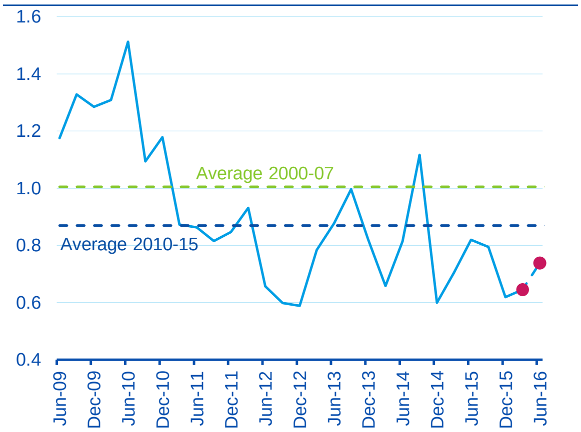
2 Fragile global growth, dependent on China

The data available for the first quarter of 2016 confirm our forecasts of stabilising growth in the global economy, with low rates albeit slightly higher than in late 2015. The BBVA-GAIN[1] indicator puts the qoq increase in global GDP at 0.6% (2.6% annualised rate), although below the average registered between 2010 and 2015 (Chart 2.1). This rate of growth may pick up slightly in the second quarter if the signs of less deterioration apparent in production, trade and business confidence indicators are consolidated, but it is still not enough to bring annual growth in the world economy to around 3.2% (which is our forecast for 2016 as a whole).

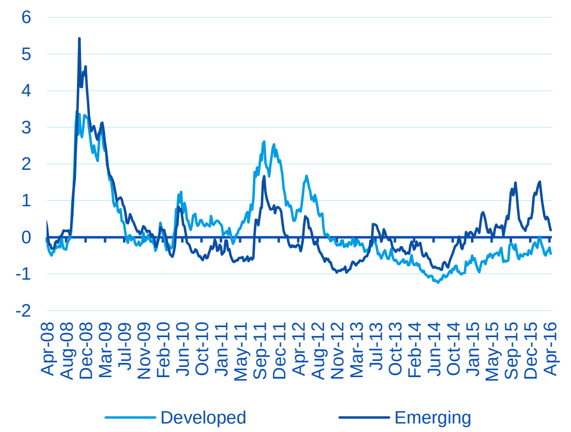
The sharp spike in financial volatility seen between December 2015 and February 2016 was not only a reaction to slowing global activity, but it also threatened to compound the situation if it continued on such a scale and led to a reduction in expenditure decisions. The better than expected pattern of economic indicators in China, and lower downward pressures on the yuan, the recovery in commodity prices and cooling of expectations for interest rate hikes by the Fed, have proved crucial in playing down financial turbulence from then on and in turn, in reducing the likelihood of a short term global stress scenario occurring.

Figure 2.1
Global GDP, % qoq 1Q and 2Q forecasts for 2016 based on BBVA-GAIN



Source: BBVA Research

Figure 2.2
BBVA financial stress index (normalized values)



Source: BBVA Research and Haver

China: fewer short-term risks, but more long-term doubts

The fact that Chinese authorities have bolstered both monetary and fiscal stimulation policies has helped to cool the effects of the reshaping the of the manufacturing sector on aggregated production, and, thus on the country's trade flows with respect to the rest of the world. In the short term, deploying countercyclical measures may help to allow a more gradual economic slowdown (softer landing) than is expected; however, if it entails putting off the correction of fundamental imbalances such as the high leverage in the corporate sector or excess supply in certain branches of industry and construction, then China's economy would become more vulnerable to shocks such as that observed in summer 2015, and this would also heighten its destabilising effects for the rest of the world. Taking these factors into account, we have revised our growth estimates for China in 2016 upwards to 6.4% and maintained growth of 5.8% in 2017.

1: See https://www.bbvaresearch.com/en/publicaciones/global-gdp-growth-remains-stuck-at-2-6-yoy-in-q1-less-cloudy-outlook-but-the-same-risks/

The Fed's decisions are shaped by the international backdrop, which helps to allay pressures on emerging markets

The delay in expectations regarding the forthcoming interest rate hike is due to the importance given to the deterioration in the international setting with regard to the Fed's reaction function. While FOMC predicted two hikes in 2016, the market has now put off the following increase to early 2017. The dollar's reaction, of further devaluation despite the good relative performance still apparent in domestic demand in the US, and the easing of the long tranches of the dollar curve, has helped to relieve funding restrictions in the emerging block, as shown by: (i) the BBVA financial stress index for this region, which has corrected the entire rebound observed in the first months of 2016 (Figure 2.2), and (ii) reactivation of foreign capital inflows, with net capital inflows in emerging countries since mid February partly due to the relocation of investment flows towards higher-return instruments.

Furthermore, insofar as central banks maintain the same direction of monetary policy in recent months (reinforcing or maintaining stimuli in the case of the ECB or the Bank of Japan; prudent approach in normalisation of interest rates by the Fed), emerging countries' authorities will have greater leeway to give priority to economic recovery, amongst their other targets. Aggressive interest rate hikes are less necessary because of the gradual approach which the Fed is expected to adopt (which supports capital flows towards the region) and the recent recovery in currencies (containing the possible increase in inflation from higher prices of imported goods).

However, the relative improvement in the global economic backdrop in the first quarter remains precarious and, in the short term, hinges very much on the performance of the Chinese economy and also on how sources of geopolitical instability in Europe will play out. In any event, bouts of financial turbulence such as those seen in early 2016 may occur again (with higher or lesser intensity), against a background of great uncertainty about emerging countries' ability to cope with the slowdown and for developed central banks to revive growth.

DISCLAIMER

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