ECONOMIC OUTLOOK

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Economic Research Unit
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CONFEDERACIÓN ESPAÑOLA DE
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Economic and political uncertainty have increased over the summer on several fronts. First of all, there has been a new episode in the **USA-China** tariff war, following eighteen months of disputes[1]. At the end of July, President Donald Trump announced a 15% tariff on Chinese imports worth $112 billion, effective from September 1. The Asian country did not take long to respond and, at the beginning of August, it allowed the Yuan to depreciate to the lowest exchange rate since 2008, and forbade the purchase of any U.S. agricultural products by its public companies. In addition, in mid-October there will be a further increase in tariffs from 25 to 30% on Chinese imports worth $250 billion.

Another open front is the **United Kingdom**. The economic consequences of Brexit are coupled with the country's political situation, following Boris Johnson's decision to suspend the British Parliament and the House of Commons' rejection to a hard Brexit, with a majority of British MPs having initiated proceedings for an Act with the aim of avoiding a hard exit from the EU on October 31. The draft legislation requires the request for an extension from Brussels until January 31, 2020, provided that the British government and the European authorities do not reach an agreement in October for an organized exit. Amidst this backdrop, the pound has depreciated against the dollar to below $1.20.

In Latin America, the spotlight is centred on **Argentina**. In late August, the Argentine government imposed a series of exchange rate restrictions with the aim of putting a halt to the devaluation of the peso against the dollar and the flight of capital, after several weeks of severe financial turmoil. In addition to the economic recession in which the country is immersed, this situation was triggered by the results of the primary elections held in August, when Peronist and presidential candidate Alberto Fernández got almost 48% of the votes, exceeding by far the 31.8% obtained by Macri.

Added to all of the above are the recent attacks on Saudi Arabia's oil industry and the possible increase in **oil** prices as a result. In fact, Brent oil recorded a strong rebound in the days that followed, reflecting fear of a significant cut in supply, and not just in the short term.

The bias change in the monetary policy of the main **central banks** has been confirmed. At the end of July, the Fed cut its benchmark interest rates from 2.5%-2.25% to 2.25%-2.00%, citing as its main reasons the impact on the US economy of the risks inherent to the global economic outlook, the trade war and the lower inflationary pressures. Meanwhile, the ECB waited until September to announce new measures: a cut in its interest rate on the deposit facility (the interest rate it charges banks for their deposits) from -0.40% to -0.50%; the resumption of the asset purchase programme (20 billion per month); and finally, the pledge that they will not hike interest rates until inflation reaches the target rate.

In light of the **increase in global risk and the bias change in monetary policy**, investors have taken refuge in sovereign bonds. Thus, the yield on the 10-year Spanish bond broke the 0.20% level on the downside. Likewise, the German bund continued falling and hit -0.6% in mid-September. Another of the safe-haven assets par excellence, gold, continued its upward trend and has consolidated at the highest price since 2013.

[1] See box 1 in report "The trade war between the USA and China: chronology and impact in global growth"

In **Spain,** the economic slowdown in both activity and employment is consolidating. The increase in GDP growth in Q2 was 0.5% and the year-on-year rate was 2.1%. If this figure is confirmed at the end of September, these are the lowest rates since 2014.

The slower progress in activity could have been a determining factor in the evolution of **employment**. The data pertaining to the Labour Force Survey for Q2 confirms the lower momentum of the labour market, with a quarterly increase in employment of 333,800 people, setting the year-on-year rate at 2.4% (vs. 3.2% in Q1). The number of people registered with the Social Security in July and August confirms this loss of employment dynamism, with an increase of 15,514 in July, the second lowest in the historical series for said month, and a decrease of 212,984 people in August, the worst record since 2008. Although the number of people registered with the Social Security. is reaching historical highs (19.5 million in July), job creation is clearly on a decreasing trend. In fact, CEOE's Economic Research Unit forecasts a quarterly rate for the seasonally-adjusted number of contributors of 0.3% in Q3, less than half than the previous 0.7%.

In this context of economic slowdown, **inflation** is advancing at particularly moderate rates. The CPI for August increased 0.3% year-on-year, with the underlying standing at 0.9%. Unit labour costs, however, registered a 2.3% increase in Q2, which could imply a loss of competitiveness for the Spanish economy if the differential with our main trading partners becomes positive.

The outlook for the end of 2019 and for next year points to the continuation of a scenario of moderation in activity and employment and, therefore, lower growth. The intensity of the expected slowdown will depend on whether or not the latent risks present this fall end up becoming a reality, namely, on the external front, the final outcome of the Brexit and the escalation of trade tensions between the US and China and their effect on Europe. Moreover, we should keep an eye on any developments in the Eurozone. Our main foreign market is registering lower growth, with exports exposed to risks, and there are many open fronts in the political situation of several countries. And finally, it is worth pointing out the crisis in Argentina and its possible impact on Latin America, given the presence of Spanish companies in the region, as well as the possible rise in oil prices. At a national level, the factors that may have the highest impact on the progress of the economy in the short term are whether an agreement to form a government finally comes through and what measures may be implemented (although institutional paralysis is also relevant), as well as the situation in Catalonia.

According to the Funcas Forecast Panel, the expected growth of Spanish GDP for 2019 is 2.2%. However, two factors must be taken into account:

1. The revised Annual National Accounts data (published on the closing date of this report) have shown that the slowdown in recent years has been more intense than expected. In fact, the increase in GDP in 2018 was 2.4%, compared to the 2.6% initially estimated.
2. It must be considered that the quarterly GDP growth of the first quarter of 2019 has also been revised downwards to 0.5% from 0.7% and this 0.5% rate is maintained in the second. The pace of progress of the activity and employment indicators published in the third quarter point to a continuity in the deceleration process.

Therefore, from both factors it could be deduced that **the growth of the Spanish economy in 2019 would be around 2.0% -2.1%, according to CEOE estimates.**

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Calle Diego de León, 50
28006 Madrid
(+34) 91 566 34 00
www.ceoe.es