BBVA Research

Global Economic Watch

July 2019

Creating Opportunities

Global | Updated forecasts: Global growth to soft land, amid trade tensions and monetary stimulus

- Global growth continues in a smooth downward path (BBVA-GAIN: steady 0.8% QoQ in 2Q19), led by the weakness of the industrial sector and exports in a context high uncertainty on trade tensions. Domestic demand remains broadly resilient across regions, but is growing at a more moderate pace, with increasing concerns of negative spillover effects from the manufacturing sector.
- With persistent uncertainty and low inflation, major central banks (Fed and ECB) have reassessed their monetary policy stance and consider new stimulus measures. We revise downward World GDP growth forecasts by 0.1pp to 3.3% in both 2019 and 2020. The impact of trade tensions is already apparent, and could be sizeable in the long term.
- US activity should gradually lose momentum towards its potential growth rate supported by a more dovish Fed (easing cycle of up to 75bp cut). We maintain our GDP growth forecasts at 2.5% in 2019 and 2% in 2020.
- In the Eurozone, growth has trended down to a more moderate rate driven by the weakness of the industrial sector and increasing uncertainty (trade issues and Brexit) but we maintain broadly unchanged our growth forecasts (+0.1pp to 1.1% in 2019 and -0.1pp to 1.2% in 2020). With inflation persistently very low levels, despite the strength of domestic demand and the labour market, the ECB is expected to be more accommodative (depo rate cut in 3Q19 and refi rate for at 0% for longer, along with a tiered system for deposits).
- In China, more fiscal stimulus measures are expected (tax cuts and expansion of regional government debt) along with cuts in both lending interest rate and reserve requirements and targeted measures to support credit in the medium-term. These stimulus measures lead us to maintain our forecast of GDP to grow by 6.0% in 2019 and 5.8% in 2020.
- In Latam, we expect a recovery in 2H19 after a disappointing first half, and we revise downwards Mexico and Brazil (also Peru and others, but the blip is only temporary). Lower inflation and a dovish Fed will allow for more accommodative monetary policies and less pressures on exchange rates.
- Risks remain strongly on the downside, linked to protectionism (but also to US recession, China's leveraged exacerbated by new stimulus, Brexit), and could be magnified by financial vulnerabilities.

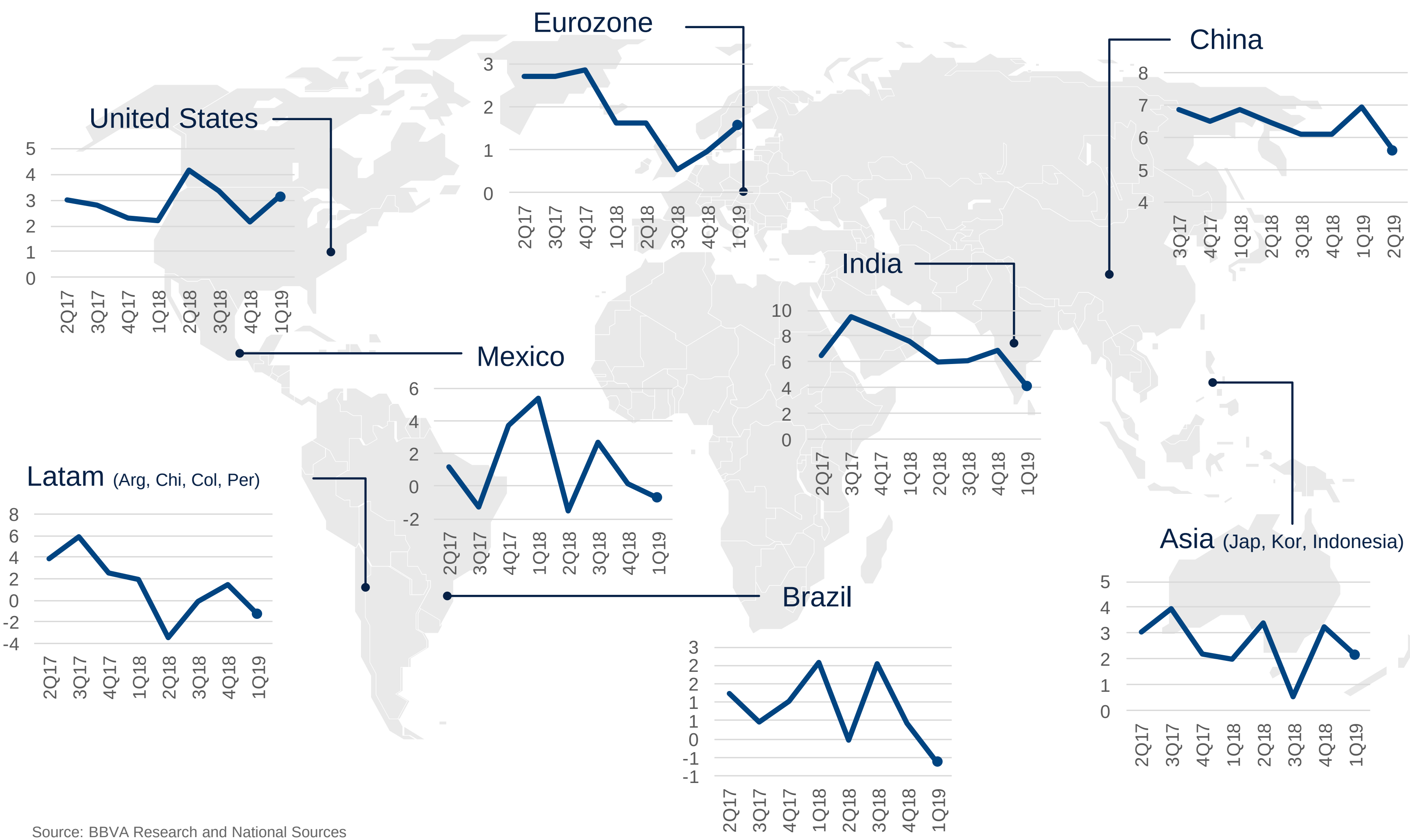
BBVA Research

01

Short term indicators

GDP growth recovered in 1Q19 in three major areas but slowed in most other countries while signs of an ongoing moderation remain

GDP growth
(%, SAAR)

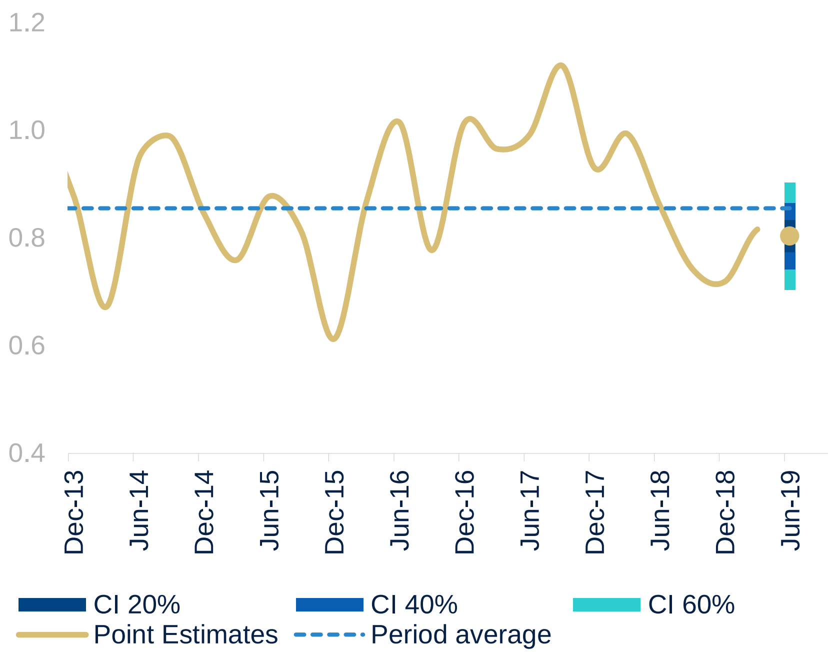


Source: BBVA Research and National Sources

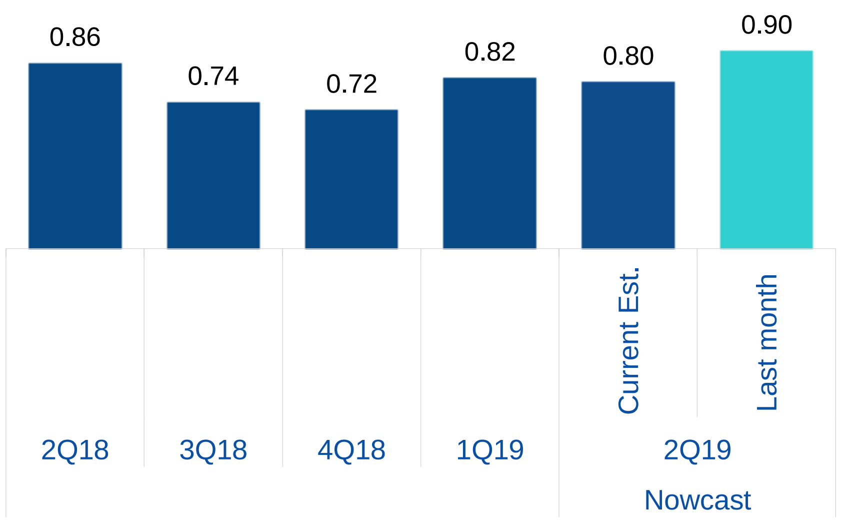
Global growth continues in a smooth downward path, led by the weakness of the industrial sector

Our BBVA-GAIN model suggests that GDP could moderate again in 2Q19, as disappointing hard data up to May and soft data up to June do not point to better prospects in the short run

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



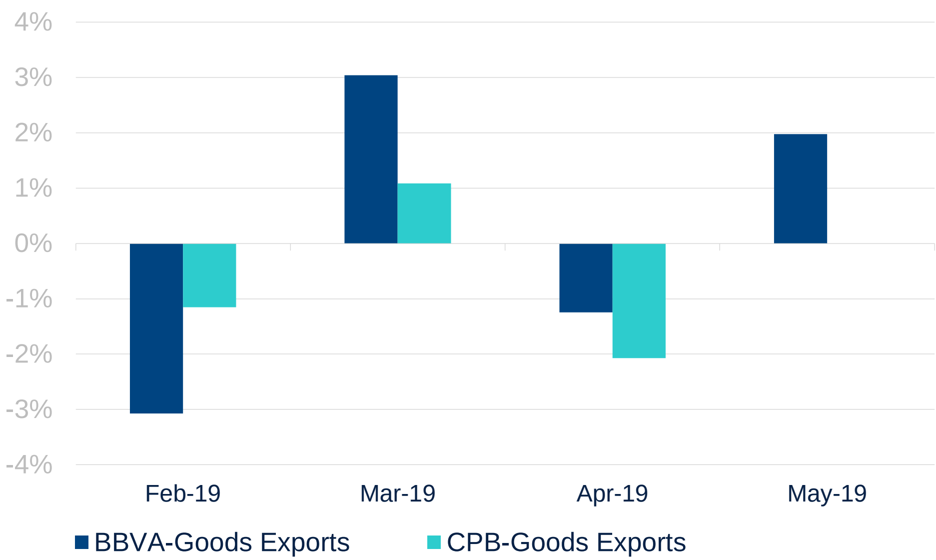
World GDP Growth
(Forecast based on BBVA-GAIN (%, QoQ))



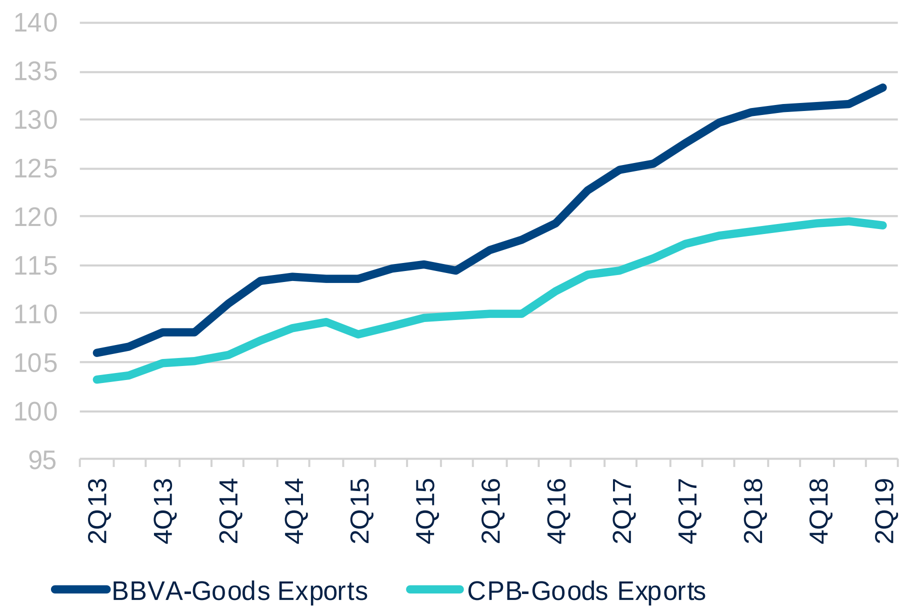
Source: BBVA Research and National Sources

Global exports remain broadly stable. Disappointing figures in April seem to be offset by the rebound of Asian exports in May

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



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

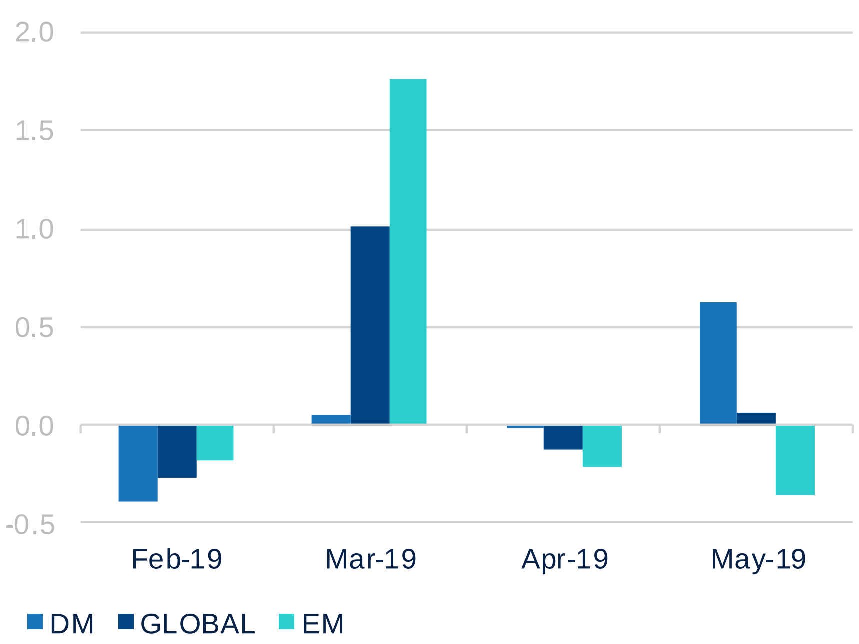


Netherlands Bureau for Economic Policy Analysis (CPB) makes a world set based on 28 developed markets and 60 emerging markets covering a 97% of world trade

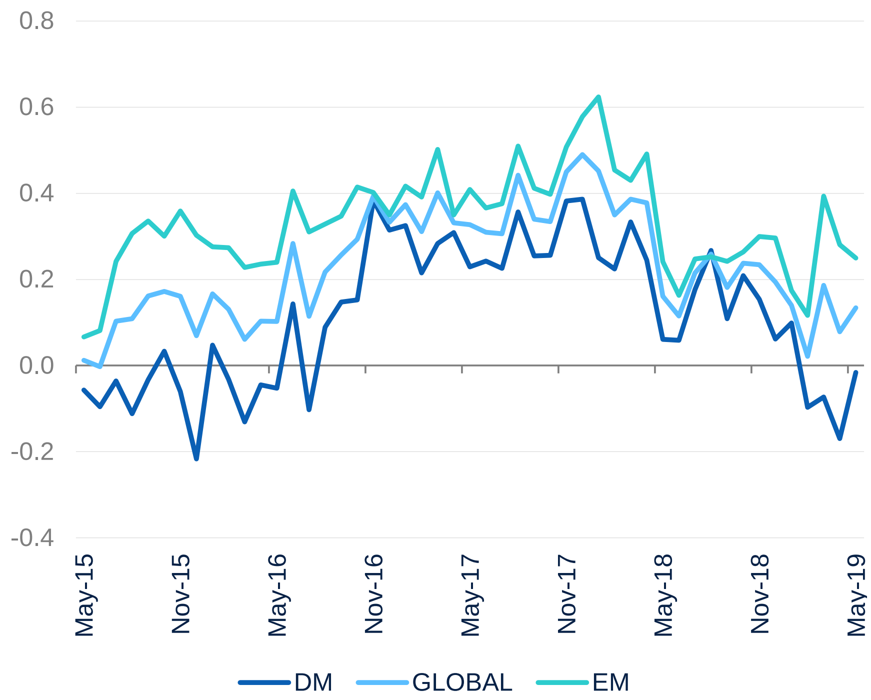
Source: BBVA Research and National Sources

Trade tensions and slowing global demand are behind the weakness in the industrial sector across the board

World industrial production
(%, MoM)



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

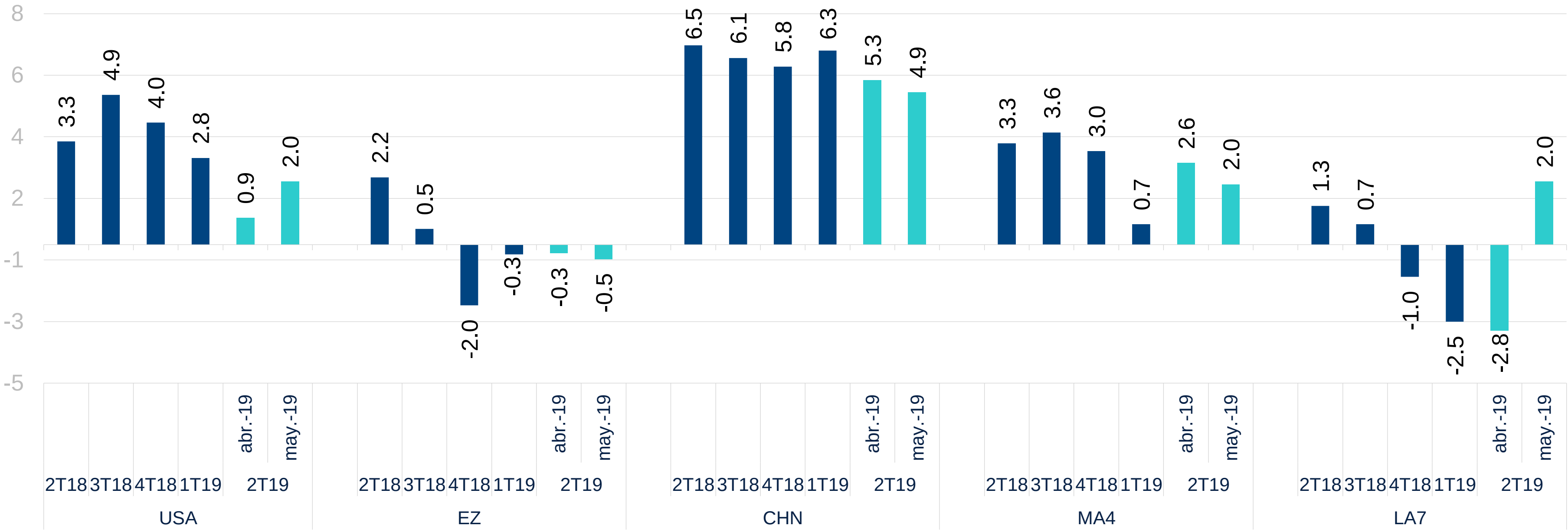


Source: BBVA Research and National Sources

Falling industrial output in Europe, while industrial production in China and emerging Asia is decelerating while it improves in the US

World industrial production: selected regions

(%, YoY)



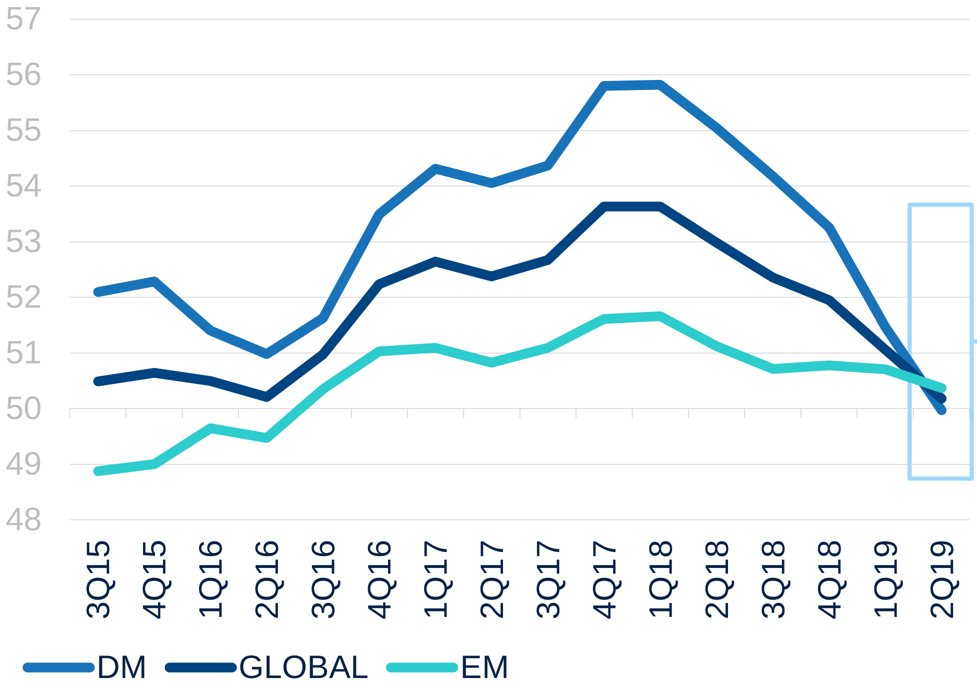
MA4: India, Indonesia, Japan and Korea

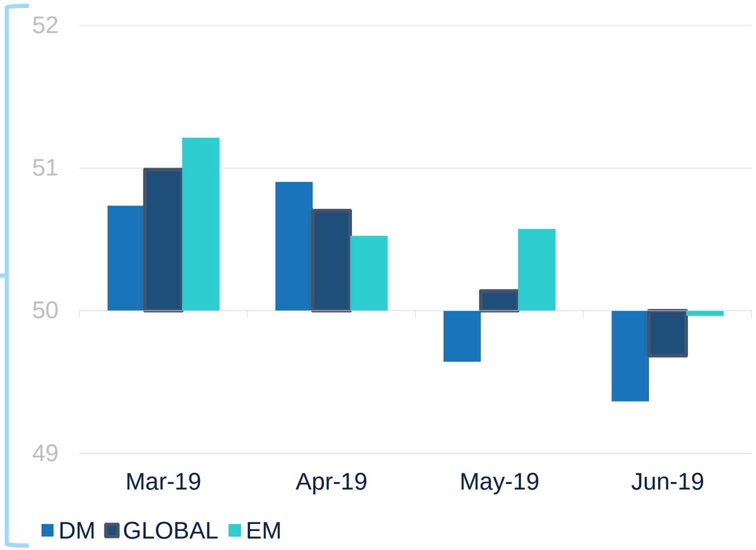
Source: BBVA Research and National Sources

Worsening global manufacturing confidence suggests trade tensions might have a protracted negative effect on the industrial sector

The main drags stem from worsening new exports (export orders from PMIs contracting for ten months) and new orders, but also from the deterioration in employment expectations

World manufacturing PMI
(Level ± 50)

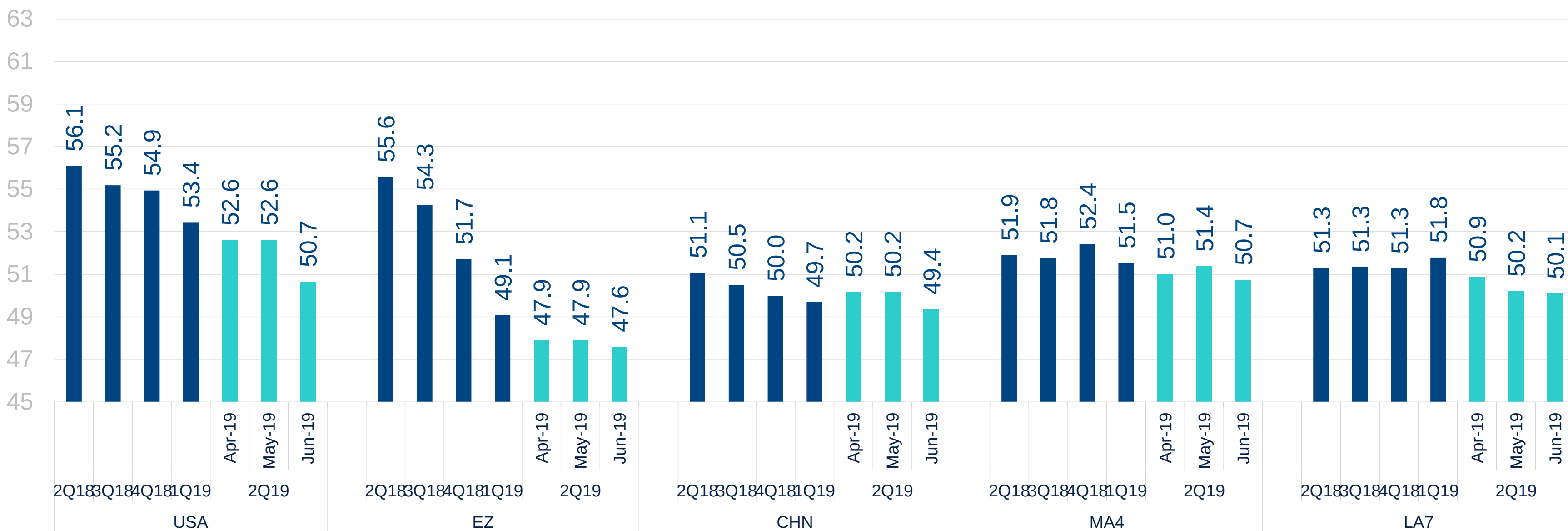




Source: BBVA Research and Markit Economics

Across regions, manufacturing PMIs in China and Europe remain in contractionary territory while in the US they point to stagnation

Manufacturing PMI: selected regions
(Level ± 50)

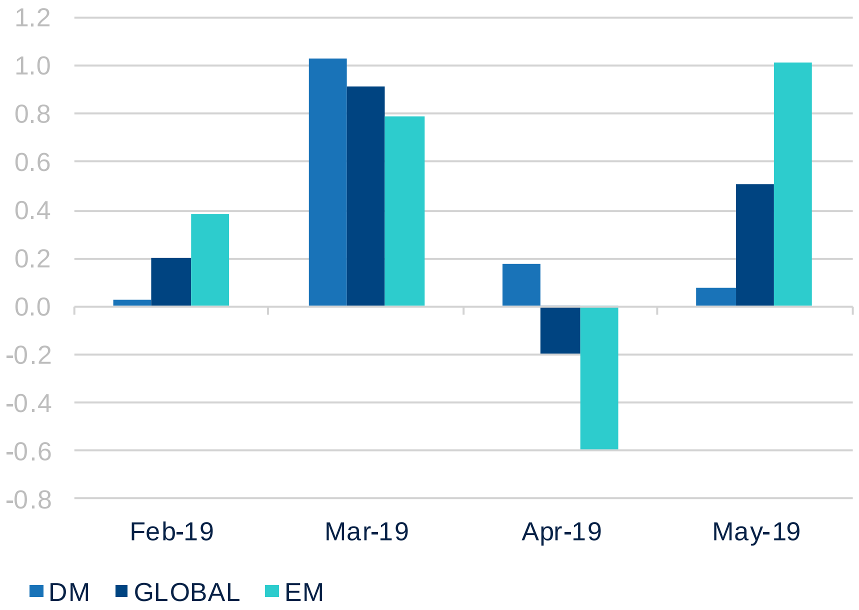


MA4: India, Indonesia, Japan and Korea

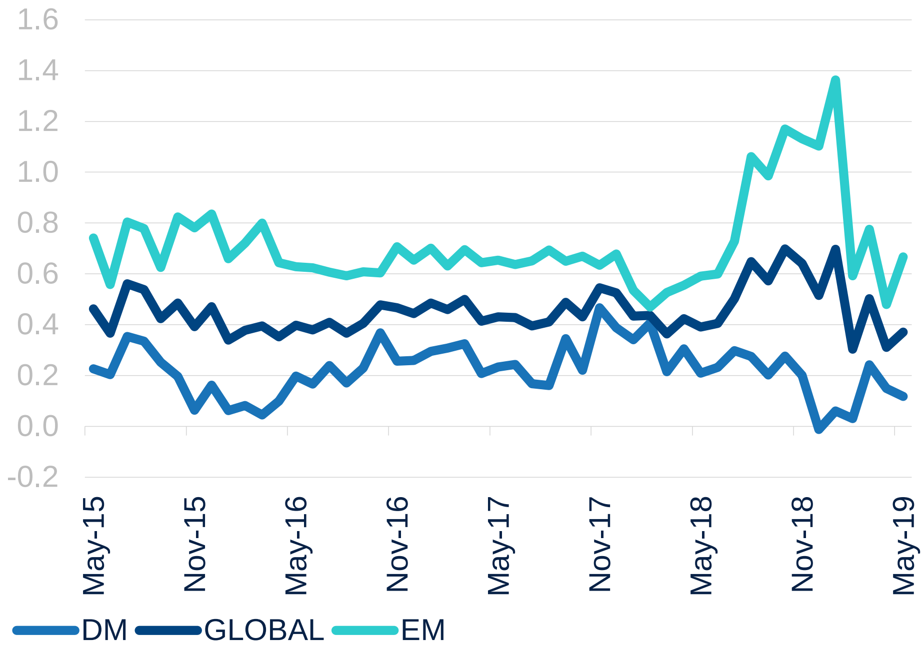
Source: BBVA Research and Markit Economics

Retail sales remain broadly resilient, but are growing moderately

World retail sales
(%, MoM)



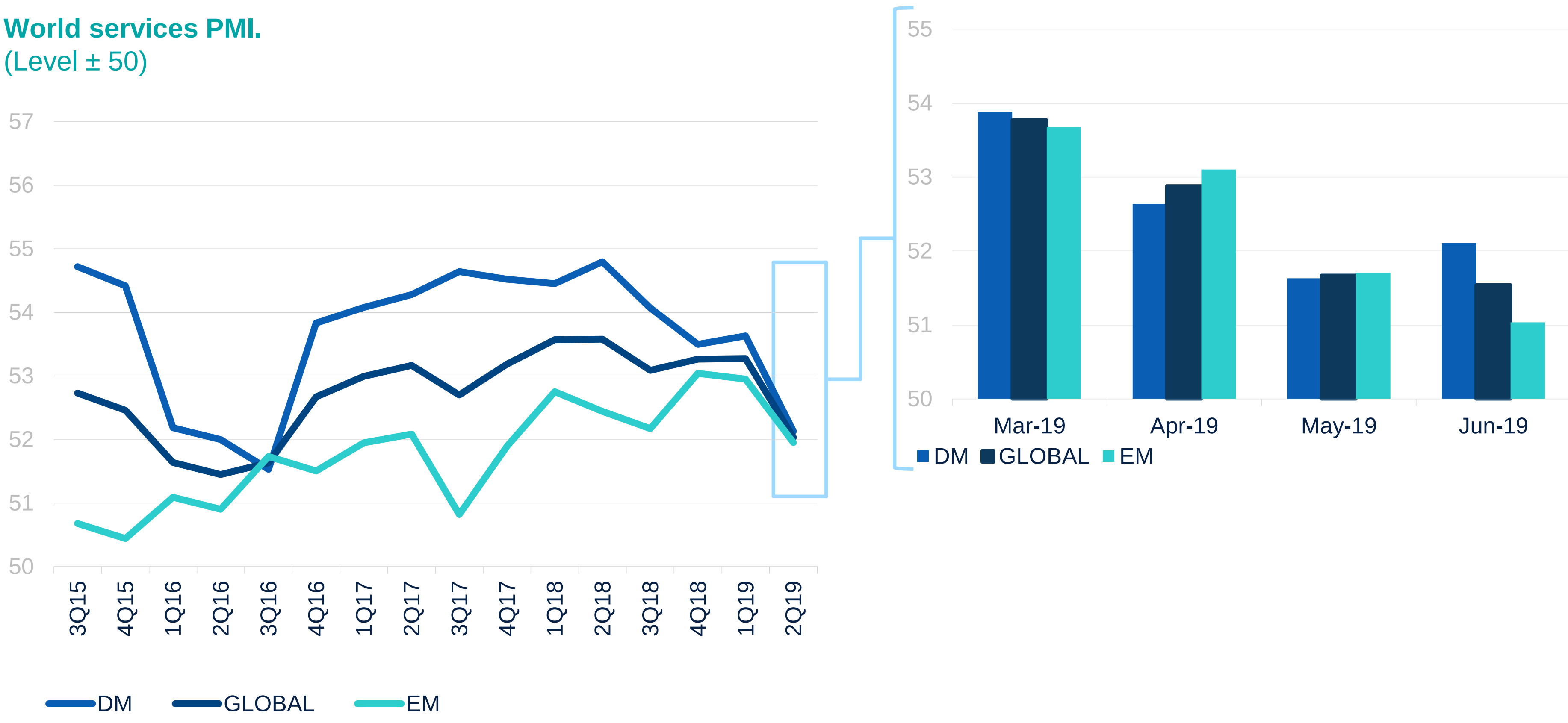
World retail sales
(%, 6-month moving average)



Source: BBVA Research and National Sources

Worsening services PMIs increase concerns about negative spillover effects from manufacturing to domestic demand…

World services PMI.
(Level ± 50)

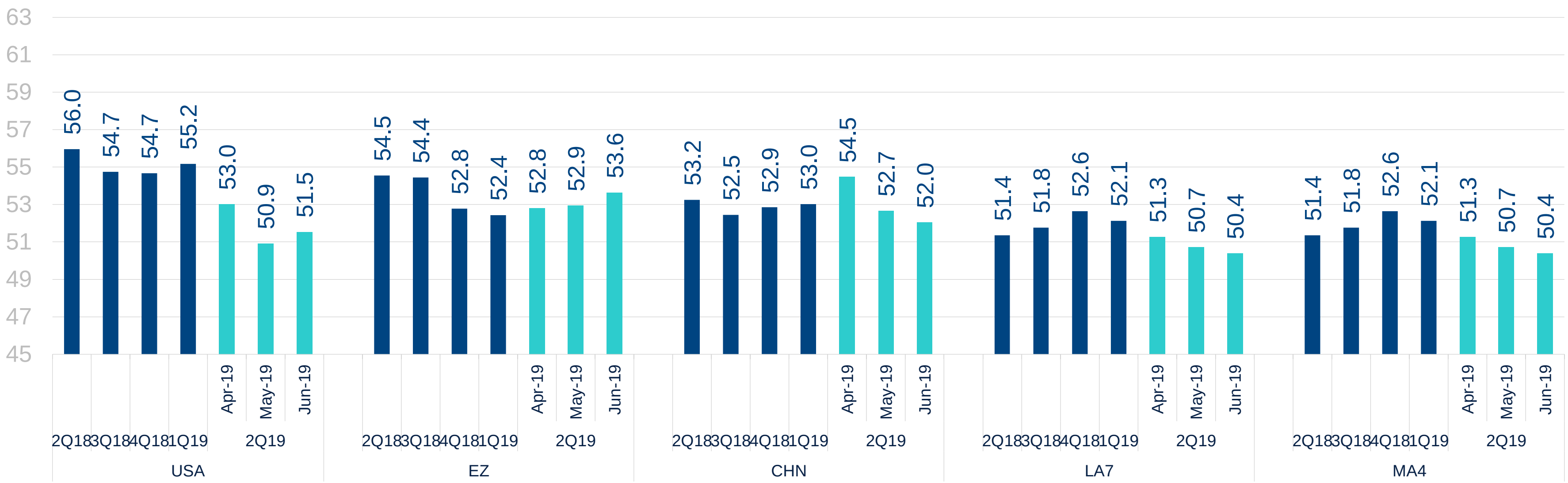


Source: BBVA Research and Markit Economics

… but with some signs of stabilization in June, while PMIs remain in expansionary territory

Services PMI: selected regions

(Level ± 50)

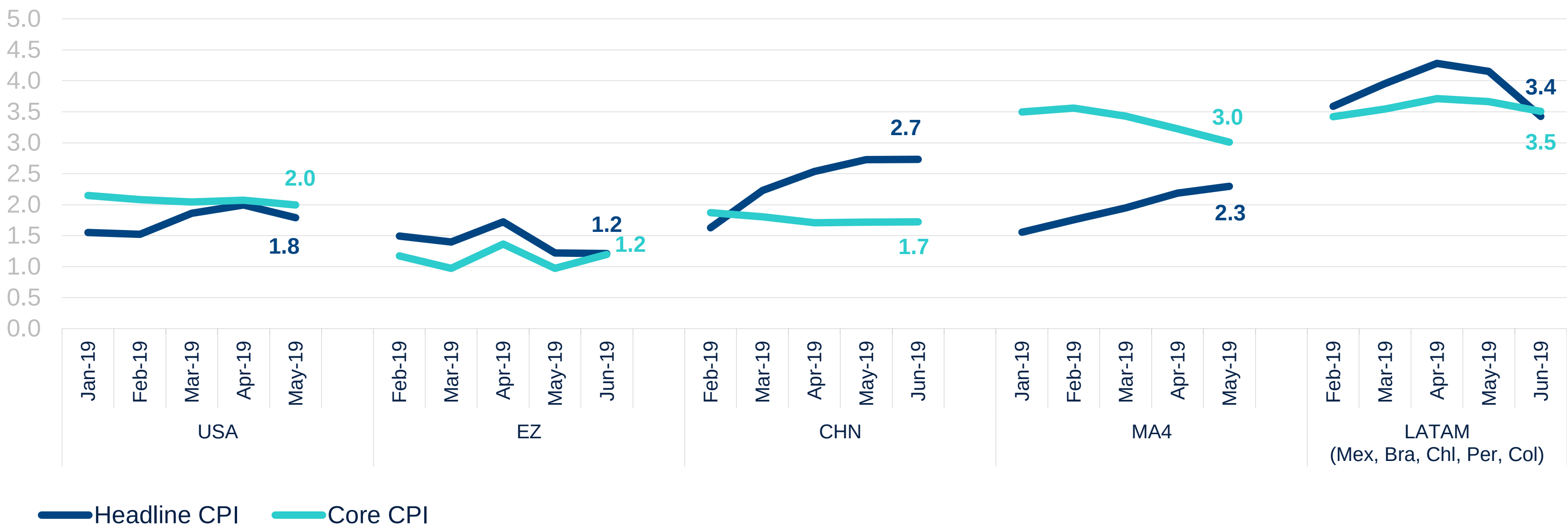


MA4: India, Indonesia, Japan and Korea

Source: BBVA Research and Markit Economics

Core inflation remains at low levels in developed countries, especially in Europe. No inflationary pressures across the board

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



MA4: India, Indonesia, Japan and Korea

Source: BBVA Research and National Sources

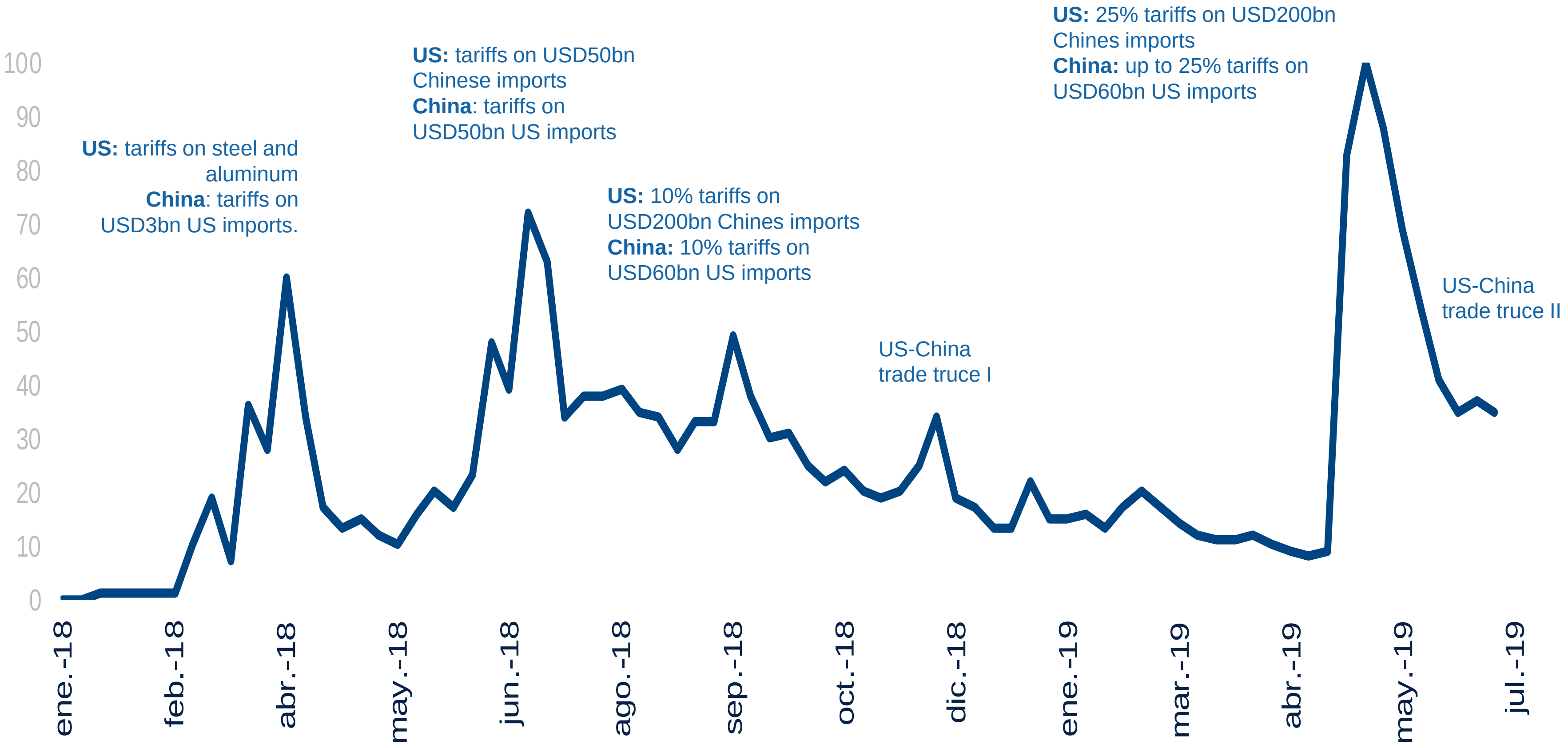
Research

02

Updated forecasts: Global growth tp soft land, amid trade tensions and monetary stimulus

The protectionist pressure continues to be a source of global uncertainty, even after the most recent US-China trade truce

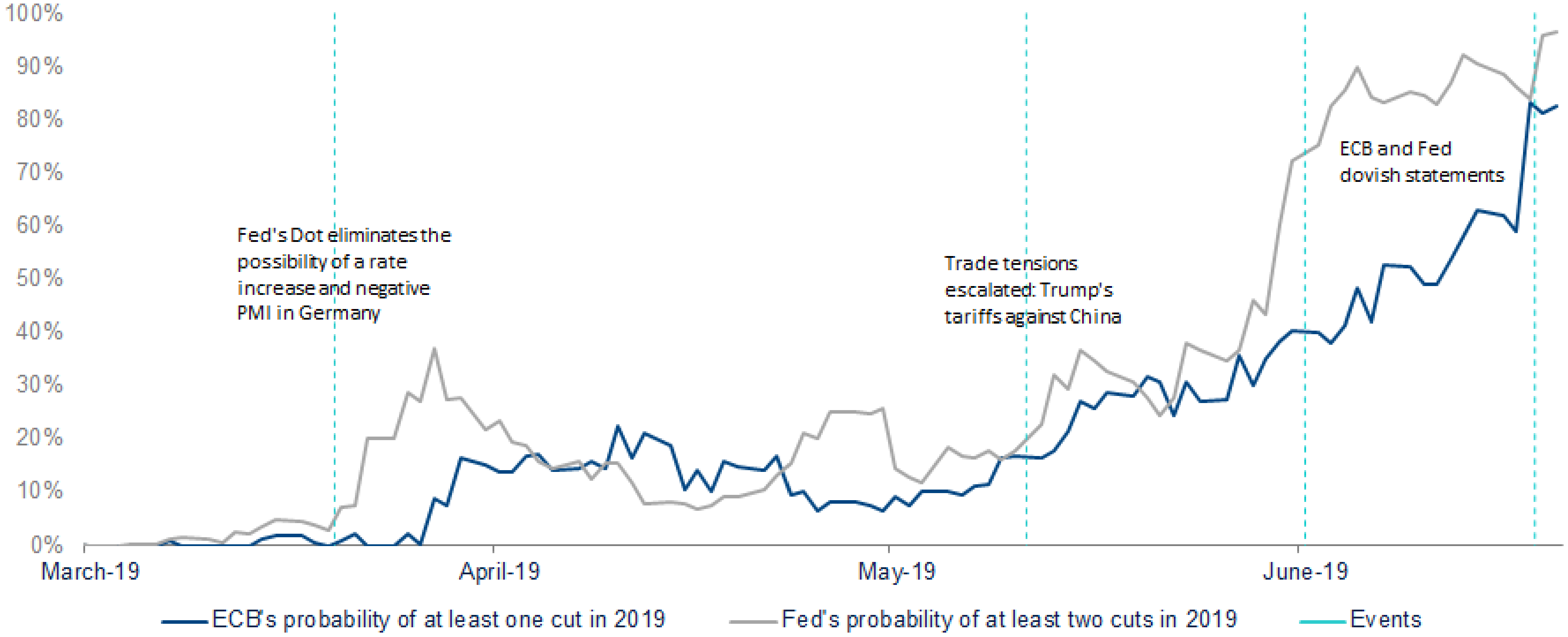
Trade war index: Worldwide google searches about the topic "trade war"
(Index: 0 to 100)



Source: BBVA Research, Google Trends

With persistent uncertainty and low inflation, central banks have reassessed their monetary policy stance and consider new measures

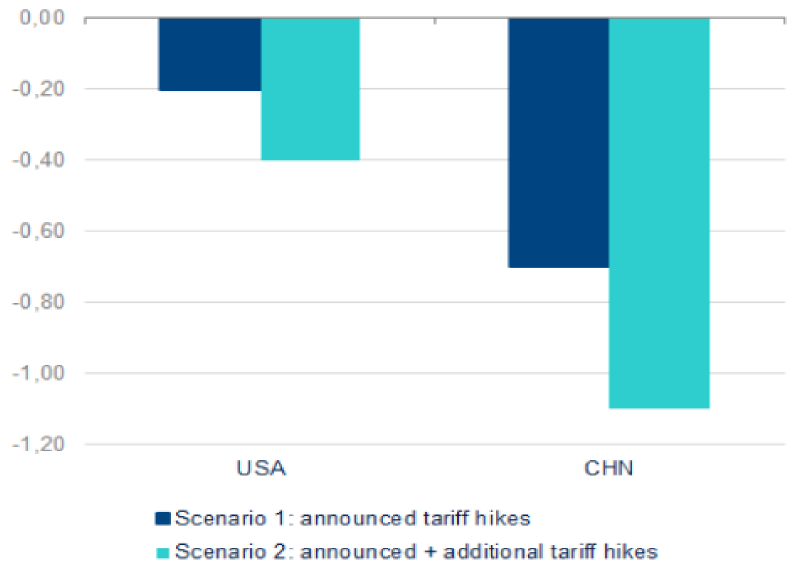
Probability of rate cuts by the FED and the ECB (%)



Source: BBVA Research and Bloomberg

Trade tensions will have a negative impact on growth, but the announced higher tariffs should not derail global growth

Impact on GDP level of two trade war scenarios on the US and China (Two years, pp)



Scenario 1: Approved: 25% tariff increase on steel, 10% on aluminum, 25% on Chinese USD250bn imports. China's retaliation: 25% on USD110bn on US imports.
Scenario 2: All Chinese imports: Previous simulation +25% on all Chinese imports (more than USD500bn). China's retaliation: 25% on USD130bn on US imports.
Source: BBVA Research

- Impact of trade tensions **difficult to estimate** (no historical precedent, unknown disruption of global value chains…)
- Data show **trade tensions have already driven growth down**
- **Particularly negative effects of the trade war in China…**
- **… but US** and other countries will also be hit
- **Non-linearities** from trade war **could result on a stronger impact** through different channels

Looking ahead, the policy stimulus is expected to offset the effect of continued trade tensions

High trade tensions

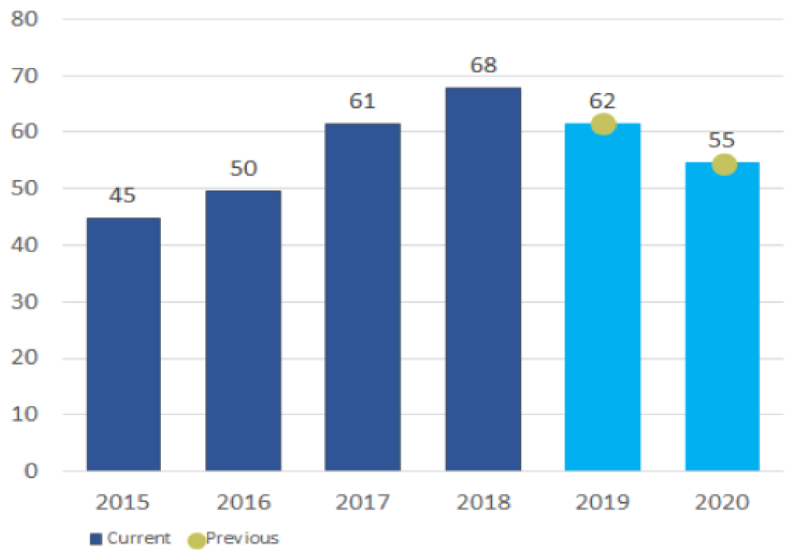
- Irreversible damage has already been done
- The strategic rivalry between US and China is here to stay
- Lingering uncertainty to weigh on business decisions (especially on investment)

Further policy stimulus and support factors

- FED and ECB: rate cuts in the short term
- China: further stimulus
- Financial tensions likely to remain under control
- Declining oil prices

Declining oil prices will provide some support to the global economy

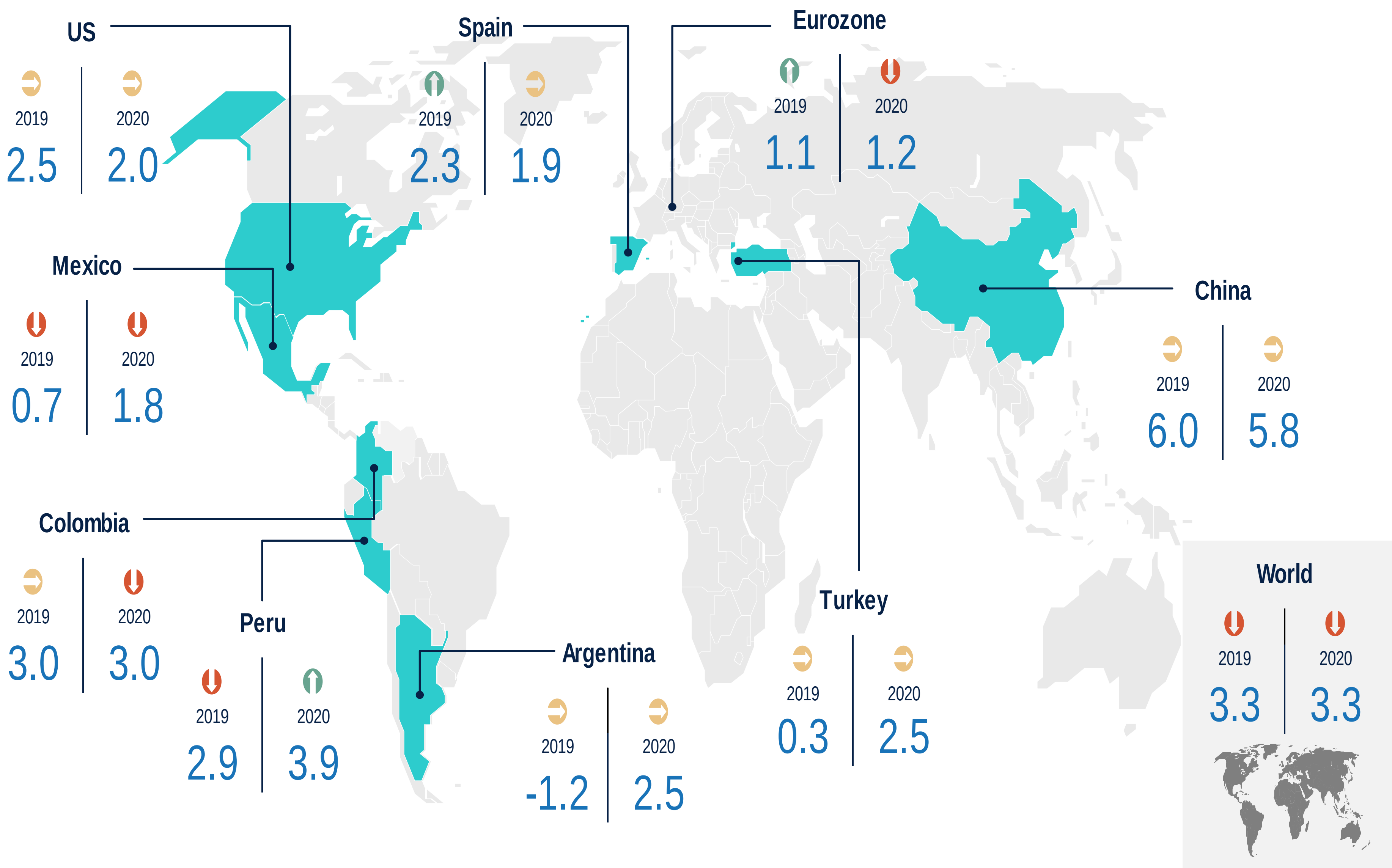
Oil prices
(USD per barrel)



Source: BBVA Research

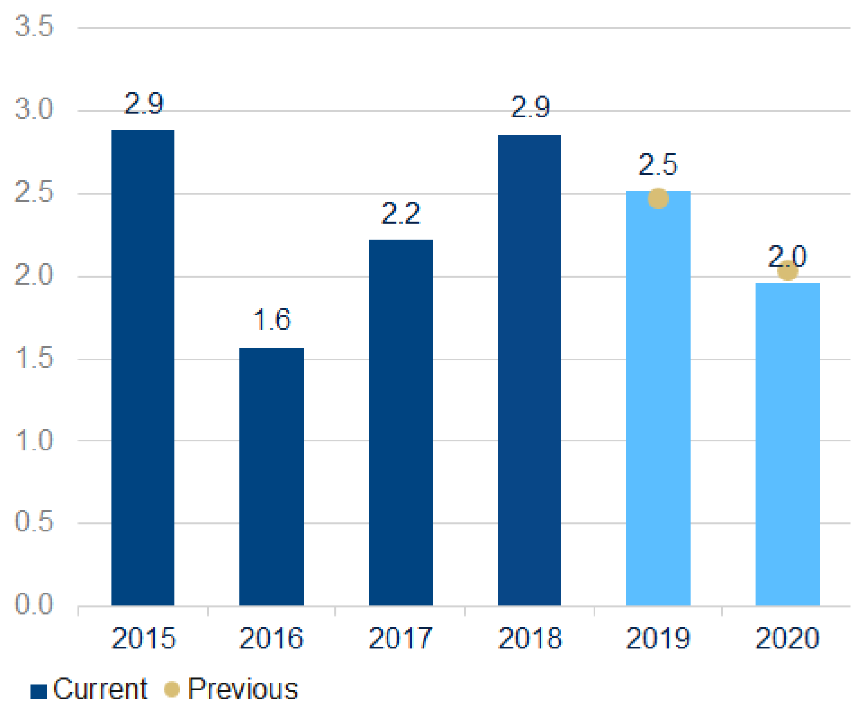
- Crude demand will be **negatively affected by weaker global growth**
- **Growing US production** would help keeping prices in check
- **OPEC + commitment to output cuts and supply disruptions** to provide some support to prices

Updated forecasts: Global growth will soft land. Minor changes in three large areas, but lower growth in Latam, mainly in 2019



US: growth to slow down, with a larger than previously expected support by the Fed

GDP growth (%)

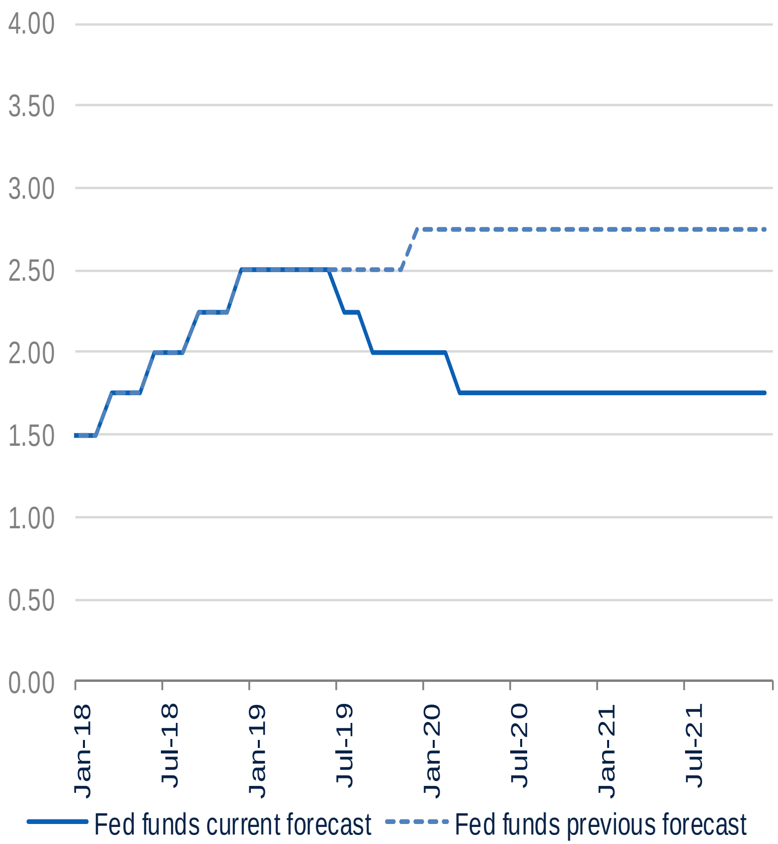


Source: BBVA Research

- GDP growth will trend closer to potential moving forward
- Boost from fiscal stimulus will fade in 2H19 if no additional measures are taken...
- ... but rebound in consumption should support moderate growth
- Core inflation is expected to remain below Fed's 2% target
- Probability of recession remains high: 40% and 60% in the next 12 and 24 months, respectively
- GDP risks are tilted to the downside

The Fed set the stage for a monetary easing cycle on low inflation and increasing downside risks

FED: interest rates (%, end of period)

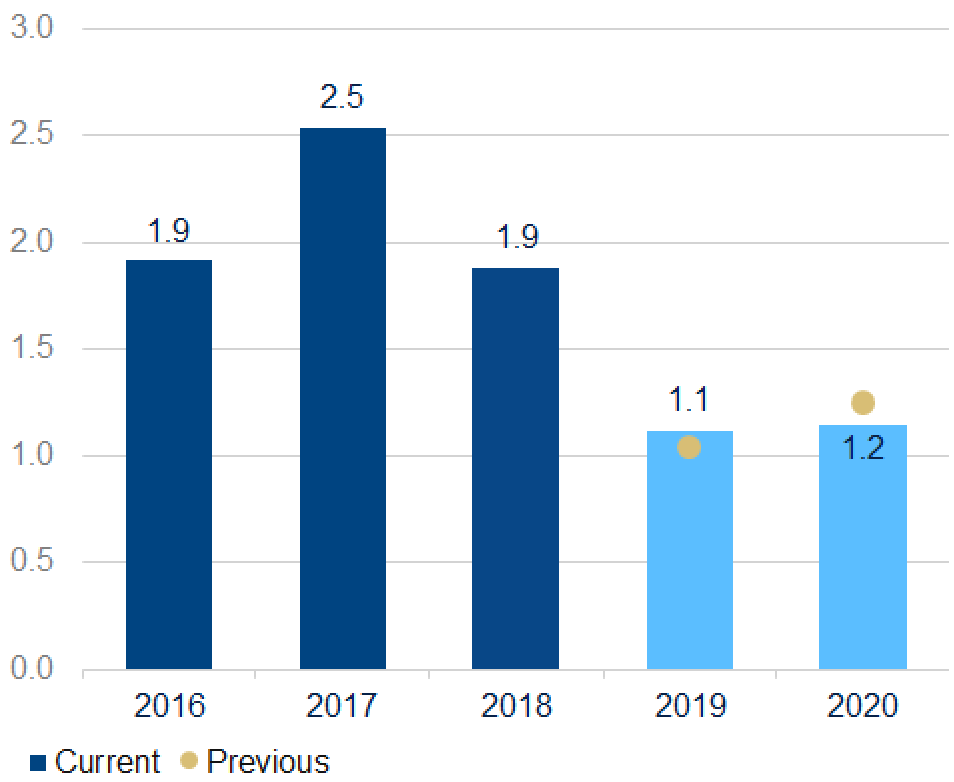


Source: BBVA Research

- FOMC concerned on low inflation and inflation expectations amid increasing downside risks to the economic outlook
- New baseline scenario: Fed to cut up to 75bp by the end of March 2020 (July 2019, Sept 2019 and March 2020)
- The Fed will stop contracting its balance sheet in September, earlier and at higher levels than expected
- Uncertainty is very high: less cuts if lower trade tensions, better data; more cuts if the risk of recession or financial tensions rises

Eurozone: persistence of both industry weakness and uncertainty

GDP growth (%)

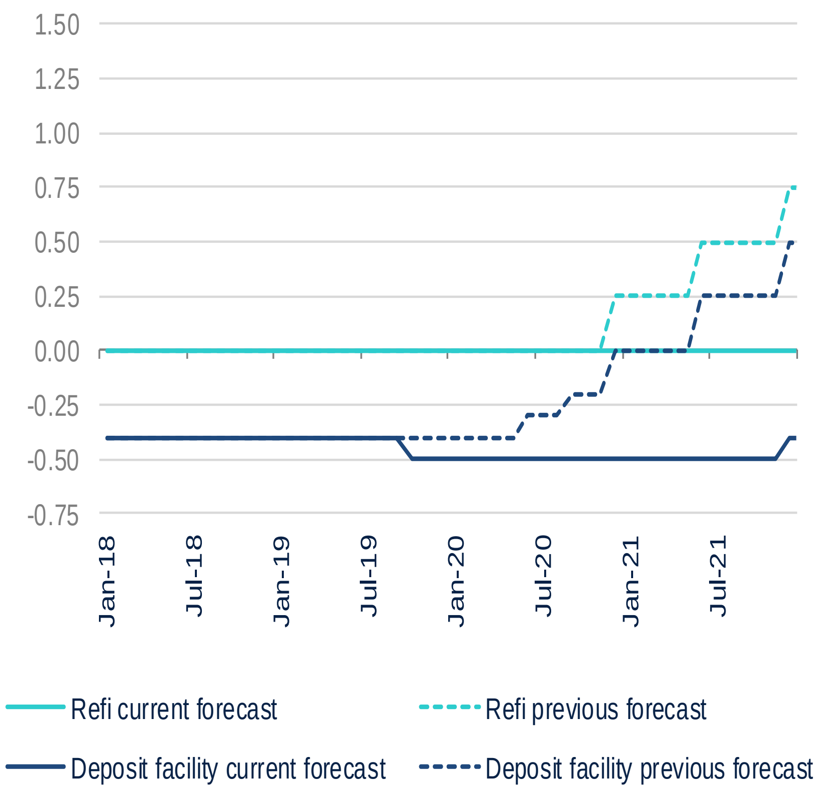


Source: BBVA Research

- Uncertainty remains high mainly due to trade issues and Brexit, which is affecting mainly exports and manufacturing
- In the absence of significant room of maneuvre, the ECB will reinforce forward guidance (lower rates for longer) and cut depo rates slightly (accompanied by tiered deposit rate system)
- Slightly expansive fiscal policy, due to looser measures in some countries
- A gradual increase of core inflation is still expected

Higher global uncertainty and lower inflation have led the ECB to switch from monetary normalization to opening to new accommodation

ECB: interest rates
(%, end of period)



Source: BBVA Research

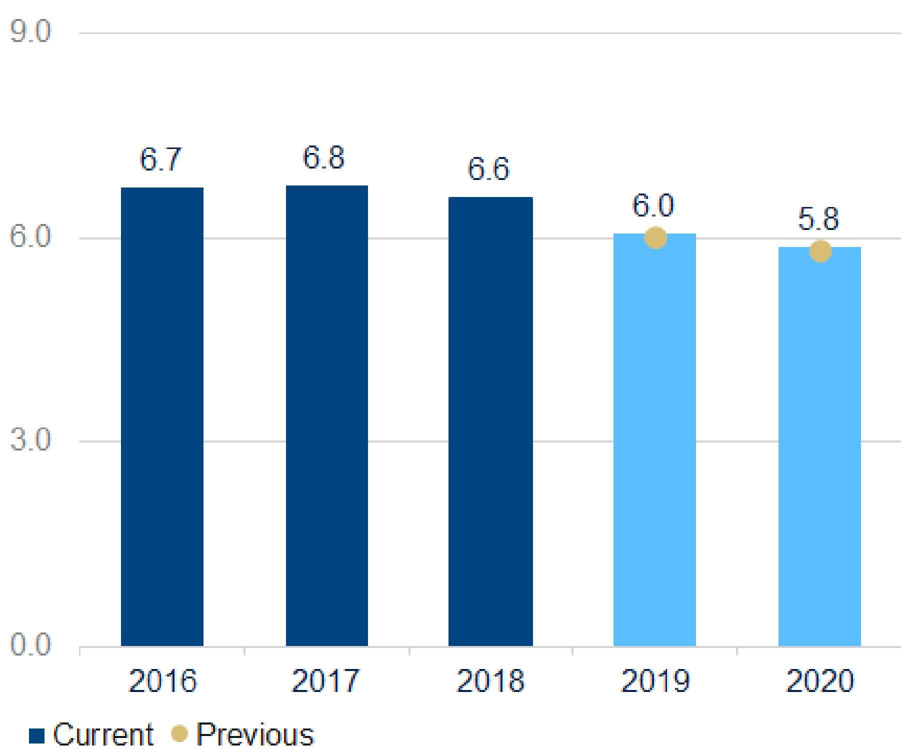
- Growth risks and very low inflation set the stage for lower rates for longer
- ECB is now expected to
  - Strengthen forward guidance
  - Cut depo rate by 10bps in 3Q19
  - Adopt a tiered deposit system

... and is also open to more QE if needed

- Balance sheet: higher, due to the launch of TLTRO-III (with less generous conditions than TLTRO II but still quite benign) and extended reinvestment of QE (since rate hikes are delayed)
- ECB presidency: The nomination of Lagarde at the ECB should not lead to a significant change in monetary policy

China: further policy measures to counterweight headwinds from trade tensions

GDP growth (%)

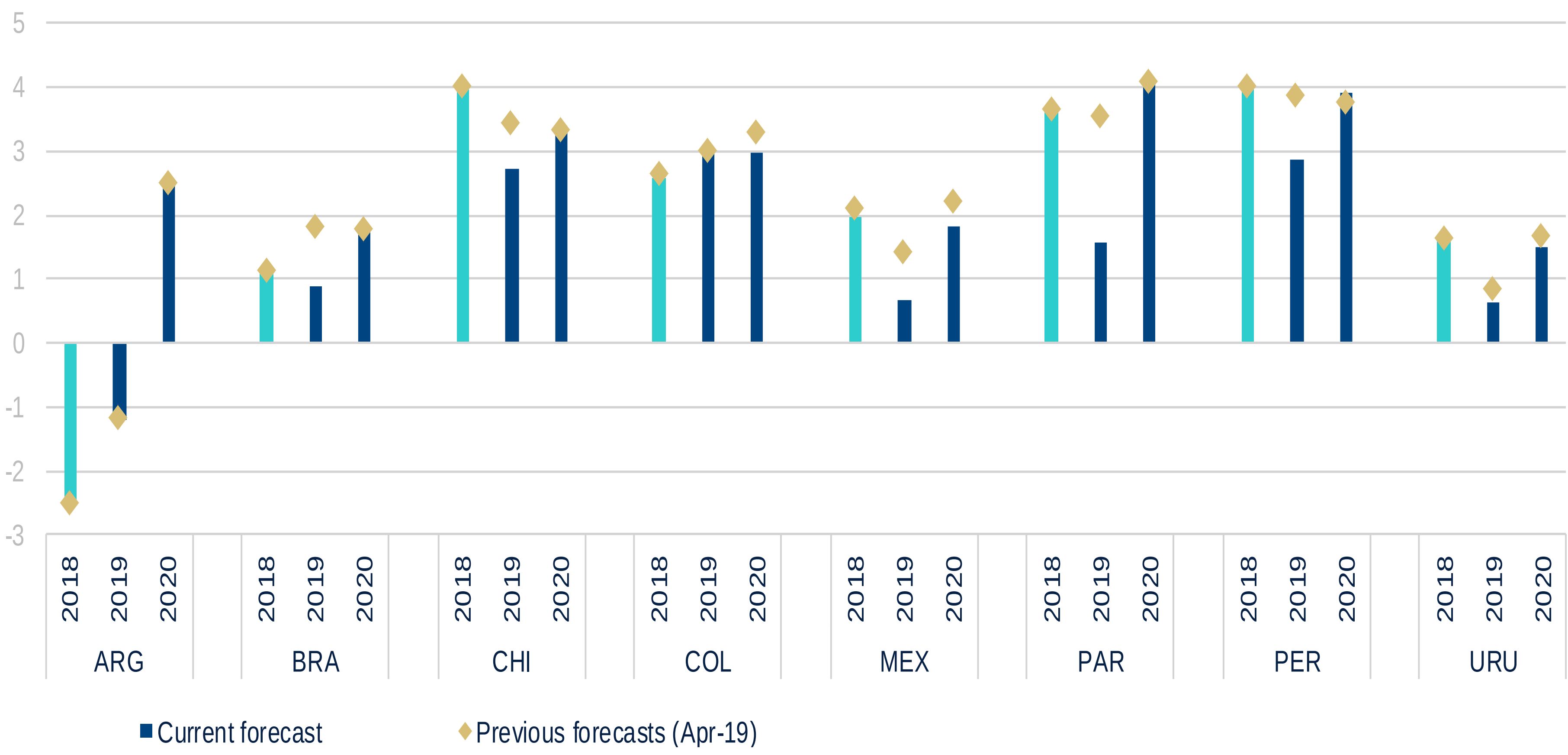


- **Growth slowdown deepened** as trade war risk intensified again, despite the easing measures
- Recent economic indicators suggest that the **ongoing growth slowdown is broad-based**
- **New stimulative measures to include**:
  - **debt issuance by local governments**
  - targeted monetary stimulus
  - increase in public deficit
- **Better outlook for consumption** than for exports and investment
- **Risks:** trade war, growth hard-landing and disorderly deleveraging

Source: BBVA Research

Growth in Latin America was disappointing in 1H19, but we expect improvements in the second half

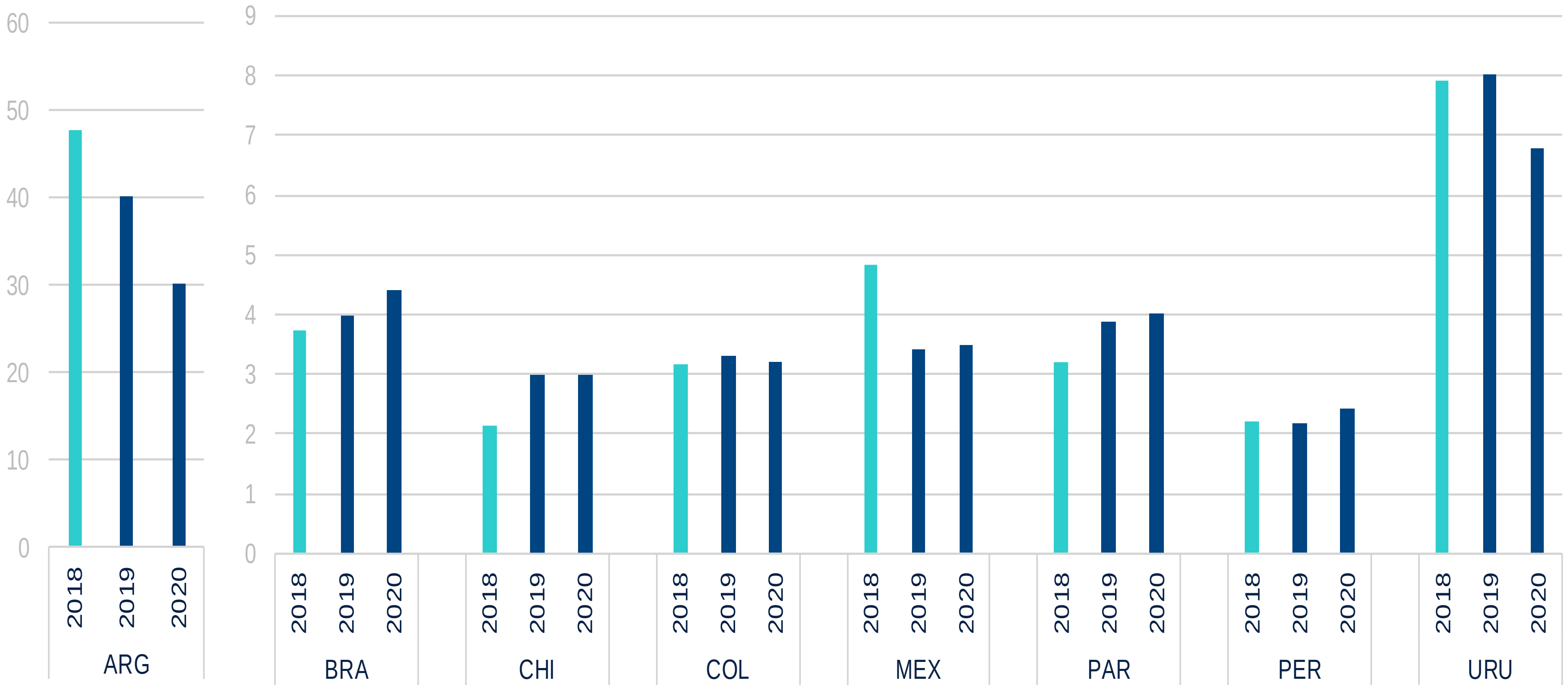
GDP GROWTH (YOY%)



Source: BBVA Research

The lower dynamism of domestic demand should help to maintain inflation close to central banks' targets

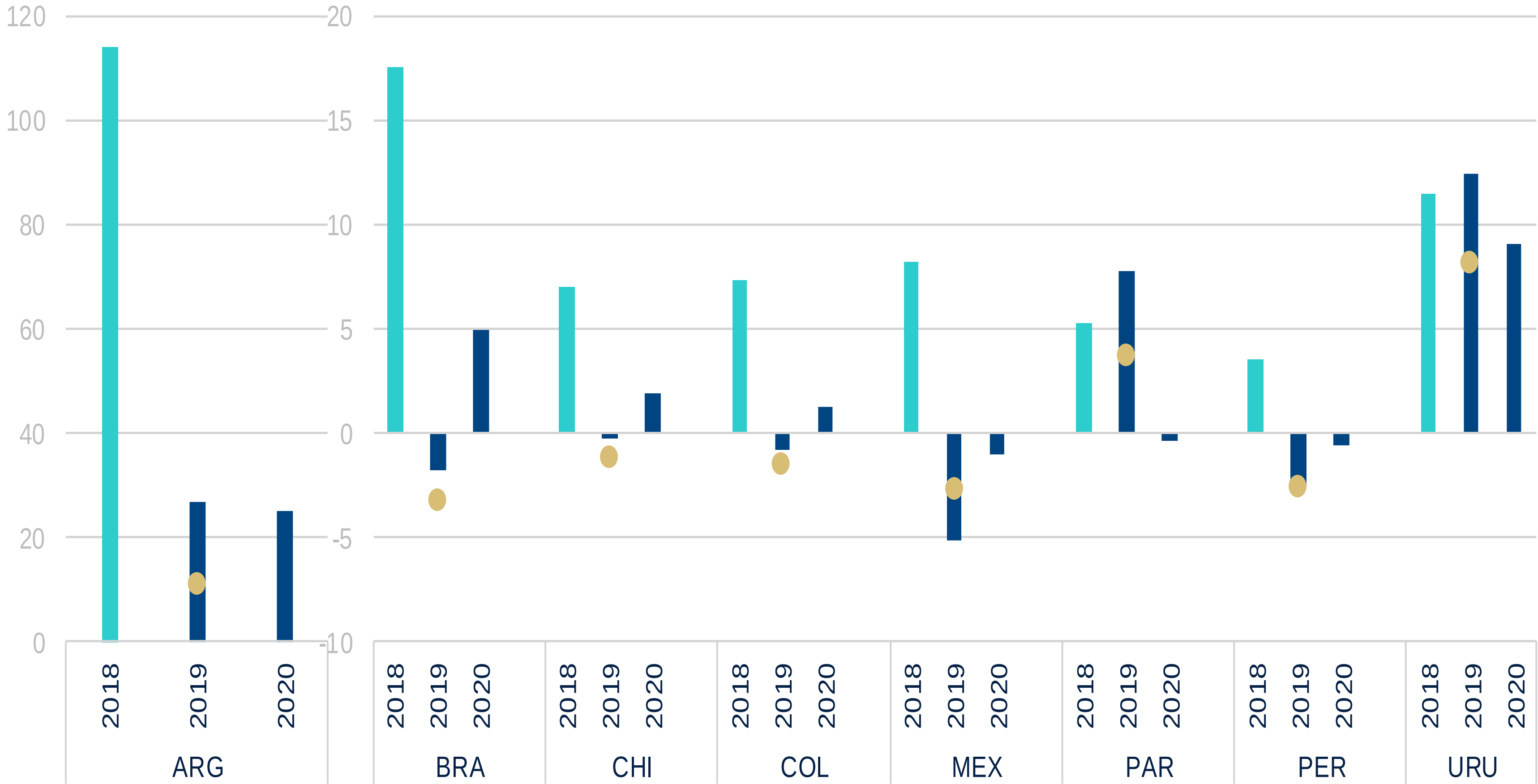
INFLATION (YOY%)



Source: BBVA Research

The accommodative tone of monetary policy, mainly in the US, will take pressure off Latin American currencies

LATAM: NOMINAL EXCHANGE RATES (*)
(%; LOCAL CURRENCY / US DOLLAR)

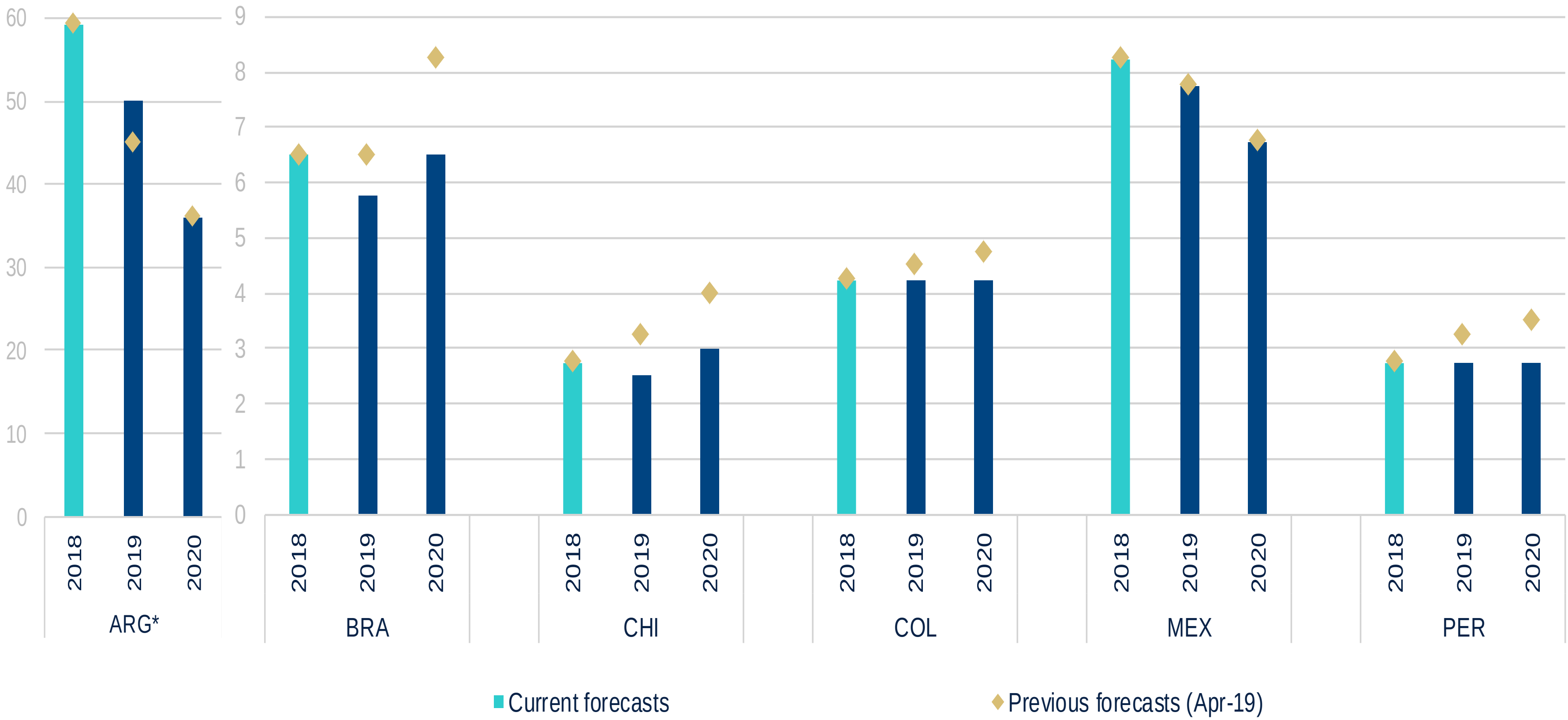


In the year up to July-11th, positive values indicate depreciations and negative values indicate appreciations

Source: BBVA Research

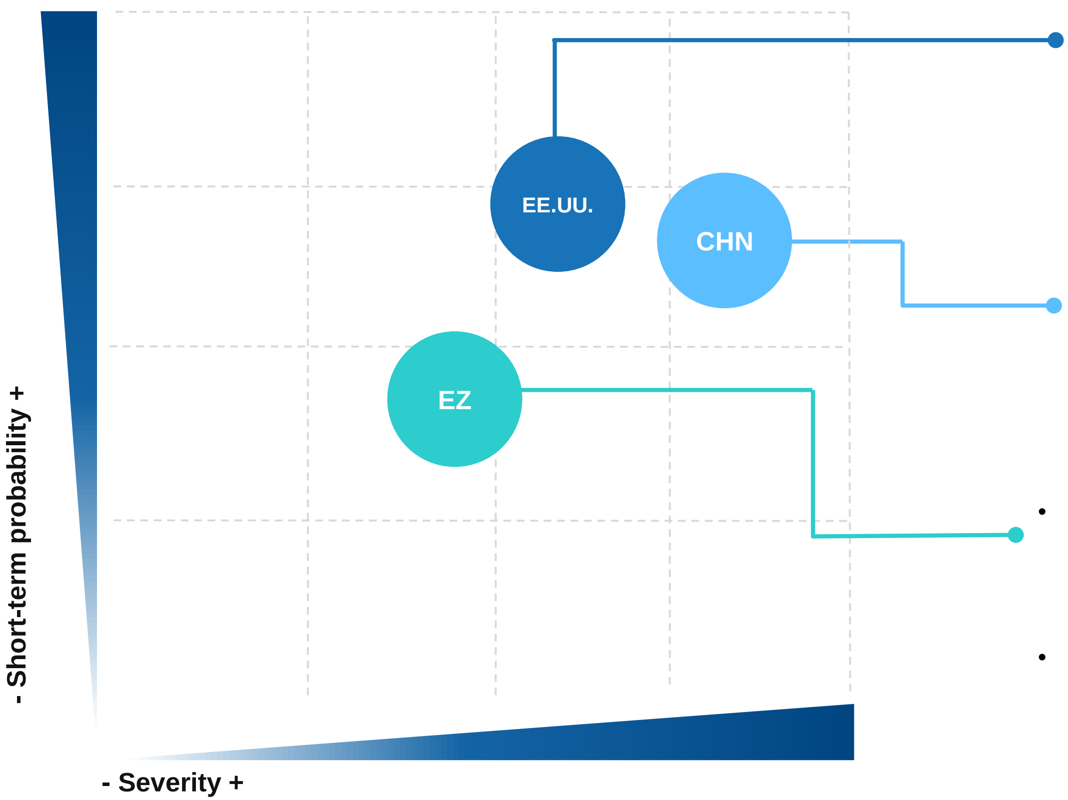
Prospects for inflation and the exchange rate in general create room for a more accommodative monetary policy in Latin America

LATAM: MONETARY POLICY INTEREST RATES (*) (%)



Source: BBVA Research

Global risks: moving upwards on the back of a full-scale trade war, especially given its potential impact on China



- **Recession: very high**
- **Protectionism: higher**

- **Protectionism: higher**
- **Disorderly deleveraging : relatively higher**

- **Growth concerns: relatively high**
  - *Brexit*
  - Italy
- **Protectionism: still contained but increasing**

Source: BBVA Research

US-China trade war: high risk and non-negligible probability of no resolution. Moreover, financial vulnerabilities can amplify the severity of the risks.

Disclaimer

This report has been produced by:

Chief Economist
Miguel Jimenez
mjimenezg@bbva.com

Mathieu Cormerais
mathieu.cormerais@bbva.com

Pedro Ezquiaga
pedro.ezquiaga@bbva.com

Rodrigo Falbo
rodrigo.falbo@bbva.com

Agustin Garcia Serrador
agustin.garcia@bbva.com