

GLOBAL OUTLOOK

ECONOMIC WATCH

July 2017



Positive global outlook, with projections revised across areas

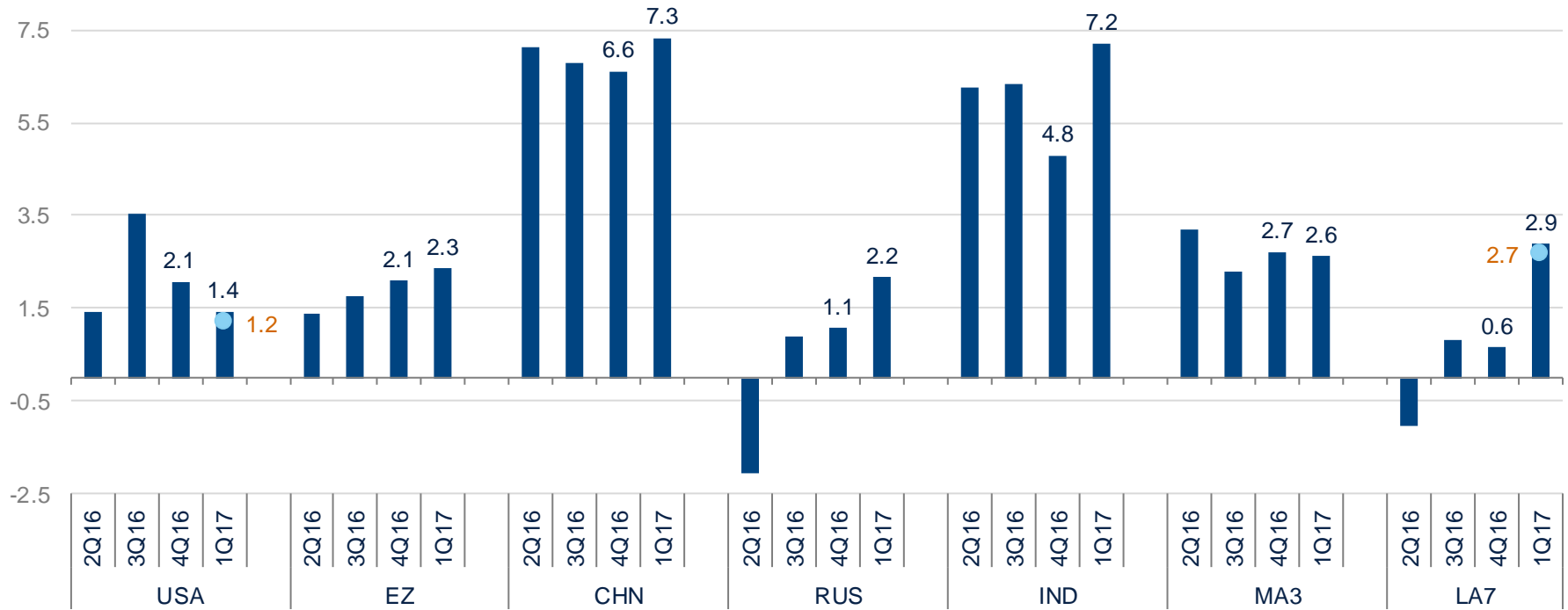
- ◆ The global outlook remains positive. Our BBVA-GAIN model estimates global GDP growth at 1% QoQ in 2Q17, slightly higher than in the previous quarter, with signs of stabilization.
- ◆ Stronger growth in China has supported the recovery of trade and investment. Across advanced economies there is some rebalancing from the US towards Europe.
- ◆ Confidence and global trade growth seem to stabilize at high levels, supporting the ongoing recovery of the industrial sector. The rebound in retail signals the resilience of consumption.
- ◆ Our new GDP forecasts for 2017-18 show some changes by areas. The Eurozone and China are revised upwards while US is revised downwards.
- ◆ Inflation remains subdued in a context of restrained wage pressures and weaker than expected oil prices.
- ◆ Major central banks in a process of very gradual normalization, while liquidity will be reduced.
- ◆ Risks remain tilted to the downside, easing in the US and Europe but unabated in China.

SHORT-TERM INDICATORS



Global GDP growth accelerated in 1Q17 driven by EMs (especially China) and Europe, despite the slowdown in the US

GDP: Selected Regions
(SAAR, %)



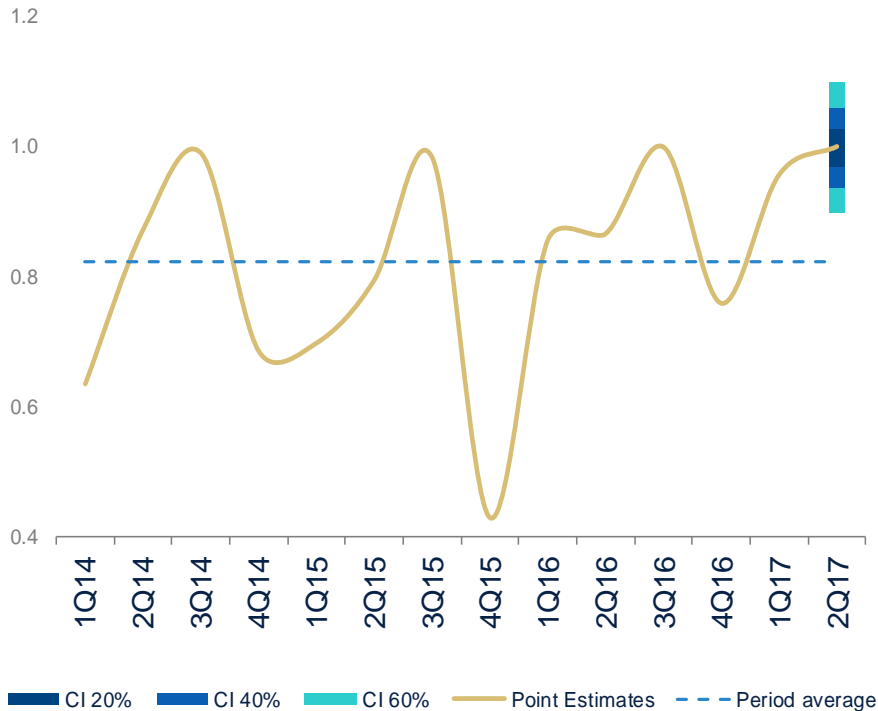
Source: BBVA Research and national sources

LA7: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela.
MA3: Indonesia, Japan, Korea

Global growth tends to stabilize in 2Q17, according to our BBVA-GAIN nowcast model (around 1.0% QoQ)

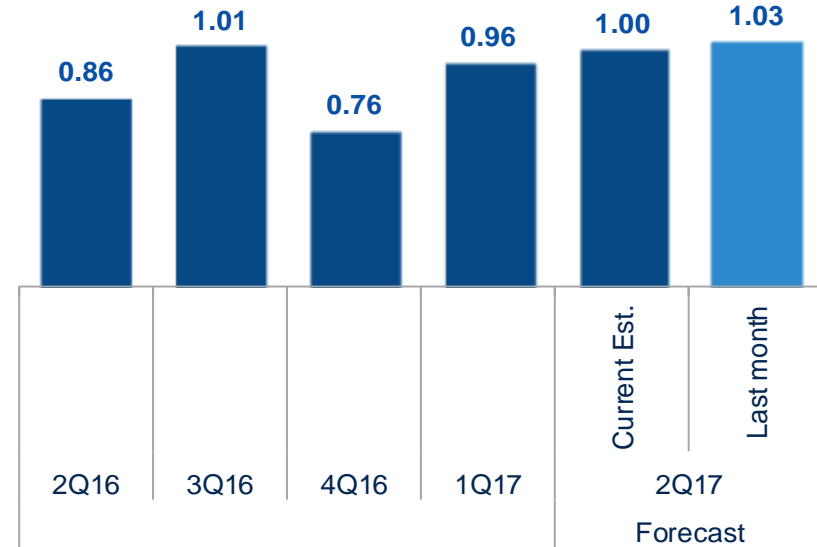
World GDP Growth

Forecast based on BBVA-GAIN (% , QoQ)



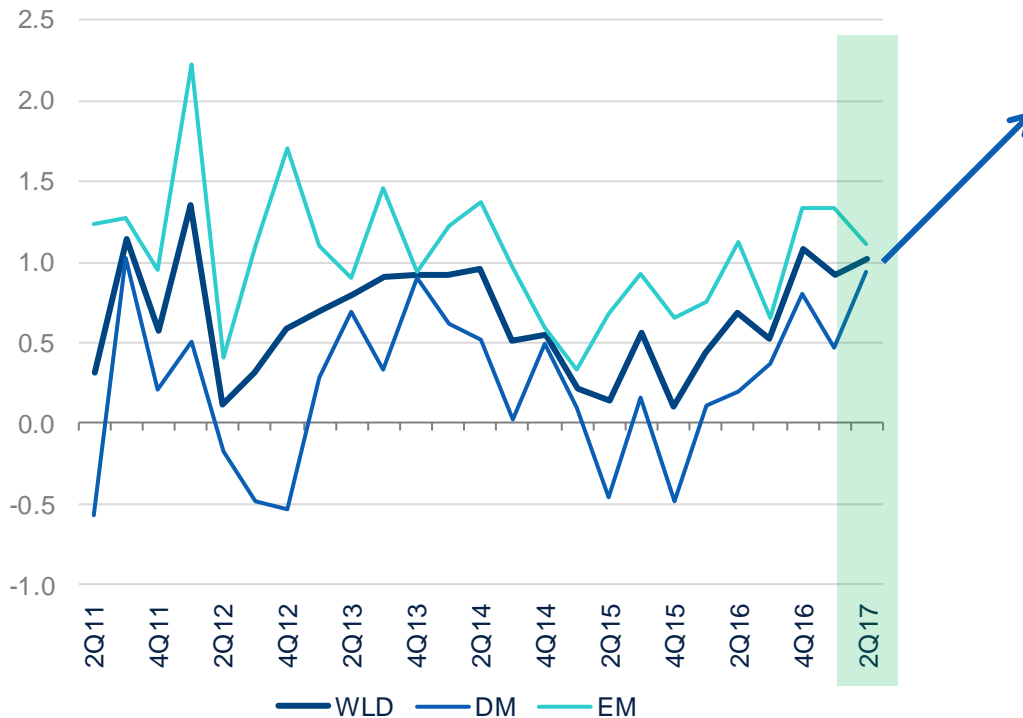
World GDP Growth: Change in forecast

QoQ, %

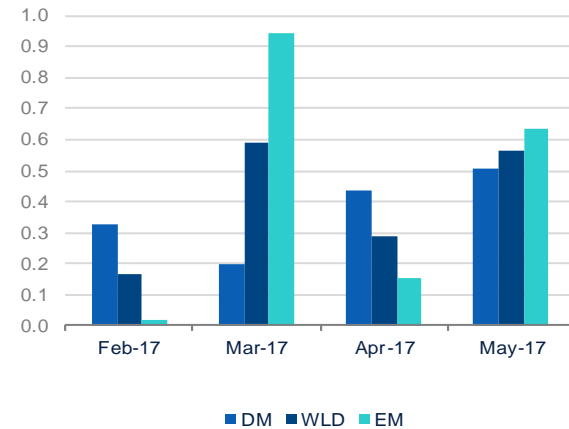


Industrial output picked up again in May...

World Industrial Production
(%, QoQ)



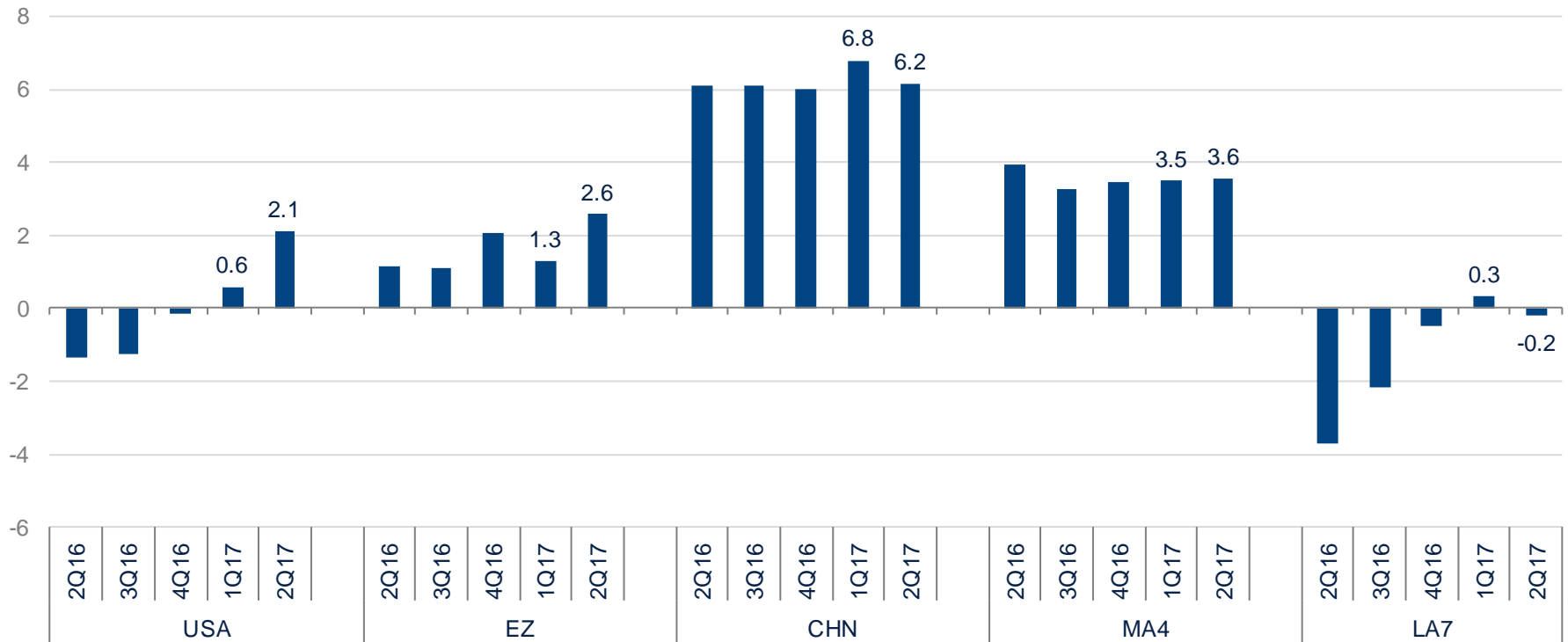
World Industrial Production
(MoM, %)



- ◆ Across DM, the upswing is gaining ground, mainly in EZ and US
- ◆ In EM's, the quarterly slowdown was concentrated in China while the rest of Asia exhibited a strong growth in 2Q17

... driven by Europe and US, with some a slowdown in Latam

Industrial Production: Selected Regions
(YoY, %)

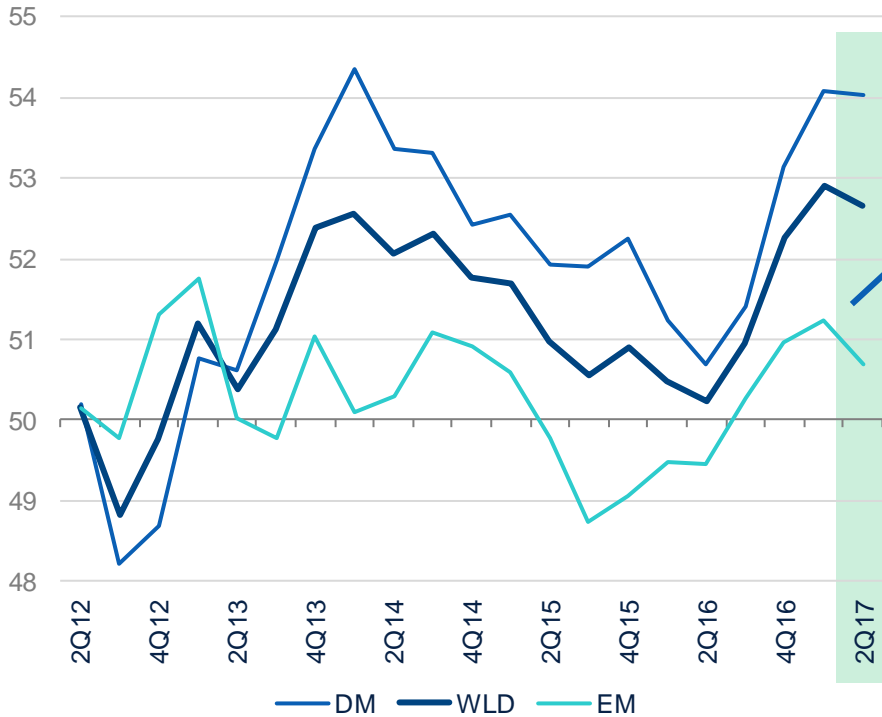


2Q17 calculated using data for April for USA and CHN.
Source: BBVA Research and national sources

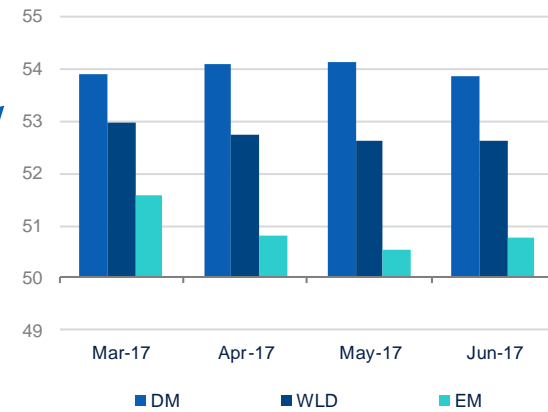
LA7: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela.
MA4: India, Indonesia, Japan, Korea

Global manufacturing PMIs remained solid and stable in June...

World Manufacturing PMI
(Level \pm 50)



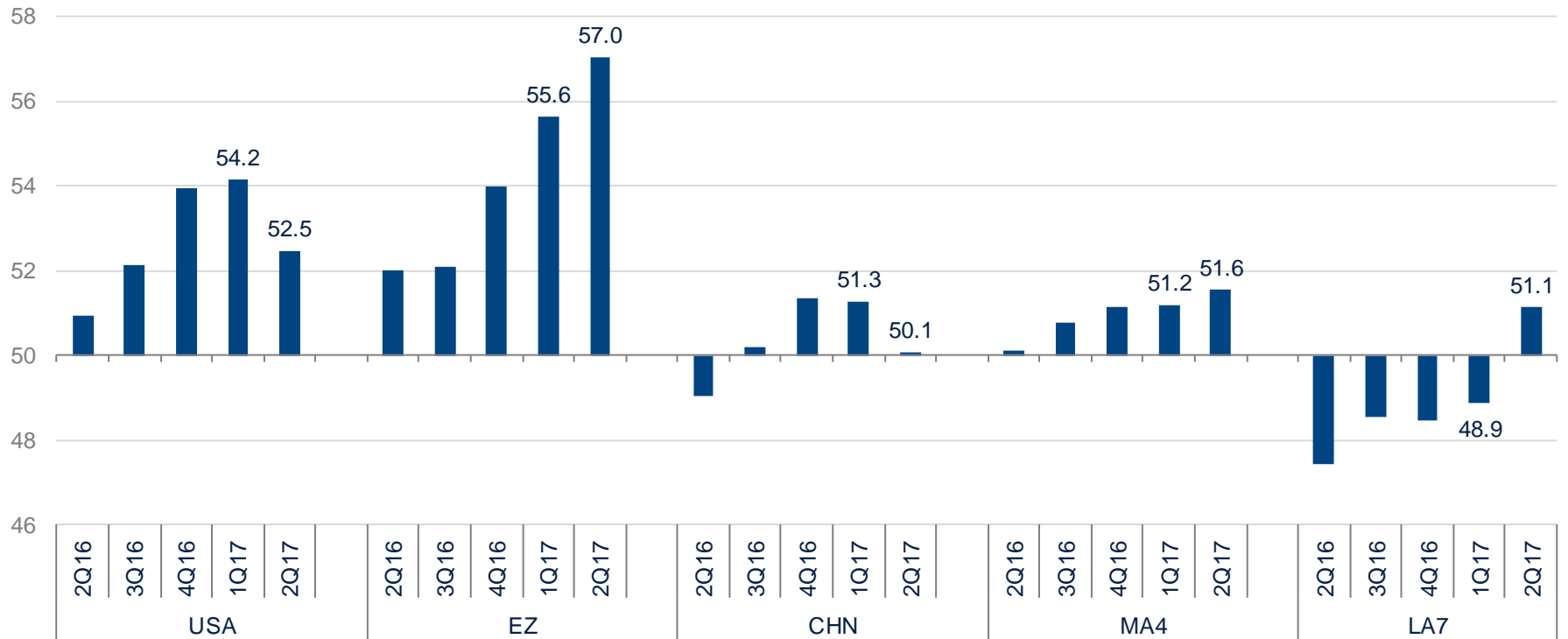
World Manufacturing PMI
(Level \pm 50)



- ◆ According to PMI's, **backlogs of work and employment rose again** despite slightly weaker increase in **new orders**
- ◆ In June, **cost pressures moderated** while **output prices accelerated** suggesting some improvement in manufacturing margins

... with clear gains in the Eurozone and Latam over the quarter

Manufacturing PMI: Selected Regions
(Level \pm 50)

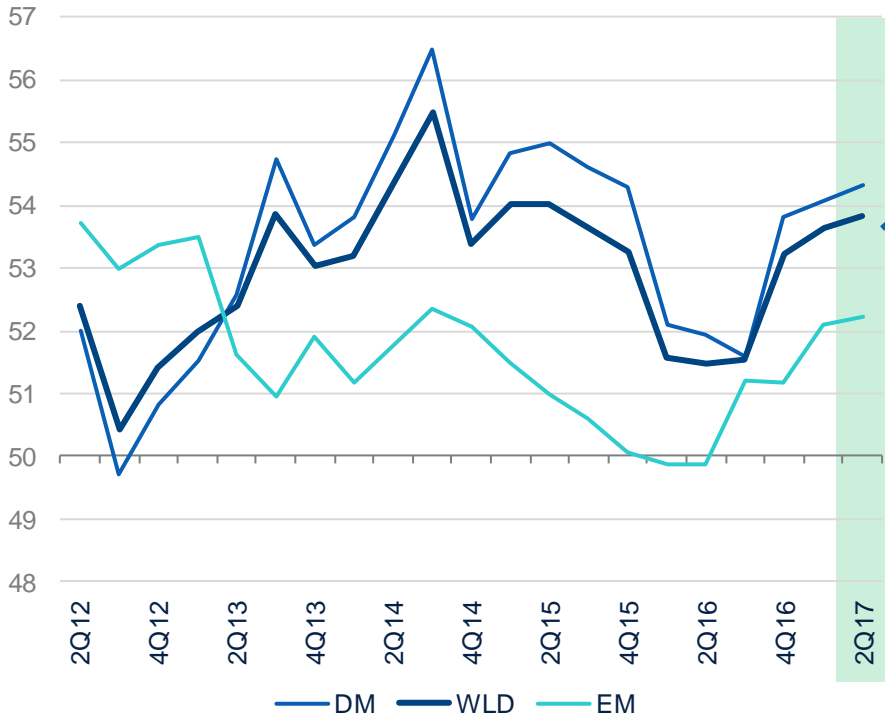


Source: BBVA Research and national sources

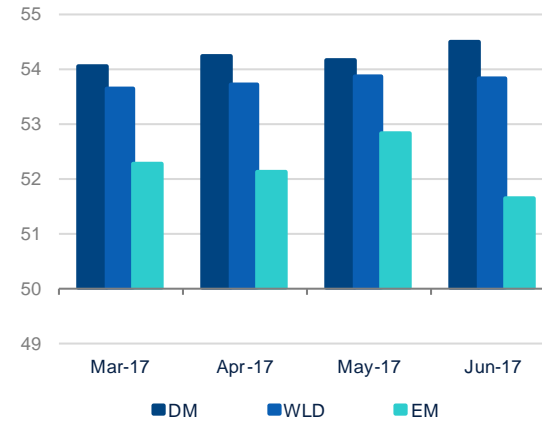
LA7: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela.
MA4: India, Indonesia, Japan, Korea

June services PMIs continue to show an expansion at a solid pace

World Services PMI
(Level \pm 50)



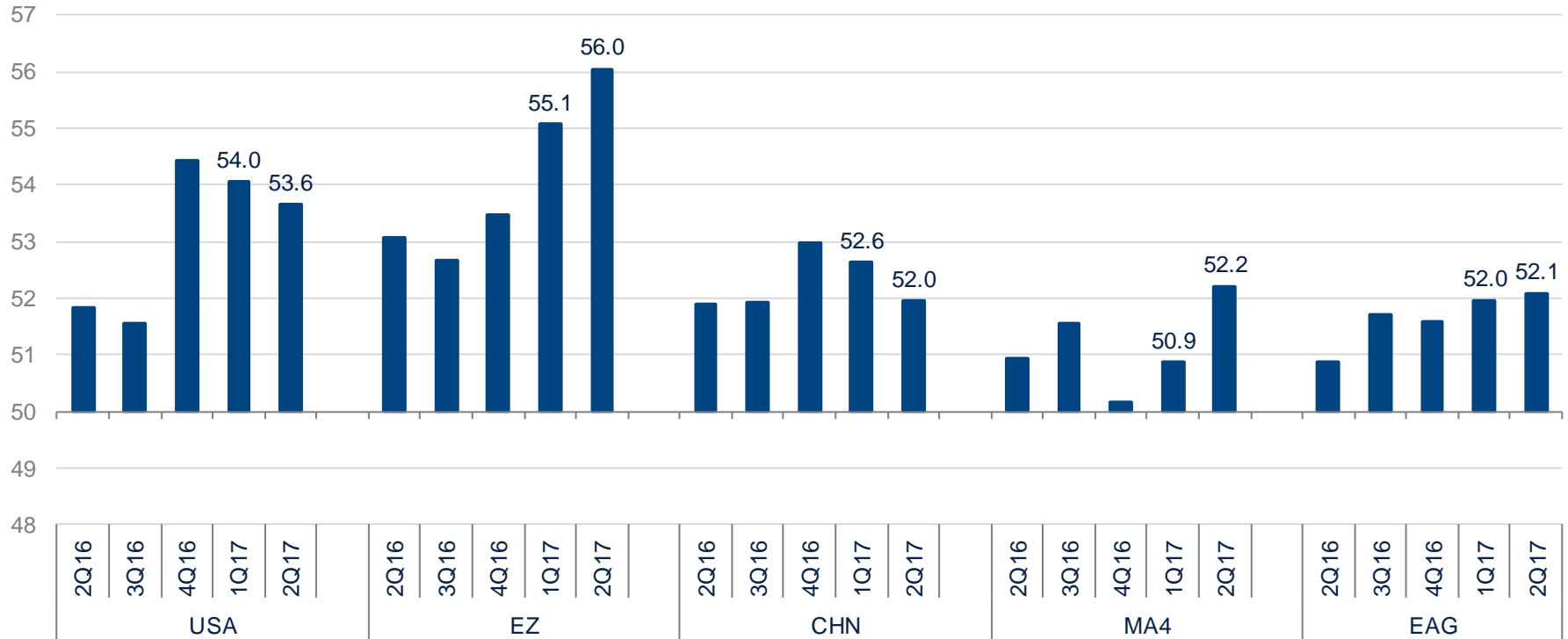
World Services PMI
(Level \pm 50)



- ◆ Higher inflows of **new work** led to a new increase in **backlogs of work** and further **job creation**
- ◆ Both **input costs** and **output charges** accelerated in June

Service sector activity improved strongly in Eurozone while in US and China softened

Services PMI: Selected Regions
(Level \pm 50)

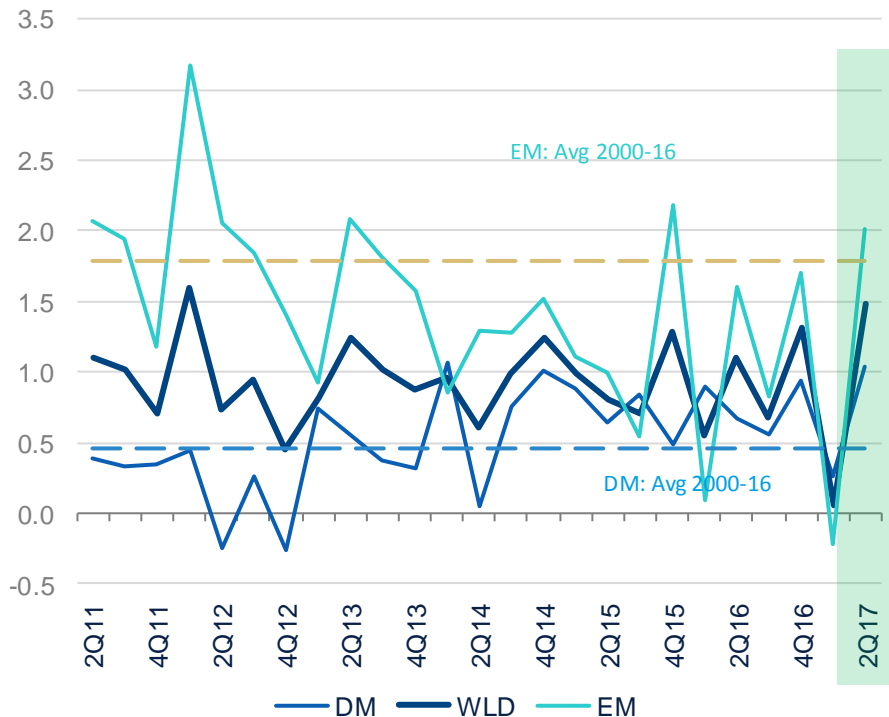


Source: BBVA Research and national sources

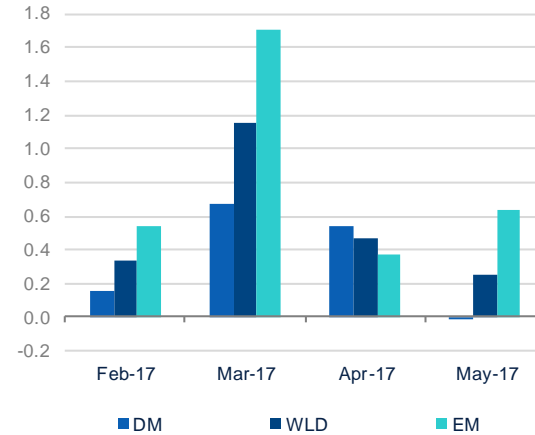
MA4: India, Indonesia, Japan, Korea
EAG (Eagles): Bangladesh, Brazil, China, Egypt, India, Indonesia, Iran, Malaysia, Mexico, Nigeria, Pakistan, Philippines, Russia, Turkey, Vietnam

Retail sales slowed in May but still point to a strong quarterly growth

World Retail Sales
(%, QoQ)



World Retail Sales
(MoM, %)

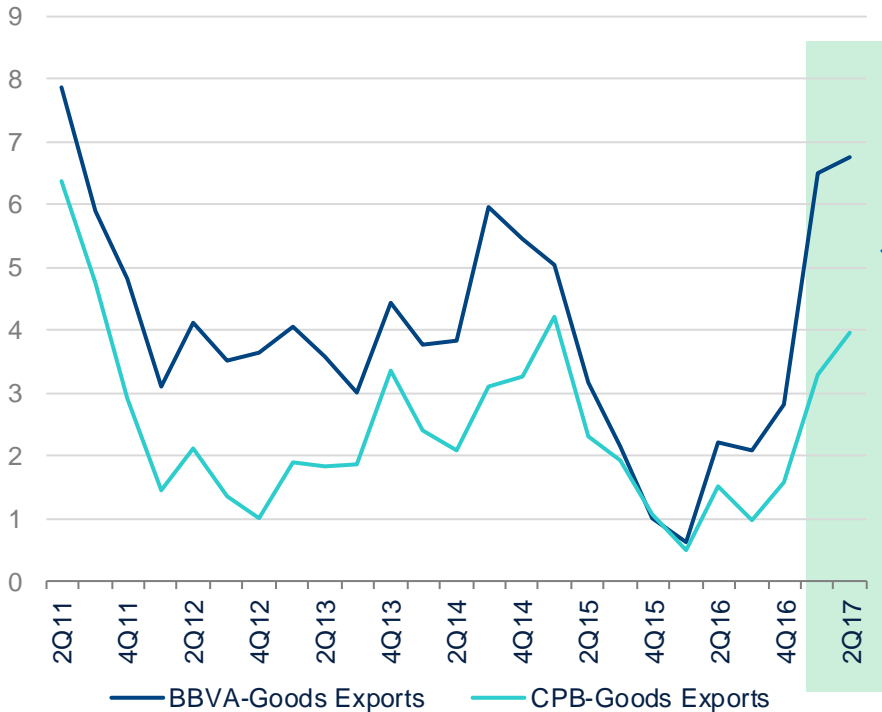


- ◆ In EM, higher quarterly rates were driven by China and to a lesser extent by emerging Asia
- ◆ Private consumption in DM's remains resilient and is likely to continue underpinning growth

Goods' exports seem to stabilize at high levels in 2Q17

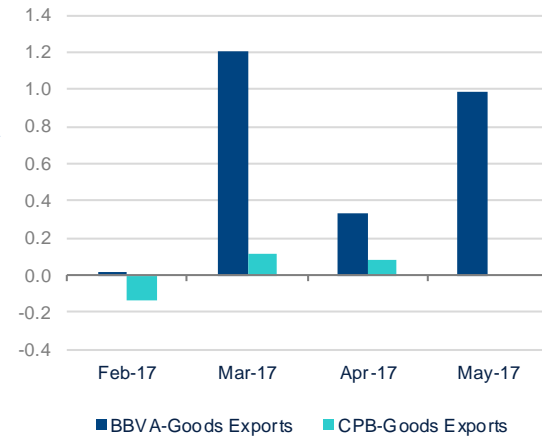
World Exports of Goods

(YoY %, constant prices, Index Jan-12=100)



World Exports of Goods

(MoM, %, constant prices)



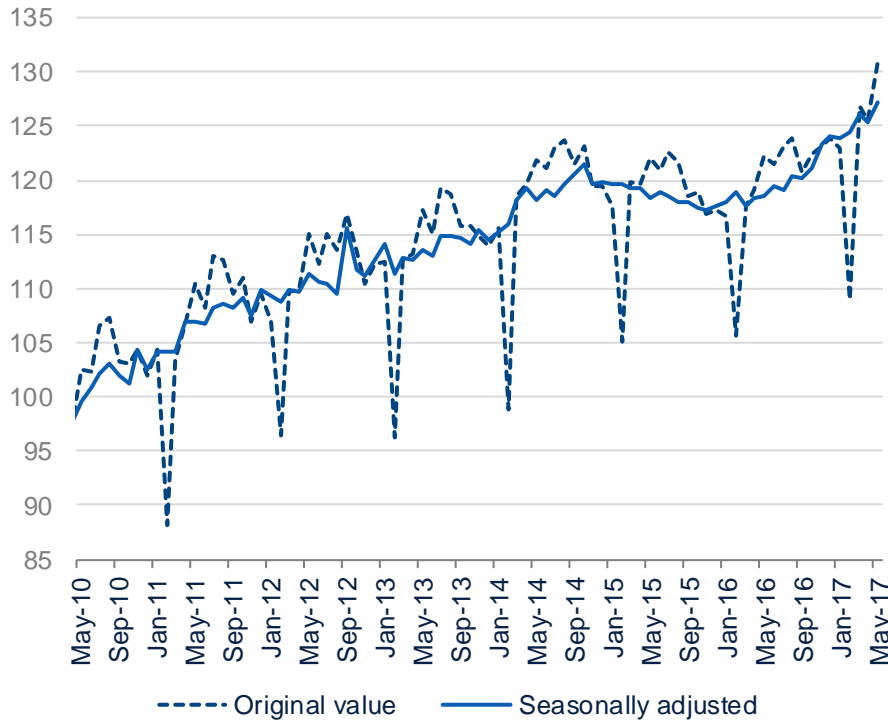
- ◆ May boost in exports was mainly supported by **developed economies**
- ◆ Mixed performance in **EM**. Poor figures in **Asia** contrast with a significant improvement in **Latam**

* Based on **BBVA-Trade Index**

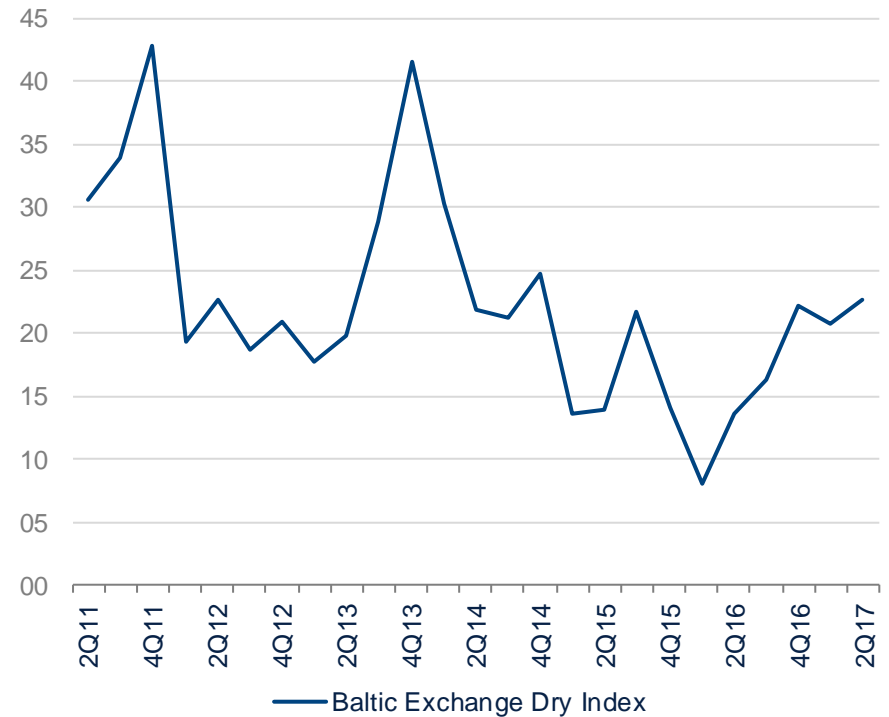
Source: BBVA Research and CPB

Freights index continue to point to positive signs in global trade

RWI/ISL Container Throughput Index
(Index, 2010=100)



Baltic Exchange Dry Index
(Index, Jan-05=100)

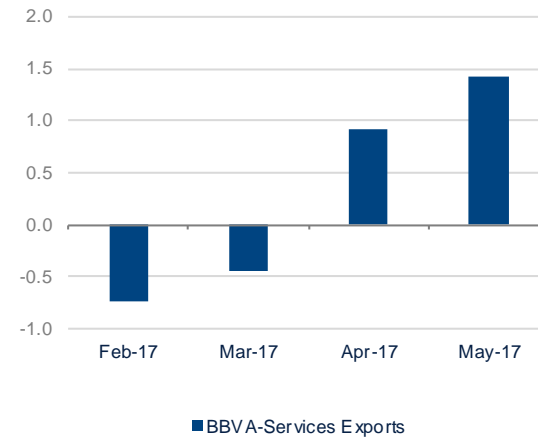


Exports of services seem to start recovering after softening since mid- 2016

World Exports of Services (Constant prices)
(YoY %, Index Jan-12=100)



World Exports of Services (Constant prices)
(MoM, %)



◆ Still limited data for May, mainly figures for **developed economies**, point to an ongoing improvement in 2Q17

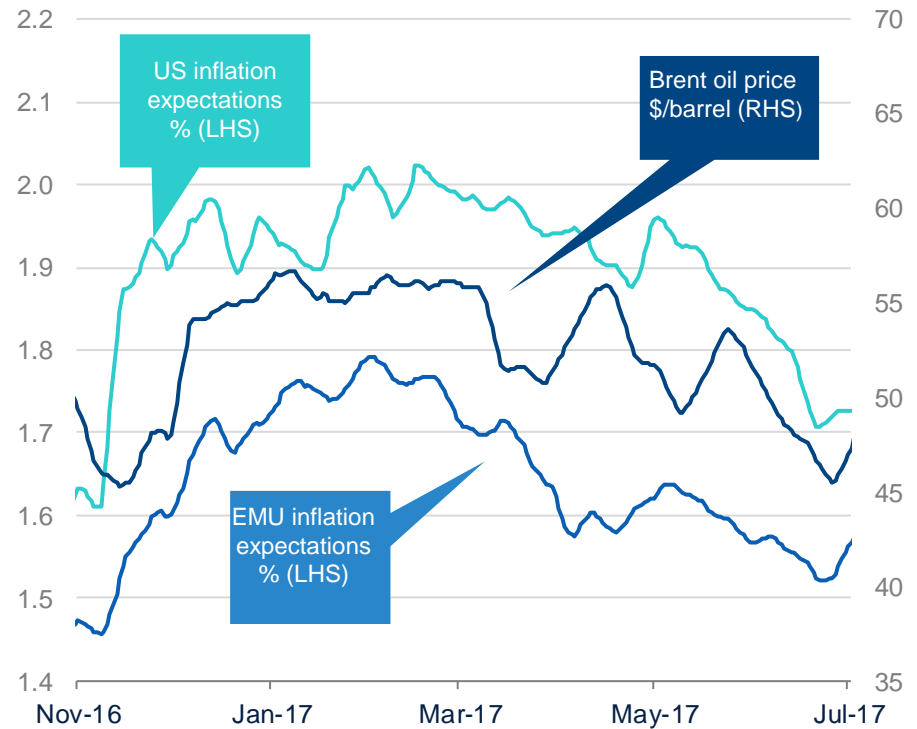
* Based on **BBVA-Trade Index**
Source: BBVA Research and CPB

Limited inflationary pressures...

- ◆ The moderation of commodity prices has reduced inflation expectations. Lower oil prices in 1H17 driven by supply factors
- ◆ Despite narrowing labor market slack wage inflation is still subdued
- ◆ In this context, core inflation remains low so far

Inflation expectations and Oil prices

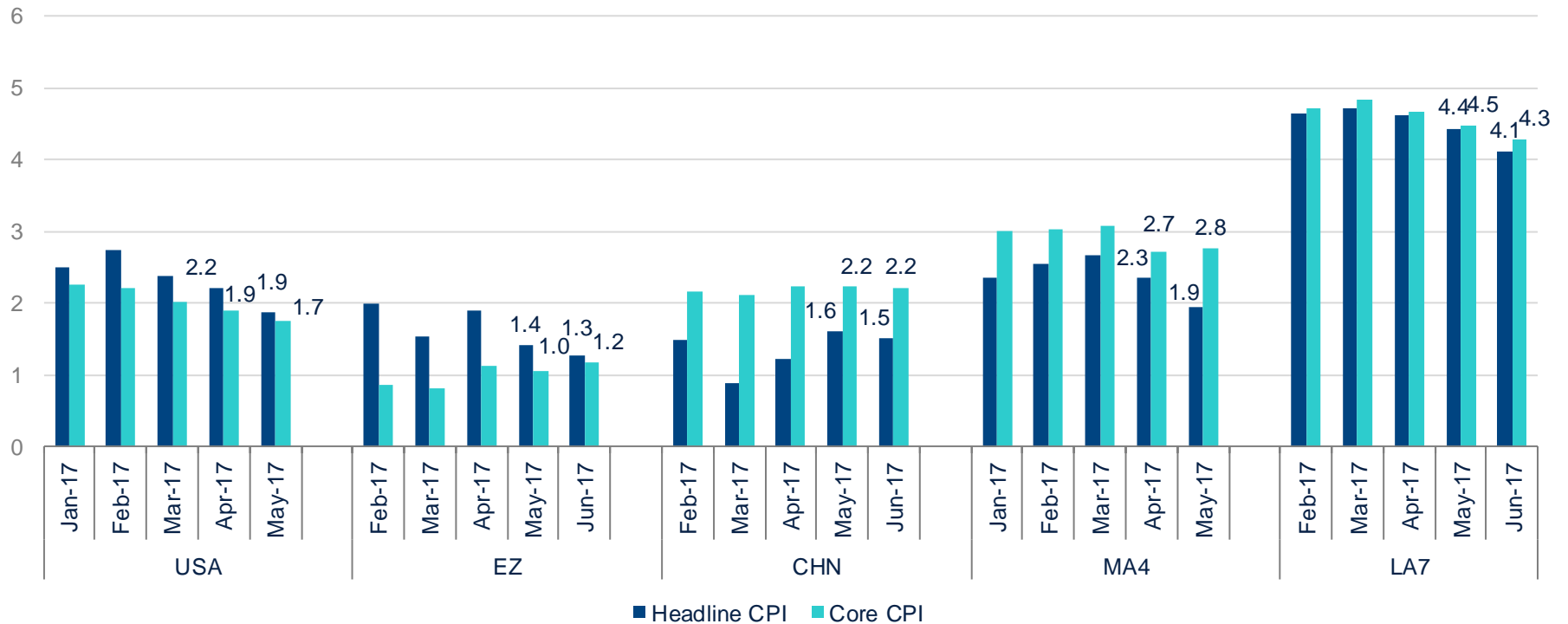
(%, \$/bbl)



... with recent easing across the board

Headline and Core Inflation: Selected Regions

(YoY, %)



NEW PROJECTIONS & GLOBAL RISKS



Global momentum remains positive

Ongoing global growth driven by China

Early signs of stabilization

Some rebalancing from the US towards Europe

Both in macro terms and in the political outlook

Still subdued inflation

Restrained wages and lower commodity prices

Central banks towards a gradual normalization

Withdrawing liquidity and rate hikes will be gradual, accommodating to the cycle

Still complacent financial markets


Low volatility and supportive central banks encourage risk taking

Risks

Risks are easing in Europe while building up in China

The rebalancing from the US towards Europe supports the euro

United States



A bit-worse-than-expected economic performance

Lower probability of a (large) fiscal stimulus

Economic policy uncertainty continues



Eurozone



Stronger-than-expected cyclical impulse

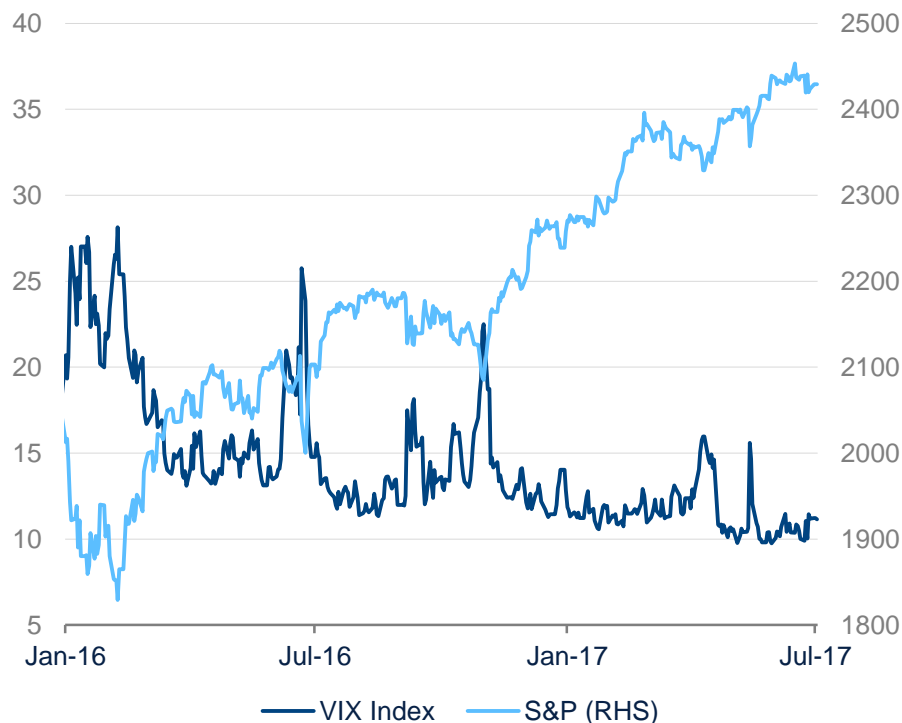
Lower political risks foster capital inflows

Likely progress expected on the European project after German elections

Still complacent financial markets

Volatility Index (VIX) vs S&P

(Index, 2010=100)



- ◆ The reversion of the US reflationary expectations has kept **long-run rates low**
- ◆ Very low **volatility and financial tensions** despite high uncertainty
- ◆ **Capital inflows** in Europe and emerging markets
- ◆ The **normalization of monetary policy** is not risk-free

Major central banks are normalizing monetary policy

Overall

- ◆ Central Banks' communication is **slightly more hawkish**, pointing more clearly towards normalization (except BoJ).
- ◆ Beyond inflation, CB's are sounding **increasingly worried about collateral effects of abundant liquidity** (asset price levels).

Fed

- ◆ The Fed expects to **raise interest rates** another 75 bp until the end of 2018 and begin to **reduce its balance** before the end of the year
- ◆ **Markets** discount a **much slower normalization** process

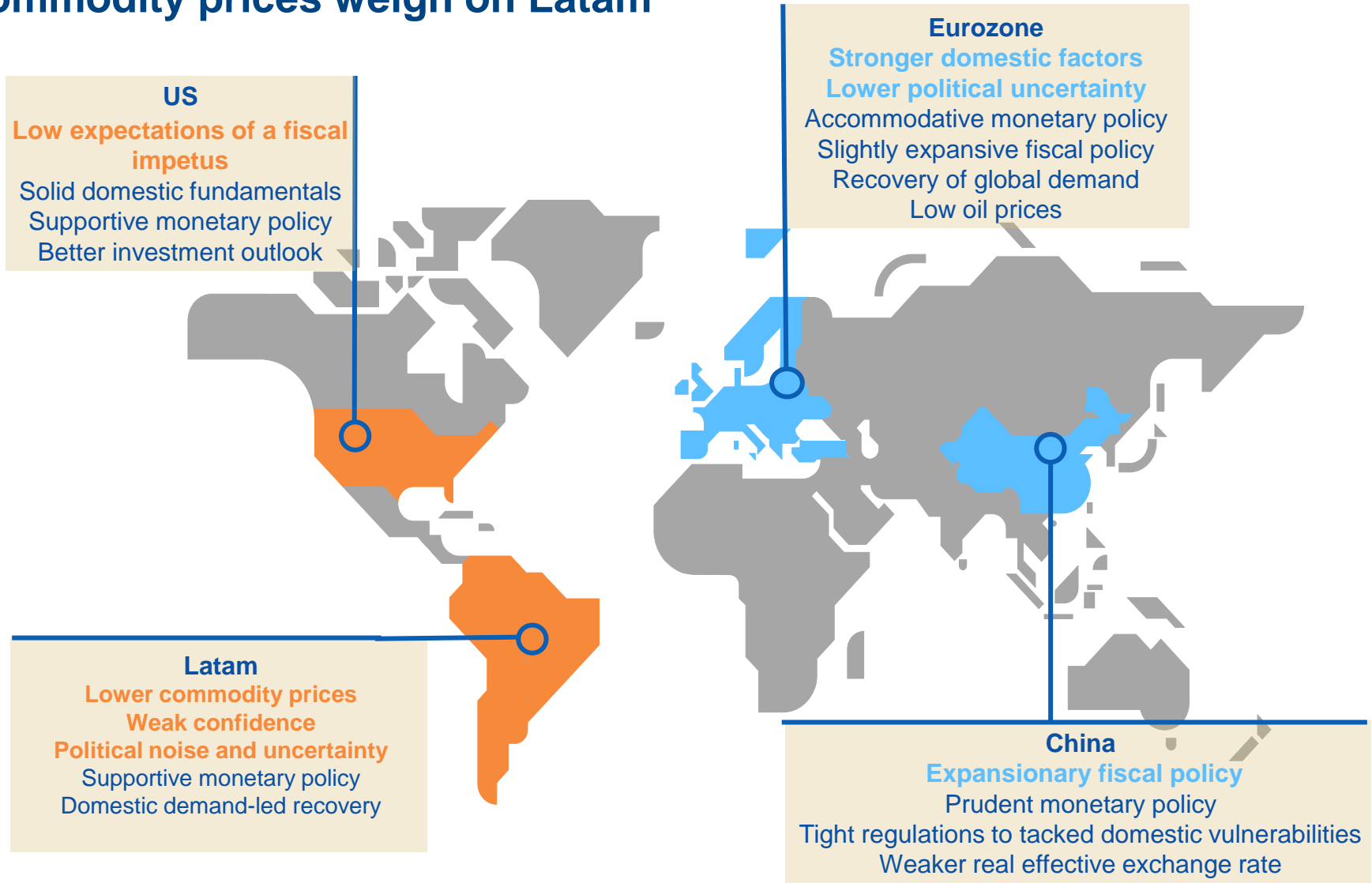
ECB

- ◆ It has taken the **first steps in the process of normalization**, changing its **communication**, but still cautiously (taking care of forward guidance)
- ◆ The discussion about the **reduction of bond purchases** will be announced **after the summer**; rate hikes will only take place towards the end of 2018

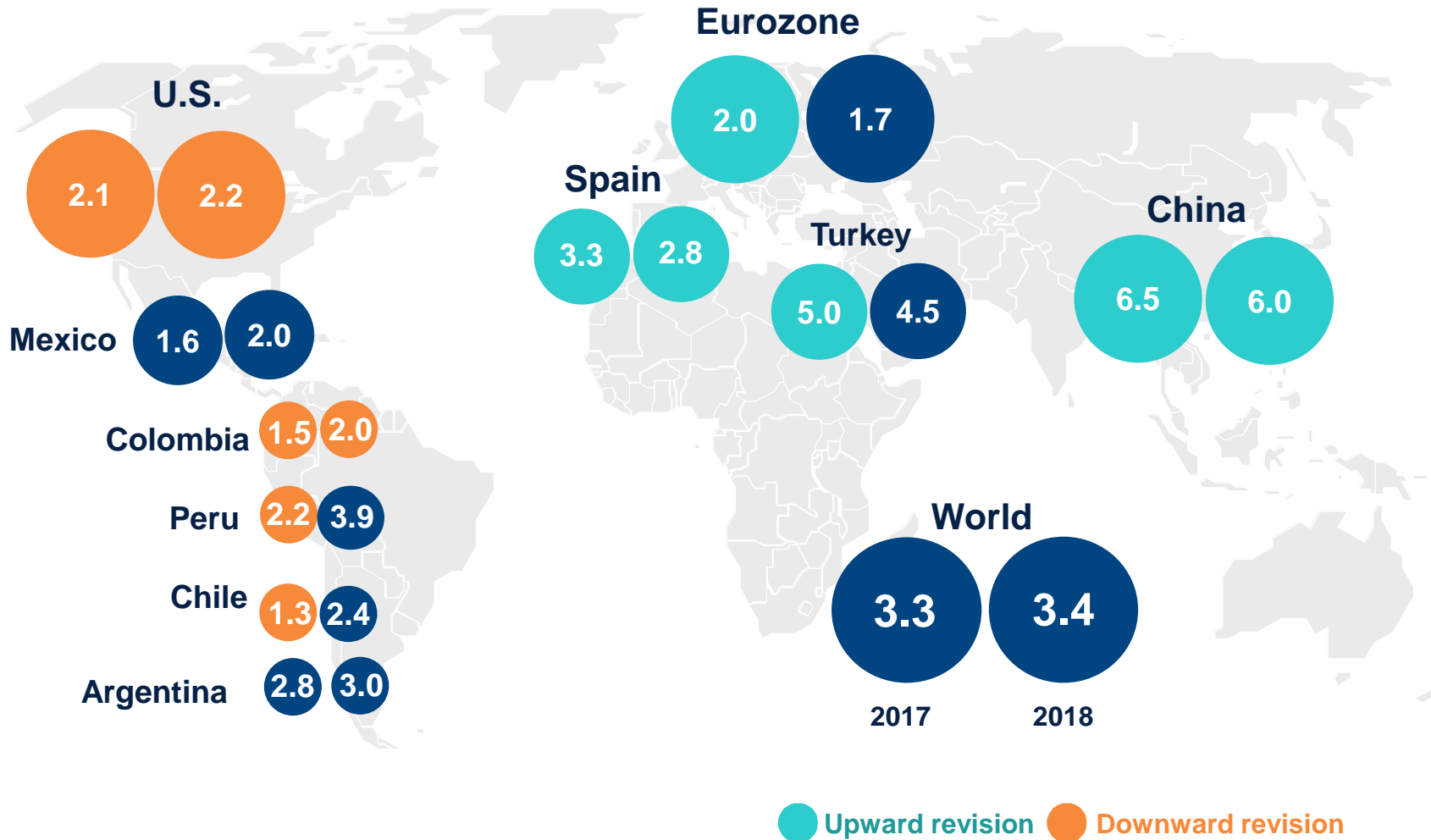
EM's

- ◆ Footprint CB's (except Mexico and Turkey) have **lowered rates a bit faster than expected** given poor data and moderating inflation.
- ◆ Looking forward, they have **room to continue decoupling from the Fed's decisions** as inflation comes down

Stronger global demand add to supportive policies, but low commodity prices weigh on Latam

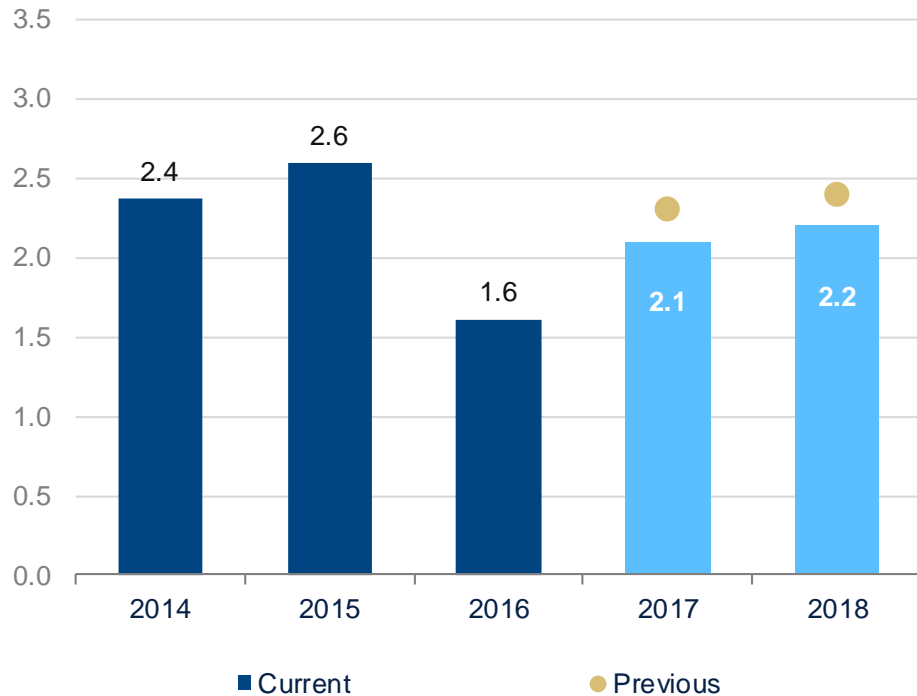


Upward GDP growth forecasts in Europe and China



US: Short expectations on fiscal stimulus

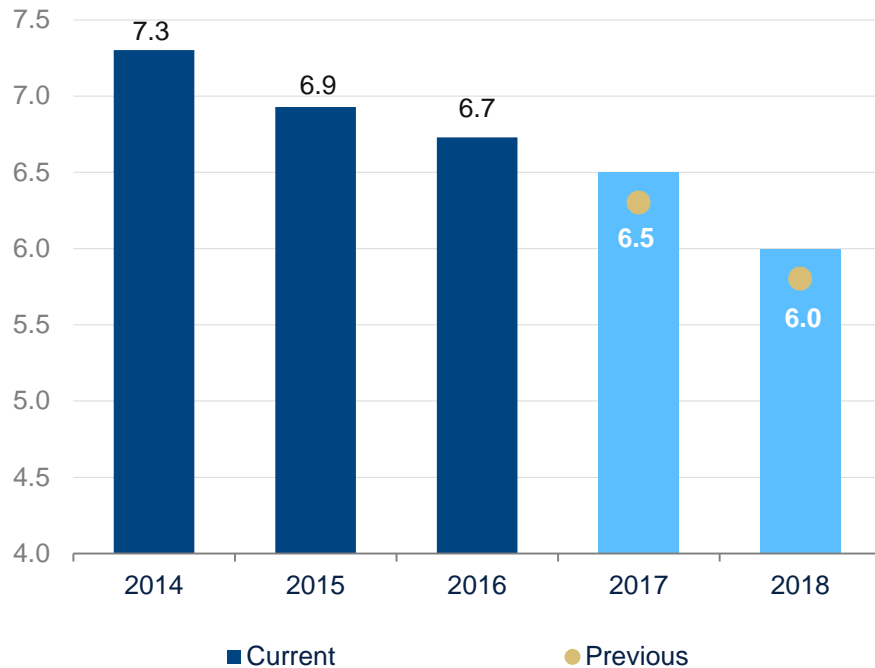
US: GDP growth
(YoY, %)



- ◆ **GDP growth revised down slightly:**
 - Policy measures not fast and strong enough
 - Ongoing rebalancing between consumption and investment
- ◆ **Fed: Solid labor markets and inflation convergence to 2% justify normalization**
 - One more rate increase in 2017 and two more in 2018
 - Balance sheet: roll-out in 4Q17 with gradual increase in caps
- ◆ **Risks:**
 - Global cycle, protectionism and geopolitical instability
 - Disinflation and asset price correction
 - Policy uncertainty; erosion of institutions and populism

CHINA: Stimulus have borne fruit in the short-run

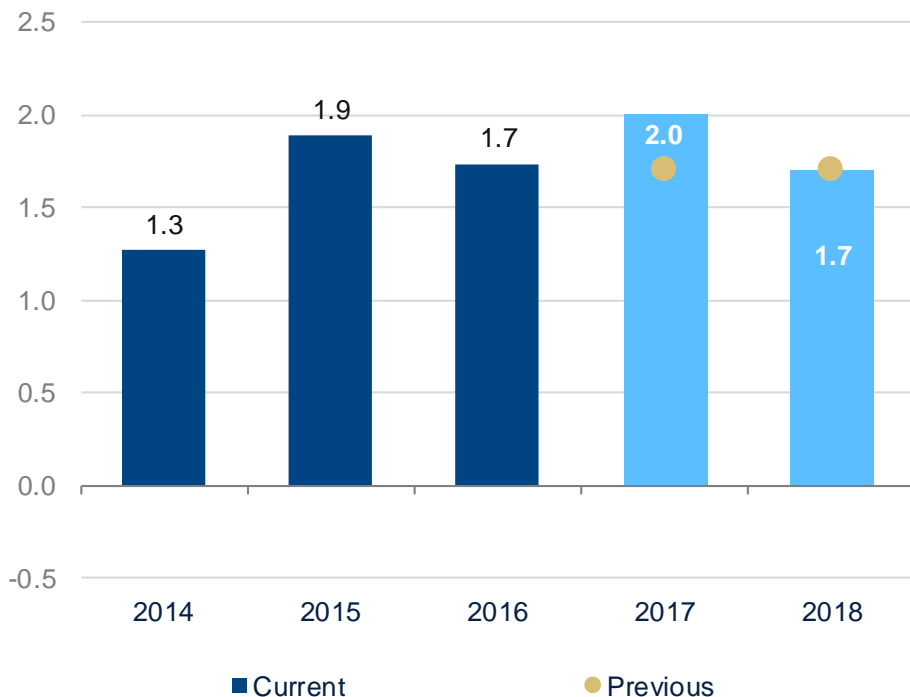
China: GDP growth
(YoY, %)



- ◆ GDP growth slowdown is set to continue but at a slower pace
 - Still debt-fuelled and investment-driven growth
 - Slightly upward revision to our projections to 6.5% in 2017 (from 6.3%) and to 6.0% in 2018 (from 5.8%).
- ◆ Prudent monetary policy with slight tightening bias in H1, while fiscal policy remains pro-growth.
- ◆ Risks:
 - Domestic financial vulnerabilities (debt and shadow banking)
 - Policy missteps could lead to a disorderly deleveraging process
 - The RMB depreciation and capital outflows

Eurozone: Clear improvement, but with limits

Eurozone: GDP growth
(YoY, %)



- ◆ Current data and statistical revisions lead to an **upward GDP growth revision in 2017**
 - Strong exports and investment, while consumption remains resilient
 - Tailwinds from high confidence, low oil prices and a depreciated euro
- ◆ Lower inflation due to oil but **core inflation is still expected to increase gradually**
- ◆ **The ECB's moving cautiously towards normalization**, exiting from QE in 2018 and hiking rates by end of that year
- ◆ **Risks:**
 - European political hurdles eased, but have not disappeared: Italy, Brexit, etc
 - Geopolitical issues stemming from the Middle East, Russia

Macroeconomic forecasts

Gross Domestic Product

YoY average, %

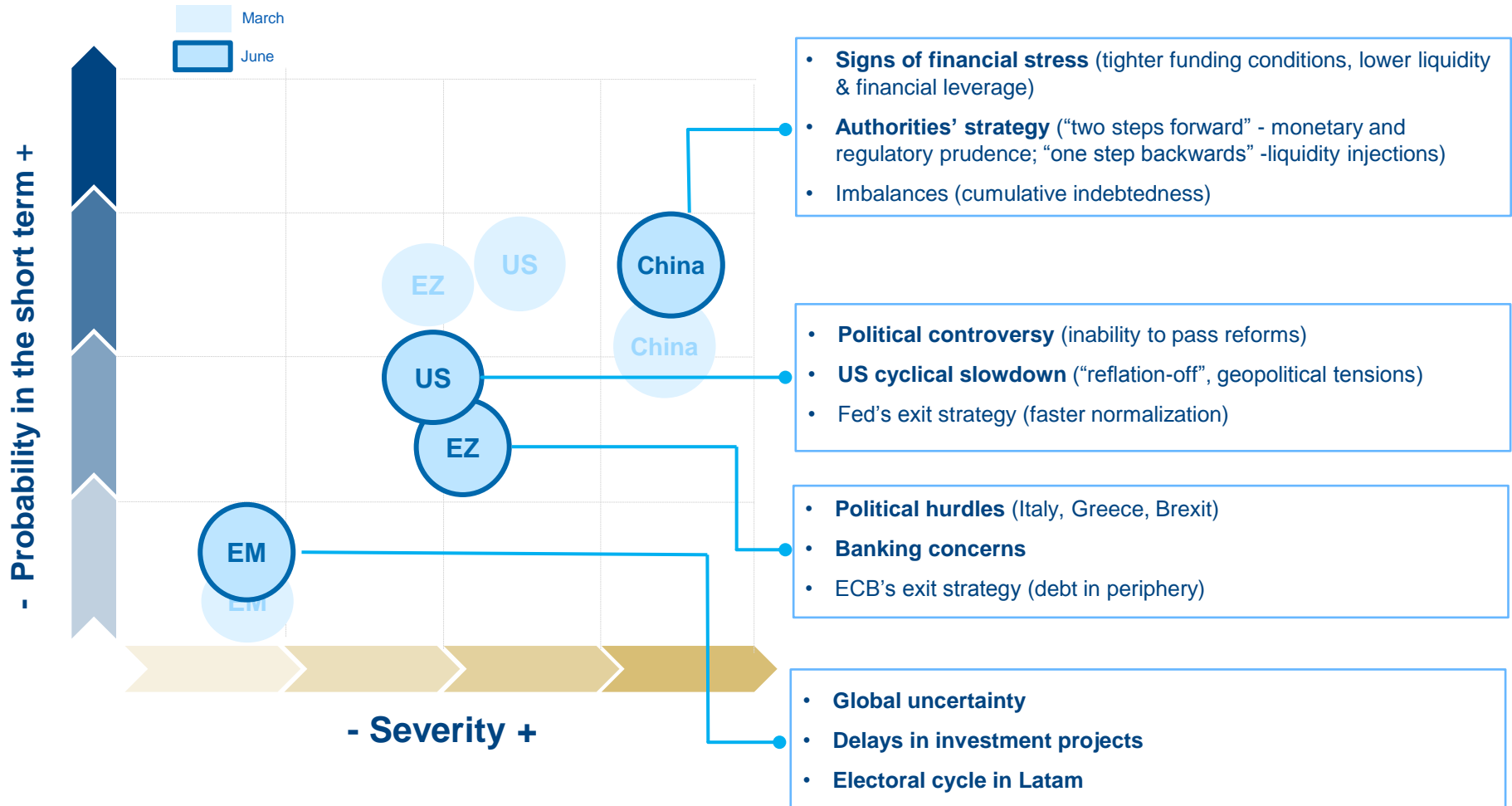
	2015	2016	2017	2018
United States	2.6	1.6	2.1	2.2
Eurozone	1.9	1.7	2.0	1.7
Spain	3.2	3.2	3.3	2.8
LatAm *	-0.4	-1.3	0.8	1.6
Argentina	2.6	-2.2	2.8	3.0
Brazil	-3.8	-3.6	0.6	1.5
Chile	2.3	1.6	1.3	2.4
Colombia	3.1	2.0	1.5	2.0
Mexico	2.7	2.0	1.6	2.0
Peru	3.3	3.9	2.2	3.9
Eagles **	4.7	5.0	5.0	5.1
Turkey	6.1	2.9	5.0	4.5
Emerging Asia	6.7	6.7	6.2	6.0
China	6.9	6.7	6.5	6.0
World	3.3	3.2	3.3	3.4

Inflation

YoY average, %

	2015	2016	2017	2018
United States	0.1	1.3	2.0	1.8
Eurozone	0.0	0.2	1.6	1.4
Spain	-0.5	-0.2	1.9	1.7
LatAm *	17.4	30.9	40.6	49.5
Argentina	26.7	41.2	27.3	16.0
Brazil	9.0	8.8	3.8	4.4
Chile	4.4	3.8	2.4	2.9
Colombia	5.0	7.5	4.5	3.3
Mexico	2.7	2.8	5.9	3.9
Peru	3.5	3.6	2.9	2.0
Eagles **	5.0	4.4	4.4	4.3
Turkey	7.7	7.8	10.5	7.6
Emerging Asia	2.6	2.8	2.8	3.0
China	1.4	2.0	1.7	2.0
World	3.7	4.7	5.8	6.3

Global risks: China's risks continue to build up while those in the EZ and the US recede



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