ECONOMIC OUTLOOK

February 2019

- ***Congress did not pass the 2019 General State Budget proposed by the Government, a fact that has forced the calling of General Elections. The Spanish economy is, therefore, undergoing greater political uncertainty right now, coupled with uncertainty about the continuity of the fiscal consolidation process.***
- ***The Spanish economy is still growing at a good pace (a quarterly 0.7% in Q4-2018). However, we are starting to see lower dynamism in consumption and investment, as indicated by the worsening of household expectations and of certain sectors. Within the deceleration path forecasted for 2019, our estimations still stand at a growth of 2.2%.***
- ***The employment creation rate rebounded on Q4-2018 and the number of people employed exceeded 19.5 million at year-end. Meanwhile, the number of workers registered with the Social Security slowed down its year-on-year rate in January to 2.9%.***
- ***Inflation continues to moderate and posted a 1% increase in January, thanks to the slower price increase in all the major groups that conform the CPI.***
- ***The world economy is still showing signs that point to a slowdown and, within this context, the IMF and the European Commission have revised their growth forecasts downwards.***
- ***Central banks kept their monetary policies unchanged. In addition, the Federal Reserve has eased the pace of its interest rate increases over 2019.***

CONTENT:

Growth forecasts. IMF (January) and European Commission (February)

	IMF				European Commission		
GDP (y-o-y rate)	2017	2018	2019	2020	2018	2019	2020
WORLD	3.8	3.7	3.5	3.6			
United States	2.2	2.9	2.5	1.8			
Japan	1.9	0.9	1.1	0.5			
Euro Area	2.4	1.8	1.6	1.7	1.9	1.3	1.6
Germany	2.5	1.5	1.3	1.6	1.5	1.1	1.7
France	2.3	1.5	1.5	1.6	1.5	1.3	1.5
Spain	3.0	2.5	2.2	1.9	2.5	2.1	1.9
Italy	1.6	1.0	0.6	0.9	1.0	0.2	0.8
United Kingdom	1.8	1.4	1.5	1.6	1.4	1.3	1.3
China	6.9	6.6	6.2	6.2			
Advanced economies	2.4	2.3	2.0	1.7			
Emerging economies	4.7	4.6	4.5	4.9			
World trade	5.3	4.0	4.0	4.0			

Source: IMF and European Commission

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INTERNATIONAL SCENE: the IMF and the European Commission revise their growth forecasts downwards

In January, the main stock markets posted a positive performance, driven by expectations of a slowdown in rate hikes by the Federal Reserve and the trade negotiations between the United States and China. However, volatility remains high and there were some setbacks in the first days of February, due to the downward revision of global growth forecasts and the uncertainty surrounding Brexit.

Thus, data released so far shows that global growth has slowed down in Q4. GDP for the Eurozone went up by a quarterly 0.2%, as in the third quarter, but slowed four tenths, to 1.2%, in year-on-year terms, affected by the political tensions in France and Italy and the difficulties of the automotive sector in Germany. In the United Kingdom, activity also slowed down, both quarterly and annually, largely due to the uncertainty still present with regards to its future relationship with the European Union. Data for Q4 is still unavailable for the United States and Japan, but leading and confidence indicators suggest that activity in the United States may have moderated slightly, although it is expected to continue showing strong dynamism, while Japan is expected to post a certain improvement after the notable decline in Q3. Among emerging economies, China grew one tenth less, both quarterly and y-o-y, to 1.5% and 6.4% respectively.

With this backdrop, the IMF and the European Commission have revised their world growth forecasts downwards. The IMF estimates that growth in 2018 stood at 3.7%, the same rate as in the fall, but it reduces its estimates for 2019 by two tenths, to 3.5%, and by one tenth for 2020, setting it at 3.6%. Both, advanced and emerging economies are expected to continue posting more moderate rates. Meanwhile, the European Commission has significantly reduced its forecasts for the Eurozone and for the EU as a whole for 2019, down to 1.3% in the first case (compared to their estimate of 1.9% in the fall), and to 1.5% in the second (also forecasted at 1.9% in autumn). This significant downward revision is due to the notable deceleration in the second part of the year, together with January's leading indicators, which seem to point to very slight growth in Q1, although they also believe that the economy's fundamentals remain solid, supported by job creation, low financing costs and a slightly expansive fiscal policy. However, both institutions point to a series of risks that may affect global growth, including a possible upsurge in tariff tensions between the United States and China, a stronger than expected slowdown in China, greater tensions in financial markets due to tighter monetary policies and the uncertainty that still surrounds the Brexit.

For Q1-2019, confidence indicators continue to point to a slowdown in growth. In January, the global composite PMI fell six tenths and stood at the lowest level since September 2016. In the Eurozone, the slowdown is more evident and the composite PMI decreased one tenth, registering its minimum level in five and a half years. In the United States, PMI indices continue to show solid growth, although somewhat less vigorous. However, consumer confidence fell sharply in January, influenced by the partial closure of the US Administration.

On the other hand, the main central banks kept their monetary policies unchanged in January. It is worth noting the change of tone in the Federal Reserve's statement which, after having raised interest rates four times throughout 2018, now mentions the existence of greater risk factors for the economy and global finances and lower inflationary pressures, so it will be more patient in determining future interest rate adjustments. Thus, for 2019, at the most two increases are expected, as opposed to the three that seemed probable a few months ago.

In regard to oil prices, they saw a moderate increase in January, with Brent crude reaching $59.0 per barrel on average, 5% more than in December, although in year-on-year terms this figure is 14.8% below the prices seen in January 2018. In euros, the decrease with respect to the previous year is somewhat softer, just 9%, due to the depreciation of the European currency against the dollar. The causes that have influenced the increase in oil prices include the cuts by 1.2 million barrels a day announced by OPEC and other producers, among them Russia, which have been implemented as of January and which will go on during the first semester of the year. However, prices have stabilized slightly above $60 per barrel due to the downward revision of the global growth outlook.

THE SPANISH ECONOMY: CEOE forecast for GDP stands at 2.2%

On February 13, Congress did not pass the General State Budget for 2019 proposed by the Government. This fact led to snap general elections being called for April 28. The Spanish economy is, therefore, undergoing greater political uncertainty, coupled with certain misgivings about the continuation of the fiscal consolidation process.

However, the content of this budget proposal was not the most appropriate to foster economic activity. Therefore, the non-approval of the Budget does not necessarily mean it will have a negative effect on growth. In fact, the forecast for GDP growth in 2019 remains unchanged, at least in the short term, at 2.2%, compared to 2.5% in 2018. The greater uncertainty at an international scale (increase in protectionism, geopolitical tensions, Brexit...) and domestic front (situation in Catalonia, electoral period), together with the gradual normalization of the monetary policy, will be factors that will weigh down on growth in the coming quarters.

Regarding the recent progress of the economy, activity and employment registered a more positive behaviour in the final stretch of 2018 thanks to the public sector. Thus, GDP figures for the fourth quarter reflect a quarterly increase of 0.7%, of which a third would be explained by the increase in public consumption. Thus, despite the slowdown observed in household consumption and investment, public spending has accelerated almost one percentage point to 3.0% year-to-year, the highest rate since the end of 2009.

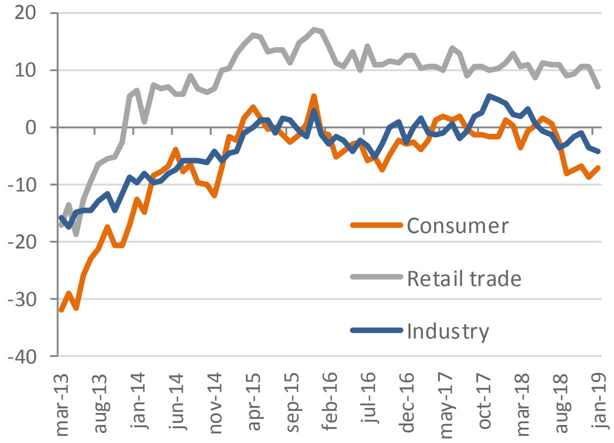
According to the LFS, employment increased in quarterly terms by 36,600 people in said period due to the growth of employment in the public sector (43,400 people). Thus, in a quarter that is usually unfavourable for the labour market due to seasonal factors, the results have been positive, since this positive evolution of public employment is added to a less negative behaviour in the private sector.

DEMAND AND ACTIVITY: a worsening in expectations starts to be noticeable in consumption and investment

As expected, in the fourth quarter the Spanish economy continued to grow at a good pace and generate employment in a remarkable manner. However, as already mentioned, a large part of this evolution was driven by the public sector, while there was a slowdown in household consumption and investment. The deceleration of consumption and investment may be explained not just by the exhaustion of certain drivers but also by worse expectations, due to the higher uncertainty and risks at both, the international and domestic fronts. In this regard, consumer confidence, after having decreased in the fourth quarter, posted similar figures in January, with expectations about the general economic situation being responsible for this deterioration. Meanwhile, the retail trade confidence indicator remained very stable throughout 2018, but the last figure also points to a slight worsening in relation to the current business environment. In recent months, the retail trade index has shown a significant slowdown, although the figures for the last quarter were still positive as a result of the favourable data posted in October. Car registrations, after recording a rather negative fourth quarter, continued to register setbacks in January (-8.0%), as a result of cars being purchased during the summer season and the comparison base with a particularly buoyant month in January 2018 (20.3%).

With regard to investment, although it continued to be the most dynamic component of the economy in the fourth quarter, it registered less growth and, predictably, it will continue along a decelerating path in 2019, in line with slower growth in domestic demand and exports, within an environment of greater uncertainty. Regarding the foreign sector, in terms of national accounts, it continued to detract from growth in the fourth quarter (-0.3 p.p.), although this negative contribution could be reduced in the coming quarters as a consequence of a lower dynamism in imports.

Confidence Indicators



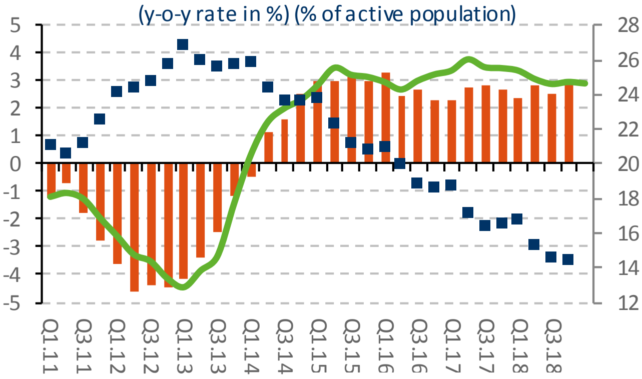
Source: European Commission

THE LABOUR MARKET: 2019 starts with a deceleration in the year-on-year increase in the number of workers registered with the Social Security

Results for the LFS in Q4-2018 were positively surprising, since the y-o-y job creation rate rose five tenths to 3.0% (+566,200 people). Thus, the number of people employed ended the year at 19.56 million, the highest level in a fourth quarter since 2008. In addition, unemployment fell in relation to the third quarter to 3.3 million people, and the unemployment rate fell one tenth to 14.45%, in both cases the lowest levels at year-end since 2008.

In contrast, the number of workers registered with the Social Security started 2019 with a decrease of 204,865 people in comparison to December, in a seasonally unfavourable month. Meanwhile, the year-on-year rate decreased two tenths, to 2.9%.

LFS employment, workers registered with the Social Security and unemployment rate
(y-o-y rate in %) (% of active population)

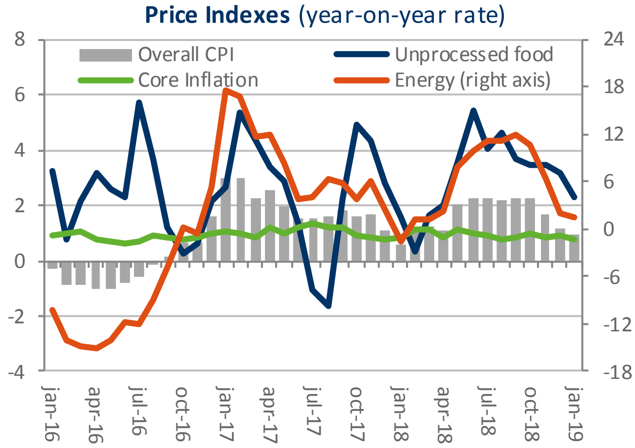


Source: INE, Ministry of Economy and Business and CEOE Economic Research Unit
Note: data for Q1.19 refers to January

PRICES: slowdown in the price increases of all the large groups that conform the CPI basket

In January, inflation dropped two tenths to 1.0% due to the slowdown in prices within all the large groups in the basket. Thus, in addition to the moderation in energy prices seen in recent months, underlying inflation and prices of unprocessed foods have also seen slower price increases. Specifically, core inflation decreased one tenth to 0.8% and all its components are still posting very moderate increases. Oil prices are currently between \$60 and \$63 per barrel, which represents a year-on-year decline of 3.6% in dollars and an increase of 4.3% in euros, due to the depreciation of our currency. Over the next few months, inflation is expected to continue at very moderate rates, to be set around 1%, within a context of economic slowdown and with the absence of inflationary pressures.

Price Indexes (year-on-year rate)



Source: INE

THE PUBLIC SECTOR: remarkable dynamism in revenues in 2018

With regard to the deficit for the General Government until November 2018, excluding the Local Governments, it was set at €18.048 billion, 28.5% lower than for the same period in the previous year. Thus, the negative balance of these three sub-sectors drops to 1.5% of GDP in terms of national accounts, which is 0.7 percentage points less than for the same period in the previous year. In addition, there was a primary surplus of 0.7% of GDP, compared to the positive balance of 0.1% of GDP for the same period in the previous year.

This drop in the deficit is a result of the 6.7% increase in non-financial resources, where it is worth highlighting the 7.5% increase from taxes and 4.9% increase from social contributions. In turn, uses also increase, but at a slower pace.

The Central Government reduced its deficit by 29.6% to 1.1% of GDP, while the Social Security Funds posted a negative balance of 0.6% of GDP. On the other hand, the Autonomous Regions increased their surplus by 978 million, to set it at 0.1% of GDP, due to the greater resources received from the Financing System over the past year.

Lastly, it is worth noting that the public debt closed 2018 at 97% of GDP.