

ECONOMIC OUTLOOK

June 2016



**Economic Research Unit
Economic & European Affairs Department**

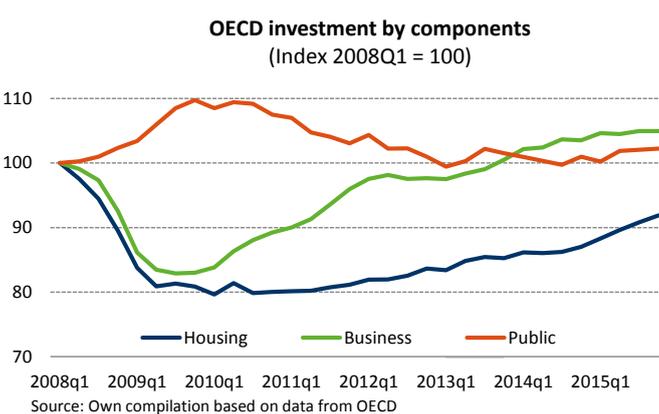
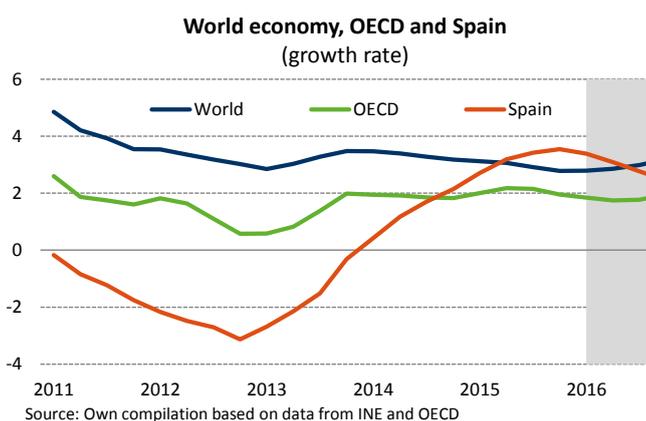
CEOE
CONFEDERACIÓN ESPAÑOLA DE
ORGANIZACIONES EMPRESARIALES

ECONOMIC OUTLOOK

The situation in financial markets has improved in recent weeks due to positive GDP data in Europe, the recovery in the price of commodities, the agreement with Greece and the expansionary stance of the monetary policy. However, volatility continues to be the dominant note due to significant uncertainty on several fronts. Firstly, the geopolitical risk, focused on the results of the UK referendum to be held on June 23, where its exit from or permanence in the European Union will be decided. This is coupled with emerging markets, due to the extent of the slowdown in their economies, in particular China's economy. And, finally, it is worth noting the normalization of the Fed's monetary policy and the outcome of the US presidential elections.

The main international organizations warn about global growth as still being slow and fragile. In fact, the OECD, the last one to publish its outlook report, has revised downwards by three tenths the estimated world GDP growth for 2016 and 2017, to set it at 3.0% and 3.3%, respectively. It highlights that there is a problem with slow growth, which is caused by the existing uncertainty, the lack of incentives to invest, due to the scarce demand (national and global), and the pace at which structural reforms are being implemented, which is very slow and even inexistent in some countries. Hence, the key to the timid strength of this new recovery cycle lies on the low investment levels, with significant impact on productivity and world trade and, as a result, a significant reduction in the growth potential, in particular, of advanced economies.

Amidst this background, the OECD suggests that, given the monetary policy's limited leeway, fiscal policy must be geared towards investment in infrastructure, including both investment in physical infrastructures (energy, transport, digitalisation), as well as investment to improve education and innovation. However, it especially emphasizes the need to implement structural policies, since they improve market competition, stimulate innovation, increase labour market flexibility and strengthen the financial system.



In Spain, following positive LFS results in the first quarter, the GDP figure was also favourable, with a quarterly growth of 0.8% for the third consecutive quarter and a year-on-year rate of 3.4% (previous figure was 3.5%). Moreover, growth on the demand side was more balanced. The net external demand had a less negative contribution to the GDP (-0.4 percentage points), while domestic demand slightly reduced its contribution to growth (3.8 percentage points), although it is still very robust.

One of the most relevant changes in Spain's activity at the beginning of the year is the deceleration in the construction sector, noticeable both, in investment and in activity. In fact, in quarterly terms, investment is down -0.2% and in GVA terms it fell -0.1%. In turn, its annual growth slowed down considerably in demand as well as in supply, a trend that is explained mainly by the item "non-residential construction" (civil engineering). This slower pace in the sector is reflected in job creation, with a very slight improvement over 2015.

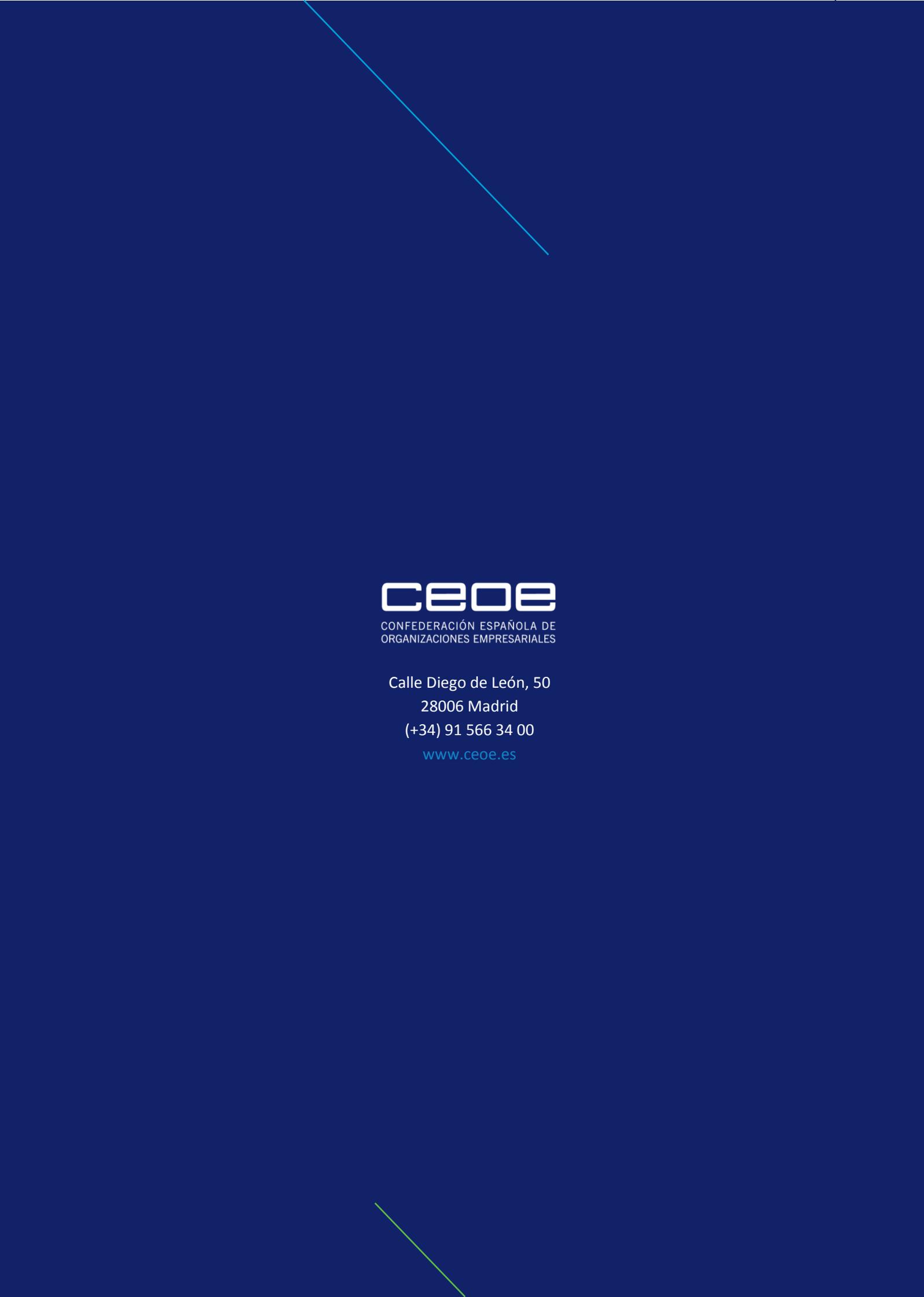
In sharp contrast, it is worth noting the dynamism in activity and employment in certain services such as "Trade, transport, accommodation and food service activities" (closely related to tourism), "Information and Communication" and "Professional Activities", all with a GVA growth over 5% year-on-year in the first quarter and a significant job creation rate (between 4% and 5%). In addition, it is also worth mentioning the strength of the manufacturing industry, whose added value reached a rate of 4.3% at the beginning of the year.

On the demand side, the strength of consumption, both private and public, stands out in the first quarter. The drop in the consumer confidence indicator has not permeated over to household expenditure decisions, which are growing at an annual rate of 3.7%, the highest since 2006, as a result of the positive job creation rate, low interest rates and an increase in purchasing power due to negative inflation rates. With regards to public consumption, there are no signs of spending restraints.

CEOE's activity indicator, with partial information for the second quarter, estimates quarterly GDP growth for the period at 0.7%, one tenth lower than the economy's 0.8% rate of growth in the first quarter. Following this positive data, CEOE has made an upward revision of its forecast for the Spanish economy in 2016, from 2.7% to 2.9% (the OECD has also increased its forecasts to 2.8%. However, the Bank of Spain has maintained its 2.7% for this year), although the decelerating trend in activity for the second half of the year is still maintained and will follow through up to 2017, when the estimated growth currently stands at 2.3%. If this forecast proves to be right, Spain will grow faster than the average for the Eurozone, although its positive differential will narrow, mainly in 2017. However, we have to bear in mind the level of uncertainty, higher than in other instances due to the non-definition over economic policies.

This scenario will positively influence the labour market, although job creation will be somewhat lower than in 2015. In LFS terms, the number of people employed could increase at a rate of 2.7% this year and 2.1% in 2017. Inflation in 2016 could be set at a negative annual average rate for the third consecutive year (-0.1%), despite the expected upturn at the end of the year; however, it is expected to grow at around 1.4% in 2017. Finally, it is worth pointing out how the external balance is expected to remain positive (2% of GDP) in both years, while the need for a stronger push towards the fiscal consolidation process continues to be the pending issue.

Inflation under control, a moderate growth of wage and salary costs and the recovery cycle underway together with the impact of the reforms undertaken have enabled Spain to advance positions in the 2016 IMD World Competitiveness Ranking. Specifically, it has risen from the 37th position to the 34th out of a total of 61 economies analysed, thanks to the improvement in its economic performance and business efficiency. However, there are still pending issues, such as the efficiency of the public sector, the regulation of the labour market, the red tape necessary to create a business and the high contribution to the social security by employers, with the risk of political instability having increased significantly in this edition.



ceoe

CONFEDERACIÓN ESPAÑOLA DE
ORGANIZACIONES EMPRESARIALES

Calle Diego de León, 50

28006 Madrid

(+34) 91 566 34 00

www.ceoe.es