

# Spain

# Economic Outlook

3Q19

## Key messages



Global growth is likely to stabilize at relatively lower levels than in previous years. A new round of policy stimulus, in particular by the Fed and the ECB, is expected to offset the impact of protracted trade tensions.



The Spanish economy is expected to continue showing a recovery, although the slowdown will continue. GDP growth for 2019 is moderately revised up to 2,3%, while that of 2020 remains at 1.9%.



The performance of the Spanish economy in the first half of the year has been better than expected due to a one-off improvement in the contribution of external demand. Despite the negative surprises in the evolution of domestic demand, specially in private consumption, public spending, and in exports, investment surprised positively.



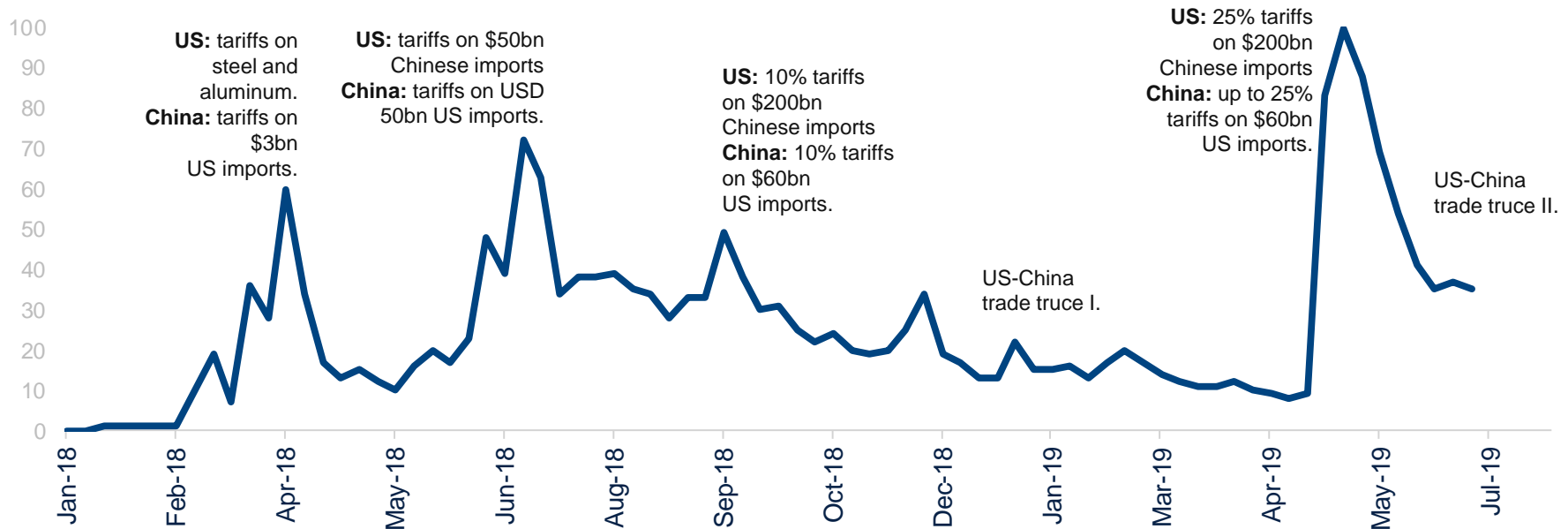
The expansionary monetary policy and the reduction of the risk premium will support growth. There is uncertainty about the impact of the ECB's measures on growth and the policies that will be implemented in Spain. A consensus is needed on the reforms needed to reverse the slowdown and increase potential growth.

# 01

## Global Outlook 3Q19

# The protectionist escalation remains a source of global uncertainty, even after the most recent US-China trade truce

## TRADE WAR INDEX: WORLDWIDE GOOGLE SEARCHES ABOUT THE TOPIC “TRADE WAR” (INDEX: 0 TO 100)



# In financial markets, a flight to safety

## SOVEREIGN DEBT YIELDS

(%)

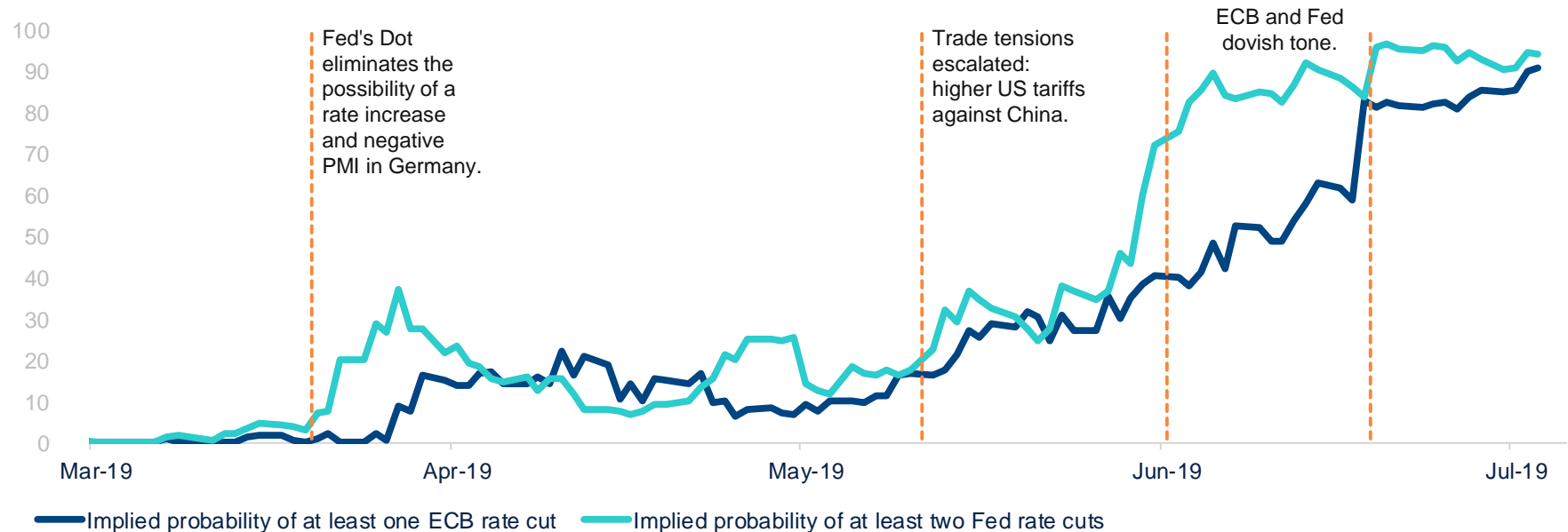


- Growth risks and trade tensions led bond yields to very low levels.
- U-turn by the Fed and the ECB triggered search for yield and gains in periphery markets...
- ...but no signs of risk-on mood.

# With persistent uncertainty and low inflation, central banks have reassessed their monetary policy stance and consider implementing new measures

## PROBABILITY OF RATE CUTS BY THE FED AND THE ECB, ACCORDING TO FINANCIAL MARKETS

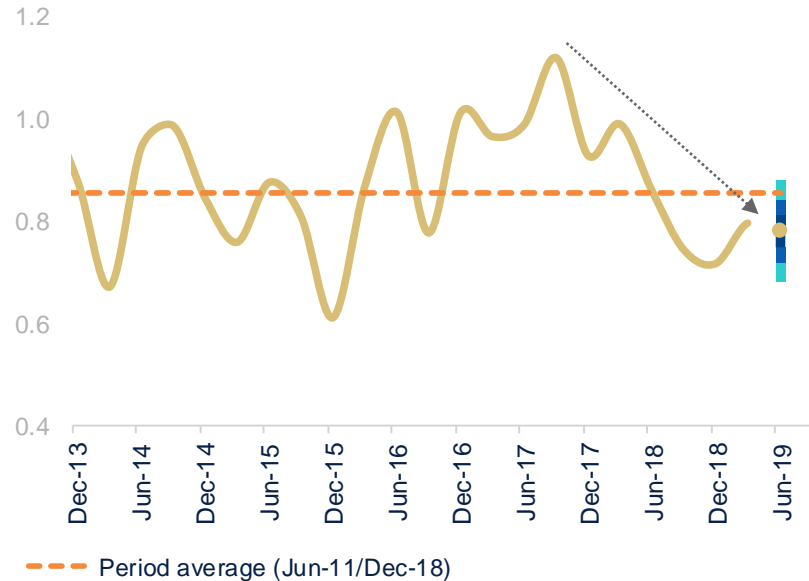
(%)



# Global growth continues on a soft downward path, despite a rebound in the first quarter

## WORLD GDP GROWTH

(FORECASTS BASED ON BBVA-GAIN; % QOQ)



- Growth has been particularly low since the middle of 2018.
- Weak performance of exports and manufacturing.
- 1Q19 growth was higher than expected, while prospects for 2Q19 are broadly unchanged.

# Looking ahead, policy stimulus is expected to offset the effect of protracted trade tensions



## High trade tensions

- Irreversible damage has already been done.
- Strategic rivalry is here to stay.
- Lingering uncertainty to weigh on business decisions.



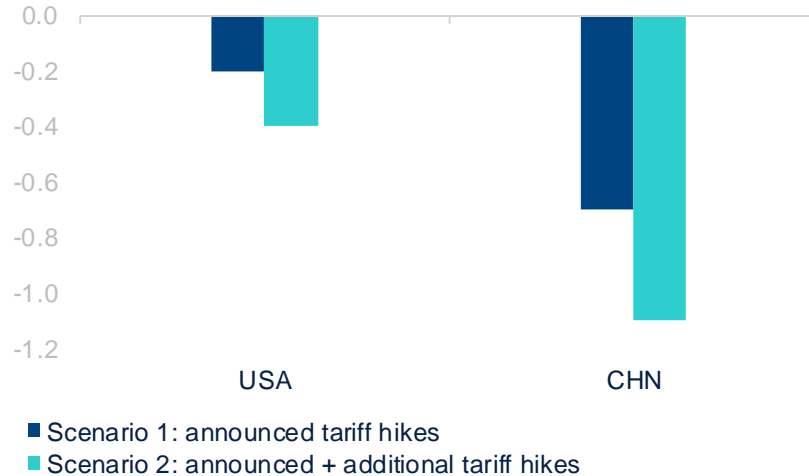
## Further policy stimulus

- FED and ECB: rate cuts in the short-term.
- China: further stimulus expected.
- Financial tensions will likely remain under control.
- Declining oil prices.



# Trade tensions will have a negative effect on global growth

## IMPACT ON GDP LEVEL OF TWO TRADE WAR SCENARIOS ON THE US AND CHINA (TWO YEARS, PP)



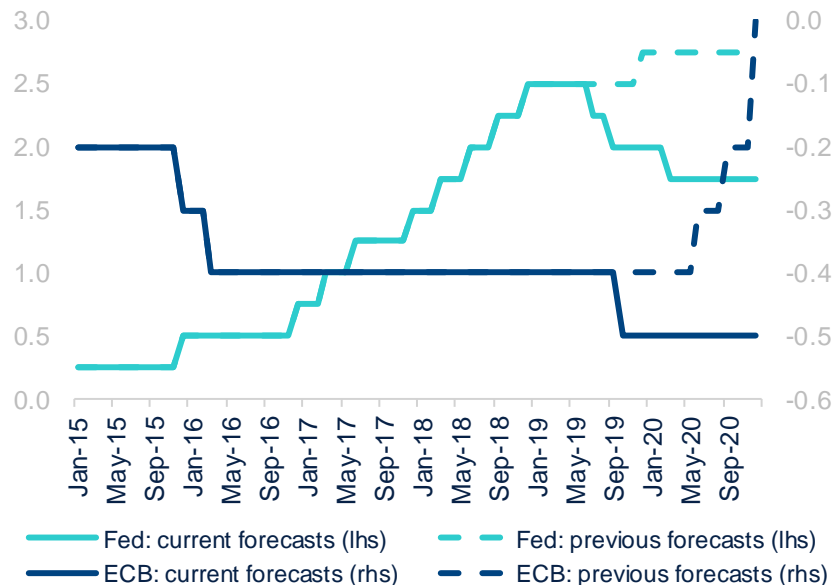
**Scenario 1:** Approved: 25% tariff increase on steel, 10% on aluminum, 25% on Chinese USD250bn imports. China's retaliation: 25% on USD110bn on US imports.  
**Scenario 2:** All Chinese imports: Previous simulation +25% on all Chinese imports (more than USD500bn). China's retaliation: 25% on USD130bn on US imports.  
 Source: BBVA Research

- Particularly negative effects of the trade war on China...
- ... but US and other countries will also be hit.
- Data show that trade tensions are already driving growth down.

# The policy reaction to a more negative global environment will continue to be led by central banks

## FED AND ECB: INTEREST RATES (\*)

(%, END OF PERIOD)

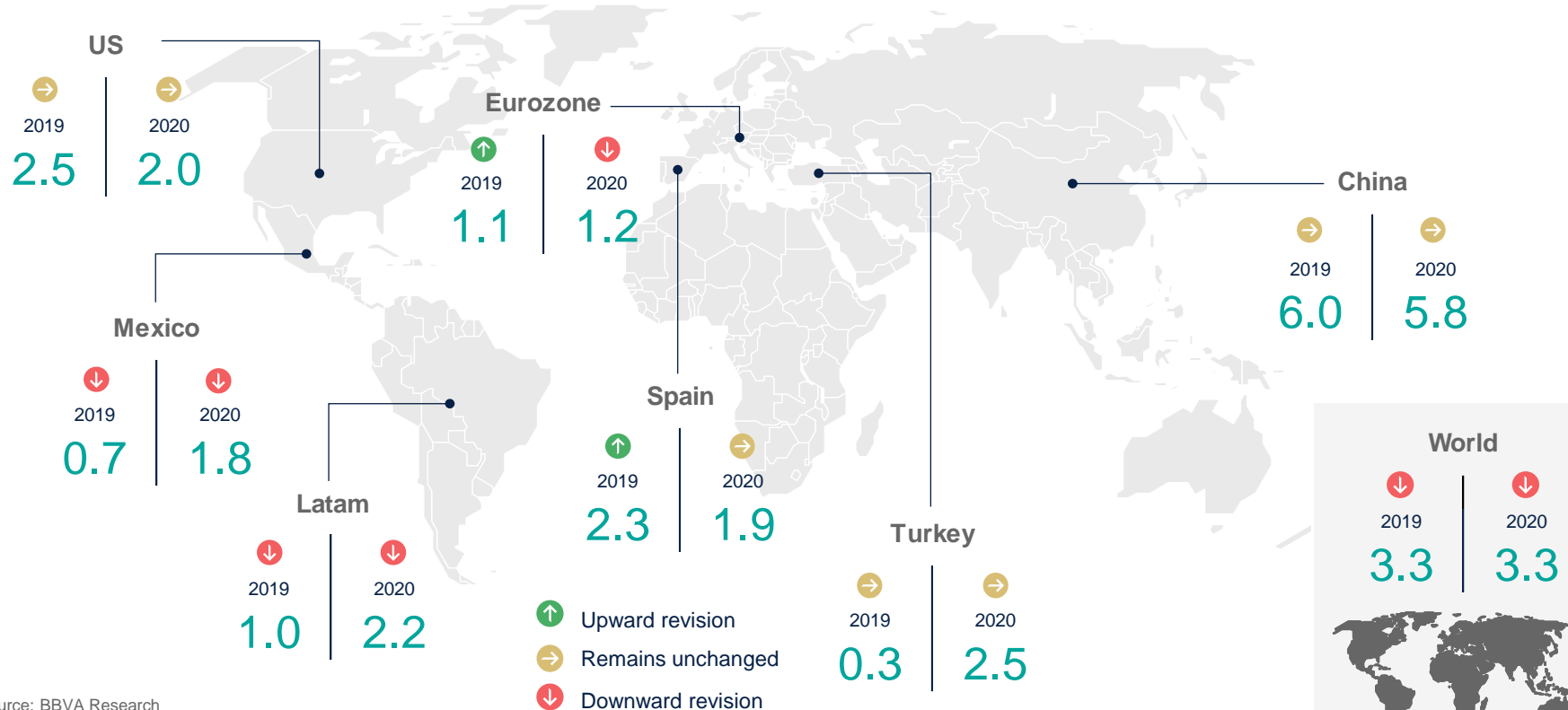


- Growth risks and low inflation set the stage for lower rates for longer.
- Fed: up to 75bps rate cuts.
- ECB is now expected to:
  - Cut depo rates by 10bps in 3Q19.
  - Adopt a tiered deposit system.
  - Strengthen forward guidance.
- In China, fiscal policy will also play a role in the effort to sustain growth.

(\*) In the case of the ECB, deposits interest rates.

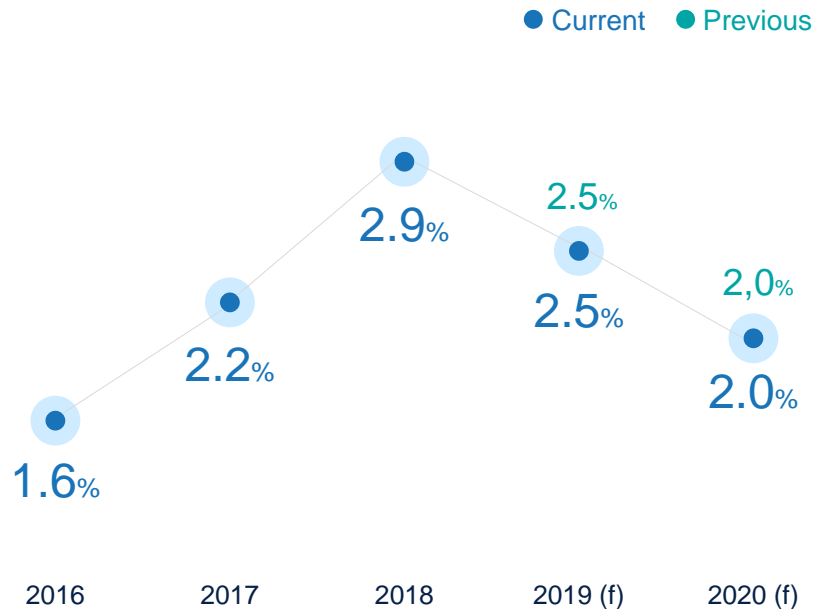
Source: BBVA Research

# Global growth will stabilize at relatively lower levels



# US: growth to slow down, with larger than previously expected support by the Fed

## GDP GROWTH (%)

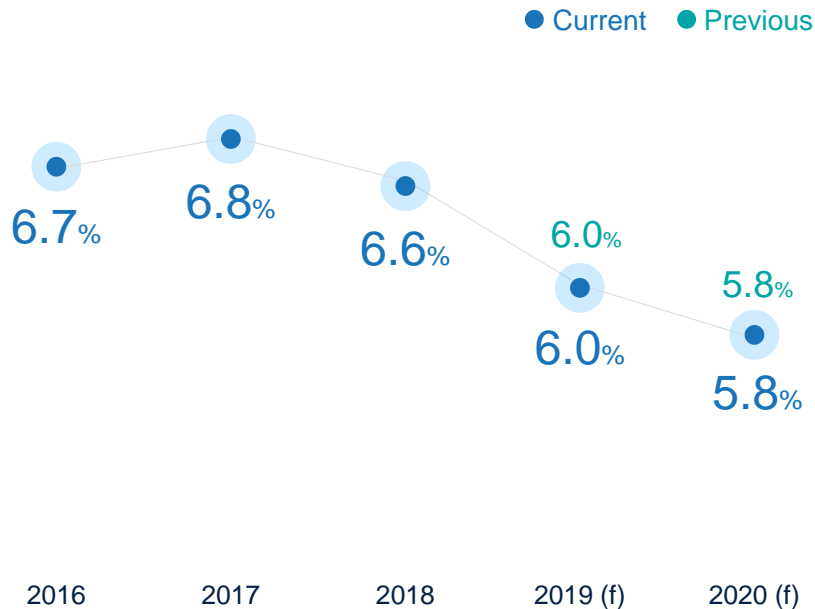


- GDP growth will trend closer to potential moving forward.
- Core inflation is expected to remain below Fed's 2% target.
- Probability of recession remains high, tilting risks to the downside.

# China: further policy measures to counterweight headwinds from trade tensions

## GDP GROWTH

(%)

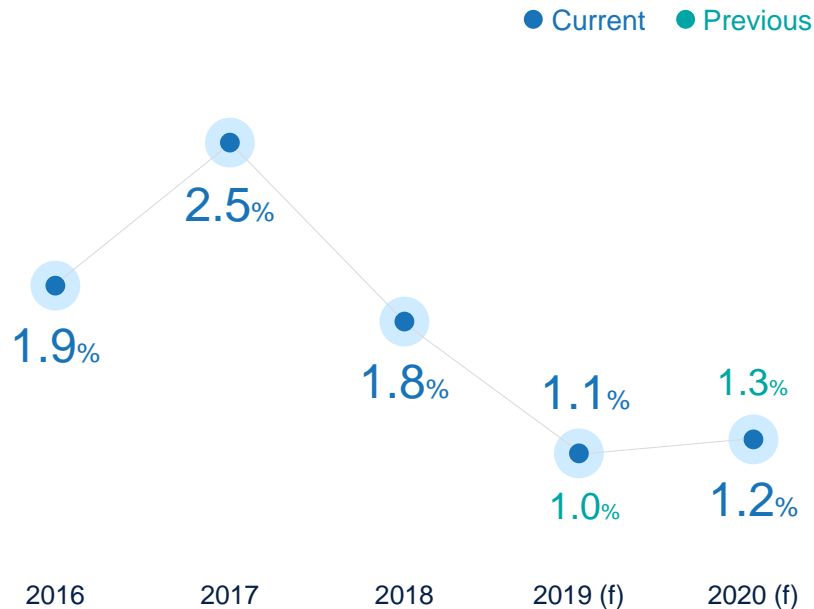


- More stimulative measures:
  - debt issuance by local governments.
  - targeted monetary stimulus.
  - increase in public deficit.
- Better outlook for consumption, than for exports and investment.
- Risks: trade war, growth hard-landing and disorderly deleveraging.

# Eurozone: softer growth due to the persistence of both manufacturing weakness and uncertainty

## GDP GROWTH

(%)

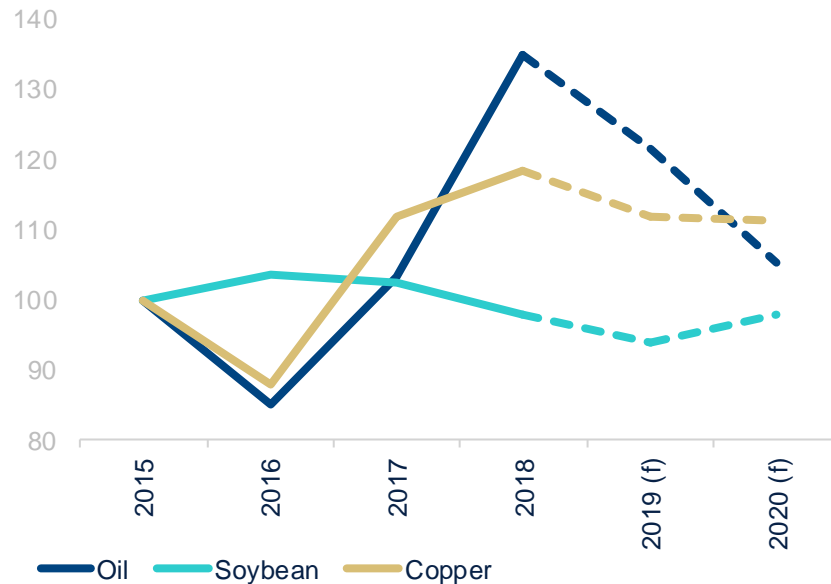


- Uncertainty remains high due to trade issues, *brexit* and Italy.
- Monetary policy to support mainly domestic demand.
- Slightly expansive fiscal policy.
- A gradual increase of core inflation is still expected.

# A more negative global environment weighs on commodity prices

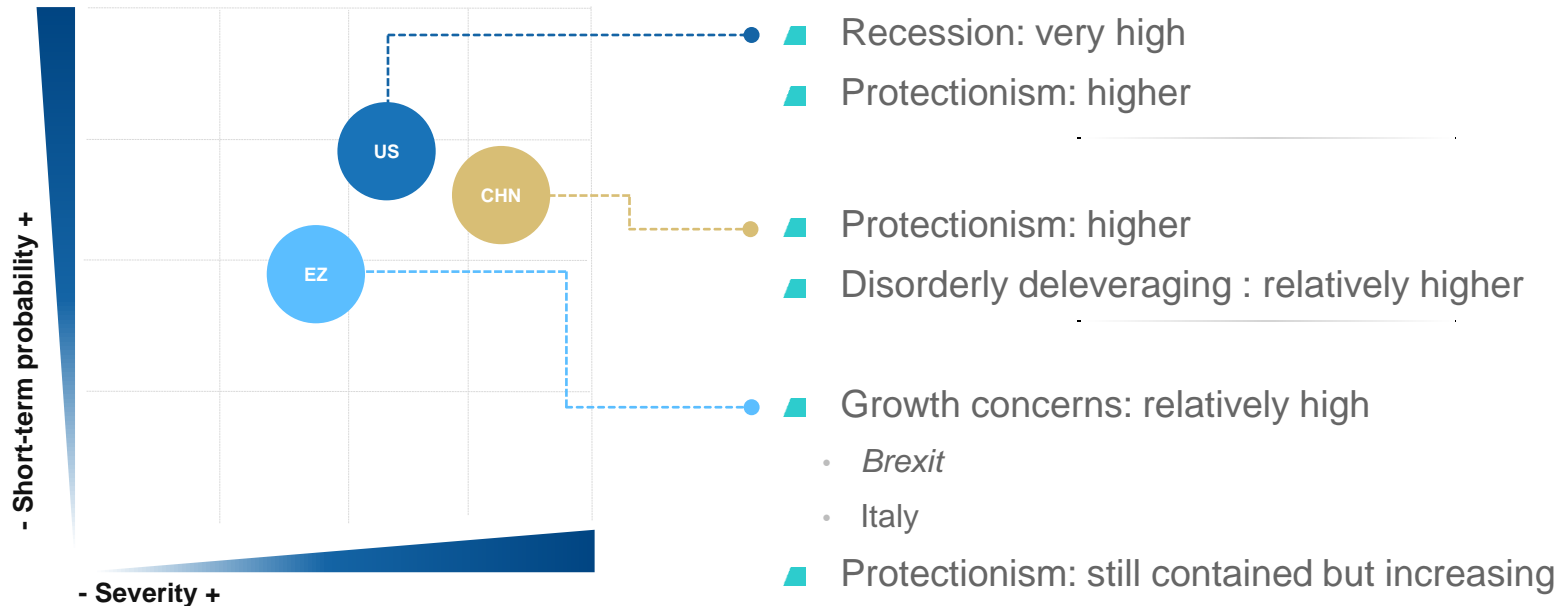
## COMMODITIES: ANNUAL AVERAGE PRICES

(INDEX: 2015 AVERAGE = 100)



- Uncertainty and weaker global growth will affect prices negatively.
- Rising US shale production will help to keep oil prices limited, despite output cuts and supply disruptions.
- Soybean forecasts revised down; but price increases are still expected.
- Price stability for copper; demand for electric cars will be supportive in the medium/long run.

# Global risks: moving upwards on the back of a full-scale trade war, especially given its potential impact on China



Source: BBVA Research

U.S.-China trade war: high risk and high probability of non-resolution.  
Financial vulnerabilities can amplify the severity of the risks.



02

# Spain Outlook 3Q19

# The evolution of the economy suggest growth will be stronger than expected three months ago



2018  
**2.6%**

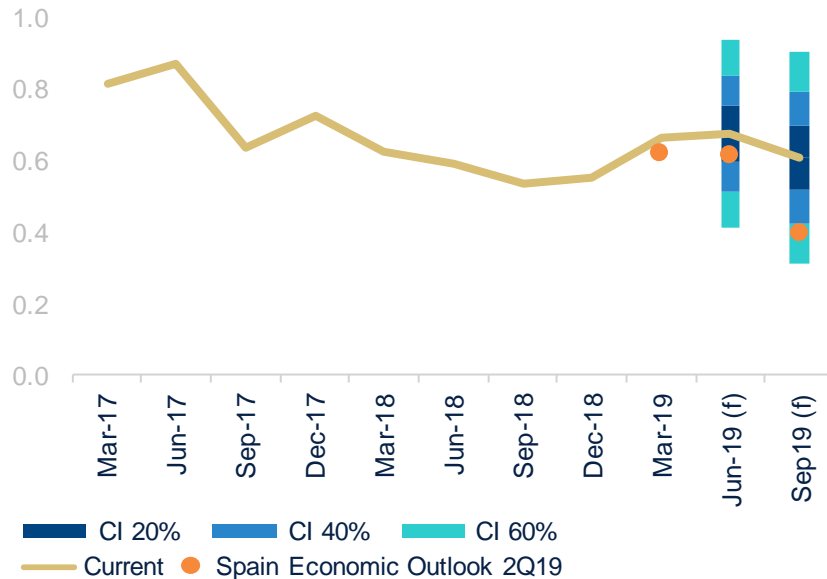
2019  
**2.3%**

2020  
**1.9%**

+0.1pp

# Somewhat stronger than expected GDP growth

## SPAIN: GDP GROWTH (FORECAST BY MICA-BBVA. % QOQ)

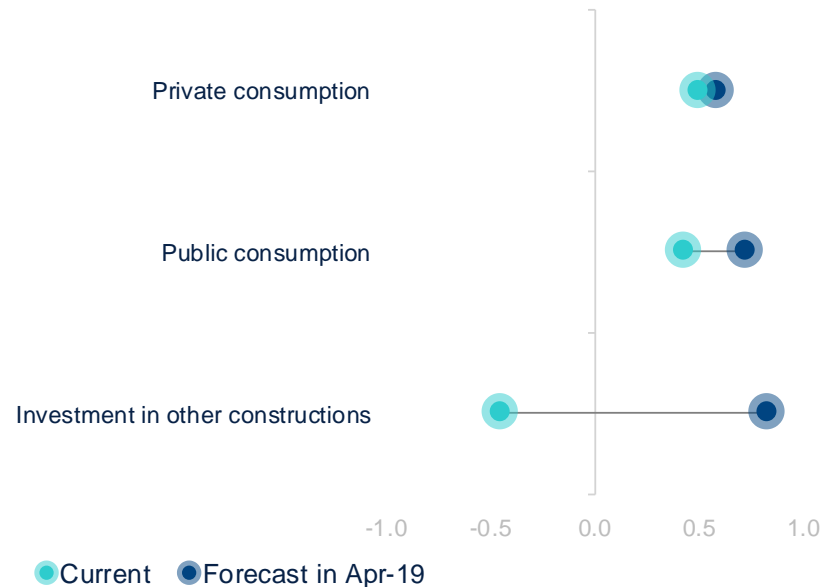


- Growth is estimated to have been 0,7% QoQ on average in the first semester of 2019, somewhat above the rate expected by BBVA Research (0.6%).
- Furthermore, BBVA Research estimates the economy is growing in 3Q19 at 0,5%-0,7% QoQ.
- The differential with respect to the European economy remains positive, as the latter grew at 0.3% QoQ in 1S19.

## Somewhat stronger than expected GDP growth

The composition was atypical, with a smaller contribution from domestic demand

### SPAIN: DEVELOPMENTS IN GDP (% QOQ AVERAGE 1Q19-2Q19)



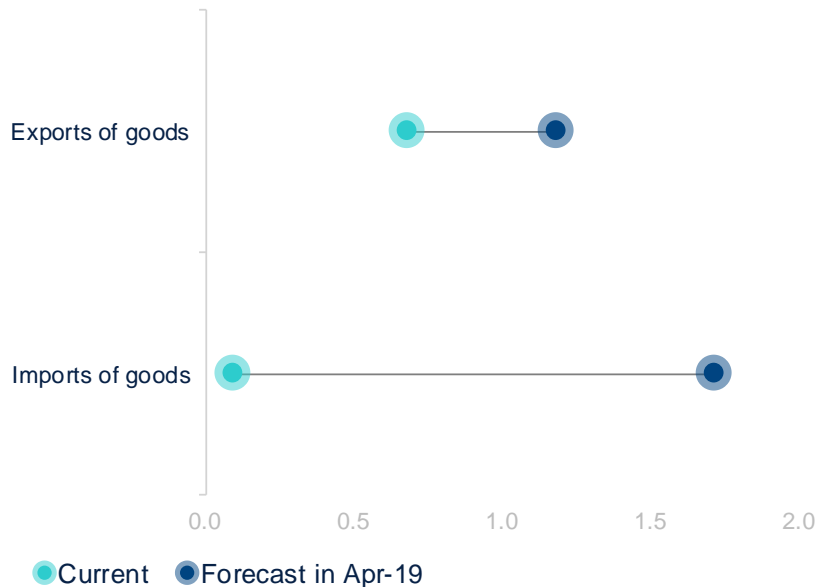
- The end of the impulse from pent up demand, the lower effect of expansionary monetary policy, greater uncertainty and the recent increase in savings will dent household consumption growth.
- Fiscal policy was less expansionary than expected in the electoral context.

# Somewhat stronger than expected GDP growth

Lower external demand, but with a greater impact on imports

## SPAIN: DEVELOPMENTS IN GDP COMPONENTS

(% QOQ AVERAGE 1Q19-2Q19)



- Uncertainty regarding the increases in tariffs or regulatory changes affects the functioning of global value chains.
- Much of the worst performance of domestic expenditure and foreign sales has been concentrated in **imports**, thus limiting the negative effect on domestic output.
- This atypical growth pattern (lower external and domestic demand, with a decline in imports) could be due to temporary factors.

# 2019-2020: Slowing growth, but the recovery will continue



## Global growth

Global growth remains stable. Sales to the EU are recovering, in a context of a solid advance in European domestic demand.



## Expansionary monetary policy

Monetary policy will support growth. Rates will remain low for a longer period of time. Consumption will increase, the expected return on investment will improve and credit will be stimulated.



## No domestic imbalances

There are no inflationary pressures, no imbalances in the labor market, and no significant deterioration of the current account.

Domestic investment remains solid.



## Slowdown trend

The stimuli that have boosted household expenditure growth are diminishing.



## Uncertainty regarding the global outlook

Trade flows and investment in M&E will recover, but at a slower pace than without uncertainty. The automobile sector seems to be facing a structural change.



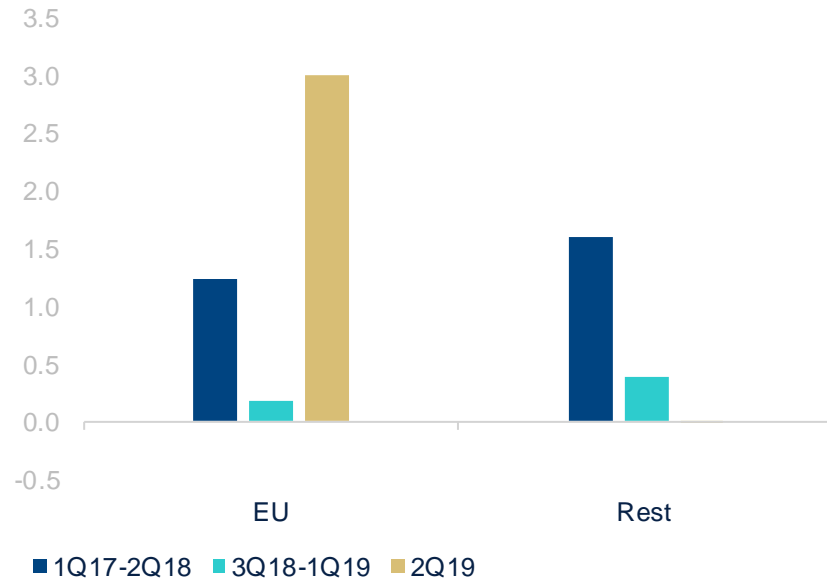
## Uncertainty regarding domestic policy

Exhaustion of the fiscal impulse. Unclear effects of regulation in the real estate sector or with respect to the increase of the minimum wage.

# The recovery will continue, although the slowdown will persist

## European demand seems to show an turning point

### EXPORTS OF GOODS BY DESTINATION (SWDA, PERIOD AVERAGE, % QOQ)



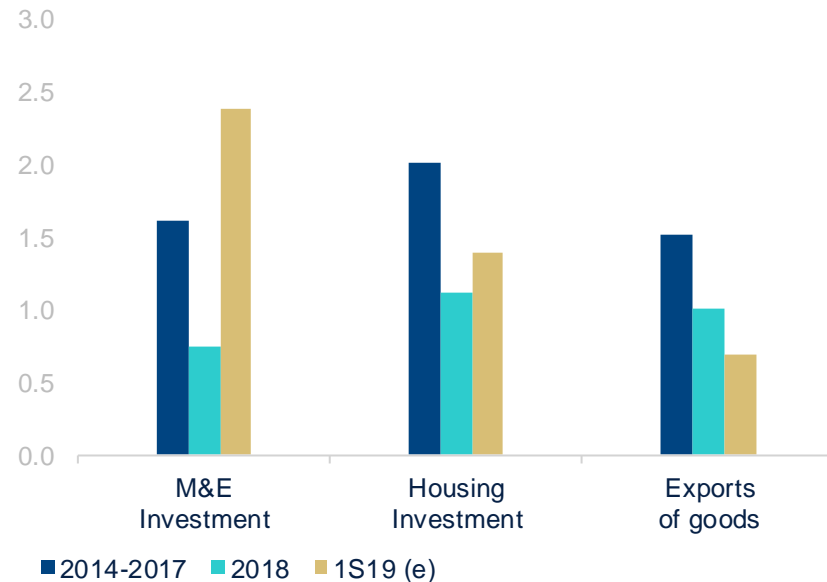
- The foreign demand for Spanish goods may be starting to grow again, although the intensity is heterogeneous across destination countries.
- A gradual decline in uncertainty regarding tariffs is expected, which would normalize the functioning of global value chains.
- The stimuli in the Euro area and China will promote growth in the sales of non durable goods.

# The recovery will continue, although the slowdown will persist

Investment remains strong, and tourism proves resilient

## SPAIN: DEVELOPMENTS IN GDP COMPONENTS

(%, QOQ AVERAGE)



- Some components of investment like machinery and equipment, and tourism spending showed relatively solid growth.
- The increase in spending in machinery and equipment is consistent with increases in Spain's global market share in the coming quarters.
- Tourism has evolved better than expected in a context of greater competition from other destinations. The slowdown persists.

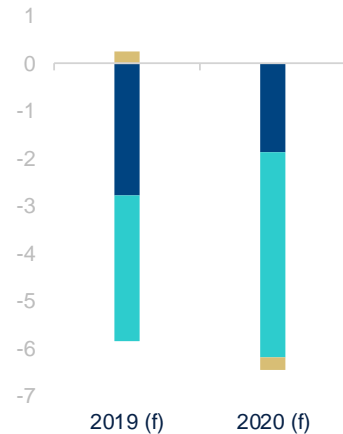


# The recovery will continue, although the slowdown will persist

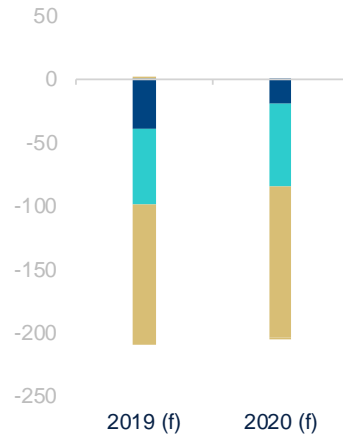
Monetary policy stimulates growth

## Change in BBVA Research forecasts

### EXCHANGE RATE €/€/\$ (%)



### LONG TERM INTEREST RATE (BP)



■ Variation Oct-18/Jan-19 ■ Variation Jan-19/Apr-19 ■ Variation Apr-19/Jul-19

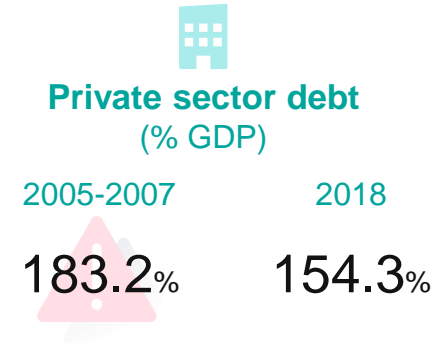
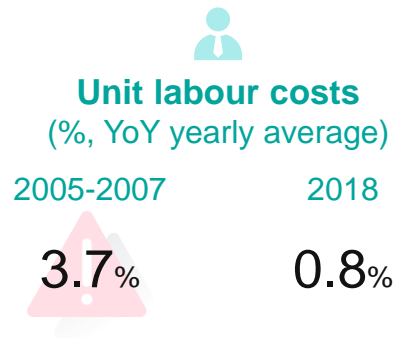
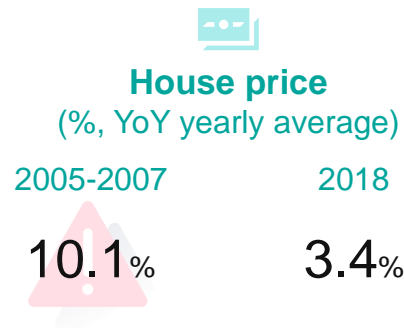
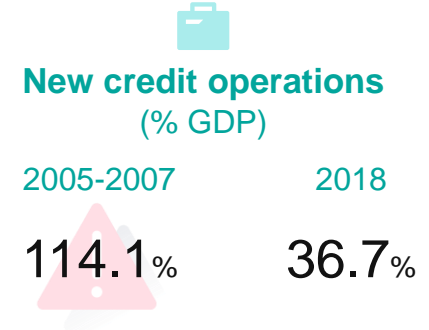
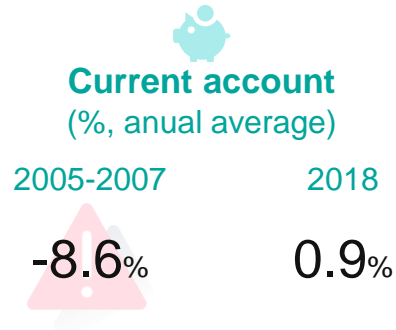
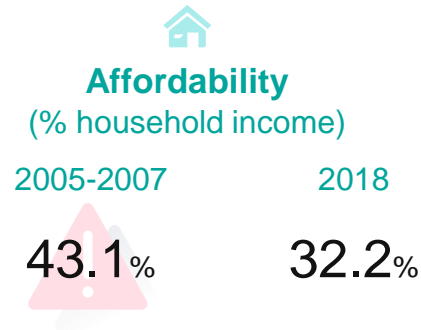
(f) forecast.

Source: BBVA Research

- Financial conditions will have a positive effect on spending decisions.
- Monetary policy will be expansionary for a longer period. No rate hike is expected in the coming 18 months.
- The positive impact on activity will be due to the certainty regarding low financing costs and the stability of the exchange rate.

# The recovery will continue, although the slowdown will persist

No signs of significant imbalances

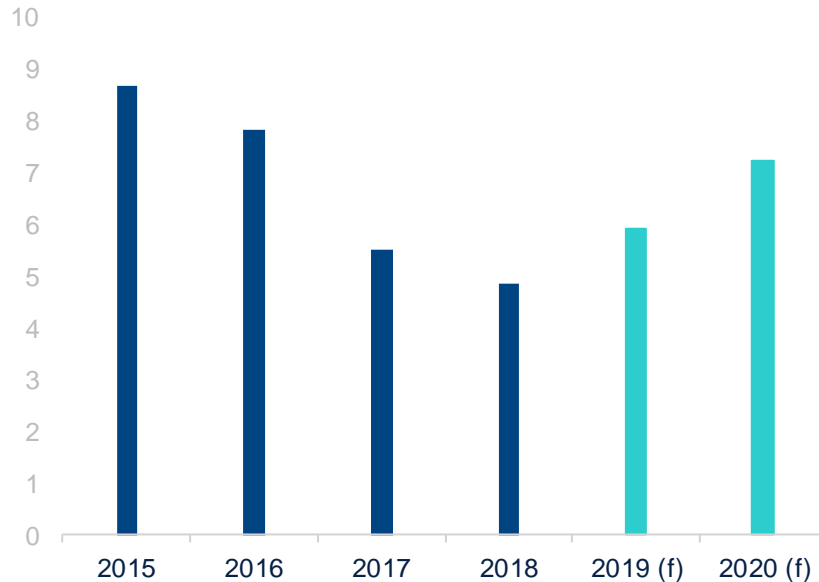


# The recovery will continue, although the slowdown will persist

The decline in the savings rate may have ended

## SPAIN: HOUSEHOLD SAVINGS RATE

(% GDI)



(f) forecast.

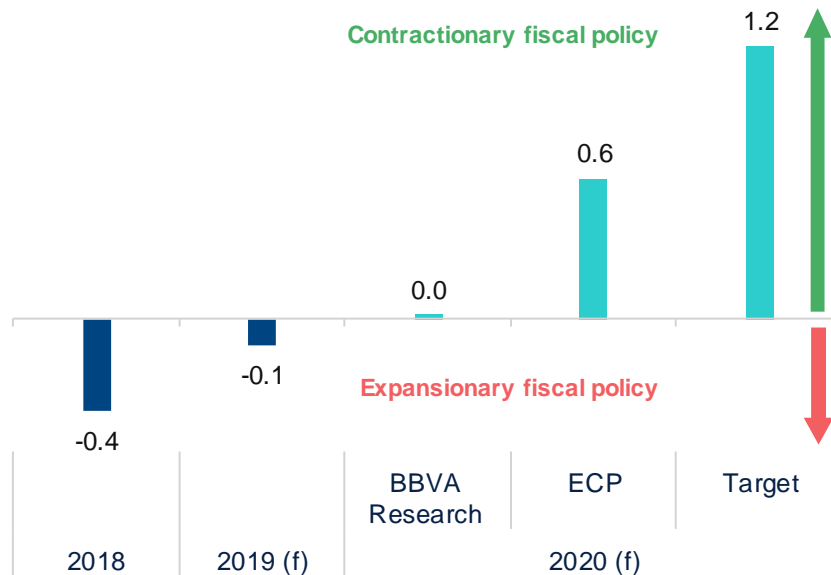
Source: BBVA Research, INE

- The latest data show a recovery in the savings rate after falling to the lowest level in 50 years.
- Structural factors such as the aging of the population, and short-term factors related to the greater uncertainty about economic policy will push savings upwards.
- The incipient rise in wages and the increase observed in public transfers mean income growth could be concentrated in households with a lower marginal propensity to consume.

# The recovery will continue, although the slowdown will persist

The fiscal policy stance changes gradually

## SPAIN: CHANGE IN STRUCTURAL PRIMARY BALANCE (% GDP)



(f) forecast.

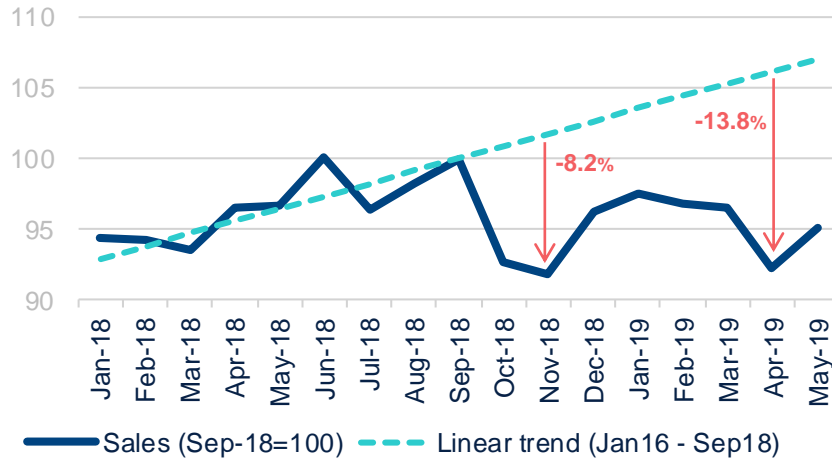
Source: BBVA Research, Finance Ministry

- The absence of a boost in spending during the first part of the year, despite the electoral cycle, is positive and may be a consequence of the institutional improvements implemented.
- In the absence of a budget for 2019, the transition to new local and regional governments could slow decision-making down and change the fiscal policy stance in 2S19.
- To achieve the stability target, the 2020 budget should include contractionary fiscal policy.

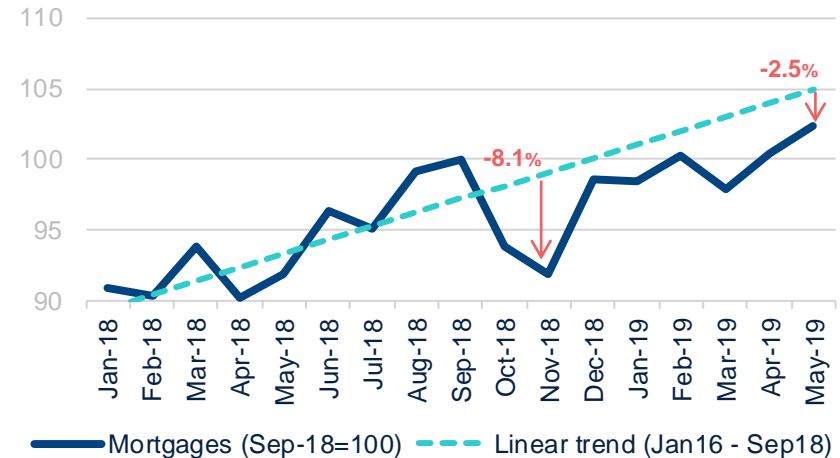
# The recovery will continue, although the slowdown will persist

## Uncertainty affects the real estate sector

### SPAIN: HOME SALES (SWDA)



### SPAIN: MORTGAGES (SWDA)



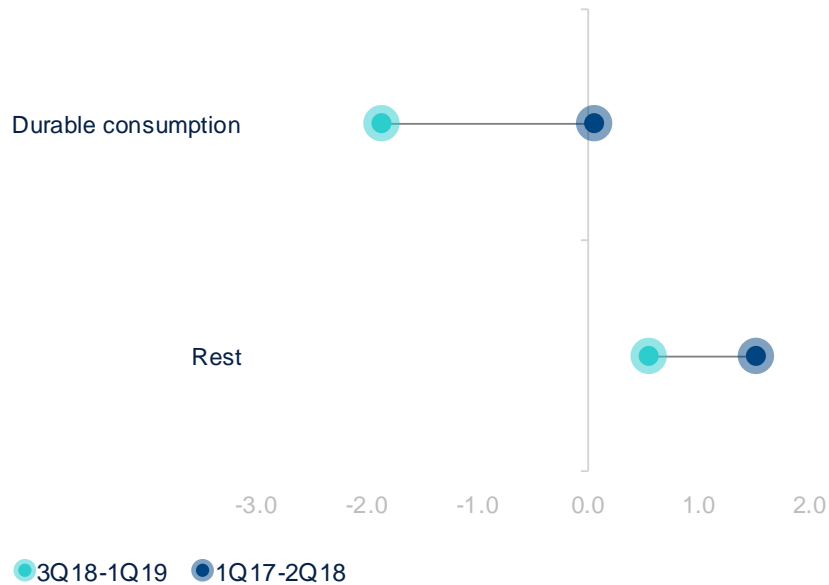
Source: BBVA Research, CIEN

The recovery of employment and the persistence of low interest rates for a longer time will act as a counterbalance. The growth of housing investment will remain strong.

# The recovery will continue, although the slowdown will persist

## Tensions in the automotive sector remain

### GOODS EXPORTS BY TYPE (CURRENT PRICES SWDA, % QOQ)



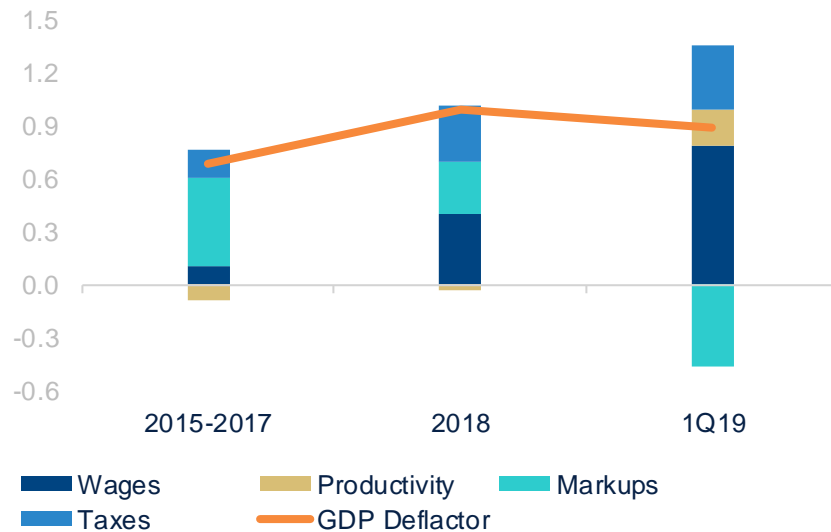
- Much of the lower dynamism of exports of goods has to do with the uncertainty that the automotive sector is experiencing.
- Both regulatory changes, as well as long-term trends and tensions related to trade conflicts, will continue to bias demand downward.

# The recovery will continue, although the slowdown will persist

Margins absorb part of the increase in the minimum wage

## SPAIN: CONTRIBUTIONS TO GROWTH OF GDP DEFLATOR (PP)

(PP)

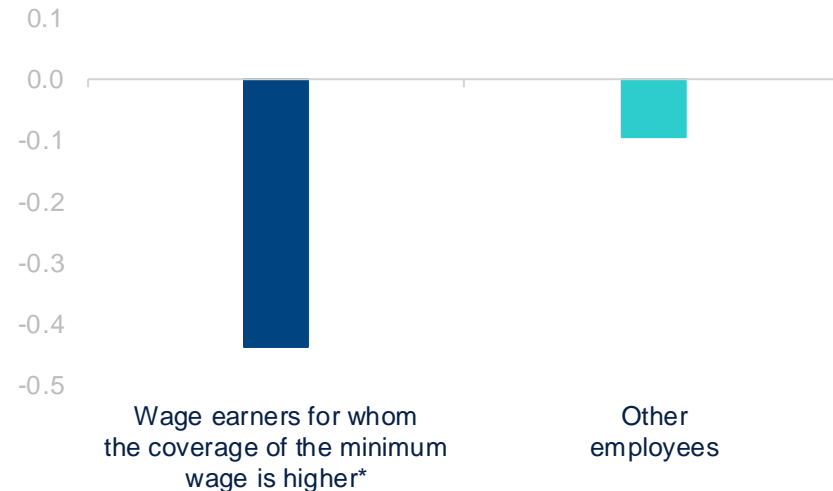


- More evidence and time is needed to make a complete analysis of the effects of the increase in the minimum wage.
- One of the fundamental factors in determining the impact on employment is whether companies could absorb it through a reduction in margins.
- The evidence suggests that, in the short term, this has occurred, which has limited the negative effect on the creation of jobs.

# The recovery will continue, although the slowdown will persist

The short term impact has been limited

## SOCIAL SECURITY REGISTRATIONS: DIFFERENCE IN THE BIANUNAL CHANGE IN 1S19 AND AVERAGE 1S17-1S18 (%)



\* Under 30, commerce, hotels and restaurants, real estate activities, professional, administrative and artistic activities and other services. Canarias, Extremadura, Andalucía y Murcia.  
Source: BBVA Research, MITRAMISS

- Employment creation has slowed down for workers under 30 years of age and in the sectors or regions with the highest coverage of the SMI (compared to what was observed in 2017 and 2018).
- The slowdown in job creation in the rest of the groups would be practically non-existent (between 0 and 0.1).
- This behavior is consistent with a limited impact of the increase of the SMI on job creation, in line with that estimated by BBVA Research: between 20 and 75 thousand jobs during 2019.



# Many risks remain and the probability of occurrence of some is rising

## Global

01

### Trade tensions

High uncertainty about the resolution of tensions between US and China, as well as *brexit*, after the extension agreed with the EU. Heterogeneous effects by region.

02

### Low growth environment

China continues to decelerate, while the probability of recession in the US remains high and increases in Europe.

## Idiosyncratic

03

### Depletion of monetary policy

Part of the reduction of rates has already been priced in. Uncertainty about the effect that ECB measures may have on credit and financing costs.

04

### Capacity restrictions in some sectors

Demand has been reduced in some key sectors (automotive, tourism). Others may be suffering from capacity constraints, the depletion of the effects of the reforms and a lower potential growth.

05

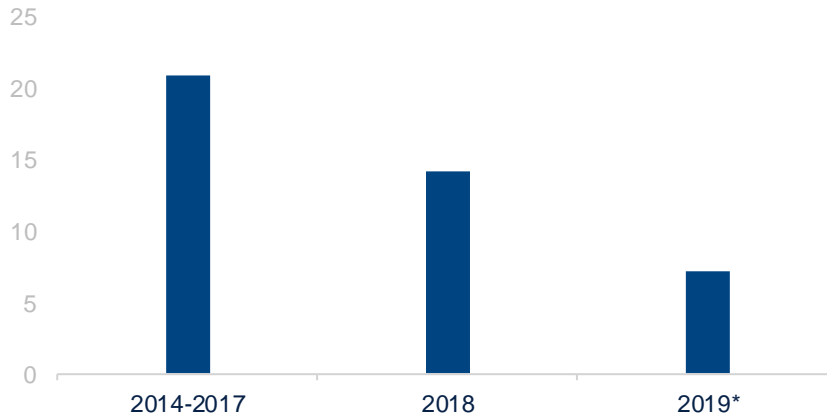
### Uncertainty regarding economic policy

Uncertainty on the fiscal policy stance the coming years. The impact on some of the approved measures remains unknown. A consensus is needed around measures that can reverse the deceleration trend.

# A slowdown in GDP remains in the Outlook

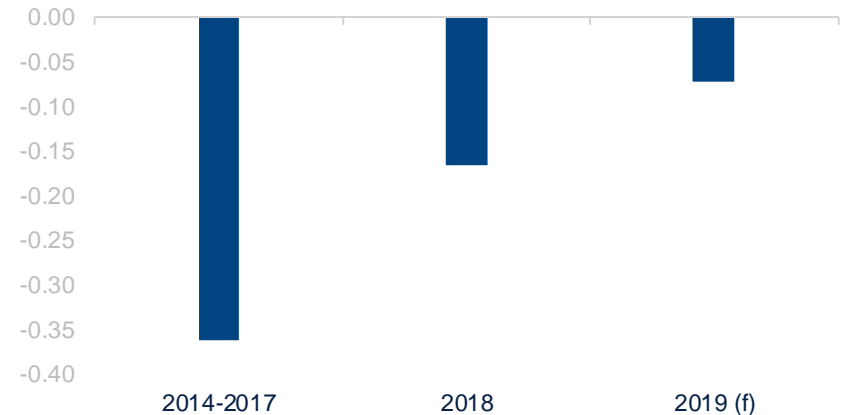
## The effect of monetary policy diminishes

**SPAIN: NEW OPERATIONS CONSUMER FINANCE**  
(%YOY GROWTH , AVERAGE)



\* Up to May.  
(f) forecast.  
Source: BBVA Research, BdE

**SPAIN: CHANGE IN INTEREST RATE ON NEW OPERATIONS**  
(%, YEARLY AVERAGE)



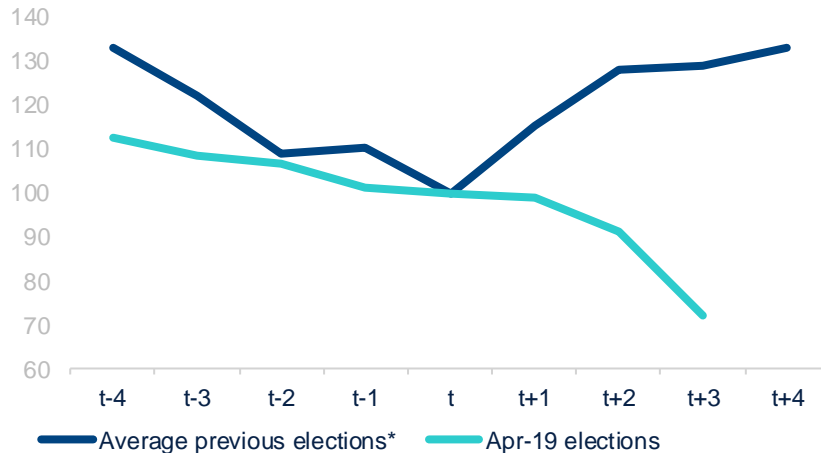
There is uncertainty about the effect that the new measures announced by the ECB may have on the growth of credit or on the cost of financing.

# A slowdown in GDP remains in the Outlook

The effects of uncertainty have been limited

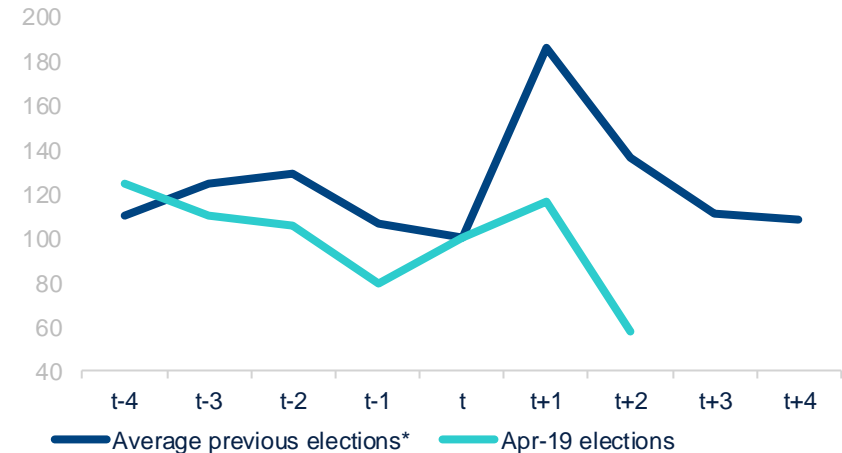
## SPAIN: RISK PREMIUM

(AVERAGE Q: APR-15, NOV-15, APR-18=100 AND MAR-19 =100)



## SPAIN: ECONOMIC POLICY UNCERTAINTY INDEX

(AVERAGE Q: APR-15, NOV-15, APR-18=100 AND MAR-19 =100)



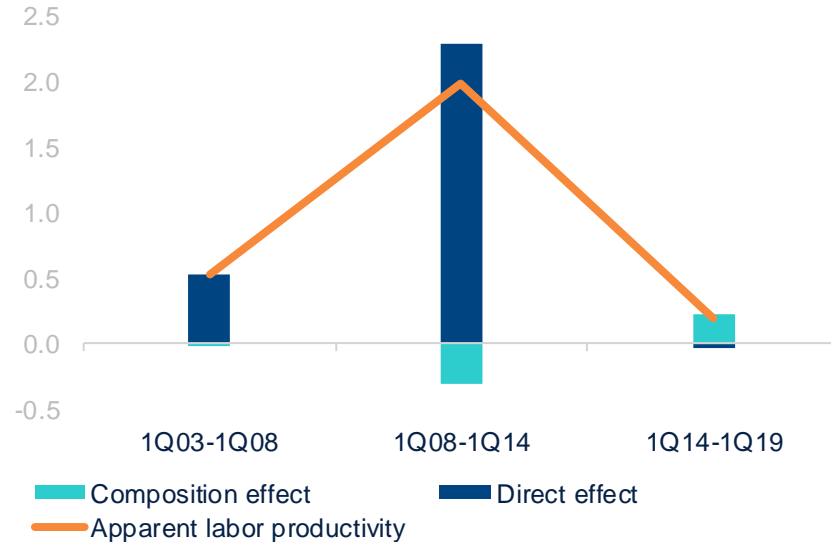
t=month before the elections in may-15\*, dic-15\*, apr-19 and vote of no confidence may-18\*.  
Source: BBVA Research, Bloomberg and Baker et al (2016)

There has not been an increase in the risk premium or a significant increase in uncertainty, in part thanks to the more expansionary stance of the ECB.

# Challenges to avoid the structural slowdown

## Increasing worker productivity

### SPAIN: AVERAGE PRODUCTIVITY PER HOUR WORKED\* (%)

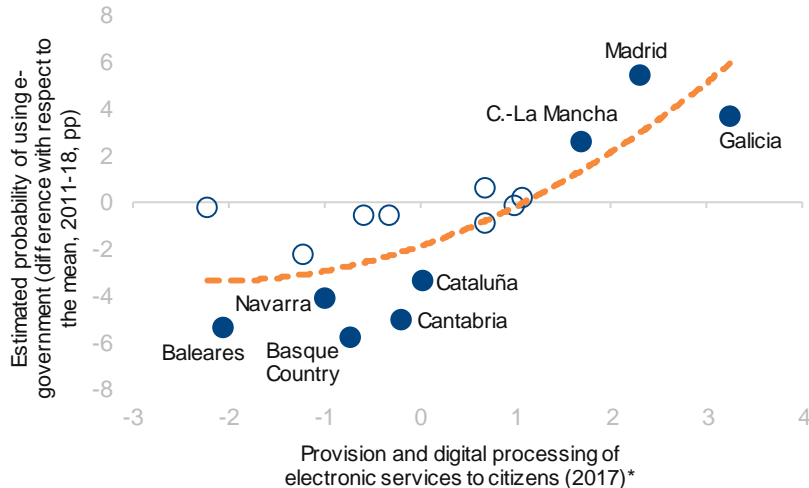


- The improvements in productivity observed since the beginning of the recovery are due to changes in the sector composition of employment and hours worked and a heterogeneous evolution of prices in each branch of activity, and not to real improvements in productivity.
- Reforms are needed to improve the training of workers, reduce the segmentation of the labor market and favor the growth of the size of companies.

# Challenges to avoid the structural slowdown

## Moving towards more digital governments

### CC. AA.: ESTIMATED PROBABILITY OF USING E-GOVERNMENT AND PROVISION AND DIGITAL PROCESSING OF ELECTRONIC SERVICES TO CITIZENS



Principal component of the indicators of citizen-centred services offered by CC.AA. (accessibility, availability to other EU citizens and existence of support and assistance functionalities) and of progress in the digital processing of these services.

For more information: <https://bit.ly/2NUhYq7>

Source: BBVA Research, Ministry of Territorial Policy and Civil Service

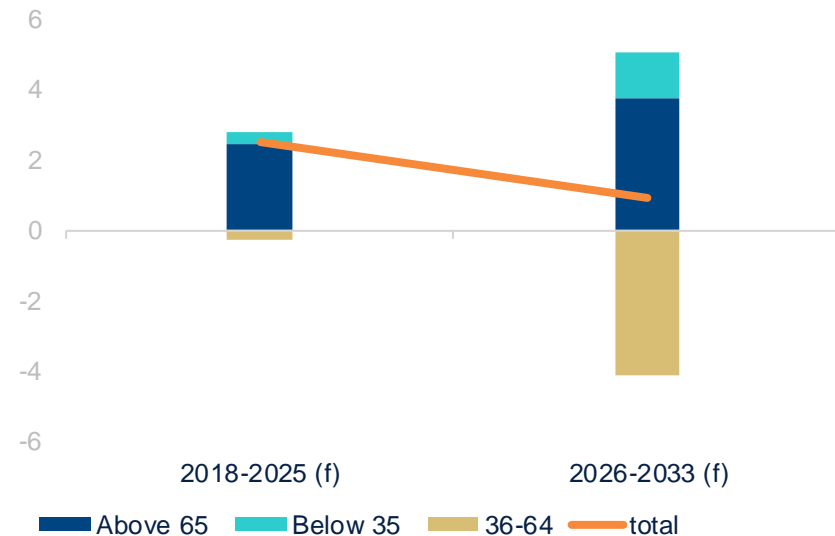
- The use of electronic administration is greater in Spain (65% of the Internet user population) than the EU average (60%).
- In order to advance in the digitalization of public services, it would be desirable to get the public sector more involved in the improvement of digital skills, optimize contact channels, expand the number of procedures that can be carried out through the Internet, increase investment in technological infrastructures and expand the provision of coverage of new generation broadband networks.

# Challenges to avoid the structural slowdown

## Counter population aging

### CONSUMPTION GROWTH AND CONTRIBUTIONS BY AGE GROUP (%)

(%)



- The next few years there will be a substantial aging of the Spanish population, causing changes in the pattern of household consumption.
- The population in age group 35-64, which tends to have a relatively high per capita consumption, will become less relevant in the population as a whole, limiting the scope for an acceleration of consumption.

(f) forecast

Source: BBVA Research and INE

## Key messages



Global growth is likely to stabilize at relatively lower levels than in previous years. A new round of policy stimulus, in particular by the Fed and the ECB, is expected to offset the impact of protracted trade tensions.



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The expansionary monetary policy and the reduction of the risk premium will support growth. There is uncertainty about the impact of the ECB's measures on growth and the policies that will be implemented in Spain. A consensus is needed on the reforms needed to reverse the slowdown and increase potential growth.

# 03

# Forecasts



# Forecasts

The recovery will continue, although the slow down will persist

% a/a	2018	2019 (f)	2020 (f)
Final Consumption Expenditure	2.3	1.8	1.7
Private Consumption	2.3	1.8	1.7
Public Consumption	2.1	1.8	1.7
Gross Fixed Capital Formation	5.3	3.1	3.4
Machinery and Equipment	5.4	3.9	3.0
Construction	6.2	3.1	3.5
Housing	6.9	3.9	3.8
Other	5.5	2.3	3.0
<b>Domestic demand (*)</b>	<b>2.9</b>	<b>2.0</b>	<b>2.1</b>
<b>Exports</b>	2.3	1.7	3.5
Exports of goods	1.8	0.5	3.6
Exports of services	3.3	4.5	3.0
All services except tourism	4.5	4.8	3.7
Financial consumption of non-residents	1.7	4.1	2.1
<b>Imports</b>	3.5	0.8	4.1
<b>External demand (*)</b>	<b>-0.3</b>	<b>0.3</b>	<b>-0.1</b>
<b>Real GDP (market prices)</b>	<b>2.6</b>	<b>2.3</b>	<b>1.9</b>

(\*) Contribution to GDP growth.

(f) forecast.

Source: BBVA Research, INE and Bank of Spain

# Spain Outlook

3Q19

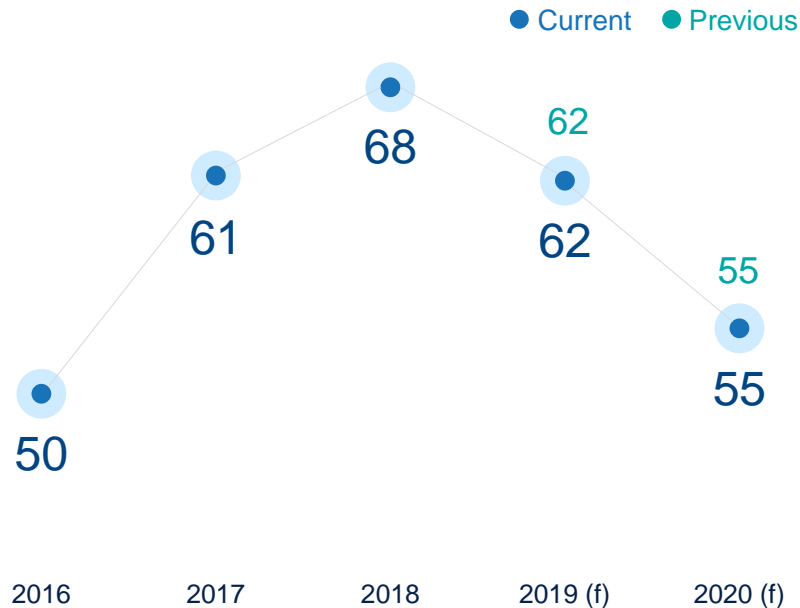
# Annex

# The recovery will continue, although the slowdown will persist

## Oil prices will support competitiveness

### OIL PRICES

(USD PER BARREL)

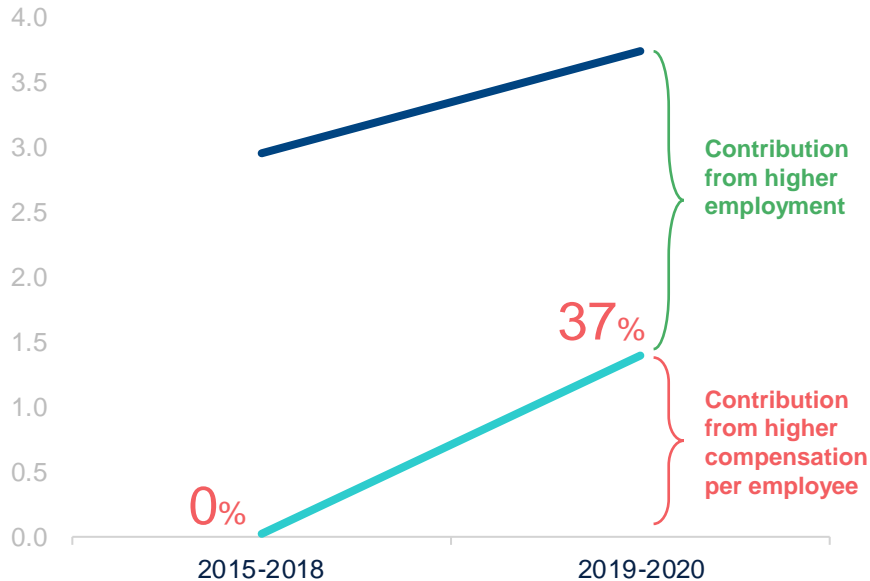


- Oil demand will be affected by weaker global growth, while increased US production will help keep prices low.
- OPEC commitment to output cuts and supply disruptions to provide some support to prices.
- The fall in the cost of fuel should support the improvement of the competitiveness of Spanish companies.

# The recovery will continue, although the slow down will persist

The savings rate may have bottomed out

## COMPENSATION OF EMPLOYEES (REAL TERMS, % YEARLY AVERAGE YOY)



- During the next two years compensation of employees will accelerate, mainly due to the increase in salaries.
- If the wage increases are concentrated in workers with higher income and lower propensity to consume, the effect could be a higher rate of savings and a diminishing effect of income on household spending.