

BBVA

RESEARCH

3rd QUARTER
2016

Economic Outlook
Spain

Global economy grows, **but modest expansion pace in the U.S. and Brexit entail a downwards revision for 2017 forecast**

In Spain, positive bias is confirmed for 2016, but **new elements in the scenario compel to reduce 2017 growth foresight**

The increased vulnerability urges to mitigate uncertainty about the economic policy to be implemented in upcoming years



Global

Global growth

Global factors during the last quarter



Slightly better than
expected economic
indicators



FED's doubts and
delays



Brexit

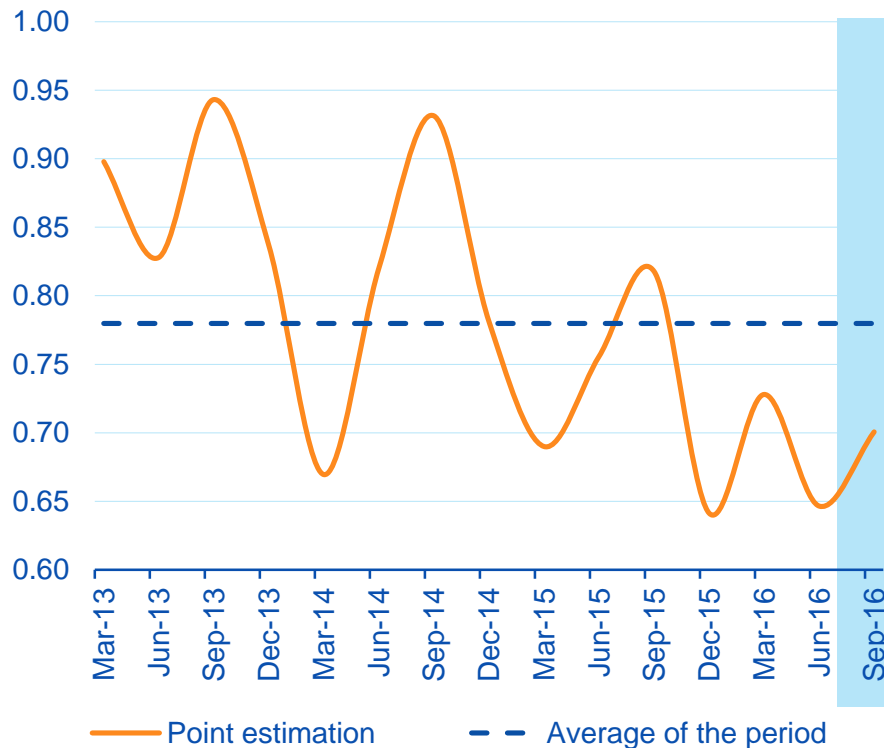
**Uncertainty
and downwards
Revisions**

mainly in advanced
economies

Global growth Remains around 3%

Global GDP growth

Estimates based on BBVA-GAIN (% , QoQ)



Industrial production kept growing in 2Q

Confidence in 3Q remained stable at low levels

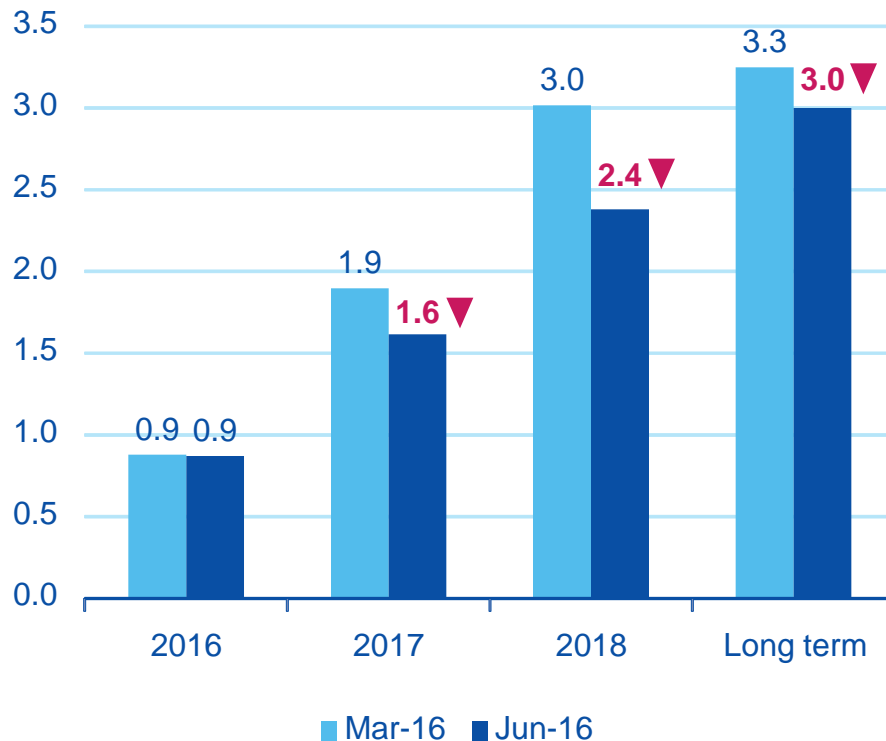
Global trade slightly hastened during 2Q

Interest rates

FED will take its time to rise interest rates

Target Fed Funds rates

Economic estimates of FOMC (%)



FED's doubts:

1. Long term growth and productivity
2. Real interest rates' equilibrium levels
3. Global shocks and their impact in U.S.

Electoral process: uncertainty influences the timing of interest rate hikes from the Fed

Brexit

Uncertainty remains high

Brexit won

High uncertainty

- Impact in markets
- When will the Article 50 be implemented?



Negotiation starts: up to 2 years

Transition period

- Dilemma between political and economic benefits
- Type of trade agreement with EU
- Necessary legislative changes in the UK



Final agreement: up to 10 years

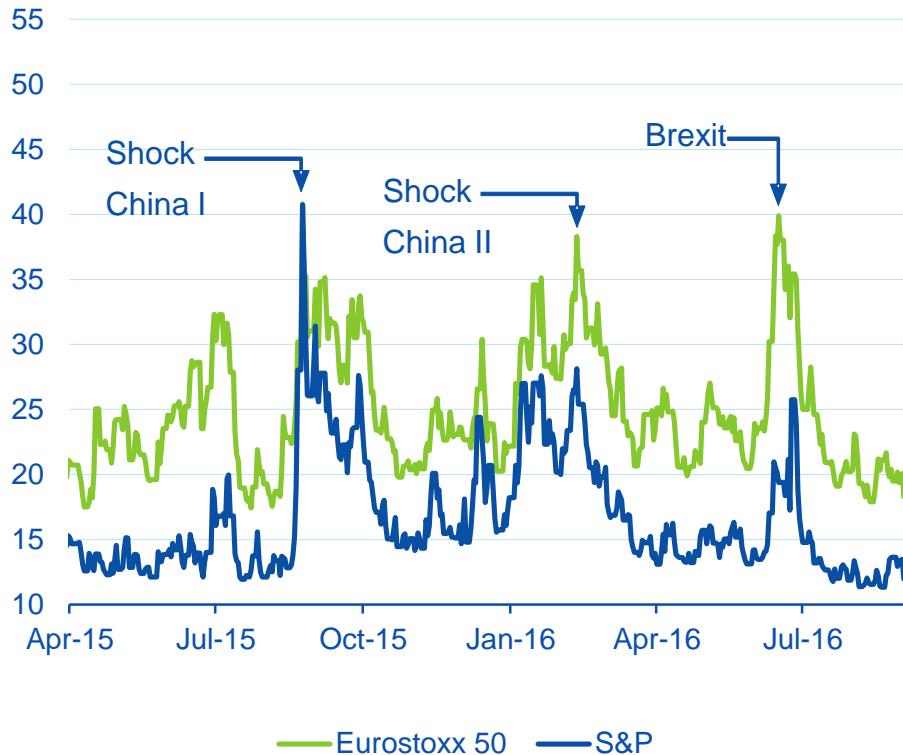
- Probable bilateral agreement
- Negative impact, not catastrophic



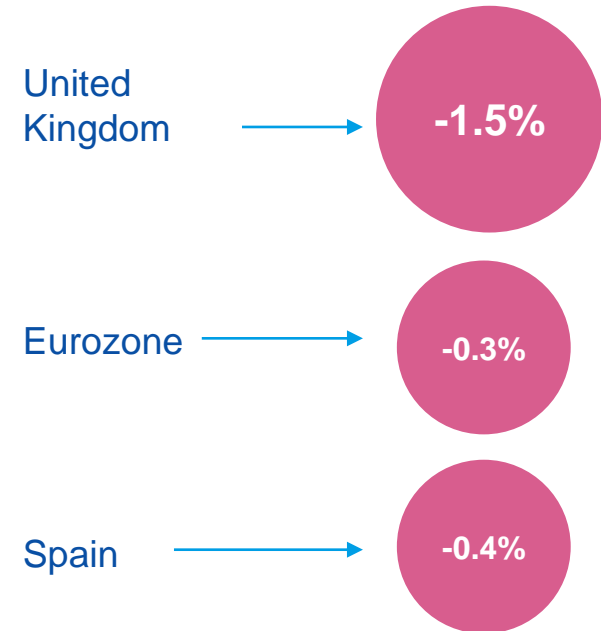
Brexit

Moderate forecast downward bias

Stock Exchange implicit volatility
(%)

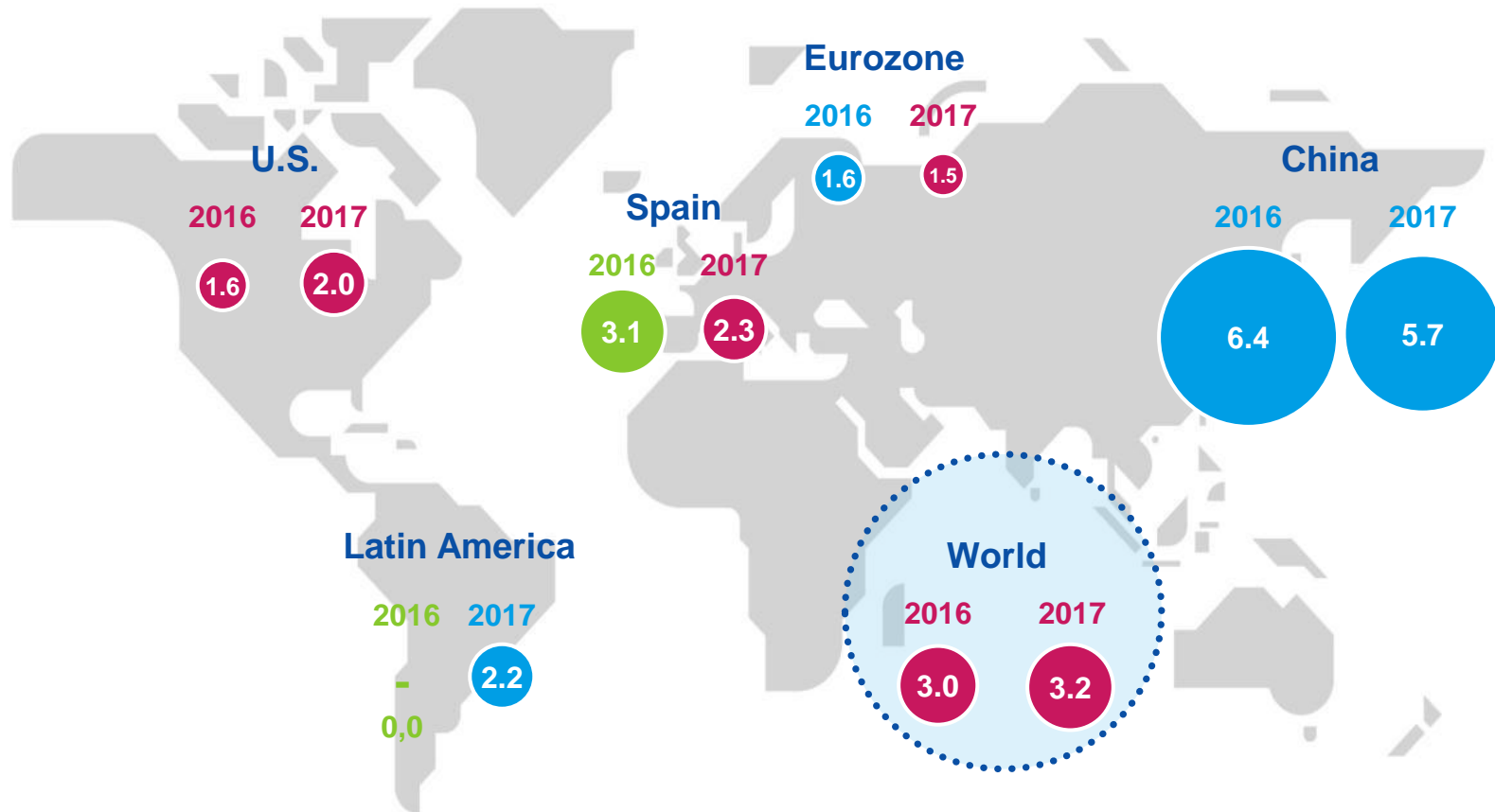


Impact on 2017 GDP growth
(%)



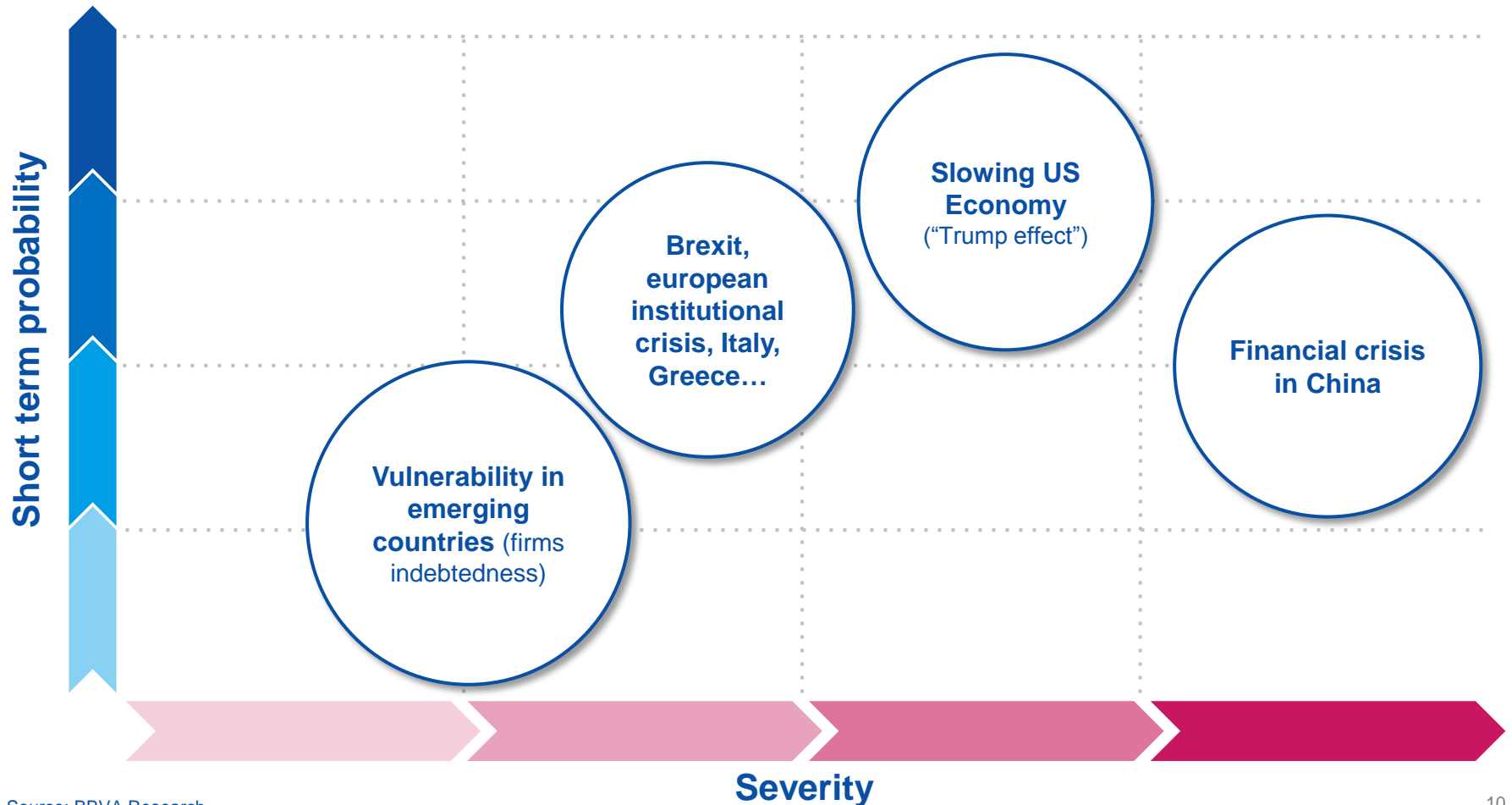
Global growth

Downwards revision in developed countries



Global risks

A complex geopolitical scenario

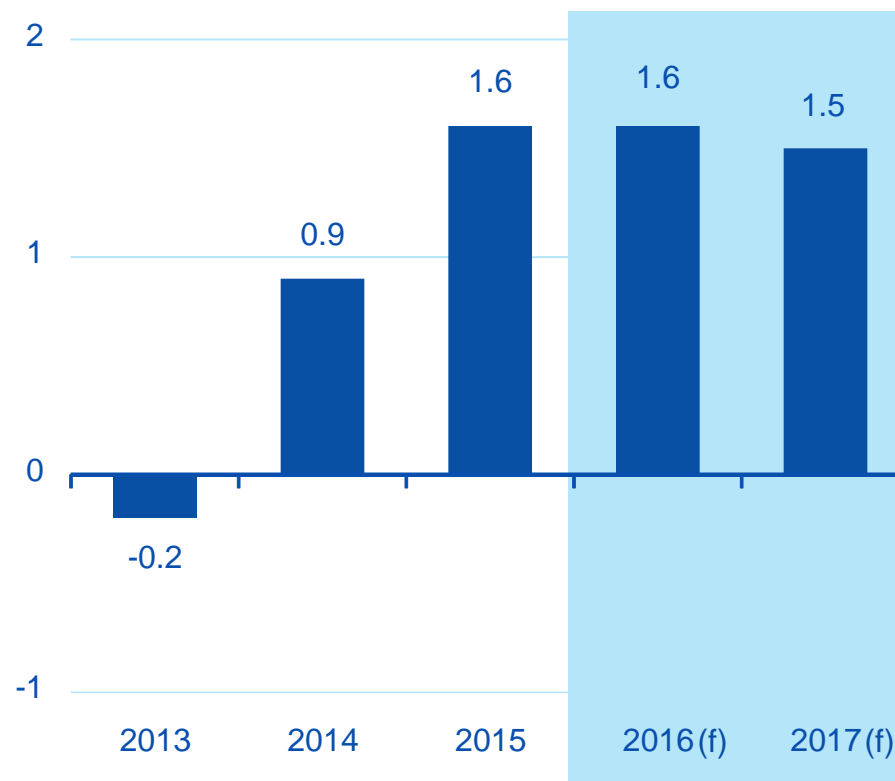


Eurozone

Brexit negatively affects EMU GDP growth

Eurozone: GDP growth

(YoY, %)



(f): forecast
Source: BBVA Research, Eurostat

Better than expected data (1Q),
mainly from domestic demand

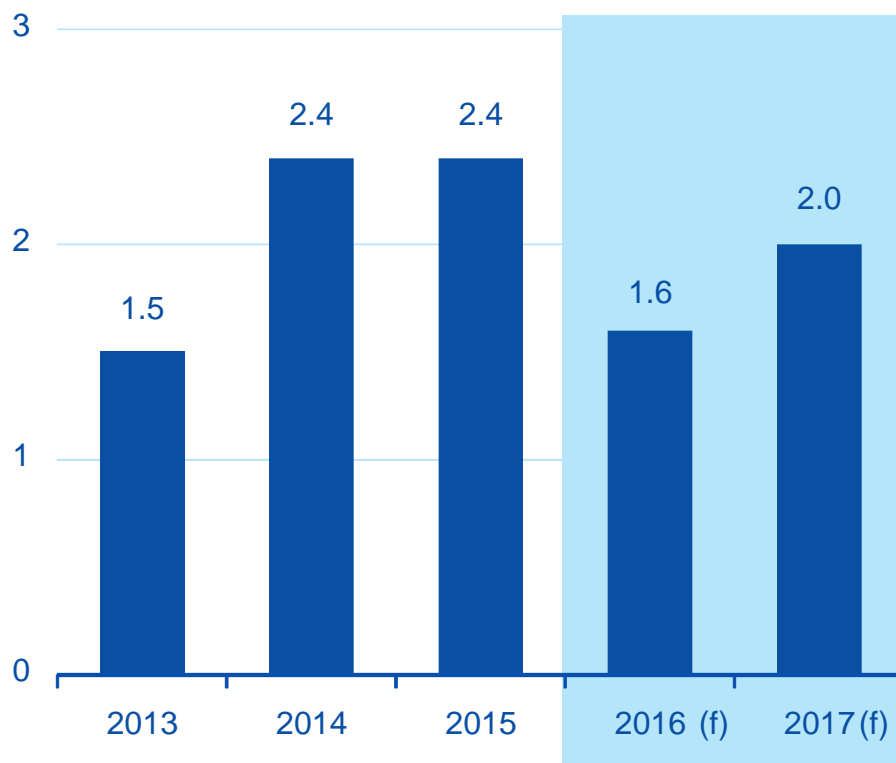
Brexit and associated uncertainties
weigh on prospects despite favorable
monetary and fiscal policies

Interest rates will remain low during
an extended period of time

Other risks: the refugee crisis,
political uncertainty and Greece

U.S Downward revision despite consumption strenght

U.S: GDP growth (YoY, %)



(f): forecast
Source: BBVA Research, BEA

Downward revision in 2016:

1. Lower than expected GDP growth
2. Higher global uncertainty and concerns about productivity growth

Fed policies: softer hikes due to domestic and global doubts

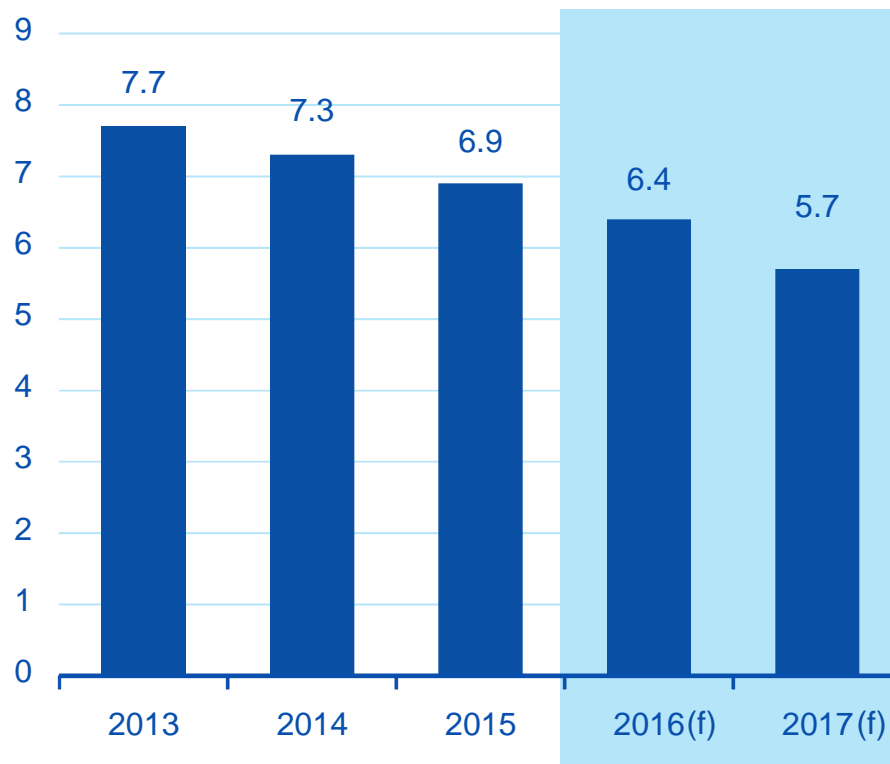
Political risks: polarization and elections

China

Growth and slow imbalances adjustment

China: GDP growth

(YoY, %)



(f): forecast
Source: BBVA Research, CNBS

Authorities prioritize a sufficiently **high growth** even at the expense of slower reforms

High tail risks:

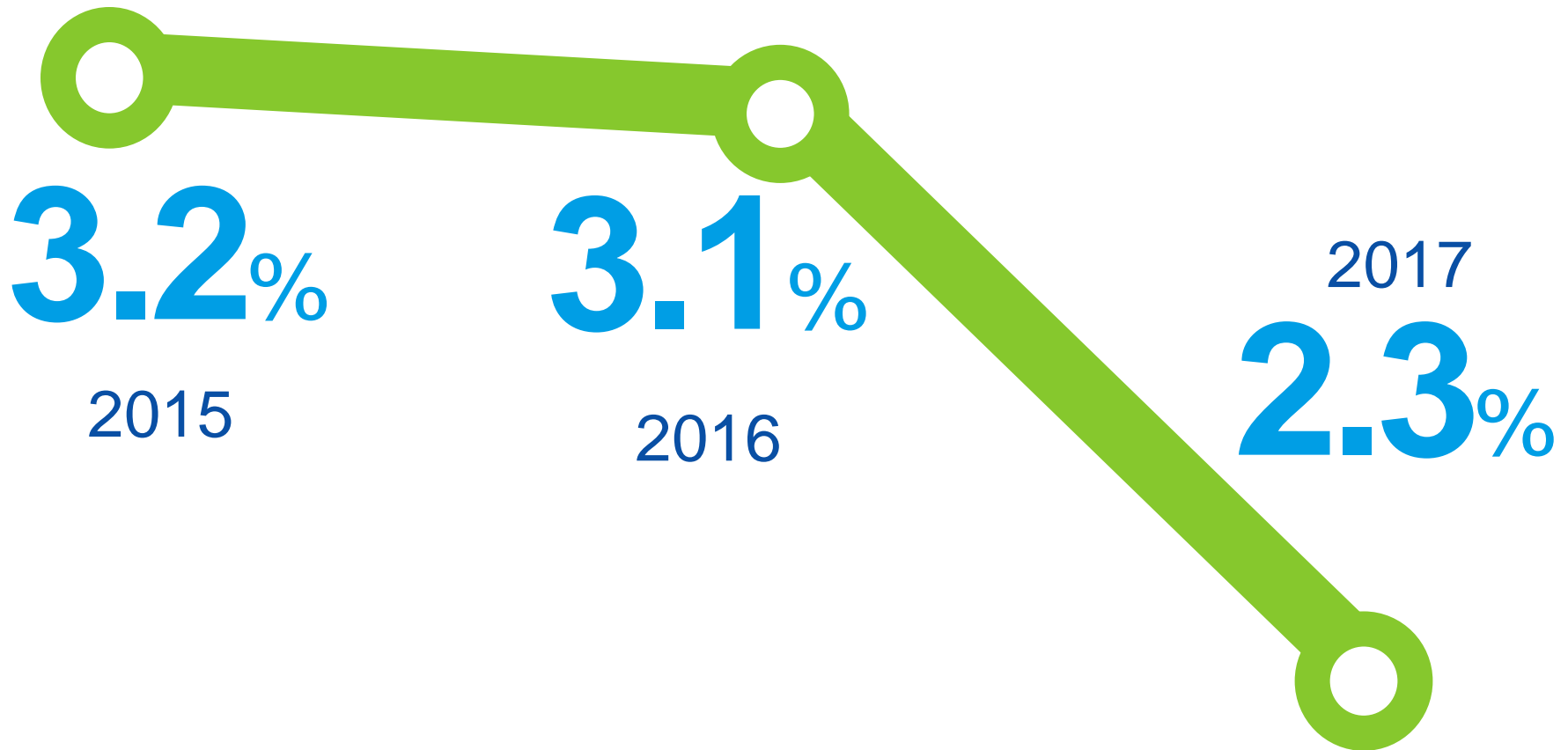
1. Exchange rate depreciation, capital outflows
2. Housing market recovery
3. Indebtedness of business and financial situation
4. Worsening global trade

A satellite night view of Spain, showing the country's outline and its coastline. The land is dark, with numerous bright yellow and orange lights representing cities and towns. The surrounding waters are dark blue, and the sky is black. The word "Spain" is overlaid in large white text at the bottom center.

Spain

Positive bias in 2016 is confirmed

Expected growth for 2017 is revised downwards

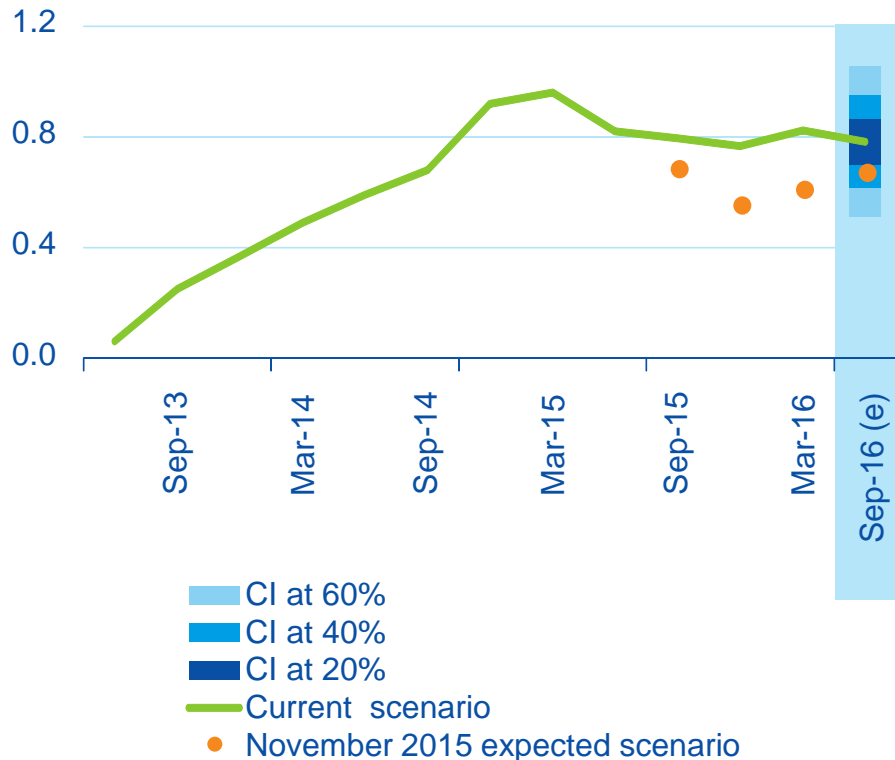


Positive bias in 2016 is confirmed

Activity grows despite uncertainty in the short term

Spain: GDP growth

(% QoQ, MICA BBVA model)



1S16 growth stayed at around 0.8 QoQ, with no signs of a slowdown

Available data shows that **the pace of growth remains stable at 0.8% in 3Q16**

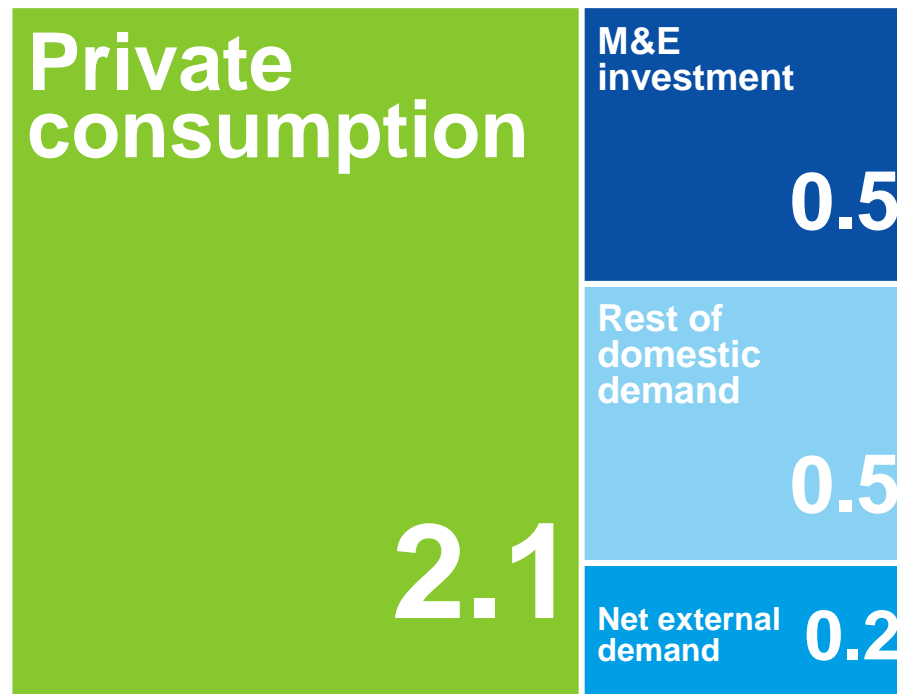
The recovery beats expectations and **allows us to improve our 2016 growth forecast (up to 3.1%)**

Positive bias in 2016 is confirmed

Domestic demand and exports: footholds

Spain: contributions to annualized GDP growth

(3Q15-2Q16 average)



Private consumption stands out as the engine for short term growth

Productive investment grows despite last year's slowdown

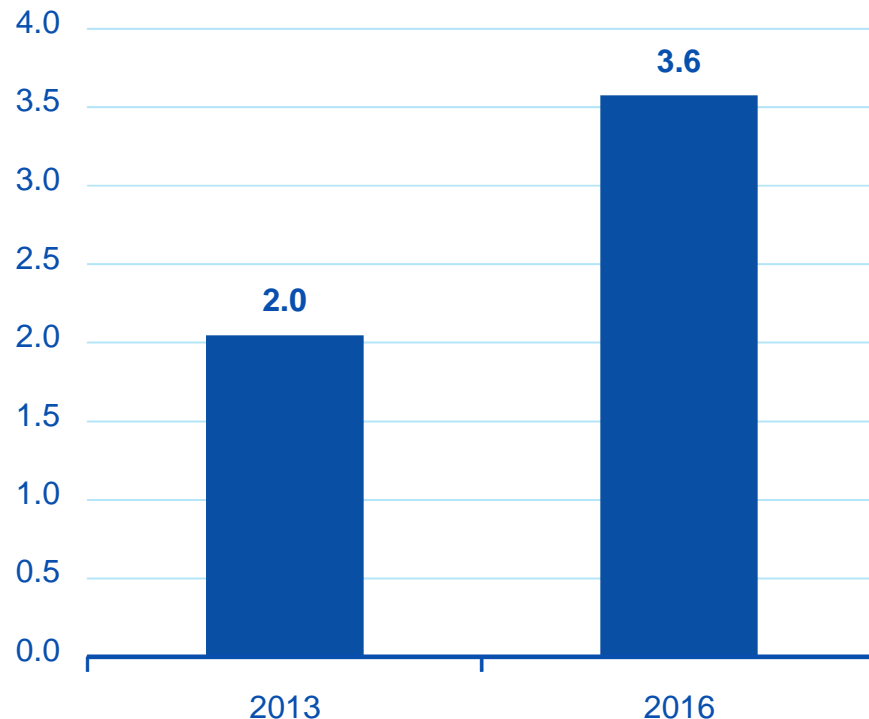
Exports gain traction but their dynamism is partially offset by imports growth

Positive bias in 2016 is confirmed

Expansionary monetary policy boosts expenditure

Spain: new credit flows for consumption purposes

(second quarter of each year, % of the disposable income)



Consumption benefits from expansionary monetary policy through several channels

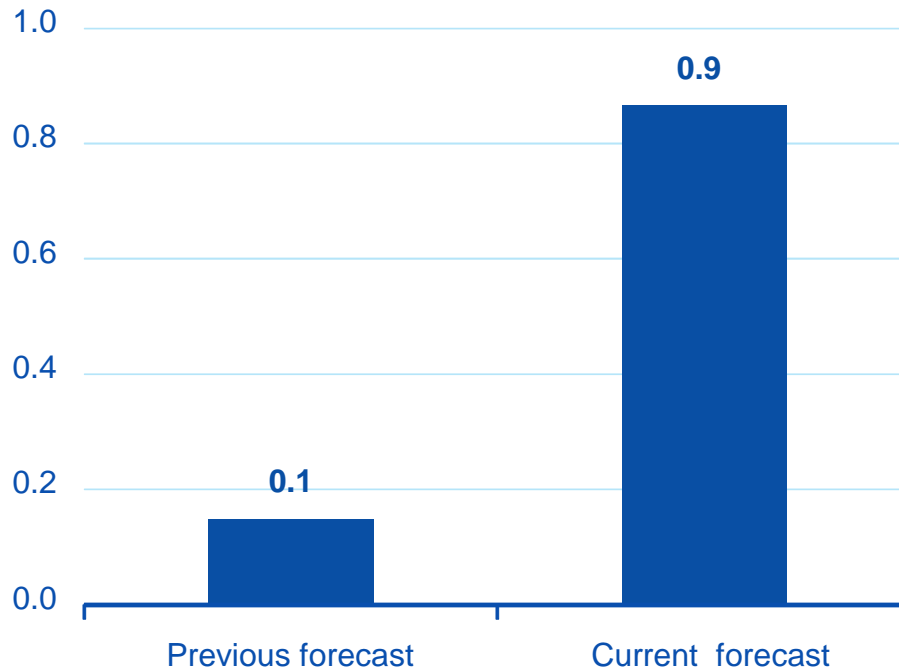
- **Directly:** lower financial burdens and improvement in funding conditions
- **Indirectly:** improving expectations about economic growth and job creation

Positive bias in 2016 is confirmed

Fiscal policy is more expansionary than expected

Spain: deterioration (+) / improvement (-) of the public deficit in 2016 due to discretionary measures

(GDP pp)



General government has implemented a more expansionary fiscal policy than the one expected a few months ago

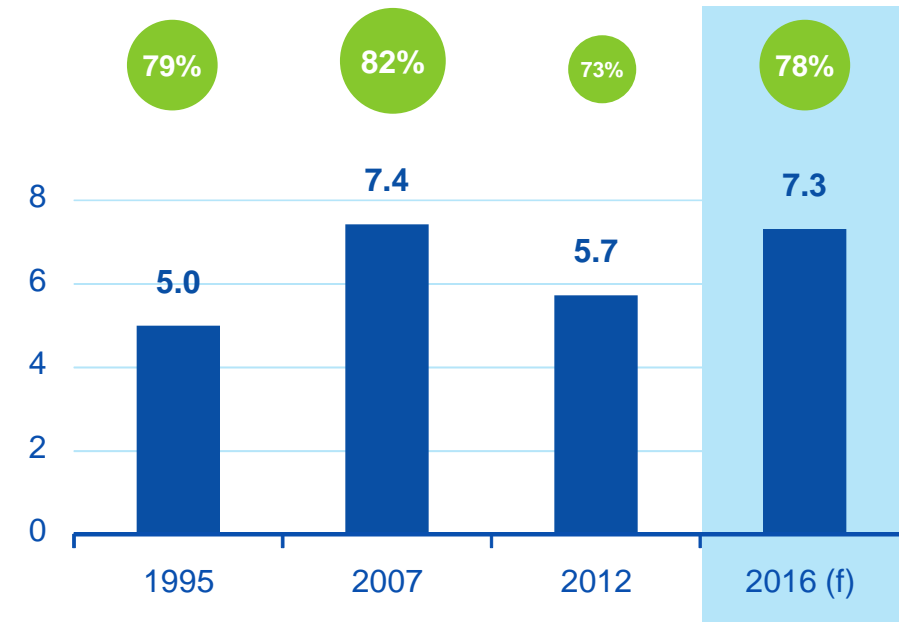
Tax reductions produced an structural fall in revenue, which was only marginally compensated by the recovery in tax bases

Positive bias in 2016 is confirmed

Reforms could be having a stronger impact

Spain: investment in M&E and production capacity utilisation

(%)



■ Share of M&E in GDP

● Industry production capacity utilisation

The **behavior of the investment in M&E** positively surprises and approaches maximum levels

Despite the idle capacity in the industry persists, **there continue to be investment opportunities**

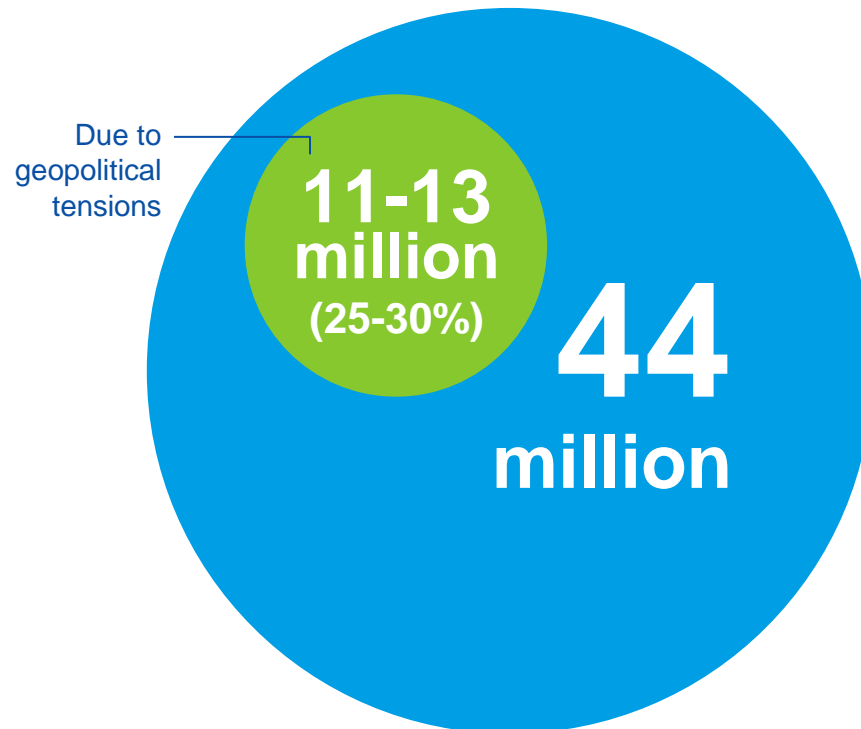
(f): forecast

Source: BBVA Research based on INE & MINETUR

Positive bias in 2016 is confirmed

Tourism remains as a positive element

Spain: rise in the overnight stays of nonresident tourists (2010-2015)



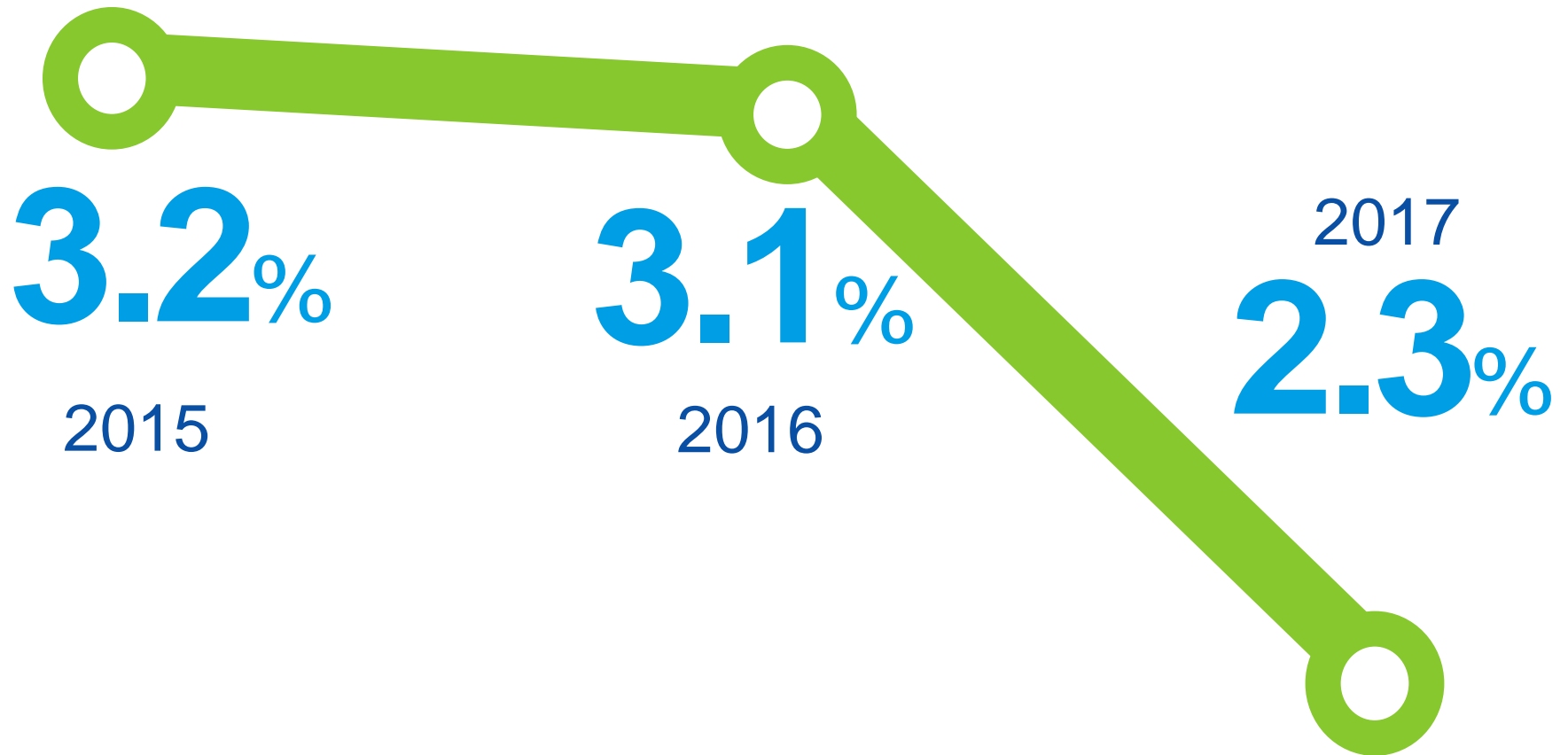
Geopolitical tensions in some of the competitors steers tourism to Spanish destinations

The overnight stays of nonresident tourists have risen by 44 millions since 2010. Close to 25-30% of them due to geopolitical tensions

Insular and mediterranean regions are the most favored

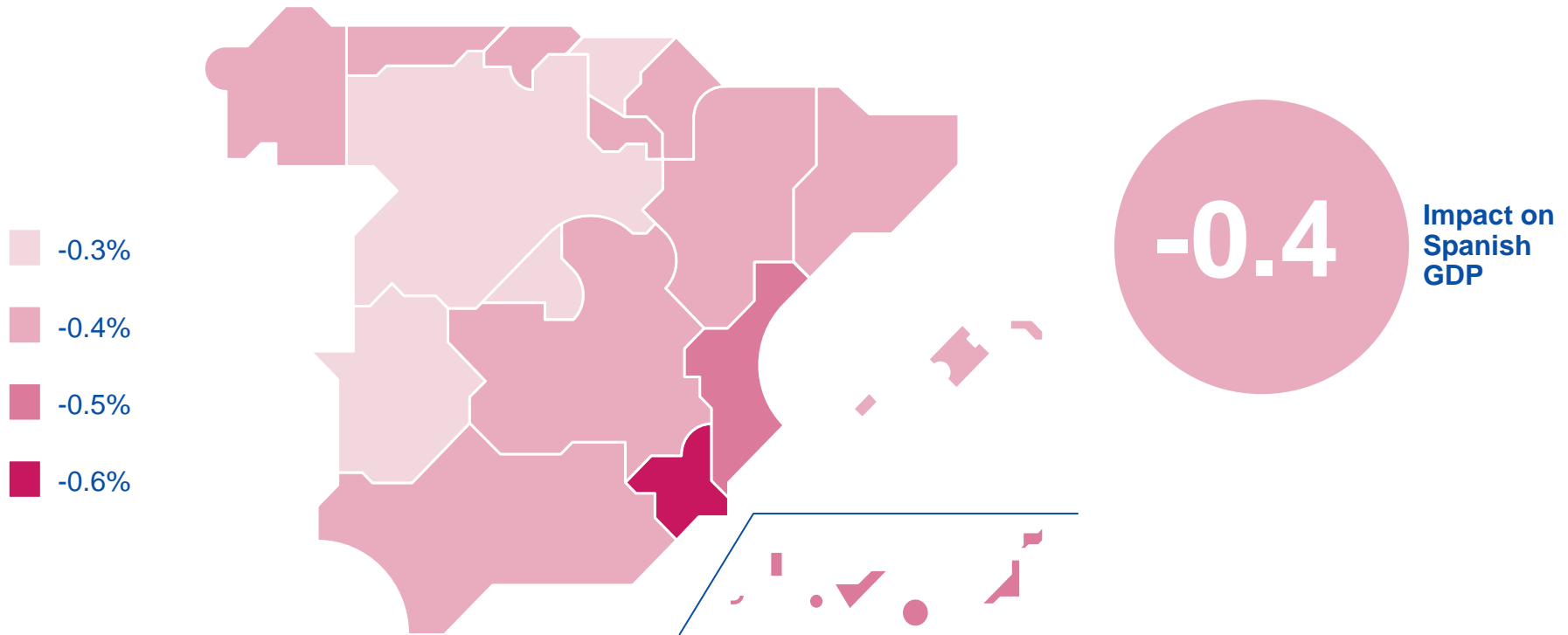
A slowdown is coming

Expected growth for 2017 is revised downwards



A slowdown is coming
Lower growth in the US and Brexit are headwinds

Brexit impact on 2017 GDP growth
 (estimated deviation from baseline scenario in pp)

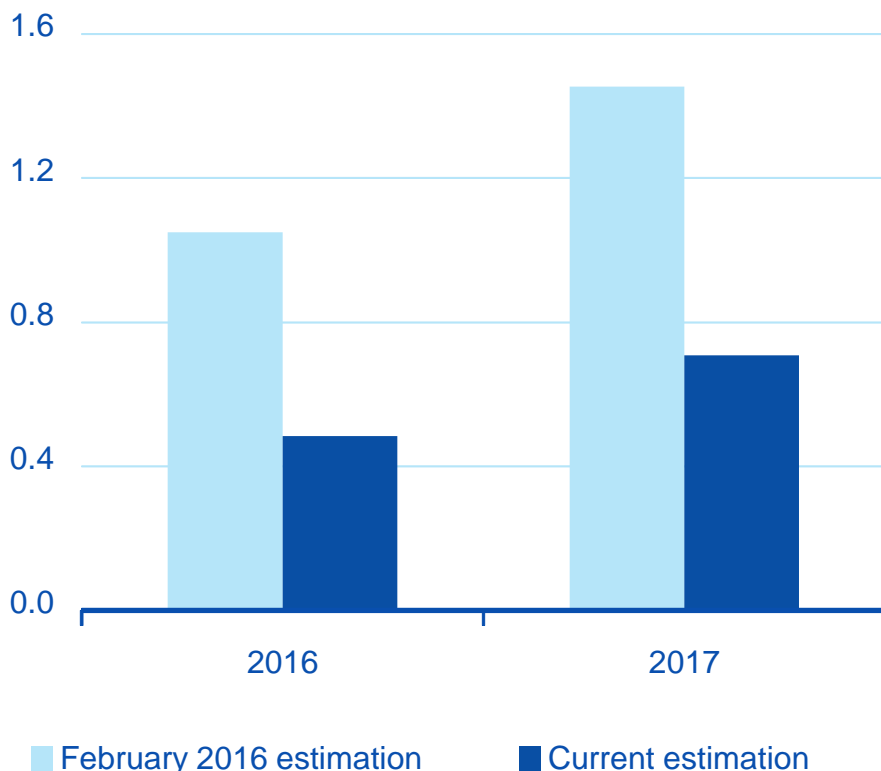


A slowdown is coming

Oil prices remain low but are revised upwards

Spain: oil price impact on GDP growth

Deviation from six months ago baseline scenario in pp)



The energy cheapening is largely due to an **increasing supply with a positive impact on GDP**

Nevertheless, **prices are revised upwards** and, therefore, their impact is revised downwards

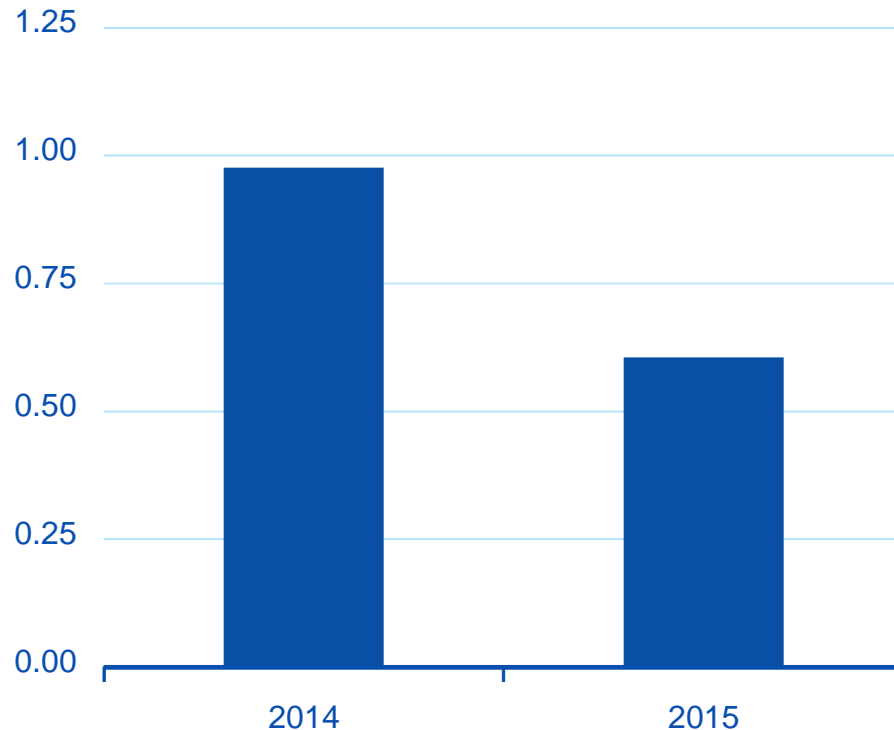
On average, this factor could contribute to growth by 0.6pp in the current biennium

A slowdown is coming

Monetary policy is a tailwind but with decreasing impact

Spain: Credit supply contribution to GDP growth

(pp)



The fall in bank credit interest rates has favored growth in recent years

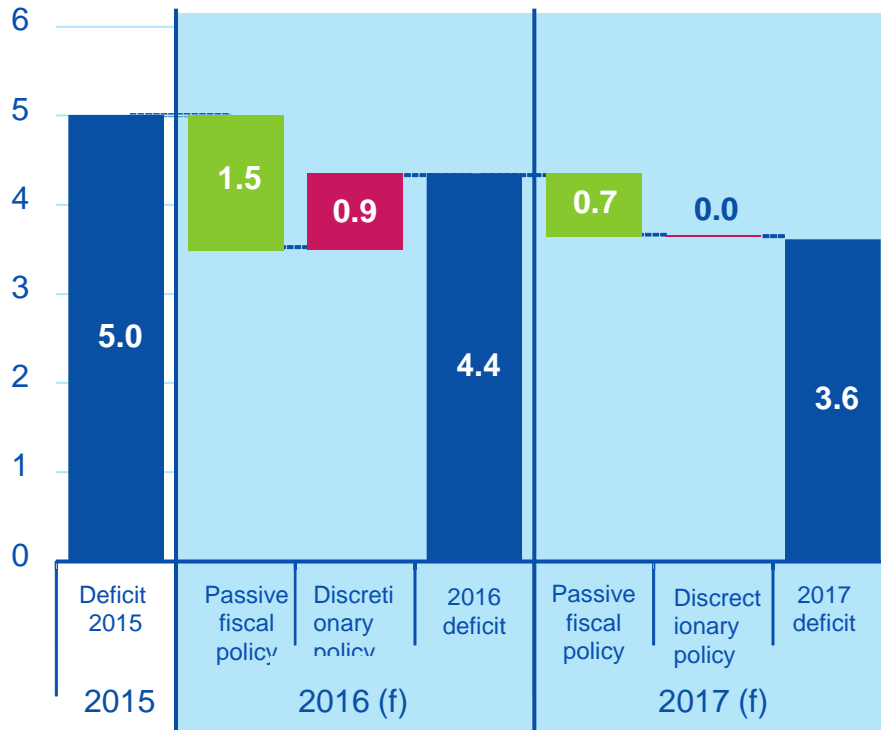
Credit risk and the interest rates ZLB suggest that **the most relevant impact might be behind**

A slowdown is coming

A less expansionary fiscal policy

Public administrations' fiscal adjustment decomposition

(pp of GDP)



Without policy changes, the fiscal stance would be broadly neutral in 2017

Nonetheless, new measures (around 0.5 pp of GDP) will be required in order to fulfill 2017's deficit target (3.1% of GDP)

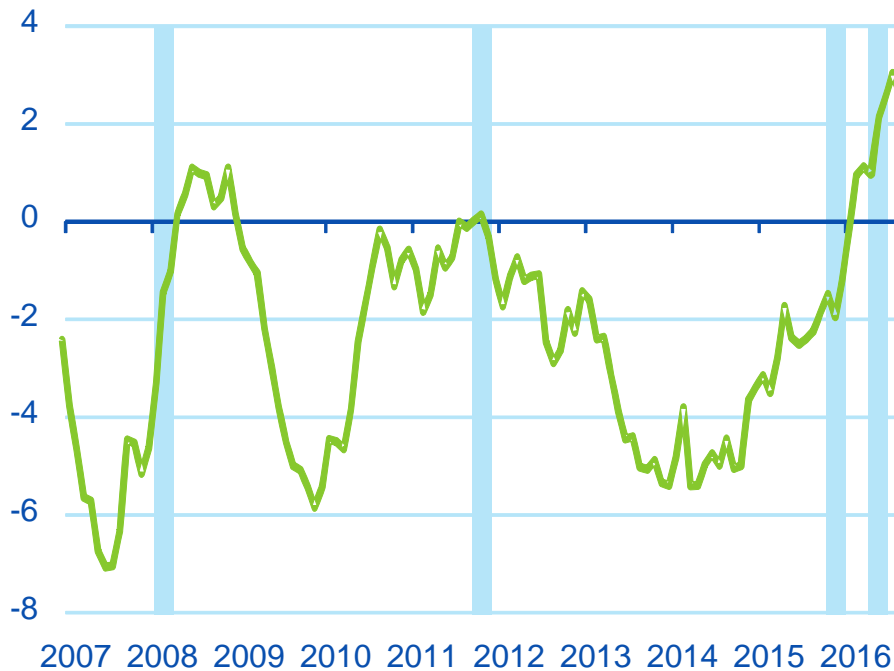
The impact on GDP growth will depend on the fiscal adjustment breakdown

(f): forecast. Aids granted to banks are not included
 Source: BBVA Research based on MINHAP e INE

A slowdown is coming
Uncertainty remains high

Spain: Economic policy uncertainty

(SM12 of the idiosyncratic component in standard deviations)



■ General elections

Strong uncertainty could be lowering growth in the 2016-2017 biennium 2016-2017 by 0,7pp

Mitigating uncertainty and reducing public deficit below 3% of GDP by the end of the following year are key points

A hand holding a tablet computer against a city skyline background. The image is split diagonally from the bottom-left to the top-right. The upper-left portion shows a hand holding a tablet, with a bright, overexposed sky in the background. The lower-right portion shows a blurred city skyline with several tall buildings under a blue sky. The overall color palette is dominated by blues and whites.

Conclusions

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