**Global Economy**

# Uncertainty, risks and downside bias

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It has become fairly commonplace to talk about the high uncertainty of the global economic scenario, about growth prospects that, whatever they may be, are generally being revised downward or at risk of default biased in that direction. This assessment by analysts is reinforced every time: i. there are negative data surprises; ii. central banks take note and announce new support measures due to a lack of inflationary tensions; iii. in financial markets, there is an increased demand for risk-free assets, such as sovereign bonds of developed economies, and a decreased demand for higher-risk assets, such as shares. Uncertainty, risks and downside biases are all related, but they are not the same.

Uncertainty is inherent in assessing the economic scenario, since it includes the definition of future prospects. Although there are various ways of approximating economic uncertainty and it is not a variable that can be directly observed, it could be said that it is higher now than in the past. Big data and natural language processing techniques mean that new indicators of uncertainty can be developed; these are added to the more traditional ones from financial market volatilities and spreads. Big data and natural language processing show that concerns surrounding economic policies—such as the governance of international trade or the possibility of geopolitical or domestic-policy events causing disruption on a global level—are increasingly present both in the media and on social networks[1]. Meanwhile, stock market volatility and sovereign emerging spreads do not reveal comparable, "pressed down" by the monetary activism of central banks of developed economies; short-term rates are at historic lows, long-term rates are anchored by forward guidance—and low nominal growth in the economy—and an abundant, cheap supply of liquidity on demand.[2]

It seems logical that, if the status quo of global trade governance is put into question, tariffs are raised and there are retaliations, which are not yet generalized. This contributes directly to the strong downward adjustment of world export flows and, in some cases, to the recession of manufacturing activity. However, the lack of evidence in recent decades of rising protectionism in the US and retaliation from China (a "new" economic power), as well as the existence of indirect channels of impact—confidence, risk premium and cost of financing—meaning that effect estimates are also very uncertain.

However, the evolution of global trade or geopolitics are not the only upward uncertainties that become relevant risks in the global economic scenario if they evolve "toward the negative side" of uncertainty (because there is also a positive side). There is also the risk of a cyclical recession in the US or in the eurozone, or that a crisis in China may arise due to the very high debt accumulated by companies, or that this comparatively low global growth after the crisis will persist into the future—no longer being the "new normal," just "normal"—or that the disruptive effects of climate change intensify.[3]

In a situation such as the current one, consensus growth forecasts for the main economies are continually being corrected downward. The reason for this is partly due to data surprises and partly due to analysts' forecasts weighing increasingly on the negative side of uncertainty. This increases the likelihood of risks being present versus the likelihood of positive surprises.

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1: More details on geopolitics and social discontent at BBVA Research Geo-World: Conflicts and protests in September
2: More details at BBVA Research, Country Risk Quarterly Report. 3Q19
3: More details at BBVA Research Global Economic Risk Outlook 3Q19

In the very short term, this process of deteriorating expectations on the global economic scenario seems unlikely to change and there are two reasons for this. Firstly, because disappointing activity and confidence indicators in the major economies have surprised to the downside. Secondly, because developments on uncertainties that are most present in the scenario, such as the risk of increased protectionism, are not dissipating — quite the opposite.

It seems reasonable to think that analysts' forecasts will cease to be overshot downward at some point in time since they will eventually adapt their expectations to the information they receive. Eventually, they will—and we will—be surprised by positive data (the evolution of the economy is cyclical). We will have to be attentive to this, as the first sign that, if, in addition to the uncertainties ceasing to reveal themselves as risks, we can begin to see an improvement in the scenario. This always happens, but if we were to place a bet, it seems that we are not there yet.

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