



Fundación **MAPFRE**

**2018 ECONOMIC AND
INDUSTRY OUTLOOK:
FOURTH QUARTER
PERSPECTIVES**

MAPFRE Economic Research

**2018 Economic and
Industry Outlook:
Fourth Quarter
Perspectives**

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Executive summary

2018 Economic and Industry Outlook: Fourth Quarter Perspectives

Several factors appear to be crystallizing the signals sighted since the beginning of the year indicating a change of cycle in the global economy, led by the US economy. The current situation makes it possible to confirm the symptoms that herald (and will characterize) this change: (i) the loss of cyclical synchrony of growth and monetary policy coordination; (ii) the rise of protectionism; (iii) the increase in the price of oil; (iv) the increase in sources of volatility and financial tension in the emerging markets; and (v) the emergence of global risks.

Thus, from 2019 global growth will still be led by the United States but will be less vigorous, giving rise to a scenario of smooth adjustment in which global GDP will be located around the potential level. This growth will be contributed to in a similar manner by both developed and emerging markets (albeit to a lesser extent than previously), and will take place in the context of a loss of coordination of monetary policy at global level.

In addition, global economic growth will co-exist with a gradual acceleration of inflation and a tightening of financial conditions as a consequence of the normalization of monetary policy in the United States and its effect on the emerging markets.

It should be noted that there will be visible differences in the growth path of the different emerging markets, which will be proportional to the excesses committed in the past (strength of their fundamentals *versus* accumulated imbalances). In this regard, it is foreseeable that Argentina and Turkey will go through a recession as a result of the effects of monetary normalization and its effects on the reversal of portfolio flows.

Global growth is confronted with a wide range of risks: risks related to global tariff escalation; risks arising from higher oil prices in an environment of still moderate secular growth (stagnation); regional sovereign risks; and global geopolitical and governance risks. Our scenario maintains strong downward biases in terms of growth and inflation, but is motivated primarily by the interaction between the risks arising from US economic and trade management, and from the imbalances and China's capacity for financial and commercial retaliation. In addition, all of this will be amplified and distributed through real and financial channels with the emerging markets as protagonists. Thus, the alternative scenario (of a sharp and disorderly correction) is a little less likely than our central scenario.

Insurance markets

The economic context, which is undoubtedly more complex, anticipates positive growth despite losing global vigor and synchrony, confirming the symptoms that herald a change in the economic cycle. At present, growth favors the insurance market at global level; however, a change of cycle would slow the pace of growth in global insurance premiums, particularly in the Non-Life and Life risk segments, given their strong link with the behavior of the economic cycle.

Some emerging markets continue to suffer financial tensions with capital outflows and depreciation of their exchange rates as a consequence of monetary normalization in the United States, obliging them to act in defense of their currencies. The increase in market interest rates and risk premiums also negatively impacts the financing possibilities of governments and companies, and this ends up being translated into valuation losses on the asset portfolios of insurance companies.

In the eurozone, the timetable for gradual monetary normalization continues. Against this background, the environment of low interest rates will continue for a while yet. For the time being, growth in the services sector is being sustained due to the recovery of the labor market (which is positive for the Non-Life and Life risk business lines); however, the relatively adverse global environment (imminence of the change of cycle) and the increasing financial and political risks have led us to lower the economic growth forecast for 2019. This slowdown would translate, for the insurance industry, into a deceleration of the business in these segments.

In Spain, the proximity of the end of the expansive monetary cycle and the expected increase in fiscal pressure lead to a downward correction of the growth forecast. Despite this, the expectations remain favorable for the insurance industry, specifically for the development of the Non-Life and

Life risk business lines, although its growth could be affected by the slowdown of the economy. As regards traditional Life savings and Whole Life annuities insurance products, the outlook remains one of low interest rates, which will continue to weigh on this business.

With respect to regulatory trends, there were new developments in relation to International Financial Reporting Standard (IFRS) 17 on Insurance Contracts (IFRS 17). This standard will, in principle, be applicable to the preparation of the 2021 consolidated accounts of listed groups. However, in order for compliance with it to be obligatory for European insurance groups, it must be adopted by the European Union, after consultation with the European Financial Reporting Advisory Group (EFRAG).

During the second quarter of 2018, EFRAG informed the standard's issuing body (IASB) that it had identified a series of issues which, in its opinion, are worthy of additional consideration. Insurance Europe (the association that represents the large European insurance groups) stated its position with regard to this request, asking for the period set out for the implementation of this standard to be extended by two additional years.

Meanwhile, the International Association of Insurance Supervisors (IAIS) launched the public consultation on the new version of the future Global Capital Standard ("ICS Version 2.0"), which will conclude at the end of October. This consultation is an important milestone in the adoption process of the definitive standard, scheduled for the end of 2019.

1. Economic outlook

1.1 The global economic outlook: the signals heralding a change of cycle are crystallizing

Several factors appear to be crystallizing the signals sighted in the second quarter of 2018 that heralded a change of cycle (anticipated in this report since the end of 2017).

Three of these appear to be the most relevant: (i) the pace of economic activity; (ii) the state of global liquidity; and (iii) the behavior of inflation.

Economic activity

Despite the fact that the PMIs (Purchasing Managers Indices) of developed markets and emerging markets alike are remaining in positive territory, we are seeing a strong slowdown in the indices for global industrial production, global retail sales and industrial orders, all in line with the sharply impaired indicators of global trade, which are already in negative territory.

However, they present a less bullish picture than six months ago, just as the majority of stock-market valuations have shrunk (except for those of the US market).

Liquidity

There has been a gradual correction of equity valuations, with a return to fundamentals in the majority of markets, i.e. to lower PBV (price/book value) ratios, consistent with the loss of vigor in economic activity. We are seeing frequent but selective tensions among emerging markets (capital outflows, currency depreciation, increases in market interest rates and risk premiums, as well as exhaustion of the funding possibilities of many corporations). All of this is taking place in an environment generally marked by a Federal Reserve that is moving from normalization of the balance sheet to withdrawal from monetary neutrality, and by other central banks that are following its example.

Inflation

Global inflation was strongly influenced by the hike in the price of oil, which rose above USD 82 per barrel during September. Against the backdrop of the current supply tensions, it is to be expected that this trend will be maintained. This price behavior was made plain in the widening of the gap between headline and core inflation seen during the last three months (+0.5% on average).

Despite this, it should be pointed out that we are beginning to see some symptoms of wage inflation, since the increase in wages among the developed markets exceeded 2% and in some cases is now located at the threshold level set as a target by the central banks.

Against this backdrop, even though the inflation expectations remain firm, the current context could be the catalyst for a gradual inflationary process if: (i) the price of oil continues to rise due to supply restrictions (some analysts see it reaching USD 100 per barrel); (ii) the effects of trade sanctions are absorbed with the lowering of the emerging markets' exchange rates; and (iii) the pro-cyclical policies of certain countries are maintained (see Charts 1.1-a and 1.1 b).

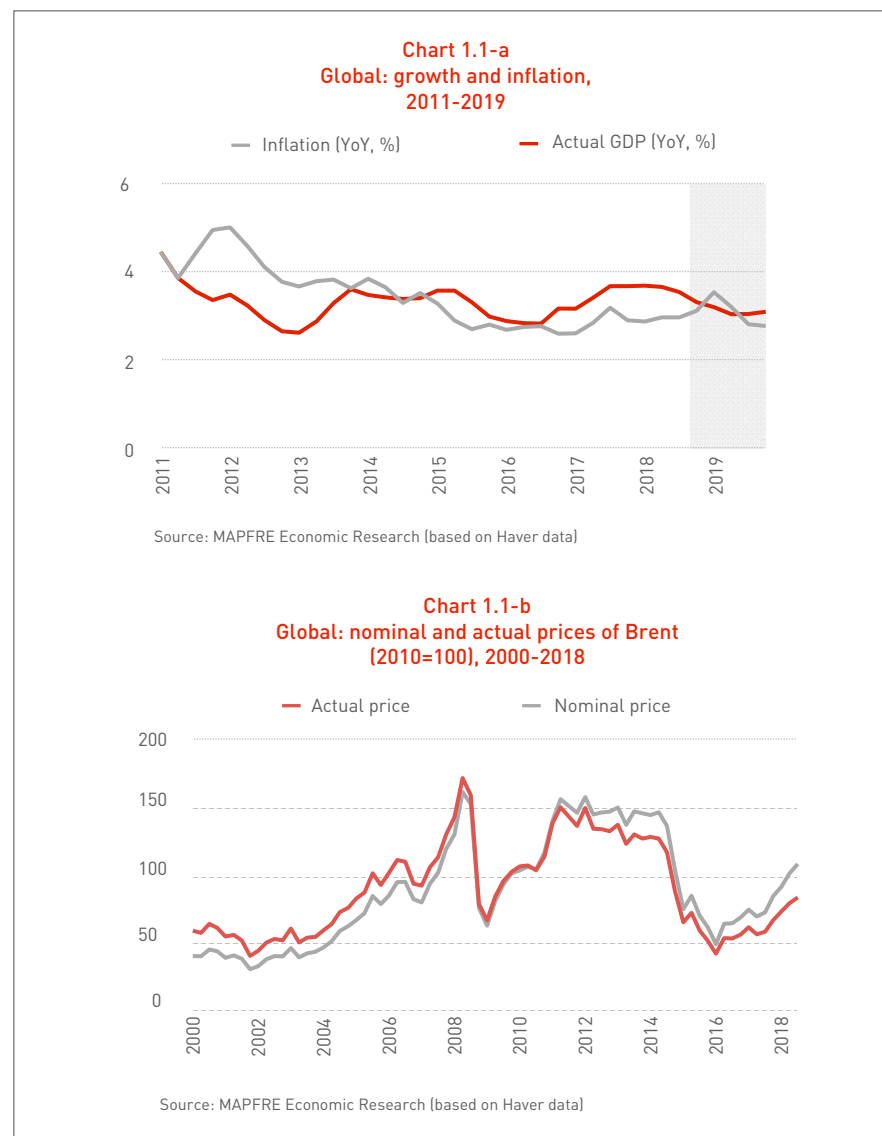
1.1.1 Change of cycle: the symptoms are confirmed

The current situation makes it possible to confirm the symptoms that herald (and will characterize) the change of cycle in the global economy: (a) loss of cyclical synchrony and monetary policy coordination; (b) rise of protectionism; (c) increase in the price of oil; (d) increase in sources of volatility and financial tension in the emerging markets; and (v) emergence of global risks.

Loss of cyclical synchrony and monetary policy coordination

The global economy, headed by the United States, is continuing to lose synchrony, while at the same time the loss of coordination in the implementation of monetary policy is becoming more acute.

- a) The United States finds itself at the end of the cycle with a visibly positive output gap (growing above the potential level) with respect to Europe and Japan, which are further back in the cycle and still maintaining a negative gap. The emerging markets, for their part,



are generally seeing a slowdown in their growth, and in some cases can be expected to enter into recession at the end of this year.

- b) In addition, a new stage of monetary policy has been reached. The US Federal Reserve appears to be accelerating the pace of increase in interest rates, but is maintaining its natural interest rate target (3%-3.5%), which is expected to be reached earlier than expected. Some believe that the Federal Reserve is seeking to gain room for maneuver on monetary policy in readiness for when the cyclical correction requires it. This contrasts with the "wait and see" attitude of the European Central Bank (ECB), which is implicitly deferring the first rise in interest rates until the end of the second half of 2019. This is one of the most important factors driving the temporary appreciation in the USD/EUR exchange rate (which would appear not to be sustainable in the long term).

Rise of protectionism

A second symptom has to do with the rise of protectionism in its three dimensions: trade, migration and finance.

- a) Trade. The real effects of protectionism are yet to come as the anticipated tariffs are applied in their entirety (to date, they range between 10% and 25% of the value of the imports, approximately USD 200 billion) and retaliatory actions by China materialize. For the moment, its effects can be seen in the postponement of investments, as well as in the deterioration of confidence and of some trade terms.
- b) Migration. Imbued in the discourse that is being put in place at global level about the dangers of migration and the loss of national identity, migratory "protectionism" may have a negative effect that will be channeled through restraints on regional governance.

- c) Finance. Protectionism is taking shape especially in the form of control over capital flows in certain markets. The International Monetary Fund (IMF) has gradually modified its line on capital controls over the past three years. The new chief economist (Gita Gopinath) is a standard-bearer for the policy of exchange rate control through the imposition of certain controls on capital flows.

Notwithstanding these short-term implications, the costs of protectionism may become more significant in the medium and long term, since they will have disruptive effects on the global value chain, impairing the current account of importers that are unable to adapt and sharply depreciating the currency of smaller economies.

Increase in the price of oil

The price of oil, which at the beginning of 2016 was USD 44 per barrel, has risen to a current level of USD 82 per barrel (see Chart 1.1-b). This behavior has been produced by problems of supply (not of demand) such as: (i) a deterioration of the production capacity of Venezuela and Angola; (ii) the sanctions imposed on Iran; (iii) the depletion of inventories; and (iv) the recent decision by the Organization of Petroleum Exporting Countries (OPEC) not to increase production in order to contain prices.

This situation is having a twofold impact on the emerging markets. The first of these impacts is occurring through the deterioration of trade terms for importers of crude oil, and the second through the erosion of real income due to inflation. However, the rising cost of crude oil in terms of real prices has been moderate, and its current price per barrel would have to more than double for there to be any resemblance to situations of tension such as those that occurred at the end of the 1970s.

Increase in sources of volatility and financial tension in the emerging markets

In addition, we are already seeing financial tensions arising from corporate leverage in strong currencies, especially in the emerging economies, and these are beginning to make evident the imbalances incurred by the strong stage of global liquidity and exposure to the devaluation effect of the exchange rate (see Box 1.2) and the rising cost of wholesale funding (and therefore in its translation into credit).

Emergence of global risks

Although the baseline scenario presented in this update of the report remains one of an orderly cyclical slowdown, the sources of global risk continue to grow, as does the imminence of those risks in some cases. Despite having a genuine origin in each region, all the risks share the possibility of being activated in one way or another as a result of interaction with the economies of the United States, China and the emerging markets. In this regard, the global risks, as things currently stand, are as follows: (1) the escalation in tariffs (with greater severity in the medium term); (2) the loss of regional governability; (3) the possibility of a monetary policy miscalculation in an adverse financial and economic climate; and (4) a disorderly financial adjustment in China, all against a backdrop of vulnerability of the emerging markets (see Box 1.2).

1.1.2 The risk has protagonists

Finally, it is important to note that there are certain sources and amplifying channels for our risk scenarios; in other words, the risk has its protagonists.

Europe

In Europe, sovereign and regional governance risks are increasing within the European Union. These risks are essentially created by two elements: (i) a no-deal Brexit is emerging as the most likely scenario (see section 1.2.6 of this report); and (ii) Italy is casting doubt on the eurozone's plans for fiscal stability by committing to a higher public deficit under growth assumptions that are difficult to sustain (rising risk premium of peripheral countries).

Emerging markets

The emerging countries are acting as amplifiers of the global risk and, given the vulnerabilities that they bear, are especially sensitive to a global financial event originating, for example, in the US economy. In the last quarter we examined¹ how global factors such as US monetary policy resulted in financial tensions and depreciation of some emerging market currencies, in proportion to the imbalances and vulnerabilities that they carried. In this update of our report, we review the nature of these economies' vulnerability with regard to the risk (see Box 1.2).

China

The Chinese economy is the origin of the most severe medium-term risks for the global economy. These risks may be felt through real and financial channels, and have two main sources. The first is the escalation of protectionism toward the United States, which, despite being in its early stages, could bring severe real and financial effects beyond the effects of the tariffs, and which could lead to certain measures that might be taken in retaliation, such as a strong depreciation of the renminbi or a disorderly sale of US debt.

Box 1.2
Vulnerability of emerging markets:
Emerging Risk Index (ERI)

Analysis of emerging vulnerability

The unconventional expansionary monetary policies of the Federal Reserve (which were introduced with the aim of counteracting the recessionary effects of the global economic crisis of the last decade) caused a strong inflow of capital that was difficult for the institutions of the emerging markets to channel in a healthy manner. The recent monetary normalization and the resumption of an expansionary path in the developed economies could pose a serious problem for the highly leveraged emerging markets.

In fact, the exchange rate volatility events experienced in recent months (analyzed in our report for the previous quarter²) are strongly influenced by imbalances accumulated in times of surplus that set alarm bells ringing when they reach levels that could be regarded as unsustainable, and result in a change of cycle. In the presence of this type of scenario, market variables such as the EMBI (Emerging Market Bond Index), CDSs (Credit Default Swaps) and exchange rates (FX) enter into a dynamic of bringing expectations sharply into line with reality, penalizing the list prices of the same.

In this framework, we propose an **Emerging Risk Index (ERI)** which aims to identify *ex-post* the vulnerability factors that cause imbalances and volatility on the markets in stress events and, in addition to monitor

ex-ante the sources of risk that act as catalysts when faced with future events of high volatility.

The variables that make up this index are assessed in relation to certain sustainability thresholds proposed by MAPFRE Economic Research and backed up by literature. Deviations with respect to these thresholds represent imbalances and are weighted to construct a risk index that ranges between 0 and 100.

The proposed risk index (ERI) is compared with the EMBI, which is the indicator of market risk based on the percentage difference (spread) between the yields on sovereign bonds of each emerging market and US Treasury bonds. The set of variables considered covers various aspects of the economic and financial situation of the studied markets and aims to serve as an early warning system, as well as a tool for analyzing the vulnerabilities of the emerging markets.

Broadly speaking, the variables that make up the ERI can be classified into a series of general aspects:

- **External vulnerability:** external debt levels specified by agent and maturity, net investment position and financing capacity or need expressed in terms of the current account of a country based on gross domestic product (GDP).

Box 1.2 (continued)
Vulnerability of emerging markets:
Emerging Risk Index (ERI)

- **Private leverage:** includes levels of credit with special attention to non-financial corporations, the leverage ratio of the financial sector and the doubtful debt measured by NPLs (Non-Performing Loans).
 - **Economic activity:** includes the observed growth of GDP and its potential, the trend of inflation and the long-term consumer price index (CPI), as well as the base interest rate of the Central Bank.
 - **Liquidity:** includes indicators of survival liquidity, i.e. the ratio between cash and reserves, or the level of exports needed to service external debt.
 - **Market:** variables such as CDSs or the EMBI, and listed risk indicators.
- The economies of Peru and Russia, meanwhile, have acceptable levels of vulnerability. It could even be considered that Russia's EMBI spread should be corrected downward to reflect the improved position of the economy following the stress of the Russian rouble in 2015 and 2018.
 - Finally, the economies of the Philippines and Colombia represent possible sources of instability in the market, with notable features being the high levels of credit in the Philippines and the large amount of external debt of Colombia.

Main conclusions of the analysis

The study of the vulnerabilities of a series of markets based on the construction of the ERI has yielded the following general conclusions (see Charts A to G of this Box):

- The economies of Argentina and Turkey have a high vulnerability scoring, and we see that the ERI makes a good early prediction of the risk situation ahead of the EMBI.

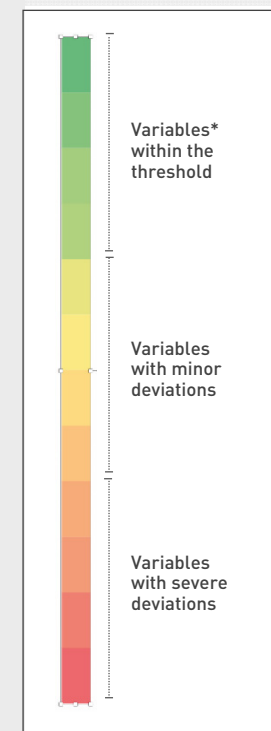
In conclusion, the Emerging Risk Index (ERI), as an indicator of emerging vulnerability, provides satisfactory results. In countries such as Peru and Russia, adaptation to the EMBI is taking place, while progress is being made in Argentina and Turkey on 2017 imbalances that materialized during 2018.

Finally, mention should be made of the case of the Philippines and Colombia, for which the EMBI does not reflect the risk shown by the ERI scoring, which could result in abrupt corrections due to high levels of external debt and the rising indebtedness of non-financial companies caused by borrowing.

Box 1.2 (continued)
Vulnerability of emerging markets:
Emerging Risk Index (ERI)

Chart A.
 Selected markets: risk profiles and estimation of the Emerging Risk Index (ERI)

	Emerging Threshold	EMERGING MARKETS									
		Argentina	Brazil	China	Colombia	Philippines	Indonesia	Mexico	Peru	Russia	Turkey
Potential GDP growth	3										
Potential inflation	10										
EMBI	8%										
CDS	20%										
CA % GDP	1%										
NIIP % GDP	-40										
External debt BC ST % GDP	4%										
External debt BC LT % GDP	1%										
External debt Government ST % GDP	2%										
External debt Government LT % GDP	34%										
External debt Corporate ST % GDP	8%										
External debt Corporate LT % GDP	27%										
External debt Banks ST % GDP	12%										
External debt Banks LT % GDP	12%										
External debt total % GDP	30%										
External debt total ST % GDP	6%										
External debt total LT % GDP	24%										
Total lending to Non-Financial Sector	20										
Lending to Government	20										
Lending to Households	20										
Lending to Non-Financial Companies	20										
Lending to Non-Financial Private Sector	20										
Leverage	10										
GDP growth	3										
Doubtful debt (NPL)	7										
Inflation	3										
Benchmark interest rate	6										
Money supply/Reserves	3										
External debt/Exports	1										
Emerging Risk Index (ERI)		45	28	42	29	23	8	20	12	20	31



Source: MAPFRE Economic Research (estimates based on OEF, Haver, IMF, BIS, Bloomberg and World Bank data)

* The variables that make up this index are assessed in relation to certain sustainability thresholds. Deviations with respect to these thresholds represent imbalances and are weighted to construct a risk index that ranges between 0 and 100.

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Box 1.2 (continued)
Vulnerability of emerging markets:
Emerging Index Risk (ERI)

Chart B.
Argentina: ERI vs EMBI

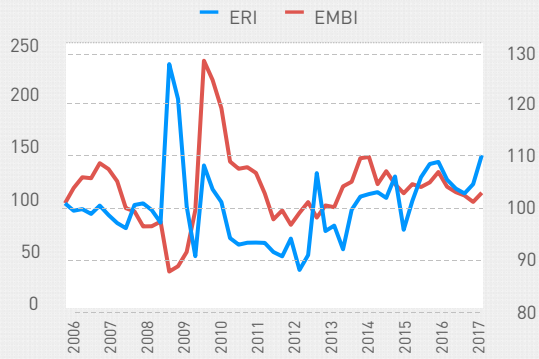


Chart C.
Colombia: ERI vs EMBI

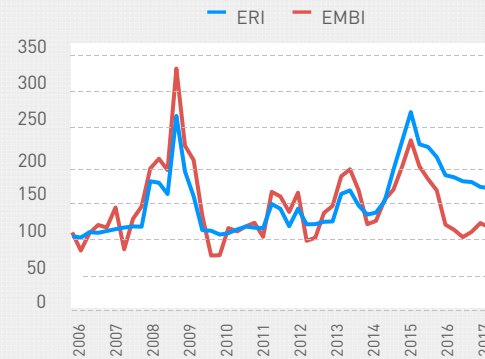


Chart D.
Peru: ERI vs EMBI

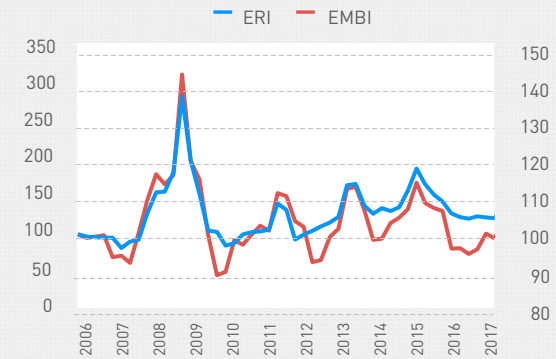


Chart E.
Turkey: ERI vs EMBI

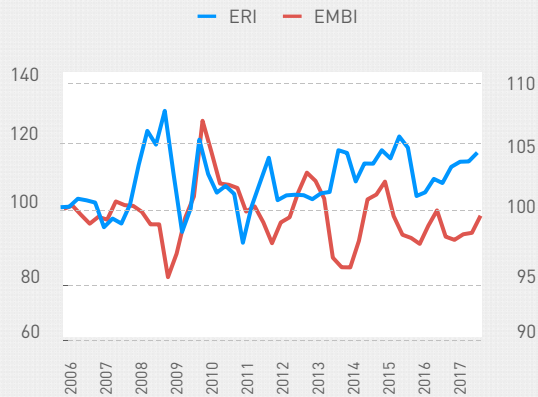


Chart F.
Philippines: ERI vs EMBI

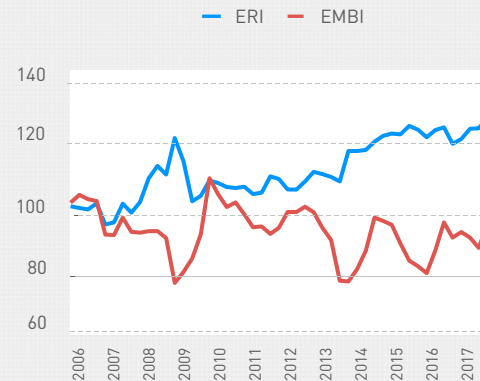
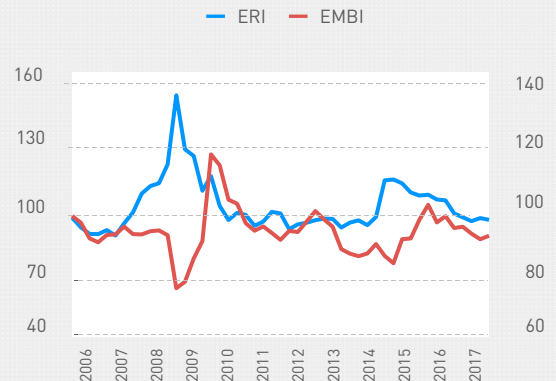


Chart G.
Russia: ERI vs EMBI



Source: MAPFRE Economic Research

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The second source is the slowing of deleveraging and the nominal and real adjustment in progress, which involves a commitment to lower growth and higher nominal stability, allowing for greater imbalances in corporate defaults, stress on "shadow banking" and an (even greater) increase in China's public debt.

United States

The United States continues to be the main source of more imminent risk (for the reasons discussed in the previous report). The most relevant of these risks (and the one that shapes our risk scenario) would be an error of monetary policy (with convergence of the expectations of the market and of the members of the Federal Reserve) involving an incorrect reading of current inflation against a backdrop of fragile US financial markets, where there are persistent misalignments in the stock-market valuation of a large part of the corporate sector, and where we see a certain generalized exuberance in all asset classes.

Moreover, the United States is facing public and private balance sheets in a tricky situation, with high debt, zero fiscal space, erosion of corporate and household savings, and a monetary policy (still) in slack territory and with little room for downward adjustments. This shapes our risk scenario, a scenario in which the Federal Reserve could rapidly raise interest rates, triggering a sharp domestic slowdown with real and financial impact, particularly vis-à-vis the eurozone (which would see its exchange rate appreciate) and the emerging markets, especially in the light of their vulnerable situation.

1.2 Forecasts and risk assessment in selected economies

1.2.1 United States

Growth is maintaining momentum: solid fundamentals, but growing risks

The interannual GDP growth of the US economy was 2.9%, the fastest pace since mid-2015, driven by consumer spending, increased business investment and a strong contribution from trade despite the backdrop of the tariff war (see Table 1.2.1 and Charts 1.2.1-a and 1.2.1-b).

- The growth of the US economy is maintaining momentum in 2018, but suggests that the cycle will run out of steam in the near future.
- The economy's fundamentals are solid, but there are growing risks.

From the second quarter of the year, the economy continued to show encouraging buoyancy, pointing toward GDP growth of around 3.3% in the third quarter. Consumer spending maintained a constant pace, while growth in business investment continued to be optimistic, albeit slightly more moderate.

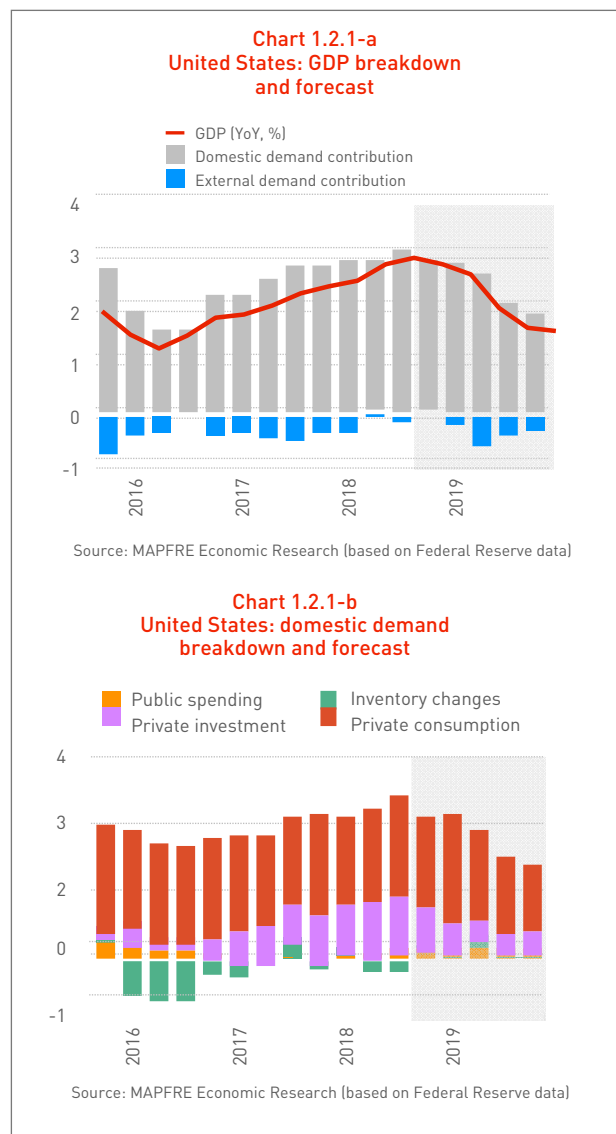
On the trade front, the most recent data show that the new tariffs imposed are affecting exports of goods, which have weakened over the last few months. The labor market, meanwhile, continues to be a bright spot for the US economy (+2 million jobs for the eighth consecutive year).

Table 1.2.1
United States: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	1.8	2.4	2.9	1.6	2.2	2.8	2.0
Domestic demand contribution	1.6	2.2	3.7	1.8	2.6	2.9	2.3
External demand contribution	0.2	0.2	-0.8	-0.3	-0.3	-0.1	-0.3
Private consumption contribution	1.0	2.0	2.5	1.9	1.8	1.8	1.6
Private investment contribution	0.7	0.6	0.7	0.3	0.8	1.0	0.5
Public spending contribution	-0.3	-0.1	0.2	0.2	0.0	0.2	0.2
Domestic demand (% YoY, average)	1.6	2.6	3.6	1.7	2.5	2.8	2.2
Total consumption (% YoY, average)	0.8	2.3	3.4	2.5	2.1	2.3	2.3
Private investment (% YoY, average)	3.6	4.9	3.3	1.7	4.0	4.8	2.2
Exports (YoY in %)	3.6	4.3	0.6	-0.1	3.0	4.6	1.5
Imports (YoY in %)	1.5	5.1	5.5	1.9	4.6	4.1	3.4
Unemployment rate (% last quarter)	6.9	5.7	5.0	4.7	4.1	3.8	3.8
Inflation (% YoY, last quarter)	1.2	1.2	0.4	1.8	2.1	1.7	2.3
Fiscal balance (% of GDP)	-5.4	-4.8	-4.4	-5.0	-3.5	-5.7	-6.0
Trade balance (% of GDP)	-4.4	-4.4	-4.4	-4.2	-4.3	-4.2	-4.3
Tax boost (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-2.1	-2.1	-2.2	-2.3	-2.3	-2.2	-2.7
Official interest rate (end of period)	0.13	0.13	0.38	0.63	1.38	2.38	2.88
Short-term rate (end of period)	0.25	0.26	0.61	1.00	1.69	2.72	2.63
Long-term rate (end of period)	3.04	2.17	2.27	2.45	2.40	3.08	2.72
Exchange rate vs. USD (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Exchange rate vs. euro (end of period)	1.38	1.21	1.09	1.05	1.20	1.19	1.25
Private lending (% YoY, average)	7.7	7.7	2.3	3.5	5.2	3.9	3.8
Household lending (% YoY, average)	0.7	1.8	1.8	2.2	3.5	3.9	5.9
P.S. non-financial lending (% YoY, average)	3.3	4.8	5.7	5.4	6.1	5.8	4.8
P.S. financial lending (% YoY, average)	2.0	2.8	2.2	4.4	3.0	2.1	2.3
Savings rate (% average)	6.4	7.3	7.6	6.7	6.7	6.9	6.6

Source: MAPFRE Economic Research (based on Federal Reserve data)
Forecasting end date: October 11, 2018.

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Inflation has remained around the Federal Reserve's target level for several months, with an interannual underlying PCE (Personal Consumption Expenditures) rate of 2.0% for the fourth consecutive month in August. We expect that the Federal Reserve's fourth increase in interest rates will take place in December, followed by a further two or three rate increases over the course of 2019.

In general, although we believe the momentum might cool off in the fourth quarter, economic growth should still register a very healthy 2.8% in 2018. The current economic cycle is now the longest in US post-war history, and this strengthens the likelihood that it will run out of steam in the near future.

The economy's fundamentals remain solid, but the risks are growing. There remains a healthy and mature labor market. The steady increase in employment and the gradual growth of salaries will continue supporting the growth of disposable income and consumption. Business investment remains steady thanks to fiscal stimulus and strong activity in the energy sector.

However, trade flows are weakening. Exports in particular have plummeted since 2015, while domestic activity continues to support imports. Overseas trade could still be a modest hindrance to growth in 2018. From the point of view of political risks, trade protectionism will put a brake on growth in economic activity, especially if fresh retaliatory actions are taken by China.

Finally, we are seeing an excess of fiscal pressure. The tardy fiscal stimulus could result in higher inflation, a more restrictive monetary policy and a larger deficit, which would have an impact on growth in 2019 and subsequent years.

1.2.2 Eurozone

Slowdown taking concrete shape

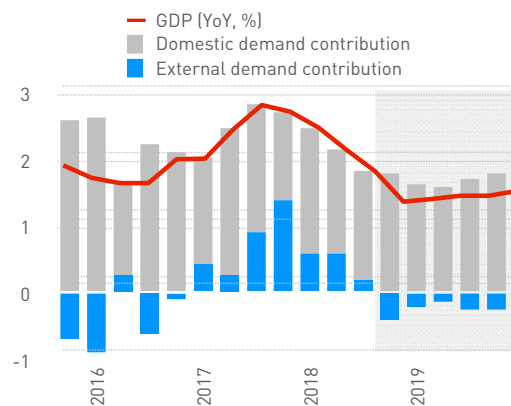
Although economic activity remains generally stable in the eurozone, the latest data suggest that growth may have been slightly milder in the third quarter. The domestic economy continues to be solid, but the adverse external environment and growing political risks cast doubt on our initial forecast for the zone, and we have therefore revised our forecast downward for 2019 (1.5%).

- Early indicators in the eurozone point to a continuation of the sluggishness seen in the second quarter.
- The ECB is delaying the first increase in interest rates, but is continuing with the methodical process of monetary normalization.

Early indicators suggest that economic growth may have slowed slightly in the third quarter: both the PMIs and the European Union's Economic Sentiment Indicator were below the averages of the second quarter. Surveys continue to show the impact being produced by commercial tensions in the manufacturing sector, while the service sector remains in relatively good health due to the strong recovery of the labor market.

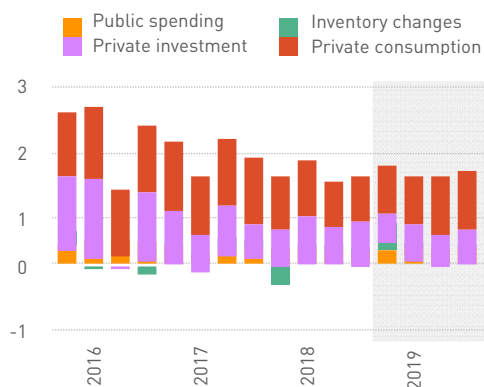
The available data for the third quarter were unconvincing, with respect both to industrial production and retail sales, which appear to be rather weak. We expect GDP growth in the third quarter to be between 0.3% and 0.4%, giving annual growth of 2% for 2018 as a whole (see Table 1.2.2 and Charts 1.2.2-a and 1.2.2-b).

Chart 1.2.2-a
Eurozone: GDP breakdown
and forecast



Source: MAPFRE Economic Research (based on ECB data)

Chart 1.2.2-b
Eurozone: domestic demand
breakdown and forecast



Source: MAPFRE Economic Research based on ECB data

Table 1.2.2
Eurozone: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	-0.2	1.4	1.9	1.8	2.5	2.0	1.5
Domestic demand contribution	-0.5	0.8	2.2	2.1	1.8	1.7	1.7
External demand contribution	0.3	0.6	-0.2	-0.3	0.8	0.2	-0.2
Private consumption contribution	-0.3	0.5	1.0	1.0	0.9	0.7	0.9
Private investment contribution	-0.5	0.1	0.9	0.7	0.6	0.6	0.5
Public spending contribution	0.1	0.2	0.3	0.4	0.2	0.2	0.3
Domestic demand (% YoY, average)	-0.6	1.3	2.3	2.2	1.8	1.8	1.8
Total consumption (% YoY, average)	-0.3	0.8	1.6	1.9	1.5	1.3	1.6
Private investment (% YoY, average)	-2.3	1.6	4.6	3.7	2.9	3.0	2.5
Exports (YoY in %)	2.2	4.6	6.3	3.0	5.5	3.1	3.1
Imports (YoY in %)	1.6	4.7	7.5	4.1	4.2	2.9	3.8
Unemployment rate (% last quarter)	11.9	11.4	10.5	9.7	8.7	8.1	7.6
Inflation (% YoY, last quarter)	0.8	0.2	0.2	0.7	1.4	1.7	1.2
Fiscal balance (% of GDP)	-3.0	-2.5	-2.0	-1.5	-0.9	-0.5	-0.5
Trade balance (% of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax boost (% of GDP)	-0.2	0.1	0.3	0.6	1.1	1.6	1.4
Current account balance (% of GDP)	2.2	2.4	3.2	3.6	3.5	3.3	3.1
Official interest rate (end of period)	0.25	0.05	0.05	0.00	0.00	0.00	0.25
Short-term rate (end of period)	0.29	0.08	-0.13	-0.32	-0.33	-0.59	-0.65
Long-term rate (end of period)	2.96	1.34	1.20	1.04	0.91	1.35	1.62
Exchange rate vs. USD (end of period)	1.38	1.21	1.09	1.05	1.20	1.19	1.25
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-0.6	-0.2	0.9	1.7	2.7	2.6	3.4
P.S. non-financial lending (% YoY, average)	-1.7	0.6	7.0	1.4	0.9	3.1	3.6
P.S. financial lending (% YoY, average)	-0.5	6.4	18.5	2.5	-0.1	-0.6	2.3
Savings rate (% average)	12.3	12.5	12.5	12.2	12.0	12.0	12.3

Source: MAPFRE Economic Research (based on ECB data)
Forecasting end date: October 11, 2018.

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Inflation rose to 2.1% in September (the highest in six years), mainly as a result of the increase in oil prices. Underlying inflation remains weak (only 0.9% in September), but can be expected to begin to rise as wage growth in the whole region strengthens and becomes more generalized.

As was to be expected, the September meeting of the ECB's Governing Council did not produce any new monetary policy announcements. The central bank remains on track to complete the bond purchases this year (in spite of the situation of Italy), and the first rise in interest rates is not expected until the second half of 2019, with a very gradual pace of increases from that time forward.

1.2.3 Spain

Gradual slowdown in the face of greater fiscal pressure and an end to the expansive monetary cycle

The Spanish economy grew by 2.5% (YoY) in the second quarter of 2018, compared with 2.8% in the first quarter, confirming that activity is continuing to be reined in (industrial production +1.2%, retail sales +0.3% YoY in August). Meanwhile, inflation in September stood at 2.3%, with the underlying rate at 0.8%.

As the close of 2018 approaches, it is expected that the Spanish

- Economic growth is benefiting from the inertia of the economic reforms of recent years, but the end of the expansive monetary cycle and the expected greater fiscal pressure mean that Spain is joining the set of countries that are falling deeper into pro-cyclical policies (at the worst possible time).
- Possible setbacks in employment or pension reforms could expose the sovereign bond to the scrutiny of the markets.

economy will end the year with an average growth of 2.6%, representing a slowdown compared with 3% for 2017 (see Table 1.2.3 and Charts 1.2.3-a and 1.2.3-b). The budget proposed by the government (with increases in public spending and tax rates) is a factor that the markets, businesses and individuals are already taking into account in their plans. The government will have to submit its budgets to Brussels and discuss them in Parliament. It is expected that there will be some tension in the approval process. In addition, possible reversals in labor and pension reforms could expose the Spanish public debt to the scrutiny of the markets and rating agencies. The IMF is generally warning all countries that pulling back on structural reforms could endanger the respective debt reduction paths.

A change in investors' appetite for Spanish sovereign debt could come from the implementation of domestic policies (budgets), or from the contagion of other economies (Italy). Moreover, this would occur in an external context characterized by the weakening of the emerging economies (especially Latin America and Turkey) and by the dilution of the ECB's support.

1.2.4 Germany

Dependent on the performance of exports

The German economy has slowed slightly so far this year (to 2.0%), mainly due to a decrease in the growth rate of exports (2.2% in August), although these picked up during the quarter (+0.5 QoQ compared with the previous 0.4). However, other indicators confirm the signs of slowdown: industrial production fell slightly in August (-0.1%); factory orders were down by -2.1%; the Ifo Business Climate Index fell slightly in September (-0.2 points) to 103.7; the ZEW Economic Sentiment survey has been negative for the last six months; and the PMI indices for September fell slightly to 55.0 (55.6 in August).

Table 1.2.3

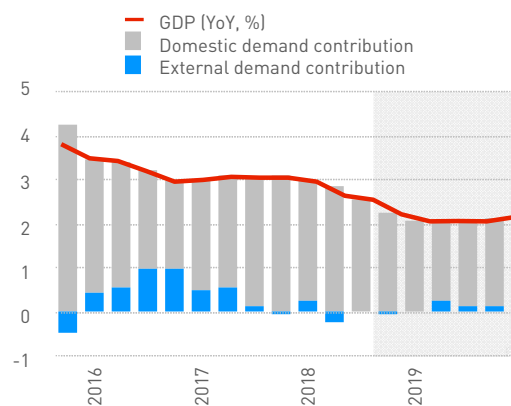
Spain: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	-1.7	1.4	3.4	3.3	3.0	2.6	2.1
Domestic demand contribution	-3.1	1.3	3.8	2.5	2.7	2.6	2.0
External demand contribution	1.4	0.1	-0.3	0.7	0.3	0.0	0.2
Private consumption contribution	-1.7	0.8	1.7	1.7	1.3	1.2	1.1
Private investment contribution	-0.7	0.5	1.3	0.7	1.1	0.9	0.6
Public spending contribution	-0.4	-0.1	0.4	0.2	0.3	0.4	0.3
Domestic demand (% YoY, average)	-3.1	1.9	3.9	2.6	2.9	2.7	2.1
Total consumption (% YoY, average)	-2.8	1.0	2.8	2.4	2.2	2.2	1.9
Private investment (% YoY, average)	-3.4	4.7	6.5	3.3	5.0	4.1	2.5
Exports (YoY in %)	4.3	4.3	4.2	4.8	5.0	2.4	3.4
Imports (YoY in %)	-0.5	6.6	5.9	2.7	4.7	2.7	3.3
Unemployment rate (% , last quarter)	25.7	23.7	20.9	18.6	16.6	14.9	13.5
Inflation (% YoY, last quarter)	0.1	-0.5	-0.3	1.0	1.4	1.4	1.1
Fiscal balance (% of GDP)	-7.1	-6.0	-5.3	-4.6	-3.1	-2.7	-2.0
Trade balance (% of GDP)	-1.4	-2.2	-2.1	-1.6	-2.0	-2.4	-2.1
Tax boost (% of GDP)	-3.5	-2.5	-2.2	-1.7	-0.5	-0.4	0.1
Current account balance (% of GDP)	1.5	1.0	1.1	1.9	1.9	1.4	1.3
Official interest rate (end of period)	0.25	0.05	0.05	0.00	0.00	0.00	0.25
Short-term rate (end of period)	0.29	0.08	-0.13	-0.32	-0.33	-0.59	-0.65
Long-term rate (end of period)	4.12	1.61	1.77	1.35	1.51	1.43	1.90
Exchange rate vs. USD (end of period)	1.38	1.21	1.09	1.05	1.20	1.19	1.25
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-5.1	-4.9	-3.6	-2.2	-1.5	-0.6	1.4
P.S. non-financial lending (% YoY, average)	-9.6	-4.6	-2.6	-2.5	-0.5	-2.4	0.7
P.S. financial lending (% YoY, average)	-14.7	-1.6	-7.9	-27.5	-10.9	-3.0	-2.4
Savings rate (% , average)	9.9	9.3	8.8	7.9	5.9	5.1	4.9

Source: MAPFRE Economic Research (based on INE data)
Forecasting end date: October 11, 2018.

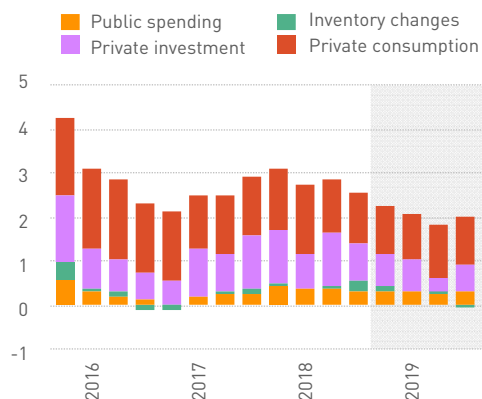
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Chart 1.2.3-a
Spain: GDP breakdown
and forecast



Source: MAPFRE Economic Research (based on INE data)

Chart 1.2.3-b
Spain: domestic demand
breakdown and forecast



Source: MAPFRE Economic Research (based on INE data)

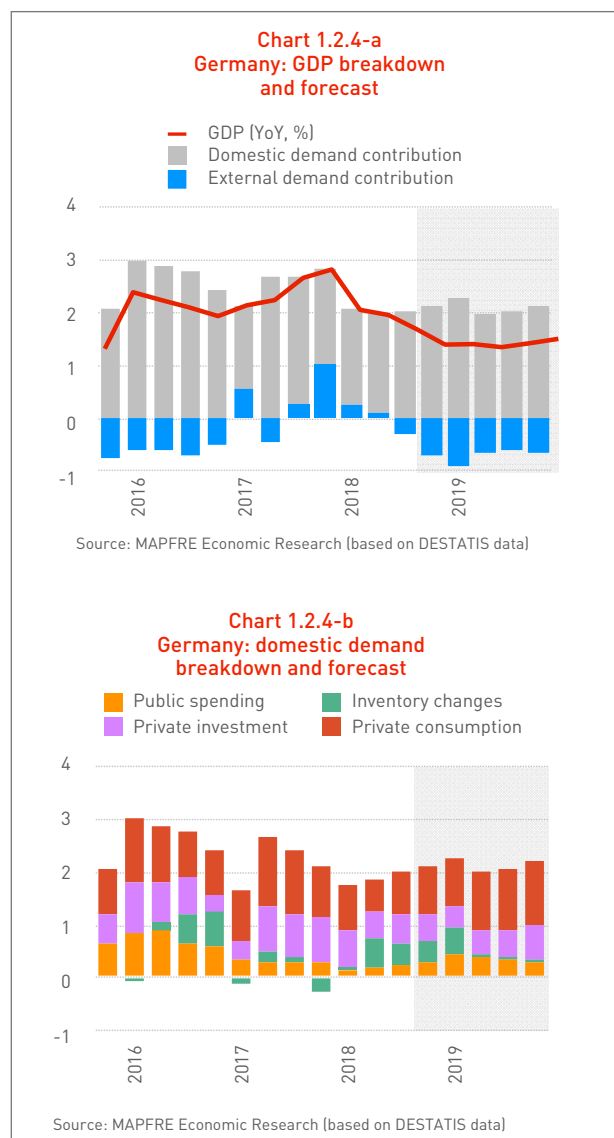


Table 1.2.4
Germany: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	0.6	2.2	1.5	2.2	2.5	1.8	1.4
Domestic demand contribution	0.9	1.0	1.3	2.8	2.1	1.9	2.1
External demand contribution	-0.3	1.2	0.2	-0.6	0.3	-0.2	-0.7
Private consumption contribution	0.4	0.6	0.9	1.0	1.1	0.8	1.1
Private investment contribution	-0.2	0.4	0.2	0.7	0.7	0.6	0.5
Public spending contribution	0.3	0.3	0.5	0.8	0.3	0.2	0.4
Domestic demand (% YoY, average)	1.0	1.6	1.4	3.0	2.3	2.1	2.3
Total consumption (% YoY, average)	0.9	1.2	1.9	2.4	1.9	1.4	2.0
Private investment (% YoY, average)	-1.1	3.9	1.0	3.4	3.6	2.9	2.5
Exports (YoY in %)	1.9	4.6	4.8	2.1	5.3	2.7	3.0
Imports (YoY in %)	3.1	3.6	5.2	4.0	5.3	3.6	5.0
Unemployment rate (% , last quarter)	6.8	6.6	6.3	6.0	5.5	5.1	4.9
Inflation (% YoY, last quarter)	1.4	0.2	0.3	1.7	1.7	1.7	1.5
Fiscal balance (% of GDP)	-0.1	0.6	0.8	0.9	1.0	2.3	1.1
Trade balance (% of GDP)	7.6	7.8	8.5	8.4	8.1	7.7	7.2
Tax boost (% of GDP)	1.9	2.0	2.1	1.9	2.0	2.9	2.5
Current account balance (% of GDP)	6.8	7.5	8.9	8.4	7.9	7.9	7.1
Official interest rate (end of period)	0.25	0.05	0.05	0.00	0.00	0.00	0.25
Short-term rate (end of period)	0.29	0.08	-0.13	-0.32	-0.33	-0.59	-0.65
Long-term rate (end of period)	1.94	0.54	0.63	0.11	0.42	0.60	0.69
Exchange rate vs. USD (end of period)	1.38	1.21	1.09	1.05	1.20	1.19	1.25
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	0.8	1.1	1.9	2.8	3.2	3.9	5.2
P.S. non-financial lending (% YoY, average)	4.2	2.5	1.8	2.1	4.7	5.2	3.5
P.S. financial lending (% YoY, average)	-7.7	-7.6	8.4	1.9	-1.1	3.5	3.9
Savings rate (% , average)	8.9	9.4	9.7	10.0	9.8	10.2	10.3

Source: MAPFRE Economic Research (based on DESTATIS data)
Forecasting end date: October 11, 2018.

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However, investment remains strong (+6.7%), as do consumer spending (+1%) and government spending (+1%). The government's fiscal accounts are in good health, and therefore some fiscal loosening is being applied to compensate for the slowdown that could come from the external sector.

- **For the moment, the symptoms of a slowdown of the German economy are mild, but the risks are high.**
- **It could be affected by the depreciation of the currencies of the destination countries for German exports.**
- **The government is carrying out a degree of fiscal loosening to support domestic demand.**

Data from surveys on the outlook for the manufacturing sector indicate a degree of uncertainty for exports due to global trade tensions. In an economy as open as Germany's, depreciation of the currencies of some large emerging markets (such as China, Russia, Brazil, Turkey and Argentina) could have a negative impact on exports. The effect of trade tensions on exports, a higher oil price and other signs of slowdown lead us to revise our GDP forecast for 2018 to 1.8% (see Table 1.2.4 and Charts 1.2.4-a and 1.2.4-b).

1.2.5 Italy

The fiscal deficit will test the trajectory of public debt

The Italian economy grew by 1.2% in the second quarter of the year. For 2018 we anticipate growth of 1.1%, a slight slowdown compared with the previous year (1.6%), with private consumption and exports cooling off (see Table 1.2.5 and Charts 1.2.5-a and 1.2.5-b).

On September 28, the Italian Government presented its budget for 2019, with a projected deficit of 2.4% for the following three years. The markets reacted negatively. The budget was of special interest to the markets since the country's debt is entering a non-sustainable trajectory (public debt of 132% of GDP), against the backdrop of a hardening of global monetary conditions and at a time when the ECB's program of monetary stimuli is close to finishing. Striking a balance between economic constraints and fiscal and political commitments, which both the League and the Five Star Movement have promised to their respective electorates, is a challenge.

The decision on the 2019 budget was seen by the market as a risky maneuver at a time when the country's solvency could be damaged by over-generous public spending. The Italian 10-year bond stands at 3.56%, representing a premium of 300 bps over the German bond. Thus, this budget could put public debt on an unsustainable trajectory and trigger a series of rating downgrades and tensions with Brussels.

More recently, Matteo Salvini, Deputy Prime Minister and Interior Minister of the Italian government, made statements with a clear tone of confrontation with Brussels, which once again created tension over the Italian public debt. The budgets will have to be discussed in Parliament and approved by the end of the year. The European Commission could put pressure on Italy by launching an excessive deficit procedure, which would involve the imposition of economic sanctions.

- **The approval of a fiscal deficit of 2.4% for three years took the market by surprise, and puts the solvency trajectory of Italian debt at risk.**
- **The risk premium is more than 300 bps, and the yield of the 10-year bond stands at 3.56%.**
- **The government will have little margin for failure in securing the tax revenues, or for deviation from the projected economic growth.**

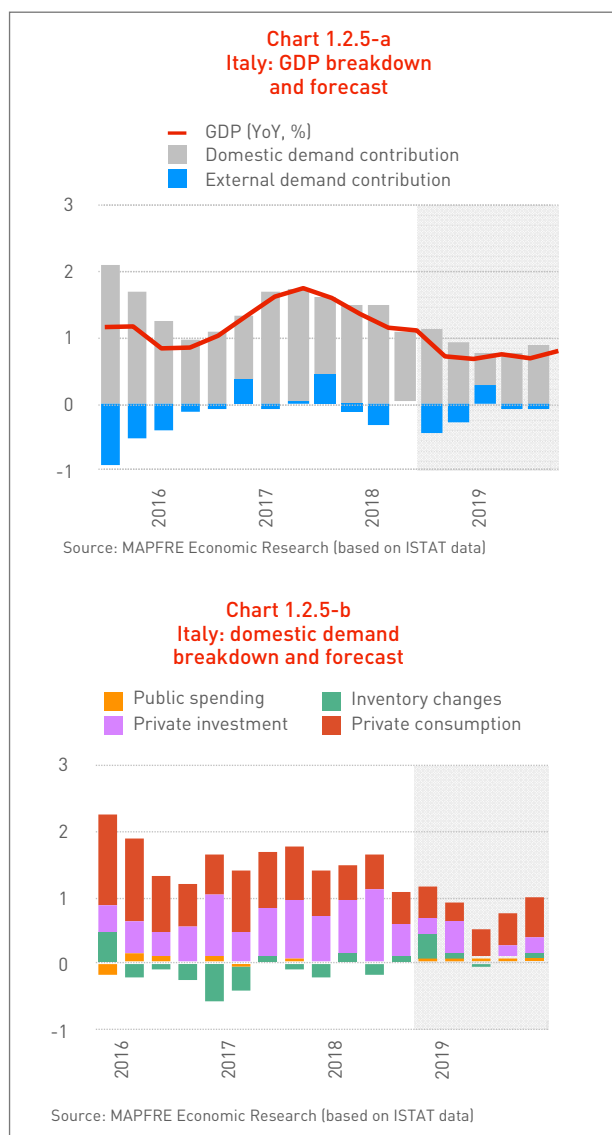


Table 1.2.5
Italy: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	-1.7	0.2	0.8	1.0	1.6	1.1	0.8
Domestic demand contribution	-2.6	0.0	1.4	1.3	1.4	1.3	0.8
External demand contribution	0.8	0.2	-0.5	-0.3	0.2	-0.2	0.0
Private consumption contribution	-1.5	0.1	1.1	0.8	0.8	0.5	0.5
Private investment contribution	-1.2	-0.4	0.3	0.6	0.7	0.7	0.2
Public spending contribution	-0.1	-0.1	-0.1	0.1	0.0	0.0	0.1
Domestic demand (% YoY, average)	-2.6	0.3	1.4	1.3	1.4	1.3	0.8
Total consumption (% YoY, average)	-1.9	0.0	1.3	1.2	1.0	0.7	0.7
Private investment (% YoY, average)	-6.6	-2.2	1.9	3.3	3.9	3.7	1.2
Exports (YoY in %)	0.9	2.4	4.2	2.6	6.0	1.1	3.4
Imports (YoY in %)	-2.3	3.0	6.6	3.8	5.7	1.9	3.6
Unemployment rate (% last quarter)	12.3	12.8	11.5	11.8	11.0	10.7	10.6
Inflation (% YoY, last quarter)	0.6	0.1	0.2	0.1	0.9	2.2	0.9
Fiscal balance (% of GDP)	-2.9	-3.0	-2.6	-2.5	-2.3	-1.8	-2.2
Trade balance (% of GDP)	1.8	2.6	2.5	3.0	2.8	2.6	2.8
Tax boost (% of GDP)	1.9	1.6	1.5	1.5	1.5	2.0	1.5
Current account balance (% of GDP)	1.0	1.9	1.5	2.6	2.8	2.7	3.0
Official interest rate (end of period)	0.25	0.05	0.05	0.00	0.00	0.00	0.25
Short-term rate (end of period)	0.29	0.08	-0.13	-0.32	-0.33	1.35	1.40
Long-term rate (end of period)	4.09	1.88	1.61	1.82	2.00	3.48	3.98
Exchange rate vs. USD (end of period)	1.38	1.21	1.09	1.05	1.20	1.19	1.25
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-1.4	-1.0	-0.3	0.4	1.3	2.1	3.7
P.S. non-financial lending (% YoY, average)	-3.9	-2.7	-1.8	-2.2	-2.0	2.7	4.8
P.S. financial lending (% YoY, average)	-28.7	-27.6	-1.1	-0.1	4.9	9.1	6.6
Savings rate (% average)	9.9	10.9	10.6	10.2	9.5	9.5	10.5

Source: MAPFRE Economic Research (based on ISTAT data)
Forecasting end date: October 11, 2018.

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1.2.6 United Kingdom

The tension over Brexit keeps all scenarios open

The UK economy grew by 1.2% (YoY) in the second quarter of the year. Retail sales rose by 3.5% and household spending by 1.6% (YoY), while exports cooled off (-2.2% in June). Investment was down by 0.6% YoY, a figure that reveals the anxiety felt by businesses in relation to Brexit. For the whole of 2018, we anticipate an average GDP growth of 1.2% and an inflation rate in the last quarter of 2.2% (see Table 1.2.6 and Charts 1.2.6-a and 1.2.6-b). At its August meeting, the Bank of England raised the base interest rate by 25 bps to 0.75%. The pound fell sharply from April to mid-August, at which point the Bank of England raised the rate, allowing the pound to find support at a level of 1.30 GBP/USD.

Brexit is deadlocked by the arm-wrestling between the two parties in the negotiating process. The latest showdown took place at the meeting of the European Council in Salzburg, where the Chequers Plan proposed by the United Kingdom was rejected. The plan proposed a "common rule book" for industrial and agricultural products, with "cooperative agreements" between regulators. The UK will have to present a new proposal at the next Council meeting on October 18/19, and if that proposal is accepted at the meeting to be held on November 17/18, the withdrawal agreement could stand. The critical issue in the British corridors of power is to avoid

- **The uncertainty over Brexit is being reflected in a gradual slowdown.**
- **A Canada-style agreement is now the most likely scenario.**
- **The risks of surprise are mainly in domestic policy, including new elections or even a new referendum.**

a physical border between Northern Ireland and the Republic of Ireland (the EU's draft protocol suggests placing the border formalities between Great Britain and Northern Ireland). The Labour Party is calling for fresh elections and a second referendum on "full participation in the single market". On the Conservative side, the anti-Europe faction of the party is redoubling its efforts to make the Prime Minister change course toward the Canadian-style free trade agreement offered by the EU.

We believe that an exit without an agreement is unlikely, since this would be detrimental for both parties. The hardline stance appears to be a negotiating strategy, and the likeliest outcome is that an agreement in the Canadian format will be reached. The risks will be mainly internal for the United Kingdom, and could include new elections or a fresh referendum.

1.2.7 Japan

Economy growing to potential

The Japanese economy grew by +1.3% YoY in the second quarter of 2018. Private consumption grew by 1.4%. Exports and investment remain the drivers, with growth of 5.0% and 9.9% respectively (see Table 1.2.7 and Charts 1.2.7-a and 1.2.7-b). Early indicators and confidence indices do not give cause to expect any setback. So far this year, the dollar has appreciated against other currencies including the yen, and this will support export activity in the coming quarters.

- **The Japanese economy grew by 1.3%, close to its potential.**
- **The monetary policy will continue to be expansionary.**
- **Re-elected as president of his party, Shinzō Abe can continue leading the country.**

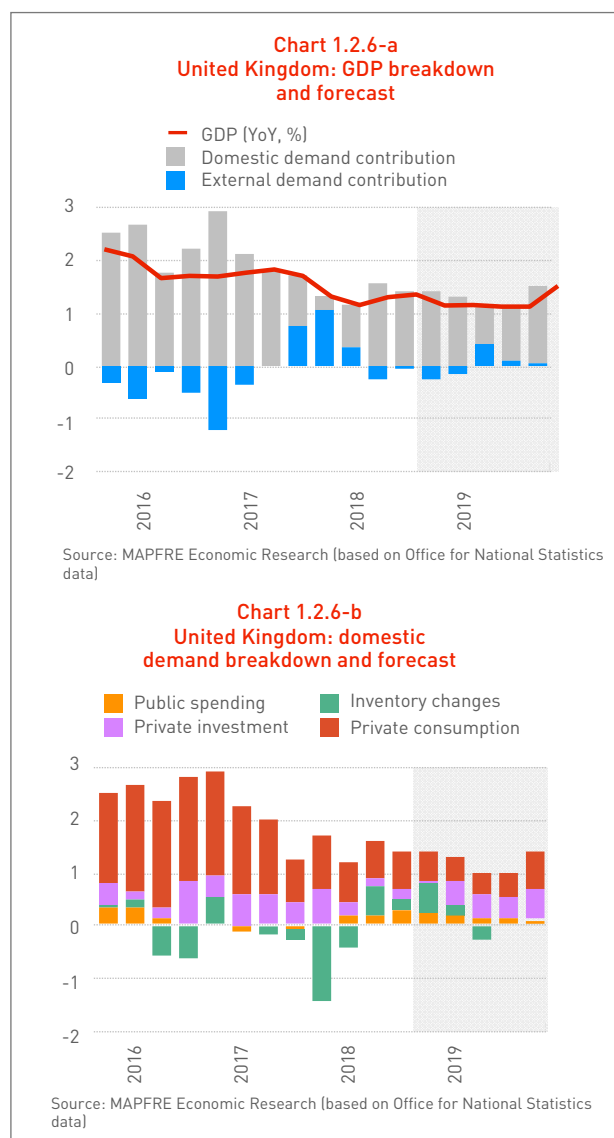


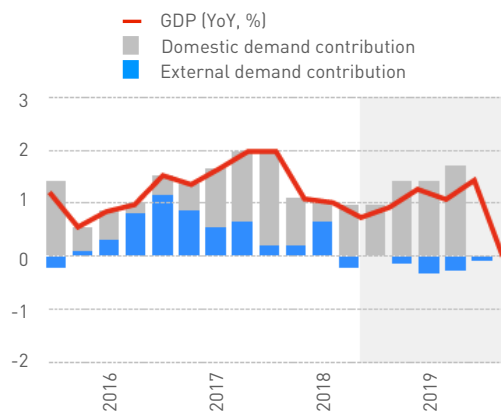
Table 1.2.6
United Kingdom: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	2.0	2.9	2.4	1.8	1.7	1.2	1.2
Domestic demand contribution	1.9	2.6	2.3	2.4	1.3	1.3	1.1
External demand contribution	0.1	0.3	0.0	-0.6	0.4	-0.1	0.1
Private consumption contribution	1.2	1.3	1.7	2.0	1.2	0.7	0.5
Private investment contribution	0.5	0.7	0.6	0.4	0.6	0.2	0.5
Public spending contribution	0.0	0.4	0.3	0.1	0.0	0.2	0.2
Domestic demand (% YoY, average)	2.0	3.6	2.4	2.4	1.3	1.3	1.1
Total consumption (% YoY, average)	1.5	2.1	2.4	2.7	1.4	1.1	0.8
Private investment (% YoY, average)	3.4	7.3	3.4	2.3	3.4	1.0	2.7
Exports (YoY in %)	1.5	2.3	4.5	1.0	5.4	-0.3	2.2
Imports (YoY in %)	3.2	3.8	5.5	3.3	3.3	-0.3	1.7
Unemployment rate (% , last quarter)	7.2	5.7	5.1	4.8	4.4	4.0	4.1
Inflation (% YoY, last quarter)	2.1	0.9	0.1	1.2	3.0	2.2	1.2
Fiscal balance (% of GDP)	-5.3	-5.4	-4.2	-2.9	-1.9	-1.8	-1.6
Trade balance (% of GDP)	-6.8	-6.6	-6.2	-6.7	-6.7	-6.4	-6.1
Tax boost (% of GDP)	-2.5	-2.7	-2.0	-0.5	0.8	0.8	1.0
Current account balance (% of GDP)	-5.2	-4.9	-4.9	-5.2	-3.9	-3.3	-2.3
Official interest rate (end of period)	0.50	0.50	0.50	0.25	0.41	0.60	0.57
Short-term rate (end of period)	0.53	0.56	0.59	0.37	0.52	0.66	0.64
Long-term rate (end of period)	3.05	1.82	2.02	1.28	1.25	1.30	1.64
Exchange rate vs. USD (end of period)	1.65	1.56	1.48	1.23	1.35	1.35	1.41
Exchange rate vs. euro (end of period)	1.20	1.28	1.36	1.17	1.13	1.14	1.13
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	1.2	2.1	3.3	4.4	4.5	2.7	3.4
P.S. non-financial lending (% YoY, average)	-1.2	-3.3	-1.9	6.2	6.1	8.3	2.3
P.S. financial lending (% YoY, average)	3.8	-9.1	-13.6	7.4	11.9	4.4	4.8
Savings rate (% , average)	8.6	8.6	9.4	6.8	4.4	4.5	4.7

Source: MAPFRE Economic Research (based on Office for National Statistics data)
Forecasting end date: October 11, 2018.

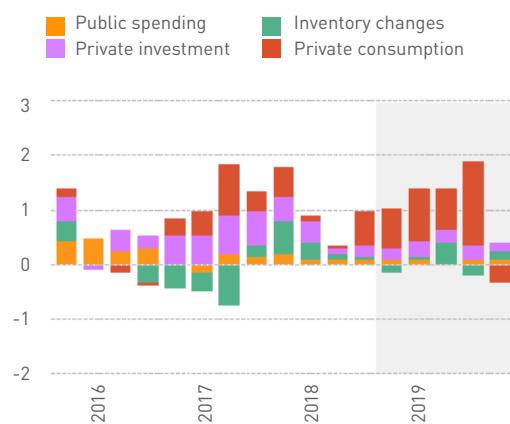
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Chart 1.2.7-a
Japan: GDP breakdown
and forecast



Source: MAPFRE Economic Research (based on Statistics Bureau data)

Chart 1.2.7-b
Japan: domestic demand
breakdown and forecast



Source: MAPFRE Economic Research (based on Statistics Bureau data)

Table 1.2.7
Japan: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	2.0	0.3	1.4	1.0	1.7	0.9	0.9
Domestic demand contribution	2.4	-0.3	1.0	0.4	1.2	0.8	1.1
External demand contribution	-0.4	0.6	0.4	0.6	0.6	0.2	-0.2
Private consumption contribution	1.4	-0.5	0.0	0.0	0.6	0.4	0.7
Private investment contribution	1.1	0.4	0.4	0.3	0.6	0.2	0.3
Public spending contribution	0.3	0.1	0.3	0.3	0.1	0.1	0.1
Domestic demand (% YoY, average)	2.4	0.3	1.0	0.4	1.2	0.8	1.1
Total consumption (% YoY, average)	2.1	-0.6	0.4	0.4	0.8	0.6	1.1
Private investment (% YoY, average)	5.0	3.0	1.8	1.2	2.5	0.9	1.1
Exports (YoY in %)	0.9	9.3	3.0	1.7	6.7	4.0	2.4
Imports (YoY in %)	3.3	8.4	0.7	-1.6	3.4	3.3	2.7
Unemployment rate (% last quarter)	3.9	3.5	3.3	3.1	2.7	2.5	2.5
Inflation (% YoY, last quarter)	1.5	2.5	0.2	0.3	0.6	0.5	2.0
Fiscal balance (% of GDP)	-7.6	-5.4	-3.6	-3.4	-3.5	-3.5	-3.5
Trade balance (% of GDP)	-1.7	-2.0	-0.2	1.0	0.9	0.7	0.6
Tax boost (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	0.9	0.8	3.1	3.8	4.0	3.7	3.8
Official interest rate (end of period)	0.07	0.07	0.04	-0.06	-0.06	-0.15	-0.47
Short-term rate (end of period)	0.15	0.11	0.08	-0.05	-0.02	-0.13	-0.45
Long-term rate (end of period)	0.74	0.33	0.27	0.04	0.05	0.07	-0.33
Exchange rate vs. USD (end of period)	105.25	119.85	120.27	116.78	112.69	108.93	108.19
Exchange rate vs. euro (end of period)	145.15	145.51	130.94	123.10	135.15	129.63	135.24
Private lending (% YoY, average)	3.5	2.2	2.1	2.2	4.5	3.3	3.3
Household lending (% YoY, average)	1.1	0.8	1.2	1.3	1.8	2.2	0.6
P.S. non-financial lending (% YoY, average)	0.0	0.4	0.5	2.1	2.6	1.6	1.9
P.S. financial lending (% YoY, average)	3.7	8.5	7.7	-0.3	7.9	3.3	1.3
Savings rate (% average)	0.3	-0.4	0.8	2.6	2.6	3.4	2.6

Source: MAPFRE Economic Research (based on Statistics Bureau data)
Forecasting end date: October 11, 2018.

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Also, the employment creation trend and economic activity are being maintained. Unemployment in the Japanese economy is very low (2.5% in August) and wage pressure is contained (+0.9% YoY). Inflation remains moderate (+1.3% in August), driven mainly by energy prices (+3.4%), fuel prices (+22.2%) and food prices (+2.0%).

In the short term, it is likely that monetary policy will remain expansive in the absence of any offsetting inflationary pressures, with the aim of returning the first season of the sovereign curve to visibly positive territory. Hence, the Bank of Japan will continue with its heterodox monetary policy (focusing on the yield curve and not on the inflation target) in order to protect its financial system.

At its September meeting, the Bank of Japan maintained the current monetary policy. The two reflationary members of the Policy Board continued to oppose the previous month's decision to increase flexibility around controls on yield curves. We believe it is very likely that the current monetary policy framework will be maintained for a long period of time. At its July meeting, the Bank of Japan had introduced a guide to the future that links with the potential effects of the increase in sales tax scheduled for October 2019. We believe this indicates that the central bank is mindful of its joint declaration with the government (January 2013) and shares the economic policy views of Prime Minister Shinzō Abe's administration.

The Liberal Democratic Party (LDP) held its internal elections on September 20 and Abe was elected for a third and final term. It is expected that Abe's government will go ahead with the sales tax increase in October 2019 as planned, with the aim of fulfilling the promise made by the LDP in the 2017 general election to use the revenue from the tax increase to fund public primary education.

1.2.8 Turkey

The medium-term plan for control and moderation of the economy seem credible

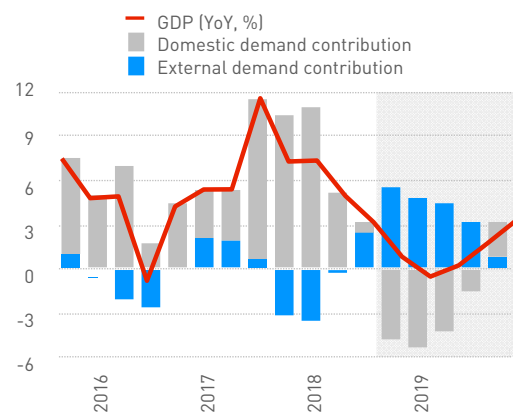
The Turkish government appears to have opted for slower growth as the least damaging way of getting out of the crisis, which reached its climax in August when the currency plummeted 18% in a single day. For 2018, growth is estimated at 4.1% (7.4% in 2017), while in 2019 it could be around 1.2% (see Table 1.2.8 and Charts 1.2.8-a and 1.2.8-b).

- The Turkish government has committed itself to a policy of adjustment that the markets have judged to be realistic.
- In spite of this, Turkey will enter into a recession between 2018 and 2019.

The economic projections announced in the Medium-Term Program are relatively optimistic. However, the revisions to the figures on economic activity are proof of the government's willingness to try to put an end (through fiscal and monetary policies) to the causes of its current crisis, that is, to reduce the past excess of stimuli that led to excessive demand. In this way, it aims to correct the vulnerabilities shown by the Turkish balance of payments. This appears to be possible only now that President Recep Erdoğan has secured power and a lower level of economic activity in the country can be permitted.

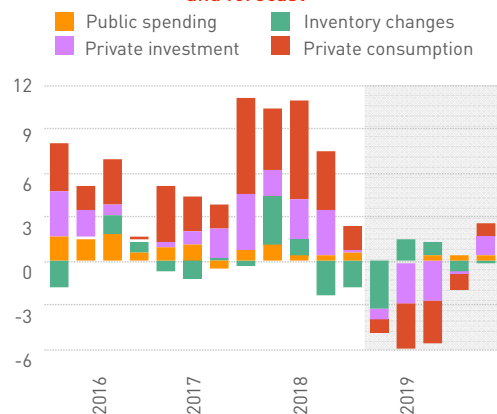
In addition, the hike in inflation caused by exchange rates and the tightening of financial conditions (including substantial increases in official interest rates) is also expected to depress domestic demand. Inflation could approach 30% at the beginning of the year as a result of the depreciation of the currency, but the pressures will gradually diminish as the economy enters into recession.

Chart 1.2.8-a
Turkey: GDP breakdown
and forecast



Source: MAPFRE Economic Research (based on TURKSTAT data)

Chart 1.2.8-b
Turkey: domestic demand breakdown
and forecast



Source: MAPFRE Economic Research (based on TURKSTAT data)

Table 1.2.8
Turkey: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	8.5	5.3	6.0	3.3	7.4	4.1	1.2
Domestic demand contribution	10.3	3.4	5.5	4.6	7.1	3.0	-2.2
External demand contribution	-1.8	1.9	0.5	-1.3	0.4	1.0	3.4
Private consumption contribution	4.9	1.9	3.4	2.2	3.7	2.9	-1.8
Private investment contribution	3.8	1.3	2.7	0.7	2.1	1.3	-1.1
Public spending contribution	1.1	0.4	0.5	1.3	0.7	0.4	0.3
Domestic demand (% YoY, average)	10.1	3.2	5.4	4.5	6.9	3.1	-2.1
Total consumption (% YoY, average)	7.9	3.0	5.1	4.7	5.9	4.5	-2.0
Private investment (% YoY, average)	14.0	5.5	9.1	2.4	7.2	4.5	-3.6
Exports (YoY in %)	1.4	8.3	4.3	-1.7	12.1	6.3	11.2
Imports (YoY in %)	8.0	-0.3	1.8	3.7	10.2	1.5	-3.2
Unemployment rate (% , last quarter)	9.3	10.7	10.5	12.1	10.3	12.0	10.6
Inflation (% YoY, last quarter)	7.5	8.8	8.2	7.6	12.3	19.4	16.2
Fiscal balance (% of GDP)	-1.1	-1.1	-1.1	-1.3	-1.6	-2.6	-1.7
Trade balance (% of GDP)	-8.4	-6.8	-5.6	-4.7	-6.9	-8.5	-5.2
Tax boost (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-6.7	-4.7	-3.7	-3.8	-5.6	-6.6	-2.4
Official interest rate (end of period)	7.10	8.51	8.81	8.31	12.75	24.00	22.00
Short-term rate (end of period)	9.12	9.79	11.47	9.90	14.61	24.08	22.59
Long-term rate (end of period)	10.20	7.96	10.74	11.40	11.72	22.44	19.43
Exchange rate vs. USD (end of period)	2.15	2.33	2.92	3.52	3.79	7.01	6.10
Exchange rate vs. euro (end of period)	2.96	2.83	3.18	3.71	4.55	8.35	7.63
Private lending (% YoY, average)	28.8	23.2	23.0	12.8	20.6	20.4	5.9
Household lending (% YoY, average)	24.0	16.3	12.5	7.1	17.5	11.2	7.6
P.S. non-financial lending (% YoY, average)	31.1	30.1	29.9	14.7	24.3	23.3	13.4
P.S. financial lending (% YoY, average)	24.3	22.4	26.4	9.0	27.2	35.7	19.4
Savings rate (% , average)	23.3	26.2	28.3	32.8	30.9	29.5	29.0

Source: MAPFRE Economic Research (based on TURKSTAT data)
Forecasting end date: October 11, 2018.

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As a result, we are projecting a visible adjustment and expect an economic contraction that will lead to a slowdown throughout 2019, which will place GDP growth at one third of potential in average terms over the course of that year (1.2%).

1.2.9 Mexico

The USMCA is restoring composure to the markets

The Mexican economy grew by 2.6% in the second quarter of 2018, due to an acceleration in exports and investment, although private consumption also supported activity with growth of 3.0%.

However, for 2018 we are moderating our expectations to an average GDP growth of 1.9% (see Table 1.2.9 and Charts 1.2.9-a and 1.2.9-b).

- **The Mexican economy performed well in the second quarter of the year, although its expectations for 2018 are moderating.**
- **The inflation surprise of September (5%) will surely influence the direction of monetary policy.**
- **The USMCA (new NAFTA) is restoring composure and stabilizing the currency at around 19 USD/MXN.**

Inflation, meanwhile, stood at 5% in September (with the underlying rate at 3.7%), higher than expected and far from the central bank's target of 3%. We expect it to end the fourth quarter of 2018 at 4.4%. This value is still high, and is mainly caused by second-round effects on food and services in general, due to the persistence of high energy prices (+19%) and prices regulated by the government (+5.4%). This will undoubtedly influence monetary policy decisions in the coming months.

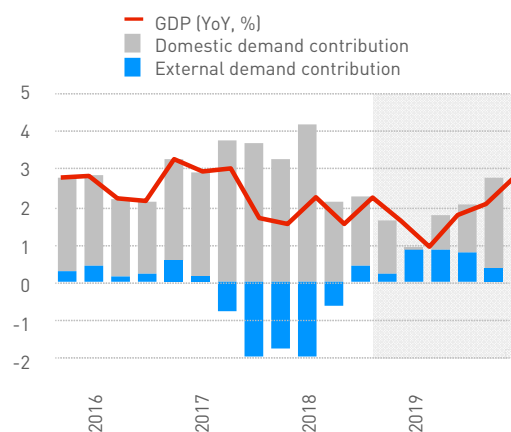
At its last meeting on October 4, the Bank of Mexico maintained the base rate at 7.75%, arguing that the shocks that have affected inflation are transitory in nature and that the expected trend for underlying inflation is downward. This argument could be abandoned if energy prices remain high.

The Mexican peso recovered from June onward, finding an apparent equilibrium around the current level of 19 USD/MXN. The Mexican stock exchange's IPC index has fallen by 2% so far this year (in euros it is down by 6%).

On August 27, Mexico and the United States reached a pre-agreement for the new trade treaty, while Canada joined the agreement on September 30 (on the last day of the allowed period). The new trade treaty, which will replace the NAFTA, will be known as the United States-Mexico-Canada Agreement (USMCA).

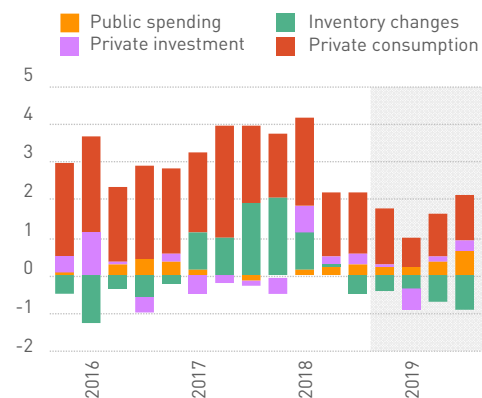
In addition, the new congress with a majority for the Morena party (led by Andrés Manuel López Obrador) became operational on September 1, and the new administration will take office on December 1. Until now, President-elect Andrés Manuel López Obrador has supported various market-friendly policies, such as the renegotiation of NAFTA, central bank autonomy, fiscal discipline and continuation of the current exchange rate regime. He also appears to have relaxed his opposition in relation to controversial issues, such as the energy reform implemented by the outgoing administration and the construction of a new airport in Mexico City.

Chart 1.2.9-a
Mexico: GDP breakdown
and forecast



Source: MAPFRE Economic Research (based on INEGI data)

Chart 1.2.9-b
Mexico: domestic demand breakdown
and forecast



Source: MAPFRE Economic Research (based on INEGI data)

Table 1.2.9
Mexico: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	1.6	2.8	3.3	2.6	2.3	1.9	1.9
Domestic demand contribution	2.1	2.0	2.5	2.3	3.4	2.4	1.2
External demand contribution	-0.4	0.8	0.8	0.4	-1.1	-0.4	0.7
Private consumption contribution	1.3	1.4	1.8	2.3	2.2	1.8	1.2
Private investment contribution	-0.7	0.3	1.1	0.2	-0.3	0.3	0.2
Public spending contribution	0.1	0.3	0.2	0.3	0.0	0.2	0.6
Domestic demand (% YoY, average)	2.0	2.5	2.5	2.3	3.4	2.4	1.2
Total consumption (% YoY, average)	1.8	2.2	2.6	3.3	2.8	2.6	2.2
Private investment (% YoY, average)	-3.3	3.0	5.1	1.1	-1.5	1.5	0.8
Exports (YoY in %)	1.3	6.9	8.6	3.5	3.9	4.5	3.6
Imports (YoY in %)	2.6	5.9	6.0	2.4	7.0	5.6	1.5
Unemployment rate (% , last quarter)	4.6	4.4	4.2	3.5	3.3	3.6	3.8
Inflation (% YoY, last quarter)	3.7	4.2	2.3	3.2	6.6	4.4	3.3
Fiscal balance (% of GDP)	-2.3	-3.1	-3.4	-2.5	-1.1	-2.4	-2.7
Trade balance (% of GDP)	-0.1	-0.2	-1.2	-1.2	-1.0	-1.7	-2.0
Tax boost (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-2.4	-1.9	-2.6	-2.2	-1.7	-1.9	-1.2
Official interest rate (end of period)	3.50	3.00	3.25	5.75	7.25	7.70	5.86
Short-term rate (end of period)	3.41	2.92	3.29	5.87	7.31	8.06	5.58
Long-term rate (end of period)	6.40	5.79	6.28	7.42	7.66	7.46	6.04
Exchange rate vs. USD (end of period)	13.04	14.74	17.20	20.74	19.67	19.04	18.05
Exchange rate vs. euro (end of period)	17.99	17.90	18.73	21.86	23.59	22.65	22.56
Private lending (% YoY, average)	13.9	10.8	13.6	16.3	12.1	13.8	6.7
Household lending (% YoY, average)	9.1	8.1	8.4	12.8	9.9	7.8	4.9
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	15.4	9.8	-11.4	3.5	1.7	1.3	15.7
Savings rate (% , average)	15.0	13.8	14.6	12.8	10.8	11.4	10.7

Source: MAPFRE Economic Research (based on INEGI data)
Forecasting end date: October 11, 2018.

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1.2.10 Brazil

Elections and urgent structural reforms

Brazilian GDP growth slowed to 1.0% YoY in the second quarter, strongly influenced by the truck drivers' strike in May that paralyzed parts of trade and industry. The ports substantially reduced their activity, and this was reflected in exports, which fell by 2.9%. Consumption growth fell to 1.7% from 2.8%. For 2018, we have revised GDP growth downward to 1.0% due to the rise in oil prices and the depreciation of the real (see Table 1.2.10 and Charts 1.2.10-a and 1.2.10-b).

- The truck drivers' strike in May affected the growth of the Brazilian economy in the second quarter.
- J. Bolsonaro's victory in the first round reassured the markets.
- Regardless of the outcome of the second round, the Congress will continue to be dominated by the centrist parties.

At its meeting on September 19, the central bank kept the SELIC rate at 6.50% because it believes that the context still requires an accommodative monetary policy stance, although the monetary stimulus will begin to be phased out in the event of any deterioration of the inflation outlook. The fiscal deficit improved, ending at 7.0% in July (1.1% of the primary deficit).

Inflation (IPCA), meanwhile, stood at 4.5% in September, with fuels (+18%) and electricity (+20%) representing the main upward pressures, while food prices rose by only 2.7%.

In the first round of the presidential elections held on October 7, the right-wing candidate Jair Bolsonaro (PSL) took first place with 46% of the votes, and will be pitted in the second round on October 28 against Fernando Haddad (PT), who gained 29.3%. The result of the elections will be crucial for Brazil, in light of the urgent structural reforms.

1.2.11 Argentina

Economy in recession during the coming quarters

The Argentinian economy contracted by 4.2% in the second quarter due to problems in the agricultural sector, drought and flooding. Exports fell by 7.5%, private consumption stagnated, and government spending is in the process of being decreased.

In the second half of the year, there was a sharp slowdown in the economy due to the strong depreciation of the peso and the rises in interest rates applied by the central bank. The hike in energy prices will affect inflation, confidence and consumption. Exports will also be affected by the fall in agricultural production.

- In August, Argentina asked the IMF for additional aid of USD 7.1 billion to maintain liquidity until the end of 2019.
- The government will have to fix the deficit in order to be able to return to the markets in 2020.
- Harder monetary conditions will be necessary to decrease capital outflows and balance the country's current account.
- New central bank base interest rates.

Table 1.2.10

Brazil: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	3.0	0.5	-3.6	-3.4	1.0	1.0	2.2
Domestic demand contribution	4.0	0.5	-7.2	-5.4	1.1	1.6	2.5
External demand contribution	-1.0	0.0	3.6	2.0	-0.1	-0.6	-0.3
Private consumption contribution	2.3	1.5	-2.2	-3.0	0.6	1.0	1.1
Private investment contribution	1.2	-0.8	-2.9	-1.9	-0.3	0.6	0.7
Public spending contribution	0.3	0.1	-0.2	0.0	-0.1	0.0	0.0
Domestic demand (% YoY, average)	3.7	0.2	-6.7	-5.1	1.1	1.6	2.4
Total consumption (% YoY, average)	3.1	2.0	-2.8	-3.5	0.6	1.2	1.3
Private investment (% YoY, average)	5.8	-4.1	-14.0	-10.1	-1.8	3.4	4.0
Exports (YoY in %)	2.7	-0.8	6.9	1.8	5.7	2.6	6.0
Imports (YoY in %)	6.9	-1.9	-14.1	-9.4	5.6	5.9	6.7

Unemployment rate (% last quarter)	6.2	6.5	9.0	12.0	11.8	12.0	10.5
Inflation (% YoY, last quarter)	5.8	6.5	10.4	7.0	2.8	4.5	4.5
Fiscal balance (% of GDP)	-3.0	-6.0	-10.2	-9.0	-7.8	-8.1	-7.2
Trade balance (% of GDP)	0.0	-0.3	1.0	2.5	3.1	3.0	2.4
Tax boost (% of GDP)	1.7	-0.5	-1.8	-2.4	-1.7	-2.1	-1.8
Current account balance (% GDP)	-3.0	-4.2	-3.3	-1.3	-0.5	-1.0	-1.5

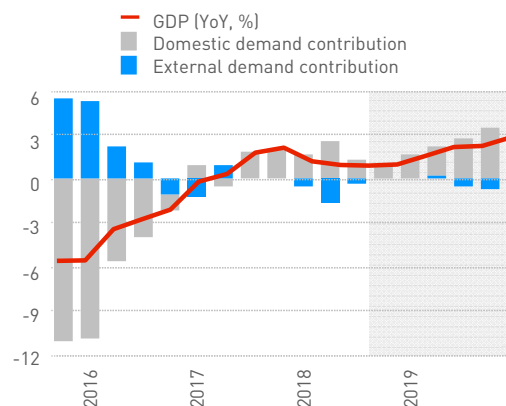
Official interest rate (end of period)	9.63	11.32	14.25	13.97	7.58	6.64	7.94
Short-term rate (end of period)	9.90	11.65	14.15	13.65	6.90	6.75	8.57
Long-term rate (end of period)	13.05	12.25	16.10	11.36	10.24	11.60	9.74
Exchange rate vs. USD (end of period)	2.35	2.66	3.90	3.26	3.31	4.34	3.77
Exchange rate vs. euro (end of period)	3.25	3.22	4.25	3.43	3.97	5.17	4.71

Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	16.4	14.0	9.9	4.3	4.6	7.2	12.4
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (% average)	22.9	20.3	18.2	17.8	18.9	19.5	19.7

MAPFRE Economic Research (based on Brazilian Institute of Geography and Statistics (IBGE) data)
Forecasting end date: October 11, 2018.

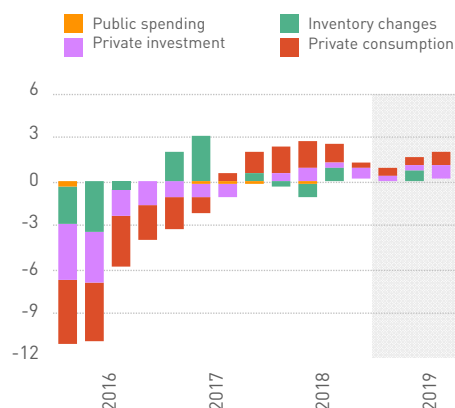
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Chart 1.2.10-a
Brazil: GDP breakdown
and forecast



Source: MAPFRE Economic Research (based on Brazilian Institute of Geography and Statistics (IBGE) data)

Chart 1.2.10-b
Brazil: domestic demand
breakdown and forecast



Source: MAPFRE Economic Research (based on Brazilian Institute of Geography and Statistics (IBGE) data)

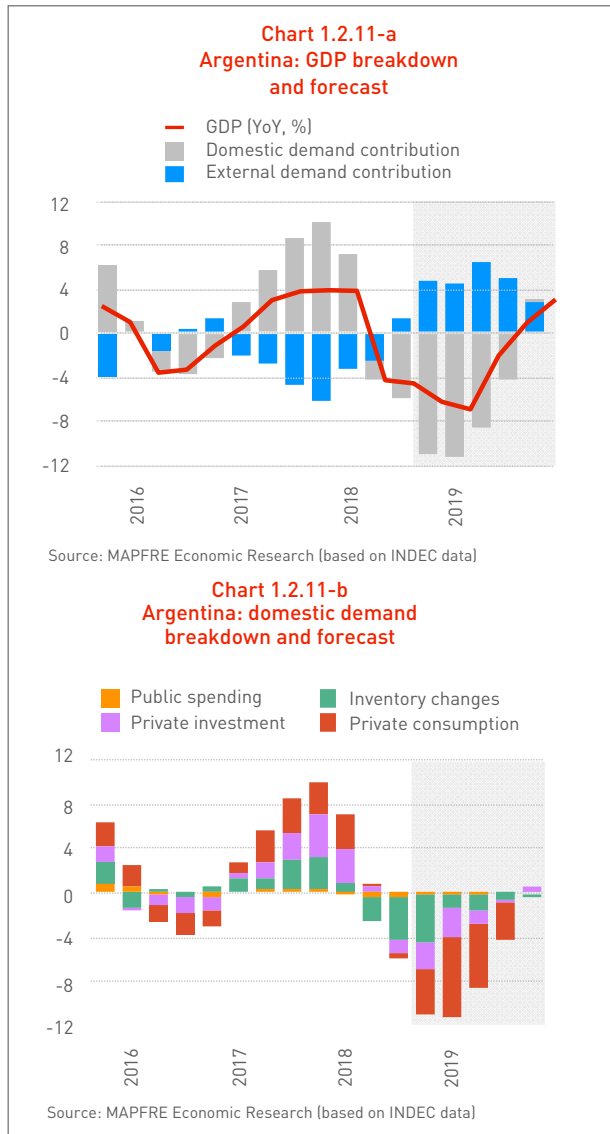


Table 1.2.11
Argentina: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	2.4	-2.5	2.7	-1.7	2.8	-2.8	-1.2
Domestic demand contribution	4.1	-4.0	4.0	-1.8	6.8	-2.9	-5.9
External demand contribution	-1.8	1.5	-1.3	0.1	-4.0	0.2	4.7
Private consumption contribution	2.6	-3.1	2.5	-0.7	2.5	-0.3	-4.0
Private investment contribution	0.5	-1.2	0.7	-0.9	2.1	-0.1	-0.9
Public spending contribution	0.6	0.4	0.9	0.0	0.3	-0.2	-0.1
Domestic demand (% YoY, average)	4.0	-3.6	3.8	-1.7	6.4	-2.6	-5.3
Total consumption (% YoY, average)	3.9	-3.2	4.1	-0.8	3.3	-0.7	-4.6
Private investment (% YoY, average)	2.5	-6.6	3.4	-4.8	10.8	0.3	-4.2
Exports (YoY in %)	-3.9	-6.2	-2.3	6.1	1.0	-0.2	7.5
Imports (YoY in %)	3.7	-9.7	3.6	4.4	15.9	-0.1	-10.4
Unemployment rate (% last quarter)	6.4	6.9	7.0	7.6	7.2	7.6	8.2
Inflation (% YoY, last quarter)	31.2	44.2	26.0	39.3	23.3	43.6	27.5
Fiscal balance (% of GDP)	-3.5	-4.8	-5.9	-5.8	-6.0	-5.9	-6.1
Trade balance (% of GDP)	0.8	1.0	-0.1	0.8	-0.9	-0.4	2.3
Tax boost (% of GDP)	-2.1	-3.2	-3.9	-4.1	-3.7	-2.5	-0.5
Current account balance (% of GDP)	-2.1	-1.6	-2.7	-2.7	-4.9	-5.6	-3.9
Official interest rate (end of period)	17.65	25.33	33.00	24.75	28.75	72.20	40.00
Short-term rate (end of period)	11.00	16.00	26.00	26.75	30.75	82.00	42.00
Long-term rate (end of period)	11.12	9.36	6.65	7.00	5.91	9.80	9.05
Exchange rate vs. USD (end of period)	6.52	8.55	13.04	15.89	18.65	41.80	50.20
Exchange rate vs. euro (end of period)	8.99	10.38	14.20	16.75	22.37	48.07	62.75
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (% average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: MAPFRE Economic Research (based on INDEC data)
Forecasting end date: October 11, 2018.

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The tensions on the foreign exchange markets in August forced the government to ask for fresh support from the International Monetary Fund (IMF) and led to a change of governor of the central bank. The IMF demonstrated its commitment to Argentina by bringing forward the funding provided for by the previous program (USD 50 billion) and increasing the program by a further USD 7.1 billion. This new program significantly reduces the likelihood of a sovereign debt default, since the country's funding needs are covered until the end of 2019. In 2020, the country should be able to return to the markets. In return, the government has to achieve primary fiscal equilibrium in 2019 (in 2018 the deficit will still be 2.6%).

Inflation, meanwhile, stood at 34.4% in August. One of the commitments made to the IMF is to control inflation by controlling the money supply, and also that the central bank will not directly finance the Treasury.

The tightening of monetary conditions will be able to control inflation. However, this tightening, together with the devaluation of the currency and lower levels of confidence, will penalize consumption and levels of activity in the short term. We anticipate an economic contraction of 2.1% in 2018, with the recession extending until at least the first quarter of 2019 (see Table 1.2.11 and Charts 1.2.11-a and 1.2.11-b).

October 1 saw the debut of the new benchmark interest rate, the 7-day LELIQ, which is set daily with the aim of allowing the central bank to influence short-term rates. The rate currently stands at 72.6% after falling from a high of 73.5%.

1.2.12 China

Tackling the tariff war against a more moderate backdrop

The momentum of economic growth in China was maintained in August, supported by slightly stronger investment and increased consumption.

Despite the softening of monetary policy announced in the second quarter, we

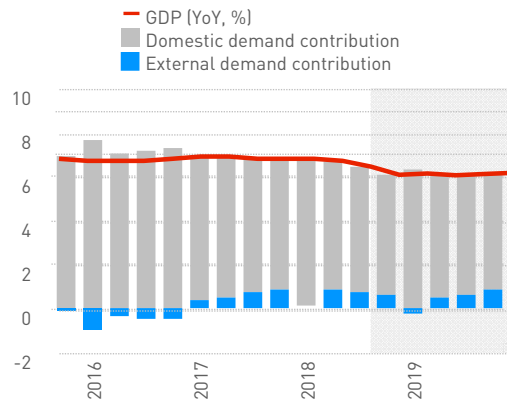
expect growth to slow down in the coming months and in 2019. The slow growth of credit and the trade conflict with the United States will contribute to this.

That being said, with the domestic economy performing reasonably well so far and the government taking measures to support growth, the slowdown should put average GDP growth around 6.5% in 2018 and a little above 6% in 2019 (see Table 1.2.12 and Charts 1.2.12-a and 1.2.12-b).

It is important to note that the slowdown in credit and the downward pressure on activity in general also weigh on the renminbi, which has depreciated in a controlled manner over the past few months. The depreciation of the renminbi, together with the central bank's more aggressive management of the balance sheet, are possible tools for dealing with the tariff escalation with the United States.

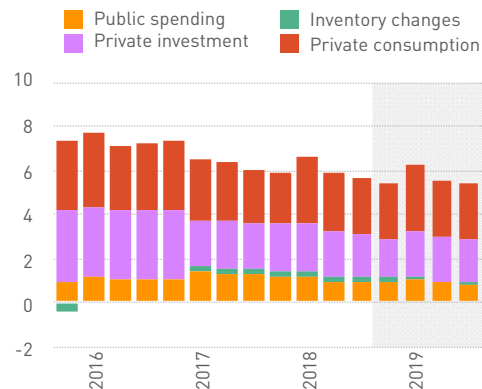
- For the moment, economic activity in China is being maintained, although non-banking credit has slowed sharply.
- Active policy on the renminbi to tackle the tariff escalation driven by the United States.

Chart 1.2.12-a
China: GDP breakdown
and forecast



Source: MAPFRE Economic Research (based on BoPRC data)

Chart 1.2.12-b
China: domestic demand
breakdown and forecast



Source: MAPFRE Economic Research (based on BoPRC data)

Table 1.2.12
China: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	7.8	7.3	6.9	6.7	6.9	6.5	6.1
Domestic demand contribution	7.9	5.7	6.9	7.3	6.2	5.9	5.7
External demand contribution	-0.1	1.6	0.0	-0.6	0.6	0.6	0.4
Private consumption contribution	3.0	3.1	3.1	3.1	2.6	2.7	2.7
Private investment contribution	4.2	2.2	3.4	3.1	2.1	1.9	2.0
Public spending contribution	0.6	0.4	0.9	1.2	1.3	1.0	0.9
Domestic demand (% YoY, average)	8.1	7.2	7.1	7.5	6.4	6.0	5.8
Total consumption (% YoY, average)	7.2	7.1	8.0	8.6	7.6	7.2	6.9
Private investment (% YoY, average)	9.3	6.9	7.4	6.7	4.6	4.3	4.5
Exports (YoY in %)	8.3	5.4	0.5	1.8	6.7	4.4	3.4
Imports (YoY in %)	10.6	7.7	0.6	3.2	8.4	6.8	5.8
Unemployment rate (% last quarter)	4.1	4.1	4.1	4.0	3.9	4.0	4.0
Inflation (% YoY, last quarter)	2.9	1.5	1.5	2.2	1.8	2.3	1.8
Fiscal balance (% of GDP)	-1.8	-1.8	-3.4	-3.8	-3.7	-3.9	-3.9
Trade balance (% of GDP)	3.7	4.2	5.3	4.4	3.9	2.9	2.6
Tax boost (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	1.5	2.3	2.8	1.8	1.3	0.3	0.3
Official interest rate (end of period)	5.40	4.96	2.32	2.59	3.09	2.88	2.73
Short-term rate (end of period)	7.50	5.75	3.05	4.25	5.53	3.72	3.22
Long-term rate (end of period)	4.55	3.63	2.82	3.05	3.91	3.57	3.24
Exchange rate vs. USD (end of period)	6.05	6.20	6.49	6.94	6.51	6.73	6.33
Exchange rate vs. euro (end of period)	8.35	7.53	7.07	7.32	7.80	8.00	7.91
Private lending (% YoY, average)	15.4	13.4	14.8	13.3	10.5	11.4	9.6
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (% average)	39.8	39.7	39.3	38.4	38.6	38.3	38.1

Source: MAPFRE Economic Research (based on BoPRC data)
Forecasting end date: October 11, 2018.

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1.2.13 Indonesia

Tightening of monetary conditions and slowing of growth

We expect solid growth in the Indonesian economy of 5.0% in 2018 and 4.7% in 2019, with inflation at around 3.7% for the next two years (see Table 1.2.13 and Charts 1.2.13-a and 1.2.13-b).

The Bank of Indonesia has increased interest rates by 150 bps so far this year, putting them at 5.75%, with the objective of stabilizing the currency in a context of rising interest rates in dollars. The increase in the real cost of financing may curb demand for imports for consumption. We expect an additional rise of 25 bps in interest rates this year, bringing them to 6.0% at the end of the year.

A higher deficit in the current account balance and a fall in the financial account surplus in 2018 resulted in a decrease of USD 17 billion in international reserves between January and September 2018. At the same time, the Indonesian rupiah (IDR) depreciated by more than 10% against the dollar.

Although it is likely that the deficits will persist next year, greater pressure on the balance of payments is not anticipated. The policy responses will help to reduce imbalances and safeguard the stability of

- **The deficit in the current account balance is widening and capital inflows are decreasing.**
- **It is not expected that the deficit will become an acute risk or a structural challenge for Indonesia's economy.**
- **The policy responses for mitigating the imbalances will give rise to slower economic growth.**

the external sector, but may also reduce growth. The recent worsening of the current account deficit was due in part to the government's fuel investment and subsidies policy, and should therefore be reversible. In addition, government initiatives to reschedule the main infrastructure projects, as well as to curb imports of some consumer and capital goods and crude oil, should slow the growth of imports and strengthen the position of the current account balance.

1.2.14 Philippines

Strong growth supported by spending, public investment and exports

The Philippine economy grew by 6% in the second quarter, and although it has slowed slightly, it remains above the average of the past 10 years (5.7%), driven by public investment and by public and private spending. Exports grew by 13%, and imports by 20%. The government has an infrastructure spending and investment plan that will represent 6% of GDP next year. Our forecast for growth is 6.3% in 2018 and 6.4% in 2019 (see Table 1.2.14 and Charts 1.2.14-a and 1.2.14-b).

- **Strong domestic activity and external demand.**
- **The infrastructure plan, government spending and exports are supporting the growth of the Philippine economy.**
- **The risks to continuing growth come from monetary tightening and a slowdown in the external context.**

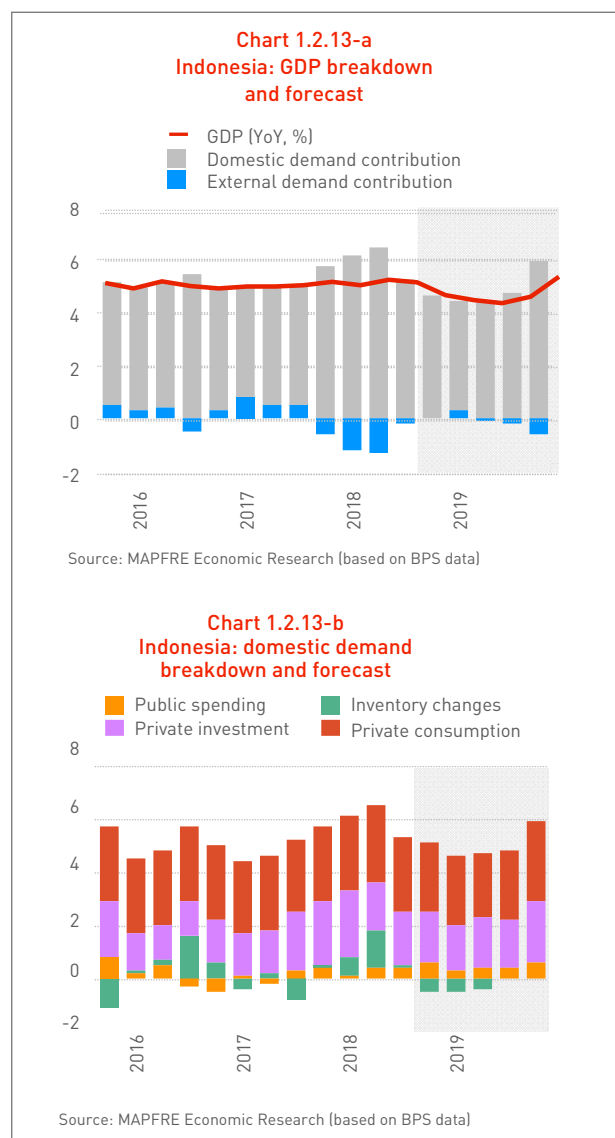


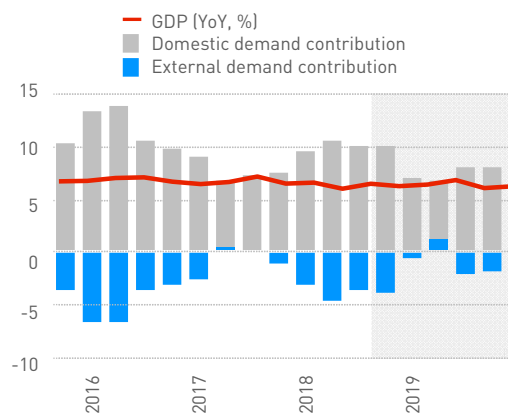
Table 1.2.13
Indonesia: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	5.6	5.0	4.9	5.0	5.1	5.0	4.7
Domestic demand contribution	5.0	4.6	3.9	4.9	4.7	5.7	4.8
External demand contribution	0.6	0.4	0.9	0.2	0.4	-0.6	-0.1
Private consumption contribution	3.0	2.9	2.7	2.8	2.8	2.8	2.7
Private investment contribution	1.6	1.0	1.6	1.5	2.0	2.1	2.0
Public spending contribution	0.6	0.1	0.5	0.0	0.2	0.4	0.4
Domestic demand (% YoY, average)	5.0	5.3	4.0	4.9	4.8	5.8	4.9
Total consumption (% YoY, average)	5.6	4.7	4.9	4.4	4.6	5.0	4.9
Private investment (% YoY, average)	5.1	4.5	5.0	4.5	6.1	6.4	6.0
Exports (YoY in %)	4.1	1.3	-2.1	-1.6	9.2	5.5	5.2
Imports (YoY in %)	2.0	2.2	-6.2	-2.5	8.1	9.4	6.1
Unemployment rate (% , last quarter)	5.7	5.9	5.8	5.5	5.3	5.4	5.0
Inflation (% YoY, last quarter)	8.0	6.5	4.8	3.3	3.5	3.6	3.7
Fiscal balance (% of GDP)	-2.2	-2.2	-2.6	-2.5	-2.6	-2.3	-2.2
Trade balance (% of GDP)	0.6	0.8	1.6	1.6	1.8	0.9	1.3
Tax boost (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-3.2	-3.1	-2.0	-1.8	-1.7	-2.29	-2.35
Official interest rate (end of period)	6.25	6.50	6.25	4.75	4.25	5.95	5.70
Short-term rate (end of period)	7.84	7.17	8.86	7.46	5.48	7.58	7.57
Long-term rate (end of period)	8.71	7.86	8.81	7.85	6.30	8.68	8.20
Exchange rate vs. USD (end of period)	12,160	12,427	13,836	13,525	13,484	15,138	14,378
Exchange rate vs. euro (end of period)	16,770	15,088	15,063	14,257	16,171	18,015	17,972
Private lending (% YoY, average)	21.9	15.2	10.6	7.8	8.2	9.8	9.3
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	16.9	4.4	32.0	10.1	15.1	3.4	3.7
Savings rate (% , average)	17.1	17.0	17.0	17.0	17.0	17.4	17.9

Source: MAPFRE Economic Research (based on BPS data)
Forecasting end date: October 11, 2018.

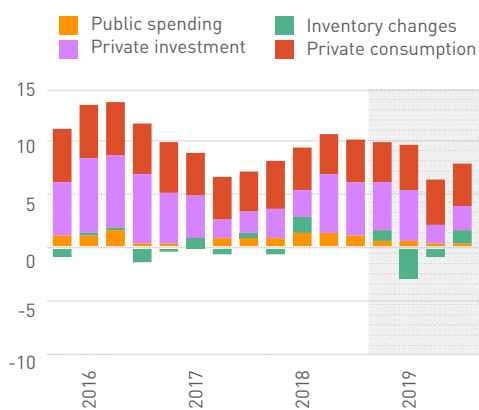
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Chart 1.2.14-a
Philippines: GDP breakdown and forecast



Source: MAPFRE Economic Research (based on PSA data)

Chart 1.2.14-b
Philippines: domestic demand breakdown and forecast



Source: MAPFRE Economic Research (based on PSA data)

Table 1.2.14
Philippines: main macroeconomic aggregates

	2013	2014	2015	2016	2017	2018	2019
GDP (% YoY, average)	7.1	6.1	6.0	6.9	6.7	6.3	6.4
Domestic demand contribution	9.8	4.8	9.1	11.9	7.5	10.1	7.2
External demand contribution	-2.7	1.3	-3.0	-5.0	-0.8	-3.8	-0.8
Private consumption contribution	4.0	3.9	4.4	4.9	4.1	3.9	4.2
Private investment contribution	2.4	1.1	3.6	6.2	2.7	4.4	2.8
Public spending contribution	0.6	0.3	0.8	0.9	0.7	1.2	0.5
Domestic demand (% YoY, average)	9.9	5.0	9.0	11.5	6.9	9.3	6.4
Total consumption (% YoY, average)	5.6	5.2	6.5	7.4	6.0	6.4	6.0
Private investment (% YoY, average)	12.0	7.2	16.6	26.6	9.5	15.6	8.9
Exports (YoY in %)	-0.6	12.6	8.7	11.7	19.6	7.7	6.7
Imports (YoY in %)	4.5	10.1	14.6	20.5	18.2	12.7	6.6
Unemployment rate (% , last quarter)	6.4	6.0	5.6	4.7	5.0	5.2	4.7
Inflation (% YoY, last quarter)	3.0	2.9	0.3	2.0	3.0	5.1	3.8
Fiscal balance (% of GDP)	-1.4	-0.6	-0.9	-2.4	-2.2	-2.6	-2.8
Trade balance (% of GDP)	-6.5	-6.1	-8.0	-11.7	-13.1	-14.2	-14.0
Tax boost (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% GDP)	4.2	3.8	2.5	-0.4	-0.8	-1.6	-1.8
Official interest rate (end of period)	3.50	4.00	4.00	3.00	3.00	4.47	4.93
Short-term rate (end of period)	2.03	3.09	3.03	2.50	3.22	4.56	4.51
Long-term rate (end of period)	3.80	4.37	4.10	4.63	5.70	7.08	7.00
Exchange rate vs. USD (end of period)	44.41	44.62	47.17	49.81	49.92	54.13	52.76
Exchange rate vs. euro (end of period)	61.25	54.17	51.35	52.51	59.87	64.42	65.95
Private lending (% YoY, average)	16.6	18.0	13.2	15.3	18.0	15.0	11.6
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	6.0	8.8	2.6	8.7	9.2	10.2	10.5
Savings rate (% , average)	8.3	9.3	7.7	7.8	8.1	7.3	7.7

Source: MAPFRE Economic Research (based on PSA data)
Forecasting end date: October 11, 2018.

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At its meeting on September 27, the central bank (BSP) raised interest rates by 50 bps to 4.5%, stating that it would do whatever is necessary to control inflation, which stood at 6.7% in September, far from the target range (2-4%). Inflation has been driven by the impact of typhoon Mangkhut on agricultural production, which has pushed food inflation to 9.7%. The BSP acknowledged that more rate rises may be needed because there are signs that inflation is persistent. However, it seems that monetary tightening alone will not be sufficient to control inflation, and liberalizing reforms will be necessary to stimulate supply.

The economy is growing dynamically above its potential, but the external backdrop of the emerging markets' currencies, the monetary tightening in the United States, as well as its own, and the persistence of high energy

prices will lead to a moderate slowdown in the pace of activity. In this context, the government's infrastructure and increased spending plan are essential supports for keeping the economic buoyant.

The persistence of twin deficits (current account and fiscal) over time will continue weighing on the depreciation of the currency and increasing the external debt burden. The credit profile of the Philippines is investment grade (BBB).

2. Industry outlook

2.1 The economic environment and its impact on the demand for insurance: update

2.1.1 Global markets

As indicated in the economic outlook section of this report, the undoubtedly more complex current context anticipates global growth of around 3.6% for 2018 and 3.4% for 2019 (3.8% in 2017, according to the latest data available). The expected growth is positive but continues to lose vigor and global synchrony, and the symptoms of exhaustion that herald a change of economic cycle appear to be confirmed. Various indicators suggest a slowdown, such as the indices relating to global trade and industrial production, retail sales or industrial orders. At present, growth favors the insurance market at global level; however, a change of cycle would slow the pace of growth in global insurance premiums, particularly in the Non-Life and Life risk segments, given their strong link with the behavior of the economic cycle.

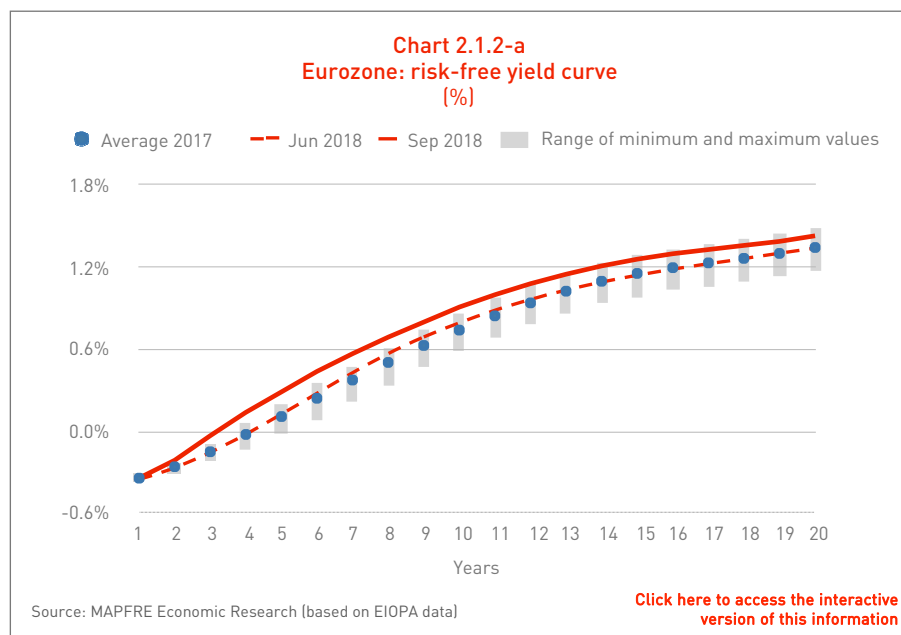
In addition, the normalization of monetary policy and protectionist measures in the United States, among other factors, keep the level of uncertainty high. Some emerging markets continue to suffer financial tensions with capital outflows and depreciation of their exchange rates, as a result of the monetary normalization in the United States, and are having

to act in defense of their currencies. The increase in market interest rates and risk premiums also negatively impacts the financing possibilities of governments and companies in those markets, and this ends up being translated into valuation losses on the asset portfolios of insurance companies. Despite this, up to now the market has differentiated the emerging markets according to the strength of their fundamentals.

In the eurozone, meanwhile, the timetable for gradual monetary normalization continues despite the slowdown in its growth, the increased risk arising from an expansionary budget in Italy and a no-deal Brexit. Against this backdrop, there will be a continuation for a while yet of the environment of low rates that is influencing the development of the Life insurance segment (in particular, the Life savings and Whole Life annuities businesses).

2.1.2 Eurozone

Activity in the eurozone is holding up, with some growth forecasts for the year as a whole of around 2% (which represents a slowdown compared with the 2.5% growth of 2017). For the moment, the growth of the service sector is being maintained due to the recovery of the labor market (which is positive for the Non-Life and Life risk business lines); however, the



relatively adverse global environment (imminence of the change of cycle) and the growing political risks have led us to lower the economic growth forecast for the year 2019 to 1.5%. This slowdown would translate, for the insurance industry, into a deceleration of the business in these segments.

Inflation in the eurozone rose to 2.1% in September, basically due to movement in the price of oil. Underlying inflation, however, remains weak (0.9% in September), but can be expected to begin to rise as wage growth in the region strengthens. In this context, the European Central Bank (ECB) is following the planned course of gradual normalization of its monetary policy, having reduced the volume of purchases to 15 billion euros

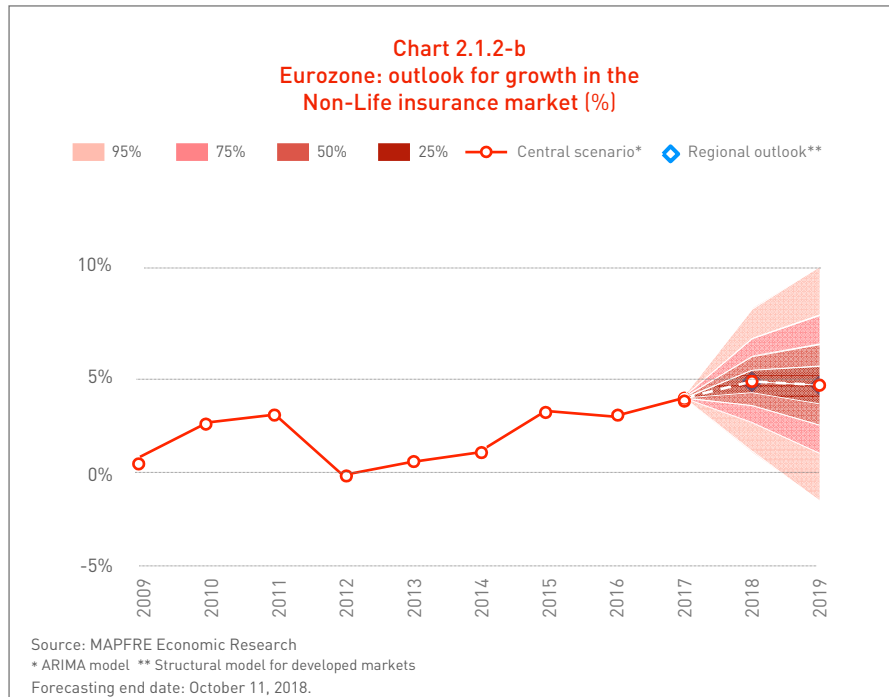
per month. The program of net asset purchases will conclude at the end of the year. However, the policy of reinvesting the principal of the bonds as they mature will be maintained for a prolonged period, or in any event for as long as necessary to maintain favorable liquidity conditions and a high degree of monetary accommodation. It is therefore expected that official interest rates will continue at their current levels (0.0% refinancing rate and -0.40% deposit rate), and we do not expect the first rise in interest rates until the second half of 2019, with a very gradual pace of tightening from then on.

In the risk-free yield curves for the eurozone produced by the European Insurance and Occupational Pensions Authority (EIOPA) there is a slight rise in rates along the curve, putting them above the average values reached in 2017 and those observed in the previous quarter

Table 2.1.2
Non-Life market: growth forecasts for selected insurance markets, 2018-2019
(central scenario, growth in local currency, %)

	Non-Life market	
	2018	2019
Eurozone	3.3%	3.2%
Spain	4.1%	4.2%
Turkey	13.7%	11.1%
United States	4.1%	4.0%
Brazil	10.9%	12.4%
Mexico	8.8%	12.8%
China	13.9%	15.5%

Source: MAPFRE Economic Research
Forecasting end date: October 11, 2018.



(see Chart 2.1.2-a). The curve continues to show a positive trend, with higher rates for higher maturities, which, as we have mentioned in previous reports, could constitute a stimulus for the development of Life savings and Whole Life annuities products to the extent that this trend is maintained, although at present the rate levels hamper their marketing. For the time being, the short segment of the curve continues to show negative values. This sustained context of low interest rates continues to be prejudicial to the development of the specified lines of business. In this general economic context, we believe that Non-Life insurance premiums in the eurozone could achieve nominal growth of around 3.3% in 2018 and 3.2% in 2019 (see Chart 2.1.2-b and Table 2.1.2).

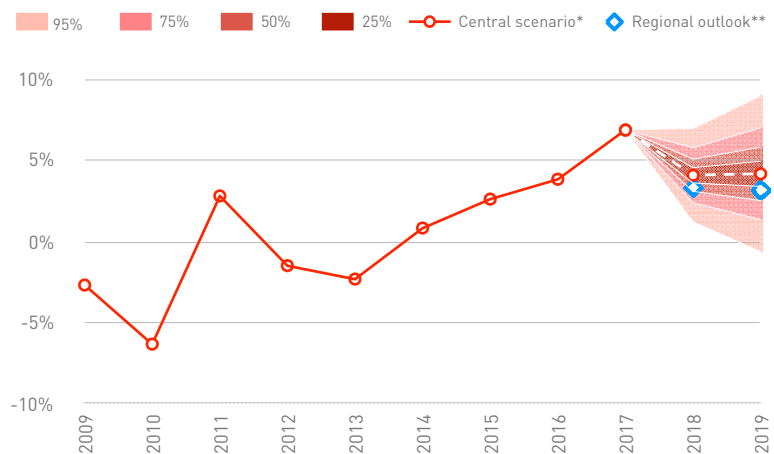
2.1.3 Spain

The growth of the Spanish economy, estimated for the whole of 2018, is around 2.6% (3% in 2017). The proximity of the end of the expansive monetary cycle and the expected increase in fiscal pressure lead to a downward correction of the growth forecast. In spite of this, the expectations for the insurance industry remain favorable, specifically for the Non-Life and Life risk business lines, although their growth could be affected by the slowing of the economy.

In addition, potential reversals in labor and pension reforms could expose the Spanish public debt to the scrutiny of the markets and international rating agencies. This, together with the conclusion of the ECB's program of net asset purchases at the end of the year, could prompt a change of risk appetite among investors by tightening the risk premiums on sovereign and corporate debt, which would have a negative impact on the profitability of the insurance industry due to the fall in value of the assets in their investment portfolios.

As regards traditional Life savings and Whole Life annuities insurance products, at least during 2018 and a large part of 2019, the outlook of low interest rates will continue to weigh on the development of this business. Meanwhile, the transition of the insurance industry toward products in which the investment holder assumes the risk of investment or traditional products that make the most of the positive slope of the rates curve has not ceased, in an interest rate environment that is counteracting the positive effect that the situation of the Spanish economy could have on these business lines. In accordance with the above, we believe that nominal insurance premiums in the Non-Life segment will grow by around 4.1% in 2018 and remain buoyant in 2019 with estimated growth of 4.2% (see Chart 2.1.3 and Table 2.1.2).

Chart 2.1.3
Spain: outlook for growth in the Non-Life insurance market (%)



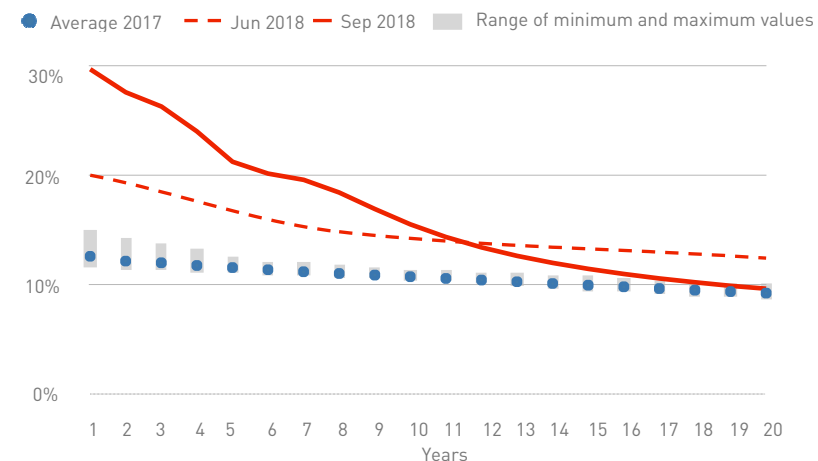
Source: MAPFRE Economic Research
* ARIMA model ** Structural model for eurozone markets
Forecasting end date: October 11, 2018.

2.1.4 Turkey

In the case of the Turkish economy, we are maintaining our forecast of a slowdown of activity in 2018 by around 4.1% (7.4% in 2017), and we also expect a slowdown for 2019 that will put its growth at 1.2% (around one third of its potential) as a result of the adjustments that the economy will have to confront. The hike in inflation caused by depreciation of the exchange rate and the tightening of financial conditions, with sharp rises

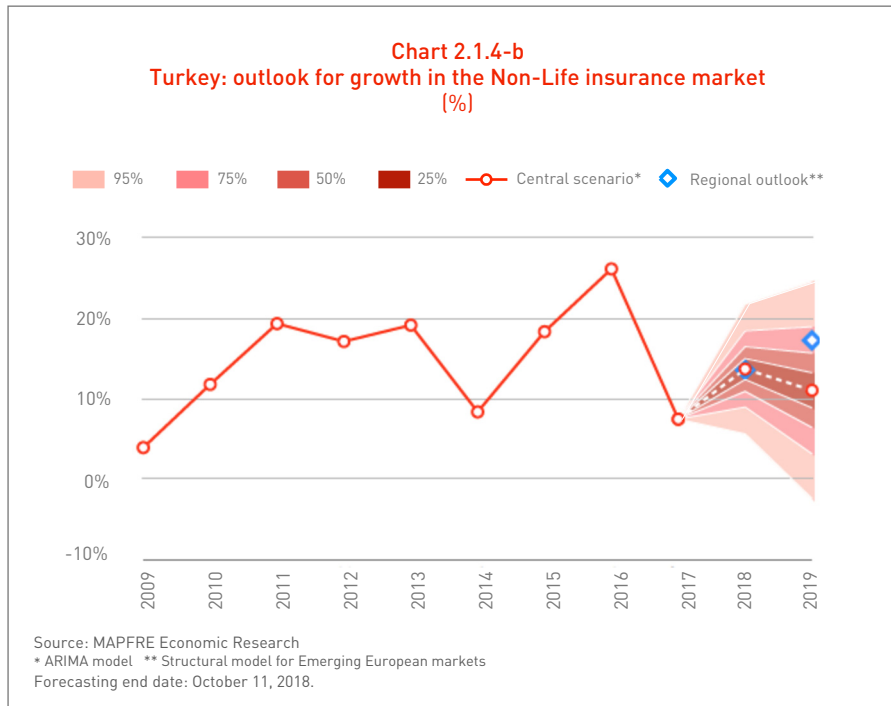
in official interest rates, is expected to drive domestic demand substantially downward. The Turkish government has committed itself to a policy of adjustment, which will result in a slowing of growth. This adjustment program aims to reduce the excess of stimuli that led to excessive demand, and to correct the vulnerabilities of the country's balance of payments. This environment will have a negative impact on the development of the Non-Life and Life risk business lines of the insurance industry. High inflation rates and currency depreciation will also have a negative impact on the cost of claims for insurance companies, although high monetary policy interest rates may help to shore up the financial profitability of these business lines.

Chart 2.1.4-a
Turkey: risk-free yield curve (%)



Source: MAPFRE Economic Research (based on EIOPA data)

[Click here to access the interactive version of this information](#)

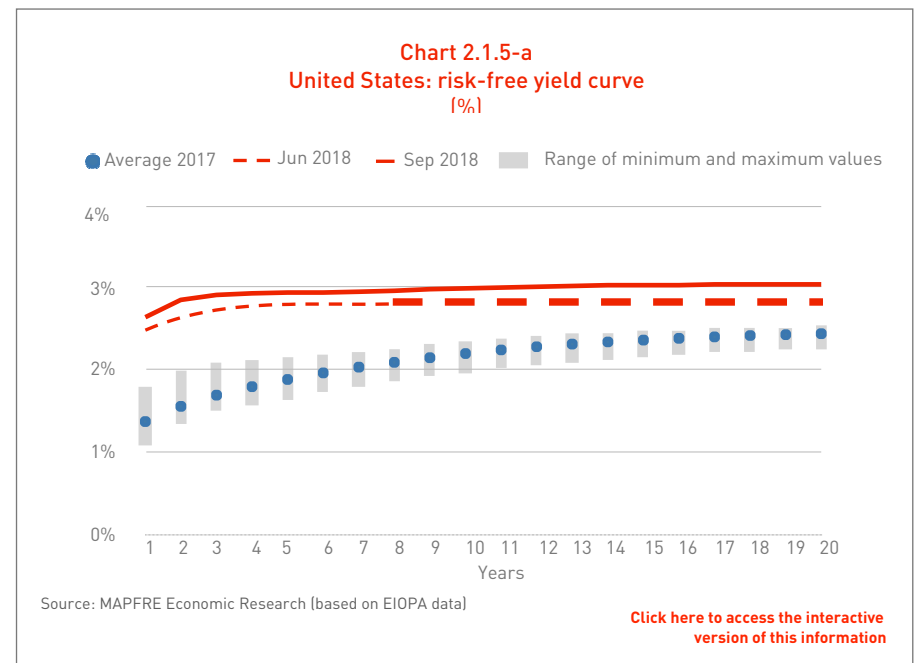


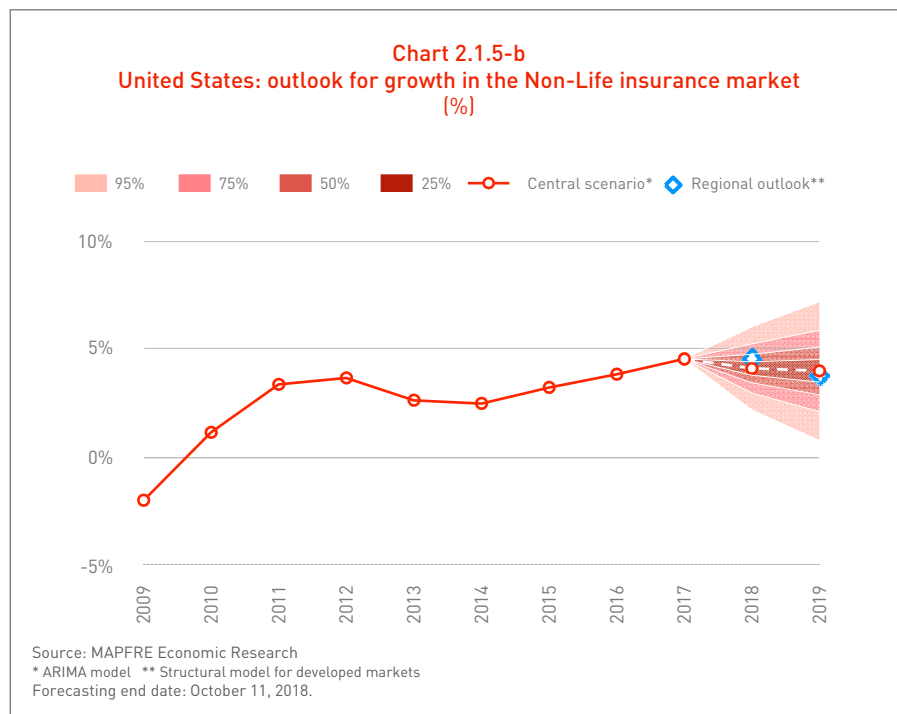
As can be seen in the EIOPA risk-free yield curves, there is an accentuation of the behavior of interest rates that was already anticipated in the previous quarter, with a sharp rise in short-term rates and a completely inverted curve for risk-free rates (see Chart 2.1.4-a). This environment is prejudicial to the development of products with long-term guarantees in the Life savings and Whole Life annuities businesses. Despite this, with such high short-term interest rates, an opportunity arises for the marketing of temporary Life savings products renewable for short terms, which allow for a review of the rate guaranteed at each renewal.

Against this backdrop, we believe that Non-Life insurance premiums will grow, in nominal terms, by around 13.7% in 2018 and 11.1% in 2019, as a central scenario, which would translate into negative real growth if we take into account the forecasts of high levels of inflation (see Chart 2.1.4-b).

2.1.5 United States

The economic growth envisaged for 2018 in the United States could be around 2.8% (compared with 2.2% in 2017). The steady increase in employment and the gradual growth of salaries will continue supporting the growth of disposable income and consumption, although at a lesser pace due to the relative exhaustion of the effect of the fiscal stimuli (business





investment has remained constant thanks to the fiscal stimulus, among other factors) and the increase in the cost of financing as a result of monetary normalization. The economy remains in a phase that, although it anticipates the change of cycle, continues to be favorable for the insurance industry, especially with regard to the Non-Life and Life risk businesses. However, the current economic cycle is already the longest in US post-war history, so it is possible that it is already at a very advanced stage which the latest fiscal stimulus is prolonging.

Meanwhile, inflation has remained close to the Federal Reserve's objective for several months. It is expected that the fourth rise in interest

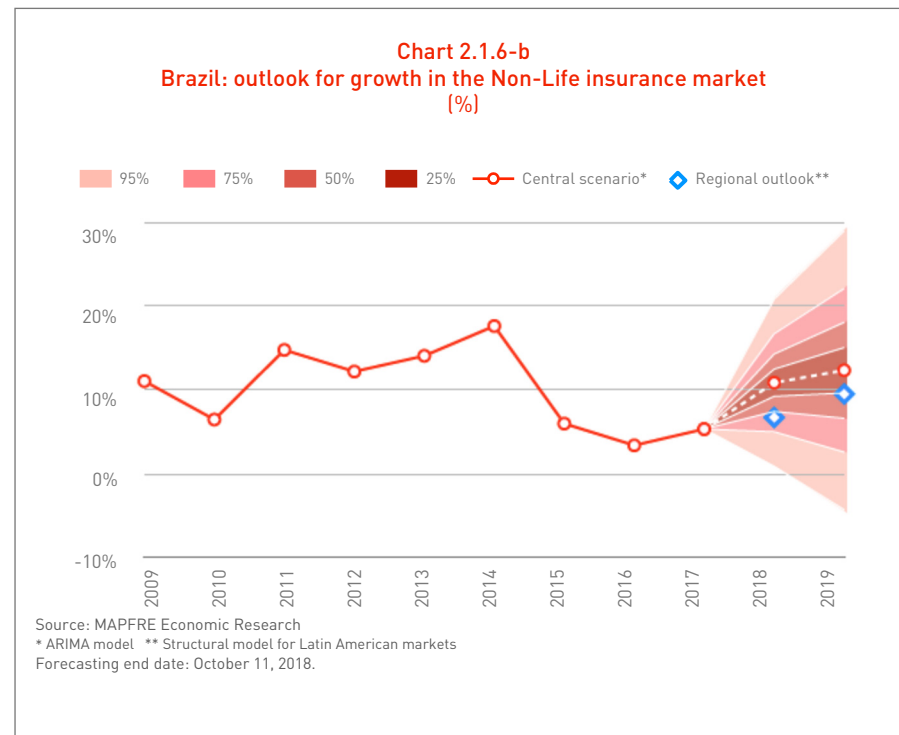
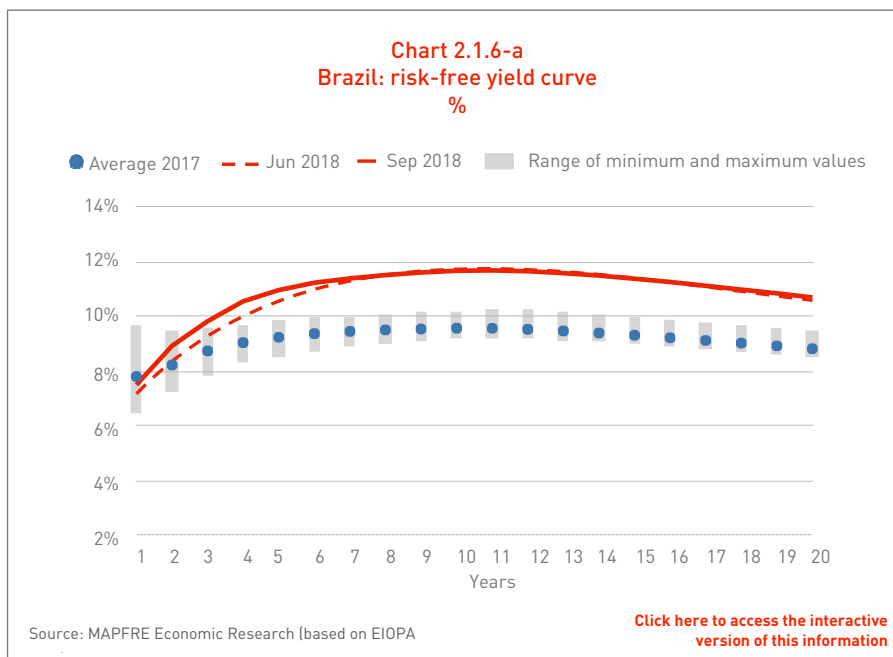
rates will take place in December, followed by a further two or three rate increases in 2019. The risk-free yield curves produced by EIOPA show the increases affecting all segments of the curve, which in the last quarter remains flat and has moved in parallel, except for the slight upturn in the two-year rate (see Chart 2.1.5-a). This environment of higher interest rates, which in principle should be favorable, actually complicates the development of the Life savings and Whole Life annuities business. A flattened curve, a sharper rise than initially expected and the same expectations of interest rate increases are prejudicial in the short term to this business, given that companies need time to adapt the new products and the guaranteed rates in their portfolios, and there may be redemptions of guarantee policies marketed at rates below the market rates. In this environment, there may also be a curbing of demand for savings products as the increases materialize. We therefore believe that Non-Life insurance premiums could experience growth, in nominal terms, of around 4.1% in 2018 and 4.0% in 2019, as the central scenario (see Chart 2.1.5-b).

2.1.6 Brazil

The Brazilian economy again suffered a significant slowdown in the second quarter, and we have therefore lowered our forecast of average growth for 2018, which we expect to be similar to that of 2017 at around 1%. This slowdown is attributable mainly to a loss of momentum in consumption and exports. In addition, the rise in oil prices, the truck drivers' strike in May and the depreciation of the Brazilian real have had a negative impact on the economy. In addition, the electoral process in which Brazil is currently immersed means that the structural reforms necessary to balance the public accounts are being postponed. This backdrop could impact the good performance of the Non-Life and Life risk business segments of the insurance industry, given their strong links with the performance of the economy as a whole. Furthermore, the rise in inflation and the depreciation of the real will have

negative repercussions on the cost of claims and could erode the profitability of the insurance business.

At its meeting on September 19, the central bank kept the monetary policy benchmark interest rate unchanged, but the monetary stimulus could be phased out if the inflation outlook deteriorates. The EIOPA risk-free yield curves indicate a slight increase in short-term rates in September compared with the June curve (see Chart 2.1.6-a). In addition, the curve is increasing its already accentuated positive slope on its short segment, against a backdrop in which rates are falling sharply, and this is a climate that could be favorable for the development of the Life savings and Whole Life annuities insurance, especially for those companies that are



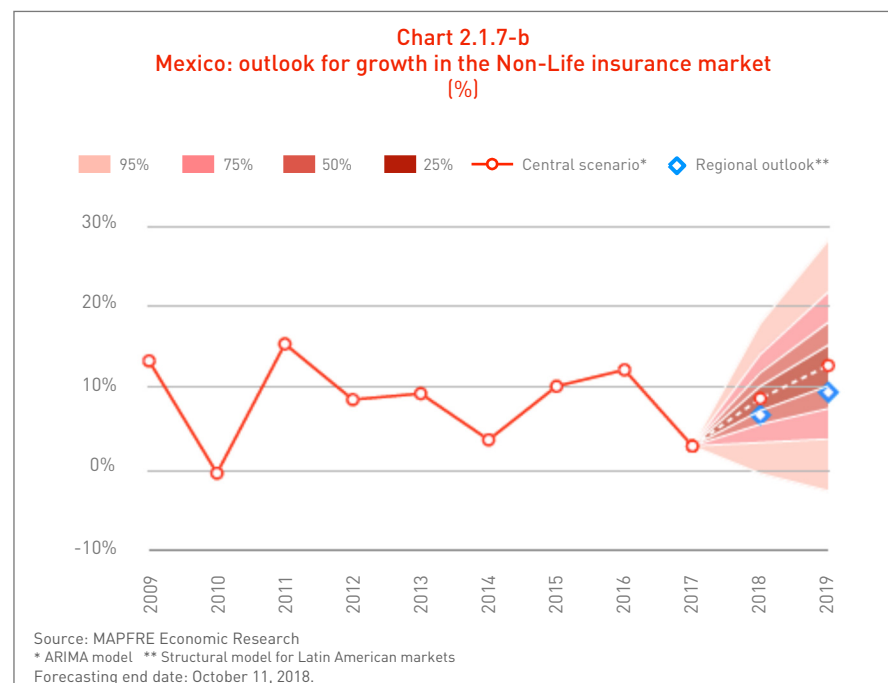
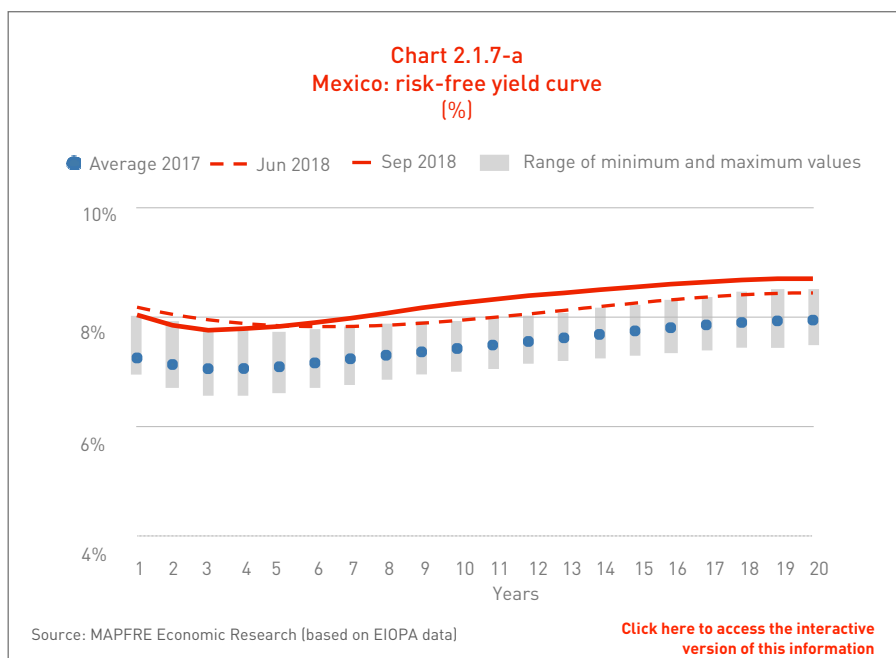
sufficiently flexible to adapt their new products quickly in this environment. However, the fresh expectations of possible rate rises due to the hike in inflation could affect demand for savings products as the increases materialize.

Against this backdrop, we believe that premiums for the Non-Life business in Brazil could grow, in nominal terms, by around 10.9% in 2018 and 12.4% in 2019, as the central scenario (see Chart 2.1.6-b).

2.1.7 Mexico

For the whole of 2018, we estimate that the Mexican economy will grow by around 1.9% [2.3% in 2017], and this dynamic is expected to be maintained in 2019. The economy performed well in the second quarter, although growth expectations for the year as a whole are moderating. This environment continues to be favorable for the development of the Non-Life and Life risk business segments of the insurance market, supported by the low penetration rate of insurance in Mexico.

Inflation stood at 5% in September, a level higher than initially anticipated, mainly due to the increase in energy prices, which negatively impacts the



profitability of the Non-Life business lines due to the increase in claims-related expenses that may be entailed. The recovery and stability being demonstrated by the currency is, however, good news for the profitability of these business lines and for the cost of coverage through reinsurance where contracts are usually negotiated in dollars.

At its last meeting on October 4, the Bank of Mexico kept the monetary policy benchmark rate unchanged, but this situation could change if the inflationary pressures persist. In the EIOPA risk-free yield curves we can see, with respect to the data for the previous quarter, a small fall in the

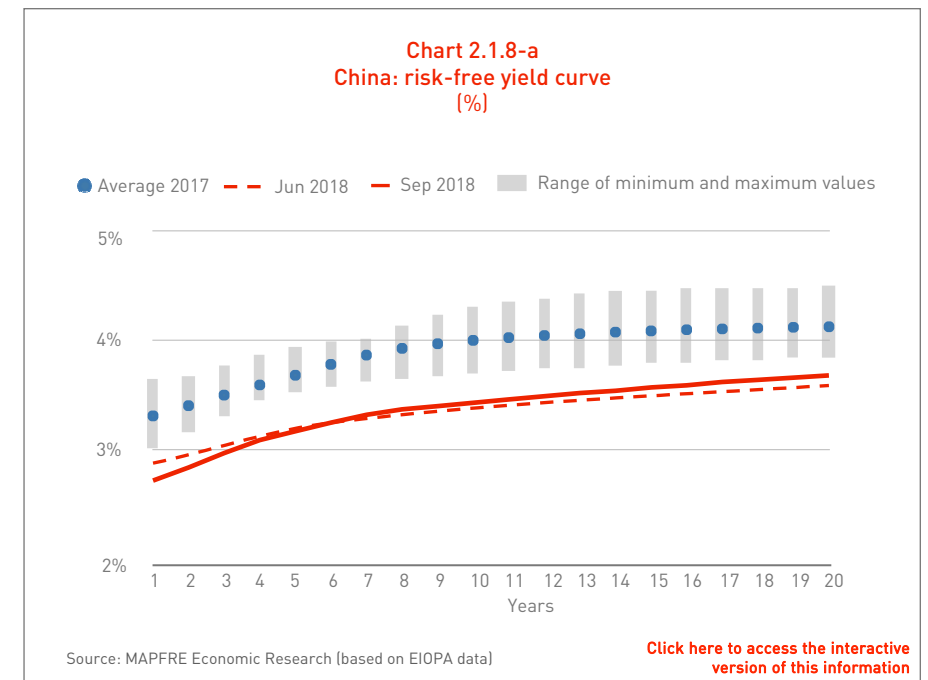
first segment of the curve toward maturities of less than four years, which continues to show a slight negative slope (see Chart 2.1.7-a). However, for maturities of around four years and more, a positive slope is recovered, with a slight rise in long-term rates, which show relatively low volatility. This environment continues to be favorable for the development of Life savings and Whole Life annuities products, making the most of the long-term rate levels as well as temporary Life savings products, renewable for periods of less than a year, which allow for a review of the guaranteed rate at each renewal. However, the expectations of possible rate rises due to the hike in inflation could affect demand for savings products as the increases materialize. We therefore believe that premiums for the Non-Life business in the Mexican insurance market could grow, in nominal terms, by around 8.8% in 2018 and 12.8% in 2019, as the central scenario (see Chart 2.1.7-b).

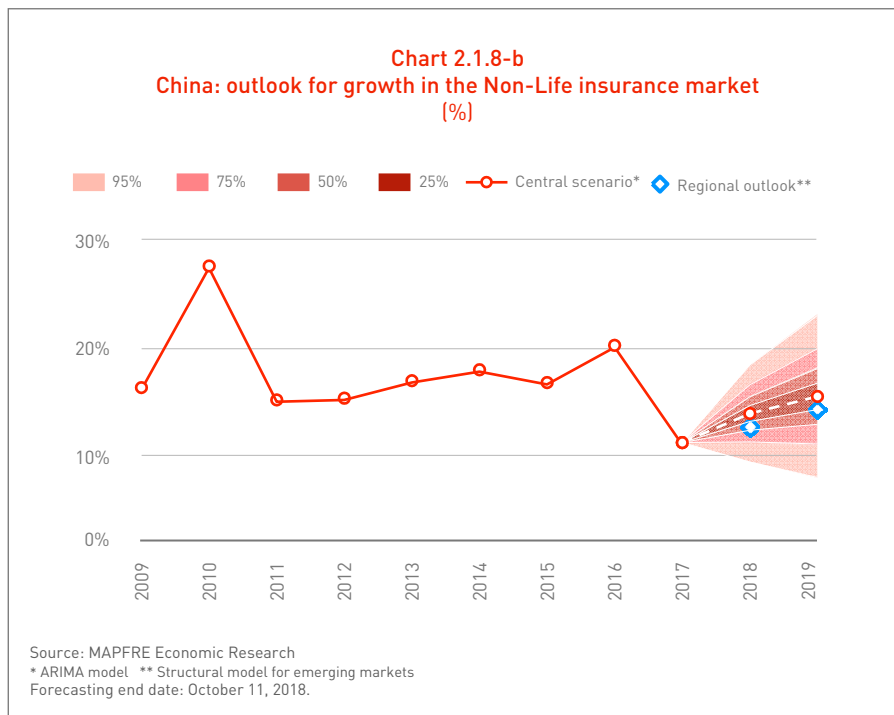
2.1.8. China

For the Chinese economy, the forecast for GDP growth is around 6.5% in 2018 (6.9% in 2017), supported by investment and consumption, although the escalation of trade tensions with the United States and the slowdown of credit mean that the growth of the economy is expected to slow in 2019 (around 6.1%).

Nevertheless, the outlook continues to be favorable for the prospects of the Non-Life and Life risk insurance business, with the help of the still low penetration rate of insurance in China, characteristic of the emerging economies, leading to greater flexibility for premium growth compared with GDP growth. It should be noted, as we have mentioned in previous reports, that the Chinese government's specific objectives include increasing the penetration rate of insurance activity.

As regards the Life savings and Whole Life annuities businesses, the EIOPA risk-free yield curves show that interest rates on the short segment of the curve continue to fall, due to the softening of monetary policy announced in the second quarter to support growth (see Chart 2.1.8-a). The curve maintains a positive slope that increases on maturities of around seven years, which is positive for these business segments. In short, the outlook for this business line continues to be favorable. We believe that premiums for the Non-Life business in the Chinese insurance market will grow, in nominal terms, by around 13.9% in 2018 and 15.5% in 2019, as the central scenario (see Chart 2.1.8-b).





2.2 Regulatory trends: new aspects in the quarter

Global trends

IAIS

On July 31 of this year, the International Association of Insurance Supervisors (IAIS) launched a public consultation on the new version of the future global Insurance Capital Standard (ICS Version 2.0)³. This

consultation is an important milestone in the process of adoption of the definitive standard, scheduled for the end of 2019. The deadline for the submission of comments on this new version of the ICS is October 30, 2018.

IFRS 17

On May 18, 2017, the International Accounting Standards Board (IASB) published International Financial Reporting Standard (IFRS) 17 on Insurance Contracts (IFRS 17), which applies to the preparation of the 2021 consolidated accounts of listed insurance companies. In the European Union, in order for compliance with it to be obligatory for the large European insurance groups, the IFRS 17 standard must be adopted by a Regulation of the European Commission, published in the Official Journal of the European Union, after consultation with the European Financial Reporting Advisory Group (EFRAG).

During the second quarter of 2018, EFRAG issued two relevant documents in the process preceding the issuing of its technical advice for the end of 2018 (which may be delayed until 2019). The first of these summarizes the questions that should be submitted for consideration by EFRAG, including evidence detected from the studies of practical examples⁴. The second relevant document is a letter dated September 3, 2018 addressed to the IASB, in which EFRAG states that it has identified a series of issues that in its opinion merit additional consideration by the IASB⁵. The identified issues are listed below:

- Acquisition costs (for the costs incurred in seeking a renewal of the contract).
- Amortization of the contractual service margin (CSM).

- Reinsurance (limits of the reinsurance contract when the underlying contract has not yet been issued).
- Transition (extension of the mitigation measures offered for the modified retrospective approach and challenges in the application of fair value).
- Annual cohorts (benefit-cost ratio).
- Certain aspects related to the presentation of the balance sheet.

In this regard, Insurance Europe (the association that represents the main European insurance groups) stated its position with regard to this request, asking for the period provided for the implementation of this standard to be extended by two additional years⁶.

European Union

On September 11, 2018, the Joint Committee of the European Supervisory Authorities (EBA, ESMA and EIOPA) published its report on risks and vulnerabilities in the European Union (EU) financial system⁷. The main risks identified in the report that could have an impact on the insurance industry are detailed below:

1. The risk of losses across asset portfolios remains imminent and high. Financial markets experienced a return of market volatility in the first half of 2018, with corresponding episodes of sharp equity price declines and a sizable widening of sovereign and corporate bond spreads. The potential for a sudden risk premium reversal remains a major concern for insurance companies and pension funds, since this could negatively impact the value of their assets.

2. These market developments might reflect to some extent a return to normality following an extended period of low interest rates. However, given the trend of monetary policy normalization with remaining uncertainty over the exact path over time, the potential for further market volatility stemming from investment portfolio reallocations and the repositioning of market participants remains a key source of concern.
3. Increasing interest rates may pose additional challenges to the still high (albeit decreasing) stock of non-performing loans (NPLs) within the EU banking sector. Meanwhile, rising volatility will exert further pressure on loan returns, generating a lower net return on companies' trading portfolios. Retail investors may also be affected by valuation risks through their portfolio holdings.
4. Uncertainties surrounding the terms of the UK's withdrawal from the EU still have the potential to expose both sides to economic and financial instability and weaken market confidence, particularly if negotiations end in a disorderly fashion. The need to prepare for a "no-deal" exit, including the risk of reduced access to financial market infrastructures and contract continuity, has become a critical issue.
5. Rising interest rates and heightened political risks could cause capital outflows in emerging economies, as shown by the recent events that unfolded in Turkey in August.
6. Finally, there is a risk of contagion between sectors after a sharp increase in yields, given the interconnection that exists between the European banking sector and the rest of the financial sector, the insurance sector and the still highly leveraged non-financial private sector.

In light of the above-mentioned risks and uncertainties, the Joint Committee recommends the following supervision measures:

- Conducting stress testing exercises across all sectors. The scenarios of increased interest rates and a potential sudden change in risk premiums are already embedded in the EIOPA and EBA stress tests for 2018.
- Paying continued attention to the risk appetite of financial institutions.
- Addressing the issue of NPLs and adapting bank business models to sustainably improve profitability.
- Careful management of interest rate risk.
- Monitoring changing investor preferences and, where appropriate, warning against risky products.
- Addressing possible contagion risks and continuing efforts in the monitoring of credit standards.
- Planning appropriate risk mitigating actions to prepare for the UK's withdrawal from the EU.

Tables: macroeconomic forecast scenarios

Table A-1
Baseline and risk scenarios: gross domestic product
(annual growth, %)

	Baseline						Risk scenario					
	2014	2015	2016	2017	2018	2019	2014	2015	2016	2017	2018	2019
United States	2.4	2.9	1.6	2.2	2.8	2.0	2.4	2.9	1.6	2.2	2.8	0.6
Eurozone	1.4	1.9	1.8	2.5	2.0	1.5	1.4	1.9	1.8	2.5	1.9	0.9
Germany	2.2	1.5	2.2	2.5	1.8	1.4	2.2	1.5	2.2	2.5	1.7	1.0
France	0.9	1.1	1.2	1.8	2.1	2.0	0.9	1.1	1.2	1.8	1.8	1.0
Italy	0.2	0.8	1.0	1.6	1.1	0.8	0.2	0.8	1.0	1.6	1.0	0.1
Spain	1.4	3.4	3.3	3.0	2.6	2.1	1.4	3.4	3.3	3.0	2.5	1.4
United Kingdom	2.9	2.4	1.8	1.7	1.2	1.2	2.9	2.4	1.8	1.7	1.2	0.8
Japan	0.3	1.4	1.0	1.7	0.9	0.9	0.3	1.4	1.0	1.7	0.9	0.5
Emerging markets	4.7	4.3	4.4	4.8	4.9	5.1	4.7	4.3	4.4	4.8	3.1	2.1
Latin America ¹	1.3	0.3	-0.6	1.3	2.0	2.8	1.3	0.3	-0.6	1.3	1.4	1.6
Mexico	2.8	3.3	2.6	2.3	1.9	1.9	2.8	3.3	2.6	2.3	1.9	0.7
Brazil	0.5	-3.6	-3.4	1.0	1.0	2.2	0.5	-3.6	-3.4	1.0	1.0	1.9
Argentina	-2.5	2.7	-1.7	2.8	-2.8	-1.2	-2.5	2.7	-1.7	2.8	-2.9	-1.3
Emerging Europe ²	3.9	4.7	3.2	5.8	4.3	3.7	3.9	4.7	3.2	5.8	3.4	1.0
Turkey	5.3	6.0	3.3	7.4	4.1	1.2	5.3	6.0	3.3	7.4	4.0	0.9
Pacific Asia ³	6.1	5.9	6.2	6.2	6.0	5.7	6.1	5.9	6.2	6.2	5.5	4.6
China	7.3	6.9	6.7	6.9	6.5	6.1	7.3	6.9	6.7	6.9	6.5	5.7
Indonesia	5.0	4.9	5.0	5.1	5.0	4.7	5.0	4.9	5.0	5.1	5.0	4.7
Philippines	6.1	6.0	6.9	6.7	6.3	6.4	6.1	6.0	6.9	6.7	6.3	6.3
World	3.6	3.5	3.2	3.8	3.6	3.4	3.6	3.5	3.2	3.8	2.4	1.5

Source: MAPFRE Economic Research

¹Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela; ²Russia, Turkey, Commonwealth of Independent States (CIS) and Central Europe; ³Association of Southeast Asian Nations (ASEAN)
Forecasting end date: October 11, 2018

Table A-2
Baseline and risk scenarios: inflation
 (end of period, %)

	Baseline						Risk scenario					
	2014	2015	2016	2017	2018	2019	2014	2015	2016	2017	2018	2019
United States	1.2	0.4	1.8	2.1	1.7	2.3	1.2	0.4	1.8	2.1	1.4	2.1
Eurozone	0.2	0.2	0.7	1.4	1.7	1.2	0.2	0.2	0.7	1.4	1.5	0.2
Germany	0.2	0.3	1.7	1.7	1.7	1.5	0.2	0.3	1.7	1.7	1.9	1.9
France	0.1	0.3	0.7	1.2	1.4	2.0	0.1	0.3	0.7	1.2	1.3	1.3
Italy	0.1	0.2	0.1	0.9	2.2	0.9	0.1	0.2	0.1	0.9	2.2	0.0
Spain	-0.5	-0.3	1.0	1.4	1.4	1.1	-0.5	-0.3	1.0	1.4	1.1	-0.2
United Kingdom	0.9	0.1	1.2	3.0	2.2	1.2	0.9	0.1	1.2	3.0	2.2	0.6
Japan	2.5	0.2	0.3	0.6	0.5	2.0	2.5	0.2	0.3	0.6	0.4	1.3
Emerging markets	4.7	4.6	4.2	4.3	4.6	4.4	4.7	4.6	4.2	4.3	5.8	5.5
Latin America¹	5.0	6.2	4.6	4.1	3.6	3.5	5.0	6.2	4.6	4.1	5.6	4.6
Mexico	4.2	2.3	3.2	6.6	4.4	3.3	4.2	2.3	3.2	6.6	4.4	3.0
Brazil	6.5	10.4	7.0	2.8	4.5	4.5	6.5	10.4	7.0	2.8	4.5	4.5
Argentina	44.2	26.0	39.3	23.3	43.6	27.5	44.2	26.0	39.3	23.3	42.7	26.5
Emerging Europe²	3.4	3.9	4.2	6.8	6.6	6.0	3.4	3.9	4.2	6.8	7.8	6.9
Turkey	8.8	8.2	7.6	12.3	19.4	16.2	8.8	8.2	7.6	12.3	19.4	15.5
Pacific Asia³	3.6	2.2	2.5	2.8	3.7	3.1	3.6	2.2	2.5	2.8	3.8	4.0
China	1.5	1.5	2.2	1.8	2.3	1.8	1.5	1.5	2.2	1.8	2.2	0.7
Indonesia	6.5	4.8	3.3	3.5	3.6	3.7	6.5	4.8	3.3	3.5	3.6	3.7
Philippines	2.9	0.3	2.0	3.0	5.1	3.8	2.9	0.3	2.0	3.0	5.1	2.7
World	2.9	2.8	3.0	3.2	3.6	3.3	2.9	2.8	3.0	3.2	3.3	2.9

Source: MAPFRE Economic Research

¹Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela; ²Russia, Turkey, Commonwealth of Independent States (CIS) and Central Europe; ³Association of Southeast Asian Nations (ASEAN)
 Forecasting end date: October 11, 2018.

Table A-3
Baseline and risk scenarios: 10-year government bond yield
 (end of period, %)

	Baseline						Risk scenario					
	2014	2015	2016	2017	2018	2019	2014	2015	2016	2017	2018	2019
United States	2.17	2.27	2.45	2.40	3.08	2.72	2.17	2.27	2.45	2.40	3.10	1.18
Eurozone	1.34	1.20	1.04	0.91	1.35	1.62	1.34	1.20	1.04	0.91	1.33	1.15

Source: MAPFRE Economic Research
 Forecasting end date: October 11, 2018.

Table A-4
Baseline and risk scenarios: exchange rates
 (end of period, %)

	Baseline						Risk scenario					
	2014	2015	2016	2017	2018	2019	2014	2015	2016	2017	2018	2019
USD-EUR	0.82	0.92	0.95	0.83	0.84	0.80	0.82	0.92	0.95	0.83	0.85	0.78
EUR-USD	1.21	1.09	1.05	1.20	1.19	1.25	1.21	1.09	1.05	1.20	1.18	1.28
GBP-USD	1.56	1.48	1.23	1.35	1.35	1.41	1.56	1.48	1.23	1.35	1.34	1.43
USD-JPY	119.85	120.27	116.78	112.69	108.93	108.19	119.85	120.27	116.78	112.69	109.19	105.25
USD-CNY	6.20	6.49	6.94	6.51	6.73	6.33	6.20	6.49	6.94	6.51	6.37	5.53

Source: MAPFRE Economic Research
 Forecasting end date: October 11, 2018.

Table A-5
Baseline and risk scenarios: benchmark official interest rate
 (end of period, %)

	Baseline						Risk scenario					
	2014	2015	2016	2017	2018	2019	2014	2015	2016	2017	2018	2019
United States	0.13	0.38	0.63	1.38	2.38	2.88	0.13	0.38	0.63	1.38	2.38	3.38
Eurozone	0.05	0.05	0.00	0.00	0.00	0.25	0.05	0.05	0.00	0.00	0.00	0.00
China	4.96	2.32	2.59	3.09	2.88	2.73	4.96	2.32	2.59	3.09	2.78	1.49

Source: MAPFRE Economic Research
 Forecasting end date: October 11, 2018.

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