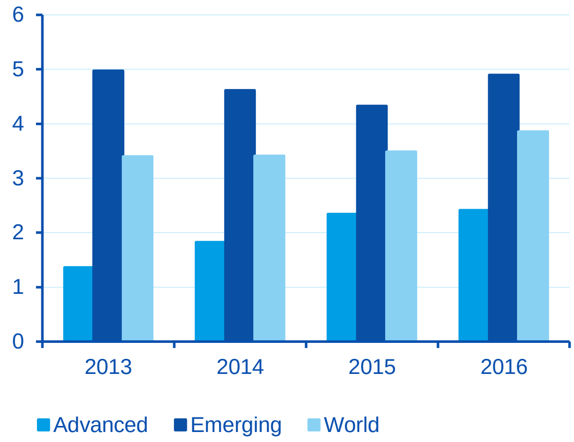
2 World growth is suffering from the slowdown in the emerging economies

World growth came off the pace in 1Q15

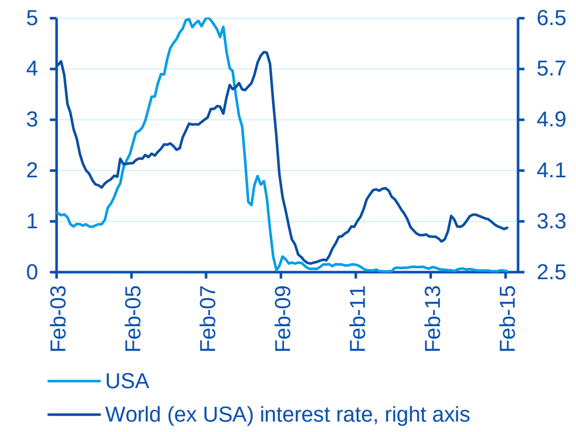
The slowdown in world growth in Q1 was produced by the slowdown in the US economy, less drive in the Chinese economy and the drop in activity in some of the most prominent emerging countries (such as Russia and Brazil). The consolidation of growth in the block of developed countries contrasts with the broad flagging trend among the emerging economies, which was more pronounced in Asia and Latin America than in Eastern Europe.

Figure 2.1
World GDP growth: 2015-16 forecasts (%)



Source: BBVA Research

Figure 2.2
Short term nominal interest rates (%)



Source: BBVA Research

We are therefore revising our world growth forecast for 2015 down to 3.5%, which is 0.1pp below the estimate from January and only 0.1pp above the figure for 2014 (see Figure 2.1). For 2016, world growth should show average growth of 3.9%, partly as a result of expansionary monetary policies in the developed countries, which ought to record their best rates since 2010. In a scenario of gradual trend deceleration in China, the emerging economies should reverse the current slowdown thanks to the pull effect from the developed economies, the gradual climb in commodity prices and a potentially more restrained rise of interest rates than in other historical episodes of Fed normalisation.

The progressive rise in commodity prices in line with our forecasts and the reinforcement of loose monetary policies worldwide have been two of the more prominent elements on the economic landscape in recent months. Central Banks have in fact been more proactive, in both developed and emerging economies, and, even if the Fed decides on a strategy of gradual monetary tightening, the emerging economies have chosen to give priority to reactivating domestic demand by looking to cut interest rates (see Figure 2.2), in some cases at the cost of both taking on greater local currency volatility and discouraging inward and continued flows of foreign capital.

Despite this, and the fact that economic policies will continue to be accommodative, the downside risks for world growth persist. The biggest threats are the extent of the slowdown in China and the fallout from the start of Fed interest rate normalisation. The deflationary pressure associated with the drop in the oil price, geo-political tensions and the potential for failure by the ECB to relaunch inflation expectations in the eurozone are risks which, despite appearing less likely and to entail less of an impact than predicted some months ago, cannot be ruled out. Finally, a risk which remains latent is the lack of any agreement between the Greek government and the European institutions and the IMF over the refinancing of its debt.

Growth slowed down in the United States in Q1…

The United States has begun 2015 with a significant slowdown in its growth rate to an annualised quarterly rate of 0.2%, from an increase of 1% on average in the three preceding quarters. The unusual severity of the weather conditions accounts for some of this deceleration, to which one might add the oil price fall and its impact on the energy sector and the beginnings of the effect of the stronger USD on exports. Even so, the robustness which the labour market continues to exhibit should continue to sustain household incomes and private consumption. Annual US growth could therefore reach 2.9% in 2015 and stay at rates of around 3% in 2016 too.

The Fed's interpretation of whether the slower growth in Q1 was temporary or longer-lasting will define how it reacts from now on. The most likely outcome is that the first policy rate hike will take place in September 2015, followed by a gradual rise to no further than 1.5% by the end of 2016.

… as it did in China too

In China the economic slowdown has taken a firmer grip in the last few months, with growth for 1Q15 registering 7% YoY and featuring an adjustment in industrial production and investment, although there was a brighter relative showing from private consumption. The slowdown is attributable to the correction playing out in the real estate market, political uncertainty ahead of the National People's Congress in March, the decline in competitiveness caused by the worldwide appreciation of the CNY, and finally the effects of the fiscal consolidation of local authorities which began in 2014.

The structural character of the factors mentioned lends weight to the prediction that China will grow less in the medium term and experience greater volatility. The annual growth target of 7% for 2015 laid down by the Chinese authorities is based on the implementation of new stimulus measures, of both a monetary and a fiscal nature. Subsequently in 2016, growth will continue to adjust at 6.6%.

The eurozone showed the biggest recovery these past few months

Of the developed economies, it was the eurozone which put in the best relative performance going into 2015. GDP could have grown at the highest pace since mid-2011, with Germany and Spain heading up growth in the area as a whole. The recovery has been driven by the better financing conditions and the euro's depreciation, both prompted by the ECB's quantitative easing programme, together with the drop in the oil price. The less restrictive fiscal policy and containment of the fall in nominal wages in the periphery countries are also helping to relaunch growth. This means that GDP should advance by 1.6% in 2015, which should rise to 2.2% in 2016.

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