

# Global and Spain Outlook

Third quarter 2014

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# Takeaways

- 1 **Global growth will continue**, although the recovery is slower than others in the past
- 2 The likelihood of a hard landing in China is low and the Fed is handling the recovery well, **but the geopolitical risks and probability of lower activity in the EMU are increasing**
- 3 **In Spain, growth is moderating in 3Q14 and will accelerate again in 2015**, due to more expansive monetary and fiscal policies, although with risks around the composition of growth and the current account
- 4 **The reforms are having a positive effect on the economy**. However, more effort can and should be put into making the recovery more intense, sustainable and long-lasting

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**The global economic recovery will continue in a complex environment of more asymmetric risks**

## Section 2

Spain: the recovery will accelerate in 2015 but with risks of a less balanced composition

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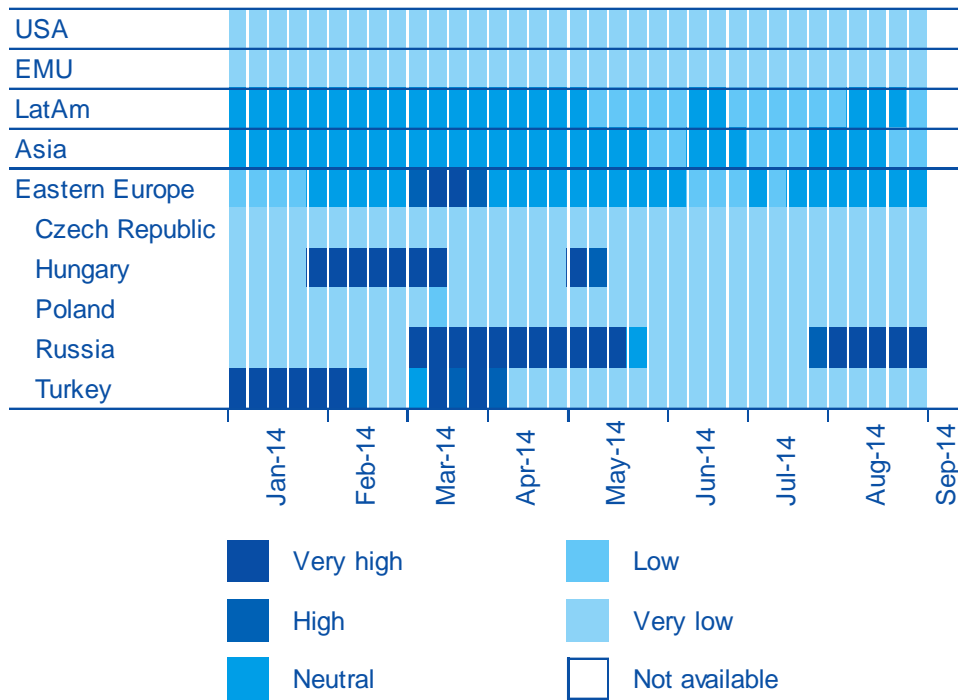
It is crucial to continue with the reform effort

Section 1

# Geopolitical risks have not raised financial stress globally...

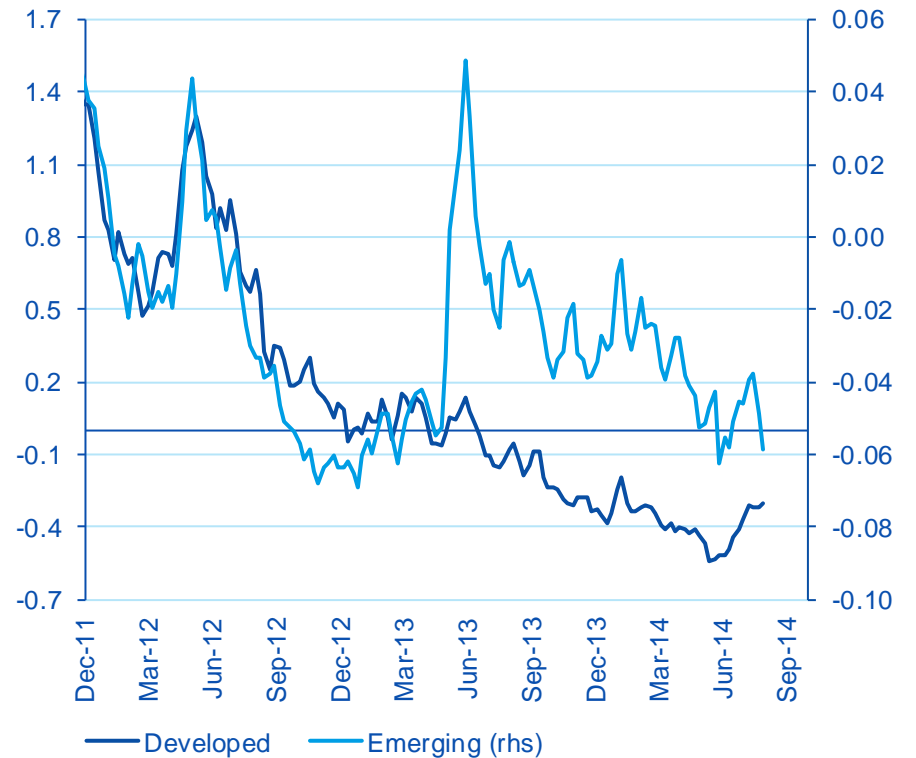
## BBVA Research map of financial tensions

Source: BBVA Research



## BBVA Research financial stress index

Source: BBVA Research

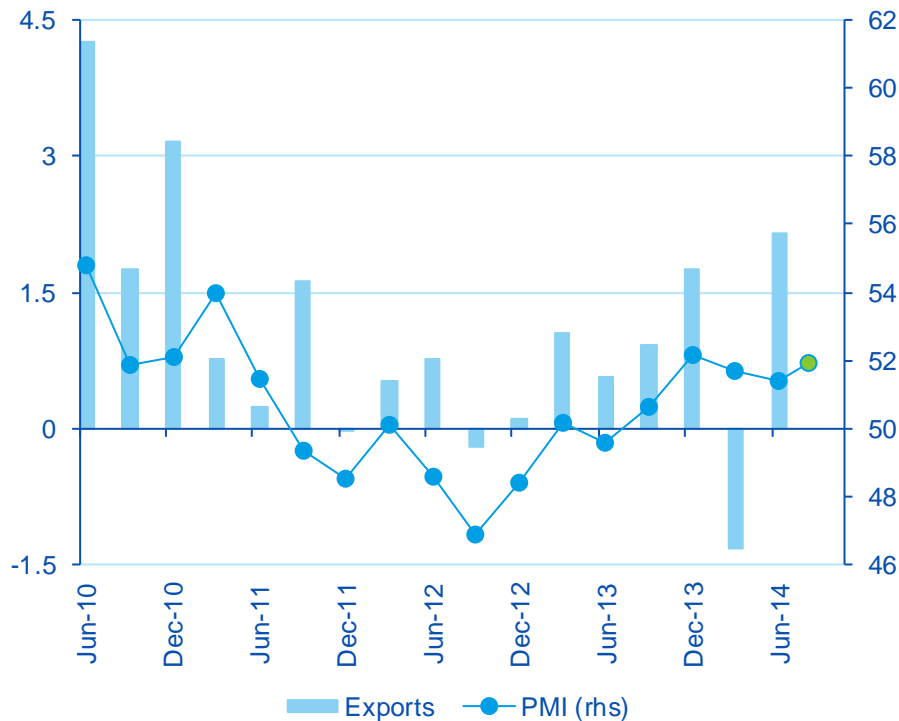


Section 1

... nor have they aborted, at least until June at any rate, the ongoing recovery of global trade

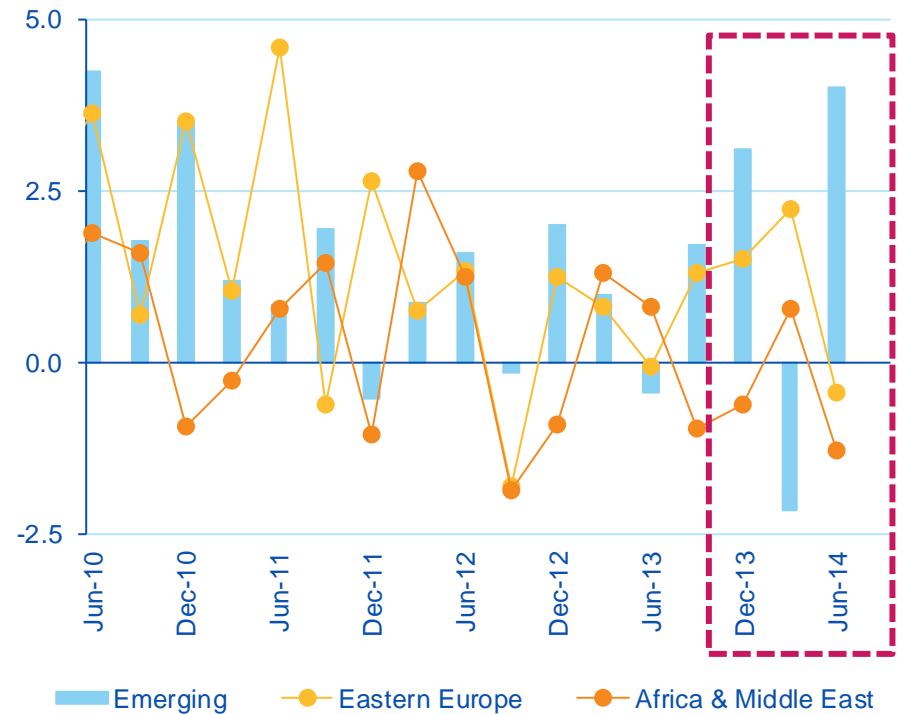
**Merchandise world trade and PMI** (export volumes, QoQ %; new export orders)

Source: CPB, JPMorgan and BBVA Research



**Goods trade in emerging economies, export volumes, % QoQ**

Source: BBVA Research based on CPB

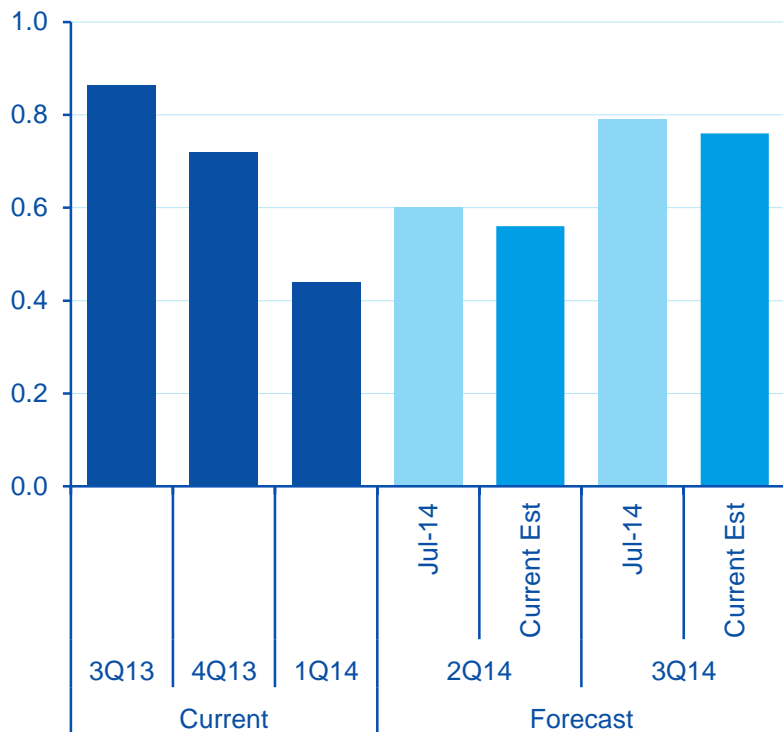


Section 1  
 ... a necessary condition for maintaining favourable growth outlooks

**Global growth based on BBVA-GAIN**

(QoQ %)

Source: BBVA Research



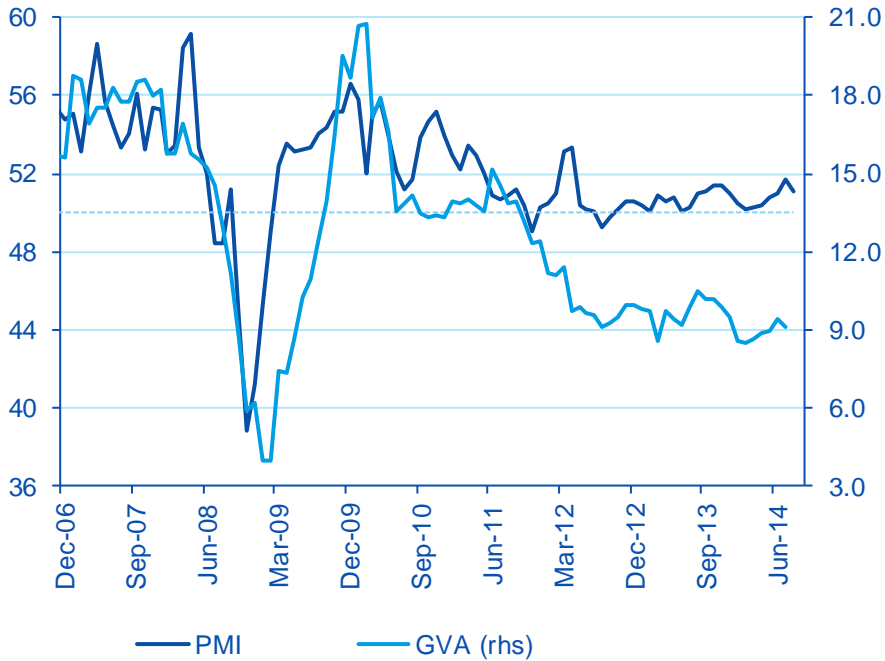
Manufacturing confidence and financial volatility indicators are consistent with continued improvement in world GDP growth

Section 1

# Some risks are melting away: China ...

## China: confidence and manufacturing activity

Source: Haver Analytics and BBVA Research



External demand and the support of fiscal and monetary policy measures drive the short-term outlook in China

The reforms put in place (financial sector and investment promotion) ought to reduce the risk of a hard landing

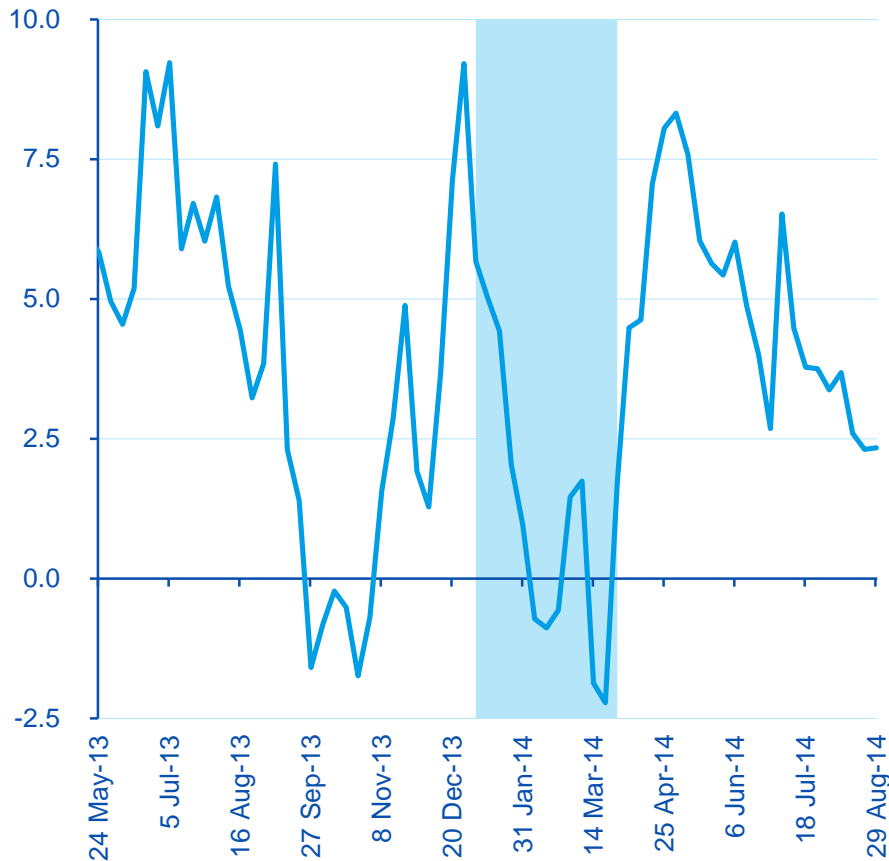
The government will continue to take supportive measures, even though it is not managing to reduce the dependence on credit

Section 1

# Some risks are melting away: USA ...

**US Weekly activity index** (% week on week)

Source: BBVA Research



In the US, the GDP fall in 1Q14 was due mainly to transitory factors

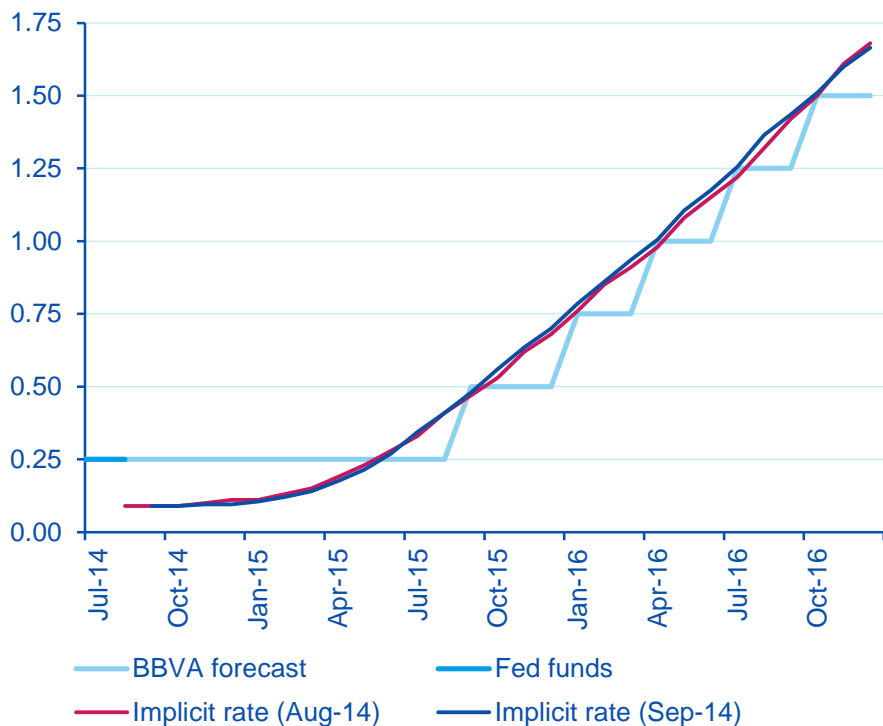
The economy is expected to grow 2.0% in 2014 and 2.5% in 2015



Section 1  
 ... but others remain: the global impact of monetary tightening on the horizon in the USA

**US: monetary policy rate (%)**

Source: BBVA Research and Federal Reserve



The Fed's balance sheet expansion is ending in October 2014 and rate hikes may be in store by mid-2015

The pace will be determined by the improvement in the labour market and economic activity in general

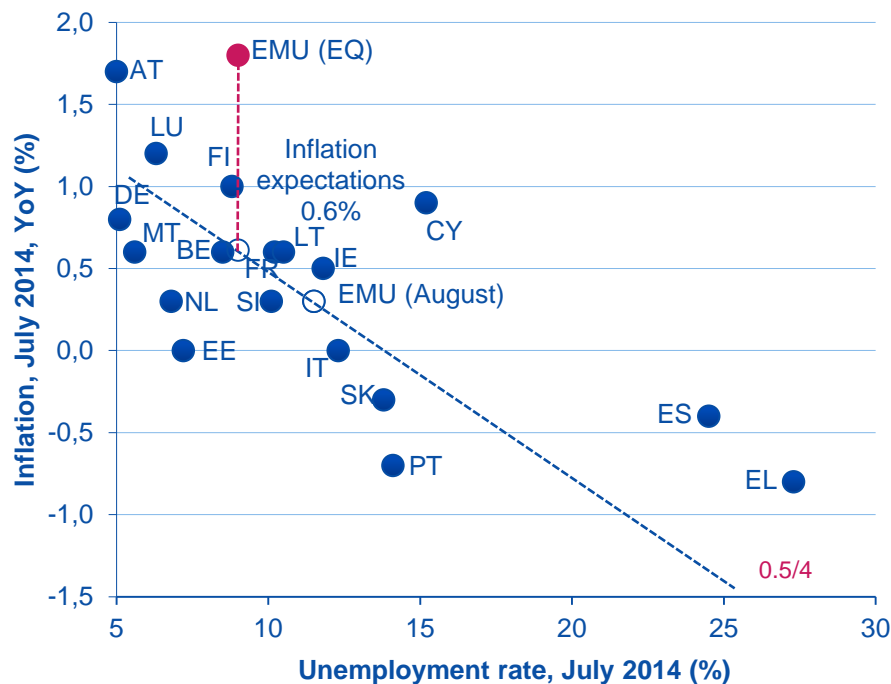
The Fed's communications policy on its exit strategy will be increasingly important

Section 1

# ...and others harden: activity and disinflation in the EMU

## EMU: unemployment and inflation (%)

Source: BBVA Research



Recovery in the EMU ought to continue, underpinned by the improvement in the external environment and a favourable policy mix

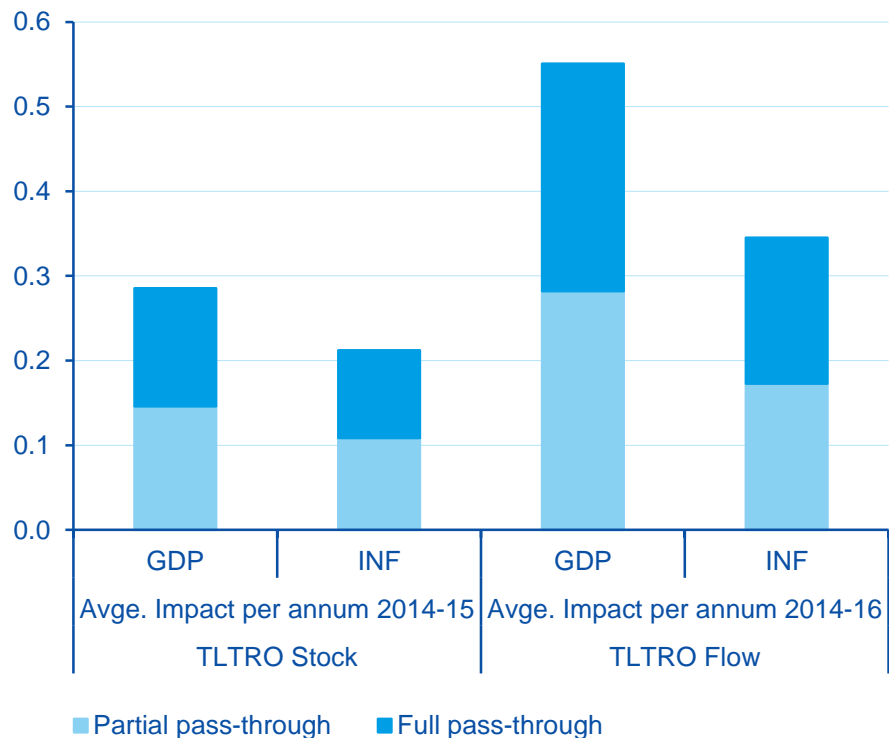
However, there is a growing risk of unanchoring inflation expectations...

... which could make recovery more difficult in highly indebted countries which need to gain competitiveness

Section 1  
**... and others harden: activity and disinflation in the EMU**

**Eurozone: impact on growth and inflation of credit increase as a result of TLTRO (pp)**

Source: BBVA Research



**ECB measures**

- Negative deposit rate
- LTROs to be extended
- TLTRO
- No sterilisation of open-market operations
- Announcement that additional measures are being analysed: ABS purchases and quantitative easing

**The measures strengthen the ECB's guidelines on interest rates and monetary policy transmission mechanisms**

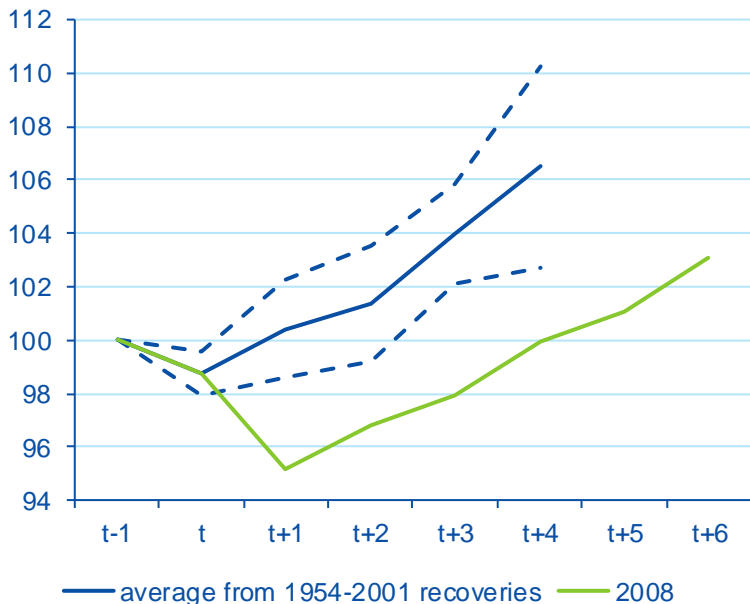
Recent activity data on activity and prices, together with Draghi's speech, confirm that risks continue to the downside

Section 1

# In any event, the pace of economic recovery is relatively slow

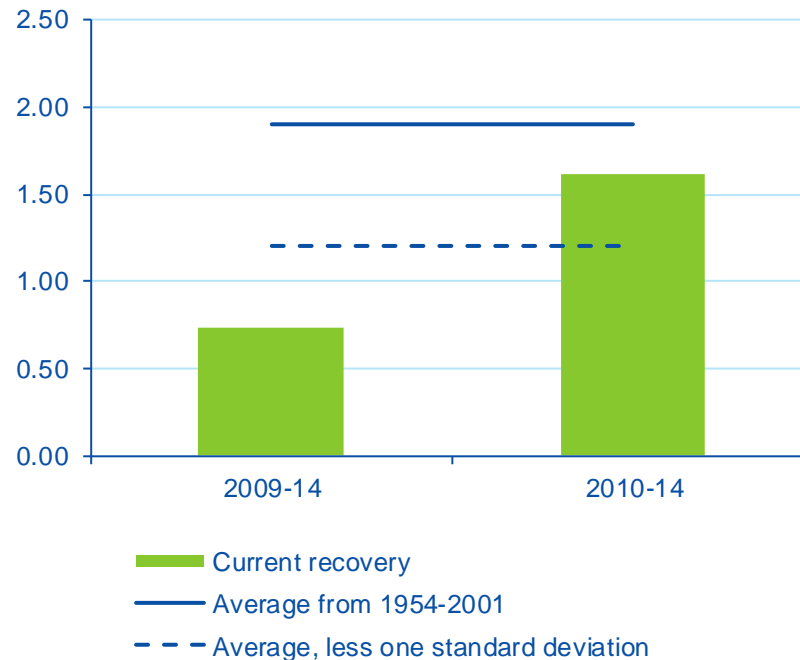
**US, comparison of economic recoveries**  
GDP per capita

Source: BBVA Research



**US, comparison of economic recoveries**  
GDP growth per capita

Source: BBVA Research



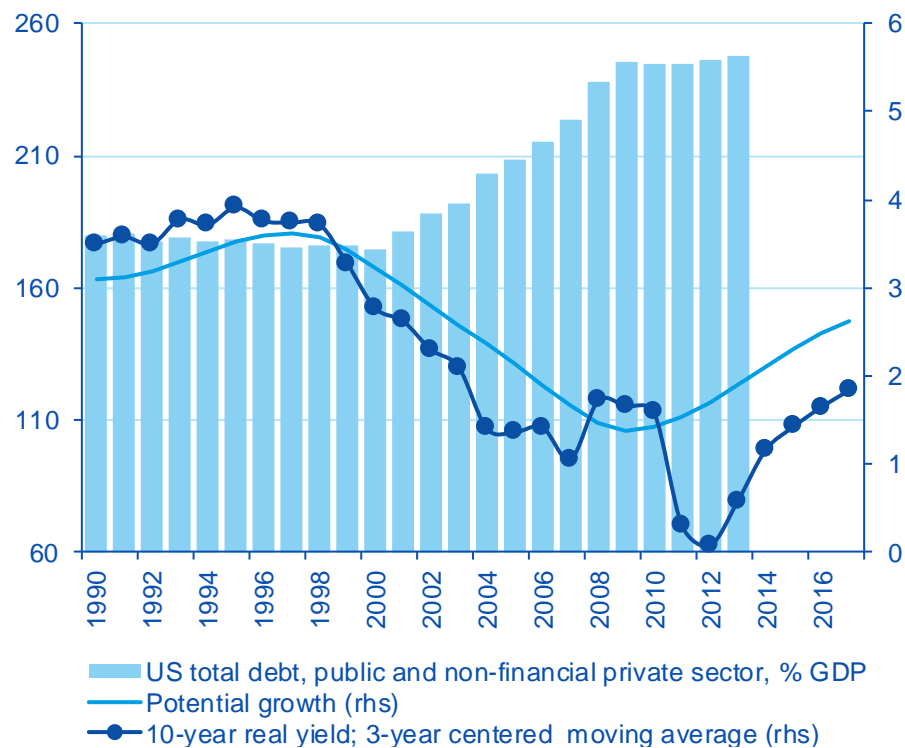
**Recessions in US: 1954, 1974, 1980, 1991, 2001, 2008**

Section 1

# In any event, the pace of economic recovery is relatively slow

## US: potential growth, real rates of interest and total debt

Source: BBVA Research



Deleveraging in the private sector is happening slowly and total debt (public + private) is still high

The adjustment of agents' balance sheets, still pending, could put a brake on recovery in the medium term

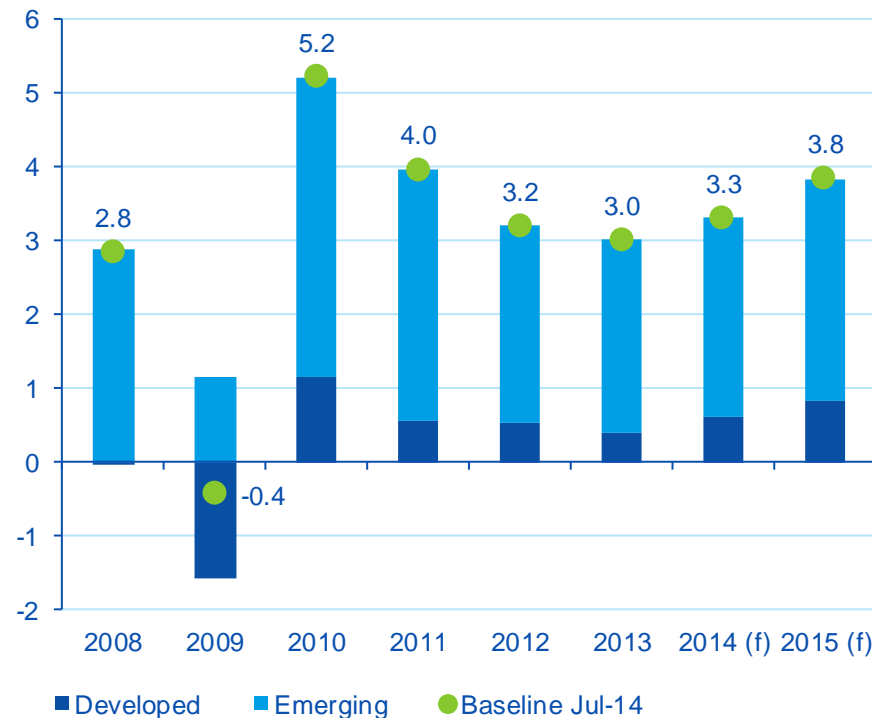
Section 1

# Snapshot

- 1 **Global growth will continue with improvements in developed economies,** the US and the eurozone, but we can expect a gentle slowdown in China
- 2 The risk of a hard landing is small and the Fed is keeping financial volatility anchored, but **geopolitical risks are arising, and activity risks in the EMU**
- 3 **The adjustment of agents' balances, still pending,** may put a brake on the recovery in the medium term

**GDP global growth (%)**

Source: BBVA Research



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## Section 1

The global economic recovery will continue in a complex environment of more asymmetric risks

## Section 2

**Spain: the recovery will accelerate in 2015 but with risks of a less balanced composition**

## Section 3

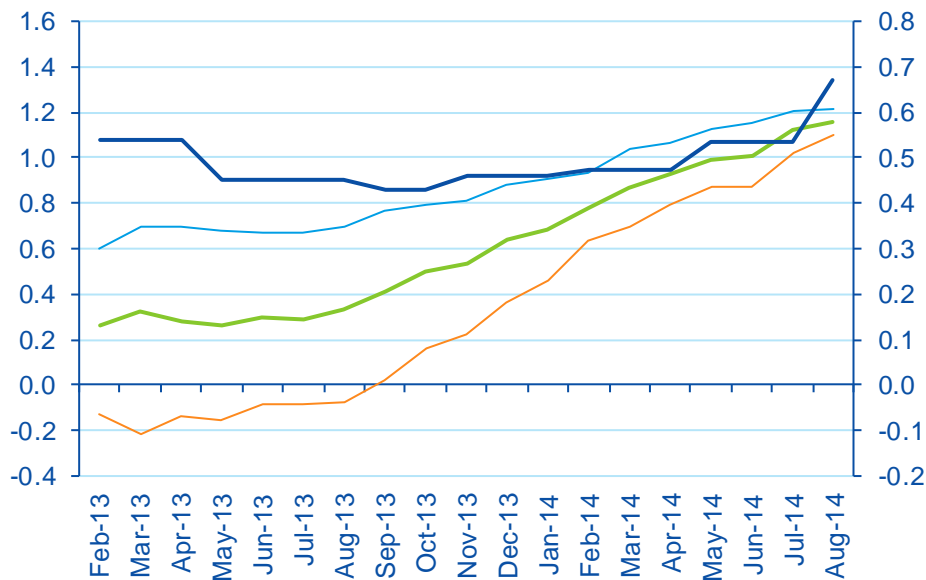
It is crucial to continue with the reform effort

Section 2

# Growth forecasts have been revised to the upside

## Spain: growth forecasts for 2014 (%)

Source: BBVA Research based on Consensus Forecasts



— Consensus (1,2%)      — National Forecasters (1,2%)  
— Foreign Forecasters (1,1%)      — BBVA Research (1,3%)

There is growing consensus about the improving growth outlook for the Spanish economy

We have revised our GDP growth forecast upwards, to 1.3% in 2014 and 2.3% in 2015

The improvement represents an aggregate 0.6pp in 2014 and 2015

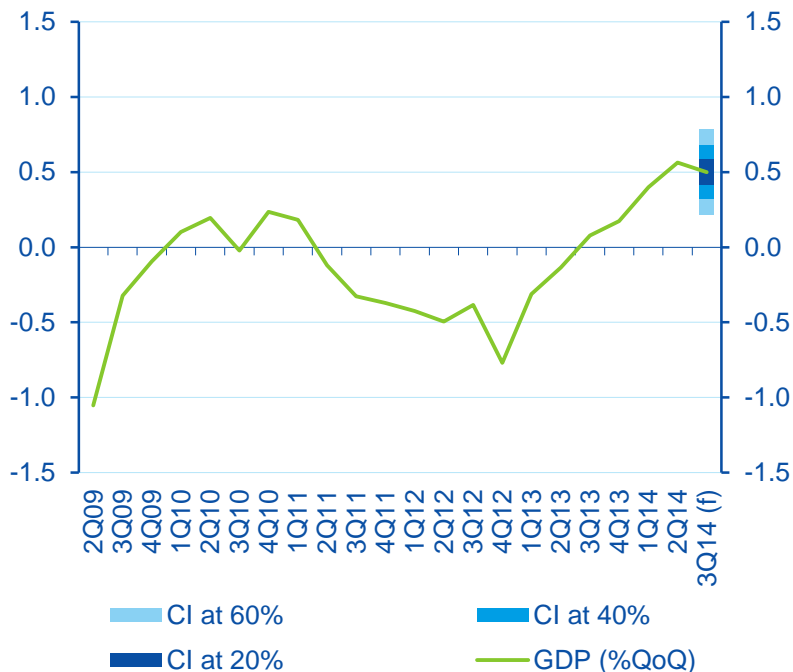


Section 2

# Expansion stretches into the third quarter ...

## Spain: GDP growth and MICA-BBVA forecasts

Source: BBVA Research



In 2Q14, GDP grew for the fourth consecutive quarter ...

... thanks to increased domestic demand, particularly private, and despite the stagnation in net exports

The trend in the 3Q14 figures is towards a moderation in the expansion rate, to 0.4% or 0.5%

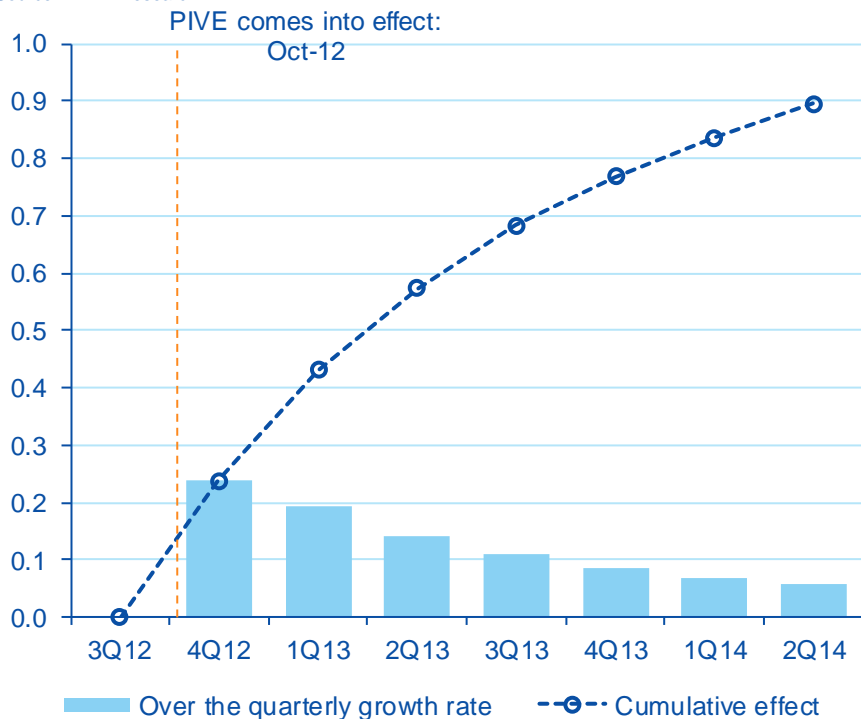
Section 2

# ... supported by domestic demand

## Spain: effect of the PIVE vehicle purchase incentive programme on private consumption

(quarterly growth rate, pp)

Source: BBVA Research



Better fundamentals, less uncertainty, some fiscal stimuli and more credit account for the increase in private consumption

Investment in machinery and equipment has grown for six quarters in a row ...

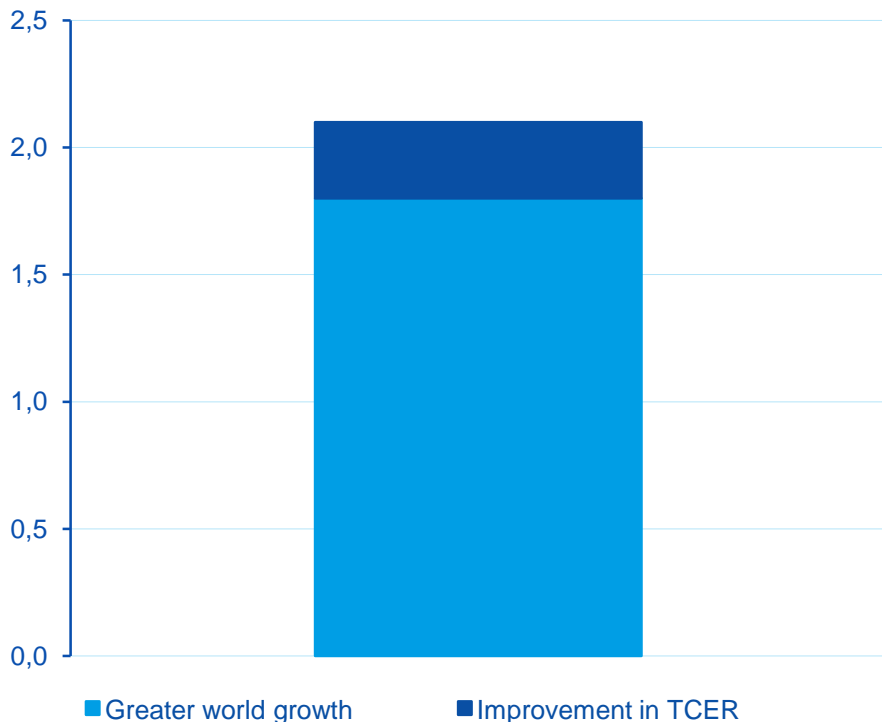
... while the economy is moving closer to reaching the public deficit target

Section 2

# 2015: crucial that exports grow

## Spain: additional exports growth in 2015 due to changes in fundamentals (pp)

Source: BBVA Research



Domestic demand's contribution will tend to fall in the next few quarters ...

... therefore, to sustain growth, it is crucial that exports recover

The recovery in external demand and a more depreciated real exchange rate will support growth in the short term

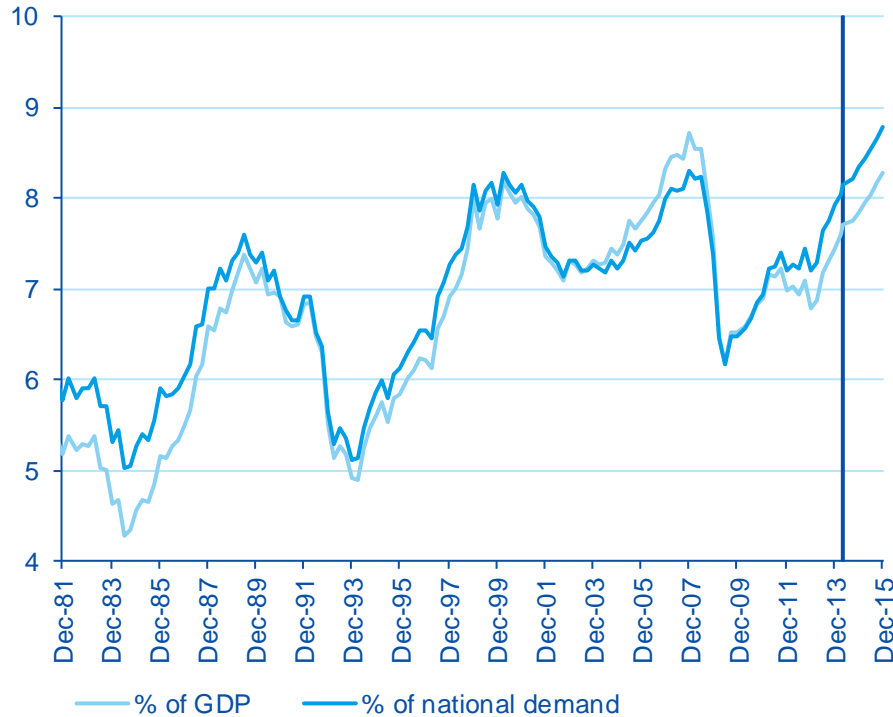
Section 2

# 2015: investment in M&E set to grow faster

## Spain: investment in machinery and equipment (M&E)

(Real ratios at 2008 prices)

Source: BBVA Research based on INE



While investment in M&E has grown 8.0% in Europe since bottoming out in 2Q09, in Spain it has leapt 22.6%

Today it makes up 45% of total real investment and over 8% of real domestic demand (record high) ...

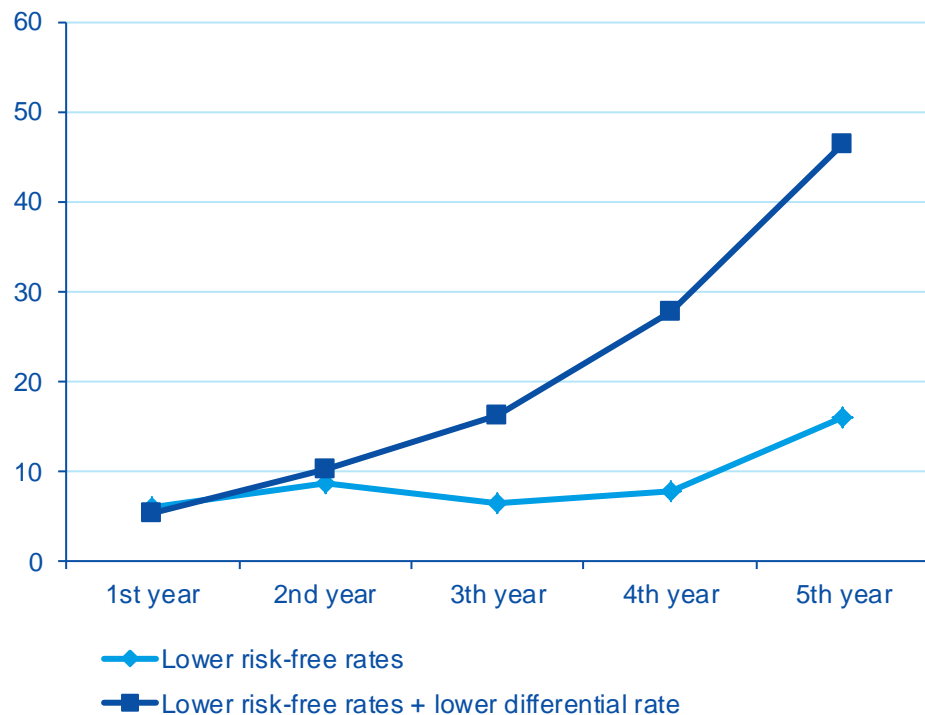
... which is consistent with the change in the productive model, directed towards the external sector

Section 2

# 2015: more expansive monetary policy

## Spain: estimated impact on private sector credit, excluding mortgages

(accumulated difference vs. latest forecasts in EUR bn)  
Source: Eurostat and BBVA Research



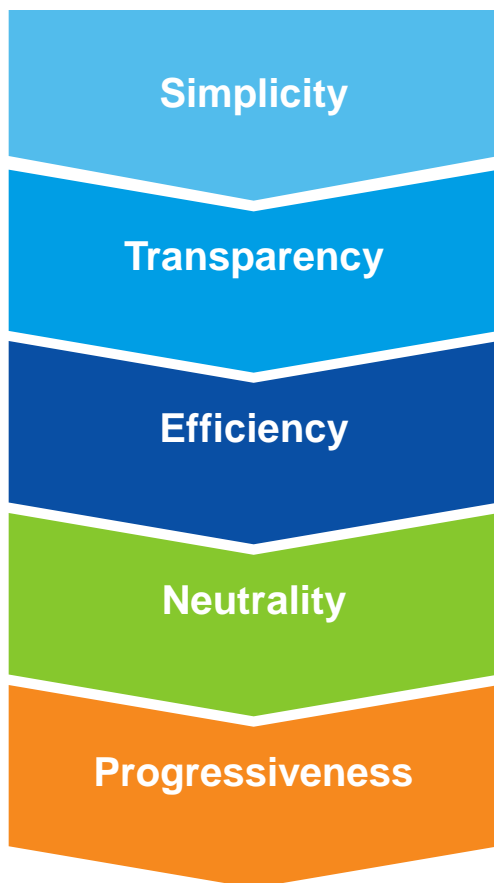
The ECB's actions are designed to reduce the cost of bank funding, conditional on an increase in credit

In Spain, lower rates will increase credit demand ...

... by as much as another EUR50bn (when compared with a scenario of no policy changes) if our forecasts of lower differentials on interest rates are confirmed

Section 2

## 2015: a more expansive fiscal policy



- Moves such as reducing the number of tax brackets, reducing direct taxation and steps towards greater neutrality in saving instruments **are welcomed**
- Nevertheless, **too many deductions remain in place** and the system is still **complex and opaque**
- **There is still a lot of room for improvement in incentivising growth and the change in the productive model**

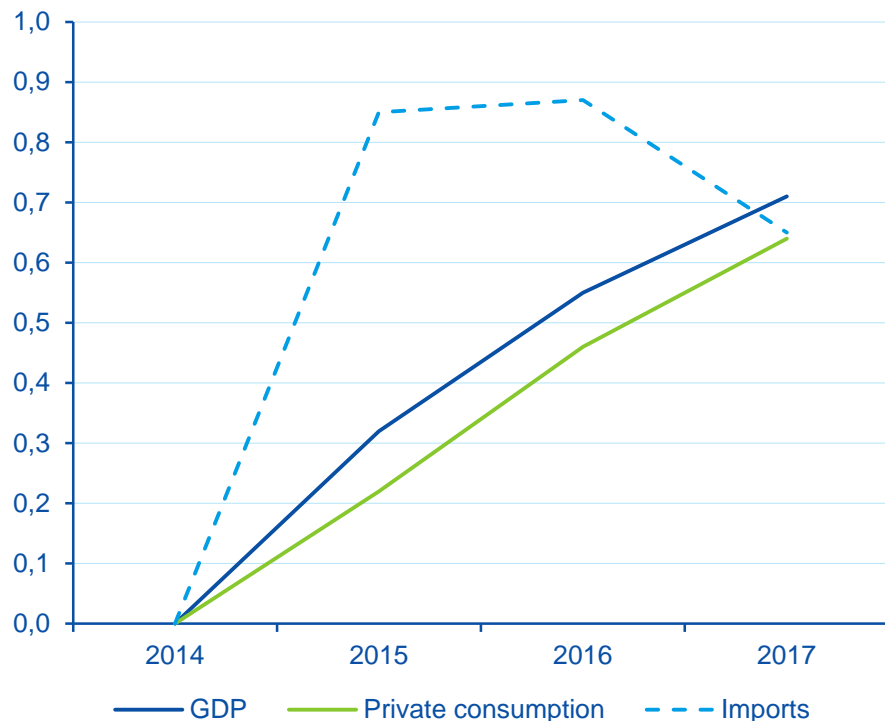
Section 2

# 2015: a more expansive fiscal policy

## Spain: impact of the tax cut on income tax (IRPF) and corporation tax (IS)

(deviation from a scenario without reform, pp)

Source: BBVA Research



In total, the tax cut will reduce revenue by EUR9bn between 2015 and 2016 ...

... which will increase internal demand, and with it imports, thus softening the impact on GDP

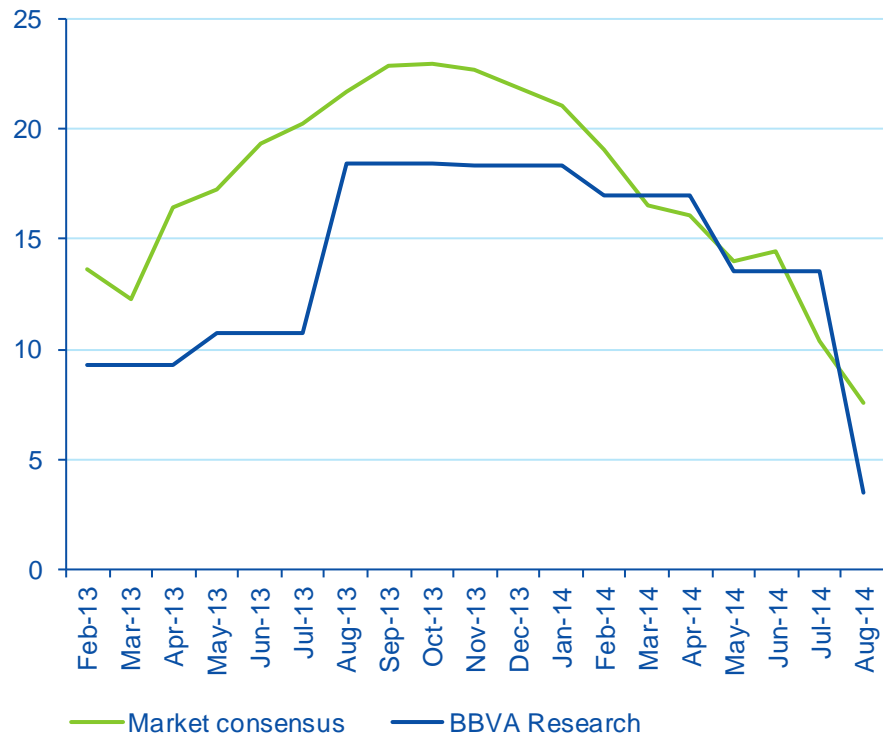
The cyclical improvement in revenue and expenses, together with meeting 2014 targets, makes the fiscal impulse easier

Section 2

# Domestic risks: adjusting the current account

## Spain: current account balance forecasts for 2014 (EUR bn)

Source: BBVA Research based on consensus forecasts



Lowered financial stress and the better position in the cycle have impacted on economic agents' expectations

who have modified their consumption, investment and savings decisions

slowing the rate of correction of external imbalances



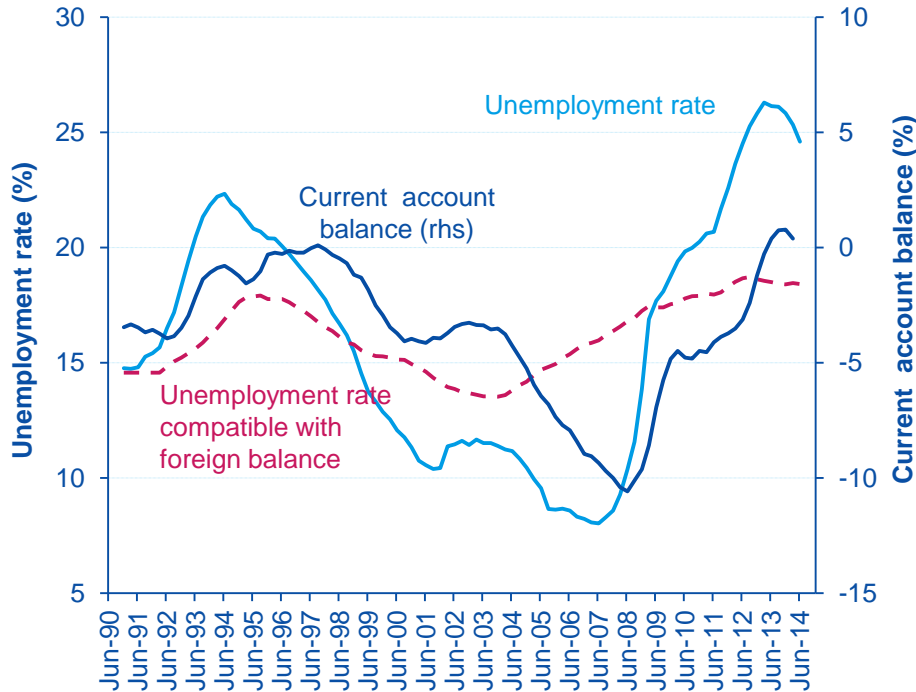
Section 2

# Domestic risks: adjusting the current account

## Spain: Current account and unemployment rate

(% of GDP and %)

Source: BBVA Research



Although significant progress has been made in improving competitiveness and exports ...

... with more employment creation, there has been a deterioration in the current account balance ...

... that must be avoided in the medium- and long-term by forging ahead with the reforms

Section 2

# Macroeconomic Forecasts

## Spain and Europe: macroeconomic forecasts

Source: BBVA Research based on INE and Eurostat

(% YoY)	2012		2013		2014 (f)		2015 (f)	
	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU
Households final consumption expenditure	-2,8	-1,4	-2,1	-0,6	1,9	0,7	2,0	1,4
General government final consumption exp.	-4,8	-0,6	-2,3	0,1	0,1	0,4	0,6	0,7
Gross fixed capital formation (G.F.C.F.)	-7,0	-3,8	-5,1	-2,8	1,2	2,5	4,9	4,6
Equipment and machinery	-3,9	-4,3	2,2	-1,9	8,5	3,3	7,3	6,4
Housing	-8,7	-3,3	-8,0	-3,4	-3,5	1,7	4,9	3,3
Other constructions	-10,6	-4,7	-10,9	-4,1	-4,9	0,9	1,1	2,5
Changes in inventories (*)	0,0	-0,5	0,0	0,0	0,0	0,0	0,0	0,0
Domestic Demand (*)	-4,1	-2,1	-2,7	-0,9	1,4	1,0	2,2	1,7
Exports	2,1	2,7	4,9	1,5	4,7	3,0	6,5	4,6
Imports	-5,7	-0,8	0,4	0,4	5,1	3,2	6,4	4,6
External Demand (*)	2,5	1,5	1,5	0,5	0,0	0,1	0,2	0,2
GDP mp	-1,6	-0,6	-1,2	-0,4	1,3	1,1	2,3	1,9

**Pro-memoria**

GDP excluding housing	-1,2	-0,5	-0,9	-0,2	1,6	1,0	2,2	1,9
GDP excluding construction	-0,4	-0,2	-0,1	0,0	2,0	1,0	2,3	1,8
Total employment (LFS)	-4,3	-0,7	-2,8	-0,8	1,0	0,5	2,1	0,8
Unemployment rate (% Active pop.)	24,8	11,3	26,1	12,0	24,5	11,7	23,1	11,4
Current account balance (% GDP)	-1,2	1,2	0,8	2,3	0,3	2,2	1,1	2,1
Public debt (% GDP) (**)	86,0	93,0	93,9	95,2	99,8	95,9	101,3	95,5
Public deficit (% GDP)	-6,8	-3,7	-6,6	-3,0	-5,5	-2,6	-4,5	-2,1
CPI (average)	2,4	2,5	1,4	1,4	0,1	0,6	0,9	1,1
CPI (end of period)	2,9	2,3	0,3	0,8	0,4	0,7	1,2	1,2

(\*) Contribution to GDP Growth

(\*\*) Excluding aid to the banking sector in Spain

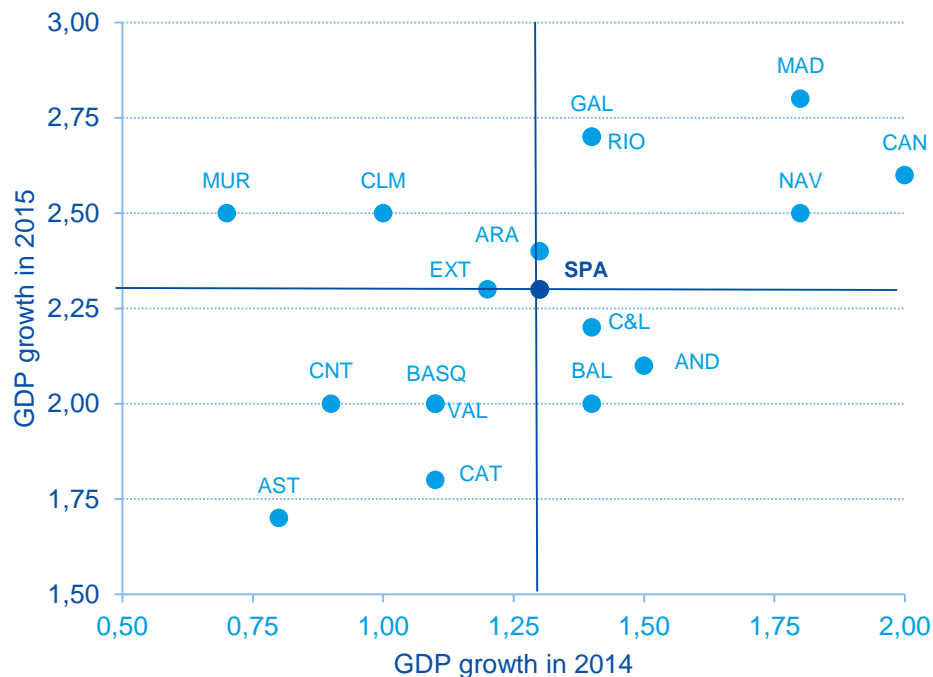
(f): forecast

Section 2

# Forecasts by autonomous communities

## GDP growth by AC

Source: BBVA Research based on national statistics institute (INE)



Our growth forecasts for the autonomous communities remain heterogeneous

Differing levels of exposure to external demand  
...

... and progress made in the fiscal consolidation process are still the main factors accounting for the differentials in growth

# Index

## Section 1

The global economic recovery will continue in a complex environment of more asymmetric risks

## Section 2

Spain: the recovery will accelerate in 2015 but with risks of a less balanced composition

## Section 3

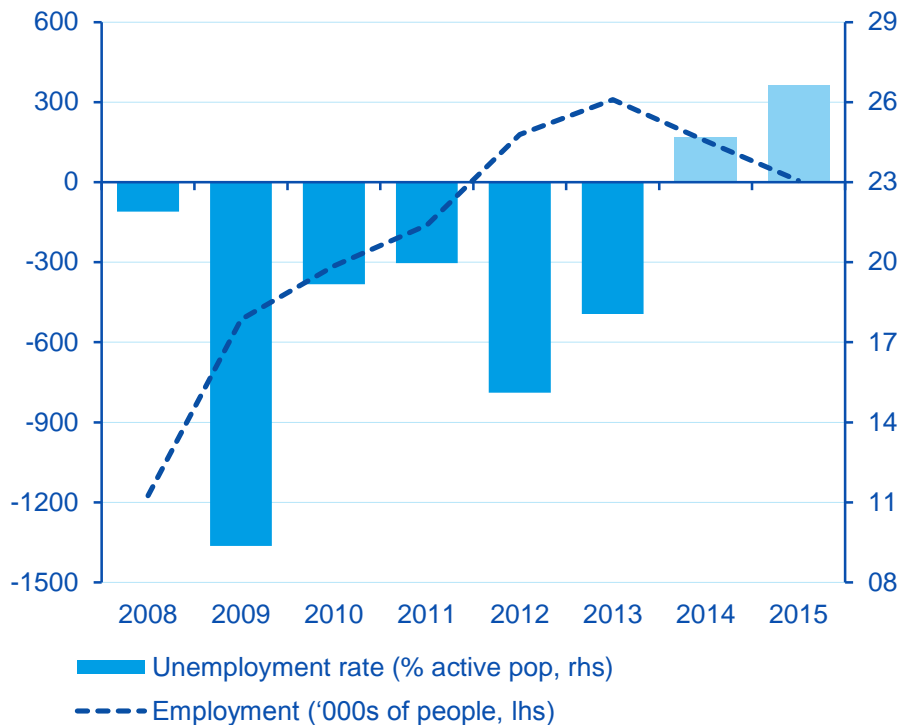
**It is crucial to continue with the reform effort**

Section 3

# The outlook for the labour market looks brighter ...

## Spain: employment and unemployment rate

Source: BBVA Research based on INE



Growth and greater labour market efficiency will contribute to increasing employment in the private sector, reducing the unemployment rate

Employment figures revised upwards:  
 2014: 170k (45k forecast in May)  
 2015: 360k (235k forecast in May)

... and the unemployment rate downwards:  
 2014: 24.5% (25.1% forecast in May)  
 2015: 23.1% (24.2% forecast in May)

## Section 3

# ... but the imbalances are still weighty

For this reason, we welcome the introduction of the National Youth Guarantee Scheme

## Progress

Designed for a **group that has been hit particularly hard** by the crisis

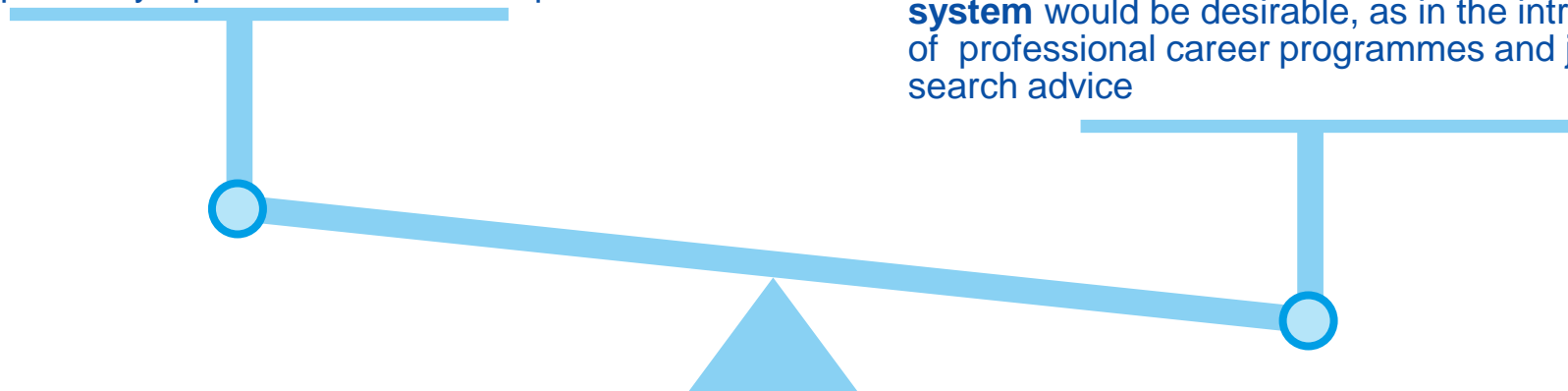
It tries to **improve young people's employability** and stop the current unfavourable circumstances having permanent repercussions on their working lives

**It will combine multiple "activation" strategies** (tax relief for employers, training, public-private cooperation, etc.) supported by a personalised roadmap

## Limitations

**The budget (EUR2.4bn) is significantly lower** than that allocated by the countries where the Youth Guarantee is already in place and less than the ILO recommendation

**Progress in the *dualisation* of the training system** would be desirable, as in the introduction of professional career programmes and job search advice

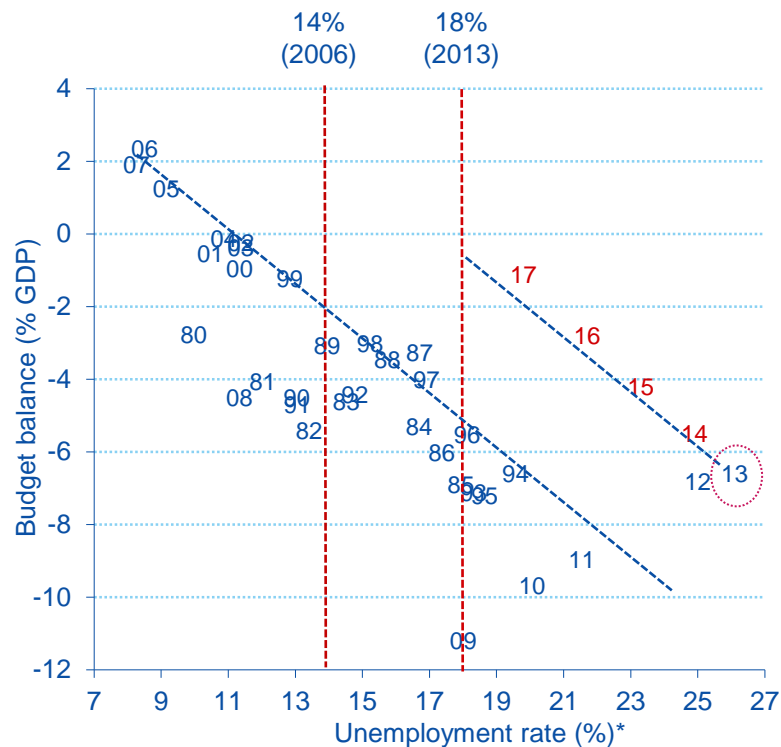


Section 3

# The tax reform: progress, but with room for improvement (1)

## Spain: unemployment rate and Public Administrations' deficits

Source: BBVA Research



It does not endanger the prospect of meeting the public deficit target in the next two years ...

... but neither does it make structural changes in the system. The budget balance will only be corrected by the better position in the cycle

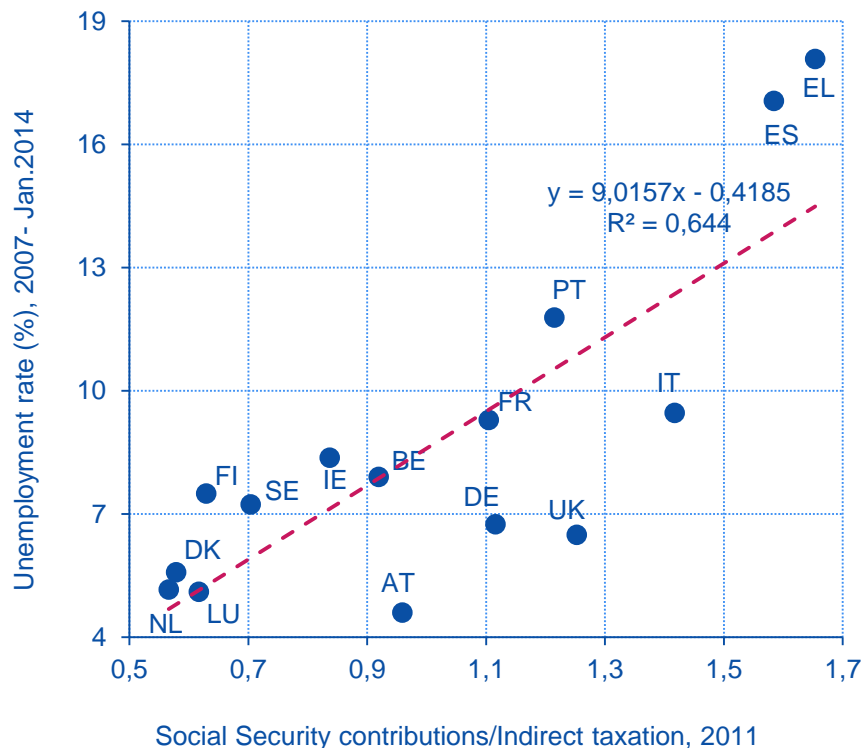
Thus, uncertainty continues about the necessary process of reducing public debt in the medium term

Section 3

# The tax reform: progress, but with room for improvement (2)

## EU15: Unemployment rate and social security payments, divided by indirect taxes

Source: BBVA Research based on Boscá, Doménech and Ferri (2013)



Greater distribution of the tax burden, from direct to indirect taxation, would be desirable

The evidence shows that if social security contributions were reduced relative to indirect taxes ...

... the impact on employment and growth would be greater, as well as contributing to an improvement in the CA and reducing income inequality



## Section 3

# The need to dig deeply with the reforms

1. Reduce debt, improve the Spanish economy's lending capacity and attract foreign direct investment

2. The Public Administrations Reform, fiscal consolidation and long-term sustainability of public finances, with an efficient fiscal system which incentivises growth and job creation -> report by the Steering Committee

3. Reforms which help to improve productivity, the size of companies, competitiveness and Spain's capacity to attract physical, human and technological capital from abroad

4. Going further with reforms which improve the efficacy of active employment policies, reduce the two-tier reality of the labour market and improve how it works -> more employment, and of higher quality

# Takeaways

- 1 **Global growth will continue**, although the recovery is slower than others in the past
- 2 The likelihood of a hard landing in China is low and the Fed is handling the recovery well, **but the geopolitical risks and probability of lower activity in the EMU are increasing**
- 3 **In Spain, growth in Spain is moderating in 3Q14 and will accelerate again in 2015**, due to more expansive monetary and fiscal policies, although with risks around the composition of growth and the current account
- 4 **The reforms are having a positive effect on the economy.** However, more effort can and should be put in to make the recovery more intense, sustainable and long-lasting

# Global and Spain Outlook

Third quarter 2014

A decorative graphic consisting of seven horizontal stripes of varying shades of blue, ranging from a very dark blue at the top to a light sky blue at the bottom, spanning the width of the page.