

3 Growth prospects for the Spanish economy

Improved fundamentals underpin the upturn in activity

The Spanish economy began 2015 by building on the recovery which got underway in mid-2013. Although the environment has not been risk-free³, the opening three months have seen a **pick-up in activity based on both outside and domestic factors**. Notable among the former are a **more dramatic fall in the oil price than anticipated, the somewhat sharper-than-expected improvement in European demand and, above all, a greater impact of ECB monetary policy** via a more intensified exchange rate depreciation. With respect to the latter two, fiscal policy has ceased to be contractionary, while the **steady improvement in the labour market and confidence continue to be conducive to consumption and investment decisions**. Those events are in part sustained by **structural elements, such as correction of domestic imbalances and some of the reforms undertaken**. In this respect, an improvement is perceived in some of drivers of certain items of private demand (for example, consumption), which the latter is proving more robust than was expected three months ago. Consequently, the private demand is approaching to its long-term equilibrium. Finally, some of the risks that loomed three months ago have not materialised (those of a geo-political nature) or have had a smaller impact than anticipated and even managed to exert a positive effect on activity in the short term (loosening fiscal tightening).

To summarise, the fundamentals of the Spanish economy endorse consolidation of the recovery over the next two years. **GDP is expected to continue rising at above its trend growth level, although a slight slowdown is predicted** in the coming months, bearing in mind the smaller tail-wind from certain factors, such as the oil price or tax cut, and the uncertainty related events of a geo-political bent. This should feed through into GDP growth of 3.0% in 2015 and 2.7% in 2016. This rate of growth could result on a **net creation of around a million jobs at the end of the period, along with a lower unemployment rate, which could come down to under 20% by the end of the forecast horizon**⁴.

Even though the scenario depicted in this edition includes an upward review of growth expectations for 2015 (by 0.3pp), **the elements underlying the expected recovery have not changed** since the last Spain Economic Outlook. Over the next two years, **economic growth will mainly rely on domestic demand** which, for the first time since 2007, will show positive annual balances for all of its components.

Activity is picking up and shows no signs of flagging for the remainder of the semester

With details of the results still to come, **the advance GDP estimate published by the National Statistics Institute (INE) indicated that the Spanish economy grew by 0.9% QoQ in 1Q15**⁵, in line with forecasts three months ago (BBVA Research: 0.8-0.9% QoQ). Should this estimate be confirmed, the rate of activity growth would have been somewhat sharper than that of the final stages of 2014 (0.7% QoQ in 4Q14) and would mean YoY growth of around 2.6%, the most substantial since early 2008.

With respect to composition of growth, the partial indicators show that **domestic demand (principally private), is likely to have sustained the whole of the upturn in activity (+0.9pp QoQ)**, (see Figure 3.1). Conversely, **net external demand probably made no contribution to growth (+0.0pp QoQ)** taking into account the virtual stagnation in goods exports. This apparent inelasticity of trade flows to the improvements

3: Among risks present are the slowdown of the major geographical areas (with the exception of the EMU) and the persistence of financial volatility and geo-political tensions.

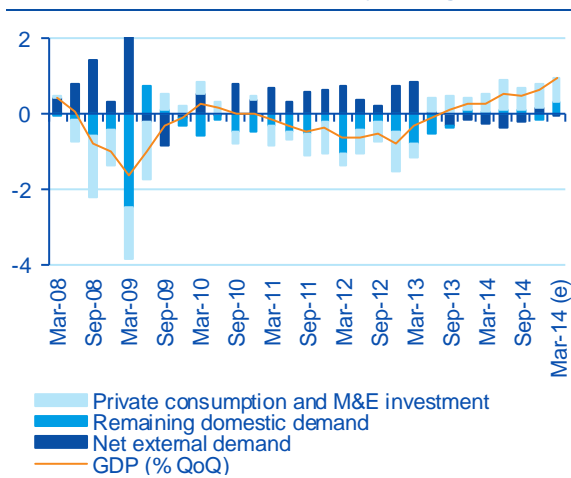
4: In average terms, employment will grow at an annual rate of 3.0% and the unemployment rate will be around 21.3% in 2016.

5: The breakdown in the Quarterly National Accounts (CNTR) for 4Q14 will be published on 28 May, when the advance estimate could be revised.

of the fundamentals is in part due to the base effect following the rallies observed over most of 2014, and is therefore expected to be only short-lived.

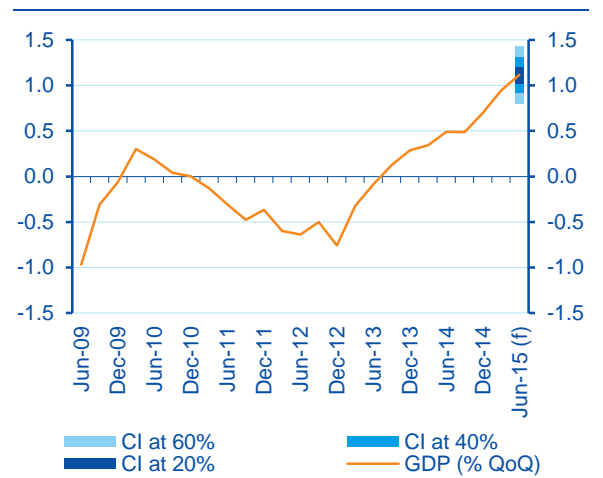
Looking ahead to the second quarter of 2015, the data available at the time of going to publication suggests that the Spanish economy continues to consolidate its recovery, and could be growing at a rate at least that observed in the first quarter of this year, which, according to the estimate offered by the MICA-BBVA⁶ model, could reach 1.1% QoQ (see Figure 3.2). This upturn is consistent with the results of the BBVA Economic Activity Survey (EAE-BBVA)⁷, which continue to reveal hopeful growth expectations (see Figures 3.3 and 3.4).

Figure 3.1
Spain: contributions to quarterly GDP growth (%)



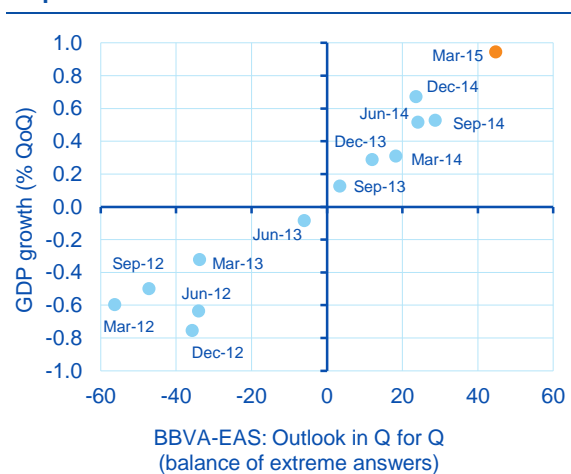
(e): estimated.
Source: BBVA Research based on INE

Figure 3.2
Spain: GDP growth, observed and predicted by the MICA-BBVA Model forecasts (% QoQ)



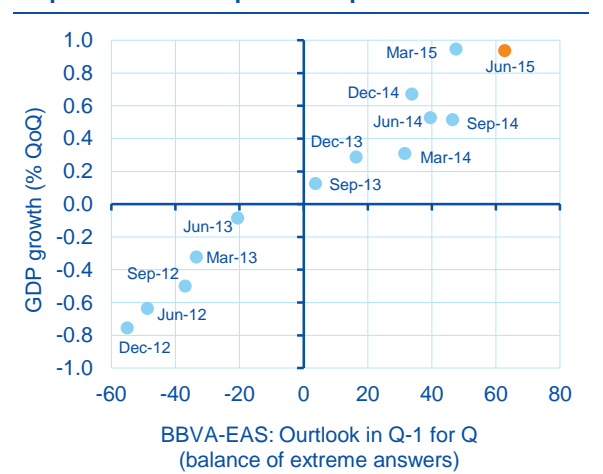
(f): forecast.
Source: BBVA Research based on INE

Figure 3.3
Spain: GDP growth and outlook of EAE-BBVA respondents



Source: BBVA Research based on INE

Figure 3.4
Spain: GDP growth and outlook of EAE-BBVA respondents in the previous quarter



(e): estimated
Source: BBVA Research based on INE

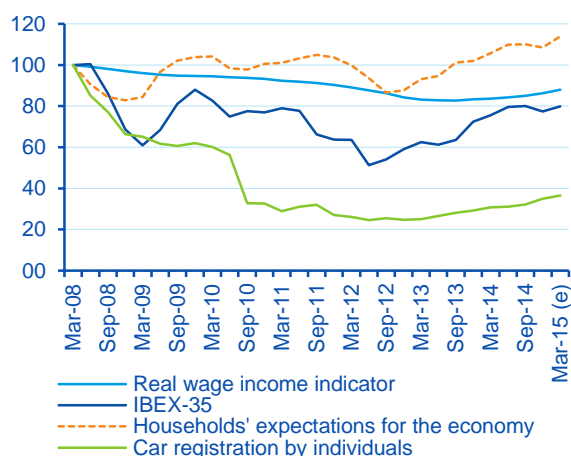
6: For further details about the MICA-BBVA model, see Camacho, M. & R. Doménech (2010): "MICA-BBVA: A Factor Model of Economic and Financial Indicators for Short-term GDP Forecasting", BBVA WP 10/21, available at: <http://goo.gl/zeJm7g>

7: For more information on the BBVA Economic Activity Survey (EAE-BBVA), see Box 1 of Spain Economic Outlook, second quarter 2014, at: <https://goo.gl/q110Fy>

The recovery of domestic demand consolidates

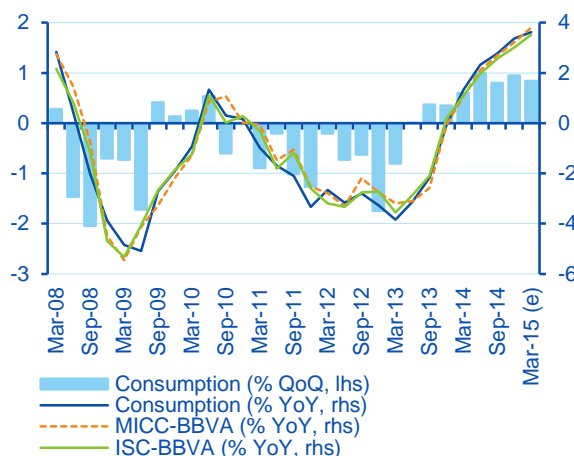
The consumption indicators, above all for durable goods and services, indicate that **household spending is likely to have returned to vigorous growth in the first quarter of 2015⁸**. The disposable income of families should have benefited from the job creation and the reform of personal income tax⁹. The stock market rally and the stabilisation of house prices probably served to lift net wealth between January and March. Besides its better fundamentals, private consumption has also been boosted by the improvement in household perceptions of the economic situation¹⁰ and the growth in new consumer loans BBVA (see Figure 3.5). As a result, both the synthetic consumption indicator (ISC-BBVA) and the coincident indicator model for consumption (MICC-BBVA) suggest that **household spending should have risen by around 0.9% QoQ in 1Q15 (3.6% YoY), in line with the preceding quarter** (see Figure 3.6).

Figure 3.5
Spain: determining factors of consumption (swda, 1Q08=100)



(e): estimated
Source: BBVA Research based on MINECO, Datastream, EC and central bank

Figure 3.6
Spain: actual household consumption data and real time forecasts



(e): estimated
Source: BBVA Research based on INE

The partial indicators for machinery and equipment investment for 1Q15 are indicative of growth similar to that seen in the previous quarter. Notable among them are the recovery of trade flows of capital goods and the fine industrial vehicle sales figure. The IPI and capital order book also performed slightly better than in 4Q14, and only industrial confidence saw a downward correction following the extraordinary records in 4Q14. As Figure 3.7 shows, the **synthetic investment indicator (ISI-BBVA) suggests that this demand item should chain nine quarters in a row of growth, with an increase of 1.9% QoQ (10.0% YoY) in the first quarter of the year.**

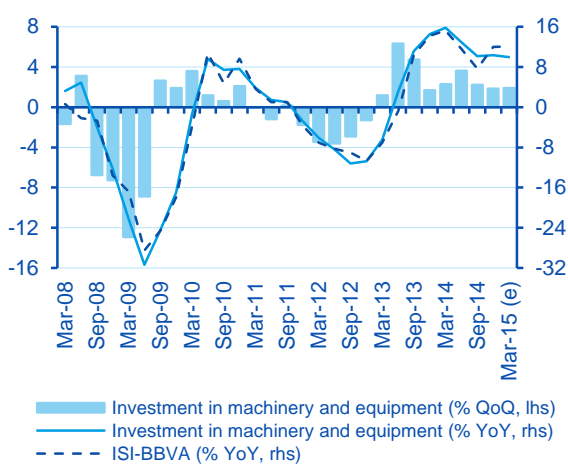
Following four consecutive quarters of growth, the housing investment indicators kept to the trend of recovery in 1Q15. The tone of the labour market in construction remained optimistic, the figures for building permits were better than in the previous quarter and business confidence of the industry sector again jumped higher. In addition to this, after adjusting for seasonality, housing sales continued to move in the direction of growth. As a result, **the composite indicator for housing construction investment (ISCV-BBVA) reveals a rise for residential investment of 1.2% QoQ (3.3% YoY) in 1Q15** (see Figure 3.8).

8: Detailed analysis of trends in household spending by type of good can be found in the Consumption Outlook, second half 2014, at: <https://goo.gl/4YopS0>.

9: An estimate of the effects of the personal income tax reform (in force since January 2015) on household incomes can be found in Box 2 of Spain Economic Outlook, fourth quarter 2014, at: <https://goo.gl/S1qKR1>

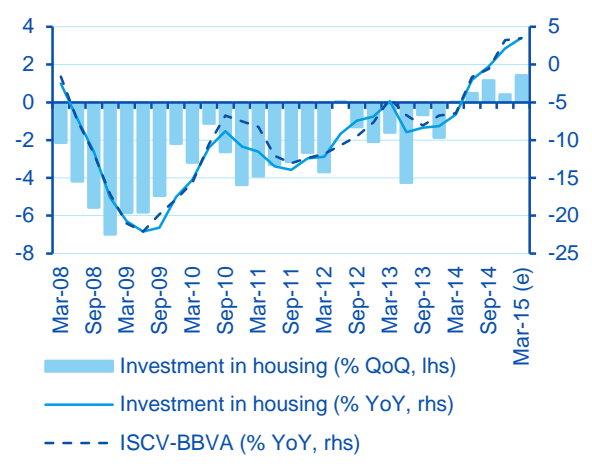
10: Household perceptions regarding the Spanish economic situation are at a historical high, while those with respect to their financial situation are at 2001 levels. Further information at: <http://goo.gl/d4XlrX>

Figure 3.7
Spain: actual data and real-time forecasts of investment in machinery and equipment



(e): estimated
Source: BBVA Research based on INE

Figure 3.8
Spain: actual data and real-time forecasts of investment in housing



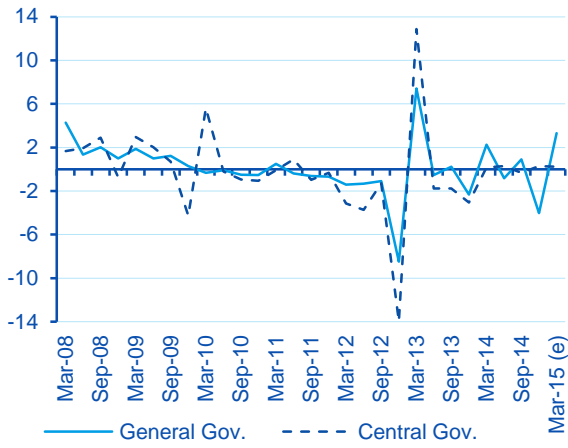
(e): estimated
Source: BBVA Research based on INE

Public sector demand rallies as 2015 commences

After the unexpected downward shift in public consumption in 4Q14, a recovery is expected to have taken place over the first quarter of this year. According to the State budget implementation figures as of March 2015, after seasonal and working day adjustments (swda), nominal final consumption expenditure by the central government is estimated to have held relatively stable with respect to the previous quarter (see Figure 3.9). Nonetheless, **real public consumption by public should have closed 1Q15 gaining momentum with respect to 2014 (1.0% QoQ: -0.6% YoY)**. On this point, the figures from the Labour Force Survey (EPA) suggest that the **wage component is likely to have contributed to the increase in the real spending**. Moreover, the number of public sector employees grew by 1.1% QoQ swda between January and March, thus chaining two consecutive quarters of rises (see Figure 3.10).

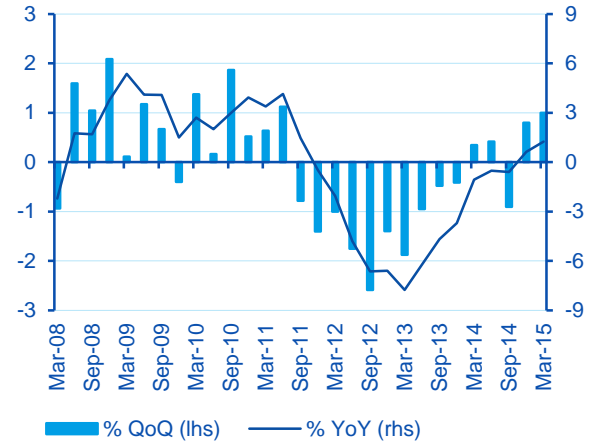
On the other hand, the public bids tender data show that in the opening months of the year this item should have lost pace, mainly due to the base effect arising from the sharp upturns in 2014 (33.0 % on average YoY) from historically low levels. Even so, the cumulative recovery of tenders last year should be contributing to **the gradual improvement in non-residential construction**, which probably grew by about 0.9% QoQ (5.1% YoY) in 1Q15.

Figure 3.9
Spain: nominal public consumption (% QoQ, swda)



(e) estimated
(*) Does not include, among others, fixed capital consumption.
Source: BBVA Research based on MINHAP and INE

Figure 3.10
Spain: public sector employees (swda)



Source: BBVA Research based on INE

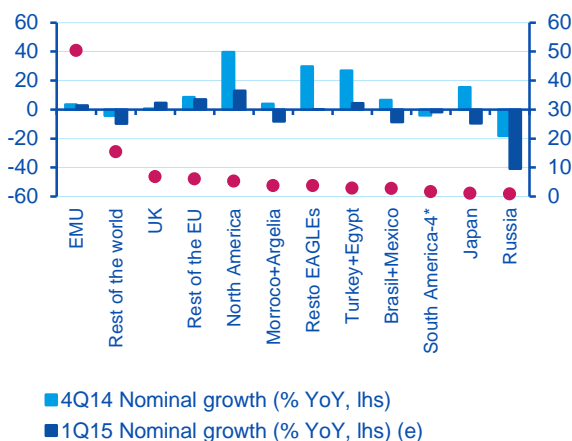
Total exports begin the year with modest growth

The commencement of 2015 was marked by **an international situation that was dominated by the slowdown of the major geographical areas with the exception of the EMU**, which displayed signs of improvement. Despite the euro depreciation and the lower costs provoked by the oil price, the uneven progress of world growth should have led to a **virtual stagnation of goods exports in 1Q15 (0.1% QoQ, 5.9% YoY)** (see Figure 3.11). Thus, despite the encouraging signs in industrial expectations (new exports orders), the spending indicators for the trade balance and sales abroad by larger companies suggest that the lethargy exhibited by goods exports has probably run on into 1Q15 after the high growth seen in the two middle quarters of 2014.

By contrary, the performance by **services in the first quarter of the year (1.6% QoQ, 3.5% YoY) is likely to support total export growth**. As regards tourism, **non-resident consumption on Spanish soil is expected to have surged ahead again (1.4% QoQ, 3.6% YoY)**, which would put sector activity at record levels again. Regarding this aspect, tourists inflows would have increased by 1.0% QoQ and real spending by them would have done so by 2.3%. Likewise, **exports of non-tourist services are thought to have made progress in 1Q15 (1.8% QoQ, 3.4% YoY)**, which would mark a continuation of the upward trend observed in 2H14 (2.4% QoQ and 2.3% YoY on average).

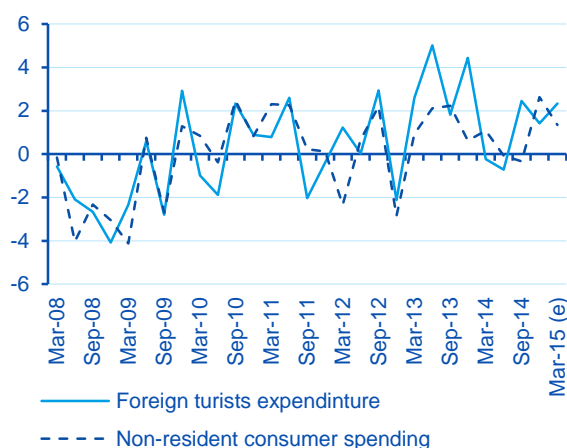
All in all, overall exports have probably grown discreetly in 1Q15 to 0.5% QoQ (5.2% YoY), although an upturn in growth is expected in the next few quarters following the fine close in 2014 (4.2%).

Figure 3.11
Spain: actual data and forecasts for goods exports by geographical areas



* South America-4 includes Colombia, Venezuela, Argentina and Chile
(e): estimated using data up to February 2015.
Source: BBVA Research based on Datacomex

Figure 3.12
Spain: actual data and forecasts for tourist service exports (% YoY, swda)



(e): estimated
Source: BBVA Research based on INE and the Institute of Tourism Studies (EGATUR)

In line with the performance of exports, the preliminary indicators available at the time of going to press suggest **moderate import growth in the first quarter of the year, rising to a rate of 0.6% QoQ (7.3% YoY)**. Even so, after the 2014 recovery, imports are likely to converge towards a higher growth path over the remainder of the year, helped by both exports and domestic demand.

To summarise, the above-mentioned elements suggest **no contribution from net external demand to quarterly growth in 1Q15 (0.0% QoQ, -0.5pp YoY)**. After closing 2014 in positive numbers (0.8% of GDP), the four quarter accumulated current account balance is estimated to have continued to show a surplus in the first quarter of the year (1.2% of GDP).

Mixed signals of labour market indicators

The labour market's recovery carried on into 1Q15. After seasonal adjustments, **average Social Security affiliation system rose for the sixth straight quarter, while registered unemployment came down for seven quarters in a row.** To be precise, with the number of affiliates to Social Security increased by 1.1% over January through to March, which is 0.3pp above the figure for 4Q14, while the drop in registered unemployment quickened by 0.8pp to a rate of -2.5% QoQ (see Figure 3.13). Hiring also picked up in Q1 (5.5% QoQ, swda), both for temporary contracts (5.4%) and, above all, for permanent ones (6.4%). While the "flat rate" of EUR100 for taking on new workers under permanent contracts was in force (from March 2014 to March 2015), the number of permanent contracts jumped by 25% (swda), while temporality rose by 14%. Despite this, the predominance of employment under temporary contracts was only reduced by 0.7pp to 91.6% swda.¹¹

The Labour Force Survey (EPA) for 1Q15 did, however, reveal a milder improvement in employment than was given to believe by the Social Security registrations. In gross terms, employment came down by 114,300 people over January to March owing to the adverse seasonal effect in the period. Adjusting for

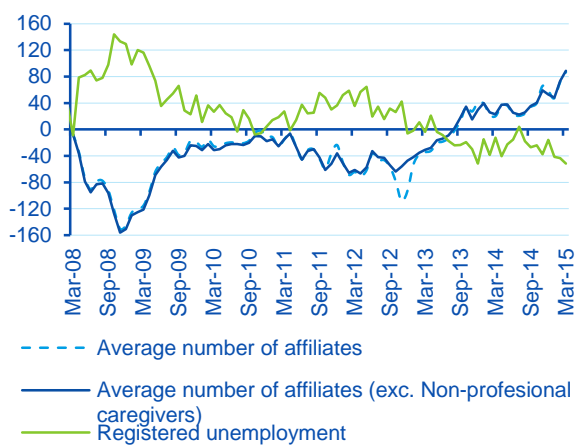
11: An assessment of this measure can be found in Box 2 of the Spain Economic Outlook, second quarter 2014, available at: <https://goo.gl/rOaUrf>. Since March the 'flat rate' has been replaced by a reduction in the employer's Social Security contribution for common contingencies of EUR500 (if the contract is permanent). This new system corrects one of the shortcomings in the 'flat rate', namely its regressive nature. Under the progressive rate, workers with low contribution quotas, who are those who are most likely to be jobless and where the demand for hiring them is more elastic in response to variations in non-wage costs, will find themselves in a relatively better position.

this factor, **the number of those in work would have grown by around 85,000 people (0.4% QoQ, swda)**, which is half of the figure in 4Q14 (170,000 people, 0.8% QoQ, swda).

Job destruction was in gross terms due to the falling **number of workers in the private sector, both salaried employees (-118,300) and self-employed workers (-25,200)**. On the other hand, public sector employment rose by 29,200 salaried staff, which is the highest growth since mid-2011.

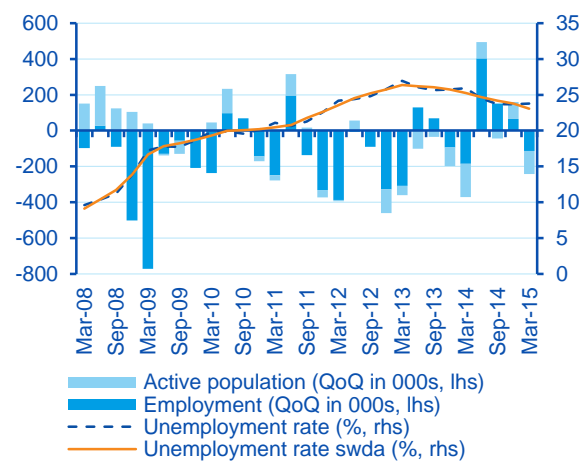
The drop in the labour force (-127,400 people) offset the job destruction, resulting on the **unemployment rate only went up by 0.1pp to 23.8%** (see Figure 3.14). After seasonal adjustments, the unemployment rate fell for the sixth successive quarter, this time by 0.6pp to 23.7% swda.

Figure 3.13
Spain: average Social Security affiliation and registered unemployment (monthly change in thousands, swda)



Source: BBVA Research based on the ME&SS data

Figure 3.14
Spain: labour market indicators



Source: BBVA Research based on INE

The current oil price level helps price and cost restraint

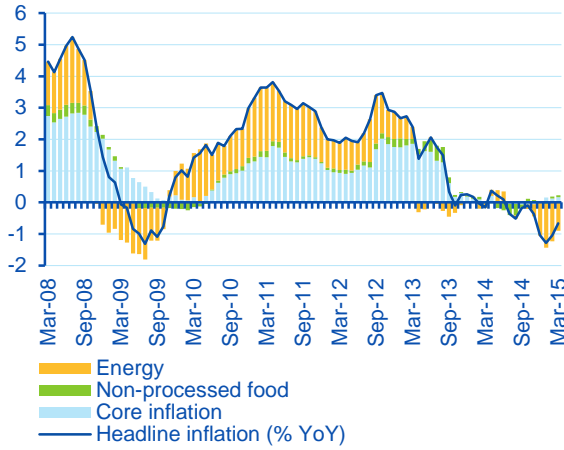
The drop in consumption prices soften as 2015 began, reaching -0.7% YoY in March¹². The negative headline inflation derives from downward pressure on the energy component (-7.4% YoY in March) mainly because of the oil price slide between June 2014 and January 2015 (-56.4%, down to close to USD50 a barrel). Since January we have seen an upward correction in the market price of oil which, together with the EUR's exchange rate depreciation, accounts for the lower fall in headline inflation at the close of 1Q15. On the other hand, **core price restraint continues and should have end with positive growth, though muted, in March** (0.2% YoY). Thus the contribution by core inflation to YoY price growth was around 0.2pp YoY in March, whereas that of the residual component was -0.8pp YoY (energy: -0.9pp YoY and non-processed foods: +0.1pp YoY) (see Figure 3.15).

According to BBVA Research estimates, the stabilisation of core prices in the Spanish economy is still ongoing within a climate of easing European inflation and a recovery of price competitiveness in Spain. Thus **the inflation differential with respect to the eurozone, as measured in terms of the trend component, remains favourable to Spain at around -0.6pp** (see Figure 3.16)¹³.

12: The leading CPI indicator confirmed the expected easing of inflation in April (by 0.2pp to -0.6% YoY). Our estimates suggest that core prices remain at 0.2% YoY. For further details, see: <http://goo.gl/nrbNyb>

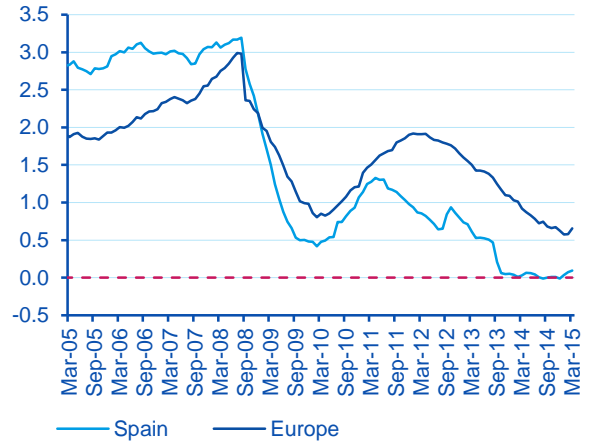
13: For further details on the calculation of trend inflation using the trimmed mean approach, see Box 1 of the Spain Economic Outlook, first quarter 2014, available at: <https://goo.gl/CYITVb>

Figure 3.15
Spain: contribution to CPI growth (pp YoY)



Source: BBVA Research based on INE

Figure 3.16
EMU: trend inflation (trimmed means method, % YoY)



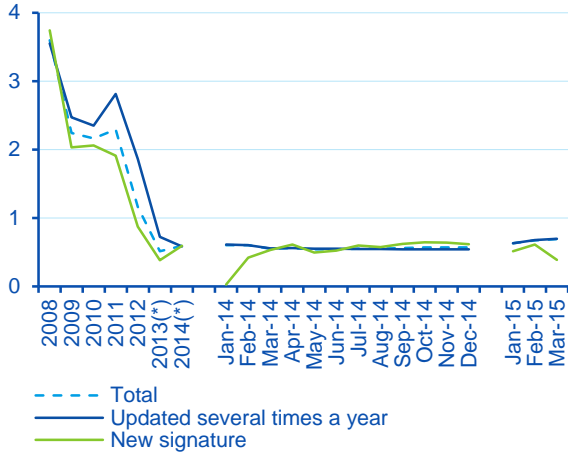
Source: BBVA Research based on INE and Eurostat

The low core inflation continued to help contain wage demands in Q1. The average wage rise agreed upon collective bargaining agreements increased by around 0.7% YoY between January to March in the 600 revised collective agreements in the multi-year review process, and 0.5% for those signed over the year (only 54), which are only binding on 54,500 workers¹⁴ (see Figure 3.17). Although positions have still not coincided over a new Employment and Collective Bargaining Agreement (*AENC* in Spanish), the wage increase agreed is approaching that set as the upper limit in the *II AENC*¹⁵ (Second Agreement on Employment and Collective Bargaining) for 2014 as a whole. As is illustrated in Figure 3.18, the wage moderation since the labour reform came into effect in 1Q12 has provided a 3.5% cumulative gain in cost competitiveness against the EMU.

14: The number of workers subject to collective bargaining amounted to more than 2.0 million to March, when those affected by agreements that were signed prior to 2015 (1,977,000) joined. This figure is 25.2% smaller than that registered up to March 2014.

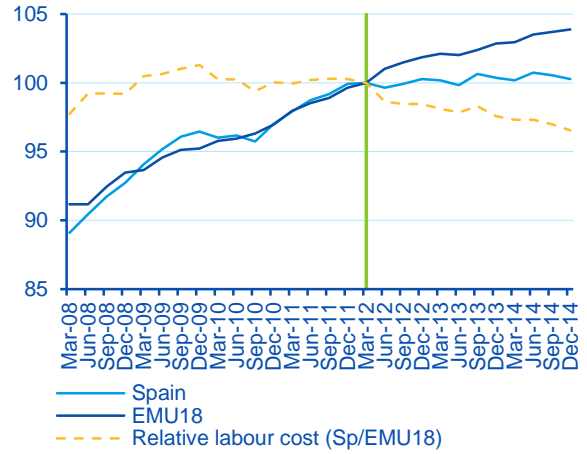
15: Note that the *II AENC* 2012-14 established that if the increase in GDP in 2013 were to be under 1%, the wage rise agreed for 2014 would not exceed 0.6%.

Figure 3.17
Spain: average wage growth agreed in collective bargaining agreements (%)



The annual data include agreements made after December which provide for reviews under the wage guarantee clause.
(*) Provisional data. The 2013 figure is not comparable with prior.
See: <http://goo.gl/WQkvNU>
Source: BBVA Research based on the ME&SS data

Figure 3.18
EMU: labour cost per hour worked in the market economy (1Q12=100)



Source: BBVA Research based on Eurostat

Credit flows pass the recovery threshold

New lending transactions (rather than the stock) are the pertinent data for supporting economic recovery, as they are directly linked to current investment and consumption decisions taken by economic agents¹⁶.

In cumulative terms for 1Q15, **new lending to large companies** (for loans of over EUR1mn) increased by a YoY figure of 1.2%, which was fourteen points up on 4Q14, **thereby consolidating the change of trend seen at the end of the previous year**, with the rate surging ahead in March (+23.6% YoY). The upward revision of expectations for the economy and the downward trend in borrowing costs are encouraging this segment to seek bank credit and to balance its borrowing structure, which had of late shown a leaning towards other sources of funding (such as bond issuance and building up equity).

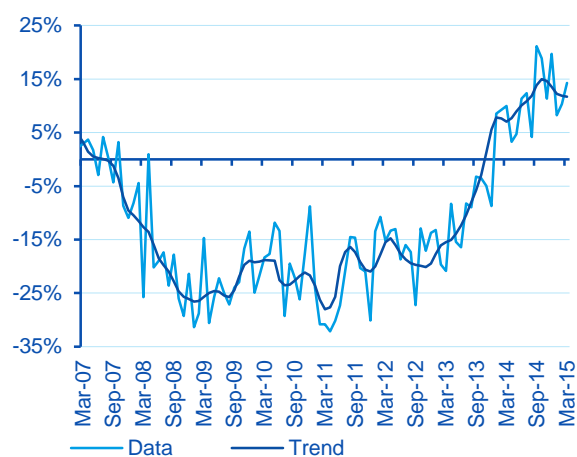
New SME lending (for loans of up to 1EURmn) **is still performing well** and shows growth for the quarter of 9.9% YoY. Although this is slightly down on the previous quarter, it still reflects the commitment of credit institutions towards this category of business, where improved confidence and the economic recovery have driven up demand. **New lending to households continued to display signs of robustness** in the quarter by growing 15.8% YoY, which is a somewhat more sustainable rate than was exhibited in the final quarter of 2014 (29.9% YoY). Thus, accumulated consumer lending rose by 20.5% YoY in 1Q15, while home loans increased by 13.2% YoY. Finally, the rest of household lending rose by a cumulative 15.7% YoY.

All in all, **total new lending posted positive growth** in the opening quarter of the year (+6.2% YoY), to a large extent thanks to the major boost from the large companies, which **appears to confirm the change of trend** detected towards the end of 2014. **Several factors mean that we can be optimistic about credit as regards the rest of the year**: the fact that transactions involving loans to companies of over EUR1mn seem to have bottomed out, the positive progress made by the retail segment (families and SMEs) (see Figure 3.19), the now brighter macroeconomic scenario, the headway towards banking union in Europe, and the set

16: Box 3 of the Spain Economic Outlook, fourth quarter 2014, offers a detailed analysis of the relationship between credit flows and economic activity.

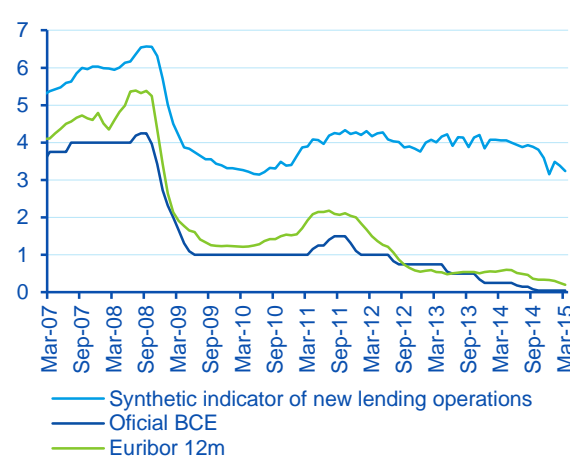
of unconventional measures that the ECB has set in train (TLTROs, asset-backed security and covered bond purchases, and monetary expansion), which could have a positive effect on loans, the low interest rates (see Figure 3.20) and the increase in creditworthy demand. In fact, the rise in new lending transactions would be compatible with the required deleveraging of outstanding balances, were the outflow (repayments) to outstrip the inflow (new transactions). According to our estimates, new lending transactions would outstrip repayments from the end of 2015, which would translate into an increase in the outstanding balance of credit.

Figure 3.19
Spain: new retail lending operations (% YoY)



Source: BBVA Research based BoS data

Figure 3.20
Spain: interest rates (%)



Source: BBVA Research based on BoS and the ECB data

2015-16 scenario: growth driven by both domestic and external factors

As was said in the introduction to this section, **the new aspects added in to the macroeconomic scenario have prompted an upward revision** of 0.3pp in this year's growth figure for the Spanish economy. **In 2015, activity will rise by 3.0% and in 2016 it will do so at a rate of 2.7%**, which is enough for there to be net cumulative job creation by the end of the period of around one million, as well as a lowering of the unemployment rate down to about 20%¹⁷.

Activity growth will be sustained by both domestic and external factors. The world economy will gradually pick up pace, which, together with the greater depreciation of the EUR, the fall in the oil price and the gains in competitiveness, will give rise to a **staggered recovery for Spanish exports**. On the domestic front, the improvement on fundamentals, the progress in correcting imbalances and the greater support from fiscal and monetary policies will lead to a **robust expansion of growth in domestic demand** (see Box 3.1). The increase final demand will trigger a considerable upsurge in imports, which in turn is likely to result in a **virtually no contribution from net external demand to growth**.

17: In average terms, employment will rise at an annual rate of 3.0% and the unemployment rate will reach around 21.3% in 2016.

Table 3.1.

Spain: macroeconomic forecasts

(% a/a salvo indicación contraria)	1Q14	2Q14	3Q14	4Q14	1Q15 (e)	2014	2015 (f)	2016 (f)
Domestic Final Consumption Expenditure	1.1	1.8	2.1	2.4	2.6	1.8	2.5	1.9
Private FCE	1.3	2.3	2.7	3.3	3.6	2.4	3.1	2.4
General Government FCE	0.3	0.3	0.3	-0.5	-0.6	0.1	0.8	0.6
Gross Fixed Capital Formation	0.8	3.9	3.9	5.1	6.2	3.4	5.7	6.4
Equipment & Machinery	15.8	12.9	10.2	10.4	10.0	12.2	7.8	6.7
Construction	-7.4	-0.7	0.1	2.4	4.4	-1.5	4.3	5.4
Housing	-6.6	-2.0	-0.2	2.1	3.3	-1.8	4.5	9.0
Other buildings and constructions	-8.0	0.3	0.3	2.6	5.1	-1.3	4.1	2.7
Domestic demand (*)	1.2	2.3	2.6	2.7	3.1	2.2	3.0	2.7
Exports	6.4	1.0	4.5	4.7	5.2	4.2	6.1	7.5
Imports	9.4	4.9	8.6	7.7	7.3	7.6	6.5	7.8
Trade balance (*)	-0.6	-1.1	-1.0	-0.7	-0.5	-0.8	0.0	0.1
Real GDP mp	0.6	1.2	1.6	2.0	2.6	1.4	3.0	2.7
Nominal GDP mp	0.0	0.8	1.4	1.4	2.5	0.9	3.8	4.9
Pro-memoria								
GDP exc. Housing investment	1.0	1.4	1.7	2.0	2.7	1.5	3.0	2.5
GDP exc. Construction	1.6	1.5	1.8	2.0	2.5	1.7	2.9	2.5
Total employment (LFS)	-0.5	1.1	1.6	2.5	3.0	1.2	3.0	2.9
Unemployment rate (% LFS)	25.9	24.5	23.7	23.7	23.8	24.4	22.3	20.7
Total employment (f.t.e)	-0.4	1.0	1.7	2.4	2.5	1.2	2.6	2.4

(*) Contributions to growth.

(e): estimated, (f): forecast.

Source: BBVA Research based on INE and BoS data

The cumulative oil price fall benefits activity in the short term

In recent months, **the oil price has partly corrected the downward course** traced by readings since mid-2014, to the extent that the Brent price stands at USD65 per barrel at the time of this Outlook going to print. **Thus the cumulative fall in the market price, which hit its lowest point in January, was reduced by 5.0pp (to -50%).** Since this is primarily a supply shock¹⁸, the net impact of cheaper energy of this kind on activity is proving particularly positive: consumption, investment and trade flows are likely to have benefited, given the improvements in the available income of families and production costs for firms. In this respect, the **BBVA Research estimates for 2015-16 point to price stabilisation at around USD68 per barrel** (two dollars below the estimate of three months ago), which, if confirmed, would on average provide at around 0.7pp of growth for the Spanish economy¹⁹.

18: BBVA Research estimates suggest that the crude price fall since June 2014 is mostly due to supply-side factors (between two-thirds and three-quarters of the adjustment), such as unconventional production in the United States (shale oil), the decision by OPEC not to cut production quotas and the minimal effect of geo-political tensions on output. The lower expectations for world growth have also had an impact on prices, albeit a secondary one.

19: For further details regarding the estimated effects of the oil price by type of shock on activity and prices in the Spanish economy, see Box 1 of Spain Economic Outlook, second quarter 2011, available at: <http://goo.gl/42s7N9>

Monetary policy is supporting cyclical recovery, in both Europe and Spain

The ECB is continuing to act in a forthright manner given the listlessness of the upturn in the European economy and the low inflation rates. In particular, at its April meeting the monetary authority's Governing Council (GC) reiterated that it intends to continue to focus on **giving full rein to the monetary policy measures that were previously announced**, and it stressed its commitment to pursuing its asset purchase programmes (APP)²⁰ until inflation has returned to a path in line with its target²¹. These measures, together with holding the main benchmark interest rate at a historical low (of 0.05%), as well as the targeted longer-term refinancing operations (TLTRO) programme, are helping to **combat the low inflation, keep long term interest rates at low levels** (around 1.5% for 2015-16 for Spain, 120bp less than in 2014), **underpin domestic demand and credit growth, and lastly to consolidate the EUR's depreciation** (a nominal 16% against the USD in 2015)²².

As for the impact of these measures, the updated economic scenario factors in a **fall for the exchange rate against the USD which is heavier than was expected** three months ago (by a further 8% on average for 2015 and 2016) and consequently **larger-than-expected European demand growth** (by 0.3pp, to 1.6%), which will provide a firmer **platform for Spanish export growth**. BBVA Research estimates suggest that a depreciation of this magnitude could add as much as 0.4pp to growth, while a cyclical upturn for Europe tends to have a one-to-one effect on the Spanish GDP²³.

Fiscal policy becomes slightly expansive

The recovery of activity and the improved borrowing costs will provide scope to implement a mildly expansive fiscal policy in the short term²⁴. Thus, following a close for the deficit of the regions in 2014 which was 0.2pp higher than forecast, and given the absence of additional measures to offset this deviation, public sector consumption is expected to grow by 0.8% in 2015 in real terms, while non-residential construction investment (affected by public works) should do so by 4.1%. In an no policy changes scenario, **the tone of fiscal policy will continue to be practically neutral in 2016. Thus**, real growth of public consumption expenditure will drop back to 0.6%, while non-residential investment will grow at a rate of around 2.7%.

Even so, the boost from the better economic situation will not be enough to offset the overall impact of the expansive policies implemented over 2015-16. Therefore, **in the absence of new fiscal consolidation measures, the government deficit is expected to slightly overshoot the stability target**.

Domestic demand will lead the way for growth

Household consumption prospects have again improved in the last quarter. Job creation, less tax pressure and the absence of inflationary pressures will all help real disposable income to recover, which will rise by more than was predicted three months ago²⁵. Forecast growth in wealth, both as regards real estate and financial positions, expectations that official interest rates will remain at historic lows and the adjustment in saving will also serve to encourage family spending. Finally, new consumer finance business will continue

20: Altogether the programme means a liquidity injection of at least EUR1.1trn (purchases of EUR60bn a month) running from March this year through to at least September 2016. The programme includes public securities issued by governments and European agencies and institutions, and encompasses those programmes previously open since 2H14 (CBPP and ABSPP): covered bond and asset-backed securities programmes which amount to approximately EUR13bn a month.

21: For further details, see the ECB Watch by BBVA Research published on 15 April 2015. Available at <http://goo.gl/4Dyji>

22: In Box 3 of Spain Economic Outlook, fourth quarter 2014, it is estimated that actions such as TLTROs could add between 0.2pp and 0.8pp to Spanish GDP growth, although only in the short term. See: <http://goo.gl/uXV9fD>

23: The estimates from the BBVA-RVAR model indicate a depreciation of 10% for the EUR/USD rate, which could contribute 0.5pp to Spanish GDP growth. For further details see Box 1 of the Spain Economic Outlook, fourth quarter 2014.

24: Notable on the revenue side are the tax cuts, the first round of which came into effect in January 2015, while the second round is scheduled for January 2016. Box 2 of the Spain Economic Outlook, fourth quarter 2014 offers an analysis of the impact of the personal income tax cuts.

25: Note that the Non-Financial Quarterly Accounts for the Institutional Sectors for 4Q14 brought in an upward revision to gross disposable household income of almost EUR4bn since 2Q14.

to rise over the coming quarters in a context of deleveraging of the outstanding credit balance, and it will support private consumption in the medium term, especially for durable goods. As a result, **consumer spending is being revised upwards by 0.7pp (on average) for 2015-16, to 3.1% and 2.4% respectively, and is close to its long-term equilibrium level.** This means that, from now onwards, family spending will tend to rise at levels more in keeping with the more traditional of its fundamentals (income, interest rates, etc.) and will be less affected by temporary factors (uncertainty, tax incentives).

In the next few quarters, **machinery and equipment investment will be favoured by the lower borrowing costs. There should also be a positive contribution from the encouraging trends in final demand:** the upward revision for growth, in both Spain and Europe, and continued EUR weakness against the major currencies will be conducive to fuller capital equipment order books for Spanish companies. Consequently, a **slight upward revision to forecast growth for machinery and equipment investment** in the coming quarters is justified. Specifically, the forecast is being raised by **0.6pp in 2015, to 7.8%, and by 0.4pp in 2016, to 6.7%.**

On the other hand, **housing investment is expected to continue along the growth path traced since 2014.** From the point of view of construction activity, for the first time since the beginning of the crisis building permits for new homes completed a year in positive ground (2.0% in 2014) and they are expected to consolidate the trend of recovery in the current two-year period. Moreover, relatively cheaper borrowing and the fine showing by housing sales augur well for new projects to spring up in zones where restrictions on supply are starting to become evident. In the next few years, transactions are predicted to carry on increasing which, given a context of shrinking supply, will work in favour of house prices starting to chart a course of steady recovery. **Housing investment is therefore expected to grow at an annual rate of 4.5% in 2015, reaching 9.0% the following year,** after seven years in a row of contributing negatively to GDP.

As regards trade flows, growth in the world economy in 2015-16 (3.5% and 3.9% respectively), the weakening of the EUR and cheaper transport costs should herald high demand for Spanish exports within the forecast horizon. Specifically, for the current two-year period **high growth is expected for both overall exports (6.8% annually, on average) and their main components:** goods exports will progress at an annual average growth rate of 6.6% and services at around 7.0%. In the case of tourism, the political uncertainty in parts of the Mediterranean overlies the above factors and, all things considered, there will again be record scenarios with annual growth rates of close to 4.5% on average.

In the medium term, this growth is likely to consolidate into gains in export shares of world goods and services markets if it is accompanied by a fall in relative export prices as a result of, among other things, structural improvements in the functioning of services markets (see Box 2). Despite the progress achieved in recent years by export companies in highly diverse geographical areas²⁶, **chief among the risks facing exports is the strategy that firms decide to pursue in terms of satisfying the rising demand from the domestic market:** reallocating away from destinations or increasing production capacity utilisation.

As a consequence of the buoyant state of final demand, **imports of goods and services should continue to grow in the next two years (7.1% annually, on average).** This means that **the contribution of net external demand to economic growth in 2015 will be negligible (0.0pp), thereafter returning to marginally positive values in 2016 (0.1pp).** Over the next two-year period, cheaper energy inputs will make the bill facing the Spanish economy in its dealings abroad somewhat more affordable, which will **provide continuity to positive current account balances in 2015-16 (1.0% of GDP on average)** and conclude the adjustment of the current account balance's structural deficit.

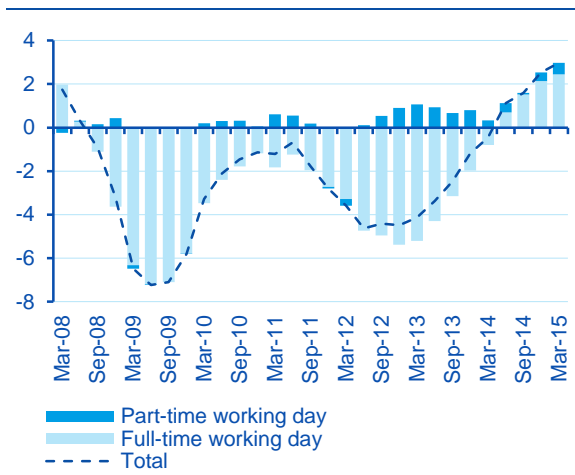
26: An analysis of the productive and geographical diversification of Spanish exports can be found in Box 3 of Spain Economic Outlook, first quarter 2014.

Imbalances in the labour market have been reduced, but they still remain

The expected momentum of the economy and the greater efficiency in the labour market will help to lift private sector employment and bring down the unemployment rate over the next two years. For 2015, the number of those in work is expected to grow by 3.0%, with a fall in the unemployment rate of 2.1 points (to 22.3%), which means 0.2pp below the figures forecast in February in both cases. In 2016, job creation will be 2.9%, but the reduction in the unemployment rate (to 20.7%) will be less pronounced than was forecast for 2015, given the improving trends for the labour force.

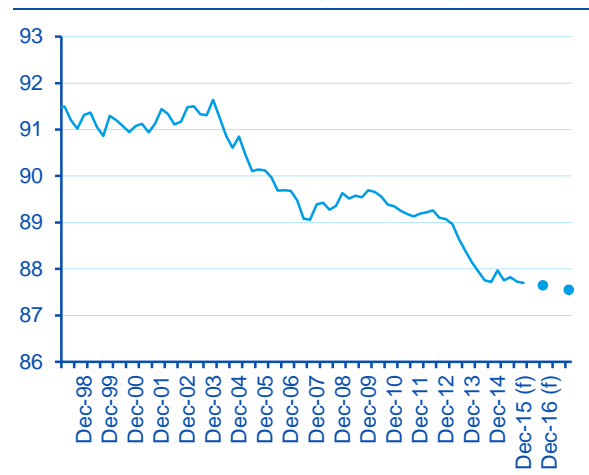
The data from the Labour Force Survey (EPA) for 1Q15 indicate that full-time employment continues to recover steadily (see Figure 3.21). If this trend is maintained in the coming quarters, the performance of full-time equivalent employment will be comparable to that of the overall figure. BBVA Research forecasts shown in Figure 3.22 suggest that the ratio of full-time equivalent jobs to total jobs will only be reduced by 0.2pp to 87.6% over the next two-year period. The expected trends for participation and employment suggest an increase in apparent labour productivity, both in 2015 (0.5%) and in 2016 (0.3%). Although these growth rates are lower than those in the past recession (2.1% on average for 2008-13), they would be in line with those seen in the earlier expansionary phase (0.4% on average for 2000-07)²⁷.

Figure 3.21
Spain: contributions to YoY employment growth (%)



Source: BBVA Research based on INE

Figure 3.22
Spain: full-time equivalent jobs / Total jobs (%)



(f): forecast.
Source: BBVA Research based on INE

The success of the reform of the system of professional training for employment, passed at the end of March²⁸, could speed up placement of the unemployed in the labour market in the medium term. The reform summarises the shortcomings of the current system in three categories: the training offered does not contribute to enhancing the employability of workers, the course content does not match the needs of the productive fabric of the economy and the lack of competition among suppliers puts limitations on what is available and makes services more expensive.

27: Box 3 analyses trends and determining factors regarding the productivity of Spanish firms in the manufacturing sector over the last three decades.
28: Royal Decree-Law 4/2015 of 22 March for urgent reform of the System of Professional Training for Employment in the labour market. Available at: <http://goo.gl/s87UXu>

To correct them, it proposes twelve strategies for action, notable among which are these four:

- Ongoing evaluation of training. Assessment will be carried out of improved performance in the job, placement and remaining in employment, and gains in competitiveness of firms.
- A system will be developed to monitor and research the labour market.
- In line with the above, multi-year strategic planning will be instituted.
- The training provided by the regions will be subjected to competitive tender. Within this context a “training voucher” system will be started, so that it is the unemployed themselves who choose the training organisation, subject to certain criteria.

Even if this diagnosis is accurate, it still ignores a key element: despite the seriousness of the problem, the unemployed are not the main segment targeted by training campaigns. Less than 40% of the costs budgeted for 2015 under training programmes are aimed at the unemployed. Furthermore, the training for the unemployed is traditionally biased in favour of the population in the 25-40 age-range and the most qualified and skilled. It would therefore be desirable to **re-balance training efforts more in favour of those with the greatest problems of placement in the labour market**. As regards areas of activity, there is a notably results-oriented approach, even though the **evaluation criteria for the training programmes are not known yet**. With respect to this, **it would be advisable to make a start on experimental assessments** to be able to pick out which of the training actions are the most effective for each segment and thus streamline the resources deployed in job training.

Inflation is set to flip up over the current two-year period

Although the oil price is expected to be slightly below what was anticipated three months ago (around the USD68 per barrel mark on average for 2015-16), the extra pressure on inflation will be counterbalanced by the greater-than-expected depreciation in the EUR exchange rate. As a result, **the forecast of a marginal fall in general consumer prices for 2015 as a whole (-0.2% YoY) is being maintained**. On the other hand, the domestic factors suggest that core inflation will remain positive, though at moderate levels (0.3% as annual average) (see Figure 3.23). On the demand side, **the still high unemployment level will keep any emergence of inflationary tensions, despite the gathering pace of domestic spending**. On the supply side, **the competitiveness regained by the Spanish economy does not hint at any significant pressures on price formation**.

Although inflation expectations are still below the target set by the monetary authority, **in both Spain and Europe prices will follow a clearly upward path over the next two years, reaching 1.4% and 1.3% on average over 2016**. As was advanced in the previous edition, this improvement has been helped by the unconventional monetary policy which the ECB has been implementing since halfway through last year (lower interest rates, stepping up credit availability, quantitative easing).

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