ECONOMIC OUTLOOK · World growth accelerates in 2016 but with downside risks that have yet to disappear

The Fed, Brexit and Brazil's political situation once again came to the fore in May. The minutes of the April meeting by the Federal Reserve (Fed), which were published in May, were more hawkish in tone than expected by the markets, suggesting a possible second hike in interest rates over the coming months, as contained in CaixaBank Research's forecast scenario. The monetary authority's stance has been helped by the improvement in global financial stability after the upsets in the early part of 2016 and the good figures for the US economy although there are several latent sources of risk in the short term. The uncertainty regarding Brexit is still high (and is damaging the United Kingdom's rate of activity) while political instability has intensified in Brazil due to the temporary suspension of President Rousseff. Nonetheless these events, among others, are within the expected parameters so they should not spoil world growth which will accelerate slightly in 2016 to 3.3% (from 3.1% in 2015). Specifically we expect the emerging countries to advance slightly more than the figures posted in 2015 (from 4.0% to 4.3%) and for moderate growth to consolidate in the advanced economies (close to 2%).

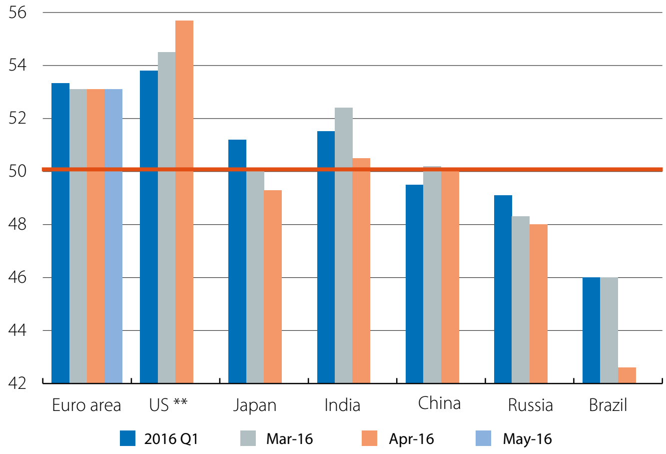
UNITED STATES

The Fed gets ready for a second interest rate hike. The minutes from the April meeting of the Federal Open Market Committee (FOMC) revealed that the institution might once again raise the Fed funds rate in the summer provided there is confirmation of the solidity of US economic activity. As a result the markets brought forward, from December to September, the most likely date for the second hike in the official interest rate, in line with the forecast of CaixaBank Research. However, apart from the exact month when the Fed will raise interest rates, of note is the confidence shown by the Fed in the solidity of US growth and in the ability of the global economy to withstand a less accommodative monetary environment, two aspects which, to date, had plagued the financial markets.

Inflation is gradually recovering, augmenting the favourable scenario for the Fed's interest rate hike. Inflation stood at 1.1% in April, 0.2 pps above the previous month's figure, while core inflation remained at a solid 2.1%. Going into more detail, of note was the sharp increase in the energy component in month-on-month terms (+3.4%) although it still posted a drop in year-on-year terms. Apart from energy prices, the rest of the components saw widespread gains.

PMI activity indicator *

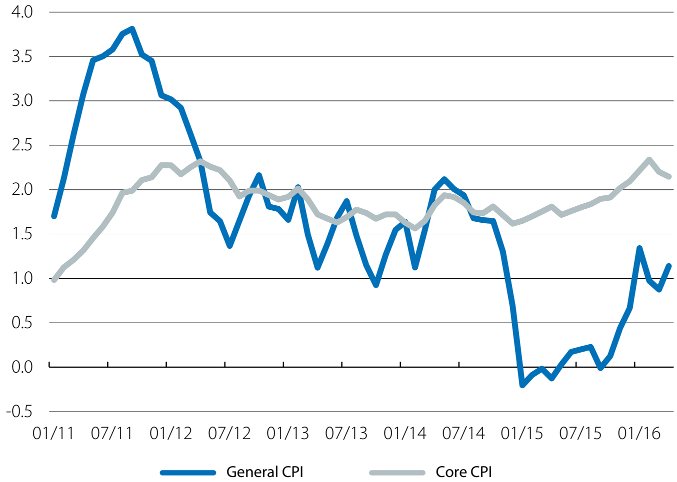
Level



Notes: * *PMI services for the advanced countries and PMI manufacturing for the emerging.*
*** The ISM index is used for the United States.*
Source: *CaixaBank Research, based on data from Markit, ISM and the Chinese Statistics Office.*

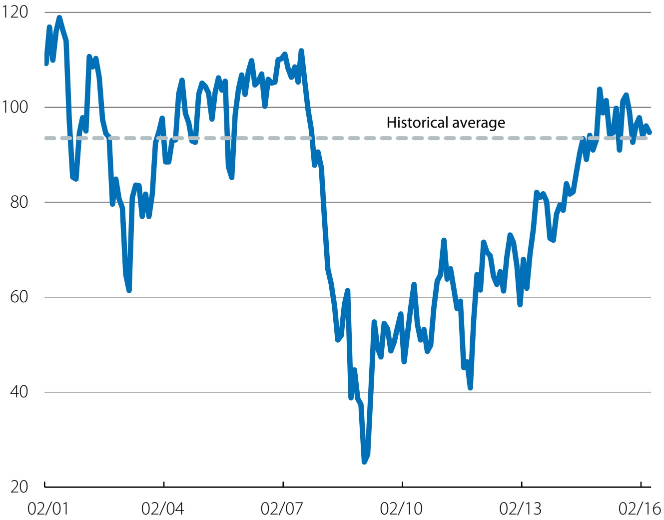
US: CPI

Year-on-year change (%)



Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics.*

US: consumer confidence index



Source: *CaixaBank Research, based on data from the Conference Board.*

The US economy continues to expand. According to the second estimate produced by the Bureau of Economic Analysis, in the United States GDP grew by 0.2% quarter-on-quarter in Q1, higher than the 0.1% of the first estimate. Although this increase is somewhat smaller than the one posted in 2015 Q4, we should remember that, every year, the GDP growth figure for the first quarter tends to be systematically underestimated by approximately 0.3 pps in terms of quarter-on-quarter growth. Regarding the different GDP components, private consumption continued to perform particularly well, up by 0.5% quarter-on-quarter and contributing 0.3 pps to GDP growth. In fact, in May the consumer confidence index produced by the Conference Board was in line with the historical average (at 92.6 points). For its part the ISM business sentiment index for manufacturing fell slightly in April to 50.8 points. However, this initial disappointment was amply offset by the solid ISM figure for services, a sector that accounts for 80% of economic activity and 85% of the jobs in the private sector.

The labour market continues its strong recovery and is approaching full employment. 160,000 jobs were created in April, a disappointing figure as it was below the threshold of 200,000 but which should not be taken as cause for alarm considering the strong recovery registered by the labour market since 2009. Unemployment remained stable at a low 5.0% and the percentage of employees working part-time but who would like to work full-time continued to fall. The rise in wages also came as a positive surprise, standing at 2.5% year-on-year, a particularly significant figure if we remember that inflation is still low.

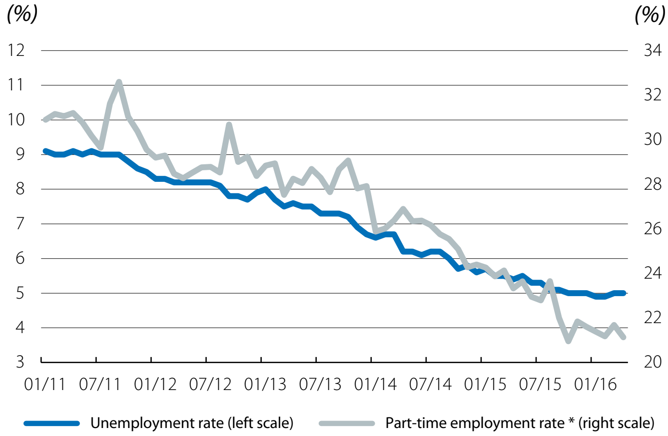
JAPAN

Japan grows more than expected in 2016 Q1 but doubts still hover over the solidity of the Japanese economy. After the previous quarter's drop, GDP grew in Q1 by 0.4% quarter-on-quarter (0.0% year-on-year), a slightly higher figure than predicted. Although the data from Japan's National Accounts system must be interpreted with great care as they are quite erratic and tend to be revised subsequently, the improvement in the foreign sector came as a positive surprise although domestic demand continued to look weak. In particular, the advance in private consumption did not manage to offset the strong decline in capital goods and residential investment. Given this situation, a voluminous fiscal package is very likely to be approved (in the order of 1.5% of GDP), coming into force as from the second half of 2016 and expected to last until 2017. In spite of this the outlook for Japan's growth is still quite mediocre with GDP growth that will only rise slightly above 0.5% both this year and the next.

EMERGING ECONOMIES AND COMMODITIES

China's activity indicators look weak again in April. However, the drop in intensity shown by some indicators is within the

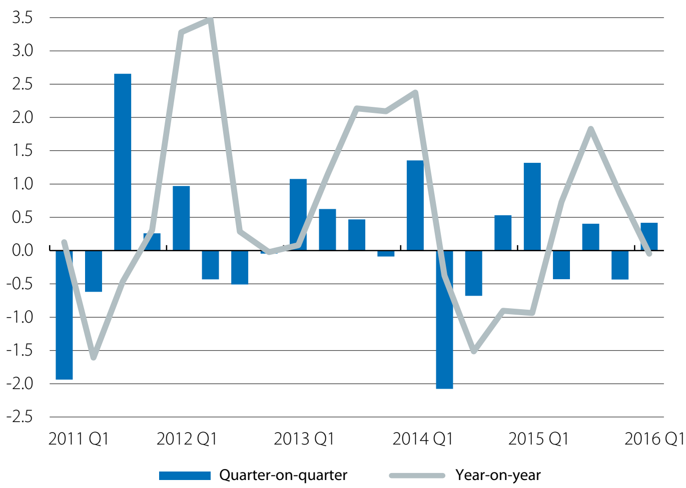
US: involuntary part-time employment rate and unemployment rate



Note: * Involuntary part-time employment rate: workers involuntarily working part-time due to economic reasons but who would like to work full-time as a percentage of all part-time workers.
Source: CaixaBank Research, based on data from the Bureau of Labor Statistics.

Japan: GDP

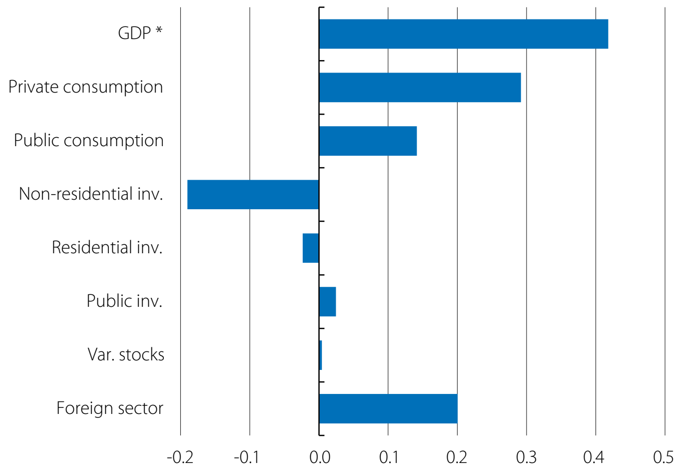
Year-on-year and quarter-on-quarter change (%)



Source: CaixaBank Research, based on data from the Ministry of the Interior and Communication.

Japan: GDP

Contribution to quarter-on-quarter growth in GDP in 2016 Q1 (pps)



Note: * Quarter-on-quarter change.
Source: CaixaBank Research, based on data from the Ministry of the Interior and Communication.

typical variations for this kind of data. In particular, exports fell again, down by 1.8% year-on-year after enjoying solid growth the previous month. Industrial production grew by 6.0% year-on-year, below its March figure of 6.8%, while retail sales were up 10.1% year-on-year, without showing any clear improvement on March's figure of 10.5%. However, we need to pay more attention to capital movements in China after the serious episode of outflows in 2015 (see the Focus «China's capital flight, a risk to be taken into account» in this *Monthly Report*). Although the rate of outflows appears to have slowed down in 2016, the Fed's less accommodative tone could affect this moderating trend.

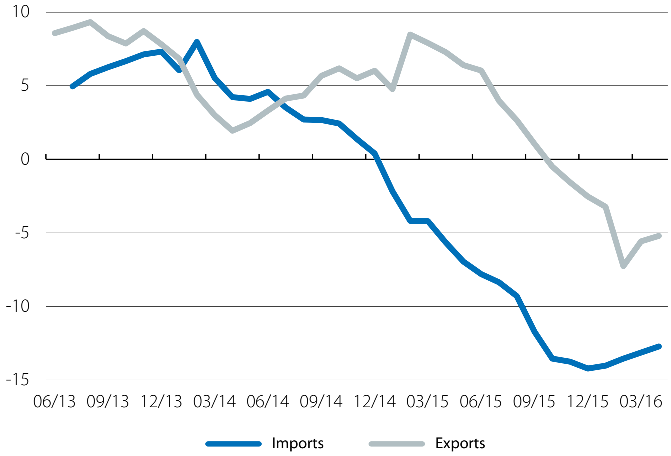
In Latin America, Mexico's good performance contrasts with the recession in Brazil. Mexico speeded up its growth in 2016 Q1, according to preliminary figures reaching 2.7% year-on-year (0.8% quarter-on-quarter). This growth is larger than expected and, judging by available indicators, the boost was probably provided by domestic demand and, in particular, private consumption. Over the coming quarters the Mexican economy is expected to remain dynamic, supported by positive expectations of a recovery in oil prices and a certain acceleration in the US in what remains of 2016. On the other hand Brazil's activity indicators continue to show that Latin America's largest economy is still immersed in a serious recession. Within this recessionary context, the downside risks have increased even further due to the political crisis and the temporary suspension of Dilma Rousseff by the Senate. The country's situation is very difficult to resolve in the short term, preventing it from taking decisions regarding its economic policy, particularly the urgently required fiscal adjustment.

The recession moderates in Russia. According to preliminary estimates, GDP fell by 1.2% year-on-year in 2016 Q1, a better figure than expected and suggesting the country has put the worst of the recession behind it. However, the fact that there are still sources of geopolitical risk and the existence of demanding international financial conditions are slowing up Russia's exit from the recession, so 2016 will probably end with another drop in GDP, which will be around 1.1%.

Oil prices continue to recover gradually. In May the trend continued of a slow recovery in the price of Brent, reaching 50 dollars a barrel, in line with CaixaBank Research forecasts. Undoubtedly the decline in investment over the last year and a half will support this scenario of price rises, in the same way that the reduction in US stocks and less supply from Iraq have supported the recent appreciation in the short term.

*China: exports and imports **

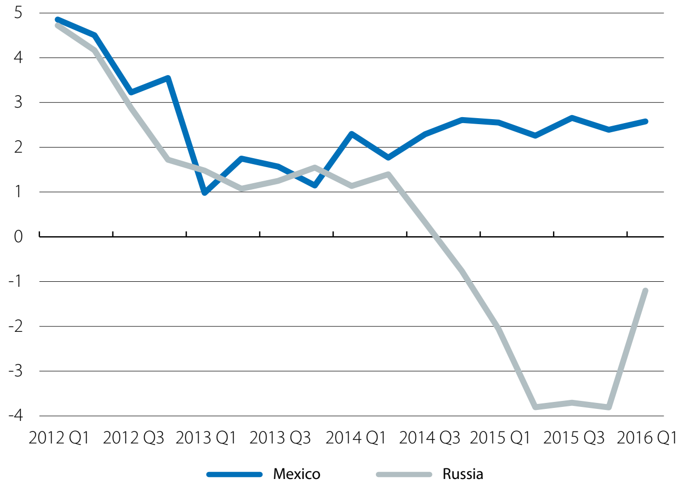
Year-on-year change, cumulative over 12 months (%)



Note: ** Nominal value of imports and exports.*
Source: *CaixaBank Research, based on data from the Chinese Customs.*

Russia and Mexico: GDP

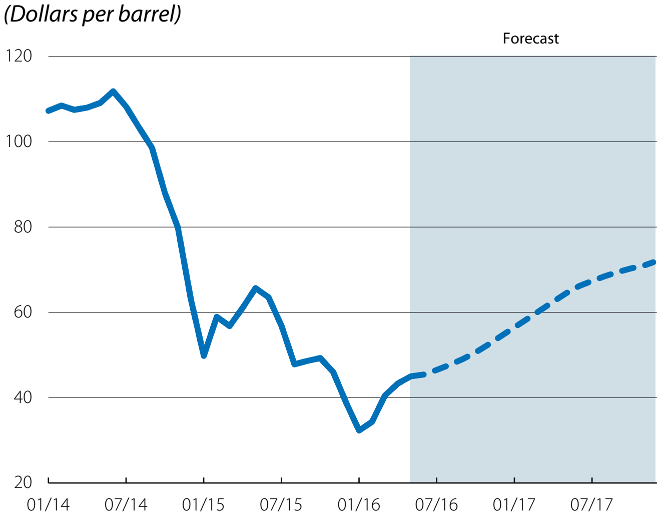
Year-on-year change (%)



Source: *CaixaBank Research, based on data from the national statistics offices.*

Oil: price of Brent barrel

(Dollars per barrel)



Source: *CaixaBank Research, based on data from Thomson Reuters Datastream.*