause of its economic downturn, pointing out that its member states such as the Netherlands, Germany, Italy and France are under significant shocks due to their export-oriented economy, the higher proportion of the auto industry as well as close economic and trade ties with China. In the future, Europe will maintain flexibility between China and the US to a certain extent and strive to strike a balance between partnership and competition.

Secondly, can Europe fully tap the policy space to shore up steady economic growth effectively? As the downward pressure on the European economy heightened, the HICP (Harmonized CPI) peaked at 2.2% in October 2018 and fell back to 0.7% in October 2019. Therefore, the European Central Bank (ECB) had to give up its original plan to phase out the quantitative easing policy and adopted a more relaxing policy instead. The ECB trimmed the benchmark interest rate to a record low of -0.5%. In 2020, whether Europe can fully tap the policy space will determine the direction of the European economy. **On the one hand, an accommodative stance on monetary policy shall be maintained.** Given the economic fundamentals, the ECB will maintain relaxed monetary policies in 2020, and the possibility of further rate cuts in extreme circumstances cannot be ruled out. Meanwhile, compared with Mr. Draghi, Ms. Lagarde, the new President will improve communication skills and transparency, bridge deep internal divisions and re-examine the monetary policy framework. **On the other hand, a more aggressive fiscal policy will be implemented.** Currently, the deficit ratio of most European countries is below the 3% target, and the fiscal balance and debt pressure have witnessed significant improvement. European countries are expected to have more room for maneuvers in 2020 than during the debt crisis. Member nations with fiscal surplus such as Germany and the Netherlands are likely to increase fiscal stimulus, and governments will step up investment in sustainable development.

Thirdly, can the UK realize Brexit with a deal and return to a certain track of development? Given the continued uncertainty over Brexit, the economic aggregate of the UK is forecast to shrink by 1.5% in 2019 and 2020 from that of the Bremain scenario. The Brexit process is key to the economic and financial situations of Europe. The UK is expected to exit from the EU with an agreement in 2020, turning their relationship back to the track of certainty. The above forecast is made mainly based on judgment on two key aspects. **First, regardless of the outcome of the election, the risk of no-deal Brexit has been sharply reduced.** Although the general election created opportunities for smaller parties, the Conservative Party and the Labor Party remain the traditional candidates for ruling parties. The Conservatives have promised to leave the EU with an agreement by the end of January next year, while the Labor Party prefers a more favorable agreement and even a Bremain. The result of polls show that the Conservatives have a big lead over the Labor, which is in second place, and people are tired of delays on Brexit and desire to remove the uncertainties as soon as possible. **Second, the UK and the EU are more likely to make progress on trade negotiations.** Seven of the UK's top ten trading partners are from the EU, which accounts for about half of the UK's imports and exports. Due to the close economic and trade ties between the two sides and a high degree of integration in relevant fields, their trade negotiations are quite likely to generate a relatively friendly outcome. Once the economic order between the UK and EU becomes clear, the previously suppressed investment and consumer demand will be released, which is expected to significantly shore up the recovery and pickup of the European economy.

Figure 2: British Pollster YouGov Surveys People's Support for the General Election



Sources: YouGov, BOC Research Institute

II. 4 The commodities price trend in 2020 and its impact on the economy of the Middle East and Africa

1. The prices of commodities will drop amid fluctuations while crude oil will remain under pressure

In 2019, geopolitical risks and frequent occurrence of supply interruptions provided short-term risk premiums for commodities such as energy and metal ores. However, given the continued downturn in the global manufacturing industry, successive trade frictions and continuous downward revision of global economic growth expectations, commodity markets can hardly go out of the sluggish situation. In the first ten months of 2019, the World Bank's average energy price index fell 14.6% from a year earlier, while the average price index of agricultural products and metal ores fell 5.4% and 6% respectively.

In our opinion, global commodity markets will remain weak on the whole in 2020 except for a few varieties, since demand continues to weaken and supply gradually recovers. **In the crude oil market**, OPEC's influence has been weakened by the continued growth of shale oil output and deepwater oilfield production, and supply pressures will re-emerge in the context of a global demand slowdown. As a result, international oil prices will continue to fall from the 2019 levels, unless there are supply interruptions. However, if potential loss of supply is caused by geopolitical events, such as further capacity cuts by OPEC+ or tensions between the US and Iran, a rally in oil price may occur.

2. A mild economic recovery is expected for the Middle East and Africa

Continued weakness in commodity prices will highlight the economic vulnerability of some countries in the Middle East and Africa, especially those economies that rely heavily on commodity exports. The impact is mainly reflected in two aspects: first, for commodity-exporting nations, the decline in export prices will directly result in the loss of their fiscal revenue, causing pressure on their economy. Second, the decline in commodity prices will significantly reduce the ability of these countries with varying degrees of political, security and social risks to attract international capital for resource development.

Economic growth in the Middle East and North Africa is expected to pick up. In 2019, due to increased downward pressure on the global economy, a general drop in international crude oil prices, intensified US sanctions against Iran and the rising geopolitical risks, the economic growth rate in the Middle East and North Africa decreased to 1.1% from 1.4% in 2018. Looking ahead to 2020, among energy exporting nations, Egypt is expected to promote the structural reform, build a more prudent fiscal management framework, and improve management of state-owned enterprises. Iraq is projected to witness rising crude oil output, while member states of the Gulf Cooperation Council (GCC) will increase investment in infrastructure, and usher in regional growth thanks to relaxed external financing conditions and other favorable factors. For oil-importing countries, as the business environment has improved and tourism continues to grow rapidly in countries such as Morocco, economic growth in the Middle East and North Africa is expected to pick up to around 2.8%. However, how the conflict between the US and Iran will evolve remains the main uncertainty affecting the region's economy.

Sub-Saharan Africa is expected to make a mild economic recovery. In 2019, among the three major economies in the region, Nigeria's economic growth rate remained basically stable, South Africa's economic recovery was weak, and Angola's economy remained in recession. The regional economic growth is at par with the 2018 level, at around 3.2%. Looking ahead to 2020, the Sub-Saharan Africa is expected to maintain the trend of modest economic recovery of around 3.6%, since the African Continental Free Trade Agreement (AfCFTA) has come into force and brought new impetus to the regional economy, and East African countries are becoming increasingly politically stable and continue to serve as the growth engine. However, financial risks in some countries, security tensions in the Sahel region and the potential spread of Ebola epidemic are major risks for the regional economy.

III. Special Researches

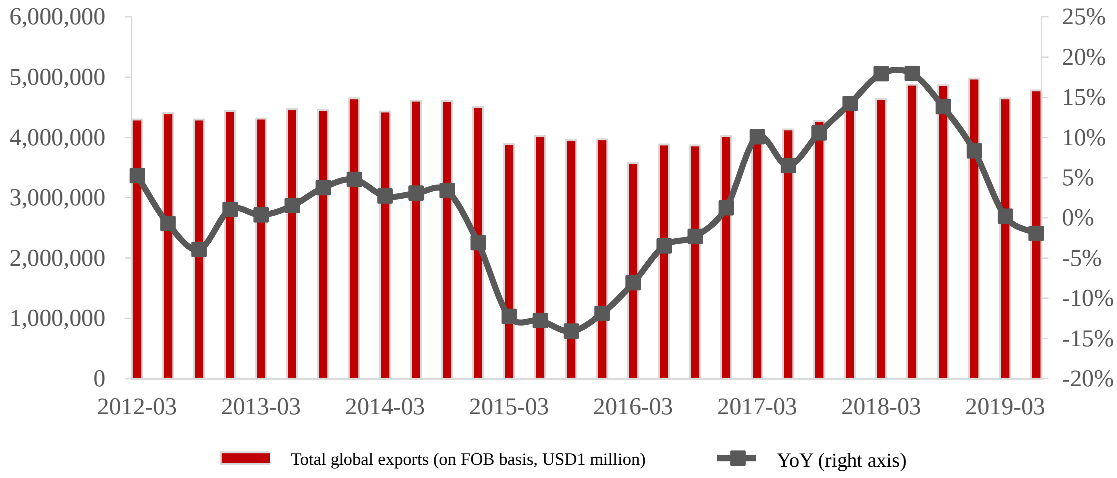
Topic 1: RCEP helps the world to break out of trade woes

The Regional Comprehensive Economic Partnership (RCEP) is a framework agreement on regional free trade involving the ten ASEAN countries, China, Japan, South Korea, Australia, New Zealand and India. Based on the bilateral FTA established by "10+6" countries, the RCEP aims to integrate the five FTAs which have already been established by ASEAN and the other six countries (Australia and New Zealand belong to the same area), establish a regional framework free trade agreement, reduce tariffs and other trade barriers, and promote economic cooperation as well as flow of goods and capital within the region.

1. Changes in global trade lead to the new trend of regional cooperation

On the one hand, trade frictions between China and the US continue to simmer, dragging down the global trade growth into the negative territory. In 2019 Q2, total global trade fell by 1.95% (on FOB basis). The WTO's Goods Trade Barometer, published in November 2019, was 96.6 for Q4, up 0.9 from the previous quarter but still at a nine-year low. Meanwhile, the WTO slashed its forecast for global trade growth of 2019 from 2.6% to 1.2%, while the ECB, the Reserve Bank of Australia and other institutions were all bearish on global trade.

Figure 3: Global Trade Growth Has Continued to Slow Down Since 2018 Q2



Sources: World Bank, BOCHK

On the other hand, RCEP countries' trade with China has been growing, and ASEAN has become China's second-largest trading partner. A cooling trade relationship between China and the US poses a significant challenge to China's foreign trade, while bilateral trade between China and RCEP countries such as ASEAN has been on the rise. In September 2019, the total bilateral trade between the ten ASEAN countries and China surpassed Sino-US trade, making ASEAN China's second-largest trading partner. In 2018, bilateral trade between RCEP countries and China accounted for 32.29% of China's total imports and exports. ASEAN takes up the biggest share, accounting for 39% of RCEP countries, closely followed by Japan and South Korea at 22% and 21% respectively.

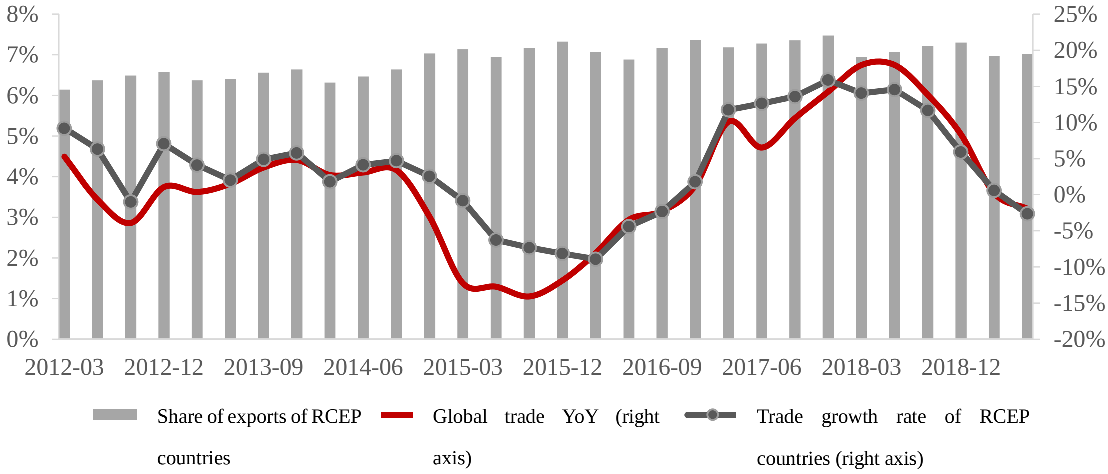
2. Breakthroughs have been made in RCEP negotiations

RCEP was first proposed by Malaysia at the 18th ASEAN Economic Ministers' Meeting in 2011 and was unanimously adopted by the ten ASEAN countries at the 19th ASEAN Summit in the same year. The negotiations, which were started in 2013, covered 18 areas, including tariffs on industrial products, trade in services and intellectual property rights. Since the negotiations required finalizing the detailed rules for several bilateral trade relations, and there were wide differences in the interests of some countries, the deadline for concluding substantive negotiations on RCEP has been extended repeatedly. On November 4, 2019, the third RCEP Leaders' Meeting was held in Bangkok, and a joint statement was released, announcing that the 15 member states had concluded all text negotiations and virtually all market access negotiations, and decided to hold final consultations on some remaining issues by the end of 2019. The next step would be legal text review. After a lengthy period of seven years, the RCEP has finally ushered in the dawn of victory, with India as the only exception, which exited RCEP temporarily because "important issues remain unresolved" as it announced at the end of the meeting.

3. The establishment of RCEP has a far-reaching impact on the global economic and trade situations

RCEP countries contribute a large share of global trade. Further strengthening of regional conglomeration will be conducive to driving regional trade and shoring up global economic recovery. According to statistics of 2018, RCEP countries accounted for one half of the world's population and nearly one third of the world's GDP, thus playing an essential role in the global economy. The proportion of the export volume of RCEP countries in the total global trade reaches 6%-7% and has displayed a trend of YoY increase. Under the negative impact of Sino-US trade frictions and the global economic slowdown, trade growth in RCEP countries has been on the decline in recent years. Enhanced trade freedom and regional conglomeration among RCEP countries will help build comparative advantages in regional trade and drive global trade growth and economic recovery.

Figure 4: Trade Growth in RCEP Countries



Sources: CEIC, BOCHK

RCEP has established a model for building economic and trade partnership in the complex geopolitical and historical context. For a long time, restricted by historical burdens, complex geopolitical relations and external forces, it's difficult for the Asia-Pacific region to realize the de-facto "regional integration" due to the complicated economic and trade ties. By integrating and straightening out the existing agreements, RCEP can help to resolve the chaotic situations of the East Asian trade system, promote regional integration, and upgrade the bilateral FTA to regional FTA, to resist the interference of external forces and some negative effects of economic globalization.

4. We remain prudently optimistic about the cooperation prospects of RCEP

Due to its vast volume and relatively low threshold compared with the FTA, RCEP mainly integrates existing agreements, and its development space and potential are enormous. Currently, there is still much room for tariff reduction in the agreements among countries. RCEP has more advantages over the North American Free Trade Area concerning population and economic volume and is very likely to develop into an FTA. However, at present, since bilateral FTA dominates RCEP, there is still a certain gap between RCEP and the regional FTA of North America with unified rules and close cooperation. In the process of development, RCEP should attach importance to the synergy of regional development and fully take the unique needs of regions with a relatively backward economy and weak industrial foundations into account. Meanwhile, special attention should be paid to systematic financial system risks, to prevent the impact on the financial system and the real economy due to hastened establishment of the FTA.

Topic 2: Global cooperation in innovation and investment boosts economic recovery

1. Global trends and outlook of the new economy

The new economy has extensive coverage and connotation, including not only emerging sectors and business formats such as the "Internet +", the Internet of Things (IoT), cloud computing, virtual reality and e-commerce in the tertiary industry, but also intelligent manufacturing, mass-customized production, 5G, space technology, advanced materials, biological pharmaceutical and human enhancement, and synthetic technology, etc. Besides, it also covers some emerging business models, such as the sharing economy and mobile payment. Different from the traditional "labor-intensive, asset-heavy and creative-light" industries, the new economy industries are asset-light while laying more emphasis on intellectual property right. Presently, the global new economy has ushered in a period of rare development opportunities.

On the one hand, the sluggish global economic recovery highlights the value of the new economy. Since the outbreak of the global financial crisis in 2008, the global economic recovery has been weak, the total factor productivity growth has slowed down, while trade protectionism and "delocalization" have been on the rise. The root cause is attributed to the fact that the traditional economic model cannot effectively stimulate the global economic recovery, and the homogenous production in various countries results in inadequate effective demand. Therefore, accelerating the development of the new economy, actively fostering new products and new business formats, stimulating demand growth, and promoting international trade and investment serve as important approaches to get the global economy out of the mire of low growth at the earliest possible time.

On the other hand, the scientific and technological innovation and development, as well as the broad application of the digital economy, can promote the rapid growth of the new economy. The digital economy is the typical manifestation of new economy. The digital revolution that began in the 1990s enabled enterprises to communicate with suppliers and customers around the world, and information and communication technologies have significantly reduced the cost of communication, thus facilitating the offshoring and globalization of production. It was also during this period that developing countries became suppliers and processing plants in global trade, stimulating a surge in the volume of global trade. Currently, advanced technologies represented by digitalization are reshaping global value chains. Emerging technologies such as digital platforms, blockchain and IoT are expected to further reduce transaction and logistics costs and promote global trade and economic development.

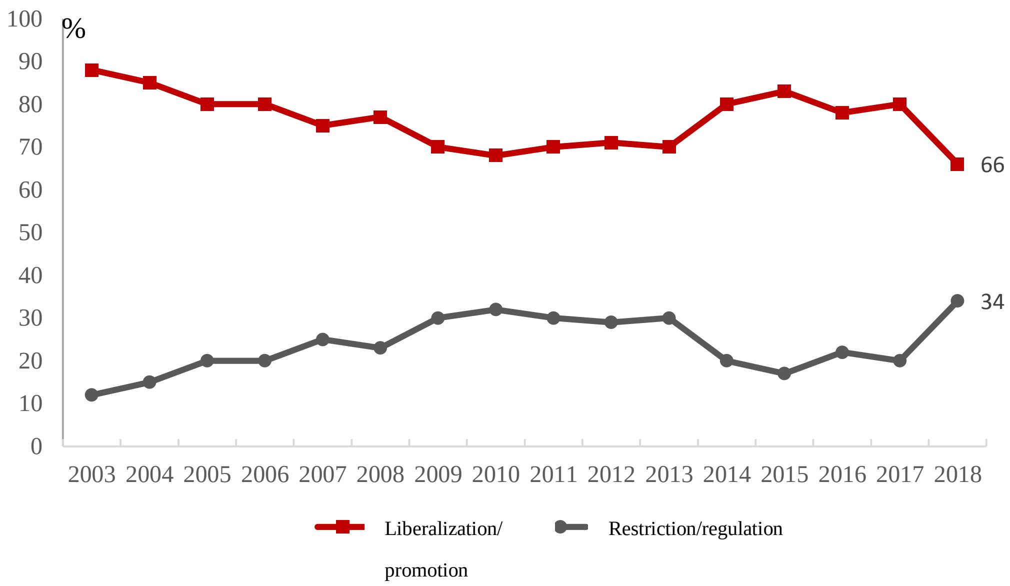
2. The world is short of investment in innovation

The new economy is mainly driven by scientific and technological innovation, and the global direct investment led by large multinational corporations plays a vital role in stimulating innovation and promoting the development of the new economy. According to the statistics of the UNCTAD, more than one third of the world's enterprise-funded R&D activities come from the world's top 100 multinationals. However, from 2016 to 2018, global direct investment shrank for three consecutive years and remains low until today, casting a shadow over the development of the new economy across the world.

Global direct investment is low. According to the Global Investment Trends Monitor Report released by the UNCTAD, FDI reached USD640 billion in 2019 H1, up 24% year on year, but fell around 23% from the 2018 H2, showing a trend of contracting from the previous period. With falling returns on investment, a shift to lighter assets and tighter investment environment, as well as global economic slowdown and trade frictions, the outlook for global direct investment growth remains unoptimistic for this year and the next.

Investment restrictions have been tightened, restricting the flow of capital into the new economy. According to UNCTAD statistics, some 55 economies launched at least 112 measures affecting foreign investment in 2018. Specifically, 34% of investment policies introduced new restrictions or regulations, the highest proportion since 2003. These restrictions mainly reflect the concerns of these countries on the foreign ownership of their critical infrastructure, core technologies and other sensitive commercial assets, and many of these restricted investment areas are directly linked to the development of new economic sectors.

Figure 5: Changes in Investment Policies of Countries: 2003-2018



Source: UNCTAD, BOC Research Institute

Cooperation in the global innovation value chain has been hampered. The international direct investment serves as an important force driving the global development of the new economy and the expansion of industrial chains, while the shrinking global direct investment would lead to stagnant cooperation along the global value chains. One key indicator is that the share of foreign value-added in global trade fell to 28% in 2018, down three percentage points from its peak in 2008. For the coming few years, it's expected that the growth of the global value chains will remain stagnant, which will become a constraint on global growth of the new economy and cooperation on innovation.

3. International investment cooperation drives innovation development

It is of great significance to promote international investment cooperation. Given the weak global growth, governments are constrained by deficits and debt problems, leaving little room for further fiscal stimulus. Meanwhile, according to empirical evidence in the past, monetary policy has been ineffective in stimulating growth. The revival of global economic growth in the future depends largely on the development of science and technology and the rise of new economic industries. Therefore, following the basic principle that optimal allocation of resources on a broader range is more conducive to economic growth and innovation, it is of great significance to share resources to the largest extent, in order to enhance scientific and technological innovation and commercialization capacity by means of international investment cooperation.

Countries are in urgent need of foreign investments. There has always been an urgent need in developing countries, particularly the least developed, to attract foreign investment and promote exports to support industrialization, economic diversification and structural transformation. For developed countries, many of the new policies to promote industrial development also rely heavily on attracting foreign investment. However, the security reviews of investment on the grounds of national security and the investment barriers can largely explain why the willingness to invest cannot be turned into effective investment.

Given the above, strengthening international investment cooperation can effectively promote the development of the new economy across the world. Firstly, inappropriate investment barriers shall be removed, and the negative impact of investment security review barriers shall be reduced. Countries should adhere to multilateralism, safeguard the rules-based multilateral trading system, promote the establishment and improvement of rules for the multilateral system of international investment, and explore the formulation of rules for promoting the cross-border flow of important factors of production such as technology. Secondly, efforts shall be made to promote the signing of bilateral and multilateral investment agreements. Given rising anti-globalization and upcoming changes in global economic and trade rules, it’s suggested to speed up the negotiation and conclusion of bilateral investment agreements such as the China-EU investment agreement, so as to drive multilateralism with bilateral progress and create new impetus to economic globalization. Thirdly, international investment cooperation in various forms shall be promoted. Efforts shall be made to set up a third-party market cooperation mechanism and cooperation fund to promote the implementation of major projects in such fields as 5G, infrastructure, energy, environmental protection, climate change and aerospace. Investment cooperation with countries along the Belt and Road shall be intensified, and support shall be provided to new economy enterprises in doing business along the Belt and Road.

Disclaimer

BOC Research Institute

1 Fuxingmen Nei Street, Beijing, 100818 China

Post Code: 100818

Telephone: +86-10-66592780

Fax: +86-10-66594040