

# ECONOMIC OUTLOOK

October 2016

- *The IMF maintains growth forecasts for the global economy and lowers those for trade, while it warns about protectionism.*
- *The price of Brent crude continued to rise in September in light of a potential agreement between the OPEC and other oil producers to stabilize the market.*
- *The slowdown in investment in capital goods and civil works could explain the slight slowdown in GDP expected for the third quarter (0.7% quarterly rate).*
- *Job creation showed a moderate increase in the third quarter, with a 3.0% yoy upward.*
- *Inflation returned to positive rates in September (0.2% year on year) and the start of a moderate upward trend is expected, possibly reaching 1% year on year by December.*
- *Companies bear the greatest burden of the effort to reduce the public deficit in 2016 due to the rise in the minimum rate to 23% (25% for banks and oil companies) in corporate income tax payments on account for companies with a turnover above €10 million. This measure may be extended until the target deficit is met.*

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IMF growth forecasts (October 2016)								
	IMF			dif. from Jul.		dif. from Apr.		
	2015	2016	2017	2016	2017	2016	2017	
GDP (year-on-year rate)								
World growth	3,2	3,1	3,4	0,0	0,0	-0,1	-0,1	
United States	2,6	1,6	2,2	-0,6	-0,3	-0,8	-0,3	
Japan	0,5	0,5	0,6	0,2	0,5	0,0	0,7	
Euro Area	2,0	1,7	1,5	0,1	0,1	0,2	-0,1	
Germany	1,5	1,7	1,4	0,1	0,2	0,2	-0,2	
France	1,3	1,3	1,3	-0,2	0,1	0,2	0,0	
Spain	3,2	3,1	2,2	0,5	0,1	0,5	-0,1	
Italy	0,8	0,8	0,9	-0,1	-0,1	-0,2	-0,2	
United Kingdom	2,2	1,8	1,1	0,1	-0,2	-0,1	-1,1	
Advanced economies	2,1	1,6	1,8	-0,2	0,0	-0,3	-0,2	
Emerging economies	4,0	4,2	4,6	0,1	0,0	0,1	0,0	
China	6,9	6,6	6,2	0,0	0,0	0,1	0,0	
World trade	2,6	2,3	3,8	-0,4	-0,1	-0,8	0,0	

Source: IMF

## **INTERNATIONAL SCENE: central banks attract the attention of financial markets**

In September, volatility in financial markets increased due to the decisions taken by the main central banks. Asian stock markets finished the month with slight losses, as did the German ones and, to a larger extent, the Italian stock market, affected by the problems faced by their financial entities. In the United States, financial markets had mixed performances, while the French and Spanish markets posted slight gains.

In contrast, the London stock market showed considerable increases, although its performance is partly influenced by the pronounced decline of the British pound. The British currency continues to depreciate against major world currencies and its price stood at the lowest level of the last 31 years, following the announcement of the start of negotiations for the Brexit in the first quarter of 2017.

As for central banks, it is worth noting that the European Central Bank did not make any changes to its monetary policy and its president, Mario Draghi, said that, for the time being, they are not considering additional stimuli. In addition, the Federal Reserve also kept its interest rates unchanged, even though it hinted about a possible hike in December, while it reiterated its intention of normalizing its monetary policy at a very gradual pace.

Meanwhile, the Bank of Japan maintained its rates at -0.1%, although it announced a new change of strategy in its monetary policy. Its goal is yield curve control, aiming to set the 10-year bond yield at around 0%. Thus, the expansion of its monetary base will be flexible, instead of the previous limit of ¥ 80 trillion. Furthermore, the Japanese institution said it would continue to expand its monetary base until inflation is set over 2% in a stable manner.

On the other hand, the IMF maintained its forecast for global growth at 3.1% for 2016 and 3.4% for 2017, with a downward revision for advanced economies and a slight rise for emerging economies. It is worth highlighting the decrease in US growth estimates by 0.6% (in comparison with the forecast in July), due to a GDP increase for the first half of the year significantly below expectations. In contrast, forecasts for the Eurozone and the UK were revised upwards by 0.1 % and for Japan by 0.2%.

Meanwhile, the improvement in emerging economies is based on a progressive overcoming of the recession in countries such as Brazil, Russia and Nigeria, which will offset the slowdown in China, although the country will continue to post robust growth. In addition, world trade will grow only 2.3% in 2016 and it is expected to regain momentum in 2017, when it will increase by 3.8%.

Nonetheless, despite the economic improvement expected for 2017, the IMF points out that there are still outstanding risks for global growth among which it names the possible effects of Brexit, the stagnation of advanced economies and "global pressure to adopt populist inward-looking policies." It also mentions ongoing realignments, such as the rebalancing of the Chinese economy, the adaptation of countries that export raw materials to a reduction in their price and the demographic and employment trends, which result in a decrease in productivity.

To foster activity, the institution calls for greater coordination between countries and for monetary policy to go hand in hand with fiscal policy and structural reforms that drive growth. In addition, it stresses the importance of promoting global trade and economic integration as factors for long-term growth, while it states that it would be advisable to include measures to mitigate the negative effects of economic changes on income distribution.

The price of Brent crude stood at an average of \$ 46.8 per barrel in September, continuing the gentle upward trend from the prior month, posting levels that are only 1.3% lower than the ones recorded in September 2015. In the last days of the month and in early October, the price has exceeded \$ 48 per barrel on the back of the decision taken at the informal OPEC meeting, held in Algiers, of cutting crude oil production, although agreements will take actual shape in November. In addition, on October 28 and 29 there will be a meeting between OPEC and other major oil producers to seek an understanding on how best to rebalance the market.

## THE SPANISH ECONOMY: a slowdown is expected from the third quarter onwards

The IMF notes that the Spanish economy will grow 3.1% in 2016 and 2.2% in 2017, which represents an upward revision for both years. The improved forecast is due to two factors: the economy grew solidly in the first half of 2016 and the external context was more favourable than initially expected. This new estimation implies that Spain's GDP will grow at a higher pace than the other major economies of the European Union in 2016 and 2017.

The Spanish economy continued to grow at a high rate in the third quarter. CEOE's activity indicator shows that GDP grew by 0.7% in quarterly terms (the same figure as the one advanced by the Bank of Spain), which is one tenth lower than in previous quarters. This slight loss of momentum would be due to investment, especially in capital goods, affected by the current uncertainty both at national and international levels. Civil works are also suffering from the lack of activity in the public sector. In

contrast, private consumption is still robust due mostly to better employment behaviour. In fact, the trend in the labour market was positive for the third quarter in terms of the number of contributors to the Social Security, with a yoy growth of 3,0%, above the 2,7% recorded in the second quarter, due to a greater momentum in employment in the services and construction sectors.

With regards to the public deficit, the caretaker Government has announced an extension of the 2016 State Budget to 2017. In fact, the ministers of Finance and the Public Administration, and of Economy and Competitiveness have prepared a report on the Budget and Effective Action Plan for 2016 and 2017, which has been sent to Brussels. The report includes the measures implemented by the Regional Governments in compliance with the Budget Stability Act; the Agreement of the Non-availability of expenses that was adopted at midyear; and the Royal Decree Act that allows instalment payments on Corporate Income Tax.

### DEMAND AND ACTIVITY: first signs of a slowdown

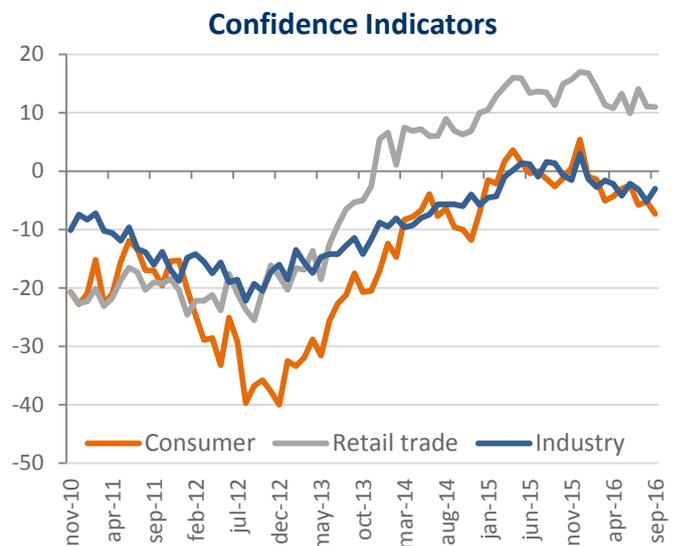
Estimations for the third quarter point to strong growth for the Spanish economy (0.7%), albeit somewhat lower than in the second quarter. This slight slowdown falls under the scenario foreseen for 2016, where the economy will begin a gentle slowdown in the second half, compatible with robust growth for the year as a whole (3.1% according to CEOE estimates). This trend is due to the depletion of some of the driving factors that have supported growth in recent quarters, coupled with a national and international context of greater uncertainty.

The economy's positive momentum is still supported by internal demand, but a decrease of its contribution to growth is starting to show in contrast to the foreign sector, which has been positively contributing since the second quarter and is expected to continue to do so in the upcoming quarters. In this regard, in July, although exports of goods decreased, imports decreased even more. Consumption has posted considerable progress thanks to the favourable evolution of employment, together with negative inflation and improved financing conditions. Consumer expectations, although still at historically high levels, show a worsening in the third quarter, showing the perception of the exhaustion of driving factors.

On the other hand, within a context of improved credit accessibility and conditions, home sales still showed notable strength in August (20.3%), following the slow-

down in July (1.1%), with used home sales posting the strongest growth.

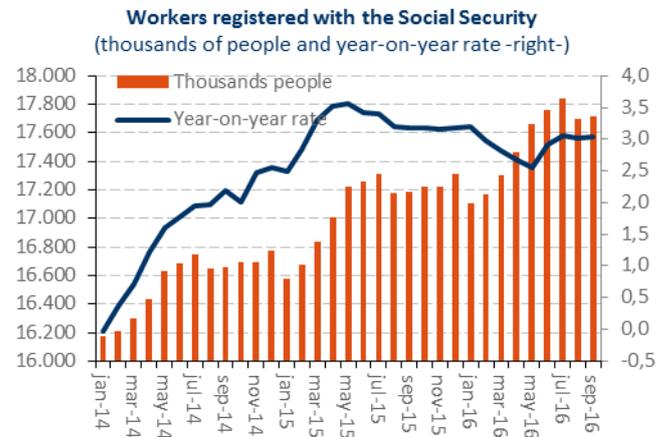
By sectors, it is worth noting the buoyancy of tourism in the months of July and August, with an average gain of more than 7% over the previous year in tourist arrivals and increased tourist spending of more than 5%. Moreover, the industrial production index picked up significantly in August, especially the capital goods component, supported by exports, and the still remarkable pace of investment in equipment goods, although less intense than in previous quarters.



Source: Eurostat

## THE LABOUR MARKET: the number of contributors to the Social Security spikes in the third quarter, being set at 3.0% year on year

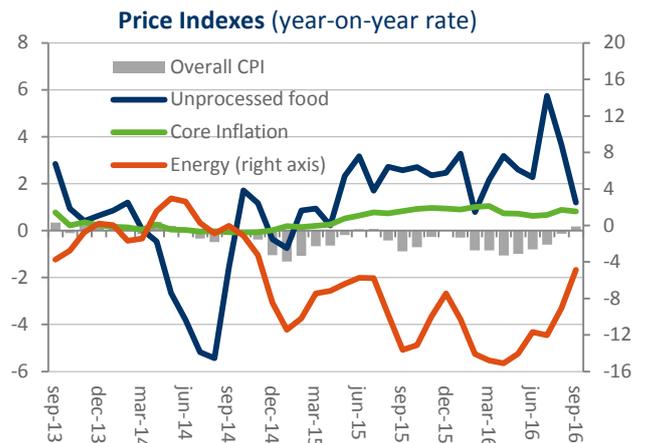
The number of contributors to the Social Security increased in September by 12,025 people, the second highest number for this month since 2006 (the other was seen in 2014). By sectors, the number of contributors increased in agriculture, industry and only slightly in construction, while it dropped in the services sector. By branches, it is worth noting the increase in Education, by almost 63,000 people, driven by the start of the school year, while the most notable declines were seen in Trade (-30,772) and the Hospitality sector (-46,346), linked to the end of summer season. The annual rate remained stable at 3.0%, although it is worth highlighting that, throughout the third quarter, the rate has rebounded to 3.0%, from the 2.7% recorded the second quarter.



Source: Ministry of Economy and Competitiveness and CEOE Economic Research Unit

## PRICES: inflation returns to positives rates and will continue to rise

Inflation in September recorded positive rates once again, being set at its maximum level since May 2014 with a slight 0.2% change. The rise in inflation is due to the fact that energy prices are no longer exerting downward pressure, since oil prices are at very similar levels to those of a year ago. Core inflation dropped 0.1% and stands at 0.8%, as the price variations of its components are very contained. Non-processed foods are still the most inflationary component, although they show considerable slowdown. In the coming months, if oil prices stay around the current level (\$50/barrel), its price increase would reach 27% in December and would exceed 50% in early 2017, which would account for general inflation rising rapidly in said period.



Source: INE

## THE PUBLIC SECTOR: increase in Corporate Taxes in order to meet the public deficit target for 2016

Data regarding the budget execution by the Government, excluding Local Governments, shows that in the period from January to July, the deficit was set at €34.484 billion, equivalent to -3.1% of GDP.

In July, the final settlement of the financing system of the Territorial Governments corresponding to 2014 was done, amounting to €8.589 billion, €7.611 billion more than the settlement paid in the previous year. This implies an improvement in the balance of the regional governments and, in return, less resources for the central Government by that same amount. Thus, the deficit of the Regional Governments is set at -0.07% of GDP, vs. -0.8% of GDP for the same period of 2015. By contrast, the Central Government deficit according to the data advanced until August was set at -2.8% of GDP, higher

than the target for 2016 (-2.2%). To this we have to add the highest deficit of the Social Security Funds in comparison to 2015, despite the higher revenues from Social Security contributions (3.2% up to July).

With regards to the public deficit, the caretaker Government has set a minimum rate of 23% (25% for banks and oil companies) for CIT payment on account for companies with a turnover of more than € 10 million. Thus, companies will have to pay in the last quarter an amount estimated at €24 billion. Furthermore, this measure could be extended until the target deficit has been met. Nobody denies that ensuring compliance with the target deficits is a priority (-4.6% of GDP in 2016), but it should not be achieved by solely increasing corporate taxes.