2. Global outlook

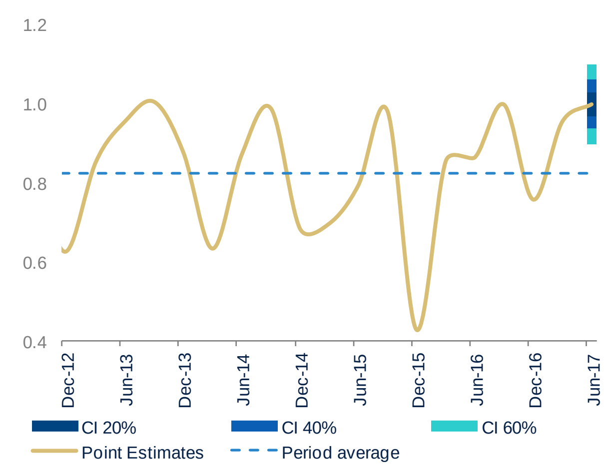
Robust and steady global growth, with some rebalancing across major areas

After a pickup in global growth in 1Q17, the expansion has stabilized. As a result, our new forecasts are for global growth to stay at 3.3% for 2017 and 3.4% for 2018, based on an upward revision for both China (in both years) and Europe (in 2017) and a modest downward revision in the U.S. In Latam, deteriorating commodity prices and heightened uncertainty in several countries have delayed the exit from recession. Forecasts indicate that in the coming quarters emerging economies should make up ground on the advanced countries and China, which have led the recent upturn.

The drivers behind the recent pick-up will remain in place, albeit with slight variations: Monetary policy accommodation will ebb as the process of normalisation unfolds while oil prices are set to continue their upward trajectory albeit with greater volatility. The flurry of geopolitical events could impact economic confidence and markets, although these headwinds are expected to moderate throughout the year.

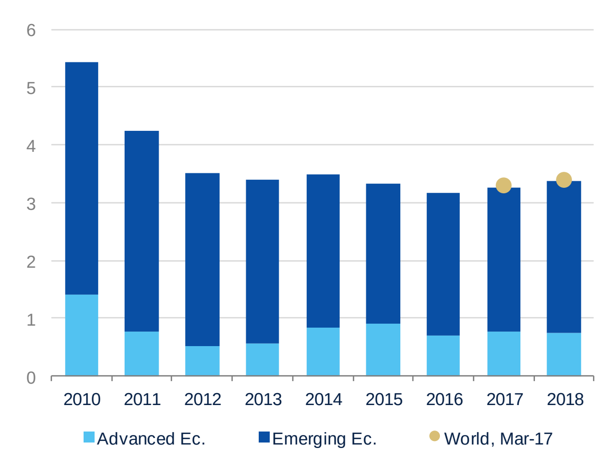
The tone in financial markets has been upbeat, with volatility at historic lows in spite of the persistent economic, political and geo-political uncertainty, as well as the correction to expectations of fiscal stimulus in the U.S. As a result, long-term interest rates have remained low, while pressures on the dollar have eased somewhat. This financial climate of low volatility and interest rates, combined with a weaker dollar and better economic conditions have boosted equities while benefiting emerging markets. European assets, including the euro, have also become more appealing, following the French elections and better economic performance in Europe, attracting capital inflows into the Eurozone.

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



Source: BBVA Research

Figure 2.2 Regional GDP forecasts
(YoY, %)



Source: IMF and BBVA Research

In Europe, economic growth has continued to pick up momentum in the first half of the year, with slightly better than expected GDP performance, standing above 2% in annualized terms. Moreover, the improvement has been broad-based, across both demand components and countries. Stronger global demand has underpinned the rebound in exports, which together with improved confidence, is spurring investment and employment. For this reason, we have revised upwards our growth forecasts in 2017 by three tenths to 2%, which means above-potential growth for the third year in a row. Inflation eased in the second quarter due to energy price base effects, while core inflation rose by two tenths and is hovering at around 1%. The smaller oil price rise, along with a stronger euro, lead us to revise our forecast slightly downwards for headline inflation by around two tenths to 1.6% in 2017 and 1.4% in 2018.

The European Central Bank (ECB) is holding interest rates unchanged and sticking to the asset purchasing programme. We expect that the ECB will take a further step by announcing a reduction in its purchasing of assets at the September meeting, which would be implemented from January 2018 onwards. Assuming that the central bank does not change the exit sequence, interest rate increases would take place by late 2018.

In China, after the rebound in growth observed earlier this year, the latest figures point to a more gradual slowdown than previously expected. Behind this performance lies the support from a prudent monetary policy and fiscal stimulus, which have boosted credit and investment. In addition, the improvement of the external environment and the depreciation of the real effective exchange rate have buoyed economic conditions. In this context, the authorities are still balancing growth, an orderly deleverage and fending off financial weaknesses. As such, we have revised upwards our GDP growth forecasts by 0.2pp in 2017-18, which would mean achieving the official target of 6.5% in 2017, although we continue to expect a slowdown to 6% in 2018.

This improving environment, which mainly affects advanced economies, is being accompanied by a rebalancing in the United States and in Europe, both in terms of activity and on the political front. In contrast, the emerging economies have performed poorly, with a slower than expected exit from the recession in Latam. The key question is whether markets are too complacent considering that policy uncertainty remains elevated. Still, the world has lived with elevated uncertainty for several years while avoiding another crisis, fundamentals appear stronger than in previous years, institutions in the developed world have managed to overcome ongoing attacks and markets have found new alternatives to hedge risks. This doesn't mean that we can rule out episodes of elevated volatility going forward, particularly as major central banks continue moving forward with an unprecedented normalisation process.

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