

ECONOMIC OUTLOOK · Uncertainty in emerging economies, expansion in the advanced

The world economy looks like it will grow by 3.2% in 2015.

Just three months before the end of 2015, it has been confirmed that growth will be slightly less this year than in 2014 and still notably below the forecasts being given in December 2014. The main reason for this situation is the gradual deterioration in outlook for the emerging economies and this dichotomy between the advanced economies speeding up and some emerging economies slipping back has tended to intensify over the summer.

EMERGING ECONOMIES

Slight worsening of the outlook for the emerging economies, especially China. Over the last few months uncertainty has increased regarding the trend in emerging countries. While, in spring, the main focus of attention was a small number of economies considered to be problematic, such as Russia, Brazil, Turkey and South Africa, concern has now spread to China. Given the country's importance and its significant global links, this issue is explored in detail in the Focus «China: the doubts return». We admit that there is now a greater risk of a hard landing for the Asian economy but, unlike other analysts who are focusing on the excessive slowdown in some activity indicators, we are more worried about the recent confusing action taken by the country's government. The events of the summer have highlighted the difficult task facing China's authorities in promoting a more market-driven economy with clear long-term benefits while kicking the habit of intervening decisively when there is any sign of a slowdown.

Two emerging countries have their own problems: Russia and Brazil. Although both have recorded a notable drop in activity and an accumulation of political problems for some time now (geopolitical in Russia and internal politics in Brazil), the situation has got worse in the last few months. In the Russian case, together with the increasing recession (remember that GDP fell by 4.6% year-on-year in Q2 compared with a 2.2% drop in Q1), of concern is rising inflation, reaching 15.8% year-on-year in August due to the 40% depreciation in the rouble over the last year. Indicators point to both trends (weak activity and strong inflationary tensions) continuing in Q3 without scarcely any let up.

The problems are piling up for Brazil. On the one hand its recession is getting worse (GDP fell by 2.6% year-on-year in Q2 compared with a 1.9% drop in Q1) while, on the other, macroeconomic imbalances are not being corrected: inflation climbed to 9.5% year-on-year in August and the current deficit rose to 4.3% of GDP in Q2. Lastly the country is still suffering from political unrest and, in this context, economic policy is

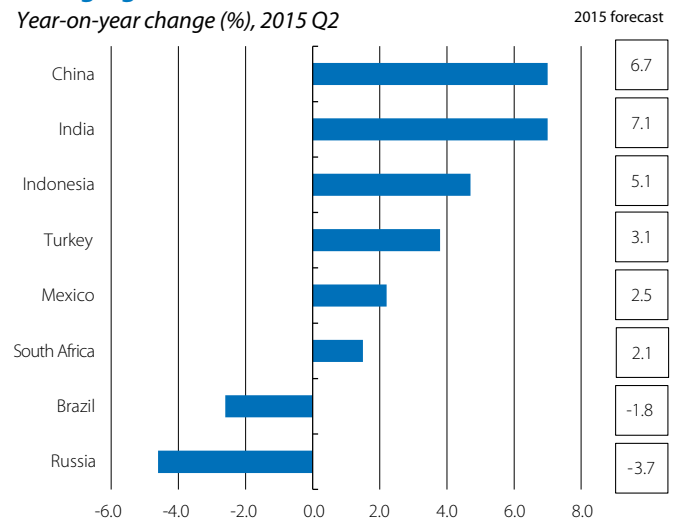
GDP growth forecasts by region (%)

	2015 forecast		2016 forecast
	Dec. 2014	Current	Current
World	3.9	3.2	3.7
Main emerging economies Russia, China, India, Brazil, Mexico, Poland and Turkey	5.4	4.7	4.7
Main advanced economies United States, Japan, United Kingdom and euro area	2.1	1.9	2.1

Source: CaixaBank Research.

Emerging countries: GDP

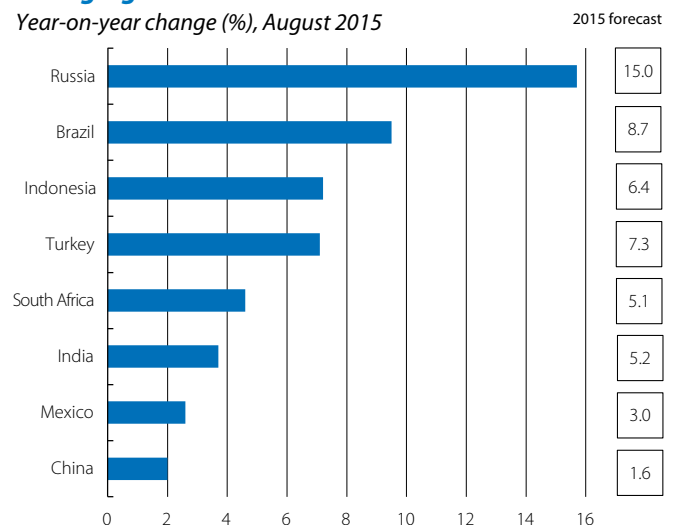
Year-on-year change (%), 2015 Q2



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

Emerging countries: CPI

Year-on-year change (%), August 2015



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

facing strong demands. While the central bank is attempting to contain the inflationary spiral by aggressively raising the interest rate (which has gone from 11.0% to 14.25% in one year), the government is trying to redress the excessively accommodative fiscal policy of the last few years via ambitious fiscal adjustment. However, it is uncertain whether it will be able to achieve this due to the worsening economic situation. The need to carry out further adjustment in 2016, already announced, will probably come up against the difficulty of implementing it in a recessionary context and the need to secure the approval of Congress (something that cannot be assumed). In fact, these difficulties in implementing fiscal policy have been put forward by the S&P rating agency as the reason for downgrading its credit rating to below *investment grade* for the first time since 2008.

Latin America and East Asia, emerging regions under scrutiny. Although some of Brazil's problems are idiosyncratic, the negative effect of the fall in the price of its commodities due to weak demand from other emerging countries (especially China) is shared by a large number of Latin America's countries. The relative exception is Mexico which is offsetting the fall in international oil prices through its close ties with the US, a country that is clearly on the path of expansion. Asia's prospects are also on a downward slide, albeit less intensively. In this region the exception is India with its growth remaining around 7%. Nonetheless even in this case the central bank has decided to take advantage of contained inflation and unexpectedly lower the official interest rate from 7.25% to 6.75%, in September.

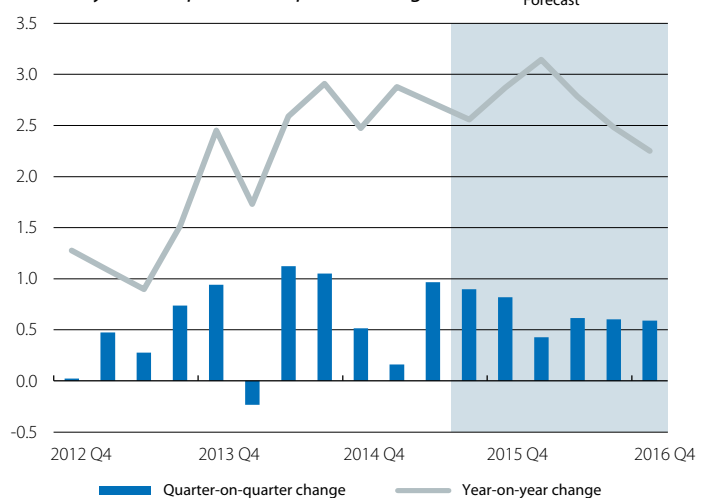
UNITED STATES

Strong growth is confirmed in the US in Q2. According to the latest revised GDP figures produced by the Bureau of Economic Analysis, the US economy advanced by 1.0% quarter-on-quarter in Q2 (2.7% year-on-year), a notable acceleration compared to the rate in Q1 (0.2% quarter-on-quarter). Given that the year started abnormally weak due to temporary factors such as the bad weather and dock strike, beyond the «rebound effect» expected in Q2 we should also examine the underlying trends in the US economy. Taking the year-on-year growth figures, which are a better reflection of such trends, it can be seen that the key component in the recovery is private consumption with four consecutive quarters of growth in the order of 3.0%-3.3% year-on-year. In addition to this key element is the clear recovery in residential investment. On the other hand the underlying trend for non-residential investment is downward while the foreign sector has been deducting somewhat from growth in the last quarters.

Consumption will continue to be the mainstay of the expansion. Based on these trends, what can we expect over the next few quarters? Our main scenario has maintained dynamic consumption as its essential aspect given that the key factors behind household decisions to spend are well

US: GDP

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



Source: CaixaBank Research, based on data from the Bureau of Economic Analysis.

US: CPI and Core CPI

Year-on-year change (%)

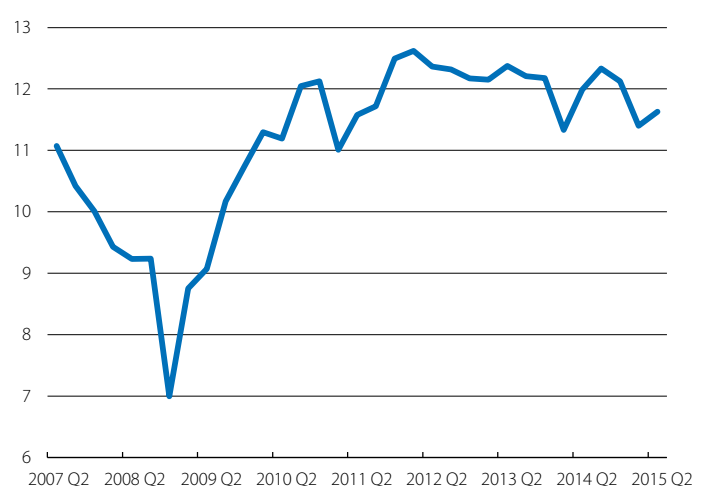


Note: * Core: general index without energy or food.

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

US: corporate earnings

(% of GDP)



Source: CaixaBank Research, based on data from the Bureau of Economic Analysis.

aligned. In particular consumption is being supported by the three-way conjunction of a strong job creation rate (with the exception of August's slightly weaker figures, since January 212,000 jobs have been created on average every month), highly accommodative financial conditions and the absence of inflationary tensions (the CPI grew by a minimal 0.2% year-on-year in August). For the time being consumption indicators published for Q3 (in particular consumer confidence) suggest that consumption will continue to be strong.

Investment is livening up. The outlook for residential investment is clearly expansionary and we expect the route already taken by the recovery will have a clear path ahead, as suggested by some early indicators such as housing starts. Even non-residential investment is likely to improve in the coming quarters because the current weak trend is partly due to the high levels accumulated previously (and this factor will therefore diminish over time). Other underlying supportive factors will also continue to be favourable: high corporate earnings (although these will be partly affected by the impact of the dollar's appreciation), a good outlook for demand and favourable financial conditions. Precisely in this last area we should note that the Fed has decided to maintain the official interest rate but has suggested that the hike, the first since 2004, will take place before the end of the year (a schedule that coincides with our scenario, predicting an increase in December that comes into effect in January).

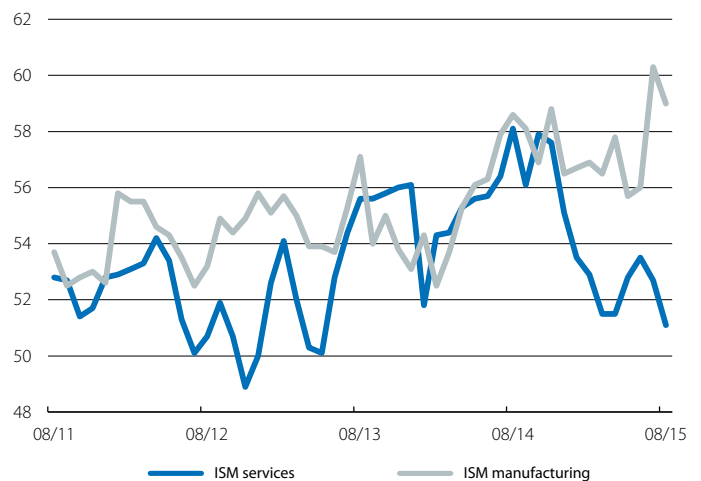
JAPAN

Japan will speed up over the coming months. After the first six months were slightly worse than expected, the forecasts now being given point to a second half of the year with stronger growth. One key factor in this scenario is the expectation of slightly livelier private consumption, boosted by the greater purchasing power produced by falling inflation as a consequence of the trend in energy prices. In spite of the positive effect of contained inflation, it is important to remember that this complicates the economic policy target of accelerating nominal growth. Another risk that should be added to this scenario of recovery comes from the foreign sector as, in spite of the weak yen, exports to the US and especially China are falling (both countries account for 37.4% of all Japanese exports).

The performance of large firms improves. As shown by the Tankan business confidence indicator, large firms improved in Q2, ending with more than one year of stagnation. Although this kind of company is being helped by the weaker yen, it should be noted that a cheap yen is not equally favourable for the rest of the economy and could particularly jeopardise small and medium-sized firms that import intermediate goods and are therefore facing higher external prices.

US: business sentiment indicators

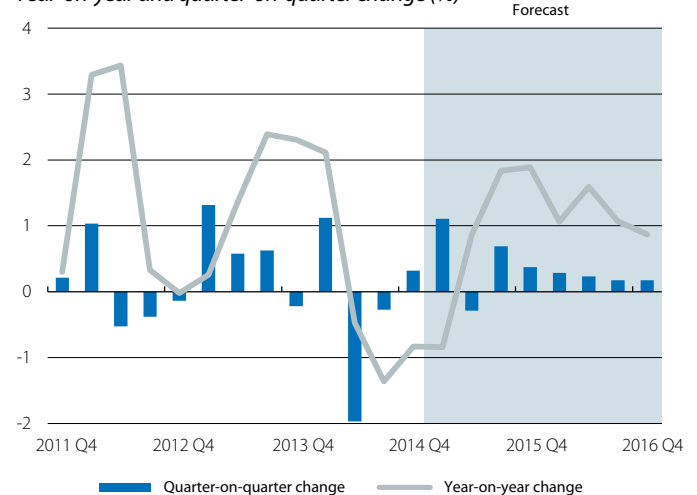
Year-on-year change (%)



Source: CaixaBank Research, based on ISM data.

Japan: GDP

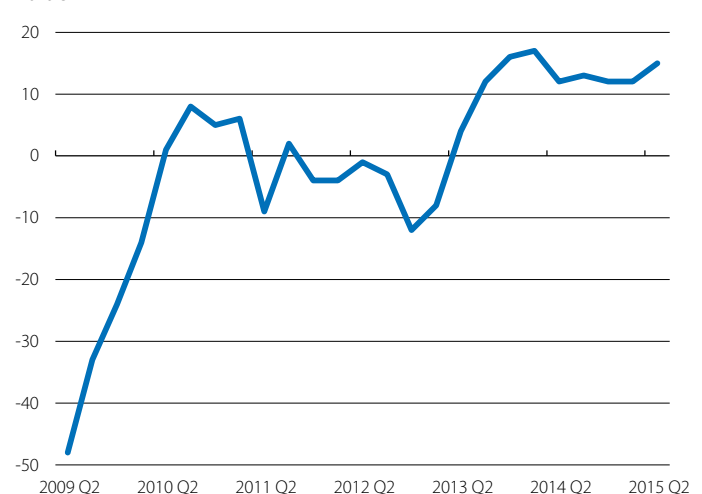
Year-on-year and quarter-on-quarter change (%)



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

Japan: business sentiment index (Tankan)

Value



Source: CaixaBank Research, based on data from the Bank of Japan.