# Improved global growth scenario is weak and fragile

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The diagnosis of the global economic scenario has improved in the last three months after the downward adjustment of global growth and the drops in financial markets. The growth registered by the Chinese economy in 1Q16 (6.7% y-o-y) calmed market nerves about the intensity of the adjustment taking place in the Asian giant, which has been softened thanks to the greater monetary and fiscal support being implemented by authorities. The risk of a sharp adjustment in the exchange rate has also diminished, while capital outflows have also been stemmed. Commodity prices, especially oil, have joined this benign trend, with increases from such low levels that they put pressure on fiscal accounts or the cost of debt for large companies in oil producing companies, whose debt is also denominated in dollars. This, apart from fiscal adjustments and halting activity in commodity producing economies, produced a negative feedback loop in the global markets and eroded the value of financial assets in the private sector, which partly offset the positive effect on growth from lower energy costs, for example.

However, the improvement in the global scenario is smaller and more fragile, without any fundamental changes in the factors that define a low-growth environment exposed to wide range uncertainties. The improvement of the last few months is smaller because the pace of global growth in the first half of 2016 is only expected to be in the 2.6% to 3% y-o-y range. Somewhat better than the 2.5% y-o-y of 4Q15, but below the 3.2% average of the 2011-15 period or the 4% of the decade before 2008. Another reason for caution is the drop off in global trade which, both in goods and services, started to slow at the end of 2014 and is already growing at the slowest rates since the crash at the end of 2008.

As for the fragile economic outlook, the fact that the ECB, the Bank of Japan or the People’s Bank of China have taken or are going to take more accommodative measures, as well as the debate in the Fed on whether to raise rates or not, show how vulnerable growth is and how difficult it is to achieve price stability. However, the fragile economic outlook mainly caused by uncertainties significant enough to spur financial market volatility and hinder growth, are more frequent now in the “new normal” after the global crisis of 2008-09 and the European sovereign debt crisis of 2010-11. This situation is due to two new developments underpin the greater prevalence of uncertainty in the economic landscape. First we have the wider range of potential risk sources: 1) emerging economies that are increasingly integrated in financial terms and which, on many occasions, take advantage of boom times in commodity markets to take on more debt, especially the business sector, at an apparently unsustainable pace, 2) the transition underway in China to a truly free market economy, for which there is no precedent to serve as a guide and 3) the structural changes in the energy market with unconventional oil extraction techniques and the reaction of the oil cartel.

Secondly, the extensive use of QE and anchored interest rates, now in uncharted waters, may have distorted risk valuations by economic agents, as valuations drift away from economic fundamentals and play a role in increasing financial volatility, given that no one has ever had to design an exit plan for such an exceptional scenario. All said, this abundance of global liquidity may also be behind the fact that ever more frequent uncertain events in the markets, their persistence and, with it, their cumulative effect on GDP, is somewhat smaller than in the run-up to the crisis that started in 2007.

In summary, the diagnosis of the global economic outlook will continue to depend on financial markets that are keeping an eye on a wide range of potential risks because the growth drivers are slowing down or losing steam.