The question marks over the global economic outlook

Moderation in growth and persistent uncertainty: for how much longer? In recent quarters, there has been a moderation in global growth. This has been partly driven by expected factors, such as the fading of the fiscal boost in the US and China's transition towards more sustainable growth rates. It has also partly been driven by other, more troubling factors, such as the rise of uncertainty in the geopolitical environment and vulnerabilities in some emerging economies, as well as the difficulties currently being faced by some industrial sectors and by the automotive sector in particular. Against the onslaught of these uncertainties, global economic activity has stood up reasonably well, with a slight moderation in growth in the year to date and resilience in the services sector. Nevertheless, notwithstanding the support for short-term economic sentiment that could be offered by the resumption of trade negotiations between the US and China, the roots of the uncertainty run deep and are likely to persist in the medium term.

Financial markets, decoupling or in a sweet spot? In this environment of heightened uncertainty, prices of financial assets have proven to be more sensitive to political statements, to certain unfavourable economic figures and, of course, to the messages of the central banks. Thus, so far this year there have been successions of periods of optimism and episodes of risk aversion and volatility. All in all, the semester has produced two clear trends: a sustained rise in the stock markets (the main indices have amassed gains slightly above 15%, with the US stock market beating its all-time highs) and an astonishing sinking of interest rates (10-year sovereign bond yields in the US and Germany have fallen by between 60 and 70 bps, reaching a level not seen since 2016 in the first case, and reaching an all-time low of –0.3% in the second). These two trends, although clear, could hide contradictions, since stock market gains tend to be supported by a favourable economic outlook, whereas the low interest rates point towards expectations of more accommodative monetary policy (which, in turn, would reflect the need to tackle a deterioration in the economic environment). One possible explanation to reconcile these two trends is that investors expect monetary policy to hit a sweet spot that sustains the expansion. But this leads us to the next question.

How far will the central banks go? After pausing the tightening of their monetary policies at the beginning of the year, both the Fed and the ECB have ended up doing a U-turn by signalling that, in the coming months, they will once again implement expansionary measures. Thus, the prices of financial assets assign a high probability of the Fed cutting interest rates in July and of the ECB doing the same in September. Although these expectations tie in reasonably well with the clues given by both central banks, the market prices go further and indicate that the monetary easing will be more significant in what remains of 2019 and throughout 2020. Nevertheless, the Fed and the ECB accompanied their accommodative messages by reiterating that, as the economic activity indicators also suggest, the economic outlook for the US and the euro area remains favourable, especially in the medium term. So, a more balanced reading of the U-turn by the central banks suggests that they are seeking to take preventive measures in order to fight the escalation of risks, rather than preparing for a new cycle of expansionary monetary policy (as the movements of the financial markets might indicate).

Spain and Portugal, from the periphery to the core? The Spanish and Portuguese economies have weathered the slowdown in the global economy better than their partners. Whereas in Q1 the euro area as a whole grew by 1.2% year-on-year, GDP growth in Spain and Portugal stood at 2.4% and 1.8%, respectively. In addition, they continue to perform well and the indicators suggest similar levels of growth for Q2. In the financial markets, Spain and Portugal's good macroeconomic performance has resulted in a significant reduction in their risk premiums (of approximately –45 and –70 bps in the semester as a whole, respectively), narrowing the gap between their sovereign yields and those of the core euro area economies. In both cases, however, there is still a long way to go. In contrast with the strong performance of domestic demand, which is well supported by the buoyancy of both labour markets, in recent months we have witnessed a loss of steam in the foreign sector, which has been moderate in Spain and somewhat more accentuated in the case of Portugal (intensified by investment, which has driven up imports). Furthermore, both economies should take advantage of their cyclical performance to continue the correction of the public deficit that allowed them to exit the excessive deficit procedure (Portugal in 2017 and Spain in 2019) and to continue to reduce their public debt ratios, which remain very high.