Growth remains strong, despite the increase in downside risks

Global activity indicators remain high, albeit they point towards a slight moderation of growth, especially in emerging markets. In particular, the global composite business sentiment index (PMI) remains in clearly expansionary territory (above 50 points), although in August it declined for the second consecutive month, to 53.4 points, its lowest level since March. This reduction in the index was more pronounced in emerging countries, which are feeling the effects of the heightened political and economic uncertainty and the gradual tightening of global financial conditions. Over the next few quarters, we expect growth in emerging economies to continue to gradually slow down, which will imply a slightly more contained global growth rate.

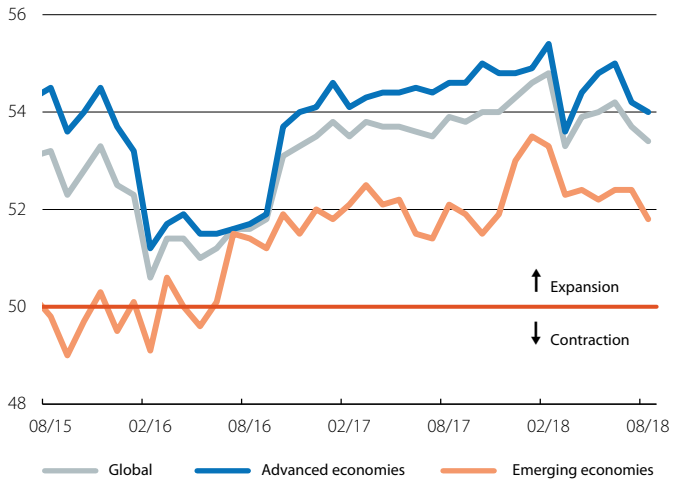
Recent geopolitical events have led to an increase of downside risks. In particular, despite having entered into negotiations with China to steer the trade tensions, the US announced another round of tariffs on Chinese imports (this time, 10% on a value of 200 billion dollars). This is in addition to the 25% tariff package on Chinese products valued at 50 billion dollars that was already implemented this summer. On the other hand, at the European policy level, the United Kingdom and the EU are hoping to reach an exit agreement over the next few weeks that will make effective, from March 29, the transition agreement previously reached. According to this agreement, the United Kingdom will remain in the single market and the customs union until the end of 2020. However, there are still important elements to be resolved – such as finding a solution to the issue of the border between Ireland and Northern Ireland – and the ratification process in the United Kingdom could prove complicated and end up delaying the agreement. It is therefore likely that the uncertainty surrounding Brexit will regain prominence over the next few weeks (or even months) until the final exit agreement is announced. This announcement could be accompanied by a statement setting out the basis for the future relationship between the United Kingdom and the EU. Finally, in Italy, everything suggests that the coalition Government will propose a significant deviation from the deficit target agreed in May in Brussels (possibly increasing it from the 0.8% agreed to 2.4%, which would make it difficult to correct the country's high level of public debt). Although official details on the final scale and composition of the fiscal measures remain uncertain, the new plans could create tensions in the financial markets and with European partners.

US

The indicators continue to suggest solid growth. In particular, following the encouraging GDP growth figure for

Activity indicators: composite PMI

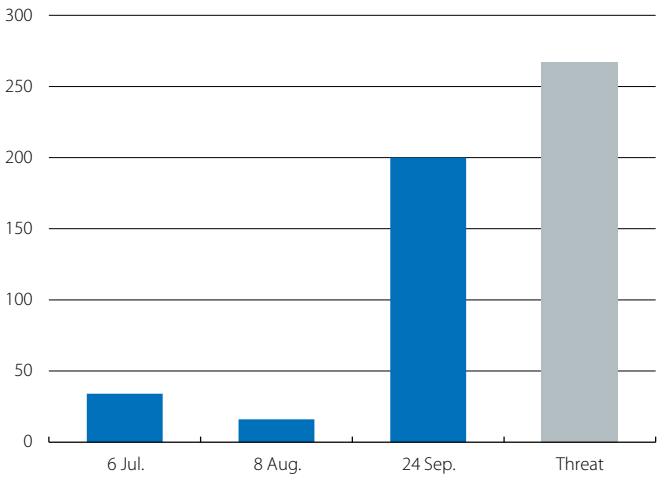
Level



Source: *CaixaBank Research, based on data from Markit.*

US: tariffs on Chinese imports

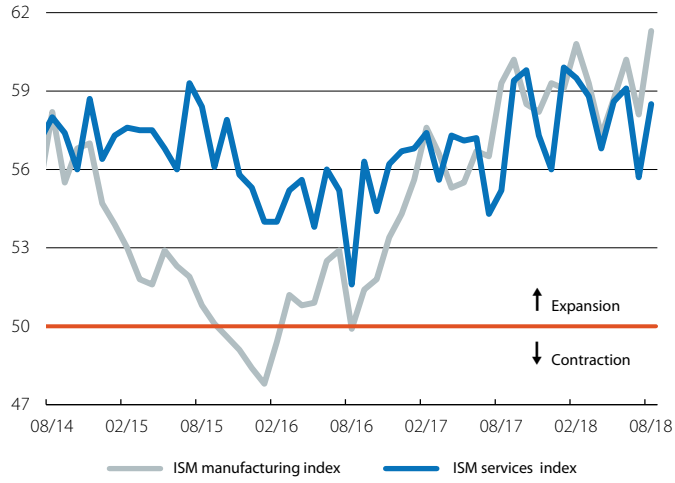
USD billions



Source: *CaixaBank Research, based on data from the US Trade Representative Office.*

US: activity indicators

Level



Source: *CaixaBank Research, based on data from the ISM.*

Q2 (1.0% quarter-on-quarter and 2.9% year-on-year), the indicators available for Q3 – some of which have been higher than expected – confirm that the US economy continues to grow at a rapid rate. As an example, nowcasting GDP models of the Federal Reserve Banks of Atlanta and New York predict an activity rate for Q3 that is well above the US economy's growth potential (which we consider it to be around 2%). In addition, the manufacturing and services business sentiment indices (ISM) increased significantly in August, reaching 61.3 and 58.5 points, respectively, and well above the threshold that separates the expansionary and recessive territories (50 points).

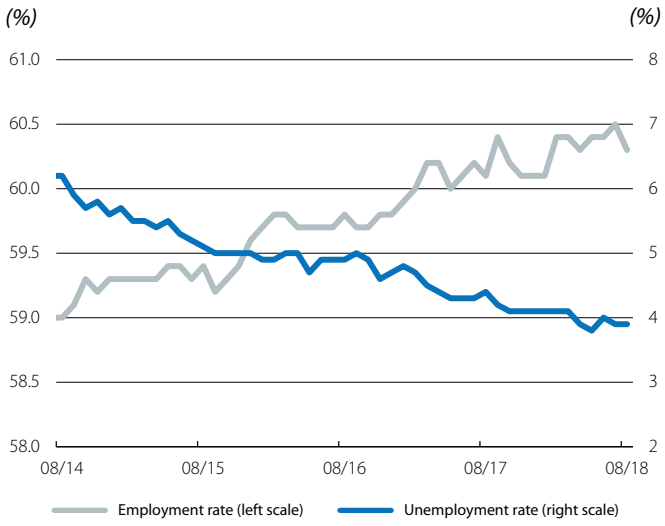
The labour market and domestic demand produce strong results. In particular, in August, 201.000 jobs were created, a considerable figure for an economy experiencing virtually full employment. In addition, the unemployment rate remained at a low 3.9%, while wages continued to rise at a steady rate (2.9%). In this context, household confidence remains high, as demonstrated by the consumer confidence index developed by the Conference Board in August, which rose to levels not seen since 2000 (133.4 points). All of this reinforces our positive growth outlook for the US economy in 2018 (2.8%, according to CaixaBank Research).

The upward trend in inflation of recent months slows, but it remains at strong levels. Specifically, headline inflation stood at 2.5% in August, 2 decimal points below the figure for the previous month, but clearly above the 2017 average (2.1%). On the other hand, core inflation, which excludes the most volatile components of energy and food, stood at 2.2% (2.4% in July). This slight moderation in the growth of prices was in part due to the expected dissipation of temporary factors, such as the base effects caused by the sharp decline in wireless telephony prices during 2017. Over the coming months, we expect that the strength of US economic activity will continue to support firm inflationary pressures, which in turn will support the Federal Reserve's intention to continue with its rate hikes (one more before the end of the year, according to CaixaBank Research).

EUROPE

The outlook for the euro area remains positive, despite the moderation in the pace of economic activity. The growth slowdown of the first half of the year was largely due to a weakening of external demand, following a very positive 2017. This reflects the weakening of global demand for goods and services, as well as the appreciation of the euro in 2017. For this reason, in its quarterly update of the macroeconomic forecasts, the ECB moderated its growth forecasts for the euro area by 1 decimal point, to 2.0% for 2018 and 1.8% for 2019 (a scenario that is very similar to CaixaBank Research's). However, over the coming quarters, we expect the economic expansion of the euro area to remain steady, with a growth rate slightly above potential,

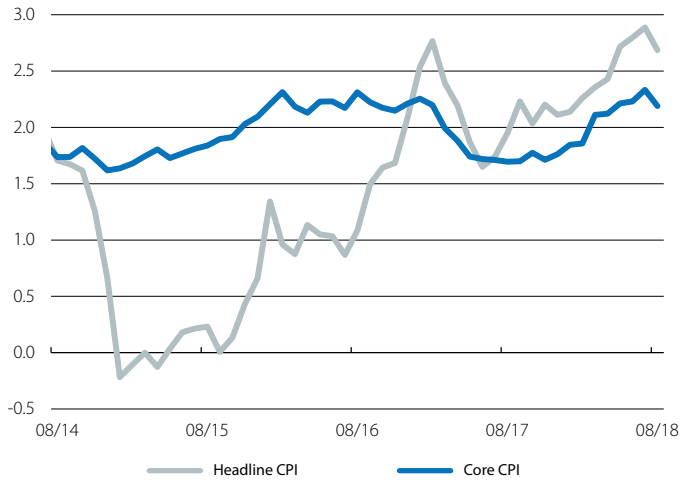
US: labour market



Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics.*

US: CPI

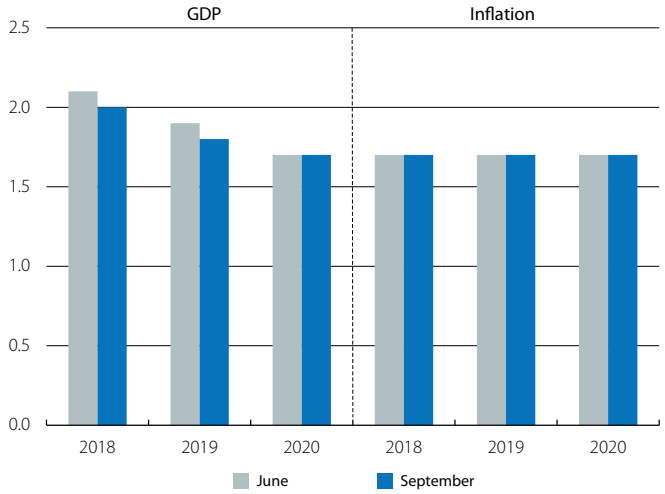
Year-on-year change (%)



Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics.*

Euro area: ECB forecasts of GDP and inflation

Annual change (%)



Source: *CaixaBank Research, based on data from the ECB.*

supported by very favourable financial conditions and a good performance of the labour market.

Domestic demand remains the main driver of growth in Q2. The breakdown of GDP in the euro area shows that Q2 growth (2.1% yoy) was driven by a 1.7 pp. contribution from domestic demand (1.8 pp. in Q1). This came as a result of growing investment, and despite the slight moderation of private consumption. On the other hand, external demand faltered again and reduced its contribution to 0.4 pps (0.6 pp. in Q1), due to modest growth in exports of goods and services.

Activity indicators suggest that growth in Q3 remains at similar levels to those seen in the first half of the year. The composite PMI index for the whole of the euro area – which measures business sentiment – stood at 54.2 points in September, 3 decimal points below the August figure but in clearly expansionary territory. Furthermore, the economic sentiment index (ESI) stood at 110.9 points in September, similar to the average for 2017 (110.7). On the other hand, and despite falling in September for the second consecutive month, down to –2.9 points, consumer confidence remains at levels similar to the average for 2017 (–2.5 points). In this regard, private consumption will continue to be supported by the labour market, which continues to perform well (in July, the unemployment rate remained at 8.2%, its lowest since November 2008).

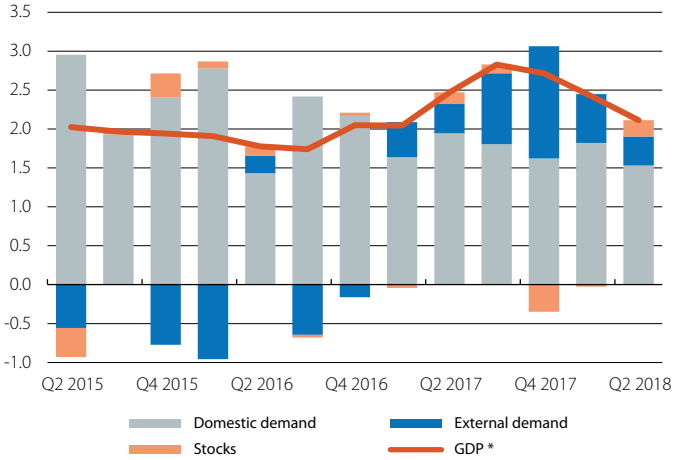
EMERGING MARKETS

In China, the economic indicators point towards a slowdown in activity over the coming months. In particular, industrial production increased by 6.1% year-on-year in August (6.0% in July), an encouraging figure, albeit below the 2017 average (6.5%). Something similar occurred with retail and consumer goods, which grew by 9.0%, 2 decimal points above the figure for July but clearly below the average for 2017 (10.2%). Also, based on available data, CaixaBank Research's activity indicator suggests a slightly lower growth rate in Q3. All this suggests that, over the coming months, the country's growth will continue to gradually slow down, despite the Government's recent policies aimed at supporting investment and credit.

In Brazil, political uncertainty continues to hold back growth. The Brazilian economy grew by 1.0% year-on-year (0.2% quarter-on-quarter) in Q2, below the Q1 figure (1.2%). This confirms that the economic recovery is yet to be consolidated, as is being held back by the significant political uncertainty in a context of presidential and legislative elections. In this regard, even after Lula's withdrawal as a candidate for the Workers Party, we expect that political uncertainty will continue to weigh down economic activity, given that none of the presidential candidates seem to have the electoral support nor the will to implement the reforms that the economy needs.

Euro area: GDP

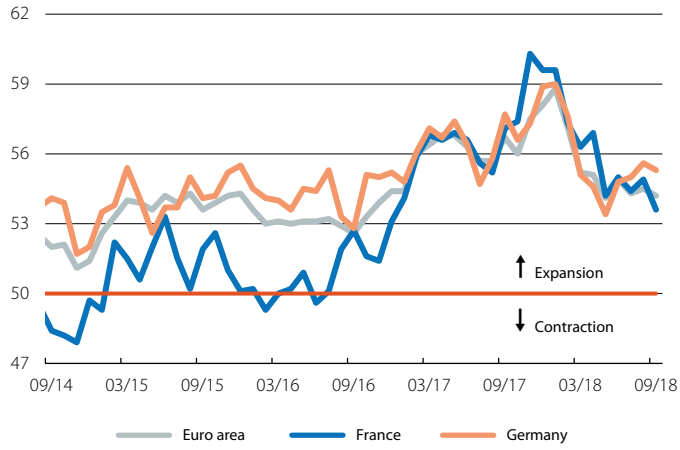
Contribution to year-on-year growth (pps)



Note: ** Year-on-year change (%).*
Source: *CaixaBank Research, based on data from Eurostat.*

Euro area: composite PMI activity indicator

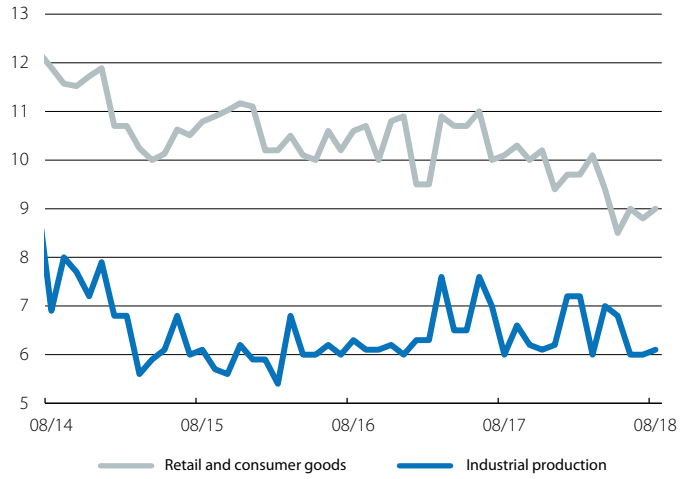
Level



Source: *CaixaBank Research, based on data from Markit.*

China: activity indicators

Year-on-year change (%)



Source: *CaixaBank Research, based on data from the National Statistics Office of China.*

Strong growth with signs of moderating

GDP growth accelerated in Q2 2018. The national accounts published by the National Statistics Institute, with the breakdown of GDP by component, show a 0.6% quarter-on-quarter growth in Q2 (2.4% year-on-year), slightly higher than the initial estimate (0.5% quarter-on-quarter and 2.3% year-on-year) and that of Q1 (0.4% and 2.2%, respectively). By component, private consumption and exports contributed the most to these positive figures, backed by the improvement in the labour market and household incomes, on the one hand, and by the disappearance of temporary factors which had held back foreign sales in Q1 (such as the lower level of refining activity), on the other. However, these encouraging figures are somewhat lower than the average observed in 2016-2017 (which was above 0.6% quarter-on-quarter). What is more, together with the latest activity and confidence indicators, they indicate that as the economy consolidates its position in the expansionary phase of the cycle, the growth rate slows. On the one hand, this slowdown reflects the loss of momentum in the factors that temporarily favoured growth in recent years (such as low oil prices and interest rates at historical lows) and, on the other hand, it reflects a reduced level of dynamism among Portugal's main trading partners. With regards to risks, at the global level downside risks prevail, particularly due to the fear of a rise in protectionism. At the domestic level, the low household savings rate (4.4% of disposable income in Q2 2018) is cause for concern, as this could hinder consumption. That said, exports could provide a positive surprise thanks to stronger car production.

The labour market exhibits a positive trend. Employment continued to grow at a healthy rate in July (2.1% year-on-year, seasonally adjusted data), although the figures are clearly lower than those of the previous year (3% on average in 2017). Thus, there are also signs of a moderation of growth in the labour market. Similarly, the reduction in the number of vacancies in job centres (in year-on-year terms and with data up to May) suggests a decline in the availability of jobs, although part of this can be explained by the relatively high starting point. On the other hand, the unemployment rate stabilised in July at 6.8%, although in year-on-year terms, this figure is 2.1 pps lower than that of July 2017.

The external lending capacity contributes to the reduction of external borrowing. In Q2 2018, the economy maintained a positive external lending capacity, although it deteriorated from 1.2% of GDP in Q1 2018 to 0.7%. This decrease was almost entirely due to the deterioration in the external lending capacity of households, which went from 1.3% in Q1 to 0.7% in Q2, while the financial sector improved its lending capacity up to 2.1% (1.9% in Q1). On the other hand, the non-financial corporate sector and the general government

Portugal: GDP

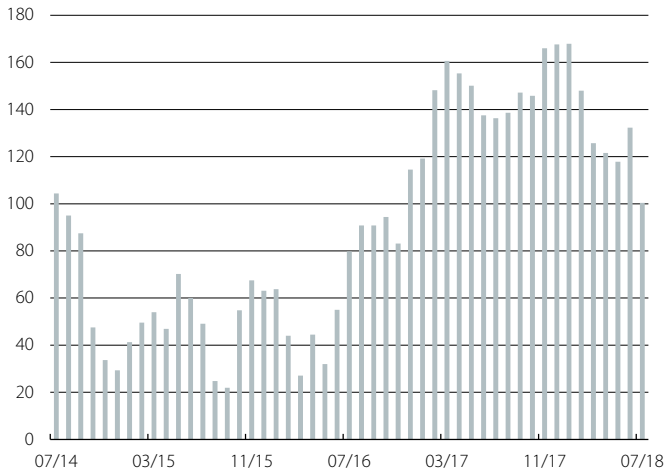
Year-on-year change (%)

	Q3 2017	Q4 2017	Q1 2018	Q2 2018
GDP	2.5	2.5	2.2	2.4
Private consumption	2.7	2.2	2.2	2.7
Public consumption	0.6	0.6	0.7	0.9
Investment	9.3	6.1	4.3	3.7
Investment in transport equipment	10.8	0.4	5.7	–5.7
Investment in capital goods	15.4	9.3	8.6	7.8
Investment in construction	8.1	6.5	2.1	3.3
Exports	6.2	7.2	4.9	7.0
Imports	8.7	7.2	5.6	7.2

Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Portugal: employment

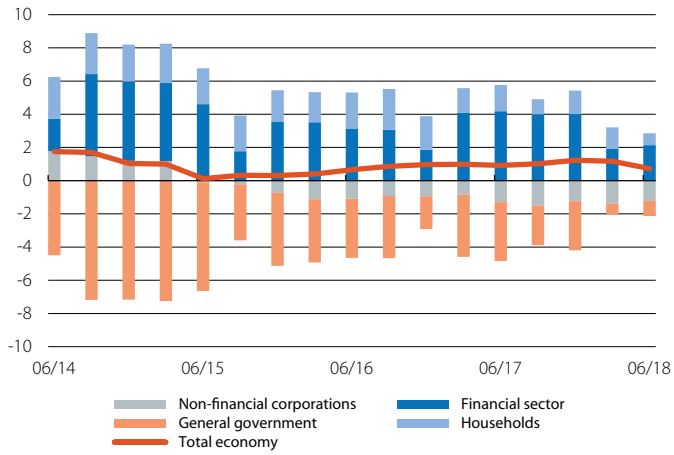
Year-on-year change (thousands)



Source: *CaixaBank Research, based on data from Datastream.*

Portugal: external lending capacity/ financing needs

(% of GDP)



Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

maintained external financing needs of 1.2% and 0.9%, respectively.

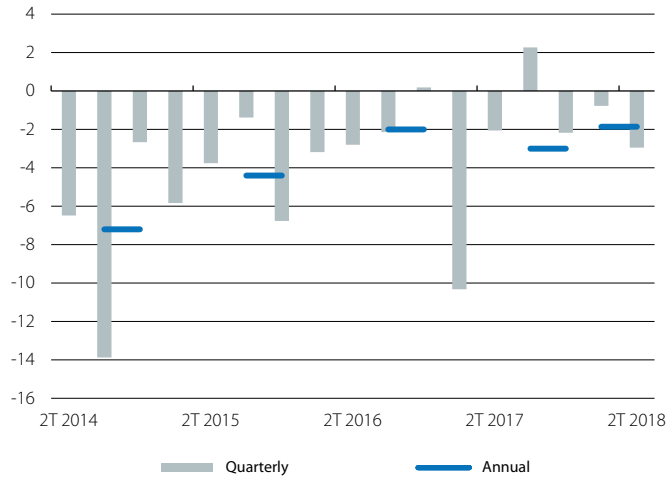
The public accounts evolve favourably and continue taking advantage of the performance of the economy. The deficit data relating to the first six months of the year confirm the improvement in the public accounts, with a deficit of 0.6% of GDP (excluding one-off factors related to bank restructuring costs, such as the recapitalisation of Novo Bank). This represents an improvement of 1.35 pps compared to the first six months of 2017. The cash flow data also show an improvement in the public accounts, with a government deficit of 577 million euros, equivalent to 0.4% of GDP (data up to August). By component, the cash flows reveal a positive performance in tax revenues (+5.3% year-on-year) and an increase of 2.1% in expenditure. This includes the reduction in staff costs (–1.2%, influenced by a base effect, since civil servants' 2017 Christmas payment was split into 12 monthly payments), which was more than offset by expenditure on the acquisition of goods and services (+7.7%) through the payment of outstanding debts to the public healthcare system. These dynamics reinforce the expectation that the public deficit will end 2018 below 1.0% of GDP.

Housing prices slow down but their growth rate remains high. The price of houses rose by 11.2% in Q2 2018, 1.0 pp below the figure for Q1 and putting an end to five consecutive quarters of acceleration in prices. However, this slowdown is expected and reinforces the expectation that supply will narrow the gap that separates it from demand, thanks to the increase in the granting of new construction licenses and new housing developments, which will contribute to a more moderate growth in prices.

The reduction in lending to the non-financial private sector slows down. In its recent assessment of the country, the IMF highlighted the increased strength of financial institutions' balance sheets and of the banking system, emphasising the progress achieved in reducing non-performing loans (NPLs), as well as the increase in operational efficiency. However, it also pointed out the need to continue to reduce the high levels of NPLs, which pose an obstacle to improving the profitability of the Portuguese banking system. The data available up to July, meanwhile, continue to reflect strong growth in new lending, with a significant increase in lending for home purchases (27.2% year-on-year) and consumer credit (15.4%). In addition, there is an increase in new lending to non-financial corporations (+14.1%, particularly in the large firm segment). Nevertheless, the stock of loans granted to the non-financial private sector continues to decline (–1.5% year-on-year in July), albeit at a more moderate rate than last year (–4.3%).

Portugal: government balance

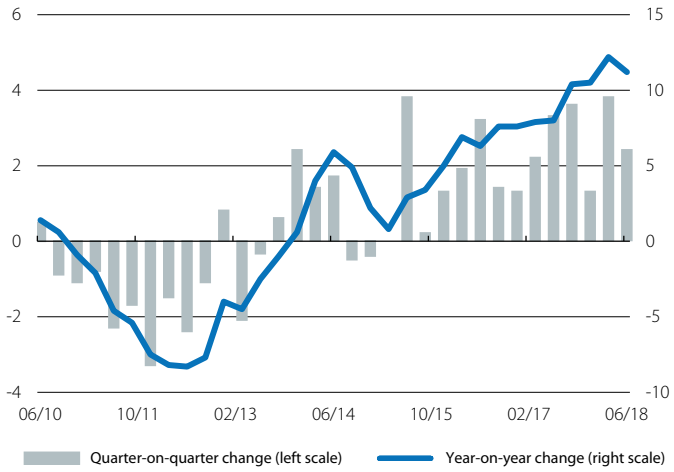
(% of GDP)



Source: *CaixaBank Research, based on data from Bloomberg.*

Portugal: housing prices

Quarter-on-quarter change (%) *Year-on-year change (%)*



Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Portugal: lending to the private sector

July 2018

	Balance (EUR millions)	Year-on-year change (%)
Lending to individuals	**120,469**	**0.0**
Loans for housing	98,178	–1.3
Consumer loans & other purposes	22,291	5.6
Consumption	14,602	12.8
Lending to companies	**72,234**	**–3.8**
Non-property developers	65,955	–3.6
Property developers*	6,279	–6.0
Total lending to the private sector*	**192,703**	**–1.5**

Note: ** Loans granted to the non-financial private sector.*
Source: *CaixaBank Research, based on data from the Bank of Portugal.*