BBVA | RESEARCH

# BREXIT, TRUMP AND THE WORLD ECONOMY IN 2017

LSE-Fundación Ramón Areces Conference

December 12, 2017

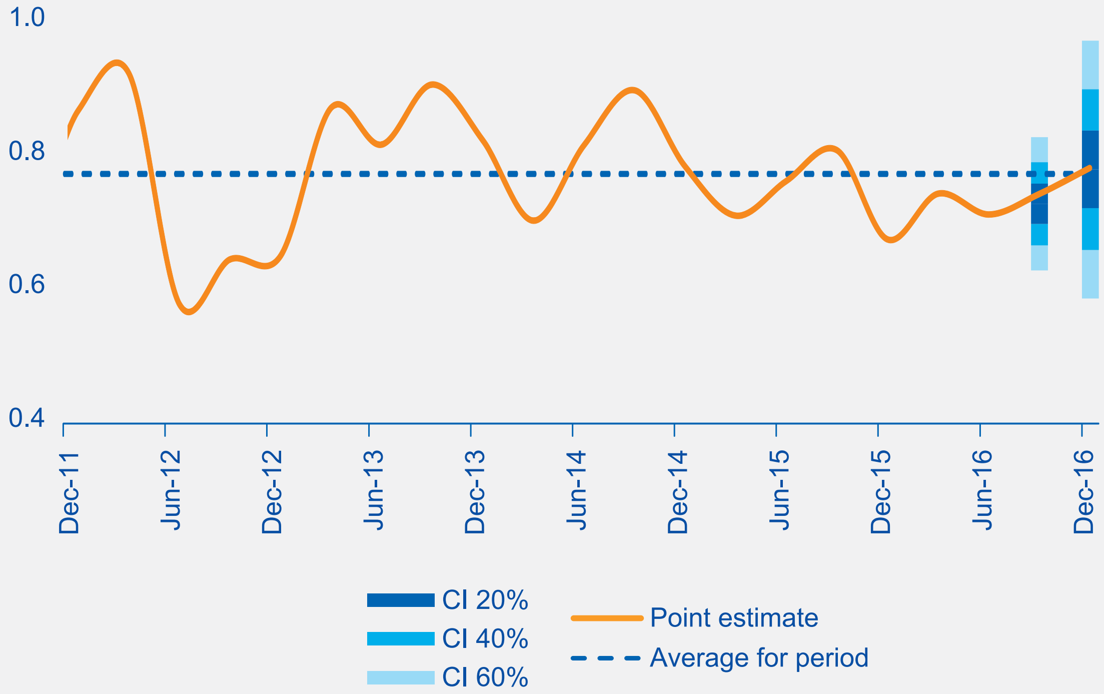
# GLOBAL

GLOBAL GROWTH

# Global growth has been accelerating slightly in 2H16

- **The slowdown in exports of goods seems to have bottomed out**, and there are signs of improvement
- Retail sales indicate that **consumption continues to show strength**
- Mixed signals on confidence indicators, **despite the signs of recovery** in many countries

**GLOBAL GDP GROWTH**
Forecasts based on BBVA-GAIN (%, QoQ)

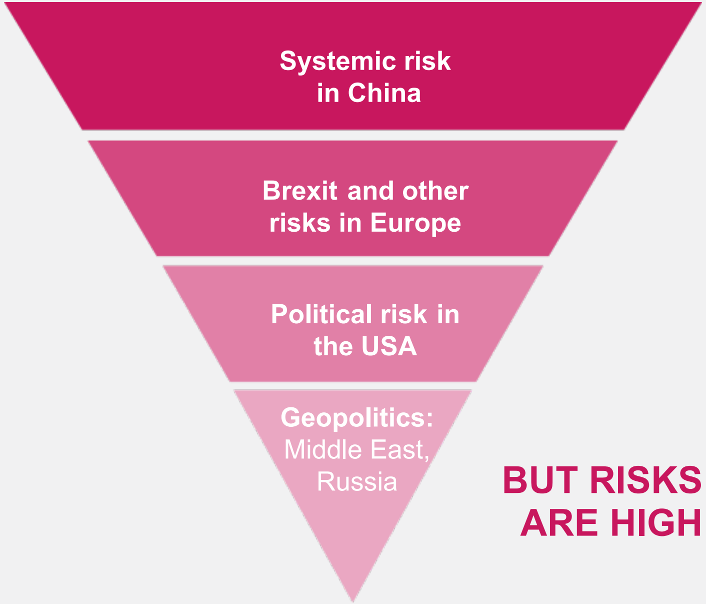



Source: BBVA Research

GLOBAL FACTORS

# Positive data in 2H16, but risks still high

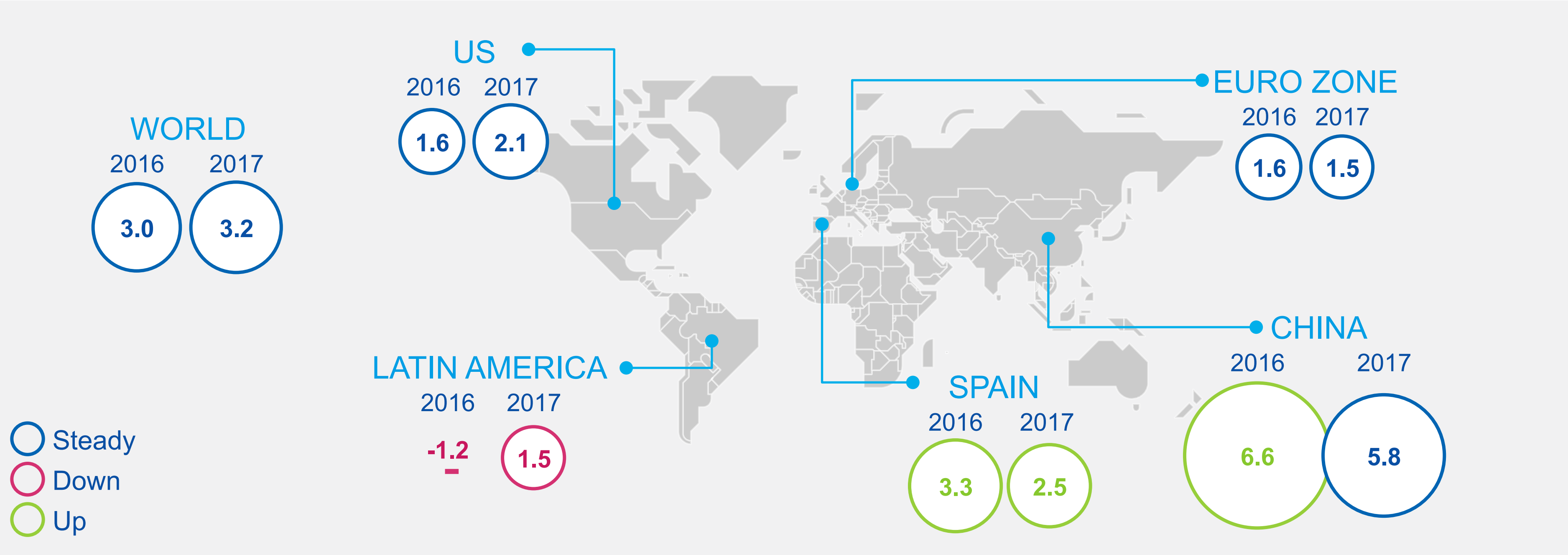
**POSITIVE FACTORS**


**BUT RISKS ARE HIGH**

GLOBAL SCENARIO

# Slight downward revision of growth in Latin America for 2016-17




Source: BBVA Research. Latin America comprises: Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, Uruguay and Venezuela

WORLD GROWTH

# Factors affecting recovery

## Central banks and low interest rates

**Low interest rates are here to stay**, due to cyclical and structural problems, but are unlikely to remain as low as they are now

**Monetary policy** is approaching its limits and starting to weigh more than its costs

## Coordination of different policies

Monetary policy should be complemented by **fiscal and structural policies**

**There is room for expansionary measures in the US and Germany,** which are more likely to be carried on in the US.

Other countries have room to adjust the **composition of public spending**

## Global trade

The **global growth slowdown** is affecting trade

The **trade elasticity** to GDP growth **is lower than it was before the crisis**

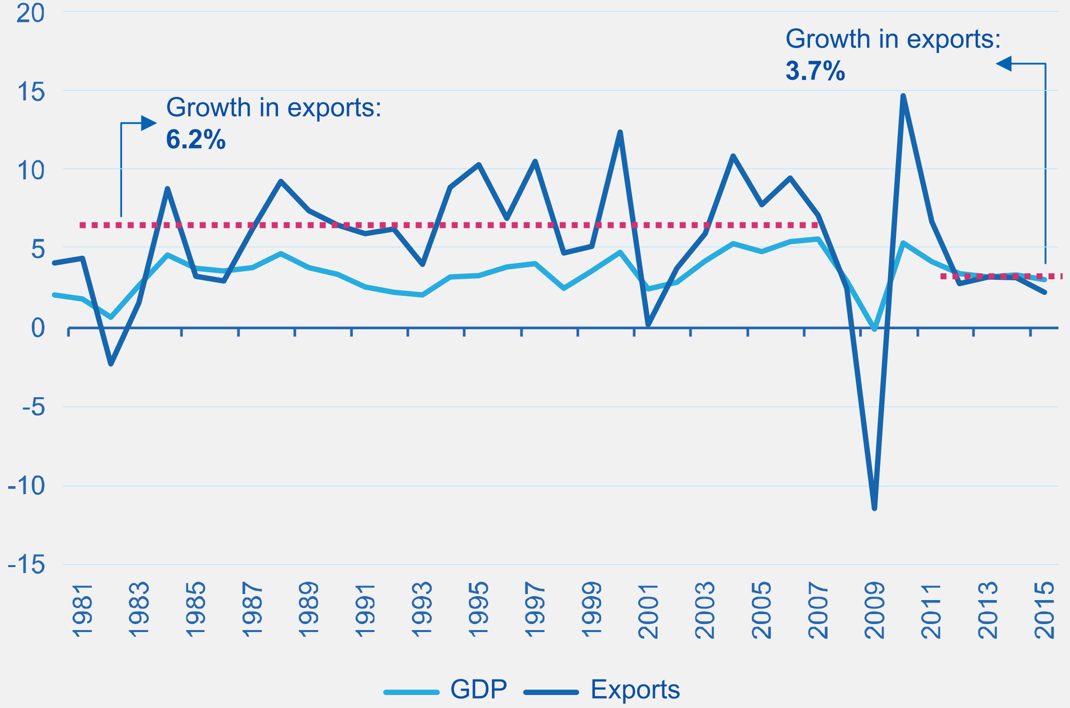
**How to manage globalization and to compensate the losers?**

GLOBAL TRADE

# World export growth: a new normal

- Lower global activity following the crisis
- Lower elasticity of trade to GDP (0.9 in 2012-15 against 1.6 between 1980 and 2007):
  - **Integration of production chains,** especially in China
  - Higher growth in **sectors and countries with lower intensity of trade**
  - **Protectionist policies** following the economic crisis

**REAL GROWTH OF EXPORTS AND GLOBAL GDP**
(YoY, %)

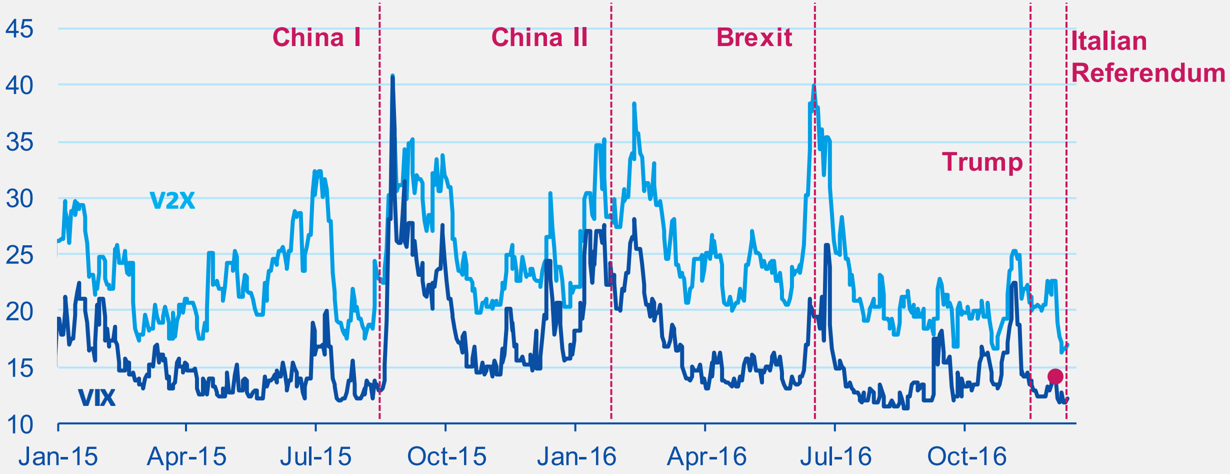



Source: BBVA Research and IMF

MARKETS CONDITIONS AFTER BREXIT, TRUMP AND THE REFERENDUM IN ITALY

# Transitory volatility and better reaction than expected

## EQUITY MARKET IMPLIED VOLATILITY
(%)




**Financial markets have recovered pre-Brexit, pre-Trump and pre-Italy referendum**

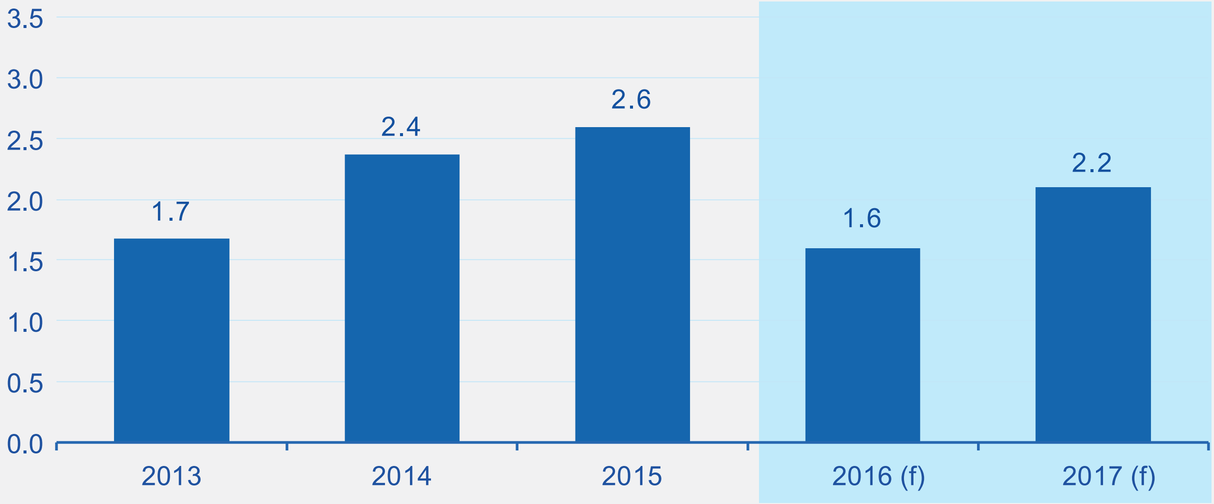
- **Quick market reversion:** just in few hours, without any central bank action, new information or data improvements
- Low global risk aversion and **signs of stabilization** in the economic cycle
- Nevertheless there seems to be **some permanent effects on some variables** and countries (exchange rates, inflation and interest rates expectations

Source: BBVA Research & Bloomberg

UNITED STATES

# Growth in 2017 around potential

**GDP GROWTH (%)**
(YoY, %)




- **Low GDP growth in 2016**:
  - Indicators suggest an insufficiently strong growth in 2H16 following the 1H16 weakness
  - Persistent low productivity
- **US Federal Reserve**: we expect an interest rate increase in December 2016 and two in 2017, up to 1.25%
- **Political and economic risks** following the presidential election

Source: BBVA Research and BEA (US Bureau of Economic Analysis)

UNITED STATES

# Post-Trump scenarios

| | Baseline<br>"Art of the deal" | Down<br>"Trump at face value" | Up<br>"Successful Trump" |
|---|---|---|---|
| **Immigration and trade** | Not as bad as announced | Tough measures, even trade war | No major changes, smooth negotiation |
| **Regulations** (financial, energy, …) | Soft positive effect | Failed positive impact | Increased efficiency |
| **Infrastructures** | Limited positive impact | Lack of impact | Large impact |
| **Monetary policy** | Fed on track | Supportive Fed policy | Fed tightening |
| **Fiscal policy and taxes** | Mildly expansionary | Failed expansionary effect | Successful expansion |
| **Effects** | **Transitory reflation: higher growth & inflation<br>Negative mild long-term effect** | **Lower growth, inflation and interest rates<br>Negative long-term effect** | **Effective boost towards the old higher potential growth** |

MARKET REACTION

# Markets’ winners and losers

## Winners

- Developed markets
- US dollar
- Equity: construction, banks and oil

## Losers

- Emerging markets
- FX: Mexico, Colombia, Turkey
- Bond yields
- Sectors as shipping companies, renewables and automobiles

- **Two main drivers:** expectations of pro-growth policies, US reflation and higher (term and risk) premia
- Are **markets underestimating Brexit, Trump and Italy uncertainties?**

EUROPE

# Political and economic uncertainty in Europe after Trump

## Main danger

**Political contagion** to other populist movements, especially **if Trump or Brexit is felt as not damaging** in the short term

## Integration

For populists, the **EU is still seen as a scapegoat**

**Europe has failed to integrate sufficiently** to rule out its unraveling

**Russia's threat**

## Lines of reaction

**Common defense policy**

**Meet people's demands:** corruption, channeling immigration, inequality

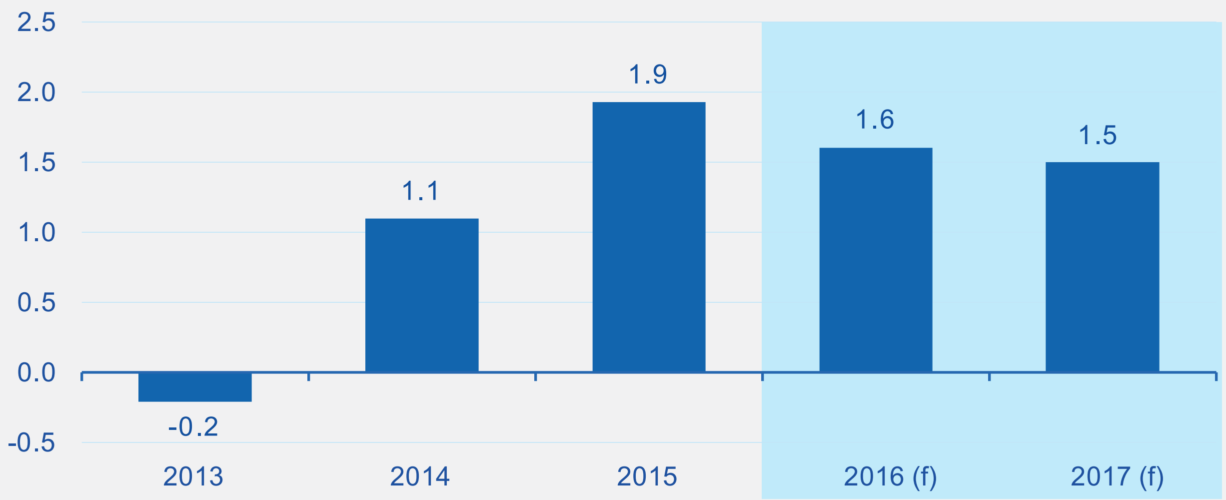
**Further integration:** two speed EU

- **March 15, 2017** **NETH Gen. elections**
- **April 23-May 7, 2017** **FRA Pres. elections**
- **Sept-Oct, 2017** **GER Gen. elections**
- **May, 2018** **ITA Gen. elections**

EURO ZONE

# Limited impact on forecasts for 2017

**GDP GROWTH**
(YoY, %)

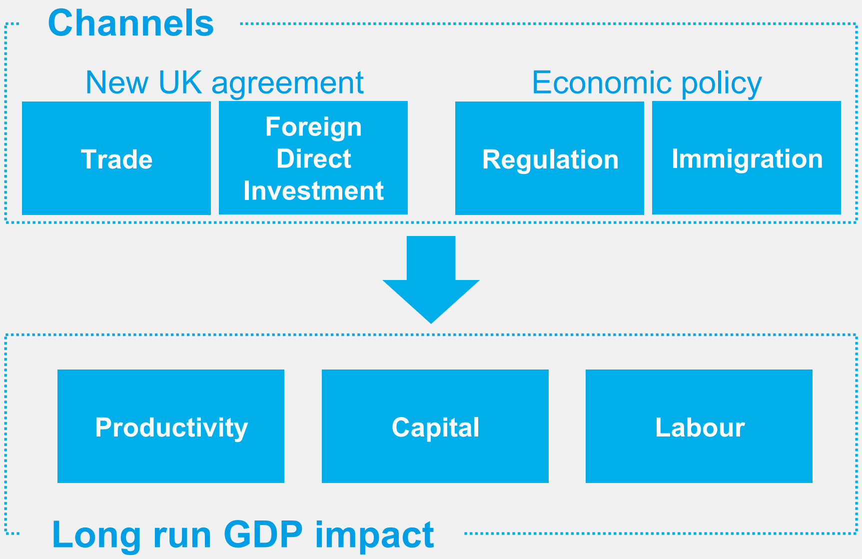



- Support of domestic demand, despite the uncertainty
- **Downward bias at year-end:** political uncertainty, the banking system and Brexit - despite the support of monetary policy
- **The ECB has little room for manoeuvre**: QE has been extended until the end of 2017 and adjusted

Source: BBVA Research and Eurostat

UK

# The negative long-term impact of Brexit for the UK

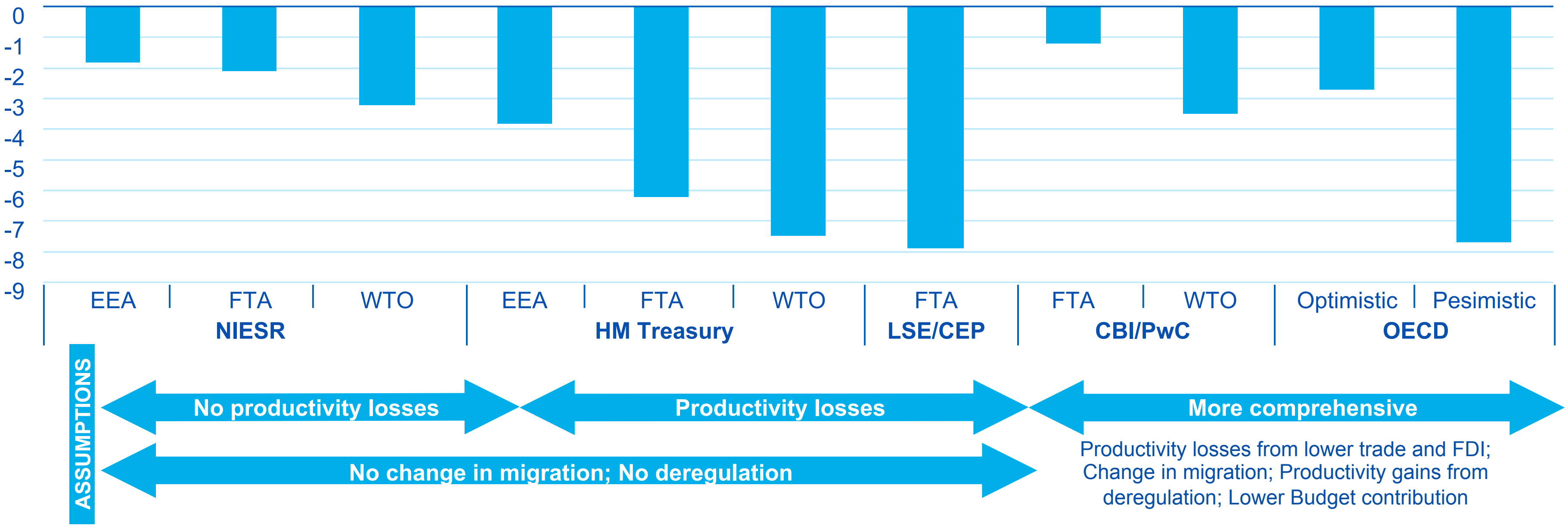



- The UK would be better off maintaining a preferential trading relationship with the EU
- Lower trade and FDI hit productivity (already low) which feeds through into lower GDP and living standards
- Potential gains from deregulation seem to be limited as the UK labour and product markets are amongst the most flexible in the OECD
- Immigration is an important driver of employment and GDP growth, with positive contribution to public finances. Risk of populist politics
- If government adopts a more liberal, pro-business policy response (especially, immigration), the level of GDP holds up better

UK

# The negative long-term impact of Brexit for the UK

**CUMULATED GDP FALL IN 2030**
(pp from baseline)




Source: NIESR, HM Treasury, LSE/CEP, CBI/PwC and OECD

ITALY

# Limited contagion after the referendum in Italy so far

**10Y YIELD SPREAD SPAIN-ITALY**
(bp)

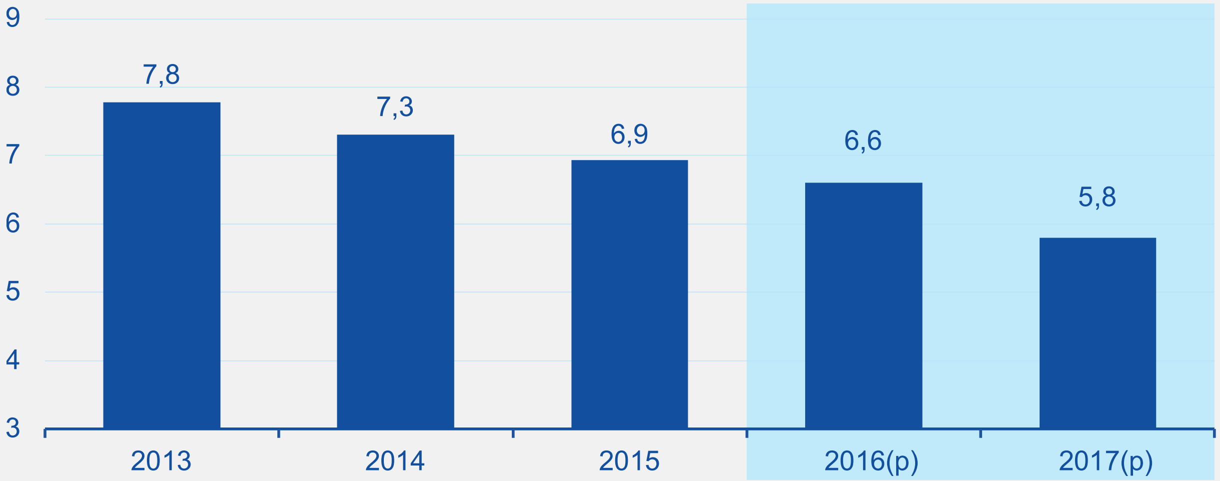

- **Short-term challenges**: solve the banking crisis and approve a new electoral law
- **Banking restructuring** will most likely require public intervention, either directly from the sovereign or through the ESM
- Little room for **structural reforms** in the short run:
  - **Public debt** to GDP over 132.7%, partially sustained by ECB's QE
  - Low **employment** (57.4% vs 59.3% in Spain) **and participation rates** (64.3% vs 75.3% in Spain)
  - **GDP per capita similar** to its level in 1997 (it increased by 28.5% in EU and 26% in Spain)
  - Huge **regional heterogeneities**

Source: Bloomberg

CHINA

# Risks remain in the medium term

**GDP GROWTH**
(YoY, %)




- **Domestic demand** strengthened by new monetary and fiscal stimulus
- The authorities have postponed any **additional monetary measures** with a view to curbing the real estate bubble, while continuing to move ahead with macroprudential measures
- Risks remain **in the medium term**:
  - Indebtedness of private companies and lack of reforms in public ones
  - Real estate market
  - Capital outflows and exchange rate
  - Shadow banking

Source: BBVA Research and CNBS

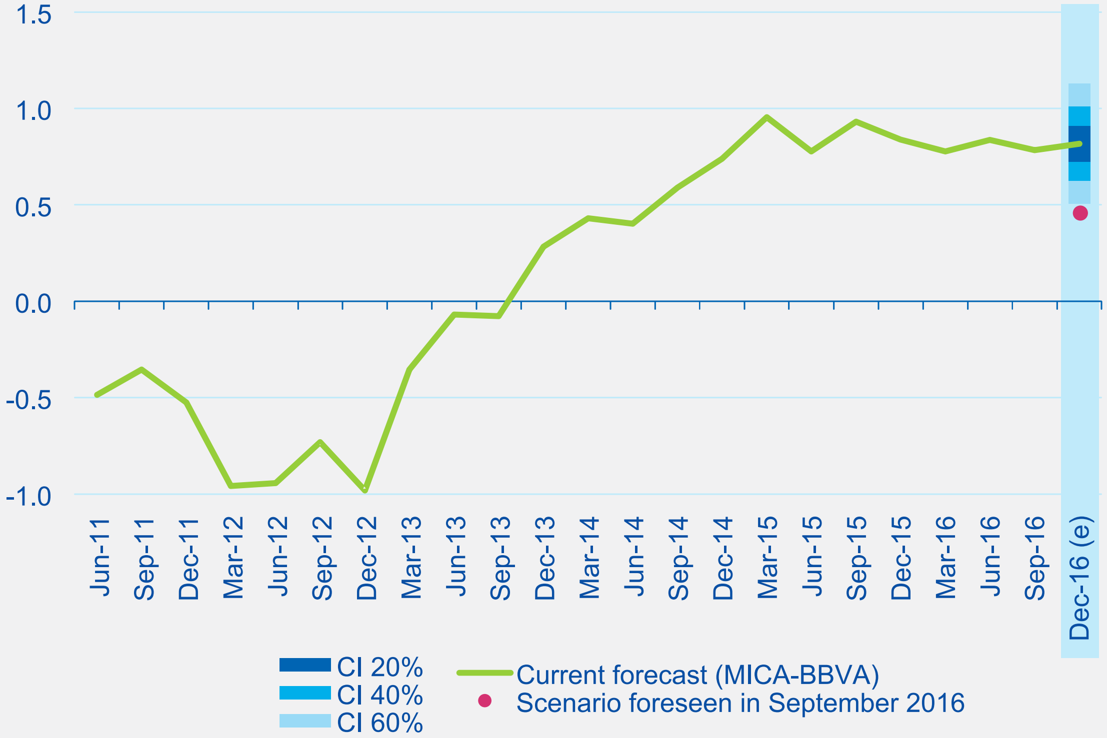
# SPAIN

## RECOVERY CONTINUES IN 2016

# The growth forecast has been revised slightly upwards

- **GDP grew by 0.7% QoQ in 3Q16,** in line with expectations
- **Expected growth for 2016 as a whole (3.3%)** shows no significant change…
- …however, leading indicators suggest that **4Q16 growth could be higher than expected (0.7% or 0.8%)**

### SPAIN: GDP GROWTH
(% QoQ, MICA BBVA model)




(e): estimated.
Source: BBVA Research based on INE (National Statistics Institute)

RECOVERY CONTINUES IN 2016

# Main drivers

**Fiscal policy** has been being in 2015 and 2016 more expansionary than expected

Expansionary **monetary policy**, but with diminishing returns

So far, lower impact of **external uncertainty**

**Tourism** continues to be a support factor

**Oil prices** have recovered but are well below 2014 levels

**Reforms** have contributed to the change of the production structure: higher **investment** in machinery and equipment, and **employment** growth with no deterioration of the **balance of payments** for the first time in many decades

OUTLOOK FOR 2017

# Expectations of slowdown in growth for 2017 remain

| 3.2% | 3.3% | 2.5% |
| --- | --- | --- |
| 2015 | 2016 | 2017 |

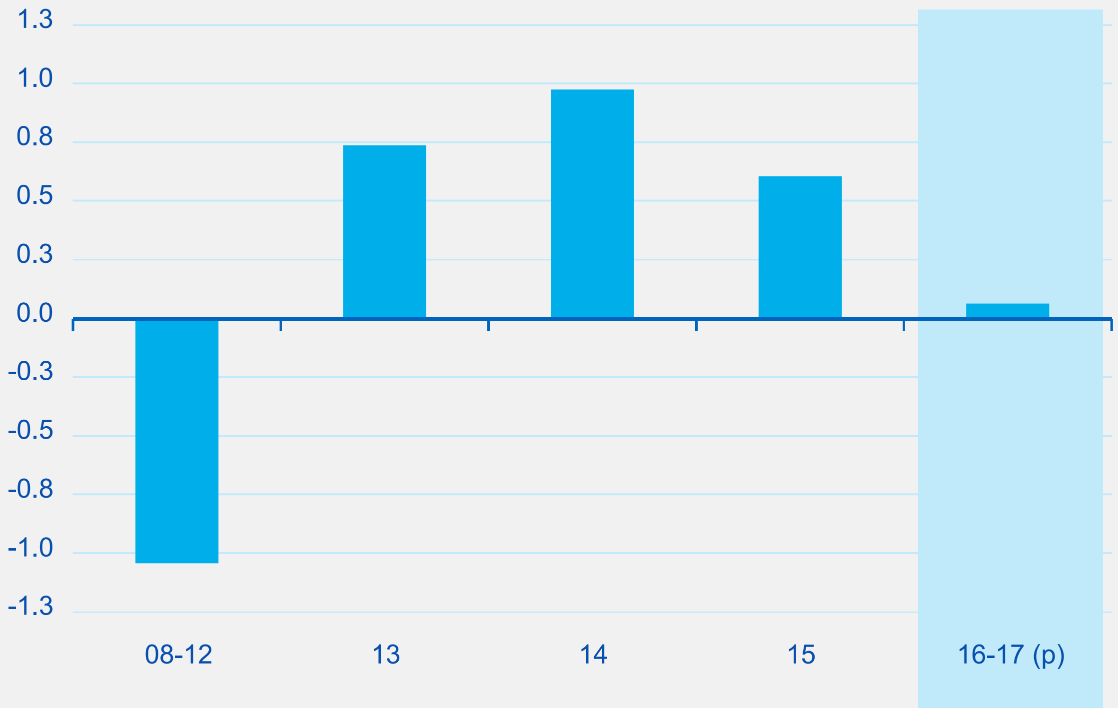
OUTLOOK FOR 2017

# Monetary policy: diminishing impact

- **The expansionary monetary policy effectiveness is limited by credit risk and the zero lower bound on interest rates**
- It may well be that its most significant effects on GDP growth are already behind us

## SPAIN: CONTRIBUTION OF CREDIT SUPPLY TO GDP GROWTH

(pp)



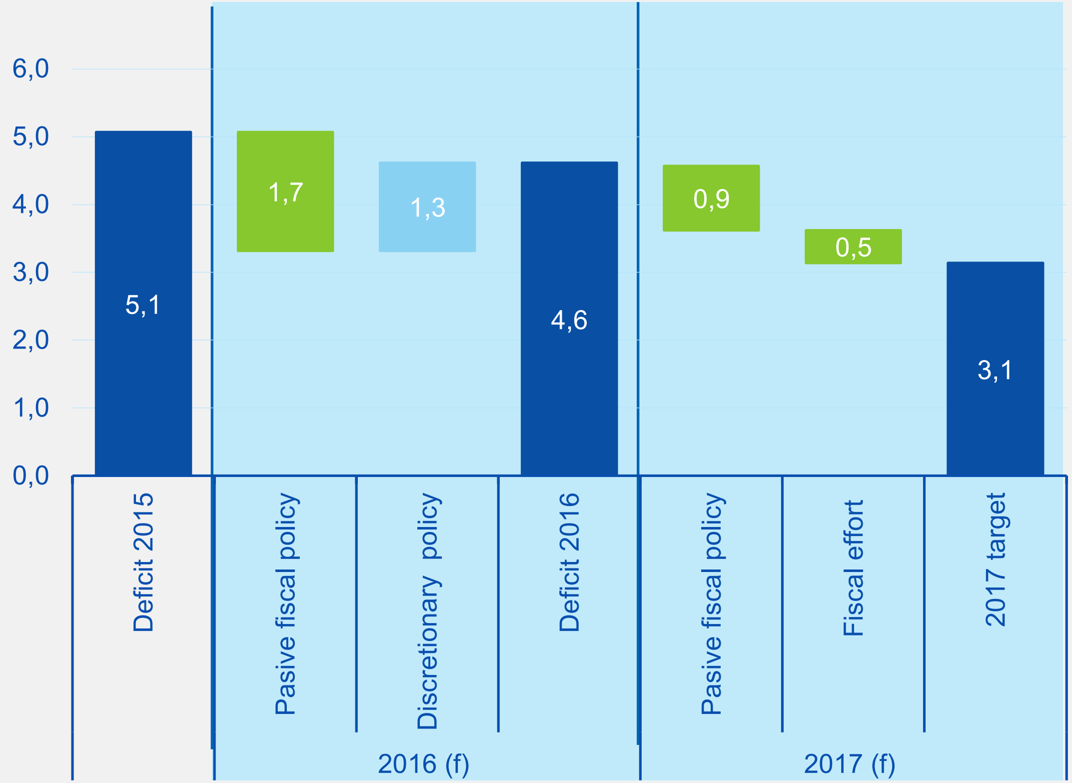

(f): forecast.
Source: BBVA Research

## OUTLOOK FOR 2017

# Fiscal policy: will become contractionary

- **Fiscal adjustments of around 0.5 pp of GDP have been necessary** in order to ensure the 2017 objective of 3.1% of GDP
- **The impact on growth will depend on the final fiscal adjustment composition**

**Public Admins. BREAKDOWN OF FISCAL ADJUSTMENT**
(pp of GDP)



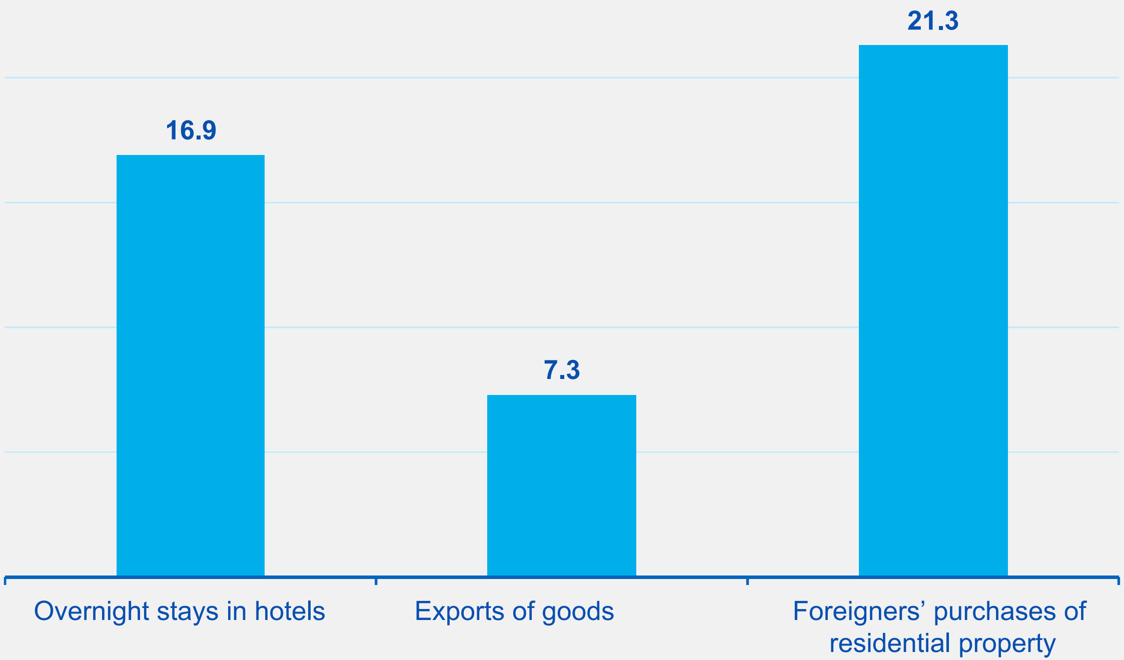

(f): forecast.
Source: BBVA Research based on MINHAP and INE

OUTLOOK FOR 2017

# Brexit: negative impact but unclear

- Given Spain's exposure to the UK, **Brexit implies a downward pressure on activity**
- Until now, **exports to the rest of the EU** had made up for the emerging markets weakness…
- …and the UK's strength explained much of this performance

**EXPOSURE TO THE UK MARKET**
(% relative to the total of each category, 2015)



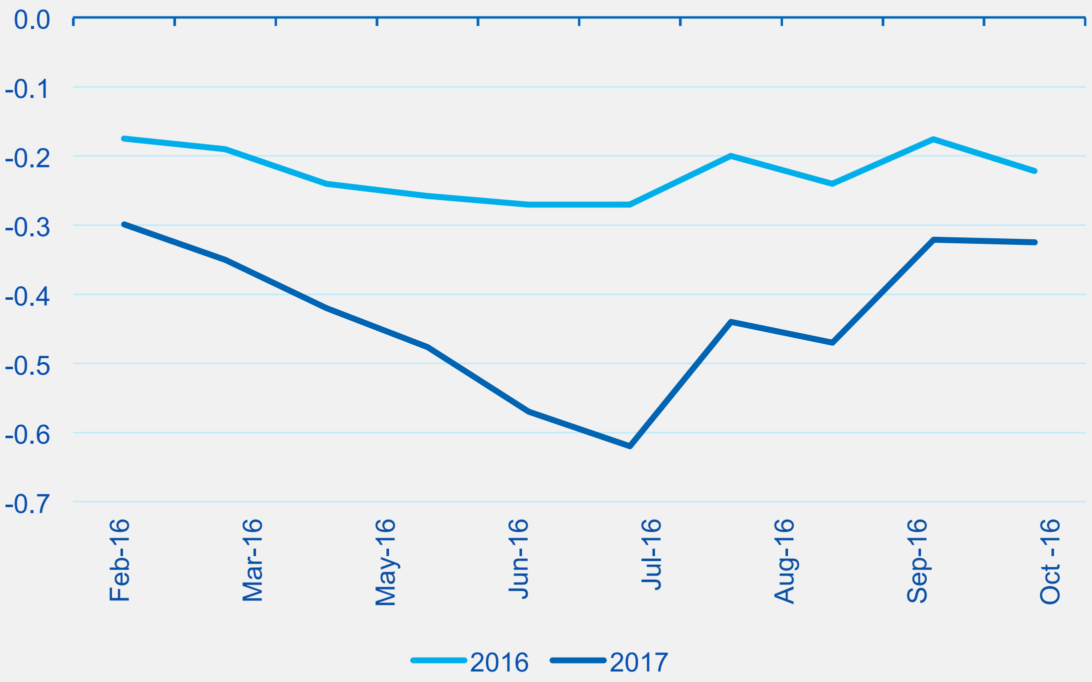

Source: BBVA Research based on INE (National Statistics Institute), Customs and MFOM (Ministry of Public Works and Transport)

OUTLOOK FOR 2017

# Uncertainty about economic policy

- **Although uncertainty about economic policy** has remained relatively high in the past few months,…
- …its impact on the Spanish economy has slightly diminished, especially for 2017
- In absence of the tensions seen during last year, **growth could have been 0.5 pp higher in the current biennium**

**SPAIN: ESTIMATED IMPACT ON GDP OF UNCERTAINTY ABOUT ECONOMIC POLICY, BY DATE OF ESTIMATE**
(pp of average annual growth)




Source: BBVA Research

OUTLOOK FOR 2017

# Uncertainty in economic policy: corporate tax

**Easing of tensions with the EU**

It avoids both fines and freezing of structural funds

It also **helps limit the damage to Spain's credibility**

**It will have a negative impact on economic activity**

But it will be limited, since it **merely involves changes in cash management for companies** not facing credit restrictions and currently with access to credit at all-time low rates of interest

What is more, it is highly likely that **companies, anticipating this situation, have boosted their savings in advance**

**The main effect will be long-term**

It introduces unnecessary uncertainty about the tax system, which might **possibly jeopardises investment**

OUTLOOK FOR 2017

# Economic policy uncertainty : labour market

**Ruling of the Court of Justice of the EU of 14 September**

Some interpretations introduce legal uncertainty as to severance pay on termination of temporary employment contracts

**Opportunity** to advance towards a **less segmented labour market**

**An agreement between the social agents and the Ministry of Employment would be desirable**

To avoid negative effects on hiring and reduce litigiousness

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