ECONOMIC OUTLOOK · **Strong global growth with balanced risks**

World growth will remain at cruising speed in 2018 and 2019. Economic activity indicators tended to improve towards the end of 2017. This endorses the CaixaBank Research benchmark scenario for 2018, namely 3.9% world GDP growth (compared with 3.7% growth predicted for 2017). We expect world growth to remain a high 3.8% in 2019. Inflation will increase slightly in 2018, both in advanced and emerging economies. The factors supporting this expansion are evident. First, monetary policy will remain accommodative in the advanced bloc (even in the US, which will continue its monetary normalisation). This acceleration in global economic activity will also be supported by higher prices for oil and other commodities, boosting exporters but without harming import growth to any great extent. Thirdly, the emerging bloc is likely to speed up its recovery. Evidence of this was provided by Russia and Brazil towards the end of 2017, as well as the economic expansion of India and other emerging Asian countries, such as Indonesia. Obviously the notable exception to this pattern is China, which will probably continue its gradual slowdown in 2018 and 2019.

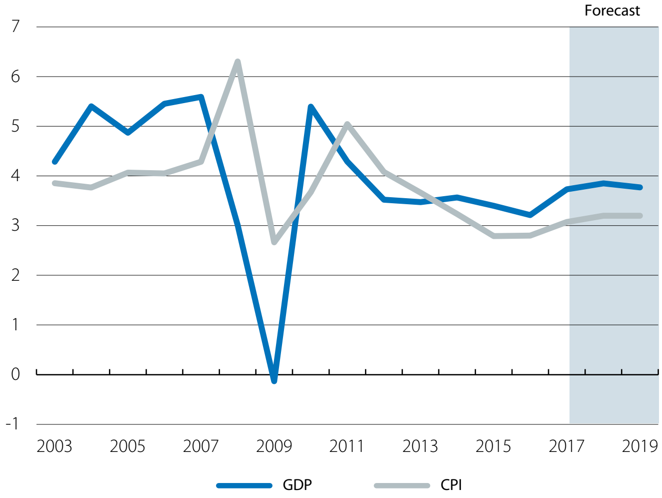
Risks are largely balanced. After several years of downside risks to growth prospects, the immediate outlook appears to be balanced. Most analysts tend to agree with this assessment, as can be seen in the IMF's recent revision of its economic outlook. Based on a similar benchmark scenario as the one mentioned above, the IMF believes that downside and upside risks offset each other, although potential adjustments in financial markets and political and geopolitical issues still warrant attention. However, from a medium-term perspective this assessment alters slightly, with the emergence of underlying aspects such as growing global debt, populist outbreaks, geopolitical uncertainty and doubts related to China's soft landing and its financial, real estate and forex risks, as well as the impact of tougher international financial conditions on emerging economies with greater external vulnerabilities. The list is quite long and the risk factors considerable.

UNITED STATES

For a good start to 2018, there is nothing like ending 2017 on the right footing. The US economy made considerable gains towards the end of 2017. For instance, business sentiment indicators (ISM) for manufacturing and services were well above 50 points in December, a clear indication of growth in secondary and tertiary economic activity. The consumer sentiment indicator provides a similar view, in December posting its best quarter since Q4 2000. Obviously this substantial growth in economic activity will support a strong start to 2018. Neither was the positive situation altered by the temporary shutdown of routine federal services in the

Global GDP and CPI

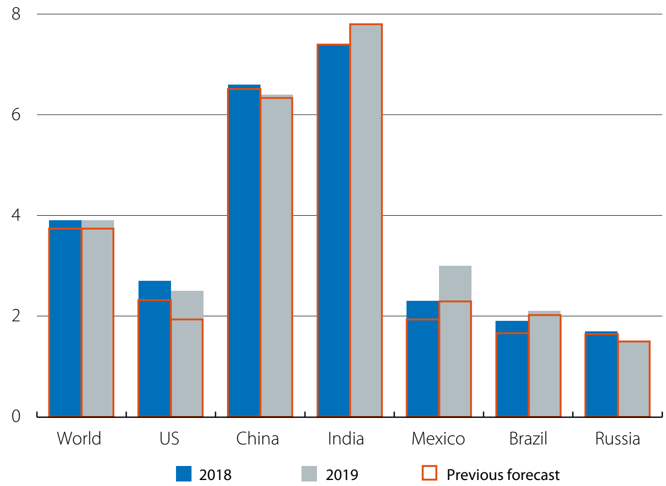
Year-on-year change (%)



Source: *CaixaBank Research.*

IMF: GDP forecasts for 2018 and 2019

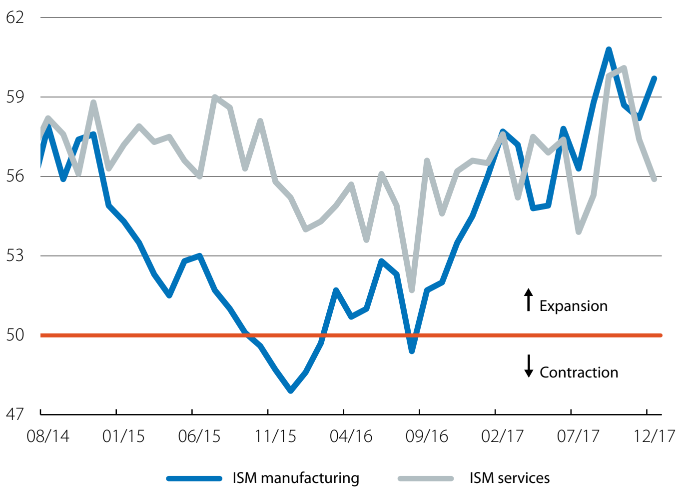
Annual change (%)



Source: *CaixaBank Research, based on data from the IMF (WEO, January 2018).*

US: economic activity indicators

Level



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

US due to the government's failure to reach an agreement to extend the federal budget. This is partly because, as on the 12 occasions this has happened since 1981, the stoppage was resolved in a few days.

The country's good economic performance at the end of 2017 is confirmed overall by Q4 GDP. Quarter-on-quarter growth reached 0.6% (2.5% year-on-year) in Q4, reflecting the expansionary tone of the US economy. By demand component, this continued strong growth rate was supported by a substantial increase in private consumption, large improvements in investment and an increase in public spending, offsetting a considerable negative contribution by stock. Such strong domestic demand points to growth continuing in the coming months.

Watch out for overheating. This acceleration in economic activity is occurring at a time when the US is close to full employment. 148,000 jobs were created in December, bringing the 2017 monthly average to a high 171,000. The unemployment rate also ended the year at a low 4.1% (very far from the 10% posted in 2009), while wages continued to rise substantially (up by 2.5% year-on-year). There are also indications the economy will continue in this mature phase of the cycle. US growth will remain high in 2018, supported by strong private consumption (given the healthy labour market), consolidated investment and a slightly expansionary fiscal policy (resulting from cuts in direct taxation on companies and, to a lesser extent, individuals). In 2019, growth is expected to remain in the area of 2%, thanks to continued support from domestic factors.

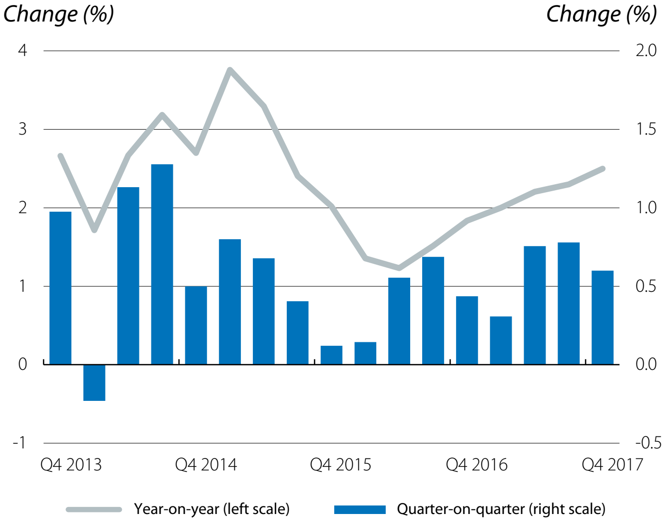
Inflation is about to get higher. This diagnosis is supported by the expected trend in inflation. In December, the CPI grew by 2.1% year-on-year, in line with the figures posted the past few months. But such contained increases will more than likely give way to greater inflationary tension in 2018, especially as from Q2. This reinforces the CaixaBank Research scenario regarding the Fed's monetary normalisation, with three interest rate hikes in 2018, bringing the fed funds rate to 3.25% by the end of the year.

EMERGING ECONOMIES

Emerging *momentum*, faster economic growth and considerable capital inflows. After several months of a slight slowdown in GDP growth, almost all emerging economic activity indicators began to rise towards the end of 2017. This improvement has been accompanied by a recovery in net portfolio capital inflows (debt and shares), with current levels approaching the peak reached in the past few years whenever optimism was high regarding emerging prospects. This increase in capital inflows has also been accompanied by the continued appreciation of many emerging currencies.

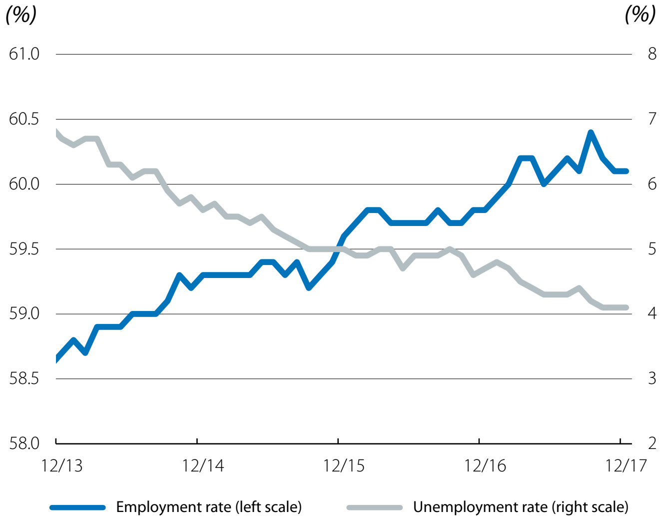
China, embarking on a 2018 with less growth. The trend in Chinese growth has been watched closely for several years now. One concern is just how far the official growth figures

US: GDP



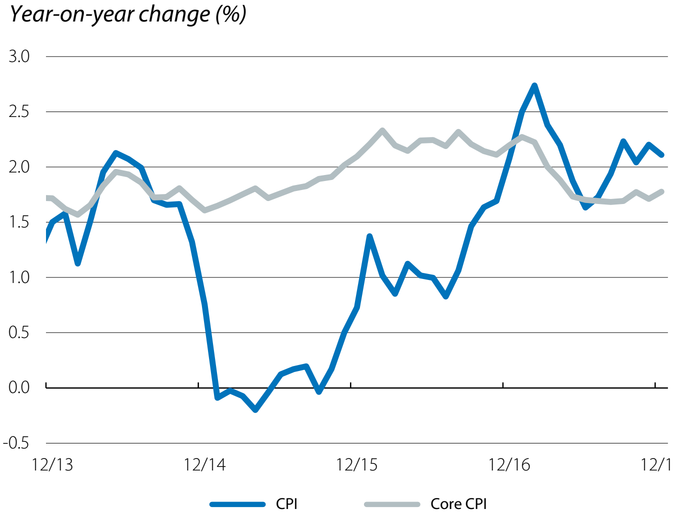
Source: *CaixaBank Research, based on data from the BEA.*

US: labour market



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

US: CPI



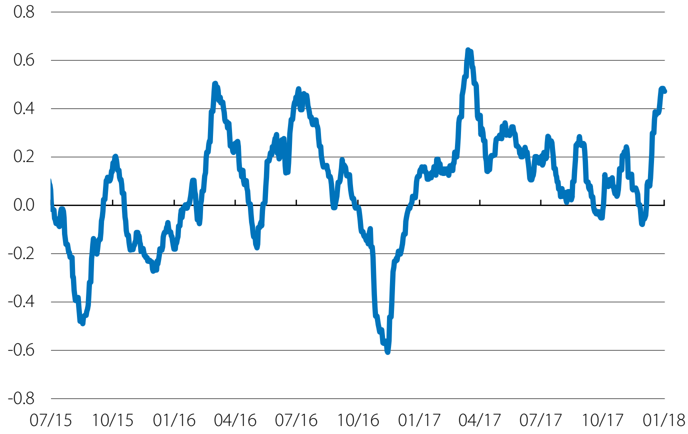
Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics.*

are in line with the information provided by other economic activity indicators (in this respect, see the Focus «China's economic growth under the microscope: past, present and future» in this Monthly Report). Such concern could grow should expectations increase of a sharper slowdown than predicted (known as a «hard landing»). For the time being, however, the trend is still positive. China's GDP grew at a good rate in 2017, 6.9% for the year as a whole (6.8% year-on-year in Q4). This annual growth figure exceeds the growth target set by the government for 2017, namely 6.5% GDP growth or higher. It is the first acceleration in Chinese economic growth since 2010 and results from good performances by consumption and exports. Nevertheless, we expect economic activity to slow down moderately over the coming months as the country continues with reforms in the area of state-owned companies and with its anti-pollution campaign and also increases supervision of the credit issued via shadow banking.

Good growth in many emerging economies. The rest of the main emerging countries are posting reasonably positive growth data. Each economy has its own particular support and negative factors. However, most are capitalising, to a greater or lesser degree, on the combination of cheap and widespread international financing, synchronised acceleration in world growth and upward commodities cycle. The large emerging Asian economies are perhaps benefiting the most from these positive factors, posting clearly dynamic figures (year-on-year growth in excess of 5%). The growth of other economies, however, is still hindered by continued pockets of uncertainty, mostly of a political and geopolitical nature, as is the case of South Africa, Mexico and Brazil.

*Emerging capital inflows (portfolio) **

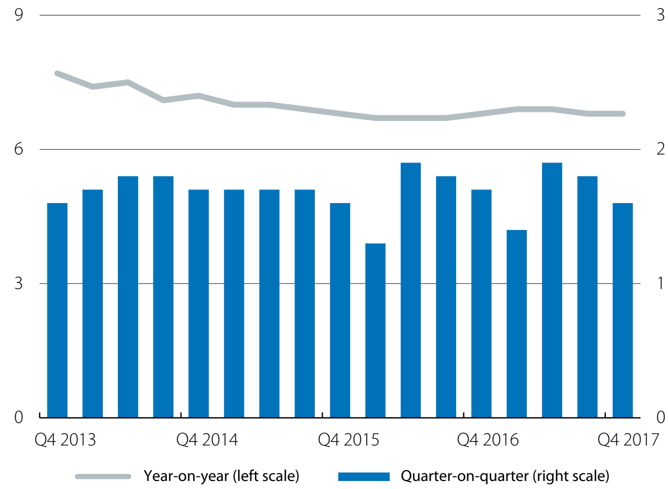
Moving three-month average (USD billion)



*Note: * Countries included: Indonesia, India, Korea, Thailand, South Africa, Brazil, Turkey, Hungary and Mexico. Net inflows of debt and shares.*
Source: *CaixaBank Research, based on data from the IIF.*

China: GDP

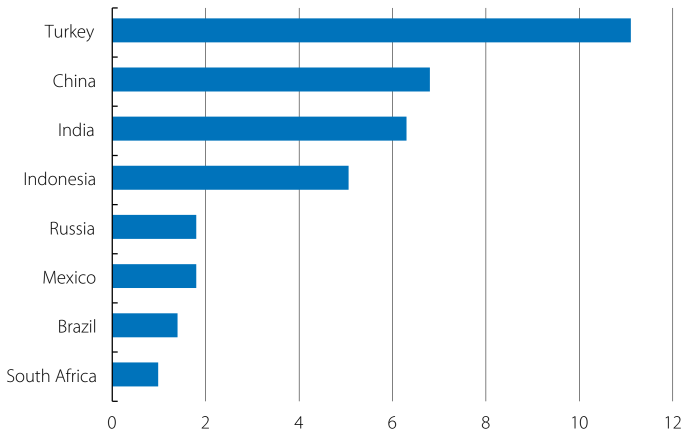
Change (%) *Change (%)*



Source: *CaixaBank Research, based on data from China's National Statistics Office.*

*Emerging economies: GDP **

Year-on-year change (%)



*Note: * The latest figure available is shown, corresponding to Q3 2017 for all countries except China and Mexico, which is Q4 2017.*
Source: *CaixaBank Research, based on data from Thomson Reuters Datastream.*