Positives and negatives in the global economy in the short and medium term

In the first third of the year, the pieces of the puzzle that makes up the soft landing of the international economy have been gradually coming together, despite the increase in geopolitical instability and the higher than expected figures for growth and inflation, which in any case reduces the likelihood of a recession. These more buoyant activity data and business earnings, particularly at this point in the spring, serve as a good foundation for growth in the rest of the year and have gone hand-in-hand with a recovery in confidence among economic agents, despite all the geopolitical noise. The only discordant note, though not unexpected, is the sign of some resistance shown by inflation on its path to the target, now that we have entered the last mile. The most unusual pattern that must be taken into consideration when shaping the monetary normalisation process is the divergences that are beginning to emerge in this last mile, as inflation aims for 2%, reflecting the uneven recovery rates recorded in recent quarters, as well as the differing patterns between sectors. This will likely result in less coordination in the interest rate cuts compared to the restrictive movement of the last two years, in the absence of overreactions in exchange rates.

All this denotes «resilience amid divergence» in the business cycle, to quote the IMF, thanks to the support which the strength of the labour market, public spending and the savings accumulated during the pandemic have provided to demand. Perhaps the most novel factor, however, is the fact that the positive dynamics that are present on the supply side have been strengthened, since the normalisation of supply chains and the fading of the energy shock have now been joined by the growth of the labour force (no one remembers the Great Resignation anymore). Therefore, the rebalancing achieved in the last half-year between global supply and demand leaves the path quite clear for the economy's return to potential growth rates, provided there are no further shocks or surprises in the geopolitical scenario that trigger a disruptive rally in the oil price relative to current levels. For now, in an environment with global demand gaining strength, disruptions to shipping and high political instability, prices have remained largely contained in recent weeks, suggesting that the supply is flexible enough to keep prices at around 85 dollars a barrel.

The problem is that the improvement in the economic scenario will not prevent short-term growth rates from remaining rather mediocre, especially in Europe, due to: the persistence of high interest rates, the gradual withdrawal of fiscal support, the delayed consequences of the shocks of recent years and the caution that economic agents continue to show when making investment or consumption decisions in an unstable context. Strengthening the balance sheets of businesses and households would help to compensate for the high funding needs of the public sector. That said, this can hold back economic activity as the fiscal stimulus disappears, especially in a world in which the growth of foreign demand may be limited by the fragmentation caused by protectionist policies under the umbrella of strategic autonomy, friendshoring or similar concepts. This increases the importance of private investment as a key variable in order for growth to return to its potential in developed economies, which is a necessary condition for achieving economic policy objectives such as those linked to the energy transition. After all, hoping for an imminent recovery in productivity is not a strategy, but wishful thinking. As the *Letta Report* has highlighted, Europe faces the additional problem of its competitive disadvantage due to the absence of adequate channels to direct domestic savings towards large investment projects, in the absence of a (complete) capital markets union. The report calls for the creation of a Savings and Investment Union that reduces the significant outflows of savings abroad (around 250 billion euros per year) and facilitates the funding of both the green and digital transitions and the defence spending requirements that come with tackling the continent's current security issues, as well as addressing the challenges faced by its pension systems. Therefore, improving the visibility of the economy's performance in the short term remains fraught with significant challenges in the medium term, in an environment in which we will see major transformations in the coming years.

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