ECONOMIC OUTLOOK · The global economy continues to perform well

Global economic activity indicators remain positive in Q2. In May, the global composite business sentiment index (PMI) (i.e. aggregating manufacturing and services) was in a comfortable expansionary zone at 53.7 points (above the 50-point threshold). It should be noted that this index is above 50 points both for the advanced and the emerging economies. This endorses the CaixaBank Research scenario which predicts that world growth will speed up moderately from 3.1% in 2016 to 3.5% in 2017.

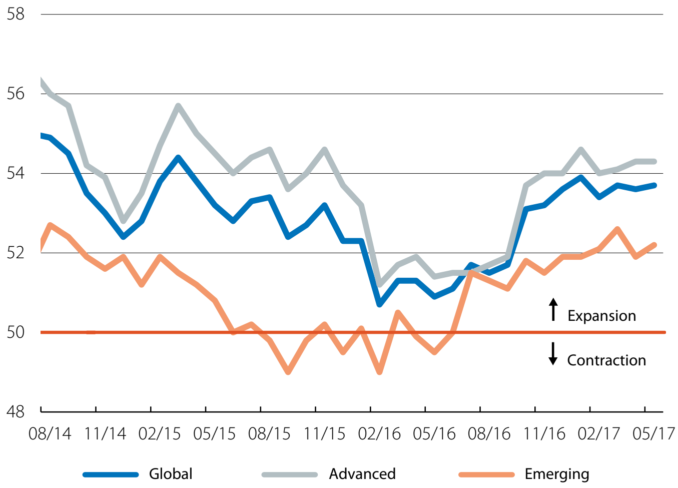
Falling inflation and political factors are still risk factors to be taken into account. In particular, global inflation has followed a clearly downward trend over the past months with a lot of countries reporting lower figures than expected, both for headline and core inflation. A key question over the coming months will therefore be whether this is a prolonged or temporary phenomenon. Should it represent an underlying trend, it could alter the current monetary policy scenario given that monetary normalisation relies on a gradual recovery in inflation towards the target. On the other hand, there are still some sources of political uncertainty. In the US, the Trump administration's ambitious agenda of reforms is still locked in stalemate; no progress has been made in the area of tax and the Senate has had to postpone voting on health reforms due to lack of agreement. The difficulty in achieving enough consensus to pass these reforms suggests that the legislative process will be slow and fraught with problems (many analysts believe that the earliest the tax reform will be passed is at the end of 2017). In Europe, uncertainty comes mostly from the start of Brexit negotiations between the EU and UK. The emerging countries also face significant downside risks, both global (tougher financial conditions, lower commodity prices than expected...) and local in specific countries (see the Focus «Emerging risks: a cocktail made up of the Federal Reserve, commodities and politics» in this *Monthly Report*).

UNITED STATES

Economic activity and sentiment indicators suggest a positive tone after slim growth in the first quarter. Q1 GDP growth was revised slightly upwards after the third and last estimate, although the economy still posted a slowdown compared with Q4 2016. Growth was 0.4% quarter-on-quarter (2.1% year-on-year), a moderate figure but 0.1 pp higher than the previous estimate (and 0.2 pp higher than the first). Recent economic activity and sentiment data therefore point to a positive trend on the whole, suggesting a Q2 upswing in growth. Labour market figures were particularly good (138,000 jobs were created in May and the unemployment rate stood at 4.3%). Business confidence indicators (ISM) for manufacturing and services were still comfortably above the 50-point threshold. The Conference Board consumer

Economic activity indicators: Composite PMI

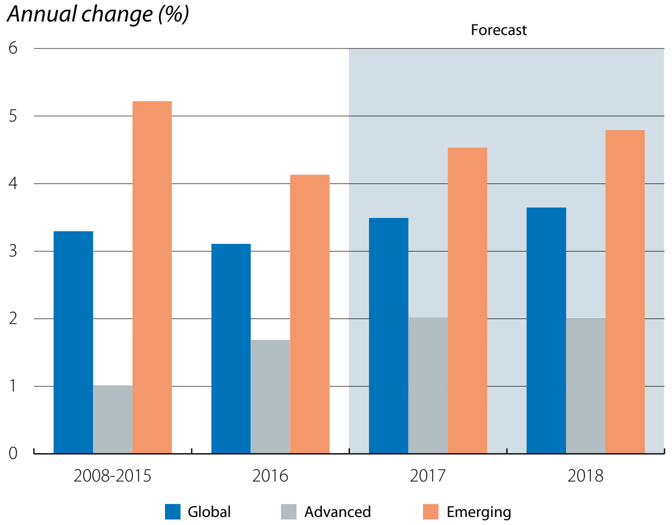
Level



Source: *CaixaBank Research, based on data from Markit.*

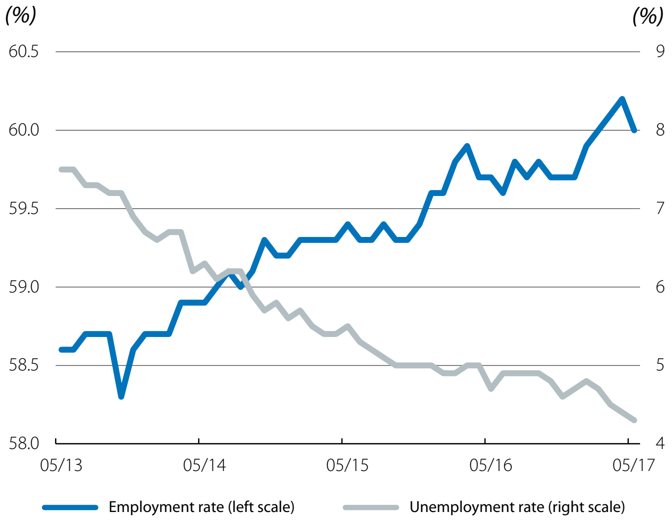
World GDP

Annual change (%)



Source: *CaixaBank Research.*

US: labour market



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

confidence index remained high and even rose slightly, from 117.6 points in May to 118.9 points in June.

Inflation is once again surprisingly low. Headline inflation posted year-on-year growth of 1.9% in May, 0.3 pp lower than the consensus of analysts and April's figure. Core inflation stood at 1.7%, 0.2 pp lower than the previous month. With these figures, headline inflation has been surprisingly low for the past three months and core inflation for two out of the last three. The big question for US economic debate is whether inflation will remain weak over the coming months or there will be a change in trend. A flatter Phillips curve (inflation reacting less strongly to lower unemployment), the dollar's appreciation and second-round effects of weak oil prices could all lie behind this recent trend in inflation. Given May's figures, CaixaBank Research has lowered its inflation forecasts: in 2017 headline inflation has been changed from 2.3% to 2.1%, while core inflation has been changed from 2.0% to 1.9%. The 2018 forecast for both types of inflation has been lowered by 1 pp.

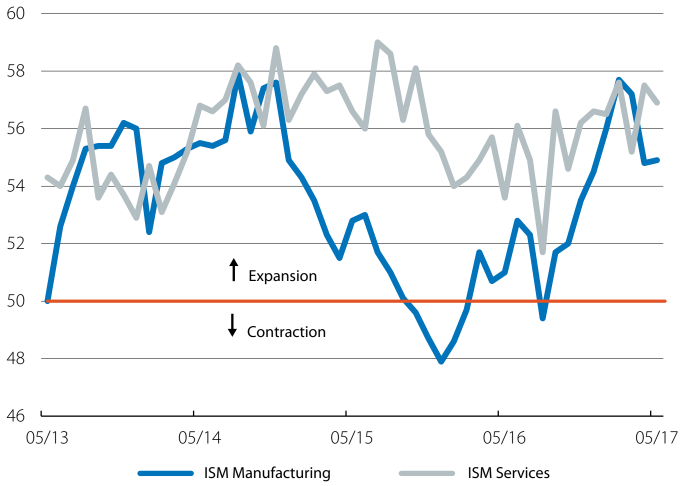
The Fed raises interest rates in June. At its June meeting, the Fed raised the federal funds rate by 25 bp to the range of 1.00%-1.25%. One of the main focuses of attention was precisely the institution's interpretation of the weak inflation figures mentioned above. The Fed noted the drop in prices over the past few months but showed remarkable confidence by stating that, in the medium term, inflation would converge towards the 2% target. The Fed also highlighted the strength of the labour market and the positive trend in private consumption and corporate capital expenditure.

The legislative process gets underway to achieve greater financial deregulation. The lower chamber passed the Financial Choice Act, a bill that aims to limit the scope of the Dodd-Frank Act, containing financial regulatory measures introduced by the Obama administration after the 2008 financial crisis. The bill will now be debated in the Senate, where the Republicans have a very small majority. It includes measures such as the elimination of the Orderly Liquidation Authority (OLA), created to ensure the quick and orderly resolution of complex financial institutions. However, many see the OLA as a way of institutionalising bail-outs, reinforcing the view that some banks are too big to fail. There is also an important proposal to allow institutions with a leverage ratio above 10% not to comply with some of the Dodd-Frank Act requirements. This could particularly benefit community banks.

EMERGING ECONOMIES

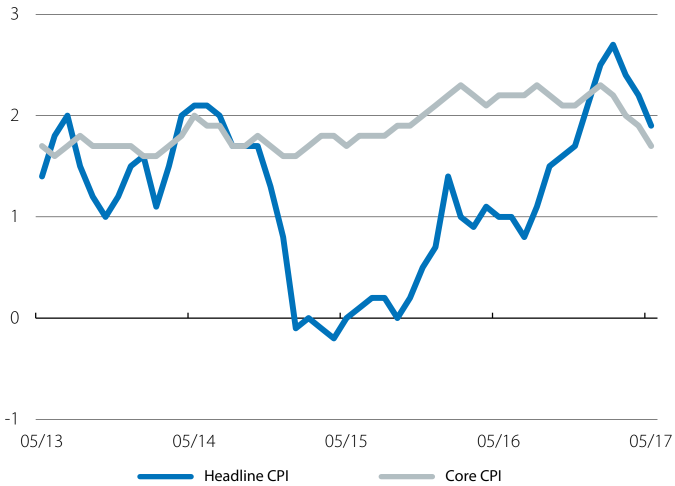
The emerging economies continue to grow apace. The good shape of the emerging economies was reflected in the IIF emerging market growth tracker, which reached 5.6% growth in May (annualised quarter-on-quarter). Although this index has slowed down over the past two months, its increase is still remarkable (0.3 pp higher than the average growth for the

US: economic activity indicators
Level



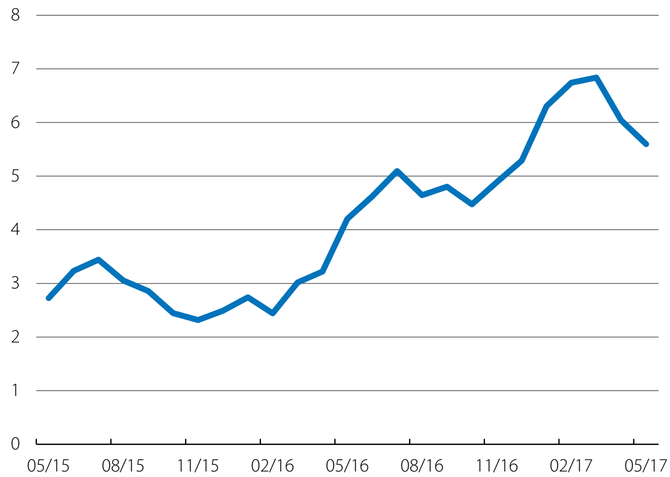
Source: *CaixaBank Research, based on data from the ISM.*

US: CPI
Year-on-year change (%)



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

Emerging economies: IIF growth tracker
Annualised quarter-on-quarter growth, three-month average (%)



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

indicator in the past 12 months). We should also remember that this indicator was at an abnormally high level at the start of the year. Reinforcing this positive scenario, in June the emerging economies reported sizeable net portfolio inflows (debt and shares) totalling USD 17.8 billion.

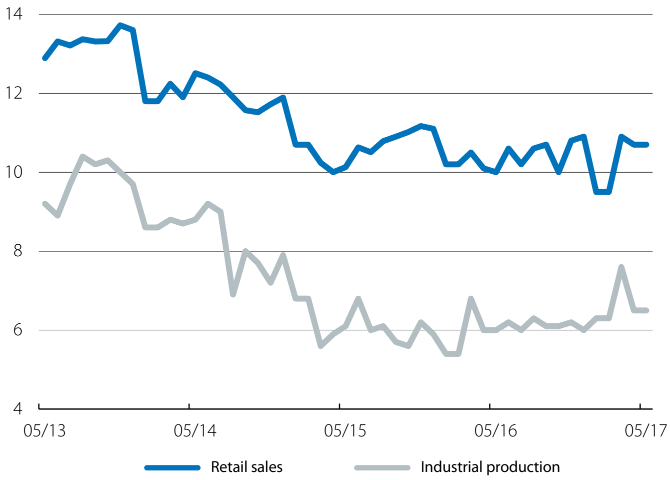
China: no news from the front. The Asian giant's latest economic activity indicators point to the economy continuing to grow at a good rate in Q2. The business sentiment index (PMI) remained in the expansionary zone while both retail sales and industrial production maintained their April growth rates (10.5% and 6.5%, respectively). The IMF has interpreted these economic figures quite optimistically, forecasting growth of 6.7% in 2017 (CaixaBank Research predicts 6.6% growth) and 6.4% between 2018 and 2020. This has been accompanied by a call to speed up the rebalancing of the economy to ensure financial stability and balanced growth in the medium term.

Brazil: the good and the bad. Positive news has come from the economic front: the country came out of recession with 1.0% quarter-on-quarter growth in Q1 2017, the first quarterly advance since the end of 2014. This recovery in growth was largely due to the incredible performance by exports, boosted by an exceptional harvest. Nevertheless, CaixaBank Research has not altered its macroeconomic scenario and growth forecasts have therefore remained unchanged (0.7% in 2017 and 2.1% in 2018). In spite of this economic improvement, however, bad news continues to come from the high political uncertainty. President Temer is once again facing an uncertain future after being formally accused of alleged corruption by Brazil's public prosecutor at the end of June. The appointment of a new President is therefore likely before the 2018 elections.

Mexico and Turkey, two countries exemplifying different emerging dilemmas. Mexico is managing to resist the shock of uncertainty related to US policy quite well, at least for the time being. The revised GDP figure for Q1 2017 places year-on-year growth at 2.8%, 0.4 pp higher than the first estimate. But any celebration would still be hasty. Uncertainty regarding the policies of the Trump administration, high inflation and upcoming presidential elections in 2018 (which could be won by the populist left-wing candidate, López Obrador) are factors that warrant caution. The Turkish economy, on the other hand, posted surprisingly strong growth in Q1 2017 with GDP up by 4.9% year-on-year (3.5% in Q4 2016), supported by a substantial increase in public expenditure. Given this good figure, CaixaBank Research has improved its growth forecasts for the Turkish economy from 2.5% to 3.5% in 2017 and from 3.0% to 3.2% in 2018. Nevertheless, the current growth rate is unlikely to be sustainable in the medium term due to high political uncertainty, the country's external vulnerabilities and high inflation.

China: economic activity indicators

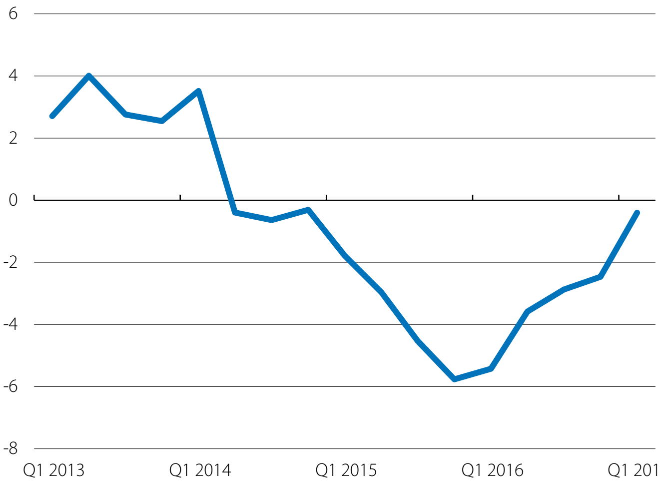
Year-on-year change (%)



Source: *CaixaBank Research, based on from the Chinese National Statistics Office.*

Brazil: GDP

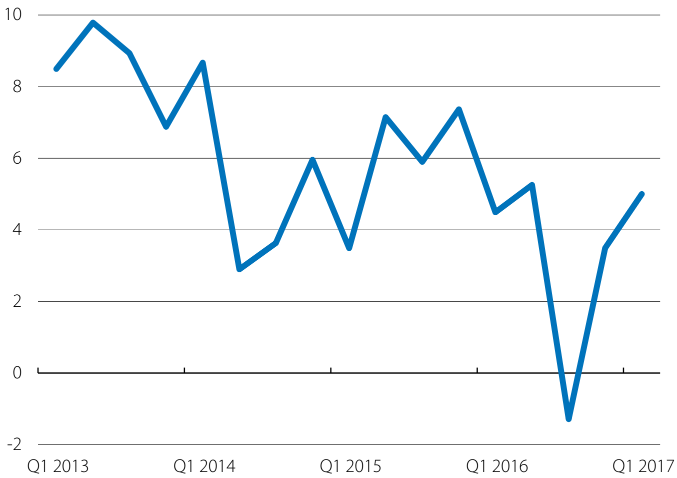
Year-on-year change (%)



Source: *CaixaBank Research, based on data from the Brazilian Institute of Geography and Statistics.*

Turkey: GDP

Year-on-year change (%)



Source: *CaixaBank Research, based on data from the Turkish Statistics Institute.*