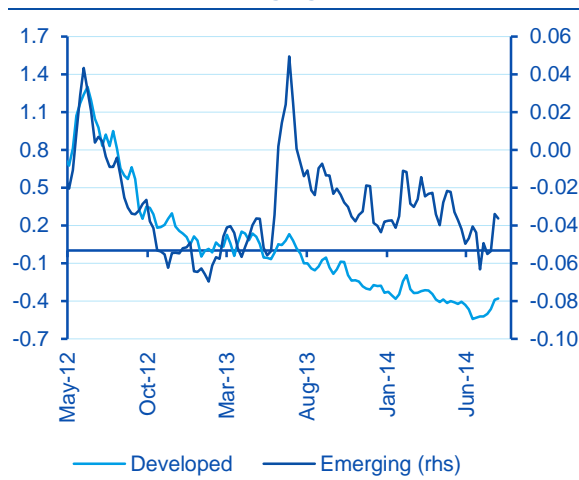


2 The global scenario is improving, but more slowly than expected

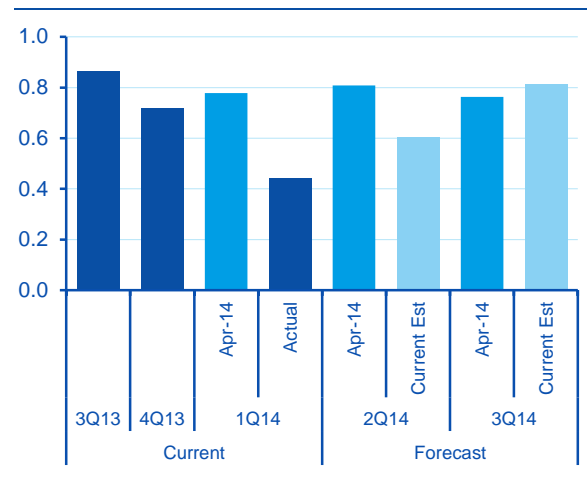
Both the financial indicators and those related to real activity are sending signals consistent with a favourable scenario for growth, despite the appearance of geopolitical-risk events. On the one hand, tensions in financial markets remain at record lows in emerging¹ and developed markets (Figure 2.1). This is in spite of the rise of several different risk factors of a geopolitical nature which, for the moment, have not altered world growth expectations. On the other, global industrial production continued to grow at around 3.4% YoY in the year to May, above the 3% mark reached by the end of 2013, while global trade also recovered in the same period from the intense, across-the-board downward correction in the first quarter of 2014.

Figure 2.1
BBVA Research's Financial Stress Index in developed and emerging countries



Source: BBVA Research

Figure 2.2
Global GDP (% QoQ)



Source: BBVA Research based on CPB

The fall in US GDP accounts for the downward revision of the growth forecast for 2014, although it is seen as a transitory phenomenon. This 2.1% quarterly annualized drop in 1Q14 of US GDP in was the sharpest of the historical series in a cyclical growth phase. The most recent information on the situation shows that the US economy has recovered by 4.0% QoQ annualized 2Q14, although the knock-on effect from the beginning of the year on estimates for world growth for 2014 as a whole was significant (Figure 2.2).

Meanwhile, uncertainty continues about the impact that the changes in the Federal Reserve's monetary policy will have on financial markets. The Federal Reserve will stop expanding its balance sheet in October, starting a phase in which policy rates and other measures will be taken based on incoming information regarding both the strength of the recovery and inflation expectations. In the most likely scenario, the first rise in the Fed funds rate will be in 2H15. However, given that the measures taken have been exceptional, in terms of their intensity and duration, their withdrawal also poses uncertainty about its effects, on both global capital flows and on asset prices, especially in the case of emerging economies, as we saw between April and May 2013.

1: The recent upturn of financial tensions in emerging markets (second half of July) is limited to Russia, which has a heavy weighting in the indexes.

We are maintaining our growth forecast for the eurozone of 1.1% for 2014 and 1.9% for 2015, although the bias is to the upside. The short-term indicators are consistent with a slight recovery in GDP, which should grow by around 0.3% in 2Q14 (vs. 0.2% in 1Q14), in line with our forecast of 1.1% for the year as a whole. The main supporting factors in the recovery are the sustained improvement in access to financial markets, reduced uncertainty, relaxation in public deficit targets in the short term, the reforms that have been taken at a national level and a more positive external environment. To these factors, **the support of the monetary policy introduced by the ECB** can now be added, which has gone further than could have been expected just a few quarters ago, with measures focused on keeping interest rates low, supporting bank funding and, at the same time, increasing the availability of credit for households and companies. However, there are risk factors to take into account, such as the **worsening of the crisis in the Ukraine** and the corollaries of the **economic sanctions against Russia**, to which the eurozone as a whole and particularly some of its largest countries will certainly not be immune.

Where is the global economic scenario heading?

The most recent indicators of confidence and financial volatility are consistent with a gradual worldwide improvement, which should enable global growth to reach 3.3% in 2014, 30 bp higher than in 2013. Maintaining favourable global financing conditions and supporting economic demand policies will help growth to accelerate faster in 2015, at rates close to 3.8%, with an increase in the contribution made by the more developed economies, which could gradually start positioning themselves for the withdrawal of the exceptional stimulus of the last few years.

Nevertheless, the speed of exit from the recession looks moderate in relative historical terms, even more so given the intensity and duration of the economic policy support measures. Consistent with moderate growth and anchored inflation, nominal interest rates remain at historical lows. A scenario such as this can end up distorting decision-taking processes affecting borrowing and investment, as well as the relationship between risk and expected profitability, which could affect whether assets are correctly valued. A situation of “prolonged stagnation” would be a challenge for economic policy management, not only for developed economies, but also in emerging economies, affected by indiscriminate inflows hunting for yield.

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