Global Economic Watch

October 2018

Creando Oportunidades

More moderate and heterogeneous growth, with increasing risks

- Our BBVA-GAIN model points to a growth moderation towards quarterly rates of 0.9% in 2H18, while regional differences would have intensified. The strength in the US contrasts with the moderation in China and the Eurozone, and significant adjustments in more vulnerable emerging economies.
- Hard data remains robust but has lost momentum, due to the downside effects from protectionism and financial market stress on confidence and investment. However, global trade has improved and stabilized after decelerating at the turn of the year.
- Downward revision to our global growth forecasts, as deceleration becomes more evident and with less synchronization across areas:
  - In the US, the increase in consumption and the strength of investment keep providing support for the unchanged forecast of 2.8% growth in 2018-19.
  - We have also maintained our projections for the EZ at 2.0% for 2018 and 1.7% for 2019 on accommodative fiscal and monetary policies, and the strength of domestic demand.
  - We revise our 2018 projections for China upwards due to strong performance in 1H18 (+0.2pp to 6.5%), but slowing to our unchanged 6% in 2019.
- Protectionism and the Fed's exit strategy are the most relevant risks on the forecast horizon, while political uncertainty increases in Europe (Italy and Brexit).

Outline

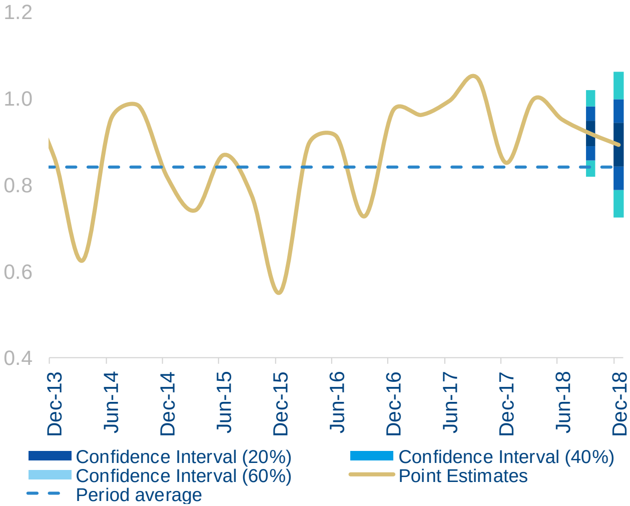
01

Short term indicators

Global growth still solid, but moderating in 2H18

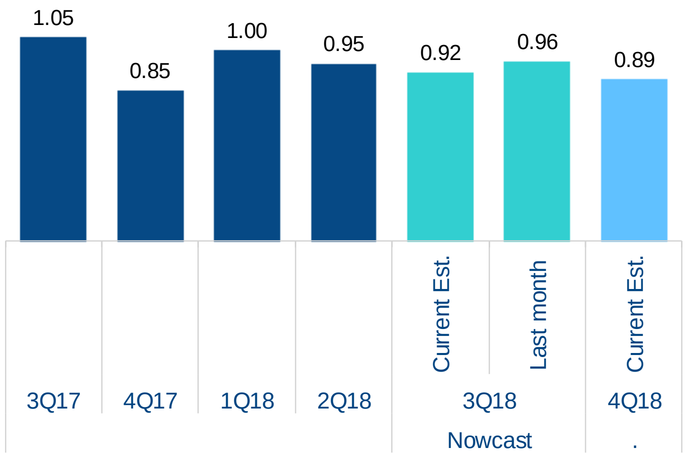
World GDP growth

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



World GDP Growth

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

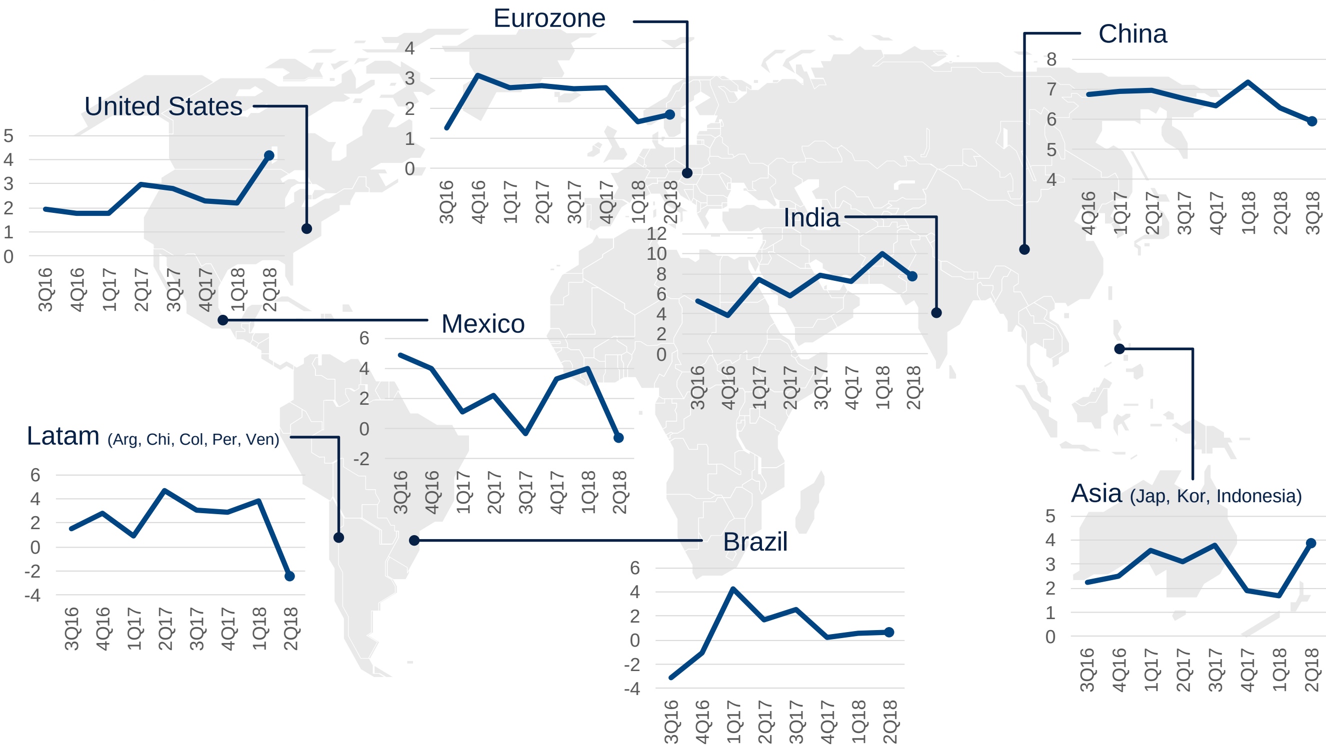


Global trade and private consumption remain supportive of economic growth despite growing uncertainty. Our BBVA-GAIN suggests that the moderation is becoming more evident, as the quarterly growth rate is expected to be at 0.9% in 2H18, down from 1% in 1H18.

Source: BBVA Research and National Sources

Global growth is becoming more heterogeneous across regions

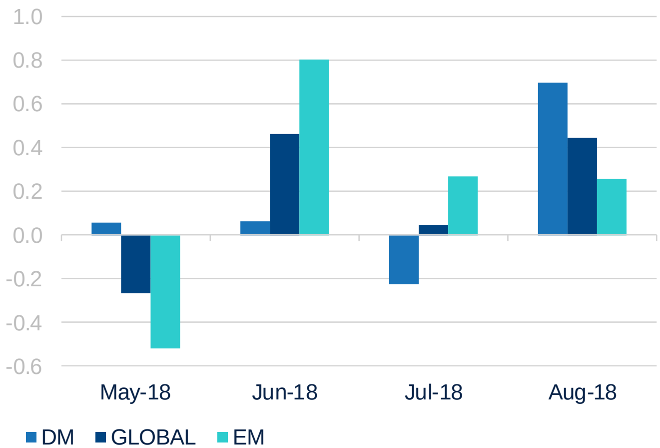
GDP Growth
(%, SAAR)



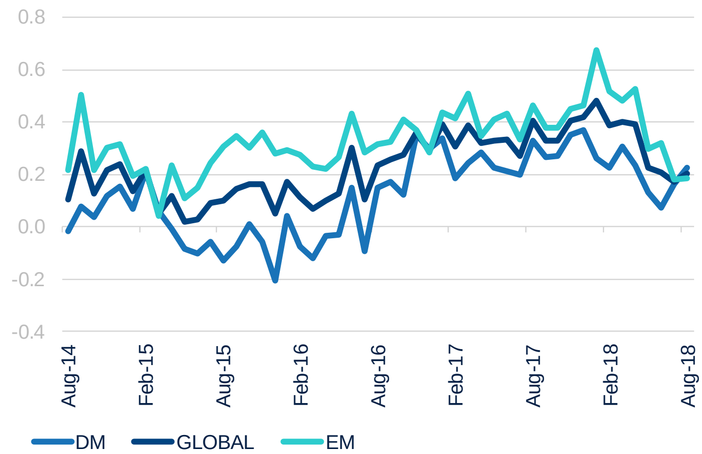
Source: BBVA Research and National Sources

Industrial production rebounded slightly in August but not enough to offset the drop in previous months

World industrial production
(%, MoM)



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



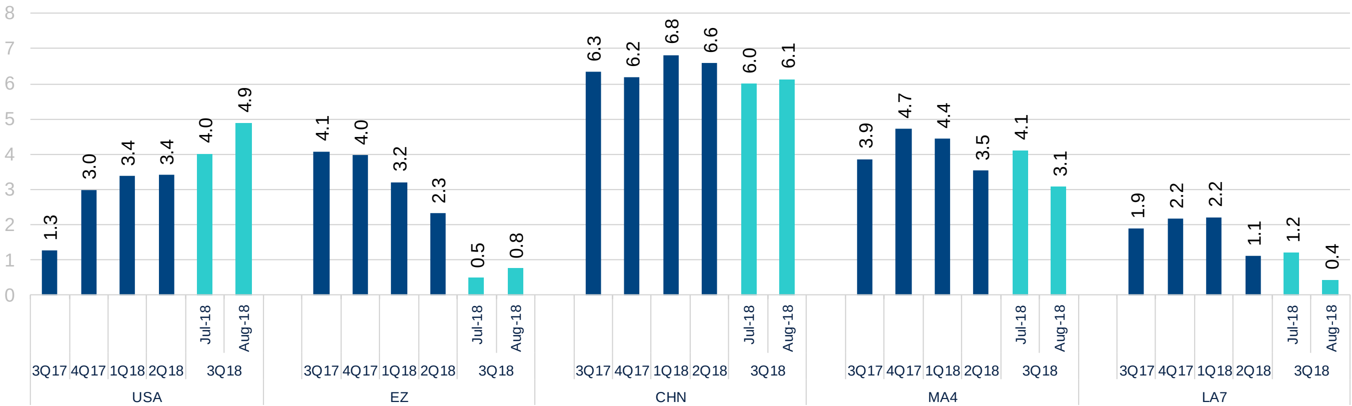
Industrial production rebounded in August, led by advanced countries. Uncertainty keeps dragging economic activity and investment decisions, especially in emerging markets, in a context of lower external demand and global tightening of monetary policy.

Source: BBVA Research and National Sources

IP keeps soaring in the US and Asia, but slows significantly in Europe

World industrial production: Selected regions

(%, YoY)

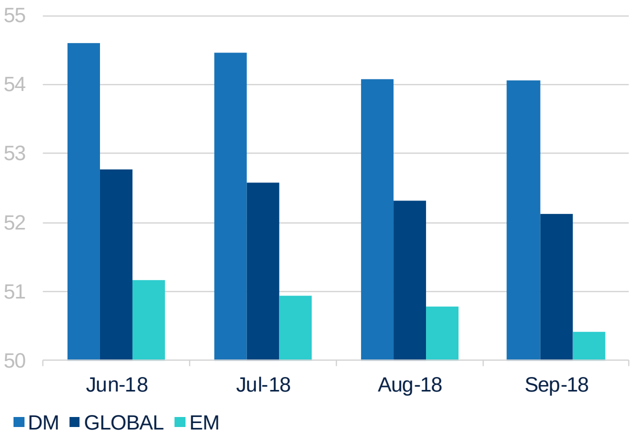


Industrial production has moderated significantly in Europe at the start of 3Q18 due to cooling foreign demand and a minor slowdown of the domestic economy. In contrast, the US and some commodity exporters in Asia are doing relatively well despite growing barriers to trade.

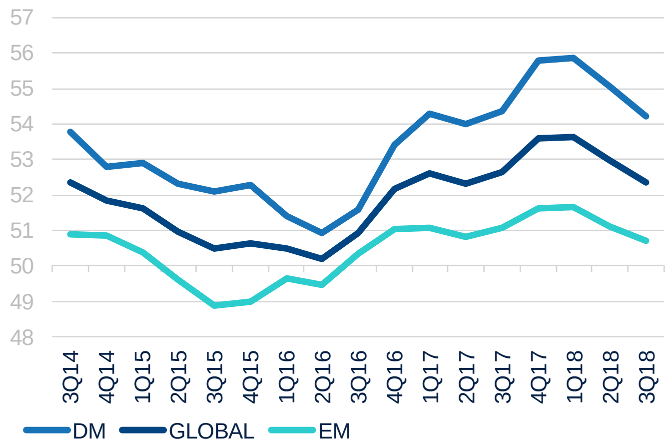
Source: BBVA Research and National Sources

Manufacturing surveys dip a bit further, but remain clearly in expansionary territory

World manufacturing PMI
(Level ± 50)



World manufacturing PMI
(Level ± 50)



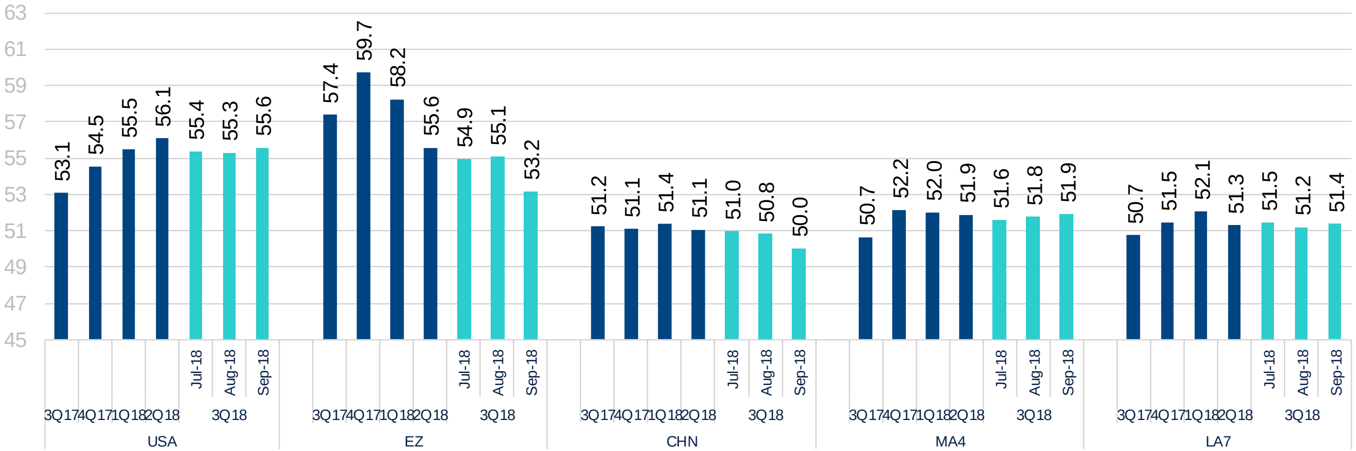
Manufacturing PMIs have weakened slightly further in September signaling growing uncertainty about the effect of increasing protectionism and stress in emerging economies. New export orders have dropped below the critical 50 point threshold level. However, details from the survey still show growing employment levels to feed production and rising backlogs of work.

Source: BBVA Research and Markit Economics

US manufacturing confidence remains strong, but expectations in China become gloomier

Manufacturing PMI: Selected regions

(Level ± 50)

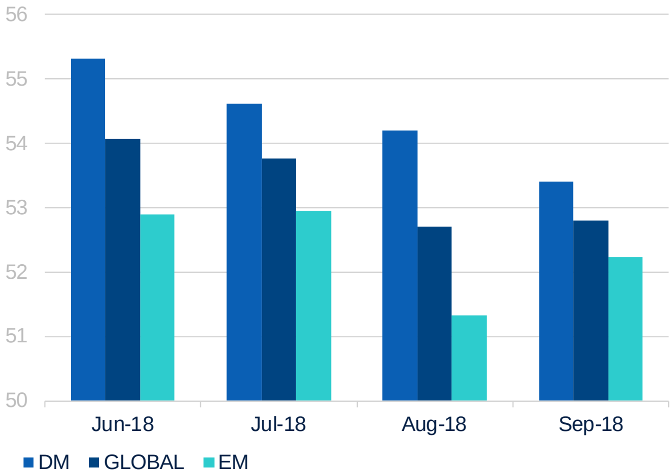


Manufacturing confidence has dropped significantly in China over the year and now stands at the 50 point threshold level that divides expansionary and contractionary activity, showing that sluggish demand is starting to drag manufacturer's production. In the rest of the world it remains generally solid despite some further slowdown in EZ economies.

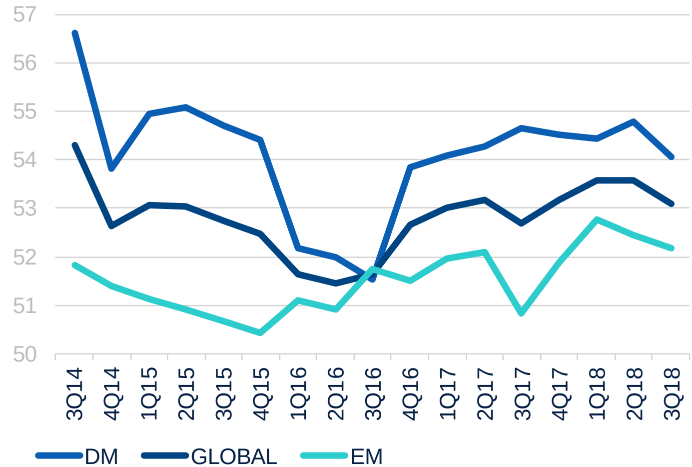
Source: BBVA Research and Markit Economics

Services PMIs stabilize in September and should keep fostering growth in coming quarters

World services PMI
(Level ± 50)



World services PMI
(Level ± 50)



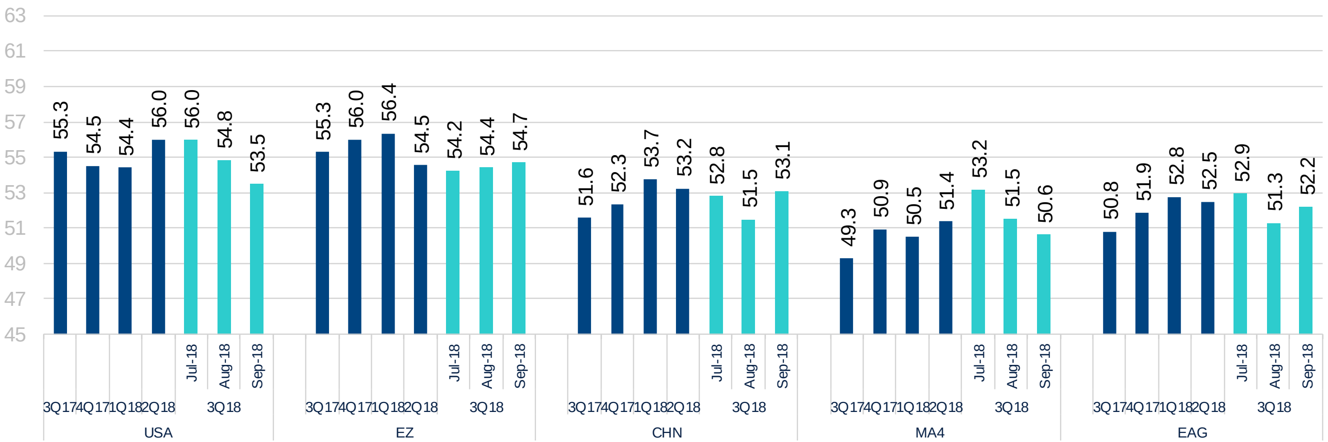
Despite this stabilization, September data displayed a stronger rate of new orders, rising backlogs of work and the highest job creation in 13 years, giving early signs of an improvement for the months ahead

Source: BBVA Research and Markit Economics

Service sector activity remains buoyant in advanced economies and improves in emerging markets

Services PMI: Selected Regions

(Level ± 50)

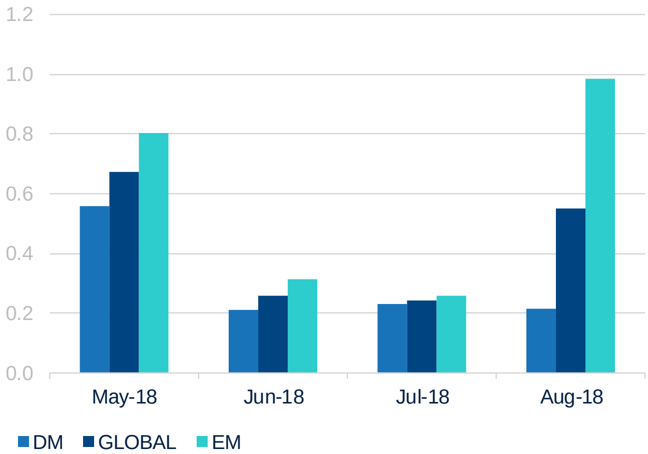


Services sector confidence shows a mild improvement after disappointing performance in previous months, thanks to a broad based improvement in the labor market and to the fiscal support in many countries. Excessive debt and political risks could however pose a threat to further expansion.

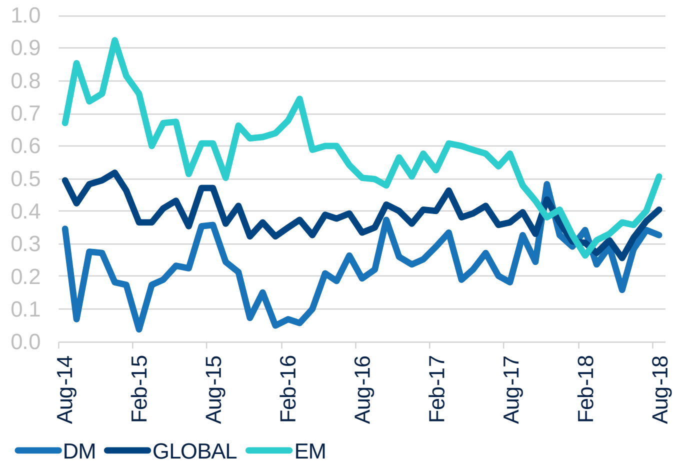
Source: BBVA Research and Markit Economics

Sharp increase in retail sales in August mostly seen as a one-off in emerging markets, but private consumption remains strong

World retail sales
(% MoM)



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

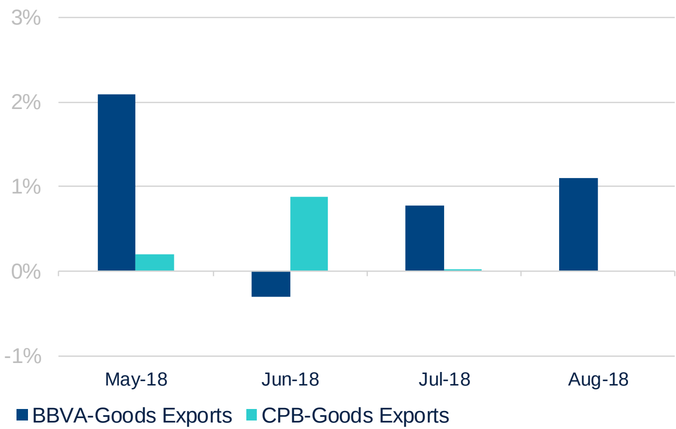


Retail sales have improved further in August suggesting that the downward trend from early year has halted and domestic demand remains at relatively strong levels, despite trade-related uncertainty.

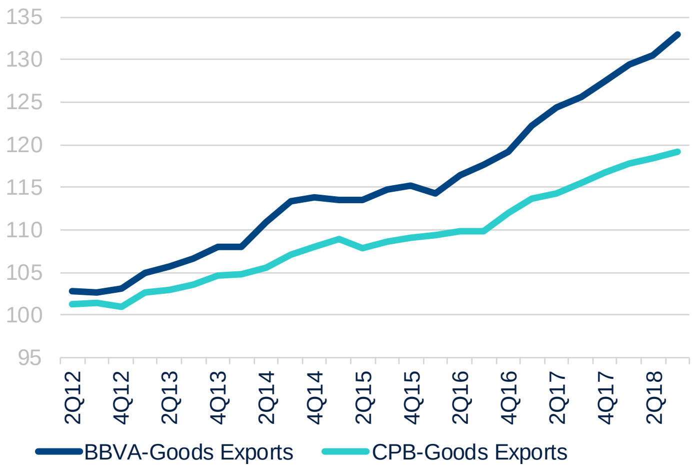
Source: BBVA Research and National Sources

Global exports kept increasing over the last two months, after a weak figure in June

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



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



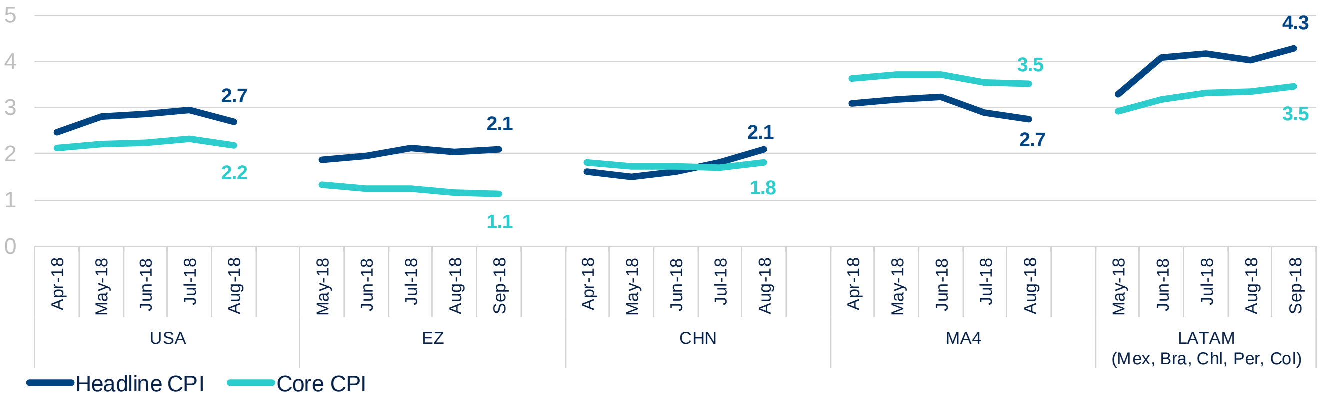
Global trade remains strong and direct effects from the trade war have yet to materialize. However, there have been some distortions in trade flows and prices for particular products and sectors, and different international organizations are increasingly warning about further potential negative effects through confidence and investment.

Source: BBVA Research and National Sources

Higher energy prices and pass-trough effects from currency depreciation keep pushing up headline inflation

Headline and core inflation: Selected regions

(%, YoY)



Inflation has taken different paths in August, but will keep increasing gradually reflecting solid domestic demand and pass-through effects from currency depreciation in emerging markets. Wage growth and employment creation continue providing support to core inflation.

Source: BBVA Research and National Sources

BBVA Research

02

New projections

Positive global growth inertia continues, although risks intensify

01

Global growth still solid, but moderating and less synchronized

Strong performance in the US contrasts with stabilization in EZ and CHN

02

Ongoing monetary policy normalization

Fed and ECB at very different stages: Fed at the end of tightening cycle and ECB ready unwind QE and start hiking interest rates

03

EM financial tensions on the rise

With differentiation among countries, those with greater vulnerabilities are now facing severe adjustments

04

US-CHN trade war escalates

Still limited impact but ready for more action, while US tensions with other countries have eased for now

05

Global risks intensify

Protectionism and Fed's exit, with EM sell-off acting as potential amplifier and greater uncertainty in Europe

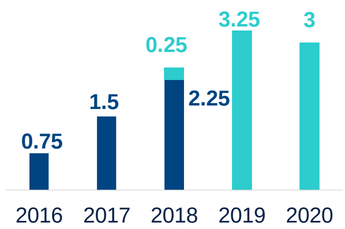
Major central banks keep normalizing monetary policy, but Fed's rates will reach their peak in 2019 while the ECB will be just starting to hike

Balance

Interest rates

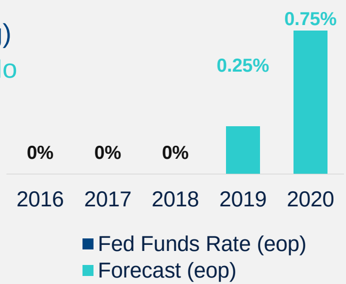
- Ongoing reduction of the size of the balance sheet (USD450bn in 2018)

- More rate hikes in 2019, but converging to neutral interest rate



- End of QE by Dec'18
- Full reinvestment until at least Dec'20
- TLTROs, to be repaid staring Jun'20

- Anchoring rates (for too long) through forward guidance. No hikes expected until Sep'19

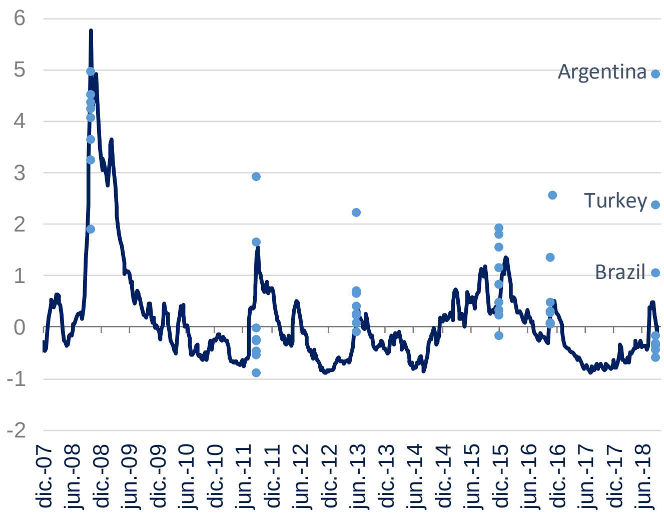


Source: BBVA Research

The spike in EMs financial stress has been less synchronized than in previous episodes

Index of financial tensions in emerging markets

(%)

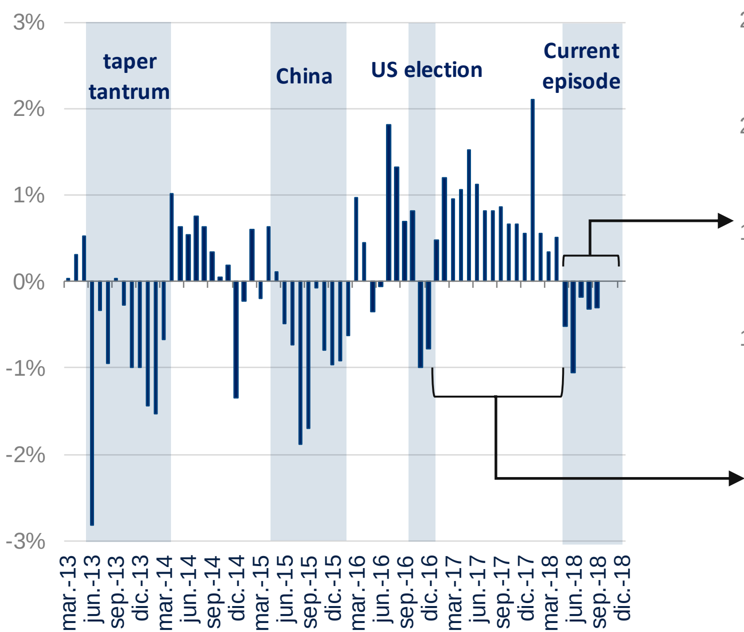


- EMs are facing greater financial tensions, resulting in a widespread currency depreciation and worsening of risk premia
- Differentiation across countries: tensions have broadly focused on most vulnerable countries. We are thus not facing a systemic crisis in EMs
- The quick adoption of monetary and fiscal measures has allowed for some stabilization

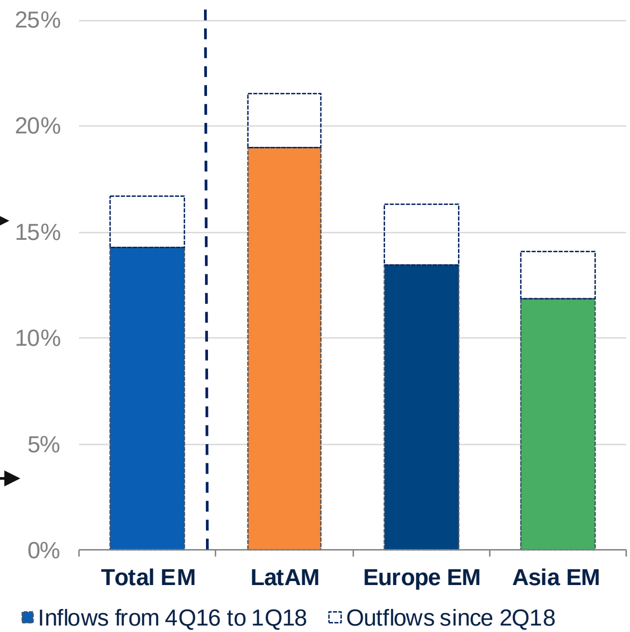
Source: BBVA Research and Bloomberg

Portfolio outflows from EMs are being persistent but still far from representing a sudden-stop episode

Portfolio flows to emerging markets
(% of stock)



Portfolio flows accumulation in the past 5 quarters
(% over accumulated since Jan'17)

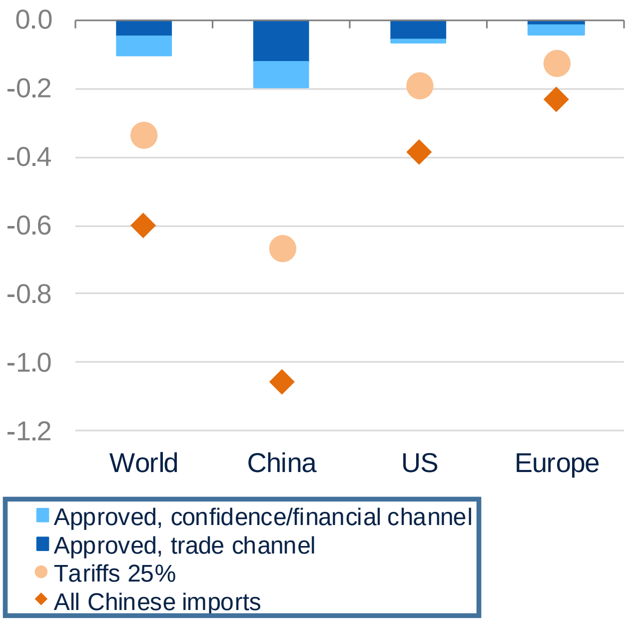


Source: BBVA Research and Bloomberg

US and CHN have raised tariffs, but the estimated effect on global growth is limited so far

Effect of US tariff increases and other countries' responses on GDP growth

(2018-20, pp)

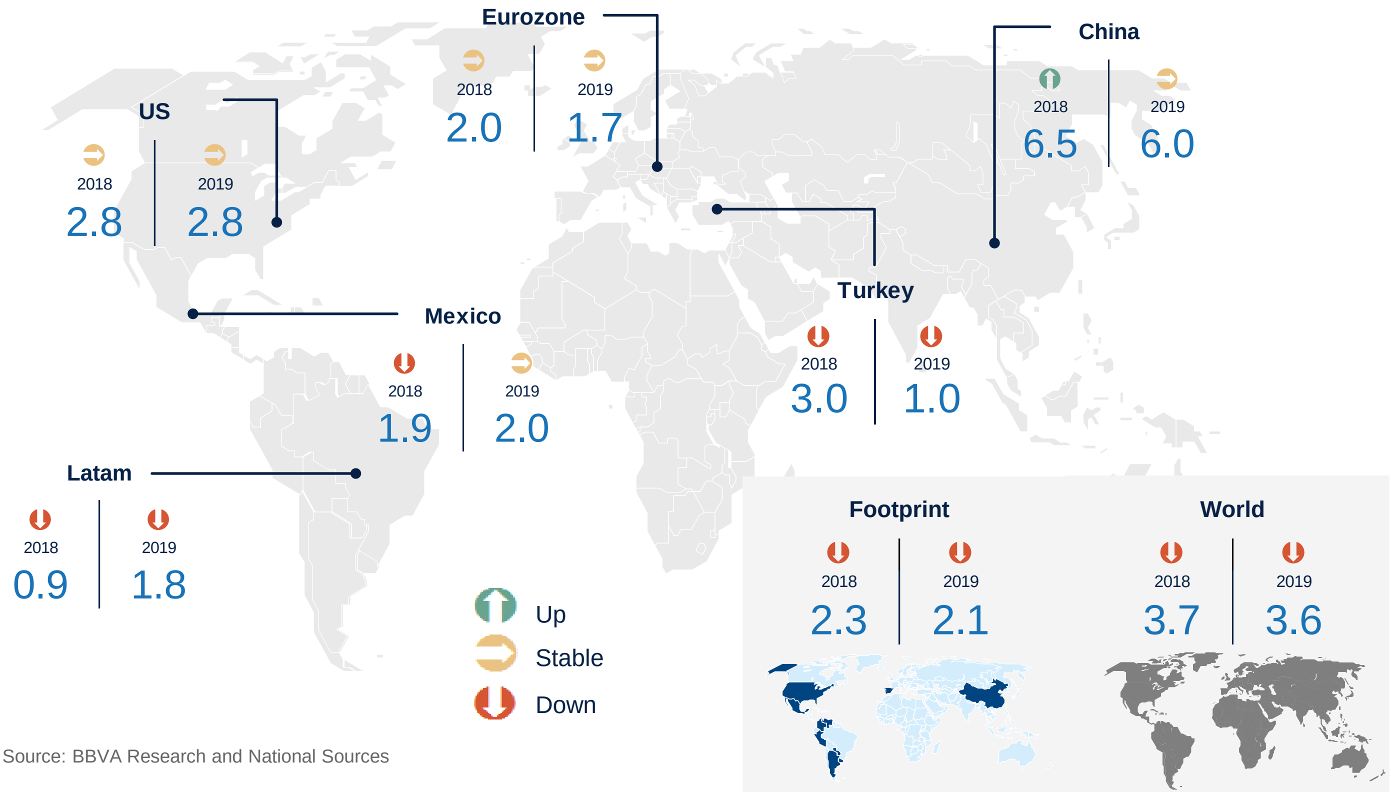


Source: BBVA Research and Bloomberg

- The expected direct effect (trade channel) from measures approved up to now will likely remain limited, but indirect effects could be sizeable, especially for China and emerging economies
- Agreement on USMCA reduces uncertainty for Mexico and Canada, although ratification is still pending
- In Europe, tariff increases on autos have been put on hold, but they will be negotiated from November onwards

The downward revision of EM growth explains the expected moderation in global activity in 2019

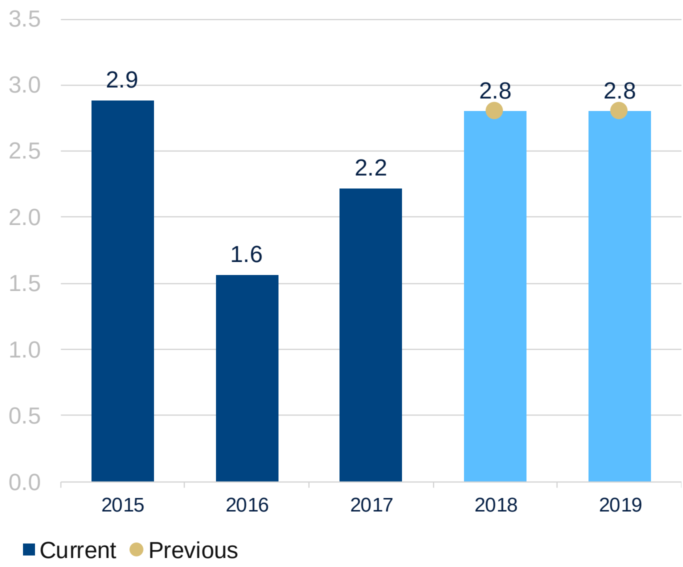
GDP Growth
(%, yoy)



Source: BBVA Research and National Sources

US: Solid domestic consumption and resilient investment supports stronger GDP growth rates, with signs of stabilization

US: GDP growth
(%)

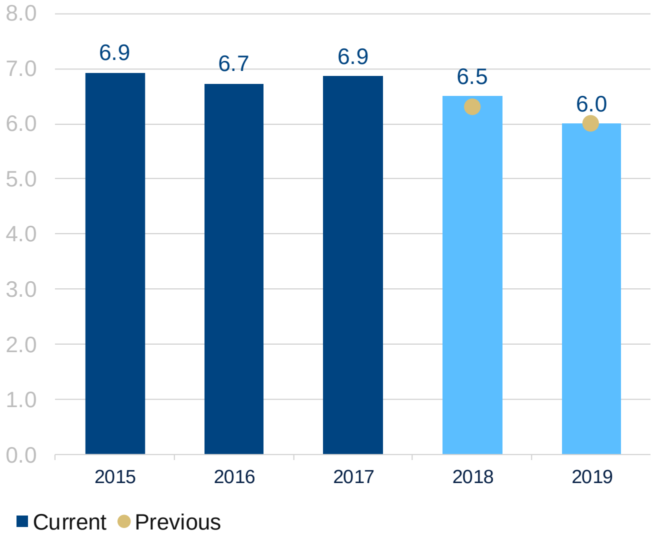


Source: BEA and BBVA Research

- Sharp GDP growth acceleration in 2Q18 will likely prove temporary after the strong contribution of external demand. Some moderation is expected in coming quarters
- Headline inflation is moderating and core inflation remains stable around 2%, reducing the probability of a high-inflation regime
- Imbalances on the rise. Uncertainty increase by 2020 due to the Fed rate hikes and the exhaustion of fiscal stimulus

China: Pro-growth policies to face increasing headwinds

China: GDP growth
(%)

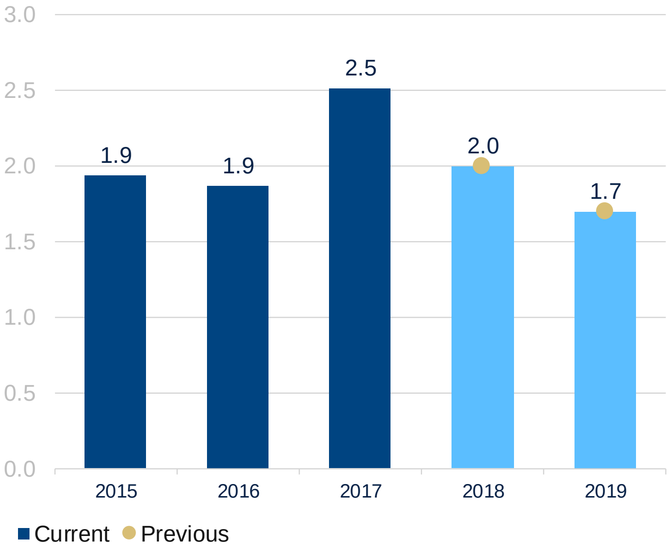


- Upward revision in our 2018 GDP forecast (+0,2pp) due to stronger growth than expected in 1H18, but moderation is turning more evident
- Policy mix of monetary and fiscal stimulus to support the economy, but contained for now, so as not to worsen financial vulnerabilities
- Protectionism remains the main source of risks, especially if it slows the necessary deleveraging process and leads to a strong currency depreciation

Source: CEIC and BBVA Research

Eurozone: Strong domestic demand will compensate heightened uncertainty and the slowdown of global growth

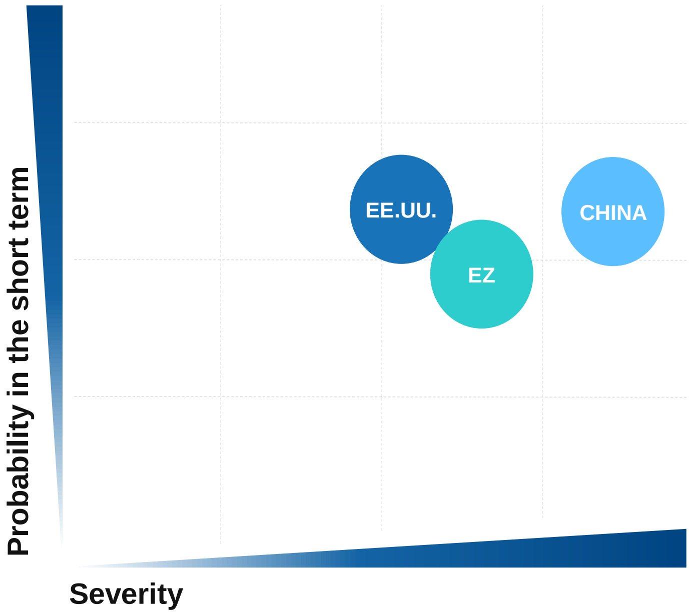
Eurozone: GDP growth
(%)



- Unchanged GDP growth forecast, but with a greater support from private consumption and investment
- Monetary and fiscal policy remains accommodative in a context of greater political uncertainty
- Trade tensions with the US have eased for now, but could weigh on confidence and investment
- Despite the rebound of headline inflation, core inflation will only increase gradually in 2019

Source: Eurostat and BBVA Research

Global risks: protectionism and Fed's exit remain at the center of the stage, with political uncertainty in Europe on the rise



CHINA

- Protectionism: rising (new tariffs and retaliation) with potential hurdle on domestic policy (financial stability, reforms)
- Excessive leverage: more contained in the short term but higher in the medium term (corporate defaults)

US

- Protectionism: rising and focused on China
- Fed's exit: high. Increasing risk of overshooting
  - Different impact on emerging markets
- Probability of recession: remains low, but rising
- Signs of financial vulnerability in some assets

EUROZONE

- Political risk: increasing, mainly due to tensions in Italy and Brexit
- Protectionism: more contained. Focus on auto industry
- ECB exit: low

Tensions in EMs could act as a potential amplifier to current global risks

(second round effects on global GDP growth)

Source: BBVA Research

Macroeconomic forecast

Gross domestic product
(YoY average, %)

	2016	2017	2018	2019
United States	1,6	2,2	2,8	2,8
Eurozone	1,9	2,5	2,0	1,7
Spain	3,2	3,0	2,6	2,4
Latam*	-1,0	1,2	0,9	1,8
Argentina	-1,8	2,9	-2,4	-0,3
Brazil	-3,4	1,0	1,2	2,4
Chile	1,2	1,5	4,3	4,0
Colombia	2,0	1,8	2,6	3,3
Mexico	2,6	2,3	1,9	2,0
Peru	4,0	2,5	3,6	3,9
Eagles **	5,2	5,4	5,3	5,1
Turkey	3,2	7,4	3,0	1,0
Emerging Asia	6,7	6,4	6,6	6,3
China	6,7	6,9	6,5	6,0
World	3,4	3,7	3,7	3,6

Inflation
(YoY average, %)

	2016	2017	2018	2019
United States	1,3	2,1	2,5	2,6
Eurozone	0,2	1,5	1,7	1,7
Spain	-0,2	2,0	1,8	1,6
Latam*	9,8	6,7	7,0	7,9
Argentina	40,4	26,1	33,3	40,8
Brazil	8,8	3,5	3,7	4,8
Chile	3,8	2,2	2,5	2,7
Colombia	7,5	4,3	3,3	3,1
Mexico	2,8	6,0	4,9	4,1
Peru	3,6	2,8	1,3	2,3
Eagles **	4,4	4,1	5,0	5,6
Turkey	7,8	11,1	16,7	22,5
Emerging Asia	2,8	2,3	3,0	3,3
China	2,0	1,7	2,2	2,5
World	3,2	3,3	4,0	4,2

(*) 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

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