

# Outlook for 2017

The global economy is expected to maintain a modest growth rate, with politics continuing to play a dominant role. In the political domain the main focus is likely to be on: (i) the negotiations over Brexit and how the UK's external deficit is to be financed; (ii) the various elections due to take place in Europe; and (iii) how Trump's policies are realised and implemented in practice.

We expect fiscal policy to be supportive of economic activity in the developed countries for the first time in several years, with inflation rising from its current low levels and financial risks seeing a change of focus. This last development is likely to take place in a context of further deleveraging in emerging markets and financial market infrastructures proving resistant to negative shocks.

It is therefore likely that central banks will be contemplating a withdrawal of monetary stimulus measures and that there will be upward pressure on yields on core government debt and a tightening of borrowing costs worldwide. On the currency markets, interest rate increases by the Fed will support a strengthening dollar. Elsewhere, the Brexit negotiations and Trump's policies will leave the pound sterling and the Mexican peso looking vulnerable.

At individual country level, US growth will be somewhat above potential thanks to an improved investment performance and a shift in policy towards fiscal easing. In the Euro area, we expect that growth will continue to be led by domestic demand. In Spain, the economy is expected to remain on a positive growth path, albeit at a slower pace than in recent years given the decreasing effect of some of the positive factors that have been driving economic activity. In the United Kingdom the economy is likely to be affected by uncertainty linked to the start of the process of leaving the EU.

Finally, the emerging markets are forecast to show some stabilisation of their economic growth. In the major countries, in fact, GDP growth rates are likely to be similar to or slightly above those seen in 2016. This growth will take place against a background in which progress has been made in reducing external and internal imbalances and China continues to take economic stimulus measures to support economic growth. This situation will give scope for reductions in official interest rates in some South American countries. However, the overall economic outlook is expected to remain fragile inasmuch as fiscal and financial conditions continue to look delicate in countries such as China and Brazil.

The European banking sector will continue to adapt to a highly challenging regulatory and operating environment. Banks should benefit from an upturn in inflation, a change in the tenor of monetary policy, and higher long-term returns on assets. However, banking sector profitability will continue to face numerous challenges due to the weak economic recovery, the prolonged low interest rate environment, asset quality issues and a high regulatory burden.