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ECONOMIC & FINANCIAL ENVIRONMENT

DOSSIER: THE THREAT OF THE ILLIBERAL SHIFT

CaixaBank Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
January 2020

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31 December 2019

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The illiberal temptation

Economic liberalism is under pressure. And we are not referring to neoliberalism, but to something much more basic about which a broad consensus has existed, and still exists, in the economic profession. This includes principles such as the essential role of prudence in fiscal policy management for ensuring macroeconomic stability, the independence of central banks as the best guarantee for achieving price stability, economies opening up to international trade being a good thing, multilateralism being at the heart of international relations, that the state tends not to be a good manager of companies and that competition is key for promoting innovation and growth over the long term.

Without a doubt, there have always been extremist or anti-system movements that would throw these principles overboard. The difference now is that traditional parties or new formations with proposals that openly question some of these principles have begun to gain strength. In the US, for example, President Trump has carried out a major fiscal stimulus with public debt at historic highs, he repeatedly attacks the independence of the Fed, he has abandoned multilateralism and discredited organisations that embody it, and he pursues protectionism in the sphere of trade in order to foster the development of the domestic manufacturing industry. In Europe, voices have also emerged calling for a relaxation of competition policy, which would facilitate the creation of European or national champions.

The pressure on economic liberalism is closely linked to the emergence of populist phenomena. Although such phenomena emerge for different reasons, one of them is the dissatisfaction produced by the economic results of the current system and the lack of answers it offers to major challenges such as technological, climate and demographic change and their consequences. A significant portion of the population feels that the system leaves them behind – their incomes are not growing in line with the average or are even declining. Another portion feels unease in the face of a world that is ruled by uncertainty and in which the speed of change is accelerating. Some answer to the siren song of populism, which offers very simple recipes – often illiberal in nature – to highly complex issues. While it is true that the current system has not been capable of offering an adequate response to all of these concerns, it would be a huge mistake to fall into the illiberal temptation.

The great challenge ahead is to generate a new consensus that provides effective responses to the challenges we face. To do this, reforms are key. In this context, it is important to strengthen those institutions that strive to ensure that public policies are in the interest of society as a whole and not of certain pressure groups. In particular, at a time when it is necessary to rethink public spending priorities, it is more important than ever to have independent mechanisms for evaluating public policies. Such accountability mechanisms are an essential tool for improving the quality of public spending and that of public interventions in general. Their use should be much more common than it currently is. In this regard, the Netherlands offers an exemplary model. There, an independent authority established in 1945 not only assesses the policies that are implemented but even evaluates the main electoral proposals of the country's political parties in terms of their budgetary cost and their likely economic effects. This mechanism disciplines the parties and provides valuable information to voters.

There is also little doubt that the new consensus on the orientation of economic policies should strive to ensure that growth is more inclusive. There will be those who consider this a requirement for the purpose of equality, but as an antidote to the illiberal temptation, it is even a matter of political sustainability of the economic and democratic system itself. Fostering inclusive growth requires reforms in the education system, which should, for example, place greater emphasis on training at early ages, as well as throughout people's working lives. In addition to ongoing training, other active labour market policies must also gain prominence in order to mitigate the costs of globalisation and an ever-changing world. For younger people, an essential component is a housing policy that promotes access at a reasonable cost. For older people, the pension and healthcare system must provide adequate benefits and, of course, certainty. These are just a few examples of the enormous task that lies ahead for economic policy-makers.

Enric Fernández
Chief Economist
31 December 2019

Chronology

DECEMBER 2019

5 OPEC and its partners raise crude oil production cuts to 1.7 million barrels per day until March 2020.
13 The US and China announce a preliminary trade deal (the first phase of a three-phase agreement).
20 Following the early election on 12 December, the United Kingdom's House of Commons approves the Brexit withdrawal agreement.

OCTOBER 2019

11 The US and China work on phase one of a trade deal, and the US suspends the implementation of a tariff increase due to take effect on 15 October.
17 The United Kingdom and the EU reach a new withdrawal agreement.
28 The EU extends the Brexit deadline to 31 January 2020.
31 The Fed cuts its benchmark interest rates by 25 bps down to the 1.50%-1.75% range.
Mario Draghi's mandate as ECB president comes to an end.

AUGUST 2019

1 The US announces a new tariff increase on 300 billion dollars of Chinese imports not previously subject to tariffs.
5 The US calls China a «currency manipulator» after the Central Bank of China allowed the yuan to depreciate to levels not seen since 2008.
23 China announces the introduction of tariffs on 75 billion dollars of US imports.

NOVEMBER 2019

10 General elections are held in Spain.

SEPTEMBER 2019

1 The US implements a tariff increase on 112 billion dollars of Chinese imports and China imposes tariffs on around 2,000 US products.
12 The ECB announces a new stimulus package, with a 10-bp cut in the deposit facility interest rate (–0.50%), a tiered system for deposit remuneration and the resumption of net purchases of assets (20 billion per month).
18 The Fed cuts its reference interest rates by 25 bps, down to the 1.75%-2.00% range.
20 The rating agency S&P improves Spain's credit rating from A– to A.

JULY 2019

16 As proposed by the European Council, the European Parliament elects Ursula von der Leyen as President of the European Commission.
24 Boris Johnson takes over from Theresa May as the British Prime Minister.
31 The Fed cuts its reference interest rates by 25 bps to 2.00%-2.5%.

Agenda

JANUARY 2020

2 Portugal: economic climate indicator (December).
3 Spain: registration with Social Security and registered unemployment (December).
9 Portugal: international trade (November).
Portugal: turnover in industry (November).
15 Spain: financial accounts (Q3).
Portugal: tourism activity (November).
22 Spain: loans, deposits and NPL ratio (November).
23 Governing Council of the European Central Bank meeting.
28 Spain: labour force survey (Q4).
29 Portugal: employment and unemployment (December).
28-29 Federal Open Market Committee meeting.
30 Euro area: economic sentiment index (January).
US: GDP (Q4 and 2019).
31 Spain: GDP flash estimate (Q4).
Spain: CPI flash estimate (January).
Euro area: GDP of the euro area (Q4).

FEBRUARY 2020

4 Spain: registration with Social Security and registered unemployment (January).
5 Portugal: employment and unemployment (Q4).
10 Portugal: turnover in industry (December).
14 Portugal: GDP flash estimate (Q4).
17 Japan: GDP (Q4).
20 Spain: foreign trade (December).
21 Spain: loans, deposits and NPL ratio (December).
27 Spain: CPI flash estimate (February).
Euro area: economic sentiment index (February).
Portugal: housing prices (January).
28 Spain: balance of payments (December).
Portugal: CPI flash estimate (February).

2020: the mature phase of the cycle, the decisive phase of the cycle

We are in the mature phase of the business cycle. Gone are the years of the global economic crisis, when we had to revise growth forecasts repeatedly down to levels that we had never imagined. Also drifting further into the past are the early years of recovery when, imbued with the pessimism generated by the recession, we struggled to believe in our ability to overcome the difficulties at hand and the positive surprises were recurrent and significant.

It is true that the pace of growth of the world's major economies is slowing down and that in recent quarters it has been somewhat lower than we expected. However, this has been largely due to the uncertainty triggered by the trade tensions between the US and China, and the erratic process of the United Kingdom's withdrawal from the EU. Although the two fronts are far from being resolved, they appear to have entered a new phase. The agreement reached between the US and China and the ratification by the British Parliament of the UK's withdrawal agreement leads us to believe that, from now on, the tone will be more constructive in both cases.

So, with a somewhat clearer outlook on these fronts, the pace of growth in the major economies can be expected to consolidate at levels commensurate with the mature phase of the cycle, a period in which underlying factors such as demography and productivity growth play a decisive role. Broadly speaking, this outlook is reflected in the forecasts produced by the main analyst groups, including CaixaBank Research, as well as in the latest indicators.

In the US, for instance, the pace of economic activity growth continues its gradual slowdown. Over the past few years, growth has been abnormally high if we take into account that the expansion has already gone on for a decade. This was due to the major fiscal stimulus implemented by the Trump administration in 2018 and 2019. In contrast, the latest economic activity indicators suggest that GDP growth stood at around 2.2% year-on-year in Q4 2019. This is well below the 2.9% registered in 2018, but more in line with the US economy's long-term growth capacity, which is no doubt below 2.0%. Despite the slowdown in the pace of economic activity, it is worth noting that the US economy continues to create employment at an impressive rate: in November, 266,000 jobs were generated and the unemployment rate remained at 3.5%, an all-time low. In this context, it is only natural that the Fed has applied the brakes and is not signalling further rate cuts over the coming quarters.

In China, the economic activity indicators are relatively satisfactory and continue to dispel fears of a hard landing for the economy, which were accentuated with the impact of the trade tensions on its foreign sector. To date, the authorities have been conducting a difficult but successful process of managing the country's monetary and fiscal policy, and they have managed to cushion the impact of the fall in exports. Thus, the economy's slowdown towards levels that are more sustainable in the long term continues in a gradual manner.

The worst omens are also fading on the Old Continent. The latest economic activity indicators suggest that the euro area closed 2019 with a growth rate of 0.9% year-on-year, a disappointing figure and somewhat below its potential growth. The culprits behind this lower growth include the difficulties experienced in the industrial sector (particularly in the automotive sector), the indirect impact of the trade tensions between the US and China on the European foreign sector, and the Brexit. Nevertheless, the resilience of the services sector and of consumption allows us to be moderately optimistic.

In short, it seems that the macroeconomic context, while not extraordinary, could prove relatively favourable over the coming quarters - provided there are no more scares in the geopolitical sphere. Without a doubt, now is a good time for economic policy to switch on the full-beam headlights and decisively address the future challenges, including climate, technological and demographic change. The economies and companies that are able use this time to think strategically and reshape their strengths will be the ones able to better cope with the difficult times when they come. **We are in the decisive phase of the cycle**.

Oriol Aspachs
Head of Research

Average for the last month in the period, unless otherwise specified

Financial markets

	Average 2000-2007	Average 2008-2016	2017	2018	2019	2020	2021
INTEREST RATES							
Dollar							
Fed funds (upper limit)	3.43	0.48	1.50	2.50	1.75	1.50	1.75
3-month Libor	3.62	0.70	1.61	2.79	1.92	1.71	1.90
12-month Libor	3.86	1.20	2.05	3.08	1.97	1.85	2.20
2-year government bonds	3.70	0.73	1.84	2.68	1.63	1.83	2.00
10-year government bonds	4.70	2.61	2.41	2.83	1.86	1.97	2.20
Euro							
ECB depo	2.05	0.40	–0.40	–0.40	–0.50	–0.50	–0.25
ECB refi	3.05	1.00	0.00	0.00	0.00	0.00	0.25
Eonia	3.12	0.65	–0.34	–0.36	–0.46	–0.45	–0.25
1-month Euribor	3.18	0.79	–0.37	–0.37	–0.45	–0.43	–0.20
3-month Euribor	3.24	0.98	–0.33	–0.31	–0.40	–0.40	–0.15
6-month Euribor	3.29	1.14	–0.27	–0.24	–0.34	–0.35	–0.05
12-month Euribor	3.40	1.34	–0.19	–0.13	–0.26	–0.30	0.05
Germany							
2-year government bonds	3.41	0.69	–0.69	–0.60	–0.63	–0.40	–0.10
10-year government bonds	4.30	1.98	0.35	0.25	–0.27	0.30	0.67
Spain							
3-year government bonds	3.62	2.30	–0.04	–0.02	–0.36	0.38	0.81
5-year government bonds	3.91	2.85	0.31	0.36	–0.09	0.61	1.05
10-year government bonds	4.42	3.82	1.46	1.42	0.44	1.10	1.37
Risk premium	11	184	110	117	71	80	70
Portugal							
3-year government bonds	3.68	4.42	–0.05	–0.18	–0.34	0.68	1.25
5-year government bonds	3.96	5.03	0.46	0.47	–0.12	0.95	1.42
10-year government bonds	4.49	5.60	1.84	1.72	0.40	1.20	1.52
Risk premium	19	362	149	147	67	90	85
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.30	1.18	1.14	1.11	1.15	1.21
EUR/JPY (yen per euro)	129.50	126.36	133.70	127.89	121.31	121.90	128.26
USD/JPY (yen per dollar)	115.34	97.50	113.02	112.38	109.18	106.00	106.00
EUR/GBP (pounds per euro)	0.66	0.83	0.88	0.90	0.85	0.84	0.82
USD/GBP (pounds per dollar)	0.59	0.63	0.75	0.79	0.76	0.73	0.68
OIL PRICE							
Brent ($/barrel)	42.3	85.6	64.1	57.7	65.4	61.5	63.0
Brent (euros/barrel)	36.4	64.8	54.2	50.7	58.8	53.5	52.1

Forecasts

Percentage change versus the same period of the previous year, unless otherwise indicated

International economy

	Average 2000-2007	Average 2008-2016	2017	2018	2019	2020	2021
GDP GROWTH							
Global	**4.5**	**3.3**	**3.8**	**3.6**	**2.9**	**3.3**	**3.4**
Developed countries	***2.7***	***1.2***	***2.5***	***2.3***	***1.7***	***1.5***	***1.6***
United States	2.7	1.4	2.4	2.9	2.3	1.8	1.8
Euro area	2.2	0.4	2.7	1.9	1.1	1.1	1.3
Germany	1.6	1.1	2.8	1.6	0.6	0.7	1.5
France	2.0	0.6	2.4	1.7	1.3	1.4	1.5
Italy	1.5	–0.7	1.8	0.7	0.2	0.5	0.7
Portugal	1.5	–0.3	3.5	2.4	1.9	1.7	1.6
Spain	3.7	0.0	2.9	2.4	1.9	1.5	1.5
Japan	1.5	0.4	2.2	0.3	1.1	0.7	1.1
United Kingdom	2.8	1.1	1.9	1.4	1.3	1.2	1.4
Emerging countries	***6.6***	***5.1***	***4.8***	***4.5***	***3.8***	***4.4***	***4.6***
China	11.7	8.4	6.9	6.6	6.0	5.8	5.7
India	9.7	6.9	6.9	7.4	5.3	6.1	6.5
Indonesia	5.5	5.7	5.1	5.2	5.0	4.8	4.7
Brazil	3.6	1.7	1.3	1.3	1.1	2.0	2.2
Mexico	2.4	2.1	2.1	2.1	0.3	1.3	2.1
Chile	5.0	3.2	1.3	4.0	2.2	2.8	2.8
Russia	7.2	1.0	1.6	2.2	1.2	1.9	1.8
Turkey	5.4	4.8	7.4	3.1	0.1	2.1	2.6
Poland	4.0	3.2	4.9	5.2	3.8	2.9	2.4
South Africa	4.4	1.8	1.5	0.7	0.4	1.4	1.9
INFLATION							
Global	**4.2**	**3.8**	**3.2**	**3.6**	**3.5**	**3.6**	**3.5**
Developed countries	***2.1***	***1.5***	***1.7***	***2.0***	***1.4***	***1.6***	***1.8***
United States	2.8	1.6	2.1	2.4	1.8	2.2	2.0
Euro area	2.1	1.4	1.5	1.8	1.1	1.2	1.7
Germany	1.7	1.3	1.7	1.9	1.3	1.3	1.8
France	1.8	1.2	1.2	2.1	1.2	1.4	1.8
Italy	1.9	1.5	1.3	1.2	0.6	1.0	1.5
Portugal	3.0	1.2	1.4	1.0	0.4	0.7	1.0
Spain	3.2	1.3	2.0	1.7	0.7	1.0	1.4
Japan	–0.3	0.3	0.5	1.0	0.5	1.1	1.2
United Kingdom	1.9	2.3	2.7	2.5	1.9	1.8	2.1
Emerging countries	***6.8***	***5.8***	***4.3***	***4.8***	***4.9***	***5.0***	***4.6***
China	1.7	2.6	1.6	2.1	2.7	2.8	2.6
India	4.5	8.5	3.3	3.9	3.7	5.0	5.1
Indonesia	8.4	5.7	3.8	3.2	3.0	2.8	2.9
Brazil	7.3	6.4	3.5	3.7	3.8	3.6	3.8
Mexico	5.2	3.9	6.0	4.9	3.7	3.7	3.5
Chile	3.1	3.5	2.2	2.7	2.2	2.8	3.1
Russia	14.2	9.3	3.7	2.9	4.6	3.7	4.0
Turkey	27.2	8.1	11.1	16.2	16.1	13.5	10.0
Poland	3.5	2.1	1.6	1.2	2.1	2.5	2.5
South Africa	5.3	6.2	5.3	4.6	4.2	4.5	4.9

Forecasts

Percentage change versus the same period of the previous year, unless otherwise indicated

Spanish economy

	Average 2000-2007	Average 2008-2016	2017	2018	2019	2020	2021
Macroeconomic aggregates							
Household consumption	3.6	–0.6	3.0	1.8	1.2	1.6	1.3
Government consumption	5.0	0.9	1.0	1.9	2.3	1.8	1.4
Gross fixed capital formation	5.6	–3.8	5.9	5.3	2.8	2.8	2.4
Capital goods	5.0	–1.5	8.5	5.7	5.1	5.3	2.6
Construction	5.7	–6.5	5.9	6.6	1.4	1.1	2.3
Domestic demand (vs. GDP Δ)	4.5	–1.2	3.0	2.6	1.7	1.9	1.5
Exports of goods and services	4.8	2.8	5.6	2.2	1.7	2.1	3.0
Imports of goods and services	7.0	–1.0	6.6	3.3	1.0	3.3	3.1
Gross domestic product	**3.7**	**0.0**	**2.9**	**2.4**	**1.9**	**1.5**	**1.5**
Other variables							
Employment	3.2	–1.5	2.8	2.5	2.2	1.4	1.1
Unemployment rate (% of labour force)	10.5	20.8	17.2	15.3	14.2	13.6	13.2
Consumer price index	3.2	1.3	2.0	1.7	0.7	1.0	1.4
Unit labour costs	3.0	0.1	0.7	1.2	2.5	2.5	2.3
Current account balance (% GDP)	–5.9	–1.1	2.7	1.9	1.6	1.3	1.4
External funding capacity/needs (% GDP)	–5.2	–0.7	2.9	2.4	1.8	1.5	1.6
Fiscal balance (% GDP)[1]	0.4	–7.1	–3.0	–2.5	–2.3	–2.0	–1.5

Note: *1. Excludes losses for assistance provided to financial institutions.*

Forecasts

Portuguese economy

	Average 2000-2007	Average 2008-2016	2017	2018	2019	2020	2021
Macroeconomic aggregates							
Household consumption	1.7	–0.2	2.1	3.1	2.2	1.9	1.7
Government consumption	2.3	–0.7	0.2	0.9	0.5	0.2	0.2
Gross fixed capital formation	–0.3	–3.5	11.5	5.8	7.4	4.4	4.4
Capital goods	1.2	–0.1	12.5	7.5	4.8	2.5	2.5
Construction	–1.5	–6.2	12.2	4.6	10.5	4.3	2.5
Domestic demand (vs. GDP Δ)	1.3	–1.0	3.3	3.2	3.1	2.3	2.0
Exports of goods and services	5.2	3.5	8.4	3.9	2.5	2.3	2.6
Imports of goods and services	3.6	1.6	8.1	5.9	5.2	3.7	3.3
Gross domestic product	**1.5**	**–0.3**	**3.5**	**2.4**	**1.9**	**1.7**	**1.6**
Other variables							
Employment	0.4	–1.1	3.3	2.3	1.0	0.5	0.2
Unemployment rate (% of labour force)	6.1	12.2	8.9	7.0	6.3	6.1	6.0
Consumer price index	3.0	1.2	1.4	1.0	0.4	0.7	1.0
Current account balance (% GDP)	–9.2	–4.1	1.2	0.4	–0.7	–0.7	–0.4
External funding capacity/needs (% GDP)	–7.7	–2.7	2.1	1.4	0.2	0.2	0.5
Fiscal balance (% GDP)	–4.6	–6.4	–3.0	–0.4	–0.3	–0.3	0.1

Forecasts

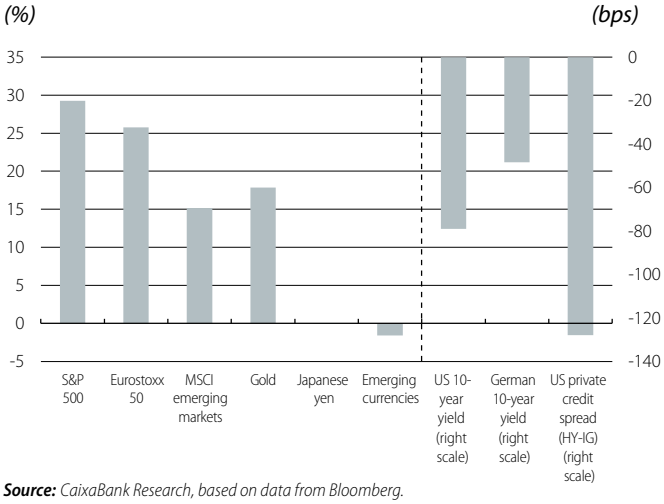
A resurgence of risk appetite brings an end to a year marked by swings in investor sentiment

Good tone in the markets at the end of the year. As we leave 2019 behind, we look back on a year in which the financial markets were marked by the trade tensions between the US and China, the resolution of Brexit, the slowdown in global growth and the return to the scene of monetary stimuli on the part of the major central banks. December was no exception, and the year ended with progress being made in the field of trade (with a first agreement between the US and China) and in the British political situation (where Parliament has approved the EU withdrawal agreement). Furthermore, the central banks strengthened their commitment to the accommodative measures of the previous months. Thus, in a scenario of stabilisation of the economic outlook, December saw a reduction in volatility in the financial markets, while investors showed a greater appetite for risk-bearing assets. All this led to widespread gains in the stock markets and commodity prices, as well as to a certain recovery in interest rates. However, despite the better performance in the closing stages of the year, the risks affecting the economic and financial scenario will remain present in 2020. Furthermore, the sensitivity that the markets have shown throughout 2019 to geopolitical events and to messages from the major central banks suggests that they will continue to determine the investor mood in the new year.

A good year for the stock markets, despite the ups and downs. While 2019 began with fears that the turbulence of late 2018 would continue to weigh down on stock prices, finally the year ended with notable and widespread gains: around 30% on a cumulative basis in the case of advanced economies and around 15% in emerging economies. These figures go beyond the rebound effect following the turmoil of the autumn of 2018. In fact, the main indices are well above their peaks reached in the summer of 2018: more than 10% above in advanced economies and around 6% above in emerging economies. The gains have been supported by the dovish measures taken by the central banks during the course of the year and a certain calm in the geopolitical uncertainties surrounding the US and China and in Europe (Brexit and Italy), as well as the finding that the risks of economic recession have been placated by the resilience of domestic demand. Nevertheless, the year has not been without difficulties and on various occasions the stock markets have registered major corrections to the sound of geopolitical tensions (such as in the episode of risk aversion of last summer). In addition to this risk factor, some western stock markets are showing high multiples (such as price-to-earnings ratios), highlighting the fears that some assets may be overvalued, as repeatedly emphasised by institutions such as the IMF and the BIS.

Interest rates take root in accommodative territory. At their December meetings, both the ECB and the Fed conveyed a message of continuity of the dovish measures taken during

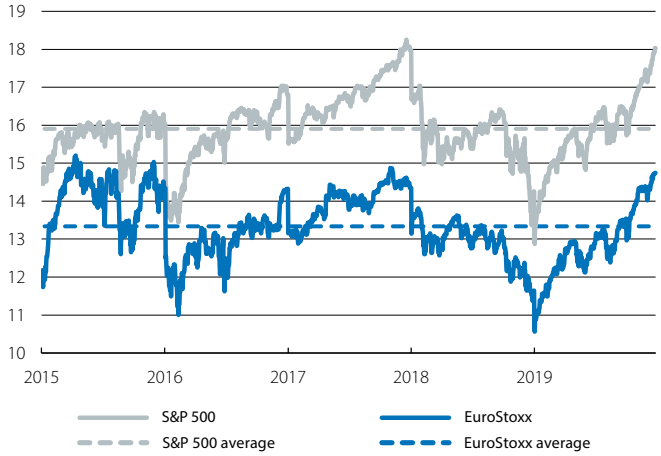
Select financial variables: change in 2019



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

PE ratio: performance and average for the past five years

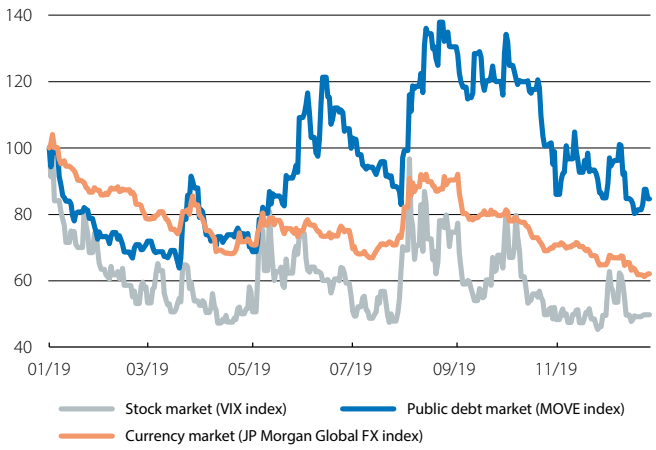
(12 months forward)



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

Implicit volatility in the financial markets

Index (100 = January 2019)



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

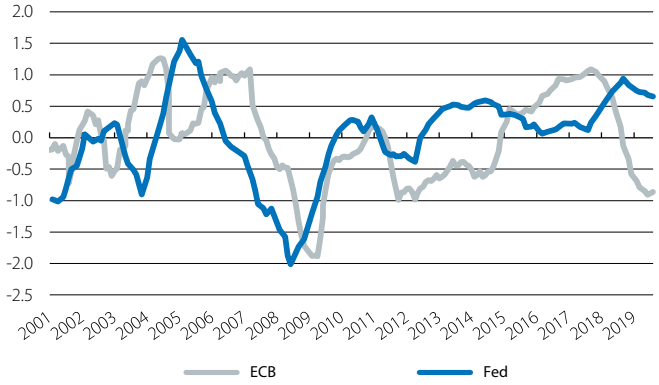
2019. On the one hand, on the occasion of Christine Lagarde's debut as the new chair, the ECB opted to keep its monetary policy unchanged and reiterated its commitment to the stimulus package announced in September (a depo rate cut down to –0.50%, a resumption of net asset purchases and more favourable conditions for the TLTRO). Furthermore, backed by its reading of a scenario marked by weak growth and a persistence of risks, the ECB reiterated the need to maintain the favourable financial conditions for a long period. The Fed, meanwhile, kept the interest rate within the 1.50%-1.75% range, after three cuts in the months of July, September and October. What is more, the Fed's latest projections show that 13 of its 17 members do not anticipate any change in rates in 2020 (while the remaining 4 expect only one increase of 25 bps). This reduces the apparent likelihood of further cuts in 2020 that are built into the valuations of financial securities. However, these messages contrast with those sent a year ago when, in December 2018, the ECB put an end to net asset purchases and the Fed stated its intention to implement three rate hikes. Indeed, in the fixed-income markets 2019 was marked by sharp falls in sovereign yields (of around –75 bps and –40 bps in the 10-year yields of the US and Germany on a cumulative basis, respectively). That said, the latter months of the year saw a moderation of these declines thanks to the recovery of investor sentiment: in December, the 10-year yields of the US and Germany rose by around 15 bps, culminating a recovery of around 50 bps from their low points of last summer.

Emerging currencies lose ground against the dollar. During 2019, the US dollar showed greater strength against most global currencies, which were penalised by economic uncertainty, trade tensions and long-term interest rate spreads. These factors took a particular toll on emerging countries, whose currencies depreciated notably against the US dollar (also weighed down by various idiosyncratic factors). The most noteworthy cases included those of the renminbi (its depreciation led it to break the barrier of 7 yuan per dollar for the first time since 2008) and most Latin American currencies (whose average depreciation in December was 4%, according to the JP Morgan Latin America index). On the other hand, in December the pound sterling appreciated by around 2% against the dollar, boosted by the result of the UK general election and the greater prospects for an orderly Brexit on 31 January.

End-of-year rally for commodities. The improvement in investor sentiment drove up commodity prices in the final straight of the year. In the oil market, in December this improvement was added to by the decision taken by OPEC and its partners (led by Russia) to cut their crude oil production by an additional 500,000 barrels per day beginning in January 2020. This raises the total cuts to 1.7 million barrels per day compared to the levels of October 2018 (for further details, see the article «Oil: piecing together the puzzle» in this same *Monthly Report*). In addition, although the duration of the agreement was not prolonged (it is due to end in March 2020), Saudi Arabia expressed a desire to continue to lead the production cuts, which favoured the rise in the price of a barrel of Brent oil above 65 dollars.

Central bank economic sentiment index

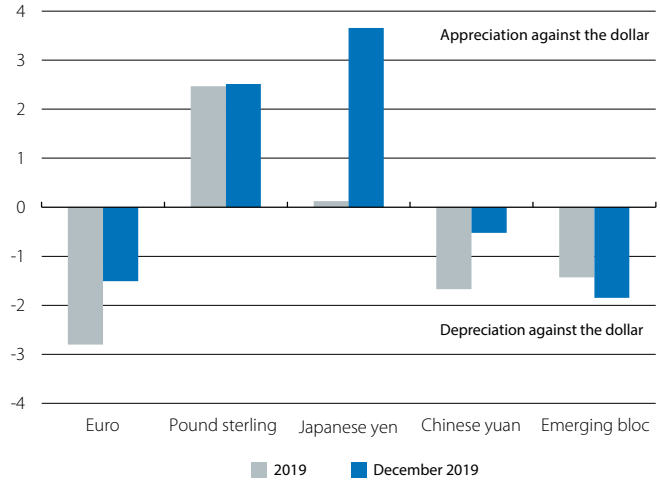
Index



Note: *The central bank sentiment index measures the pessimism or optimism conveyed in the Fed press release and the ECB press conference following their respective meetings. For further details, see «The «sense and sensibility» of the ECB's communication» in the MR11/2019.*
Source: *CaixaBank Research.*

International currencies against the US dollar

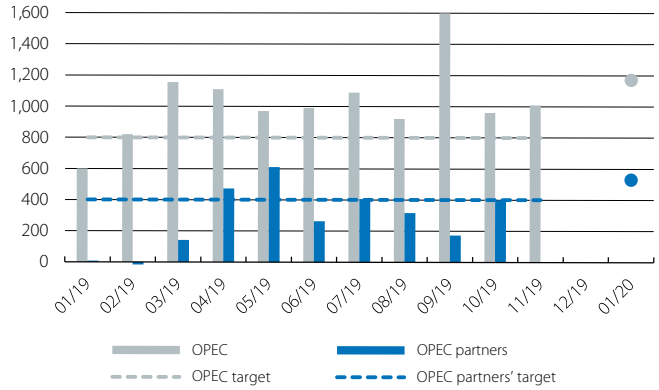
Change (%)



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

OPEC: fulfilment of the cuts agreed in December 2018

Million barrels a day (mb/d)



Note: *Values above the dotted lines imply that the production cut agreement is being over-fulfilled. The point at the end shows the cut that was agreed on 6 December and which will be effective from January 2020.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Oil: piecing together the puzzle

- **In December, OPEC announced new cuts to its production in order to narrow the gap between supply and demand in the crude oil market. This has occurred, above all, due to a lower than expected increase in demand.**
- **Looking ahead into 2020, uncertainty surrounding economic growth coupled with the classic supply factors (OPEC cuts, geopolitical tensions and events in the shale industry) could introduce volatility into the oil market.**

In early December 2019, OPEC and its partners (OPEC+) decided to cut oil production even further. Specifically, they increased the cuts implemented in December 2018 by 0.5 million barrels a day (mb/d), bringing them to 1.7 mb/d compared to the levels of October of the same year. In doing so, **the cartel seeks to sustain the oil price slightly above the 60-dollar mark. Will it succeed?** Below, we will piece together the puzzle of what happened in 2019 and we will see whether the same pieces can be used to do the same for the puzzle of 2020.

2019: Brent oil fluctuates to the sound of demand...

Doubts over demand have determined the path of the oil price throughout 2019. Following an episode of major financial turbulence at the end of 2018 (stoked by fears of an abrupt slowdown in global economic activity), the dovish shift of the major central banks and a more constructive tone (apparently) in the trade dispute between the US and China in the early stages of 2019 eased the initial fears of economic weakness, giving rise to a **recovery in investor sentiment**. Thus, **the year began with a recovery in the outlook for demand and a sustained rally in the Brent oil price**, which rose by more than 20 dollars to reach 74 dollars a barrel. The rise in sentiment is well illustrated in the first chart, which shows how the price of a barrel of Brent oil mimicked the rise of the US stock market in the first half of 2019.[1]

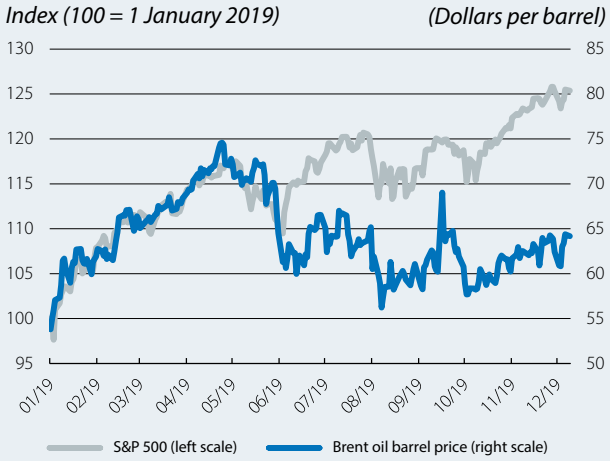
However, in the lead up to summer, concerns over demand returned to the fore with the resurgence of the trade tensions between the US and China. **The renewed fears of an abrupt slowdown in global economic activity and the observation of a steady increase in crude oil inventories generated doubts over the steadiness of the demand for oil**. All this resulted in a reduction in the forecasts for oil demand over the following quarters. For instance, whereas in October 2018 OPEC anticipated an increase in demand of 1.4 mb/d in 2019, in its latest report (November 2019) the forecast has been reduced to 1.0 mb/d. The fact that this reduction in expectations can be explained by the slowdown in global GDP is well illustrated by a simple exercise: if we estimate the sensitivity of oil demand to changes in the economic growth of advanced and emerging economies, we obtain similar results. In particular, according to the economic growth we envisaged at the end of 2018, demand for oil should have increased in 2019 by 1.2 mb/d. However, our most recent GDP forecasts suggest that it will have only increase by 0.8 mb/d. Furthermore, the exercise indicates that the decline in the expected demand mainly occurred in OECD countries, since it was previously expected that they would increase their consumption by 0.15 mb/d, whereas the latest projections suggest that it will end up falling by 0.19 mb/d.

This trend can also be seen in the forecasts for 2020. Whereas at the end of 2018 we anticipated a demand of 101.9 mb/d in 2020, the historical sensitivity of economic growth and the demand for crude oil suggests that, in the end, it will only amount to 101.2 mb/d. This is equivalent to a year-on-year increase of 1.2 mb/d (as opposed to the 1.4 mb/d originally foreseen).

...in spite of geopolitical tensions

In the second part of the year, the price of a barrel of Brent oil proved much more stable and fluctuated around the 60-dollar mark. However, a turbulent episode at the end of September reminded us that **the geopolitical tensions in the Middle East can be disruptive for the oil market**. This time, in addition to acts of sabotage against merchant vessels around the Strait of Hormuz,[2] the market saw how it was possible to attack strategic infrastructure. Specifically, a Yemeni rebel group attacked the largest refinery in Saudi

US stock market and Brent oil



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

1. In addition, some supply-side elements, such as production cuts by OPEC+ and bottlenecks in the infrastructure of the shale industry, supported this price surge. For further details, see «The oil price roller coaster: up, down and what next?» in the MR09/2019.
2. A strategic area in the Persian Gulf through which around 20% of the world's oil passes.

Arabia, damaging nearly half of the country's productive capacity, which is equivalent to 5% of global production. The impact of this shock on the oil price was by no means negligible,[3] but it only lasted a few days: the inventories of crude oil accumulated over the past few years were able to dampen what could have been a much more serious supply shock in other periods with a more saturated oil market.

What might happen in 2020?

The consensus of analysts is that, in 2020, **the price of a barrel of Brent oil will remain stable between 60 and 65 dollars**, a view that we share. On the one hand, **shale production acts as a brake for rising oil prices**. Since the breakeven price of the shale industry is somewhat higher than that of other production sources,[4] if the price of a barrel of Brent were to increase a lot, one would expect a rebound in the supply of shale from wells that require higher prices in order to be profitable. This reaction makes sustained deviations above 70 dollars per barrel less likely.

On the other hand, with its latest decision, OPEC has shifted its strategy somewhat. In particular, at this meeting the cartel increased the scale of the cuts but did not extend them beyond March. In doing so, OPEC is able to drive up the spot price of crude oil without having an excessive impact on futures contracts (see last chart). As we have discussed in the past,[5] **the fact is that OPEC feels more comfortable with the oil market in backwardation** (i.e. with a spot price higher than the future price), since such a situation is less favourable for shale producers, whose productive model depends more on future prices. Nevertheless, the cuts announced by OPEC and its partners are not a guarantee of supply stability: in fact, the countries involved have steadily deviated from the agreement (cutting production by more in the case of OPEC and by less in the case of non-OPEC).

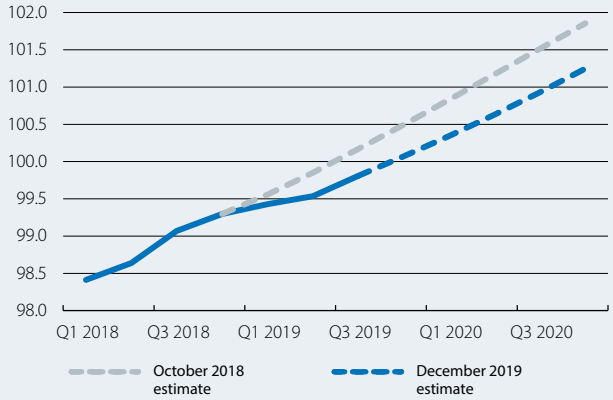
Finally, what happens to the demand for oil will play a key role. We have seen how in 2019 demand was the key factor in determining the movements in the price of a barrel of Brent oil. In 2020, global economic activity is expected to be somewhat more buoyant. This is a reflection of a gentle slowdown in economies such as the US and China, the continuity of moderate growth in the euro area and the recovery of emerging economies that had a worse than expected performance in 2019. This should support the demand for oil and drive the price up to the aforementioned levels. Nevertheless, as the experience of 2019 shows, **uncertainty surrounding the expectations for economic growth could, once again, inject volatility into the oil market**.

All in all, it seems clear that **the main pieces of the puzzle of 2019 will remain present in 2020** (OPEC, geopolitical tensions, economic growth and the shale industry). As is tradition in the oil market, these pieces could end up fitting together in multiple configurations. Furthermore, new pieces, such as stricter environmental regulations on carbon emissions or on the consumption of single-use plastic, could gain prominence over the coming years.

Ricard Murillo Gili

Global demand for oil

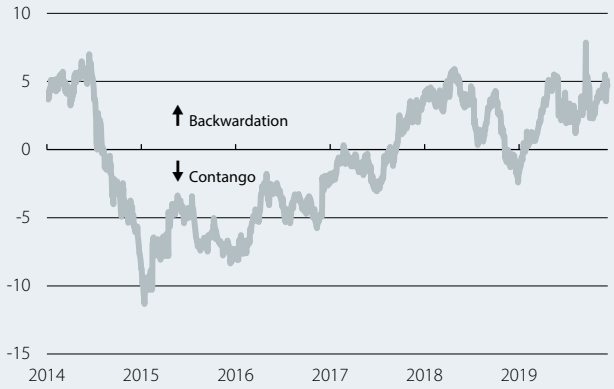
Million barrels a day (mb/d)



Note: *Four-quarter moving average.*
Source: *CaixaBank Research, based on data from the International Energy Agency.*

Difference between the spot price and the 12-month future price of a barrel of Brent oil

(Dollars)



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

3. The price of a barrel of Brent oil surged by over 15% in a single session, representing the biggest daily increase since the outbreak of the Gulf War in 1990.
4. On average, the West Texas barrel price (slightly lower than the Brent price in recent years) from which a well in the US shale industry becomes profitable is 50 dollars, while in Saudi Arabia the breakeven price is less than 10 dollars.
5. For further details, see «OPEC's dilemma and an end to the contango structure in the crude oil market» in the MR09/2017.

Interest rates (%)

	31-Dec.	30-Nov.	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	0.00	0.00	0	0.0	0.0
3-month Euribor	–0.38	–0.40	2	–7.4	–7.3
1-year Euribor	–0.25	–0.27	2	–13.2	–12.8
1-year government bonds (Germany)	–0.64	–0.62	–2	–6.7	–5.8
2-year government bonds (Germany)	–0.60	–0.63	3	0.9	1.3
10-year government bonds (Germany)	–0.19	–0.36	18	–42.7	–35.0
10-year government bonds (Spain)	0.47	0.42	5	–94.8	–93.3
10-year government bonds (Portugal)	0.44	0.40	4	–128.0	–127.1
US					
Fed funds	1.75	1.75	0	–75.0	–75.0
3-month Libor	1.91	1.91	0	–89.9	–88.6
12-month Libor	2.00	1.95	4	–100.9	–100.6
1-year government bonds	1.57	1.59	–2	–103.0	–102.0
2-year government bonds	1.57	1.61	–4	–91.9	–89.9
10-year government bonds	1.92	1.78	14	–76.7	–70.3

Spreads corporate bonds (bps)

	31-Dec.	30-Nov.	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	44	48	–4	–44.6	–44.9
Itraxx Financials Senior	52	57	–5	–56.9	–60.4
Itraxx Subordinated Financials	114	118	–5	–114.8	–114.2

Exchange rates

	31-Dec.	30-Nov.	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
EUR/USD (dollars per euro)	1.121	1.102	1.8	–2.2	–1.2
EUR/JPY (yen per euro)	121.770	120.610	1.0	–3.2	–1.4
EUR/GBP (pounds per euro)	0.846	0.852	–0.7	–5.9	–6.0
USD/JPY (yen per dollar)	108.610	109.490	–0.8	–1.0	–0.2

Commodities

	31-Dec.	30-Nov.	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
CRB Commodity Index	401.6	386.4	3.9	–1.9	–1.9
Brent ($/barrel)	66.0	62.4	5.7	22.7	20.2
Gold ($/ounce)	1,517.3	1,464.0	3.6	18.3	18.1

Equity

	31-Dec.	30-Nov.	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
S&P 500 (USA)	3,230.8	3,141.0	2.9	28.9	28.7
Eurostoxx 50 (euro area)	3,745.2	3,703.6	1.1	24.8	25.1
Ibex 35 (Spain)	9,549.2	9,352.0	2.1	11.8	11.7
PSI 20 (Portugal)	5,214.1	5,127.4	1.7	10.2	10.0
Nikkei 225 (Japan)	23,656.6	23,293.9	1.6	18.2	18.2
MSCI Emerging	1,114.7	1,040.1	7.2	15.4	16.6

2020: at the gates of a demanding year, again

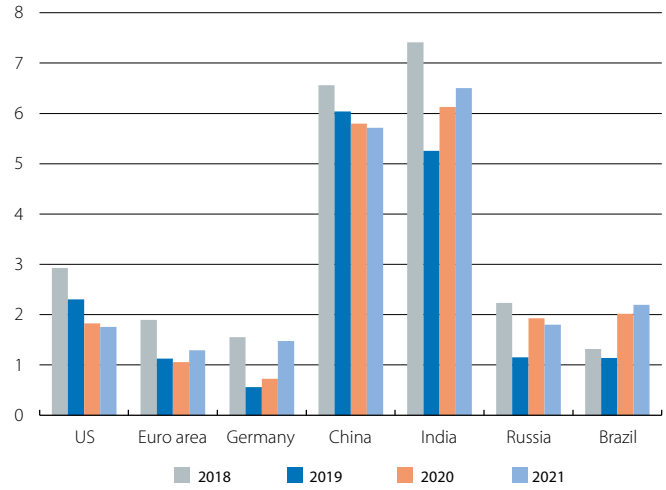
A turning point in the path of global slowdown? Following a few difficult quarters in which the economic sentiment indicators were losing ground at the global level, recently there has been a rebound in some representative confidence indicators. For instance, the global composite PMI indicator for November stood at 51.5 points (+0.7 points compared to October). A similar reading can be drawn from the global manufacturing PMI, which for the first time since April stood in expansive territory (above 50 points) thanks to the recovery of emerging economies following the bump in the sector (not the case in advanced economies). These figures are a harbinger of hope for the slight improvement expected in this new year: we expect global GDP growth to go from the 2.9% of 2019 to 3.3% in 2020. This will be particularly driven by the rebound of those emerging countries that fared worse in 2019 (Brazil, India, Russia and Turkey), while a controlled slowdown is expected in the US and Chinese economies, and in the euro area we expect continuity of the low but nonetheless positive levels of growth.

The trade risks persist, but have been mitigated in the last month. The global economic slowdown witnessed in recent quarters can be explained by a combination of factors of a differing nature that are acting simultaneously and are expected to continue to limit the growth of the major economies (the US, euro area and China) in the near future. These factors are well known by our readers, namely, the trade dispute between the US and China, Brexit and the problems in the European automotive industry. In the last month, there has been an improvement in the outlook for two of these factors, specifically the trade dispute (in particular) and Brexit. In relation to the trade dispute, in mid-December the US and China announced a first trade agreement (the first phase of a total of three). Under the deal, China undertakes to substantially increase its purchases of US goods and services, while the US subsequently suspended a tariff hike scheduled for 15 December, as well as lowering the tariffs imposed in September 2019 (for further details, see the article «International Trade: first impression of the First Phase» in this *Monthly Report*). The balance of the deal is positive, as it helps to reduce the uncertainty that has caused so much damage in 2019, while it also represents a first step towards addressing deeper-routed aspects of the US-China dispute, such as intellectual property rights and forced technology transfer. Thus, it represents a positive first step, albeit with a caveat of caution: we will have to see how the negotiations of the following phases play out and we must bear in mind that it will take time for consumers and businesses to regain confidence.

The uncertainty over Brexit clears... for now. The United Kingdom's general election of 12 December gave Boris Johnson's Conservative Party an absolute majority (with 365 of the 650 seats in the House of Commons). The outcome thus allowed for a quick ratification, in the House of Commons on

GDP forecasts

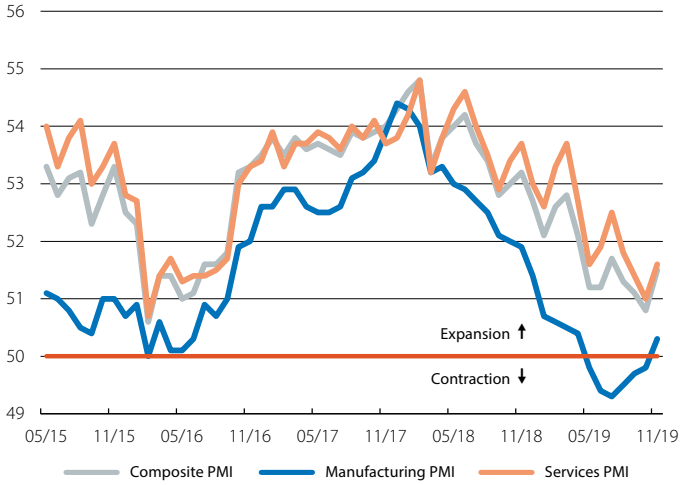
Year-on-year change (%)



Source: *CaixaBank Research.*

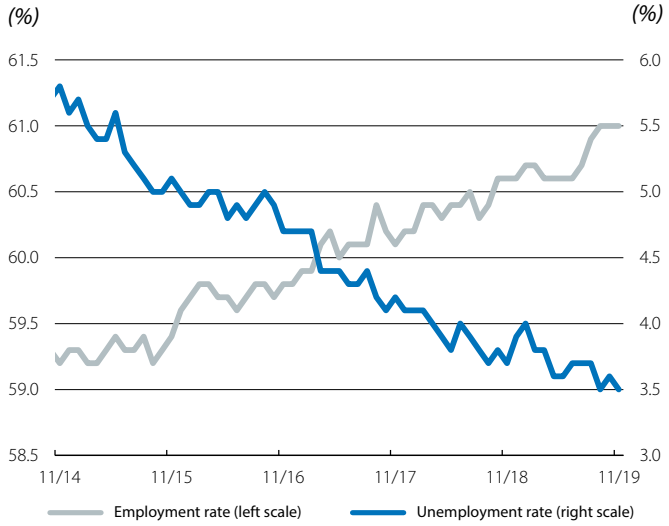
Global economic activity indicators: PMI

Level



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

US: labour market



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

20 December, of the withdrawal agreement bill that Johnson had agreed with the EU. Brexit will therefore occur no later than 31 January 2020, giving way to a transition period in which the United Kingdom will remain within the European common market and subject to EU rules while the terms of the new relationship are negotiated. Thus, 2020 will be the year of negotiations between the United Kingdom and the EU to seal a new trade agreement, a process that looks set to be complex and that could generate new episodes of uncertainty (in the absence of an agreement, the end of the transition period would give rise to a hard Brexit). In fact, the bill approved includes a new clause forbidding the government from extending the transition phase beyond 31 December 2020, which will add complexity to what are already set to be difficult negotiations.

US

The US faces its most challenging year. In 2020, the economy is expected to continue to slowdown due to the maturity of the business cycle (the US is currently in the longest expansion in its modern history, with over 40 quarters amassed to date) and the fading of the fiscal stimulus implemented in late 2017, although the slowdown will be softened by the dovish shift of the Fed in the second half of 2019. All in all, according to our projections, growth will stand at around 1.8% on average for the year, a reasonably encouraging level that is close to the average for the past two decades (2.1%). In any case, the macroeconomic scenario will not be able to break free from the political ecosystem, with all eyes on the outcome of the impeachment process against President Trump and, above all, the presidential elections on 3 November this year.

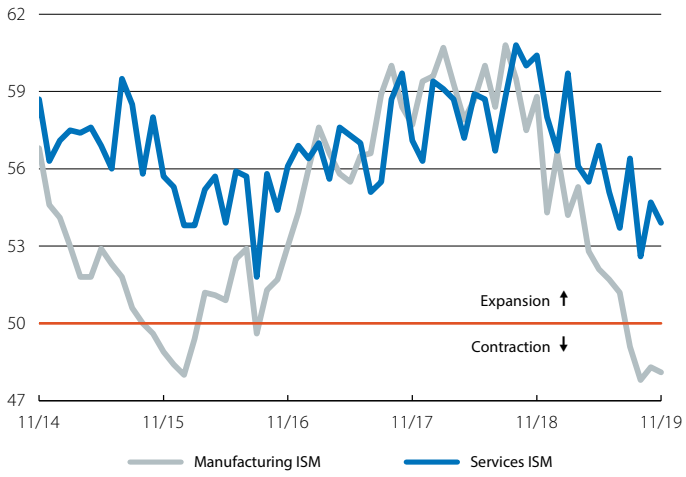
Mixed signals in the closing stages of 2019. The US sentiment indicators continued to point towards a slowdown in economic activity in Q4. The business sentiment index (produced by the ISM) for the manufacturing industry in November decreased slightly from what were already low levels (48.1 points, below the 50-point mark). The services ISM index, meanwhile, also fell (–0.8 points, down to 53.9 points) although this figure remains comfortably above the 50-point threshold. On the other hand, job creation in November proved much stronger than anticipated (266,000 jobs) and than what can be expected from an economy in full employment (the unemployment rate remained at a contained 3.5%).

JAPAN

Improved outlook for the Japanese economy. The country's cabinet has launched a fiscal stimuli plan which, in addition to fiscal incentives, includes major expenditure measures. These are aimed at mitigating the negative impact of the VAT rise implemented in October 2019 and the slowdown in global trade, as well as the risk derived from a slowdown of the economy following the Olympic Games in Tokyo 2020. This stimulus, coupled with the significant upward revision of GDP growth in Q3 2019 (from the preliminary 0.1% quarter-on-quarter to 0.4%), has improved the outlook for Japan's growth in 2020 and 2021.

US: economic activity indicators

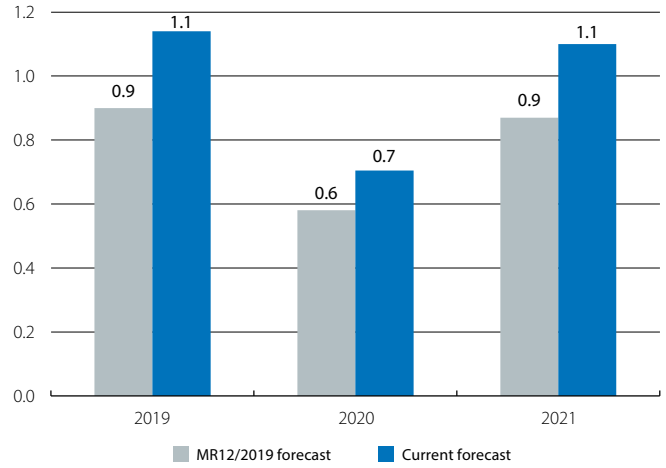
Level



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

Japan: GDP forecasts

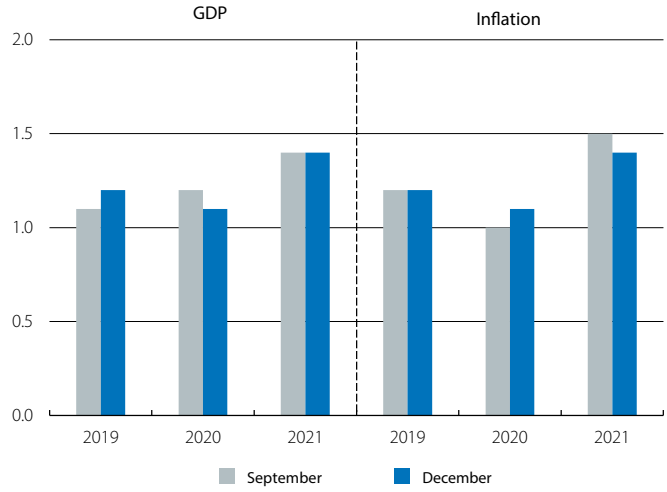
Annual change (%)



Source: *CaixaBank Research.*

Euro area: ECB forecasts for GDP and inflation

Annual change (%)



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

EURO AREA

A year of transition? We anticipate that the euro area will maintain a similar rate of growth in 2020 to that of last year, at around 1.1%. 2020 will therefore be a year of transition devoted to healing recent wounds: if the trade dispute between the US and China tempers and the injured automotive sector gradually recovers, the euro area could see an improvement and end 2020 in a somewhat better position to face the coming years with more optimism (albeit keeping in mind that relatively modest productivity growth and adverse demographics will remain ever present). A similar reading can be drawn from the update of the ECB's economic forecasts, which point towards greater buoyancy from 2021 thanks to the reduction of uncertainty following an orderly Brexit, the improvement in foreign demand and a relaxation of fiscal policy in some countries.

Indicators at differing levels. The manufacturing sector remains in recession, as indicated by both the sector's PMI, which stood at 45.9 points in December (46.9 in November, clearly below the 50-point threshold that separates the expansive and contractive territory), and the latest industrial production data (–2.4% year-on-year in October). By country, of particular note was the significant decline in industrial production in Germany (–6.3% year-on-year), indicating that the German economy has not yet left its problems behind. In contrast, both business sentiment in the services sector and consumer confidence performed well in the closing stages of the year. This provides some hope as it shows that the problems in the industrial sector have not extended to the economy as a whole (we analyse this potential contagion in the article «The difficulties of the industrial sector: will there be contagion to services?» in this *Monthly Report*).

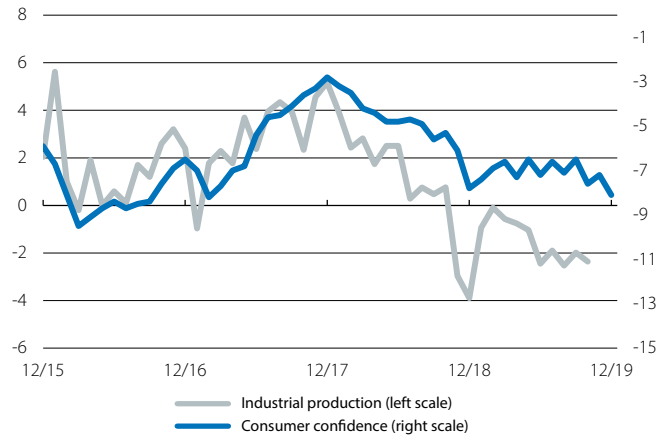
EMERGING MARKETS

China enjoys a little more breathing space. The economic activity indicators recovered some steam at the end of 2019. Coupled with the signing of the trade agreement with the US, this renders the possibility of China suffering a sudden slowdown in the coming quarters even more unlikely (remember that the foreign sector has been penalised in recent months by the US protectionist measures). As such, 2020 should be a year marked by a very gentle slowdown in the economy.

The recovery of the rest of the emerging bloc is already set in motion. We stated in the introduction that the rebound of some emerging countries that have experienced difficulties in 2019 will explain the slight improvement in the global economy in 2020. In fact, this rebound has already begun in some economies at the end of 2019. In Brazil, GDP growth in Q3 was higher than expected, with a rate of 1.2% year-on-year supported by the recovery of consumption and investment. Turkey, meanwhile, also grew more than expected (0.9% year-on-year). That said, doubts persist over its future growth, since the corporate restructuring process has not yet been completed, the country is vulnerable to geopolitical risks and its use of external financing remains high.

Euro area: industrial production and consumer confidence*

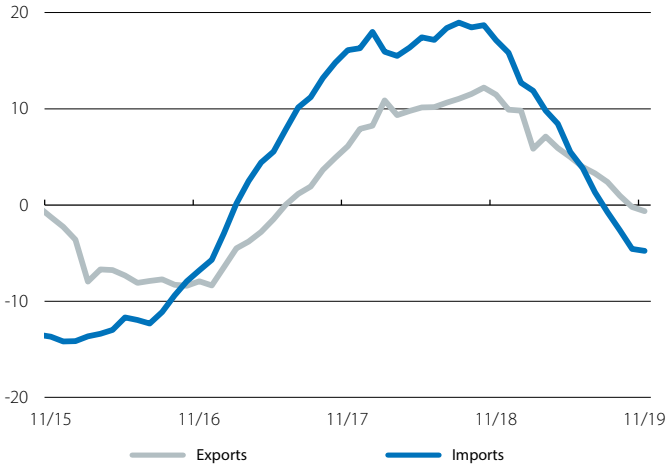
Year-on-year change (%) *Level*



Note: ** Seasonally adjusted series.*
Source: *CaixaBank Research, based on data from Eurostat and the European Commission.*

*China: foreign trade in goods **

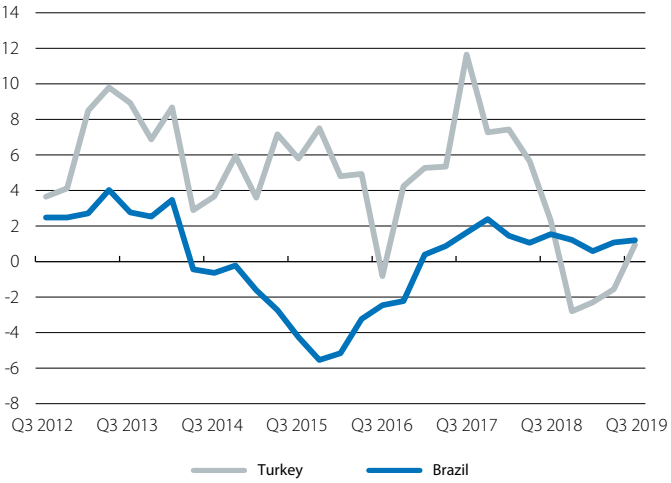
Year-on-year change in the 12-month cumulative balance (%)



Note: ** Change obtained using nominal data in dollars.*
Source: *CaixaBank Research, based on data from Chinese customs.*

Turkey and Brazil: GDP

Year-on-year change (%)



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

The difficulties of the industrial sector: will there be contagion to services?

- **Contagion from industry to services has, so far, been moderate. However, services could end up suffering if the risks affecting global growth intensify.**

The weakness of the industrial sector, which we have recently analysed,[1] is one of the major factors behind the slowdown in the global economy and, in particular, that of the euro area. However, the resilience exhibited by the services sector, which accounts for the bulk of economic activity,[2] continues to drive growth and gives continuity to the expansion. But just how resilient has the services sector really proven to be? Is there a risk of contagion from industrial weakness?

Industry and services: where are we in the cycle?

Since the end of 2017, there has been a widespread moderation in manufacturing activity, with the sector finally entering a recession in 2019. This is well illustrated by the decline in indicators such as the manufacturing PMI, which measures activity through surveys that capture the sentiment of business managers in the sector. Specifically, concern over the resilience of services and the possibility of contagion arises when we observe that the services PMI has also suffered a steady slowdown since the end of 2017. However, we should not be overly hasty to draw conclusions from this figure. As can be seen in the first chart, the moderation in services activity has been less intense and, in stark contrast with industry, the indicators continue to suggest expansion in the services sector.

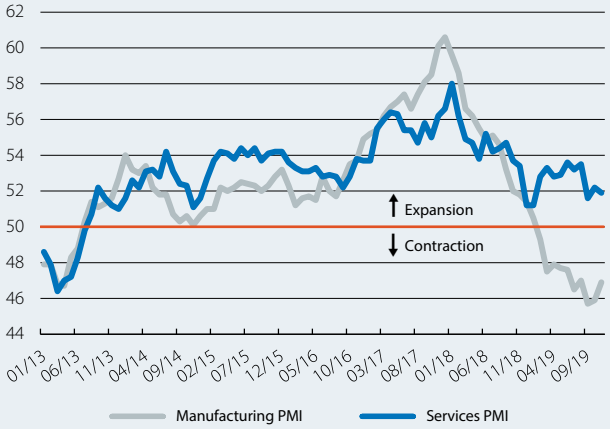
In addition, while sentiment indicators such as the PMI are useful for measuring the growth of real activity in both industry and services,[3] a 1-point drop in the services PMI does not reflect the same reality in industry as it does in services: as shown in the second chart for the specific case of the euro area it projects a slowdown in the gross value added (GVA) in the industrial sector which is almost three times greater than that projected for the services GVA. In other words, the fall in the services PMI would need to be almost three times greater than that of the manufacturing PMI in order to reflect the same slowdown in real activity in both sectors of the euro area.

This is precisely the opposite of what has happened since 2017, so it is not surprising that the GVA of services has slowed down much less than that of industry (see third chart) and that it continues to grow by around 2% in the

1. See «The difficulties of the global manufacturing sector» in the MR12/2019.
2. In the euro area and Spain, for instance, it accounts for around 75% of the gross value added.
3. As demonstrated in the second chart by R-squared values that are both high and similar in both sectors.

Economic activity indicators: euro area PMI

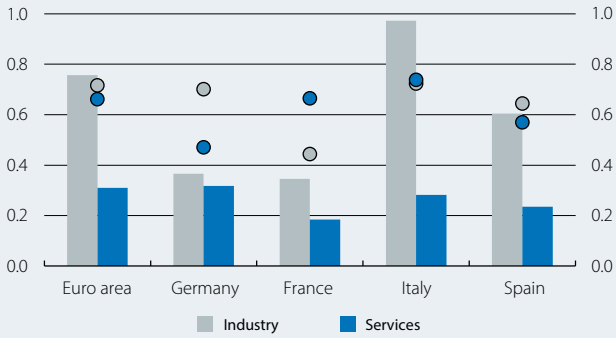
Index



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

Relationship between PMI and gross value added (GVA)

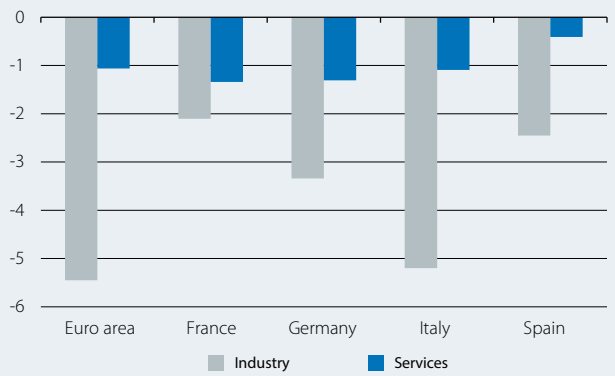
*Sensitivity of GVA to PMI (pps) ** *R-squared **



Note: ** We plot β (left scale) estimated from the regression $\Delta VAB_{t,j} = \alpha + \beta\, PMI_{t-1,j} + \varepsilon_{t,j}$ where $\Delta VAB_{t,j}$ corresponds to the year-on-year growth of the gross value added of sector **j**. The circles (right scale) represent the R-squared of each regression.*
Source: *CaixaBank Research, based on data from Eurostat and Markit.*

Gross value added: slowdown between Q4 2017 and Q3 2019 *

(pps)



Note: ** Difference between the year-on-year growth in Q4 2017 and in Q3 2019.*
Source: *CaixaBank Research, based on data from Eurostat.*

euro area as as whole (1.7% year-on-year in Q3 2019).[4] In any case, it is also clear that there has been a moderation in services (the growth of the sector's GVA in the euro area was 2.8% in Q4 2017) at the same time as there has been in manufacturing. This also comes as no surprise: the ageing of the business cycle and the erosion that the trade tensions exert on confidence (two of the factors that have penalised industry) have also weighed down on services.

Risk of contagion

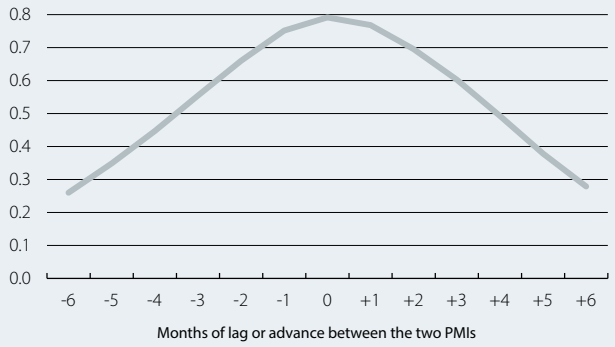
Despite the resilience of services set out above, there is a risk that it could be only a matter of time before industry's weakness is transmitted to the services sector. Nevertheless, the historical relationship between the two sectors does not appear to support this fear. In particular, as shown in the fourth chart, the correlation between the manufacturing and services PMIs for the euro area is at its strongest when we compare their contemporary values. In other words, the evolution of manufacturing and services activity is, largely, simultaneous (or at least close) in time.

However, there are two major aspects that could revive fears. The first is the question over the true weight of industry, one that is important to address. On the one hand, we know that in most economies, especially advanced ones, the relative weight of industry has steadily declined. For instance, in the US the sector has gone from representing 20% of nominal GDP in the 1970s to 10% today. On the other hand, it is also known that part of the services sector has been «industrialised», meaning that despite being services, its activity is more integrated with industry than it is with other sectors or the final consumer. In this regard, a recent study by the Bank of Spain[5] suggests that this «manufacturing bias» of services is moderate: the turnover of the services sector that is generated by the manufacturing industry represents between 7% and 12% of the total turnover of services in Germany, France, Italy and Spain.

Secondly, never in the recent past had there been an increase in uncertainty over the policies governing global trade as we have seen in the past three years. Therefore, what will come of this interaction between uncertainty and the cyclical slowdown remains to be seen. On paper, services should be less affected because, by their very nature, they are less open to trade and, in addition, they have been excluded from the tariff war. However, if the indirect effect of the trade conflict (i.e. uncertainty) were to dominate rather than the direct effect of tariffs on the affected trade flows, a contagion to services as a result of a worsening of consumer, investor and business confidence could not be ruled out.

Euro area: comovement between the manufacturing and services PMIs

*Association indicator **



Note: ** R-squared of the regression of the manufacturing PMI against the lagged (or advanced) value of the services PMI.*
Source: *CaixaBank Research, based on data from Markit.*

All in all, the latest indicators are reasonably favourable and recent geopolitical events (see the Focus «International trade: first impression of the First Phase» in this *Monthly Report*) suggest that the uncertainty ought to subside, although the recovery of confidence will be a gradual process. That said, history recommends us to be cautious: when, in previous episodes, the weakness of industry has opened up a gap with the performance of services, sometimes services have remained resilient and the gap has been closed with the recovery of industry, but on other occasions industry's weakness has ended up dragging services down.

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4. Besides taking into account the fact that the PMI-GVA sensitivities are different in industry and services, the fall in the services PMI observed in the euro area (a 3-point difference between the quarterly averages for Q4 2017 and Q3 2019) is consistent with the slowdown registered by the GVA (1 pp). In contrast, the fall of the manufacturing PMI (13 points) suggested a much greater contraction of industrial GVA (10 pps, versus the 6 pps observed).
5. See the article «The recent slowdown in activity from a sectoral perspective» in the Bank of Spain's *Quarterly report on the Spanish economy* for Q4 2019.

International trade: first impression of the First Phase

- **In mid-December, the US and China announced that they had reached a trade agreement. Specifically, they agreed on a Phase One deal (of a total of three phases), which should resolve the trade war in which the two powers have been embroiled since early 2018.**
- **Despite the shortage of technical and legal details, the assessment of the agreement is positive. In particular, this is because it reduces trade uncertainty in the short term.**

Key elements

Firstly, **the US did not proceed with the tariff hike that was due to come into force on 15 December** 2019 and which would have affected some 160 billion dollars of Chinese imports (mainly consumer goods). It also proceeded to lower the tariffs **imposed in September 2019** (from 15% to 7.5%) on around 120 billion of imports from China (see first chart for the current tariffs and trade flows).

Secondly, **China has committed to substantially increasing its purchases of US goods and services**, which in 2018 amounted to 120 billion dollars. Specifically, it will increase its purchases by 200 billion dollars in the next two years (much of which will be purchases of agricultural products).[1]

Thirdly, **the agreement covers issues relating to intellectual property rights and technology transfers**, matters on which US companies operating on Chinese soil are subject to pressure. The inclusion of these topics, which are so important yet so delicate, was not initially envisaged in this first round.[2] While we do not expect this to immediately resolve the multiple demands in this field, their mere inclusion was very well received by the financial markets, especially in the prices of technology stocks, the sector most affected by this part of the conflict. This is well illustrated in the second chart, which shows how the markets reacted more to the publication of such details than they did to the initial announcement of the agreement.

Fourthly, **China has undertaken to reduce the current barriers** faced by US companies in the agricultural and financial sectors. In the latter case, for instance, limitations exist on foreign capital invested in Chinese financial companies and there are regulatory requirements that discriminate against foreign companies.

Finally, **the agreement includes a chapter that sets out currency practices that are to be avoided** (such as competitive devaluations) and the need for a high degree of transparency in the setting of exchange rates.

The future

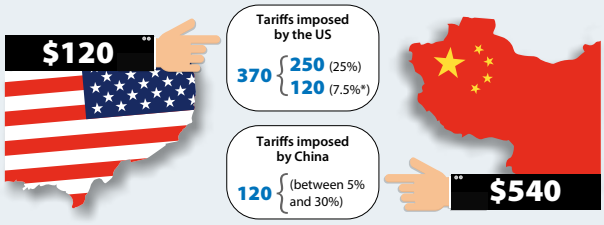
After agreeing on this First Phase, during 2020 the US and China will continue negotiations to reach trade agreements on Phases Two and Three. This could lead to the gradual roll-back of the tariffs currently in force, although it should be borne in mind that the issues to be addressed in the following phases (such as the opening up of Chinese markets and delving deeper into aspects relating to intellectual property and technology) are extremely demanding.

Such agreements would have a positive impact on global economic activity due to the reduction of protectionist measures (direct channel) and, above all, the reduction of uncertainty (indirect channel).[3] In fact, the decrease in uncertainty and its positive impact on economic confidence would be the main driver of the improvement in global economic activity, just as it was the main culprit behind its deterioration during 2019. In any case, the recovery of confidence will be a very gradual process: investors have already seen on previous occasions how this conflict appeared to be back on track, only to escalate once again.

Clàudia Canals

US and China: trade flows and tariffs

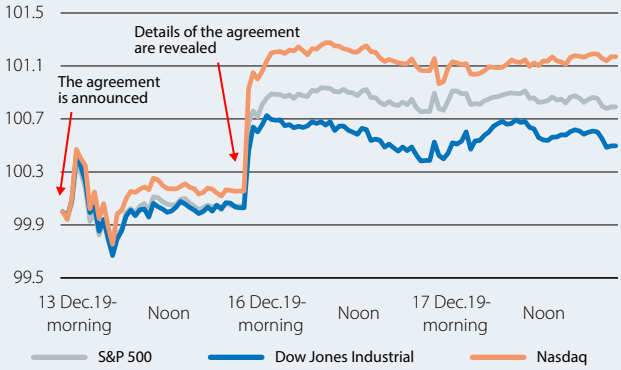
(USD billions)



Note: ** Following the Phase One deal, the US reduced the tariffs imposed on 120 billion dollars of Chinese imports, established in September 2019, from 15% to 7.5%.*
Source: *CaixaBank Research, based on data from US Foreign Trade (data for 2018) and the US Trade Representative.*

Stock markets: reaction following the announcement of the trade deal (Phase One)

Index (100 = 13 December, opening of the US market)



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

1. The additional 200 billion dollars refer to the levels of purchases registered in 2017, which totalled 128 billion dollars according to data from the US Census Bureau, compared to the 120 billion dollars in 2018.
2. See «The US and China: escalation of the trade conflict» in the MR05/2018 for more details on the triggers of the escalation in trade tensions between the two countries.
3. See «The threat of protectionism in the global economy» in the MR07/2019 to understand the ways in which the impact is transmitted through the direct and indirect channels.

Year-on-year (%) change, unless otherwise specified

UNITED STATES

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	09/19	10/19	11/19
Activity									
Real GDP	2.4	2.9	2.5	2.7	2.3	2.1	–	–	...
Retail sales (excluding cars and petrol)	4.5	4.7	3.5	3.4	3.6	4.2	4.3	3.7	3.3
Consumer confidence *(value)*	120.5	130.1	133.6	125.8	128.3	132.1	126.3	126.1	126.8
Industrial production	2.3	3.9	4.0	2.9	1.2	0.2	–0.2	–1.3	–0.8
Manufacturing activity index (ISM) *(value)*	57.4	58.8	56.9	55.4	52.2	49.4	47.8	48.3	48.1
Housing starts *(thousands)*	1,209	1,250	1,185	1,213	1,256	1,282	1,266	1,323	1,365
Case-Shiller home price index *(value)*	200	211	214	215	216	217	217	218	...
Unemployment rate *(% lab. force)*	4.4	3.9	3.8	3.9	3.6	3.6	3.5	3.6	3.5
Employment-population ratio *(% pop. > 16 years)*	60.1	60.4	60.6	60.7	60.6	60.9	61.0	61.0	61.0
Trade balance[1] *(% GDP)*	–2.8	–2.4	–3.0	–3.0	–3.1	–3.0	–3.0	–3.0	...
Prices									
Headline inflation	2.1	2.4	2.2	1.6	1.8	1.8	1.7	1.8	2.1
Core inflation	1.8	2.1	2.2	2.1	2.1	2.3	2.4	2.3	2.3

JAPAN

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	09/19	10/19	11/19
Activity									
Real GDP	2.2	0.3	–0.3	0.8	0.8	1.9	–	–	...
Consumer confidence *(value)*	43.8	43.6	42.8	41.3	39.5	36.8	35.6	36.2	38.7
Industrial production	2.9	1.0	0.5	–1.1	–1.2	–1.1	–0.3	–6.6	–6.6
Business activity index (Tankan) *(value)*	19.0	20.8	19.0	12.0	7.0	5.0	–	–	0.0
Unemployment rate *(% lab. force)*	2.8	2.4	2.4	2.4	2.4	2.3	2.4	2.4	2.2
Trade balance[1] *(% GDP)*	0.5	–0.1	–0.2	–0.3	–0.5	–0.4	–0.4	–0.5	–0.4
Prices									
Headline inflation	0.5	1.0	0.9	0.3	0.8	0.3	0.2	0.2	0.5
Core inflation	0.1	0.3	0.3	0.4	0.6	0.6	0.6	0.6	0.8

CHINA

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	09/19	10/19	11/19
Activity									
Real GDP	6.8	6.6	6.4	6.4	6.2	6.0	–	–	...
Retail sales	10.3	9.0	8.3	8.5	8.5	7.6	7.8	7.2	8.0
Industrial production	6.6	6.2	5.7	6.4	5.6	5.0	5.8	4.7	6.2
PMI manufacturing *(value)*	51.6	50.9	49.9	49.7	49.6	49.7	49.8	49.3	50.2
Foreign sector									
Trade balance[1,2]	420	352	352	381	395	430	428	438	435
Exports	7.9	9.9	4.0	1.2	–1.0	–0.4	–3.2	–0.8	–1.2
Imports	16.3	15.8	4.4	–4.4	–3.9	–6.4	–8.1	–6.2	0.3
Prices									
Headline inflation	1.6	2.1	2.2	1.8	2.6	2.9	3.0	3.8	4.5
Official interest rate[3]	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Renminbi per dollar	6.8	6.6	6.9	6.8	6.8	7.0	7.1	7.1	7.0

Notes: *1. Cumulative figure over last 12 months. 2. Billion dollars. 3. End of period.*
Source: *CaixaBank Research, based on data from the Department of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Standard & Poor's, ISM, National Bureau of Statistics of Japan, Bank of Japan, National Bureau of Statistics of China and Thomson Reuters Datastream.*

EURO AREA

Activity and employment indicators

Values, unless otherwise specified

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	09/19	10/19	11/19
Retail sales *(year-on-year change)*	2.5	1.6	1.7	2.5	2.1	2.6	2.7	1.4	...
Industrial production *(year-on-year change)*	3.0	0.9	–2.0	–0.5	–1.4	–2.2	–1.8	–2.2	...
Consumer confidence	–5.4	–4.9	–6.4	–7.0	–7.0	–6.7	–6.5	–7.6	–7.2
Economic sentiment	110.1	111.2	108.8	106.0	104.1	102.5	101.7	100.8	101.3
Manufacturing PMI	57.4	55.0	51.7	49.1	47.7	46.4	45.7	45.9	46.9
Services PMI	55.6	54.5	52.8	52.4	53.1	52.8	51.6	52.2	51.9
Labour market									
Employment (people) *(year-on-year change)*	1.6	1.5	1.4	1.4	1.2	1.0	–	–	...
Unemployment rate *(% labour force)*	9.1	8.2	7.9	7.8	7.6	7.6	7.6	7.5	...
Germany *(% labour force)*	3.8	3.4	3.3	3.2	3.1	3.1	3.1	3.1	...
France *(% labour force)*	9.4	9.1	8.9	8.6	8.5	8.6	8.6	8.5	...
Italy *(% labour force)*	11.3	10.6	10.5	10.3	10.0	9.8	9.9	9.7	...
Real GDP*(year-on-year change)*	2.7	1.9	1.2	1.4	1.2	1.2	–	–	...
Germany *(year-on-year change)*	2.8	1.6	0.6	1.0	0.3	0.5	–	–	...
France *(year-on-year change)*	2.4	1.7	1.2	1.3	1.4	1.4	–	–	...
Italy *(year-on-year change)*	1.8	0.7	–0.1	0.0	0.1	0.3	–	–	...

Prices

Year-on-year change (%), unless otherwise specified

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	09/19	10/19	11/19
General	1.5	1.8	1.9	1.4	1.4	1.0	0.8	0.7	1.0
Core	1.1	1.2	1.2	1.1	1.2	1.1	1.2	1.2	1.4

Foreign sector

Cumulative balance over the last 12 months as % of GDP of the last 4 quarters, unless otherwise specified

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	09/19	10/19	11/19
Current balance	3.2	3.2	3.2	3.1	2.8	2.8	2.8	2.8	...
Germany	8.1	7.3	7.3	7.2	7.1	7.5	7.5	7.6	...
France	–0.7	–0.6	–0.6	–0.5	–0.7	–0.9	–0.9	–0.9	...
Italy	2.7	2.6	2.6	2.6	2.8	2.9	2.9	3.1	...
Nominal effective exchange rate[1] *(value)*	96.5	98.9	98.5	97.3	97.3	97.7	97.4	97.3	96.7

Credit and deposits of non-financial sectors

Year-on-year change (%), unless otherwise specified

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	09/19	10/19	11/19
Private sector financing									
Credit to non-financial firms[2]	2.5	3.8	4.0	3.7	3.9	3.9	3.6	3.8	...
Credit to households[2,3]	2.6	3.0	3.2	3.3	3.3	3.4	3.4	3.5	...
Interest rate on loans to non-financial firms[4] *(%)*	1.3	1.2	1.2	1.2	1.1	1.1	1.1	1.2	...
Interest rate on loans to households for house purchases[5] *(%)*	1.7	1.6	1.6	1.6	1.6	1.5	1.5	1.5	...
Deposits									
On demand deposits	10.2	7.9	7.1	7.1	7.6	8.6	8.5	9.0	...
Other short-term deposits	–2.7	–1.5	–0.9	–0.4	0.4	0.7	1.2	0.6	...
Marketable instruments	1.6	–4.2	–3.1	–3.4	–4.9	–1.7	–1.1	–2.4	...
Interest rate on deposits up to 1 year from households *(%)*	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.2	...

Notes: *1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated. 2. Data adjusted for sales and securitization. 3. Including NPISH. 4. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 5. Loans with a floating rate and an initial rate fixation period of up to one year.*

Source: *CaixaBank Research, based on data from the Eurostat, European Central Bank, European Commission, national statistics institutes and Markit.*

Spain: a year of transition

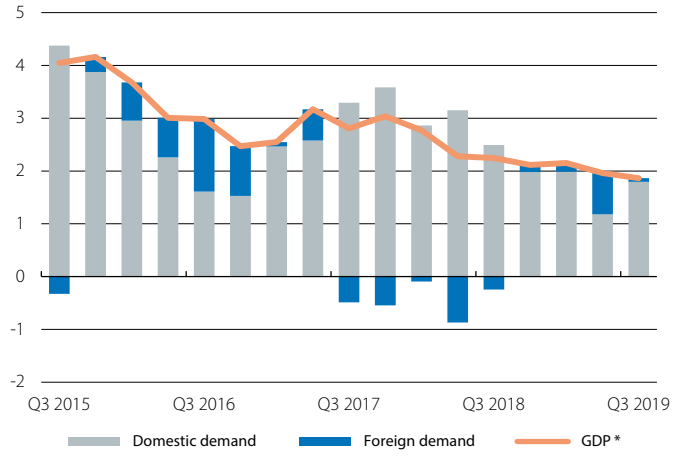
A gradual moderation of growth. With the data available from three of the four quarters of the recently-ended 2019, all the indicators suggest that the growth of the economy for the year will have stood at around 1.9%. While this is a more contained rate than the previous year (2.4%), it remains well above the average growth anticipated for the euro area (1.1%). This moderation of growth can be put down to the fading of the cyclical boost offered by the initial phase of the economic recovery and the deterioration of the global trade environment. The latter – a product of elements such as the trade dispute between the US and China, uncertainties over Brexit and the difficulties of Europe's automotive sector (due to the introduction of new regulations and the technological change that the sector is going through) – has had an impact on Spanish exports of goods and services through the demand channel, but it is not a sign of declining competitiveness in relative terms. Thus, the slowdown that we can see largely represents the process of growth converging towards levels more in line with the economy's potential growth. Over the coming year, we expect this process of convergence to continue and the economy to grow at a rate of around 1.5%.

Economic activity maintains a good tone in the closing stages of the year. The performance of the indicators over the past month has been mixed. On the one hand, consumer confidence in November fell by 1.2 points down to –10.3 points, while industrial production in October dropped by 1.3% year-on-year (+0.6% in September). In contrast, both the manufacturing and the services PMI for November showed a slight improvement and rose by 0.7 and 0.5 points, respectively, reaching 47.5 and 53.2 points. Once we incorporate the full set of indicators into the Nowcasting model for short-term GDP projections, we obtain a forecast of 0.4% quarter-on-quarter growth for Q4 2019, similar to the figure for the previous quarter. In addition, this rate would be consistent with our forecast for annual growth of 1.9% for 2019.

The gradual slowdown of the labour market takes a respite in November. In particular, affiliation with Social Security increased by 2.3% year-on-year, the same growth rate as a month ago, albeit below that of November 2018 (2.9% year-on-year). As such, despite the slowdown in the economy, the pace of job creation remains strong and will continue to provide support for the growth of incomes and consumption. On the other hand, the growth in incomes is expected to be increasingly supported by a gradual recovery of wages, which the data have been showing for several quarters now. Whereas in 2017 wages per effective working hour remained stagnant (–0.1% annual growth), in 2018 their growth rose to 1.5%, while in Q3 2019 it accelerated up to 1.9% year-on-year.

Spain: GDP

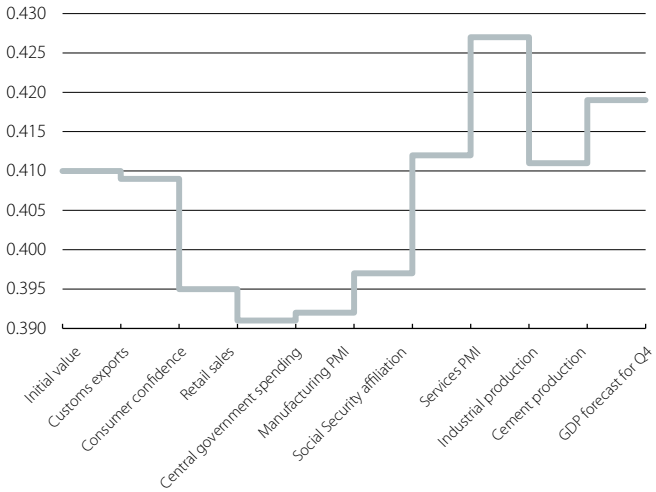
Contribution to year-on-year growth (pps)



Note: ** Year-on-year change (%).*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Nowcasting of Q4 GDP: evolution over the last 30 days

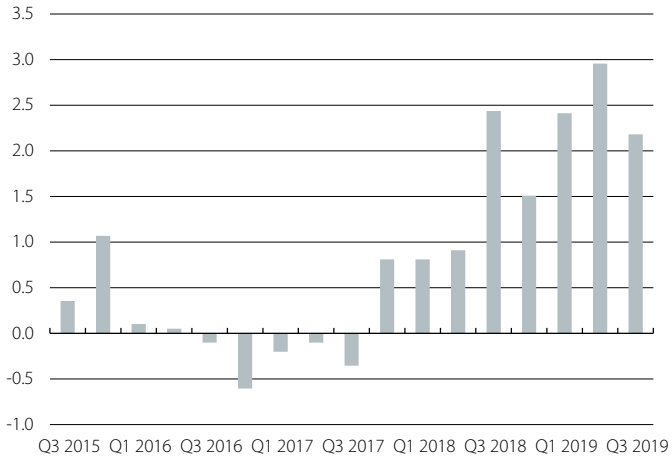
Quarter-on-quarter change (%)



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

*Spain: total labour cost per hour **

Year-on-year change (%)



Note: ** Series adjusted for seasonality and calendar effects.*
Source: *CaixaBank Research, based on data from the National Statistics Institute (Quarterly Labour Cost Survey).*

Saving remains stable in Q3. The steady pace of job growth and the recovery in wages have been reflected in the growth of households' gross disposable income, which in Q3 2019 stood at 4.2% year-on-year. Furthermore, consumption grew at a significant – albeit somewhat more modest – rate of 2.6% year-on-year. The savings rate thus stood at 7.0% of gross disposable income (four-quarter cumulative figure), 1.4 pps higher than in Q3 2018 and similar to the figure for the previous quarter. Although the recovery of the savings rate from its lows of last year (5.5% at its lowest point) has meant lower growth in consumption, it also constitutes an improvement in households' financial buffers, thus making the economy more resilient.

Inflation rebounds in December. The consumer price index (CPI) rose to 0.8% in December (0.4% in November) as the base effects of the oil price continue to fade. In particular, the price of oil in euros went up in December by 13.0% year-on-year, compared to a fall of 5.2% in November, thus ending the downward effect that energy prices have had on the CPI in recent months. In January we do not expect the base effects of the oil price to play any part, but we do anticipate that headline inflation will continue to fall more in line with core inflation, which in November remained at a moderate 1.0%.

The general government accounts show a slightly larger deficit than expected. With data up to Q3 2019, the consolidated general government deficit, including local corporations, stood at 1.5% of GDP, 3 decimal points above the figure for Q3 2018. This result was mainly due to the deterioration in the accounts of the autonomous community regions, although it was also partially influenced by the effect of tax settlements. By component, the consolidated revenues of the general government (excluding local corporations) up until October rose by 3.8% compared to the same period in the previous year (4.3% in September). This was mainly driven by social contributions, which grew by a vigorous 7.9% year-on-year. Consolidated expenditure, meanwhile, increased in the same period by 4.9% due to increases in the remuneration of public sector employees and social benefits that were agreed in 2019. As a whole, the data up to Q3 reinforce our forecast that the deficit will end up slightly above the 2.0% target.

The price of housing grows more than expected in Q3. The transaction prices published by the National Statistics Institute rose by 1.6% in quarter-on-quarter terms (more than in the previous three quarters), although in year-on-year terms they slowed down to 4.7%. While in Q4 they may pick up slightly due to a base effect related to the poor figure registered in Q4 2018 (quarter-on-quarter growth of 0.4%), overall the indicators continue to point towards an underlying slowdown, in line with the slower pace of growth in the economy.

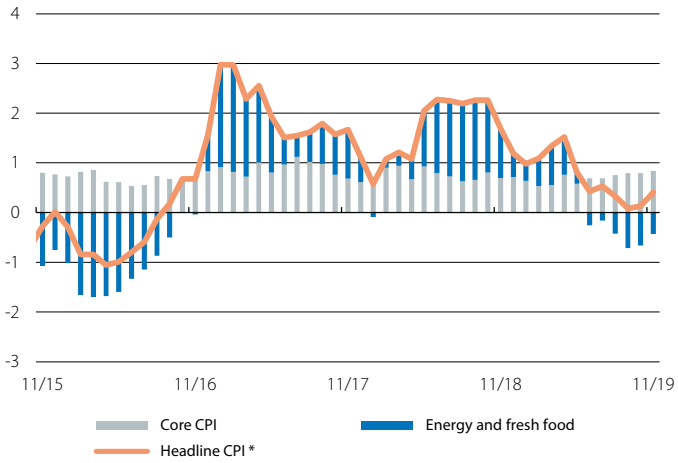
Spain: savings rate

(% of gross disposable income)

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

Spain: CPI

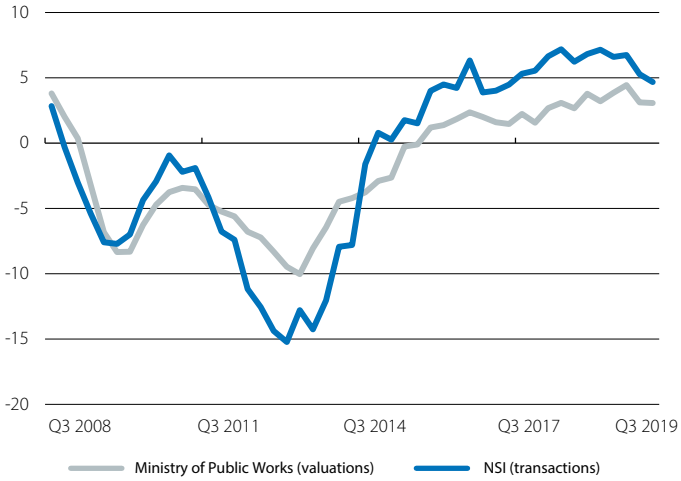
Contribution to year-on-year growth (pps)



Note: ** Year-on-year change.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: price of unsubsidised housing

Year-on-year change (%)



Source: *CaixaBank Research, based on data from the National Statistics Institute and the Ministry of Public Works.*

The slowdown of the Spanish labour market is knocking at the door

- **The pace of job creation fell more sharply than expected in 2019. This, together with the growth of the labour force, is holding back the reduction of the unemployment rate.**
- **In 2020 the pace of job growth will continue to moderate, but will nonetheless remain considerable, in line with the growth of economic activity.**

After four years with increases of around half a million workers per year, the pace of job growth is reducing, both in parallel with and as a result of the slowdown in economic activity. For instance, according to the labour force survey (LFS), employment increased by 1.8% year-on-year between Q4 2018 and Q3 2019 (346,000 workers in the cumulative four-quarter period), below the year-on-year growth experienced between 2015 and 2018 (+2.7% year-on-year on average). In seasonally adjusted terms, the slowdown in employment in Q3 was even more pronounced, with a minimum increase of 0.1% quarter-on-quarter, well below the rate experienced over the past four quarters (+0.6% on average). Besides methodological differences in the LFS, this reduction in the rate of job growth can also be observed in Social Security affiliation,[1] the growth of which stood at 2.1% in November (excluding non-professional carers who are registered).

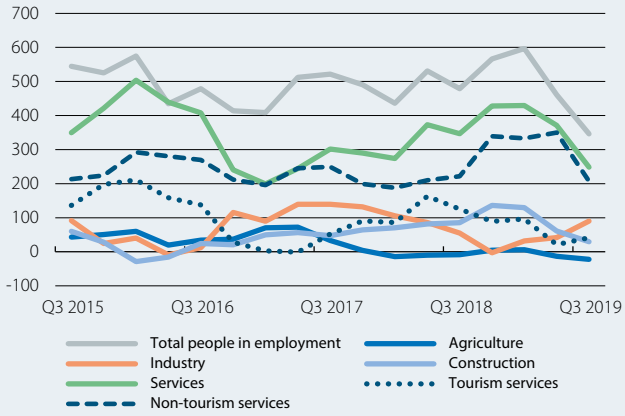
This slowdown in job creation is quite widespread across the various economic sectors. According to the LFS for Q3 2019, employment in the services sector, which accounts for 75.6% of the total, increased by 249,000 people (Q4 2018 - Q3 2019), one third less than in the previous year, despite the third quarter being traditionally strong. Tourism services have been slowing down for several quarters now, but in Q3 2019 non-tourism services also weakened following three quarters of strong recruitment figures. One sub-sector that has seen a particular reduction in recruitment is that of households employing domestic staff (–8.8% year-on-year), which could be more affected by the rise in the minimum wage.

This lower employment growth is occurring in parallel with another, more encouraging trend: after falling between 2013 and 2017, last year the labour force turned a corner and began to grow (+0.3%). In Q3 2019, 235,000 people had joined the labour force (four-quarter cumulative figure), representing a +1% year-on-year increase. This was particularly due to the incorporation of foreign workers (around 200,000 of the total were non-Spanish nationals). Although this figure does not necessarily correspond to inflows of foreigners, both variables show the same change in trend. The foreign migration balance has become positive since 2015, reaching a net inflow of 330,000 in 2018. This is well above the figure for 2017 (+172,000) and contrasts with the net outflows experienced between 2011 and 2014 according to the Migration Statistics (National Statistics Institute).

1. For more information on the differences between these sources of data on the labour market, see the article «The labour market in Spain - does it all depend on the colour of the glass you're looking through?» in the MR10/2018.

Spain: employment by economic sector

Year-on-year change (thousands)



Source: *CaixaBank Research, based on data from the National Statistics Institute (labour force survey).*

As a result, the unemployment rate is no longer falling at the pace we had become accustomed to in recent years (–2 pps per year on average between 2015 and 2018). In particular, the unemployment rate stood at 13.9% in Q3 2019, a figure similar to that of Q2 (14.0%) and only 0.7 pps below that of Q3 2018 (14.6%).

In 2020 we anticipate a further reduction in the rate of economic activity growth down to 1.5% (compared to the 1.9% estimated for 2019). In this context of economic slowdown there is some uncertainty over the speed of the slowdown in job creation. In previous episodes of economic slowdown in Spain, employment tended to slow down more than in the current one and also more abruptly than in other European economies. That is, the elasticity of employment to economic activity in Spain was higher. However, there is some evidence to suggest that this elasticity could have been reduced, partly due to the greater internal flexibility provided by the labour reform of 2012 and because of the more widespread use of non-standard employment contracts (part-time, etc.).[2,3] As a result, in 2020 employment can be expected to continue to grow at a similar rate to economic activity (+1.4%, according to our forecasts). This moderate rise in employment, together with the anticipated increase in the labour force (+0.8%), should allow the unemployment rate to continue to decline, albeit at a slower pace, reaching 13.6% in 2020.

Josep Mestres Domènech

2. For more detail on the case of Spain, see the article «Strong recovery in employment: explanatory factors» in the MR07/2018.
3. Employment is also proving more resistant than in other periods of slowdown in Germany, France and Italy (for more details, see https://blog.funcas.es/el-empleo-dique-de-contencion-ante-una-recesion/).

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	10/19	11/19	12/19
Industry									
Industrial production index	3.2	0.3	–2.6	0.0	1.4	1.0	–1.3	...	...
Indicator of confidence in industry *(value)*	1.0	–0.1	–1.9	–3.8	–4.6	–2.0	–7.9	–5.1	...
Manufacturing PMI *(value)*	54.8	53.3	51.8	51.1	49.9	48.2	46.8	47.5	...
Construction									
Building permits *(cumulative over 12 months)*	22.9	25.7	23.9	25.8	21.9	13.0	11.8	...	...
House sales *(cumulative over 12 months)*	14.1	14.2	11.5	8.3	5.5	1.3	–2.0	...	...
House prices	6.2	6.7	6.6	6.8	5.3	4.7	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	10.0	4.0	0.9	1.0	1.5	2.1	1.6	...	...
Services PMI *(value)*	56.4	54.8	54.0	55.3	53.2	53.5	52.7	53.2	...
Consumption									
Retail sales	1.0	0.7	1.4	1.3	2.2	3.3	2.9	2.9	...
Car registrations	7.9	7.8	–7.6	–7.0	–4.4	–7.9	6.3	2.3	...
Consumer confidence index *(value)*	–3.4	–4.2	–6.2	–4.8	–4.0	–5.8	–9.1	–10.3	...
Labour market									
Employment [1]	2.6	2.7	3.0	3.2	2.4	1.8	–	–	–
Unemployment rate (% labour force)	17.2	15.3	14.4	14.7	14.0	13.9	–	–	–
Registered as employed with Social Security [2]	3.6	3.1	3.0	2.9	2.8	2.5	2.3	2.3	...
GDP	**2.9**	**2.4**	**2.1**	**2.2**	**2.0**	**1.9**	**–**	**–**	**–**

Prices

Year-on-year change (%), unless otherwise specified

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	10/19	11/19	12/19
General	2.0	1.7	1.7	1.1	0.9	0.3	0.1	0.4	0.8
Core	1.1	0.9	0.9	0.7	0.8	0.9	1.0	1.0	...

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	10/19	11/19	12/19
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	8.9	2.9	2.9	2.4	2.3	1.7	1.1	...	...
Imports *(year-on-year change, cumulative over 12 months)*	10.5	5.6	5.6	6.1	3.9	3.0	1.6	...	...
Current balance	**31.1**	**23.3**	**23.3**	**19.6**	**20.6**	**21.0**	**22.3**	**...**	**...**
Goods and services	41.6	32.6	32.6	30.2	31.5	31.4	32.7	...	...
Primary and secondary income	–10.5	–9.3	–9.3	–10.6	–10.9	–10.4	–10.3	...	...
Net lending (+) / borrowing (–) capacity	**33.9**	**29.1**	**29.1**	**25.5**	**26.6**	**26.3**	**27.6**	**...**	**...**

Credit and deposits in non-financial sectors [3]

Year-on-year change (%), unless otherwise specified

	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	10/19	11/19	12/19
Deposits									
Household and company deposits	2.8	3.2	3.7	5.2	5.8	5.4	5.1	...	...
Sight and savings	17.6	10.9	10.0	11.3	10.9	10.3	9.8	...	...
Term and notice	–24.2	–19.9	–16.8	–13.7	–12.8	–13.2	–13.3	...	...
General government deposits	–8.7	15.4	16.9	17.8	15.7	3.7	1.3	...	...
TOTAL	**1.9**	**3.9**	**4.5**	**5.9**	**6.3**	**5.3**	**4.8**	**...**	**...**
Outstanding balance of credit									
Private sector	–2.2	–2.4	–2.2	–2.1	–1.1	–1.1	–1.9	...	...
Non-financial firms	–3.6	–5.5	–5.7	–5.5	–3.0	–2.3	–3.5	...	...
Households - housing	–2.8	–1.9	–1.4	–1.1	–1.2	–1.6	–1.6	...	...
Households - other purposes	3.7	5.1	4.7	4.2	3.8	3.1	1.5	...	...
General government	–9.7	–10.6	–11.8	–10.4	–7.2	–5.4	0.8	...	...
TOTAL	**–2.8**	**–2.9**	**–2.8**	**–2.6**	**–1.5**	**–1.4**	**–1.7**	**...**	**...**
NPL ratio (%)[4]	**7.8**	**5.8**	**5.8**	**5.7**	**5.4**	**5.1**	**5.1**	**...**	**...**

Notes: *1. Estimate based on the Active Population Survey. 2. Average monthly figures. 3. Aggregate figures for the Spanish banking sector and residents in Spain. 4. Period-end figure.*

Source: *CaixaBank Research, based on data from the Ministry of Economy, the Ministry of Public Works, the Ministry of Employment and Social Security, the National Statistics Institute, the State Employment Service, Markit, the European Commission, the Department of Customs and Special Taxes and the Bank of Spain.*

Portugal: favourable momentum despite the international uncertainty

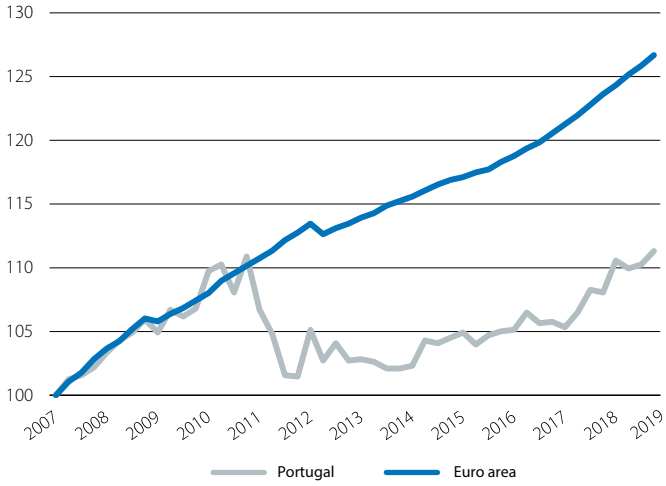
In 2020, Portugal will continue to grow more than the euro area. With the arrival of the new year, the projections suggest that 2020 will be the fifth consecutive year in which Portugal will grow above the euro area as a whole. Between 2016 and 2019, Portugal's average annual growth was 2.5%, 0.6 pps above that of the euro area, and all the indicators suggest that in 2020 the Portuguese economy will maintain this gap. In fact, we anticipate that Portugal will grow by 1.7%, in contrast with the 1.1% projected for the euro area. In the current expansive phase, Portugal has a position of greater resilience, since the macroeconomic imbalances it still suffers from are lower than in the past. In particular, households have less debt (with an indebtedness ratio of around 65% of GDP, whereas in 2007 it was 87%). The same can be observed in the case of companies, with a ratio of 101%, 7 pps less than in 2007. Moreover, in the external accounts, the current account balance has shifted from a deficit of around 10% of GDP in 2007 to one of around 1% in 2019. There has also been a recovery in the competitiveness indicators. In annual average terms, between 2007 and 2019 labour costs rose by 1.4% in Portugal, which contrasts with the 2.1% in the euro area as a whole. Similarly, in 2019 Portugal's inflation was 0.9 pps lower than that of the euro area, whereas in 2007 it was +0.3 pps higher. Nevertheless, there is still work to be done, and as the expansion advances the economy will receive less support from the cyclical momentum. In particular, further progress still needs to be made on the high levels of external indebtedness (net external debt has risen from 66% of GDP in 2007 to 89% in 2019) and indebtedness of the public sector (public debt stands at just below 120% of GDP, compared to around 73% in 2007).

The short-term indicators reflect a good performance of economic activity in the last quarter of 2019. Most notably, in November the Bank of Portugal's coincident indicators stabilised at 1.9% in the case of the aggregate economic activity indicator and at 2.6% in the case of private consumption. This suggests that Q4 growth will have been similar to that of Q3 (when it was 0.3% quarter-on-quarter and 1.9% year-on-year). Other encouraging signals came from the stabilisation of the economic climate indicator at 2.1% and the improvement in consumer confidence up to –6.9 (figures relating to November).

The economy maintains its external lending capacity. In Q3 2019, the economy's financing capacity was 0.3% of GDP (four-quarter cumulative figure), 0.2 pps less than in the previous quarter. This mainly reflects the reduction in the state financing capacity down to 0.0% of GDP (0.2% in Q2). As for all other sectors, of particular note was the improvement of the situation of households, especially the increase in their financing capacity and in the savings rate, both of 1 decimal

Portugal: labour costs

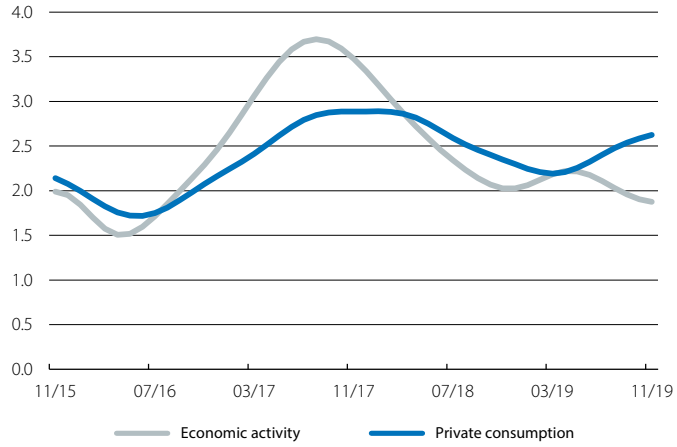
Index (100 = Q4 2007)



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

Portugal: coincident economic activity indicators

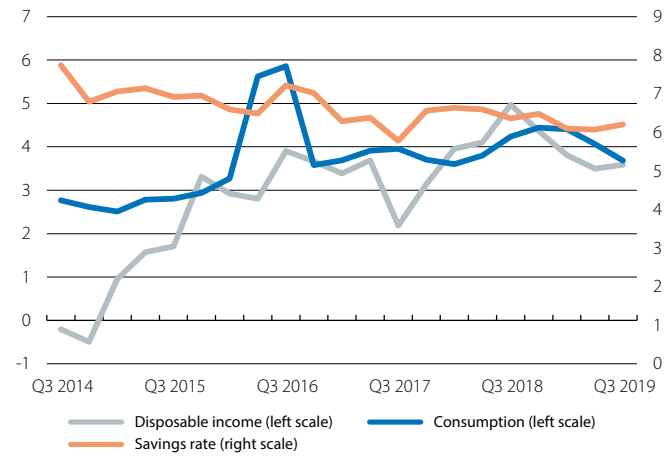
Year-on-year change (%)



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

point. Specifically, households' financing capacity rose to 1.2% of GDP, while the savings rate increased up to 6.2% of disposable income. This improvement in the saving rate reflects the acceleration in the pace of growth of disposable income up to 3.6% year-on-year, 1 decimal point more than before, while consumption slowed down to 3.7% year-on-year, 4 decimal points less than in the previous quarter.

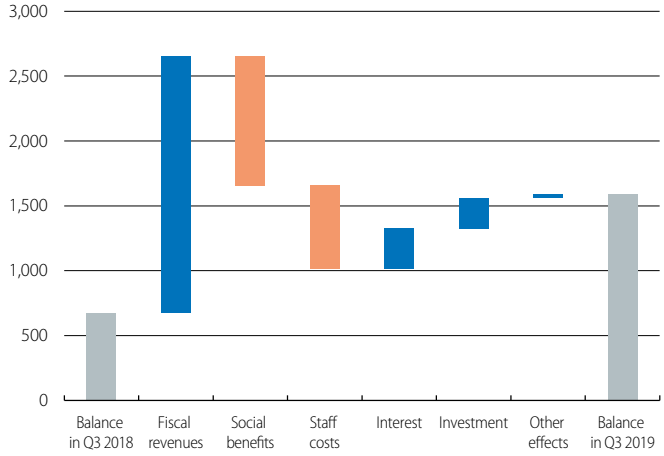
The budgetary balance remains in positive territory in Q3. With cumulative data for the first three quarters of 2019, the balance reached +1.0% of GDP in Q3 2019 (1,590 million euros), representing an improvement of 0.4 pps of GDP compared to Q3 2018. This increase is due to a bigger rise in income (4.2%) than in expenditure (2.8%), driven especially by the growth of social security contributions (6.1%) and the reduction of interest expenses (–6.1%). On the other hand, staff costs and social benefits account for almost all of the increase in expenditure in this period. Also of note is the decline in investment, down 9.0% from Q3 2018. Thus, as a whole, the budget execution up until Q3 2019 reinforces the government's estimates for the budgetary balance for the whole of the year reflected in the 2020 State Budget (–0.1% of GDP). With regard to 2020, the budget, which have been developed with a forecast for GDP growth of 1.9%, project a surplus of 0.2% of GDP. This is supported by fiscal and contributory tax revenues and a lower interest expense, despite the increase in staff costs and social benefits. In parallel, the budgets foresee a fall in the public debt ratio down to 116% of GDP, compared to an estimate of 119.2% of GDP in 2019.

The real estate market remains buoyant. In Q3 2019, real estate prices rose by more than expected (1.2% quarter-on-quarter and 10.3% year-on-year), driven by the acceleration in the growth rate of prices of existing housing. In the same period, the number of house sales fell by 0.2% year-on-year, after registering a drop of 6.6% in the previous quarter. Over the coming quarters, the increase in residential construction, the effect of a potential slowdown in the tourism sector and the effects of uncertainty at the global level can be expected to contribute to generating a more moderate growth in prices.

New lending proves buoyant in the second half of the year. More specifically, new lending to the non-financial private sector accelerated by 9.4% year-on-year in October (cumulative year to date), above the 7.2% figure for September. This performance was driven by the acceleration of new loans to companies (8.0% year-on-year, versus the 5.7% up to September) as well as to households (11.7%, versus 9.8% up to September). In the household segment, lending for housing showed particular buoyancy, benefiting from the context of low interest rates. However, growth rates remain below the double-digit rates registered in 2018. At the same time, despite this acceleration in new lending, the stock of non-financial private sector loans continues to contract (–0.5% year-on-year in October), highlighting that the trend in new lending is also accompanied by the early repayment of loans granted in the past.

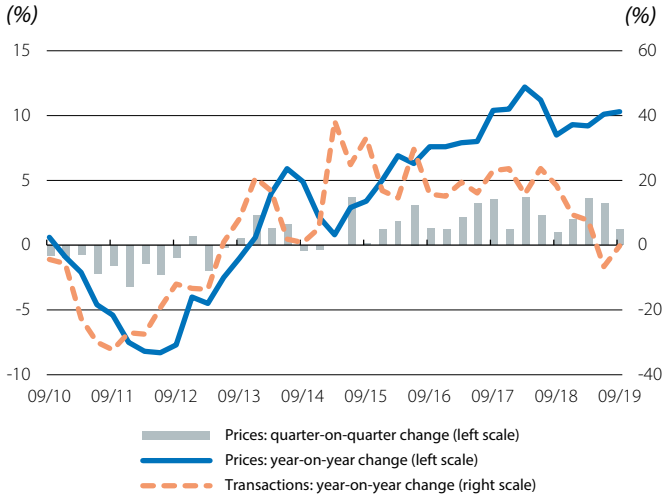
Portugal: government balance

(EUR millions)



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

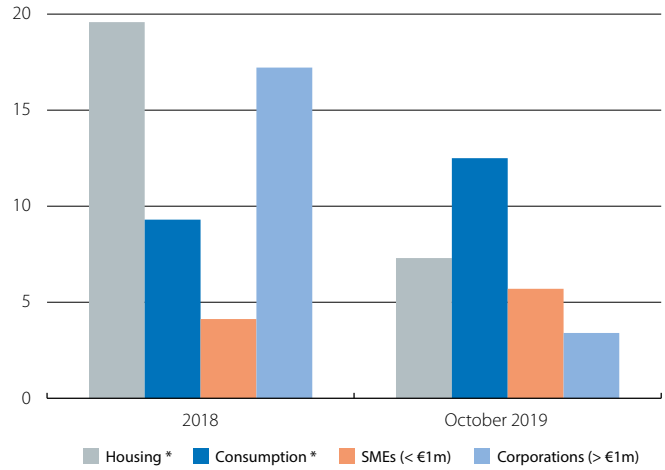
Portugal: housing prices and transactions



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

Portugal: new lending

Year-on-year change (%)



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

The portuguese economy has greater margin for manoeuvre

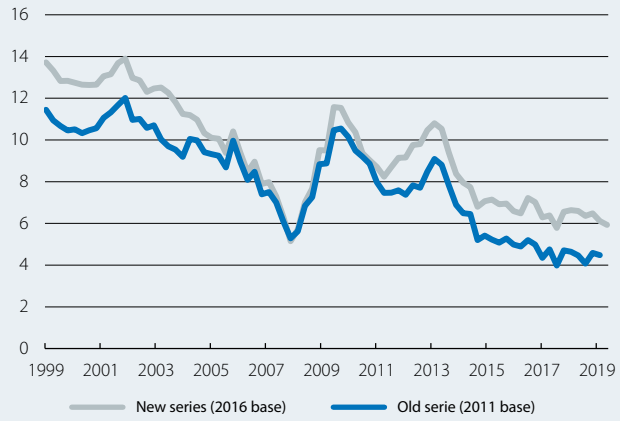
- **The statistical reviews conducted by the National Statistics Institute and the Bank of Portugal have produced substantial changes in the data on Portugal's growth and external position. In particular, the country grew by an average of 2.7% between 2016 and 2018 (2.3% in the previous series), and the surplus of the external accounts went from 0.4% to 1.4% of GDP in 2018. Investment was the variable that saw the biggest upward revision.**
- **However, the trends remain unchanged: growth continues to slow down and the external surplus is still deteriorating.**

Recently, the National Statistics Institute conducted a review of the national accounts. This is a process coordinated at the European level that occurs every five years with the goal of incorporating new information and methodological improvements, namely reclassifications between private and public consumption expenditure and investment. For Portugal, this revision has resulted in an improvement in the growth figures since 2016, which show a greater convergence towards the euro area average. In addition, the external accounts were revised upwards, putting Portugal in a better place than previously expected.

Put briefly, the reviews have incorporated changes in the register of e-commerce purchases of goods and services (with a greater impact on private consumption and imports), as well as reclassifications of vehicle purchases (with a greater impact on private consumption and investment). The statistical review of the external accounts, meanwhile, has affected both exports (especially due to changes in the figures for tourism services) and imports (particularly in the category of goods). On the whole, as shown in the table, the biggest changes have occurred in the growth figures for 2017 and 2018, in which there have been significant revisions in investment, in private consumption and in imports and exports (in general, upward revisions).

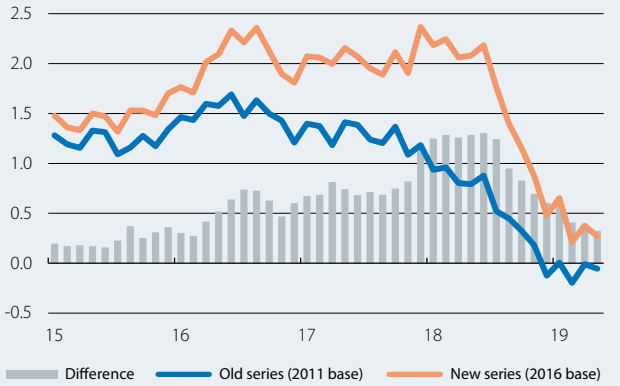
The new figures show that, between 2016 and 2018, the economy grew by 8.2% in cumulative terms, 1.2 pps more than in the previous series. By component, we highlight the higher growth of investment, which reaches 21.0%, 4.2 pps above the rate estimated initially.

Portugal: household savings rate
(% of disposable income)



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

Portugal: current account and capital balance
(% of GDP)



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

Portugal: GDP growth, components and statistical revision

	New series (2016 base, %)				Revision with respect to the old series (2011 base, pps)			
	2016	2017	2018	H1 2019	2016	2017	2018	H1 2019
Real GDP	2.0	3.5	2.4	2.0	0.1	0.7	0.3	0.2
Private consumption	2.6	2.1	3.1	2.3	0.1	–0.2	0.5	0.2
Public consumption	0.8	0.2	0.9	0.5	0.0	0.0	0.0	0.0
GFCF	2.5	11.5	5.8	9.5	0.2	2.3	1.3	0.2
Exports	4.4	8.4	3.8	2.3	0.1	0.6	0.2	–0.5
Imports	5.0	8.1	5.8	5.8	0.3	0.0	1.0	0.2
GVA	1.6	3.3	2.1	1.6	0.0	0.9	0.4	0.0

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

This is thanks to a better performance from investment in transport equipment (43.7% in the new series versus 34.6% in the old one), construction (16.2% versus 10.6%)[1] and intellectual property products (18.7% versus 11.1%). The second most affected component was imports, which amassed growth of 20.1% over the same three-year period, 1.5 pps more than in the previous series, as a result of a revision of the data relating to e-commerce. The new figures also show greater buoyancy in exports and private consumption: 0.9 pps more, in the case of exports, and 0.4 pps in the case of private consumption, both of which are affected by the incorporation of new information related to e-commerce.

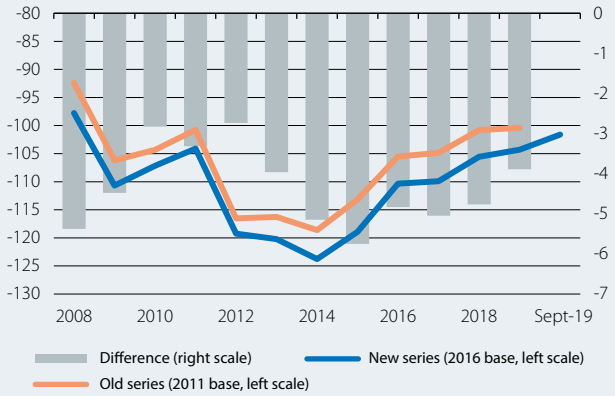
The statistical review has also led to better figures for the economy's financing capacity, which for 2018 went from 0.2% of GDP according to the old series to 1.2% per the new one. The most significant changes occurred in the figures for non-financial and financial corporations, as well as those for households. In the latter case, the new series have led to a considerable increase in disposable income (of around 3,500 million euros, equivalent to 1.7% of GDP) and in the savings rate, which rose from 4.6% to 6.5% of disposable income (see first chart).

The upward revision of disposable income reflects changes in the balance of payments, related with an update of data regarding the pensions of Portuguese people who have worked abroad and thus receive pensions from foreign countries, as well as pensions received by foreign retirees who hold resident status in Portugal.

In fact, the revision of the pension income received by former Portuguese emigrants and foreign retirees residing in Portugal explains the majority of the revision of the balance of payments, especially in the balance of secondary incomes. In 2018, this represented 2.0% of GDP in the new series, 0.8 pps more than in the previous one. Therefore, the current account balance was revised up to 0.4% of GDP, 1.0 pp more than previously, which helped to boost the current account and capital balance up to 1.4% of GDP (0.4% in the previous series). However, while this change represents an improvement in the levels recorded, it does not substantially alter the trends: the current account and capital balance still shows a decline, going from 2.1% of GDP in 2017 to 1.4% in 2018 (and down to 0.4% in the first half of 2019). On the other hand, the external balance was also affected by the incorporation of new information related to e-commerce (with a negative impact on the balance of goods and services, since it has led to higher imports), while the tourism balance benefited from the inclusion of information relating to local accommodation.

Portugal: net international investment position

(% of GDP) *(pps)*



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

Finally, the statistical reviews have revealed a more negative net international investment position (standing at –105.6% of GDP in 2018, a deterioration of 4.8 pps in comparison to the previous figures). This is the result of an upward revision of foreign direct investment which, in net terms, now stands at 82,000 million euros for 2018, representing 40.2% of GDP.[2]

All in all, the revision of the national and external accounts shows that Portugal has a greater margin for manoeuvre to deal with the deceleration of the global economy. Nevertheless, the main trends exhibited by the old series remain present in the new ones: the deterioration of the current account and capital balance persists, as does the moderation of growth. We expect the external balance (i.e. that of the current account and capital balance) to remains positive but closer to 0%, while growth will slow down to levels slightly below 2%.

Teresa Gil Pinheiro

1. Furthermore, between 2016 and 2018, investment in construction of new homes grew by 22.7%, 4.0 pps more.
2. In 2018, foreign direct investment in Portugal amounted to 161,000 million euros, i.e. 79% of GDP, while Portuguese direct investment abroad reached 79,000 million euros, i.e. 38.8% of GDP.

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2017	2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	10/19	11/19	12/19
Coincident economic activity index	3.4	2.5	2.1	2.2	2.0	...	1.9	1.9	...
Industry									
Industrial production index	4.0	0.1	–3.7	–2.2	–4.1	...	–2.4	0.2	...
Confidence indicator in industry *(value)*	2.1	0.8	–1.4	–3.3	–3.7	–4.3	–4.2	–4.4	–4.3
Construction									
Building permits *(cumulative over 12 months)*	16.6	19.1	20.9	16.0	12.5	...	...	...	...
House sales	20.5	16.8	7.6	–6.6	–0.2	...	...	...	...
House prices *(euro / m² - valuation)*	5.1	5.8	6.7	7.5	7.9	...	7.6	8.0	...
Services									
Foreign tourists *(cumulative over 12 months)*	16.0	4.8	4.5	4.9	5.8	...	6.6	...	...
Confidence indicator in services *(value)*	13.3	14.1	15.3	14.2	11.5	10.6	10.4	11.4	10.1
Consumption									
Retail sales	4.1	4.2	4.3	5.9	4.5	...	3.7	3.8	...
Coincident indicator for private consumption	2.7	2.6	2.2	2.3	2.5	...	2.6	2.6	...
Consumer confidence index *(value)*	–5.4	–4.6	–8.3	–8.9	–7.6	–7.1	–7.2	–6.9	–7.2
Labour market									
Employment	3.3	2.3	1.5	0.9	0.9	...	0.9	...	...
Unemployment rate (*% labour force*)	8.9	7.0	6.8	6.3	6.1	...	6.5	...	...
GDP	**3.5**	**2.4**	**2.1**	**1.9**	**1.9**	**...**	**...**	...	...

Prices

Year-on-year change (%), unless otherwise specified

	2017	2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	10/19	11/19	12/19
General	1.4	1.0	0.8	0.5	–0.2	0.2	0.0	0.3	0.4
Core	1.1	0.7	0.8	0.6	0.1	0.5	0.3	0.6	0.4

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2017	2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	10/19	11/19	12/19
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	10.0	5.1	5.8	3.3	2.2	...	2.4	...	...
Imports *(year-on-year change, cumulative over 12 months)*	13.7	8.2	9.2	8.3	8.0	...	8.0	...	...
Current balance	**2.4**	**0.8**	**–1.1**	**–1.2**	**–1.6**	**...**	**–1.9**	**...**	**...**
Goods and services	2.9	1.6	0.1	–0.5	–1.1	...	–1.1	...	...
Primary and secondary income	–0.5	–0.8	–1.2	–0.7	–0.5	...	–0.7	...	...
Net lending (+) / borrowing (–) capacity	**4.1**	**2.8**	**1.0**	**0.8**	**0.4**	**...**	**0.0**	**...**	**...**

Credit and deposits in non-financial sectors

Year-on-year change (%), unless otherwise specified

	2017	2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	10/19	11/19	12/19
Deposits [1]									
Household and company deposits	1.7	3.8	4.9	4.5	5.3	...	5.4	...	...
Sight and savings	15.7	14.3	14.2	13.3	15.1	...	15.4	...	...
Term and notice	–5.8	–3.0	–1.9	–2.3	–2.5	...	–2.7	...	...
General government deposits	1.3	–1.9	–11.6	–11.9	–17.1	...	–23.0	...	...
TOTAL	**1.6**	**3.5**	**4.1**	**3.6**	**4.1**	**...**	**3.9**	**...**	**...**
Outstanding balance of credit [1]									
Private sector	–3.8	–1.5	–2.0	–1.3	–0.7	...	–0.5	...	...
Non-financial firms	–6.5	–4.0	–6.0	–4.1	–3.3	...	–2.4	...	...
Households - housing	–2.5	–0.8	0.0	0.1	0.1	...	–0.2	...	...
Households - other purposes	0.9	4.2	2.8	2.3	3.8	...	4.4	...	...
General government	9.3	2.4	–12.5	–8.2	–6.4	...	–8.2	...	...
TOTAL	**–3.3**	**–1.4**	**–2.5**	**–1.6**	**–1.0**	**...**	**–0.8**	**...**	**...**
NPL ratio *(%)* [2]	**13.3**	**9.4**	**8.9**	**8.3**	**...**	**...**	**...**	**...**	**...**

Notes: *1. Residents in Portugal. The credit variables exclude securitisations. 2. Period-end figure.*
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal, Bank of Portugal and Datastream.*

Illiberal forms of economic policy: evolution or radical change from the existing consensus?

In 2018, on the occasion of its 175th anniversary, the weekly publication *The Economist* stated that: «Liberalism created the modern world, but the modern world is turning against it». This is no light statement, coming from the publication that has embodied a liberal vision of society, politics and the economy come hell or high water. But is this really the case? In this Dossier we will analyse, from different angles, whether economic policies are shifting away from what, broadly speaking, could be considered orthodox practices and what might be the causes and effects of this shift. With this goal in mind, the logical starting point for this first article of the Dossier is to try to precisely define what we mean when we talk about the «emergence of illiberal forms of economic policy».

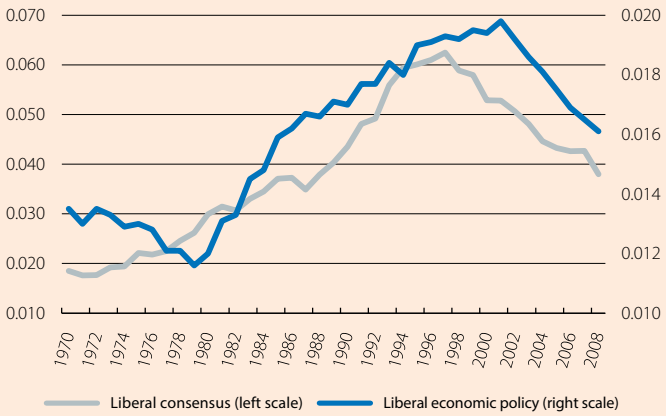
An attempt at a definition: what are illiberal policies?

In order to understand what we refer to as illiberal (economic) policies, we must first define what we mean by liberal economic policies, since they will serve as our frame of reference. We will then be able to assess the extent to which the economic policies of recent years diverged from this framework.

The essential idea is that there is a reasonably broad and consolidated consensus among economists about what characteristics are shared by economic policies that predominantly improve countries' economic prospects, both in the short and long term. Far from any simple and universal recipe («do this and the economy is certain to grow more in the long term»), there are a few general principles that are sufficiently common across the board. This is what Rodrik (2005) refers to as first-order economic principles, and they can be defined reasonably accurately by collating a broad series of contributions from across the economic literature of recent decades.[1] In particular, these principles emerge from reviewing three major areas of academic work: that which rethinks and modernises the economics of development,[2] that which guides the transition towards a market economy in the former planned economies[3] and, finally, that which draws conclusions on how economic policy should change as a result of the lessons learned from the Great Recession of 2008-2009.[4]

Presence of the terms «liberal consensus» and «liberal economic policy»

Frequency of the appearance of the terms in books published in English (per million words)



Source: *CaixaBank Research, based on Google Books Ngram Viewer.*

So, what are these first-order principles of economic policy on which there is a reasonable consensus? In general terms, we can identify four major areas:

- The markets for productive factors and for goods and services have to be competitive, since this is the primary mechanism for generating efficiency in an economy.
- The macroeconomic and institutional framework has to generate an environment that facilitates stability, since such stability offers conditions (credibility, the anchoring of expectations, the reduction of uncertainty, etc.) which improve the prospects for growth, both in the short and long term.
- Integration into global flows of goods, services and factors is essential in order to improve the prospects for creating prosperity. This integration also has to be as «undirected» as possible.

1. See D. Rodrik (2005). «Growth strategies». Handbook of Economic Growth, 1, 967-1014.
2. In addition to Rodrik, also see J. Williamson (1990). «Latin American Adjustment: How Much Has It Happened?». Washington, D.C.: Institute for International Economics; J. Williamson (2000). «What Should the World Bank Think about the Washington Consensus?» World Bank Research Observer, 15(2): 251–64. And A. Saad-Filho (2010). «Growth, poverty and inequality: From Washington consensus to inclusive growth». New York, NY: UN.
3. See T. Besley, M. Dewatripont and S. Guriev (2010). «Transition and Transition Impact: A Review of the Concept and Implications for the EBRD». Report for the EBRD's Office of the Chief Economist.
4. See J.B. Taylor (2010). «Getting back on track: macroeconomic policy lessons from the financial crisis». Federal Reserve Bank of St. Louis Review, 92(3), 165-176. O. Blanchard, G. Dell'Ariccia and P. Mauro (2010). «Rethinking macroeconomic policy». Journal of Money, Credit and Banking, 42, 199-215. And W. White (2009). «Modern macroeconomics is on the wrong track». Finance and Development, 46(4), 15-18.

- The critical long-term economic policy is that of supply, and it has to be coherent with the two previous principles. For example, an industrial policy that tries to select specific sectors or firms (picking winners) tends to be less effective than a broader industrial policy that addresses competitiveness factors that are common to most sectors.

These principles generally share a liberal approach to understanding what the best way for an economy to function is, namely the conviction that growth is the best way to increase prosperity for society as a whole.[5] Thus, in this article, as in many others, we categorise this set of principles as the liberal consensus on economic policy.

Therefore, if these are the characteristics or, to be more precise, the principles which guide a liberal approach to economic policy, a departure from them will entail an increase in the degree of illiberalism (a new term that first appeared in the 1990s). In other words, in this Dossier an illiberal economic policy will be understood as one which is significantly removed from all or some of the principles set out above.

A moderate or radical shift from the core principles?

At this juncture, an important question is to what extent this illiberal departure merely represents a more or less pronounced evolution in the consensus or, on the other hand, something more disruptive. Answering this question, however, is no easy task. As the economic literature has highlighted, there are multiple variants of economic policy that can all be considered liberal.[6] One example, within the principle of macroeconomic stability, would be everything related to central banks. A fundamental truth in this field of macroeconomic stability is that such stability is difficult to achieve without a framework for monetary stability, and in order to attain such monetary stability it is considered essential to have an independent central bank. The specific institutional manner in which this independence is established is not predetermined, with the system of the Fed and that of the ECB offering just two of many different varieties that do not alter the aforementioned principle. Similarly, monetary policy can be implemented in different ways. For instance, the goal of the Fed, as expressed by the mandate assigned to it by Congress, is to support three objectives: to achieve price stability, to achieve the highest possible level of sustainable employment and to have a moderate long-term interest rate. In contrast, in the case of the ECB only the first variable is considered essential. No one disputes that both alternatives allow their respective institutions to contribute to ensuring macroeconomic stability.

Up to this point, there should be little debate: two distinct institutions with two different policy mandates can be equally liberal. In contrast, a more controversial matter could be assessing the unconventional monetary policy followed by many central banks after the financial crisis. In 2016, the Centre For Macroeconomics,[7] a British institution, asked a panel of economists about the role and consequences of unconventional monetary policy. The responses confirmed the division that this topic generates. As an example, some interviewees stated that these unconventional policies were quasi-fiscal interventions that could end up damaging the independence of the central banks. These are strong arguments that would place these practices at the limit of the liberal consensus, if this were the opinion held by the majority and there were evidence to support it.

Beyond the personal views of the authors of this article (we cannot resist expressing that, in our view, unconventional monetary policy, as it has been implemented up until now, is a practice that falls within the principle of seeking macroeconomic stability in the liberal manner set out above), what is important is to understand the difficulty in the real world of objectively judging whether a particular economic policy approach is liberal or not, especially if it is not an extreme approach. In order to avoid, insofar as possible, the subjective biases that are inherent to a value judgement, in the next article of the Dossier we will quantify in a reasonably precise manner the extent to which this departure from the liberal consensus is occurring. Only then can we say that we are entering unknown territory, that of illiberalism, and begin to reflect on causes and consequences, two questions that we will explore in articles three and four of this same Dossier. At the risk of revealing too much (spoiler alert), we can say now that the departure from liberalism, which has occurred in a relatively short period of time, is significant and, in our opinion, should not be taken lightly.

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5. This conception of the economy does not fit into the redistributive mechanisms that must be articulated once the objective of increasing the well-being of society as a whole is achieved.
6. In this regard, see Rodrik (2005), who has developed the idea of «one common principle, many feasible institutions».
7. Survey available at https://cfmsurvey.org/surveys/future-role-unconventional-unconventional-monetary-policy. «The future role of (un)conventional unconventional monetary policy», The CFM Surveys, June 2016.

The illiberal shift in economic policy: let the data speak!

There is a perception in recent years that there has been a proliferation of economic policies, and political approaches in general, that diverge from what could be called the liberal consensus. By this, we refer to a series of elements on which consensus had been reached among economists and economic policy-makers as the preferred approach for improving economic prospects (see the article «Illiberal forms of economic policy: evolution or radical change from the existing consensus?» in this same Dossier). However, in order to determine whether this perception is a reality, we must find a way to quantify this shift towards more illiberal policies as accurately as possible. It is precisely this endeavour that will be the goal of this article, which proposes an explicit measure of the illiberal shift that will allow us to explore which areas of economic policy have seen a greater departure from the liberal consensus.

Identifying and quantifying the illiberal shift

As mentioned in the previous article of this Dossier, although distinguishing a liberal economic policy from an illiberal one is feasible in theory, making such a distinction in practice is not so simple and, furthermore, ideological biases are difficult to eliminate. In order to address this challenge, one possibility is to «translate» political proposals into some form of quantitative measure. This is the exercise carried out by the economists De Bolle and Zettelmeyer (2019). This exercise allows us to obtain a numerical measure of just how liberal the election programmes were among the parties participating in elections held before and after the Great Recession of 2008-2009, across a large group of countries.[1] This measure is developed on the basis of an assessment of the various economic proposals of the parties contending the elections in question, assigning each one a numerical value according to its degree of illiberalism.[2] In this Dossier, we have used the information available in this exercise by De Bolle and Zettelmeyer so as to illustrate the issues that interest us, namely the way in which the illiberal shift is materialising, its causes and its effects.

Change in illiberalism

Change relative to levels prior to the Great Recession

Note: *This chart indicates the average change in illiberalism, calculated as the unweighted average of all the countries in the sample. For each country and sphere, the weighted average of the degree of illiberalism of each party is calculated, weighted according to their share of the votes. The aggregate illiberalism index is defined as the average of the seven spheres.*
Source: *CaixaBank Research, based on De Bolle and Zettelmeyer (2019).*

Specifically, seven spheres of economic policies introduced by these economists have been used in order to «translate» the first-order principles defined in the first article of the Dossier into specific areas. This allocation is as follows:

- The departure from the principle we call «competitive markets for productive factors and goods and services» is assessed by analysing the economic policy sphere known as «illiberal competition policy».
- The assessment of the macroeconomic and institutional framework aimed at ensuring stability is conducted in the sphere of «macroeconomic illiberalism».
- The question of integration into the global flows of goods, services and factors as a means to create prosperity is explored through four different spheres: «restrictions to international trade», «restrictions to foreign direct investment (FDI)», «restrictions to immigration» and «anti-multilateralism».
- Departure from the principle of liberal supply-side policies is assessed through the sphere «illiberal industrial policy».

For each of these spheres, a measure is obtained that approximates the degree of illiberalism present in the political manifestos of the various parties in each country, weighted by each party's share of the vote in the elections in question. Finally, averaging the results of the seven spheres in each country provides an aggregate measure of illiberalism.

Which areas explain the shift towards a more illiberal policy agenda?

We are now in a position to answer the question of how the illiberal shift has materialised. When we analyse the spheres mentioned above, a first observation is that all of them, with the exception of restrictions to FDI, have diverged away from liberalism towards illiberalism.[3] The extent of this divergence is quite varied, being more apparent in the spheres of macroeconomic

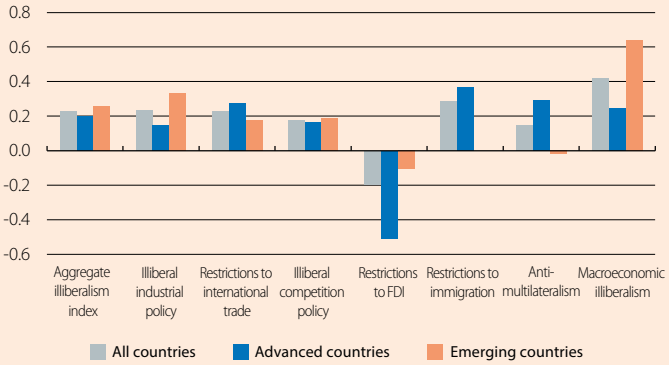
1. Specifically, De Bolle and Zettelmeyer (2019) analyse, for each country in the G-20, the programmes of the parties participating in elections before (typically held between 2004 and 2007) and after the Great Recession (the election following the crisis is avoided, in order to best capture more permanent preferences, such that the majority are held between 2014 and 2017). See M. De Bolle and J. Zettelmeyer (2019). «Measuring the Rise of Economic Nationalism». Working Paper 19-15. Peterson Institute.
2. The scale ranges from 1 to 5, where a 1 is allocated to clearly liberal political proposals and a 5 to clearly illiberal proposals. For illustrative purposes: in the field of competition policy, if a party proposes that cartels are illegal and that an independent authority in the field of competition is essential, this measure will be allocated a score of 1. Meanwhile, if another proposes abolishing this authority in order to foster the formation of cartels or monopolies and thus create «national champions», it will be given a score of 5.
3. In the case of restrictions to FDI, it should be mentioned that is a sphere for which only a minority of parties express their preferences, so we should not read too much into this somewhat atypical situation.

illiberalism and restrictions to immigration, followed some distance behind by changes in the spheres of illiberal industrial policy and restrictions to international trade. It should be noted that these spheres are central to the current orthodox consensus on economic policy, as they encompass issues such as having an adequate macroeconomic stability framework (which includes key aspects like having an independent central bank) and the assumption that integration into the global economy and financial system is key to generating prosperity.

A logical question at this point in the discussion is to try to determine the scale of these quantitative changes in the measure of illiberalism. In the absence of sufficient temporal context (unfortunately, a comprehensive history of elections is not available), what can be compared is the variation between countries, from which certain information can be extracted. Specifically, if we choose the US – a country which, historically, we can clearly associate with the liberal consensus – and we compare it with China – a state that we can qualify as illiberal without too much discussions –, the difference in the degree of aggregate illiberalism (the average of the seven spheres) is 0.9 points. Therefore, a deterioration of 0.2 points in the aggregate index and for a broad set of countries in a relatively short space of time should not be looked upon with complacency.

Change in illiberalism: advanced vs. emerging

Change relative to levels prior to the Great Recession



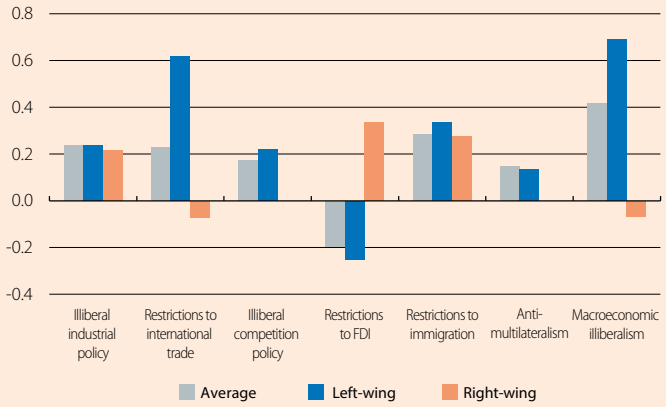
Note: *This chart indicates the average change in illiberalism, calculated as the unweighted average of all the countries in the sample. For each sphere, the average change in illiberalism in advanced and emerging countries is calculated as the unweighted average of the advanced and emerging countries of the sample, respectively.*
Source: *CaixaBank Research, based on De Bolle and Zettelmeyer (2019).*

Advanced and emerging countries: two increasingly similar worlds at the aggregate level, but with differences depending on the sphere

The above conclusion is reinforced even more when we analyse the differences observed between advanced and emerging countries. The illiberal shift materialises with few differences between the two groups, at least at the aggregate level, such that the gap in the degree of illiberalism between advanced and emerging markets remains stable in a context of an increase in the phenomenon. However, the spheres affected are somewhat different: whereas the areas that undergo the biggest changes in more developed countries are immigration policies, anti-multilateralism and restrictions to international trade, in emerging countries the two main areas are macroeconomic illiberalism and that of industrial policy.

Change in illiberalism: left vs. right

Change relative to levels prior to the Great Recession



Note: *In producing this chart, only parties that participated in both elections (before and after the Great Recession) are taken into consideration. This chart indicates the average change in illiberalism of the left and right-wing parties in the sample, calculated as the unweighted average.*
Source: *CaixaBank Research, based on De Bolle and Zettelmeyer (2019).*

As for individual countries, the most illiberal countries are Russia, India, Italy, China and South Africa. With the exception of China, which has seen a significant drop in its degree of illiberalism over the period in question, all four other states are among those that have seen the biggest increase in their illiberalism. At the other end of the spectrum, the most liberal countries are, in this order, South Korea, Japan, Canada, Australia and the US. In the first three, illiberalism has fallen, while in the last two it has increased, albeit not excessively.

Ideology matters and is expressed in different spheres

When we analyse the preferences expressed in electoral programmes and their tendency to shift towards greater illiberalism, as might be expected the differences between what we will refer to as left and right, for the purposes of simplicity, are quite stark. For starters, the data suggest that parties on the left of the political spectrum tend to shift more noticeably towards illiberalism than those on the right. Here the reader could raise the possibility that right-wing parties were already more illiberal before the period studied (i.e. left-wing parties had more room to diverge from liberalism). Nevertheless, the available data suggest that there is no clear relationship between parties' level of illiberalism and the change observed in recent years.

Not only have left-wing parties tended to shift more towards illiberalism than right-wing parties, but the two ideologies have embarked on their excursion towards illiberalism with an emphasis on different areas: whereas the left has focused on restrictions to international trade and macroeconomic illiberalism, the right has focused on restrictions to immigration and FDI.

In short, this review of the data provides an important conclusion, in addition to confirming the shift towards illiberalism taking place in economic policies: there are notable differences depending on the sphere of economic policy in question beyond the type of country and party ideology. This will be the fundamental line of investigation for determining, with reasonable accuracy, the root causes of the departure from the liberal consensus. Follow us in the next article to the heart of the study on the causes of the illiberal shift.

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The causes of the illiberal shift of economic policy: shedding some light on an open debate

In the previous articles of the Dossier, we have described the phenomenon of the illiberal shift of economic policy in a significant sample of countries. Now it is time to understand the causes. This is an ambitious exercise which is the subject of a broad academic and public debate, to which this article seeks to contribute an enriching analytical overview.

The great debate: are the causes solely economic in nature?

Let us recapitulate the main conclusions of the first two articles of the Dossier, as they set the starting point for what follows herein. In the article «Illiberal forms of economic policy: evolution or radical change from the existing consensus?» we define what we call the liberal consensus on economic policy, justifying the need to find a quantitative measure that approximates the hypothesis of the recent departure from that consensus. This measurement exercise is performed in the second article of the Dossier, in which it is concluded that there are notable differences between different spheres of economic policy, such that in some spheres the shift is highly noticeable, while in others it is less so. The challenge is therefore to try to determine whether there are elements that are common to all the spheres. If there are not, there is a risk of falling into an almost never-ending list of reasons affecting economic policy «in sphere *z* of country *j*». Making progress on this issue requires a telescope more than a microscope, but first we need to know where to point it.

Among the many possible intellectual fishing grounds, the authors of this Dossier consider the most promising one to be the academic debate, as well as the public debate, around the root causes of political polarisation. This phenomenon is defined as a greater divergence between the proposals of the major political parties. The measure used here to approximate the illiberal shift is related to the preferences of political parties and, therefore, whether they have become more extreme and antagonistic. In this regard, it is quite plausible that the illiberal shift led by many political parties is closely related to political polarisation and can therefore be placed within the framework of this widely documented political phenomenon. In other words, the illiberal shift could be a specific manifestation of a wider political trend: polarisation. In this same publication, we previously explored the root causes of the increase in political polarisation (i.e. the disparity in preferences). In particular, in two articles that focused on the structural and contextual outlook, respectively, Ruiz (2019) and Canals (2019) noted that the «usual suspects» in both the theoretical and the empirical literature were the economic effects of major crises, the increase in inequality (a major root cause of which was technological change) and the increase in migration flows.[1]

However, these types of causes, which we can broadly label socio-economic, do not exhaust all the possibilities. In the vast literature on populism – one of the specific forms that the increase in polarisation can take – it is noted that there are also institutional and cultural factors involved. It is within this line of thought, for instance, that the whole debate around what is known as «cultural backslash» is framed, which has been argued in the theses of authors such as Pippa Norris and Ronald Inglehart. The aforementioned article by Ruiz (2019) set out the hypothesis that secular changes in western societies, such as tertiarisation, have led to a double effect: that which could be called economic insecurity and that which presents itself as an increase in diversity. Combined with a shift in previous decades towards post-materialist and socially progressive values, these effects have generated a movement in the opposite direction by the socially more conservative segments of western countries, thus contributing to an increase in ideologically more polarised positions.

A multi-causal approximation of the illiberal shift: an empirical exercise

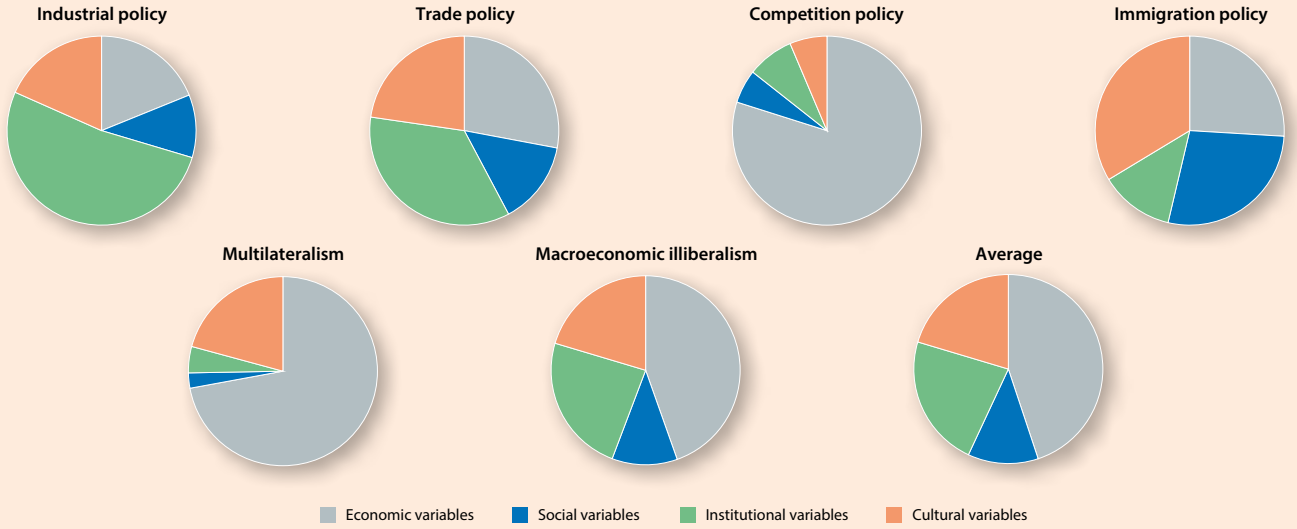
Do the available data confirm that the illiberal shift – that special form of polarisation of preferences that we are studying – is caused by different kinds of factors? To answer this question, we have chosen a series of variables that cover the aforementioned theoretical spectrum and have grouped them into four different categories. First are the strictly economic causes, which primarily measure the direct effect of the Great Recession through the evolution of GDP per capita and the unemployment rate. A second block is comprised of social variables, such as inequality and migration flows. A third group consists of institutional variables and, more specifically, the rule of law and the degree of control over corruption. A fourth and final category encompasses cultural and ideological variables, such as secularity, the liberality of society (for details of the definition, see the charts) and the position of parties on the left-right axis.

When the relative weight of these blocks of variables is quantified in seeking to explain the change in the degree of aggregate illiberalism, as defined in article «The illiberal shift in economic policy: let the data speak!», the results are quite enlightening. A first conclusion when analysing which factors are more related to each of the different areas of economic policy is that, generally speaking, the main determining factors are in an economic nature. This is not surprising, since the policies we are dealing with are, precisely, economic ones.

1. See the Dossier «The causes of polarisation» in the MR05/2019.

Explanatory factors for the change in illiberalism

Percentage of the variance explained (%)



Note: *Each portion of the circle represents the proportion of the variance of the change in the degree of illiberalism in the six spheres that are explained by the various independent variables (we do not examine the sphere of restrictions on FDI, given that few parties express their opinion on this issue). A regression is calculated for each sphere in which the dependent variable, at the party level, is the change in the degree of illiberalism, weighted according to the change in the party's share of the votes, defined as: Change in the illiberalism of the electorate =* $\text{Vote}_{i,t2} * \text{Illiberalism}_{i,t2} - \text{Vote}_{i,t1} * \text{Illiberalism}_{i,t1}$, *where illiberalism is the degree of illiberalism in each sphere of the political agenda. The last chart illustrates the average of the proportions in each sphere. The independent variables are divided into four categories: economic (the change in GDP per capita during the financial crisis and unemployment), social (the change in the Gini coefficient and the stock of immigrants), institutional (the level of control over corruption and a measure of the quality of the rule of law) and, finally, cultural variables (the political orientation of the party, secular values such as the importance of religion or conformity to norms, and «emancipatory» values such as the acceptance of homosexuality or gender equality in politics).*

Source: *CaixaBank Research, based on calculations by the authors and data from the World Bank (global governance indicators), World Value Survey and the IMF.*

Nevertheless – and this would be a second major conclusion –, when assessing the different areas, it becomes apparent that both the cultural and the institutional elements have a non-negligible influence on the illiberal shift. As is clear from the charts, this is the case in areas such as trade policy, which are dominated by institutional factors, and in cultural areas, which play an important role in migration policy. In contrast, the social elements, at least as they have been defined, appear to play a less important role. The exception to this is the field of immigration policy, in which social factors do appear to explain a large part of the shift towards illiberalism.

At this point in the analysis, it is worth considering whether any conclusions can be drawn for the cases of Spain and Portugal. Although data for the variable in question (the degree of illiberalism) are not available for Spain and Portugal, the above exploration of the causes allows us to make a first attempt at approximating the level of pressure that exists for these countries to become more or less illiberal. When we analyse the trend in the different explanatory variables, it becomes clear that in both countries, albeit more so in Spain, the dynamics of several of these variables before and after the financial crisis indicate growing pressure towards a greater degree of illiberalism. Specifically, the trend in the blocks of economic and social variables (especially the fall in GDP as a result of the crisis, as well as a higher unemployment rate and level of inequality than the average for the sample between 2008 and 2013) indicates potential pressure in areas that are more sensitive to these factors (it should be noted, however, that in both the institutional and the cultural sphere Spain and Portugal show trends in line with other countries).

Finally, the exercise conducted here leads us to the same main conclusion as other similar exercises in the social science literature conducted on other areas of polarisation or on the change in preferences in general. Specifically, single-cause explanations do not tie in well with the available data, and while economic factors play a bigger role, social, institutional, cultural and ideological factors are also relevant. To the extent that the world will evolve in the direction that most economists and analysts predict, the pressures in all areas in many of the most important countries in the world to diverge from the liberal consensus will persist, or even increase. After all, it is hard to picture major improvements materialising in long-term growth, in inequality reduction, in changes in migration flows or in institutional regeneration. In this context, we need to explore the effects that this illiberal shift could have: an exercise that we undertake in the fourth and final article of the Dossier.

Álvaro Leandro and Àlex Ruiz

The effects of the illiberal shift: little evidence, much concern

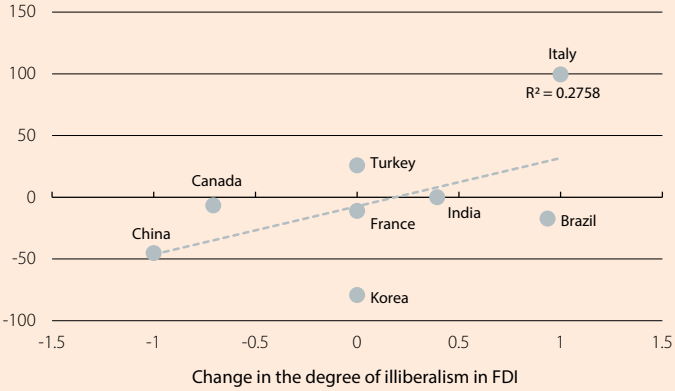
In 1972, at the historical dinner at which Richard Nixon and Zhou Enlai endorsed the restoration of diplomatic relations between the US and China, someone asked the Chinese premier about his opinion regarding the French Revolution of 1789. After a long pause, he replied, «it is too early to say». While it is likely that the reliability of this anecdote is dubious, like many that surround famous quotes, we do believe that it is applicable to another quieter and less media-covered revolution that does not involve barricades or shots fired from the Bastille, which we have called here the illiberal shift. As we shall set out below, it is perhaps still too early to assess its effects, but unlike Zhou Enlai, we do believe that there are sufficient elements to warn of the risks it entails. Without further ado, let us address these issues one by one.

Effects of the illiberal shift: limited evidence for the time being

When we analyse whether the change in the extent of aggregate illiberalism, as set out in the article «The illiberal shift in economic policy: let the data speak!» of this Dossier, has an impact on key macroeconomic variables, the results are inconclusive. If the increase in the illiberal shift corresponded with a deterioration in potential growth, we would be in a position to state that the shift affects economies' baseline. However, there is no statistically significant relationship between the two variables. A second hypothesis could be that illiberalism eroded inflation expectations. Here, once again, the data do not support this premise. Finally, could it be that, despite not hindering growth or price stability, it could have an impact on the perception of country risk? Again, the change in the level of country risk in the countries studied does not appear to be caused by the shift towards illiberalism. In other words, investors are not clearly inclined to consider countries that have embraced the illiberal agenda as being inherently riskier.

Relationship between the change in the degree of illiberalism in FDI policy and the change in the CDS for the countries in the sample

Change in the CDS (%)



Source: *CaixaBank Research, based on calculations by the authors and Bloomberg.*

If we abandon our measure of aggregate illiberalism as an explanatory variable and we use the various measures that approximate the illiberal shift in the seven spheres mentioned above (as a reminder: illiberal competition policy, macroeconomic illiberalism, restrictions to international trade, restrictions to foreign direct investment [FDI], restrictions to immigration, anti-multilateralism and illiberal industrial policy), the results barely improve. Thus, neither the expectations of long-term growth nor inflation seem to have changed due to variations in the level of illiberalism in any of these spheres, and only the increase in the level of country risk seems to be related to variations in some of these spheres. Specifically, in countries where parties have proposed introducing measures that restrict FDI in one way or another, there has been a movement in the country risk indicators that seems to point towards a more negative assessment among investors. However, given that the causality in this field is complex, and the number of observations low (it is an aspect on which many parties and countries do not express an opinion in their political programmes), this result should be taken with a pinch of salt.

In short, the empirical evidence is inconclusive as to the effects of the illiberal shift. However, a dismissive attitude towards the possible negative effects of this shift could be misguided. To make further progress in this regard, it is important to understand why the data may be hiding risks for future prosperity.

Why do the data not show any significant effects of the illiberal shift?

First of all, our inability to identify an economic effect may be due to there being two types of discontinuities operating between cause (illiberal shift) and effect (impact on the economy). The first would be due to the fact that the process of policy implementation is complex. A change in preferences (which is what we are able to measure with our methodology, which, remember, is based on the reading of electoral programmes) may not lead directly to a shift in economic policy in the same direction and with the same intensity. It could be, for instance, that parties propose an illiberal agenda in order to win elections but then, once in government, they end up carrying out a more orthodox economic policy (for example, due to pressures from international investors or the existence of an institutional system that acts as a counterweight to illiberal tendencies).

All in all, it is true that, generally speaking, changes in preferences tend to be reflected in new economic policies or variations of existing ones. Even if this is the case, a second discontinuity between cause and effect might be at play: given that many of the

measures in which this departure from the liberal consensus materialises are of a structural nature, in many cases it is likely, quite simply, that insufficient time has passed for the new policies to have a significant effect.

Little room for complacency in the face of the illiberal shift: a coded reading of risks

How should we interpret the above results (or, strictly speaking, the lack thereof)? Any hint of complacency must be immediately discarded. Although the empirical evidence has not found clearly negative macroeconomic effects, as stated previously, it may be only a matter of time before they begin to emerge. Furthermore, we do not know the counterfactual situation: the fact that a country implements a clearly illiberal agenda with no noticeable change in its potential growth tells us nothing about what might have happened if its economic policy had remained liberal (it could, for instance, have grown more).

However, we must place another possibility on the table, and this is a conclusion that as economists we may find unsettling: it may be that the effects of an illiberal agenda might not be as negative as one might expect. Here we enter into intellectual quicksand and we must proceed with caution. For starters, we must remember that there is some consensus on the fact that the first-order economic principles, which we set out in the article «Illiberal forms of economic policy: evolution or radical change from the existing consensus?» of this Dossier, can be tailored to different circumstances. As such, they could take different forms for countries at different stages of development.

The most representative case in this field is the study of emerging countries. Many countries, particularly those in Asia, have opted to keep certain strategic sectors protected until they have been deemed ready to withstand international competition.

However, tailoring the principles is very different to revoking them altogether. This is illustrated by the case of the heterodox economic policies that were followed in different Latin American countries in the 1970s and 1980s, or in Venezuela in this century. These policies led to major macroeconomic imbalances that ended up destabilising these economies and generating a significant deterioration in economic well-being.

All in all, besides startling errors like those set out above, and assuming that we are talking about countries with a comparable level of development, could it be that illiberalism sometimes works, from an economic perspective? The literature on the economic effects of populism, which has parallels with the kind of intellectual reflection we propose to the reader here and which is still at an early stage of academic development, suggests that a key element is determining what type of restrictions are removed by unorthodox policies.[1] A part of the liberal economic policy agenda focuses on restrictions, whether technocratic (an independent central bank, fiscal rules, etc.), or external (for instance, opening up to international capital involves fiscal discipline). If the restrictions removed are ones that certain power groups had previously established for their benefit (for instance, not all forms of integration into globalisation are neutral, as there is evidence that they sometimes reflect the preferences of certain economic sectors rather than those of the population as a whole), then there could be an efficiency gain. Therefore, the paradox is that an illiberal measure could enable the recovery of a situation that the liberal consensus was originally seeking to achieve and which, to some extent, had been perverted.

However, even if this is the case, the bottom line is that this temptation to break free of restrictions is often fraught with danger. It could end up wearing away at the limits on which reaching consensus has taken so much effort and of which the benefits are backed by ample evidence. As a very clear example: it took nearly two decades for the majority of emerging countries to have independent central banks, yet this independence is being sacrificed at an alarming rate in countries that, until recently, were considered exemplary. Are we playing with fire?

Moreover, and what follows suggests an even more serious risk, it should be borne in mind that the rupture of the liberal consensus has implications that go beyond the strictly economic sphere. In a society in which the seed of illiberalism germinates, it is difficult to imagine that the illiberal temptation will be constrained to the sphere of economic policy, and this poses the risk of an anti-democratic trend. History reminds us that whenever there has been a shift that has significantly eroded pluralist, democratic and liberal norms, the path followed has ended badly. Let us hope that this Dossier, with its attempt at characterising and measuring the phenomenon, provides a small contribution to a fundamental debate which we cannot afford to get wrong.

Álvaro Leandro and Àlex Ruiz

1. See R. Dornbusch and S. Edwards (1991). «The Macroeconomics of Populism in Latin American». Chicago: University of Chicago. And D. Rodrik (2018). «Is Populism Necessarily Bad Economics?» AEA Papers and Proceedings, vol. 108, p. 196-99, for instance.

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