BBVA | Research

Spain Economic Outlook

1ST QUARTER 2018 | SPAIN AND PORTUGAL UNIT

Contents

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1. Editorial

The GDP growth forecasts for 2017 and 2018 have been maintained at 3.1% and 2.5% respectively. **More over, the recovery is expected to continue in 2019, with growth similar to the one observed this year (2.3%) and with the improvement of the economy beginning to be translated into more growth in wages**. These positive outlooks are a consequence of the strength shown by the Spanish economy and the expectation of a favourable global environment, despite the rise in oil prices and the increase in uncertainty related to the political environment in Catalonia. In this regard, a negative impact on activity is estimated, the known data and the evolution of sentiment indexes point to a limited impact, consistent with the continuation of the recovery.

The most recent data confirms the strong inertia of activity. In particular, it is estimated that GDP growth during 4Q17 would have been 0.8% QoQ, a rate that in annualised terms continues to be above 3%. This dynamism is caused by the positive contribution of domestic demand, but also by the recovery seen in goods sales abroad. Thus, household consumption would have maintained the strength that has characterised it throughout the year, in an environment of increased disposable income in households, supported by the creation of employment, the low cost of financing and high availability of credit. In any case, the increase in consumption is below that observed for GDP. This is important as it allows for a turning point in the drop that has occurred in the household savings rate, which has reached historicallow levels. Meanwhile, exports of goods seem to have consolidated the recovery initiated during the third quarter of the previous year, supported by the favourable global environment. This probably justifies the positive evolution of investment in machinery and equipment, which during the second part of 2017 appears to have shown relatively high growth rates.

Uncertainty, especially with regard to the political environment in Catalonia, could already be having an effect on economic activity. **Nevertheless, for the moment the impact seems to be limited and in line with what was expected.** Different indicators suggest that GDP growth during the first half of 2018 could be slightly lower than that observed on average during the last three years. In the first place, foreign perception of the Spanish economy shows a more moderate deterioration in relative terms, which is reflected in a less positive evolution of certain financial variables. Secondly, some sectors and regions are showing a differential development. Tourism in particular has suffered. In addition, different indicators of expenditure and employment suggest that growth in Catalonia could be moderating more than in the rest of the country and that the former could be moving to other neighbouring regions. Finally, both the financial indicators and those related to real activity, as well as those measuring uncertainty show that although the impact was likely to have been intense, its scope appears to have been quite limited for the time being. This is consistent with a scenario of continued growth during the coming months.

Looking ahead, a synchronised global recovery and the decrease in uncertainty in the EMU will support the evolution of exports. The upward revision in growth, especially in Europe, will offset the possible loss of competitiveness that will result in a price of oil partially higher than that forecasted in the previous edition of this publication. Likewise, both investor sentiment and central bank policies point to a financial environment of low volatility and reduced credit costs for a prolonged period of time. Of particular importance has been the reduction of political uncertainty in Europe, both related to the electoral cycle, and with the incipient progress being made towards Brexit.

At domestic level, fiscal policy will continue to be neutral, while the monetary impulse will become increasingly evident in the evolution of credit. Within a context of unchanged economic policy, Spain is expected to exit the Excessive Deficit Protocol and reduce its deficit to levels around 2.4% of GDP by the end of 2018. This reduction will be explained by the contribution of the economic improvement to the reduction of the imbalance in the public accounts. Meanwhile, new credit transactions continue to grow, which, together with the slowdown in amortisations, is bringing forward the end of the deleveraging period in the private sector. Contributing to the foregoing are both demand and supply factors, likely to be maintained over the next two years, which will sustain the growth of domestic expenditure.

In any case, the scenario is not exempt of risks. On the one hand, there is uncertainty about when the General State Budget for 2018 will be presented and approved. This could have costs for economic activity if there are delays in the implementation of investment projects, expansion of staff or consumption expenditure by public administrations. Likewise, the forthcoming **culmination of a new electoral cycle at a regional and local level** raises risk levels with regard to public accounts, given the observed deviations from the expenditure rule in 2015. On the other hand, it is possible that the continuation of the recovery in certain companies, in some sectors and in the autonomous communities with lower unemployment will begin to have an **increasingly greater impact on wage formation**. This growth is welcome if it is a consequence of productivity improvements. However, if these increases are derived from the existence of a high rate of structural unemployment, they could increase the inequality between those who have a job and those who do not. In this regard, to the extent that the rest of the distribution of salaries is not affected by the increase in the Minimum Wage (SMI), this increase should not have a significant impact on employment, since although it is relatively significant, its prevalence is limited. However, there are certain groups whose exposure is higher, as they are subject to contracts linked to the SMI, and for which the increase in the cost of hiring could reduce their likelihood of finding a job.

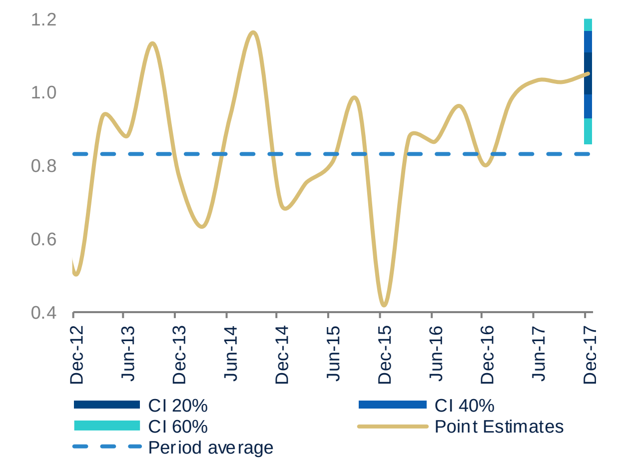
Finally, **although uncertainty indicators point to a reduction from the levels reached last October, they remain high.** Moreover, it is also possible that some of the effects on activity are only observed with a delay, given the maturation required by large investment projects. Regardless of the above, recent events have diverted attention from the necessary reforms that would help increase potential growth in the medium term and reduce the vulnerability of the Spanish economy, reducing the imbalances that still persist during the recovery.

2. Global growth is strengthened

Robust and sustained global growth in 2017

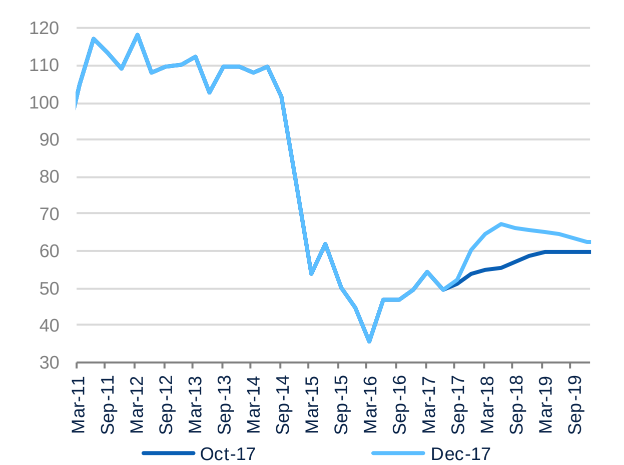
World economic growth has consolidated in late 2017 at around 1% QoQ (see Figure 2.1), reflecting improved results in all major areas and showing signs of continuing over the coming quarters. Support from economic policy has fostered growth of the real economy, particularly in developed economies. Investment has gained traction with support from increased global demand and an upturn in international trade, allowing a recovery of the industrial sector. Private consumption continues to perform well in advanced economies and is gaining momentum in emerging economies. At the same time, prospects and confidence in many of the latter have been favoured by the increase in raw materiales prices (see Figure 2.2), enhanced market confidence and foreign capital inflows. Confidence indicators suggest that the economic expansion is set to improve, favoured by a solid economic performance and reduced short-term risks. In this context, we forecast **global growth to increase by four tenths to 3.7% in 2017**, two tenths more than what was expected three months ago.

Figure 2.1 World GDP growth (QoQ, %)
Forecasts based on BBVA-GAIN



Source: BBVA Research

Figure 2.2 Price of a barrel of Brent crude (Dollars)



Source: BBVA Research

Over the past three months, there have been **further reasons to remain optimistic in all the major areas**. Throughout 2017, recovery in the U.S. has been strengthened, with slightly higher-than-expected growth rates and improvement in the labour market. The fiscal reform has finally passed wich could lengthen the cyclical recovery. However, we don't expect it to have a significant impact in the long-term. Also,recent Fed appointments suggest continuity in monetary policy, which should be reflected by a very gradual normalisation. In China, the measures approved by the government have managed to stabilise the economy, while some structural reforms have been introduced and an economic strategy more focused on reducing economic imbalances -and less on meeting growth targets- has been adopted. Finally, the eurozone has recorded a higher growth than the one expected in 2017, supported by an improved global outlook and stronger domestic demand that is benefiting from a reduced political uncertainty.

This scenario of increased growth and higher demand has been accompanied so far by **subdued inflation**, despite the expansionary measures adopted by major central banks and the gradual reduction of the idle capacity in developed economies. Doubts remain as to whether factors underpinning the weakness of inflation are transitory or permanent. Globalisation, the flexibility of labour markets, low inflation expectations or increased productivity could lie behind the slower response of prices to increased economic activity. In this context, the degree to which inflationary pressure will remain contained is uncertain, at least for the time being. In any case, continued economic growth and higher oil prices should put upward pressure on inflation in the short-term, facilitating **advances in the normalisation of central banks policy in developed economies. Meanwhile, emerging economies still have room for manoeuvre to continue using monetary policy to bolster growth**.

Optimism in financial markets amidst the normalisation of central banks

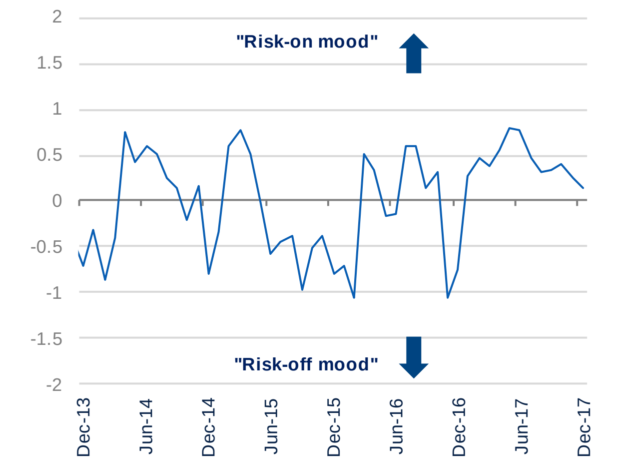
An optimistic stancehas predominated in financial markets over the final quarter of 2017. In the absence of adverse global shocks, market fundamentals have continued to support risk taking by investors (see Figure 2.3). In particular, the upbeat economic environment has been added to still accommodative monetary conditions -thanks to the abundant liquidity and interest rates at record lows- which has helped to maintain volatility at record lows while giving a new boost torisky assets (as is the case of peripheral debt and emerging countries' assets). This is generating **doubts about a potential overvaluation of certain assets**, including equities in advanced countries, which have maintained their upward trend. The **flattening of the US yield curve** due to low long-term interest rates as short-term rates are adjusting upwards following monetary policy decisions, is another question marks hanging over financial markets as we enter 2018.

As regards to central banks, there have been no surprises. Nevertheless, **the strong pace of growth which characterises the current economic scenario is increasingly pointing to a more clear normalisation of monetary policy**. This positive outlook has also triggered an upward revision of economic projections by the main central banks - the U.S. Fed and the ECB- and has also accelerated the process of scaling back the current monetary stimuli.

In December, the Fed increased interest rates to 1.25-1.5% for the fifth time since the beginning of the interest rate hikes in late 2015, and at the same time. they have started the gradual reduction of their balance sheet. The Fed's adequate communication policy is also facilitating the transition towards the new phase of monetary policy **without causing major shocks in financial markets**. Moreover, they maintain their forecast of **three interest rate hikes of 25 basis points in 2018** -in line with our upward revised current expectation, adjusted after the introduction of the tax reform and its estimated impact on economic growth. Thus far, the dollar has not capitalised the new fiscal and monetary policy decisions (as it continues to trade at around $1.20 against the euro).

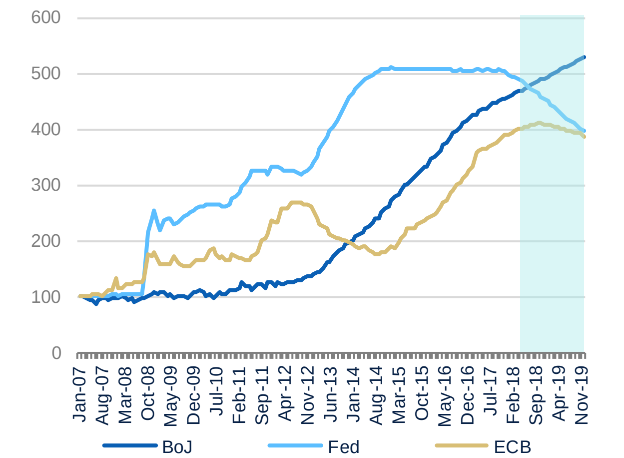
The **ECB**, as expected, will reduce assets purchases in 2018, but with an approach that differs from the Fed's. **Asset purchases have been reduced substantially (up to half, to 30 billion euros per month)**, while in turn **the programme has been extended at least until September. In this setting,** the ECB is maintaining its commitment not to raise interest rates until sometime after the end of quantitative easing, **in order to anchor interest rate expectations**. **This means that ECB's quantitative easing** (QE) **will probably not end until Autumn this year**, and therefore **interest rate will not be raised until 2019** (we expect the first deposit rate increase to occur in March and the repo rate to be lifted in June). All in all, it is likely that the debate on the ending of QE will intensify in the spring.

Figure 2.3 Risk appetite indicator
(overall factor based on EPFR flows)



Source: BBVA Research based on EPFRestima

Figure 2.4 Central bank balance
(index 100 = January 2007)



Source: BBVA Research

Other central banks, such as the Bank of England and the Bank of Canada, **are taking steps in the same direction** (with specific rate rises). The Bank of Japan has maintained its monetary policy unchanged, although it has slowed its asset purchases in line with major central banks. All in all, **financial markets will have to adapt** to a more “normal” monetary environment: **liquidity will be scarcer and financing conditions less accommodative** (see Figure 2.4).

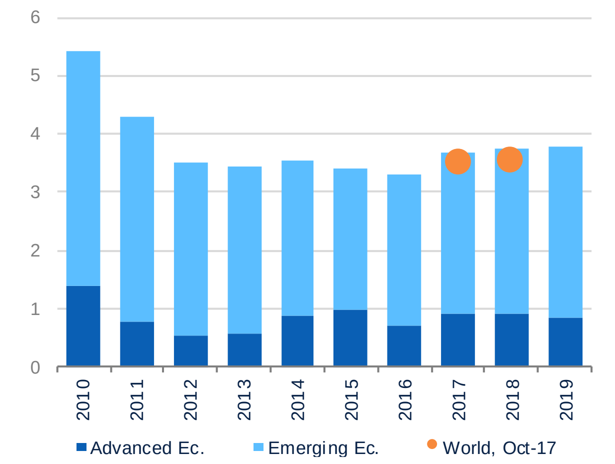
World growth will tend to stabilise in 2018-19

Our **forecasts point to global growth slightly accelerating the next two years by around one tenth to 3.8%** per year (see Figure 2.5). This represents an upward revision of 0.3% on our expectations from three months ago in response to higher growth forecasts for the U.S, China and the Eurozone in 2018. This is mainly due a more buoyant economic activity than expected in past quarters, but also thanks to the aforementioned economic measures underway in the first two key areas. In Latin American economies we now expect a somewhat stronger recovery this year, due to the upward revision of global demand and raw materials prices. Despite the expected stability of world growth, **we still expect a mild moderation in developed economies in 2019,** while emerging economies will continue consolidating their recovery. On top of this, **there are still a number of political risks** that could drag economic confidence and impact financial markets. **These uncertainties are however less significant** than three months ago.

U.S: higher economic growth in the short term

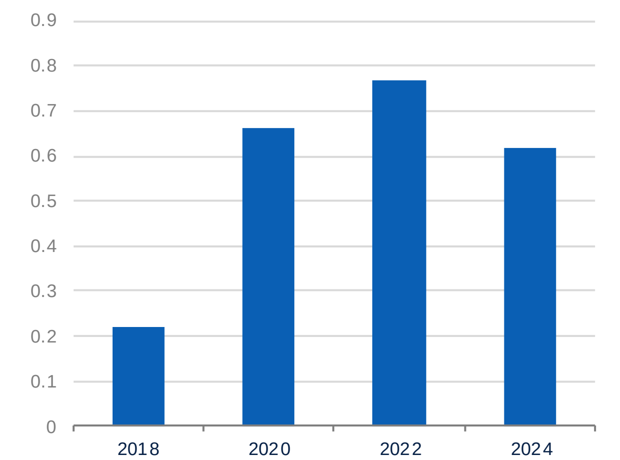
Economic activity surged once again by **slightly over an annual pace of 3% in the third quarter of 2017**. Although the most recent indicators suggest a certain slowdown over the 4Q17, this appears to be transitory, and the consequence of rebuilding works after recent hurricanes and delays to investment pending the implementation of certain fiscal measures. **Various factors have bolstered the recent strengthening of the economy.** Higher oil prices and the depreciation of the US dollar have supported investment, while greater global demand favoured a further rebound in global exports. In addition consumption has also increased at a relatively stable and solid pace, in contrast to the more gradual recovery of the labour market, higher inflation and a slight tightening of financial conditions. Finally, public expenditure made a very positive contribution to growth, despite Congress agreeing to increase caps over discretionary expenditure. As a result of all the above, GDP would increase by around **2.2% in 2017**.

Figure 2.5 World GDP growth forecast by region (%)



Source: IMF and BBVA Research

Figure 2.6 Impact of U.S. tax reforms on GDP (%)



Source: BBVA Research

Improved domestic and global fundamentals could lift 2018 growth by around 0.2pp. We also estimate the **tax reform** to further add another 0.2pp, **increasing our 2018 GDP growth forecast to 2.6%** (see Figure 2.6). The impact of lower taxes on personal income will not be too pronounced, as they will mainly affect those with the highest earnings –with lower propensity to consume-. The greatest impact will stem from cuts to corporate taxes, although here again, we expect that this will be relatively limited given the temporary nature of some provisions, the higher financing costs and a possible increase in savings instead of investment. Taking into account all these factors, we estimate that the **accumulated effect of the tax reform on GDP could be around 0.6% up to 2024**. Although monetary policy will remain accommodative, the improved economic outlook will strengthen the process of normalisation started by the Fed. As a result, we expect growth to moderate at 2.5% in 2019. **Despite a reduction of risks, these remain high**, given the considerable amount of political tension and the threat of a pronounced shift towards protectionism, while some assets could be showing signs of overvaluation.

China: a more moderate slowdown

The most recent figures suggest that economic growth remained stable over the second half of last year, showing some resilience to measures adopted by the authorities to tackle financial vulnerabilities and to move towards an ordered deleveraging of the economy. As a result, **growth could have stabilised at 6.7% in 2017**, with a slight slowdown in both consumption and investment, compensated with positive net exports figures. Despite the good economic performance, **we still expect a growth moderation moving forward, albeit to a lesser extent** than in our previous forecasts due to an improved international outlook and the economic policy strategy presented at the 19th Communist Party Congress.

The factors underpinning this scenario remain unchanged: **less support from economic policies**, with a more prudent monetary policy, the regulatory tightening, the end to industrial over-capacity and a less expansive fiscal policy. **Nevertheless, the withdrawal from a strict growth target suggests a greater focus on the reduction of structural imbalances, while the measures aimed at opening up the economy and the introduction of structural reforms could help to improve potential growth**. We now forecast that GDP will slow to 6.3% in 2018 (three tenths higher than the expected three months ago) and to around 6% in 2019. Higher raw materialsprices will lead to an upward pressure on inflation, which had been subdued at the end of last year. However. This effect will be offset by a stronger currency and a stricter regulatory framework. As a result, we expect to see inflation pick up to 2.3% during 2018 (from 1.7% last year), rising to 2.5% in 2019. **The central bank is expected to keep benchmark interest rates at the current level all through this year**, discharging the precautionary approach of monetary policy to macro-prudential and regulatory tools.

The strategy put forward by the authorities and the more gradual slowdown of growth have **reduced domestic risks in the short term**. They nevertheless remain at high levels in the medium term, which adds to external risks related to increased protectionism.

Eurozone: upward revision of growth but slowing in 2018-19

The **recovery of the eurozone economy stepped up over 2017 to a surprising extent**, with GDP growth at a relatively stable rate of around 0.6% per quarter. There was a greater balance in terms of components, with growth more evenly spread across the member states. **The strength of internal demand and the positive contribution stemming from net exports have allowed a GDP acceleration of the area by six tenths to 2.4% in 2017**.

Moving forward, the favourable economic sentiment could be prolonged, though it will be difficult to maintain current growth pace - clearly above potential- all through the forecast horizon. **Recent figures, along with an increase in global demand and less uncertainty, have led us to revise up our GDP growth forecasts for 2018 by four tenths to 2.2%**, while we estimate growth at 1.8% for 2019.

The lower level of uncertainty after election results last year together with increased corporate profits should bolster a **recovery of investment, which will moderate somewhat in 2018-19** after the strong growth seen over the past two and a half years. The eurozone will also benefit from a significant **export growth momentum**, although these may experience a slowdown given the currency appreciation and the stabilisation of global growth. On the other hand job creation will lose some traction (around to 1% in 2018-19 from 1.6% in 2017), but will be sufficient to sustain household income and a **strong growth in private consumption**.

Inflation moderated towards the end of the year due to the base effect of energy prices. This trend is set to continue entering 2018, taking headline inflation to around 1%. Nevertheless, **we now expect Brent prices to increase by around 16% more than the estimated three months ago**, meaning that the aforementioned base effect will fade from March onward. As a result, **we are increasing our headline inflation forecast by three tenths to 1.5% for 2018** and to 1.6% for 2019. Regarding **core inflation, we continue to forecast a gradual increase to 1.3% in 2018 and to 1.6% in 2019**, driven by a strong domestic demand, a healthier labour market and the reduction of the idle capacity.

Domestic risks for the eurozone as a whole are still downward biased, although they have diminished and are moderated. Despite the fact that the political outlook partially cleared in 2017, there are still latent risks, such as Italian elections in March and difficulties in strengthening the European project. Brexit negotiations have moved forward, although we are still far from ensuring that this will not be a disruptive event if a trade agreement is not reached by early 2019.

![BBVA Research]

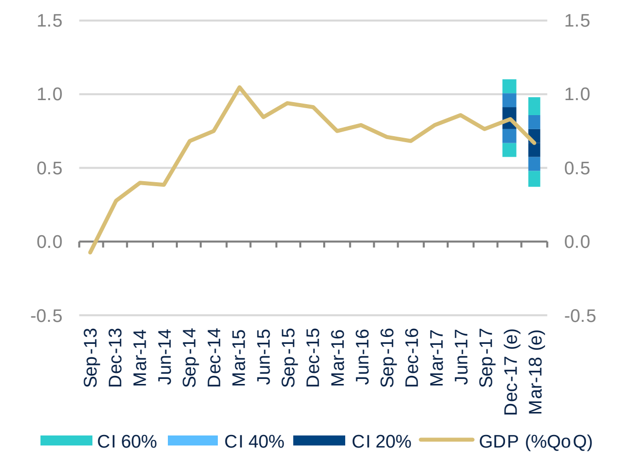
3. Growth outlook for the Spanish economy

The pace of recovery is solid, but it could be moderating

The information known at the closure of this this report indicates that, despite economic policy uncertainty derived from the political environment in Catalonia, **the Spanish economy is expected to have grown 0.8% QoQ SWDA in 4Q17 (forecast of the MICA-BBVA model)**. If this estimate is confirmed, the increase in GDP in 2017 would have reached 3.1%, which exceeds that estimated a year ago (2.7%) and represents the third annual advance above the historical average since 2007[1].

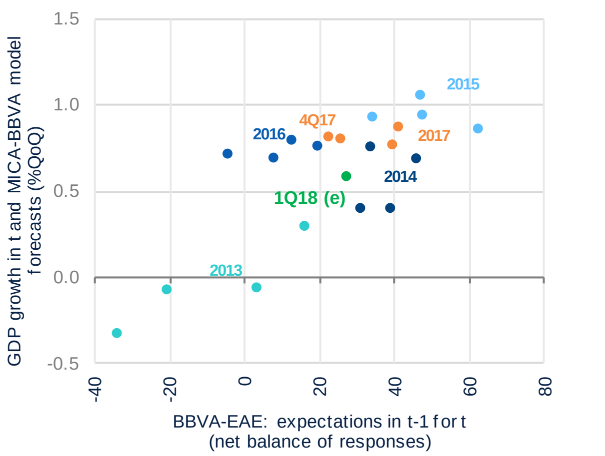
In spite of the above, BBVA Research's real-time estimates indicate that **GDP growth is slightly moderating in the first quarter of 2018** (forecast of the MICA-BBVA model: between 0.6% and 0.7% QoQ, see Figure 3.1). However, the pace of progress will continue to be healthy, in line with the results of the BBVA Economic Activity Survey (EAE-BBVA)[2], which reveal positive growth expectations for the coming months (see Figure 3.2).

Figure 3.1 Spain: observed growth in GDP and forecasts of the MICA-BBVA Model (% QoQ)



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

Figure 3.2 Spain: economic growth and expectations of participants in the BBVA-EAE in the previous quarter



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

1: The average annual growth between 1971 and 2016 stood at around 2.5%.
2: For details on the BBVA Economic Activity Survey (EAE-BBVA), see Box 1 of the Spain Economic Outlook for the second quarter of 2014, available at: https://goo.gl/JNy1jG

All domestic demand items grow

The signals extracted from the expenditure indicators[3] suggest that, for the third consecutive quarter, private consumption could have grown by 0.7% QoQ (2.7% YoY) in 4Q17. If this forecast is met, **2017 would have closed with an average annual increase in household spending of 2.5% YoY**, 0.4 pp below that observed in the previous year. Regarding public demand, it is estimated that the moderate upward trend continued in the final part of 2017. Thus, the data available for budget execution indicate that the growth of final consumption expenditure of public administrations could have increased by 0.2 pp to 0.6% QoQ (2.2% YoY) in 4Q17. That would mean that **the past financial year would have ended with an increase of 1.2% in public consumption**, 0.4 pp higher than that of 2016.

On the side of **investment in machinery and equipment**, partial indicators[4] suggest that, after the volatility observed in the central part of the year (-0.1% QoQ in 2Q17 and 2.5% QoQ in 3Q17), this component of demand could have grown by 1.4% QoQ (4.0% YoY) in 4Q17. Thus, despite the economic policy uncertainty experienced in the final stretch of the year, **2017 could end with a 6.2% annual advance of this investment component**, 1.2pp higher than that reached in 2016.

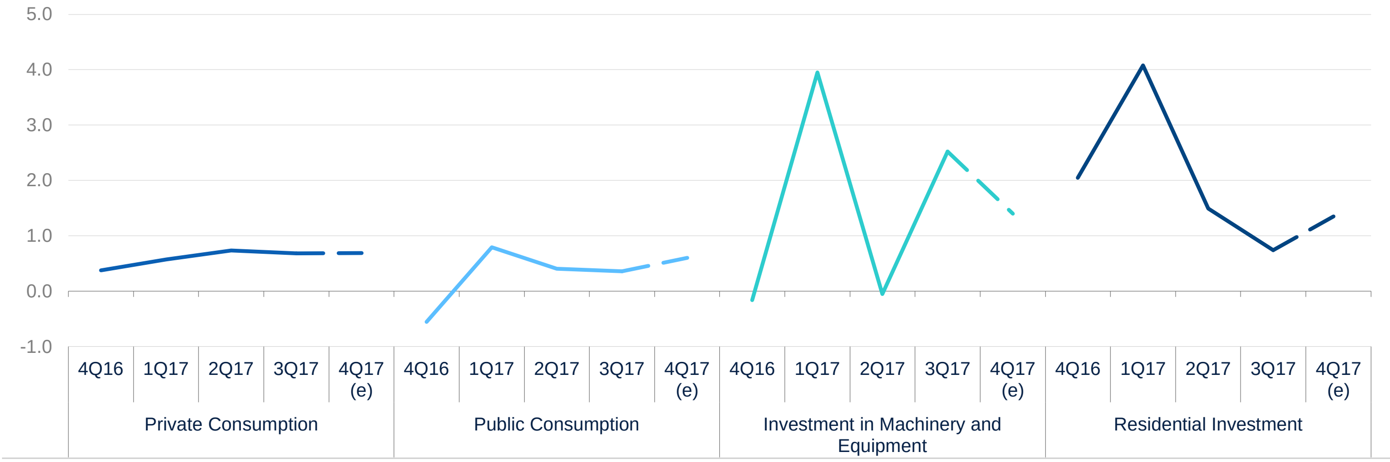
On the other hand, available information[5] indicates that **residential investment could be recovering traction**, following the deceleration observed in the third quarter of last year. Thus, it is estimated that investment in housing could have increased by 1.4% QoQ (7.9% YoY) in 4Q17. As a result, **this demand component is expected to have added 7.6% in 2017 to the recovery undertaken in 2016 (4.4%)**. Regarding investment in other constructions, BBVA Research estimates growth of 0.3% QoQ (1.2% YoY) in 4Q17, with which 2017 would have ended with an average growth of 1.5% YoY (0.9% in 2016).

Domestic spending explained most of the growth in 2017

In summary, partial indicators suggest that in 3Q17 **domestic demand could have contributed 0.7 pp to the quarterly increase in GDP** thanks to the growth in all its components. If the year closes like this, **domestic demand will have contributed 2.4 pp to average economic growth in 2017**, only 0.2 pp less than in 2016.

3: Wage incomes, stock prices, credit and retail sales lost strength, while car registrations grew and confidence showed no signs of deterioration despite economic policy uncertainty.
4: Qualitative indicators, such as confidence or the order backlog, showed a significant momentum during 4Q17 while industrial production index continued growing at the beginning of the quarter, after the spectacular result in the month of September. On the contrary, spending indicators, such as industrial vehicles sales or capital goods imports show some stagnation.
5: New growth of new construction starts expected in 4Q17. In addition, employment in construction continues to show a higher-than-average growth, partly also due to the recovery seen in public works and non-residential works. On the other hand, there has been a moderation in the agents' confidence indices in the sector.

Figure 3.3 Spain: growth observed and forecasts of the major components of domestic demand (% QoQ)



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

Exports recovered at year-end

After two quarters of sluggishness, **Spanish total exports could have recovered in 4Q17 (1.2% QoQ, 4.6% YoY), which would allow the year to end with an average expansion slightly higher than that registered in 2016 (5.1% vs. 4.8%)**. In particular, available indicators[6] suggest that the momentum gain would have been due mainly to **exports of goods** (see Figure 3.4)**, which would have grown by 1.5% QoQ (5.4% YoY) in 4Q17 and 5.0% on average during the whole of 2017** (3.1% in 2016).

Meanwhile, **exports of services were expected to have grown marginally in 4Q17 (0.4% QoQ, 2.8% YoY), and to have slowed over the year as a whole (5.3% as against 8.8% in 2016**). On the one hand, the known information[7] indicates that economic policy uncertainty, together with the August terrorist attacks in Catalonia could have contributed to a fall in consumption by non-residents in national territory in 4Q17 (-0.6% QoQ and 5.1% YoY) which, in any case, would not have been enough to tarnish the positive close for 2017 **(+8.7% as against 9.7% in 2016)**. On the other hand, exports of non-tourism services are estimated to have increased by 1.1% QoQ (1.3% YoY) in the last quarter of 2017 and to have ended the year with an average increase of nearly 3.0% (5.2 pp below the growth posted in 2016).

External demand would have contributed 0.5 pp to GDP growth in 2017

In line with the behaviour of final demand, information available at the time of writing suggests that **imports might have grown by 1.1% QoQ (4.5% YoY) during 4Q17 and would close 2017 with an increase of 3.9% (2.7% in 2016).** This, together with the expected performance of total exports, would mean that **net external demand contributed 0.1 pp QoQ (0.2 pp YoY) to Spain's GDP growth in 4Q17 and 0.5 pp for the whole year (0.7 pp in 2016)**.

6: Exports by large companies accelerated in 4Q17, while the backlog of export orders stagnated. Available information on the balance of trade also points to a decline in exports of goods in the quarter.
7: Overnight hotel stays by non-resident tourists fell by -1.9% QoQ SWDA in 3Q17. On the other hand, registered entries increased (06% YoY SWDA). Meanwhile, balance of payments revenues from tourism fell -1.7% MoM SWDA in October.

Figure 3.4 Spain: growth observed and forecasts of the major components of external demand (% QoQ)

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

Greater job creation despite the uncertainty

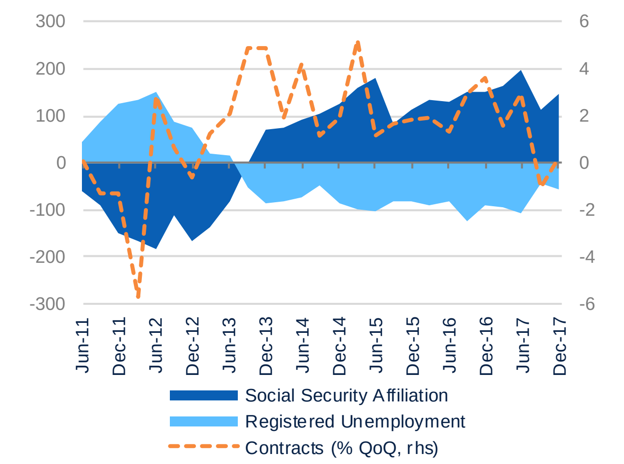
Controlling for variations caused by seasonal factors, **Social Security affiliation increased by 0.8% YoY in the fourth quarter**, 0.2 pp more than in 3Q17 (see Figure 3.5). After falling unexpectedly between July and September, recruitment grew marginally (0.2% QoQ SWDA) in the final three months of the year. As the number of temporary contracts stagnated and the number of permanent contracts grew by 2.4% QoQ SWDA, the temporary hiring ratio decreased to 90.5% SWDA. The fall in registered unemployment, generalised by sector of activity, also accelerated in 4Q17. Thus, the decrease in registered unemployment by -1.7% QoQ SWDA, half a point more than in 3Q17.

The Labour Force Survey (LFS) for the fourth quarter confirmed the trend hinted by Social Security registration and unemployment figures. BBVA Research estimates suggest that employment would have increased by around 0.8 pp between September and December in seasonally adjusted terms, in line with what happened in 3Q17. Given that the size of the active population has hardly varied, the unemployment rate would have declined seven tenths to 16.1% SWDA (see Figure 3.6).

The service sector would have boosted employment in 2017

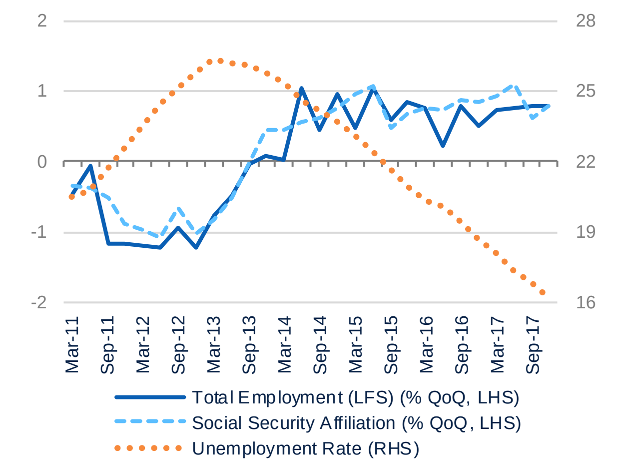
Thus, with the figure for 4Q17, the fourth consecutive year of net job creation would be closed. On average, the number of people in employment increased by 500,000 in 2017, almost 30,000 fewer than in 2016. The increase in employment was concentrated in the service sector (eight of every ten new jobs) and in temporary employment contracts. If the expected fall in the active population for the whole year (-85,000 people) is met, the unemployment rate would be around 17.1%, 2.5 pp less than in 2016.

Figure 3.5 Spain: labour market records (SWDA). Quarterly variation in thousands of people, except where indicated otherwise)



Source: BBVA Research, based on Ministry of Employment and Social Security

Figure 3.6 Spain: labour market indicators (SWDA)



(e) estimate
Source: BBVA Research, based on Ministry of Employment and Social Security and INE

The growth of prices moderates, while that of wages remains limited

Headline inflation decrease during the fourth quarter of 2017 to reach 1.2% YoY in December (2.0% as the year average). **The standout observation behind this evolution is the weakness of core inflation**, which moderated 0.3 pp between September and December to 1.2% YoY (1.1% as the average for the year). **There would also have been a contribution from the slowdown in energy prices**, which, nevertheless, was due to the absorption of the base effect generated by the uptick observed in late 2016 and early 2017.

Gains in price-competitiveness were maintained

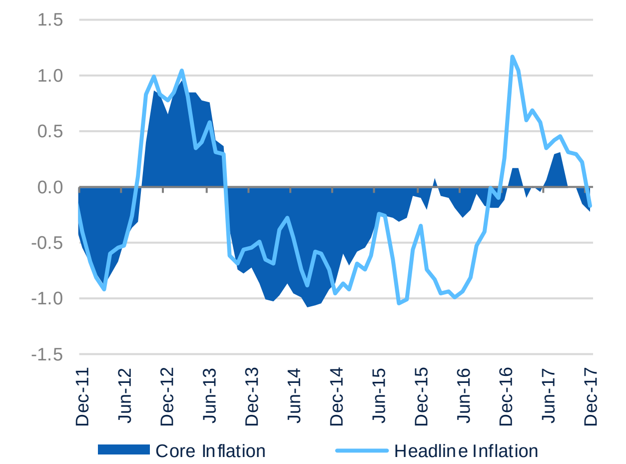
In this context, **the unfavourable headline inflation differential with respect to the euro zone narrowed to being practically non-existent (0.2pp)**. On the other hand, BBVA Research estimates indicate that, using the core inflation as a reference, the price growth differential has become slightly favourable towards Spain (see Figure 3.7).

The demands for wage increases barely increased during the fourth quarter. The average wage growth agreed in the collective bargaining agreement up to November was similar to that recorded up to September (1.4%). Although the moderation continued in the revised pluriannual agreements (1.3%), the agreed increase in remuneration exceeded 1.7% in those signed during the current year, which related to 2,303,000 workers[8]. However, the average

8: The number of workers covered by collective bargaining agreements was close to 6.6 million up to November including those affected by agreements signed before 2017 (4,591,000), 2.2% less than that registered up to November 2016.

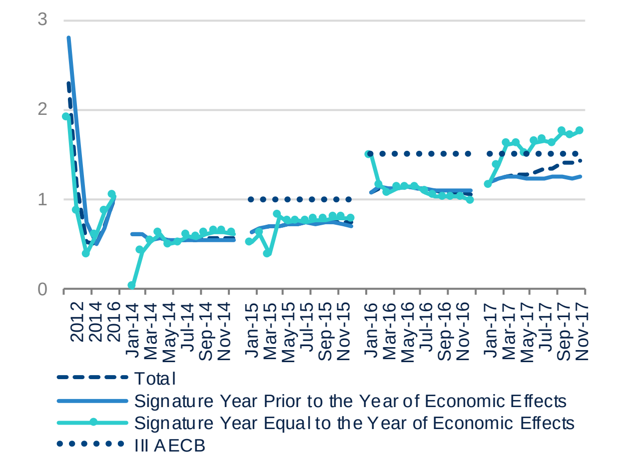
wage increase was less than 1.5%, a figure established as the maximum limit in the 3rd Agreement for Employment and Collective Bargaining (AENC) for the previous year[9] (see Figure 3.8).

Figure 3.7 Spain: inflation differentials relative to the euro zone (% YoY)



Source: BBVA Research, based on INE and Eurostat

Figure 3.8 Spain: average wage increase agreed in collective agreements (%)



Annual data include agreements registered after December each year and incorporate the review using the wage guarantee clause.
(*) Data for 2015 and 2016 are provisional. The figures from 2013 onwards are not strictly comparable with those of previous years.
Source: BBVA Research, based on Ministry of Employment and Social Security

The flow of credit grows

The stock of credit to the private sector moderated its fall in October to -1.5% YoY (-2.0% in September). At the same time, the change in **the new transactions granted continues to be consolidated in positive territory** (5.5% YoY in the cumulative figure for the year up to November), due to the improvement in company financing transactions for amounts exceeding €1 million (0.5% YoY compared to -32.8% for the whole of 2016). Also in the retail sectors (households and SMEs[10]), we have seen the flow of credit recover in the first nine months of 2017 (8.1% YoY, see Figure 3.9)[11].

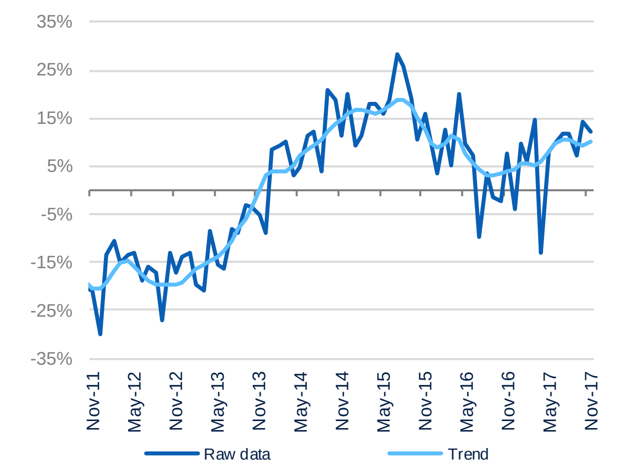
Credit strengthens its improvement trend

On the other hand, the price of new loans remains at minimum levels (see Figure 3.10), favoured by the negative Euribor, liquidity conditions for banks, the relative containment of sovereign risk –despite economic policy uncertainty – and the lower credit risk faced by the entities. However, in some portfolios a minimum threshold of narrowing interest margins may have been reached, in an environment of changes in the term structure. Also, the rates for housing acquisition (2.20% APR average in August, 12 bps less than a year ago), show a clear resistance to

9: The 3rd AENC, signed in early June 2015 by CEOE, CEPYME, CCOO and UGT, sets limits on the wage increases agreed in collective bargaining agreements. In 2015 they were not allowed to exceed 1%, and in 2016 this figure was 1.5%. The increase in 2017 will depend on the development of GDP growth in 2016 and the government's macroeconomic forecasts.
10: The lending to SMEs is close to that because of what was granted in amounts below €1 million
11: However, this growth is less than it could have been given the base effect deriving from the refinancing of portfolios (counted as new transactions) to eliminate "floor clauses" in April 2016.

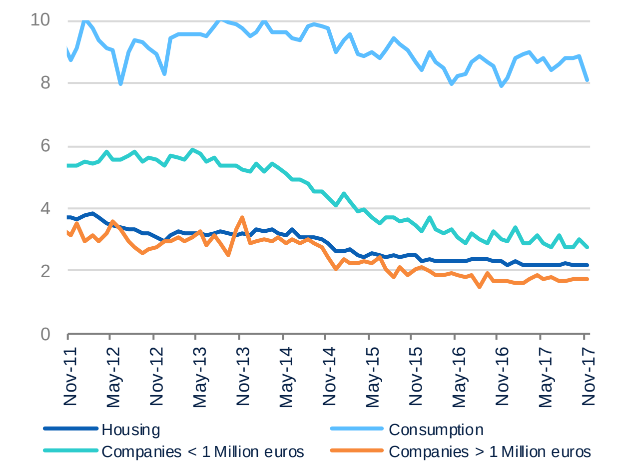
continued decline supported by the growing importance of fixed rate mortgages. According to this indicator, which includes commissions, Spanish mortgage loans continue to be cheaper than those of many other European countries such as France and Ireland.

Figure 3.9 Spain: new retail sector credit transactions (% YoY)



Source: BBVA Research, based on Banco de España

Figure 3.10 Spain: interest rates on new lending transactions (% APR)



Source: BBVA Research, based on Banco de España

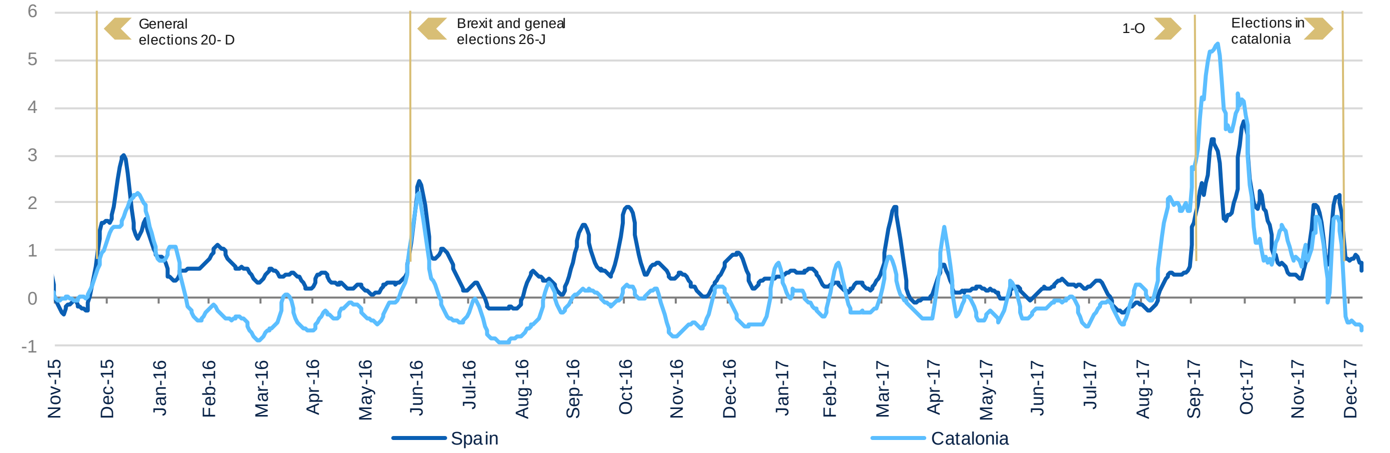
Scenario 2018-2019: the recovery continues, but it is slowing

The fundamentals of the Spanish economy support the continued recovery over the next few years, although at a lower rate than that observed since the beginning of the recovery. These expectations of a slowdown are based on the moderation of the momentum provided by the expansionary monetary policy and low oil prices, as well as the exhaustion of domestic demand and a practically neutral tone of fiscal policy. Added to these factors is the negative effect of the economic policy uncertainty arising from the Catalan political environment (see Figure 3.11).

Tailwinds lose intensity

Growth expectations have been maintained with respect to those presented in the previous edition of this publication. Although the expected development of the main trading partners has remained stable and continues to promise demand for exports, domestic demand will slow down. This is because the fundamentals are still solid, but less accentuated than in previous years. This slowdown in final demand will not prevent a further expansion in imports which, together with a certain depletion in tourist exports, will cause the biennium to close with a marginal contribution of net external demand to growth (0.2pp YoY in 2018 and 0.0% YoY in 2019).

Figure 3.11 Spain and Catalonia: economic policy uncertainty indicex
(standard deviations from the mean, one-week moving average)



Source: BBVA Research based on GDELT

Thus, the current year will result in an annual growth of 2.5%, while in 2019 the economy will grow by 2.3%, eight tenths less than the average observed during the previous biennium (see Table 3.1). Despite the slowdown, domestic demand will continue to be the main support for growth (2.3 pp on average) while the recovery of imports will limit the contribution of net external demand (0.1 pp on average). Even so, if this scenario is met, the increase in activity would be sufficient to create nearly 860,000 jobs over the two-year period (120,000 less than in the previous biennium) and reduce the unemployment rate to around 14.0% in 2019[12].

12: By the end of the period, the number of people in employment will have increased by 783,000 and unemployment rate will have declined to around 13.4% by late 2019.

Table 3.1 Spain: macroeconomic forecasts

(% YoY unless otherwise indicated)	3Q17	4Q17(e)	2016	2017 (f)	2018 (f)	2019 (f)
National Final Consumption Expenditure	2.0	2.6	2.5	2.2	2.1	1.9
Private Consumption	2.4	2.7	2.9	2.5	2.2	1.9
Public Consumption.	1.0	2.2	0.8	1.2	1.8	1.9
Gross Fixed Capital Formation	5.4	5.8	3.3	5.0	3.7	4.4
Equipment and Machinery	6.3	8.0	5.0	6.2	3.5	4.3
Construction	4.9	4.3	2.4	4.3	3.4	4.1
Housing	8.6	7.9	4.4	7.6	5.3	5.7
Other Buildings and Constructions	1.6	1.2	0.9	1.5	1.6	2.7
Domestic demand (*)	**2.7**	**3.1**	**2.5**	2.6	**2.4**	**2.3**
Exports	4.9	4.6	4.8	5.1	4.4	5.2
Imports	4.0	4.5	2.7	3.9	4.4	5.8
External balance (*)	**0.4**	**0.2**	**0.7**	0.5	**0.2**	**0.0**
Real GDP at market prices	**3.1**	**3.3**	**3.3**	3.1	**2.5**	**2.3**
Nominal GDP at market prices	**4.2**	**4.7**	**3.6**	4.1	**4.2**	**4.4**
Total employment (LFS)	2.8	3.1	2.7	2.7	2.5	2.0
Unemployment rate (% of labour force)	16.4	16.1	19.6	17.1	15.3	14.0
Full-time equivalent employment (FTE)	2.9	3.1	3.0	2.9	2.2	1.7

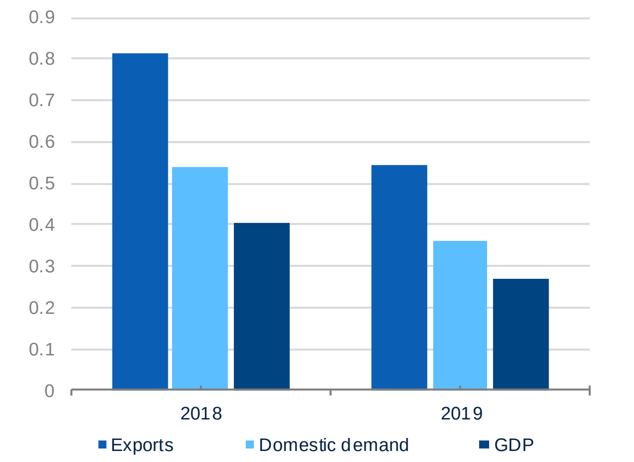
(*) Contributions to growth.
(e): estimate (f): forecast.
Source: BBVA Research based on INE and Banco de España

The external environment for the Spanish economy remains favourable

The upward revision of the expected global growth (3.8% in 2018 and 2019) will provide a greater potential demand for Spanish exports throughout the biennium, despite the expected appreciation of the euro exchange rate. Particularly relevant is the improvement in growth expectations of European demand (which will grow 2.2% in 2018 and 1.8% in 2019) since, according to BBVA Research estimates, they could be translated to the Spanish economy at a rate of one-to-one (see Figure 3.12).

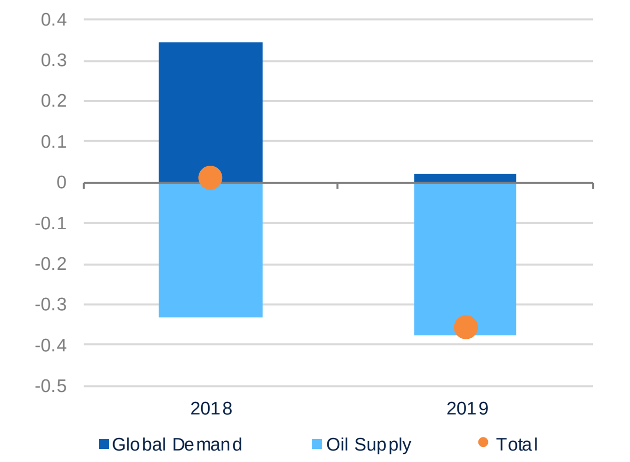
In this context, the trajectory of the oil price has been corrected upwards, with the Brent rate being around US$64 per barrel during the month of December. Going forward, BBVA Research forecasts indicate that, on average, the price will be around US$65 per barrel during the next two years, 11.9% above the value estimated three months ago. In any case, it is expected that the impact of this review on economic activity in Spain will not be significant (see Figure 3.13)[13]. In particular, it is estimated that a significant part of the increase in prices is explained by the acceleration of global activity and, consequently, the higher demand could mitigate the negative effect on margins and disposable income derived from higher energy prices.

Figure 3.12 Spain: impact of the revision of growth in the euro zone (% YoY, deviation of annual growth in pp compared to the base scenario of three months ago)



Source: BBVA Research

Figure 3.13 Spain: impact of the oil price revision (deviation of annual growth in pp compared to the baseline scenario of three months ago)



Source: BBVA Research

The ECB prepares the progressive withdrawal of monetary stimuli during the current biennium

Following the recalibration of the asset purchase programme announced in October, **the European Central Bank (ECB) decided to maintain the monetary policy stance at its December meeting**. However, the monetary authority was more confident about the balance of biases in activity and prices in the euro zone. Thus, the growth forecast for the coming years has increased significantly, following the strong rebound in GDP observed in the second half of 2017, the solid domestic fundamentals and the improvement in global demand. It also revised the inflation forecast for 2018 upward– given the increase in energy prices – and, more importantly, affirmed that it is expected to be at 1.7% (close to the target) in 2020.

Monetary policy stance unchanged, despite the better balance of risks

In this context, the ECB reiterated that **the asset purchase programme will continue in 2018, although between January and at least until September, the acquisitions will decrease down to** a monthly rate of €30 billion, with no expiry date having been established. On this point, however, there has been a debate within the ECB, with several members openly in favour of ending the programme. With regard to interest rates, the monetary authority has maintained the benchmark rate at 0% and the deposit rate at -0.40%, and **remains true to its commitment to keep interest rates unchanged well beyond the horizon of purchases of net assets**.

In summary, the ECB faces an important challenge in 2018: to adjust the recalibration of the asset purchase programme, define its end date and start communicating the next exit phase, in which the interest rate increases will occur. For the time being, the central bank is in no hurry, but it is important that it is ready to adjust its policy. As economic expansion gains strength, the interest rate component in the future direction of monetary policy (forward guidance) will become more important.

Bank credit will maintain a positive path during the 2018-2019 period

Going forward, we expect new lending to continue increasing, for reasons of both demand and supply. The demand for credit will be stimulated by the positive trend in activity, both domestically and internationally, and by the still-low interest rates. On the supply side, positive contributions will be felt because of improvements in liquidity conditions (thanks to the progress made towards the banking union in Europe and the expansionary monetary policy of the ECB) and lower portfolio risk. However, the new Spanish Mortgage Law, which is expected to be approved during 2018, will substantially change the legal framework (in terms of requirements for execution, commissions for early repayment or the possibility of converting fixed rates into variables, among other aspects), which could affect the price of these loans.

However, it is expected that the recovery of new credit operations should accompany the improvement in economic activity, so that the banking sector attends to solvent demand and especially to the retail sector, which is more dependent on bank financing. Under these favourable conditions, **the credit stock is expected to stabilise and achieve positive growth throughout the second part of 2018**, after 10 years of private lending by the private sector.

Public demand will increase at a moderate pace

Growth of public investment remains moderate

In a scenario without changes in economic policy, it is expected that the stance of the fiscal policy will return to being neutral in 2018 and 2019, as it was in 2017. Thus, the cyclical recovery of tax collection will allow a new **increase in public consumption spending (on average 1.7% in real terms for the current biennium).** Meanwhile, investment in other constructions, affected in part by the process of containing public spending, will present a path of sustained growth with rates of around 2%.

All the components of private demand will grow, although at a slower pace than in the previous biennium

After standing at around 2.5% in 2017, **the growth of private consumption is expected to slow down to 2.2% in 2018 and 1.9% in 2019**. In line with the scenario presented in November, it is expected that the fundamentals of household expenditurewill continue to show signs of strength, albeit less marked than in previous years. Although a rebound in inflation is not expected, the real income increase of households will be moderated by the slower pace of job creation. Net financial wealth will continue to contribute to the increase in expenditure, but probably less than in 2017 due, in part, to the completion of the deleveraging process. Likewise, consumer financing, supported by still-low interest rates, will continue to rise, albeit at a slower pace than in the 2016-2017 biennium, while real estate wealth will be boosted by the acceleration of growth in the price of housing. Finally, it is expected that the greater uncertainty existing in 4Q17 will have an impact on household spending in 2018, which could contain the downward path of its savings rate.

The fundamentals of domestic demand continue strong, albeit less accentuated

The growth of investment in machinery and equipment will remains at high levels over the 2018-2019 period, although this growth will probably be slower than that seen since the beginning of the recovery. Contributory factors to this deceleration will be the slowdown in machinery and equipment demand, the anticipated deceleration of some of the components of domestic demand and, in the short term, the economic policy uncertainty. Likewise, some elements of the international environment, such as the progressive withdrawal of monetary stimuli (expected for the current biennium), the rise in oil prices and the appreciation of the exchange rate, will contribute to the moderation of growth. On the other hand, the expected growth in demand for exports will continue to support the expansion of installed capacity. On balance, after three years growing at an annual average of 7.6%, we expect investment in machinery and equipment to increase by 3.5% and 4.3% in 2018 and 2019 respectively.

Housing investment will be consolidated as one of the most dynamic demand items in the coming years, supported by the solid recovery of its fundamentals. The economy will continue to create employment in the next biennium, which, together with favourable financing conditions, will encourage the domestic demand for housing. In addition, the higher expected growth in neighbouring countries will maintain the significant levels of foreign demand. All this in an environment of still-low interest rates that will keep the cost of financing at relatively low levels. In this context, entrepreneurs in the sector will continue to launch new projects, despite the pressure resulting from the economic policy uncertainty. In summary, it is expected that, after closing the last year with growth of 7.6%, investment will rise by 5.3% in 2018 and 5.6% in 2019.

Exports will remain dynamic

The good tone of global growth expectations continues to support a strong potential demand for Spanish exports, despite the gradual correction of oil prices and the appreciation of the exchange rate of the euro against different currencies. However, some elements of uncertainty remain and are conditioning the future of external demand in the short term. In the external environment, doubts persist about the Brexit conditions and their possible impact on financial and real variables. In the national environment, several factors seem to be having a negative impact on the tourism sector. In the first place, the loss of competitiveness observed during the last few years. Secondly, the deterioration of the foreign perception following the terrorist attacks suffered last August in Catalonia. Finally, economic policy uncertainty has not abated and seems to be reflected already in a reduced activity in the Catalan tourism sector.

The tourism sector could be approaching saturation levels

However, the forecasts of sales abroad for 2018 and 2019 are still positive: **We expect total exports to grow by 4.4% this year and 5.2% the next**, both figures being in line with the estimated three months ago. On the other hand, **sales of goods abroad are expected to grow at an average annual rate of 5.2%** during the current biennium, and that the increase in **consumption by non-residents will slow down from 8.7% in 2017 to 2.8% in 2018 and 2.9% in 2019**. Factors contributing to this include not just those weighing on tourist demand in the short term but also the possible structural exhaustion of supply. The evidence indicates that the sector could be nearing saturation levels – particularly at the traditional seaside resorts – and that future increases in demand will be increasingly likely to translate into higher prices and wages rather than boosting growth and employment in the sector.

The expected evolution of final demand will **once again lead to a high increase in imports during the current biennium (5.6% on average)**, which will consequently limit the contribution of net external demand to growth (0.2 pp in 2018 and 0.0 pp in 2019). In any case, this evolution of the external balance will favour the maintenance of the current account balance in positive figures (average of the biennium: 1.7% of GDP).

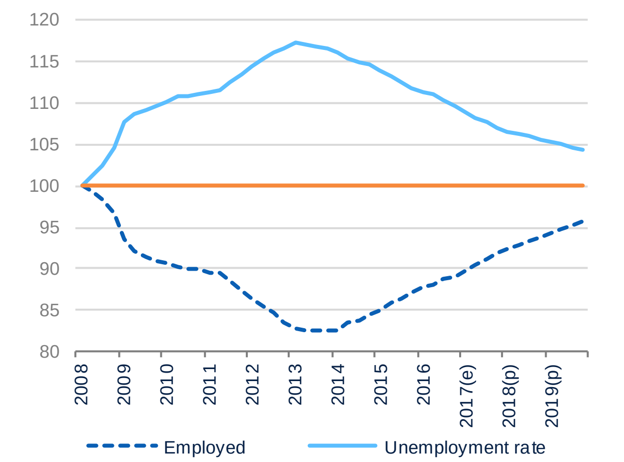
The creation of employment continues, with a practical stagnation of the productivity in the labour factor

Given that the growth expectations of the activity for 2018 and 2019 have scarcely changed with respect to the November scenario, the prospects for job creation have not changed either. After rising around 2.7% in 2017, **employment is expected to grow 2.5% on average in 2018 and moderate to 2% in 2019**. Although the active population is expected to increase by around 0.3 pp in 2018 and 2019, it is estimated that employment growth will translate into a **decrease of more than 3 pp in the unemployment rate to 14% in 2019**. Thus, although the recovery of the labour market will continue during the 2018-2019 biennium, there is still a long way to reach pre-crisis levels. As Figure 3.14 illustrates, by the end of 2019 the level of employment will be around 4% below that existing at the beginning of 2008, while the unemployment rate will be four points higher. In addition, the expected

Even by late 2019 the labour market will not have returned to its pre-crisis level development of activity and full-time equivalent employment – which will increase by around 2% on average in the 2018-2019 period – suggests a very small uptick in the growth of apparent productivity of labour (see Figure 3.15).

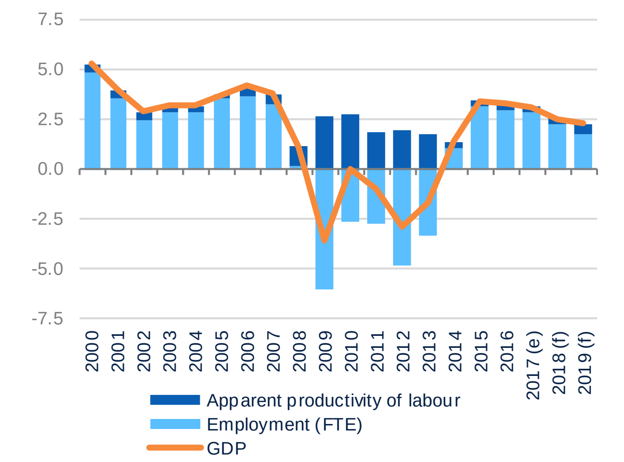
The increase of 4% in the minimum wage (SMI) in 2018 will hardly affect the prospects of the labour market, given the low percentage of workers who receive it and the expectation that it will not be transmitted to the rest of the wage distribution. In any case, it could hinder the access to employment of certain groups. In this regard, BBVA Research (2017) warned that the increase of the SMI in 2017 would damage the employability of groups that have a greater exposure to contracts linked to the SMI: women, young people, foreigners, the less qualified, those on part-time contracts, temporary workers and those who have less seniority within the company[14].

Figure 3.14 Spain: level of employment and unemployment rate (1Q08 = 100. SWDA data)



Source: BBVA Research based on INE

Figure 3.15 Spain: growth in apparent productivity of labour (%)



Source: BBVA Research

The trend in inflation will be positive, although moderate

Despite the recent increase in energy prices, the start of 2018 will continue to be marked by the depletion of the base effect after the increased upswings observed a year ago. **Headline inflation will increase from the second quarter and the year will close with an annual average of around 1.6%**, 0.2 pp above that estimated three months ago, which can be explained by the upward revision in the price of raw materials. On the other hand, **core inflation will maintain a gradual upward trend (1.2% annual average for 2018)**, supported by the expected reduction in the unemployment rate and in the stimuli that monetary policy is still providing. In 2019 core inflation will continue to grow (1.4% on average per year) which, together with energy prices, will place headline inflation at 1.7%.

14: More details in Archondo, I., J. R. García and C. Ulloa (2017): "Repercussions of the increase of the minimum wage in Spain" ("Repercusiones del aumento del salario mínimo en España"), BBVA Economic Observatory, Mar-17. Available in Spanish at: https://goo.gl/baXZ7a

The economy will not lose competitiveness

If these estimates are met, **the headline inflation differential with respect to the euro zone will remain practically non-existent during the 2017-2018** biennium after being in an unfavorable position to Spain in 2017 (0.5 pp on average). Likewise, in terms of the core component, the inflation differential will be practically nil.

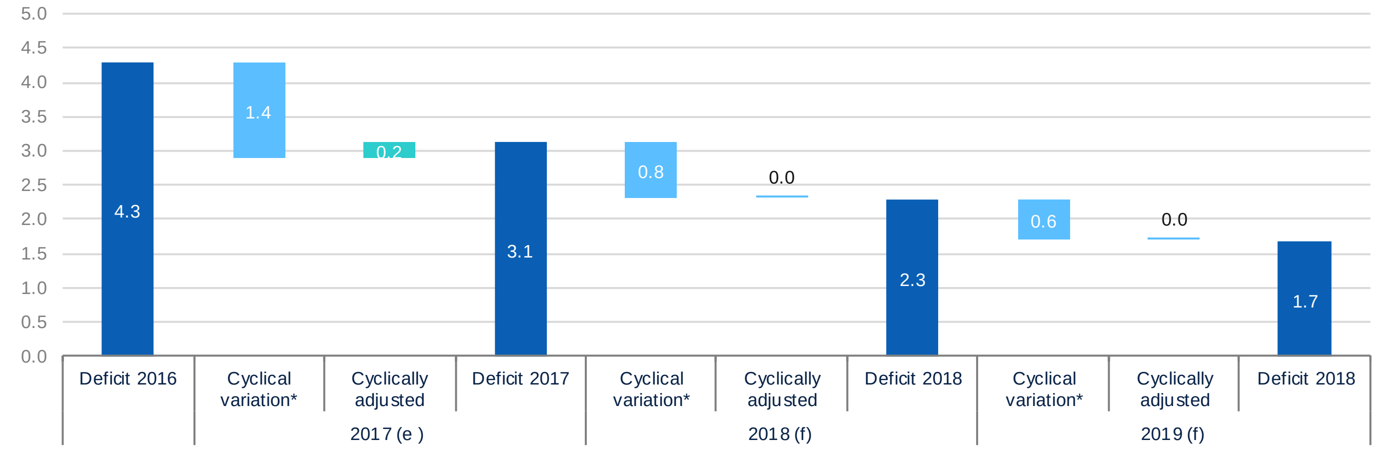
The cyclical recovery favours meeting the stability objectives forthe next biennium

The information available on the budgetary execution of all public administrations until September 2017 confirms the practically neutral stance of the fiscal policy, as was expected at the beginning of that year. Although an adjustment is estimated in the ratio of expenditure to GDP in 2017 (one percentage point below that observed in 2016), this adjustment would have originated in the improvement of the labour market – which reduces the amount of unemployment benefits - as well as in lower costs of financing, and with a rate of growth of the rest of public spending below that of nominal GDP. **On the revenue side, the impact of the measures adopted in the last quarter of 2016 was somewhat lower than expected**, although sufficient to facilitate closing 2017 with a deficit of around 3.1% of GDP, which represents a reduction of 1.2 pp of GDP, and the fulfilment of the budgetary stability objective.

Spain will exit the excessive deficit protocol in 2018

Throughout the 2018-2019 biennium, the economic cycle will continue to reduce the deficit, both due to the effect of automatic stabilisers and the reduction of social benefits, which will be accompanied by a lower interest burden. Thus, given the absence of new announcements of adjustment policy, **the deficit would be reduced only by the impact of the cycle, and would be around 2.4% of GDP in 2018 and 1.7% of GDP** in 2019, slightly above the stability targets required by the European Commission (see Figure 3.16).

Figure 3.16. Public administration: breakdown of fiscal adjustment, excluding bail-outs of financial institutions (% of GDP)



(e) estimate.
(1) Includes changes in interest charges.
(2) 2016: 0.6 pp structural deterioration + 1,0 pp expansive policies – 0.7 pp fiscal adjustment measures.
Source: BBVA Research based on Ministry of Finance and Public Administration and INE

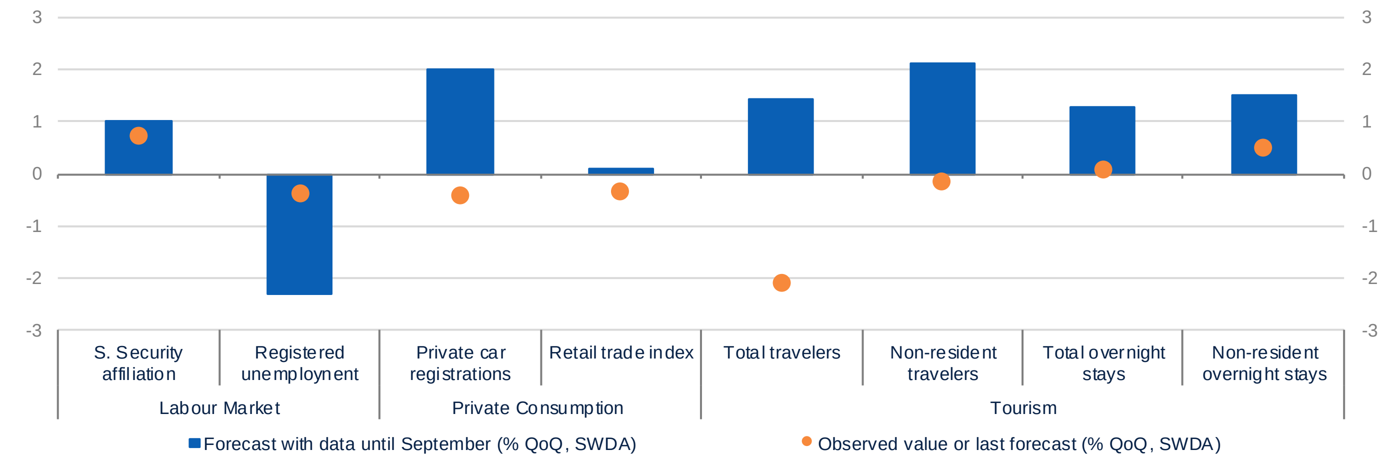
In this context, we estimate that the structural primary balance will have deteriorated by around 0.2 pp of GDP in 2017, while for 2018 and 2019 we foresee a stabilisation of the same around -0.1% of GDP. In this way the structural correction of the public accounts will help to approach the fulfilment of the deficit targets, but will remain far from the adjustment rate recommended by the Commission (0.5 pp a year) to significantly reduce the high level of public debt (an estimated 98.2% of GDP in 2017).

The risks to the scenario are still significant

Although the forecasts contemplated in this publication do not differ significantly from those presented three months ago, there are still some **risks**. On the external front there is still uncertainty regarding world trade, linked to future US trade policy and the UK's departure from the EU. In addition, the consequences of the difficulties in forming a government in Germany and of the upcoming elections in Italy remain an additional unknown in the external panorama.

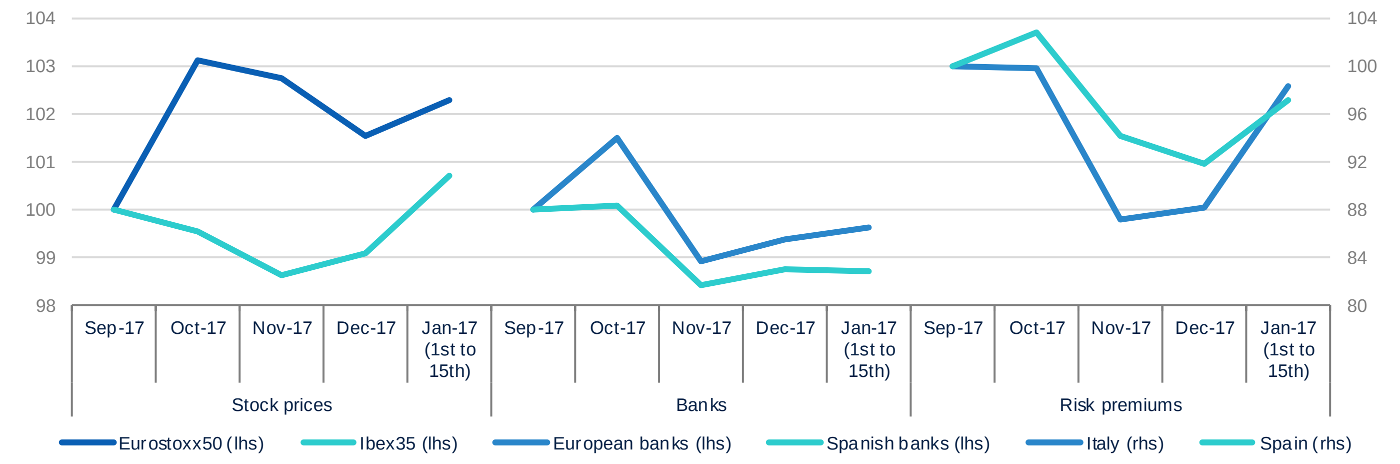
In the domestic environment, **economic policy uncertainty continues to be significant after the elections in Catalonia**, despite having moderated with respect to the historical maximum reached at the beginning of October. Although up to now the favourable trends for the whole Spanish economy have been maintained, there has been a somewhat worse evolution than that expected in some indicators of the labour market, consumption and tourism, especially in Catalonia (see Figure 3.17). In addition, the Spanish stock market aggregates and the risk premium show a worse performance than that observed in other neighbouring countries, which will probably be noticed in the real economy during the coming months (see Figure 3.18). Thus, BBVA Research estimates indicate that the economic policy uncertainty observed to date could subtract between 0.1 pp and 0.3 pp from GDP growth in 2018 and 2019 (between 0.3 pp and 1.0 pp for Catalonia) (See Figure 3.19)[15]. If the uncertainty does not dissipate favourably, or even worse, if it increases, it could have a more significant impact on the economic decisions taken by companies and households.

Figure 3.17 Catalonia: observed data and forecasts in a scenario in absence of economic policy uncertainty (%, QoQ SWDA)



Source: BBVA Research based on ANFAC, INE and the Ministry of the Economy and Social Security

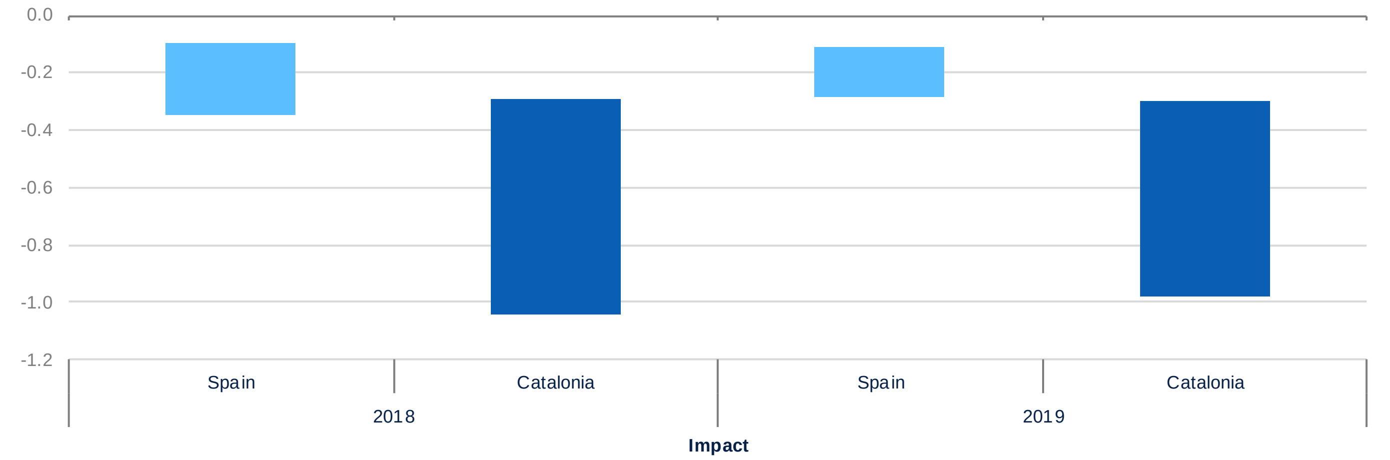
Figure 3.18 Financial indicators (Index sep-17=100, monthly averages)



Source: BBVA Research based on Bloomberg

15: For more details on estimating the effects of economic policy uncertainty on activity in the Spanish economy, see Box 1 of the Spain Economic Outlook for the first quarter of 2016, available at: https://goo.gl/qmjdML

Figure 3.19. Spain and Catalonia: estimated impact of economic policy uncertainty on GDP (deviation of annual growth in pp from base scenario)



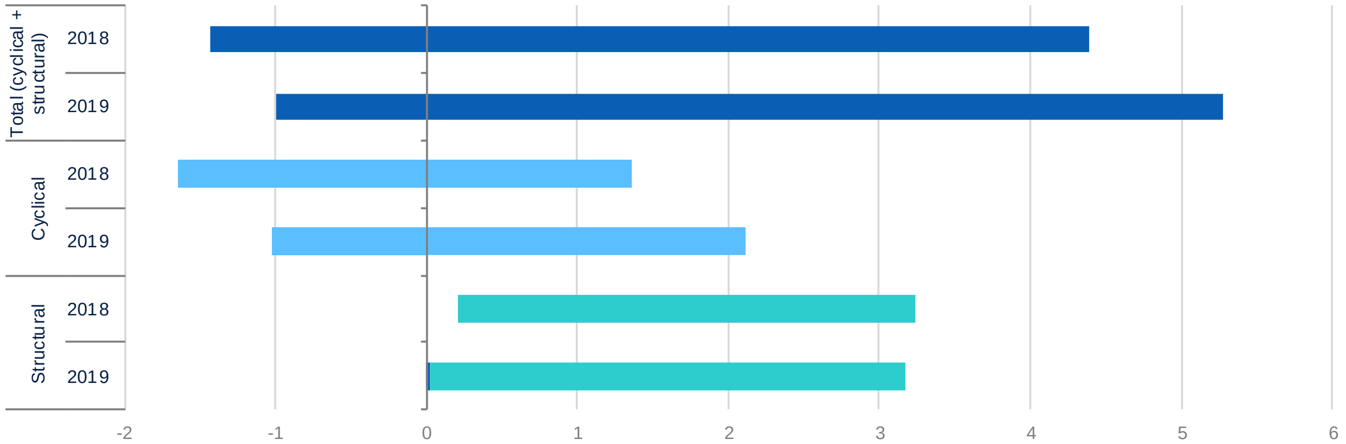
Source: BBVA Research

At the fiscal level, although Spain will come out of the excessive deficit protocol in 2018, important challenges will persist. In terms of public accounts, the risks are concentrated in the upward pressures on public spending derived from the upcoming municipal and regional elections in 2019, as well as in the specific disbursements made to rescue certain toll motorways[16]. Likewise, there is uncertainty about public revenues, given the current situation of budget extension and the significant deviations from the initial forecasts observed in recent years. On the other hand, the fulfilment of stability objectives and the surplus situation of local corporations opens up the possibility of a relaxation in the application of the spending rule. In the longer term, the challenges are focused on improving the efficiency of public spending, ensuring the sustainability of public accounts and undertaking a comprehensive reform of territorial financing.

On the other hand, **a depletion of the recovery in employment cannot be ruled out**, as a result of capacity constraints in some sectors or lack of skilled labour. So as cyclical unemployment is absorbed, that is, that the unemployment rate gets closer to its structural level, it is possible that a slowdown in the recovery of employment partially compensated by an increase in wages may be observed. The above could increase the inequality between those who have a job and those who don't. Given BBVA Research' forecasts of growth in GDP and employment, the increase in compensation per employee should not exceed 2% in the biennium so that the unemployment rate falls in line with the forecasts presented in this publication.

16: Currently there are judicial proceedings open on eight toll motorways that could result in a financial liability somewhere between the €3.7 billion estimated by the Court of Auditors and the €2 billion that the Government has included in the Budget Plan for 2018.

Figure 3.20 Spain: decomposition of the expected growth in remuneration per employee
(Confidence interval at 90% probability)



Estimates made based on the NAWRU, using the remuneration per employee of the Quarterly National Accounts.
Source: BBVA Research

In summary, the current environment brings with it a relevant opportunity cost for Spain, since it seems to be delaying the discussion on reforms that would help to reduce structural imbalances more quickly and/or prepare the economy to grow when external winds are not favourable. Going forward, it would be convenient to build the necessary consensus so that the legislative priority could concentrate on the consolidation of the recovery and the reduction of inequality. In particular, improvements in the functioning of the labour market, the pension system and regional financing are vital.

4. Tables

Table 4.1 Macroeconomic forecasts Gross domestic product

(Annual average %)	2015	2016	2017	2018 (f)	2019 (f)
United States	2.9	1.5	2.2	2.6	2.5
Euro zone	2.0	1.8	2.4	2.2	1.8
Germany	1.5	1.9	2.6	2.4	1.8
France	1.0	1.1	1.9	1.9	1.6
Italy	0.9	1.1	1.6	1.5	1.3
Spain	3.4	3.3	3.1	2.5	2.3
United Kingdom	2.3	1.9	1.4	1.2	1.4
Latin America*	-0.1	-1.0	1.1	1.7	2.5
Mexico	3.3	2.9	1.9	2.0	2.2
Brazil	-3.5	-3.4	1.0	2.1	3.0
Eagles**	4.8	5.2	5.4	5.4	5.5
Turkey	6.1	3.2	7.0	4.5	4.3
Asia and Pacific	5.6	5.6	5.6	5.5	5.5
Japan	1.4	0.9	1.4	1.0	1.2
China	6.9	6.7	6.7	6.3	6.0
Asia (ex. China)	4.6	4.7	4.6	4.7	5.0
World	3.4	3.3	3.7	3.8	3.8

* Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela.
** Saudi Arabia, Bangladesh, Brazil, China, the Philippines, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Russia, Thailand and Turkey.
Forecast closing date: 12 January 2018.
Source: BBVA Research and the IMF

Table 4.2 Macroeconomic Forecasts: 10-year government bond yield

(Annual average %)	2015	2016	2017	2018	2019
US	2.13	1.84	2.33	2.62	3.02
Germany	0.52	0.13	0.37	0.76	1.25

Forecast closing date: 12 January 2018.
Source: BBVA Research and the IMF

Table 4.3 Macroeconomic forecasts Exchange rates

(Annual average %)	2015	2016	2017	2018	2019
EUR-USD	0.90	0.90	0.89	0.83	0.81
USD-EUR	1.11	1.11	1.13	1.20	1.23
USD-GBP	1.53	1.35	1.29	1.34	1.44
JPY-USD	121.07	108.82	112.20	115.38	119.33
CNY-USD	6.23	6.64	6.76	6.69	7.07

Forecast closing date: 12 January 2018.
Source: BBVA Research and the IMF

Table 4.4 Macroeconomic forecasts: Official interest rates

(End of period, %)	2015	2016	2017	2018	2019
US	0.50	0.75	1.50	2.25	2.75
Euro zone	0.05	0.00	0.00	0.00	0.50
China	4.35	4.35	4.35	4.35	4.10

Forecast closing date: 03 November 2017.
Source: BBVA Research and the IMF

Table 4.5 EMU: macroeconomic forecasts (YoY change. %. Unless otherwise indicated)

(End of period, %)	2015	2016	2017(f)	2018 (f)	2019 (f)
Real GDP	2.0	1.8	2.4	2.2	1.8
Private consumption	1.8	2.0	1.8	1.7	1.6
Public consumption	1.3	1.7	1.1	1.2	1.1
Gross fixed capital formation	3.0	4.5	4.1	4.1	3.3
Inventories (*)	0.0	-0.1	0.1	0.0	0.0
Domestic demand (*)	1.9	2.3	2.2	2.1	1.8
Exports (goods and services)	6.1	3.3	4.7	3.7	3.6
Imports (goods and services)	6.5	4.7	4.6	3.9	4.1
External demand (*)	0.1	-0.5	0.2	0.1	0.0
Prices					
CPI	0.0	0.2	1.5	1.5	1.6
CPI Core	0.8	0.8	1.1	1.3	1.6
Labour market					
Employment	1.0	1.3	1.6	1.3	0.9
Unemployment rate (% of labour force)	10.9	10.0	9.1	8.3	7.9
Public sector					
Deficit balance (% GDP)	-2.1	-1.5	-1.1	-0.9	-0.8
Debt (% GDP)	89.9	88.9	86.5	83.6	81.0
External sector					
Current Account Balance (% GDP)	3.1	3.3	3.3	3.2	3.0

(f) forecast.
Forecast closing date: 12 January 2018.
Source: official organisations and BBVA Research

Table 4.6 Spain: macroeconomic forecasts (Annual rates of change in %, unless otherwise indicated)

(Annual average %)	2015	2016	2017	2018	2019
Activity					
Real GDP	3,4	3,3	3,1	2,5	2,3
Private consumption	3,0	2,9	2,5	2,2	1,9
Public consumption	2,1	0,8	1,2	1,8	1,9
Gross Fixed Capital Formation	6,5	3,3	5,0	3,7	4,4
Equipment and machinery	11,5	5,0	6,2	3,5	4,3
Construction	3,8	2,4	4,3	3,4	4,1
Housing	-1,0	4,4	7,6	5,3	5,7
Domestic Demand (contribution to growth)	3,9	2,5	2,6	2,4	2,3
Exports	4,2	4,8	5,1	4,4	5,2
Imports	5,9	2,7	3,9	4,4	5,8
External Demand (contribution to growth)	-0,4	0,7	0,5	0,2	0,0
GDP at current prices	4,1	3,6	4,1	4,2	4,4
(Billions of euros)	1080,0	1118,5	1164,9	1213,8	1266,7
GDP excluding housing	3,6	3,2	2,9	2,4	2,1
GDP excluding contruction	3,4	3,4	3,0	2,4	2,1
Labour market					
Employment, LFS (Labour Force Survey)	3,0	2,7	2,7	2,5	2,0
Unemployment rate (% Labour force)	22,1	19,6	17,1	15,3	14,0
Employment, full time equivalent	3,2	3,0	2,9	2,2	1,7
Productivity	0,3	0,3	0,3	0,3	0,6
Prices and costs					
CPI (annual average)	-0,5	-0,2	2,0	1,6	1,7
CPI (end of period)	0,0	1,0	1,5	1,2	1,9
GDP deflator	0,6	0,3	1,0	1,6	2,0
Compensation per employee	1,6	-0,3	0,0	1,6	2,4
Unit Labour Cost (ULC)	1,4	-0,6	-0,2	1,3	1,8
External sector					
Current Account Balance (% GDP)	1,1	1,9	1,8	1,9	1,7
Public sector (*)					
Debt (% GDP)	99,4	99,0	98,1	96,4	94,1
Deficit (% GDP) (*)	-5,2	-4,3	-3,1	-2,3	-1,7
Households					
Nominal disposable income	2,2	2,0	2,8	4,6	4,9
Savings rate (% nominal disposable income)	8,8	7,9	6,4	7,4	8,4

(p) projected.
Forecast closing date: 12 January 2018.
(*) Excluding aid to Spanish banks.
Source: BBVA Research

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5. Glossary

Initials

- APP: Asset Purchase Programme
- APR: Annual Percentage Rate
- AECB: Agreement for Employment and Collective Bargaining
- BBVA: Banco Bilbao Viscera Argent aria
- BBVA–EAE: BBVA Economic Activity Survey
- BBVA–GAIN: BBVA's overall index of economic activity
- CC.OO: The Comisiones Obreras trade union
- CEOE: Confederación Española de Organizaciones Empresariales (“Spanish Confederation of Employers' Organisations”)
- CEPYME: Confederación Española de la Pequeña y Mediana Empresa (“Spanish Confederation of SMEs”)
- CG: Governing Council
- CPI: Consumer Price Index
- EAGLES: Emerging and Growth-Leading Economies
- ECB: European Central Bank
- EU: European Union
- E(FTE) Employment (full-time equivalent)
- EMU: Economic and Monetary Union
- Euríbor: Euro Interbank Offered Rate
- FED: US Federal Reserve System
- GDP Gross domestic product
- JPY: Japanese Yen LATAM Latin American countries. Includes Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
- LFS Labour Force Survey
- ME&SS Ministry of Employment and Social Security
- MICA-BBVA: BBVA Coinciding Activity Indicators Model
- MFPA Ministry of Finance and Public Administration
- NFCE: National Final Consumption Expenditure
- PPAA Public Administrations
- QE: Quantitative easing
- QNA: Quarterly National Accounts
- RDL: Royal decree-law
- SCA Seasonally and calendar-adjusted data
- SME: Small and medium enterprise
- SMI: Salario mínimo interprofesional (legal minimum wage)
- Stability and Growth Program (PEC)
- UGT: The Unión General de Trabajadores trade unión
- U.S.: United States of America
- USD: United States DollarUSD: United States Dollar

Abbreviations

- YoY: Year on Year
- CI: Confidence Interval
- Bn: billions
- bps: basis points
- MP: Market price
- pp: Percentage points
- QoQ: Quarter on Quarter

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