A global outlook of anaemic and more fragile growth

The intensification during the last quarter of 2015 of some of the risk clusters with a global impact led to a further downward revision of world economic growth forecasts for this year. The transition to a lower growth pattern in China, with economic reforms and changes to key objectives such as the exchange rate, is being accompanied by bouts of intense financial volatility and falling commodity prices. All this leads to a much less favourable global panorama for large commodity-exporting economies such as Russia or Brazil, but also for those perceived as more vulnerable financially.

Although the level of activity seen in the second half of 2015 is consistent with quarterly growth of world GDP above those seen in the first half of the year, advance business confidence indices and the increase in financial stresses point to more moderate growth in early 2016 than was foreseen three months ago. If this trend is confirmed, world GDP will grow by just 3.2% in 2016, repeating the advance of 2015 and postponing the recovery to 2017 when it should reach rates of around 3.5%. This lower growth rate, still the lowest since 2009, reflects slackening demand in the emerging economies, particularly those of Latin America, which look like contracting for two years in a row. Recovery in the developed economies is still fragile and highly dependent on the eventual impact of the slowdown in world trade and the increase in financial instability, and will not be enough to offset emerging markets' expected relatively poor performance.

The recent behaviour of the financial markets is largely explained by doubts about the strength of the world economic cycle. Even leaving the extent of China's slowdown out of the equation, the fact that the major emerging economies are all being similarly affected by the persistent fall in commodity prices has contributed to increasing risk aversion on a global scale. Moreover, a further source of uncertainty has arisen in the form of the Chinese yuan, a reserve currency with an exchange rate more subject to market forces since the summer of 2015 and on which the authorities do not seem to have a settled view. In this situation, the capital outflows that the emerging economies have been suffering since the beginning of 2015 are rivalling those seen in 2013, when the markets had factored in a rate hike by the US Federal Reserve which in the end did not take place. As shown by the persistent withdrawal of capital, across the board, with very little discrimination among economies, the nature of the current episode is such that it may have more serious consequences for access to financing and for the growth rate of those economies that are most reliant on external savings. China and the Latin American countries are together those with the biggest capital outflows and consequently those in which financial conditions are deteriorating most.

The depreciation of emerging market currencies, which in some cases has brought their exchange rates to similar or even higher levels than those seen in the crisis of 2008, is one of the most clear signs of the punishment suffered by emerging financial markets. In addition to doubts about the effects of the adjustments to China's economy on global trading channels and financing are growing external imbalances, renewed flare-ups of geopolitical tension and the constraints faced by the authorities in managing the economic slowdown without compromising financial stability. In cases where the cumulative depreciation of the currency is more intense and lasting, rates of inflation are starting to pick up and to diverge from the levels set by their central banks as monetary policy objectives. The change of regime in the pricing of the yuan constitutes, without doubt, an additional depreciation factor for most emerging currencies, in an environment of reduced external demand in which a significant deterioration in the terms of trade may exacerbate the correction of domestic demand.

The dilemma faced by emerging market central banks is heightened by the risks entailed by the accumulation of debt by the business sector over the past decade and, with greater intensity, from 2007. The abundant liquidity in the capital markets and the reduction of financial costs were triggers for the private
sectors of quite a few emerging countries to opt for borrowings, in many cases denominated in foreign currency, as a means of financing. **An increase in financial costs** (and corporate credit spreads have come under significant stress in the past few months), **in a context of lower revenues and falling business profitability, may jeopardise debt servicing and lead to a sharp reduction in capital expenditure.** In this regard, the approach to monetary policy adopted by the developed economies’ central banks will continue to be of decisive importance. However, with this price containment taking place within a context of weak growth in demand, persistently high indebtedness and key interest rates firmly anchored to the bottom, close to zero in Europe and Japan, **the margin for monetary policy to reactivate growth and dispel doubts about the effects of the adjustment in emerging markets is very limited.** This is particularly so when the downturn in emerging market activity is due not just to cyclical factors but also to a secular decline in key sources of revenue such as the export of commodities.

All the same, **the world economy faces a 2016 of limited growth (3.2%), similar to that of 2015, and with a risk balance sheet showing a negative bias and concentrated in the emerging bloc.** How China’s economy evolves, both as regards the degree of slowdown in activity and how the authorities manage the financial imbalances that exist, will continue to have a significant influence on financing flows and commodity prices in general, not just oil. The level of corporate indebtedness in those emerging countries most vulnerable to the circumstances described constitutes an additional source of instability, in a context of lower earnings and higher financing costs (bigger risk premiums). Allied to this, geopolitical tensions in certain parts of the world and the risk of a scenario of low growth and low inflation in the major developed economies complete the panorama expected for the world economy in 2016.
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