

A high-angle, close-up photograph of an ancient sundial. The sundial is circular and features a wide outer ring with Roman numerals. Inside this ring, there are several concentric rings. The innermost ring shows zodiac signs, including a scorpion, a bull, and a fish. The next ring out has numbers. The central part of the sundial is a circular plate with a hole in the center, and a gnomon (the shadow-casting object) is attached to it. The gnomon is a long, thin metal rod that points towards the sky. The sundial is set on a stone surface, and the overall scene is bathed in warm, golden light, suggesting a sunset or sunrise.

Fundación **MAPFRE**

**ECONOMIC AND INDUSTRY
OUTLOOK 2019: FOURTH
QUARTER PERSPECTIVES**

MAPFRE Economic Research

**Economic and industry
outlook 2019:
fourth quarter
perspectives**

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Executive summary

Economic and industry outlook 2019: fourth quarter perspectives

We are in a position where factors such as the trade war and other crises are currently holding back economies globally, creating a situation in which an additional shock could tip the balance toward recession, although this situation is still not in the baseline scenario of this report. However, indicators suggesting an impending global recession are mixed and it cannot be ruled out. If it does happen, the ability to reverse a slowdown through the usual monetary and fiscal levers could prove difficult. This is a situation of global vulnerability in which, while the possibility of a recession is still not the central scenario, it is a growing risk, and the tools for dealing with it are limited and their social and economic consequences still uncertain.

Insurance markets

The slowdown in economic growth, together with the widespread implementation of accommodative monetary policies, will end up having an impact on the growth of global insurance premiums. The messages from the main central banks that point to additional interest rate reductions may be a stimulus for the Life savings and annuities business in the short-term (only in those economies that still have relatively high interest rates), although they will also end up harming this type of business.

In Spain, the slowdown is beginning to have a greater impact on consumption and may influence the use of credit by families and companies which have significantly increased their savings rate. The result is a reduction in the growth forecasts in the insurance market's Non-Life and Life risk business which is closely linked to the performance of the economic cycle. The traditional Life savings and annuities business will continue to be hampered by the low-interest rate environment affecting the whole of the eurozone.

Other emerging economies are also facing a possible slowdown in the growth of their insurance business. In Argentina, the outlook is complicated as its economy is falling into a deeper recession. In Turkey, however, the situation is improving as it has technically emerged from a recession, although growth is expected to be weak. In Brazil and Mexico, the weakness of their economic growth is currently being passed through to their respective insurance markets, but forecasts for next year are looking better.

1. Economic outlook

1.1. The world economic outlook:

1.1.1 The economic slowdown

This update of the report "economic and industry outlook 2019" confirms the view that the global economy is facing a situation reflected in indicators that show accumulated corrections since the end of 2018, and that resemble those experienced widely a decade ago, with the exception that for now they have not fully transferred to consumer confidence or the service sector, and that there is still no sign of contraction on a global scale, but rather in very specific countries.

In general, the world economy remains stable, but it is clearly slowing down. For the 2019-2020 period, average global growth is expected to be close to, but below, the 3% level. This figure is noticeably lower than that recorded two years ago but is still far from the figure that is commonly associated with a global recession (below 1%).

The developed countries are not expected to make a large contribution to global growth. If they do not exceed their potential, they are forecast to grow at around 2% or less on average during 2019 and 2020. The emerging countries, by contrast, will make a more significant contribution, growing steadily by around 4.3% over both years. This is thanks to more benign financial conditions, a certain margin for the implementation of fiscal

stimulus policies, and an improvement in the terms of trade, especially for the agricultural raw material-producing countries which will to some extent capitalize on the side effects of US trade tensions of the United States with China and the European Union.

It is important to point out that many of the vulnerabilities in the emerging countries will be reduced by the current shift in monetary policy. However, serious vulnerabilities continue to persist in some of these markets, with enough potential to produce regional financial disruptions, mainly through risk aversion and the generation of a risk off mood that affects the composition of portfolios (see Box 1.1.1-a).

A clear indication of the coming stagnation in economic activity at a global level is the perception that, even with disruptions on the supply side, there is a sufficient gap between supply and demand for oil to prevent its price increasing in either the short- or medium-term. Currently, Brent has dropped noticeably since the mid-September rebound and is significantly below 70 USD/b, with no forecast correction toward long-term values until the end of 2022.

A key risk factor for the global economy in the current context is the number of international trade disputes taking place, including the trade war between the United States and China. A trade war, or an abrupt and poorly negotiated change in global trading relations (regardless of the protagonists), is a

Box 1.1.1-a
Emerging vulnerability analysis:
evolution of the Emerging Risk Index (ERI)

Analysis of the emerging vulnerability

The information shown in the heat map and other charts in this box refers to the 2018 fiscal year in emerging countries. In general, that year saw an exacerbated situation that was a continuation of the diagnosis we published in the previous year (with information from 2017).

During 2018, the emerging markets saw an ever-greater worsening of the imbalances and the vulnerability of their fundamentals escalated and became more generalized as global monetary policy (dictated by the normalization of the Federal Reserve) abandoned the accommodative tone. The tightening of financial conditions by the Federal Reserve in 2018 was transmitted abruptly to those economies with high leverage levels and, more notably, to those with a propensity to indebtedness through external debt and dollar-denominated issuances. The result was a deterioration of most scores in our **Emerging Risk Index (ERI)** for the countries analyzed that, however, has been slow to be seen in other vulnerability and risk indicators such as the EMBI, which again shows the capacity of our metric to capture emerging risk before aggregate indicators such as this one.

Main conclusions from the analysis

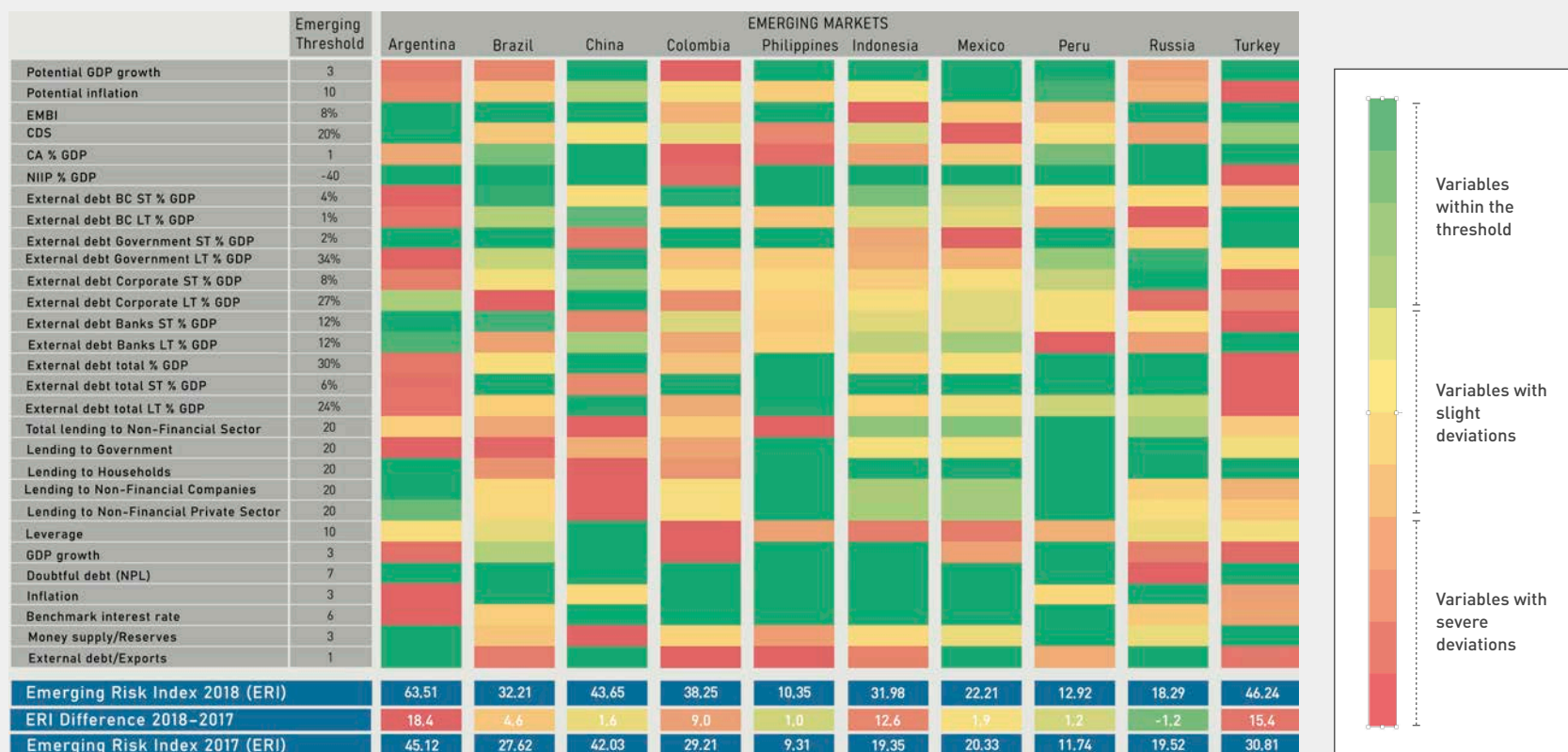
The study of the vulnerabilities of a number of emerging markets through the construction of the ERI has allowed the following general conclusions to be drawn about economies that, in the framework of this analysis, are noteworthy (see Charts A to G in this box):

- The economies of Argentina and Turkey have a high vulnerability score that, in 2018, moved further away from the figures included in the EMBI. The external imbalances of both economies resulted in strong foreign exchange adjustments in the second half of the year.
- The economies of Peru and Russia, moreover, maintained stable vulnerability levels. As can be seen from the previous analysis, the EMBI ended up closing its gap with regard to the scoring which, despite the depreciation of both currencies, continue to show a healthy position.
- Finally, we have the economies of Indonesia and Colombia. Both economies show a possible point of instability that, far from being resolved, continues to worsen. The position of their current accounts continues to deteriorate, amplified in the case of Colombia because of its high levels of external debt. Despite the tightening of financial conditions, Indonesia's lending to the non-financial sector continues to increase as a risk factor.

The results of this study continue to show that, in terms of the economic-financial situation of the emerging countries analyzed, three groups can be distinguished due to their level of vulnerability: (i) Argentina and Turkey, for which our scoring is a good early warning, show a high level of vulnerability; (ii) Peru and Russia, which have low risk levels, with a score moving in parallel with the EMBI; and, (iii) finally, Indonesia and Colombia, which have a relatively healthy position, but with certain points of instability that, far from improving, are in fact increasing.

Box 1.1.1-a (continued)
Emerging vulnerability analysis:
evolution of the Emerging Risk Index (ERI)

Chart A.
 Selected markets: risk profiles and emerging risk index (ERI) estimation



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

* Data re-estimated for Indonesia and the Philippines following the publication of final data for 2017 and 2018.

** The variables used to construct this index are assessed in relation to certain sustainability thresholds. Deviations from these thresholds mean imbalances and they are weighted to construct an index ranging from 0 to 100.

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

Box 1.1.1-a (continued)
Emerging vulnerability analysis:
evolution of the Emerging Risk Index (ERI)

Chart B.
Argentina: ERI vs EMBI

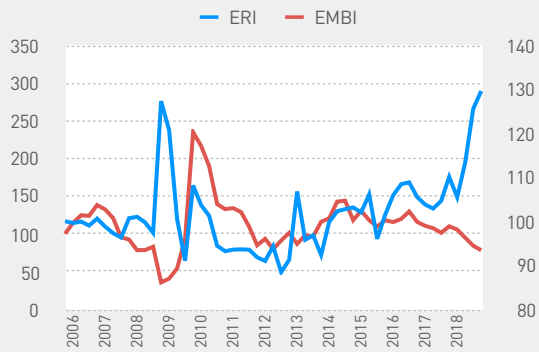


Chart C.
Peru: ERI vs EMBI

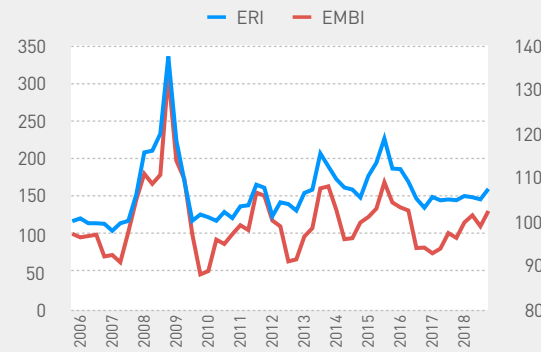


Chart D.
Indonesia: ERI vs EMBI

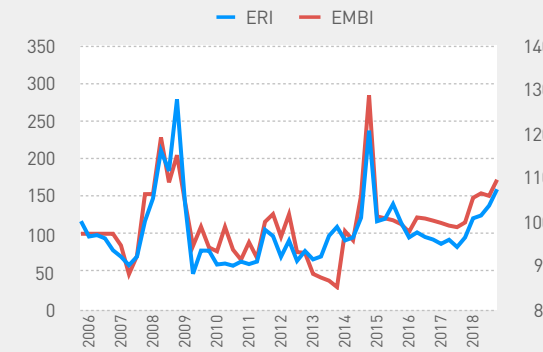


Chart E.
Turkey: ERI vs EMBI

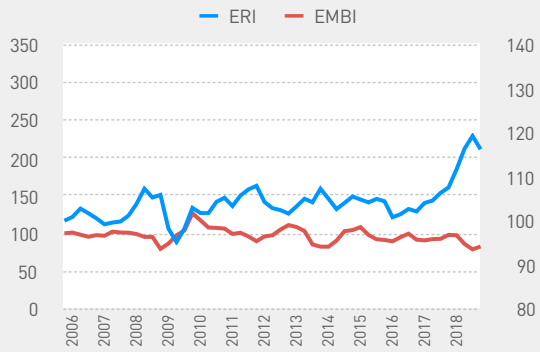


Chart F.
Russia: ERI vs EMBI

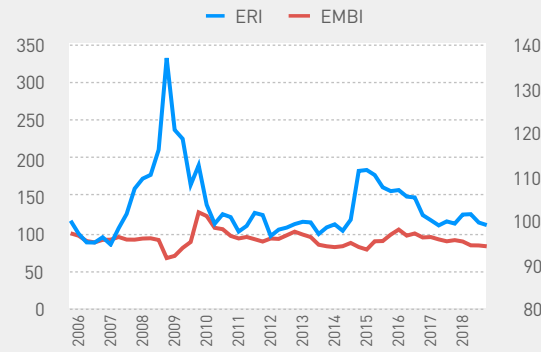
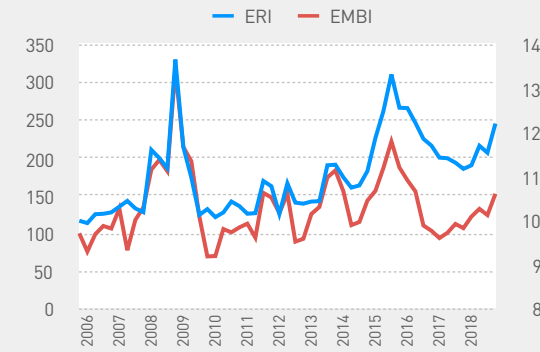


Chart G.
Colombia: ERI vs EMBI



Source: MAPFRE Economic Research

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

central part of the baseline scenario of this report and the intensity of the trade disruptions is the element likely to influence the extent of the current slowdown that we anticipate will continue until the end of 2021.

Global trade tensions

Although the threat of a change in trade relations between the United States and China, which was due to take place on December 15 and was causing great concern, seems to have diminished (given the new truce reached between the two governments on October 13), other tariffs may still enter into force, such as those on the imports of cars and other European industrial goods. Beyond tensions between the United States and China, warning signs of trade conflicts between the United States and the European Union (EU) are emerging, while the emergence of a politically motivated trade conflict between Japan and South Korea suggests that the Trump administration's approach to trade and foreign policy might be spreading. Changes to the existing trading system is now the baseline scenario considered by this report.

The protagonists

In the United States, GDP growth has remained at around 2%, while low unemployment and slow increases in actual salaries have sustained the level of consumer demand. The tariffs imposed by the Trump administration as part of its trade war with China have not yet been reflected in changes in consumer confidence. China, moreover, is trying to manage the local economic consequences of the trade war, although it remains to be seen whether these will actually materialize given the agreement reached. The official Chinese GDP growth rate of 6.2% seems quite healthy, but external analyzes suggest that the real figure is significantly lower. At a broad level, differences between the United States and China appear to be increasing, not only in trade but also in politics, and tensions are likely to persist even in the face of a hypothetical departure of President Trump from office.

Slowdown vs. recession

The global environment has changed rapidly from our pre-summer report¹. There are many warning signs of a possible recession: the 10-year yield curve for most mature economies remains inverted, corporate profits in the United States have fallen for more than 12 months, and the uncertainty seems to be generating the first signs of a liquidity drain in the wholesale markets, as has been recently experienced. In this context, global economic confidence is so weak that one or more disturbances could have sharp effects and cause disruptions for the financial markets, consumer demand and investment.

The next part of this section of the report explores the balance of risks and vulnerabilities that could turn this slowdown into a recession, such as that described in the alternative scenario in this document². It is also possible at the level of specific topics to identify potential sources of confidence and/or financial shocks such as those that may be caused by a supply shock in the commodities market (notably oil), or by a *shock* originating in the financial markets with an impact on the liquidity of the system and/or on the stability of the balance sheets of economic agents. The temporary reduction of financing in the interbank market, the possible problems in the balance sheets of the holders of low covenant debt, the sudden correction in the fixed and variable income market, and corporate and sovereign debt problems are just some of the factors to be taken into account in the multitude of risks in that scenario.

In the current circumstances facing the global economy, recession may be considered as an alternative scenario (it was not one previously). If it were to occur, it would probably accelerate many of the geopolitical trends that have defined the past five years, including growing nationalism and protectionism, an increasingly fractured international system and the resurgence of formal and informal trade barriers. In this scenario, companies would be directly affected by the outcomes of such policies and the uncertainty on issues such as increased trade barriers, fewer free trade

agreements and the inability to coordinate multilateral responses to issues such as migration, climate change and international security crises. Such a scenario could create a position in which economic agents have to perpetually adapt to protectionist reactions and arbitrary restrictions in the supply chain or access to the market imposed by radical policies seeking immediate responses without considering the long-term effects.

Limits of the current economic policy

The environment described above is all the more worrying as the financial institutions and regulators have very few instruments to deal with the effects of a sharp and clear decline in economic activity.

Recently, the renewal of the ultra-accommodative shift in global monetary policy was consolidated with decisions made by both the United States Federal Reserve and European Central Bank (ECB), which have been followed by a large number of central banks worldwide (see Box 1.1.1-b). While it is true that this shift helps contain the financial risks arising from the debt of many countries, thanks to the sound financial conditions resulting from the containment of the appreciation of the US dollar, the euro and the fall in interest rates, we are also beginning to see the crystallization of a consensus that the current situation is an *impasse* that is difficult to resolve.

Firstly, the effects of monetary policy are infinitely more limited in the current context of the valuation of assets, liquidity and global risk spreads, in contrast with the effect they had, for example, in the Lehman crisis. Secondly, the average interest rate in the G7 is below 1%, which puts it very close to the Zero Lower Bound, which acts as an asymptote in the rates from which point there is a greater incentive for monetary savings as a precaution rather than credit and investment. And finally, such low interest rates (negative in many cases) have perverse effects on a bank's maturity transforming business, lending and on the ability to remunerate investors from the non-banking financial system (insurance companies, for example).

On the expansion side of the Federal Reserve and ECB balance sheets, we should mention that to achieve an effect equivalent to the necessary reduction in interest rates traditionally used to bring an economy out of recession (approximately 350 basis points), a monetary authority must make purchases for a sum representing approximately 20% of the country's GDP, something that not all countries are in a position to do at this time (the EMU could be in a position to do so). In this context, there is growing consensus that the only viable economic policy is aggressive fiscal expansion. This strategy could benefit from the low interest rates and high fiscal multipliers currently found in both developed and emerging countries, or be supported or supplemented by a public policy strategy to amplify the intermediation in savings (see Box 1.1.1-c). The President of the ECB, Mario Draghi, recently advocated the implementation of a more active fiscal policy. However, governments are reluctant to assume that responsibility.

Box 1.1.1-b Monetary policy update

A new phase of global monetary relaxation

The slowdown being seen in many economies throughout the world, which is accompanied by a moderation in inflation, is leading a significant number of central banks to reduce their benchmark interest rates. With this, financial conditions are more favorable and the pressure on exchange rates against the dollar have eased, but the current imbalances and vulnerabilities in the financial system continue to grow.

The change in the tone of global economic policy is fundamentally dictated by the movements taking place in the United States and the eurozone, but these are being widely followed by the rest of the world, both emerging and developed.

European Central Bank

The suspicions of a recession lying in wait for Germany, as well as the slowdown looming over the eurozone as a whole, have led the President of the European Central Bank (ECB), Mario Draghi, to make a new decision to get the European economy back on track, or at least keep the ship steady.

A few weeks after Draghi's term of office ended, being replaced by the former head of the International Monetary Fund (IMF), Christine Lagarde, the ECB announced a -0.5% reduction in the deposit facility interest rate, i.e. the interest rate the organization charges banks for depositing liquidity increased. For all other interest rates (the financing rate and the marginal

lending facility rate), they will remain at their current levels (0.00% and 0.25%, respectively).

The ECB also expects to maintain these levels (or even lower levels) "until it has seen inflation outlook robustly converge to a level sufficiently close to, but below, 2%." As such, the ECB's communiqué warns that, on the one hand, it may reduce interest rates again but, contrarily, it might not wait for inflation to reach 2% to raise them again.

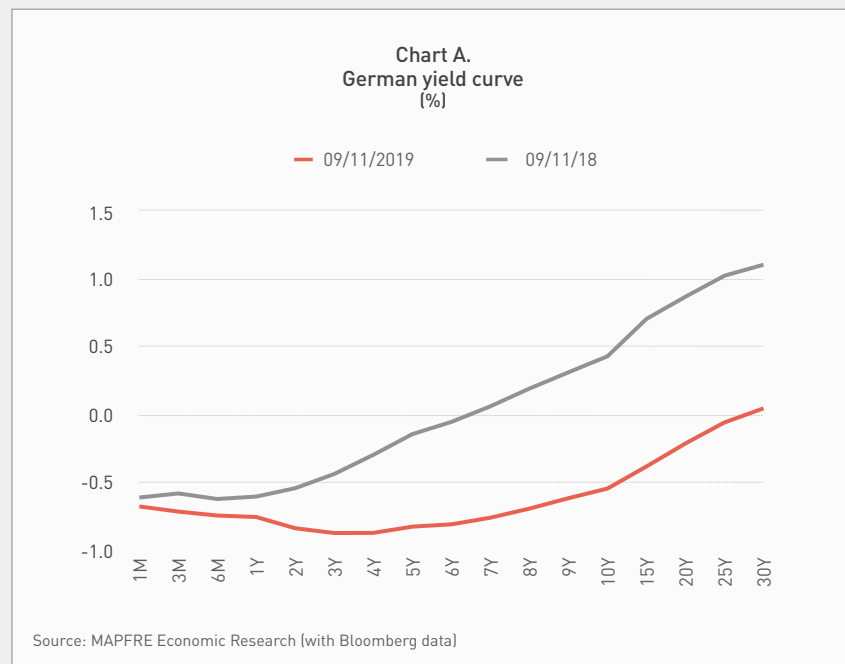
However, to reduce the impact of the measure on banks, the ECB discloses that for banks whose eligible net loans exceed a benchmark value, the rate applied in TLTRO III operations will be lower, and can be as low as the average interest rate of the deposit facility prevailing over the life of the operation. Furthermore, the monetary body's board has announced new purchases at a rate of 20 billion euros a month, starting with the term of office of C. Lagarde, noting that they will be maintained for "the time needed," although they will end before interest rates are raised again.

Looking ahead

The new round of monetary easing has returned to mitigate the persistent macroeconomic deterioration and the impact of a series of global uncertainties that continue to solidify rather than dissipate. However, given the limited room for maneuver in the field of monetary policy, the next counter-cyclical movements should be based on fiscal policy, with Christine Lagarde's having fitting expertise.

Box 1.1.1-b (continued) Monetary policy update

In the short-term, this synchronization of the expansionary tone of both policies (fiscal and monetary) could re-stimulate the economy and start up inflation once again. The generation of primary deficits and the consequent accumulation of debt would continue to be sustained by the downward trend in debt interest rates and their prospects of enduring over time (see Chart A).



In the longer term, the effect of fiscal expansion (both through increased spending and tax cuts) tends to fade over time, as has been seen in the US economy since the end of 2018. In this case, the European economy would again face the dilemma of resuming pending structural reforms that would allow the economy to become more flexible in an increasingly complex environment, or continuing with economic "Japanization" by increasing the intensity and duration of stimuli.

The Federal Reserve

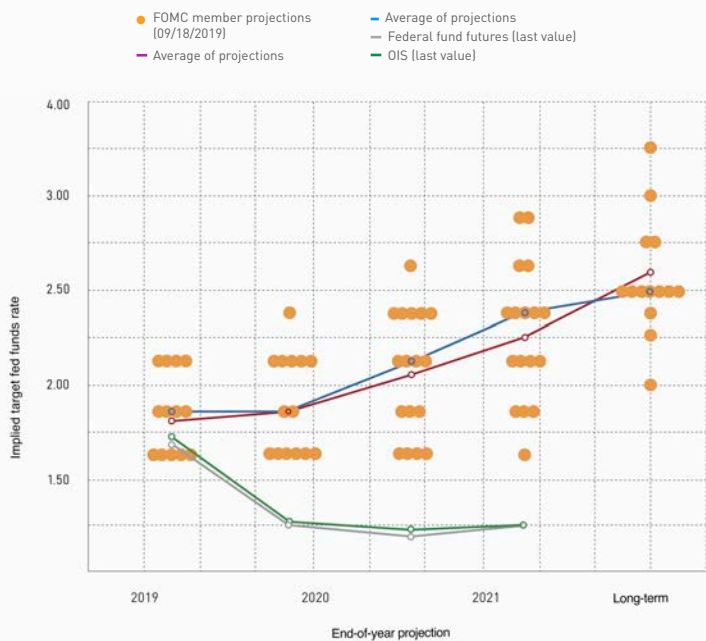
The United States Federal Reserve, at its September meeting, again cut interest rates by 25 basis points to the range of 1.75-2.00%. Behind this decision by the US monetary authority is consensus that the cuts applied to date constitute preventive measures designed to promote economic expansion. However, and as the most recent dot plot analysis indicates (see Chart B), there seems to be a greater difference of opinions among committee members as regards upcoming meetings, thus penalizing the forward looking communication tool.

According to the schedule established, a new meeting of the United States Federal Reserve will be held on October 30, where a further 25 basis point drop to 1.50-1.75% is expected (with a 90% probability). The markets have also discounted a not insignificant probability of an additional reduction before the end of the year.

With regard to the Quantitative Easing, (QE) balance sheet tools, the possibility of recovering them has been ruled out in the short-term, despite recent turbulence in the interbank market that has forced the Federal

Box 1.1.1-b (continued)
Monetary policy update

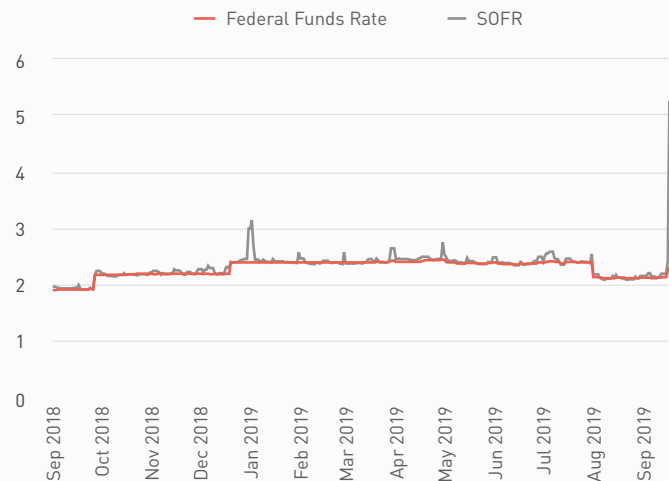
Chart B.
US Federal Reserve Dot Plot (September 2019)



Source: MAPFRE Economic Research (with Bloomberg data)

Reserve to provide the market with \$130 billion in just 2 days after a strong upturn in the repo operation rates, which reached 5.25% (See Chart C).

Chart C.
SOFR (Secured Overnight Financing Rate) vs Federal Funds Rate (09/18/2019)



Source: MAPFRE Economic Research (with Bloomberg data)

Box 1.1.1-b (continued)
Monetary policy update

However, and as discussed in our previous monetary policy update (see: MAPFRE Economic Research (2019), *Economic and Industry Outlook 2019: third quarter perspectives*, Madrid, Fundación MAPFRE), the President of the Federal Reserve System, Jerome Powell, has announced the possibility of shifting the balance sheet position of this monetary authority if the risks and uncertainties do not dissipate, or in the face of signs of economic weakening that become recessionary. The idea is beginning to be generalized in light of the recent aversion shown by the negative interest rate policy prevailing in other monetary authorities such as the ECB and the Bank of Japan.

It should be noted that repo operations constitute a traditional monetary policy instrument, through which liquidity is injected into the market with the purchase of bonds under very short-term repurchase agreements and, generally, at their target rate. Due to the upward pressures on interest rates experienced in the last awards that forced the liquidity injections of the New York Federal Reserve to be extended until early November, J. Powell announced the decision to increase the amount spent on the operations to 60 billion per month (compared to the previous 45 billion), as well as extend their duration, at least until the first half of 2020.

As a result, the balance sheet of the Federal Reserve has again increased in size, although at a moderate rate of expansion and under conventional monetary policy mechanisms. In fact, and as highlighted in the communiqué from its last meeting, these are operations that, while having aims similar to those of the purchasing programs under QE, are very different from them, since through the QE acquisitions the bonds included

in the balance sheet were purchased with the intention of holding them to maturity.

In this way, the covering of market liquidity gaps will continue to be organized using conventional financing operations, retaining some room for maneuver in both the amount of the awards (still through competition) and the benchmark interest rates under which they are taken and, finally, with the possibility of changing its position on non-conventional mechanisms such as QE.

Euros/US dollar implications

Finally, as discussed above, the Federal Reserve opted to go further with its relaxation of monetary policy. However, the 1.10 EUR/USD exchange rate continues to show that the stimuli of the US agency are not being reflected in the exchange rate. In an environment in which the global demand for the dollar creates currency strength, far from its fundamental exchange values (1.20–1.25) and where monetary stimuli are not transmitted to the exchange rate, the decision to weaken the currency could begin to become relevant.

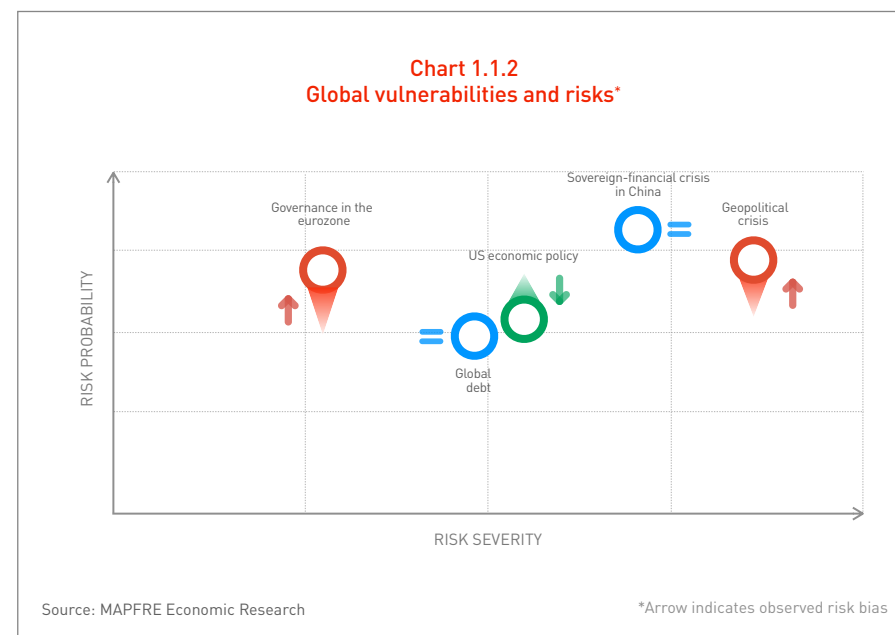
1.1.2 Risk assessment

As illustrated in Chart 1.1.2, five global risks are identified from the revision of the risk environment for the international economy, assessing their probability and severity.

Firstly, the risk environment identifies a risk related to the governance of the eurozone and there is an increase in the probability of this materializing. The recent reintroduction of monetary stimuli in the eurozone, which has been accompanied by a call for support from fiscal policies, has led to a divergence in economic positions in the eurozone. On the one hand, we have doubts about the effectiveness of monetary policy and the possible risk of generating a greater overvaluation of assets, and, on the other, we have the divergent fiscal gap and the willingness of each country to use it, together with the repeated postponement of the necessary structural reforms. These combine to create a complex outlook that overlaps with the volatile final stretch of Brexit.

Secondly, there is the risk derived from the economic policy of the United States, although a lower probability is identified for this. With the interest rate reductions that took place in July and September, the Federal Reserve has chosen to implement a preventive monetary policy that reflects the current economic weakness. Similarly, the US government appears to have softened its belligerent tone on trade and tariff discussions with China, although the markets have already learned to be cautious and nominal improvements (exchange rates and asset prices) have been limited. In contrast, tension has once again been aimed at Europe, with many threats about the imposition of tariffs on imports of industrial goods (aviation and automobiles), which could weigh even more heavily on the already weak performance of Germany and other exporting countries in the eurozone.

Thirdly, there is the risk associated with the possible macro-financial adjustment in China, the probability of which is unchanged from our previous assessment. The slowdown in the Chinese economy continues to be softened by the expansive economic policies of the government, while the impact of tariffs is being absorbed by the adjustment to the local currency, which entails growing imbalances and vulnerabilities in the sovereign financial sector, but whose sudden adjustment could result in a sharp correction in the country's activity and an internal debt crisis.



Box 1.1.1-c Savings analysis

Savings: general concepts

The total savings available for an economy is the sum of *foreign savings*, that is, savings from abroad in the form of current account financing, plus *gross national savings* (GNS), that is, savings generated domestically. Gross national savings (GNS) is the sum of public savings and private savings. This indicates the amount of domestic resources a country has to invest in itself and in the rest of the world, as well as to deal with contingencies.

Its definition in national accounts establishes the well-known relationship with investment (assuming there is no capital account or change in reserves): $[S_H + S_C] + (T-G) - CF = I$. Where $(T-G)$ is the balance of the public accounts and therefore *public savings*, $[CF]$ is the balance of the financial account that finances the current account and, therefore, *foreign savings*, and $[S]$ is the sum of *household savings* and *corporate savings* $[S_H + S_C]$, with *household savings* being formed by the savings in real and financial assets [deposits + direct investment + cash + savings through life insurance + collective investment + pension funds] and *corporate savings* being the pre-tax profits retained by companies.

It should be noted that deposits and cash generally account for approximately 50% to 60% of financial savings, individual and collective investment instruments for between 25% and 30%, and contributions to pension plans and life insurance savings amount to between 25% and 10% of total financial savings, depending heavily on the country in question. For example, in Europe the weight of the latter is closer to 25% on average, while in the United States it is closer to 10%.

In this way, *gross national savings* are the total amount of savings generated in a country over a period of time, which, when added to public savings and foreign savings, forms total savings $[TS]$, or the resources available to a country to finance its investment. This is important because increasing investment is the only way to ensure an increase in the level of income over the long-term (even outweighing the performance of the labor input, population and technological change as given), and to guarantee a certain level of income that will affect the long-term per capita consumption level that can be reached, which ultimately reduces inequality and supports the attainment of maximum social welfare.

In this note we will look at private savings, S_H (which, as can be seen in Charts A to E, accounts for the bulk of total savings,) and to make it easier to understand we will examine it on the basis of the word "*savings*," therefore ignoring public and foreign savings.

The behavior of savings

There are three fundamental (not necessarily mutually exclusive) ideas about the behavior of savings. The first is that savings are calculated by agents discounting how much they will have to consume during their active life and dissaving during their inactive life (Modigliani's *Life-Cycle Hypothesis*); this means that savings are a proportion of the ratio of remaining time as an active person $[V_{RA}]$ and total remaining time $[V_{TA}]$, that is, $S = (1 - V_{RA} / V_{TA}) \cdot Y$. **Therefore, savings are strongly conditioned by the life expectancy, fertility, longevity and, especially, dependency ratio (adult) of a society.**

Box 1.1.1-c (continued)
Savings analysis

Chart A.
Total savings: global
(% of GDP)

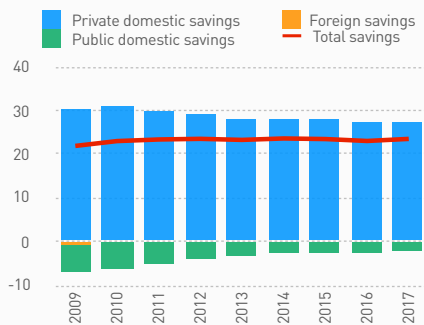


Chart B.
Total savings: post-demographic dividend countries
(% of GDP)

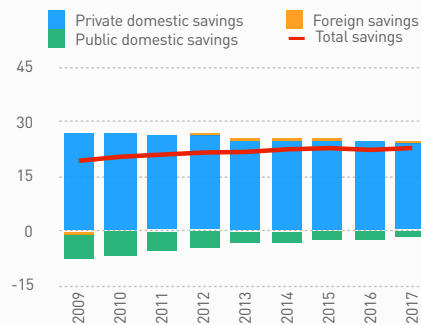


Chart C.
Total savings: advanced demographic dividend countries
(% of GDP)

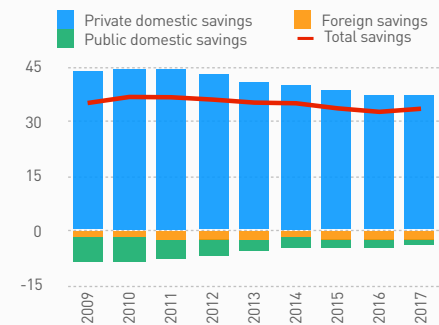


Chart D.
Total savings: initial demographic dividend countries
(% of GDP)

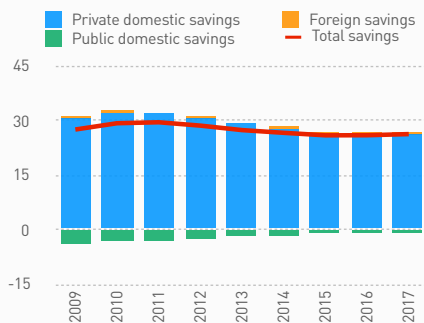


Chart E.
Total savings: pre-demographic dividend countries
(% of GDP)

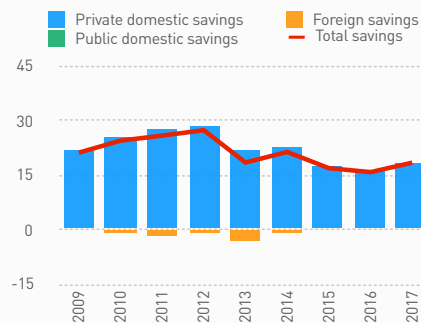
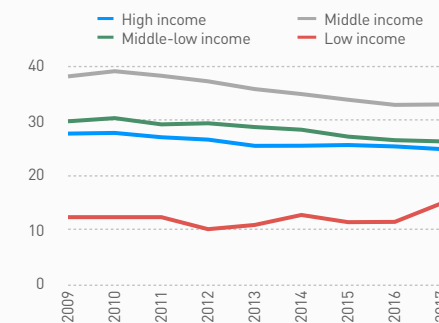


Chart F.
Private savings by income level
(% of GDP)



Box 1.1.1-c (continued)
Savings analysis

The second fundamental idea is that the savings, being complementary to consumption ($S=Y-C$), are a proportion of the permanent income or salary and non-salary income flows expected throughout the consumer's life, discounted to present value (Friedman's *Permanent Income Theory*). That is to say: $S=s\cdot Y$. This means that it is affected by the long-term trends in employment, population, salary income, intensity of physical and human capital, depreciation, productive technology, interest rates, existing wealth, and the propensity to save (which is complementary to that of consumption, $s=1-c$) and is therefore linked to income distribution (sensitive to per capita income and income inequality). **Savings are therefore proportional to a country's economic and productive performance and conditional on its financial conditions.**

The third idea is, as established by the *Golden Rule* savings rate (Edmund Phelps), that there is an optimal level of savings at which the propensity to save is such that it guarantees the maximum level of per capita consumption possible in the long-term. **Saving therefore influences the equilibrium levels of capital, income and, by extension, consumption and social welfare over the long-term.**

Reasonable savings

The existence of *national private savings* reduces the dependence on foreign financing (limiting the well-known external vulnerabilities), and promotes increased short-term investment and increased productivity over the longer term, increasing a country's potential growth, its capital needs and interest rates to remunerate it. At the margin, saving is crucial to increase investment and income which raises the capital stock, disposable income and consumption in the long-term, ideally to the point where consumption

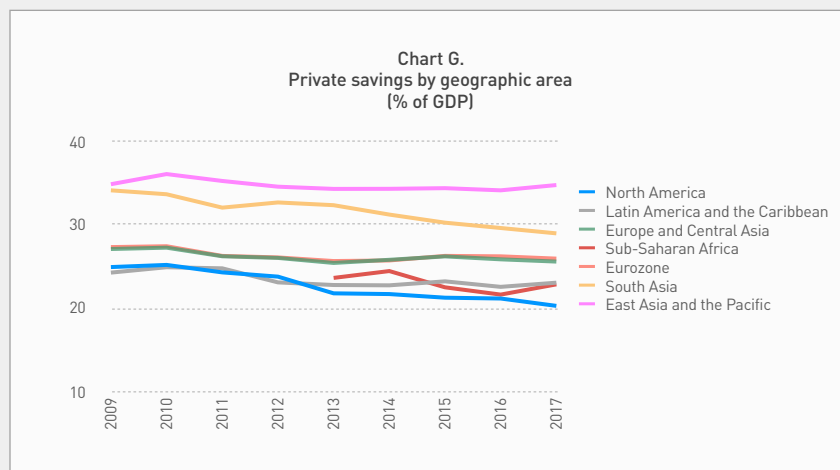
is maximized and, foreseeably, welfare. Moreover, private household savings (ideally involving the financial system) complement the financing of a society's statutory costs as well as its public welfare system.

However, not all savings, or even many savings, need produce social welfare gains. Excessive saving not involving the financial system may cause liquidity problems (if the saving is in real assets) and, if saving involves little involvement of the financial system, such as cash and deposits, it may have little effect on investment (although in some cases it facilitates the bank's "maturity transformation" function). Excessive cash savings may also be counterproductive, as the increase in real monetary balances influences the economy and reduces interest rates, rates that may already be under pressure in aging saving societies where the stock of capital per worker is significantly high.

In this way, *excess saving* may lead to the stagnation of economic growth, falling interest rates or declining consumption, and even deflation (in classic cases such as Japan), resulting in welfare losses and serious financial risks. On the contrary, a *lack of saving* (as in some emerging countries) may lead to insufficient financing resources and dependence on the foreign sector (as in the case of Argentina), as well as to low growth potential, the inability of income and consumption levels to converge, and increased inequality.

Savings depend very significantly, but not only, on the income of countries. In some cases, emerging countries may converge (emerging Asia and the Middle East) with the savings levels of higher income countries (see Chart G), but this always depends on the level of financial depth and the capacity of the financial sector to capture long-term savings (especially the non-

Box 1.1.1-c (continued)
Savings analysis



Source: MAPFRE Economic Research (with World Bank data)

banking sector). Demographic factors also strongly influence the savings dynamic in countries, understanding that the savings dynamic has nuances depending on where society is at in terms of the demographic dividend.

Finally, if the capital increase occurs in line with demographic trends that allow it to do so, and the population grows at a rate above replacement, the capital stock per worker will increase until it reaches a rate at which it will remain constant and in the process it will increase its profitability, also pushing interest rates in different time horizons.

Fourthly, there is the risk associated with global leverage levels. Sovereign and corporate solvency risk remains stable, albeit high. In one sense, the relaxation of global monetary policy (and in particular that of the United States) limits its financial costs, avoiding a problem of short-term financing. However, conversely, the increasing private emissions and the maintenance of high primary deficits imply a lack of sustainability of the debt in the medium-term, in light of the gradual reduction of potential growth at a global level.

Finally, there is the risk derived from a potential geopolitical crisis, which is now more probable. The uncertainty surrounding Brexit, given the confrontational attitude of the Prime Minister Boris Johnson, the tense trade war whose effects continue to harm economic growth and the current world trade model, the hostility of protests in Hong Kong and Iran's defiant lead in the conflicts taking place in the Middle East continue to push the geopolitical risks upward.

1.2 Forecasts and risk assessment in selected economies

1.2.1 United States

The slowdown is worsening

Economic activity in the United States is decelerating moderately. GDP grew 2.3% in the second quarter, with domestic demand still strong thanks to the strength of the labor market (unemployment level at 3.5%, and creation of 136,000 jobs), salary increases (2.9%), the availability of credit and favorable financial conditions (low interest rates and appreciation of the USD). By comparison, however, investment has stagnated due to uncertainty about the evolution of foreign demand as a result of trade tensions and the global slowdown. Exports are falling (-1.7% YoY in the second quarter) and subsequent data from July and August show that they have not made a recovery (0.1% YoY in August).

- **The continued deterioration of leading indicators does not define the limits of the slowdown, but a recession would require a shock and it is difficult to see where this would come from.**
- **The Federal Reserve is reducing rates to cushion the fall in economic activity, and two further cuts are expected during the remainder of the year.**
- **Announcement of a pre-agreement with China and suspension of planned tariffs.**

The leading indicators confirm both the slowdown in activity levels and the way in which it has already been transferred to the confidence of economic agents. The latest ISM (Advanced Production Indicator) survey in September reveals a worsening of sentiment in the manufacturing sector (47.1), which

currently contrasts with that of services (52.6), although both have deteriorated proportionally. Industrial production has been slowing down for a year and has stopped growing (0.4% YoY in August), and factory orders are negative (1.9% in August). The fall is similar to that experienced by the PMIs, although the latter still remain on the side of expansion (composite 51.0; manufacturing 51.1). As a result, our growth forecast for 2019 is 2.2% and for 2020 it is 1.6% (see Table 1.2.1 and Charts 1.2.1-a and 1.2.1-b).

Moreover, inflation has moved away from the 2% target, with the consumer price index (CPI) at 1.7% and the PCE (Personal Consumption Expenditures Price Index) at 1.4% in September, mainly due to the reduction in energy prices, since underlying inflation remained at 2.4% (CPI August) and 1.8% (PCE August). Low inflationary pressure and growing concern about domestic activity and global trade prompted the Federal Reserve, at its meeting on September 18, to lower federal funds by 25 basis points (bps) to the range of 1.75-2.00%, following the July reduction (-25 bps). In upcoming meetings, the Federal Reserve is expected to make two further cuts, bringing interest rates down to 1.25-1.50% by the end of 2019.

Furthermore, on October 11, the Federal Reserve announced that it would continue to intervene through a liquidity injection in the interbank market, with at least USD 60 billion a month until at least January, in order to stabilize the repos market and maintain its interest rate within the official rate band. This move is further evidence that the event seen at the beginning of January (when the repo rate touched 10%) may have had more to do with a liquidity problem than with the coincidental problems initially claimed³.

With regard to trade policy, on October 11 the United States and China agreed to sketch out the principles of a trade agreement, which is understood as a preliminary minimum agreement. The agreement suggests that: China (i) will significantly increase its purchase of agricultural products from the United States, from the current USD 16 billion to USD 50 billion annually as of 2020; (ii) will accelerate the opening of its financial sector; (iii) will establish a transparent, market-based exchange rate regime; (iv) will reach an

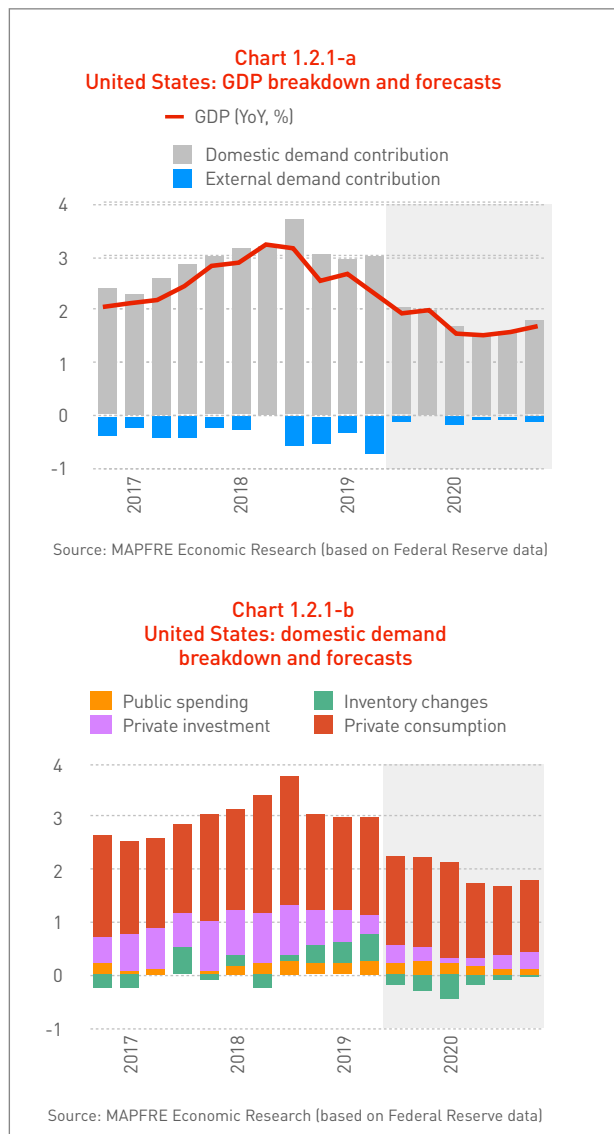


Table 1.2.1
United States: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	2.5	2.9	1.6	2.4	2.9	2.2	1.6
Domestic demand contribution	2.3	3.7	1.9	2.7	3.3	2.5	1.7
External demand contribution	0.2	-0.8	-0.3	-0.3	-0.3	-0.3	-0.1
Private consumption contribution	2.0	2.5	1.9	1.8	2.1	1.7	1.5
Private investment contribution	0.6	0.7	0.4	0.8	0.9	0.4	0.2
Public spending contribution	-0.1	0.3	0.3	0.1	0.2	0.2	0.2
Domestic demand (% YoY, average)	2.7	3.6	1.8	2.6	3.1	2.4	1.6
Total consumption (% YoY, average)	2.3	3.4	2.6	2.3	2.8	2.4	2.0
Private investment (% YoY, average)	5.1	3.3	1.9	3.7	4.1	1.9	1.0
Exports (YoY in %)	4.2	0.5	0.0	3.5	3.0	0.2	1.1
Imports (YoY in %)	5.0	5.3	2.0	4.7	4.4	1.7	1.5
Unemployment rate (% , last quarter)	5.7	5.0	4.8	4.1	3.8	3.6	3.6
Inflation (% YoY, last quarter)	1.2	0.4	1.8	2.1	2.2	1.8	2.0
Fiscal balance (% of GDP)	-5.2	-4.8	-5.4	-4.2	-6.5	-6.7	-6.5
Trade balance (% of GDP)	-4.4	-4.4	-4.2	-4.3	-4.4	-4.2	-4.3
Fiscal stimulus (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-2.1	-2.2	-2.3	-2.3	-2.4	-2.5	-2.7
Official interest rate (end of period)	0.25	0.50	0.75	1.50	2.50	1.50	1.50
Short-term rate (end of period)	0.26	0.61	1.00	1.69	2.81	1.68	1.63
Long-term rate (end of period)	2.17	2.27	2.45	2.40	2.69	1.50	1.64
Exchange rate vs. USD (end of period)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Exchange rate vs euro (end of period)	1.21	1.09	1.05	1.20	1.15	1.09	1.12
Private lending (% YoY, average)	7.5	2.4	3.1	6.6	4.2	4.8	4.6
Household lending (% YoY, average)	1.7	1.9	2.2	3.5	3.5	3.9	6.9
P.S. non-financial lending (% YoY, average)	5.2	5.7	5.3	6.3	8.9	6.6	3.6
P.S. financial lending (% YoY, average)	2.7	2.1	4.3	2.9	2.2	2.0	1.3
Savings rate (% , average)	7.3	7.6	6.8	7.0	7.7	8.2	7.7

Source: MAPFRE Economic Research (based on Federal Reserve data)
Forecast end date: October 16, 2019.

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agreement of principles on technology transfer; and (v) will modify intellectual property practices. In return, the United States will suspend the tariff increase scheduled for October 15 (tariffs of 25% to 30% on USD 250 billion of Chinese imports).

The markets are concerned about the possibility of a recession (now with a probability of around one third)⁴. However, it is expected that the US administration, 12 months from the 2020 elections, will do everything possible to avoid a recession until then. Moreover, the Federal Reserve, whose dual mandate is to monitor inflation and growth, will also work in this regard. If there is a recession before November 2020, it will be triggered by a shock in the financial markets that may well be due to liquidity, confidence, a fall in corporate profits, a shock in the corporate or sovereign bond markets or a *shock* in oil prices as a result of geopolitical tensions in the Persian Gulf.

1.2.2 Eurozone

Economic slowdown and industrial recession: the ECB to the rescue again

The eurozone is slowing down in line with the global economy. GDP in the second quarter grew by only 0.2% QoQ, bringing the annual rate to 1.2%. Industrial production is in recession (-2.0% YoY) and is on a downward trend. The PMIs continue to worsen, with the composite only marginally positive (50.1), that of services (51.6) starting to feel the effects of the less positive context, and the manufacturing one clearly in the contraction zone (45.7). Similarly, the business climate survey (-0.2) has not seen these levels since 2013. The Sentix investor confidence index has also fallen to minimums not seen since 2014. Given the evidence of a worsening in the slowdown, our growth forecast is 1.1% in both 2019 and 2020 (see Table 1.2.2 and Charts 1.2.2-a and 1.2.2-b).

Inflation, by comparison, has been falling for a year and moving away from the 2% target to stand at 0.9% in September (leading), with underlying inflation at 1.0%, mainly due to energy-based effects. Due to the fall in inflation and the sluggishness of economic activity, the ECB decided, at its meeting on September 12, to lower the deposit interest rates

by 10 bps to -0.50% and restart the asset purchase program with 20 billion monthly starting on November 1, with no end in sight (it is already starting to be referred to as "as long as it takes"). To limit the negative impact on banks' reserves, the ECB has introduced a "tranches" (Tiers) system.

In addition to the measures introduced, the central bank has again emphasized that it is now necessary for governments to also act with fiscal stimuli, suggesting that monetary stimuli alone are reaching the limits of their effectiveness. Germany and France are already considering implementing public spending packages to stimulate the economy, while the European Commission could begin to be more tolerant of certain countries, including Italy and Spain, when it comes to their fiscal deficit.

The risks to activity in the eurozone are varied, but the weakness of inflation is starting to be a cause for concern. The slowdown in domestic demand and investment due to structural factors and foreign trade problems, with the increase in protectionism, are seen as not insignificant risks. The worsening of the recession in the manufacturing sector, if extended over time, could begin to feed through to employment and salary levels, and begin to contaminate the services sector. On the positive side, we have the new monetary

- **Economic activity in the eurozone is slowing down.**
- **The European Central Bank, to the rescue again, has announced a new asset purchase program.**
- **The countries in the eurozone are finally beginning to consider tax stimuli.**

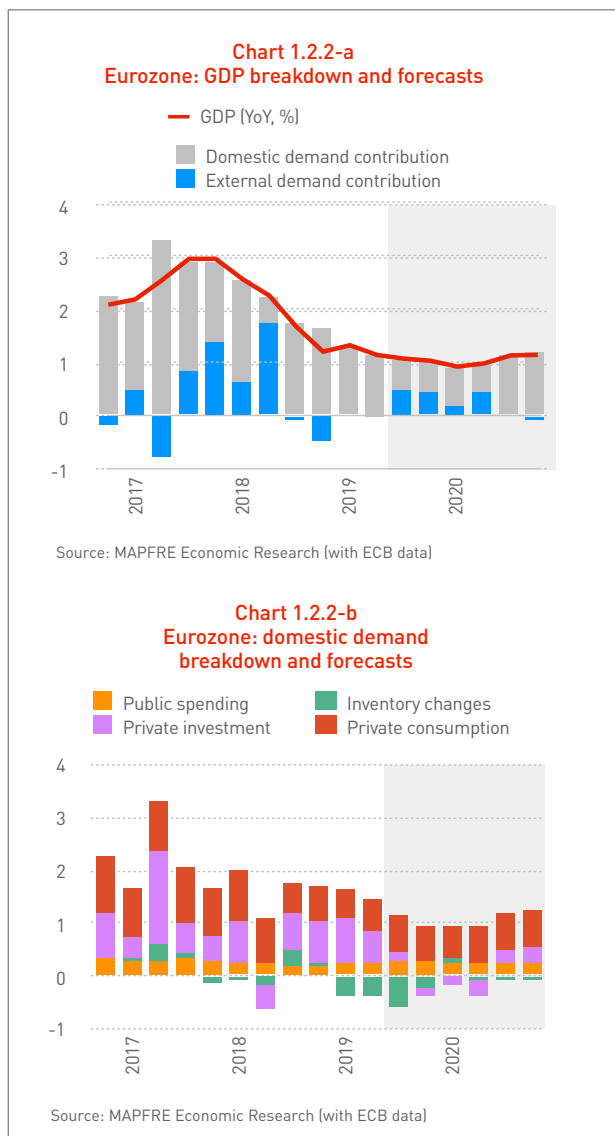


Table 1.2.2.
Eurozone: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	1.4	2.0	1.9	2.7	1.9	1.1	1.1
Domestic demand contribution	0.8	2.1	2.3	2.2	1.5	0.9	0.9
External demand contribution	0.6	-0.1	-0.4	0.5	0.5	0.3	0.1
Private consumption contribution	0.5	1.0	1.0	1.0	0.7	0.6	0.7
Private investment contribution	0.1	0.9	0.8	0.8	0.5	0.4	0.0
Public spending contribution	0.2	0.3	0.4	0.3	0.2	0.3	0.3
Domestic demand (% YoY, average)	1.4	2.2	2.4	2.2	1.5	0.9	1.0
Total consumption (% YoY, average)	0.9	1.7	1.9	1.7	1.3	1.2	1.3
Private investment (% YoY, average)	1.5	4.7	4.0	3.8	2.3	1.7	0.0
Exports (YoY in %)	4.7	6.4	3.0	5.7	3.5	2.1	1.4
Imports (YoY in %)	4.9	7.5	4.2	5.0	2.7	1.8	1.2
Unemployment rate (% , last quarter)	11.4	10.5	9.7	8.7	7.9	7.5	7.4
Inflation (% YoY, last quarter)	0.2	0.3	0.7	1.4	1.9	1.0	1.3
Fiscal balance (% of GDP)	-2.5	-2.0	-1.6	-1.0	-0.5	-0.7	-0.8
Trade balance (% of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fiscal stimulus (% of GDP)	0.1	0.3	0.6	1.0	1.3	1.8	1.6
Current account balance (% of GDP)	2.3	2.6	3.2	3.1	3.1	2.6	2.5
Official interest rate (end of period)	0.05	0.05	0.00	0.00	0.00	0.00	0.00
Short-term rate (end of period)	0.08	-0.13	-0.32	-0.33	-0.31	-0.39	-0.33
Long-term rate (end of period)	1.23	1.26	0.93	1.13	1.17	-0.10	0.54
Exchange rate vs. USD (end of period)	1.21	1.09	1.05	1.20	1.15	1.09	1.12
Exchange rate vs euro (end of period)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-0.2	0.9	1.5	2.3	2.7	3.4	3.9
P.S. non-financial lending (% YoY, average)	2.1	8.6	1.8	1.4	1.9	0.6	1.2
P.S. financial lending (% YoY, average)	4.1	17.0	3.5	1.8	-0.2	1.1	1.5
Savings rate (% , average)	12.6	12.3	12.1	11.7	11.9	12.6	12.5

Source: MAPFRE Economic Research (based on ECB data)
Forecast end date: October 16, 2019.

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stimulus announced in September, as well as the fiscal measures and reforms that could be implemented by governments.

However, from a political perspective, political fragmentation is a fact and building agreements and coalitions is increasingly difficult in many countries. The debate on its reasons and consequences is becoming increasingly broad.

Finally, after the British parliament legislated against a no-deal Brexit, and as the date of October 31 is now close, everything indicates that a further postponement will be requested. The subject, however, remains an area of uncertainty.

1.2.3 Spain

Slowdown in line with the region

Spain grew by 2.0% (YoY) and 0.4% QoQ in the second quarter of 2019, confirming the expected slowdown. The symptoms of this reduction in the pace of economic activity can be seen in a lower contribution of domestic demand, especially marked by the slowdown in consumption and the contraction of investment. In addition, given the levels of deficit and debt this cannot be offset by a greater contribution of public consumption. Private consumption failed to grow in the second quarter, while investment fell (-0.2%

- **The Spanish economy is slowing down in line with the eurozone, although external demand remains a cushioning element for now.**
- **Consumer confidence has deteriorated and a translation of the weakness to households is anticipated.**
- **Public spending will reach its limits in 2020.**

QoQ) and public spending showed a slight increase (+0.4% QoQ). Although the foreign sector is still avoiding the slowdown (exports +1.7% QoQ), with a contribution to GDP of 1.0%, doubts about its sustainability over time are increasing given the global slowdown and the possible imposition of tariffs (for EU-manufactured vehicles and agricultural products) which would lead to the need for exports to be redirected to other destinations.

As predicted in previous reports, and in keeping with the rest of the world, the economic slowdown in Spain is characterized by the exhaustion of the manufacturing cycle, as reflected in the systematic contraction of industrial production and PMIs. Although the indicators related to services and the composite figures in general (composite PMI) are still in positive ground, their weakening shows that they are gradually being affected through the channel of consumer confidence (consumer confidence in September was -6.2).

In the short-term, the Spanish economy is expected to continue growing close to its potential, supported by domestic demand and especially consumption. Added to this will be the creation of employment and the real growth in salary income that will still have some inertia, as well as the lagged effects of the fiscal expansion seen before the November elections. In 2020, however, the slowdown will accelerate in keeping with the rest of the eurozone. Fiscal expansion, and the use of savings and income, will reach its limits in 2020. Moreover, the current primary deficit appears unsustainable and the unemployment rate will be located in a frictional, somewhat high area by 2020.

A new series of national accounts, revised since 1995, was published by the National Statistics Institute (INE) on September 16 to update the estimation methods and sources. This new series subtracts two tenths from 2018 GDP, leaving it at 2.4% YoY compared to 2.6% according to the previous methodology.

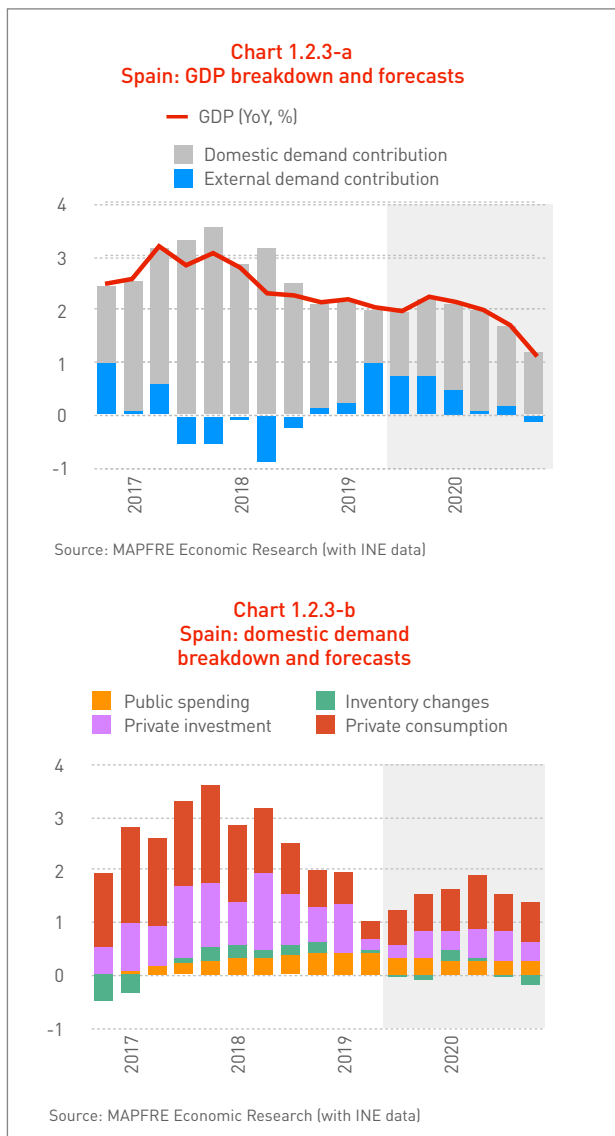


Table 1.2.3
Spain: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	1.4	3.8	3.0	2.9	2.4	2.0	1.7
Domestic demand contribution	1.4	3.9	2.0	3.0	2.6	1.4	1.6
External demand contribution	0.0	-0.1	1.0	-0.1	-0.3	0.7	0.2
Private consumption contribution	1.0	1.7	1.6	1.7	1.1	0.6	0.8
Private investment contribution	0.3	0.9	0.4	1.1	1.0	0.4	0.5
Public spending contribution	-0.1	0.4	0.2	0.2	0.3	0.4	0.3
Domestic demand (% YoY, average)	1.9	4.1	2.1	3.1	2.7	1.5	1.6
Total consumption (% YoY, average)	1.1	2.7	2.3	2.5	1.9	1.3	1.4
Private investment (% YoY, average)	4.1	4.9	2.4	5.9	5.3	2.4	2.4
Exports (YoY in %)	4.5	4.3	5.4	5.6	2.2	2.8	2.2
Imports (YoY in %)	6.8	5.1	2.7	6.6	3.3	0.5	2.4
Unemployment rate (% , last quarter)	23.7	20.9	18.6	16.6	14.5	13.6	12.9
Inflation (% YoY, last quarter)	-0.5	-0.3	1.0	1.4	1.7	0.4	1.4
Fiscal balance (% of GDP)	-6.0	-5.3	-4.4	-3.0	-2.5	-2.3	-1.9
Trade balance (% of GDP)	-2.1	-1.9	-1.3	-1.9	-2.4	-1.9	-1.5
Fiscal stimulus (% of GDP)	-2.6	-2.3	-1.7	-0.6	-0.1	0.1	0.5
Current account balance (% of GDP)	1.7	2.0	3.2	2.7	1.9	1.6	1.2
Official interest rate (end of period)	0.05	0.05	0.00	0.00	0.00	0.00	0.00
Short-term rate (end of period)	0.08	-0.13	-0.32	-0.33	-0.31	-0.39	-0.33
Long-term rate (end of period)	1.61	1.77	1.35	1.51	1.41	0.18	0.89
Exchange rate vs. USD (end of period)	1.21	1.09	1.05	1.20	1.15	1.09	1.12
Exchange rate vs euro (end of period)	n/a.	n/a.	n/a.	n/a	n/a	n/a	n/a
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-5.0	-3.6	-2.3	-1.4	-0.3	0.3	2.9
P.S. non-financial lending (% YoY, average)	-4.6	-2.7	-2.6	-0.6	-2.5	1.7	2.5
P.S. financial lending (% YoY, average)	-1.4	-5.7	-25.4	-9.6	-1.0	-5.8	2.6
Savings rate (% , average)	6.6	7.6	7.4	5.9	6.2	8.7	8.7

Source: MAPFRE Economic Research (based on INE data)
Forecast end date: October 16, 2019.

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Given this, our forecast for 2019 is revised downward to 2.0% YoY, a reduction of two tenths explained by the ongoing slowdown and another two tenths explained by the methodological review by the INE (see Table 1.2.3 and Charts 1.2.3-a and 1.2.3-b). Thus, we expect growth of slightly below 2% throughout 2019 and 2020. It is important to note that our growth forecasts for the Spanish economy are subject to a wide margin of uncertainty given some clear idiosyncratic risks: the outcome of the November general elections, the crisis in Catalonia and the final format of Brexit.

Moreover, the September leading indicator for year-on-year inflation has fallen to 0.1% (0% QoQ), with the reduction in electricity standing out. Similarly, the unemployment rate has fallen to 14%, but the rate of employment creation is slowing down, a determining factor in the growth of consumption.

Finally, it should be noted that due to the lack of parliamentary support, it has proved impossible to form a government within the legally established period, so the Spanish parliament has been dissolved after four months of activity and new elections have been called for November 10. So far the lack of a government has not significantly impacted economic activity, but the lack of political consensus and the risk of continuing with a *deadlock* after the elections may begin to have a negative impact on job creation, consumer confidence, and even credibility in the sovereign financing markets. United States' tariffs on agricultural products, and the foreseeable tariffs on imports of cars manufactured in the EU may also weaken economic activity.

1.2.4 Germany

Teetering on the brink of recession

The German economy contracted by 0.1% QoQ in the second quarter, leaving the annual rate at 0.4% YoY. The published indicators point to a worsening of the slowdown, so it is very likely that in the third quarter of the year the economy will have shrunk again and will have therefore fallen into recession. The September IFO forecasts indicator is the worst since 2009 (90.8), as is the manufacturing PMI (41.7) and the composite (48.5). The services PMI is also showing the first indications of the same symptoms (51.4). Moreover, the ZEW survey of growth expectations stood at -22.5 in September, while factory orders are showing a year-on-year fall of -6.6%.

- All indicators point to Germany officially falling into recession (awaiting GDP figures from the third quarter).
- The possibility of an expansionary fiscal package has disappeared.
- Germany would be the country most affected by a round of tariffs on the car industry and other industrial goods.

Given this outlook, MAPFRE Economic Research has revised its growth forecasts for 2019 and 2020, reducing the figure for 2019 by 4 tenths to 0.6% YoY and that for 2020 by 8 tenths, to 0.7% YoY (see Table 1.2.4 and Charts 1.2.4-a and 1.2.4-b). Currently, with no prospect of a global recovery or clarity regarding Brexit, and with the threat that the United States will impose tariffs on EU vehicle imports, no significant recovery is expected before 2021.

The words of the German Finance Minister, Olaf Scholz, on the possibility of implementing a package of tax measures worth several billion to stimulate the economy had a positive impact on market expectations. These measures

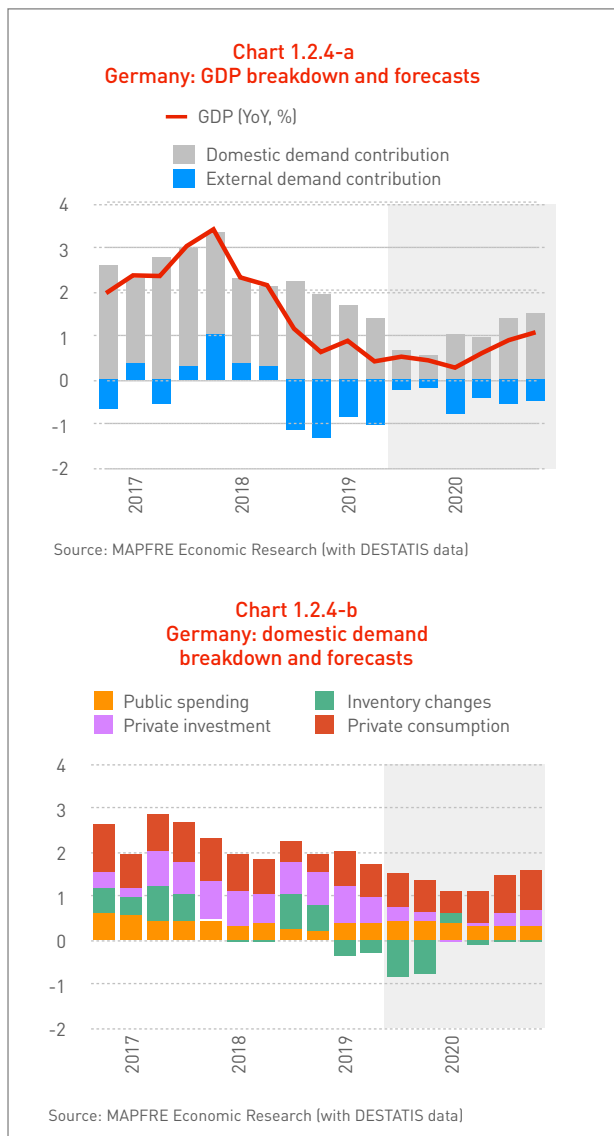


Table 1.2.4
Germany: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	2.2	1.5	2.1	2.8	1.6	0.6	0.7
Domestic demand contribution	1.1	1.3	2.8	2.4	2.0	1.1	1.3
External demand contribution	1.1	0.2	-0.6	0.3	-0.4	-0.5	-0.5
Private consumption contribution	0.6	1.0	1.1	0.9	0.7	0.7	0.7
Private investment contribution	0.4	0.2	0.7	0.6	0.7	0.5	0.2
Public spending contribution	0.3	0.5	0.8	0.5	0.3	0.4	0.3
Domestic demand (% YoY, average)	1.7	1.4	3.0	2.6	2.1	1.2	1.3
Total consumption (% YoY, average)	1.2	2.1	2.6	1.9	1.3	1.6	1.5
Private investment (% YoY, average)	3.3	1.2	3.6	3.1	3.5	2.4	0.9
Exports (YoY in %)	4.7	4.9	2.2	5.5	2.3	0.7	0.8
Imports (YoY in %)	3.9	5.4	4.2	5.7	3.8	2.1	2.2
Unemployment rate (% , last quarter)	6.6	6.3	6.0	5.5	5.0	5.0	6.0
Inflation (% YoY, last quarter)	0.2	0.2	1.5	1.4	1.6	1.2	1.4
Fiscal balance (% of GDP)	0.6	0.9	1.2	1.2	1.9	1.5	0.6
Trade balance (% of GDP)	7.5	8.1	8.0	7.8	6.7	6.7	5.9
Fiscal stimulus (% of GDP)	2.2	2.2	2.2	2.3	2.8	2.5	1.7
Current account balance (% of GDP)	7.3	8.6	8.4	8.1	7.5	7.4	6.4
Official interest rate (end of period)	0.05	0.05	0.00	0.00	0.00	0.00	0.00
Short-term rate (end of period)	0.08	-0.13	-0.32	-0.33	-0.31	-0.39	-0.33
Long-term rate (end of period)	0.54	0.63	0.21	0.43	0.25	-0.55	-0.14
Exchange rate vs. USD (end of period)	1.21	1.09	1.05	1.20	1.15	1.09	1.12
Exchange rate vs euro (end of period)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	1.1	1.9	2.8	3.2	3.6	5.1	5.4
P.S. non-financial lending (% YoY, average)	2.9	2.9	3.0	4.7	7.7	4.3	2.2
P.S. financial lending (% YoY, average)	-7.9	5.0	0.5	-1.2	4.1	5.0	1.6
Savings rate (% , average)	9.7	10.0	10.3	10.3	10.9	10.8	10.9

Source: MAPFRE Economic Research (based on DESTATIS data)
Forecast end date: October 16, 2019.

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would be in line with those suggested by the ECB, that is, the application of fiscal stimuli in those countries that can afford it. However, the implementation of this plan may face some difficulties due to the 0.35% deficit limit introduced into the German Constitution in 2009, as well as the commitment of the current coalition government to maintain a balanced budget.

September inflation fell to 1.2%, while underlying inflation fell to 1.4%, a further symptom of the slowdown in demand. Unemployment is stable at 5.0% and it is possible that the minimum has been reached in this cycle. To the second quarter, salaries (unit labor costs) remained strong (+4.2% YoY), which, when associated with low inflation, is positive for disposable income.

The risks to the German economy are, on the one hand, the eventual transfer, via salaries, of the recession in the manufacturing sector to the services sector, as well as lower domestic demand and, in addition, the imposition of tariffs by the United States on vehicles manufactured in the EU and possibly on other goods, in response to the Airbus case.

1.2.5 Italy

New government to face the usual challenges

Italy, stagnant at an economic level, grew as much as possible to achieve positive figures throughout the year. A shrinking industrial sector (-0.7% to July), consumer confidence about the future (ISTAT) being in negative ground (-16.3 in September), and the purchasing manager survey (composite PMI), which is in positive ground (50.6 in September), while manufacturing remains in contracting ground (47.8), indicate that, for now, no economic recovery is on the horizon.

In this context, MAPFRE Economic Research forecasts virtually zero growth in 2019 and expects a slight recovery in 2020, based primarily on the meager exports due to the sluggishness of private demand, the necessary correction of public spending (given the pending excessive deficit pro-

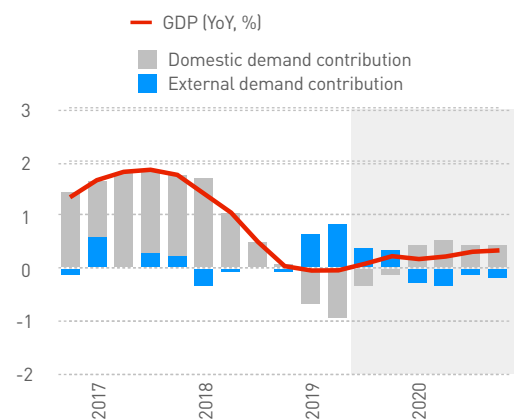
cedure) and the contraction of investment (see Table 1.2.5 and Charts 1.2.5-a and 1.2.5-b). Export growth, however, depends on the failure of the United States to impose the threatened tariffs on European cars and agricultural and industrial goods.

Moreover, inflation in September stood at 0.4% YoY, reflecting the weakness of demand which remains stagnant despite the unemployment rate being at 9.5%. This can be explained by salaries remaining stagnant (+0.7% YoY in June).

Italy has a new government, the coalition between the Democratic Party and Five Star Movement. This new government will have to implement various reforms to boost growth and correct the public accounts. The most pressing point in the short-term is the foreseeable u-turn on the increase in VAT (sales tax) scheduled to take place within a few months, which will force it to seek fiscal balance through a greater reduction in expenditure. The adoption of the 2020 budget will be the key to government stability and its credibility with the markets and the European Commission. Italy was freed by the European Commission from excessive deficit proceedings before the summer, but the 2020 budget will be essential to maintaining that confidence.

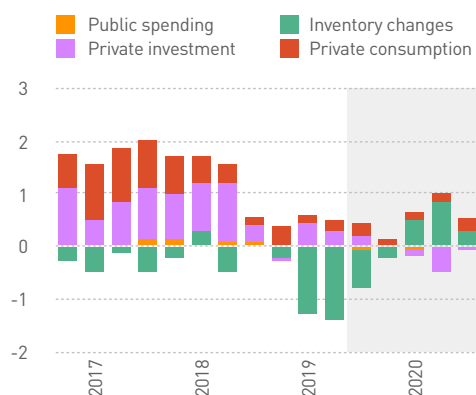
- The new government in Italy will face a lack of growth and restrictions on public spending.
- There would be an impact from potential tariffs on the export of European vehicles.
- Salary growth is stagnant which is another factor hindering the growth of economic activity.

Chart 1.2.5-a
Italy: GDP breakdown and forecasts



Source: MAPFRE Economic Research (with ISTAT data)

Chart 1.2.5-b
Italy: domestic demand breakdown and forecasts



Source: MAPFRE Economic Research (with ISTAT data)

Table 1.2.5
Italy: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	0.2	0.8	1.2	1.8	0.7	0.0	0.2
Domestic demand contribution	-0.1	1.3	1.6	1.5	0.8	-0.5	0.5
External demand contribution	0.3	-0.5	-0.4	0.3	-0.1	0.6	-0.2
Private consumption contribution	0.1	1.1	0.8	0.9	0.3	0.2	0.2
Private investment contribution	-0.4	0.3	0.6	0.8	0.6	0.2	-0.1
Public spending contribution	-0.1	-0.1	0.0	0.1	0.0	0.0	0.0
Domestic demand (% YoY, average)	0.3	1.4	1.7	1.5	0.9	-0.5	0.5
Total consumption (% YoY, average)	0.0	1.3	1.0	1.2	0.5	0.2	0.2
Private investment (% YoY, average)	-2.1	1.9	3.7	4.5	3.3	1.2	-0.8
Exports (YoY in %)	2.4	4.2	2.3	6.4	1.4	2.4	0.8
Imports (YoY in %)	3.0	6.7	3.8	5.8	1.8	0.7	1.6
Unemployment rate (% , last quarter)	12.7	11.5	11.8	11.0	10.5	9.8	10.1
Inflation (% YoY, last quarter)	0.1	0.2	0.1	0.9	1.4	0.4	1.0
Fiscal balance (% of GDP)	-3.0	-2.6	-2.4	-2.4	-2.2	-2.2	-2.5
Trade balance (% of GDP)	2.6	2.5	2.9	2.8	2.2	2.9	2.9
Fiscal stimulus (% of GDP)	1.6	1.5	1.5	1.4	1.5	1.4	1.1
Current account balance (% of GDP)	1.9	1.3	2.5	2.6	2.5	2.7	2.7
Official interest rate (end of period)	0.05	0.05	0.00	0.00	0.00	0.00	0.00
Short-term rate (end of period)	0.08	-0.13	-0.32	-0.33	-0.31	-0.39	-0.33
Long-term rate (end of period)	1.88	1.61	1.82	2.00	2.77	0.87	2.05
Exchange rate vs. USD (end of period)	1.21	1.09	1.05	1.20	1.15	1.09	1.12
Exchange rate vs euro (end of period)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-1.0	-0.3	0.4	1.3	1.7	2.3	4.1
P.S. non-financial lending (% YoY, average)	-2.5	-1.9	-2.0	-2.8	-1.1	-1.1	0.0
P.S. financial lending (% YoY, average)	-27.0	-3.0	-3.9	-11.5	25.7	13.4	-4.2
Savings rate (% , average)	11.0	10.3	10.1	9.3	9.4	10.0	9.8

Source: MAPFRE Economic Research (based on ISTAT data)
Forecast end date: October 16, 2019.

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1.2.6 United Kingdom

Evident slowdown

The United Kingdom recorded a contraction of -0.2% QoQ in the second quarter of the year, leaving the year-on-year rate at 1.3%. Private consumption has grown 1.2% YoY, while investment has stagnated (0.3%) and exports have contracted (-1.4%). Surveys on the situation are not very encouraging: all the PMIs (composite, manufacturing and services) are in a contraction area (below 50 points). Consumer confidence (GfK) was at -12 points in September, remaining in negative territory since 2016. Industrial production stabilized in July at +0.1% QoQ, but shows a cumulative decrease of -0.9% this year.

- **Uncertainty (the lack of clarity about Brexit plus the world economic cycle) is pushing the United Kingdom's economy to the brink of recession (GDP -0.2% in the second quarter).**
- **Annual growth for 2019 is forecast to be 1.3%.**
- **The postponement of Brexit is increasingly likely, with possible elections and a new referendum.**

In this context, we maintain the growth forecast of 1.3% in 2019 and lower the forecast for 2020 by 8 tenths to 1.1%, given the global economic slowdown and the continued unresolved mechanism for the United Kingdom to exit the European Union, which has consolidated a lower growth scenario for both external and internal reasons (see Table 1.2.6 and Charts 1.2.6-a and 1.2.6-b).

The labor market seems to be remaining strong, with an unemployment rate slightly under 4% since the beginning of this year. Annual salary growth has continued to strengthen to reach the highest rate in more than a decade

(4.0% in July). In spite of the above, inflation continues on a downward trend in line with global figures. Inflation stood at 1.7% in August, with underlying inflation at 1.5%, following a downward trend since the beginning of 2018.

The Bank of England held interest rates steady at 0.75% at its meeting held on September 19 and considers different scenarios. It also warns that monetary policy could go in either direction depending on the Brexit scenario and that interest rates could therefore move in either direction. In the case of a soft and agreed Brexit and a recovery in demand, conditions could be generated that justify an increase to maintain inflation at around 2%. In contrast, in the event of a no-deal exit, the Bank of England would have to balance the inflationary effects of a probable depreciation of the currency and reduction in supply with the effects of a reduction in demand (economic slowdown).

In relation to Brexit, we continue to consider a postponement as a highly likely scenario, based on the decision of the British Parliament to ask for a further extension if there was no deal before October 19. Although London and Brussels have recently reached an agreement, this is not expected to be passed in the British Parliament's vote on October 18.

Finally, it should be noted that the pound sterling is not showing a clear trend, having depreciated when it appeared that the solution was a no-deal Brexit and then recovering when Parliament legislated against that possibility.

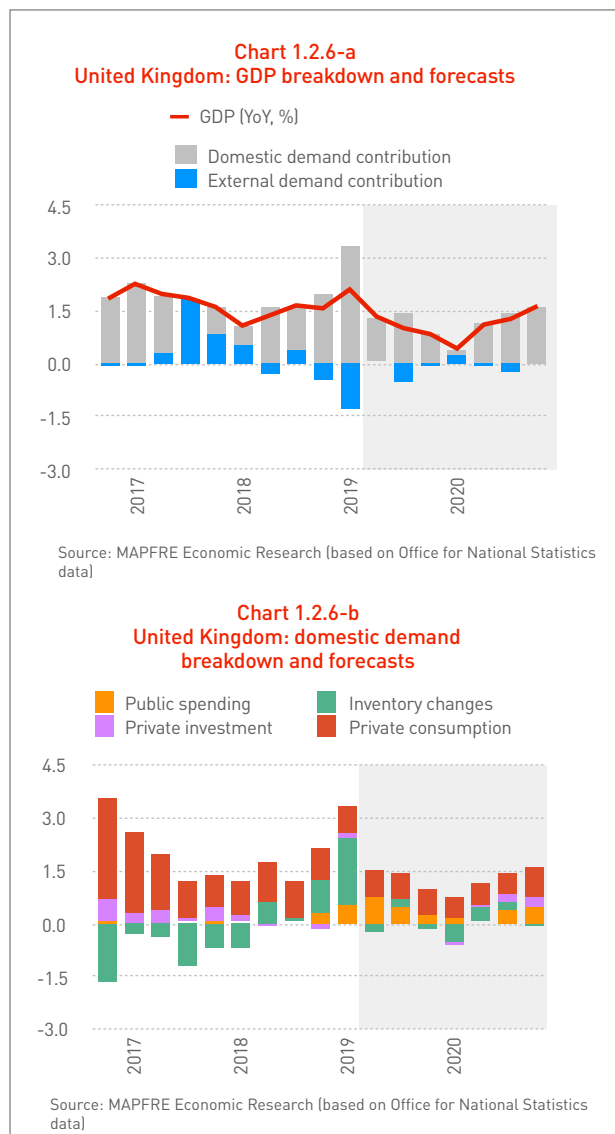


Table 1.2.6
United Kingdom: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	2.6	2.4	1.9	1.9	1.4	1.3	1.1
Domestic demand contribution	2.6	2.5	2.5	1.1	1.3	1.7	1.1
External demand contribution	0.0	-0.1	-0.6	0.7	0.1	-0.4	0.0
Private consumption contribution	1.5	1.8	2.4	1.4	1.0	0.7	0.7
Private investment contribution	0.7	0.6	0.6	0.3	-0.0	0.0	0.1
Public spending contribution	0.4	0.3	0.2	0.0	0.1	0.5	0.3
Domestic demand (% YoY, average)	3.7	2.5	2.6	1.2	1.3	1.8	1.1
Total consumption (% YoY, average)	2.4	2.7	3.2	1.8	1.4	1.5	1.2
Private investment (% YoY, average)	6.7	3.7	3.6	1.6	-0.1	0.3	0.7
Exports (YoY in %)	1.1	3.8	2.7	6.2	-0.8	-1.1	0.5
Imports (YoY in %)	3.6	5.5	4.4	3.5	0.7	2.8	-1.0
Unemployment rate (% , last quarter)	5.7	5.1	4.7	4.4	4.0	3.8	3.8
Inflation (% YoY, last quarter)	0.9	0.1	1.2	3.0	2.3	1.9	1.7
Fiscal balance (% of GDP)	-5.5	-4.5	-3.2	-2.4	-2.2	-2.2	-2.4
Trade balance (% of GDP)	-6.5	-6.1	-6.7	-6.6	-6.6	-6.7	-6.1
Fiscal stimulus (% of GDP)	-2.9	-2.2	-0.9	0.2	0.2	0.0	-0.2
Current account balance (% of GDP)	-4.7	-4.9	-5.2	-3.5	-4.3	-4.6	-3.7
Official interest rate (end of period)	0.50	0.50	0.25	0.50	0.75	0.75	1.00
Short-term rate (end of period)	0.56	0.59	0.37	0.52	0.91	0.79	1.06
Long-term rate (end of period)	1.82	2.02	1.28	1.25	1.33	0.49	0.91
Exchange rate vs. USD (end of period)	1.56	1.48	1.23	1.35	1.28	1.20	1.27
Exchange rate vs euro (end of period)	1.28	1.36	1.17	1.13	1.11	1.10	1.14
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	1.7	2.9	4.0	3.9	3.4	3.4	3.2
P.S. non-financial lending (% YoY, average)	-3.3	-1.9	6.2	9.5	1.7	1.3	2.4
P.S. financial lending (% YoY, average)	-9.2	-13.9	7.3	9.4	5.1	5.0	5.0
Savings rate (% , average)	9.4	10.0	7.2	5.3	6.1	6.1	5.8

Source: MAPFRE Economic Research (based on Office for National Statistics data)
Forecast end date: October 16, 2019.

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1.2.7 Japan

Effect of VAT to be seen at the close of 2019

The Japanese economy grew by 1.0% (YoY) and 0.3% QoQ in the second quarter of the year. Private consumption is the component sustaining growth, as exports have contracted (-1.2% YoY) and investment is barely increasing (0.3%). In the third quarter, it is expected that consumption will be brought forward as a result of the entry into force of the VAT increase, with an increase from 8% to 10% from October

1. However, in the fourth quarter and in early 2020, the tax hike is expected to have a negative effect. The government hopes to mitigate this effect with the application of certain exemptions in the food sector and temporary measures in the case of the real estate and automobile sectors. Moreover, the hosting of the Olympic Games in 2020 is expected to have a positive effect on consumption.

Given the global trade tensions (now also between Japan and South Korea) and the global slowdown, exports are not expected to boost the economy. The figures published recently show a continuous deterioration of goods exports (-8.2% in August) and industrial production (-2.0% in August; -4.7% not seasonally adjusted). Investment also seems unable to drive a recovery due to several factors (sluggish exports and population aging), despite growing by 0.8% YoY (2.0% QoQ) in the second quarter.

- **Better performance of the Japanese economy in 2019, but stagnation in 2020.**
- **VAT rose from 8% to 10% on October 1, forcing it to soften the impact through tax exemptions and other benefits.**
- **Exports are being inhibited by the different trade tensions.**

Consumer confidence is in free fall (35.8 in September) and the Tankan Short-Term Economic Survey of Enterprises continues to worsen for both current conditions and expectations. Similarly, the PMI indices anticipate a worsening, mainly in the industrial sector (48.9 in September), while the service sector remains in positive ground (52.8).

Our growth forecast for 2019 has improved by 3 tenths, to stand at 0.8%, motivated by the resilience of domestic consumption in the second quarter and the bringing forward of purchases given the VAT increase, which will occur from the third quarter. However, by 2020, the growth forecast will be maintained just above zero due to sluggish exports and the slowdown in consumption as a result of fiscal policies (see Table 1.2.7 and Charts 1.2.7-a and 1.2.7-b).

In the face of increasing deflationary pressures, the Bank of Japan kept official interest rates unchanged at its last meeting on September 19, at -0.10%, but does not want to go further with negative rates given their unfavorable impact on the banking sector. However, one cannot rule out the Bank of Japan adopting new unconventional measures to address the issue of possible deflation.

With regard to the Yen, the global slowdown and the accommodative approach of the central banks around the world mean that the Japanese economy does not stand out in a negative way. The result is that some stability can be seen in the currency, moving in the range of 105-108 JPY/USD.

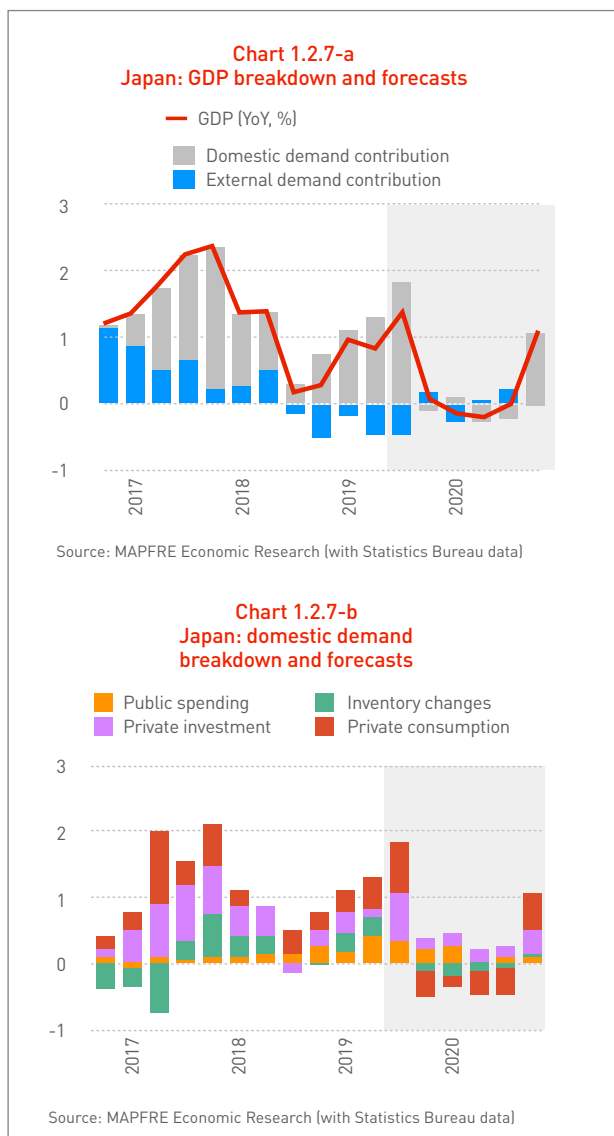


Chart 1.2.7
Japan: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	0.3	1.3	0.6	1.9	0.8	0.8	0.2
Domestic demand contribution	-0.3	0.9	0.0	1.4	0.8	1.0	0.2
External demand contribution	0.6	0.4	0.6	0.6	0.0	-0.2	0.0
Private consumption contribution	-0.5	-0.1	-0.1	0.6	0.2	0.3	-0.1
Private investment contribution	0.4	0.4	-0.1	0.7	0.2	0.3	0.2
Public spending contribution	0.1	0.3	0.3	0.1	0.2	0.3	0.1
Domestic demand (% YoY, average)	0.3	0.9	0.0	1.3	0.8	1.0	0.2
Total consumption (% YoY, average)	-0.6	0.3	0.3	0.9	0.5	0.8	0.0
Private investment (% YoY, average)	3.0	1.7	-0.3	3.0	1.0	1.4	0.9
Exports (YoY in %)	9.3	3.0	1.7	6.8	3.5	-2.0	0.9
Imports (YoY in %)	8.4	0.7	-1.6	3.4	3.3	-0.7	0.6
Unemployment rate (% , last quarter)	3.5	3.3	3.0	2.7	2.4	2.4	2.4
Inflation (% YoY, last quarter)	2.5	0.2	0.3	0.6	0.9	1.3	0.4
Fiscal balance (% of GDP)	-5.4	-3.6	-3.5	-3.0	-2.5	-2.8	-3.2
Trade balance (% of GDP)	-2.0	-0.2	1.0	0.9	0.2	0.0	-0.1
Fiscal stimulus (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	0.8	3.1	3.9	4.2	3.5	3.3	3.1
Official interest rate (end of period)	0.07	0.04	-0.06	-0.06	-0.06	-0.06	-0.06
Short-term rate (end of period)	0.11	0.08	-0.05	-0.02	-0.07	-0.08	-0.07
Long-term rate (end of period)	0.33	0.27	0.04	0.05	0.01	-0.20	-0.20
Exchange rate vs. USD (end of period)	119.85	120.27	116.78	112.69	109.70	107.00	105.17
Exchange rate vs euro (end of period)	145.51	130.94	123.10	135.15	125.61	116.57	117.48
Private lending (% YoY, average)	2.1	2.0	2.2	4.6	3.1	2.9	1.9
Household lending (% YoY, average)	0.7	1.1	1.3	2.2	2.8	1.0	-0.4
P.S. non-financial lending (% YoY, average)	0.4	0.4	1.8	2.4	1.9	3.2	1.5
P.S. financial lending (% YoY, average)	8.5	7.8	-0.2	8.0	5.9	0.8	1.7
Savings rate (% , average)	-0.2	1.2	2.9	2.5	4.3	4.3	4.3

Source: MAPFRE Economic Research (with Statistics Bureau data)
Forecast end date: October 16, 2019.

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1.2.8. Turkey

Monetary relaxation helps but structural weaknesses remain

The Turkish economy has gone through a significant cyclical adjustment after two quarters of contraction in the second half of 2018, leading to the exit from a recession in early 2019. This is thanks mainly to the fiscal stimulus. In the second quarter of 2019, economic activity in Turkey grew by 1.2% QoQ, although in year-on-year terms it remains negative (-1.5% YoY). Private consumption in the second quarter began to recover compared to the previous quarter but remains negative (-1% in year-on-year terms, and investment fell even further to -23% YoY. Moreover, exports grew by 8.1% and imports continued to fall, -17% year-on-year, continuing the current account adjustment. This moved into surplus in July (+0.1% of the GDP) following the devaluation of the currency. Unemployment was 13%, after reaching a peak of 14.7% at the beginning of this year.

- **Turkey's economy seems to have come out of recession but remains very weak, especially on the investment side.**
- **There is a structural weakness resulting from high private dollar-denominated debt, so it needs external financing to avoid a balance-of-payments crisis.**

Inflation in September, at 9.3% YoY (compared to 15% in August), is notable. To a large extent, this is a base effect (+24.5% in September of the previous year), as can be seen in the month-by-month inflation, which has been 1%. However, in view of the annual evolution, MAPFRE Economic Research is lowering its inflation forecast for 2019 from 14.5% to 10.5%.

The accommodative approach to monetary policy at a global level and the good inflation figures allowed the central bank to cut interest rates by 325 bps on September 13, to stand at 16.5% (750 bps cumulative reduction from the 24% level recorded in June). MAPFRE Economic Research forecasts show an additional reduction of 150 bps to around 15.0% at year-end.

Despite coming out of recession, economic recovery is still not being seen in all areas of the Turkish economy, mainly due to weak investment. Industrial production (-0.4% YoY in July), the manufacturing PMI (50.0 in September) and consumer confidence (55.1 in September) confirm that this recovery is not on the horizon.

The ability to react through fiscal and monetary policies has weakened, and foreign currency reserves are insufficient for commitments at 12 months. In this context, in the event of external financing difficulties, Turkey could have problems with its balance of payments. It is enough to point out that Turkey's private and public sector has debt renewals of USD 180 billion over the next 12 months (accounting for 24% of GDP).

The fiscal stimulus carried out in 2018 and 2019 to overcome the recession, however, has left the budget deficit (according to IMF data) at 5.2% and the primary deficit at 2.9%, resulting in an upward trend for debt and leaving little room for new stimuli. Paradoxically, the global slowdown, the easing of inflation and the global lowering of interest rates have favored Turkey, allowing it to reduce its interest rates.

Taking into account the global economic context and the recent dynamics of the Turkish economy, MAPFRE Economic Research has revised its GDP growth estimates for the year 2019 as a whole, with GDP growth now expected to stand at 0%, up from -1.6%. By 2020, we estimate that it will again grow to a level of 2.5% due to the recovery of consumption and investment (see Table 1.2.8 and Charts 1.2.8-a and 1.2.8-b).

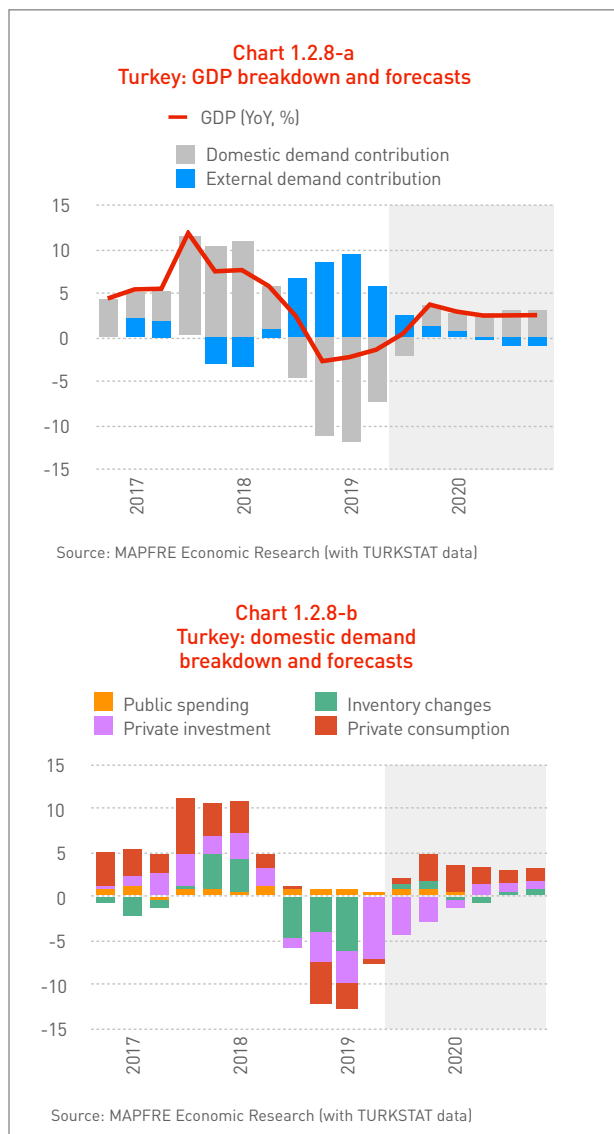


Table 1.2.8
Turkey: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	5.3	6.0	3.3	7.4	3.1	0.0	2.5
Domestic demand contribution	3.4	5.5	4.6	7.1	0.0	-4.7	2.8
External demand contribution	1.9	0.5	-1.3	0.3	3.2	4.7	-0.3
Private consumption contribution	1.9	3.4	2.2	3.8	0.3	0.0	2.0
Private investment contribution	1.3	2.7	0.7	2.4	0.0	-4.4	0.5
Public spending contribution	0.4	0.5	1.3	0.7	0.9	0.8	0.4
Domestic demand (% YoY, average)	3.2	5.4	4.5	7.0	0.1	-4.6	3.0
Total consumption (% YoY, average)	3.0	5.1	4.7	6.0	1.6	1.1	3.2
Private investment (% YoY, average)	5.5	9.1	2.4	8.2	0.1	-15.2	2.2
Exports (YoY in %)	8.3	4.3	-1.7	12.0	7.6	5.8	3.1
Imports (YoY in %)	-0.3	1.8	3.7	10.2	-6.3	-14.4	6.0
Unemployment rate (% , last quarter)	10.7	10.5	12.1	10.3	12.3	13.6	12.8
Inflation (% YoY, last quarter)	8.8	8.2	7.6	12.3	22.4	10.5	10.8
Fiscal balance (% of GDP)	-1.1	-1.1	-1.3	-1.6	-1.9	-2.8	-2.3
Trade balance (% of GDP)	-6.8	-5.6	-4.7	-6.9	-5.4	-2.8	-3.4
Fiscal stimulus (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-4.7	-3.7	-3.8	-5.6	-3.5	0.1	-1.2
Official interest rate (end of period)	8.51	8.81	8.31	12.75	24.06	14.81	12.83
Short-term rate (end of period)	9.79	11.47	9.90	14.61	24.07	14.79	13.37
Long-term rate (end of period)	7.96	10.74	11.40	11.72	16.53	12.93	12.00
Exchange rate vs. USD (end of period)	2.33	2.92	3.52	3.79	5.29	5.88	5.93
Exchange rate vs euro (end of period)	2.83	3.18	3.71	4.55	6.06	6.40	6.63
Private lending (% YoY, average)	23.2	23.0	12.8	20.6	18.3	8.9	9.3
Household lending (% YoY, average)	16.3	12.5	7.1	17.5	9.8	0.3	12.7
P.S. non-financial lending (% YoY, average)	30.1	29.9	14.7	24.3	20.9	-8.0	7.3
P.S. financial lending (% YoY, average)	22.4	26.4	9.0	27.2	25.1	20.7	9.6
Savings rate (% , average)	26.2	28.3	32.8	30.9	30.0	27.6	26.2

Source: MAPFRE Economic Research (based on TURKSTAT data)
Forecast end date: October 16, 2019.

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Finally, the Turkish Lira, after recovering in the second quarter of the year, has found some stability in the third quarter, fluctuating in the range of 5.60-5.80 TRY/USD. This has been helped by the relaxation of global monetary policies, especially that of the United States.

1.2.9 Mexico

Growth has weakened in response to the fall in investment

The Mexican economy has stagnated in the second quarter of the year, at 0% QoQ, leaving year-on-year growth at 0.3%. This slowdown can be seen in private consumption (+0.6% YoY seasonally adjusted) and government spending (-1.9% YoY adjusted), but mainly in investment (-5.2% YoY adjusted, -4% private and -11.5% public). In the second quarter, exports grew by 3.2% YoY and imports by 0.7%, even without clear signs of the effect of the US trade policy on its industrial and agricultural sectors.

- Growth of 0% QoQ in the Mexican economy in the second quarter means that technically it has avoided a recession.
- The fall in investment (-5.2% YoY adjusted for seasonality) is the main culprit.
- The growth forecast for 2019 has been revised to 0.3%.

As a result, GDP growth could be 0.3% in 2019 and 1.1% in 2020 (see Table 1.2.9 and Charts 1.2.9-a and 1.2.9-b). In the future, the limited growth forecast will be caused by consumption and the foreign sector, while industrial production and investment will feel the effect of the global cyclical shift. Industrial production in July fell -1.7% year-on-year, in line with many developed countries, although in the case of Mexico this is aggravated by lower

private sector investment. The September manufacturing PMI stood at 49.1, in the contraction zone.

Moreover, inflation fell to 3.2% in August, with the underlying rate at 3.8%, due to lower energy prices and the absence of inflationary pressure on agricultural products. At its September meeting, the Bank of Mexico reduced interest rates by 25 bps, to 7.75%, with a cumulative 50 bps reduction so far this year. This was largely possible due to the lowering of interest rates in the United States and the moderation of inflation. Given the possible interest rate reductions by the Federal Reserve, the Bank of Mexico could follow the same path for the remainder of the year.

On September 6, the government published a document called "General Economic Policy Criteria" which sets out its commitment to fiscal discipline and sets a primary surplus target of 0.7% of GDP. A new approach is also being adopted to public spending management, based on the principles of efficiency and austerity. In the case of the Mexican economy, risks generally stem from a lack of recovery in investment and the absence of growth due to lower than estimated tax revenues and oil production.

1.2.10 Brazil

Progress in the social security reform

The Brazilian economy grew 0.4% QoQ in the second quarter, leaving the year-on-year rate at 1.0%. Private consumption (+1.6%) and investment (+5.2%) have picked up in the second quarter, as have exports and imports, which have grown by 1.8% and 4.7%, respectively.

In general terms, the situation seems to be improving, but the global lower growth environment may hinder economic recovery in Brazil. Industrial production increased by 0.8% MoM in August, attributable to the recovery of mining production. The purchasing managers' index (PMI) has returned to

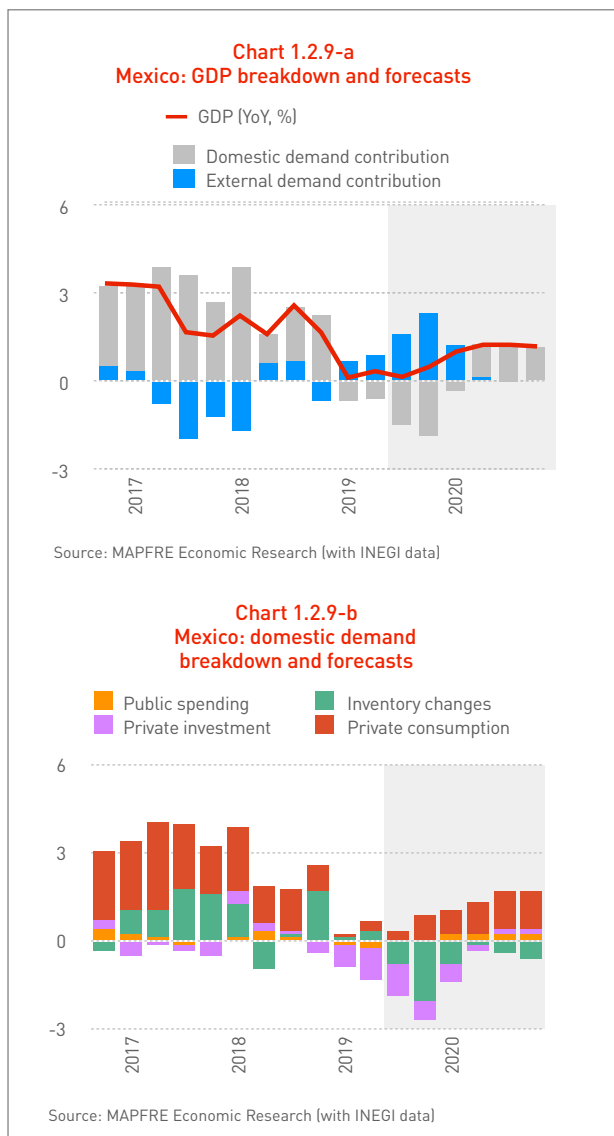


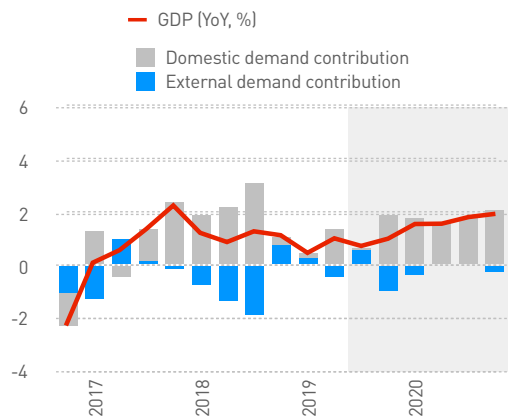
Table 1.2.9
Mexico: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	2.8	3.3	2.6	2.4	2.0	0.3	1.1
Domestic demand contribution	2.0	2.5	2.2	3.3	2.2	-1.1	0.8
External demand contribution	0.8	0.8	0.4	-0.9	-0.2	1.4	0.4
Private consumption contribution	1.4	1.8	2.3	2.3	1.5	0.4	1.1
Private investment contribution	0.3	1.1	0.2	-0.3	0.1	-0.9	-0.1
Public spending contribution	0.3	0.2	0.3	0.1	0.2	-0.1	0.2
Domestic demand (% YoY, average)	2.5	2.5	2.2	3.3	2.2	-1.1	0.8
Total consumption (% YoY, average)	2.2	2.6	3.4	3.0	2.1	0.4	1.7
Private investment (% YoY, average)	3.0	5.1	1.1	-1.6	0.6	-4.3	-0.4
Exports (YoY in %)	6.9	8.6	3.6	4.3	5.6	3.1	1.6
Imports (YoY in %)	5.9	6.0	2.4	6.9	6.2	-0.7	0.7
Unemployment rate (% , last quarter)	4.4	4.2	3.5	3.3	3.3	3.7	3.9
Inflation (% YoY, last quarter)	4.2	2.3	3.2	6.6	4.8	3.2	3.4
Fiscal balance (% of GDP)	-3.1	-3.4	-2.5	-1.1	-2.0	-2.0	-2.4
Trade balance (% of GDP)	-0.2	-1.2	-1.2	-0.9	-1.1	-0.7	-1.7
Fiscal stimulus (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-1.9	-2.6	-2.3	-1.7	-1.8	-1.1	-1.8
Official interest rate (end of period)	3.00	3.25	5.75	7.25	8.25	7.25	7.25
Short-term rate (end of period)	3.31	3.50	6.02	7.56	8.50	7.45	6.51
Long-term rate (end of period)	5.79	6.28	7.42	7.66	8.70	6.84	6.79
Exchange rate vs. USD (end of period)	14.74	17.20	20.74	19.67	19.65	19.90	20.40
Exchange rate vs euro (end of period)	17.90	18.73	21.86	23.59	22.50	21.67	23.46
Private lending (% YoY, average)	10.8	13.6	16.3	12.1	10.4	9.1	6.1
Household lending (% YoY, average)	8.1	8.4	12.8	10.0	8.4	6.1	3.0
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	9.8	-11.4	3.5	1.7	-0.8	4.0	16.9
Savings rate (% , average)	13.8	14.6	12.8	10.7	12.5	16.2	16.4

Source: MAPFRE Economic Research (based on INEGI data)
Forecast end date: October 16, 2019.

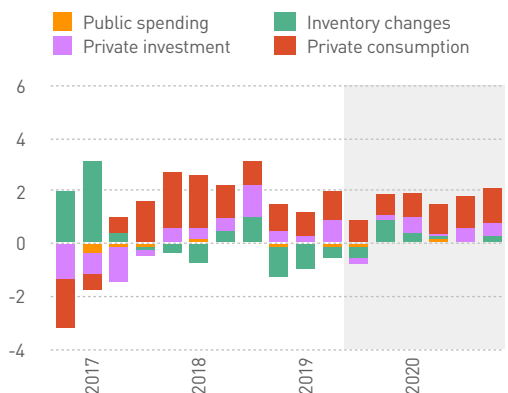
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Chart 1.2.10-a
Brazil: GDP breakdown and forecasts



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

Chart 1.2.10-b
Brazil: domestic demand breakdown and forecasts



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

Table 1.2.10
Brazil: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	0.5	-3.6	-3.3	1.1	1.1	0.8	1.7
Domestic demand contribution	0.5	-7.1	-5.1	1.1	1.9	0.9	1.8
External demand contribution	0.0	3.6	1.8	-0.1	-0.8	-0.1	-0.1
Private consumption contribution	1.5	-2.2	-2.7	0.9	1.3	0.9	1.2
Private investment contribution	-0.7	-2.9	-2.3	-0.4	0.7	0.3	0.4
Public spending contribution	0.1	-0.2	0.0	-0.2	0.0	-0.1	0.1
Domestic demand (% YoY, average)	0.2	-6.7	-4.9	1.1	1.8	0.9	1.8
Total consumption (% YoY, average)	2.0	-2.8	-3.0	0.9	1.5	1.0	1.4
Private investment (% YoY, average)	-4.1	-14.0	-11.9	-2.4	4.1	1.6	2.5
Exports (YoY in %)	-1.3	6.9	0.7	5.8	3.5	0.7	1.9
Imports (YoY in %)	-2.3	-14.1	-9.7	5.6	7.7	1.3	2.2
Unemployment rate (% , last quarter)	6.5	8.9	12.0	11.8	11.6	11.1	10.1
Inflation (% YoY, last quarter)	6.5	10.4	7.0	2.8	4.1	3.3	3.7
Fiscal balance (% of GDP)	-6.0	-10.2	-9.0	-7.8	-7.1	-6.1	-5.8
Trade balance (% of GDP)	-0.3	1.0	2.5	3.1	2.8	2.7	2.5
Fiscal stimulus (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-4.1	-3.0	-1.3	-0.7	-1.2	-1.4	-1.4
Official interest rate (end of period)	11.75	14.25	13.75	7.00	6.50	4.00	5.00
Short-term rate (end of period)	11.65	14.15	13.65	6.90	6.40	4.40	4.40
Long-term rate (end of period)	12.25	16.10	11.36	10.24	9.28	6.78	6.65
Exchange rate vs. USD (end of period)	2.66	3.90	3.26	3.31	3.87	4.10	3.90
Exchange rate vs euro (end of period)	3.22	4.25	3.43	3.97	4.44	4.47	4.36
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	14.1	10.1	4.3	4.6	6.8	10.9	16.4
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (% , average)	20.3	18.2	17.3	18.3	18.5	18.0	18.2

Source: MAPFRE Economic Research (with data from the Brazilian Institute of Geography and Statistics (IBGE))
Forecast end date: October 16, 2019.

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positive ground (52.5 in September), anticipating some recovery. Consumer confidence has improved slightly, up to 89.7 in June. The need for fiscal consolidation will prevent public spending from being a significant driver of economic activity. Accordingly, we expect growth of 0.8% in 2019 and 1.7% in 2020 (see Table 1.2.10 and Charts 1.2.10-a and 1.2.10-b).

In the absence of inflationary pressures (3.4% in August, consistent with the Central Bank's target) and with low growth prospects, at the September meeting the Central Bank reduced the Selic rates by 50 bps to 5.5% and opened the door to additional reductions in the future, arguing that a favorable inflation outlook would allow for additional adjustments in the scale of the stimulus. MAPFRE Economic Research estimates an additional reduction of 50 bps in October, followed by another reduction of 50 bps in December, ending the year at 4.50%.

On October 2, the Senate passed the social security reform in a first vote, with 56 votes for and 19 against. Of the 78 amendments proposed by the opposition, only one has been approved: a cut of 81.7 billion reals, which puts the expected savings over the next 10 years at 702 billion reals. The final vote is scheduled for late October. The approval of this reform will allow the government to focus on fiscal reform and privatization, with the aim of reforming and stabilizing the public finances. In August, the budget deficit rose to -6.3% in total, and the primary deficit to -1.4%.

- **The first vote on social security reform in Brazil was approved. The second and final vote is scheduled for the end of October.**
- **The next reforms: taxation and privatization, with the priority of fixing the budgetary path and debt.**
- **Slight recovery in industrial production due to the performance of the mining industry.**

As for the Brazilian Real, in the run-up to the vote on the social security reform it lost ground to around 4.2 BRL/USD, but after the result of the vote it recovered to the 4.0 BRL/USD level.

1.2.11 Argentina

Economic forecasts continue to worsen

In the second quarter of the year, the Argentine economy contracted by -1.8% YoY (seasonally adjusted). Private consumption and imports continued to contract in the second quarter (-7.7% and -30%, respectively), while in the same period investment continued to contract by -18% YoY. The real adjustment and currency depreciation have boosted exports, which grew by around 7.5% in August. The unemployment rate rose 5 tenths in the second quarter to 10.6%. As a result, the recession has deepened: industrial production fell -6.4% to August and construction by -5.9%, while the consumer confidence index remains in pessimistic ground, at 42 points in September.

Given the worsening recession, we have revised our forecast for GDP growth down to -3.0% YoY for 2019. We are also pushing back the recovery beyond 2020, a year in which the economy is forecast to still see negative growth of -1.3% (see Table 1.2.11 and Charts 1.2.11-a and 1.2.11-b).

- **The expected contraction of Argentine GDP worsened to -3.0%.**
- **The strong depreciation of the Argentine peso since August (+28%) will bring inflation of more than 55% year-on-year.**
- **The first round of the general elections will take place on October 27, in a context of uncertainty.**

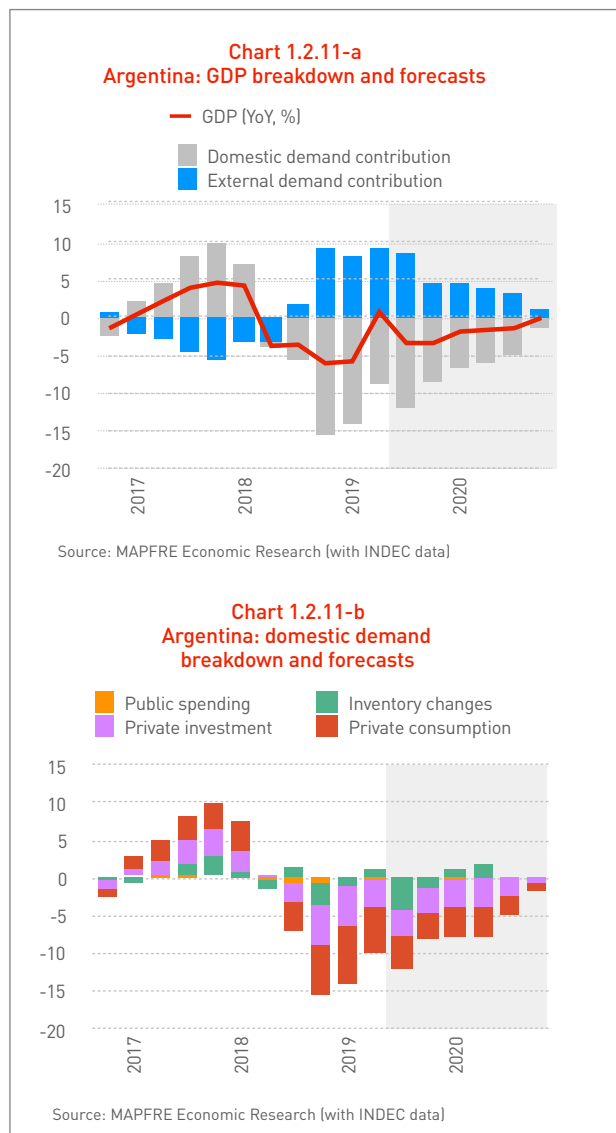
Table 1.2.11

Argentina: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	-2.5	2.7	-2.0	2.7	-2.4	-3.0	-1.3
Domestic demand contribution	-4.2	4.4	-1.6	6.4	-3.6	-10.7	-4.6
External demand contribution	1.7	-1.7	-0.4	-3.7	1.3	7.7	3.3
Private consumption contribution	-3.1	2.5	-0.5	2.9	-1.7	-5.5	-2.8
Private investment contribution	-1.2	0.7	-1.1	2.3	-1.1	-3.9	-2.6
Public spending contribution	0.4	0.9	-0.1	0.4	-0.4	-0.1	0.1
Domestic demand (% YoY, average)	-3.8	4.2	-1.5	6.0	-3.2	-9.8	-4.5
Total consumption (% YoY, average)	-3.2	4.1	-0.7	3.8	-2.6	-6.3	-3.2
Private investment (% YoY, average)	-6.6	3.4	-5.7	12.0	-4.5	-19.3	-15.8
Exports (YoY in %)	-6.8	-2.8	6.0	1.7	-0.4	8.2	4.2
Imports (YoY in %)	-11.2	4.9	6.1	15.3	-3.8	-20.9	-9.7
Unemployment rate (% , last quarter)	6.9	7.0	7.6	7.2	9.1	9.9	9.3
Inflation (% YoY, last quarter)	44.2	26.0	37.5	23.3	47.4	53.0	34.7
Fiscal balance (% of GDP)	-4.8	-5.9	-5.8	-5.9	-5.0	-4.5	-4.5
Trade balance (% of GDP)	1.0	-0.1	0.8	-0.9	-0.2	4.2	6.3
Fiscal stimulus (% of GDP)	-3.2	-3.9	-4.1	-3.7	-2.2	-0.3	-0.5
Current account balance (% of GDP)	-1.6	-2.7	-2.7	-4.9	-5.1	-1.4	0.5
Official interest rate (end of period)	25.33	33.00	24.75	28.75	59.25	85.52	27.00
Short-term rate (end of period)	27.27	23.50	26.23	27.44	56.76	75.17	26.10
Long-term rate (end of period)	9.36	6.65	7.00	5.91	10.86	22.22	8.88
Exchange rate vs. USD (end of period)	8.55	13.04	15.89	18.65	37.70	60.48	82.14
Exchange rate vs euro (end of period)	10.38	14.20	16.75	22.37	43.17	65.90	91.75
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (% , average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: MAPFRE Economic Research (based on INDEC data)
Forecast end date: October 16, 2019.

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Inflation continues to be out of control, aggravated by the strong currency depreciation (54.5% YoY in August). We expect it to end the year at around 53%. The Central Bank's benchmark interest rate, the 7-day LELIQ, stood at 68% on the date of the report. Official rates should remain high to stabilize the currency and finance its current account deficit.

Moreover, the Argentine peso has not managed to return to the levels seen before the Primaries in August. Instead, it is gradually losing ground at the same time as forecasts are continuing to deteriorate. September closed at 57.6 ARS/USD and we expect it to be around 65 ARS/USD by the end of 2019, and 88 ARS/USD by the end of 2020.

The presidential elections in Argentina will take place on October 27, with a potential runoff on November 24. Alberto Fernández is the favorite after having beaten Mauricio Macri in the primaries by more than 15 points. This situation is having an impact on confidence, investment flows and, ultimately, the currency. The government chosen in the October elections should seek to align itself with the requirements of the IMF aid program and with the interests of foreign private creditors. If this does not happen, the administration could again demand high levels of public debt write-offs, negotiations that could be lengthy and that would prevent an economic recovery in the short-term. In this case, the government would have to resort to financing by the Central Bank, with the adverse outcomes already experienced in the past.

1.2.12 China

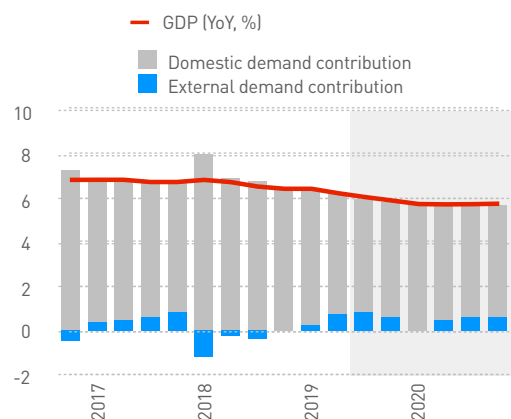
Uncertainty about the trade agreement

China's economy grew by 6.2% in the second quarter of the year, demonstrating a certain degree of resilience to difficulties. The government has implemented a successful program of measures to stimulate domestic demand and counteract the slowdown in the foreign sector caused by the trade war (reduction in taxes and boost of credit to the private sector). However, despite the pre-agreement reached between the United States and China, uncertainty regarding possible future trade tensions remains.

- **The United States and China reached a pre-agreement on trade. Despite this, uncertainty remains.**
- **Internal stimulus policies will continue to cushion the now inevitable global slowdown.**

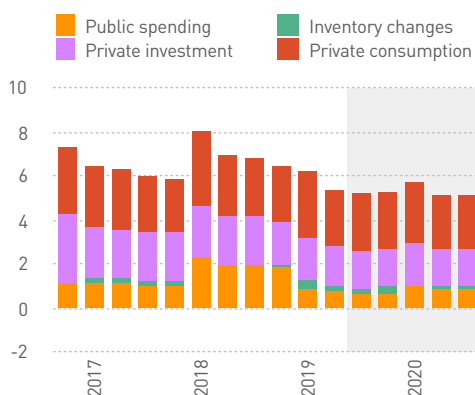
In August, there was an upturn in the Caixin/Markit composite PMI index and in September this was also seen in the index for the manufacturing sector, both in the expansion zone (51.6 and 51.4, respectively). However, a slowdown is expected in the fourth quarter due to the worsening tariff war. At the moment, the Chinese economy is overcoming the trade war, aided by stimuli and exports to other countries in Asia and Latin America. Given the global slowdown, an impact on foreign demand for manufactured products is expected. In this environment, and considering the fiscal and monetary stimuli applied by the Chinese government, MAPFRE Economic Research forecasts a slowdown in the coming years, with GDP growth of 6.1% in 2019 and 5.7% in 2020 (see Table 1.2.12 and Charts 1.2.12-a and 1.2.12-b). The risks to these forecasts, however, consist mainly of an aggravation of the tariff war and a reduction in investment by industry due to the uncertainty created.

Chart 1.2.12-a
China: GDP breakdown and forecasts



Source: MAPFRE Economic Research (with BoPRC data)

Chart 1.2.12-b
China: domestic demand breakdown and forecasts



Source: MAPFRE Economic Research (with BoPRC data)

Table 1.2.12
China: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	7.3	6.9	6.7	6.8	6.6	6.1	5.7
Domestic demand contribution	5.7	6.9	7.3	6.1	7.1	5.5	5.3
External demand contribution	1.6	0.0	-0.6	0.6	-0.5	0.6	0.4
Private consumption contribution	3.1	3.1	3.1	2.6	2.9	2.7	2.6
Private investment contribution	2.2	3.3	3.1	2.2	2.1	1.8	1.7
Public spending contribution	0.4	0.9	1.1	1.1	2.0	0.7	0.9
Domestic demand (% YoY, average)	7.1	7.1	7.5	6.2	7.2	5.6	5.4
Total consumption (% YoY, average)	7.1	8.0	8.5	7.2	9.4	6.5	6.5
Private investment (% YoY, average)	6.9	7.3	6.7	4.8	4.7	4.0	4.0
Exports (YoY in %)	5.4	0.4	1.9	6.9	4.4	2.0	2.1
Imports (YoY in %)	7.7	0.5	3.2	8.2	6.6	0.1	2.6
Unemployment rate (% last quarter)	4.1	4.1	4.0	3.9	3.8	3.6	3.6
Inflation (% YoY, last quarter)	1.5	1.5	2.2	1.8	2.2	3.2	2.7
Fiscal balance (% of GDP)	-1.8	-3.4	-3.8	-3.7	-4.2	-4.3	-4.7
Trade balance (% of GDP)	4.2	5.3	4.4	3.9	2.9	3.1	3.0
Fiscal stimulus (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	2.3	2.8	1.8	1.6	0.4	0.9	0.8
Official interest rate (end of period)	4.96	2.32	2.59	3.09	3.07	2.55	2.64
Short-term rate (end of period)	5.75	3.05	4.25	5.53	3.70	2.85	2.97
Long-term rate (end of period)	3.63	2.82	3.05	3.91	3.26	2.90	3.02
Exchange rate vs. USD (end of period)	6.20	6.49	6.94	6.51	6.88	7.22	6.98
Exchange rate vs euro (end of period)	7.53	7.07	7.32	7.80	7.87	7.87	7.80
Private lending (% YoY, average)	13.4	14.8	13.3	10.5	12.0	12.4	11.0
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (% average)	39.7	39.3	38.3	38.6	38.3	38.9	39.2

Source: MAPFRE Economic Research (based on BoPRC data)
Forecast end date: October 16, 2019.

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Moreover, it is expected that the Chinese government could adjust the intensity of the monetary and fiscal stimuli, due to stable inflation (2.8% in August) and the outlook of a slowdown in activity levels. This will be achieved by decreasing the medium-term credit facility (which refers to bank loans), lowering the reserve requirement and increasing investment in infrastructure.

The Yuan (CNY) depreciated again in August and September, from 6.9 to 7.1 CNY/USD. The continuation of the trade war means that greater depreciation cannot be ruled out, although in our scenario the Yuan will end the year at around 7.2 CNY/USD.

1.2.13 Indonesia

The economy will accelerate again in 2020 and 2021

The Indonesian economy grew by 5.0% in the second quarter of 2019, confirming a gradual slowdown in keeping with the cycle of raw materials, specifically palm oil and coal, in the context of a global slowdown. This slowdown has been seen in exports, which have contracted in the last two quarters. In turn, import constraints imposed have led to a slowdown in infrastructure investment. However, consumption, government spending and investment remain strong. The outlook for 2020 and 2021 is for an upturn in the economy. On the agenda of the country's president,

- **The project to build a new capital in Indonesia is an important milestone for the coming years.**
- **The economy will accelerate with the expected growth of investment in infrastructure.**
- **The central bank may lower rates, taking advantage of the global monetary policy trend.**

Joko Widodo, is ambitious infrastructure development projects, including the construction of a new capital.

Indonesia is not immune to the global slowdown, the effect coming mainly through commodity prices, but the country's economy is less exposed to trade than other Asian economies. As a result, according to MAPFRE Economic Research, in 2019 the economy is expected to grow by 5.0%; a growth rate very similar to that expected for 2020 and 2021 (see Table 1.2.13 and Charts 1.2.13-a and 1.2.13-b).

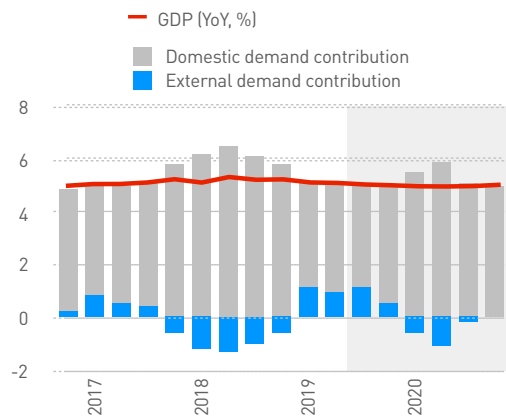
Moreover, inflation, standing at 3.4% in September, is stable and in the central bank's target range (2.5-4.5% for 2019 and 2.0%-4.0% for 2020). We therefore forecast that inflation will continue to be under control as a result of the absence of pressure on energy prices.

In relation to monetary policy, after having raised interest rates last year by 175 bps (to 6.0%), there have been three consecutive reductions (July, August and September) this year, to stand at 5.25%. These policies are in keeping with those taken by other central banks and are expected to have a positive impact on Indonesia's growth. However, it would be desirable for the country to maintain an attractive interest rate spread in order to attract direct foreign investment and finance a current account balance that will remain high thanks to investment in infrastructure and strong domestic demand.

In addition to the project for the new capital and the infrastructure plan, Indonesia is seeking to increase its exposure to global supply chains. This is due to the Asian country's need to balance its high import need with exports. The Indonesian government has already secured direct investment commitments in the electric vehicles, electronic products and textiles sectors.

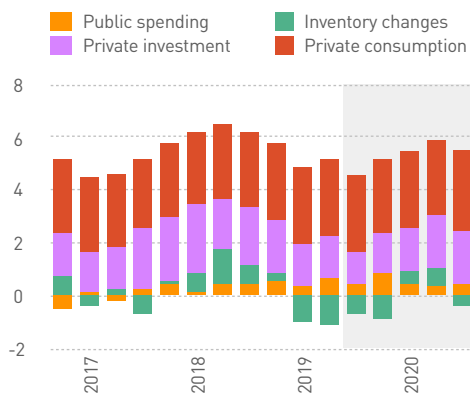
The trade war between the United States and China is not affecting Indonesia significantly or directly, it being able to capture part of the new direct

Chart 1.2.13-a
Indonesia: GDP breakdown and forecasts



Source: MAPFRE Economic Research (with BPS data)

Chart 1.2.13-b
Indonesia: domestic demand
breakdown and forecasts



Source: MAPFRE Economic Research (with BPS data)

Table 1.2.13
Indonesia: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	5.0	4.9	5.0	5.1	5.2	5.0	4.9
Domestic demand contribution	4.6	3.9	4.9	4.8	6.2	4.1	5.4
External demand contribution	0.4	0.9	0.1	0.3	-1.0	1.0	-0.4
Private consumption contribution	2.9	2.7	2.8	2.8	2.8	2.9	3.0
Private investment contribution	1.0	1.6	1.5	2.0	2.2	1.5	2.0
Public spending contribution	0.1	0.5	-0.0	0.2	0.4	0.5	0.5
Domestic demand (% YoY, average)	5.3	4.0	5.0	4.8	6.3	4.1	5.4
Total consumption (% YoY, average)	4.7	4.9	4.4	4.6	5.1	5.5	5.4
Private investment (% YoY, average)	4.5	5.0	4.5	6.1	6.7	4.5	6.0
Exports (YoY in %)	1.3	-2.1	-1.6	9.0	6.5	-4.4	2.3
Imports (YoY in %)	2.2	-6.2	-2.4	8.1	12.2	-9.1	4.8
Unemployment rate (% , last quarter)	5.9	5.8	5.5	5.3	5.2	4.8	4.5
Inflation (% YoY, last quarter)	6.5	4.8	3.3	3.5	3.2	3.5	3.4
Fiscal balance (% of GDP)	-2.2	-2.6	-2.5	-2.6	-1.7	-2.1	-2.3
Trade balance (% of GDP)	0.8	1.6	1.6	1.9	-0.0	0.1	0.5
Fiscal stimulus (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-3.1	-2.0	-1.8	-1.6	-3.0	-2.73	-2.50
Official interest rate (end of period)	6.50	6.25	4.75	4.25	6.00	5.00	5.01
Short-term rate (end of period)	7.17	8.86	7.46	5.48	7.70	6.05	6.44
Long-term rate (end of period)	7.86	8.81	7.85	6.30	7.90	7.23	7.31
Exchange rate vs. USD (end of period)	12,427	13,836	13,525	13,484	14,380	14,350	14,068
Exchange rate vs euro (end of period)	15,088	15,063	14,257	16,171	16,465	15,634	15,715
Private lending (% YoY, average)	15.2	10.6	7.8	8.2	10.8	10.3	10.7
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	3.6	32.0	10.1	15.1	5.6	1.6	7.9
Savings rate (% , average)	17.0	17.0	17.0	17.0	17.1	17.1	17.0

Source: MAPFRE Economic Research (based on BPS data)
Forecast end date: October 16, 2019.

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investment. However, it could be affected through the capital markets if there is a risk event affecting investor appetite in the region.

1.2.14 Philippines

Growth is returning to its path

The Philippine economy is growing at a rate of under 6% in 2019. It has grown by 5.5% during the second quarter of the year, mainly because of the slump in public investment in infrastructure at the beginning of the year (0.6% QoQ in the first quarter), as well as the mid-term elections in May. In the second quarter, public investment has rebounded (1.4% QoQ), and a greater rebound is expected for the rest of the year. This will see a return to the growth rate of 1.5% per quarter. However, investment in both equipment and housing continued to slow down due to the inertia of high financing costs.

As a result of the May elections, there was a postponement of public spending that led to a slowdown in household consumption to 5.5% in the first quarter, and public consumption fell to 6.9% (from 7.4%).

- Domestic demand remains strong.
- The central bank lowered interest rates to 4.0% and bank reserve requirements to 15%.
- The low participation of the Philippine economy in global supply chains partially insulates it against the global slowdown and the main effects of the trade war.

The trade balance has spent years with a worsening deficit due to strong domestic demand for imports of equipment and manufactured products and the absence of a strong export industry like that in other countries in the region. In 2019, however, this decline was halted thanks to the fall in the price of oil imports and the postponement of capital goods imports as a result of the temporary freeze on public expenditure. In light of this situation, if it wants to avoid the deterioration of its current account the Philippines must find a formula that strengthens its industry in a context of growing domestic demand and focus on exports.

Consumer and business confidence has picked up, except for construction, suggesting that the underlying trend is one of recovery. The fact that the Philippines is less integrated into global supply chains has prevented it from taking advantage in the past, but it also makes it more resilient to the effects of the ongoing global slowdown. In this context, at MAPFRE Economic Research we forecast growth in the Philippine economy of 5.6% in 2019 due to the poor start to the year, but growth will return to its path in 2020 (5.8%) if there are no further disruptions in emerging markets and currencies (see Table 1.2.14 and Charts 1.2.14-a and 1.2.14-b).

As for inflation, it has suffered a sharp fall over the last 12 months to 1.7% in August, thanks to less pressure on food (mainly rice) and fuel. The central bank has revised its inflation forecast to 2.5% for 2019 and 2.9% for 2020 and 2021. Following its September meeting, the central bank lowered the monetary policy rates (*overnight reverse repo*) by 25 bps to 4.00%. With this, the cumulative reduction is 75 bps this year. The governor of the monetary authority expressed his desire to reverse the 175 bps rise seen in 2018. The next day, the central bank lowered the required reserve ratio (RRR) for banks by 100 bps to 15%, with a cumulative reduction of 300 bps this year.

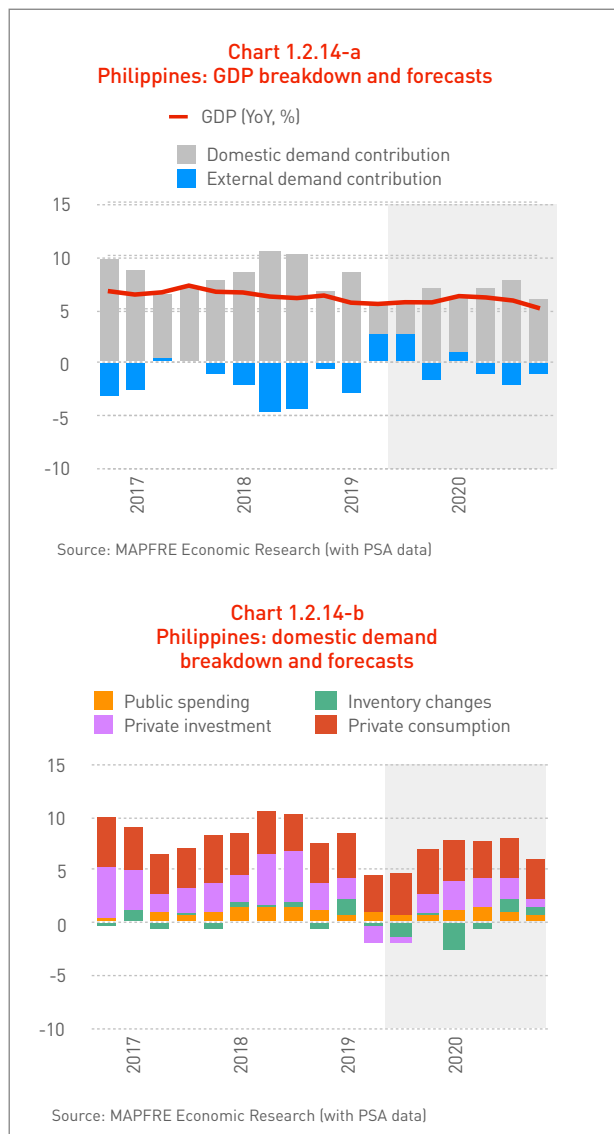


Table 1.2.14
Philippines: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	6.1	6.0	6.9	6.7	6.2	5.6	5.8
Domestic demand contribution	4.8	9.1	11.9	7.4	9.0	5.3	6.6
External demand contribution	1.3	-3.0	-5.0	-0.7	-2.8	0.3	-0.8
Private consumption contribution	3.9	4.4	4.9	4.1	3.8	4.1	3.7
Private investment contribution	1.1	3.6	6.2	2.7	3.7	0.4	2.1
Public spending contribution	0.3	0.8	0.9	0.6	1.4	0.8	1.1
Domestic demand (% YoY, average)	5.0	9.0	11.5	6.8	8.4	4.7	6.0
Total consumption (% YoY, average)	5.2	6.5	7.4	5.9	6.6	6.1	6.0
Private investment (% YoY, average)	7.2	16.6	26.6	9.4	13.2	1.4	7.1
Exports (YoY in %)	12.6	8.7	11.7	19.7	13.4	4.6	4.7
Imports (YoY in %)	10.1	14.6	20.5	18.2	16.0	3.7	5.2
Unemployment rate (% , last quarter)	6.0	5.6	4.7	5.0	5.1	5.5	5.3
Inflation (% YoY, last quarter)	2.9	0.3	2.0	3.0	5.9	1.9	3.0
Fiscal balance (% of GDP)	-0.6	-0.9	-2.4	-2.2	-3.2	-2.5	-3.0
Trade balance (% of GDP)	-6.1	-8.0	-11.7	-12.8	-15.4	-14.9	-15.3
Fiscal stimulus (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	3.8	2.5	-0.4	-0.7	-2.6	-2.2	-2.4
Official interest rate (end of period)	4.00	4.00	3.00	3.00	4.75	3.76	3.77
Short-term rate (end of period)	3.09	3.03	2.50	3.22	5.03	4.08	4.13
Long-term rate (end of period)	4.37	4.10	4.63	5.70	7.05	4.36	4.45
Exchange rate vs. USD (end of period)	44.62	47.17	49.81	49.92	52.72	52.89	51.92
Exchange rate vs euro (end of period)	54.17	51.35	52.51	59.87	60.37	57.63	58.00
Private lending (% YoY, average)	18.0	13.2	15.3	18.0	17.0	10.0	14.2
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	8.8	2.6	8.7	9.2	10.2	6.8	8.8
Savings rate (% , average)	9.3	7.7	7.8	8.1	7.7	7.4	8.7

Source: MAPFRE Economic Research (based on PSA data)
Forecast end date: October 16, 2019.

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Toward the end of the year, with inflation unexpectedly falling and central banks around the world relaxing their monetary policies, we expect there to be an additional reduction of 25 bps to the end of the year to place them at 3.75%.

2. Industry outlook

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

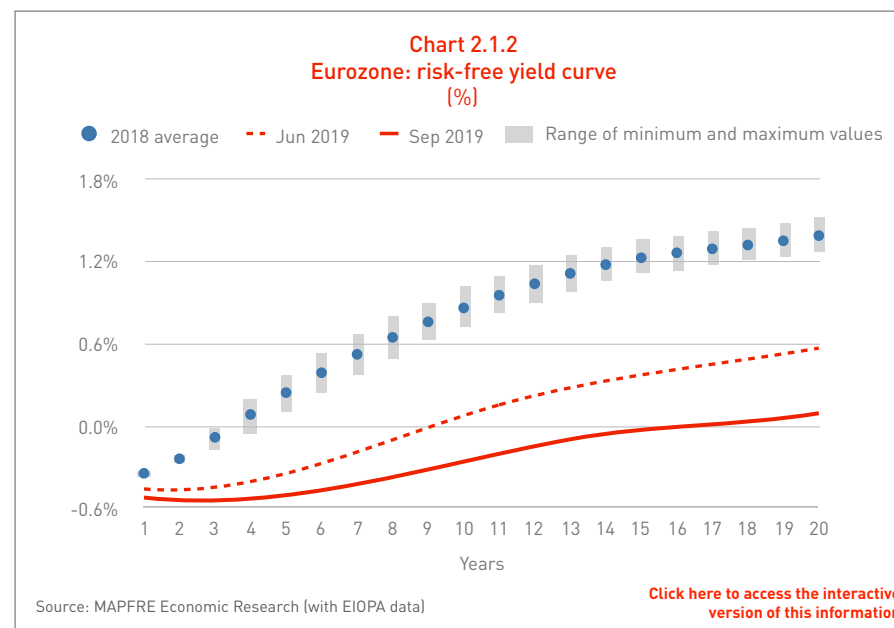
2.1.1 Global markets

The current economic situation suggests a greater slowdown in world growth than expected, below 3% on average for this year and next year, compared to 3.6% growth in 2018. This slowdown in economic growth, together with the implementation of accommodative monetary policies by most of the monetary authorities, will end up affecting the growth of global insurance premiums. The messages from the main central banks, which point to additional interest rate cuts, could be a stimulus for the Life savings and annuities business in the short-term in those economies where levels are still relatively high, but in the end they will be a negative factor for this type of business.

2.1.2 Eurozone

We forecast real GDP growth in the eurozone for 2019 of around 1.1%, a reduction of two tenths compared to the previous quarter's forecast and a notable slowdown compared to the growth of 2018 (1.9%), in line with the trend that began in 2017 (2.7%). The slowdown in world trade, the growth rate in the second quarter of 2019 and the confidence indicators, which

have been worsening in recent months, are causing this downward revision of the forecasts. This slowdown in the eurozone will eventually be reflected in the growth of the insurance business, especially the Non-Life and Life risk business lines.



Low inflation and weak economic growth led the European Central Bank (ECB), at its September 12 meeting, to lower the deposit facility rate by 10 basis points (bps) to -0.50% (with a system that is implemented in tranches to limit the negative impact on the profitability of financial intermediaries) and to reactivate, for as long as necessary, the purchase program at a monthly pace of 20 billion euros as from November 1. This is in addition to the unconventional accommodative monetary policy measures adopted in the previous quarter, with a two-year liquidity program for the banks at an interest rate of ten basis points above the average rate applied to the main financing operations (TLTRO III).

The risk-free yield curves as on September produced by the European Insurance and Occupational Pensions Authority (EIOPA) show a further fall in interest rates along the curve, to levels significantly below those seen in the previous quarter and a long way from the minimum levels in 2018 (see Chart 2.1.2). The curve shows negative values for all curve maturities shorter than 20 years, which in practice hinders the development of the Life savings and annuity business lines. However, the Euro Stoxx 50 index has risen by 18.9% in the year to date, which, together with the environment of depressed interest rates, can favor the development of Life insurance products in which the policyholder assumes the risk of the investment.

The aforementioned Chart 2.1.2 shows the minimum, average and maximum levels reached in 2018, along with the level of the latest curves published by EIOPA for June and September 2019.

2.1.3 Germany

In Germany, the forecast for real GDP growth has been lowered by four tenths, to around 0.6% in 2019 (1.6% in 2018). The notable economic slowdown that took hold in the second half of last year, and which for the time being comes from the industrial sector, is continuing. The slowdown could end up negatively affecting domestic consumption and the growth of the Non-Life and Life risk business lines in the insurance market. The labor market and salaries remain strong for now and disposable income has improved in an environment of low inflation, which could soften the impact on the growth of the insurance business. However, there is considerable uncertainty about the impact on industry and employment in Germany of trade tensions and the potential imposition of tariffs on European exports to the United States.

As for Life savings and traditional annuity insurance, the low interest rate outlook continues, which will continue to weigh on this business, particularly in Germany where sovereign debt has the lowest interest rates in the eurozone.

2.1.4 Italy

In Italy, the estimated real economic growth for 2019 is virtually non-existent (0.7% in 2018). The slight growth seen in the first half of the year, which meant that it technically avoided falling into recession, is due to the improvement in the performance of exports. However, economic growth remains endemic and its high level of public debt continues to be its main vulnerability. This low economic growth environment is unfavorable for the development of the insurance market's Non-Life and Life risk business lines, which are closely linked to economic growth.

With regard to Life savings and conventional annuity insurance, the risk premium for Italian sovereign debt has been relaxed following the

announcement of new unconventional monetary policy measures by the ECB, with a 10-year bond with returns that at the end of the second quarter of 2019 were around 1%. Although Italian sovereign debt with long maturities continues to offer a positive term premium higher than that of the rest of the large economies in the eurozone, this has been greatly reduced, so the interest rate environment is again unfavorable for the development of Life savings and conventional annuities products.

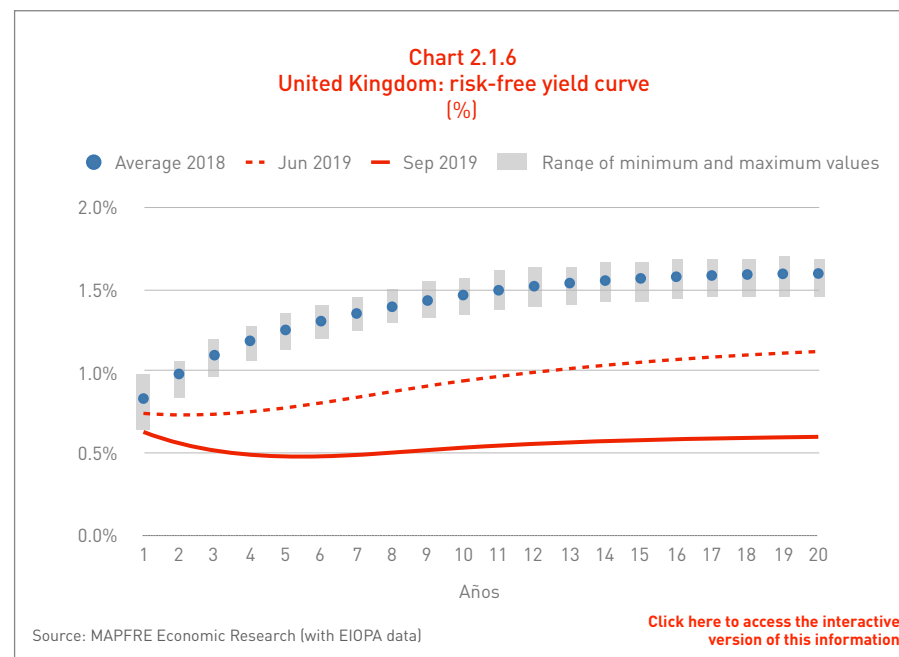
2.1.5. Spain

The Spanish economy continues to slow and real GDP growth in 2019 is forecast at around 2.0% (2.4% in 2018), a four-tenths decline from the forecast in the previous quarter. The slowdown in the second quarter affected consumption and private investment to a greater extent, although it was partly offset by growth in the contribution from the foreign sector. The inertia in the labor market is still a feature, but uncertainty could impact on the use of credit by families and businesses, with the savings rate increasing significantly in the second quarter. This slowdown in the economy has led to a worsening of the forecasts for the development of the insurance market's Non-Life and Life risk business lines, closely linked to the behavior of the economic cycle.

With regard to traditional Life savings and annuity insurance, the outlook of low interest rates that has been hampering this business still persists and will continue in line with the latest monetary policy measures and messages from the ECB.

2.1.6 United Kingdom

The uncertainty generated by exiting the European Union (EU) and international trade tensions continue to affect economic growth in the United Kingdom, which fell in the second quarter, taking the country to the brink of recession. The real growth forecast for 2019 could be around 1.3% (1.4% in 2018), far from the growth experienced in the years prior to the referendum on exiting the EU, whose terms are still being negotiated at this time with the aim being to reach an agreement by October 31 of this year. However, unemployment remains low (around 3.8%) and strong growth can be observed in actual salaries. This environment will influence the performance of the insurance sector, which may resist the slowdown in the economy, although uncertainty regarding growth is high.



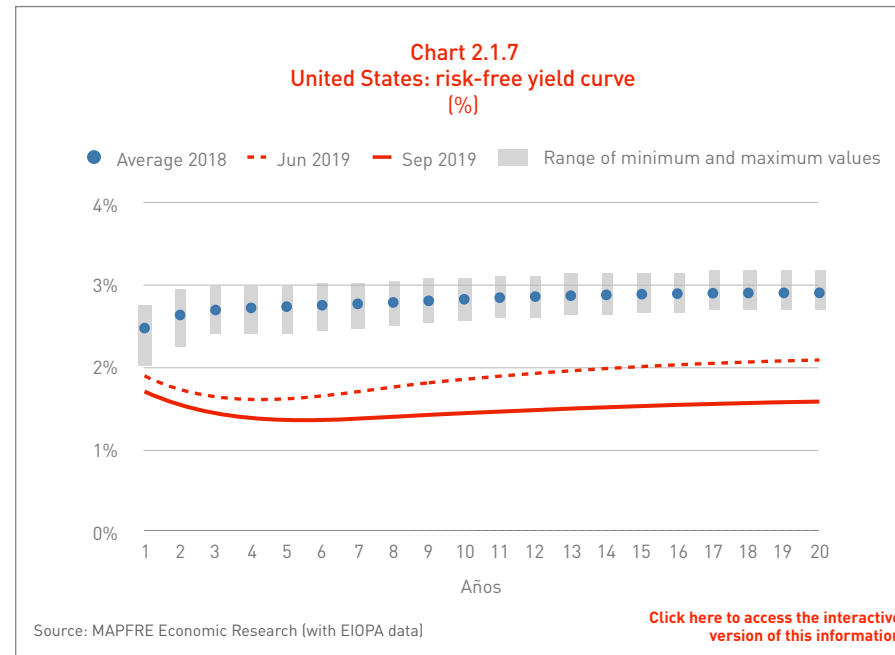
The depreciation of the pound seen throughout this process may negatively impact the profitability of the Non-Life business lines by increasing the cost of claims.

As for traditional Life savings and annuity insurance, the low interest rate outlook persists in the UK as well, and this will continue to weigh on this line of business. There is uncertainty about the direction monetary policy will take as this depends on the outcome of the negotiations and how they affect the exchange rate. However, in the risk-free yield curves of EIOPA (see Chart 2.1.6) we can see a new generalized fall in the level of interest rates in all sections of the curve compared to the previous quarter, increasing the reduction to stand below the minimum levels of 2018. The curve has inverted in its first section, up to five years. From there the curve has a slight positive slope, although there is no term premium for short-term rates and the levels are at a minimum, so the environment continues to be unfavorable for the development of these types of products.

In addition, the recovery of the stock markets, after the fall suffered at the end of 2018, may favor the development of insurance products in which the policyholder assumes the risk of the investment, which are widespread in this market. However, volatility is high and caution persists, stemming mainly from the weakness of the macroeconomic environment and the uncertainties generated by the UK's exit from the EU.

2.1.7 United States

The real GDP growth forecast for the US economy has been revised downward by three tenths to around 2.2% in 2019 (compared to 2.9% in 2018). The US economy experienced a slowdown in growth in the second quarter due to the slowdown in private investment and the poor performance of the foreign sector. Private consumption remains unaffected at the moment, supported by an unemployment rate at minimum levels and growth in actual salaries of around 2.9%, which



continues to boost disposable income and private consumption. This is in addition to the reduction in the cost of borrowing derived from the accommodative monetary policy implemented by the Federal Reserve. The environment therefore continues to be favorable for the Non-Life and Life risk businesses of the insurance industry, although the gradual slowdown expected throughout this year could translate into lower growth in these lines of business.

As for Life savings and annuity products, the favorable effect of economic growth may be negatively affected by interest rate behavior. The Federal Reserve agreed to lower interest rates twice in the second quarter, once in July and again in September, and announced in October that it will continue to intervene by injecting liquidity into the interbank market to

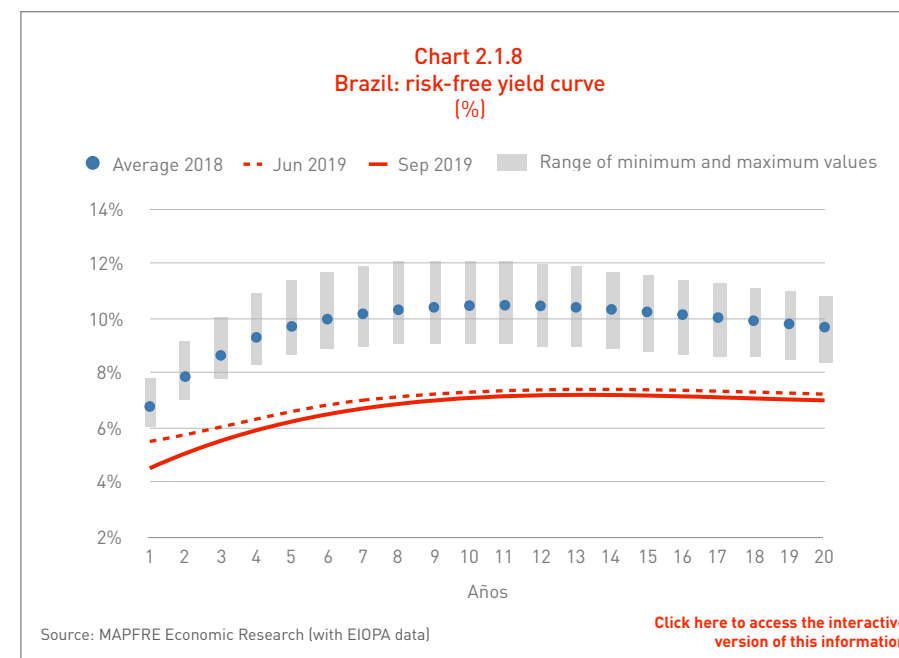
stabilize the repos market and maintain its interest rate within the official rate band. The latest EIOPA risk-free yield curves (see Chart 2.1.7) show another fall in all of the curve's sections compared to their level at the end of the previous quarter, falling a long way below the 2018 lows in all sections. The curve continues to have a negative slope at terms of less than five years. Expectations of new rate cuts could stimulate demand for savings products in the short-term, but it is bad news for the future of the Life savings business, especially for those offering interest rate guarantees in the medium- and long-term.

In addition, the stock markets have recovered from the falls suffered at the end of 2018 and remain strong, which is good news for the development of insurance products in which the policyholder assumes the investment risk. Despite this, the high levels they present mean that there may be some caution when investing in this type of product, taking into account the historical highs of the main stock market indices in the United States, in an environment in which indicators keep pointing toward a slowdown at a macroeconomic level.

2.1.8 Brazil

In Brazil, the indicators point to a slowdown, which has led us to lower our initial forecast for real GDP growth in 2019 to 0.8% (1.1% in 2018). Expectations of a global slowdown continue to reduce growth forecasts, and the strong imbalance in its public accounts persists. However, the government is managing to push through important structural reforms that may help to halt its deterioration in the medium-term, following the latest advances in the reform of the pension system which could be ratified by the Senate at the end of October. These downward revisions of the economic growth forecasts also worsen the growth prospects for the insurance market's Non-Life and Life risk insurance business. Inflation is controlled and continues to fall, which is positive for the performance of these business lines.

The control of inflation and the lack of pressure to maintain exchange rates, in an international environment of generalized accommodative monetary policies, has allowed the Brazilian central bank to make a slight cut to the monetary policy benchmark interest rate in order to stimulate the economy. In the EIOPA curves (see Chart 2.1.8), we can see that the risk-free interest rates fall slightly along the entire curve but their positive slope has increased. This favors the development of the Life savings and annuity insurance business by being able to offer guaranteed medium- and long-term rates that are higher than the short-term rates. While interest rates for all maturities are at relatively low levels (compared to those seen in previous years), additional reductions by the monetary authority to continue supporting economic growth have not been ruled out. This may imply that we will start to see improvements in the environment for

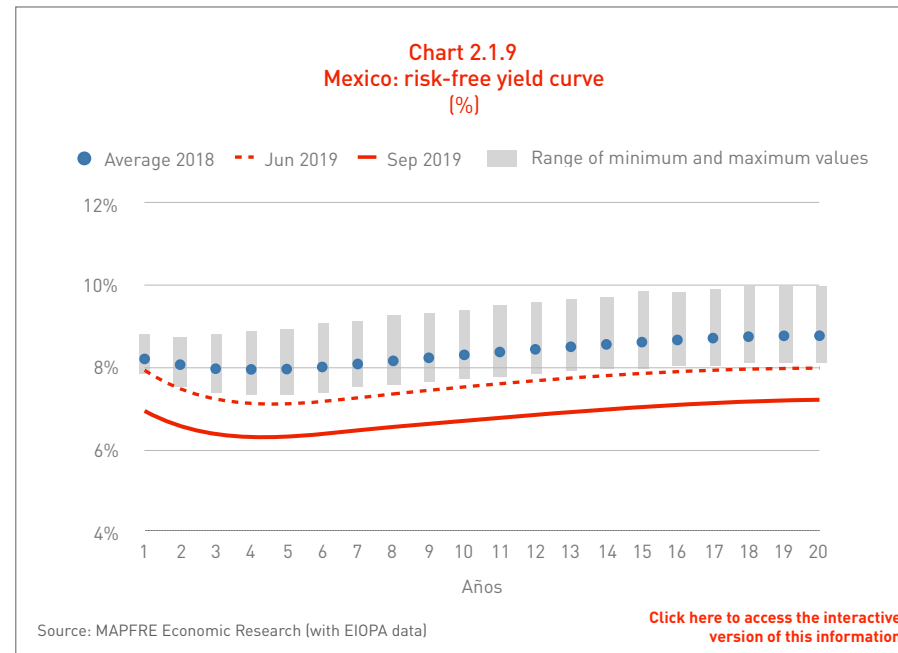


marketing new products for these business segments which have been adversely affected in recent quarters by the sharp reductions in interest rates.

2.1.9 Mexico

The Mexican economy has not yet managed to recover, having zero growth in the second quarter, after the slowdown in the previous quarter, which leads us to forecast real growth for the Mexican economy in 2019 of around 0.3% (2% in 2018), with a downward revision for the year as a whole of one percentage point, a situation that should improve in 2020. The reduction in inflation and the pressure on the exchange rate (thanks to the looser monetary policy in the United States) is allowing the Bank of Mexico to relax its monetary policy, seeking to stimulate its economy. At the moment, the economic slowdown could end up feeding through to the insurance market, especially to the Non-Life and Life risk business segments given their strong link to economic behavior. However, the fact that inflation is moderating and exchange rates are performing strongly against the dollar is good news for the profitability performance of the Non-Life business lines (which were negatively affected by the upturn in previous months), the positive effect on claims expenses and the cost of reinsurance coverage.

In the EIOPA curves (see Chart 2.1.9) we can see a fall in all sections of the curve at the end of September 2019 compared to the level seen in June, falling below the minimum levels of 2018, in all sections. The curve continues to have a slightly negative slope in maturities of less than four years. Despite this fall, this environment continues to be favorable for the marketing of Life savings and annuity products, which take advantage of long-term rate levels, as well as temporary Life savings products renewable for periods of less than a year, which allow for the guaranteed rate to be reviewed at each renewal. The positive impact that this could have on the economy and the expectations that interest rates will continue to fall could help to market this type of product.



2.1.10 Argentina

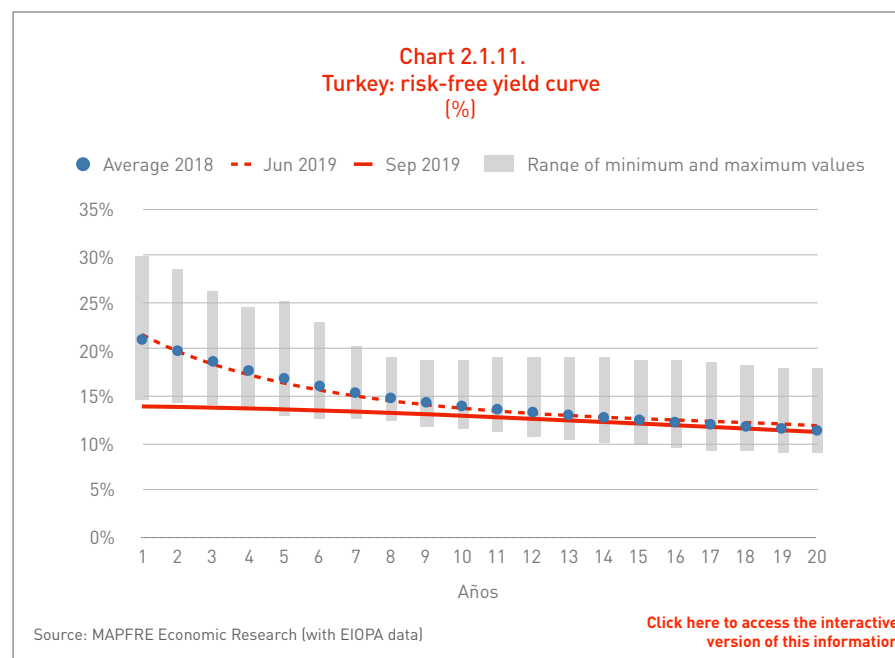
The forecast for the Argentine economy in 2019 is a reduction in GDP in real terms of -3% (-2.4% in 2018), which is a significant worsening of the forecasts. This also extends to the following year and is the result of the poor performance of inflation and exchange rates, which are still out of control. This recessive environment, which is worsening, negatively affects the development of the insurance business, especially Non-Life and Life risk lines. Difficulties in curbing inflation, 54.4% year-on-year in July, will have a negative impact on the claims costs of insurance companies that are unable to take full advantage of the high interest rates of monetary policy to shore up the financial profitability of these lines of business. This is due to the regulatory limits imposed on insurance companies for investments in short-term public debt instruments. This interest rate environment could also be an opportunity to market annual temporary Life savings insurance products that are renewable with short maturity terms, offering a renegotiation of the guaranteed rate for each maturity term. However, the aforementioned regulatory limits make the development of this kind of product difficult.

2.1.11 Turkey

Turkey has emerged from the recession it entered in the second half of last year and forecasts are improving, although growth is still weak. Real GDP growth is expected to be virtually zero in 2019 (compared to a corrected growth of 3.1% in 2018) and to start bouncing back next year. Its main vulnerability continues to be the high volume of dollar-denominated debt. The improvement in the situation has in recent months allowed for the partial relaxation of the strict monetary policy it was implementing to defend its exchange rate, although the geopolitical situation is causing it to become tighter again. This environment of weak growth will affect the development of the Non-Life and Life risk business lines of the insurance industry, which was also affected by the price control system in mandatory third-party liability automobile insurance. The inflation rate is moderating

and the currency has performed better due to the restrictive monetary policy measures adopted, so we see the continued moderation of the negative influence that the drop in these indicators entails in the cost claims for insurance companies. The monetary policy's still high interest rates may help compensate for these adverse effects, underpinning the financial profitability of these lines of business.

Moreover, as can be seen in the EIOPA risk-free yield curves, short-term interest rates are relaxing and the curve is flattening out, losing the notably inverted slope seen in previous quarters (see Chart 2.1.11). This high volatility environment and the slightly inverted interest rate curve is detrimental to the development of products with long-term guarantees in the Life savings and annuity business. However, the still high levels of



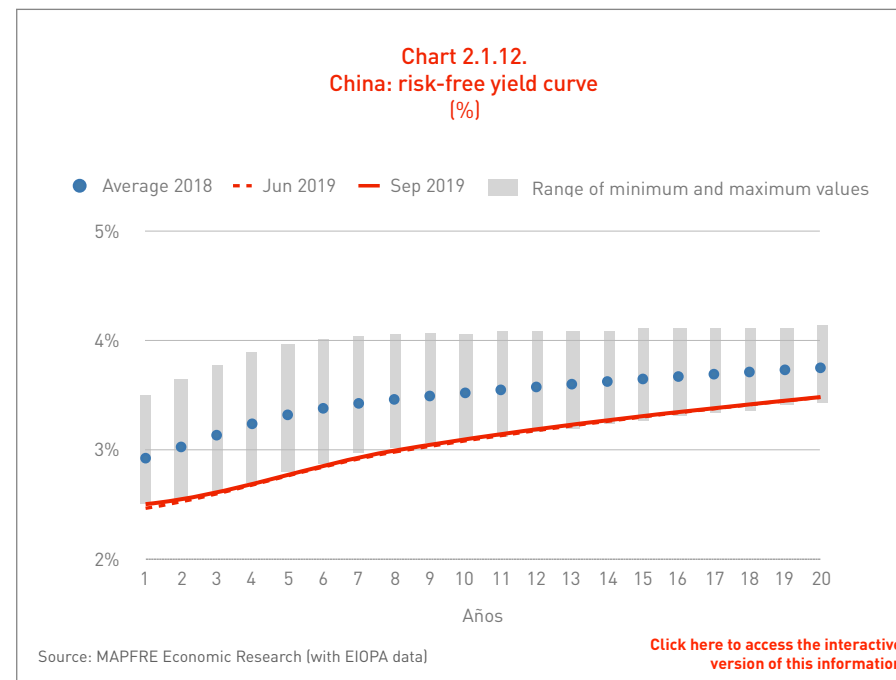
short-term interest rates continue to present a business opportunity for the marketing of renewable temporary Life savings products in short terms, which allow for the guaranteed rate to be reviewed at each renewal.

2.1.12 China

The forecast for the Chinese economy is for GDP growth of around 6.1% in 2019, in real terms, with no change compared to the forecast for the previous quarter (6.6% in 2018). The trade tensions with the United States, the slowdown in credit growth and the expected slowdown in global growth continue to point to a reduction in the real growth of its economy, which is expected to worsen in 2020.

The government's fiscal stimulus program to counteract the reduction in growth will continue to soften the slowdown. Despite the slowdown, growth forecasts remain positive for the Non-Life and Life risk insurance business in China, whose penetration rate is still far from the levels seen in the more developed economies.

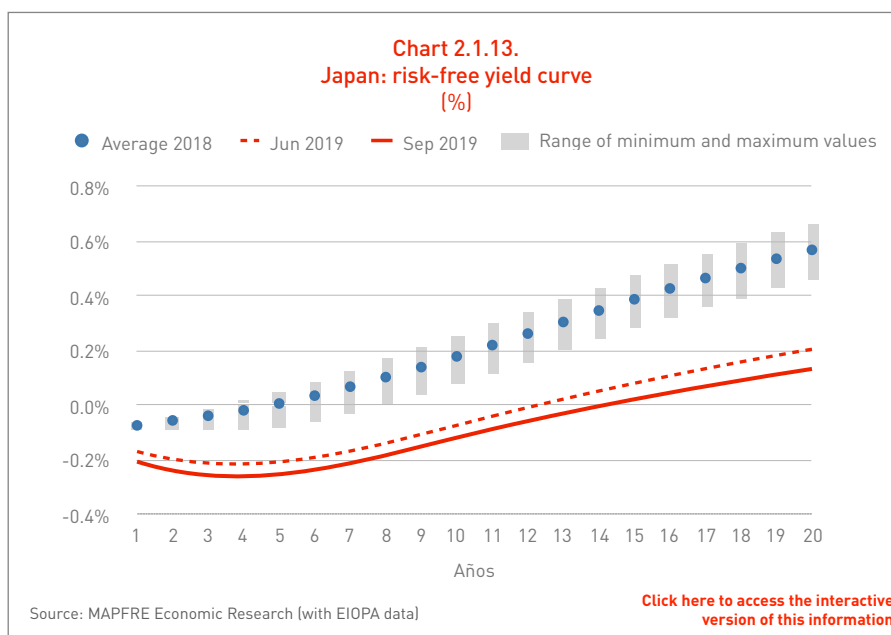
With regard to the Life savings and annuities businesses, the EIOPA curves (see Chart 2.1.12) show that risk-free interest rates are relatively unchanged, following a significant fall in 2018 due to the monetary stimuli applied to prevent an excessive slowdown of the economy. The curve is still showing a positive slope even though interest rates in all maturities are at low levels, compared to those seen in 2018, which makes it difficult to market new products for these business segments, although the expectation that they will continue to fall to avoid any greater slowdown in the economy, with inflation under control, could stimulate their development.



2.1.13 Japan

The real GDP growth forecast for the Japanese economy has been revised upward by three tenths, placing it at around 0.8% in 2019 (similar to its growth in 2018). At the moment consumption is driving growth, but exports and industrial production continue to deteriorate and the forecast is for growth to continue to weaken in the next few years, which means that the growth performance of the Non-Life and Life risk insurance business is also expected to be weak.

The EIOPA curves (see Chart 2.1.13) show that the fall in rates along the curve increased in the month of June compared to the level in the previous quarter. The curve is showing negative values for maturities of up to 12 years and the term premium from those maturities continues to be



depressed and has fallen again, which makes it very difficult to market Life savings and annuity products. This sustained context of low interest rates continues to be detrimental to the development of the specified lines of business.

2.1.14 Philippines

The forecast for the Philippine economy is GDP growth of 5.6% in real terms in 2019 (6.2% in 2018), a fall of two tenths compared to the forecast in the previous quarter. Growth is being driven by domestic demand, mainly from private consumption, which remains strong, as investment has shown little growth in the second quarter. The central bank has relaxed its monetary policy again, which may help restore investment growth. The trade deficit continues to show a downward trend since it is a strongly importing economy. In any case, the economic growth outlook is favorable for the prospects of the Non-Life and Life risk insurance business, with the help of the still low rate of insurance penetration in the Philippines. Inflation continues to moderate, which is good news for the profitability of these business lines as the growth in insurance companies' claims costs has moderated.

In addition, the easing of the restrictive monetary policy applied by the Central Bank has entailed an additional cut in the monetary policy benchmark rate to 4% (from 4.75% at the start of the year) and the yield on the ten-year sovereign bond, which stood at 7% in December 2018, is forecast to decline to levels around 4.4% at the end of 2019. This interest rate environment, with rate decreases expected and now materializing, along with the flattening of the risk-free yield curve, complicates the outlook for the Life savings and traditional annuity insurance business lines.

2.2 Regulatory trends

European Union

Risk and vulnerabilities in the financial system

Last August 26, the Joint Committee of the European System of Financial Supervision (EBA, ESMA and EIOPA) released its report on risks and vulnerabilities in the financial system of the European Union⁵. The report highlighted that the prospect of a weakened eurozone and world economy, trade tensions, a no-deal Brexit and the challenges associated with high levels of debt are the key concerns, which may have implications for financial stability. In addition to these risk factors, there is concern about higher-risk strategies in search of higher yields, implemented as a result of the prolonged low interest rate environment. Finally, it also refers to risks related to sustainable financing and environmental, social and governance (ESG) factors.

Risks related to a UK decision on exiting the European Union without a deal

A no-deal Brexit could result in strong corrections in financial markets, with increased risk premiums and a fall in asset prices. This could have negative repercussions for institutions that are significantly interconnected, particularly the Central Securities Depositories (CSDs) and Central Counterparty Clearing Houses (CCPs) in the United Kingdom.

Risks related to the low interest rate environment

The prolongation of the low interest rate environment, when it appeared that a slight recovery had been taking place, has led to the return of concerns among supervisory authorities about higher-risk strategies in search of higher returns, focusing on investments of lower liquidity, including unlisted shares and loans and lower credit quality fixed income securities. While the monetary policy response to weakening growth and inflation forecasts has helped to restore confidence in the financial markets in the short-term, in the medium-term the low-interest rate environment will encourage strategies of this type.



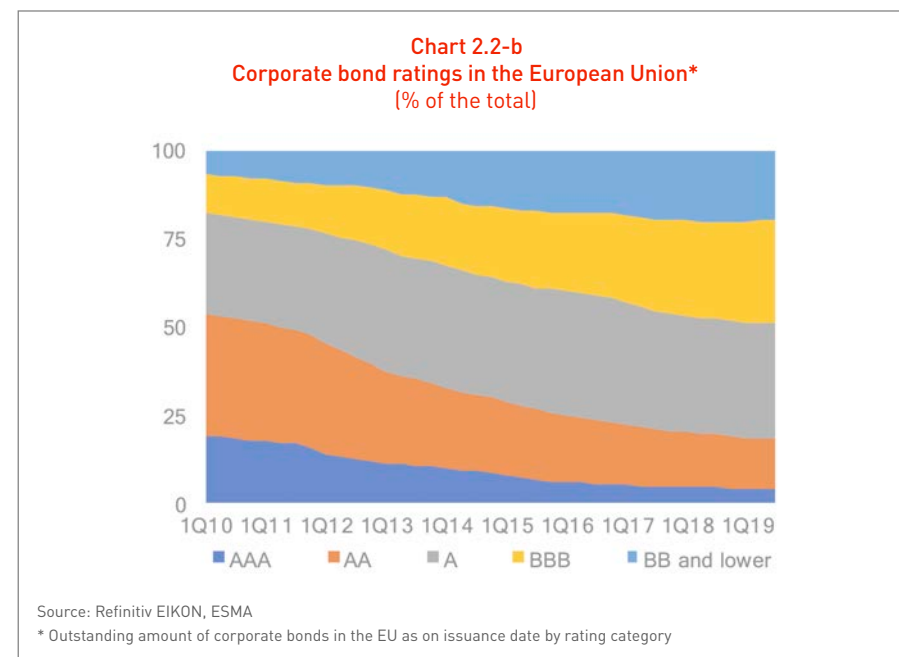
The report highlights the fact that the European bond spreads and forward *rates* have reduced again since the beginning of the year, driven by changes in monetary policy forecasts (see Chart 2.2-a). Corporate bond yields are around their historical minimums and had declined significantly as at the end of April by an average of 50 bps, and by 79 bps in the specific case of BBB-rated bonds.

Insurers invest heavily in government and corporate bonds, making them vulnerable to a sudden revaluation of risk premiums and an increase in credit spreads. Government and corporate bonds represent about two-thirds of the total investment portfolio, with Life insurers being the most dependent on fixed income assets due to the importance of the long-term asset-liability adequacy of their obligations.

Moreover, the report of the Joint Committee highlighted the context of a gradual deterioration in the credit quality of corporate bonds in circulation from EU issuers over the past decade (see Chart 2.2-b). While investment-grade issuing remains the norm, the proportion of outstanding BBB-rated bonds has increased from less than 10% in 2009 to almost 30% in 2019. This reflects a combination of ratings being lowered and the number of bonds being issued by companies with lower ratings increasing. As a result, the proportion of bonds rated as AAA fell from 19% in 2009 to less than 4% in 2019.

The report also refers to the market-related risks of leveraged loans and collateral obligations, given the lack of clarity as to their volume and the major holders of risks of many tranches of securitized debts (CLOs and CMOs).

For the insurance industry, the segment most affected is the Life insurance business, which depends on the performance of investments to cover the long-term obligations of insurance policyholders with guaranteed rates. Legacies from old portfolios with interest rate guarantees continue to constitute the bulk of the technical provisions in the European Economic Area (EEA), considering that approximately two thirds have a guaranteed interest rate. Insurance companies are trying to adapt by reducing guaranteed rates and focusing on products linked to investment funds in which the policyholder assumes the investment risk. However, these legacies continue to squeeze the profitability of these companies, especially those with greater misalignments in the durations of their portfolios.



The report also highlights that the European insurance industry remains well capitalized but the prolonged environment of low-interest rates continues to raise questions about its profitability, which has continued to deteriorate in 2018. The average yield on investments fell significantly in 2017 to only 1.95%, compared to 2.83% in 2016. In addition, the average return on surplus assets over liabilities fell from 5.6% in 2017 to 4.9% in 2018.

It also emphasizes that the European pension fund sector is being negatively affected by the persistence of low interest rates, especially defined benefit plans with long-term guarantees. Similarly, defined contribution plans, in which the investment risk rests with the participant, may be exposed to value losses through more risky investment strategies.

Risks related to sustainable financing and environmental, social and governance (ESG) factors

Climate change risks are often divided into two categories, physical risks and transition risks. The first relates to actual climate change resulting from the intensive use of fossil fuels, which disrupts the economy (flooding and other extreme weather phenomena) and affects the value of assets, while the second refers to risks resulting from an abrupt transition (whether political, technological or related to consumer demand) to a more sustainable economy with low carbon emissions.

These climate and sustainable financing-based risks are increasingly important in the international financial program, which is more aware that they can be mitigated by encouraging a timely and sustained transition. A disorderly transition could create a potentially disruptive scenario in terms of financial stability and create challenges for the viability of the long-term business model for institutions with high exposure to climate-sensitive sectors.

The revision of the Regulations of the European System of Financial Supervision has seen sustainable financing become a key consideration for those bodies. In carrying out their duties, the authorities will have to take into account risks related to ESG factors and provide guidance on how to incorporate sustainability considerations into relevant EU financial legislation and promote the consistent implementation of these provisions. Investors are also taking into account ESG criteria, alongside traditional financial factors, in their investment decision-making processes. This is reflected in the vigorous expansion of the still-emerging global green bond market.

According to the report, the European Investment Bank issued the first green bond in 2007 and, since then, its EU issuances have increased, reaching an outstanding balance of 210 billion euros in May 2019. Compared to the total issuance of bonds, they represent a limited but fast-growing global market share. According to a recent study on the sector, green bond issuances accounted for more than 2% of global bond issuances in the last two years, rising to 4.4% in the last quarter of 2018. As on January 2019, 36% of outstanding green bonds had been issued by the finance sector; around 20% by international organizations; and around 15% each by supranational, sovereign and non-financial institutions.

Financial institutions play an important role in ensuring a gradual transition to a more sustainable economy, ultimately contributing to avoiding any possible impact on financial stability. This is achieved not only through the incorporation of ESG factors into their investment decisions, but also through their commitment to economic agents through their business activities and the use of ESG risk-based pricing and underwriting practices.

In particular, EIOPA has analyzed the exposure of insurance companies' assets to climate change-related risks in order to assess the investments that could be at risk in a transition to a more carbon neutral economy. According to this analysis, up to 13% of the assets of the insurers could be vulnerable in a scenario of climate-related transition. This figure represents more than 1 trillion euros in assets and accounts for almost two thirds of total shareholders' equity of the EEA.

EIOPA's action plan on sustainable financing foresees the development and application of an analysis of climate-related risk scenarios. This analysis would be based on more detailed information at the asset level than the sector-related data available in Solvency II reports. In addition, EIOPA aims to make better use of the experience of insurers and reinsurers, data experts and the risk modeling sector to establish best practices for climate scenarios that insurance companies can use as part of a risk assessment under Solvency II, for example, in the Own Risk and Solvency Assessment (ORSA).

Statements were also made in the opinion published by EIOPA on September 30, 2019 on sustainability within Solvency II⁶. In this same vein, in June 2019, EIOPA launched a consultation on a draft report with the objective of integrating the risks of sustainability, in particular those related to climate change, into the investment and underwriting practices of insurance companies.

Adoption of measures recommended by the Joint Committee of the European System of Financial Supervision

Contingency plans. Financial institutions and supervisors should continue their work on contingency planning and ensuring business continuity in the event of a no-deal Brexit. EIOPA has urged insurance companies and national supervisors to develop contingency plans and to take any steps required to ensure service continuity in cross-border insurance contracts in the event that no Brexit deal is reached. EIOPA and its members have agreed Memorandums of Understanding with the relevant British authorities for the supervision of insurance companies and employment pension institutions, to ensure sound prudential supervision, conduct and financial stability in a situation where no deal is reached.

"Low rates for a long time." Supervisors and financial institutions should continue to take into account a scenario of low interest rates over the long-term and their associated risks. Low interest rates are an important factor in reducing bank profitability, remain the main risk for the insurance and pension fund sectors, and contribute to a greater accumulation of valuation risks in investment funds and securities markets, with a transition to less liquid and more highly leveraged investments through strategies seeking higher returns.

Bank profitability. It is necessary to continue to address the issue of unprofitable banks and their business models in order to increase the resistance of the institutions to a more difficult economic environment. Some of the responses to low profitability include other investments in financial technologies and exploring opportunities for the consolidation of the banking sector. In this sense, transparency and the consistent application of common prudential requirements and supervisory standards

in all jurisdictions are prerequisites that could help to take advantage of the opportunities offered by cross-border consolidation.

Market for leveraged loans. The risks related to the market for leveraged loans and collateral obligations in the financial sector should be further explored and identified. There is a lack of clarity about the total volume of outstanding leveraged loans and the major holders of risks of the different tranches of securitized debts (CLOs and CMOs). Supervisors have expressed their concern that the risks are not being adequately assessed, so the analysis of these risks should be enhanced.

Sustainable financing and ESG risks. Supervisory authorities and financial institutions should continue their efforts to identify exposure to climate-related risks and facilitate investor access to sustainable assets. Scenario analysis and stress testing are important tools that can be implemented by supervisors to incorporate sustainability considerations into the risk assessment. Financial institutions should incorporate climate risk and other ESG factors into their risk management framework, taking into account the impact of these factors on their activities. In the future, the European Supervisory Authorities should take a proactive stance in fulfilling the mandates on sustainable financing, including how these considerations can be incorporated into the regulatory and supervisory framework of EU financial institutions.

Solvency II

Review of the regulatory framework planned for 2020

On October 15, 2019, EIOPA launched a public consultation prior to the sending to the European Commission of its technical advice on the Solvency II review, scheduled for next year⁷. This is a long document that raises numerous issues affecting the main elements of the aforementioned regulatory framework, including various components of the risk-free interest rates relevant to the calculation of technical provisions.

In the opinion of EIOPA, the Solvency II framework is generally working well. Therefore, the focus has been on "evolution rather than revolution." The main issues raised relate to its supervisory experience, for example, in relation to cross-border operations, or the broader economic context, particularly in relation to interest rate risk, as explained by the institution itself.

Interested parties have until January 15, 2020 to submit their comments. Following an analysis of the replies received and the additional data collected in the coming months on their quantitative impact, EIOPA will draw up the final report to be sent to the Commission in June 2020.

Calculation of risk-free interest rates

Furthermore, EIOPA is in a transition process in relation to the main source of data to be used in the calculation of the relevant risk-free interest rates applicable for the valuation of the technical provisions, when determining the solvency ratio under the Solvency II regulations. This transition will be finalized for risk-free rates to be published from the end of January 2020 and will mean that the main provider of the necessary data will be Refinitiv, rather than Bloomberg⁸. As part of this process, from

the end of September and until the change is fully applicable, EIOPA will publish the relevant risk-free rates⁹ according to the information from both data providers, so that interested parties can compare the results obtained with both sources.

Emerging risks

Finally, it is worth highlighting the report published by EIOPA in September on the challenges and opportunities posed by cyber risks for the insurance industry¹⁰, based on the qualitative information obtained through a survey involving 42 large European insurance groups, in order to improve its understanding of these risks that are beginning to be insured and to which the insurance companies are exposed.

Tables: macroeconomic forecast scenarios

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

	Base Scenario						Risk Scenario					
	2015	2016	2017	2018	2019	2020	2015	2016	2017	2018	2019	2020
United States	2.9	1.6	2.4	2.9	2.2	1.6	2.9	1.6	2.4	2.9	2.2	1.1
Eurozone	2.0	1.9	2.7	1.9	1.1	1.1	2.0	1.9	2.7	1.9	1.1	1.0
Germany	1.5	2.1	2.8	1.6	0.6	0.7	1.5	2.1	2.8	1.6	0.6	0.6
France	1.1	1.2	2.2	1.5	1.3	1.3	1.1	1.2	2.2	1.5	1.3	1.1
Italy	0.8	1.2	1.8	0.7	0.0	0.2	0.8	1.2	1.8	0.7	0.0	0.1
Spain	3.8	3.0	2.9	2.4	2.0	1.7	3.8	3.0	2.9	2.4	2.0	1.6
United Kingdom	2.4	1.9	1.9	1.4	1.3	1.1	2.4	1.9	1.9	1.4	1.3	1.1
Japan	1.3	0.6	1.9	0.8	0.8	0.2	1.3	0.6	1.9	0.8	0.8	0.2
Emerging markets	4.3	4.6	4.8	4.5	4.3	4.4	4.3	4.6	4.8	4.5	4.3	3.9
Latin America ¹	0.3	-0.6	1.2	1.0	0.9	2.2	0.3	-0.6	1.2	1.0	0.9	2.0
Mexico	3.3	2.6	2.4	2.0	0.3	1.1	3.3	2.6	2.4	2.0	0.3	0.9
Brazil	-3.6	-3.3	1.1	1.1	0.8	1.7	-3.6	-3.3	1.1	1.1	0.8	1.6
Argentina	2.7	-2.0	2.7	-2.4	-3.0	-1.3	2.7	-2.0	2.7	-2.4	-3.0	-1.4
European emerging markets ²	4.8	3.3	6.0	3.6	0.8	2.8	4.8	3.3	6.0	3.6	0.8	2.6
Turkey	6.0	3.3	7.4	3.1	-0.0	2.5	6.0	3.3	7.4	3.1	-0.0	2.3
Asia Pacific ³	5.9	6.2	6.2	6.0	5.6	5.5	5.9	6.2	6.2	6.0	5.6	5.4
China	6.9	6.7	6.8	6.6	6.1	5.7	6.9	6.7	6.8	6.6	6.1	5.5
Indonesia	4.9	5.0	5.1	5.2	5.0	4.9	4.9	5.0	5.1	5.2	5.0	4.8
Philippines	6.0	6.9	6.7	6.2	5.6	5.8	6.0	6.9	6.7	6.2	5.6	5.7
World	3.4	3.4	3.8	3.6	3.0	2.9	3.4	3.4	3.8	3.6	2.9	1.4

Source: MAPFRE Economic Research

¹Argentina, Brazil, Chile, Colombia, Mexico, and Peru; ²Russia, Turkey, Community of Independent States (CIS) and Central Europe; ³Association of Southeast Asian Nations (ASEAN)
Forecast end date: October 16, 2019.

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

	Escenario Base						Escenario de Riesgo					
	2015	2016	2017	2018	2019	2020	2015	2016	2017	2018	2019	2020
United States	0.4	1.8	2.1	2.2	1.8	2.0	0.4	1.8	2.1	2.2	1.8	1.4
Eurozone	0.3	0.7	1.4	1.9	1.0	1.3	0.3	0.7	1.4	1.9	1.0	0.7
Germany	0.2	1.5	1.4	1.6	1.2	1.4	0.2	1.5	1.4	1.6	1.2	0.9
France	0.1	0.3	1.2	2.1	1.3	1.5	0.1	0.3	1.2	2.1	1.2	1.4
Italy	0.2	0.1	0.9	1.4	0.4	1.0	0.2	0.1	0.9	1.4	0.4	0.7
Spain	-0.3	1.0	1.4	1.7	0.4	1.4	-0.3	1.0	1.4	1.7	0.4	0.7
United Kingdom	0.1	1.2	3.0	2.3	1.9	1.7	0.1	1.2	3.0	2.3	1.9	1.5
Japan	0.2	0.3	0.6	0.9	1.3	0.4	0.2	0.3	0.6	0.9	1.3	-0.1
Emerging markets	4.6	4.2	4.5	5.0	4.7	4.6	4.6	4.2	4.5	5.0	4.6	4.5
Latin America ¹	6.2	4.6	5.9	7.1	5.6	4.9	6.2	4.6	5.9	7.1	5.4	4.6
Mexico	2.3	3.2	6.6	4.8	3.2	3.4	2.3	3.2	6.6	4.8	3.2	3.3
Brazil	10.4	7.0	2.8	4.1	3.3	3.7	10.4	7.0	2.8	4.1	3.3	3.4
Argentina	26.0	37.5	23.3	47.4	53.0	34.7	26.0	37.5	23.3	47.4	52.9	33.8
European emerging markets ²	3.9	4.2	6.8	10.2	8.3	7.4	3.9	4.2	6.8	10.2	8.1	7.2
Turkey	8.2	7.6	12.3	22.4	10.5	10.8	8.2	7.6	12.3	22.4	10.5	10.4
Asia Pacific ³	2.2	2.5	2.8	3.8	2.9	3.0	2.2	2.5	2.8	3.8	3.1	3.1
China	1.5	2.2	1.8	2.2	3.2	2.7	1.5	2.2	1.8	2.2	3.2	2.4
Indonesia	4.8	3.3	3.5	3.2	3.5	3.4	4.8	3.3	3.5	3.2	3.5	3.3
Philippines	0.3	2.0	3.0	5.9	1.9	3.0	0.3	2.0	3.0	5.9	1.9	2.0
World	2.8	3.0	3.3	3.7	3.4	3.2	2.8	3.0	3.3	3.7	3.4	3.2

Source: MAPFRE Economic Research

¹Argentina, Brazil, Chile, Colombia, Mexico, and Peru; ²Russia, Turkey, Community of Independent States (CIS) and Central Europe; ³Association of Southeast Asian Nations (ASEAN)
 Forecast end date: October 16, 2019.

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

	Base Scenario						Risk Scenario					
	2015	2016	2017	2018	2019	2020	2015	2016	2017	2018	2019	2020
United States	2.27	2.45	2.40	2.69	1.50	1.64	2.27	2.45	2.40	2.69	1.50	4.19
Eurozone	1.26	0.93	1.13	1.17	-0.10	0.54	1.26	0.93	1.13	1.17	-0.10	1.23

Source: MAPFRE Economic Research
 Forecast end date: October 16, 2019.

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

	Base Scenario						Risk Scenario					
	2015	2016	2017	2018	2019	2020	2015	2016	2017	2018	2019	2020
USD-EUR	0.92	0.95	0.83	0.87	0.92	0.90	0.92	0.95	0.83	0.87	0.92	0.87
EUR-USD	1.09	1.05	1.20	1.15	1.09	1.12	1.09	1.05	1.20	1.15	1.09	1.15
GBP-USD	1.48	1.23	1.35	1.28	1.20	1.27	1.48	1.23	1.35	1.28	1.20	1.29
USD-JPY	120.27	116.78	112.69	109.70	107.00	105.17	120.27	116.78	112.69	109.70	107.00	104.00
USD-CNY	6.49	6.94	6.51	6.88	7.22	6.98	6.49	6.94	6.51	6.88	7.22	6.82

Source: MAPFRE Economic Research
 Forecast end date: October 16, 2019.

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

	Base Scenario						Risk Scenario					
	2015	2016	2017	2018	2019	2020	2015	2016	2017	2018	2019	2020
United States	0.50	0.75	1.50	2.50	1.50	1.50	0.50	0.75	1.50	2.50	1.00	0.50
Eurozone	0.05	0.00	0.00	0.00	0.00	0.00	0.05	0.00	0.00	0.00	0.00	0.00
China	2.30	2.50	2.40	3.20	2.55	2.64	2.30	2.50	2.40	3.20	2.55	2.28

Source: MAPFRE Economic Research
 Forecast end date: October 16, 2019.

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References

1/ See: MAPFRE Economic Research (2019), *Economic and industry outlook 2019: third quarter perspectives*, Madrid, Fundación MAPFRE.

2/ Characterized by a strong increase in the aversion to global risk and corrections in the variable and fixed income markets, especially in the United States, the response to which is the collapse of the term premium and renewal of ultra-accommodative monetary conditions on a global scale.

3/ Recently it seems to have been confirmed that the liquidity problem stems from inadequacies and inefficiencies in the clearing house controlled by the only custodian (private) bank currently authorized to provide collateral that the banks can deposit into the system in exchange for the liquidity offered.

4/ The treasury bond curve is inverted in the 1 month - 6 years tranches. This expansion has already been going on for 124 months, from June 2009 to October 2019, the longest on record. In addition, the unemployment rate is at a minimum. While this is a sign of current strength, it is also a sign that the economic cycle is about to run out of steam. The fall in business and investment confidence is also a clear sign of the state of expectations.

5/ <https://eiopa.europa.eu/Publications/Reports/Joint%20Committee%20Autumn%202019%20Risk%20Report.pdf>

6/ <https://eiopa.europa.eu/Publications/Opinions/2019-09-30%20OpinionSustainabilityWithinSolvencyII.pdf>

7/ <https://eiopa.europa.eu/Pages/Consultation-Paper-on-the-Opinion-on-the-2020-review-of-Solvency-II.aspx>

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