Global economic activity on track

An optimistic start to 2018 for the world economy. Indicators point to a 3.6% increase in global economic activity in 2017 as a whole compared with 3.2% in 2016, fulfilling predictions of faster growth made one year ago. Economic activity benefited from improved business and consumer confidence, particularly in the advanced economies. The financial markets also saw considerable gains in stock prices. Investor optimism was especially strong in the US, with the S&P 500 stock market index rising by nearly 20% for the year as a whole (+9.5% in 2016). But it was also notable in Europe, where the Eurostoxx 50 went from a meagre 0.7% rise in 2016 to a significant +6.5% in 2017. The MSCI Emerging Markets index also appreciated by more than 30% with key economies exiting recessions, such as Brazil and Russia, and a recovery in the Chinese stock market after the downturn early in 2016 (Shanghai stock exchange index +6.6% in 2017 compared with –12.3% in 2016).

Politics and central banks are setting the pace. However, there are still geopolitical and macrofinancial risks in spite of this favourable macroeconomic situation. One repeated risk among the emerging economies is how China will handle its economic transition as domestic consumption and services become more important to the economy – as well as its financial imbalances. In December, the Communist Party's Politburo made it a priority for 2018 to alleviate financial risks, combat pollution and reduce poverty, suggesting less economic stimulus and environmental measures that will contribute to a moderate slowdown in growth. In advanced economies the focus has shifted towards the maturity of US expansion and the Fed's monetary policy normalisation. In particular, after a hesitant 2016 in which the central bank only carried out one of the three hikes predicted, the Fed eventually carried out three increases in 2017. The latest was in December, raising the fed funds rate to 1.25%-1.50%. Given the strong US labour market and expected upswing in inflation, in December the Fed also repeated that it would carry out three more hikes in 2018. This scenario was reinforced mid-month by the Trump administration's tax reform finally being approved. The reform should provide a moderate boost for growth but, as the US economy is almost at full employment, there is more risk of a greater impact on inflation and therefore more aggressive monetary normalisation. However, financial assets are assuming fewer than three Fed hikes, so any readjustment of financial expectations is another source of risk, especially given the currently booming US stock market.

Europe is making stronger progress. Among the advanced economies, the biggest positive surprise of the year came from the euro area. The region has clearly outperformed the forecasts made a year ago, growing by 2.4% in 2017 as a whole. The stronger scenario was reflected in the revised macroeconomic scenario presented by the European Central Bank (ECB) at its December meeting, projecting 2.3% growth in 2018. This better outlook is due to a more even distribution of growth across countries and also in the EU as a whole. In fact, this month's Dossier examines the growing importance of emerging European economies, whose GDP grew by 5.3% in Q3 2017, led by Poland (5.2%), the Czech Republic (5.0%), Hungary (4.1%) and Romania (8.6%). Since joining the EU, these economies have clearly modernised their institutional fabric but populist policies have gained support in recent years. In Poland, for example, in response to controversial reforms of the judicial system carried out by the government, this December the European Commission launched a legal process which could result in it withdrawing the country's EU voting rights.

Spain stands out among the euro area economies. Economic activity indicators suggest that growth remained high in the last quarter of the year and the CaixaBank Research forecast model points to + 0.7% quarter-on-quarter, very similar to Q3's 0.8%. The Spanish economy will have therefore enjoyed three exceptionally good years, growing above 3% and creating 1.5 million jobs. Growth is also likely to remain high in 2018, with the main imbalances continuing their correction. As a result of this good economic performance and the low interest rate environment, in 2017 the public deficit will have achieved the 3.1% target agreed with the European Commission and is expected to fall to 2.5% by 2018. However, given the high level of government debt, the deficit's correction should not be left to cyclical growth alone. Measures are still required to ensure a structural improvement in public finances.