GLOBAL OUTLOOK

ECONOMIC WATCH

October 2017

Global growth forecasts: a more synchronized recovery

- Sustained momentum in global growth. Our BBVA-GAIN model estimates global GDP growth at around 1% QoQ in 2H17, after strengthening on the first half of the year.

- Improved hard data, but still suggesting a somewhat less optimistic outlook than strong confidence surveys. Industrial output picked up again in August, global trade recovery remains on track while retail sales point to a still resilient consumption.

- Broadly unchanged global scenario: steady global growth in 2017-18

  - Sustained growth in the US despite the impact of hurricanes and political uncertainty.

  - More positive outlook for China in the short-term, but growth will moderate next year due to lower support from economic policies.

  - Higher growth in the Eurozone thanks to the strength of domestic demand, with very gradual increase in inflation.

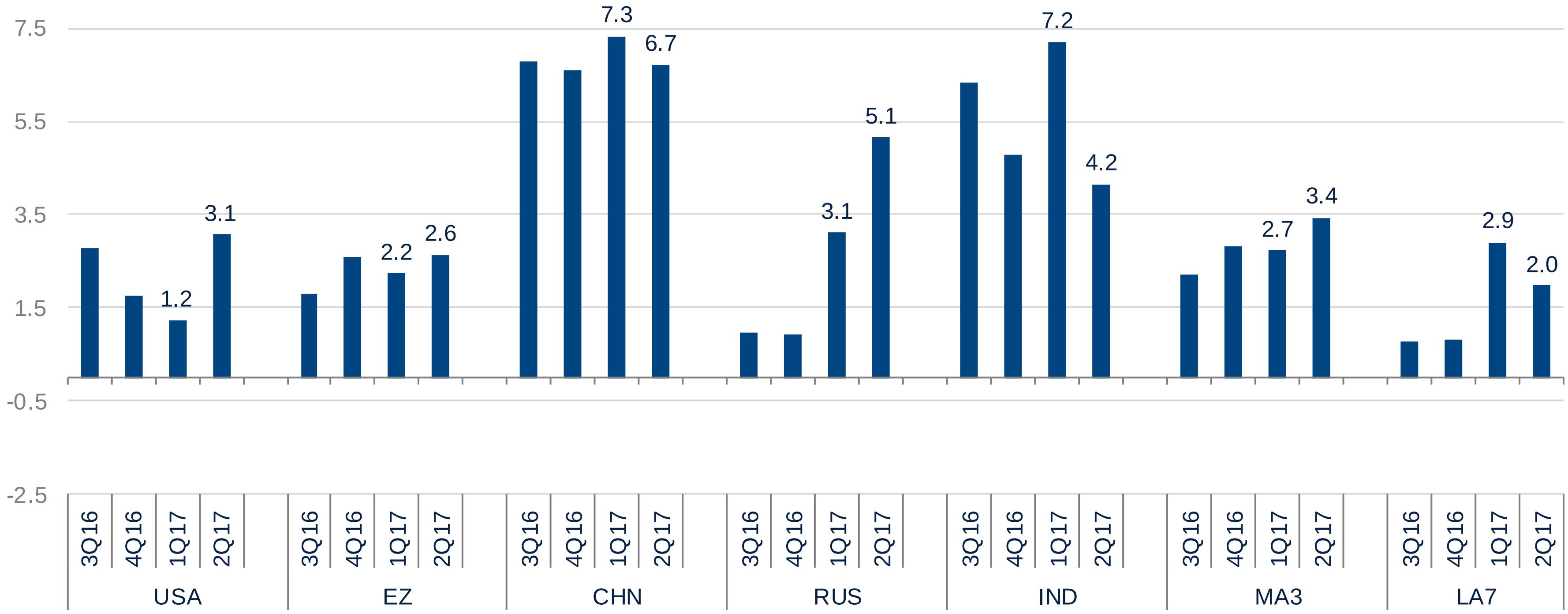
- Major central banks are moving towards very gradual normalization, constrained by still subdued inflation and increasing uncertainty about the medium-term.

- Risks are tilted to the downside, with some rebalancing from China to the US in the short-run.

SHORT-TERM INDICATORS

GDP data for 2Q17: Overall improvement and upward surprises in China and the Eurozone

GDP: Selected Regions
(SAAR, %)

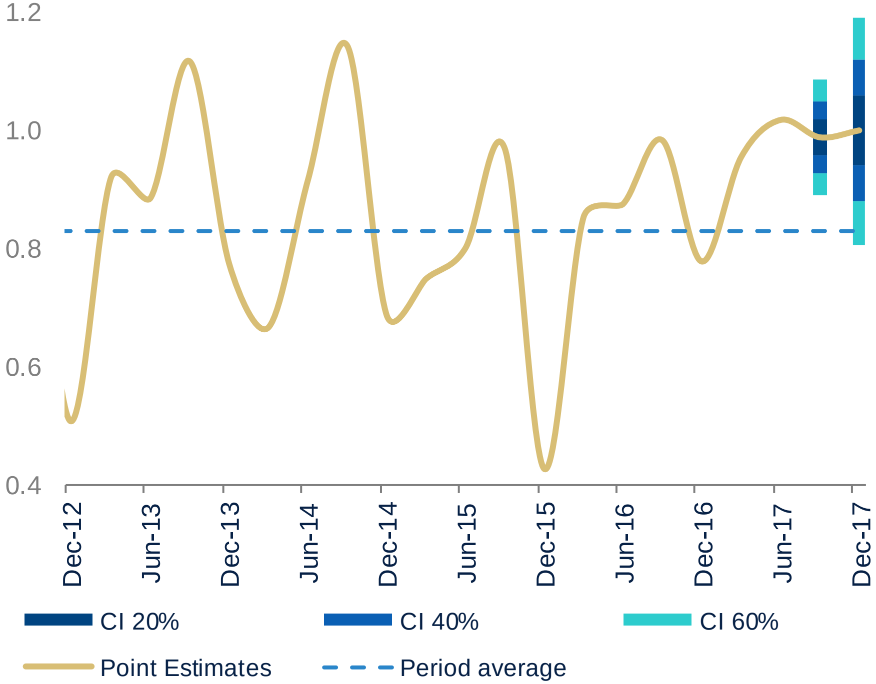


Source: BBVA Research and National sources

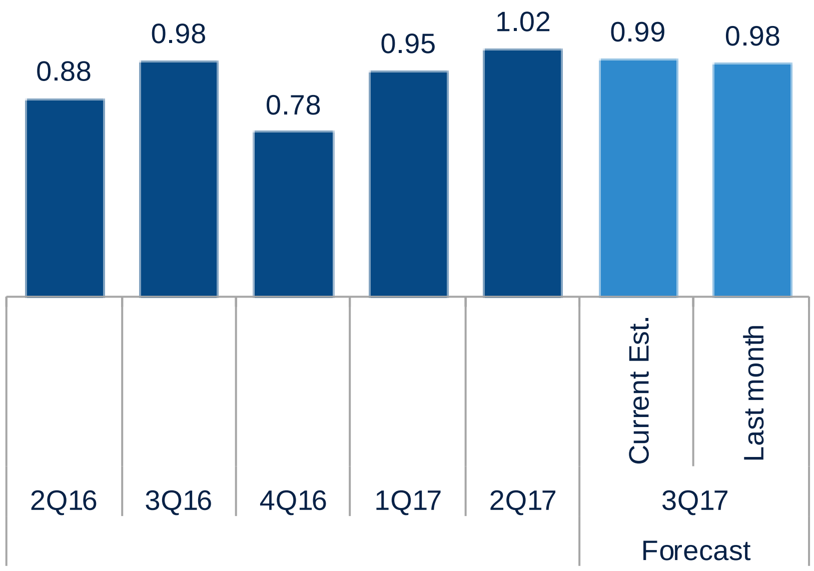
LA7: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela.
MA3: Indonesia, Japan, Korea

Global GDP short-term indicator broadly unchanged at a steady 1% t/t

World GDP Growth
Forecast based on BBVA-GAIN (%, QoQ)



World GDP Growth: Change in forecast
QoQ, %

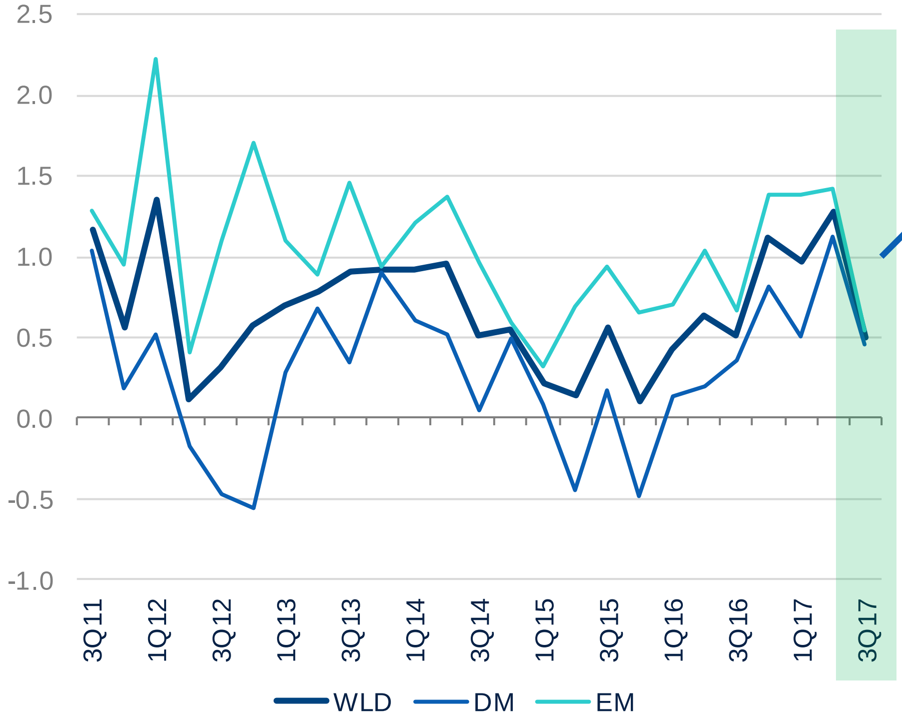


Source: BBVA Research and CPB

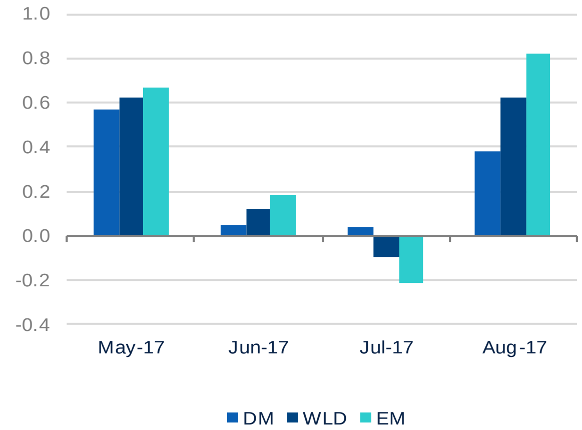
* Forecast and nowcast based on BBVA-GAIN

Industrial output picked up again in August after moderating in the previous two months

World Industrial Production
(%, QoQ)



World Industrial Production
(MoM, %)



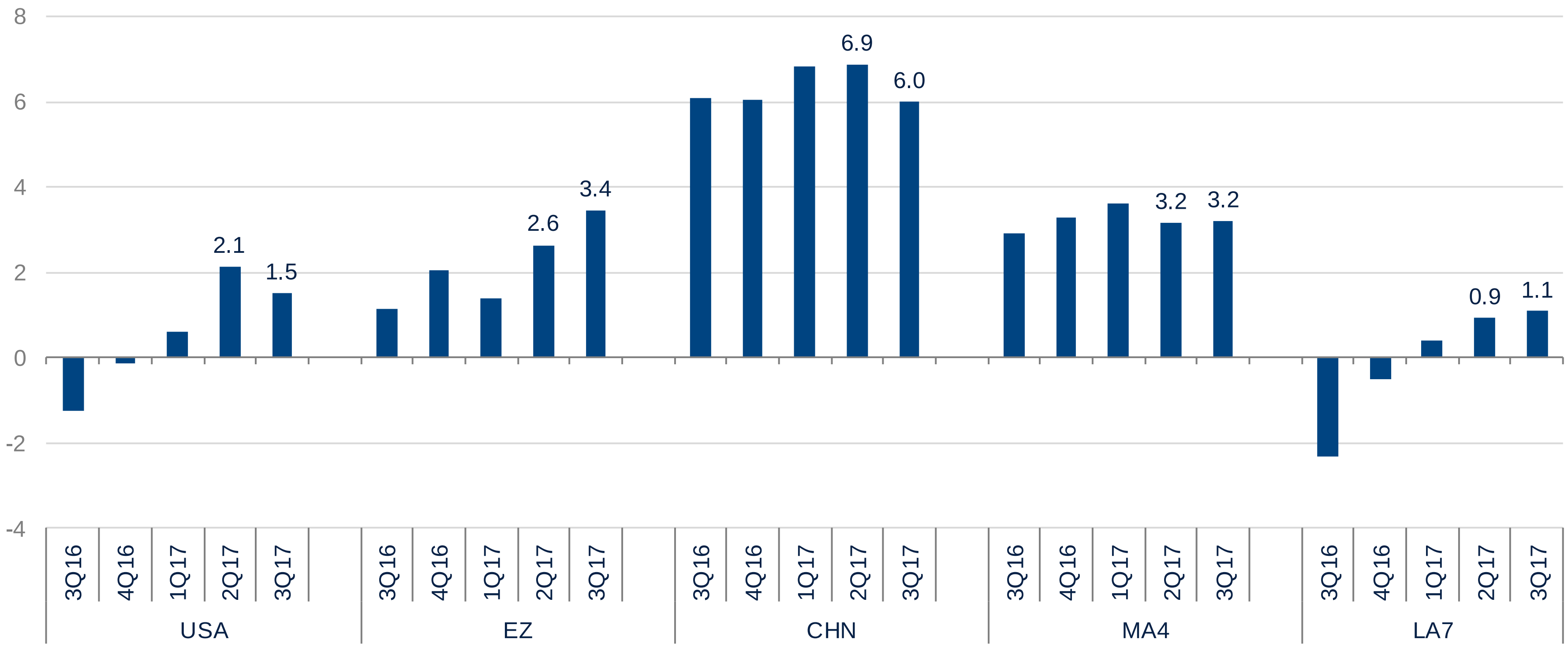
- Across DM's, the sharp increase in the EZ contrasts with the weaker figures in the US (data distorted by the negative impact of Hurricane Harvey)
- In EM, the improvement is more apparent in Asia, while Latam begins to gain ground

Source: BBVA Research and National sources

The recovery of the industrial sector continues apace driven by Europe and Latam while growth in China remains resilient

Industrial Production: Selected Regions

(YoY, %)

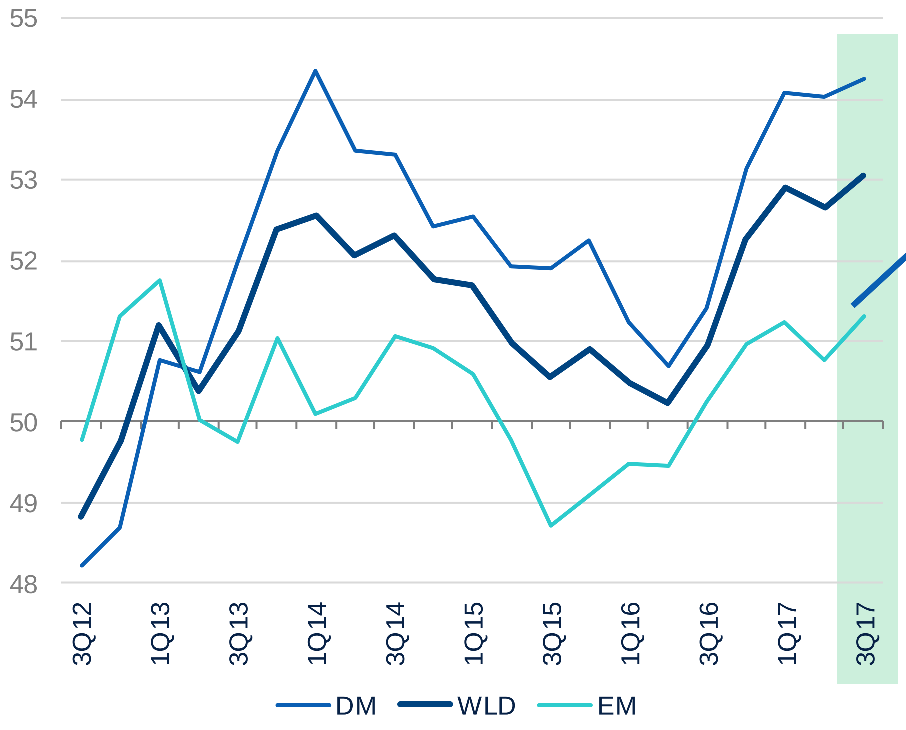


3Q17 calculated using data for July for USA, EZ, CHN and MA4.
Source: BBVA Research and National sources

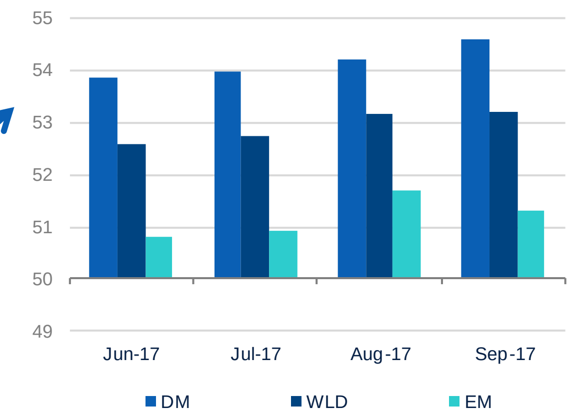
LA7: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela.
MA4: India, Indonesia, Japan, Korea

Manufacturing PMI's remained strong and broadly stable, suggesting that sector growth should continue in 2H17

World Manufacturing PMI
(Level ± 50)



World Manufacturing PMI
(Level ± 50)

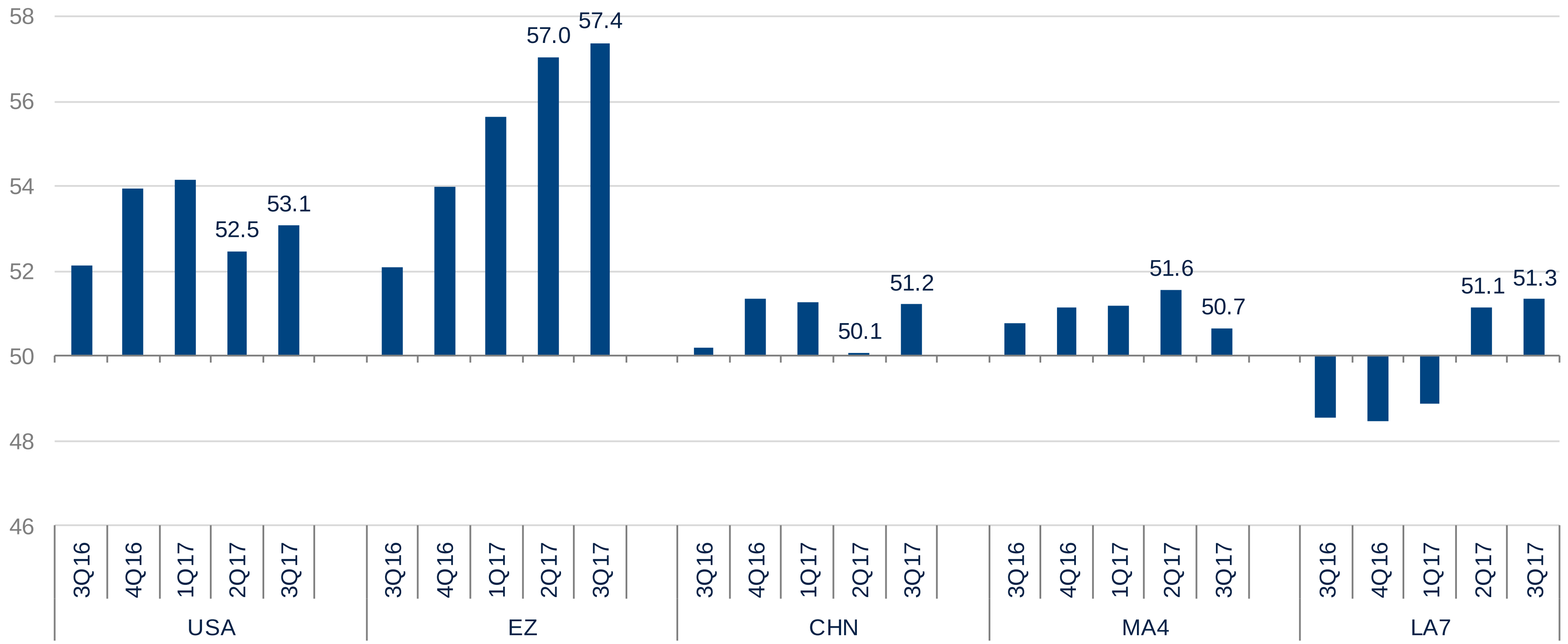


- Robust growth in output and new orders exerted further pressure on capacity, encouraging firms to raise employment
- Increasing cost pressures (higher commodity prices and increased supply-chain pressures), led to higher output charges

Source: BBVA Research and Markit

Across large areas, the US and EZ continue strong while China and Latam improve

Manufacturing PMI: Selected Regions
(Level ± 50)

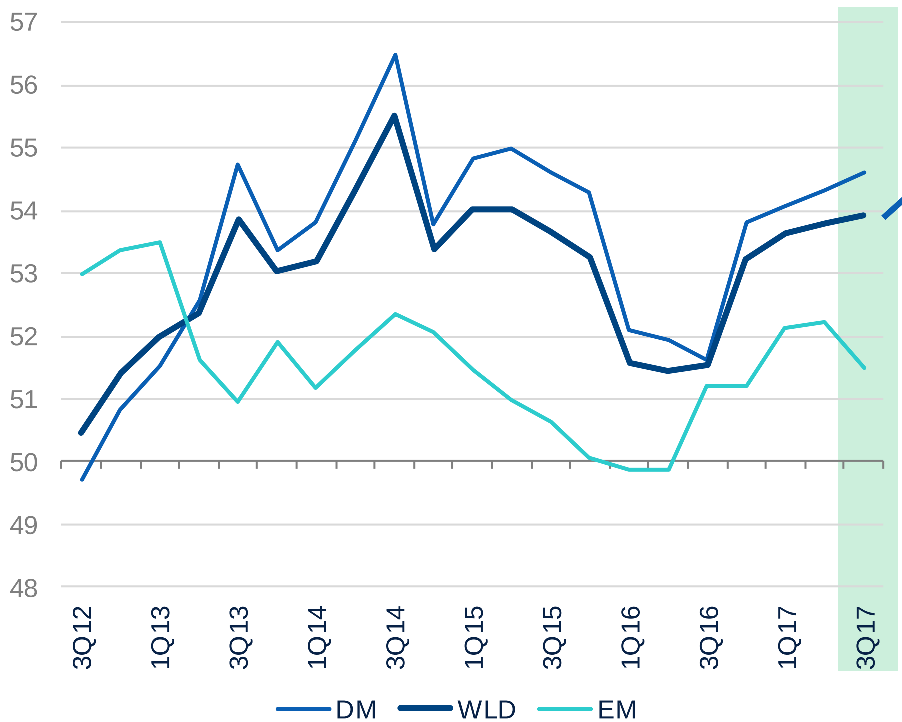


3Q17 calculated using data for July.
Source: BBVA Research and Markit

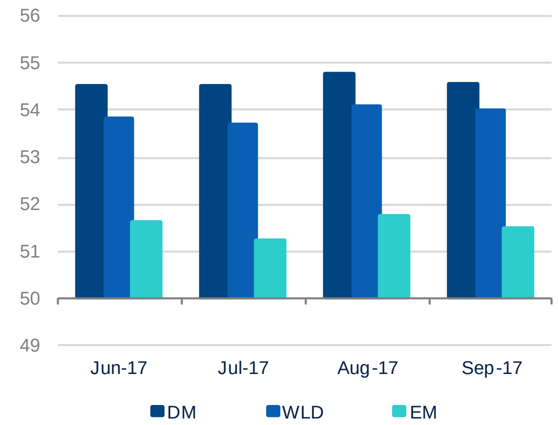
LA7: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela.
MA4: India, Indonesia, Japan, Korea

Global services PMIs registered in 3Q17 their best quarter in two years…

World Services PMI
(Level ± 50)



World Services PMI
(Level ± 50)



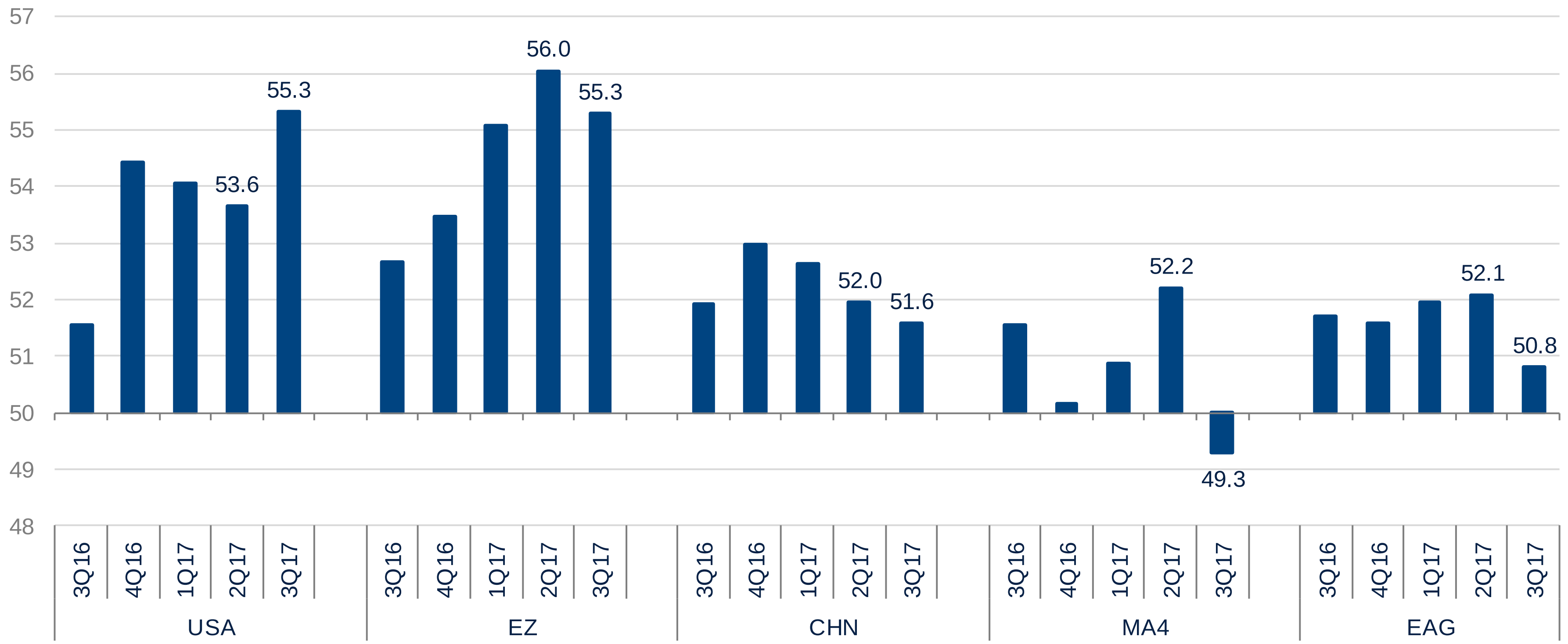
- Further increases in backlogs of work and employment suggest that the current strong expansion could continue
- The pass-through of higher input prices led to the steepest increase in output charges since April 2014

Source: BBVA Research and Markit

…driven by the improved confidence in the US, with declines in other areas

Services PMI: Selected Regions

(Level ± 50)

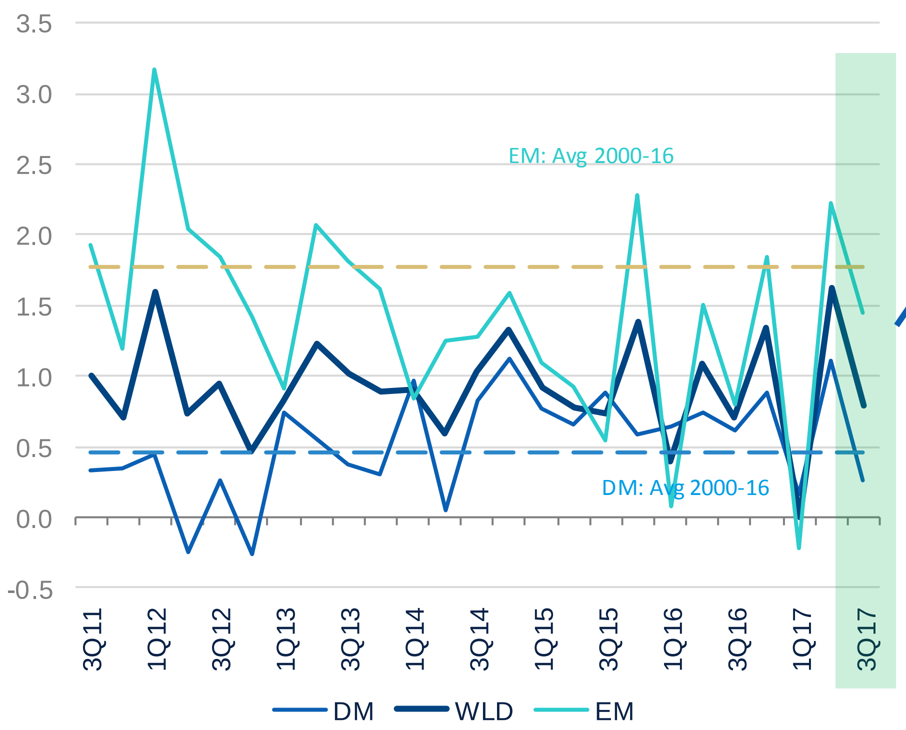


3Q17 calculated using data for July.
Source: BBVA Research and Markit

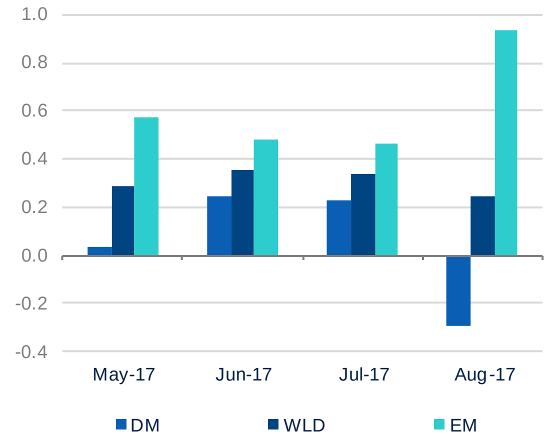
MA4: India, Indonesia, Japan, Korea
EAG (Eagles): Bangladesh, Brazil, China, Egypt, India, Indonesia, Iran, Malaysia, Mexico, Nigeria, Pakistan, Philippines, Russia, Turkey, Vietnam

Retail sales moderated in August as the sharp increase in EM could not offset the drop in DM

World Retail Sales
(%, QoQ)



World Retail Sales
(MoM, %)



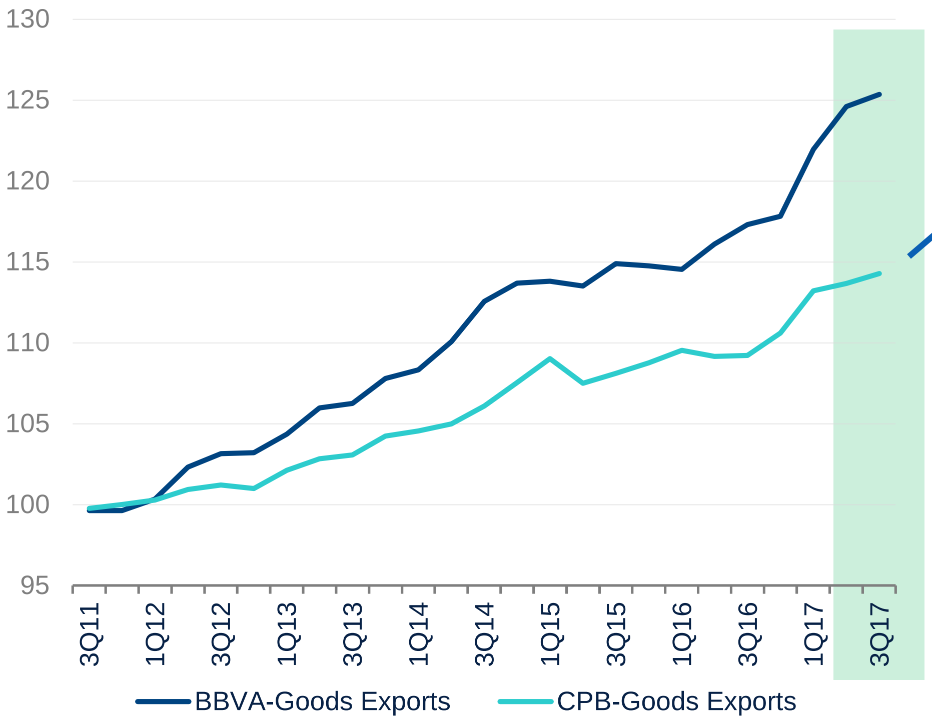
- Divergence across EM: good performance in China, but still poor figures in Latam
- In DM, disappointing figures in both US (also due to hurricanes impact) and EZ suggest some moderation in consumer spending over Q3

Source: BBVA Research and national sources

Goods' exports: a pause in trend data

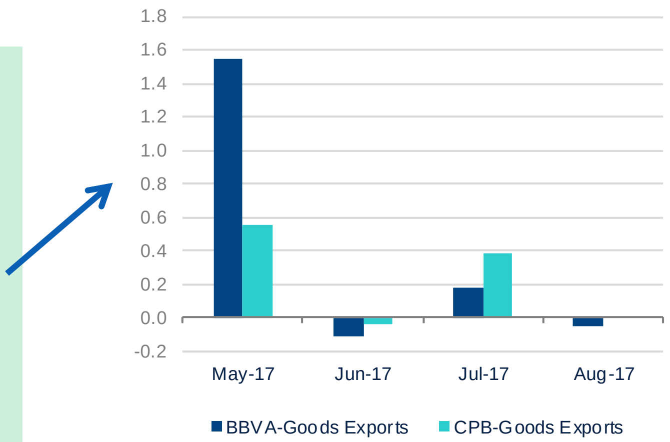
World Exports of Goods (index, constant prices)

(Index Jan-12=100)



World Exports of Goods (growth, constant prices)

(3-month moving average MoM%)



- China's exports stop falling while the rest of Asia showed a small increase.
- Non-smoothed August data and preliminary September figures are positive again, in line with other indicators in 3Q17

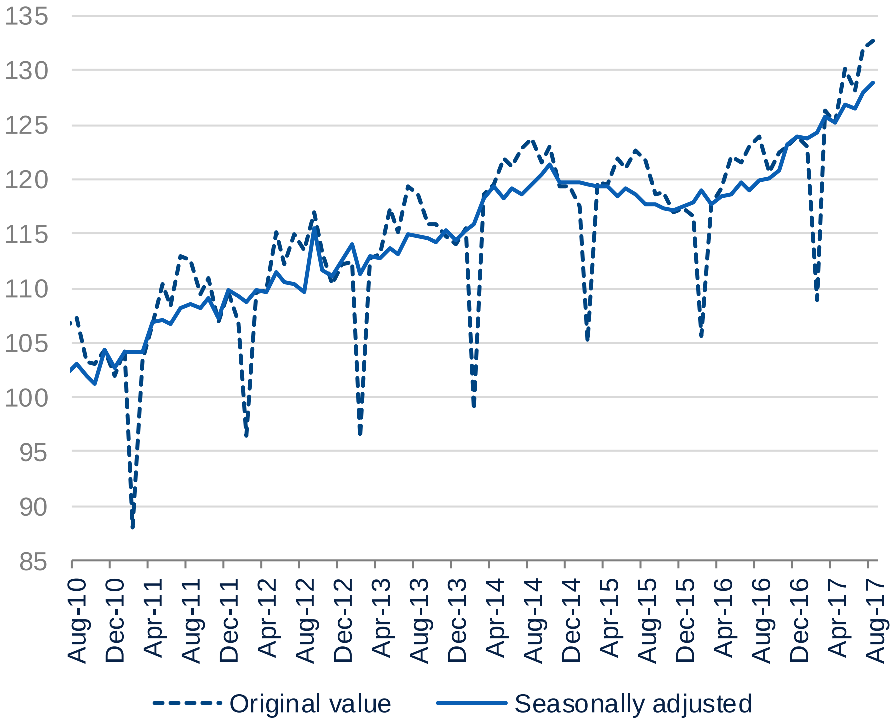
* Based on **BBVA-Trade Index**

Source: BBVA Research and CPB

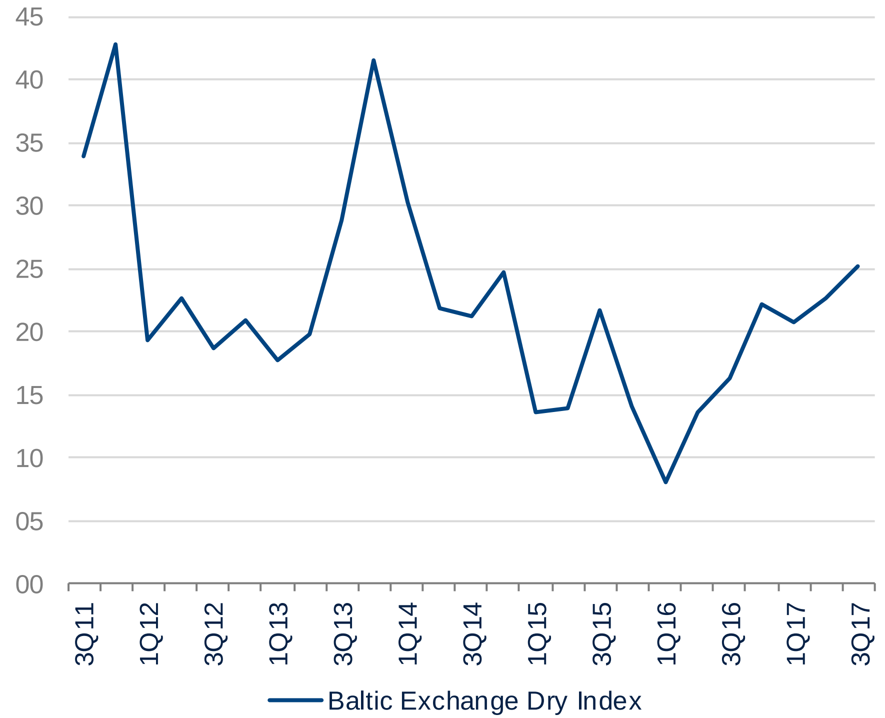
BBVA Research

More optimistic signs on global trade stem from freights

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



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

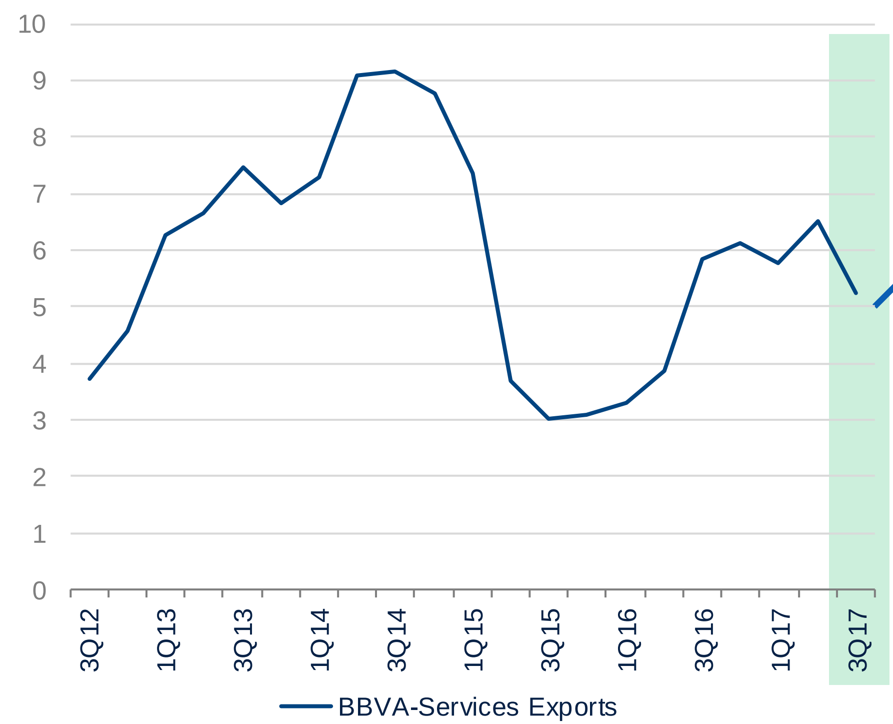


Source: Institute of shipping economics and logistics

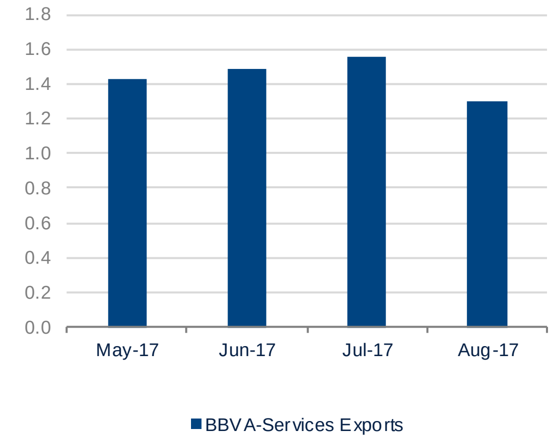
* **The Baltic Dry Index** (BDI) is an economic indicator issued daily by the London-based Baltic Exchange
Source: London Baltic Exchange and BBVA Research

Good performance of service exports despite a slight moderation in August

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



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



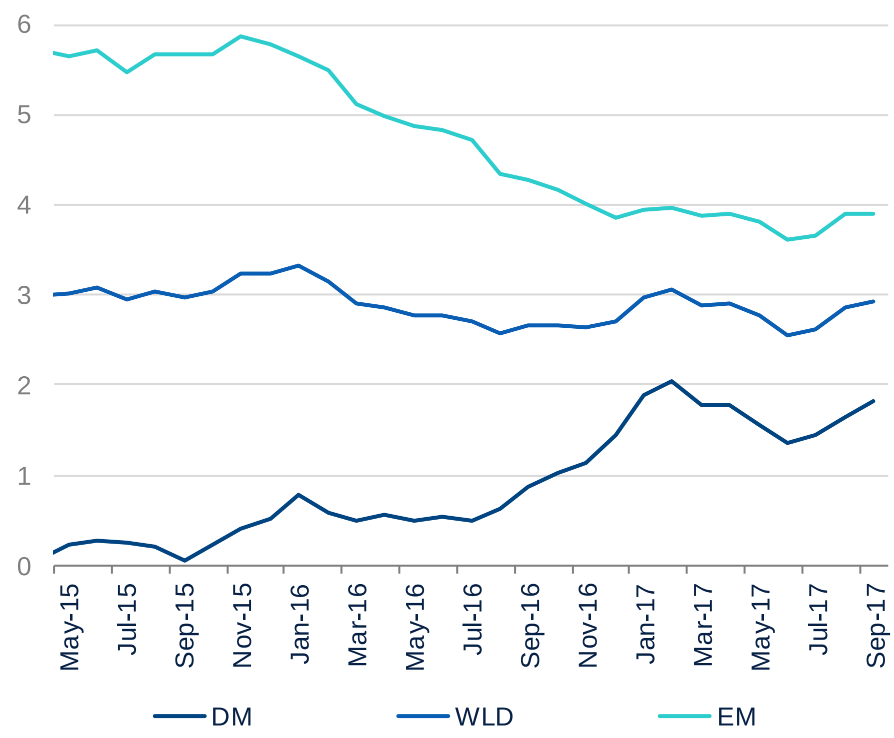
- Low annual rates after the rebound a year earlier. However, monthly figures show a more optimistic outlook

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

Global inflation accelerated slightly in September, mainly driven by DM…

- In DM's, volatile components continued to be the main drivers (unprocessed food inflation in EZ and energy prices in the US)
- In EM's inflation remained broadly unchanged in September as the increase in emerging Asia was offset by the moderation in China

World Headline Inflation
(YoY, %)

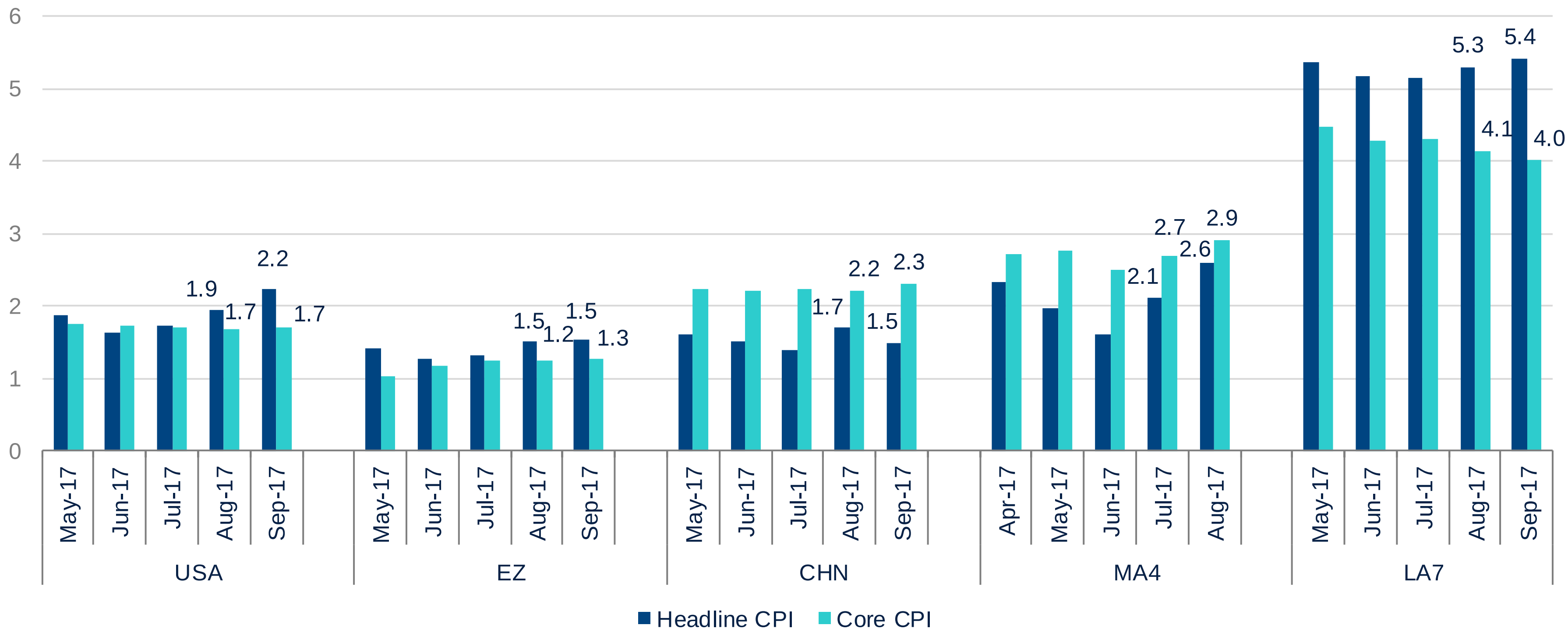


Source: BBVA Research and National sources

… although core inflation measures remain broadly stable in most areas despite improved labour market conditions

Headline and Core Inflation: Selected Regions

(YoY, %)



Source: BBVA Research and National sources

NEW PROJECTIONS & GLOBAL RISKS

Stabilization in a more synchronized recovery

Robust and steady global growth

Albeit with some decoupling between confidence and hard data in Q3

A more synchronized recovery across areas

With an improvement in emerging markets

Still subdued inflation

Early hints of wages moving up, but doubts about its sustainability

Central banks proceed with normalization

Increasing uncertainty and different pace between the US and Eurozone

Low financial volatility still favors EM

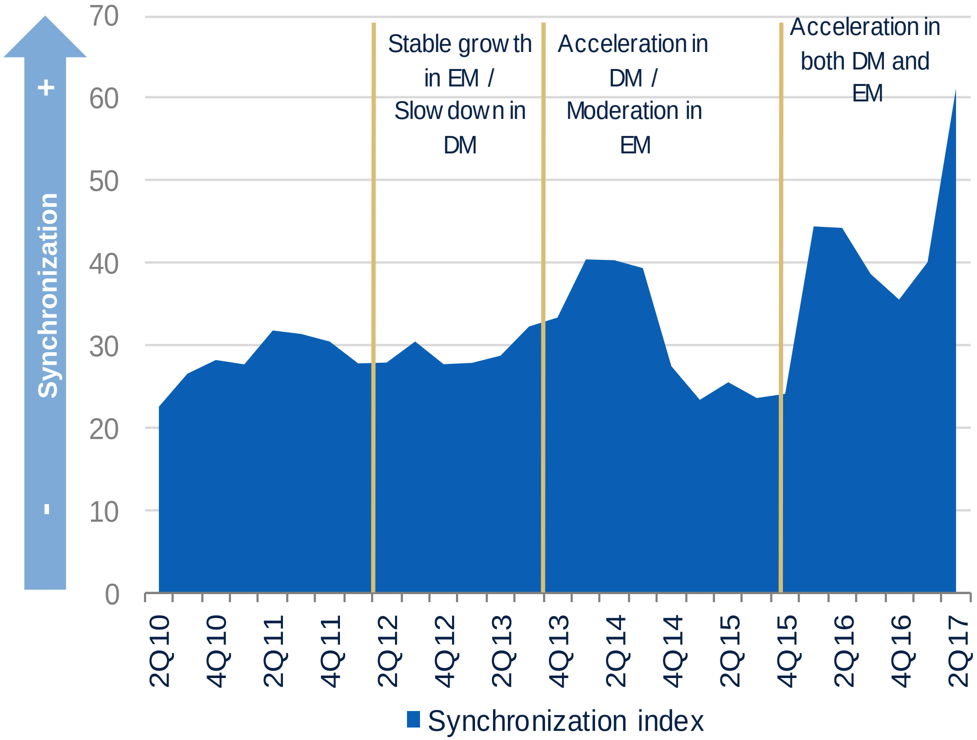
Although “tailwinds” are likely to fade gradually

Global risks to the downwards

Short-term risks rebalance from China to US

The current recovery phase is more synchronized across areas

Synchronization index
(based on the time variance of GDP)

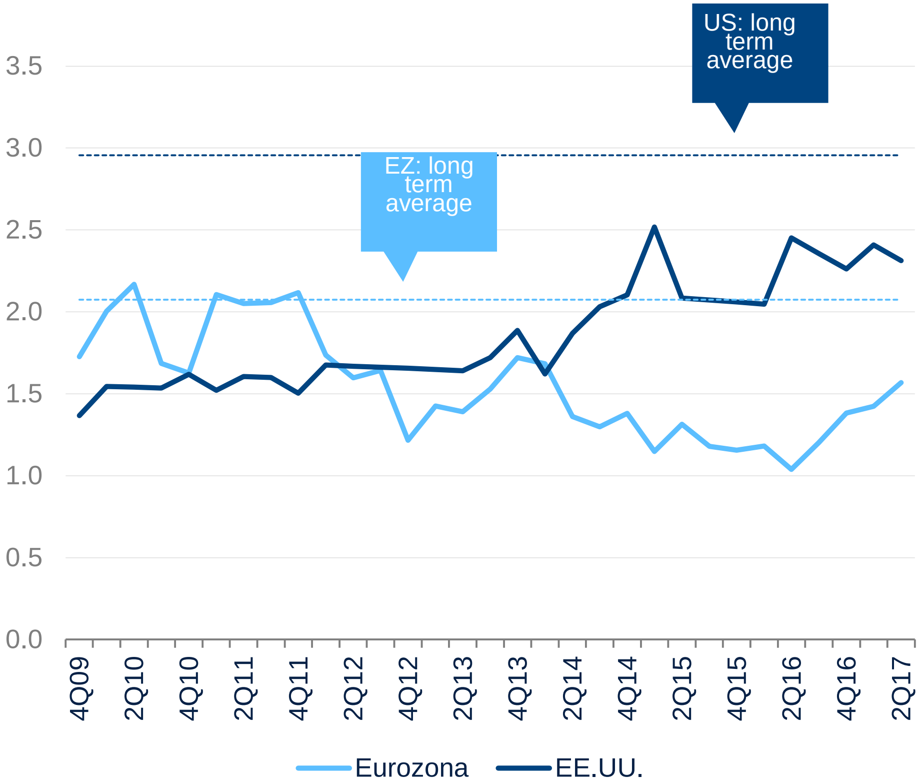


- **Developed economies:**
  - Strong rebound in the US after Q1
  - Positive surprise in Europe
- **Emerging economies:**
  - Slight slowdown in China, although better than expected. Will continue to support the rest of Asia
  - Recovery in Russia and Brazil means that these two are no longer dragging global growth
  - Growth in LatAm countries is gaining traction

Inverse index of standard deviation of quarterly growth observed in countries
Source: BBVA Research and National sources

Still restrained wage growth, with some signs of acceleration in the EZ

US and EZ: wages and salaries
(%, YoY)



- Despite economic growth and improved labor market conditions, core inflation remains at low levels
- Doubts about the consolidation of incipient wage increases. Inflationary pressures contained
- Uncertainty about determintants: temporary vs. permanent changes
- Caution of central banks, especially in developed countries. More room for monetary policy in emerging economies

Source: BBVA Research, Eurostat and BEA

Central banks are moving towards very gradual normalization

FED

Normalisation of the balance sheet from October onwards and next interest rate hike in December, with two additional rates in 2018

Reduction of debt purchases by 2018, but rate hikes are not expected before mid-2019

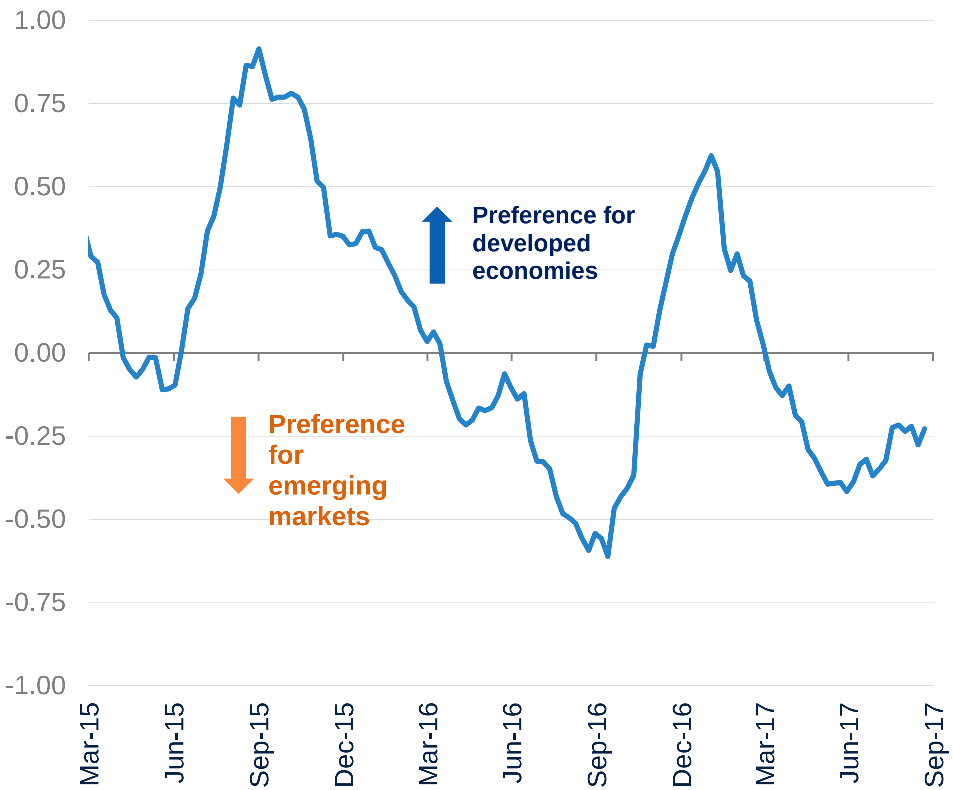
BCE

High uncertainty

- In the **US**, due to the moderation of inflation and the expected change in the FOMC in 2018
- In the **Eurozone**, bias towards a more gradual tapering (euro strength) and a delay in the cycle of rate hikes (low inflation)

Financial markets still favour emerging economies

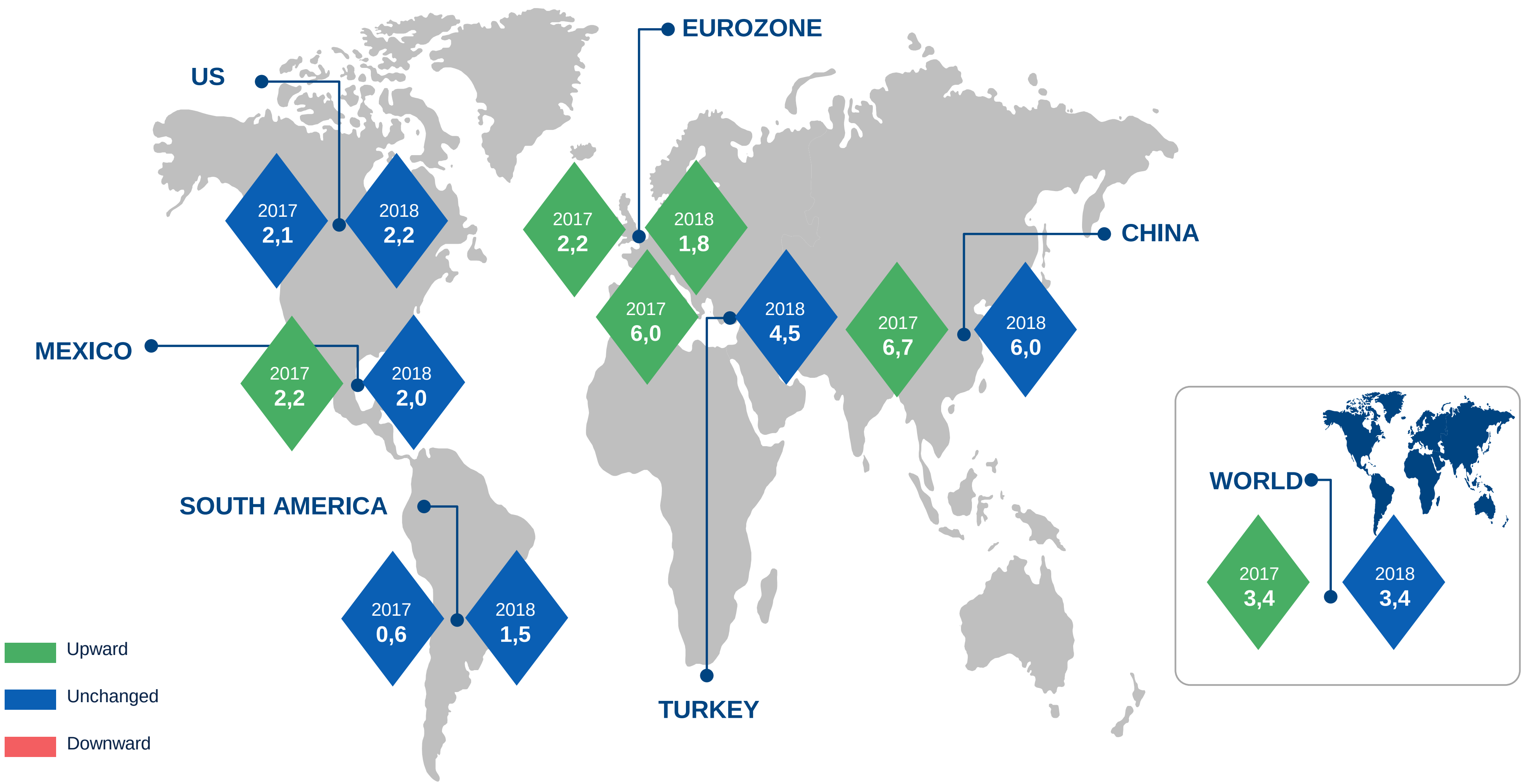
Regional asset relocation indicator
(Standard deviation from historical mean)



- Weaker USD dollar and subdued US bond yields are boosting “hunt for yield” strategies, supporting EM assets
- Global liquidity will remain high, given the gradual normalisation proccess of the Fed and the ECB
- Although these tailwinds for EM portfolio flows will fade as central banks gradually withdraw monetary policy stimulus

Source: BBVA Research and Bloomberg

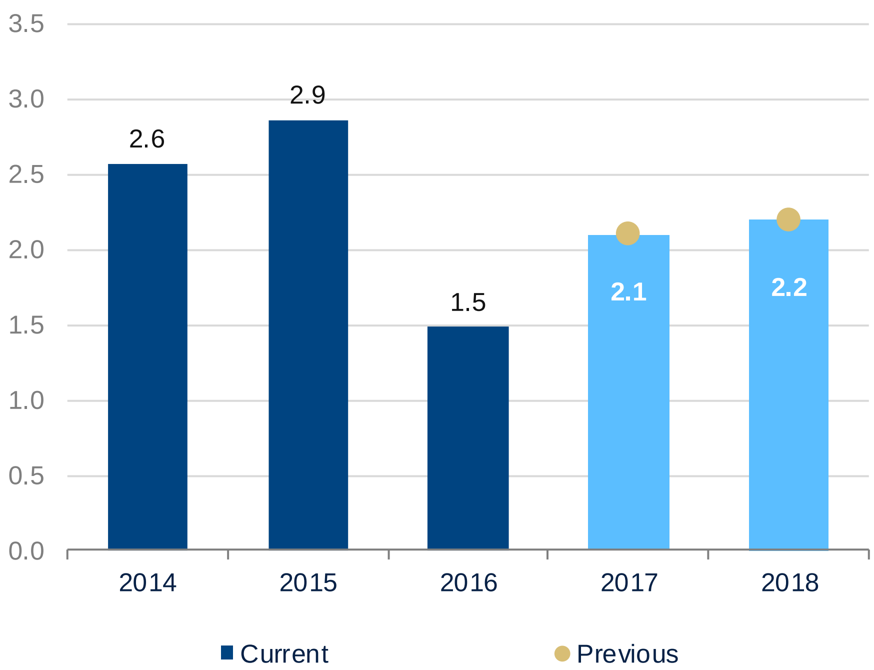
Upward revision in global growth for 2017



Fuente: BBVA Research

US: sustained growth despite political uncertainty and hurricanes

US: GDP growth
(YoY, %)

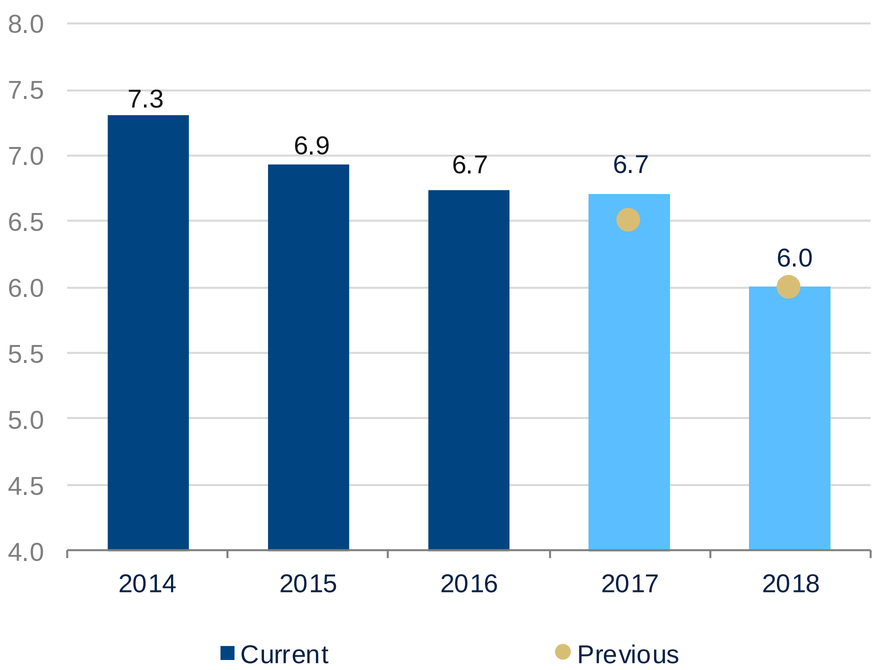


- The net economic impact of hurricanes at a national level is moderate, so we maintain growth forecasts for 2017 – 2018 (2.1 and 2.2% respectively)
- Tax reform plan to reduce individual and corporate taxes, with estimated net cost of 2.2 tr USD in 10 yrs. Still lacking details, and unlikely to boost activity
- Risks:
  - Political controversy and cyclical slowdown
  - Financial instability: signs of overvaluation in some assets

Source: BEA and BBVA Research

China: more positive outlook in the short term, with an eye on Party congress

China: GDP growth
(YoY, %)

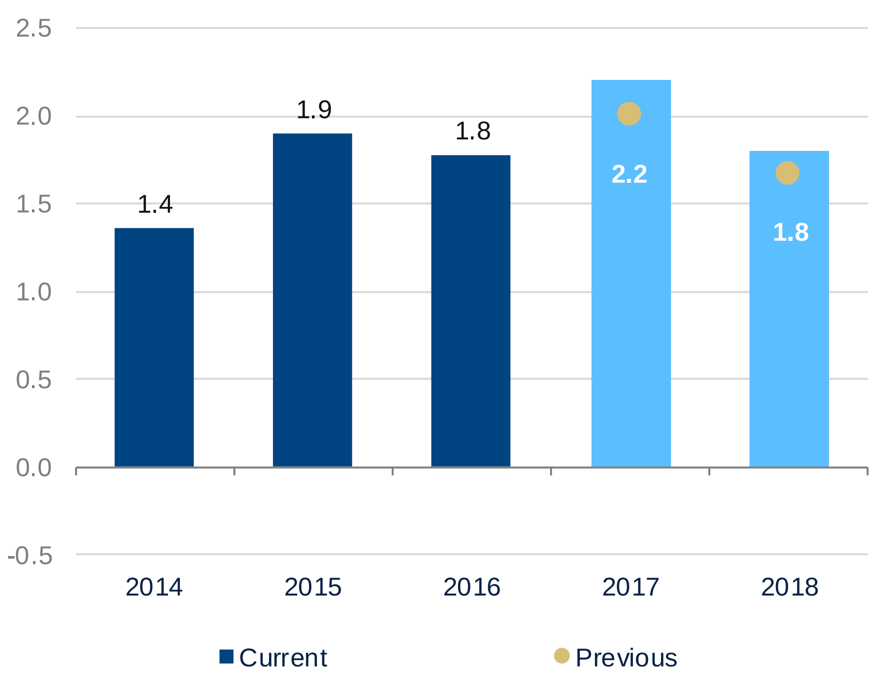


- Slight upward revision of GDP growth in 2017 (+0.2pp to 6.7%) due to a stronger than expected 1H17
- However, we still project growth to moderate in 2018 by lower support from economic policies (monetary prudence and less fiscal support) and appreciation of the RMB
- Pending on key decisions to be taken at the 19th Party Congress with a potential impact on long-term growth
- Risks:
  - Deleveraging risk is still high but more contained in the short run thanks to regulatory measures
  - Sluggish growth if regulatory and balance sheet strengthening measures are not taken

Source: CEIC and BBVA Research

Eurozone: higher growth thanks to the strength of domestic demand

Eurozone: GDP growth
(YoY, %)



- Upward revision in 2017-2018 GDP growth (+0,2pp in 2017 and +0,1pp in 2018) on account of better incoming data and strengthening domestic drivers
  - Solid expansion of investment adds to consumption strength
  - The negative effect of euro appreciation seems to be limited
- Very gradual increase in inflation expected towards the ECB target
- Risks: domestic and banking political risks continue (Spain, Italy, support for the European project, *Brexit*), though more contained

Source: Eurostat and BBVA Research

Macroeconomic forecasts

Gross Domestic Product
YoY average, %

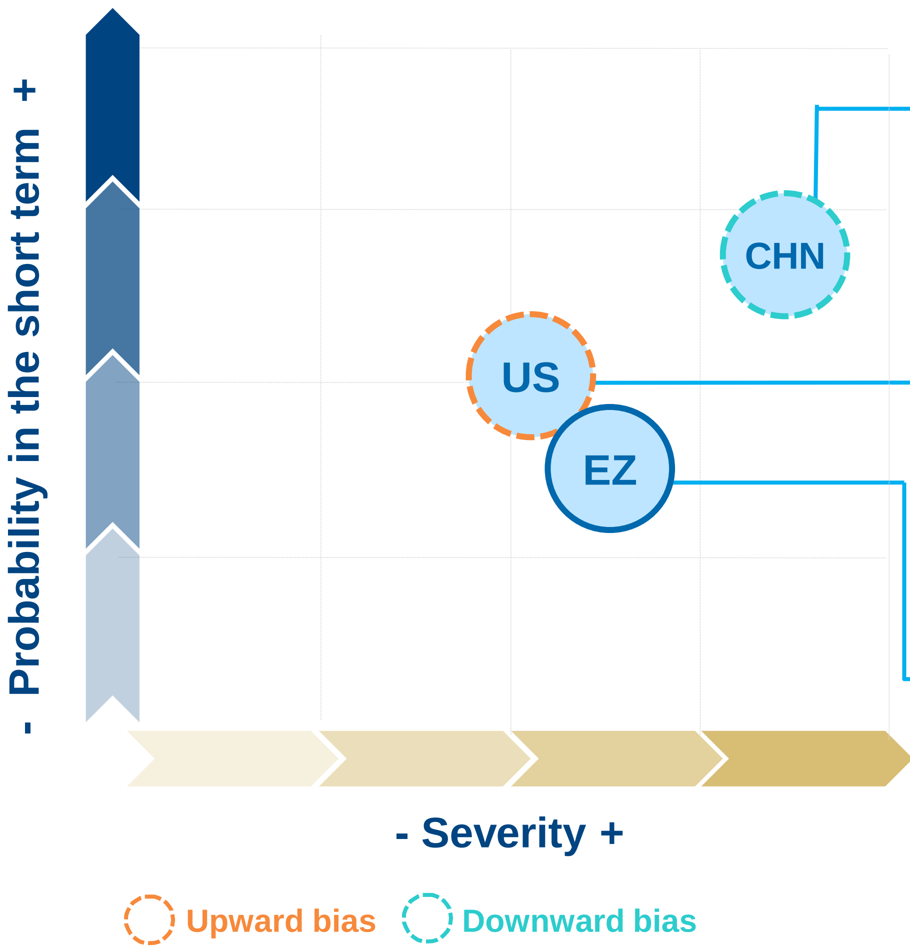
Oct-17	2015	2016	2017	2018
United States	2.9	1.5	2.1	2.2
Eurozone	2.0	1.8	2.2	1.8
Latam *	-0.4	-1.3	1.0	1.6
Argentina	2.6	-2.2	2.8	3.0
Brazil	-3.8	-3.6	0.6	1.5
Chile	2.3	1.6	1.3	2.4
Colombia	3.1	2.0	1.5	2.0
Mexico	2.7	2.0	2.2	2.0
Peru	3.3	4.0	2.4	3.9
Eagles **	4.7	5.2	5.2	5.1
Turkey	6.1	2.9	6.0	4.5
Emerging Asia	6.7	6.7	6.3	6.0
China	6.9	6.7	6.7	6.0
World	3.4	3.3	3.4	3.4

Inflation
YoY average, %

Oct-17	2015	2016	2017	2018
United States	0.1	1.3	2.0	1.7
Eurozone	0.0	0.2	1.5	1.2
Latam *	17.4	31.2	41.5	94.0
Argentina	26.7	40.4	25.5	17.6
Brazil	9.0	8.8	3.5	3.9
Chile	4.4	3.8	2.2	2.6
Colombia	5.0	7.5	4.4	3.2
Mexico	2.7	2.8	6.2	3.7
Peru	3.5	3.6	3.0	2.1
Eagles **	5.0	4.4	4.2	4.1
Turkey	7.7	7.8	10.8	8.4
Emerging Asia	2.6	2.8	2.4	2.8
China	1.4	2.0	1.7	2.0
World	3.7	4.7	5.7	9.1

Source: BBVA Research

Global risks: short-term risks rebalance from China to US



- **Deleveraging risk: still high but more contained in the short run** (more gradual economic slowdown & authorities strategy):
- **The need for reforms of public enterprises**
- **Soft landing management**: corporate debt continues to grow although at a slower pace, slightly below nominal GDP in 1Q17

- **Political controversy & cyclical slowdown risk:** still high despite recent advances in tax reform proposal
- **Financial instability risk: signs of overvaluation in some assets.** Potential spillovers on private sector
- **Fed's exit risk:** high uncertainty on hikes path

- **Political and banking concerns:** more contained except in Spain
  - **Brexit**: towards a soft position (two-year transition period "based on the existing structure of EU rules")
- **ECB's exit risk: low;** very gradual starting with tapering in 2018

BBVA Research

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