A global outlook of anaemic and more fragile growth

The intensification of some risk clusters in the last quarter of 2015 has prompted a new downward revision of expected world economic growth this year. The transition to a pattern of slower growth in China, with reforms in the economy and changes in the definition of key objectives such as the exchange rate has been accompanied by episodes of severe financial volatility and declines in raw material 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.

World GDP will grow 3.2% in 2016, repeating the 2015 breakthrough, and accelerate moderately in 2017 to 3.5%. This growth, which remains the lowest since 2009, is conditioned by the decline in demand from the bloc of emerging economies, particularly in Latin America, which look like contracting for two years in a row. The recovery in developed economies remains fragile and highly dependent on the eventual impact of the slowdown in world trade and the effect of financial instability on production, business investment decisions and consumer spending. With the US growing at 2.5% and the euro zone by less than 2%, the tenuous improvement in activity in the developed economies as a whole will not be enough to offset the relatively poor performance expected from the emerging markets.

Figure 2.1
World GDP, (% YoY)

Figure 2.2
BBVA index of financial stress (normalised values)

Source: BBVA Research

Source: BBVA Research and CRB

1: For further detail, see BBVA Research’s Global Economic Outlook and Europe Economic Outlook publications for the first quarter of 2016, available at: https://www.bbvaresearch.com/
The recent behaviour of the financial markets is largely explained by doubts about the strength of the world economic cycle. Even regardless of the magnitude of the slowdown China may be experiencing, the fact that the major emerging economies are being jointly affected by the continuing correction in the price of raw materials has contributed to increasing risk aversion on a global scale. 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 BBVA financial stress index for emerging countries has climbed back up to the levels seen in the summer of 2015 (first wave of the Chinese stock exchange crisis), matching the stress levels of 2011. Unlike then, volatility remains contained in the developed economies, in a context in which the reallocation of capital to financial assets with a lower risk profile is intensifying the flight-to-safety in sovereign bonds of countries such as Japan, the US or Germany.

The orientation of monetary policy adopted by central banks in developed economies will remain decisive. The start of the process of normalisation of interest rates by the US Federal Reserve in December 2015 has not led to any substantial increase in financial volatility, thanks to the Fed's repeated assurances that the process will be a gradual one. The recent correction in inflation figures in developed countries in response to falling oil prices, and the renewed fall in medium-term price expectations may once again change how their central banks react; in the case of the Fed, delaying the next rate hike; in that of the ECB and the Bank of Japan, making their monetary strategy even more accommodative.

The sharp increase in stocks, unprecedented in recent years, is consistent with the steep fall in the price of oil since mid-2014 and with growth in supply far ahead of that seen in consumption, which has been in line with its historical average. Until the spring of 2015, the excess in supply reflected the United States’ increase in production to which, since the end of 2014, the oil cartel has added with its policy shift of not cutting production in the face of declining prices. Since September 2015, production has begun to slow down, especially in the US and other non-OPEC countries, where production costs and higher leverage have begun to have an effect. However there is still excess supply equivalent to 1.2% of world consumption. Added to this resistance of supply to a lower price environment, more recently we have started to see a context of financial instability and risk aversion that is symptomatic of a gradual lowering of expectations of demand. All these factors have accelerated the trend toward falling prices in the last part of 2015 and early 2016. In the medium term, as excess supply dwindles, there should be a gradual increase in prices, albeit less intense than that forecast in a scenario in which the world economy were to regain more vigorous growth rates than the current ones.

All the same, the world economy faces a 2016 of limited growth (3.2%), similar to that of 2015, and with a risk balance showing a negative bias and being concentrated in the emerging bloc. How China’s economy evolves, both in regards to the degree of slowdown in activity and to how the authorities manage the existing financial imbalances, will continue to have a significant influence on capital 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 profits 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 major developed economies complete the outlook for the world economy in 2016.

Euro zone: no changes to expected growth. Inflation forecasts revised sharply downwards. The ECB, prepared to strengthen monetary stimulus measures

Euro zone GDP has matched the behaviour expected three months ago, settling at quarterly growth rates of 0.3-0.4%, giving an advance expected figure of 1.5% for the whole of 2015. If the recent recovery dynamic is maintained, the euro zone could grow by 1.8% this year and 2.0% in 2017, the same figures that were forecasted last quarter. The positive effect that the fall in energy prices, a more expansionary fiscal
policy and the continuation of loose monetary conditions would have on domestic demand and specifically on private consumption, would be partly offset by the negative impact of the slowdown in international trade on the export of goods and of increased financial and political instability on investment decisions.

In fact, the composition of GDP for the third quarter of 2015 and forecast for the fourth shows consumption, both public and private, as the most dynamic item, thanks to the recovery in employment and the fall in prices due to cheaper oil, in a context in which household confidence has remained high. The negative surprises come basically from capital expenditure, despite businesses’ improved perception of the economic situation, the increase in new bank lending and the low interest rates.

Doubts about the strength of external demand (trade in euro zone goods is suffering as a result of both falling sales to the emerging bloc and a slowdown in sales to developed countries) and the climate of political uncertainty prevailing in certain countries could be acting as a drag on investment. Furthermore, the delay in meeting public deficit objectives and implementing key structural reforms to revitalise the activity in the medium term are other factors that may also be hindering decision-making on capital expenditure.

In this context of political instability, the role of the ECB will continue to be crucial to prevent a serious deterioration in financing conditions. In December of 2015, faced with deterioration in the global economic context and the fall in commodity prices, the ECB decided to bolster its stimulus measures with a further cut in its deposit facility rate to -0.3% and the extension of its bond-buying programme until at least March 2017. The stability of the euro exchange rate against the dollar, in a range of 1.08 to 1.10 in the past two months, and above all the fall in inflation rates caused by the downward revision of the oil price forecast for 2016, led the ECB in January to open the door to a new round of stimulus measures, steps which might be announced as early as March. If Brent crude trades at an average of $30 a barrel in 2016, euro zone headline inflation would be just 0.2%, 0.9 percentage points less than was forecast three months ago. The gradual recovery of energy prices in 2017 also reduces expected inflation for the following year, which at an average of 1.4% is far removed from the ECB’s objective of price stability. All this without assuming significant second round effects on core inflation deriving from cheaper energy.
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