Global Economic Watch

July 2018

Creando Oportunidades

Steady global growth, but risks intensify

- Our BBVA-GAIN model projects that global growth could remain slightly above 1% in 2Q18, but points to a slight moderation (0.98% in 3Q18) looking forward. Growth will remain supported by trade and investment, while private consumption loses some steam.
- Hard data remains solid, but with differences across areas. Confidence improves in the services sector and stabilizes in manufacturing, but leading components are moderating.
- We maintain our forecasts for global growth at 3.8% for the period 2018-19, but with some changes in projections by area that reflect a less synchronized growth:
  - In the US, we maintain our projections at 2.8% for both 2018 and 2019 as the impulse from the fiscal stimulus counteracts some domestic and external imbalances.
  - The EZ economy has shifted faster-than-expected to a more moderate growth regime as uncertainty and higher oil prices weigh on activity. We thus revise our projections for 2018 by -0.3pp to 2% and 2019 by -0.1pp to +1.7%.
  - We continue to expect a gradual slowdown in China, and project its GDP to grow by 6.3% in 2018 and 6.0% in 2019 (unchanged).
- Downward risks have increased over the last quarter, mainly related to political uncertainty, vulnerabilities in emerging economies and, above all, trade protectionism.

BBVA Research

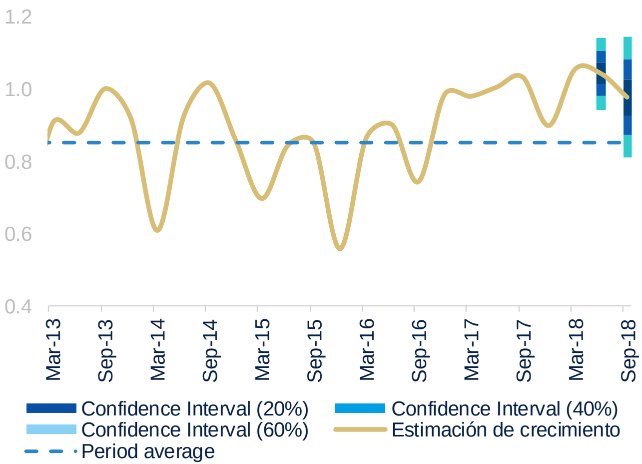
Outline

01

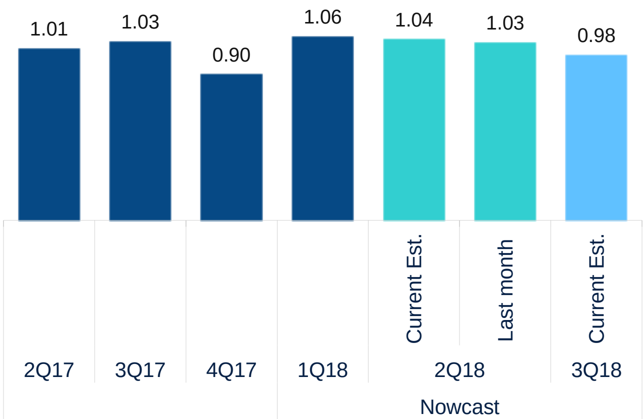
Short term indicators

Global GDP growth remains resilient in 1H18, but is showing signs of a slight moderation going forward

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



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

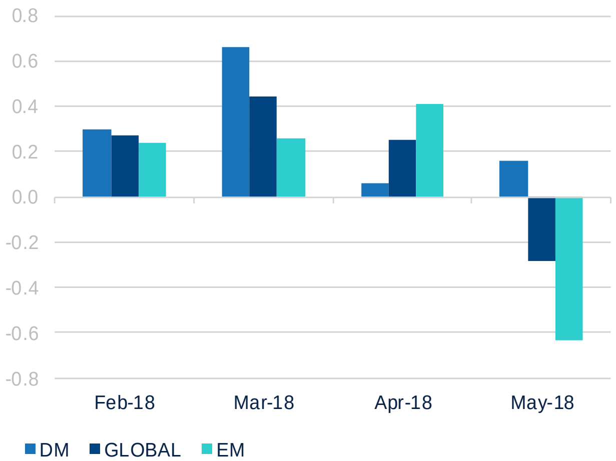


Our BBVA-GAIN indicator estimates that global growth could remain slightly above 1% in 2Q18 (after 1.05% in 1Q18) before decelerating to around 0.98% in 3Q18. The recovery remains solid and supported by trade and investment. Private consumption has lost some ground as financial conditions tighten and risks mount in different regions.

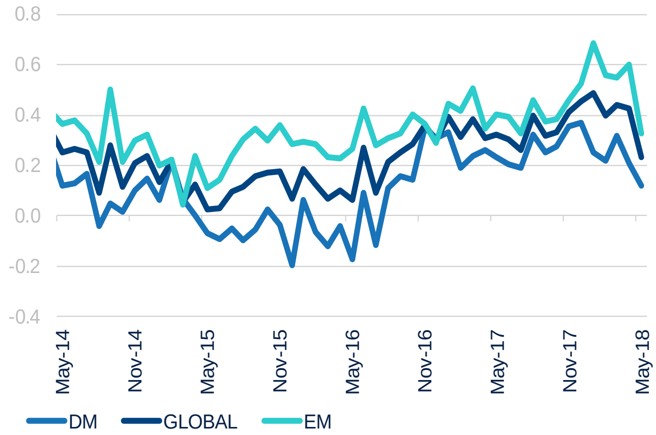
Source: BBVA Research and National Sources

The industrial recovery continues, but is moderating after the rebound in early year

World industrial production
(%, MoM)



World industrial production
(%, 6-month moving average)



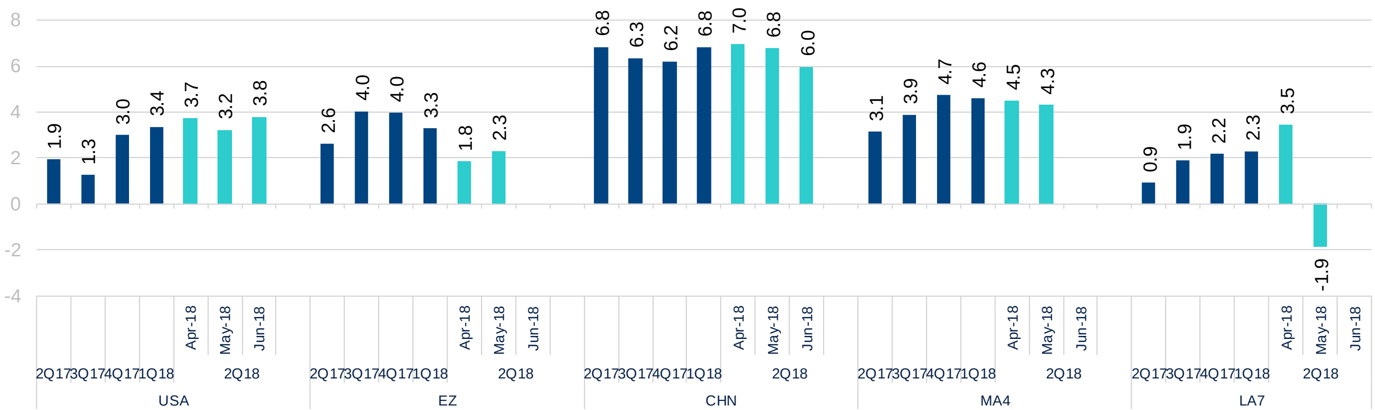
Figures by country are still limited in June, but suggest some recovery from disappointing figures in May. Beyond volatility, the industrial recovery is likely to return to a more moderate growth during the second half of the year.

Source: BBVA Research and National Sources

Industrial production recorded a minor uptick in Europe and dropped in Latin America due to transport strikes in Brazil

World industrial production: Selected regions

(%, YoY)

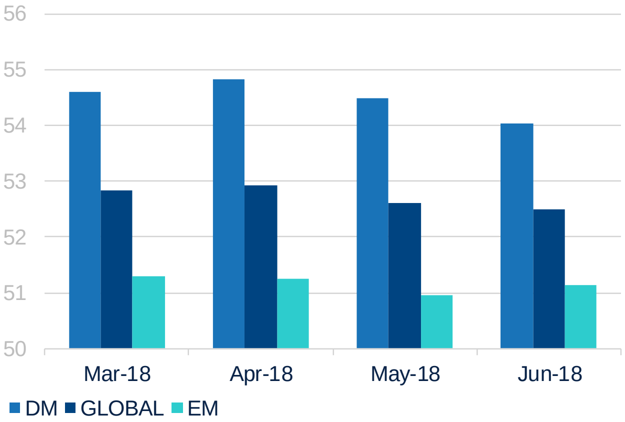


In advanced economies, industrial recovery has slowed in recent months but shows some signs of stabilization. Industrial output in Latin America has dropped due to strikes of truck drivers in Brazil, but is expected to recover reflecting stronger production in commodity export countries.

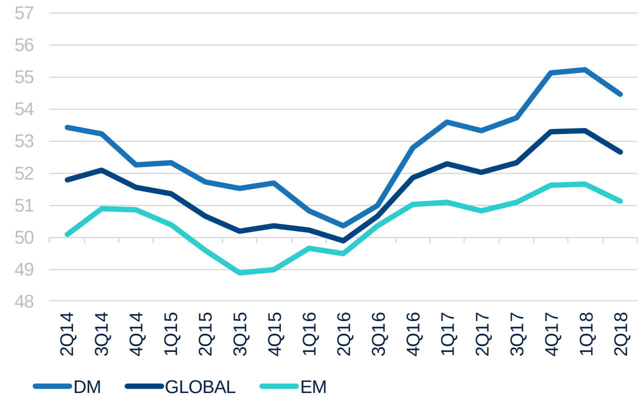
Source: BBVA Research and National Sources

Manufacturing sentiment registers a further broad-based moderation, but remains at expansionary territory

World manufacturing PMI
(Level ± 50)



World manufacturing PMI
(Level ± 50)



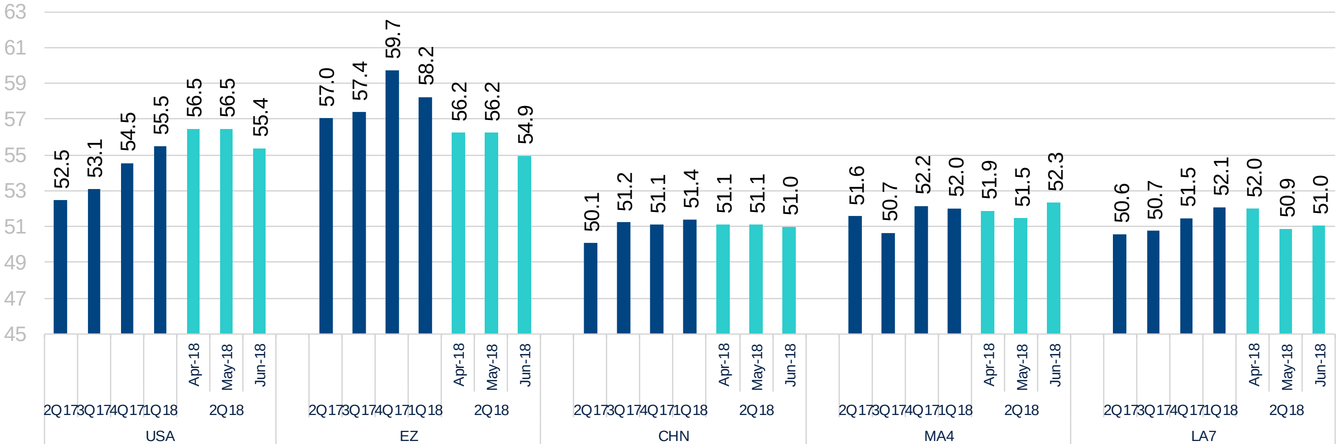
June manufacturing PMIs dropped again in June as uncertainty surrounding trade negotiations takes its toll on business confidence. Job creation has accelerated for the first time so far this year in response to supply-side constraints, and input costs reach the highest value in the past seven years.

Source: BBVA Research and Markit Economics

The gradual softening in manufacturing PMIs hits in particular advanced economies, but confidence remains resilient in EM

Manufacturing PMI: Selected regions

(Level ± 50)

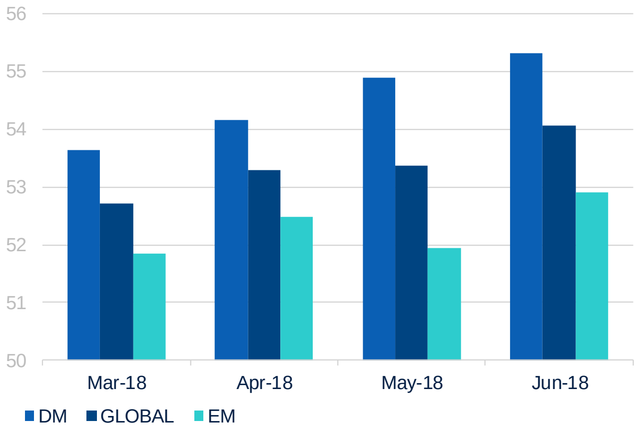


Confidence in the manufacturing sector loses momentum in June as production and new orders show lower readings across the main regions. Survey respondents' fears about tariff escalations is also broadly shared and has an impact on business confidence.

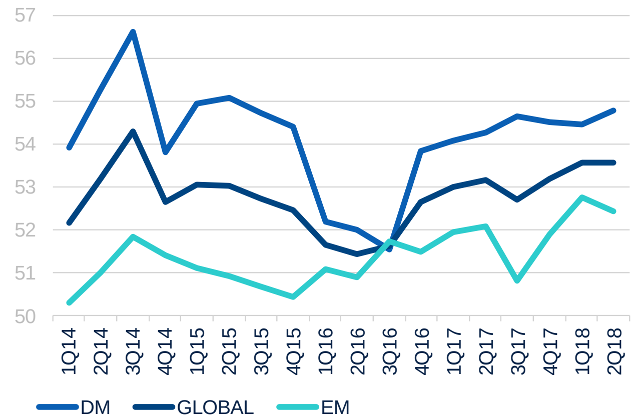
Source: BBVA Research and Markit Economics

Services PMIs accelerate in June for the fourth consecutive month and reach their highest value in more than three years

World services PMI
(Level ± 50)



World services PMI
(Level ± 50)



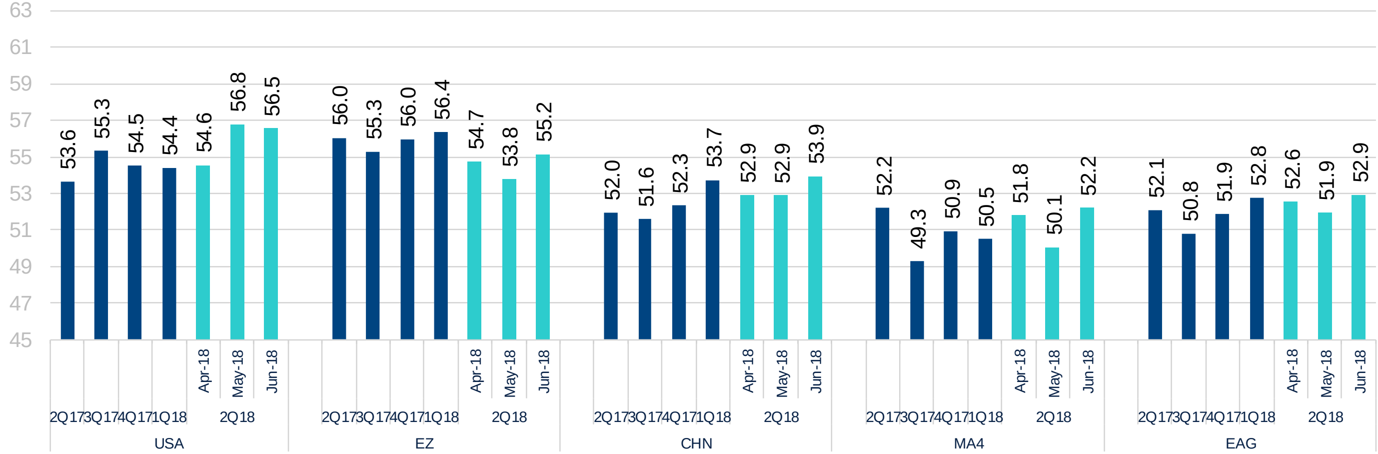
Global service sector sentiment improves further in most countries reflecting robust domestic demand conditions. Staffing levels were exceptionally high in response to a greater flow of new orders, and price pressures were again evident due to increased backlogs of work and delivery times.

Source: BBVA Research and Markit Economics

Improving services PMIs across countries point to a robust domestic demand

Services PMI: Selected Regions

(Level ± 50)

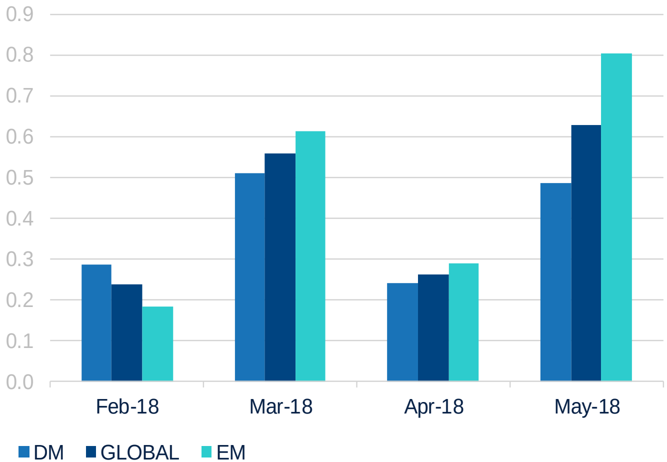


Survey data for June remains exceptionally high in several regions and reflects a solid activity in the services sector. Several countries in the EZ have reported better readings, while the US keeps benefitting from a supportive business environment.

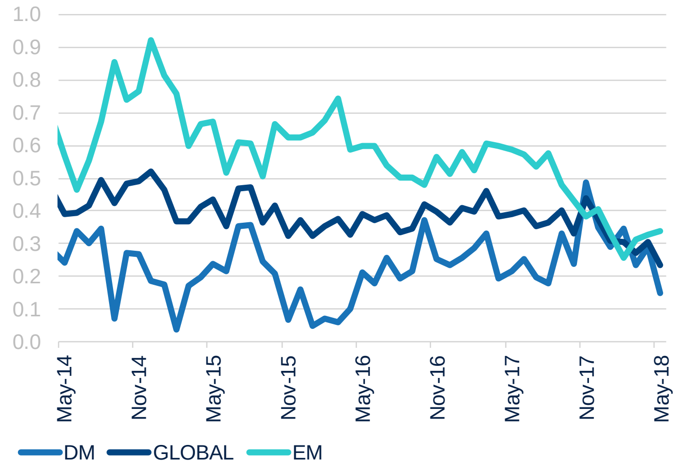
Source: BBVA Research and Markit Economics

Retail sales have strengthened in recent months, but fail to revert to the solid growth observed over last year

World retail sales
(% MoM)



World retail sales
(%, MoM 6 period mov avg)

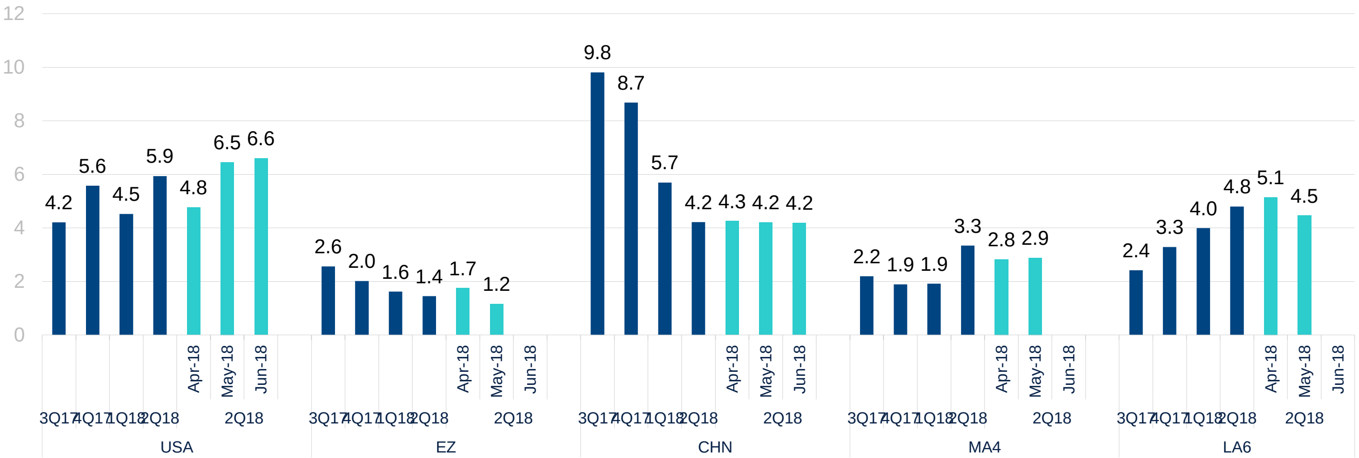


Retail sales maintain a slow trend deceleration as inflationary pressures weigh on household spending. However, the mood of consumers appears to have improved slightly in 2Q18 in emerging Asia, benefiting from an ongoing cyclical recovery and credit expansion.

Source: BBVA Research and National Sources

Retail sales point to a significant rebound in consumption in the US, but moderate in both the Eurozone and China

Retail sales: Selected regions
(%, YoY)

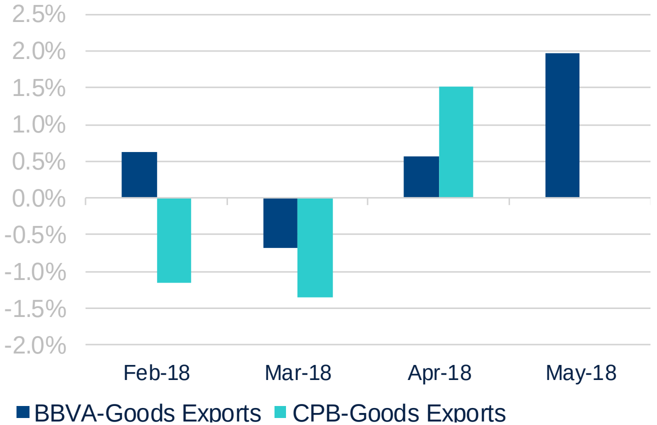


In Europe, retail consumption keeps subdued despite ongoing improvements in the labour market, low core inflation and early signs of wage growth. The US market becomes increasingly buoyant and Chinese consumers become less prone to spend in a context of credit deleveraging and financial tightening.

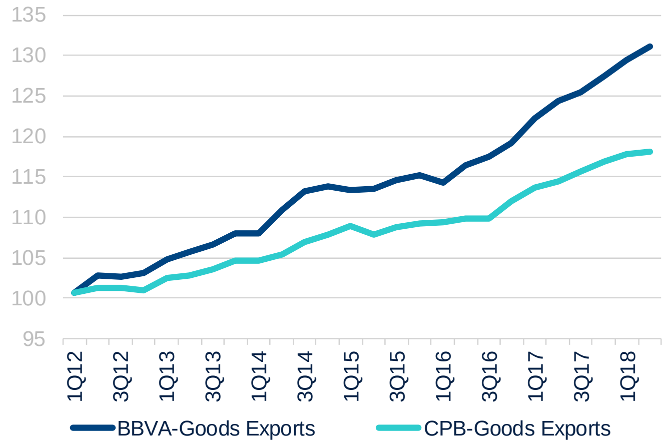
Source: BBVA Research and National Sources

Global trade remains very dynamic, and does not capture yet negative any effects derived from protectionist measures

World exports of goods (growth, constant prices)
(MoM%)



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



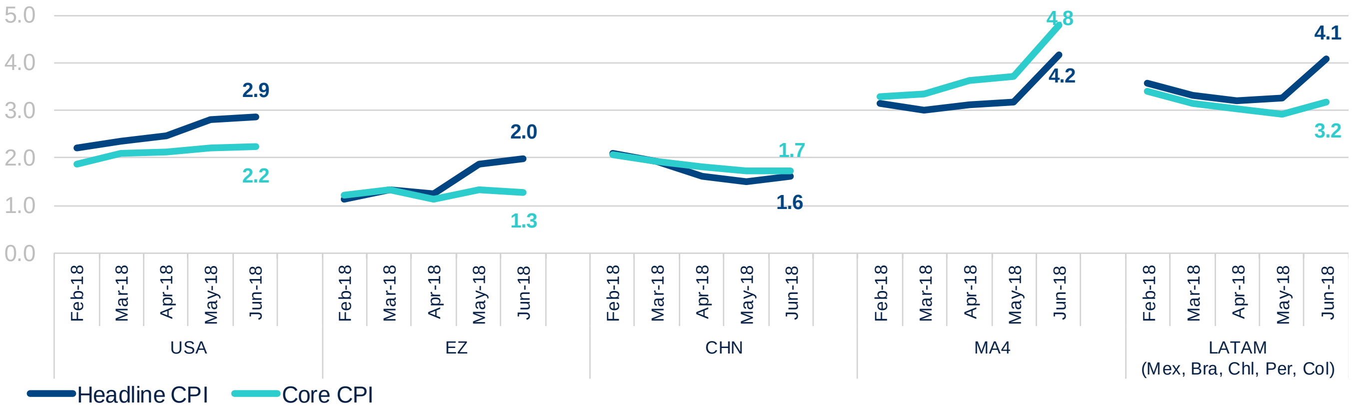
Global trade remained very dynamic in May and kept fuelling the economy despite the negative signals observed in survey indicators. The protectionist rhetoric has however increased and the first tariffs have entered into force, increasing the probability of a full-blown trade war.

Source: BBVA Research and National Sources

Inflation has risen markedly due to energy prices, but core inflation continues to increase only gradually in the large areas

Headline and core inflation: Selected regions

(%, YoY)



Headline inflation figures have increased in both developed and emerging economies reflecting the acceleration of energy prices, and will presumably remain above target in the US in the short term. Core inflation has increased slightly in the US and the EZ to a lesser extent, in contrast with the rebound in some EMs due to pass-through effects from currency depreciation.

Source: BBVA Research and National Sources

02

New projections and global risks

Global growth remains but risks intensify

01

Steady global expansion, but less synchronized

Growth is strong in the US due to fiscal stimulus, and stable in China, but slowing in Europe

02

Increasing protectionism

The impact on growth is still limited, but it could be larger if the announced measures were implemented and spread via confidence or financial channels

03

Higher oil prices

Upward pressures on inflation add a brake on growth in oil importing countries

04

Monetary normalization at different speed in the Fed and the ECB

Strengthening the dollar and tightening global financial conditions

05

More volatility in emerging markets

Higher financial tensions due to the increase in funding costs and protectionist threats

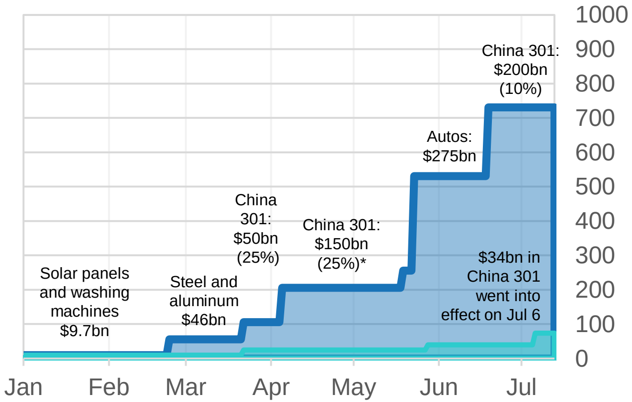
06

Global risks intensify

The possibility of a trade war comes together with higher risks in emerging economies and in Europe

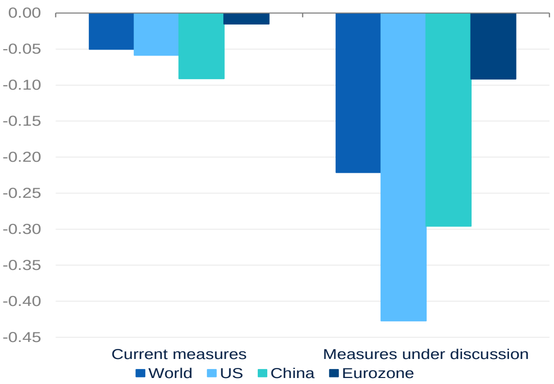
Limited effect of approved tariff increases, but significant if those discussed are implemented (automotive sector)

US import tariffs applied vs. announced
(volume under threat of new tariffs, $bn)



*Tariff increase was reduced to 10% after Trump announced additional $200bn on Jun 18

Effect of US tariff increases and other countries' responses on GDP growth
(2018-19, pp)



Current measures: 25% tariff increase on steel, 10% on aluminum and 25% on Chinese imports worth $50bn; **Under discussion:** up to 20% tariff increase on cars and on Chinese imports worth $200bn

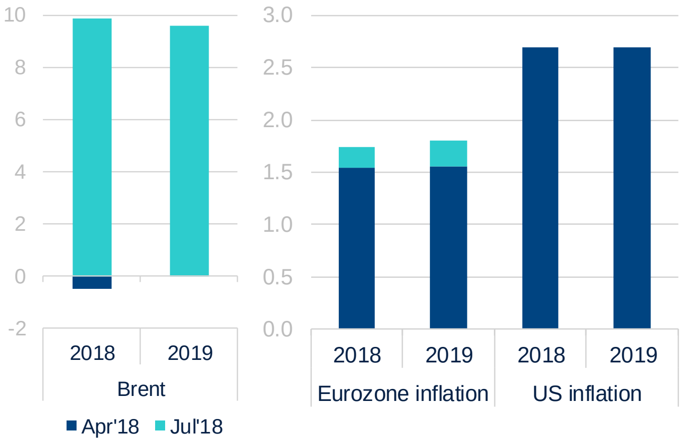
Global GDP growth could be reduced by around 0.2pp due to the trade channel if announced measures were fully implemented. Indirect effects via confidence and financial channels could emerge in 2H18. If protectionism escalated, the negative effects would also be significant in the US, and to a lesser extent in Europe, differing by country (mainly Germany and Eastern countries).

Source: BBVA Research and National Sources

The rise in the price of oil will push inflation upward and could weigh on growth

Upward revision in oil prices and inflation

(%)



- The oil price increase is mainly due to a drop in supply, and it will remain relatively stable in 2018 and 2019
- Higher inflation in the eurozone but below target, while core inflation will gradually increase from very low levels
- In the US the impact will be lower, but inflation will remain above the target in 2018-19
- The exit strategy of the Fed and the ECB is reinforced

Source: BBVA Research

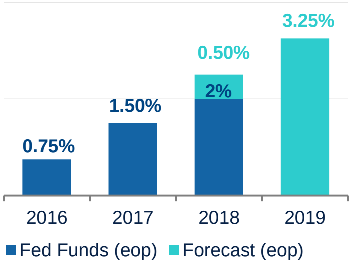
The Fed and the ECB return to conventional monetary policies at different paces

Balance

Interest rates

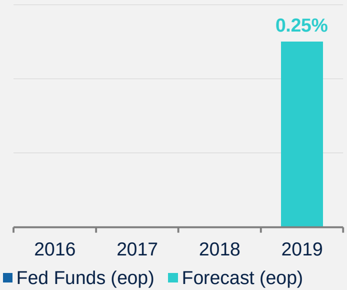
- Reduction by USD450bn in 2018

- Rate hikes accelerate in 2018



- Gradual end of the QE, between Sep-Dec 2018

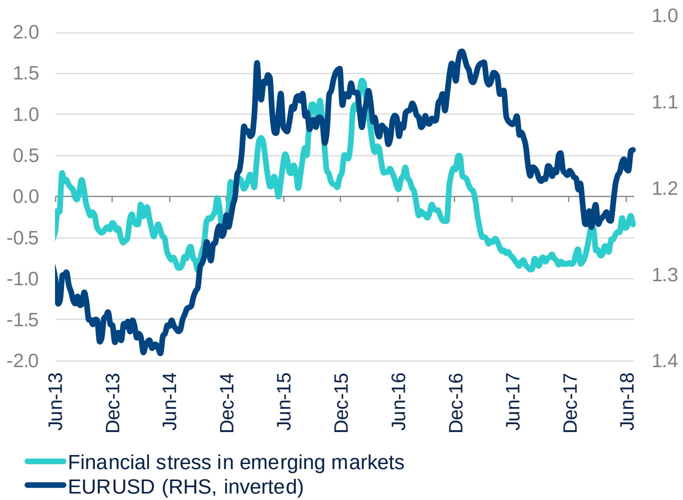
- Rate hikes delayed until September 2019



Source: BBVA Research

The strength of the dollar and higher interest rates lead to an adjustment in emerging markets

EURUSD and BBVA index of financial stress in emerging markets

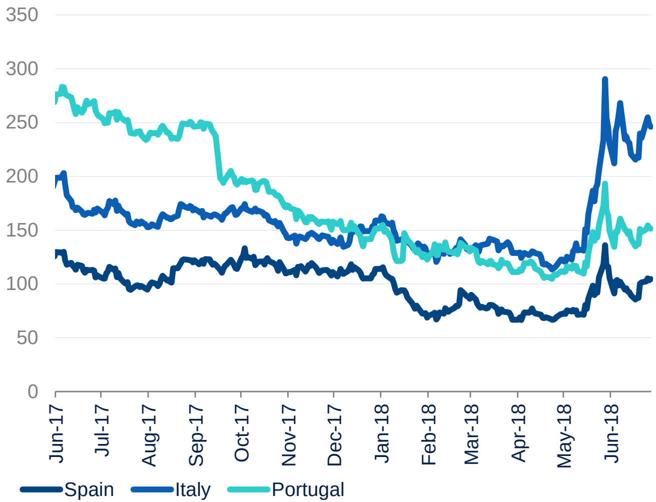


- The most vulnerable countries are those with the largest trade deficits and the largest external financial needs
- A move towards a tightening of monetary policy in emerging markets (exc. China) to avoid further depreciation of their currencies
- Increasing financial tensions also reflect the intensification in the trade dispute

Source: BBVA Research

Political uncertainty in Italy and Germany weakens the euro and widens peripheral risk premia

Risk premia in Italy, Spain and Portugal
(%)

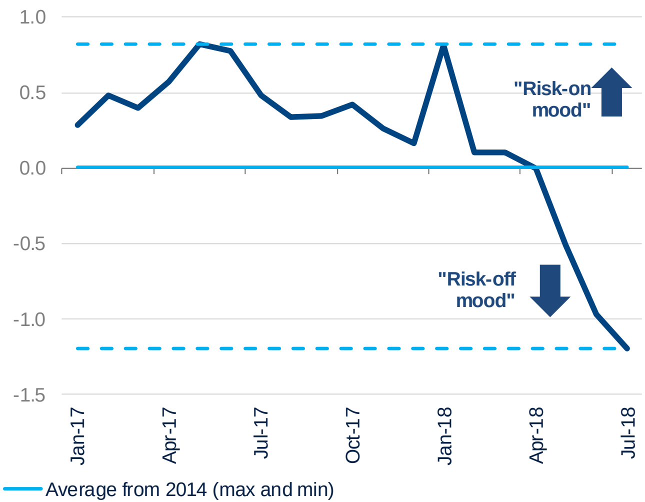


- The resurgence of risk on the periphery is mainly linked to political uncertainty in Italy, with negative effects on progress in European integration
- Despite the significant increase in the Italian risk premia, there was moderate spread to the rest of the periphery
- However, this episode had global repercussions, with refuge effects on German and US bonds and a strong depreciation of the euro

Source: BBVA Research

Protectionism and political factors lead to growing risk aversion

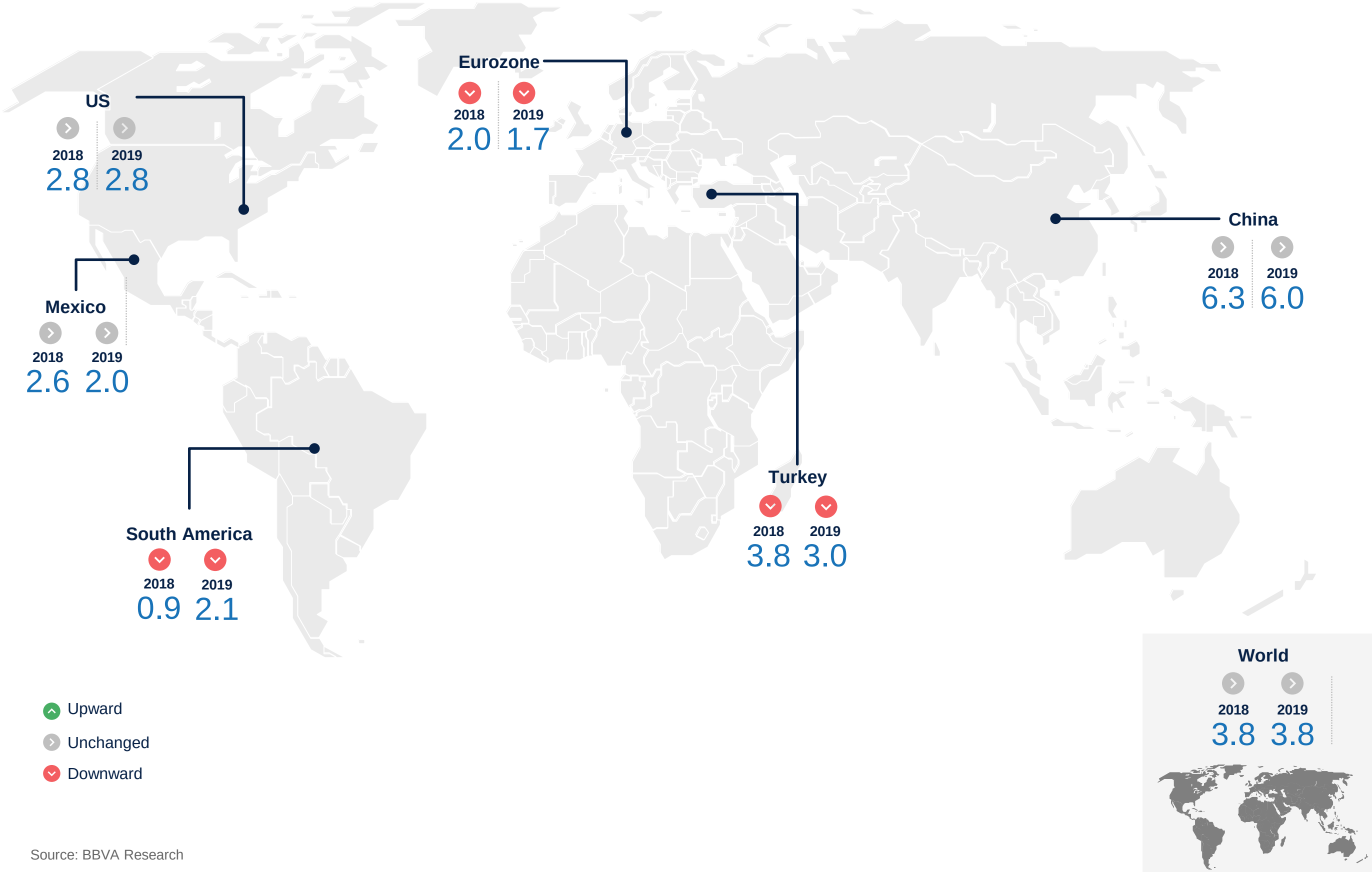
Index of risk-on/risk-off mood



- Investors sentiment has shifted from a regime of risk-taking (and even some complacency) to one of risk aversion
- The change is causing a rotation of flows between assets: from emerging to developed markets, and from equities to bonds
- Trade tensions can lead to an environment of flight towards quality

Source: BBVA Research

GDP growth projections: Steady growth in the US, but slowdown in other areas

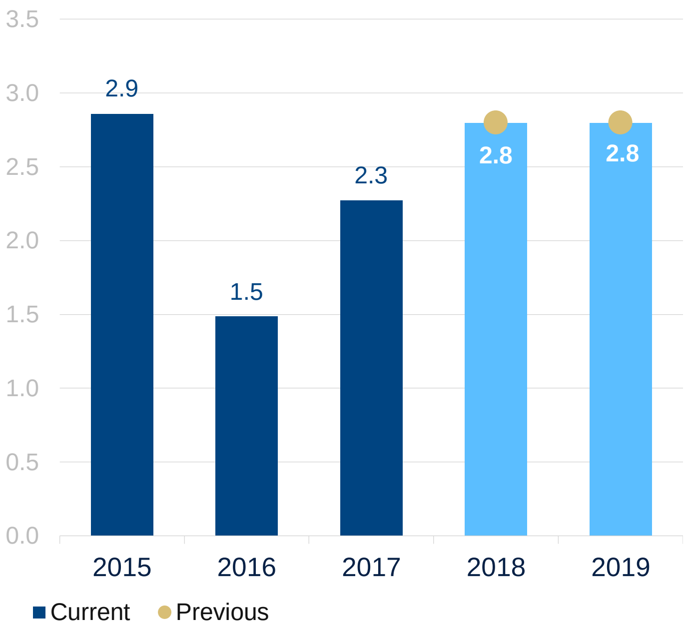


Upward
Unchanged
Downward

Source: BBVA Research

US: Growth supported by fiscal stimulus, but entering the final stage of expansion

US: GDP growth
(%)

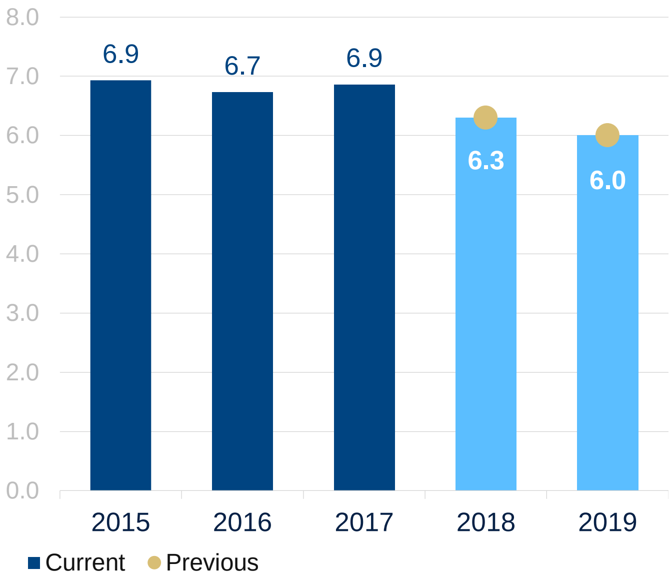


Source: BBVA Research

- Growth accelerated in 1H18, supported by fiscal stimulus and the improvement of the labour market
- Trade tensions could weigh on production and global demand
- The absorption of idle capacity anticipates the final stage of expansion
- Inflation will temporarily exceed the Fed’s target due to higher energy prices, but inflation expectations remain anchored

China: Mild growth moderation thanks to more stimulus

China: GDP growth
(%)

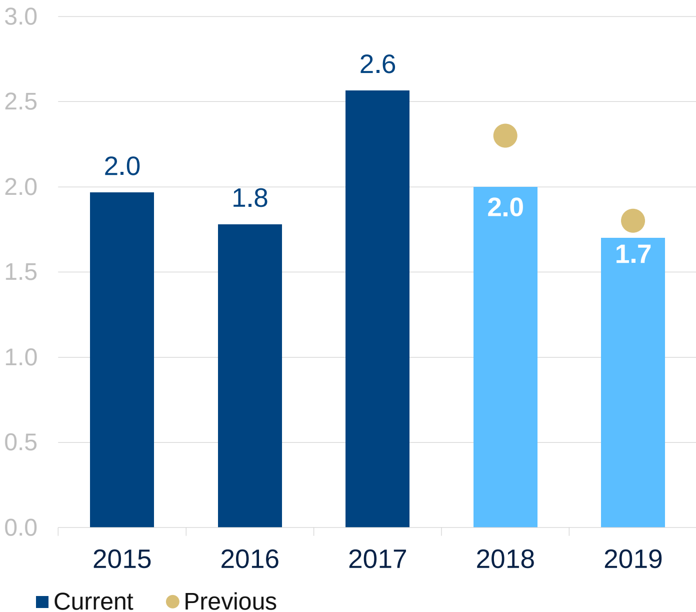


- Growth moderation will continue in 2H18, although data so far are somewhat more positive than expected
- Policies to address financial vulnerabilities remain in place, but mitigated by fiscal and monetary stimulus to sustain growth
- Protectionism threatens the sustainability of exports, as well as the restructuring of the economy

Source: BBVA Research

Eurozone: Rapid transition towards more moderate growth, but above potential

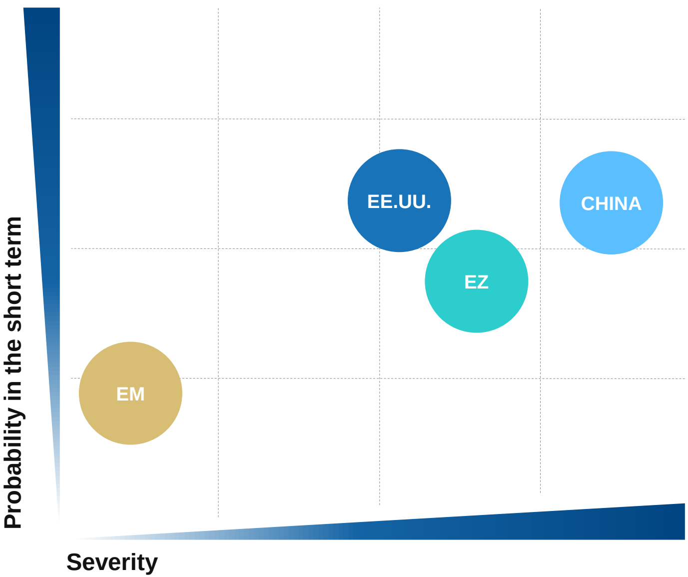
Eurozone: GDP growth
(%)



Source: BBVA Research

- Increasing uncertainty and higher oil prices are weighing on activity, but domestic demand remains strong
- The depreciation of the euro and global demand will continue to support exports
- Somewhat more accommodative policies: lower interest rates for longer and fiscal loosening in some countries
- Despite the rebound of inflation in the short-run, core inflation will only increase gradually, especially in 2019

Global risks: The most important one is the trade war, but also those associated with emerging economies and Europe



CHINA

- Deleveraging risk: more contained in the short-run
- Protectionism: increasing (retaliation) and potential hurdle to domestic deleveraging (easing credit conditions)

US

- Protectionism: increasing
- Fed's exit: still high. Tighter monetary policy due to a transitory spike in inflation.
- Signs of overvaluation in some assets

EUROZONE

- Political uncertainty: increasing, mainly in Italy. *Brexit*: risk of an abrupt exit
- Protectionism: increasing, focus on automotive sector
- ECB exit: falling after the announced delay in rates normalization

EMERGING MARKETS

- Increasing. Global risks and domestic vulnerabilities in some countries increase the risk of systemic crisis

Source: BBVA Research

Macroeconomic forecast

Gross domestic product
(YoY average, %)

Jul-18	2016	2017	2018	2019
United States	1.5	2.3	2.8	2.8
Eurozone	1.8	2.6	2.0	1.7
Spain	3.3	3.1	2.9	2.5
Latam*	-1.0	1.2	1.4	2.1
Argentina	-1.8	2.9	0.5	1.5
Brazil	-3.5	1.0	1.6	2.4
Chile	1.3	1.5	3.2	3.2
Colombia	2.0	1.8	2.6	3.3
Mexico	2.6	2.3	2.6	2.0
Peru	4.0	2.5	3.6	3.9
Eagles **	5.2	5.5	5.4	5.3
Turkey	3.2	7.4	3.8	3.0
Emerging Asia	6.7	6.5	6.4	6.3
China	6.7	6.9	6.3	6.0
World	3.3	3.8	3.8	3.8

Inflation
(YoY average, %)

Jul-18	2016	2017	2018	2019
United States	1.3	2.1	2.6	2.7
Eurozone	0.2	1.5	1.7	1.8
Spain	-0.2	2.0	1.8	1.7
Latam*	9.9	6.8	6.5	6.2
Argentina	40.4	26.1	28.4	24.1
Brazil	8.8	3.5	3.7	4.7
Chile	3.8	2.2	2.3	2.7
Colombia	7.5	4.3	3.4	2.9
Mexico	2.8	6.0	4.6	3.9
Peru	3.6	2.8	1.2	2.3
Eagles **	4.4	4.1	4.5	4.5
Turkey	7.8	11.1	13.3	11.6
Emerging Asia	2.8	2.3	3.1	3.3
China	2.0	1.7	2.2	2.5
World	3.2	3.3	3.7	3.7

(*) 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, Malasya, Mexico, Nigeria, Pakistan, Philippines, Russia, Turkey and Vietnam.
Source: BBVA Research and IMF

BBVA Research

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Creando Oportunidades