

Spain

Economic Outlook

4Q19

Key messages



Prospects of a slowdown in global economic activity are **strengthening** in an increasingly uncertain environment. Global economic growth will decline from 3.7% in 2018 to 3.2% in 2019 and 3.1% in 2020.



Spain's GDP is forecast to grow 1.9% in 2019 and 1.6% in 2020, **below our forecast 3 months ago**, as a result of the revisions to historical data, the negative trend shown by some components of demand and the deterioration in the international environment. High uncertainty has a negative impact on spending.



The Spanish economy is **now better prepared** to face an environment of lower global growth. There are no major imbalances, the financial situation of the private sector is much stronger and the ECB ensures low financing costs.



It is important to reinforce these trends and enhance the resilience of **the economy with a comprehensive reform plan** of an inclusive nature that increases growth capacity.

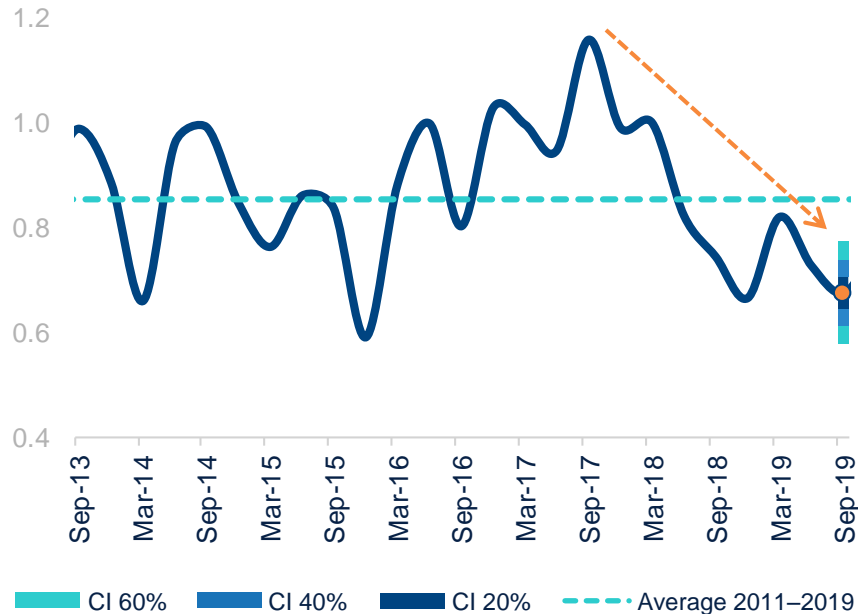
01

Global
Economic Outlook
4Q19

Global growth continues to lose momentum

WORLD GDP GROWTH

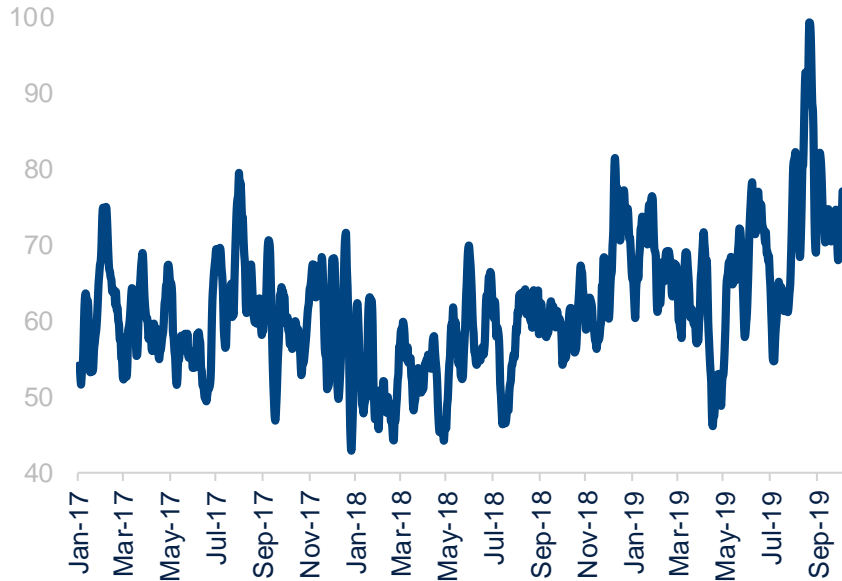
(FORECASTS BASED ON BBVA-GAIN MODEL, % Q/Q)



- Recent information confirms that uncertainty and protectionism are having a negative impact on growth.
- The slowdown in activity has been larger than expected, particularly in China and Europe.
- Exports and the manufacturing sector continue to perform particularly poorly...
- ...and there are already indications that this weakness is starting to spillover to the services sector.

Uncertainty remains high

BBVA ECONOMIC POLICY UNCERTAINTY INDEX* (INDEX FROM 0 TO 100)



- High uncertainty due to:
 - Trade and technological tensions
 - *Brexit*
 - Political and geopolitical instability

- The impact on confidence is compounding the effects of the structural slowdown in China and the cyclical moderation in the US.

* Note: reports of economic uncertainty tone index, seven-day moving average.

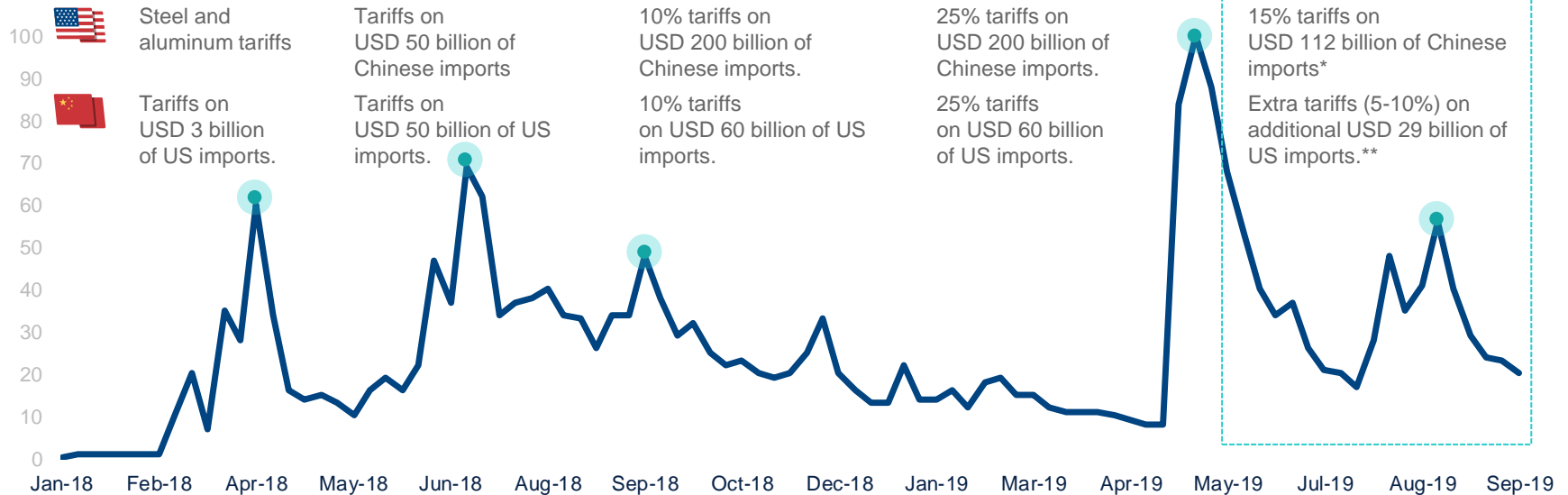
100 = June 27, 2016, corresponding to the maximum value recorded by the index for the available period (January 2016 to October 2019).

Source: BBVA Research, based on GDELT data

New protectionist measures are increasing trade tensions

TRADE WAR INDEX: GOOGLE SEARCHES FOR THE TERM "TRADE WAR"

(INDEX FROM 0 TO 100)



(*) And until December 2019, extra tariffs of 5% on USD 250 billion and 15% on additional USD 288 billion of imports from China.

(**) And until December 2019, extra tariffs (5%–10%) on additional USD 46 billion of US imports.

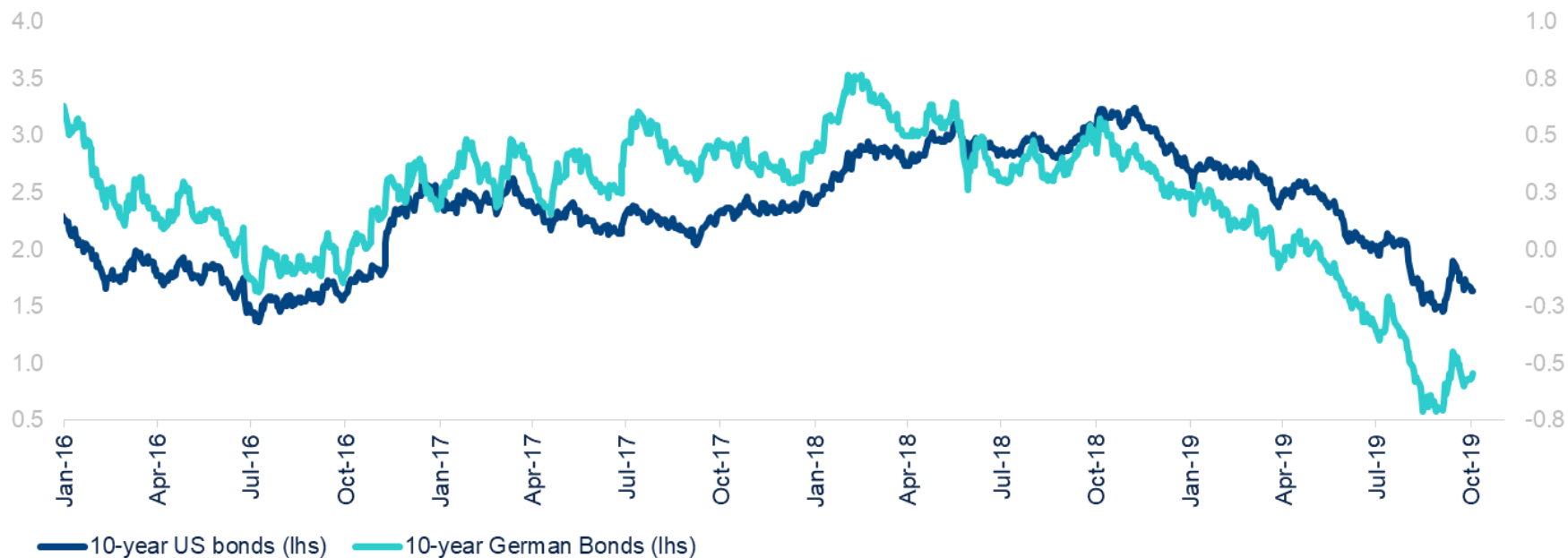
100 is the maximum value recorded by the index for the available period (January 2016 to October 2019).

Source: BBVA Research, based on Google Trends

Flows toward safe assets continue in financial markets.

SOVEREIGN DEBT YIELDS

(%)



Countercyclical policies will help to control financial tensions, but will not prevent the global slowdown



COUNTERCYCLICAL POLICIES

Monetary policy:

- Will continue to lead the **countercyclical effort...**
- **...despite its reduced effectiveness** in the current context.
- **Further adjustments** in the coming months.

Fiscal policy:

- Should play a **bigger role...**
- **...but the political environment and high levels of debt restrict its use.**
- **Measures in China** and to a lesser extent in Europe.

Multilateralism:

- **International policy coordination has become less likely.**

GLOBAL UNCERTAINTY

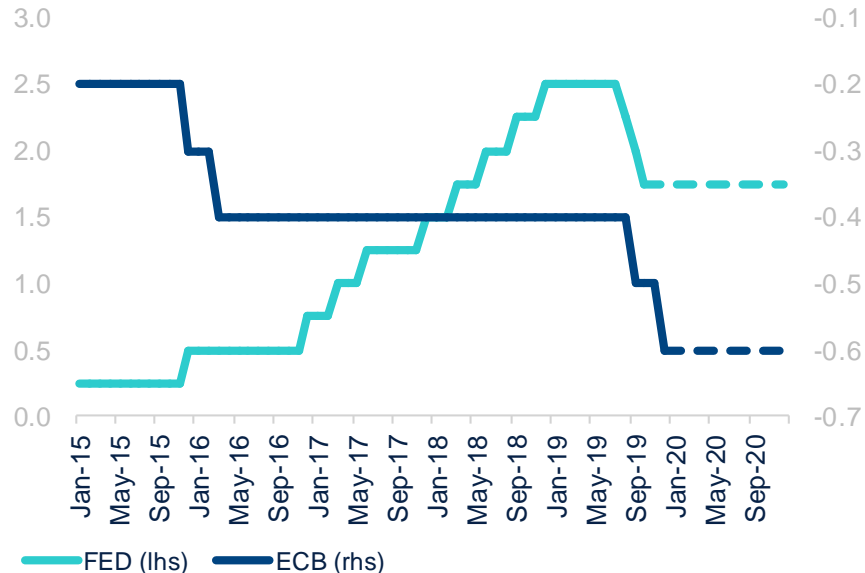
Tensions between the US and and China will persist:

- Although a partial trade agreement between the two countries is likely...
- **...it is unlikely that tariffs will return to the levels seen a few months ago**
- **...structural and technological issues will continue to generate instability.**

Brexit, as well as **political and geopolitical tensions** in certain regions, will continue to fuel uncertainty.

Central banks will maintain the expansionary stance of monetary policy over an extended period

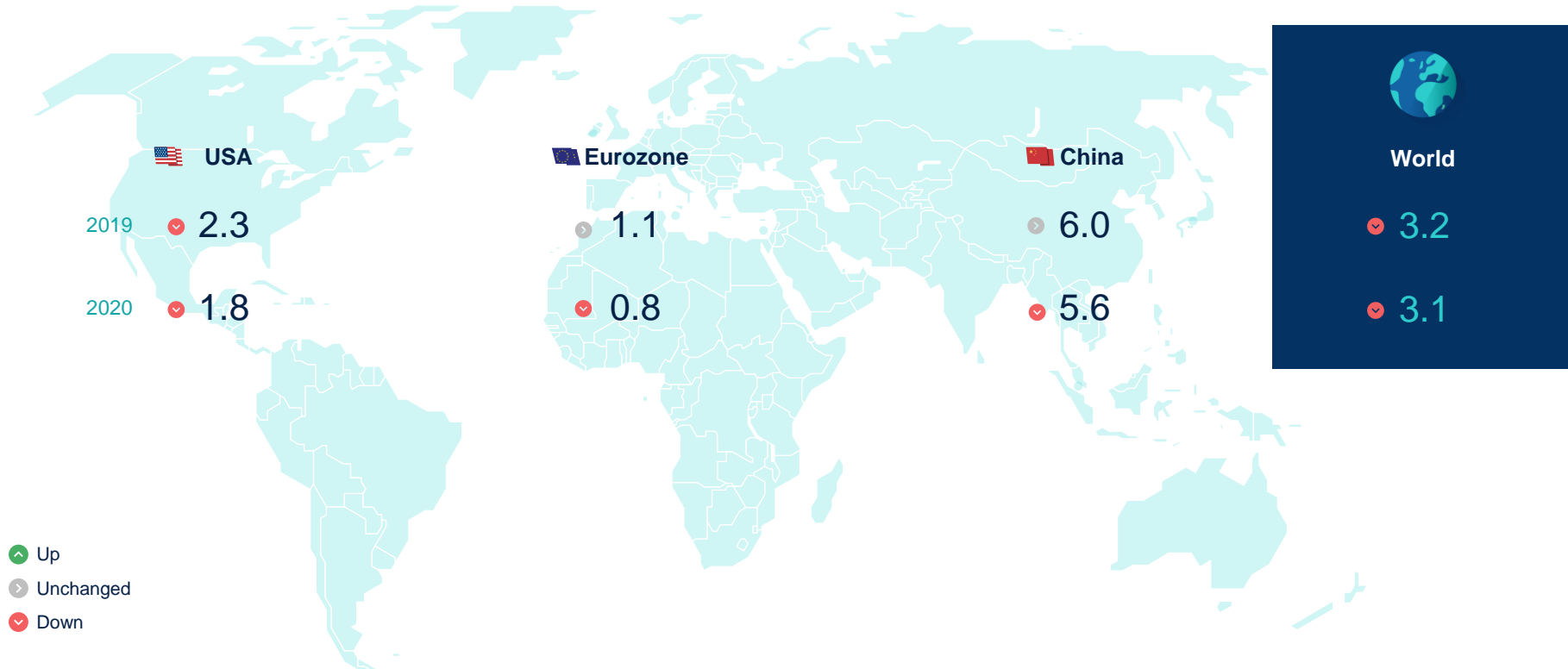
FEDERAL RESERVE AND ECB: INTEREST RATES (*) (%, END OF PERIOD)



(*) Deposit interest rates for the ECB. Forecasts as of October 2019.
Source: BBVA Research based on the Fed and ECB

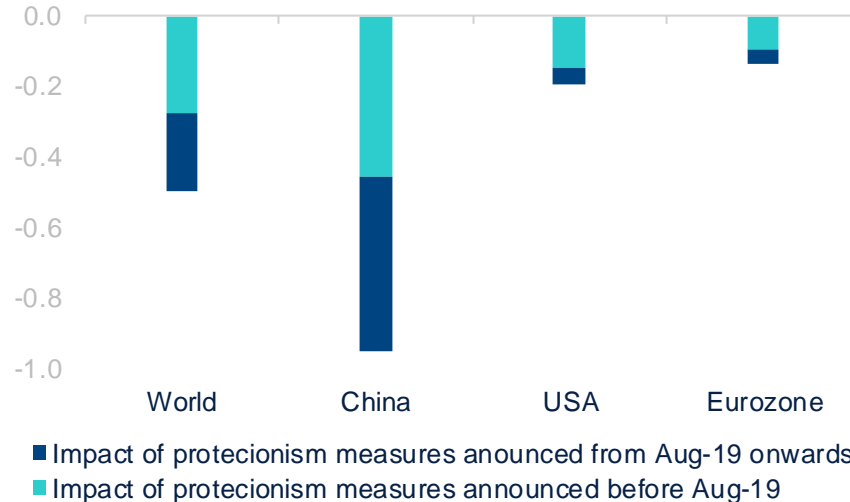
- **Fed:** a reduction of 50 basis points (bp) in rates in recent months, and an additional cut of at least 25 bp in October.
- **ECB:** an aggressive monetary package
 - 10 bp cut in deposit rates
 - Tiered deposit rate system
 - Quantitative expansion
 - Liquidity auctions with more advantageous conditions
- **In Europe, an additional reduction of 10 bp in deposit rates is likely.**
- **China and other emerging countries:** more aggressive interest rate cuts.

Global economic growth will experience a more intense slowdown



This more intense slowdown is due in part to the persistence of protectionist tensions

EFFECT OF PROTECTIONISM ON GDP (ACCUMULATED EFFECT ON GROWTH, PP)



(*) Direct and indirect effect. **Measures taken before August 2019:** US: 25% tariffs on steel, 10% tariffs on aluminum and 25% tariffs on USD 250 billion of Chinese imports.

China: 25% on USD 110 billion of US imports.

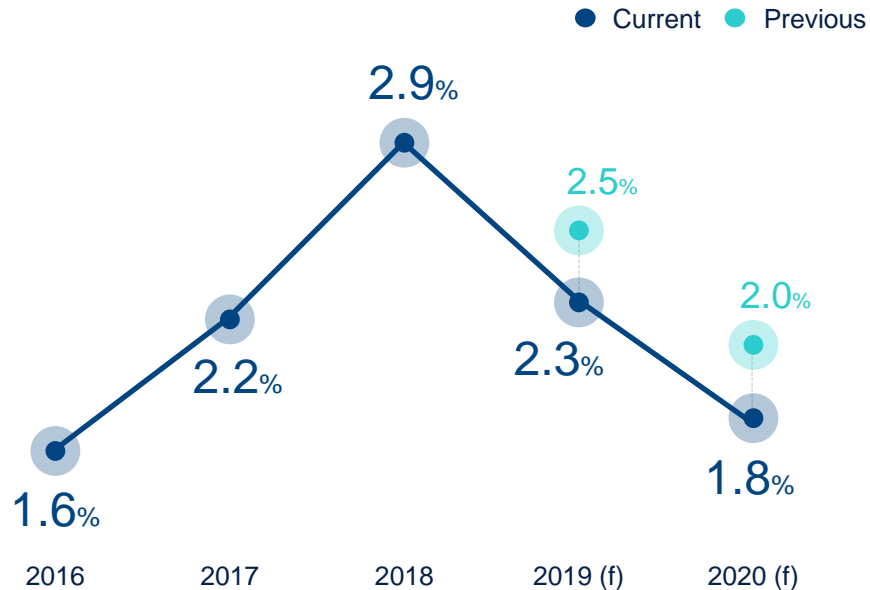
Measures taken from August 2019 (to be implemented, if there is no agreement, and in place up to December 2019): US: Extra tariffs of 5% on USD 250 billion and 15% on USD 300 billion of Chinese imports. China: Extra tariffs (5%-10%) on USD 75 billion of US imports.

Source: BBVA Research

- Revisions to growth are related to the estimated impact of protectionism.
- Particularly in China, the impact has been mitigated by counter-cyclical measures.
- The deterioration may be even greater in the Eurozone due to fewer exports to the United Kingdom (*Brexit*) and the problems faced in the automotive sector.
- **Risks:** if negotiations break down between the US and China, or if escalating tariffs between the US and Europe go further, there would be an additional negative effect on the global economy.

US: Global slowdown and internal uncertainty help to explain the lower growth

GDP GROWTH (%)



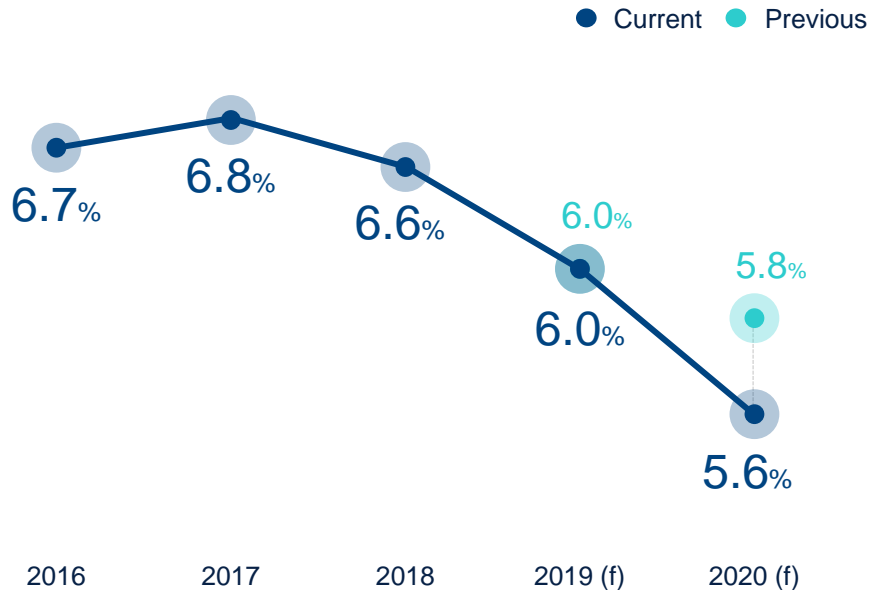
- Growth will approach its **potential rate** more quickly.
- Inflation will remain close to the 2% **target**.
- The likelihood of a recession has increased and investment is losing its momentum.
- Trump's **impeachment process** increases uncertainty and reduces the likelihood of fiscal measures.

(f) Forecasts.

Source: BBVA Research based on BEA figures

China: Trade tensions are exacerbating the structural slowdown

GDP GROWTH (%)



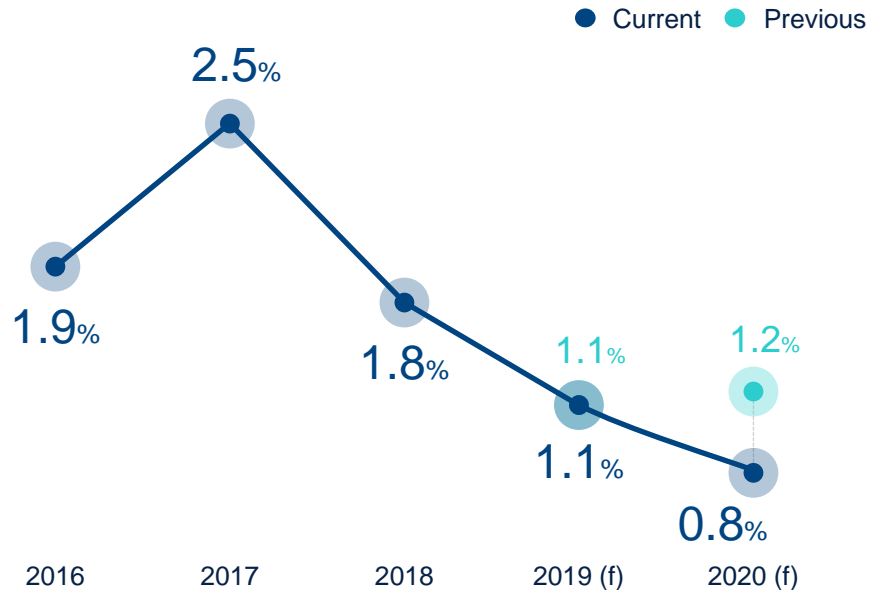
- There are growing signs of **widespread moderation** in the economy.
- **Fiscal and monetary stimulus measures** will prevent a more pronounced slowdown, but could increase financial vulnerabilities.
- The exchange rate will remain at a **more depreciated level** to cushion the effects of greater protectionism.

(f) Forecasts.

Source: BBVA Research from the Bank of China figures

Eurozone: Risks are increasing and activity slowing down

GDP GROWTH (%)



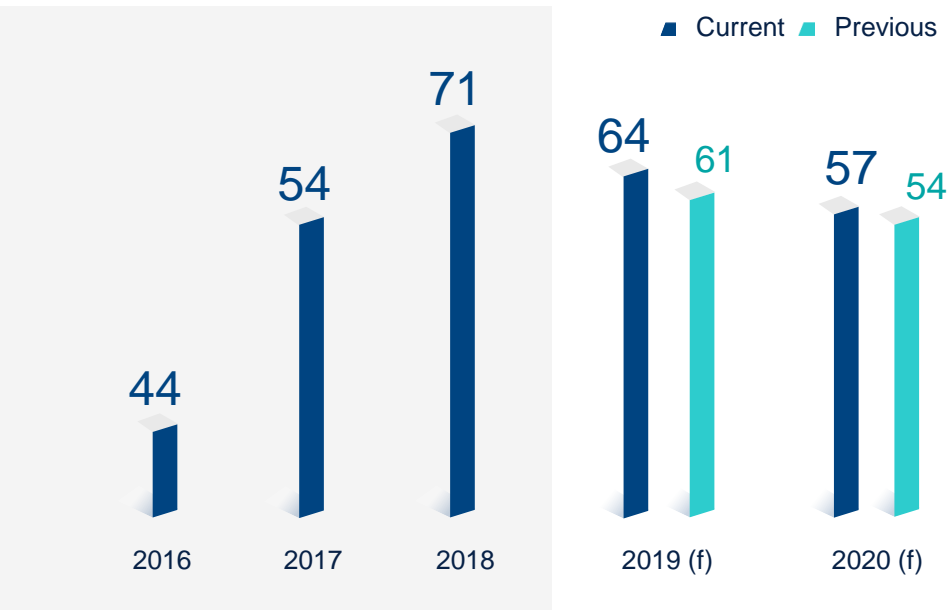
(f) Forecasts.
Source: BBVA Research based on Eurostat figures

- *Brexit* and problems in the automotive sector, in addition to trade tensions, have affected activity...
- ...and have contributed to a greater fall in exports to the rest of Europe and the United Kingdom than elsewhere.
- Greater divergence between countries in the region due to differences in exposure to the external sector.
- Inflation will remain very low (1.2% in 2019; 1.1% in 2020).
- The risk of recession continues to rise.

Oil: Upward pressure after the attack in Saudi Arabia, although in the medium term, prices will continue to fall

PRICE OF OIL

(DOLLARS PER BARREL, ANNUAL AVERAGE)

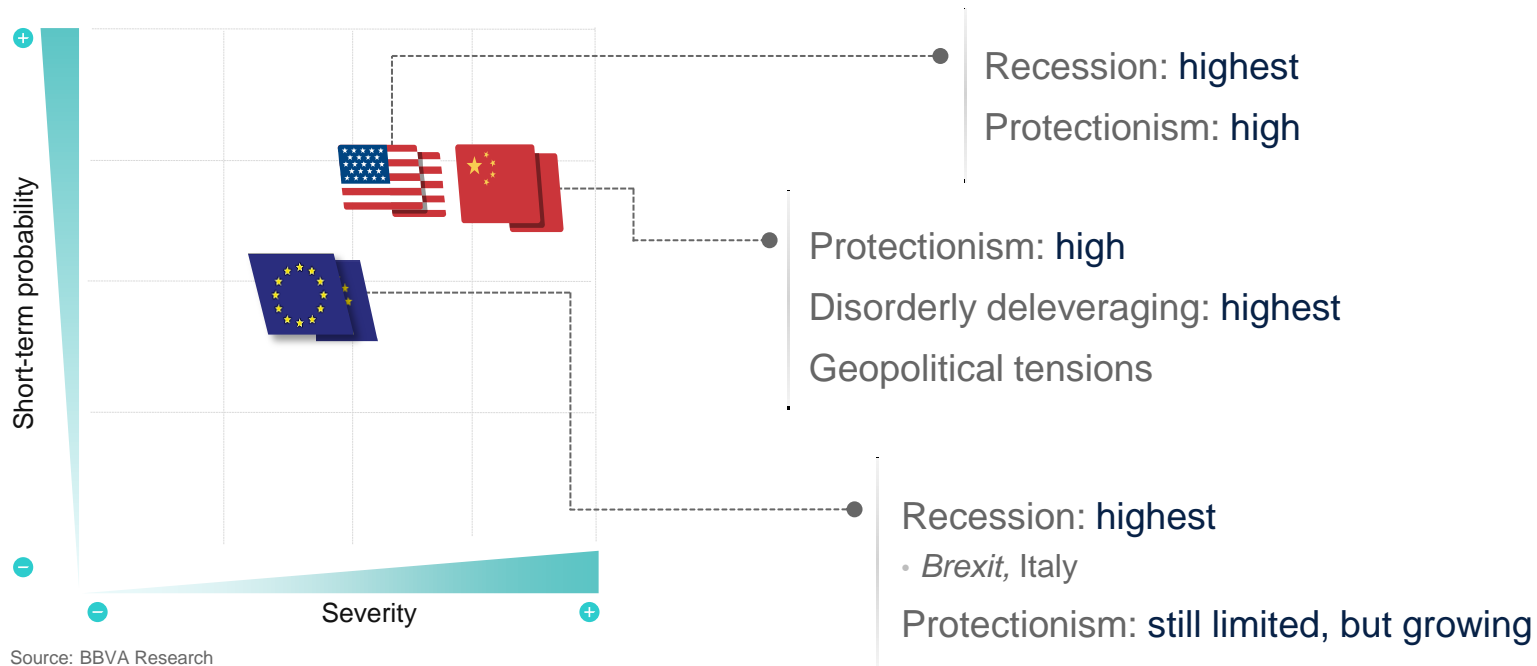


- Short-term forecasts are revised slightly upwards and there is a risk that escalating tensions in producing countries will lead to increases in the price of crude oil.
- In any case, the medium-term outlook for moderation remains, given the relative robustness of supply in an environment of lower demand.

(f) Forecasts.

Source: BBVA Research, based on Bloomberg figures

Global risks are increasing, mainly due to tensions between China and the US



The risk of geopolitical instability in the Middle East has also increased.
Financial vulnerabilities may increase the severity of risks.

02

Spain
Economic Outlook
4Q19

Economic developments point to lower GDP growth compared to predictions published three months ago



2018
2.4%

-0.2pp

2019
1.9%

-0.4pp

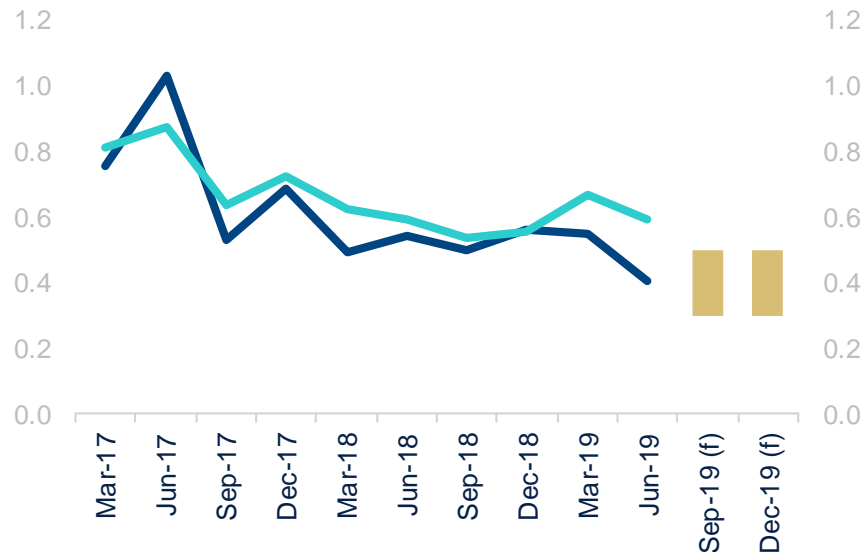
2020
1.6%

-0.3pp

Reasons for the downward revision to forecasts

1. Review of the INE's National Accounts

SPAIN: GDP GROWTH (% QOQ)



- According to the INE, GDP growth during 1Q19 would have been 0.5% QoQ, compared to the 0.7% previously advanced.
- In addition, it has been confirmed that growth in 2Q19 would have fallen to 0.4% QoQ, below BBVA Research's three-month forecast (0.6%).
- Growth remained sluggish during 3Q19 and is expected to be between 0.3% and 0.5% QoQ.

— Current ● Previous GDP trajectory

(e) Estimate. (f) Forecast.

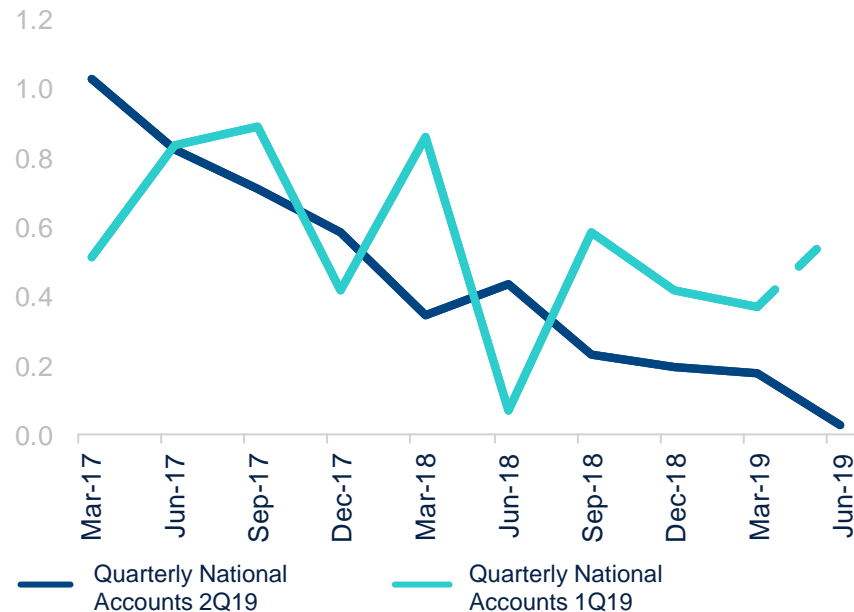
Source: BBVA Research, based on national sources

Reasons for the downward revision to forecasts

2. Changes in the composition of growth

SPAIN: PRIVATE CONSUMPTION

(% QOQ)



- The slowdown is **greater in domestic demand**, due to sluggish private consumption, especially of durable goods.
- **Investment growth is also less vigorous** than expected and positive 1Q19 data has reverted in recent months.
- **The developments in exports have been positive**, although heterogeneous across components.

Reasons for the downward revision to forecasts

3. Growth in EMU revised downward

SPAIN: IMPACT OF THE DOWNWARD REVISION OF GROWTH IN EMU (DEVIATION FROM THE BASELINE SCENARIO IN PP)

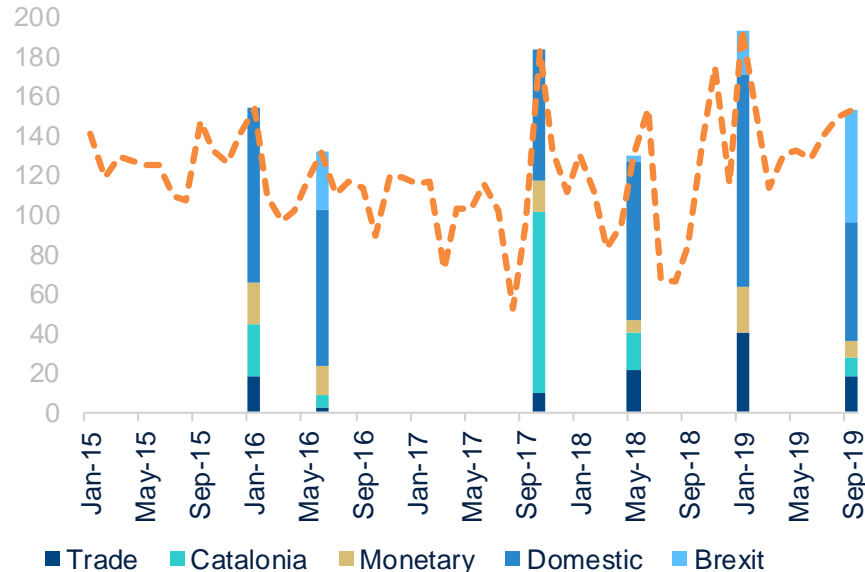


- GDP in the EMU is stagnating, mainly affected by the adjustment of trade flows.
- However, domestic demand remains stable, preventing a recession in the EMU for the time being.
- BBVA Research's estimates indicate that economic activity in Spain is moderating at the same relative rate as that of EMU.
- The impact on Spanish exports is significant.

Going forward uncertainty is rising

Related to economic policy

SPAIN: BREAKDOWN OF THE ECONOMIC POLICY UNCERTAINTY INDEX (INDEX, 100 = AVERAGE 1997–2019)



- Uncertainty about economic policy increases again, influenced mainly by a volatile external environment.
- Tariff tensions and the increased likelihood of a no-deal *brexit* have had a large impact on world trade over a much more prolonged period than expected.

Going forward uncertainty is rising

Related to *brexit*



BREXIT

Lower growth in the UK
Greater uncertainty in capital markets
Depreciation of the pound against the euro



TRADE



Goods



Services



INVESTMENT



Non-residential



Residential



MIGRATION



Emigration



Immigration



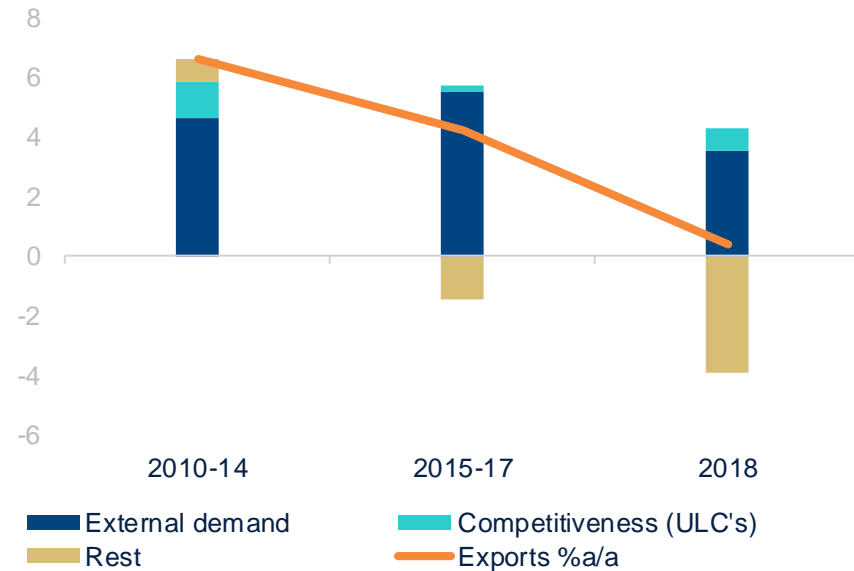
Brexit will drive trade transactions, reduce bilateral investment flows, hinder the provision of cross-border financial services and limit the free movement of people.

Going forward uncertainty is rising

Related to trade tensions

SPAIN: DETERMINANTS OF THE GROWTH IN THE EXPORT OF GOODS

(AVERAGE CONTRIBUTIONS YOY, NOMINAL)

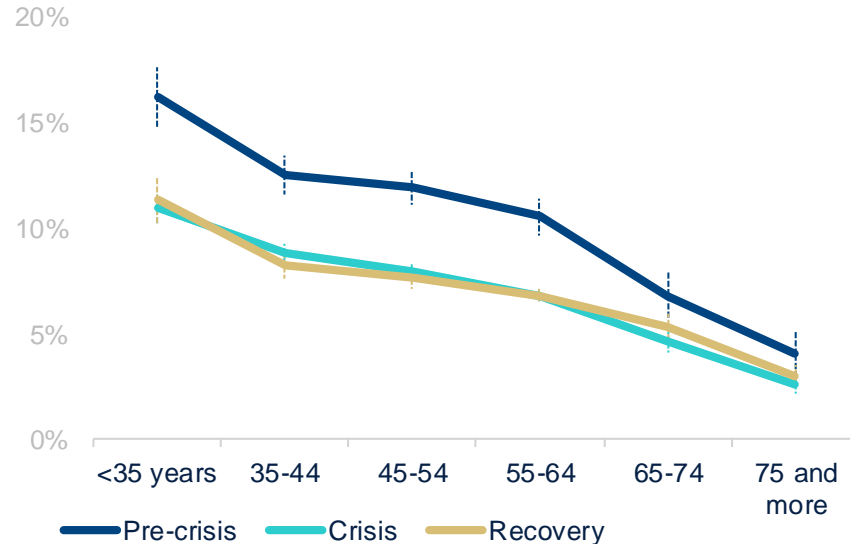


- Exports of goods have behaved extraordinarily during much of the recovery.
- Since 2018, there has been a slowdown that cannot be explained, either by loss of competitiveness or by a dramatic fall in demand from the main trading partners.
- Uncertainty around trade tensions, problems in the automobile sector and *brexit*, are some of the factors that may be weakening export growth.

Going forward uncertainty is rising

Related to changes in consumer patterns

ESTIMATED PROBABILITY OF BUYING A CAR BY AGE GROUP (%)



----- 95% CI.

For more information see "Situación Consumo 1S19": <https://bit.ly/30Vb5WU>

Source: BBVA Research based on INE, EPF (National Institute of Statistics)

- Fluctuations in the demand for vehicles are mainly explained by cyclical reasons: purchasing power, uncertainty, financing and incentives...
- ...but also by structural causes: changes in preferences and demographic.
- For example, the likelihood of young people buying a car has fallen since 2007 and not only because of transitory factors.
- The likelihood of buying a car is higher in less populated municipalities ► existence of close substitutes plays a role.

Going forward uncertainty is rising

Related to regulatory changes in the housing market

SPAIN: VARIABLES IN THE REAL ESTATE SECTOR

(LEVEL DEVIATION FROM TREND*, IN PP)

	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19
Home sales	-0.7	0.6	0.5	-8.5	-7.3	-17.3
Mortgages	-0.7	-2.9	4.9	-4.4	-6.0	-13.0
Property transactions	-3.5	-0.1	-0.3	-9.4	-6.0	-12.9
Housing investment	2.1	0.4	-0.6	-2.7	-3.9	-4.8
Visas	-0.7	2.1	4.2	-1.1	-0.6	-2.9
Affiliates in construction	0.1	0.3	0.6	0.7	1.0	0.3
Employed in construction	-0.5	1.1	1.4	4.7	4.7	0.6
House price	-0.1	0.4	0.3	1.1	1.8	1.1

- Investment is slowing as is consistent with an environment of growing uncertainty affecting businesses.
- In recent months, several variables linked to the real estate sector have shown a more negative than expected trend.
- The variables most linked to residential demand are showing a greater correction, although part of this could be short-lived once legal changes are assimilated.

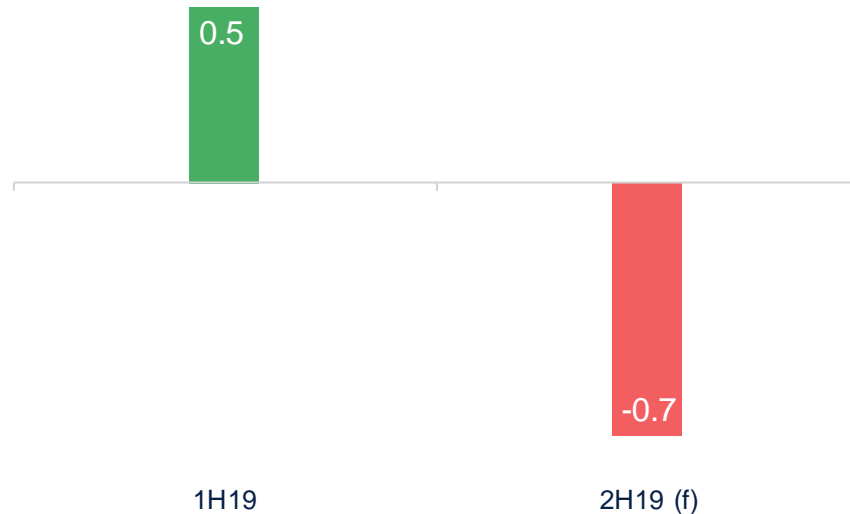
* Note: Linear trend Jan 16–Sep 18.

Source: BBVA Research, based on national sources

Going forward uncertainty is rising

Related to fiscal policy

SPAIN: CHANGE IN THE CYCLICALLY-ADJUSTED BALANCE REQUIRED TO MEET THE GOVERNMENT DEFICIT TARGET* (PP)



- Fiscal policy would have been expansionary during the first half of the year.
- Meeting fiscal targets warrants an adjustment of more than half a percentage point during the second semester.
- The public deficit forecast for 2019 is 2.3% of GDP. In a no-policy-change scenario, the imbalance would continue to decline to 1.9% of GDP.

* The government deficit target is 2.0%.

Source: BBVA Research based on Ministry of the Treasury (Hacienda) data

What are the supporting factors of the Spanish economy?

Unlike the 2005–2007 period, there are now no signs of imbalances



Housing affordability

(% household income)

2005–2007

2018

43.1%

32.3%



Current account balance

(%, annual average)

2005–2007

2018

-8.6%

1.8%



New credit transactions

(% GDP)

2005–2007

2018

114.6%

36.9%



Housing prices

(%, YoY annual average)

2005–2007

2018

10.1%

3.4%



Unit labor costs

(%, YoY annual average)

2005–2007

2018

3.7%

0.8%



Private sector debt

(% GDP)

2005–2007

2018

173.5%

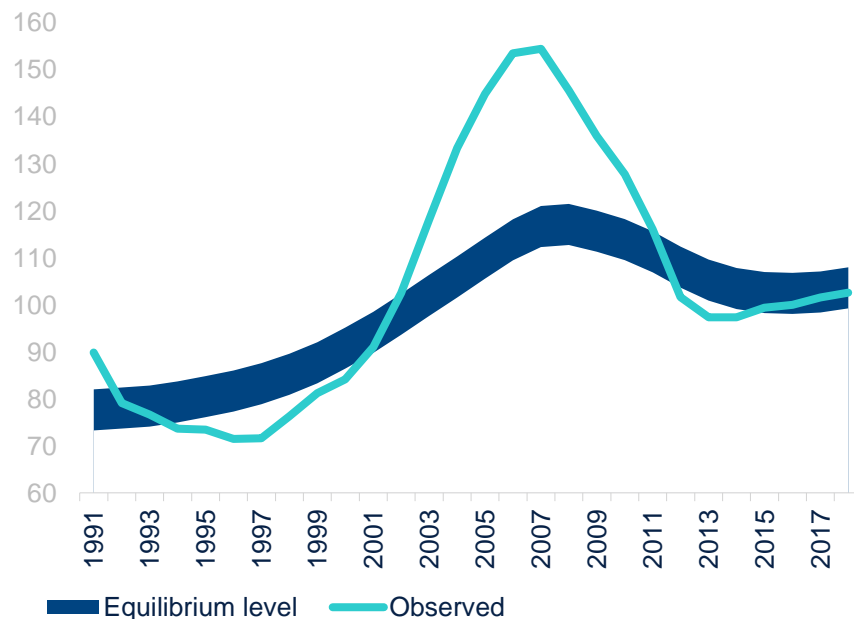
132.5%

What are the supporting factors of the Spanish economy?

Growth in the real estate market continues

SPAIN: HOUSE PRICES

(CURRENT PRICE INDEX)



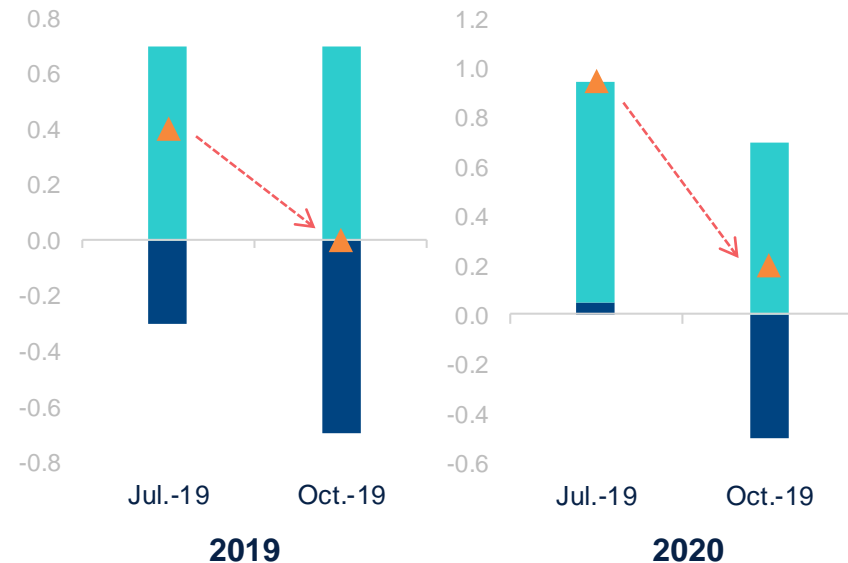
- The real estate market has recovered in the previous five years and shows no signs of aggregate imbalances.
- Housing prices are around their equilibrium level, and, in real terms, are about 30% below the maximum reached in the last decade.
- In any case, the geographic heterogeneity of the Spanish residential market is very high.

What are the supporting factors of the Spanish economy?

Positive impact of monetary policy

SPAIN: INTEREST RATES AND RISK PREMIUM

(%)



- A decline in interest rates will be a positive factor for economic growth, although the effect is diminishing.
- The low interest rates applicable to public debt allow for a more expansionary fiscal policy.

■ 10-year EMU* rate ■ Risk premium ▲ 10-year Spain rate

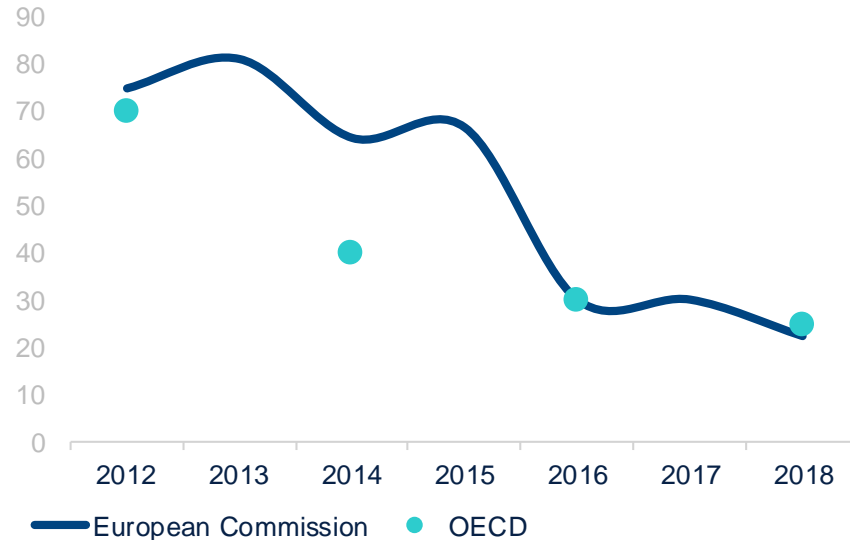
* This refers to the 10-year German rate.

Source: BBVA Research, based on Bloomberg figures

The economy requires reforms that support growth

The consensus regarding the measures to be implemented has decreased

SPAIN: ECONOMIC POLICY RECOMMENDATIONS FROM THE EUROPEAN COMMISSION AND THE OECD (COMPLIANCE INDEX*)



- Between 2012 and 2015 there was considerable progress in the compliance with the economic recommendations of the European Commission and the OECD.
- Since 2016, that momentum has diminished.
- This momentum needs to recover in order to protect the Spanish economy when faced with less favorable environments.

* A higher index means that there has been a greater degree of compliance with the recommendations. In the opinion of the European Commission, a high degree of compliance means that all, many or some measures needed to comply with the recommendations have been implemented. In the opinion of the OECD, the indicator reflects that specific legislative reforms have been implemented to comply with the recommendations.

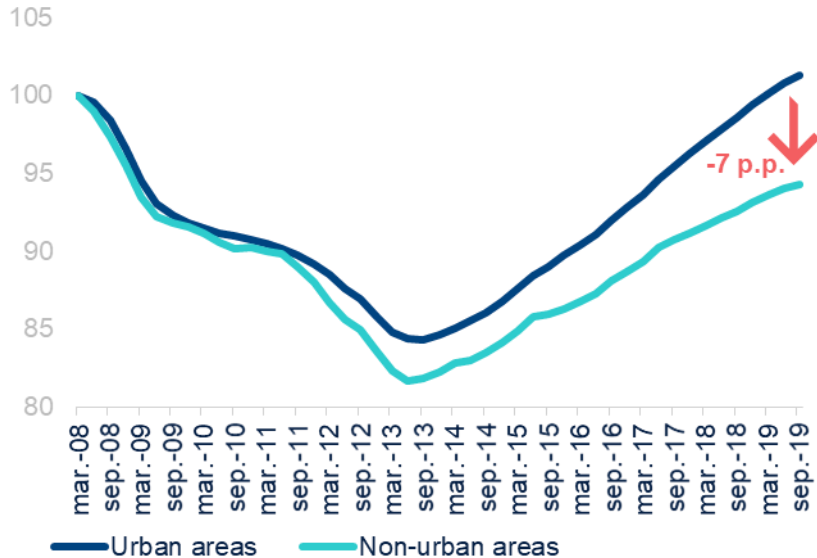
Source: BBVA Research, based on the European Parliament, Committee of Economic Governance and OECD

The economy requires reforms that support growth

Challenges of working toward an inclusive recovery

SPAIN: EVOLUTION OF SOCIAL SECURITY REGISTRATIONS IN URBAN AND NON-URBAN AREAS

(1T08=100)



- The drop in employment during the crisis was more intense in non-urban areas, and the recovery is less dynamic.
- Almost a quarter of Spain's registrations—24.3%—are located in municipalities outside of a large urban area.
- There are 14 Spanish provinces in which at least half of the jobs created are located in municipalities outside of a large urban area.

Note: The Ministry of Development defines large urban areas as areas comprising at least 753 municipalities, that is, the 9.3% of Spain where 68.9% of the population live. See <https://bit.ly/2Vuk2VA>

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

03

Forecasts

Forecasts

Recovery will continue, although the slowdown will be consolidated

% YoY	2018	2019 (f)	2020 (f)
National final consumption expenditure	1.9	1.1	1.4
Private consumption	1.8	0.8	1.3
Public consumption	1.9	2.0	1.7
Gross fixed capital formation	5.3	2.3	3.0
Equipment and machinery	5.7	1.6	2.6
Construction	6.6	2.9	2.6
Housing	7.7	3.5	3.9
Other buildings and structures	5.3	2.2	1.1
Domestic demand (*)	2.6	1.3	1.7
Exports	2.2	2.0	2.9
Goods exports	2.1	1.1	3.3
Service exports	2.3	4.0	2.0
Non-tourism services	2.8	5.2	2.8
Final consumption of non-residents in the economic territory	1.7	2.4	0.7
Imports	3.3	0.2	3.4
External demand (*)	-0.3	0.6	-0.1
Real GDP at market prices	2.4	1.9	1.6

(*) Contribution to GDP growth. (f) Forecast.

Source: BBVA Research, based on INE and BdE data

Forecasts

Recovery will continue, although the slowdown will be consolidated

% YoY	2018	2019 (f)	2020 (f)
Employment (full-time equivalent) based on quarterly national accounts	2.5	2.2	1.4
Employment, based on Labor Force Survey	2.7	2.2	1.4
Unemployment rate (% of labor force)	15.3	14.1	13.3
CPI (annual average)	1.7	0.7	1.1
GDP deflator	1.1	1.2	0.9
Public Deficit (% GDP)	-2.5	-2.3	-1.9
Current account (% GDP)	1.8	1.6	1.4

Annual change in %, unless expressly indicated.

(f) Forecast.

Source: BBVA Research, based on INE and BdE data

Spain

Economic Outlook

4Q19

Appendix

Recovery will continue, although the slowdown will be consolidated

The short-term impact of the minimum wage increase will be limited

VARIATION IN SOCIAL SECURITY REGISTRATIONS BETWEEN JANUARY AND SEPTEMBER (2019 VS 2017–2018 AVERAGE, %)



- Registrations in groups with the largest amount of members on the minimum wage continues to slow down compared to 2017 and 2018 figures.
- In the remaining groups, the increase in registrations was 0.4pp less than the 2017–2018 average.
- Its impact on employment remains **limited** (between 10,000 and 50,000 registrations) and in line with our January estimates for 2019 (between 0.1pp and 0.4pp).

* People under the age of 30.

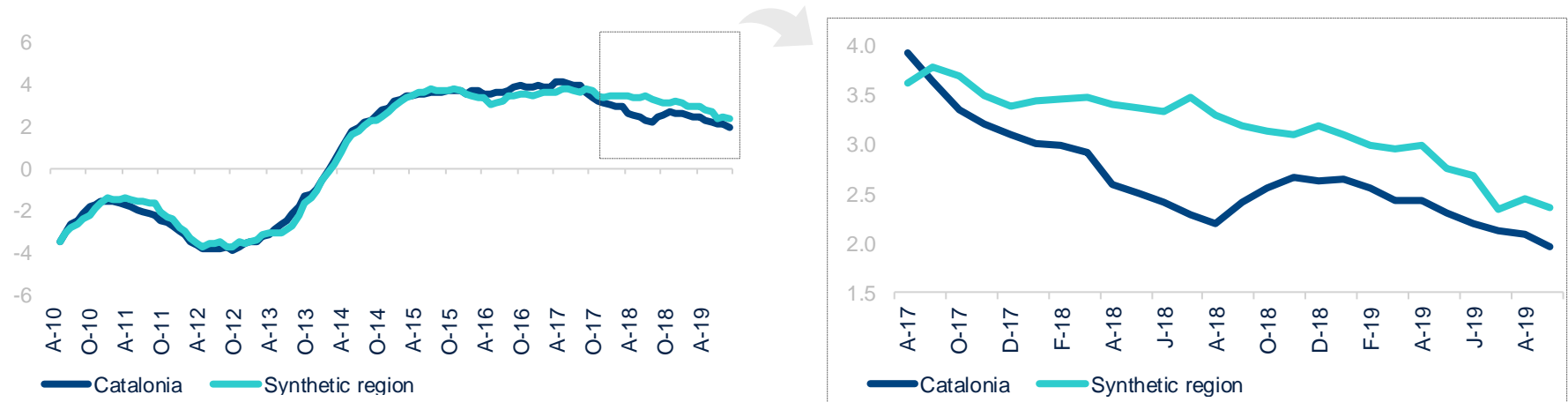
Trade; hospitality; real estate activities; professional, administrative and artistic activities; and other services. Canary Islands, Extremadura, Andalusia and Murcia.

Source: BBVA Research, based on MITRAMISS (Spanish Ministry of Labor, Migrations and Social Security) data

Risks: uncertainty regarding economic policy

SOCIAL SECURITY REGISTRATIONS IN THE PRIVATE SECTOR

(% YOY)



■ The slowdown in employment was more intense in Catalonia at the end of 2017 and the start of 2018.

■ To establish a counterfactual situation, we used a synthetic control methodology designed by Abadie and Gardeazábal (2004).

■ Since November 2017, employment growth has been on average 0.5 pp lower than in the counterfactual situation. This means that today Catalonia has 30,000 fewer registrations than the equivalent synthetic region (about 1% of employment).

There are still numerous risks

Brexit

- Trade is one of *brexit's* main transmission channels...
 - Spanish exports to the United Kingdom account for 3.2% of GDP (EMU: 4%); imports, 2.0% (EMU: 2.8%).
 - Exposure to the British market is comparatively high in exports of tourism services (1 in 5 travelers), as well as in exports of telecommunications, financial, transport and business services.
 - 7% of goods exports are destined for the UK. Transport materials and agri-food sectors are those most affected...
- ...but not the only ones
 - Financial channel: Spain's assets in the UK account for 13% of total (17% of GDP), while liabilities (UK investments in Spain) account for 10% of the total (20% of GDP).
 - Real estate channel: British people are responsible for 16% of the housing transactions completed by foreigners.
 - Immigration channel: Almost 300,000 British nationals live in Spain. 40% are 65 or older.

The impact will depend on the type of exit and the future relationship between the UK and the EU.