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BBVA Research

Global Economic Watch

April 2018

Creando Oportunidades

Global growth remains firm but risks intensify

- Global growth remains firm at the beginning of 2018, although uncertainty is increasing. Our BBVA-GAIN model estimates global GDP to grow at rates similar to those observed over last year (1Q18 projected at 0.97% QoQ)
- Investment spending and international trade have gained momentum allowing a recovery of the industrial sector, but confidence data so far show some signs of moderation
- The fiscal stimulus approved in the US may support growth in other areas, but protectionism poses a risk
- We maintain our forecasts for global growth unchanged at 3.8% for the period 2018-19, with some adjustments across regions:
 - In the US, our projections for growth improve on the back of the short-term effects derived from the approved fiscal package and the positive figures in activity and external trade. Growth is projected at 2.8% for both 2018 and 2019 (upwardly revised by 0.2 and 0.3 pp respectively)
 - In the EZ, slower consumption is being more than offset by rising exports and investment. We marginally revise our 2018 growth forecast upwards to 2.3% and leave 2019 unchanged at 1.8%
 - For China, we maintain our scenario of gradual slowdown, projecting GDP growth at 6.3% and 6.0% for 2018 and 2019, respectively

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02 New projections and global risks



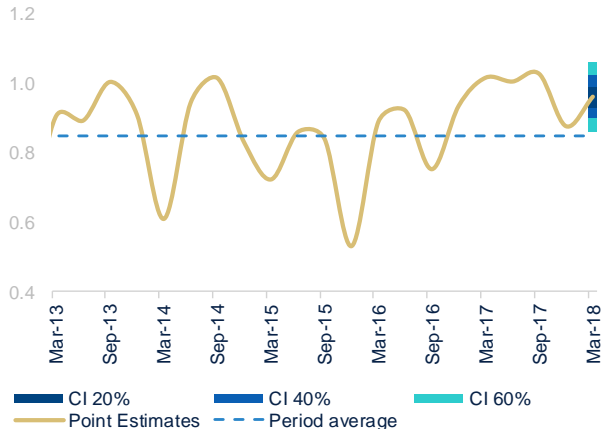
01

Short term indicators

The global economy is expected to grow firmly in 1Q18, at rates similar to those of most of last year (1% quarterly)

World GDP growth

(Forecast based on BBVA-GAIN (% , QoQ))



World GDP Growth

(Forecast based on BBVA-GAIN (% , QoQ))

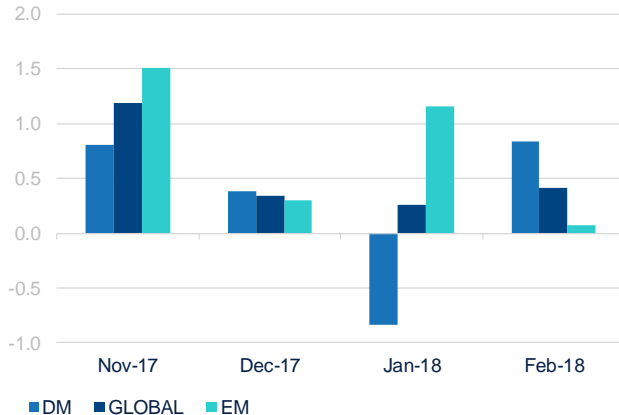


Global economy will grow steady during first months of 2018, at rates similar to those of last year (≈1% QoQ). Our BBVA-GAIN model estimates 1Q18 GDP growth at 0,97 QoQ, meaning growth will resume after slowing at the end of 2017. The new fiscal stimulus approved by US the administration and resilient activity in China will likely underpin the growth momentum in 2018

Industrial production remains growing steadily in several regions, despite some monthly volatility

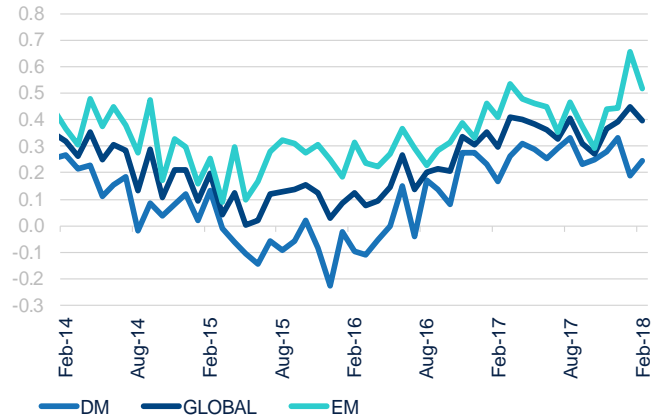
World industrial production

(%, MoM 6 period mov avg)



World industrial production

(%, MoM 6 period mov avg)

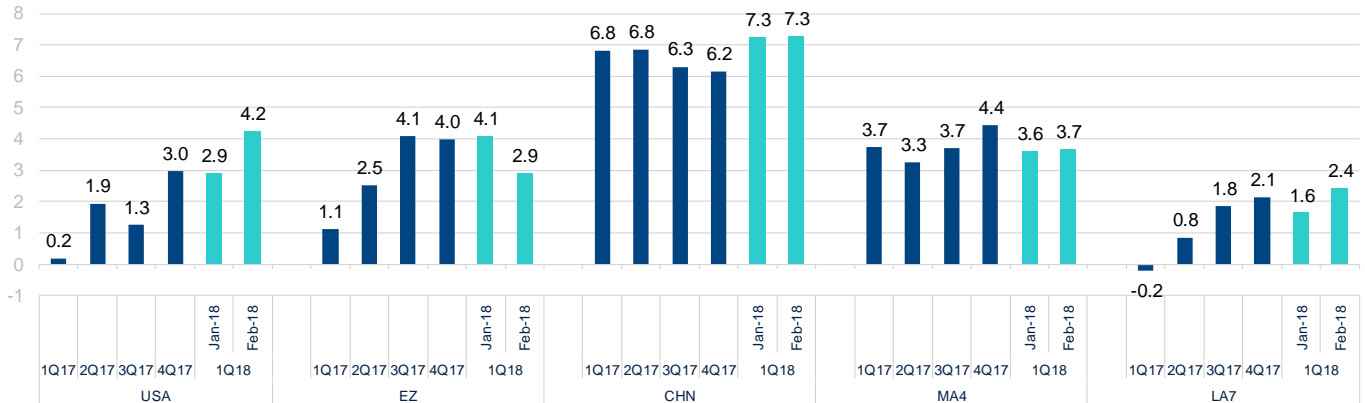


The ongoing recovery of business investment in advanced economies is being reflected in stronger industrial activity, despite some monthly volatility. Emerging countries are also finding support from stronger commodity prices and buoyant private investment

Solid expansion in EM's industrial output, notably in China and India. In DMs, higher growth in the US offsets slower activity in the Eurozone

World industrial production: Selected regions

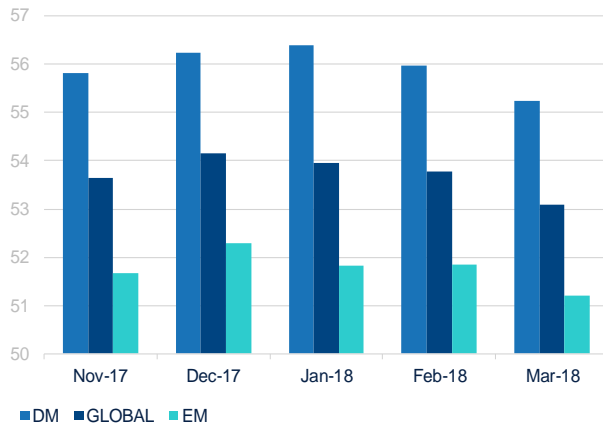
(%, YoY)



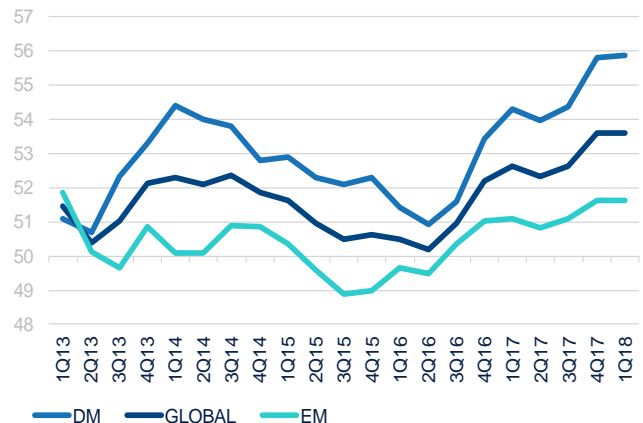
China's industrial output has strengthened over the first two months of the year, despite slowing infrastructure investment and increasing barriers to trade

Manufacturing confidence shows signs of stabilization, but remains high compared to historical standards

World manufacturing PMI (Level \pm 50)



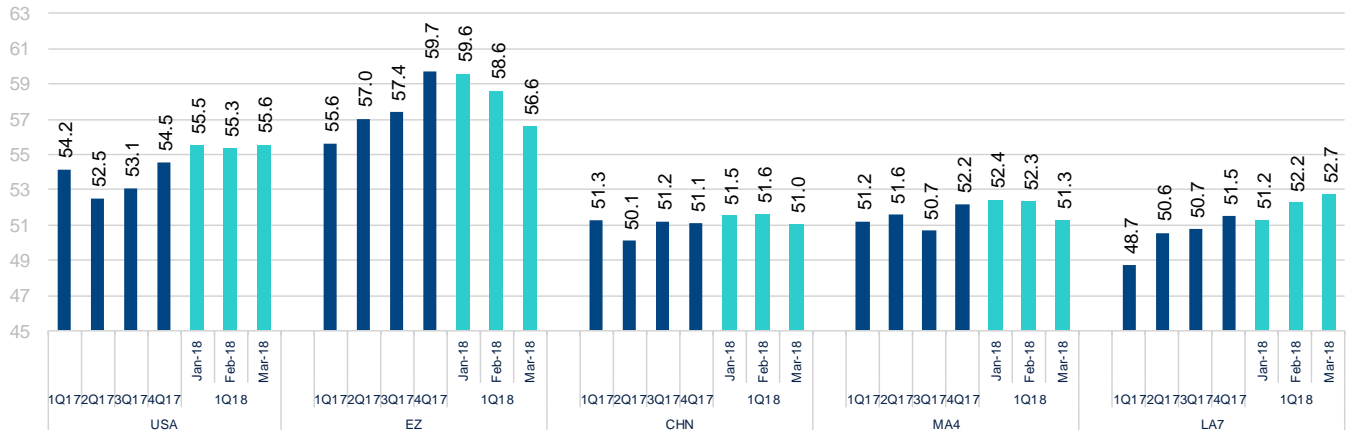
World manufacturing PMI (Level \pm 50)



Manufacturing PMIs have retreated from Dec'17 historical highs hit by an exhaustion in capacity, but also due to temporary factors such as abnormal weather conditions in Europe. This slowdown is still consistent with a prolonged period of expansion, and may be reflecting a more prudent assessment of the economy

Marked slowdown in EZ manufacturing confidence, while CHN and US remain close to their historical highs and Latam gains traction

Manufacturing PMI: Selected regions (Level \pm 50)

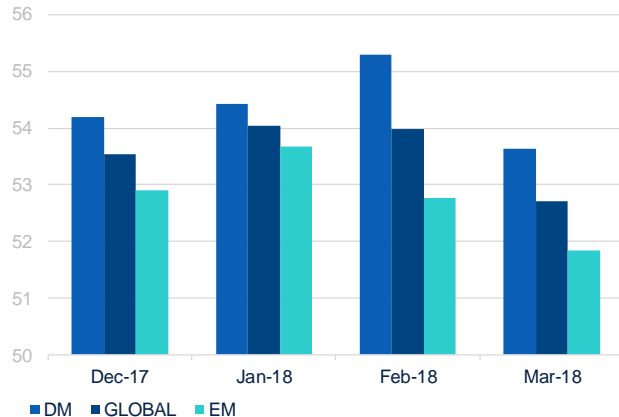


Eurozone manufacturing output has recently been hit by weather conditions and capacity exhaustion, resulting in a slight deceleration in the rate of new orders. In contrast, the US and CHN keep benefitting from increasing optimism and remain robust (with no impact yet from protectionist threats)

Services PMIs remain strong, but fall due to a softer expansion in business activity and order figures

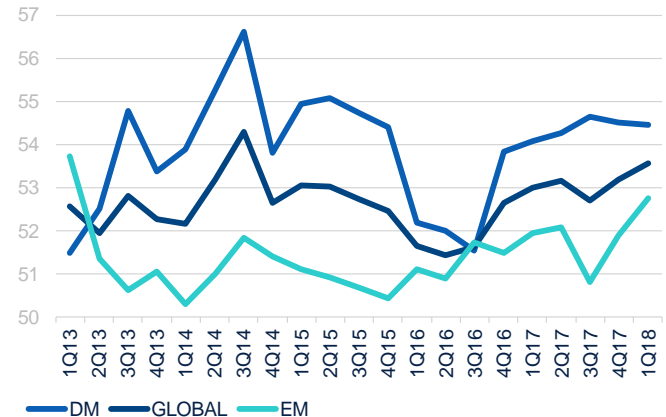
World services PMI

(Level \pm 50)



World services PMI

(Level \pm 50)

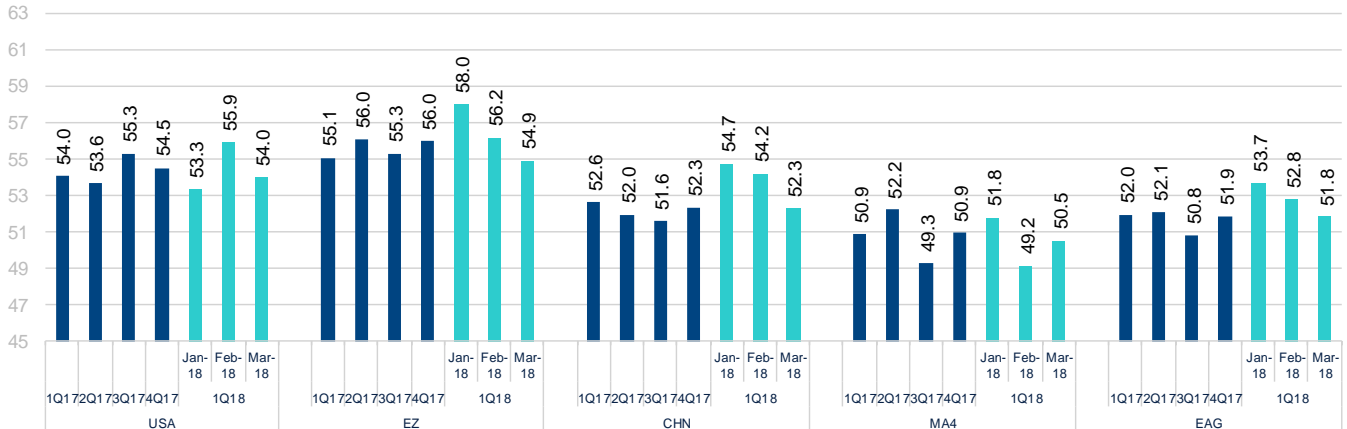


Global service sector activity expands at the slowest pace in 17 months in March, easing in most economies. Despite the relatively weak monthly figure, quarterly average remains the highest since 3Q17, and business expansion and employment keep adding additional pressure on capacity

Services PMIs receded in March in all major economies

Services PMI: Selected Regions

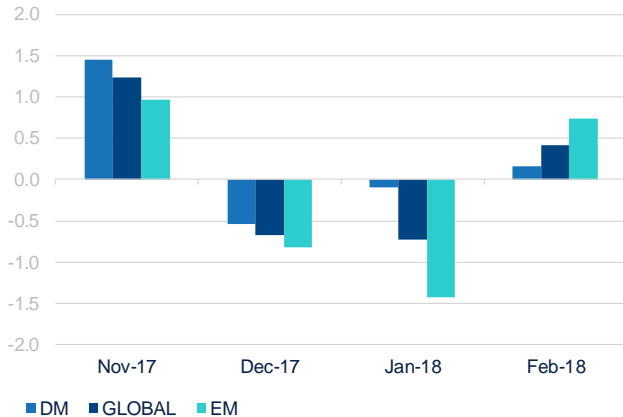
(Level \pm 50)



Sharp deceleration in the EZ since the start of the year, reflecting slowing demand but also temporary factors. US output remains strong despite a slower expansion, while CHN experiences a cooling of demand that might be related with lower tourist numbers and more restrictive credit conditions

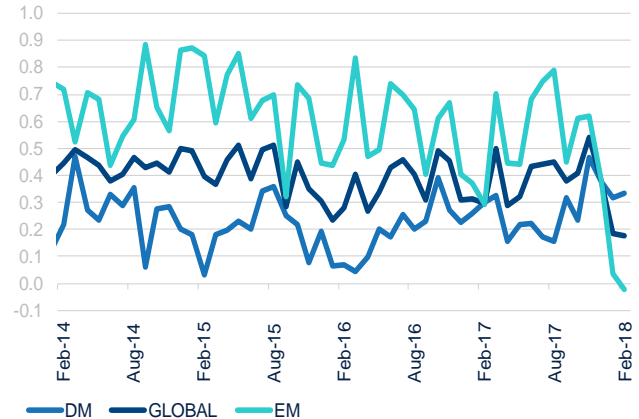
Retail sales lost some ground by year-end, but should continue to support the recovery

World retail sales (% MoM)



World retail sales

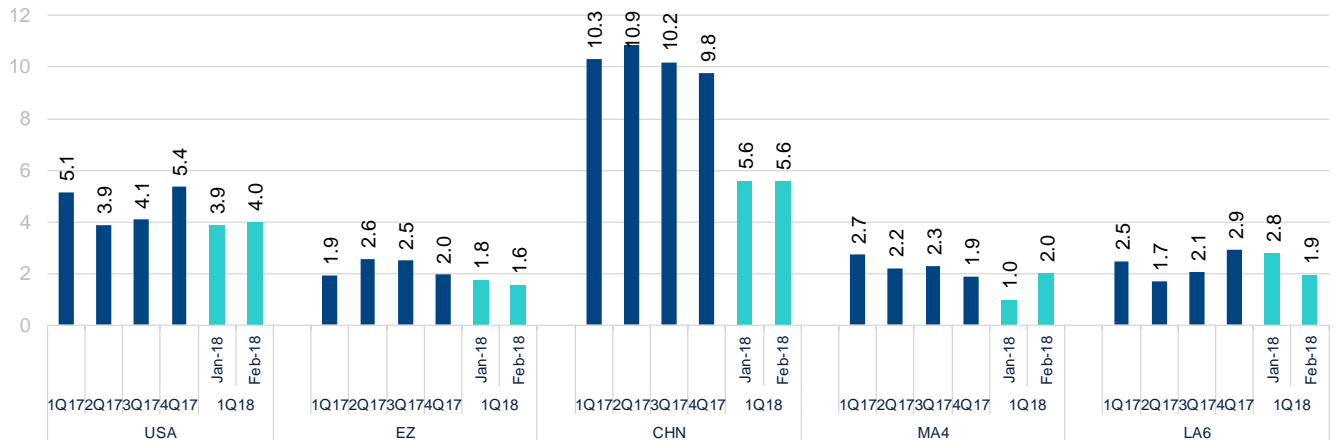
(%, MoM 6 period mov avg)



Global domestic demand decelerated by year end, suggesting a slower recovery in consumption. But other factors, including employment gains and expansionary fiscal policies, point to resilient household spending

The weakening in retail sales figures has been broad-based

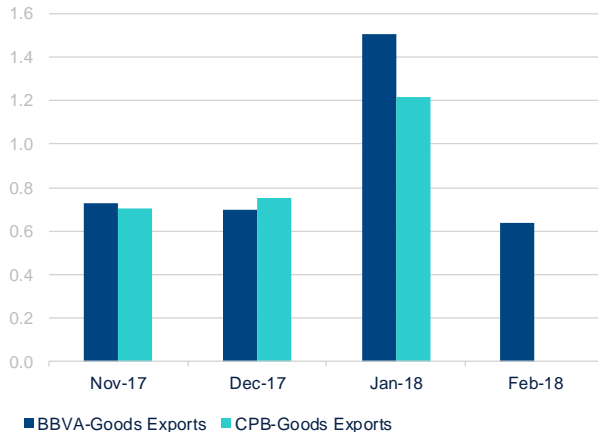
Retail sales: Selected regions (%, YoY)



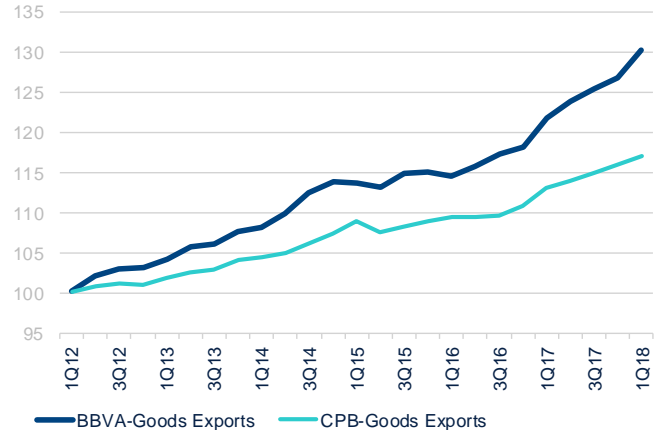
Retail sales have lost some ground in emerging economies (notably China), but is also experiencing mild contractions in EZ economies such as Germany or Italy. Figures in the US have also deteriorated during the first two months of the year, despite the announcement of tax measures and the fiscal package

Export growth remains very solid, but risks of protectionism have intensified and posing a threat to current dynamics

**World exports of goods
(growth, constant prices)**
(3-month moving average MoM%)



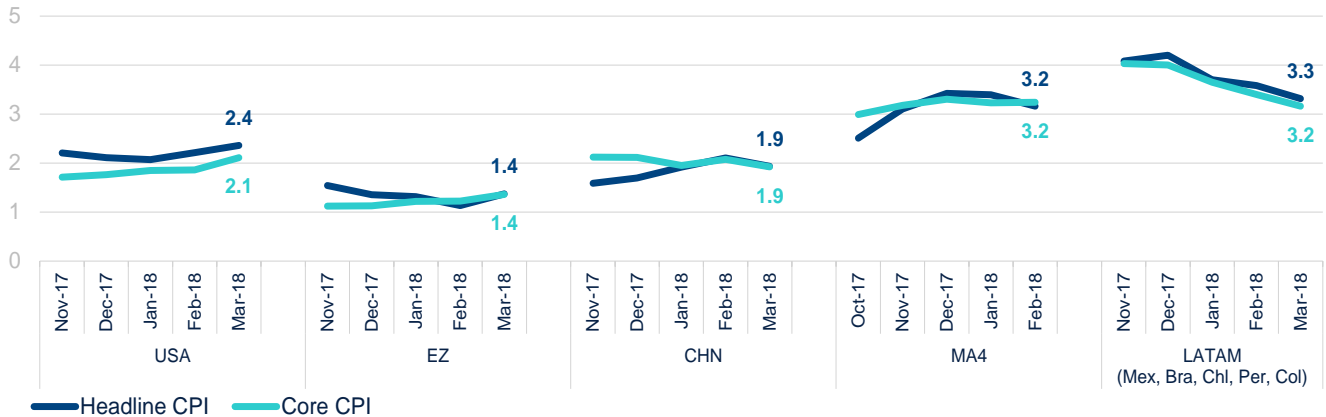
**World exports of goods
(index, constant prices)**
(Index, Jan-12=100)



Trade activity remains healthy, underpinned by the recovery of investment and the industrial sector. Exports in China and India have intensified, and emerging countries are finding support from increasing commodity prices. In Europe and the US trade remains strong, despite a contraction in EZ exports

Inflation remains low, with core inflation increasing only gradually in developed markets

Headline and core inflation: Selected regions (%, YoY)



Inflation remains contained, and has increased only gradually in advanced economies. That said, some downward forces could be disappearing, leaving room for further gradual increases, mainly in core inflation. Inflation in Latam resumes its downward trend, and approaches target in several countries



02

New projections & global risks

Global growth remains but risks intensify

01

Steady global momentum remains

Supported by the recovery of trade and investment

02

Economic policies underpin the cyclical recovery

The US fiscal stimulus can support other areas

03

Higher financial volatility

The unusual low-volatility environment is now past

04

Uncertain effect of US protectionist measures

The direct effect of approved measures is not very large, but it may presage more aggressive measures

05

Normalization of central banks' monetary policy

Somewhat faster than expected in the Fed, while the ECB has already taken its first steps

06

Global risks

Increasing in the short-run by a possible escalation of protectionist measures

Upward revision at USA and Eurozone

USA



The fiscal reform will have a positive effect on growth

The Fed will continue normalisation

Protectionism is a risk

CHINA



Headwinds from both policy and trade could moderate growth in 2018

“Two sessions” revealed a number of economic and policy targets

EUROZONE

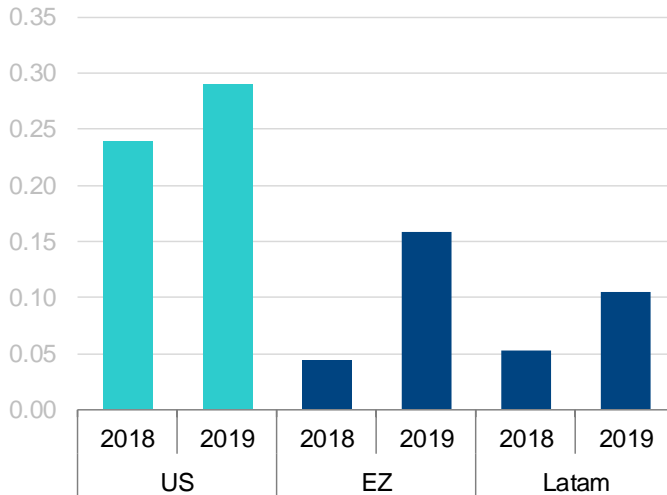


ECB is making progress on its exit from QE, but avoiding tensions

Trade and investment sustain momentum in 2018

The upward revision of US growth forecasts, due to fiscal stimulus, could add further support to the recovery in other areas

Impact of US fiscal stimulus on growth (pp)

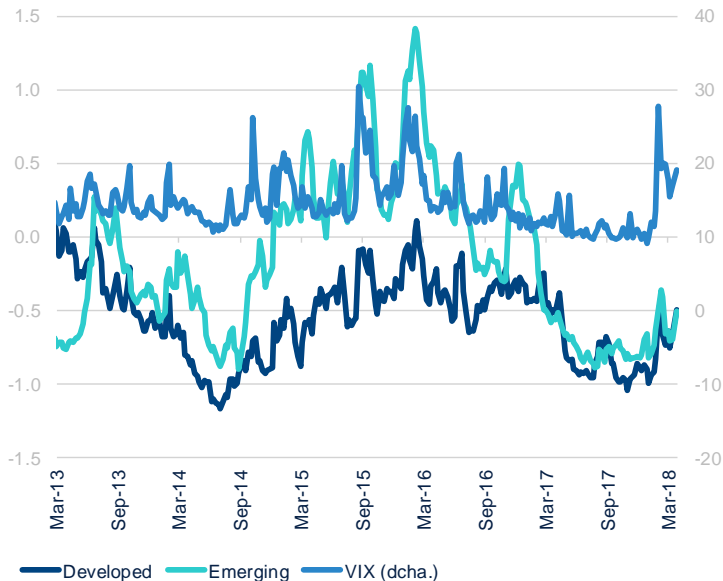


- The larger effect would be in 2019, especially in the eurozone
- This support could offset some headwinds in other areas (political uncertainty in Latam or higher global volatility)
- The weakness of the dollar could mitigate the positive impact of higher US demand

Financial tensions are beginning to reflect a less accommodating environment

VIX and BBVA Research financial tension

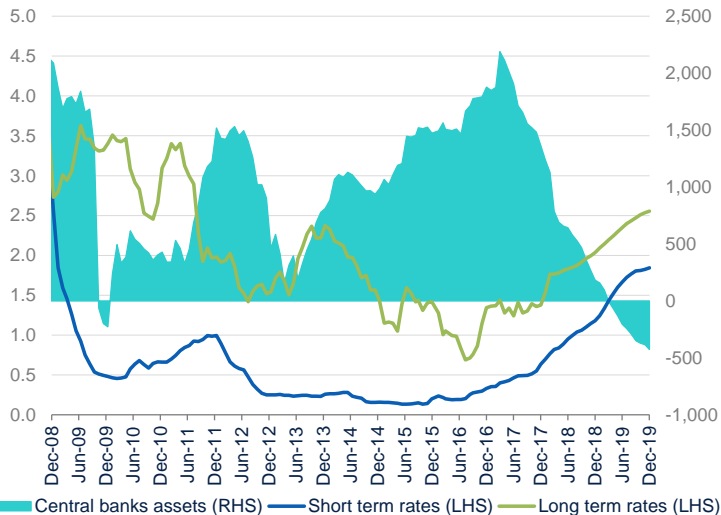
(%)



- Concerns about inflation (US) and protectionism have led to higher volatility and stock market correction
- The contagion effect is limited, but it will depend on the persistence of the current shock
- Markets are unlikely to be as complacent with uncertainty as in 2017

Financial conditions will be less accommodating

Global financial conditions* (Deviations)



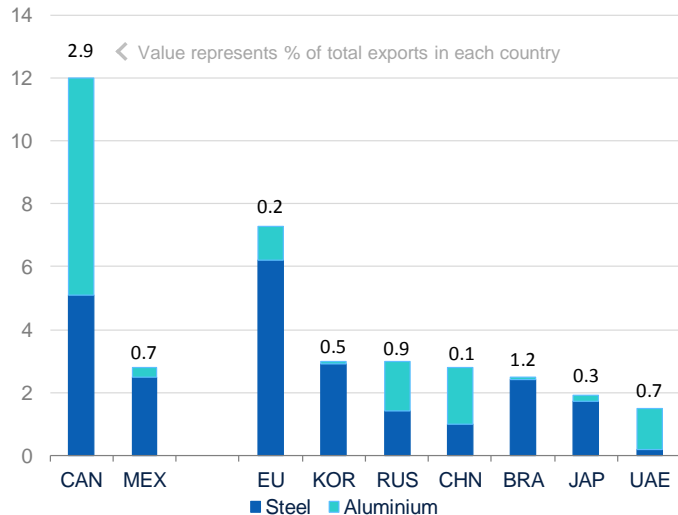
- As central banks will reduce their balance sheets and interest rates gradually increase...
- ... volatility shocks could be more frequent and persistent
- More cautious investor mood

(*) Short and long term interest rates, 3-month and 10y bond yield average for the US and Germany. Central banks balance sheet includes Fed, ECB, BoE and BoJ

The risk of protectionist escalation creates uncertainty about the global economic outlook

US imports of steel and aluminium and export share by country

(USD billions, % total exports)



- US tariffs on steel and aluminum have a small direct impact on activity:
 - They represent only a small share of total exports
 - Exemption for many countries until May
 - The greatest negative impact may come from indirect effects and possible reaction of the countries concerned

- The mutual tariff increase between the US and China (25%, 50bn USD in 2017):
 - Larger effect: 38% exports to China (3% of the total US exports) and 11% of exports to the US (2% of the total chinese exports)
 - They can only be the beginning of a major escalation

Further Fed rate hikes due to better economic outlook

US: Fed interest rate

(%s)



- Fed is likely to increase rates by further 75bp this year and 50bp in 2019
- Monetary conditions will remain accommodative, with real interest rates close to zero

ECB is making progress to QE without causing any strain

QE



The QE will end in 2018

Monthly purchases of assets (30bn EUR) up to September

Purchases withdrawal between September and December

Interest Rates



As we approach the end of QE, the **focus shifts to the rate hikes:** when and at what pace

But the **ECB will remain in debt markets:** reinvestment of maturities

The **challenge** for the ECB is to **manage the interest rate expectations** (*forward guidance*)

Key points in crisis exit:



Long rates and risk premiums

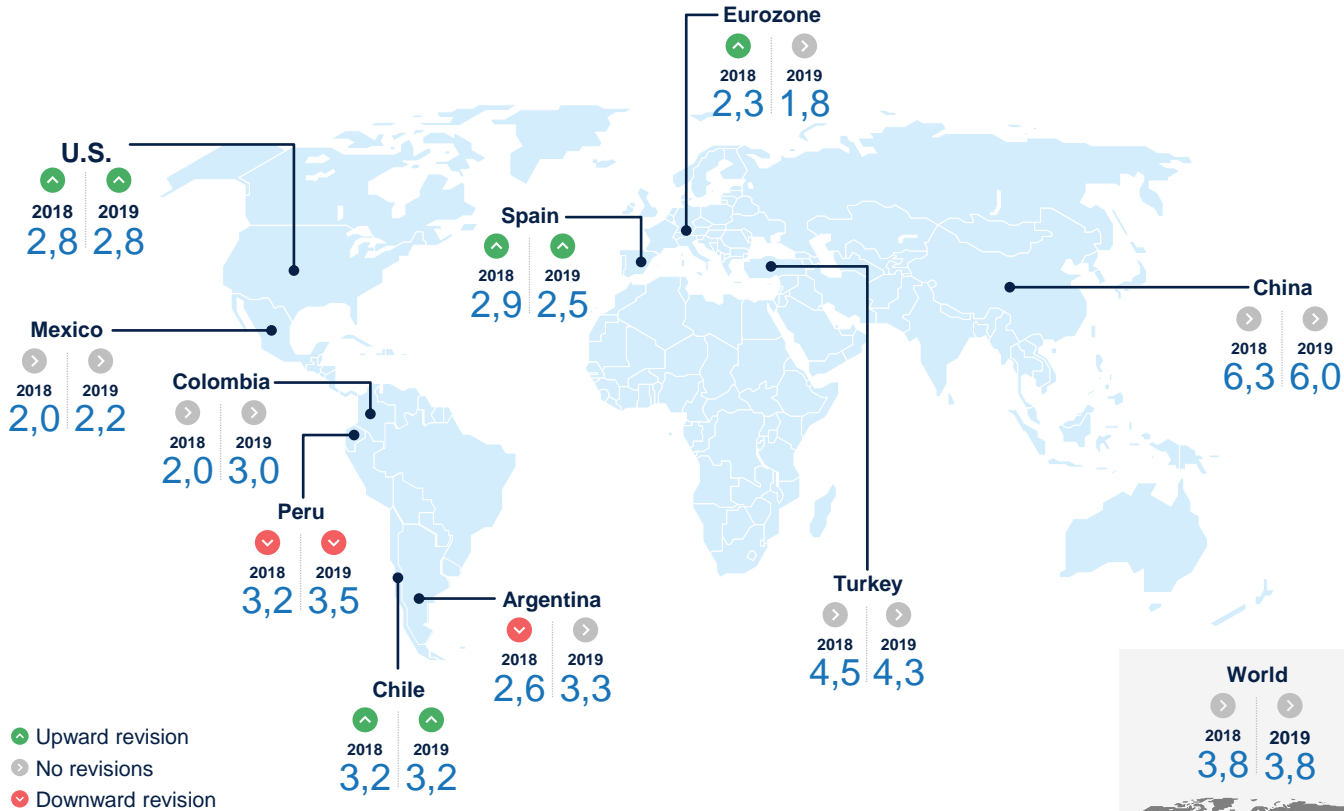


Exchange Rate (€)



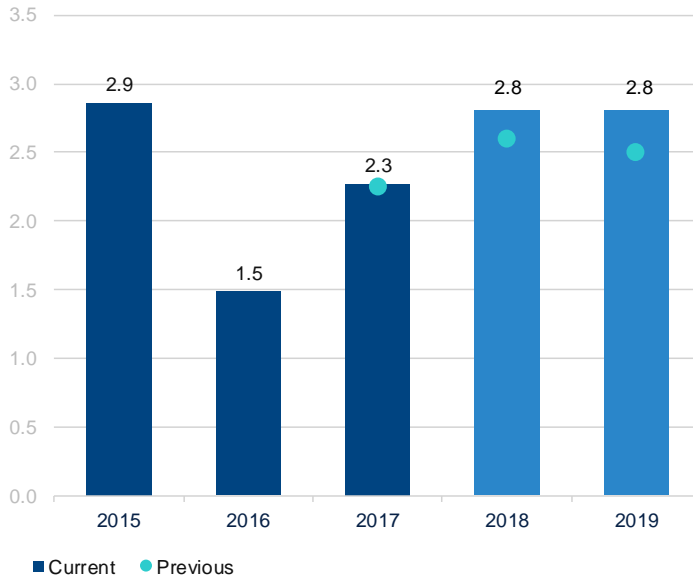
Rate increase expectations

Upward GDP growth forecasts in the US and other areas



US: Higher growth on new budget deal

US: GDP growth (YoY, %)

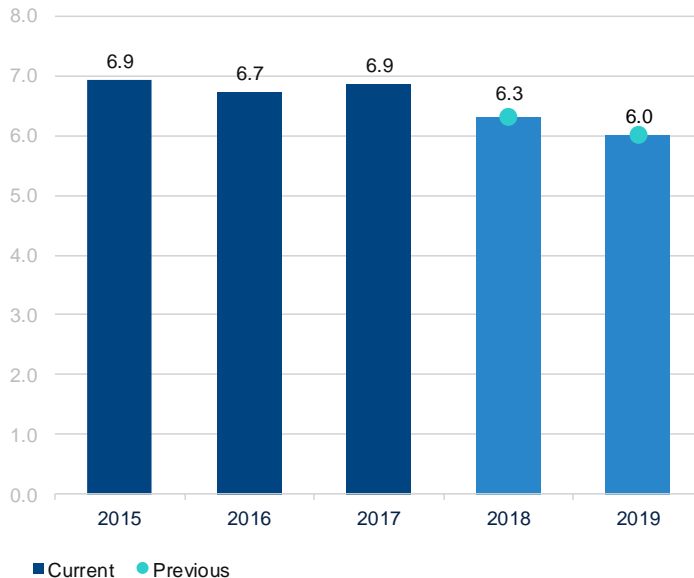


Source: BEA and BBVA Research

- Moderate impact of the new fiscal stimulus in the short term as the economy approached full employment without measures to support a significant increase in potential growth
- The favourable global environment and strong domestic demand complement the positive impact of higher public spending (upward revision 0.2 and 0.3pp in 2018-19)
- Inflation is likely to temporarily exceed the Fed's target, but will remain contained

China: Growth holds well while policy uncertainty abates

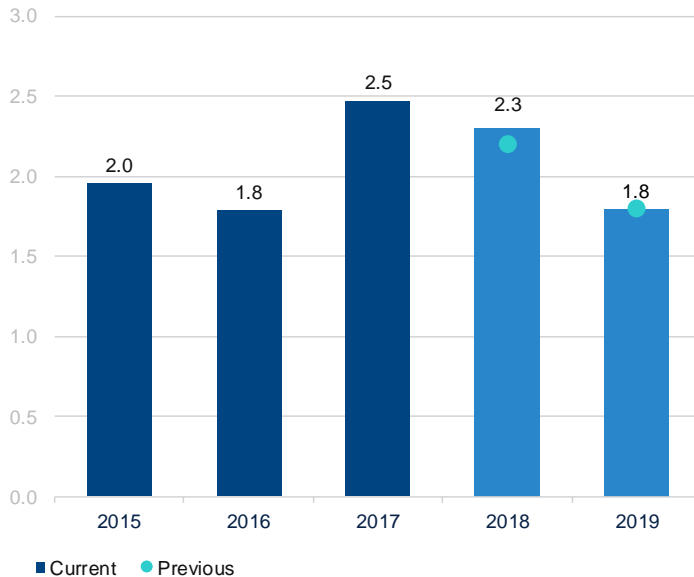
China: GDP growth (YoY, %)



- The strength of credit and exports allowed the economy to stabilize in 1Q18
- Forecast unchanged: growth moderation in 2018 due to more prudent economic policy
- Increasing probability of implementing structural reforms in the medium term and addressing financial vulnerabilities
- Increasing protectionism threatens the sustainability of exports

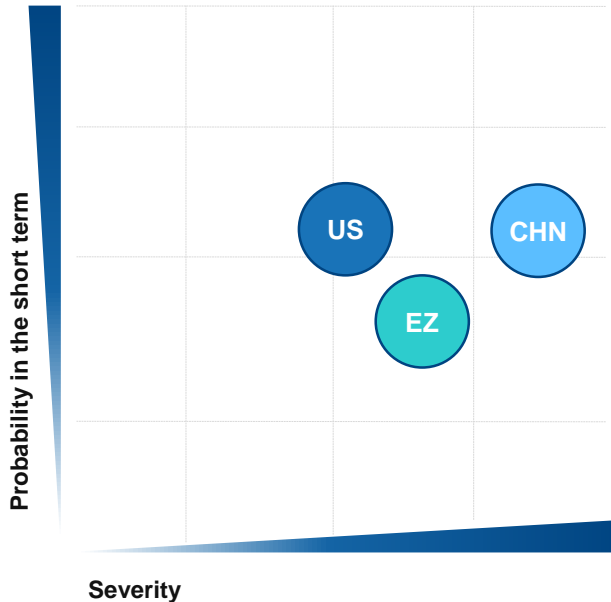
Eurozone: Small upward revision for 2018 despite recent softer data

Eurozone: GDP growth (YoY, %)



- Stronger exports, supported by increased global demand, help maintain momentum in 2018
- Lower domestic demand contribution, although domestic fundamentals remain strong
- Core inflation will continue to rise gradually, but clearly below 2%.
- Recovery is widespread in most countries, but the problem of low potential growth persists

Global risks: Turning again towards the US. The protectionism threat (with potential global range) joins to the Fed's exit risk



CHINA

- **Deleveraging risk more contained in the short term**, coexisting with a slower than expected GDP moderation
- **Potential negative outcome derived from increased protectionist rhetoric**

US

- **Protectionism risk increases after recent measures**
- **Political controversy risk despite fiscal stimulus**
- **Signs of overvaluation in certain assets**
- **Fed exit risks**: tighter monetary policy in response to a transitory spike in inflation (without demand support). Risk of sell-off in bonds

EUROZONE

- **Political concerns increase following Italian elections outcome**
 - **Italy**: uncertainty on the Government formation, and risk of a populist / heterodox government contrarian to European project
 - **Brexit**: uncertainty on negotiations outcome
- **ECB's exit risk is low**, but will require monitoring the risk of a faster normalization

Macroeconomic forecast

Gross domestic product

(YoY average, %)

Apr-18				
	2016	2017	2018	2019
United States	1.5	2.3	2.8	2.8
Eurozone	1.8	2.5	2.3	1.8
Spain	3.3	3.1	2.9	2.5
Latam *	-1.0	1.1	1.4	2.5
Argentina	-1.8	2.9	2.6	3.3
Brazil	-3.5	1.0	2.1	3.0
Chile	1.6	1.6	3.2	3.2
Colombia	2.0	1.8	2.0	3.0
Mexico	2.9	2.0	2.0	2.2
Peru	4.0	2.5	3.2	3.5
Eagles **	5.3	5.4	5.4	5.5
Turkey	3.2	7.4	4.5	4.3
Emerging Asia	6.7	6.5	6.3	6.3
China	6.7	6.9	6.3	6.0
World	3.3	3.7	3.8	3.8

Inflation

(YoY average, %)

Apr-18				
	2016	2017	2018	2019
United States	1.3	2.1	2.7	2.7
Eurozone	0.2	1.5	1.5	1.6
Spain	-0.2	2.0	1.5	1.6
Latam *	9.9	6.7	5.8	5.1
Argentina	40.4	26.1	23.7	15.1
Brazil	8.8	3.5	3.3	4.5
Chile	3.8	2.2	2.2	3.0
Colombia	7.5	4.3	3.2	2.7
Mexico	2.8	6.0	4.6	3.6
Peru	3.6	2.8	1.3	2.2
Eagles **	4.4	4.1	4.3	4.2
Turkey	7.8	11.1	9.5	8.2
Emerging Asia	2.8	2.3	2.9	3.2
China	2.0	1.6	2.3	2.5
World	3.2	3.3	3.6	3.4

(*) Includes Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela in the GDP composite. Excludes Venezuela from inflation composite.

(**) Bangladesh, Brazil, China, Egypt, India, Indonesia, Iran, Malaysia, Mexico, Nigeria, Pakistan, Philippines, Russia, Turkey and Vietnam.

Source: BBVA Research and IMF

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