

2. Global environment: global growth consolidates but there are still risks

Gradual acceleration and more restrained extreme scenarios

During the second half of 2016, the global **GDP growth rate stood** at 0.9% QoQ, and the most recent data point to similar rates for the beginning of 2017, which compares positively with the 0.8% recorded on average since 2011. The overall improvement in confidence indicators, along with the advance of global trade are behind this acceleration in activity. **The performance of the advanced economies continues to be particularly positive** thanks to the

The global economy continues to accelerate

consolidation of the USA recovery and Europe growing at rates that are above their potential. **On the contrary, Latin American** will emerge this year from the recession, although with a moderate growth.

Improved global behaviour is accompanied by some **clarification regarding the course of the economic policy in USA**, where expectations of a rapid reflation have been limited, or at least the timing of measures to support changes in that direction has been limited. Therefore, the government appears to be considering moderate proposals on a possible renegotiation of the NAFTA, while it continues to face obstacles in pursuing policies to restrict immigration. Nevertheless, the difficulty of pushing forward with the reform of the health care system has also revealed problems with getting other measures approved, such as those linked with tax cuts or the infrastructure expenditure plan, which eliminates the likelihood of a strong fiscal impulse in the short run.

Financial markets have remained calm over the last months, recording low volatility in spite of the high uncertainty. Financial tensions have relaxed, especially in the emerging economies, which were more negatively affected at the end of last year due to the uncertainty after the US elections. **Europe is an exception to this trend**, as the uncertainty about the elections in France has widened the debt spread in France and the periphery.

Moving towards monetary policy normalisation

The combination of a cyclical upturn, the reversal of inflation from negative rates and, above all, the moderation or disappearance of deflationary risks have provided the basis for the central banks to leave ultra-expansionary policies behind. **The Fed, which leads this process has brought forward its third rate increase** to March. The rise in rates has not caused any adverse effects on the financial markets, fundamentally because it is broadly in line with the progress made by the economy, which is nearing full employment, and also because the Fed is maintaining its gradual exit message. In addition, the Federal Reserve is discussing how to approach the third phase of the exit strategy, i.e. the reduction of the balance sheet (once the -QE- bonds purchase programme is completed, and as interest rate increases are consolidated). But it is something that will probably not happen until next year and will be put in place passively.

The ECB is also more optimistic about growth, but still not very confident about inflation reaching its medium term target. Thus, the announced QE recalibration is being taking place since April, reducing monthly purchases of public and private debt, from 80 billion to 60 billion euros. This reduction in purchases and some changes in the ECB's communication are a first step in the exit strategy. In this regard, the monetary authority is expected to change its forward guidance to prepare the market for the timing and order that will follow. According to our scenario, we expect the ECB to continue reducing the bond purchases during the first part of 2018 and to not extend them beyond the summer, to start the upward cycle of rates at the end of the same year.

In short, we are facing a normalisation process for monetary policies, which, until now, were very accommodative. Therefore, an increase in financing cost can be expected at global level on the projected horizon. Communication policy will be key into this process, to prevent mistakes like the famous "taper tantrum" (overreaction in 2013 of the bonds market to the withdrawal of stimulus) in the USA. The tightening of financing conditions not only depends on the intervention rates set by the central banks but also on the long term interest rates. In this case, there are factors that continue to pin down the long end of the curve, such as elevated uncertainty, the lack of safe-haven assets and certain regulatory features.

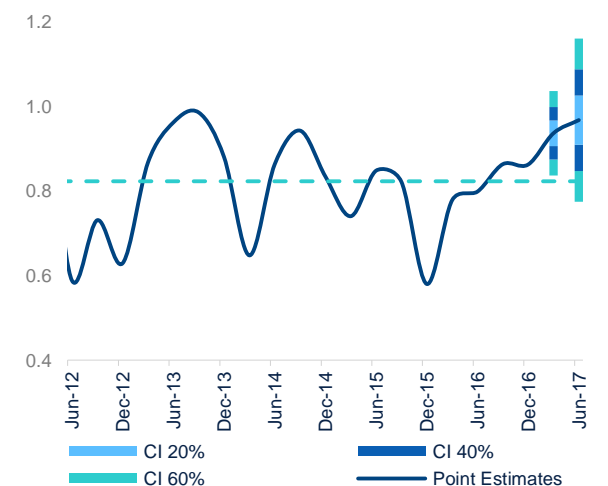
Slightly upward revision of growth but still with risks of a downturn

Overall, growth forecasts for 2017-18 are only marginally revised. The positive start of the year move them up for the Eurozone and especially China, while for the Latin American countries are rather more negative this year (with the notable exception of Mexico). As a result, expected global growth is **3.3% for 2017 and 3.4% for 2018**, which, in both cases, is 0.1pp higher than our previous forecasts.

Risks associated with increased protectionism remain

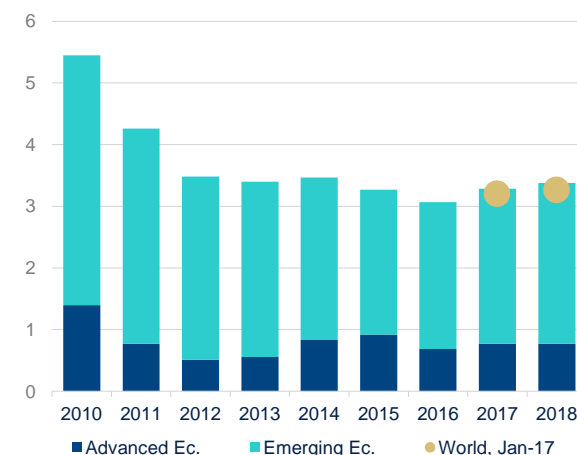
In spite of the above, the risk events that are perceived, if produced, would mostly reduce growth. In particular, beyond the uncertainty that is still associated with the **measures about to be approved in the USA**, doubts centred around the election results in **France and Italy**, due to the highly negative impact they could have on the Eurozone stability in the (unlikely) event of overcoming strongly anti-European options. Additionally, there is also the **risk associated with the Chinese economy**, where the recent strength of investment may slow down the imbalance reduction process. Other significant elements that remain uncertain and which will be important to consider in the coming months include the evolution of the negotiations on Brexit, the multiple open geopolitical events and the risks associated with the normalisation of monetary policy, especially in the USA.

Figure 2.1 Global GDP growth Forecasts based on BBVA-GAIN (% , QoQ)



Source: Haver and BBVA Research

Figure 2.2 Global growth by region (% , year-on-year)



Source: BBVA Research

United States: growth just above 2% in 2017-2018

The investment underpins the upturn in activity in the USA

The probability that the new administration could implement the promised fiscal reforms and that they would have a positive impact on the projected horizon has decreased and, at any event, its impact on growth should be limited in an economy that is continuing to grow above their potential. GDP **growth continues to be 2.3% for 2017 and 2.4% for 2018, supported by acceleration in investment**, which will benefit from the improvement in expectations, stable oil prices and the recovery of the housing market. This should compensate the expected moderation in consumption due to higher inflation and a more gradual improvement in the labour market. In this context, **the Fed is expected to continue with the gradual normalisation of monetary policy**, although we are now expecting two additional rises this year (up to 1.50%) and two more in 2018, up to 2%.

China: upward growth revision due to improved recent data, as a result of its economic policy support

After relatively stable economic growth throughout last year (around 6.7% for the year), **the signs of certain acceleration in 4Q16 appear to be confirmed at the beginning of 2017**. The available indicators point to a growth close to 7% in annual terms, caused by investment, which continues to benefit from the support of an accommodating monetary policy and fiscal stimulus. Despite the upward revision of GDP growth forecasts in 2017-2018 of around 0.5%, **we continue to expect a deceleration in growth on the projected horizon**, from 6.7% in 2016 to **6.3% this year and 5.8% in 2018**. Despite of the significant increase in industrial prices due to an increase in commodity prices and shrinking supply, **inflation remains moderate** (2.3% expected in 2017 and 3% in 2018). However, apart from the improved expectations, based on a more growth-oriented economic policy, **the risks will increase in the medium**

term as the growth pattern adjustment process has halted and could accentuate the financial fragilities derived from a recovery based on the increase of the indebtedness of the economic agents.

Europe: a little more growth, with no significant risk of inflation

Risks in Europe are mostly political

GDP growth may have gained traction at the beginning of this year (around 0.5% QoQ) supported by improved global demand and confidence. However, the above-mentioned risks make difficult to think about greater forward acceleration in an economy that has already been growing above its potential since 2015. However, **we have slightly revised growth to a 0.1% rise in 2017 and 2018, to 1.7% in both years**, reflecting the more positive data, which, as in the case of the USA or China, are based more on foreign trade and investment than on private consumption. BBVA Research scenario also estimates a moderation in inflation from the first half of the year, as the sharp increase seen since the end of 2016 was mainly due to the base effect of energy prices and the increase in unprocessed food prices. On the other hand, core inflation remains stable and at low levels while, wage growth is highly contained. Therefore, we have slightly revised the inflation forecast upwards to 1.8% in 2017, but we are keeping a price change of 1.6% for 2018, while **we still expect core inflation to be at around 1.5% by the end of 2018**.

5. Glossary

Acronyms

- AENC: Bipartite Inter-Confederal Agreement on Employment and Collective Bargaining
- APP: Asset Purchase Programme
- APR: Annual Percentage Rate
- BBVA: Banco Bilbao Vizcaya Argentaria
- BBVA – EAE: BBVA Economic Activity Survey
- BBVA – GAIN: BBVA Global activity index
- CDS: Credit Default Swaps
- CEOE: Spanish Confederation of Employers' Organizations
- CEPYME: Spanish Confederation of Small and Medium sized Enterprises
- CC. OO: Trade Union Confederation of Workers' Commissions
- CPI: Consumer Price Index
- EAGLES: Emerging and Growth-Leading Economies
- ECB: European Central Bank
- EMU: European Economic and Monetary Union
- EPU: Economic Policy Uncertainty Index
- EU: European Union
- EURIBOR: Euro interbank Offered Rate
- FCE: Final Consumption Expenditure
- FED: Federal Reserve System
- FTE: Full time equivalent
- GC: Governing Council
- GDP: Gross Domestic Product
- IC37: Group of Industrial Countries comprising the 28 EU members plus the US, Canada, Japan, Switzerland, Norway, Australia, New Zealand, Mexico and Turkey
- INE: National Institute of Statistics
- LATAM: Latin America aggregated including Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela
- LFS: Labour Force Survey
- ME and SS: Ministry of labour and social security
- MICA-BBVA: Factor Model of Economic and Financial Indicators for Short-term GDP Forecasting
- MINHAP: Ministry of Finance and Public Administration
- NAFTA: North American Free Trade Agreement
- OPEC: Organization of the Petroleum Exporting Countries
- PA: Public Administration
- QE: Quantitative easing
- ULCs: Unit labour costs
- US: United States
- UK: United Kingdom
- SMEs: Small and medium-sized enterprises
- SWDA: Seasonally and working day adjusted
- UGT: General Workers Union

Abbreviations

- bps: Basic points
- CI: Confidence interval
- MoM: Month on month change
- pp: Percentage points
- QoQ: Quarterly on quarter change
- YoY: Year on year change

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