BBVA | RESEARCH

Spain Economic Outlook

Second quarter 2015
Spain Unit

- The Spanish economy continues to accelerate and face an improvement on its fundamentals, while the risks have still not materialised
- Spain should take advantage of this situation by making progress in reforms that enable it to continue growing, even in less promising
- Increasing domestic saving and improving regulation to increase investment and reduce external, a challenge for the Spanish
- The law of the second chance will help in deleveraging process of households, improving resource allocation, and promoting entrepreneurial activity
- The deregulation of services sector: key to continue improving of competitiveness

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Closing date: 30 April 2015

1 Editorial

The Spanish economy continues to accelerate its growth rate and improve its fundamentals, while the downward risks have still not materialised. All of this means that we can revise the forecast for 2015 GDP growth upwards to 3.0% and assert that the economy will continue to advance at above its trend rate in 2016 (2.7%). However, a slowdown in growth is expected to occur during the coming quarters, as the drivers sustaining domestic demand run out of steam. **If it happens that certain risks that relate to geo-political uncertainty do not arise**, or if policies should have a greater-than-expected impact on activity, **the bias to these forecasts would be on the upward side.**

The data in the last three months confirm the pick-up in activity that was forecast in the previous edition of the Spain Economic Outlook. Specifically, GDP rose by 0.9% during the first quarter of the year, in line with the BBVA Research estimate of between 0.8% and 0.9%, showing a strong contribution from domestic demand and services exports to the upturn in activity. In contrast, higher imports and the virtual standstill in exports of goods persist in limiting increases on the supply side. In any case, trends for various indicators suggest that **growth could quicken to levels of around 1% in the second quarter of the year**, which is slightly higher than forecasted three months ago.

With respect to recent trends in domestic demand, the revisions for the figures on disposable income, family saving and house prices offer a more encouraging picture of how household income and wealth have improved in the last few quarters. Thus, **the buoyancy shown until now by private consumption appears to be more sustainable and** longer-lasting than in the past. This momentum could be amplified by a bigger-than-expected impact of some of the public policies, or by the non-materialise of risks noted in the past. For example, **such progress has coincided with a higher-than-expected deficit for the regions as a whole at the 2014.** Specifically, greater spending as a result of tax incentives to promote employment under permanent contracts or lower elasticity on aggregate of public revenues to economic recovery would explain the deviation. This fiscal policy, which was slightly more expansive in 2014, in conjunction with the measures taken from early on in the year (reduction in the average rate of personal income tax), could be having a larger effect on demand than initially estimated. On the other hand, although some uncertainties on a European level (for example Greece) or within the domestic orbit have still not been resolved, neither trends in spending **nor confidence indicators reflect any adverse impact at all from the geo-political risks that still persist.** Regarding to this point, the monetary policy of the European Central Bank, the institutions set up in recent years, and the measures taken domestically seem to confirm that the Eurozone and Spain are better equipped to face scenarios involving greater uncertainty.

Looking ahead, the “tail-winds” that were highlighted one quarter ago, and which will continue to underpin domestic recovery in the next few months, have intensified. On the one hand, the economy of the country’s key trading partners has performed rather better than expected as reflected in an upward revision of GDP growth forecasts for the EMU for 2015 to 1.6%, gathering pace in the following months to reach growth rates of close to or over 2%. On the other hand, gains in competitiveness boosted by the lower oil price, the exchange rate depreciation and the fall in interest rates over the next two years are likely to be greater than were forecast three months ago. All of this, together with the solid growth which continues to be observed in machinery and equipment investment, is laying a sound base for an upturn in exports and domestic demand.

Whatever the case, several risks still hover over this scenario. First, the vigour shown by services exports (especially tourism), **has not been accompanied by increased goods exports.** Although this stagnation is assumed to be a transitory phenomenon, and it’s likely to be a consequence of the pick-up observed in the first nine months of 2014, the risk that the process of internationalisation has slowed down due to the growth in domestic demand exists. This scenario would be a cause for concern, as the sustainability of recovery and the correction to the imbalances in the Spanish economy depend to a large extent on consolidating the upward trend in exports of goods and services.

Second, one of the biggest challenges facing the economy over the next few years is **to step up investment, while at the same time cutting external borrowing,** for which purposes, besides inflows of foreign direct investment, an increase in domestic saving is required. In this respect, while the private sector has made substantial progress in the right direction (see Box 1), there is evidence that the process of fiscal consolidation is relying increasingly on economic recovery and not so much on discretionary measures. Given the way the regional financing system is designed, in 2014 the regions could not benefit from the increase in tax revenues and, in the absence of measures to balance this out in terms of expenditure, they have widened their deficit, thereby breaching to meet the targets set (see Box 4). Thus, it is important that there should be medium-term plans, with credible targets by type of administration, measures that soften the impact on both growth and the provision of social services as much as possible, as well as rigorous implementation budget.

Finally, although the risks of a geo-political nature do not seem be having an impact on the consumption and investment decisions of families and businesses, or on the financing costs of the economy, there is no guarantee that this will remain the case. Moreover, in the short term **it is hard to conceive of a more suitable environment for growth prospects in Spain, given the fundamentals described above. Working towards the economy being able to continue growing at its current pace, even in less kind scenarios, should be the priority.** In this respect, the efforts are positive which are being made to incentivise employment under permanent contracts and enhancing the progressiveness of allowances granted for employer contributions to Social Security payments (first 500 euros). **Stimuli of this kind in any case still fall short** in resolving definitively the problem of duality in the Spanish labour market, as this needs a substantial change in the recruitment system that can reduce the temporality of employment.[1]

Likewise, the reform of the professional training system for employment is welcomed, as this correctly diagnoses a large portion of the obstacles that hinder the reintegration of the unemployed within the labour market. In particular, the reform makes headway in increasing the employability of workers by better suiting the content of courses to the needs of the productive fabric and fomenting competition among suppliers. Given the heterogeneity among those who are jobless, it becomes necessary to **rebalance training efforts in favour of those with the most problems in obtaining work.** It is also advisable to implement rigorous processes of evaluation and supervision as soon as possible, to make it possible to distinguish what training activities are the most effective for any particular category of job-seekers.

On the other hand, **we welcome as positive the introduction of a framework for personal insolvency** (law on second chance), as appropriate regulation could encourage entrepreneurial initiative and smooth the adverse effects of a sudden drop in the income of individuals (see Box 3). **It would in any case be important to create tools to monitor and evaluate** legislation, so as to be able to find out what works well and correct what does not.

It is also worth remembering the **importance of fostering greater competition in non-tradable goods sectors, to gain in competitiveness.** Until now a large portion of the relative improvement with respect to key trading partners has come from increasing productivity, on a scale which will be hard to keep up, and wage restraint, and restoring part of the competitiveness lost before the crisis. Certain reforms which have been delayed, such as for professional services, are key to ensuring that Spanish companies have access to inputs in relatively favourable conditions (see Box 2), which would lead to an additional boost for the internationalisation process and growth for Spanish businesses.

1: See “Measures to promote permanent hiring”, BBVA Research & Fundación Sagardoy, 14 November 2014, available at: https://goo.gl/811EvQ

2 International environment[2]

The available information suggests that world growth is likely to have slowed down in 1Q15 to a rate of 3.0% YoY, which is almost half a point below the estimate for 2H14. This is consistent with the brake on activity in the United States, the more resolute recovery in the eurozone, and lower growth for the bulk of the emerging economies, particularly China and in South America. In any event, a scenario of moderate global growth is being maintained of **moderate global growth for the upcoming quarters**, in which world GDP is expected to speed up to 3.9% in 2016, thanks to the support of the developed economies, which should notch up their best record since 2010.

The eurozone has been one of the developed economies which exhibited better relative growth as 2015 got underway, as GDP could have grown by between 0.4% and 0.5% QoQ in the first three months of the year, which would represent the highest rate since the middle of 2011. With regard to the breakdown of growth, private consumption and exports are probably offsetting for the weakness of investment. By country, Germany and Spain appear to be at the forefront of the progress made in the area as a whole. The more relaxed borrowing conditions and the euro depreciation arising from the ECB's quantitative easing programme, coupled with the oil price fall and less restrictive fiscal policy, are proving crucial to the recent dynamics of recovery. Further ahead, if these support factors remain in place, it could lift eurozone GDP growth to 1.6% in 2015, 0.3pp above the forecastedin January, and to 2.2% in 2016.

Turning to the ECB's recent bond purchase programme (the volume of purchases of private and public sector securities had reached EUR134bn in mid-April), the transmission channels which are showing the greatest reaction are FX (against the USD, the average market rate for the EUR should be around parity in 2015) and interest rates, which have come down at the long end. Together with the steady improvement in domestic demand and the gradual rise expected for the oil price, the latter will keep headline inflation at close to 0% in 2015 and under 1.5% in 2016. Thus, even though expectations over inflation have managed to be anchored, the fact that it is holding at relatively low levels guarantees that monetary stimuli will be here to stay in the next two years.

Nonetheless, this scenario still offers an overall **balance of risks to the downside**. First, because of the **geo-political conflicts** might cause disruptions to activity in the Middle East or Eastern Europe (Ukraine and Russia) and could have a global impact through the channels of financial mechanisms and expectations. Second, if the **slowdown in China provides an even harder landing than expected,** and leads to stimuli which **delay the necessary process of adjustment in highly heavily indebted sectors** or those with a high dependence on the real estate market. Third, though by no means less important, **uncertainty still pervades the eurozone**. In contrast to the welcome progress made on banking union and the increasing vigour of the economic cycle, there is the **risk of a lack of an agreement between Greece and the European authorities** to ensure that the country's funding, without compromising the agenda of reforms aimed at enhancing its capacity for structural growth and to guarantee its financial adequacy. If disagreement leads to default in the servicing of Greek debt, a scenario would open up which could end with Grexit, yet which would in any event put the ECB's capacity to head off financial spill-over to the test, as it would that of the authorities to demonstrate their commitment to the further strengthening of monetary union.

2: For further details, please see the Global Economic Outlook, available at: https://goo.gl/zPfxdf and Europe Economic Outlook available at: https://goo.gl/CKyBUI.

3 Growth prospects for the Spanish economy

Improved fundamentals underpin the upturn in activity

The Spanish economy began 2015 by building on the recovery which got underway in mid-2013. Although the environment has not been risk-free[3], the opening three months have seen a **pick-up in activity based on both outside and domestic factors**. Notable among the former are a **more dramatic fall in the oil price than anticipated**, **the somewhat sharper-than-expected improvement in European demand and, above all, a greater impact of ECB monetary policy** via a more intensified exchange rate depreciation. With respect to the latter two, fiscal policy has ceased to be contractionary, while the **steady improvement in the labour market and confidence continue to be conducive to consumption and investment decisions.** Those events are in part sustained by **structural elements, such as correction of domestic imbalances and some of the reforms undertaken.** In this respect, an improvement is perceived in some of drivers of certain items of private demand (for example, consumption), which the latter is proving more robust than was expected three months ago. Consequently, the private demand is approaching to its long-term equilibrium. Finally, some of the risks that loomed three months ago have not materialised (those of a geo-political nature) or have had a smaller impact than anticipated and even managed to exert a positive effect on activity in the short term (loosening fiscal tightening).

To summarise, the fundamentals of the Spanish economy endorse consolidation of the recovery over the next two years. **GDP is expected to continue rising at above its trend growth level, although a slight slowdown is predicted** in the coming months, bearing in mind the smaller tail-wind from certain factors, such as the oil price or tax cut, and the uncertainty related events of a geo-political bent. This should feed through into GDP growth of 3.0% in 2015 and 2.7% in 2016. This rate of growth could result on a **net creation of around a million jobs at the end of the period,** along with a **lower unemployment rate, which could come down to under 20% by the end of the forecast horizon**[4]**.**

Even though the scenario depicted in this edition includes an upward review of growth expectations for 2015 (by 0.3pp), **the elements underlying the expected recovery have not changed** since the last Spain Economic Outlook. Over the next two years, **economic growth will mainly rely on domestic demand** which, for the first time since 2007, will show positive annual balances for all of its components.

Activity is picking up and shows no signs of flagging for the remainder of the semester

With details of the results still to come, **the advance GDP estimate published by the National Statistics Institute (INE) indicated that the Spanish economy grew by 0.9% QoQ in 1Q15**[5], in line with forecasts three months ago (BBVA Research: 0.8-0.9% QoQ). Should this estimate be confirmed, the rate of activity growth would have been somewhat sharper than that of the final stages of 2014 (0.7% QoQ in 4Q14) and would mean YoY growth of around 2.6%, the most substantial since early 2008.

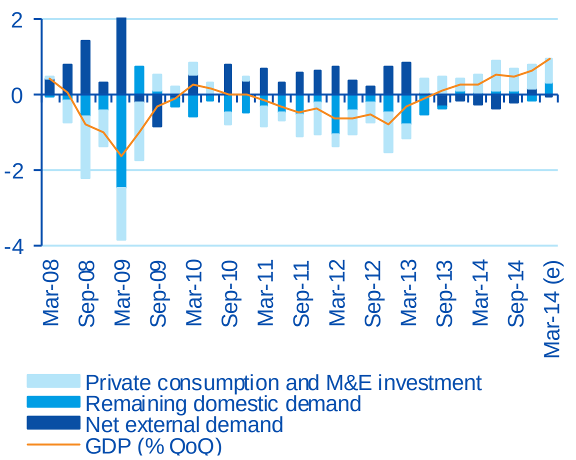
With respect to composition of growth, the partial indicators show that **domestic demand (principally private), is likely to have sustained the whole of the upturn in activity (+0.9pp QoQ)**, (see Figure 3.1). Conversely, **net external demand probably made no contribution to growth (+0.0pp QoQ)** taking into account the virtual stagnation in goods exports. This apparent inelasticity of trade flows to the improvements

3: Among risks present are the slowdown of the major geographical areas (with the exception of the EMU) and the persistence of financial volatility and geo-political tensions.
4: In average terms, employment will grow at an annual rate of 3.0% and the unemployment rate will be around 21.3% in 2016.
5: The breakdown in the Quarterly National Accounts (CNTR) for 4Q14 will be published on 28 May, when the advance estimate could be revised.

of the fundamentals is in part due to the base effect following the rallies observed over most of 2014, and is therefore expected to be only short-lived.

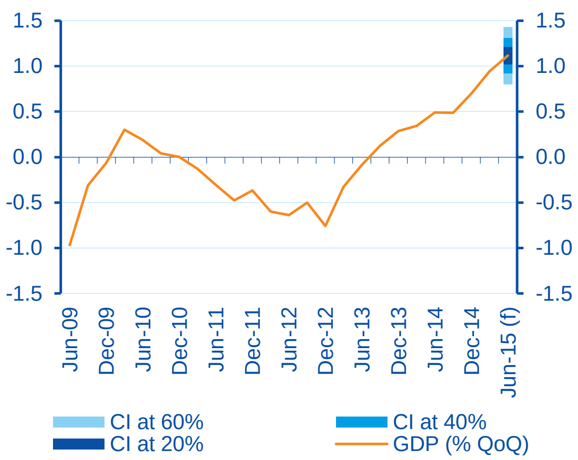
Looking ahead to the second quarter of 2015, the data available at the time of going to publication suggests that the Spanish economy continues to consolidate its recovery, and could be **growing at a rate at least that observed in the first quarter of this year, which, according to the estimate offered by the MICA-BBVA[6] model, could reach 1.1% QoQ** (see Figure 3.2). This upturn is consistent with the results of the BBVA Economic Activity Survey (EAE-BBVA)[7], which continue to reveal hopeful growth expectations (see Figures 3.3 and 3.4).

Figure 3.1
Spain: contributions to quarterly GDP growth (%)



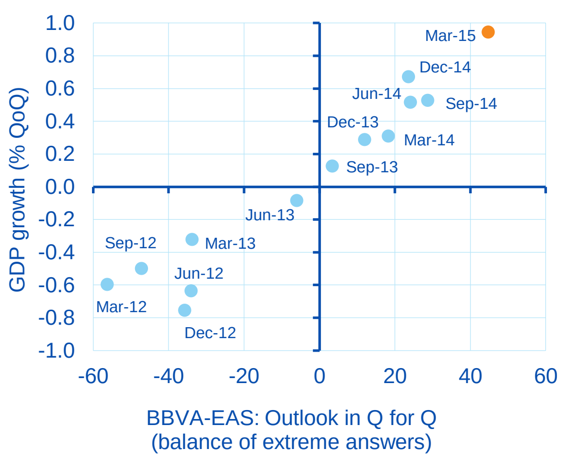
(e): estimated.
Source: BBVA Research based on INE

Figure 3.2
Spain: GDP growth, observed and predicted by the MICA-BBVA Model forecasts (% QoQ)



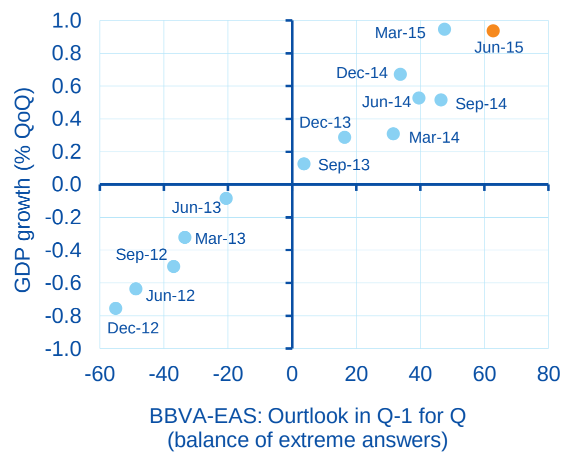
(f): forecast.
Source: BBVA Research based on INE

Figure 3.3
Spain: GDP growth and outlook of EAE-BBVA respondents



Source: BBVA Research based on INE

Figure 3.4
Spain: GDP growth and outlook of EAE-BBVA respondents in the previous quarter



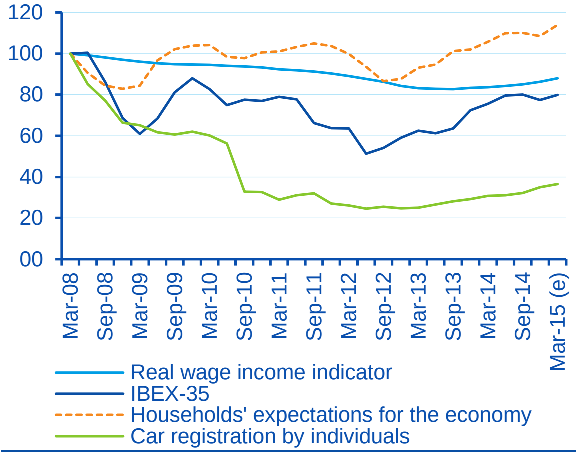
(e): estimated
Source: BBVA Research based on INE

6: For further details about the MICA-BBVA model, see Camacho, M. & R. Doménech (2010): "MICA-BBVA: A Factor Model of Economic and Financial Indicators for Short-term GDP Forecasting", BBVA WP 10/21, available at: http://goo.gl/zeJm7g
7: For more information on the BBVA Economic Activity Survey (EAE-BBVA), see Box 1 of Spain Economic Outlook, second quarter 2014, at: https://goo.gl/q1l0Fy

The recovery of domestic demand consolidates

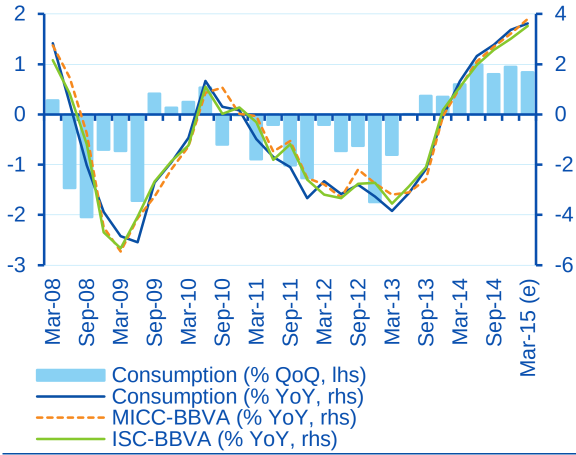
The consumption indicators, above all for durable goods and services, indicate that **household spending is likely to have returned to vigorous growth in the first quarter of 2015**[8]. The disposable income of families should have benefited from the job creation and the reform of personal income tax[9]. The stock market rally and the stabilisation of house prices probably served to lift net wealth between January and March. Besides its better fundamentals, private consumption has also been boosted by the improvement in household perceptions of the economic situation[10] and the growth in new consumer loans BBVA (see Figure 3.5). As a result, both the synthetic consumption indicator (ISC-BBVA) and the coincident indicator model for consumption (MICC-BBVA) suggest that **household spending should have risen by around 0.9% QoQ in 1Q15 (3.6% YoY), in line with the preceding quarter** (see Figure 3.6).

Figure 3.5
Spain: determining factors of consumption (swda, 1Q08=100)



(e): estimated
Source: BBVA Research based on MINECO, Datastream, EC and central bank

Figure 3.6
Spain: actual household consumption data and real time forecasts



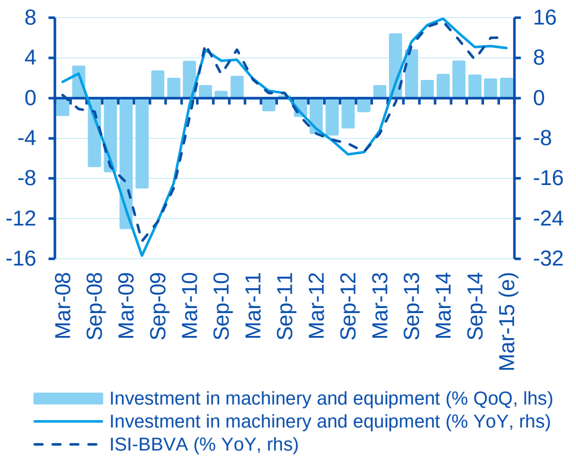
(e): estimated
Source: BBVA Research based on INE

The partial indicators for machinery and equipment investment for 1Q15 are indicative of growth similar to that seen in the previous quarter. Notable among them are the recovery of trade flows of capital goods and the fine industrial vehicle sales figure. The IPI and capital order book also performed slightly better than in 4Q14, and only industrial confidence saw a downward correction following the extraordinary records in 4Q14. As Figure 3.7 shows, the **synthetic investment indicator (ISI-BBVA) suggests that this demand item should chain nine quarters in a row of growth, with an increase of 1.9% QoQ (10.0% YoY) in the first quarter of the year.**

Following four consecutive quarters of growth, the housing investment indicators kept to the trend of recovery in 1Q15. The tone of the labour market in construction remained optimistic, the figures for building permits were better than in the previous quarter and business confidence of the industry sector again jumped higher. In addition to this, after adjusting for seasonality, housing sales continued to move in the direction of growth. As a result, **the composite indicator for housing construction investment (ISCV-BBVA) reveals a rise for residential investment of 1.2% QoQ (3.3% YoY) in 1Q15** (see Figure 3.8).

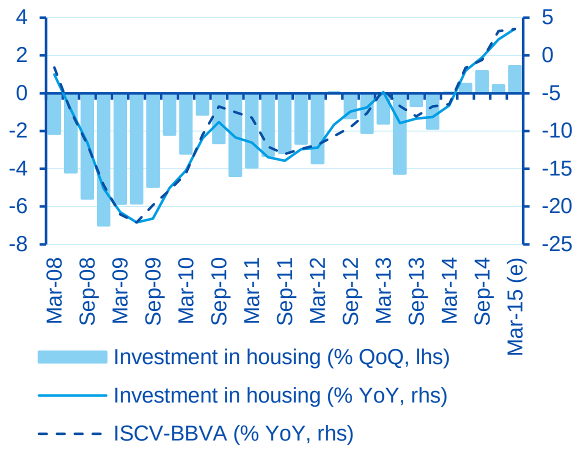
8: Detailed analysis of trends in household spending by type of good can be found in the Consumption Outlook, second half 2014, at: https://goo.gl/4YopS0.
9: An estimate of the effects of the personal income tax reform (in force since January 2015) on household incomes can be found in Box 2 of Spain Economic Outlook, fourth quarter 2014, at: https://goo.gl/S1qKR1
10: Household perceptions regarding the Spanish economic situation are at a historical high, while those with respect to their financial situation are at 2001 levels. Further information at: http://goo.gl/d4XIrX

Figure 3.7
Spain: actual data and real-time forecasts of investment in machinery and equipment



(e): estimated
Source: BBVA Research based on INE

Figure 3.8
Spain: actual data and real-time forecasts of investment in housing



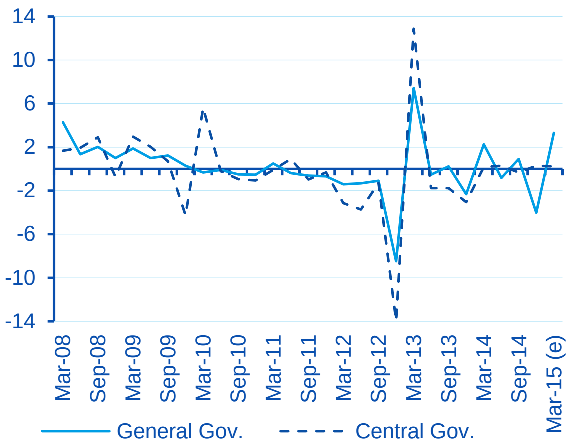
(e): estimated
Source: BBVA Research based on INE

Public sector demand rallies as 2015 commences

After the unexpected downward shift in public consumption in 4Q14, a recovery is expected to have taken place over the first quarter of this year. According to the State budget implementation figures as of March 2015, after seasonal and working day adjustments (swda), nominal final consumption expenditure by the central government is estimated to have held relatively stable with respect to the previous quarter (see Figure 3.9). Nonetheless, **real public consumption by public should have closed 1Q15 gaining momentum with respect to 2014 (1.0% QoQ: -0.6% YoY).** On this point, the figures from the Labour Force Survey (EPA) suggest that the **wage component is likely to have contributed to the increase in the real spending.** Moreover, the number of public sector employees grew by 1.1% QoQ swda between January and March, thus chaining two consecutive quarters of rises (see Figure 3.10).

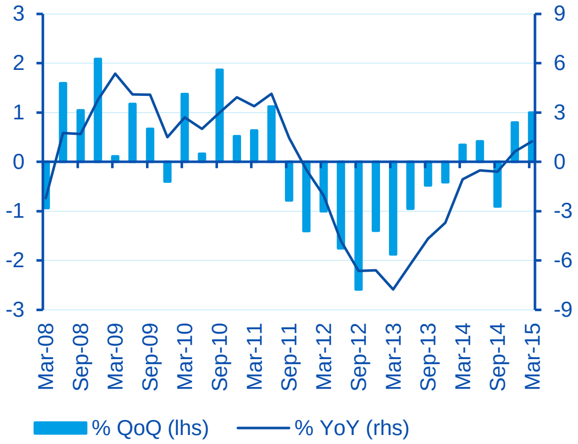
On the other hand, the public bids tender data show that in the opening months of the year this item should have lost pace, mainly due to the base effect arising from the sharp upturns in 2014 (33.0 % on average YoY) from historically low levels. Even so, the cumulative recovery of tenders last year should be contributing to **the gradual improvement in non-residential construction**, which probably grew by about 0.9% QoQ (5.1% YoY) in 1Q15.

Figure 3.9
Spain: nominal public consumption (% QoQ, swda)



(e) estimated
(*) Does not include, among others, fixed capital consumption.
Source: BBVA Research based on MINHAP and INE

Figure 3.10
Spain: public sector employees (swda)



Source: BBVA Research based on INE

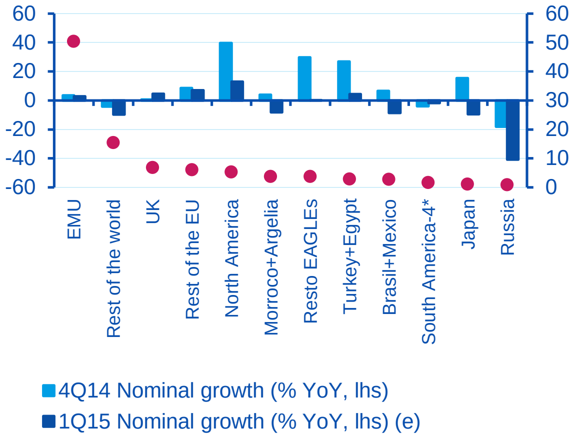
Total exports begin the year with modest growth

The commencement of 2015 was marked by **an international situation that was dominated by the slowdown of the major geographical areas with the exception of the EMU**, which displayed signs of improvement. Despite the euro depreciation and the lower costs provoked by the oil price, the uneven progress of world growth should have led to a **virtual stagnation of goods exports in 1Q15 (0.1% QoQ, 5.9% YoY)** (see Figure 3.11). Thus, despite the encouraging signs in industrial expectations (new exports orders), the spending indicators for the trade balance and sales abroad by larger companies suggest that the lethargy exhibited by goods exports has probably run on into 1Q15 after the high growth seen in the two middle quarters of 2014.

By contrary, the performance by **services in the first quarter of the year (1.6% QoQ, 3.5% YoY) is likely** to support total export growth. As regards tourism, **non-resident consumption on Spanish soil is expected to have surged ahead again (1.4% QoQ, 3.6% YoY),** which would put sector activity at record levels again. Regarding this aspect, tourists inflows would have increased by 1.0% QoQ and real spending by them would have done so by 2.3%. Likewise, **exports of non-tourist services are thought to have made progress in 1Q15 (1.8% QoQ, 3.4% YoY),** which would mark a continuation of the upward trend observed in 2H14 (2.4% QoQ and 2.3% YoY on average).

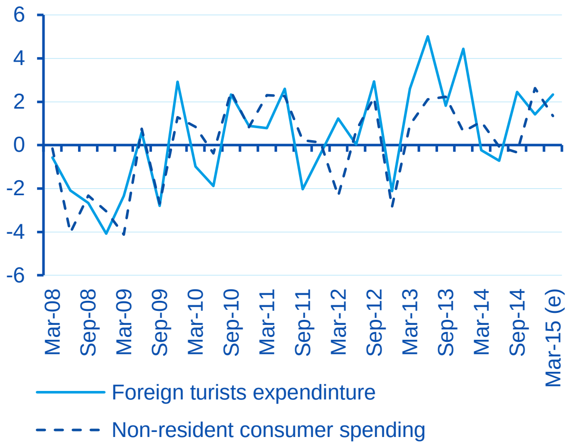
All in all, overall exports have probably grown discreetly in 1Q15 to 0.5% QoQ (5.2% YoY), although an upturn in growth is expected in the next few quarters following the fine close in 2014 (4.2%).

Figure 3.11
Spain: actual data and forecasts for goods exports by geographical areas



* South America-4 includes Colombia, Venezuela, Argentina and Chile
(e): estimated using data up to February 2015.
Source: BBVA Research based on Datacomex

Figure 3.12
Spain: actual data and forecasts for tourist service exports (% YoY, swda)



(e): estimated
Source: BBVA Research based on INE and the Institute of Tourism Studies (EGATUR)

In line with the performance of exports, the preliminary indicators available at the time of going to press suggest **moderate import growth in the first quarter of the year, rising to a rate of 0.6% QoQ (7.3% YoY)**. Even so, after the 2014 recovery, imports are likely to converge towards a higher growth path over the remainder of the year, helped by both exports and domestic demand.

To summarise, the above-mentioned elements suggest **no contribution from net external demand to quarterly growth in 1Q15** (0.0% QoQ, -0.5pp YoY). After closing 2014 in positive numbers (0.8% of GDP), the four quarte accumulated current account balance is estimated to have continued to show a surplus in the first quarter of the year (1.2% of GDP).

Mixed signals of labour market indicators

The labour market's recovery carried on into 1Q15. After seasonal adjustments, **average Social Security affiliation system rose for the sixth straight quarter, while registered unemployment came down for seven quarters in a row**. To be precise, with the number of affiliates to Social Security increased by 1.1% over January through to March, which is 0.3pp above the figure for 4Q14, while the drop in registered unemployment quickened by 0.8pp to a rate of -2.5% QoQ (see Figure 3.13). Hiring also picked up in Q1 (5.5% QoQ, swda), both for temporary contracts (5.4%) and, above all, for permanent ones (6.4%). While the "flat rate" of EUR100 for taking on new workers under permanent contracts was in force (from March 2014 to March 2015), the number of permanent contracts jumped by 25% (swda) , while temporality rose by 14%. Despite this, the predominance of employment under temporary contracts was only reduced by 0.7pp to 91.6% swda.[11]

The Labour Force Survey (EPA) for 1Q15 did, however, reveal a milder improvement in employment than was given to believe by the Social Security registrations. In gross terms, employment came down by 114,300 people over January to March owing to the adverse seasonal effect in the period. Adjusting for

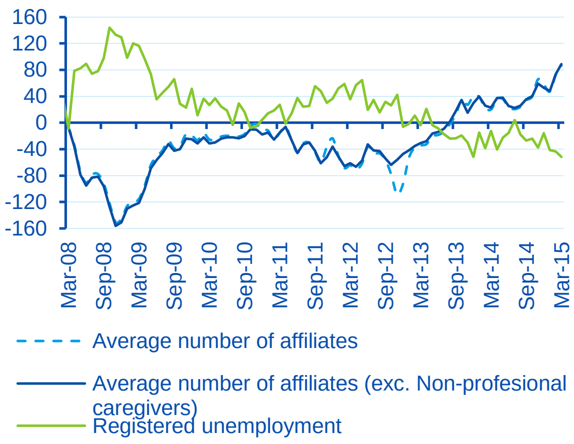
11: An assessment of this measure can be found in Box 2 of the Spain Economic Outlook, second quarter 2014, available at: https://goo.gl/rOaUrF. Since March the 'flat rate' has been replaced by a reduction in the employer's Social Security contribution for common contingencies of EUR500 (if the contract is permanent). This new system corrects one of the shortcomings in the 'flat rate', namely its regressive nature. Under the progressive rate, workers with low contribution quotas, who are those who are most likely to be jobless and where the demand for hiring them is more elastic in response to variations in non-wage costs, will find themselves in a relatively better position.

this factor, **the number of those in work would have grown by around 85,000 people (0.4% QoQ, swda)**, which is half of the figure in 4Q14 (170,000 people, 0.8% QoQ, swda).

Job destruction was in gross terms due to the falling **number of workers in the private sector, both salaried employees (-118,300) and self-employed workers (-25,200).** On the other hand, public sector employment rose by 29,200 salaried staff, which is the highest growth since mid-2011.

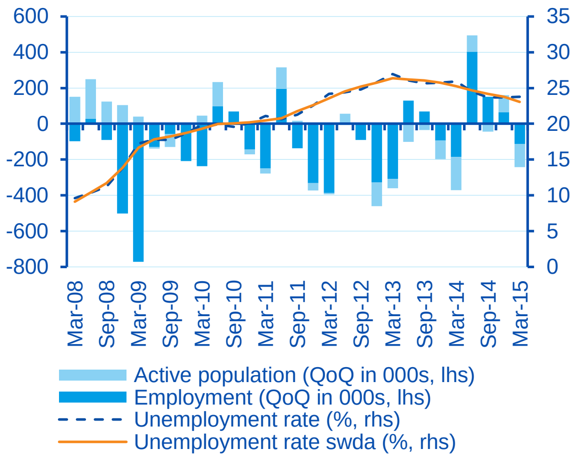
The drop in the labour force (-127,400 people) offset the job destruction, resulting on the **unemployment rate only went up by 0.1pp to 23.8%** (see Figure 3.14). After seasonal adjustments, the unemployment rate fell for the sixth successive quarter, this time by 0.6pp to 23.7% swda.

Figure 3.13
Spain: average Social Security affiliation and registered unemployment (monthly change in thousands, swda)



Source: BBVA Research based on the ME&SS data

Figure 3.14
Spain: labour market indicators



Source: BBVA Research based on INE

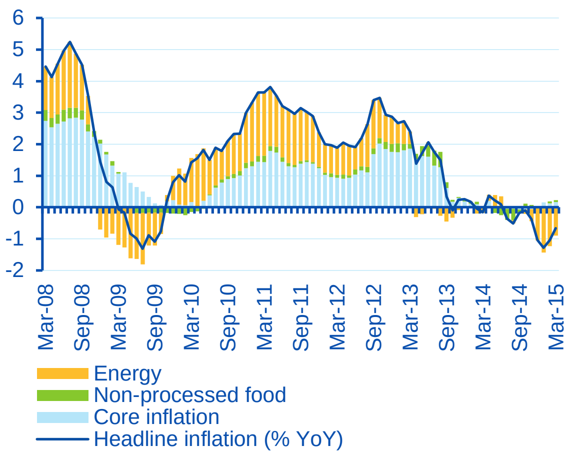
The current oil price level helps price and cost restraint

The drop in consumption prices soften as 2015 began, reaching -0.7% YoY in March[12]. The negative headline inflation derives from downward pressure on the energy component (-7.4% YoY in March) mainly because of the oil price slide between June 2014 and January 2015 (-56.4%, down to close to USD50 a barrel). Since January we have seen an upward correction in the market price of oil which, together with the EUR’s exchange rate depreciation, accounts for the lower fall in headline inflation at the close of 1Q15. On the other hand, **core price restraint continues and should have end with positive growth, though muted, in March** (0.2% YoY). Thus the contribution by core inflation to YoY price growth was around 0.2pp YoY in March, whereas that of the residual component was -0.8pp YoY (energy: -0.9pp YoY and non-processed foods: +0.1pp YoY) (see Figure 3.15).

According to BBVA Research estimates, the stabilisation of core prices in the Spanish economy is still ongoing within a climate of easing European inflation and a recovery of price competitiveness in Spain. Thus the **inflation differential with respect to the eurozone, as measured in terms of the trend component, remains favourable to Spain at around -0.6pp** (see Figure 3.16)[13].

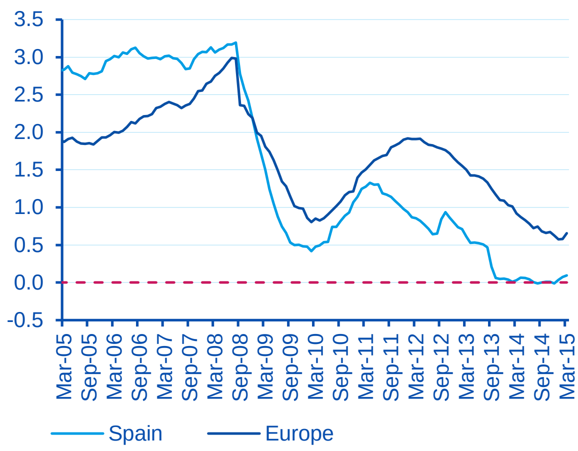
12: The leading CPI indicator confirmed the expected easing of inflation in April (by 0.2pp to -0.6% YoY). Our estimates suggest that core prices remain at 0.2% YoY. For further details, see: http://goo.gl/nrbNyb
13: For further details on the calculation of trend inflation using the trimmed mean approach, see Box 1 of the Spain Economic Outlook, first quarter 2014, available at: https://goo.gl/CYITVb

Figure 3.15
Spain: contribution to CPI growth (pp YoY)



Source: BBVA Research based on INE

Figure 3.16
EMU: trend inflation (trimmed means method, % YoY)

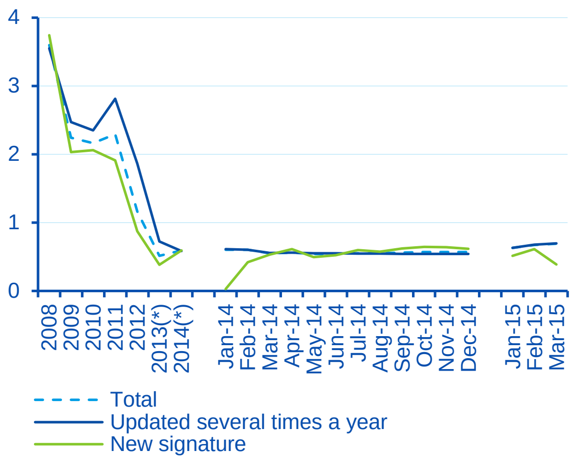


Source: BBVA Research based on INE and Eurostat

The low core inflation continued to help contain wage demands in Q1. The average wage rise agreed upon collective bargaining agreements increased by around 0.7% YoY between January to March in the 600 revised collective agreements in the multi-year review process, and 0.5% for those signed over the year (only 54), which are only binding on 54,500 workers[14] (see Figure 3.17). Although positions have still not coincided over a new Employment and Collective Bargaining Agreement (*AENC* in Spanish), the wage increase agreed is approaching that set as the upper limit in the *II AENC*[15] (Second Agreement on Employment and Collective Bargaining) for 2014 as a whole. As is illustrated in Figure 3.18, the wage moderation since the labour reform came into effect in 1Q12 has provided a 3.5% cumulative gain in cost competitiveness against the EMU.

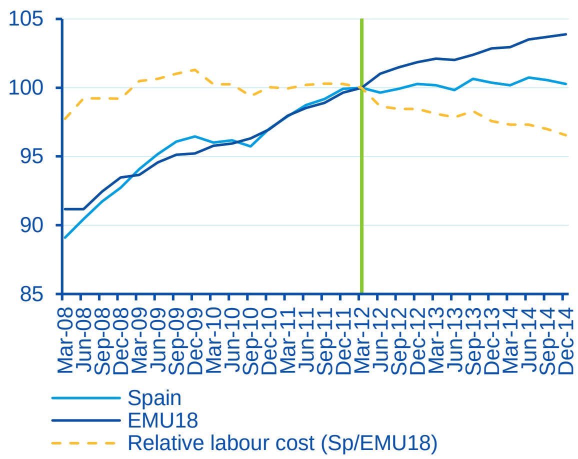
14: The number of workers subject to collective bargaining amounted to more than 2.0 million to March, when those affected by agreements that were signed prior to 2015 (1,977,000) joined. This figure is 25.2% smaller than that registered up to March 2014.
15: Note that the II AENC 2012-14 established that if the increase in GDP in 2013 were to be under 1%, the wage rise agreed for 2014 would not exceed 0.6%.

Figure 3.17
Spain: average wage growth agreed in collective bargaining agreements (%)



The annual data include agreements made after December which provide for reviews under the wage guarantee clause.
(*) Provisional data. The 2013 figure is not comparable with prior. See: http://goo.gl/WQkvNU
Source: BBVA Research based on the ME&SS data

Figure 3.18
EMU: labour cost per hour worked in the market economy (1Q12=100)



Source: BBVA Research based on Eurostat

Credit flows pass the recovery threshold

New lending transactions (rather than the stock) are the pertinent data for supporting economic recovery, as they are directly linked to current investment and consumption decisions taken by economic agents[16].

In cumulative terms for 1Q15, **new lending to large companies** (for loans of over EUR1mn) increased by a YoY figure of 1.2%, which was fourteen points up on 4Q14, **thereby consolidating the change of trend seen at the end of the previous year,** with the rate surging ahead in March (+23.6% YoY). The upward revision of expectations for the economy and the downward trend in borrowing costs are encouraging this segment to seek bank credit and to balance its borrowing structure, which had of late shown a leaning towards other sources of funding (such as bond issuance and building up equity).

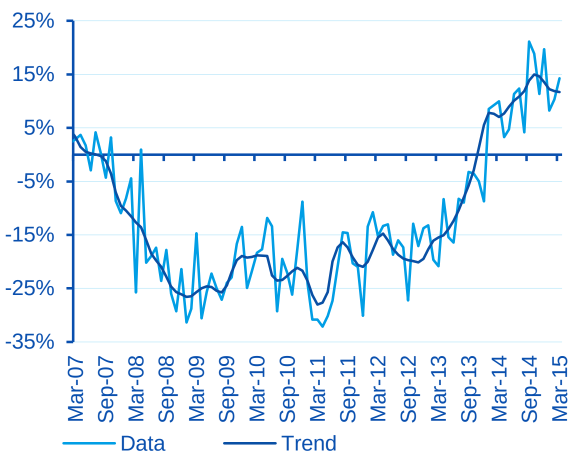
New SME lending (for loans of up to 1EURmn) **is still performing well** and shows growth for the quarter of 9.9% YoY. Although this is slightly down on the previous quarter, it still reflects the commitment of credit institutions towards this category of business, where improved confidence and the economic recovery have driven up demand. **New lending to households continued to display signs of robustness** in the quarter by growing 15.8% YoY, which is a somewhat more sustainable rate than was exhibited in the final quarter of 2014 (29.9% YoY). Thus, accumulated consumer lending rose by 20.5% YoY in 1Q15, while home loans increased by 13.2% YoY. Finally, the rest of household lending rose by a cumulative 15.7% YoY.

All in all, **total new lending posted positive growth** in the opening quarter of the year (+6.2% YoY), to a large extent thanks to the major boost from the large companies, which **appears to confirm the change of trend** detected towards the end of 2014. **Several factors mean that we can be optimistic about credit as regards the rest of the year:** the fact that transactions involving loans to companies of over EUR1mn seem to have bottomed out, the positive progress made by the retail segment (families and SMEs) (see Figure 3.19), the now brighter macroeconomic scenario, the headway towards banking union in Europe, and the set

16: Box 3 of the Spain Economic Outlook, fourth quarter 2014, offers a detailed analysis of the relationship between credit flows and economic activity.

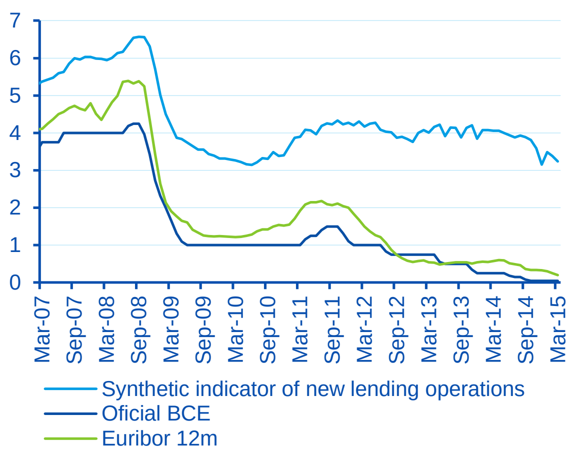
of unconventional measures that the ECB has set in train (TLTROs, asset-backed security and covered bond purchases, and monetary expansion), which could have a positive effect on loans, the low interest rates (see Figure 3.20) and the increase in creditworthy demand. In fact, the rise in new lending transactions would be compatible with the required deleveraging of outstanding balances, were the outflow (repayments) to outstrip the inflow (newtransactions). According to our estimates, new lending transactions would outstrip repayments from the end of 2015, which would translate into an increase in the outstanding balance of credit.

Figure 3.19
Spain: new retail lending operations (% YoY)



Source: BBVA Research based BoS data

Figure 3.20
Spain: interest rates (%)



Source: BBVA Research based on BoS and the ECB data

2015-16 scenario: growth driven by both domestic and external factors

As was said in the introduction to this section, **the new aspects added in to the macroeconomic scenario have prompted an upward revision** of 0.3pp in this year's growth figure for the Spanish economy. **In 2015, activity will rise by 3.0% and in 2016 it will do so at a rate of 2.7%,** which is enough for there to be net cumulative job creation by the end of the period of around one million, as well as a lowering of the unemployment rate down to about 20%[17].

Activity growth will be sustained by both domestic and external factors. The world economy will gradually pick up pace, which, together with the greater depreciation of the EUR, the fall in the oil price and the gains in competitiveness, will give rise to a **staggered recovery for Spanish exports**. On the domestic front, the improvement on fundamentals, the progress in correcting imbalances and the greater support from fiscal and monetary policies will lead to a **robust expansion of growth in domestic demand** (see Box 3.1). The increase final demand will trigger a considerable upsurge in imports, which in turn is likely to result in a **virtually no contribution from net external demand to growth**.

17: In average terms, employment will rise at an annual rate of 3.0% and the unemployment rate will reach around 21.3% in 2016.

Table 3.1.
Spain: macroeconomic forecasts

(% a/a salvo indicación contraria)	1Q14	2Q14	3Q14	4Q14	1Q15 (e)	2014	2015 (f)	2016 (f)
Domestic Final Consumption Expenditure	1.1	1.8	2.1	2.4	2.6	1.8	2.5	1.9
Private FCE	1.3	2.3	2.7	3.3	3.6	2.4	3.1	2.4
General Government FCE	0.3	0.3	0.3	-0.5	-0.6	0.1	0.8	0.6
Gross Fixed Capital Formation	0.8	3.9	3.9	5.1	6.2	3.4	5.7	6.4
Equipment & Machinery	15.8	12.9	10.2	10.4	10.0	12.2	7.8	6.7
Construction	-7.4	-0.7	0.1	2.4	4.4	-1.5	4.3	5.4
Housing	-6.6	-2.0	-0.2	2.1	3.3	-1.8	4.5	9.0
Other buildings and contructions	-8.0	0.3	0.3	2.6	5.1	-1.3	4.1	2.7
Domestic demand (*)	**1.2**	**2.3**	**2.6**	**2.7**	**3.1**	**2.2**	**3.0**	**2.7**
Esports	6.4	1.0	4.5	4.7	5.2	4.2	6.1	7.5
Imports	9.4	4.9	8.6	7.7	7.3	7.6	6.5	7.8
Trade balance (*)	**-0.6**	**-1.1**	**-1.0**	**-0.7**	**-0.5**	**-0.8**	**0.0**	**0.1**
Real GDP mp	**0.6**	**1.2**	**1.6**	**2.0**	**2.6**	**1.4**	**3.0**	**2.7**
Nominal GDP mp	**0.0**	**0.8**	**1.4**	**1.4**	**2.5**	**0.9**	**3.8**	**4.9**
Pro-memoria								
GDP exc. Housing investment	1.0	1.4	1.7	2.0	2.7	1.5	3.0	2.5
GDP exc. Construction	1.6	1.5	1.8	2.0	2.5	1.7	2.9	2.5
Total employment (LFS)	-0.5	1.1	1.6	2.5	3.0	1.2	3.0	2.9
Unemployment rate (%, LFS)	25.9	24.5	23.7	23.7	23.8	24.4	22.3	20.7
Total employment (f.t.e)	-0.4	1.0	1.7	2.4	2.5	1.2	2.6	2.4

(*) Contributions to growth.
(e): estimated, (f): forecast.
Source: BBVA Research based on INE and BoS data

The cumulative oil price fall benefits activity in the short term

In recent months, **the oil price has partly corrected the downward course** traced by readings since mid-2014, to the extent that the Brent price stands at USD65 per barrel at the time of this Outlook going to print. **Thus the cumulative fall in the market price, which hit its lowest point in January, was reduced by5.0pp (to -50%). Since this is primarily a supply shock[18], the net impact of cheaper energy of this kind on activity is proving particularly positive**: consumption, investment and trade flows are likely to have benefited, given the improvements in the available income of families and production costs for firms. In this respect, the **BBVA Research estimates for 2015-16 point to price stabilisation at around USD68per barrel** (two dollars below the estimate of three months ago), which, if confirmed, would on average provide at around 0.7pp of growth for the Spanish economy[19].

18: BBVA Research estimates suggest that the crude price fall since June 2014 is mostly due to supply-side factors (between two-thirds and three-quarters of the adjustment), such as unconventional production in the United States (shale oil), the decision by OPEC not to cut production quotas and the minimal effect of geo-political tensions on output. The lower expectations for world growth have also had an impact on prices, albeit a secondary one.
19: For further details regarding the estimated effects of the oil price by type of shock on activity and prices in the Spanish economy, see Box 1 of Spain Economic Outlook, second quarter 2011, available at: http://goo.gl/42s7N9

Monetary policy is supporting cyclical recovery, in both Europe and Spain

The ECB is continuing to act in a forthright manner given the listlessness of the upturn in the European economy and the low inflation rates. In particular, at its April meeting the monetary authority's Governing Council (GC) reiterated that it intends to continue to focus on **giving full rein to the monetary policy measures that were previously announced**, and it stressed its commitment to pursuing its asset purchase programmes (APP)[20] until inflation has returned to a path in line with its target[21]. These measures, together with holding the main benchmark interest rate at a historical low (of 0.05%), as well as the targeted longer-term refinancing operations (TLTRO) programme, are helping to **combat the low inflation, keep long term interest rates at low levels** (around 1.5% for 2015-16 for Spain, 120bp less than in 2014), **underpin domestic demand and credit growth, and lastly to consolidate the EUR's depreciation** (a nominal 16% against the USD in 2015) [22,].

As for the impact of these measures, the updated economic scenario factors in a **fall for the exchange rate against the USD which is heavier than was expected** three months ago (by a further 8% on average for 2015 and 2016) and consequently **larger-than-expected European demand growth** (by 0.3pp, to 1.6%), which will provide a firmer **platform for Spanish export growth**. BBVA Research estimates suggest that a depreciation of this magnitude could add as much as 0.4pp to growth, while a cyclical upturn for Europe tends to have a one-to-one effect on the Spanish GDP[23].

Fiscal policy becomes slightly expansive

The recovery of activity and the improved borrowing costs will provide scope to implement a mildly expansive fiscal policy in the short term[24]. Thus, following a close for the deficit of the regions in 2014 which was 0.2pp higher than forecast, and given the absence of additional measures to offset this deviation, public sector consumption is expected to grow by 0.8% in 2015 in real terms, while non-residential construction investment (affected by public works) should do so by 4.1%. In an no policy changescenario , **the tone of fiscal policy will continue to be practically neutral in 2016. Thus,** real growth of public consumption expenditure will drop back to 0.6%, while non-residential investment will grow at a rate of around 2.7%.

Even so, the boost from the better economic situation will not be enough to offset the overall impact of the expansive policies implemented over 2015-16. Therefore, **in the absence of new fiscal consolidation measures, the government deficit is expected to slightly overshoot the stability target**.

Domestic demand will lead the way for growth

Household consumption prospects have again improved in the last quarter. Job creation, less tax pressure and the absence of inflationary pressures will all help real disposable income to recover, which will rise by more than was predicted three months ago[25]. Forecast growth in wealth, both as regards real estate and financial positions, expectations that official interest rates will remain at historic lows and the adjustment in saving will also serve to encourage family spending. Finally, new consumer finance business will continue

20: Altogether the programme means a liquidity injection of at least EUR1.1trn (purchases of EUR60bn a month) running from March this year through to at least September 2016. The programme includes public securities issued by governments and European agencies and institutions, and encompasses those programmes previously open since 2H14 (CBPP and ABSPP): covered bond and asset-backed securities programmes which amount to approximately EUR13bn a month.
21: For further details, see the ECB Watch by BBVA Research published on 15 April 2015. Available at http://goo.gl/4Dyjfi
22: In Box 3 of Spain Economic Outlook, fourth quarter 2014, it is estimated that actions such as TLTROs could add between 0.2pp and 0.8pp to Spanish GDP growth, although only in the short term. See: http://goo.gl/uXV9fD
23: The estimates from the BBVA-RVAR model indicate a depreciation of 10% for the EUR/USD rate, which could contribute 0.5pp to Spanish GDP growth. For further details see Box 1 of the Spain Economic Outlook, fourth quarter 2014.
24: Notable on the revenue side are the tax cuts, the first round of which came into effect in January 2015, while the second round is scheduled for January2016. Box 2 of the Spain Economic Outlook, fourth quarter 2014 offers an analysis of the impact of the personal income tax cuts.
25: Note that the Non-Financial Quarterly Accounts for the Institutional Sectors for 4Q14 brought in an upward revision to gross disposable household income of almost EUR4bn since 2Q14.

to rise over the coming quarters in a context of deleveraging of the outstanding credit balance, and it will support private consumption in the medium term, especially for durable goods. As a result, **consumer spending is being revised upwards by 0.7pp (on average) for 2015-16, to 3.1% and 2.4% respectively, and is close to its long-term equilibrium level.** This means that, from now onwards, family spending will tend to rise at levels more in keeping with the more traditional of its fundamentals (income, interest rates, etc.) and will be less affected by temporary factors (uncertainty, tax incentives).

In the next few quarters, **machinery and equipment investment will be favoured by the lower borrowing costs. There should also be a positive contribution from the encouraging trends in final demand**: the upward revision for growth, in both Spain and Europe, and continued EUR weakness against the major currencies will be conducive to fuller capital equipment order books for Spanish companies. Consequently, a **slight upward revision to forecast growth for machinery and equipment investment** in the coming quarters is justified. Specifically, the forecast is being raised by **0.6pp in 2015, to 7.8%, and by 0.4pp in 2016, to 6.7%.**

On the other hand, **housing investment is expected to continue along the growth path traced since 2014**. From the point of view of construction activity, for the first time since the beginning of the crisis building permits for new homes completed a year in positive ground (2.0% in 2014) and they are expected to consolidate the trend of recovery in the current two-year period. Moreover, relatively cheaper borrowing and the fine showing by housing sales augur well for new projects to spring up in zones where restrictions on supply are starting to become evident. In the next few years, transactions are predicted to carry on increasing which, given a context of shrinking supply, will work in favour of house prices starting to chart a course of steady recovery. **Housing investment is therefore expected to grow at an annual rate of 4.5% in 2015, reaching 9.0% the following year,** after seven years in a row of contributing negatively to GDP.

As regards trade flows, growth in the world economy in 2015-16 (3.5% and 3.9% respectively), the weakening of the EUR and cheaper transport costs should herald high demand for Spanish exports within the forecast horizon. Specifically, for the current two-year period **high growth is expected for both overall exports (6.8% annually, on average) and their main components:** goods exports will progress at an annual average growth rate of 6.6% and services at around 7.0%**.** In the case of tourism, the political uncertainty in parts of the Mediterranean overlies the above factors and, all things considered, there will again be record scenarios with annual growth rates of close to 4.5% on average.

In the medium term, this growth is likely to consolidate into gains in export shares of world goods and services markets if it is accompanied by a fall in relative export prices as a result of, among other things, structural improvements in the functioning of services markets (see Box 2). Despite the progress achieved in recent years by export companies in highly diverse geographical areas[26], **chief among the risks facing exports is the strategy that firms decide to pursue in terms of satisfying the rising demand from the domestic market**: reallocating away from destinations or increasing production capacity utilisation.

As a consequence of the buoyant state of final demand, **imports of goods and services should continue to grow in the next two years (7.1% annually, on average)**. This means that **the contribution of net external demand to economic growth in 2015 will be negligible (0.0pp), thereafter returning to marginally positive values in 2016 (0.1pp)**. Over the next two-year period, cheaper energy inputs will make the bill facing the Spanish economy in its dealings abroad somewhat more affordable, which will **provide continuity to positive current account balances in 2015-16 (1.0% of GDP on average)** and conclude the adjustment of the current account balance's structural deficit.

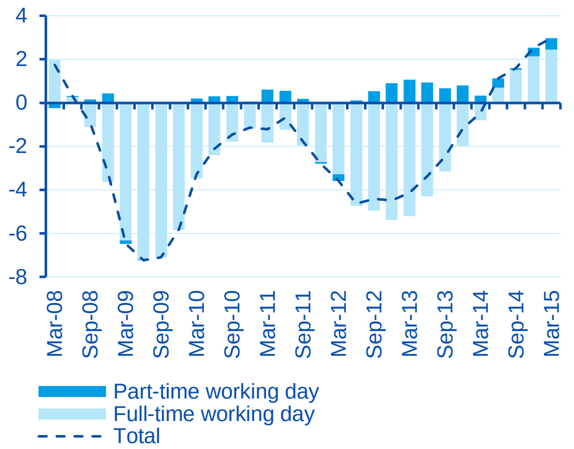
26: An analysis of the productive and geographical diversification of Spanish exports can be found in Box 3 of Spain Economic Outlook, first quarter 2014.

Imbalances in the labour market have been reduced, but they still remain

The expected momentum of the economy and the greater efficiency in the labour market will help to lift private sector employment and bring down the unemployment rate over the next two years. For 2015, the number of those in work is expected to grow by 3.0%, with a fall in the unemployment rate of 2.1 points (to 22.3%), which means 0.2pp below the figures forecast in February in both cases. **In 2016, job creation will be 2.9%, but the reduction in the unemployment rate (to 20.7%) will be less pronounced than was forecast for 2015,** given the improving trends for the labour force.

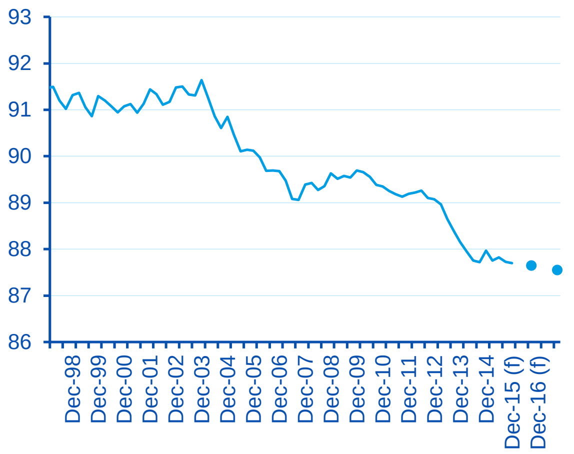
The data from the Labour Force Survey (EPA) for 1Q15 indicate that full-time employment continues to recover steadily (see Figure 3.21). If this trend is maintained in the coming quarters, the performance of full-time equivalent employment will be comparable to that of the overall figure. BBVA Research forecasts shown in Figure 3.22 suggest that the ratio of full-time equivalent jobs to total jobs will only be reduced by 0.2pp to 87.6% over the next two-year period. The expected trends for participation and employment suggest an increase in apparent labour productivity, both in 2015 (0.5%) and in 2016 (0.3%). Although these growth rates are lower than those in the past recession (2.1% on average for 2008-13), they would be in line with those seen in the earlier expansionary phase (0.4% on average for 2000-07)[27].

Figure 3.21
Spain: contributions to YoY employment growth (%)



Source: BBVA Research based on INE

Figure 3.22
Spain: full-time equivalent jobs / Total jobs (%)



(f): forecast.
Source: BBVA Research based on INE

The success of the **reform of the system of professional training for employment**, passed at the end of March[28], **could speed up placement of the unemployed in the labour market in the medium term**. The reform summarises the shortcomings of the current system in three categories: the training offered does not contribute to enhancing the employability of workers, the course content does not match the needs of the productive fabric of the economy and the lack of competition among suppliers puts limitations on what is available and makes services more expensive.

27: Box 3 analyses trends and determining factors regarding the productivity of Spanish firms in the manufacturing sector over the last three decades.
28: Royal Decree-Law 4/2015 of 22 March for urgent reform of the System of Professional Training for Employment in the labour market. Available at: http://goo.gl/s87UXu

To correct them, it proposes twelve strategies for action, notable among which are these four:

- Ongoing evaluation of training. Assessment will be carried out of improved performance in the job, placement and remaining in employment, and gains in competitiveness of firms.
- A system will be developed to monitor and research the labour market.
- In line with the above, multi-year strategic planning will be instituted.
- The training provided by the regions will be subjected to competitive tender. Within this context a “training voucher” system will be started, so that it is the unemployed themselves who choose the training organisation, subject to certain criteria.

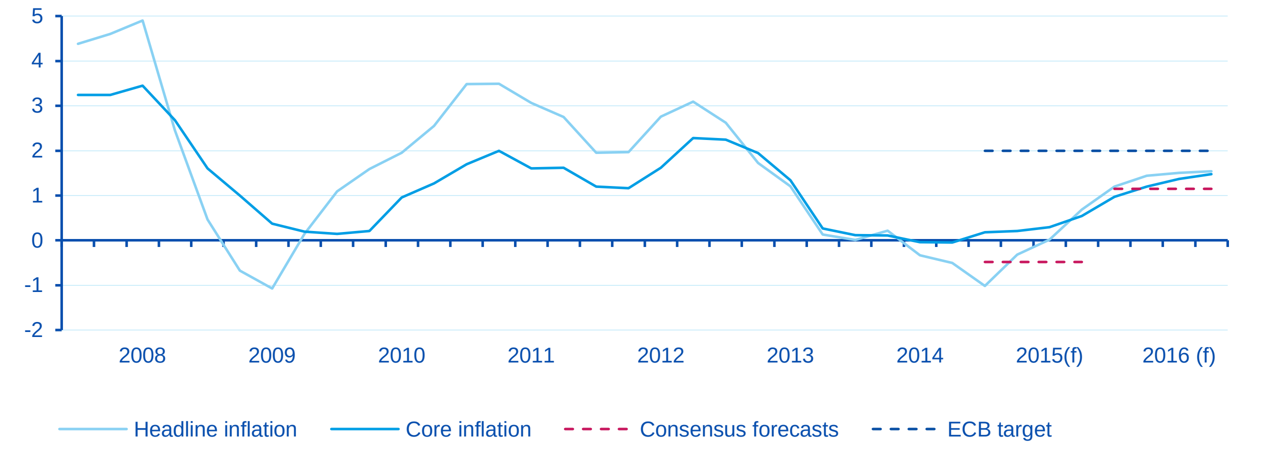
Even if this diagnosis is accurate, it still ignores a key element: despite the seriousness of the problem, the unemployed are not the main segment targeted by training campaigns. Less than 40% of the costs budgeted for 2015 under training programmes are aimed at the unemployed. Furthermore, the training for the unemployed is traditionally biased in favour of the population in the 25-40 age-range and the most qualified and skilled. It would therefore be desirable to **re-balance training efforts more in favour of those with the greatest problems of placement in the labour market.** As regards areas of activity, there is a notably results-oriented approach, even though the **evaluation criteria for the training programmes are not known yet**. With respect to this, **it would be advisable to make a start on experimental assessments** to be able to pick out which of the training actions are the most effective for each segment and thus streamline the resources deployed in job training.

Inflation is set to flip up over the current two-year period

Although the oil price is expected to be slightly below what was anticipated three months ago (around the USD68 per barrel mark on average for 2015-16), the extra pressure on inflation will be counterbalanced by the greater-than-expected depreciation in the EUR exchange rate. As a result, **the forecast of a marginal fall in general consumer prices for 2015 as a whole (-0.2% YoY) is being maintained.** On the other hand, the domestic factors suggest that core inflation will remain positive, though at moderate levels (0.3% as annual average) (see Figure 3.23). On the demand side, **the still high unemployment level will keep any emergence of inflationary tensions, despite the gathering pace of domestic spending.** On the supply side, **the competitiveness regained by the Spanish economy does not hint at any significant pressures on price formation.**

Although inflation expectations are still below the target set by the monetary authority, **in both Spain and Europe prices will follow a clearly upward path over the next two years, reaching 1.4% and 1.3% on average over 2016.** As was advanced in the previous edition, this improvement has been helped by the unconventional monetary policy which the ECB has been implementing since halfway through last year (lower interest rates, stepping up credit availability, quantitative easing).

Figure 3.23
Spain: inflation (% YoY)



(f): forecast
Source: BBVA Research based on INE and Consensus Forecast Inc.

The scenario is not a risk-free one

Despite the fact that the Spanish economy is still gaining traction and that, in the most likely scenario a cumulative recovery of almost six points of GDP will be observed over 2015-16, **the rekindling of activity still depends on** whether or not certain risks materialise.

Externally, the geo-political risks remain a threat, above all those attaching to negotiations between Greece and the institutions, though also others, such as those from the crises in Russia-Ukraine and the Near East. On the other hand, there is still uncertainty over **the response by certain emerging markets to the shifts in monetary policy** by the US Federal Reserve. Similarly negative some of these markets might be the **uncertainty stemming from the oil price slide**. Finally, **the slowdown of growth in China** could have an adverse impact on world demand, with negative fallout for demand for Spanish goods and services.

In Europe, the election calendar still shapes the future in at least eight countries. The policies carried out by the governments to be elected will be key to evading risk scenarios where growth is held back by uncertainty. **Moreover, the process of reducing financial fragmentation has not concluded**, and an unwanted by-product of ECB asset purchasing is that its progress could be hampered because it does not involve fully-shared risk.[29] Further ahead, **the Eurozone member states should work on supply-side policies** which enhance the capacity for structural growth.

To conclude, **Spain faces the challenge of achieving both sustained and sustainable growth**. The recovery should continue to give rise to intensive job creation and, in turn, not compete with managing to obtain positive current account balances. **Any reversal of changes to the production model should be avoided which could lead to interruption of the correction of external imbalances**. In this regard, the strategy which firms decide to pursue to satisfy rising domestic demand in the medium to long term will prove decisive, and in this sense it is desirable to increase production capacity instead of refocussing away from other destinations in favour of the domestic market: in an environment of higher investment rates, the economy's financing capacity should therefore gain a firmer footing via increased saving (see Box 1).

29: For further details, see BBVA Research's ECB Watch of 22 January 2015. Available at: http://goo.gl/cVng0E

Box 1. The private sector has sustained savings in the economy during the crisis

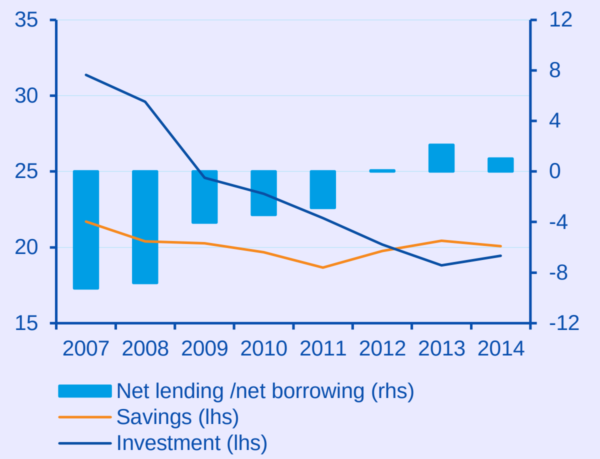
The reduction in the Spanish economy's net borrowing is unparalleled in other European economies. The adjustment has been carried out at the expense of a major fall in investment at the same time as the savings rate has remained relatively stable. This was possible because the drop in public saving was offset by private sector saving, which is something not seen in other economies. Thus, it is considered important to analyse trends in the saving components of the various institutional sectors in the Spanish economy, with special attention to households and companies.

The adjustment in investment has allowed the economy to show net lending capacity

The Spanish economy closed 2014 with financing capacity of 1.0% of GDP. Although this means a decrease of over one point relative to the 2013 level, it is still at a 30-year maximum. This reduction in the balance was mainly due to the rise in the investment rate, which grew for the first time since the start of the crisis, reaching 19.4% of the GDP, which is 0.6pp more than in 2013. This all took place in a context of a slightly decrease of savings rate to 20.1% of GDP after a rise in consumption, which more than offset the recovery in the economy's gross disposable income (see Figure B.1.1).

The 2014 performance is representative of the contribution of saving and investment to the external balance over the crisis period (2008-14): **the adjustment in the funding requirements (of 10.3pp of GDP) in this period was above all due to a reduction in the investment rate,** which fell by almost 12pp. Meanwhile the savings rate proved comparatively more stable and, having fallen by a little under 2pp since the end of 2007, it has held at levels slightly below the historical average (21.3% of GDP).

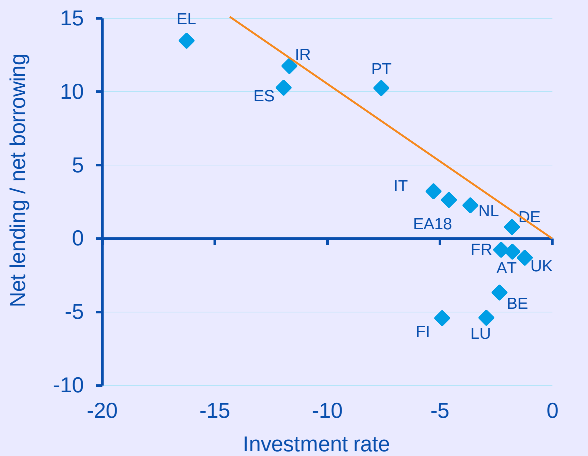
Figure B.1.1
Spain: net lending / net borrowing (% of GDP)



Source: BBVA Research based on INE

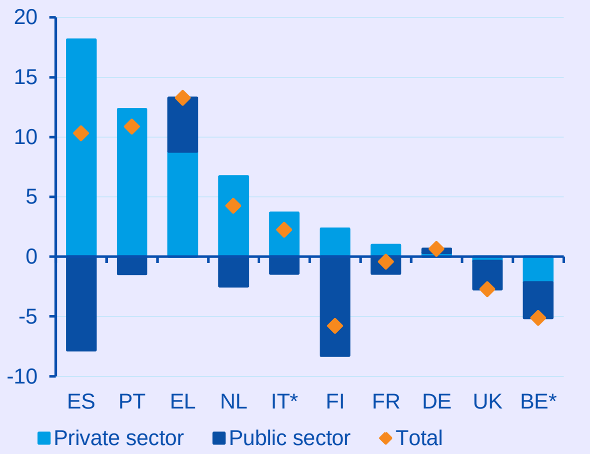
Looking at the European comparative analysis, as can be seen in Figure B.1.2, only in Greece, Ireland and Portugal a similar adjustment in the financing needs took place over this last economic crisis. As with Spain, in these countries the fall-off in investment was the factor accounting for the bulk of the correction in the net borrowing position, as the savings rate exhibited a relatively muted variation. In the other European economies the variation in the lending capacity or funding requirement during the crisis has not been so marked. Furthermore, in these last countries the source of the variation in the external balance has, above all, derived from the movements registered in the savings rate, while the investment rate has generally held relatively stable.

Figure B.1.2
EU: net lending / net borrowing vs. the investment rate. 2014-07 var. (pp of GDP)



Source: BBVA Research based on AMECO and INE

Figure B.1.3
EU: net lending / net borrowing. 2014-07 var. (pp of GDP)



* Data as of 2013
Source: BBVA Research based on AMECO and INE

In the breakdown into institutional sectors, **the private sector adjustment in recent years has made it possible to whittle down the high funding requirements the Spanish economy had** the beginning of the crisis. Thus, both households and non- financial companies shifted from evidencing financing needs in 2007 to having financing capacity from 2009. Resulting an improvement of their respective balances by 7.9pp and 9.6pp of GDP over the last seven years. **On the other hand, the balance for the public sector deteriorated spectacularly** at the outset of the crisis, moving from a net lending of 2% of GDP in 2007 to a net borrowing of 11% of GDP in 2009. Since then, the fiscal consolidation measures set in train have gradually brought down the public deficit to around 5.8% of GDP at the end of 2014.

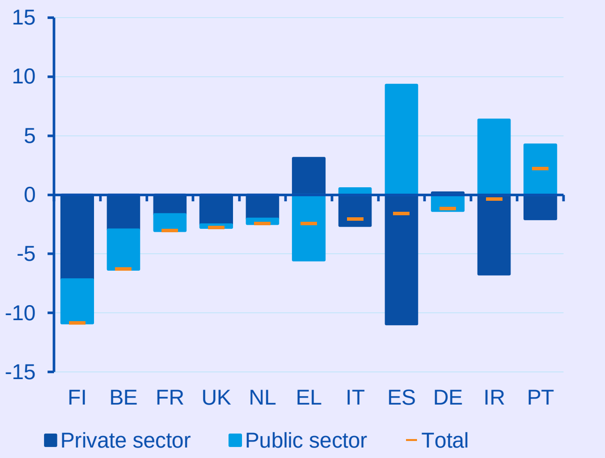
This performance displayed by the Spanish economy does not seem to be observable in the other European economies and although it is true that during the crisis the private sector showed it had regained financing capacity in most of the European economies, nowhere was this as accentuated as in Spain, as can be seen from Figure B.1.3. On the other hand, the deterioration in the public sector's net lending position in the other economies has generally been far more moderate than in Spain's case in the crisis period.

The sector analysis shows that the **adjustment in investment has in particular come from the private sector**. There have been especially severe cut-backs in investment in Greece, Spain and Portugal. Furthermore, the public sector investment rate has also suffered, contrary to what has happened in the other countries, where it has remained virtually steady. In the case of the savings rate, the performance has been more varied among other economies, and Spain has been one of the countries where this has stayed most even.

What is the explanation for the smaller variation in the savings rate in Spain?

Trends in the savings rate for the various institutional sectors show that, since 2008, Spain has been the European country in which private sector saving has grown the most. However, this increase was not enough to outweigh the fall of over 10pp of GDP in public sector saving, which has revealed negative savings rates since 2009. The international comparative shows that, although less sharp than in the Spanish case, the decline in public saving was common to most European economies, while the behaviour for private saving was not uniform among them (see Figure B.1.4).

Figure B.1.4
EU: 2007-14 savings rate variation (pp of GDP)

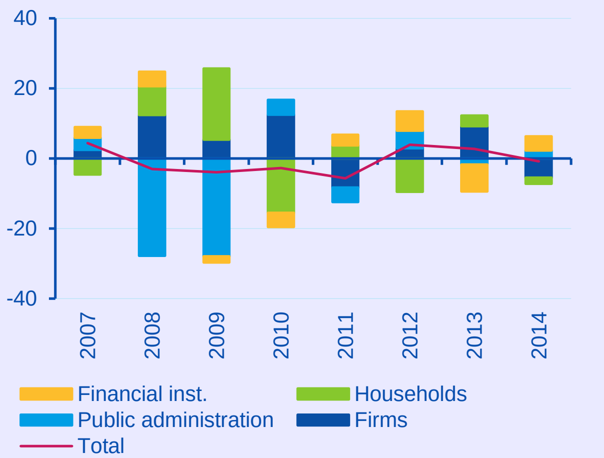


Source: BBVA Research based on AMECO and INE

From a broader time perspective, the Spanish public administration was responsible for the increase in saving seen during the period of economic expansion. At the beginning of the crisis, **the fall in public saving was offset the increased saving in households and firms**. As the economy appeared to be reviving in 2H10, households gently rekindled their former consumption habits and began to save less. Firm's saving continued to rise to 15.5% of GDP in 2013, which took the private sector's saving rate up to a historical high of 24.5% of GDP. Finally, the recovery of activity recorded in 2014 was prompted by a drop in the savings rate, both for households and companies.

These dynamics displayed by Spanish economic agents could, to some extent, be a case of the well-known phenomenon of Ricardian equivalence, although there are other factors which could explain this behaviour (i.e. the negative affect of automatic stabilisers on public saving, or the private sector's need to deleverage). As is illustrated in Figure B.1.5, early on in the crisis the Spanish public administrations lifted their spending and, as a result, their deficit. Conversely, given the reigning uncertainty, households cut back considerably on their consumption and increased saving, thereby making up for a substantial part of the fall in public sector saving. Households were probably not only trying to set funds aside to provide for future tax hikes, but also stepping up their saving for precautionary reasons. Such behaviour, however, was not observed within the corporate sector.

Figure B.1.5
Spain: sector contributions to YoY savings growth (pp)



Source: BBVA Research based on INE

The course traced by gross disposable income (GDI) is key to understanding developments in saving. During the expansion, the rise in saving was due to greater growth in GDI than consumption. In the crisis, although income has always contributed negatively to saving patterns, it has been the adjustments to consumption which have marked the differences in trend for saving.

We now go on to examine the performances of the various components of saving, paying special attention to the private sector, above all to households and companies. In doing so, we will study how the different components of gross available income have varied for these two economic agents.

The rise in household saving largely served to offset the deterioration in public saving

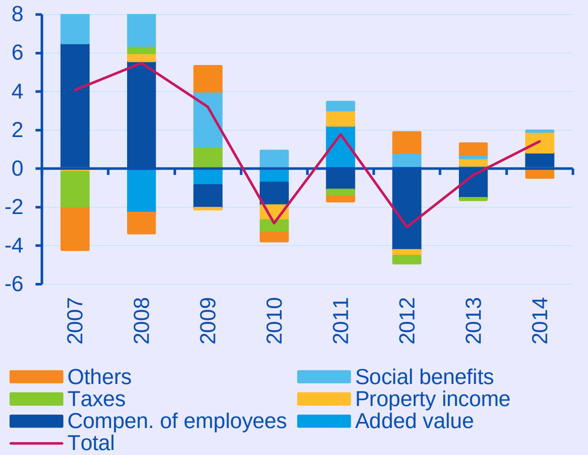
During the economic growth phase, the household savings rate suffered a major fall due to an increased consumer spending. **As the crisis emerged, households began to rein in consumption sharply, which worked in favour of a rise in saving**, this being to a great extent precautionary[30]. Not even the reduction of gross disposable income managed to stop savings from growing. Nonetheless, since 2010 the fall in household GDI has caused the savings rate (% GDI) to describe a downward path, and at present it is still below pre-crisis levels.

As can be seen in Figure B.1.6, **this drop in household income was linked to falls in the remuneration of employees,** both on account of wage restraint and, above all, rising unemployment. Nonetheless, with the recovery of employment, which started to become evident in 2H13, the negative contribution of the remuneration of employees to household GDI began to diminish. Thus the stronger job creation in 2014 allowed the wage component of GDI to contribute positively to saving.

Conversely, throughout the whole crisis the increase in **social benefits counteracted partly the fall in household's gross income**, although its contribution has waned gradually. In fact, since early 2014 social benefits have made a negative contribution to household saving, this stems from two factors: job creation and the running out of entitlements to benefits of the long-term unemployed.

Another of the factors which has boosted the recovery of household income in recent months is property income. The increase in resources could, on the one hand, be associated with the dividends paid out by companies rewarding investors, and on the other hand the reduction in interest paid by households (deriving from the fall in rates) means less of it is spent, and therefore represents greater income.

Figure B.1.6
Households: contribution to YoY GDI growth by components (pp)



Source: BBVA Research based on INE

The savings rate of non-financial companies has been rising throughout the whole crisis

In spite of the drop in activity, the corporate savings rate has risen sharply since 2007, a tendency which was only temporarily interrupted in 2011 (see Figure B.1.7). This has fundamentally been a consequence of a better performance by business saving than by GDP. Although the gross value added of companies sank during the crisis, there are other factors, which we shall go on to describe, that account for the growth of corporate saving in the last seven years.

First, the crisis brought with it an adjustment in the wage bill of firms, above all due to downsizing. As a result, **resources associated with the remuneration of employees have experienced a notable contraction over the period under review**.

28: For further details, see Box 1 of the Consumption Outlook, First Half 2013: "Trends in the household savings rate in Spain: the role of fundamentals", available at: https://www.bbvaresearch.com/wp-content/uploads/migrados/1306_Situacionconsumo_tcm346-391486.pdf

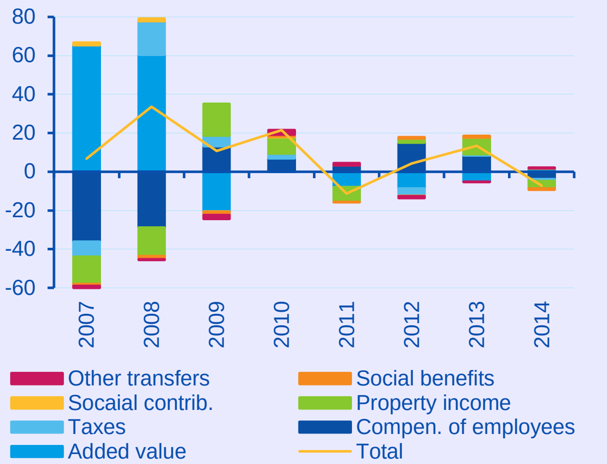
Second, the **property income has boosted business saving**. According to the information held at the Central Balance Sheet Records Office, since the beginning of the crisis firms have constraint dividend pay-out (thus limiting dividend payments), which has fomented an increase in the GDI of companies. Likewise, after the upturn noted in the interest burden on companies in 2011 and 2012, the end of financial stress and the fall in interest rates have led to a further round of reduced spending of property income, which has contribute positively to savings growth.

Third, the decline in business activity during the crisis entailed a reduction in social benefits provided by companies and, although this amounts to a relatively small item, the adjustment in it also contributed to savings growth.

Finally, the lowering of corporate tax in 2007 and 2008, as well as the resurgence of tax incentives to business activity, had positive effect on corporate saving. The impact of these measures gradually wore off over time, and in 2012 taxes drained off again a small part of corporate savings.

From 2014, the savings rate began to reduce. The signs of economic recovery at the start of the year and the feeling of certainty that the economy was gaining traction lifted business confidence. This meant that in 2014 companies increased hiring, which prompted a rise in the compensations of employees. Moreover, a reduction in property income became noticeable, which could be attributed to the decision to return to a policy of distributing dividends to shareholders.

Figure B.1.7
Companies: contributions to YoY GDI growth by components (pp)



Source: BBVA Research based on INE

The public sector contributed negatively to the maintenance of savings in the economy during the crisis

The collapse in tax revenues going into the crisis dragged public sector gross disposable income down with it and turned to negative its savings rate. Since then, despite the tax rises brought in since 2010, the weakness of economic activity held government revenues down at a low, although relatively stable. Together with this, public sector consumption did not witness any major variations until 2012, when the austerity measures imposed speeded up the fiscal adjustment. Finally, **in 2014, although still negative, public sector saving showed a mild recovery,** resulting mainly from a small increase in the gross available disposable of government bodies.

The dynamics of property income determines the progress of the savings rate at financial institutions

Within the **private sector, the savings rate of financial institutions has shown itself to be more stable** than that of households and companies. The savings rate of the financial institutions in 2014 was actually only 0.7pp of GDP above that for 2007.

Over the crisis period, the GDI of financial institutions, and by extension their saving levels, has been determined by the developments in activity in the opening part of recession and trends in property income in recent years.

Conclusions

The Spanish economy closed 2014 with net lending capacity of 1.0% of GDP, and although this represented a reduction of more than one point with respect to 2013**, it means an improvement in the economy's external balance of 10.3pp of GDP since 2007**. This recovery has arisen mainly due to a fall in the investment rate, given that the savings rate has remained far more stable.

In Europe, only Greece, Ireland and Portugal has exhibited a similar adjustment of funding requirements over 2007-14. In the other economies the variation in the net lending or borrowing position has in particular been a consequence of the behaviour exhibited by the savings rate, as the investment rate has generally held relatively stable.

Looking at the institutional agents concerned, in Spain the **increase in private saving seen since 2007 largely offset the reduction in public saving.** The downturn in economic activity dragged public sector revenues, which was the primary cause of the decrease in the savings of the public administration. On the other hand, the increase in household savings arose from a contraction in consumption larger than the drop in gross disposable income. Finally, the economic downturn forced companies to implement adjustments in production, which result on to a cut in the compensation of employees and led to strategic decisions such as to reduce pay-outs of profits to shareholders. All of this led to a hitherto unseen rise in the corporate savings rate.

In 2014, with economic recovery underway, the Spanish economy's savings rate fell again, which may be explained by factors such as the increase in household consumption, the recovery of output, access to credit or the return to a profit distribution policy.

Looking ahead, the Spanish economy faces the challenge of avoiding a further deterioration of the external balance such as occurred during the last growth phase. In this regard, **the process will be virtuous if, in an environment of deleveraging such as we are witnessing, the recovery in the financing requirement is brought about by restoring saving rather than lowering investment**. Here the reconsolidation of public savings will be key in the next few years.

Box 2. Competitiveness of the Spanish economy and services sector regulation

This box aims to examine the recent developments in the price competitiveness of the Spanish economy and deepen on the elements which aspire for enhancing it. The gains in price-competitiveness in Spain since 2009 has been underpinned by the combination of three elements: wage restraint, productivity growth and moderation of the inflationary bias of profit margins. Signs are nonetheless appearing that productivity growth is running out of steam at a time when the importance of this variable if further gains are to be made in the future is unquestionable. Against this backdrop, we show how removing barriers to competition within the services sector could provide valuable room for manoeuvre for companies to becoming more competitive as a result of a decrease in the price of the intermediate goods and services which come into their production chain.

Recent stylised facts on price competitiveness in Spain

In the six years since the slump in world trade in 2009, Spain's real exports have grown by an enviable 29%, thanks to the increase in goods trade (36%) and, to a lesser extent, services (16%). Over the whole of this time the domestic productive fabric has undergone significant changes, ranging from a high number of firms going out of business to a refocus of surviving companies' towards the international market. As a result, the weight of exports in GDP has risen by seven points (hitting 31% in 2014) and this share is expected to continue to climb in the next few years. The medium-term growth of Spanish exports is likely to require good progress from three factors: world growth, price competitiveness, and business decisions linked to expansion strategy (in terms of scale and geographical presence) and production (in terms of product variety and quality). What has been the recent development of price competitiveness in Spain? What mix of elements will be essential to enhancing this in the medium term?

Table B.2.1 offers the first standard measure of price competitiveness, captured in the inflation differential between Spain and the EMU countries. The evidence suggests that the negative inflation differential with the EMU since 2009 has been as a result of the helpful performance in the wage-productivity gap and the receding inflationary bias which has typically been a feature of profit margins in Spain[31]. Underlying the first factor are the high gains in productivity during the crisis, which have been based on job destruction. Moreover, even though labour reform has permitted greater elasticity of wages to employment[32], its effects still remain to be seen in an environment of recovery. 2014 is likely to have closed with a negative contribution of margins (-1.0pp) to inflation for the second time since 1999. On the other hand, a less reassuring combination can be discerned in the performance of the wage-productivity gap, where wage restraint has probably been accompanied by a considerable slowdown in apparent productivity. Although the Spanish economy made headway in productivity compared to the three major European economies over the crisis, the gains in the medium term are likely to have supported by on productivity growth - the underlying factors of which have been examined by BBVA Research (2015)[33] - and on the removal of the stubbornly inflationary bias of profit margins via, for example, improvements in the competitive functioning of product markets.

31: Readers interested in the reasons underlying the course of the inflation differential with the eurozone can consult Box 1 under the heading "The fall in Spanish inflation over the last five years" in the Spain Economic Outlook, first quarter 2014, available at: https://www.bbvaresearch.com/wp-content/uploads/migrados/1402_Situacion_Espana_tcm346-423173.pdf.
32: Readers interested in the effects of the Agreement on Employment and Collective Bargaining, as well as Labour Reform, on the dynamics of the labour market in Spain can consult Box 2, under the heading "Persistence of unemployment and wage dynamics in Spain" in the Spain Economic Outlook, second quarter 2013, available at: https://www.bbvaresearch.com/wp-content/uploads/migrados/1305_Situacionespana_tcm346-385826.pdf.
33: Readers interested in a study of the determinants of productivity at corporate level can consult Box 3 under the heading "Human capital and productivity: an analysis of the manufacturing company in Spain since the 90s" in the Spain Outlook, first quarter 2015, available at: https://www.bbvaresearch.com/wp-content/uploads/2015/02/Situacion-Espana_1T15-web_vf.pdf.

Table R.2.1
Breakdown of inflation using the GDP deflator: sample of EMU-12 countries, 2009-14

	Total	Wages	Productivity	Mark-up	Taxes
EMU-12	1.05	0.89	0.16	0.11	0.21
Deviation to the EMU-12 average					
Germany	0.46	0.15	-0.29	0.06	-0.04
Spain	-0.93	-0.25	0.91	0.10	0.14
France	-0.23	0.20	0.19	-0.20	-0.04
Italy	0.17	-0.30	-0.27	0.06	0.14

Notes:
1. Contributions to change. Annual average growth rates (%).
2. Data available to 2013 and leading 2014 figures.
3. The contribution of profit margins is calculated as residual.
4. The total is the sum of contributions from wages, margins and taxes, less the productivity contribution.
5. Productivity is measured as output per employee.
Source: BBVA Research based on AMECO

If the analysis is confined to the international market, **the gains in price competitiveness that are reflected in the Real Effective Exchange Rate (REER) of total exports during the crisis are less striking** (Table B.2.2). The cumulative real depreciation in 2009-14 reached 3.8%, which is a long way off the figures of 6.2% for France or 5.7% for Germany. These figures conceal two additional stylised facts.

First, secular trend is not observable in the fall of the relative price of exports in Spain (Figure B.2.2). Unlike the figures for Germany or France (Figure B.2.3), as a whole, Spanish export companies have not been forced to implement strategy of reducing relative prices to achieve high growth figures[34]. Only at the end of the sample a slight fall can be seen in the relative price of exports together with the nominal depreciation in the euro, which are both positive factors in making progress in terms of competitiveness. At this juncture it should be pointed out that the price of total Spanish industrial exports rose by 8.3% YoY between 2009 and 2014, while only the export prices of non-durable consumer goods came down (Figure B.2.4). Therefore the gains in competitiveness obtained by reducing relative prices have not implied an across-the-board drop in the nominal revenue per unit exported for companies, although a less heartening performance from 2013 is in fact discernible[35].

Second, the trends in the nominal effective exchange rate (NEER) have contributed somewhat less to the real depreciation in the economy (-1.3%) compared to that of its key European competitors. The attainment of gains in competitiveness through this channel requires diversifying exports, more than Spain's competitors, to destinations where exchange rate movements are favourable. Although this is a slow process, the diversification of Spain's exports by destination continues on course[36].

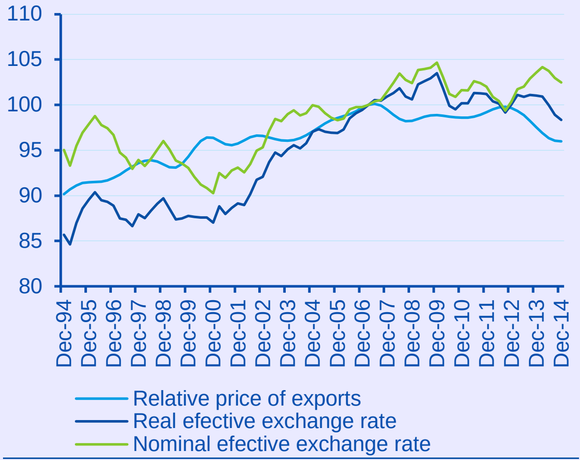
34: An argument consistent with the results obtained in estimating export equations (see IMF, 2013).
35: Nonetheless, this situation would not be incompatible with a rise in total nominal revenues from the increase in exported units.
36: Readers interested in the geographical and productive diversification of Spanish exports can consult Box 3 under the heading "The diversification of exports as an explanatory factor in regional growth" in the Spain Outlook, first quarter 2014, available at: https://www.bbvaresearch.com/wp-content/uploads/migrados/1402_Situacion_Espana_tcm346-423173.pdf.

Table R.2.2
Breakdown of the REER using the goods and services export deflator, 1Q09-4Q14 (% var.)

	Real efective exchange rate	Nominal efective exchange rate	Relative price
Germany	-5.7	-2.1	-3.7
Spain	-3.8	-1.3	-2.5
France	-6.2	-1.7	-4.6
Italy	-2.5	-1.5	-1.0

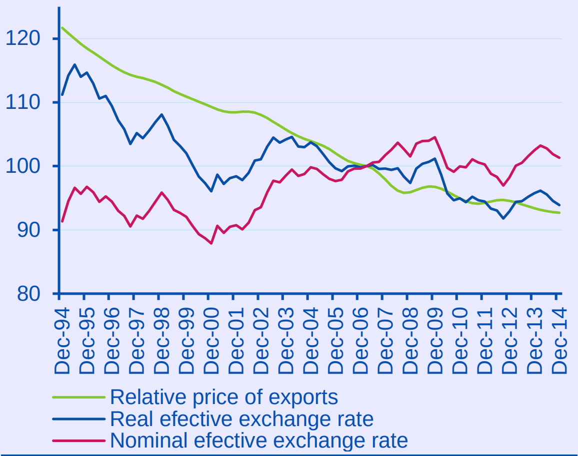
Note:
1: REER against 37 industrialised countries.
Source: BBVA Research based on the European Commission

Figure R.2.1
Spain: REER for goods and services exports, 1994-2014 (1Q07=100)



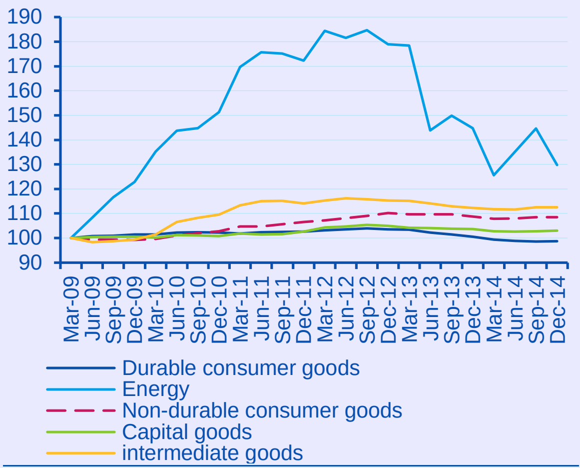
Source: BBVA Research based on the European Commission

Figure R.2.2
Germany: REER of goods and services exports, 1994-2014 (1Q07=100)



Source: BBVA Research based on the European Commission

Figure R.2.3
Spain: Export price indexes (1Q09=100)



Source: BBVA Research based on INE

Even though since entry into the EMU the Spanish economy has managed to hold up its export share in spite of the increase in the relative price of exports[37], in the medium term **the deepening process of globalisation through the expansion of global value chains means that perseverance in sharpening competitiveness via relative export prices is likely to be called for.** Three elements required to achieve this goal are well-documented in economic literature: i) high productivity growth; ii) wage growth in line with the latter, and iii) restraint in corporate profit margins. Another much less well-known element is confined to the role of regulation in the markets of services which act as inputs in the production processes of the various sectors of the economy (see, for example, Barone & Cingano, 2011, Bourlès et al., 2013). The

37: Seee Correa-López & Doménech (2012)

increasing variety of intermediate consumption which is part of value-added creation has magnified the importance of the services sector in the productive structure. In this context, the existence of a regulatory framework which stifles competitiveness in the services market could have adverse consequences for the intermediate input prices paid by companies, which would mean relatively higher costs along all the stages in the production chain. Removing these restrictions on competition could provide an additional boost to the competitiveness of companies in both the domestic and international markets.

Services regulation and business competitiveness

Econometric model

To examine the existence of a link between regulation and price for intermediate consumption we estimate a panel data model which is applied to the Spanish economy. To be specific, based on the records from the ESEE (Survey of Business Strategies) by the SEPI Foundation, an annual sample is analysed of 3,540 companies from 10 manufacturing industries in 1991-2007. The survey is noted internationally for the richness of the available data regarding to trends in different price indicators at company level, among these intermediate input prices. The variable which measures the impact of anti-competitive regulation in the services sector on each manufacturing industry (REG) combines information on the restrictions on competition in the energy, transport, communications and professional services markets, and on the dependence of each manufacturing industry on the inputs produced by each of these four services, as outlined in Correa-López & Doménech (2014).

The specification which relates both variables of interest takes the following form:

$$g_{it}^{PCI} = \alpha + \beta \Delta REG_{jt} + \gamma g_{jt}^{CPI\_US} + \delta g_{jt}^{X\_WORLD} + \varphi recesion_{it} + \eta_j + \lambda_t + \mu_i + \varepsilon_{it}, \quad (1)$$

where the subscripts *i*, *t* and *j* respectively denote the firm, the year and the manufacturing industry in the sample. In expression (1), the rate of variation in the price of intermediate inputs is directly explained by the change in the regulatory framework for the services sector. Furthermore, we control for another two variables at industry level which could have a bearing on the price of the intermediate inputs paid by firms: variation in the price of intermediate inputs recorded in the manufacturing industries in the United States and real growth of world exports. The first variable would capture the presence of exogenous technological factors and the second those associated with demand pressures. Expression (1) also includes a dummy variable which seeks to approximate the firm's self-reported position in the cycle (recession versus stable/expansion), a dummy variable λ_t, which controls for the economic cycle effect common to all firms, and another which is industry-indicative. Similarly the fixed effect μ_i describes the unobserved heterogeneity at firm level and ε_{it} is the idiosyncratic component. Estimation of the specification (1) is carried out using alternative estimators, to be precise, fixed and random effects, where the latter makes it possible to use variability of time and between firms in the unbalanced panel. Table B.2.A.1 in the appendix shows the results of the estimation.

Results

The results which appear in Table B.2.A.1 indicate the existence of a positive and significant relation between the variation in the price of intermediate inputs and the change in services sector regulation. Given that Spain made a major effort to deregulate in the period reviewed (see Correa-López & Doménech, 2014), **the results suggest that the removal of barriers to competition in services reduced inflationary pressure on the intermediate input prices paid by manufacturing firms.** As for the scale of the effect, we find that increasing efforts to deregulate by one-tenth diminishes the variation in the price of intermediate inputs by between 1.7pp and 2.2pp. This price mechanism would underlie the positive impact of services deregulation on the real exports of manufacturing firms (Correa-López & Doménech, 2014). On the other hand, both the variation in the price of intermediate inputs in US manufacturing and the real growth of world exports are positively related to the variation in the price of the intermediate inputs of Spanish firms, which confirms the existence of technological and demand trends as determinants of the price of intermediate inputs. Finally, a firm in a recessionary phase exerts downward pressure on the prices of its intermediate inputs[38].

Conclusion

The gains in price competitiveness which the Spanish economy has built up since 2009 have been based on three elements: wage restraint, productivity growth and reduced inflationary bias of profit margins. In the medium term there is no doubt that the most important variable for competitiveness is productivity, and the latest data offers evidence that growth in this during the crisis could have had a high cyclical component. The need to continue to make productivity gains through prices is evident in a global environment which is delving deeper into the mechanisms and opportunities available via globalisation. Added to the productivity effort which the Spanish economy needs to make is that of removing barriers to competition in the services sector, especially in those segments where they are still substantial (for example professional services). **Ensuring market competition in such services could provide valuable room for manoeuvre for firms in order to becoming more competitive in both the domestic and international markets, which resulting from a fall in the prices of intermediate goods and services participating in their production chain.**

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38: The results of the estimation are robust to the inclusion of other determinants, such as variation in the price of energy imports and the alternative regulatory measures constructed in Correa-López & Doménech (2014).

Annex

Table R.2.A1

Regulation and prices of intermediate consumption: sample of firms of manufacture sector, 1991-2007

Dependent variable: Price variation of intermediate consumption

	Fixed effects estimate		**Estimador efectos aleatorios**	
Regresors:	**Coef.**	**Std. Error**	**Coef.**	**Std. Error**
ΔREG	17.260 ***	[4.731]	22.476 ***	[4.011]
Price variation US	0.281 ***	[0.041]	0.355 ***	[0.039]
World exports	0.007 **	[0.003]	0.009 ***	[0.002]
Recesion	-0.351 **	[0.141]	-0.221 *	[0.120]

Notes: 1: All specifications include a constant, binary time variables and industry-year interaction.
2: (***) denotes statistical significance to 1%, (**) to 5% and (*) to 10%.
3: Robust standard errors.
4: A binary variable with self-declared cyclical position (recession or not) is included
Source: BBVA Research based on ESEE Foundation SEPI

Box 3. The second chance mechanism

The Spanish government recently passed legislative changes to legal regulation of personal insolvency in Spain, via a model that is more akin to that used in most European countries. This reform is intended to help deleverage families, improve resource allocation and boost entrepreneurial activity. Previously, the general rule had laid down that individuals in debt were liable for their entire assets and earnings, both present and future, which impeded Spanish obligors to invoke a second chance. Consequently, this legal deprivation served to encourage informal economic activity. The introduction of Royal Decree-Law (RDL) 1/2015 of 27 February, on the Mechanism for a Second Chance, Reducing Financial Burden and other Social Measures, represents a substantive change as regards this matter. The RDL: i) establishes a second chance mechanism in bankruptcy procedure for individuals; ii) widens the scope defining the collective that is protected under the Code of Good Practice, meaning that clauses which set a minimum on their mortgage instalments will not apply to them, and iii) extends the moratorium on evictions, which was due to expire in May 2015, for a further two years until 2017.

As regards a second chance, a framework for personal bankruptcy is being developed that is modelled on experiences in other countries (it is essentially an adaptation of the German and Italian regulations), after this was requested by international organisations. Its primary objective is to enable individuals to overcome financial hardship (such as a failed business venture) without having to be indefinitely encumbered by a debt they would be unlikely to be able to pay off in the future. This would therefore allow someone in debt who has lost everything after liquidating their entire estate to be released from most of their debts still outstanding.

Specifically, the system of personal bankruptcy proceedings developed in the RDL considers two phases:

The first of these is known as an extra-judicial payment settlement, and is where obligors have to try to reach a settlement with their creditors before the case is brought to judge. The concept of the extra-judicial payment settlement had earlier been brought in under law 14/2013 on measures to support entrepreneurs, but this had been solely reserved for entrepreneurs and the self-employed. The most notable changes under the present RDL are:

1. Broader and more flexible extra-judicial payment settlements, which include people ranging from those in business and the self-employed to non-business-owning individuals. The legal effects of such a settlement can extend to dissenting creditors holding guarantees *in rem* (i.e. those who are not in agreement with the majority, whenever the pre-defined majorities are satisfied)
2. Enhancement and easing of the legal concept of the mediator, who is to be appointed by a notary or registrar. For non-business-owning individuals the mediator can be a notary, while for legal entities this can be the Official Chambers of Commerce
3. The establishment of specially simplified procedural rules for individuals (shorter time-frames for appointing persons, creditors' meetings and rulings — it there be no settlement within two months, bankruptcy proceedings must be instigated within 10 days) and a substantial lowering of notarial and registry fee scales
4. The time during which an extra-judicial settlement cannot be requested again is extended from three to five years.

The second phase, which involves the actual bankruptcy proceedings, makes it possible to even reach a situation whereby there is complete exoneration of the sum owed if two conditions are fundamentally satisfied: i) the obligor acts in good faith, and ii) their assets have previously been liquidated. Specifically, a new system of discharge from **debts is provided for**[39] (provisional for a five-year period), which will apply after the conclusion of bankruptcy proceedings and is also subject to the following conditions:

- **Submitting and committing to a payment plan for non-exempt debt** (against the obligor's estate and for privileged creditors, i.e. debts with public sector creditors, wages, court costs) which the judge shall approve and may amend if he deems this appropriate
- Not having benefited from a prior debt relief in the previous 10 years
- Not having turned down a suitable job offer in the previous four years (prior to the declaration of provisional exoneration)
- Accepting that **the exoneration of the debt be available for inspection in the Public Bankruptcy Records for a period of five years.**

During the provisional phase the decision on exoneration may be revoked at the request of the creditors where evidence is provided that the obligor has concealed earnings or assets, or that said debtor has achieved a substantial improvement in circumstances or failed to fulfil the payments plan. **After five years have elapsed the judge shall declare exoneration to be definitive** if after such time the obligor has satisfied non-pardoned debts or has made an appreciable effort to defray them.

Considering the importance of the matters raised in this RDL, it will be tabled as a bill in the Spanish parliament.

Besides the RDL, the government has proposed a **change in the court jurisdiction for individuals bankruptcy proceedings for those not owning businesses**, which shall fall to the courts of First Instance. This thus removes the situation of a concentration of all bankruptcy-related matters within the Commercial Courts, as has occurred up to now.

With respect to the **new aspects brought into the Code of Good Practice** for mortgage debtors:

- The number of beneficiaries is being increased: the limit for the annual family income is being raised from EUR19,170.39 to EUR22,365.42 and debtors over 60 years of age are being included among those considered to be in vulnerable circumstances. According to own estimates based on the Survey of Households finances, this would mean widening this group from 700,000 to 975,000 households. The rise is not higher because a lower proportion of the over-60s have mortgages[40].
- Eligible houses are being increased: the maximum purchase price will be allowed to be 20% above the index published by the Ministry of Public Works, up to a ceiling of EUR300,000 (EUR250,000 for lieu of

37: Besides maintaining the current system whereby exoneration has been conditional upon full payment of sums owed to preferred creditors and 25% of those owed to ordinary creditors
38: According to the 2011 financial survey of families, the mean income of the 20th percentile (the 20% with the least income) is EUR8,000 a year, while that of the 20th to 40th percentile is EUR16,000, and that of the 40th to the 60th percentile is EUR25,000, so we therefore assume that up to the 40th percentile families are below the limit of EUR21,000.
• Assuming 13 million families in Spain (according to the financial survey of families), this would mean some 5.2 million families with an income of under 21,000.
• Of the 20th percentile, 6.2% have a mortgage on buying their home. From the 20th to the 40th this is 22.8%. This gives us 754,000 families with a mortgage and income of less than EUR21,000.
• Additionally, those families with a head of family in the 55-64 year-old range amount to 17.5% (we use half of families), in the 65-74 range 14.7%, and those over 75 come to 14.2%. Of these, some 11%, 3.9% and 1.3% respectively have mortgages, which adds a further 224,000 families, although a portion of them could have been already included on account of their incomes.
• At most, the Code should affect 978,000 families (754,000 via income and 224,000 by reason of age).

payment involving surrender of the property), which was formerly EUR250,000.

- The benefits are being extended: minimum instalment clauses shall not apply to them.

Finally, **the suspension period for evictions is being extended to 2017** for the permanent homes of especially vulnerable categories of people, while the possibility has been established of more people becoming eligible for suspension of this kind on terms similar to those provided for in the Code of Good Practice.

Assessment

The introduction of **a personal insolvency framework is a welcome move**. Suitable regulation will encourage entrepreneurial initiative and soften the negative impact of a fall in income for ordinary individuals. Extending the extra-judicial payment settlement to individuals and giving a second chance to those in debt who have acted in good faith, yet find themselves overstretched financially, is positive, as is the fact that they will be able to ask for loans from a position of creditworthiness in the future.

It is important to **set aside funds** so that the legislation works properly, given that the number of bankruptcy proceedings is likely to rise. Although it is envisaged that straightforward cases involving individuals will go through the Civil Courts of First Instance, while those of corporates will be dealt with by the Commercial Courts, it is important not to neglect this aspect.

It would be desirable for there to be **screening by income or wealth level in place** for access to these procedures (only the filter of a limit of EUR5mn in liabilities is being maintained for access to individual bankruptcy proceedings, which already existed), to weed out opportunistic behaviour patterns or acts of bad faith. Were this not the case, high net-worth individuals could wriggle out of their debt obligations at little cost.

It would also be preferable for the law to include mechanisms to **disincentive the informal economy**. For example, if the payment plan affects a percentage of the debtor's income (and not a lump sum), this encourages people to work unofficially so as to minimise their payments.

It could be said that the reform **brings in *datio in solutum*** as an option, though only after seeking an extra-judicial settlement, liquidating the debtor's entire estate, and following a five-year plan for payments to certain creditors.

Setting up some kind of mechanism to monitor and evaluate second chance legislation would be key to being able to find out what works well or badly and to correct the latter.

4 2015 makes way for a more expansive fiscal policy

The 2014 deficit correction was due to both the recovery in tax revenues and expenditure restraint, above all by central government

The Spanish public administration closed the year in 2014 with a deficit of 5.7% of GDP[41] (0.2pp higher than expected), which means the figure strayed slightly from the target of a shortfall of 5.5% of GDP which the government had set itself, although it is below the deficit level of 5.8% agreed with the European Commission in order to comply with the Excessive Deficit Procedure (EDP). Thus the Spanish government deficit is again the highest among the EMU countries after excluding aid to financial sector. Even so, this figure represents an improvement of 0.6pp of GDP with respect to the 2013 close, and **it means a cumulative adjustment of over 3.5pp of GDP since 2011, which is the fifth largest in Europe** (see Figure 4.1)

By public administrations, in 2014 the central government (where the biggest adjustment took place) brought down its deficit by around 0.7pp to 3.5% of GDP, in line with its stability target. Behind it, both the local corporations and the Social Security administrative offices returned the same balances as for the previous year, with the local corporations again posting a surplus of over 0.5% of GDP, ahead of their budget equilibrium target. While, the Social Security recorded a deficit of 1.1% of GDP, which was 0.1pp above its target. Finally, the regions were not only again off-target relative to their stability goal (-1.0%), but increased their deficit to 1.7% of GDP, a little over 0.1pp above the level observed in 2013[42].

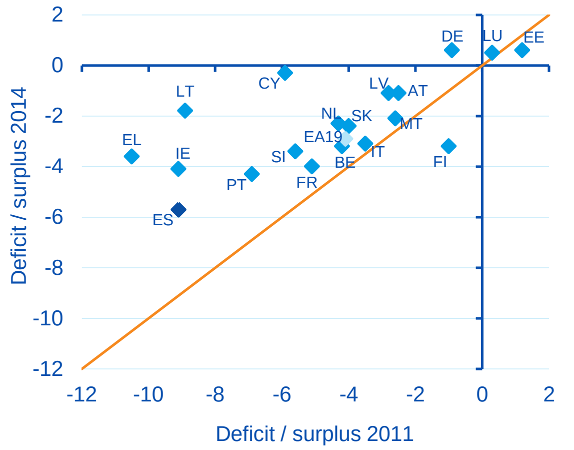
In analysing the deficit adjustment observed, BBVA Research estimates reveal that the recovery in activity, combined with lower borrowing costs, benefited a narrowing of the Spanish government deficit of approximately 0.6 points of GDP in 2014. Thus implies that the **observed deficit reduction could be almost exclusively attributable to the cyclical improvement in activity and could mark an end to the restrictive tone of fiscal policy initiated in 2010**.

Both the recuperation of revenue flows and a certain restraint in public expenditure are likely to have been equally responsible for the correction to the Spanish public accounts in 2014. Government revenues gained momentum and picked up to around 37.8% of GDP, which is 0.3pp above the figure for 2013 and at levels on a par with those seen in the mid-90s. On the other hand, public expenditure dropped in 2014 by approximately 0.3pp against the previous year to 43.5% of GDP. This comes in contrast to the average situation among the EMU countries, where the deficit adjustment tended to come from reining in public spending, although it is also true that there is a high degree of disparity among the various states.

If we look at how the adjustment breaks down into sub-sectors, Figure 4.2 shows that **the fall-off in spending seen over 2014 was focussed on central government and, to a lesser extent, Social Security, basically resulting from the drop in welfare benefits**. Meanwhile, among the regional administration, following the adjustment in previous years, public expenditure remained virtually stable in 2014. Lastly, **the recovery seen in tax revenues has been almost entirely concentrated within central government**.

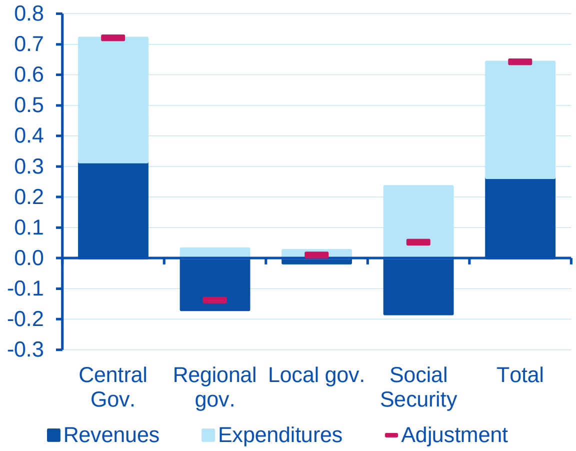
41: The deficit examined in this section is always excluding subsidies to the financial sector.
42: See Box 4, “Regional finances in 2014 and the impact of the financing system” in this Outlook for an in-depth analysis of the 2014 close for the regions.

Figure 4.1
EMU: net lending / net borrowing*, (% of GDP)



(*): Excluding aid to the financial sector
Source: BBVA Research based on Eurostat

Figure 4.2
Public administrations: breakdown of the fiscal correction in 2014 (pp of GDP)

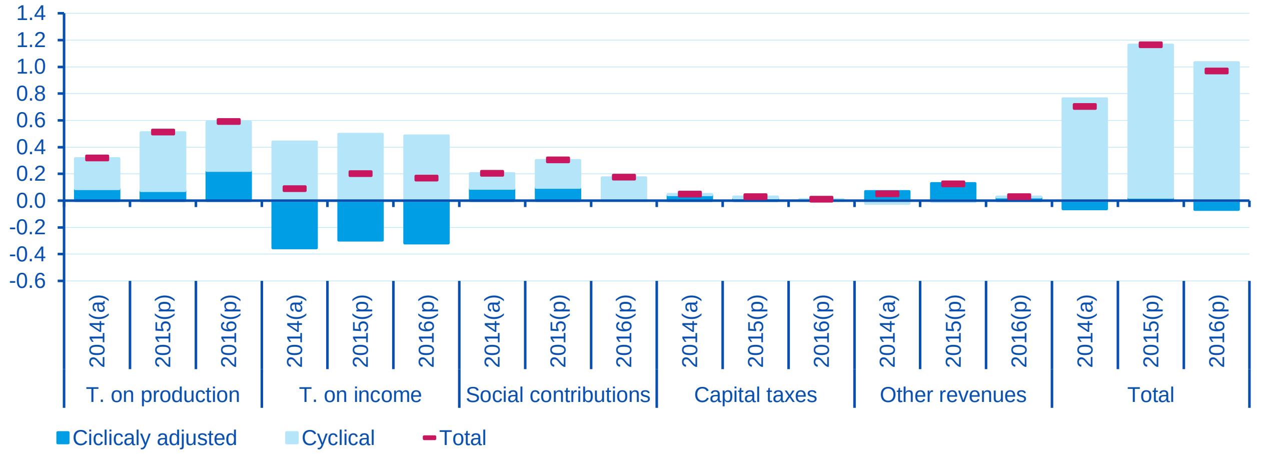


Note: (+) Revenue rises, spending drops, the deficit shrinks; (-) revenues fall, spending rises, the deficit grows
Source: BBVA Research based on MINHAP

The breakdown of revenues and expenditure into cyclical factors (associated with cyclical variations in activity) and structural (arising from discretionary fiscal policy decisions or permanent impairment to any of their components) means that we can set a value on the nature of the fiscal adjustment carried out in 2014. Therefore, according to BBVA Research estimates, the **economic cycle probably boosted tax revenues collected in 2014** by around 0.8pp of potential GDP, mainly via personal income tax and taxation on production (see Figure 4.3). This rise in tax funds is likely to have arisen largely thanks to the **improvement of the taxable base, which has been fundamentally cyclical** in the case of gross disposable income. On the other hand, one-third of the increase in the taxable base for VAT (around 0.6pp of potential GDP) is likely to have been due to the cyclical recovery in final consumption expenditure, whereas the rest of the increase (1.3pp) could be not so much traceable to a structural recovery in consumption as to spending in anticipation of the tax cuts in effect since January 2015.

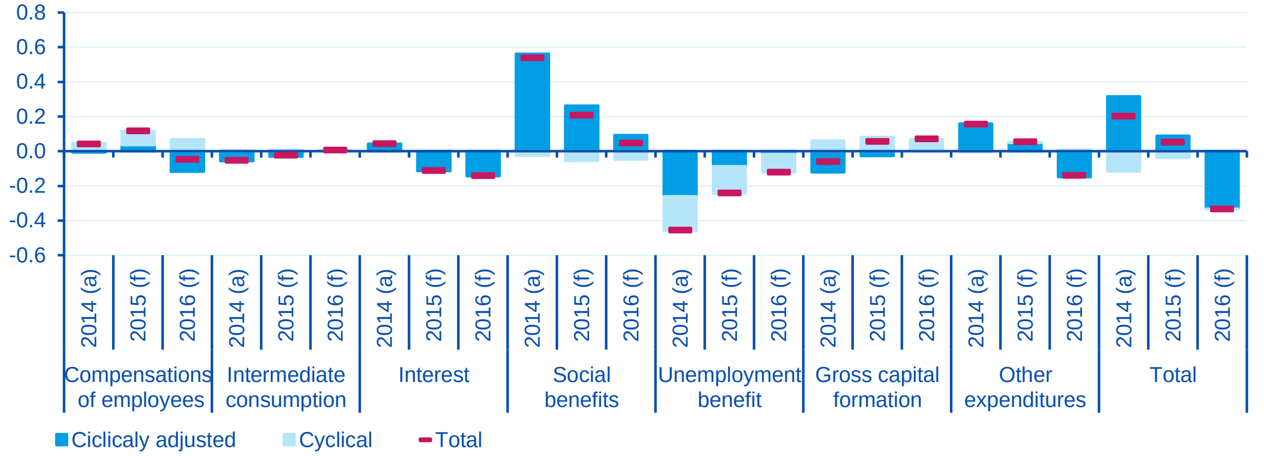
On the other hand, in terms of potential GDP, **the economic cycle should have worked in favour of the reduction in expenditure in 2014, essentially via unemployment benefits**. On the other hand, the unforeseen growth in welfare benefits, recorded at the end of the year, is probably behind the discretionary increase in public expenditure of over 0.3pp of potential GDP. On top of this, **a certain adjustment in the discretionary component is still observable** in items such as compensation of employees, intermediate consumption and gross capital formation (see Figure 4.4).

Figure 4.3
The regions: variation in non-financial revenues (pp of potential GDP)



Note: (+) revenues rise and the deficit shrinks; (-) revenues drops and the deficit grows
(a): advance; (f): forecast
Source: BBVA Research based on MINHAP and INE

Figure 4.4
The regions: variation in non-financial expenditure (pp of potential GDP)



Note: (+) expenditure rises and the deficit grows; (-) expenditure drops and the deficit shrinks
(a): advanced; (f): forecast
Source: BBVA Research based on MINHAP and INE

The economic recovery and the tax cuts will set the tone for fiscal policy in the coming years

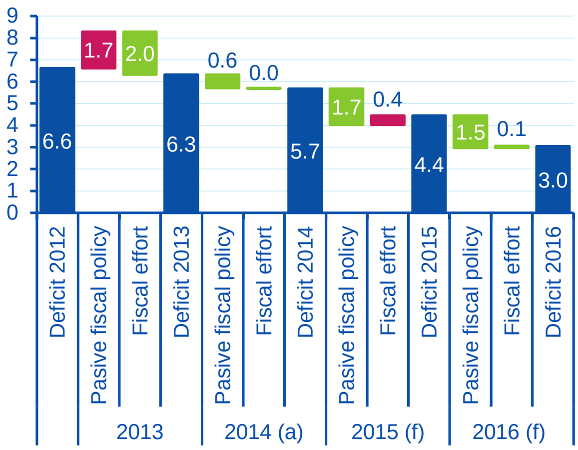
Fiscal policy in 2015 and 2016 will be shaped by the tax cuts in effect since January 2015, which will represent a boost for growth as the average effective rate applicable to the net taxable base for income tax is expected to come down substantially[43]. Within this context, BBVA Research's forecasts suggest that the **tax cuts will lead to a fall in structural revenues from income tax which, in the short term, will be offset by the cyclical recovery in taxable bases**. On the other hand, the economic cycle will continue to drive forward the revenues collected from both taxes on production and social security contributions. Thus public revenues for 2015 will rise to 38.2% of GDP (0.4pp above the figure at the close of 2014) and to 38.5% in 2016.

43: See Box 2. "The impact of the personal income tax reform" in Spain Economic Outlook, fourth quarter 2014.

On the expenditure side, **this is expected to continue to be corrected over the next two years**, partly due to the deficit reduction policies working through that were implemented in previous years, but above all because of the expected improvement in the labour market, which will reduce the amount paid out in unemployment benefit, and the fall in financial costs. As a result, public expenditure will stand at around 41.4% of GDP by the end of 2016, a level similar to those at the beginning of the crisis.

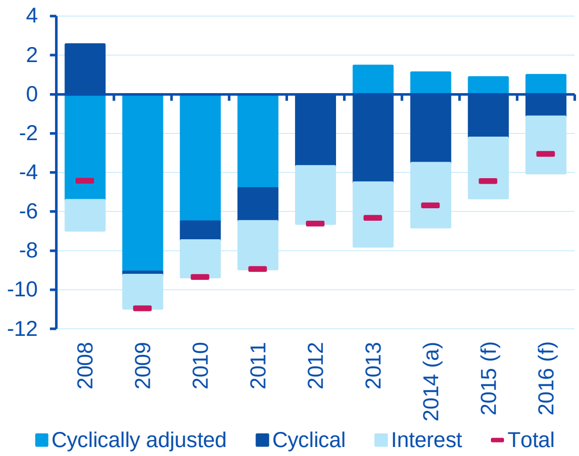
Thus, for **2015 the economic cycle is expected to continue to rectify the fiscal impairment, both on account of the impact of automatic stabilisers and that of reduced pressure from interest charges and welfare benefits**. In conjunction with this, the effects of the expansive policies that have been implemented will bring the 2015 deficit to around 4.4% of GDP, which is above the target level agreed for this year of 4.2%. As for 2016, the economic cycle should press ahead with correcting the deterioration in the public accounts so that, in a scenario without any changes in fiscal policy, the deficit for the year ought to be pared down by 1.5pp to 3.0% of GDP (see Figure 4.5).

Figure 4.5
Public administrations: breakdown of the fiscal correction (pp of GDP)



(a): advanced; (f): forecast
Source: BBVA Research based on MINHAP and INE

Figure 4.6
Public administrations: net lending / net borrowing (% of GDP)



(a): advanced; (f): forecast
Source: BBVA Research based on MINHAP and INE

If this scenario materialises, the **cycle-adjusted public sector balance should stand at around -2.0% at the end of 2016.** Excluding aid to financial sector, a primary structural surplus of approximately 1% would have been recorded since 2013 (see Figure 4.6), which represents an adjustment of over 10pp since 2009. This implies that if the consolidation measures applied were permanent, in the coming years the Spanish public accounts would be producing primary surpluses of the order of 1.0% of GDP. **In spite of this, there are major imbalances which persist within the Spanish economy that still have not been corrected**, i.e. the high unemployment rate and soaring debt levels**, which call for a continuation of structural reforms** with direct effects on both the economy's growth capacity and the long-term sustainability of the public accounts. In this sense, and in line with the Eurogroup's recommendations, Spain should forge ahead with both employment reform and restructuring the tax system. By the same token, it should continue with policies to keep public expenditure under control, in such a way that this enhances the capacity to generate primary surpluses on a sufficient scale to cut public borrowing at the pace required to comply with the country's commitments under the European Fiscal Pact.

Table 4.1
Public administrations: net lending / net borrowing*

(% of GDP)	2013	2014 (a)	2015 (f)	2016 (f)
Compensations of employees	10.9	10.8	10.7	10.5
Intermediate consumption	5.3	5.2	5.1	5.0
Interests	3.3	3.3	3.1	2.9
Unemployment benefits	2.8	2.3	2.0	1.9
Social benefits	13.4	13.8	13.7	13.5
Gross capital formation	2.1	2.1	2.1	2.1
Other spending	5.9	6.0	5.9	5.7
Non-financial expenditure	**43.8**	**43.5**	**42.6**	**41.5**
Tax on production	11.0	11.2	11.5	11.9
Tax on income, wealth, atc.	10.0	10.0	10.0	10.0
Social contributions	12.2	12.3	12.3	12.3
Capital taxes	0.5	0.5	0.5	0.5
Other income	3.8	3.8	3.8	3.8
Non-financial revenues	**37.5**	**37.8**	**38.2**	**38.5**
Net lending / net borrowing	**-6.3**	**-5.7**	**-4.4**	**-3.0**
Stability target	-6.5	-5.5	-4.2	-2.8

(*) Excluding aid to financial sector
(a): advanced; (f): forecast.
Source: BBVA Research based on MINHAP and INE

Box 4: Regional finances in 2014 and the impact of the financing system

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Introduction

The regions again failed to meet the deficit target set for 2014, and even revealed a larger imbalance than had been observed in 2013. This deviation is in part attributable to certain features of regional financing system which have led to a drop in net transfers from the State in a year of recovery for public revenues. With an increase in transfers on a par with that seen in the case of State tax collection, the imbalance in the regional accounts would have been reduced by 0.2% of GDP. Yet such progress would have still been insufficient to meet the target set.

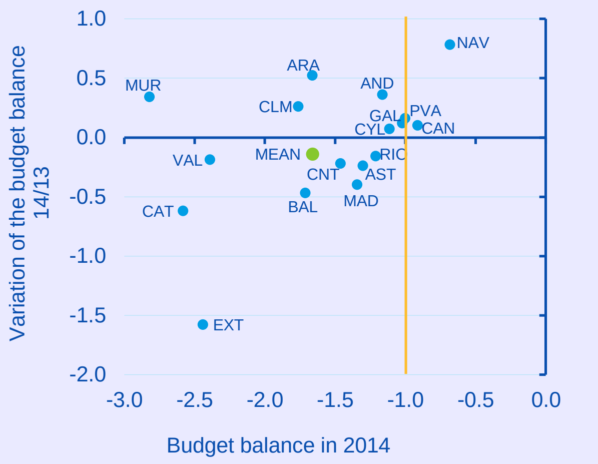
Analysis of the regional finances in 2014

The State Comptroller General's Office (IGAE, 2015a and b) has recently published the accounts of the regions for2014. Figure B.4.1 shows the budget balance for each region according to this source, together with the variation compared to the previous year. The vertical line shows the budget stability target set for 2014 of 1% of GDP for all the regions, and the dark blue circle represents all of the regional governments taken as a whole.

In 2014 the regions as a whole showed a budget deficit of 1.66pp of national GDP, which was 0.14pp more than in 2013. There is no doubt that there is a wide assortment of different situations in the various regions. As can see in Figure B.4.1, only four of them (Navarre, the Canary Islands, the Basque Country and Galicia) met the target, at least roughly. While, two others (Andalusia and Castille and Leon) remained close to their targets. Moreover, all of them managed to narrow their budget deficits compared to 2013. The other regions overshot their deficit targets by at least 0.2pp of GDP. Some of them improved their circumstances compared to the previous year, though others experienced notable impairment in their accounts, including Madrid, the Balearic Islands, Catalonia and Extremadura, their deficits widening by between 0.4pp and 1.6pp of GDP on the previous year.

Figure R.4.1

2014 budget balance by region vs. variation in the balance on 2013



Soruce: BBVA Research based on MINHAP

The slightly worse aggregate budget balance for the regions represents a disappointing step backwards in the progress made by the fiscal consolidation efforts begun in 2009. The situation is nevertheless quite a lot less worrying than it might seem at first sight. The regional deficit is not due to any return to uncontrolled spending, but rather to "technical" slippage in revenues which traces its origin to the design of the regional financing system. Specifically, the structure of payments on account based on revenue projections and settlement carried out with a two-year lag means that the system passes on the variations in tax revenues to the regions with some delays, especially at times of change in the cycle, both upward and downward. Thus regional revenues from transfers from other administrative bodies came down by 1.47% between 2013 and 2014, despite the observed increase in tax revenues collected by the central fovernment. This transfer item encompasses the bulk of central government payments in connection with the regional financing system, including the share of the regional governments in the common regime with regard to VAT and special taxes.

Table R.4.1

Net revenues and expenditure for the regions as a whole and components of their budget balance

	% GDP			Millions of euros		
	2013	2014	var	2013	2014	var %
Net revenues	12.79	12.5	-0.28	134,149	132,330	-1.36
Taxes	4.55	4.57	0.03	47,708	48,411	1.47
Transfers from other public administrations	7.87	7.68	-0.18	82,538	81,322	-1.47
Transfers to other public administrations	-1.16	-1.27	-0.11	-12,161	-13,485	10.89
Remaining revenues	1.53	1.52	-0.01	16,064	16,082	0.11
Net expenses (without transf. To other PA)	14.3	14.16	-0.15	150,081	149,859	-0.15
Budget balance	-1.52	-1.66	-0.14	-15,932	-17,529	10.02

Source: BBVA Research based on IGAE

It is imperative to understand the role played by revenues and expenditure in recent developments regarding the regional deficit and its impact on the regional financing system. For that purpose we reorganise the accounts for the regions as a whole as has been done in Table B.4.1 and move the item of “transfers to other public administrative bodies” from the expenditure section (where the IGAE puts it) over to the revenue section, where it appears as a reduction. This is logical because the item covers transfers from the regions to the central government under related to the regional financing system (such as Navarre’s contribution or the negative balances in the Adequacy Fund of certain regions within the common regime) which decrease the net revenues available for regions. Also included here are transfers to local institutions, which are to a large extent funded out of final transfers from central government, for which reason it is also appropriate to deduct them from regional revenues.

From that perspective, regional expenditure has continued to come down in 2014 (at a rate of 0.15% YoY, which translates into a fall of 0.15pp in its share of GDP) and the upturn in the deficit is entirely due to a 1.36% drop in net regional revenues, which made a contribution of 0.28pp to the observed increase in the deficit. Resulting from a 3.61% reduction in net transfers received from other public administrations (i.e. from the difference between transfers received from, and those paid to, other public administrations). Since this fall has come about at a time when tax revenues have begun to pick up, it seems clear that its origin should be explored more in terms of the inertia associated with payments on account than any genuine shortcomings associated with tax collection.

On the basis of Table B.4.1, gaining a reasonably accurate idea of the impact of this technical problem becomes straightforward. Thus, in Table B.4.2 a calculation is made of the deficit that would have been observed in 2014 under different scenarios regarding the growth rate of net transfers from other public administrations. The information offered by the IGAE (2015b) on trends in Central Government tax revenues is used as a reference to establish a plausible range of values for this parameter. According to this source, between 2013 and 2014 the tax revenues in of central government were increased by 1.88%.

Table R.4.2

Budget balance for the Regions as a whole in 2013 and 2014: observed situation and hypothetical scenarios for 2014, percentage points of GDP

Growth rate of net transfers from other public administrations	2013	2014	var.
-1,47% = realised data	-1.52	-1.66	-0.14
0%	-1.52	-1.42	0.1
1.88% = growth of fiscal revenues from central government	-1.52	-1.29	0.23

Source: BBVA Research based on IGAE

Table B.4.2 shows how the 2014 deficit would have changed depending on the growth rate of the net transfers which the regions receive from other public administrations (basically the central government). If this item had remained constant, the regional deficit would have come down by 0.1pp in 2014 instead of widening. The scenario which most closely resembles what might be considered "normal circumstances", in the sense of cutting out the problem of the sluggishness of payments on account, is likely to be where net transfers from the central government grow at the same pace as its tax revenues. Under this assumption the regional deficit would have been reduced from 1.52% of GDP in 2013 to 1.29% in 2014, with the corresponding increase in the central government's deficit, whereby its net revenues would have been curtailed by the higher transfers to the regions.

Conclusion

As has been illustrated in this box, after correcting for the technical distortions generated by the structure of the regional financing system, it can be observed that the regional governments have continued to make improvements in reducing their budget imbalances in 2014. Progress has nonetheless been modest and not enough to hit the deficit target set of 1% of GDP, for which reason there should be no room for complacency.

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5 Tables

Table 5.1

Macroeconomic Forecasts: Gross Domestic Product

(YoY rate)	2012	2013	2014	2015(f)	2016(f)
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 5.2

Macroeconomic Forecasts: 10-year government bond yield

(Annual average)	2012	2013	2014	2015(f)	2016(f)
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 5.3

Macroeconomic Forecasts: Exchange Rates

Average	2012	2013	2014	2015(f)	2016(f)
USD-EUR	0.78	0.75	0.75	0.96	0.94
EUR-USD	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 5.4

Macroeconomic Forecasts: Official Interest Rates

(End of period)	2012	2013	2014	2015(f)	2016(f)
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

Table 5.5

EMU: macroeconomic forecasts (YoY change, %, unless otherwise indicated)

	2012	2013	2014	2015(f)	2016(f)
Real GDP	**-0.8**	**-0.4**	**0.9**	**1.6**	**2.2**
Private consumption	-1.3	-0.6	1.0	1.7	1.6
Public consumption	-0.1	0.2	0.7	0.5	0.9
Gross fixd capital formation	-3.5	-2.4	1.0	1.5	4.4
Inventories (contribution to growth)	-0.7	-0.1	-0.1	0.0	0.0
Domestic demand (contribution to growth)	**-2.2**	**-0.8**	**0.8**	**1.3**	**2.0**
Exports	2.6	2.1	3.7	5.2	5.9
Imports	-1.0	1.3	3.8	4.9	6.1
Net exports (contribution to growth)	**1.4**	**0.4**	**0.1**	**0.3**	**0.2**
Prices					
CPI (% average)	2.5	1.4	0.4	0.1	1.3
CPI core (% average)	1.8	1.3	0.9	0.8	1.2
Labour market					
Employment	-0.5	-0.7	0.6	1.0	0.9
Unemployment rate (% of labour force)	11.3	12.0	11.6	11.0	10.3
Public sector					
Budget balance (% GDP)	-3.6	-2.9	-2.4	-2.1	-1.6
Debt (% GDP)	89.1	90.9	91.9	92.4	91.9
External sector					
Current account balance (% GDP)	1.5	2.2	2.3	3.2	3.2

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

Table 5.6
Spain: macroeconomic forecasts (YoY change, %, unless otherwise indicated)

	2012	2013	2014	2015(f)	2016(f)
Activity					
Real GDP	-2.1	-1.2	1.4	3.0	2.7
Private consumption	-2.9	-2.3	2.4	3.1	2.4
Public consumption	-3.7	-2.9	0.1	0.8	0.6
Gross fixed capital formation	-8.3	-3.7	4.2	5.3	6.0
Machinery and equipment	-9.1	5.3	12.2	7.8	6.7
Construction	-9.3	-9.2	-1.5	4.3	5.4
Housing	-9.0	-7.6	-1.8	4.5	9.0
Domestic demand (contribution to growth)	-4.3	-2.7	2.2	3.0	2.7
Exports	1.2	4.3	4.2	6.1	7.5
Imports	-6.3	-0.5	7.6	6.5	7.8
Net exports (contribution to growth)	2.2	1.4	-0.8	0.0	0.1
Nominal GDP	-1.9	-0.6	0.9	3.8	4.9
(EUR bn)	1055.2	1049.2	1058.5	1098.6	1152.3
PIB sin inversión en vivienda	-1.7	-0.9	1.5	3.0	2.5
PIB sin construcción	-1.1	-0.2	1.7	2.9	2.5
Labour market					
Employment (LFS)	-4.3	-2.8	1.2	3.0	2.9
Unemployment rate (% active pop.)	24.8	26.1	24.4	22.3	20.7
Employment QNA (full-time equivalent)	-4.4	-3.3	1.2	2.6	2.4
Apparent labour productivity	2.3	2.0	0.2	0.5	0.4
Prices and costs					
CPI (anual average)	2.4	1.4	-0.2	-0.2	1.4
CPI (en-of-period)	2.9	0.3	-0.5	0.6	1.5
GDP deflator	0.2	0.7	-0.5	0.7	2.1
Compensation of employees	-0.6	1.7	-0.2	0.3	1.7
Unit albour cost (ULC)	-3.0	-0.3	-0.4	-0.2	1.3
External sector					
Current account balance (% of GDP)	-0.3	1.4	0.8	0.9	1.0
Public sector					
Debt (% GDP)	84.4	92.1	97.7	99.7	98.4
Budget balance (% GDP (*)	-6.6	-6.3	-5.7	-4.4	-3.0
Households					
Nominal disposable income	-3.0	-0.3	1.4	2.3	2.9
Saving rate (% nominal income)	11.9	9.7	10.7	9.9	9.2

(*): Excluding aid to financial sector
Forecast closing date: 30 April 2015.
Source: Official bodies and BBVA Research

DISCLAIMER

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