Global Economic Outlook

Second quarter 2015
Economic Scenarios Unit

- World is suffering from the slowdown in the emerging economies
- Global risk aversion, Fed rates and emerging markets: US growth and local vulnerabilities are key

Index

Closing date: 30 April 2015

1 Editorial

World growth slowed in the first quarter of 2015 to an annualised rate of around 3.0%, nearly half a point below our estimate for the second half of 2014. This deceleration is consistent with the moderation in activity in the US, the firmer recovery in the eurozone and slower growth in the bulk of the emerging economies (EMs), particularly China and South America. In any case, our scenario is for **moderate global growth,** more or less in line with the average of the last two years, without inflationary tensions at a global level and **uneven in the various geographical areas.** Such differentiation between geographies also affects the performance of the financial markets, in particular amongst the EMs.

Due to its global impact, one of the key points to this scenario is the Fed's reading of how activity has slowed down in the US. The lack of inflationary tensions suggests that interest rates are likely to be raised, possibly starting in September 2015 and very gradually thereafter to avoid any undesirable outcome. One novelty in the start of the Fed's normalisation of monetary policy, the first since 2004, is its **divergence with the Bank of Japan and the ECB,** which have stepped up monetary easing to head off the risk of deflation and hold long-term rates at low levels. In the eurozone, although the risks of deflation are limited, medium-term inflation expectations are still a long way from the ECB's stability target.

In the **EMs**, **widespread proactive monetary policy** to support domestic spending is having **different impacts on real interest rates, exchange rates and capital flows.** The room for manoeuvre available to these economies is limited by the degree to which the recent depreciation of their currencies is passed through to inflation, and the effects that a fall in yields may have on financing their current account deficits. In addition, intense currency depreciation could eventually compromise their external debt servicing. The **diversity of responses to economic policy in the EM economies** is coherent with the combination of two factors that are inter-dependent: first, the **uncertainty regarding the cyclical strength of each economy and the evolution of inflation; and second,** the impact of the timing and **pace at which the Fed will eventually raise its interest rates.**

All in all, **the context for global growth remains favourable.** In the most likely scenario, global GDP will accelerate to 3.9% in 2016 due to the support of the DMs, which will register their strongest growth since 2010. In the case of the EMs, given the downward trend in China, their brightest outlook for the next year lies in the support of the DMs on world trade, steadily rising commodity prices and a tightening up of financial conditions which, in line with the above, will be much more gradual than in previous Fed rate-hike cycles.

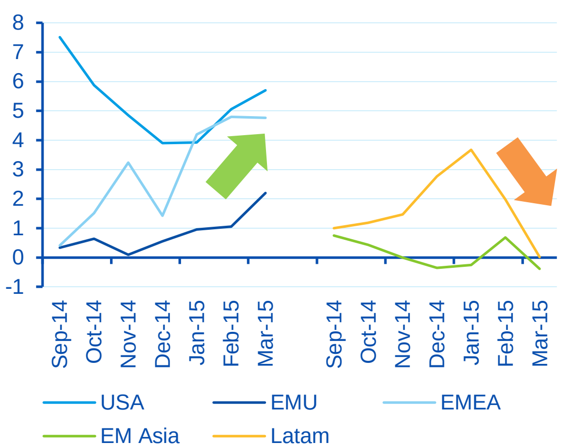
The **balance of risks to this scenario remains to the downside.** First, due to the **geopolitical conflicts**, which could result in disruptions to activity in the Middle East and Eastern Europe (Ukraine and Russia), and have a global impact via financial channels and expectations. Second, **the slowdown in China, if it proves even more acute than expected** and leads to stimuli that **delay the necessary adjustment process in highly leveraged sectors** or with high dependence on the real estate market. Third, but none the less important, **the ongoing uncertainties in the eurozone.** The positive valuation of the progress made in banking union and the strengthening of the economic cycle is offset by **the risk that no agreement will be reached between Greece and the European authorities** that will guarantee the financing for the former without compromising the reform agenda aimed at enhancing the country's capacity for growth and ensuring that it is financially self-sufficient. If any lack of agreement were to result in Greece defaulting on its debt servicing, this would open up a scenario that could end in the extreme event of Grexit, testing the ECB's ability to avoid financial contagion and the authorities' commitment to an additional strengthening of the monetary union.

2 World growth is suffering from the slowdown in the emerging economies

The available economic indicators point to **a gradual slowdown in world growth in the first quarter of 2015 towards a 3% annualised rate**[1], a few tenths below the figure in 2H14 (between 3.3% and 3.6%). The slowdown in the US economy, the lower dynamism of China, and the decline in activity in certain key emerging economies (such as Russia and Brazil, though not India) account for the bulk of the slowdown worldwide, which have not been offset by the relatively better performance of the eurozone and the United Kingdom.

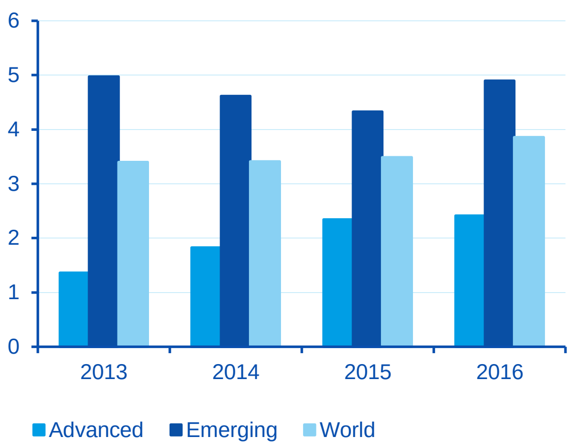
The differentiation among geographical areas and sectors of activity remains in the pattern of world growth at the start of 2015. On the one hand, consolidation of growth among the developed countries contrasts with the almost general loss of steam among the emerging countries, which is more intense in Asia and Latin America than in Eastern Europe, according to the business confidence, industrial production and foreign trade indicators. On the other hand, the improvement in private consumption, as gauged by the recovery in household disposable income within a context of lower energy prices, job-creation and increased financial wealth, is giving support to the services sector in the major developed economies (mainly in the eurozone), while the gains in industrial production and investment are more tepid. These developments could be due to the doubts about the sustainability of the recovery in private consumption, which is delaying industry's decisions on investment and production.

Figure 2.1
Manufacturing PMI (deviation from the 50 point mark — activity holding)



Source: BBVA Research and Haver

Figure 2.2
World GDP: forecast annual growth 2015-16 (%)



Source: BBVA Research

The fact that global activity has performed slightly worse than expected in 1Q15 and the impact of the weakness of the domestic demand, the stabilisation of commodity prices at low levels and the Fed rate hike on key emerging economies lead us to revise our world growth forecast for 2015 to 3.5%, 0.1pp less than forecast in January and only 0.1pp more than the 2014 figure[2]. In 2016, world GDP should record an average growth of 3.9%, partly as a result of the expansive monetary policies in the developed countries,

1: Estimate based on BBVA Research's global activity indicator (GAIN). Details of the methodology can be found at: http://bit.ly/1nl5RIn
2: The impact on the world GDP estimate of the revision of India's National Accounts should be particularly noted. Indian economic growth moved from 5.0% to 7.2% in 2013-14, which raises world GDP growth by between 0.1 and 0.2pp, an upward change which is also included in the forecasts.

which ought to achieve their best registered figure since 2010. The emerging economies should, within a scenario of a trend of gradual slowdown in China, manage to reverse the current decline thanks to the positive spill-overs from the developed economies, the steady increase of commodity prices and a cycle of interest rate hikes by the Fed that will be more gradual than in previous episodes.

The progressive rise in commodity prices, in line with BBVA Research forecasts, and the **reinforcement of loose monetary policies** have been two of the most remarkable elements in the economic global picture in recent months. The base effect of the former **has helped to contain the fall in inflation rates in certain geographical regions, mainly in developed countries, which, together with the change in the tone of monetary policies, has anchored the inflation expectations discounted by markets. Both of these, however, have failed to inhibit financial volatility indicators from continuing to tick upwards, although from very low levels and only gradually**. This appears consistent with a context of uncertainty about the strength of economic recovery, the timing and the intensity of Fed rate normalisation and the distortions caused by ECB balance-sheet expansion on the price levels of those financial assets with the greatest weight in the portfolios of economic agents.

Having built up a fall of over 45% between September 2014 and January 2015, the price of oil has since climbed by about 15%, with Brent crude standing at c.USD60/bbl. The result has been an easing of downward pressure on headline inflation rates (the average level recorded among the United States, China, Japan and the eurozone remained at under 1% in February), which, however, has not been mirrored in other representative price indicators such as core inflation (stable at 1.5% on average for the group mentioned) or production costs (the fall in industrial or import prices is particularly substantial in China).

The absence of short-term inflationary pressures (even though the oil price is converging to USD70/bbl at the end of the financial year) and long-term inflation expectations being contained at levels below those targeted by the central banks have served to justify a **greater degree of proactive moves by central banks, both in developed and emerging economies**. In the former case, by continuing at length with asset purchase programmes (ECB and in Japan) or by giving consideration to delaying reference rate hikes (the Fed and the Bank of England); in the latter case, taking further measures aimed at monetary loosening by cutting rates (although Brazil is the main exception here). There is no doubt that this **latter aspect represents one of the distinguishing factors of the present economic cycle**. Even if the Fed might have decided on a strategy of gradual monetary tightening, the beginning of which could come about in 2H15, the emerging economies have chosen to give priority to kick-starting their domestic demand by trying to cut real interest rates, in some cases at the cost of accepting greater exchange-rate volatility and running the risk of reduced incentives for foreign capital inflows. A sign of this is the slowdown of the short-term nominal interest rate for the world’s major economies (excluding the United States), which stands at 3.2%, which is 20bp below the level a year ago.

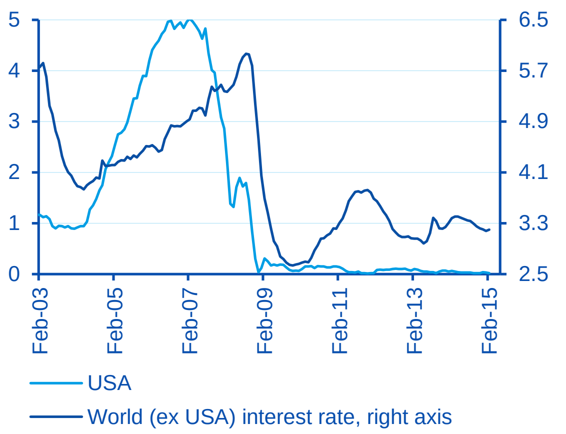
The other side of the coin is the strengthening of the dollar at a global level and the **almost across-the-board depreciation of emerging economy currencies, which is more pronounced in those countries that have a greater reliance on foreign funding, a larger share of revenue from commodity exports or a higher reaction to the global liquidity scenario**. Moreover, those which decided to implement expansive monetary policies given such “fundamentals” have come off the worse for it. In the short term, the depreciation of emerging currencies can promote the external competitiveness of those countries and kick-start economic growth. That said, this can end up giving rise to adverse effects which are uneven among economies and institutional segments, by making it harder to refinance the debt taken on in foreign currency (in most cases dollars), thereby making the servicing of this more costly.

The contrast in the monetary strategies of the ECB and the Fed will continue to shape the direction taken by capital flows and, by extension, the behaviour of financial variables. The ECB’s liquidity injection from buying-up government bonds has reinforced the correction in long-term interest rates among the developed nations and, to a greater extent, in the eurozone, and has magnified the euro's depreciation relative to its main exchange currencies (it stands at close to parity against the dollar).

This trend is likely to remain until the Fed implements the first increase in fed funds. Thus it will be its communication strategy regarding the pace of the forthcoming hikes which shapes the rally for yields in the bond market and the degree of financial volatility. The scale of any capital outflows from the emerging countries will therefore hinge on Fed monetary policy, though also on local factors associated with the point in the cycle and the vulnerabilities of each country, especially when the volatility from the first or first few hikes wears off. Thus, as in terms of growth, major divergences in the course taken by exchange and interest rates among the emerging countries are to be expected.

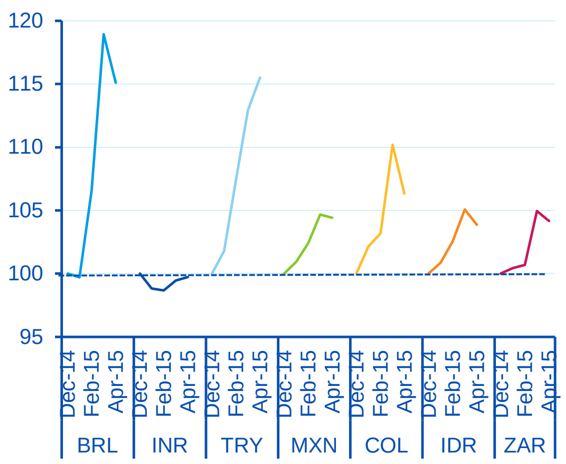
On balance, and although economic policies will continue to be accommodative, **the risks to the downside persist for world growth**. The most significant of these rest with the extent of the slowdown in China and the spill-overs coming from the beginning of the Fed's rate normalisation process. The deflationary pressures associated with the oil price, geopolitical tensions and any failure of the ECB to reactivate inflation expectations in the eurozone are risks that, despite appearing less likely and less significant in terms of expected impact than some months ago, cannot be ruled out. Finally, a risk which still lurks in the wings is that of a failure to reach agreement between the Greek government and the European institutions and the IMF on how to refinance its debt servicing obligations.

Figure 2.3
Short-term nominal interest rates (%)



Source: BBVA Research and Bloomberg

Figure 2.4
Exchange rates against the dollar, Dec 14=100
A rise in the index denotes dollar appreciation



Source: BBVA Research and Bloomberg

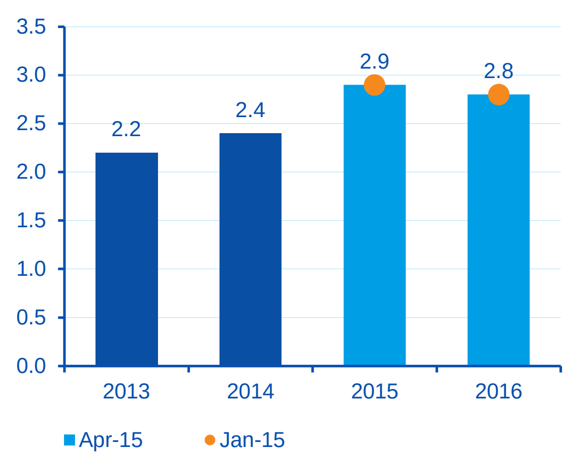
With regard to the **details for the major economies, the United States has begun 2015 with a substantial slowdown in its growth rate**, which could translate into GDP moving ahead by barely 0.2% QoQ, which compares with an average increase in the previous three quarters of 1%. The unusually harsh weather conditions account for a portion of the slowdown, though this is not the sole cause. The impact of lower oil prices on energy sector activity and the early effects of the dollar appreciation on exports are also having a bearing.

The strength still shown by the labour market, with employment gains at a rate of close to 2% YoY since October 2014, should continue to support household income and private consumption in a scenario of low energy prices, a steady improvement in nominal wages and inflation holding at low levels (in 2015 the average headline rate could be around 0.6% and rise to 1.9% in 2016). The strength of domestic demand, and especially consumer spending, is essential to offset likely export weakness and allow GDP to grow at rates of between 0.7 and 0.8% QoQ for the remainder of the year. Only thus can US growth reach 2.9% and hold at rates approaching 3% as well in 2016.

The interpretation which the Fed makes of whether the lower first-quarter growth is transitory or permanent will define how it reacts from now on. Equally significant will be the changes that arise in the international context, which will be shaped by growth among the emerging nations and currency market volatility. At the March meeting of the FOMC, the Fed changed its communication strategy and laid down the reasons for tackling the initial Fed funds rate rise, although it did reiterate that the course taken by monetary tightening will be gradual and conditional upon how the domestic cycle evolves. This, together with the downward revision of its forecasts for growth and inflation, has led the FOMC itself to lower expectations regarding the level for reference rates in the medium term.

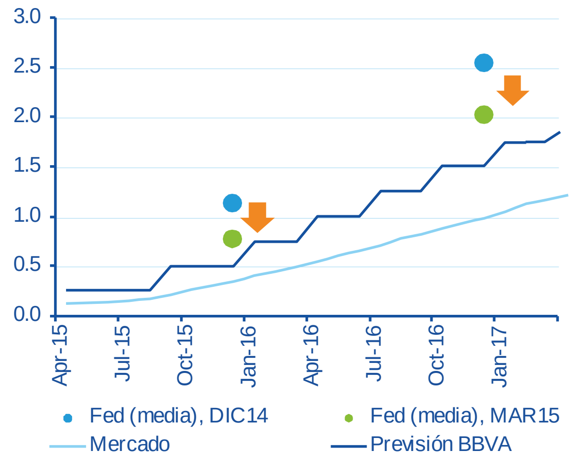
As a result, the **most likely scenario is that the first rise in the Fed funds rate will occur before or in September 2015**, but could be put off if the recovery is not as strong as desired. Unlike with other rounds of Fed monetary normalisation (the last of which began in mid-2004), US core inflation and price expectations for the longer term are at significantly lower levels and well below the central bank's target, and there is greater doubt over world growth. For these reasons **the rate hike process is likely to be gradual, with a target level of no more than 1.5% at the end of 2016**.

Figure 2.5
US economic growth, % annual



Source: BBVA Research

Figure 2.6
US Fed Funds expectations (%)



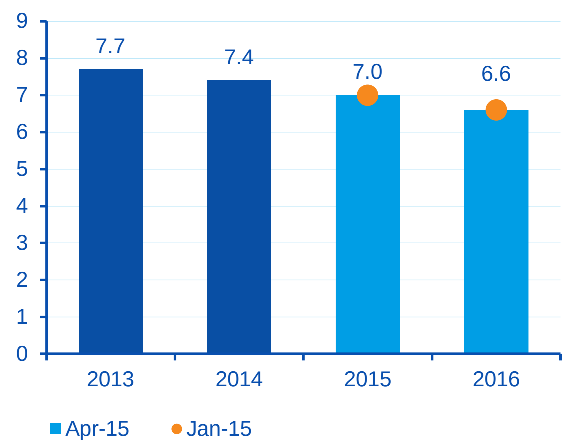
Source: BBVA Research and Bloomberg

In China, the economic slowdown has accelerated in the last few months, with GDP moving ahead by 7% YoY in 1Q15. Balance of activity indicators place the adjustment focus on the industrial sector (production is growing at under 7% YoY, a historical low) and fixed asset investment (almost 14% ahead YoY, two points below the 2014 average), while it reveals a better relative performance from private consumption, buoyed by the vigour of the labour market and the fall in inflation (1.3% in March).

There are several factors behind the slowdown in the Chinese economy. Firstly, there is a correction underway in the real estate market, with an impact on construction investment and activity in auxiliary sectors. Secondly, the political uncertainty ahead of the National People's Congress in March, which has left decisions by companies about expanding productive capacity or making new contracts on hold. Thirdly, the decline in competitiveness abroad implied by the worldwide appreciation of the yuan (in terms of the real effective exchange rate). Last but not least, the effects of fiscal consolidation of local authorities which began in 2H14.

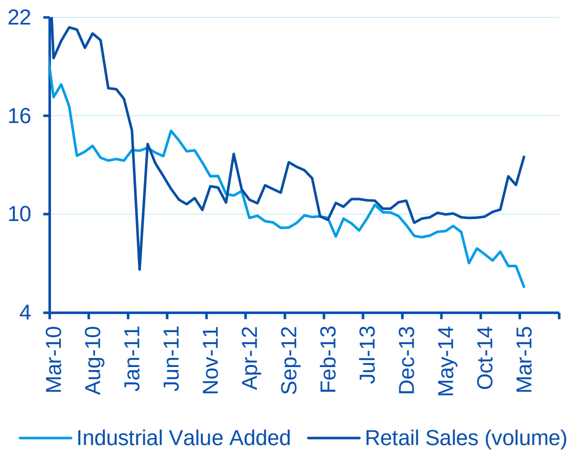
The structural nature of the factors mentioned above supports our assessment that China should grow more slowly in the medium term and with greater volatility. The target annual growth rate of 7% for 2015 which was set by the Chinese authorities relies on implementation of new stimulus measures, both monetary and fiscal, to allow a soft landing for the economy without compromising the process of internal adjustment in progress and the development of structural reforms to raise growth potential. Further cuts to the reference rate (to 5.1% at the end of this year) and the minimum reserves held by banks are likely to be made, and greater fiscal expansion will probably be applied by the central government, which will lead to a certain depreciation of the yuan, which limits the minor impact of external demand on aggregate activity.

Figure 2.7
China: economic growth, % annual



Source: BBVA Research

Figure 2.8
China: Industrial production and retail sales (% YoY)



Source: BBVA Research and BIS

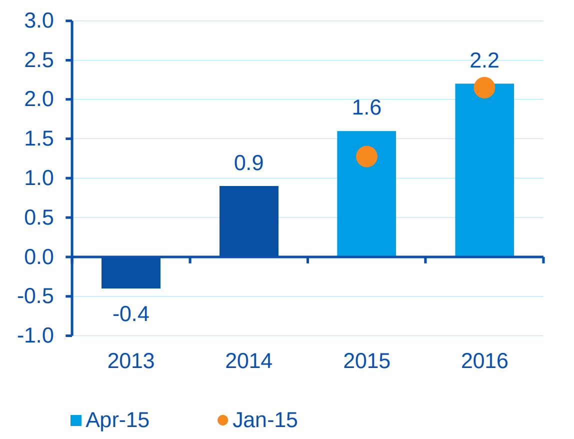
Of the developed economies the eurozone is the one which has put in the best relative performance as 2015 gets underway. The GDP could have grown by 0.4-0.5% QoQ in the first three months of the year, which would imply the quickest pace since mid-2011. Private consumption and exports should be offsetting continued substantial investment weakness, with Germany and Spain heading up growth for the area as a whole. The easing of financing conditions and the euro depreciation triggered by the ECB's quantitative easing programme, together with the drop in the oil price, are proving crucial to the recent dynamic of recovery. The less restrictive nature of fiscal policy and containment of falling nominal wages in the countries on the periphery are also helping to promote growth again.

Maintaining these supporting factors over the rest of the year could lead to GDP increasing to 1.6%, 0.3pp above the forecast we made in January. So far the steady improvement in domestic demand is not feeding through into an increase in core inflation, which is stable at 0.6%. This is an element which, together with the rise in the oil price, will keep inflation at close to 0% in 2015 and below 1.5% in 2016.

With respect to the recent ECB asset-purchase programme (the volume of purchases of private and public stock was around EUR134bn in mid-April), the transmission channels that are showing the biggest reaction are euro depreciation (its real effective exchange rate stands at the 2002 low) and the trimming of long term interest rates and risk premiums. How this works through to spreads applying to new banking credit business, as well as to long-term inflation expectations, remains to be seen. The latter have been anchored since the announcement of quantitative easing of government bonds, but they are still under the ECB's 2% reference rate.

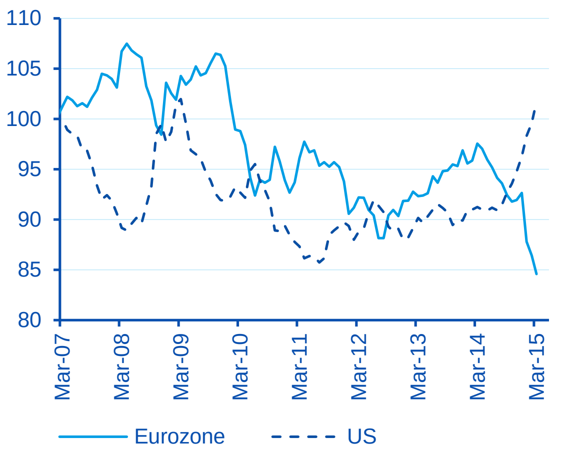
A more accentuated slowdown than expected for the Chinese economy and increasingly fraught political and institutional tensions in Greece together comprise the main risks to the eurozone in the short term. In the former case, because it would weigh on export growth, which is vital for sustained improvement in GDP, and in the latter case because it would re-open the debate over the current make-up of the monetary zone and could give rise to a substantial increase in financial volatility. The liquidity restrictions Greece faces in repaying the official financial assistance forthcoming under the different bail-out programmes and the reluctance of the organisations involved to renew or inject flexibility into their terms will add to uncertainty over resolving the Greek crisis until at least the end of 2Q15.

Figure 2.9
Eurozone: economic growth, % annual



Source: BBVA Research

Figure 2.10
Real effective exchange rate, Jan 2007=100
An increase in the index implies appreciation



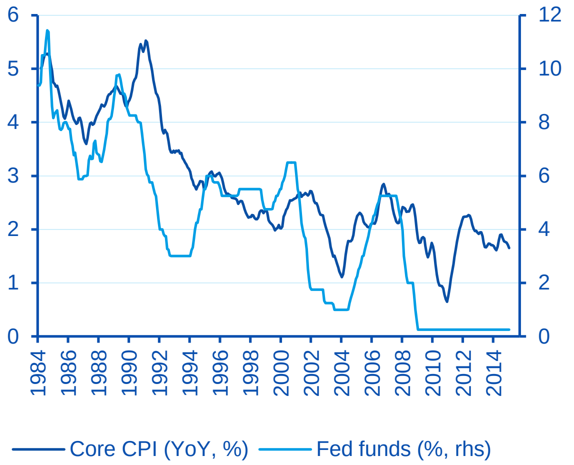
Source: BBVA Research and BIS

3 Global risk aversion, Fed rates and emerging markets: US growth and local vulnerabilities are key

The start of the monetary normalisation process by the Federal Reserve (hereafter 'the Fed') in September 2015 **represents one of the major sources of uncertainty in the world economic scenario** after seven years in which the benchmark interest rate (*Fed funds*) has kept at levels close to 0% and the Fed's balance sheet has ballooned from representing 6% of United States GDP to topping 25%. **The exceptional nature of the current cycle does not only affect the United States. The recovery in global activity is relatively slow** and a hallmark of it is the absence of inflationary pressures (partly due to the high indebtedness levels which have built up), which has allowed the reference central banks to be proactive in their monetary policy. All of this makes it hard to judge the potential effects of the shift in Fed policy on global financing conditions and, by extension, the global economic cycle.

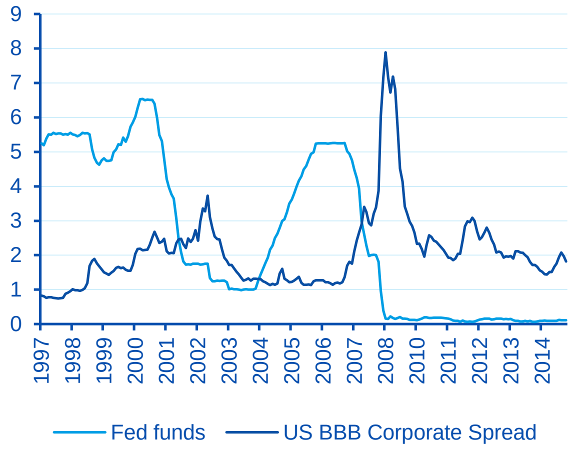
The special dynamic of the expected path to be taken by the rises in the Fed funds compared to other periods of monetary tightening (Dec 93-Mar 95; Jun 99-Dec 00 and Jun 04-Sep 06) **might also alter how economic agents react,** to the extent that both the members of the FOMC and the market itself are considering a very gradual rise in rates and a final level for the upward cycle that is substantially lower than it was in former cases of tightening.

Figure 3.1
US reference rates and core inflation



Source: BBVA Research and Haver

Figure 3.2
US reference rates and global risk aversion (%)



* Same reading using the VIX as a measure of risk aversion
Source: BBVA Research and Bloomberg

The possible upturn in risk aversion and financial volatility represent one of the major transmission channels through which the US rate rises can determine how capital flows are re-allocated, thereby penalising high-risk financial assets and, among these, those of the emerging markets. This means that in addition to having to face higher borrowing costs (an increase in risk premiums measured by the sovereign bond EMBI indexes), the EMs could run up against restrictions on raising new funds (capital outflows as a result of the relatively low yield of their assets compared to US assets) and refinancing debt already taken out in foreign currency, in a scenario of global dollar appreciation.

The historical relation between the Fed funds and traditional measures of risk aversion, such as the VIX (the Chicago options market's volatility index) or the US corporate BBB spread, **is not conclusive when it comes to establishing what rises in the former have been accompanied by upticks in financial volatility**. Using a 1997-2015 time horizon, three periods can be discerned in which the relation between both variables changes:

(i) **1997-2004:** on average there is a positive relation (rises/falls in the Fed funds rate were accompanied by rises/falls in financial volatility), although this was not always at the same time. Higher interest rates generally mean requiring a larger return for taking on risk in financial asset portfolios.

(ii) **2004-2006:** rises in the Fed funds rate were accompanied by stabilisation of financial volatility at low levels relative to the historical average. It should be noted that these years were the most dynamic for the world economy (nominal GDP growth of close to 9%), coinciding with the sharp price rise of commodities. The monetary tightening by the Fed was therefore necessary to head off overheating of the US economy and the associated risks of financial exuberance.

(iii) **2007-15:** in the first two years the sharp rise in financial volatility that was sparked by the Lehman Brothers crisis prompted a cut in the Fed funds rate to 0% (inverse relation). From here on the lack of change in the Fed funds rate is associated with the stabilisation of financial volatility, also at low levels, although there is one factor that distinguishes this from 2004-06: the effect of the balance sheet expansion of the most relevant central banks in the developed economies (liquidity effect).

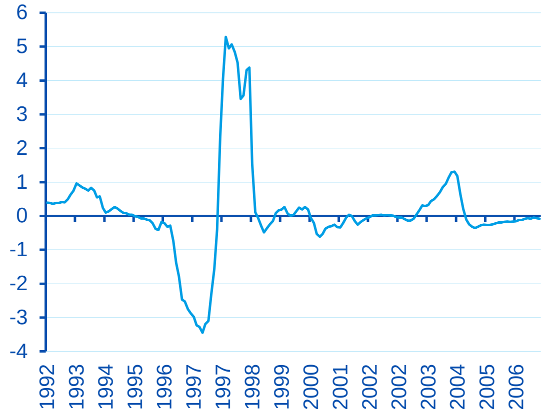
Statistically, the variability of this relation is corroborated by the unconditional elasticity[3] of the VIX to the Fed funds rate in the period leading up to the recent financial crisis. Thus, even when the Fed's monetary strategy is a decisive element in global financial conditions it is not the only one, and its impact on these to a large extent depends on other factors such as the phase of the cycle in which both the United States and the world economy finds itself, the volume of liquidity in the system or specific tensions in markets such as that for sovereign bonds in the eurozone.

The elasticity of global financial volatility to changes in the Fed funds rate is negative if the Fed alters its monetary policy in response to variations in the place of the United States in the economic cycle, i.e. rises in the Fed funds rate are accompanied by drops in volatility. On the other hand, when the variation in the Fed funds rate does not arise as a direct result of changes in US activity (the market has greater problems in anticipating Fed monetary policy), the elasticity of volatility is positive (rises in the VIX given rises in the Fed funds rate)[4].

3: The unconditional elasticity of the VIX to the Fed funds rate corresponds with the linear regression coefficient between both variables (besides a constant) calculated for a two-year moving data window.

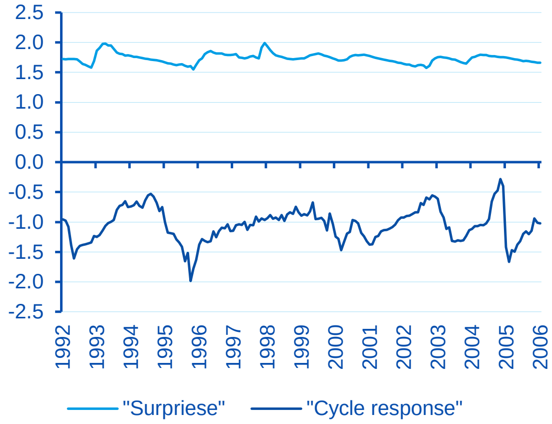
4: The conditional elasticity is estimated in similar fashion to its unconditional counterpart, but using only the component of the VIX and the Fed funds rate accounted for by the relevant type of shock (cycle response: unemployment rate shock; "surprise": shock exogenous to the US economic cycle), i.e. these are paths taken by the VIX and the Fed funds rate that would have happened if only shocks of this kind had been present. To isolate these components a structural vector auto-regression (SVAR) model is used using as variables the Fed funds rate, the VIX, core inflation and the US unemployment rate in keeping with economic theory.

Figure 3.3
Historical elasticity of the VIX to Fed funds rate variations (%): 1992-2006



Source: BBVA Research, Bloomberg and Haver

Figure 3.4
Elasticity of the VIX to Fed funds rate variations in response to changes in the US cycle or exogenous factors ("surprise"), %



Source: BBVA Research, Bloomberg and Haver

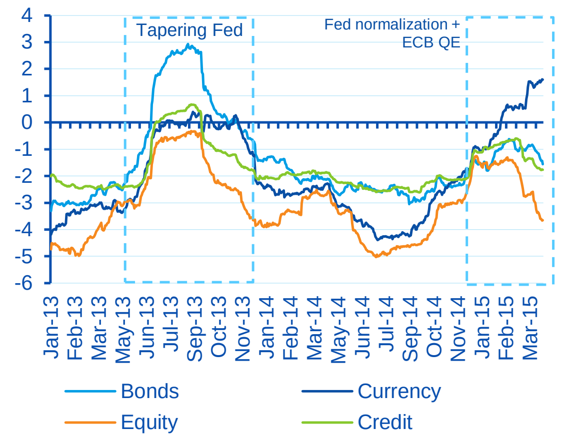
In the current cycle, the **quantitative easing programmes in progress and the more pro-active approach by the emerging market central banks**, with virtually across-the-board cuts in the reference rate, **constitute distinguishing factors that could help soften the blow of a potential rise in risk aversion in the coming months,** as a result of disappointment over economic growth in the United States or other negative surprises.

Since the start of 2015, the VIX has come down from levels of 22% to 13% at the end of April and the US corporate BBB spread, which bounced at the start of the year to levels at the time of the tapering statement, has again fallen back, moving from 2% in January to 1.6% in April. The larger-than-expected scale of the ECB asset programme could have been key in containing the perception of global risk. The lowering of expectations of a rate hike by the members of the FOMC, thereby closing up the gap with the path discounted by the market, has also been influential.

All in all, it is worth noting the differentiated volatility performance by asset class. The composite global volatility indexes constructed by BBVA Research for the major markets show a generalised increase in volatility in January and February 2015, to the point of reaching September 2013 levels, and a subsequent fall in the bond, stock and corporate credit markets. The exception lies in the currency market, with volatility at a high since early 2012, essentially as a result of movements in EM currencies and by those of developed economies such as the euro and the Swiss franc, etc.

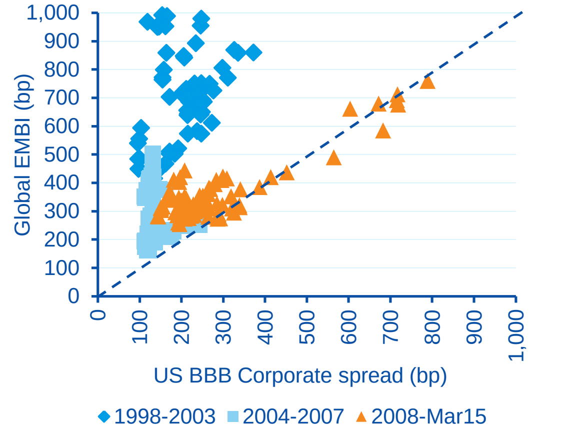
Therefore, **although it cannot be ruled out that we are witnessing the prelude to a rise in financial volatility, this could be limited and might not compromise economic recovery locally and for the rest of the world** if the Fed is consistent in linking rate hikes to the strength of domestic demand in the United States (data dependence). Only if the Fed were to plump for a strategy of sharp and aggressive rate rises, which the market interpreted as monetary policy failure given the lack of inflationary pressures, and/or an unexpected and systemic shock were to arise (for example a sudden slowdown in the Chinese economy or some disruption intervening in the Greek crisis), could the rise in volatility be high and, above all, persistent.

Figure 3.5
BBVA Research global volatility index by financial asset. The higher the index, the greater the volatility



Source: BBVA Research and Bloomberg

Figure 3.6
Global risk aversion (US corporate BBB spread) and risk premium for the EM sovereign bond market (EMBI global)



Source: BBVA Research and Bloomberg

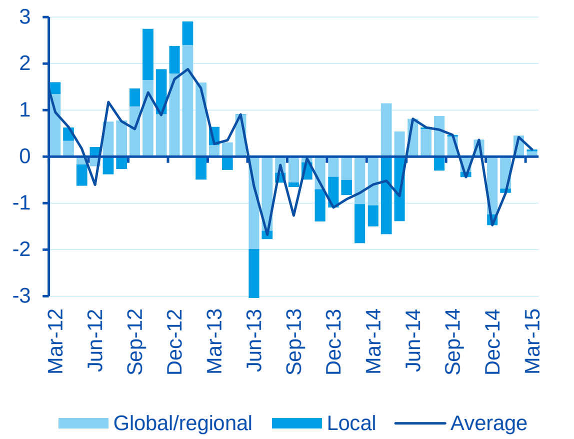
The vulnerability of the emerging markets to another episode of global risk aversion principally lies in the close link that exists between changes in the prices of their financial assets and the global volatility indexes ("emerging markets beta"). In the particular case of the bond market, rises in the US corporate BBB spread bring with them upturns in the EMBI global of a similar or larger size, which is why the latter is the first thing to watch out for. **Of equal importance though**, and a reflection of this initial focus for attention, **is the impact of the re-allocation of capital flows between emerging and developed markets**. According to the BIS[5], the volume of banking dollar credit to non-resident agents in the United States mainly responds to changes in short-term interest rates (for example: LIBOR USD), whereas funding via bonds (also in dollars) is more reactive to changes in US long-term interest rates, and specifically to the term premium for the dollar sovereign curve (the net difference between the 10- and two-year yields on government bonds).

Having said this, the expected gradual nature of the path of rises in the Fed funds rate should translate into a similarly steady upturn at the long end of the dollar curve, also bearing in mind the low inflation rates and the spill-overs coming from the quantitative easing by the ECB and the Japanese central bank will continue to exert on the bond market.

The recent dynamics of capital flows towards emerging markets[6] make it clear that, following the correction in late 2014 in common among the major countries in response to a possible early tightening by the Fed ("global factor"), **differentiation has taken hold in the first months of 2015, with "local factors" linked to vulnerabilities of each country gaining in explanatory force**. The degree of openness of the capital account, the external position (the overall figure for the current account balance and the volume of external debt), the dependence on commodities, the strength of domestic demand or political and institutional stability are some of the elements which define the relative punishment one can expect for emerging market assets at times of rising risk aversion. The uneven performance by market exchange rates for certain key currencies, as 2015 gets underway, is indicative of this.

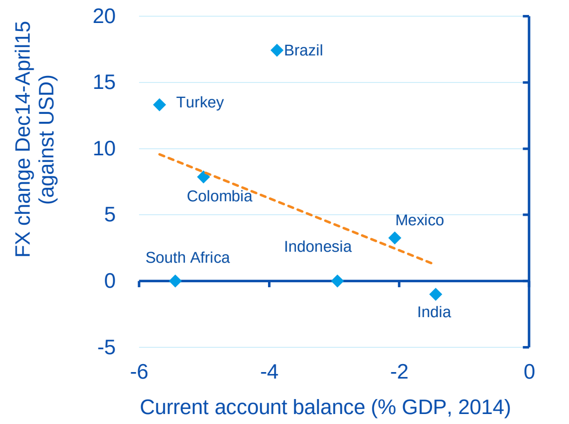
5: Global dollar credit: links to US monetary policy and leverage, BIS WP, January 2015
6: See Flows and Assets Report | First Quarter 2015. https://www.bbvaresearch.com/en/publicaciones/flows-and-assets-report-first-quarter-2015/

Figure 3.7
Portfolio capital flows to emerging economies (% var. MoM): breakdown into global and local factors according to BBVA Research



Source: BBVA Research and IMF-IFS

Figure 3.8
Current account balance and exchange rate variation for emerging economies

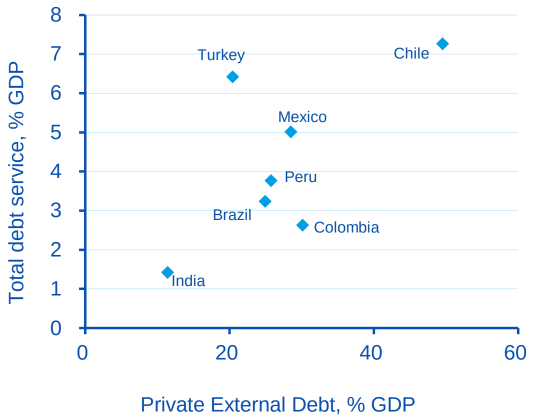


* Exchange rate rises mean depreciation of the local currency
Source: BBVA Research, IMF and Bloomberg

Yet apart from the above-mentioned idiosyncratic factors, which to a greater or lesser extent were at work in other periods of increased financial volatility, **one new aspect in this cycle is the upsurge in the volume of external foreign currency debt** (mainly dollar-denominated) and in particular assumed by the private sector. The divergence between the Fed's monetary policy and that of the other key central banks is likely to continue to maintain upward pressure on the USD, thus making it harder to service dollar debt.

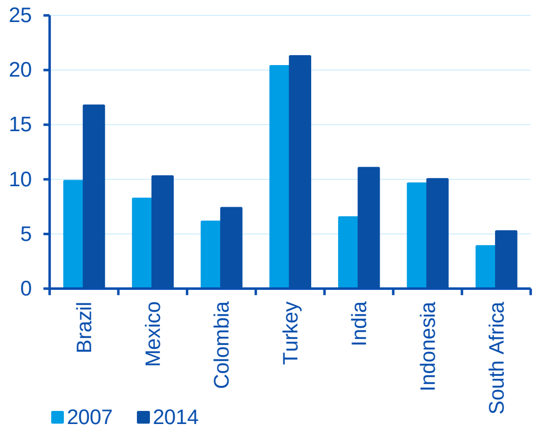
All things considered, the start of the phase of Fed rate rises is not always synonymous with a sharp and persistent upturn in global risk aversion, above all if it takes place progressively and is accompanied by an improvement in the world economic cycle and maintained monetary stimulus policies in other geographical zones. That said, it is certainly true that economic agents could start to punish the excessive assumption of risk in financial assets where their reference economies show weaknesses that compromise their medium-term growth capacity. The unique nature of the current context should additionally be stressed, which makes it hard to predict the possible outcome of US rate hikes.

Figure 3.9
External dollar debt and debt-servicing, 2014



Source: BBVA Research, IIF and IMF

Figure 3.10
Private external debt (% GDP)



* 2013 for Brazil, Turkey, Mexico, Indonesia and South Africa
Source: BBVA Research, IIF and IMF

4 Tables

Table 4.1
Macroeconomic Forecasts: Gross Domestic Product

Average, %	2012	2013	2014	2015	2016
United States	2.3	2.2	2.4	2.9	2.8
Eurozone	-0.8	-0.4	0.9	1.6	2.2
Spain	-2.1	-1.2	1.4	3.0	2.7
UK	0.7	1.7	2.8	2.5	2.3
Latin America *	2.8	2.5	0.8	0.6	2.1
EAGLES **	5.8	5.6	5.3	4.9	5.3
Asia Pacific	5.7	5.9	5.7	5.8	5.8
Japan	1.8	1.5	0.0	1.3	1.2
China	7.8	7.7	7.4	7.0	6.6
Asia (exc. China)	4.1	4.5	4.3	4.9	5.0
World	3.4	3.4	3.4	3.5	3.9

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 30 April 2015.
Source: BBVA Research and IMF

Table 4.2
Macroeconomic Forecasts: Inflation

Average, %	2012	2013	2014	2015	2016
United States	2.1	1.5	1.6	0.6	1.9
Eurozone	2.5	1.4	0.4	0.1	1.3
Spain	2.4	1.4	-0.2	-0.2	1.4
UK	2.8	2.6	1.5	0.3	1.7
Latin America *	7.8	9.2	12.6	13.5	13.5
EAGLES **	5.2	5.2	4.6	4.8	4.5
Turkey	8.9	7.6	8.9	7.3	7.2
Asia Pacific	3.9	4.1	3.3	2.7	3.3
Japan	0.0	1.6	2.7	1.0	1.6
China	2.6	2.6	2.0	1.7	2.5
Asia (exc. China)	4.8	5.2	4.4	3.5	3.9
World	4.5	4.2	3.9	3.8	4.1

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 30 April 2015.
Source: BBVA Research and IMF

Table 4.3
Macroeconomic Forecasts: Current Account

Average, % GDP	2012	2013	2014	2015	2016
United States	-2.8	-2.4	-2.4	-2.9	-2.9
Eurozone	1.5	2.2	2.3	3.2	3.2
Spain	-0.3	1.4	0.8	0.9	1.0
UK	-3.7	-4.5	-5.5	-5.1	-4.8
Latin America *	-1.6	-2.4	-2.5	-2.7	-2.3
EAGLES **	0.9	0.5	0.7	0.7	0.9
Turkey	-6.1	-7.9	-5.7	-4.2	-4.6
Asia Pacific	1.1	1.3	1.9	2.3	1.9
Japan	1.0	0.7	1.4	1.4	1.4
China	2.6	2.0	2.1	2.8	2.8
Asia (exc. China)	-0.1	0.8	1.7	1.8	1.2

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 30 April 2015.
Source: BBVA Research and IMF

Table 4.4
Macroeconomic Forecasts: Government Balance

Average, % GDP	2012	2013	2014	2015	2016
United States	-6.8	-4.1	-2.8	-2.8	-2.5
EMU	-3.6	-2.9	-2.4	-2.1	-1.6
Spain *	-6.6	-6.3	-5.7	-4.4	-3.0
UK **	-8.3	-5.7	-5.7	-4.4	-3.4
Latin America ***	-2.3	-2.4	-4.3	-4.2	-3.2
EAGLES *****	-1.3	-2.0	-2.6	-3.4	-3.0
Turkey	-2.1	-1.2	-1.6	-1.5	-1.5
Asia Pacific	-2.7	-3.0	-2.9	-3.0	-2.9
Japan	-7.6	-9.2	-7.9	-7.0	-6.5
China	-1.1	-1.5	-1.8	-2.3	-2.5
Asia (exc. China)	-3.9	-4.1	-3.7	-3.6	-3.2

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 30 April 2015.
Source: BBVA Research and IMF

Table 4.5
Macroeconomic Forecasts: 10-year government bond yield

Average, %	2012	2013	2014	2015	2016
United States	1.8	2.3	2.5	2.1	2.7
Germany	1.6	1.6	1.2	0.3	1.0

Forecast closing date: 30 April 2015.
Source: BBVA Research and IMF

Table 4.6
Macroeconomic Forecasts: Exchange Rates

Average	2012	2013	2014	2015	2016
EUR-USD	0.78	0.75	0.75	0.96	0.94
USD-EUR	1.29	1.33	1.33	1.04	1.07
GBP-USD	1.59	1.56	1.65	1.47	1.60
JPY-USD	79.8	97.5	105.8	124.3	131.7
CNY-USD	6.31	6.20	6.14	6.19	6.09

Forecast closing date: 30 April 2015.
Source: BBVA Research and IMF

Table 4.7
Macroeconomic Forecasts: Official Interest Rates

End of period, %	2012	2013	2014	2015	2016
United States	0.25	0.25	0.25	0.50	1.50
Eurozone	0.75	0.25	0.05	0.05	0.05
China	6.00	6.00	5.60	4.60	4.60

Forecast closing date: 30 April 2015.
Source: BBVA Research and IMF

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