ECONOMIC OUTLOOK

November 2018

- ***CEOE revises its GDP growth forecast down to 2.6% in 2018 (previously at 2.7%), in line with the European Commission. For 2019, CEOE does not change its forecast of 2.3%, while the European Institution sets it at 2.2%.***
- ***The Spanish economy stabilizes its quarterly growth at 0.6% in the third quarter. It is worth mentioning, on the one hand, a notable deceleration in exports and, on the other, the decline in productivity and the rebound of ULCs.***
- ***According to the LFS, the number of people employed exceeded 19.5 million people in the third quarter for the first time since 2008 and the unemployment rate dropped to 14.6%. Meanwhile, the number of workers registered with the Social Security starts the fourth quarter with an unexpected boost.***
- ***Oil prices rose again in October, reaching the highest level since 2014. Nonetheless, towards the end of the month there was a reversal of the trend, which has followed through into the beginning of November.***
- ***Inflation remains at 2.3% in October, while core inflation rises to 1.0%.***
- ***The European Commission revises its growth forecasts downwards, pointing out that the degree of uncertainty it still high.***

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European Commission forecasts (November 2018)

	GDP			Inflation			Unemployment rate		
	2018	2019	2020	2018	2019	2020	2018	2019	2020
United States	2.9	2.6	1.9	2.5	2.4	2.2	3.9	3.5	3.5
Japan	1.1	1.0	0.5	0.8	1.0	1.3	2.7	2.6	2.5
Eurozone	2.1	1.9	1.7	1.8	1.8	1.6	8.4	7.9	7.5
Spain	2.6	2.2	2.0	1.8	1.7	1.5	15.6	14.4	13.3
Germany	1.7	1.8	1.7	1.8	1.9	1.6	3.5	3.2	3.0
France	1.7	1.6	1.6	2.1	1.7	1.6	9.0	8.8	8.4
Italy	1.1	1.2	1.3	1.3	1.5	1.4	10.7	10.4	10.0
EU-28	2.1	1.9	1.8	2.0	2.0	1.8	6.9	6.6	6.3
EU-27	2.2	2.0	1.9	1.8	1.9	1.7	7.4	7.0	6.6
United Kingdom	1.3	1.2	1.2	2.6	2.0	1.9	4.3	4.5	4.7
China	6.6	6.2	5.9	1.8	2.0	--			
World	3.7	3.5	3.5						

Source: European Commission

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INTERNATIONAL SCENE: the European Commission also revises downwards its global growth forecasts

During October, financial markets have shown quite a negative behaviour, with drops of over 5% in the main European, Asian and American stock markets. Geopolitical and trade tensions, together with the uncertainty raised by the Brexit negotiations and the passing of the Italian budget, have conditioned the investors' behaviour. In addition, Moody's downgraded the rating of the Italian bond one level, from Baa2 to Baa3, leaving it just one notch above "junk bond" status because it foresees an increase in the deficit in the coming years that will set its debt at around 130%, instead of reducing it, and due to the lack of economic and fiscal structural reforms.

The European Commission, in its autumn report, has revised downward its global growth forecast, as have the OECD and the IMF recently. Specifically, the European Commission expects the world economy to grow 3.7% in 2018 and 3.5% in 2019 and 2020, having lowered its forecasts for both, advanced and emerging economies. Regarding Europe, the European Commission has lowered its GDP growth estimation for the Eurozone by two tenths in 2018, to 2.1%, and by one tenth in 2019, to 1.9%, in comparison with the forecast issued in the spring. By 2020, economic growth is forecasted at 1.7%.

The European Commission points out that there is a high degree of uncertainty in the forecasts due to several interconnected downside risks: an overheating of the US economy that may result in a faster than expected increase in interest rates; a resurgence of US trade tensions with China; and, within the EU, concerns about the sustainability of the public finances of the most indebted Member States and the Brexit negotiations. In fact, on November 13, it was announced that the United Kingdom and the EU had reached a "technical agreement" on the Brexit, albeit this agreement must still go through a series of procedures on both sides, the British and the European.

The first estimations for economic activity in the third quarter throw an unequal picture. In the Eurozone, the slowdown in GDP growth was surprising over this period, with a quarterly increase of 0.2%, compared to 0.4% in the two previous quarters, which slowed year-on-year growth to 1.7%. In this respect, Germany's figure stands out for having registered a drop in GDP of -0.2% in the third quarter (due to a deterioration in exports), which represents the first contraction since the beginning of 2015. In contrast, in the United States, GDP continues to grow robustly, 0.9% quarter-on-quarter in the third quarter, after having posted 1.0% in the second quarter, and setting the year-on-year rate one tenth higher at 3.0%. Meanwhile, in China, GDP for the third quarter slowed its growth rate by two tenths to 6.5% year-on-year.

In addition, confidence indicators being released for the fourth quarter show heterogeneous signals depending on the region. The global composite PMI index increased two tenths in October to 53.0 points, which partly offsets the notable drop recorded in September. In the United States, confidence indicators show a clear improvement, with a one-point increase in the composite PMI index, up to 54.9 points. In contrast, in the Eurozone, the composite PMI dropped one point, to 53.1 points, the lowest value since September 2016. Moreover, the Eurozone Economic Sentiment Indicator fell in October, which could indicate a new slowdown of economic activity in the last quarter of 2018.

The main central banks kept their monetary policies unchanged in October and so far in November. The ECB, after its meeting in October, once again confirmed that the asset purchase program will continue until the end of December 2018, at a rate of €15 billion per month, while interest rates will remain at current levels at least until the summer of 2019. Meanwhile, it is expected that the Federal Reserve will implement a new rate hike in December, which will be the fourth increase in 2018, and gradual hikes will continue throughout next year.

In October, oil prices rose again and Brent crude reached an average of $81.6 per barrel, the highest value since October 2014. The main causes for this price rise were geopolitical tensions and the proximity of the US sanctions to Iran. However, in the final part of the month, the trend reversed and, in the first days of November, the price is fluctuating around $70 per barrel. The increase in production by Russia and Saudi Arabia and their claims supporting further increases, together with the downward revision of the global growth outlook are the main reasons behind this slowdown in prices.

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THE SPANISH ECONOMY: growth composition in the spotlight

The Spanish economy stabilized its quarterly rate of growth at 0.6% in the third quarter, the same figure posted in the previous two quarters. In year-on-year terms, the growth rate is also stable at 2.5%. Therefore, the Spanish economy continues to grow at significant rates within a weaker European context, although two relevant issues should be noted.

1. Growth shows a much more unbalanced trend than the previous year, due to the weakening of exports. In fact, exports have registered a notable slowdown since the beginning of the year, and they may close 2018 with a 1.7% increase, the lowest since the start of the recovery phase. All this is having an impact on the balance of payments, which will have a lower surplus, possibly closing the year below 1% of GDP.
2. The stalling, and even drop, in productivity and the rebound of labour costs. This behaviour hinders the competitiveness of the Spanish economy, which, coupled with the greater uncertainty and the foreseeable increase in costs for companies, could restrain growth and job creation in the coming quarters.

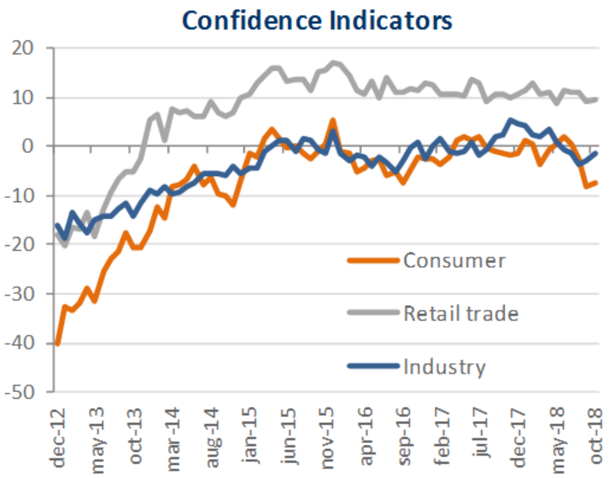
Due to all of the above, CEOE has revised downwards its GDP growth forecast for 2018 by one tenth to 2.6% (without ruling out 2.5% if growth proves lower in the fourth quarter), while it keeps estimations for 2019 unchanged at 2.3%. These forecasts would be in line with the ones published by the European Commission, which estimates 2.6% for 2018 and 2.2% for 2019. The uncertainty generated by the economic policy measures announced that, in most cases, still need to be defined further, could only contribute to a more pronounced slowdown.

On the other hand, the behaviour of the labour market deserves special mention, with job creation having stabilized. If we analyse the number of workers registered with the Social Security without taking into account the fields of agriculture or education (which have added some volatility in recent months), we can see certain stability in the employment creation rate, set at around 3% year-on-year, breaking the decelerating trend observed since the beginning of the year.

DEMAND AND ACTIVITY: the economy continues its rate of progress due to strong consumption and investment

According to the first GDP estimates for the third quarter, the economy has continued to grow at a healthy pace as a result of the good momentum of domestic demand, although it decreased its contribution to growth three tenths to stand at 3.0 percentage points. By components, private consumption posted a higher quarterly growth after the loss of momentum in the second quarter, although in year-on-year terms it registered a mild drop to 2.1%. Continued sustained job creation rates, together with favourable financial conditions and the increase in consumer credit, have allowed the increase in household consumption to stay above 2%, despite the low savings rate and the worsening of household expectations in recent months. Another driving factor for the period was the increase in car registrations in July and August, due to the entry into force of a new regulation in September. With respect to investment, according to data from the National Accounts, it continues to be the economy's most dynamic component, although it posted a slight deceleration and stands at 6.3% year-on-year. The information available for the third quarter also reflects a somewhat more moderate behaviour. Thus, after registering high rates in July and August, the IPI on capital goods turned negative in September and, although this may be one-off figure, the industrial climate index for capital goods registered a significant deterioration in the third quarter. Therefore, these indicators seem to indicate a slowdown.

The foreign sector subtracted 0.5 pps. from growth in the third quarter, according to estimations from the National Statistics Institute. With regards to indicators on the external sector, they also indicate a lower contribution to growth. Thus, according to the preliminary data on the Balance of Payments until August, the current account surplus was set at €2 billion, compared to €9.2 billion the year before, as a result of the higher deficit in the balance of goods.

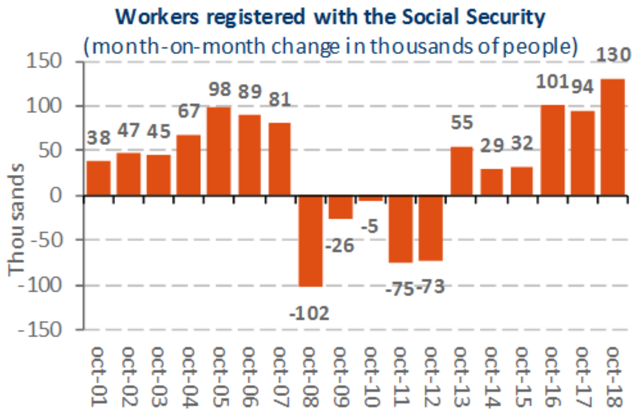


Source: European Commission

THE LABOUR MARKET: unexpected boost in the number of workers registered with the Social Security, which bounces to 3.1% year-on-year in October

According to the LFS, the labour market lost dynamism in the third quarter. The year-on-year job creation rate dropped three tenths to 2.5%. Even so, the total number of people employed exceeds 19.5 million people, the highest since 2008. Meanwhile, the number of unemployed individuals fell to 3.3 million people, and the unemployment rate decreased to 14.6%

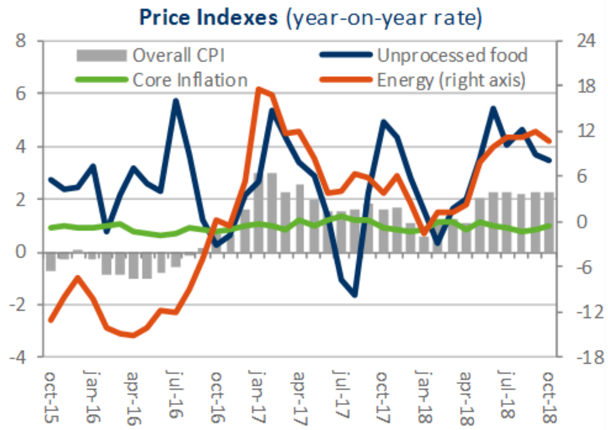
On the other hand, the number of workers registered with the Social Security started the fourth quarter with an unexpected boost. In October, it increased by 130,360 people, the highest increase in the historical series for this month. In addition, the year-on-year rate rebounded two tenths to 3.1%, where contributing sectors included agriculture and services, and education in particular. In fact, excluding agriculture and education, the year-on-year rate slowed down by one tenth, standing at 2.9%.



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

PRICES: inflation remains unchanged at 2.3%, while core inflation rises to 1.0%

Annual CPI growth rate stayed at 2.3% in October. The lower growth of the most volatile components (unprocessed foods and energy products) offset the increase in core inflation, which still shows moderate rates (1.0% in October). If we analyse core CPI components, we see that prices in services increased three tenths to 1.6%, non-energy industrial goods turned positive and grew by 0.1%, while processed foods rose two tenths to 1.0%. If oil prices manage to remain below $70 per barrel, the upward influence of energy on prices could be mitigated, although the annual average rate will be around 1.7%.



Source: INE

THE PUBLIC SECTOR: remarkable momentum in revenues

The State's net borrowing up to September were set at 1.1% of GDP, under the figure registered in the same period the previous year, which was 1.5% of GDP. It is worth pointing out the increase in the primary surplus, which reached 0.5% of GDP, vs. 0.2% of GDP the previous year.

This improvement in the Central Government's budgetary balance is due to the strength of non-financial resources, which rose 8.3% up to September. The most notable item is revenues from current taxes on income and wealth, which exceed by 10.5% those from the previous year. Within this group, Income and Corporate taxes increased by 11.1% and 7.6%, respectively.

Non-financial uses also registered remarkable momentum, with a year-on-year growth of 4.9%, a trend that extends across all items, except for debt interest and aid to investment and other capital transfers. It is worth pointing out, because it is the item with the strongest weight in expenditures (58%), the 4% increase in current and capital transfers among the Public Administrations, with those to the Autonomous Regions and to the Social Security Funds standing out.

With regards to the deficit of the Public Administrations as a whole (excluding the Local Governments) up to August, it stands at -2.0% of GDP, lower than the -2.4% of GDP registered in the same period in 2017.