

Spain

Economic Outlook

4TH QUARTER 2015 | SPAIN UNIT



01 Although the expected slowdown is confirmed, growth will remain close to 3%

02 Export dynamism will not be stalled due to the recovery of domestic demand

03 Rising corporate saving, over a mixed cross-section of corporate sizes, is boosting investment

04 Bringing down the deficit calls for implementing reforms that increase tax collection

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Closing date: 6 November 2015

1 Editorial

Developments in the Spanish economy have confirmed the expectations of three months ago and, in the absence of changes as regards the international scenario or in the policies to be implemented, the forecast of GDP growth of 3.2% for 2015 and 2.7% in 2016 is being maintained. Production in particular continues to increase rapidly at rates going over 3% in YoY terms. Much as expected, this implies a deceleration of activity compared to the figures seen in the first part of the year, when the economy was growing at around 4% YoY. The reasons behind this lower growth rate are several and include the loss of momentum of world demand, exhaustion of certain cyclical factors and increasing uncertainty, which is partly associated with the Spanish electoral cycle. Whatever the case, the tail winds driving the recovery are expected to prevail, and growth to hold at levels in the 2.5-3.0% range in the coming quarters. The risks to this scenario relate to slower growth of the world economy and the volatility which uncertainty over economic policy might inflict on domestic demand going forward.

Growth continues to exhibit relatively high rates, underpinned by the vigour of domestic demand, though by exports as well. Specifically, in the third quarter of the year GDP flipped up 0.8% with respect to the second, which implies that the economy is still growing at rates above 3.0% in YoY terms. The available information suggests that private consumption continues to be the mainstay of the strong performance by domestic demand. Moreover, the good performance shown by exports and by investment in machinery and equipment are signs that the larger share of both factors in aggregate demand is a trend that will be kept up over time. For example, although the fall in household and corporate spending partly explains the rise in exports throughout the crisis (around 40%), the impact seems to be asymmetric given that in the upswing the effect of greater domestic demand on sales abroad has not been significant (see Box 1). By the same token, the upsurge in machinery and equipment investment since 1Q13 has already gone past 30% and is three times bigger than that observed for the EMU as a whole over the same time. Part of this improvement can be explained by the increase in saving by companies which, through the use of an assortment of instruments and depending on their size, have managed to bring down their borrowings on differing scales and generate the funds required to be able to invest (see Box 2). This indicates that over the coming months the export capacity of the Spanish economy will continue to increase and that, in the absence of restrictions on demand, the internationalisation of companies will progress.

The deceleration in the second half of this year is as expected, while there appear to be several reasons for it. As was already announced in recent Spain Economic Outlooks, growth is likely to have hit its top speed in the first half of 2015. The causes of the slowdown in 2H15 range from weaker global demand or the loss of momentum of certain drivers, through the deferment of consumption and investment decisions associated with the hectic election timetable. For example, even though China's economy barely represents 2% of Spanish exports, this share has doubled over the crisis. Moreover, the indirect impact via the reliance exhibited by emerging economies, or certain key trading partners such as Germany, could be delaying goods export growth¹. Similarly, certain boosts to the competitiveness of Spanish companies have not been as powerful as had been previously expected, notable here being the euro's exchange rate depreciation, mainly with respect to currencies in emerging markets, where greater uncertainty has led to inversion of the trend.

A portion of the rise in consumer spending by families during the recovery might have been triggered by pent-up demand that had built up over a long period of uncertainty. The double-digit increase that has been observed for certain items of private spending, such as car purchases, far overstates

1: For a more in-depth examination, please see Spain Economic Watch, September 2015 by BBVA Research, "Spain: Potential channels of contagion of economic shocks in China and Greece", available at <https://goo.gl/DQFAVs>

the improvement that is suggested by gross disposable income or family wealth figures. Added to this, the upswing in consumption has been uneven, as this has risen among middle- or high-income households, while it has remained the same or even fallen back among the least well-off. As this pent-up demand, which is concentrated among a certain bracket of households, runs out of steam, it will mean that over the next few quarters these items of consumption will grow at rates that are more in keeping with their fundamentals.² Finally, although the situation has been partly turned round in the past few weeks, the relatively deterioration in risk perception of Spain's economy that has arisen from political uncertainty has led to a rise in what the Spanish Treasury has to pay on the debt it issues in comparison with its Italian counterpart. Were this situation to remain the case or worsen over the coming months, the Spanish economy could begin to count the cost in terms of growth and job creation.

The recovery is expected to progress further, and that the economy will continue growing at rates of 2-3% in YoY terms over the next few quarters. This is, first of all, based on a global setting that remains sufficiently conducive to the expansionary process moving ahead. To explain, although world growth will still hold at a level below its historical average in 2015 and 2016, it should pick up gently over the coming quarters. Crucial here will be the better relative performance expected of the developed economies, particularly Europe. Second, the oil price is still at a comparatively low level, which should help to keep Spanish firms competitive and support disposable household income. Finally, the shift in the emphasis of demand-side policy is consolidating, especially on the monetary front, where the European Central Bank could announce additional measures in December to ensure a firmer recovery of credit and domestic demand, as well as convergence towards target inflation. All of this is reflected in the fact that Spain's economy continues to show high growth rates, while on this point it is worth noting that GDP in 4Q15 is likely to have grown by 0.7% against the previous quarter.

Spain finds itself in a virtuous circle, where growth, low inflation and external deleveraging have all come together in a sort of "divine coincidence"³. Going forward, it is important to keep this triple set of factors in concert and recognise what part of this situation is temporary and derives from the muted oil price and low interest rates. It would, nonetheless, not be very advisable to ignore the fact that reaching this point has also been as the result of implementing structural measures which should be persevered with. For example, although the imbalance displayed by general government's saving is gradually decreasing, there is still a long way to go (see Section 3 and Box 3). Likewise, improvements in goods and services markets over the last few years explain the better performance of investment in relation to other neighbouring economies. Persisting with deficit and public debt reduction, as well as permanently decrease unemployment and nurturing the competitive advantage achieved via ambitious reforms represent the biggest challenges for next government.

2: For further information, please see BBVA Research (2015), Consumption Outlook, First half 2015, available at <https://goo.gl/cKnbQF>.

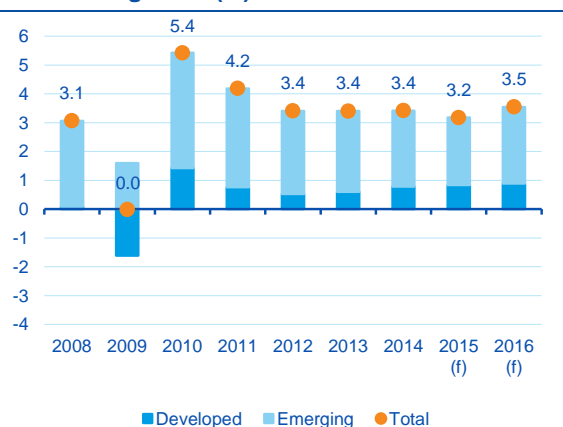
3: Blanchard & Galí (2007) employ this term in reference to those situations where the relationship between inflation and the welfare-relevant output gap is such that the latter can be stabilised through monetary policies that control inflation. See Blanchard, O., & J. Galí (2007). "Real Wage Rigidities and the New Keynesian Model". *Journal of Money, Credit, and Banking*, 39(1), pp. 35-65.

2 A slowdown of world growth in 2015 and marginal improvement in 2016⁴

According to BBVA Research estimates⁵, in 3Q15 world GDP is likely to have grown at a rate that is smaller than expected, yet similar to the figures observed at the beginning of the year (0.6% QoQ, 2.4% YoY), which would mean four straight quarters of growth below the 2010-14 average. This is explained by the steady slowdown among the major emerging markets in a context where doubts on the strength of the economic cycle and the financial stability of China prompted a spike in financial turmoil and another round of commodity price corrections. Thus, GDP could close 2015 with YoY growth of 3.2% (0.2pp less than was being predicted three months ago), which is the lowest since 2009 (Figure 2.1). This would imply that the gradual recovery by the set of developed countries would not manage to make up for the slowdown by the emerging group, which, assuming our forecasts prove to be right, should grow by only 4% YoY, following average growth in the previous five years that had topped 5.5%.

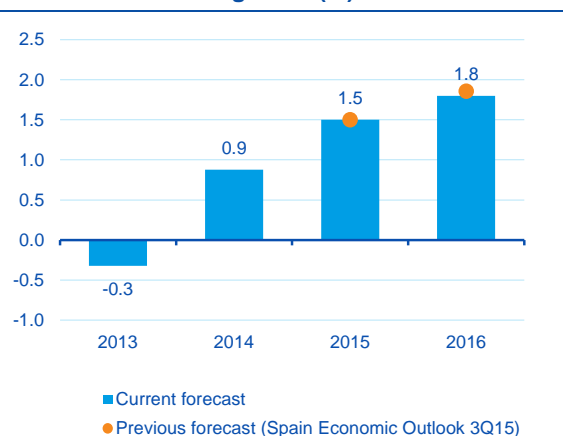
The prospects for 2016 are a slightly more favourable, sustained by a brighter relative performance by both the developed and the emerging economies. Consequently, world growth could tick up to 3.5%, which is 0.3pp below the previous quarter's forecast. However, the recent flare-up of some of the risk trouble spots with the biggest global impact potential, such as the slowdown in China's manufacturing sector with its repercussions for the commodities cycle and world trade, ratchets up uncertainty and augments the downside risks to the recovery of those countries most dependent on outside demand and saving. The potential worsening of medium-term growth expectations for developed countries such as the United States is also an element to factor into global growth prospects.

Figure 2.1
World GDP growth (%)



(f): forecast
Source: BBVA Research

Figure 2.2
Euro area: economic growth (%)



Source: BBVA Research

4: For further details, please see both the Global and the Europe Economic Outlooks by BBVA Research covering the fourth quarter of 2015 and available at <https://www.bbva.com/research>
5: Estimates based on the BBVA Research global activity index (GAIN). Details of the methodology at <http://bit.ly/1nI5RIn>

Euro area: resilient domestic demand and an ECB ready to head off any inflation relapse

In the euro area, economic recovery continues with no signs of acceleration, as was predicted a few months ago. Quarterly GDP growth rates have steadied within the 0.3-0.4% band, which means that there is still hope of annual growth managing to reach 1.5% in 2015. **The oil price fall, low interest rates and the fledgling recovery by new flows of private credit are what underlie stronger domestic demand, and particularly consumption,** while improvement in fixed capital investment remains timid, despite the positive flags from business confidence indicators and the easing of borrowing conditions. The fine relative performance shown by goods exports across the area as a whole contrasts with the more marked lull in world trade, which is partly due to the fact that 60% of euro area trade is with developed countries. The euro's depreciation could also be contributing to the competitiveness of sales abroad.

Although the **balance of risks to area growth still has downside bias**, due to both the uncertainty over global growth and the persistence of idiosyncratic exposure (chiefly the political instability associated with the election processes underway and something of a delay in implementing structural reforms in certain key economies), **euro area GDP could see a pick-up in its growth rate in 2016 to 1.8%**, which is only 0.1pp below what was expected the previous quarter. **Italy and France, which still have low growth rates in 2015, should be behind the revival of the area as a whole**, which has thus far relied on recovery in the periphery countries.

Despite this, the improvement in activity continues to be gradual and does not appear to entail any upturn in price expectations. Coincident inflation readings have again responded to the drop in energy prices that has been seen in recent months, which means that the headline rate will hold at close to 0% up to the year-end and 1% in 2016. For the time being, core inflation has settled at levels marginally below 1%.

The sharpening of the downside risks regarding inflation forecasts, which to a large degree arises from the cheapening of imported goods, **together with the euro's recent appreciation, call back into question the scope for improving monetary conditions in the euro area. The ECB's responsiveness to this scenario is high and should warrant the adoption of additional stimulus measures in the short term**, as it has suggested. A combination of further cuts to benchmark rates (probably that of the marginal deposit facility) and the expansion of the bond purchase programme (over time and/or in terms of the amount of liquidity injected) would then be deployed to anchor long-term interest rates at low levels for longer and achieve a certain depreciation of the euro to bring deflationary pressures to heel.

3 The growth outlook for the Spanish economy

The recovery continues, in spite of the short-term deceleration

As was flagged in the previous Outlook, **Spain's economy closed 3Q15 with a gentle slowdown of quarterly GDP growth, which is likely to be continuing into Q4**. There are various explanations for this observed deceleration, including the worsening of global growth expectations (mainly among the emerging markets), the playing out of the effects of certain cyclical drivers, and the delay of certain expenditure decisions given the busy election schedule.

Nevertheless, sound growth figures are still expected for the second half (approaching 3.0% YoY), and these are based on both external and internal elements. Factors from outside include **the low oil price, the steady improvement in European demand and, above all, ECB monetary policy**, which helps to provide a suitable euro and interest rate backcloth. In this respect, the monetary authority gave advance notice that from December onwards additional measures might be announced to ensure a stronger recovery of credit and domestic demand, as well as price convergence towards inflation target.

Regarding domestic determinants, it should be noted that **the upturn in demand since the middle of 2013 has been sustained not only by transitory elements** (such as fiscal stimuli), but also structural factors that will continue to encourage an expansion of activity into the medium term. Among these are the reforms and also the changes in the structure of production featuring, for example, a reorientation of investment towards machinery and equipment components (partly based on the rise in corporate saving) or an increased presence of Spanish products abroad (partly spurred by the deterioration of domestic markets during the crisis).

To summarise, the conjunctural data for the first nine months of the year, together with the changes in the external environment and economic policy (mainly monetary), **enable us to maintain the forecast for Spanish GDP growth for 2015 and 2016 (3.2% and 2.7% respectively)**. This pace of growth could bring about net creation of around one million jobs by the end of the period, with the unemployment rate standing at nearly 20% at the 2016 year-end⁶.

Quarterly growth of the Spanish economy is losing pace

With the final figures yet to be released, the flash GDP estimate published by the National Statistics Institute (INE) indicated that the **Spanish economy grew at 0.8% QoQ in 3Q15⁷, which is slightly above the rate forecasted three months ago (BBVA Research: 0.7% QoQ)**. If this estimate is confirmed, economic activity's quarterly growth would have been moderated by 0.2pp (after two years of steady rises), giving us a YoY gain of 3.4% (3.1% YoY in 2Q15). Turning to GDP breakdown, partial short-run indicators show that **domestic demand is likely to have explained entirely the quarterly growth**, whereas external demand would have made no contribution at all (see Figure 3.1).

Looking to the fourth quarter, the available information suggests that **the Spanish economy's recovery continues, though at a somewhat slower pace than was observed in the third quarter (MICA-BBVA forecast⁸: 0.7% QoQ)** (see Figure 3.2). This path is consistent with the findings from the BBVA Survey of

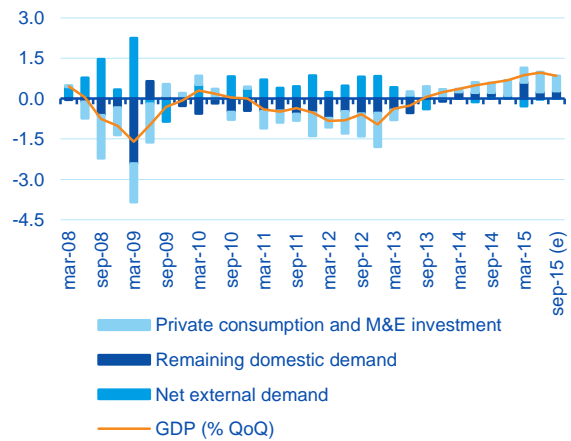
6: On average, employment will rise at an annual rate of 3.1% and the unemployment rate will stand at around 20.5% in 2016.

7: Details of the National Quarterly Accounts (CNTR) for 3Q15 are due to be released on 26 November, with a possible revision of the advance estimate.

8: For more details on 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>

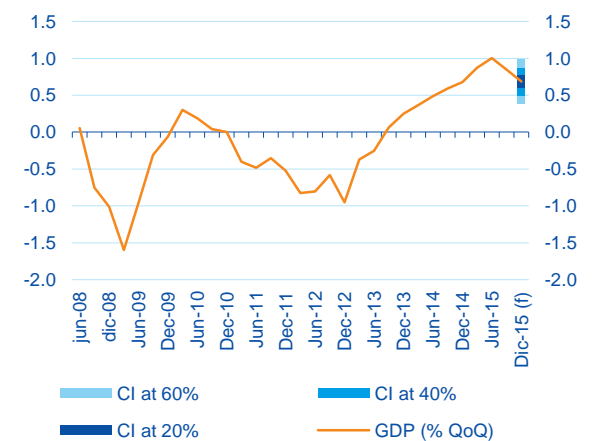
Economic Activity (EAE-BBVA)⁹, which continue to reveal a moderating trend for growth expectations (see Figures 3.3 and 3.4).

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



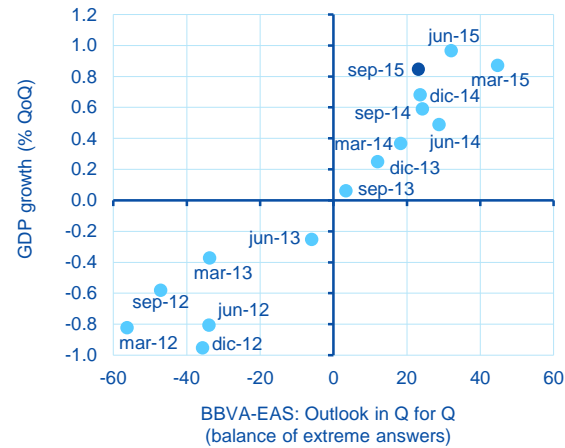
(e): estimate
Source: BBVA Research based on INE

Figure 3.2
Spain: observed GDP growth and MICA-BBVA model estimates (% QoQ)



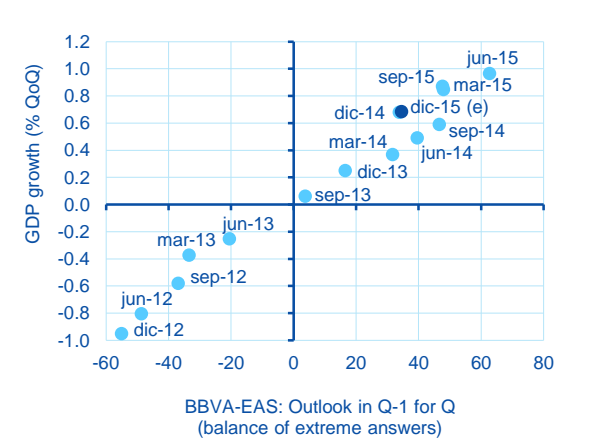
(e): estimate
Source: BBVA Research based on INE

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



Source: BBVA Research based on INE

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



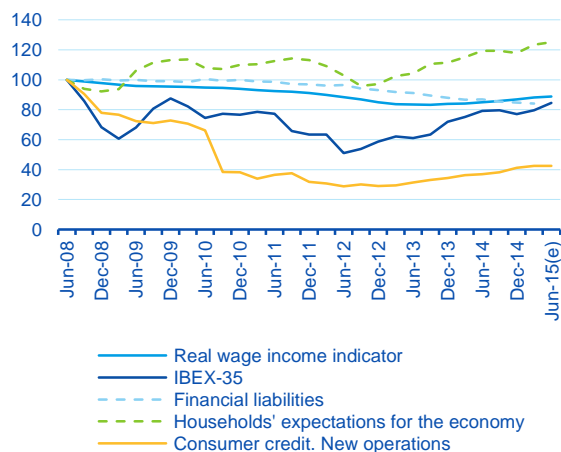
(e): estimate
Source: BBVA Research based on INE

9: For more information on the BBVA Survey of Economic Activity (EAE-BBVA), see Box 1 of Spain Economic Outlook, Second quarter 2014, available at <http://goo.gl/epUinr>

Private domestic demand is losing dynamism

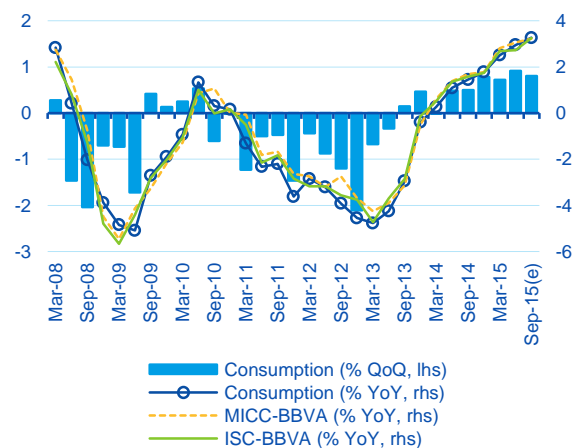
Consumption indicators, for both goods and services, suggest that **household spending should have risen in 3Q15, though by less than in Q2**. Even though job creation slowed down between July and September, family disposable income is likely to have increased thanks to the personal income tax reform¹⁰. The expected drop in financial liabilities and the rise in house prices should have offset the dive taken by stock market prices, for which reason net wealth should have increased. Besides the improvement in fundamentals, private consumption has also benefited from the rise in new lending transactions, while the view of households regarding the economic situation remains positive¹¹ (see Figure 3.5). As a result, both the composite consumption indicator (ISC-BBVA) and the coincident consumption indicators model (MICC-BBVA) show that **household spending is likely to have risen by around 0.8% QoQ (3.2% YoY) in 3Q15, which is 0.1pp less than in 2Q15** (see Figure 3.6).

Figure 3.5
Spain: drivers of consumption
(swda, 2Q08=100)



(e): estimate
Source: BBVA Research based on MINECO, Datastream, the EC and the Bank of Spain

Figure 3.6
Spain: observed data and real time estimates of household consumption



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

Machinery and equipment investment is likely to have grown again in 3Q15, although less strongly than in Q2. Although financial conditions remain relatively favourable, the political uncertainty and expectations of a demand slowdown both at home and from abroad are providing grounds for deferring new investment projects. This is confirmed by the partial short-run indicators which, after the positive surprise in Q2, suggest that this component of demand has lost traction. Specifically, improved industrial vehicle sales were partly offset by the drop in the capital goods order-book figure, the downward correction of industrial confidence, and the deceleration of capital imports. Consequently, the composite investment indicator (ISI-BBVA) estimates that in **3Q15 machinery and equipment investment ought to have risen by around 1.5% QoQ (9.6% YoY)** (see Figure 3.7).

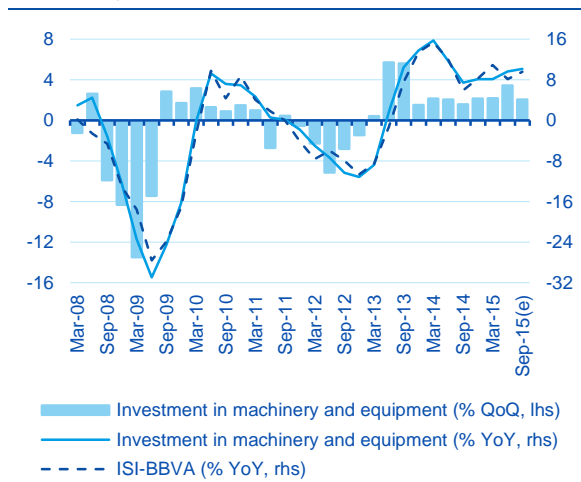
Although the key **residential investment indicators offered mixed signals in 3Q15**, on balance the information suggests that the deceleration also affected this component of demand. While housing starts could have picked up slightly, construction sector job creation diminished significantly. On the other hand, cement consumption and business confidence fell with respect to the previous quarter. In summarised terms, the

10: Estimation of the repercussions of the Personal Income tax (IRPF) Reform (in effect since January 2015) on household income can be found in Box 2 of Spain Economic Outlook, Fourth quarter 2014, at <http://goo.gl/0ClnbI>

11: The view of households regarding the situation of the Spanish economy is at a historic high, while with respect to their financial situation this is at 2001 levels.

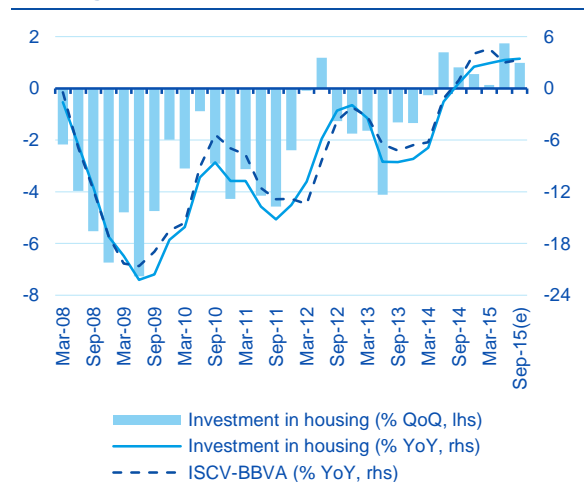
composite housing construction investment indicator (ISCV-BBVA) shows a **reduction in the growth rate to 1.0% QoQ (3.5% YoY)**, which means that this investment component should, in any case, have put together six straight quarters of positive growth (see Figure 3.8).

Figure 3.7
Spain: observed data and real-time estimates for machinery and equipment investment



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

Figure 3.8
Spain: observed data and real-time estimates for housing investment



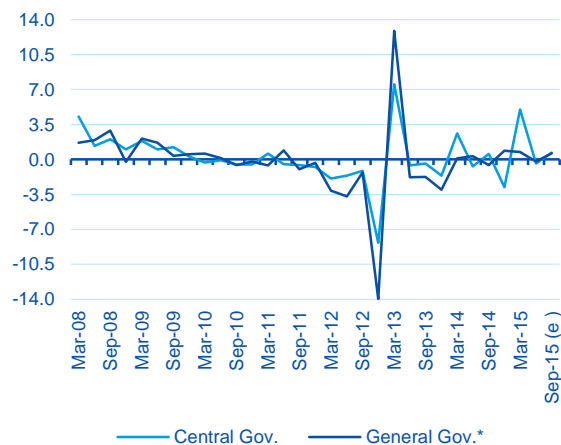
(e): estimate
Source: BBVA Research based on INE

Public sector demand shows less impetus than in the first half

Following the upturn observed as the year got underway, public sector demand growth is probably easing off. Adjusting for seasonal and working day variation (swda), the State's budget execution figures indicate a marginal rise in nominal public sector consumption in 3Q15, which is similar to that in 2Q15 and substantially below the rate observed up to 1Q15 (see Figure 3.9). Likewise, **real expenditure by general government should have ended 3Q15 in positive ground, even though growth would have been only modest (0.3% QoQ, 2.0% YoY)** and close to the reading in the previous quarter. Here, figures from the Labour Force Survey (EPA in Spanish) suggest that the **wage component is likely to have contributed to the growth of expenditure by the administrations taken as a whole**, and in fact the number of public sector salaried employees rose by 0.3% QoQ swda over 3Q15, after dropping back by 0.1% in 2Q15 (see Figure 3.10).

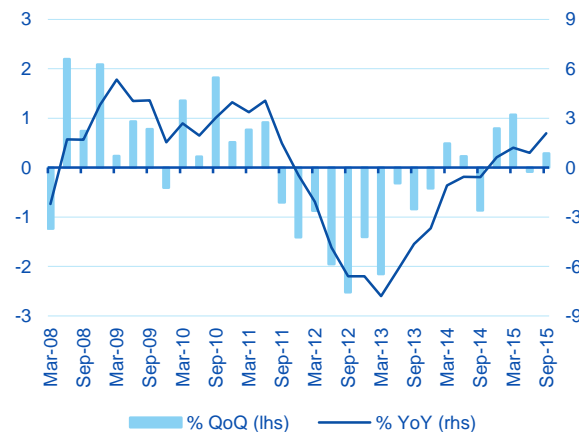
Meanwhile, the fall in official tendering processes over the first nine months of 2015 points to a dampening of public sector investment after the upturn in the first half of the year. As a result, **non-residential construction investment should have come off the pace and grown in the third quarter of the year at around 0.8% QoQ (7.3% YoY)**.

Figure 3.9
Spain: observed data and estimates for nominal public sector consumption (% QoQ, swda)



(e): estimate
(*) Among other items, this does not include fixed capital consumption.
Source: BBVA Research based on MINHAP and INE

Figure 3.10
Spain: salaried public sector employees (swda)



Source: BBVA Research based on INE

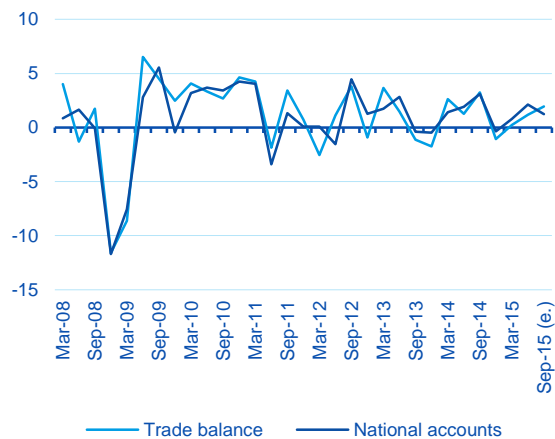
Tourism’s fine performance has not managed to avert an export slowdown

3Q15 was marked by a **somewhat less promising global situation for Spanish exports**. Although transport costs stayed low (thanks to another fall in the oil price), the euro exchange rate strengthened and global demand growth disappointed (mainly among the emerging markets, starting with China)¹². In keeping with this, the positive feel to industrial expectations wore off slightly (the export order book) and signs of a deceleration became evident among the indicators for sales by larger companies abroad and the balance of trade. In short, the information out thus far suggests that, **after the mild improvement observed in 2Q15 (2.1% QoQ), goods export growth was pinned back to 1.3% QoQ (3.9% YoY) in 3Q15**.

The overall performance by services exports in 3Q15 was modest (0.5% QoQ, 4.2% YoY) although it still compares positively with respect to previous quarter (-0.3% QoQ). After slipping back in 2Q15, non-tourism service exports are likely to have seen growth in 3Q15 (0.5% QoQ, 4.0% YoY), in spite of the adverse signs revealed by the breakdown for the balance of payments up to August. Conversely, non-resident consumption on Spanish soil has probably grown strongly again (1.7% QoQ, 4.3% YoY), which is keeping the tourist sector at record levels of activity, with tourist inflows likely to have risen by 2.7% QoQ swda between June and September, while real spending by this segment has probably done so by 1.2% swda.

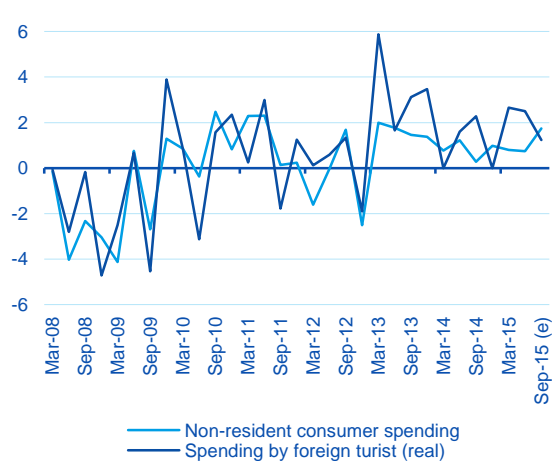
12: For greater detail regarding the potential channels through which activity shocks in China and Greece can be transmitted, see the Spain Economic Watch of September 2015, which is available at <https://goo.gl/qlgDn4>

Figure 3.11
Spain: goods export indicators (% QoQ, swda)



(e): estimate
Source: BBVA Research based on INE and customs information

Figure 3.12
Spain: tourism service export indicators (% QoQ, swda)



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

In line with the trend for final demand, the information available as this Outlook goes to print suggests that **import growth decelerated in 3Q15 (1.1% QoQ, 4.8% YoY)**. Growth is nonetheless likely to have been sufficient to cancel out the progress made by overall exports (1.2% QoQ, 3.9% YoY), which would have led to a **non-existent contribution by net external demand to the Spanish economy's quarterly growth**.

Developments in aggregate external sector figures contributed to bringing down the current account surplus during 3Q15 and estimates indicate that, after a 0.2pp improvement in the preceding quarter, the cumulative annual surplus figure came down by 0.1pp to 1.3% of GDP over 3Q15.

Job creation is slowing down

Labour market became less buoyant in 3Q15. After seasonal adjustments, average Social Security affiliation achieved eight quarters in a row of growth, but the rise in those registered was down by 0.8pp, reaching 0.3% QoQ swda. By the same token, the reading for the drop in unemployment moderated to -1.7% QoQ over July to September, compared to 2.6% QoQ in 2Q15 (see Figure 3.13)¹³.

The 3Q15 Labour Force Survey (EPA) confirmed the employment pattern suggested by the affiliation records. In gross terms, employment climbed by 210,200 people over July to September, which was a bit more than BBVA Research had anticipated¹⁴. Seasonally adjusting for the period, employment increased by around 0.6% QoQ, which was 0.4pp less than in Q2.

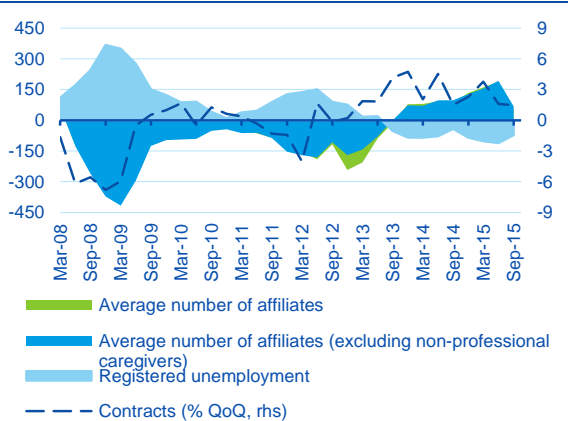
The private sector, and specifically services, led the way in job creation over July to September, especially for temporary work. The upturn in the number of salaried employees with a temporary contract (186,600) and the fall in recruitment under permanent contracts (18,800 people) gave rise to a 1.1 point increase in the temporary employment rate to 26.2%. After seasonal adjustment, the percentage of salaried personnel with a temporary contract has risen by three percentage points from its cyclical low of 1Q13.

13: The October readings confirm the anticipated labour market improvement following the weakness in the months around the halfway mark for the year. Adjusting for seasonality, BBVA Research estimates indicate that registration rose by around 32,000 people, while the fall in unemployment was 15,000. For additional information, please see <https://goo.gl/QMkQDg>

14: A detailed assessment of the 3Q15 EPA data can be found at <https://goo.gl/fxMqF8>

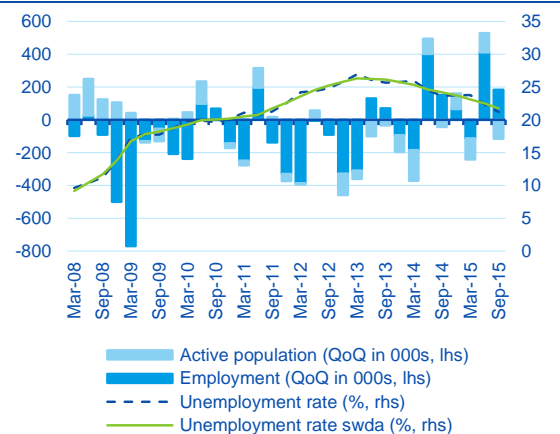
The rise in employment and the fall in the labour force (-116,000 people), which was greater than expected, brought about a **drop in the unemployment rate to 21.2% (21.7% swda)**. Since its cyclical peak in 1Q13, the swda unemployment rate has come down by almost five percentage points (see Figure 3.14).

Figure 3.13
Spain: labour market figures (QoQ var. in thousands of persons, unless otherwise stated, swda)



NPC: non-professional carers
Source: BBVA Research based on MEySS

Figure 3.14
Spain: labour market indicators



Source: BBVA Research based on INE

Price and cost restraint continued in 3Q15, helped by the oil price collapse

Headline consumer prices went back to negative territory in Q3, reaching -0.9% YoY in September¹⁵.

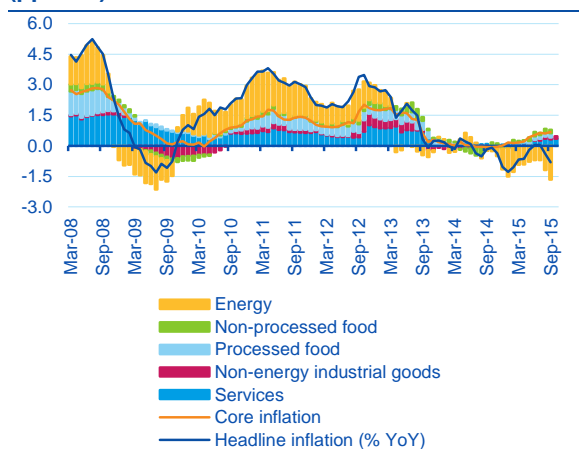
This development arose from the drop in the energy component (-13.6% YoY in September), which was mainly attributable to the new fall in the oil price (to around USD50/bbl at the close of this note). Despite the fact that there was less imported inflation, **core prices maintained its trend of steady growth (of around 0.8% YoY)**, which the improvement in domestic demand will continue to help to fuel (in spite of its deceleration), as will the monetary policy being implemented by the ECB. Core inflation's contribution to YoY price growth was close to 0.7pp in September, while that of the residual component was -1.5pp (energy: -1.7pp and non-processed foods: 0.2pp) (see Figure 3.15).

According to BBVA Research estimates, core price stabilisation continues to take place in the Spanish economy in a context of low inflation in Europe and a recovery of price-competitiveness in Spain. Thus the **inflation differential with respect to the euro area (measured in terms of the trend component) remains in Spain's favour, at around -0.4 pp** (see Figure 3.16)¹⁶.

15: The advance CPI indicator concealed a marginal setback for headline inflation in October due to the drop in fuel prices. Our estimates suggest that core inflation might have stayed at 0.6% and 0.7% (YoY). For more information, see <https://goo.gl/oLilby>

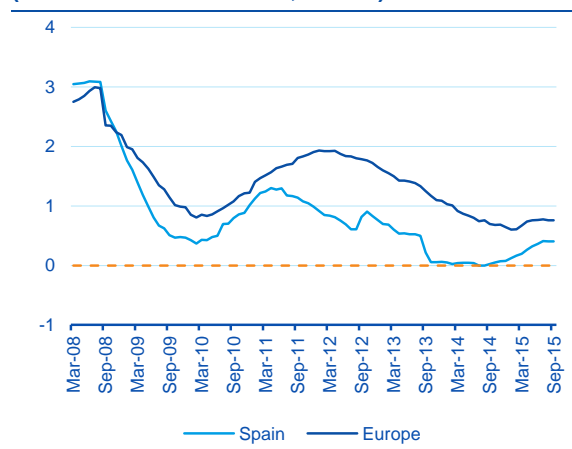
16: For further information on calculation of trend inflation using the trimmed means method, see Box 1 of Spain Economic Outlook, first quarter 2014, available at <https://goo.gl/pYTc7R>

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

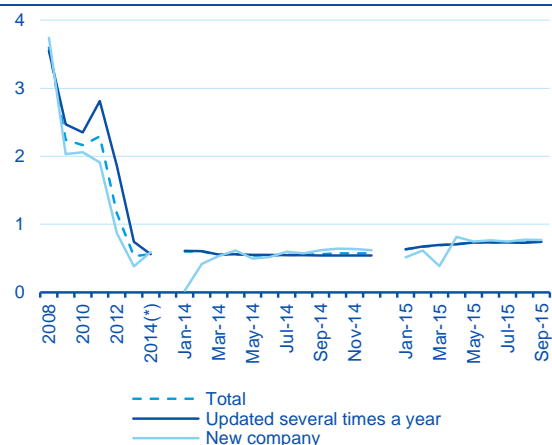
Wage demands held stable throughout the third quarter despite the upturn in core inflation. The average wage increase settled on under collective agreements rose by approximately 0.7% YoY over July to September for those agreements subject to multi-year review process, and by 0.8% for those signed over the year in progress (525 to September), which are binding on 1,643,000 workers¹⁷ (see Figure 3.17). All in all, the average wage rise agreed to September is under the figure of 1% established as the upper limit in the III Agreement on Employment and Collective Bargaining (AENC) for the year in 2015¹⁸.

As Figure 3.18 illustrates, the wage restraint that has been seen after the labour market reform came into effect in 1Q12 has implied a cumulative gain in cost-competitiveness with respect to the EMU of 4.5%.

17: The number of workers subject to collective bargaining was over 5.1 million to September, when those affected by agreements signed prior to 2015 (3,520,000) joined them. This figure is 23% higher than that recorded up to September 2015.

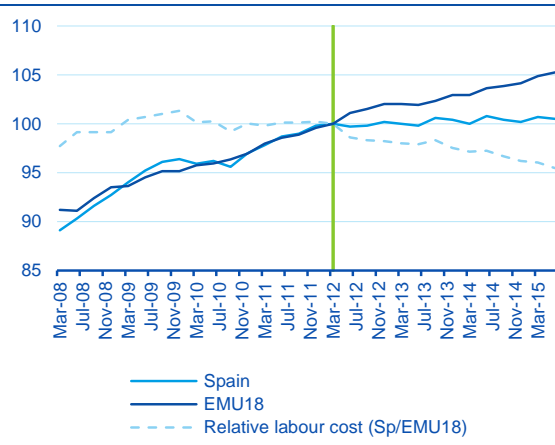
18: The III AENC (Agreement on Employment and Collective Bargaining), that was signed in early June by CEOE, CEPYME, CC, OO, and UGT, establishes a set of recommendations as guidelines for bargaining towards collective agreements over the next three years. As with the preceding one, the III AENC sets limits on the wage rises agreed under a collective settlement. In 2015 they may not exceed 1% and in 2016 this is 1.5%. The rise in 2017 will depend on the course of GDP growth over 2016 and the government's macroeconomic forecasts. Although the agreement does not explicitly stipulate the inclusion of wage review clauses, it does indicate that the wage rise agreed over the 2015-16 period must be higher than the sum of the inflation figures for both years.

Figure 3.17
Spain: average wage increase under collective bargaining agreements (%)



The annual data includes agreements registered after December each year and incorporates the review under the wage guarantee clause.
(*) Provisional data. The figures since 2013 are not comparable with years previous to this. See: <http://goo.gl/WQkvNU>
Source: BBVA Research based on MEySS

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



Source: BBVA Research based on Eurostat

New credit flows are keeping the recovery steady

While the stock of credit is falling at a slower pace (-4.3% in August), **the inflow of credit (new lending transactions granted) continues to show strong drive as it accompanies the economic recovery.** The cumulative figure from January to September for new transactions was up by 17.2% YoY. Besides the fact that all the constituent portfolios saw positive growth, on this occasion there was a notable recovery of lending to larger companies (+14.6% YoY in cumulative terms), such transactions being classified as those of over one million euros. During the crisis and most of the Spanish economy's recovery, these companies had chosen to raise money by other means, such as on wholesale markets or via intra-group loans but as credit conditions improved recently they have been gradually turning to the banks to borrow again.

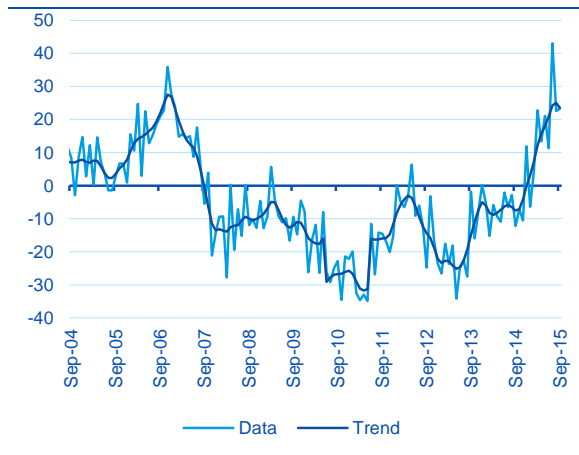
Meanwhile, retail transactions are still proving robust and generally gathering momentum, among both the SMEs (reaching 15.8% YoY, YtD), where these transactions are classified as those of less than one million euros, and households, in the various forms of loans such as mortgages (36.9% YoY, YtD), consumer credit (19.6% YoY, YtD) and other loans (23.4% YoY, YtD). Should this pattern be maintained, our estimates suggest that the inflow of new credit will outstrip the outflow (repayments and NPLs) by the year-end in 2015 or early in 2016, which will be when the stock begins to grow again.

On the other hand, the cost of new credit stopped its moderating pace during 3Q as a result of a mild upturn in the sovereign risk premium, yet its downward trend has not altered with respect to the levels that were seen a year ago. To give a specific example, the Annual Percentage Rate (APR) on mortgage lending was 2.42% in September, and 9.21% for consumer credit transactions, which was roughly 70 basis points (bp) below the level observed in the same month in 2014 in both cases. The average interest rate on new SME loans has come down by almost 100bp over the past 12 months, to 3.56% APR, and the rate on larger company loans is 2.14% APR, which is almost 80bp below the rate of a year ago.

This display of strength by new credit should continue over the next few quarters, for reasons associated with both demand and supply. On the demand side, the recovery of domestic spending, the expected rise in exports and the lower cost of credit will encourage loan applications. On the supply side, the improvement seen in liquidity conditions (thanks to the progress towards banking union and the ECB's

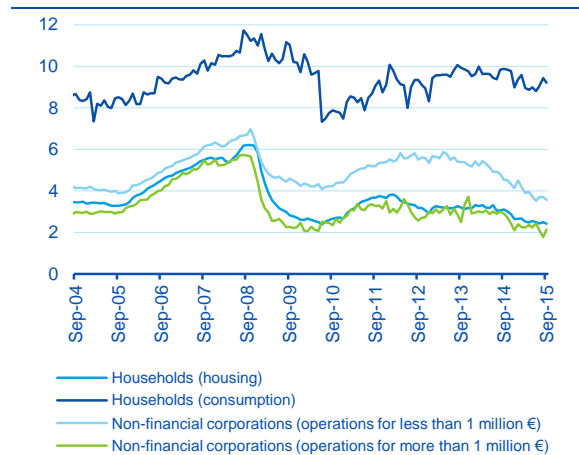
monetary policy), the reduced portfolio risk brought about by the brighter economic situation, and the headway being made in banking sector restructuring will act as positive forces. One of the fundamental goals of the banks is to boost the recovery of new lending business as economic activity picks up.

Figure 3.19
Spain: new lending transactions (% YoY)



Source: BBVA Research based on the Bank of Spain

Figure 3.20
Interest rates on new lending transactions (% APR)



Source: BBVA Research based on the Bank of Spain

2015-2016 Scenario: growth hits its top speed

As advanced in the introduction to this section, **the fundamentals built into the macroeconomic scenario allow the Spanish economy to maintain growth forecasts for the current biennium. In 2015 activity will move ahead by 3.2%, while in 2016 it will slacken to 2.7%**, which should be enough to allow one million jobs to be created over this time, which would bring the unemployment rate down to around 20%¹⁹.

The growth of activity will rest on both domestic and external factors. The downward revision of growth expectations for the world economy will be offset by rather more expansive monetary policy and the greater oil price restraint that is expected. On the domestic front, together with the structural improvement on fundamentals, the support from economic policy will lead to **a well-grounded expansion of domestic demand** (see Table 3.1). The increase in final demand will cause a notable upturn in imports, which is likely to give rise to a **practically negligible contribution to growth from net external demand**.

19: On average, employment will rise at an annual rate of 3.0% and the unemployment rate will hit about 20.5% in 2016.

Table 3.1.

Spain: macroeconomic forecasts

| (% YoY save indication to the contrary) | 3Q14 | 4Q14 | 1Q15 | 2Q15 | 3Q15 (e) | 2014 | 2015 (f) | 2016 (f) |
|---|-------------|------------|-------------|-------------|-------------|-------------|-------------|------------|
| Domestic Final Consumption Expenditure | 1.1 | 1.2 | 2.2 | 2.6 | 2.9 | 0.9 | 2.6 | 2.0 |
| Private FCE | 1.4 | 1.8 | 2.5 | 2.9 | 3.2 | 1.2 | 2.9 | 2.5 |
| General government FCE | 0.2 | -0.5 | 1.3 | 1.7 | 2.1 | 0.0 | 1.8 | 0.4 |
| Gross Fixed Capital Formation | 3.4 | 4.9 | 6.0 | 6.1 | 6.4 | 3.5 | 6.1 | 5.5 |
| Machinery & Equipment | 7.4 | 8.1 | 8.1 | 9.6 | 9.6 | 10.6 | 8.9 | 6.3 |
| Construction | 1.3 | 4.1 | 6.2 | 5.4 | 5.7 | -0.2 | 5.6 | 5.0 |
| Housing | 0.6 | 2.5 | 2.9 | 3.3 | 3.5 | -1.4 | 3.4 | 7.5 |
| Other buildings and structures | 1.8 | 5.2 | 8.8 | 7.1 | 7.3 | 0.8 | 7.3 | 3.2 |
| Domestic demand (*) | 1.8 | 2.0 | 2.9 | 3.2 | 3.6 | 1.6 | 3.3 | 2.6 |
| Exports | 6.4 | 6.5 | 5.9 | 6.2 | 3.9 | 5.1 | 5.2 | 5.2 |
| Imports | 7.3 | 6.8 | 7.1 | 7.0 | 4.8 | 6.4 | 6.0 | 5.1 |
| External balance (*) | -0.1 | 0.1 | -0.2 | -0.1 | -0.2 | -0.2 | -0.1 | 0.1 |
| Real GDP at market prices | 1.7 | 2.1 | 2.7 | 3.1 | 3.4 | 1.4 | 3.2 | 2.7 |
| Nominal GDP (mp) | 1.5 | 1.8 | 3.1 | 3.6 | 3.9 | 1.0 | 3.7 | 4.7 |
| Memorandum items | | | | | | | | |
| GDP ex housing investment | 1.8 | 2.1 | 2.6 | 3.1 | 3.4 | 1.5 | 3.1 | 2.5 |
| GDP ex construction | 1.8 | 1.9 | 2.3 | 2.9 | 3.2 | 1.5 | 2.9 | 2.5 |
| Total employment (LFS) | 1.6 | 2.5 | 3.0 | 3.0 | 3.1 | 1.2 | 3.0 | 2.9 |
| Unemployment rate (% labour force) | 23.7 | 23.7 | 23.8 | 22.4 | 21.2 | 24.4 | 22.2 | 20.5 |
| Total employment (fte) | 1.7 | 2.4 | 2.9 | 3.0 | 2.9 | 1.1 | 3.0 | 2.5 |

(*) Contributions to growth.

(e): estimate; (f): forecast.

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

The fall in oil price will make a moderate contribution to growth

Over the past few months, the **oil price has again come under downward pressure**, to the point where, as this note went to print, the Brent crude price has fallen to just under USD50/bbl, which is over 20% below the closing price for 1H15 (17%, in euro terms) (see Figure 3.21). Although the uncertainty as to the nature of this disturbance still rides high, **the available information suggests that on this occasion most (approximately two-thirds) of this is attributable to global demand factors**²⁰.

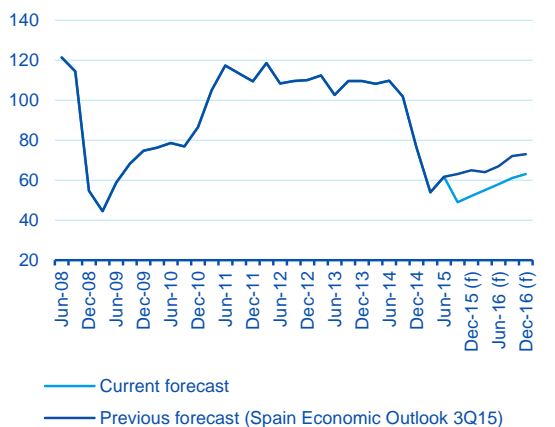
Given how energy-reliant Spain's economy is, we can expect a direct positive impact on activity in 2016. Even so, since this is mainly a demand shock, its scale is likely to be only moderate. Cheaper energy will lift family disposable income and bring down corporate production costs, which will boost consumption, investment and trade flows. Nonetheless, the lower level of global demand will directly counteract part of the positive effect on Spain's exports, and therefore the impact on activity²¹.

BBVA Research estimates point to a gradual steadying of the price at around USD60/bbl at the end of 2016 which, if it materialises, should add 0.1pp to the growth of the Spanish economy on average this year (see Figure 3.22).

20: BBVA Research estimates suggest that supply-side factors have played a secondary role in the slide by crude prices since the summer (equating to roughly one third). Such elements most notably include unconventional oil production in the United States (shale oil), the deals reached with Iran, OPEC's decision not to cut production quotas in spite of the pressure on prices, and finally the only marginal effect of geo-political tensions on production.

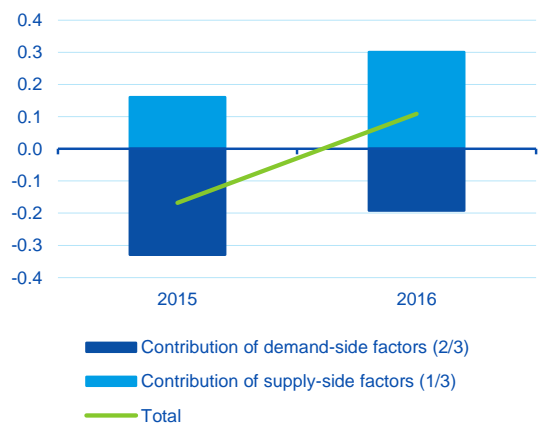
21: For greater details on estimation of the effects of the oil price by type of shock on activity and prices in the Spanish economy, please see Box 1 of the Spain Economic Outlook, second quarter 2011, available at: <http://goo.gl/42s7N9>

Figure 3.21
Oil price scenario
(USD/bbl, Brent)



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

Figure 3.22
Spain: impact of the oil price slump
(pp of annual growth)



(f): forecast
Source: BBVA Research

Demand-side policies will continue to underpin the recovery

Given the weakness of Europe’s economic recovery and the low inflation rates, **the ECB is standing by its commitment to resolute implementation of the previously announced set of measures, and it reiterates its willingness to use the full armoury of instruments at its disposal throughout its mandate, should this be called for.** Specifically, the monetary authority’s Governing Council (GC) stated that it will review the degree of flexibility of its policy at its next meeting, which could produce an extension of the asset purchase programme beyond the provisional date for its finalisation that had previously been set (up to September 2016 or until the ECB considers that inflation is back on a track that is more in keeping with its objective)²².

On top of holding its key benchmark rate at a historic low (0.05%) and expectations that the Federal Reserve will hike the US reference rate in December, these measures will contribute to maintain euro depreciated against the dollar (see Figure 3.23). Even so, **the downward revision of world growth and residual financial turmoil are partly neutralising the impact of ECB monetary policy.** Therefore, the updated economic scenario features a **marginal downward revision of forecast EMU growth** (of 0.1pp, to 1.8% in 2016). Overall, these elements will continue to support the recovery, although these revisions suggest that their impact could be less forceful than was expected three months ago (see Figure 3.24).

22: For further details, please see the ECB Watch by BBVA Research that was published on 22 October 2015. Available at <https://goo.gl/I6IP9L>

Figure 3.23
Euro exchange rate scenarios (EUR/USD)



(f): forecast
Source: BBVA Research based on the ECB

Figure 3.24
Impact of the downward growth revision on the EMU in 2016 (pp of annual growth)



Source: BBVA Research

Fiscal policy is mildly expansive

As has been said in previous Outlooks, **the government has made the most of the recovery of activity and the improvement in the cost of borrowing by implementing a mildly expansive fiscal policy over 2015**. On both the revenue and expenditure sides, measures have been taken which, at least for the time being, almost bring to a close the episode of contractionary fiscal policy in Spain's economy²³. In this situation, 2015 is expected to conclude with real public sector consumption growth of around 1.8%, while non-residential construction investment (affected by public works projects) will grow by close to 7.3%. In a scenario where there are no changes in economic policy, **the character of fiscal policy will be virtually neutral in 2016**. On the expenditure side, real public sector consumption growth will pull back to 0.5%, while non-residential investment will offer a growth rate of around 3.2%.

Even though the fiscal consolidation's negative contribution to growth should be coming to an end, it should be recalled that **imbalances remain in Spain's economy** (high debt levels, for example) **which justify adjustments and additional reforms** to heighten the economy's growth capacity and ensure the long-term sustainability of the public finances (see Box 3).

Domestic demand's shine is wearing off, yet it will continue leading growth

The consumption outlook for households remains favourable. Job creation, less tax pressure²⁴ and the absence of inflation pressure will go some way towards the recovery of real disposable income over the coming quarters. An expected increase in real estate asset value, expectations of official interest rates remaining at historic lows and the saving adjustment will also drive on family spending. Finally, new consumer finance business will continue to increase and prop up household spending in the medium term, especially on durable goods. As a result, **private consumption will grow by about 2.9% in 2015, in line with our forecasts of three months ago. In 2016**, transitory factors which have incentivised family spending up to the halfway mark this year will disappear, such as the PIVE (incentive programme of grants for buying new, more fuel-efficient cars), or else be relegated to a residual role, such as cheaper oil or the

23: On the revenue side, the most notable aspect is the tax cut, the opening part of which became effective in January 2015, while the coming into effect of the second part was brought forward to 1 July 2015. On the expenditure side, measures have been brought in such as the reinstatement of another part of the extraordinary payment which was withdrawn in December 2012, or the capital expenditure stimulus expected in 2015.

24: BBVA Research estimates indicate that bringing forward the personal income tax (IRPF) cut which was scheduled for 2016 to July 2015 should contribute 0.1pp to private consumption growth over the 2015-16 period.

tax cuts. On top of this, the contribution of some of the drivers behind them, such as financial wealth and real interest rates, will drop, and consequently, **private consumption growth will ease back to 2.5%**.

Machinery and equipment investment should continue to grow over the coming quarters, though at somewhat more moderate rates than those seen recently, still sustained by a setting of activity growth and stable corporate saving²⁵, with relatively low interest rates and a revival of new lending business. Meanwhile, though domestic demand growth will be less vigorous than it had been in the first half of 2015, which mixed in with the political uncertainty, will influence implementation of new investment projects in the short term. **Overall, healthy machinery and equipment investment growth is still forecast for the current two-year period (8.9% in 2015 and 6.3% in 2016).**

The housing investment recovery which began in 2014 will likewise probably continue over the coming months. The residential market is coming on as expected and both supply and demand indicators point to a positive performance. Family mortgage lending business is still growing strongly, which is helping housing sales to recover (9.5% YoY between January and August). Moreover, the area of urban plots sold (reflecting the prelude to a start on new real estate development projects) is also advancing (16.7% YoY in the period referred to). **As a result, residential investment ought to grow by 3.4% in 2015, rising to 7.5% the following year.**

The trend underlying the export performance is positive, in spite of the downward revision of short-term forecasts

The downward revision for expected world growth (to 3.2% in 2015 and 3.5% in 2016), means **an environment rather less conducive to short-term Spanish export growth**, despite the euro's expected depreciation against some of the currencies of developed countries. Nonetheless, the trend applying to the progress of exports abroad is still positive and, in the most likely scenario, will not be truncated by the recovery of domestic markets (see Box 1). Thus, although **forecasts for export growth over 2015-16 are being revised downwards, they remain bright, as exports overall will move ahead at an average annual rate of 5.2%**, the goods component will grow at 5.1% in each of the years and non-resident consumption will rise by 3.8% in 2015 and 3.3% in 2016.

Although the slowdown in final demand will have an adverse effect on imports, their growth will still be robust (6.1% in 2015 and 5.1% in 2016) and will outstrip that of sales abroad, so the **contribution to economic growth of net external demand will be almost non-existent in both 2015 and 2016 (-0.1pp and 0.1pp respectively)**. Cheaper oil will continue to make the Spanish economy's energy bill with the world outside it more affordable which will **give continuity to positive current account balances over 2015-16 (1.7% of GDP on average)** and the conclusion of the adjustment of the current account's structural deficit.

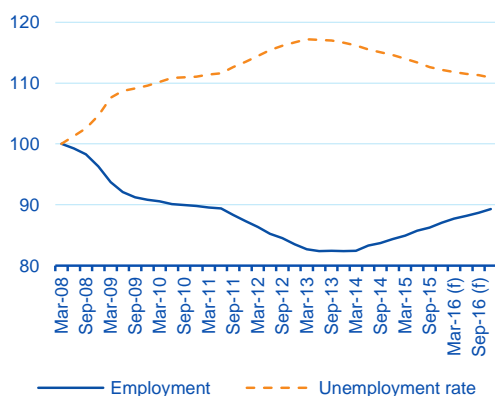
25: Part of the improvement in productive investment is due to the increased saving by businesses which, by using various different instruments, and depending on their size, have managed to bring down their borrowings and generated the funds needed to take on new projects (see Box 2).

The outlook for the labour market is positive, but the challenges are still exceptional

The economy will continue to see job creation over the upcoming two years. Given the expected level of economic growth, employment could rise by around 3% in 2015, while the unemployment rate should come down by over two points to 22.2%, in line with what was predicted in August. In 2016, the rise in the number of employees should ease off slightly (to 2.9%) and the drop in the unemployment rate should be less pronounced (moving to 20.5%) than was forecast for 2015 given the less promising progress expected by the labour force.

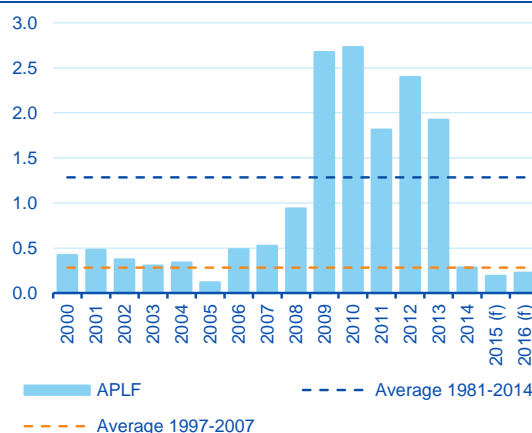
Despite the fact that labour market prospects are good, the distance from pre-crisis levels is likely to remain considerable at the end of next year. As Figure 3.25 shows, in 4Q16 employment should stand at around 10% below the level going into 2008, while the unemployment rate should be 10 points above it. Moreover, expected trends for activity and full-time equivalent employment (which will increase by approximately 5% over 2015 and 2016) suggest that the **rise in apparent labour productivity will be insignificant**, both this year (0.2%) and in 2016 (0.2%). These increases are in line with those that were seen in the previous expansive phase (averaging 0.3% over 1997-2007) but are below the historical average growth rate (1.3% between 1981 and 2014) (see Figure 3.26). The challenges which the labour market still faces are thus exceptional.

Figure 3.25
Spain: employment level and unemployment rate (1Q08=100, swda)



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

Figure 3.26
Spain: growth of apparent labour productivity (%)



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

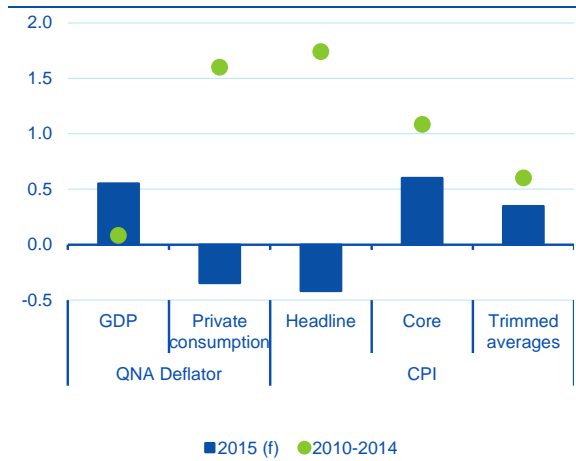
The oil price will keep inflation pinned in negative territory, but only in the short term

In spite of an expected euro depreciation, the fall in oil price (to around an average of USD60/bbl for 2015-16) **has been pulling headline inflation down during 2015 (to an annual average of -0.4%)**. Nevertheless, the domestic drivers indicate that both core inflation and the implied GDP deflator will remain in positive terrain, albeit at moderate levels in 2015 (an annual average of 0.6% in both cases) (see Figure 3.27).

In 2016, both headline and core inflation will keep an upward trend, reaching an annual average of 1.2%, which is still below the monetary authority targets (see Figure 3.28). As was previously said in earlier Outlooks, this steady improvement **will be helped by the monetary policy measures** which the ECB has

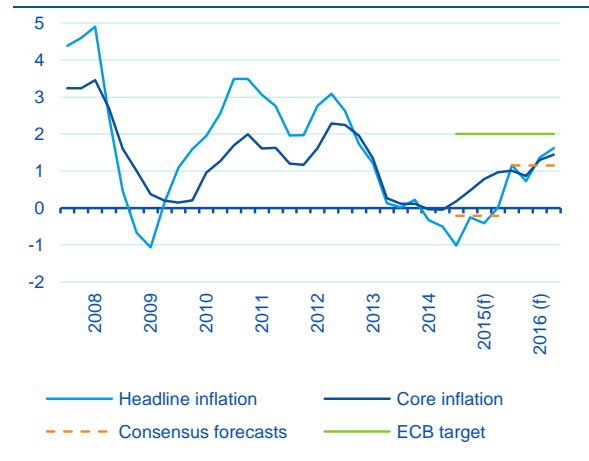
been reinforcing since midway through last year (cutting interest rates, encouraging more available credit, quantitative easing), as well as the improvement in domestic demand and the labour market.

Figure 3.27
Spain: price indicators
(% YoY)



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

Figure 3.28
Spain: observed data and expectations for
inflation (% YoY)



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

The scenario is not without risk

Although the Spanish economy is still growing at a healthy rate, some external and domestic risks persist. Among those from outside, bigger risks that are linked with the slowdown among the emerging economies are in evidence (mainly in China). At the same time, in some of these economies there is lingering uncertainty over the potential response to shifts in monetary policy by the Federal Reserve, while on the other hand geo-political risks remain.

In domestic terms, the likelihood remains high of the government deficit reaching 4.5% of GDP at the year-end and overshooting the stability target. Larger than expected scale deviations would displace a bigger portion of the adjustment towards 2016 and could affect domestic demand's recovery. Maintaining credibility when it comes to controlling the public finances has a direct impact on the trust of European institutions, and therefore on the ability to hold down the cost of borrowing for an economy overladen with debt owed abroad. Finally, the current uncertainty over the political situation might be starting to have a bigger influence on business and family decision-making. Up to now, the deterioration in the financial variables has been marginal and only relative. A commitment to legislation and driving forward measures to enhance the functioning of goods and services markets would allay some of this uncertainty.

4 The economic recovery will not be enough to meet the stability targets

The upturn in activity helped towards correcting the budget deficit in the first half of the year

Spain's public administrations closed the first half of 2015 showing a deficit of 2.9% of GDP²⁶, thus making a 0.4pp improvement on the imbalance recorded in the same time interval in 2014 (see Figure 4.1). This fundamentally arose from the performance by central government, where there was an improvement of some 0.4pp which took the deficit to 1.9% of GDP. Behind it, both the regions and the local corporations improved on the balance from the previous year by 0.2pp and 0.1pp of GDP respectively. Finally, the Social Security system was the only administrative body that closed the first half of the year with a worse position than in the previous year.

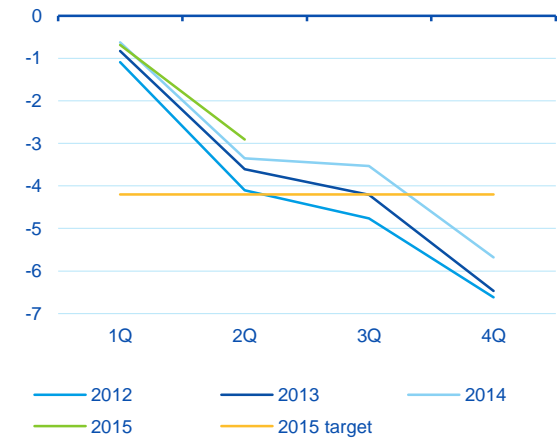
Analysing the observed deficit adjustment, BBVA Research estimates show that the recovery in activity helped to reduce the Spanish government deficit by roughly 0.7 points of GDP over the first half of 2015 (see Figure 4.2). This was accompanied by a moderation of the structural deficit, which is likely to be making up for a large part of the structural fall in revenues as a result of the cut in the average rate on personal income tax (IRPF). Thus the **deficit's reduction could, to a large extent, be attributable to the cyclical improvement in activity, and confirm an end to the restrictive emphasis given to fiscal policy in previous years.**

In this situation, over 1H15 the upswing in activity absorbed practically all of the structural fall in government revenue that derived from the tax cut that had been in effect since the start of the year. To be precise, in 1H15 the tax reform represented a draining of almost one point of GDP in YoY terms from general government's structural revenue. This mainly focused on personal income tax, where structural revenue was diminished by around 0.7 percentage points. Meanwhile, the economy's cyclical upturn over the first two quarters of the year added one more percentage point of GDP to revenues. As a result, total public revenue in cumulative terms, over four quarters taken together, would have reached around 37.9% of GDP as of the close of 2Q15, thereby holding practically stable with respect to the first half of last year.

On the other hand, over the first two quarters of the year one can detect a YoY adjustment in the structural component of expenditure of over 0.7 percentage points of GDP, which is spread across all the spending items, although this is particularly pronounced in investment, which saw a cumulative structural adjustment of 0.4pp of GDP, and in the structural component of unemployment benefits (0.3pp of GDP). Likewise, the cycle helped bring down unemployment benefits and interest servicing. This meant that total annual cumulative expenditure for general government as a whole would have been 43.1% of GDP, one percentage point below the cumulative figure for June 2014.

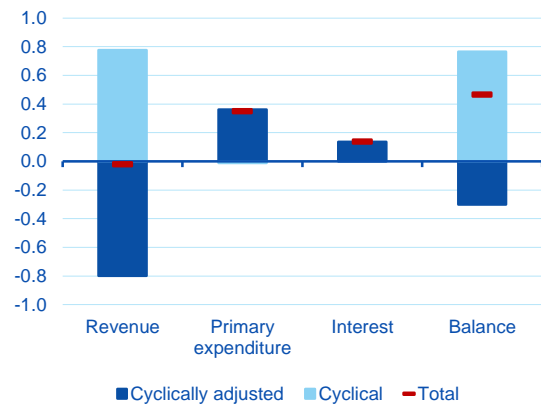
26: The deficit examined in this section always excludes assistance for the financial system.

Figure 4.1
General government: net lending / net borrowing (% of GDP)



Source: BBVA Research based on MINHAP

Figure 4.2
General government: breakdown of the fiscal correction in 1H15 (pp of GDP)



Note: (+) Revenue rises, expenditure falls, the deficit comes down; (-) revenues fall, expenditure rises, the deficit rises
Source: BBVA Research based on MINHAP

Budget execution could insufficient to ensure that the stability target is met

Turning to the final half of the year, as was said in section 3 of this Outlook, the latest figures put the cumulative public deficit (excluding local corporations) to August 2015 at around 3.4% of GDP, which is 0.7pp lower than the deficit that had built up over the same interval in 2014. These figures show that, in absolute terms, correction of the deficit is still focussing on restoring revenues, much as expected, and on bringing down the costs of external borrowing.

With regard to this, the results observed during the first half of the year might not be enough to ensure that the stability target is met. Although the recovery of revenues should continue and the economic cycle will benefit the public finances, the measures to lift spending which have been announced increase the chances of falling short of the target. On this basis, BBVA Research forecasts that public revenue in 2015 will come in at only 0.1pp above the level achieved in 2014. On the expenditure side, the pick-up of activity will bring down the expenditure to GDP ratio by a bit over one percentage point, even though the only fall will be observable in interest servicing expenses and unemployment benefits (see Table 4.1).

Table 4.1.

General government: net borrowing, excluding assistance for the financial sector

| % of GDP | 2014 | 2015 (f) | 2016 (f) |
|-------------------------------|------|----------|----------|
| Employee compensation | 10.9 | 10.7 | 10.4 |
| Intermediate consumption | 5.2 | 5.1 | 5.0 |
| Interest | 3.3 | 3.1 | 2.9 |
| Unemployment benefit | 2.3 | 1.8 | 1.7 |
| Pensions | 10.8 | 10.7 | 10.5 |
| Gross capital formation | 2.1 | 2.0 | 2.0 |
| Other expenditure | 9.0 | 9.0 | 8.8 |
| Non-financial expenditure | 43.6 | 42.4 | 41.2 |
| Taxes on production | 11.3 | 11.4 | 11.8 |
| Taxes on income, wealth etc. | 10.0 | 10.1 | 10.1 |
| Social Security contributions | 12.3 | 12.2 | 12.1 |
| Taxes on capital | 0.5 | 0.5 | 0.5 |
| Other income | 3.9 | 3.7 | 3.7 |
| Non-financial funding | 38 | 37.9 | 38.2 |
| Net borrowing | -5.7 | -4.5 | -3.0 |
| Stability target | -6.5 | -4.2 | -2.8 |

(f): forecast

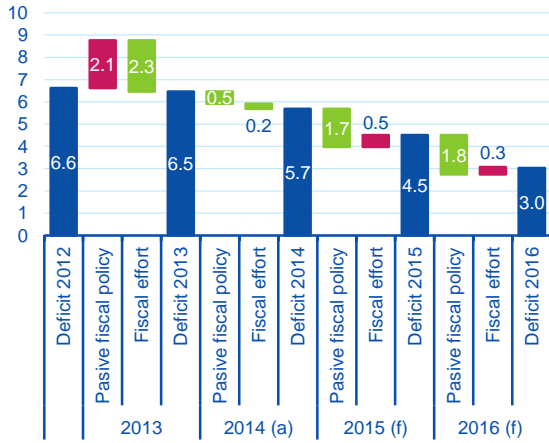
Source: BBVA Research based on MINHAP and INE

Given these circumstances, BBVA Research suggests that the **tax cuts will give rise to a reduction in structural revenue from personal income tax which, in the short term, will be offset by the cyclical recovery of the tax base**. Meanwhile, the economic cycle will continue to drive up tax collection from both production and social security contributions, so public revenue will rise to 37.9% of GDP in 2015 and then up to 38.2% in 2016.

On the expenditure side, in an unchanged scenario as regards fiscal policy **the step-up in expenditure should carry on over the next two years**, which will be compensated by the positive impact from the cycle. As a result, public expenditure will end 2016 at around 41.2% of GDP, which is on a par with pre-crisis levels.

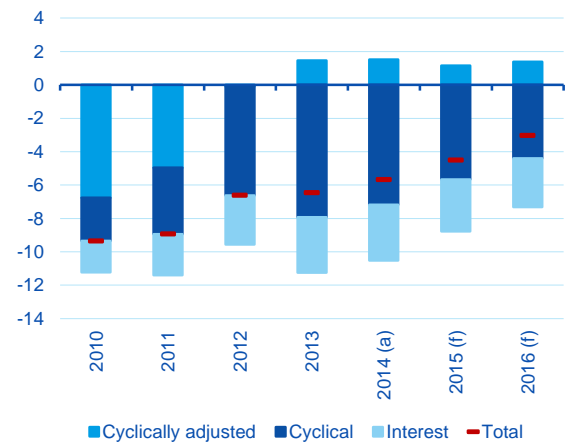
The economic cycle should therefore continue to correct the fiscal deterioration in 2015, due to both the effect of automatic stabilisers and less pressure from the burden of interest-servicing and pensions. Along with this, the impact of the expansive policies already implemented will leave the 2015 deficit at about 4.5% of GDP, which is more than the 4.2% target decided for this year. Looking to 2016, the economic cycle is expected to continue correcting the slippage in the public finances so that, in a scenario of unchanged fiscal policy, the 2016 deficit should be trimmed by 1.5pp to 3.0% of GDP (see Figure 4.3).

Figure 4.3
General government: breakdown of the fiscal correction (pp of GDP)



(a): advance est.; (f): forecast
Source: BBVA Research based on MINHAP and INE

Figure 4.4
General government: net lending / net borrowing (% of GDP)



(a): advance est.; (f): forecast
Source: BBVA Research based on MINHAP and INE

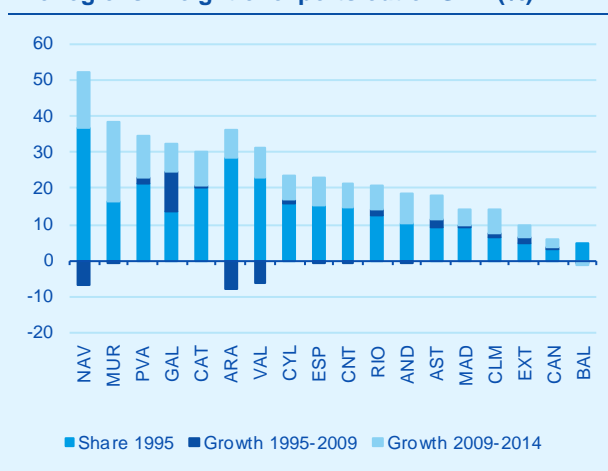
Should such a scenario arise, **the cycle-adjusted public deficit should be slightly above 1.5% at the end of 2016**, which represents an improvement of only 0.3pp since 2014. If interest payments are deducted, a primary structural surplus of around 1.4% since 2013 would emerge (see Figure 4.4). This means that, according to BBVA Research forecasts, the pace of rectification of the structural balance of Spain’s public finances is running some way below the rate that was recommended by the European Commission in 2013 (a 1.9pp reduction over 2015 and 2016²⁷). On this point, the Commission’s recent official opinion on the draft General State Budget for 2016 draws attention to the risk of failing to fulfil what was agreed in the Stability and Growth Pact, and recommends that the draft be updated as soon as possible to include the measures needed to achieve the objectives. Consequently, over the coming years there should be a continuation of policies to control public spending so as to enhance the capacity to generate primary surpluses that are large enough to bring down the level of public debt to a rate consistent with keeping economic recovery on course and preserving the confidence of creditors.

27: See http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/126-07_council/2013-06-21_es_126-7_council_en.pdf

Box 1. Does the performance of domestic demand affect export growth?

Spain's export growth over the next few years could be key for keeping the recovery on track and helping to bring about and ordered deleverage relative to the rest of the world. **The crucial nature of exports has been particularly reinforced since the outbreak of the crisis and the slump in domestic markets.** For example, over the past recession the drop in the Spanish economy's GDP would have been some 9 percentage points (pp) deeper than was actually observed in absence of any positive contribution to growth from net external demand. Given this situation, goods exports have taken on new significance in Spain's economy, reaching 23% of nominal GDP, which is 8pp above their weight in 2009. It is worth noting here that, as Figure B.1.1 illustrates, this growth was across the board in regional terms.

Figure B.1.1
The regions: weight of exports out of GDP (%)



Source: BBVA Research based on Datacomex and INE

What lies behind goods exports performance over the past recessionary cycle?

Numerous studies²⁸ find that trends for the more traditional drivers, such as world demand and the real effective exchange rate, are not in themselves enough to account for the recent growth of exports among the EMU economies in a setting where world growth is on the wane and there is stickiness in the nominal exchange rate

28: See, for example, the ECB (2013), the IMF (2013) or the Bank of Spain (2015).

against the currencies of key trading partners.

This box seeks to explain the growth of Spanish exports, based on the influence of domestic demand pressures on export activity.

The findings tell us that:

- **The traditional determinants of goods exports exhibit elasticities in line with the latest literature.** Over the long term, world demand growth passes through to an increase in exports with an elasticity approaching 1, while a 1% depreciation of the REER boosts Spain's exports by around 0.4pp.
- **Private domestic consumption appears to have a substitution effect in relation to export activity.**
- **The influence of domestic demand trends on exports is asymmetric, being stronger (and significant) when domestic consumption falls.** In specific terms, it is estimated that the contraction in domestic consumption accounted for 40% of the growth of export goods over 2010-13. On the other hand, domestic demand's recovery is likely to have had a relatively insignificant effect on export activity. No downward pressure on exports is therefore expected from domestic demand growth in the medium term.

The following sections expand on the methodology used and then we set out the key conclusions.

Model, variables and results

To gain a better understanding of the factors behind how Spanish exports behave²⁹, **a dynamic data panel model has been estimated for the regions, running from 1997 to the first quarter of 2015**³⁰. In the chosen specification, regional non-energy exports are dependent in the long term on international demand and regional price-competitiveness. These variables are constructed, respectively, as a weighted average of the real GDPs of the main trading partners of each region and as a REER that is based on the regional Consumer Price Indexes (CPIs). The deviations from the long-run equilibrium level arise from the quarterly variations in both demand from abroad and price-competitiveness.

The results suggest that regional goods exports respond positively to shifts in demand by major trading partners and negatively to appreciation of the REER. In precise terms, the elasticities show themselves to be in line with those in the latest literature (Bank of Spain (2012), Bank of Spain (2015)). In the long run, world demand growth passes through with an elasticity of close to 1 to increased regional exports, while a 1% appreciation in the REER brings down sales abroad by around 0.4pp (see the “Traditional estimation” column in Table B.1.1).

These coefficients are slightly lower than those obtained over the 90s (see Buisán & Gordo (1994), Doménech & Taguas (1996) or García & Gordo (1998). Several factors underlie this reduction of elasticities. First, as is noted in the ECB (2014) and Gopinath (2015), Spain’s greater involvement in global value chains could have modified the response by exports to variations in

global demand and competitiveness. At the same time, in keeping with what was set out by the Bank of Spain (2015), commencing the sample at the end of the 90s means not including the peseta devaluations in the first part of that decade. Estimation focuses on a period when the nominal exchange rate does not represent an economic policy instrument. Finally, Ortega *et al.* (2007) suggest that the response by exports to relative prices could have weakened owing to factors that relate to quality and product differentiation.

In the short run, it is found that quarterly variations in price-competitiveness do not seem to have a significant contemporaneous effect on export activity. On the other hand, the elasticity of goods exports with respect to quarterly increases in world demand is estimated to be 2.2. Finally, short-term deviations from the equilibrium level are corrected by around 40% every quarter.

In a second stage, the correlation between domestic consumption and export activity is estimated to test whether this factor helps to partly explain the exceptional growth by exports over the last recessionary cycle. For these purposes, a composite consumption indicator is constructed for each region based on the key partial spending indicators available on a regional level: retail sales, vehicle registrations, services sector activity index, consumer goods imports and national domestic consumption³¹ (see Figure B.1.2). The methodology applied to construct this indicator is based on PCA (principal component analysis)³².

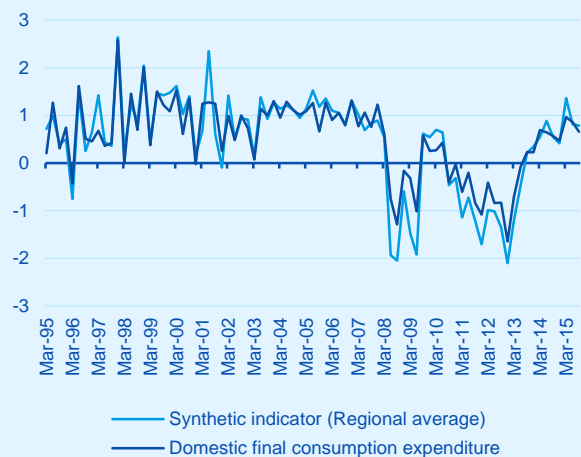
29: Owing to its high volatility, the energy component has been removed from goods exports.

30: See the annex for more detailed information on the methodology used.

31: Only consumption indicators have been selected, since the investment effect of domestic demand on exports might be two-way in the sense that exports increase installed productive capacity.

32: For more detailed information on this methodology, see Pearson, K. (1901). "On Lines and Planes of Closest Fit to Systems of Points in Space". *Philosophical Magazine* 2 (11): 559–572. and Stock, J & Watson, M. "Forecasting Using Principal Components From a Large Number of Predictors" *Journal of the American Statistical Association* Dec. 2002, Vol.97, No 460, Theory and Methods.

Figure B.1.2

Spain: domestic consumption and the composite consumption indicator (QoQ, %)

Source: BBVA Research based on Customs information, DGT and INE

The results of the second regression, which includes the composite consumption indicators, provide elasticities for the traditional determinants of exports that are consistent with those obtained in the first specification (see the “Traditional estimation + Consumption” column in Table B.1.1). Moreover, there is a discernible **inverse correlation between domestic consumption³³ and export growth**, although this coefficient is only weakly significant. From a theoretical standpoint, the correlation between domestic demand and exports is not direct, because there are arguments supporting both the presence of substitution effects and potential complementarity. Even so, as Melitz (2003) and Vannoorenberghe (2012) show, given productive capacity constraints, there might be a trade-off between sales in the domestic market and abroad, given that firms respond to a market shock by adjusting their sales in the other market accordingly. From this it can be inferred that exports can be a negative function of domestic sales, which is especially marked in situations of low capacity utilisation.

33: The estimation indicates a negative coefficient that is associated with movements in domestic consumption with a lag of two time periods, in line with what is set out in the ECB (2015) article, and three time periods in the Bank of Spain (2015) piece, reflecting the time required by firms to begin or increase their export activity.

What is more, **the correlation between domestic demand and exports can be asymmetric**. As Belke *et al.* (2012) suggest, in times of domestic stress, given the shortfall of domestic demand with respect to installed productive capacity, firms try to substitute domestic sales via sales abroad and their willingness to meet costs associated with international expansion rises. Yet once they have assumed the sunk costs of internationalisation and having adapted investment and production to suit foreign consumers, it appears highly unlikely that firms will reverse this process, so sales growth within borders might have an effect that is complementary to exports. In this way, gains in export share could have a structural nature.

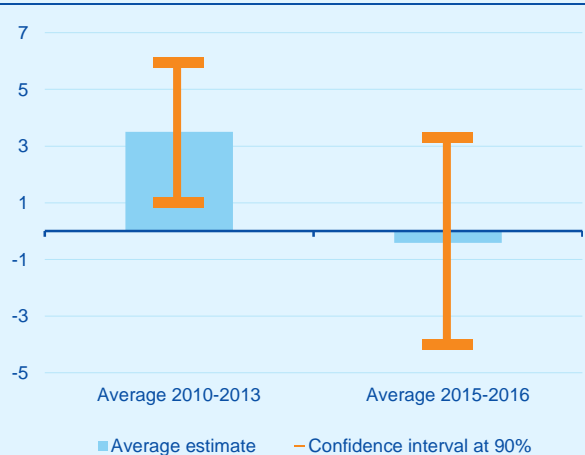
Such asymmetry in export elasticity with respect to domestic consumption can be seen in the third specification in Table B.1.1 (see the “Traditional estimation + Asymmetric consumption” column). In it, the consumption variable is truncated into two variables. The first, “Domestic consumption⁺”, shows the positive variations in consumption, while the second, “Domestic consumption⁻”, gives the falls in consumption.

The results of this estimation suggest that only the drops in domestic consumption make a significant impact on export activity. Specifically, we find that export activity exhibits elasticity approaching 1 with respect to falls in domestic consumption. Thus, **a contraction of domestic demand is likely to have accounted for around 40% of goods export growth between 2010 and 2013**. On the other hand, the low level of significance associated with positive variations of domestic consumption does not allow clear identification of whether this exerts a substitution effect with regard to sales abroad or whether, on the contrary, their behaviour is complementary. Here, **no downward pressure**

on export activity is expected to arise from the current recovery in domestic demand (see Figure B.1.3).

Finally, we make the point that including the consumption variables does not alter the significance or the coefficients of the traditional variables.

Figure B.1.3
Spain: contributions of domestic consumption to goods export growth (annual average and confidence interval, %)



Source: BBVA Research and INE

Table B.1.1
The regions: estimates of determinants of goods export growth (1Q97-1Q15)

| | Traditional estimation | | Traditional estimation + Consumption | | Traditional estimation + Asymmetric consumption | |
|---|------------------------|---------|--------------------------------------|---------|---|---------|
| | Coef. | P-value | Coef. | P-value | Coef. | P-value |
| Long run correlation | | | | | | |
| Demand from abroad | 0.954 | 0.000 | 0.972 | 0.000 | 0.976 | 0.000 |
| Competitiveness | -0.351 | 0.003 | -0.408 | 0.000 | -0.463 | 0.000 |
| Short run correlation | | | | | | |
| Coefficient of convergence to equilibrium | -0.368 | 0.000 | -0.403 | 0.000 | -0.390 | 0.000 |
| Δ Demand from abroad | 2.234 | 0.000 | 2.577 | 0.000 | 2.705 | 0.000 |
| Δ Competitiveness | -0.005 | 0.180 | -0.006 | 0.148 | -0.005 | 0.194 |
| Δ Domestic consumption | | | -0.579 | 0.082 | | |
| Δ Domestic consumption ⁺ | | | | | -0.133 | 0.826 |
| Δ Domestic consumption ⁻ | | | | | 1.076 | 0.021 |
| Log Likelihood | 1195.3 | | 1209.3 | | 1222.8 | |
| # of obs. (NxT) | | | | | 1241 | |

(*) The change of sign in the case of "Domestic consumption⁻" is for ease of interpretation
Source: BBVA Research and INE

Conclusions

In this study the determinants of goods exports have been analysed using a dynamic data panel model for the Spanish regions. The results confirm that **exports respond positively to shifts in demand by major trading partners and negatively to appreciation of the real effective exchange rate.**

It has also been found that **domestic consumption seems to exert a substitution effect regarding sales abroad**, which gives rise to a rebalancing of resources between domestic and foreign markets.

Finally, it emerges that **the relationship between growth in Spanish domestic demand and that of sales abroad is asymmetric. Only falls in the domestic market have a significant effect on export activity**, by triggering a reorientation of sales and making firms more inclined to take on internationalisation costs.

Therefore, in a climate of weakness on the part of main trading partners and nominal exchange rate stickiness, **the domestic demand contraction could have boosted export activity by around 3 percentage points a year over 2010-13, which would account for 40% of the growth registered over that time.** On the other hand, the impact of the positive domestic demand variations and their potential effect on exports (substitution or complementarity) does not appear significant. Here, after assuming the sunk costs of internationalisation and the economies of scale that might be produced, it seems highly unlikely that firms should go back on such an expansion of their export activity despite the current pick-up in domestic demand.

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Annex

This box examines the growth determinants of goods exports using an error correction model with regional panel data. After Pesaran & Smith

(1995) and Pesaran, Shin & Smith (1997, 1999), we assume that regional goods exports follow an Autoregressive Distributed-Lag (ARDL) process $(1, q_1, \dots, q_{1k})$:

$$X_{it} = \lambda X_{it-1} + \sum_{j=0}^q \delta'_{ij} Z_{i,t-j} + \mu_i + \varepsilon_{it}$$

$$(t = 1997q1, \dots, 2015q1) \quad [1]$$

where $Z_{i,t-j}$ is a $k \times 1$ vector of explanatory variables (in this case, real GDP of key trading partners as a proxy for demand from abroad, the Real Effective Exchange Rate (REER) as a proxy for price-competitiveness, and a composite indicator of regional domestic consumption (ICI for the Spanish). μ_i is a fixed effect for each region and ε_{it} is an error term that is independently distributed over i and t .

If the variables are cointegrated³⁴ and the regressors are strictly exogenous³⁵, this can be expressed [1] as an error correction mechanism:

$$\Delta X_{it} = \phi_i (X_{it-1} - \theta'_i Z_{it}) + \lambda^* X_{it-1} + \sum_{j=0}^{q-1} \delta'_{ij} \Delta Z_{i,t-j} + \varepsilon_{it} \quad [2]$$

where $\phi_i = (\lambda_i - 1) < 0$ denotes the speed of convergence towards the long-run equilibrium growth rate, $\theta_i = \sum_{j=0}^q \delta_{ij} / (1 - \sum_k \lambda_{ik})$ represents the equilibrium relationship between the variables and $\delta^*_ij = -\sum_{m=j-1}^q \delta_{im}$ $j = 1, 2, \dots, q - 1$ gives the short-run disequilibrium.

In the case which concerns us here, the equation that is finally estimated using the method of maximum likelihood³⁶ is:

$$\Delta X_{it} = \phi_i (X_{it-1} - \theta_{0i} - \theta_{1i} \ln PIB_{it} - \theta_{2i} \ln REER_{it}) + \delta_{3i} \Delta PIB_{it} + \delta_{4i} \Delta REER_{it} + \delta_{5i} \Delta ICI_{it} + \varepsilon_{it} \quad [2]^{37}$$

34: Unit root tests were carried out both for individual members and for the panel of data as a whole, Pedroni (1999 and 2004) and Westerlund, J. (2005). The tests suggest that the real variables are $I(1)$. The results of the panel cointegration and unit root tests are available for readers who may be interested.

35: Testing for potential endogeneity of the variables was carried out. The results suggest that there could be contemporaneous endogeneity between exports and domestic consumption, even if this relationship disappears with the ICI variables lagged by two quarters.

36: The Hausman test rejects the existence of systematic differences between mean group (MG) estimation and pooled mean group (PMG) estimation. The PMG estimator is chosen since it is efficient. PMG restricts the long-run relationship to being identical between regions, while it allows some short-run coefficients to be different according to region.

37: As was previously explained, the ΔICI variable is included in the first "traditional" estimation and split into two to test for potential asymmetries of elasticity in the "Traditional estimation + Asymmetric consumption" column.

Box 2. Spain: trends in corporate saving

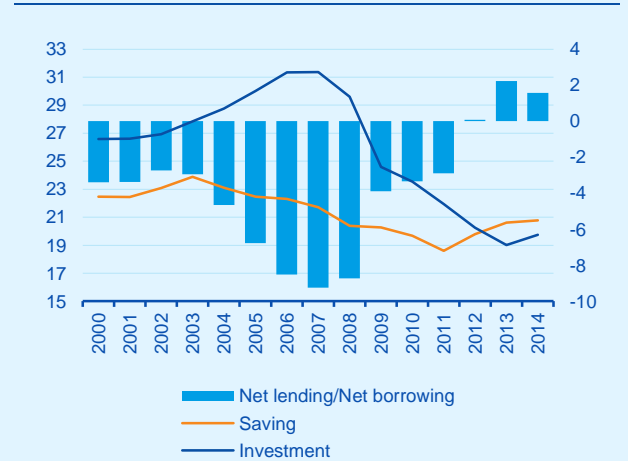
The stability of the saving rate over recent years has meant that the sharp drop in investment has been almost wholly passed on to an improvement in the Spanish economy's net borrowing in relation to the rest of the world. Despite this stability, the aggregate figure conceals a significant increase in corporate saving. In order to analyse the determinants of this process, this box uses data from the Central Balance Sheet Data Office (CBI) and, even though the conclusions presented here should be treated with caution owing to certain limitations of the figures used, some difference in behaviour is discernible depending on company size. In more precise terms, small to medium-sized companies might have increased their saving more than the larger ones, while also using different instruments to do so.

During the crisis, the drop in public sector saving was offset by the rise within the private sector, above all among non-financial companies

The relative stability of the saving rate over the past few years has meant that the sharp drop in investment has almost wholly been passed on to an improvement in net borrowing (see Figure B.2.1), so for the first time since the mid-80s the economy achieved financing capacity in 2013, which is a situation that it has managed to keep up in 2014 and 2015.

Nonetheless, despite this stable situation, a detailed analysis of saving patterns in Spain reveals very disparate trends among economic agents. For example, public sector saving, which reached a rate of 7.3% of GDP in 2007, went negative from 2009, staying this way until 2Q15, when public consumption outstripped revenues by an amount equivalent to 3.1% of GDP. On the other hand, in the private sector the path taken by the saving rate over time was positive. More narrowly, that for households moved from 3.6% of GDP in 2007 to 6.2% in 2014. In the case of companies, saving growth was stronger, moving from 8.6% of GDP to 15.5% over the same time³⁸ (see Figure B.2.2). This rise has actually allowed companies to generate financing capacity, even of late, when there has been an observable rise in investment.

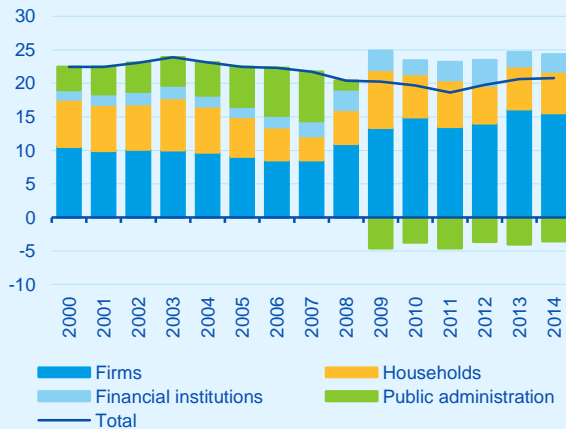
Figure B.2.1
Spain: net lending / net borrowing
(Cumulative annual figure. % of GDP)



Source: BBVA Research based on INE

38: The saving rate specific to financial institutions remained virtually constant over the crisis, at a rate of close to 2.5% of GDP.

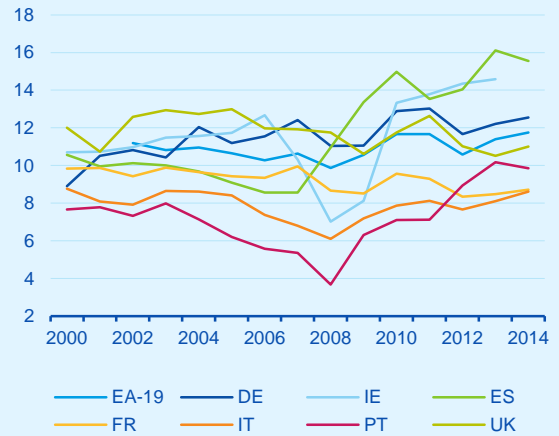
Figure B.2.2
Spain: net lending / net borrowing
(Cumulative annual figure. % of GDP)



Source: BBVA Research based on INE

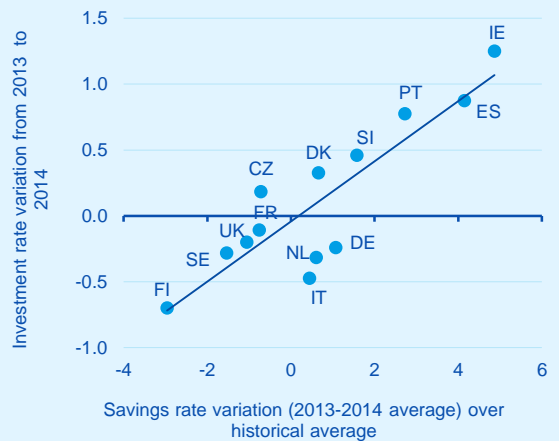
The strong rise in the business sector's saving rate in Spain is unparalleled among other neighbouring economies and is only comparable to that of firms in Ireland or Portugal (see Figure B.2.3). Moreover, those countries where the saving rate rose the most in relation to its historical average have been those that have advanced the most in terms of the investment rate (see Figure B.2.4). This relationship provides the prime inspiration for this box, and in it we try to find out **where this rise in the saving rate during the economic crisis came from, which is to a large extent responsible for the increase in the investment rate.**

Figure B.2.3
EU: saving rate of non-financial companies
(% GDP)



Source: BBVA Research based on Eurostat

Figure B.2.4
EU: trends in saving and investment rates
(Cumulative annual figure. Percentage points of GDP)



Source: BBVA Research based on Eurostat

The Bank of Spain's Central Balance Sheet Data Office enables more in-depth analysis

To analyse business saving performance, we have turned to the Bank of Spain's Central Balance Sheet Data Office (CBI) in conjunction with the Trade Registers. This is a source that collates and keeps a record of economic and financial information relating to Spanish non-financial companies.

The advantage of using this database is in the ability to separate out saving trends for companies by different characteristics and the greater detail it offers compared to other databases. In particular, the CBI enables analysis that distinguishes trends for firms according to the average number of people who work at them³⁹, their core activity, whether they are public or private, etc. On top of this the CBI offers greater detail⁴⁰ on the various accounting items than the data from the INE's Non-Financial Accounts for the Institutional Sectors, which allows the study to be more precise. Overall, the CBI includes information on some 600,000 companies and features around 40% of the business census according to the DIRCE (Central Companies Directory). The selected sample also represents around 45% of the GVA generated by non-financial companies (see Table B.2.1).

Whatever the case, certain limitations, such as the lack of representativeness of the sample or the homogeneity of the series, as well as the way the statistics are gathered, advise caution regarding the conclusions offered here. First, the companies included do not constitute a statistical sample. On the other hand, registrations of companies are clearly represented, but not withdrawals from the records. Similarly, the series are not homogeneous because from 2003 to 2007 the classification of business activity was according to the CNAE 93 and the European SEC 95 accounting system,

whereas from 2008 to 2013 the series are sorted according to CNAE 09 and SEC 2010, which makes sector analysis difficult. Furthermore, even though the data on most of the companies (especially among the smaller and medium-sized firms) comes from the Trade Registers, the information for some 10,000 companies (mainly larger ones) is obtained from voluntary completion of questionnaires from the Central Balance Sheet Data Office. For all of these reasons, the conclusions here should be treated with caution.

These shortcomings are likely to be behind the difference suggested in the behaviour of companies in the two databases. An example of this is the fact that the CBI figures show that saving in the non-financial productive sector probably remained stable as a percentage of GDP, which contradicts the increase indicated by the Non-Financial Accounts for the Institutional Sectors (where the figures come from which are commented on in the previous paragraph).

The aim of the study below is to determine what instruments were used by companies to boost their saving, depending on their different characteristics and without managing to offer a full explanation of the increase that has been noted over recent years.

39: Classification of company size is done according to average number of employees. Thus a microenterprise is held to be a company that has no salaried staff or less than nine; smaller companies have 10-49 salaried employees, while medium-sized companies have 50-199 workers, and larger companies have over 200.

40: For example, the CBI offers details about one the items seeming to have played a key role in corporate saving trends, namely dividends. In the INE's Non-Financial Accounts for the Institutional Sectors this item is included within the more general one of property income.

Table B.2.1
Representation level for the Central Balance Sheet Data Office

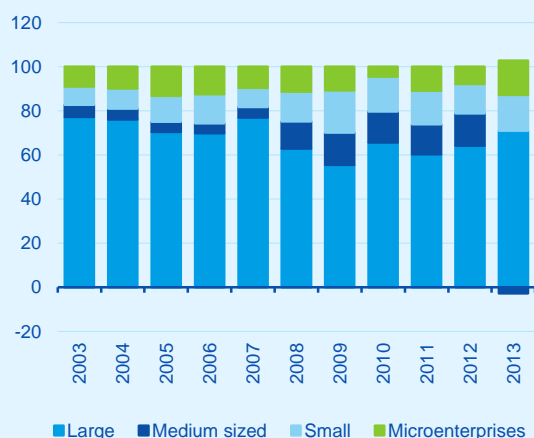
| % of total | CNAE 93 | | | | | CNAE 09 | | | | | |
|---------------|---------|------|------|------|------|---------|------|------|------|------|------|
| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Num. of firms | 25.7 | 29.2 | 33.3 | 33.0 | 18.2 | 30.3 | 40.5 | 41.4 | 42.8 | 42.4 | 37.9 |
| Av. GVA mp | 37.7 | 41.5 | 43.6 | 43.9 | 33.9 | 41.7 | 45.6 | 47.3 | 50.3 | 49.8 | 44.3 |

Source: BBVA Research based on Eurostat

Company size and activity trends, key to explaining how productive sector saving has changed

Traditionally, the corporate saving which the CBI shows has been influenced by how the larger companies have behaved. On average these have accounted for the lion's share of overall gross business sector saving. In the 2003-07 pre-crisis period, the larger companies used to accumulate a little over 74% of total gross saving, thanks above all to the saving by those with over 1,000 salaried employees. During the crisis, in 2008-13, the proportion of saving of the larger companies dropped to around 63%. In contrast to this, the proportion of total saving by both smaller and medium-sized companies rose over the crisis. Meanwhile, the proportion of total saving accounted for by micro-enterprises held relatively steady at around 10% throughout both periods (see Figure B.2.5).

Figure B.2.5
Companies: saving rate by corporate size (% total)



Source: BBVA Research based on the Bank of Spain

But what were the chief determinants of saving trends? As key factors in business saving, the literature cites activity, trends in intermediate consumption, the interest burden on external borrowing, taxes on profits and dividend policy (Maroto Acín, JM (1999)). Yet the variation in corporate saving could be due to different mechanisms. For example, in Ruscher and Wolff (2012) it can be observed that German companies lifted their saving by cutting employee compensation, while in Japan this was done by cutting dividends. On the other hand, the Quarterly Report on the Euro Area (2014) reveals that the different dividend policies that were adopted can influence the pattern of corporate saving. When the crisis arrived, non-financial companies in the United States decided to slash dividends to shareholders, while in the euro area the reduction was more modest, which supports the impression that US companies are generally more given to saving than their European counterparts.

Figure B.2.6 shows how, during the economic upturn (2003-07), activity's progress was the key factor sustaining corporate saving.

When the crisis came along, production began to contract⁴¹, and therefore so did operating profit, which led to a reduction in its positive contribution to corporate saving. Other major factors which account for developments as regards saving are trends in intermediate consumption and the compensation of salaried employees. With respect to the former, it can be seen that the rise in input consumption during the expansion phase prevented saving from growing further. Yet when

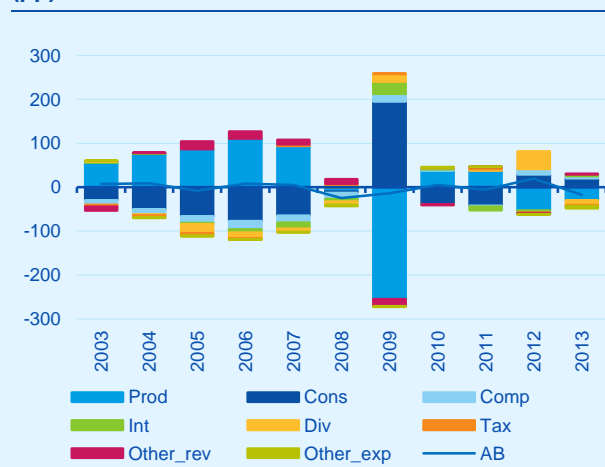
41: Except for 2010 and 2011, which coincide with the small upturn in the Spanish economy before it relapsed into depression.

the crisis arrived, corporate austerity plans led to a reduction of intermediate consumption, which encouraged saving trends. Something similar is evident in relation to the employee compensation item, where the rise in production over 2003-07 was accompanied by rises in employment and wages, which pushed up salaried employee compensation through both channels, contributing negatively to saving. However, in 2008-13 the contribution of this item to saving trends turned positive, since company downsizing and wage deflation were positive for saving.

Another of the strategy decisions which has had its effects on corporate saving performance is to do with policy on paying out profit to shareholders. Whereas more profit was paid out during the upswing in the form of dividends, the advent of the crisis led to a shift in strategy. From 2009 on, dividends came to make a positive contribution to generating savings, which coincided with the decision by companies not to pay out profits to shareholders, and this strategy was pursued throughout practically the entire crisis.

Finally, it is worth noting the developments in the corporate interest burden, which was influenced by the deleverage process, monetary policy, uncertainty in Europe and the restructuring of a section of the financial sector. Over 2003 to 2007, companies increased their borrowings which, coupled with the interest rate rise in 2006-08, produced a greater interest servicing expense, which was a drain on savings. It was in 2009 when there was a sea-change in this factor's contribution to saving as this turned positive, which arose from the interest rate correction. Since then, a smaller impact from interest on saving has been apparent on account of the deleveraging that companies are carrying out. There is also evidence of a change of sign for the contribution that derives from rate curve movements, and more specifically those with respect to the risk premium⁴², which hit a high in July 2012.

Figure B.2.6
Companies: contribution to the variation in saving (pp)



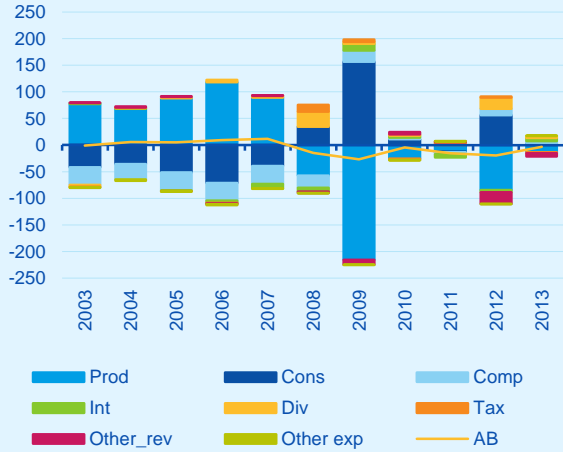
Source: BBVA Research based on the Bank of Spain

Saving components show mixed behaviour by company size

Distinguishing by company size, we can see that micro-enterprise saving is more prone to changes in production and consumption than larger-sized companies. Cutting back on intermediate consumption and employee compensation was key to keeping up the saving rate for small to medium-sized companies over the crisis (Figure B.2.7). Furthermore, among the medium-sized companies the scale of external borrowing meant that the spike in the risk premium over 2010-12 increased their interest burden, which impacted negatively on their ability to generate savings.

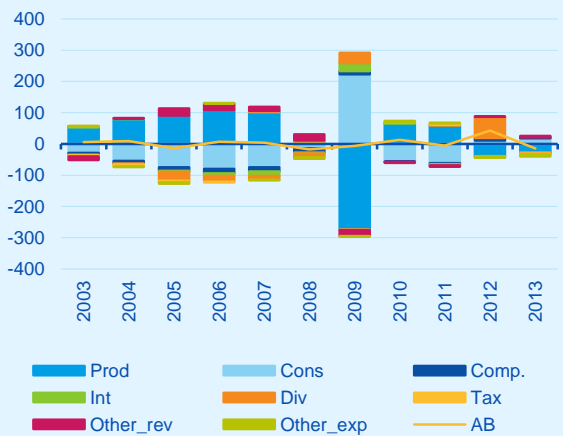
42: Spain's risk premium, which is measured as the 10-year bond's spread against the German Bund, hit a high of almost 640 basis points in July 2012. From then on it embarked on a steady fall until, by the end of 2013 it stood at slightly over 200 basis points.

Figure B.2.7
Smaller companies: contribution to variation in saving (pp)



Source: BBVA Research based on INE

Figure B.2.8
Larger companies: contribution to variation in saving (pp)



Source: BBVA Research based on INE

On the other hand, among the larger companies, dividend policy in combination with trends as regards production and intermediate consumption was one of the decisive factors in how their pattern of saving has evolved. With the onset of the crisis, the larger companies chose to waive pay-outs against

profits, which freed up more funds for saving. This aspect is not apparent among the medium-sized companies which seem to have stuck to existing dividend policy. Notable too was the lower impact of the interest burden on saving, above all among the very biggest companies, which could be due to their easier access to funding and diversification in sources of credit⁴³ (Figure B.2.8).

Conclusions

The saving rate's stability has helped Spain's economy to show financing capacity since 2013, according to the Non-Financial Accounts for the Institutional Sectors. This stability in saving has been achieved thanks to growth in saving by the private sector, and more especially by non-financial companies, as the crisis brought with it a drag on public saving.

Based on the information from the Bank of Spain's Central Balance Sheet Data Office, it can be seen that although most of Spanish business sector saving comes from the larger companies, over the crisis the contribution by SMEs grew from levels during the upswing to the detriment of saving by the larger companies.

Key among those factors which exerted an adverse influence on the progress of corporate saving over the crisis was the fall in revenue for companies that derived from a drop in production. On the other hand, even though the interest burden initially eased off with the fall in rates, when the risk premium rose this item began to eat into saving again, although its negative contribution was smaller than it had been during the upswing, in part due to the headway made in the deleverage process.

On the other hand, there were several factors that boosted the growth of corporate saving, namely: i) the fall in the item allocated to employee compensation, from both the drop in employment and wage correction, and ii) the shift in policy as regards pay-outs of profits to shareholders, as the

43: In Giménez Zuriaga (2013) it is claimed that problems of access to funding are more serious among the SMEs than the larger companies, and became more acute with the advent of the crisis.

In *Los retos de financiación del sector empresarial* (Funding challenges facing the business sector, 2014) an in-depth analysis is made of the various financing alternatives which are normally available to companies, depending on their size among other characteristics.

crisis led to companies choosing to scale down or even halt dividend payments. All of this was accompanied by a process of cutbacks on intermediate consumption that were intended to match these with the new production levels, although this was temporarily interrupted in 2010 and 2011 when the economy began to experience an upturn again, which ultimately failed to take off.

The breakdown of saving by company type according to size shows that performances were mixed. Whereas among the smaller companies saving hinges more on variation in intermediate input consumption to bring this into line with production, among the larger companies dividend policy was a bigger factor. On the other hand, the interest bill hit saving by medium-sized companies harder than it did the larger companies, possibly because the latter have more financing channels available to them that are not interest rate dependent.

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Box 3. Fiscal policy as we emerge from the crisis*

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October 2015

Introduction

What fiscal policy should Spain pursue over the next few years now that we finally seem to be over the worst of the crisis? Most opinion in the know accepts that we must continue to bring down the public sector deficit towards a balanced budgetary position as fast as possible, not only because this is what European rules and our own Constitution dictate, but also because we need to wear down the high stock of public debt.

Even within this basic consensus there is still scope for very broad array of strategies, both as regards the speed at which a balanced budgetary position should be achieved and with respect to the size of the public sector and the structure of public revenue and expenditure. Perhaps the main bone of contention at the moment is whether the present level of public revenue as a percentage of GDP (around 38%) is enough to cater for the public spending needs of Spanish society at large or whether the weight of government spending should be stepped up significantly to guarantee the sufficiency and quality of public services and provision.

Adopting an informed stance in this debate calls for scrutiny of the recent evidence. The most dyed-in-the-wool champions of an increase in spending tend to base their argument on the contention that the cuts that have been forced by the crisis have led to a virtual dismantling of the welfare state to the point where a swift injection of increased spending has become essential to win back the minimum quality levels in basic services that have been relinquished in the past few years. As we will see, the facts do not back up this view.

That said, and this is one of the central conclusions in this review, this does not imply that the current volume of revenues is enough to cover all of our public expenditure requirements.

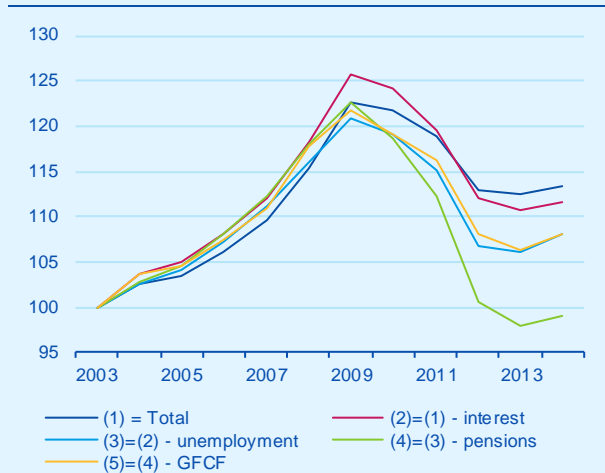
A few thumbnail calculations prompt us to propose a strategy that lies somewhere between the two camps which we have just described and, above all, brings into the picture a third area for manoeuvre that is crucial, namely structural reforms to boost employment and activity, and by extension tax revenues, without hiking tax rates.

Looking back: are we down to the bare bones?

Drawing on data from the National Accounts prepared by the Government Comptroller's Office (IGAE, 2015a and b), Figure B.3.1 shows the trends for several of the expenditure items measured in per capita terms and at constant 2010 prices, using the GDP deflator. Real expenditure per inhabitant by general government as a whole was pared down by slightly over nine percentage points over 2009-14. Even so, this came after a cumulative rise of 23 percentage points over 2003-09, which implies that there was still a net increase of more than 13pp between 2003 and 2014. Total spending and even net interest expenditure per inhabitant are currently running at 2007 levels again, at the very least. The facts therefore do not bear out the perception that there has been a swingeing cutback in spending since 2009, which is seriously jeopardising the provision of essential public services.

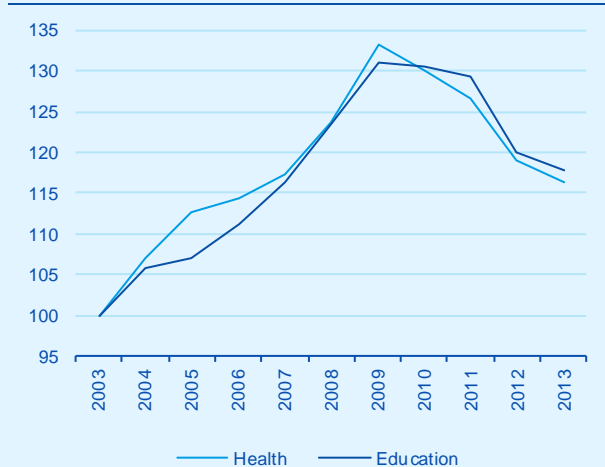
*: This box summarises the article soon to be published in *Revista de Economía ICE* under the title "Notes for Fiscal Policy at the Exit of the Crisis" in which, besides the issues discussed here, a toolbox of improvements are proposed with reference to the regulatory framework for fiscal policy as is a more proactive approach in applying the Budget Stability Law. Over the rest of this note we refer to this paper as ADD (2015). The authors are grateful to the Ministry of the Economy and Competitiveness for its assistance through grants ECO2014-59196-P and ECO2014-53150-R.

Figure B.3.1
Spending per inhabitant at constant prices, 2003=100, general government, ex assistance for the financial sector



Source: own research, based on IGAE

Figure B.3.2
Spending by general government on health and education per beneficiary at constant prices, 2003=100



Source: own research, based on IGAE

Analysis with more of a breakdown corroborates this conclusion. Figure B.3.1 successively strips out interest, spending on unemployment and pensions, and investment from total spending per inhabitant (measured at constant prices). After taking out spending on unemployment and pensions, as well as interest, real spending per inhabitant on other services and provisions fell away by almost 24 points over 2009-14, thereby cancelling out almost all of the increase observed

over the run-up to the crisis and returning to roughly the starting level of 2003.

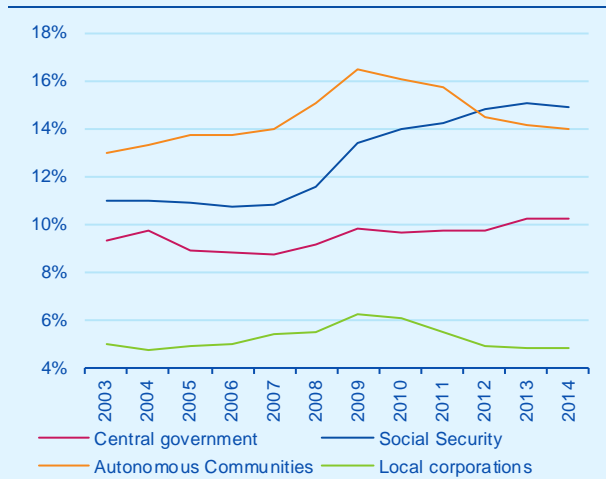
On the other hand, it should be recalled that, even with respect to these items, the fall in current spending was far smaller than that of total spending, as public investment was dramatically slashed over the crisis. While it is true that, were this policy to have been pursued for much longer, it would have harmed growth, in the short run it surely represented a sensible way of softening the blow to the public from the crisis. Therefore, the blue line in Figure B.3.1, from which investment is also excluded, is surely the one that offers us a more realistic picture of how levels of general service provision have performed, after taking out interest, unemployment benefit and pensions. In terms of this aggregate spending item, the fall of 13 points per capita from its peak in 2009 must not be allowed to mask an 8 point rise since 2003. Although this gain is certainly modest compared to that achieved over the boom years, it does not necessarily point to any savage deterioration in the quality of essential services that were considered to be satisfactory ten years ago. The level of spending in 2014 was in fact practically the same as in 2007, just before the economic crisis set in.

Along the same lines, Figure B.3.2 (featuring data that in this case only extends to 2013) shows the trend for current spending per beneficiary with respect to two items that are key on account of their impact on the present and future welfare of the public: health and education. Real current spending divided by the number of beneficiaries, which is measured as the number of inhabitants in the case of health, and by the population of an age to be in it full-time (6 to 24 years old) in the case of education, indicates an already familiar pattern, making great strides up to 2009, followed by a cutback in the in the last few years of the sample which takes us back to the levels just before the crisis got underway, while there are still very respectable gains over the period reviewed as a whole.

Figure B.3.3 disaggregates spending according to the level of government at which it is executed, while transfers to other arms of government are omitted. What is striking is the surge in Social Security spending, which overtakes that by the regions in 2012 to become the government department with the greatest weight in public spending.

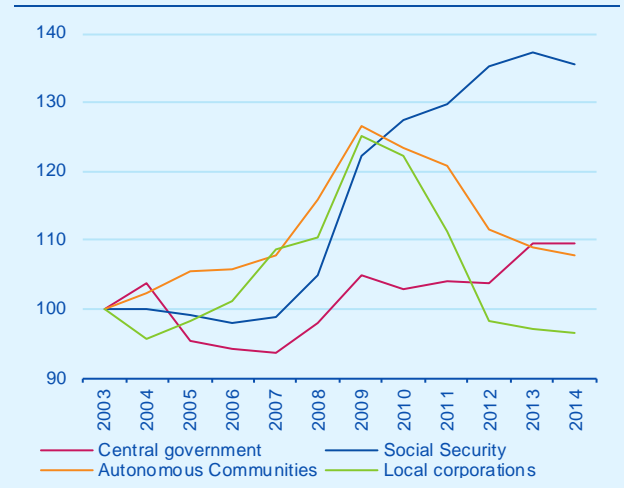
The breakdown by items of expenditure is also very revealing. As Figures B.3.5 and B.3.6 illustrate, the item which grew the most over the whole period covered was, by some distance, Social Security contributory pension payments, which increased its weight within GDP by 3 points between 2003 and 2014. Expenditure on personnel, purchases of goods and services, interest payment and unemployment benefit have also each contributed around 1 point of GDP to the increase in expenditure, whereas the drop in investment has shaved 2 points of GDP from this indicator.

Figure B.3.3
Non-financial expenditure net of assistance to the financial sector and transfers to other arms of government, % of GDP



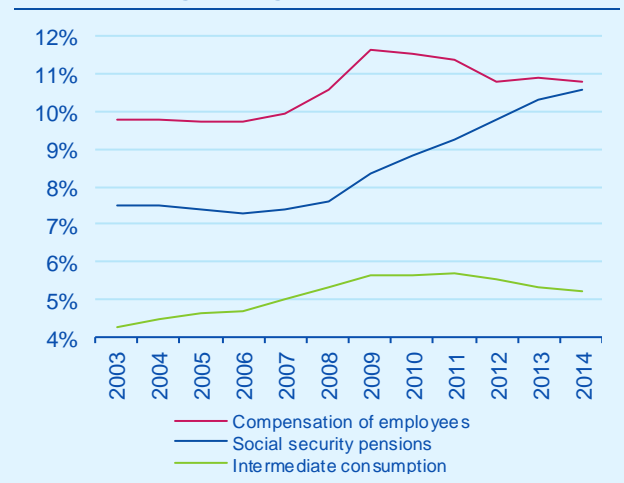
Source: own research based on IGAE

Figure B.3.4
Non-financial expenditure net of assistance to the financial sector and transfers to other arms of government, 2003=100



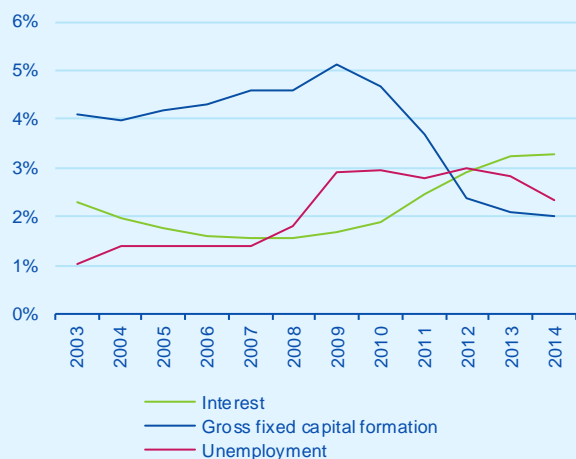
Source: own research based on IGAE

Figure B.3.5
Employee compensation, pensions and intermediate consumption, general government, % of GDP



Source: own research based on IGAE

Figure B.3.6

Gross capital formation, unemployment and interest, general government, % of GDP

Source: own research based on IGAE

Looking ahead: is the 2015 Stability Programme realistic?

The recently updated Stability Programme (SP, Kingdom of Spain, 2015, pp. 31 *et seq.*) outlines a fiscal strategy that consists of keeping the present level of public sector revenue measured as a fraction of GDP (c.38%) constant while steadily bringing down the expenditure to GDP ratio to levels on a par with those of 2003, which would allow a balanced budgetary position to be practically achieved by 2018. Given the forecast growth rates for nominal GDP (which rise progressively from 3.6% in 2015 to 4.6% in 2018), are the growth rates for the various different components of public spending realistic enough to cut the public expenditure to GDP figure by 5.5pp to 38%?

As is shown in ADD (2015), the most problematic item by a long way is pensions expenditure. To bring down its weight in GDP to the 2003 level by 2018 would call for *reducing* an expenditure item by an annual 4.7% which was actually *growing* at a rate of 4.4% a year over 2009-14. This target appears hard to achieve given Spain's demographic prospects and the tendency for such expenditure to grow, which arises from the fact that the initial pensions of new recipients are generally higher than those people have at the time of leaving the system when they die. The

Stability Programme itself (p. 49) actually offers a forecast of an average annual increase in pension expenditure of 3%, which is consistent with the growth data observed or budgeted for this variable in recent years that is offered by the Ministry of Employment and Social Security (2014, p. 217).

To give an idea of how this item is expected to move as a percentage of GDP, we have assumed that pensions expenditure grows at an annual rate of 3% between 2014 and 2018. If the GDP forecasts are fulfilled, in 2018 pension expenditure would be 10.18% of GDP, or 0.42 points of GDP below the value for 2014, yet 2.7pp above its 2003 value. After noting that in ADD (2015) that for the other expenditure items a return to the 2003 weight in GDP does in fact appear viable, the smaller margin for cutting pensions expenditure leaves us with an achievable spending cut of 2.8 points of GDP, compared to the cut of 5.5 points that would be required to return to a balanced budgetary position, which would still leave us with a public sector deficit of almost 3 points of GDP.

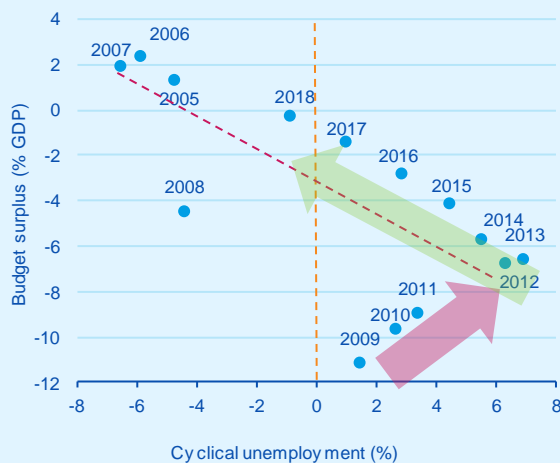
On the other hand, there are certain revenue items where cyclical "normalisation" should lead to considerable gains in collection without the need for regulatory change. The most significant is Corporate Income Tax, where the collection currently stands at around 1 point of GDP below its 2003 level. The same is true of tax revenues from housing sales, which stand to regain some 0.4pp of GDP.

In short, our calculations suggest that there is room to reduce the deficit by 4.16 points of GDP between 2014 and 2018. Since the deficit was around 5.7% of GDP, we would need about a further 1.5 points to hit a balanced budgetary position once the situation normalises.

This shortfall of 1.5pp of GDP in 2018 roughly coincides with what we estimate using a different procedure for a neutral cyclical situation. This second method is illustrated in Figure B.3.7. The vertical axis gives the budget balance for general government as a percentage of GDP, while the horizontal axis measures the unemployment rate's

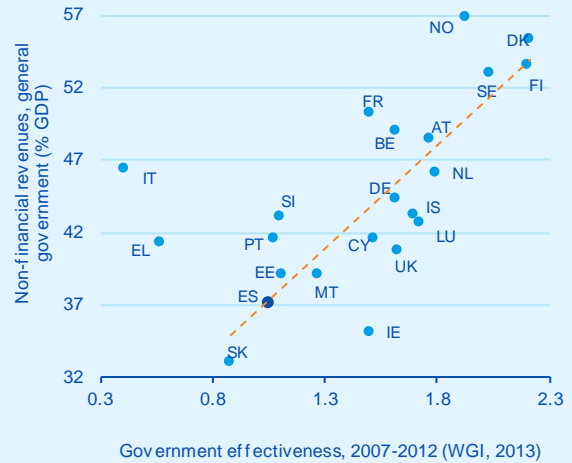
cyclical component.⁴⁴ In a neutral cyclical situation, cyclical unemployment is nil and we would be on the vertical red line shown in the Figure. In expansive phases, when cyclical unemployment is negative, the budget balance tends to improve as a result of public revenue growth and the decrease in certain items of expenditure, such as unemployment benefit. On the other hand, the opposite happens in recessions, which means that the budget balance worsens. This responsiveness of the budget balance to cyclical unemployment is represented as the blue dotted line with a negative slope, which tells us that for each point of increase of unemployment, the budget balance tends to be reduced by approximately 0.75 points of GDP.

Figure B.3.7
Public sector budget balance and cyclical unemployment, 2005-18



Source: own research based on IGAE

Figure B.3.8
Public sector revenue to GDP and efficiency of general government, 2007-12



Source: own research based on IGAE

The strategy in the Stability Programme basically consists of a cyclical adjustment to a structural deficit of around 1%, which follows the green arrow in Figure B.3.7 along a path of decreasing unemployment that derives from the economic recovery.

With these forecasts, the current level of tax revenues will not be enough to wipe out the deficit and cater for current spending needs. This conclusion is further backed up when we look ahead and bear in mind the considerable upward pressure on public spending in the areas of the health service, dependency and pensions that is reasonable to expect over the next decades. The only good news in this regard is that, as was seen in the previous section, we are not in an emergency situation deriving from a deterioration in public services that calls for an urgent step-up in spending, so we can proceed by working on two complementary strategies simultaneously.

The first and most promising of these strategies centres on bringing in structural reforms that give bring about enduring reductions in Spain's unemployment rate. As is shown in Figure B.3.7, bearing in mind the responsiveness of the budget

44: Cyclical unemployment is no more than the difference between the unemployment rate and its long-term structural component, which is assumed to be constant at 18% over the Stability Programme's forecast horizon to 2018.

balance to the unemployment rate, a 4pp permanent reduction in the unemployment rate would be sufficient for the structural balance to improve by 3 points, which would leave us with a structural surplus of close to 2 points. Even though the structural unemployment estimate involves a large dose of uncertainty, we can gain a rough idea of what its level might be and the huge amount of room for improvement that exists based on the estimated structural unemployment rates for Spain and other advanced economies. At the point of greatest growth, Spain's unemployment rate managed to come down to 8%, whereas over the economic crisis it peaked at over 26%. The mean for this low and high is slightly under 18%, which is a very similar figure to that estimated using more accurate and sophisticated econometric procedures. If we assume a linear relationship between the fall in structural unemployment and an improvement in the public finances, permanently reducing a structural unemployment level of close to 18% to levels approaching 6%, such as those seen in Germany, the United States, the Netherlands, the UK, Denmark or Sweden, would be capable of providing us with a margin of almost 9 points of GDP of permanent improvement in the budget balance, which would also allow us to defray the increase in public spending which the state pensions and health systems will need, or the improvement of other public policies and provision.

Obviously a permanent reduction in unemployment on such a scale is not something that can be achieved overnight, but rather, slowly and after implementing a whole battery of complementary measures in such disparate areas as the labour and product markets, where continued progress in reforming them is vital. Substantial improvement of public sector efficiency, results within both the educational system and professional and in-service training, and the quality of institutions will also be essential. Yet, beyond being a crucial objective for a society that aspires to putting an end to the scourge of unemployment, a reduction in the unemployment

rate on this scale would have enormous budgetary implications.

The second strategy consists of hitting on the best way to lift our public revenues to close up the gap with the spending requirement that would be capable of persisting after we have exhausted the options for rationalising expenditure and boosting growth and employment. This revenue increase will have to be compatible with encouraging saving, building up human capital and, ultimately, with economic growth. With respect to how to make inroads along these lines, there is broad agreement that the best way to keep the distortions that are associated with a higher level of tax collection to a minimum implies increasing revenues through widening the key tax bases and keeping tax rates as low as possible. There is also consensus, albeit it certainly less widespread, that increasing the weight of indirect taxation in the total is appropriate. These ideas have cropped up again and again in the recommendations of the major international organisations and in papers and reports by numerous Spanish experts on tax matters, notable among which is the recent report by the Committee of Experts chaired by Professor Lagares (Lagares et al., 2014). While this is not the most suitable place to go into the ins and outs of a highly involved discussion that would merit at least a separate article, we do wish to point out that, broadly speaking, we concur with the ideas raised. In this regard, one option which appeals is that of raising the effective average rate of indirect taxes, which is considerably lower than that applying in other neighbouring countries, by, for example, increasing environmental taxes and/or narrowing the range of products which are liable for reduced and heavily-reduced VAT rates. It would also be advisable to broaden the personal and corporate income tax bases, perhaps by doing away with the module system and stepping up surveillance of non-salary income. Finally, we think that it would be a good idea to move towards more extensive use of co-payment mechanisms (especially regarding the health system and universities, though also in infrastructure and transport), which would be sufficiently well

designed so that nobody is excluded by virtue of their income level.

Whatever the case, the increase in the tax burden should at least be accompanied, if not preceded, by an improvement in the operational efficiency of general government. The more efficient the public sector is, the more willing society will be to make a greater tax contribution in the knowledge that it will receive more and better services. The available evidence for the European countries, which is illustrated in Figure B.3.8, indicates that there is a close correlation between government administrative efficiency and the weight of public revenues in GDP, with the odd exception that is not exactly a success story.

Conclusions

Since 2003, Spain's public finances have shown an extraordinary increase in expenditure up to 2009, which has only partly been reversed, as public spending per capita in 2014 is similar that which we had in 2007 in real terms, which means that our public services have been better-placed to withstand the crisis with respect to funding than has typically been claimed. Yet this should not allow us to forget the future fiscal challenges that we have to address. There is scope to reduce public expenditure as a proportion of GDP as the latter rises and to keep up total public spending per inhabitant at constant prices in the short term, while avoiding further retrenchment in addition to that carried out over the crisis. But this margin will not be sufficient to wipe out the current deficit completely and foot the bill for the increased spending needs that arise from an ageing population. For these reasons we must embrace structural reforms that bring in tax revenue through greater employment and faster growth of the economy, as well as tax reforms which cause a minimum of distortion and enable a modest increase in revenue collection without having to raise rates levied by broadening the tax base.

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5 Tables

Table 5.1

Macroeconomic Forecasts: Gross Domestic Product

| Annual Average, % | 2012 | 2013 | 2014 | 2015 | 2016 |
|------------------------|------|------|------|------|------|
| United States | 2.2 | 2.2 | 2.4 | 2.5 | 2.5 |
| Eurozone | -0.8 | -0.3 | 0.9 | 1.5 | 1.8 |
| Germany | 0.6 | 0.2 | 1.6 | 1.6 | 1.8 |
| France | 0.2 | 0.7 | 0.2 | 1.1 | 1.6 |
| Italy | -2.8 | -1.7 | -0.4 | 0.8 | 1.4 |
| Spain | -2.1 | -1.2 | 1.4 | 3.2 | 2.7 |
| UK | 0.7 | 1.7 | 2.9 | 2.4 | 2.2 |
| Latin America * | 2.8 | 2.5 | 0.8 | -0.3 | 0.5 |
| Mexico | 4.0 | 1.4 | 2.1 | 2.2 | 2.5 |
| Brazil | 1.8 | 2.7 | 0.2 | -2.5 | -0.5 |
| EAGLES ** | 5.8 | 5.6 | 5.2 | 4.7 | 5.0 |
| Turkey | 2.1 | 4.1 | 2.9 | 2.8 | 3.3 |
| Asia Pacific | 5.7 | 5.9 | 5.7 | 5.6 | 5.4 |
| Japan | 1.7 | 1.5 | -0.1 | 0.8 | 1.0 |
| China | 7.7 | 7.7 | 7.3 | 6.9 | 6.2 |
| Asia (exc. China) | 4.1 | 4.5 | 4.3 | 4.4 | 4.8 |
| World | 3.4 | 3.4 | 3.4 | 3.2 | 3.5 |

* 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: 10 November 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 | 2.4 |
| Germany | 1.6 | 1.6 | 1.2 | 0.5 | 0.7 |

Forecast closing date: 6 November 2015.

Source: BBVA Research and IMF

Table 5.3

Macroeconomic Forecasts: Exchange Rates

| Annual Average | 2012 | 2013 | 2014 | 2015(f) | 2016(f) |
|----------------|------|------|-------|---------|---------|
| USD-EUR | 0.78 | 0.75 | 0.75 | 0.90 | 0.92 |
| EUR-USD | 1.29 | 1.33 | 1.33 | 1.11 | 1.09 |
| GBP-USD | 1.59 | 1.56 | 1.65 | 1.53 | 1.64 |
| USD-JPY | 79.8 | 97.5 | 105.8 | 121.44 | 130.92 |
| USD-CNY | 6.31 | 6.20 | 6.14 | 6.30 | 6.70 |

Forecast closing date: 10 November 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 | 1.00 |
| Eurozone | 0.75 | 0.25 | 0.05 | 0.05 | 0.05 |
| China | 6.00 | 6.00 | 5.60 | 4.35 | 4.35 |

Forecast closing date: 6 November 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 | -0,2 | 0,9 | 1,5 | 1,8 |
| Private consumption | -1,2 | -0,6 | 0,9 | 1,8 | 1,8 |
| Public consumption | -0,1 | 0,2 | 0,8 | 1,1 | 0,9 |
| Gross fixed capital formation | -3,4 | -2,6 | 1,3 | 2,3 | 3,5 |
| Inventories (contribution to growth) | -0,8 | 0,2 | -0,1 | -0,2 | 0,0 |
| Domestic demand (contribution to growth) | -2,2 | -0,6 | 0,8 | 1,5 | 1,9 |
| Exports | 2,9 | 2,2 | 3,9 | 4,5 | 4,4 |
| Imports | -0,7 | 1,4 | 4,2 | 4,9 | 5,2 |
| Net exports (contribution to growth) | 1,5 | 0,4 | 0,1 | 0,0 | -0,1 |
| Prices | | | | | |
| CPI | 2,5 | 1,4 | 0,4 | 0,1 | 1,1 |
| CPI core | 1,8 | 1,3 | 0,9 | 0,8 | 1,3 |
| Labour market | | | | | |
| Employment | -0,4 | -0,7 | 0,6 | 1,0 | 0,8 |
| Unemployment rate (% of labour force) | 11,3 | 12,0 | 11,6 | 11,0 | 10,4 |
| Public sector | | | | | |
| Budget balance (% GDP) | -3,7 | -3,0 | -2,6 | -2,2 | -1,8 |
| Debt (% GDP) | 89,3 | 91,1 | 92,1 | 93,2 | 92,9 |
| External sector | | | | | |
| Current account balance (% GDP) | 1,2 | 1,8 | 2,1 | 2,6 | 2,4 |

(f): forecast

Forecast closing date: 10 November 2015.

Source: BBVA Research

Table 4.6

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

| Activity | 2012 | 2013 | 2014 | 2015(f) | 2016(f) |
|--|--------|--------|--------|---------|---------|
| Activity | | | | | |
| Real GDP | -2.1 | -1.2 | 1.4 | 3.2 | 2.7 |
| Private consumption | -3.5 | -3.1 | 1.2 | 2.9 | 2.5 |
| Public consumption | -3.7 | -2.9 | 0.0 | 1.8 | 0.4 |
| Gross fixed capital formation | -8.3 | -3.7 | 4.8 | 6.2 | 5.5 |
| Machinery and equipment | -8.5 | 4.0 | 10.6 | 8.9 | 6.3 |
| Construction | -8.3 | -7.1 | -0.2 | 5.6 | 5.0 |
| Housing | -5.4 | -7.2 | -1.4 | 3.4 | 7.5 |
| Domestic demand (contribution to growth) | -4.3 | -2.7 | 1.6 | 3.3 | 2.6 |
| Exports | 1.2 | 4.3 | 5.1 | 5.2 | 5.2 |
| Imports | -6.3 | -0.5 | 6.4 | 6.1 | 5.2 |
| Net exports (contribution to growth) | 2.2 | 1.4 | -0.2 | -0.1 | 0.1 |
| Nominal GDP | -2.6 | -1.1 | 1.0 | 3.7 | 4.7 |
| (EUR bn) | 1042.9 | 1031.3 | 1041.2 | 1079.9 | 1131.0 |
| GDP excluding housing investment | -2.4 | -1.4 | 1.5 | 3.1 | 2.5 |
| GDP excluding construction | -1.8 | -1.0 | 1.5 | 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 | 22.2 | 20.5 |
| Employment QNA (full-time equivalent) | -4.4 | -3.3 | 1.1 | 3.0 | 2.5 |
| Apparent labour productivity | 2.3 | 2.0 | 0.3 | 0.2 | 0.2 |
| Prices and costs | | | | | |
| CPI (annual average) | 2.4 | 1.4 | -0.2 | -0.4 | 1.2 |
| CPI (en-of-period) | 2.9 | 0.3 | -0.5 | 0.0 | 1.6 |
| GDP deflator | 0.0 | 0.6 | -0.4 | 0.5 | 1.9 |
| Compensation of employees | -0.1 | 1.8 | -0.1 | 0.9 | 1.7 |
| Unit labour cost (ULC) | -2.5 | -0.2 | -0.4 | 0.7 | 1.5 |
| External sector | | | | | |
| Current account balance (% of GDP) | -0.2 | 1.5 | 1.0 | 1.5 | 1.9 |
| Public sector | | | | | |
| Debt (% GDP) | 84.4 | 92.2 | 97.8 | 99.0 | 98.2 |
| Budget balance (% GDP (*)) | -6.6 | -6.5 | -5.7 | -4.5 | -3.0 |
| Households | | | | | |
| Nominal disposable income | -3.2 | -0.8 | 0.9 | 2.2 | 3.3 |
| Saving rate (% nominal income) | 10.9 | 9.0 | 10.2 | 9.8 | 9.5 |

(*): Excluding aid to financial sector

Forecast closing date: 6 November 2015.

Source: Official bodies and BBVA Research

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