

2. Global context: more growth, greater uncertainty and long-term risks

While the global context improved in the closing months of 2016 and continues to do so at the start of 2017, greater uncertainty shrouds the year to come and a note of caution is advisable in making economic predictions.

Global economy accelerates

Global GDP growth accelerated in the last quarter of 2016 by 0.9% of the quarterly rate, and suggests slightly higher rates in the first quarter of this year, in contrast with the rates below 0.8% during most of last year. There is a notable increase in confidence in all areas, and the indicators for the industrial sector are growing alongside a budding improvement in world trade.

The performance of the advanced countries has been behind this improvement, with the US recovering in the second half of the year (after a very weak first half) and Europe consolidating growth rates of just over 1.5% YoY, above its potential. China has also advanced more than expected, thanks to the monetary and fiscal stimulus packages implemented during the past year, which have in part carried along other Asian countries. In Latin-American countries, recent trends are more notably varied. All in all, the global economy would have grown 3% in 2016, below the 3.3% of 2015, however with a positive trend through the year.

Figure 2.1

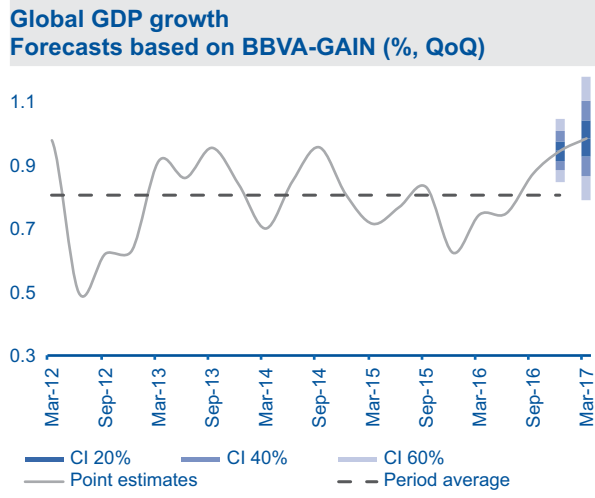
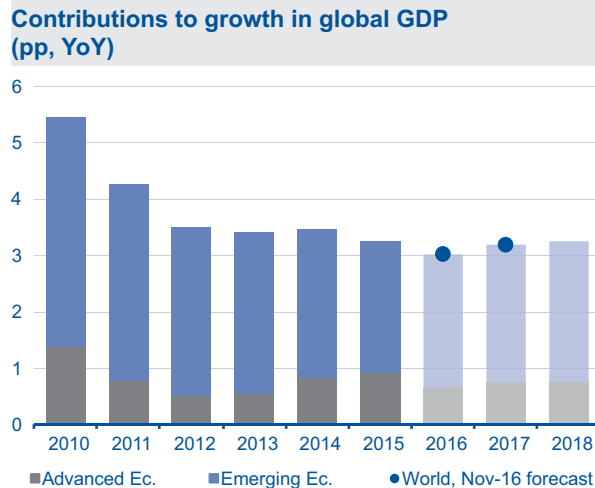


Figure 2.2



Despite this acceleration, the outlook for 2017 and 2018 is plagued with uncertainty. This is principally related with the economic policy of the new US administration, the shape of which remains largely to be seen. Measures for fiscal stimulus and deregulation in various sectors have been announced, to a positive reception following the elections. Since Trump's victory, 10-year interest rates have risen by 63 base points to 2.50%, with a global knock-on effect – both in Europe and emerging markets. The value of share indices has increased globally (+6.6% in the US, +8.5% in Europe), and the dollar is up by about 2% against major currencies and the euro. Emerging markets were negatively affected by the US election result, recording capital outflows and experiencing downward pressure on their currencies, particularly Mexico.

That said, the announcement of protectionist measures (withdrawal from the TPP trade agreement in Asia, considerable doubt about the TTIP with Europe and requests for renegotiating NAFTA, with forewarnings of potential increases in tariffs), could seriously harm international trade in the medium and long term and impinge on confidence in the near future, particularly outside the US. The magnitude of the fiscal impulse remains to be defined, and likewise what form it will ultimately take (higher bills for infrastructure or, more than likely, corporate tax reductions) and above all, to what extent it may stimulate activity or generate greater inflation, given that the US economy may be close to reaching its potential growth. For this reason, from the start of the year, markets have been showing moderate optimism and their dynamics have corrected slightly. Markets remain more cautious as they try to assess the negative impact of protectionist measures in the medium and long term. Looking ahead, disengaging increased uncertainty about economic policy from low volatility at an aggregate level does not appear sustainable.

Uptick in inflation generates pressure over monetary policy

The magnitude of inflationary pressures is another unknown opening up at a global level. The costs of raw materials have rebounded in recent months, somewhat more than predicted, following the OPEC agreement and the improvement in activity. The price of Brent crude oil was around 56 USD/barrel at the start of 2017, whereas we had been hoping to see a somewhat slower transition to its level of long-term balance (60 USD/barrel, which we expect will be reached by the end of 2018). This is coupled with how the underlying effects of energy prices are driving annual inflation at rates closer to the inflation targets of the central banks, which has raised expectations for long-term inflation discounted by the markets. Tying this in with the scale of the accumulated balances in recent years through quantitative growth programs and the outlook for fiscal stimulus packages, means the result is that the deflation risks of only a few quarters ago have been replaced by inflationary pressures, raising questions about how monetary policy may respond.

In theory, the Federal Reserve is taking a cautious approach and continues to point towards a relatively sluggish normalisation of rates (although recently they have slightly upwardly revised their interest rate expectations in 2017, with three increases of 0.25% in 2017, up to 1.50%). In its latest communications it has acknowledged a slight improvement in the outlook for growth and inflation, based on forecasts for fiscal growth, while maintaining a balanced tone between upward and downward risks. Our forecast is for two interest rate increases to take place this year, with a further two in 2018.

At the end of 2016, the ECB approved an extension of QE until December 2017, while reducing monthly asset purchases from 80bn to 60bn euros from March onward, underlining that we are not looking at a gradual withdrawal from the programme. Even so, the pressures to bring forward the normalisation of monetary policy have already begun with a hike in prices in Germany, and may well intensify in the coming months when inflation in the Eurozone approaches 2% owing to the effects of energy prices. As part of our forecasting, we expect the ECB will begin the process of withdrawal from QE in early 2018 and decide on the first interest rate increase at the end of that year.

All in all, our growth projections for 2017 have undergone no substantial revision, although they are subject to a higher degree of uncertainty than normal. The base effect of increased growth at the end of 2016 and its inertial effect, together with the fiscal stimulus packages expected in the US, encourage us to both moderately and upwardly revise the forecasts for the US and Europe, and slightly more for China, while the forecasts for Latin-American countries are being revised downward, principally due to idiosyncratic factors.

The scenario is not exempt from risks, especially from protectionism

The risks are largely downward and are governed by the mentioned uncertainty linked with protectionism in the US, a less friendly attitude towards immigration and the danger that the fiscal stimulus policies will not have any impact on growth and will increase inflation, or that the deregulation announced in various sectors will not be properly managed. In addition, there is the potential reaction of other countries or regions to these pro-

tectionist impulses. An anticipated increase in inflation may lead to a toughening of monetary policy from the major central banks, with global consequences. In the long term, the risks of the accumulation of imbalances in China, together with the lack of structural reforms and the restructuring of public companies, may have an impact on capital flows and currency and lead to sudden slow-down in growth. Europe is subject to substantial political risks, in a year that is packed with election dates, and where certain increasingly powerful parties propose going back on structural reforms or on measures to quit the euro zone or the European Union. And, generally speaking, geopolitical risks continue to run high.

The U.S.: no major changes while awaiting the first political economy measures

GDP growth in 2016 closed at 1.6%, following a second half of the year (3.5% annualised in Q316 and 1.9% in Q416), which was notably more positive than the first (0.8% and 1.4%). The likelihood that the new administration could implement regulation and fiscal reforms at random and that they would have a significant effect this year is not very high, given their ambition and the reduced margin for growth above the potential, although corporate confidence and short-term investment could be encouraged, due to the latter we have revised our forecasts slightly upward up to 2.3% this year, and we expect 2.4% in 2018. We see inflation exceeding the target and climbing by an average of 2.3% this year before reverting to 2% in 2018.

China: slower deceleration than expected owing to fiscal stimulus

The growth in the fourth quarter was 6.8% YoY, which closed out 2016 at 6.7% on average, slightly above what was expected. Various activity indicators, including industrial production and retail sales, improved in December and suggest better times at the start of this year. For 2017 on the whole, we expect growth of 6% (revised two tenths upward from our previous forecast), and around 5.2% for 2018, given the vulnerabilities which the economy is faced with and an economic policy geared more towards ensuring financial stability rather than maintaining growth. Our predictions for inflation remain unchanged at 2.7% and 3.0% in 2017 and 2018, respectively.

Eurozone: resistance to numerous shocks

Growth in 2016 closed at 1.7%, slightly higher than what was expected, after a positive last quarter (0.5% QoQ) which shows the recovery of industrial activity and, to a lesser degree, exports. Confidence indicator figures remain quite high, despite the political surprises experienced in recent months (Brexit and the referendum on Italian constitutional reform). For 2017 and 2018 similar rates of growth are expected (1.6% in both years), above potential growth, supported by very relaxed monetary conditions, a devalued euro and non-restrictive fiscal policies. The factors geared against stability are oil prices (slightly higher than expected) and the political risks affecting many countries in the region. Inflation should in theory remain below the target of 2% over both years, although it will reach a peak at the start of this year, close to this value owing to base effects and energy price increases, before subsequently marginally reverting. The key, in this sense, will be to observe how underlying inflation develops, being currently stable below 1%, and which should approach rates above 1.5% at the end of the forecast period.

Emerging economies: the management of weaknesses will have a decisive impact due to domestic and external factors

In Turkey, inflationary pressures have increased due to the depreciation of the Lira, which may trigger a harsher monetary policy in 2017 in a context of lower than expected growth, around 2.5% in 2016 and 2017, before recovering some traction in 2018. In Mexico, the economy moderated its growth by just over 2% in 2016 and this could drop further to 1% in 2017 owing to the uncertainty relating to trade measures which the US may adopt, along with a hardening of monetary policy to anchor inflation forecasts. For 2018, it is estimated that the growth in GDP will once again increase by around 2%. For Latin America as a whole, the GDP may have contracted by more than 2% in 2016, although it ought to recover and increase slightly by around 1% in 2017, thanks to a greater contribution of the external sector, the end of the downturn in Brazil, private investment in Argentina and plans for public investment in countries such as Colombia.

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