ECONOMIC OUTLOOK

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Financial markets have been less volatile in the past few weeks, setting a moderately bullish trend that may be due to several factors. Firstly, tensions stemming from the US-China trade war have been alleviated, and a possible agreement seems to be in the making. Other factors supporting the markets include the American economy, which is still behaving positively, the new stimulus measures introduced in China to try to mitigate its decelerating path and the outcome of the Brexit, which looks as though will not be imminent and may extend in time a little longer.

In addition, central banks are pointing towards moderation in their monetary policy normalization process. At its last meeting, the ECB was more cautious, revising GDP growth forecasts down to 1.1% in 2019, and stating that interest rates will remain at current levels until the end of this year. It also announced new targeted longer-term refinancing operations (TLTRO) starting in September, and that it would continue to reinvest, for an extended period of time, its balance sheet's maturing bonds. As for the Federal Reserve, its president has continued to convey a softer tone in relation to further interest rate hikes and even suggested the possibility of slowing down the rate at which it is currently reducing its balance sheet, if required by economic and financial events.

With regard to oil, Brent stood at an average of $64.3 per barrel in February and no significant price fluctuations are expected, since production cuts by the OPEC and other allies contrast with the increase in production in the US.

This does not mean that there are no risks in the global economy, which is losing strength, especially in the industrial sector. In fact, the OECD has revised its global GDP growth forecast down by two tenths to 3.3% in 2019. By blocks, Europe is probably the area that concentrates the greatest growth uncertainty (in addition to the ECB, the European Commission has also revised GDP growth for 2019 downward to 1.3% and the OECD to 1%, compared to 1.8% in 2018), with several open fronts such as Italy's current recession and the associated doubts about whether it will be able to meet its deficit target, the riots in France, and the slowdown in the German economy mainly due to the weakness of the foreign sector.

This situation in Europe is not going to help the Spanish economy, since the EU is our main market with a 69.3% export share in 2018 (including the United Kingdom). This is why the deceleration of the Spanish economy will continue throughout 2019. The key point in this regard lies on the intensity of the slowdown in activity and employment, which may be even greater if all the risks end up becoming a reality. Consequently, these risks point to a downward effect. Within this context, the main economic institutions foresee growth slightly above 2.0% in 2019 (2.1% in the case of CEOE) and a few tenths below 2% in 2020, although it should be noted that the range of forecasts is very limited.

Employment evolution will be a key variable for forecasts for 2019, due to the effects of the rise in the national minimum wage (NMW), the increase in social contributions and the higher salaries. According to the Bank of Spain, the higher probability of job loss arising from the rise in the NMW for 2019, along with the greater incidence in relation to that estimated in 2017, would increase the impact on the loss of full-time jobs in 2019 up to 125,000 people. Additionally, the maximum Social Security contribution base has gone up to €4,070.1 per month, an increase of 7% in relation to 2018.

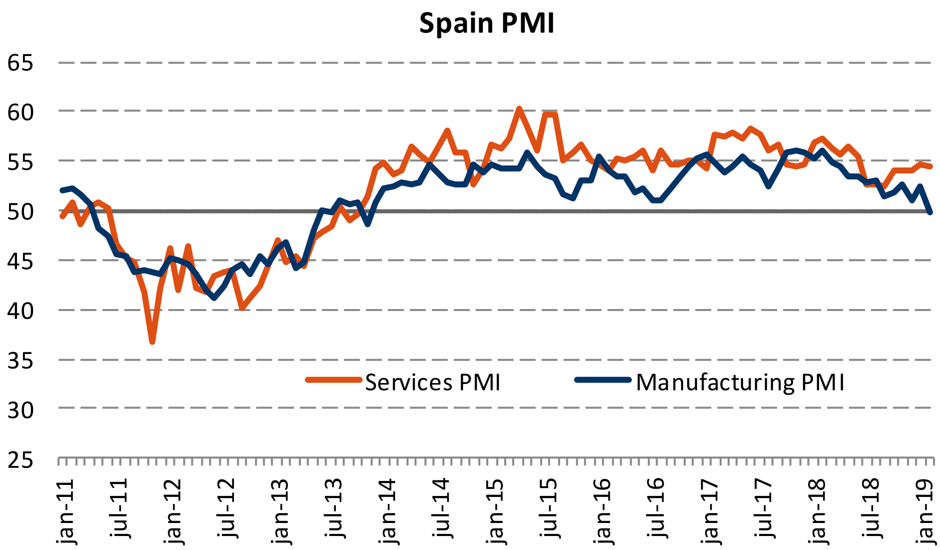
If, due to lower economic growth, employment was already expected to increase less than in 2018 (when 500 thousand jobs were created), with these new measures the number of new jobs in 2019 will probably stand below 400,000. The number of people registered with the Social Security during the first months of the year shows a decelerating trend that, although still not very pronounced, already points towards lower dynamism in the labour market.

Another area that will lower its contribution to GDP growth in 2019 is exports, which will continue to lose momentum not just due to the low growth in Europe, but also because of the foreseeable loss of competitiveness of the Spanish economy as a result of increased costs. In this regard, it should be borne in mind that the increase in exports to the United Kingdom that has taken place in recent months may have a positive temporary effect due to this country's increase in inventories from the EU prior to its planned exit.

Another source of concern for the Spanish economy is the fiscal consolidation process. The public deficit could increase due to approved measures that imply an increase in spending (pensions, civil servants' salaries). Thus, it is likely that measures will have to be implemented in the second part of the year to correct the structural public deficit. The question is whether the new government will apply measures to raise taxes or tackle the issue through expenditure control. In this regard, either one involves an adjustment that will affect activity, employment or investment growth.

Finally, it is also worth pointing out that the risk of having certain structural reforms reverted still persists, mainly the labour reform, in addition to the political uncertainty associated with the situation in Catalonia or the result of an election if there is no a clear majority of parties that can govern.

Regarding the evolution of the Spanish economy in the first quarter of 2019, available indicators point to lower GDP growth, around 0.6%, compared to 0.7% in the previous quarter. In the supply side, it should be noted that the corresponding confidence indicators show a dichotomy between industry and services. Specifically, the services PMI was set at 54.5 in February, slightly below the 54.7 registered in January. Activity in the services sector has increased steadily during the last 64 months, and the surveyed companies link the latest increase to an increase in new orders received. In contrast, the PMI for the Spanish manufacturing sector was set at 49.9 in February, compared to 52.4 in January. This is the first time this figure stands below 50 since November 2013, thus putting an end to more than five years of continuous growth in the sector. On the other hand, indicators related to investment in construction continued to show a good performance, although there is a notable dichotomy between residential construction and civil engineering works.



Source: MInistry of Economy and Business

Meanwhile, it should be noted that the net lending position of the Spanish economy in 2018 decreased to almost half. In other words, the aggregate balance of the current and capital accounts was positive in 2018 by €14.0 billion (1.2% of GDP), compared to €24.2 billion in 2017 (2.1% of GDP).

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