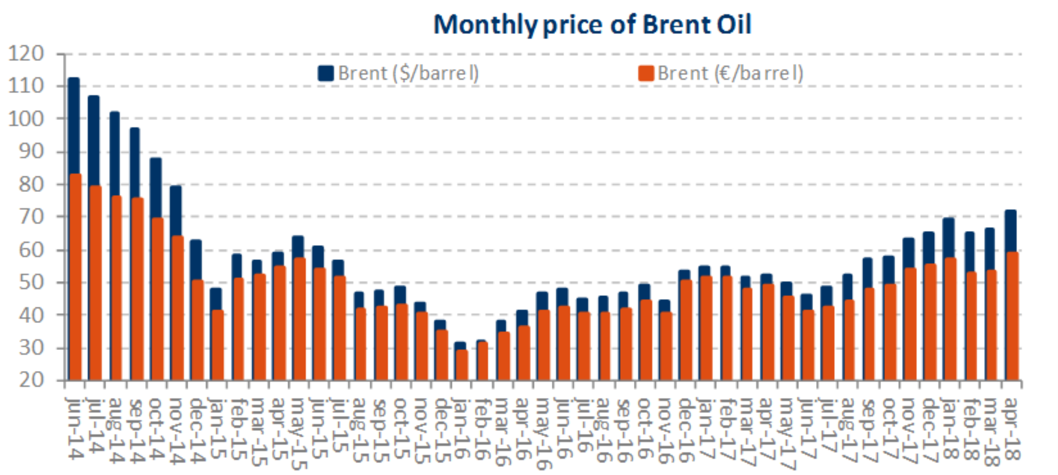
ECONOMIC OUTLOOK

May 2018

- ***The European Commission improves forecasts for global growth up to 3.9% for 2018 and 2019, but insists on the increase in global risks.***
- ***The main central banks keep their monetary policies unchanged.***
- ***Oil prices rise sharply due to geopolitical tension in Iran.***
- ***Forecasts for the Spanish economy in 2018 improve, although within a context of greater uncertainty.***
- ***The Spanish economy keeps growing at a high rate at the beginning of 2018, although some indicators are starting to reflect a slowdown.***
- ***The number of workers registered with the Social Security grows at a slower year-on-year rate in April, which is set at 3.1%.***
- ***Inflation decreases by a tenth to 1.1% due to the Easter effect on tourist services. Core inflation remains very subdued, but energy prices are starting to pick up.***

CONTENT:



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

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INTERNATIONAL SCENE: significant increase in oil prices

The European Commission, in its spring report, highlights that although the growth rate seems to have slowed down in the first months of the year, it is due to one-off factors and, therefore, global activity will continue to follow its strong momentum, supported by the strength of investment and trade at a global level.

Within this scenario, it has revised upwards its forecasts for world GDP to 3.9%, both for 2018 and for 2019, two tenths higher than the forecast issued this past November and in line with other international organizations such as the IMF, who, in April, also raised its global growth forecasts to 3.9%.

The improvement has been more pronounced in advanced economies, mainly in the United States, where the approved fiscal stimulus will foster activity and GDP is expected to increase by 2.9% this year. On the other hand, in the Eurozone, growth will slow down slightly as the monetary stimuli are gradually withdrawn, and GDP is expected to reach 2.3% in 2018 and 2% in 2019. The latter year will also continue to deal with the uncertainty about the United Kingdom's relationship with Europe following Brexit. In terms of emerging and developing economies, growth is estimated to increase to 5% in 2018 and 2019, with the countries that export raw materials benefitting from their price increase.

However, the European Commission warns about the existing risks, among which it is worth pointing out a possible overheating of the economy in the United States, which could lead to a quicker interest rate increase and, in turn, generate financial turmoil and difficulties for emerging economies that are highly indebted in dollars. Another worrying issue highlighted is the increase in protectionism, which could lead to higher tariffs and, as a consequence, a slowdown in world trade, and an increase in geopolitical tensions.

With regards to leading indicators for the second quarter, in general they show a positive behaviour. Thus, in April, the global composite PMI improved by half a point, indicating a slight acceleration in activity. Growth gains momentum in the United States and an improvement is also shown by Japan's PMIs, while in Europe there is a mild slowdown, despite which the growth rate remains robust. Among the emerging economies, the evolution is varied, with increases in the PMIs in Russia and India and deterioration in Brazil, although they still record values above 50 points, thus indicating timid growth.

Meanwhile, the main central banks have maintained their monetary policies unchanged in their meetings at the end of April and beginning of May. The ECB again confirmed that asset purchases, amounting to €30 billion per month, will keep on going until the end of September or even further if necessary, until inflation returns to numbers that are compatible with the objectives of the institution, i.e. close to 2%. On the other hand, the Federal Reserve noted the good performance of the economy and the labour market and underlined that the monetary policy is still accommodative. Therefore, expectations point to a possible interest rate hike at the next meeting in June.

On the other hand, the main world stock exchanges had a mostly positive behaviour during April, compensating the bad results of the previous two months. The decisions from central banks to keep interest rates unchanged and the good results posted by the energy sectors, supported by the evolution in crude oil prices, have boosted stock indices.

In April, oil prices increased significantly, with Brent crude standing at an average of $72 per barrel, 9.1% higher than in March and the highest level since November 2014. In year-on-year terms, the price rise was 37.8%, although in euros the increase was somewhat lower, just 20.4%, due to the appreciation of the European currency against the dollar over the past year. Among the factors that are having an impact on the price increase are good prospects for global growth, which will increase oil demand, the possible extension of production cuts by the OPEC and by other countries such as Russia, together with geopolitical tensions in the Middle East. The departure of the United States from Iran's nuclear agreement and the possibility of establishing new economic sanctions against Iran have continued to push up crude oil prices, which exceeded $80 per barrel in mid-May.

THE SPANISH ECONOMY: positive outlook within a context of greater uncertainty

The outlook for the Spanish economy continues to be positive for 2018. Specifically, the European Commission, in its latest spring report, raised Spain's growth forecast to 2.9% this year and 2.4 % next year. In addition, the last edition of the Funcas Panel increased the GDP forecast for this year by one tenth to 2.8% (in line with CEOE's forecast), while it continues to expect 2.4% for 2019.

However, there is greater uncertainty at a domestic as well as a foreign level, which could have a downward effect on this positive growth trend. The external factors that may affect growth include, first of all, the rise in oil prices, which reached $80 per barrel. If this upward trend consolidates, company costs and household disposable income will be affected, with the subsequent impact on investment and consumption. Secondly, we should highlight the new barriers that are being imposed on free trade, which may have a negative impact on world trade and our exports. Finally, geopolitical tensions in the Middle East and North Korea, together with the Brexit negotiations and the formation of a Government in Italy, are factors that could create greater volatility among financial markets. At a domestic level, the political situation in Catalonia is still the greatest source of uncertainty.

In terms of the budget, and as a new item with regard to the General State Budget for 2018, it is worth noting an agreed increase in pensions of 1.6% for 2018 and 2019 and the delay in applying the sustainability factor, which is pushed back to 2023. These measures will undoubtedly increase public spending and will pose an additional constraint to meeting the public deficit objectives in the short and medium term.

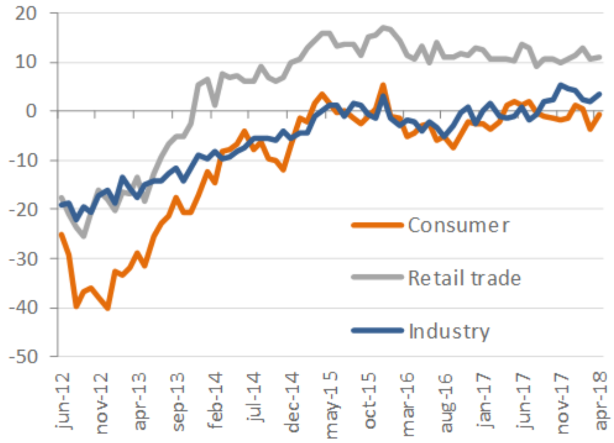
DEMAND AND ACTIVITY: the economy continues to show strong momentum, although some exhaustion is seen in certain components

According to the data advanced by the National Institute of Statistics, the Spanish economy once again grew at 0.7% in the first quarter of 2018, accumulating three quarters with the same quarterly rate. With this data, the year-on-year rate would be set at 2.9%, two tenths lower than the previous quarter. The good performance of the economy is leading to upward revisions of the forecast for 2018 by certain institutions such as the European Commission or the Funcas Panel, as mentioned above.

According to the information available, domestic demand would have continued posting strong momentum, both for consumption and investment, thus continuing to be the economy's driving force, although it may decelerate slightly in the second quarter. There is a certain slowdown in job creation rates and, although expectations for households and sectors are still quite positive, they are lower than in the first quarter. Growth in consumption may be limited by the exhaustion of pent-up demand and the decline in the savings rate.

From the point of view of the external sector, exports of goods continued to grow at a good pace, although imports of goods have also accelerated. Thus, in terms of volume and according to Customs data, exports increased 2.3% and imports increased 3.4% on average in January and February. On the other hand, according to preliminary data on the Balance of Payments in the first two months of the year, the net lending position of the economy could post a better result than in the same period for the previous year, due to an improvement in the capital account.

Confidence Indicators



Source: European Commission

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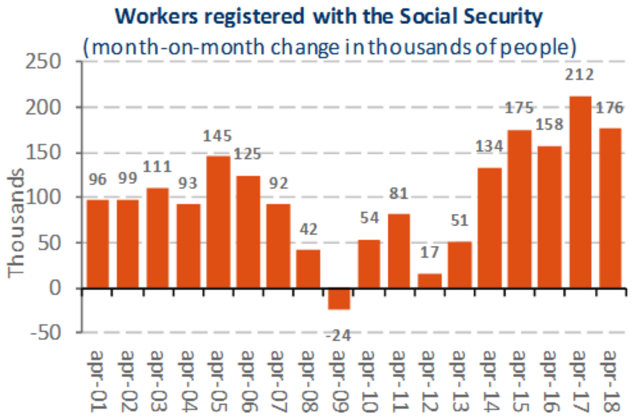
THE LABOUR MARKET: the number of workers registered with the Social security slowed its year-on-year rate of growth in April, down to 3.1%

According to the LFS, the number of people employed decreased by 124,100 in the first quarter, more than expected, which is the sharpest fall in this period since 2014. The year-on-year job creation rate fell two tenths to 2.4%. In addition, the number of people unemployed and the unemployment rate increased with respect to the fourth quarter of 2017, up to almost 3.8 million people and 16.7%, respectively.

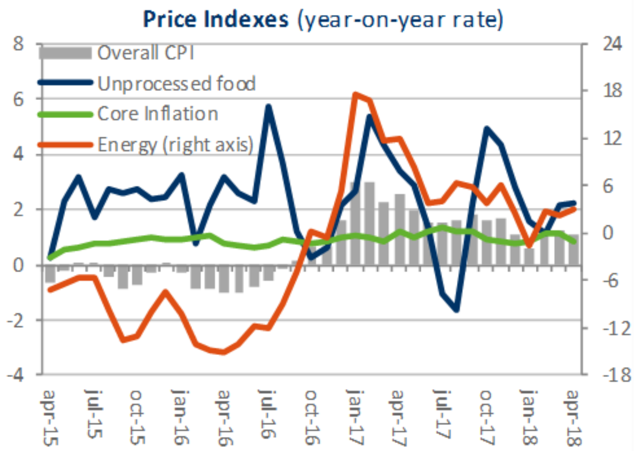
Meanwhile, in April, the number of workers registered with the Social Security increased by 176,373 in comparison to March, the second highest figure in the historical series for April. However, the year-on-year rate slowed down to 3.1%. Thus, the total number of workers registered stands at around 18.68 million, reaching levels last seen at the end of 2008.



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

PRICES: inflation decreased down to 1.1% due to the slowdown in core inflation

In April, the year-on-year growth rate of the CPI decelerated one tenth to 1.1%. Core inflation fell four tenths, to 0.8%. This evolution was mainly due to the decrease in the price of holiday packages and accommodation services as a result of the Easter effect. The rest of the core inflation components continue to post restraint growth. However, energy prices break their downward path, due to the increase in fuel prices and the price of heating oil and electricity. If oil prices remain at current levels, inflation could rise to around 2% in the summer months, although the annual average would be set around 1.5%.



Source: INE

THE PUBLIC SECTOR: the budget implementation up to March shows strong revenues and also strong expenditures

According to the State's budgetary implementation until March, the deficit has been reduced by 14.4% with respect to the same period of 2017, which in terms of GDP equals 0.37%. Excluding accrued interest, there was a primary surplus of € 1.586 billion, 41.2% higher than in the first quarter of 2017.

This improvement in the budget balance is explained by an increase in revenues of 8.4%, while expenses only grew by 5.9%. Within non-financial revenues, tax revenues, which represent 89.8% of the total, increased by 8.5%, with revenues from VAT (7.4%) and Income Tax (7.8%) collection standing out. In the case of non-financial uses, the significant increase has been conditioned by a greater contribution to the EU, up by 34.9%, and a 4.9% increase in transfers to the Regional and Local Governments.

With regard to the net borrowing of Central Government, the Social Security Funds and the Regional Government as a whole, up to February, it was set at -0.8% of GDP, vs. -1% of GDP in the same period of the previous year.

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