

A nighttime photograph of a city skyline. In the foreground, a multi-lane highway shows long, bright white and yellow light trails from moving vehicles. To the left, a large, dark building with many lit windows stands prominently. Other skyscrapers are visible in the background under a dark sky.

Fundación **MAPFRE**

## **ECONOMIC AND SECTOR OUTLOOK 2017**

MAPFRE Economic Research

**Q1 / 2017**



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# Executive Summary

## ECONOMIC AND SECTOR OUTLOOK 2017: Q1 update

During Q4 2016 global activity continued its upward trend reporting quarterly growth in the neighborhood of 1%. Although there is a certain degree of disagreement between the surveys and the "hard" data, namely the Purchasing Managers Index (PMI) and the global production and trade figures (IP and WFI), anticipating a sound economic pulse during 1Q 2017 can be forecast.

In annual terms, global growth throughout 2017 is expected to stand at around 3.1%. This represents a slight increase compared to the previous year, but is a long way off the figures reported before the global recession. The economic activity in 2017 will be largely sustained on better performance of developed markets, growth of China's economy and is expected to be more resilient when compared to the figures initially reported for the emerging markets. Hence, it is estimated that this year the developed markets will grow by around 1.9% whereas the emerging markets will report growth of 4.6%.

### Inflation

The global inflation dynamics have barely changed compared to the forecasts anticipated at the start of the year, although the global reflation expectations, headed up by the expected tax expansion in the United States are in general terms now more moderate. Although inflation has risen as a result of some baseline effects and the commodities price cycle,

underlying inflation remains contained in most of the developed world. In a scenario of static inflation expectations, the energy effects and the past monetary laxity will soon fade. In this context, global inflation of around 2% is expected throughout 2017.

### Risk assessment in the central scenario

In general terms, the central scenario of the global economy have not changed from the forecasts at the start of 2017. Nevertheless, based on the development of the economic policies in the US (legislative resistances and a degree of uncertainty about the implementation process) and the accumulation of global vulnerabilities (global leverage, exuberance of asset prices, sovereign / financial risks, etc.) the baseline scenario for the remaining part of 2017 tends towards less downside risks for growth and inflation.

This risk scenario could materialize through poor communication of the monetary policy in the US, or through materialization of some of the end risks in Europe (linked to Euro-scepticism or sovereign / financial vulnerability of some member states in the region). In this sense, the elections in France and political development in Italy are key factors to monitor over the coming months.

## Monetary policy

The US Federal Reserve is expected to adjust its monetary policies in an orderly fashion with gradual interest rate increases until 2019, alternating with normalization of its balance sheet only after the end of 2018. In this context, in 2017 two further raises are expected to position interest rates between 1.5% and 1.75% at the end of the year, emphasising that the uncertainty about this forecast is ample, particularly in relation to implementation of the tax policy, institutional design of financial regulations and even because of integration of the Federal Reserve in the near future.

In the Eurozone the monetary policy remains unchanged despite the fact the economic activity and inflation outlook is rather benign. Nevertheless, a debate has arisen about the normalization of the Central European Bank's balance (ECB), even discussing the eventual sequence of said normalization: eliminating negative rates, a gradual increase of interest rates and finally normalization of the balance sheet after the end of 2019. This has not yet been officially notified by the ECB, but that process will undoubtedly alter the guidelines of market expectations.

It is important to emphasise that communication about normalization of the ECB balance will require caution, particularly in a scenario where interest rates are still low, global portfolios still fragile, major financial stress still growing at flatter and flatter interest rate curves, over-valued assets, leverage in dollars and the foreseeable reduction of cash flow in strong currencies owing to reduced stimuli.

In the emerging markets scenario, there is a more selective, diverse monetary policy. Turkey and Mexico keep their bias on tightening their stance to consolidate their currencies in a scenario of relatively moderate activity, whereas Brazil relaxes it. The former countries have increased the average cost of funding by over 300 basis points (BPS) and further tightening is foreseeable in their monetary policies. Business activity in Mexico has reported better signs of resistance to those initially

anticipated, which will permit the Central Bank to continue defending the Peso by raising interest rates to up to 7%. In China, the Central Bank (PBoC) has increased interest rates since November, pointing out that this avoids monetary conditions being too slack. The monetary and financial policies in China will continue to have a prudential macro bias, seeking exchange intervention, correction and restriction of excesses and stabilization of portfolio flows. Other emerging markets (Argentina, Philippines and Indonesia) will also employ a tighter monetary policy.

## Exchange rates

Some events have had a considerable impact on the Euro - Dollar relationship. The more optimistic forecasts (concerning activity, inflation and interest rates) in the US, favour appreciation of the dollar, but the lack of materialization of the reflation expectations in any visible way curb it. The EMU on the other hand, the changes in language by the ECB and the reduction in political tension could favour appreciation of the Euro. The final result could see the Euro continuing its depreciation trend, but not as pronounced as before. Indeed, the Euro is expected to be valued at 1.01 against the dollar at the end of the year. The bias in this case, along with unmet expectations by the new federal administration in the US and a more optimistic language by the ECB, will be lower (i.e. appreciation of the Euro).

The perspectives in the emerging markets are diverse. In Brazil and Turkey higher depreciation of both local currencies is expected to be in line with real, financial vulnerabilities present in both economies today, which could also be accentuated in view of the domestic politics. Intervention by the PBoC is expected in order to seek stability of the Renminbi at depreciated levels around the end of 2017.



The outlook for the Mexican Peso is one of stabilization at current levels, providing the risks stemming from relations with the United States are not worsened and the monetary policy by the Federal Reserve does not speed up. For the rest of the currencies, moderate depreciation trends against the dollar are forecast in general, owing to normalization of the monetary policy in the US and the effects on the flows of global portfolios.

### **Risks**

At global level the risks appear to stem from the performance of the economic policy in the US, particularly if the market expectations concerning reflation are not met and if the asset prices (currently not aligned with fundamentals) undergo a severe correction (corporate debt, commercial land prices, valuation of variable revenue). In this sense, the normalization process of the Federal Reserve's monetary policy being carried out in an orderly, well-communicated manner is very relevant in order to prevent a process similar to the tapering process seen in 2013 with effects on global portfolios.

The political results of the French elections in Europe could trigger a systemic event, particularly if an Euro-sceptic party wins the second round of the presidential elections and then the legislative elections in June.

In the emerging markets, the vulnerabilities are linked to strong corporate leverage, in some cases in dollars. In China moreover, the risk of global implications arises from the relationship between the real estate sector, financial markets and management of the economic policy. It is worth noting that measures have been taken to slow down the economy, and as a result some asset inflation and nominal volatility processes (exchange rate, among others) have appeased.

### **Insurance markets**

Insofar as the global insurance industry is concerned, an acceleration over the coming two years is expected (in line with the general forecasts for economic activity), with the emerging markets heading up this growth, which is in line with the positive relationship between the increase in global premiums and rising interest rates and inflation.

Although the global insurance business forecasts are for an upward trend, it has been confirmed that both Life insurance and Non-Life insurance performance will continue to be higher in emerging markets compared to developed economies, owing to the higher sensitivity to economic growth because of the existence of a significant gap in insurance protection.



# 1. Economic Outlook

## 1.1 Global Economic Outlook: update

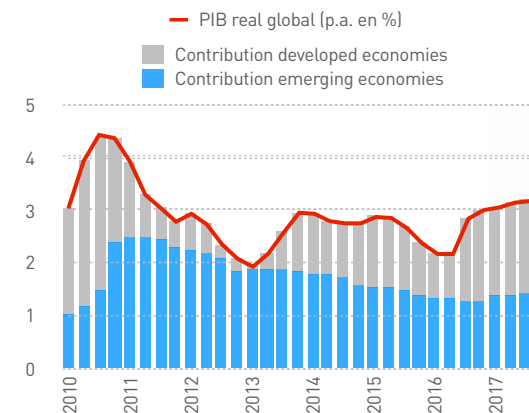
### General aspects

As expected, 2016 closed with a moderate acceleration in economic activity positioning overall annual growth at 3.1%. The forecast **anticipated for emerging economies** (4.1%) contributed more to the global economy than expected whereas the developed economies contributed by 1.7%. Overall, activity remained below the long-term growth of the global economy, as anticipated in the previous report (See ECONOMIC AND SECTOR OUTLOOK 2017, January 2017).

With regards to the **first quarter 2017**, our forecast is to continue throughout 2017 with growth in developed and emerging countries standing at 1.9% and 4.6% respectively. This leads to a total growth rate of 3.1%. Likewise, we maintain our forecast for very gradual acceleration of trade throughout 2017-2018. Similarly, we keep the central scenario of our previous report, although evidence about the new federal administration in the United States cancels out any rising bias hypothesis of the forecasts, at the same time as the decreasing bias is more pronounced.

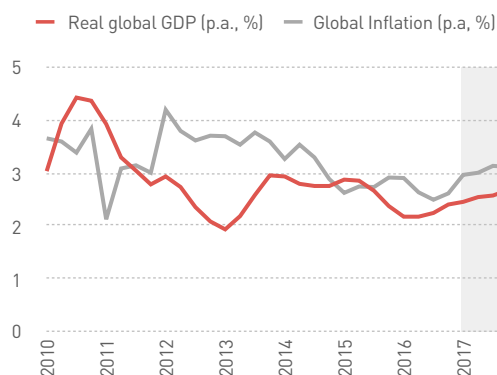
- Slight, although very moderate acceleration of global trade.
- The emerging markets have been at the forefront in the first quarter of the year.

Graph 1.1-a  
Global: contribution to growth by regions,  
2010-2017



Source: MAPFRE Economic Research (with data from Bloomberg)

Graph 1.1-b  
Global: growth and inflation, 2011-2016



Source: MAPFRE Economic Research (with data from Bloomberg)

## Relevant trends

At the start of 2017 a certain degree of divergence has been noted between, on the one hand the confident indicator readings (PMIs, consumer confidence, valuation of variable revenue and corporate debt) and on the other, what has been extracted to date from the formal data such as industrial production and the global trade index (See Graph 1.1.-c). This divergence could be being created by the **reflation expectations** linked to an expected expansion of tax policies in the United States and globally. .

Nevertheless, the metrics concerning reflation remain moderate: long-term interest rates are currently limited to the rise reported in the final quarter of 2016, particularly in the US and the Eurozone where the earnings recorded in the first season (by term) are diminishing. Likewise, the price of inflation indexed bonds are consistent with a reversal of expectations.

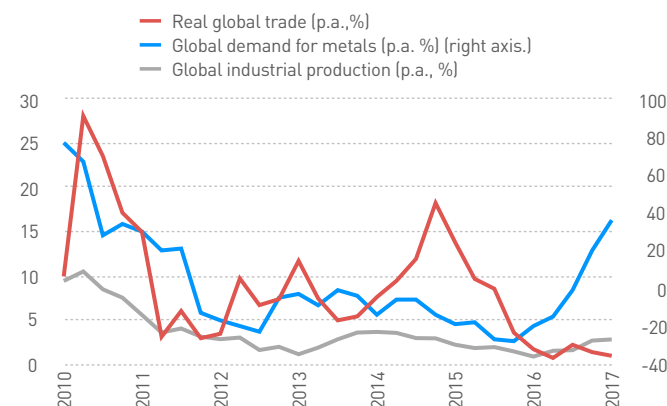
On the other hand, the portfolio flows returned to the emerging countries seeking yield equivalent to the US. This process partly permitted a slight recovery and stabilization at depreciated currency levels (mainly China and Mexico).

The reduced impetus of long--term interest rates and moderation in inflation forecasts have, for now, contained part of the appreciation impulse of the dollar against the rest of the currencies, although this will necessarily follow the line of divergence of monetary policy between the US and the rest of the world.

In general terms, the **monetary policy** at global level is still unequal and is conditioned by the current differences of the economic moment of the different economies (higher in developed markets than in emerging markets), inflation pressure, global portfolio flows, defence of the Chinese currency, determination by the US Federal Reserve and other factors such as the complementarity and viability of more relaxed tax policies. In general, the divergence in intensity and in the direction of monetary policy in the US applies pressure to the global monetary policy (See Graph 1.1-d):

- In the **United States** the course of monetary normalization continues, albeit gradually and employing correct communication of expectations over inflation and consumption. The lower stimuli (tapering) of the Federal Reserve in 2013 is reminiscent of the effects of a monetary policy that was not properly anticipated by the market (interest rate and exchange rate volatility, exhausted reserves, capital flow refuge and low selective pressure on certain assets, appreciation of liabilities, etc.), owing to which the gradualist approach by the FOMC (Federal Open Market Committee) in March emphasising the need to balance monetary normalization with containing financial volatility is very relevant.

Graph 1.1-c  
Global: global activity indicators, 2010-2017



Source: MAPFRE Economic Research (with data from Bloomberg)



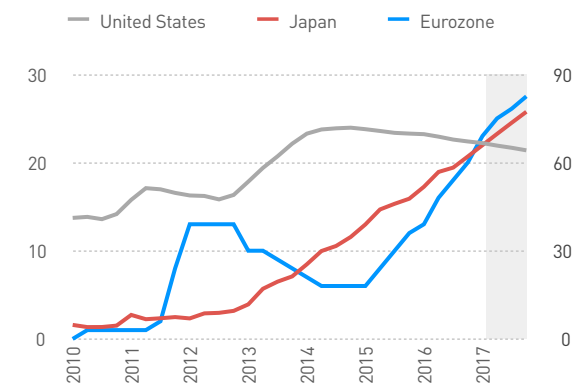
The President of the Federal Reserve, J. Yellen, has underscored the need to withdraw “QE\_infinity”<sup>1</sup> from the ideology of the markets. To achieve this, gradual interest rate increases can be seen on the horizon (the consensus anticipates rates around 1.5-1.75% for the end of 2017) followed by new increases in interest rates in 2018, but accompanied by normalization steps in the Federal Reserve balance, firstly through non-reinvestment of yields and later with the gradual sale of assets (expecting the asset balance value to fall from 23% of the GDP to 10% of the GDP between 2019 and 2025).

- The **Eurozone**, the Central European Bank (ECB) is further away from normalization and still guarantees the purchase of assets at a rate of €60 billion until December 2017, the end of negative interest rates at the start of 2018 and a hypothetical start of rate increases in 2019. Although we cannot yet start talking about the sale of assets, the fact of knowing the time-line permits identifying the sequence and anticipating a reduction in the balance after 2020, leading to the market coining the term “eurotapering”, referring to the aforementioned normalization.

It is important to point out that the joint dynamics of the Federal Reserve and the ECB anticipate (despite the differences in sequence) a shortage of global liquidity in strong currencies at the end of 2019 (the dollar and Euro account for 85% of the global total), with the subsequent implications this has for businesses in emerging markets and financing in those currencies.

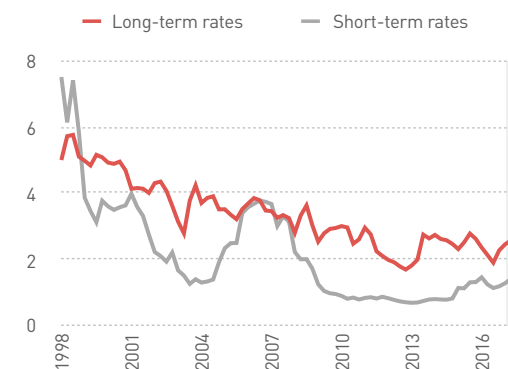
- In **Japan** the monetary policy has focussed on guaranteeing positive (or zero) interest rates in the long sections of the curve. Nevertheless, pressure on the temporary premium (by term) by the US has applied pressure to this objective and has forced more aggressive sales/purchases of Japanese / US bonds, thus altering the Yen.
- In the case of **China**, the prudent policy with a slightly restrictive bias to protect the Renminbi has involved sales of treasuries from the US, entailing higher rising pressure for the US interest rate curve.

Graph 1.1-d  
Global: Central Bank balances (% of GDP)  
2010-2017



Source: MAPFRE Economic Research (with data from Bloomberg)

Graph 1.1-e  
Global: gradient of the global interest rate curve in short and long-term (%), 1998-2016.



Source: MAPFRE Economic Research (with data from Bloomberg)

## Flat curves are added to the financial sector problems

Despite the increasingly restrictive bias of the US monetary policy, the time structure of interest rates still has a very low profile<sup>2</sup> and that profile moreover is reducing in line with the **flattening of the term premium slope suffered** over the last months of 2016 despite the promising initial rise<sup>3</sup>.

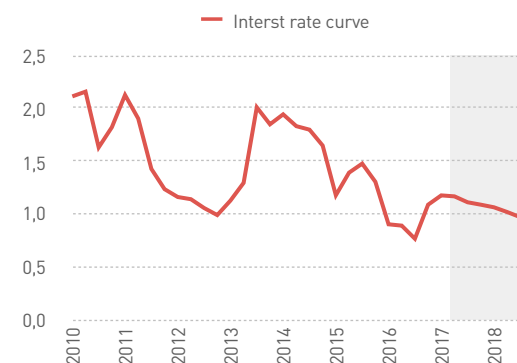
Although the reflation policy is moderately encouraging growth expectations, inflation and interest rates, the general consensus is beginning to admit that the gradual increases of official rates is not being proportionally transferred to the rest of the curve, and consequently upward displacement of the level is taking place adding to the traditional problems of financing liabilities in the finance sector with a scenario of more onerous capital costs. This situation is very similar to the one that took place in 2005, which was also caused by the effect of Duration Risk<sup>4</sup> (Duration Risk) on global portfolios, although back then it was due to the saving action, mostly in China, and today it appears to obey the global action of Central Banks in the form of hoarding of treasuries long-term.

## Crude oil and raw materials cycle

Since the start of the year, the **increase in crude prices** has tempered slightly, moving from 57 USD/bp in January, to 52 USD/bp today. Nevertheless, the price of the Brent barrel of crude oil is still 43% below the prices recorded in 2014.

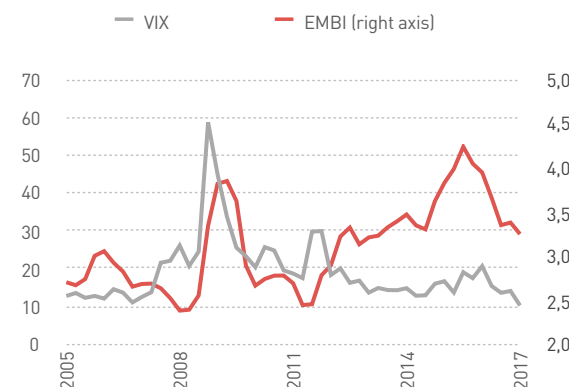
Concerning this, we hold our forecasts made last quarter, bearing in mind that we consider 60 USD/bp could be the balancing price in the long-term that should be reached, and that the forces acting on price setting of crude products are maintained (lack of production capacity at low prices, exhausting stocks, increase in global demand and OPEC agreements on quantities). It is therefore foreseeable for the Brent barrel to reach that price (60 USD/bp) by the end of 2018.

Graph 1.1-f  
Global: gradient of the global interest rate curve (%),  
2010-2018



Source: MAPFRE Economic Research (with data from Bloomberg)

Graph 1.1-g  
Global: Risk appetite / aversion, 2005-2017



Source: MAPFRE Economic Research (with data from Bloomberg)

### Global vulnerabilities: leverage and exuberance

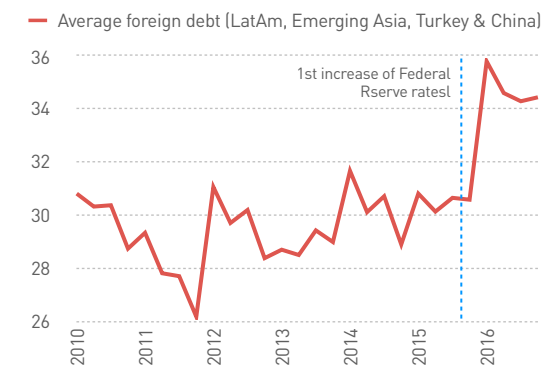
The **current global debt**, i.e., that accumulated by all players (both private and public sectors) increased by 70 billion dollars in 2007 to 215 billion (325% of the global GDP) at the end of 2016. The developed markets have contributed to this debt by the amount of 33 billion (to reach 160 billion, equivalent to 390% of their GDP) and the emerging economies by 38 billion (reaching 56 billion, 215% of their GDP).

Comparatively, the emerging markets are the ones that have become most leveraged since the start of the crisis, whereas the developed economies have de-leveraged. This has basically taken place in the non-financial corporate sector, that are being increasingly financed in international markets. For example, the issue of corporate bonds in local currencies of emerging countries such as Turkey, Chile and China was for 31 billion dollars (185% of their GDP) between 2007-2016, whereas the issue of bonds in dollars during this period accounted for 7 billion dollars (30% of their GDP).

This phenomenon has three significant implications:

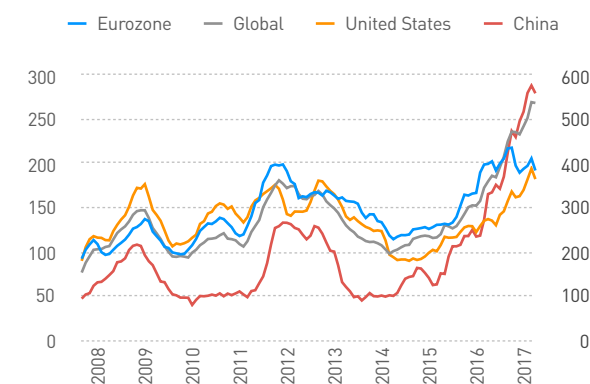
- On the one hand, it sets challenges for the scope of implementation of tax policies, particularly in a scenario of increasing financing costs (owing to rising global interest rates, country risk premia plus appreciation of the dollar).
- On the other hand, the de-leveraging of the corporate sector is more pronounced, where increasing resources have to be assigned in order to face the financial cost of debt at the expense of investment.
- And finally, in a context of deficient exchange coverage or weakened international reserves, the exchange risk could become credit risk in the channel of portfolio flows. In this sense, the role of the major institutional investors (particularly the insurance industry) on the global stability of flows gains major importance (See Chart 2.1.1.-b).

Graph 1.1-h  
Global: average external debt in emerging markets (% of GDP), 2010-2016



Source: MAPFRE Economic Research (with data from Bloomberg)

Graph 1.1-i  
Global: Economic policy uncertainty indexes, 2007-2017



Source: MAPFRE Economic Research (with data from Bloomberg)

In addition to the vulnerability stemming from leverage, the international economy appears to be increasingly exposed to risks stemming from the **exuberance in the valuation of certain assets** (fixed corporate income unlinked to credit risk, real estate assets above the fundamental value and equity earnings with extremely high P/E) constructed in a context of extreme liquidity and appetite for risk forcing the value of certain assets out of harmony with the fundamentals. This phase of exuberance appeared to be linked to higher growth, activity and inflation expectations stemming from the global reflation process. This financial turmoil, the aligning of credit risks with current economic fundamentals, or poor communication of monetary policy decisions by the Federal Reserve could act as a possible detonator for a situation of global financial and economic stress. Proof of the implied risk that a mismatch between fundamentals and expectations has over the price of assets can be observed by comparing the price of global hedging and the risk aversion index.

### Balance of risks

The **balance of risks is consistent with that described in our previous report**. In the short-term, the following have been identified: Firstly, the possibility of renewing the notion of "secular stagnation" on the basis of the US's inability to implement its economic policy as expected, in a context where the peak of the cycle appears to have been reached (currently with full employment, 4.5% unemployment), as proven through the health reform and the rest of the economic reforms (See Chart 1.2.1).

Secondly, problems with corporate debt in emerging countries (and some developed countries) entailing a high risk of non-materialized credit, with implications for financing and which has effects on the balance of other entities, with effects on credit, trade, investment and employment.

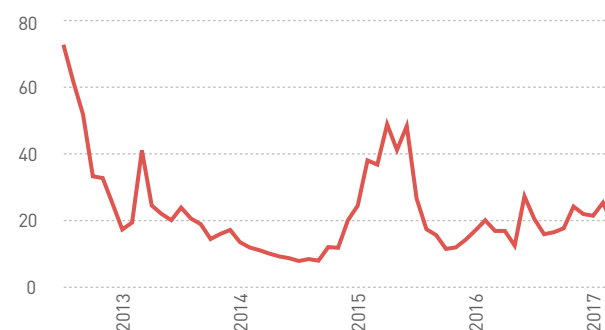
Thirdly, the problems stemming from geo-politics (entailing higher risk spread) and with the regional European politics and regional governance. In a context of weak banks in some relevant countries that cannot afford any

additional financial costs (Italy) and where there is a visible risk of fragmentation of the Eurozone (See Graph 1.1-j) despite the evident about turn of Euro-scepticism that populist parties have capitalized on (See Graph 1.2.2- c).

And fourthly, a latent risk of a real, financial collapse in China, although not negligible, is now less likely owing to the rather severe, prudential macro measures that have been implemented to limit credit risk and asset exuberance (measures that apply to the residential and financial sectors).

Nearly all of them are risks whose probabilities have increased compared to the previous report, owing to which the central scenario remains valid, and these extreme risks advise caution.

Graph 1.1-j  
Eurozone: Sentix Index (probability of fracture of the EMU),  
2012-2017



Source: MAPFRE Economic Research (with data from Bloomberg)



## 1.2 Risk assessment in selected economies

### 1.2.1 United States

#### Tempering expectations

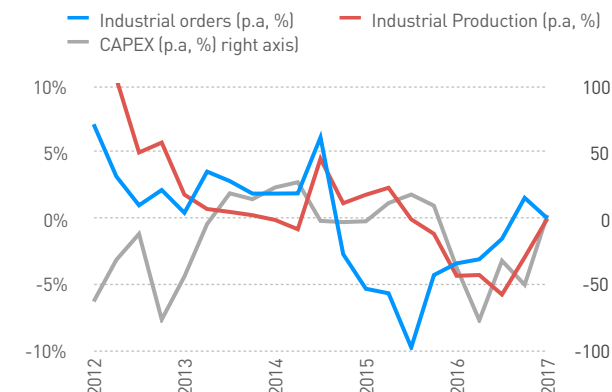
As anticipated in our previous report, the US economy ended 2016 with growth of 1.6%, after recording a growing GDP of 1.9% per annum during the final quarter mainly supported by private consumers and stock accumulation.

Nevertheless, these factors are expected to lose force temporarily during Q1 2017 as a result of lower dynamism of actual disposable income, owing to the provisional rise of inflation.

Moreover, the employment figures for March (98 thousand new jobs vs. the forecast 131 thousand) are essentially explained by lower job creation in retail sales. This is not a bad figure, since it is in line with the current level of employment (unemployment of 14.5%, considered to be full employment), but the moderate rise of salaries of only 2.7% is emphasised (caused by low productivity) also in a context of moderate inflation.

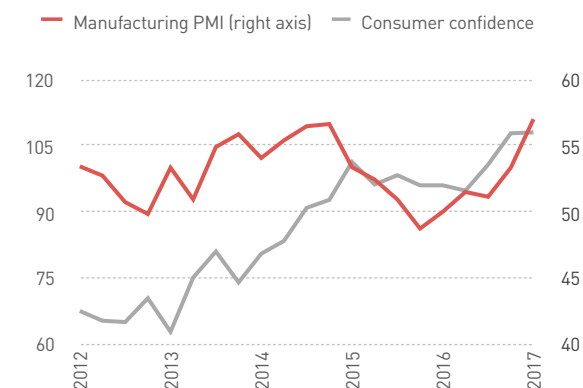
- The expectations with a view to the economic policies of the Trump Administration are tempered owing to the implementation difficulties, particularly the tax policies.
- A positive outlook is maintained on trade and employment, but supported on domestic demand with an increasing role of investment.
- The Federal Reserve is speeding up the rate of monetary normalization, consolidating appreciation of the dollar.
- The risks continue to report a falling trend. The risk of corporate financial adjustment could end up affecting the nominal variables (weaker dollar and interest rates in the long-term).

Graph 1.2.1-a  
United States: expectation indicators (1), 2012-2017



Source: MAPFRE Economic Research (with data from Bloomberg)

Graph 1.2.1-b  
United States: expectation indicators (2), 2012-2017



Source: MAPFRE Economic Research (with data from Bloomberg)

As a counterbalance, better performance of investments is expected (in equipment and residential), sustained on better investment expectations, healthy corporate balance sheets and a still benign energy outlook. The lead indicators (ISM), and the very dynamics of variable earnings (with higher P/E ratios) appear to anticipate this. In the remaining part of the year, trade acceleration (2.3% per annum) is still expected, supported on domestic demand thanks to salary and employment earnings, and foreign trade.

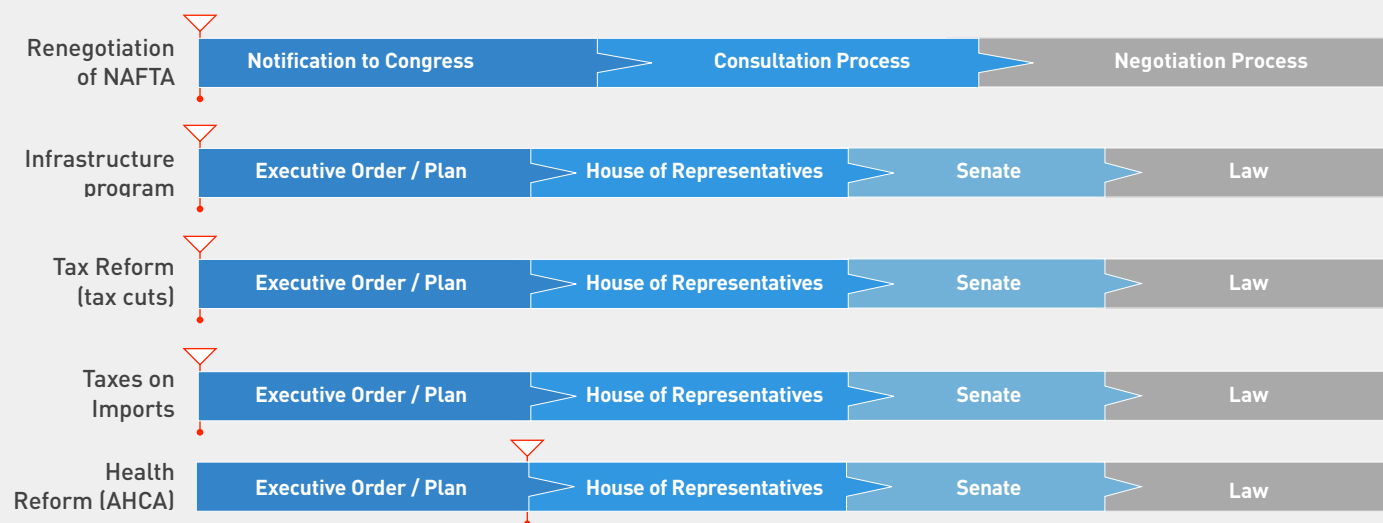
In general higher risks of lowering are forecasts are observed, owing to the slow materialization of the economic policies by the Trump Administration and

particularly the difficulty of activating the initially anticipated tax policy (See Chart 1.2.1). In view of the dynamism in activity, consolidation of salary earnings and the increase in rents and health costs, inflation is expected to increase from Q1 recording rates consistent with the Fed target (+2%). The acceleration of demand and inflation guarantee continuity of the monetary policy normalization process.

The Federal Reserve is expected to increase interest rates at least twice in the remaining part of 2017 (+25 bp each time), positioning the reference rate somewhere between 1.5% and 1.75% at the end of 2017. In the second quarter

we also expect to see an agreement about how the normalization process of the Federal Reserve balance sheet will materialize, and for this to start at the end of the year with non-reinvestment of yields during most of 2018 leading afterwards to the sale of assets in 2019. This will lead to long-term convergence of interest rates (10-y Tbill) at 2.75-3% at the end of 2018.

**Chart 1.2.1**  
Advance of implementation of  
the main milestones in economic policy



Source: MAPFRE Economic Research

This forecast (shared with the market) has caused an increase in the gradient of the interest rate curve (increase in time premium +50bp since December), although in recent months the curve has visibly flattened off in line with the descriptions provided in the global section of this report. The monetary policy differential and the reflation pulse (although this is rhetoric for the time being) point to a dollar forecast in constant appreciation compared to the Latin American currencies and on a par with the Euro.

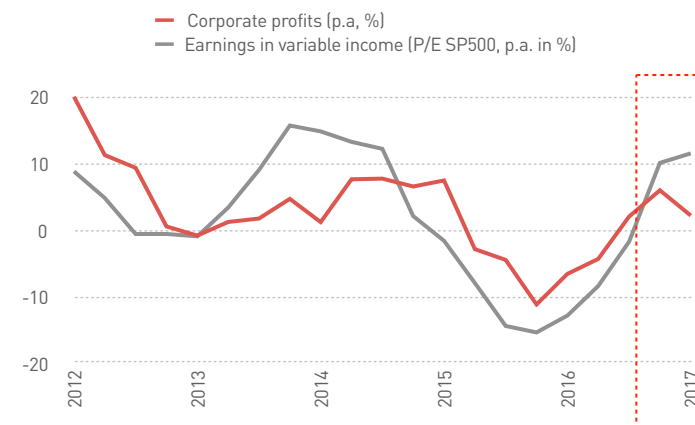
In addition to the restrictions on implementing the plans comprising the electoral promises, a series of events have forced attention to be turned to modulation (if not contradiction) of President Trump's rhetoric, changing the international policy priorities, redefining the trade strategy, modulating expectations for tax and health reform, and returning legitimacy to the Federal Reserve in an attempt to adapt to reality and to manage the expectations of 100 days of office<sup>5</sup>.

The most immediate risks stem from the uncertainty concerning implementation of the economic policy. The intense executive activity by President Trump has not been aligned with a credible articulation of the economic policy, and to date the formulae do not contain sufficient details to permit assessment thereof. On a par, most of the proposals have come up against resistance in both groups in Congress, which reduces the probability of them being implemented. A recent example is the abolished health reform proposal which has also hindered articulation of the tax policy. Furthermore, the legislative and executive uncertainty appear to justify the growing questioning of the political legitimacy of the new Administration, and fear of a loss of legal security.

At financial level, the concern that the Federal Reserve will succumb to the pressure of market expectations and end up increasing interest rates faster than forecast could lead to overshooting of the exchange rate that is in line with flattening of the interest rate curves, although at high interest rates. This last risk gains special importance at a time when the consensus by analysts is starting to speculate about the divergence between the real sector (still reporting moderate dynamism) and the exuberance found on the

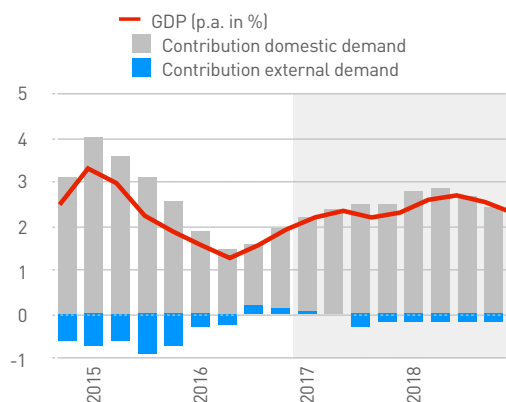
financial markets. The valuation of corporate debt and variable income find support in expectations from tax stimuli, but not in business investment yet.

**Graph 1.2.1-c**  
**United States: stock market vs. corporate performance,**  
**2012- 2017**



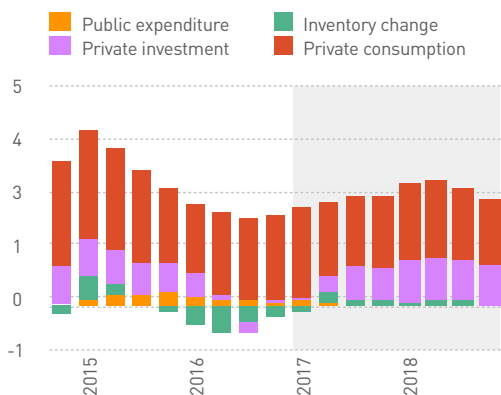
Source: MAPFRE Economic Research (with data from Bloomberg)

**Graph 1.2.1-d**  
United States: GDP breakdown and forecasts, 2014-2018



Source: MAPFRE Economic Research (based on Federal Reserve data)

**Graph 1.2.1-e**  
United States: breakdown and forecasts of domestic demand, 2014-2018



Source: MAPFRE Economic Research (based on Federal Reserve data)

**Table 1.2.1**  
United States: main macro-economic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	2.2	1.7	2.5	2.6	1.6	2.3	2.5
Contribution of the domestic demand	2.2	1.4	2.1	3.3	1.6	2.4	2.7
Contribution of the external demand	0.1	0.3	0.2	-0.7	-0.1	-0.1	-0.1
Contribution of private consumption	1.0	1.0	1.9	2.2	1.8	1.8	1.7
Contribution of investment	1.2	0.6	0.5	0.8	0.1	0.5	0.9
Contribution of public consumption	-0.1	-0.4	-0.1	0.2	0.1	0.1	0.0
Domestic demand (average % p.a.)	2.1	1.3	2.5	3.2	1.6	2.3	2.6
Total consumption (average % p.a.)	1.0	0.8	2.2	2.9	2.3	2.2	2.1
Investment (average % p.a.)	6.3	3.1	4.2	3.8	0.7	2.5	4.6
Exports (p.a. as %)	0.4	0.5	0.6	0.0	0.1	0.3	0.4
Imports (p.a. as %)	-0.4	-0.2	-0.4	-1.2	-0.1	-0.4	-0.5
Unemployment rate (end of period)	7.8	6.9	5.7	5.0	4.7	4.6	4.6
Inflation (p.a.. end of period)	1.9	1.3	1.2	0.4	1.8	2.2	2.2
Fiscal balance (% GDP)	-8.9	-5.4	-4.9	-4.5	-4.9	-5.0	-5.4
Trade balance (% GDP)	-4.8	-4.4	-4.5	-4.4	-4.1	-4.0	-4.0
Current account balance (% GDP)	-2.8	-2.2	-5.7	-2.6	-2.6	-2.6	-2.7
Official interest rate (end of period)	0.13	0.13	0.13	0.17	1.00	1.50	2.00
Interest rate 10 year	1.71	2.75	2.28	2.19	2.09	2.72	3.00
Exchange rate against the USD (end of period)	1.31	1.37	1.11	1.13	1.05	1.01	1.04
Private credit (% per annum. average)	2.9	7.6	7.7	2.3	3.6	6.2	5.0
Family credit (% per annum. average)	-0.4	0.8	2.4	2.5	3.3	5.2	5.5
Non-financial S.P. credit (% per annum. average)	2.3	3.4	4.8	5.7	5.4	4.2	4.1
S.P. credit (% per annum. average)	-1.9	2.2	2.9	2.2	4.2	3.6	2.6

Source: MAPFRE Economic Research (based on Federal Reserve data)

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## 1.2.2 Eurozone

### Continuation of the compromising economic situation and monetary policy

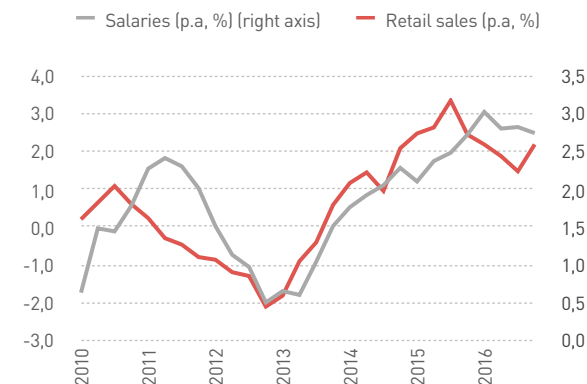
2016 closed with average annual growth (1.7% per annum) higher than expected, thanks to an increase in activity during the final quarter 2016 (0.5% quarter on quarter). The latest indicators (PMIs and consumer expectations, among others) anticipate that the "moment" will be maintained through the first quarter 2017.

On the other hand, although from here on a gradual slow down is expected that will lead to growth rates in line with the long-term trend, growth expectations are visibly higher than estimates last quarter. Average growth of between 1.5% is expected between 2017 and 2018 as a result of a more favourable scenario for business investment and global demand.

This year activity will be supported by domestic demand, and increasingly by foreign trade thanks to appreciation of the dollar and the dynamism of the US and China, and the rest of the world. The dynamics of domestic demand will be marked by a gradual substitution of consumption for investment. Consumption will lose strength since the growth of wages will slow down due to a forecast for more moderate growth in salaries than inflation in a context where access to credit does not substitute salary earnings. The financial conditions (although favourable) are not sufficiently broad.

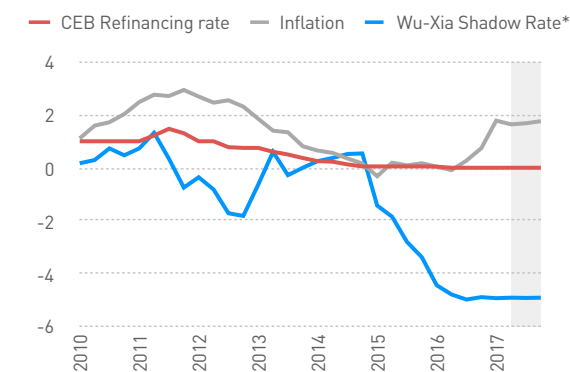
- **Economic activity maintains its pulse. Our forecasts for 2017-2018 have increased.**
- **Unchanging monetary policy at least until the end of 2018, but "Eurotapering" has been considered.**
- **The political risks appear as the biggest and most imminent risk, but they are not the central scenario at the moment.**

Graph 1.2.2-a  
Eurozone: earnings and retail sales, 2010-2016



Source: MAPFRE Economic Research (with data from Bloomberg)

Graph 1.2.2-b  
Eurozone: inflation and monetary policy (total monetary conditions), 2010-2017



Source: MAPFRE Economic Research (with data from Bloomberg)  
\*Interest rate equivalent to current monetary policy (QE + rate)

Investment, however, will be favoured by the exhaustion of installed capacity (investment has been weak since the financial crisis), which will require higher investment in a high corporate saving context through retained profits, and a higher and better access to financing, both through banks and wholesale markets, particularly in a context where the corporate sector has substantially reduced its debt levels.

On the other hand, inflation will rise in the last few months, leaving behind the deflation fears of the past. The increase was mostly due to transitory factors, whereas underlying inflation and inflation expectations remain firmly rooted. As in the final quarter of 2017 inflation is expected to slowly converge to meet the 2% objective established by the Central European Bank (ECB) over the coming two years. At the end of 2017 inflation is still expected to be the 2% threshold.

On the other hand, the economic policy measures remain oriented towards supporting growth. The monetary policy keeps interest rates at zero and the sovereign buying program by the ECB will remain at 60 thousand million euros until December. In this sense, it is worth emphasising the change in language by the ECB President Mario Draghi, anticipating a less accommodating bias of the monetary policy in the future; "tapering" of the ECB is already in the market environment. Even so, the start of normalization of the monetary policy in the Eurozone is not expected until the end of the first quarter 2018, insofar as the start of interest rate increases could take place at least in the middle of 2019. Before the start of "tapering" however, it will be necessary to correct the current negative interest rate policy in the marginal ease of deposits (one off).

On the other hand, the corporate bond purchasing program by the ECB (Corporate Sector Purchase Programme, CSPP) that began a year ago, in general terms has translated as cheapening of capital whilst at the same time it has allowed credit to flow to the financially sound entities, which appears to be encouraging investment in the zone.

The tax policy in the Eurozone (Junker Plan, national plans, etc.) remain neutral, with no changes since the last quarter, although the next political cycle could emphasise a rising bias (Macron in France, Rajoy in Spain, etc.). Based on the foregoing, it is possible to ratify the forecast in the sense that tax support will stimulate growth of the GDP (tax boost) at around +50bp over the coming two years.

With the deflation risk have attenuated, the biggest challenge the Eurozone faces is in relations between regional governance, the advance of breakaway populism and sovereign / financial problems, which although are somewhat idiosyncratic, could be the catalysts for an event with systemic consequences that nearly took place in 2011.

In this sense, the division in outlooks remains (the "Rhine Divide"<sup>6</sup>) concerning the nature, economic policy and mutual character of the Eurozone, which is still a factor that hinders the articulating of key structural reforms (bank and tax unity, among others) and unity in implementation of an inclusive economic policy.

The above is a subject that could continue legitimising the advance of Eurosceptical parties. Moreover, in a context of high real and financial vulnerability, this rhetoric emphasises the perception of risk by the markets. A reflection of this is the increase in the sovereign spread and the CDS in most countries in the region. The increase makes financing costs more expensive, and in conjunction with poor communication of the monetary policy in a context of weak banking (such as the case of Italy), it could cause a liquidity problem leading to a solvency and stability crisis in the financial system with the consequent repercussions in the real sector of the economy; more so in a context where the monetary policy appears to have reached its limits.

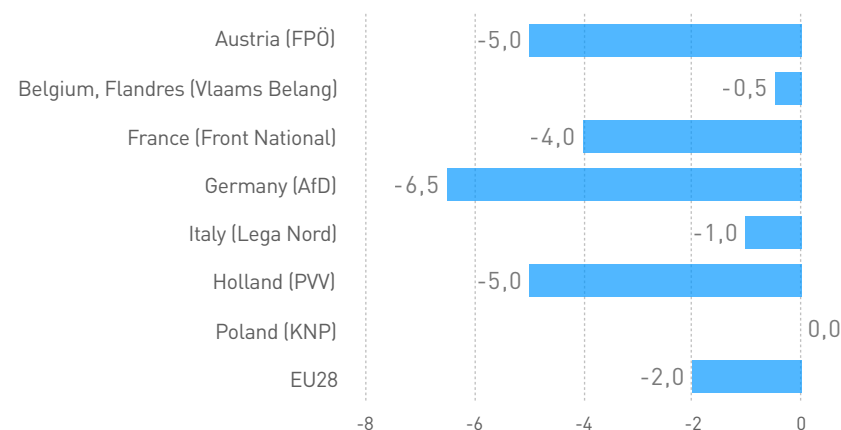
Despite the foregoing, the global reflation process and accelerating economic activity have alleviated the regional financial tensions and consolidated a gradual recovery of occupation and salary growth, leaving European populism with weakened arguments. On the other hand, the Brexit could have been the required warning for the Eurozone members to franchise their responsibilities in favour of regional governance. Perhaps the Brexit and the "no" to the Italian constitution reform have marked the zenith of the rise of populisms in Europe. In December 2016 "Euro-scepticism" accounted for 25% of votes in favour of "Euro-sceptical" parties; whereas five months later, this support has fallen to 20%. The Eurozone Sentix vulnerability index, which measures the probability of Euro rupture, has been visibly corrected since December (See Graph 1.1-j).

Therefore, the risk in Europe will be linked to political cycles and the coming legislative dynamics of the region. Since March 29th, Brexit has been triggered and a long period of negotiations has begun in which both parties (the European Union and the United Kingdom) have negotiation strategies which in addition to delaying an agreement, mean an WTO type exit is the most likely outcome, which will undoubtedly increase financial volatility in the coming months, more so in a context of change in the Presidency of the Eurogroup and renewal of tension with Greece (some significant maturity deadlines are approaching concerning their debt in the second half of the year).

At the same time, after the elections in Austria (December) and in Holland (March), the elections in France are approaching (Parliamentary - 18th June), in Germany (24th September) and in Italy (most likely second half of 2017), and although no Euro-sceptical party is expected to win, neither is an absolute majority by any establishment party viable, which will force alliances with higher or lower degrees of stability in turn hindering governance of the region in the short-term. In particular, in France, although the markets predict a parliamentary win by E. Macron<sup>7</sup>, external pressures (political, media or terrorist) and high economic fatigue, could favour LePen. A parliamentary victory by LePen would have system

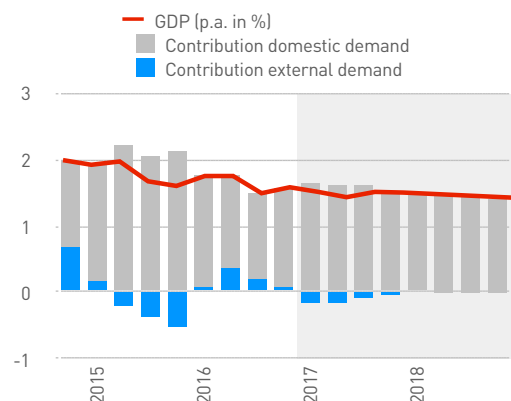
consequences, owing to her intention of leaving the Euro<sup>8</sup>, but for now, this is not our central scenario. In line with this forecast, a gradual correction of the French CDS and risk premia and banking CDS's are expected, among others. Political fragmentation has proved to lead to solutions that are not ideal for governability.

**Graph 1.2.2-c**  
Eurozone: Euro-scepticism in Europe  
(% variation in voting intention from polls in January)



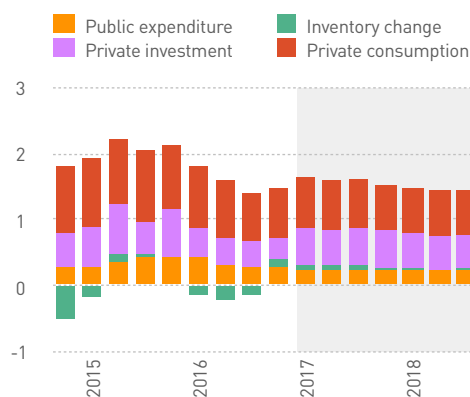
Source: Eurobarometer

**Graph 1.2.2-d**  
Eurozone: GDP breakdown  
and forecasts, 2014-2018



Source: MAPFRE Economic Research (with data from ECB)

**Graph 1.2.2-e**  
Eurozone: breakdown and forecasts  
for domestic demand, 2014-2018



Source: MAPFRE Economic Research (with data from ECB)

**Table 1.2.2**  
Eurozone: principal macro-economic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	-0.9	0.8	1.6	1.8	1.7	1.5	1.5
Contribution of the domestic demand	-2.0	0.8	0.8	2.0	1.5	1.6	1.5
Contribution of the external demand	1.1	-0.1	0.7	-0.2	0.2	-0.1	0.0
Contribution of private consumption	-0.7	0.2	0.8	1.0	0.8	0.7	0.7
Contribution of investment	-0.9	0.1	0.1	0.6	0.4	0.6	0.5
Contribution of public consumption	-0.1	0.1	0.2	0.4	0.3	0.2	0.2
Domestic demand (average % p.a.)	-2.0	0.9	1.3	2.1	1.5	1.7	1.5
Total consumption (average % p.a.)	-0.9	0.4	1.3	1.8	1.5	1.3	1.2
Investment (average % p.a.)	-4.1	0.7	1.7	3.3	2.0	2.7	2.5
Exports (p.a. as %)	1.0	1.4	2.9	1.8	1.2	1.3	1.3
Imports (p.a. as %)	0.1	-1.5	-1.5	-3.3	-1.0	-1.4	-1.3
Unemployment rate (end of period)	12.1	11.6	11.0	10.1	9.4	9.0	8.7
Inflation (p.a.. end of period)	1.4	0.6	0.2	-0.1	1.6	1.5	1.8
Fiscal balance (% GDP)	-3.3	-2.8	-2.3	-1.9	-1.6	-1.4	-1.2
Trade balance (% GDP)	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Current account balance (% GDP)	1.9	2.1	2.9	3.2	2.8	2.5	2.3
Official interest rate (end of period)	0.60	0.23	0.05	0.00	0.00	0.00	0.00
Interest rate 10 year	2.82	2.22	1.28	0.88	1.40	1.74	2.02
Exchange rate against the USD (end of period)	1.31	1.37	1.11	1.13	1.05	1.01	1.04
Private credit (% per annum. average)	12.3	12.4	12.5	12.5	12.6	12.6	12.6
Family credit (% per annum. average)	-0.3	-0.6	0.4	1.3	2.5	3.3	3.6
Non-financial S.P. credit (% per annum. average)	-0.3	-1.5	4.9	3.5	-0.3	0.0	1.4
S.P. credit (% per annum. average)	7.6	-2.8	16.2	4.8	-0.0	0.9	1.6

Source: MAPFRE Economic Research (with data from ECB)

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### 1.2.3 Spain

#### Following winds prevail, but only moderately

In Q4 2016 the GDP grew by 0.7% quarter on quarter, thanks to the boost in domestic demand, which was favoured by real salary growth. Foreign trade also grew substantially, particularly with the export of services, but the strong growth in exports, levelled off this contribution. During the first quarter 2017 the boost is expected to hold, but will slacken off over the year as a result of falling tail winds observed to date. This tailing off of growth is however less than forecast in the last quarter, owing to which we expect growth to stand at around 2.5% in 2017 (a long way off the maximum recorded in 2015 and 2016).

Deceleration of consumption is expected due to exhausting of growth in real wages, with pay rises expected to be below the inflation rate that will occasionally rise due to the delayed effects of raw material prices and depreciation of the Euro recorded at the end of last year. Moderation in public consumption is also expected over 2017 (although tinged by the recently announced plans by the government to create public employment). Part of the lower dynamism will be set off with more vigorous investment, particularly in the residential sector, which will offset a certain level of sluggishness in equipment investments. The reduction of the housing stock, the still lax financial conditions (rates and low spreads) and institutional support for credit, along with the vigour of housing transactions and rising prices of new homes, will contribute to substantial growth in construction investments.

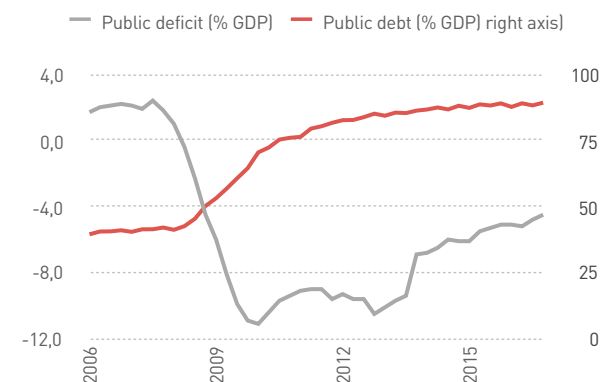
- **Failing tail winds and moderation in growth based on consumption (higher financial costs and less real salary growth).**
- **Gradual substitution of consumption for investment.**
- **Slower correction of real and financial vulnerabilities (family leverage, structural halt and public accounts).**

Graph 1.2.3-a  
Spain: real income growth 2011-2017



Source: MAPFRE Economic Research (with data from Bloomberg)

Graph 1.2.3-b  
Spain: Public accounts, 2006-2016



Source: MAPFRE Economic Research (with data from Bloomberg)

Insofar as external demand is concerned, the outlook is positive given the depreciation of the Euro and enhanced global dynamism, particularly within the Eurozone, the United States and China (jointly +65% of the Spanish market); all of which has taken place within a context that has favoured the export of services (tourism).

The Brexit effect and depreciation of the Sterling has not affected exports to the United Kingdom (8% of the total), proving the success of the hedging instruments (prefixed prices, exchange rate hedges, etc.).

On the other hand, the prevailing winds that had favoured performance by the Spanish economy are expected to remain, although somewhat weaker, throughout 2017:

- a) The Brent is holding for now at 43% below the 2014 level, with a certain margin for increase (expected to be at around 57-58 USD/b by the end of the year).
- b) The Euro will almost be on a par with the dollar at the end of the year, and will only start to revert at some point in 2018.
- c) Relaxed financial conditions will remain: low interest rates, spreads sovereign contents, improved credit spreads (thanks to the improved situation of the financial sector with NPLs slightly above 9% and more health balance sheets in general) and improved credit conditions.
- d) Dynamism of global demand will increase (although still moderate if compared with previous recoveries).

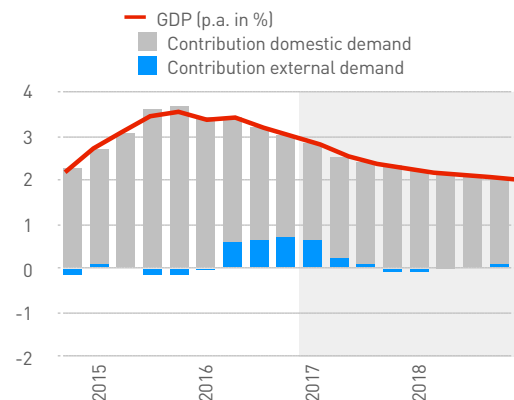
Inflation rose at the end of 2016 and start of 2017 due to the performance of crude prices and other raw materials, but the forecasts remain firm and no second round effects are expected. Hence, on average throughout the year, inflation will not rise above 2%.

On the other hand, the vulnerabilities of the Spanish economy are being corrected very slowly. The improved economic activity will continue to contribute to occupation and participation, owing to which we expect unemployment to be at around 17% by the end of 2017. Despite the considerable efforts made since the crisis (unemployment has fallen by near 10 points), the structural problems remain. The unemployment rate that we forecasted for the end of the period coincides with the structural unemployment rate forecast for the same date, which would exhaust the adjustment capacity of the economy if there are no major structural reforms. Families still need to de-leverage, which will limit consumption and saving, and the financial sector has not finished cleansing and repairing its balance sheets.

In terms of tax policy, the deficit in 2016 was 4.4%, above the limits established by Brussels, despite the fact that the tax boost was somewhat modest. The current government's goal of a 3.1% deficit is a credible proposal, despite the latest changes in the current goal (changing public employment from interns to permanent staff).

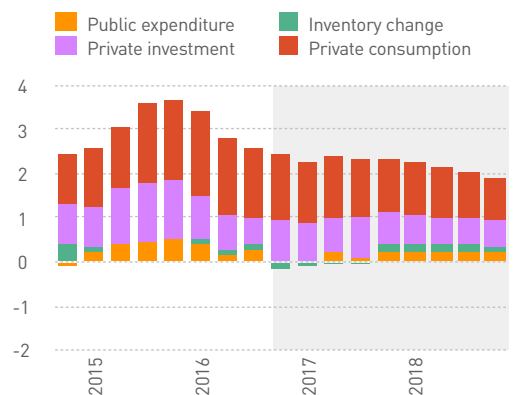
In conjunction with the foregoing, economic policy uncertainty, problems of territorial governance and other related subjects, continue to affect Spanish activity, although less so than in the past (estimated to take 0.5 points off the GDP in 2016). Resistance linked to a government without majority is particularly evident in the inability to implement structural reforms; a very relevant subject when raising productivity of certain sectors that contribute to the GDP.

**Graph 1.2.3-c**  
Spain: GDP breakdown  
and forecasts, 2014-2018



Source: MAPFRE Economic Research (with data from INE)

**Graph 1.2.3-d**  
Spain: breakdown and forecasts  
for domestic demand, 2014-2018



Source: MAPFRE Economic Research (with data from INE)

**Table 1.2.3**  
Spain: principal macro-economic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	-2.9	-1.7	1.4	3.2	3.2	2.5	2.1
Contribution of the domestic demand	-4.9	-3.1	1.3	3.2	2.8	2.3	2.1
Contribution of the external demand	2.0	1.4	0.1	-0.0	0.5	0.2	0.1
Contribution of private consumption	-2.0	-1.7	0.9	1.6	1.7	1.3	1.1
Contribution of investment	-1.9	-0.7	0.4	1.2	0.8	0.8	0.6
Contribution of public consumption	-1.0	-0.4	-0.1	0.4	0.2	0.1	0.2
Domestic demand (average % p.a.)	-5.0	-3.1	1.9	3.4	2.9	2.4	2.2
Total consumption (average % p.a.)	-3.8	-2.8	1.1	2.6	2.6	2.0	1.8
Investment (average % p.a.)	-8.6	-3.4	3.8	6.0	3.9	3.9	2.9
Exports (p.a. as %)	0.3	1.3	1.6	1.3	1.4	1.3	1.1
Imports (p.a. as %)	1.6	0.1	-1.1	-2.4	-0.9	-1.1	-1.1
Unemployment rate (end of period)	25.8	25.7	23.7	20.9	18.6	17.2	16.2
Inflation (p.a.. end of period)	3.1	0.1	-0.5	-0.3	1.0	1.4	1.4
Fiscal balance (% GDP)	-10.3	-7.1	-6.0	-5.2	-4.5	-3.2	-2.7
Trade balance (% GDP)	-2.8	-1.4	-2.2	-2.0	-1.3	-0.9	-1.0
Current account balance (% GDP)	-0.3	1.5	1.0	1.4	1.9	1.2	1.1
Official interest rate (end of period)	0.75	0.37	0.05	0.05	0.00	0.00	0.00
Average cost of interest rates	5.57	4.16	2.00	1.71	1.31	2.17	2.52
Exchange rate against the USD (end of period)	1.31	1.37	1.11	1.13	1.05	1.01	1.04
Private credit (% per annum. average)	-7.9	-4.2	-3.1	-2.4	-2.0	-0.8	-0.4
Family credit (% per annum. average)	-3.9	-5.1	-4.9	-3.8	-1.2	4.9	3.6
Non-financial S.P. credit (% per annum. average)	-3.4	-9.2	-5.1	-4.0	-1.0	4.8	1.8
S.P. credit (% per annum. average)	7.0	-17.4	-11.4	-5.3	-27.3	-18.2	-18.6

Source: MAPFRE Studies Service (with data from INE)

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## 1.2.4 Germany

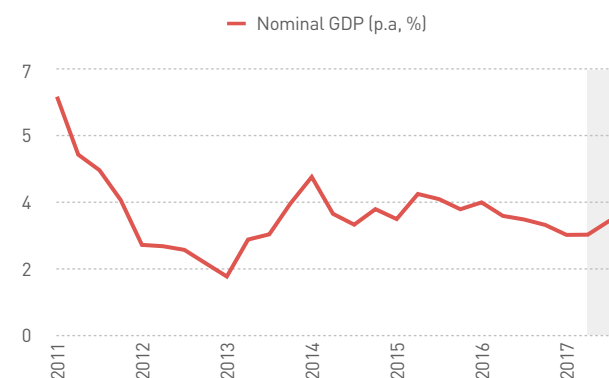
### Dynamism is maintained although at a lower speed

German economic activity ended 2016 with a significant degree of dynamism that is expected to remain through the Q1 2017. The vigour of domestic demand is evident not only in consumption and investment, but also in imports, which reduced the capacity of contribution to foreign trade. The dynamism of the domestic demand responds to good performance of activity in a context of high employment and contained inflation, ensuring growth of real salary earnings through the second half of the year. Nevertheless, as the support of a low inflation rate diminishes, some caution will re-emerge traditionally linked to the constraining of domestic demand in view of a foreseeable reduction in dynamism of wage increases. On the other hand, less current expenses and capital by the State is expected, and this will not be fully set off by dynamism in the private sector. Investment, closely linked to profits withheld from previous years (corporate savings), have reached their peak of highest dynamism and will gradually be reduced. Growth of around 1.5% is expected in the coming year, with domestic demand still being the main driving force.

- **2016 saw the most dynamic situation since the end of the crisis, but this will level off in 2017-2018.**
- **Low inflation will no longer be a supporting factor and will affect the dynamics of real salaries, limiting consumption and partly limiting investment.**
- **The foreign trade sector will keep its dynamism on the back of the current account surplus, contributing to differentially lower long-term interest rates than the rest of the Eurozone.**

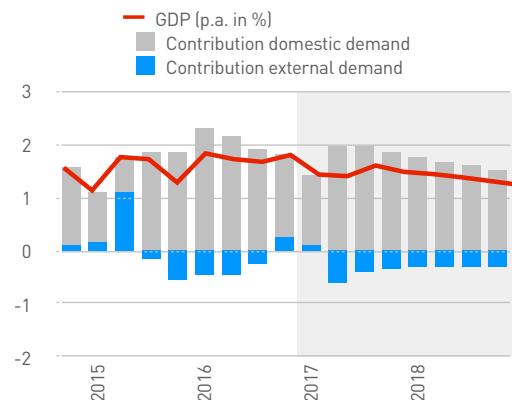
A tight job market and depreciated exchange rate anticipate inflation rates higher than those seen to date. Effects of the second round of pay cuts are still ruled out however. Germany will maintain its current account surplus, (at around 7% of the GDP), reinforcing its positive foreign position, attracting capital flows and pushing long-term interest rates below the rest of the Eurozone. Politically, at the general elections on 24th September, despite the rise in populist groups, no risk scenario is forecast. The Social-Democrat candidate Martin Schultz is still in a close coalition with Merkel, particularly insofar as foreign relations are concerned and relations with the United States. The only governability risk would be a SPD+Green party +Ex-Communists coalition, but the Euro is not questioned under any of these scenarios.

Graph 1.2.4-a  
Germany: nominal GDP growth, 2011-2017



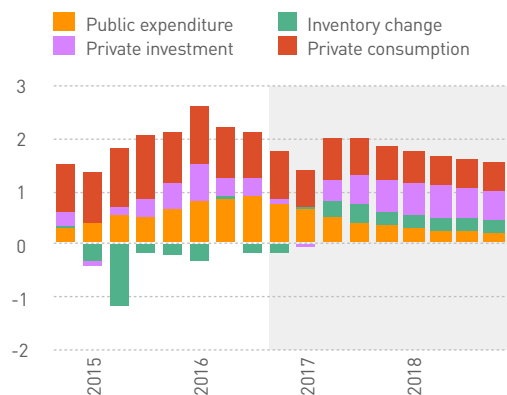
Source: MAPFRE Economic Research (with data from Bloomberg)

**Graph 1.2.4-b**  
Germany: GDP breakdown  
and forecasts, 2014-2018



Source: MAPFRE Economic Research (with data from DESTATIS)

**Graph 1.2.4-c**  
Germany: breakdown and forecasts  
for domestic demand, 2014-2018



Source: MAPFRE Economic Research (with data from DESTATIS)

**Table 1.2.4**  
Germany: principal macro-economic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	0.7	0.6	1.6	1.5	1.8	1.5	1.4
Contribution of the domestic demand	-0.7	0.9	0.8	1.3	2.0	1.8	1.6
Contribution of the external demand	1.4	-0.3	0.8	0.2	-0.2	-0.3	-0.3
Contribution of private consumption	0.7	0.5	0.5	1.1	1.0	0.7	0.6
Contribution of investment	-0.0	-0.2	0.4	0.2	0.4	0.4	0.6
Contribution of public consumption	0.2	0.2	0.2	0.5	0.8	0.5	0.3
Domestic demand (average % p.a.)	-0.8	1.0	1.4	1.4	2.2	1.9	1.8
Total consumption (average % p.a.)	1.3	1.0	1.0	2.1	2.4	1.6	1.1
Investment (average % p.a.)	-0.1	-1.0	3.5	1.2	1.9	1.9	2.9
Exports (p.a. as %)	1.6	0.9	2.1	2.0	1.0	0.9	1.1
Imports (p.a. as %)	-0.1	-1.3	-0.8	-3.1	-1.3	-1.2	-1.4
Unemployment rate (end of period)	6.8	6.8	6.6	6.3	6.1	5.9	5.9
Inflation (p.a.. end of period)	2.0	1.3	0.5	0.3	0.9	1.8	1.9
Fiscal balance (% GDP)	-0.0	-0.2	0.3	0.7	0.5	0.1	-0.0
Trade balance (% GDP)	7.3	7.6	7.8	8.5	8.7	7.8	7.4
Current account balance (% GDP)	7.1	6.8	7.4	8.4	8.8	7.1	6.4
Official interest rate (end of period)	0.75	0.37	0.05	0.05	0.00	0.00	0.00
10 year rate (end of period)	1.42	1.80	0.78	0.57	0.16	0.60	0.95
Exchange rate vs. USD (end of period)	1.31	1.37	1.11	1.13	1.05	1.01	1.04
Family credit (% per annum. average)	1.1	0.8	1.1	1.9	3.0	3.7	3.8
Non-financial S.P. credit (% per annum. average)	-0.0	-0.3	-0.3	-0.3	-0.2	0.1	0.5
Financial S.P. credit (% per annum. average)	0.8	-0.4	0.3	0.2	-0.1	-0.5	-0.2

Source: MAPFRE Economic Research (with data from DESTATIS)

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## 1.2.5 Italy

### Better signs of activity, more complex political situation

The Italian economy is showing general signs of recovery. Economic activity grew by around 0.9% in 2016 and reports a certain degree of resilience for 2017-2018.

The economy is expected to grow again by around 1%, which is satisfactory if compared to the performance since the end of the crisis. In 2016 most dynamism in the economy was largely due to domestic demand, and particularly to investment.

Anticipated indicators such as the PMIs indicate that activity will remain as it is at present during Q1 2017.

Higher inflation and increased political uncertainty will pay a toll on the real disposable earnings, on the one hand, and on consumer and business confidence on the other, with domestic demand levelling off in 2017. Foreign trade however will potentially compensate that trend.

As for the balance risk, political uncertainty in Italy remain high, and the probability of legislative elections being held this year has increased since the "No" in the constitutional referendum at the end of last year. A result favouring the proportional majority would increase uncertainty further still,

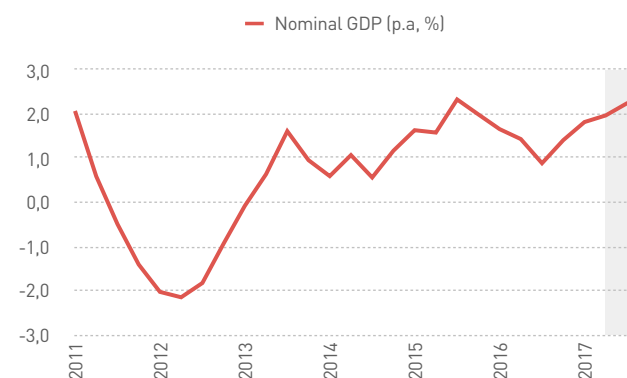
- The signs of recovery will be maintained in 2017, setting growth at around 1% over the coming two years.
- Growth however, will be weak and conditioned to political performance.
- The probability of a fragmented political scenario after the early elections has increased, but is not the central scenario.

since any coalition within the fragmented political situation that could be formed after the elections would be unstable.

Within this fragmentation, leadership by the Five Stars Movement and the Northern League (after breakdown of the Democrat Party) will undoubtedly add to the uncertainty of the political process. The Five Stars Movements is a Euro-sceptical party, and could head up a coalition with a view to leaving the Euro. Despite this, a more central, pro-European coalition is expected.

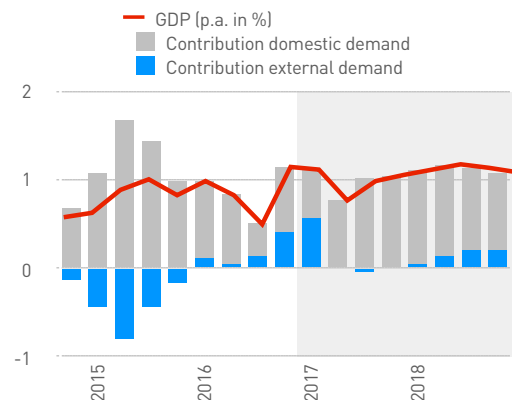
In a context which, in addition to the banking industry and sovereign risks undergoing strong tensions, political uncertainty will almost certainly lead to an upward correction in the cost of external financing (higher interest rates).

Graph 1.2.5-a  
Italy: nominal GDP growth, 2011-2017



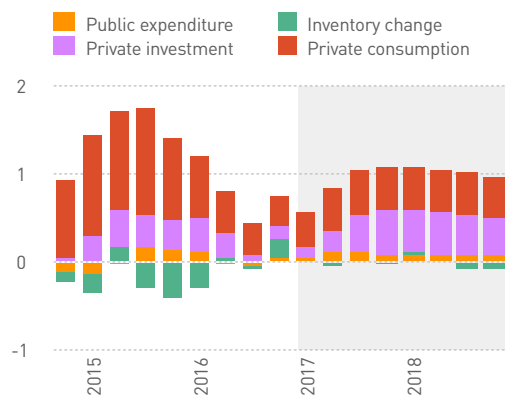
Source: MAPFRE Economic Research (with data from Bloomberg)

**Graph 1.2.5-b**  
Italy GDP breakdown  
and forecasts, 2014-2018



Source: MAPFRE Economic Research (with data from ISTAT)

**Graph 1.2.5-c**  
Italy: breakdown and forecasts  
for domestic demand, 2014-2018



Source: MAPFRE Economic Research (with data from ISTAT)

**Table 1.2.5**  
Italy: principal macro-economic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	-2.7	-0.4	0.3	0.8	0.9	1.0	1.1
Contribution of the domestic demand	-4.8	-0.5	0.3	1.3	0.7	0.9	1.0
Contribution of the external demand	2.1	0.1	0.0	-0.5	0.2	0.1	0.2
Contribution of private consumption	-2.2	-0.5	0.6	1.1	0.5	0.5	0.5
Contribution of investment	-1.6	-0.7	-0.3	0.4	0.2	0.3	0.5
Contribution of public consumption	-0.2	-0.2	-0.1	0.0	0.0	0.1	0.1
Domestic demand (average % p.a.)	-4.8	-0.5	0.4	1.3	0.7	0.9	1.0
Total consumption (average % p.a.)	-2.9	-0.8	0.5	1.4	0.6	0.7	0.7
Investment (average % p.a.)	-8.7	-4.2	-1.5	2.1	1.3	1.9	2.6
Exports (p.a. as %)	0.5	0.5	1.3	0.4	0.6	0.7	1.0
Imports (p.a. as %)	1.5	-0.4	-0.8	-1.6	-0.6	-0.7	-0.8
Unemployment rate (end of period)	12.1	12.4	12.2	11.6	11.5	11.3	10.9
Inflation (p.a.. end of period)	1.2	0.5	0.1	-0.4	1.5	1.1	1.8
Fiscal balance (% GDP)	-2.8	-2.9	-2.9	-2.4	-2.5	-2.1	-1.7
Trade balance (% GDP)	1.4	2.1	2.6	2.9	2.8	2.5	2.6
Current account balance (% GDP)	0.4	1.3	1.8	2.3	2.5	2.6	2.4
Official interest rate (end of period)	0.60	0.23	0.05	0.00	0.00	0.00	0.00
10 year rate (end of period)	4.20	3.01	1.81	1.40	2.50	3.16	3.35
Exchange rate vs. USD (end of period)	1.31	1.37	1.11	1.13	1.05	1.01	1.04
Family credit (% per annum. average)	-1.2	-1.4	-0.7	0.1	0.4	2.1	3.7
Non-financial S.P. credit (% per annum.	-2.4	-4.0	-2.0	-2.1	0.8	2.4	3.2
Financial S.P. credit (% per annum. average)	-9.3	-40.5	-8.8	5.4	6.7	6.4	6.0

Source: MAPFRE Economic Research (with data from ISTAT)

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## 1.2.6 United Kingdom

### Conditioned by Brexit

A second estimate for the GDP somewhat lower than initially forecasted (1.8%), thanks to a quarterly growth of around 0.6% supported by public and private consumption, as anticipated in the previous report. The leading indicators foresee a certain loss in the boost of consumption, owing to the real disposable earnings it is slacking off as a result of inflation and the fact that public spending (in the form of transfers) will not set it off, despite the moderate increase scheduled in the annual budget. The budget and its long-term forecasts show little variation compared to the 2016 forecasts in terms of long-term growth, owing to which the events linked to Brexit appear to be fully priced in.

In view of the moderation in consumption a timid growth rate is expected in the first quarter of the year and growth of the GDP in 2017 is expected to be around 1.6%, mostly supported by private consumption and to a small degree investment. The strong depreciation of the pound (around 30% against the USD since June 2016), and higher global growth will provide additional support to growth of the GDP through external demand.

- **The British economy will grow less in 2017, losing part of the support from private consumption and in view of the investment caution caused by Brexit.**
- **The Brexit road map establishes a break away from the European Union (EU) in April 2019. The negotiating positions between the EU and UK are opposing, and short-term friction is anticipated.**
- **The monetary (and tax) policy will continue with the accommodating / expansive trend.**

Inflation is still rising as a result of depreciation of the currency and the delayed effects of rising energy prices that directly or indirectly affect consumer expenditure (through more expensive intermediate goods). Nevertheless, the effects of a second round on wages and prices are not considered. Although an acceleration in inflation was forecast to around 2.8% at the end of 2017, weak demand and uncertainty about investments stemming from Brexit lead us to suppose that the monetary policy will remain extremely accommodating (without upsetting balance sheets or increasing interest rates until after 2019).

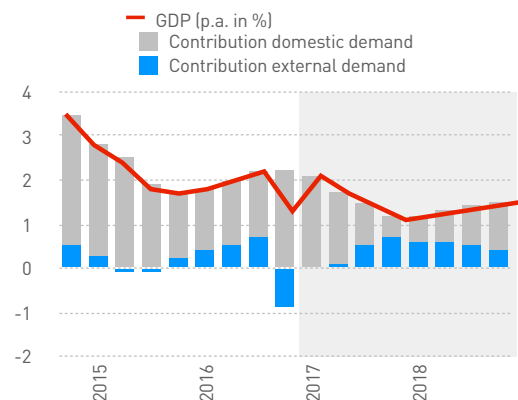
The Brexit time line and the negotiation positions anticipate two uncertain years with notable nominal volatility that will be passed on to the exchange rate and the credit spreads. The most probable scenario for Brexit will lead to WTO type trade relations with the European Union. Moreover, the early elections called by the Prime Minister, T. May, may add an additional degree of volatility and uncertainty.

Chart 1.2.6  
Brexit Time Line

March 29	Early April	April	May-June	May
T. May enables Article 50 and formally communicates the United Kingdom's (UK) intention to leave the European Union (EU).	Negotiation Framework outline (guides, principles and possible disagreements in the EU).	Negotiation Framework Guide subjected to ratification by the EU and is sanctioned.	Appointment of Negotiation Committee. Mandate and confidential guidelines.	UK prepares "The Great Repeal Bill" to transpose EU law where applicable.
September 17.	October-December	March (2018)	October (2018)	April (2019)
Elections in Germany.	Start of negotiations. The EU (M. Barnier) prefers to negotiate first the exit and treatment of migrants afterwards. UK wants this to take place at the same time.	Horizon of past inaction which cannot be negotiated.	Deadline imposed by EU (Barnier) for an agreement. If this does not happen, the exit will be WTO type.	Exit of the United Kingdom from the EU.

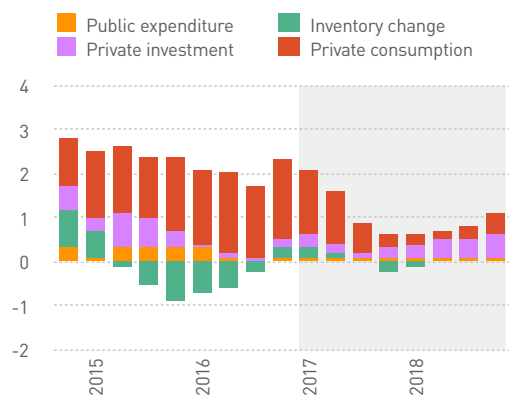
Source: MAPFRE Economic Research

**Graph 1.2.6-a**  
United Kingdom: GDP breakdown  
and forecasts, 2014-2018



Source: MAPFRE Economic Research (with data from the Office for National Statistics)

**Graph 1.2.6-b**  
United Kingdom: breakdown and forecasts  
for domestic demand, 2014-2018



Source: MAPFRE Economic Research (with data from the Office for National Statistics)

**Table 1.2.6**  
United Kingdom: main macro-economic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	1.3	1.9	3.1	2.2	1.8	1.6	1.3
Contribution of the domestic demand	2.1	1.9	2.7	2.1	1.7	1.3	0.8
Contribution of the external demand	-0.8	0.0	0.4	0.1	0.2	0.3	0.4
Contribution of private consumption	1.2	1.0	1.3	1.5	1.7	0.9	0.3
Contribution of investment	0.4	0.5	0.6	0.6	0.1	0.2	0.4
Contribution of public consumption	0.3	0.1	0.5	0.3	0.2	0.1	0.1
Domestic demand (average % p.a.)	2.2	1.9	3.6	2.1	1.7	1.3	0.8
Total consumption (average % p.a.)	1.9	1.3	2.2	2.2	2.3	1.3	0.5
Investment (average % p.a.)	2.4	3.2	6.7	3.4	0.7	1.2	2.4
Exports (p.a. as %)	0.2	0.3	1.0	1.3	0.4	0.7	1.1
Imports (p.a. as %)	-0.9	-1.1	-0.5	-2.2	-0.8	-0.4	-0.5
Unemployment rate (end of period)	4.7	3.8	2.6	2.3	2.3	2.5	2.3
Inflation (p.a., end of period)	2.7	2.1	0.9	0.1	1.2	2.8	1.9
Fiscal balance (% GDP)	-8.3	-5.7	-5.6	-4.3	-3.4	-2.9	-2.5
Trade balance (% GDP)	-6.6	-6.9	-6.7	-6.4	-7.0	-6.9	-6.3
Current account balance (% GDP)	-3.7	-4.4	-4.7	-4.3	-4.8	-3.5	-2.5
Official interest rate (end of period)	0.50	0.50	0.50	0.50	0.25	0.25	0.25
10 year rate (end of period)	1.80	2.80	2.11	1.92	1.30	1.74	2.04
Exchange rate vs. USD (end of period)	1.61	1.62	1.58	1.52	1.24	1.25	1.22
Exchange rate vs. Euro (end of period)	1.24	1.19	1.27	1.39	1.15	1.23	1.19
Saving rate (%)	8.4	6.7	6.8	6.5	5.7	4.9	5.1
Family credit (% per annum. average)	1.1	1.2	2.1	2.8	3.8	2.2	2.0
Non-financial S.P. credit (% per annum. average)	5.0	-2.5	-3.9	-1.0	-0.2	3.7	2.6
Financial S.P. credit (% per annum. average)	2.7	7.2	-10.3	-15.5	-1.5	2.7	3.7

Source: MAPFRE Economic Research (with data from the Office for National Statistics)

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## 1.2.7 Japan

### Tail winds but limited performance

The Japanese economy grew at 1% in 2016, supported, in equal shares, by domestic and foreign demand, and depreciation of the Yen (owing to the monetary policy differential against the United States).

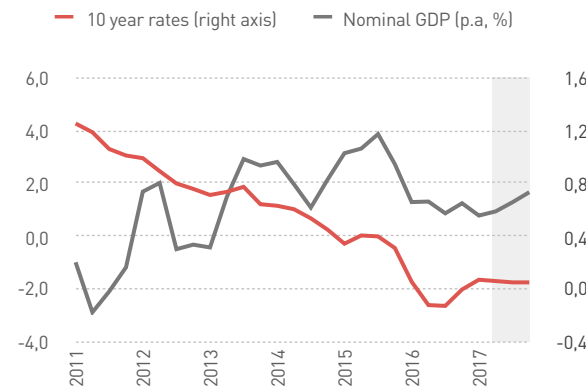
The forecasts for the future suggest growth in the contribution of consumption and investment, until they eventually become the motors of moderate acceleration for the growth of Japan's economy.

In this context, support by monetary and fiscal demand policies are expected to contribute to additional growth of the GDP by approximately 0.25% on average in the coming two years.

Inflation appears to be moving away from deflation, which permits a certain degree of freedom to adjust the monetary heterodoxy. Although the latter continues to be focussed on the interest rate curve (and not on the target of inflation) in order to protect the country's financial system, the speed of normalization of the monetary policy in the United States is hindering this goal.

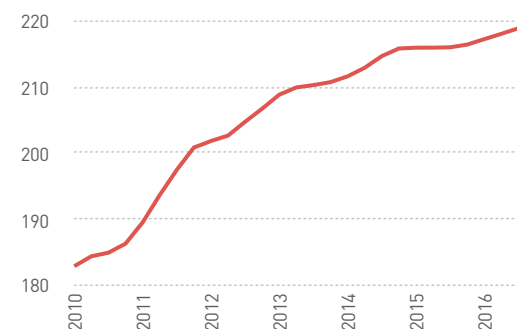
- Although apparently limited, the perspectives of the Japanese economy are favourable thanks to foreign demand, the tax boost and depreciation of the Yen.
- The Yen will continue to depreciate against the US dollar, owing to the growing differential in interest rates in the long term in the United States.
- The tax boost in Japan will be large (around 1% of the GDP) and in a context where the current monetary policy trend will be maintained.

Graph 1.2.7-a  
Japan: nominal growth of GDP  
and interest rates, 2011-2017



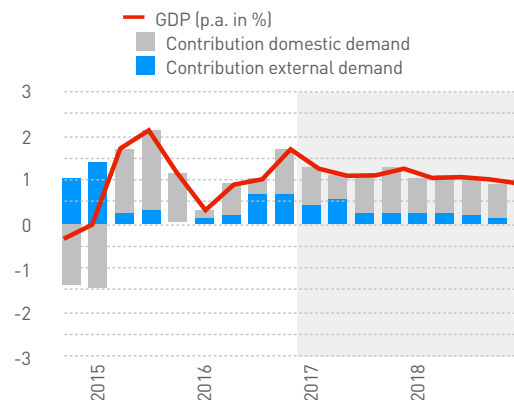
Source: MAPFRE Economic Research (with data from Bloomberg)

Graph 1.2.7-b  
Japan: Public debt (% of GDP) 2010-2016



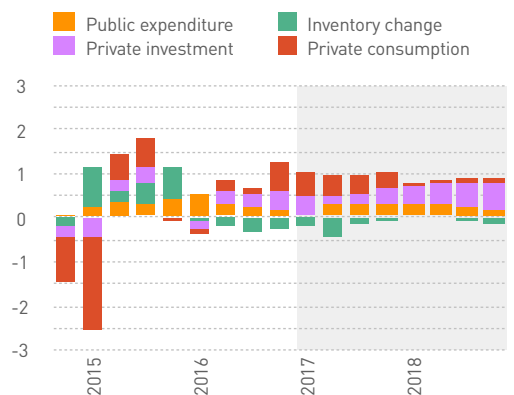
Source: MAPFRE Economic Research (with data from Bloomberg)

**Graph 1.2.7-c**  
Japan: GDP Breakdown  
and forecasts, 2014-2018



Source: MAPFRE Economic Research (with data from Statistics Bureau)

**Graph 1.2.7-d**  
Japan: breakdown and forecasts  
for domestic demand, 2014-2018



Source: MAPFRE Economic Research (with data from Statistics Bureau)

**Table 1.2.7**  
Japan: principal macro-economic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	1.5	2.0	0.3	1.3	1.0	1.2	1.0
Contribution of the domestic demand	2.4	2.4	-0.3	0.7	0.6	0.8	0.8
Contribution of the external demand	-0.9	-0.4	0.6	0.5	0.4	0.4	0.2
Contribution of private consumption	1.2	1.4	-0.5	-0.2	0.2	0.5	0.1
Contribution of investment	0.8	1.1	0.3	0.0	0.2	0.3	0.5
Contribution of public consumption	0.3	0.3	0.1	0.3	0.3	0.2	0.3
Domestic demand (average % p.a.)	2.4	2.4	0.3	0.7	0.6	0.8	0.8
Total consumption (average % p.a.)	2.0	2.2	-0.6	0.2	0.7	0.9	0.5
Investment (average % p.a.)	3.5	5.0	2.9	0.2	0.9	1.4	2.2
Exports (p.a. as %)	0.0	0.1	1.4	0.6	0.1	0.4	0.5
Imports (p.a. as %)	-0.9	-0.6	-1.0	-0.6	0.4	-0.0	-0.3
Unemployment rate (end of period)	4.2	3.9	3.5	3.3	3.1	2.8	2.5
Inflation (p.a.. end of period)	-0.2	1.5	2.5	0.2	0.3	0.7	0.9
Fiscal balance (% GDP)	-8.3	-8.1	-5.9	-5.1	-5.0	-6.2	-5.7
Trade balance (% GDP)	-0.9	-1.7	-2.1	-0.1	1.1	1.2	1.3
Current account balance (% GDP)	1.0	0.9	-5.7	3.1	3.8	4.1	4.1
Official interest rate (end of period)	0.08	0.07	0.06	0.08	-0.04	-0.04	-0.04
10 year rate (end of period)	0.76	0.64	0.45	0.31	0.00	0.05	0.05
Exchange rate vs. USD (end of period)	81.28	100.4	114.5	121.4	109.45	122.25	126.75
Exchange rate vs. Euro (end of period)	105.4	136.7	142.8	133.0	118.01	123.47	129.84
Saving rate (%)	0.9	3.6	1.6	2.1	-1.0	2.7	3.1
Family credit (% per annum. average)	-0.5	0.9	1.3	2.0	2.2	0.8	0.4
Non-financial S.P. credit (% per annum. average)	-1.7	-0.1	0.7	0.5	1.2	1.9	2.0
Financial S.P. credit (% per annum. average)	4.3	3.9	8.5	7.6	-2.5	2.9	2.3

Source: MAPFRE Economic Research (with data from Statistics Bureau)

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## 1.2.8 Turkey

### Tension and weakness in an environment of uncertainty

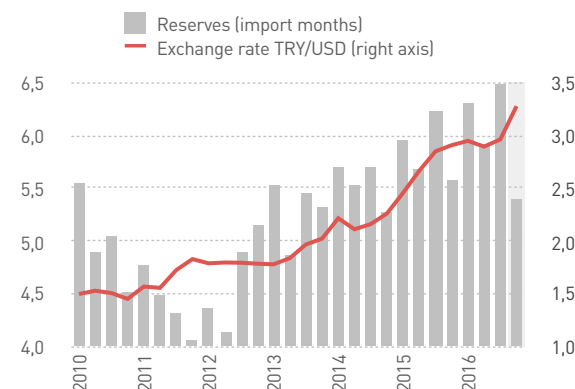
Economic activity in Turkey during the fourth quarter 2016 reported a per annum increase of 3.5%. This accounted for a quarterly rate of 3.8% working and calendar day adjusted growth, which more than offsets the slump in the previous quarter (-1.8%). With this figure the GDP grew by 2.9% on average throughout 2016. This is more than forecast in the final quarter 2016, but lower than the rate recorded in 2015, and well below the long-term growth (5%) if we consider the new national accounting.

- **Moderation of domestic demand through less public support.**
- **Continued depreciation of the Turkish Lira.**

Economic growth in Turkey is exclusively supported by domestic demand, which is decisively conditional to the incentives system implemented by the government (in the form of directed credit, tax relief and public guarantees). Proof of this is that only the public spending and investment, and to a certain degree related investments (residential and intermediate goods), accounted for the factors that contributed to growth of the GDP in 2016.

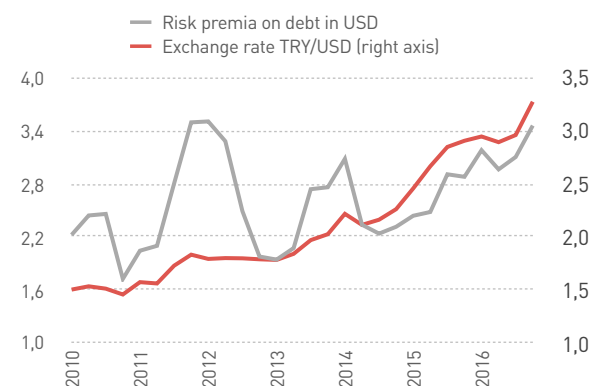
Looking ahead, the Turkish economy is expected to continue its gradual adjustment, reporting further deceleration of the GDP to 2.3% in 2017. This behaviour will be due to deceleration in domestic demand as a result of exhausting the supporting items to credit, real salary cuts (salaries contained within a context of high inflation) and tightening of the monetary policy. Investment will also experience a deceleration in line with the real adjustment of the economy.

**Graph 1.2.8-a**  
Turkey: exposure to exchange rate (1),  
2010-2016



Source: MAPFRE Economic Research (with data from Bloomberg)

**Graph 1.2.8-b**  
Turkey: exposure to exchange rate (2),  
2010-2016



Source: MAPFRE Economic Research (with data from Bloomberg)

Despite the expected depreciation of the currency (3.8 TRY/USD, at the end of 2017), the foreign sector will continue to drain dynamism from the economy. The current deficit in Turkey is fundamentally structural, and does not fluidly obey a moderation of domestic demand.

On the other hand, inflation broke the two figure barrier at the start of the year, and in March reported an even higher annual increase of 11.3%. Continued depreciation of the currency has long-lasting effects on underlying inflation. Moreover, the economic activity recorded over the last few years was compatible with a more restrictive monetary policy that was not addressed, and consequently the effects of a second round on prices and salaries are plentiful. Inflation has been above the Central Bank's five year target (now barely credible) and is expected to continue so in 2017.

The monetary policy in 2016 was loose, seen now from the new national accounting standpoint. Since then, although the average cost of financing has increased moderately, the liquidity window (the marginal rate) has increased by over 450 bp, becoming the main instrument of monetary policy. Only in the first quarter 2017 the increase in the marginal rate was 300 bp, due to inflation and the need to control depreciation of the Lira in an environment strongly leveraged by the private sector of the USD (See Graph 1.2.8-a).

The political uncertainty and its effects on confidence, investment, consumption and the exchange rate could worsen with the result of the referendum by means of which Turkey will become a Presidential Republic instead of a Parliamentary one<sup>9</sup>.

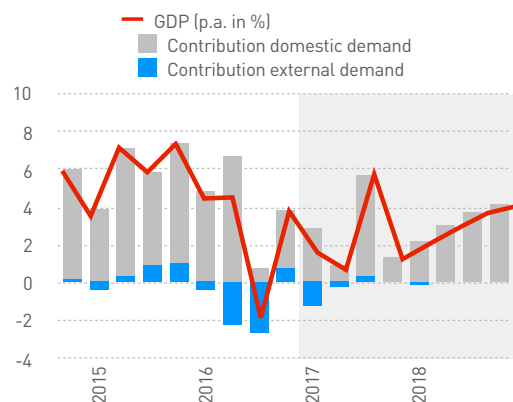
The depreciation of the currency and curving expectations in general is forecast. The expected increase in interest rates before the end of year will focus on mitigating financial and exchange rate instability that could arise afterwards. In the international field, the result of the referendum will irreparably condition relations between Turkey and the European Union, and the access plans to join the Union, which are already delicate.

It is important to emphasise that, at the start of the year, the Turkish Statistics Office (TURKSTAT) made some significant adjustments to its national accounting system. More specifically, this entailed adjustments in assigning and quantifying some accounting entries on the revenue side of the accounts (R&D, financial sector earnings and particularly insurance earnings) for a two sided ultimate purpose: on the one hand to standardize accounting with the ESA 2010 accounts, and on the other to change from a system based on survey estimation to one that uses physical item entries in the social security system.

The fundamental change was the new estimate of the GDP throwing a figure of 7.5% average growth over the last five years, and not 4% as previously published. Consequently, accumulated growth of the economy is 25% higher, reaching the level of GDP per capita of the Organisation for Economic Cooperation and Development (OECD) and reporting growth rates and new estimates of potential similar to a country in South-east Asia.

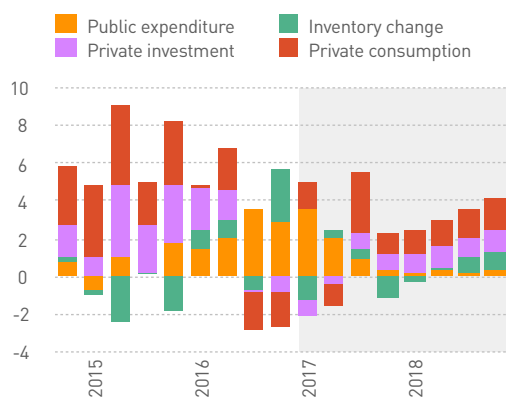
This correction is somewhat striking since higher growth of the economy and the GDP per capita dilute many of Turkey's external and internal vulnerabilities, justifies perception that the monetary policy has been excessively loosen over the last five years and legitimises inflation that is systematically above the target of the Central Bank, headed up by high underlying inflation. On the other hand, the adjustment means the Lira has strongly devalued compared to its fundamentals and fosters expectations for gradual correction (appreciation in the future).

**Graph 1.2.8-c**  
Turkey: GDP breakdown  
and forecasts, 2014-2018



Source: MAPFRE Economic Research (with data from TURKSTAT)

**Graph 1.2.8-d**  
Turkey: breakdown and forecasts  
for domestic demand, 2014-2018



Source: MAPFRE Economic Research (with data from TURKSTAT)

**Table 1.2.8**  
Turkey: principal macro-economic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	4.9	8.5	5.3	6.0	2.9	2.3	3.2
Contribution of the domestic demand	1.8	10.3	3.4	5.5	3.9	2.6	3.2
Contribution of the external demand	3.2	-1.8	1.9	0.5	-1.1	-0.3	-0.0
Contribution of private consumption	2.0	5.0	1.9	3.4	-0.3	1.2	1.5
Contribution of investment	0.8	3.8	1.3	2.6	0.7	0.1	1.0
Contribution of public consumption	1.0	1.1	0.4	0.5	2.4	1.7	0.3
Domestic demand (average % p.a.)	1.7	10.1	3.2	5.4	3.8	2.6	3.1
Total consumption (average % p.a.)	3.8	7.9	3.0	5.2	2.4	3.6	2.3
Investment (average % p.a.)	2.9	14.0	5.5	9.1	2.3	0.4	3.5
Exports (p.a. as %)	3.7	0.3	1.8	1.0	-1.0	-0.2	0.7
Imports (p.a. as %)	-0.1	-2.1	0.1	-0.4	-0.7	-0.0	-0.8
Unemployment rate (end of period)	8.6	9.3	10.7	10.5	11.8	11.4	11.2
Inflation (p.a., end of period)	6.8	7.5	8.8	8.2	7.6	8.1	6.7
Fiscal balance (% GDP)	-1.9	-1.1	-1.1	-1.0	-1.3	-2.0	-2.1
Trade balance (% GDP)	-7.5	-8.4	-6.8	-5.6	-4.6	-4.4	-3.9
Current account balance (% GDP)	-5.5	-6.7	-5.7	-3.8	-4.2	-5.4	-5.1
Official interest rate (end of period)	5.71	4.50	8.25	7.50	7.71	8.50	7.25
10 year rate (end of period)	5.92	6.20	9.11	9.39	8.53	9.00	7.74
Exchange rate vs. USD (end of period)	1.79	2.02	2.26	2.91	3.27	3.84	3.67
Exchange rate vs. Euro (end of period)	2.32	2.75	2.82	3.19	3.53	3.88	3.76
Saving rate (%)	19.8	28.8	23.2	23.0	12.3	11.8	10.9
Family credit (% per annum. average)	15.9	24.0	16.3	12.5	7.1	17.8	18.3
Non-financial S.P. credit (% per annum. average)	21.5	31.1	30.1	29.9	14.7	5.9	7.2
Financial S.P. credit (% per annum. average)	13.1	24.3	22.4	26.4	6.8	7.9	10.5

Source: MAPFRE Economic Research (with data from TURKSTAT)

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## 1.2.9 Mexico

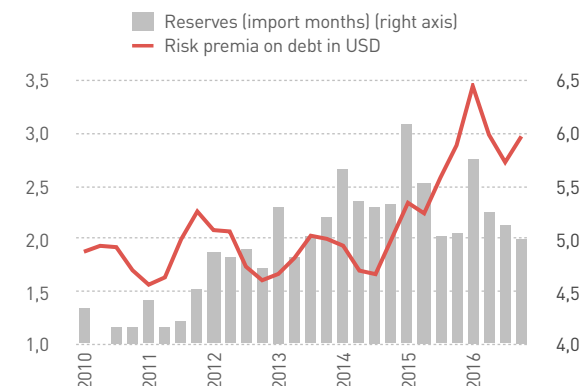
### Deceleration continues

Growth is expected to be weak throughout 2017 with risks to the downside. Private consumption, the only support for growth of the GDP will lose steam as the monetary policy is tightened, and real income erode due to inflation. Investment and the foreign sector subtract growth, owing to the tightening of monetary and financial conditions, and the political uncertainty that undermines any corporate and consumer expectations.

Inflation has risen, guided by an increase in underlying inflation (from 1.5% at the end of the second quarter 2016, to a per annum figure of 5.3%), which leads us to believe that inflation expectations are growing. We expect it to stand at 4% at the end of 2017, high but within the targets set by the Central Bank (3% - 5%). Banxico will continue to move away from monetary slackness, although the interest rate is still below the natural level. The refinancing rate increased by +25 bp in March to reach 6.5%. In view of the route by the Federal Reserve (two more rises), recent depreciation of the currency and volatility of portfolio flows in an environment of limited reserves, it is expected for the Central Bank to continue tightening the monetary policy, bringing interest rates at around 7% by the end of 2017. The exchange rate is once again positioned at 19 Pesos per Dollar (April) after closing the previous year at almost 20. Our forecast is for it to be between 20-21 Pesos per Dollar over the coming years. The change in the language by the Trump Administration's Trade Secretary (Ross) leads us to expect more tempered adjustments in NAFTA than initially anticipated last quarter.

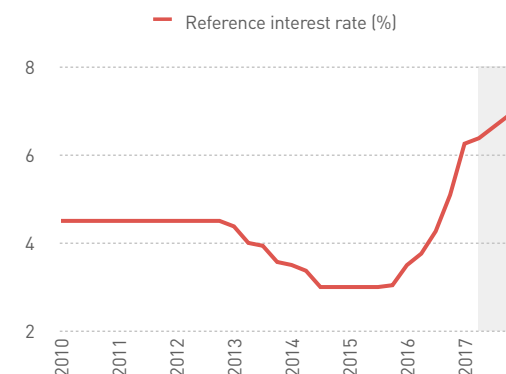
- **Weak growth of the GDP in 2017, with negative contributions by the foreign sector and domestic demand more dependant on consumption.**
- **Inflation will continue its upward trend, whereas the Peso will depreciate further. The monetary policy still has a small margin to abandon current slackness.**
- **The risks are still negatively biased: the main one stemming from trade and migration relations with the United States has slackened off. Attention is increasingly centred on the rise of populisms heading up to the presidential elections in 2018.**

**Graph 1.2.9-a**  
Mexico: exposure to exchange rate,  
2010-2016



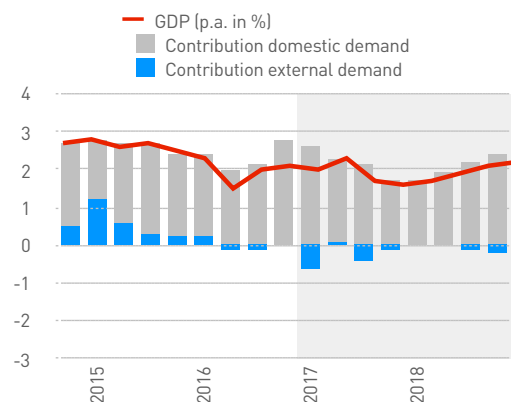
Source: MAPFRE Economic Research (with data from Bloomberg)

**Graph 1.2.9-b**  
Mexico: reference interest rates,  
2010-2017



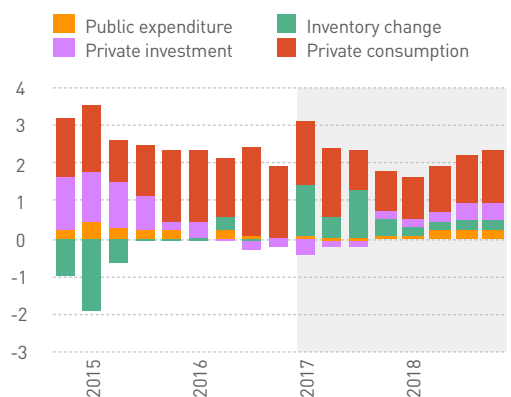
Source: MAPFRE Economic Research (with data from Bloomberg)

**Graph 1.2.9-c**  
Mexico: GDP Breakdown  
and forecasts, 2014-2018



Source: MAPFRE Economic Research (with data from INEGI)

**Graph 1.2.9-d**  
Mexico: breakdown and forecasts  
for domestic demand, 2014-2018



Source: MAPFRE Economic Research (with data from INEGI)

**Table 1.2.9**  
Mexico: principal macro-economic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	3.8	1.6	2.3	2.6	2.3	1.9	2.0
Contribution of the domestic demand	3.4	2.0	1.4	2.1	2.3	2.2	2.1
Contribution of the external demand	0.3	-0.4	0.8	0.6	-0.0	-0.3	-0.2
Contribution of private consumption	3.1	1.7	1.2	1.5	1.9	1.4	1.3
Contribution of investment	1.1	-0.3	0.4	0.9	-0.0	-0.1	0.3
Contribution of public consumption	0.4	0.1	0.2	0.3	0.1	0.0	0.2
Domestic demand (average % p.a.)	3.4	2.0	2.0	2.1	2.3	2.2	2.1
Total consumption (average % p.a.)	4.5	2.3	1.8	2.3	2.5	1.8	1.9
Investment (average % p.a.)	4.8	-1.5	2.9	4.4	-0.1	-0.6	1.6
Exports (p.a. as %)	1.9	0.7	2.3	3.7	-0.1	0.2	0.7
Imports (p.a. as %)	-1.5	-1.1	-1.2	-4.0	-0.2	-0.4	-0.8
Unemployment rate (end of period)	4.9	4.6	4.4	4.2	3.8	3.9	4.1
Inflation (p.a., end of period)	4.1	3.7	4.2	2.3	3.2	4.7	3.0
Fiscal balance (% GDP)	-2.6	-2.4	-3.2	-3.4	-2.6	-2.4	-2.4
Trade balance (% GDP)	0.0	-0.1	-0.2	-1.3	-1.7	-2.3	-2.2
Current account balance (% GDP)	-1.4	-2.5	-5.7	-2.9	-3.0	-3.2	-3.1
Official interest rates (end of period)	4.50	3.57	3.00	3.04	5.09	6.88	6.63
10-year rate (end of period)	5.42	6.15	5.88	6.06	6.81	8.01	7.67
Exchange rate against the USD (end of period)	12.95	13.02	13.90	16.76	19.84	20.84	20.24
Exchange rate against the euro (end of period)	16.79	17.72	17.37	18.36	21.39	21.05	20.73
Private credit (% per annum. average)	15.0	14.0	10.8	13.6	15.8	7.3	5.2
Family credit (% per annum. average)	11.3	9.1	8.2	8.4	12.8	7.2	5.5
Saving rate (%)	13.4	13.3	12.3	12.6	11.9	10.6	11.2
Financial S.P. credit (% per annum. average)	1.4	15.4	9.8	-11.4	4.7	12.9	7.4

Source: MAPFRE Economic Research (with data from INEGI)

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## 1.2.10 Brazil

### Need to recover credibility

According to GDP data, the fourth quarter of 2016 saw a decline in the GDP of -3.6 p.a. particularly owing to the negative contribution of the domestic demand.

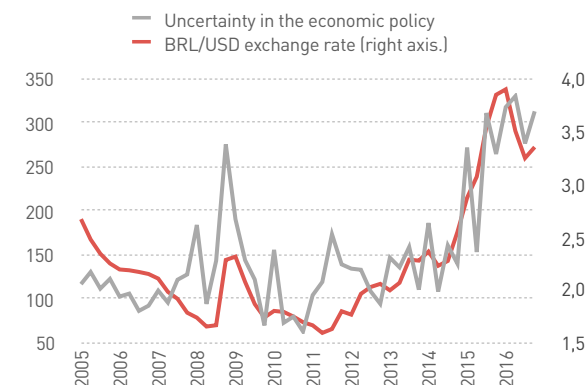
Although data on confidence, consumption and exports recorded in the first quarter of this year, are consistent with the rising positive data, we affirm that the weakness of economic activity will persist throughout this year. Although there has been a slight improvement in the performance of real disposable income, as a result of the break in inflation, the GDP growth in 2017 will be near to zero. Monetary support will be accompanied by fiscal incentives, which could lead to almost half a point in the GDP growth on average over the next two years. However, it will all depend on fiscal and political viability.

The surprising fall in inflation helps to eliminate pressure on monetary policy. It is forecast that the Central Bank will cut interest rates between 2 and 4 times during the rest of the year, taking the intervention interest rates (SELIC) to approximately 300 bps under what they are now. We foresee that this strategy will also be maintained during 2018.

A climate of low institutional credibility is perceived, even more so after declarations by President Temer and the Odebrecht conglomerate scandal, which has become the major problem of the country. In this contest, political risk has not diluted for the time being.

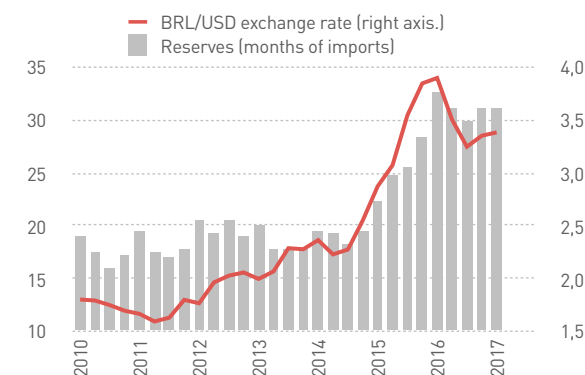
- **Very weak current performance with little prospects of recovery.**
- **Inflation will remain high, but the Central Bank will aggressively cut interest rates in 2017.**
- **Recovery will depend on the credibility of the Central Bank and of the government. It is essential to stop deterioration of the risk premia and the depreciation of the Brazilian real.**

**Graph 1.2.10-a.**  
Brazil: credibility and the exchange rate, 2005-2016.



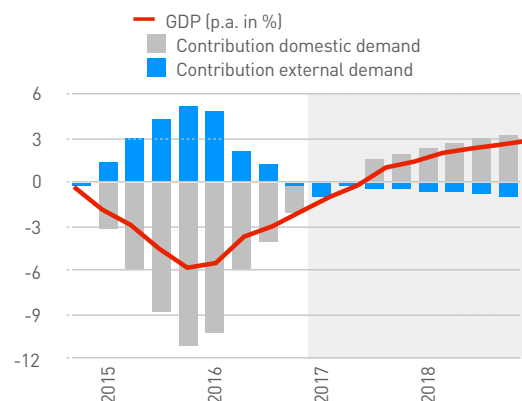
Source: MAPFRE Economic Research (with Bloomberg data)

**Graph 1.2.10-b.**  
Brazil: exposure to the exchange rate, 2010-2017.



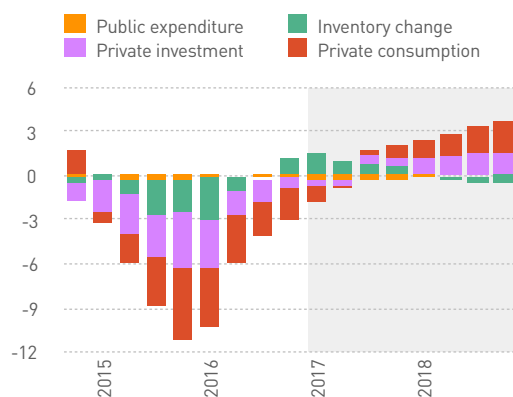
Source: MAPFRE Economic Research (with Bloomberg data)

**Graph 1.2.10-c.**  
**Brazil: breakdown**  
**and forecasts of the GDP, 2014-2018**



Source: MAPFRE Economic Research (with data from the Brazilian Institute of Geography and Statistics, IBGE)

**Graph 1.2.10-d.**  
**Brazil: breakdowns and forecasts**  
**of the domestic demand, 2014-2018**



Source: MAPFRE Economic Research (with data from the Brazilian Institute of Geography and Statistics, IBGE)

**Table 1.2.10.**  
**Brazil: main macroeconomic aggregates**

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	1.9	3.0	0.5	-3.8	-3.6	0.3	1.9
Contribution of the domestic demand	2.1	4.0	0.5	-7.3	-5.5	0.8	2.8
Contribution of the external demand	-0.2	-1.0	-0.0	3.5	2.0	-0.5	-0.9
Contribution of private consumption	2.3	2.3	1.5	-2.7	-2.9	0.0	1.7
Contribution of investment	0.2	1.2	-0.8	-2.9	-1.8	0.1	1.3
Contribution of public consumption	0.4	0.3	0.1	-0.2	-0.1	-0.3	0.0
Domestic demand (average % p.a.)	2.0	3.7	0.2	-6.8	-5.3	0.8	2.7
Total consumption (average % p.a.)	3.3	3.1	2.0	-3.4	-3.5	-0.3	1.9
Investment (average % p.a.)	0.8	5.8	-4.1	-14.0	-9.6	0.8	7.7
Exports (p.a. as %)	0.0	0.3	0.2	0.7	0.5	-0.2	0.5
Imports (p.a. as %)	-0.2	-1.3	0.4	2.3	1.5	-0.3	-0.9
Unemployment rate (end of period)	6.9	6.2	6.5	9.0	12.2	12.3	11.7
Inflation (p.a.. end of period)	5.6	5.8	6.5	10.4	7.4	4.7	4.2
Fiscal balance (% GDP)	-2.3	-3.0	-6.0	-10.2	-9.3	-9.2	-7.5
Trade balance (% GDP)	0.7	0.0	-0.3	1.0	2.6	2.2	2.0
Current account balance (% GDP)	-3.0	-3.0	-5.7	-3.2	-1.0	-1.1	-1.3
Official interest rates (end of period)	7.28	9.63	11.32	14.25	14.00	10.30	9.20
10-year rate (end of period)	9.21	12.17	12.29	15.74	11.77	10.80	10.10
Exchange rate against the USD (end of period)	2.06	2.28	2.55	3.84	3.35	3.30	3.40
Exchange rate against the euro (end of period)	2.67	3.10	3.19	4.21	3.64	3.30	3.50
Family credits (average % p.a.)	17.6	16.4	14.1	10.0	4.3	6.9	12.5
Savings rate (%)	13.4	14.2	11.7	9.2	9.2	9.0	8.8
Fiscal impulse	-0.8	-0.5	-2.2	-1.3	-0.8	0.2	0.7

Source: MAPFRE Economic Research (with data from the Brazilian Institute of Geography and Statistics, IBGE)

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## 1.2.11 Argentina

### The new administration faces reality

Recent data confirm a boost in economic activity from the fourth quarter of 2016, particularly in the first quarter of this year. This is owing to the public infrastructure and the recovery of agriculture, owing to improved prices of commodities.

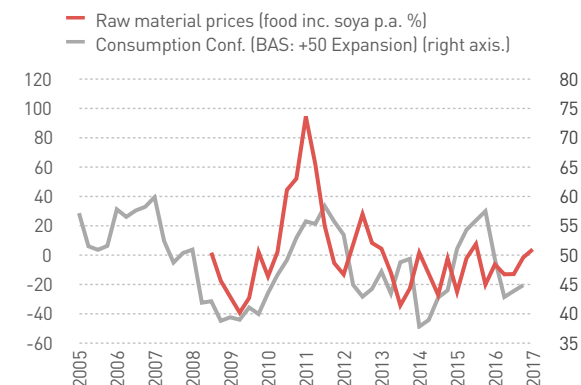
After last year's recession, investment has become the main driver of growth (particularly in agriculture, renewable energy and public infrastructure), which leads us to forecast a growth of 2.5% in 2017.

Underlying inflation shows signs of acceleration. This introduces an upward trend in the current forecast for 2017, which is already a fairly hawkish forecast. Interest rates will be maintained at a consistent, limited trend, and they may even be tightened, if inflationary pressures are not diluted.

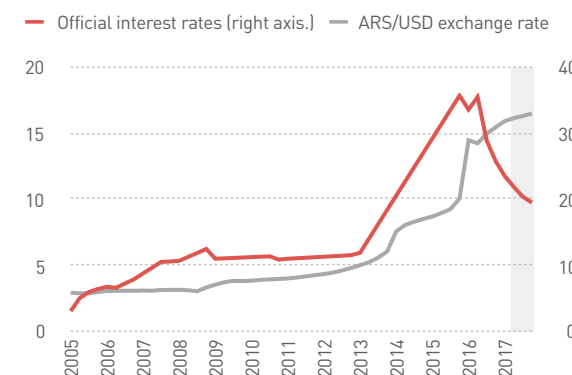
On the other hand, political risks are still significant. The public discontent regarding President Macri affects expectations particularly in a growth environment of non-labor intensive sectors (energy, finance, etc.), persistent inflation and the erosion of State tax income. Confidence could deteriorate owing to union protests and reform of credit card price practices. Also, difficult fiscal consolidation, public discontent and tensions on the bond market, could again have implications for the capital markets, indicating possible new depreciations against the dollar. The next elections will take place during the fourth quarter of 2017.

- **Economic situation gain backed on confidence and price cycle of raw materials.**
- **Agriculture and investment in the energy industry, support elements for the GDP.**
- **Inflation and exchange still out of control; the monetary policy will be tightened.**
- **Downside risks stemming from social and political discontent.**

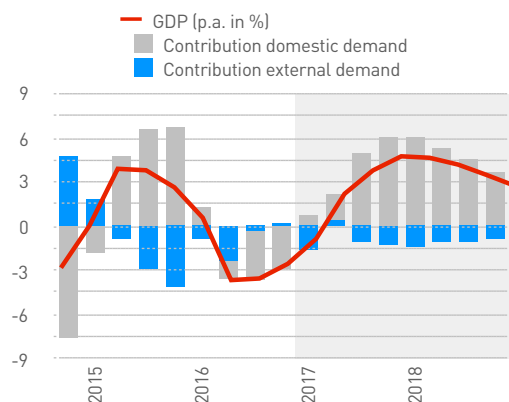
**Graph 1.2.11-a.**  
Argentina: income and consumption  
2005-2017.



**Graph 1.2.11-b.**  
Argentina: monetary policy and the exchange rate  
2005-2017.

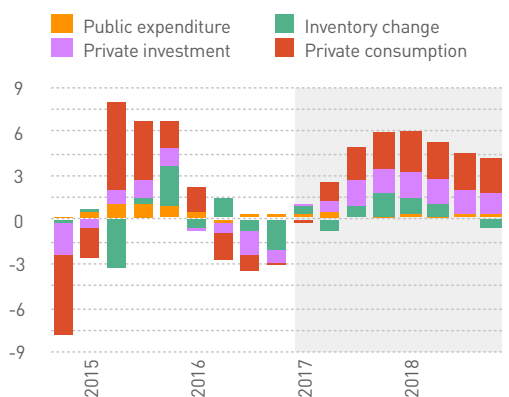


**Graph 1.2.11-c.**  
Argentina: breakdown  
and forecasts of the GDP, 2014-2018



Source: MAPFRE Economic Research (with INDEC data)

**Graph 1.2.11-d.**  
Argentina: breakdown and forecasts  
of the domestic demand, 2014-2018



Source: MAPFRE Economic Research (with INDEC data)

**Table 1.2.11.**  
Argentina: main macroeconomic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	-0.9	2.4	-2.5	2.6	-2.3	2.5	3.8
Contribution of the domestic demand	-1.3	4.2	-4.2	4.1	-1.5	3.4	4.9
Contribution of the external demand	0.4	-1.8	1.7	-1.5	-0.8	-1.0	-0.8
Contribution of private consumption	0.8	2.6	-3.1	2.4	-0.4	1.5	2.6
Contribution of investment	-1.5	0.5	-1.2	0.7	-0.9	1.1	1.6
Contribution of public consumption	0.4	0.7	0.4	0.9	0.3	0.3	0.3
Domestic demand (average % p.a.)	-1.2	4.0	-3.8	4.0	-1.4	3.2	4.6
Total consumption (average % p.a.)	1.4	3.9	-3.2	4.0	-0.2	2.1	3.3
Investment (average % p.a.)	-7.0	2.5	-6.6	3.8	-4.6	5.5	8.3
Exports (p.a. as %)	-0.8	-0.7	-0.5	-0.8	0.6	0.2	0.6
Imports (p.a. as %)	1.1	-1.0	2.3	-1.2	-1.5	-1.1	-1.8
Unemployment rate (end of period)	6.9	6.4	6.9	6.4	8.4	7.8	7.1
Inflation (p.a., end of period)	13.4	26.2	39.0	24.9	43.5	21.6	15.1
Fiscal balance (% GDP)	-2.1	-1.9	-2.4	-3.9	-4.1	-4.1	-3.3
Trade balance (% GDP)	2.6	0.8	1.1	-0.1	0.4	-0.3	-0.3
Current account balance (% GDP)	-0.3	-2.0	-1.4	-2.5	-2.7	-2.8	-2.4
Official interest rates (end of period)	11.54	18.38	27.02	35.67	25.75	19.50	14.62
10-year rate (end of period)	12.02	11.29	9.58	7.26	6.87	6.68	7.01
Exchange rate against the USD (end of period)	4.80	6.05	8.51	10.04	15.44	16.48	17.09
Exchange rate against the euro (end of period)	6.22	8.24	10.64	10.99	16.65	16.65	17.50
Savings rate (%)	21.2	24.5	16.3	10.9	8.4	7.2	7.2

Source: MAPFRE Economic Research (with INDEC data)

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## 1.2.12 China

### Controlled downturn

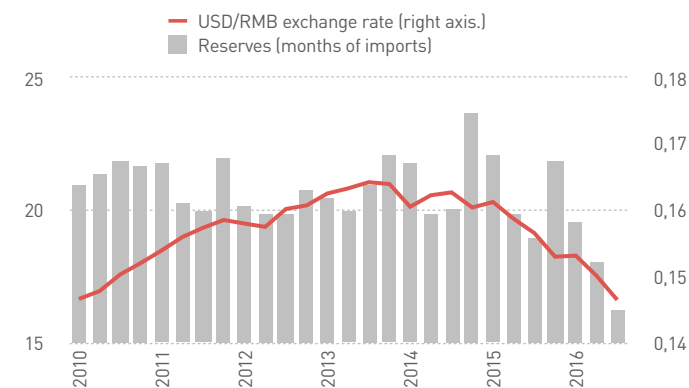
In 2016, the economic growth objective of 6.5%, set by the Chinese government, was reached. This was owing to investment (residential and team), and private and public consumption, which meant that the contribution of the domestic demand exceeded the sluggish contribution by the external sector.

The Chinese economy started 2017 with a strong boost in growth. The expectations embedded in the PMIs suggest a healthy rate of ongoing expansion and export of goods. This confirms that global demand is strengthening, and this trend should continue backing the external Chinese demand in coming months, assuming that the trade policy with the United States does not hinder it (downside risk). The upturn of imports of goods is also a reflection on the strength of internal demand and the price increase of raw materials; element which will continue to be present in 2017 and 2018.

- **Confirmed growth of 6.7% in 2016, in line with the government's objectives (set at 6.5%), with the services sector offsetting part of the weakness of manufactured goods.**
- **In spite of its initial upturn, growth will slowly converge towards more moderate rates, as a result of the Chinese economic policy.**
- **Risks derived from the relation between imbalances of the residential sector, excess credit and financial stability, will remain.**
- **The government favors financial stability and the strength of the renminbi over the growth target.**

However, the growth of the GDP is expected to reduce to 6.3% this year, as the tightening of purchase restrictions in many major cities will have a bearing on real estate investment. The administration is more focused on the reduction of financial risks and less so on guaranteeing at least the 6.5% GDP growth target, mentioned above. The central bank (PBoC) has, in fact, increased interest rates since November, indicating that it is avoiding monetary conditions from becoming too lax. Additionally, it is predictable that public policies will continue to be directed to exchange rate intervention and to the restriction of portfolio flows, to avoid further depreciations. In accordance to what was indicated in our previous report, this will also influence the dynamics of the sovereign curve of the United States, as China is the main foreign holder of treasuries.

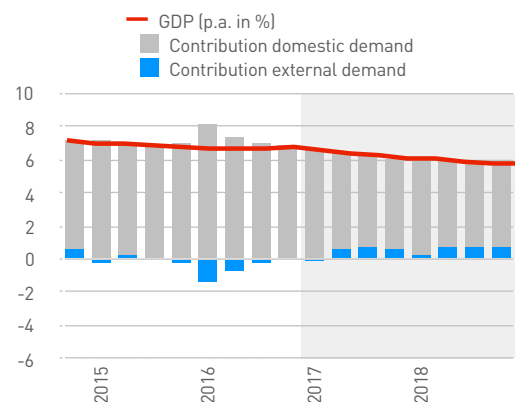
**Graph 1.2.12-a.**  
**China: reserves and the exchange rate**  
**2010-2016.**



Source: MAPFRE Economic Research (with Bloomberg data)

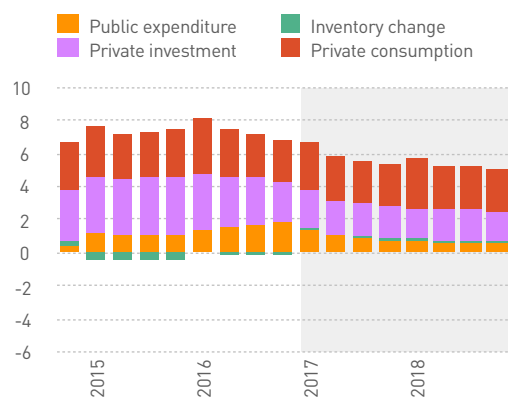


**Graph 1.2.12-b.**  
China: breakdown  
and forecasts of the GDP, 2014-2018



Source: MAPFRE Economic Research (with data from the BoPRC)

**Graph 1.2.12-c.**  
China: breakdown and forecasts  
of the domestic demand, 2014-2018



Source: MAPFRE Economic Research (with data from the BoPRC)

**Table 1.2.12.**  
China: main macroeconomic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	7.8	7.8	7.3	6.9	6.7	6.3	5.9
Contribution of the domestic demand	7.7	7.9	5.7	6.9	7.3	5.9	5.3
Contribution of the external demand	0.1	-0.1	1.6	0.0	-0.6	0.5	0.8
Contribution of private consumption	3.6	3.0	3.1	2.9	2.9	2.7	2.7
Contribution of investment	3.9	4.2	2.2	3.4	2.9	2.1	1.9
Contribution of public consumption	0.8	0.6	0.4	1.1	1.6	1.0	0.6
Domestic demand (average % p.a.)	8.0	8.1	7.2	7.1	7.5	6.0	5.4
Total consumption (average % p.a.)	8.7	7.2	7.2	8.0	8.8	7.1	6.4
Investment (average % p.a.)	8.7	9.3	6.9	7.5	6.3	4.5	4.2
Exports (p.a. as %)	1.5	2.3	2.0	0.5	0.5	0.8	1.1
Imports (p.a. as %)	-1.6	-2.6	-1.5	-1.0	-1.2	-1.1	-1.2
Unemployment rate (end of period)	4.1	4.1	4.1	4.1	4.0	4.0	4.0
Inflation (p.a.. end of period)	2.1	2.9	1.5	1.5	2.2	2.8	2.8
Fiscal balance (% GDP)	-1.6	-1.8	-1.8	-3.4	-3.8	-4.8	-4.8
Trade balance (% GDP)	3.6	3.7	4.2	5.2	4.4	3.9	3.7
Current account balance (% GDP)	2.5	1.5	2.7	3.0	2.2	1.6	1.4
Official interest rates (end of period)	2.25	2.25	2.00	2.00	2.00	2.00	2.00
10-year rate (end of period)	3.08	4.17	3.33	2.51	2.65	2.85	2.94
Exchange rate against the USD (end of period)	6.24	6.09	6.15	6.39	6.83	7.15	7.03
Exchange rate against the euro (end of period)	8.10	8.29	7.68	7.00	7.37	7.22	7.21
Private credit (average % p.a.)	16.1	15.4	13.4	14.8	13.3	11.1	10.5
Savings rate (%)	37.8	39.8	39.7	40.0	39.4	38.9	38.3

Source: MAPFRE Economic Research (with data from the BoPRC)

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## 1.2.13 Indonesia

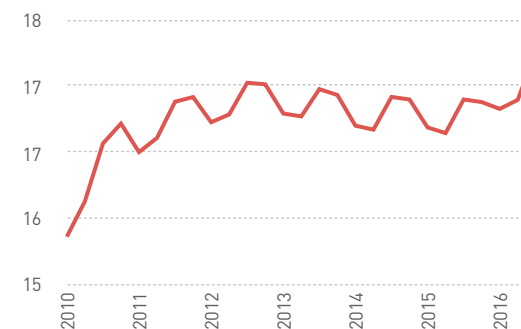
### Growth supported by domestic factors

The economy has benefited from various tailwinds: a) a strong domestic demand and supported on structural reforms, a favorable raw material cycle, and a strong increase in employment and wages (almost full employment). All this within a context of a population of 260 million, mainly young people; b) the delayed impact of a lax monetary policy which favors credit; c) a relatively orthodox administration which anticipates possible structural and fiscal reforms, to encourage both portfolio and direct investment in infrastructures (Indonesia is near to reaching the investment grade); and d) an external demand that is still robust and relatively diversified within the ASEAN. It is predictable that all these factors are maintained during 2017, and hence we anticipate a slight growth acceleration in line with its potential (5.2% in 2017).

Inflation in 2017 will accelerate above 4% owing to the delayed effects of the currency depreciation that leads to imported inflation, the effects of the lax monetary policy, and the modification of some regulated prices (electricity). However, inflation will remain within the target ranges of the Central Bank. The financial balance of the current account is highly financed with external flows at relatively short terms, which introduces certain volatility to the currency, particularly in view of changes in the United States monetary policy (as occurred in 2013). Indonesia also has moderate corporate financing in USD, which suggests certain vulnerability in view of the currency volatility. Having said this, the current economic situation, the sovereign bond yield, and the expectations of achieving the investment grade shortly, are significant supports to contain depreciation in an additional way to the incipient tightening of currency depreciation. In spite of this, the currency is expected to depreciate moderately throughout 2017.

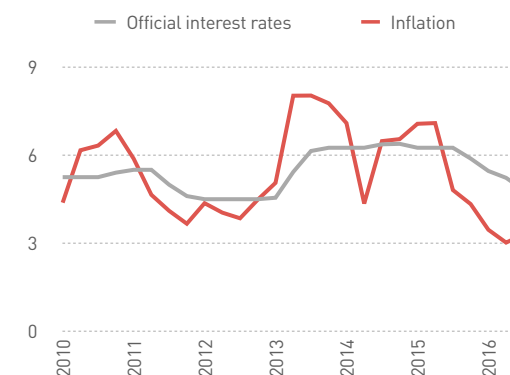
- **Tailwinds favor short and long-term growth (strong domestic demand, compromising monetary policy, attractive investment and diversified, dynamic regional demand).**
- **Vulnerability lies in the leverage of the corporate sector; the normalization of the United States monetary policy could have harmful effects.**

Graph 1.2.13-a.  
Indonesia: saving rate (% of the GDP),  
2010-2016.



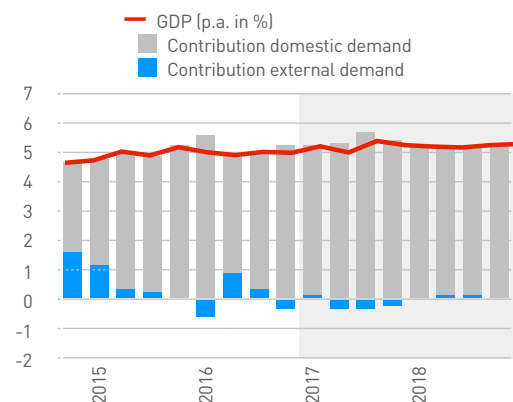
Source: MAPFRE Economic Research (with Bloomberg data)

Graph 1.2.13-b.  
Indonesia: inflation and interest rates (%),  
2011-2016.



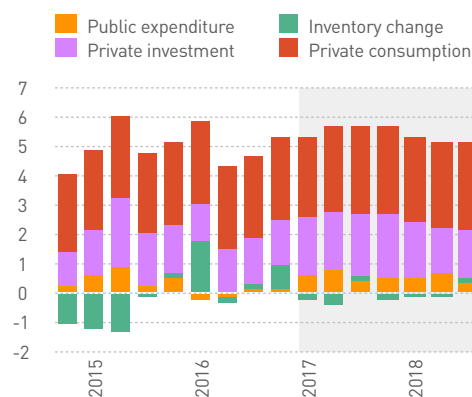
Source: MAPFRE Economic Research (with Bloomberg data)

**Graph 1.2.13-c.**  
Indonesia: breakdown  
and forecasts of the GDP, 2014-2018



Source: MAPFRE Economic Research (with BPS data)

**Graph 1.2.13-d.**  
Indonesia: breakdown and forecasts  
of the domestic demand, 2014-2018



Source: MAPFRE Economic Research (with BPS data)

**Table 1.2.13.**  
Indonesia: main macroeconomic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	5.7	5.3	4.9	5.0	5.0	5.2	5.2
Contribution of the domestic demand	6.1	4.9	3.3	4.5	4.9	5.4	5.2
Contribution of the external demand	-0.4	0.4	1.6	0.5	0.1	-0.2	0.1
Contribution of private consumption	3.1	3.0	2.7	2.8	2.8	2.9	3.0
Contribution of investment	2.6	1.4	0.9	1.8	1.5	2.1	1.8
Contribution of public consumption	0.1	0.6	0.2	0.5	-0.0	0.6	0.5
Domestic demand (average % p.a.)	6.2	4.9	4.7	4.6	5.0	5.5	5.2
Total consumption (average % p.a.)	4.9	5.6	4.5	5.2	4.3	5.4	5.4
Investment (average % p.a.)	8.0	4.2	4.4	5.6	4.5	6.5	5.4
Exports (p.a. as %)	0.3	1.0	0.6	-1.2	-0.1	0.7	0.8
Imports (p.a. as %)	-0.6	-0.6	0.7	0.7	0.2	-0.9	-0.7
Unemployment rate (end of period)	5.7	5.7	6.0	5.6	4.5	4.4	4.3
Inflation (p.a.. end of period)	5.1	7.1	7.1	3.5	3.8	4.3	4.2
Fiscal balance (% GDP)	-1.8	-2.0	-2.4	-3.7	-1.7	-3.0	-2.5
Trade balance (% GDP)	0.5	0.9	1.3	1.4	1.7	1.6	1.9
Current account balance (% GDP)	-3.1	-3.1	-2.5	-2.1	-2.1	-2.4	-2.3
Official interest rates (end of period)	4.55	6.25	6.25	5.46	4.75	5.00	5.25
10-year rate (end of period)	5.78	7.89	7.93	7.61	7.82	8.22	8.36
Exchange rate against the USD (end of period)	9.782	11.616	13.124	13.309	13.505	13.899	14.000
Exchange rate against the euro (end of period)	12.778	15.926	14.506	15.029	14.180	14.044	14.537
Private credit (average % p.a.)	17.1	17.0	17.0	16.9	17.6	18.2	18.5
Financial S.P. credit (average % p.a.)	14.0	16.1	13.1	22.4	3.8	9.3	9.3

Source: MAPFRE Economic Research (with BPS data)

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## 1.2.14 Philippines

### Sustained growth of the domestic demand

The Philippines GDP remains at high rates, in line with its potential. Most of this dynamism comes from the domestic demand, the export of services and remittances reception. The growth forecast for 2017 will be a little less than the previous year, owing to moderation (advisable) of the domestic demand, particularly in consumption, which is expected, however, to be offset by public expenditure.

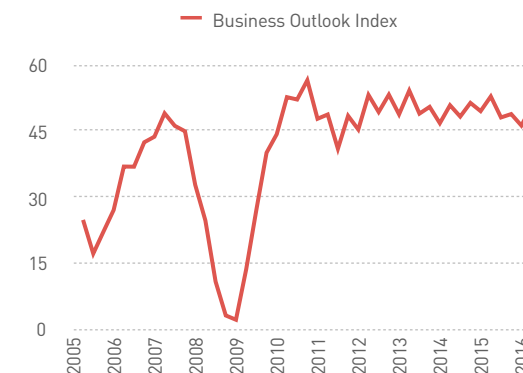
Philippines has a sound balance of payments, in spite of being a net importer, as a result of the savings glut and strong foreign direct investment (FDI), particularly from the United States. It is important that the risk of the country perceived by portfolio and direct investors, is kept controlled. Geopolitical events with China, the ethnic groups from the south of the archipelago, or the uncertainty itself of economic policy, are not favorable elements, and it is advisable to monitor them. The FDI has reduced and the portfolio investment flows have decreased over the past few months.

With regard to inflation, the Philippines is not only a net importer of oil, but also of food. A weaker currency means a greater import cost, which would boost inflation. Hence higher inflation is expected in 2017, but the figure will continue within the target range of the Central Bank (2-4%).

The Philippine peso will probably weaken against the dollar in 2017. A wider fiscal deficit and a much narrower current account surplus, will also put pressure on the currency.

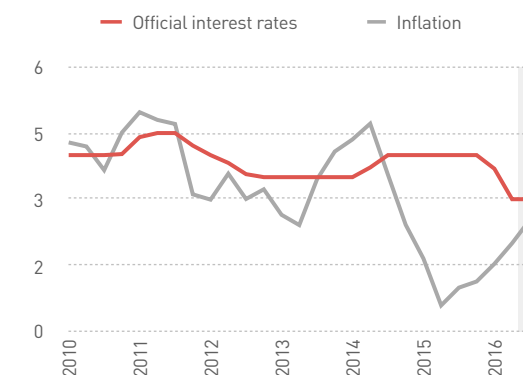
- Robust growth based essentially on the domestic demand.
- Consumption, exports of services and remittance are sources of dynamism.
- Risks related to relations with the United States and the course of monetary policy.

Graph 1.2.14-a.  
Philippines: Business Outlook Index.  
2005-2016.



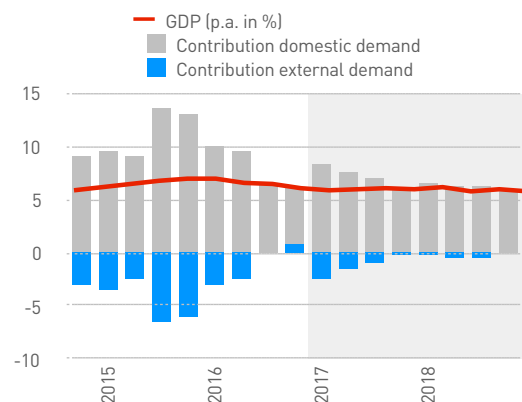
Source: MAPFRE Economic Research (with Bloomberg data)

Graph 1.2.14-b.  
Philippines: inflation and interest rates (%),  
2010-2016.



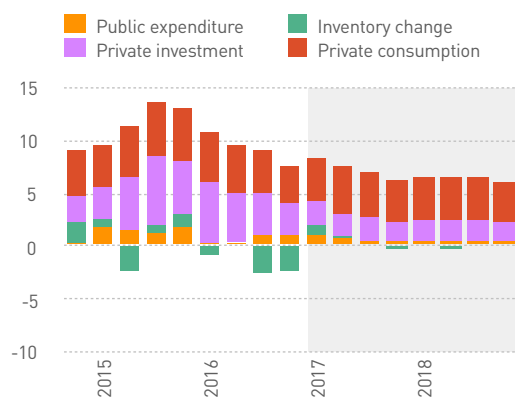
Source: MAPFRE Economic Research (with Bloomberg data)

**Graph 1.2.14-c.**  
Philippines: breakdown  
and forecasts of the GDP, 2014-2018



Source: MAPFRE Economic Research (with PSA data)

**Graph 1.2.14-d.**  
Philippines: breakdown and forecasts  
of the domestic demand, 2014-2018



Source: MAPFRE Economic Research (with PSA data)

**Table 1.2.14.**  
Philippines: main macroeconomic aggregates

	2012	2013	2014	2015	2016	2017	2018
GDP (average % p.a.)	7.5	6.3	5.8	6.6	6.7	6.0	6.0
Contribution of the domestic demand	9.0	7.7	5.0	11.3	7.8	7.3	6.3
Contribution of the external demand	-1.5	-1.3	0.8	-4.7	-1.2	-1.3	-0.1
Contribution of private consumption	4.1	4.2	3.9	4.7	4.3	4.3	3.9
Contribution of investment	3.1	1.1	1.5	5.0	4.3	2.0	2.0
Contribution of public consumption	1.2	0.2	0.3	1.5	0.7	0.7	0.4
Domestic demand (average % p.a.)	9.1	7.6	5.9	11.1	7.4	6.8	5.8
Total consumption (average % p.a.)	6.5	5.5	5.3	7.7	6.2	6.3	5.4
Investment (average % p.a.)	15.9	5.4	10.2	22.7	17.1	7.3	7.3
Exports (p.a. as %)	0.2	4.1	4.1	5.4	4.7	2.4	3.3
Imports (p.a. as %)	-1.5	-5.6	-3.4	-12.3	-6.1	-3.7	-3.6
Unemployment rate (end of period)	7.5	7.0	6.4	6.1	4.1	3.6	3.7
Inflation (p.a.. end of period)	2.7	4.4	1.7	1.5	3.1	3.7	3.8
Fiscal balance (% GDP)	-2.4	-1.4	-0.0	-1.9	-2.8	-3.1	-2.9
Trade balance (% GDP)	-6.2	-6.7	-6.5	-10.1	-11.5	-10.4	-9.6
Current account balance (% GDP)	4.4	3.2	-5.7	1.0	0.6	0.9	1.4
Official interest rate (end of period)	3.50	3.50	4.00	3.69	3.00	3.25	3.87
Interest rate 10 year	2.94	2.77	3.26	3.11	2.90	3.35	3.97
Exchange rate against the USD (end of period)	41.76	44.13	44.67	46.52	49.71	47.96	46.93
Exchange rate against the euro (end of period)	54.55	60.51	49.37	52.53	52.20	48.47	48.73
Savings rate (%)	7.8	8.8	8.4	7.9	8.8	9.5	9.4
Financial S.P. credit (average % p.a.)	8.6	9.1	2.9	6.6	8.6	9.1	9.5

Source: MAPFRE Economic Research (with PSA data)

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## 2. Sector outlook

### 2.1 The economic environment and its impact on insurance demand: upgrading and forecasts

Several **factors of a macroeconomic nature condition activity and the dynamics of the insurance industry**. Hence, aspects such as the economic activity rate, the level and development of interest rates, the behavior of exchange rates and the degree of financial volatility all have an impact on the level of demand for insurance products, on the income and structure of costs, on the value of assets of the insurance industry, and on the capacity of managing these assets in relation to their liabilities. Even factors like the behavior and level of interest rates could have a determining impact on the viability of a certain part of the business model in Life insurance. This has been seen in those regions of the world, which have faced prolonged periods of low interest rates.

This highly conditioned insurance industry with respect to the main economic and financial variables, **can be explained by the links that the insurance industry has on practically all areas of economic operation**. Firstly, protection and risk compensation undertaken by the insurance sector, supports the operation of different sectors of the real economy (primary activities, industry and services), through a wide range of damage insurance and against liability. Similarly, insurance provides stability and continuity of the economic process against the occurrence of events of a catastrophic nature (characterized for being low frequency and high

severity). This helps the economy to normalize operations in relatively short periods of time. Insurance also stimulates and enables multiple activities and trade transactions to be undertaken, both at domestic level and foreign trade level, through protection, provided by credit insurance. From the viewpoint of individuals and families, the insurance activity provides stability to personal and family income, through the protection and compensation offered by risk, life, accident, health home and motor insurance, among others (see Box 2.1.1-a).

Nevertheless, one of the basic functions of insurance in the economy concerns the savings-investment process. Essentially through life insurance with saving components, the insurance industry contributes to the creation of internal savings in the economy, and with this, to the process of capital formation. In this sense, **the insurance industry is one of the main institutional investors at global level**. Through this function, it not only channels savings to financing productive activities, but also (through the characteristics of its business model and its implicit investment function), it provides the economic system with an element of countercyclical stabilization (see Box 2.1.1-b).

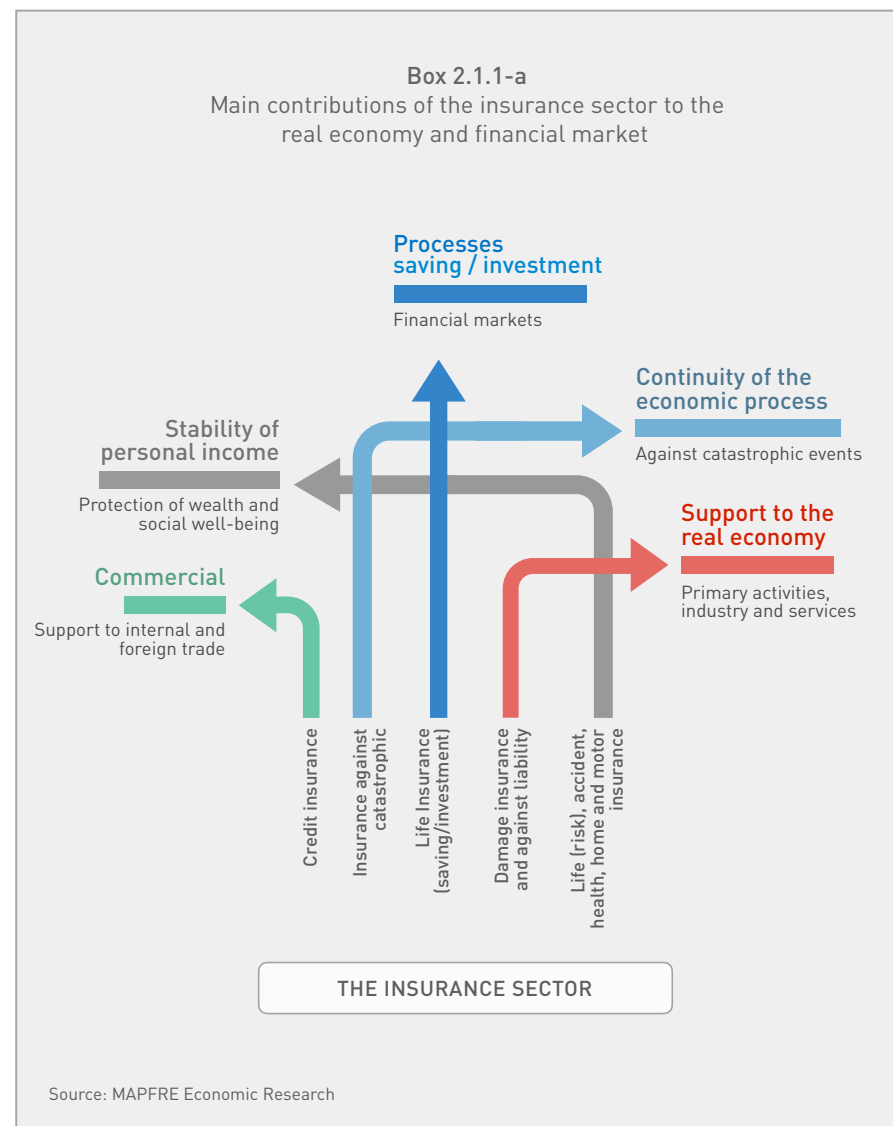
## 2.1.1 Global Markets

The moderate acceleration of global growth, with a contribution from emerging countries above the initially forecast figure, forms a favorable environment for the development of the insurance market at global level. In accordance with the basic scenario forecast in this report, it is estimated that premiums of the **Life market segment** in **developed markets**, could grow to an average of around 1.7% in 2017 and slightly fall to 1.4% in 2018, in nominal terms (see Table A-7 and Graph 2.1.1-a).

On the other hand, it is forecast that nominal growth of Life business premia will be higher than in **emerging markets**, with rates varying in values of around 11.7% and 11.2% in 2017-2018 respectively (see Graph 2.1.1-b). These growth values amply surpass inflation forecasts, and are coherent with greater flexibility of insurance premiums, in view of growth in the income of emerging markets, in which the insurance protection gap is even wider.

With regard to the **Non-Life market segment**, in accordance with the central scenario of this report, the growth levels forecast for **developed markets** are around 4.9% in 2017, decreasing to 3.6% in 2018. In types of insurance, the motor business will grow by 1.4% in 2017, moderating its growth to 1.2% in 2018. Accident and health business will be positioned at rates of 3.7% in 2017, reducing to around 3.1% in 2018 (see Tables A-9 and A-10, and Graph 2.1.1-c).

Following the same line as Life Insurance, improved behavior is expected in the Non-Life segment in **emerging markets**, with annual growth slightly above 9% in the 2017-2018 period. Rates in motor insurance are forecast for 13.4% and 14.1% during the same period, and 10.9% and 10.5% for the accident and health business (see Graph 2.1.1-d).





**Box 2.1.1-b****The function of the insurance industry  
as an institutional investor**

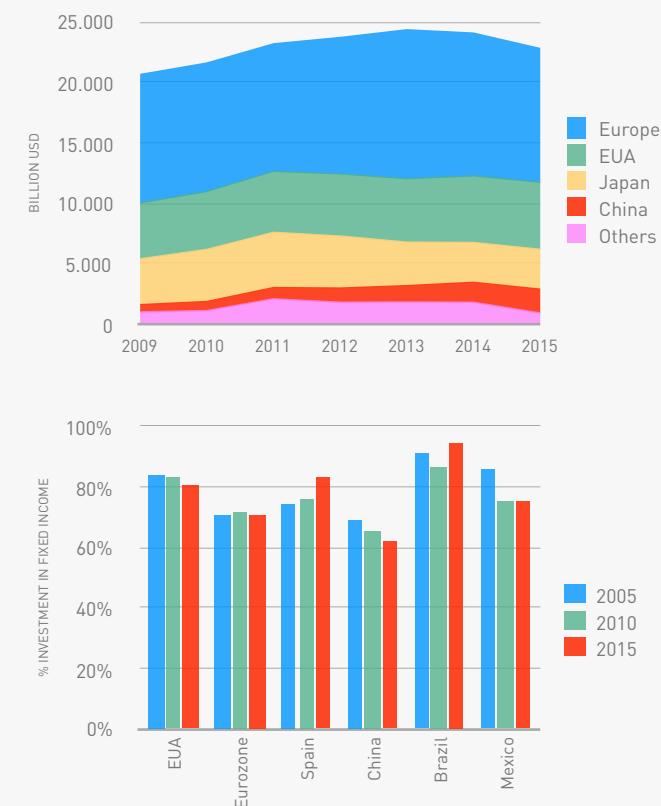
Apart from the function of risk compensation and dispersion performed by the insurance sector, which supports and boosts the operation of the real economy, the insurance sector undertakes a significant function in the financial circuit of transforming saving into investment.

The insurance sector is one of the main institutional investors at global level. By carrying out this function, in 2015 it contributed 22,838 billion dollars to support financing of productive activities at international level (see Graph R-2.1). Out of this total, 48.4% came from European insurance entities (30.2% considering the Eurozone only), 24.2% from insurance entities of the United States, 14.4% from Japanese entities and 8.6% from insurance entities operating in China.

Unlike what occurs with other institutional investors, it is important to highlight that the investment function made by the insurance sector has several significant characteristics:

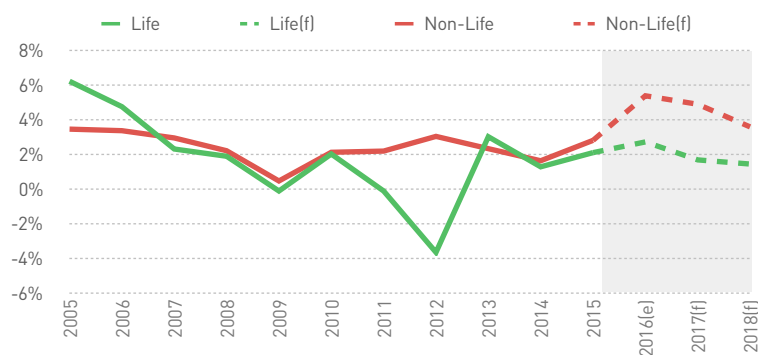
- (1) Firstly, it is a stable flow of resources inasmuch as, owing to its business model, investment decisions of insurance entities follow the characteristics of their liabilities. This means that, it is a subsidiary and dependent function of the particularities of the liability driven structure, which is modified only in relatively long intervals.
- (2) Secondly, inasmuch as the major part of these investments sustain obligations of life insurance, it is the long-term investments (and in a high percentage of fixed income) that enable investment projects to be supported, which could find greater difficulties through traditional mechanisms of funding.
- (3) Thirdly, owing to the characteristics indicated above, investment flows from the insurance sector have the feature that they do not suffer significant variations in the lower part of the economic cycle, providing the economic system with a countercyclical stabilization element.

**Graph R-2.1.1-a.**  
**Investments of the global insurance sector and percentage**  
**of investment in fixed income of selected countries**



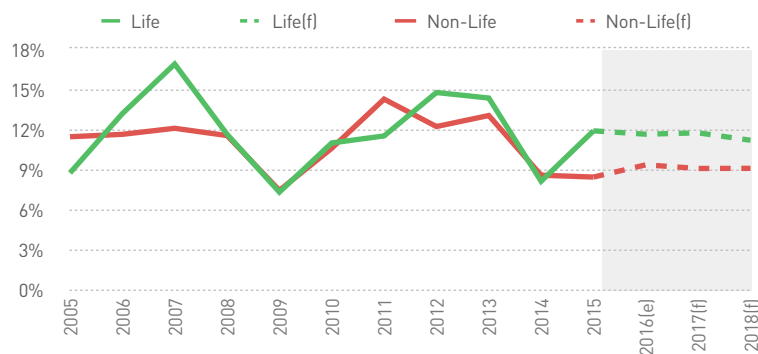
Source: MAPFRE Economic Research (with data from the OEDC and local supervisors)

**Graph 2.1.1-a.**  
Developed markets: adjustments and forecasts of the model for the Life market medium-term growth, %



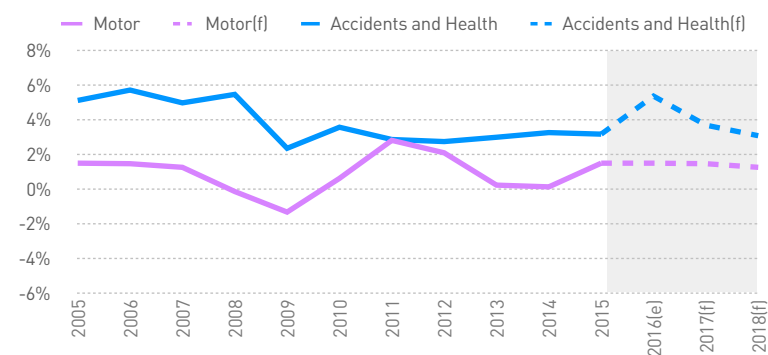
Source: MAPFRE Economic Research

**Graph 2.1.1-b.**  
Emerging markets: adjustment and forecasts of the model for the Life market medium-term growth, %



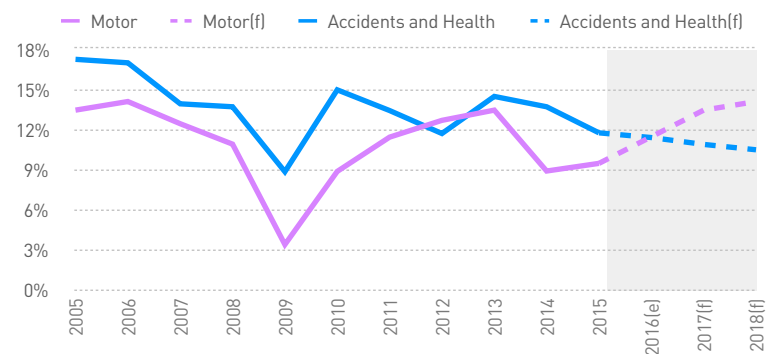
Source: MAPFRE Economic Research

**Graph 2.1.1-c.**  
Developed markets: adjustments and forecasts of the model for the Motor and Accident and Health market medium-term growth, %



Source: MAPFRE Economic Research

**Graph 2.1.1-d.**  
Emerging markets: adjustments and forecasts of the model for the Motor and Accident and Health market medium-term growth, %



Source: MAPFRE Economic Research

As can be seen from the previous analysis, improvements introduced in the pension model (see Box 2.1.1-c), together with a greater contribution to growth from emerging countries than initially foreseen, result in an upward revision of the estimates included in the previous report.

## 2.1.2 Eurozone

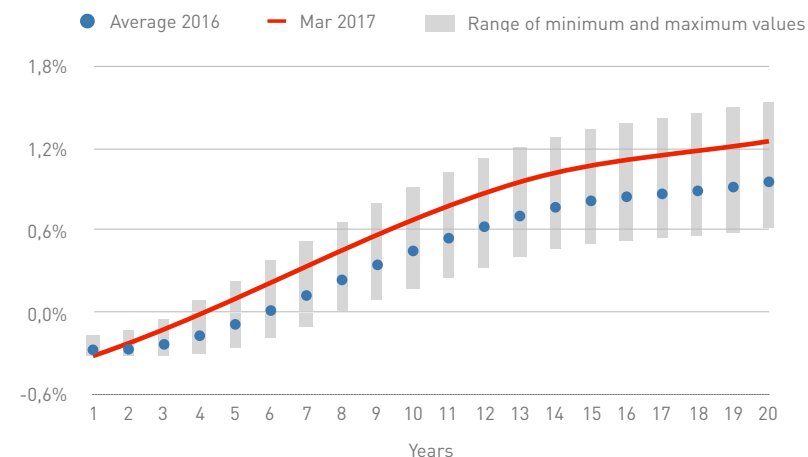
Improvement in expectations for the Eurozone, with growth forecasts in terms of the GDP of around 1.5% in 2017 and 2018, allow us to think of a more favorable environment for the development of the insurance sector. This is particularly true in the Non-Life and Life risk market segments, highly correlated with the economic cycle.

It is estimated that insurance premiums of the Non-Life sector could experience nominal growth of around 4.9% in 2017, decreasing to a rate of 3.7% in 2018. In motor insurance, growth would be placed at around 1.7% for 2017 and 2018, whilst in accident and health insurance, expected growth would be 3.3% in 2017 and 2.6% in 2018.

Likewise, the upturn of inflation in the Eurozone could lead to reconsidering the monetary policy of the ECB in the future. However, this is not expected to materialize before the end of 2018. Nevertheless, in the risk-free euro curves, calculated by the European Insurance Occupational Pensions Authority (EIOPA) for valuation purposes of the technical provisions, an increase in rates can be seen, compared to the minimum levels of July 2016 [see la Graph 2.1.2 which shows the minimum, medium and maximum levels reached in 2016, along with the level of the last curve published by the EIOPA corresponding to 31 March 2017].

As can be observed, the increase is greater in the long sections of the curve, around 50 bps in the ten-year interest rate, compared to the

**Graph 2.1.2.**  
**Eurozone: risk-free interest rate curve**  
[%]



Source: MAPFRE Economic Research (with EIOPA data)

minimum level in the month of July. For longer sections, the increase is even higher, above 60 bps for maturities over seventeen years.

In spite of still being in an environment of low-interest rates, this increase in rates and the slope of the curve appear to indicate the start of a favorable period for the development of Life savings and annuity income products. In this sense, it is estimated that premiums of the Life business could grow to rates of 1.4 in 2017 and 1.3% in 2018.

**Box 2.1.1-c**  
Premium growth forecast model:  
Methodological aspects

**Construction of the database and dependent variables**

As part of this report, an empirical **model has been proposed of the estimate in premium growth of the insurance market**, based on the macroeconomic theory of consumption and permanent income. For these purposes, annual data are collected of premiums per each main type of insurance (Life, Non-Life, Motor and Accidents and Health), to be used as endogenous variables. With regard to the sample period, the model addresses the period between 1980 and 2016, with forecasts for the 2017-2018 period. To record the short-term predictive capacity, quarterly data are used. To do this, the annual premiums of each class were calculated at a quarterly rate, using data interpolation (characterized by a seasonal pattern). Variables of premiums are processed in logarithms and transformed into the first differences to attain their seasonality. Likewise, to obtain premiums in regions, the median of premiums was used of countries corresponding to each region.

In order to construct a model with a high explanatory capacity, each insurance type has been analyzed by regions which are the main interest. On the one hand, **developed markets** which encompass a set of 14 countries: 8 of the European Union (Austria, France, Germany, Italy, Malta, the Netherlands, Portugal and Spain); 4 not belonging to the European Union (Australia, Canada, United Kingdom and Denmark), and the United States and Japan. And on the other hand, **emerging markets**, which encompass a set of 24 countries: 14 Latin American countries (Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Panama, Peru, Dominican Republic, Uruguay and Venezuela), 5 from emerging Asia (China, Thailand, Philippines, Hong Kong, South Korea), 3 countries from emerging Europe (Russia, Poland and Turkey), and Saudi Arabia and South Africa.

**Target of the model and explanatory variables**

The macroeconomic background of the model is based on the analysis of the joint dynamics of variables linked to income and wealth, with consumption and saving. Hence, the model is able to observe the interrelation between insurance premiums and their GDP, risk aversion and risk premiums or certain financial variables, associated to interest rates. The explanatory part of the model is thus composed of the following variables: GDP, interest rates, exchange rates, inflation, risk premiums, employment, price of oil. It also includes dummy variables in the regression, in order to capture the incremental effect of belonging to one region or another. The analysis, for which the model uses as a base, is mainly focused on the dynamics between premiums and macroeconomic and financial variables. Information is also provided on the explanatory capacity of the premiums themselves.

For this purpose a Panel VAR (Vector Autoregression with Panel Data) model is used. Owing to the pursued target and to data obtained, an unbalanced panel data structure is applied with fixed effects. Firstly, the model is unbalanced, as not all regions can be observed in all the periods. Moreover, on seeking the individual effect of each region on the premiums, and considering that these individual effects are independent, the use of fixed effects appears trivial. However, beyond the methodology applied, the main justification of the model in panel data is to provide information on the different and temporary populations, meaning information on a joint dynamic of variables.

Lastly, the use of a Panel VAR gives the analysis a flexible, dynamic structure between macroeconomic variables. It also enables estimating the individual effect of each population. Other studies, such as the Xin Shen study (2015), provide the effect of household wealth on consumption and its impact in the short and long term.

### 2.1.3 Spain

Growth forecasts of the Spanish GDP in 2017 of around 2.5% (with a slight slowdown compared to 2016, when it was at 3.2%) lead us to think of a correlative moderation in the growth of Non-Life and Life risk market segments. However, the greatest dynamism perceived in the residential sector could offset the effect of moderation forecast in consumption. In this environment, it is estimated that Non-Life insurance premiums could experience nominal growth above the average forecast for countries of the Eurozone.

On the other hand, in spite of the improvement experienced in 2016, the persistence of low interest rates in the environment continues, weighing on the traditional Life savings and annuities market segment. However, the upward turn in risk-free interest rates in long terms of the curve (see Graph 2.1.2) may favor their marketing (in line with what occurred in 2016), helped by the zero profitability of deposits in credit institutions, which are still facing a marginal facility of negative deposits.

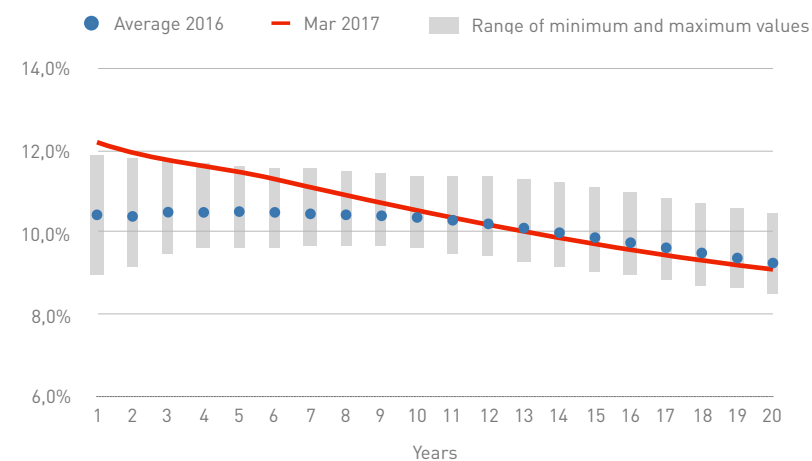
### 2.1.4 Turkey

Economic growth for Turkey in 2016 of 2.9%, continues a long way from its potential and the growth of 6% reached in 2015. Together with the deceleration forecast for 2017 (with values of around 2.3%), owing to less growth forecast in the domestic demand, this situation could limit the dynamics of growth in the insurance business in Non-Life and Life risk insurance types, if the high correlation with the economic cycle is considered.

Likewise, the high uncertainty owing to domestic and geopolitical tensions, is being transferred to a volatile and inverted interest rate curve (see Graph 2.1.4). This could hinder the development of Life savings and annuities

business, in spite of risk-free rates still being positive in all sections of the curve. This volatility of interest rates increases the likelihood of increased surrenders. Similarly, the upturn of inflation, along with the deterioration of real salaries and its currency, could be a factor that undermines the suitable technical performance of the insurance business.

**Graph 2.1.4.**  
Turkey: risk-free interest rate curve  
[%]



Source: MAPFRE Economic Research (with EIOPA data)

### 2.1.5 United States

In accordance with our previous report, in the United States, the growth expectations of the GDP of 1.6% materialized in 2016. Although with certain caution owing to the fact that expansive fiscal policies promised by the Trump Administration, were not fully specified, the growth forecast for 2017 is maintained at around 2.3%. This is a favorable environment for the development of the insurance sector in Non-Life and Life risk segments.

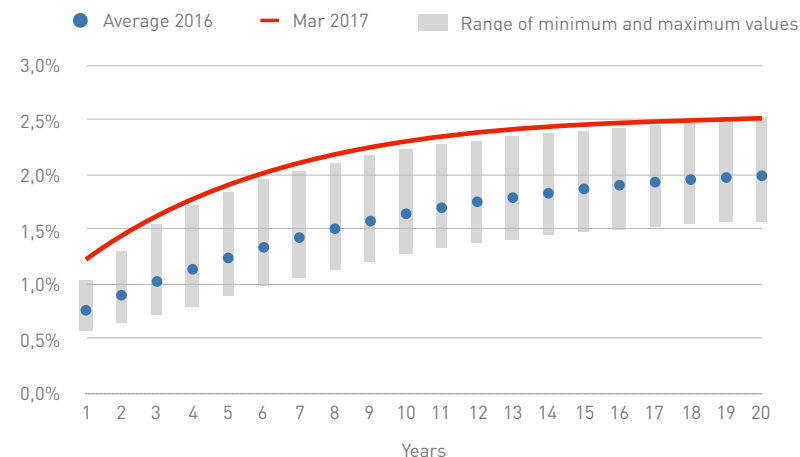
It is estimated that Non-Life business premiums could experience growth above 2.7% in the 2017-2018 period, although in an asymmetrical form for different insurance types. Thus, the forecast for the motor segment is that growth rates could moderate in 2017 and 2018, while the forecast growth for accident and health insurance would be 4.7% in 2017, to reach 5.1% in 2018.

Likewise, the materialization of gradual increases in long-term interest rates will favor the development of the Life saving and annuities insurance segment. This is because higher guaranteed rates can be offered, and the situation of entities in terms of appropriate matching of durations in portfolios can be improved. In risk-free interest rate curves for the United States dollar, calculated by the EIOPA (see Graph 2.1.5), the rise of rates compared to the level in 2016, can be observed. It is estimated that these increases could lead to growth in the Life business segment of around 1.2% in 2017 and 4.5% in 2018.

### 2.1.6 Brazil

A decrease of -3.6% in the Brazil economy is confirmed for 2016, with an estimate of 0.3% for 2017. Expansive fiscal and monetary policies could lead to a change of tendency and achieve positive growth rates in coming years, which would be favorable for the performance of the insurance

Graph 2.1.5.  
United States: risk-free interest rate curve  
(%)

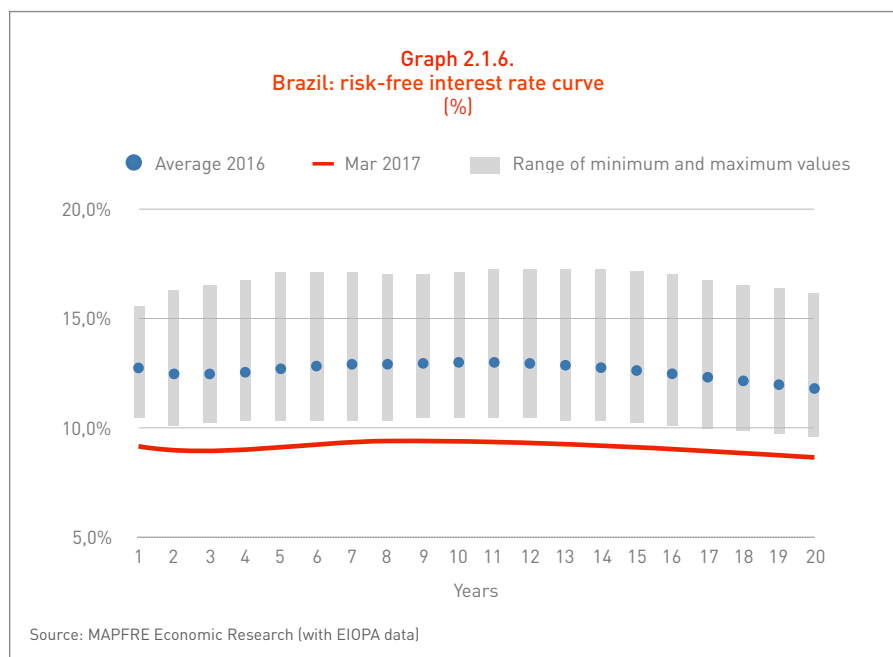


Source: MAPFRE Economic Research (with EIOPA data)

sector. However, the environment is still complicated bearing in mind the weakness of the economic performance.

Interest rates are at values under the minimum rates of 2016 and continue to fall, with a flattening of the curve, which even has a slight negative slope in its long section (see Graph 2.1.6). This will create a complex environment for the development of Life saving and annuities products, in spite of the fact that rates continue to be positive at all points of the curve.

On the other hand, the expansive fiscal and monetary policies could lead to a deterioration of the real, with the consequential negative impact on the insurance business results, by transferring the impact to the costs structure. This situation could improve in the medium term, if forecasts are finally consolidated and later return to growth in 2018. However, there is still uncertainty in this sense.

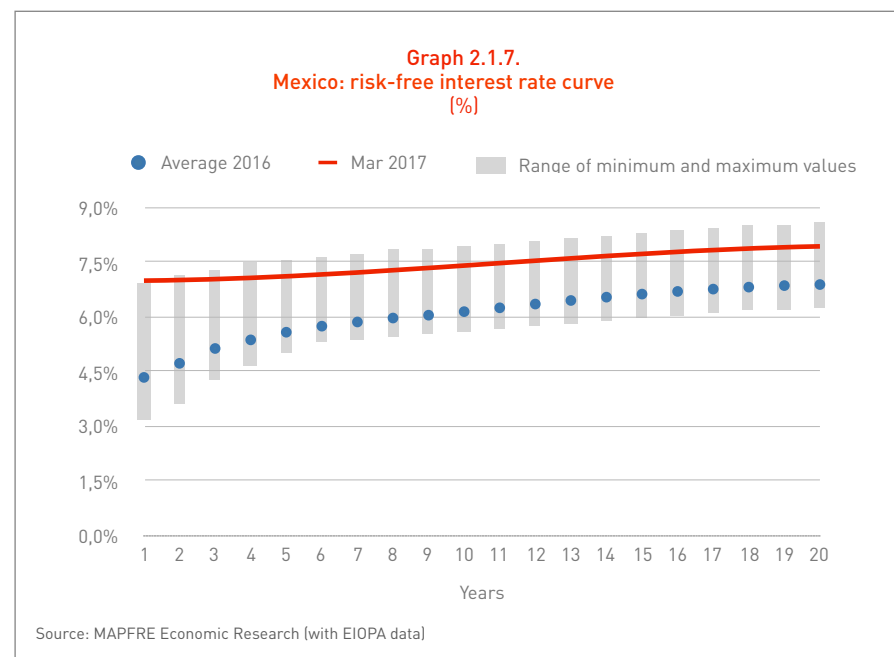


## 2.1.7 Mexico

The weakness of the economic growth process foreseen for Mexico in 2017, along with the erosion of real income, owing to the the growth in inflation,

forecasts a weak performance and growth of Non-Life and Life risk insurance types, although above the growth of the general economic activity.

The outlook for Life saving and annuities insurance could be favorable, given the forecast increases in the interest rates by the Central Bank, and the perspectives to sustain a restrictive monetary policy, which has raised the interest rates in the short section of the curve (see Graph 2.1.7). Nevertheless, the volatility observed continues to be high, which could also have an adverse effect on the indicated business. This is because similarly to other emerging economies, it hinders marketing of these products, and leads to potential risks of surrenders.



### 2.1.8 China

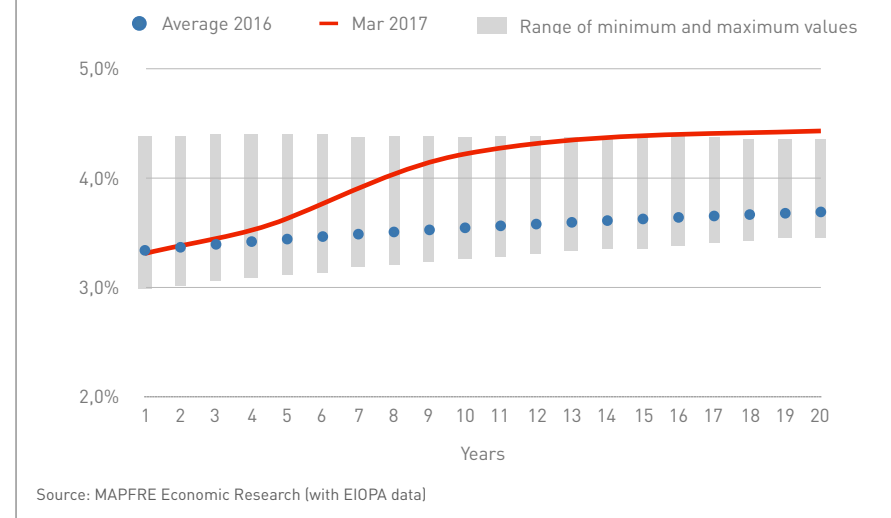
The forecast of a favorable economic environment in China is positive for the perspectives of its insurance sector. This is owing to its still reduced insurance penetration rate (inherent to emerging economies), which leads to greater flexibility in the growth of premiums in view of GDP growth.

It should be underlined that the Chinese government includes explicit targets for the insurance activity, to increase the penetration rate (premiums/GDP). Thus, the growth of economic activity in 2016 of 6.7%, together with growth expectations of around 6.3% in 2017, will form a favorable environment for the development of Non-Life and Life risk insurance segments, also considering that the weight of residential investment and in capital goods is significant in these growth expectations. However, the forecast of possible tightening of conditions to access home purchase, could also have a negative effect on the growth forecasts for the insurance sector.

In this sense, it is estimated that growth rates of the Non-Life insurance segment could have two-digit values during the 2017-2018 period. Motor insurance will experience growth of around 15.5%, while health and accident insurance could reach rates above 25% in the same period.

On the other hand, the forecast of implementing monetary policies by the central bank, in an attempt to avoid more depreciations of the currency, mark out a favorable outlook for Life saving and annuity insurance business.

**Graph 2.1.8.**  
**China: risk-free interest rate curve (%)**



In the EIOPA curves (see Graph 2.1.8) this effect can be observed, particularly in the long-term of the curve, with a rise in long-term interest rates and a curve that gains slope, which is positive for marketing Life saving and annuity products. In this way, it is estimated that the growth rates of Life business premiums during the 2017-2018 period, could reach values of almost 20%.



### 2.1.9 Reinsurance

In general terms, estimated data point towards an increase in the accident rate owing to catastrophic events. The economic damage of these events in 2016 exceeded by around 86% the figures for 2015, and in terms of insured damage, around 42%. This is the worst figure since 2012, which in any event was a period that reported low catastrophe rates. The insurance protection gap against this type of risk continues to be substantial and asymmetrical by different regions<sup>10</sup>. This upturn is expected to push reinsurance premiums upwards.

## 2.2 Regulatory trends

### Global trends

At the beginning of March, the International Association of Insurance Supervisors (IAIS) launched a consultation to revise the core principles for the supervision of insurance, an integral part of the so-called “ComFrame”, for the supervision of Internationally Active Insurance Groups, IAIGs). Analysis for revision refers to some aspects regarding the introduction of principles, assessment methodology, system of governance, supervision, cooperation, measures to be adopted by supervisors and the resolution of these groups. The deadline to send comments ends on 1 June 2017.

On the other hand, the insurance project between the United States and the European Union on the so-called Cyber Risk should be highlighted. On 9 March 2017, an agreement was reached on the nomination of experts of both jurisdictions to discuss cybersecurity issues and the transatlantic coordination of this and other related matters. Participants included

members of the European Commission, the National Association of Insurance Commissioners (NAIC), the Federal Insurance Office (FIO) of the Department of the Treasury, and the United States Federal Reserve Bank (FRB)<sup>11</sup>.

### United States

On 15 March 2017, the NAIC sent to the United States Department of the Treasury a letter indicating its position referring to the bilateral Agreement reached on 13 January, in terms of insurance and reinsurance with the European Union. Ratification is now pending from the United States Congress<sup>12</sup>.

In its letter<sup>13</sup>, the NAIC underlined the confusion, which it believes exists, regarding the nature of rights and obligations derived from the Agreement between the current government officials, who negotiated the Agreement at the time, regulators and the industry itself. For this reason, it presents a list of clarifications on the interpretation of the terms of the Agreement, in order for the Department of the Treasury to seek written confirmation from the European Union in this sense. It is understood that this clarification is required to assess whether the Agreement has been made in the best interest for the United States, and for its suitable implementation.

On the other hand, President Donald Trump remains firm in his promise to reform regulations that affect the financial sector, particularly the “Dodd-Frank Act”, in order to eliminate regulations considered inefficient. However, it is still early days to anticipate how these possible reforms are to be specified, and the effects they may eventually have on the financial sector, particularly on the insurance sector.

## European Union

### European Supervisory Authorities

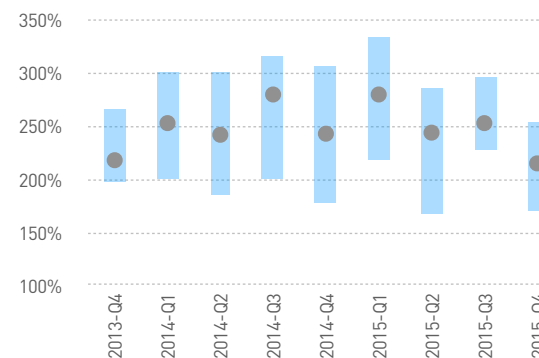
On 21 March, the European Commission launched a public consultation<sup>14</sup> on the operation of the European Supervisory Authorities (EBA, ESMA and EIOPA). The aim was to identify areas which could be improved and reinforced, as they are an important element in the development and integration of financial markets of the European Union. This consultation is held in the context of a general revision planned by the Supervisory Authorities this year, as established in its founding rules. The deadline to send comments ends on 16 May 2017.

### Solvency II

On 9 February 2017, the European Insurance and Occupational Pensions Authority (EIOPA) published the risks chart, to which it is understood that the insurance industry of the European Union (EU) is exposed<sup>15</sup>. Information was supplied on the solvency ratio of samples of insurance companies at individual and group level, together with their comparison with ratios presented under the previous system (see Graphs 2.2-a and 2.2.-b).

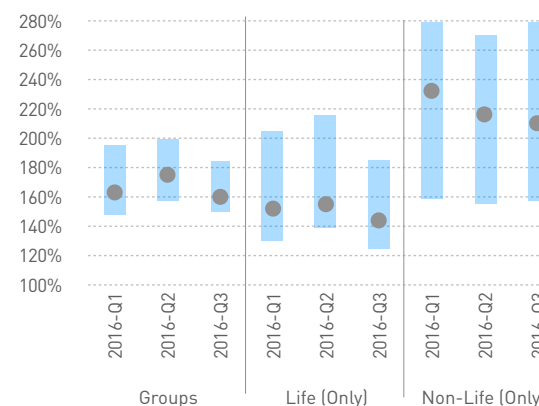
On 5 April, the EIOPA published the methodology to derive the ultimate forward rate (UFR) for extrapolating risk-free interest rate curves, to be used in the valuation of technical provisions to determine the solvency ratio<sup>16</sup>. As a result of this new methodology, the UFR for the euro curve is decreased from 4.2% to 4.05% in 2018, with additional reductions in later years until reaching 3.65%, according to the value estimated by the EIOPA. Annual reductions may not be higher than 15 bps.

Graph 2.2-a.  
Solvency I ratio: Groups



Source: MAPFRE Economic Research (with EIOPA data)

Graph 2.2-b.  
Solvency II ratio: Groups, Life and Non-Life



Source: MAPFRE Economic Research (with EIOPA data)

Lastly, it should be underlined, that the deadline ended on 3 March to send comments regarding the document for discussion on the reform of some specific elements of the standard formula. This was part of the process to draw-up technical advice, requested by the European Commission, which should be sent on 31 October. The EIOPA is now in the process of analyzing the comments received<sup>17</sup>.

### **Private pension funds**

The new revised text of the Directive of Institutions for Occupational Retirement Provision (IORP II) was published in the Official Journal of the European Union on 23 December 2016. This Directive pursues a minimum harmonization between different national legislations, regarding the regulation of pension funds linked to an occupational relation. It attempts to guarantee minimum levels regarding transparency, governance and risk management. This Directive should be transposed at the latest by 13 January 2019.

The EIOPA underlines the high level of heterogeneity of this type of fund in the European Union, and is developing various initiatives that may contribute to the efforts to reduce market fragmentation. In this sense, a survey is underway to collect the opinions of different significant stakeholders. The deadline ends on 4 April. The EIOPA also intends to launch the Pension Stress Test 2017 next May.

Lastly, it should be highlighted that the European Commission continues to work on a legislative proposal regarding an individual pan-European pension product, based on the technical advice given by the EIOPA in July 2016, and the public consultation undertaken by the Commission itself at the end of 2016. This was on the possible measures related to this type of instrument, to face demographic challenges, innovation and the development of markets, along with the mobility of funds at European Union level, among other aspects.

### **Distribution of insurance**

On 1 February, the EIOPA published technical advice<sup>18</sup> sent to the European Commission, on possible delegated acts planned by the Directive<sup>19</sup> on the Distribution of Insurance. The purpose was to facilitate a common framework for better governance and supervision of processes concerning the launch and follow-up of products by insurance companies, focusing on consumer protection. It also draws-up legislative proposals regarding the distribution of investment products, based on insurance, management of conflicts of interests, incentives and suitability and adaptation of products acquired by insurance consumers.

At the beginning of February, the EIOPA sent to the European Commission its proposal of the Technical Implementation Standard<sup>20</sup> on the harmonized contents of the pre-contractual information document, which should be handed to Non-Life insurance consumers (Insurance Product Information Document, IPID). At the same time, work is continued by the member States regarding the transposition of the Insurance Distribution Directive, the deadline of which is 23 February 2018.

### **Consumer protection**

On 23 March, the European Commission announced an Action Plan for consumers<sup>21</sup> to improve the possibility of choice and access to financial products from the whole Union. This is a horizontal initiative focused on the use of digital instruments, which covers a wide range of financial products, such as bank accounts, car insurance and money transfers.

In relation to financial innovation and consumer protection, on 17 March 2017, the deadline ended to reply to the document drawn-up by the EBA-ESMA-EIOPA Joint Committee, on the use of "Big Data" by financial institutions, which has had reactions from financial institutions, supervisors and other stakeholders<sup>22</sup>. The Committee is now analyzing these answers.



## Tables: scenarios of macroeconomic and sector forecasts

Table A.1.  
Basic and Risk Scenarios: gross domestic product  
(annual growth. %)

	Basic Scenario						Risk Scenario					
	2013	2014	2015	2016	2017	2018	2013	2014	2015	2016	2017	2018
United States	1.7	2.5	2.6	1.6	2.3	2.5	1.7	2.5	2.6	1.6	1.5	1.1
Eurozone	0.8	1.6	1.8	1.7	1.5	1.5	0.8	1.6	1.8	1.7	1.0	1.0
Germany	0.6	1.6	1.5	1.8	1.5	1.4	0.6	1.6	1.5	1.8	1.1	1.4
France	0.6	0.6	1.3	1.3	1.3	1.6	0.6	0.6	1.3	1.3	0.8	1.3
Italy	-0.4	0.3	0.8	0.9	1.0	1.1	-0.4	0.3	0.8	0.9	0.5	0.9
Spain	-1.7	1.4	3.2	3.2	2.5	2.1	-1.7	1.4	3.2	3.2	1.6	1.7
United Kingdom	1.9	3.1	2.2	1.8	1.6	1.3	1.9	3.1	2.2	1.8	1.2	0.8
Japan	2.0	0.3	1.3	1.0	1.2	1.0	2.0	0.3	1.3	1.0	0.4	0.1
Emerging markets	5.1	4.7	4.2	4.1	4.6	4.8	5.1	4.7	4.2	4.1	3.9	4.0
Latin America <sup>1</sup>	2.9	1.0	0.0	-0.6	1.6	2.1	2.9	1.0	0.0	-0.6	1.2	1.2
Mexico	1.6	2.3	2.6	2.3	1.9	2.0	1.6	2.3	2.6	2.3	1.6	0.6
Brazil	3.0	0.5	-3.8	-3.6	0.3	1.9	3.0	0.5	-3.8	-3.6	0.1	2.3
Argentina	2.4	-2.5	2.6	-2.3	2.5	3.8	2.4	-2.5	2.6	-2.3	2.3	3.3
European emerging	2.8	2.8	3.6	3.3	3.1	3.2	2.8	2.8	3.6	3.3	3.0	3.1
Turkey	8.5	5.3	6.0	2.9	2.3	3.2	8.5	5.3	6.0	2.9	2.7	3.1
Asia Pacific	5.8	5.6	5.5	5.8	5.6	5.6	5.8	5.6	5.5	5.8	5.0	4.5
China	7.8	7.3	6.9	6.7	6.3	5.9	7.8	7.3	6.9	6.7	6.0	4.4
Indonesia	5.3	4.9	5.0	5.0	5.2	5.2	5.3	4.9	5.0	5.0	4.6	4.0
Philippines	6.3	5.8	6.6	6.7	6.0	6.0	6.3	5.8	6.6	6.7	5.3	5.1
World	3.4	3.5	3.4	3.1	3.1	3.2	3.4	3.5	3.4	3.1	2.6	2.5

Source: MAPFRE Economic Research (with IMF data)

<sup>1</sup>Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.  
Closure date of forecasts: 31 March 2017.

**Table A.2.**  
**Basic and Risk Scenarios: inflation**  
 (annual average. %)

	Basic Scenario						Risk Scenario					
	2013	2014	2015	2016	2017	2018	2013	2014	2015	2016	2017	2018
<b>United States</b>	1.2	1.2	0.4	1.8	2.3	2.2	1.2	1.2	0.4	1.8	2.1	2.4
<b>Eurozone</b>	0.6	0.2	-0.1	1.6	1.5	1.8	0.6	0.2	-0.1	1.6	1.1	1.0
Germany	1.3	0.5	0.3	0.9	1.8	1.9	1.3	0.5	0.3	0.9	1.3	1.4
France	1.0	0.6	0.1	0.3	1.0	1.1	1.0	0.6	0.1	0.3	0.9	0.9
Italy	0.5	0.1	-0.4	1.5	1.1	1.8	0.5	0.1	-0.4	1.5	0.5	0.8
Spain	0.1	-0.5	-0.3	1.0	1.4	1.4	0.1	-0.5	-0.3	1.0	1.0	1.0
<b>United Kingdom</b>	2.1	0.9	0.1	1.2	2.8	1.9	2.1	0.9	0.1	1.2	2.4	1.6
<b>Japan</b>	1.5	2.5	0.2	0.3	0.7	0.9	1.5	2.5	0.2	0.3	0.0	0.3
<b>Emerging markets</b>	5.5	4.7	4.7	4.5	4.4	4.2	5.5	4.7	4.7	4.5	4.4	4.2
<b>Latin America<sup>1</sup></b>	4.6	4.9	5.5	5.8	4.2	3.8	4.6	4.9	5.5	5.8	4.2	3.8
Mexico	3.7	4.2	2.3	3.2	4.7	3.0	3.7	4.2	2.3	3.2	4.2	5.1
Brazil	6.4	8.5	9.1	4.8	4.6	4.2	6.4	8.5	9.1	4.8	5.4	4.4
Argentina	21.9	38.0	26.7	41.2	28.8	17.2	21.9	38.0	26.7	41.2	25.5	16.8
<b>European emerging</b>	4.3	3.8	2.9	3.1	4.2	4.2	4.3	3.8	2.9	3.1	2.8	2.5
Turkey	7.5	8.8	8.2	7.6	8.1	6.7	7.5	8.8	8.2	7.6	7.4	6.6
<b>Asia Pacífico</b>	5.8	5.6	2.2	3.0	3.9	4.0	5.8	5.6	2.2	3.0	4.5	4.4
China	2.9	1.5	1.5	2.2	2.8	2.8	2.9	1.5	1.5	2.2	2.4	3.0
Indonesia	7.7	6.1	4.9	3.4	4.3	4.3	7.7	6.1	4.9	3.4	5.3	5.2
Philippines	3.6	3.1	1.1	2.6	3.5	3.8	3.6	3.1	1.1	2.6	3.7	3.6
<b>World</b>	3.7	3.2	2.8	2.5	3.0	3.1	3.7	3.2	2.8	2.5	2.9	3.0

Source: MAPFRE Economic Research (with IMF data)

<sup>1</sup>Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.  
 Closure date of forecasts: 31 March 2017.

**Table A.3.**  
**Basic and Risk Scenarios: interest rate of 10-year public debt**  
 (annual average. %)

	Basic Scenario						Risk Scenario					
	2013	2014	2015	2016	2017	2018	2013	2014	2015	2016	2017	2018
<b>United States</b>	2.34	2.53	2.13	1.80	2.60	2.90	2.34	2.53	2.13	1.80	2.27	1.79
<b>Eurozone</b>	1.63	1.25	0.54	0.86	1.22	1.55	1.63	1.25	0.54	0.86	1.21	1.39

Source: MAPFRE Studies Service (with IMF data)  
 Closure date of forecasts: 31 March 2017.

**Table A.4.**  
**Basic and Risk Scenarios: exchange rates**  
 (annual average)

	Basic Scenario						Risk Scenario					
	2013	2014	2015	2016	2017	2018	2013	2014	2015	2016	2017	2018
<b>USD-EUR</b>	0.73	0.80	0.91	0.90	0.99	0.98	0.73	0.80	0.91	0.90	0.89	0.91
<b>EUR-USD</b>	1.36	1.25	1.10	1.09	1.01	1.02	1.36	1.25	1.10	1.09	1.12	1.09
<b>GBP-USD</b>	1.62	1.58	1.52	1.24	1.25	1.22	1.62	1.58	1.52	1.24	0.77	0.78
<b>USD-JPY</b>	136.75	142.83	133.01	118.01	123.47	129.84	136.75	142.83	133.01	118.01	123.47	129.84
<b>USD-CNY</b>	6.09	6.15	6.39	6.83	7.15	7.03	6.09	6.15	6.39	6.83	6.95	6.80

Source: MAPFRE Economic Research (with IMF data)  
 Closure date of forecasts: 31 March 2017.

**Table A.5.**  
**Basic and Risk Scenarios: official benchmark interest rate**  
 (end of period. %)

	Basic Scenario						Risk Scenario					
	2013	2014	2015	2016	2017	2018	2013	2014	2015	2016	2017	2018
<b>United States</b>	0.30	0.30	0.30	0.80	0.90	1.70	0.30	0.30	0.30	0.80	0.60	0.10
<b>Eurozone</b>	0.30	0.10	0.10	0.10	0.00	0.00	0.30	0.10	0.10	0.10	0.00	0.00

Source: MAPFRE Economic Research (with IMF data)  
 Closure date of forecasts: 31 March 2017.

**Table A.6.**  
**Basic Scenario: gross public debt**  
 (with regard to the GDP. %)

	Basic Scenario					
	2013	2014	2015	2016	2017	2018
United States	105.4	105.2	105.6	107.4	108.3	108.9
Germany	77.5	74.9	71.2	67.6	64.7	62.0
France	92.3	95.2	96.2	96.6	97.4	97.4
Italy	129.0	131.8	132.0	132.6	132.8	131.6
Spain	95.4	100.4	99.8	99.3	98.5	97.9
United Kingdom	86.2	88.1	89.0	89.2	89.0	88.7
Mexico	46.4	49.5	53.7	58.1	57.2	56.8
Brazil	60.2	62.3	72.5	78.3	81.2	82.7
Argentina	42.2	43.6	52.0	51.3	49.4	49.2
Turkey	31.3	28.7	27.6	29.1	29.8	29.8
Japan	124.2	126.2	125.3	127.9	130.7	132.6
China	37.0	39.9	42.6	46.2	49.3	52.0
Indonesia	24.8	24.7	26.9	27.9	28.2	28.5
Philippines	39.3	36.4	36.3	33.7	32.6	31.7

Source: MAPFRE Economic Research (with IMF data)  
 Closure date of forecasts: 31 March 2017.



**Table A.7.**  
**Life insurance market. growth forecasts of premiums**  
 (nominal median growth in local currency. %)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016e	2017f	2018f
<b>Developed markets</b>	6.2%	4.7%	2.3%	1.9%	-0.2%	2.0%	-0.2%	-3.7%	3.0%	1.3%	2.1%	2.7%	1.7%	1.4%
United States	1.4%	5.9%	7.4%	2.1%	-10.2%	-1.0%	5.8%	-5.9%	9.5%	-0.2%	4.7%	-0.8%	1.2%	4.5%
Japan	1.2%	-3.6%	-11.8%	5.2%	1.1%	1.4%	1.6%	3.0%	-4.5%	1.3%	3.6%	4.6%	2.2%	0.6%
Eurozone	9.2%	5.3%	2.0%	2.0%	3.6%	4.3%	-2.9%	-4.5%	2.6%	2.0%	1.1%	2.6%	1.4%	1.3%
Remaining developed	6.9%	9.1%	8.4%	-0.9%	-6.3%	-0.8%	3.5%	-3.2%	3.8%	-0.5%	1.0%	3.0%	1.8%	1.6%
<b>Emerging markets</b>	8.8%	13.2%	16.9%	11.6%	7.3%	11.0%	11.5%	14.7%	14.3%	8.1%	11.9%	11.6%	11.7%	11.2%
Latin America	7.1%	15.1%	17.3%	12.5%	8.5%	16.4%	14.2%	18.1%	15.6%	7.2%	14.6%	15.4%	16.5%	12.8%
Emerging Asia*	12.4%	12.3%	20.2%	17.4%	10.9%	16.8%	7.0%	6.7%	11.1%	15.2%	15.3%	20.3%	17.1%	14.9%
Emerging Europe	-8.0%	17.8%	18.6%	13.4%	-4.8%	12.6%	16.4%	13.4%	18.3%	-0.0%	8.5%	14.6%	16.2%	11.8%

Source. MAPFRE Economic Research

\* Including China

Closure date of forecasts. 31 March 2017.

**Table A.8.**  
**Non-Life insurance market. growth forecasts of premiums**  
 (nominal median growth in local currency. %)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016e	2017f	2018f
<b>Developed markets</b>	3.4%	3.3%	2.9%	2.2%	0.4%	2.1%	2.2%	3.0%	2.3%	1.6%	2.8%	5.4%	4.9%	3.6%
United States	1.7%	3.9%	3.4%	1.3%	-1.3%	0.6%	2.7%	3.4%	2.7%	2.3%	3.5%	2.7%	2.7%	2.8%
Japan	0.1%	-0.4%	-4.6%	-1.7%	-2.0%	-0.6%	2.7%	2.6%	5.1%	6.2%	4.8%	4.9%	4.2%	2.6%
Eurozone	3.5%	3.2%	2.7%	2.0%	-0.6%	1.7%	1.8%	-0.1%	0.8%	0.7%	2.5%	3.7%	4.9%	3.7%
Remaining developed	4.9%	5.1%	4.9%	6.6%	5.6%	6.3%	2.5%	5.1%	7.3%	4.2%	2.8%	6.4%	6.1%	4.2%
<b>Emerging markets</b>	11.5%	11.6%	12.1%	11.5%	7.5%	10.6%	14.3%	12.2%	13.0%	8.6%	8.5%	9.4%	9.1%	9.1%
Latin America	12.1%	11.7%	15.7%	17.7%	12.0%	12.5%	15.8%	12.9%	14.2%	13.5%	14.3%	16.1%	17.8%	17.1%
Emerging Asia*	11.7%	14.3%	15.3%	14.1%	12.2%	18.2%	16.0%	13.3%	15.1%	12.1%	11.1%	16.4%	15.1%	14.0%
Emerging Europe	17.8%	17.6%	13.1%	12.5%	5.1%	7.5%	13.8%	14.7%	11.4%	8.1%	3.0%	8.0%	9.2%	7.9%

Source. MAPFRE Economic Research

\* Including China

Closure date of forecasts. 31 March 2017.

**Table A.9.**  
**Motor insurance market: growth forecasts of premiums**  
 (nominal median growth in local currency, %)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016e	2017f	2018f
<b>Developed markets</b>	1.5%	1.4%	1.2%	-0.2%	-1.4%	0.6%	2.8%	2.1%	0.2%	0.1%	1.5%	1.5%	1.4%	1.2%
United States	-3.6%	-3.4%	-0.4%	-2.4%	-2.9%	0.3%	-0.2%	1.0%	4.2%	0.5%	1.0%	1.1%	0.7%	0.7%
Japan	0.2%	0.4%	-4.2%	-1.8%	-1.7%	0.5%	3.2%	2.9%	4.6%	5.2%	6.2%	3.2%	0.2%	0.4%
Eurozone	1.7%	1.7%	1.4%	-0.4%	-2.5%	-1.4%	2.0%	-0.5%	-2.3%	-1.6%	1.4%	1.6%	1.7%	1.7%
Remaining developed	1.9%	1.8%	2.2%	1.7%	1.8%	5.6%	6.3%	4.1%	1.0%	2.2%	1.7%	1.8%	1.9%	1.8%
<b>Emerging markets</b>	13.4%	14.1%	12.4%	10.9%	3.4%	8.9%	11.4%	12.7%	13.4%	8.9%	9.5%	11.5%	13.4%	14.1%
Latin America	13.9%	13.2%	14.7%	12.5%	5.7%	10.4%	14.6%	11.4%	15.0%	14.7%	11.0%	12.5%	13.9%	13.2%
Emerging Asia*	11.0%	17.3%	19.3%	11.7%	10.6%	20.1%	13.9%	14.2%	14.9%	13.4%	13.3%	12.2%	11.0%	13.1%
Emerging Europe	22.0%	15.3%	11.8%	11.2%	1.8%	7.3%	13.4%	15.6%	11.9%	5.4%	7.2%	14.6%	22.0%	15.3%

Source: MAPFRE Economic Research

\* Including China

Closure date of forecasts: 31 March 2017.

**Table A.10.**  
**Accident and Health insurance market. growth forecasts of premiums**  
 (nominal median growth in local currency. %)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016e	2017f	2018f
<b>Developed markets</b>	5.1%	5.7%	5.0%	5.4%	2.3%	3.5%	2.8%	2.7%	3.0%	3.2%	3.1%	5.3%	3.7%	3.1%
United States	12.0%	9.7%	6.0%	6.1%	1.0%	2.5%	3.9%	4.7%	1.3%	4.1%	6.2%	6.4%	4.7%	5.1%
Japan	1.6%	0.1%	-1.1%	1.2%	-1.4%	0.4%	1.5%	0.6%	4.6%	8.4%	-6.8%	-0.9%	1.1%	1.4%
Eurozone	5.1%	6.1%	5.0%	5.0%	2.8%	3.7%	3.1%	2.3%	2.2%	2.4%	2.8%	3.0%	3.3%	2.6%
Remaining developed	5.5%	5.4%	6.6%	7.0%	2.3%	6.9%	2.9%	4.8%	5.5%	5.8%	3.0%	7.1%	4.3%	3.2%
<b>Emerging markets</b>	17.2%	17.0%	13.9%	13.7%	8.9%	14.9%	13.4%	11.7%	14.5%	13.7%	11.7%	11.4%	10.9%	10.5%
Latin America	18.5%	21.1%	16.7%	15.1%	11.1%	28.5%	18.8%	18.1%	20.2%	18.4%	12.4%	15.4%	18.5%	21.3%
Emerging Asia*	19.4%	16.4%	13.2%	19.3%	10.9%	15.7%	12.9%	15.5%	18.9%	21.2%	19.8%	26.7%	20.5%	18.4%
Emerging Europe	16.7%	17.1%	15.5%	14.1%	5.5%	14.4%	13.5%	12.7%	12.0%	13.1%	10.7%	9.8%	10.9%	8.3%

Source. MAPFRE Economic Research

\* Including China

Closure date of forecasts. 31 March 2017.

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## References

1/ Referring to the replacement of market conditions by conditions created by the "market maker" capacity of the Federal Reserve Bank.

2/ In fact, since 2012 and up to the first quarter of 2017, the variation in long-term interest rates of the curve has been +/- 160 bps, which demonstrates the limited distance of the temporary premium of the curve. This is particularly so if it is considered that part of the profile gain from the minimum (Brexite) to the maximum (victory of D. Trump) has been undermined during the first quarter of the year (-60 bps of the +160 bps gained).

3/ The most recent register of a similar situation was in 2005, when the then president of the Federal Reserve, A. Greenspan, coined the phrase "Conundrum" to refer to the paradoxical situation in which the Federal Reserve increased rates +150 bps, without transmitting it to the rest of the curve (unchangeable 10-year rate), leading the curve to level out, similarly to today's curve.

4/ The duration risk is the sensitivity of the present value discounted from a fixed income asset, to the variations of interest rates. The duration risk is the effect through which increases in interest rates produce more than proportional increases in the demand of ever shorter-term assets, increasing its price or reducing its interest rate. In the context of increases in the temporary premium, this allows the slope of the rate curve to increase. When the global stock of assets decreases, the duration risk remains suppressed and the slope of the curve does not increase.

5/ Evidence of this is given in the following facts: a) The recent military action in Syria against the Bashar al Assad regime, which seemed to contradict the United States electoral message, focused on domestic policy, and which also caused tension (to levels not seen since the Cold War) in the relations with Moscow. Meanwhile the geopolitical risk is raised to a global level (pending the effects on oil prices). b) The recent summit with Xi Jinping, the leader of China (main exporter to the United States), which changed relations with this country. President Trump no longer accuses China of manipulating the exchange rate, in addition to placing value on mutual commercial relations. So, beyond reducing the likelihood of commercial financial reprisals in the short term, this point could precede a general position adjustment in commercial policies, which would also affect the renegotiation of the NAFTA. It should be noted that recently, President Trump changed the name of trade tax to "Import reciprocal matching mirror", suggesting a change in tone. c) In interviews with the Wall Street Journal and the Fox TV network, President Trump modulated the expectations on the speed and intensity of the tax reform, postponing it at least to the end of 2017 or beginning of 2018. At the same time, he unites the institutional discourse referring to it, the health reform and support to investment in infrastructures, suggesting the need to negotiate with the democrats. d) President Trump also expounded on the role of the institution and the person who should be in charge of the Federal Reserve. At the same time, he publicly favored a lax monetary policy, and a weaker dollar, (which would coincide with lesser fiscal stimulus).

6/ "Rhine Divide" is a concept coined by Max Webber. Today it is used to express the German divergence of views, characterized by the principles of solvency, austerity and responsibility; and the French view, which praises the liquidity of the financial system, joint responsibility (fiscal union) and the mutualization of risks (Eurobonds).

7/ Emmanuel Macron is favorably perceived by the markets by virtue of his liberal economic focus, with a certain short-term expansive bias (fiscally), but with a long-term liberal edge (fiscal reform and the labor market).

8/ Constant references to the end of the Gold Standard between 1936 and 1941, to put forward the advantages of the floating exchange rate, without taking into consideration that the euro is not viable without France.

9/ The constitutional reform subject to referendum on 16 April 2017 in Turkey, is the fourth one since the current constitution was sanctioned in 1982. The set of measures approved by referendum, includes 18 measures that will amend or reject 76 constitutional articles.

10/ Swiss RE “Natural catastrophes and anthropogenic losses in 2016: a year of extensive damage”.

11/ <https://eiopa.europa.eu/Publications/Press%20Releases/2017-01-17%20THE%20EU%20%E2%80%93%20U.S.%20INSURANCE%20PROJECT%20ADDRESSES%20CYBER%20RISK.doc.pdf>

12/ Link to: [EU-US Joint Statement](#)

13/ Link to: Letter of the NAIC to the Treasury Department

14/ [https://ec.europa.eu/info/finance-consultations-2017-esas-operations\\_en](https://ec.europa.eu/info/finance-consultations-2017-esas-operations_en)

15/ [EIOPA Risk Dashboard-February 2017](#)

16/ <https://eiopa.europa.eu/Publications/Press%20Releases/2017-04-05%20UFR%20Press%20Release.pdf>

17/ <https://eiopa.europa.eu/Pages/Consultations/EIOPA-CP-16-008-Discussion-Paper-on-the-Review-of-Specific-Items-in-the-Solvency-II-Delegated-Regulation.aspx>

18/ [https://eiopa.europa.eu/Publications/Reports/EIOPA%20Final\\_Report\\_on\\_IDD\\_Technical%20Advice.pdf](https://eiopa.europa.eu/Publications/Reports/EIOPA%20Final_Report_on_IDD_Technical%20Advice.pdf)

19/ <http://eur-lex.europa.eu/legal-content/ES/TXT/?uri=CELEX%3A32016L0097>

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21/ [http://europa.eu/rapid/press-release\\_IP-17-609\\_es.htm](http://europa.eu/rapid/press-release_IP-17-609_es.htm)

22/ <https://www.esma.europa.eu/press-news/consultations/joint-committee-discussion-paper-use-big-data-financial-institutions>

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