

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

Spain Economic Outlook

2T19

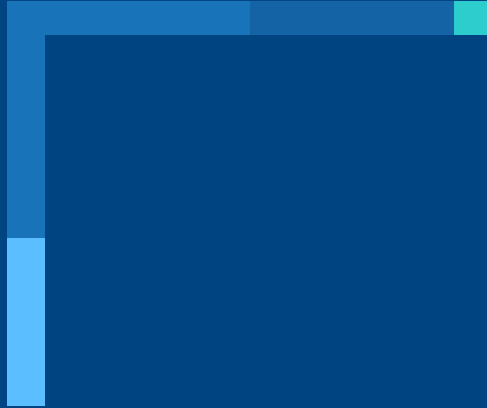
April 2019

Creando Oportunidades

Key messages



- The weakness of global economic activity has continued and uncertainty remains high. Economic (in particular, monetary) policy has reacted, aiming to smooth the slowdown of growth
- GDP growth is revised downwards slightly to 2.2% in 2019 and to 1.9% in 2020, as a result of lower european demand and a growing uncertainty regarding economic policy. Structural factors and the impact of certain policies also point to a slowdown. In any case, the recovery will continue due to the gradual acceleration of world growth and the support of monetary policy
- In Spain, the growth of economic activity remains at around 0.6% QoQ, as a result of the performance of private consumption, public expenditure and exports of non-touristic services
- Risks remain high and the likelihood of occurrence of some of them is rising, which introduces a downward bias on growth expectations. In this context, a consensus regarding the necessary actions to reduce the vulnerability of the spanish economy to surrounding changes is becoming all the more necessary



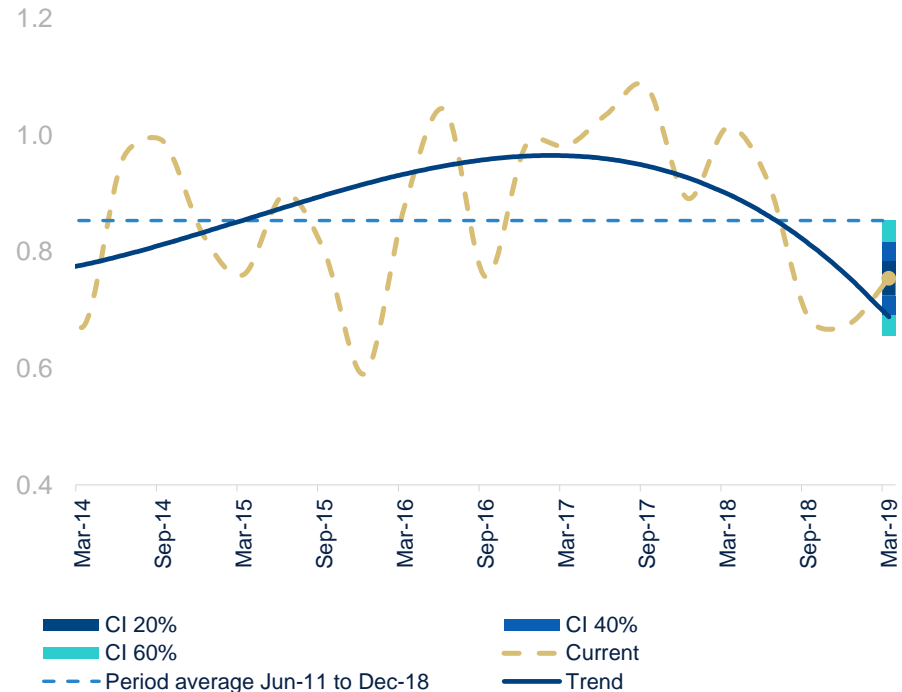
01

Global Economic Outlook 2Q19

Global GDP has moderated more than expected

World GDP growth

(Forecasts based on BBVA-GAIN % QoQ)



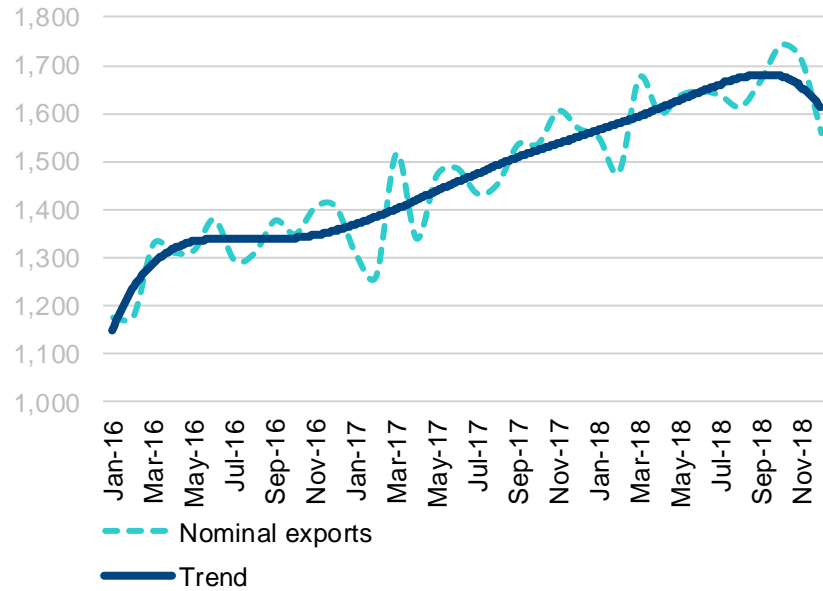
Source: BBVA Research

- Global growth has slowed due to China's structural moderation, high uncertainty in Europe, trade protectionism and the cyclical slowdown in the US
- A slight improvement is possible in the short run, but activity will remain less dynamic than in previous years

Exports and investment are weak, but private consumption remains relatively robust

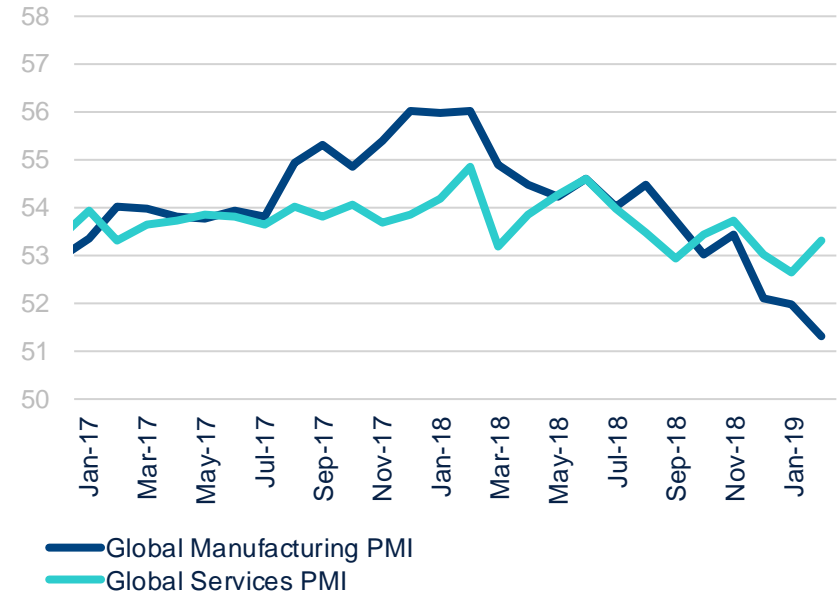
World Exports

(Billions of dollars)



PMIs

(Level)



Growth moderation has caused a shift in monetary policy in the US and the Eurozone, and new stimuli in China

Fed

- Long pause in the **rate hikes**, but there could be a hike by the end of the year
- The **normalization (reduction) of the balance sheet will end earlier than expected** (September 2019)

BCE

- **Postponement of monetary normalization**
- **Lower interest rates** for longer and additional liquidity

China

- **Additional monetary stimulus:** RRR and lending rate reductions in 2019
- **Increase in public deficit**, to 2.8% of GDP in 2019
- **Tax cuts** (2% of GDP)

Latam and other emerging countries

- There is room for a **more dovish monetary policy**

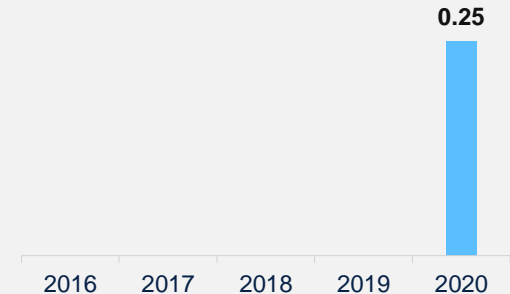
ECB's increased caution: lower rates for longer and more liquidity



- ▲ **End of QE** (December 2018)
- ▲ **Total QE reinvestment** after the beginning of interest rate's hiking cycle
- ▲ **New round of liquidity auctions (TLTRO III)** from September 2019 to March 2021, with a two-year maturity:
 - To avoid an abrupt adjustment of the financing of the banking sector
 - Less generous conditions than in previous rounds

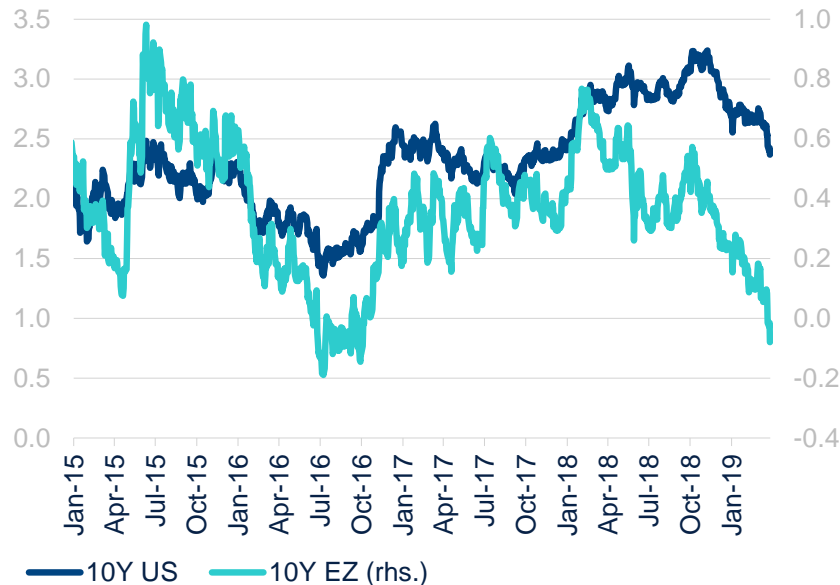


- ▲ **Low interest rate expectations reinforced** due to the economy's poorer performance and higher risks
- ▲ **No rate hikes expected until December 2020**



Markets: long-term yields excessively low due to cyclical risk and “safe haven” effect. Volatility is limited by central banks' dovish tone

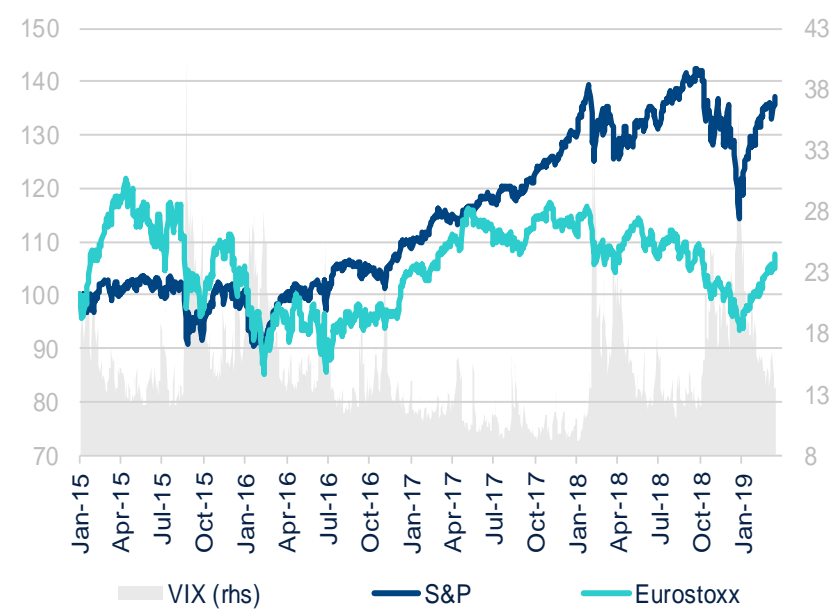
Sovereign debt yields (%)



Source: BBVA Research based on Haver data

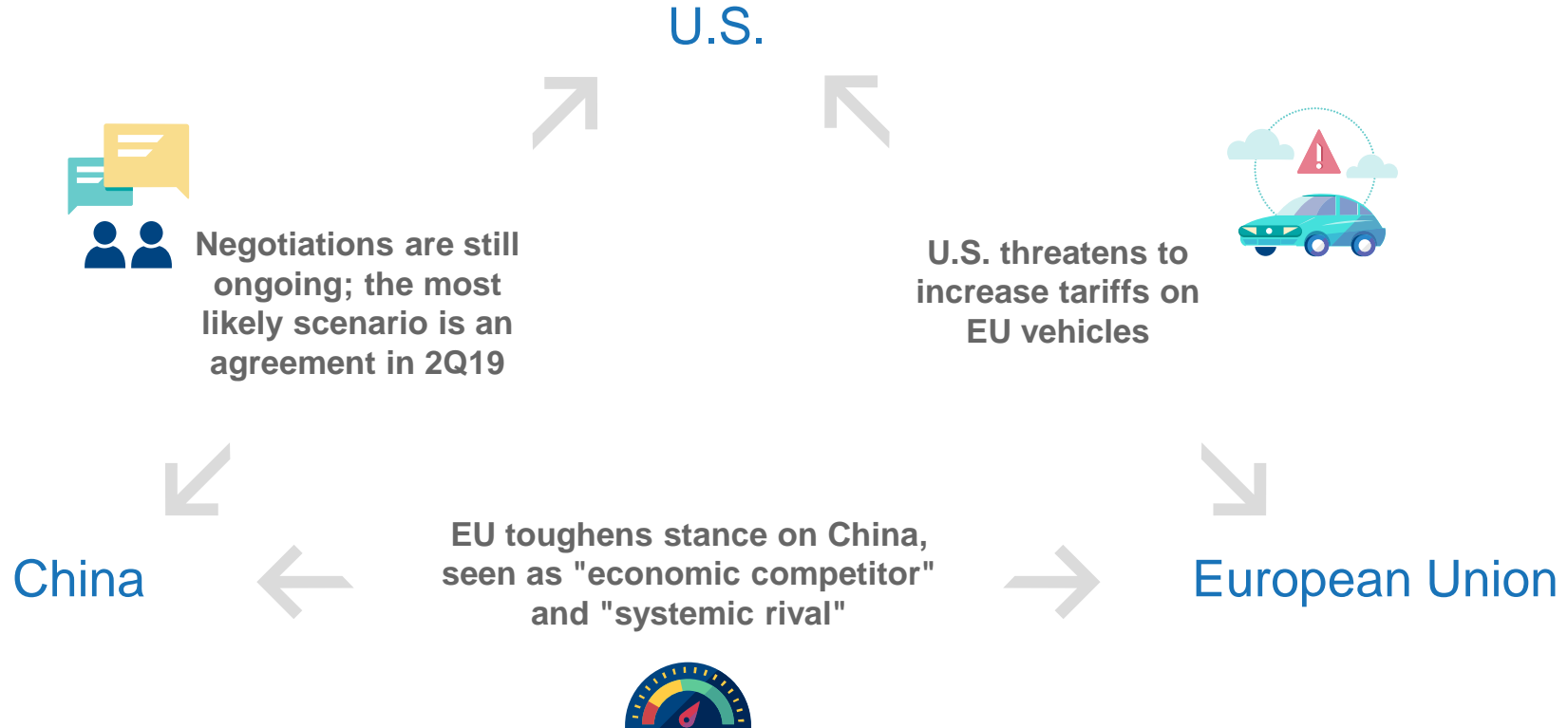
Equity indexes and Volatility (VIX)

(Base 100 in Jan-15 and %)



Source: BBVA Research based on Haver data

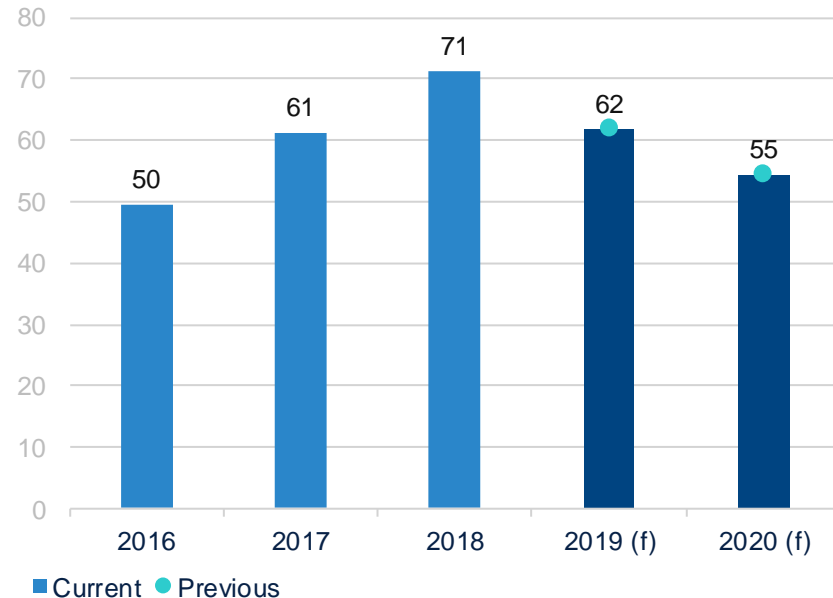
Protectionism: US-China trade agreement delayed, as the EU begins to gain prominence as focus of tensions



Oil markets: as expected, supply adjustments propped up prices in 1Q19, which will likely move down from now onwards

Brent prices

(USD per barrel, end-of-period)



Source: BBVA Research based on Haver data

- Production cuts have driven oil prices up (65 dollars per barrel, on average, in 1Q19)
- We maintain prospects for lower prices in 2H19 and 2020, on slower economic growth and rising US supply
- We continue to expect prices to converge to the long-term equilibrium level of \$60/b

Action by central banks and an absence of "accidents" would enable global growth to soft-land

More signs of global slowdown



New stimulus policies



Assumption on the evolution of the global outlook: no "accidents"



01

Protectionism

A US-China trade agreement is still likely, despite the delay



02

Brexit:

Greater uncertainty, for a longer time



03

Financial markets:

volatility constrained by central banks' measures



04

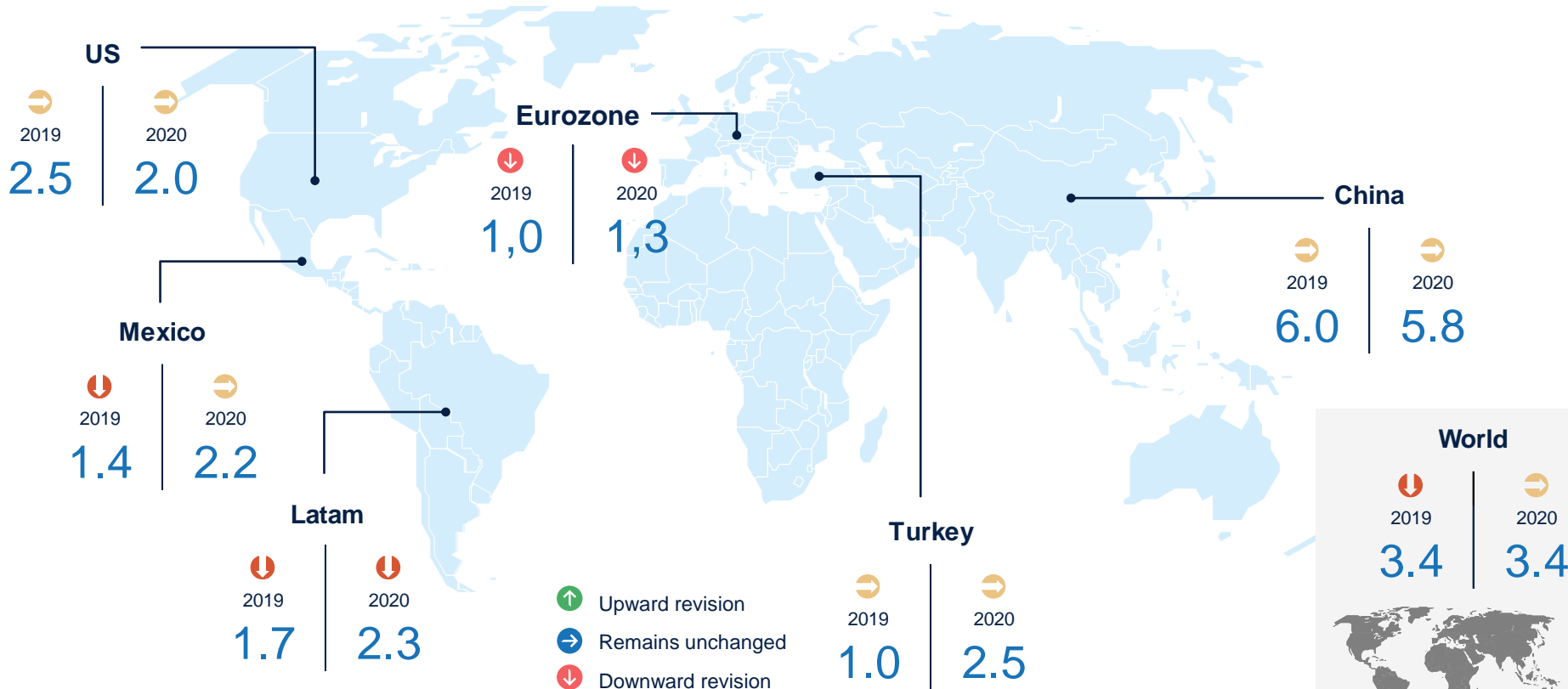
Oil:

Price moderation following the recent upturn



Global growth soft-lands

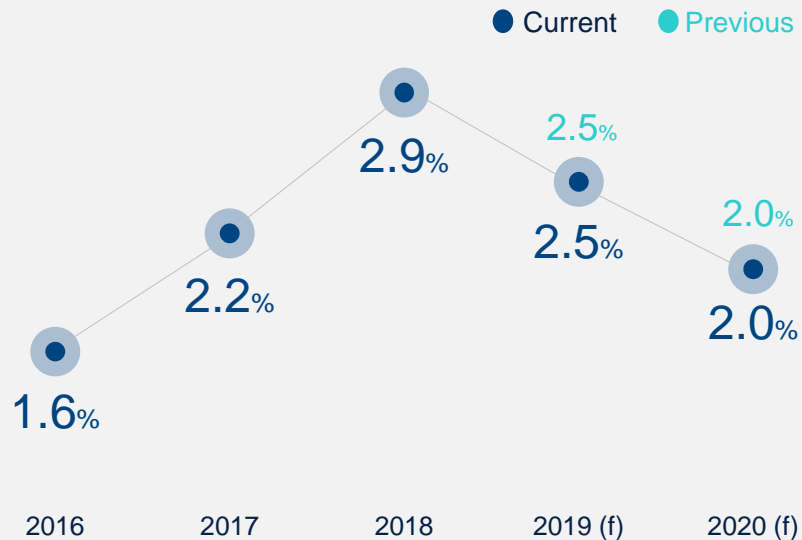
Without "accidents", global growth will decelerate gradually



Source: BBVA Research

US: a cyclical activity moderation and a more patient Fed

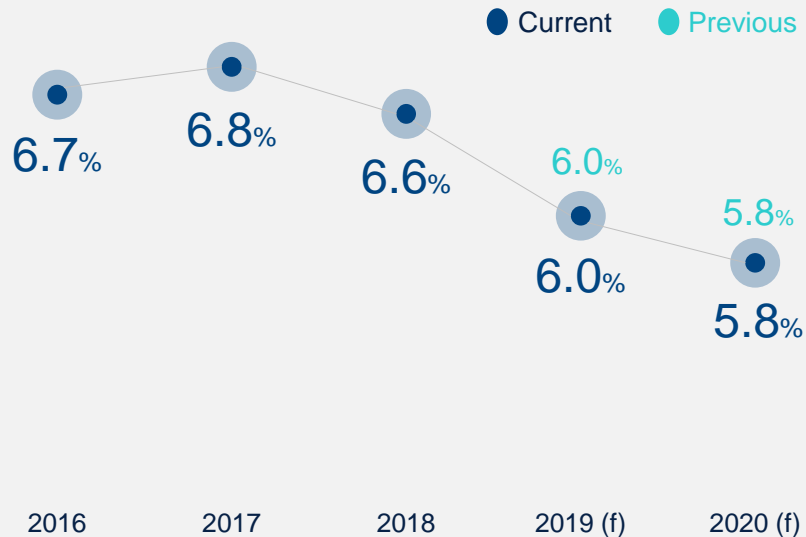
US: GDP growth (% YoY)



- Growth will continue to lose steam going forward, converging to the potential rate
- Unchanged growth forecasts (with a downward bias), while the risk of recession remains high
- Inflation is expected to continue below the 2% mark during 2019

China: a trade agreement with the US and more expansionary policies will lead to a soft landing

China: GDP growth (% YoY)



- The growth target for 2019 was reduced to a 6.0%-6.5% range
- A sharp slowdown in growth remains an important risk
- **Monetary stimulus:** cuts in bank reference rates and RRR's
- **Fiscal stimulus:** VAT-centered tax cuts of 2% of GDP

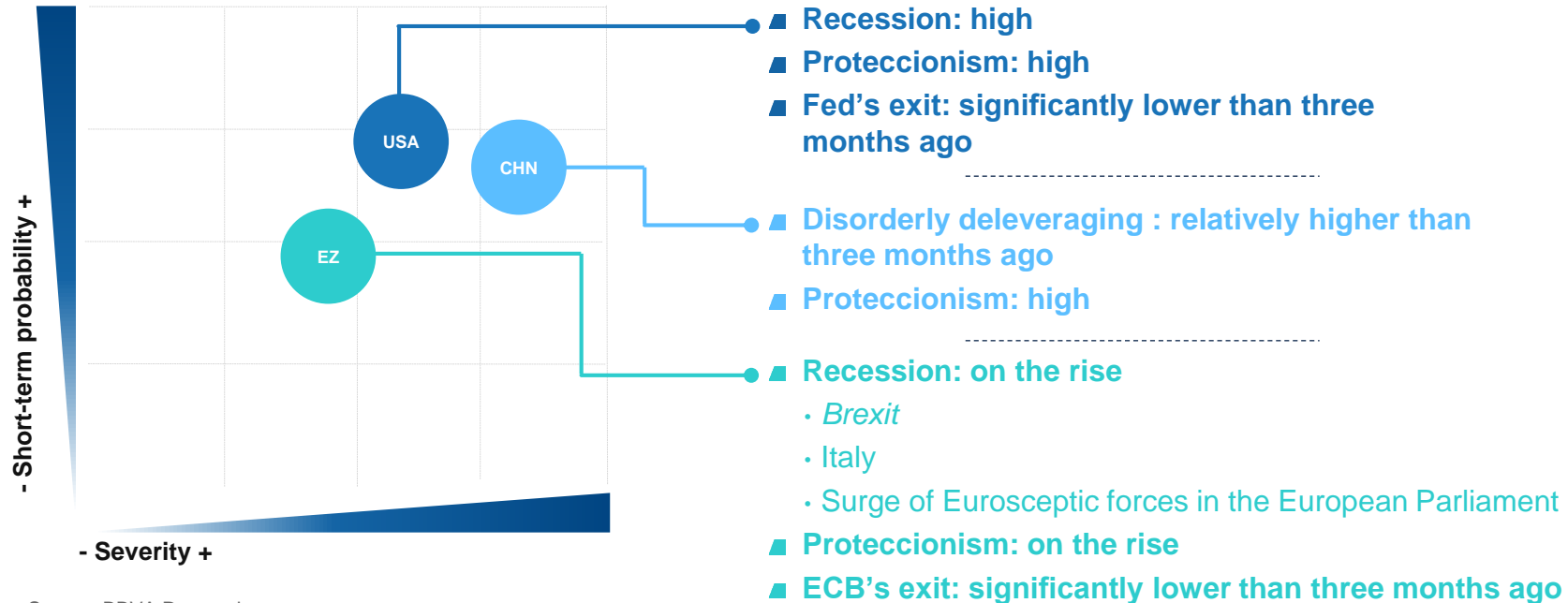
Eurozone: more prolonged activity weakness to cause lower growth in 2019, some recovery expected in 2020

Eurozone: GDP growth (% YoY)

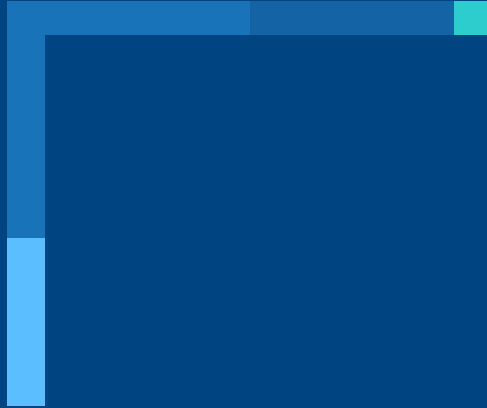


- Downward revision of GDP growth forecasts
- Adjustment in activity expectations concentrated on exports and investment, given lower external demand and lingering uncertainties
- The euro is expected to appreciate from mid-2019 onwards, but at a more gradual pace than expected

Global risks: increasing fears about a recession in the US and in the Eurozone, in spite of central banks' broader support



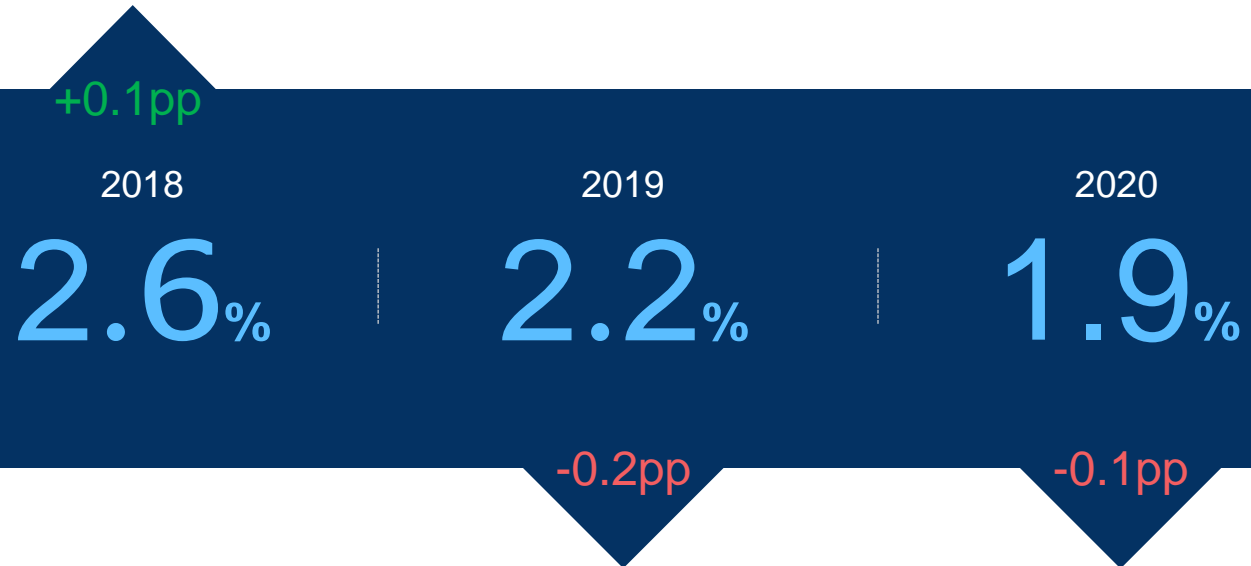
Financial vulnerabilities can amplify the severity of the risks



02

Spain Economic Outlook 2Q19

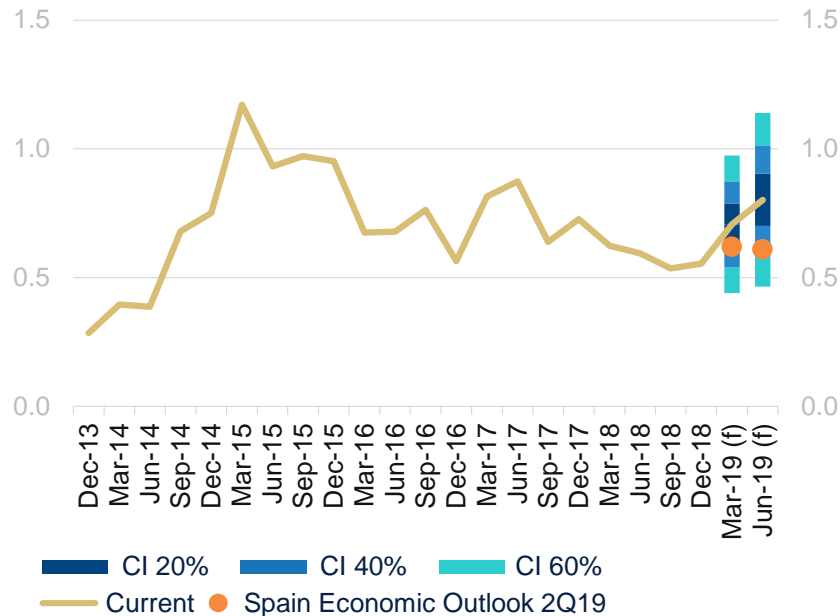
Growth forecasts are revised downwards and downside risks are more prominent



The increase in activity will remain solid in the short run

Spain: GDP growth

(MICA-BBVA model forecasts, % QoQ)



(CI) Confidence interval. (f) Forecast.

Source: BBVA Research based on national sources

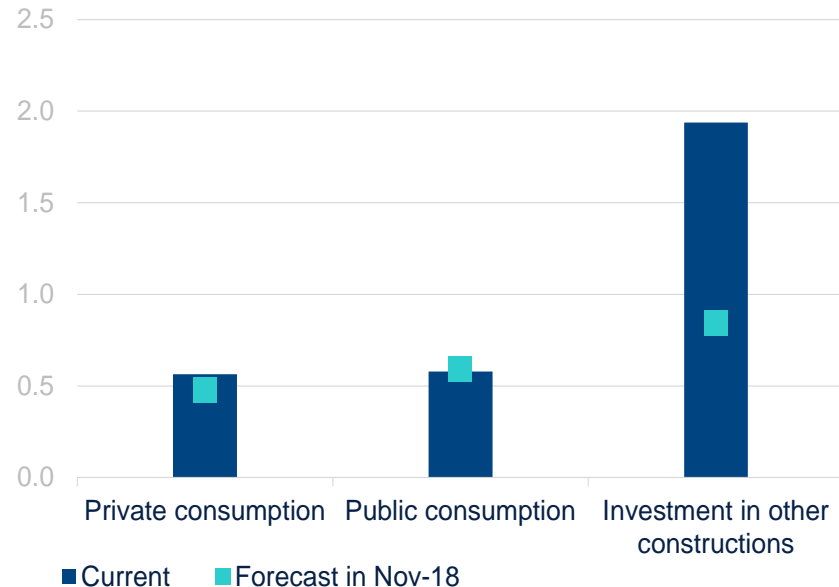
- GDP growth could remain between 0.6% QoQ and 0.7% QoQ in 1Q19, in line with expectations
- For 2Q19, BBVA Research estimates suggest that GDP growth could be between 0.5% QoQ and 0.8% QoQ.
- The Spanish economy keeps growing at a faster pace than the rest of the EMU (0.3% QoQ on average in the last four quarters)

The increase in the activity will remain solid in the short run :

The trends in consumption and public investment growth are positive

Spain: Consumption and investment in non-residential construction

(QoQ average growth, 4Q18-1Q19*, %)



(*) Data estimates for 1Q19.

Source: BBVA Research based on INE

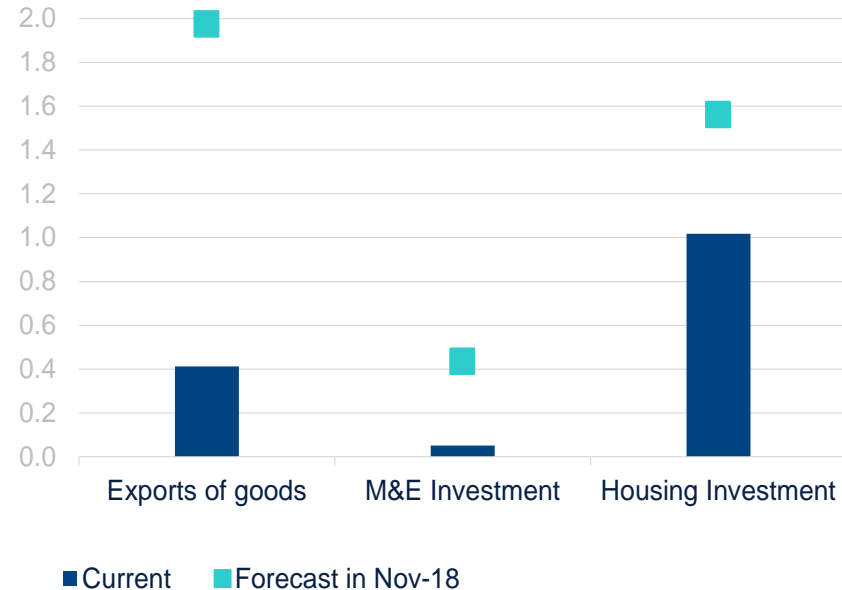
- ▲ Economic policy measures adopted recently (pension increases, minimum wage and public wages), financing increase and the good performance of employment support spending
- ▲ Furthermore, the electoral period ahead could lead to a further increase in spending and public investment

The increase in activity will remain solid in the short run:

There has been a rise in volatility in investment and the exports of goods

Spain: Exports of goods and investment

(QoQ average growth, 4Q18-1Q19*, %)



(*) Data estimates for 1Q19.

Source: BBVA Research based on INE

- Exports have been conditioned by international trade tensions, EMU growth deceleration, and the changes taking place in the automobile industry
- In addition, uncertainty regarding economic policy may have negatively affected the decisions on M&E investment
- Legal uncertainty resulting from regulatory changes in the residential market has contributed to housing investment's slowdown

Outlook 2019-2020:

The recovery will continue, although expectations are tempered



Global demand grows despite uncertainty

The various risk events are unlikely to materialize, which will support global recovery



The monetary policy stance turns more expansionary

The Fed and the ECB will help growth by keeping lower interest rates for longer. In Europe there will be a new TLTRO auction and the exchange rate will depreciate further



Oil prices remain at low levels

This limits the increase in production costs and prices, which favors spending and investment of companies and families



The expansionary stance of fiscal policy may fade

The impact of the political cycle casts doubts on the developments in public expenditure and the fulfilment of deficit targets



The effects of some policies implemented are still uncertain

The positive effect of the increase in the minimum wage may fade in the coming quarters and could be offset by the negative effect on employment



Uncertainty affects real estate market growth

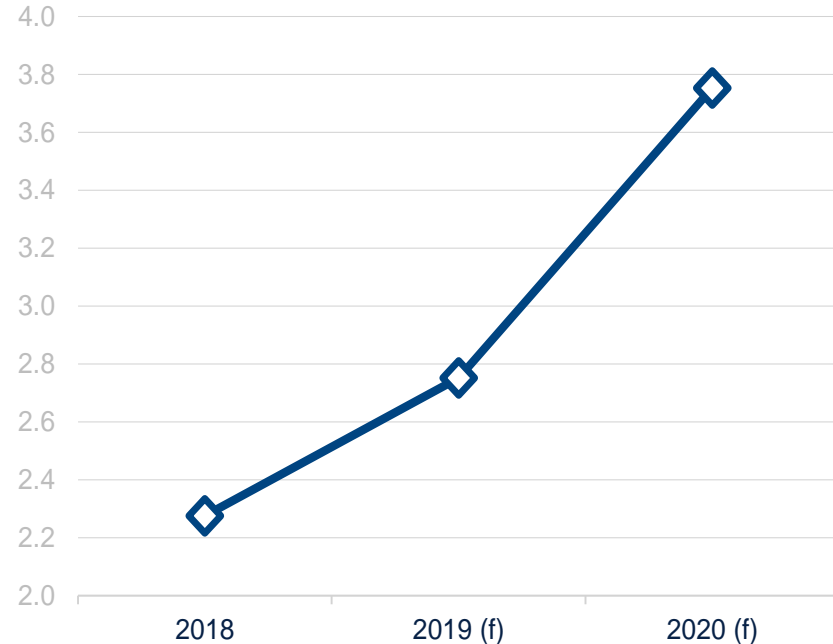
Legal uncertainty could influence housing investment growth, at least in the short run

The recovery will continue, although expectations are tempered

EMU growth's slowdown will revert on 2020

Spain: exports growth

(%)



(f) Forecast.

Source: BBVA Research based on INE

- Uncertainty on tariff tensions, *brexit* or the recovery in China, is expected to gradually decrease, which will support the recovery of trade
- Supply factors that negatively affected the auto sector could be reverting
- Gains in competitiveness (euro depreciation, decline of oil prices) will also boost export growth

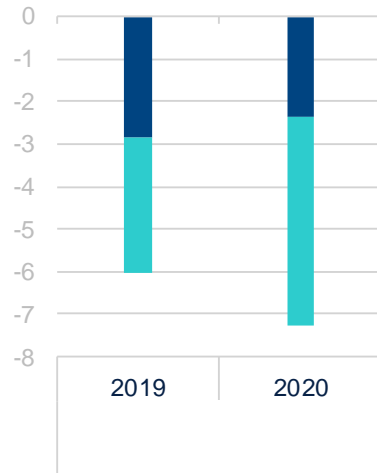
The recovery will continue, although expectations are tempered

The monetary policy stance becomes more expansionary

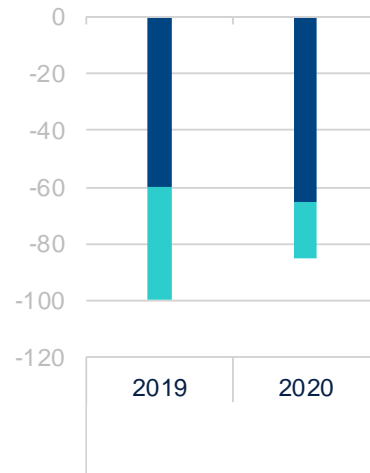
Change in 10-y interest and exchange rates for the Spanish economy

(forecast end of period)

Exchange rate (%)



Long run interest rate (pp)



■ Variation Oct18-Jan19 ■ Variation Jan19-Apr19

Source: BBVA Research

■ Financial conditions will remain favourable to spending decisions:

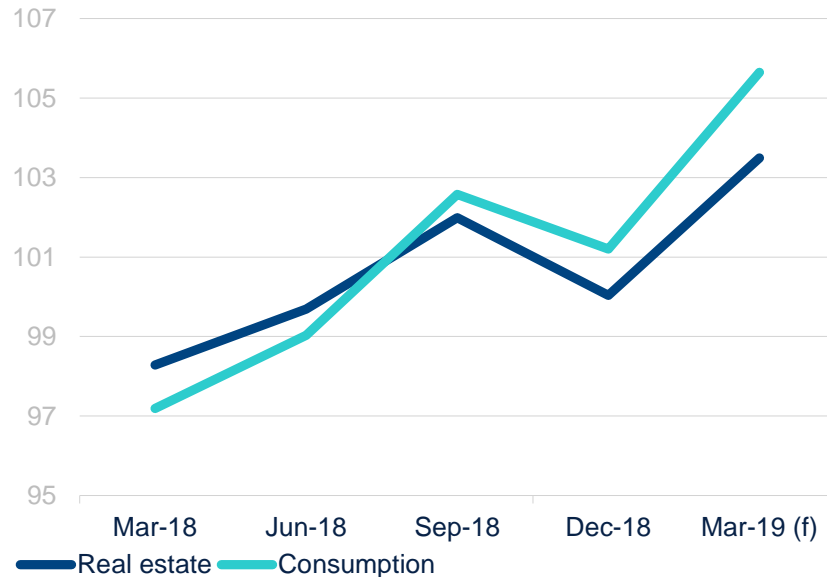
- First official interest rate hike will not take place until 4Q20
- Besides, ECB will implement a new auction of liquidity (TLTRO III)
- Long term interest rates and exchange rates are expected to be lower than expected three and six months ago

The recovery will continue, although expectations are tempered

Credit demand by households will continue growing

Spain: new credit transactions

(Average 2018=100, SWDA series)



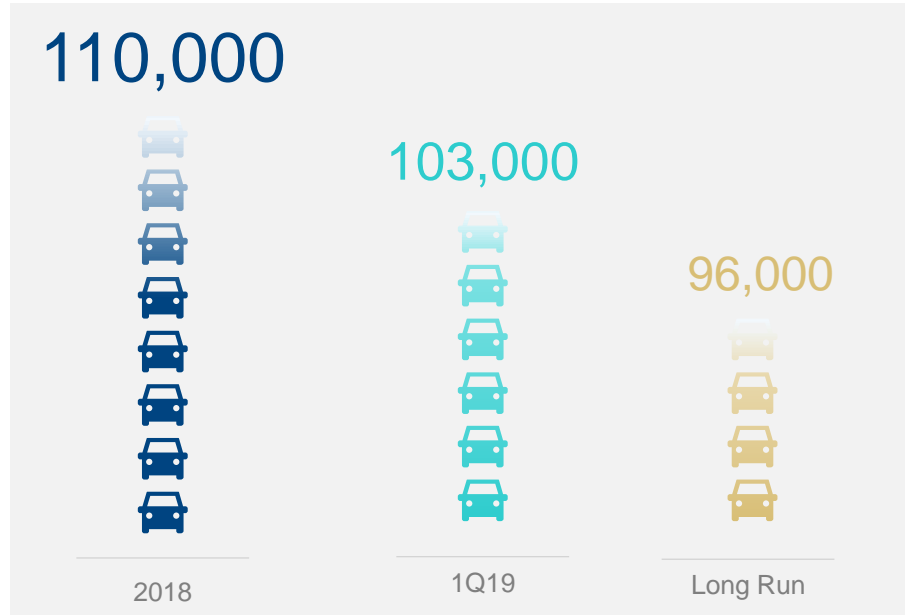
- Household confidence and job creation keeps growing, which will continue to support credit demand
- In a context of persistently low interest rates, outstanding credit to households is still falling. Deleveraging continues in the mortgage market.

The recovery will continue, although expectations are tempered

Possible slowdown in consumption growth

Spain: vehicle registrations

(Monthly average, SWDA)



Source: BBVA Research based on ANFAC

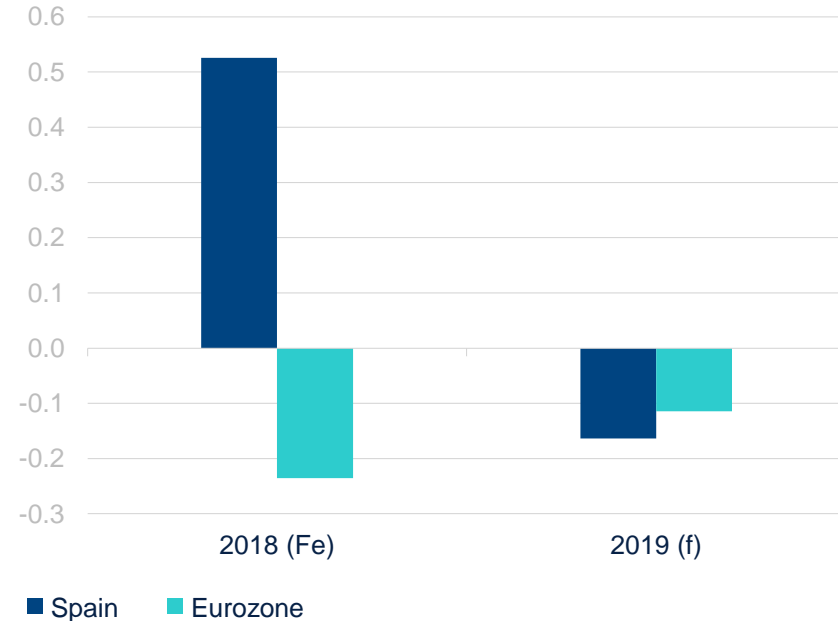
- Low savings rate and the diminishing effect of pent-up demand point to lower growth of household spending going forward
- In addition, there may be diminishing returns regarding solvent credit demand
- Finally, auto sector has suffered from regulatory uncertainty that seems to be affecting demand

The recovery will continue, although expectations are tempered

The expansionary stance of fiscal policy may wane

Change in primary expenditure for public sector

(bp of GDP)



Remark: AMECO forecasts for Eurozone and BBVA Research forecasts for Spain (Fe) Flash estimate. (f) Forecast.

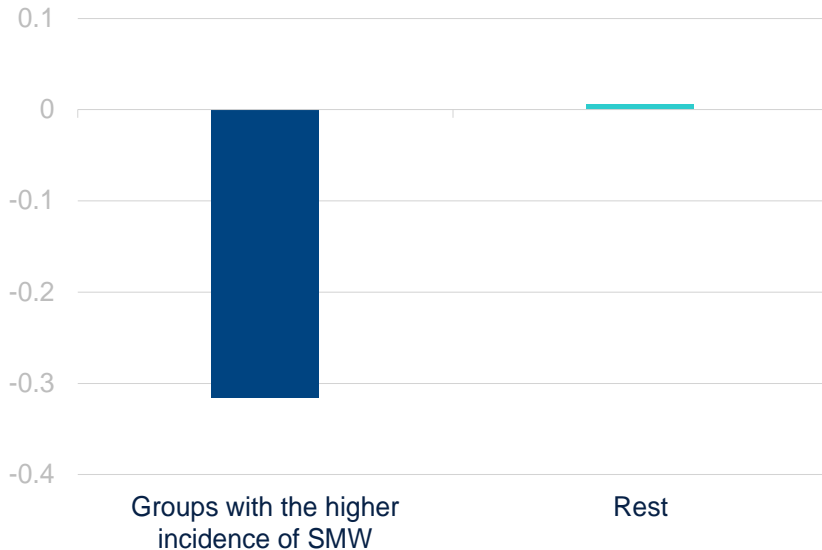
Source: BBVA Research based on Ministerio de Hacienda and AMECO

- High revenue growth has helped reduce the fiscal deficit to about 2,6% of GDP, despite the increase of public expenditure in 2018
- Uncertainty about fiscal policy in the coming biennium has increased, and will remain high at least until the formation of the new government
- There is a risk of stalling public demand in 2S19, in the aftermath of spending expansion in 2018 and 1S19 as a result of the policies implemented and the electoral cycle

The recovery will continue, although expectations are tempered

Uncertainty about the impact of the increase of the statutory minimum wage

Social Security Registration: difference between quarterly variation in 1Q19 and in the average 1Q17-1Q18 (General Regime, %)



* Under 30 years.

Trade, hostels and restaurants, real estate activities, professionals, administratives and artistic services and other services. Canary Islands, Extremadura, Andalucía and Murcia

Source: BBVA Research based on MITRAMISS

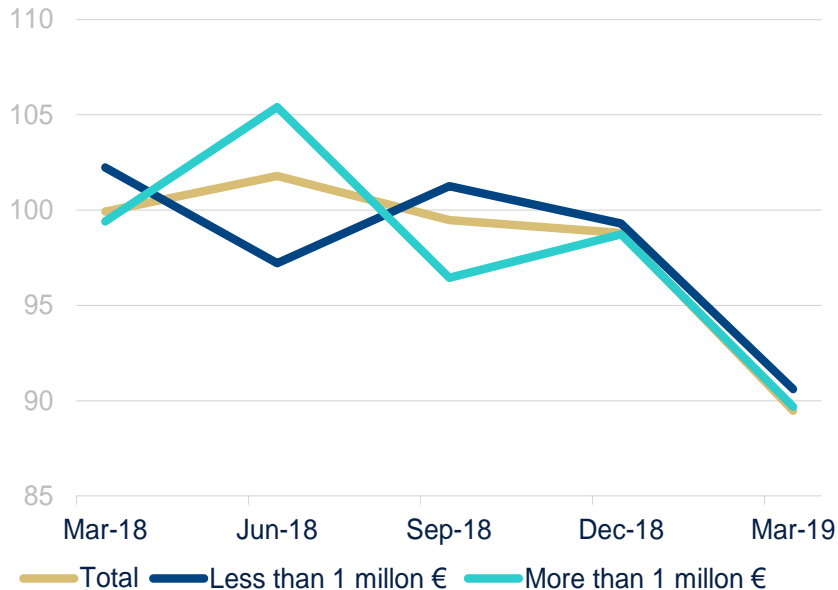
- The increase of the statutory minimum wage (SMW) has raised household income and expenditure, and has had limited impact on employment and activity in the short run, in line with expectations
- However, BBVA Research estimates suggest that the effect in the long run will depend on whether companies absorb wage increase or pass it into prices
- Job destruction will affect vulnerable groups and may increase inequality

The recovery will continue, although expectations are tempered

Uncertainty on economic policy affects investment

Spain: new financing transactions to companies

(Average 2018=100, SWDA)



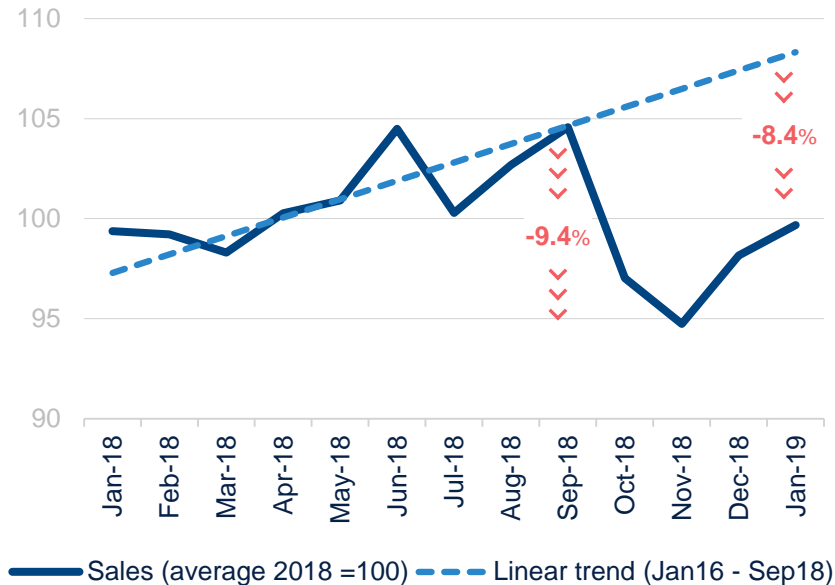
- **Uncertainty** regarding global recovery, trade tensions or *brexit*, **may be reducing** investment spending and, thus, **credit demand**
- In addition, there is **uncertainty regarding economic policy** in Spain in the short run, related to electoral cycle

The recovery will continue, although expectations are tempered

Legal uncertainty is having an effect on housing investment

Spain: housing sales

(SWDA and linear trend)



- Uncertainty regarding changes in taxation has led to a correction, transitory at least, of housing sales
- Regulatory changes in renting will impact on investment decisions permanently
- EMU economic slowdown may lead to lower demand from foreigners
- Housing investment will grow 4,4% on average the coming bienium, 1,6pp less than expected three months ago

Risks are still numerous and the likelihood of occurrence of some of them is increasing

Global

01

Trade tensions

High uncertainty regarding the resolution of tensions between USA and China, as also about *brexit*, after the agreed deadline extension with EU.

02

Environment of low growth

China's slowdown continues, while the likelihood of a recession is rising in Europe

Idiosyncratic

03

Economic policy uncertainty

The electoral cycle makes fiscal policy uncertain. Likewise, the impact of certain approved measures (statutory minimum wage increase, changes in housing market) is still unknown

04

Limitations of capacity in certain sectors

Demand has reduced in certain key sectors (auto, tourism). Others are starting to suffer from limitations of capacity, exhaustion of the effects of reforms and lower potential growth

05

Job creation pace

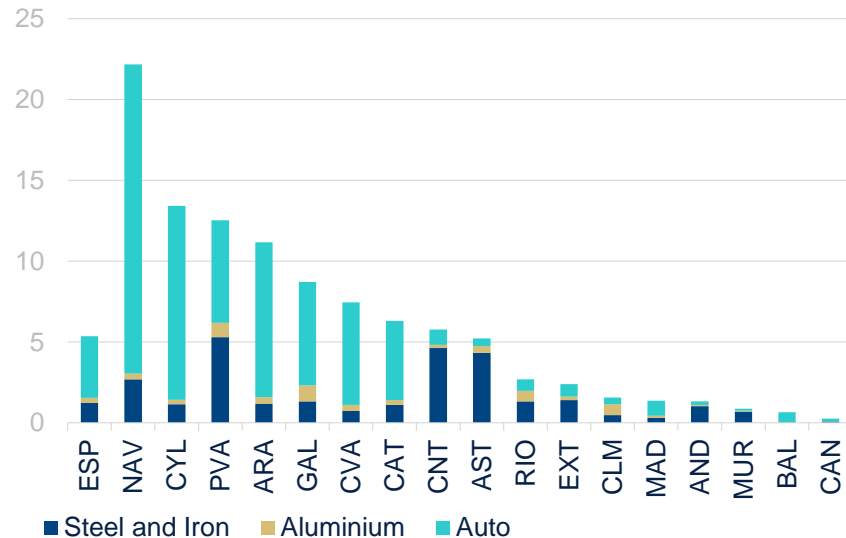
Wage pressures, along with supply side composition of growth, are a key factor to be closely watched. The public sector created a quarter of the jobs in 2018

Risks are still numerous

Trade tensions remain

Exports of products likely to be affected by trade war in 2018

(% GDP*)



* 2017 GDP. Nominal data

Source: BBVA Research based on Datacomex

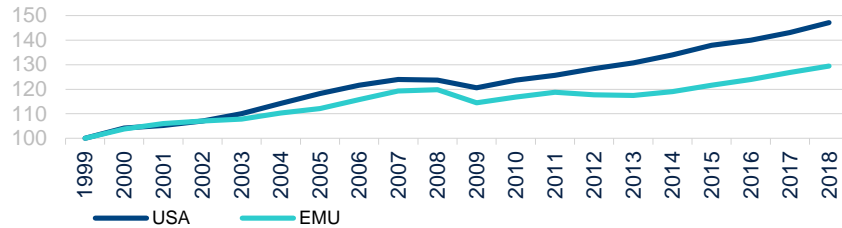
- Until now, trade tensions have affected sectors with a relatively low weight in Spanish exports
- The threat of higher tariffs on USA imports of european cars may have an important effect in some Spanish regions if implemented
- *Brexit* also represents a risk, and may have both a direct impact (exports), and an indirect one (financial market disruptions)
- The uncertainties particular to the auto sector (regulation, technological change, etc.) are also relevant

Risks are still numerous

Low EMU growth may be structural

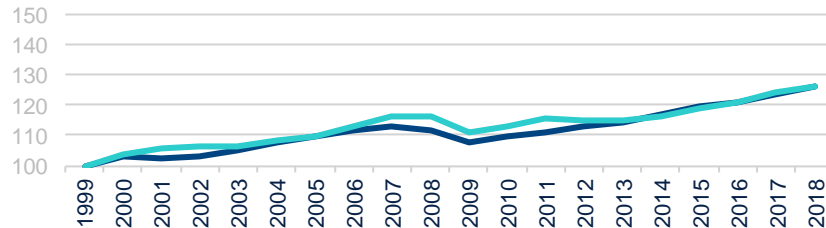
Real GDP evolution

(1999=100)



Real GDP per population in working age

(1999=100)



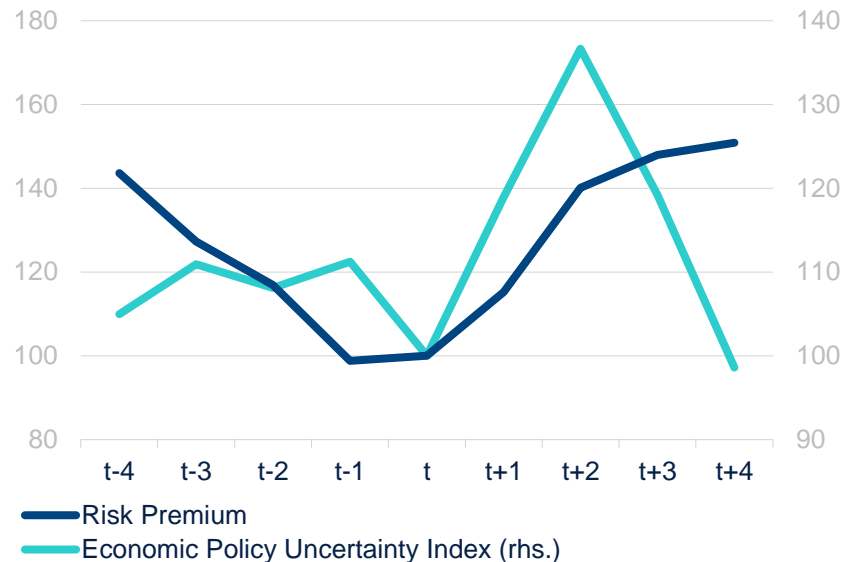
- EMU's GDP growth has recently decelerated, however divergence pattern with USA is structural
- Reforms towards a deepening in the european integration process and that relaunch EMU's growth are necessary, albeit other measures point to that the problem may not be that severe.

Risks are still numerous

Uncertainty regarding economic policy

Spain: risk premium and Economic Policy Uncertainty Index

(Average Apr-15, Nov-15 y Apr-18 =100)



t=month prior to May-15 and Dec-15 elections and the motion of censure on May-18
 Source: BBVA Research based on Bloomberg and y Baker et al. (2016)

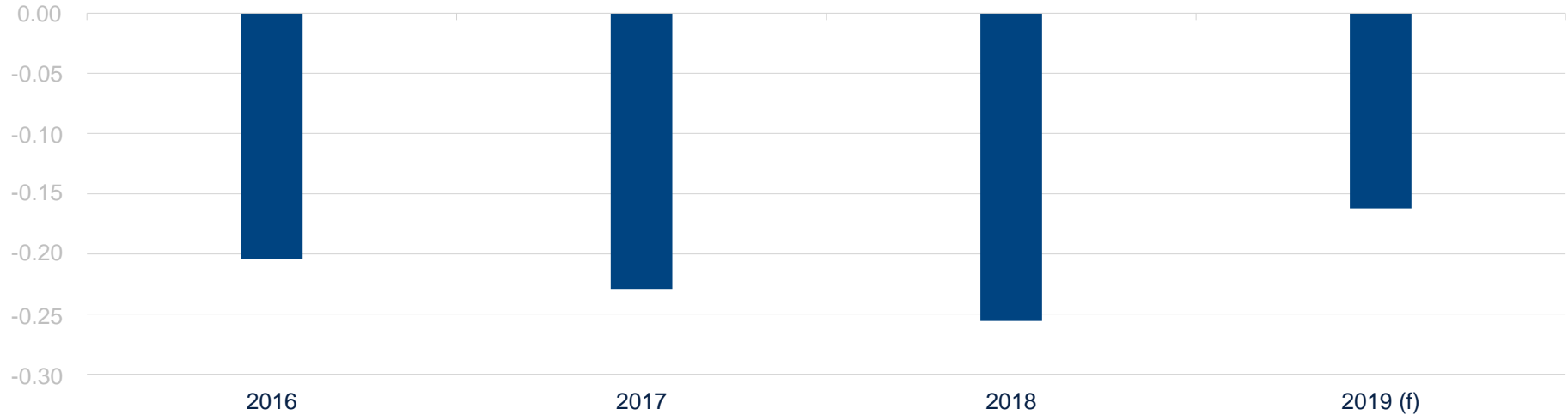
- **Uncertainty won't fade:** given the fragmentation of the Spanish Parliament, uncertainty increases in a year of intense electoral activity cannot be ruled out
- **In the past, increases in tensión lead to higher financing costs of the Spanish economy**

Risks are still numerous

Uncertainty regarding economic policy

Spain: impact of economic policy uncertainty on GDP

(Deviation from level in pp)



(f) Forecast.
Source: BBVA Research

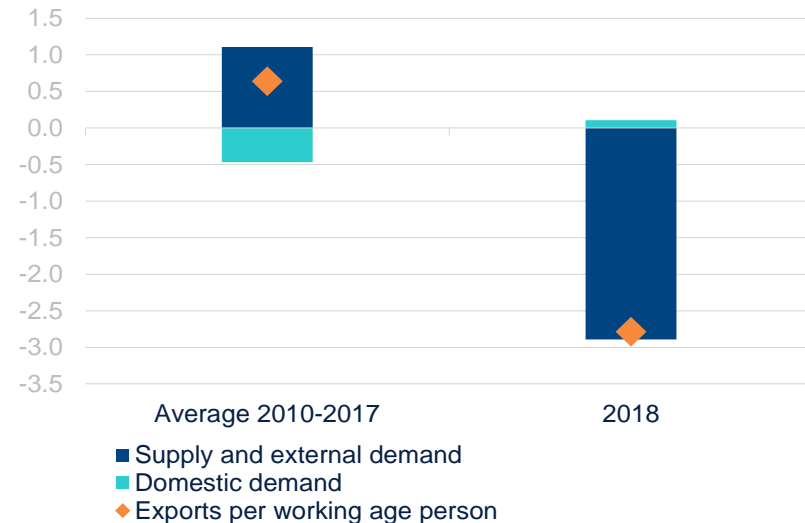
Economic policy uncertainty will reduce the level of GDP by two tenths in 2019 and, if it reaches the levels observed in the last elections, it could subtract one or two tenths more

Risks are still numerous

Capacity constraints in certain sectors

Spain: decomposition of growth in exports of goods and services per person in working age

(% YoY, deviation from the average)



*Contributions of the structural perturbations have been represented in deviations with respect to the average growth of 4,3% in the sample period 4Q92-4Q18.

See Boscá, J.E., Doménech, R., Ferri, J. y Ulloa, C. (2019): "Determinantes del ciclo económico en 2018", Economic Watch. Available at: <https://bit.ly/2G00x13>

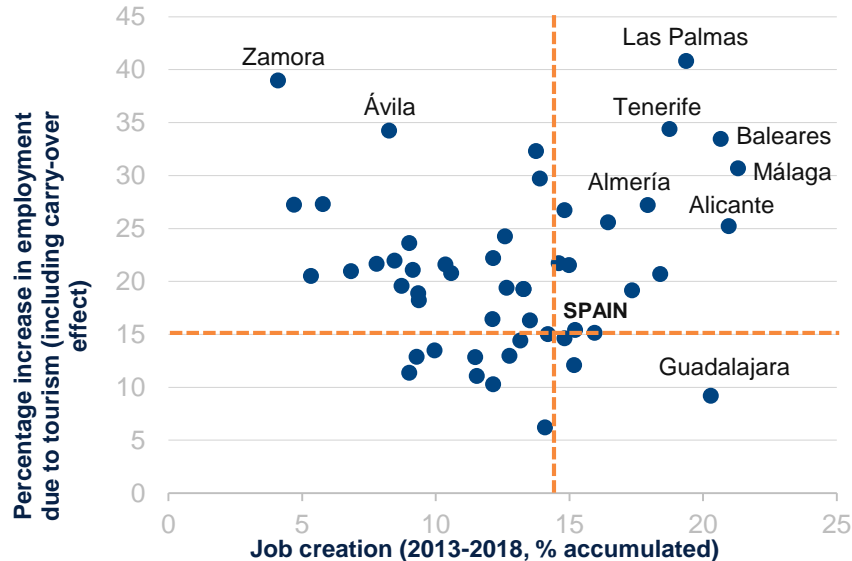
Source: BBVA Research

- While it may contribute to exports growth, the “crowding out” effect from domestic demand adjustment is of minor importance
- Supply (improvement in competitiveness) and demand factors (global recovery) would partly drive the internationalization of Spanish firms
- While the recent slowdown is partly explained by global demand, the benefits of reforms may have vanished and supply constraints may also starting to be observed

Risks are still numerous

Demand has reduced in some key sectors

Contribution of the tourism sector to job creation (2013-2018, %)



For more information: Echevarría, V. (2019): "El empleo ante la desaceleración del turismo: un análisis provincial", Observatorio Económico. Available at: <https://bit.ly/2G0pV75> AND Díez-Catalán, L., Ramallo, S. y Ulloa, C. (2019): "Turismo exterior en España: pérdida de tracción a la espera de mejoras en la competitividad", Economic Watch. Available at: <https://bit.ly/2FuOVI9>
Source: MTSS

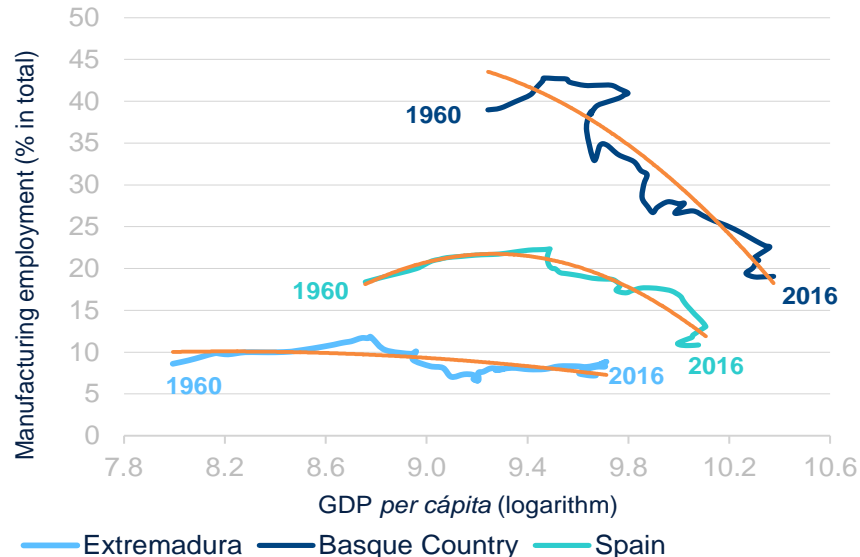
- The tourism industry has created around 15% of jobs during the recovery, and even more in some provinces
- However, tourism growth is now slowing down as a result of:
 - Fluctuations of hotel fares and transport costs
 - Economic performance of the eurozone, the main source of tourists
 - Geopolitical tensions receding in some competitors
- It is an opportunity for investment, transformation and to improve competitiveness

Risks are still numerous

Some Spanish regions experience “premature deindustrialization”

Manufacturing employment on full employment and GDP per cápita between 1960 and 2016

(% and logarithms)

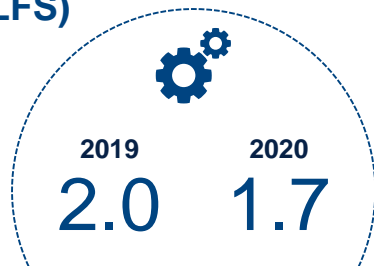


See Barandiaran, J., Cardoso, M. y Díez-Catalán L. (2019): “Desindustrialización prematura en España”, Economic Watch. Available at: <https://bit.ly/2H4Hqoh>
Source: BBVA Research based on INE and BDMORES

- As in the rest of the developed world, from 80s there is a deindustrialization trend
- Some Spanish regions have suffered a “premature deindustrialization” process: manufacturing employment has peaked at lower levels for late industrializers
- Industrial development is important, but within a broader development: digitalization and investment in human capital

2019-2020: Inflation and labour market forecasts

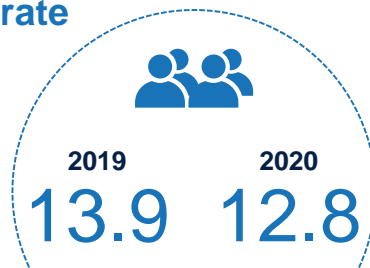
Employment growth (LFS)



Inflation



Unemployment rate



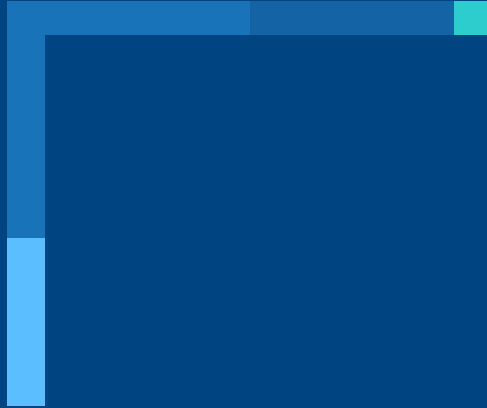
Compensation per employee



Key messages



- The weakness of global economic activity has continued and uncertainty remains high. Economic (in particular, monetary) policy has reacted, aiming to smooth the slowdown of growth
- GDP growth is revised downwards slightly to 2.2% in 2019 and to 1.9% in 2020, as a result of lower european demand and a growing uncertainty regarding economic policy. Structural factors and the impact of certain policies also point to a slowdown. In any case, the recovery will continue due to the gradual acceleration of world growth and the support of monetary policy
- In Spain, the growth of economic activity remains at around 0.6% QoQ, as a result of the performance of private consumption, public expenditure and exports of non-touristic services
- Risks remain high and the likelihood of occurrence of some of them is rising, which introduces a downward bias on growth expectations. In this context, a consensus regarding the necessary actions to reduce the vulnerability of the spanish economy to surrounding changes is becoming all the more necessary



03

Forecasts

Changes in our forecasts

The fundamentals still support a relatively strong recovery

% YoY	2018	2019 (f)	2020 (f)
Final consumption expenditure	2.3	2.0	1.7
F.C.E. Households	2.3	2.0	1.7
General government	2.1	2.2	1.6
Gross fixed capital formation	5.3	4.1	3.9
Equipment and machinery	5.4	3.0	3.7
Construction	6.2	4.8	3.7
Housing	6.9	4.6	4.3
Other constructions	5.5	5.0	3.0
Domestic demand (*)	2.9	2.4	2.1
Exports	2.3	2.8	3.8
Exports of goods	1.8	2.0	4.1
Exports of services	3.3	4.4	3.0
Non-touristic services	4.5	6.5	4.4
F.C.E. by non-residents in the economic territory	1.7	1.5	1.0
Imports	3.5	3.8	4.5
External demand (*)	-0.3	-0.3	-0.2
GDP mp	2.6	2.2	1.9

(*) Contribution to GDP growth

(f) Forecast.

Source: BBVA Research based on INE and BdE

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

Spain Economic Outlook

2T19

April 2019

Creando Oportunidades



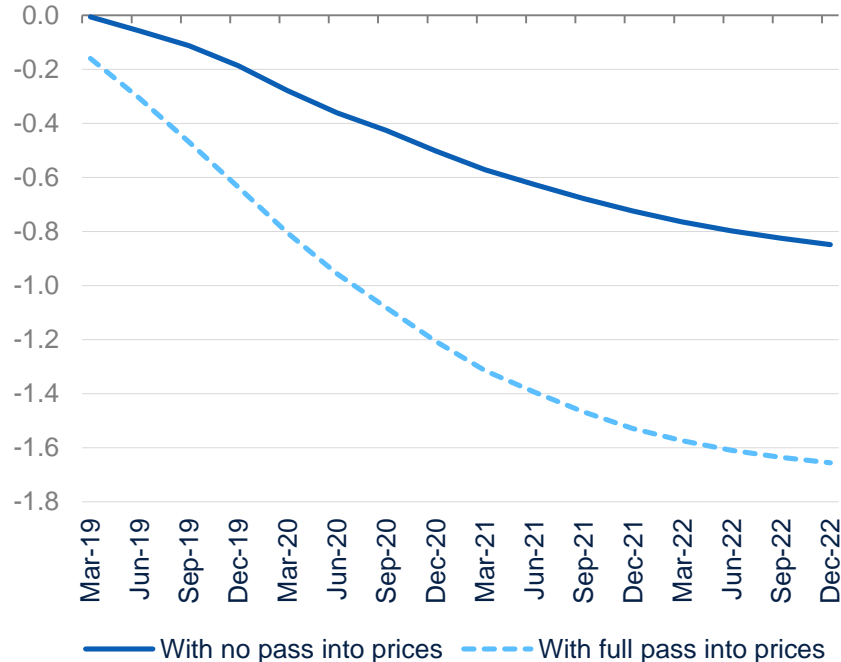
Annex

The recovery will continue, although expectations are tempered.

Uncertainty about the impact of the increase of the statutory minimum wage

Impact of the increase of SMW on FTE employment

(Deviation from baseline scenario level in pp)



Source: BBVA Research based on MITRAMISS

- The increase of the statutory minimum wage (SMW) has raised household income and expenditure, and has had limited impact on employment and activity in the short run, in line with expectations
- However, BBVA Research estimates suggest that the effect in the long run will depend on whether companies absorb wage increase or pass it into prices
- Job destruction will affect vulnerable groups and may increase inequality