

# ECONOMIC OUTLOOK SPAIN

1<sup>ST</sup> QUARTER 2017



**The global scenario is improving, but uncertainty remains high, especially due to the risks of US protectionism**

**In Spain, recent data confirm the upward bias in the scenario.**

**The economy will grow by 2.7% in 2017 and 2018**

**The vulnerability of the Spanish economy makes it necessary to continue with new reforms**

# GLOBAL

1<sup>ST</sup> QUARTER 2017



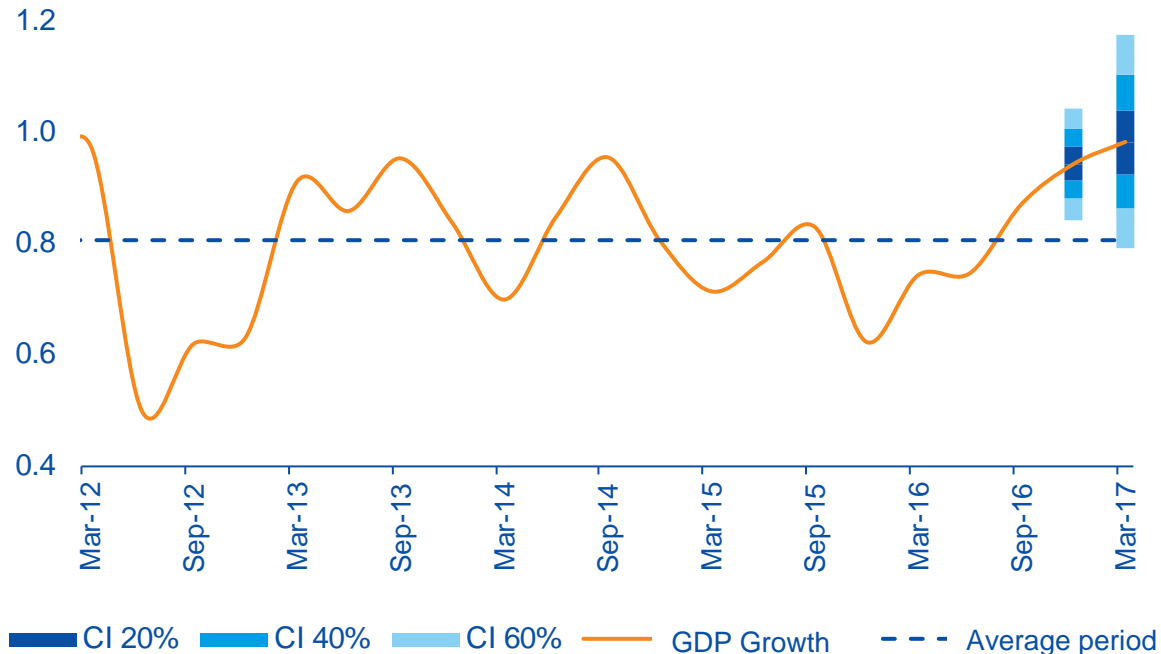
ACTIVITY

# Global growth is accelerating

- Better-than-expected data at the end of 2016 in the US, China, and the euro zone
- **Recovery of the industrial sector and global trade**
- Confidence indicators are improving

## GLOBAL GDP GROWTH

Forecasts based on BBVA-GAIN (% , QoQ)

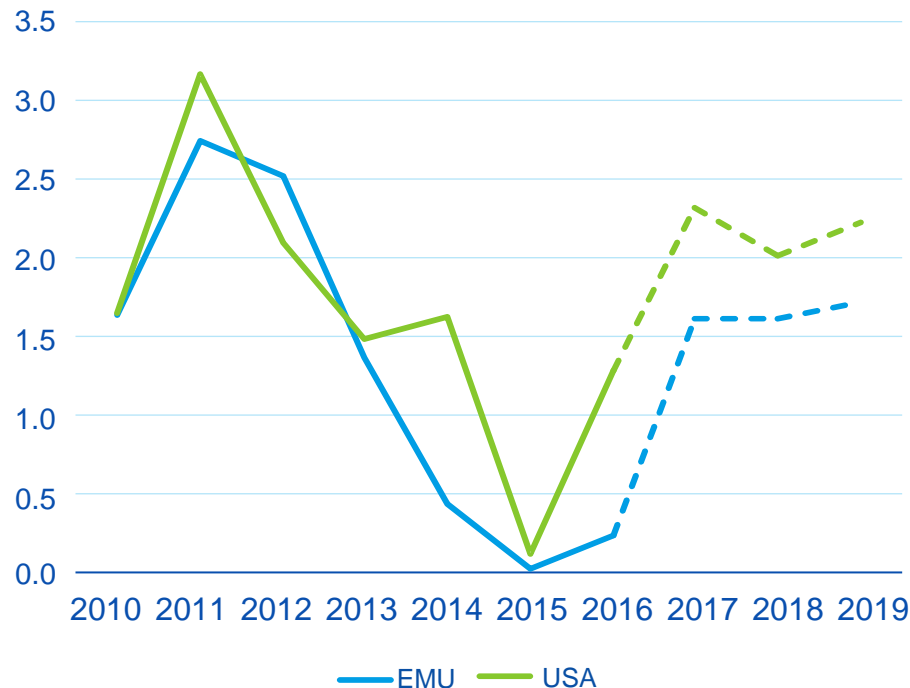


INFLATION

# The increase in commodity prices opens the way to normalisation of inflation

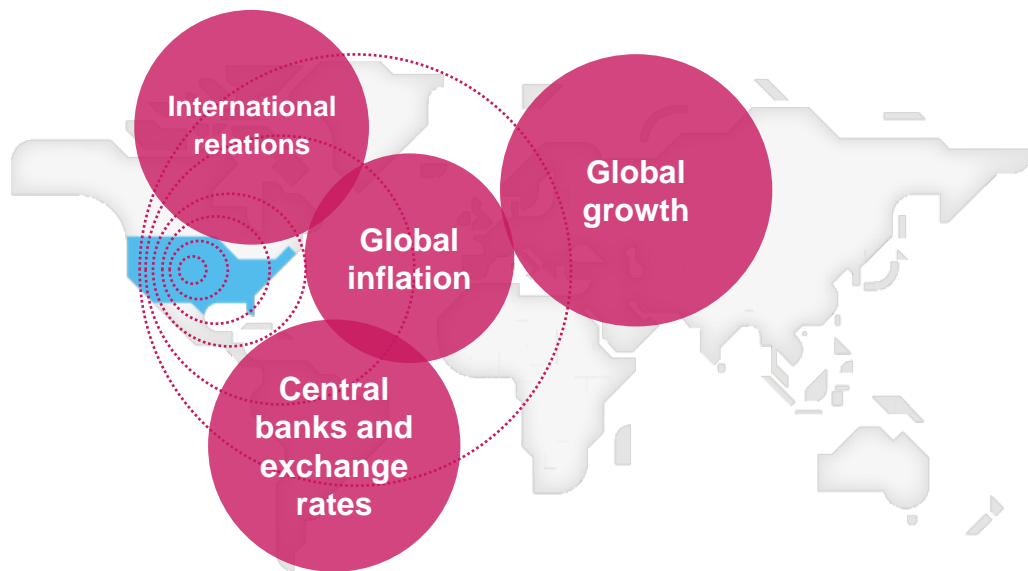
- **Inflation in advanced economies has recovered** due to the base effect of energy prices and the increase of the oil price
- **Core inflation** remains at **moderate rates**
- The recovery of inflation points to the **normalisation of interest rates**

CPI HEADLINE INFLATION  
(%, YoY)



A FEW UNKNOWNNS

# US economic policy and its global effects



Priorities of fiscal policy?  
.....

Impact of fiscal stimulus on growth and inflation in an economy with full employment?  
.....

What impact will Trump have on potential growth?

What will be the protectionist measures? When will they be applied? What will be their impact?  
.....

What will the reaction of other countries be (such as China)?  
.....

Which sectors will be deregulated, and how?

## A FEW UNKNOWNNS

# What do we know about the new USA policies?



## FISCAL REFORM

- Focused on corporation tax (tax rate from 35% to 20% and fewer deductions)



## TRADE POLICY

- First option: border tax adjustment (revenues/expenditure)
- Bilateral approach of trade
- Conflicting signals on NAFTA
- TTIP rejected and TPP in danger



## FISCAL POLICY

- More focus on tax reform than on spending on infrastructure



## IMMIGRATION

- Entry restrictions
- Executive order to build the “wall”
- Deportations?



## DEREGULATION

- Repeal of Obamacare, with no clear alternative
- Abolition of the Environmental Protection Agency and repeal of the Dodd-Frank Act



## A FEW UNKNOWNNS

# Will central banks' strategy change?

## US FEDERAL RESERVE

(brought forward)

### Need to balance:

- Fiscal policy and its effect on inflation
- Stronger dollar

## ECB

(behind schedule)

### Bias towards sooner-than-expected exit:

- Very low risk of deflation
- Weak euro
- Growing pressure within the ECB as inflation consolidates

Medium  
and long  
term

### The main challenges remain unchanged:

- Large size of balances
- Low potential growth (productivity) and low equilibrium interest rates

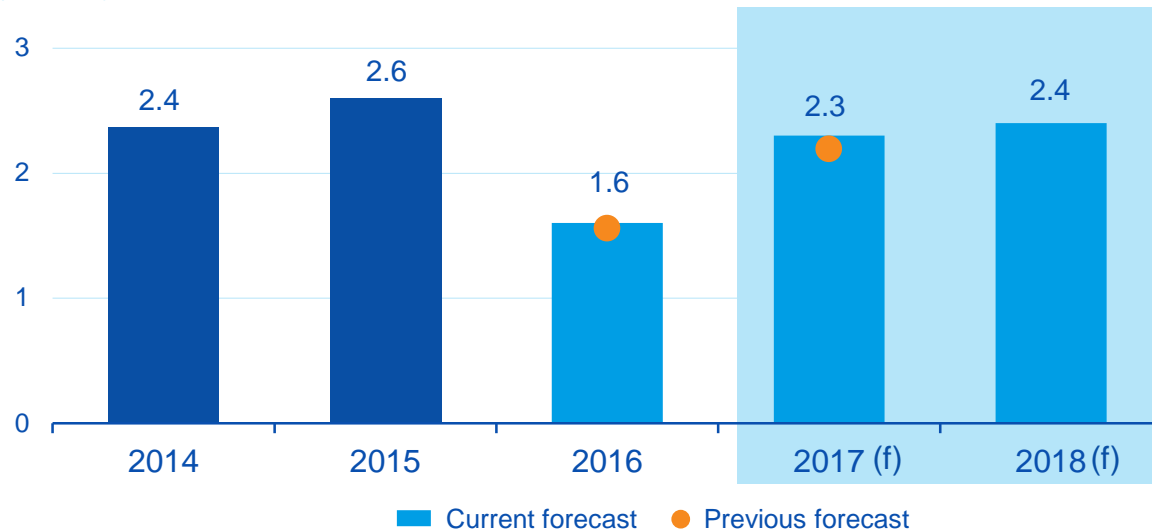
Short  
term



UNITED STATES

# Boost in the short term, but with a high degree of uncertainty

**GDP GROWTH**  
(YoY, %)



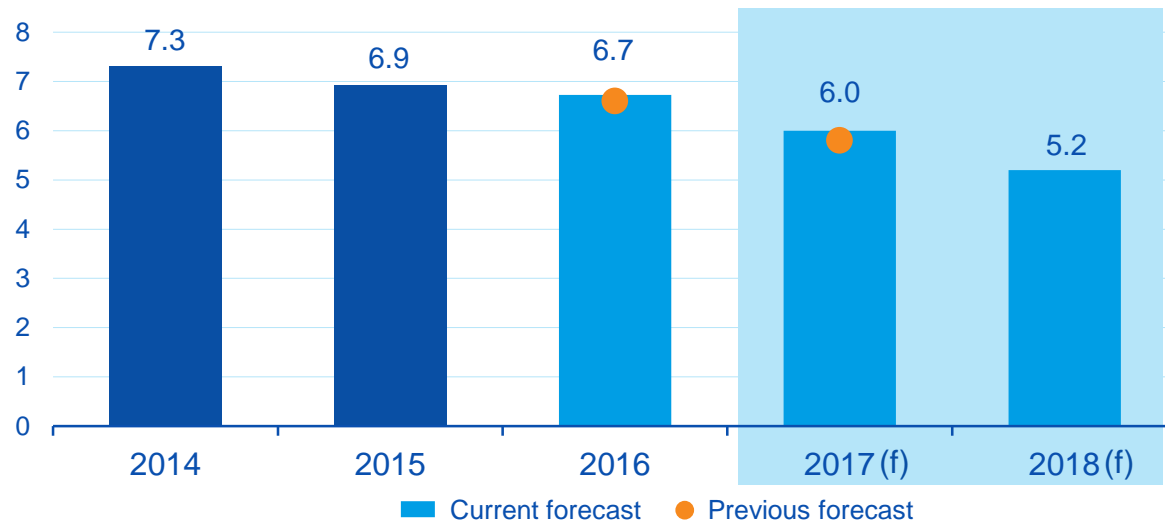
- **Slight upward revision in 2017, pending concrete decisions**
  - Less downward pressure from mining, oil and construction
  - Solid employment situation and rising wages together with recovering corporate earnings
  - Improvement in confidence indicators and market expectations
- **Monetary policy: forecast of rate hikes**, although the Federal Reserve will remain cautious (two hikes in 2017 and 2018, up to 1.75%)
- **Risks:** economic policy; inflation, dollar and interest rates

(f): forecast  
Source: BBVA Research based on BEA (Bureau of Economic Analysis)

CHINA

# Stability takes priority over growth

**GDP GROWTH**  
(YoY, %)



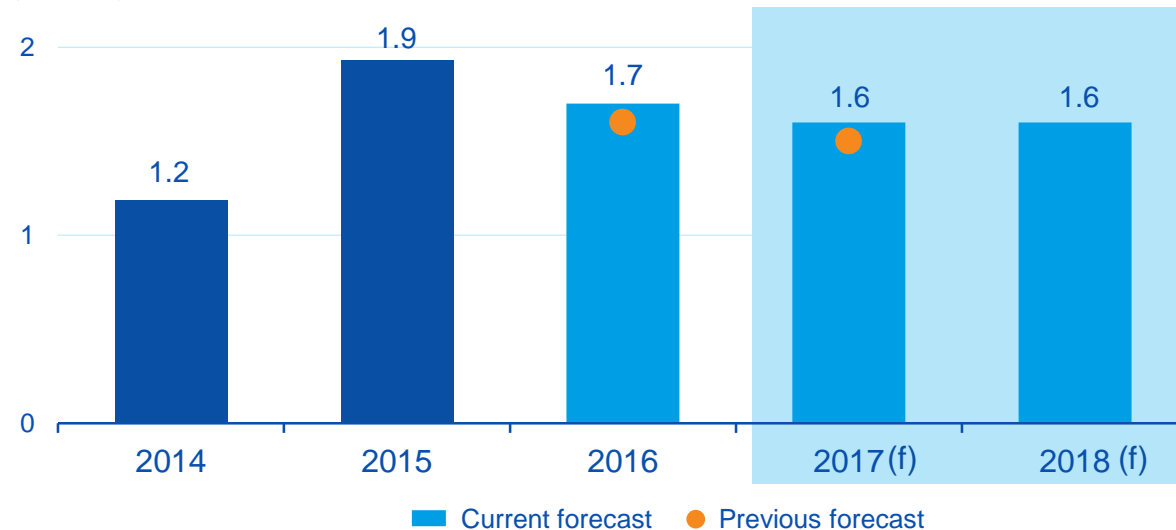
- **China continues to stimulate its economy** in order to ensure a high growth rate in the short term
- **Monetary stimulus measures have been postponed** (real estate bubble), but macroprudential measures remain and **fiscal policy continues to support activity**
- **Relevant medium-term risks:**
  - US trade policy
  - Real estate market
  - Capital outflows and exchange rate
  - Corporate debt and lack of reforms in state-owned enterprises

(f): forecast  
Source: BBVA Research based on CEIC data

EURO ZONE

# Slight upward revision, high degree of political uncertainty

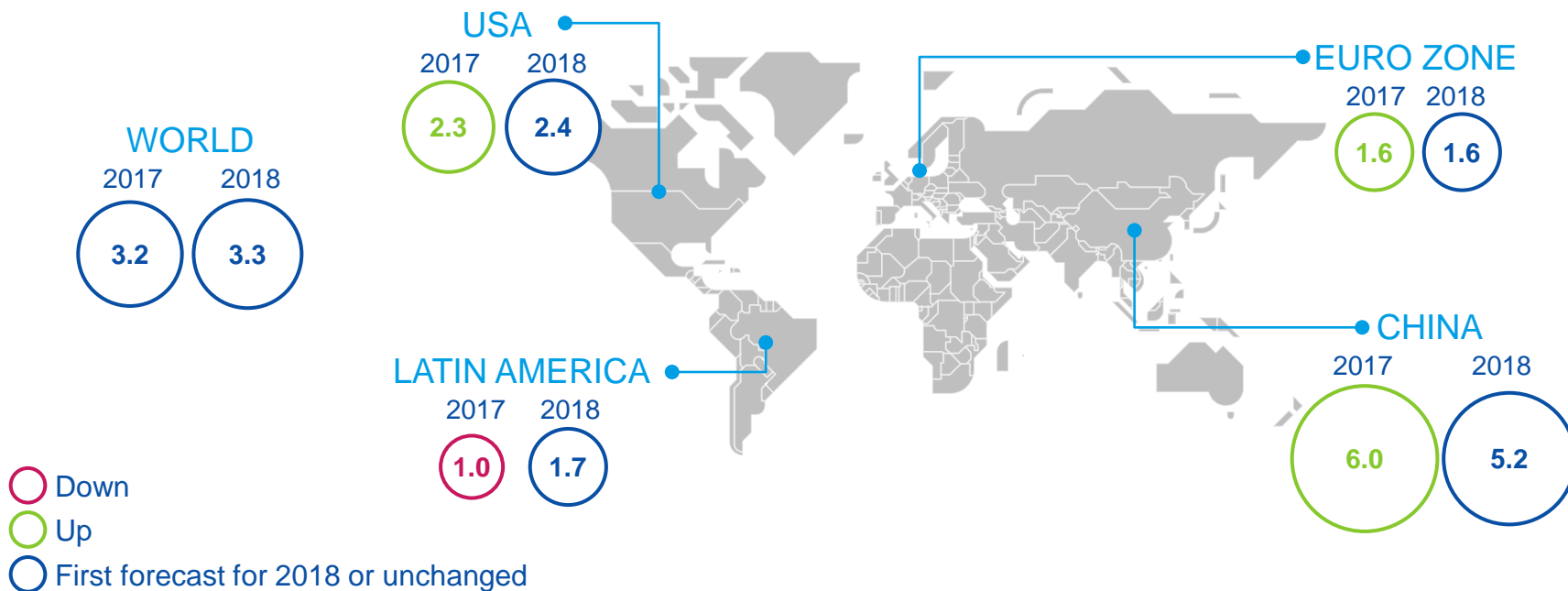
**GDP GROWTH**  
(YoY, %)



- The **positive factors** supporting activity remain in place, despite the global uncertainty: **recovery of global trade and weak euro**
- **Pressure on the ECB will increase in line with inflation:** withdrawal of QE during 2018 and first interest rates hike towards the end of that year
- **Mainly political risks:** “hard” Brexit, electoral cycle, banking system, programme of assistance to Greece, geopolitical risks

GLOBAL SCENARIO

# The economy will accelerate in 2017 and 2018



# SPAIN

1<sup>ST</sup> QUARTER 2017



OUTLOOK FOR 2017 &amp; 2018

# Growth is robust, but will slow down

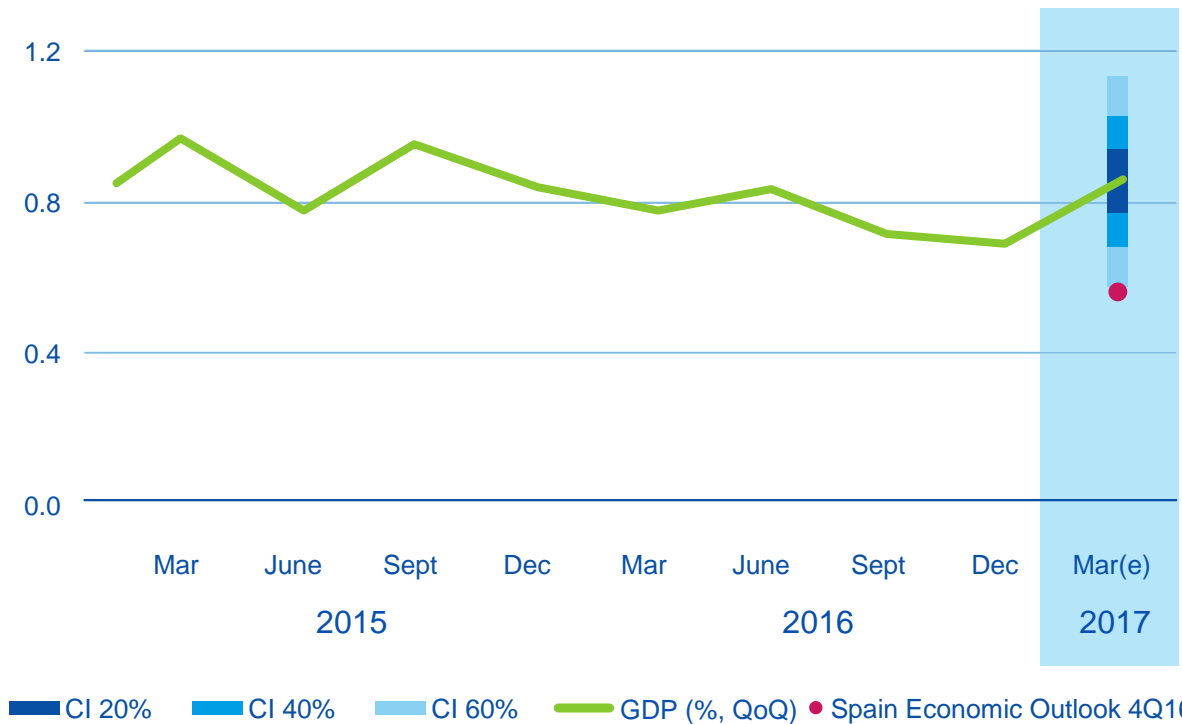


GROWTH IN 1Q

# Upward bias

- GDP growth stabilised at 0.7% QoQ in 4Q16
- Leading indicators suggest that growth in 1Q17 could be higher than expected (0.8% QoQ)
- However, the economy is expected to slowdown compared to the growth pace observed in 2016

**SPAIN: GDP GROWTH**  
(% QoQ, MICA BBVA model)



(e): estimate  
Source: BBVA Research

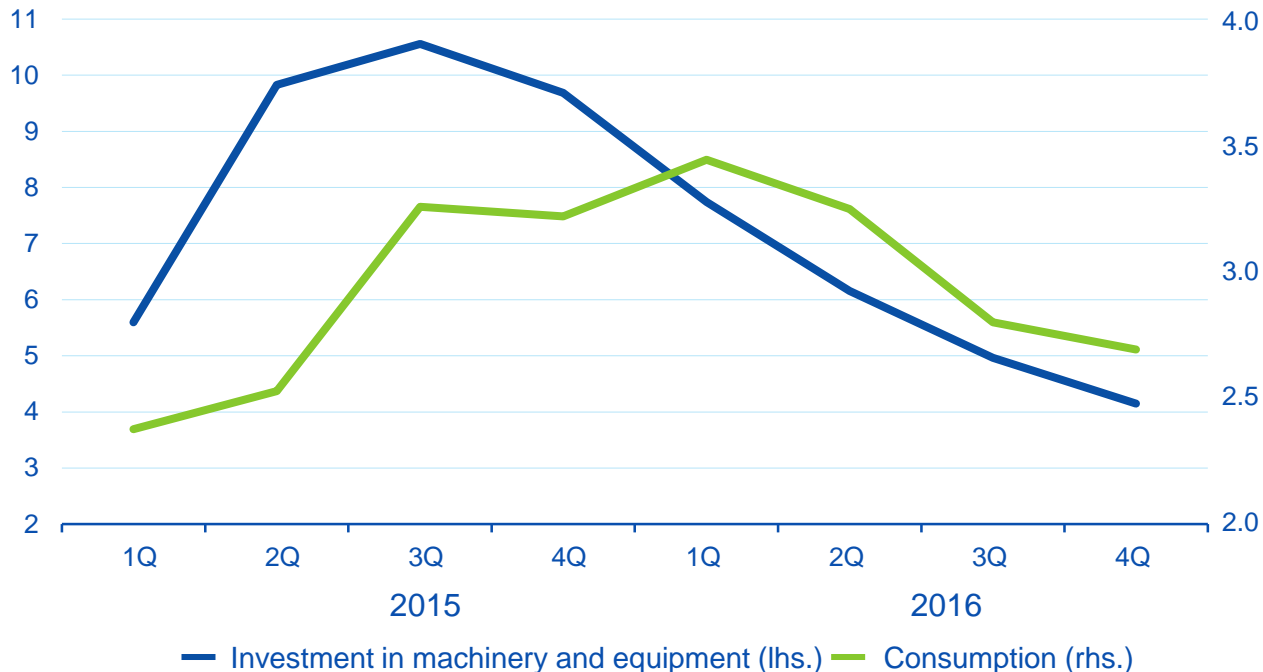


PRIVATE DOMESTIC DEMAND

# Symptoms of lower growth

- The slowdown is already affecting both, **household consumption** and **investment in machinery and equipment**

SPAIN: CONSUMPTION AND INVESTMENT IN MACHINERY AND EQUIPMENT (% YoY)



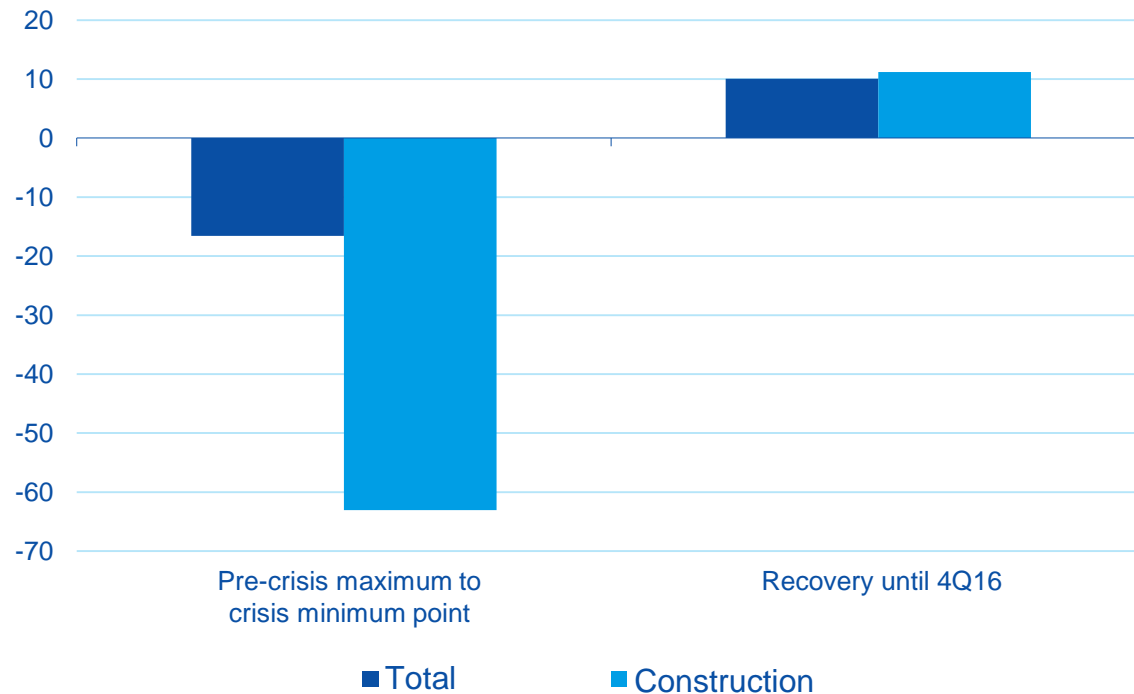
PRIVATE DOMESTIC DEMAND

# Symptoms of lower growth

- Recovery in construction (especially of housing) remains modest
- However, there are **positive signs** in certain regions, especially in the **major urban areas**

## SPAIN: SOCIAL SECURITY AFFILIATION

(%)

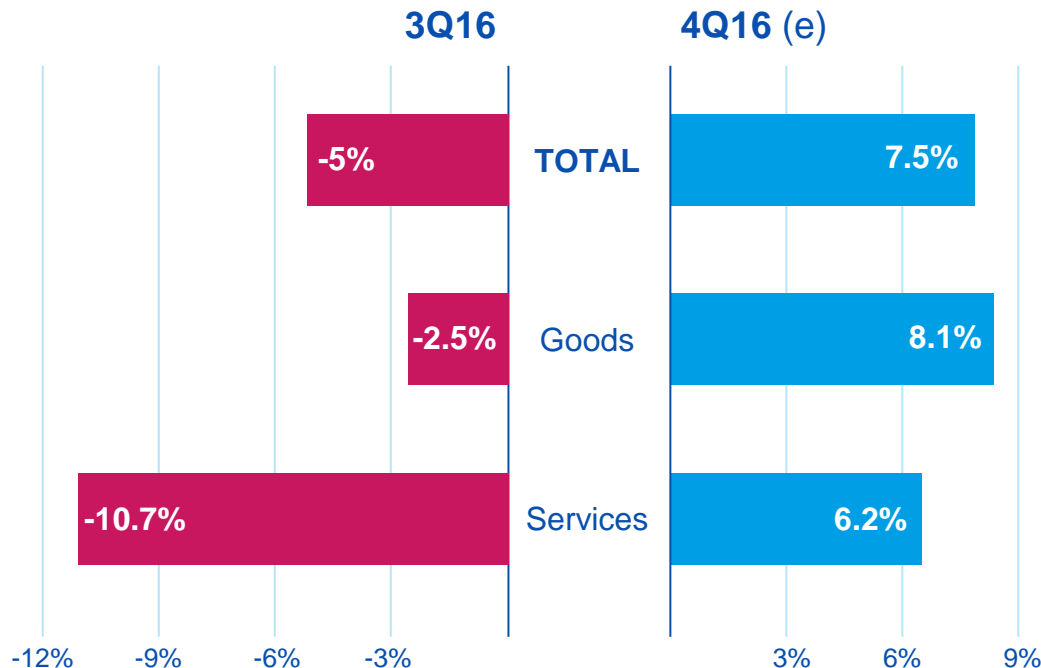


EXTERNAL DEMAND

# Exports are recovering...

- The disappointing figure observed in 3Q16 was **temporary**, and it seems that sells abroad are still on a positive and indeed encouraging trend.
- **Geographical diversification is key.** Exports to emerging countries, especially China, are recovering

SPAIN: EXPORTS  
(%, QoQ annualised)



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

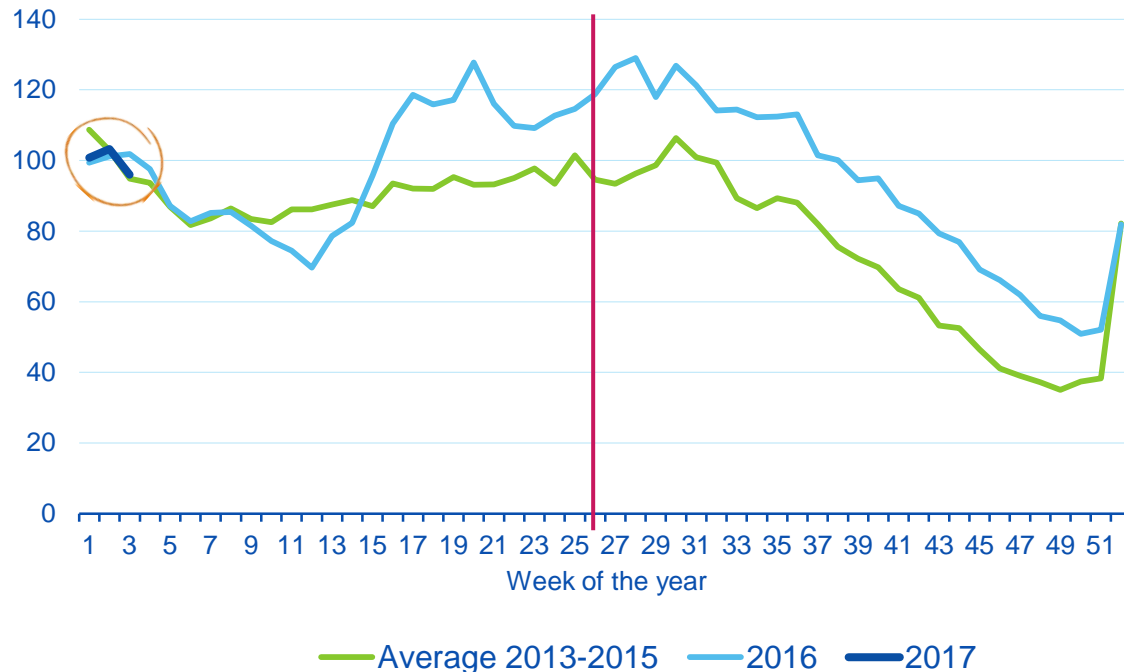
EXTERNAL DEMANDA

# ... in spite of Brexit

- So far, the impact on **Spain's aggregate exports has been limited** and concentrated in exports of goods
- However, it continues to be a risk going forward

## GOOGLE SEARCHES FOR HOTELS IN SPAIN FROM UK

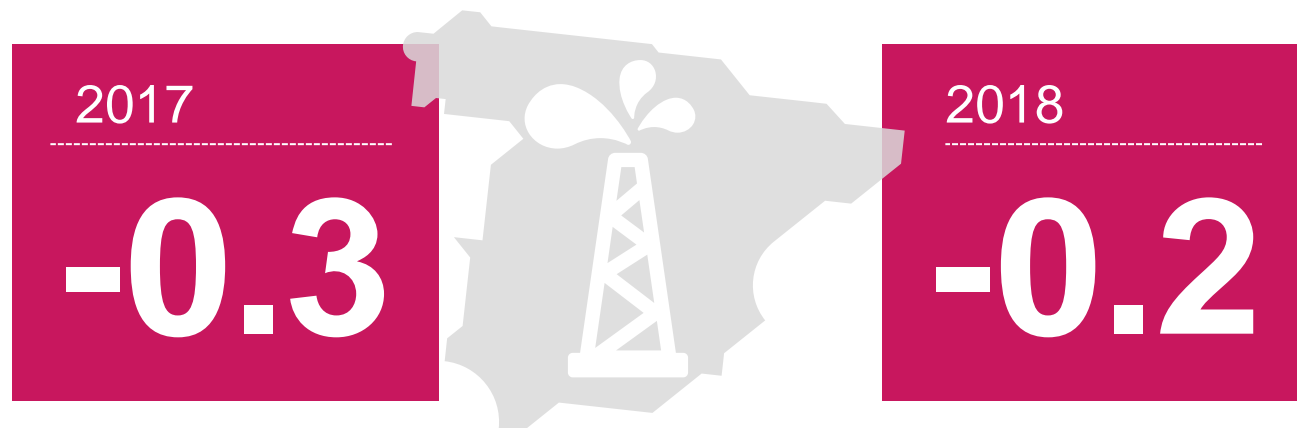
(January average = 100)



## CHANGES IN THE SCENARIO

## Oil price rise

SPAIN: IMPACT OF OIL PRICES REVISION ON GDP  
(pp, YoY)



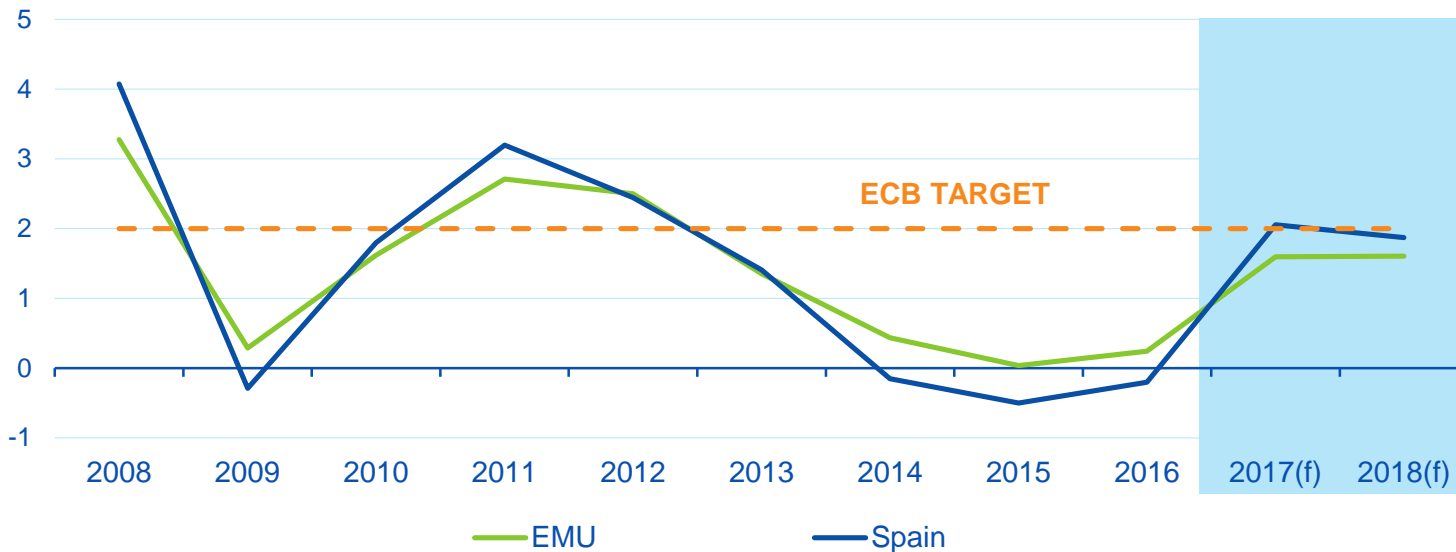
- The upward correction (US\$55-US\$60/barrel), linked to supply factors, is a **risk**:
  - to growth (-0.4 pp over the biennium)
  - to price-competitiveness

CHANGES IN THE SCENARIO

# Transitory uptick in inflation

## SPAIN AND EUROPE: HEADLINE INFLATION

(%, YoY)



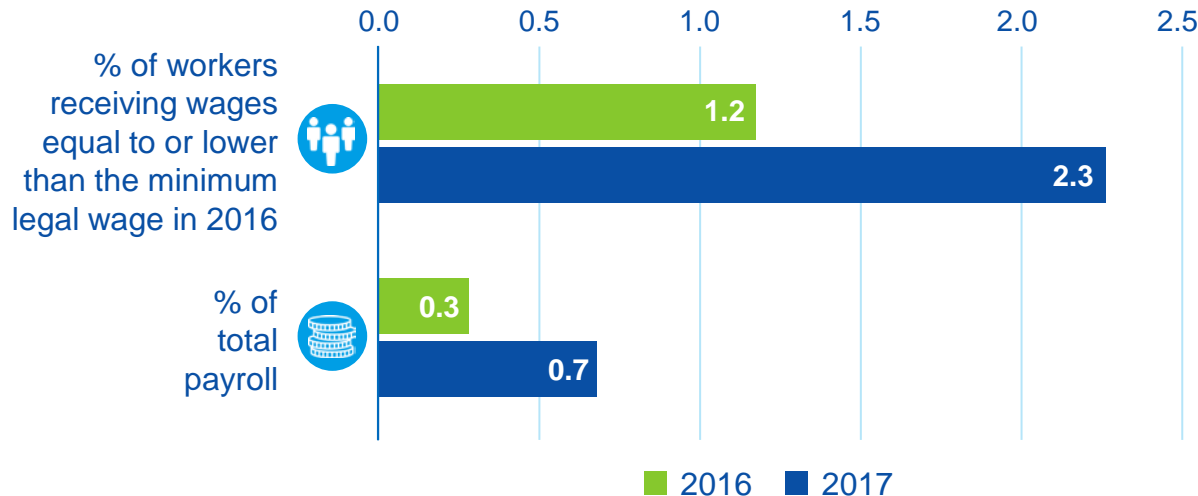
Competitive gains are running low

CHANGES IN THE SCENARIO

# Wage pressure will be a factor to watch

## COVERAGE OF THE LEGAL MINIMUM WAGE

(Non-agricultural employment, %)



- Despite the 8% increase in the legal minimum wage, coverage **will continue to be limited**
- For this reason, **the direct effects will be marginal in the short term**
- But the indirect effects could be significant if the increase encourages wage demands by workers as a whole

Source: BBVA Research and INE

(\*) An analysis of the legal minimum wage which we shall undertake in a forthcoming Watch

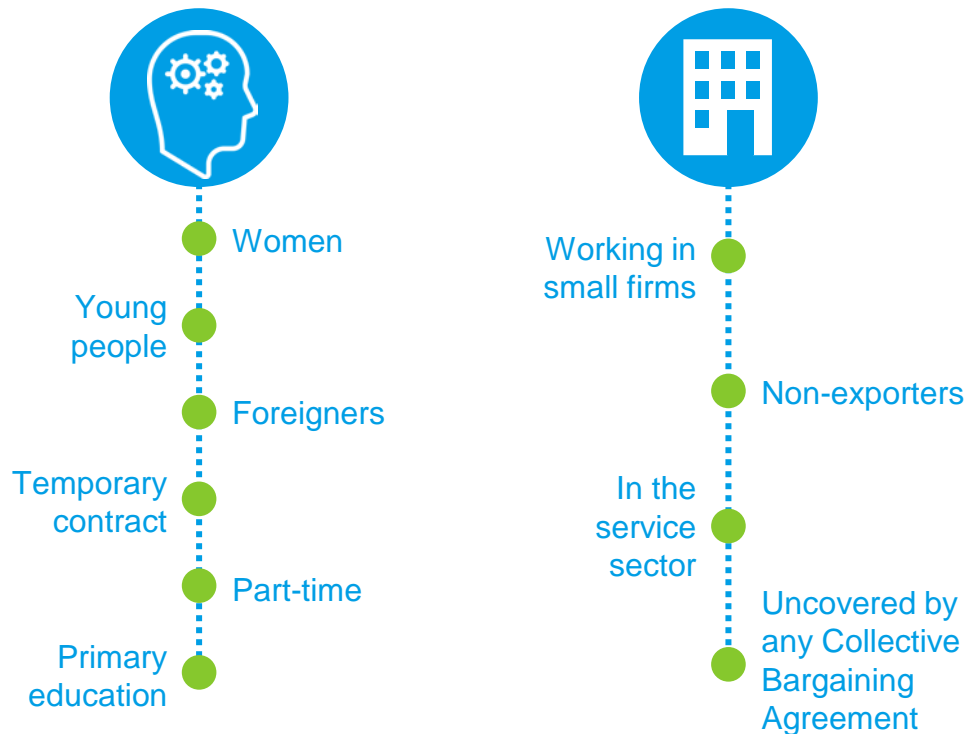


CHANGES IN THE SCENARIO

# The new legal minimum wage may make it harder for some groups to find a job

- Although the impact at the aggregate level is relatively small...
- ... it will be necessary to watch who is affected and to counteract the effects with active policies

CHARACTERISTICS OF RECIPIENTS OF LEGAL MINIMUM WAGE



Source: BBVA Research and INE

(\*) An analysis of the legal minimum wage which we shall undertake in a forthcoming Watch

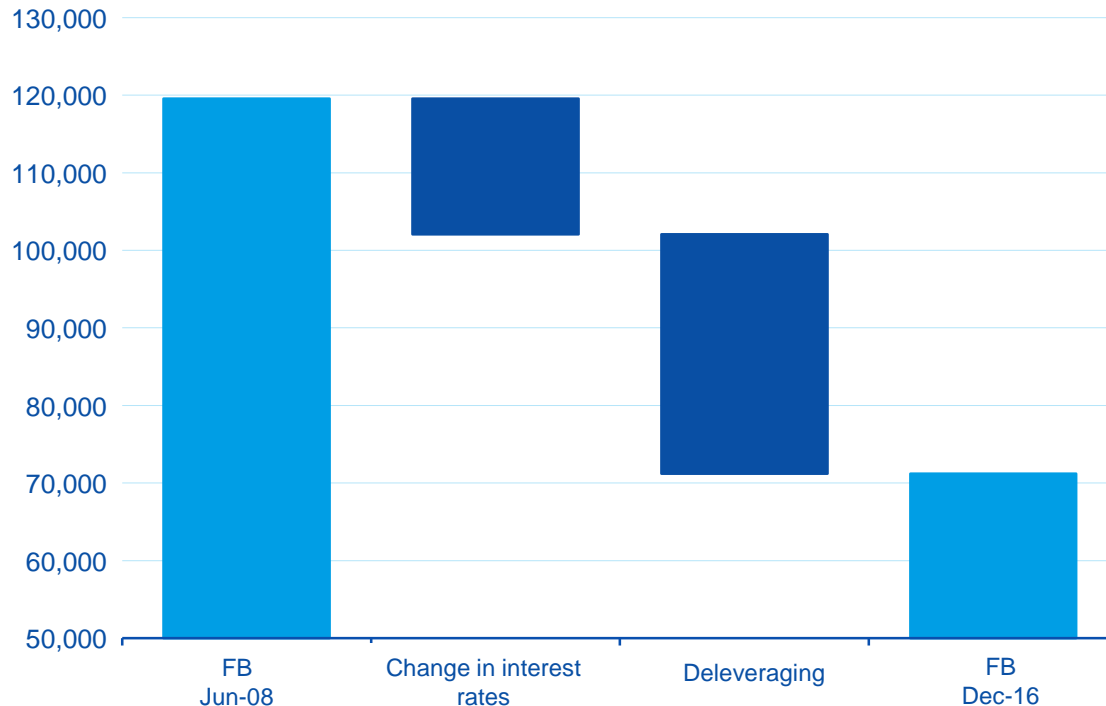
CHANGES IN THE SCENARIO

# Interest rates are a risk for households...

- The reduction of interest rates benefited households during the crisis and the recovery
- However, **no further falls are expected**
- Higher interest rates in the US and inflationary pressures in Europe entail risks

## SPAIN: HOUSEHOLDS' FINANCIAL BURDEN

(€ millions)



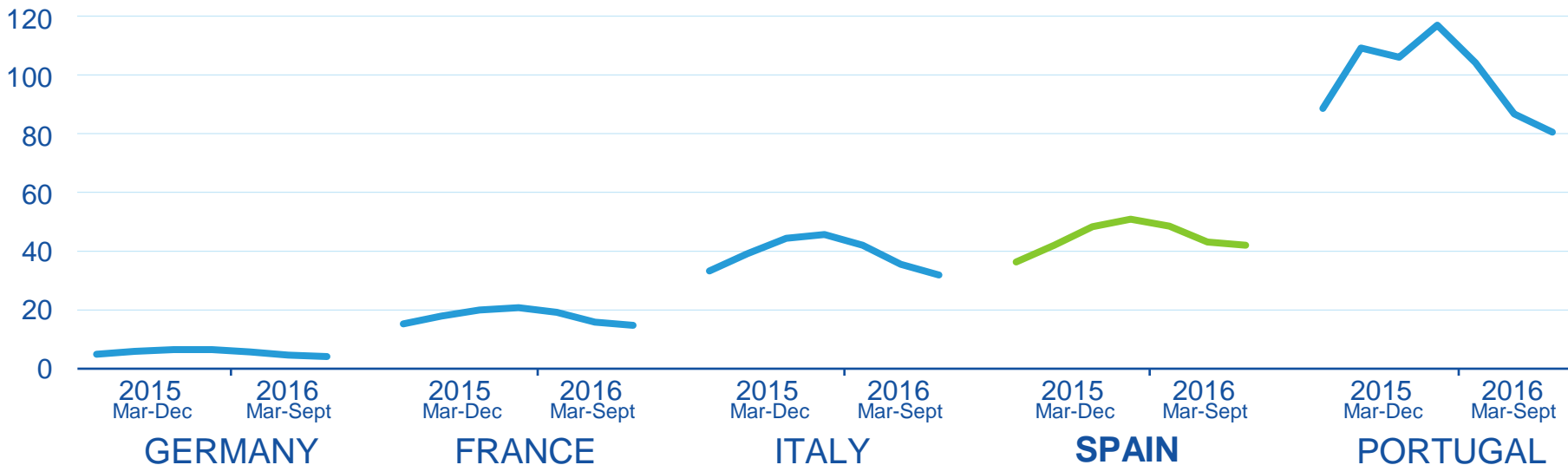
Source: BBVA Research based on Banco de España  
 (\*) Consumer Situation 2H16

CHANGES IN THE SCENARIO

# ... and for the financing of the economy

## IMPACT OF THE ECB'S ASSET PURCHASE PROGRAM ON FIVE YEARS CDS

(basis points)

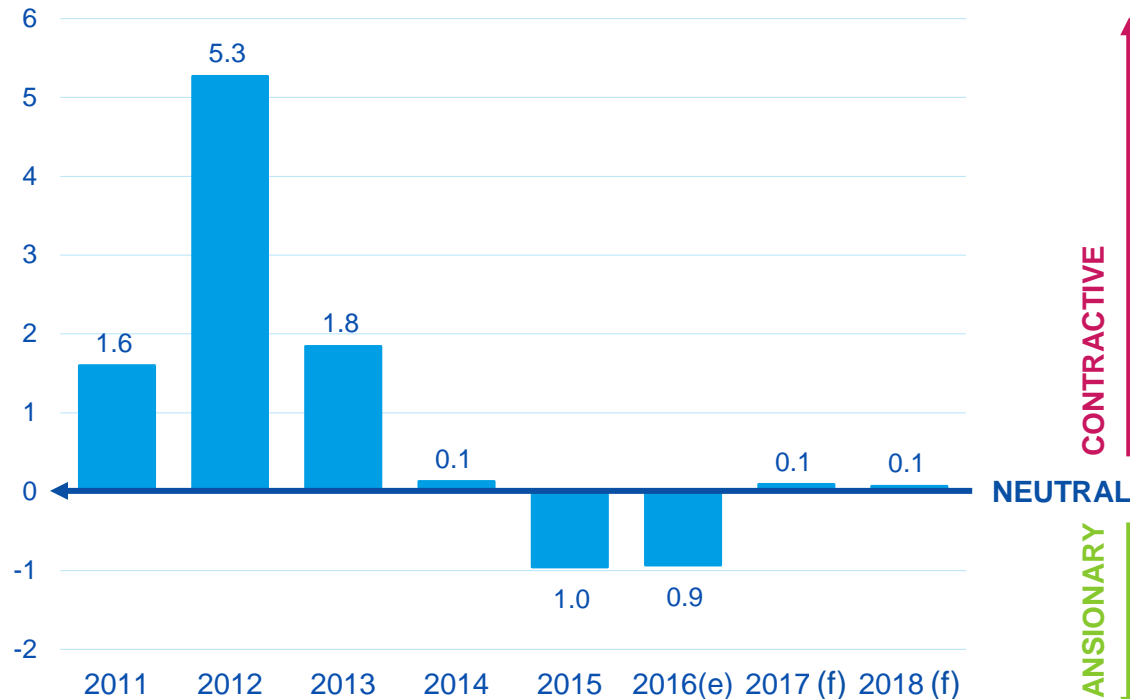


CHANGES IN THE SCENARIO

# Fiscal policy will be neutral

- We will see a **shift in fiscal policy**, from **expansive to neutral** in one year
- **The improvement in activity would have been enough** to bring the imbalance in public finances down to the target set, with no need for tax increases

SPAIN: STRUCTURAL ADJUSTMENT TO THE PRIMARY FISCAL BALANCE (pp of GDP)



(e): estimate, (f): forecast

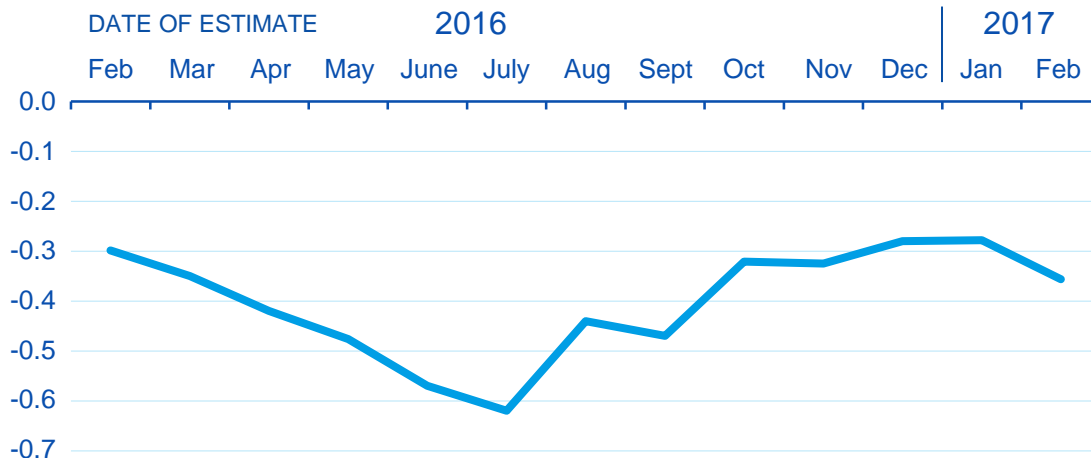
Source: BBVA Research based on INE and Banco de España

CHANGES IN THE SCENARIO

# Uncertainty decreases, but still relevant

## SPAIN: EFFECT OF UNCERTAINTY ON ECONOMIC POLICY ON GDP GROWTH FOR 2017

(pp YoY)



- Uncertainty about Spain's economic policy has diminished in the past few months
- However, **it remains high**
- Recent **tax and regulatory changes** could lead to postponement of future **investment plans**

The **global scenario is improving**, but uncertainty remains high, especially due to the **risks** of US protectionism

In Spain, recent data confirm the **upward bias in the scenario.**

The economy will grow by **2.7% in 2017 and 2018**

The **vulnerability of the Spanish economy** makes it necessary to continue with **new reforms**

# ECONOMIC OUTLOOK SPAIN

1<sup>ST</sup> QUARTER 2017

