World Economic and Financial Outlook

Juan José Echavarría, Governor, Colombia
CVIII Meeting of Central Bank Governors - CEMLA

*** The opinions contained in this presentation are the sole responsibility of the author and do not represent the Banco de la República or its Board of Directors.**

Risks and vulnerabilities

Short-term effects

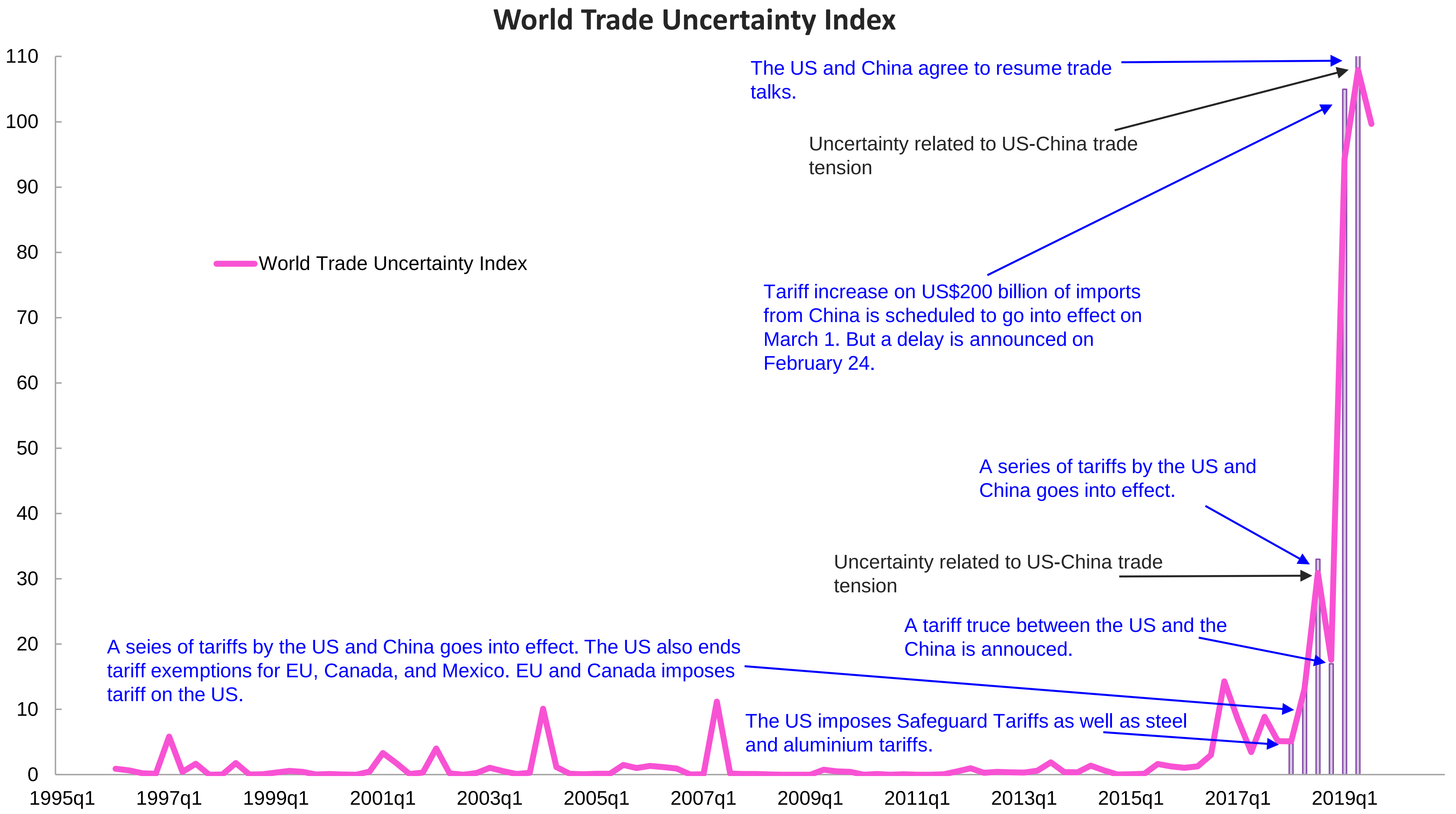
Trade tensions and uncertainty

Lower global growth

Monetary stimulus

Asset prices

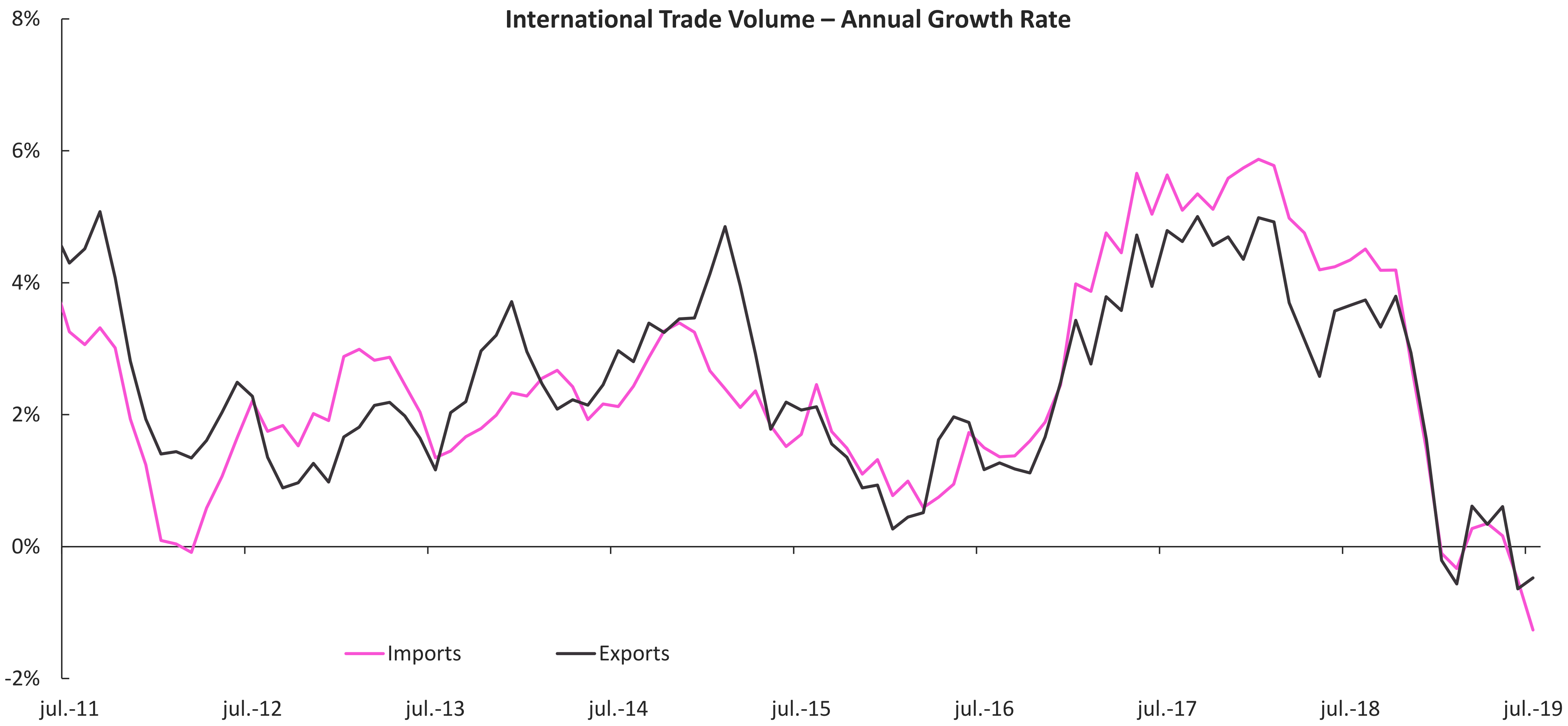
- **Trade tensions** are an important source of uncertainty in the global economy.



Source: Ahir, H, N Bloom, and D Furceri (2018), "World Uncertainty Index", Stanford mimeo.

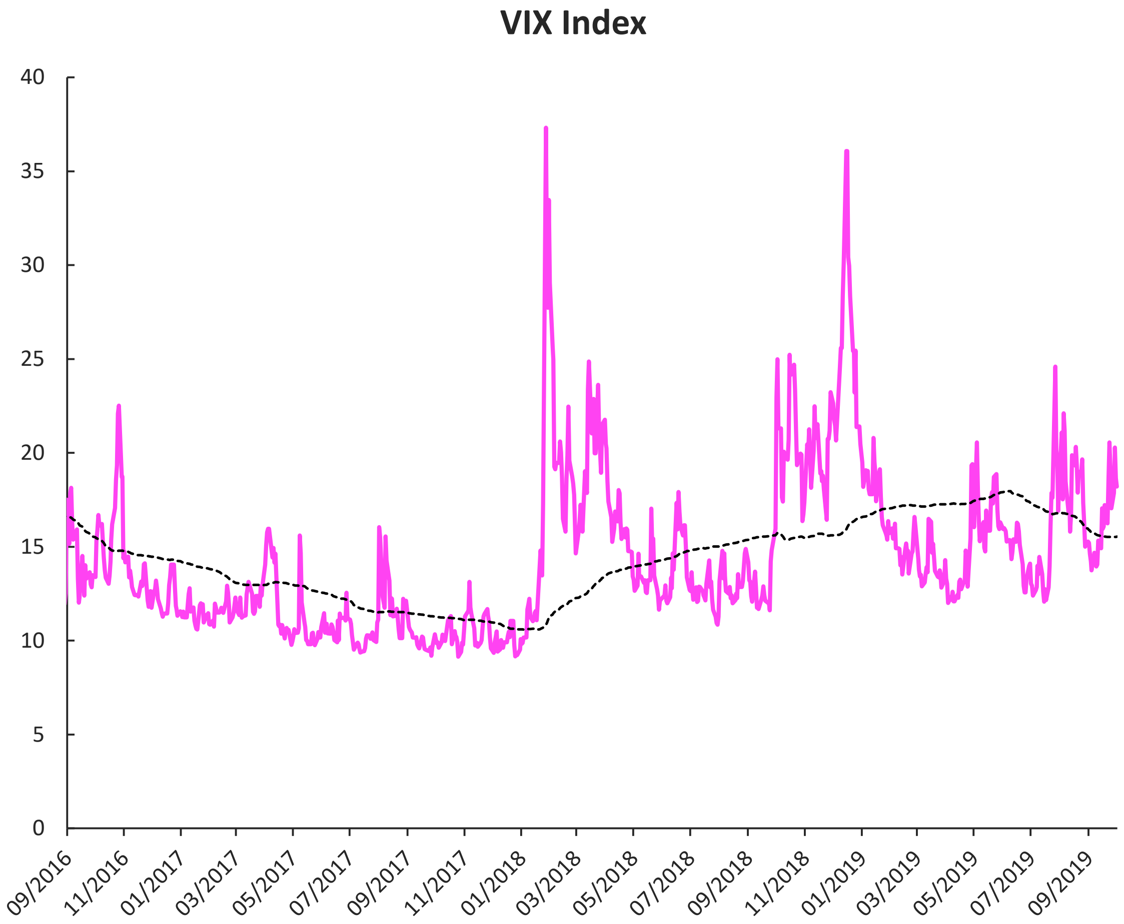
The Economist

- **Trade tensions** are affecting international trade flows.

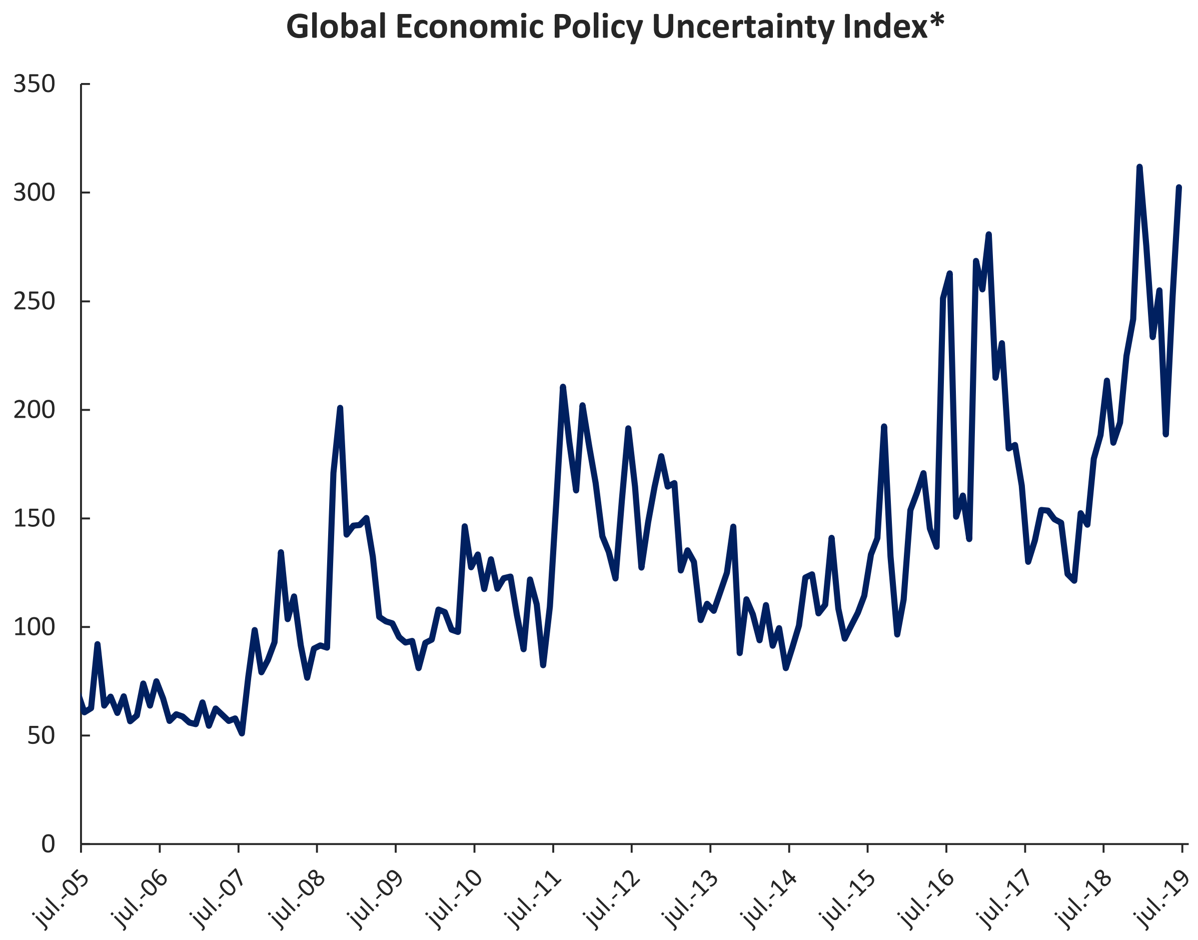


Fuente: *Bureau for Economic Policy Analysis. Annual growth rate for imports and exports volume.*

- Furthermore, brexit and geopolitical developments add to the current uncertain environment.



Source: Bloomberg



Source: Davis, Steven J., 2016. "An Index of Global Economic Policy Uncertainty," Macroeconomic Review * The GEPU index is a GDP-weighted average of national EPU indices for 16 countries that account for two-thirds of global output. Each national EPU index reflects the relative frequency of own-country newspaper articles that contain a trio of terms pertaining to the economy, uncertainty and policy-related matters.

Risks and vulnerabilities

Short-term effects

Trade tensions and uncertainty

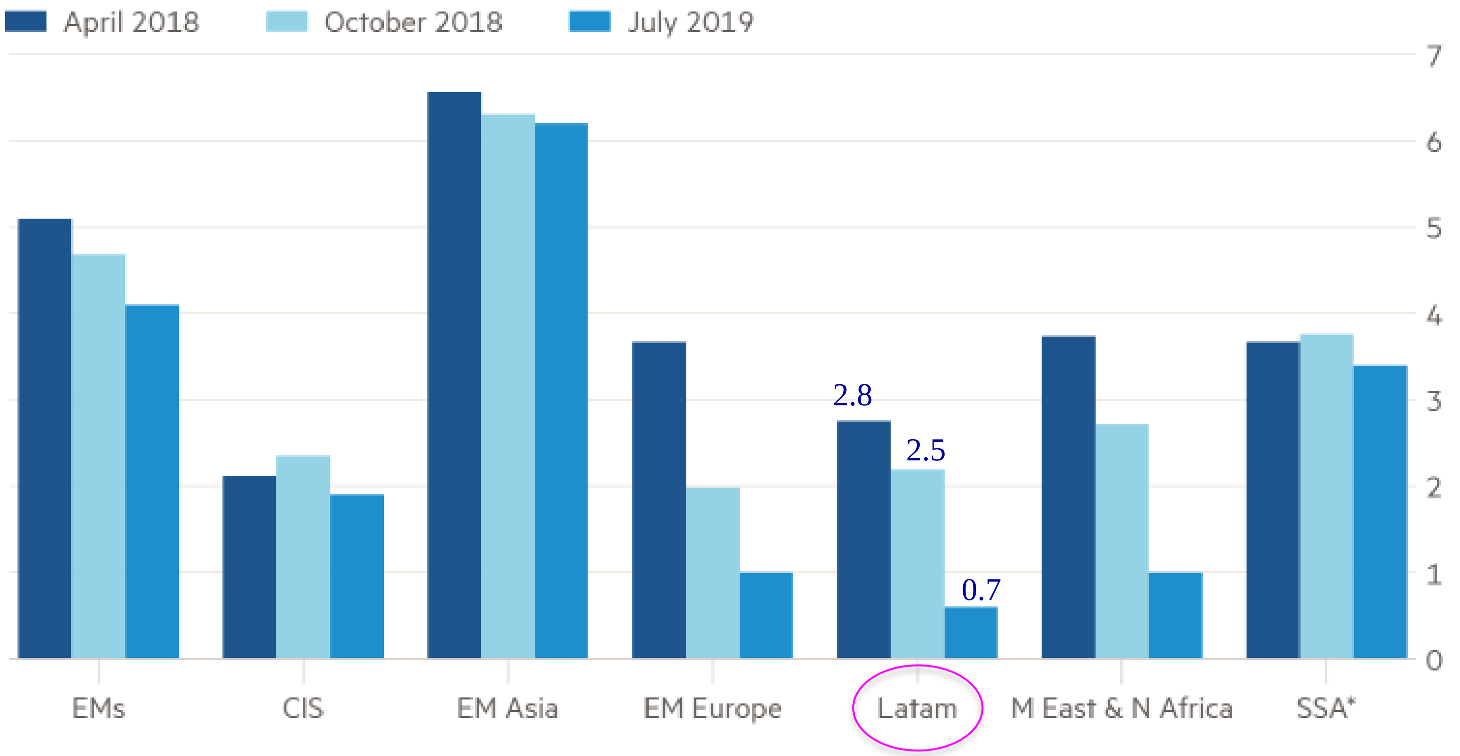
Lower global growth

Monetary stimulus

Asset prices

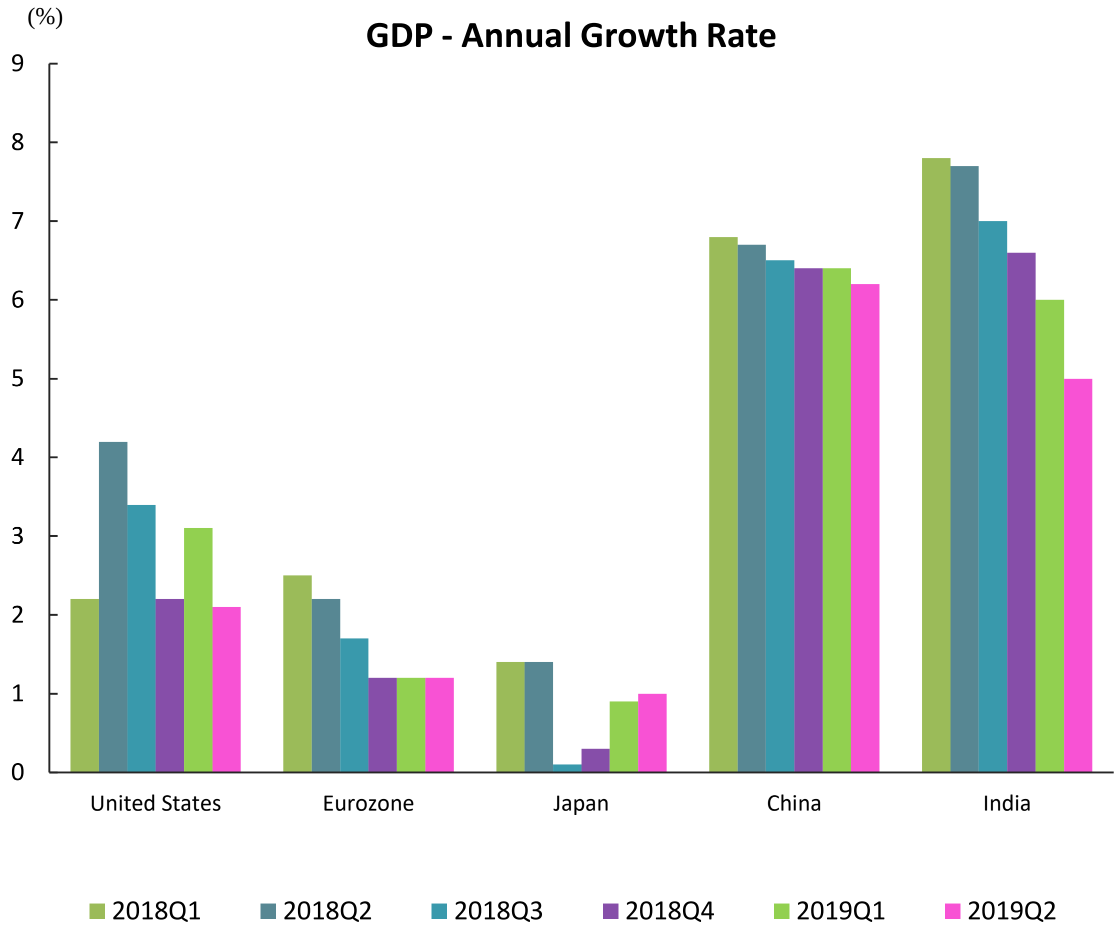
Deepening gloom

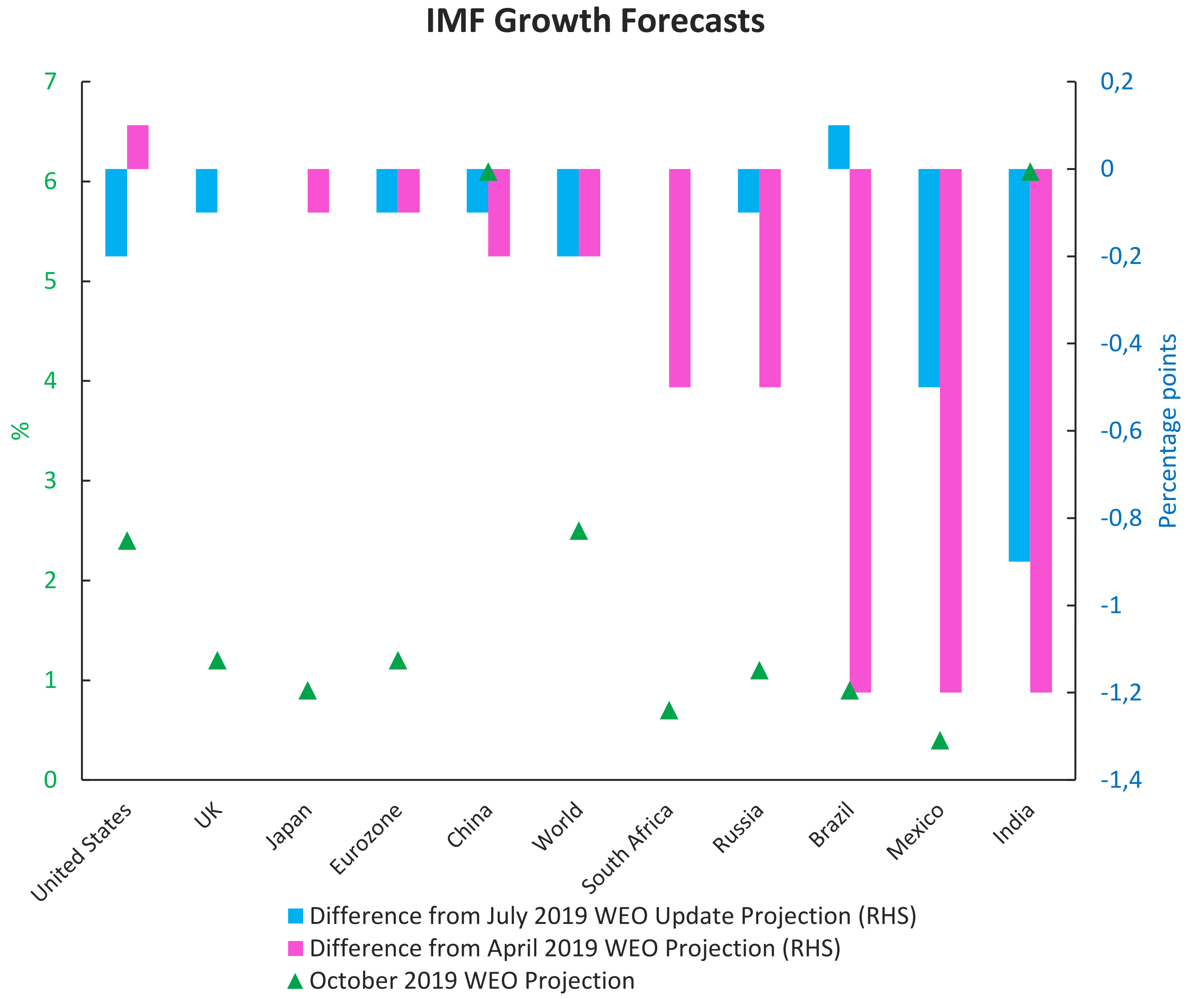
GDP growth forecasts for 2019 (%), by date made



*sub-Saharan Africa
Source: IMF World Economic Outlook

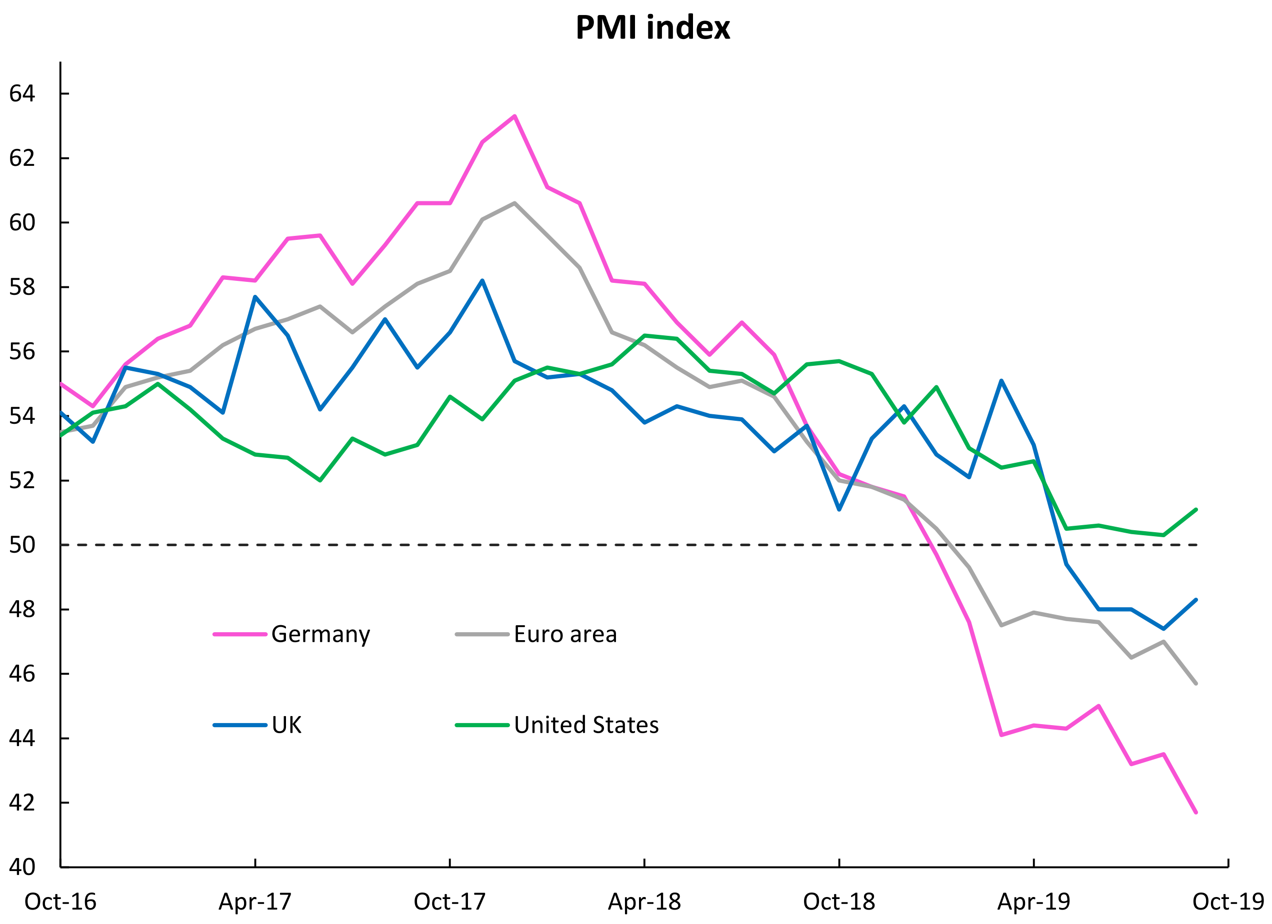
- The global economy is decelerating, and growth forecasts are lower.
- Trade tensions and uncertainty might be the reason behind lower growth.

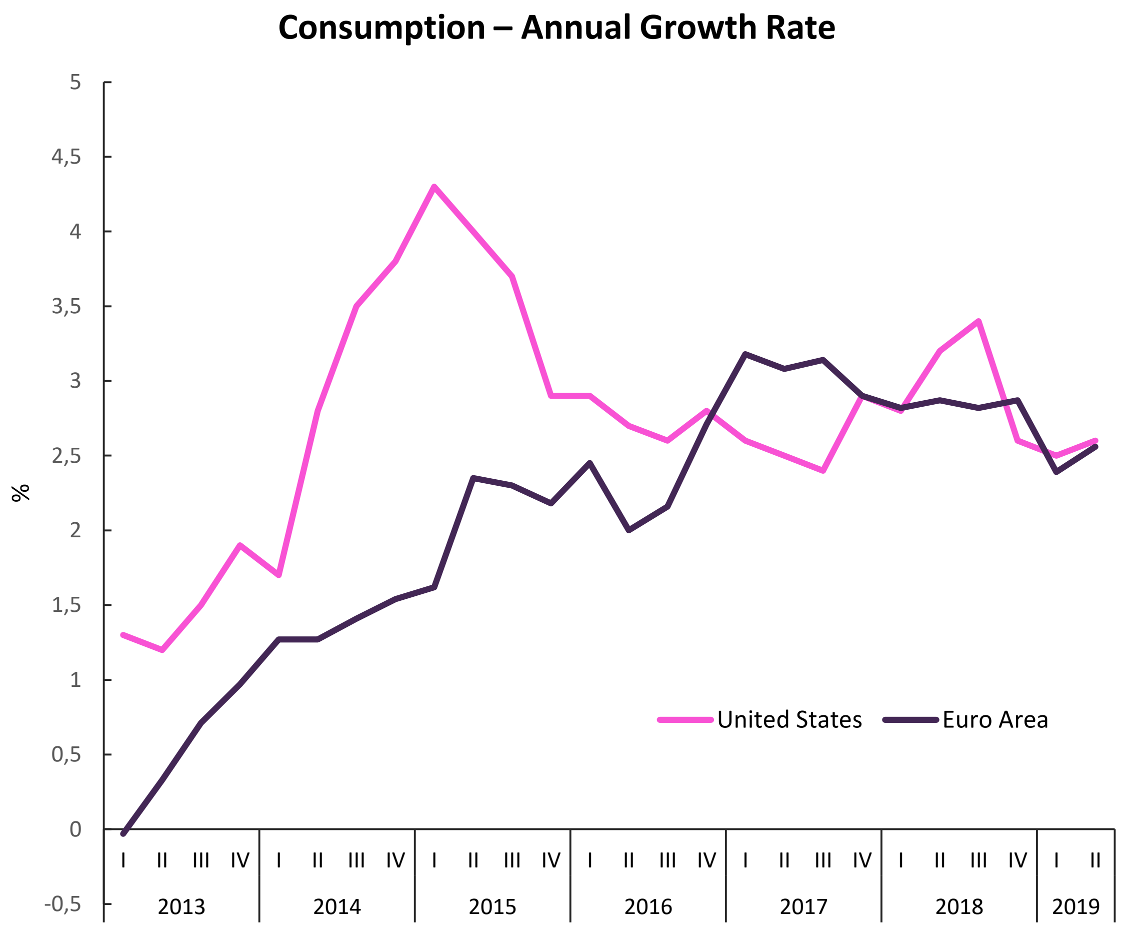




Source: IMF – World Economic Outlook

- The signs of global deceleration are clear in the manufacturing sector. On the other hand, consumption remains strong.

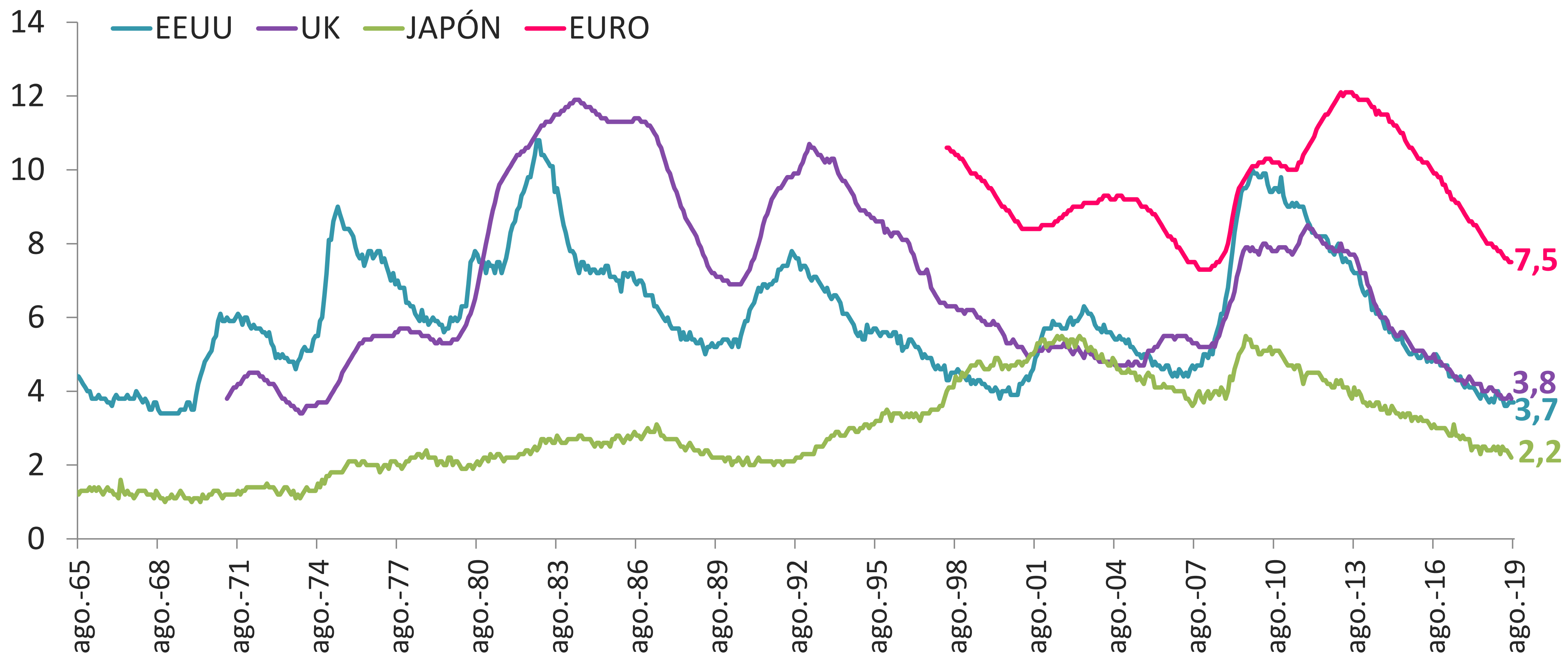




Fuente: Bloomberg, St. Louis Fed and ECB. For the United States, growth of the Personal Consumption Expenditure (PCE).

And unemployment very low

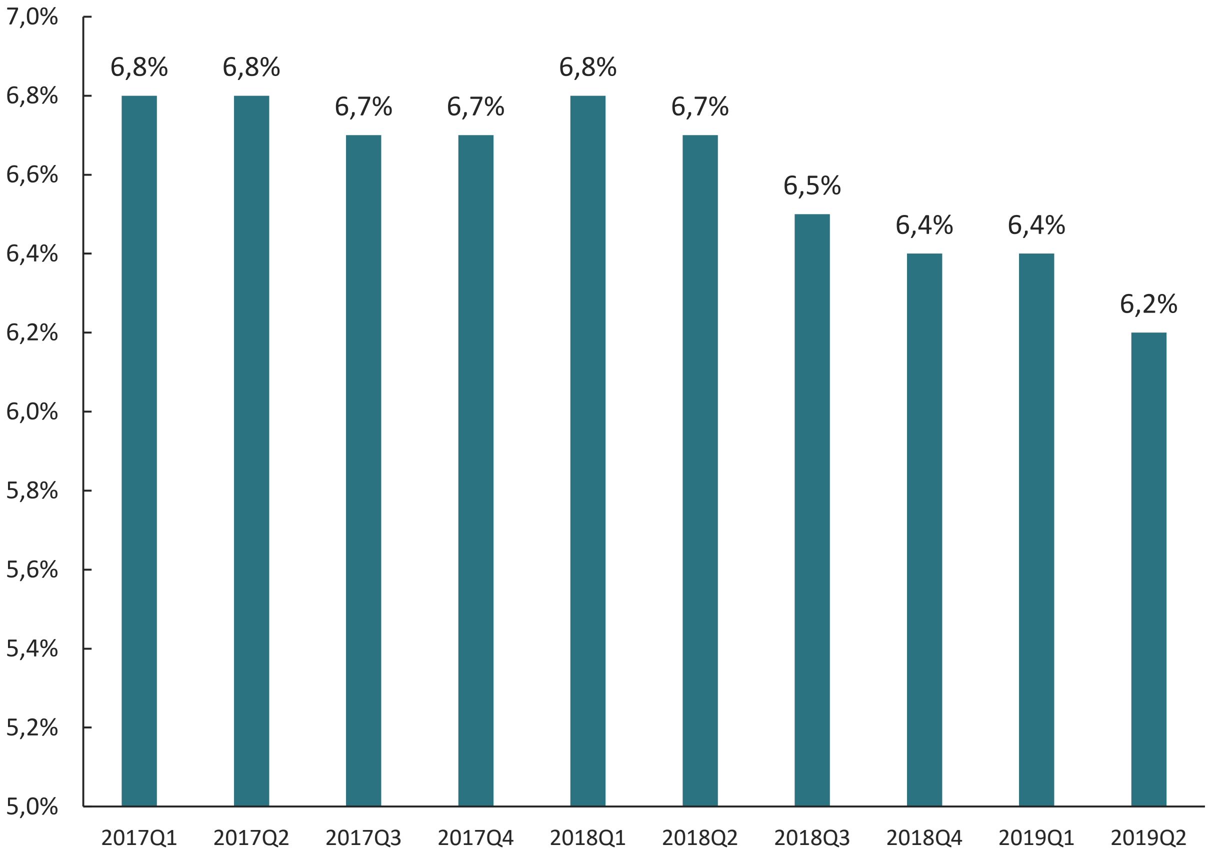
(%)



Source: Bloomberg.

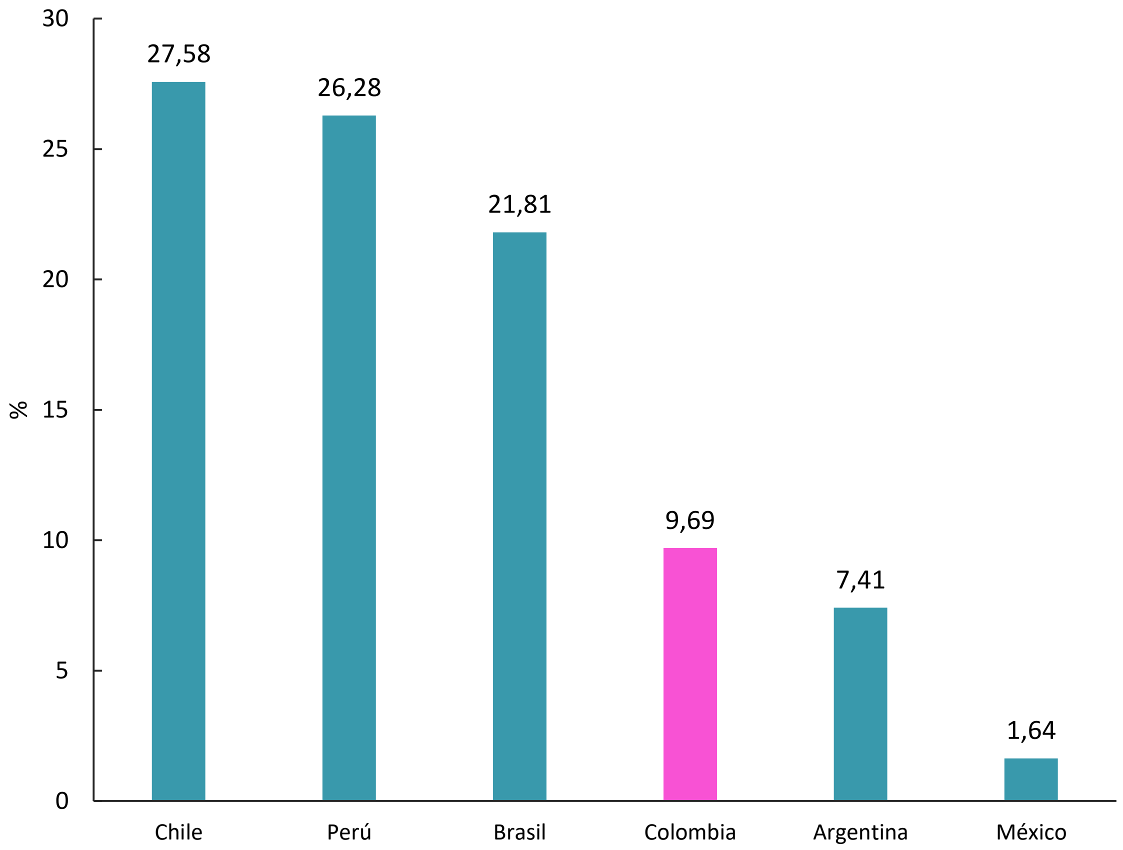
- The lower growth rate in China is of particular concern. A profound deceleration could have consequences on the region through the trade and investment channels.

China - GDP Annual Growth rate



Fuente: FMI

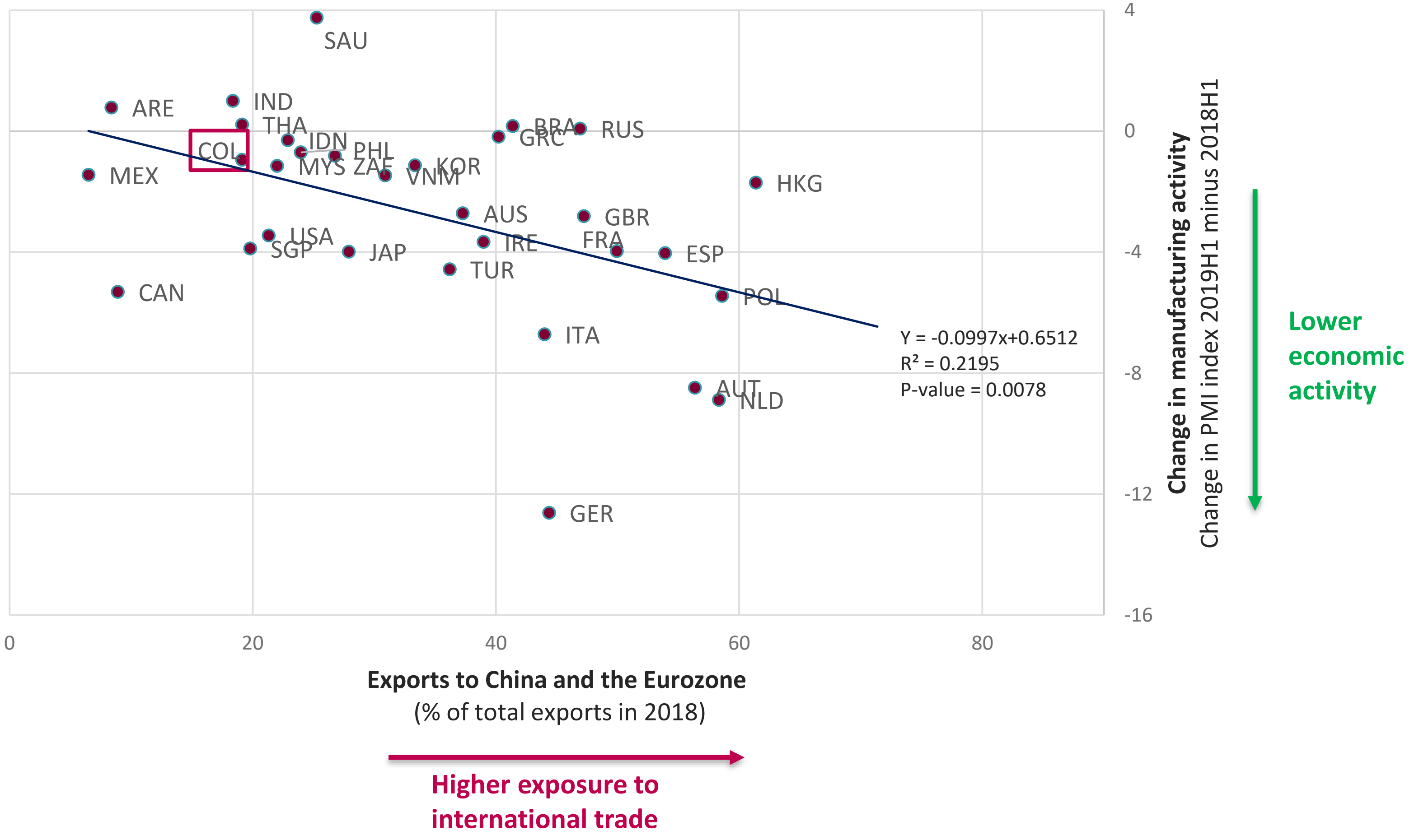
Exports to China as a percentage of total exports



Fuente: UNCOMTRADE y DANE

- Trade tensions could be behind lower growth. Countries more exposed to international trade, and to the regions involved in trade tensions, have seen a larger deceleration in manufacturing activity.

Exposure to international trade and changes in manufacturing activity



Source: Banrep, IMF – *Direction of Trade Statistics and* Bloomberg. Based on a graph for the BIS June meeting of Governors.

- Besides affecting growth levels, the highly uncertain environment could cause higher volatility in Latam currencies through more volatile commodity prices.

Results of a IGARCH (1,1) model

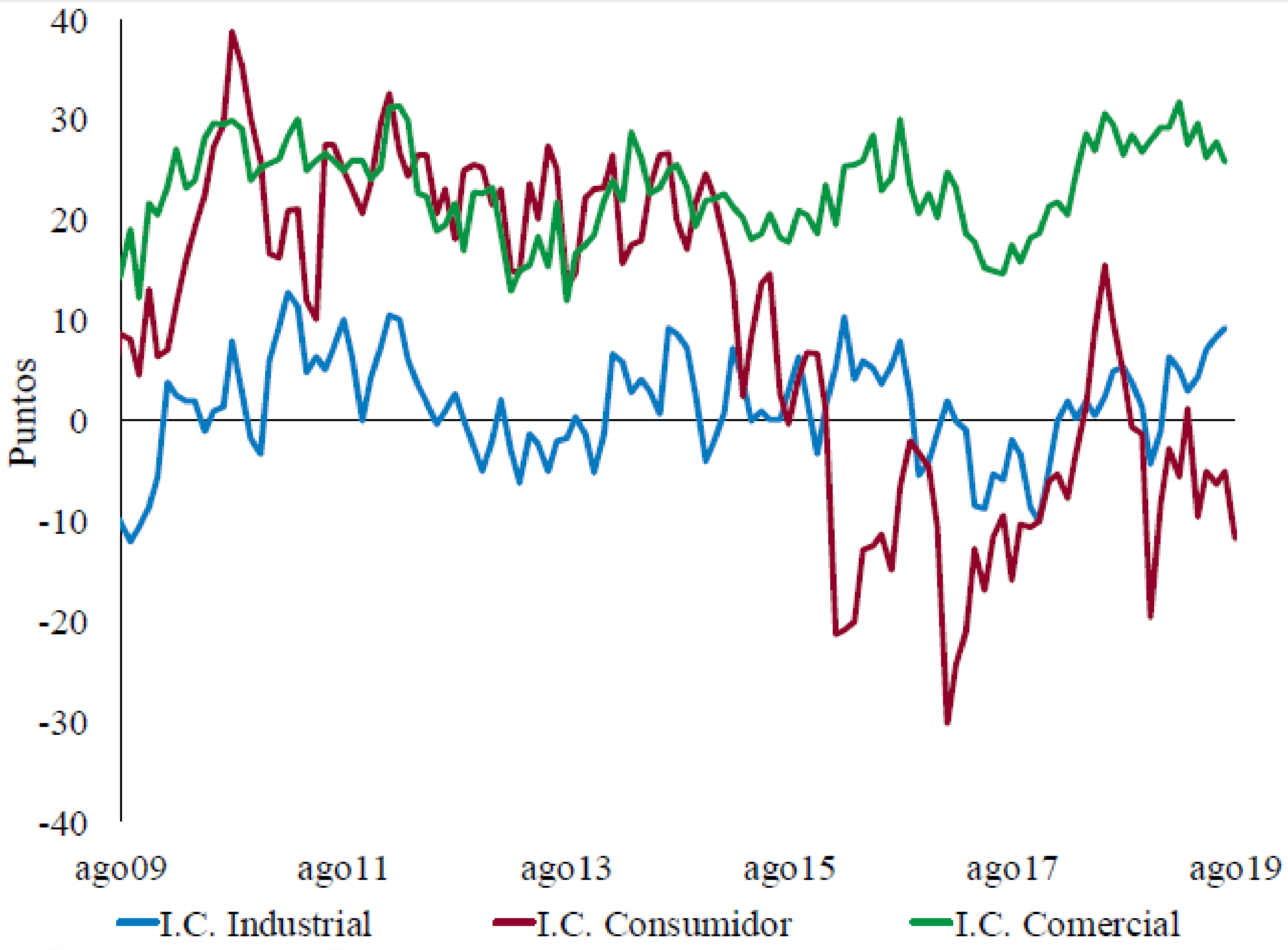
	COP volatility	BRL volatility	CLP volatility	MXN volatility	PEN volatility
Trade Uncertainty	**0.000022** (0.000011)**	**0.0059*** (0.0030)**	**0.0027*** (0.0010)**	**0.000012 (0.000013)**	**0.0017*** (0.0003)**
Interest rate differential volatility	-0.0221** (0.0106)	0.0478* (0.0258)	0.0630*** (0.0204)	-0.0064 (0.0061)	0.0072*** (0.0026)
Oil volatility	0.0019** (0.0080)			0.0042** (0.0020)	
Soy volatility		0.0055*** (0.0021)			
Copper volatility			0.0024** (0.0011)		0.0000 (0.0000)

Source: Banco de la República. Coefficients are obtained from the following IGARCH(1,1)-M model with a sample from Jan 2003 to Sep 2019:

$$Returns = \beta_0 + \beta_1 Returns_{t-1} + \beta_2 \Delta Interest\ Rate\ Differential_t + \beta_3 \Delta CDS + \beta_4 Commodities\ Returns + \beta_5 \sqrt{\sigma_t^2} + \varepsilon_t$$

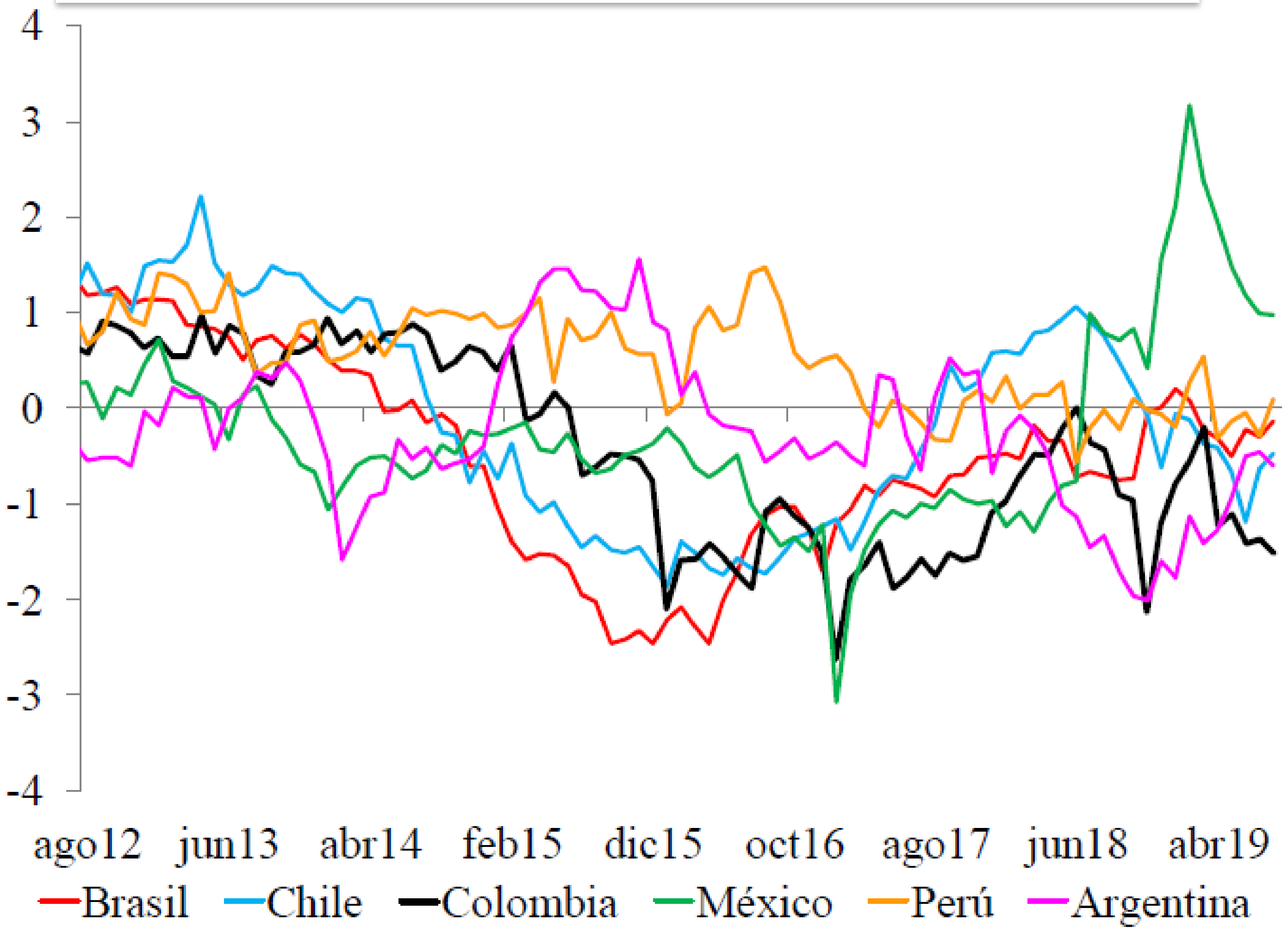
$$\sigma_t^2 = \alpha_1 \varepsilon_{t-1}^2 + \alpha_2 \sigma_{t-1}^2 + \alpha_3 Trade\ Uncertainty + \alpha_4 Vol\ Commodities\ Returns + \alpha_5 Volatility\ of\ Interest\ Rate\ Differential, \quad where\ \alpha_1 + \alpha_2 = 1$$

Surveys in Colombia: manufacturing, trade and consumption



Source: Fedesarrollo

Consumption surveys in Latin America



Risks and vulnerabilities

Short-term effects

Trade tensions and uncertainty

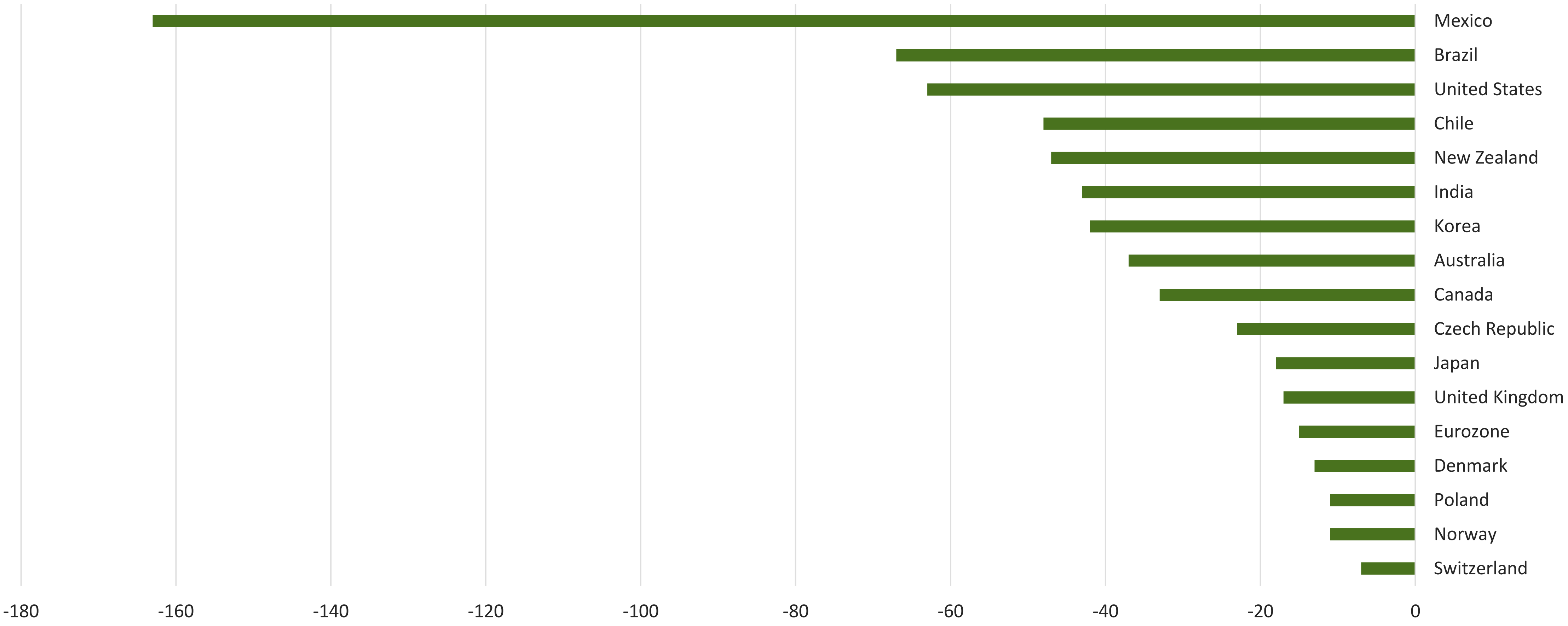
Lower global growth

Monetary stimulus

Asset prices

- Global liquidity continues to be strong, and given the lower growth and higher uncertainty, markets expect monetary policy easing in the future.

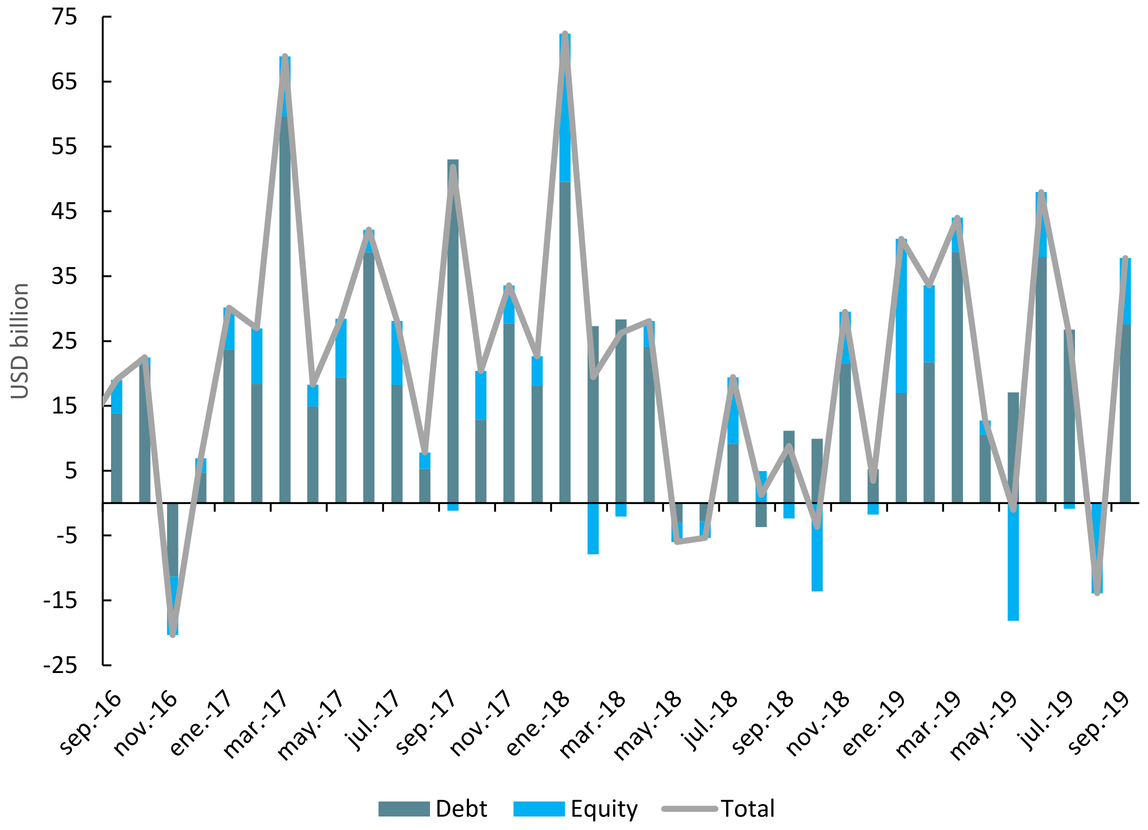
One-Year Ahead Market Implied Changes in Monetary Policy Rate
(bp, as of oct. 10 2019)



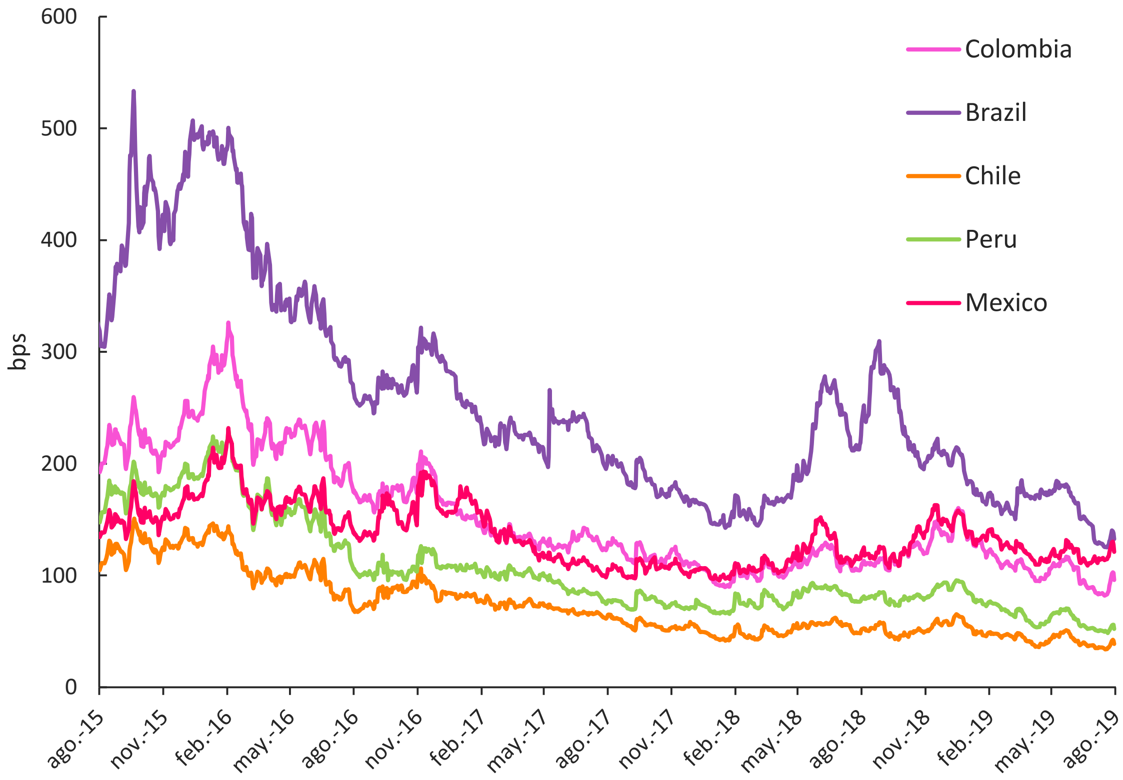
Source: Bloomberg

- Emerging markets could benefit from monetary easing through higher capital flows. However, an increase in international uncertainty could alter the financing conditions for these economies.

Portfolio Flows to Emerging Markets



5-Year CDS



Source: Bloomberg and IIF.

Risks and vulnerabilities

Short-term effects

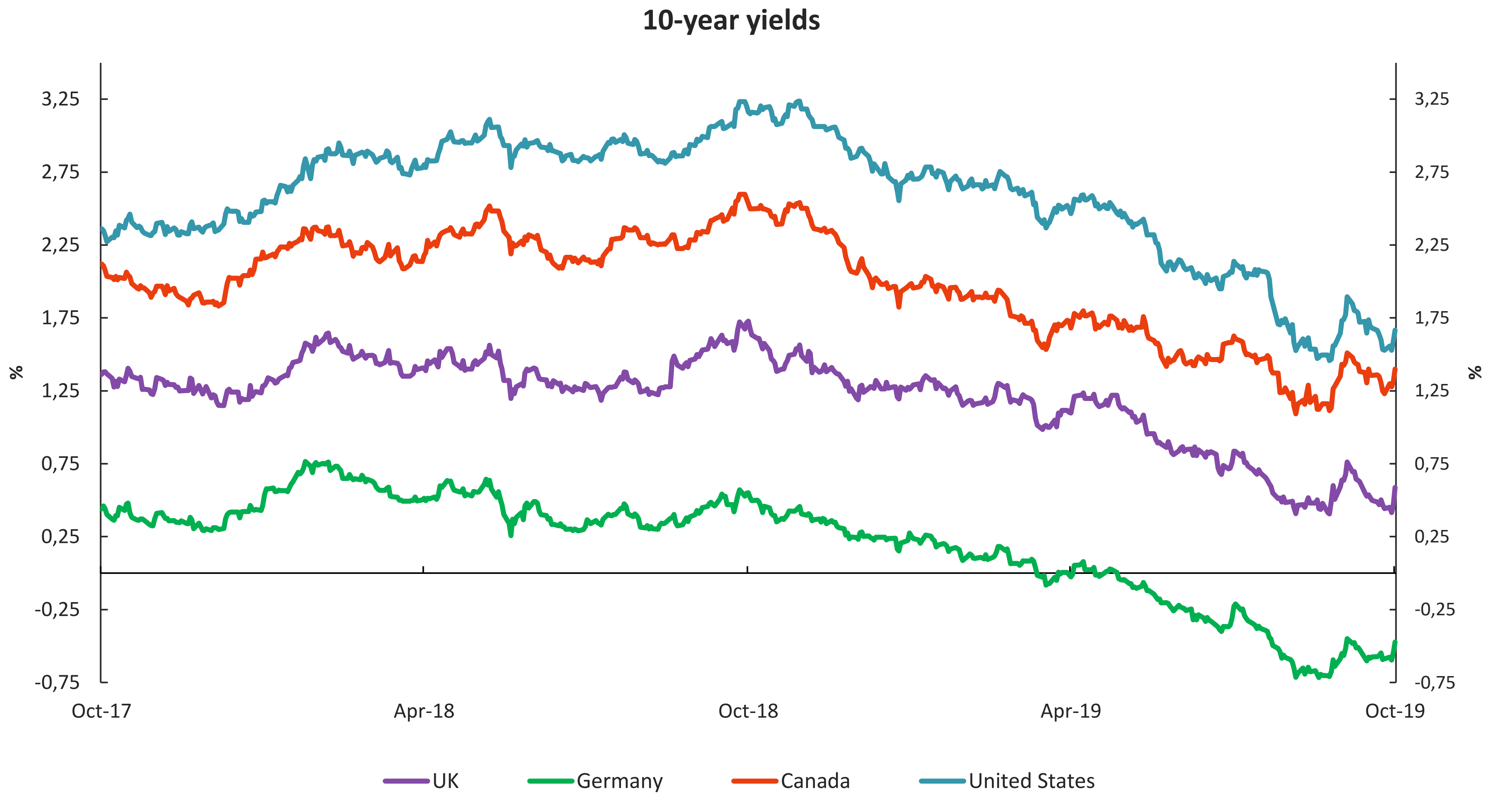
Trade tensions and uncertainty

Lower global growth

Monetary stimulus

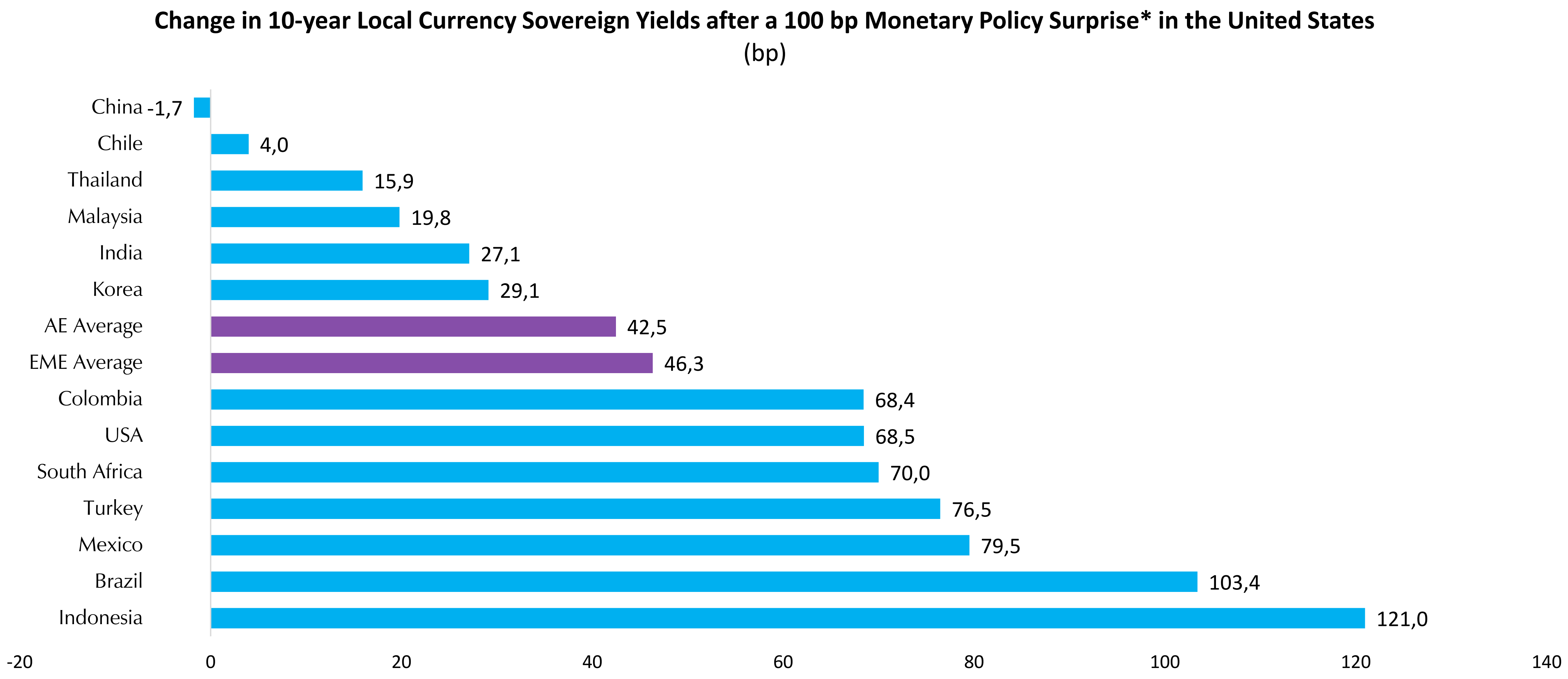
Asset prices

- Changes in monetary policy expectations, lower growth, and higher international uncertainty have influenced long-term yields in advanced economies.



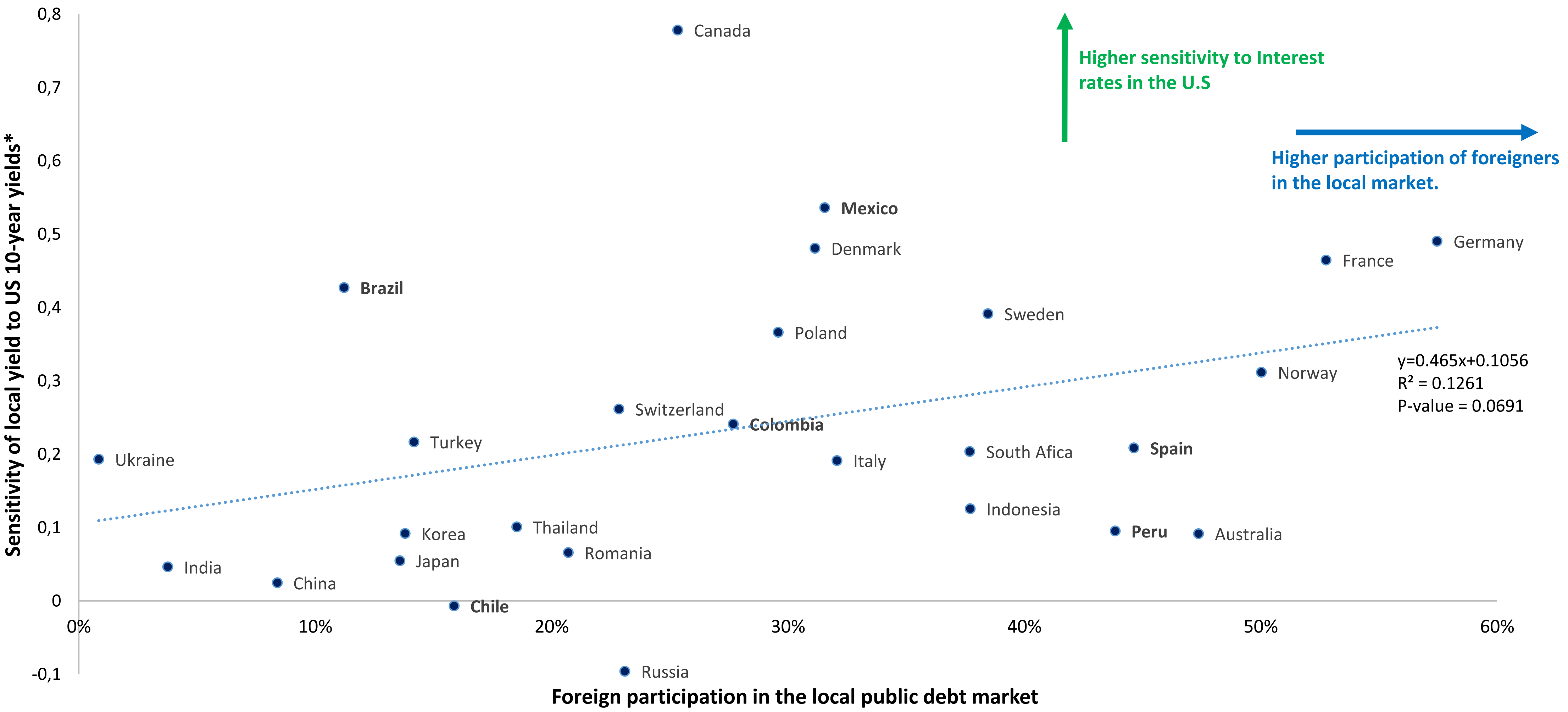
Source: Bloomberg

This change could have consequences on local yields and financial conditions.



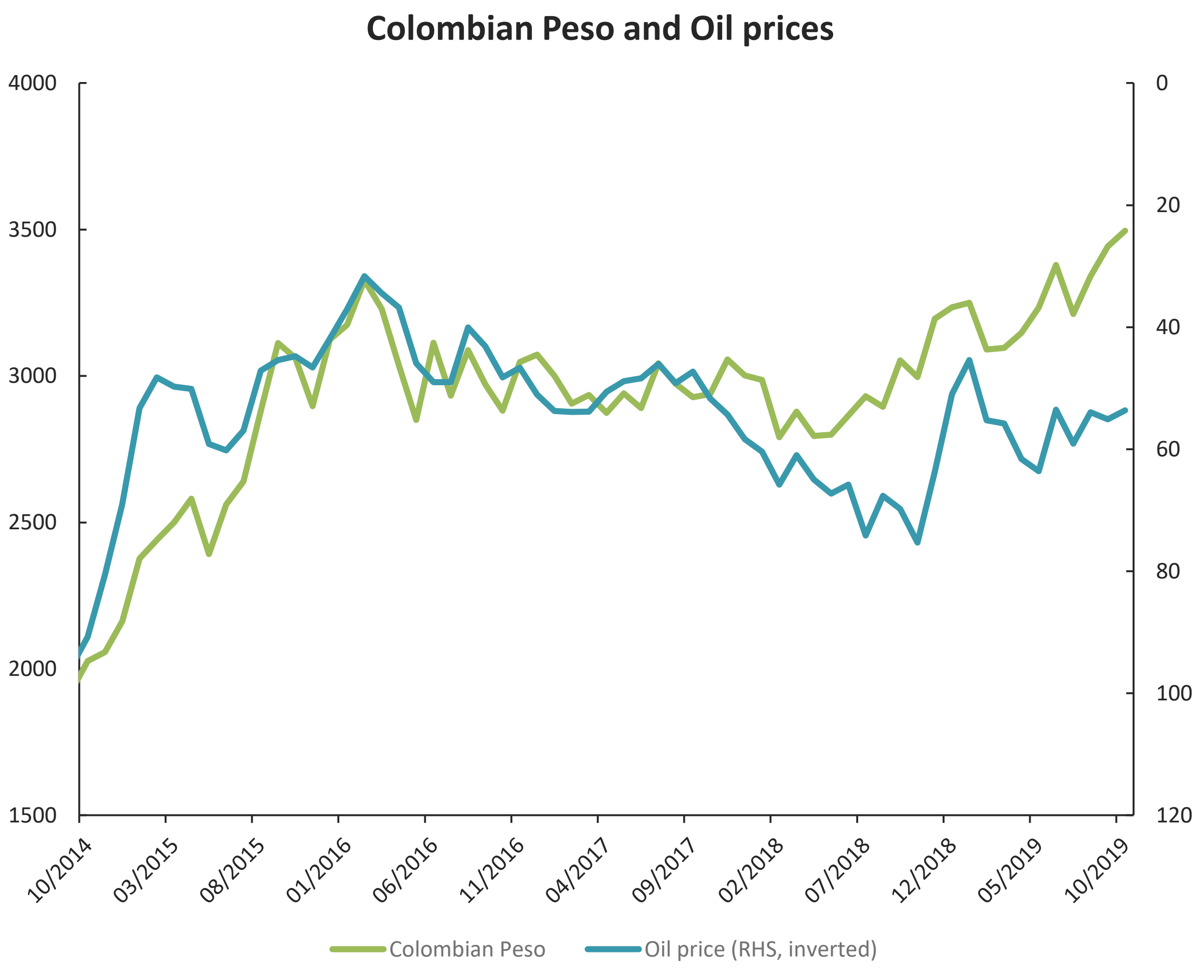
Source: Hoek, Jasper, Steven B. Kamin, and Emre Yoldas, 2019. "When Is Good News Bad News? U.S. Monetary Policy, Macro Surprises, and Financial Conditions in Emerging Markets," Federal Reserve Board, unpublished manuscript. The sample spans Jan. 2010 – Aug. 2018 (69 FOMC meetings). *The monetary policy surprise measure is the change in 8-quarter ahead yield implied by Eurodollar futures contract in 1-hour window around FOMC statements. Standard deviation of this surprise measure is about 7 bps. All EME asset prices are measured from day before to day after FOMC statements.

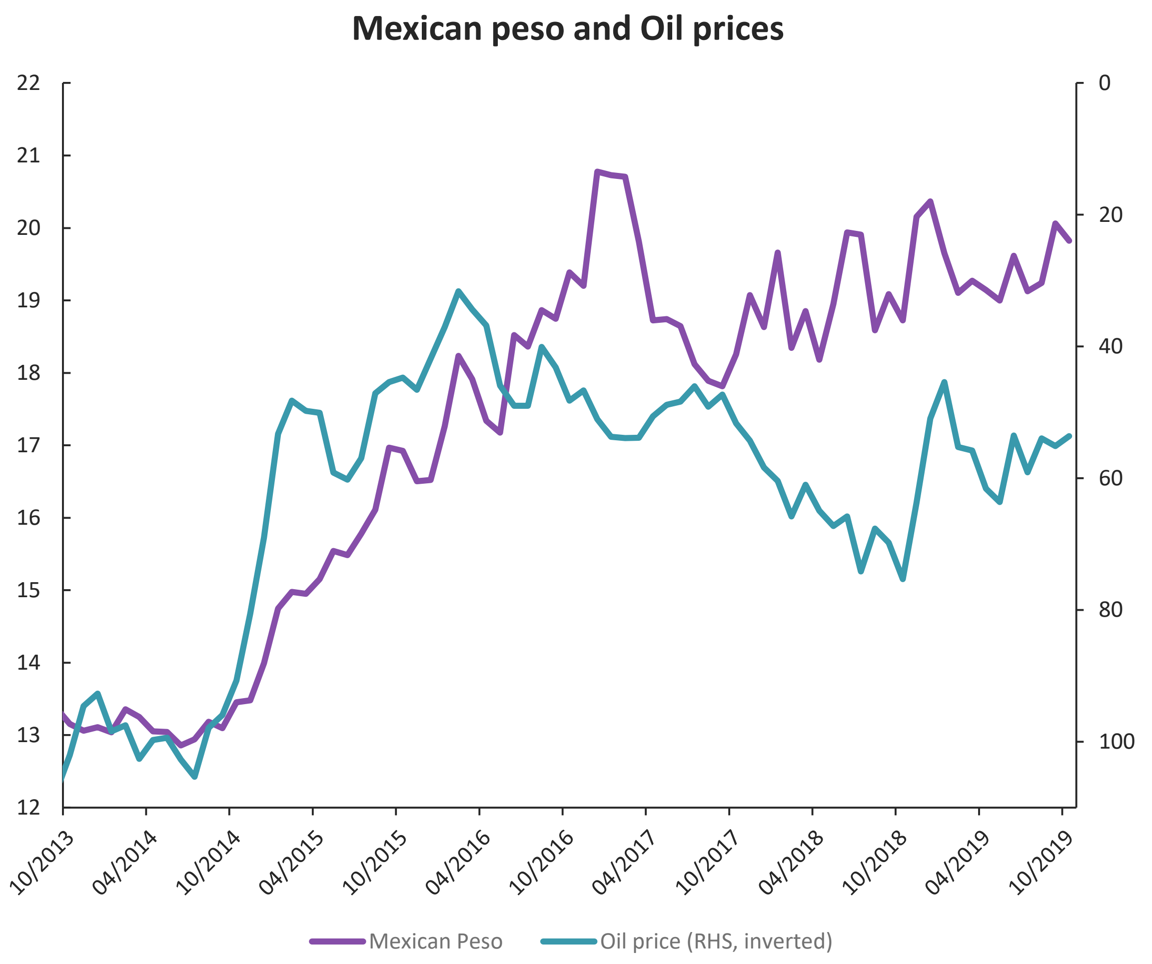
- Some countries might be more sensitive to this spillover given the participation of foreign investors in their financial markets.



Source: Banrep and Hoek, Jasper, Steven B. Kamin, and Emre Yoldas, 2019. "When Is Good News Bad News? U.S. Monetary Policy, Macro Surprises, and Financial Conditions in Emerging Markets," Federal Reserve Board, unpublished manuscript. *Change in 10-year Local Currency Sovereign Yields after a 100 bp Monetary Policy Surprise* in the United States

- Some currencies in the region are experiencing a decoupling from their traditional fundamental factors.





Source: Bloomberg

Thank you