BBVA | RESEARCH

Spain Economic Outlook

Third quarter 2015
Spain Unit

- The speed of the Spanish economy´s recovery peaked in the first semester underpinned by expansionary policies and tail-winds.
- The likelihood of a deceleration in economic growth has increased, although the slowdown will be temporary.
- Over one million jobs would be created between 2015 and 2016, but there is still a long way to go.
- Risk of deflation has gone away owing to ECB measures and the improvement in the domestic demand.
- Maintaining the credibility with regard to control of the public finances, key to contain the borrowing cost of the economy.

Index

Closing date: 31 July 2015

1 Editorial

The balance of the most recent data, the change in the external environment and the announcements in economic policy have allowed us to revise our GDP growth forecast for Spain marginally upwards to 3.2% for 2015, while leaving our 2016 forecast unchanged at 2.7%. In particular, the Spanish economy continues to record strong growth at around 4% in annualised terms. Nonetheless, the expenditure figures being released already indicate a deceleration which we expect to consolidate during the second half of the year, in line with the scenario that we presented three months ago. In any case, and for the time being, this deceleration is less intense than we anticipated. Going forward, the increased uncertainty associated with the international scenario could reduce the positive impact of monetary policy in Spain, or slow the growth in exports. In any event, these headwinds would be partially offset by a fiscal policy which is slightly more expansive than we expected, and by the sharper fall in the price of oil. Finally, note this scenario is subject to risks, associated with a greater deterioration in global activity levels, a significant failure on the public deficit, and an electoral timetable which could generate uncertainty on the public policies that will be implemented.

Growth remains at high levels although, as we expected, there are already signs of a change in the trend. In the first two quarters of the year, the economy grew by 0.9% and 1.0% QoQ respectively, in line with our forecasts. The main driver of this growth was internal demand, which continues to explain the majority of the recovery. Meanwhile, exports of goods exhibited an upturn which could be reflecting the impact of the various tailwinds that have favoured the improvement in competitiveness of Spanish companies. Looking ahead, the data available at the closing date of this publication allow us to anticipate that GDP growth will be somewhat slower during the third quarter of the year (0.7%), which suggests that economic growth peaked in the second quarter. However, these rates of growth are stronger than we forecasted three months ago, which explains the upward revision of our estimates for 2015.

There are various causes of the moderate deceleration we expect in the coming quarters. On the one hand, the employment data confirm that the contribution to growth from public sector employment was significant in the first half of the year. The same figures show that its importance will be less during the coming months, which will be reflected in both job-creation and in household expenditure. On the other hand, investment in machinery and equipment is growing slightly more slowly than we predicted six months ago. This deceleration could be due to the exhaustion of some cyclical factors which have explained the increase in expenditure during the last three months, to the global economy which has limited export growth, or to the uncertainty derived from the domestic political environment, although we cannot say which factor has weighed the most. At the same time, the recovery in the supply of housing is slightly slower than we expected, even taking into account the large imbalances that accumulated during the recession.

Although the economy will continue to benefit from tailwinds that will support growth, several factors could limit their strength. The downward revision of rates of growth in the emerging economies (with particular concerns about what is happening in China), and in the developed economies (the EMU and the US in particular), could have a negative effect on demand for Spanish goods and services in the coming months. Furthermore, the possibility that this reduced activity at a global level obliges to delay the increase of interest rates in various countries (especially in the US) has limited expectations of euro depreciation vs. other currencies. At the same time, the tension in the negotiations between Greece and the rest of the EMU has led to a moderate rise in the risk premium paid by the Spanish economy. These last two factors set a higher threshold for gains in competitiveness by Spanish companies.

This slower growth could be partially offset by some structural changes observed in the global economy driven by the innovations announced in terms of economic policy. On the one hand, we perceive that the plunge in the price of oil is largely attributable to increases in supply, on this occasion related to less political uncertainty (e.g. the agreements reached with Iran). Traditionally, this type of shock has a positive impact on the Spanish economy, as it implies a transfer of resources from the producer countries to the importers, and is not associated with a drop in world demand, which would reduce the outlook for growth in international trade. On the other hand, the Spanish government's announcement that it was bringing forward to July of this year the cut in the rate of personal income tax which had been expected for the beginning of next year, will increase households' disposable income, which will contribute less than 0.1pp to GDP growth.

The probability of some risks, in particular that of entering into a deflationary process**, has lessened considerably.** Various measures of inflation trends point to a change in the process of price formation, both in the EMU and in Spain. Furthermore, the expectations of higher inflation appear not to have affected how Spanish companies improve their competitiveness *vis à vis* their European peers, as core inflation in Spain is expected to remain lower than in other EMU countries. At this stage, it is not clear which factor is most responsible for the change of trend: the recovery in internal demand, the depreciation of the euro or the impact of expectations as a consequence of the policy implemented by the ECB. In any case, the inflation trend remains at relatively low levels, such that we do not expect a change in the central bank's policies in the short term.

Nonetheless, the probability of other risks emerging has increased and could eventually interact with others, driving negative scenarios for the Spanish economy. In particular, the budget execution of the general government in the first five months of the year is inconsistent with reaching the deficit target of 4.2% of GDP at the end of 2015. Thus we forecast that, in the absence of additional measures, the imbalance in the public accounts could be 4.5% of GDP in cumulative annual terms. As we estimate in this publication, the impact of the economic recovery in Spain has taken the deficit to levels around 4.0% of GDP. This means that, if the deviation we anticipate does materialise, the administration would have taken discretionary expansive measures of around half a point of GDP, despite the fact that there is still an ambitious programme ahead to reduce the deficit and the public debt. Although the potential deviation still does not look particularly significant, bear in mind that one of the principal assets of the Spanish economy during the past few years has been its capacity to reduce the public deficit. **Maintaining credibility on the control of public finances,** and thus the confidence of the European institutions, **is key to contain the financing costs** of an economy with excessive levels of foreign debt. If we add to this uncertainty regarding fiscal policy the doubts that could arise on the rest of the measures that will be implemented in the coming years, the vulnerability of the Spanish economy would increase considerably. These uncertainties could increase ahead of the election dates coming up in the months ahead. As a result, it is crucial that the administration takes advantage of the last few months of its term in office to take the necessary steps to ensure compliance with the public deficit reduction target, and to continue the reforms that will make fiscal consolidation a more virtuous and less painful process.

2 Moderation in world growth and a marked deceleration in the emerging economies[1]

Global economic growth continues, but at a slightly slower rate than we expected three months ago. In the EMs, economic growth will slow down for the fifth consecutive year, coinciding with the deceleration of growth in China and lower commodity prices. However, the outlook for the DMs remain favourable and growth in 2015 should be at its strongest since 2010, supported by the monetary policy of central banks, lower private-sector debt and lower oil prices. In the most likely scenario, global GDP growth in 2015 will repeat the 3.4% increase seen in 2014 and will accelerate to 3.8% in 2016.

Among the emerging economies, China has become the focus of attention in the last quarter due to the sharp stock market correction and the potential impact that this might have on both its domestic economic cycle and world growth. For the moment, the first half of the year has produced a 7% increase in GDP YoY, although the pace of the economy's growth is likely to ease up during the next two quarters, owing to the impact of the recent bout of financial tensions. Consequently, the update of the macroeconomic scenario includes the **downward revision in the growth forecast for China in 2015 and 2016 to 6.7% and 6.2% respectively** (0.3pp and 0.4pp lower than in our May scenario).

Although the developed economies continue to share encouraging growth prospects, these were revised slightly downwards. In the US, the worse than expected first half on balance **warrants a downward revision of growth for 2015 as a whole**, which could amount to 2.5%, or some 0.4pp below the level we forecasted in May. The uncertainty over how the economic cycle will perform in the coming quarters has now been heightened bearing in mind the impact of the persistent dollar appreciation on exports, the weakness of private investment and the deterioration in the global context. Even so, US GDP could grow by 2.8% in 2016.

The transient nature of the recent correction of activity continue to suggest that the first fed funds rate hike is set to take place in September. Nonetheless, the path of the hikes will be conditioned by the soundness of economic recovery and inflation expectations. The need for the monetary normalisation process makes reasonable for 2015 to be the year when the first rate hike occurs.

The pattern in the euro area is still one of sustained recovery, with quarterly GDP growth rates in the order of 0.4% in the first half of the year. Domestic demand, and in particular, private consumption, are underpinning an improvement of activity, which is beginning to become a common feature among the key economies. In this regard**, the fall in the oil price and the ECB monetary stimuli constitute key elements of support for GDP growth**. In fact, the improvement in demand and the scale of the ECB's liquidity injections are in fact reducing the risk of deflation, judging by the stabilisation of inflation readings and the upturn in medium-term price expectations. We will nonetheless have to wait until 2017 to see inflation rates converging towards 2%.

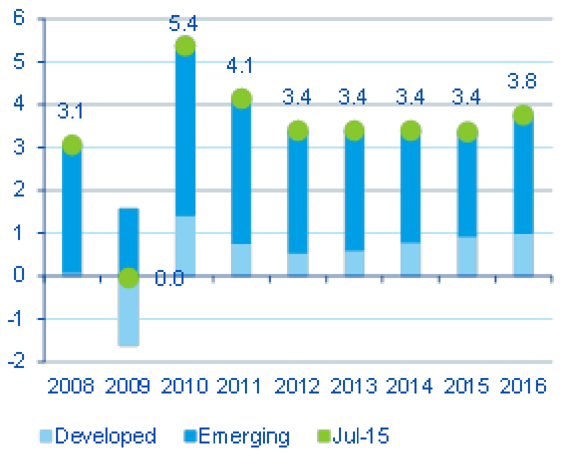
Nevertheless, the lower world economic growth and the emergence of certain risk hotspots with differing impacts, could slightly reduce estimated growth for 2015 and 2016 for the UEM (+1.4% in 2015 and +1.9% in 2016, 0.1pp and 0.3pp below those we forecasted in May)**. In that regard, the economic recession in Russia and the deceleration in China could affect export dynamics** in a context where euro depreciation

1 For further details, please see the Global Economic Outlook, available at: https://goo.gl/HFhUxz and Europe Economic Outlook available at: https://goo.gl/37Vwd2.

might be more contained than expected at the start of the year. Besides, any tighter financing linked to uncertainty over the Greek crisis could eventually affect new lending decisions, one of the outstanding issues in euro area recovery.

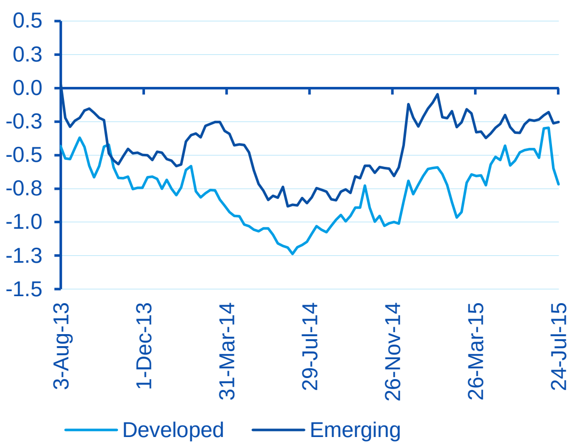
In addition to consolidating the economic recovery, the euro area faces major challenges in the medium term. Without a doubt, the most significant of these is to try and dispel any scepticism about the irreversibility of the monetary union project. The monetary firewalls, progress in banking union and the reforms undertaken in the area's various economies, as well as the reinforcement of the economic cycle, have substantially reduced the financial contagion from the Greek crisis compared to 2010 and 2012. Even so, in the absence of greater progress towards unifying banking and capital markets which might allow a reduction in financial fragmentation, plans that demonstrate the will to move towards greater fiscal integration, and without any rethinking of potential bailout programmes, the risk of disruptive scenarios emerging in the euro area as a whole is high. The discrepancies observed in the negotiations between the Greek government and the Institutions are evidence of the need to define a framework for handling financial assistance for countries with debt sustainability problems that goes beyond fiscal consolidation.

Figure 2.1
World growth: annual growth (%). 2015-16 forecasts



Source: BBVA Research

Figure 2.2
BBVA financial tensions index



Source: BBVA Research

To sum up, a hallmark of the global context in the last quarter has been **the manifestation of some of the risk events that we singled out three months ago** and, if they take a turn for the worse, this could bring the global economic recovery to a halt. The first of these involves the **bout of financial instability in China.** This was brought about by the sharp correction of its stock market, within a situation of trend deceleration in growth, which has drawn on substantial borrowing, and a process of financial liberalisation still underway. The second, which is equally significant, is the **Greek crisis**, and the constrains to reach an agreement that ensures that the country will face its financial commitments in the short term, as well as the sustainability of its debt via reforms to enhance the economy's capacity to grow in the long term.

The combination of these two risk events, together with the approach of the Fed's rate hike, has heightened financial tensions over the world, with a heavier impact on the euro area and Asia. **However, the maintenance of loose monetary policies,** above all in the wake of the implementation of the ECB's public debt purchase programme -that will be fully implemented until at least September 2016, is proving decisive.

3 Growth prospects for the Spanish economy

The recovery is sound but will ease in the short term

The Spanish economy closed the first half of 2015 with a pick-up in the recovery that began two years ago. Although the environment has not been risk-free[2], the improvement in activity is underpinned by both external and domestic factors. Among the former, have been **the low oil price, the gradual strengthening of European demand and, above all, ECB monetary policy,** which fosters a favourable context for the euro´s exchange rate and interest rate. With respect to domestic factors, fiscal policy is proving a little more expansive than initially envisaged on both the revenue and expenditure fronts.

Looking ahead, the data available increases the likelihood of there being a moderate loss of momentum in the growth rate in the next few quarters, bearing in mind the smaller boost which some of the factors discussed above will provide and the uncertainty from the domestic political scene and some of the headwinds from outside. Noteworthy among these are the downward revision of expected growth for both the developed and the emerging economies, the chance that such a lower level of activity will force a delay to interest rate hikes in several economies (especially in the United States) and the heightened financial upheaval during the negotiations between Greece and the institutions. These considerations could lead to a lower depreciation of the euro than was expected three months ago, lower growth in the EMU and a slight increase in the Spanish risk premium, all of which might undermine trade flows and private productive investment.

In any case, this transitory gear shift has turned out to be milder than was predicted in May. First, the steady improvement in the labour market and confidence are partly based on structural elements which will continue to promote activity in the medium term. Second, the bringing forward to July of the reduction in personal income tax will lift disposable income and therefore family spending as early as 2015. Third, the weaker pull from external demand could be offset by other structural changes in the world economy. Specifically, a new rise in the oil supply is becoming apparent, this time related to the deal reached with Iran, which has sparked a downward correction of energy prices, hence favouring growth expectations for the Spanish economy.

On balance, the encouraging short-term data for the first half, economic policy and the change in the external situation **make it advisable to marginally revise upwards the GDP growth forecast for Spain in 2015 to 3.2%, and to hold the same figure for 2016 at 2.7%.** This expansion rate could give rise to net job creation of around one million by the end of the period, with an unemployment rate of close to 20% at the end of 2016[3].

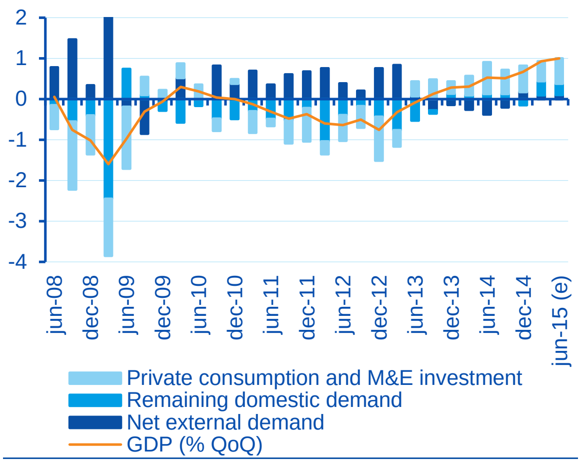
2: Chief among risks were the slowdown in the major geographical areas and the persistence of financial volatility and geopolitical tensions.
3: In average terms, employment will grow at an annual rate of 3.1% and the unemployment rate will be around 20.5% in 2016.

The upturn in activity at the close of the first half is giving way to a gentle slowdown

While we await the release of the detailed results, the advance GDP estimate published by the National Statistics Institute (INE) indicated that the **Spanish economy rose by 1.0% QoQ in 2Q15[4],** which is 0.1pp more than in 1Q15. If this estimate is confirmed, **activity would have been recovering for two years, which would mean an acceleration of YoY growth to 3.1%**, the highest rate seen since late 2007. With respect to composition of growth, the partial short-run indicators suggest that both domestic demand (above all from the private sector) and net external demand contributed positively to quarterly growth with 0.9pp and 0.1pp respectively (see Figure 3.1).

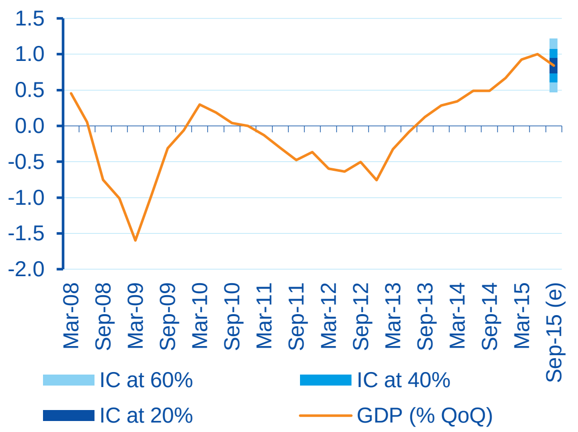
Looking ahead to the third quarter of 2015, the data available suggests that the Spanish economy continued its recovery, although it did so at a **marginally slower pace than was seen in the first half of the year (MICA-BBVA forecast[5]: 0.7% QoQ,** see Figure 3.2). This pattern is consistent with the results from the BBVA Economic Activity Survey (EAE-BBVA)[6], which revealed more moderate 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

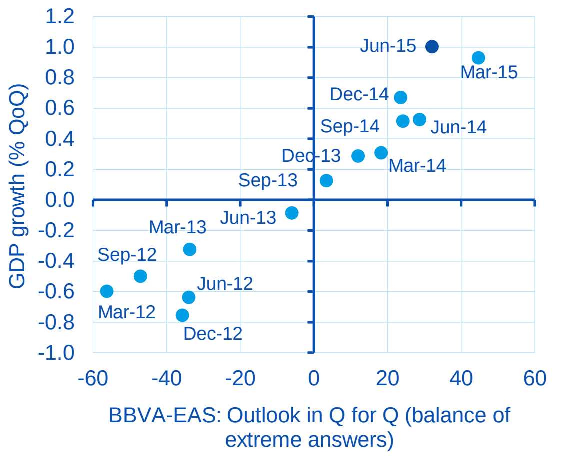
Figure 3.2
Spain: GDP growth, observed and predicted by the MICA-BBVA Model forecasts (% QoQ)



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

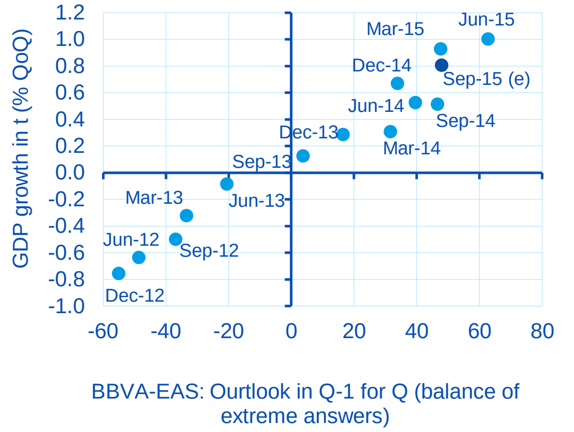
4: The details of the National Quarterly Accounts (CNTR) for 2Q15 are due to be published on 27 August and there is a possibility of the advance being revised.
5: For further details in relation to the MICA-BBVA model, see Camacho, M. & R. Doménech (2010): "MICA-BBVA: A Factor Model of Economic and Financial Indicators for Short-term GDP Forecasting", BBVA WP 10/21, available at: http://goo.gl/zeJm7g
6: For more on the BBVA Economic Activity Survey (EAE-BBVA), see Box 1 of the Spain Outlook, second quarter 2014, available at: http://goo.gl/epUinr

Figure 3.3
Spain: economic growth and perception of respondents in the EAE-BBVA



Source: BBVA Research based on INE

Figure 3.4
Spain: economic growth and perception of respondents in the EAE-BBVA in the previous quarter



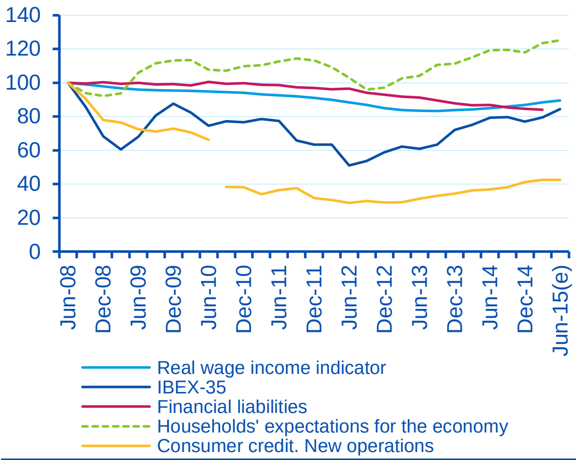
(e): estimated
Source: BBVA Research

Private domestic demand remained buoyant in 2Q15

Consumption indicators for both goods and services suggest that **household spending is likely to have risen again in the second quarter**[7]. Family disposable income would have been boosted by job creation and the reform of personal income tax[8]. The stock market rally, the expected reduction of financial indebtedness and the stabilisation of house prices probably served to lift net wealth between April and June. Besides its better fundamentals, private consumption has also benefited from the improvement in household perceptions of the economic situation[9] and an increase in new consumer credit transactions (see Figure 3.5). As a result, both the synthetic consumption indicator (ISC-BBVA) and the coincident indicator model for consumption (MICC-BBVA) show that **household spending is likely to have risen by between 0.7% QoQ and 1.0% QoQ in 2Q15, in line with what was observed over the preceding quarter** (see Figure 3.6).

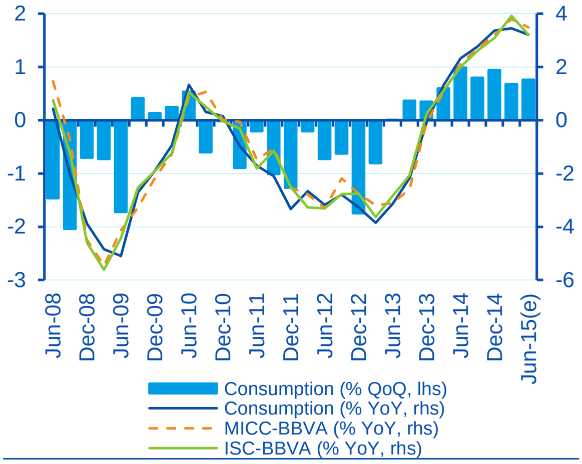
7: An in-depth analysis of patterns in household consumption by product type can be found in the Consumption Outlook, first half 2015, which is available at https://goo.gl/4jHd0t
8: Estimation of the repercussions of IRPF reform (effective from January 2015) on household income can be found in Box 2 of Spain Outlook, fourth quarter, 2014, at: http://goo.gl/0ClnbI
9: Household perceptions of the outlook for the Spanish economy are at a historical high, while those regarding their financial situation are at 2001 levels.

Figure 3.5
Spain: determinants of consumption (Figures swda. 2Q08=100)



(e): estimated
Source: BBVA Research based on the Ministry of Economy & Competitiveness, Datastream, the EC and the Bank of Spain

Figure 3.6
Spain: observed data and real time forecasts for household consumption

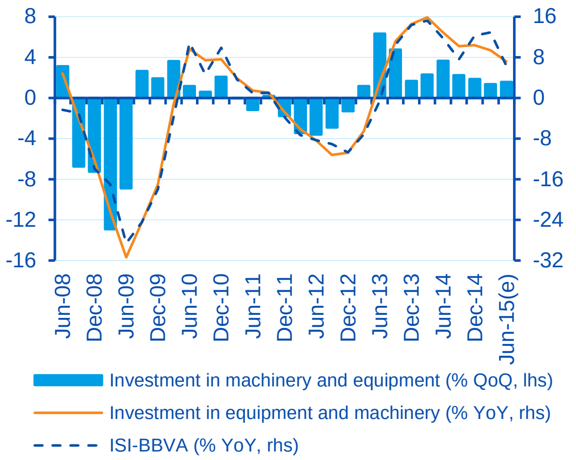


(e): estimated
Source: BBVA Research based on INE

The growth exhibited by machinery and equipment investment since the beginnings of the recovery carried on up to the close of the first half of the year. In a context of helpful financial conditions, domestic demand expansion and the greater traction of exports ought to have justified going ahead with investment projects again over the second quarter. Even so, partial short-run indicators suggest that, **after lower-than-expected growth in 1Q15, this demand item could have slowed down in 2Q15**. Chief among the less encouraging signs are the loss of momentum in industrial production of capital equipment and the sluggishness of capital goods imports. The synthetic investment indicator (ISI-BBVA) thus estimates **growth for machinery and equipment investment for 2Q15 of 1.1% QoQ (6.6% YoY)** (see Figure 3.7).

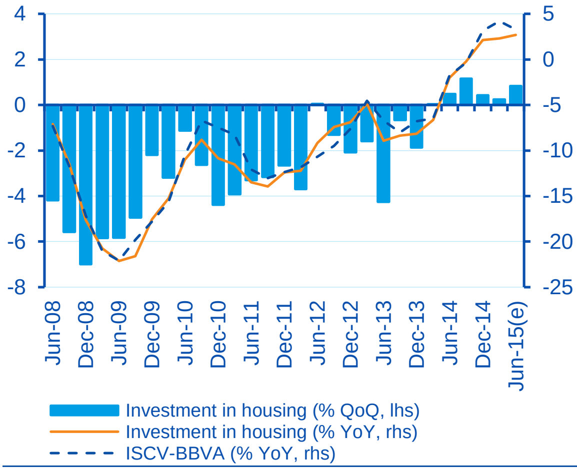
Although most of the housing investment indicators showed improvement in 2Q15, certain signs of weariness in the recovery are apparent after disappointing growth in the past two quarters. Thus, for example, the Business Survey of Construction Sector (ECC in Spanish) betrays a deterioration in expectations regarding residential construction, while sector employment and new building permits flagged. The synthetic indicator for housing construction investment (ISCV-BBVA) nonetheless reveals that **recovery continued in 2Q15, although at a relaxed pace (0.8% QoQ, 2.7% YoY)** and from a historically low level (see Figure 3.8).

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



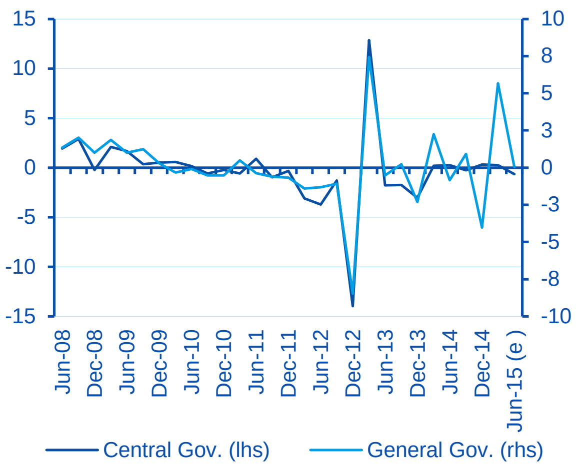
(e): estimated.
Source: BBVA Research based on INE

Public sector demand growth is subsiding after the first quarter upturn

After a larger-than-anticipated positive correction in the first quarter, public sector consumption growth is expected to have abated in 2Q15. In relation to this, the State budget performance figures as of June 2015 confirm that nominal final consumption expenditure by the central government dropped off marginally compared to the previous quarter, after seasonal adjustments (see Figure 3.9). **Real public consumption should therefore have closed 2Q15 showing a modest rise (0.6% QoQ, 1.1% YoY).** On this point, the figures from the Labour Force Survey (EPA) suggests that the wage component probably contributed to the slowdown in spending, and indeed the number of public sector employees virtually stagnated between April and June (-0.1% QoQ swda), after averaging growth of 0.9% QoQ for the two previous quarters (see Figure 3.10).

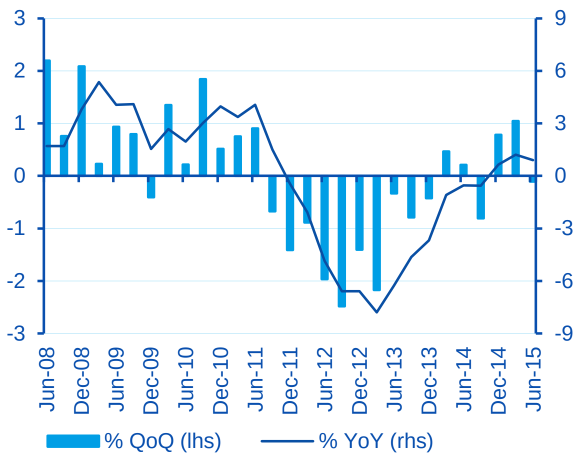
Meanwhile, the fall registered in public bids tender activity over the first five months of 2015 is indicative of an easing off of public sector investment. Consequently**, growth for non-residential construction investment (affected by public work) is estimated to have lost momentum in 2Q15,** slipping back to around 1.5% QoQ (6.4% YoY), following the larger-than-expected rise in 1Q15.

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



(e) estimated.
(*) Does not include, among other items, fixed capital consumption.
Source: BBVA Research based on the Ministry of Finance & Public Administrations and INE

Figure 3.10
Spain: public sector employees (swda)



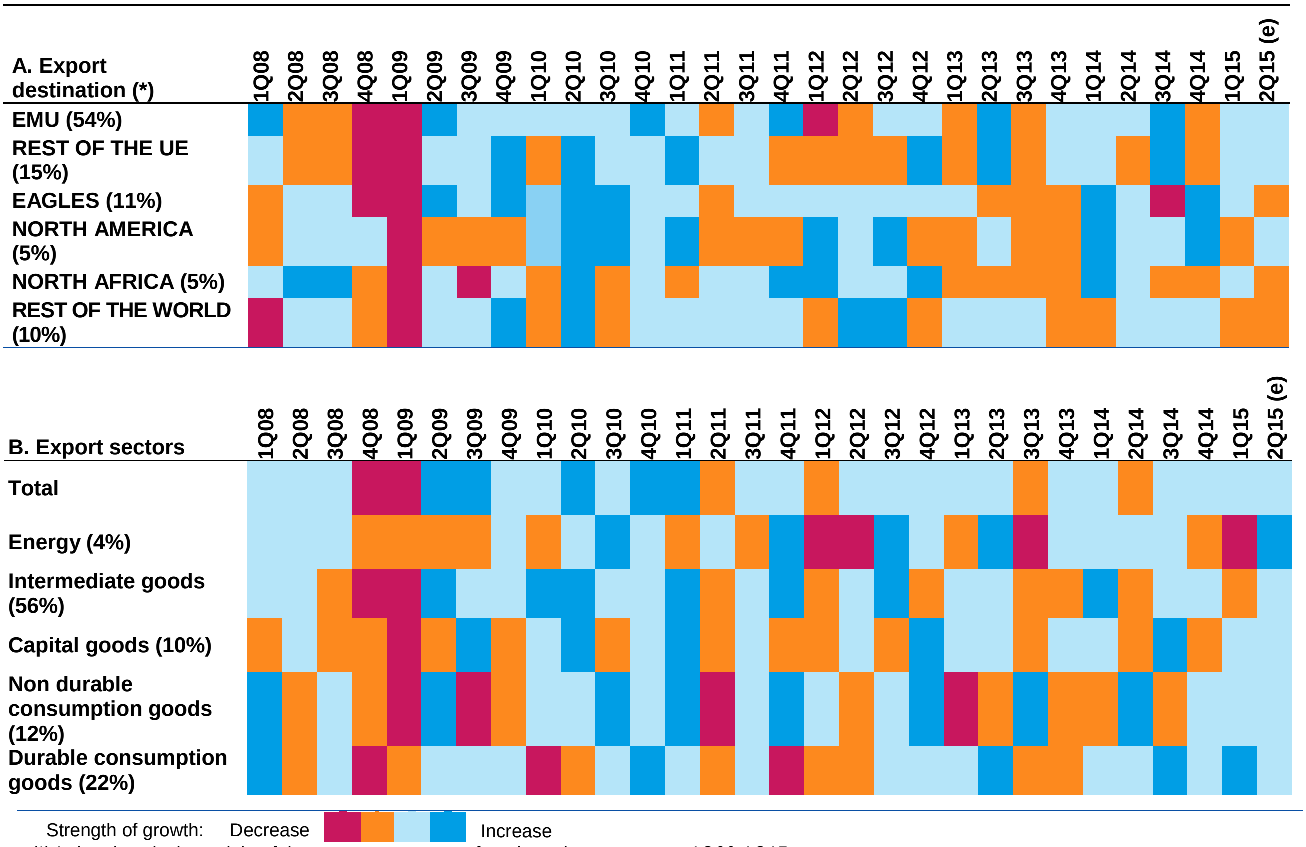
Source: BBVA Research based on INE

Exports are on the rise again, in line with their fundamentals

The second quarter of the year was again marked by an **encouraging setting for Spanish exports,** with steady (albeit mixed) growth of global demand, a weak euro and relatively low transport costs (thanks to the containment of the oil price). Accordingly, the positive tone to industrial expectations (new export orders) held up and improvements were observed in the spending indicators for both sales abroad by larger companies and the trade balance, this being true across all sectors and involving all the major destinations (see Figure 3.11). The available information thus suggests that the **sluggishness exhibited by goods exports that was seen up to 1Q15 has probably subsided, giving way to growth of 2.3% QoQ (3.8% YoY) in 2Q15.**

Conversely, the overall performance of services exports in the second quarter compares negatively with Q1 (-2.5% QoQ, 10.5% YoY). This should not be interpreted as any drying up of the supply, but rather as a phenomenon influenced by the likely **downward correction in billings of non-tourism services (-5.0% QoQ, 15.6% YoY)** after the unprecedented spike observed in 1Q15 (16% QoQ, 17.8% YoY). With regard to tourism, **consumption by non-residents on Spanish soil should have surged again in 2Q15 (1.7% QoQ, 3.3% YoY),** which keeps sector activity at record levels, as the tourists inflows ought to have risen by 1.1% QoQ swda between April and June, while real spending by them is likely to have done so by 1.5% swda.

Figure 3.11
Spain: growth of goods exports (% QoQ, swda)



(*) In brackets is the weight of the area or sector out of total goods exports over 1Q06-1Q15
(e): estimated featuring data up to May 2015.
Source: BBVA Research based on customs information.

In line with the performance of final demand, the short-term data available at the time of going to publication suggests that **the recovery of imports continued in 2Q15 (0.5% QoQ, 5.8% YoY).** This development would have largely offset the rise in total exports (0.8% QoQ, 5.8% YoY) and produced only a **marginal contribution by net external demand to growth (0.1pp QoQ, 0.2pp YoY).** After the positive close in 2014 (0.8% of GDP), we estimate that the current account balance registered a cumulative annual surplus again in the second quarter of the year (1.0% of GDP).

Labour market indicators declined over the quarter

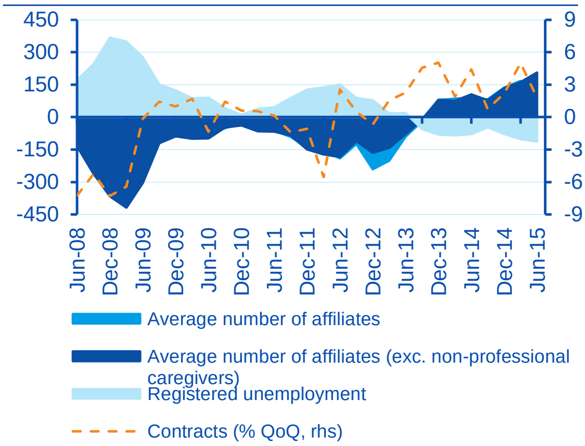
The labour market situation continued to improve in 2Q15 despite the fact that employment grew by less than had been expected in May and, above all, in June. After seasonal adjustments, **average Social Security affiliation system rose for the seventh quarter in succession, while registered unemployment managed to mark two years of moving downwards**. Specifically, the number of affiliates to Social Security rose by 1.0% between April and June, which was in line with the preceding quarter, while the fall in registered unemployment accelerated by 0.3pp to -2.6% QoQ (see Figure 3.12). On the contrary, hiring decelerated in Q2, owing to the growth slowdown in the number of permanent contracts (-2.4% QoQ, swda).

The Labour Force Survey (EPA) for 2Q15 confirmed the pattern for employment evidenced by Social Security registrations. In gross terms, employment increased by 411,700 people between April and June, which was somewhat less than expected by BBVA Research[10]. **After seasonal adjustments, employment increased by around 180,000 people** (1.1% QoQ), which made up for the sluggishness observed in 1Q15. Even though all the productive sectors made positive contributions, market services accounted for seven out of every 10 jobs created in 2Q15.

The rise in the number of salaried workers with temporary contracts (307,600), combined with the moderate increase in employment under permanent contracts (60,700 workers), prompted a **1.5 point rise in temporality, taking this up to 25.1%**. Helpful seasonal factors were only responsible for a portion of this increase and, if these are adjusted for, temporality actually grew by 0.7pp, to 25%.

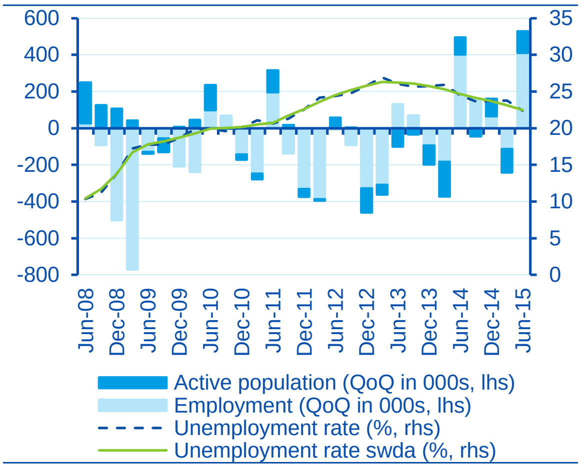
Job creation brought about a decrease in the unemployment rate (of 1.4 points, to 22.4%) in spite of the fact that the labour force rose by 116,000 people. Adjusting for seasonal factors, the unemployment rate fell for the ninth quarter in a row, this time by 0.6pp to 22.5% swda.

Figure 3.12
Spain: labour market figures (var. QoQ, thousands of persons, save where otherwise indicated, swda)



CNP: Non-professional carers
Source: BBVA Research based on the Ministry of Employment and Social Security

Figure 3.13
Spain: labour market indicators



Source: BBVA Research based on INE

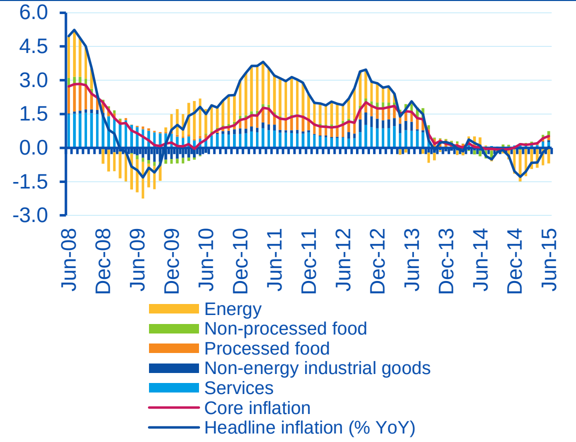
A change of trend in price formation and costs

General consumer prices rose 0.1% YoY in June, which represents the first positive rate in the last year[11]. This shift in trend for headline inflation readings is largely attributable to the upward correction in the oil price between January and June and the depreciation in the euro exchange rate. Meanwhile, **core inflation accelerated by 0.4pp between March and June, reaching 0.6% YoY,** which is probably not only due to greater imported inflation, but also to the improvement in domestic demand and/or the impact on expectations resulting from the policy implemented by the ECB. The contribution of core inflation to YoY price increases was thus close to 0.6pp in June, whereas that of the residual component was -0.4pp (energy: -0.7pp and non-processed foods: 0.2pp) (see Figure 3.14).

10: A detailed assessment of the 2Q15 EPA figures is to be found at https://goo.gl/jD8EgX
11: The leading CPI indicator concealed a marginal dip in headline inflation due to the fall in fuel prices. Our estimates suggest that core inflation could have stayed between 0.6% YoY and 0.7% YoY. For further details, see https://goo.gl/oLiIby

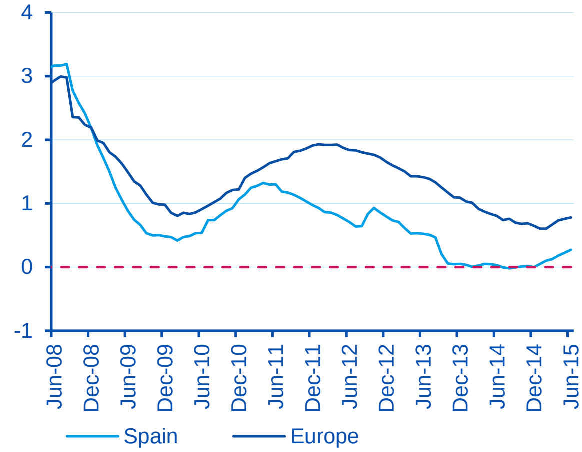
According to BBVA Research estimates, the shift in trend of consumer prices in the Spanish economy is still happening in a context of a recovery of price competitiveness. Thus, **the inflation differential with respect to the eurozone, as measured in terms of the trend component, remains favourable to Spain's at around -0.5pp** (see Figure 3.15)[12].

Figure 3.14
Spain: contribution to CPI growth (pp YoY)



Source: BBVA Research based on INE

Figure 3.15
EMU: trend inflation (trimmed means method, % YoY)



Source: BBVA Research based on INE and Eurostat

Despite the spike in core inflation, wage demands were still restrained in the second quarter. The average wage rise agreed upon collective bargaining increased by around 0.7% YoY between April and June for those agreements reviewed in the multi-year review process, and by 0.8% for those signed over the current year (only 246), which are only binding 293,000 workers[13] (see Figure 3.16). As Figure 3.17 illustrates, the wage moderation witnessed since the labour market reform came into effect in 1Q12 has provided a 4.0% cumulative gain in cost competitiveness against the EMU.

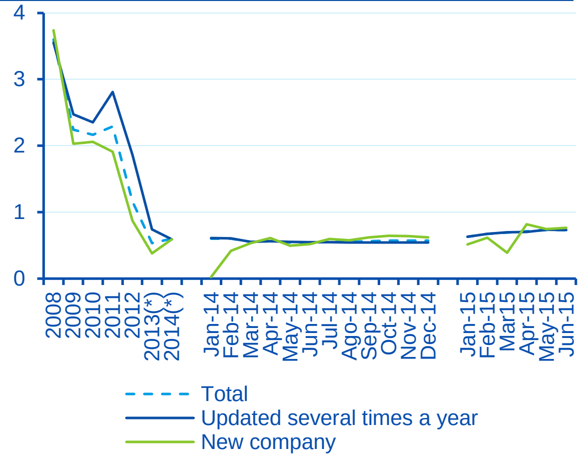
The average wage increase agreed to June is less than 1%, which is a figure established as the upper limit under the III Agreement on Employment and Collective Bargaining (III AENC in Spanish) for 2015. The AENC[14], which was signed in early June by CEOE, CEPYME, CCOO and UGT, establishes a set of recommendations that will guide the negotiation of collective bargaining agreements for the next three years. The agreements must promote stable employment, encourage the recruitment of young people, enhance the flexibility of internal mechanisms and adjustment of the intensive margin in restructure processes, contribute to the development of professional training instruments, facilitate the right to receive information and consult, promote equal treatment and make progress in occupational health and safety.

As with the previous agreement, **the III AENC encourages performance-related pay and sets caps on the wage increases in collective bargaining agreements.** In 2015 these will not be allowed to exceed 1% and in 2016 this figure will be 1.5%. The increase in 2017 will depend on the pattern of GDP growth in 2016 and the government's macroeconomic forecasts. Although the agreement does not explicitly establish the inclusion of wage review clauses, it does indicate that the wage increase agreed in 2015-16 must be greater than the sum total of inflation for both years.

12: For further details on the calculation of trend inflation using the trimmed means method, see Box 1 of the Spain Outlook, first quarter 2014, available at: http://goo.gl/j0rlT8
13: The number of workers subject to collective bargaining is approximately three million up to June, when those affected by agreements that were signed prior to 2015 (2,930,000) joined them. This figure is 18.7% less than that recorded up to June 2014.
14: Resolution of 15 June 2015 of the Directorate-General for Employment to register and publish the III Agreement on Employment and Collective Bargaining 2015, 2016 and 2017. Available at: http://www.boe.es/boe/dias/2015/06/20/pdfs/BOE-A-2015-6865.pdf

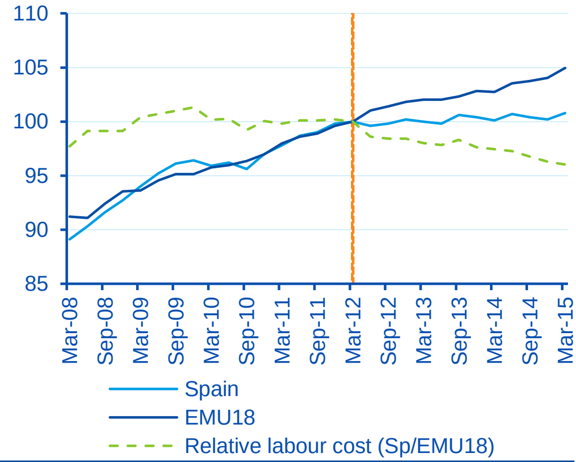
To summarise, the **AENC 2015-17 represents a pooling of good intentions that mostly suffer from a lack of precision**, which could make it hard to meet some of the objectives set forth. Moreover, the recommendations with regard to wages do not correct past errors. Even though the agreement indicates that wage growth 'could be made modulated for each sector or firm' according to productivity trends, it is likely that the limits suggested for 2015-17 will eclipse average productivity growth for the economy as a whole. In this regard, BBVA Research estimates point to meagre growth of apparent labour productivity in 2015 and 2016. Finally, the AENC backs the inclusion of safeguard clauses in collective bargaining agreements, which does not help the Spanish economy to break away from indexing and, consequently, lift competitiveness and job creation.

Figure 3.16
Spain: average wage increase agreed in collective bargaining agreements (%)



The annual data includes agreements registered after December each year and incorporates revision under the wage guarantee clause.
(*) Provisional data. The figures since 2013 are not comparable with prior. See: http://goo.gl/WQkvNU
Source: BBVA Research based on the Ministry of Employment and Social Security

Figure 3.17
EMU: labour cost per hour worked in the market economy (1Q12=100)



Source: BBVA Research based on Eurostat

Suitable trends for credit: the stock is falling and flows are on the rise

The outstanding credit balance in the Spanish economy is still coming down (-4.6% YoY to May), which implies that the inflow (new transactions) is still lower than the outflow (repayments and bad debts). **This fall in the outstanding balance is desirable for several reasons.** On the one hand, relative indebtedness seems to be far higher than in other, neighbouring countries, with the credit to GDP ratio standing at over 120% in Spain, compared to 95% throughout the euro area. On the other hand, lending to construction and real estate firms still represents 14% of the total figure, compared to a contribution to the economy's gross value added that is only as high as 6.0%. Even so, cumulative credit deleveraging is losing traction, as the rate at which this is falling is easing up compared to the average of -6.5% in 2014 or -12.1% for 2013.

All of this is compatible with an increase in the flow of new transactions, which is very positive since this is what relates to current investment and consumption decisions (see Figure 3.18)[15]. In **cumulative terms from January to June, new transactions climbed by 12.9% YoY**, with positive growth rates among all the constituent portfolios. **Particularly significant was the progress made by the new lending to large**

15: Box 3 of Spain Outlook, fourth quarter, 2014 offers an in-depth analysis of the relationship between credit flows and economic activity.

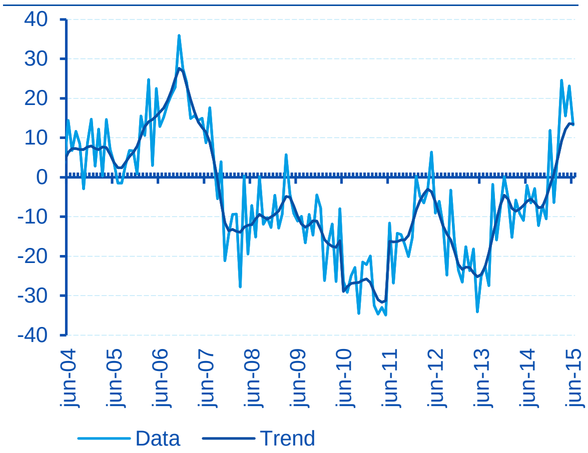
companies (+7.1%, classified in approximate terms as transactions of over EUR1mn), which had for the most part of the crisis elected to finance themselves using other means, such as wholesale markets or intra-group loans, and are turning to bank lending again, now that conditions are improving.

The retail segment is still showing substantial vigour, both in loans to SMEs (13.3% of transactions of under EUR1mn) and those granted to households: mortgage loans (which have picked up to 18.8%), consumer credit (stable at 16.1%) and other loans (71.2%). Nonetheless, there is still some way to go, since this is measured from low levels: the new transactions so far this year only represents 41% of the loans granted in the same period of 2008. If these trends in the growth of new transactions can be maintained, the flow of new credit will manage to outstrip loan repayments towards the end of the year, which marks the point when the outstanding balance begins to grow.

The cost of new credit has continued to moderate and converge on the levels seen in the euro area's core countries (see Figure 3.19). First, this fall in interest rates was brought about by the reduction in Spain's sovereign risk, which translated into a lower cost of borrowing for the banks that was further transferred to their customers. Second, subsiding credit risk (the lower NPL ratio) is helping to make loans cheaper. For example, the average interest rate on new loans to SMEs has come down by 1.8 percentage points in the last 14 months, shedding one third of its former level as it moved from 5.1% in March 2014 to 3.3% in May 2015.

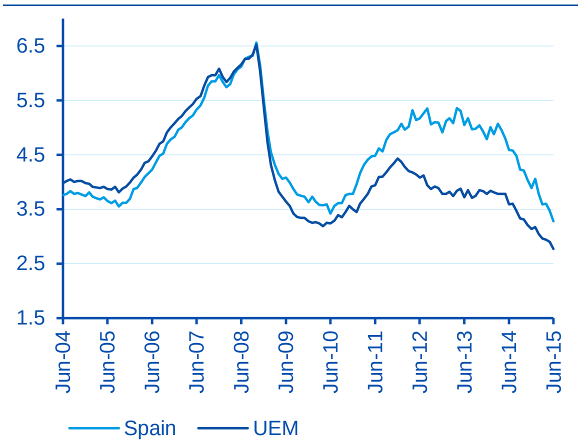
This strength in new lending can be expected to continue in the next few quarters, for reasons relating to demand as well as supply. On the demand side, the economic recovery and the lower borrowing costs will boost funding requests. On the supply side, the improvement in liquidity conditions that has been noted (thanks to banking union and ECB policy), the lower portfolio risk and the progress made in banking restructure will be positive forces. One of the banks sector's overriding objectives is to encourage the recovery of new lending transactions. **After the crisis, lending should come back onto a path of sustainable growth that strikes a better balance among sectors**.

Figure 3.18
Spain: new retail lending business (% YoY)



Source: BBVA Research based on the Bank of Spain

Figure 3.19
Interest rates applying to new lending to SMEs (transactions of up to EUR1mn and up to one year, %)



Source: BBVA Research based on the Bank of Spain and the ECB

2015-16 scenario: growth reaches its peak speed

As was said in the introduction to this section, **the new aspects added in to the macroeconomic scenario have prompted an upward revision** of 0.2pp in this year's growth figure for the Spanish economy. **In 2015, activity will rise by 3.2% and then in 2016 it will do so at rate of 2.7%,** which is enough for there to be net cumulative job creation by the end of the period of one million jobs over the period, as well as a lowering of the unemployment rate down to around 20%[16].

Activity growth will be sustained by both domestic and external factors. The downward revision of expected growth for the world economy and the smaller-than-expected depreciation in the euro's exchange rate will be partly offset by the greater oil price restraint that is foreseen. On the domestic front, the support from both fiscal and monetary policy, together with the structural improvement of the fundamentals, will give rise to **sound domestic demand growth** (see Table 3.1). The increase in final demand will trigger a considerable upsurge in imports, which is likely to **result in a virtually no contribution from net external demand to growth**.

Table 3.1
Spain: macroeconomic forecasts

(% YoY save indication to the contrary)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15(e)	2014	2015 (f)	2016 (f)
Domestic Final Consumption Expenditure	1.1	1.8	2.1	2.4	2.6	2.8	1.8	2.8	2.0
Private FCE	1.3	2.3	2.7	3.3	3.4	3.4	2.4	3.3	2.5
General government FCE	0.3	0.3	0.3	-0.5	0.1	1.0	0.1	1.3	0.6
Gross Fixed Capital Formation	0.8	3.9	3.9	5.1	6.0	5.2	3.4	5.2	5.8
Machinery & Equipment	15.8	12.9	10.2	10.3	9.4	6.7	12.2	6.5	6.4
Construction	-7.4	-0.7	0.1	2.4	4.9	4.8	-1.5	4.8	4.8
Housing	-6.6	-2.0	-0.2	2.1	2.3	2.7	-1.8	2.6	7.1
Other buildings and structures	-8.0	0.3	0.3	2.6	6.8	6.4	-1.3	6.5	3.1
Domestic demand (*)	1.2	2.3	2.6	2.7	3.0	3.0	2.2	3.0	2.7
Exports	6.4	1.0	4.5	4.7	5.7	5.8	4.2	4.7	7.1
Imports	9.4	4.9	8.6	7.7	7.4	5.7	7.6	4.5	7.5
External balance (*)	-0.6	-1.1	-1.0	-0.7	-0.3	0.2	-0.8	0.1	0.0
Real GDP at market prices	0.6	1.2	1.6	2.0	2.7	3.2	1.4	3.2	2.7
Nominal GDP (mp)	0.0	0.8	1.4	1.4	3.2	3.6	0.9	4.0	4.5
Memorandum items									
GDP ex housing investment	1.0	1.4	1.7	2.0	2.7	3.2	1.5	3.2	2.6
GDP ex construction	1.6	1.5	1.8	2.0	2.4	3.0	1.7	3.0	2.5
Total employment (LFS)	-0.5	1.1	1.6	2.5	3.0	3.0	1.2	3.2	3.0
Unemployment rate (% labour force)	25.9	24.5	23.7	23.7	23.8	22.4	24.4	22.2	20.5
Total employment (fte)	-0.4	1.0	1.7	2.4	2.8	2.9	1.2	3.0	2.5

(*): Contributions to growth.
(e): estimated; (f): forecast.
Source: BBVA Reseach based on INE and the bank of Spain

16: On average, employment will rise at an annual rate of 3.1% and the unemployment rate will be 20.5% in 2016.

The downward oil price revision will make a positive contribution to growth

There have been changes in the oil market in recent weeks that left the Brent price at USD53 per barrel at the time of this Outlook going to print, which is almost 15% below the average price observed in June. The available information suggests that most of this fall owes itself to an **additional increase of the supply which derives from the agreements struck with Iran. This comes on top of those that are already built into the scenario**[17]: the increased unconventional crude production in the United States (shale-oil), the OPEC decision to maintain production quotas and the minimal impact of geo-political upheaval on output.

Since this is primarily a supply shock, and given the Spanish economy's high energy dependence**, this additional fall can be expected to have a net positive impact on activity**. In this regard, BBVA Research estimates indicates a gradual price correction of around USD73 at the end of 2016 (six dollars below the estimate of three months ago), which, if confirmed, **would provide another 0.2pp of growth for the Spanish economy[18].**

Demand-side policies will continue to support recovery

The ECB shows no sign of changing the tone of its monetary policy in the face of an economic outlook which, in its opinion, has not altered, despite the upturn in financial strain. At its July meeting the monetary authority's Governing Council reiterated its **commitment to resolute implementation of the monetary policy measures that were previously announced** and reaffirmed its willingness to use all of the instruments at its disposal within its mandate if required[19]. Overall, the monetary policy measures adopted by the ECB are helping to **hold the euro's exchange rate down and consolidate the downward trend followed by interest rates, which is useful in tackling low inflation and underpin domestic demand and credit growth**.

Despite the above, the downward revision of growth and the possibility of a lower level of activity forcing a delay to interest rate hikes (especially in the United States), as well as the financial tightening prompted by the negotiations between Greece and the Institutions, counteract part of the ECB's monetary policy stimulus through several channels. The updated economic scenario factors in a **smaller depreciation of the euro rate against the dollar** (of 5% for the remainder of 2015 and 2016), **lower forecast growth in the EMU** (down to 1.5% in 2015 and 1.9% in 2016) **and a moderate increase in Spain's risk premium** (of 15bp on average to 115bp for 2015-16). On balance, these elements will continue to provide support for recovery, although these revisions suggest that their impact could be lower than expected three months ago.

The cyclical recovery will not be enough to offset the impact which expansive policies will have on the government deficit

The public administration is making the most of the recovery of activity and the improved borrowing costs by implementing mildly expansive fiscal policy in the short term[20]. Thus, public sector consumption is expected to grow by 1.3% in 2015 in real terms, while non-residential construction investment (affected by public works) should do so by around 6.5%. In a no policy change scenario, **the tone of fiscal policy will be practically neutral in 2016**, with the real growth of public consumption expenditure moderating to 0.6%, while non-residential investment will grow at a rate of 3.1%. Nevertheless, **as a percentage of GDP, total public expenditure is expected to continue to be cut back over the next**

17: BBVA Research estimates suggest that between 2/3 and 3/4 of the crude price correction since June 2014 is due to these supply factors.
18: For further details on estimation of the effects of the oil price by type of shock on activity and prices in the Spanish economy, see Box 1 of the Spain Outlook, second quarter 2011, available at http://goo.gl/42s7N9
19: For more details see the ECB Watch by BBVA Research published on 16 July 2015 and available at https://goo.gl/gDT39n
20:: Prominent on the revenue side is tax reform, while on the expenditure side measures are included such as giving back a portion of the extraordinary payment that was withdrawn in December 2012 to government employees, or the capital expenditure drive planned for 2015.

two years, largely because of the predicted improvement in the labour market, which will reduce the figure for unemployment benefit payments, and also because of the reduction in financial costs (see Table 3.2).

On the side of public revenues, BBVA Research forecasts suggest that the recovery in the economic cycle is still contributing positively to both the collection on production taxes and Social contributions. **The tax cuts will lead to a fall in structural revenues from income tax which, in the short term, will be partially offset by the cyclical recovery in taxable bases**. In this respect, the bringing forward of the introduction of the lower rate of personal income tax (IRPF) to July 2015, that was initially scheduled for January 2016, will barely have any impact on activity (less than 0.1pp of GDP), for which reason the whole of the cost of the tax reduction (around EUR1.5bn[21]) will be passed on to collection levels.

Table 3.2
General Government: net lending / net borrowing*

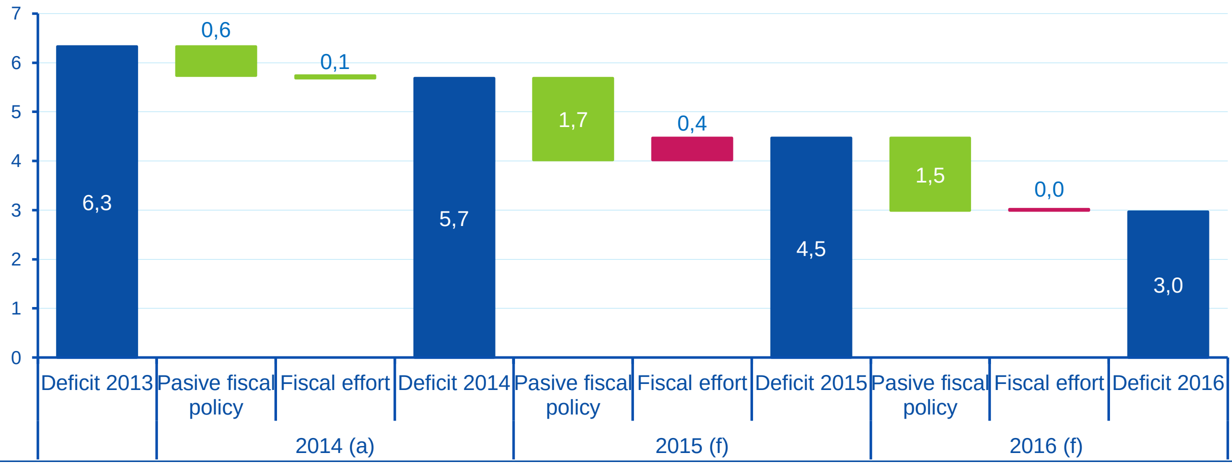
(% GDP)	2013	2014 (a)	2015 (f)	2016 (f)
Compensations of employees	10.9	10.8	10.7	10.5
Intermediate consumption	5.3	5.2	5.1	5.0
Interest	3.3	3.3	3.1	2.9
Unemployment benefit	2.8	2.3	1.9	1.8
Social benefits	13.4	13.8	13.9	13.7
Gross capital formation	2.1	2.1	2.0	2.0
Other expenditure	5.9	6.0	5.9	5.6
Non-financial expenditure	**43.8**	**43.5**	**42.5**	**41.4**
Taxes on production	11.0	11.2	11.5	12.0
Taxes on income, wealth, etc.	10.0	10.0	10.1	10.1
Social Security contributions	12.2	12.3	12.2	12.2
Taxes on capital	0.5	0.5	0.5	0.5
Other income	3.8	3.8	3.8	3.7
Non-financial revenue	**37.5**	**37.8**	**38.1**	**38.5**
Net lending / net borrowing	**-6.3**	**-5.7**	**-4.5**	**-3.0**
Stability target	-6.5	-5.5	-4.2	-2.8

(*): Excluding aid to the financial sector
(a): advance; (f): forecast.
Source: BBVA Research based on the Ministry of Finance & Public Administrations and INE

Overall, the cyclical stimulus will not be enough to offset the general impact of the expansive fiscal policies implemented over the two-year period 2015-16 (see Figure 3.20). **Therefore, in the absence of new fiscal consolidation measures, the public deficit is expected to be a fraction above the stability target** over the next two years. The disequilibrium in the national accounts should therefore be narrowed by 1.2pp of GDP in 2015 to 4.5% and by 1.5pp in 2016 to 3.0% of GDP (compared to targets of 4.2% and 2.8% respectively).

21: Just in the case that all the regions pass on the rate reduction to the regional tax category.

Figure 3.20
General government: breakdown of the fiscal correction (pp of GDP)



(a): advance; (f): forecast
Source: BBVA Research based on the Ministry of Finance & Public Administrations and INE

To summarise, the fiscal consolidation should conclude its negative contribution to growth within 2015-16. We should recall though, that **major disequilibrium persist in the Spanish economy**, such as high borrowing levels and unemployment rate, which **warrant further reforms that emphasise the** economy's growth potential and ensure long term sustainability of the public accounts.

The recovery of domestic demand continues, but the tail winds are dropping slightly

The consumption outlook for households remains encouraging. Job creation, less tax pressure[22] and the absence of inflationary pressures will all help real disposable income to recover in the coming quarters. Forecast growth in wealth, both as regards real estate and financial positions, expectations that official interest rates will remain at historically lows, and savings adjustment, will also serve to encourage family spending. Finally, new consumer finance business will continue to rise in a context of deleveraging of the outstanding credit balance and sustain household spending, especially for durable goods. As a result, **private consumption will grow by around 3.3% in 2015, 0.2pp more than was forecast three months ago**. **In 2016**, the temporary factors which incentivised family spending up to the middle of the current year will disappear, such as the PIVE (incentive programme of grants for buying new, more fuel-efficient cars), or will play a merely residual role, such as the cheaper oil price and the tax reduction. On top of this, certain fundamentals will make them less dynamic, so **private consumption will ease back to 2.5%**, which is 0.1pp above the forecast offered in May.

In the coming quarters, **machinery and equipment investment** will be favoured by the lower borrowing costs, buoyant domestic demand and the rise in export orders. Nonetheless, as was mentioned at the beginning of this section, **some of these fundamentals will have less of an impact than was anticipated three months ago,** which, together with the less robust growth of private capital expenditure coming into 2015, foreshadows a slowdown for this segment of demand in the short term. The deceleration will, in any case, be gentle and is likely to remit after the uncertainty over the election timetable has been dispelled,

22: BBVA Research estimates indicate that the bringing forward to July 2015 of the lowering of personal income tax (IRPF) that was due to come into effect in 2016 will add 0.1pp to private consumption growth in 2015-16.

when some of the more risk-averse investors should pick up the pace of new project execution. As a result, **forecast growth for machinery and equipment investment is being slightly revised downwards, by 1.3pp to 6.5% in 2015 and by 0.4pp to 6.3% in 2016.**

Similarly, **the recovery of housing investment, which began in 2014, is expected to advance at a slower pace than was anticipated three months ago**. In spite of the improvement in the demand fundamentals and relatively cheaper borrowing, growth for this investment item also produced a negative surprise in 4Q14 and 1Q15, which will affect its progress for the current year as a whole. Even so, after seven years in a row of contributing negatively to GDP, **housing investment should grow by 2.6% in 2015 and then speed up to 7.1% in the following year,** which means 1.9 points less than was forecasted in May in both cases.

Trade flows are reviving, although with less momentum than anticipated three months ago

The downward revision of expected world growth (3.4% in 2015 and 3.8% in 2016), coupled with the lower than expected depreciation of the euro, makes for a slightly less supportive external environment for Spanish exports over the current two-year period. **The growth estimate is thus being revised downward for both total exports (by 1.4pp to 4.7% in 2015 and by 0.3pp to 7.1% in 2016) and its chief components:** goods exports will move ahead by 3.3% in 2015 and 7.3% next year (2.7pp less than the cumulative rise that was being forecasted three months ago), and consumption by non-residents will increase at an average annual rate of 3.4% (1.1pp below the May estimate). Given the positive surprise registered in 1Q15, non-tourism services exports stand outside this downward bias in the short term (2015-16 average: 10.1%).

As a consequence of the buoyant state of final demand, **imports of goods and services should continue to grow in the next two years.** Nonetheless, given the high import content within Spanish exports, downward revision of these should lead to less vigorous buying from abroad (down by 2.0pp to 4.5% in 2015 and by 0.3pp to 7.5% in 2016). This would mean that **the contribution of net external demand to economic growth in both 2015 and in 2016 will be negligible (0.1pp and 0.0pp respectively)**. The cumulative drop in the oil price 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 2015-2016 (1.3% of GDP on average)** and conclude the adjustment of the current account balance's structural deficit.

Job creation is ongoing but still has a long way to go

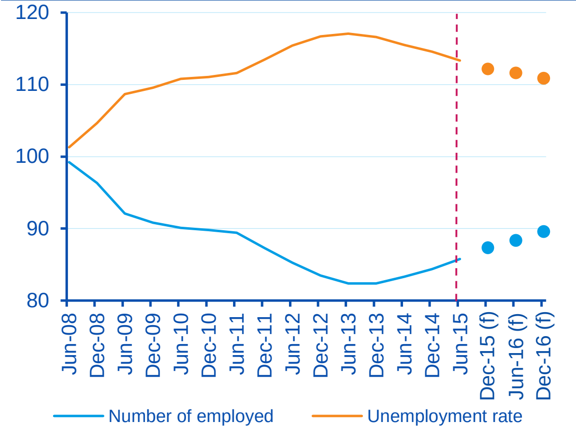
The forecasted economic growth and greater efficiency of the labour market will play a part in lifting private sector employment and bringing down the unemployment rate over the next two-year period. The number of those in work is thus expected to rise by 3.2% in 2015, while the unemployment rate should come down by 2.2 points (to 22.2%), which is 0.1pp less than was forecast in May. **In 2016, job creation will be 3.0%, but the drop in the unemployment rate (to 20.5%) will be less sharp than that predicted for 2015**, given the expected growth of the labour force.

Although the prospects for employment are promising, the distance from pre-crisis levels will still be considerable at the end of next year. As Figure 3.21 illustrates, in 4Q16 employment should be roughly 10% lower than at the start of 2008, whereas the unemployment rate ought to be 10 points higher. **There is therefore no room for complacency**. To encourage stable hiring and protect those segments facing greater problems in finding work, it would be desirable to combine effective simplification of the range of contract options with a substantial overhaul of the severance pay system. With respect to this, BBVA

Research and the Sagardoy Foundation (2014) suggest a mixed system where a portion of the contract termination compensation would depend on the worker's time in service at the firm, while the other part would comprise an individual savings account similar to the Austrian model[23]. Reform of this kind would reduce the uncertainty that stands in the way of permanent hiring, encourage investment in specific human capital, enhance productivity, incentivise job and geographical mobility, benefit sectorial reallocation of employment and go some way to modernising collective bargaining.

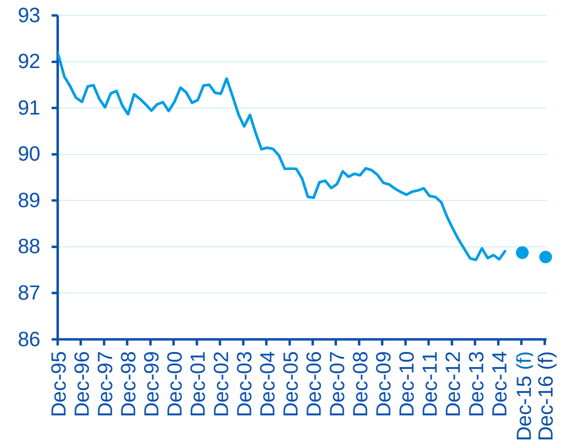
The expected trends for participation and full-time equivalent employment, which will grow by 5.5% over 2015 and 2016, **points to a significant increase in apparent labour productivity**, both in 2015 (0.2%) and in 2016 (0.2%). These growth rates are in line with those seen in the previous expansionary phase (0.4% on average for 2000-07), but are smaller than those observed during the crisis (2.1% on average for 2008-13).

Figure 3.21
Spain: employment level and unemployment rate (1Q08=100, swda)



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

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



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

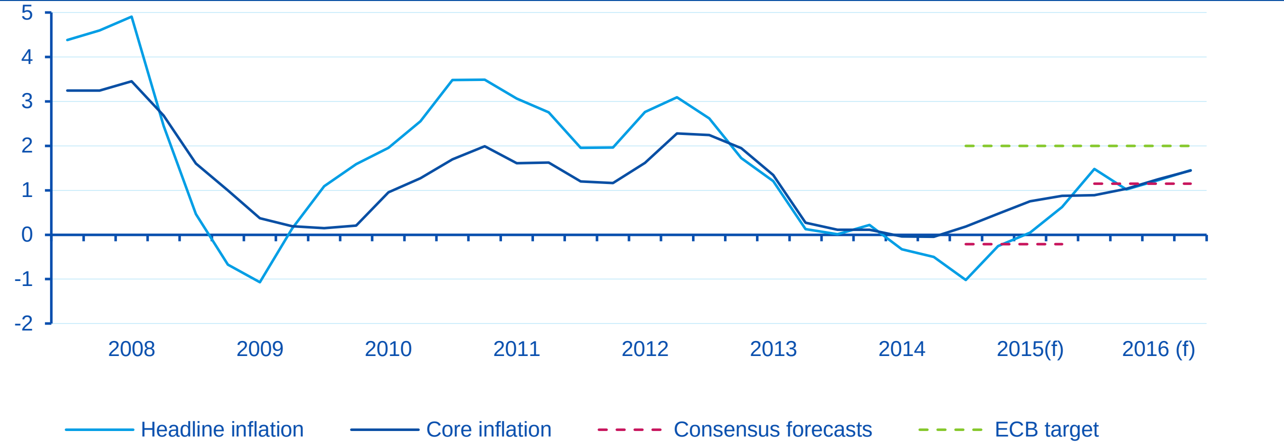
The shift in the inflation trend will take hold over this two-year period

Although the update for the macroeconomic scenario factors in a heavier-than-expected depreciation of the euro and an average oil price slightly below the forecast of three months ago, **the additional pressure on inflation will be offset by the improvement of medium term expectations**. As was anticipated in previous editions of this Outlook, this improvement has been helped by **the monetary policy measures** which the ECB has been implementing since the middle of last year (lower interest rates, more readily available credit, quantitative easing), as well as the progress in domestic demand and the labour market.

As a result, the forecast of a marginal fall in general consumer prices for 2015 as a whole (-0.2% YoY) is being maintained, and estimated core inflation is being raised by 0.3pp to 0.6% (see Figure 3.23). **In 2016, in both Spain and the Europe prices will follow a clearly upward path, in both cases reaching 1.3% on average,** which is still below the monetary authority's target.

23: Further details in BBVA Research and Sagardoy Foundation (2014): "Measures to promote permanent hiring", Spain Economic Watch, Madrid. Available at https://goo.gl/5kj1ja

Figure 3.23
Spain: inflation (% YoY)



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

The scenario is not risk-free

Although 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 in the current two-year timeframe 2015-2016, **certain external and domestic risks persist and hang over the recovery**.

Outside Spain, greater risks are apparent in relation to the slowdown in world growth (in both the emerging markets and the developed countries) which could have a negative impact on the demand for Spanish goods and services. Likewise, geo-political risks remain a threat, while 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.

On the domestic front, the likelihood of certain risks materialising has increased. To be precise, in the absence of further measures, the public deficit should stand at 4.5% at the close of the year, which would overshoot the stability target. Given the cyclical recovery of the economy, the expected deviation implies that during the current year discretionary measures of an expansive nature that account for almost half a point of GDP would have been taken, in spite of the ambitious process of structural deleveraging for the public sector that still lie ahead. While the scale of the potential deviation is not high, it should be recalled that one of the Spanish economy's chief assets in the past few years has been its ability to cut down the structural government deficit. Retaining credibility with regard to control of the public finances, and consequently the trust of the European institutions, is key to contain borrowing costs for an economy with an excess of foreign debt. If, on top of this uncertainty over fiscal policy, we add the potential doubts that might arise concerning the other measures to be implemented in the next few years, the vulnerability of the Spanish economy ought to be considerably increased. These doubts could take on greater proportions in the light of the election timetable for the coming months. It is therefore vital that these last few months in office are put to good use by taking the necessary steps to ensure that the deficit target is met and pressing ahead with the reforms that will make the fiscal consolidation process more virtuous and less painful.

4 Tables

Table 4.1
Macroeconomic Forecasts: Gross Domestic Product

(YoY rate)	2012	2013	2014	2015(f)	2016(f)
United States	2.3	2.2	2.4	2.5	2.8
Eurozone	-0.8	-0.3	0.9	1.5	1.9
Germany	0.6	0.2	1.6	1.5	1.9
France	0.3	0.7	0.2	1.3	1.7
Italy	-2.8	-1.7	-0.4	0.7	1.3
Spain	-2.1	-1.2	1.4	3.2	2.7
UK	0.7	1.7	3.0	2.5	2.3
Latin America *	2.8	2.5	0.8	0.3	1.2
Mexico	4.0	1.4	2.1	2.5	2.7
Brazil	1.8	2.7	0.2	-1.5	0.5
EAGLES **	5.7	5.6	5.2	4.8	5.2
Turkey	2.1	4.1	2.9	3.0	3.9
Asia-Pacific	5.7	5.9	5.7	5.7	5.6
Japan	1.8	1.5	-0.1	1.3	1.2
China	7.8	7.7	7.3	6.7	6.2
Asia (exc. China)	4.1	4.5	4.3	4.9	5.1
World	3.4	3.4	3.4	3.4	3.8

(f): forecast
* 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: 31 July 2015.
Source: BBVA Research and IMF

Table 4.2
Macroeconomic Forecasts: 10-year government bond yield

(Annual average)	2012	2013	2014	2015(f)	2016(f)
United States	1.8	2.3	2.5	2.3	2.6
Germany	1.6	1.6	1.2	0.6	1.0

(f): forecast
Forecast closing date: 31 July 2015.
Source: BBVA Research and IMF

Table 4.3
Macroeconomic Forecasts: Exchange Rates

Average	2012	2013	2014	2015(f)	2016(f)
USD-EUR	0.78	0.75	0.75	0.92	0.91
EUR-USD	1.29	1.33	1.33	1.09	1.10
GBP-USD	1.59	1.56	1.65	1.53	1.65
USD-JPY	79.8	97.5	105.8	123.3	131.7
USD-CNY	6.31	6.20	6.14	6.18	6.22

(f): forecast
Forecast closing date: 31 July 2015.
Source: BBVA Research and IMF

Table 4.4
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

(f): forecast
Forecast closing date: 31 July 2015.
Source: BBVA Research and IMF

Table 4.5
EMU: macroeconomic forecasts (YoY change, %, unless otherwise indicated)

	2012	2013	2014	2015(f)	2016(f)
Real GDP	-0.8	-0.3	0.9	1.5	1.9
Private consumption	-1.3	-0.6	1.0	1.7	1.7
Public consumption	-0.1	0.2	0.6	0.8	0.8
Gross fixd capital formation	-3.5	-2.3	1.2	1.9	3.9
Inventories (contribution to growth)	-0.7	0.0	-0.1	0.0	0.0
Domestic demand (contribution to growth)	-2.2	-0.7	0.9	1.5	1.9
Exports	2.9	2.1	3.7	4.4	5.1
Imports	-0.6	1.3	4.0	4.8	5.6
Net exports (contribution to growth)	1.4	0.4	0.0	0.0	0.0
Prices					
CPI (% average)	2.5	1.4	0.4	0.3	1.3
CPI core (% average)	1.8	1.3	0.9	0.8	1.2
Labour market					
Employment	-0.5	-0.7	0.8	1.0	0.9
Unemployment rate (% of labour force)	11.3	12.0	11.6	11.0	10.4
Public sector					
Budget balance (% GDP)	-3.6	-2.9	-2.4	-2.2	-1.8
Debt (% GDP)	89.1	90.9	91.9	93.2	92.9
External sector					
Current account balance (% GDP)	1.2	1.8	2.1	2.6	2.5

(f): forecast
Forecast closing date: 31 July 2015.
Source: BBVA Research

Table 4.6
Spain: macroeconomic forecasts (YoY change, %, unless otherwise indicated)

	2012	2013	2014	2015(f)	2016(f)
Activity					
Real GDP	-2.1	-1.2	1.4	3.2	2.7
Private consumption	-2.9	-2.3	2.4	3.3	2.5
Public consumption	-3.7	-2.9	0.1	1.3	0.6
Gross fixed capital formation	-8.3	-3.7	4.2	4.2	5.7
Machinery and equipment	-9.1	5.3	12.2	6.5	6.3
Construction	-9.3	-9.2	-1.5	4.8	4.8
Housing	-9.0	-7.6	-1.8	2.6	7.1
Domestic demand (contribution to growth)	-4.3	-2.7	2.2	3.0	2.7
Exports	1.2	4.3	4.2	4.7	7.1
Imports	-6.3	-0.5	7.6	4.5	7.5
Net exports (contribution to growth)	2.2	1.4	-0.8	0.1	0.0
Nominal GDP	-1.9	-0.6	0.9	4.0	4.5
(EUR bn)	1055.2	1049.2	1058.5	1100.8	1149.8
GDP excluding housing investment	-1.7	-0.9	1.5	3.2	2.6
GDP excluding construction	-1.1	-0.2	1.7	3.0	2.5
Labour market					
Employment (LFS)	-4.3	-2.8	1.2	3.2	3.0
Unemployment rate (% active pop.)	24.8	26.1	24.4	22.2	20.5
Employment QNA (full-time equivalent)	-4.4	-3.3	1.2	3.0	2.5
Apparent labour productivity	2.3	2.0	0.2	0.2	0.2
Prices and costs					
CPI (anual average)	2.4	1.4	-0.2	-0.2	1.3
CPI (en-of-period)	2.9	0.3	-0.5	0.6	1.5
GDP deflator	0.2	0.7	-0.5	0.8	1.7
Compensation of employees	-0.6	1.7	-0.2	1.0	1.5
Unit albour cost (ULC)	-3.0	-0.3	-0.4	0.8	1.3
External sector					
Current account balance (% of GDP)	-0.3	1.4	0.8	1.3	1.4
Public sector					
Debt (% GDP)	84.4	92.1	97.7	98.8	98.0
Budget balance (% GDP (*)	-6.6	-6.3	-5.7	-4.5	-3.0
Households					
Nominal disposable income	-3.0	-0.3	1.4	2.8	3.1
Saving rate (% nominal income)	11.9	9.7	10.7	9.9	9.8

(*): Excluding aid to financial sector
Forecast closing date: 31 July 2015.
Source: Official bodies and BBVA Research

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