
BBVA Research

# Spain Economic Outlook

## Fourth quarter 2018

Spain & Portugal Unit

Creating Opportunities

# Index



Closing date: **11 October 2018**

# 1. Editorial

**GDP growth expectations in Spain have been revised downwards to 2.6% in 2018 and 2.4% in 2019 (0.3pp and 0.1pp less, respectively, than our forecast three months ago), due to the fact that economic activity did not advance as much as was estimated during the first half of the year.** Of particular importance in explaining the slowdown is the fall in the growth of both exports and private consumption. Regarding exports, some factors that have negatively affected their evolution could be reversed during the second half of the year. However, others that have had an impact on household spending or tourism could be maintained. Going forward, growth is expected to remain strong, albeit below the average of the last three years, due to the expected recovery in external demand, the possible reversal of the upward trend in the price of oil and the impact of monetary and fiscal policy. In any case, risks remain numerous and the uncertainty about the way they come to fruition could be sufficient to slow down growth over the next few months below our forecasts.

**As mentioned above, GDP growth in the first half of 2018 was lower than estimated.** The recent National Institute of Statistics (INE) review of data from the Spain's national accounts showed that during the first quarter of the year, GDP growth would have been 0.1% lower than initially published (0.7% compared to 0.8%). In addition, despite strong growth in employment, the increase in GDP in the second quarter of 2018 was 0.2% below BBVA Research's estimate (0.6% vs. 0.8%). This fully explains the downward revision in the expected growth for the annual average from 2.9% to 2.6% YoY. The slowdown stems from a somewhat smaller increase in private consumption and exports of goods and, more recently, of tourism-related services. In contrast, investment, whether in construction or in machinery and equipment, remains relatively high.

**During Q3, there may have been an upturn in the GDP growth up to 0.7% QoQ.** This would be a consequence of the recovery in consumer spending, both public and private, after the stagnation recorded between April and June. Although exports of goods are expected to accelerate, this could be offset by the fall in tourism flows. Finally, the contribution of investment to growth might temporarily slow down, given the notable increases during the first part of the year.

**Going forward, growth is expected to remain relatively high at more than half a point above that of the rest of the EMU.** Exports of goods could therefore show an acceleration given the continued recovery in Spain's main trading partners, the recent depreciation of the euro against the dollar, expectations of a partial reversal in the current trend in the price of oil, the absence of inflationary pressures at a domestic level and the excellent performance of investment in machinery and equipment. Furthermore, monetary policy will continue to be expansive and low interest rates will continue to encourage the growth of credit demand. This may be particularly favourable for the recovery of the labour-intensive residential segment of the construction sector, in which the contribution to job creation should increase. Finally, fiscal policy has become expansive. This can already be seen in the increase in public investment and may be consolidated over the coming months as the stimuli approved in the Spanish National Budget for 2018 take effect.

**In any case, the consolidation of an environment of lower growth of the Spanish economy compared to past years is expected.** This is firstly due to the fact that the tendency toward moderation in private consumption will continue over time. In particular, pent-up demand appears to have been exhausted. Over the last two years, household spending has grown faster than its fundamentals, with its pace exceeding the recovery of variables such as disposable income and wealth, both financial and real estate, and the savings rate. Much of the purchase of (durable) goods in recent years has therefore been the result of postponing spending during the recession and its subsequent realization once the uncertainty decreased.

**Secondly, there are growing doubts concerning the sustainability of tourism's contribution to job creation.** There are several factors that may explain the slowdown in tourism flows. While some are of a temporary nature, others point that the sector that may reduce its contribution to economic recovery in the near future. For example, companies have lost price competitiveness in recent years. This is firstly a consequence of the capacity restrictions that have been generated in some destinations and the resulting price increase. Secondly, it is the result of the appreciation of the euro against the US dollar as seen in the second half of last year. Meanwhile, negative externalities produced by the expansion of the sector have led to an increase in regulation that might have contributed to its deceleration. Likewise, the growth of domestic demand in the main countries of origin of tourists visiting Spain has lost impetus. Finally, the terrorist attacks last year in Catalonia, together with the improvement in the perception of security in alternative destinations, may also help to explain the weakening of the sector. Some of these factors have already reversed, such as the appreciation of the exchange rate, or are expected to do so in the coming quarters, such as the rise in oil prices. Moreover companies will take measures, for example, by concentrating on segments with higher value added. In any case, it is expected that the trend of redirecting tourists to other destinations will continue and have a negative impact on sector margins, investment and the capacity to create employment.

**Thirdly, the price of oil has risen considerably compared with the levels observed a couple of years ago.** The first response of exporting companies seems to have been to absorb the increase in transport costs into margins, without transferring the increase in the value of inputs to their customers. This does not seem to have significantly affected investment or job creation. In any case, this could be temporary, even if there are additional price increases.

**Finally, uncertainty about economic policy remains high, both in Spain and worldwide.** The increase in trade conflicts between some of the world’s major economies puts globalization at risk as a mechanism for generating wealth, and could already be having negative effects on investment and growth. The likelihood of no deal being reached on the United Kingdom’s exit from the European Union is also increasing. Moreover, there is the proposal by the Italian Government to exceed the deficit targets previously set for the coming years, which may lead to a confrontation with European institutions and an increase in peripheral risk premiums. Meanwhile, the US Federal Reserve continues to raise the dollar benchmark interest rate, which has led to a restructuring of investment portfolios and greater volatility in flows to emerging markets, some of which have compounded their reaction with economic policy errors. In such a context, negative impact seems to be limited to countries to which Spain has reduced exposure in terms of trade. However, the risk of a scenario with contagion from other markets remains.

**In Spain, uncertainty regarding the measures that will be implemented over the next few years needs to be countered given the slowdown shown by the economy, the high imbalances that persist, and an increasingly vulnerable foreign environment.** If the forecasts in this report are fulfilled, the public deficit will fall to 2.2% of GDP by the end of 2019 in a scenario without changes in economic policy and therefore without the introduction of new fiscal measures. This means that to reduce it to levels between 1.3% and 1.8% (which are the stability objectives under discussion), additional adjustment measures will need to be approved beyond those under consideration in order to offset any increase in spending that might arise. In addition, it would be desirable that the reduction of the public deficit is made minimizing the impact on economic activity – assessing expenditure, identifying and eliminating the one that is inefficient, and providing certainty regarding long-term sustainability. In this regard, it would be important to avoid the implementation of measures that aggravate the imbalance in the pension system and postpone its resolution. If it is decided to increase the tax burden, it should be done following strict efficiency criteria, that is, with higher indirect taxation, promoting savings and stable flows of financing, and making sure that the competitiveness of companies is not affected, under the risk of reducing business investment, innovation, job creation or productivity growth. Finally, one of the best ways to promote inclusive growth, with wages increases based on productivity, is through ambitious labor market reforms that reduce the rate of structural unemployment and temporary employment, and continue to advance in the determination of the remunerations of workers according to the situation of the company, in an environment of greater competition in the product markets.

# 2. Global environment: Growth moderates slightly and risks intensify

**The world economy continues to show positive signs, albeit within a context of increasing uncertainty. The inertia of growth has continued in the past three months**, prolonged by the effect of the fiscal stimulus in the US and certain stability in the Chinese and European economies. Nevertheless, **the protectionist escalation between US and China has intensified,** while the appreciation of the dollar has been reflected in an increase in financial tension in emerging economies, albeit with a clear differentiation between countries, resulting in a significant adjustment in those that are the most vulnerable, such as Turkey and Argentina. In such a context, both the **Federal Reserve and the European Central Bank are making progress towards a normalisation of monetary policy,** representing a gradual tightening of monetary conditions that will continue to put pressure on emerging economies over the coming quarters. In spite of this, it does not seem that we are facing a systemic crisis in these countries. Given the overall scenario of relative continuity coupled with a slight slowdown in 2019, the main risk in the short term is still that of protectionism.

## Slight slowdown in global growth in the second half of 2018 and less synchronisation

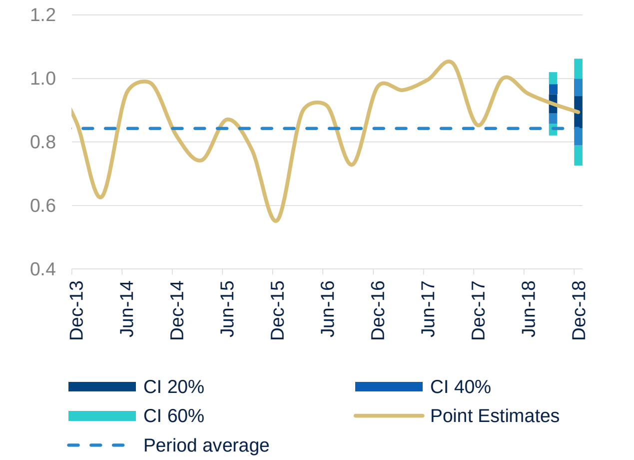
Data available up to September suggests that **overall growth slowed slightly in the third quarter of the year** (BBVA-GAIN: 0.9% for the quarter compared to 1% in 2Q18 – see Figure 2.1) with **greater differences between the regions**. The strength of the US economy contrasts with the moderation recorded in China and the Eurozone and, above all, with the significant adjustments observed in the most vulnerable emerging economies due to the increase in financial tensions.

**Growth in the industrial sector is moderate** and still does not recover from its poor performance at the start of the year. This behaviour seems **to reflect the worsening of the outlook on domestic demand in emerging countries rather than the solid advance of global trade until August**. Nonetheless, it is still too soon for trade figures to reflect the possible negative effects of the escalation of protectionism in the US and China. On the contrary, both of these economies may have been favoured by the bringing forward of certain trade exchange in the face of the threat of new tariff increases.

**Confidence indicators up to August also point to a gradual slowdown in world growth, although they continue at high levels.** The loss of confidence in the manufacturing sector is due to a worsening of employment expectations and export orders, affected by the uncertainty concerning trade relations and the need for some emerging economies to reduce their external deficit levels. The prospects of the service sector have also fallen, although they remain above the historical average, partly bolstered by strong domestic demand in developed economies. In particular, retail sales suggest that the trend toward lower household spending in recent months has come to a halt, meaning that **consumer spending will probably continue to support global growth.**

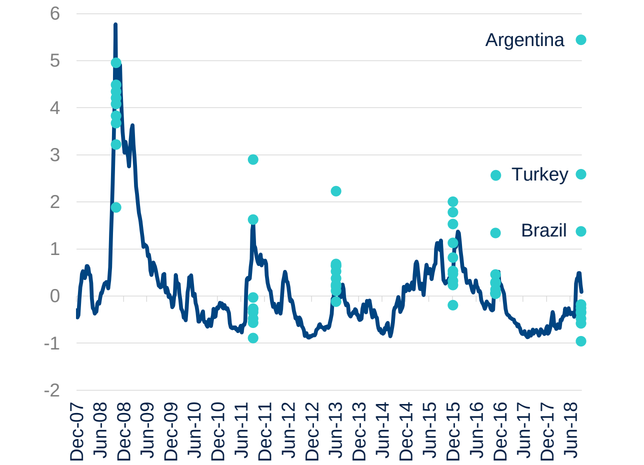
**The evolution of the prices of raw materials has slowed inflation after the upturn recorded in the first half of the year.** Meanwhile, core inflation remains contained, although is expected to gradually raise as a consequence of robust domestic demand in advanced economies and the impact of currency depreciations on prices in emerging economies.

Figure 2.1 World GDP growth (QoQ, %)




Source: BBVA Research

Figure 2.2 BBVA index of financial tension in emerging economies (normalised index)




Source: BBVA Research

## The normalisation of monetary policy and increased uncertainty will continue to put pressure on emerging economies

In spite of the confirmation of signs of a slowdown in the world economy over the past three months, **global inertia is still positive, especially in developed economies, and strengths the normalisation process underway in leading central banks in the coming quarters**, something which will continue to affect financial conditions in emerging markets. The feeling of risk aversion among investors has lingered, **particularly affecting the most vulnerable emerging countries**, namely those with the greater needs for external financing and high indebtedness in foreign currency (see Figure 2.2).

In such a context, the repercussions faced by **Argentina and Turkey** are especially noteworthy. Their currencies have fallen by 30% and 24% respectively over the past three months, while their risk premium has increased. However, **financial tension eased on the adoption of monetary and fiscal measures**. Elsewhere, trade disputes continue, albeit with somewhat limited effect to date, helped by the fact that **China's currency has stabilised, halting growth deceleration** through economic policy incentives.

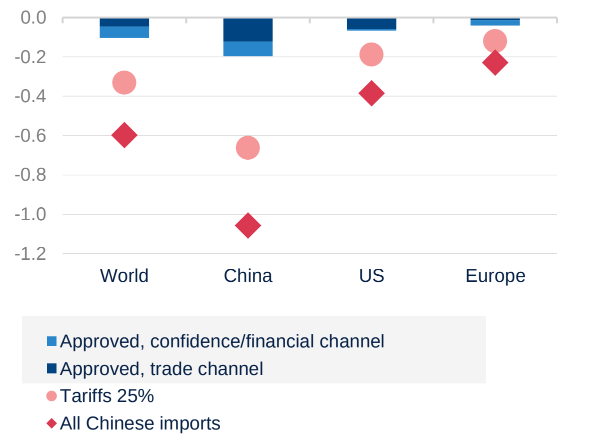
Europe was the other center of attention, for two reasons. Firstly, **risk tied to Italy increased** over the summer, and, above all, after the government's fiscal proposals (deviating from the path set by the European Commission), with the subsequent widening of the Italian risk premium to above the 300 bp barrier. However, with a very limited contagion to other peripheral countries. Secondly, the deadlock in Brexit negotiations has increased the probability of the UK leaving the EU without a deal in place.

The **increased tension stemming from global credit conditions will very probably continue in the forecasting horizon**. On one hand, **the Fed is set to continue the normalisation of its monetary policy**. Having raised its intervention rate 75 bp so far this year (it currently stands at 2.25%), an **additional increase of 25 bp to 2.5% is expected by the end of the year and to 3.25% by late 2019**. On the other hand, the **ECB has begun its exit strategy (see below). In addition to this, appreciation pressure on the dollar against other main currencies** remains, driven by capital flight flows to quality and a favourable increased rate differential.

**Uncertainty over the escalation of protectionism remains high. Despite the fact that trade tensions between the US and some regions have relaxed for now**, the agreement with Mexico and Canada is yet to be ratified. Negotiations about the automotive sector with Europe will also begin after the US mid-term elections in November. **We have also seen the implementation of the first protectionist threats made by the US to China**, with the respective countermeasures announced by the latter. The US has passed a bill to raise tariffs by up to 10% on Chinese imports representing an increase of 200 billion dollars, in addition to the 50 billion dollars on imports levied at 25%. China has reacted by raising its tariffs on US imports by 10%, an increase of $60 billion, in addition to the 25% tariff on products, a total of $50 billion. **The impact that these measures will have on gross domestic product,** along with those already approved on steel and aluminum imports, through the trade channel **is limited** (around 0.1% of China's GDP). However, to this direct impact we have to add other **indirect effects as a consequence of the loss of confidence experienced by economic agents and the repercussions that these measures will have on financial markets** which will be mainly borne by China and other emerging economies and which may result in a further 0.1% decrease in growth (see Figure 2.3).

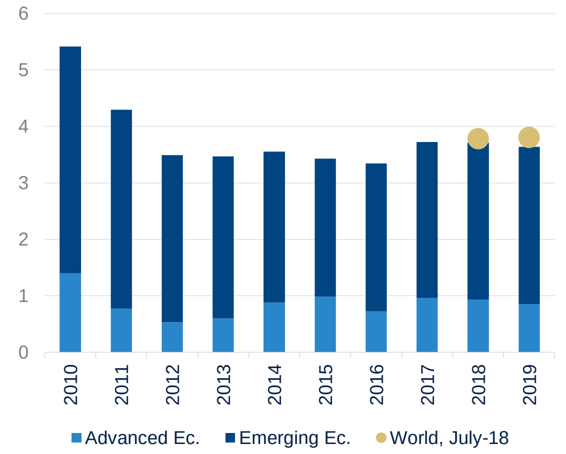
Negotiations with China will probably restart toward the end of the year. If America's demands are not met (above all in matters relating to intellectual property), the **10% tariff passed in September may increase to 25% from January 2019 onward**. In this scenario, and assuming that China reacts in kind, **the impact on growth will be more significant**. As shown in Figure 2.3, the tariff increase may result in a 0.7% and 0.2% falls in the growth of the Chinese and US economies respectively, which would imply a 0.3% fall of the world GDP growth rate and around a 0.1% fall for Europe. Although the Chinese authorities are prepared to apply policies in support of growth, a trade war that will affect all their trade agreements could derail economic recovery worldwide.

Figure Effect on GDP growth due to US tariff increases and the response of other countries (2018-2020, %)




Source: BBVA Research

Figure 2.4 Forecast world GDP growth (YoY, %)




Source: BBVA Research

## The ECB reaffirms its exit strategy and does not anticipate any rate increase before the second half of 2019

As expected, at the two meetings which took place over the summer, the ECB confirmed that the asset purchase program or APP will **end in December** of this year, given the progress that has been made toward a sustained adjustment of inflation, while **maintaining the anchoring of interest rate expectations intact.**

The ECB made it clear that the bond purchase program will remain in place until the end of the year at a monthly rate of 15 billion euros from October to December, when net asset purchasing will cease. With regard to interest rates, the Bank is maintaining the benchmark rate at 0% and the deposit rate at -0.4% and it repeated that benchmark rates will remain unchanged until at least the summer of 2019. Within such a context and without any changes to the future course of monetary policy, BBVA Research forecasts **regarding the interest rates remain unchanged, with the first increase in the deposit rate to come in September 2019 (+15bp) and to the official benchmark rate (+25pb) the following December.**

With the end of asset purchase program in sight, **the focus in the coming months will be on how the reinvestment of the principal of the securities acquired through the asset purchase program will be implemented as they mature, and when and at what pace interest rates will rise**. Until now, the ECB seems to be satisfied with market expectations, which have ruled out an initial rate rise in October 2019, and it doesn't appear to be on any rush to change direction, although the first few months of next year may provide us with further clues.

## The downward revision of growth in emerging economies explains the expected moderation of global growth

**Global growth forecasts for both 2018 and 2019 have been revised downward by around 0.1% to 3.7% and 3.6% respectively** (see Figure 2.4), as the slight moderation expected over the course of the second half of the year is consolidated as we move forward. This slowdown in global activity is **mainly due to the slower-than-forecast growth in emerging economies,** especially those with greater vulnerabilities in a context of tightening financial conditions globally.

**In the US, the increase in consumption and the soundness of investment will bolster growth by 2.8% in 2018 and 2019.** The strength of private consumption is backed by a dynamic employment market and higher wage growth, resulting in greater household optimism. Investment is still benefitting from favourable financial conditions and higher oil prices. Nonetheless, the acceleration of the economy in the second half of the year would appear to be transitory after the boost it received from foreign trade, meaning that a certain moderation can be expected in coming quarters due to the appreciation of the dollar. In this context, the strength of a domestic demand partly driven by a more expansive fiscal policy and the upturn in oil prices has led to higher inflation through the year, although the core rate has remained stable at around 2%.

**In China, the authorities are implementing more accommodative policies in order to try to halt the slowdown in domestic demand and counteract the rise in protectionism.** The good performance of the economy in the first half of the year means we should slightly adjust GDP expectations upwards by 0.2% to 6.5% for 2018, maintaining the 2019 forecast at 6%. As far as fiscal matters are concerned, personal and company tax cuts are being introduced, favouring an expansion of the investment in infrastructures. With regard to monetary policy, the key measures are aimed at encouraging banks to extend credit to small- and medium-sized companies as well as stabilising exchange rates.

**In the Eurozone, strong domestic demand and flexible policies might offset the increased uncertainty and slowdown in global demand.** After the slowdown recorded in Q1, growth appears to have stabilised over the year so far, leading us to **maintain our GDP growth forecasts at 2% for 2018 and 1.7% for 2019. We expect to see** greater support for private consumption on the back of a stronger employment market, as well as for investment, boosted by favourable financial conditions and the absorption of idle capacity. The depreciation of the euro over the second half of this year, together with more buoyant world trade, will continue to bolster exports, although this will not prevent a drop in foreign demand due to strong import-related investment. The uptick in inflation is a response to notably higher energy prices, and should therefore moderate in the coming months if oil prices maintain their current levels, while core inflation will only increase gradually, especially in 2019.

## Protectionism and the Fed's exit strategy, the main risks on the forecasting horizon. Political uncertainty in Europe to become increasingly important

**The global scenario continues to be threatened by downside risks. Firstly, the risk of a trade war shows no sign of abating and may even increase after the US mid-term elections in November, especially with China, although negotiations between the EU and Japan are also set to reopen.** While the direct impact of the new measures will be limited, the risk of a trade war **could act as a drag on confidence, increasing risk aversion in the markets and curbing global flows of direct investment,** with the consequent impact on global growth potential. In addition, **escalating oil prices** due to sanctions on Iran also represents a risk to bear in mind as a result of its potential asymmetric impact on different countries.

Secondly, in a more volatile financial context, **the increase in financial tensions in emerging economies may worsen,** especially in the most vulnerable countries, **having a magnifying effect on global risk.** The combination of greater protectionism, a faster normalisation of the US monetary policy and a possible slowdown in the world economy could trigger the perception of risk in emerging financial markets, increasing the probability of capital flow coming to a standstill. In this context, the possibility of a sudden adjustment of the Chinese economy remains, as some of the measures to respond to a slowdown in demand and the effects of protectionist measures imposed by the US might limit or delay the process of deleveraging and restructuring of its economy.

Finally, **political risks in Europe have also intensified.** In Italy, the forecast deficit increase may heighten concern regarding the sustainability of the country's public accounts, pushing its risk premium even higher and leading to a potential resurgence of financial tension in other bond markets. Finally, we cannot rule out a possible UK exit from the EU without a deal.

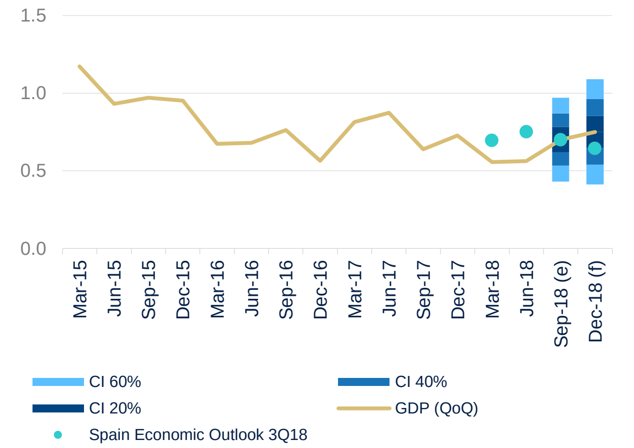
# 3. Growth outlook for the Spanish economy

## Activity continues to advance, although uncertainty regarding the pace of growth increases

The information available at the time of writing this report indicates that **the Spanish economy grew 0.7% QoQ SWDA[1] in 1Q18 (forecast using the MICA-BBVA model[2])**. If this estimate is confirmed, the increase in activity between July and September will again be in the lower bound of the forecasting range presented at the beginning of the quarter (MICA-BBVA: between 0.7% and 0.9% QoQ).

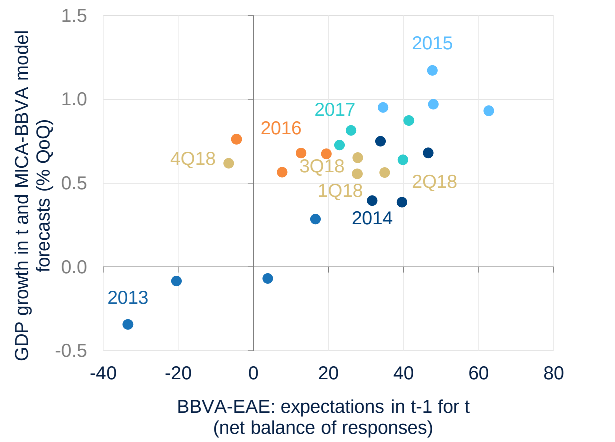
Looking **to the fourth quarter, BBVA Research estimates suggest that the improvement in activity could be maintained** (forecast of the MICA-BBVA model: between 0.7% and 0.9% QoQ, see Figure 3.1). However, uncertainty about the pace of progress has increased, as evidenced by the less favourable view that is drawn from the results of the BBVA Economic Activity Survey (EAE-BBVA).[3] (see Figure 3.2).

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




(e) Estimate; (f) Forecast.
Source: BBVA Research based on INE (Spanish Office of National Statistics) data

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




Source: BBVA

1: SWDA: Seasonally and working day-adjusted data.
2: For more details on the MICA-BBVA model, see Camacho, M. and R. Doménech (2010): "MICA-BBVA: A Factor Model of Economic and Financial Indicators for Short-Term GDP Forecasting" BBVA WP 10/21, available at: https://bit.ly/2OTgtI1
3: For details on the BBVA Economic Activity Survey (EAE-BBVA), see Box 1 of the Spain Economic Outlook journal for the second quarter of 2014, available at: https://bit.ly/2pKEh31

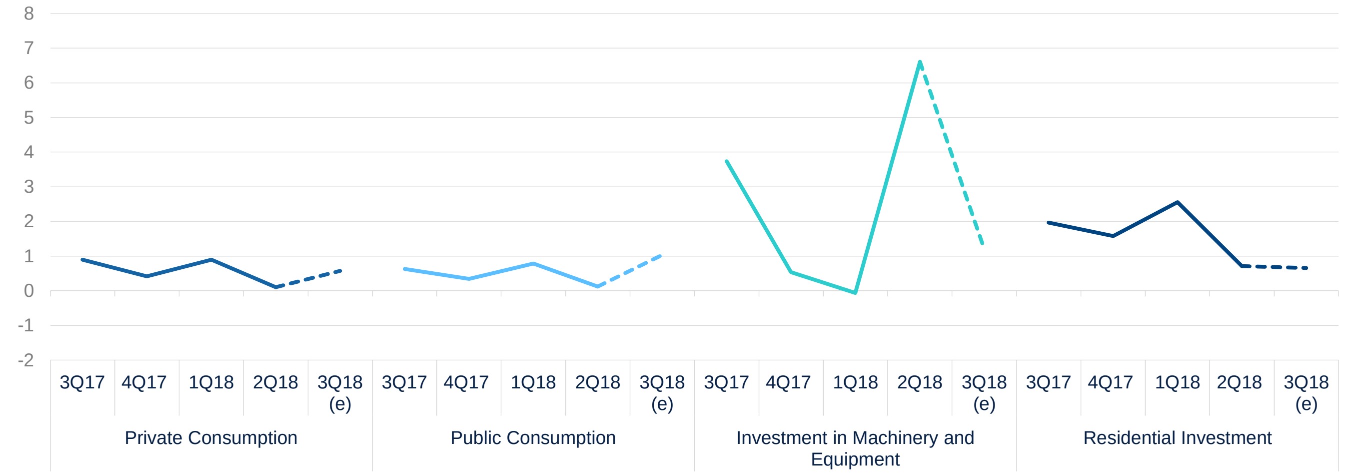
## Domestic demand remains at the forefront of economic growth

**Consumption, both private and public, is recovering part of the dynamism lost in 2Q18.** Thus, the signs extracted from the expenditure[4] indicators suggest that household consumption may have increased by around 0.6% QoQ (2.0% YoY) in 3Q18, after the practical stagnation observed in the previous quarter (0.1% QoQ). Similarly, the data available on budgetary execution show that the final consumption of public administrations may have rebounded by 1.0% QoQ (2.3% YoY), 0.9 pp more than in 2Q18.

Regarding **investment in machinery and equipment, it is estimated that growth will have remained at healthy levels during 3Q18**. The partial indicators[5] suggest that, despite the volatility of the series in the last biennium, this demand item could rise by 1.2% QoQ (8.4% YoY), around 1 pp below the average growth observed since the beginning of 2017. On the other hand, the **recovery path in residential investment continues**. Thus, the data known to date[6] indicate that the progress of investment in housing would have remained around 0.7% QoQ (5.6% YoY) in 3Q18. Finally, it is estimated that the increase in investment in other buildings and structures will have slowed down to 0.6% QoQ (6.0% YoY) after the exceptional figure recorded in 2Q18 (3.9% QoQ; 6.9% YoY).

In summary, **BBVA Research estimates that domestic demand remains at the forefront of the growth of the Spanish economy in the short term** (estimated contribution of 0.7 pp of quarterly GDP growth), thanks to the generalised progress of its components (Figure 3.3).

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




(e): Estimate.
Source: BBVA Research based on INE (Spanish Office of National Statistics) data

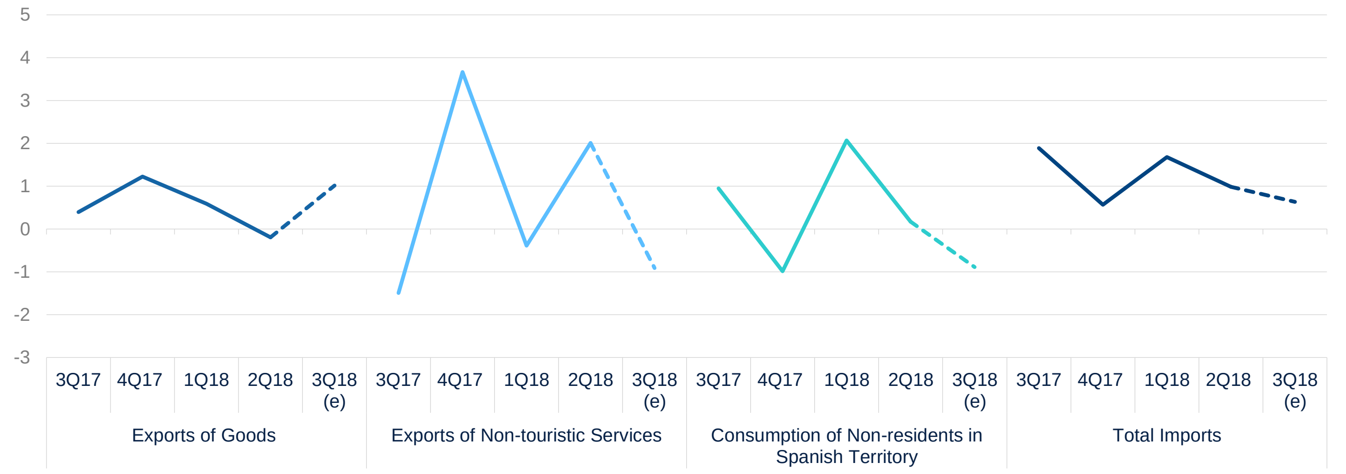
4: These indicators are again showing mixed signals. On the one hand, there has been an acceleration of passenger car registrations (despite the stagnation of the private channel), sales by large companies and new consumer financing. Additionally, the confidence of households and the activity of the service sector are still at high levels. On the other hand, the trend in share prices was negative and a slowdown in wage income is expected as well as a marginal decline in retail sales.
5: The indicators show an acceleration in sales of commercial vehicles and a slight progress in the IPI of capital goods. In contrast, the imports of capital goods, the industrial confidence and the order books of capital goods are all stagnating.
6: The Social Security registration in construction grew during 3Q18 by a monthly average of 0.6%, three times the overall rate. For their part, the July data on building permits show an increase of 5.2% MoM SWDA.

## More exports of goods, but less of services

**In the third quarter, total exports could have increased slightly** (0.4% QoQ; 2.6% YoY, see Figure 3.4). On the one hand, it is estimated that, with a growth of 1.0% QoQ (2.2% YoY), sales of goods abroad would have regained some traction after the sluggishness observed during the first half of the year (0.2% QoQ on average)[7]. On the other hand, exports of services could have been corrected downwards (-0.9% QoQ, 2.6% YoY), after the moderate growth recorded in the previous quarter (1.2% QoQ; 3.1% YoY). In particular, it is estimated that both consumption of non-residents (-0.9% QoQ; 0.3% YoY)[8] and exports of non-tourist services will have fallen (-0.9% QoQ). While part of the depletion of foreign sales is due to temporary changes, such as the increase in the oil price, weak European demand, or the appreciation of the real effective exchange rate, in the case of tourism it may be due to more permanent factors, such as the recovery of some competing markets.

Given the composition of the increase in final demand, **imports would probably have returned to grow above exports** during the third quarter of the year (0.7% QoQ, 4.0% YoY). Thus, it is estimated **net external demand would have had three consecutive quarters with a negative contribution to growth (-0.1 pp QoQ; -0.3 pp YoY).**

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




(e) Estimate.
Source: BBVA Research based on INE (Spanish Office of National Statistics) data

## The labour market recovery loses momentum

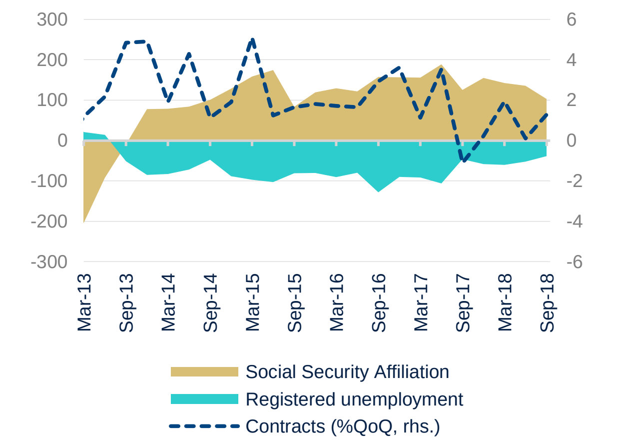
After discounting seasonal variations, **Social Security affiliations increased by 0.6% QoQ in the third quarter of 2018, 0.1 pp less than in the second quarter** (see Figure 3.5). The decline in registered unemployment, which was widespread across sectors, also slowed down between July and September. Thus, the number of unemployed decreased by -1.2% QoQ SWDA, 0.4 pp less than in the previous quarter. Since mid-2013, Social Security registration has grown by 16.2% SWDA, but is still 2.9% below the pre-crisis peak reached in early 2008. Although unemployment has fallen by 33.7% in the last five years, it is still 63.8% higher than in mid-2007.

7: After the consolidation of levels in July (0.0% MoM SWDA), the information available on the balance of trade points to a slight recovery in exports of goods in the third quarter mainly due to the behaviour of sales of intermediate goods. Exports from large industrial companies also anticipate an upturn in foreign sales.
8: With information up to August, partial tourism indicators show a decline in 3Q18. Overnight hotel stays by non-resident tourists fell by 1.8% QoQ SWDA. However, visitor border arrivals grew by only 0.7% and tourist spending by 1.4%, more than 1 pp below the 2Q18 figures in both cases.

**The sluggishness of job creation contrasts with the dynamism of hiring.** After stagnating in 2Q18 (0.1% QoQ SWDA), the number of contracts rebounded to 1.3% QoQ SWDA between July and September. Although fixed-term contracts advanced five tenths (1.4% a/a), open-ended advanced 8.3% QoQ SWDA (25.8% YoY), and therefore the temporality ratio continued to decrease down to 88.9% SWDA. Since the end of 2013, the percentage of fixed-term contracts has fallen by 4 pp, as shown in Figure 3.6.

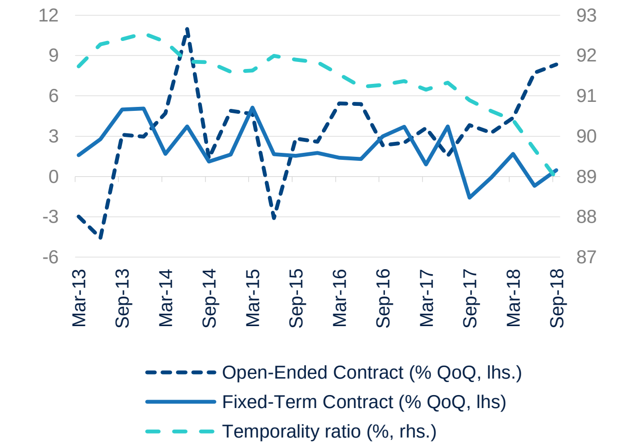
**The Labor Force Survey (LFS) for the third quarter is expected to confirm the trend marked by Social Security registration and unemployment figures.** BBVA Research estimates suggest that employment would have increased between 0.5 pp and 0.6 pp in the third quarter in seasonally adjusted terms (2.5% YoY), almost half that in the second quarter. If the active population barely grows, as it is expected, job creation will translate into a decrease of 0.4 pp in the unemployment rate, down to 15.0% SWDA (14.5% in gross terms).

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




Source: BBVA Research based on Ministry of Labour, Migration and Social Security data

Figure 3.6 Spain: trend in recruitment
(SWDA data)




Source: BBVA Research based on Ministry of Labour, Migration and Social Security data

## Prices and wages are increasing, but still in a restrained manner

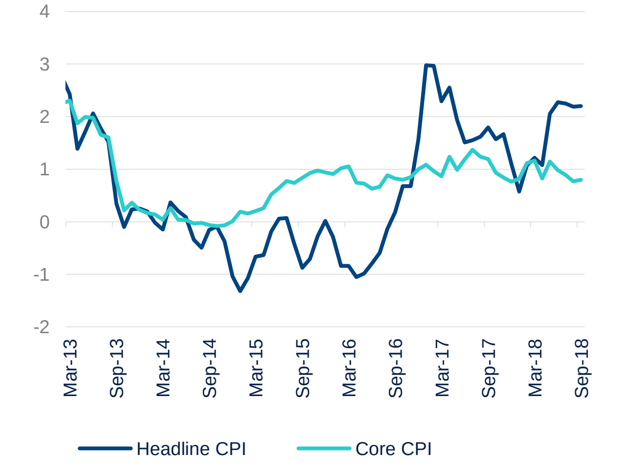
**After the upturn in the first half of the year, headline inflation remained stable at around 2.3% YoY between July and September.** Energy inflation was consolidated at levels close to 12% YoY, following the increase observed in the two previous quarters caused by the rise in oil prices. Furthermore, core inflation increased gradually and closed the month of September at 0.8% YoY (see Figure 3.7). Even so, BBVA Research estimates indicate that the **inflation differential with respect to the Eurozone remains practically closed**, both in terms of headline and core inflation.

**Wage demands have also marginally rebounded during the third quarter.** The average wage growth agreed in collective bargaining agreements up to August was close to 1.6%, one tenth more than that registered at the end of 2Q18. In line with what happened in 2017, the agreed increase in remuneration in the revised multiyear agreements (1.5%) was lower than the increase in those signed during the current year (2.0%), which affect 1,785,000 workers[9]. As can be seen in Figure 3.8, the average agreed wage increase in the agreements signed up

9: The number of workers subject to a collective bargaining agreement exceeded 7.5 million up to August when those affected by the agreements signed before 2018 (5,742,000) were incorporated, 31.3% higher than the figure registered until August 2017.

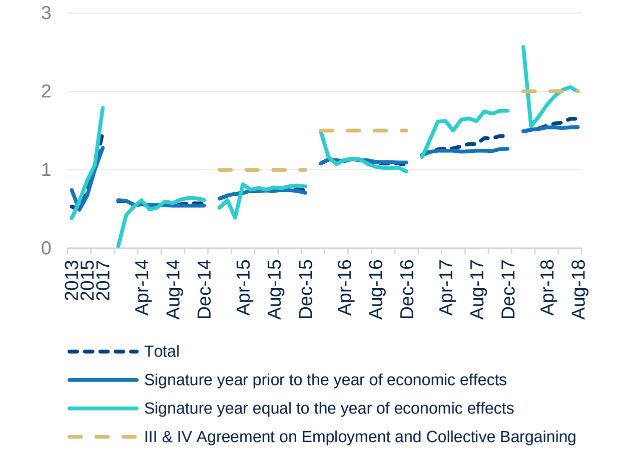
to August coincides with that recommended in the 4th Agreement for Employment and Collective Bargaining (AENC)..[10]

Figure 3.7 Headline and core inflation
(% YoY)




Source: BBVA Research based on INE (Spanish Office of National Statistics) data

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




Annual data include agreements registered after December each year and incorporate the review using the wage guarantee clause.
(*) Data for 2017 and 2018 are provisional.
Source: BBVA Research based on Ministry of Labour, Migration and Social Security data

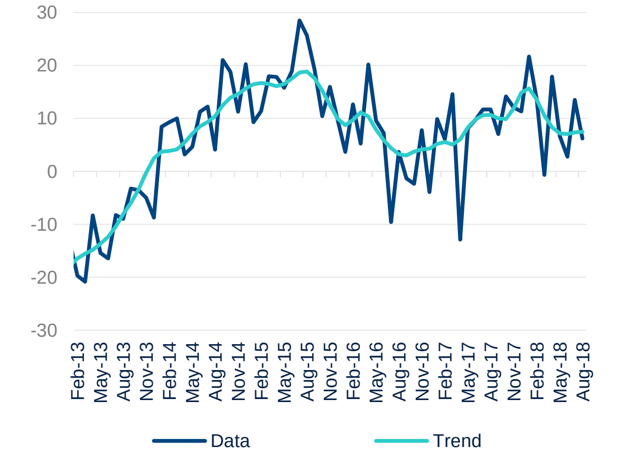
## New lending moderates its pace in the first eight months of 2018

**The stock of credit to the private sector slowed down slightly until -3.0% YoY in July. The volume of new transactions continue to increase strongly** (10.0% until August), although they lost some traction since the beginning of the second half of the year. The growth of financing transactions to companies of more than €1 million has also decreased, but still came to 10.3% YoY in the cumulative January-August figure. On the other hand, transactions of less than €1 million, with hesitant behaviour and delayed growth with respect to the rest of the portfolios, seemed to improve in the second half of the year and increased by 6.2% YoY up to August (see Figure 3.9). New financing to families also progressed with some impetus and grew 17.5% YoY up to August.

**The price of new credit remains at a minimum,** favoured by low interest rates, good liquidity conditions for banks, the containment of sovereign risk and the lower credit risk faced by banks. However, in some portfolios there is evidence of a minimum threshold having been reached in an environment of narrowing interest margins and changes in the term structure (see Figure 3.10). Accordingly, the rates for housing acquisition (2.21% APR average in August, 1 bp more than a year ago), show a clear resistance to further decline given the growing importance of fixed rate mortgages.

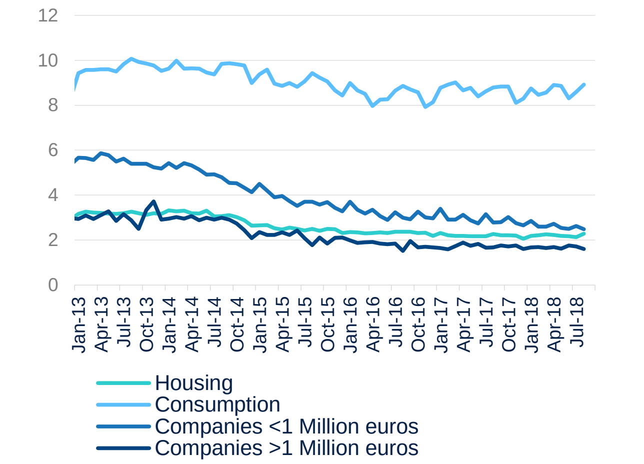
10: The 4th AENC, signed in early June 2018 by CEOE, CEPYME, CCOO and UGT, recommends salary increases of around 2% in 2018, 2019 and 2020, plus a variable portion that will depend, among other factors, on the trend in productivity, the company's results and unjustified days absenteeism.

Figure 3.9 Spain: new credit transactions to the retail sector (% YoY of the gross figure and its trend)




Source: BBVA Research based on Banco de España figures

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




Source: BBVA Research based on Banco de España figures

## 2018-2019 scenario: downward revision of growth expectations

**The fundamentals of the Spanish economy** guarantee the continuation of the recovery during the current biennium. However, the loss of momentum of the observed demand during the first half of the year makes it advisable to **revise downward the growth expected in the short term** (see Table 3.1). BBVA Research estimates that **GDP growth will slow down to 2.6% in 2018 and 2.4% in 2019**, 0.3 pp and 0.1 pp lower than was forecast in the previous edition of this publication. As a consequence of the depletion of the pent-up demand for consumer goods and the gradual recovery of competing tourist markets, both domestic and non-resident private consumption are expected to moderate their growth to align with the evolution of their fundamentals. On the other hand, exports of goods and investment in machinery and equipment are expected to rebound, and the recovery in construction investment is expected to be consolidated (see Table 3.1). Even so, the increase in activity would be sufficient to create nearly 920,000 jobs over the two-year period and reduce the unemployment rate to around 13.7% in 2019.[11].

11: Employment will increase by 930,000 people between 4Q17 and 4Q19 and the unemployment rate will fall to levels below 13% by late 2019.

Table 3.1 Spain: macroeconomic forecasts (% YoY unless otherwise indicated)

| (% YoY unless otherwise indicated) | 1Q18 | 2Q18 | 3Q18 (e) | 2017 | 2018 (f) | 2019 (f) |
|---|---|---|---|---|---|---|
| National Final Consumption Expenditure | 2.9 | 2.2 | 2.1 | 2.4 | 2.4 | 1.9 |
| Private FCE | 3.1 | 2.3 | 2.0 | 2.5 | 2.4 | 1.8 |
| FCE Public Admins | 2.4 | 1.9 | 2.3 | 1.9 | 2.3 | 2.3 |
| Gross Fixed Capital Formation | 3.9 | 7.7 | 6.2 | 4.8 | 6.0 | 5.0 |
| Equipment and Machinery | 1.9 | 11.1 | 8.4 | 6.0 | 7.4 | 5.0 |
| Construction | 5.7 | 7.0 | 5.8 | 4.6 | 6.1 | 5.0 |
| Housing | 9.3 | 7.0 | 5.6 | 9.0 | 6.8 | 6.0 |
| Other Buildings and Structures | 2.1 | 6.9 | 6.0 | 0.6 | 5.5 | 4.0 |
| **Domestic demand (*)** | **3.1** | **3.3** | **2.8** | 2.9 | **3.1** | **2.5** |
| Exports | 3.4 | 2.3 | 2.6 | 5.2 | 2.8 | 5.7 |
| Imports | 4.7 | 5.2 | 3.9 | 5.6 | 4.7 | 6.2 |
| **External balance (*)** | **-0.3** | **-0.8** | **-0.3** | 0.1 | **-0.5** | **0.0** |
| **Real GDP at market prices** | **2.8** | **2.5** | **2.5** | 3.0 | **2.6** | **2.4** |
| **Nominal GDP at market prices** | **4.0** | **3.3** | **3.9** | 4.2 | **3.7** | **4.4** |
| Total employment (LFS) | 2.4 | 2.8 | 2.5 | 2.6 | 2.6 | 2.2 |
| Unemployment rate (% of labour force) | 16.7 | 15.3 | 14.5 | 17.2 | 15.3 | 13.7 |
| Full-time equivalent employment (Quarterly National Accounts) | 2.6 | 2.5 | 2.4 | 2.9 | 2.4 | 2.1 |

(*) Contributions to growth.
(e): Estimate; (p): Forecast.
Source: BBVA Research based on INE (Spanish Office of National Statistics) and Banco de España data

## Monetary policy continues to support growth and partially offsets the pressure applied by headwinds

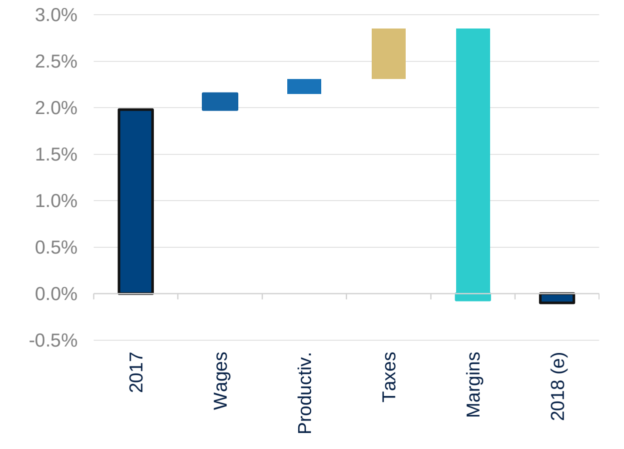
**The cost of financing the Spanish economy remains at low levels and will favour the advancement of most of the components of aggregate demand,** at least until the ECB's monetary normalisation process gains ground. In addition, the monetary policy strategy of the Fed will help the euro/dollar exchange rate to continue to favour exports[12] (see Section 1).

Thus, **the accommodative tone of monetary policy will make it possible to offset, at least partially, the external headwinds** that hover over the Spanish economy. Among these, the increase in protectionism – which, until now, would have had a limited impact on Spanish exports – and the upward pressure on oil prices (up to around US$73.2 per barrel on average for the biennium)[13] stand out. In this regard, recent data indicate that,

12: BBVA Research estimates indicate that a permanent 5% appreciation of the euro-dollar exchange rate means an appreciation of the nominal effective exchange rate equivalent to 1.7%. The estimated effect on GDP growth during the first year is between 0.2 pp and 0.3 pp, and the pressure on the annual increase of exports is estimated at 1.3 pp.
13: Since the increase in oil prices is mostly due to supply shocks and, given the energy dependence of the Spanish economy, this could subtract about 0.3 pp from the growth in the current year, and 0.6 pp during the next. For further details on estimating the effects of oil prices by type of shock on activity and prices in the Spanish economy, see Box 1 of the Spain Economic Outlook journal for the second quarter of 2011, available at: https://bit.ly/2E5UKbC.

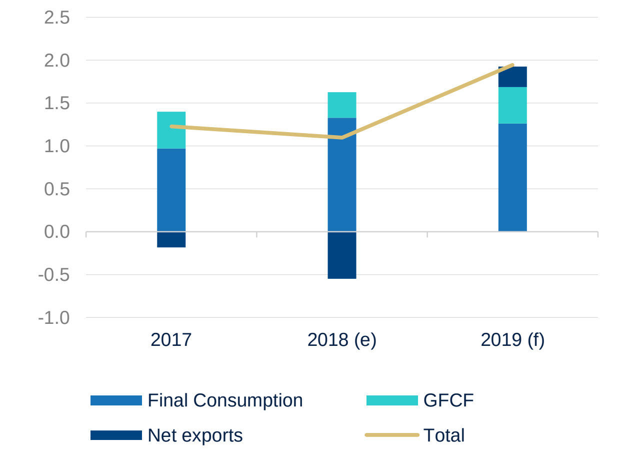
probably because it is perceived as temporary, most of the increase in energy prices has not been fully transferred to production prices (mainly of exportable goods and services), but has been absorbed, via margins and without perceptible consequences for employment or investment (see Figures 3.11 and 3.12).

Figure 3.11 Spain: GDP deflator (average annualised % of growth rate QoQ and contributions)




Source: BBVA Research based on INE (Spanish Office of National Statistics) data

Figure 3.12 Spain: GDP Deflator (% and contributions)



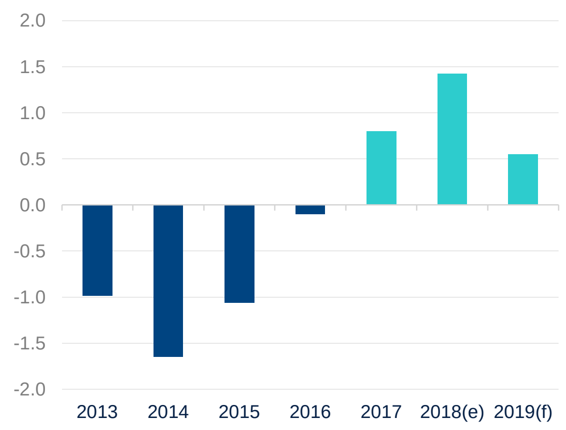

(e): Estimate.
(p): Forecast.
Source: BBVA Research based on INE (Spanish Office of National Statistics) data

## A less dynamic internal demand, but that will continue to lead growth

**The evolution of private consumption will be less favourable than was forecast in July.** BBVA Research forecasts that the growth in household spending will moderate to 2.4% in 2018 and 1.8% in 2019, 0.2 pp and 0.3 pp less, respectively, than in the previous scenario. What factors explain the loss of traction in private consumption? Firstly, the disappearance of the transitory elements that encouraged spending in previous years, such as sluggish oil prices and pent-up demand for durable[14] goods (see Figure 3.13). Secondly, the lower dynamism of some of the determinants of consumption, such as net financial wealth, which has been affected, among other things, by the decline in stock prices. Finally, the impact of uncertainty, which fences the downward trend in the savings rate (see Figure 3.14). On the contrary, the permanent fiscal impulse included in the 2018 Spanish National Budget[15] and the uninterrupted growth of real estate wealth and consumer[16] financing will sustain the progress of consumption.

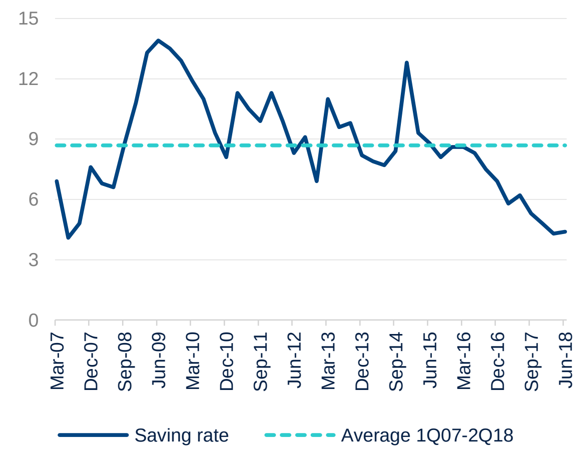
14: Between 2013 and 2016, household consumption grew faster than its long-term fundamentals (disposable income, wealth and interest rates) as a consequence of the absorption of pent-up demand for durable goods during the crisis. This factor ceased to contribute to household expenditure growth in 2017 as pent-up demand exhausted.
15: The Spanish National Budget for 2018 includes budgetary measures for an amount of €11 billion in disposable income, which, according to BBVA Research estimates, will contribute 0.4 pp to the growth of private consumption in the 2018-2109 biennium. See the Spain Economic Outlook review for the third quarter of 2018, available at: https://bit.ly/2plO4py.
16: Real estate wealth has grown by around 18% since mid-2013, and is expected to continue to increase in line with house prices. Consumer finance, which has progressed at double-digit rates since 2014, will continue to grow over the coming quarters, albeit at slightly more contained rates.

Figure 3.13 Spain: Difference between observed consumption and consumption explained by its fundamentals*
(% of consumption explained by its fundamentals)




(*) Disposable income, financial and real estate wealth and interest rates.
Source: BBVA Research based on INE (Spanish Office of National Statistics) and Bank of Spain data

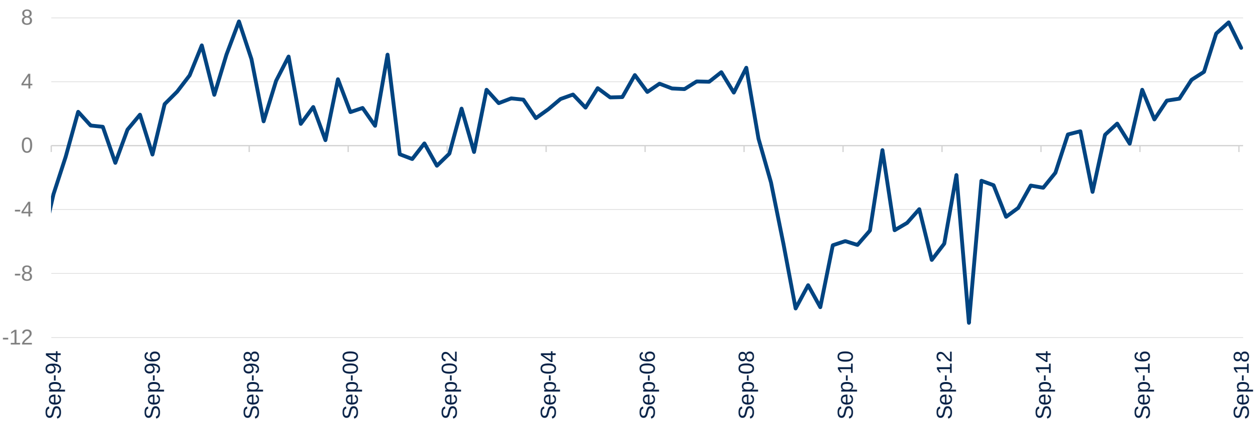
Figure 3.14 Spain: Household savings rate (%of gross disposable income, SWDA data)




Source: BBVA Research based on INE (Spanish Office of National Statistics) data

**Investment in machinery and equipment will remain dynamic in the short and medium term.** It is estimated that after growing 6.0% YoY on average in 2017, the increase will accelerate up to 7.4% in the current year and will be corrected gently down to 5.0% in 2019. This entails an upward revision of more than 4 pp in the accumulated growth for the biennium with respect to the forecast three months ago. The expected dynamism of productive investment is based on the gradual increase expected from the other components of domestic demand, the recovery of exports of goods and the low cost of financing that the Spanish economy still enjoys. In this regard, it is noted that the use of productive capacity in sectors such as the production of machinery and equipment remains at a historical maximum (see Figure 3.15), reflecting the need for additional increases in investment to meet projected demand. These factors will be sufficient to compensate for the headwinds that threaten this demand item, among which the salient components are, externally, the increase in the price of oil and, internally, the uncertainty about economic policy.

Figure 3.15 Spain: use of productive capacity in machinery and equipment (deviations from the historical average, pp)




Source: BBVA Research based on European Commission data

For its part, **the real estate sector maintains a positive and stable evolution.** The increase in the supply of credit, supported by still-low interest rates[17], the dynamism of the labour market, and the high levels of confidence of households are acting as support for the growth of the sector and encouraging the start-up of new projects and investments. In this context, it is estimated that residential investment will increase by 6.8% in 2018 and 6.0% in 2019, only 0.5 pp less than the previous forecast for the biennium. For its part, it is estimated that investment in other buildings and structures will rise by 5.5% in 2018 and 4.0% in 2019, mainly driven by regional governments.

As for the public sector, it is estimated that fiscal policy will maintain an expansive tone during 2018. The evolution of expenditure in 2019 will depend on when the Spanish National Budget can be approved and the measures included on it. In an environment without changes in economic policy, it is estimated that the final consumption of public administrations will accelerate 0.4 pp up to 2.3% in 2018 and 2019**.**

## Trade flows will lose momentum in 2018, but will regain it in 2019

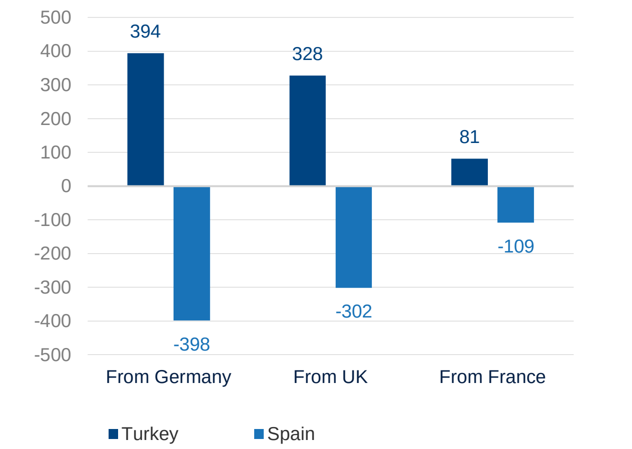
Despite the moderate appreciation of the real effective exchange rate for the Spanish economy (0.7 pp on average for the biennium), **the expected global growth (3.7% in 2018 and 3.6% in 2019) will provide a favourable environment for exports.** However, the available evidence suggests that the exhaustion of some of the tailwinds that favoured the advance of foreign sales in recent years has already begun to materialise, forcing the growth rate to be revised downward. These include the recovery of competing tourist markets and the upward trend in oil prices.

**Thus, total exports are expected to decelerate by 3.4 pp down to 2.8% this year, and to increase by 5.7% over the next year** (0.7 pp and 0.3 pp lower than was forecast three months ago). In particular, after growing 5.2% in 2017, sales of goods abroad are expected to moderate to 2.8% in 2018 (0.2 pp less than previously estimated) and regain traction in 2019 to 6.2%. On the other hand, it is estimated that sales of services will grow at an average annual rate of 3.7% during the current biennium, which contrasts with the strong progress observed in the previous biennium (7.1% as an annual average). In particular, the increase in **consumption by non-residents in Spain is expected to slow down from 8.9% in 2017 to 2.1% in 2018 and 1.1% in 2019, barely half of what was**

17: The mortgage interest rate for new transactions closed the month of August at 2.28%, 0.15 pp higher than in the previous month. This rise could be related to the increase in the proportion of fixed-rate mortgages, which in August accounted for almost 40% of the total. On the other hand, the 12-month Euribor maintains the slight rise trend initiated in March 2018. Between February 2018, when it reached a low (-0.19%) and August 2018 (-0.17%), the reference rate rose by 3 basis points.

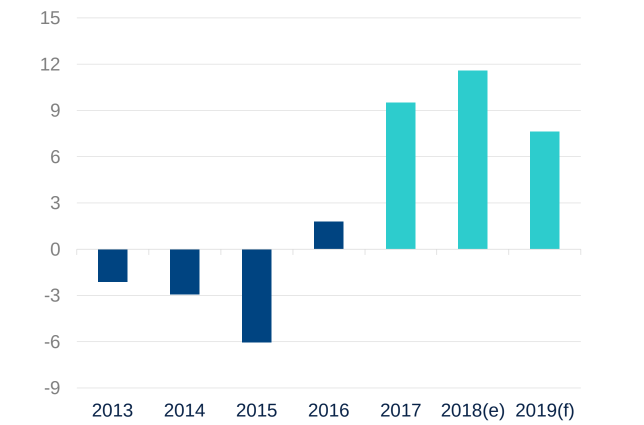
**expected in the previous quarter.** Behind this downward revision lie some structural factors already mentioned in previous editions of this publication. At the domestic level, there has been an increase in prices and a loss of competitiveness as a result of restrictions on the growth of the supply and an increase in the demand of the most popular destinations. Additionally, last year's terrorist attacks in Catalonia also contributed to limit the visits of foreign tourists. Externally, on the one hand, it highlights the rebound in transport costs linked to the increase in the price of fuel. On the other hand, there has been a recovery in some of the competing markets that have suffered in recent years from geopolitical tensions, such as Turkey, where the depreciation of the nominal exchange rate has also been fundamental (Figure 3.16). In this regard, BBVA Research estimates suggest that about 10 pp of tourism growth in recent years cannot be explained by its fundamentals. Therefore, in the absence of proactive management by companies, which allows them to improve competitiveness and the value added of their product, the slowdown in the sector could last over time (Figure 3.17).[18].

Figure 3.16 Spain: border entry by tourists in Turkey and Spain (variation in thousands of people)




Source: BBVA Research based on Turkstat and INE (Spanish Office of National Statistics) data

Figure 3.17 Spain: exports of tourism services in levels (natural logarithms)




(e): Estimate.
(f): Forecast.
Source: BBVA Research

The expected trend in final demand will lead to **an increase in imports** of around 5.5% on average during the current two-year period which, as a result, will limit the contribution of net external demand to growth (-0.5 pp in 2018 and 0.0 pp in 2019). Although this development in the external balance is consistent with a slowdown in the current account balance, expectations of a surplus for the whole of the biennium remain positive (average: 1.3% of GDP).

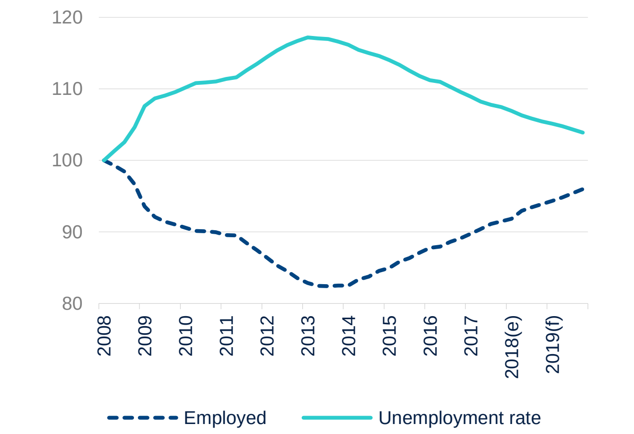
## The recovery of the labour market will continue in 2019, but at a slower pace

Although the expectations of economic growth for 2018 have worsened slightly with respect to those of three months ago, the forecast of job creation has been revised slightly upwards due to the positive surprise recorded in 2Q18.[19] **Employment is expected to grow by 2.6% YoY on average in 2018**, 0.3 pp more than in the previous scenario. Given that the increase in the labour force will be modest, **the increase in employment will result in a decrease of 2 pp in the unemployment rate down to 15.3%. The increase in employment and the fall in the unemployment rate will continue in 2019**, but at a slower pace, to 2.2% and 13.7%, respectively.

18: For more information on this aspect, see the BBVA Research Economic Watch: "Are geopolitical tensions in competing markets affecting Spanish tourism?", available at: https://bit.ly/2pQHhul
19: See https://bit.ly/2OLKWHK

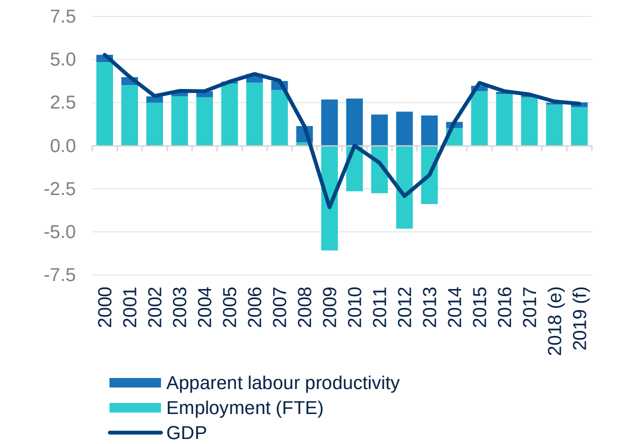
If the forecasts of BBVA Research are met, the number of employed people would reach around 20 million by the end of 2019 and the unemployment rate would be below 13%. **However, there is still a long way to go to regain pre-crisis levels.** As Figure 3.18 shows, by the end of 2019 the level of employment will be around 4% below that existing at the beginning of 2008, while the unemployment rate would be 4 pp higher. In addition, the expected development of activity and full-time equivalent employment (FTE), which will increase by around 2.3% on average in the 2018-2019 period, suggests a limited contribution from the of apparent productivity of labour (see Figure 3.19).

Figure 3.18 Spain: level of employment and unemployment rate (1Q08 = 100. SWDA data)




(e) Estimate.
(f) Forecast.
Source: BBVA Research based on INE (Spanish Office of National Statistics) data

Figure 3.19 Spain: growth in apparent productivity of labour (%)




(e) Estimate.
(f) Forecast.
Source: BBVA Research based on INE (Spanish Office of National Statistics) data

## Inflation will remain at still-moderate levels during the current biennium

After stabilising in the third quarter, **BBVA Research expects headline inflation to gradually decline over the rest of the year and reach an average of around 1.7%.** This development is largely due to the pressure on energy prices and the depreciation of the euro exchange rate observed throughout the financial year. Notwithstanding the above, there are still no significant second-round effects (i.e. transfers to margins or salaries of the increase in the cost of energy) and **core inflation** is expected **to remain relatively stable for the remainder of the year (0.9% annual average for 2018).**

In 2019, underlying prices will continue to grow (1.1% on annual average), given the prolonged fall in the unemployment rate and the still accommodative nature of monetary policy. This, together with the negative base effect on energy prices, will put headline inflation at 1.6%, 0.1 pp lower than expected three months ago.

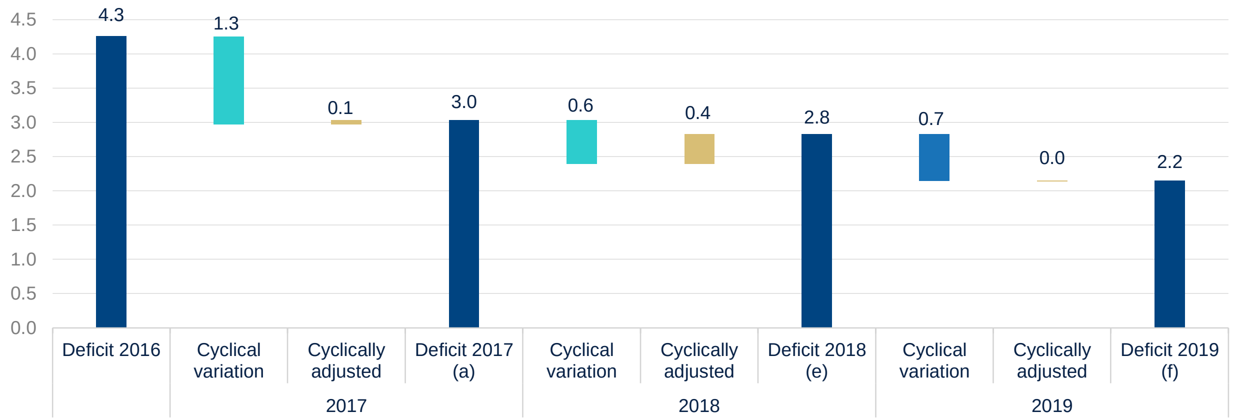
If these estimates are fulfilled, **Spain's inflation differential with respect to the Eurozone will remain practically non-existent during the 2018-2019 biennium** after being in an unfavourable position for Spain in 2017. Similarly, the underlying component of inflation is also expected to match that observed for the Eurozone.

## Political uncertainty sets the agenda for fiscal policy in 2019

**The available budgetary execution details up to July 2018 confirms that the recovery of economic activity would boost tax collection** somewhat more moderately than was expected at the beginning of the year.[20] For its part, public spending has slightly accelerated its growth, driven by the expansionary[21] measures approved in the Spanish National Budget 2018, which are being reflected mainly in compensation of employees, social benefits and, above all, in investment spending.

In a slightly more moderate growth scenario than was expected three months ago, the cyclical correction of the fiscal imbalance would be around 0.6% of GDP in 2018. However, the **discretionary measures adopted this year will offset much of this cyclical improvement and, as a result, the general government deficit will be reduced by only 0.2 pp down to 2.8% of GDP.** For 2019, in a scenario without changes in fiscal policy, a new cyclical correction of public accounts to 2.2% of GDP is expected (see Figure 3.20).

Figure 3.20 Public administration: breakdown of fiscal adjustment, excluding bail-outs of financial institutions (% of GDP)




(a): Advance; (e): Estimate; (f): Forecast.
Source: BBVA Research based on Ministry of the Treasury and INE (Spanish Office of National Statistics) data

**These forecasts entail a deterioration of the structural balance of around 0.4 pp of GDP,** which, in the current context of economic slowdown, increases the probability of non-compliance with the fiscal obligations. Going forward, the fiscal policy is conditioned by the uncertainty about when the Spanish National Budget for 2019 will be approved and which measures will be included. The forecasts on this publication only consider the policies approved so far.

## Downward risks continue to dominate the bias balance

As was the case three months ago, the scenario is not without risks which, if they materialise, will lead to a further slowdown in activity in the short term. As regards **the external environment, there has been a notable increase in economic policy uncertainty.** First, the aggravation of **trade tensions between the United States and China** are putting at risk the expansion of global trade and, therefore, of investment and growth. Secondly, the likelihood that no agreement will be reached on an **orderly exit by the UK from the European Union** has increased.

20: See https://bit.ly/2OhGeSB.
21: Among the measures approved for their impact on activity stand out: the rise in salaries for public sector employees, the increase in pensions, the partial reduction of income tax, and the authorisation to reinvest the surplus of the autonomous regions in 2017 in financially sustainable investments. All this amounts to €7 billion in 2018. It is expected that these pro-cyclical fiscal measures will give a boost to growth in the short term of between 0.3 pp and 0.8 pp over the 2018-2019 biennium.

Thirdly, the environment of uncertainty in Europe is heightened by the **intention of the Italian Government to fail to meet its deficit targets,** which has already led to an increase in its financing cost, with an almost null impact, for the moment, on Spain.

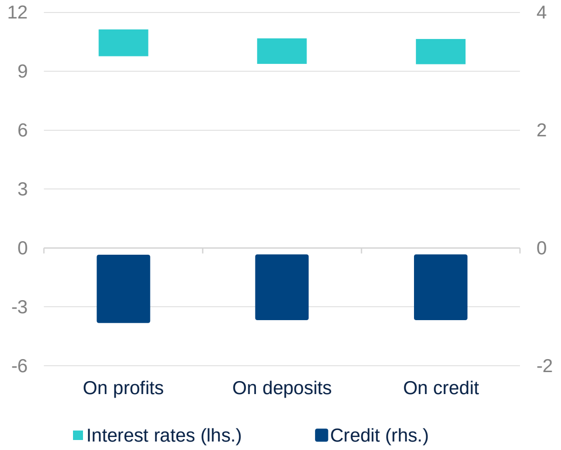
On the other hand, although the **increase in the price of oil** has not been fully transferred to output prices and does not seem to be affecting investment or job creation, this could be temporary if a scenario of maintaining prices around current levels is consolidated, or even with additional increases. Finally, **the changes in the US monetary policy strategy are leading to a recomposition of investment portfolios and greater volatility in the flows towards emerging markets**, some of which have exacerbated the reaction with economic policy mistakes. Although the impact seems to be limited to countries to which Spain has a reduced commercial exposure, the risk of a scenario of contagion to other markets remains.

**At domestic level, the uncertainty over political economy remains high.** BBVA Research has been estimating in previous publications its impact on economic activity, which, for the moment, has been limited. In 2018 it would be around 0.3% of GDP, in line with the forecast for 2017.[22] Although the approval of the Spanish National Budget 2018 has reduced uncertainty about the policies that would be implemented in the short term, doubts persist about the measures that will finally be included and approved in the Spanish National Budget 2019, as well as about the political context in Catalonia.

If the scenario set by BBVA Research for this year is met, it would be necessary to adopt additional measures equivalent to 0.4 pp of GDP to reduce the deficit to around 1.8% of GDP during the following year.[23] In this regard, the advisable thing to diminish the imbalance in the public accounts would be the identification and elimination of inefficient expenses. If it was necessary to increase the tax burden, efficiency criteria should be followed to limit the negative impact on activity. In this respect, the tax burden on labour and on companies in Spain is not very different from that observed in the rest of the EMU. Although, there is a divergence regarding the level of indirect taxation. Furthermore, the creation of finalist taxes is only recommended if there are negative externalities that want to reduce. This is not the case of banking activity, where an increase in taxation on the sector would lead to an increase in the cost of financing, a decrease in the provision of credit and, finally, a lower growth of GDP and investment (see Figures 3.21 and 3.22).[24]

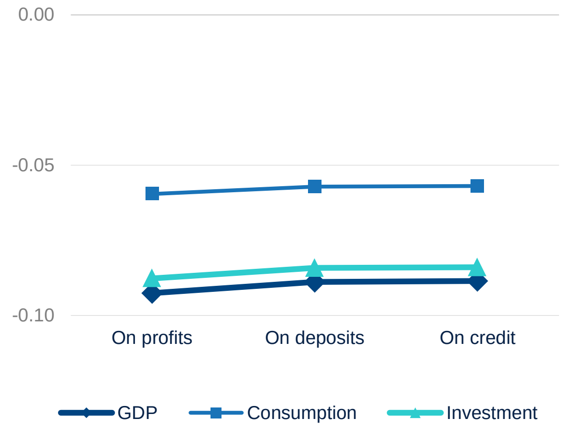
22: BBVA Research estimates indicate that increases in economic policy uncertainty since January 2016 drained nearly 0.3 pp from growth in 2016 and 2017 For more details on estimating the effects of uncertainty about economic policy on activity in the Spanish economy, see Box 1 of the Spain Economic Outlook journal for the first quarter of 2016, available at: https://bit.ly/2NwxUZO
23: Stability objectives under discussion: 1.3% approved in July last year and 1.8% proposed by the current government.
24: For more details, see the Economic Watch on the “Macroeconomic Effects of Taxes on the Banking System”, available at: https://bit.ly/2DwxcMu

Figure 3.21 Spain: Long-term effect of a bank tax* on credit rates and credit growth (bps and %, respectively)




(*) Ex-ante increase in tax revenue by 0.1% of GDP.
Source: BBVA Research based on INE (Spanish Office of National Statistics) data

Figure 3.22 España: Spain: Long-term effect of a bank tax* on GDP growth, consumption and investment (%)

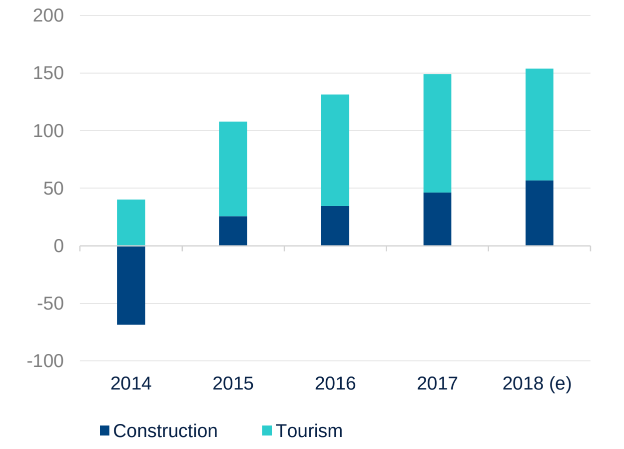



(*) Ex-ante increase in tax revenue by 0.1% of GDP.
Source: BBVA Research based on INE (Spanish Office of National Statistics) data

Moreover, **the risks associated with a possible depletion in the rate of job creation are increasing.** In particular, given the predictably structural nature of the slowdown in tourism, doubts arise about the capacity of other sectors with higher growth rates, such as construction, to create jobs. In fact, the number of new Social Security registrations from construction in the 2014-2017 period barely accounted for a tenth of those employed in tourism (see Figure 3.23). In addition, the unemployment rate is approaching its structural level, so it is possible that, in the face of capacity constraints or a lack of skilled labour in specific sectors, job creation will slow down and wages will rise above productivity. In this regard, BBVA Research estimates indicate that the increase in compensation per employee for the economy as a whole should be around 2.0% per year in the biennium and therefore the unemployment rate will moderate in line with the forecasts presented in this publication[25].

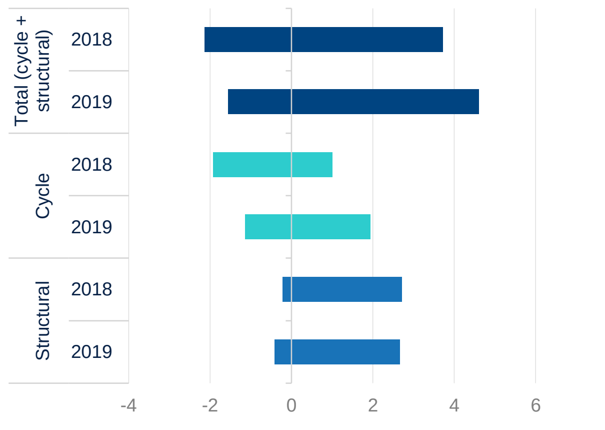
25: The principle of agreement signed by the social partners to renew the State Collective Bargaining Agreement until 2020 is placed around this threshold.

Figure 3.23 Spain: Social Security registrations in construction and tourism (annual variation in thousands of persons)




(e): Estimates.
Source: BBVA Research based on INE (National Statistics Institute) data

Figure 3.24 Spain: breakdown of expected growth in remuneration per employee (*) (90% confidence interval)




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

# 4. Tables

Table 4.1 Gross Domestic Product (annual average, %)

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| United States | 2.9 | 1.6 | 2.2 | 2.8 | 2.8 |
| Eurozone | 1.9 | 1.9 | 2.5 | 2.0 | 1.7 |
| Germany | 1.5 | 2.2 | 2.5 | 1.9 | 1.7 |
| France | 1.0 | 1.1 | 2.3 | 1.6 | 1.7 |
| Italy | 0.8 | 1.3 | 1.6 | 1.1 | 1.1 |
| Spain | 3.6 | 3.2 | 3.0 | 2.6 | 2.4 |
| United Kingdom | 2.3 | 1.8 | 1.7 | 1.4 | 1.5 |
| Latin America* | -0.1 | -1.0 | 1.2 | 0.9 | 1.8 |
| Mexico | 3.3 | 2.6 | 2.3 | 1.9 | 2.0 |
| Brazil | -3.6 | -3.4 | 1.0 | 1.2 | 2.4 |
| Eagles** | 4.8 | 5.2 | 5.4 | 5.3 | 5.1 |
| Turkey | 6.1 | 3.2 | 7.4 | 2.8 | 1.0 |
| Asia and Pacific | 5.7 | 5.7 | 5.6 | 5.7 | 5.5 |
| Japan | 1.4 | 1.0 | 1.7 | 1.0 | 1.2 |
| China | 6.9 | 6.7 | 6.9 | 6.5 | 6.0 |
| Asia (ex. China) | 4.6 | 4.7 | 4.6 | 4.9 | 5.0 |
| World | 3.4 | 3.4 | 3.7 | 3.7 | 3.6 |

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, Egypt, Philippines, India, Indonesia, Iran, Malaysia, Mexico, Nigeria, Pakistan, Russia, Turkey and Vietnam.
Forecast closing date: 11 October 2018.
Source: BBVA Research

Table 4.2 Inflation (annual average, %)

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| United States | 0.1 | 1.3 | 2.1 | 2.5 | 2.6 |
| Eurozone | 0.0 | 0.2 | 1.5 | 1.7 | 1.7 |
| Germany | 0.1 | 0.4 | 1.7 | 1.9 | 1.8 |
| France | 0.1 | 0.3 | 1.2 | 1.9 | 1.7 |
| Italy | 0.1 | -0.1 | 1.3 | 1.3 | 1.7 |
| Spain | -0.5 | -0.2 | 2.0 | 1.8 | 1.6 |
| United Kingdom | 0.0 | 0.7 | 2.7 | 2.5 | 2.1 |
| Latin America* | 8.3 | 9.8 | 6.7 | 7.0 | 7.8 |
| Mexico | 2.7 | 2.8 | 6.0 | 4.9 | 4.1 |
| Brazil | 9.0 | 8.8 | 3.5 | 3.7 | 4.8 |
| Eagles** | 5.0 | 4.4 | 4.1 | 5.0 | 5.6 |
| Turkey | 7.7 | 7.8 | 11.1 | 17.4 | 23.4 |
| Asia and Pacific | 2.2 | 2.3 | 2.1 | 2.6 | 2.9 |
| Japan | 0.8 | -0.1 | 0.5 | 1.0 | 1.0 |
| China | 1.4 | 2.0 | 1.7 | 2.2 | 2.5 |
| Asia (ex. China) | 2.8 | 2.5 | 2.4 | 3.0 | 3.3 |
| World | 3.0 | 3.2 | 3.3 | 4.0 | 4.2 |

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, Egypt, Philippines, India, Indonesia, Iran, Malaysia, Mexico, Nigeria, Pakistan, Russia, Turkey and Vietnam.
Forecast closing date: 11 October 2018.
Source: BBVA Research

Table 4.3 Interest rate on ten-year government bonds (annual average, %)

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| USA | 2.13 | 1.84 | 2.33 | 2.89 | 3.37 |
| Germany | 0.52 | 0.13 | 0.37 | 0.52 | 1.04 |

Forecast closing date: 11 October 2018.
Source: BBVA Research

Table 4.4 Exchange rates (annual average)

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| EUR-USD | 0.90 | 0.90 | 0.89 | 0.84 | 0.83 |
| USD-EUR | 1.11 | 1.11 | 1.13 | 1.19 | 1.21 |
| USD-GBP | 1.53 | 1.35 | 1.29 | 1.35 | 1.41 |
| JPY-USD | 121.07 | 108.82 | 112.20 | 110.68 | 116.25 |
| CNY-USD | 6.23 | 6.64 | 6.76 | 6.48 | 6.46 |

Forecast closing date: 11 October 2018.
Source: BBVA Research

Table 4.5 Official interest rates (end of period, %)

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| USA | 0.50 | 0.75 | 1.50 | 2.50 | 3.25 |
| Eurozone | 0.05 | 0.00 | 0.00 | 0.00 | 0.25 |
| China | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 |

Forecast closing date: 11 October 2018.
Source: BBVA Research

Table 4.6 EMU: macroeconomic projections (YoY) (End of period, %)

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| GDP at constant prices | 1.9 | 1.9 | 2.5 | 2.0 | 1.7 |
| Private consumption | 1.8 | 1.9 | 1.7 | 1.4 | 1.6 |
| Public consumption | 1.3 | 1.9 | 1.2 | 1.2 | 1.2 |
| Gross fixed capital formation | 4.6 | 3.8 | 2.8 | 3.1 | 3.0 |
| Inventories (*) | 0.0 | 0.1 | 0.0 | 0.2 | 0.0 |
| Domestic demand (*) | 2.2 | 2.3 | 1.7 | 1.8 | 1.8 |
| Exports (goods and services) | 6.3 | 2.9 | 5.5 | 3.1 | 3.6 |
| Imports (goods and services) | 7.5 | 4.1 | 4.1 | 3.0 | 4.1 |
| External demand (*) | -0.2 | -0.4 | 0.8 | 0.1 | -0.1 |
| **Prices** | **1.9** | **1.9** | **2.5** | **2.0** | **1.7** |
| CPI | 0.0 | 0.2 | 1.5 | 1.7 | 1.7 |
| Underlying RPI | 0.8 | 0.8 | 1.1 | 1.2 | 1.5 |
| **Labour market** | | | | | |
| Employment | 1.0 | 1.4 | 1.6 | 1.4 | 1.0 |
| Unemployment rate (% of active population) | 10.9 | 10.0 | 9.1 | 8.3 | 7.8 |
| **Public sector** | | | | | |
| Deficit (% of GDP) | -2.0 | -1.5 | -0.9 | -0.7 | -0.8 |
| Debt (% of GDP) | 89.9 | 89.0 | 86.7 | 84.0 | 81.5 |
| **External sector** | | | | | |
| Balance of payments on current account (% of GDP) | 2.9 | 3.2 | 3.2 | 3.1 | 3.0 |

(*)Contributions to growth.
Forecast closing date: 11 October 2018.
Source: BBVA Research

Table 4.7 Spain: macroeconomic forecasts (Annual rates of change in %, unless otherwise indicated)

| (Annual average, %) | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| **Activity** | | | | | |
| Real GDP | 3.6 | 3.2 | 3.0 | 2.6 | 2.4 |
| Consumo privado | 3.0 | 2.8 | 2.5 | 2.4 | 1.8 |
| Consumo público | 2.0 | 1.0 | 1.9 | 2.3 | 2.3 |
| Formación Bruta de Capital | 6.7 | 2.9 | 4.8 | 6.0 | 5.0 |
| Equipment and Machinery | 11.9 | 5.2 | 6.0 | 7.4 | 5.0 |
| Construction | 3.6 | 1.1 | 4.6 | 6.1 | 5.0 |
| Housing | -0.9 | 7.0 | 9.0 | 6.8 | 6.0 |
| Domestic Demand (contribution to growth) | 3.9 | 2.4 | 2.9 | 3.1 | 2.5 |
| Exports | 4.2 | 5.2 | 5.2 | 2.8 | 5.7 |
| Imports | 5.4 | 2.9 | 5.6 | 4.7 | 6.2 |
| External Demand (contribution to growth) | -0.3 | 0.8 | 0.1 | -0.5 | 0.0 |
| Nominal GDP | 4.2 | 3.5 | 4.2 | 3.7 | 4.4 |
| (Billions of euros) | 1081.2 | 1118.7 | 1166.3 | 1209.2 | 1262.7 |
| **Labour market** | | | | | |
| Employment, based on Labour Force Survey | 3.0 | 2.7 | 2.6 | 2.6 | 2.2 |
| Unemployment rate (% of labour force) | 22.1 | 19.6 | 17.2 | 15.3 | 13.7 |
| Employment (full-time equivalent) based on Quarterly National Accounts | 3.3 | 3.0 | 2.9 | 2.4 | 2.1 |
| Apparent labour productivity | 0.3 | 0.1 | 0.1 | 0.1 | 0.3 |
| **Prices and costs** | | | | | |
| CPI (annual average) | -0.5 | -0.2 | 2.0 | 1.8 | 1.6 |
| CPI (end of period) | 0.0 | 1.0 | 1.1 | 2.0 | 1.5 |
| GDP deflator | 0.5 | 0.3 | 1.2 | 1.1 | 1.9 |
| Pay per salaried employee | 0.9 | -0.5 | 0.3 | 0.9 | 2.1 |
| Unit labour cost | 0.5 | -0.6 | 0.2 | 0.8 | 1.8 |
| **External sector** | | | | | |
| Balance of payments on current account (% of GDP) | 1.1 | 1.9 | 1.9 | 1.4 | 1.3 |
| **Public sector (*)** | | | | | |
| Debt (% of GDP) | 99.4 | 99.0 | 98.3 | 96.7 | 94.2 |
| Balance Public Admin. (% of GDP) | -5.2 | -4.3 | -3.1 | -2.8 | -2.1 |
| **Households** | | | | | |
| Nominal disposable income | 2.3 | 1.8 | 1.6 | 3.5 | 44 |
| Savings rate (% of nominal income) | 8.9 | 8.0 | 5.7 | 5.3 | 6.2 |

Annual change in %, unless expressly indicated.
Forecast closing date: 12 October 2018.
(*) Excluding financial assistance to Spanish banks.
Source: BBVA Research

# 5. Glossary

## Siglas

- AA. PP: Public Administrations
- AECB: Agreement for Employment and Collective Bargaining
- BBVA: Banco Bilbao Viscera Argent aria
- BBVA – GAIN: BBVA's overall index of economic activity
- ECB: European Central Bank
- BOE: Spanish Official Gazette
- 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
- QNA: Quarterly National Accounts
- SCA Seasonally and calendar-adjusted data
- EAE – BBVA: BBVA Economic Activity Survey
- EAGLES: Emerging and Growth-Leading Economies
- LFS: Labour Force Survey
- e.t.c / FTE: Employment (full-time equivalent)
- Euríbor: Euro Interbank Offered Rate
- FED: US Federal Reserve System
- NFCE: National Final Consumption Expenditure
- GDELT: The Global Database of Events, Language and Tone
- CPI: Consumer Price Index
- JPY: Japanese yen
- LATAM: Latin American countries. Includes Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
- INE: Instituto Nacional de Estadística (Spanish Office of National Statistics)
- ME&SS Ministry of Employment and Social Security
- MICA-BBVA: BBVA Coinciding Activity Indicators Model
- MFPA Ministry of Finance and Public Administration
- GDP: Gross domestic product
- SME: Small and medium enterprise
- QE: Quantitative Easing
- RDL: Royal Decree-Law
- SMI: Salario mínimo interprofesional (legal minimum wage)
- APR: Annual Percentage Rate
- TPV/POS: POS terminal
- EU: European Union
- EMU: Economic and Monetary Union
- UGT: The Unión General de Trabajadores trade union
- USD: US dollar

## 2. Abbreviations

- YoY: Year-on-year change
- CI: Confidence Interval
- mM: Billions
- bps: Basis points
- MP: Market price
- pp: Percentage points
- QoQ: Quarterly change

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