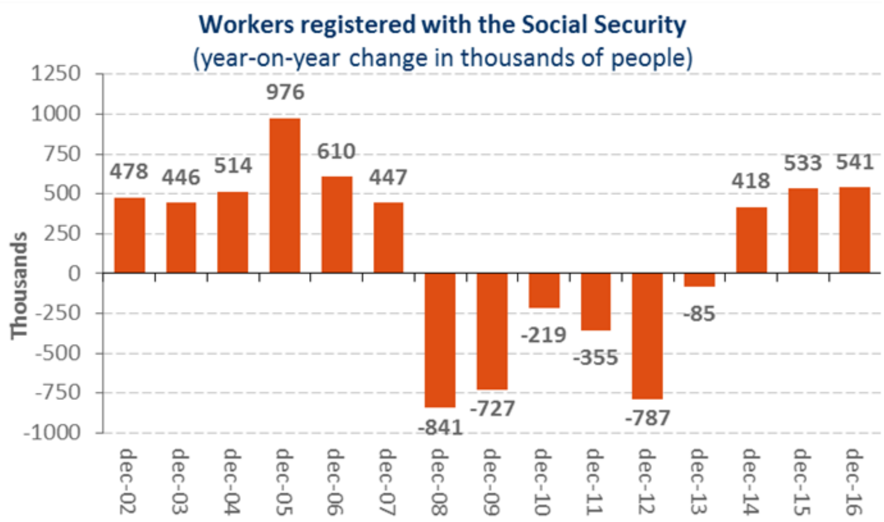
ECONOMIC OUTLOOK

January 2017

- ***The Federal Reserve raised interest rates in the United States by a quarter of a point, up to the 0.5% to 0.75% range.***
- ***Oil prices increased substantially in December, following the agreement between the OPEC countries and other producers to cut production by 1.8 million barrels a day.***
- ***Positive balance for the Spanish economy in 2016 in terms of growth and employment and in the adjustment of economic imbalances.***
  - ***GDP, at a quarterly rate of 0.7% in the fourth quarter, could close 2016 with an average growth of 3.2% for the second consecutive year.***
  - ***Employment, measured in terms of the number of workers registered with the Social Security, increased by 3.0% in 2016.***
  - ***Information up to September for the Public Administration points to compliance with the public deficit objective in 2016 (-4.6% of GDP) being feasible.***
  - ***The positive trade balance is expected to widen in 2016, exceeding 2% of GDP.***
- ***Inflation, with an average rate of -0,2% in 2016, registered a significant rebound in December (1.5%) and will continue to rise in the upcoming months.***
- ***The amendment of the Corporate Income Tax in December may affect business investment, job creation and competitiveness.***

CONTENT:



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

INTERNATIONAL SCENE: The Federal Reserve increased interest rates

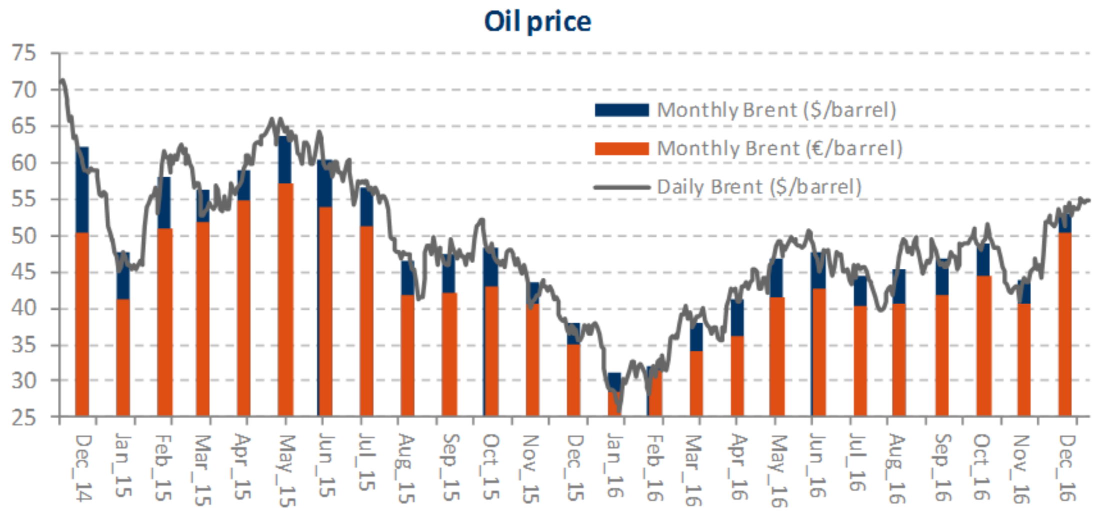
In December, financial markets were influenced by the decisions of the main central banks and the increase in oil prices. Most of the world's stock markets posted positive performances, helped by the good progress of the activity in some of the advanced economies, with the United States standing out, and improved forecasts on the evolution of world growth, as indicated by the rise in the confidence and activity indicators, with global composite PMI at the high of the last eleven months.

With regards to central banks, it is worth highlighting the divergence in the decisions adopted in Europe, extending the duration of monetary stimuli, and the United States, where interest rates were increased, leading to lower yields in European public debt and a depreciated euro vs. dollar. Thus, the ECB extended its debt repurchase program a further nine months, up to December 2017, although it will reduce its monthly volume from €80 billion to €60 billion, starting in April. Furthermore, it expanded the type of debt it may acquire.

In contrast, the Federal Reserve approved an increase in interest rates of 25 bps, up to the 0.5% / 0.75% range. This is the second hike in the price of money in almost 10 years, following the first one implemented a year ago, which marked the start of the normalization process of the United States monetary policy. The decision is based on the strength of the country's macroeconomic data, with an annualised growth of 3.5% in the third quarter and a decreasing unemployment rate that was set at 4.6% in November, together with core inflation over 2%. Nonetheless, the Fed's President, Janet Yellen, reiterated that the rate hikes will continue to be gradual, although her strategy has become slightly more aggressive and three new hikes are expected throughout 2017, in comparison to September's expectations of only two hikes. If the Fed´s plans are met, rates could end up around the 1.25% / 1.50% range by the end of this year, although it will ultimately depend on the behaviour of the inflation and the pace of the economy and employment figures.

Meanwhile, the central banks in the United Kingdom and Japan kept interest rates unchanged as well as their plans for monetary stimuli.

With regards to oil, it is worth mentioning the marked increase in prices in December. Brent crude reached, on average, $53.1 per barrel, which represents a 20.7% increase vs. November and is 39.8% more expensive than in December 2015. This rise in prices occurred as a consequence of the agreement reached by the OPEC countries this past November 30 to reduce production by 1.2 million barrels/day, to which other producers, including Russia, joined, bringing the total production cuts to 1.8 million barrels/day. For the next few months, the price of Brent oil futures indicate a continued upward trend in prices, although at a slower rate. However, some factors could weight down on crude oil prices, such as an increase in production by third countries, including the United States, an appreciation of the dollar or for the agreed cuts to not be respected within the OPEC. On the other hand, a greater momentum of the global economy could drive prices higher.



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

THE SPANISH ECONOMY: Positive balance for growth and employment in 2016

The economy will close 2016 with a high rate of growth in activity and employment. In line with CEOE's estimations, the Bank of Spain forecasted quarterly GDP growth at 0.7% in the fourth quarter thanks to strong domestic demand, while the external sector could have a more neutral contribution to the GDP. With this rate, GDP growth for 2016 would reach 3.2%, the same as in 2015. With regards to employment, the number of workers registered with the Social Security increased by 540.7 thousand people in December 2016, in comparison to the same month in 2015, and the average annual growth was set at 3.0%.

As for the adjustment of macroeconomic imbalances, information on the balance of payments up to September points to a new surplus in 2016. The accumulated figure for the last twelve months shows that the Spanish economy registered a net lending of €26.2 billion, higher than the €21.7 billion in 2015. With respect to the public deficit, budget data up to September covering all the Public Administrations, with a deficit of -2.6% of GDP, points to a high probability of meeting the objective for 2016 (-4.6% of GDP), after years of non-compliance. Finally, we should mention the significant rebound of inflation in December, up to 1.5%. Even so, average inflation for 2016 will be set at -0,2%.

For 2017, the Spanish economy will continue its recovery cycle, but at a slower pace (2.3%) due to a depletion, and even a reversal, of the factors that have driven growth. The rise in oil prices will negatively affect costs. We must also take into account the impact that changes in the Corporate Income Tax will have on corporate investment. The Government will collect €4.3 billion with said change, instead of reducing non-productive public spending. At the same time, growth of household disposable income will be slower due to the lower creation of employment and higher inflation. All this in the midst of a foreign environment with considerable uncertainties.

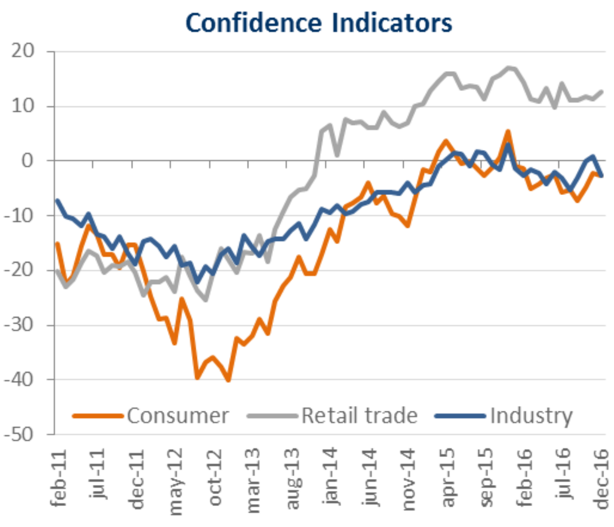
DEMAND AND ACTIVITY: Improvement in confidence in the final stretch of the year

According to the Bank of Spain's forecast, the Spanish economy will close the year with a growth of 0.7%, in line with CEOE's estimations and identical to the rate posted in the third quarter. With this figure, the economy is still showing strong momentum and growth for the year could be set around 3.2%, the same rate as in 2015. However, the outlook for 2017 is not so positive, as has been said before.

Information relative to the fourth quarter shows an improvement in confidence indicators in the last stretch of the year, with a more positive behaviour of the Economic Sentiment and the composite PMI Index. In this regard, the consumer confidence index, which had been showing a worsening trend throughout the year, improved slightly in the fourth quarter, with the retail trade confidence indicator remaining at similar levels to third quarter. In this context, car registrations posted remarkable growth in the fourth quarter, 9.0%, although somewhat lower than in the third quarter. For the whole of 2016, car sales exceeded 1.1 million vehicles, the highest level since 2008.

By sectors, the confidence indicators for industry, construction and services recorded a significant rebound in the fourth quarter. In addition, the indicators for the tourism sector showed very positive behaviour in the last months of the year. Both the arrival of tourists and tourist spending registered growth of over 10% year-on-year in the October-November period. So far this year, the number of tourists has grown by 10.1%, almost double the increase recorded in 2015.

Regarding the external sector, exports grew by 0.9% until October, while imports fell by -1.6%, which enabled a -26.6% reduction in the deficit accumulated in the first 10 months. However, the increase in oil prices, in addition to slowing private consumption growth, will translate into an increase in our foreign payments and, in turn, weigh down on our current account balance.

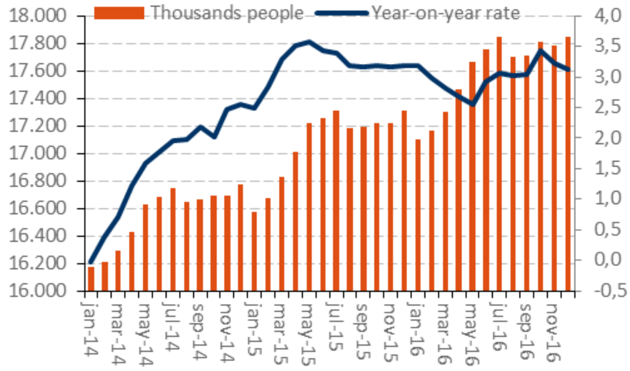


Source: European Commission

THE LABOUR MARKET: the number of workers registered with the Social Security rebounded in the fourth quarter, up to 3.3% year-on-year

The number of workers registered with the Social Security increased in December by 68,531 people, the third highest figure (following 2014 and 2015) for this month in the historical series. This is due, in part, to the favourable performance of agriculture and the positive effect of the Christmas campaign on retail businesses. Hence, 2016 closed with 17.85 million workers registered with the Social Security, the highest number since October 2009. In year-on-year terms, the number of workers registered with the Social Security increased in 540,655 people, which is the best figure for December since 2006. In contrast, the year-on-year rate slowed down slightly to 3.1%, although it should be pointed out that in the fourth quarter the rate rebounded three tenths to 3.3%.

Workers registered with the Social Security
(thousands of people and year-on-year rate -right-)

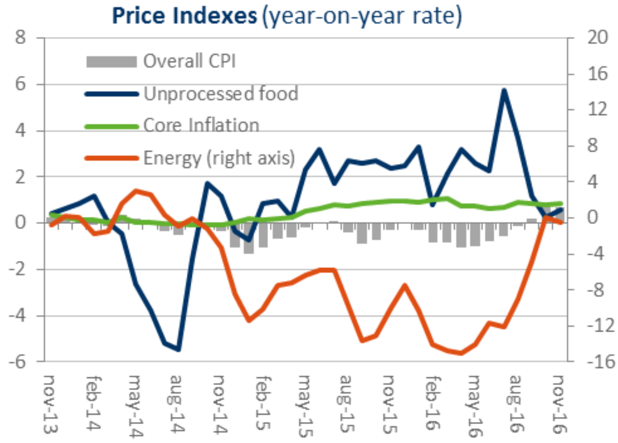


Source: Ministry of Economy, Industry and Competitiveness and CEOE Economic Research Unit

PRICES: Inflation accelerated rapidly due to higher energy prices

According to preliminary data from the National Statistics Institute, inflation in December would be set at 1.5%, eight tenths over the November figure, placing the yearly average at -0.2%. Inflation is on an upward trend that will continue in 2017 and whose intensity will mainly depend on the differential of the year's oil prices with last years', since at current levels there could be increases of more than 50% in the first few months. In addition to the increase in fuel prices there has been a rise in tobacco and alcohol taxes and the phone and gas fees will also go up. However, for the time being, core inflation is still very contained, under 1%, and it is expected to remain at similar levels over the next few months.

Price Indexes (year-on-year rate)



Source: INE

THE PUBLIC SECTOR: New budgetary trend for Autonomous Regions

With information up to September, the deficit for all the Public Administrations is set at -2.6% of GDP, a difference of two points in relation to the objective for the year as a whole (-4.6% Of GDP). Therefore, compliance with this objective seems feasible in 2016. In addition, the budget implementation up to October of all the Public Administrations except Local Governments posted a negative balance of -2.7% of GDP, which means a reduction of 15.4% over the same period in the previous year. The Social Security system, whose balance in October already represented -0.8% of GDP, is the only level of the Public Administrations that widened its deficit in 2016.

As for the central Government, with preliminary information up to November, there is certain deficit stability in comparison to 2015, with it being set at -2.4% of GDP. Despite the increase in revenues generated by the change in the Corporate Income Tax, the increase in returns in November slowed down the upward trend in revenues. Meanwhile, payments continued to decline up to November, albeit a moderate -1.7%.

Lastly, the Government has set new public deficit objectives for the Autonomous Regions for the 2017-2019 period, in line with the agreement reached in the Fiscal and Financial Policy Council. For 2016, the objective established is -0.7% of GDP, which is feasible, and it goes down to -0.6% of GDP for 2017, with the fiscal adjustment path intensifying in the following years (-0.3% of GDP for 2018 and 0.0% of GDP for 2019).