2. Global outlook

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

The world economy has been picking up in recent quarters with growth rates of 1% QoQ; **although it has tended to stabilise**. **Global confidence is clearly positive**, especially in the advanced economies, showing robust figures. **World trade growth** has recovered swiftly from the very low levels of the middle of last year and **only seems to have slowed somewhat in April and May**. All of this has also led to a recovery in industrial activity and investment globally.

This positive dynamic is a consequence of the **prime driver of the recent expansion - the economic policy stimulus of the Chinese economy-** that has driven growth in other Asian countries and in turn in the rest of the world economy. Other drivers of the global cyclical pattern, such as **extremely accommodative monetary policies** in most of the advanced nations, **fiscal policies that have recently generally been neutral or expansionary and relatively moderate commodity prices**, have also helped the global recovery. Financial markets have also been calm and have not suffered persistently from sources of political tension; the latest, the presidential elections in France.

This improving environment, which is mainly affecting the advanced economies is being accompanied by a certain **rebalancing from the United States towards Europe, both in terms of activity** (negative surprises in the United States earlier in the year and positive ones in the Eurozone). In addition, **on the political front** with the US administration's difficulties in pushing through measures compared to the outcome of elections in Europe that had threatened to cast doubts over the euro project. In contrast, **the performance of Emerging Economies has been asymmetrical**, with a slower than expected exit from the recession of net commodity exporters, such as Latin America, and better performance from those experiencing positive terms of trade.

This environment of positive growth is currently accompanied by **moderate inflation levels**. Whereas **deflation risks appear to have been overcome**, the glut of liquidity in markets because of very expansionary monetary policies has not translated into an acceleration of inflation. This is because of the overhang of unused capacity (especially of labor) seems to be putting the brake on any substantial pressure from wages and core inflation, while **the delay and, to some extent, reversal of oil prices in recent months has dampened price expectations and headline inflation rates.**

Calm financial markets and normalisation of monetary policies

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 a fiscal impulse in the United States. As a result, **long-term interest rates have remained anchored, partly correcting the rises in previous quarters, while the dollar has interrupted its firming course.** This financial climate of low volatility and interest rates, and a weaker dollar combined with a better economic environment **has boosted equities and the financial assets of**

emerging markets. European assets, including the euro, have also become more appealing. Following the French elections and better economic performance in Europe, capital inflows into the Eurozone have turned around.

The **big question is whether the markets are being too complacent**, particularly bearing in mind that the major central banks are moving forward in the normalisation process. Even though the tone of monetary policy is still accommodative, in the last quarter, in tandem with the improvement of the economy, steps were taken to prepare the markets for a gradual withdrawal of stimuli.

The US Federal Reserve (Fed) has hiked interest rates twice in 2017; reaching 50 basis points overall, **and has announced and outlined a plan to gradually reduce its balance sheet.** From now until year end the Fed intends to carry out one more 25bp hike, probably in December, and embark on a “passive” course of action (i.e. by not renewing overdue assets) and steady scaling down the balance sheet, which it is likely to start in October. Even so, in the absence of robust growth and with very restrained price and wage inflation, market expectations are not aligned with those of the Fed (which are more bearish). In any case, shrinking official rates will make it more challenging to ease monetary policy in Emerging Markets.

The European Central Bank (ECB) is holding interest rates unchanged (the refi rate at 0% and the deposit rate at a negative level of -0.40%), as well as sticking to the asset purchasing programme (currently at 60bn euros per month). Nonetheless, **the ECB is more confident about the strength of growth and considers that the risk of deflation has disappeared, which has given rise to the first changes in its forward guidance**. In June the ECB removed its downward bias as regards rates, which is interpreted as a first step on the long road of normalisation. **We expect that, the ECB will take a further step by announcing a reduction in its purchasing of assets (i.e. tapering) at the September meeting, which would be implemented from January 2018 onwards**. Assuming no change in the exit sequence, interest rate rises would take place by late 2018. Here, **a good communication strategy is key** to avoiding tensions in financial markets, especially since they have been rather sceptical about any imminent normalisation.

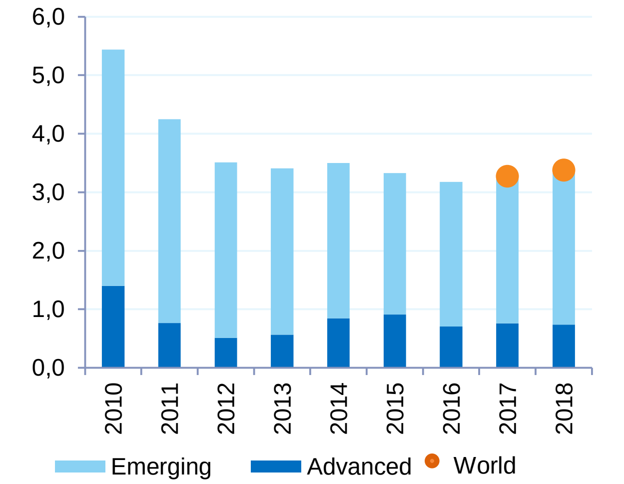
We maintain a stable growth forecast in 2017-18, with risks still on the downside

Our **new forecasts imply that global growth will stay at 3.3% for 2017 and 3.4% for 2018**, with **an upward revision for both China (in both years) and Europe** (in 2017). The latter is due to a better-than-expected first half of the year, whereas **our estimate for the United States has been slightly revised downwards** due to a poorer than expected performance in the first quarter, as well as greater difficulties in getting expansive fiscal measures and undertaking reforms approved. In Latam, deteriorating commodity prices this year and heightened domestic uncertainty in several countries have meant that exiting the recession is taking longer than had been foreseen. These forecasts indicate that in the coming quarters the emerging economies should make up ground on the advanced countries and China, which has led the recent upturn.

The drivers behind the recent pick-up will remain in place, albeit with slight variations: **monetary policies will gradually enter into a process of normalisation, while fiscal policies will remain relatively neutral or**

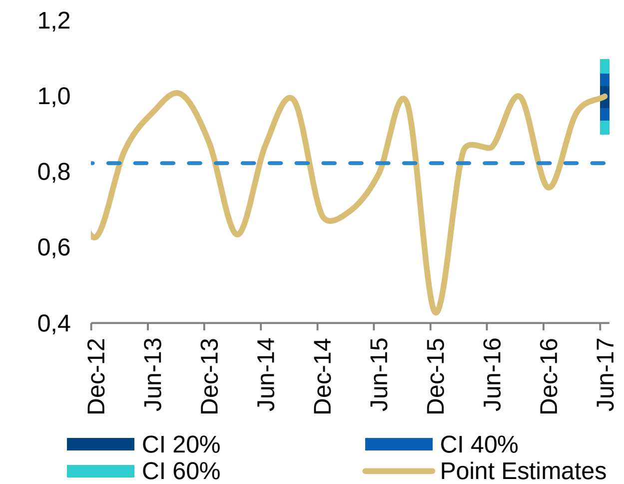
expansionary. Oil prices, which have slowed down their progression to long term equilibrium levels (USD60/bbl) due mainly to increased supply factors (from producer countries such as Libya, Nigeria and the United States), **are set to continue their rising course.** The flurry of politically-related events (elections in Germany and Italy, Brexit negotiations, initiatives geared towards closer integration in the European Union, the political agenda in the United States, and the electoral cycle in LatAm in 2018) could influence economic confidence and the situation in the markets, although these seem to be having less of a long-lasting impact.

Figure 2.1 Regional GDP forecasts (YoY, %)



Source: IMF and BBVA Research

Figure 2.2 World GDP growth (QoQ, %) Forecasts based on BBVA-GAIN



Source: BBVA Research

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