

# Spain Economic Outlook 1Q18

January 2018



# Key messages

- ◆ **The stronger global growth consolidates.** Widespread upward revision in 2018 across areas, but trending towards stabilization in 2019
- ◆ In Spain, **activity and employment continue to grow**, despite economic policy uncertainty. **However, a slowdown is expected in 1Q18**
- ◆ **GDP growth forecasts for Spain in 2017 and 2018 are maintained at 3.1% and 2.5% respectively.** In addition, the recovery is expected to continue in 2019 (2.3%) and the improvement in the economy to begin to translate into wage growth
- ◆ **Among domestic risks, the political environment, fiscal adjustment, structural unemployment and the slowdown of reforms remain put**



# GLOBAL ECONOMIC OUTLOOK 1Q18



# Global growth is strengthened

**01**

## Better forecasts for the US, China and the Eurozone

There is less uncertainty in the short term

**02**

## More positive perspectives for emerging countries

Increased global demand and higher price of raw materials

**03**

## More caution in financial markets

Expectations of less liquidity can reduce flows to emerging markets

**04**

## Core inflation contained

Although the factors of downward pressure are disappearing

**05**

## Central banks continue to make progress towards normalization

The reasons for withdrawing stimuli materialize

**06**

## Global risks

Lower in the short term; no changes in the medium and long term

# Reasons for optimism in large areas, although with caution

## USA



Upward revision of growth

Improvement in the labor market

Approval of the tax reform

Continuous changes in the Fed

## CHINA



Moderate deceleration

Some reforms already underway

Positive conclusions at the XIX Congress  
of the CPC

Higher potential growth

## EUROZONE



Stronger growth than expected

More robust domestic demand

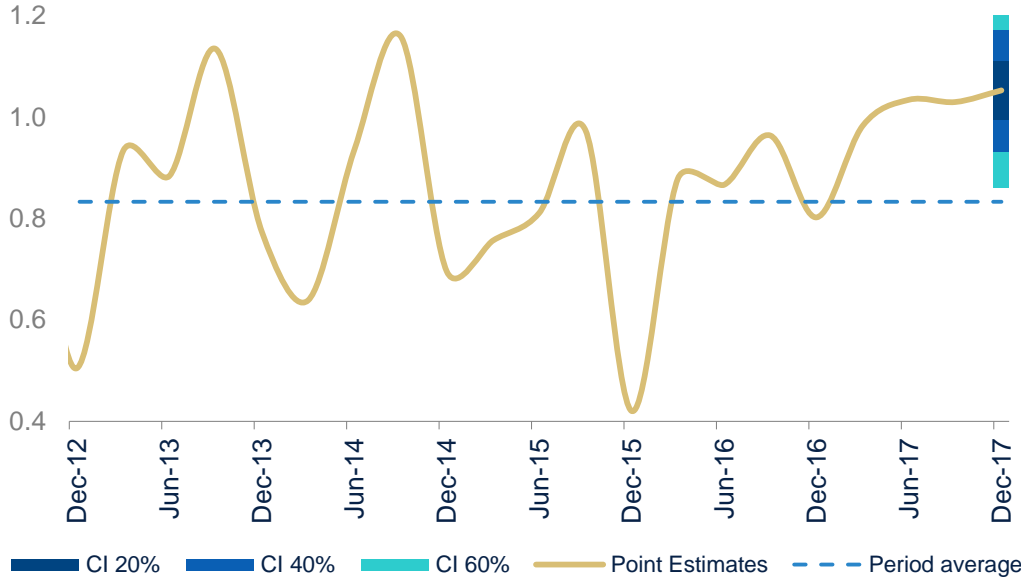
Less political uncertainty

Plans of greater integration

# Robust and sustained global growth

## World GDP growth

(Forecasts based on BBVA-GAIN, % QoQ)



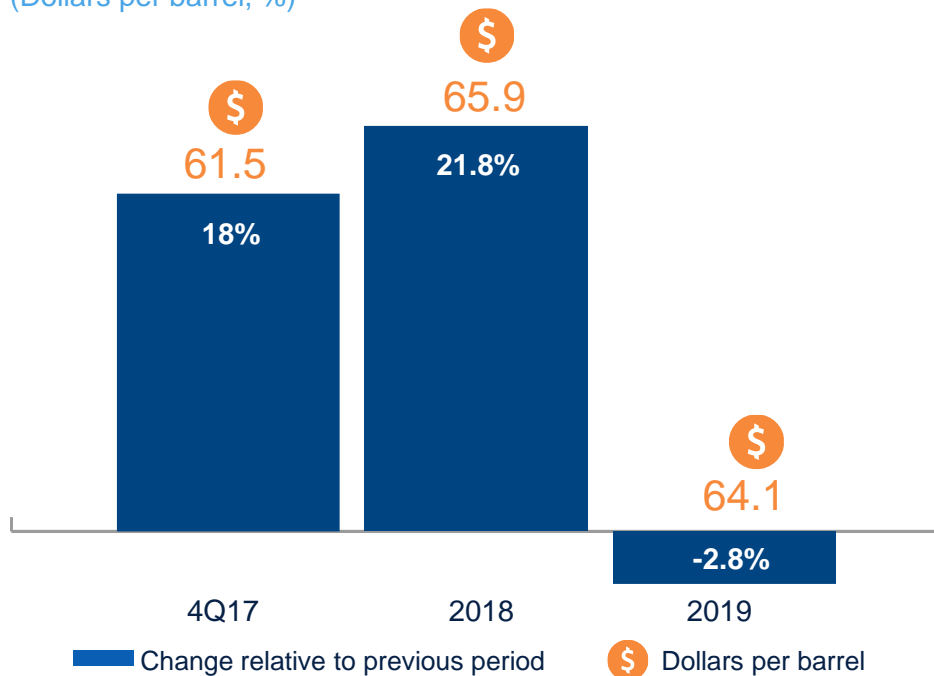
- ◆ Global growth, bolstered by the recovery of the industrial sector, remains stable
- ◆ Confidence indicators continue to improve, and anticipate that the positive outlook will continue
- ◆ Private consumption continues to sustain growth in advanced economies and gains momentum in emerging economies



## The outlook for emerging economies improves

### Price of oil

(Dollars per barrel, %)

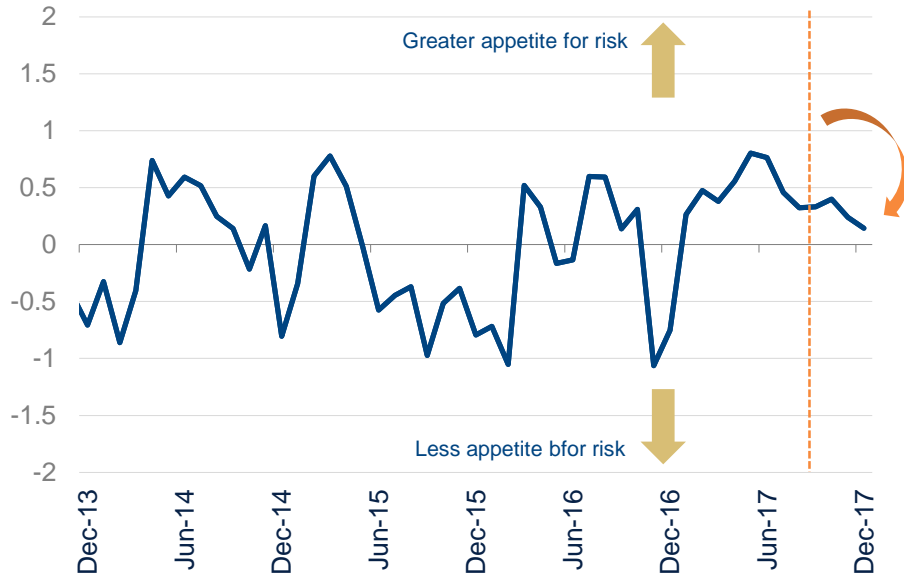


- ◆ Higher oil prices reflect greater global demand, which would account for 60% of the increase
- ◆ However, it is also due to supply factors, linked to geopolitical risks and the correction of inventories
- ◆ Positive and significant impact on commodity producing emerging economies
- ◆ However, we still expect prices to converge to \$60 per barrel in the medium term, due to increased competition and structural changes in the energy sector

# Caution in financial markets, with moderation of flows to emerging markets

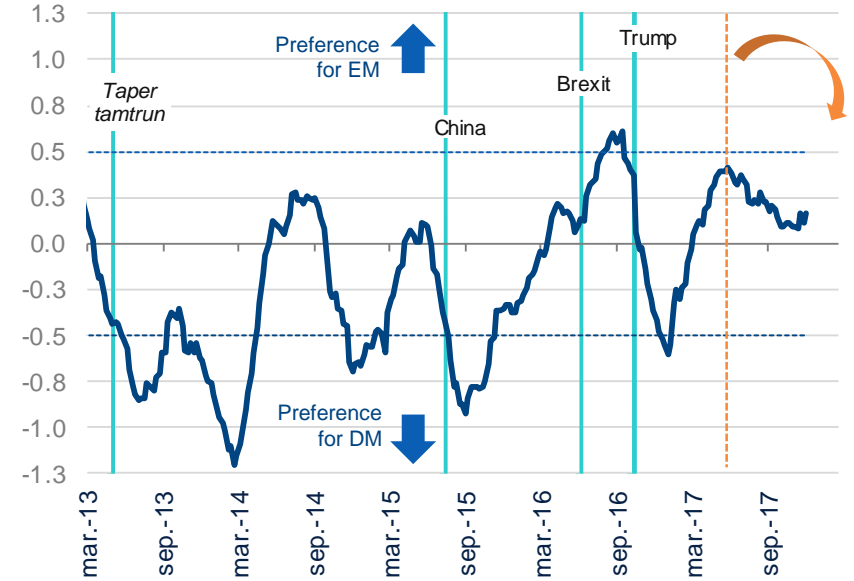
## Risk appetite indicator

(Factor 1 (global), EPFR flow analysis )



## Investor appetite for emerging (EM) vs developed (DM)

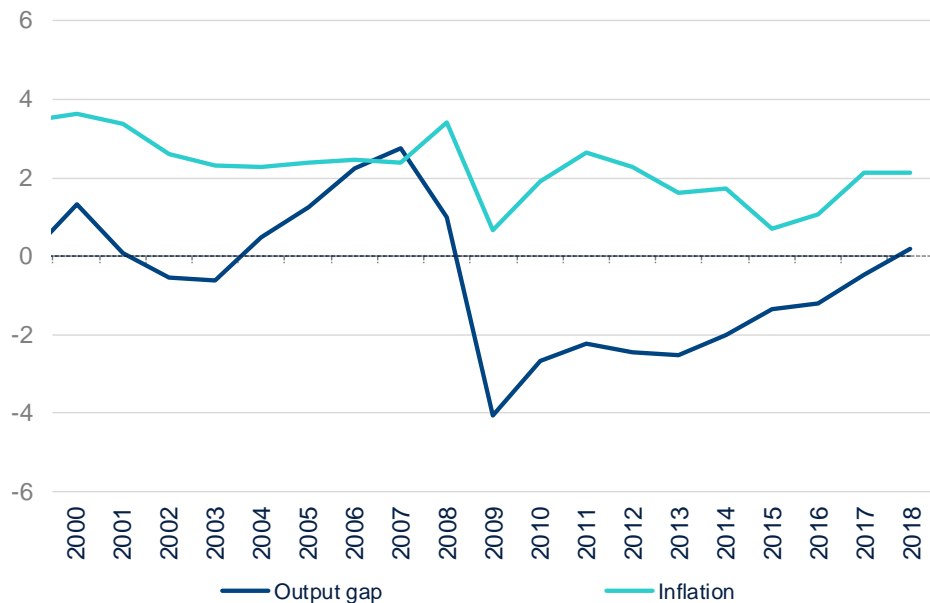
(Inflows in EM vs. DM in % of assets under management)





# Core inflation contained

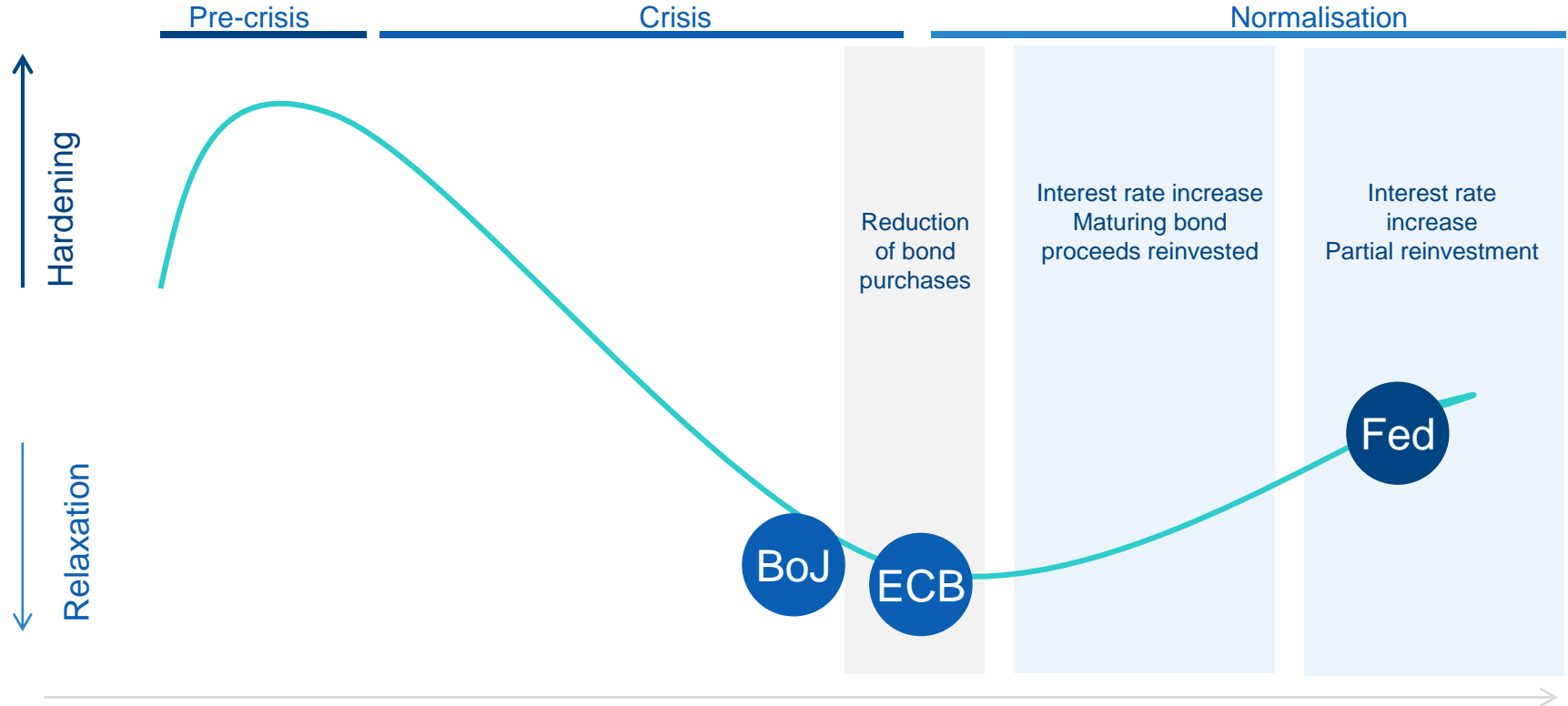
## OECD: Production gap and inflation (% of potential GDP, % YoY)



Source: BBVA Research and OECD

- ◆ Reduction in the economies' output gap, but with **room to grow without strong inflationary pressures**
- ◆ **Less price reaction to the increase in activity**, for several reasons:
  - Globalisation
  - Increased flexibility in the labour market:
  - Low inflationary expectations
  - Reduced productivity growth
- ◆ **The increase in the price of oil will push up inflation in the short term**, facilitating central bank moves towards normalisation in developed economies

# Withdrawal of non-conventional monetary policy measures



# The Fed accelerates normalisation while the ECB keeps it gradual



FED

## Hawkish rate cycle and balance sheet reduction under way

Estimated rise of 0.75% in 2018 to 2.25% and reduction of the balance sheet by US\$420 billion

*Focus: gain room for manoeuvre*



ECB

**QE reduction**, but extended to September 2018

**No interest rate increases before 2019**

*Focus: avoid sudden jump in long-term rates*

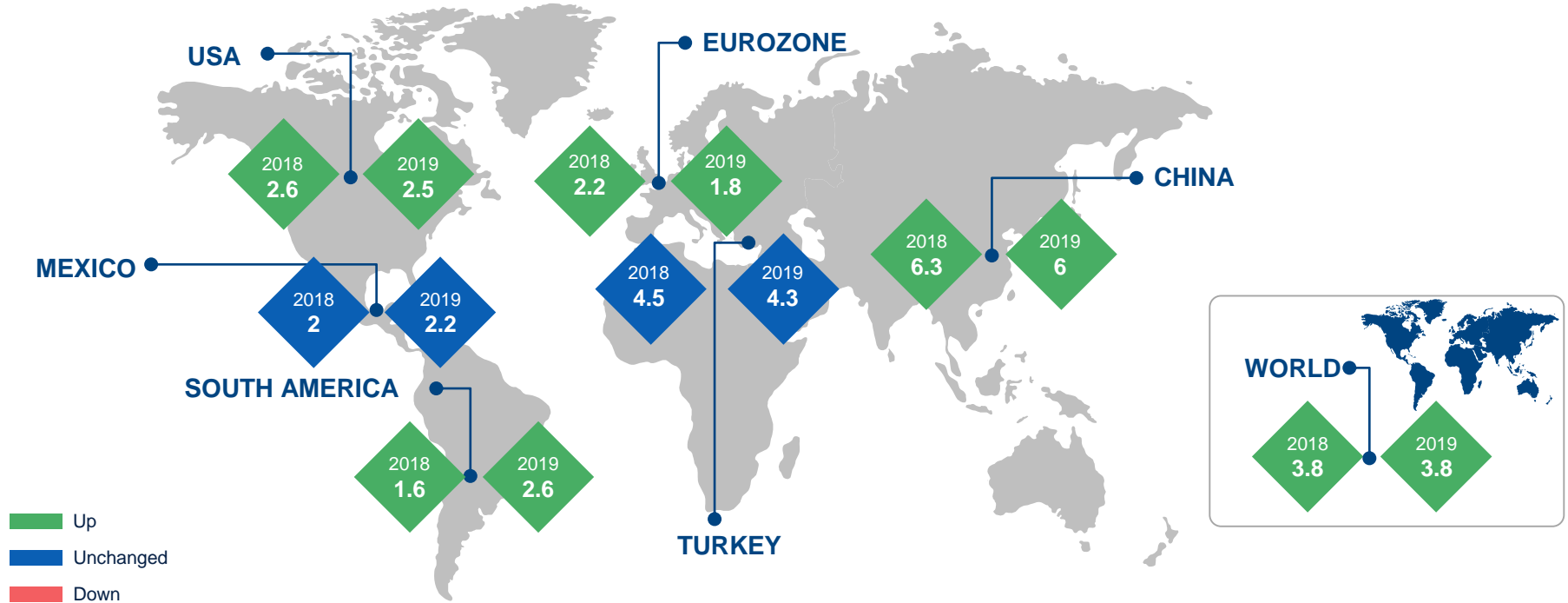
## Elements of uncertainty:

**Politics:** changes in governing councils (Fed, ECB)

**Macro:** possible surprises in inflation and in economies' reaction to higher interest rates

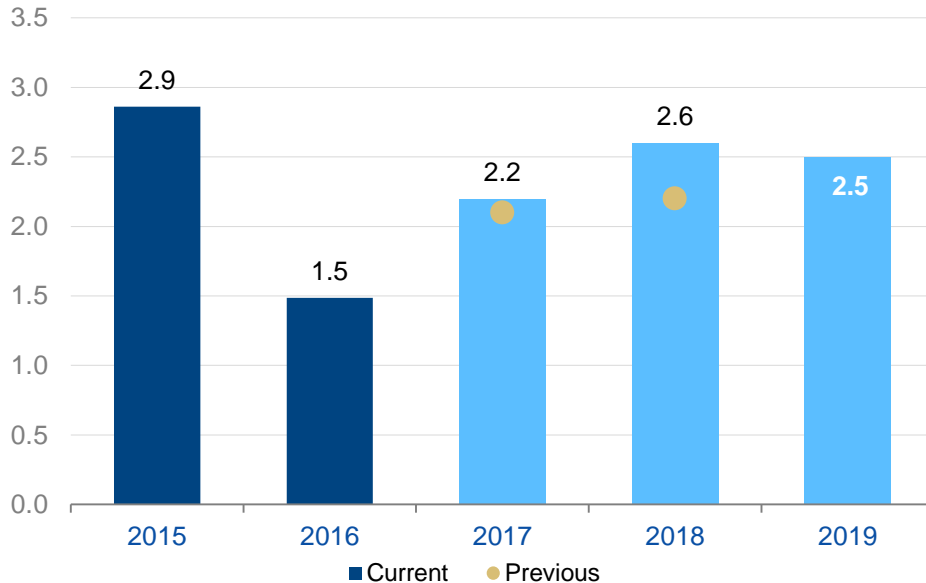
**Markets:** long-term rates and steepness of the curve

# Widespread upward GDP growth forecasts (2018-19)



## USA: Stronger economic growth in the short term

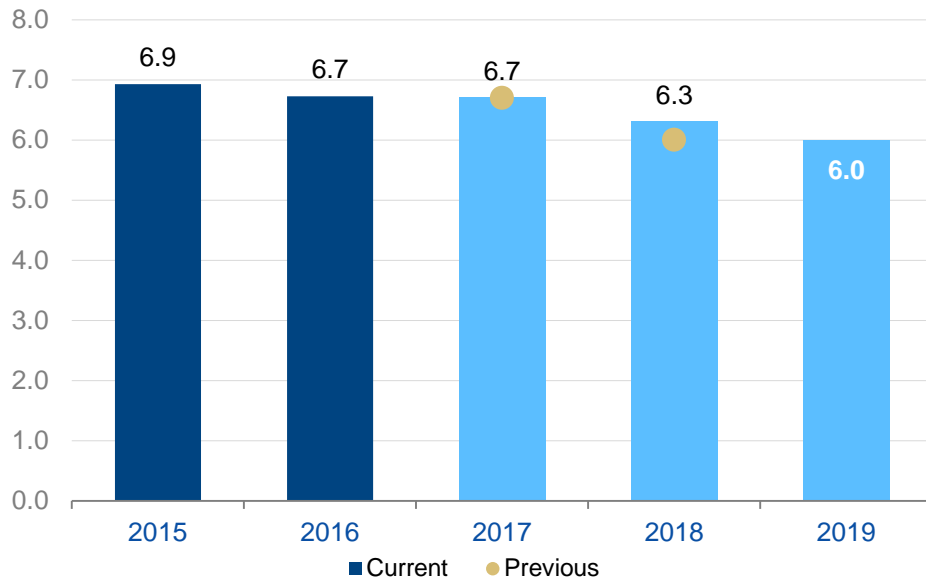
### USA: GDP growth (YoY, %)



- ◆ Positive impact of the oil price increase, global demand and the weakness of the dollar on investment and exports
- ◆ Positive but limited effect of the tax reform (around 0.2% in 2018), mainly due to changes in corporate taxation. Doubts about the long-term effect
- ◆ Monetary policy will remain accommodative, despite normalisation

# China: More moderate slowdown in growth

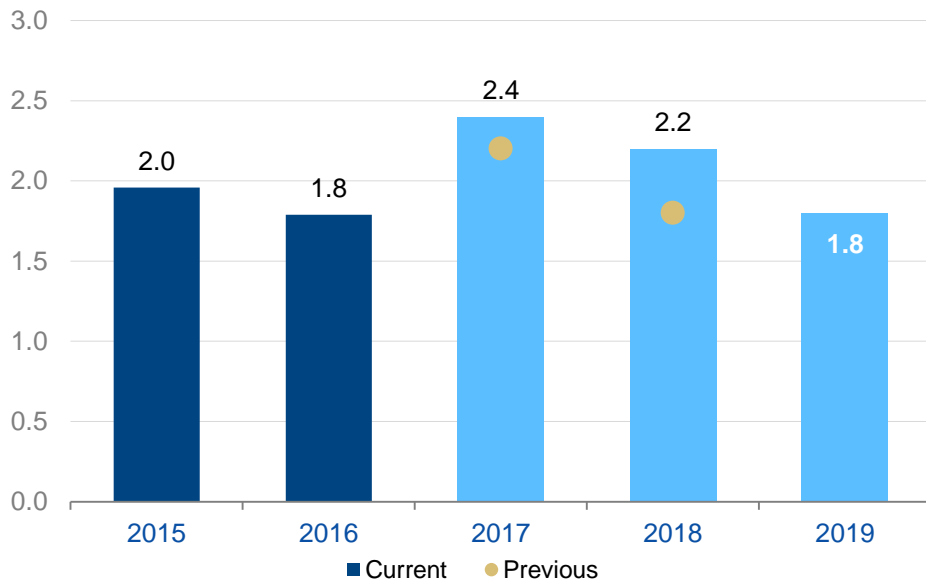
## China: GDP growth (YoY, %)



- ◆ Due to ongoing structural reforms and less support from economic policy
- ◆ Nevertheless, the good economic performance reduces the risk of a sudden adjustment in the short term
- ◆ Eliminating the growth objective limits imbalances
- ◆ The measures aimed at opening up the economy, together with more qualitative objectives, will drive structural reforms and potential GDP

## Eurozone: Stronger and more balanced growth

### Eurozone: GDP growth (YoY, %)

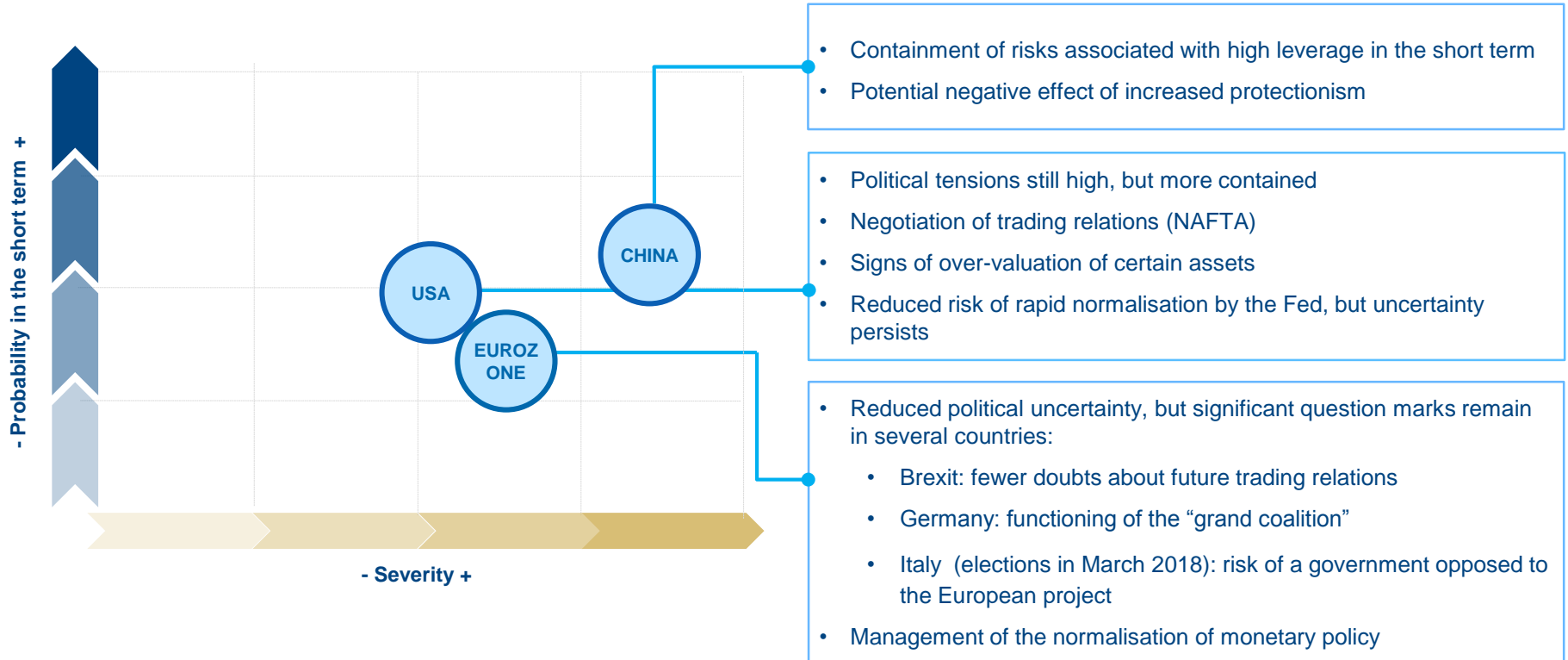


Source: BBVA Research based on Eurostat figures

- ◆ The increase in disposable income continues to support solid private consumption
- ◆ Greater support from global demand, with limited impact from the euro's appreciation
- ◆ Easing uncertainty and increased earnings will underpin the recovery in investment
- ◆ Monetary policy will contribute to favourable financial conditions and a relatively stable euro
- ◆ The cyclical improvement will allow the deficit to be reduced by means of a somewhat expansive fiscal policy



# Global risks: Fewer in the short term

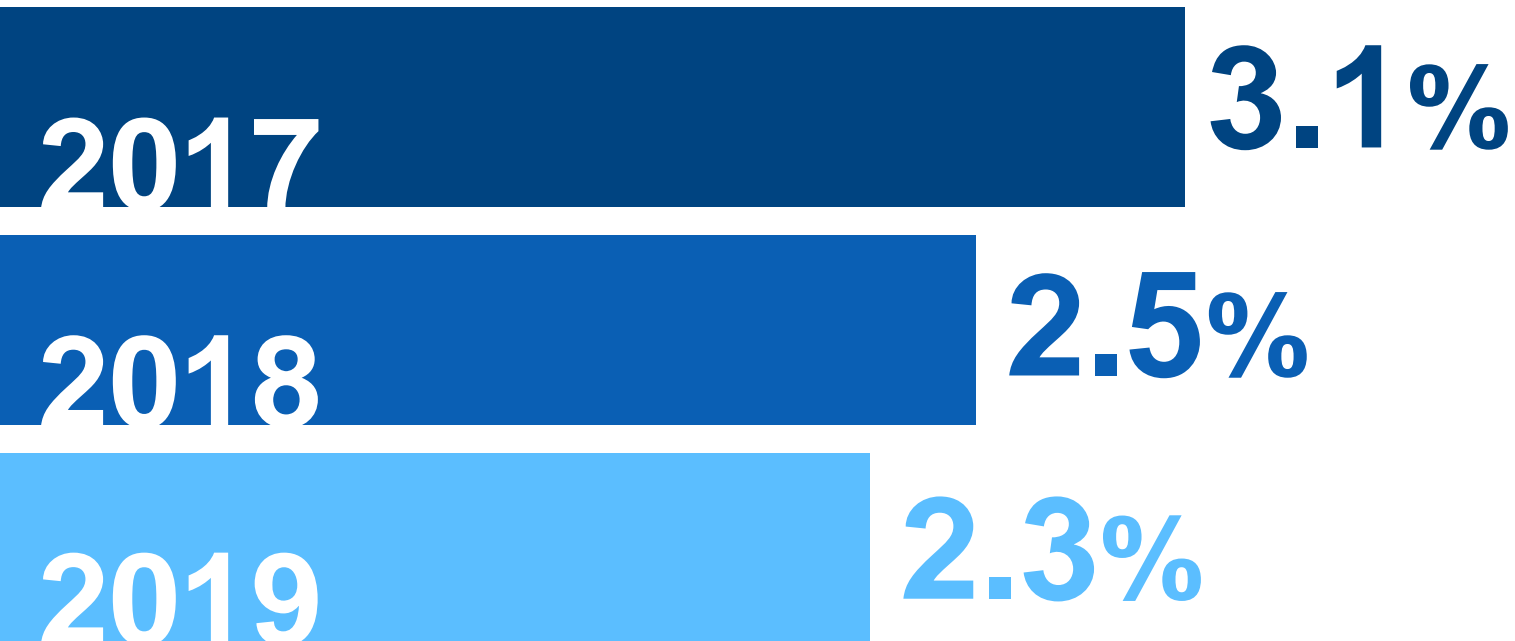


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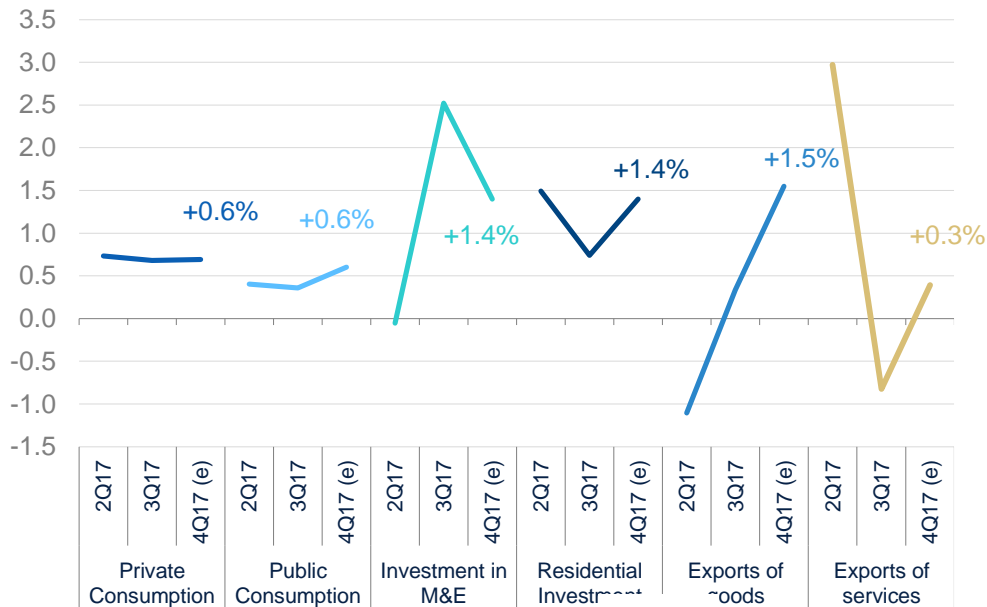


## Growth will moderate in 2018 and in 2019



# The closing of 2017 was positive

## Spain 4Q17 forecasts (% QoQ)

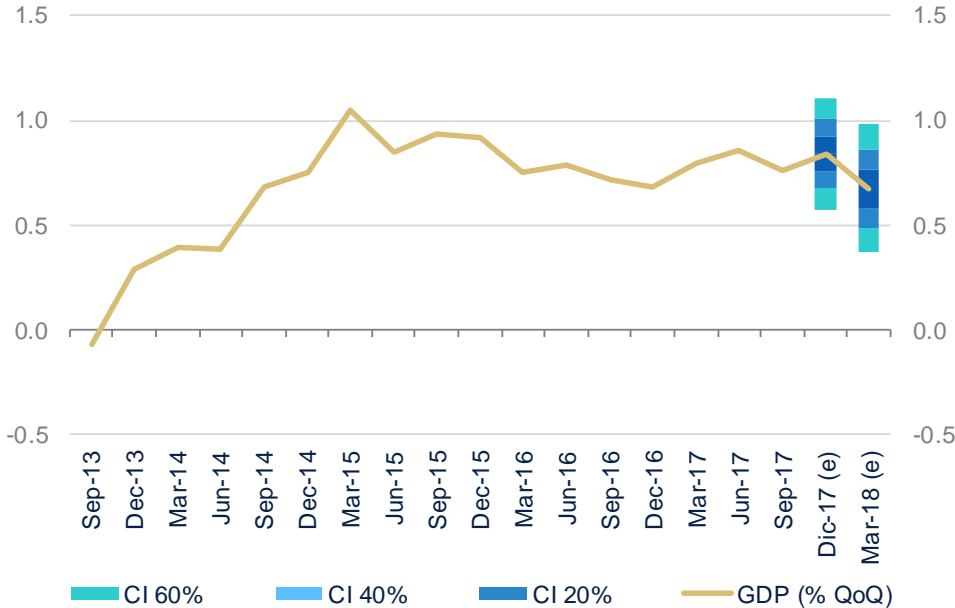


(e): estimate  
Source: BBVA Research based on INE

- ◆ Consumption (both private and public) increased at a sustained pace, while other aggregates recovered
  - After a disappointing 2Q, investment in machinery rebounded strongly
  - Residential investment gained traction at the end of the year
  - Exports of goods recover, but those of services remain weak, due to both structural factors and those related to the political environment in Catalonia

# The activity could lose momentum in 1Q18

**Spain: observed growth in GDP and MICA-BBVA model forecasts**  
(%, QoQ)

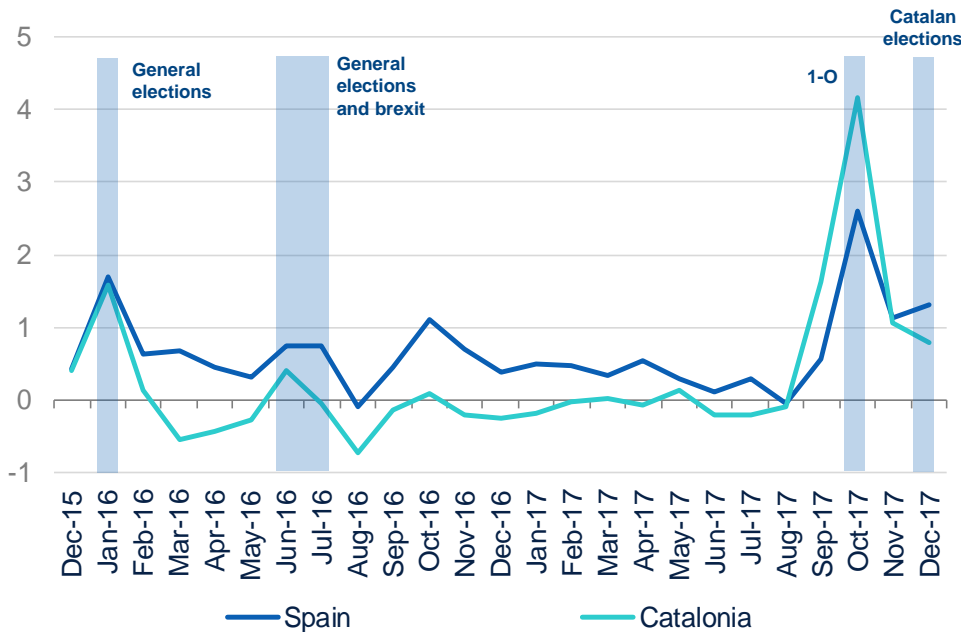


(e): estimate  
Source: BBVA Research based on INE

- ◆ Despite the economic policy uncertainty, the Spanish economy could have grown 0.8% QoQ in 4Q17
- ◆ However, BBVA Research estimates indicate that GDP growth could moderate in 1Q18 (0.6% - 0.7% QoQ)

# Activity loses momentum in 1Q18

## Economic policy uncertainty (EPU) (Standard deviations, monthly average)



- ◆ The economic policy uncertainty remains high, after reaching historical records in October
  - The impact on the real economy could be noticed in the coming months
  - If it does not dissipate, or even worse, if it increases again, it could have additional effects on expenditure decisions of households and companies

# Uncertainty has had a negative impact, although limited



## Financial data

The impact on aggregate growth of the real economy could be noticed from 1S18



## Activity in Spain

Indicators of employment, production and confidence have maintained a relatively positive stance



## Activity in Catalonia

There is an impact observed in expenditure indicators and tourism



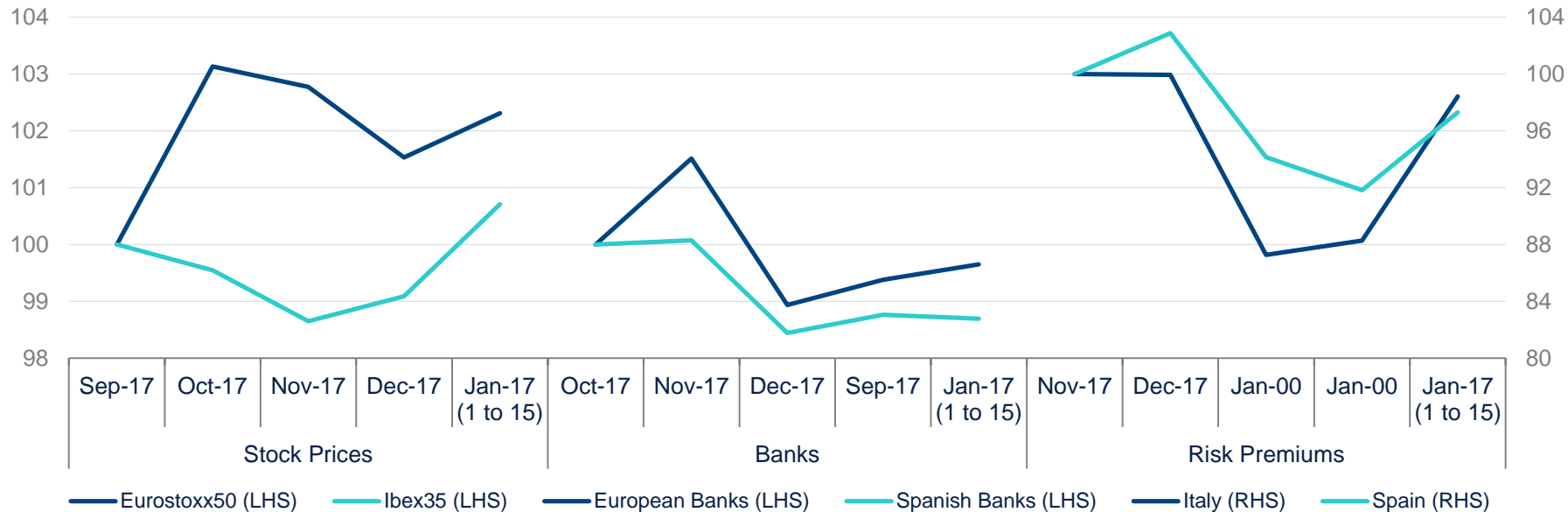
## Summary

The aggregate impact may be limited in the short term, but at a higher pace in Catalonia



# Uncertainty has had a negative impact, although limited: Financial variables

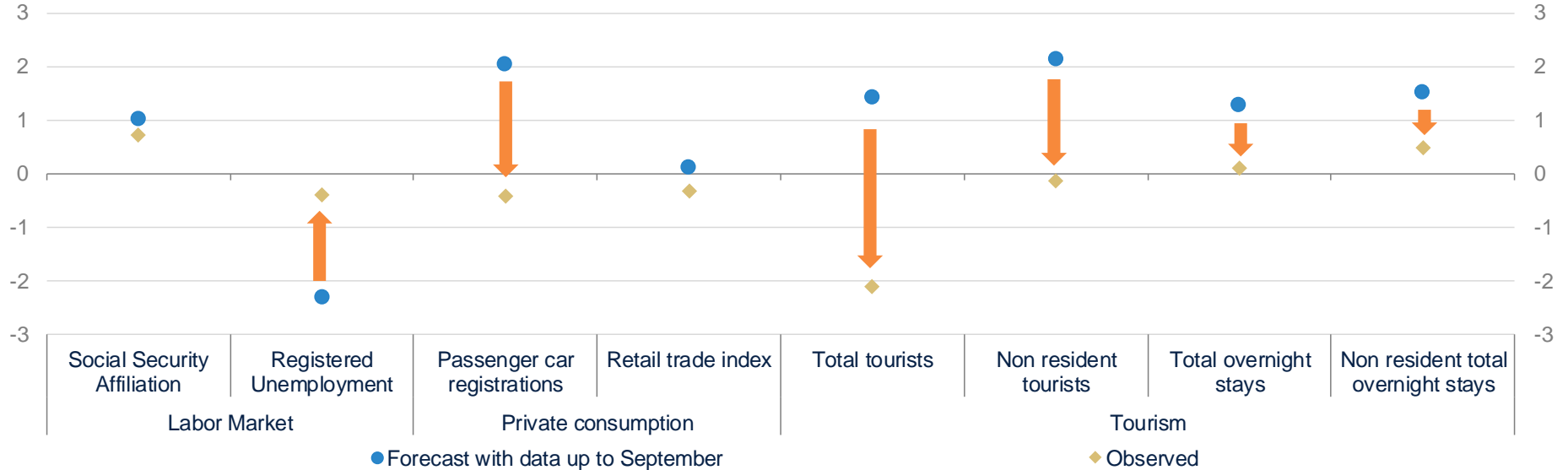
Financial indicators (index Sep-17=100, monthly averages)



Source: BBVA Research based on Bloomberg

# Economic policy uncertainty remains high, and has affected some variables: **Activity in Catalonia**

Catalonia: Observed data and forecasts in a scenario in the absence of economic policy uncertainty (% QoQ SWDA)

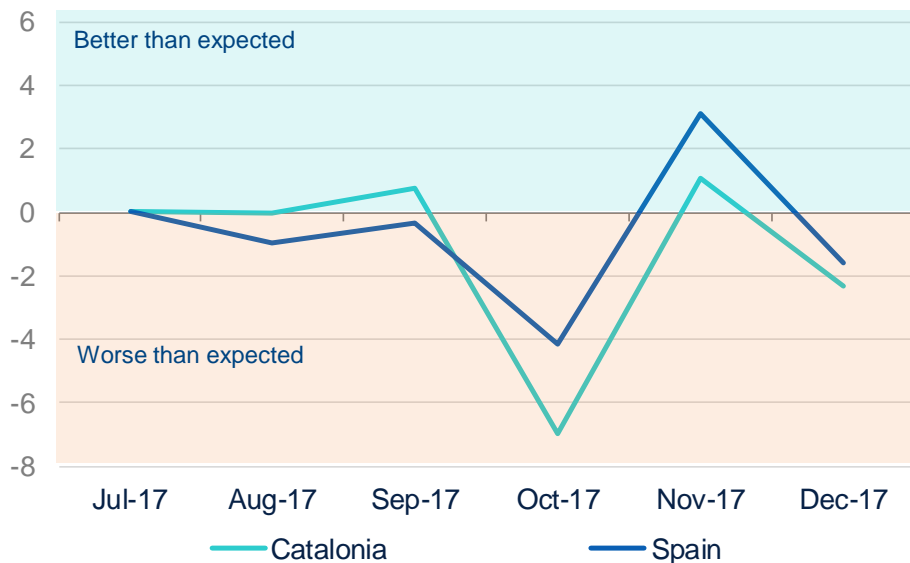


# Uncertainty has had a negative impact, although limited:

## BBVA DATA

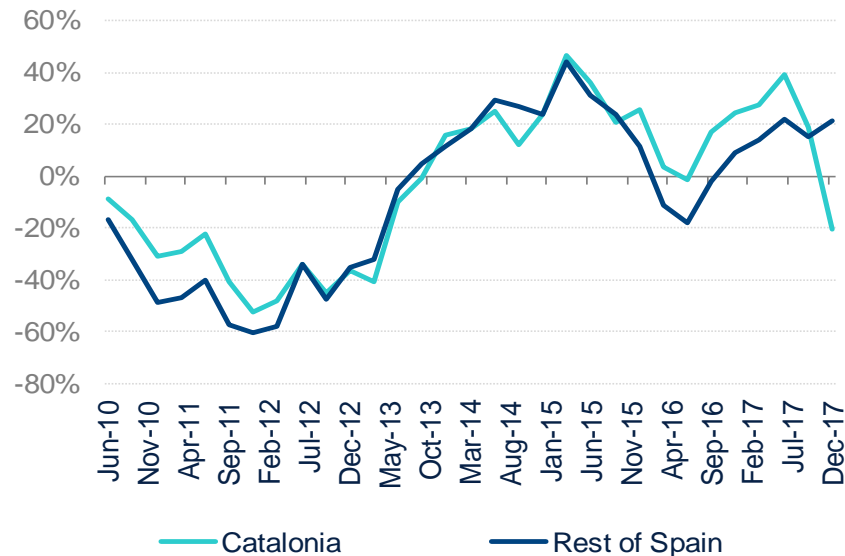
### Expenditure in BBVA POS\*

(Average weekly percentage difference with respect to 2015)



### Perspectives on the evolution of activity in the current quarter

(Net balance of answers, preliminary data)



(\*) Expenditure in BBVA points of sale (POS) plus expenditure in POS made by BBVA clients  
 Source: BBVA Research y BBVA Data & Analytics

# 2018-2019: The external environment will support growth



## Oil prices

- Still low (compared to 2014), despite the upward revision



## Exchange rate

- The recent appreciation will have a limited impact for Spain



## Global growth

- Upward revision in Europe
- A more synchronized global recovery is positive for Spain given the diversification of exports



## Monetary policy support

- Gradual withdrawing from the ECB
- Low long-term interest

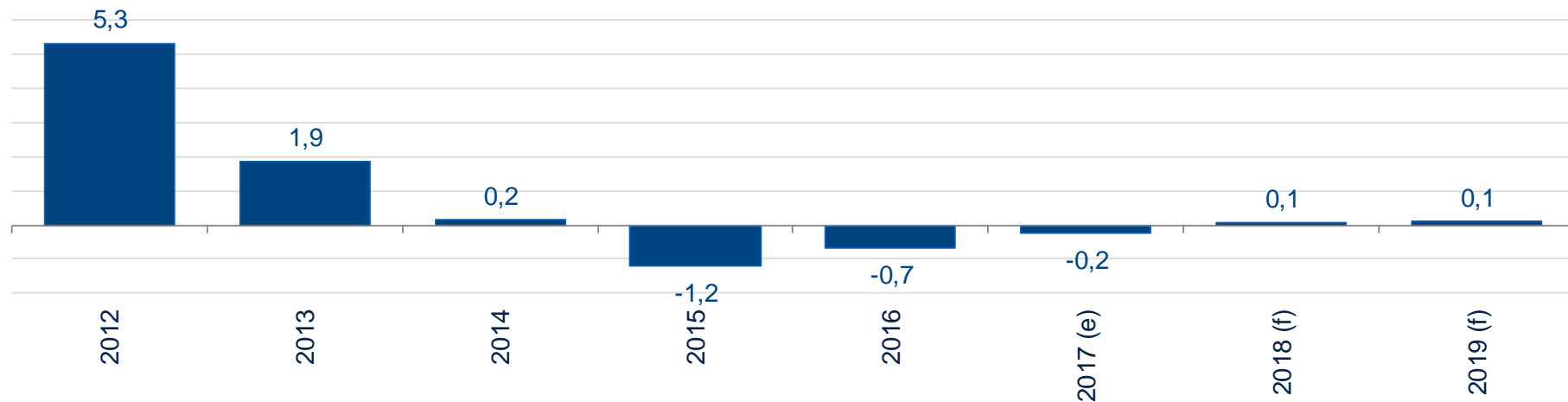


## Relatively low risk premium

- In addition, the structural model suggests that there is scope for a downward revision (positive for growth)

## 2018-2019: The fiscal policy will be practically neutral

Spain: Change in cyclically adjusted primary balance\*  
(pp of GDP)

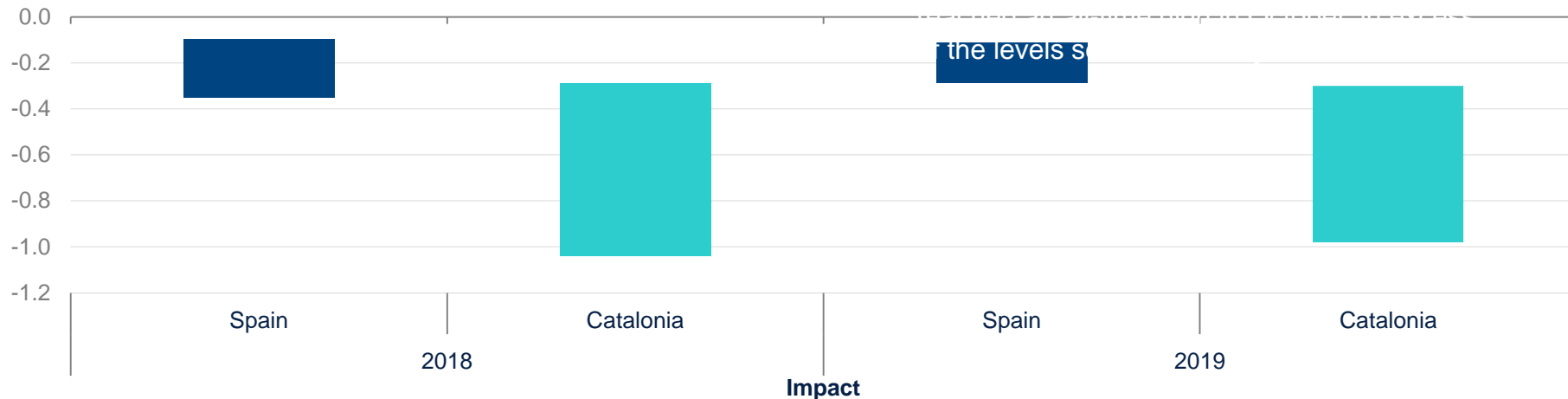


(\*) Excluding aid from the financial sector Source: BBVA Research from MINHAP. (e): estimate (f): forecast

The cyclical recovery will help reduce the deficit, although a small deviation from the objective is possible

# 2018-2019: Economic policy uncertainty will have an impact on activity

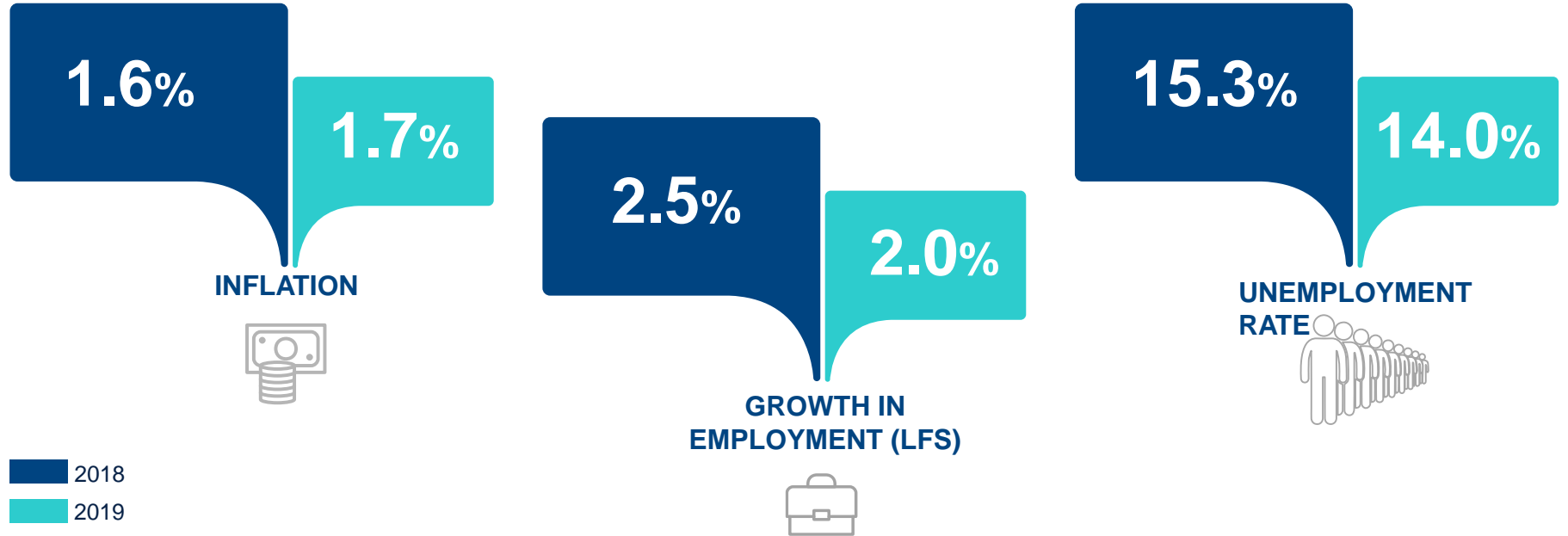
**GDP response to economic policy uncertainty shocks**  
 (% YoY, deviation from the base scenario)



Source: BBVA Research

The increase in uncertainty and the deterioration observed in external perception (tourism, financial variables) will affect the expenditure of households and companies, limiting growth over the next two years

# 2018-2019: Inflation and labor market forecasts

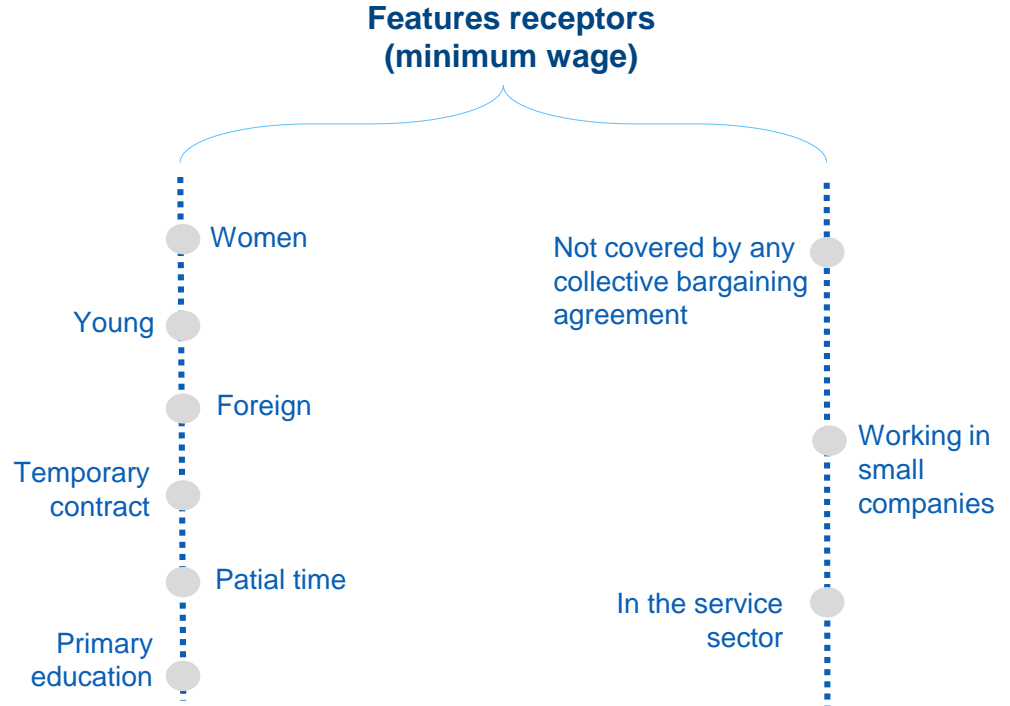




## Internal risks: Increase of the minimum wage

To the extent that the rest of the distribution of wages is not affected by the increase in the minimum wage, its increase should not significantly affect the creation of employment

However, there are certain groups for which the increase in the cost of hiring could reduce its probability of finding a job

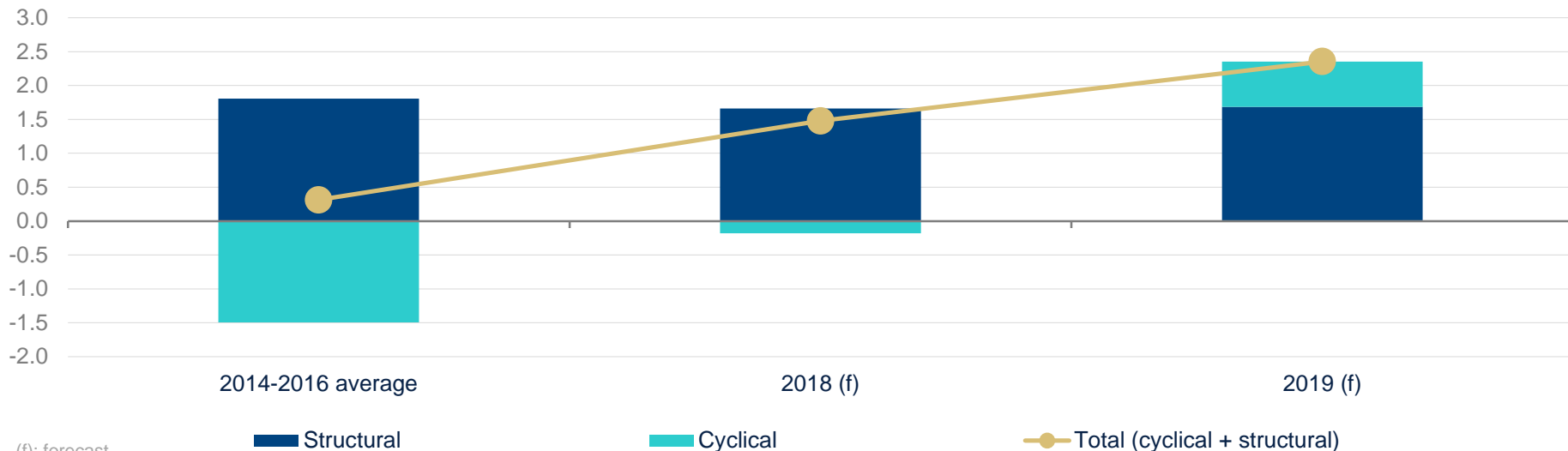


Source: BBVA Research based on INE  
 See: Archondo I., J. R. García y C. Ulloa (2017): "Repercusiones del aumento del salario mínimo en España"  
 Available at: [https://www.bbvaesearch.com/wp-content/uploads/2017/03/Observatorio\\_SMI\\_feb17.pdf](https://www.bbvaesearch.com/wp-content/uploads/2017/03/Observatorio_SMI_feb17.pdf)

## Internal risks: High structural unemployment

### Spain: Decomposition of nominal compensation per employee

(%, YoY)



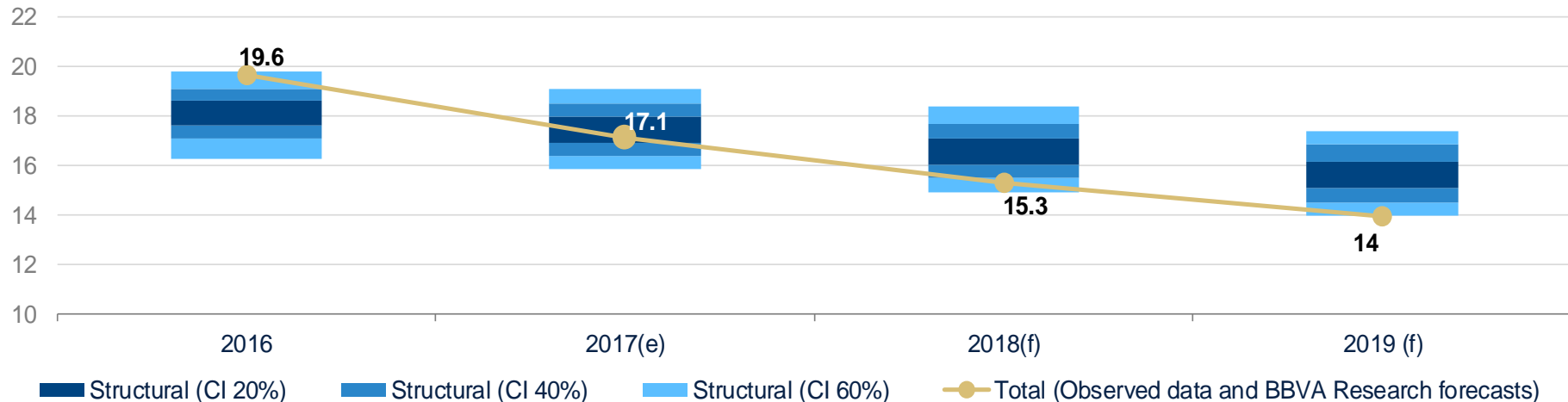
(f): forecast  
Source: BBVA Research

It is possible that the continuation of the recovery will begin to have a greater impact on the formation of wages. This growth is welcome if it is a consequence of productivity improvements

# Internal risks: Structural unemployment rate remains high

## Spain: Unemployment rate

(%)



(e): estimate (f): forecast

Source: BBVA Research based on INE

**If a significant part of the unemployment rate reflects capacity constraints, the recovery could lead to a further increase in inequality between those who have a job and those who do not.**

# Local risks: Fiscal deficit

## Public administration.: fulfillment of the LEP spending rule

	G.G.	A.C.	L.C.
2013	Accomplished	Accomplished	Accomplished
2014	Accomplished	Lower degree of Non-compliance	Lower degree of Non-compliance
2015	Greater degree of Non-compliance	Greater degree of Non-compliance	Lower degree of Non-compliance
2016	Lower degree of Non-compliance	Accomplished	Accomplished
2017*	Accomplished	Lower degree of Non-compliance	Lower degree of Non-compliance

Greater degree of Non-compliance  
 Accomplished  
 Lower degree of Non-compliance



Number of Autonomous Communities that did not comply

(\*) In 2017, according to the budget execution for the general government and the autonomous communities up to october and up to 3Q17 for local corporations

- ◆ The **autonomous elections** of 2019 and the possible relaxation of the spending rule increase the uncertainty
- ◆ Doubts persist about the approval or extension of the **General State Budgets (PGE)**
- ◆ Recent developments also introduce uncertainty about the **tax revenues projected by the Government**

# Challenges: Taking advantage of the opportunities of the 4th Industrial Revolution

## Characteristics of workers in occupations with increased risk of automation \*



- ◆ The **technological transformation** is an opportunity and also a challenge
- ◆ The aggregate impact is positive, but **36% of employment in Spain faces the risk of automation**
- ◆ It is crucial to lead the change, with policies that soften the transition, cushion costs and enhance benefits

Source: BBVA Research based on Frey, Osborne (2017) & INE

(\*) An analysis on the individuals affected by the digital revolution will be approached in an Outlook available shortly

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# Key messages

- ◆ **The stronger global growth consolidates.** Widespread upward revision in 2018 across areas, but trending towards stabilization in 2019
- ◆ In Spain, **activity and employment continue to grow**, despite economic policy uncertainty. **However, a slowdown is expected in 1Q18**
- ◆ GDP growth forecasts for Spain in 2017 and 2018 are **maintained at 3.1% and 2.5% respectively**. In addition, the recovery is expected to continue in 2019 (2.3%) and the improvement in the economy to begin to translate into wage growth
- ◆ **Among domestic risks, the political environment, fiscal adjustment, structural unemployment and the slowdown of reforms remain put**





# APPENDICES

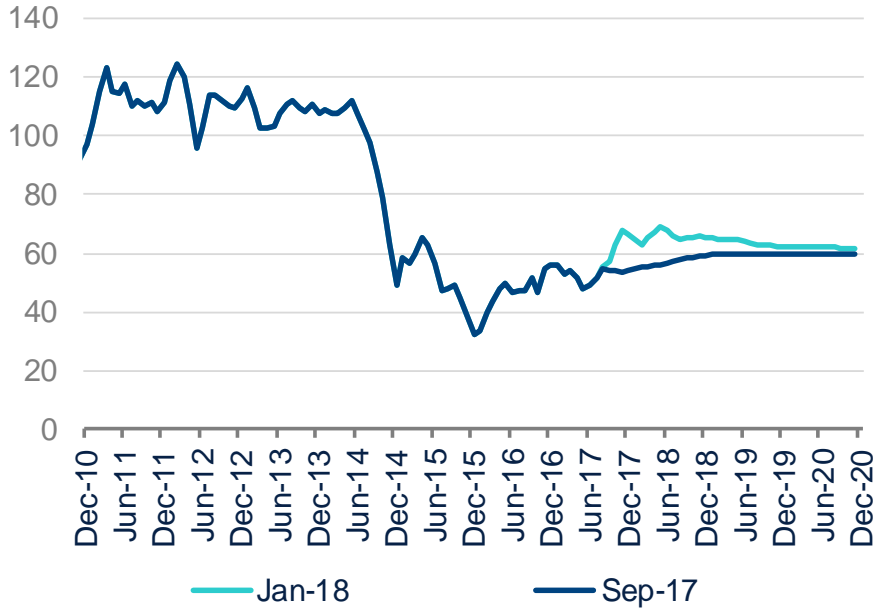




# External fundamentals: higher oil price

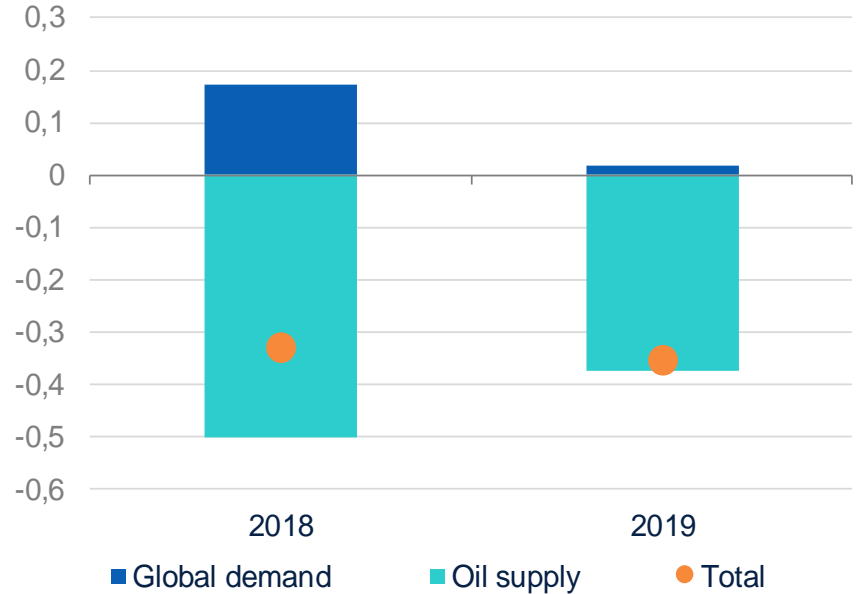
## Brent forecast

(Dollars per barrel)



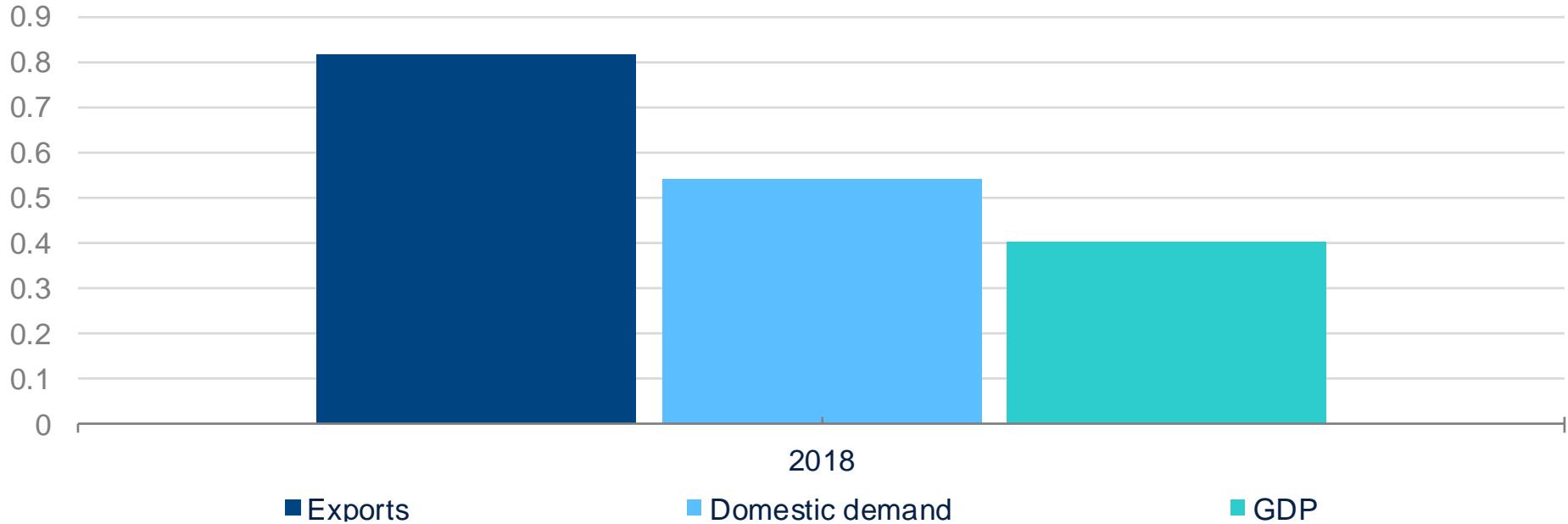
## Spain: Impact of oil price on GDP according to type of shock

(pp YoY)



# External fundamentals: stronger growth in the EMU

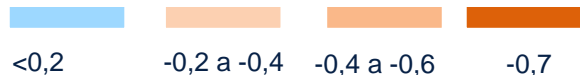
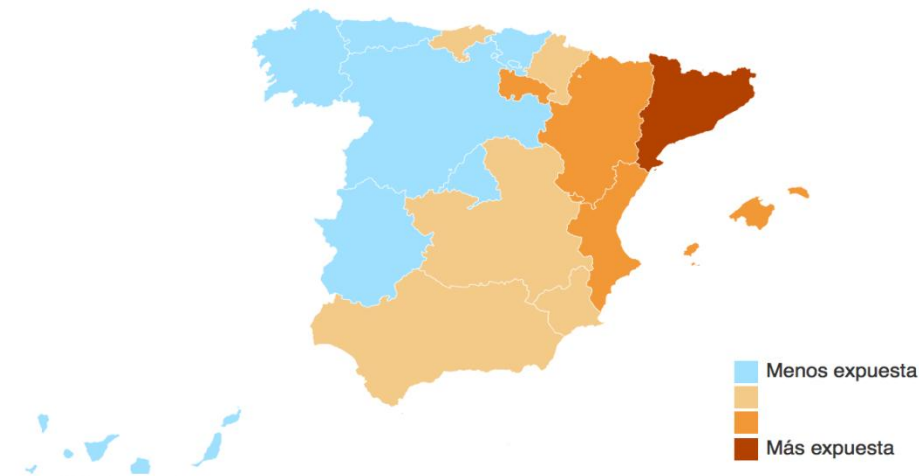
## Spain: Effect on GDP of the EMU demand shock (pp YoY)



## 2018-2019: Economic policy uncertainty will have a real cost

### GDP response to the current increase in economic policy uncertainty

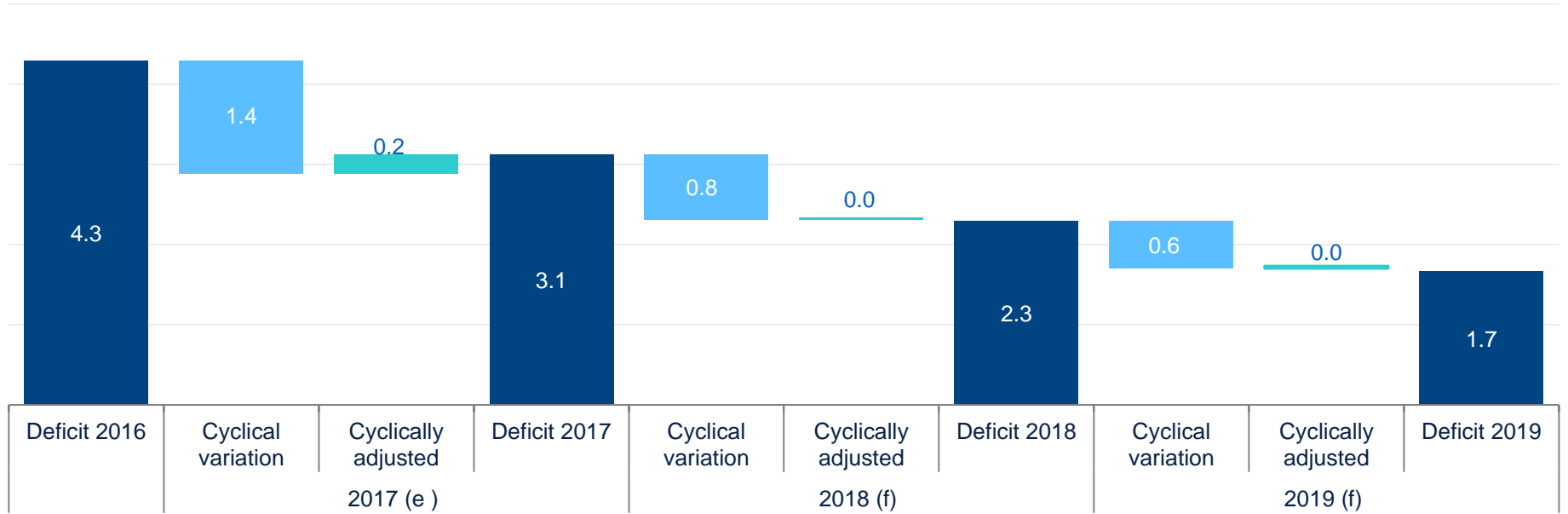
(% YoY, deviation from the baseline scenario)



- ◆ The trade channel is the most relevant to determine the impact in other regions of Spain
- ◆ It is expected that the other channels (home acquisition, tourism ...) have a secondary role

# 2018-2019: Fiscal policy will be practically neutral

## Spain: Fiscal adjustment (% of GDP)



## Changes in our forecasts

## The fundamentals continue to support a relatively strong recovery

% YoY	2016	2017 (f)	2018 (f)	2019 (f)
Final consumption expenditure	2,5	2,2	2,1	1,9
F.C.E. Households	2,9	2,5	2,2	1,9
General government	0,8	1,2	1,8	1,9
Gross fixed capital formation	3,3	5,0	3,7	4,3
Equipment and machinery	5,0	6,2	3,5	4,3
Construction	2,4	4,3	3,4	4,1
Housing	4,4	7,6	5,3	5,7
Other constructions	0,9	1,5	1,6	2,7
<b>Domestic demand (*)</b>	<b>2,5</b>	<b>2,6</b>	<b>2,4</b>	<b>2,3</b>
<b>Exports</b>	4,8	5,1	4,4	5,2
Exports of goods	3,1	5,0	5,0	5,4
Exports of services	8,8	5,3	3,3	4,7
Non-turistic services	8,2	3,0	3,7	6,1
Final consumption of non-residents in the economic territory	9,7	8,7	2,8	2,9
<b>Imports</b>	2,7	3,9	4,4	5,8
<b>External demand (*)</b>	<b>0,7</b>	<b>0,5</b>	<b>0,2</b>	<b>0,0</b>
<b>GDP mp</b>	<b>3,3</b>	<b>3,1</b>	<b>2,5</b>	<b>2,3</b>

(\*) Contribution to GDP growth

Source: BBVA Research based on INE &amp; BdE

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