BBVA Research

Global Economic Watch

January 2019

Creando Oportunidades

Mild adjustment of global growth, but more uncertain due to political risks

- Our BBVA-GAIN model suggests a rebound during 4Q18 to around 0.8%, but with signs of stabilization ahead. Downturn more evident in developed nations, mainly Eurozone, and Emerging Asia, while Latin America will continue to recover, albeit more slowly.
- Global growth headwinds led by a rise in general uncertainty, fueled by one-off factors, mounting protectionism and a slowdown in China. Bulk of the recent growth downturn led by marked deceleration in global trade.
- Factory activity indicators such as IP and PMIs across many major economies point towards weakening demand. In addition, one-off, temporary factors have exacerbated activity slowdown in the EZ.
- We revise downwards our global growth forecasts by 0.1 pp to 3.5% in 2019 as the persistence of general uncertainty continues to weigh on activity, fuel financial tensions and undermine confidence.
- In the US, while growth remains robust still, we expect it to slowdown to 2.5% in 2019 and 2% in 2020 dragged by flagging external demand, waning impact of fiscal stimulus and uncertainty at home and abroad.
- In the EZ, we expect a faster moderation in growth from 1.8% in 2018 to 1.4% in 2019-20. While domestic fundamentals remain solid, reduced external support and country specific issues, such as those related to German auto sector, Italian politics, French protests and the Brexit deadlock weigh on activity and sentiment.
- We expect China's growth to continue trending lower, from 6.5% in 2018 to 6% in 2019 and 5.8% in 2020, weighed, in large part, by domestic deleveraging measures and protracted trade tensions with the US.
- Protectionism, the increased likelihood of recession in the US and greater adjustment to growth in China are most significant risks in the forecast horizon.

Outline

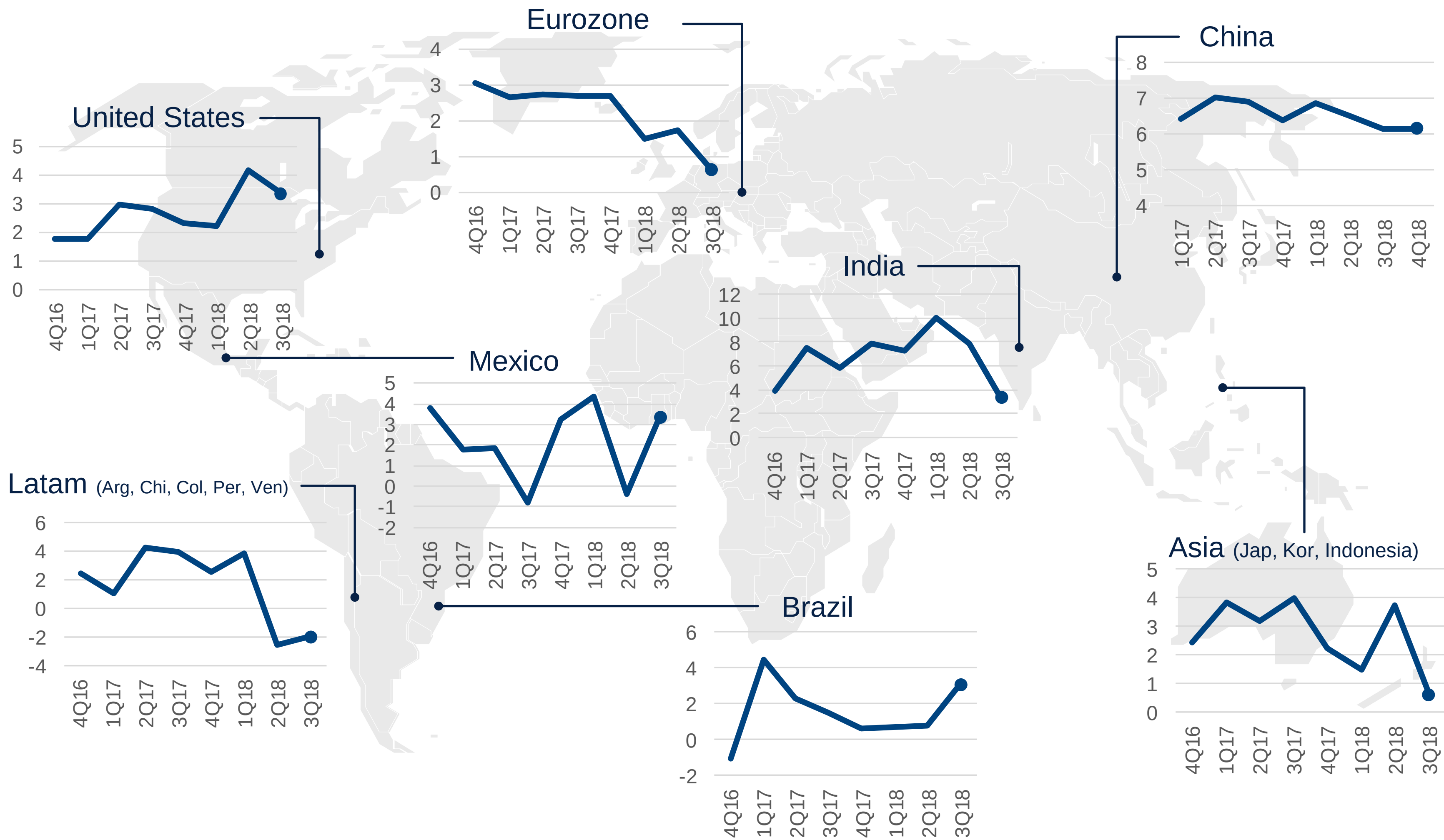
01

Short term indicators

GDP growth slowed in 2H18 across the board, with one-off factors weighing on some regions (EZ, India, Japan)

GDP growth

(%, SAAR)

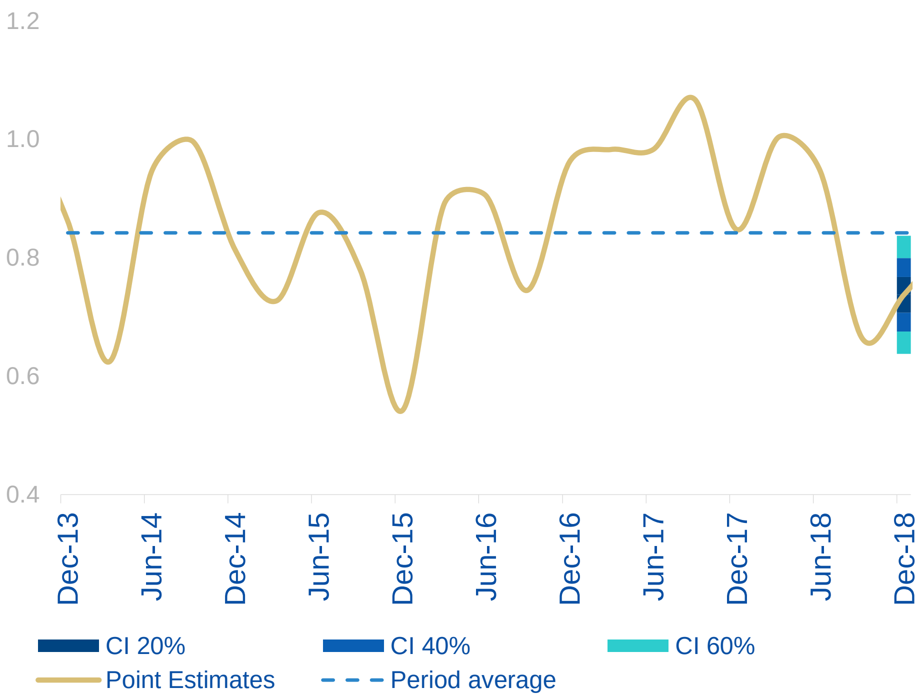


Source: BBVA Research and National Sources

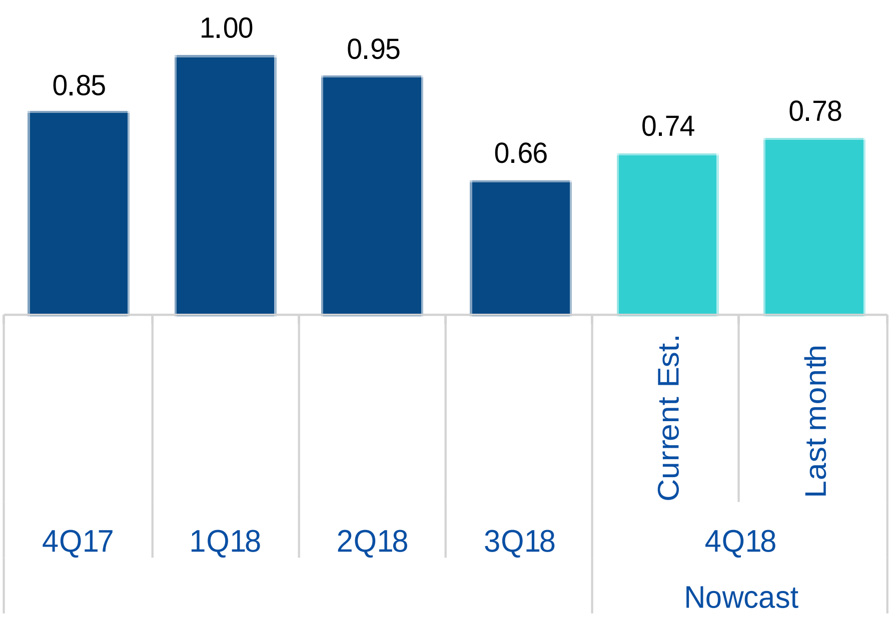
Global GDP will likely recover somewhat in 4Q18, but the trend is clearly downwards

Our BBVA-GAIN model suggests a slight rebound in 4Q18 to around 0.8%, as some one-off effects will fade, but growth is unlikely to return to the strong rates of the last two years.

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



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

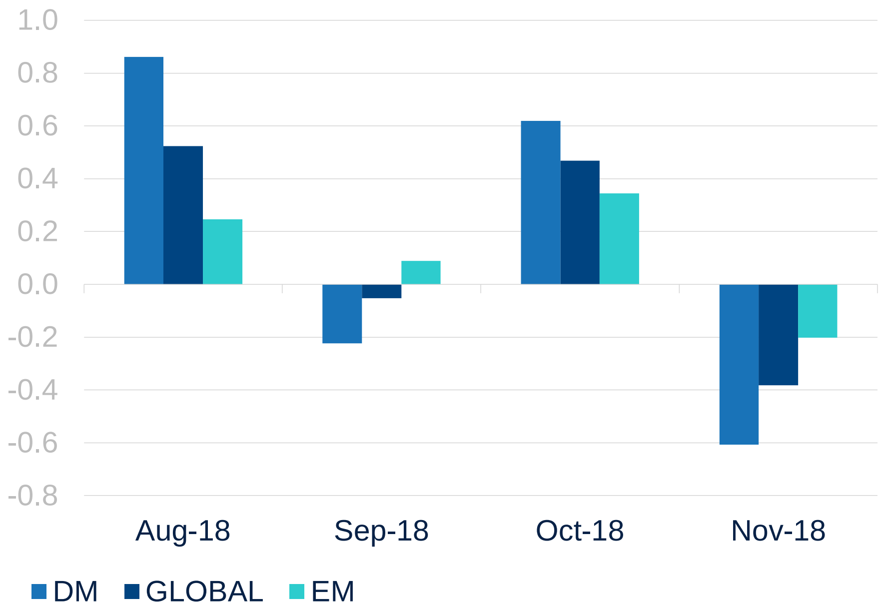


Source: BBVA Research and National Sources

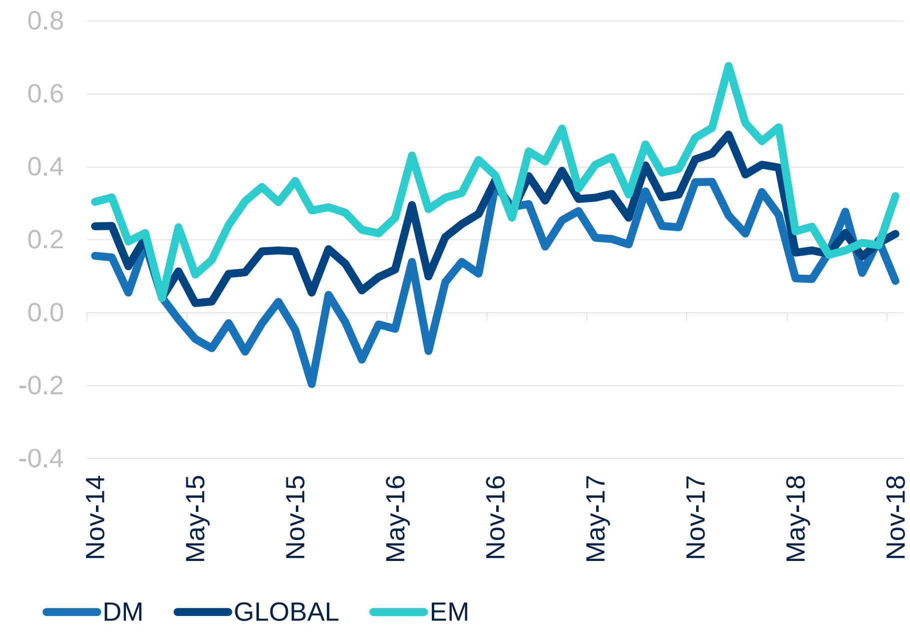
Manufacturing activity slowed across the board, induced by protectionist fears

More evident effect of protectionism on global slowdown, especially in China (and perhaps Germany), along with fears of higher tariffs in coming months.

World industrial production
(%, MoM)



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



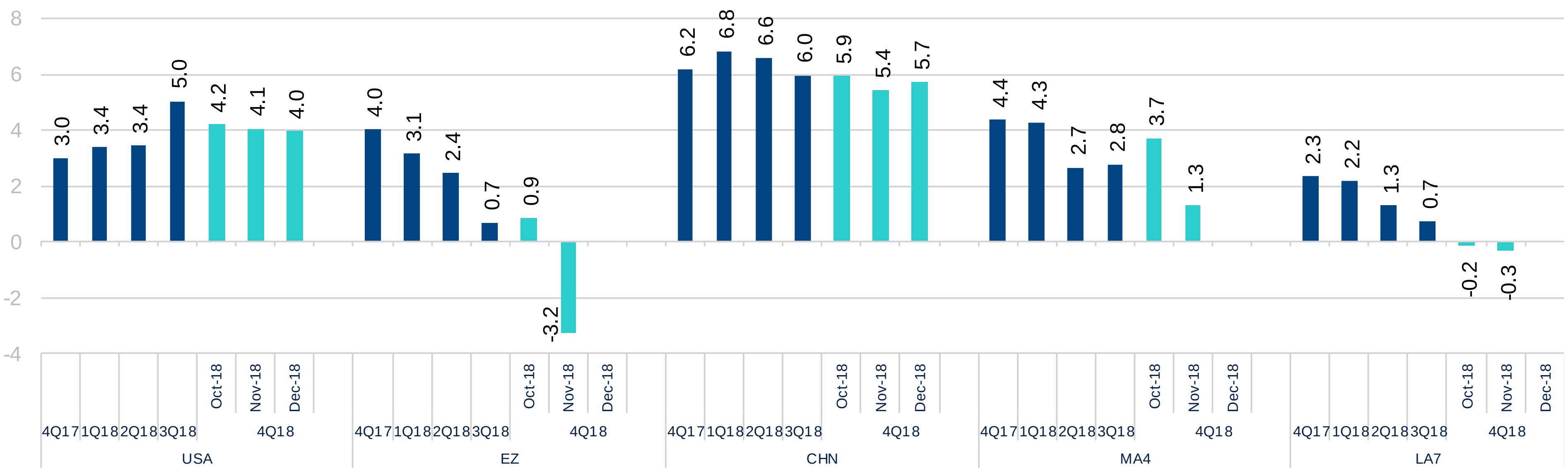
Source: BBVA Research and National Sources

Industrial production growth held solid in the US during December but relatively weak in China and slipped significantly in the EZ

Industrial production was particularly down in the EZ in November after disappointing figures across the bloc. Output continued to grow at a solid pace in US, while mostly unchanged in China and LA7

World industrial production: selected regions

(%, YoY)



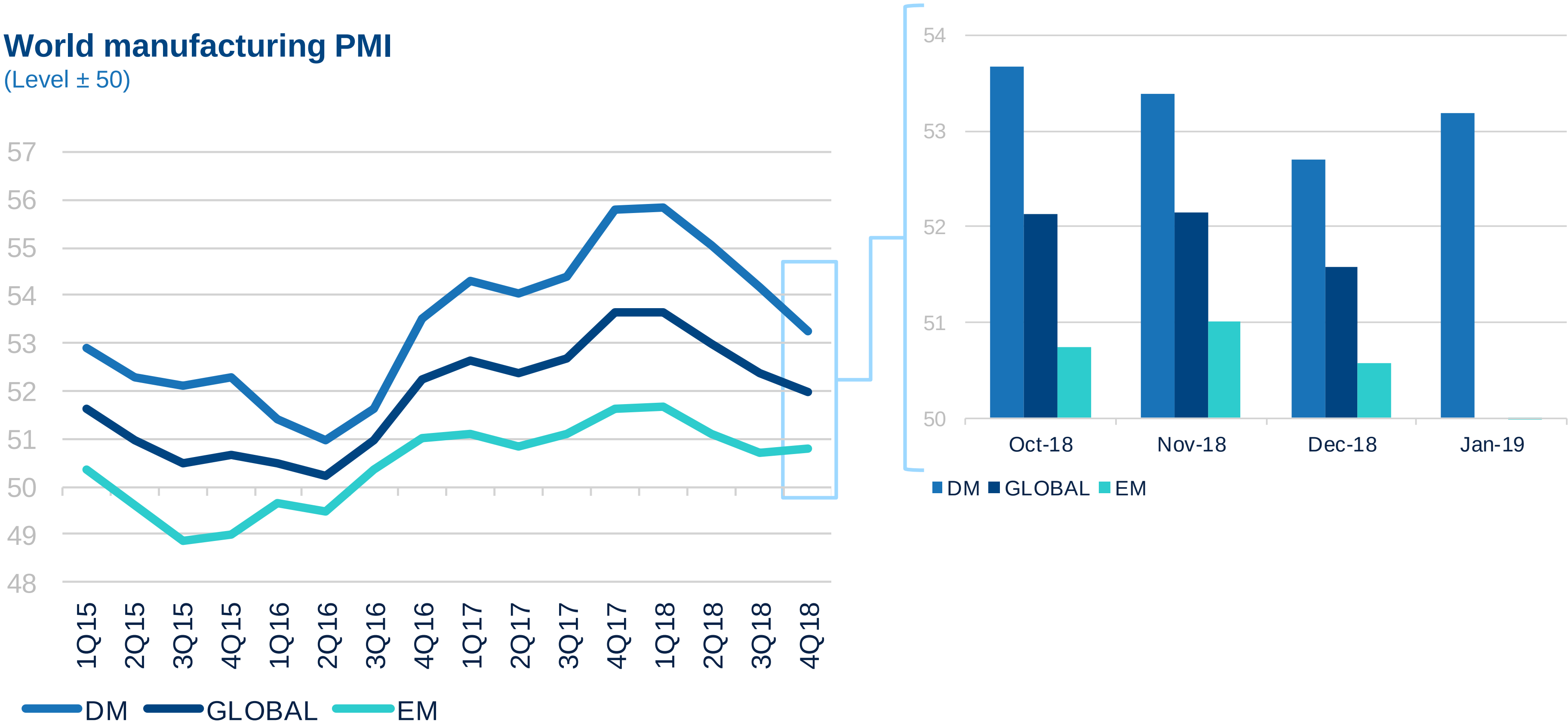
Source: BBVA Research and National Sources

Looking ahead, PMI surveys anticipate a recovery in manufacturing activity in developed markets in January*

While manufacturing activity weakened in December, incoming PMI survey data for January signals a rebound as continued strength in the US industrial sector offsets weakness in the EZ.

World manufacturing PMI

(Level ± 50)



(*) Note: data available so far for around 60% of develop economies, results might change as all data are released

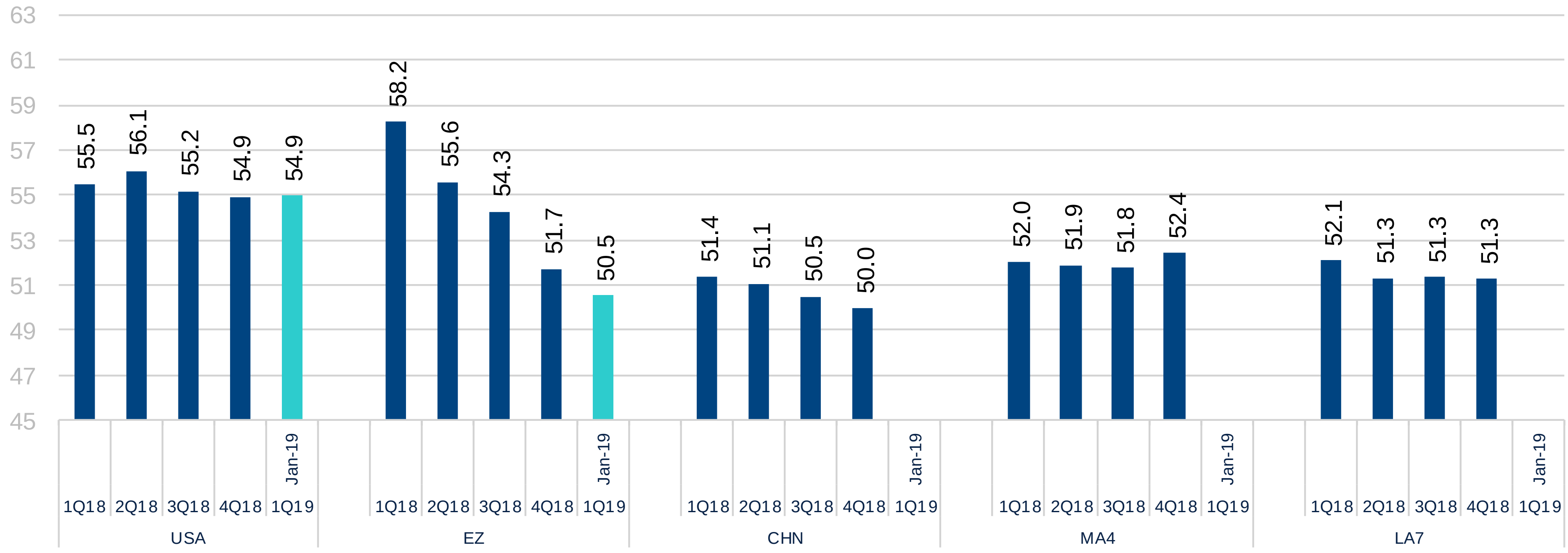
Source: BBVA Research and Markit Economics

PMI indicators suggest further slowdown in manufacturing activity in the EZ while it remains robust in the US

The slowdown is taking root in the EZ as PMIs edge closer to stagnation while data in the US suggest a solid start to the new year with scarce detrimental impact from the shutdown on the private sector.

Manufacturing PMI: selected regions

(Level ± 50)



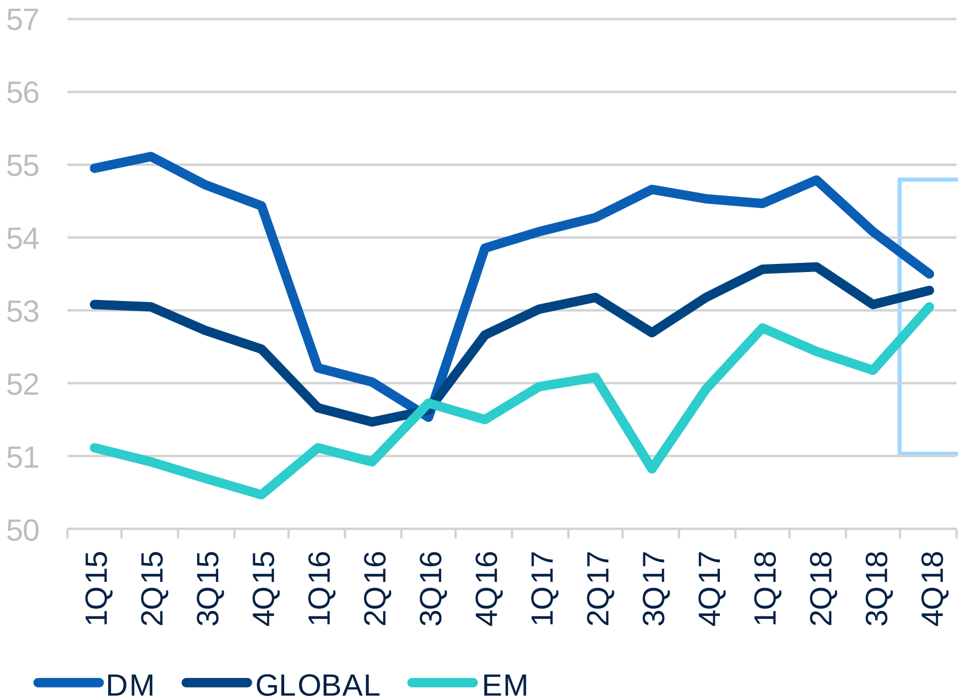
Source: BBVA Research and Markit Economics

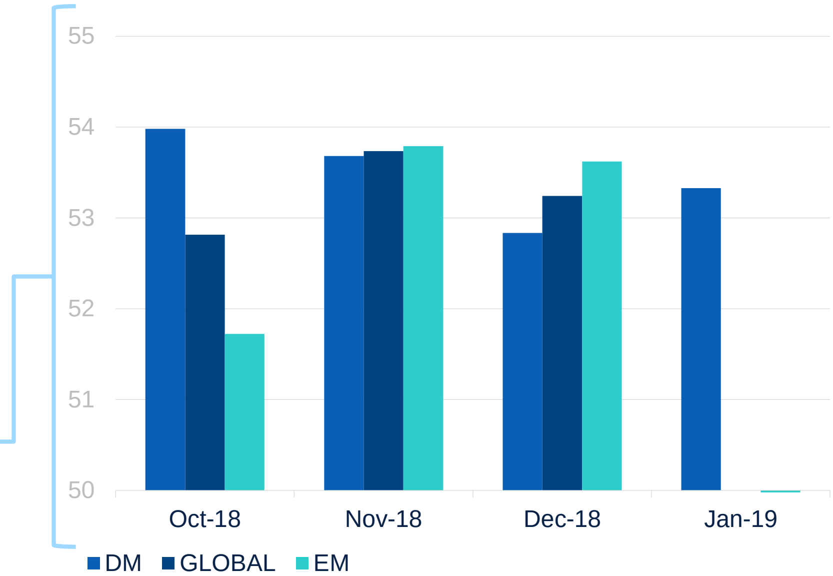
Global services PMIs rebounded slightly in developed markets during January

A pick up in services PMIs in emerging markets offset the drop in advanced economies in December. However, January* has seen a slight improvement in developed economies' services PMIs.

World services PMI

(Level ± 50)





(*) Note: data available so far for around 60% of develop economies, results might change as all data are released

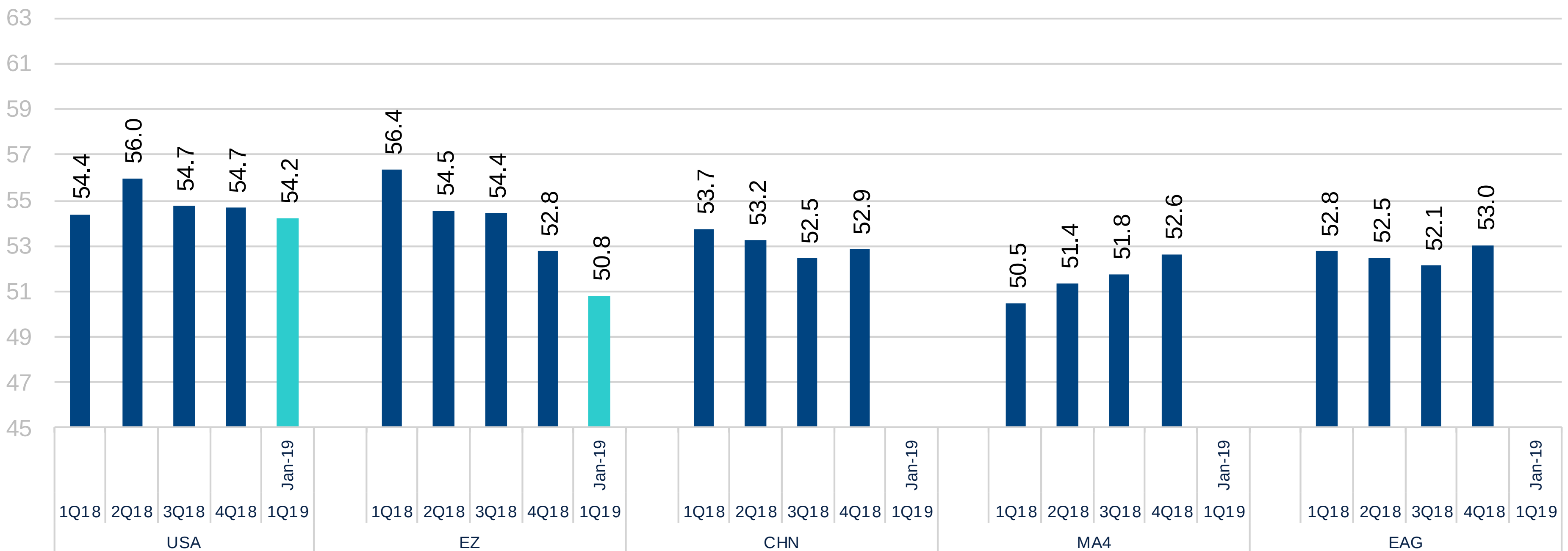
Source: BBVA Research and Markit Economics

Services PMIs depict a sharper-than-expected slowdown in services sector growth in the EZ while growing at a still robust pace in US

Services PMI came in lower than expected in the EZ in January led by weak export orders while in the US, services PMIs declined slightly but to a level that still suggests solid growth.

Services PMI: selected regions

(Level ± 50)

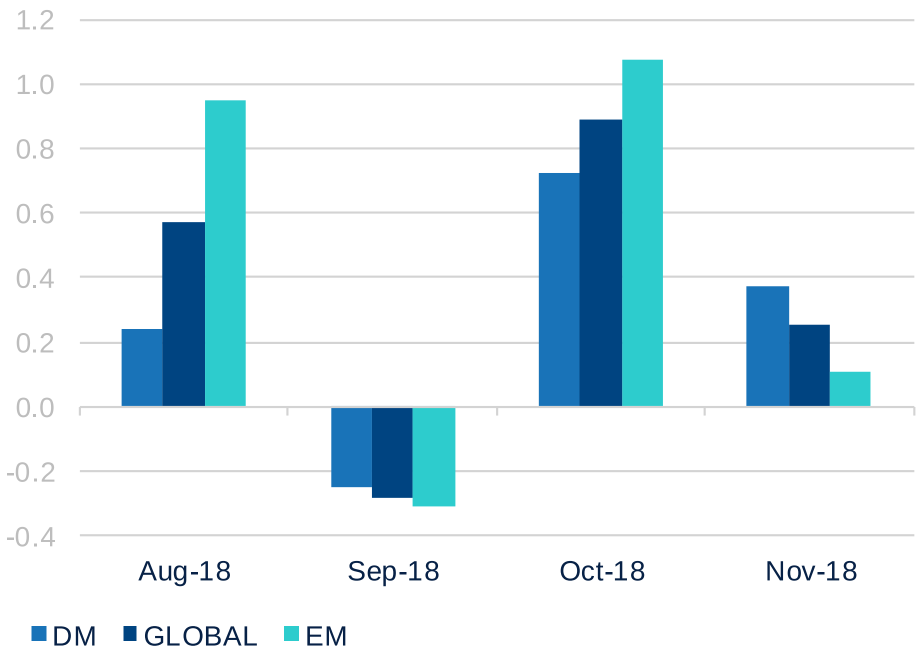


Source: BBVA Research and Markit Economics

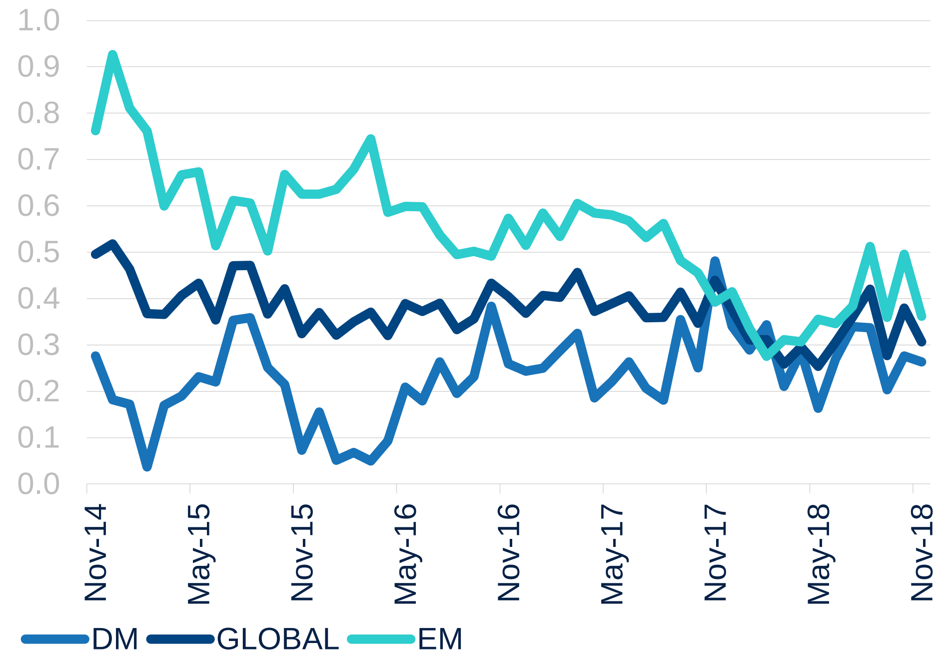
Domestic demand remains resilient, but lower growth is taking root

Lower growth in both consumption and investment is taking root, amid elevated concerns regarding the global slowdown, tariff disputes and political uncertainty

World retail sales
(%, MoM)



World retail sales
(%, 6-month moving average)

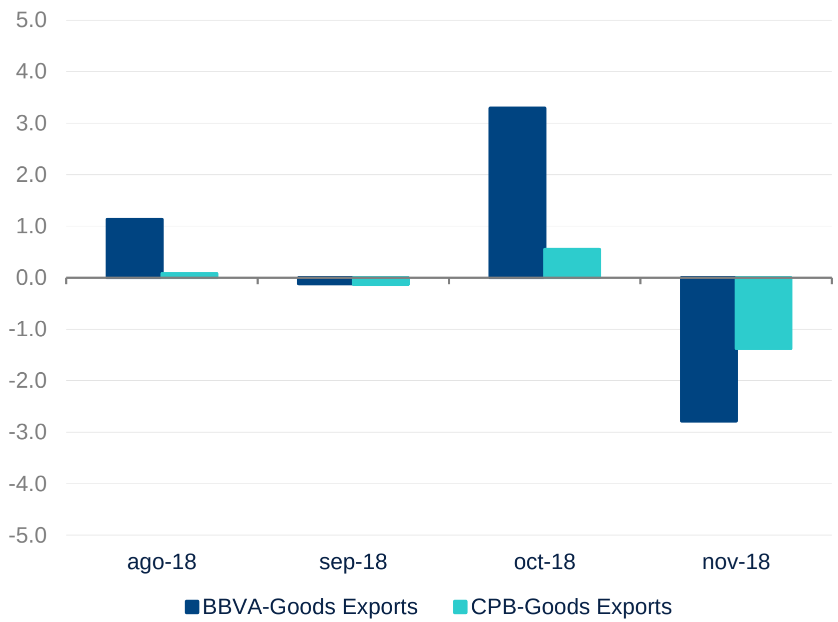


Source: BBVA Research and National Sources

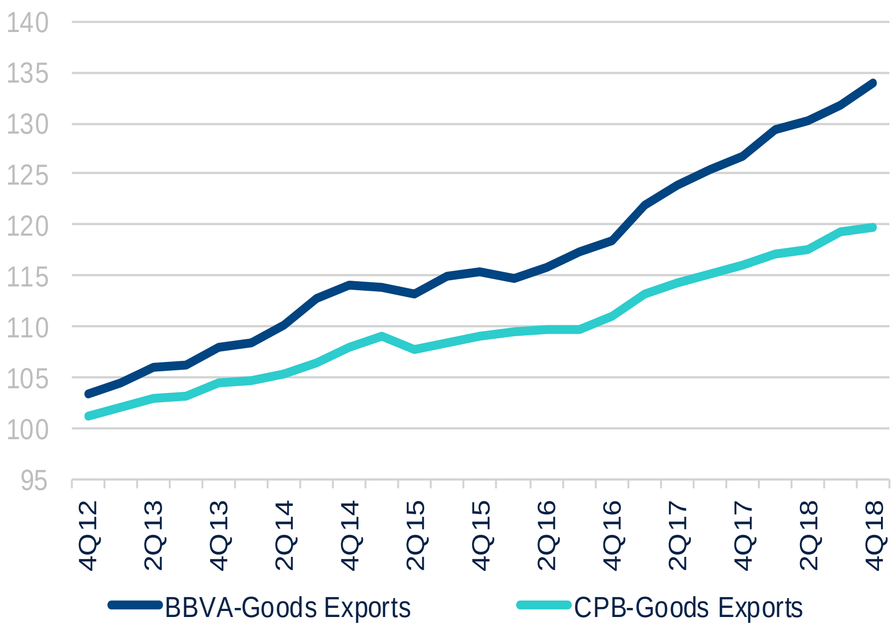
Global trade slowdown weighed by protectionist threat, although we expect new tariff threats to fade over 1H19

October's outperformance was driven by the front-loading of exports chiefly by China. However, such adjustment effect has faded since, with trade growth expected to weaken further going forward.

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



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

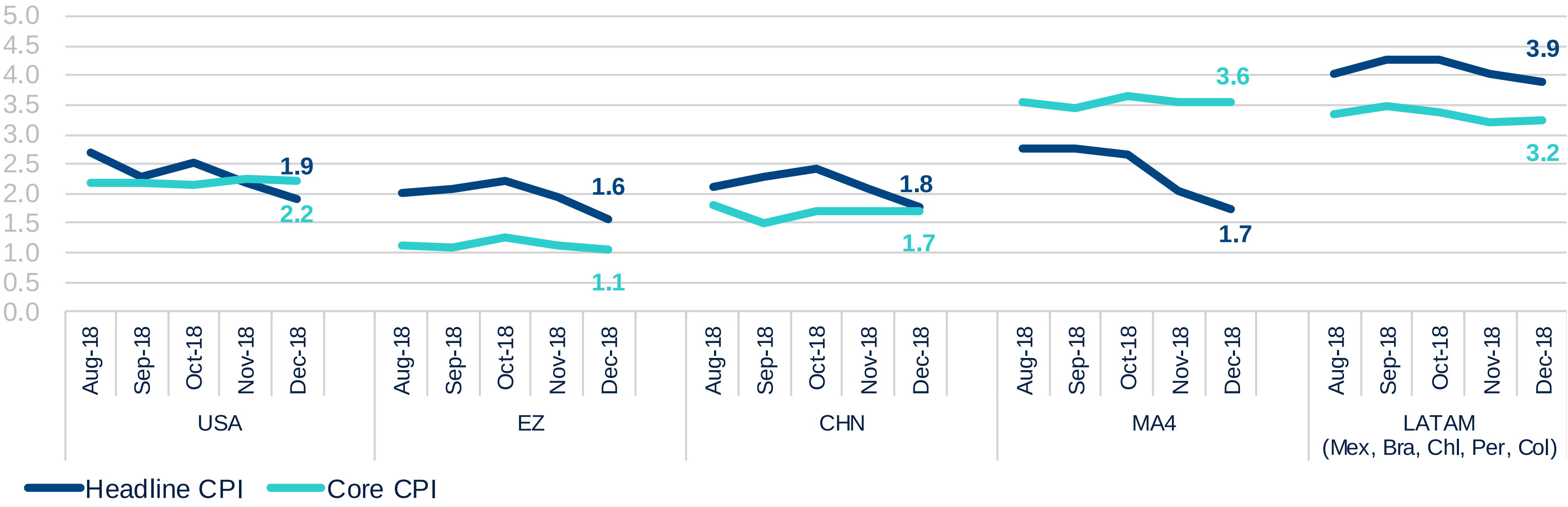


Source: BBVA Research and National Sources

Headline inflation to dip further in coming months amid easing oil prices, while core inflation should remain contained, mainly in DMs

Headline and core inflation: selected regions

(%, YoY)



Source: BBVA Research and National Sources

02

New projections

Key features of our projections: still soft landing, but more uncertain due to dependence on politics and policies

Worse macro outcomes

Faster slowdown than expected (Protectionism+China+negative one-offs)

Evidence that impact from **US fiscal stimulus** will fade earlier than expected

Higher financial stress

Risks of **hard landing global growth**

Tougher financial conditions

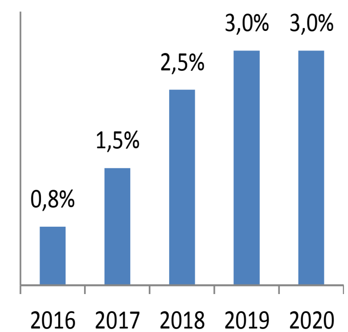
Three key assumptions in our projections:

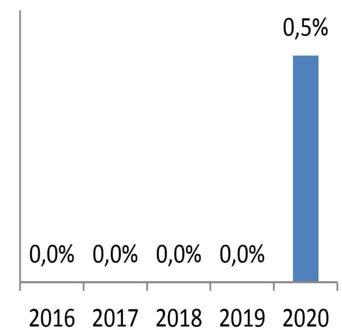
1. **Easing US-China trade tensions**: Unchanged tariffs, but structural issues remain
2. **Tail risks in Europe are eventually resolved** (orderly Brexit; Italy)
3. **More dovish Fed (**2 vs 3 hikes in 2019; "data dependent") and **ECB (**refi-rate hike postponed to 2020), **further room for EM** central banks

Soft landing in global growth (vs gloomier markets' view), **with downward revisions** across the board (except in China due to further stimulus), but **highly uncertain** (policy mistakes on trade, Fed, Brexit…)

Major central banks to alter the normalization process: the Fed to pause earlier than expected and the ECB to delay

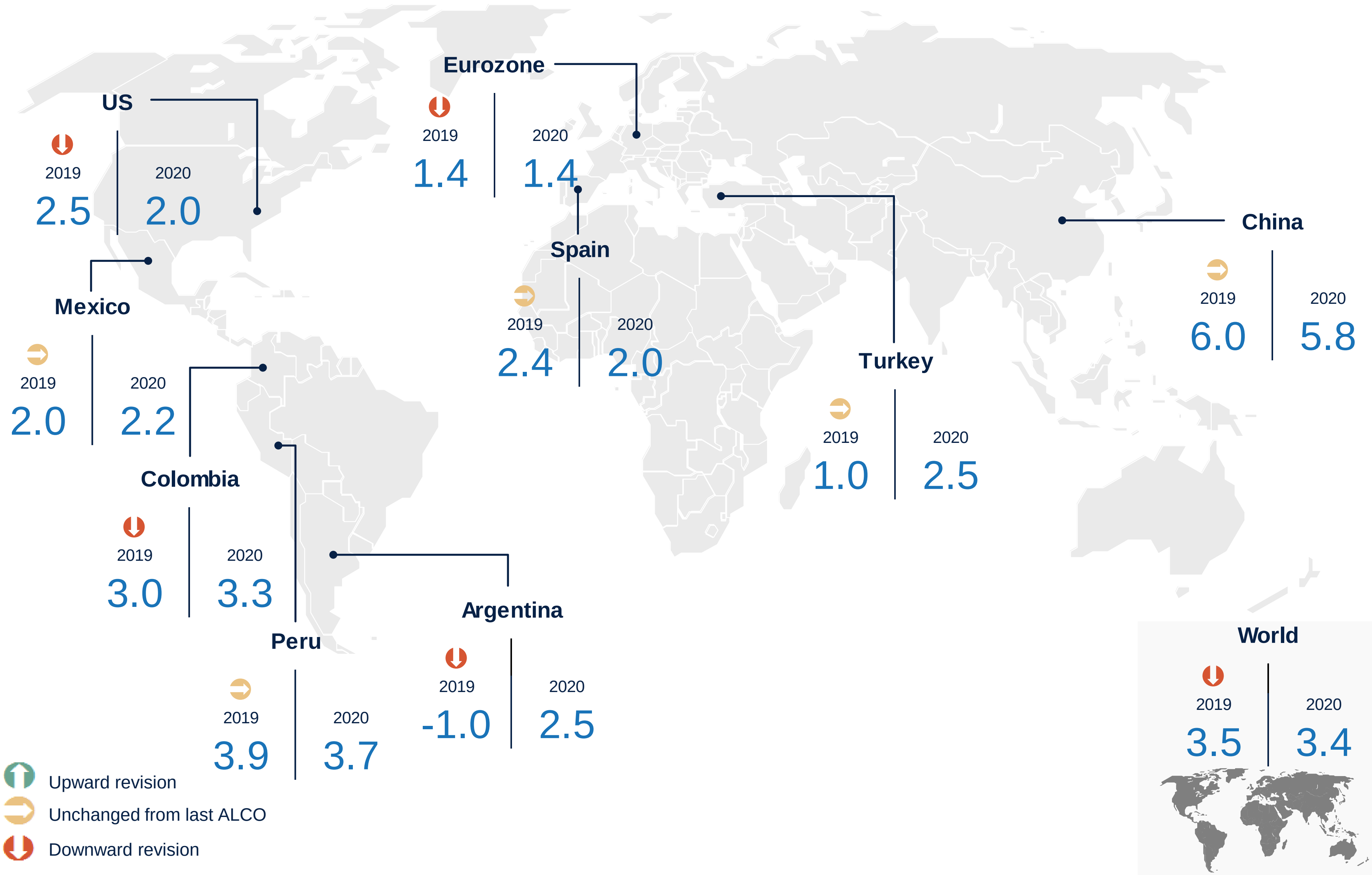
	Balance	Interest rates
Fed	**Ongoing reduction of the size of the balance sheet** (USD500bn in 2019)	**The end of the hiking cycle is near:** two more rate hikes in 2019 are expected instead of three
ECB	**The QE ended in Dec18** **Enhanced forward guidance on reinvestment:** to continue well beyond the start of interest rate hikes **Liquidity:** another TLTRO before Jun19 is likely to be announced to avoid liquidity cliff in 2020.	**Delay in the rate** hike path due to a less supportive global outlook and higher risks. **First depo rate hike (+10bps) in** Dec19 vs. Sept19. **First refi rate hike (+25bps) in Jun20** vs Dec19





Source: BBVA Research

Downward revision in almost all footprint countries



After the recent turmoil, Fed's pause, China' stimulus and US-China talks allowed a partial recovery

01

The Fed's "pause", China's stimulus and hopes of easing trade tensions spurred a relief rally across the board

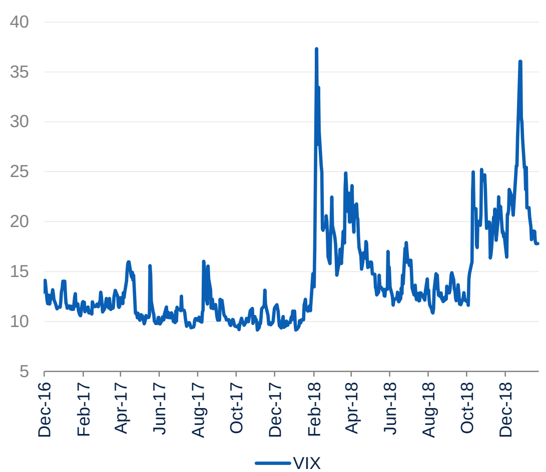
02

Among the developed, **US recovered at higher pace than** European assets (due to growth concerns) while EM coped with recent turmoil and now, benefited the most from Fed's "pause".

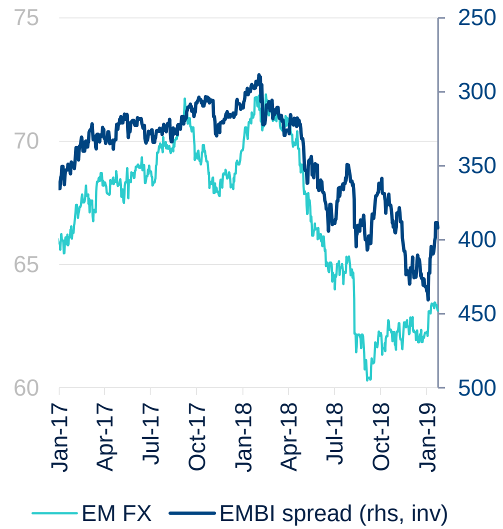
03

However, core **sovereign yields remained low** (peripheral spreads narrowed) and the JPY continued strengthening, signaling caution on risks surrounding the global outlook (slowdown, trade, politics and Brexit).

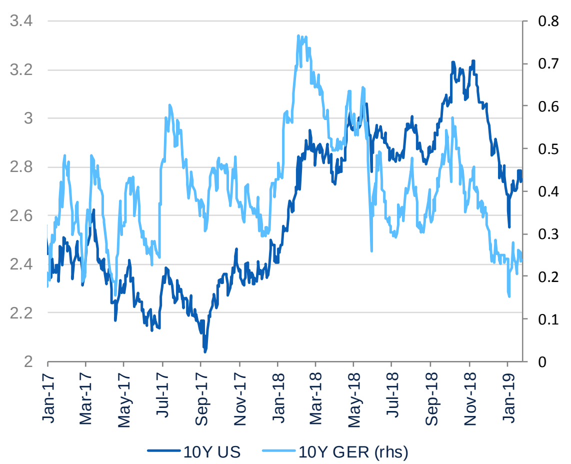
VIX (%)



FX and Equity EM
(Index)



US and Germany 10Y sovereign yields
(%)

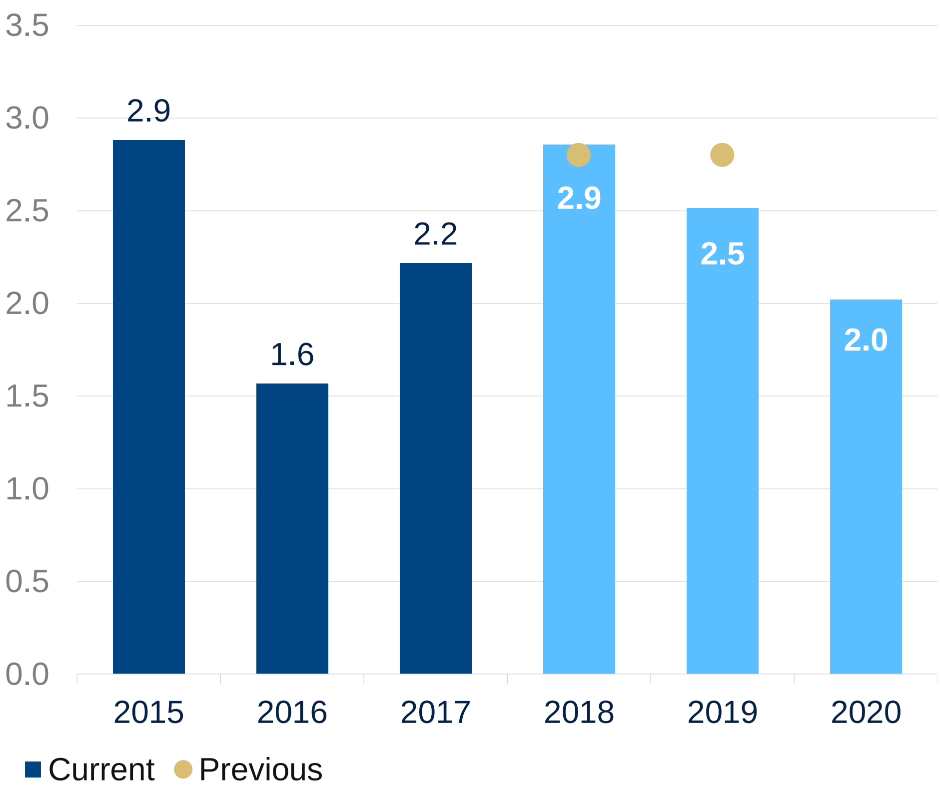


Fuente: BBVA Research

US: downward revision to GDP, together with financial vulnerabilities, underlie revision from three to two interest rate increases in 2019

Main macroeconomic indicators

(% YoY, % GDP)

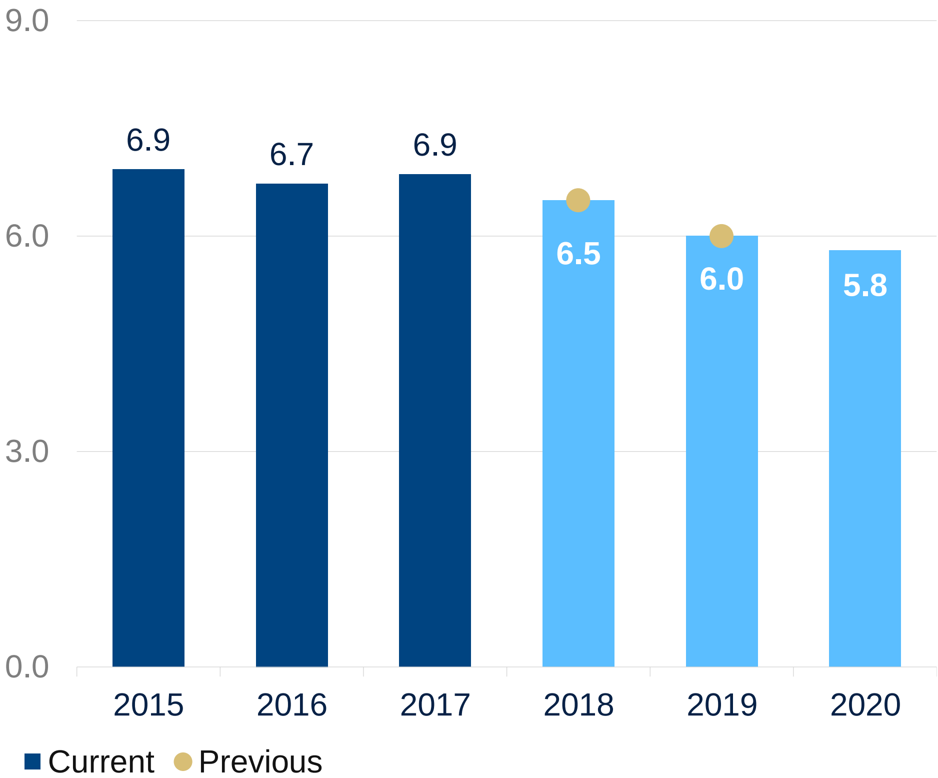


- Downward revision to GDP on less optimistic outlook for private investment and public spending
- Inflation to overshoot modestly in short-run, returning to slightly below the Fed target in 2020
- Financial vulnerabilities and lower growth outlook underlie revision from three to two rate increases in 2019. Time in between rate changes to increase to 6-months, as Fed attempts to fine-tune its strategy in the final stages of this interest rate normalization cycle
- Local risks: balanced to the downside due to potential global headwinds and uncertainty, and U.S. recession risk, particularly over a 24-month horizon

Source: BBVA Research

China: tackling growth slowdown assumes policy priority

Main macroeconomic indicators
(% YoY, % GDP)

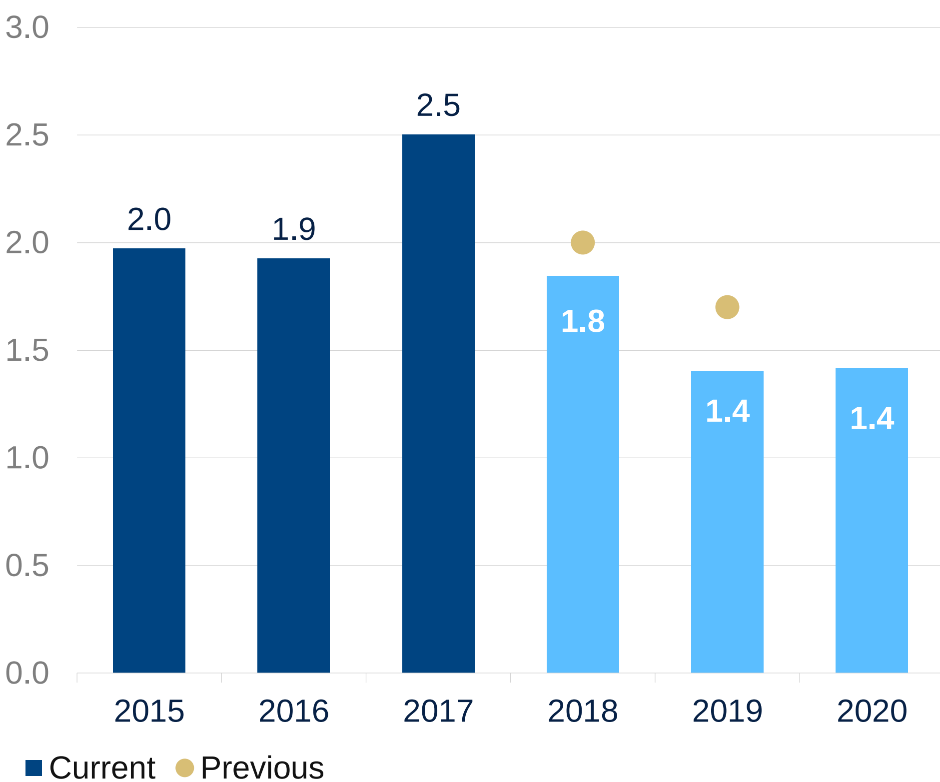


- PBOC stepping up growth stimulating policy easing. China's monetary policy to stay accommodative in 2019.
- PBOC doing a delicate balancing act between trying to stem flagging economic growth without fueling financial stability concerns amid elevated debt levels.
- Maintain our FX forecast at 6.75 RMB to USD for Dec'19 in our baseline scenario, under which we expect US and China to soon reach an agreement after the 90-day trade war truce ending March 2019.
- Local risks: trade war uncertainty, domestic deleveraging, housing market slowdown, expansionary local government debt

Source: BBVA Research

Eurozone will trend faster to potential growth as external support fades away

Main macroeconomic indicators
(% YoY, % GDP)



- Lower oil prices and weaker euro add to the strength of domestic drivers, but not enough to offset the drag of net exports
- More supportive monetary and fiscal policy could help to prevent the effect of worsening confidence on private spending
- The sharp fall in oil prices will shape inflation down clearly below the ECB's target earlier this year, but core inflation should increase very gradually
- Domestic risks tilted to the downwards and predominantly political (Brexit, political uncertainty)

Source: BBVA Research

Macroeconomic forecasts (updated Jan-19)

Gross domestic product
(annual average, YoY)

	2017	2018	2019	2020
United States	2.2	2.9	2.5	2.0
Eurozone	2.5	1.8	1.4	1.4
Spain	3.0	2.5	2.4	2.0
Latam*	1.9	1.6	2.1	2.4
Argentina	2.9	-2.4	-1.0	2.5
Brazil	1.1	1.2	2.2	1.8
Chile	1.5	4.0	3.4	3.3
Colombia	1.8	2.6	3.0	3.3
Mexico	2.3	2.2	2.0	2.2
Peru	2.5	3.9	3.9	3.7
Eagles **	5.4	5.2	5.0	5.0
Turkey	7.4	3.0	1.0	2.5
Emerging Asia	6.4	6.4	6.1	6.0
China	6.8	6.6	6.0	5.8
World	3.7	3.6	3.5	3.4

(*) Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru and Uruguay

(**) Bangladesh, Brazil, China, Egypt, India, Indonesia, Iran, Malasya, Mexico, Nigeria, Pakistan, Philippines, Russia, Turkey

Source: BBVA Research and IMF

Inflation
(annual average, YoY)

	2017	2018	2019	2020
United States	2.1	2.4	2.2	2.1
Eurozone	1.5	1.7	1.6	1.6
Spain	2.0	1.7	1.3	1.5
Latam*	6.6	7.4	7.6	5.8
Argentina	25.4	36.3	40.1	20.5
Brazil	3.3	3.9	4.1	5.0
Chile	2.2	2.5	2.8	2.9
Colombia	4.2	3.2	3.3	2.9
Mexico	6.0	4.9	4.2	3.8
Peru	2.8	1.3	2.3	2.4
Eagles **	4.0	4.7	5.1	4.7
Turkey	11.1	16.3	18.4	13.4
Emerging Asia	2.2	2.6	2.8	3.1
China	1.5	1.9	2.3	2.5
World	3.3	3.9	3.9	3.6

(*) Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru and Uruguay

(**) Bangladesh, Brazil, China, Egypt, India, Indonesia, Iran, Malasya, Mexico, Nigeria, Pakistan, Philippines, Russia, Turkey

Source: BBVA Research and IMF

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