

Stranger Things

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2016 has been a year of surprises. First came the surprise result of the UK referendum in favour of leaving the EU, to be followed a few months later by the US presidential elections. Both events mark the end of the status quo. It remains to be seen whether they signal the start of a new paradigm, but they certainly raise some big questions. Which makes it all the more surprising that the markets should have reacted relatively calmly to the great uncertainty characterising the global environment. For rather than going into a general downward spiral of asset prices as we have seen with previous shocks, this time the markets have reacted with short-lived dips, i.e. the losses have reversed more or less quickly. At year-end, financial risk indicators such as volatility in both developed and emerging stock markets and credit spreads are lower than they were at the beginning of the year; except for continental Europe the main stock market indices are higher; and US interest rates are picking up again, not just because of the outlook on inflation but also due to expectations of greater growth, which are at 3.8% for 4Q16 on an average worldwide basis according to BBVA Research estimates. So have we witnessed in 2016 a manifestation of "the upside-down", the parallel universe of the hit TV series "Stranger Things"? It is too early to say: it may be that we will only be able to assess the implications of the events of 2016 with the passage of time.

Neither the Brexit vote nor Trump's victory were really events likely to lead to generalised risk aversion. While the results were admittedly unexpected, they were nonetheless very much on everyone's radar. Which was not the case in the summer of 2015 when China's central bank suddenly changed its policy on the currency's trading band. Due to the lack of credible communication on the part of the authorities, we had to wait two months for the data to confirm that no sudden and intense adjustment to the real economy was taking place. In the next few weeks we will have to stay alert to any new bouts of volatility stemming from the rebalancing of China's economy, which is under strain from having to continue growing while maintaining social peace and at the same time correcting the excessive debt and inefficient allocation of resources which are secondary effects of its having stretched out its expansive monetary policies. A difficult balancing act, set to continue in 2017.

The immediate negative impact of the Brexit vote was partly mitigated by the active role played by the Bank of England and the implicit support of other central banks. However, monetary policy is not the appropriate instrument with which to react to the challenges looming for the EU, and particularly for the UK: negotiation of the break from the EU, trade treaties with third countries, the impact on financial flows deriving from the change of status of the City, London's financial centre, etc.

As for Trump's victory, apparently a politically conciliatory and economically reflationary acceptance speech was enough to spread optimism. And this encouraged investors to take more risk, moving out of fixed income into equities, which are buoyed by expectations of increased earnings. Yet much remains to be seen, not least the trade policy that the new administration will implement. The statements made so far, with a mercantilistic view of trade, have questioned agreements with major trading partners and ignored the role of global value chains. If confirmed, this policy could lead to quite the opposite of what is intended, namely more uncertainty, lower growth and less employment in the US and in the rest of the world.

In summary, in 2016 we witnessed strange events, the dénouement of which remains to be seen, so 2017 gets off to a very uncertain start both politically and in terms of economic policies to be implemented. We

should keep our eyes on the West Wing of the White House - another great series. Happy 2017

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