2. 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 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.

The global economy continues to accelerate

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 been 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.

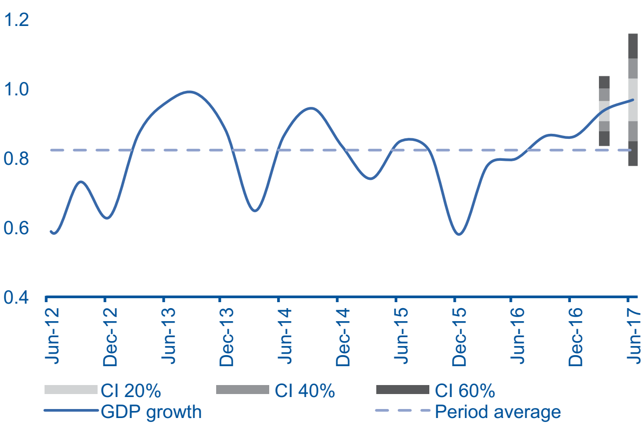
Slightly upward revision of growth but still with risks of a downturn

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

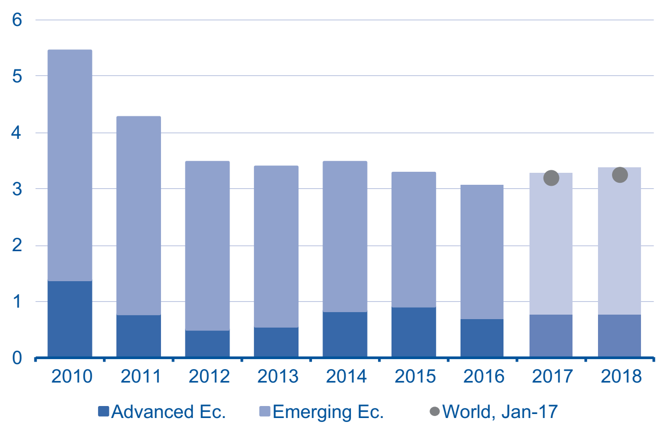
In spite of the above, the risk events that are perceived, if produced, would mostly reduce growth. In particular, beyond the uncertainty that is still associated with the measures about to be approved in the USA, doubts centred around the election results in France and Italy, due to the highly negative 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.

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called “BBVA”) to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document is based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates´ salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates’ proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

This document is provided in the United Kingdom solely to those persons to whom it may be addressed according to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 and it is not to be directly or indirectly delivered to or distributed among any other type of persons or entities. In particular, this document is only aimed at and can be delivered to the following persons or entities (i) those outside the United Kingdom (ii) those with expertise regarding investments as mentioned under Section 19(5) of Order 2001, (iii) high net worth entities and any other person or entity under Section 49(1) of Order 2001 to whom the contents hereof can be legally revealed.

The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA Bancomer and the rest of BBVA Group who are not members of FINRA (Financial Industry Regulatory Authority), are not subject to the rules of disclosure for these members.

“BBVA Bancomer, BBVA and its subsidiaries, among which is BBVA Global Markets Research, are subject to the Corporate Policy Group in the field of BBVA Securities Markets. In each jurisdiction in which BBVA is active in the Securities Markets, the policy is complemented by an Internal Code of Conduct which complements the policy and guidelines in conjunction with other established guidelines to prevent and avoid conflicts of interest with respect to recommendations issued by analysts among which is the separation of areas. Corporate Policy is available at: www.bbva.com / Corporate Governance / Conduct in Securities Markets”.

BBVA | Research

This report has been produced by the macroeconomic unit of Mexico:

Chief Economist
Carlos Serrano
carlos.serranoh@bbva.com

Javier Amador
javier.amadord@grupobbva.com

Iván Martínez
ivan.martinez.2@bbva.com

Fco. Javier Morales
francisco.morales@bbva.com

Arnulfo Rodríguez
arnulfo.rodriguez@bbva.com

With the collaboration of:
Economic Scenarios

BBVA Research

Group Chief Economist
Jorge Sicilia

Macroeconomic Analysis
Rafael Doménech
r.domenech@bbva.com

Global Macroeconomic Scenarios
Miguel Jiménez
mjimenezg@bbva.com

Global Financial Markets
Sonsoles Castillo
s.castillo@bbva.com

Long Term Global Modelling and Analysis
Julián Cubero
juan.cubero@bbva.com

Innovation and Processes
Oscar de las Peñas
oscar.delaspenas@bbva.com

Financial Systems and Regulation
Santiago Fernández de Lis
sfernandezdelis@bbva.com

Countries Coordination
Olga Cerqueira
olga.gouveia@bbva.com

Digital Regulation
Álvaro Martín
alvaro.martin@bbva.hk

Regulation
María Abascal
maria.abascal@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Financial Inclusion
David Tuesta
david.tuesta@bbva.com

Spain and Portugal
Miguel Cardoso
miguel.cardoso@bbva.com

Unidos States
Nathaniel Karp
Nathaniel.Karp@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Middle East, Asia and Geopolitical
Álvaro Ortiz
alvaro.ortiz@bbva.com

Turkey
Álvaro Ortiz
alvaro.ortiz@bbva.com

Asia
Le Xia
le.xia@bbva.com

South America
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Julio Pineda
juliocesar.pineda@bbva.com

BBVA Research Mexico
Paseo de la Reforma 510
Colonia Juárez
C.P. 06600 México D.F.
Publications:
e-mail: bbvaresearch_mexico@bbva.com

These and other BBVA Research publications are available in English and in Spanish at:
www.bbvaresearch.com

Other Publications: