BBVA Research

Global Economic Watch

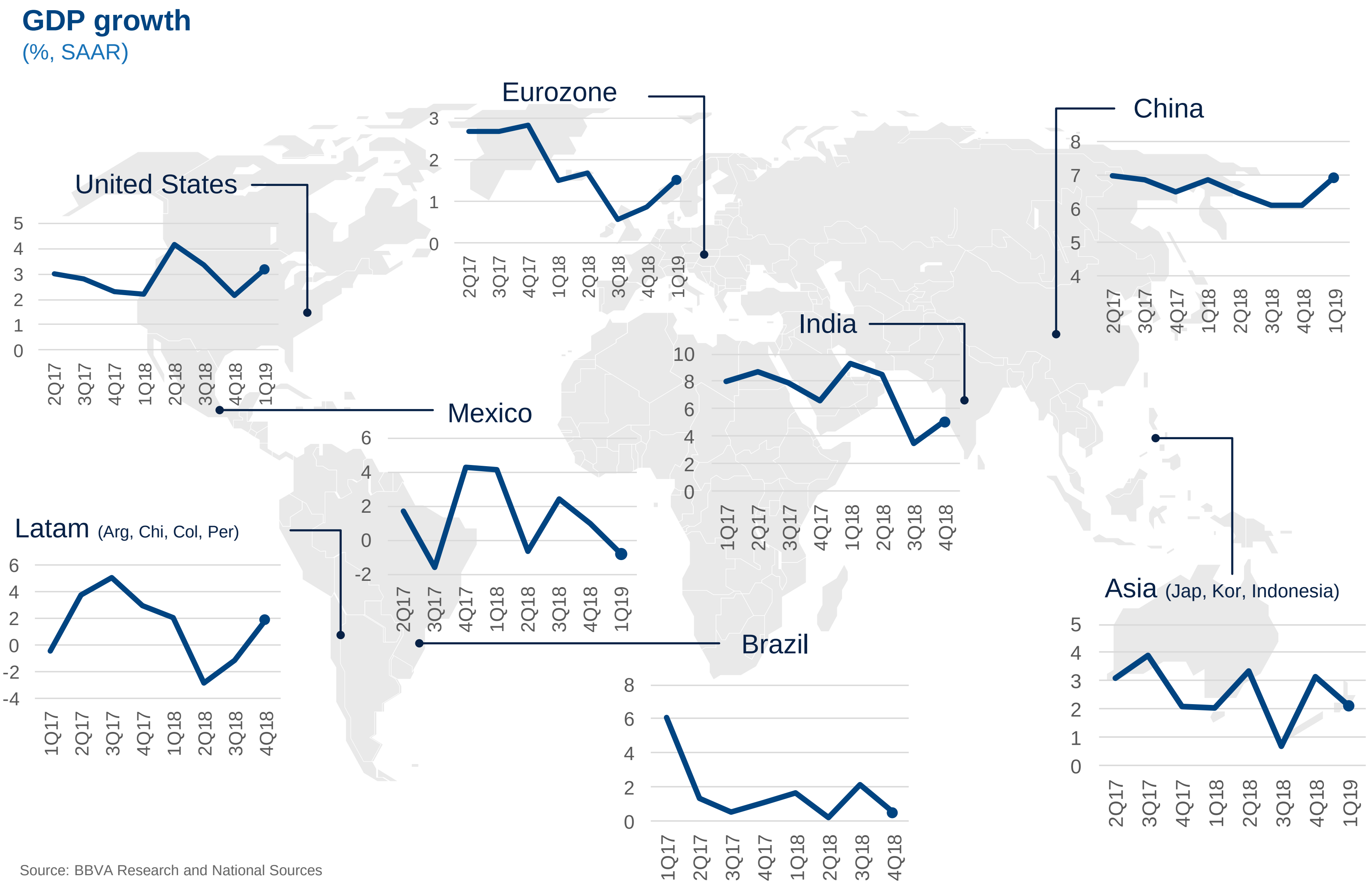
May 2019

Creando Oportunidades

Global | Growth gained momentum in early 2019, but protectionism is a threat

- Growth in the Eurozone, China and US surprised on the upside in 1Q19, but with some worrying signs stemming from its composition as it was supported by building inventories and declining imports, likely related with trade concerns and slowing domestic demand. In Europe, the positive surprise could also be linked to fading negative one-off effects in previous quarters and the positive effect of mild winter.
- Our BBVA-GAIN model shows a slight deceleration in global growth in 2Q19 to 0.9% from a positive 1% in 1Q19.
- Up to March hard data was mixed: retail sales are still strong across the board, suggesting that domestic demand remains as the main driver of growth across regions, but contrast with the weakness of industrial sector and global trade.
- But soft indicators slid again in April: Global manufacturing confidence remains gloomy, while services PMIs fell in developed and emerging economics and increased concerns about contagion effect from trade and manufacturing to services.
- The escalation of US-China trade war (tariff increases and technological disputes) could weigh markedly on China's GDP growth if they are not reversed, and would also the US and the EZ, eventually could negatively affect the good growth performance so far this year. However, this negative impact could be offset in the short-term by further expansionary fiscal and monetary policies (mostly in China).
- The rise in oil prices could shape headline inflation in coming months, likely delaying the expected moderation in annual rates, but core inflation should remain low as to maintain the dovish stance of central banks in a more uncertainty global outlook.

Growth in the Eurozone, China and US surprised on the upside in 1Q19 and recovered some momentum, after slowing in 2H18…



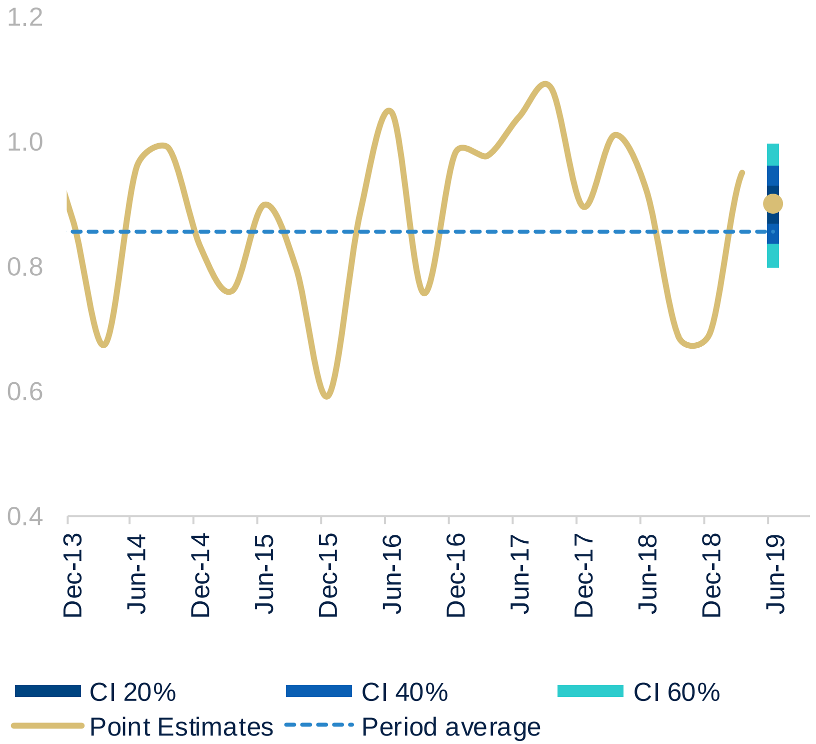
Source: BBVA Research and National Sources

… but our BBVA-GAIN for 2Q19 suggests that global activity is trending to a more subdued growth rate than in previous years

The global economy recovers from the slowdown observed in 2H18, but is **unlikely to gain further momentum** due to negative effects from the trade dispute, weak manufacturing and increasing political uncertainty

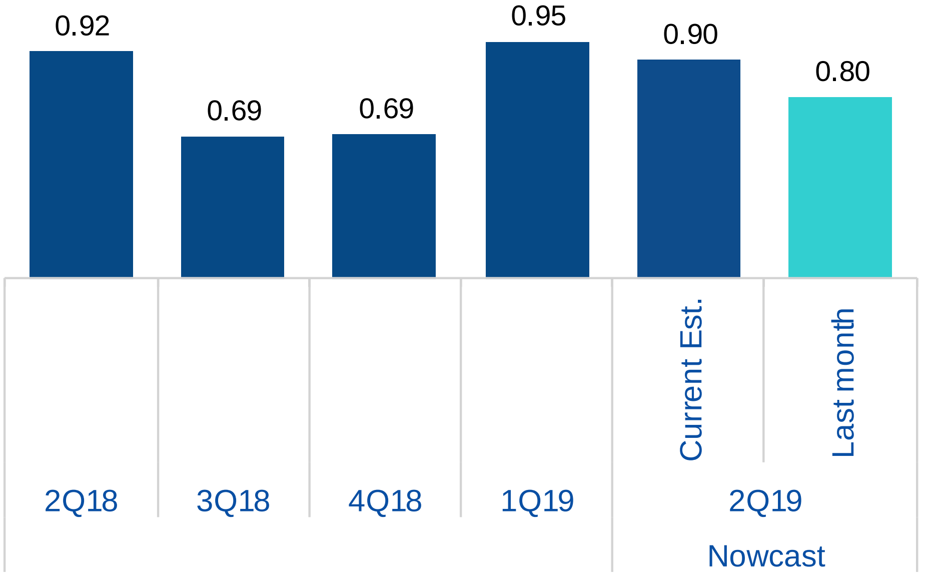
World GDP growth

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



World GDP Growth

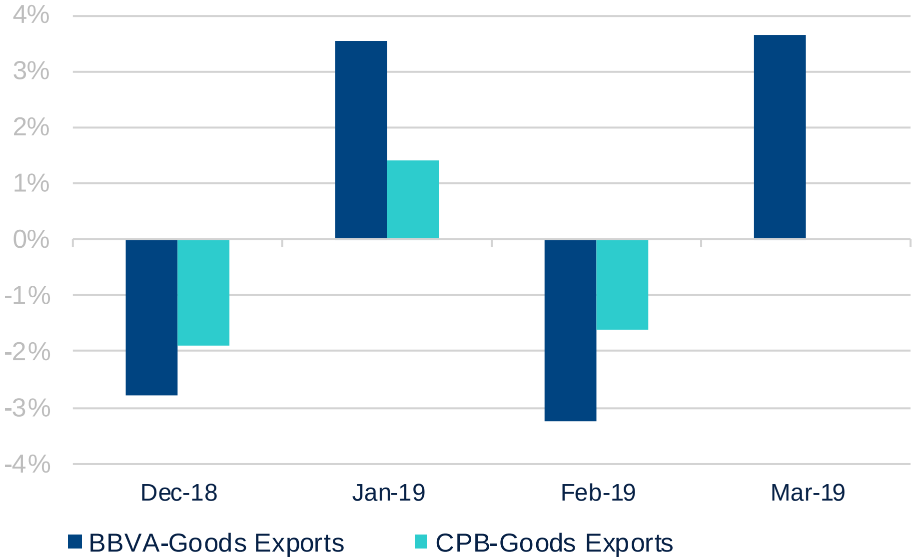
(Forecast based on BBVA-GAIN (%, QoQ))



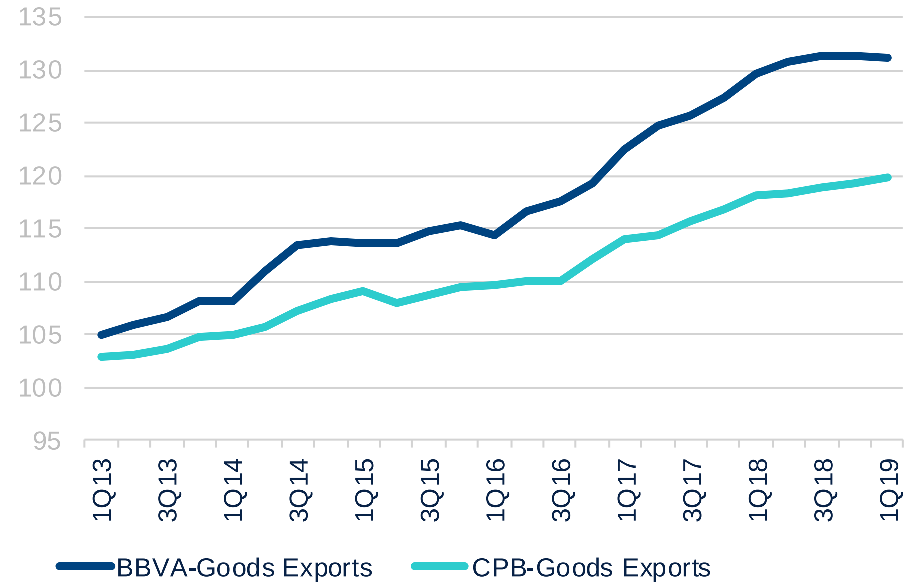
Source: BBVA Research and National Sources

Global exports still remain broadly stagnant, beyond short-term volatility, and have put a break to activity over recent quarters

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



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



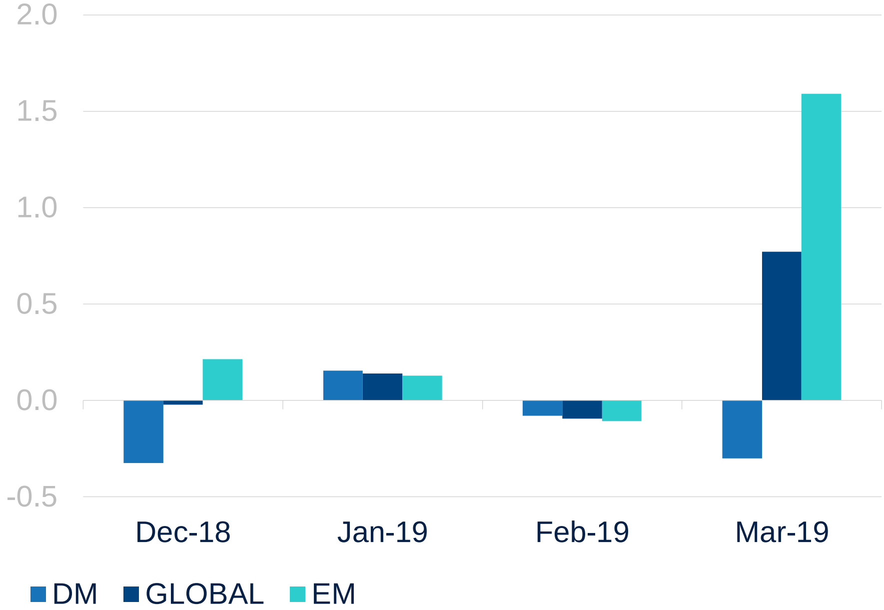
Netherlands Bureau for Economic Policy Analysis (CPB) makes a world set based on 28 developed markets and 60 emerging markets covering a 97% of world trade

Source: BBVA Research and National Sources

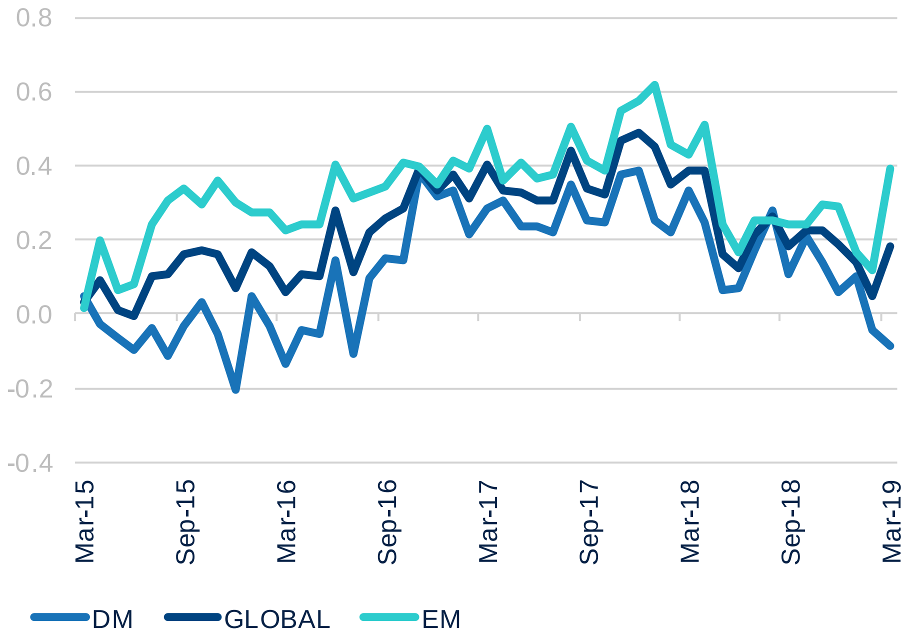
The downward trend in the industrial sector halted in March at the global level, but remains subdued in developed countries…

Lower foreign orders have been dragging down industrial production

World industrial production
(%, MoM)



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



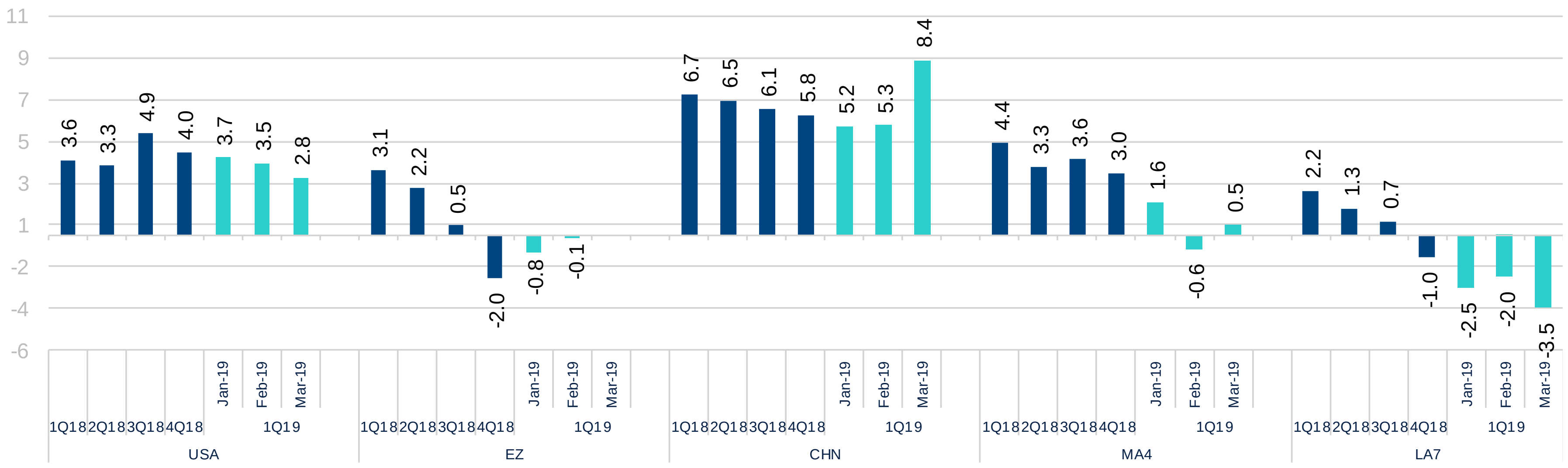
Source: BBVA Research and National Sources

… while the good performance by EMs in March was largely due to the exceptional figures of the Chinese industry

China's industrial production jump is largely due to a seasonal effect of the new year and the effect of the fiscal stimulus on the manufacturing sector.

World industrial production: selected regions

(%, YoY)



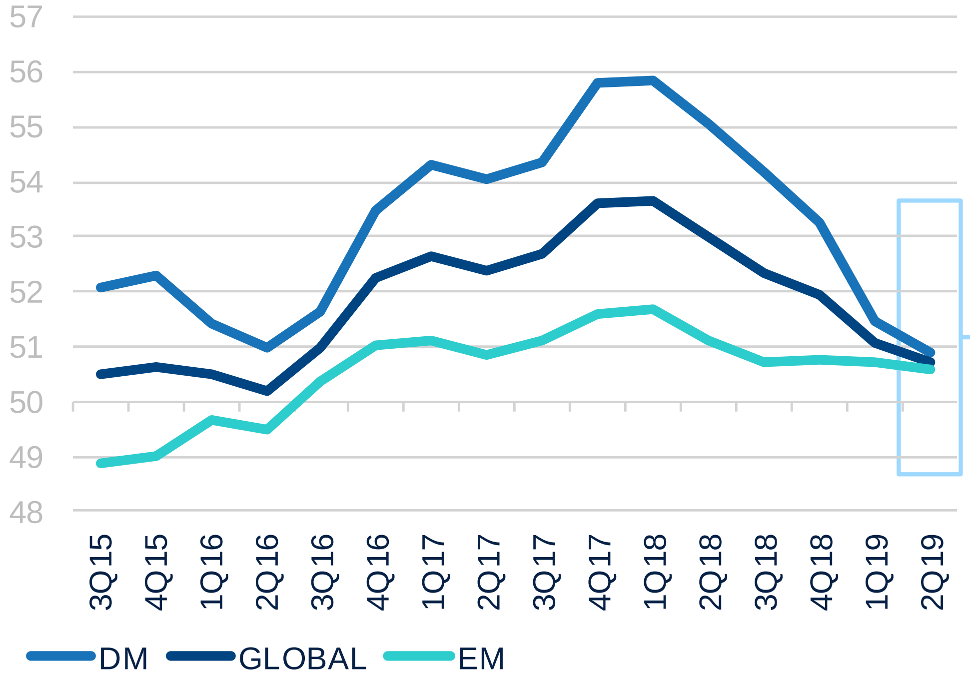
MA4: India, Indonesia, Japan and Korea

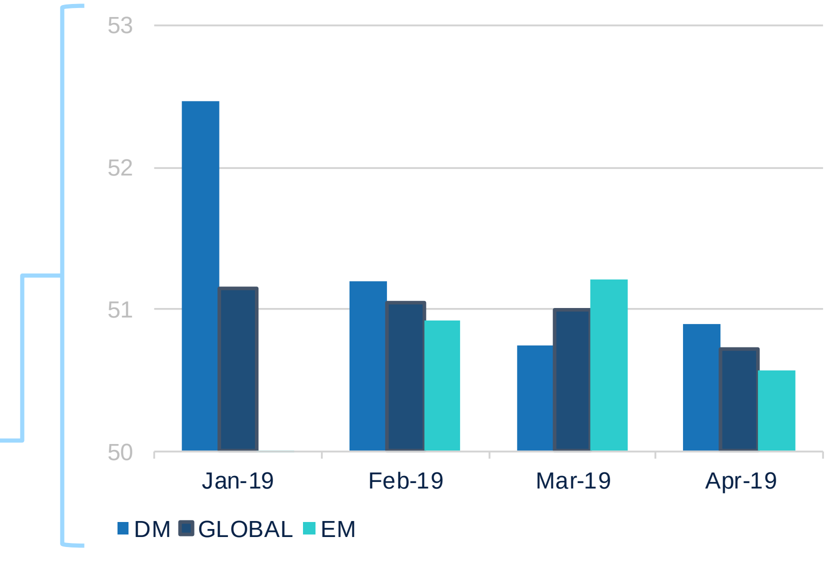
Source: BBVA Research and National Sources

But global manufacturing confidence slipped again in April

The **main drag remains the declining trend of new foreign orders.** In addition, the sharp decline in production of intermediate and capital goods could anticipate lower investment looking forward**.**

World manufacturing PMI
(Level ± 50)





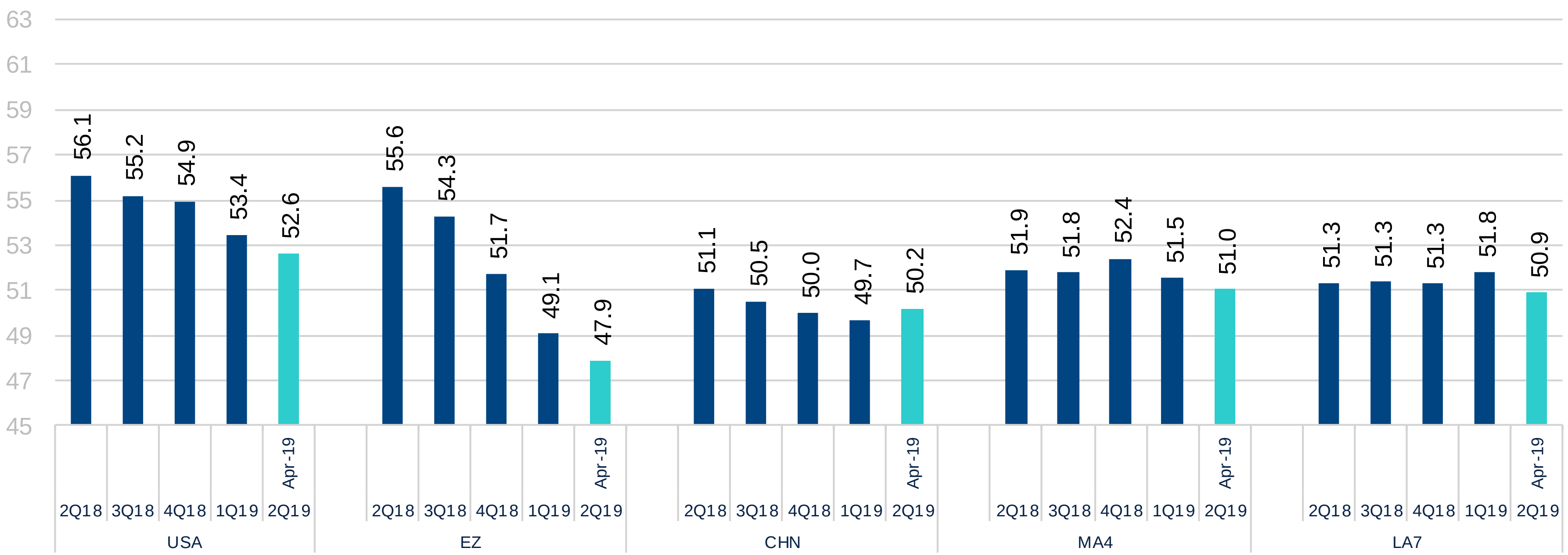
Source: BBVA Research and Markit Economics

Across regions, manufacturing PMIs remain subdued, beyond the improvement in China.

The **improvement** from March to April in developed economies is mainly due to the positive evolution **in the United States and the Eurozone, but it still below previous quarters readings**

Manufacturing PMI: selected regions

(Level ± 50)



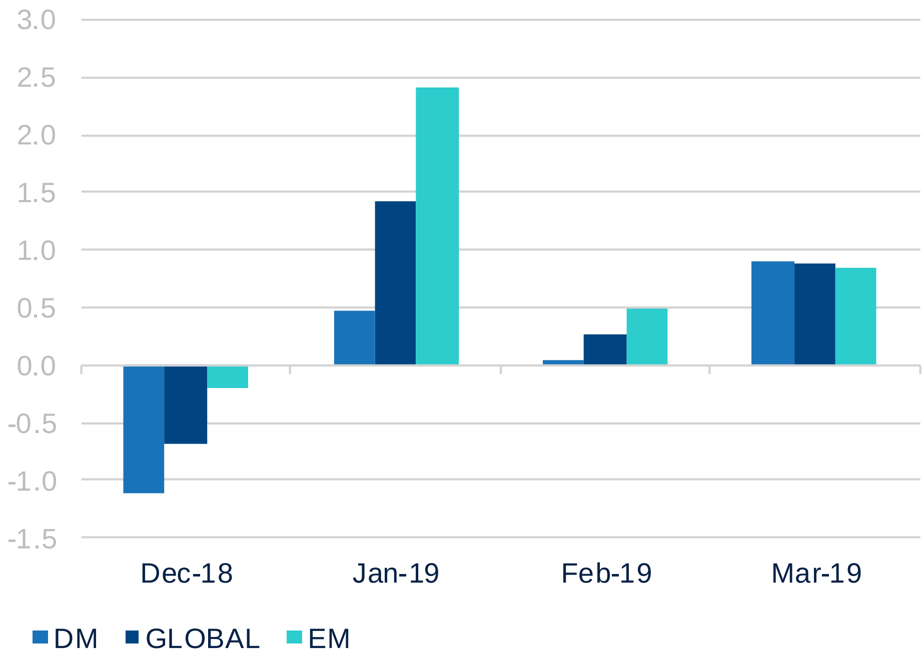
MA4: India, Indonesia, Japan and Korea

Source: BBVA Research and Markit Economics

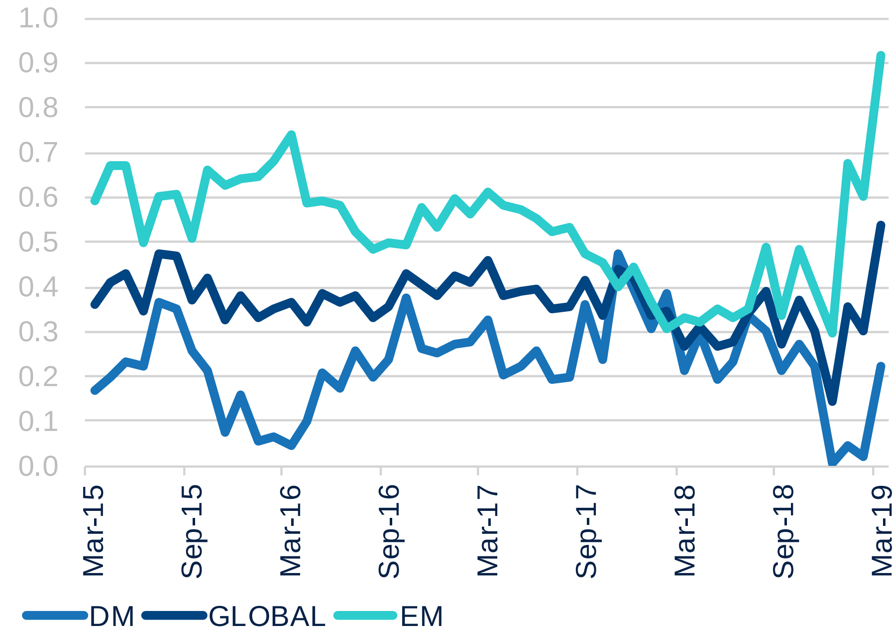
Retail sales recovered momentum in Q1 up to March across the board, showing more evidence that domestic demand is the main growth driver across regions

Developed countries led the recovery in retails sales, reaching the highest rate in the last five months, but emerging economies also contributed positively.

World retail sales
(%, MoM)



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

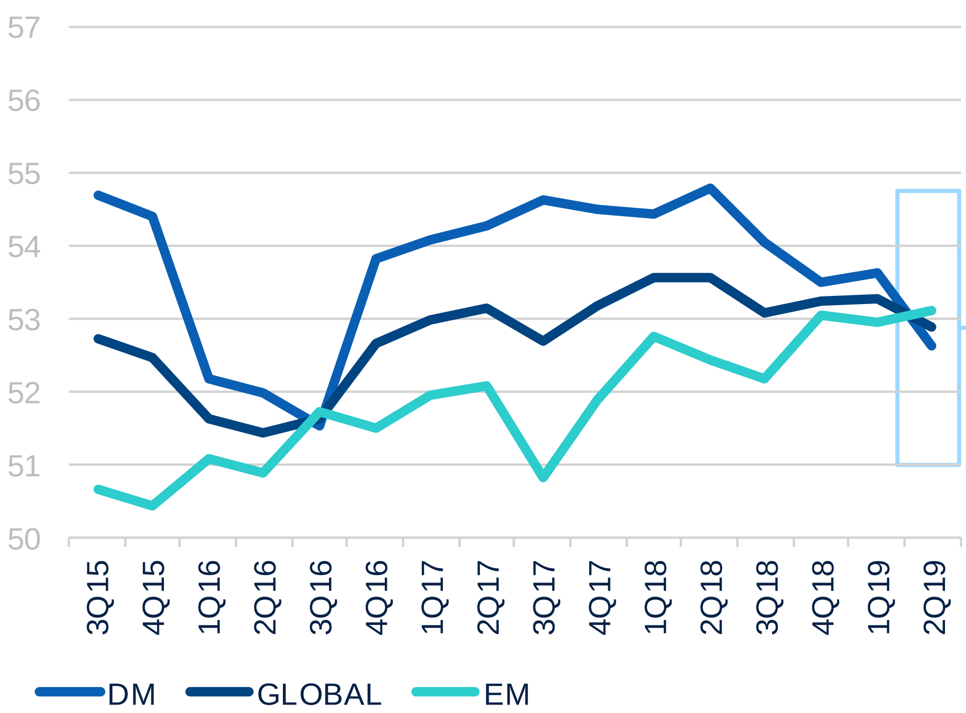


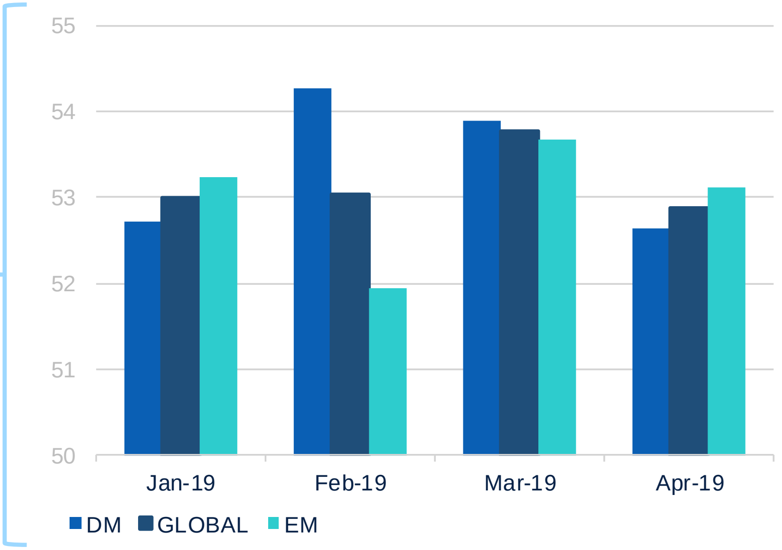
Source: BBVA Research and National Sources

April's services PMIs fell in both DM and EM, increasing concerns about contagion effect from trade and manufacturing to services

Services PMIs decreased in April 2019, but still remain clearly in the expansive territory

World services PMI.
(Level ± 50)



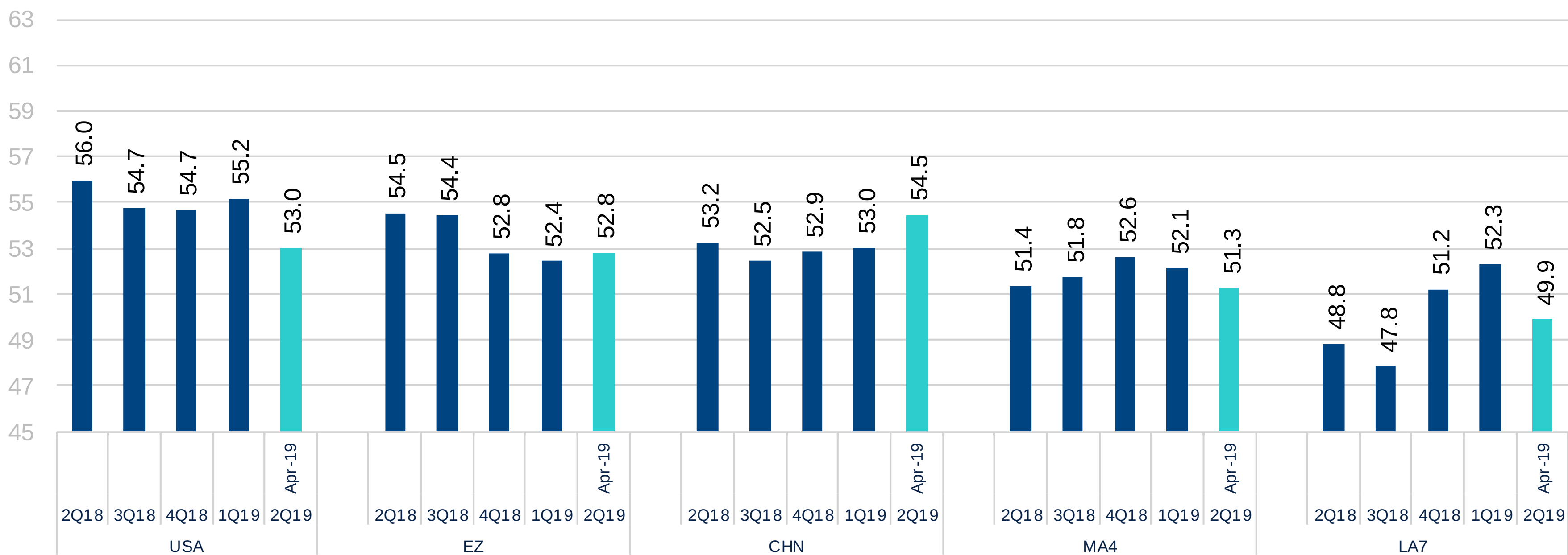


Source: BBVA Research and Markit Economics

Service PMIs increased in China, but moderated in the Eurozone and fell in the United States and the rest of emerging economies

Services PMI: selected regions

(Level ± 50)



MA4: India, Indonesia, Japan and Korea

Source: BBVA Research and Markit Economics

Trade war: US-China tensions escalate amid tit-for-tat tariffs and new restrictions on Huawei; EU gets a temporary respite from US auto tariffs

What happened

US-China

- **US-China trade talks unexpectedly derailed** following months of apparent smooth progress.
- **US raised tariffs on $200 bn Chinese goods from 10% to 25%; also mulling raising tariffs to 25%** on rest of Chinese imports.
- **In retaliation, China hiked tariffs on $60 bn of US imports** to as high as 25%, effective June 1st.
- Beyond trade, **US restricted Huawei from buying semiconductor chips** from US firms, later delayed by 3 months

US-Other

- **Auto tariffs:** The US agreed to **postpone by 6 months decision to apply auto tariffs** on Europe and Japan on grounds of national security.
- Should Trump follow through on his threat, **EU has warned that it would "react in a swift and adequate manner".** EU is prepared to retaliate with tariffs on up to $22.5 bn of US goods.
- **USMCA**: US agreed to lift tariffs on steel and aluminum from Canada and Mexico, removing a key obstacle for approval of USMCA, which still faces challenges in the US House of Representatives.

Prospects

US-China

- The trade war is extending into a **technology war**
- Trump and Xi could break the impasse at **G20 (Jun-28)**
- **We still expect some kind of agreement (2/3 prob),** but prospects of a full-blown trade war have increased

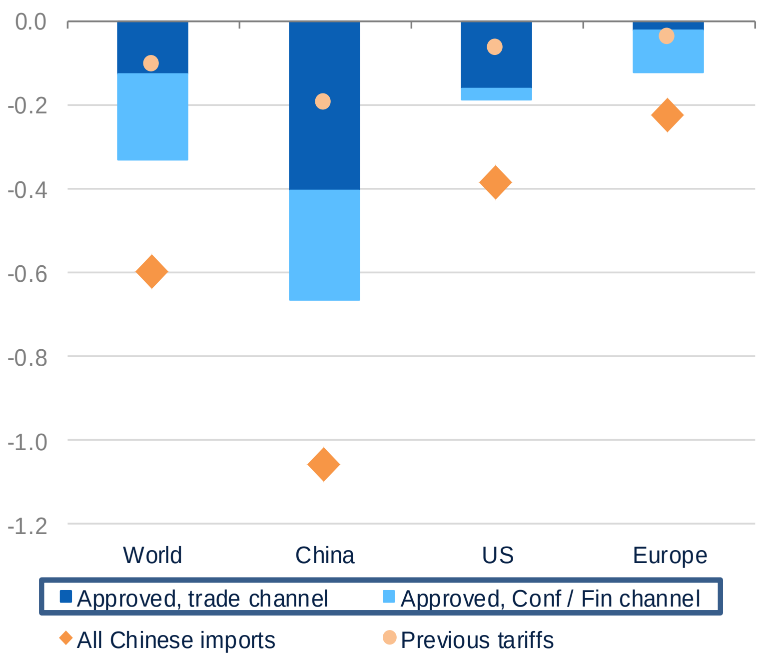
US-Other

- **Despite the six month window, EU-US trade tensions will persist,** as the bloc still faces tariffs on up to $53 billion of EU's car and related exports

The escalation of US-China trade war would weigh markedly on China's GDP growth, but also on the US and it could derail global growth

Effect of approved US tariff increases and retaliation on GDP growth. **May 2019**

(two years, pp)



Simulations**:**

- **Approved:** 25% tariff increase on steel, 10% on aluminum, **25% on Chinese USD250bn imports. China's retaliation**: **25% on USD110bn on US imports**
- **All Chinese imports**: Previous simulation +**25% on all Chinese imports (more than USD500bn). China's retaliation: 25% on USD130bn on US imports**
- Previous tariffs: 25% tariff increase on steel, 10% on aluminum, 25% on Chinese USD50bn imports and 10% on USD200bn. China's retaliation: 25% on USD50bn and 10% on USD60bn

Source: BBVA Research and National Sources

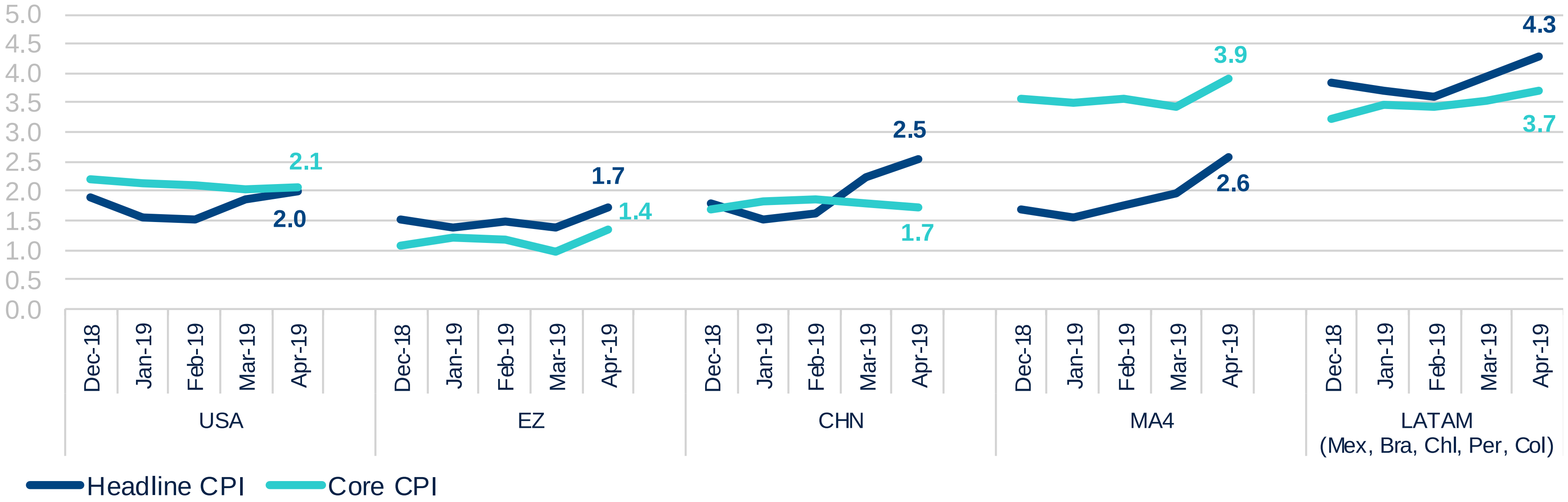
- This increase in tariffs could have an **impact on China's GDP of about 0.5pp to add to 0.2pp of measures already adopted. On the US and the Eurozone, the impact would be much lower** (a total impact of 0.2pp and 0.1pp respectively)
- **US-China negotiation seems to remain open**. The G20 summit in June could provide an opportunity for them to have a deep talk
- **If tariffs were extended to all China's exports, the total impact on China GDP would be larger** (1pp of GDP) **and those on the US and the Eurozone more sizeable** (0.4pp and 0.2pp)

Headline inflation increased again in April due to energy and services prices, especially in the Eurozone due to the Easter calendar effect

The rise in oil prices could shape headline inflation in coming months, but **core inflation should remain low** as to maintain the dovish stance of central banks.

Headline and core inflation: selected regions

(%, YoY)



MA4: India, Indonesia, Japan and Korea

Source: BBVA Research and National Sources

BBVA Research

Global Economic Watch

May 2019

Creando Oportunidades

Disclaimer