

BBVA

RESEARCH

SECOND
QUARTER
2016

Economic
Outlook

Spain

The global economic scenario has improved in the past three months, but **growth is still weak, and vulnerable** to several risks

In Spain, data on activity lend an **upward bias to our growth forecast for 2016**, while increased uncertainty **gives a downward bias for 2017**

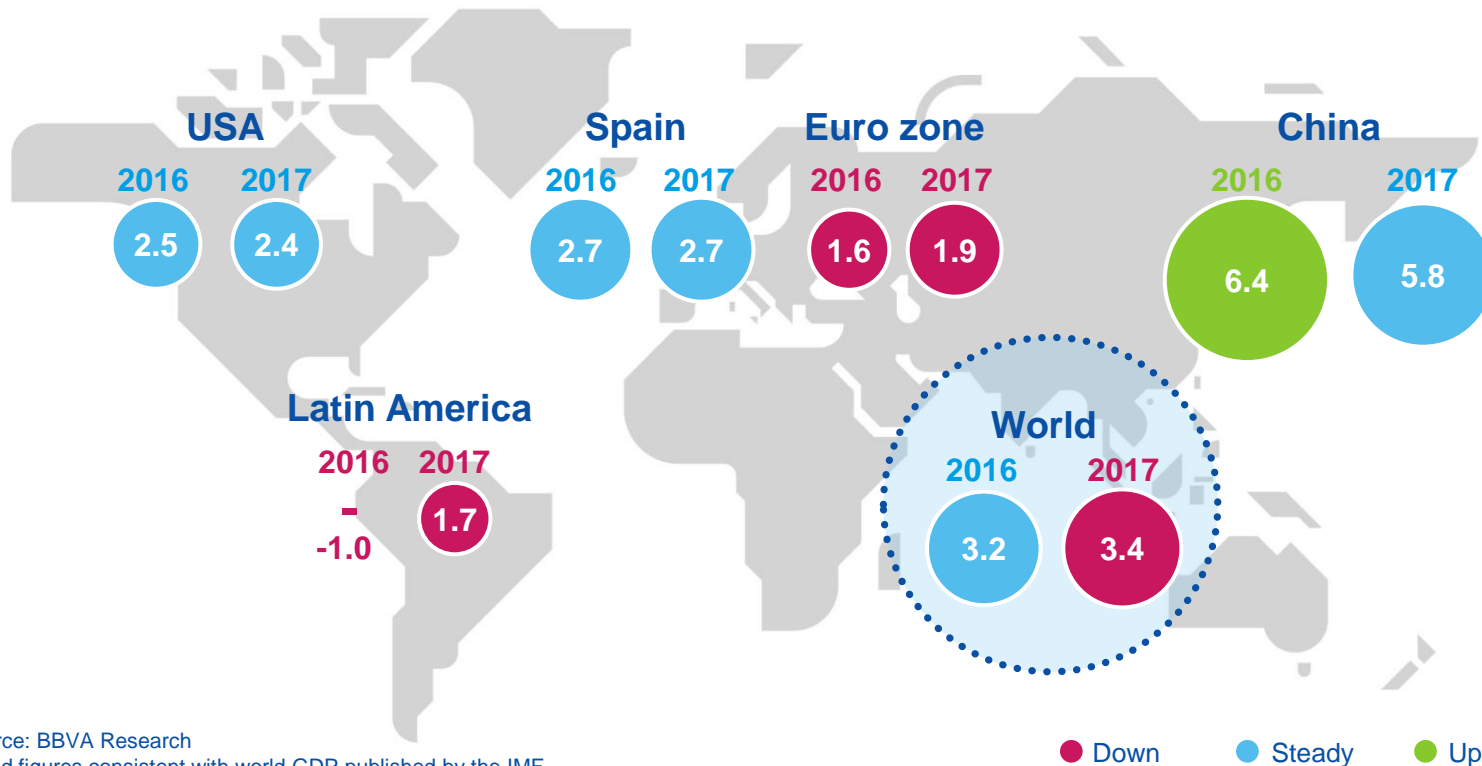
A less positive environment makes it more necessary to **push for an ambitious programme of reforms**

The background of the slide is a high-angle photograph of Earth from space. The planet's surface is visible as a dark blue and black expanse, with a thin, bright white line representing the atmosphere and the horizon of the Earth. The overall color palette is dominated by deep blues and blacks, with a bright white glow at the horizon.

Global

The world

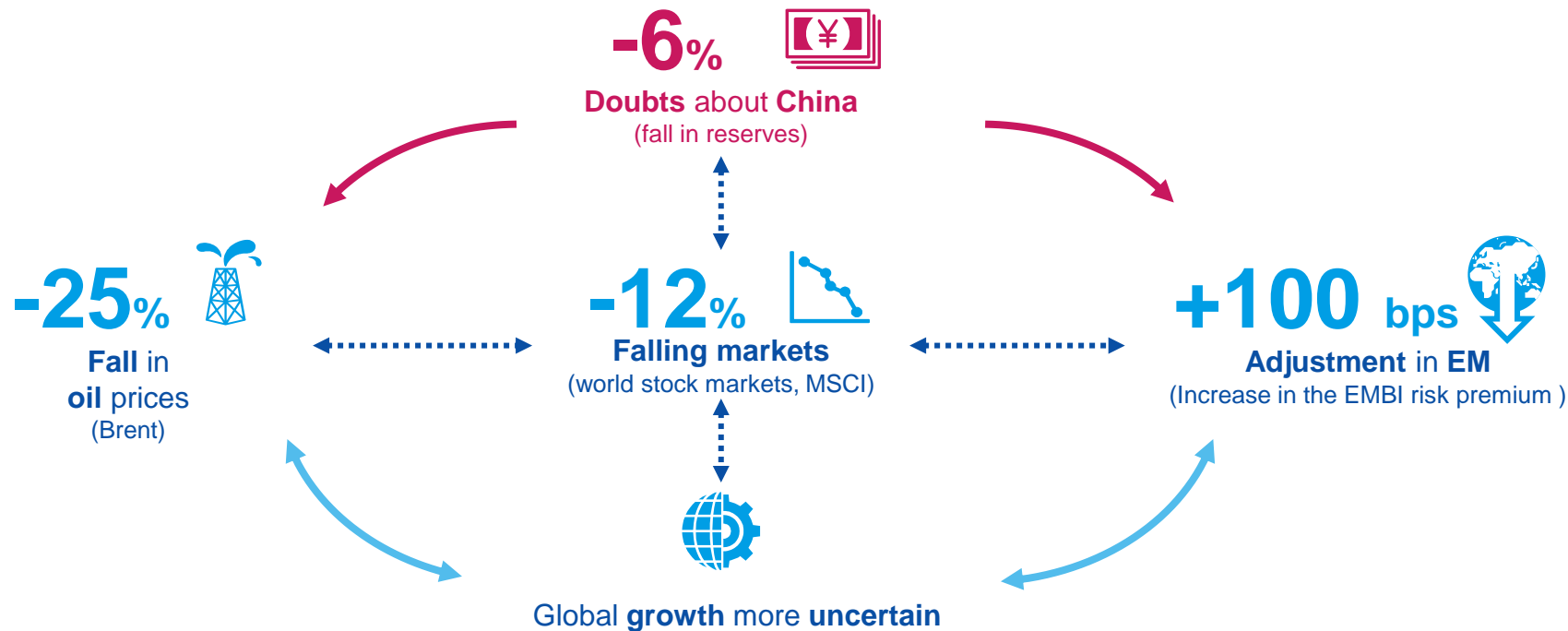
Weak growth, fragile and more vulnerable to risks



Source: BBVA Research
World figures consistent with world GDP published by the IMF

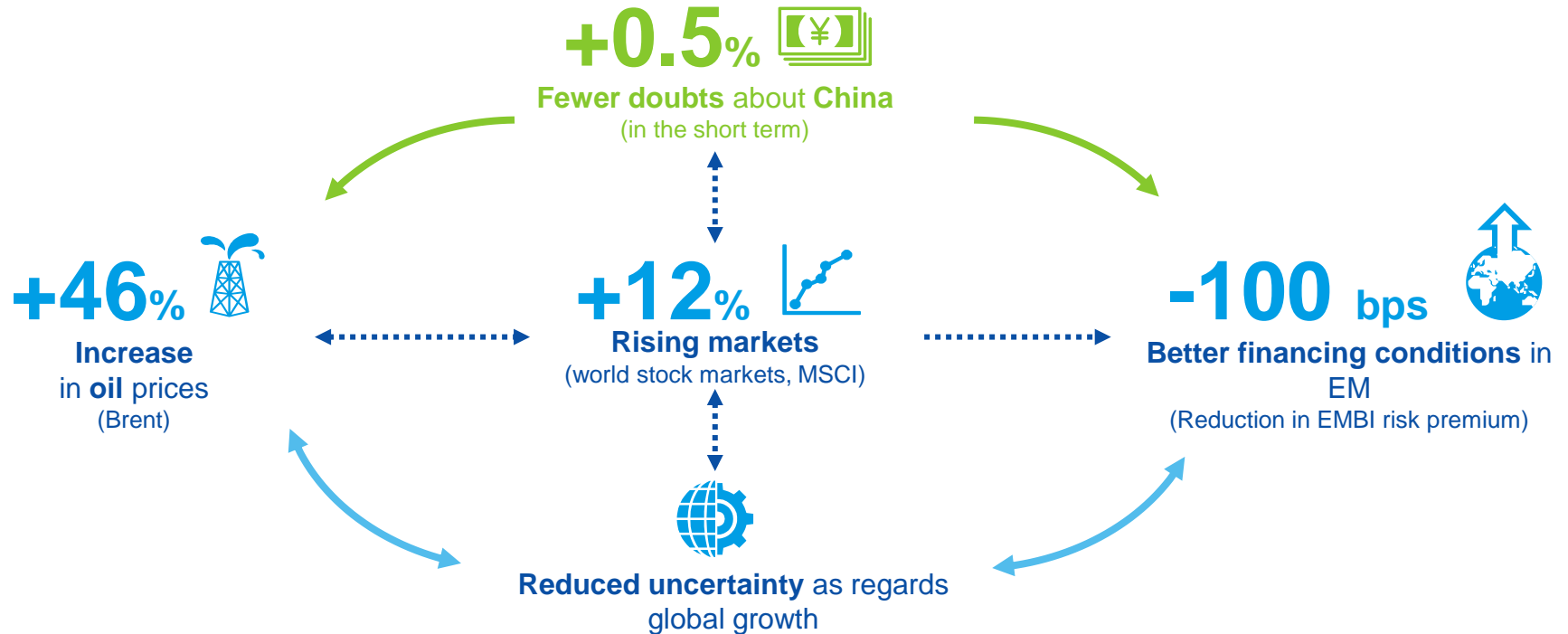
Three months ago

The economic outlook was quite negative



Now

The economic situation is improving...

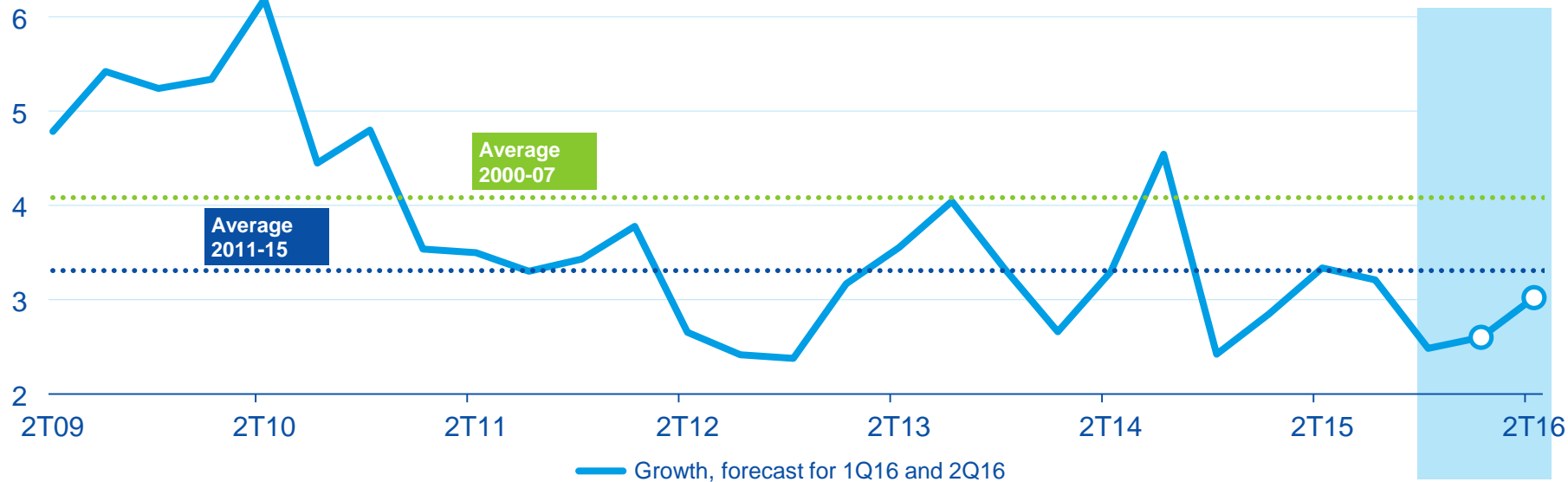


Now

...although growth continues to be weak and subject several risks

Global economic growth

Forecasts based on BBVA-GAIN (% , annualised rate)

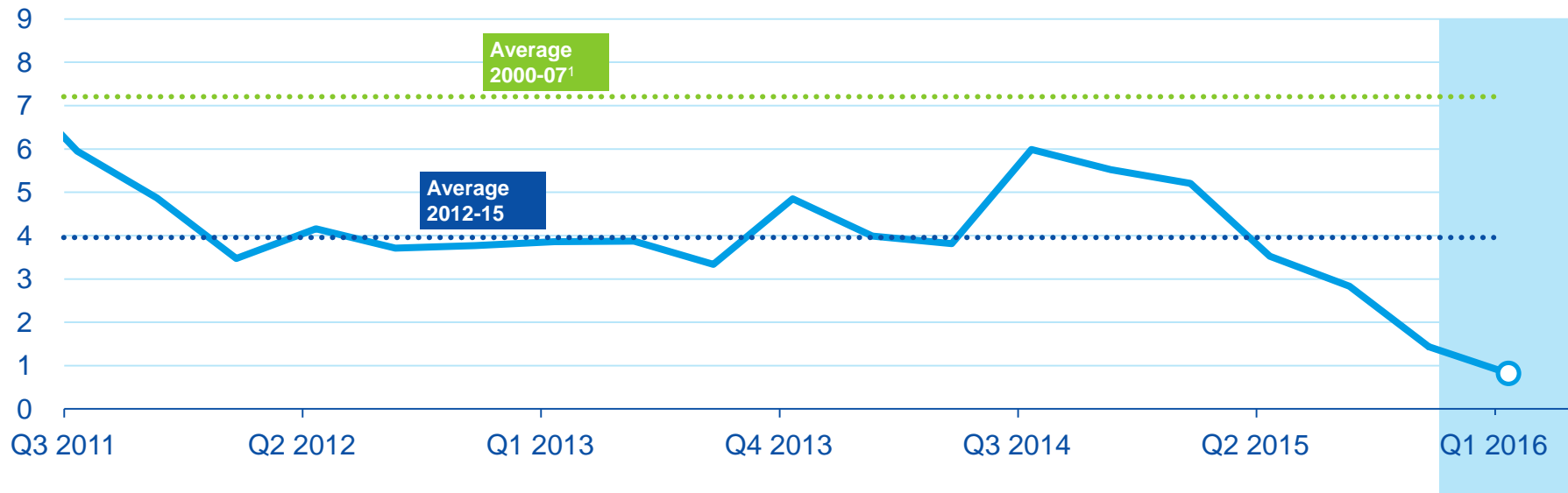


Caveats

World trade is sending warning signals

Growth in world trade

Exports of goods, % YoY - BBVA indicator

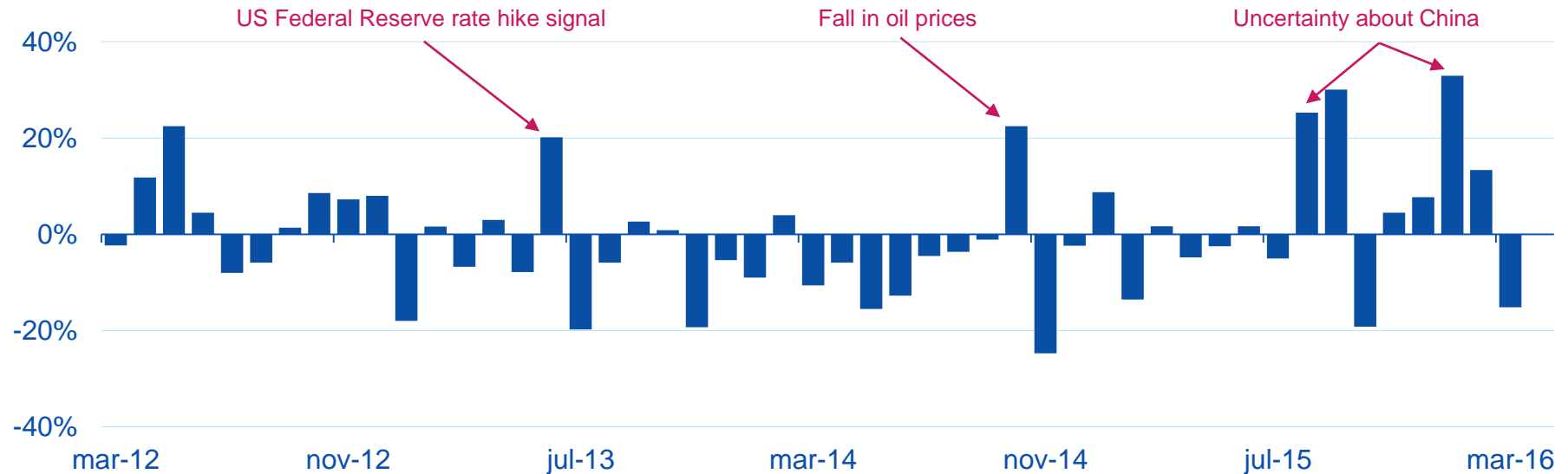


1: IMF data
Source: BBVA Research and IMF

Caveats

Events of uncertainty are more frequent...

Immediate effect of uncertainty events on financial volatility¹



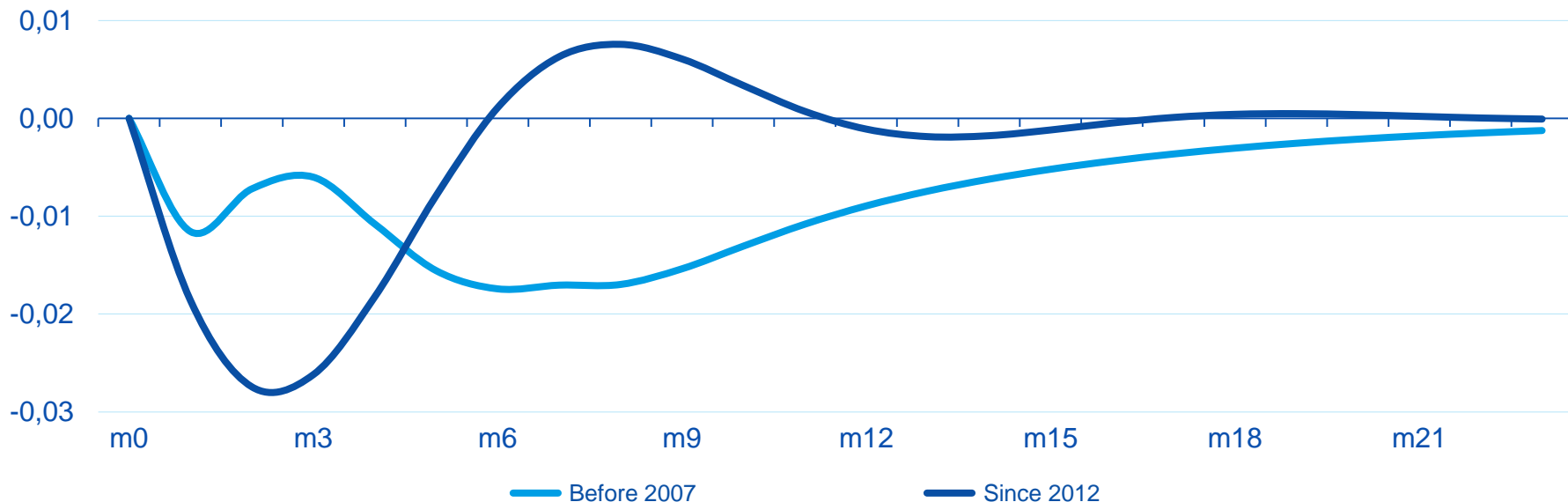
1: Based on econometric modelling of the VIX (S&P 500 volatility index) and quarterly world GDP growth. Details in Global Outlook Q2 2016. Source: BBVA Research

Caveats

...and with a more intense but also more transitory impact

Effect on economic growth of a transitory volatility increase¹

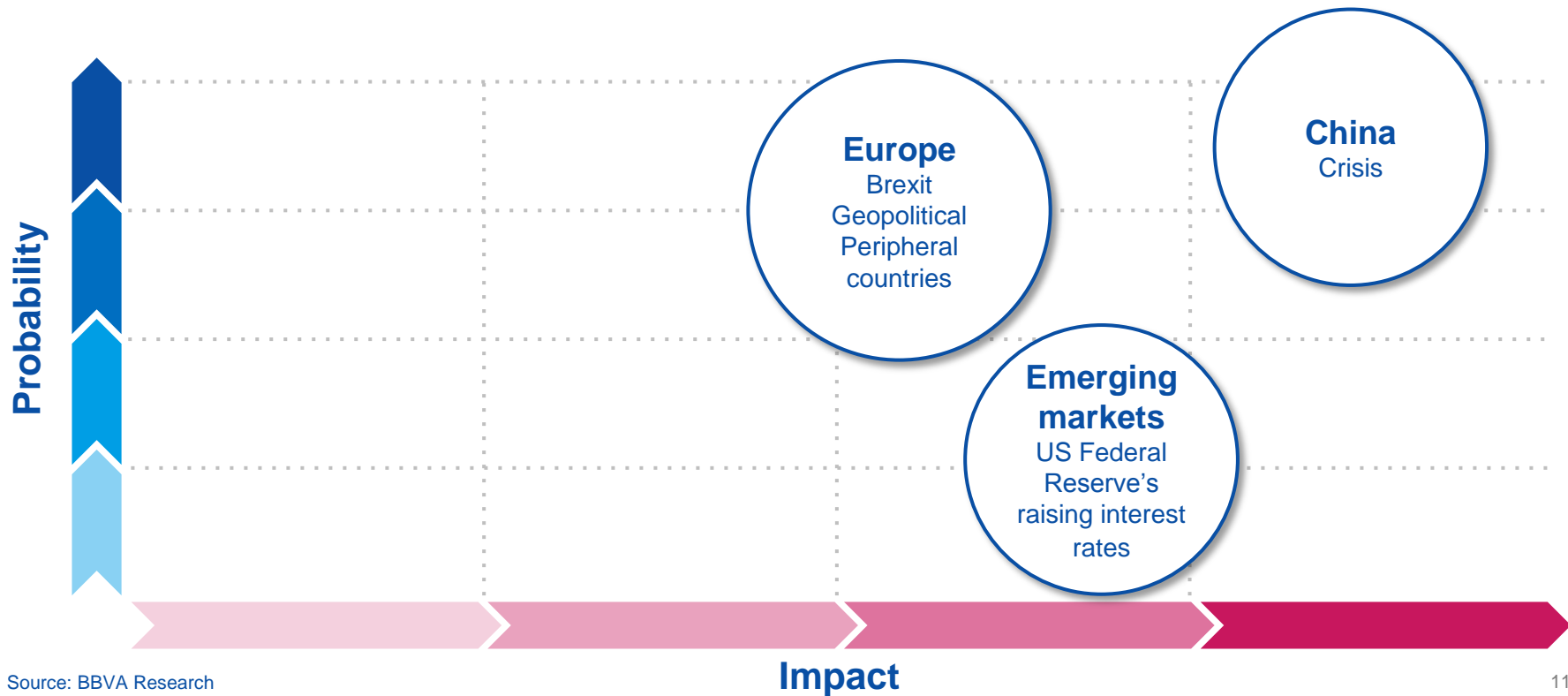
(Percentage points)



1: The increase in volatility is caused by an increase in uncertainty. Details in Global Outlook Q2 2016.

Source: BBVA Research

What are the risks on the global scenario?

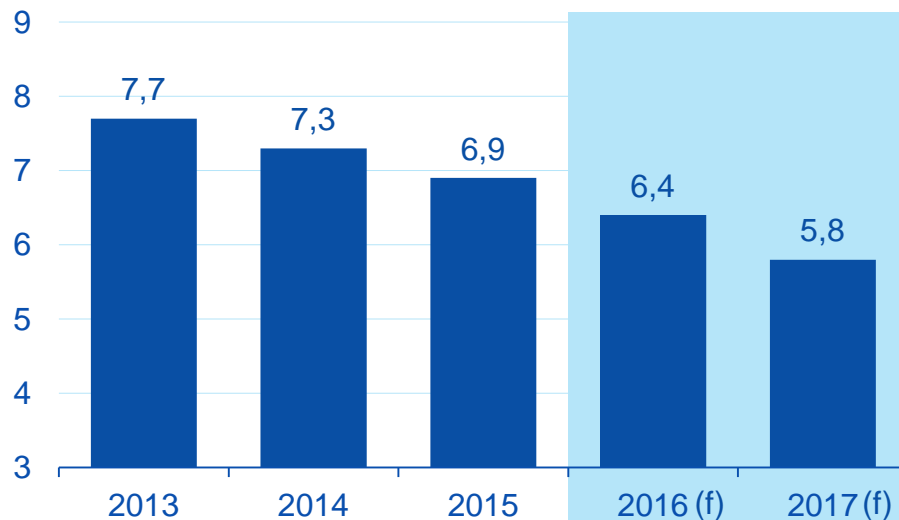


Forecasts

China: slow adjustment to continue

China: GDP growth

(YoY %)



In the short term, **monetary and fiscal policies will modulate the adjustment** to China's growth, which will continue

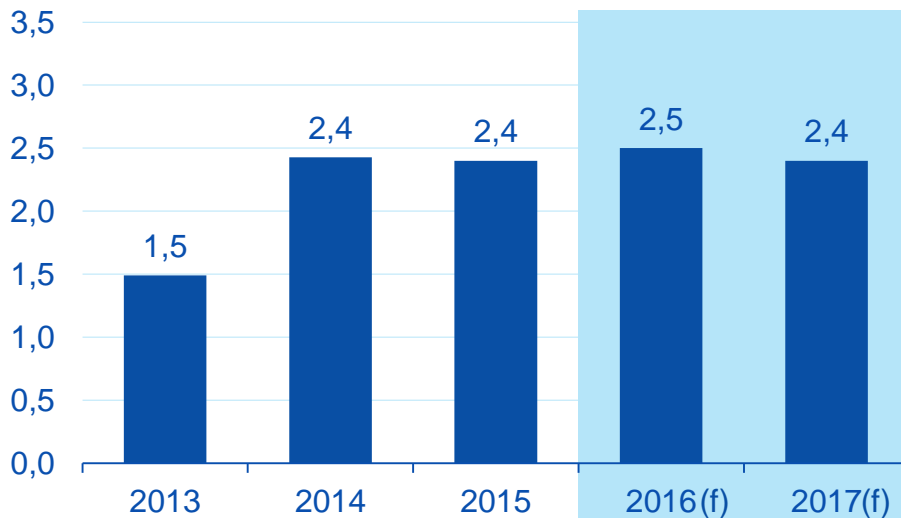
Semi-public enterprises: sustained by debt and with overcapacity. Without reforms, **they will act as a brake on growth in the medium term**

Forecasts

USA: growth increasing over the course of 2016

USA: GDP growth

(YoY %)



After a gentle start, **the economy will accelerate** over the course of the year, driven by employment

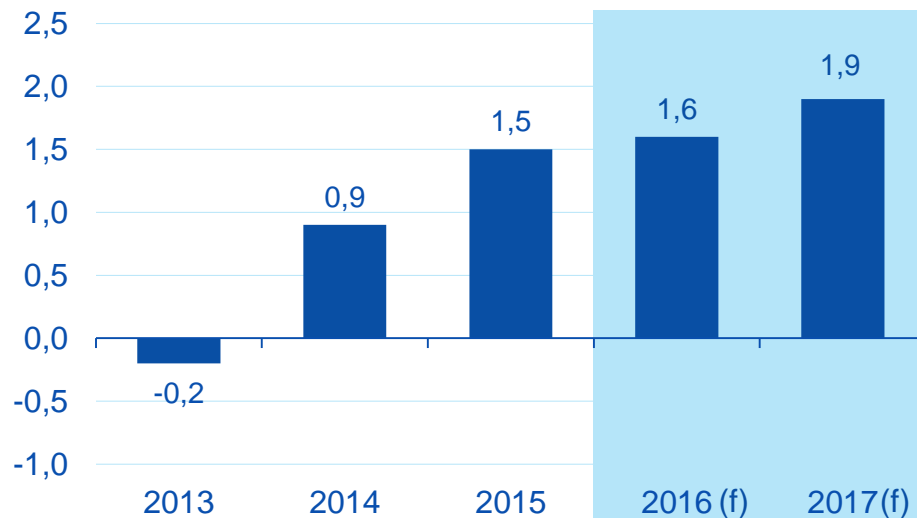
The Federal Reserve will take into account the strength of the domestic economy and the negative effect on the global environment when **deciding on the timing and extent of its interest rate hikes**

Forecasts

Euro zone: revised downwards, but recovery continues

Euro zone: GDP growth

(YoY %)



The external environment weighs down exports and growth

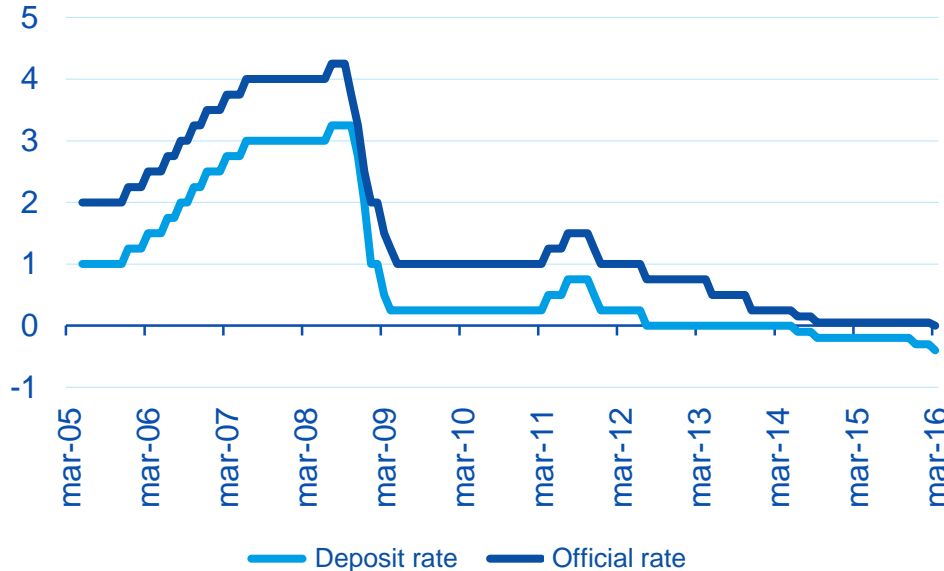
Certain support factors are fading: the positive effects of low oil prices and the euro's depreciation

Meanwhile, **policies continue to support growth**: specially monetary policy and, marginally, fiscal policy

Forecasts

Euro zone: monetary policy is nearing its limit

Euro zone: official rate and deposit rate
(%)



The ECB approves a new package of measures: interest rate cuts, extension of QE and new liquidity supply (at zero cost)

These measures will mitigate bank financing doubts, but their **impact on the real economy and credit is uncertain**

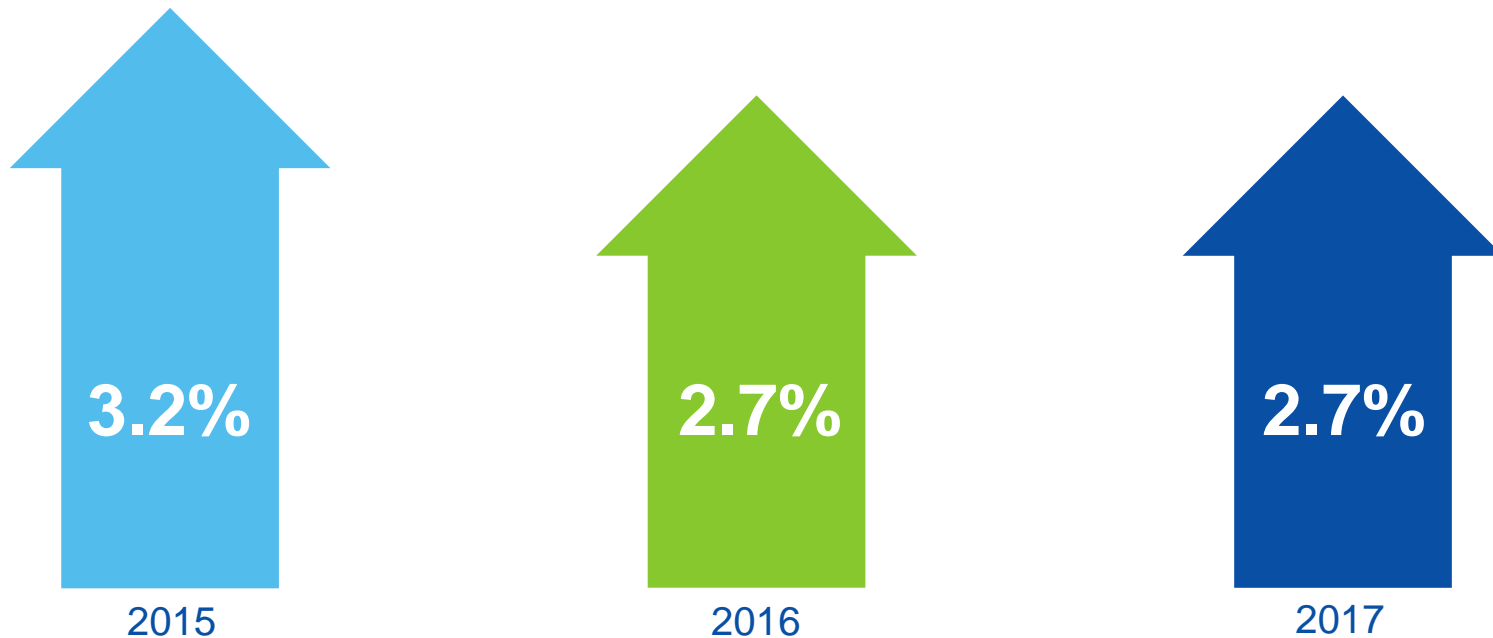
The ECB is starting to take account of **the side-effects of negative rates**

A satellite night view of Spain, showing the country's outline and the dense network of city lights. The lights are concentrated in the coastal areas and major urban centers, with a few smaller lights scattered in the interior. The surrounding waters are dark, and the landmasses of the Mediterranean and Atlantic are visible.

Spain

GDP growth

The recovery continues

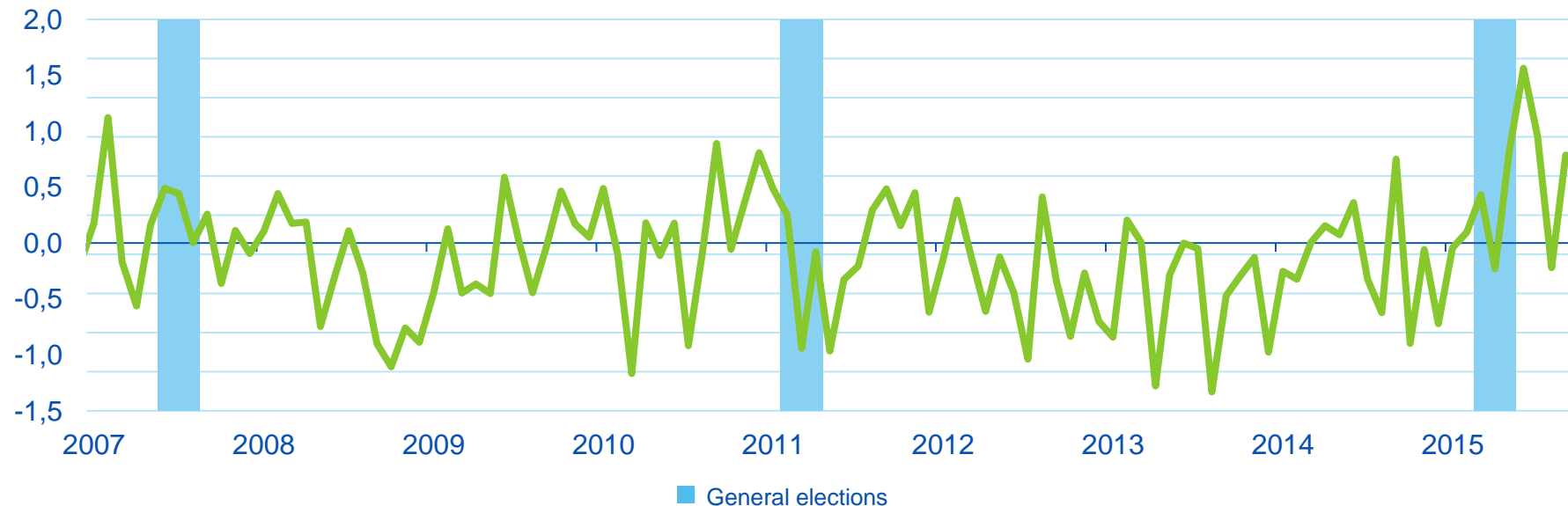


Economic policy and growth

Uncertainty remains high...

Spain: Economic Policy Uncertainty

(idiosyncratic component in standard deviations)

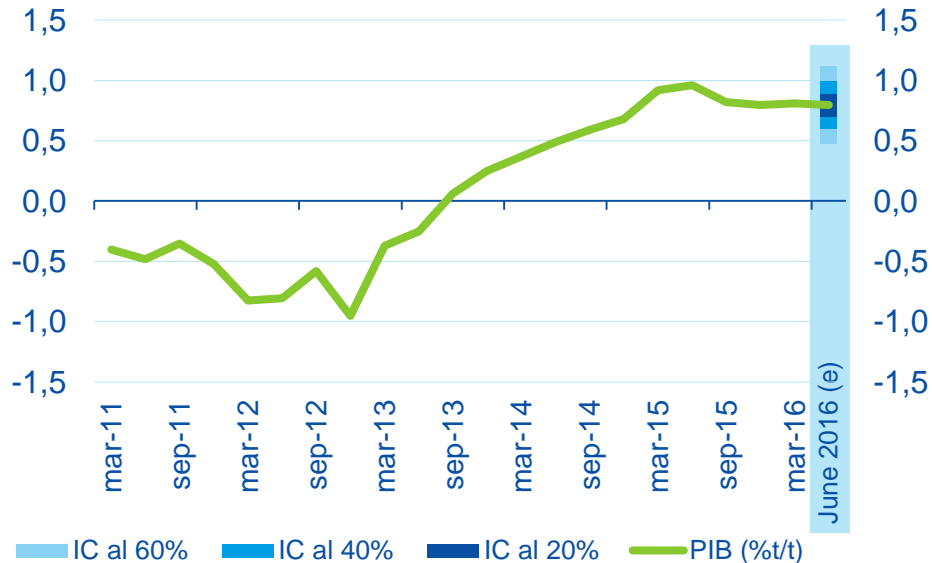


Economic policy and growth

... but the recovery continues

Spain: GDP growth

(% QoQ, MICA-BBVA model)



(e): estimated.

Source: BBVA Research based on INE

Available data point to GDP's completing **four consecutive quarters of growth at 0.8%** in 2Q16.

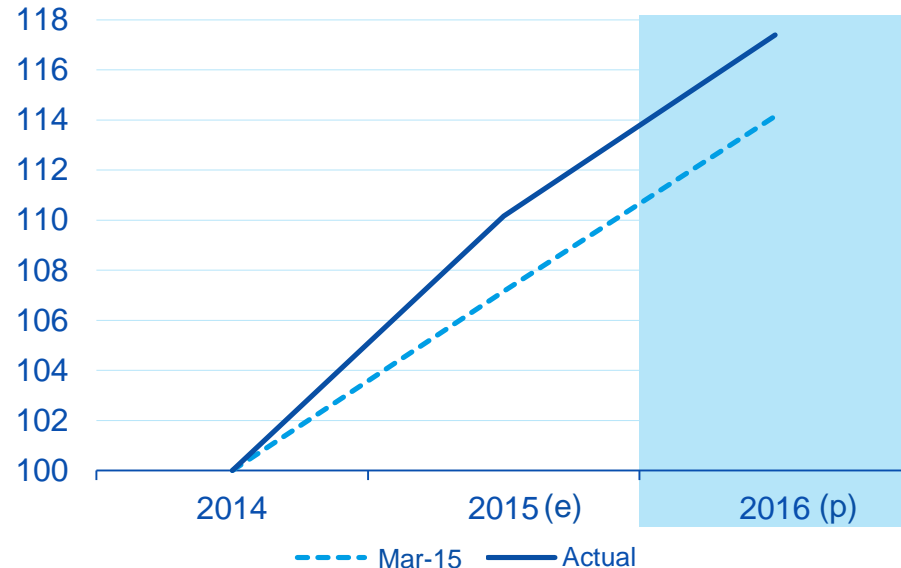
If this is confirmed, **it will increase the probability of growth exceeding 2.7%** in 2016

Domestic demand and exports of services support the recovery

Positive composition of growth

Investment in productive capital

Spain: investment in machinery and equipment
(Consensus Forecasts 2014 = 100)



(e): estimated; (p): projected
Source: BBVA Research based on INE and FUNCAS (Savings Banks Foundation)

The **behaviour** of this component **in 2015 proved better than expected...**

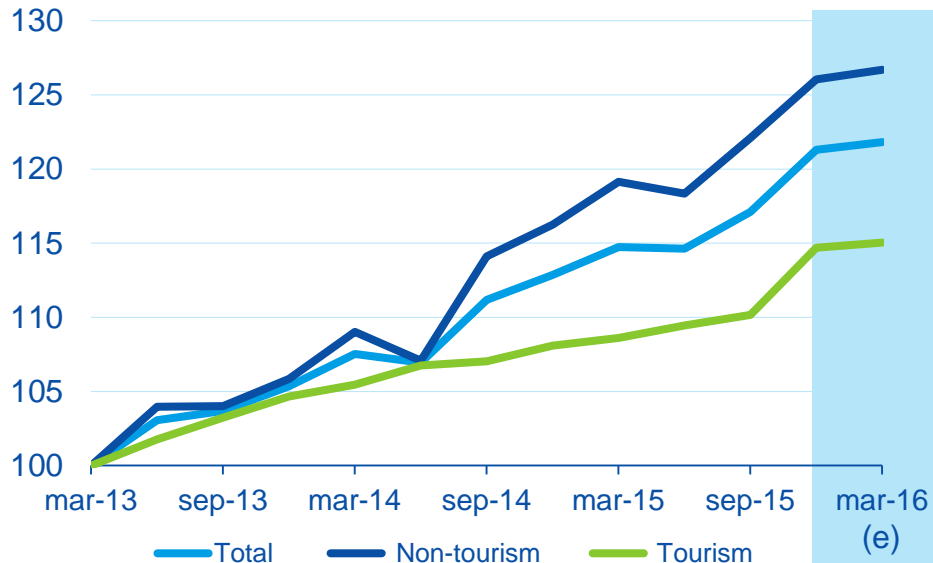
...and it is not expected to deteriorate in the short term

Never before has such a large part of domestic spending been channelled into the **formation of productive capital**

Positive composition of growth Production focused on exports

Spain: exports of services

(Q1 2013 = 100)



(e): estimated.

Source: BBVA Research based on INE

Tourism has been a supporting factor...

...however, **exports of non-tourism services** have performed much better

Growth will be upheld by the **improvements in competitiveness** that have been achieved, together with the geopolitical uncertainties affecting tourist destinations competitors

Tailwinds

Growth will continue to be supported by

Record low oil prices

Expansive monetary policy

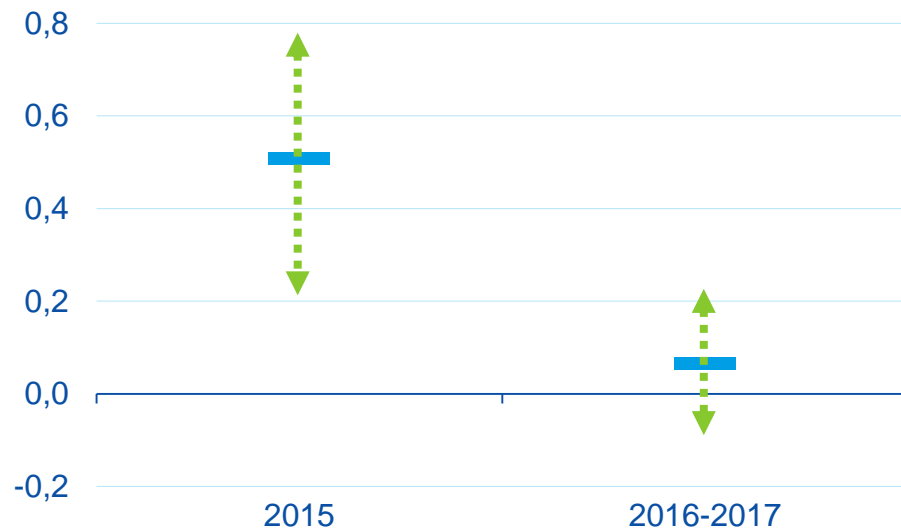
Moderated acceleration in the euro zone

Neutral fiscal policy

Although its effect is fading Monetary policy

Impact of non-conventional measures¹

(pp of annual growth)



1: Monetary policy measures approved since mid-2014.

The arrows indicate the confidence intervals from the 16 and 84 percentiles

Source: BBVA Research

The non-conventional easing measures have succeeded in **reducing credit spreads** ...

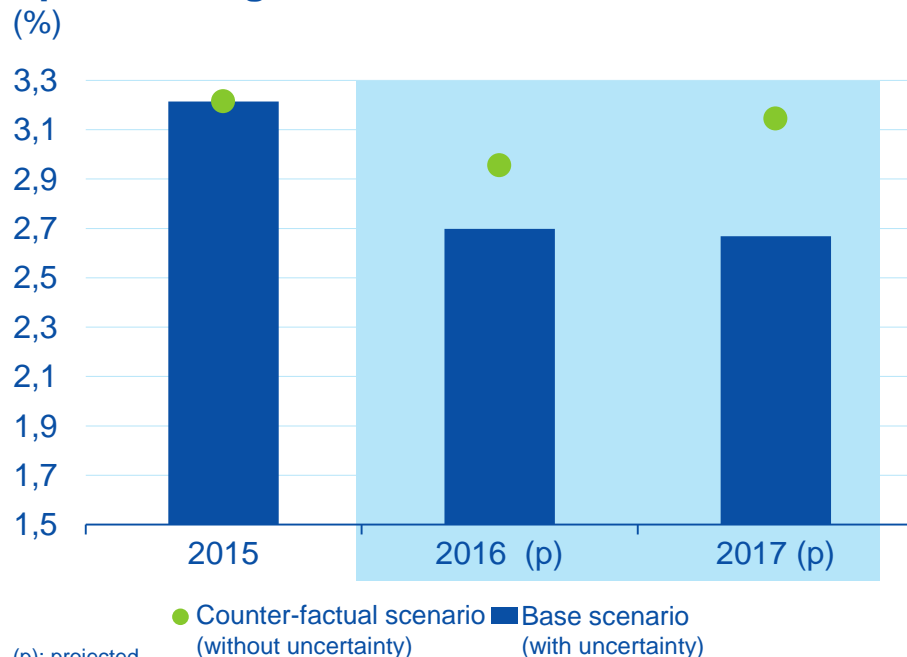
...and extending the expected period of **low interest rates**

However, credit risk and the zero lower bound suggest that **the most important part of the impact has already gone**

Domestic risks

Economic policy uncertainty

Spain: GDP growth scenarios



Source: BBVA Research based on INE

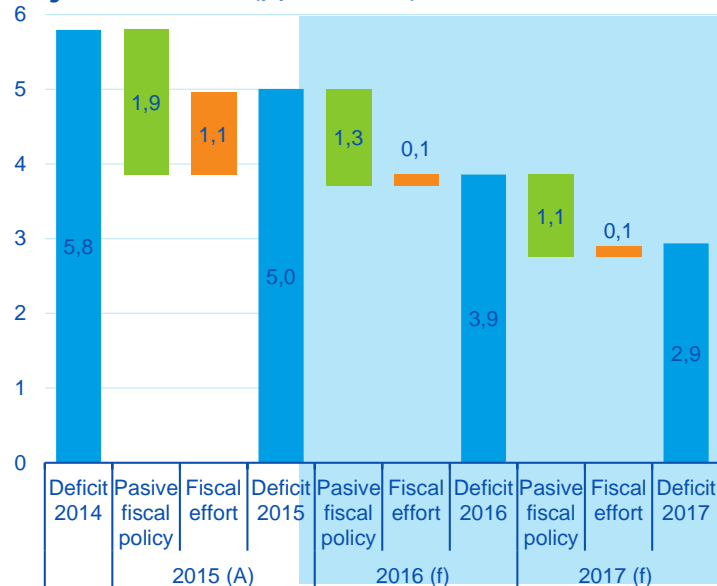
In an environment without uncertainty, the economy could have grown by **0.3 pp more in 2016 and 0.5 pp more in 2017**

The longer this situation persists, the greater the impact will be

Domestic risks

Non-compliance with fiscal commitments

Breakdown of public administrations' fiscal adjustment. (pp of GDP)



(a): advance; (f): forecast. Not including assistance to banks
 Source: BBVA Research based on MINHAP and INE

In the absence of stimulus measures, **the government would have reached the deficit target in 2015**

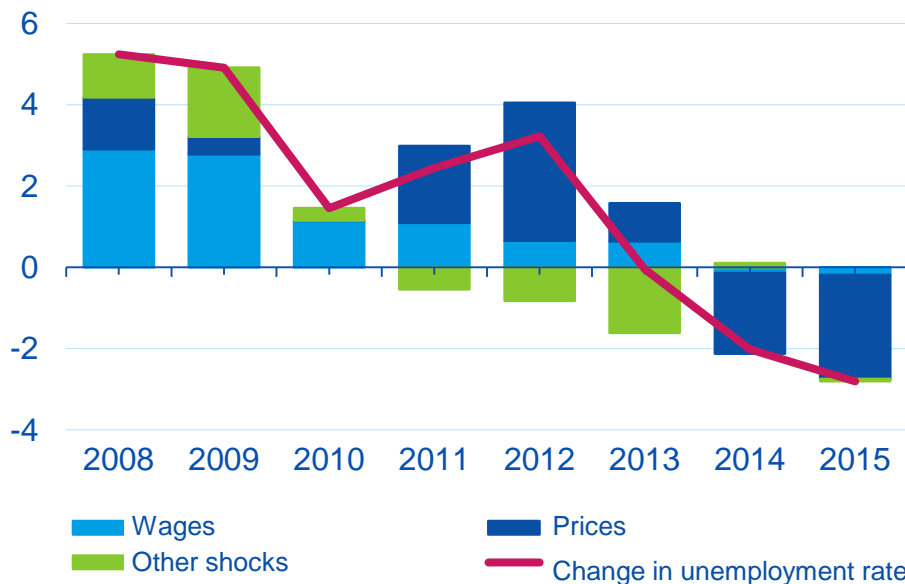
In the short term, the **fiscal impetus** contributed about **half a percentage point to growth**

In the long run, the costs may be significant: the overshoot is likely to increase the risk premium by about 25 bps relative to a scenario in which the commitments had been met

Box 1

More reforms to correct structural deficiencies

Spain: historical breakdown of changes in the unemployment rate (pp)



Source: BBVA Research

1: See Doménech, García and Ulloa (2016) 2: See [Economic Observatory Spain](#), 6 May, 2016.

Wage and price rigidity led to **an increase of 11.5 pp in the unemployment rate** during the crisis¹

Greater wage flexibility since 2012 has accelerated job creation

The labour market still need **additional measures to boost its efficiency and fairness**²

A hand holding a tablet computer against a city skyline background. The image is split diagonally from the bottom left to the top right. The top-left portion shows a hand holding a tablet, with a blurred city skyline in the background. The bottom-right portion is a solid blue gradient. The word "Conclusions" is written in large blue font in the bottom right.

Conclusions

The **global economic scenario** has improved in the past three months, but **growth** is still **weak, and vulnerable** to several risks

In Spain, data on activity lend an **upward bias to our growth forecast for 2016**, while increased uncertainty **gives a downward bias for 2017**

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