

## More growth, but with more risks

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The Spanish economy is growing and creating employment. During the next two years it is likely that just over 900,000 jobs will be created and that the unemployment rate will fall to around 15% by the end of 2018. However, certain risks have arisen. In order to reduce the vulnerability of the Spanish economy to these events, it is necessary to resume the process of improving the operation of markets for goods and services. The trend in the most recent activity data indicates that GDP could continue to grow at a brisk pace in the first quarter of the, by about 0.8% QoQ. This positive impetus, together with expectations that factors such as monetary policy and the increasingly dynamic global environment will stimulate domestic demand and exports, points to growth continuing at between 2.5% and 3.0% over the next two years. However, we note the recent appearance of some risks that need to be watched.

For example, the negative impact of the uncertainty about the UK's possible leaving the European Union is still an unknown, and protectionist movements are resurgent in several countries. Added to this is a possible change in public policies in the US as a result of the change of administration. In this regard it is possible that these factors are already affecting capital expenditure, particularly of Spanish exporters. Also, the cost of energy has increased, although it is still below the average for the past three years. In any case the recent increase in oil prices involves a transfer of income from Spain to oil producing countries and will shave between two and three tenths of a percentage point off GDP growth in 2017.

As a result of the increase in energy prices, inflation has picked up and reached level of around 3%. This increase in price inflation is temporary, and on average inflation for the year will barely exceed 2%. However, it will be necessary to keep a close watch on the extent to which this shock feeds through into other prices. In this regard special attention will have to be paid to how income evolves. Any attempt by employers or workers to shift the cost of this loss of competitiveness entirely onto the other, or onto consumer, could slow growth in investment and in exports, as well as acting as a brake on job creation and leading to greater inequality.

Another factor that may start to produce uncertainty is the effect of inflation on interest rate movements. While the normalisation of monetary policy can be expected to be a slow process, with interest rates staying low for quite some time, a disorderly increase in the cost of financing may be particularly negative for an economy as heavily indebted as Spain's still is, especially in the public sector. In this regard, the ECB's asset purchase programme is estimated to have reduced the risk premium on Spain's ten-year sovereign bonds by between 50 and 70 bps approximately. What is more, we cannot rule out the possibility that the effect of the programme on the cost of financing is actually even greater than this, if for example it avoids increases during bouts of uncertainty like the recent ones.

Lastly, uncertainty about public policies remains high. This has been contributed to, for example, by the measures implemented to boost tax revenues relating to Corporation Tax. This uncertainty extends beyond the taxation issue to approval of the central state budget for 2017 and the programme of economic reforms that will have to be implemented in the next few years. In a framework of institutional stability, reducing the vulnerability of the Spanish economy to the materialisation of these risks requires the implementation of policies that contribute to the orderly reduction of such major imbalances as long-term unemployment, the deficit and public debt and private sector leverage.

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