Article

Recent developments

2019 outlook

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A year ago, this editorial focused on the political challenges for the year that is about to come to an end. It focused on Trump, Brexit and the Italian elections. We also expressed a wish: that this year's editorial, on the outlook for 2019, would not have to focus once again on populist movements. Unfortunately, we have to do so again: the trade war between the US and China, Brexit and Italian politics remain the three major elements of uncertainty and risk.

The tensions between the US and China have ended up affecting the global economy in recent months. The imposition of tariffs on Chinese imports by the US, and China's response by also raising tariffs on US imports, has been akin to throwing sand into the gears of the global supply chains. Furthermore, we cannot rule out the possibility of the tensions escalating further, despite the truce agreed at the G20 meetings in Buenos Aires. The US feels ready for a (trade) war, with an economy supported by a significant fiscal stimulus that is driving domestic demand, and this strengthens the credibility of its president's threats (which are quite unpredictable, on the other hand). In any case, we expect that an agreement will end up being reached, because there seems to be scope for it and because it is in the interest of all the parties not to prolong the uncertainty. Otherwise, Trump could end up feeling the pressure of the American stock market.

With regards to Brexit, we face a challenging obstacle course ahead. This month, Parliament in Westminster will decide whether to approve or reject the agreement reached between Theresa May and the EU. A rejection would greatly increase the risk of an abrupt and disorderly departure for the United Kingdom on 29 March, which would have serious repercussions for economic activity in the country and would shake the British pound. If an agreed departure is achieved, there will still be the negotiation on the future framework of relations between the United Kingdom and the EU to deal with. Nevertheless, the transitional period currently envisaged, which is due to last until the end of 2020 and could be extended to the end of 2022, seems to provide enough margin to properly negotiate an agreement that will be extremely complex. We are more concerned about the short-term risk than the uncertainty surrounding the negotiation on the future framework of relations.

Finally, there is Italy, a factor with the capacity to destabilise the euro area. If the confrontation between the Italian Government and the European Commission escalates, Italy's risk premium could soar, causing Italy to lose access to the markets. This would be a highly tense situation. The ECB would intervene to limit the contagion to other countries, but it would hardly be in a position to support Italy unless the Government requested a bailout. Faced with this predicament, a likely scenario would be an election in Italy and the formation of a new Government to regain the confidence of the markets. That said, we would still be looking at a few months of enormous uncertainty, which would once again call the integrity of the euro area into question.

To a large extent, how these three major challenges develop will determine the course of 2019. Our central scenario assumes that the worst-case scenario will not materialise in any of these challenges, although we also do not expect to see a speedy resolution to any of the uncertainties. Depending on their outcome, 2019 could turn out to be worse than expected, or then again, perhaps better. Happy 2019!

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