Risks persist amidst a global slowdown

Moderation in global economic activity in Q3. In a context of significant pockets of geopolitical uncertainty, which intensified over the summer, the various indicators published in the past month have confirmed the moderation in global economic activity in Q3 2019. This is reflected by economic activity indicators such as the global composite Purchasing Managers' Index (PMI), which was rather contained in August (51.3 points, slightly below the figure for July). Looking at the different components, the manufacturing index remained below the 50-point threshold (49.5), indicating contraction in the manufacturing sector whereasthe services indexremained above 50 points (51.8) but is drawing ever closer to this threshold. With these indicators in mind, CaixaBank Research slightly reduced last month its global growth forecasts for 2019 and 2020 down to 3.0% and 3.2%, respectively, 2 decimal points less than expected before the summer.

Tit for tat in the trade war between the US and China. In early September, the US imposed the first round of tariffs announced in August, while China responded in kind by imposing tariffs on US imports. In particular, as the US applied 15% tariffs on 112 billion of Chinese imports, which represents the first round of the tariffs announced on 300 billion of imports, China imposed tariffs of between 5% and 10% on nearly 2,000 US products. Despite the escalation of protectionism implied by these tariffs, September also saw some developments of a more constructive tone in terms of trade: the US and China agreed to restart negotiations in October, the US announced the delay of some tariffs on Chinese imports and China withdrew 16 US products from its tariff list. A basic agreement between the two parties therefore remains on the cards. Nevertheless, uncertainty has already dented economic sentiment and it is not clear that a potential agreement will be stable in the medium term. As a result, the eroded trust will only be restored gradually and the negative impact of the trade tensions on economic activity will persist for the remainder of 2019 and throughout 2020.

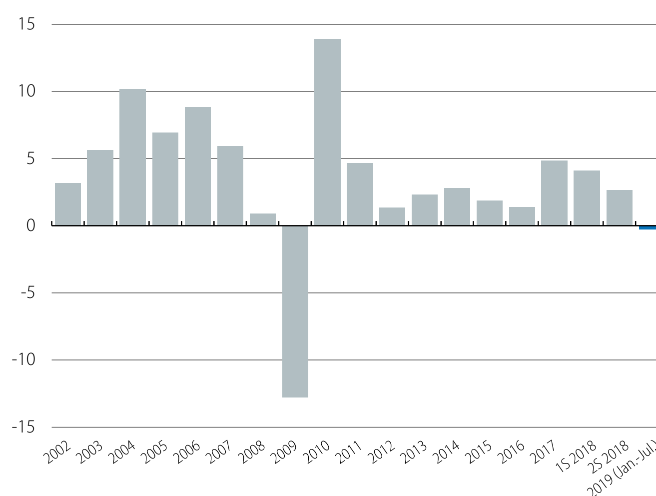
In Europe, Brexit provides no respite, while Italy sees a reduction in political uncertainty. All the indicators in the United Kingdom suggest that a hard Brexit at the end of October is unlikely. The reason is that the House of Commons passed a law obliging the government to request a new extension to Brexit if no agreement is reached with the EU by 19th October. In addition, the suspension of the country's Parliament until 14th October was cancelled by the Supreme Court, increasing the likelihood of an extension at the end of October. However, a no-deal Brexit cannot be ruled out, and elections resulting in a new Parliament with

GDP growth
Annual change (%)

	2018	2019		2020	
	Figure	Current forecast	Forecast as of January 2019	Current forecast	Forecast as of January 2019
Global	3.6	3.0	3.5	3.2	3.5
Developed countries	2.2	1.7	2.0	1.4	1.8
US	2.9	2.2	2.3	1.6	1.9
Euro area	1.9	1.0	1.8	1.1	1.7
Emerging countries	4.5	3.9	4.5	4.4	4.6
China	6.6	6.0	6.2	5.8	6.0

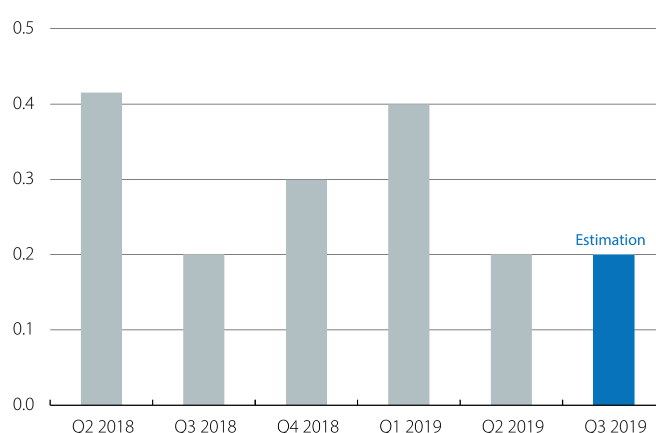
Source: *CaixaBank Research, based on data from Thomson Reuters Datastream.*

International trade in goods
Year-on-year change in volumes (%)



Source: *CaixaBank Research, based on data from the CPB World Trade Monitor (Merchandise).*

Euro area: CEPR-Eurocoin GDP estimate for Q3
Quarter-on-quarter change (%)



Source: *CaixaBank Research, based on data from Eurostat and from the CEPR-Eurocoin model for the Q3 2019 estimate.*

a pro-Brexit majority could support this option. Besides, in Italy, following the collapse of the government in August, the alliance between the Five Star Movement and the Democratic Party made way for a new government to be formed during the past month. With this new coalition, the risk of another fiscal confrontation with the EU has been reduced. Nonetheless, this does not dramatically change Italy's macroeconomic scenario and its indicators remain weak.

EUROPE

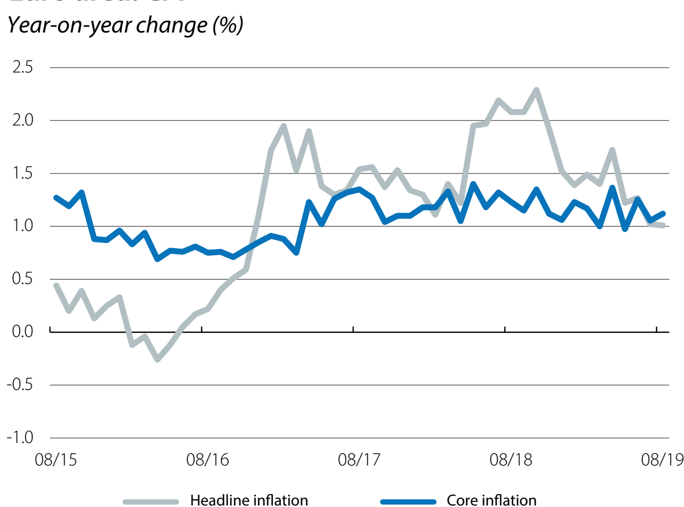
In the euro area, weakness remains prevalent. The euro area's economic activity indicators continue to point towards very contained growth rates. The Bank of Italy's real-time forecasting model predicts that euro area GDP will grow at a discrete 0.2% quarter-on-quarter in Q3, the same figure as in the previous quarter and well below the rates seen in 2017 (0.6%). This suggests that the moderation in economic activity that the euro area has been experiencing since 2018 will continue in the second half of 2019. At the country level, the weakness of Germany stands out in particular. The country's industrial production suffered a new and sharp drop in July (–5.3% year-on-year), contrasting with relatively modest variations in the rest of the region's major economies. Similarly, Germany's IFO business activity indicator fell sharply in July and August.

Uncertainty over trade and an automotive shock at the core of the European slowdown. The uncertainty generated by the trade dispute between the US and China is one of the elements that could be weighing down on European economic activity the most. Nevertheless, other idiosyncratic elements such as the shock in the automotive industry are also behind the slowdown in Europe. All of this is particularly pronounced in the case of the German economy, where GDP is expected to have contracted once again in Q3 (see the article «Germany: why is the European locomotive losing steam?» in this same *Monthly Report*). In this predicament, the ECB presented a somewhat weaker macroeconomic scenario at its September meeting, with reductions in its growth and inflation forecasts. In particular, in 2019, the ECB predicts a growth of 1.1% (1 decimal point below June's forecast) and, in 2020, of 1.2% (2 decimal points lower). Headline inflation is forecast to stand at 1.2% in 2019 and at 1.0% in the 2020, 1 and 4 decimal points. This is below what was forecast a few months ago and is clearly below the ECB's target rate (~2%). As a result, at the meeting, the ECB presented a new monetary stimulus programme consisting of the ingredients that were expected by most analysts: a cut in the deposit facility rate, a resumption of net purchases of assets, a two-tier reserve remuneration system and more attractive TLTRO-III (see the section on Financial Markets for further details on the monetary measures).

Germany: IFO business activity index
Level

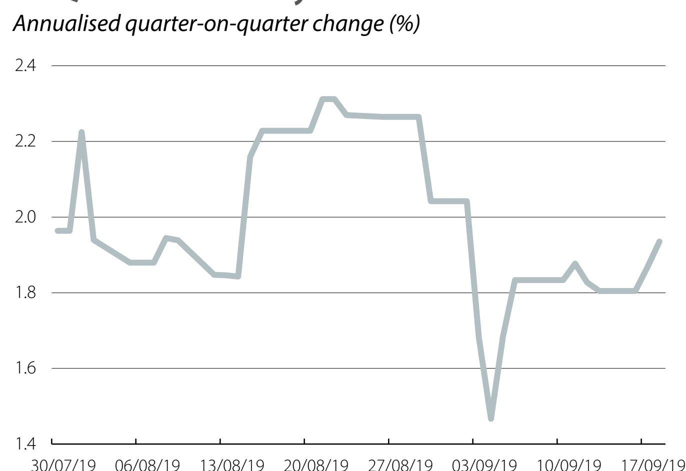
Source: *CaixaBank Research, based on data from the IFO Institute.*

Euro area: CPI *
Year-on-year change (%)



Note: ** The data correspond to the HICP.*
Source: *CaixaBank Research, based on data from Eurostat.*

US: Q3 GDP estimate by the Atlanta Fed *
Annualised quarter-on-quarter change (%)



Note: ** Change in the estimate as key economic activity indicators become available.*
Source: *CaixaBank Research, based on the Atlanta Fed's Nowcasting model (GDP Now).*

US

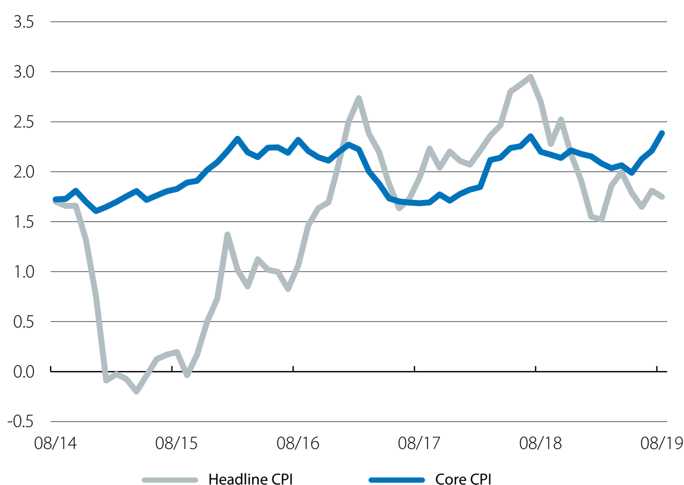
The economic activity data continue to indicate considerable growth, despite the trade dispute and the Trump impeachment enquiry. The GDP forecast models of the various federal reserves place GDP growth in Q3 at around 2.0% in annualised quarter-on-quarter terms (i.e. similar to that of Q2). In fact, this growth rate is relatively close to the potential we attribute to the US economy. In this environment, a new escalation in trade tensions and further protectionist measures pose significant risks for the country's economic activity. Potential fiscal stimulus measures in 2020 (an election year), as well as the Fed's new interest rate cut at its September meeting, could nevetheless counteract part of these disruptive factors. In particular, the country's monetary institution cuts the reference interest rate by 25 bps down to the 1.75%-2.00% range. The institution attributes the move to the context of global risks since it kept its macroeconomic outlook practically unchanged: growth of around 2.0% and with no acceleration in inflationary pressures.

EMERGING MARKETS

The Chinese economy continues to slow down, hence the authorities will continue to stimulate the economy. The main economic activity indicators for China showed a slowdown in August. In particular, growth in industrial production moderated down to 4.4% (4.8% in July), the lowest figure in 17 years, while retail sales were also tempered with year-on-year growth of 7.5% (7.9% in July), stunted by the drop in car sales (–8.1% year-on-year). There was also a decline in exports, of 1.0% year-on-year, weighed down by the trade conflict and the global slowdown. These data suggest that the Chinese economy continues to slow down, and it could be doing so somewhat faster than we envisaged a few months ago. In this context, the country's government cabinet is supporting the economy with various measures, including some aimed at boosting investment in infrastructure. Specifically, an increase has been announced in the volume of bonds issued by local corporations to finance infrastructure investment projects. This support will persist over the next few quarters.

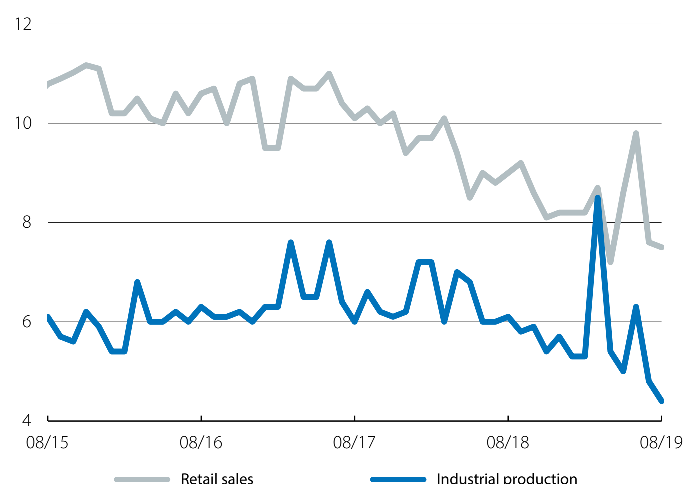
Turkey's GDP fell by less than expected in Q2. In Q2 2019, GDP fell by 1.5% year-on-year. This was less than expected, due to the contribution of the external sector being significantly greater than in previous quarters, more than offsetting the decline in domestic demand. This figure indicates that the macroeconomic adjustment is having a significant impact, particularly in the foreign sector: in Q2, the current account balance was positive, standing at +0.1% of GDP, something not seen since 2002. All in all, the immediate outlook remains restricted by the contraction in domestic demand.

US: CPI
Year-on-year change (%)



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

China: economic activity indicators
Year-on-year change (%)



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

Turkey: GDP
Year-on-year change (%)

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