Favourable outlook for the start of 2018

The global economy has started the year optimistically. World economic activity improved towards the end of 2017 and beginning of 2018, as confirmed by the continual stream of favourable economic data. This endorses the CaixaBank Research scenario which predicts global GDP growth in 2017 will speed up by 0.2 pp to 3.9%. Various factors support this acceleration First the emerging economies' good performance which, beyond each country's idiosyncratic factors, continue to benefit from favourable financial conditions. Second, the upward cycle in commodities and third, the favorable growth prospects of the developed economies. The latest figures for the US economy confirm its good performance. For instance, US quarter-on-quarter GDP growth stood at 0.6% in Q4 2017 and all the evidence suggests this trend will continue throughout 2018, supported by Trump's tax reforms among other factors.

Nevertheless, risks are still high. One substantial risk is the high growth in global debt, especially in some emerging economies, as well as the complacency induced by low interest rates, which may have led to some financial bubbles. As inflation consolidates its upward trend in the main developed economies, interest rates are also likely to rise. This is particularly relevant in the US, where financial markets will probably go through episodes of correction, as seen recently. The upswing in oil prices is also important since it might damage growth in global economic activity should it become more acute.

Upside surprises in Europe. The shift up in gear in the euro area's growth rate in 2017 augurs well for 2018. Moreover, the European economy's support factors, such as improved confidence in its growth capacity (until recently hampered by political uncertainty), faster global growth and the ECB's accommodative monetary policy, will remain in place throughout 2018. The current CaixaBank Research growth forecast for 2018, of 2.2%, therefore has a clear upside risk.

The ECB remains on script but stirs debate. The improved economic outlook and the euro's recent appreciation had created some expectations regarding the ECB's stance. But at its last meeting Mario Draghi repeated the message of the past few months, namely the current pace of net asset purchases would continue until at least September 2018. Only then, and after a substantial period, would it start to raise interest rates very gradually. The key to this scenario lies in the inflation forecast. In spite of the economic recovery, the ECB continues to stress that inflation is recovering very gradually and monetary normalisation should therefore be just as gradual.

Political factors are still the main source of euro area uncertainty. The first key event is Italy's election on 4 March. A highly fragmented parliament is expected to emerge, giving the government very little room to manoeuvre. Second, while the agreement reached on the first phase of negotiations has made a soft Brexit more likely, the second phase will probably see more episodes of tension between the UK and EU. Nevertheless, we believe that a scenario where the UK leaves the EU in a disorderly manner is highly unlikely and expect that both parties will reach an agreement on a transition period. Finally, negotiations continue in Germany between the conservatives and social democrats to form a coalition government. Should an agreement be reached, this could boost the European project.

The markets reward improved macroeconomic scenarios in Spain and Portugal. The publication of Spain's Q4 2017 GDP growth figures (0.7%) has confirmed the country grew by 3.1% in 2017. The economy has therefore posted three consecutive years of growth above 3%, continuously outperforming most of the developed economies. We expect a slight slowdown in growth in 2018 due to diminishing support factors (higher oil prices and the end of interest rate compression process). Nevertheless, the more balanced nature of this new phase (growth combined with current account surpluses, adjustments in public deficit and private sector deleveraging) is reaping its rewards. For instance, Spain's risk premium has fallen substantially and is now between 70 and 80 bp. Portugal's good economic activity data at the end of 2017 point to continued economic growth above 2% in 2018. As a result of this positive outlook, as well as a more favourable public debt dynamic and the progress made in bank restructuring, Fitch upgraded the country's rating from BBB to BB+.