

The logo for BBVA Research, featuring the word "BBVA" in a bold, white, sans-serif font, followed by the word "Research" in a smaller, lighter weight of the same font. A small teal square is positioned to the right of the word "Research".

BBVA Research

# Catalonia Economic Outlook

2<sup>nd</sup> half 2018

October 2018

Creating Opportunities

# Key messages

- The positive global environment is being maintained, but growth is moderating in emerging economies and in the euro zone
- In Catalonia, GDP growth will moderate to 2.5% in 2018 and to 2.3% in 2019. This would allow for the creation of 130,000 new jobs throughout the two-year period, and reduce the unemployment rate to 10% on average in 2019
- The continuation of the recovery will be based on a favourable environment for the growth of exports, the reduction of uncertainty and the support of fiscal and monetary policies
- Among the factors that justify the moderation of growth it is worth noting the depletion of some of the tail winds (pent-up demand, oil price), the weakening of tourism, the terrorist attacks in August 2017 and the increase in uncertainty related to the political environment
- In the absence of the events of the second half of the previous year (terrorism, uncertainty), the economy could have created 30,000 more jobs
- The greater vulnerability of the recovery demands the implementation of policies that reduce uncertainty and encourage inclusive growth, while increasing investment



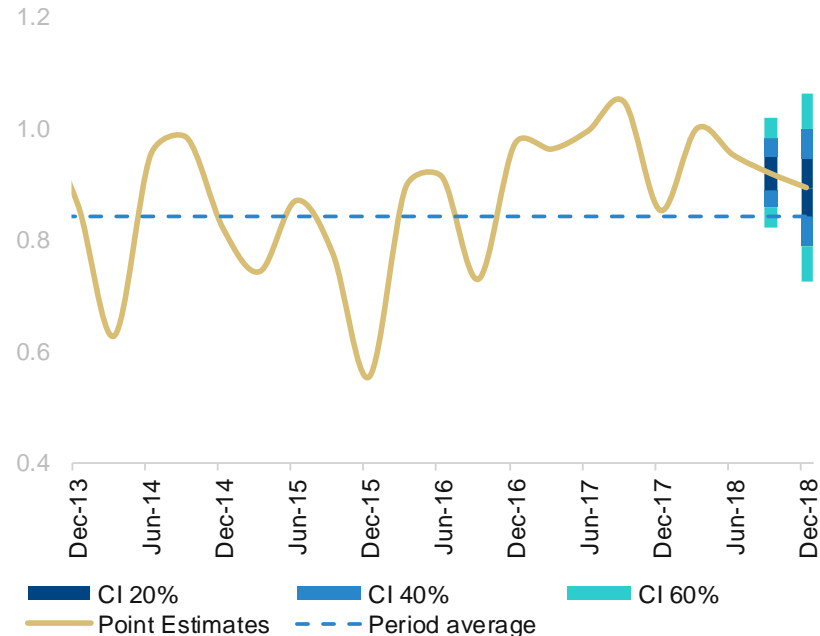
# 01

## Global Economic Outlook 4Q18

# Moderation of global growth

## World GDP growth

(Forecasts based on BBVA-GAIN, % QoQ)



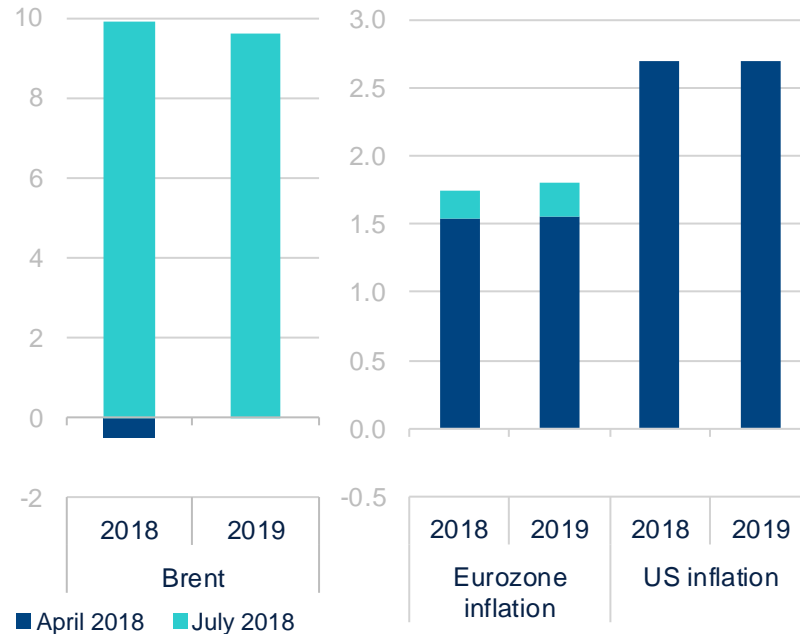
Source: BBVA Research

- Slight moderation of global growth towards rates slightly below 1% QoQ in 2S18
- Activity data remain strong, but have lost momentum, since protectionism growth weighs on confidence, trade and investment
- Beyond volatility, world trade has improved and stabilized after the slowdown at the beginning of the year

# The rise in oil prices is placing upward pressure on inflation

## Upward revision of oil prices and inflation

(%)



- The increase is due to a reduction in supply. The price will remain relatively stable in 2018 and 2019
- Increased inflation in the euro zone, but below the target, while underlying inflation will increase gradually from very low levels
- In the USA the impact will be lower, but inflation will remain above the target in the 2018-19 biennium
- The exit strategy of the Fed and the ECB is reinforced

# Monetary policy continues to normalize and will diverge between the Fed and the ECB from 2019



## Balance

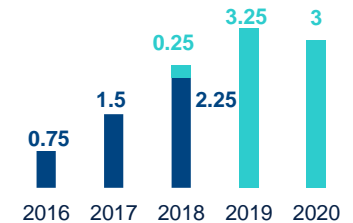


## Interest rate



**Continues the reduction of the balance** (450mM dollars in 2018)

**More rate hikes in 2019, but the cycle ends** (natural interest rate)

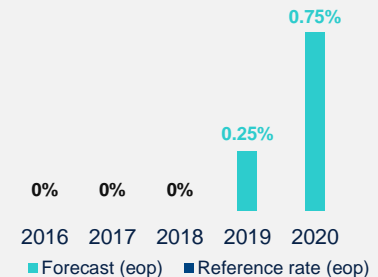


**End of QE** (December 2018)

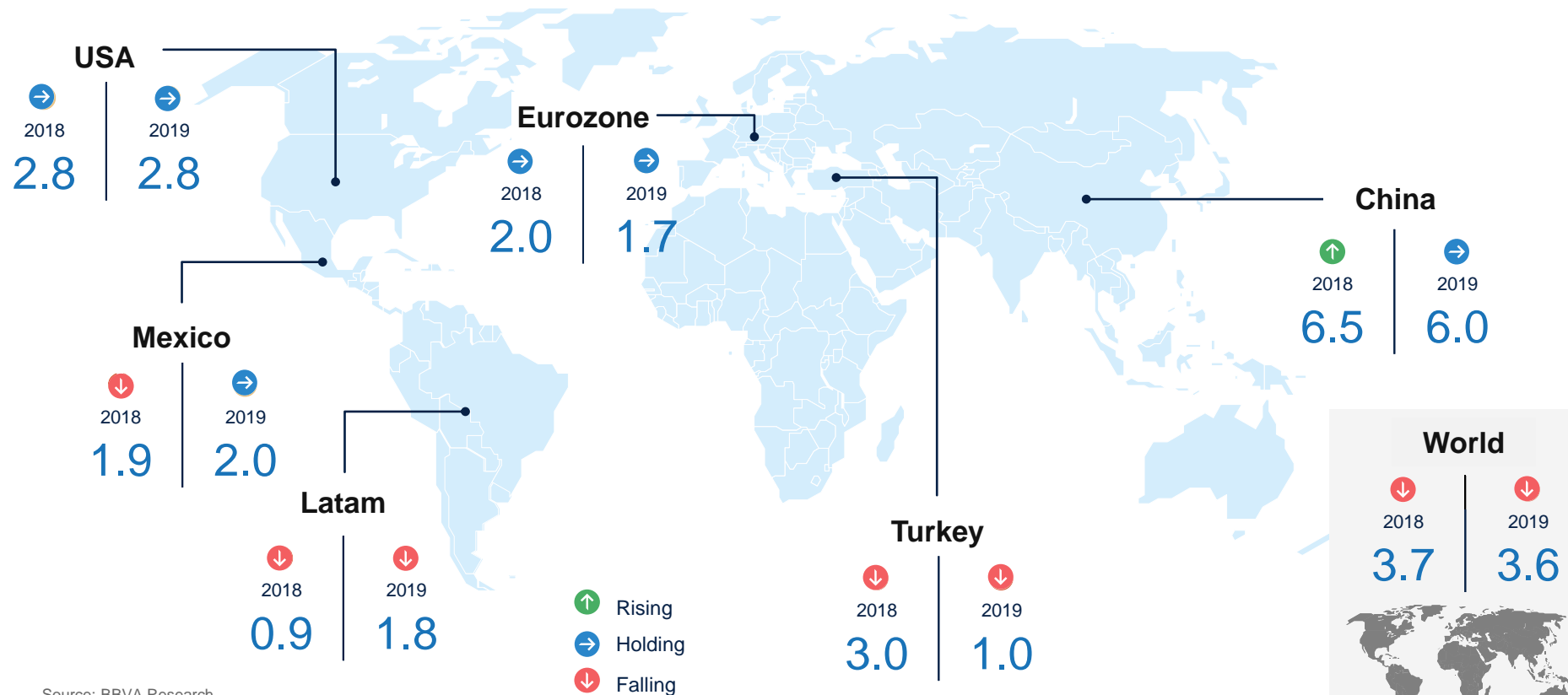
Anchored expectations of low rates for a prolonged period. **No increases are expected until September 2019**

**Total reinvestment** at least until December 2020

**Repayment of TLTROs** from June 2020



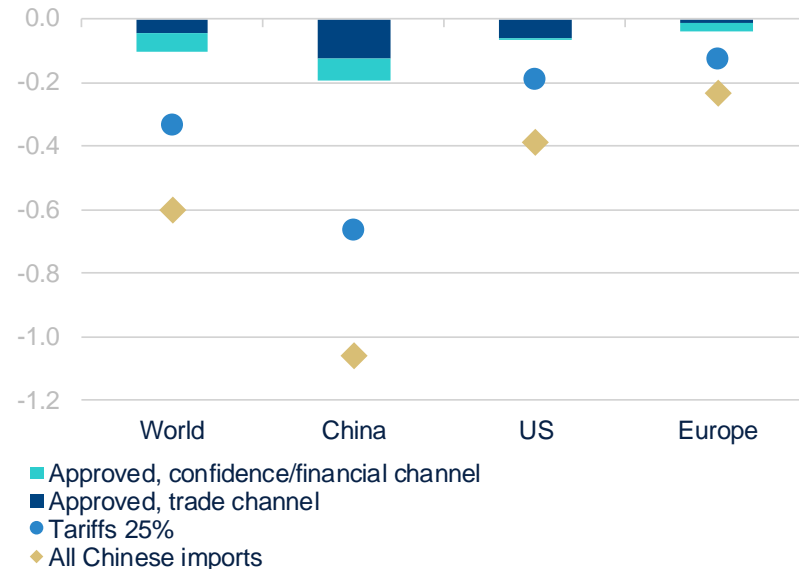
# The downward revision of growth in emerging economies explains the expected moderation of global growth in 2019



# The USA and China have announced higher tariffs, but with an estimated effect on global GDP limited

## Effect on GDP growth of US tariff increases and the response of other countries

(2018-20, pp)



Increase in tariffs approved: USA (25% on steel, 10% on aluminium, 25% on Chinese imports worth \$50 billion and 10% on imports worth \$200 billion); China (25% on US imports worth \$50 billion dollars and 10% on imports worth \$60 billion).

Source: BBVA Research

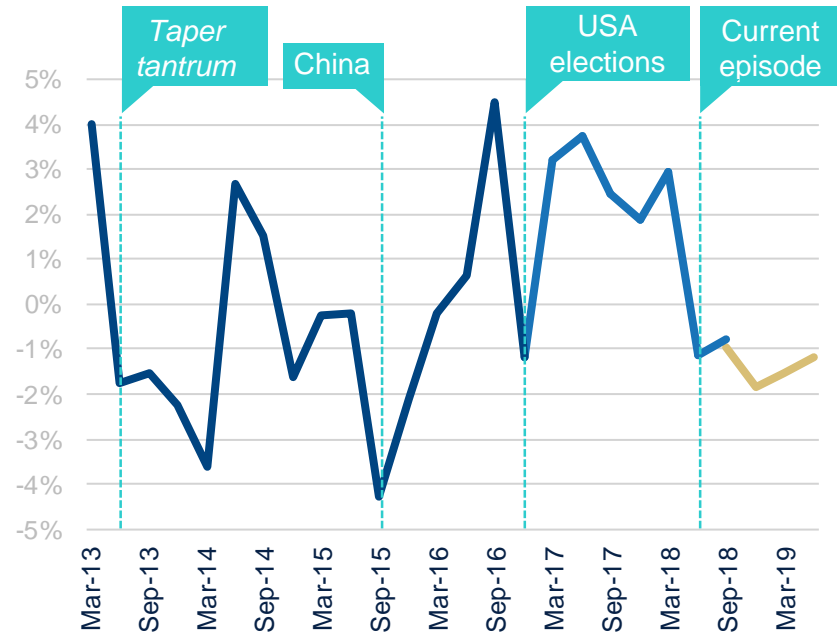
- The impact on the growth of the measures approved so far through the commercial channel could be limited, but the indirect effects could be considerable, especially for China and emerging economies
- The signature of the USMCA reduces the uncertainty with Mexico and Canada
- In Europe, the increase in tariffs on cars is currently frozen, although it will be negotiated again in November



# The outflows of emerging economies are still persistent, but we are far from a typical episode of sudden-stop

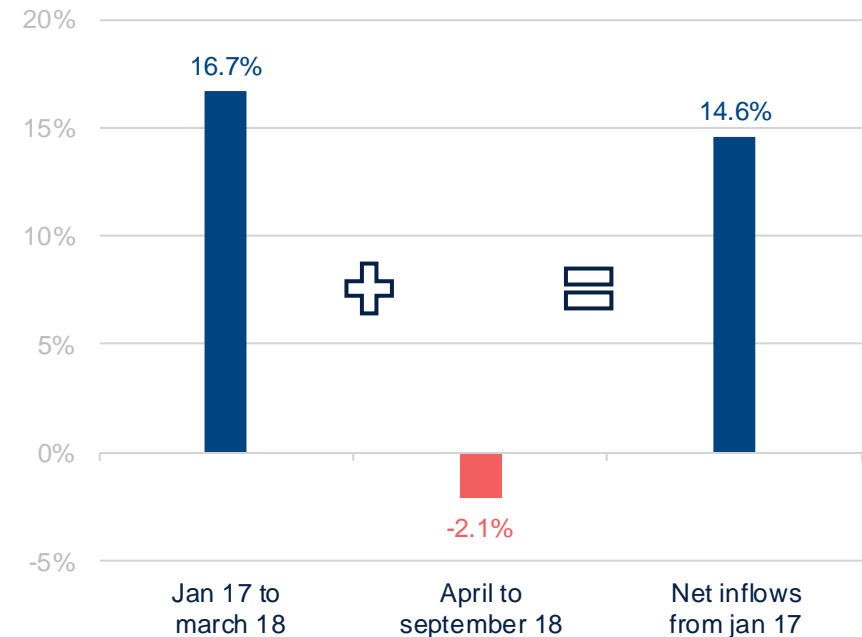
## Portfolio flows to emerging economies

(% of total assets, monthly data)



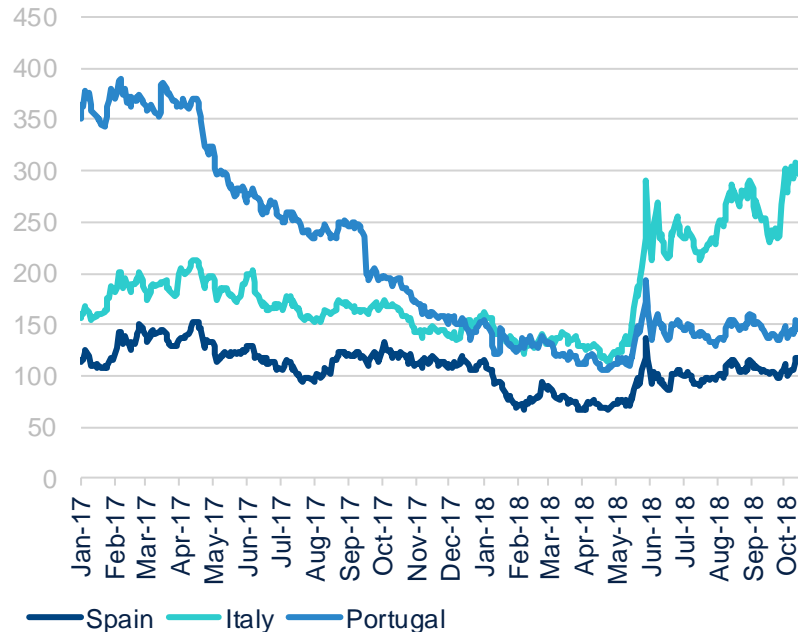
## Accumulation of flows in the last 5 quarters

(% accumulated since January 2017)



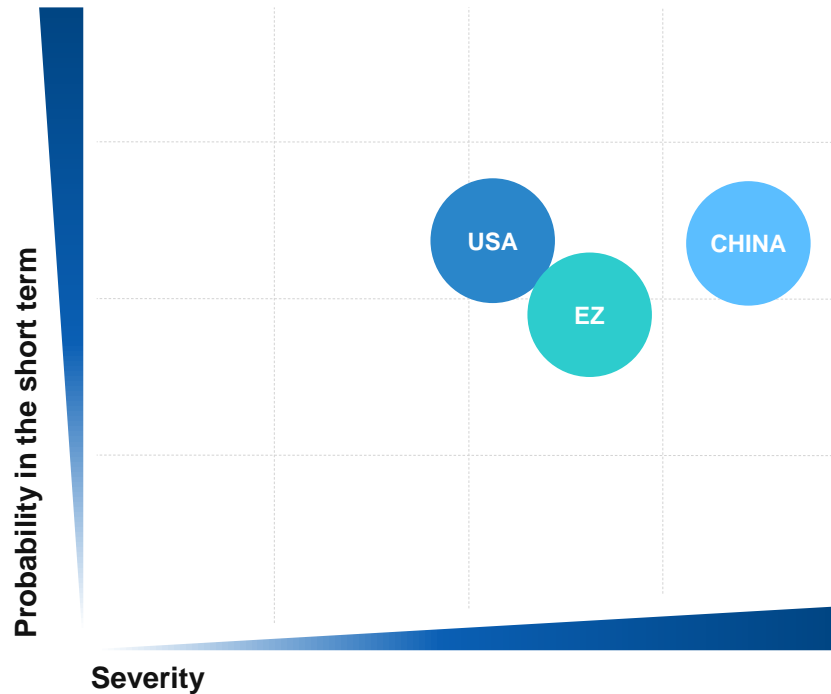
# Political uncertainty in Italy and Germany is weakening the euro and expanding risk premiums in peripheral countries

Risk premium for Spain, Italy and Portugal  
(bps)



- The reappearance of risk in the periphery countries is linked, above all, to the political uncertainty in Italy, which is putting the brakes on the advance of European integration
- Although the Italian risk premium was expanded significantly, the contagion to other peripheral countries was moderate...
- ...which did not prevent a safe-haven effect on German and US bonds, and a sharp depreciation of the euro

# Global risks: protectionism and the exit of the Fed remain the most relevant, but political uncertainty in Europe increases



## CHINA

- **Protectionism:** upward (new tariffs and reprisals) with an impact on domestic policies (financial stability, reforms)
- **High indebtedness:** more content in the short-term, but higher in the medium term (private debt continues to rise)

## USA

- **Fed exit:** rises of higher than expected rates
  - Differential impact on emerging markets
- **Protectionism:** upward and concentrated in China
- **Economic recession:** low probability, but rising
- **Signs of financial instability** in some assets

## EUROZONE

- **Political uncertainty:** upwards, led by **tensions in Italy** and Brexit
- **Protectionism:** more restrained with focus on the automotive sector
- **ECB's exit:** downward



Tensions in emerging economies can amplify the impacts of the aforementioned global risks (effects of "second round" on global growth)



01

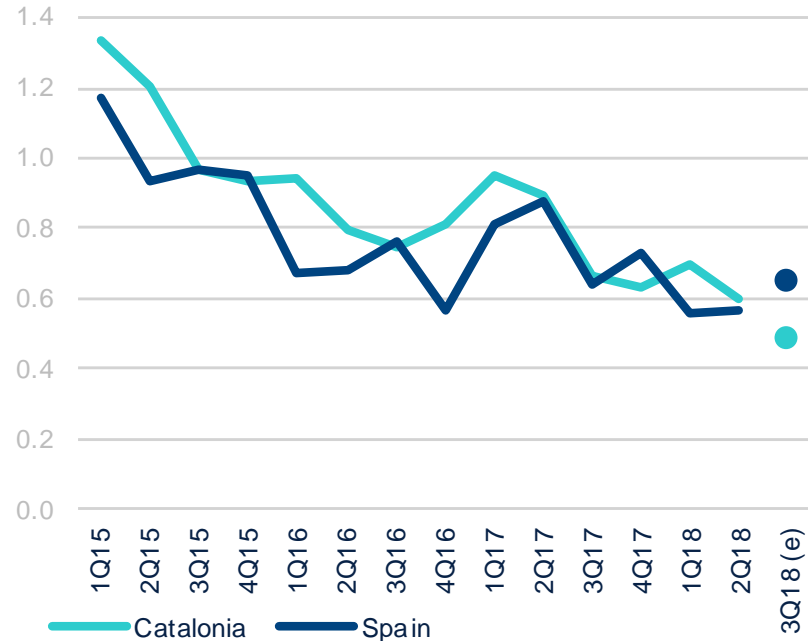
**Catalonia Economic Outlook**  
2<sup>nd</sup> half 2018

# Growth is moderating but will continue to be dynamic



# Growth is moderating but will continue to be dynamic

## GDP growth observed and forecasted using MICA-BBVA model (QoQ %)



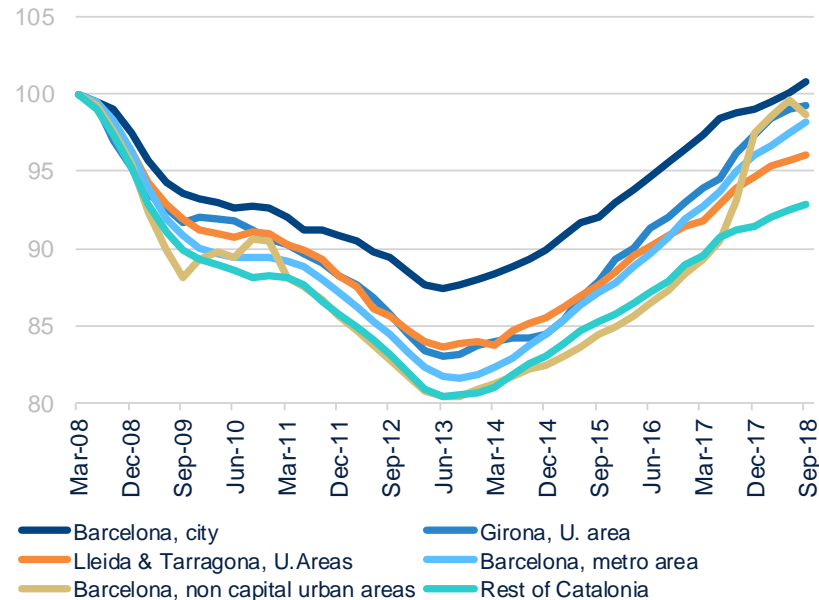
(e) estimated.  
Source: BBVA Research

- The data from BBVA Research suggest that the slowdown in the Catalan economy has continued in 1S18, with growth of around 2.5%
- In any case, it is a slight trend of lower growth, which does not prove stagnation
- The most recent data confirm this evolution

# Heterogeneous recovery in Catalonia

## Catalonia Social Security registrations by urban areas

(1Q08 = 100, SWDA)



Source: BBVA

- The labour market slows down in 2018: Social Security registrations increased by 0.6% QoQ SWDA on average in the first nine months (0.9% QoQ SWDA in Sep-17)
- This is due to the lower contribution of professional activities, retail trade and accommodation and food services
- The GAUs of Barcelona and Girona are more dynamic, while Lleida, Tarragona and non-urban areas are still far from recovering the pre-crisis employment level

# Outlook 2018-2019: Still far from stagnation



## The global expansion remains at a steady pace

Exports of goods should pick up soon, and the drop in tourism flows could also be contained



## Monetary policy should remain accommodative

For the next year, interest rates will remain low, supporting credit demand



## Oil prices

We are expecting a reversion of recent trends that should help firms' competitiveness



## A more expansive fiscal policy

It should boost growth in the second half of 2018 as we approach regional and local elections



## Still a lot of unused capacity

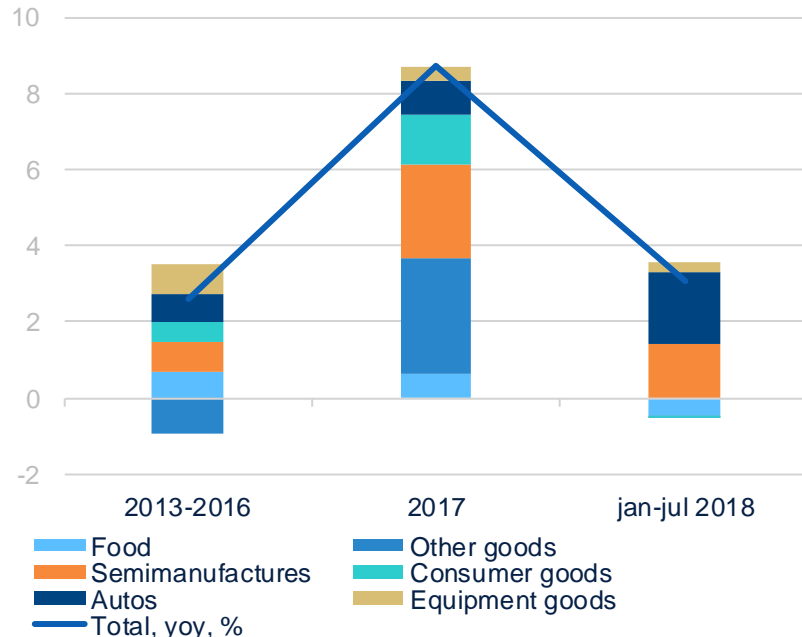
Real sector should boost job creation, while wage growth remains subdued



# 2018-2019: Exports of goods will continue to support growth

## Catalonia: Exports of goods by sector

(YoY, % and sectoral contributions pp, nominal)






- After the extraordinary growth at the end of 2017, exports of goods are showing similar behaviour to that of previous years
- The depreciation of the exchange rate, the recovery of the euro zone and the reversal of the price of oil are support factors so this improvement in exports can continue

# 2018-2019: The tone of economic policy will be expansive

## Spain: Impact of the downward revision of the euro exchange rate\*

(Deviation from base scenario levels in pp)

		2018		2019
 <b>GDP</b>	>	0.1	>	0.2
 <b>Exports</b>	>	0.7	>	1.1
 <b>Nominal effective exchange rate</b>	>	-0.9	>	-1.5



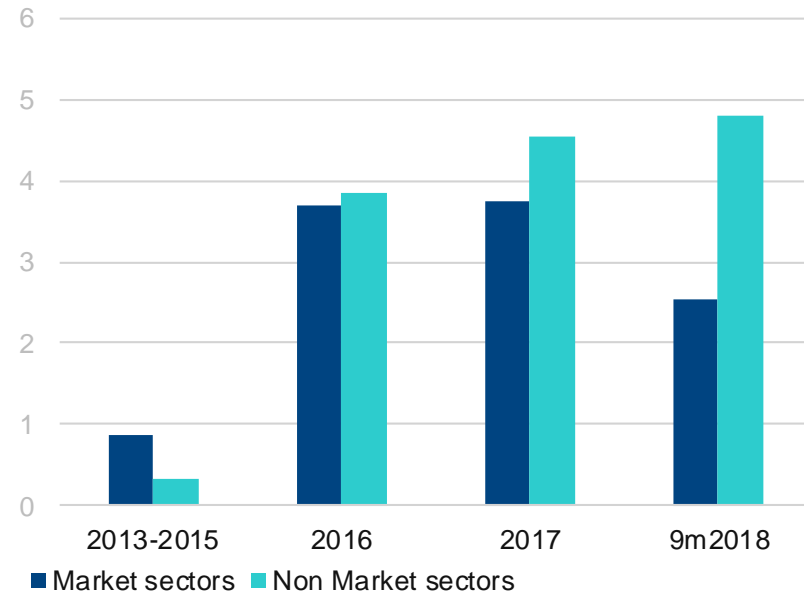
The delay in the rise of interest rates, together with a more depreciated euro, would facilitate a greater growth of exports over the coming months

\* The scenario of BBVA Research estimates that the appreciation of the EUR-USD will be 2.5% lower than previously estimated for 2018 (-4.5% in 2019).  
Source: BBVA Research

# 2018-2019: Fiscal policy will be expansive

## Social Security registrations in Catalonia in market and non-market sectors

(YoY, %)



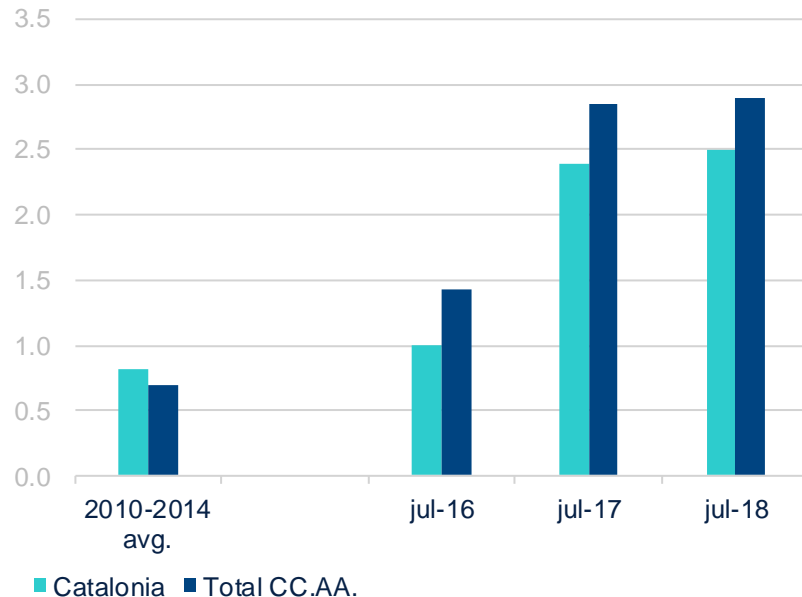
Source: BBVA Research based on Social Security data

- The Generalitat de Catalunya has taken advantage of the economic recovery to **boost spending on final consumption**, which has allowed employment to be expanded in non-market sectors
- The accounts of the Generalitat achieved a **budgetary balance in July 2018**
- The employment of the public sector is not being slowed, **as it is the case in the market sectors**

# 2018-2019: Fiscal policy will be expansive

## Generalitat de Catalunya and the Autonomous Regions as a whole: Public consumption

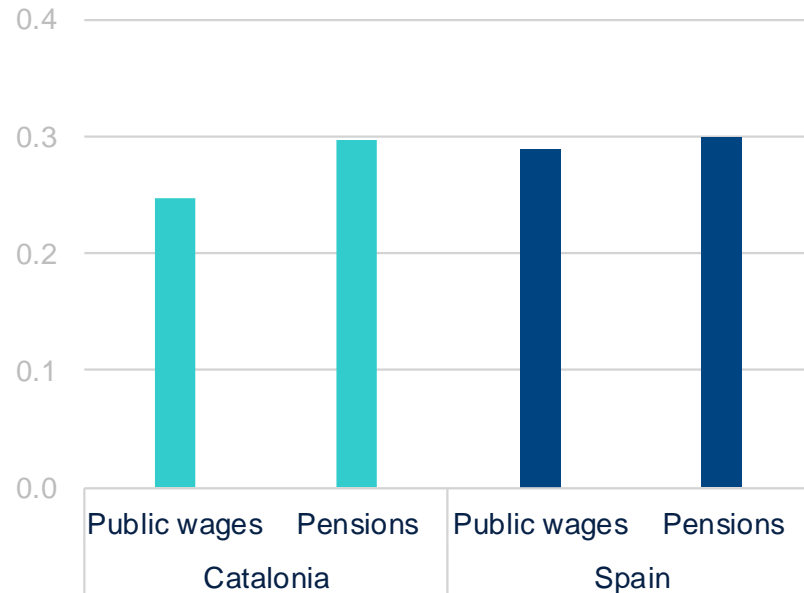
(YoY, %)



- The Generalitat is maintaining a rate of growth in public consumption similar to that of the autonomous regions as a whole. This increase, below nominal GDP, implies that the consolidation efforts until July is similar to the last year's
- Given the execution of the first half, in order to reach the goal of 0.4% deficit in 2018, the Generalitat de Catalunya needs to continue containing the increase in spending

## 2018-2019: Fiscal policy will be expansive

**Increase in disposable income as a result of increases in public salaries and pensions (pp of regional GDP)**

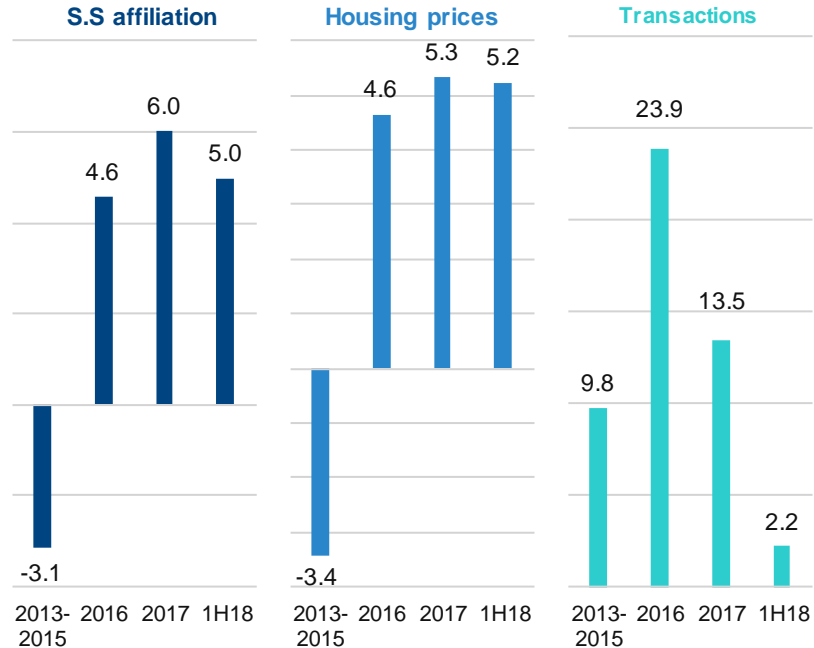


Source: BBVA Research

- Catalonia has a **weight of the public sector in the economy which is lower** than that of Spain as a whole, which partially offsets a greater weight of pensioners
- The injection of public funds in these two items (**€11 billion for Spain as a whole**) will increase the disposable income of Catalan households by 0.5 pp of regional GDP

# 2018-2019: The real estate sector will consolidate the trend of recovery

## Construction and housing: main indicators (YoY, %)

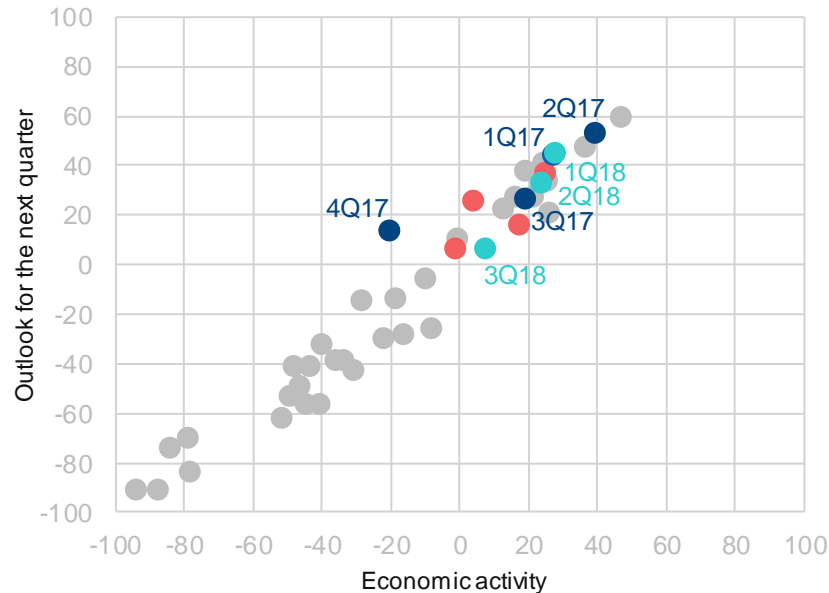


- The recovery of disposable income and good financing conditions are boosting the demand for primary residences
- The upward pressure of prices, due to the lack of supply, will continue to drive transactions, after the temporary slowdown linked to uncertainty in 1S18
- Employment in construction is maintaining its dynamism

# What is behind the slowdown? Structural and temporary factors

## BBVA Survey of Economic Activity in Catalonia

(Balances of extreme responses, %)



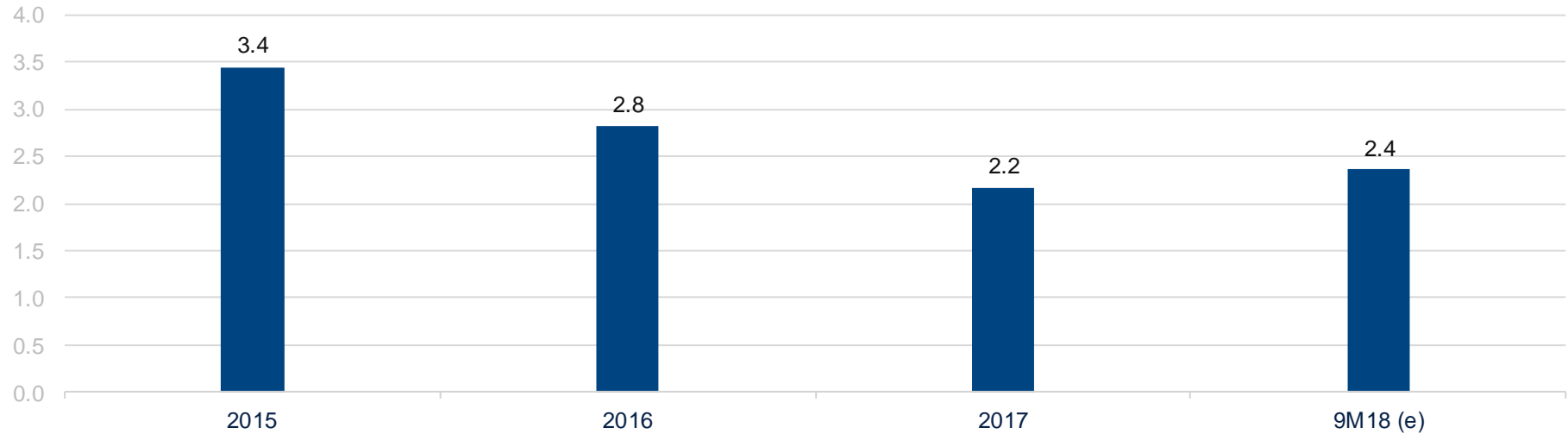
- The Catalan economy is gradually slowing down so far this year
- In any case, the vision continues to be favourable, both in the third and fourth quarter of 2018

# What is behind the slowdown?

## Structural factors: Depletion of the pent-up demand

### Regionalised Composite Consumption Indicator (ISCR-BBVA)

(% QoQ, SWDA)



(e) Estimated  
Source: BBVA Research based on DGT, CORES, Datacomex and INE data

The absorption of pent-up demand (postponed spending during the crisis) of durable goods stops contributing favourably to growth in 2017. Since then...

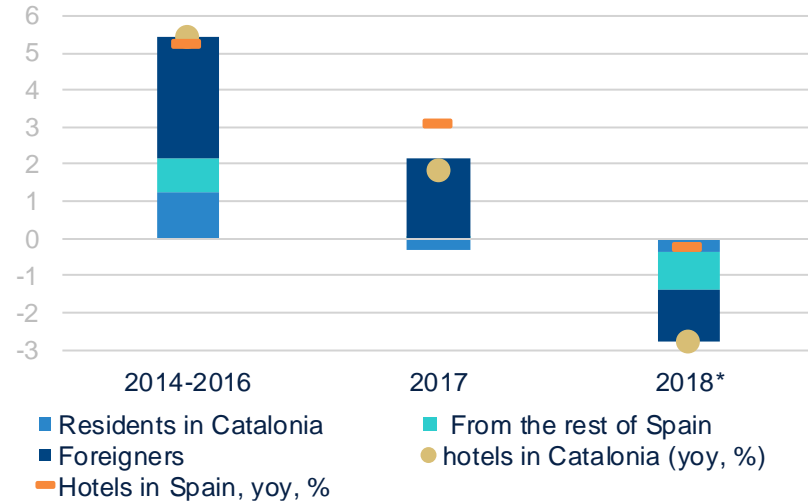
...consumer spending has increased above what is consistent with its fundamentals (available income, financial wealth, etc.). It is expected that in future quarters this will be progressively corrected



# What is behind the slowdown?

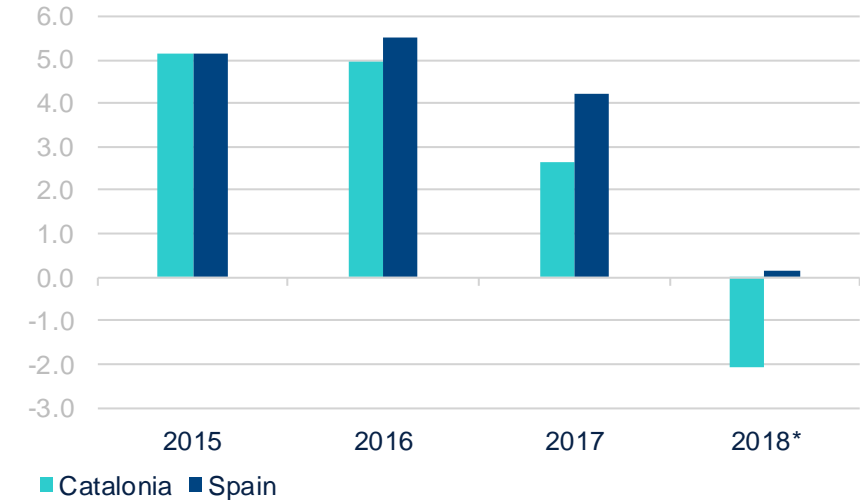
## Structural factors: Tourism begins to slow down

### Overnight stays in hotels (YoY, %, contributions by origin)



Source: BBVA Research based on data from INE and IDESCAT

### Hotel prices (YoY, %, 2018)



(\*) 2018, year-on-year data of the accumulated figure up to August.  
Source: BBVA Research and INE

The correction of prices so far this year has been insufficient to slow the fall in the number of visitors and overnight stays

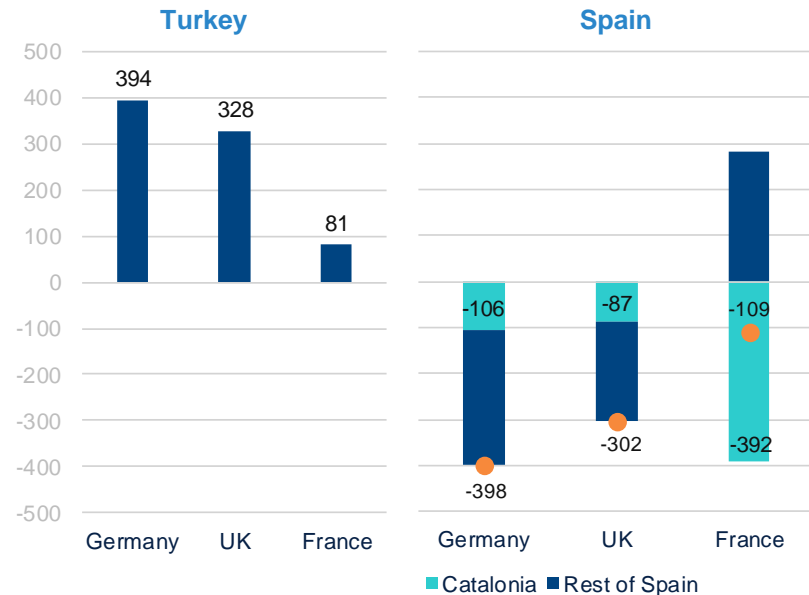
This contraction is explained, in part, by structural factors (competitiveness-price, recovery of competing markets) but also due to other circumstances (exchange rate, internal political tension, terrorist attacks)

# What is behind the slowdown?

## Structural factors: Tourism is beginning to slow down

### Tourist border entries: Turkey, Catalonia and rest of Spain

(Variation in YoY in thousands of people, Jan-Jul 18)

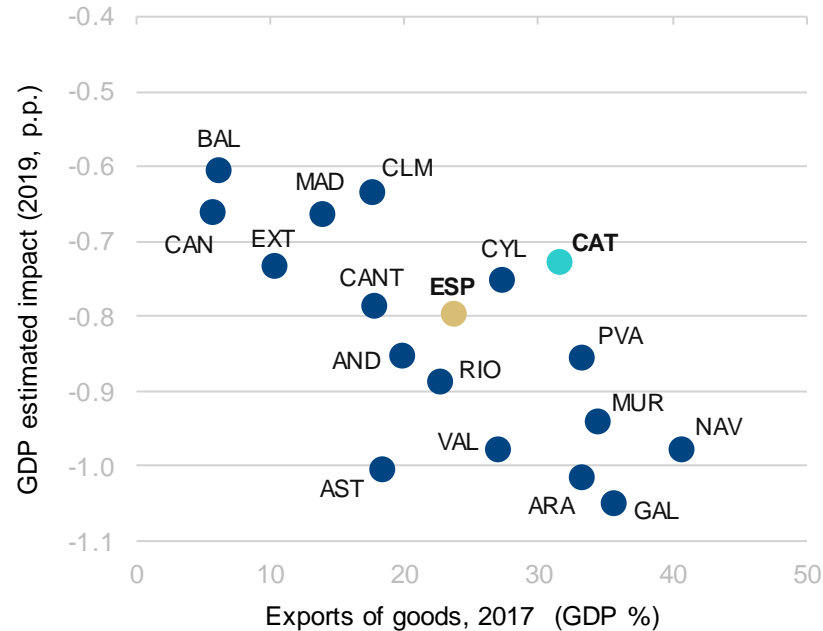


- The redirection to other destinations is especially noticeable for tourists of European origin
- The moderation in the growth of consumption does not explain the fall observed in visitors arriving from Germany, the United Kingdom and France
- Particularly price-sensitive tourists could continue to change their holiday destination due to the depreciation of some emerging currencies

# What is behind the slowdown?

## Factors that could be temporary: Oil prices

### Impact of the change in oil price forecasts (pp of regional GDP)

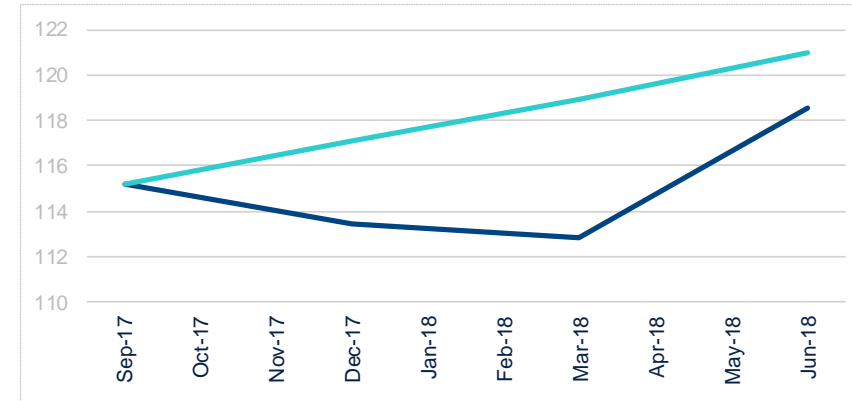
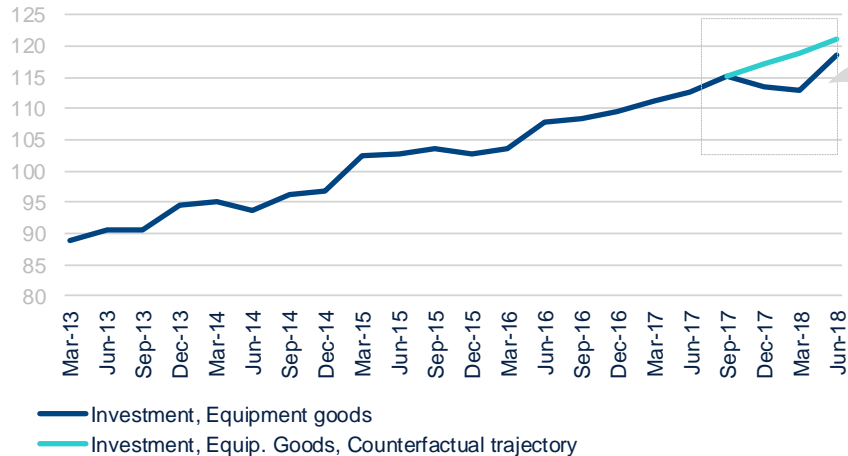


- It is assumed that 75% of the impact is related to supply factors (OPEC, Iran, Venezuela, etc.). The rest is explained by the increase in demand linked to the continuation of strong global growth
- The impact for Catalonia in terms of GDP could be around 0.7 pp.
- The autonomous regions which are most open and those with the most energy-intensive production are the most affected

# What is behind the slowdown?

## Factors that could be temporary: Political uncertainty

### Evolution of Catalan investment in capital goods (Level)



■ Although 2Q18 saw a recovery in the growth of Catalonia's investment in capital goods, there is still a loss of level due to negative investment shocks

■ It is estimated that between 3Q17 and 2Q18 Catalan investment in capital goods grew 2 pp less than it would have done in the absence of idiosyncratic shocks to investment

■ In terms of GDP, this contraction of investment would have meant 0.4 pp less of accumulated growth between 3Q17 and 2Q18

# 2018-2019 risks: Increase in number and probability of occurrence

## Global

01

### Lower EMU Growth

Already included in the performance, worse than expected, of exports of goods during the first half of 2018  
Watch out for: confrontation between Italy and the European institutions

02

### Higher oil prices

It is expected that most of the increase will reflect supply restrictions, which should generate a stronger negative impact

03

### Protectionism

At the moment, the direct impact in Spain is insignificant, but it could reduce investment expectations  
*Brexit*

## Idiosyncratic

04

### Political uncertainty

The approval of the PGE 2018 reduces uncertainty about economic policy, but it remains high

05

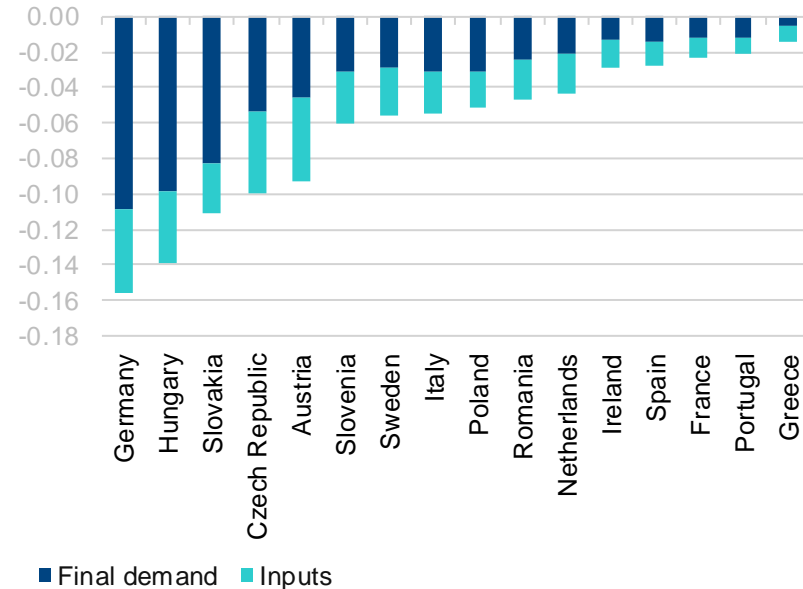
### Tourism slowdown

It is expected to continue, but the impact will be limited, while the sector concentrates in segments of greater value added

# The risk of an increase in US tariffs to the European automotive sector continues, with a limited and different effect per country

## Effect on GDP growth of US tariff increases to the European automotive sector

(2018-20, pp)



Simulation: increase in tariffs to 20% in the European automotive sector, Japan and South Korea in addition to the measures approved so far.

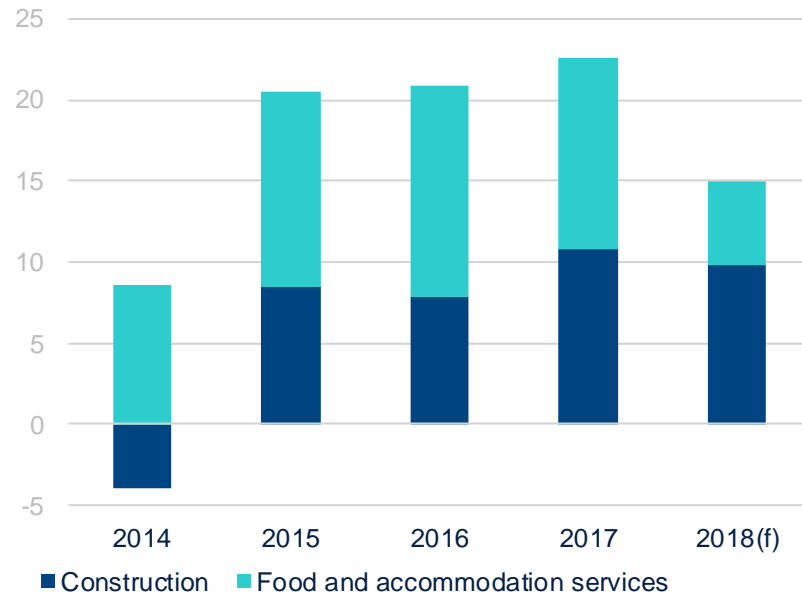
Source: BBVA Research

- An increase of the tariff to the European automotive sector up to 20% (2.5% currently) could subtract between one and two tenths of the growth of Germany the northern European countries
- There is uncertainty about the effect of tightening the amount of *inputs* produced in North America (75%) in the USMCA in European automobile companies, but the impact should be smaller
- The automobile industry employs 100,000 people in Catalonia, and accounts for 15% of exports. 20% of the cars that are made in Spain are produced in Catalonia
- Brexit: the risk is slightly lower for Catalonia, since the United Kingdom weighs less than in Spain as a whole on exports of goods and tourism

# Risks: Moderation of tourism and impact on job creation

## Social Security registrations in the construction and food and accommodation services

(Variation in YoY in thousands of people)



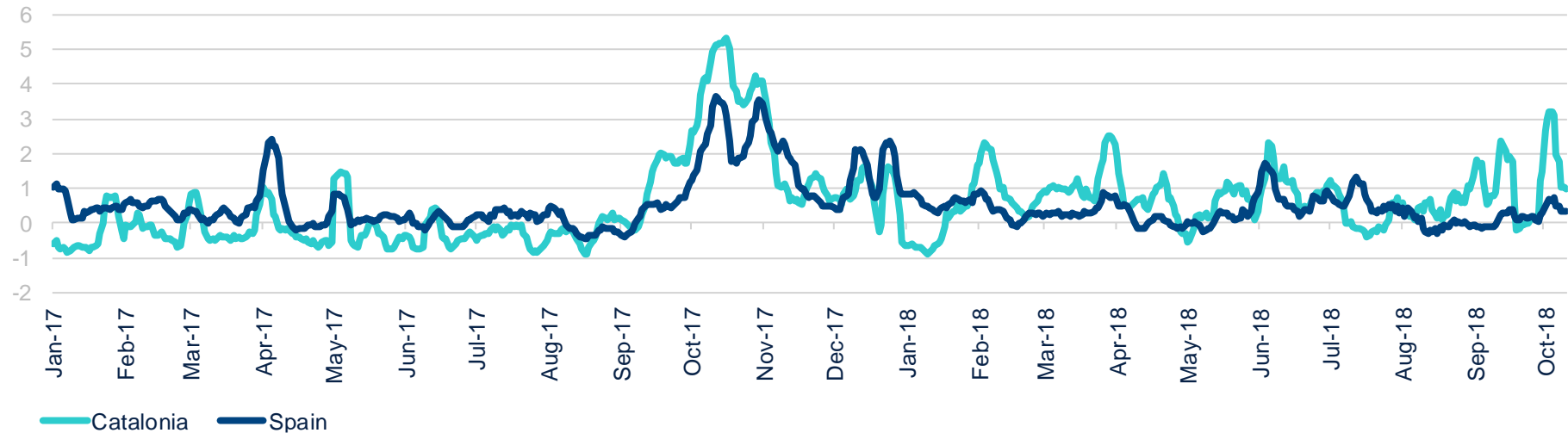
(p) Forecast.  
Source: BBVA Research based on Social Security data

- Between 2013 and 2017 the growth of Social Security registrations in the food and accommodation services was 45,000 people in Catalonia, 11% of total employment creation
- There are doubts about the capacity of other sectors to compensate for the slowdown that is already being observed
- Looking into the future, sectors such as construction still have a long way to go to replace tourism as a source of job creation

# Risks: Uncertainty regarding economic policy

## Catalonia and Spain: Indicator of economic policy uncertainty

(Standardised data)



Source: BBVA Research based on GDELT data

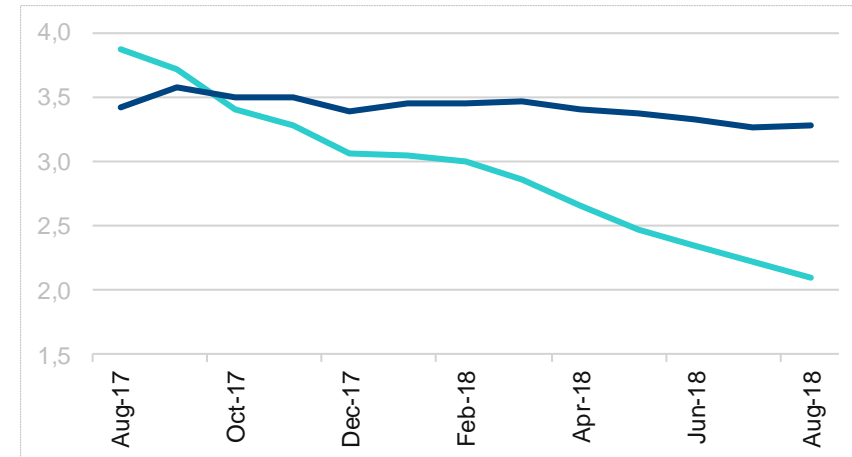
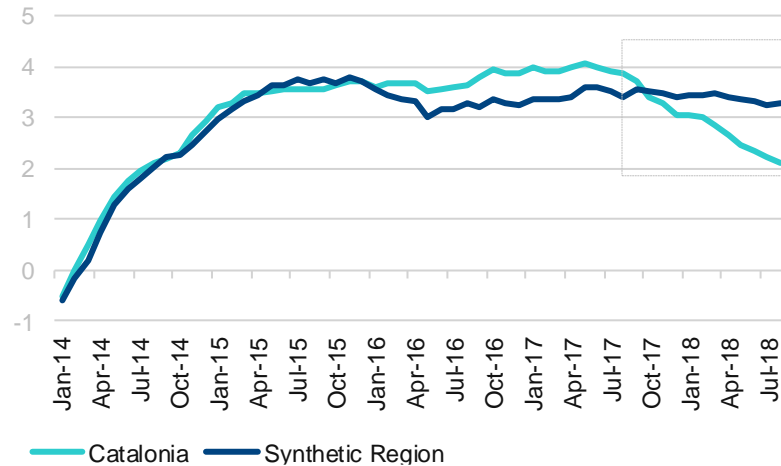
Uncertainty on the rise again in 3Q18. The approval of the Spanish National Budget 2018 helped moderate it in Spain in 2Q18, but there are doubts about the measures that will be implemented in the future... in Spain and in Catalonia



# What is behind the slowdown?

## Factors that could be temporary: Political uncertainty

### Social Security registrations in the private sector (% YoY)



- The slowdown in employment is more intense in Catalonia

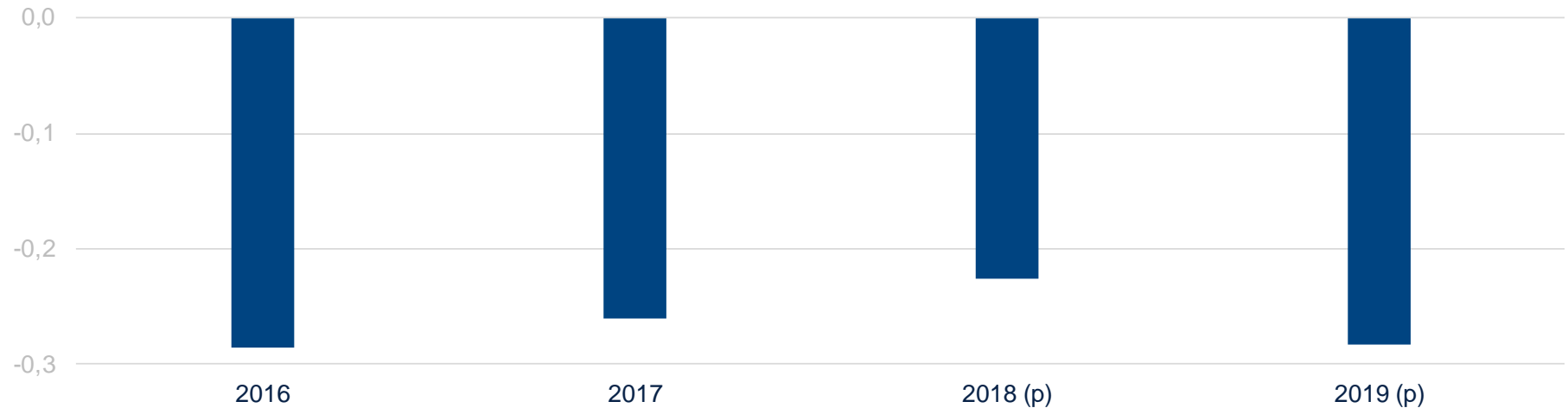
- To establish a counterfactual we use a methodology of synthetic control, as in Abadie and Gardeazábal (2004)

- The growth of employment is currently 1.4 pp less than in the counterfactual. This means that Catalonia today has 30,000 Social Security registrations less than the equivalent synthetic region would have had (about 1% of employment)

# Risks: Uncertainty regarding economic policy

## Impact of the uncertainty of economic policy on the annual growth of Spain's GDP

(%)



(f) Forecast.  
Source: BBVA Research based on GDELT data

**Uncertainty increases in 2Q18. The approval of the Spanish National Budget 2018 would have helped to moderate it, but there are still doubts about the measures that will be implemented in the future**

# Summary of forecasts with the main figures



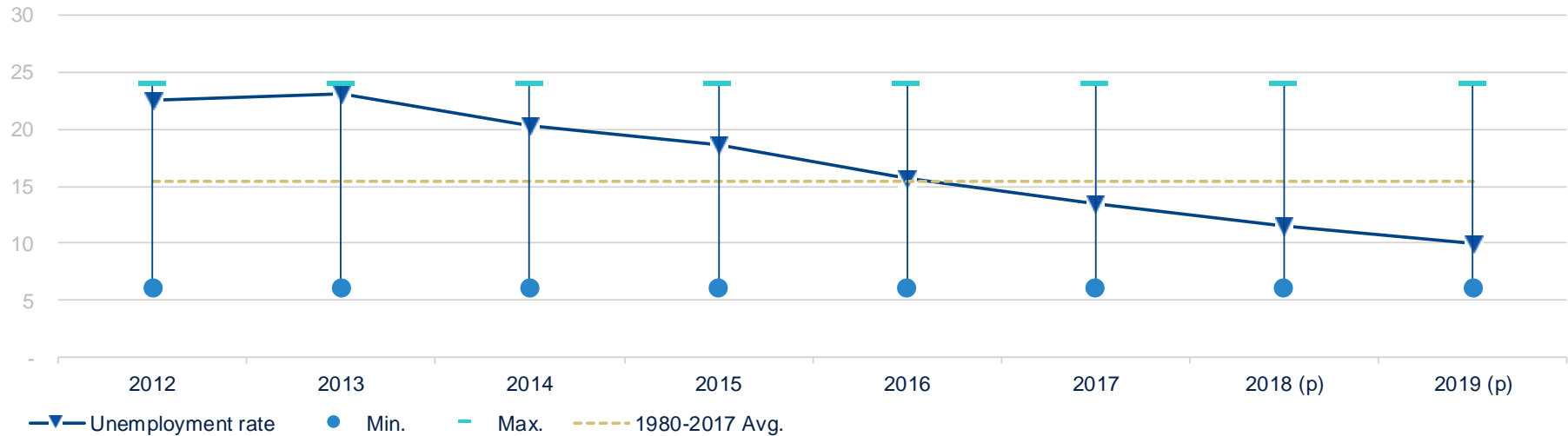
(\*) Annual average.  
Source: BBVA Research

**130,000 jobs will  
be created in  
the biennium 2018-2019**

**But the unemployment rate at the end of the biennium will still be 2.6 pp  
above the level in early 2008. Creating more and better jobs is a challenge  
of first magnitude**

# Challenges: High structural unemployment

## Catalonia: Unemployment rate (%)



(p) Forecast.

Source: BBVA Research based on INE data

**It is possible that the continuation of the recovery will begin to have an increasing impact on the formation of salaries. This growth is welcome if it is a consequence of improvements in productivity**

# Key messages

- The positive global environment is being maintained, but growth is moderating in emerging economies and in the euro zone
- In Catalonia, GDP growth will moderate to 2.5% in 2018 and to 2.3% in 2019. This would allow for the creation of 130,000 new jobs throughout the two-year period, and reduce the unemployment rate to 10% on average in 2019
- The continuation of the recovery will be based on a favourable environment for the growth of exports, the reduction of uncertainty and the support of fiscal and monetary policies
- Among the factors that justify the moderation of growth it is worth noting the depletion of some of the tail winds (pent-up demand, oil price), the weakening of tourism, the terrorist attacks in August 2017 and the increase in uncertainty related to the political environment
- In the absence of the events of the second half of the previous year (terrorism, uncertainty), the economy could have created 30,000 more jobs
- The greater vulnerability of the recovery demands the implementation of policies that reduce uncertainty and encourage inclusive growth, while increasing investment

The logo for BBVA Research, featuring the word "BBVA" in a bold, white, sans-serif font, followed by the word "Research" in a smaller, lighter weight of the same font. A small teal square is positioned to the right of the word "Research".

**BBVA** Research

# Catalonia Economic Outlook

2<sup>nd</sup> half 2018

October 2018

Creating Opportunities