BBVA Research

Spain Economic Outlook

2nd Quarter 2019

Contents

Closing date: **5 April 2019**

1. Editorial

Spanish GDP growth may reach 2.2% in 2019 and 1.9% in 2020, somewhat below the level of growth that was expected three months ago (2.4% and 2,0%, respectively). This would lead to around 630,000 jobs being created over the course of those two years and to a decline in the unemployment rate down to 12% by the end of the following year, while salaries are expected to begin rising consistently above inflation (2.1% in 2019 and 2.3% in 2020). This scenario is expected to take place against a backdrop of a gradual recovery in global demand, expansionary monetary policy, relatively low oil prices, and the expected fading of uncertainty. In any case, despite the fact that growth expectations have been lowered, there is still a negative bias in terms of forecasts owing to the fact that the number of risks remains high, with some of them being increasingly likely to occur, especially in 2H19 and 2020.

The solid GDP growth observed at the end of last year continued in 1Q19 (+0.6% QoQ) as a result of the good performance of private consumption and public spending. On one hand, household spending has been boosted by increased levels of disposable income which, in turn, can be attributed to public policy and the performance of the labour market, which has shown signs of salary acceleration and continues job creation, partly through the support of public employment. Moreover, consumer financing continues to grow at a double-digit rate while savings remain at historically low levels. All of this has happened in spite of the increased uncertainty observed in recent months. On the other hand, investment in non-residential construction is encouraged by fiscal stimuli.

Activity is increasing despite weak and uneven performance of private investment and exports. Although spending on machinery and equipment and export sales are expected to recover in the first part of the year, the recovery would follow declines in 2H18. The factors that have had an adverse impact in this regard include uncertainty regarding world trade, slowdown of growth in the EMU, regulatory changes in the automobile sector, and uncertainty surrounding economic policy. Moreover, residential investment has been negatively impacted, albeit temporarily, by legal uncertainty. Lastly, tourism sales to the rest of the world remain volatile, but with a trend shifting toward a slowdown as a result of a loss of competitiveness when compared to alternative destinations.

In any case, the improvement in terms of activity may be temporary, as the nature of the growth and the increased uncertainty surrounding economic policy make the recovery more vulnerable. For example, the good performance in terms of consumer spending and construction investment can be attributed to fiscal stimuli, but without the adoption of measures that could continue with the expansive stance, and with general, local and regional elections scheduled for the coming months, the economy will undergo a "fiscal adjustment" during the second part of the year. Moreover, the positive impact that the increase in the statutory minimum wage has had on demand will likely become less marked as the negative impact on employment increases over the coming months. Furthermore, there may be a slowdown in consumer growth due to the exhaustion of the pent-up demand accumulated during the crisis, the relatively low rates at which families are saving, and the possibility of diminishing returns resulting from credit demand being solvent. Finally, housing investment may make a smaller contribution than expected given the regulatory changes impacting the sector and the increased legal uncertainty for landlords, thus reducing the incentives for large investors. Furthermore, purchases in regions with exposure to the tourism sector are becoming less attractive.

Despite the risks, the recovery is expected to continue thanks to gradual improvement of the global environment and more expansionary monetary policy. Most significantly, this is due to the fact that the slowdown in the economies of our main trading partners should be bottoming out as the uncertainty that has been negatively impacting investment and international trade may begin to subside. Although growth forecasts for the EMU have been lowered from 1.4% to 1,0% for 2019, the trend toward moderate acceleration in terms of activity moving forward is continuing. Secondly, this weakness with regard to activity has led the European Central Bank to attempt to manage expectations with respect to interest rates, signalling that the benchmark interest rate used for monetary policy will not rise until at least the end of the current year. Moreover, in order to avoid liquidity stresses, the ECB has announced a new round of targeted longer-term refinancing operations (TLTROs). Both of these decisions will keep financing costs low for a period longer than had been expected three months ago, and will cause the euro-dollar exchange rate to depreciate somewhat. The expansionary stance of monetary policy will therefore be maintained, boosting domestic demand growth.

There are still numerous risks, and the probability of some of them occurring is increasing, which in turn has led to growth expectations being lowered. More specifically, although the most likely scenario is that trade tensions subside, high levels of uncertainty persist with regard to the outcome of negotiations between the United States, on the one hand, and China or the European Union on the other (particularly in the automotive sector). The negotiations regarding the withdrawal agreement between the United Kingdom and the European Union may be particularly important in terms of investment and prospects for growth in some regions, sectors and companies. The likelihood of a disorderly UK exit from the EU is increasing, which is having a negative impact on financial markets and economic activity. Moreover, the recent slowdown of growth in the EMU, which has occurred in spite of the monetary stimulus put in place by the ECB, is a cause for concern. The disappointing performance of the European economy is particularly worrying, as it reveals structural weaknesses relating to a lack of consensus with regard to reforms with the potential to boost European integration and generate environments to promote greater growth.

Domestic uncertainty is also on the rise. On the one hand, some of the measures put in place during the first part of the year may have a negative impact on employment and investment. These measures include the increase of the statutory minimum wage and the recent changes to regulations on housing rental contracts. On the other hand, reduced demand has been observed in some of the Spanish economy's core sectors (e.g. automotive and tourism), which may limit employment growth over the coming years. Finally, although the recent slowdown in terms of exports is the result of the slowdown in demand in Europe, the fact that capacity constraints are starting to be observed in some parts of the industry should not be ignored. In the same vein, salaries are beginning to accelerate, which is perhaps an indicator of a lack of qualified human capital. This, in conjunction with the absence of labour productivity growth, could lead to a slowdown in terms of job creation and to increased income inequality. All of the above is occurring in an environment where the electoral cycle is generating uncertainty with regard to measures that may be implemented over the next few years, rendering the Spanish economy increasingly vulnerable.

2. Mild slowdown in global growth

World growth has slowed down more than expected over recent months, raising fears of an abrupt downturn in economic activity. In this context, the Fed and the ECB have altered their roadmap and have announced new monetary stimulus measures. Similarly, China has implemented additional expansionary policies, both of a fiscal and monetary nature. This reaction by the economic authorities in the main economies points to a milder slowdown of world growth. However, an unforeseen reduction in dynamism in the Chinese economy, a new wave of protectionist measures and the disorderly exit of the UK from the European Union, among other risks, could trigger more negative scenarios if they materialize.

Global economic activity has slowed down, with a particularly weak performance in exports and the manufacturing sector

Having grown at an average of 1% QoQ since 2016, **the preliminary data suggest that world GDP could reach 0.8% QoQ in the first quarter of this year.** This would mean that, despite a slight improvement in world growth during the last two quarters of last year (0.7% QoQ), economic dynamism continues to be below that of previous years.

A number of factors have contributed to the slowdown in global activity, particularly; i) the structural deceleration of the Chinese economy now that it has stopped increasing its indebtedness; ii) trade protectionism; iii) in Europe, high uncertainty as well as certain specific—and probably temporary—events, such as the effects of the new European regulations on emissions in the automotive sector; and iv) the cyclical moderation in the US, in a context where the effects of fiscal stimulus are losing strength.

The factors underlying the world slowdown have affected activity, mainly in terms of exports and manufacturing. For now, it is compensated by private consumption, which remains relatively strong, supported by the dynamism of labour markets and limited inflation.

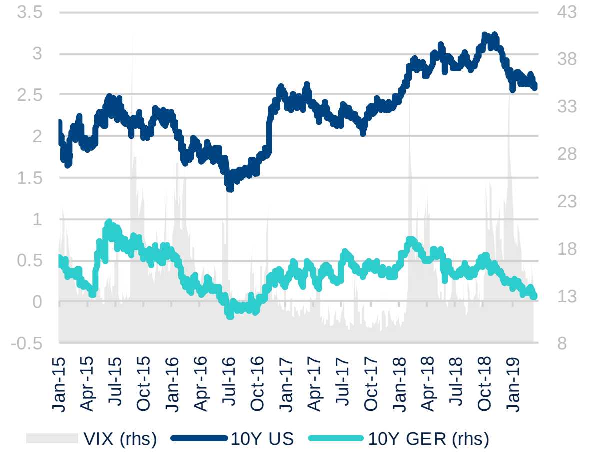
The downturn in growth has led to an unexpected turn in US and Eurozone monetary policy

The more negative stance of the world economy has generated a certain level of concern, as well as an increase in financial volatility. Against this backdrop, and given that inflationary pressures continue to be limited, the Fed and the ECB have reacted, making an aggressive turn in their communication on the assessment of the environment and the expected path of their policies. The US monetary authority has significantly adjusted its stance and strategy towards a more accommodating monetary policy. In this regard, in addition to revealing it will be "patient" when considering additional interest rate rises, the Fed has announced that its balance sheet reduction process will end by September of this year, sooner than expected, at a level of around 17% of GDP (between 3.5 and 3.8 trillion dollars). Given their prudence and the low inflation pressures, rates could be expected to remain stable, or even decline, if activity data reveal a growing slowdown of the economy. In any event, there would still be room for a final increase of 25 bps, to 2.75% by the end of 2019, if the moderation in growth proves to be mild and limited (previously, two rate increases were expected in 2019, which would have resulted in reference rates reaching 3%).

As for the ECB, the change towards a more expansionary policy has translated into a delay in interest rate rise expectations and the announcement of a new round of liquidity auctions. As for the former, the ECB has delayed its rate increase expectations from summer 2019 to at least the end of the year. On the other hand, the monetary authority announced a new series of targeted longer term refinancing operations (TLTRO-III), to be carried out between September 2019 and March 2021. In this context, rate forecasts have been adjusted, with a first rise in deposit rates expected by June 2020 and that of the official reference rate by December 2020. The ECB is expected to provide further details on the terms and conditions of the new TLTROs in June.

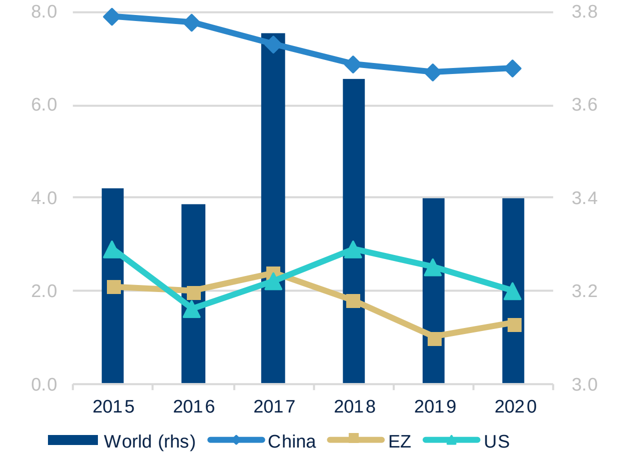
China has also reacted to the growing concern regarding the deterioration of the economic outlook. Specifically, local authorities have confirmed a tax cut, focused on VAT, of 2 percentage points of GDP, as well as an increase in public deficit, from 2.6% of GDP in 2018 to 2.8% of GDP in 2019. Signs of greater monetary accommodation are also evident. In this regard, two additional cuts of 25 bps in the reference interest rates, as well as two reductions in the bank reserve requirements in the second and third quarters, are envisaged.

Figure 2.1 Performance of sovereign debt and equities market volatility (VIX) (%)



Source: Haver and BBVA Research

Figure 2.2 Annual GDP growth: 2015-2020 (*) (%)



(*) Forecasts as of 2019.
Source: BBVA Research

Weaker global growth is affecting financial market performance

The deteriorating outlook of global activity and the associated reduction in inflation expectations, along with central banks' more prudent approach, **have led to a sharp drop in the yields of 10 year bonds in the US and Germany** (see Figure 2.1), supporting the view that they will remain at significantly low levels for a long period of time. This adjustment has led to the flattening of yield curves, which has given rise to additional doubts about whether they are discounting a further slowdown.

In any event, the change by the Fed and the ECB towards a more accommodating monetary policy and a certain optimism regarding the results of the US-China trade negotiations have supported stock markets, partially offsetting the negative effects of cyclical deterioration. However, if the economic activity continues to disappoint, financial markets will find it hard to maintain their recovery. Finally, with regard to equity market volatility, this is most likely to remain relatively limited over the coming months, with a VIX between 15 and 18, supported by the prudent approach of the central banks and below the levels of the last months of the previous year (see Figure 2.2).

Global growth is expected to reach 3.4% both in 2019 and in 2020

The new economic stimuli support an orderly moderation of world growth. **Global GDP, which grew by 3.8% in 2018, would grow to 3.4% in 2019 and to 3.4% in 2020 (see Figure 2.2)**.The soft landing of the world economy is subject to the US and China managing to reach a trade agreement in the second quarter of the year, which is fundamental to reduce uncertainty and prevent an additional deterioration of international trade. Moreover, another important condition in this scenario of gradual moderation of growth is that the UK's exit from the European Union (Brexit) does not significantly disrupt the relations between the two regions. Lastly, the probable upcoming reduction in oil prices due to dwindling demand and growing supply in the US will help to maintain inflationary pressure under control, and provide room for manoeuvre for central banks to execute their monetary policy (the price of a barrel of Brent is expected to fall from around $65 in the first quarter of the year to close to 62 and 55 dollars by the end of 2019 and 2020, respectively).

In the US, growth will continue to gradually lose momentum, approaching potential. In particular, US GDP is estimated to grow by 2.5% in 2019 and by 2.0% in 2020. Although the growth forecasts for the country remain unchanged, the trend is downward and the risk of recession continues to be significant, given the possibility of a further slowdown in investment, financial vulnerability and the more negative tone of the global scenario, among other factors.

In Europe the downturn in activity, mainly present in exports and in the industrial sector, has been longer than expected. Moreover, the uncertainty regarding the outcome of the Brexit negotiations and the US threat to increase tariffs on vehicles produced in the region remains high. **In this context, growth forecasts for the Eurozone have been revised downwards, from 1.4% to 1.0% in 2019, and from 1.4% to 1.3% in 2020**. The bias of these forecasts is downward.

As for China, the trade agreement with the US is expected to be formalized and recent stimuli are expected to support domestic demand, which would enable GDP to grow by 6.0% in 2019 and by 5.8% in 2020, in line with previous forecasts. The expansionary policies reduce the risk of a sharper drop in growth, but at the cost of hindering the reduction of the country's structural problems, such as its high leverage levels.

The greater slowdown of world growth will bring about additional difficulties for the economic activity of emerging countries. However, the more accommodating policies of the main economies could reduce the pressure on currency and money markets in emerging markets.

In this context the slowdown in growth will tend to further reduce the pressures on inflation both in the main developed and the emerging economies. This will be further helped by the expected drop in oil prices.

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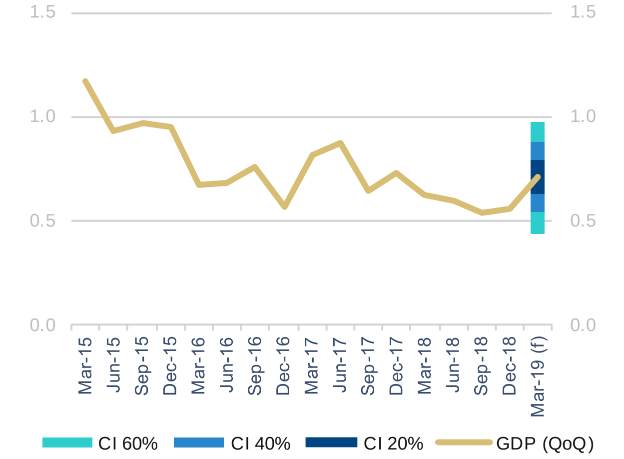
3. Growth outlook for the Spanish economy

Activity maintains a good rate of growth, although uncertainty remains high

The information available at the closing date of report was written suggests that **the Spanish economy may have grown between 0.6% and 0.7% QoQ SWDA (2.9% YoY)[1] in 1Q19** (forecast using the MICA-BBVA model).[2] If this estimate is confirmed, the increase in activity between January and March would be towards the lower bound of the forecasts made at the beginning of the quarter (MICA-BBVA: between 0.6% and 0.8% QoQ) and in line with the data observed at the end of the previous year (0.6% QoQ in 4Q18)[3].

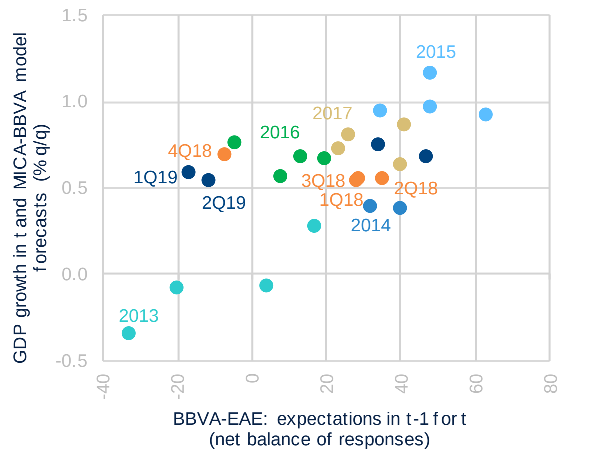
For the second quarter of 2019, uncertainty about the rate of growth remains high, as shown by the less favourable view of the results of the BBVA Economic Activity Survey (EAE-BBVA)[4] (See Figure 3.2).

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



(e) Estimate.
Source: BBVA Research based on INE (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 M. Camacho 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: It should be noted that the downward revision of the growth figures provided by the INE for 2H18, one tenth in each quarter, partly explains the downward revision of the growth expectations for 2019.
4: 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

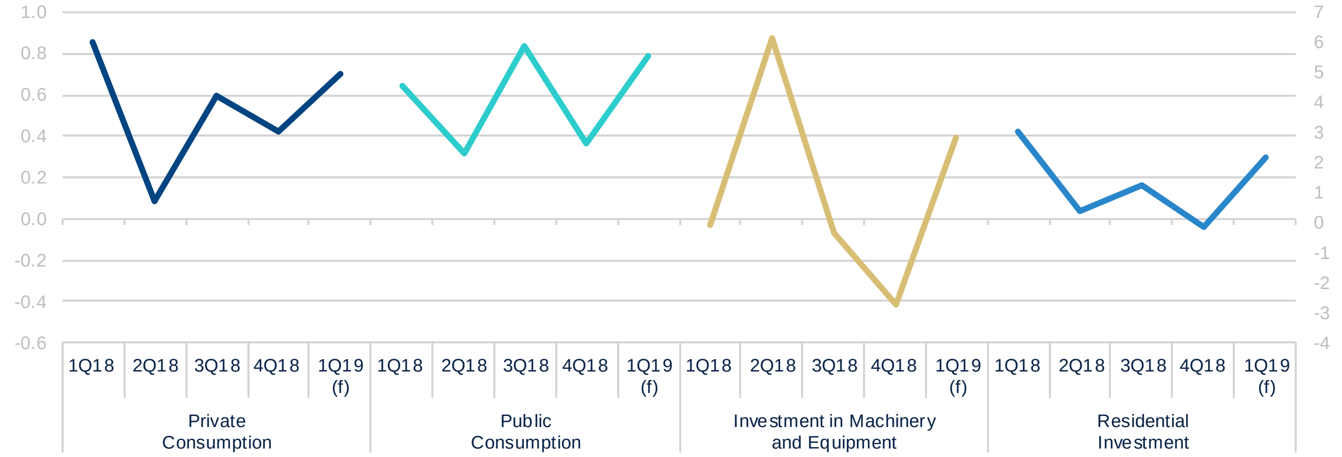
Domestic demand was again the main support for economic growth in the first quarter

Private and public consumption expenditure is increasing at a high rate at the start of the year. Expenditure[5] indicators suggest that household consumption may have increased by around 0.7% QoQ (1.8% YoY) in 1Q19, after a slowdown at the end of last year (0.4% QoQ, 1.9% YoY in 4Q18). In turn, the available data on budgetary execution suggest that public consumption expenditure may have increased by 0.8% QoQ (2.3% YoY) in 1Q19, 0.4 pp more than in 4Q18.

As for investment, an upward adjustment is expected following the disappointing performance in the second half of 2018. Thus, partial economic indicators suggest that investment in machinery and equipment may have rebounded to 2.8% QoQ (5.8% YoY), which would offset the decline recorded in 4Q18 (-2.7% QoQ)[6]. Similarly, residential investment seems to have returned to positive ground (2.2% QoQ; 3.7% YoY), following the stagnation observed in the last quarter (-0.1% QoQ, 4.6% YoY in 1Q19)[7]. On the other hand, it is estimated that quarterly growth in investment in other constructions will remain high (1.0%; 7.9% YoY), although below the levels recorded in 4Q18 (2.8% QoQ; 8.1% YoY).

In summary, partial economic indicators suggest that in 1Q19 **domestic demand may have contributed 1.0 pp to the quarterly increase in GDP** thanks to growth in all components, especially consumption (see Figure 3.3).

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



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

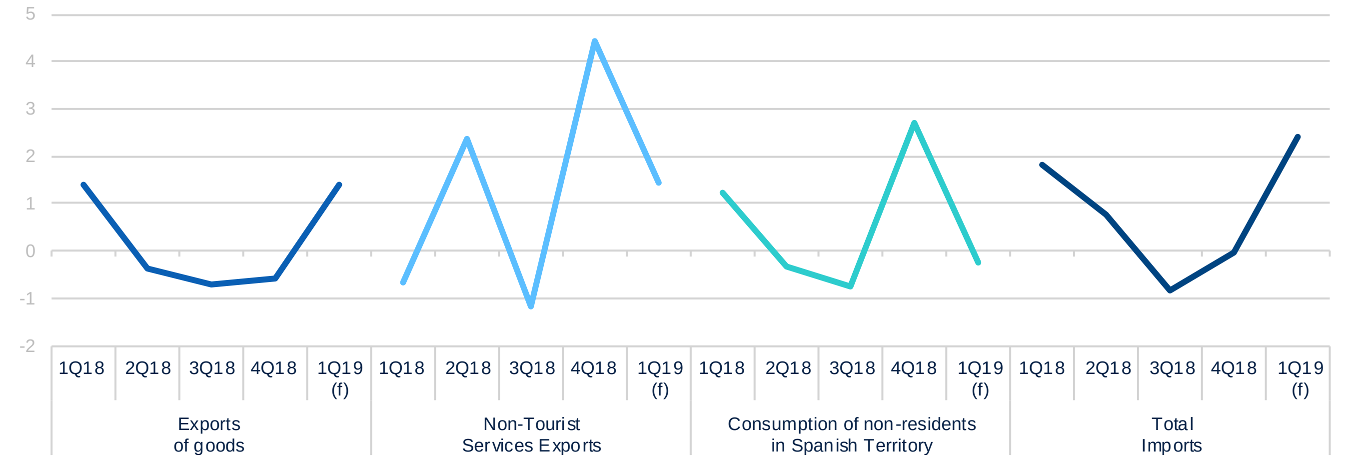
5: Spending indicators are showing mixed signs Retail trade turnover lost momentum in 1Q19 due to the decline in spending on durable goods. Moreover, private vehicle registrations showed moderate growth following the two-digit fall in 4Q18 caused by the demand ahead of the third quarter due to the entry into force of the new emissions approval cycle (WLTP). Financial position indicators show an upturn in real wage incomes, driven by job creation and the wage increases agreed in collective bargaining agreements, the rise in share prices, which had receded for six consecutive quarters, and in new consumer financing. Although household perception of the economy shows a deterioration, neither expectations regarding the financial situation of the household nor purchase intent for durable goods show any change.
6: Most of the indicators have evolved positively in the quarter. Only industrial confidence in capital goods recorded a worse performance than in the previous quarter. Meanwhile, the report underlines the increase in sales of industrial vehicles after the fall in the last quarter of 2018. The indicators also show a return to IPI growth in capital goods, imports of capital goods and the order books of capital goods following the reductions seen in 4Q18.
The indicators mainly show a reduction in sales of industrial vehicles and a contraction in industrial confidence. Capital goods orders also shrank, but less than in the previous quarter. For its part, the IPI of capital goods increased, but less than in 3Q18, and imports of capital goods stagnated
7: The employment indicators available in the construction sector show a steady pace of growth at the end of the year. Meanwhile, the number of visas is expected to increase in 1Q19 after the first drop in nine quarters recorded in 4Q18. In addition, the business confidence index in the sector is also expected to improve in relation to last quarter.

Trade flows return to positive growth in 1Q19, but caution is warranted

Exports of goods and services may have grown by 1.2% QoQ (1.2% YoY) at the start of the year, following the volatility observed throughout 2018 (see Figure 3.4). In particular, and despite high levels of uncertainty, exports of goods may have grown by 1.4% QoQ (-0.3% YoY) in 1Q19, after three consecutive quarters of decline.[8] In turn, exports of services would remain on positive ground (0.7% QoQ, 4.7% YoY), although growth would only be due to exports not linked to foreign tourism (1.5% QoQ; 7.2% YoY), while exports corresponding to non-resident consumption in national territory would experience practical stagnation (-0.2% QoQ; 1.4% YoY)[9].

In line with the trend in final demand, the information available at the close of this publication suggests that imports may have increased 2.4% QoQ (2.3% YoY) in the first quarter of the year. This, together with the expected performance of total exports would mean that net external demand contributed -0.4 pp QoQ (-0.3 pp YoY) to growth of the Spanish economy in 1Q19.

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



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

Job creation continued at a steady rate at the start of 2019

Once seasonal variations are discounted for, **Social Security affiliations increased by 0.7% QoQ in the first quarter of 2019 (2.9% YoY), 0.1 pp less than in the fourth quarter of the previous year, with close to 19,200,000 contributors in March** (see Figure 3.5). However, the decline in registered unemployment, while widespread across all sectors of activity, lost momentum between January and March. Thus, the number of unemployed people decreased by -1.1% QoQ SWDA (-5.3% YoY), 0.8 pp less than in the previous quarter. [10]

The positive growth in affiliation concur with a worse employment performance in some vulnerable groups. In any case, there is still not enough data to say whether this trend is related to the increased minimum wage or to other factors. The information available until March suggests a worse performance in Social Security registration among young people, those engaged in traditionally low-wage service activities (such as retail or

8: Partial indicators of sales abroad gave conflicting signals. While the available trade balance information points to growth in 1Q19, exports by large companies and the order book foresee a stagnation or slight decline.
9: Overnight hotel stays by non-resident tourists dropped by 0.9% MoM SWDA on average in January and February. Visitor border arrivals reduced by 0.5% MoM. Tourism income of the balance of payments reduced by 0.8% SWDA in January.
10: Since mid-2013, Social Security registration has grown by 18.0% SWDA, but is still 1.4% below the pre-crisis peak reached in early 2008. Although unemployment has fallen by 35.7% in the last five years, it is 59.8% higher than in mid-2007.

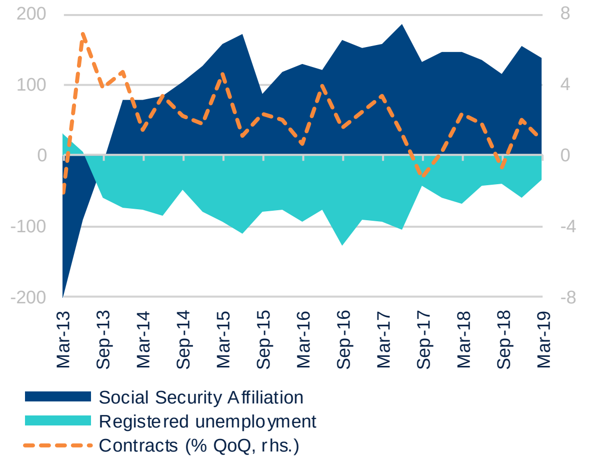
hospitality) and residents of Andalusia, the Canary Islands, Extremadura and the Region of Murcia. As shown in Figure 3.7, the number of affiliates under 30 in the first quarter fell 1.6% from the fourth quarter of last year, 0.3 pp more than in the first quarters of the two-year period 2017–2018. A similar result is obtained from comparing registration in sectors or regions with greater minimum wage coverage in 1Q19 compared to the same period in previous years.

Theoretically, the increase in minimum wage could have an impact not only on the level of occupation, but also on its composition. In particular, increased wage costs could cause a decline in salaried employment and an increase in self-employment. However, **the Social Security data** seen in Figure 3.7 **do not show clearly that this may be happening among workers who are potentially most affected by the rise in minimum wage**. For example, the number people under 30 affiliate under the general regime fell 1.7% in 1Q19, 0.3 pp more than in the same period in 2017 and 2018.

In line with registered unemployment, recruitment saw reduced levels of growth. After growth of 2.0% QoQ SWDA (5.4% YoY) in 4Q18, the increase in recruitment slowed to 0.9% QoQ SWDA (3.9% YoY) between January and March due to a decline, for the second consecutive quarter, in permanent contracts (-6.7% QoQ; -0.7% YoY). Combined with a rise in the number of temporary contracts (1.7% QoQ SWDA, 4.4% YoY), this triggered an increase of 0.8 pp in the ratio of temporary employment, to 90.6% SWDA. However, the percentage of temporary contracts is two points lower than the figure at the end of 2013, as shown in Figure 3.6.

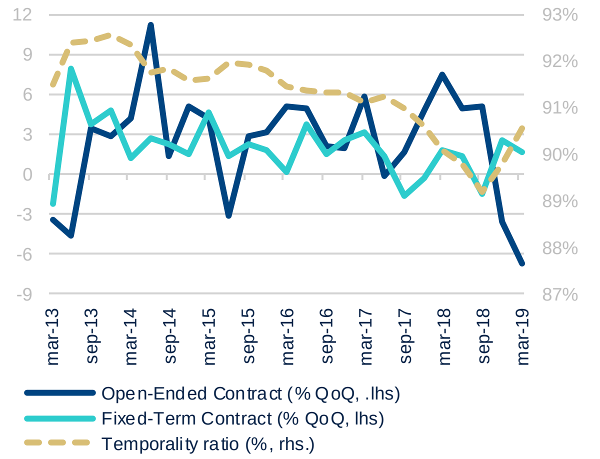
The Labour Force Survey (LFS) for 1Q19 is expected to confirm the trend suggested by Social Security affiliation and unemployment figures. Employment may have increased by about 0.6% QoQ SWDA (2.9 % YoY) in the first quarter, between 0.2 pp and 0.3 pp less than in 4Q18. If the active population barely grows, as expected, the rise in employment would bring about a fall of 0.4 pp in the unemployment rate, down to 14.1% SWDA. [11]

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



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

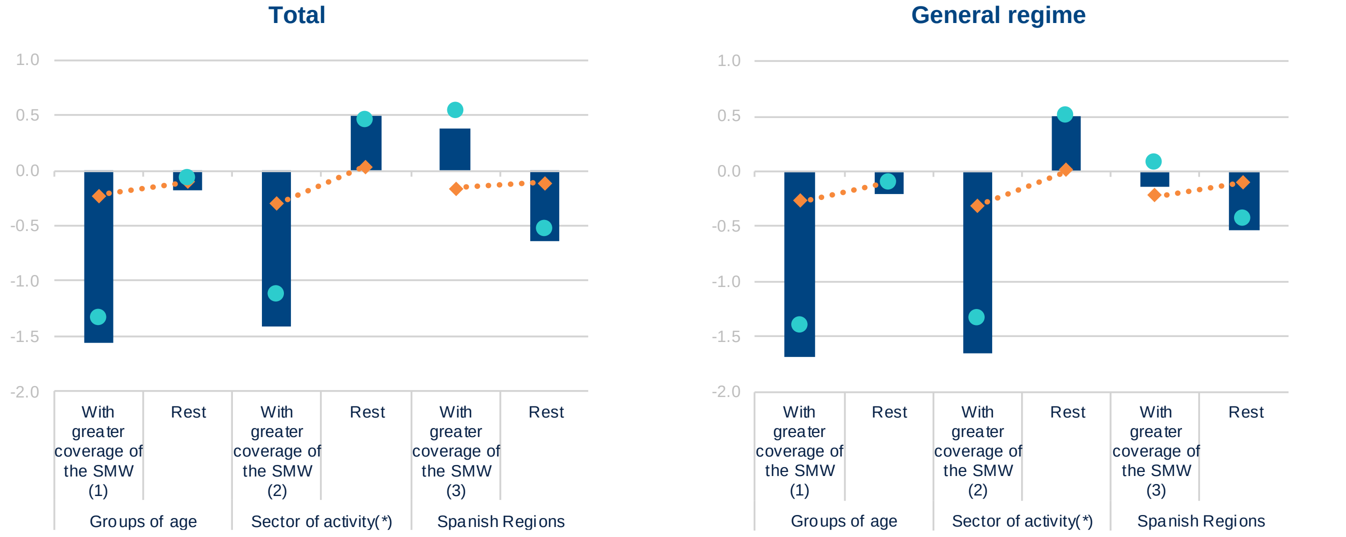
Figure 3.6 Spain: trend in recruitment
(SWDA data)



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

11: Given the negative seasonality of the period, the unemployment rate would exceed 14.7% in 1Q19.

Figure 3.7 Spain: quarterly variation of Social Security registration in the first quarters (1Q vs 4Q, %)



(*) General regime and self-employment regime.
(1) People under 30.
(2) Commerce, hospitality, real estate activities, professional, administrative and artistic activities and other services.
(3) Canary Islands, Extremadura, Andalusia and Murcia.
Source: BBVA Research based on Ministry of Labour, Migration and Social Security data

Prices break their downward trend, while wage demands have been on the rise

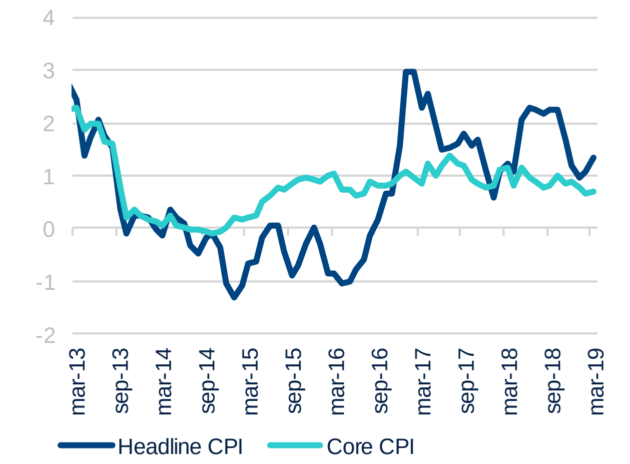
At the start of the year, headline inflation ended its downward trend and, according to the indicator, closed March at 1.3% YoY (see Figure 3.8). Significant events behind this trend include the upward adjustment of energy prices, which accelerated 0.7 pp between January and March, to 5.7% YoY, due to the base effect after the fall one year ago. In contrast, **core inflation fell throughout 1Q19 and closed March at 0.5% YoY**, due in part to the base effect created by the timing of the Easter holidays.

In this context, **the headline inflation differential compared to the eurozone remained favourable to Spain at the start of 2019 (-0.4 pp YoY in March).** In addition, BBVA Research estimates suggest that, using core inflation as a reference, the price growth differential also stood at -0.4% YoY in March.

Wage demands rebounded in the first quarter. The average wage growth agreed in collective bargaining agreements up to February exceeded 2.2% YoY, 0.5 pp more than at the end of 4Q18. In contrast to developments since early 2017, the agreed increase in remuneration in the revised multi-year agreements was similar to the increase in the agreements signed during the current year (2.2%), which relate to just 61,800 workers.[12] As seen in Figure 3.9, the wage increase established in the agreements signed up to February exceeds by 0.2 pp the minimum level recommended in the 4th Agreement for Employment and Collective Bargaining (AENC).[13]

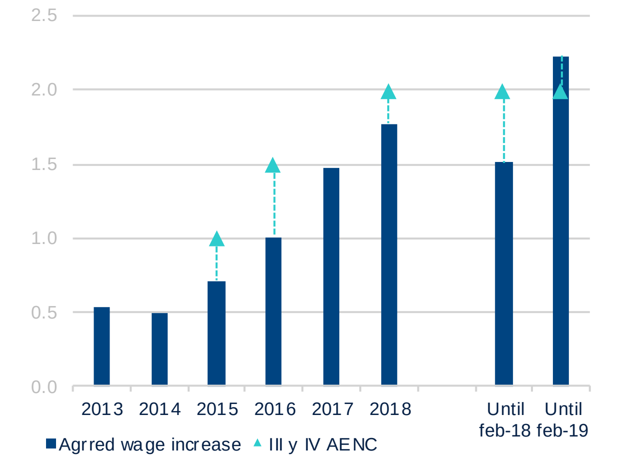
12: As at February, the number of workers covered by collective bargaining agreements was close to 6,200,000 million, including those affected by agreements signed before 2019 (6,145,000), 30% more than that registered up to last February.
13: The 4th AENC, which was signed in early July 2018 by the CEOE, CEPYME, CC.OO. and UGT, recommends wage increases of around 2% in 2018, 2019 and 2020, plus a variable portion that depends, among other factors, on productivity, the company's earnings and levels of unjustified absenteeism.

Figure 3.8 headline and core inflation (% YoY)



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

Figure 3.9 Spain: average wage increase agreed in collective agreements (% YoY)



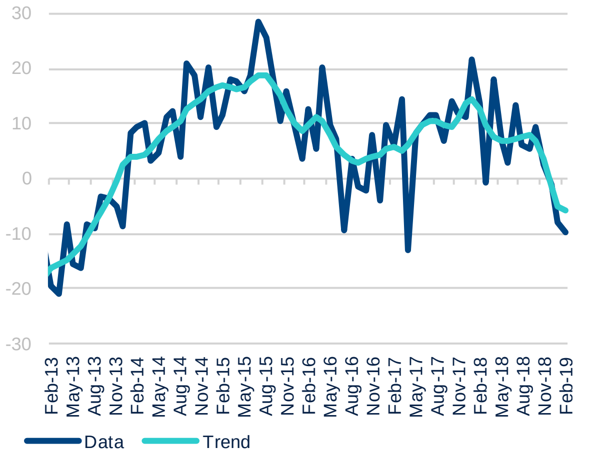
Annual data include agreements registered after December each year and incorporate the review using the wage guarantee clause.
(*) Data since 2017 are provisional.
Source: BBVA Research based on Ministry of Labour, Migration and Social Security data

New lending shrinks in the first months of 2019

The private sector credit stock slowed its decline at the start of 2019, with a fall of -3.1% YoY in January. Newly granted operations were also on negative ground at the start of 2019, falling -9.4% YoY in the year to February. By type of operation, lending to companies has shown a negative performance during the first two months of the year. Lending to companies of over one million euros saw a 10.2% cumulative decrease YoY in January and February 2019, while lending to companies of under one million euros was -14.4% YoY. Part of this decline is due to the base effect of the end of targeted longer-term refinancing operations (TLTROs) in February 2018. In household lending, some fatigue is seen at the start of the year, but growth of 3.2% YoY is maintained throughout January and February, supported by operations aimed at financing consumer goods and purchasing homes, but held back by other components of household lending.

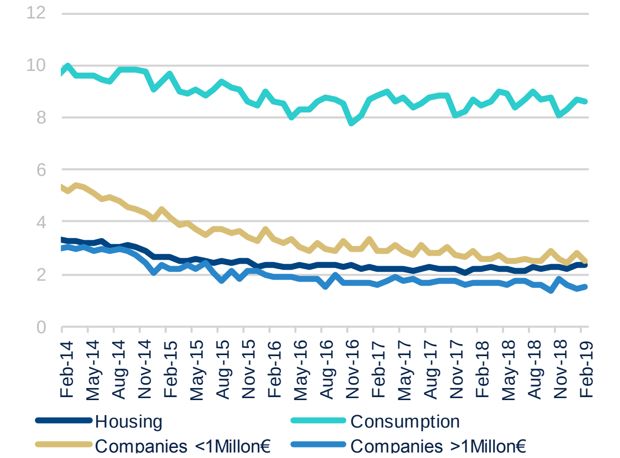
The price of new loans remains low, favoured by low interest rates, good liquidity conditions for banks, the containment of sovereign risk and the lower credit risk faced by banks. However, in some portfolios there is evidence of a minimum threshold having been reached in an environment of narrowing interest margins and changes in the term structure. Such is the case with rates for purchasing homes (2.38% average APR in February, 17 basis points more than the previous year). This is due to the rise in fixed-interest-rate mortgages (40% of new mortgage loans as at February, compared to 35% in 2018) and the very slight upturn in the 12-month Euribor (8 basis points more than the previous year) from levels below zero. In this regard, there is still no clear evidence of the possible impact on mortgage rates from the imposition of stamp duty tax to banks.

Figure 3.10 Spain: new lending to the retail sector (% YoY of the gross figure and its trend)



Source: BBVA Research, based on Banco de España data

Figure 3.11 Spain: interest rates on new lending operations (% APR)



Source: BBVA Research, based on Banco de España data

Scenario 2019–2020: Growth loses traction

This year could result in annual growth of 2.2%, while in 2020 the economy will grow 1.9%, 0.2 pp and 0.1 pp less than the growth forecast in the previous edition of this publication and, on average, 0.7 pp below the extension observed during the previous two-year period (see Table 3.1). Despite this slowdown, domestic demand will continue to be the main supporting factor for growth (2.3 pp on average) while the contribution of net external demand will again be negative (-0.2 pp on average). Even so, if this scenario comes to pass, the increase in activity will be enough to create 760,000 jobs and reduce the unemployment rate to around 12.7% on average in 2020.[14]

14: Employment will increase by 660,000 people between 4Q18 and 4Q20 and the unemployment rate will fall to levels of around 12%.

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

(% YoY unless stated otherwise)	4Q18	1Q19 (e)	2017	2018	2019 (f)	2020 (f)
National Final Consumption Expenditure	2.0	1.9	2.4	2.3	2.0	1.7
Private FCE	1.9	1.8	2.5	2.3	2.0	1.7
FCE Public Authorities	2.2	2.3	1.9	2.1	2.2	1.6
Gross Fixed Capital Formation	4.4	5.3	4.8	5.3	4.1	3.9
Equipment and Machinery	2.8	5.8	6.0	5.4	3.0	3.7
Construction	6.3	5.7	4.6	6.2	4.8	3.7
Housing	4.6	3.7	9.0	6.9	4.6	4.3
Other Buildings and Structures	8.1	7.9	0.6	5.5	5.0	3.0
Domestic demand (*)	**2.5**	**2.7**	2.9	**2.9**	**2.4**	**2.1**
Exports	1.0	1.2	5.2	2.3	2.8	3.8
Imports	1.7	2.3	5.6	3.5	3.8	4.5
External balance (*)	**-0.2**	**-0.3**	**0.1**	**-0.3**	**-0.3**	**-0.2**
Real GDP at market prices	**2.3**	**2.3**	**3.0**	**2.6**	**2.2**	**1.9**
Nominal GDP at market prices	**3.1**	**3.9**	**4.2**	**3.6**	**3.8**	**3.5**
Total employment (LFS)	3.0	3.0	2.6	2.7	2.0	1.7
Unemployment rate (% of labour force)	14.4	14.8	17.2	15.3	13.9	12.8
Full-time equivalent employment (Quarterly National Accounts)	2.6	2.5	2.8	2.5	2.0	1.6

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

The downward revision of growth expectations is partly due to the poor performance of the European economy. In any case, the external environment will continue to be favourable

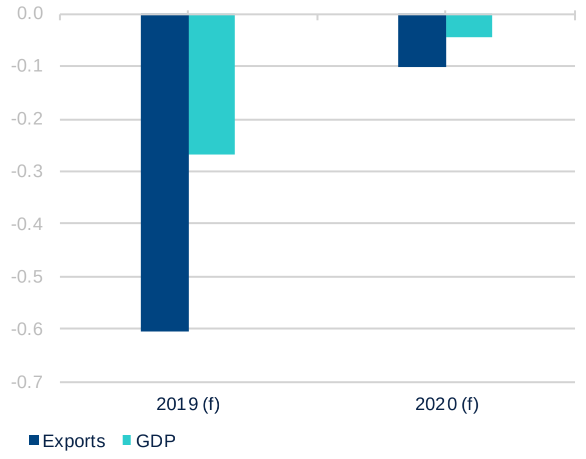
Although global activity is advancing at a solid rate, the composition is different (see Section 1). In particular, while domestic demand remains robust, trade flows are deteriorating due to tensions over tariff levels, in an environment of great uncertainty about the strength of recovery in the US and China. In any case, confidence is expected to increase as these tensions are favourably resolved, creating a favourable environment for the evolution of activity in Spain.

In Europe, growth expectations have been revised downwards (by 0.4 pp to 1.0% in 2019 and by 0.1 pp to 1.3% in 2020), which partially explains the deterioration of GDP growth forecasts for the Spanish economy (see Figure 3.12). However, activity in the eurozone is expected to gradually recover from factors that have slowed the growth of industry and exports. These factors include trade tensions, uncertainty about Brexit and one-off factors affecting the automotive sector.

It is also expected that the **delay in the process of normalising the ECB monetary policy** – after keeping interest rates at reduced levels and announcing a new round of long-term liquidity auctions (TLTROs) – will help keep financing conditions loose and promote growth of activity. This, together with the Fed's monetary policy strategy, has led to a downward revision of the euro exchange rate, which will also help to partially offset the negative effect of lower European demand (see Figure 3.13).[15]

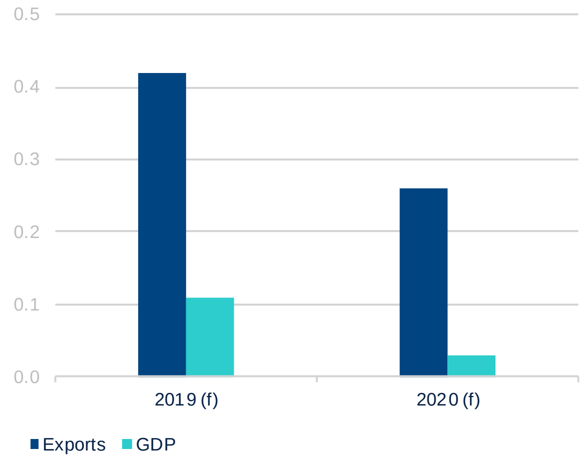
Finally, the relief provided by **the price of oil** that, according to BBVA Research forecasts, could fall from $71 per barrel in 2018 to $62 in 2019 and $55 in 2020 is of particular relevance[16].

Figure 3.12 Spain: impact of the downward revision of growth on the Economic and Monetary Union (pp of annual growth)



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

3.13 Spain: impact of the downward revision of the euro exchange rate (pp of annual growth)



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

In short, despite an environment of greater uncertainty and a slowdown in activity for some trading partners of the Spanish economy, the global environment is expected to be favourable and include a progressive recovery of the eurozone. In addition, **lower oil prices along with the accommodating stance of the monetary policy will allow improvements in competitiveness and will continue to support growth in domestic demand**.

Domestic demand will support growth, despite the slowdown

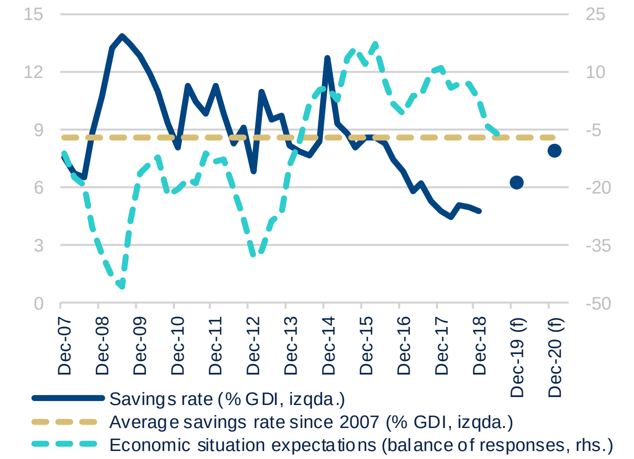
Private consumption will lose traction in the two-year period 2019–2020. BBVA Research forecasts that growth in household spending will slow to 2.0% in 2019 and 1.7% in 2020, 0.1 pp less, on average, than the growth forecast in the previous edition of this publication. What factors explain the decreased dynamism of private consumption? Firstly, the disappearance of transitory elements that stimulated spending in previous years, such as

15: 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.

16: Although the fall in energy prices is due to the slowdown in activity at a global level, supply factors are also playing a role and, consequently, a net positive effect is estimated for business margins, household disposable income and economic activity in Spain. 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://goo.gl/6DM3cE pent-up demand for durable goods.[17] Secondly, the decreased vigour of some of the determinants of consumption, such as net financial wealth, which is affected by the volatility of stock prices, the reorientation of savings towards safer but less profitable assets and the end of the household deleveraging process. Finally, the impact of uncertainty, reflected in the deterioration of household expectations about the economic situation, which limits the downward trend in the savings rate (see Figure 3.14).[18]

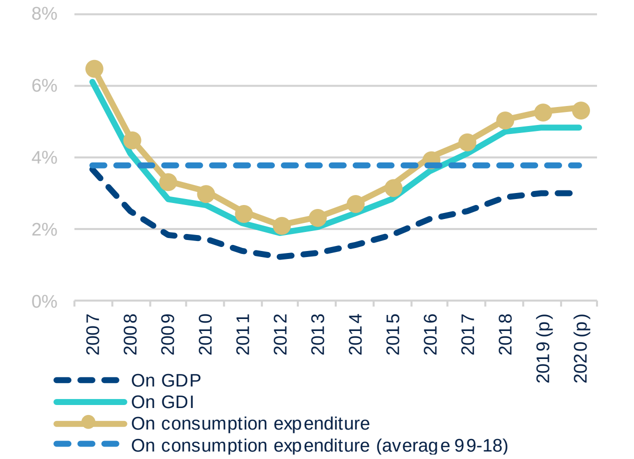
On the contrary, the fiscal stimuli included in the 2018 State General Budgets and the additional measures approved in recent months (including the increase in pensions and remuneration for public employees in 2019) will continue to contribute to the growth of household income. The increase in minimum wage could also boost wage-earner compensation between 0.1 pp and 0.2 pp in 2019 and 2020 if companies absorb the increase rather than passing it on to prices.[19] Similarly, spending will be stimulated by the continuing growth in real estate wealth and by the fact that demand for housing and the consumption of certain goods and services supplement one another.[20] Finally, loans will continue to increase in the coming quarters, although probably at a lower rate than in the previous two-year period given the disappearance of pent-up demand and the growing difficulty of finding creditworthy profitable niches. However, the growth of financing will make household consumption more credit-intensive. As shown in Figure 3.15, it is estimated that about 5.3% of nominal household spending between 2019 and 2020 will be financed, three points more than in 2012, but still 1.3 points less than the peak of 2007.

Figure 3.14 Spain: household expectations regarding the economic situation and the savings rate (SWDA data)



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

Figure 3.15 Spain: new consumer financing (% GDP, disposable income and consumer spending)*



* New consumer financing data linked between 2007 and 2010.
Source: BBVA Research based on Banco de España and INE (Spanish Office of National Statistics) data

17: Between 2013 and 2016, household consumption grew faster than its long-term fundamentals (disposable income, wealth and interest rates) as a result 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 disappeared.
18: Having fallen to 4.5% SWDA of disposable income in 1Q18, the savings rate of households increased by 0.3 pp to 4.8% SWDA in 4Q18.
19: BBVA Research estimates indicate that the increase in the minimum wage would even have a negative impact on wages in the short term if companies suffer the full impact (up to five tenths in 2020). In this scenario, the negative impact on the employment rate would outweigh the positive impact on wages. See the Spain Economic Outlook review for the first quarter of 2019.
20: A household's consumer spending rises by around 20% when buying a home, regardless of any changes that may occur in the size of the family unit, the income or employment status of its members. The "property effect" reaches 35% in the case of furniture and household appliances. See Box 2 of the Spain Economic Outlook review for the second half of 2017, available at: https://www.bbvaresearch.com/public-compuesta/situacion-consumo-segundo-semestre-2017/

Investment in machinery and equipment will grow over the period 2019–2020 at somewhat more moderate rates than expected three months ago. In particular, this demand item is expected to grow 3.0% in 2019 and 3.7% in 2020 (0.9 pp and 0.5 pp less than the figures forecast in the previous edition of this publication), which remains below the rate observed throughout the recovery (5.7% in the two-year period 2017–2018)**.** Several factors explain this change. On a domestic level, uncertainty surrounding economic policy persists and regulatory changes around the automotive sector are affecting investment decisions. On an international level, the recent sluggishness in global demand, along with slower growth of the European economy and a lack of agreements to put an end to trade tensions, are pushing exports down and therefore delaying the implementation of new investment projects in machinery and equipment. In contrast, the continued expansionary stance of monetary policy and the fall in oil prices serve as supporting factors.

Growth in housing investment will slow down significantly during the current two-year period. The close of 2018 was marked by growing legal uncertainty caused by regulatory changes around settlement of the stamp duty tax. This resulted in a slowdown of residential sales, which is probably temporary, but the sector has still not completely recovered so far this year[21]. In addition, legislative changes around the residential rental market[22] could be of a more permanent nature, as the increased legal uncertainty of lessors could discourage investor incentives – both private and institutional – and have an impact on rental supply. This could be more pronounced in regions with greater exposure to tourism, which are also affected by the depletion of non-resident visitor flows. As a result, a downward revision of housing investment is forecast in the current two-year period, which will be somewhat more intense in 2019 given the greater impact of regulatory changes. Thus, investment growth of 4.6% is expected in the current year (1.6 pp lower than in the previous scenario) and 4.3% in 2020 (1.9 pp lower)**.**

It is expected that the contribution to growth of **public demand will turn positive, as a result of the recently approved expansionary measures of the fiscal policy, but will remain conditioned by the electoral cycle**[23]. In any case, political uncertainty and the forming of new governments will determine the evolution of spending, especially in the second half of the year. In this respect, a slight acceleration is expected in the public final consumption; up to 2.2% YoY in 2019 but gradually slowing to 1.6% YoY by 2020. In turn, **under the current scenario of budgetary extension, a slight slowdown is expected in public investment**, which would mean that investment in other constructions would grow at a YoY rate of 5.0% in 2019 and 3.0% in 2020.

The slowdown in the European economy explains the sluggishness of trade flows

The downward revision of growth expectations for Europe (1.0% in 2019 and 1.3% in 2020) and the weakness of the rest of global demand suggest that the expected growth rate for Spanish exports should also be revised downwards for the next two-year period. Even so, global economic growth (3.4% in 2019 and 2020), the lower expected appreciation of the real effective exchange rate and low oil prices are enough to keep foreign demand on positive ground. As such, **total exports are expected to increase by 2.8% YoY on average this year and by 3.8% the following year, 2.4 pp and 0.7 pp less than previously estimated**, respectively.

Specifically**, exports of goods are expected to leave behind a disappointing 2018 and recover some of the traction they lost**, with their growth reaching around 2.0% in 2019, and 4.1% in 2020. This involves a revision of the decrease of 3.4 pp and 0.8 pp, respectively, compared with previous forecasts. In any case, the growth rate

21: Royal Decree-Law 17/2018 of 8 November, amending the Consolidated Text of the Act on Tax on Patrimonial Transmissions and Documented Legal Acts: goo.gl/Hr6QCe
22: Royal Decree-Law 7/2019, of 1 March, on urgent measures in housing and rental matters: goo.gl/vnHKMw
23: In particular, the 2.25% increase in the wages of public employees (Royal Decree-Law 24/2018 of 21 December), the 1.6% increase in contributory pensions and 3% increase in non-contributory pensions (Royal Decree-Law 28/2018 of 28 December), as well as the measures for the extension of paternity leave (Royal Decree-Law 6/2019 of 1 March), the restoration of unemployment benefits for persons over the age of 52 and the approval of a new bonus for contracts with the long-term unemployed (Royal Decree-Law 8/2019 of 8 March).

forecast for 2020 is somewhat higher than the growth rates seen since the beginning of the recovery (3.7% on average), as a result of the disappearance of the factors that would have affected the automotive sector in particular, the gradual recovery that is forecast for the Eurozone and the gains in competitiveness from the fall in oil prices, the cost of financing and the value of the euro against the dollar. Meanwhile, exports of services are expected to grow by 4.4% in 2019 and 3.0 in 2020, 0.4 pp less than the annual average estimated in the previous quarter and almost two points below the increase seen since 2014.

In terms of foreign tourism, BBVA Research forecasts suggest that, after growing at an average annual rate of 5.6% during the last five years, consumption of non-residents in Spain could prolong its slowdown in the next period, with growth of 1.5% in 2019 and 1.0% in 2020, meaning 0.2 pp more than forecast in the last edition of this publication of 2019, but 0.6 pp less in 2020. As mentioned in previous editions of this publication, certain structural factors continue to contribute to this slowdown in foreign tourism. Domestically, doubts remain about supply –side limitations at destinations.[24] Externally, the recovery of some competing markets that had been burdened in recent years by geopolitical tensions has led to a reversal of some flows that had shifted towards the Spanish market in the last five years.[25] Lastly, export sales of non-tourism services are expected to grow by 6.5% in 2019 and 4.4% in 2020 (0.4 pp less and 0.2 pp more than previously forecast), on average for the growth over the last five years (5.7% on average).

The expected composition of growth of final demand will lead to **an increase in imports of around 4.2% on average** during the current two-year period, which will result in a negative contribution of net external demand to growth (-0.3 pp in 2019 and -0.2 pp in 2020). This performance of the external balance is consistent with a moderate slowdown of the current account balance to 0.9% of GDP in 2019 and 0.8% in 2020.

Slowdown in job creation

In line with the trend in economic activity, **the recovery of the labour market will lose traction in 2019 and 2020**. The slowdown in growth and the impact of the 2019 increase in the minimum wage will limit job creation to 2.0% this year.[26] Given that the increase in the labour force will be modest, the increase in employment will result in a decrease of 1.4 pp in the unemployment rate to 13.9%. The increase in employment and the fall in the unemployment rate will continue in 2020, but at a slower pace, to 1.7% and 12.8%, respectively.

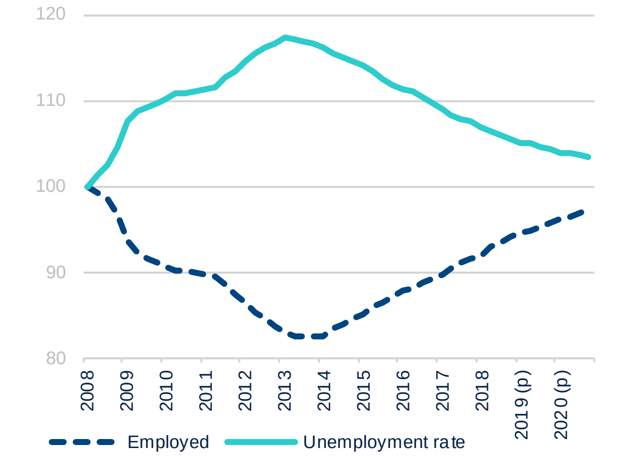
If the forecasts of BBVA Research prove to be accurate, the number of employed people would exceed 20.2 million by the end of 2020 and the unemployment rate would be about 12.4%, still far from pre-crisis levels. As Figure 3.16 illustrates, in 4Q20 the level of employment will be around 2.5% below that existing at the beginning of 2008, while the unemployment rate will be three points higher. In addition, the expected development of activity and full-time equivalent employment (FTE), which will increase by around 1.8% on average in the 2019-2020 period, anticipate a limited contribution by the growth of apparent productivity of labour (see Figure 3.17).

In order to mitigate the impact of the slowdown in activity on job creation and the increase in the minimum wage, it should be accompanied by improvements in the efficiency of active employment policies. It would

24: Evidence would indicate that the sector may be approaching saturation levels, especially in traditional beach destinations, and that, going forward, the likelihood will increase that demand growth will move towards higher prices and wages, instead of boosting growth and employment in the sector.
25: In this regard, the estimates of BBVA Research would suggest that nearly 10 pp of tourism growth over recent years is not due to traditional fundamentals such as the evolution of global demand or the real effective exchange rate. For a more detailed explanation of the structural factors that are slowing foreign tourism, see the BBVA Research Economic Watch: "Foreign tourism in Spain: Loss of traction pending improvements in competitiveness", available at https://bit.ly/2FuOVl9
26: The 22.3% increase in minimum wage by 2019 could have a significant impact on growth and employment in the Spanish economy. BBVA Research estimates, available in the Spain Economic Outlook for the first quarter of 2019, indicate GDP in 2019 would be between 0.1 pp and 0.3 pp lower than in the base scenario and that employment would be between 0.1 pp and 0.4 pp lower, depending on whether companies absorb the wage increase or pass it on to prices. In the long term, the effect will depend on the adoption of policies that contribute to increasing the productivity the workers who have the potential to be the most affected, such as young people, foreigners or less skilled workers, among others. If its productivity does not grow, the rise in the minimum wage could place GDP between 0.7 pp and 1.2 pp below the baseline scenario and the employment rate between 0.9 pp and 1.6 pp.

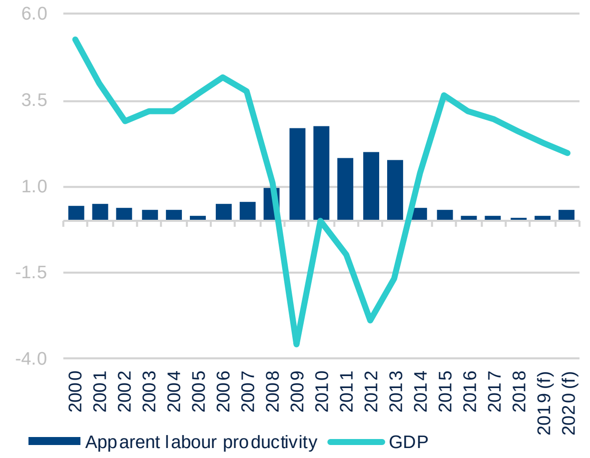
be advisable to adopt stimulus strategies aimed at strengthening the employability of groups that may be most affected by the wage increase, particularly those whose qualifications would hinder achieving a level of productivity that is commensurate with the new threshold.

Figure 3.16 Spain: level of employment and unemployment rate (1Q08 = 100. SWDA data)



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

Chart 3.17 Spain: GDP growth and contribution by the growth of apparent productivity of labour (%)



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

Inflation will remain at moderate levels during the current two-year period

Following the slowdown in consumer prices seen during the second half of last year and part of the first quarter of this year, headline inflation is expected to gradually stabilise, with 2019 coming to a close with an annual average of about 1.1% YoY (0.2 pp below what was forecast three months ago). On the other hand, core inflation will remain virtually unchanged (0.8% YoY in annual average for 2019), supported by the expected fall in the unemployment rate and the stimuli still being provided by monetary policy. In 2020, core inflation will continue to rise very gradually (1.1% on average per year) which, together with moderate energy prices, will place headline inflation at 1.4% YoY.

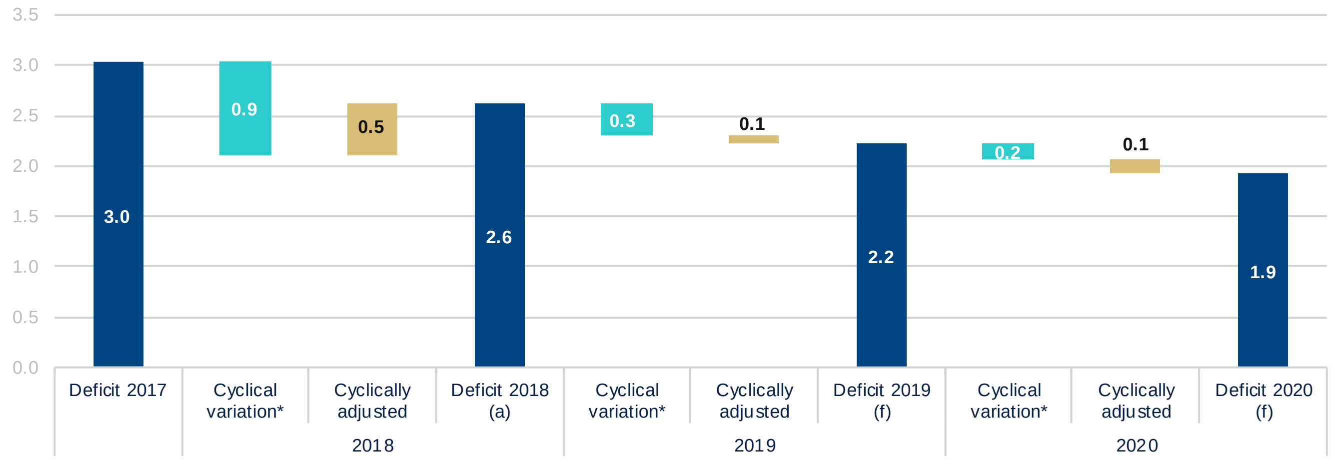
If these estimates prove correct, the differential of headline inflation against the eurozone would become slightly favourable to Spain during the 2019-2020 period (-0.1 pp on average), having closed the gap in 2018.

The economic cycle will favour the reduction of the deficit, although the fiscal targets for the 2019-2020 period will not be met

Recent information on the closing of the 2018 public accounts showed a reduction in public deficit to 2.6% GDP, above the budgetary stability target (-2.2%), but slightly below what was expected at the end of the year. These figures were due to faster than expected growth in public spending during the second half of the year, which offset the positive impact of improving labour market and lower financing costs. Tax revenues have risen by more than expected at the start of the year. In this way**, the fiscal adjustment seen in 2018 was essentially cyclical**.

In an environment of budgetary extension and uncertainty about fiscal policy, the first budgetary execution data of January 2019 shows the same dynamics as observed at the end of the previous year, when public debt reached 2.6% of GDP. As such, it is hoped that, **throughout the 2019-2020 period, the economic cycle will reduce the public deficit once again,** both due to the effect of automatic stabilisers and the reduction of unemployment benefits, which will be accompanied by a lower interest burden arising from favourable financing conditions. This cyclical improvement will be partly offset by the impact of the measures adopted at the end of last year and during the first months of the present year.[27] As a result, the aggregate deficit of public administrations will decrease by only 0.4 pp in 2019, to 2.2% of GDP, putting it above the stability target. For 2020, in a scenario with no changes in fiscal policy, a new cyclical correction of public accounts to 1.9% of GDP is expected (see Figure 3.18), which will mean a new deviation from the stability target (-0.5%).

Figure 3.18 AA. Public administration: breakdown of fiscal adjustment, excluding bail-outs of financial institutions (% of GDP)



(e) Estimate. (f) Forecast.
(1) Includes changes in interest charges.
Source: BBVA Research based on Ministry of the Treasury and INE (Spanish Office of National Statistics) data

In this scenario, we estimate that the structural primary balance will have deteriorated by 0.5 pp of GDP in 2018, while for 2019 and 2020 we foresee a stabilisation at around -0.4% of GDP. This would result in a practically neutral stance during the 2019-2020 period. Consequently, with a deficit below 3% of GDP, Spain would leave the excessive deficit correction component protocol, but would remain under close surveillance for the next three years due to the high level of public debt. This situation requires a structural adjustment rate of 0.65 pp per year to significantly reduce the high level of public debt (which stood at 97.2% at the close of 2018).

Risks increase and responsiveness to these risks decreases

Although the downwards revision of the activity in the BBVA Research scenario update is moderate, the vulnerability of the economy is greater. Growth is increasingly dependent on domestic demand and, in particular, it is biased toward public spending and private domestic consumption. Furthermore, with the progressive exhaustion of the effectiveness of monetary policy and the prevailing need for fiscal adjustment, the capacity of the Spanish economy to react to the risks posed by the scenario is modest. The number of risks, on the other hand, continues to grow, as does their likelihood.

27: The forecasts made for this publication only take into account the measures of the current tax policy, which are as listed in note 23, above.

Externally, doubts about the strength of global growth are on the rise. The question of the slowdown in China's economy and its structural capacity remains unanswered, while the US economy is slowing down. **In this context, there is still uncertainty regarding the resolution of trade tensions** between the US and China, as well as the materialisation of the UK's departure from the EU following the agreed extension, and whether or not its departure will take place in an orderly manner. Furthermore, within EMU, and despite the monetary stimulus put in place by ECB, the weakening of the economy, which could highlight structural problems linked to the need for reforms that speed progress towards European integration and creating an environment conducive to growth, is a concern. In this respect, the European elections in May and the possible growth of political parties critical of the common European project represent an additional unknown in the external context.

On a domestic level, the risks are also significant. Firstly, **uncertainty about economic policy remain high**. For example, **uncertainty around fiscal policy has grown with the electoral cycle and it is likely to remain high until the new governments are formed (central, autonomous community and local)**. In particular, it is feared that on the eve of the elections there will be upward pressures on public spending, which could bring forward a slowdown in public demand during the second part of the year. Another focus of concern are the recent regulatory changes in the real estate market, the effect of which on investment in the sector is still uncertain.

These risks, together with those linked to the Spanish labour market, suggest caution regarding a slowdown of **job creation.** First, it should be noted that, although the effects of the increase in the minimum wage have been in line with the baseline scenario forecast by BBVA Research so far, there are still doubts regarding its impact in the medium and long term. As yet, no ripple effect has been seen in the rest of the wage distribution, nor have end prices been affected, but it is not yet possible to rule out these more adverse scenarios, especially in the absence of measures that boost productivity and strengthen demand for employment.[28] Specifically in the present scenario, where the unemployment rate is gradually approaching its structural level and capacity restrictions or lack of skilled labour may begin to arise in specific sectors, wage pressure may increase.

Secondly, **the sector composition of growth could also weaken job creation** in the coming years. The most recent data indicates that the public sector was responsible for a quarter of the increase in occupation in 2018, therefore showing that it could also be affected by the possible containment of public spending after the electoral period[29]. The weakness shown by the foreign sector over the last year is also worrying. The boost to the exports of goods and foreign tourism has favoured job creation in the past, but they have been slowing in recent months.[30] Going forward, this represents a challenge for the Spanish economy. Moreover, the tourism industry is gradually losing weight in the economy and it is not clear which other business sectors with greater dynamism can take on the challenge of relieving these sectors as drivers of growth and job creation.[31]

In short, and putting aside the direct effect that some of the approved measures may have, uncertainty about economic policy continues to have a negative impact on the performance of economic activity. As such, BBVA Research estimates that, if it does not ease, it may continue to reduce GDP level by 0.2 pp during the current year[32] (see Figure 3.19). In this context, following the elections this spring, **the ability to reach agreements** on the

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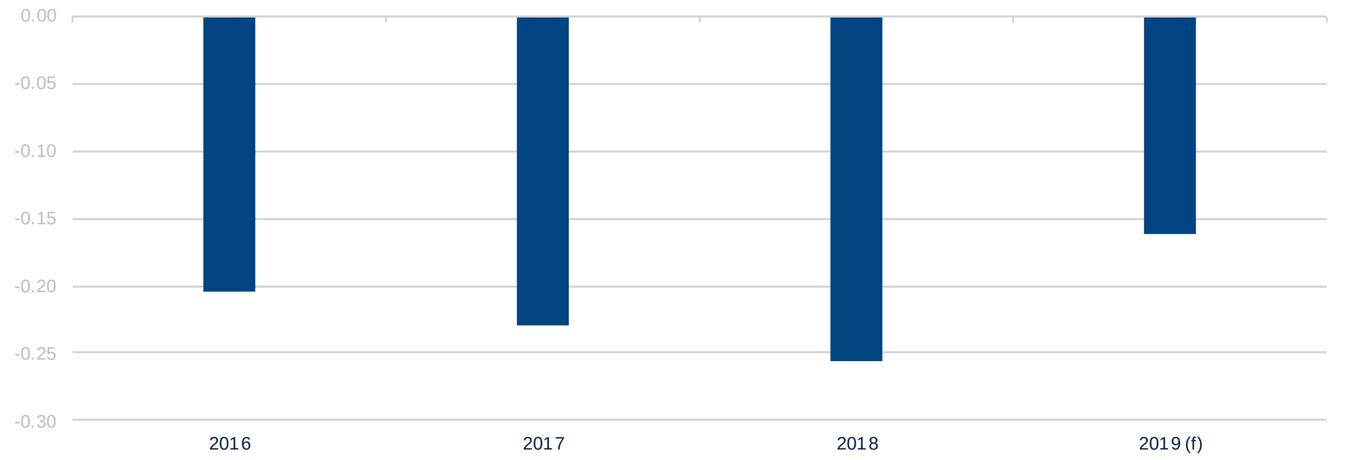
28: BBVA Research estimates suggest that GDP would be between 0.1 pp and 0.3 pp lower than in the baseline scenario and that employment would be between 0.1 pp and 0.4 pp lower, depending on whether companies absorb the wage increase or pass it on to prices. That is, the economy would create between 75,000 and 195,000 fewer jobs in the 2019-2020 period than in the absence of the minimum wage increase. To estimate the repercussions of the increase in the legal minimum wage, we used the model proposed in Doménech, R., García J. R. and Ulloa C. (2018): "The effects of wage flexibility on activity and employment in Spain", Journal of Policy Modeling, Vol. 40 (6), 1200-1220.
29: This contribution, above 0.6 pp of growth, had not been recorded since the crisis (mid-2008 to mid-2011), when the public sector tried to limit job losses in the private sector.
30: In this regard, BBVA Research estimates suggest that foreign tourism helped create 280,000 jobs between 2014 and 2017 (versus a loss of 10,000 for the economy as a whole). For more information on this matter, see the BBVA Research Economic Watch: "Foreign tourism in Spain: Loss of traction pending improvements in competitiveness", available at https://bit.ly/2FuOVl9
31: For more information on the evolution of the industry in Spain in recent decades, see the BBVA Research Economic Watch: "Premature deindustrialization in Spain", available at https://bit.ly/2H4Hqoh
32: 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

measures required to continue the recovery and to improve the long-term functioning of the economy will be key. Meanwhile, the expansion of these agreements and measures could result in a higher level of uncertainty and, consequently, a greater negative impact on economic activity. For example, since 2016, the various outbreaks of uncertainty regarding economic policy have slowed average annual growth by around 0.2 pp.

Figure 3.19 Spain: impact of economic policy uncertainty on GDP (Deviation from scenario level in absence of uncertainty)



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

4. Tables

Table 4.1 Macroeconomic forecasts Gross domestic product (Annual average %)

	2016	2017	2018	2019	2020
US	1.6	2.2	2.9	2.5	2.0
Eurozone	1.9	2.5	1.8	1.0	1.3
Germany	2.2	2.5	1.5	0.8	1.4
France	1.1	2.3	1.6	1.2	1.5
Italy	1.2	1.7	0.8	-0.2	0.5
Spain	3.2	3.0	2.6	2.2	1.9
United Kingdom	1.8	1.8	1.4	1.3	1.6
Latin America*	-0.2	1.8	1.5	1.7	2.3
Mexico	2.7	2.3	2.0	1.4	2.2
Brazil	-3.3	1.1	1.1	1.8	1.8
Eagles**	5.2	5.4	5.2	4.9	5.0
Turkey	3.2	7.4	2.6	1.0	2.5
Asia and Pacific	5.6	5.6	5.6	5.3	5.2
Japan	0.6	1.9	0.8	0.7	0.5
China	6.7	6.8	6.6	6.0	5.8
Asia (ex. China)	4.6	4.6	4.7	4.6	4.6
World	3.3	3.7	3.6	3.4	3.4

* 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: 5 April 2019.
Source: BBVA Research

Table 4.2 Inflation (Annual average %)

	2016	2017	2018	2019	2020
US	1.3	2.1	2.4	1.7	2.1
Eurozone	0.2	1.5	1.8	1.2	1.5
Germany	0.4	1.7	1.9	1.4	1.6
France	0.3	1.2	2.1	1.3	1.5
Italy	-0.1	1.3	1.2	0.9	1.2
Spain	-0.2	2.0	1.7	1.1	1.4
United Kingdom	0.7	2.7	2.5	1.8	1.8
Latin America*	9.8	6.7	7.1	7.9	6.4
Mexico	2.8	6.0	4.9	4.0	3.7
Brazil	8.8	3.5	3.7	3.8	4.8
Eagles**	4.4	4.0	4.7	4.8	4.3
Turkey	7.8	11.1	16.3	16.3	9.4
Asia and Pacific	2.3	2.0	2.3	2.3	2.6
Japan	-0.1	0.5	1.0	0.9	1.3
China	2.1	1.5	1.9	2.0	2.2
Asia (ex. China)	2.5	2.4	2.7	2.6	2.9
World	3.2	3.3	3.8	3.7	3.5

* 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: 5 April 2019.
Source: BBVA Research

Table 4.3 Macroeconomic Forecasts: 10-year government bond yield (Annual average %)

	2016	2017	2018	2019	2020
US	1.84	2.33	2.91	2.78	3.00
Germany	0.13	0.37	0.46	0.15	0.58

Forecast closing date: 5 April 2019.
Source: BBVA Research

Table 4.4 Macroeconomic forecasts: exchange rates (Annual average %)

	2016	2017	2018	2019	2020
EUR-USD	0.90	0.89	0.85	0.88	0.84
USD-EUR	1.11	1.13	1.18	1.14	1.19
USD-GBP	1.35	1.29	1.33	1.37	1.46
JPY-USD	108.82	112.20	110.47	111.49	110.67
CNY-USD	6.64	6.76	6.61	6.72	6.71

Forecast closing date: 5 April 2019.
Source: BBVA Research

Table 4.5 Macroeconomic forecasts: official interest rates (End of period, %)

	2016	2017	2018	2019	2020
US	0.75	1.50	2.50	2.75	2.75
Eurozone	0.00	0.00	0.00	0.00	0.25
China	4.35	4.35	4.35	3.85	3.85

Forecast closing date: 5 April 2019.
Source: BBVA Research

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

	2016	2017	2018	2019	2020
GDP at constant prices	**1.9**	**2.5**	**1.8**	**1.0**	**1.3**
Private consumption	1.9	1.8	1.3	1.3	1.5
Public consumption	1.8	1.2	1.0	1.4	1.2
Gross fixed capital formation	4.0	2.9	3.1	2.2	2.3
Inventories (*)	0.1	-0.1	0.1	0.0	0.0
Internal demand (*)	**2.3**	**1.7**	**1.6**	**1.4**	**1.5**
Exports (goods and services)	3.0	5.5	3.0	2.1	2.6
Imports (goods and services)	4.2	4.1	2.9	3.1	3.5
External demand (*)	**-0.4**	**0.8**	**0.2**	**-0.4**	**-0.3**
Prices					
CPI	0.2	1.5	1.8	1.3	1.5
Core CPI	0.8	1.1	1.2	1.3	1.5
Labour market					
Employment	1.4	1.6	1.5	0.8	0.6
Unemployment rate (% of active population)	10.0	9.1	8.2	7.8	7.7
Public sector					
Deficit (% GDP)	-1.6	-1.0	-0.6	-1.0	-1.0
Debt (% GDP)	89.1	86.8	84.2	82.7	81.1
External sector					
Current account balance (% of GDP)	3.1	3.2	2.9	2.5	2.4

Forecast closing date: 5 April 2019.
Source: BBVA Research

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

(Annual average, %)	2016	2017	2018	2019	2020
Activity					
Real GDP	3.2	3.0	2.6	2.2	1.9
Private consumption	2.9	2.5	2.3	2.0	1.7
Public consumption	1.0	1.9	2.1	2.2	1.6
Gross Fixed Capital Formation	2.9	4.8	5.3	4.1	3.9
Equipment and machinery	5.2	6.0	5.4	3.0	3.7
Construction	1.1	4.6	6.2	4.8	3.7
Housing	7.0	9.0	6.9	4.6	4.3
Domestic Demand (contribution to growth)	2.4	2.9	2.9	2.4	2.1
Exports	5.2	5.2	2.3	2.8	3.8
Imports	2.9	5.6	3.5	3.8	4.5
External Demand (contribution to growth)	0.8	0.1	-0.3	-0.3	-0.2
Nominal GDP	3.5	4.2	3.6	3.8	3.5
(Billions of euros)	1118.7	1166.3	1208.2	1254.8	1299.1
Labour market					
Employment, LFS (Labour Force Survey)	2.7	2.6	2.7	2.0	1.7
Unemployment rate (% of labour force)	19.6	17.2	15.3	13.9	12.8
Employment, FTE (Full Time Equivalent)	3.1	2.8	2.5	2.0	1.6
Productivity	0.1	0.1	0.1	0.2	0.3
Prices and costs					
CPI (annual average)	-0.2	2.0	1.7	1.1	1.4
CPI (end of period)	1.6	1.1	1.7	1.2	1.5
GDP deflator	0.3	1.3	1.0	1.6	1.6
Compensation per employee	-0.5	0.3	0.8	2.1	2.3
Unit labour cost	-0.6	0.2	0.8	1.9	2.0
External sector					
Current Account Balance (% GDP)	2.3	1.8	1.0	0.9	0.8
Public sector (*)					
Debt (% GDP)	99.0	98.1	97.2	95.9	94.5
Balance Public Admin. (% GDP)	-4.3	-3.0	-2.6	-2.2	-1.9
Households					
Nominal disposable income	1.8	1.6	3.7	4.7	5.2
Savings rate (% nominal disposable income)	8.0	5.7	5.4	6.6	8.0

Annual change in %, unless expressly indicated.
Forecast closing day: 5 April 2019.
(*) Excluding aid to Spanish banks.
Source: BBVA Research

5. Glossary

Initials

- AA. PP: Public Administrations
- AECB: Agreement for Employment and Collective Bargaining
- BBVA: Banco Bilbao Viscera Argentaria
- 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

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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