



But the changing market expectations for ECB and BoJ policy have the potential to induce another bout of market turbulence akin to the taper tantrum of mid-2013, though likely with more limited implications for the global economy and financial markets.

While our baseline scenario sees a global economy that continues to grow at a moderate pace over the next two years, there are substantial risks on either side. On the down side, global financial markets could respond much more negatively to Fed normalization than we expect, with adverse repercussions for household and business spending around the globe. The gap between the market's and the Fed's forecasts for interest rates suggests that this negative response could result from an upward adjustment in market expectations towards the Fed, even without more aggressive tightening than the Fed currently envisions. A signal that the Fed will begin to wind down its reinvestment of securities could add to this turbulence. This downside risk would be exacerbated if there were a surprising resurgence of inflation pressures in the US as the unemployment rate moves below full employment. Such a development would likely prompt the Fed to adopt a significantly more rapid pace of normalization. A more aggressive Fed would, in turn, be negative for risk assets with potentially strong depressing effects on aggregate demand. A sharper-than-expected slowdown in China next year would have obvious knock-on effects on commodities, global trade and emerging markets. But on the positive side, it is possible that the recent poor performance of productivity growth globally (especially in the US) has been an aberration, and that recent technological advances could spur a surprising recovery. Faster supply-side growth would allow normalization to proceed very slowly and support a stronger recovery on the demand side of the economy. In addition, the risks to our US outlook are skewed to the upside: the peak drag on business investment from the sharp drop in oil prices is likely behind us, and the drag from net exports from the dollar surge is likely to dissipate beyond mid-year.

In what follows, we begin by presenting our baseline forecast for the global economy and financial markets, with an emphasis on 2016, but also a peek into 2017. We then provide a more detailed description of the outlook for the globe's major economic blocks. Next, we summarize our asset class views for the year ahead. We conclude by fleshing out the upside and downside risks to our baseline outlook in more detail.