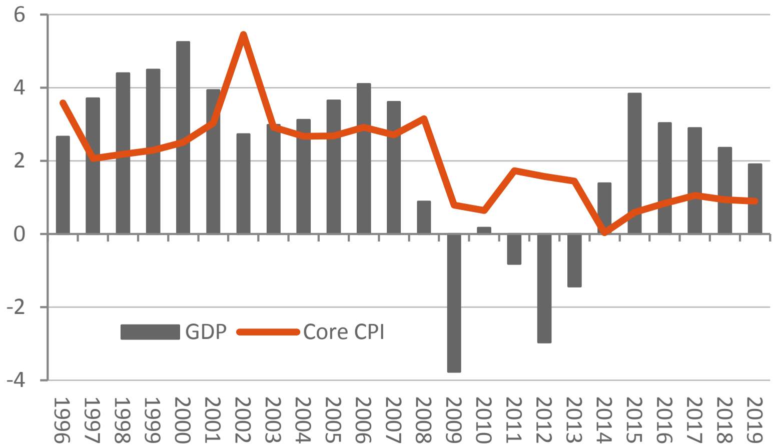
ECONOMIC OUTLOOK

January 2020

- ***The slowdown in global activity is becoming less pronounced and growth for 2020 is estimated to reach similar levels than in 2019, which was the lowest figure since the financial crisis.***
- ***Central banks will continue to maintain their very lax monetary policies, with low interest rates and public debt purchases.***
- ***In 2019, GDP will grow by 1.9%. This estimate is, in turn, based on a GDP rate for Q4 forecasted at 0.4%, which would be a sign of stability in the final stretch of the year.***
- ***Meeting the public deficit target (-2.0% of GDP) in 2019 seems complicated.***
- ***Looking ahead to 2020, CEOE's forecasts point to a further slowdown in the Spanish economy (GDP growth of 1.6%).***
- ***The number of people registered with the Social Security continued to lose momentum in the final stretch of 2019 and will continue to do so in 2020. However, in December it reached a historic high, exceeding 19.4 million people.***
- ***Inflation rebounded in December due to the slower decline in energy prices and closed the year at 0.8% year-on-year.***
- ***If the spending measures announced are implemented in the 2020 Budget, the deficit could rise this year, thus breaking the fiscal consolidation path. However, we believe that the Government will do its best to prevent it from exceeding -3% of GDP, so as not to return to the excessive deficit procedure.***

CONTENT:

GDP and core inflation (y-o-y rate)



Source: INE

INTERNATIONAL SCENE: 2020 will continue being a year with many uncertainties

In December, the main world stock markets continued the upward trend followed in recent months, encouraged by the negotiations for a trade agreement between the United States and China, the lesser uncertainty about the Brexit, the continuation of lax monetary policies by central banks, and the signs that the slowdown in world activity could be on the path to subsiding. Thus, in 2019 as a whole, most stock exchanges showed very positive performance, with very notable growth compared to the previous year.

Meanwhile, global PMI indicators point to some improvement in activity. Manufacturing PMI for December was down two-tenths of a point in comparison to the previous month, but at 50.1 points it remained in expansionary territory for the second month in a row, while global services PMI improved by five-tenths of a point to 52.1 points, bringing the composite PMI index up by three tenths to 51.7 points, the best figure since April.

Despite the improvement shown by these leading indicators, 2019 will end with worldwide growth of around 2.9% or 3.0%, which will be the slowest pace since the financial crisis. For 2020, the estimates of the main international organizations point to a similar or slightly higher growth, in a context that still shows notable sources of uncertainty, such as Brexit, trade tensions, geopolitical instability (mainly in the Middle East), among other factors, although some of them have diminished in recent months.

The United States is expected to experience a mild slowdown, despite the maturity of its economic cycle and the fact that the effects of the tax reform have already been diluted. The US economy continues to show positive signs, with significant job creation. In addition, the three interest rate cuts carried out by the Federal Reserve in 2019 dismissed the idea of a possible recession and GDP growth for 2020 is estimated at around 2%, some three tenths of a point lower than in the previous year. The slowdown in China is also expected to continue but, as in the United States, it will be mild, especially after the trade agreement reached between both countries.

Meanwhile, in the Eurozone, growth is expected to be similar to that of 2019, around 1.1%. It will be conditioned by the evolution of the automobile industry, and whether tariffs in this sector for exports to the United States finally increase or not, and by the negotiations on the future relationship between the European Union and the United Kingdom, following the latter's departure — right now scheduled for January 31st. In this regard, the new Prime Minister, Boris Johnson, has expressed his intention to not extend the transitional period. To this end, a law has been approved to disallow any extensions beyond 31 December 2020, which will add more pressure to the negotiations. In Japan, some slowdown is also expected for 2020, despite the holding of the Olympic Games in Tokyo. We will have to see how consumption behaves in the country after the VAT increase implemented last October, although the government has launched a new fiscal stimulus plan to mitigate its impact.

With regard to emerging markets, some improvement is expected in 2020. In India, successive interest rate cuts and reforms to simplify taxes and lighten trade regulations are expected to stimulate private consumption and investment. The outlook for Brazil is also more favourable, following the upward revision of growth in Q3 and the approval of the pension reform. Similarly, in Mexico, some recovery is expected, following the trade agreement with Canada and the United States.

Furthermore, most of the central banks will continue to follow very lax monetary policies. In this regard, at their December meetings, both the ECB and the Fed maintained their interest rates and debt purchase programmes unchanged. Similarly, the Bank of England and the Bank of Japan left their very accommodating monetary policies unchanged, a situation that is expected to continue over time.

In December, oil prices experienced an upward trend following the agreement reached by the OPEC countries and other producers, including Russia, to cut crude oil production by half a million barrels a day in Q1 of 2020. In addition, progress in trade negotiations between the United States and China has also contributed to the rise in crude oil prices. Thus, in December the average price of Brent stood at $69.1 per barrel, 8.3% higher than in the previous month and 22.8% higher than in December 2018. In spite of the tensions in the Middle East, the price is expected to slow down slightly to $60 per barrel by the end of the year.

THE SPANISH ECONOMY: the economic policy in the spotlight

GDP growth for Q3 was confirmed at a quarterly 0.4%. However, the slight downward revision of this figure and that of previous quarters makes it more likely for the GDP to close 2019 with a growth of 1.9%. This estimate is, in turn, based on a GDP rate for Q4 forecasted at 0.4%, which would be a sign of stability in the final stretch of the year

This lower growth in activity in 2019 is coupled with the absence of inflationary pressures (the CPI stood at 0.8% in December and 0.7% on average) and with a net lending position that is expected to be close to 2% of GDP. Great attention is focused on the public deficit, which is unlikely to stay within target in 2019. The social spending measures approved, together with overestimated revenues (growing below nominal GDP), may lead to a year-end deficit that exceeds the goal of -2.0% of GDP (-2.4% of GDP, according to CEOE).

Looking ahead to 2020, CEOE and most international institutions forecast a continued slowdown in the Spanish economy (1.6%), which will be reflected in a slower job creation rate, very similar to that of GDP. Although the main economic policy measures have not yet been specified, those included in the current government programme point to an expansionary policy in terms of public spending, which will be accompanied by a rise in taxes, mainly on companies (social contributions, corporate tax). If all the expenditure measures are implemented in the 2020 Budget, the deficit could rise, thus breaking the fiscal consolidation path. However, we believe that the Government will do its best to prevent it from exceeding -3% of GDP, so as not to revert to the excessive deficit procedure.

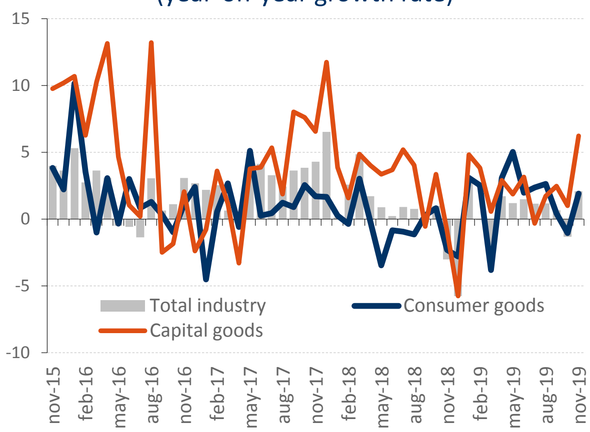
DEMAND AND ACTIVITY: the Spanish economy grows at a sustainable rate

According to the available indicators, the growth rate of the Spanish economy in Q4 is expected to be similar to Q3, around 0.4% quarter-on-quarter. With this figure, annual growth would stand at 1.9%, half a point lower than the previous year, but notably higher than growth recorded in the Eurozone as a whole. This slower growth in 2019 is due to domestic factors such as the maturity of the economic cycle or increased political uncertainty, and external factors such as the slowdown in global trade.

In Q4, indicators for household consumption did not show a clear pattern. On the one hand, consumer confidence continued to deteriorate to levels not seen since 2014, mainly due to the worsening perception of the general economy. However, the retail trade confidence index, although continuing its gradual deterioration, has shown a rebound in December. In this sense, retail trade indices and domestic sales of large companies, with data up to November, also point to a positive evolution, and consumption seems to keep on growing at sustained rates. On the other hand, car registrations, although registering four consecutive months of positive progress, closed the year with an annual fall of -4.8%.

As for investment, it continues to be the most dynamic component of the economy and the information available for Q4 indicates a positive trend. Thus, the capital goods industrial production index, with data up to November, showed greater dynamism than in Q3 and the entry of orders in October recorded higher growth than the average for Q3. The outlook for the beginning of 2020 is positive, especially as some of the uncertainties that have weighed on the economy in 2019 are resolved or appeased.

Industrial Production Index
(year-on-year growth rate)

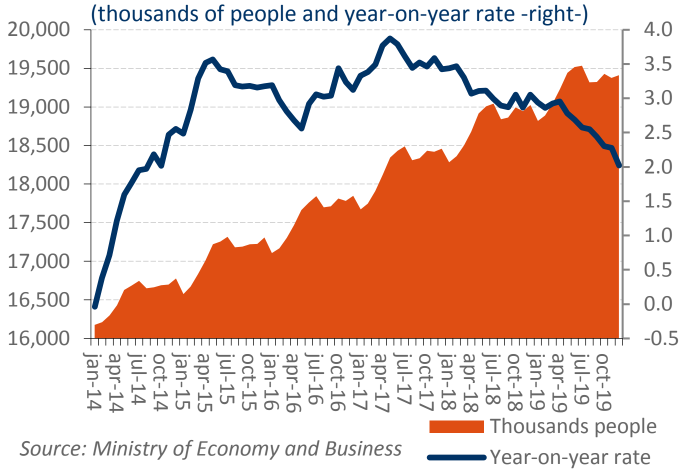


Source: INE

THE LABOUR MARKET: job creation continued to lose momentum in the final stretch of 2019

Job creation continued to slow down in the final stretch of 2019. The number of people registered with the Social Security increased by 31,660 in December, the smallest increase for this month since 2012, and the year-on-year rate decreased to 2.0% (1.8% excluding non-professional caregivers). According to estimates by CEOE's Research Unit, in Q4 the seasonally adjusted figure grew by 0.4% quarter-on-quarter, one tenth less than in the previous quarter. Over the year as a whole, the number of registered people increased by 490,000, compared to an increase of 565,000 in 2018. The loss of momentum in job creation is expected to continue through to 2020. The most positive note is that the number of contributors exceeded 19.4 million in December, reaching a peak in said month's historical series.

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

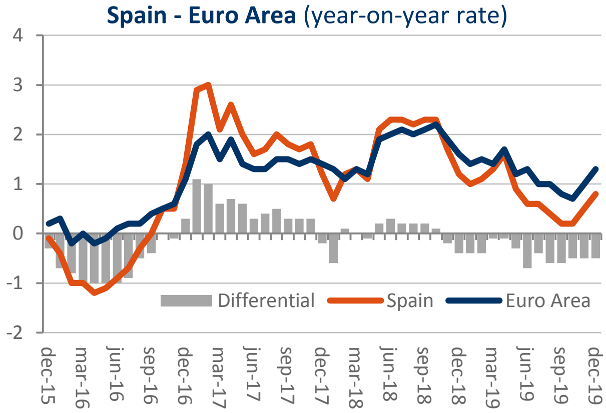


Source: Ministry of Economy and Business

PRICES: inflation rebounds due to a lower decrease in energy prices and closes the year at 0.8% year-on-year

In December, the year on year CPI rate increased four tenths to 0.8%, due to the evolution of energy product prices. With this data, the average for 2019 stood at 0.7%. Energy product prices continued to fall, but less sharply due to the upturn in oil prices in the face of the OPEC+ agreements to reduce supply and the tensions in Iran in January. Core inflation, meanwhile, remained very stable at 1.0% and the groups that comprise it continue to make very moderate progress. Forecasts suggest that oil prices could show a downward trend in the coming months, so inflation should start to slow down from February onwards.

Inflation differential
Spain - Euro Area (year-on-year rate)



Source: INE

THE PUBLIC SECTOR: revenues grow below nominal GDP

Until October the deficit of the State, the Social Security and the Autonomous Communities as a whole stood at -1.4% of GDP, higher than the -1.1% of GDP accumulated until October 2018. The main difference in comparison with 2018 is the behaviour of the budgetary balance for the Autonomous Communities', which rose to -0.35% of GDP vs. the previous year's surplus of 0.14%. Thus, up to October, the State shows a lower deficit than in 2018, while the Social Security system maintains its negative balance, despite the dynamism of revenues from social contributions (growing by more than 8%).

With preliminary information on the State until November, it presents a deficit of -0.9% of GDP, representing a decrease of -6.2% and being the Public Administration level that has most reduced its imbalance in 2019. This result is explained by an accumulated increase in revenues (2.6%) that exceed the rise in expenditures (2%). In addition, the positive primary balance remains at around 0.9% of GDP.

The tax categories that show the most dynamic collection in 2019 are income tax (7.6%) and VAT (3.7%). However, overall revenues are growing below nominal GDP (3.5%). On the expenditure side, the biggest increase is in social spending (pensions, paternity deductions, disability), wages (wage equalisation, salary increase) and intermediate consumption (elections).