

# SPAIN Economic Outlook

with view on the real estate sector

GRI 2017

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## Main messages

- The world economy continues to improve, albeit within an environment in which risks are still present
- In Spain, current activity trends confirm that growth remains strong. We expect GDP growth to remain around 3,0% in 2017 and 2018 (2,7%).
- Housing demand is picking up, as prices have stabilized or even increased significantly in certain regions. Trends in construction point to the sector finally beginning to contribute to job creation.
- Although reforms have had a positive impact, there are still significant imbalances



# Global Economic Outlook

2<sup>ND</sup> QUARTER 2017



## The positive dynamic takes hold

### The main trends continue...

Recovery of industrial activity and international trade is confirmed

Financial markets rather stable amidst growing geopolitical tension

Headline inflation continues to rise, while core inflation remains stable

### ...while uncertainties take shape

A substantial growth stimulus in the US seems less likely...

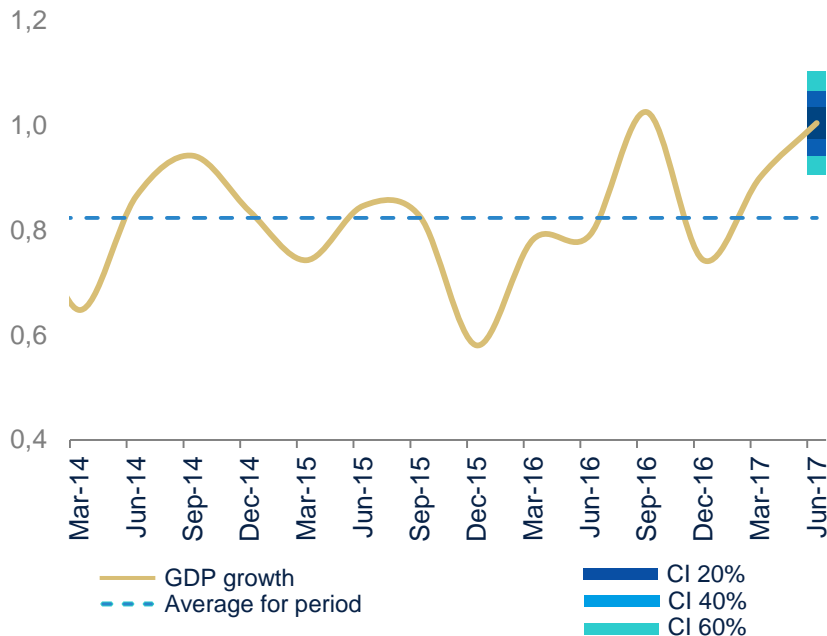
...A more protectionists' stance is also less likely

Central banks move towards normalisation

# The world's economy continues to accelerate in early 2017

## Global GDP growth

Forecasts based on BBVA-GAIN (% QoQ)

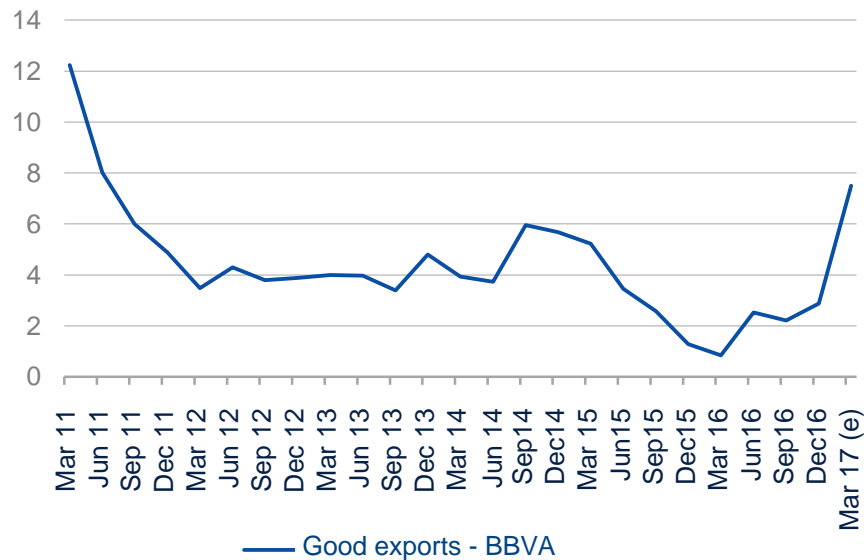


- ◆ Confidence indicators are at very high levels, but hard indicators only partially reflect that improvement
- ◆ Advanced economies show signs of strength. However, China's indicators signal growth moderation in April and emerging economies are performing more irregularly

# Exports improve around the world

## World exports of goods (constant prices)

(YoY, %)

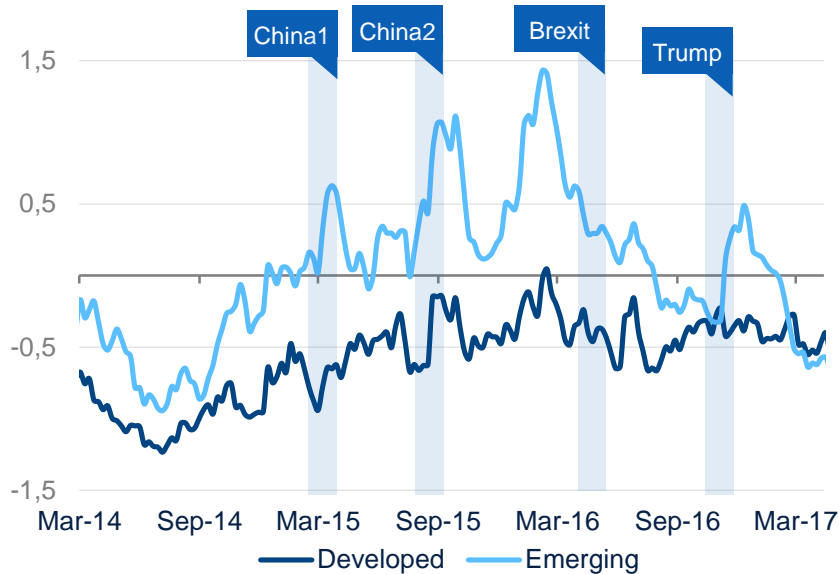


- ◆ **World trade** shows signs of acceleration, driven by investment in China
- ◆ **Industrial activity** partially reflects this improvement
- ◆ **Consumer indicators** show some signs of slowing down

(e): estimated  
 Based on BBVA-Trade Index figures  
 Source: BBVA Research and CPB

# Financial tension remains relatively low

**BBVA financial tension index**  
(normalised index)



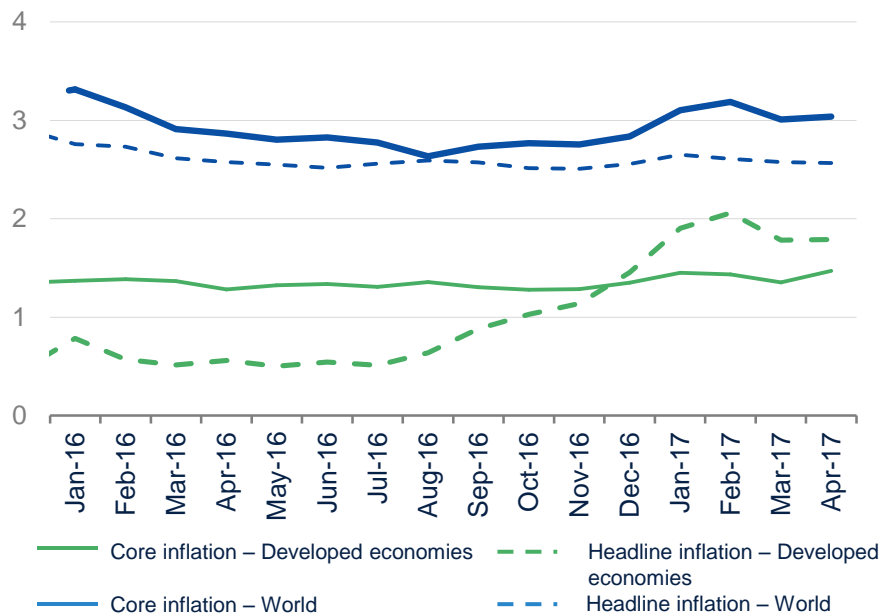
- ◆ **Volatility has shrunk** despite the economic policy uncertainty
- ◆ **Fiscal and Monetary stimulus** mask substantives concerns
- ◆ **In Europe**, risk premia have returned to pre-French election levels as political uncertainty has mostly dissipated (with exceptions such as Italy)



# Inflation shows no signs of second round effects so far

## Headline and core inflation

(YoY, %)



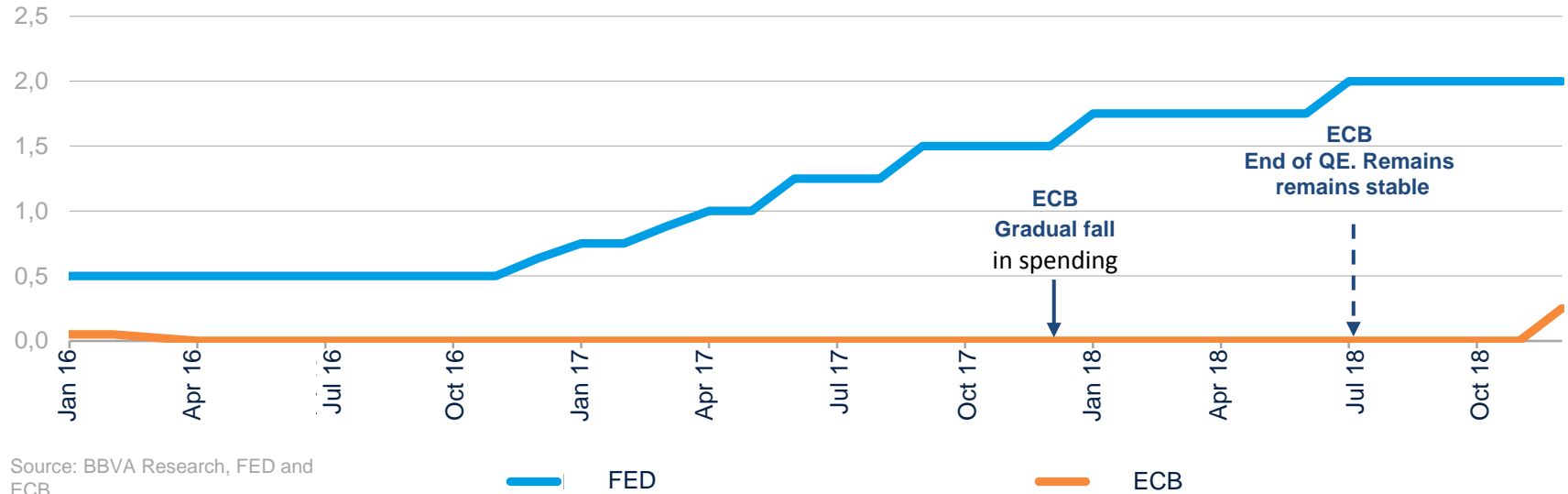
- ◆ The effect of commodity prices on inflation is reaching its maximum level
- ◆ Core inflation remains low, without apparent second-round effects
- ◆ As a result, inflation forecasts have been lowered



# Central banks move towards a normalisation of their policies

## FED and ECB interest rates

(bp)



Source: BBVA Research, FED and ECB

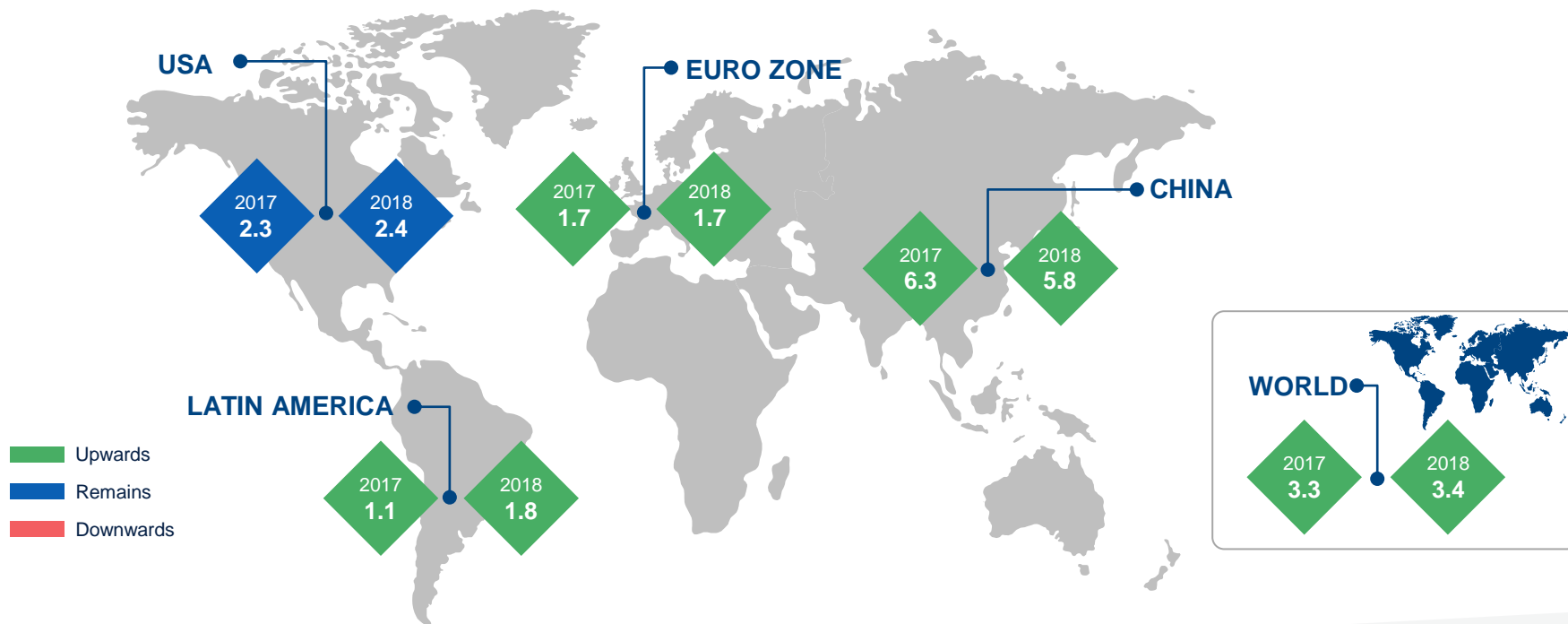
— FED

— ECB

The Federal Reserve continues to raise interest rates, although it remains cautious about the economic

The ECB is increasingly looking at an exit strategy for monetary policy

# Upward revision in China and the eurozone, slightly higher in Latin America. Unchanged in the US.



# Spain Economic Outlook

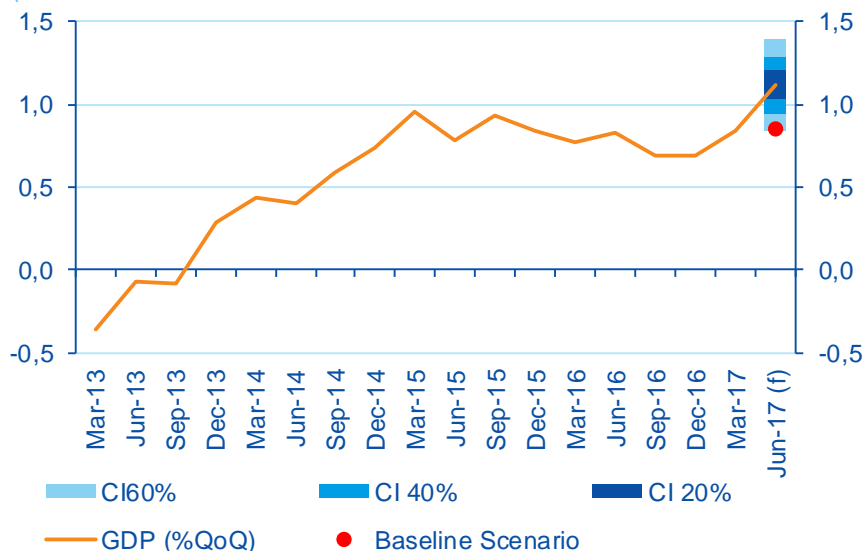
2<sup>ND</sup> QUARTER 2017



# Upward bias confirmed

## Spain: Observed GDP growth and forecasts of the MICA-BBVA Model\*

(% QoQ.)



(e): estimated

Source: BBVA Research

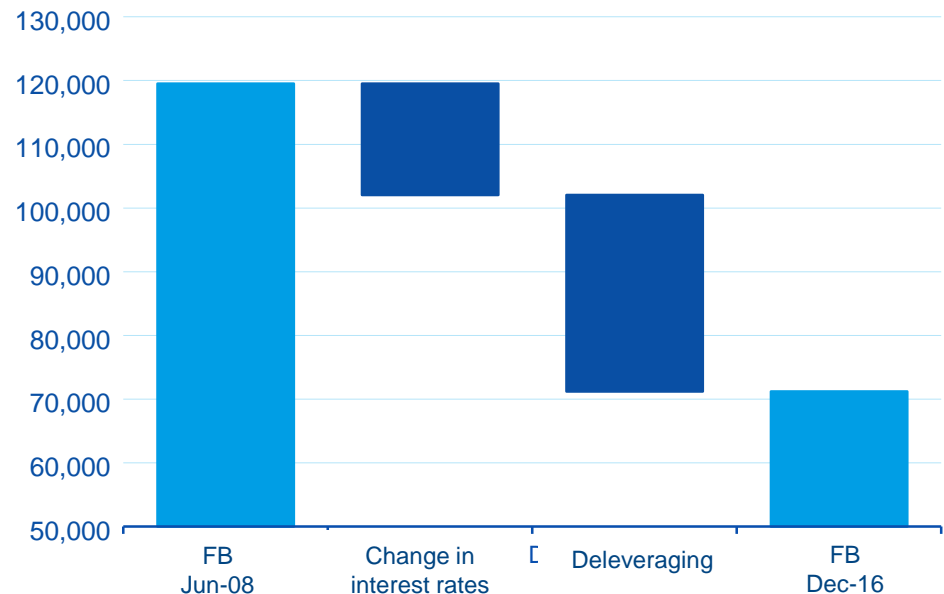
(\*) Camacho, M. and R. Doménech (2010): "MICA-BBVA: A Factor Model of Economic and Financial Indicators for Short-term GDP Forecasting", BBVA WP 10/21, available at: <http://goo.gl/zeJm7g>

- ◆ Recent economic figures (e.g. employment and exports) point to a **slightly better than expected short-term outlook**
- ◆ Upward revision of 0.3pp in the **growth forecast, which now stands at 3% for 2017**

# Tailwinds: Monetary policy and pent-up demand are boosting expenditure...

- ◆ Consumption benefits from expansionary monetary policy through several channels
- ◆ **Directly:** lower financial burdens and improvement in funding conditions
- ◆ **Indirectly:** improving expectations about economic growth and job creation

**Spain: Household's financial burden**  
(€ millions)

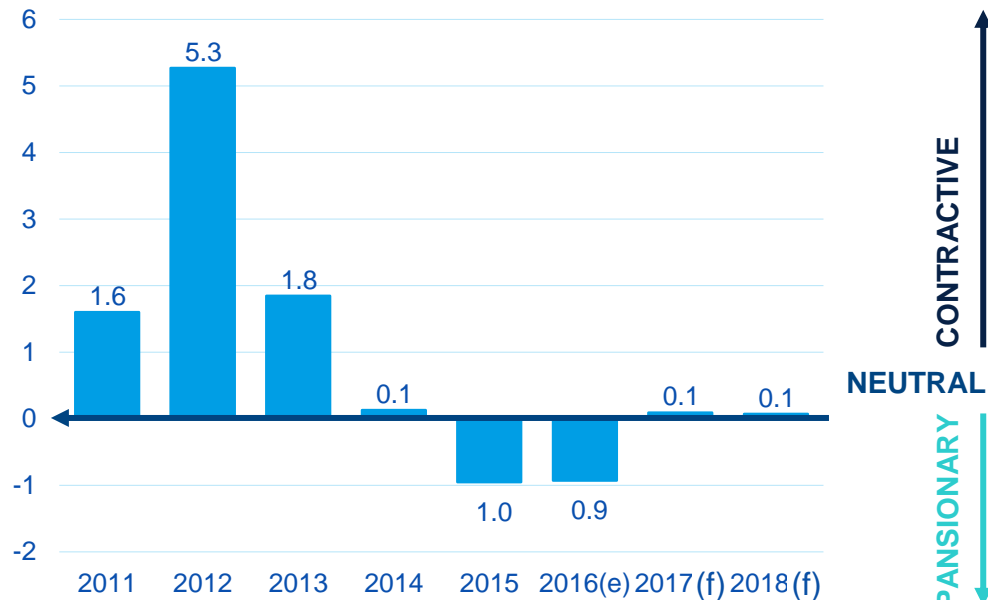


## Tailwinds: Fiscal policy turned expansionary

- ◆ The impact of fiscal reform in direct taxation was stronger than expected
- ◆ This increased disposable income for households and firms, boosting expenditure in 2015 and 2016

### Spain: Structural adjustment to the primary fiscal balance

(pp of GDP)



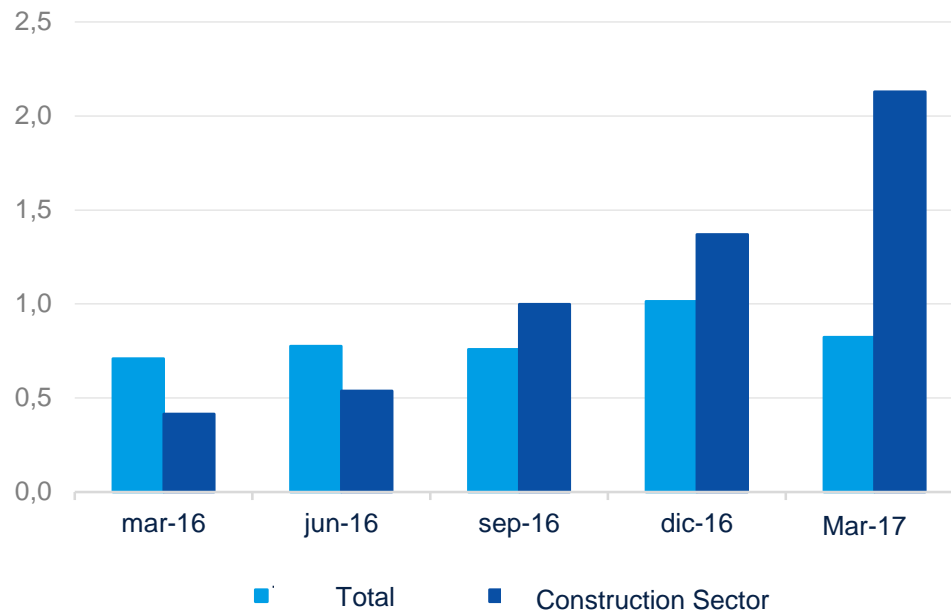
(e): estimate, (f): forecast

Source: BBVA Research based on INE and Banco de España

## Tailwinds: Residential investment gains momentum

- Recent figures point to the long-awaited **acceleration in the real estate sector**
- Demand, along with a reduction in oversupply, have been the causes of the **price increases and the uptick in activity in certain urban areas**

**Spain: Social Security affiliation growth**  
(SCA, % QoQ)

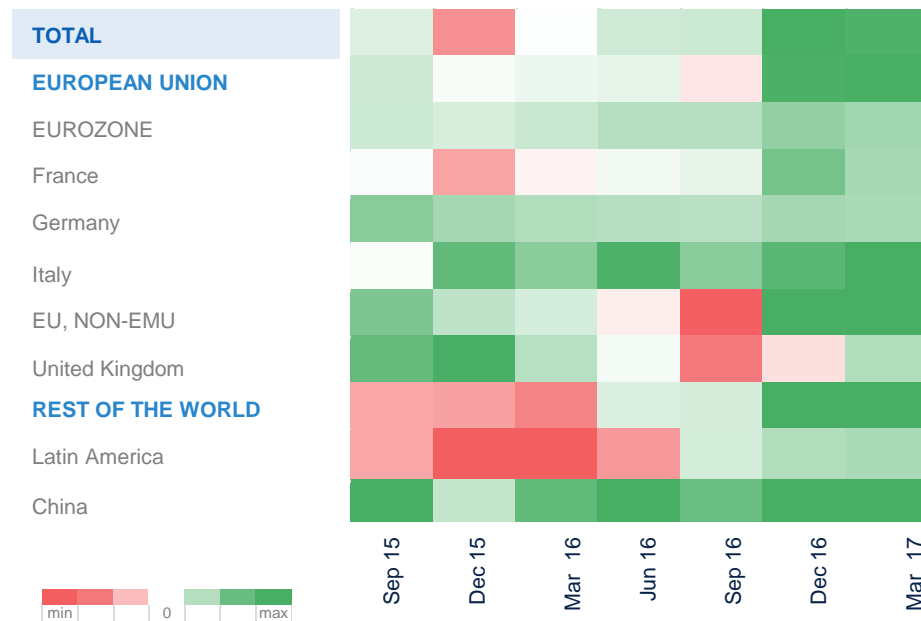




# Tailwinds: Exports of goods recover, despite Brexit

- ◆ The recovery in goods exports can be explained partly by **improved performance in emerging markets**
- ◆ **The euro zone continues to bolster growth in exports, while lower sales to the United Kingdom has had a relatively small impact**

**Spain: Exports per country**  
(trend, %YoY)



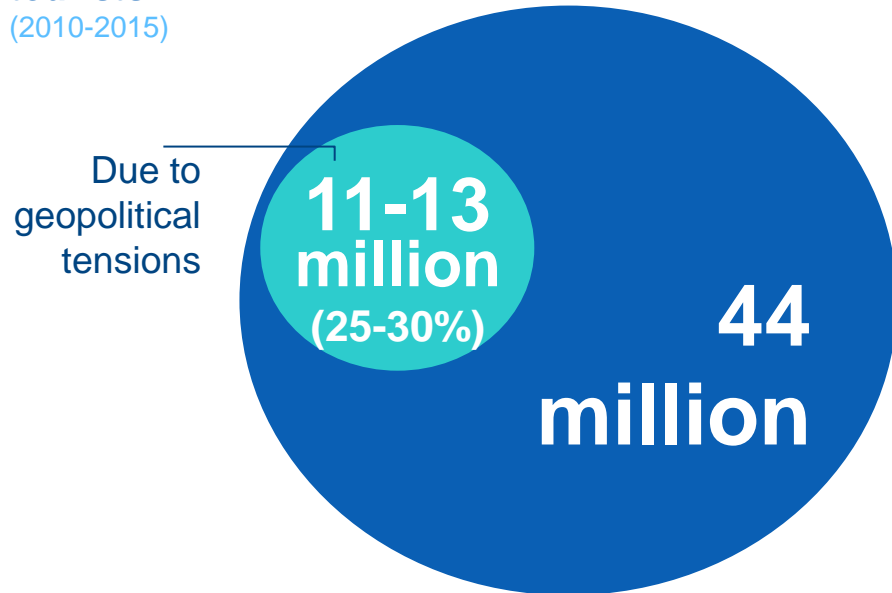
(e): estimated

\*Red and green respectively indicate negative and positive quarterly trend variations  
Source: BBVA Research based on INE figures

## Tailwinds: Tourism remains as a positive element

- ◆ Most of the increase in activity comes from **improvements in competitiveness and higher investment.**
- ◆ **Geopolitical tensions** in some of the competitors steers tourism to Spanish destinations account for 25-30% of the rise in overnight stays by nonresidents.

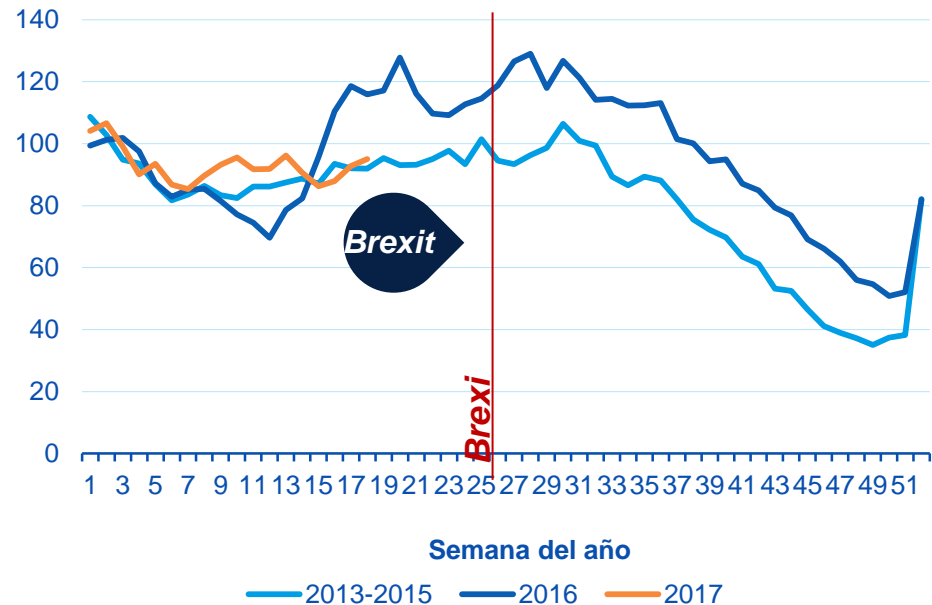
**Spain: rise in the overnight stays of nonresident tourists**  
(2010-2015)



# Tailwinds: Risks have not had the expected negative impact

- ◆ So far, the impact of Brexit on Spain's aggregate exports has been limited and concentrated in exports of goods
- ◆ However, it continues to be a risk going forward

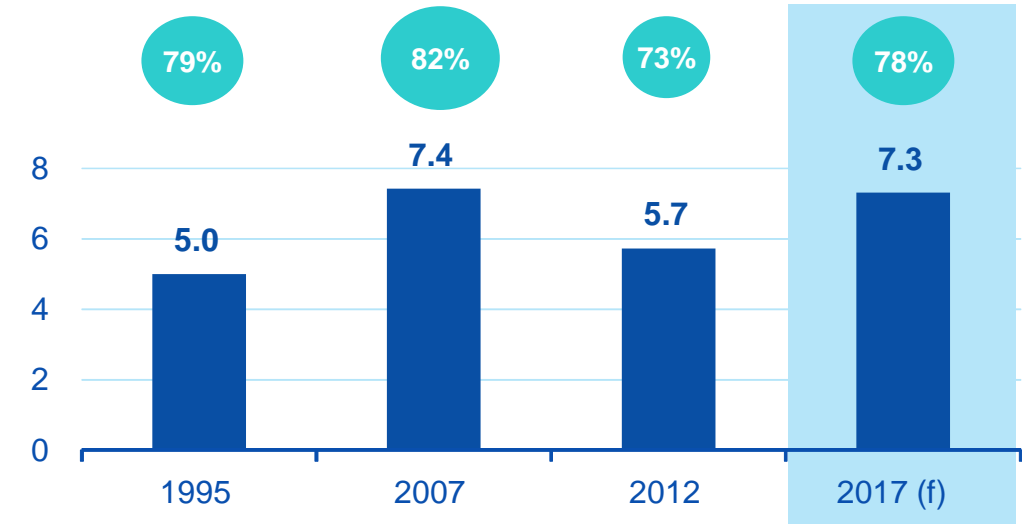
**GOOGLE searches for hotels in Spain from the UK**  
(January average = 100)



# Tailwinds: Reforms could be having a stronger impact

- ◆ The behavior of the investment in M&E positively surprises and approaches maximum levels
- ◆ Despite idle capacity in industry persists, there continue to be investment opportunities

**Spain: Investment in M&E and Capacity Utilization**  
(%)



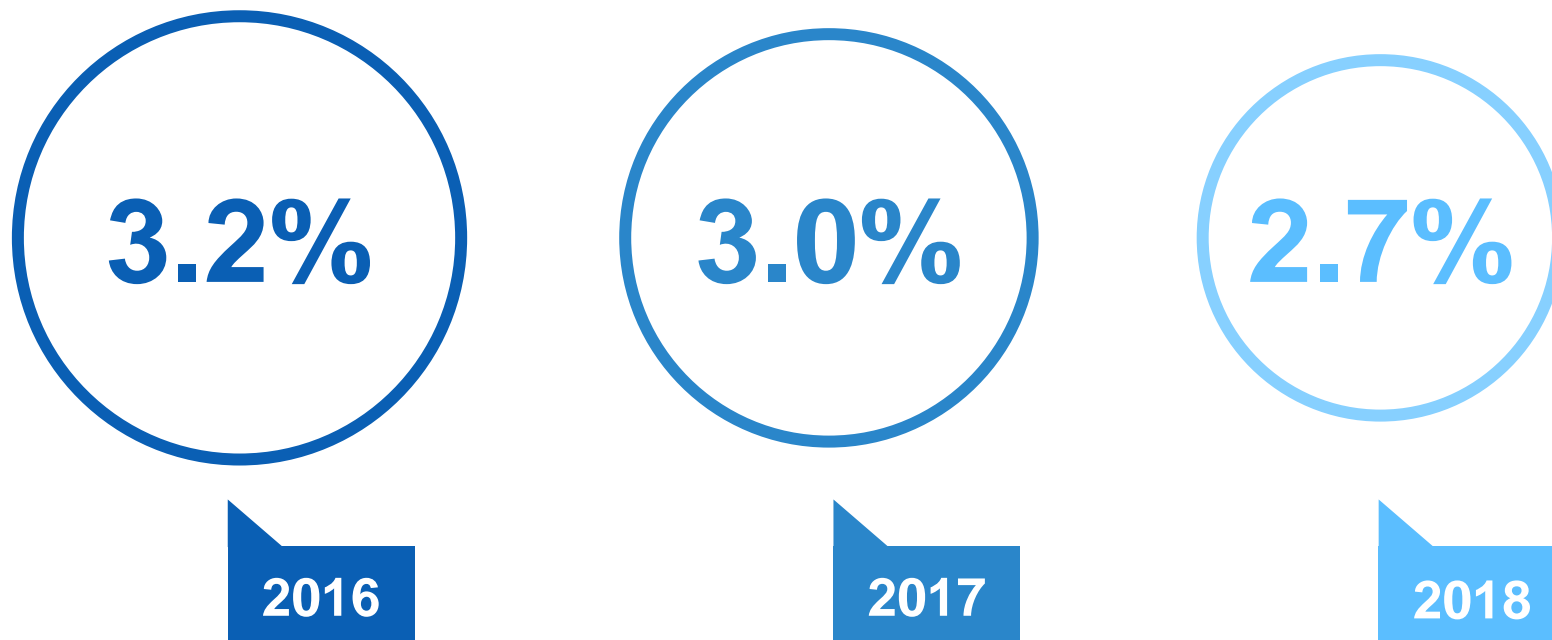
■ Share of M&E in GDP

● Industry production capacity utilisation

(f): forecast

Source: BBVA Research based on INE & MINETUR

## We revise our 2017 GDP growth forecast to 3%



# The global context, positive for Spain

**1****Global demand**

Positive perspectives, especially in the euro zone and in emerging markets, will drive the exports

**2****Oil price**

Despite increases in recent months, prices stay 40% below 2014 levels

**3****Geopolitical tension**

Tourism in Spain will continue to benefit from the perception of insecurity in competing destinations

**4****Euro exchange rate**

The euro is still depreciated against the dollar in 2017, but with an upward trend for 2018

**5****Official Interest rates**

At historical lowest levels, with expectations of moderate increases in the short term interest rates in late 2018

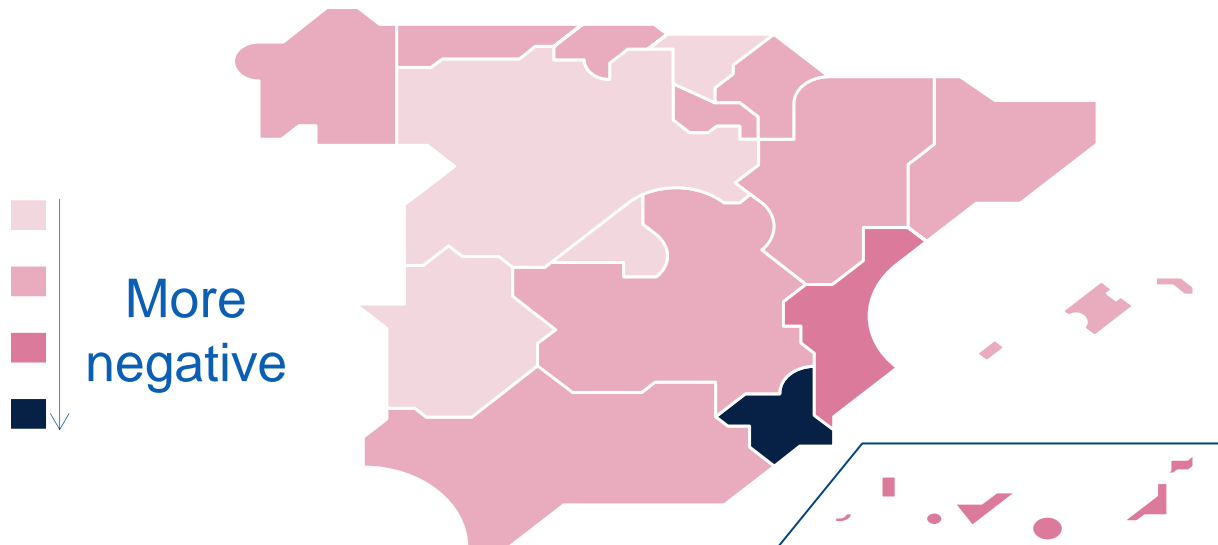
**6****Risk premium**

Still low as a result of the ECB's Asset Purchase Programme

## Some headwinds: Brexit will have an impact

### Brexit impact on GDP on Spanish regions

(estimated deviation from baseline scenario in pp)

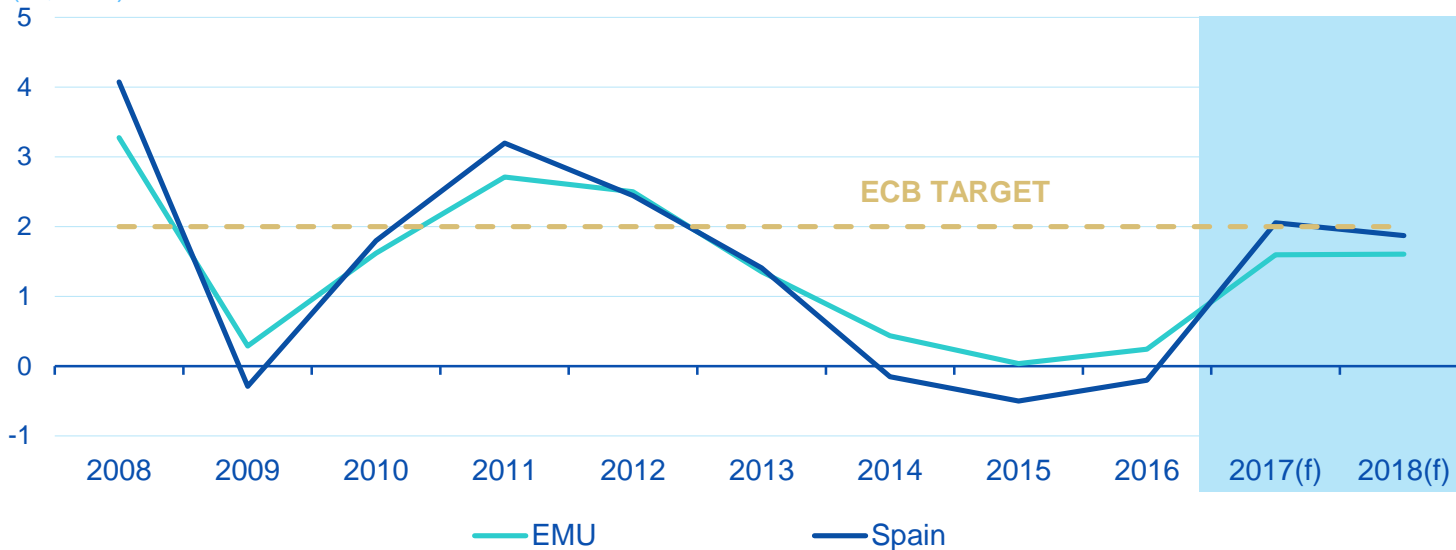




# Some headwinds: transitory uptick in inflation

## Spain and Europe: headline inflation

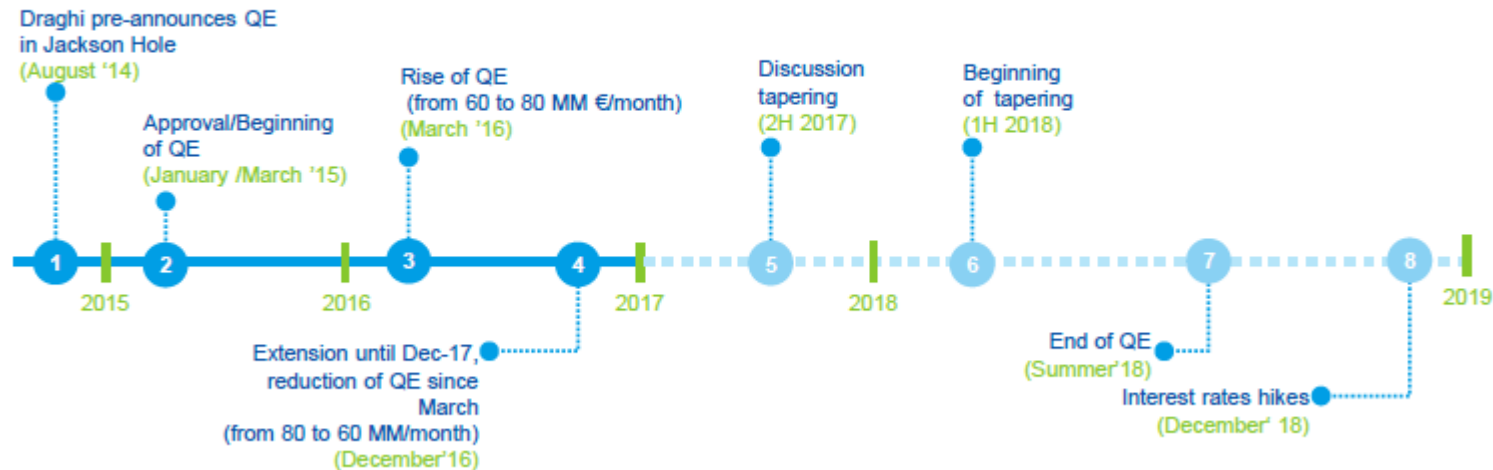
(%, YoY)



**2<sup>nd</sup> round effects remain limited**

# Some headwinds: interest rates will begin normalization in 2018

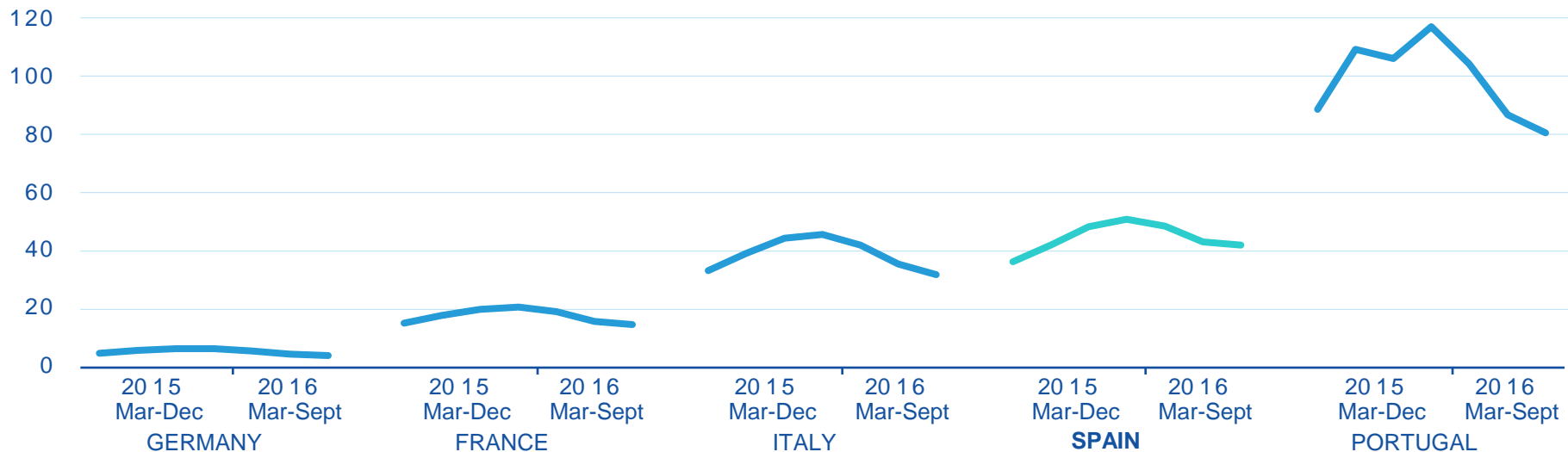
Calendar for the ECB's asset purchase programme and euro zone inflation monitor (\*)



# Some headwinds: interest rates could begin normalization

## Impact of the ECB's Asset Purchase Program on five year CDS

(basis points)



## Some headwinds: policy uncertainty remains

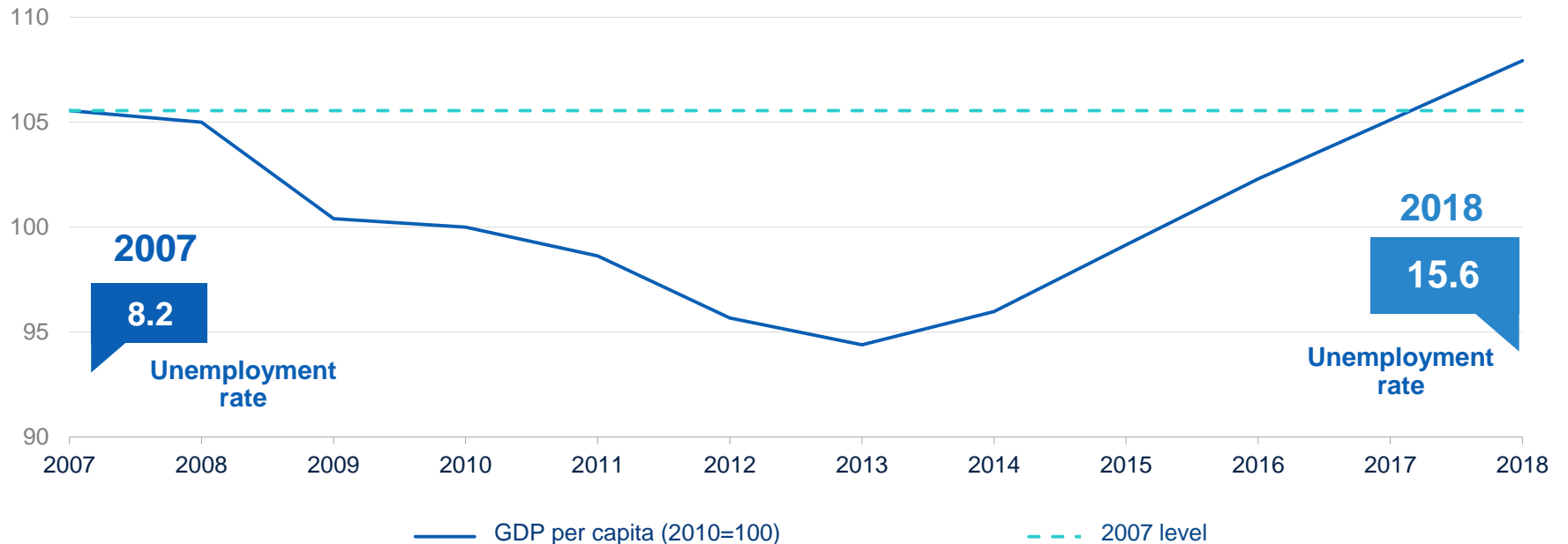
Spain: effect of uncertainty on economic policy on 2017 GDP growth (pp YoY)



- ◆ **Uncertainty** about Spain's economic policy **has diminished** in the past few months
- ◆ However, it **remains high**
- ◆ Recent tax and regulatory changes could lead to postponement of investment plans

# In any event, there is still much to be done

**Spain: GDP per capita**  
(2010=100)



Source: BBVA Research based on INE figures

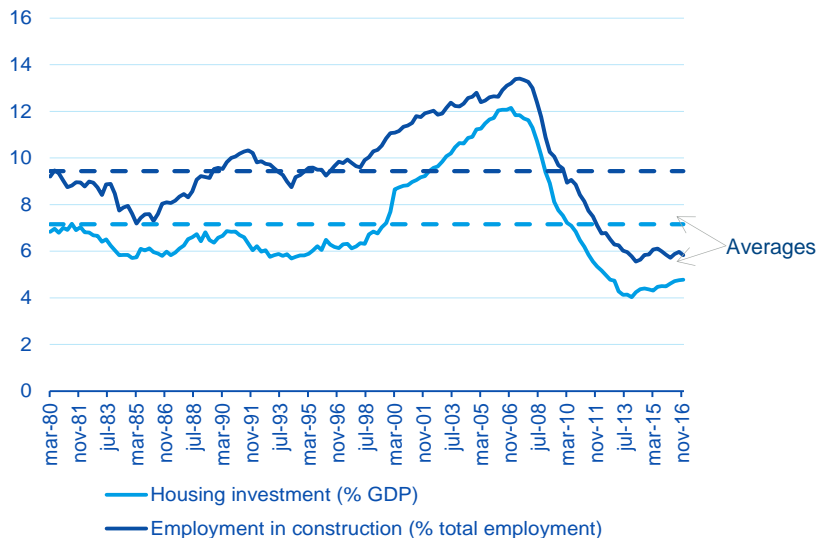
# Real Estate Economic Outlook

2<sup>ND</sup> QUARTER 2017



# Real Estate: Imbalances have been corrected

## Spain: housing investment and employment in construction

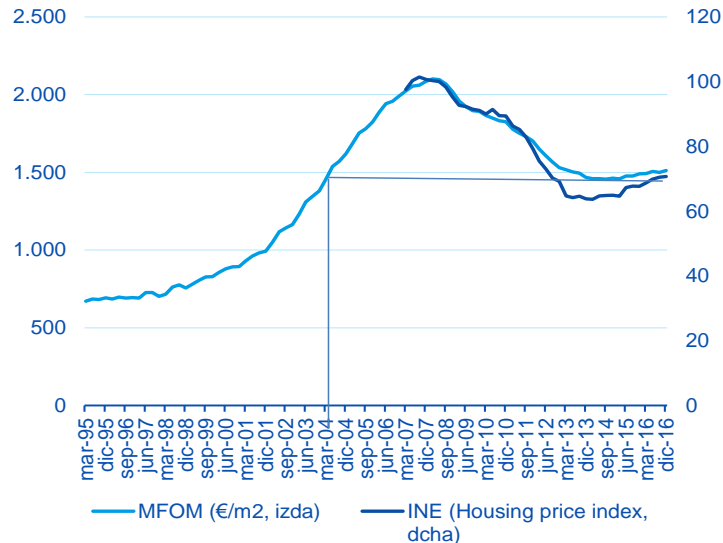


- ◆ The sector has gone through a long and painful period of restructuring.
- ◆ Investment dropped from close to 12% of GDP to 5% currently, while employment went from representing close to 14% of the total to around 6% today.
- ◆ Deleveraging by firms and households along with the restructuring of a part of a financial sector and price adjustment have been key.

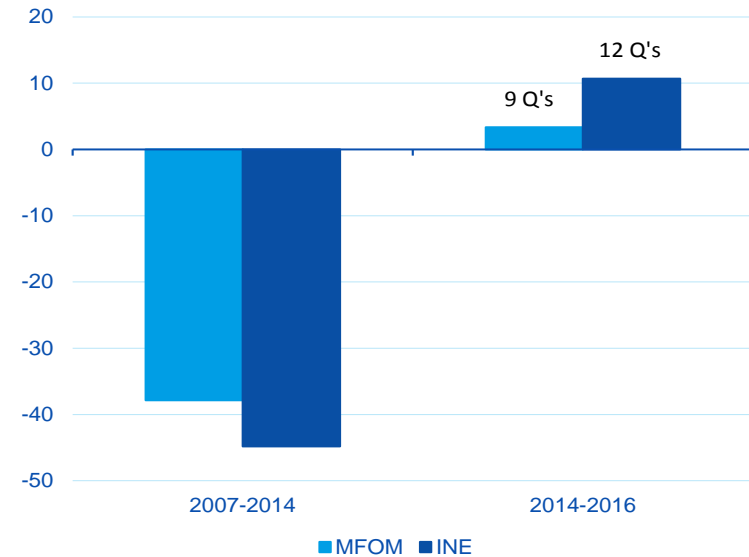


# Prices have reflected the adjustment, but now they have stabilized

## Spain: home prices



## Spain: home real prices variation and # quarters in positive

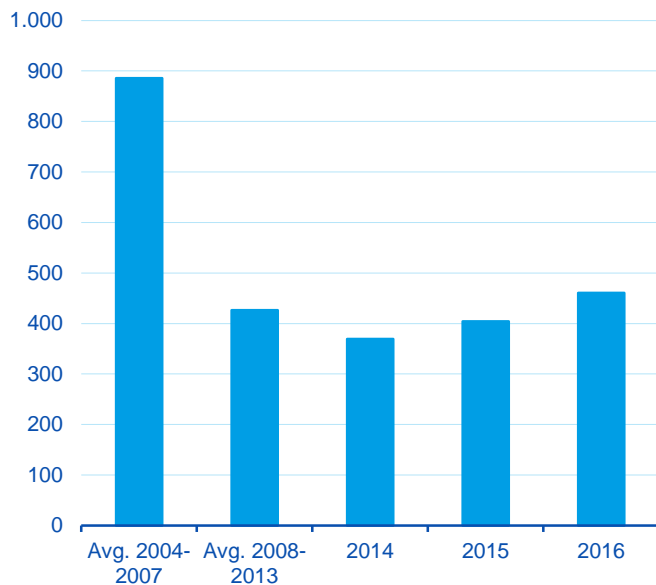


Source: BBVA Research based on INE and MFOM

## Real Estate: Home sales accumulate three years of growth

### Spain: home sales

(thousands)



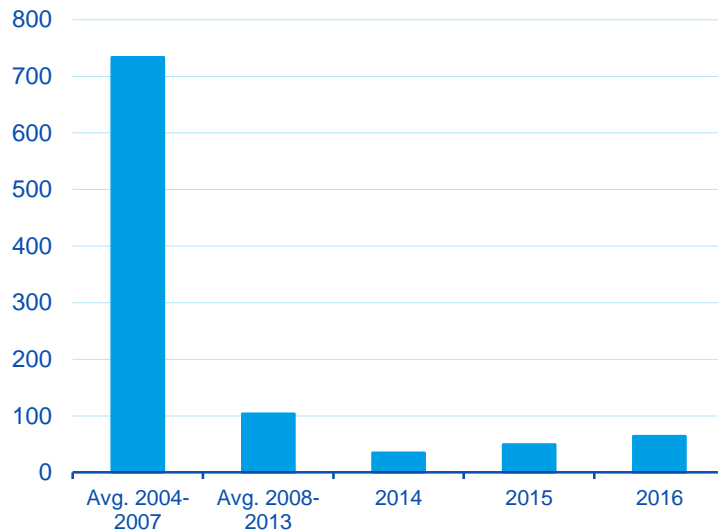
Source: BBVA Research based on CIEN

- ◆ In the boom period an average of 885,500 homes were sold per year in Spain. In contrast, in 2014 were sold just over 300,000 homes
- ◆ In the last 3 years the sales of homes has grown 52% to 460,000 homes sold in 2016. But this is only 53% of the sales made each year of the expansion
- ◆ Pent-up demand, lower interest rates, increasing credit growth and job recovery have been behind this upward trend.

## Housing initiation increases but remains at very low levels

### Spain: home building permits

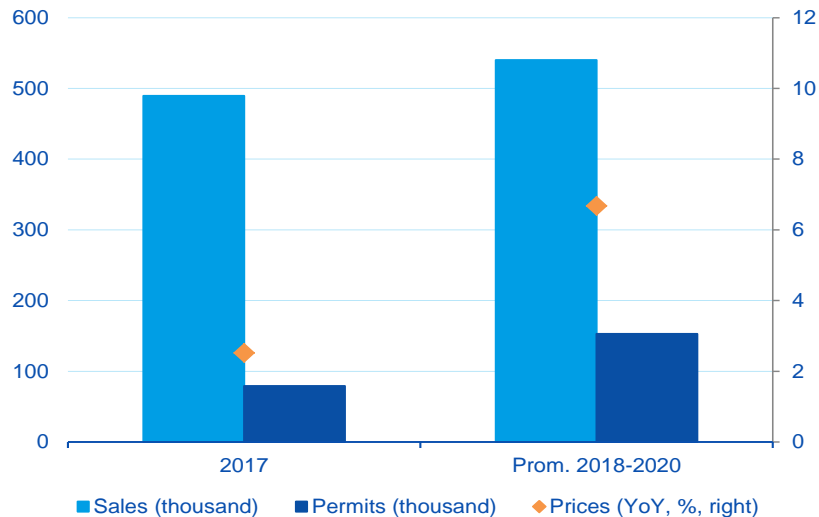
(thousands)



- ◆ Permits decreased 96% between 2006 and 2013, from over 850,000 to over 34,000 units
- ◆ Since 2014 permits have grown about 90%, but levels are still low. Permits in 2016 (65.400) represented only 7,6% of permits in 2006
- ◆ In addition, land transactions have also increased their dynamism since 2016: Since 2013 land area sold has increased 71,0%

# Adjustments made along with the recovery should help Real Estate

## Spain: forecasts of Real Estate variables



- ◆ GDP growth over the coming years ensures robust job growth and maintaining household confidence at relatively high levels
- ◆ Housing sales growth will continue to stimulate the construction of homes. Finished housing will remain at very low levels
- ◆ The scarcity of new housing and the impulse of demand point to new price increases

## Main messages

- The world economy continues to improve, albeit within an environment in which risks are still present
- In Spain, current activity trends confirm that growth remains strong. We expect GDP growth to remain around 3,0% in 2017 and 2018 (2,7%).
- Housing demand is picking up, as prices have stabilized or even increased significantly in certain regions. Trends in construction point to the sector finally beginning to contribute to job creation.
- Although reforms have had a positive impact, there are still significant imbalances



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## Forecasts

(% YoY)	2015		2016		2017 (f)		2018 (f)	
	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU
Households final consumption expenditure	2,8	1,8	3,2	1,9	2,5	1,4	2,4	1,4
General government final consumption exp.	2,0	1,3	0,8	1,8	1,0	1,2	2,0	1,0
Gross fixed capital formation	6,0	3,0	3,1	2,5	3,3	2,5	4,5	3,0
Equipment and machinery	8,9	4,3	5,0	5,0	3,6	4,1	4,4	4,7
Housing	3,1	1,9	3,7	3,7	4,3	2,9	5,8	1,7
Other constructions	6,4	0,5	0,4	0,9	1,4	1,0	2,8	1,5
Changes in inventories (*)	0,1	-0,2	0,2	-0,1	0,1	0,1	0,0	0,0
<b>Domestic Demand (*)</b>	<b>3,3</b>	<b>1,7</b>	<b>2,8</b>	<b>1,9</b>	<b>2,3</b>	<b>1,6</b>	<b>2,6</b>	<b>1,5</b>
Exports	4,9	6,3	4,4	2,7	5,8	3,9	5,0	3,5
Imports	5,6	6,3	3,3	3,4	4,2	4,0	5,2	3,6
<b>External Demand (*)</b>	<b>-0,1</b>	<b>0,2</b>	<b>0,4</b>	<b>-0,2</b>	<b>0,7</b>	<b>0,1</b>	<b>0,1</b>	<b>0,1</b>
<b>GDP mp</b>	<b>3,2</b>	<b>1,9</b>	<b>3,2</b>	<b>1,7</b>	<b>3,0</b>	<b>1,7</b>	<b>2,7</b>	<b>1,7</b>

### Pro-memoria

Total employment (LFS)	3,0	1,0	2,7	1,3	2,6	1,1	2,6	1,0
Unemployment rate (% Active pop.)	22,1	10,9	19,6	10,0	17,3	9,5	15,6	9,1
Current account balance (% GDP)	1,4	3,2	1,9	3,3	1,8	3,0	1,5	2,9
Public debt (% GDP) (**)	99,8	90,4	99,3	89,6	97,8	88,4	95,0	86,4
Public deficit (% GDP)	-5,1	-2,1	-4,3	-1,9	-3,1	-1,7	-2,1	-1,4
CPI (average)	-0,5	0,0	-0,2	0,2	2,1	1,8	1,9	1,6

(\*) Contribution to GDP Growth

(\*\*) Excluding aid to the banking sector in Spain



SPAIN  
**Restructuring of financial sector to allow a better transmission of monetary policy**

Phase 1: slow paced

Change of legal framework and focus on capital

Phase 2: definite

Focus on asset valuation, provisions, bad bank and capital injections (EU assisted)

Efficiency increased

**-37,3%**

Reduction in number of branches since 2008

Solvency improved

**8,7%**

Ratio of Capital plus Reserves over total assets in 2016 (up from 5,5% in 2010)

Liquidity got better

**110%**

Loans to deposit ratio in 2017 (down from 170% in 2007)

Credit came back

**16,8%**

Average annual percentage increase on new credit flows to families since 2014

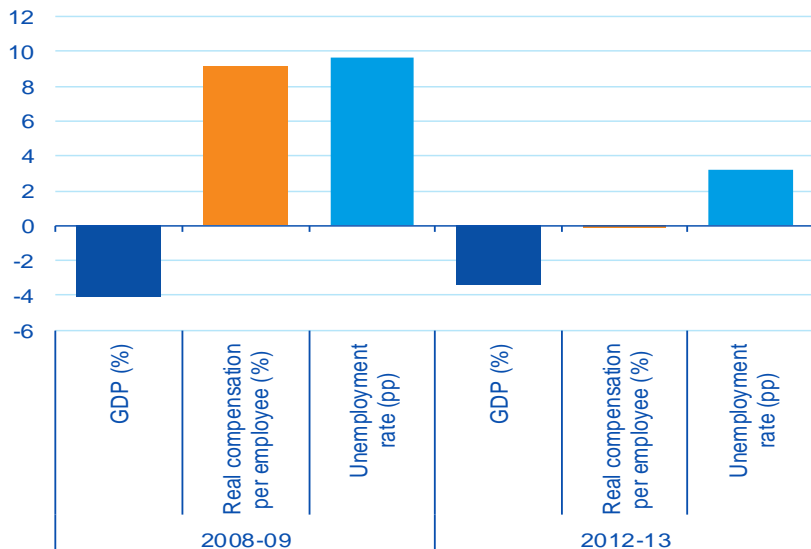
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# Effects of structural reforms on labor market performance

**Spain: GDP, real wages and unemployment rate\***

(cumulative change, SWDA )

Source: BBVA Research



The 2012 Labor market reform and the 2nd Agreement on Employment and Collective Bargaining prevented greater job destruction

Wages now seem to respond more to individual firm conditions: wage moderation could have prevented the loss of 900,000 jobs up to 2015

There would be 2 million more jobs in the long-term if wage moderation had been implemented at the beginning of the crisis

\*/ BBVA (2016), “The role of wage flexibility in the recovery of the Spanish labor market”, in Spain Economic Outlook, Second Quarter, 2016.

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## Effects of structural reforms on competitiveness

ULC annual growth 2003-2007  
3.5% Spain vs 1.5% EU



ULC annual growth 2014-2016  
-0.2% Spain vs 0.3% EU

GDP deflator annual growth 2003-  
7  
3.8% Spain vs 2.5% EU



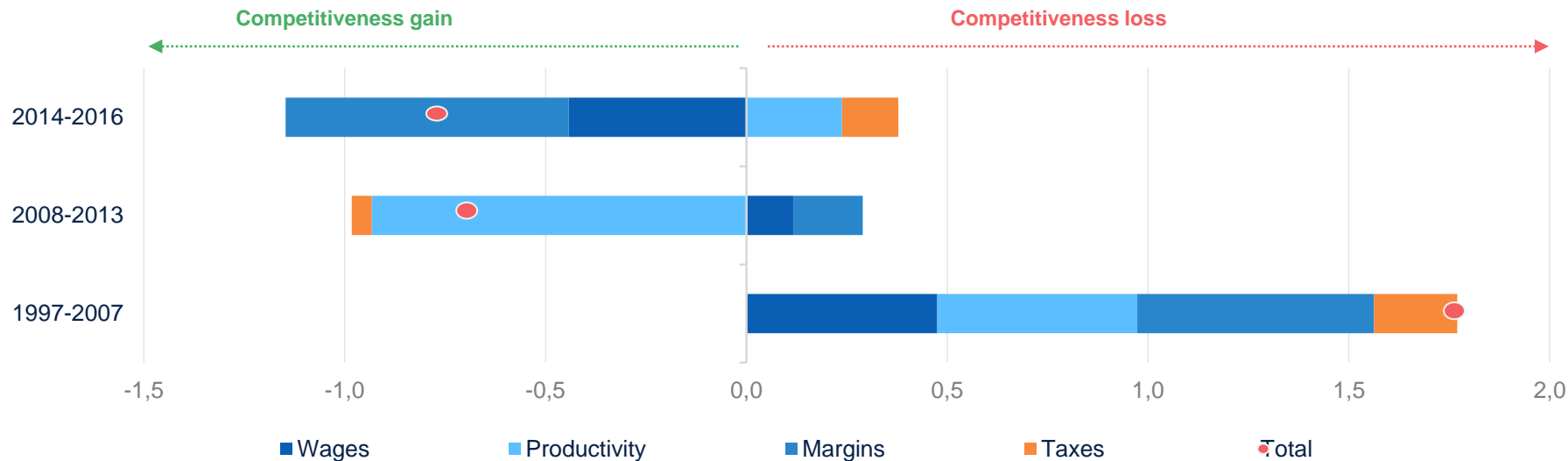
GDP deflator annual growth 2014-  
16  
0.4% Spain vs 0.8% EU

Exports/GDP  
Spain 25.5% in 1Q2008



Exports/GDP  
Spain 33.8% in 4Q2016

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**Inflation: gains from competitiveness**  
 Spain: breakdown of the inflation differential with respect to the EMU 12 based on the GDP deflator (average annual growth)



Source: BBVA Research based on AMECO figures

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## Economic performance highlights structural improvements

Spain: Potential 2015 GDP growth by forecast date (%)

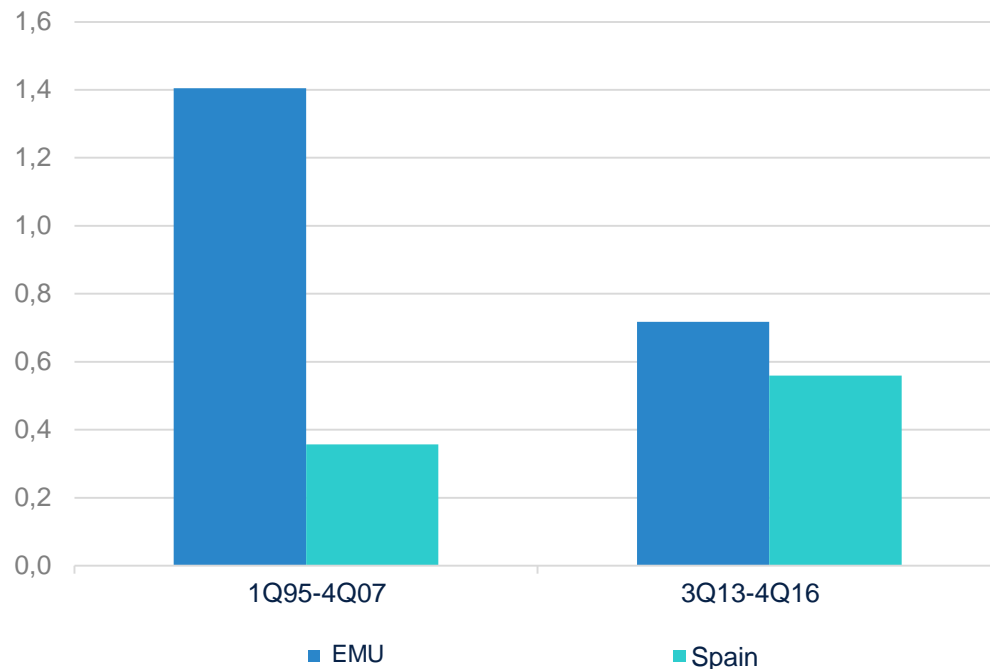


Source: BBVA Research based on INE and CF INC

**SPAIN**  
**In the medium term, improved productivity will be a key factor**

- ◆ The **gap** between Spain and the EMU in **productivity growth has decreased** in recent years
- ◆ **Productivity growth is still low**, although in part this might be the result of global factors
- ◆ There are some signs of **structural improvement**

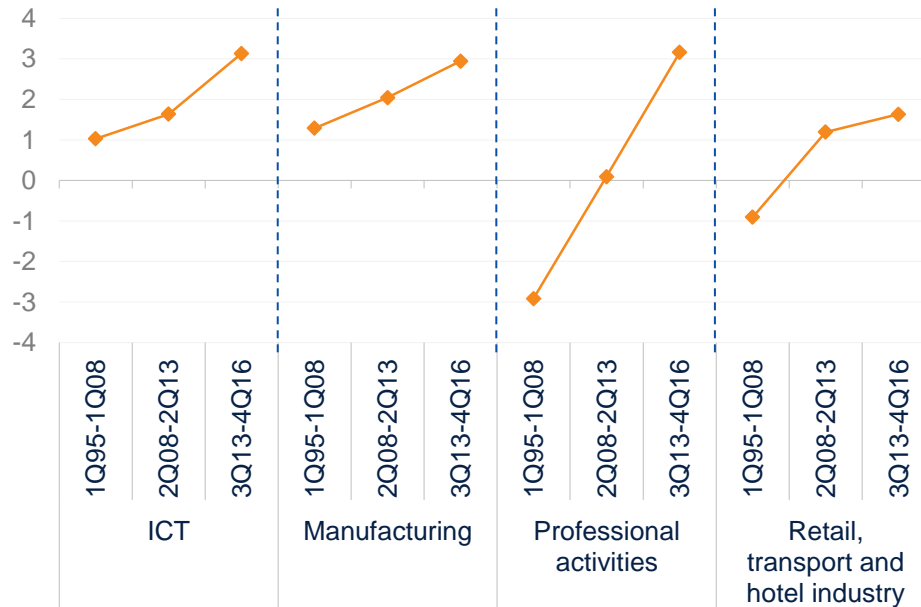
**Spain: Labour factor productivity**  
 (GVA per hour worked % QoQ, annualised average)



SPAIN  
**Sectoral composition shows some reasons for optimism**

- ◆ Productivity performance is influenced by **traditionally leading sectors, such as ICT and Manufacturing**
- ◆ Recently, **other labour intensive sectors** have increased productivity, as well as creating employment

**Spain: Labour productivity factor GVA per hour worked** (% QoQ, average annualised)

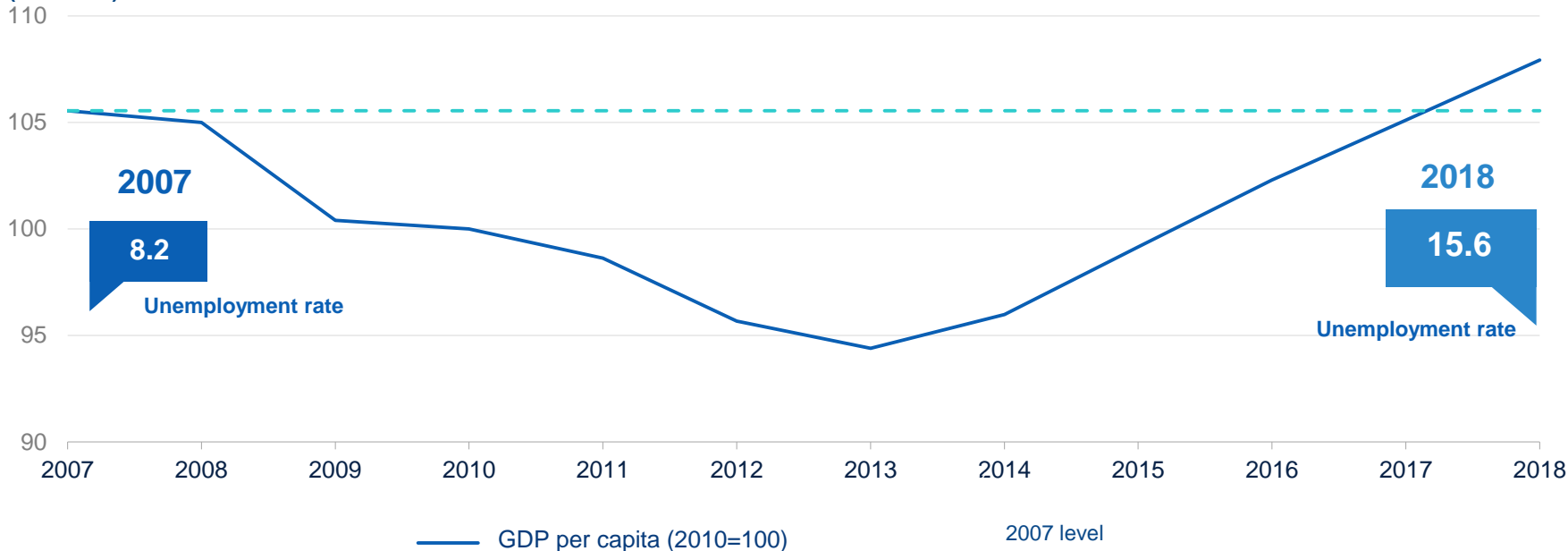


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# In any event, there is still much to be done

## Spain: GDP per capita

(2010=100)



2007 level

Skill mismatch in the labor market  
Productivity enhancing measures