Cause for concern?
The top 10 risks to the global economy 2019

A report by The Economist Intelligence Unit
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Introduction

The outlook for the global economy is worsening. Given concerns over slowing growth in key economies, including China and the EU, and the wider impact of a trade war between the US and China, The Economist Intelligence Unit expects global growth to decelerate from 2.9% in 2018 to 2.8% in 2019 and 2.6% in 2020. However, even when taking into account this downbeat assessment, there remain a number of risks emanating from three key areas that could drive growth even lower than we currently forecast in 2019-20.

First, geopolitical uncertainty is on the rise and will remain a source of significant risk, potentially impacting trade, financial markets and the oil sector. The impact of the increase in populist and nationalist leaders in recent years has yet to become fully apparent; however, it has already contributed to growing protectionist sentiment that could escalate and widen the current US-China trade war, with a damaging effect on the global economy. On top of slowing global growth and rising geopolitical uncertainty, there are also significant vulnerabilities in large economies—including sizeable debt burdens in China, the US and Italy, among others—and also in emerging markets, which are, in some cases, highly exposed to global trade and capital flows. If badly managed, these frailties have the potential to significantly accentuate any downturn as the global economy cools.

Lastly, a longer-term shift in global power dynamics, particularly regarding the rise of China in competition with the US, ensures that security risks continue to threaten global economic stability. Moreover, while there remain long-standing territorial disputes and conventional military threats, the security landscape continues to develop, as technological innovation adds new dimensions and more complex requirements. With various sources of risk in play, policymakers and businesses attempting to operate in such an uncertain environment will need to devote greater resources to contingency plans, which in itself is likely to constitute a drag on global growth.

In the latest edition of this report, we offer a snapshot of our risk-quantification abilities by identifying and assessing the top ten risks to the global political and economic order. Each of the risks is outlined and rated in terms of its likelihood and its potential impact on the global economy. We also provide operational risk analysis on a country-by-country basis for 180 countries through our Risk Briefing, and detailed credit risk assessments on 131 countries via our Country Risk Service. Together, these products enable our clients to anticipate and plan for the main threats to their organisations, supply chains and sovereign creditors. We offer robust risk modelling, scenario analysis and daily events scanning for the threats and opportunities that abound in today’s global economy.
CAUSE FOR CONCERN?
THE TOP 10 RISKS TO THE GLOBAL ECONOMY 2019

Top 10 global risks in order of intensity

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Global risk scenarios

- Political
- Military
- Financial

A full-blown global trade war
Corporate debt-driven US recession
Major cyber-attack cripples online activity
Broad-based emerging market crisis
Supply shortages spark oil-price spike
A disorderly no-deal Brexit
An Italian banking crisis
War on the Korean peninsula
China economic crisis
Outbreak of major hostilities in South China Sea
A US-China trade conflict morphs into a full-blown global trade war

Moderate risk; Very high impact;

Risk intensity = 15

China and the US have started negotiations to resolve the current trade dispute, and the US government has decided to suspend further increases in tariffs on US$200bn-worth of Chinese goods. We believe that this is a temporary truce: a full-blown trade war between the US and China remains part of our baseline forecast, owing mainly to the fact that US demands for China to address contentious issues on technology transfer and intellectual property theft remain unlikely to be met. However, beyond bilateral protectionism, there remains a risk that trade conflicts will escalate on additional fronts in the coming years, to the extent that global trade could actually decline, with major knock-on effects for inflation, business sentiment, consumer sentiment and, ultimately, global economic growth. Currently, the most immediate risk emanates from threats by the US president, Donald Trump, to impose additional tariffs on imports of EU cars, which would result in a broader trade conflict as the EU attempts to defend its interests. However, there are further related risks. Given

Trade risks have grown consistently
(global average; 0-100)

Sources: The Economist Intelligence Unit; Risk Briefings.
rising negative sentiment over national security concerns from countries such as Germany, the UK, Canada and Australia towards Chinese network providers such as Huawei, there is a risk that a number of additional countries could be dragged into a technology trade war, with international companies’ supply chains disrupted by split global network coverage. As global growth slows, this scenario could also be triggered if a number of countries were to decide to impose broad-based import tariffs and subsidise local industries in order to combat international protectionism. In either of these cases, we would expect global trade to shrink, inflation to rise, consumers’ purchasing power to fall, investment to stagnate and global economic growth to slow.
US corporate debt burden turns downturn into a recession

**Moderate risk; High impact;**

**Risk intensity = 12**

Falling consumer sentiment and manufacturing activity indicators highlight the worsening outlook for the US economy as it faces the effects of a trade war with China, the impact of a lengthy government shutdown in December-January and an eventual turn in the business cycle. Nonetheless, the economy’s fundamentals remain fairly robust, with economic growth at an estimated 2.9% in 2018, and inflation slowing to 1.9% year on year in December, despite gradually rising wage growth. In addition, the Federal Reserve (the central bank) moved to a more cautious approach to monetary policy in early 2019. Therefore, although we expect economic growth to slow to 2.3% in 2019 and to just 1.5% in 2020, our central forecast is that the US will avoid a damaging recession in 2019-20. However, along with a number of external headwinds, such as the trade war and slowing growth in Europe, domestic financial sector vulnerabilities could make the downturn much deeper than we currently expect. Fuelled by a prolonged period of ultra-low interest rates, corporate debt as a percentage of GDP has surged to just under 47%, higher than the previous peak during the global financial crisis in 2008-09. In addition, the quality of this debt has fallen, with over half of US corporate debt rated BBB—the lowest investment grade—and about 60% of loans were issued without maintenance covenants in 2018. As a result, a downturn could lead to an increasing number of firms cutting investment and hiring, while also struggling to meet debt repayments, as their profits decline and as ratings agency downgrades lead investors to withdraw funding to corporates. In this scenario, a US recession would greatly exacerbate a global slowdown, with countries affected by declining US demand for goods and weakening investment.

**Quality Breakdown of US Investment Grade Corporate Bond Index**

(% with BBB ratings)

Sources: IMF, Bloomberg, Standard & Poors.
Contagion spreads to create a broad-based emerging-markets crisis

**Moderate risk; High impact;**

**Risk intensity = 12**

Many emerging markets suffered currency volatility in 2018, primarily as a result of US monetary tightening and the strengthening US dollar. In a few instances, such as Turkey and Argentina, a combination of factors, including external imbalances, political instability and poor policymaking, led to full-blown currency crises. More recently, however, the pressure on most emerging markets’ capital accounts has eased, as the US Federal Reserve has adopted a more cautious monetary policy stance. Nonetheless, market sentiment remains fragile, and pressure on emerging markets as a group could re-emerge if market risk appetite deteriorates further than we currently expect. One trigger for this could be if a number of major emerging markets were to fall into crisis, either through domestic issues and/or the impact of external pressures such as the US-China trade war. Indeed, several are already at risk, including Brazil, Mexico and South Africa. Alternatively, investors could flee emerging markets if the recent currency crises in Argentina and Turkey escalate into full-blown banking crises as the rising value of foreign-currency debt leads to defaults (although this appears unlikely). In this scenario, capital outflows from emerging markets could become more indiscriminate and severe, forcing countries with external imbalances to make painful adjustments, with the most vulnerable falling deep into crisis. Emerging-market GDP growth would fall sharply as a result, weighing on the global economy.

**Emerging-market exchange rates**

(US$/local currency; 100 in April 2018)

Sources: Haver; The Economist Intelligence Unit.
China suffers a disorderly and prolonged economic downturn

Low risk; Very high impact;

Risk intensity = 10

In China, a shift towards looser macroeconomic policy settings is under way as a result of the escalating trade conflict with the US. This will support domestic demand in the short term, but in the process previous goals of lowering unsold housing stock and corporate deleveraging are receiving less emphasis. There is a risk that, in the government’s efforts to support the economy, policy missteps will be made. The stock of domestic credit remained at over 230% of GDP at the end of the third quarter of 2018, a major vulnerability. Although it is likely that the authorities would make every effort to prevent a funding crunch in any bank, even a hint of banking sector distress could cause problems, given the boom in debt over recent years. Resolving these issues, particularly as the trade conflict with the US also weighs on economic activity, could prove challenging, forcing the economy into a sudden downturn. The bursting of credit bubbles elsewhere has usually been associated with a sharp deceleration in economic growth and, if this were accompanied by a house-price slump, the government might struggle to maintain control of the economy—especially if a slew of small and medium-sized Chinese banks, which are more reliant on wholesale funding, were to falter. If the Chinese government were unable to prevent a disorderly downward economic spiral, this would lead to much lower global commodity prices, particularly in metals. This, in turn, would have a detrimental effect on the Latin American, Middle Eastern and Sub-Saharan African economies that had benefited from the earlier Chinese-driven boom in commodity prices. In addition, given the growing dependence of Western manufacturers and retailers on demand in China and other emerging markets, a disorderly slump in Chinese growth would have a severe global impact—far more than would have been the case in earlier decades.

China’s debt burden remains a concern
(% of GDP; adjusted for breaks)
Supply shortages lead to a globally damaging oil-price spike

**Low risk; High impact;**

**Risk intensity = 8**

Market fears of oil-supply shortages have eased since the US granted six-month sanction waivers to eight of the key purchasers of Iranian oil in December. Along with higher output from Saudi Arabia and Russia, and global growth concerns, this has caused the price of dated Brent Blend to fall to close to US$60/barrel, compared with highs of over US$80/b in September. However, the risk of major supply disruptions remains. Should the US manage to crack down efficiently on Iran’s “ghost tankers” and also strike deals with other importers to switch their supplier bases away from Iran once the waivers have expired, Iran’s oil exports could drop well below the 1.2m barrels/day that we currently expect in 2019-20. To combat this, Saudi Arabia and Russia have the capacity to ramp up supply, and US shale production could also fill the gap. However, as spare production capacity is used up to cover Iranian cuts, it will become more difficult to cover a sudden and sizeable cut to supply elsewhere, particularly in volatile countries such as Libya and Venezuela. As a result, prices could soar to well above the US$80/b seen in 2018, with producers unable to increase output sufficiently to put a lid on price rises. Such a scenario would push up inflation and weigh on global growth.
Territorial or sovereignty disputes in the South or East China Sea lead to an outbreak of hostilities

Low risk; High impact;

Risk intensity = 8

The national congress of the Chinese Communist Party in October 2017 was a milestone in terms of China’s overt declaration of its pursuit of great-power status, setting the goals for China to become a “leading global power” and have a “first-class” military force by 2050. The president, Xi Jinping, is keen to develop China’s global influence, probably sensing opportunity during a period of US retrenchment. How China intends to deploy its expanding hard-power capabilities in support of its territorial and maritime claims is a source of growing concern for other countries in the region. In the South China Sea the sovereignty of a number of islands and reefs is in dispute. Several members of the Association of
South-East Asian Nations (ASEAN) have sought to strengthen their own maritime defence capabilities amid increasingly aggressive moves by China to place military hardware on the disputed territories. A partial abdication of US leadership of global affairs could embolden China to exert its claimed historical rights in the South China Sea. Distinct possibilities include an acceleration of China’s island reclamation measures and the declaration of a no-fly zone over the disputed region. There is also a risk that an emboldened Mr Xi will step up his government’s efforts to unify Taiwan with mainland China, with the president having previously noted that the cross-Strait issue was one that could not be passed “from generation to generation”. Were military clashes to occur over any of these issues, the global economic consequences would be significant, as regional supply networks and major sea lanes could be disrupted.
Cyber-attacks and data integrity concerns cripple large parts of the internet

Moderate risk; Low impact;

Risk intensity = 6

Public, corporate and government faith in the internet as a source for global good is under strain. Revelations of major data breaches across a range of social media, and the use of that data for propaganda, are likely to see social media companies facing tighter regulation in the coming years. Meanwhile, cyber-attacks continue apace. In March 2018 the US blamed Russia for a cyber-attack on its energy grid. At a similar time there was a sustained attack on German government networks. Although these attacks have been relatively contained so far, there is a risk that their frequency and severity will increase to the extent that corporate and government networks could be brought down or manipulated for an extended period. Cyber-warfare covers a broad swathe of varying actors, both state-sponsored and criminal networks, as well as differing techniques. Recent data breaches and cyber-attacks could well be part of wider efforts by state actors to develop the ability to cripple rival governments and economies, and include efforts to either damage physical infrastructure or gain access to sensitive information as a means to influence democratic processes. These breaches of security have shaken consumer faith in the security of the internet and threaten to put at risk billions of dollars of daily transactions. Were government activities to be severely constrained by an attack or physical infrastructure damaged, the impact on economic growth would be even more severe.
There is a major military confrontation on the Korean peninsula

Very low risk; Very high impact;

Risk intensity = 5

There was a pick-up in diplomatic activity on the Korean peninsula in 2018, peaking with a historic summit in June between Mr Trump and the North Korean leader, Kim Jong-un, in Singapore. Decades of carefully planned approaches between the US and North Korea have failed, but there is a glimmer of hope that a more improvised and personal approach by two unorthodox leaders could make progress, with a second meeting between the two scheduled for late February. However, we maintain the view that there are irreconcilable differences between the US and North Korea on both the pace and the breadth of denuclearisation. Although recent statements by the US Department of State have hinted at a slight easing of demands for complete, verifiable and irreversible denuclearisation by 2020—the end of Mr Trump’s term—US goals nevertheless remain significantly at odds with the North’s long-term commitment to its nuclear programme. Any realistic denuclearisation (which would be a step-by-step programme) would require 1020 years of sustained engagement. Such levels of bilateral trust are unlikely to be achieved under the current administration. Our core forecast is that the US will eventually be forced to revert to a containment strategy. However, should the diplomatic talks fall apart, the Trump administration could see this as justifying a more aggressive stance, including strategic strikes on the North. This option has been publicly favoured by some of Mr Trump’s close advisers, such as John Bolton, the national security adviser, who was at the summit on June 12th with Mike Pompeo, the secretary of state. Under such a scenario, North Korea would almost certainly retaliate with conventional weaponry and, potentially, short-range nuclear missiles, bringing devastation to South Korea and Japan, in particular, at enormous human cost and entailing the destruction of major global supply chains.
Political gridlock leads to a disorderly no-deal Brexit

Low risk; Low impact;

Risk intensity = 4

Although a withdrawal agreement between the EU and the UK was finalised at an EU summit on November 25th, it was initially rejected by UK members of parliament in a vote in mid-January, and only received parliamentary backing in a later vote on condition that the Irish border backstop be renegotiated. (The backstop stipulates that the UK would remain in a customs union with the EU indefinitely should a trade agreement preserving an open Irish border not be found.) However, the EU has so far rejected any reopening of withdrawal agreement negotiations. With so little room for manoeuvre before the March 29th deadline, we think that the UK prime minister, Theresa May, will be forced to delay Brexit by requesting an extension of the Article 50 window. The alternative would be to crash out of the EU without a withdrawal agreement and transition arrangements in place, which the government and parliament would wish to avoid. Were a no-deal Brexit to occur, we would expect this to trigger a sharp depreciation in the value of the pound and a much sharper economic slowdown in the UK than we currently forecast. In addition, the EU has indicated that under a no-deal scenario it would treat the UK as a “third country”, leading to tariffs, border checks and border controls, a stance that the UK would probably respond to in kind. Although some contingency plans have been made, the hit to UK and EU trade and investment under a disorderly no-deal scenario is likely to go beyond just the negative impact on EU economies and prove sizeable enough to dent global economic growth.

Government Brexit impact assessment
(projected % change in GDP over 15 years compared with current relationship with EU; central estimate)

Source: HM Government.
Political and financial instability lead to an Italian banking crisis

Low risk; Low impact;

Risk intensity = 4

After positive growth in the preceding 14 quarters, the Italian economy contracted in both of the final quarters of 2018, constrained by a mixture of domestic political and economic uncertainty, tightening liquidity conditions and the worsening global trade outlook. In the light of this, we expect real GDP growth to slow from 0.8% in 2018 to just 0.2% in 2019. There is, however, a risk of a much deeper recession should investor confidence lead to another spike in bond yields. Triggers for this could include an early general election being called, following the possible splintering of the fragile governing coalition, or another budget stand-off (we expect weak economic growth to result in a much larger budget deficit than the stipulated 2% limit agreed with European Commission). With government debt already at over 130% of GDP, and a significant amount still held by domestic banks, this could, in turn, lead to a banking crisis, given the already-weak state of the country’s banks. As Italy is Europe’s third-largest economy, such a scenario would weigh on the region’s overall GDP growth, risk contagion to other European banks holding Italian assets and lead to volatility in global financial markets.
In an age of increased unpredictability and event risk, firms and governments are more than ever seeking to insulate themselves from the consequences. Global businesses cannot avoid risk—and too much risk aversion can be bad for growth—but they can prepare for risk, just as they can for opportunity.

The Economist Intelligence Unit is perfectly placed to assist, and has a number of risk products and services available:

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Risk Briefing provides you with expert analysis to identify and mitigate operational risk in 180 markets, enabling you to make business decisions with confidence. Risk Briefing provides forecasts, alerts, background studies, and data covering a wide range of risk factors.

At the centre of the service sits a risk model that assesses a country’s overall business operating risk. It combines our renowned political and economic analysis with new material covering the business conditions on the ground. The resulting scores allow us to rank countries by operating risk.

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- Regular events-driven coverage affecting our assessment of operating risk
- One model across all countries enabling quick and easy comparison
Country Risk Service

Sovereign risk ratings and analysis for 131 countries
Country Risk Service provides detailed credit risk assessments in 131 developed and emerging markets, combining The EIU’s market-leading data capability and country expertise in a rigorous risk modelling framework.
Each report includes a one-page summary covering the five main rating categories (sovereign, currency, banking, politics and economic structure), analysis and explanation of these ratings, including any grade changes, positive and negative factors, and the ratings outlook over the next twelve months.
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- Consistent country by country comparisons
- Access to frequently published events-driven coverage

Country Risk Model

An interactive tool for analysing country and sovereign risk
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- A wide range of monthly and quarterly macroeconomic data
- Ratings and data which can be easily compared across countries over time
- Regular updates to ensure deteriorating trends are caught early