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.

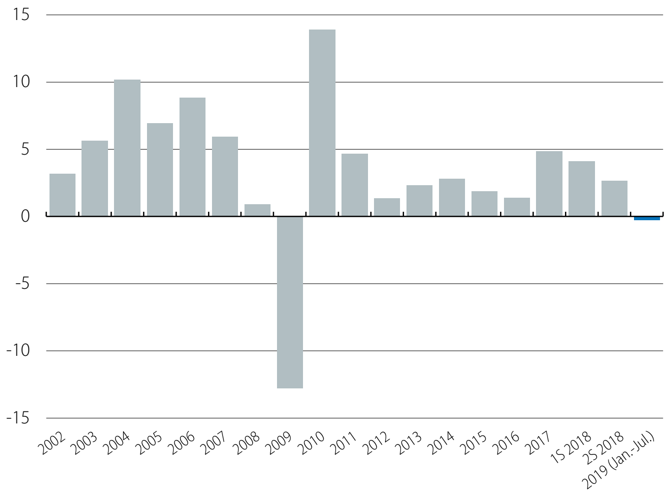
In Europe, Brexit provides no respite, while Italy sees a reduction in political uncertainty. All the indicators in the United Kingdom suggest that a hard Brexit at the end of October is unlikely. The reason is that the House of Commons passed a law obliging the government to request a new extension 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

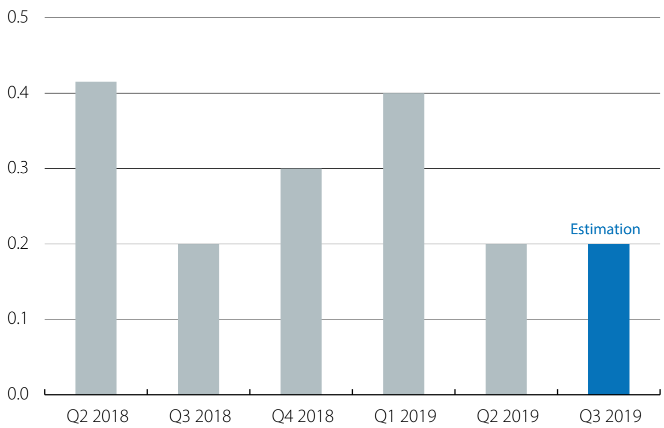
Source: *CaixaBank Research, based on data from Thomson Reuters Datastream.*

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.

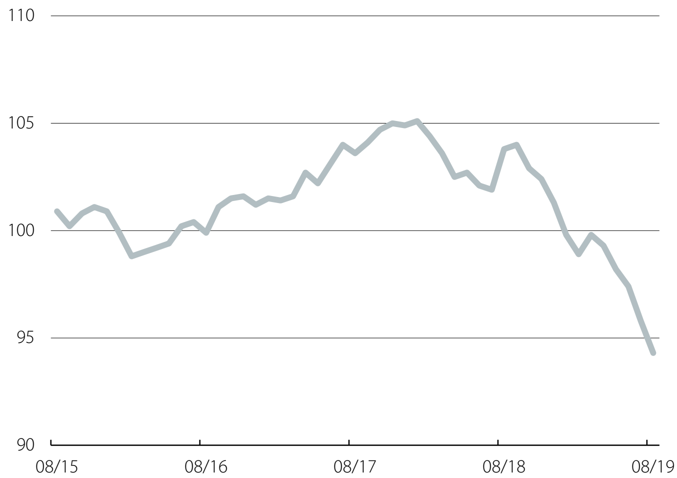
EUROPE

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

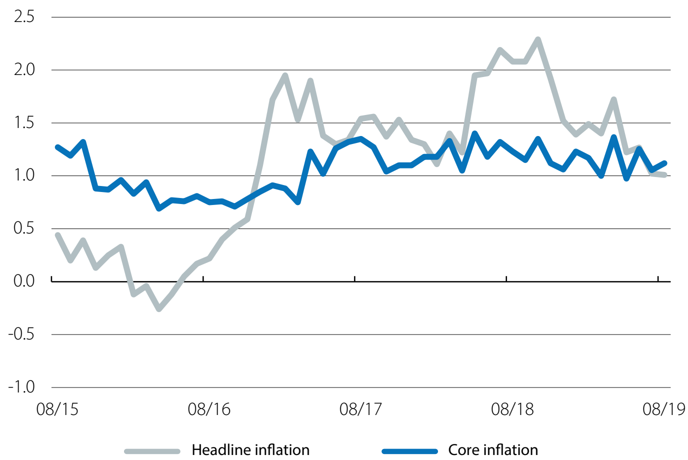
Level



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

Euro area: CPI *

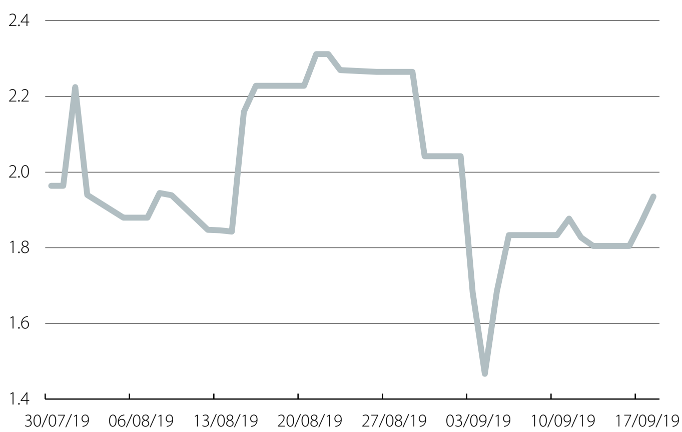
Year-on-year change (%)



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.

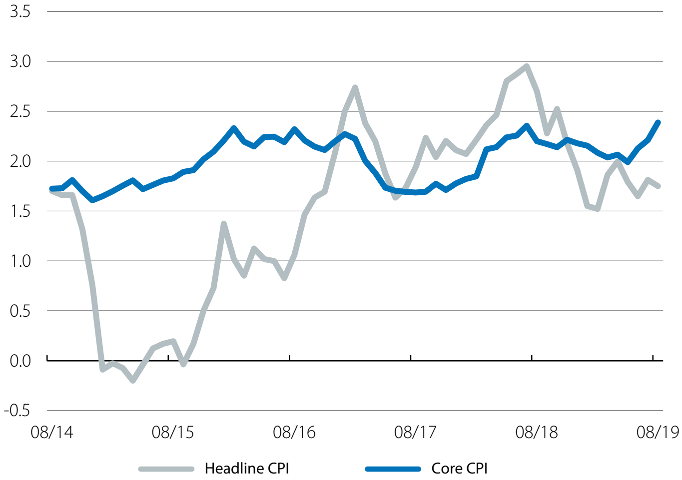
EMERGING MARKETS

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

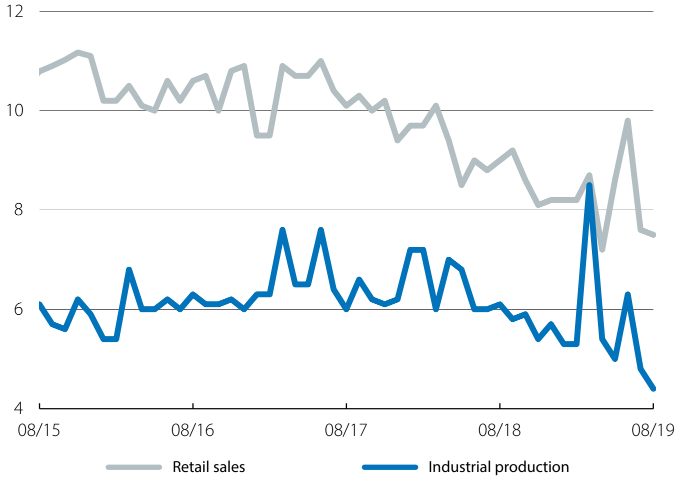
Year-on-year change (%)



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

China: economic activity indicators

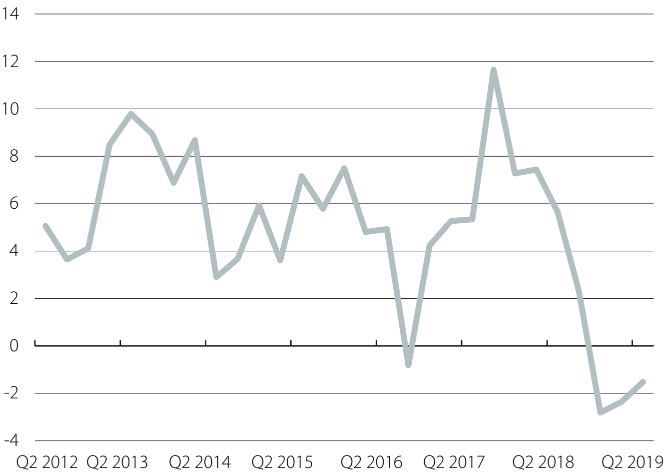
Year-on-year change (%)



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.*

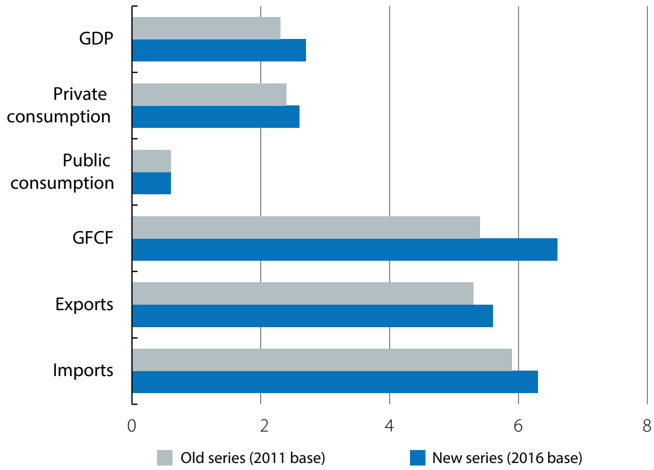
The Portuguese economy shows a positive performance

The statistical review of the national accounts reveals a more positive picture of the Portuguese economy. In September, the National Statistics Institute (NSI) conducted a review of the historical GDP series, which resulted in a significant improvement in the growth figures for the past three years. In particular, according to the new series, GDP grew at an average annual rate of 2.7% between 2016 and 2018, 0.4 pps higher than according to the previous series. Another especially noteworthy aspect was the upward revision of investment, with an average annual growth over the three-year period of 6.6%, 1.2 pps higher than in the previous series. This was driven by upward revisions of the construction, transport equipment and intellectual property subcomponents. The new series also shows that GDP growth was higher in the first half of 2019 (+2.0%, compared to the 1.8% previously estimated). This leads us to raise our forecast for the year as a whole to 1.8%, 1 decimal point higher than previously estimated. These revisions, however, do not change the trend towards a gradual slowdown in growth. On the one hand, this slowdown reflects the fact that the economy is in a more mature phase of the cycle, in which it is natural for growth to moderate down to its potential. On the other hand, in a demanding external environment, the slowdown of the global economy will also contribute to moderating the growth of the Portuguese economy. Indeed, the Bank of Portugal's coincident economic activity indicator (which is closely associated with GDP) fell in July to 1.8%.

The new series also mitigate the deterioration of the external situation. In particular, following the NSI's revisions, in Q2 2019 the economy's financing capacity stood at 0.4% of GDP (four-quarter cumulative figure). This is clearly more positive than the figure reflected in the previous series (according to which the country had external financing needs amounting to 0.1% of GDP). Furthermore, it indicates that the process of reducing Portugal's still high level of external debt (around 100% of GDP) remains on track. Similarly, the household savings rate was revised upwards, now standing at 5.9% of gross disposable income in Q2 2019 (four-quarter cumulative figure). This represents an increase of around +1.5 pps compared to the previous series. Despite these improvements, the trend of a gradual decline in savings continues as consumption continues to grow faster than disposable income. This trend is favoured by confidence in the evolution of the labour market and households' financial situation (see the article «Portuguese household savings rate at rock bottom: how concerned should we be?» in this same *Monthly Report*).

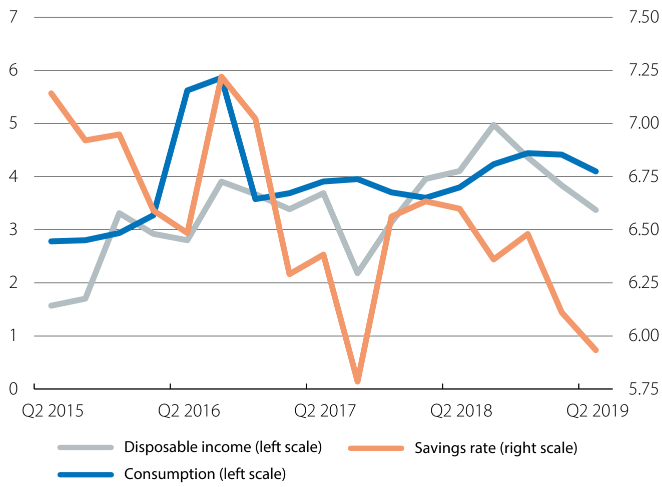
The budgetary balance improved substantially in the first half of the year. In June 2019, the public sector balance stood at –0.8% of GDP according to the national accounting data

Portugal: GDP and components
Average annual growth for 2016-2018 (%)



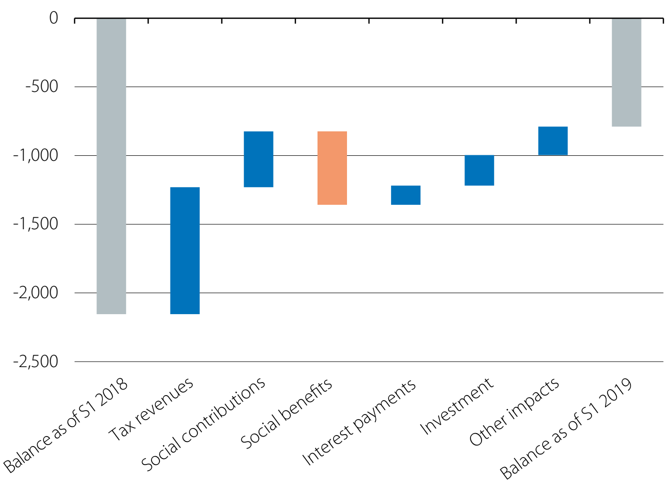
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Portugal: household savings, income and consumption
Year-on-year change (%) *(% of gross disposable income)*



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

Portugal: central government balance
(EUR millions)



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

(–789 million euros), representing a clear improvement over the figure for the same period in 2018 (–2.2% of GDP). This improvement reflects the considerable growth in revenues (5.0%), compared to a moderate increase in expenditure (1.4%), with the reduction in interest costs (–4.2%) and the fall in investment (–14.1%) standing out. The monthly budget execution, meanwhile, continues to follow a favourable trend and reached a surplus of 402 million euros with data up to August, indicating that the improvement in the public finances will continue for the rest of the year.

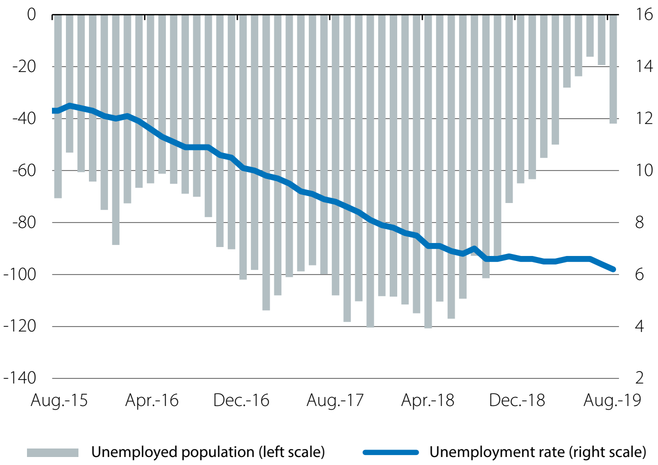
The unemployment rate has dropped to levels of 2002. In August, the unemployment rate fell to 6.2% (in seasonally-adjusted terms), representing a 0.8 pps reduction in the past 12 months. The number of people in employment also continued to grow more moderately than in the past (1.1% year-on-year, versus 2.0% in August 2018 and 2.3% on average in 2018), and in August it reached the highest level since early 2009. Both figures were better than expected. However, looking ahead to the coming quarters a more moderate trend can be expected in the labour market, as it has entered a more mature phase.

The real estate sector remains buoyant. In Q2 2019, housing prices rose by 10.1% year-on-year, 0.9 pps more than in the previous quarter. This trend can be explained by the increase in the relative weight of non-resident buyers in the sum of all property transactions (they have gone from representing 7% of transactions in 2017 to 13% in 2018). Furthermore, this group of buyers is concentrated in the most luxurious segments of the market (in 2018, the average price paid by non-residents exceeded the average price paid by residents by 58%, which may be related to the fact that purchasing houses for over 500,000 euros is one of the requirements for obtaining Portuguese residency through investment activities). These signals, however, contrast with the 6.6% year-on-year decline in sales in Q2 (the first decline since Q1 2013).

Non-financial private sector lending continues to contract, with a –1.5% year-on-year reduction in July. On the one hand, the stock of lending to households fell by 0.8% year-on-year, largely due to lending for housing (–1.5%) and in particular due to repayments, given that new lending operations remain strong. On the other hand, the recovery in new lending to non-financial corporations has softened the contraction of total lending (–2.7% in July, versus –6.0% at the beginning of the year). Finally, it should also be noted that sales of doubtful loans have a negative impact on lending stock: excluding this effect, the lending stock would have increased by 2.4% up to July.

Portugal: unemployed population and unemployment rate

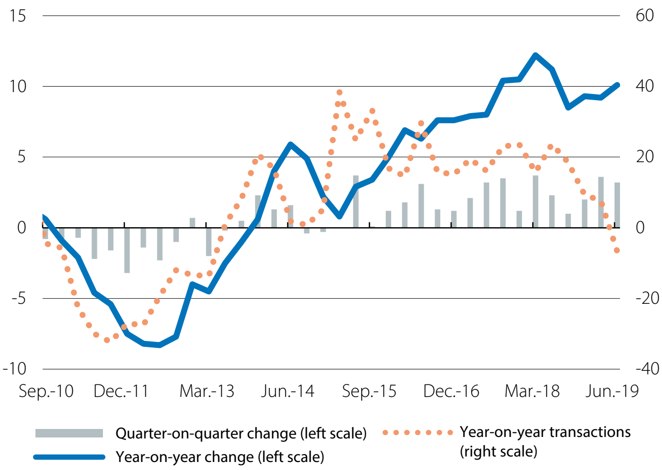
Year-on-year change (thousands) *(%)*



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

Portugal: housing prices and transactions

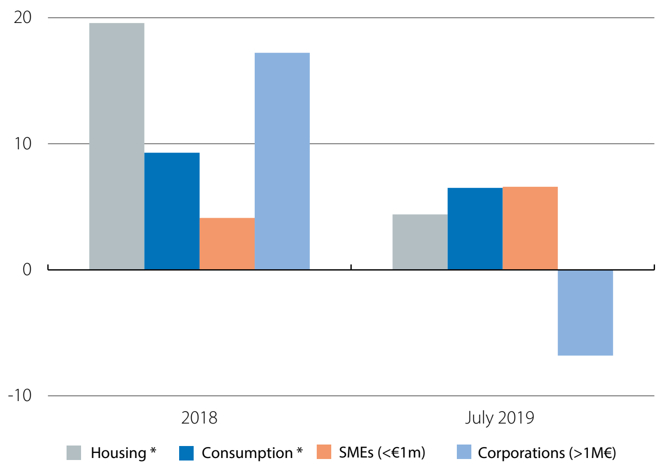
Year-on-year change (%) *Year-on-year change (%)*



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

Portugal: new lending operations

Year-on-year change (%)



Note: ** Excluding renegotiations.*
Source: *CaixaBank Research, based on data from the Bank of Portugal.*