COVID-19 a new risk in 2020

The recovery of economic activity in early 2020 put at risk. Driven by a reduction in geopolitical uncertainty, in the early stages of the year the economic indicators confirmed the continuity of the recovery in economic activity initiated in late 2019. For instance, the global composite Purchasing Managers' Index (PMI) for the month of January climbed up to 52.2 points, a clear improvement over the low point reached in October (50.9). However, this improvement is likely to suffer from the outbreak of the COVID-19 health emergency. The potential impact of this epidemic on economic activity in Q1 2020 is not negligible. Although these types of events usually pose a temporary shock to the economy, uncertainty is high. China has closed factories and urged its citizens to stay at home. This will undoubtedly have an impact on the country's own economy, but also on other economies that are highly integrated with the country, such as Japan. Furthermore, the epidemic has spread to other advanced economies (such as Italy), so their activity will suffer not only indirectly from the economic downturn suffered by China, but also directly as a result of the coronavirus. In this regard, at CaixaBank Research we have downgraded our forecast for global growth in 2020 by 2 decimal points, placing it at 3.0%. While this is still a reasonable growth rate, if the COVID-19 epidemic intensifies there could be further reductions in the forecasts.

Monetary and fiscal policy, tools for supporting the economy. China's central bank has begun to relax its monetary policy and it may take further steps in order to mitigate the impact of the COVID-19 virus outbreak. In fact, most emerging economies are cutting interest rates. Also, in advanced economies, the Fed announced a 50-bp interest rate cut, bringing it to the 1.00%-1.25% range, in response to the risk posed by the coronavirus. The Chinese cabinet, meanwhile, is designing fiscal measures to support the economy. Japan, another country hard hit by the coronavirus outbreak, had announced a major fiscal stimulus package focused on public expenditure measures prior to the health emergency. Finally, the euro area will also maintain a slightly expansionary fiscal policy in some regions, and the governments of Italy and Germany have already made reference to specific measures.

Another difficut year for trade flows. 2019 was a bad year for international trade. Although a far cry from the debacle of 2009, when trade flows of goods contracted by around 13% (in real terms), initial estimates point towards a slight decline in flows in the past year (–0.4%). The escalation of US protectionism dragged the trend of flows into negative territory. In 2020, the first phase of the trade deal reached between the US and China, a seemingly less belligerent US attitude towards trade and the slight recovery expected in global manufacturing activity led to expectations of an improvement in international trade. However, the outbreak of the coronavirus in China, the heart of one of the most important value chains in the world, has the potential to depress trade flows in the first few months of 2020.

GDP growth: CaixaBank Research forecasts

Annual change (%)

	2019	2020	
		Forecast as of February	Forecast as of March
Global	2.9	3.2	3.0
Developed countries	1.7	1.5	1.4
US	2.3	1.8	1.8
Euro area	1.2	1.1	1.0
Emerging countries	3.8	4.4	4.2
China	6.1	5.9	5.5

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

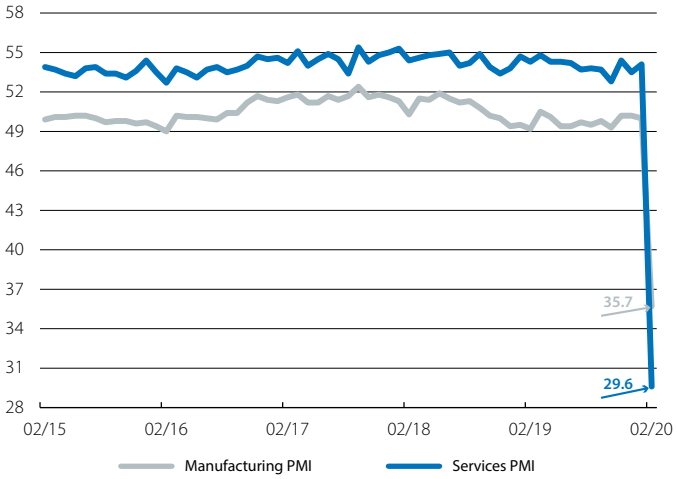
International trade of goods (volume)

Year-on-year growth (%, 3-month moving average)

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

China: economic activity indicators

Level



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

EMERGING ECONOMIES

China: the economy that will suffer the deceleration the most in early 2020. As the epicentre of the coronavirus outbreak, China's economy is likely to stagnate or even shrink in Q1 2020. In fact, the official Purchasing Managers' Index for the month of February indicates a significant deterioration in economic activity (35.7 points for the manufacturing PMI and 29.6 points in the case of services, historically low levels in both cases). Thus, despite the fact that the economic downturn caused by epidemics is followed by a rebound in activity in subsequent quarters, the economic stagnation that the country is suffering will be enough to subtract at least 4 decimal points from annual growth per our estimate of a month ago. China is therefore unlikely to grow by more than 5.5% in 2020, after advancing 6.1% in 2019. This is a sharper slowdown than expected, but it is the result of a factor that we consider to be temporary. In 2021, the country should return to the growth path it was on prior to the emergence of the coronavirus, with figures more in line with the gradual deceleration of the economy as it continues with the change of its productive model initiated some years ago (towards a greater role of the tertiary sector).

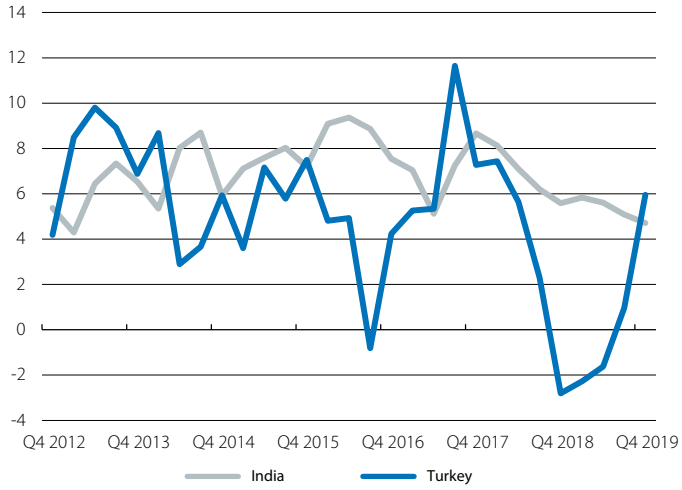
Turkey and India, the head and tails of growth at the end of 2019. The Turkish economy grew by a buoyant 6.0% year-on-year in Q4 2019, versus the 1.0% of the previous quarter, bringing annual growth to 0.9%. While this figure is clearly below the 2.8% of 2018, in recent quarters economic activity has made a significant recovery. That said, there are major concerns over the sustainability of Turkey's future growth, with its significant inflationary pressures and high levels of corporate debt. These risk factors are particularly relevant in the face of the global pressures brought about by COVID-19. India, meanwhile, grew by a meagre 4.7% in Q4 2019, compared to 5.1% in the previous quarter (the figure for Q3 was revised upwards from 4.5% to 5.1%). The loss of buoyancy in exports and the contraction of investment for the second consecutive quarter slowed growth. Thus, the rising star only grew by 5.3% in 2019, the most modest figure since 2012.

ADVANCED ECONOMIES

Significant contraction of Japan's GDP at the end of 2019, placing the annual figure at 0.8%. Japan's GDP fell by 1.6% quarter-on-quarter (–0.4% year-on-year) in Q4 2019. Whilst a drop in economic activity in the last quarter of the year was expected, as a result of the VAT increase introduced in October and the effect of the typhoons that hit the country, it proved to be much greater than anticipated. Moreover, this disappointing figure is compounded by the highly likely negative effects of the coronavirus in the first few months of the year: it is an open economy with close trade links with China through Asia's global value chain (China is the largest recipient of Japan's exports and the leading source of its imports). In addition, Japan is a very popular destination for Chinese tourists (it is the main source of international tourism in Japan). Thus, following the poor GDP figure, and taking into account the effects that the coronavirus could have in Q1 2020, we have significantly reduced the annual growth forecast for the Japanese economy (by around 5 decimal points, to 0.3% in 2020).

India and Turkey: GDP

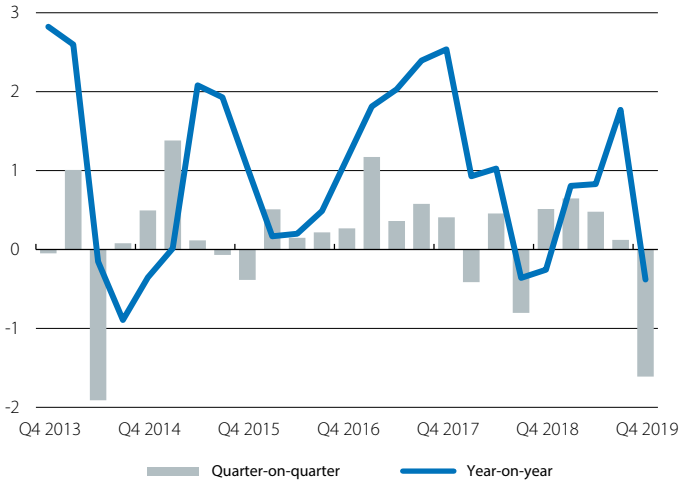
Year-on-year change (%)



Source: *CaixaBank Research, based on data from the national statistics institutes.*

Japan: GDP

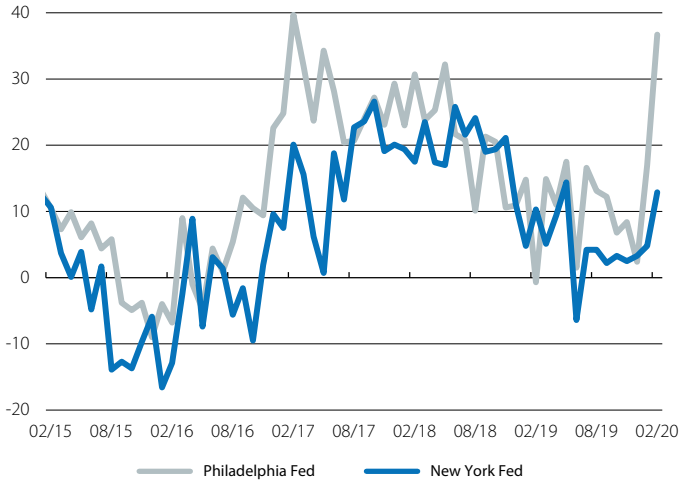
Change (%)



Source: *CaixaBank Research, based on data from the Cabinet Office of Japan.*

US: manufacturing indices

Level



Source: *CaixaBank Research, based on data from the Philadelphia Fed and the New York Fed.*

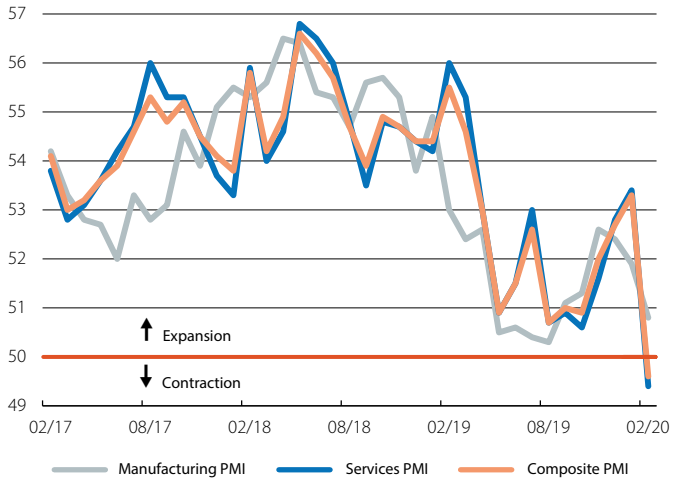
The US ended 2019 on a solid note, but it will experience a slowdown in 2020. The US economy grew by a robust 0.5% quarter-on-quarter in Q4 2019 (2.3% in year-on-year terms), thus closing the year with annual growth of 2.3%. This is a significant figure, in spite of the protectionist measures and trade tensions with China. In 2020, growth will reduce to levels more in line with the country's potential (around 1.8%). The very maturity of the business cycle and the fading of the fiscal boost implemented in late 2017 will support this gradual slowdown. That said, it could be more pronounced in the first few months of 2020 due to the potential impact of the coronavirus on economic activity, although this should not persist for too long. For now, the economic activity indicators show a mixed picture. On the positive side, the data for the labour market remain very strong, with healthy job creation in January (225,000 jobs). Similarly, the manufacturing indices of the New York and Philadelphia Feds indicated a significant rebound in activity in February in those parts of the country. On the other hand, both the manufacturing index of the Richmond Fed and the composite index produced by Markit for the same month fell sharply. These latest indicators may already reflect the uncertainty derived from the coronavirus outbreak.

The United Kingdom grew by 1.4% in 2019, after stagnating in Q4 2019 (1.1% in year-on-year terms). The stagnation of private consumption and the contraction of investment compared to the previous quarter, partly affected by uncertainty surrounding Brexit, explain the weak figure at the end of last year. For 2020, a somewhat clearer political outlook should favour more buoyant economic activity. Following the United Kingdom's official departure from the EU on 31 January, in February a transition period began that will last until the end of the year and during which the United Kingdom will remain within the European single market and subject to EU rules. In addition, the terms of the new relationship between the two regions will be negotiated during this period. This will be a complicated process and will no doubt require more time than stipulated.

In the euro area, the pace of growth was modest at the end of 2019 and the outlook for 2020 remains moderate. The region grew by 0.1% quarter-on-quarter in Q4 2019, which placed the total figure for the year at 1.2%. The latest economic activity indicators also suggest that the region will maintain positive but moderate growth rates. Among other factors, of particular concern is the weakness of the German economy. It registered 0.0% quarter-on-quarter growth in Q4 2019 (0.6% for the year as a whole), hampered by a decline in investment in machinery and equipment, as well as by a stagnation of private consumption. The trend in consumption is concerning, as it had proven resilient in the preceding quarters. In addition, the country will feel the loss of buoyancy in global trade flows expected in the early stages of the year. Finally, the coronavirus epidemic gained strength in Europe at the end of the month and will probably act as another restriction for economic activity. In this context, while we have reduced our forecasts for the growth of the euro area in 2020 by only 1 decimal point, to 1.0%, an intensification of the COVID-19 outbreak in Europe could lead to further reductions over the coming months.

US: economic activity indicators

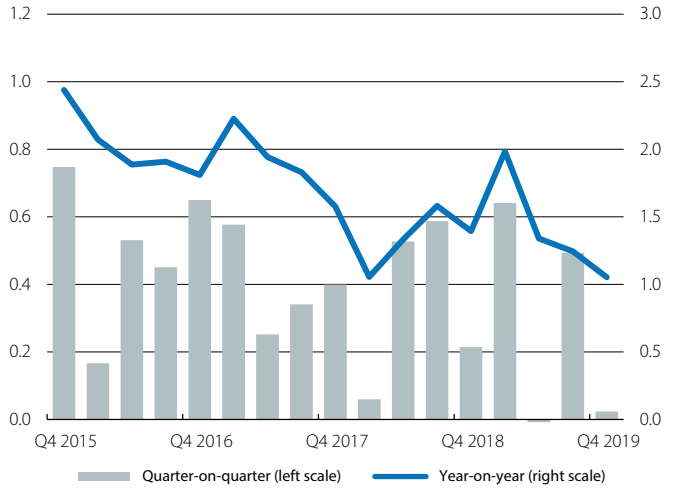
Level



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

United Kingdom: GDP

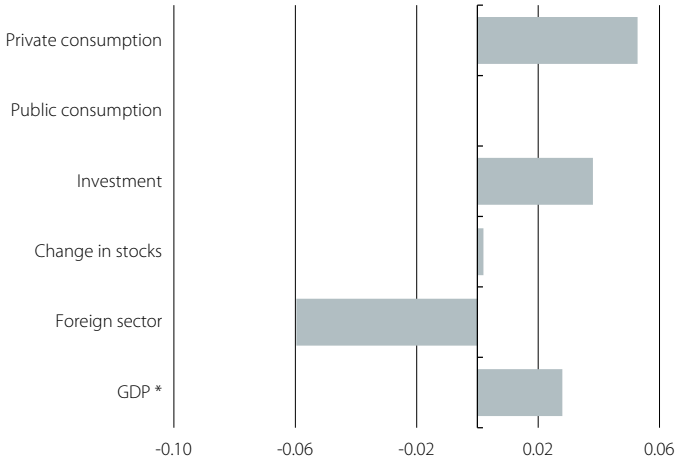
Change (%) *Change (%)*



Source: *CaixaBank Research, based on data from the United Kingdom Office for National Statistics.*

Germany: components of GDP

Contribution to quarter-on-quarter growth in Q4 2019 (pps)



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

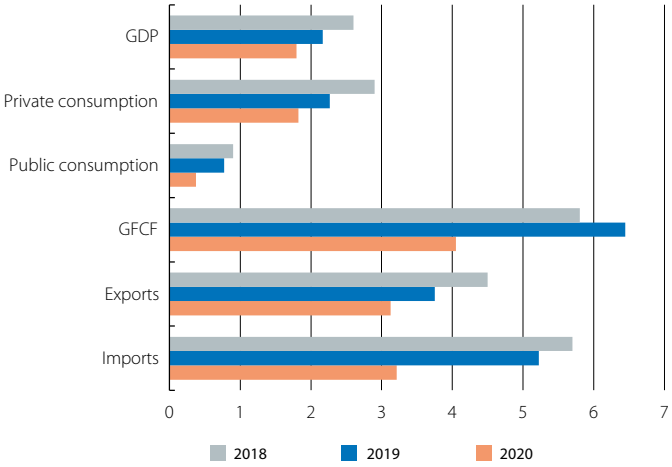
Portugal ended 2019 on a good note, but it is not immune to the uncertainty of the coronavirus

The economy grew by a solid 2.2% in 2019. Economic activity accelerated in Q4 2019 (2.2% year-on-year and 0.7% quarter-on-quarter) thanks to a better than expected contribution from external demand (+1.3 pps), partly as a result of the statistical revisions that the Bank of Portugal has carried out in the balance of payments series. Domestic demand, meanwhile, had a more moderate contribution in the last quarter of the year, although in 2019 as a whole it has remained the driving force behind the expansion. In particular, the 2.2% GDP growth rate in 2019 reflects a 2.7-pp contribution from domestic demand (this includes investment, which grew by an impressive 6.5%, boosted by the acceleration of investment in intellectual property products up to +6.5% and in construction up to 9.4%). External demand, on the other hand, provided a negative contribution to GDP of 0.6 pps for the year as a whole, largely explaining the slowdown of GDP compared with the 2.6% registered in 2018. In 2020, however, some indicators are starting to show some deterioration. Whereas in January the Bank of Portugal's coincident indicators remained strong (2.0% in aggregate activity and 2.4% in private consumption), in February the consumer and industry confidence indices declined to –8.1 points (the lowest level since June 2019) and –4.2 points, respectively. This decline is mainly due to less positive expectations with regard to the country's economic situation over the next 12 months, which may reflect the unknown impact of the COVID-19 coronavirus. In fact, this uncertainty factor is what leads us not to improve our growth forecast for 2020 (1.7%), in spite of the strong growth in 2019.

Slowdown in the labour market in the closing stages of 2019. The population in work continued to rise in Q4 2019 (+24,600 people), albeit at a slower pace than in the past (0.5% year-on-year, versus 0.9% in Q3 and 2.3% for 2018 as a whole). On the other hand, the unemployment rate rose to 6.7% (versus 6.1% in Q3). The deterioration in the unemployment rate at the end of the year is normal, but on this occasion it was higher than expected as a result of the significant rise in the overall labour force, and the foreign labour force in particular, in addition to the reduced capacity to generate employment in a more mature phase of the cycle. For 2020, we anticipate that the labour market will continue to improve, albeit at a much more moderate rate than in recent years.

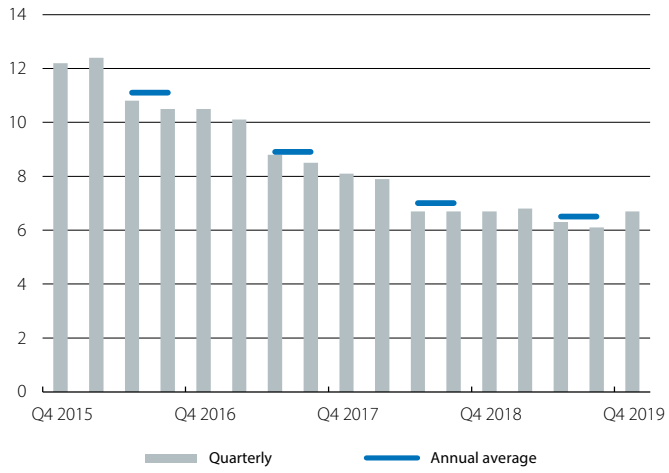
The current account balance ends 2019 with a slight deficit. After six years in positive territory, the current account balance ended 2019 with a deficit of –0.1% of GDP (181.5 million euros), which represents a deterioration of

Portugal: GDP and components
Annual growth (%)



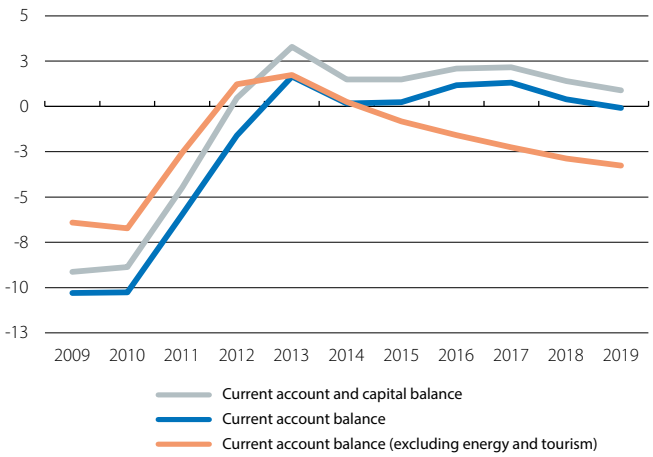
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Portugal: unemployment rate
(%)



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

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



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

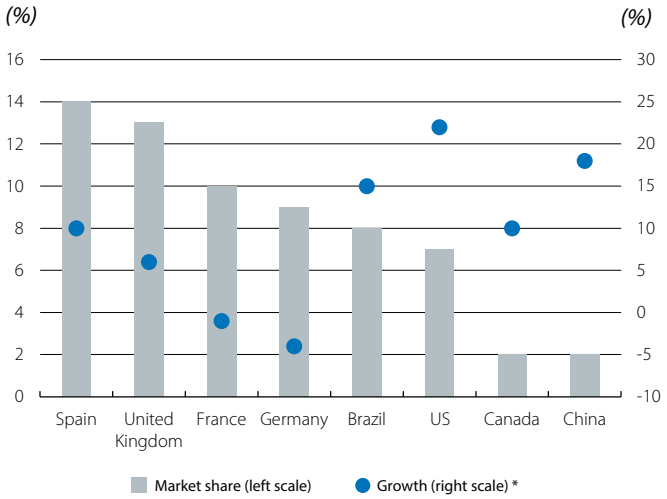
3 decimal points compared to the +0.2% registered in 2018. This was a result of the deterioration in the trade deficit in goods (7.9% of GDP; a deficit 2 decimal points greater than in 2018, affected by the import component of investment), as well as the lower surplus of non-tourism services (+2.1% of GDP, –0.25 pps compared to 2018), since the tourism surplus improved by 1 decimal point to reach 6.2% of GDP. The sum of the current account and capital balance, meanwhile, remained positive, allowing the country to continue to reduce its external indebtedness. In particular, the overall surplus stood at +0.9% of GDP (5 decimal points lower than in 2018), while external debt improved, falling to 85.1% of GDP (89.5% in 2018).

Tourism activity accelerated in 2019. Last year, Portugal registered a total of 27 million tourists, of which 11 million were domestic and 16 million, foreign. This represented a 7.3% increase in tourism activity in 2019 (5.3% in 2018), with a 7.1% increase in the number of international tourists (4.8% in 2018). Tourists from Spain, the US and Brazil were primarily responsible for this trend, accounting for more than half of the total growth in foreign tourists. Furthermore, the average revenue per available room increased once again in 2019, reaching 49.4 euros (48.5 euros in 2018), while revenues of tourist accommodation establishments grew by 7.3%. If these trends continue, Portugal could exceed 17 million international tourists in 2020. However, tourism will probably be one of the sectors to suffer the most from the coronavirus health emergency.

Meagre inflation rates persist. In February, headline inflation slowed to 0.4% year-on-year (0.8% in January), due to both the fall in energy prices and the slowdown in core inflation. The latter excludes energy prices and unprocessed food, and stood at 0.1% year-on-year, 0.3 pps lower than in January.

Demand for credit remained strong in 2019. New lending to the non-financial private sector grew by 8.9% year-on-year in 2019 (12.3% in 2018). By segment, new lending for the purchase of housing accelerated in the closing months of last year, following the slowdown in the first few months (in 2019 as a whole, it rose by 10.4%). Consumer lending was also buoyant, with growth of 14.8%. In both cases, however, the figures reflect a base effect: in the final months of 2018, both segments were adversely affected by the Bank of Portugal's implementation of stricter macroprudential measures in the granting of credit. Finally, growth was also robust in the field of non-financial firms (5.6%, versus 11.8% in 2018). Despite the buoyancy of new lending, the stock of credit to the non-financial private sector decreased again at the end of the year (–0.4% year-on-year), due to the contraction of credit of non-financial firms (–3.5% year-on-year; adjusting for sales of doubtful loans, it would have increased by 0.7%). As for households, the 1.5% year-on-year increase was largely due to the growth in consumer credit (+10.6% year-on-year).

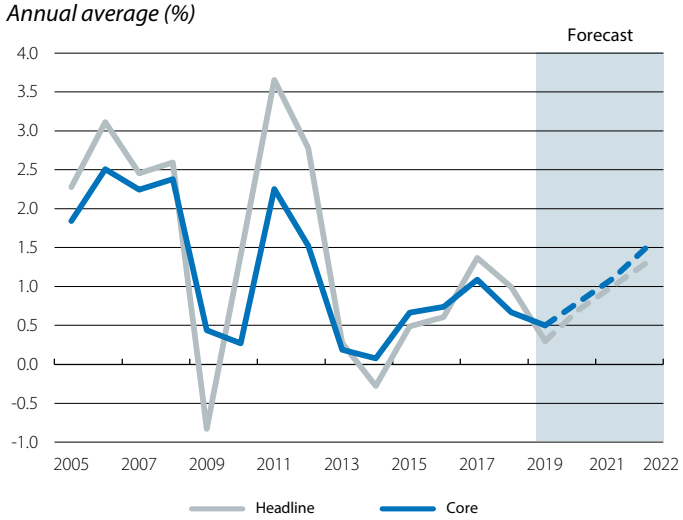
Portugal: non-resident tourism



Note: ** 12-month cumulative growth up to December 2019, year-on-year change*
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Portugal: CPI

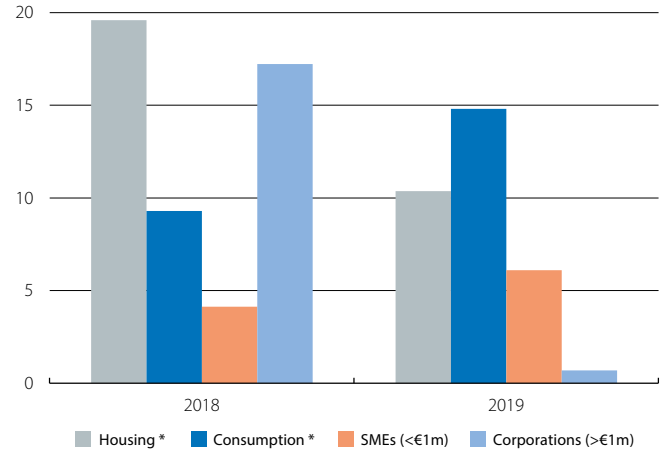
Annual average (%)



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

Portugal: new lending

Year-on-year change (%)



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