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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

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ECONOMIC & FINANCIAL ENVIRONMENT

FINANCIAL MARKETS

The Greek banking system, between a rock and a hard place

INTERNATIONAL ECONOMY

Saudi Arabia's big gamble

EUROPEAN UNION

Financing in Swiss francs in emerging Europe: a limited risk

SPANISH ECONOMY

A tail wind will help reduce the public deficit

DOSSIER: THE ECB QE: CAUSES AND EFFECTS

On the need and effectiveness of the ECB's QE

The dilemma of Europe's central banks in the face of the ECB's policies

QE comes to the euro area for a long visit

Banking in the face of QE: caught between wishes and reality



"la Caixa" Research

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March 2015

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The euro area: in the hands of the ECB?

The most recent figures for economic activity in the euro area are surprisingly good after several quarters in which pessimism had prevailed among analysts. Some observers attribute this incipient change in trend to the new stance taken by monetary policy, with the start of quantitative easing (QE) at the beginning of March. However, this positive trend began last autumn and can only be indirectly attributed to factors of a monetary nature. Economic agents may have expected the ECB to carry out something significant but this was highly uncertain for a long time.

The euro area's economic improvement is due, firstly, to considerable changes in the price of oil and the euro. The price of oil (in euros) has fallen by almost 35% since mid-2014 while the euro has depreciated by 6.5% compared with a representative basket of currencies. Expectations regarding the euro area's monetary policy will have certainly played an indirect role in this last case but other factors that also lie behind the recovery are related to decisions taken in other areas of economic policy: structural reforms that are producing results in some member countries (including Spain), institutional reforms at the level of the euro area itself (banking union, successful bank reviews) and a stance taken by fiscal policy that, for the countries as a whole, has gone from contractionary to neutral, for the moment not supporting the expansion of aggregate demand but not holding it back either.

In this edition of the *Monthly Report* the Dossier is devoted to an in-depth examination of the nature and effectiveness of quantitative easing (QE) policies with particular focus on the euro area, given its overwhelming importance in public discussion. By way of a summary, we should note four broad issues regarding this policy in the European case.

Firstly, QE is already a success thanks to its mere existence, insofar as it proves that the ECB (the only truly federal and executive power in the EU) has enough political and administrative autonomy to take bold decisions, even when these place the institution on shaky ground. Given the incorrect institutional design of the Economic and Monetary Union, it is vital for the ECB to have and use broad powers to ensure the EMU remains complete and in place.

Secondly, QE was and is a necessary response to the macroeconomic context insofar as the rest of the world's large central banks had already embarked on similar policies. The ECB had not employed this tool, condemning the euro area to a comparatively restrictive monetary policy with unwelcome side effects such as the euro's appreciation.

Thirdly, highly accommodative monetary policy alone is not enough on its own. As Mario Draghi has repeated on several occasions, it needs to be accompanied by a more accommodative fiscal policy in those countries with healthy public accounts and, most particularly, by structural reforms; in other words, by actions that strengthen supply in the economy.

Fourthly, the Dossier reminds us that the ECB's QE is one more step by the main central banks on an uncertain path that raises huge questions for the global monetary order. It is a policy that places some central banks from small countries in a very uncomfortable position. And, more importantly, it is a policy that may be logical from the point of view of each large central bank, given the actions taken by the rest of the monetary authorities, but it is not necessarily the right policy from a collective point of view as it implies that the main countries on the planet continue to prolong the upward spiralling debt in their economies.

Jordi Gual
Chief Economist
28 February 2015

CHRONOLOGY

FEBRUARY 2015

- 23** The Greek government reaches an agreement with the institutions to extend its bail-out programme another four months. In exchange, it has promised to carry out an ambitious agenda of structural reforms.

JANUARY 2015

- 22** The European Central Bank announces the enlargement of its asset purchase programme to 60 billion euros a month, including both public and private debt. This programme will continue until September 2016 but might be extended if inflation is still well below 2%. It also cut the TLTRO interest rate from 0.15% to 0.05%.
- 25** Syriza wins the general election in Greece and plans to renegotiate the country's debt and austerity policies.

DECEMBER 2014

- 16** Russia's central bank raises the official interest rate by 6.5 pps to 17% to slow down the rouble's depreciation.
- 24** Shinzo Abe is re-elected as Japan's Prime Minister.
- 29** Early elections are called in Greece.

NOVEMBER 2014

- 1** The Federal Reserve's third asset purchase programme (QE3) comes to an end. From now on, it will only reinvest capital from the bonds maturing in its portfolio.
- 21** The ECB starts its asset-backed security purchase programme.

OCTOBER 2014

- 20** The ECB starts its third covered bond purchase programme.
- 26** The ECB and EBA publish the results from the stress tests carried out on 130 European banks. 25 banks failed in total, with a capital deficit of 24.6 million euros at year-end 2013. This exercise was the precursor to the start of the Single Supervisory Mechanism in November.

SEPTEMBER 2014

- 4** The ECB reduces the Refi rate to 0.05% and the deposit facility rate to -0.20%. It also announces a programme to buy up asset-backed securities (ABS) and covered bonds.

AGENDA

MARCH 2015

- 3** Registration with Social Security and registered unemployment (February).
- 5** Governing Council of the European Central Bank.
- 6** Industrial production index (January).
- 17** Quarterly labour cost survey (Q4).
- 18** Loans, deposits and NPL ratio (January).
Fed Open Market Committee.
- 19** European Council.
- 20** International trade (January).
- 30** Flash CPI (March).
Economic sentiment index of the euro area (March).
Household savings rate (Q4).
- 31** Balance of payments (January).
Net international investment position (Q4).
Fiscal balance (2014).

APRIL 2015

- 2** Registration with Social Security and registered unemployment (March).
- 10** Industrial production index (February).
- 15** Governing Council of the European Central Bank.
Financial accounts (Q4).
- 17** Loans, deposits and NPL ratio (February).
- 20** International trade (February).
- 23** Labour force survey (Q1).
- 28** Fed Open Market Committee.
- 29** Economic sentiment index of the euro area (April).
Flash GDP of the US (Q1).
- 30** Flash GDP (Q1).
Flash CPI (April).
Balance of payments (February).

Global economic expansion is taking hold

After a slightly worrying start to 2015 due to the increase in downside risks, February has eased the gloomiest predictions. A good barometer to measure this change in tone is the performance of financial markets: although financial volatility picked up in January, in February it calmed down again. At a global level this is due to the combination of an intensification in expansionary policies by central banks (18 central banks have cut their interest rates so far this year), positive activity figures from many economies and the resolution, albeit only partial, of some sources of geopolitical and political conflict (a ceasefire in Ukraine and the extension of the bail-out programme for Greece). This temporary relief is encouraging expectations of the global expansion consolidating over the coming months in spite of it being notably uneven between countries.

More solid expansion in the US, China going through a soft landing and Japan coming out of recession in slow motion. The unevenness of the recovery can particularly be seen in the cyclical differences between large non-European countries. The US started 2015 by maintaining a good growth rate, largely thanks to the positive tone of private consumption (particularly helped by cheaper oil), to the recovery in investment, both corporate and residential, and to less fiscal adjustment. Given this expansionary scenario, the fundamental debate is still when the Federal Reserve will start to raise the reference interest rate. For the time being, given the low inflation and contained wages, the bulk of the evidence suggests that the Fed will wait until the end of 2015 before starting to normalise its monetary policy. Compared with the US situation, China continues to engineer a soft landing by taking measures of an expansionary nature (lowering the official interest rate and reducing the cash reserve ratio, as well as bringing forward different infrastructure projects and measures to support the real estate sector), which should stop the slowdown from becoming a hard landing. With regard to Japan, it is still battling to completely exit the recession of 2014. Positive growth in 2014 Q4 means it has now recovered from two consecutive quarters of declines in GDP but is doing so at a slower rate than expected.

Europe is improving but the future is far from risk-free. The euro area has resolved some of its most pressing problems but doubts remain in the medium term.

Good economic growth figures for 2014 Q4 (up 0.3% quarter-on-quarter) have been followed by activity indicators in January and February that suggest the recovery is gradually becoming more dynamic. Inflation also picked up in February, dispelling deflationary fears even though it is still in negative terrain. This risk has also been reduced by the onset, in March, of QE (quantitative easing) by the European Central Bank (ECB). Nonetheless it should be noted that the acceleration in growth we expect over the next few quarters depends largely on the combination of four factors: the fall in oil prices, the euro's depreciation, the ECB's monetary expansion and the Juncker Plan for investment. In short, Europe's expansion is on track but this is partly due to temporary factors, highlighting the need to continue with further structural reforms that, in turn, provide more room for fiscal policy. A second source of problems is Greece and its negotiations with the Eurogroup regarding the terms of its financial aid. After much dissent, the two parties in the dispute have agreed to extend the bail-out programme for another four months, on condition that a large number of reforms will be carried out. The agreement has considerably reduced uncertainty in the short term but only represents a temporary solution until a new framework of financial aid is adopted and there may be some temporary upswings in financial volatility while this new, more definitive agreement is being drawn up.

Spain is benefitting from a favourable environment. The Spanish economy continues to capitalise on a series of conditions that are in its favour for the time being. Thanks to cheaper oil and the euro's depreciation, the economy ended 2014 and started 2015 in better shape than expected. The boost provided by these temporary factors, which have momentum, and the fact that growth in 2014 Q4 was greater than expected, have led us to revise upwards our growth forecasts for 2015 (from 2.3% to 2.5%) and for 2016 (from 2.1% to 2.3%). Although we expect the driving forces behind this expansion will still be private consumption and investment, as the scenario advances exports are likely to improve their contribution to growth. These positive figures have spread to other areas of the economy: the rate of job creation is still vigorous, the real estate sector is showing signs of improvement, both in demand and supply, and inflation picked up in February. We expect these three trends to continue in 2015.

FORECASTS

Year-on-year (%) change, unless otherwise specified

International economy

	2013	2014	2015	2016	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
GDP GROWTH										
Global¹	3.3	3.3	3.6	3.8	3.3	3.3	3.5	3.6	3.5	3.6
Developed countries¹	1.1	1.6	2.3	2.2	1.5	1.5	2.1	2.3	2.3	2.4
United States	2.2	2.4	3.5	2.7	2.7	2.4	3.9	3.6	3.1	3.3
Euro area	-0.4	0.9	1.4	1.8	0.8	0.9	0.9	1.3	1.6	1.7
Germany	0.2	1.6	1.6	1.9	1.2	1.5	1.1	1.6	2.0	1.8
France	0.4	0.4	0.8	1.3	0.4	0.2	0.5	0.9	0.9	1.1
Italy	-1.9	-0.4	0.5	1.2	-0.4	-0.3	-0.1	0.4	0.7	0.9
Spain	-1.2	1.4	2.5	2.3	1.6	2.0	2.5	2.6	2.7	2.4
Japan	1.6	0.0	0.8	1.1	-1.3	-0.4	-1.3	0.9	1.9	1.7
United Kingdom	1.7	2.6	2.3	2.1	2.6	2.7	2.6	2.3	2.1	2.1
Emerging countries¹	6.2	5.8	5.6	5.7	5.9	5.8	5.7	5.5	5.4	5.6
China	7.7	7.4	7.0	6.6	7.3	7.3	7.3	7.1	6.8	7.0
India ²	6.7	7.4	6.7	6.7	8.2	7.5	7.6	6.8	6.6	7.0
Indonesia	5.7	5.1	5.7	6.1	4.9	5.4	5.5	5.7	5.8	5.9
Brazil	2.5	0.2	0.7	1.9	-0.2	-0.2	0.0	0.7	0.9	1.0
Mexico	1.4	2.1	3.1	3.7	2.2	2.6	3.1	3.1	3.2	3.2
Chile	4.1	1.7	2.6	4.1	0.8	1.5	1.6	2.6	2.8	3.2
Russia	1.3	0.5	-3.3	-0.8	0.7	-0.2	-2.8	-3.5	-3.5	-3.2
Turkey	4.1	2.9	3.6	4.3	1.7	2.9	2.9	3.5	3.9	4.1
Poland	1.6	3.3	3.4	3.9	3.3	3.2	3.0	3.3	3.5	3.6
South Africa	2.2	1.5	2.3	2.8	1.5	1.3	2.1	2.4	2.7	2.4
INFLATION										
Global¹	3.7	3.4	3.3	3.8	3.5	3.1	3.2	3.3	3.3	3.6
Developed countries¹	1.4	1.3	0.4	2.1	1.4	1.0	0.1	0.0	0.4	1.2
United States	1.5	1.6	0.3	2.5	1.8	1.2	-0.1	-0.2	0.2	1.1
Euro area	1.4	0.4	0.3	1.6	0.4	0.2	-0.4	-0.1	0.4	1.1
Germany	1.6	0.8	0.5	1.7	0.8	0.4	-0.3	0.1	0.6	1.4
France	1.0	0.6	0.3	1.6	0.5	0.3	-0.2	0.0	0.4	1.1
Italy	1.3	0.2	0.1	1.6	-0.1	0.1	-0.4	-0.2	0.2	0.8
Spain	1.4	-0.1	-0.1	1.9	-0.3	-0.5	-1.1	-0.6	0.1	2.4
Japan ³	0.4	2.7	1.1	1.5	3.3	2.5	2.4	0.3	0.5	1.3
United Kingdom	2.6	1.5	1.0	1.9	1.5	0.9	0.3	0.6	1.1	1.7
Emerging countries¹	4.4	3.8	4.2	4.2	3.8	3.1	4.1	4.4	4.0	4.1
China	2.6	2.0	1.8	2.4	2.0	1.5	1.1	1.8	2.0	2.2
India	10.1	7.2	4.6	6.4	7.4	5.0	5.4	4.8	3.4	4.7
Indonesia	6.4	6.9	8.1	5.8	4.5	8.4	8.2	9.0	8.4	6.9
Brazil	6.2	6.3	6.5	5.8	6.6	6.5	6.8	6.5	6.5	6.4
Mexico	3.8	4.0	3.5	3.1	4.1	4.2	3.7	3.9	3.3	3.2
Chile	2.1	4.4	3.2	3.0	4.7	5.3	3.9	3.4	2.9	2.6
Russia	6.8	7.8	13.0	6.6	7.7	9.6	14.0	14.5	13.4	10.0
Turkey	7.5	8.9	6.3	6.5	9.2	8.8	6.6	6.1	6.0	6.3
Poland	1.2	0.2	0.4	1.9	-0.1	-0.6	-0.7	0.0	0.7	1.4
South Africa	5.8	5.9	3.7	6.1	5.9	5.3	3.0	3.3	3.3	4.9

Notes: 1. In purchasing power parity. 2. Annual figures represent the fiscal year. 3. Takes into account the consumption tax hike introduced in April 2014.

Forecasts

Spanish economy

	2013	2014	2015	2016	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
Macroeconomic aggregates										
Household consumption	-2.3	2.4	2.6	1.6	2.8	3.4	3.4	2.7	2.4	1.8
General government consumption	-2.9	0.1	0.5	0.1	0.3	-0.5	-1.0	0.3	0.8	2.0
Gross fixed capital formation	-3.7	3.4	4.6	4.2	3.9	5.1	5.7	4.4	4.3	4.0
Capital goods	5.6	12.3	7.7	5.3	10.2	10.4	9.9	7.6	6.8	6.5
Construction	-9.2	-1.4	2.9	3.4	0.1	2.4	3.7	2.8	3.0	2.3
Domestic demand (contr. Δ GDP)	-2.7	2.2	2.4	1.7	2.6	2.7	2.8	2.5	2.2	2.2
Exports of goods and services	4.3	4.2	5.2	6.0	4.5	4.7	5.8	6.3	3.6	5.1
Imports of goods and services	-0.4	7.7	5.5	4.9	8.6	7.7	7.8	6.7	2.8	4.7
Gross domestic product	-1.2	1.4	2.5	2.3	1.6	2.0	2.4	2.5	2.5	2.4
Other variables										
Employment	-3.2	1.2	2.3	2.0	1.7	2.4	2.5	2.3	2.4	2.0
Unemployment rate (% labour force)	26.1	24.4	22.7	21.5	23.7	23.7	24.0	22.6	22.1	22.2
Consumer price index	1.4	-0.1	-0.1	1.9	-0.3	-0.5	-1.1	-0.6	0.1	1.2
Unit labour costs	-0.4	-0.4	0.1	1.1	-0.3	-0.1	0.0	-0.3	0.2	0.6
Current account balance (cum., % GDP) ¹	1.4	0.1	0.6	0.6	0.0	0.1	0.2	0.3	0.5	0.6
Net lending or borrowing rest of the world (cum., % GDP) ¹	2.1	0.7	1.2	1.2	0.6	0.7	0.8	0.9	1.1	1.2
Fiscal balance (cum., % GDP) ¹	-6.8	-5.7	-4.8	-3.3						

Financial markets

INTEREST RATES										
Dollar										
Fed Funds	0.25	0.25	0.29	0.88	0.25	0.25	0.25	0.25	0.25	0.42
3-month Libor	0.27	0.23	0.52	1.16	0.23	0.24	0.30	0.48	0.61	0.68
12-month Libor	0.68	0.56	1.00	1.68	0.56	0.57	0.71	0.94	1.10	1.25
2-year government bonds	0.30	0.44	0.98	1.77	0.50	0.52	0.61	0.90	1.11	1.31
10-year government bonds	2.33	2.53	2.38	3.26	2.49	2.27	1.94	2.23	2.49	2.84
Euro										
ECB Refi	0.54	0.16	0.05	0.05	0.12	0.05	0.05	0.05	0.05	0.05
3-month Euribor	0.22	0.21	0.05	0.06	0.16	0.08	0.05	0.05	0.05	0.05
12-month Euribor	0.54	0.48	0.25	0.30	0.44	0.33	0.27	0.25	0.25	0.25
2-year government bonds (Germany)	0.13	0.05	-0.19	0.02	-0.01	-0.04	-0.17	-0.20	-0.20	-0.20
10-year government bonds (Germany)	1.62	1.23	0.36	0.81	1.06	0.76	0.37	0.35	0.35	0.35
EXCHANGE RATES										
\$/euro	1.33	1.33	1.13	1.10	1.33	1.25	1.15	1.13	1.13	1.12
¥/euro	129.65	140.42	140.73	139.14	137.68	142.89	136.58	139.48	142.13	144.74
£/euro	0.85	0.81	0.74	0.72	0.79	0.79	0.75	0.74	0.74	0.73
OIL										
Brent (\$/barrel)	108.47	99.45	60.20	78.68	103.38	77.03	54.59	56.52	62.13	67.55
Brent (euros/barrel)	81.67	74.83	53.14	71.26	78.02	61.68	47.59	49.84	55.08	60.20

Note: 1. Four quarter cumulative.

Forecasts

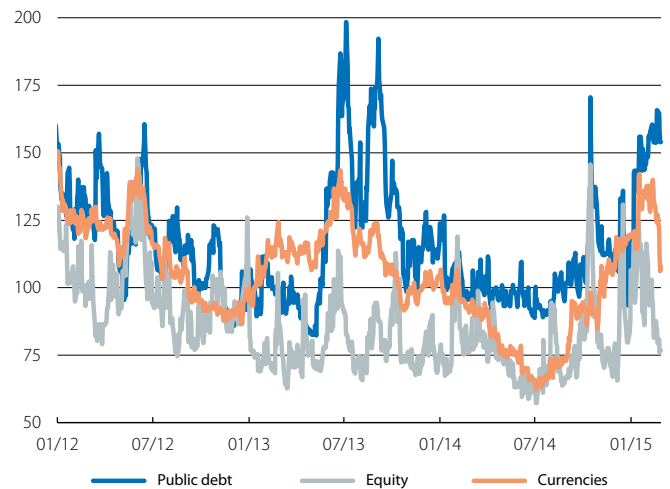
FINANCIAL OUTLOOK · Favourable winds in the financial markets

Europe is leading the improvements in the global financial environment. After a volatile start to the year, the events of the last few weeks have reduced some of the tail risks present in financial markets. The advances seen in Europe have been particularly significant, where the imminent start of quantitative easing (QE) by the European Central Bank (ECB) and activity gaining traction have been accompanied by an agreement concerning Greece's bail-out and some rapprochement in the Ukraine conflict. All this has helped to revive the upward trend in stock markets on the Old Continent. Outside the euro area, the tone of the markets is still dominated by the accommodative strategy of monetary authorities, with 18 central banks cutting interest rates since the start of the year, an unprecedented figure. However, the ups and downs experienced by emerging assets and uncertainty regarding the decision to raise interest rates by the Federal Reserve (Fed) are still sources of risk. Nonetheless, we expect the large appetite for risk to continue, particularly in the case of European assets, and volatility to remain under control.

Debate regarding the first interest rate hike by the Federal Reserve is intensifying. In her semi-annual testimony before Congress and the Senate, Fed Chairman, Janet Yellen, continued the prudential tone of the last few communications regarding the institution's interest rate normalisation strategy. Yellen ruled out the possibility of the first rise in the official rate in over eight years occurring before the Fed's meeting in June. In spite of this cautious approach, solid economic growth and a strong labour market have led investors to expect a hike in the non-too distant future and the monetary authority's intention to assess the decision «meeting by meeting», based on economic figures, will continue to intensify this debate. For the time being, we have maintained our forecast that interest rate normalisation will begin in November of 2015, although the market expects this to happen a little sooner.

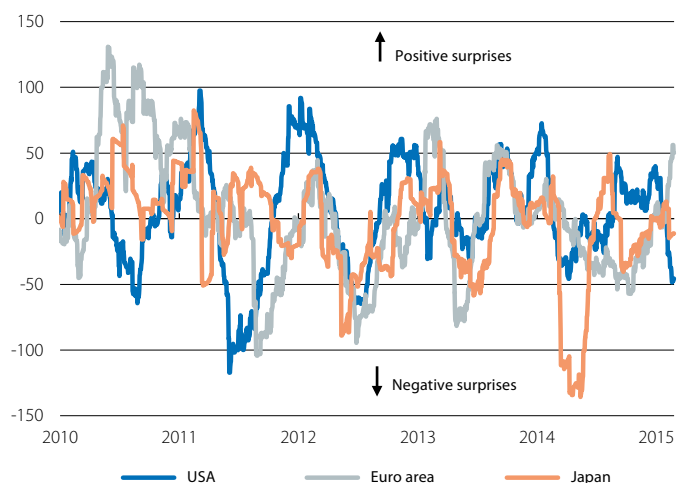
Treasury yields pick up in February, especially in the long tranche of the curve. This upswing contains several different aspects: macroeconomic (the solidity of the US economy and improved inflation expectations); monetary (an imminent hike in interest rates by the Fed); and financial (less capital retreating to safe havens). At the same time, the uncertainty present on these three fronts has increased volatility in the US government bond market. Over the coming months, if these factors continue, this situation should push up yields on US sovereign debt even further, albeit very gradually and with possible interruptions, as investment flows enter in a search for yield given the effects of Europe's QE. However, the Fed's forward guidance must be concise and clear to prevent greater instability in the US government bond market.

Implied volatility in financial markets Index (January 2013 = 100)



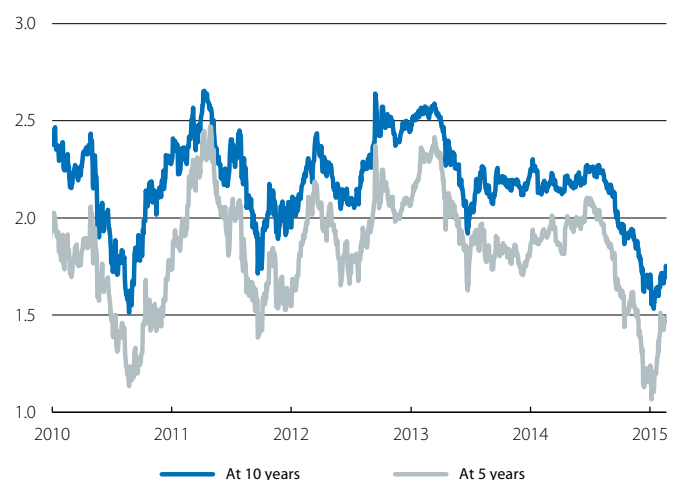
Source: "la Caixa" Research, based on Bloomberg data.

Index of economic surprises (Level)



Source: "la Caixa" Research, based on Bloomberg data.

USA: inflation expectations (%)



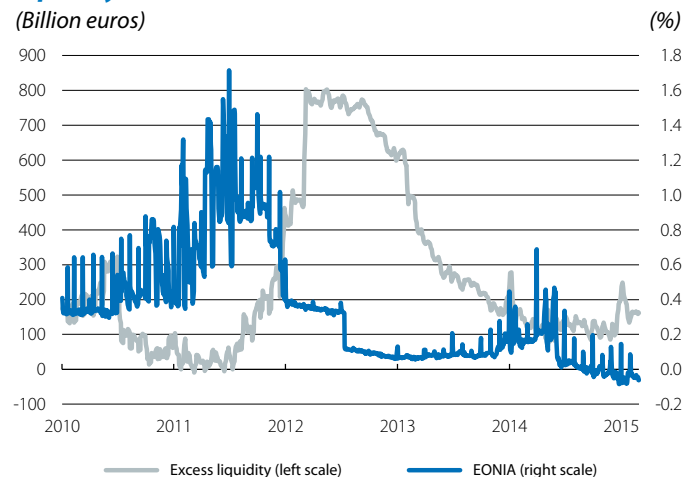
Source: "la Caixa" Research, based on Bloomberg data.

The ECB starts its sovereign debt purchase programme with the Greek question still pending. The markets will be watching the ECB Council meeting in March for answers to two very different questions: the first being the start of sovereign debt QE in March, with more details regarding how this will be carried out. It is expected that the resulting increase in the ECB's balance sheet of close to a trillion euros until at least September 2016 will push up the price of financial assets, although this rise may be limited in scope (see the article «QE comes to the euro area for a long visit» of the Dossier). The second question revolves around the next steps to be taken after the agreement reached with Greece. The ECB is likely to decide to increase the amount Greek banks can request under the ELA scheme while waiting for Greek debt to be accepted once again as collateral in LTROs. However, this last aspect needs the Greek government to comply with its commitments agreed with its creditors.

Tensions resulting from the negotiation for Greece's bail-out are limited to the Greek area. For most of February, the financial markets were keeping a close eye on negotiations between the new Greek government and the Eurogroup regarding the conditions of the country's bail-out programme. Finally, after long meetings, Alexis Tsipras's government reached an agreement that helps to ease the conditions imposed on its economy in exchange for presenting a list of structural reforms. However, this agreement needs to be ratified in April after the efforts made by the Greek government have been assessed, so we cannot rule out further tension for Greek sovereign debt. The upswing in yield was significant throughout the Greek sovereign curve last month and particularly in the short and medium tranche (the IRR on three-year debt exceeded 20% compared with 10% for 10-year bonds). With regard to the rest of the countries in the euro area, the impact on sovereign yields has been minimal, unlike in previous episodes. The IRR on the government bonds of some core countries fell, the German bund reaching an all-time low of less than 0.3%, while periphery yields also saw reductions. In both cases this performance was supported by the safety net provided by the start of the ECB's QE.

European stock markets see strong gains. After a doubtful and ill-defined performance in January, European equity was clearly on the up in February. This is due firstly to the favourable outcome of the Greek problem and, secondly, to the imminent start of euro area sovereign debt purchases (QE) by the ECB, attracting significant flows of investors towards European stock markets in search of higher yields. Lastly, the euro area's positive growth figures came as some surprise, helping to reinforce the optimism of investors who now expect greater profits in the future. This scenario contrasts with the timid advances made by the stock market in the US. In spite of positive figures for US corporate earnings in 2014 Q4, investors are cautious given the slight growth in turnover of US companies. The relatively better performance of

Euro area: EONIA interest rate and excess liquidity *



Note: * Bank assets on demand with the ECB above the mandatory reserves.
Source: "la Caixa" Research, based on Bloomberg data.

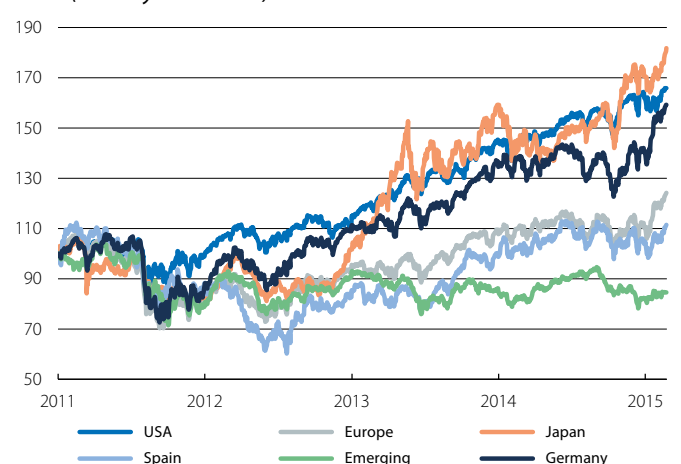
Euro area: yield on 10-year public debt



Note: * Average of the yields of Italy, Ireland, Spain and Portugal.
Source: "la Caixa" Research, based on Bloomberg data.

Main international stock markets

Index (January 2011 = 100)



Source: "la Caixa" Research, based on Bloomberg data.

European stock markets compared with the US is likely to continue in the medium term, although subject to two conditions: the good rate of growth in the euro area continuing, as we expect, and the sources of geopolitical risk remaining under control. For their part the stock markets of the emerging countries have seen mixed results, attributable to the orderly slowdown in the Chinese economy.

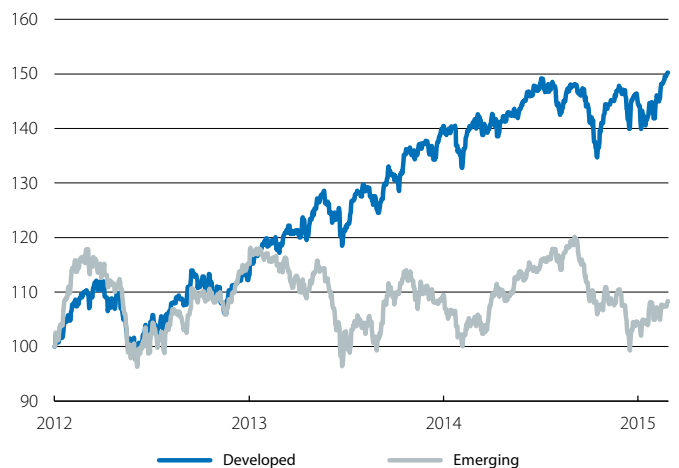
The emerging central banks intensify their expansionary strategy. Over the last few weeks the accommodative spiral started by the ECB's QE and followed by other European central banks has spread to the emerging monetary authorities. There have essentially been three reasons for such actions: the loss of traction in some economies over the last few quarters; a reduction in inflationary pressures due to falling oil prices; and the appreciation of their currencies given the incredibly accommodative policies adopted in developed countries. In this respect, the central banks of Turkey and India have cut their official interest rates. Even more significant is confirmation of the expansionary approach adopted by China's monetary authority, reducing its official credit and deposit interest rates for the second time in less than four months, to 5.35% and 2.5% respectively.

On the currency front, the dollar takes a break. The interruption in the euro's depreciation against the dollar over the last few weeks, which had reached \$1.12 by the end of February, is due to the Fed's repeatedly cautious approach. However, the start of the ECB's QE and the likelihood of the Fed toughening up its discourse will help the dollar to appreciate further against the euro.

Not a very encouraging outlook for commodities. After sharp falls early in 2015, the price of Brent oil has picked up again, now back at around 60 dollars/barrel. This upswing is due to lower levels of supply expected in the future because of crude oil exploitation and extraction projects being cancelled. In the short term, the trend in oil prices is likely to be erratic and ill-defined. The rest of commodities have not seen any great gains or losses, although the underlying weakness is widespread. One of the factors highlighting this situation is the weak tone of some emerging economies, particularly China. In the medium term doubts will continue to plague the commodities markets given the orderly slowdown being implemented by the Chinese authorities.

Developed and emerging stock markets

Index (January 2012 = 100)

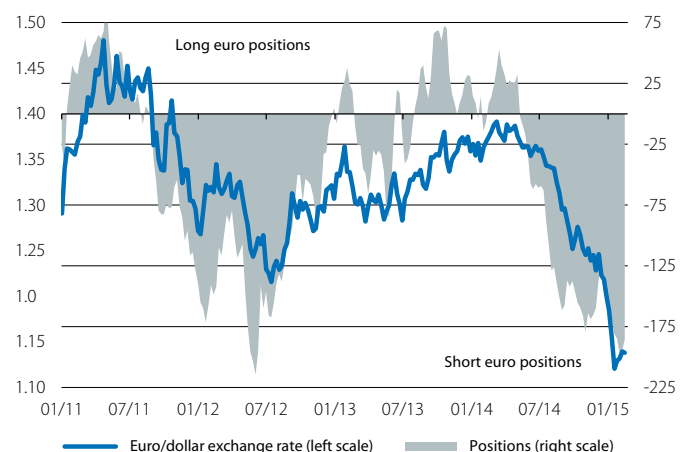


Source: "la Caixa" Research, based on Bloomberg data.

Currencies: speculative positions on the euro/dollar

(Dollars per euro)

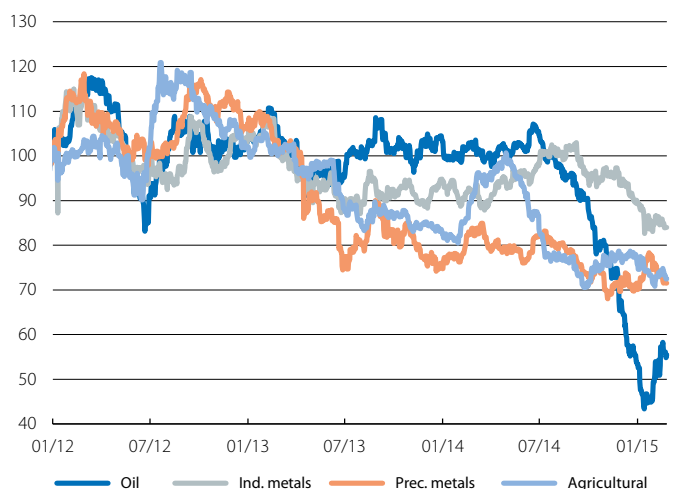
(Thousands of contracts)



Source: "la Caixa" Research, based on Bloomberg data.

Commodities

Index (January 2012 = 100)



Source: "la Caixa" Research, based on Bloomberg data.

FOCUS · The Greek banking system, between a rock and a hard place

The major sources of funding for European banks are usually deposits, the interbank and private debt markets and the liquidity operations carried out by the European Central Bank (ECB). During the crisis, the markets remained closed to many banks, whose dependency on the Eurosystem increased considerably. Specifically, the ECB provides two channels of funding: regular liquidity operations (MROs and LTROs) and emergency liquidity assistance (ELA). The latter is considered to be a source of financing of last resort, only employed when banks have particular liquidity problems, and it is therefore infrequently used. However, Greece's banks have had to resort to ELA to offset the deposits lost as a result of its recent political instability.

In general terms, banks use ELA when they do not have enough eligible assets as collateral to obtain financing in ordinary operations. Since they do not meet these criteria, they choose the ELA provided by national central banks (which assume the credit risk) but at a higher cost, as the collateral conditions are more flexible. However, although these financial operations are managed by national banks, the ECB maintains control by setting the maximum funds permitted (68.3 billion euros in the Greek case) and the possibility to cancel them if it believes they interfere with its monetary policy mandate.

Over the last few months Greece's political instability has led to bank deposits plummeting, falling by 9.7% between November and January. This contraction in liabilities has increased the liquidity required by Greece's banks which, lacking eligible assets and as a last resort, have had to turn to ELA. Two decisions by the monetary authority have accentuated this lack of collateral. The first and most recent was the suspension of the eligibility of Greek government securities as collateral in the ECB's liquidity operations.¹ The second was the exclusion of government-guaranteed bank bonds as collateral as from March. The first reduces eligible collateral in the Eurosystem by 8 billion euros while the second affects almost 50 billion. Although these guaranteed bonds were already due to become ineligible, and many of them mature very soon, the banks have continued to depend on them to finance 50% of the funds obtained from the Eurosystem.

The fact that a considerable proportion of the collateral in the Greek banking system can only be accepted via ELA, and that the limit to these emergency funds totals 68.3 billion euros (almost 60 billion have already been used),

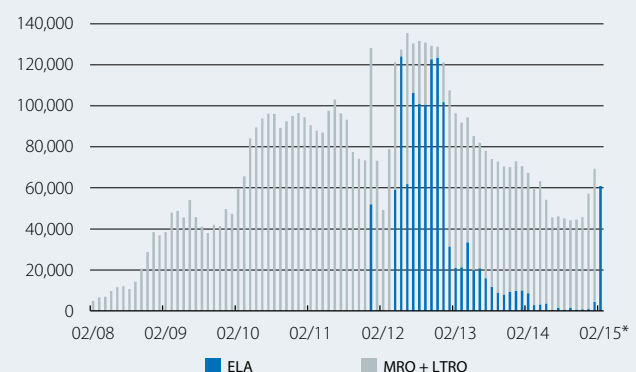
1. Participation in the bail-out programme made this debt eligible, albeit with a low credit rating. If the programme is extended, it might be accepted again.

could make it difficult to finance the banking system if deposits continue to be withdrawn. As an example of just how necessary it is to reduce political instability by the government reaching an agreement with European institutions, we have simulated the financing capacity of Greece's banks in the Eurosystem² in different scenarios. If deposits continue to be withdrawn at the same rate as in January (7.3%), by April the banks will find it difficult to finance themselves as they will not have enough eligible collateral. But if deposits shrink at the average rate achieved between November and January (3.3%), this will not be a problem until June.

Although deposits are not expected to continue falling at this rate, such figures underline the risk that would exist should political instability and the consequent deposit outflow not be curbed.

Eurosystem funding of Greek banks

(Million euros)

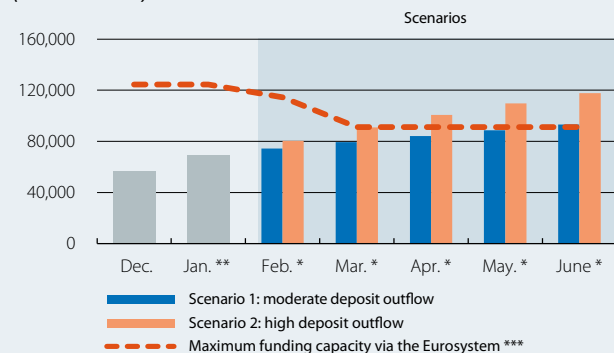


Note: * Only includes ELA funding (estimates based on ECB balance sheets).

Source: "la Caixa" Research, based on data from the Bank of Greece and the ECB.

Funding requirements of Greek banks

(Million euros)



Notes: * Estimates assuming that the entire reduction in deposits is financed via the Eurosystem. Scenario 1, average deposit outflow between November and January (3.3% month-on-month). Scenario 2, deposit outflow the same as in January (7.3% month-on-month). ** Estimated figure based on ECB balance sheets. *** Estimate dependent on the ELA fund limitation.

Source: "la Caixa" Research, based on data from the National Bank of Greece, the ECB and Bloomberg.

2. Both via the ECB and ELA.

FOCUS · Cash accumulation across US firms: a change at last?

The financial crisis that started in mid-2007 marked a change in corporate strategy worldwide. Over the last few years, most companies have redesigned their growth strategies and have attempted to control their leverage, combining cost optimisation with selling off non-core assets. However, the unclear trend in aggregate demand, uncertainty related to the economic cycle in general and highly accommodative monetary policies have been powerful reasons for companies to record growing cash surpluses on their balance sheets. The phenomenon of cash accumulation has been particularly noticeable in the US and raises the question of how this cash will be used now that the economy seems to be enjoying stronger growth.

A historical perspective of trends in liquidity (calculated as cash reserves and other liquid assets) in the US corporate sector shows an unusual upswing in the last few years. In 2014 this reached 11.9% of all corporate assets compared with 6.4% on average between 1995 and 2005. In addition to the above-mentioned factors which led companies to save as a precautionary measure, other tax and regulatory aspects were also relevant, discouraging firms from reinvesting their earnings. Specifically, the high cost, in corporate tax terms, of repatriating profits earned abroad has helped to increase the cash held by subsidiaries outside US borders. With the aim of easing the tax burden to some extent, one of the arguments put forward by corporate lobbies to the authorities is the negative impact of retaining earnings overseas on capital expenditure (capex), a variable whose weakness in the last few years has hindered economic growth in the US.

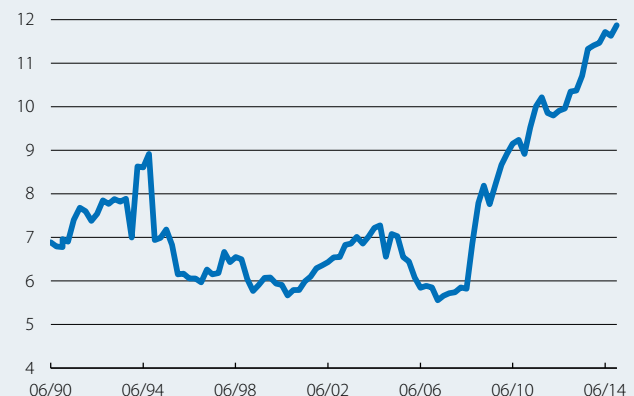
However, this tendency to accumulate cash could be starting to change. Better growth prospects globally, the strong recovery of the US economy and the stabilisation of financial risks are creating a new environment for business. According to the latest survey carried out by the Association for Financial Professionals on chief finance officers, US companies started the year with the firm intention to reduce the size of their cash surpluses. Although this is a recurring new year's resolution which has nevertheless not been kept, this time the resounding response would be in line with a change in trend in cash accumulation.

Also according to the survey's findings, such a shift would satisfy the demands of institutional investors (investment and pension funds, etc.) as the overwhelming majority would like to see cash being moved about more as it hardly generates any returns when held on balance sheets. The big question being asked by analysts and investors therefore concerns how companies might use

their surplus liquidity. They have four main choices. Firstly, to increase capex, investing in the company itself in order to boost organic growth. Secondly, to carry out mergers or acquisitions. Thirdly, to improve returns to shareholders via dividends or share repurchases. And fourthly, to reduce medium and long-term debt. Surveys on managers and analysts show that they clearly prefer the first and then the third option, with the other two very much at a secondary level (except in specific cases). For the time being, the actions taken by US companies also seem to be leaning towards these preferences. The rise in capex is still modest (although promising) and deleveraging is very gradual (without a sense of urgency). However, the last few months have seen a notable increase in mergers as well as stock buybacks. This suggests that a shift by US companies towards less conservative liquidity strategies is underway, although it does not look like being aggressive in capex terms this year.

Liquidity of US firms *

(% of total assets)



Note: * Liquidity includes cash holdings and the rest of liquid assets.

Source: "la Caixa" Research, based on Bloomberg data.

KEY INDICATORS

Interest rates (%)

	27-Feb	30-Jan	Monthly change (bps)	Year-to-date (bps)	Year-on-year change (bps)
Euro area					
ECB Refi	0.05	0.05	0	0	-20
3-month Euribor	0.04	0.05	-2	-4	-25
1-year Euribor	0.23	0.27	-4	-10	-32
1-year government bonds (Germany)	-0.19	-0.14	-5	-13	-29
2-year government bonds (Germany)	-0.23	-0.18	-5	-13	-32
10-year government bonds (Germany)	0.33	0.30	3	-21	-123
10-year government bonds (Spain)	1.26	1.42	-16	-35	-223
10-year spread (bps) ¹	93	112	-19	-14	-100
USA					
Fed funds	0.25	0.25	0	0	0
3-month Libor	0.26	0.25	1	0	2
12-month Libor	0.68	0.62	6	5	13
1-year government bonds	0.19	0.14	5	-2	9
2-year government bonds	0.62	0.45	17	-5	30
10-year government bonds	1.99	1.64	35	-18	-65

Spreads corporate bonds (bps)

	27-Feb	30-Jan	Monthly change (bps)	Year-to-date (bps)	Year-on-year change (bps)
Itraxx Corporate	50	60	-10	-13	-23
Itraxx Financials Senior	54	68	-14	-13	-35
Itraxx Subordinated Financials	122	143	-21	-27	-10

Exchange rates

	27-Feb	30-Jan	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
\$/euro	1.120	1.129	-0.8	-7.5	-18.3
¥/euro	133.940	132.650	1.0	-7.5	-4.3
£/euro	0.725	0.750	-3.2	-6.6	-11.7
¥/\$	119.630	117.490	1.8	-0.1	17.1

Commodities

	27-Feb	30-Jan	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	420.9	422.5	-0.4	-3.8	-11.5
Brent (\$/barrel)	61.8	50.8	21.7	10.9	-43.3
Gold (\$/ounce)	1,213.2	1,283.8	-5.5	2.4	-8.9

Equity

	27-Feb	30-Jan	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	2,104.5	1,995.0	5.5	2.2	13.5
Eurostoxx 50 (euro area)	3,599.0	3,351.4	7.4	14.4	14.8
Ibex 35 (Spain)	11,178.3	10,403.3	7.4	8.7	10.0
Nikkei 225 (Japan)	18,797.9	17,674.4	6.4	7.7	26.0
MSCI Emerging	990.3	961.6	3.0	3.6	2.8
Nasdaq (USA)	4,963.5	4,635.2	7.1	4.8	14.9

Note: 1. Spread between the yields on Spanish and German 10-year bonds.

ECONOMIC OUTLOOK · Led by the United States

The United States is leading an uneven recovery with Japan plunged into lethargy and China immersed in its «soft» landing. Among the rest of the emerging economies, India and Turkey have improved their outlook while oil-exporting countries (such as Russia) continue to suffer the consequences of cheap oil.

UNITED STATES

The GDP figure for 2014 Q4 was revised downwards from 0.7% to 0.5% quarter-on-quarter (2.4% year-on-year) due to a worse performance by exports and stocks compared with the initial estimates for the quarter's flash figure. Nonetheless, this does not change the annual figure for 2014 (2.4%) or our main scenario for 2015 (3.5%). In the medium term, the US economy will continue to expand thanks to support from domestic consumption, the push provided by corporate investment, less fiscal adjustment and a recovery in real estate that will gradually consolidate as a result of sustained improvement in the labour market. The appreciation of the dollar, which has the opposite effect, will be largely offset by weak oil prices.

Business indicators confirm the strength of consumption.

In January the Conference Board Consumer Confidence index passed the benchmark of 100 points for the first time since November 2000 (the historical average is 93 points) and, in spite of February's decline (to 96.4 points), the indicator looks very likely to continue improving. The weakness in retail and consumer goods in January, calculated at current prices, was largely due to low fuel prices.

The business climate points to a recovery in investment

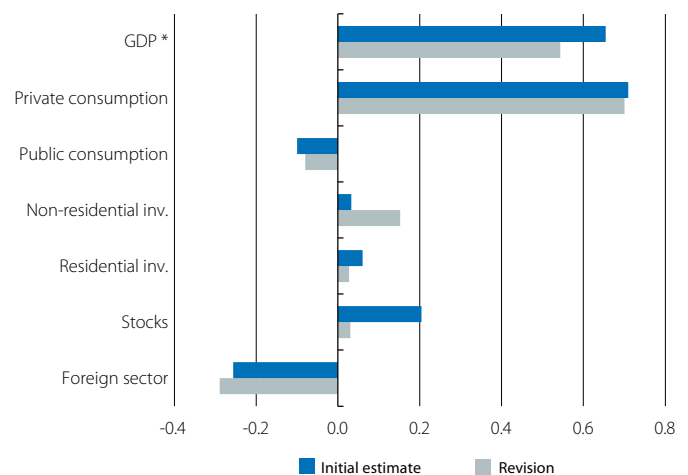
after the hiatus in 2014 Q4. The ISM business sentiment indices (53.5 points for manufacturing and 56.7 for services) remain at levels in line with strong growth in the economy overall, particularly in the case of services which employs 83.6% of workers in the private sector.

The labour market performed well in January but wage growth is still moderate.

In January 257,000 jobs were created, above the 200,000 threshold that is indicative of a strong market. The unemployment rate rose but only marginally to 5.7% while the participation rate improved by 0.2 pps to 62.9%. However, the unemployment rate which includes both the unemployed and the under-employed (people forced to work part-time due to the economic situation), rose by 0.1 pps to 11.3%, preventing any larger growth in wages. In this respect, wage rises (2.2% year-on-year in January) are still clearly below the zone that Janet Yellen, Chairman of the Federal Reserve (Fed) believes to be «normality» (between 3% and 4%).

USA: GDP

Contribution to quarter-on-quarter growth in GDP in Q4 (pps)

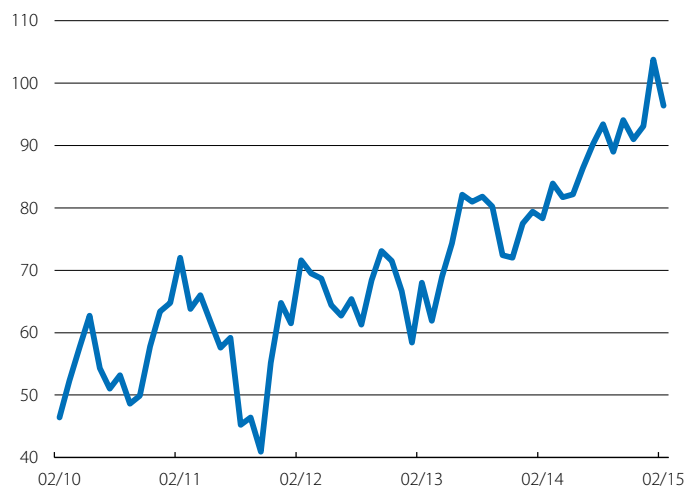


Note: * Quarter-on-quarter change.

Source: "la Caixa" Research, based on data from the Bureau of Economic Analysis.

USA: consumer confidence

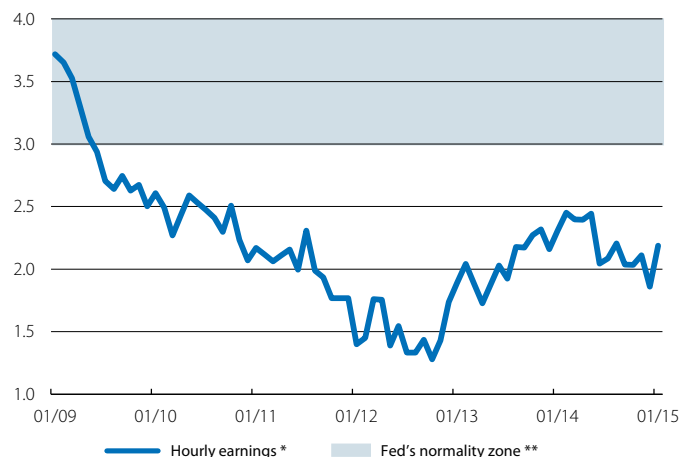
Index



Source: "la Caixa" Research, based on data from the Conference Board.

USA: hourly earnings

Year-on-year change (%)



Notes: * For workers in the private sector (except agriculture), in nominal terms.

** The normal range for hourly earnings according to the Fed.

Source: "la Caixa" Research, based on data from the Bureau of Labor Statistics.

Inflation drops into negative figures for the first time in the US since the crisis of 2008. January's CPI fell by 0.9 percentage points to -0.1% year-on-year, slightly below our forecasts and those of the consensus. Once again the large drop in energy prices, 9.7% between December and January, has supported this sharp adjustment. Nonetheless, the core CPI rose by 0.2% month-on-month, keeping year-on-year growth flat at 1.6%, a figure that will sustain debate regarding when the Fed will start to raise interest rates.

JAPAN

GDP in 2014 Q4 takes Japan out of recession but is disappointing. The Japanese economy grew by 0.6% quarter-on-quarter in 2014 Q4 after two consecutive quarters of decline due to the VAT hike (from 5% to 8%) last 1 April. But quarter-on-quarter growth was clearly lower than expected by the consensus and left growth for the whole of 2014 at 0.0%. The breakdown of GDP in Q4 was also disappointing: (i) private consumption provided the biggest shock, increasing by 0.3% quarter-on-quarter with no sign of improving; (ii) the significant contribution of stocks will not continue; and (iii) investment still looks weak. All this has led us to reduce our growth forecast in 2015 from 1.2% to 0.8%.

Japan is growing in nominal terms but is once again close to deflation. The quantitative expansion by the Bank of Japan (BOJ), whose assets totalled 63.8% of GDP in January compared with 33.6% at the beginning of 2013, to revitalise prices and achieve nominal growth has had some success, helping to reduce the percentage of public debt to GDP (245% of GDP in 2014 according to IMF estimates). But here the risks are also downwards. The CPI without foods but with energy (used as a benchmark by the BOJ) rose in January to 2.2% year-on-year and to 0.2% discounting the VAT effect (the general CPI rose by 2.4%, 0.3% discounting VAT), very far from the BOJ's 2.0% target.

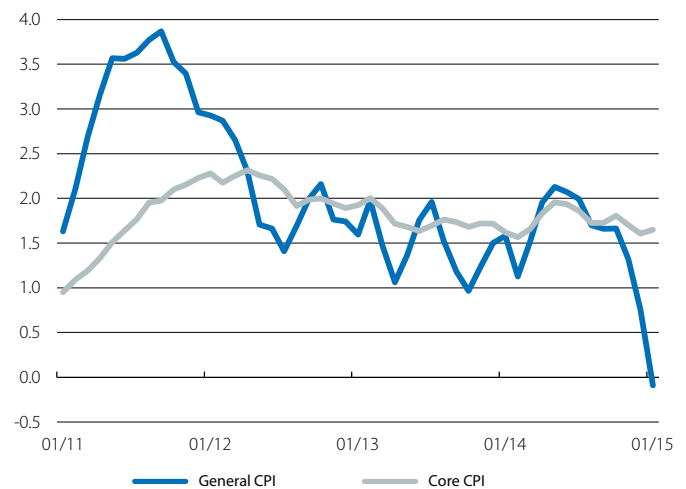
Wages, the key to reactivating domestic demand, continue at a standstill. Almost all wage rises between 2012 and 2014 were by increasing bonds and extraordinary payments (and not increases in the basic wage), indicating that entrepreneurs still see no improvement in long-term growth.

EMERGING ECONOMIES

The main scenario for China is a soft landing, in line with the controlled slowdown desired by the government which will probably lower its official growth target in March from 7.5% to 7.0%. January's indicators introduce a downward bias to our scenario with the PMI manufacturing index falling slightly below the benchmark of 50 points for the first time since September 2012 and exports and imports decreasing by 3.3% and 19.2% year-on-year in nominal terms, respectively. Although the business indicators from January and February must be interpreted with caution due to the distortions produced by the change in date for the Chinese New Year,

USA: CPI

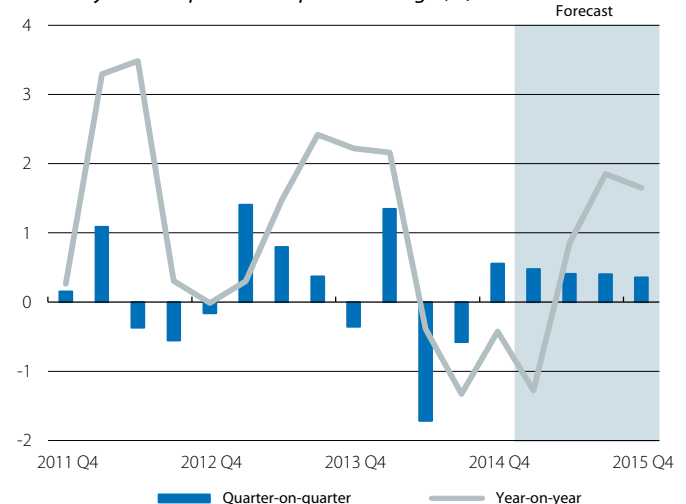
Year-on-year change (%)



Source: "la Caixa" Research, based on data from the Bureau of Labor Statistics.

Japan: GDP

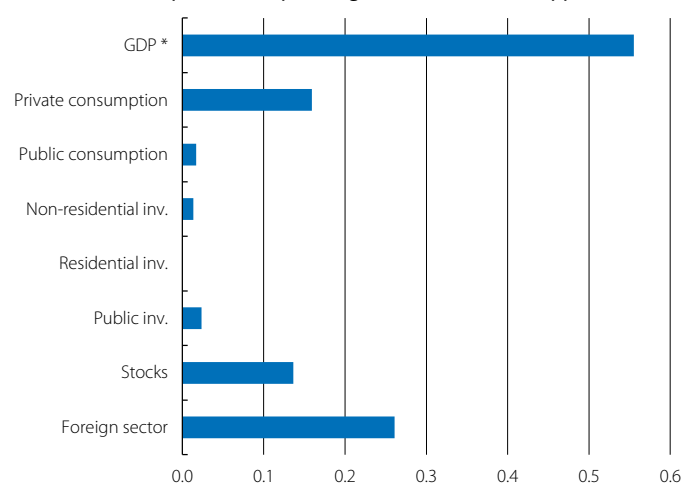
Year-on-year and quarter-on-quarter change (%)



Source: "la Caixa" Research, based on data from the Japanese Ministry of Communications.

Japan: GDP

Contribution to quarter-on-quarter growth in GDP in Q4 (pps)



Note: * Quarter-on-quarter change.

Source: "la Caixa" Research, based on data from the Japanese Ministry of Communications.

the continued slowdown of imports is still a source of concern. However, the government has not hesitated to cut the official interest rate for a second time in less than four months (to 5.35%) to support the economy and January's low inflation, 0.8% year-on-year, provides ample room for further expansionary policies.

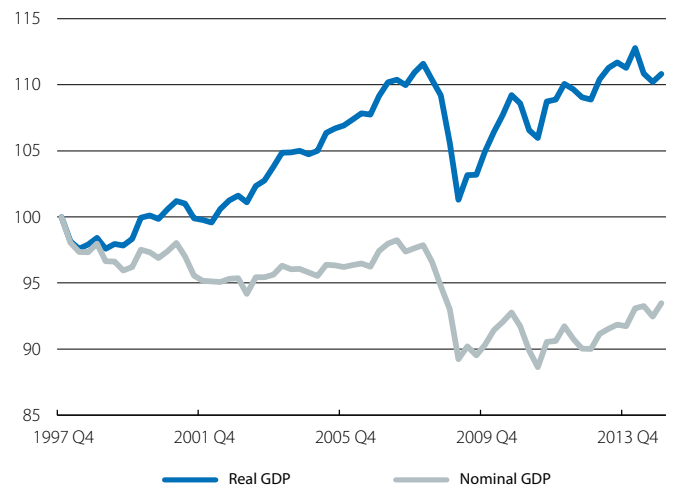
India improves its statistics and revises its GDP growth notably upwards. According to the new official measurement, GDP advanced by 7.5% year-on-year in Q4, lower than the 8.2% figure for Q3 but much higher than the 5% flash figure provided by the old series. The new GDP series introduces comprehensive changes to bring it more in line with international accounting standards: the market price (MP) criterion replaces that of factor cost (FC) and the items of mining and local industries, intellectual property and software have been included. On the supply side, the new series gives more relative weight to manufacturing (traditionally weak in comparison with China) and, in demand, increases the relative weight of fixed capital formation and private consumption.

In the rest of the emerging economies, Turkey has improved its outlook while Brazil and Mexico are worse. In Brazil, the standstill in activity at the end of 2014, difficulties in implementing the fiscal adjustment announced and a more restrictive monetary policy than expected have led us to lower our growth forecast for 2015 from 1.0% to 0.7%. Hikes in indirect taxes and higher administered prices have also caused us to increase our inflation forecast from 6.0% to 6.5% in 2015. Mexico accelerated to 2.6% year-on-year in 2014 Q4 (2.2% in Q3), bringing the annual figure for 2014 to 2.1% (1.4% in 2013). In spite of this faster growth, the announced adjustment in government spending (0.7% of GDP), which will affect Pemex investments, means that growth should be slightly lower in 2015 (3.1% compared with 3.4% previously). In contrast, indicators in Turkey point to activity speeding up at the end of 2014 and we have therefore revised upwards our main scenario for 2014 (from 2.8% to 2.9%). In 2015, in addition to the good end to 2014, increased monetary accommodation will also play in its favour and we have revised our growth forecast for 2015 from 3.4% to 3.6%.

Russia continues to face the biggest risks among the large emerging countries. The Minsk II agreements could represent the start of a decline in geopolitical risks and, in the medium term, the withdrawal of sanctions. Given the uncertainty still present, it is premature to improve our main scenario (-3.3% in 2015) although the recent upswing in inflation and a larger than expected depreciation of the rouble justify an upward revision for inflation: from 9.4% to 13%.

Japan: nominal and real GDP

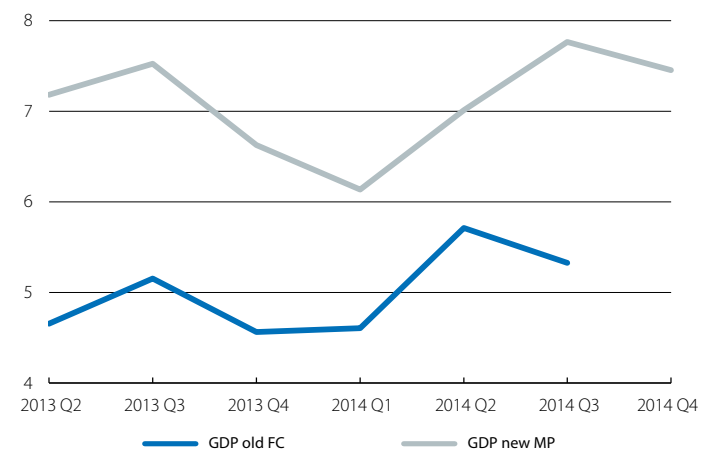
Index (100 = 1997 Q1)



Source: "la Caixa" Research, based on data from the Japanese Ministry of Communications.

India: GDP

Year-on-year change (%)



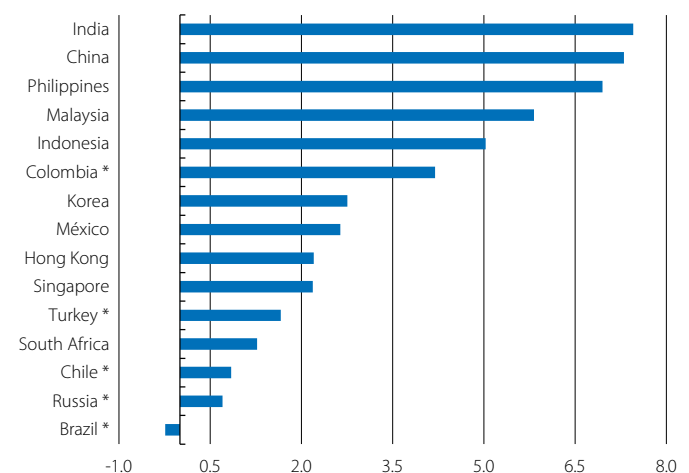
Note: Old FC: factor cost (old benchmark). New MP: market price (new benchmark).

MP = FC + indirect taxes - production subsidies.

Source: "la Caixa" Research, based on data from India's Central Office of Statistics.

Emerging countries: GDP growth in 2014 Q4

Year-on-year change (%)



Note: * Data for 2014 Q3.

Source: "la Caixa" Research, based on data from Thomson Reuters Datastream.

FOCUS · Turkey: a more manageable balance of risks in 2015

In the last few years Turkey has quite frequently been included among the so-called fragile emerging economies, a label for the different countries with macroeconomic imbalances. In Turkey's case the most worrying are inflation and its current account deficit. The figures suggest that progress was made last year in adjusting the second of these imbalances although this is not so much the case with inflation. The current account imbalance went from 7.9% of GDP at the end of 2013 to 5.9% in 2014 Q3, a notable improvement which was mainly due to two factors. The first: falling oil prices. Turkey's oil imports represent 6% of its GDP, so cheaper crude oil has had a considerable impact. A second element has been the adjustment in domestic demand resulting largely from more restrictive financial conditions (the reference rate was raised from 4.5% to 10.0% in January 2014).

However, inflation remained high during most of last year, specifically 8.9% on average and reaching an annual peak of 9.5% in August. To a large extent this was due to larger margins for the distributors of agricultural products, pushing up the end price.¹ Although the dip in the energy component helped to temporarily reduce inflation towards the end of 2014, both the current figure (7.2% in January) and inflation expectations are still far from the 5% target set by Turkey's central bank. Given this situation, the institution's decision to lower its reference interest rate by 250 bps over the last few months has been controversial.

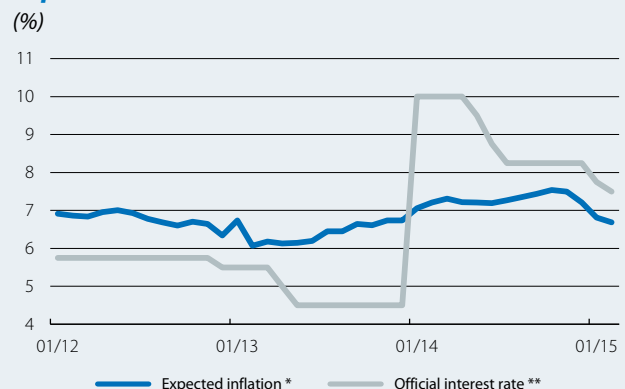
Nonetheless, growth and inflation forecasts help to ease this controversy to some extent. Growth is expected to speed up slightly in 2015. The most important factor behind this recovery is the full impact of beneficial effects for the country provided by the current phase of lower oil prices. Cheaper crude means higher growth, lower inflation and further reductions in the current account deficit, all at the same time. Activity will also be supported by the effect of easier monetary conditions in 2014 and the beginning of 2015. In this scenario, in 2015 Turkey would see average inflation of 6.3% and a current account deficit of 4.3% of GDP. It should also be noted that, even though 2015 is an electoral year, the expected trend for public finances is notably favourable, partly thanks to higher fiscal revenue resulting from planned privatisations.

Nevertheless, although the recovery is expected to consolidate gradually in 2016, Turkey will continue

to move within a scenario containing considerable downside risks. Firstly because the macroeconomic improvements it will experience in the short term are not structural in nature: the recovery in oil prices will push up both inflation and the current account deficit again. Nevertheless, the recovery of the country's main trading partners, the euro area and Russia, should also support Turkey's external balance.

Two additional risks threaten the Turkish economy. The first is the reaction by international investors once the Federal Reserve starts to raise its reference rate. Although Turkey is clearly less reliant on external financing than in previous years, once this happens we cannot rule out a weak period for the lira and a resulting hike in the reference rate in an attempt to defend it. A second risk is geostrategic in nature, given that conflict in Turkey's region has become markedly worse over the last few years.

Turkey: reference interest rate and inflation expectations



Notes: * Inflation expectations at 12 months, survey by Turkey's central bank.

** One-week repo rate.

Source: "la Caixa" Research, based on Bloomberg data.

Turkey: main indicators

	2007-2011	2012	2013	2014 (f)	2015 (f)	2016 (f)
Real GDP growth (%)	3.7	2.1	4.1	2.9	3.6	4.3
CPI inflation (%) (y)	8.3	6.8	7.5	8.8	6.3	6.8
Current account balance (% GDP)	-5.8	-6.2	-7.9	-5.4	-4.3	-5.0
Fiscal balance (% of GDP)	-2.9	-2.1	-1.2	-1.5	-1.7	-1.5
Public debt (% of GDP)	44.7	40.1	39.6	38.2	37.4	35.1

Note: (f) Forecast; (y) Year-end figure.

Source: "la Caixa" Research, based on data from Thomson Reuters Datastream.

1. In fact, the gap between Turkey's actual and potential GDP increased in 2014, according to OECD estimates, which should have reduced inflationary pressures.

FOCUS · Saudi Arabia's big gamble

The slump in oil prices since the summer of 2014, which is still 45% in spite of the slight upswing seen in the last few weeks, is especially due to supply factors. Of particular note is the change in strategy of Saudi Arabia which, faced with increasing global production, has refused to play its role as a «swing producer» in order to quash competition.

Over the last few years, Saudi Arabia has taken advantage of its privileged position to act as a swing producer and keep global oil supply in line with demand at any given time, thereby helping to stabilise prices. However, within the current context of increasing supply, OPEC's major producer has decided not to reduce its production, a stance which has clearly pushed down prices, something the country can easily withstand given its low extraction costs (see the first graph).

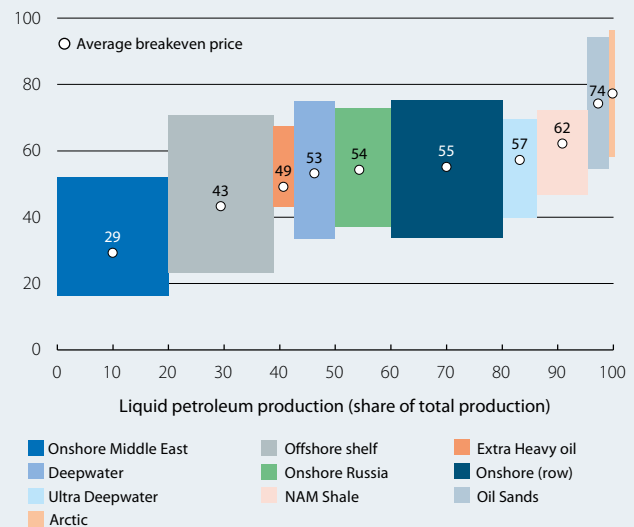
But this is a card that not all oil-producing countries can play. At current prices, part of the supply is no longer profitable, which should help to gradually push up the crude price as those producers most affected by lower profits will cut back on their investment, leading to a reduction in supply over the medium term. It should be noted that the cost of producing oil depends both on the region and on the method of extraction: the cheapest petroleum to extract is, precisely, onshore oil in the Middle East, followed at some distance by offshore shelf and Russian onshore extraction. Among the most expensive is North American shale oil. According to estimates by Rystad Energy, the average price at which shale exploitation becomes profitable is around 62 dollars per barrel, 2.5 higher than the figure for Saudi Arabia. Unusually low prices for a prolonged period of time would therefore seriously punish shale oil production in the US.¹

So is Saudi Arabia managing to curtail production by its competitors? This does seem to be the case. In the US, the number of oil platforms in operation has dropped to its lowest level since 2011 while the number of new shale extraction permits has also fallen, from close to 3,000 a month granted in September 2014 to 1,500 in December 2014. More generally, large oil companies have announced investment cuts to the tune of 20% (see the second graph), such announcements being in line with the cancellation of numerous exploration projects in the Arctic area, where crude oil has yet to be exploited due to high extraction costs.

1. It is important to note that the cost curve graph corresponds to costs at current production levels. For example, if Saudi Arabia increased its production substantially, its average cost would be higher as it is increasingly more expensive for the country to increase its production.

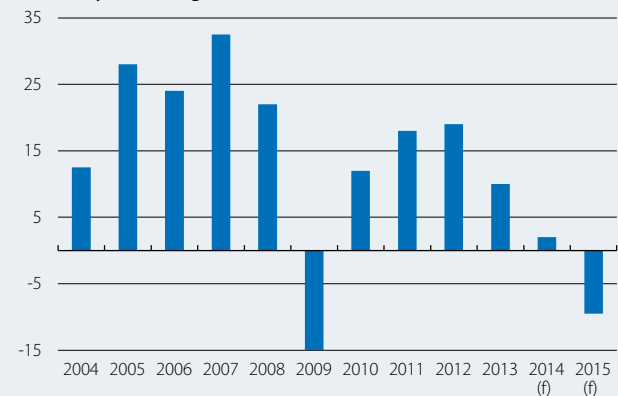
In short, oil prices are likely to recover gradually given the lower amount of capital being invested by energy firms. Nonetheless, we cannot rule out further shocks to the price, especially as crude oil inventories have increased considerably over the past few months.

Cost curve of global liquid petroleum supply
USD/Brent barrel



Source: "la Caixa" Research, based on data from Rystad Energy research & analysis.

Global investment in the petroleum industry *
Year-on-year change (%)



Note: * Capital investment aimed at exploration and exploitation in the petroleum industry; (f) Forecast.

Source: "la Caixa" Research, based on data from J. P. Morgan.

KEY INDICATORS

Year-on-year change (%), unless otherwise specified

UNITED STATES

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	01/15	02/15
Activity								
Real GDP	2.2	2.4	1.9	2.6	2.7	2.4	–	...
Retail sales (excluding cars and petrol)	3.5	3.9	2.3	4.1	4.4	4.8	5.7	...
Consumer confidence (value)	73.2	86.9	80.5	83.4	90.9	92.7	103.8	96.4
Industrial production	2.9	4.2	3.3	4.2	4.7	4.5	4.8	...
Manufacturing activity index (ISM) (value)	53.8	55.7	53.5	55.5	56.9	56.9	53.5	...
Housing starts (thousands)	930	1,001	925	985	1,030	1,065	1,065	...
Case-Shiller home price index (value)	158	171	169	171	170	173	...	...
Unemployment rate (% lab. force)	7.4	6.2	6.6	6.2	6.1	5.7	5.7	...
Employment-population ratio (% pop. > 16 years)	58.6	59.0	58.9	58.9	59.0	59.2	59.3	...
Trade balance ¹ (% GDP)	–2.8	–2.9	–2.8	–2.9	–2.8	–2.9	...	...
Prices								
Consumer prices	1.5	1.6	1.4	2.1	1.8	1.2	–0.1	...
Core consumer prices	1.8	1.7	1.6	1.9	1.8	1.7	1.6	...

Note: 1. Cumulative figure over last 12 months.

Source: "la Caixa" Research, based on data from the Department of Economic Analysis, Department of Labor, Federal Reserve, Standard & Poor's, ISM and Thomson Reuters Datastream.

JAPAN

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	01/15
Activity							
Real GDP	1.6	0.0	2.2	–0.4	–1.3	–0.4	–
Consumer confidence (value)	43.6	39.3	38.8	39.1	40.9	38.5	39.1
Industrial production	–0.6	2.1	8.3	2.6	–1.1	–1.2	–1.3
Business activity index (Tankan) (value)	6.0	13.5	17.0	12.0	13.0	12.0	–
Unemployment rate (% lab. force)	4.0	3.6	3.6	3.6	3.6	3.5	3.6
Trade balance ¹ (% GDP)	–2.4	–2.6	–2.8	–2.9	–2.9	–2.6	–2.3
Prices							
Consumer prices	0.4	2.7	1.5	3.6	3.3	2.5	2.4
Core consumer prices	–0.2	1.8	0.6	2.3	2.3	2.1	2.0

Note: 1. Cumulative figure over last 12 months.

Source: "la Caixa" Research, based on data from the Communications Department, Bank of Japan and Thomson Reuters Datastream.

CHINA

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	01/15
Activity							
Real GDP	7.7	7.4	7.4	7.5	7.3	7.3	–
Retail sales	13.1	10.3	11.9	12.3	11.9	11.7	...
Industrial production	9.9	9.8	8.7	8.9	8.0	7.6	...
PMI manufacturing (value)	50.8	50.7	50.3	50.7	51.3	50.4	49.8
Foreign sector							
Trade balance ¹ (value)	258	380	233	253	321	0	408
Exports	7.8	6.1	–3.4	5.0	13.0	8.6	–3.3
Imports	7.3	0.6	1.6	1.4	1.1	–1.7	–19.9
Prices							
Consumer prices	2.6	2.0	2.3	2.2	2.0	1.5	0.8
Official interest rate ² (value)	6.00	5.60	6.00	6.00	6.00	5.60	5.60
Renminbi per dollar (value)	6.1	6.2	6.1	6.2	6.2	6.1	6.2

Notes: 1. Cumulative figure over last 12 months. Billion dollars. 2. End of period.

Source: "la Caixa" Research, based on data from the National Bureau of Statistics of China and Thomson Reuters Datastream.

ECONOMIC OUTLOOK · The figures are more encouraging but still immersed in uncertainty

The euro area's GDP grew by 0.3% quarter-on-quarter in 2014 Q4 (0.2% in Q3), 0.1 pps more than expected. This places total growth for the year at 0.9% (–0.4% in 2013). The strong growth enjoyed by the German economy in Q4, namely 0.7% quarter-on-quarter (0.1% in Q3), exceeded expectations and was a key factor in the euro area's recovery. GDP growth in Spain, 0.7% quarter-on-quarter, and in Portugal and the Netherlands, 0.5%, also helped to speed up the euro area's rate of recovery. However, France continued to show signs of weakness with only 0.1% growth, due particularly to the bad performance of investment, and Italy has yet to completely come out of recession (0.0%). The disparity between countries therefore remains, with Spain and Germany in the leading group and France and Italy among those at the back.

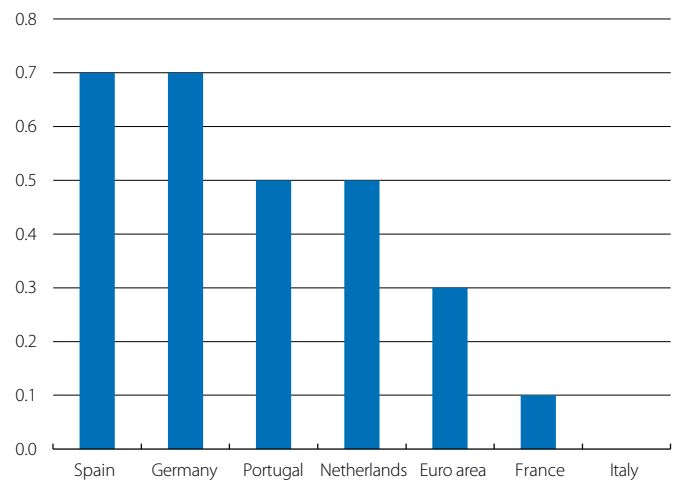
The European Commission (EC) has improved its GDP growth forecasts for the euro area to 1.3% in 2015 and 1.9% in 2016, 0.2 pps above its autumn predictions. For the first time since 2007 positive growth is expected in 2015 for all countries of the euro area, albeit at differing speeds. Part of the increase in growth in 2015 is supported by temporary factors such as the fall in oil prices, the euro's depreciation and the start-up of large-scale asset purchases by the European Central Bank (ECB). Worthy of note are the improved forecasts for Spain (+0.6 pps) and for Germany (+0.4 pps) although it is important to eliminate sources of uncertainty in the euro area, such as the Greek crisis, for this improvement to continue over the coming months.

The EC allows France to delay the correction of its deficit in exchange for a larger reduction in its structural deficit. The country has until 2017 to reduce its fiscal deficit to below 3.0% of GDP. At the same time, however, the EC expects France to reduce the part of its deficit that corresponds to structural factors, currently at a high level compared with other euro area countries. Specifically the EC has urged France to make an effort to reduce its structural deficit by 0.5% of GDP in 2015, 0.2 pps more than had been demanded to date. It has also announced a revision in May to supervise the country's deficit reduction and implementation of reforms. In the case of Italy, the EC has warned of its high level of debt (133% expected in 2015) and its failure to meet the deficit target for the year (2.6% instead of the 2.2% forecast), although it has decided not to impose sanctions, recognising the difficult macroeconomic context and the effort being made by the Italian government in the area of reforms.

Agreement between Greece and the Eurogroup to extend the bail-out programme until June. The institutions have approved the initial list of measures presented by the Greek government which include the following: a reform of VAT and

GDP in 2014 Q4

Quarter-on-quarter change (%)



Source: "la Caixa" Research, based on Eurostat data.

GDP growth forecasts of the European Commission

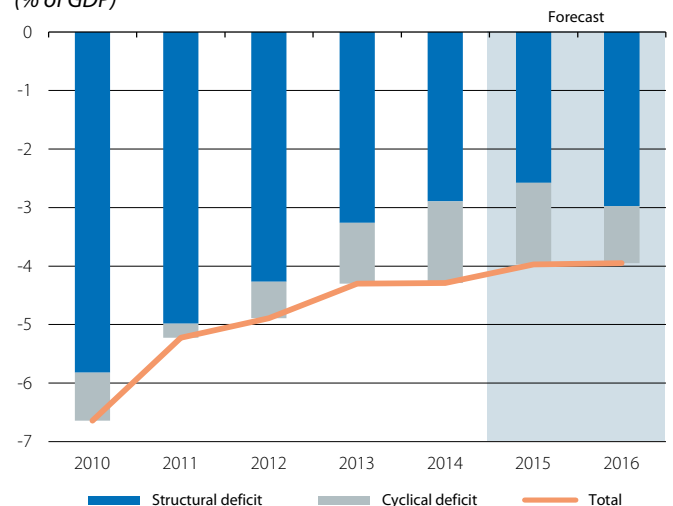
Annual change (%)

	Forecast		Change compared with the forecast in autumn 2014	
	2015	2016	2015	2016
Euro area	1.3	1.9	▲ 0.2	▲ 0.2
Germany	1.5	2.0	▲ 0.4	▲ 0.2
France	1.0	1.8	▲ 0.3	▲ 0.3
Italy	0.6	1.3	=	▲ 0.2
Spain	2.3	2.5	▲ 0.6	▲ 0.3
Portugal	1.6	1.7	▲ 0.3	=
Greece	2.5	3.6	▲ 0.4	▼ 0.1

Source: "la Caixa" Research, based on European Commission data.

France: public deficit

(% of GDP)



Source: "la Caixa" Research, based on European Commission data.

income tax; combating corruption and tax evasion; making the labour market more flexible (although the minimum wage will be increased) and continuing the privatisations already underway (although any that have yet to start will be revised). Although this all seems favourable at first sight, the lack of concrete details for these measures means that the ECB and International Monetary Fund remain cautious. In any case, the 7.2 billion euro still to be disbursed in the bail-out agreement will not be paid until Greece can show that it is implementing the proposed reforms. Uncertainty will therefore remain over the next few months. In the short term, the Greek parliament must still pass these measures and the Prime Minister will need the support of his party and its coalition partners, which might be complicated due to differences of opinion. Moreover, there will probably be an upswing in financial tension resulting from difficulties faced by the Greek Treasury to meet its imminent debt repayments and the delicate situation of the country's banking system.

The rate of the euro area's recovery speeds up in 2015 Q1.

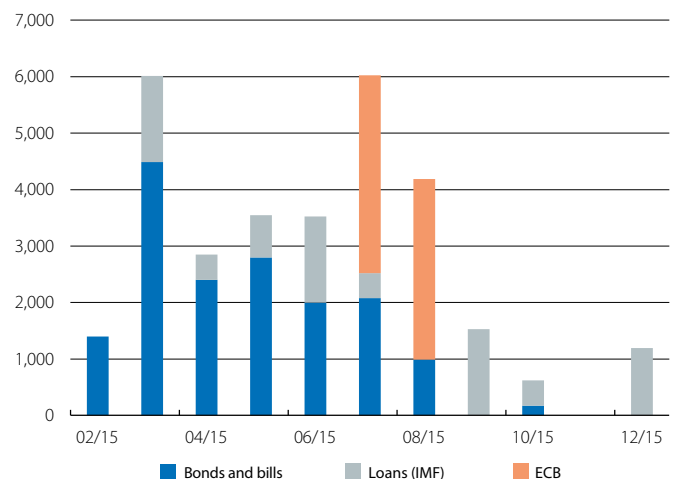
The composite PMI of the euro area reached 53.5 points in February, its highest level in the last seven months. This improvement was particularly due to the strong increase recorded in services. By country, France provided a pleasant surprise with its composite PMI rising to 52.2 points, the highest value since August 2011. Moreover, the upward path of Germany's PMI ratifies that its economy is still the driving force behind the recovery. German dynamism can also be seen in the trend for IFO indicators (Germany's business climate index) and ZEW (index for investor and analyst expectations), which improved for the fourth consecutive month in February. The breakdown for German GDP in Q4 was also favourable: the contribution of domestic and foreign demand to quarter-on-quarter growth was 0.7 and 0.2 pps, respectively, while the variation in stocks deducted 0.2 pps.

Widespread improvement in demand indicators. Judging by the figures for retail and consumer goods, whose rate of growth accelerated to 2.8% year-on-year, private consumption is on the up. This is also suggested by the strong increase in consumer confidence in February, reaching levels not observed since summer 2007. Although the labour market's recovery is gradual, it is undoubtedly helping to boost domestic demand. Employment expectations, both in manufacturing and services, continued to grow in the first two months of the year. By country, of note is the sharp increase in job creation prospects in Germany, another sign of the country's strength, and also in Spain whose labour market is gradually recovering from its nosedive. However, France saw more subdued growth, in line with its activity's moderate recovery.

Inflation remains in negative terrain but embarks on a phase of recovery. The inflation rate is expected to have risen in February because, after their sharp fall in previous months, oil prices then increased by 18.3% month-on-month. In fact, in Germany, Italy and Spain, countries where February's figures have already been released, a clear upswing in inflation has

Greece: public debt maturities

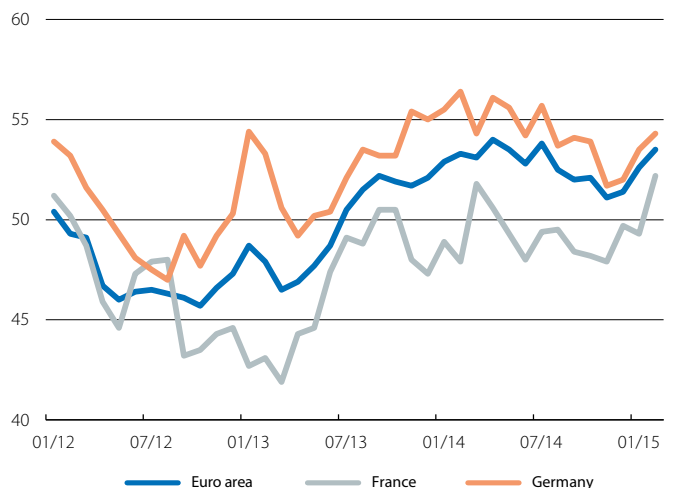
(Million euros)



Source: "la Caixa" Research, based on Bloomberg data.

Composite PMI activity indicator

Level

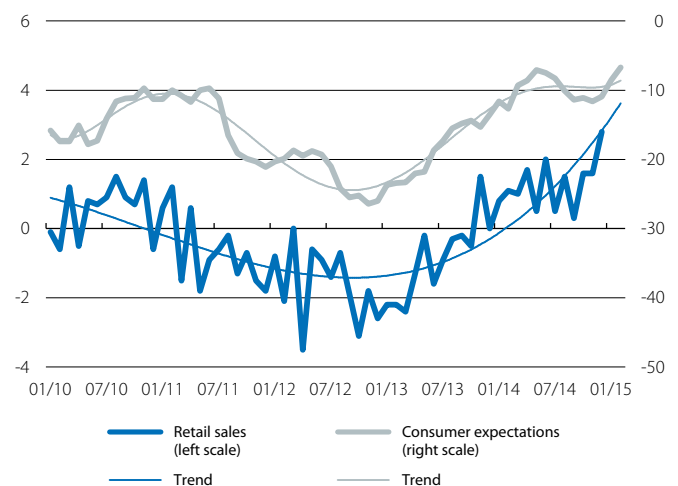


Source: "la Caixa" Research, based on Markit data.

Euro area: consumption indicators

Year-on-year change (%)

Level



Source: "la Caixa" Research, based on Eurostat data.

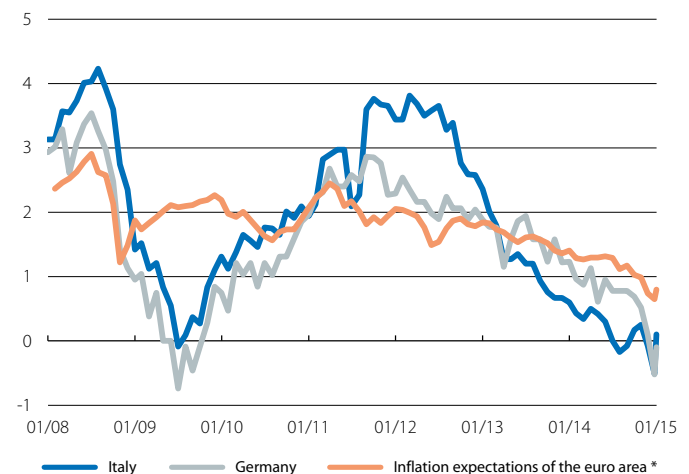
been noted. The rise in inflation expectations in the second month of the year, after the announcement of the ECB's quantitative easing programme, also seems to back up a change in trend. We therefore expect inflation to pick up gradually as oil prices return to higher levels and growth in domestic demand intensifies. The euro area will end 2015 with average inflation around 0.4%. In 2016, this will rise to 1.6% on average, once the level effect of the energy component disappears.

Cheaper oil and the euro's depreciation will boost the current surplus in 2015. The current account balance of the euro area maintained its good tone from 2014 and posted a surplus of 2.4% of GDP in December (cumulative over 12 months). All this has contributed, to a large extent, to the surplus in the goods account for December, thanks to a strong increase in exports of 8% year-on-year which more than exceeded the 1% rise in imports year-on-year. Over the coming months the current account surplus will be strengthened by two factors. On the one hand, the price of oil will remain low, helping to contain the bill for energy imports. On the other hand, exports will be helped by the euro's depreciation. In fact, one of the consequences of the ECB's large-scale government and private bond purchase programme has been that, since it was announced, the euro has depreciated by 3.6%, down to 1.12 €/£ at the end of February. We expect the exchange rate to remain at these levels for several months and depreciate further at the end of the year once the Fed starts to raise its interest rates.

The good figures from the United Kingdom revive debate regarding the start of interest rate hikes by the Bank of England (BoE). GDP growth reached 2.6% in 2014, supported particularly by the good performance of domestic demand. The rate of growth in retail and consumer goods in January 2015, namely 5.5% year-on-year, and the low unemployment rate (5.7% in November) suggest this pattern of growth has continued in 2015 Q1, reviving debate about when the BoE will start to raise interest rates. For the moment, inflation has remained low due to falling oil prices but in 2014 Q4 wages grew above inflation for the first time since mid-2008. Over the coming months we expect inflation to get back to normal and upward pressures on wages to increase. Provided the good pace of growth continues, this should allow the BoE to gradually normalise its monetary policy as from 2015 Q3.

Harmonised CPI and inflation expectations

Year-on-year change (%)

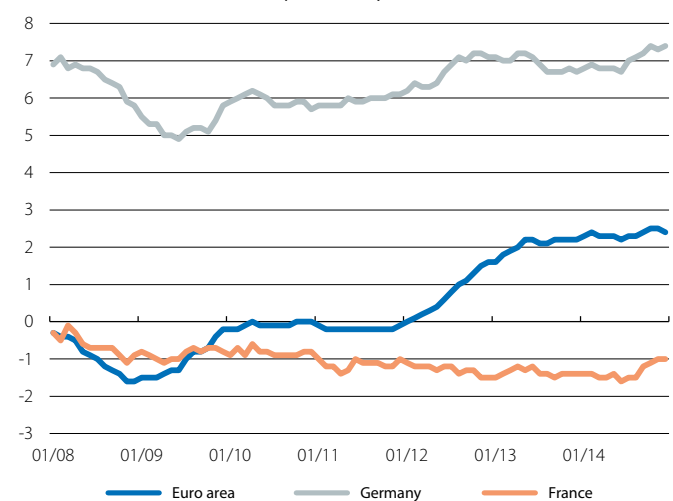


Note: * 5-year inflation swap.

Source: "la Caixa" Research, based on data from Destatis, Istat and Bloomberg.

Current account balance

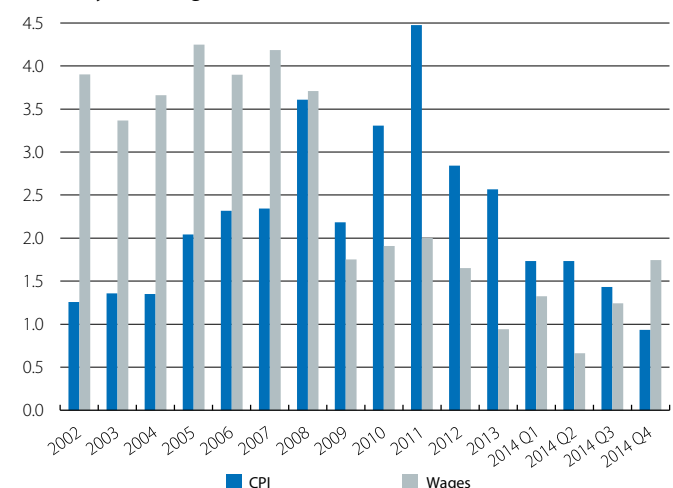
Cumulative over 12 months (% of GDP)



Source: "la Caixa" Research, based on ECB data.

United Kingdom: CPI and wages

Year-on-year change (%)



Source: "la Caixa" Research, based on data from the ONS.

FOCUS · Labour reform in Italy: a big step forward

The markedly dual nature of Italy's labour market has meant that the economic crisis has resulted in significant losses of temporary jobs, in particular among the young. In 2014 Q3 the youth unemployment rate reached 42.8% (compared with 12.8% overall) and, for 2013 as a whole, precarious employment was such that 52.5% of contracts for young employees were temporary (compared with 13.2% overall). Given this situation, in December 2014 a labour reform was passed as part of a series of important measures (reform of the legal and tax system, of public administrations, etc.) promoted by the Prime Minister, Matteo Renzi, to boost the Italian economy. The Jobs Act, which will come into force throughout this year, will bring about a significant change in Italy's labour market. Below we analyse the main aspects of this reform.

One first element that should be noted are the changes in permanent employment contracts. Specifically, severance pay will be less costly and readmission in the case of unfair dismissal will be eliminated. With the new law, severance payments will increase in accordance with the length of time employed by the firm at a rate of 2 months per year worked, with a minimum of 4 months and a maximum of 24. Moreover, objective reasons for dismissal have been clarified, defining the reasons that would justify dismissal be they financial, due to demand or technological or organisational changes in the company. The new law also makes it possible for managers and workers to come to a settlement in the case of dismissal, another important step forward to boost the labour market and reduce uncertainty when hiring new workers. This compensation would cost even less but would also increase in line with the time employed by the firm (1 month per year worked, with a maximum of 18 months).

The second and most controversial change introduced by the labour reform is that employers, should they lose a case brought before an employment tribunal, are no longer obliged to re-admit the workers with permanent contracts they had dismissed, and can compensate them financially instead. Before the reform, workers had to be readmitted by the company, increasing managers' uncertainty and pushing up labour costs. However, readmission of workers has been maintained for cases of discrimination and fraudulent dismissal.

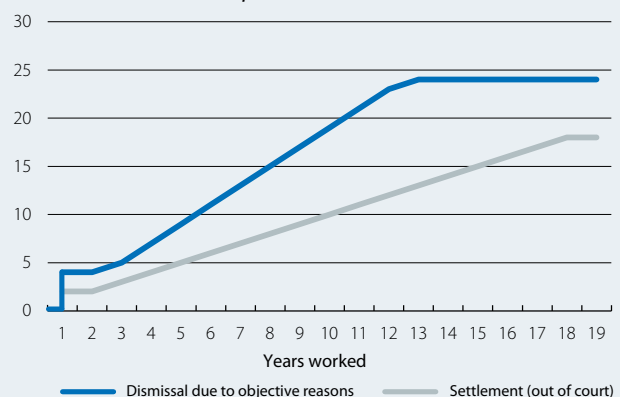
This greater flexibility when hiring permanent employees has been complemented by greater coverage both in terms of unemployment benefit and the minimum wage. Until now, unemployment benefit in Italy mainly covered workers in firms of more than 15 employees, leaving a considerably large proportion of the workforce unprotected. The new unemployment benefit will now

have greater coverage. Similarly, the minimum wage will be extended to sectors without a national collective agreement.

The changes introduced should significantly increase the incentive to give permanent contracts (which will also enjoy tax benefits during the first year) and could reduce, at least in part, the dual nature of Italy's labour market, particularly benefitting young people. The success of this reform will largely depend on it being implemented correctly and whether it manages to increase the speed and predictability of new employment contracts. Moreover, the Italian government plans to complete this reform with additional changes, such as a contract that will replace atypical temporary contracts to prevent these from being misused in jobs which, given their nature, should be permanent. It also aims to reduce the existing number of employment contracts. Another important task that will be carried out is the development of active employment policies, at present very few and not very effective. In any case, labour legislation alone will not be able to boost the Italian economy but must form part of an overall modernisation with transformations in the legal, tax and educational systems, among others. Italy therefore has a gigantic task ahead of it but it does look as if it is already getting down to work.

Italy: dismissal costs of a worker with a permanent contract after the labour reform

Number of months' compensation



Source: "la Caixa" Research, based on current legislation.

FOCUS · Financing in Swiss francs in emerging Europe: a limited risk

The decision taken on 14 January by Switzerland's central bank to no longer peg the Swiss franc to the euro immediately led to the Swiss currency appreciating significantly against the main currencies, including those of Central Europe. Since that date, the Croatian kuna has lost 14% of its value against the Swiss franc; the Bulgarian lev, 13%; the Polish zloti and the Romanian leu, 12%; and the Hungarian forint, 10%. This depreciation has reminded us of a practice that is sometimes overlooked: certain countries in emerging Europe have tended to make extensive use of loans in foreign currency (including the Swiss franc), both individuals and firms. The most extreme case is Croatia, where close to 75% of all credit is via loans in foreign currencies, while Bulgaria, Romania, Hungary and Poland have shares of between 40% and 60% of all credit. Given this situation, there have been warnings that the appreciation of the Swiss franc could lead to difficulty in paying back these loans.

Fortunately this diagnosis becomes less alarming when we broaden our focus of analysis to include more data. The most frequent error has been to believe that all countries have taken advantage of cheap financing in Swiss francs to the same degree. Although the data provided by national banks are not always exhaustive, the most widely used currency for financing in Croatia, Bulgaria and Romania, and also for corporate credit in Hungary,¹ has actually been the euro and not the Swiss franc. Given that the currencies of these countries have appreciated against the euro, the threat posed by exchange rates has shrunk considerably. The risk remains, however, for loans to households in Hungary and Poland, whose debt is largely in Swiss francs.²

In both cases, certain factors mitigate the effect of the depreciation of national currencies. In order to reduce the high exposure to exchange rate risk of household loans, Hungary introduced a rule, highly controversial due to its adverse effect on banks, which states that the exchange rate applied between the forint and the Swiss franc must be the one on November 2014. At the time, Hungarian banks also hedged for exchange rate risk, so the impact of the forint's depreciation has been covered. With

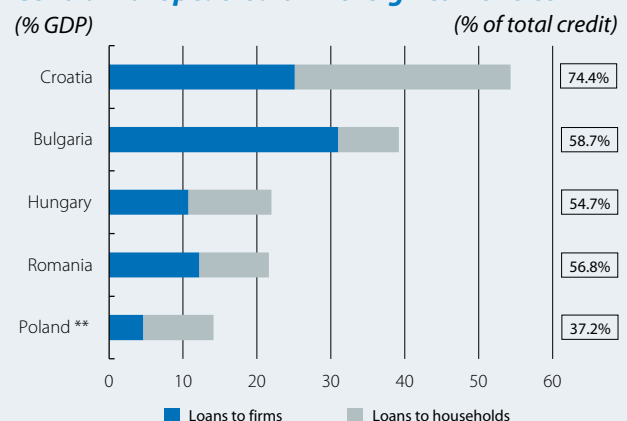
1. In Bulgaria, almost all credit in foreign currency is in euros while, in Croatia and Romania, the share is approximately 90%. In Hungary, 83% of corporate loans in foreign currency are in euros. No detailed figures are available for Poland but it would be reasonable to assume that its pattern does not vary greatly from other Central European economies, so most foreign currency loans to companies would be in euros.

2. In Hungary, 90% of loans to households in foreign currency are in Swiss francs while, in Poland, the share of mortgage loans in Swiss francs is 80% of foreign currency mortgages (there are no data for other types of loan to households).

regard to Poland, the key factor reducing the effect of the Swiss franc's appreciation is contractual in nature as most loans have revision clauses that establish the mortgage exchange rate paid in Swiss francs must be close to the interbank rate for the Swiss currency. As the latter's value has fallen since the franc was floated (specifically the mortgage rate could drop from 2% to 1%, approximately, if the current spread continues), this lower financial cost would partly offset the increase in the nominal value of debts resulting from the zloti's depreciation.

To conclude, one additional element that should reduce fears of the effect of the Swiss franc's appreciation is the fact that the banks in these five countries are reasonably solvent (see the second graph). Nonetheless, we should not become complacent as it would not be the first time that episodes of high exchange rate volatility ended up causing problems for the banking system.

Central Europe: credit in foreign currencies *



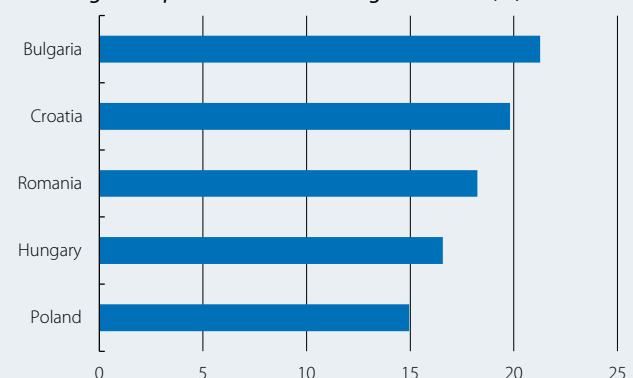
Notes: * The data are for 2014 Q3 except for Croatia, year-end 2013.

** Poland's loans to households only include mortgages.

Source: "la Caixa" Research, based on data from the Bureau of Economic Analysis.

Solvency ratio of the financial system *

Total eligible capital ** out of risk-weighted assets (%)



Notes: * Data from June 2014. ** Sum of CET1, additional Tier 1 and Tier 2.

Source: "la Caixa" Research, based on data from the European Central Bank.

KEY INDICATORS

Activity and employment indicators

Values, unless otherwise specified

	2012	2013	2014 Q1	2014 Q2	2014 Q3	2014 Q4	01/15	02/15
Retail sales (year-on-year change)	-1.6	-0.8	1.0	1.4	0.9	2.0	...	...
Industrial production (year-on-year change)	-2.4	-0.7	1.3	1.0	0.4	-0.1	...	...
Consumer confidence	-22.1	-18.6	-11.2	-7.7	-9.9	-11.2	-8.5	-6.7
Economic sentiment	90.6	93.6	101.5	102.2	100.8	100.7	101.4	102.1
Manufacturing PMI	46.2	49.6	53.4	52.5	50.9	50.5	51.0	51.1
Services PMI	47.6	49.3	52.1	53.0	53.2	51.7	52.7	53.9
Labour market								
Employment (people) (year-on-year change)	-0.5	-0.8	0.0	0.4	0.6	...	-	...
Unemployment rate: euro area (% labour force)	11.3	12.0	11.8	11.6	11.5	11.4	...	...
Germany (% labour force)	5.4	5.2	5.1	5.0	5.0	4.9	...	...
France (% labour force)	9.8	10.3	10.1	10.1	10.3	10.3	...	...
Italy (% labour force)	10.7	12.2	12.7	12.5	12.9	13.2	...	...
Spain (% labour force)	24.8	26.1	25.3	24.7	24.1	23.8	...	...

Source: "la Caixa" Research, based on data from the Eurostat, European Central Bank, European Commission and Markit.

Foreign sector

Cumulative balance over the last 12 months as % of GDP of the last 4 quarters, unless otherwise specified

	2012	2013	2014 Q1	2014 Q2	2014 Q3	12/14	01/15	02/15
Current balance: euro area	1.6	2.2	2.3	2.2	2.4	2.4	...	...
Germany	7.1	6.7	6.8	6.7	7.2	7.4	...	...
France ¹	-1.5	-1.4	-1.5	-1.6	-1.2	-1.0	...	...
Italy	-0.4	1.0	1.2	1.3	1.6	...	...	...
Spain	-0.3	1.4	1.1	0.3	0.0	0.1	...	...
Nominal effective exchange rate² (value)	98.0	101.7	104.0	103.9	101.7	99.7	95.9	94.0

Notes: 1. Methodology changed as from 2014. 2. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated.

Source: "la Caixa" Research, based on data from the Eurostat, European Commission and national statistics institutes.

Financing and deposits of non-financial sectors

Year-on-year change (%), unless otherwise specified

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	12/14	01/15
Private sector financing								
Credit to non-financial firms ¹	-2.3	-2.2	-3.1	-2.5	-2.0	-1.4	-1.1	-0.9
Credit to households ^{1,2}	0.3	0.5	0.3	0.4	0.5	0.7	0.8	0.9
Interest rate on loans to non-financial firms ³ (%)	2.2	2.0	2.2	2.1	1.9	1.8	1.9	...
Interest rate on loans to households for house purchases ⁴ (%)	2.8	2.6	2.8	2.7	2.6	2.4	2.5	...
Deposits								
On demand deposits	7.9	6.0	5.9	5.2	5.9	7.2	8.2	9.2
Other short-term deposits	0.0	-2.1	-2.5	-2.0	-1.7	-2.1	-2.4	-3.1
Marketable instruments	-14.8	-7.2	-12.7	-11.7	-6.1	1.5	5.5	4.6
Interest rate on deposits up to 1 year from households (%)	2.0	1.3	1.6	1.4	1.3	1.1	1.0	...

Notes: 1. Data adjusted for sales and securitization. 2. Including NPISH. 3. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 4. Loans with a floating rate and an initial rate fixation period of up to one year.

Source: "la Caixa" Research, based on data from the European Central Bank.

ECONOMIC OUTLOOK · The pace of growth intensifies

Private consumption and investment: the engines of growth

Details of the breakdown of GDP for Q4 have confirmed that the Spanish economy grew by 0.7% quarter-on-quarter (0.5% in Q3) thanks to the increase in private consumption and investment which offset lower public consumption. These good figures for Q4, slightly better than expected, and the positive business indicators for January show that recent positive shocks (falling oil prices and the euro's depreciation) are tending to have a greater impact than expected on economic activity. The effect of these temporary factors, which have momentum, has led us to revise upwards both our growth forecast for GDP in 2015, to 2.5% (+0.2 pps) and also our forecast for 2016, to 2.3% (+0.2 pps). These forecasts are in line with the ones published at the beginning of February by the European Commission, which places growth at 2.3% for 2015 (previously 1.7%) and at 2.5% for 2016 (previously 2.2%).

The foreign sector will gradually add to growth. The good performance by domestic demand lies behind almost all the growth in GDP in Q4 but it should also be noted that, for the first time in this period of recovery, exports will no longer deduct from growth. However, for 2014 as a whole, in which GDP growth reached 1.4%, the contribution made by domestic demand was 2.2 pps while the contribution by exports was negative, namely -0.8 pps. We expect the euro's depreciation and the recovery of the euro area to boost exports throughout 2015 so that the foreign sector will gradually improve its contribution to growth, although this contribution will be limited as imports will also continue to grow strongly, in line with the trend in domestic demand.

The data from the National Accounts system confirm the good labour market trend in 2014 Q4. Growth in full-time equivalent employment was 0.7% quarter-on-quarter, in line with the forecasts after the positive LFS data for Q4, indicating that the good performance by activity is being passed on to the labour market. With this figure, the annual rate of change stands at 1.2% in 2014, representing a net creation of 392,000 full-time equivalent jobs. The figures also show that wage moderation continued to support improvements in competitiveness. Wages per employee remained constant in Q4 with 0.0% change quarter-on-quarter. The fact that wage rises contained in collective agreements have remained stable at 0.6% year-on-year for more than a year suggests that wage moderation will continue although the agreements that are due to be made between employers and trade unions in the near future will be crucial for the future trend in wages.

Job creation continues in 2015. The number of registered workers affiliated to Social Security grew in January (12,613 seasonally adjusted), accumulating 18 consecutive months of increases. The negative trend in agriculture obscured the

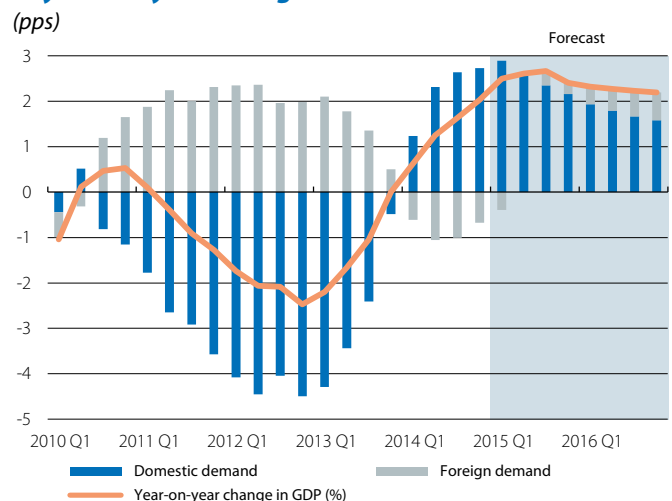
GDP

Quarter-on-quarter change

	2014 Q1	2014 Q2	2014 Q3	2014 Q4
GDP	0.3	0.5	0.5	0.7
Private consumption	0.6	1.0	0.8	0.9
Public consumption	1.0	-0.4	-0.1	-1.0
Investment	0.4	2.0	1.1	1.4
Capital goods investment	2.3	3.6	2.2	1.8
Investment in construction	-0.9	1.3	0.5	1.4
Exports	0.1	0.7	3.9	0.0
Imports	1.1	2.1	5.0	-0.6

Source: "la Caixa" Research, based on INE data.

Contribution of domestic and foreign demand to year-on-year GDP growth

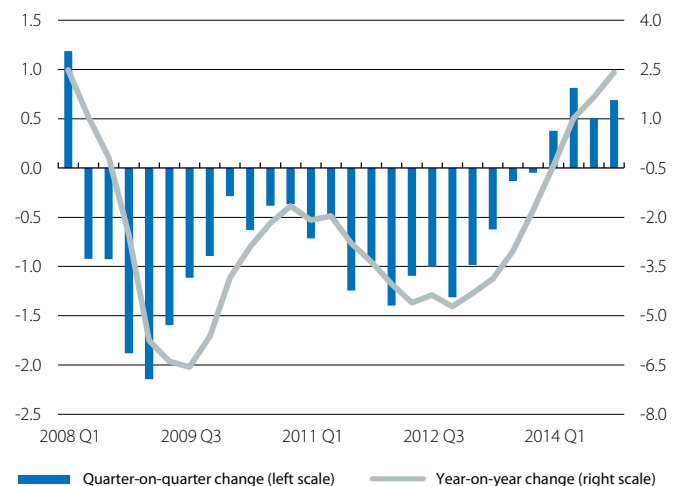


Source: "la Caixa" Research, based on INE data.

Employment

Quarter-on-quarter change (%)

Year-on-year change (%)



Source: "la Caixa" Research, based on INE data.

improvement recorded in the rest of the sectors, which speeded up their rate of job creation. For its part, registered unemployment fell by 42,723 people, seasonally adjusted. Growing employment expectations, especially in industry, show that the revival in the labour market will continue to spread through all sectors. It therefore seems that the rate of improvement in the labour market is intensifying in Q1, partly due to the positive impact of the above-mentioned supporting factors, and we have therefore improved our employment growth forecast for 2015 and 2016 by 0.1 pps, up to 2.3% and 2.0%, respectively, as well as revising downwards the unemployment rate by 0.1 pps, also for both years.

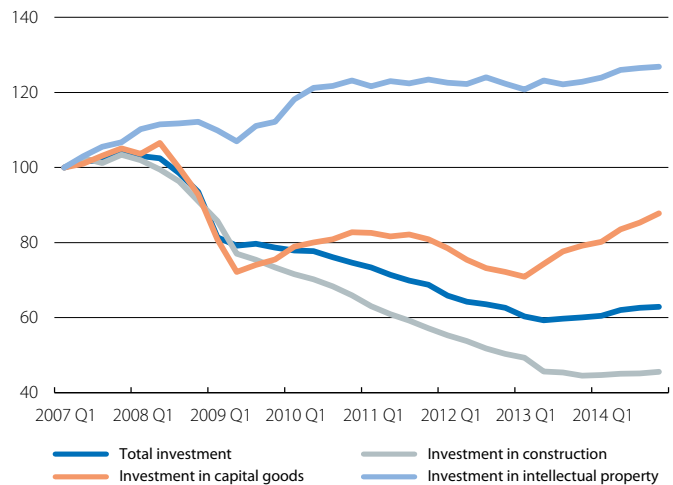
Domestic demand remains firm. The strength of private consumption, which grew by 0.9% quarter-on-quarter in Q4, looks like continuing in 2015 thanks to growing employment and better financing terms. The consumer confidence indicator stood at -1.8 points on average in January and February, a clearly higher figure than the -9.6 points posted in Q4. Regarding investment, the rise in the industrial confidence indicator (-4.4 in January and February compared with -5.3 in Q4) and the upswing in the PMI manufacturing index in January (54.7 compared with 53.7 in Q4) suggest the industrial sector is performing well, which would be compatible with further growth in capital goods investment, up by 1.8% quarter-on-quarter in Q4. The change in trend for investment in construction has also consolidated, posting its first quarter-on-quarter positive growth in 2014 Q2 (residential investment in 2014 Q3).

The real estate sector is showing signs of improving, both in demand and supply. After six years of adjustment, house sales rose by 2.2% in 2014 compared with the previous year (319,000 compared with 312,000), although the actual number of transactions is still very low. On the supply side, new building permits, up by 4.0% year-on-year on average in Q4 (cumulative over 12 months), suggest that the recovery in activity will gradually gain traction. In addition to the rise in investment in construction, employment in the sector also grew in Q4, specifically by 3.3% year-on-year. House prices shrank by 2.4% in 2014 as a whole but grew by 0.5% quarter-on-quarter in Q4. This was the first positive growth since March 2008, from which date prices had fallen by 30%. It therefore seems that 2014 was the year when the real estate sector bottomed out. The outlook is favourable for 2015: we expect both construction activity and prices to continue their recovery, supported by improvements in activity, in the labour market and in financing terms, but at a very moderate rate due to the high stock of residential properties still to be sold. Nonetheless the trend will be uneven between different regions: in large cities, where the stocks are lower, rises in prices might be seen while in other regions, which still have a large amount of surplus real estate to sell, prices may continue to fall.

Change in direction for inflation. The trend for the general CPI over the last few months has been affected by oil prices.

Trend in investment components

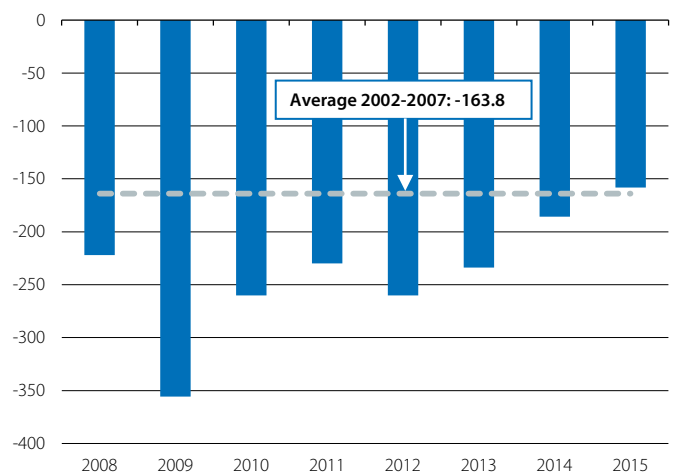
Index (100 = 2007 Q1)



Source: "la Caixa" Research, based on INE data.

Registered workers affiliated to Social Security *

Change in January (thousands)



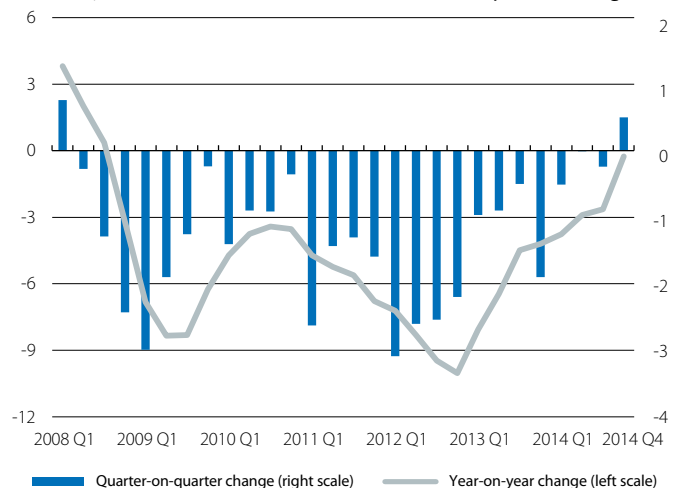
Note: * Excludes agriculture.

Source: "la Caixa" Research, based on data from the Ministry of Employment and Social Security.

House prices

Year-on-year change (%)

Quarter-on-quarter change (%)



Source: "la Caixa" Research, based on data from the Ministry of Public Works.

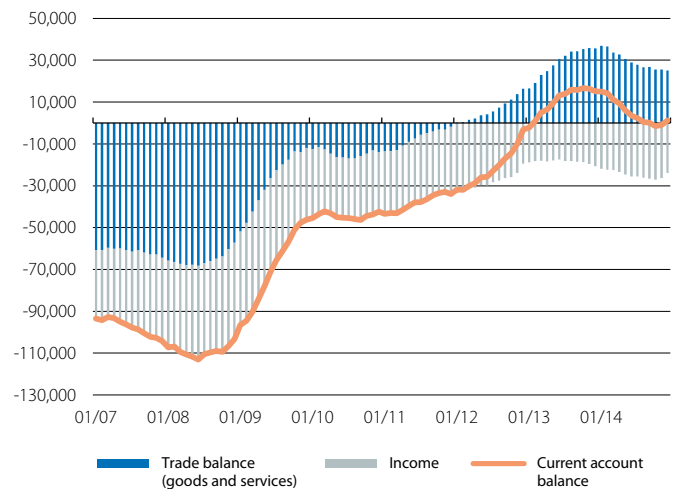
In January, inflation stood at -1.3% year-on-year, reflecting the 11.5% year-on-year drop in the energy component. Similarly, February's rise in oil prices (18% month-on-month) pushed up inflation to -1.1% . This upswing in oil prices has led us to revise upwards our inflation forecast, to -0.1% in 2015 (previously -0.3%). Nonetheless we expect inflation to remain in negative terrain until the middle of the year, when the level effect of the energy component disappears.

2014 ended with a current account surplus equal to 0.1% of GDP, a notably lower figure than in 2013 when the surplus reached 1.4% of GDP. This deterioration can largely be explained by the significant decline in the trade deficit for goods (-2.3% in 2014 compared with -1.2% in 2013), caused mostly by the strong upswing in imports ($+6.3\%$) and the merely moderate growth in exports ($+2.4\%$) in nominal terms. Nonetheless December's balance of payments posted notably better figures than the previous month, confirming a change in trend that is supported by the aforementioned temporary shocks, whose effect is expected to continue throughout the year and will help the current account balance to improve to 0.6% of GDP by the end of 2015. Firstly, the fall in oil prices has reduced the value of energy imports. Secondly, the euro's depreciation is benefitting exports and especially tourism, in January exceeding 65 million tourists. Thirdly, the reduction in financing costs thanks to the ECB's QE will improve the income balance. Support from such temporary factors will diminish in 2016 so we do not expect any additional gains in the current account surplus. In the long term it will be vital to continue making gains in competitiveness to improve the external balance further.

The government approves a decree-law to relaunch its social agenda. The main measure passed is the fresh-start act for private individuals, extending to persons (in addition to companies) the ability to restructure their debt before going bankrupt (out of court agreement), as well as reinforcing the role of mediators in reaching agreements. In bankruptcy proceedings, debt write-downs will be allowed (except public ones) for individuals even though they may not be covered by all the assets. On the other hand, debtors must comply with a five-year payment plan. Measures were also passed to encourage permanent employment contracts. Specifically, 500 euros of salary are exempt from Social Security contributions for two years in the case of new permanent contracts. Aid for self-employed workers was also passed (100% refund of Social Security contributions for one year when the working day is reduced to care for children or another worker is recruited), and tax breaks for single parent families with two children. Although the improvement in the economic cycle provides some margin to increase spending, it is vital to remain alert in order to ensure the deficit target is met (see the Focus «A tail wind will help reduce the public deficit»).

Current account

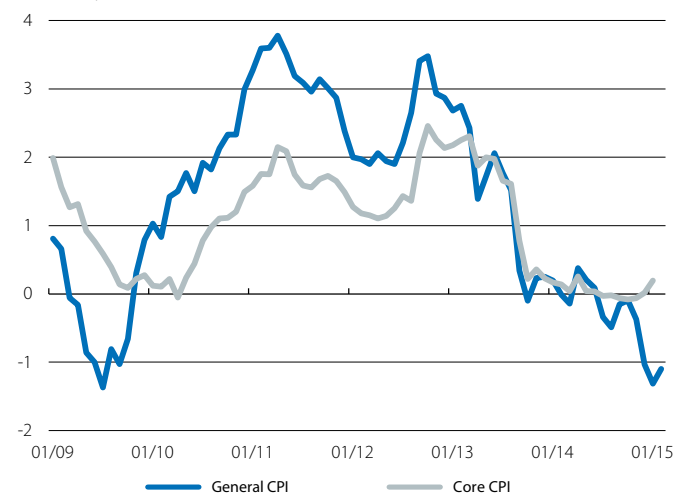
Cumulative figures over 12 months (million euros)



Source: "la Caixa" Research, based on data from the Bank of Spain.

Consumer price index

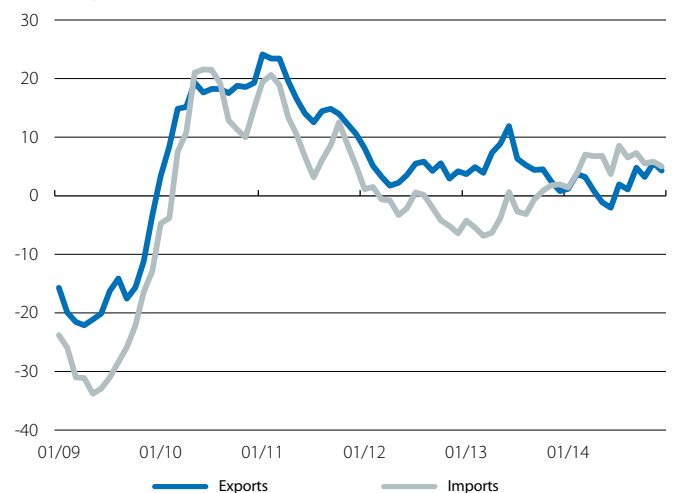
Year-on-year change (%)



Source: "la Caixa" Research, based on INE data.

International trade of goods

Year-on-year change, moving 3-month average (%)



Source: "la Caixa" Research, based on data from the Customs Dept.

FOCUS · From the barrel to the pump: how are diesel prices determined?

Oil prices have been the focus of attention of all analysts since they started to plummet in July 2014. Since then, the price in euros of a barrel of Brent crude oil has fallen by more than 40% while, over the same period, the price of diesel, which represents 80% of the retail fuel market, has fallen by 20% according to data from the AOP (Spanish Association of Petrol Product Operators). Below we analyse why the drop in the price of this fuel has been less than the drop in the price of crude oil.

The price of a litre of diesel is made up of three elements: the wholesale cost of the diesel, the gross margin plus distribution costs and taxes. The first price component, the wholesale cost of diesel (i.e. the price of crude oil plus refining costs), has recorded a 38% drop since July 2014, a figure very similar to that of oil. It therefore comes as no surprise that its relative weight in the price paid by consumers has gone from 43% in July 2014 to 33% in January 2015.

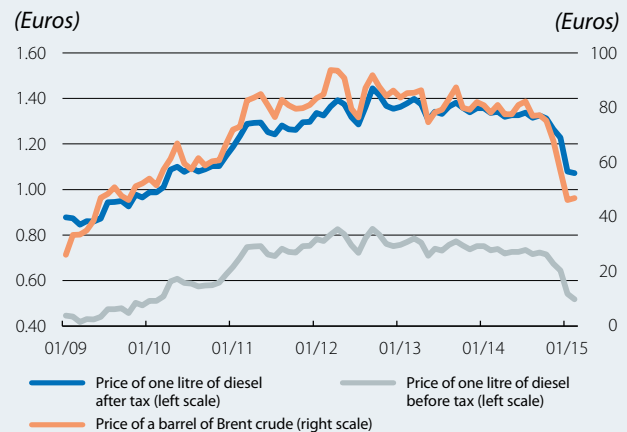
Other important elements in the sale price of a litre of diesel are the wholesaler's gross margin and distribution costs. The latter include the cost of petrol station personnel and maintenance, petrol transport costs and a contribution to the National Energy Efficiency Fund.¹ This component represented 15% of the final price of diesel in January 2015 (compared with 12% in July 2014) and is fixed, at least in the short term. Adding together the two parts described above, we get the price of diesel before tax, which has fallen by 30% since July.

Lastly, in Spain, taxes constitute the most substantial part of the price of diesel at the pump. Specifically three taxes are applied to diesel consumption: special state and autonomous community taxes, of a fixed sum, which total 0.331 and 0.037 euros per litre respectively, while 21% VAT is also applied to the final price, which includes the special taxes. The sum of all taxes in January 2015 came to 0.554 euros per litre, 52% of the final price and a much larger relative weight than the figure posted in July 2014, namely 45%.

Within the context of the euro area, due to the similarities between countries and a common environmental policy, the same analysis reveals that the sale price of diesel has experienced a similar trend to the one in the Spanish market: falling between 15% and 22%, depending on the country, between July 2014 and January 2015. However, if we cross the Atlantic and analyse the US market, we find a completely different situation, with petrol as the main

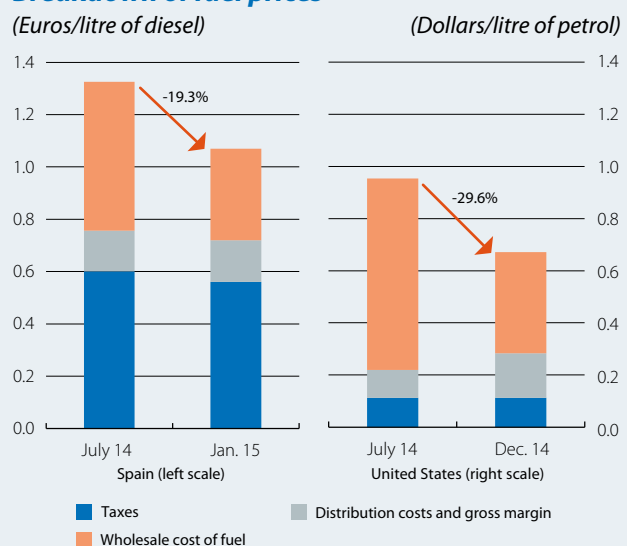
fuel and much lower taxes. As can be seen in the second graph, taxes barely account for 16% of the final price of petrol while the wholesale cost of the fuel represents almost 60% of the end price. The cost of this component has halved since July due to falling crude oil prices and a considerable reduction in refining costs, to such an extent that the price of petrol at US pumps has fallen by 30%, a percentage logically higher than the reduction seen in Spain and in the euro area as a whole.

Price of diesel and barrel of Brent crude oil



Source: "la Caixa" Research, based on data from the AOP and Thomson Reuters Datastream.

Breakdown of fuel prices



Source: "la Caixa" Research, based on data from the AOP and the IEA.

1. Set up in July 2014 by Royal Decree-Law 8/2014 in compliance with Directive 2012/27/EU of 25 October 2012.

FOCUS · Employment and innovation: a key combination for the labour market to recover

In 2014 the Spanish economy created jobs for the first time since 2007 and the figures were quite impressive: the increase in the number of employed totalled 433,900 people. Now that the recovery is starting to build up steam in the labour market, it is a good time to analyse which sectors are creating employment. Whether the economic recovery turns out to be strong and sustained will depend on whether the most innovative sectors gradually gain in importance.

To measure the degree of innovation in different industries, we use the Survey on Innovation in Companies by the Spanish statistics office (INE), with information on the percentage of firms from each sector carrying out technological innovation (new products, processes and technological advances) and non-technological innovation (improved methods for selling products or organising business practices).¹ According to this survey, those industries whose companies have the most technological innovation are also those with the most non-technological innovation. It can also be seen that the percentage of companies carrying out technological innovation in industrial sectors is higher than in services, and that the difference between both narrows when innovation is non-technological. In any case, given the strong correlation between technological and non-technological innovation, the average is used to quantify the degree of innovation in each sector.

Net employment in industry and services grew by 409,600 people in 2014.² After distributing these new jobs by the innovative intensity of each sector, we can see that most are concentrated in industries with low innovation (see the first graph). However, this figure should not come as a surprise as 40% of the jobs are concentrated in this kind of sector. The services sector, for example, has a lower innovation rate than industry and employs 82% of all workers considered.

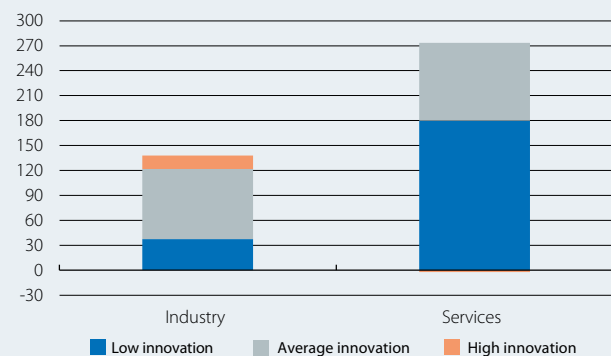
To analyse whether the recovery in employment is due to the more innovative sectors taking centre stage, it is vital not to focus on the figures in absolute terms but look at the contribution to the increase in employment of each sector in relation to its relative weight. This is precisely what the second graph shows, where it can be seen that a significant proportion of average innovation sectors in industry contributed more to the creation of jobs in 2014 than the number corresponding to their relative share of

all employment. Of particular note are the increases seen in employment in the energy and food sectors. Some high innovation sectors in industry also performed very well (motor vehicles, chemicals, pharmaceuticals and petroleum) although this cannot be seen overall as some sectors from the same group destroyed jobs, such as the electrical material sector. On the other hand, the average and high branches of innovation in services performed badly and the least innovative sectors contributed the most to the rise in employment, not just those related to tourism.

In short, although it is true that many industries with high rates of innovation are creating jobs, this is still not a widespread phenomenon. For the encouraging recovery in the labour market to consolidate, innovation and job creation must go much more hand in hand.

Net job creation in 2014 according to the sector's innovative intensity *

Annual change (thousands)



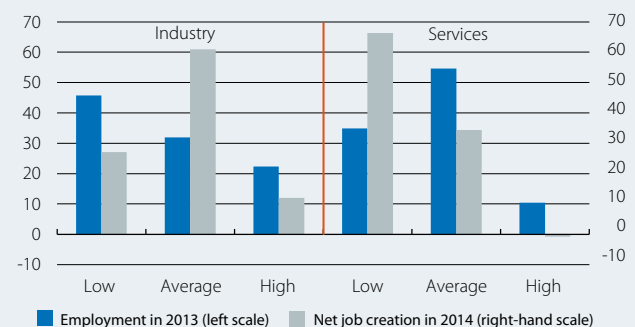
Note: * Criterion for classifying innovative intensity: all sectors in industry and services are ordered separately from less to more innovative and the 1/3 and 2/3 percentiles are taken as the cut-off value for the three groups.

Source: "la Caixa" Research, based on INE data (Survey on Innovation in Companies and Labour Force survey).

Distribution of net job creation by sector and innovative intensity *

(% of total employment in 2013)

(% of total net jobs created in 2014)



Note: * Criterion for classifying innovative intensity: all sectors in industry and services are ordered separately from less to more innovative and the 1/3 and 2/3 percentiles are taken as the cut-off value for the three groups.

Source: "la Caixa" Research, based on INE data (Survey on Innovation in Companies and Labour Force Survey).

1. A more complete analysis should also take into account the intensity of innovation in each sector but, given that the innovation intensity index is closely correlated with the percentage of innovative firms, the results are similar.

2. The employment data exclude public administration and education to make them comparable with the sectors available in the Survey on Innovation in Companies.

FOCUS · A tail wind will help reduce the public deficit

The Spanish economy will reach its cruising speed in 2015. Underlying factors such as the implementation of structural reforms and bank restructuring already started to produce results in 2014. This year growth is being further boosted by temporary but significant factors such as the fall in oil prices, the depreciation of the euro and the ECB's new measures which will help to achieve a growth rate of around 2.5%. After six years of recession or very weak growth, the Spanish economy will finally be helped by the economic cycle to balance public administration accounts.

In the case of revenue, the increase in employment, activity and consumption will speed up the rate of growth in tax revenue. Improved activity and employment will increase the disposable income of households and corporate earnings, pushing up revenue from personal income tax and corporate tax. Household consumption, growing at a rate of 2.4% in 2014 and which we expect to remain at similar levels in 2015, will continue to support the rise in VAT revenue. As a reference, in November 2014 the tax collected for VAT posted year-on-year growth of 6.0%. Increased Social Security contributions will also boost revenue thanks to the expected progress in employment. On the whole, the expected increase in revenue due to improved economic growth will reduce the public deficit by 0.7 pps of GDP.

According to the government, the tax reform will have an overall positive impact, increasing revenue by 0.3 pps of GDP, with the reduction in income tax and corporate tax being offset by growth in activity resulting from these lower taxes, as well as by the increase in revenue from introducing the direct settlement system for Social Security contributions.

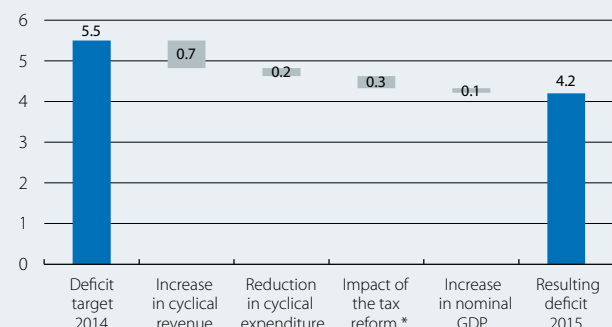
The improved economic cycle will also reduce pressure on the expenditure of public administrations. One of the items that will benefit the most from the improved economic cycle is expenditure on unemployment benefits. In 2014 this item already fell by 17.2% and the reduction will be similar in 2015 thanks to growth in employment, which we expect to be slightly above 2%. The interest paid on public debt will be reduced in an environment of low interest rates encouraged by the ECB's sovereign debt purchase programme. However, the expected increase in stock of public debt will mean that interest payments as a whole will rise by 3.7%. Overall, the impact of the economic improvement on these two lines of expenditure will reduce the public deficit by 0.2 pps of GDP.

Moreover, if we also take into account growth in nominal GDP (the denominator of the deficit/GDP ratio), the

economic improvement is expected to reduce the public deficit by 1.3 pps of GDP, taking into account the impact of the tax reform. Starting from the 5.5% target set for 2014, the deficit would be 4.2% in 2015, precisely the target set for this year. In other words, the higher economic growth forecast for 2015 would mean that the target deficit for this year would be met. Therefore, the opportunity to reduce the public deficit with additional spending of a more structural nature should not be missed. The level of debt rose from 35.5% in 2007 to 97.7% in 2014, and, in 2015, it will be just above 100%. Even if, over the next 10 years, the rate of debt reduction agreed with Brussels is actually achieved, it will still be around 85% of GDP in 2025. As recently pointed out by the EC, efforts must continue to reduce the public deficit and relieve the burden of public debt. The authorities should take advantage of this superb opportunity finally presented to them by the improved economic cycle.

Effect of the economic cycle on the public deficit in 2015

(% of GDP)

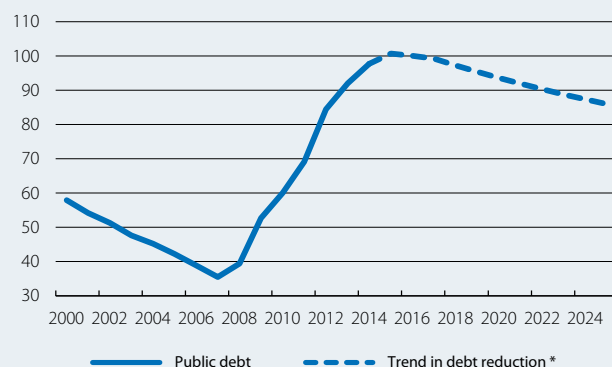


Note: * Includes the estimated impact of tax and Social Security reforms (direct settlement, etc.) in the State Budget.

Source: "la Caixa" Research, based on data from the 2015 State Budget, AlReF, the Tax Agency, the Ministry of Employment and Social Security and the State Public Accounts.

Public debt

(% of GDP)



Note: * Reduction in the level of debt above 60% by 5% annually, according to EC projections.

Source: "la Caixa" Research, based on data from the Bank of Spain.

KEY INDICATORS

Year-on-year (%) change, unless otherwise specified

Activity indicators

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	01/15	02/15
Industry								
Electricity consumption	-2.1	-0.2	-0.3	1.0	0.3	-1.7	3.6	...
Industrial production index	-1.5	1.2	1.5	2.6	0.6	-0.1	...	...
Indicator of confidence in industry (<i>value</i>)	-13.9	-7.1	-9.1	-8.2	-5.7	-5.3	-4.5	-4.3
Manufacturing PMI (<i>value</i>)	48.5	53.2	52.5	53.4	53.1	53.7	54.7	...
Construction								
Building permits (<i>cumulative over 12 months</i>)	-36.3	-7.7	-21.5	-11.2	-2.1	4.0	...	...
House sales (<i>cumulative over 12 months</i>)	0.4	-5.4	-8.9	-8.3	-4.9	0.4	...	...
Services								
Foreign tourists	5.8	7.2	8.1	7.8	7.6	5.4	3.6	...
Services PMI (<i>value</i>)	48.3	55.2	54.2	55.7	56.7	54.3	56.7	...
Consumption								
Retail sales	-3.7	1.0	-0.1	0.7	0.4	2.9	...	...
Car registrations	5.6	18.4	11.8	23.2	17.0	21.7	27.5	...
Consumer confidence index (<i>value</i>)	-25.3	-8.9	-11.8	-6.1	-7.9	-9.6	-1.5	-2.1

Source: "la Caixa" Research, based on data from the Ministry of Finance, Ministry of Public Works, INE, Markit and European Commission.

Employment indicators

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	12/14	01/15
Registered as employed with Social Security¹								
Employment by industry sector								
Manufacturing	-4.3	0.1	-1.3	0.0	0.6	0.9	1.1	1.2
Construction	-12.1	-1.6	-5.3	-2.3	-0.5	1.6	2.6	3.4
Services	-2.0	2.2	1.1	2.2	2.6	2.8	3.0	3.2
Employment by professional status								
Employees	-3.8	1.4	0.1	1.4	1.9	2.3	2.6	2.5
Self-employed and others	-0.6	2.2	1.4	2.3	2.5	2.5	2.4	2.5
TOTAL	-3.2	1.6	0.4	1.5	2.0	2.3	2.6	2.5
Employment²	-2.8	1.2	-0.5	1.1	1.6	2.5	-	-
Hiring contracts registered³								
Permanent	-14.2	18.8	6.8	24.0	21.5	23.0	19.2	22.2
Temporary	6.4	13.1	19.4	14.2	11.1	7.7	6.4	7.5
TOTAL	4.0	13.4	18.2	15.0	11.8	8.8	7.2	8.6
Unemployment claimant count³								
Under 25	-6.2	-8.2	-9.4	-10.9	-5.5	-6.9	-6.0	-10.3
All aged 25 and over	3.7	-5.3	-3.7	-5.9	-5.9	-5.7	-5.3	-5.6
TOTAL	2.7	-5.6	-4.2	-6.4	-5.9	-5.8	-5.4	-6.0

Notes: 1. Mean monthly figures. 2. LFS estimate. 3. Public Employment Offices.

Source: "la Caixa" Research, based on data from the Ministry of Employment and Social Security, INE and Public Employment Offices.

Prices

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	01/15	02/15
General	1.4	-0.1	0.0	0.2	-0.3	-0.5	-1.3	-1.1
Core	1.5	0.0	0.1	0.1	0.0	0.0	0.2	...
Unprocessed foods	3.6	-1.2	0.7	-2.3	-4.1	0.8	-0.7	...
Energy products	0.1	-0.8	-1.0	2.4	-0.2	-4.3	-11.4	...

Source: "la Caixa" Research, based on data from the INE.

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2013	2014	2014 Q1	2014 Q2	2014 Q3	10/14	11/14	12/14
Trade of goods								
Exports (year-on-year change)	5.2	2.5	3.2	-2.0	4.8	4.1	3.2	5.7
Imports (year-on-year change)	-1.3	5.7	7.0	3.7	7.3	7.7	2.0	5.1
Current balance	15.1	1.2	11.2	3.5	0.1	-1.5	-0.8	1.2
Goods and services	35.7	25.1	33.6	29.0	26.7	25.6	25.5	25.1
Primary and secondary income	-20.6	-23.9	-22.4	-25.5	-26.6	-27.0	-26.4	-23.9
Net lending (+) / borrowing (-) capacity	22.0	5.6	18.3	9.9	6.0	4.2	4.9	5.6

Source: "la Caixa" Research, based on data from the Department of Customs and Special Taxes and Bank of Spain.

Public sector

Percentage GDP, cumulative in the year, unless otherwise specified

	2012	2013	2014 Q1	2014 Q2	2014 Q3	10/14	11/14
Net lending (+) / borrowing (-) capacity	-10.3	-6.8	-0.6	-3.4	-3.7	-	...
Central government ¹	-7.9	-4.8	-0.9	-2.5	-3.1	-2.9	-3.4
Autonomous regions	-1.8	-1.5	-0.3	-1.1	-1.2	-1.3	-1.4
Local government	0.3	0.5	0.1	0.1	0.4	-	...
Social Security	-0.9	-1.1	0.3	-0.2	0.0	0.0	-0.1
Public debt (% GDP)	84.4	92.1	94.9	96.4	96.8	-	97.7

Note: 1. Includes measures related to bank restructuring but does not include other central government bodies.

Source: "la Caixa" Research, based on data from the IGAE, Ministry of Taxation and Bank of Spain.

Financing and deposits of non-financial sectors

Year-on-year change (%), unless otherwise specified

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	12/14	Balance 12/14 ¹
Financing of non-financial sectors ²								
Private sector	-8.2	-5.2	-6.4	-5.5	-4.4	-4.5	-4.0	1,705.2
Non-financial firms	-10.6	-5.2	-7.0	-5.7	-4.0	-4.3	-3.4	959.4
Households ³	-5.0	-5.1	-5.6	-5.2	-5.0	-4.7	-4.7	745.8
General government ⁴	16.8	6.9	8.5	6.6	5.9	6.7	7.0	1,034.0
TOTAL	-1.1	-1.1	-1.5	-1.4	-0.9	-0.6	-0.1	2,739.1
Liabilities of financial institutions due to firms and households								
Total deposits	2.1	-0.9	0.2	-0.8	-1.2	-1.7	-1.5	1,160.0
On demand deposits	4.2	10.8	7.4	7.4	13.6	14.8	16.6	328.8
Savings deposits	-0.1	5.8	3.8	5.9	6.9	6.8	7.5	221.9
Term deposits	1.7	-7.6	-3.6	-6.1	-9.4	-11.3	-12.0	587.6
Deposits in foreign currency	16.8	1.1	-1.1	0.1	0.3	5.2	0.8	21.5
Rest of liabilities ⁵	-16.8	-8.2	-11.1	-8.3	-6.8	-6.8	-5.5	129.3
TOTAL	-0.2	-1.7	-1.1	-1.6	-1.7	-2.2	-1.9	1,289.3
NPL ratio (%) ⁶	13.6	12.5	13.4	13.1	13.0	12.5	12.5	-
Coverage ratio (%) ⁶	58.0	58.1	58.6	59.4	59.1	58.1	58.1	-

Notes: 1. Billion euros. 2. Resident in Spain. 3. Including NPISH. 4. Total liabilities (consolidated). Liabilities between different levels of government are deduced. 5. Aggregate balance according to supervision statements. Includes asset transfers, securitized financial liabilities, repos and subordinated deposits. 6. Data end of period.

Source: "la Caixa" Research, based on data from the Bank of Spain.

THE ECB QE: CAUSES AND EFFECTS

On the need and effectiveness of the ECB's QE

Since the global financial crisis began in 2008, the central banks of the main developed countries have adopted extremely accommodative monetary policies. After cutting interest rates almost to zero, they resorted to unconventional monetary tools such as quantitative easing (QE) and forward guidance in order to relax credit and liquidity conditions even further. The European Central Bank (ECB), which has employed an extensive arsenal of unconventional tools to combat first the global financial crisis and then the sovereign debt crisis in the euro area, had so far resisted any large-scale purchases of public debt.¹ However, on 22 January it announced it would expand its asset purchase programme to include sovereign bonds. What led the ECB to launch this programme? How effective will QE be in reviving the euro area's economy?

The ultimate goal of quantitative easing is no different from when a central bank cuts its official interest rate in that both actions aim to stimulate aggregate demand by reducing the interest rate paid by households and firms, encouraging them to consume and invest and thereby increase economic activity and inflation. The difference lies in how the impact of these measures is passed on to the real economy. While the aim is to reduce long-term interest rates by cutting short-term rates in the first case, the objective of QE is to have a direct effect on long-term interest rates. Specifically, when the central bank makes large-scale purchases of a certain kind of asset, its yield falls, encouraging investors to rebalance their portfolios with other assets that offer more attractive yields, so that this fall in interest rate is passed on to riskier assets.

That is the theory. In practice it is still premature to draw any conclusions regarding the effectiveness of public debt purchases by the ECB as the programme has only just begun. However, the numerous studies carried out on the US economy find that QE had a significant effect on the prices of financial assets and government, bank and corporate bonds, as well as on equity prices (see the article «QE comes to the euro area for a long visit» in this Dossier). Evidence is less conclusive, however, regarding the effect on the real economy but the overall belief is that successive rounds of QE prevented a deeper recession in the US. Nonetheless, the recovery has been a lot slower than expected. Although there are many different reasons for such sluggishness, one of factors limiting the speed of recovery in the US was the high level debt among households and companies which, as they had to extensively deleverage, did not respond to monetary stimuli as energetically as on other occasions. We can therefore assume that the deleveraging underway in the euro area, which has yet to be completed in several economies, will limit the effectiveness of the ECB's QE. This observation forms part of a broader debate regarding the limitations of monetary policy in terms of generating economic growth by stimulating aggregate and credit demand. In other words, the effectiveness of demand policies depends both on the willingness of private agents to increase their consumption and investment by enlarging their debt and also on the willingness of the banking sector to assume the risk (see the article «Banking in the face of QE: caught between wishes and reality» in this Dossier for an analysis of the role played by banks). Moreover, the lack of growth in the euro area is largely due to a problem of supply and not so much to demand. In this respect, in his appearances after the Governing Council meetings, Mario Draghi constantly warns that monetary policy measures must be accompanied by structural reforms that increase investment, stimulate job creation and boost productivity in euro area economies.

Although the effectiveness of the ECB's new programme is not guaranteed, to some extent the monetary authority has been forced to implement it due to the impact on the euro's exchange rate of extremely accommodative monetary policies employed by the rest of the developed world. According to economic theory, when a central bank cuts its official interest rate, the exchange rate tends to depreciate until the yields expected in different countries balance out. This impact on other economies is potentially greater in the case of quantitative easing given the significant amount of liquidity injected into banks and financial markets. In a globalised economy, capital flows move quickly to other economies and this can lead to sharp changes in exchange rates. Nonetheless central banks usually justify their decisions citing internal reasons; i.e. they take monetary measures mainly to influence domestic demand. Exchange rate effects are therefore considered to be an inevitable consequence of such policies rather than an end in themselves. However, it is true that the effects of monetary policy decisions are not merely limited to the economy adopting them but are felt beyond its borders, and they are not always welcomed by the country's trading partners. For example, some emerging economies such as Brazil and China, whose currencies appreciated considerably in 2010, accused the United States of starting a currency war. More recently the central bank of Japan has come under similar criticism. There is ample evidence for the benefits of coordinating policies at an international level in order to avoid situations that could increase volatility and even damage the credibility of the central bank itself, such as those that would result in a full-blown currency war. Nonetheless,

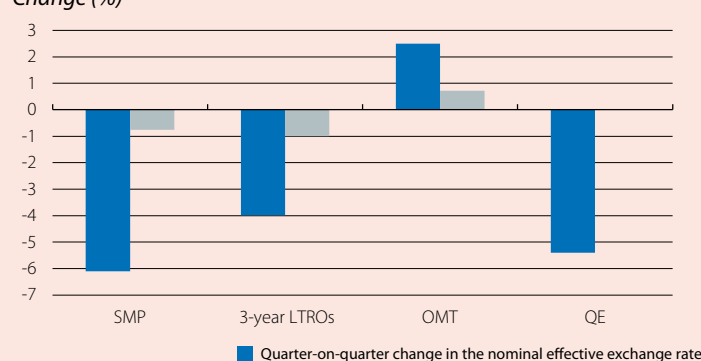
1. The ECB bought public debt under the Securities Market Programme (SMP) between May 2010 and September 2012 with the aim of improving the government bond market in those countries where high stress was preventing the effective transmission of monetary policy.

it should be noted that the IMF (Spillover Report 2011) concludes that the effects of the United States' QE were positive globally as the improvement in the cyclical situation of the US economy and in global financial conditions had a positive effect on its trading partners which more than offset the negative effects caused by the dollar's depreciation.

Returning to Europe's case, between 2012 and March 2014 the euro appreciated by 9.9% in nominal effective terms. A strong euro does not only affect the region's competitiveness by making domestic exports more expensive; it also pushes down prices by making imports cheaper. As inflation in the euro area is at a very low level, the ECB has had no choice but to launch its own QE programme to promote price stability. In turn, the euro area's quantitative easing is pressurising other economies to adopt accommodative monetary policies as well if they want to stop their currencies from appreciating against the euro (see the article «The dilemma of Europe's central banks in the face of the ECB's policies» in this Dossier). One of the channels through which the ECB's QE could stimulate the economy is by depreciating the euro, boosting the export sector of some countries in the euro area.²

Euro area: impact of monetary policy on the euro's exchange rate

Change (%)

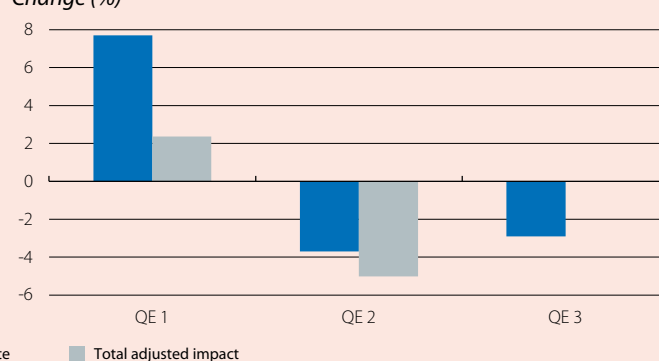


Note: The adjusted total impact for the euro area is estimated based on Fratzscher, M., Lo Duca, M., Straub, R. (2014), «ECB Unconventional Monetary Policy Actions: Market Impact, International Spillovers and Transmission Channels», IMF. The adjusted total impact for the United States is estimated based on Fratzscher, M., Lo Duca, M., Straub, R. (2103) «On the international spillovers of US Quantitative Easing», ECB working paper. No estimates are available for the adjusted total impact of the ECB's QE or for the Fed's QE3. The quarter-on-quarter change in the nominal effective exchange rate is the variation between two months before and one month after the policy was announced.

Source: "la Caixa" Research, based on data from Thomson Reuters Datastream, the ECB and the Fed.

USA: impact of monetary policy on the dollar's exchange rate

Change (%)



An analysis of the impact of the main monetary tools adopted by the Fed and the ECB on the nominal effective exchange rate of the dollar and euro, respectively, shows that these measures have tended to depreciate the domestic exchange rate, as predicted by the theory (see the previous graph)³ but with two notable exceptions: the first round of QE by the Fed and the outright monetary transactions (OMT) by the ECB. In both cases these actions represented a watershed in restoring confidence to their respective economies after significant shocks (the Lehman Brothers crash in the US and the sovereign debt crisis in the euro area). Although the monetary policy was accommodative, lower risk aversion pushed capital flows towards these economies, causing their currencies to appreciate.

Currency exchange movements as a consequence of monetary policy are therefore considerable. Once Mario Draghi started to explicitly state that the ECB would closely monitor the euro's exchange rate, in April 2014, the nominal effective exchange rate of the euro started a downward slide, falling by 4.8% between April and December. At the start of 2015 the euro depreciated even further due to the announcement of QE and the expectations of an interest rate hike by the Fed and the Bank of England. This depreciation will therefore be the main channel to boost the euro area's economy, reviving the exports of some countries on the one hand and pushing up import prices on the other. All this should help to achieve the ECB's objective of price stability.

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2. For a detailed analysis of the effect of the exchange rate on exports in the different countries of the euro area, see the Focus «The sensitivity of euro area exports to exchange rate movements» in the Monthly Report of December 2014.

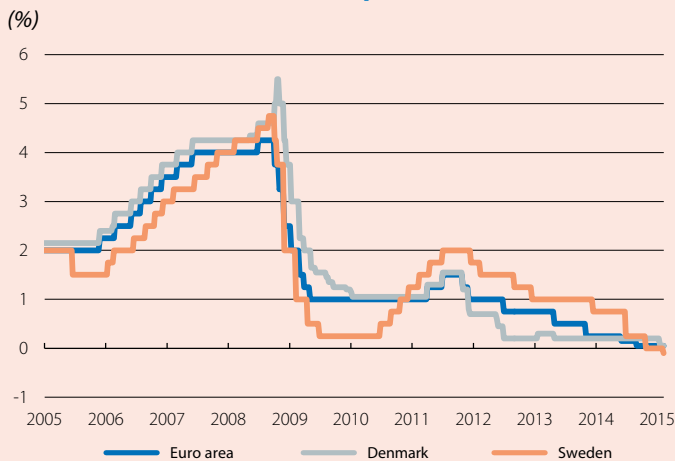
3. The change in the exchange rate is shown between two months before and one month after the announcement of each measure, as well as the total impact estimated by Fratzscher *et al.* (2013 and 2014). These studies use daily data to isolate the impact of monetary policy from other contemporary effects that could influence the exchange rate, taking into account both the impact of the day of the announcement and the days of its implementation.

The dilemma of Europe's central banks in the face of the ECB's policies

Over the last few years, the European Central Bank (ECB) has adopted extremely accommodative monetary policies, a strategy that has visibly influenced the decisions of many central banks from other European countries, to the point of jeopardising their monetary sovereignty. The expansionary measures recently adopted by some of them, given the ECB's announcement that it will start large-scale purchases of assets (QE), has intensified this debate. A review of the monetary strategies adopted by the National Bank of Denmark and the Swedish Riksbank could throw some light on this issue.

An analysis of Europe's small advanced economies, and in particular of Denmark and Sweden, shows that two of their distinctive features are their complete openness to the free circulation of capital and their markedly commercial orientation towards other countries. By way of example, in 2013, Danish exports accounted for 54% of the country's GDP while in Sweden this figure was 44%. Moreover, in both cases almost half the goods exported were sent to the euro area. Given such parameters, the increasingly accommodative monetary conditions provided by the ECB, and more specifically the euro's depreciation, have had a notable effect on these countries. On the one hand, the fact that their exports, in euros, are becoming more expensive makes them less competitive compared with the euro area, slowing up their economic activity. On the other hand the euro's depreciation places deflationary pressure on domestic prices via the import channel.

Official interest rates of Europe's main central banks



Source: "la Caixa" Research, based on Bloomberg data.

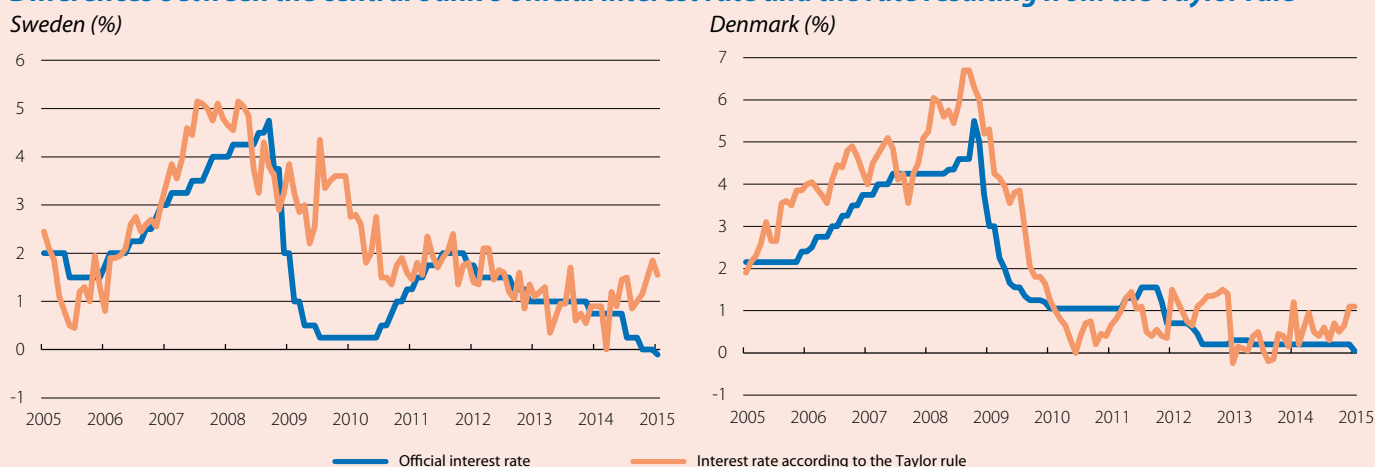
In spite of their similarities, these countries have very different exchange rate strategies that determine the tools available to counteract this situation. Firstly there are economies which opt to peg their currency to the euro in order to lessen the risks associated with exchange rate volatility. A case in point is Denmark which, in 1999, pegged the value of its currency at 7.46 Danish krone per euro, with a fluctuation band of $\pm 2.25\%$, via the EU's Exchange Rate Mechanism. Although this strategy has been clearly favourable in terms of trade, it is also true that it has one considerable drawback from a monetary point of view as, within a situation of freely circulating capital, a country with a fixed exchange rate system actually loses its monetary autonomy. As a consequence, Danish monetary policy depends on that of the ECB, representing a significant limitation at times when both economies are following different economic cycles since interest rates cannot be used to correct any undesirable deviations in inflation or growth.

This dependence can be seen graphically in the marked correlation observed between the Denmark's official interest rate and that of the ECB over the last decade. In fact, on 22 of the 25 occasions when the ECB has changed the interest rate since 2005, Denmark's central bank has responded almost immediately.

Other problems faced by countries whose currency is pegged to the euro are due to the difficulty, on occasion, of maintaining this system. One example is the increase in reserves accumulated by the Swiss National Bank (SNB) between 2011 and 2014, from 40% to 86% of GDP, to defend the limit set for the appreciation of its currency. Finally, at the beginning of 2015, and given the imminent announcement of QE by the ECB, the SNB decided to remove the peg from its currency and allow it to fluctuate freely, cutting the official interest rate to -0.75% . Those countries that decide to have a flexible exchange rate policy, like Sweden, face different problems. Unlike the Danish case, the central banks of these economies do enjoy monetary autonomy. Consequently, within the current context of abundant liquidity and financial interconnection, these banks are facing a serious dilemma. They can exercise this autonomy, taking monetary decisions based on the economic conditions at home, which will more than likely import deflation and reduce economic activity via the exchange rate channel. Or, if they embark on an unconventional monetary approach to prevent their currency from appreciating too much, they might be applying an ultra-expansionary recipe to their economy that could push asset prices to an unacceptably high level.

The behaviour of Sweden's Riksbank over the last few years helps to illustrate both alternatives. In mid-2010, the improved tone of the Swedish economy and solid inflation prospects, above the central bank's target, led the Riksbank to gradually raise interest rates from 0.25% to 2% in just over one year. This policy's divergence from the ECB's own monetary policy, which was much more

Differences between the central bank's official interest rate and the rate resulting from the Taylor rule *



Note: * Taylor rule calculated as: $\text{interest} = 1 + 1.5 \times \text{core inflation} - 1 \times \text{unemployment gap}$.

Source: "la Caixa" Research, based on Bloomberg data.

accommodative at the time, had quite a negative effect in the exchange rate between both regions, with the Swedish krona appreciating by close to 20% in 2010. This has provided the background to an intense debate between those justifying higher interest rates, both from a macroeconomic perspective and also to ensure financial stability, and those who believe that this decision plunged Sweden into a subsequent period of deflation and economic slowdown. Although neither side has clearly won this debate, it was probably very much present in the minds of those currently responsible for Sweden's monetary policy as, after the ECB announced the start of QE, they have taken an opposite route to the one chosen in 2010, cutting interest rates to below zero for the first time in their history (−0.10%) and starting a programme to purchase sovereign debt.

In short, events over the last few months have clearly shown the impact of the euro area's monetary policy on the official interest rates of other European countries, either because their currencies are pegged to the euro (such as the National Bank of Denmark) or in an attempt to minimise the effect of the euro's depreciation on their economy (such as the Riksbank). One way to test this dependency is by using the Taylor rule. According to this rule, the interest rate of each economy is modelled as a function of inflation and the unemployment gap (i.e. the difference between the unemployment rate and its structural level)¹. In those economies with lower inflation rates and slack in the labour market, the Taylor rule implies an interest rate that could boost the economy. As can be seen in the graph above, in the cases of Sweden and Denmark, the Taylor rule has been suggesting a gradual rise in official interest rates for some months now, the opposite to the decisions recently adopted by the respective central banks. Should they remain tied to the ECB's strategy, the difference between the optimum interest rate in accordance with the economy's internal conditions and the interest rate established by the monetary authority is likely to go on growing as both Nordic economies gain traction. The consequences of this divergence represent a risk to the financial stability of both countries: should accommodative monetary conditions continue for too long, this could lead to the price of some financial assets and real estate overheating, as well as encouraging higher levels of debt in a private sector that is already notably leveraged, with a debt to GDP ratio of 257% in Denmark and 265% in Sweden (compared with 202% and 113% in Spain and Germany, respectively).

In an increasingly globalised financial world, the ECB's monetary policy has a great influence on the decisions of the rest of Europe's central banks. It is crucial for these economies to adopt measures to reduce the effects of excessively accommodative monetary conditions. The design of macroprudential policies could help to reinforce the sustainability of banks and correct the high level of debt in the private sector. In this respect, the creation of the Financial Supervisory Authority in Sweden and its initial recommendations to reduce the high level of mortgage debt among households (for example, by reducing the average length of mortgages, which are very long, or by removing tax breaks for purchasing a home) are an attempt to achieve this goal. However, it is vital for central banks to remember that, although these measures are important, they are not enough on their own to prevent imbalances resulting from excessive dependence. Otherwise they may be putting their financial stability in jeopardy.

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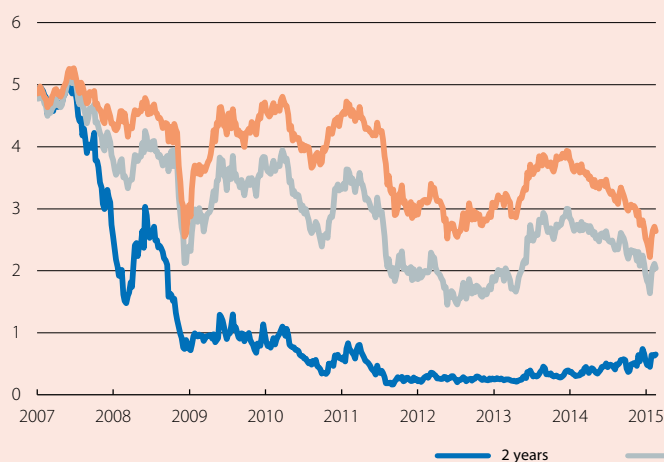
1. We have used the following approach to calculate the Taylor rule: $\text{target interest rate} = 1 + 1.5 \times \text{core inflation} - 1 \times \text{unemployment gap}$. See Nechio, F. (2011), «Monetary Policy: When one size does not fit all», FRBSF Economic Letter.

QE comes to the euro area for a long visit

This month the European Central Bank (ECB) has started up an ambitious quantitative easing programme or QE. Its impact on the region's financial markets, in particular the sovereign debt market, is crucial for this unconventional monetary stimulus to reach the real economy. To throw some light on this issue, it is useful to compare the ECB's current QE programme with the one carried out in its day by the US Federal Reserve (Fed). The initial conditions and environment are quite different for both cases so the effects on interest rates for European public debt could differ considerably from that seen in the US. While the impact across the Atlantic was strong (in terms of pushing down yields), concentrated (on bonds maturing within 5 and 10 years) and limited in time, QE in the euro area is likely to be less intense but more widespread and longer in duration. In other words, the main contribution of the ECB's QE will be to prolong the current scenario of very low interest rates for a long period of time, thereby affecting risky assets (such as stock markets) and the euro.

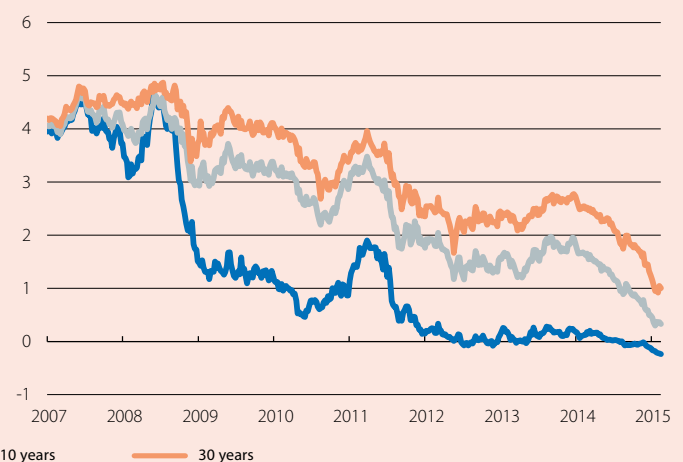
USA: nominal interest rate

(%)



Germany: nominal interest rate

(%)



Source: "la Caixa" Research, based on Bloomberg data.

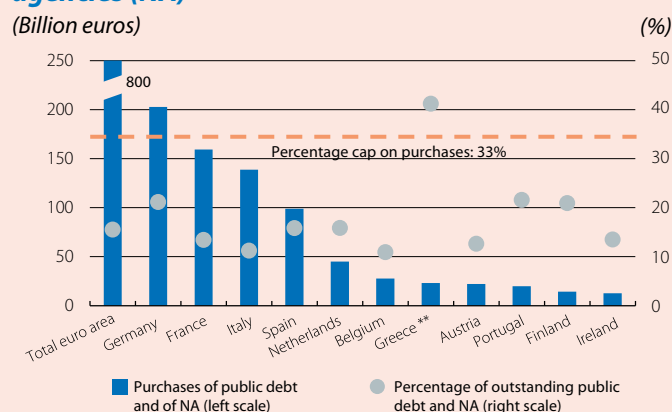
The essential size of these purchases is a good starting point to compare QE in the United States and the euro area. Since it implemented the first of its three QE programmes in 2008, the Fed has increased its balance sheet by 4 trillion dollars, with two trillion being in public debt. This last figure accounts for 12% of the United States' GDP and 17% of its outstanding Treasury market. Sovereign debt purchases within the ECB's recently announced QE programme are initially expected to reach 800 billion euros, equivalent to 8% of the euro area's GDP and 16% of its government bond market. The relative amounts are therefore quite similar. Regarding the impact of the Fed's purchases on Treasury yields, empirical studies estimate that, at their peak, this was between 100 and 120 bps in the case of the 10-year bond, largely attributable to the reduction in the term premium.¹ However, when comparing the developments witnessed in yields on Treasuries and those expected in the euro area, two big differences arise between both programmes that should be considered. Firstly, the level of long-term interest rates at the start of each programme. When the Fed decided to undertake large-scale asset purchases, long-term interest rates in the US were between 3.5% and 4.5%. This contrasts with the current environment of very low interest rates in the euro area, particularly in the core countries (at present, the German 10-year bond barely offers 0.3% and its 30-year bond is below 1%). Secondly, the Fed concentrated most of its purchases in bonds with maturities of between five and ten years, aiming to push down the term premium in this tranche of the curve. The ECB's government bond purchases will be much more broadly based, however, taking place throughout the whole debt curve from two to thirty years.

Given the meagre yields in Europe at present, should we therefore conclude that, from now on, the effects of QE on the government bond market will be irrelevant? Not at all. All things being equal, the arrival of such a large demand for government debt in the secondary market due to large-scale purchases by the ECB should push down yields on the euro area's public debt. It is true that any additional descent in long-term interest rates is likely to be limited, but in comparison with the United States, it will probably have a greater effect on ultra-long maturities and for a longer duration. The combination of several factors suggests

1. For a description and interpretation of the bond term premium, see the Focus «US Treasury term premiums: not yet, but likely» in the Monthly Report of December 2014.

this scenario will come about. Firstly, investors already expected the ECB would resort to sovereign debt purchases several months ago, leading to widespread drops in public debt yields as investors took up positions in this market. This illustrates how one of the main channels to pass on unconventional monetary policy works: the so-called signalling effect, which now appears to have run out of steam. Secondly, the inclusion of bonds ranging from two to thirty years results in a much flatter curve than in the US; i.e. a decrease in the term premium across all periods, even ultra-long (30 years). This is the result of another channel to pass on unconventional measures, namely the portfolio balance effect, which comes into play when bond markets are at least partly segmented by different maturities and also when there is segmentation by country. In this respect, periphery debt promises higher returns than core debt, so the spread between periphery and German debt may narrow even further. However, whether this actually comes about depends on two important conditions: the positive boost provided by growth in countries such as Spain needs to continue, as we predict, and the elections to be held this year in Spain and Portugal must not destabilise their respective debt markets. Thirdly, the drop in yields that tends to happen after the launch of a large-scale asset purchase programme is announced usually gives way, after a period of time, to an opposite effect. In other words, as quantitative easing progresses and reaches maturity, long-term interest rates will start to rise again due to the expectations formed by investors regarding a recovery in growth and inflation in the future and, consequently, the end of QE itself. Here the channel in operation is the confidence effect. In the case of the Fed's QE3, this happened relatively quickly (as a result of tapering in spring 2013), while the macroeconomic conditions of the euro area, given the ECB's commitment to continue QE until inflation approaches 2%, suggest that this will take longer to happen.

ECB: purchases of public debt and national agencies (NA)*



Notes: * Purchases of securities with residual maturities between 2 and 30 years.

** Greek public debt will not be purchased unless the country meets the conditions in its bail-out agreement.

Source: "la Caixa" Research, based on data from Bloomberg and the Spanish Treasury.

Given the intensification and maintenance of extremely accommodative monetary conditions in the euro area, prices of risky assets will be boosted by favourable capital flows. Essentially, the low interest rates of European sovereign debt and the little probability of them falling much lower provide a clear incentive for investors to restructure their portfolios towards assets with higher risk and expected returns, such as the stock market or corporate bonds. This redirection of capital flows should be seen as a portfolio balance effect by asset type which, together with the aforementioned signalling and confidence effects, constitutes an important channel to pass on unconventional monetary policies. At the same time, the positive news we expect to hear over the coming months in terms of the euro area's economic growth will reinforce the sustained improvement seen in European and the Spanish stock markets. Investors increasing their search for yield will also boost European corporate bond markets since the expected compression of risk premia in this market will lead to larger issuances of corporate debt, which will help companies to enter capital markets under favourable conditions. This revived appetite for risk will also be noticed beyond Europe's borders, particularly in the emerging bloc.² The use of the euro as a currency to issue debt in emerging countries or to finance carry trade positions in foreign exchange markets will be another of the consequences associated with this highly accommodative context. According to recent figures by the BIS, euro-denominated issuances of corporate debt by companies not resident in the euro area rose by 14.1% year-on-year in 2014 Q3, up to approximately 800 billion euros.

In conclusion, QE in the euro area will strengthen and prolong, for some time, an environment of very low interest rates and abundant liquidity. However, this situation could encourage risky assets to overheat and also excessive leverage, which might represent a future source of instability. Turbulent episodes such as the events occurring in emerging markets after the pre-announcement of tapering in May 2013 illustrate the need to make an even greater effort to guarantee financial stability, both locally and globally.

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2. On the effects of large-scale asset purchases in primary corporate bond markets, see Lo Duca, M., Nicoletti, G. and Vidal, A. (2013), «Global corporate bond issuance: what role for US quantitative easing», ECB Working Paper Series No. 1649.

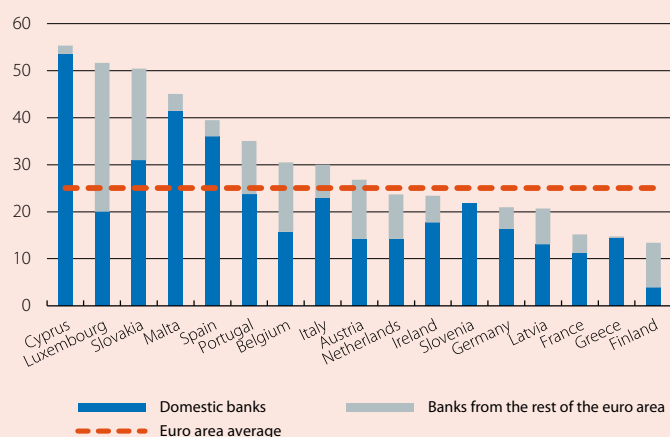
Banking in the face of QE: caught between wishes and reality

In January, the European Central Bank (ECB) announced the start-up of a new unorthodox monetary policy tool: the large-scale purchase of sovereign debt (also known as quantitative easing or QE). With this strategy, the euro area monetary authority aims to combat low inflation and stimulate its economy, reducing long-term interest rates for households and firms and thereby encouraging them to consume and invest. Unlike what happened in the US, where financial markets played an important role, in Europe the role of the banking system will be key to the effects of this measure being passed on to the real economy. The aim of this article is to describe why banks play such a vital role and how their decisions might determine whether the programme is a success.

In Europe, banks form an essential part of the transmission mechanism of any monetary policy decision as financing in the euro area is highly concentrated on banks. Alternative financing channels such as the corporate bond market are not very developed and only accessible for large firms. The success of policies aiming to generate economic growth by stimulating aggregate demand and credit therefore rely on the credit capacity of these financial institutions. In the particular case of QE, moreover, banks will have an additional role due to the size of the public debt portfolio on their balance sheets. As they hold most of the euro area's sovereign bonds, the impact of QE on the price of these assets will depend not only on how much the ECB wishes to buy but also on how willing the banks are to sell them. Both reasons suggest that the success of QE will largely come from two conditions being met: banks deciding to reduce the share of public debt on their balance sheets and this being replaced by loans to the private sector.

Public debt held by banks in the euro area

(% of all outstanding debt)

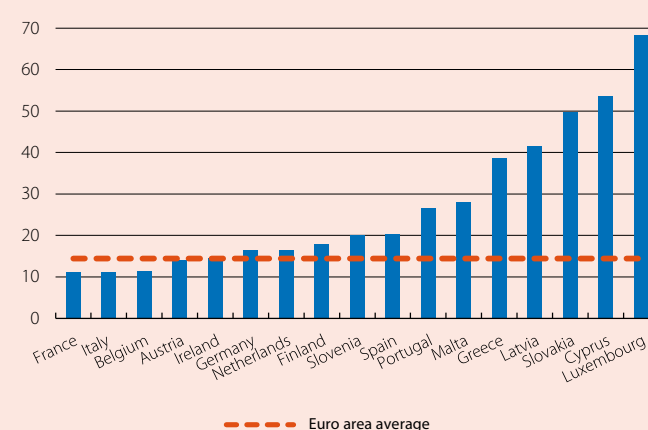


Note: Data for 2014 Q3.

Source: "la Caixa" Research, based on ECB data.

ECB public debt purchases *

(% of outstanding debt held by the non-banking sector)



Note: * Estimates based on the maximum volume of purchases and capital key for each country.

Source: "la Caixa" Research, based on ECB data.

Regarding the first condition, since the financial crisis began, banks have preferred to keep most of their assets in liquid, low-risk securities, government bonds being a prime example. This decision has mainly been brought about by two factors. On the one hand, these securities have provided an attractive and very safe return in an environment where the alternative of credit has been too risky and costly in terms of regulatory capital. On the other hand, regulators have introduced new liquidity requirements to tackle any disruption of wholesale funding markets, demanding that banks maintain an important buffer of liquid assets. As QE pushes down yields on public debt and the risk profile of those demanding credit improves thanks to a more favourable macroeconomic environment, the first of these conditions will start to be met and banks will gradually reduce the share of government debt on their balance sheets. However, the credit capacity ultimately freed up will depend on how much is left in this portfolio once the aforementioned liquidity requirements have been met. EBA estimates suggest that the ability of banks to reduce their liquid assets might be limited given that the short-term liquidity coverage ratio for the euro area averages about 115% (100% being the mandatory minimum).

The second of the conditioning factors for QE to be a success is for any freed-up credit capacity to be effectively directed at granting loans. In this respect, the ECB's new programme comes at a good time to underpin the incipient growth in the demand for financing, especially in those countries where economic activity is growing strongly and deleveraging is more advanced. The

beneficial effects of QE on credit demand will essentially be noticed in three ways. Firstly, more accommodative monetary policies are expected to keep the euro depreciated, which will reinforce the economic recovery by boosting exports and this will gradually be reflected in the employment figures. Secondly, a flatter interest rate curve will encourage investors to take more risk and their increased demand for risky assets (such as shares, private debt and property) will push up the prices of these assets. This increase in asset prices will result in an improved risk profile for those demanding credit in the future as a larger proportion of the loan being granted will be covered by the higher value of the assets provided as collateral. Lastly, if QE manages to anchor expectations regarding higher inflation and growth in the medium term, those investment projects which have been shelved due to the uncertain outlook could be dusted off, thereby leading to a need for financing.

The increase in demand for credit and its better quality should therefore ensure that yields on risk-adjusted credit become more attractive than investment in public debt. Nonetheless, for credit to expand appreciably, it is necessary to eliminate the obstacles that are still stopping banks from taking on more risk in their balance sheets and relaxing their credit standards. Banks are still facing significant regulatory uncertainty even though the asset quality review carried out by the ECB of the assets of the 130 largest European banks verified the solvency of most of Europe's banking system and clarified the needs of the weakest banks. Over the next two years, both the minimum required eligible liabilities (or MREL) for bail-ins and the maximum level of deleveraging must be defined. Moreover, the ECB has stated that it intends to harmonise regulations in different countries as much as possible, gradually eliminating the different criteria applied discretionally by national supervisors. These three measures could have a significant impact on banks and influence their investment decisions while such uncertainties continue. In this respect, neither do banks have the option of securitising credit and sharing the risk of investment with other agents since the regulations for this kind of security have become considerably tighter after the financial crisis.

Given the uncertainty that still exists, and while securitisation requirements are not eased, we cannot rule out part of the freed-up capacity due to the reduction in the public debt portfolio being used for alternatives to bank credit with more favourable regulatory treatment, at least in the short term. This could be the case of government bonds from the United States or United Kingdom, countries that are starting to consider raising their interest rates and whose securities also enjoy regulatory advantages in capital terms. Another attractive investment in terms of yield could be corporate bonds although they lack the regulatory advantage of government bonds.

All this suggests that, at present, the effects of QE on credit may be rather modest. Nonetheless, it is important to note that QE could have other implications for banks apart from stimulating credit. Some of the restructuring of investors' portfolios is likely to boost demand for bank shares, subordinated debt and senior debt. This will help banks to adapt to the aforementioned new regulatory requirements that require a larger share of capital, as well as bail-in debt, in their funding structure. On the other hand, a prolonged environment of low interest rates will reduce bank profits and encourage them to gain in size, which could help to concentrate the banking industry.

In short, greater economic growth and less regulatory uncertainty are the necessary ingredients to start up a virtuous circle of QE. In the meantime, banks will be hovering between their wish to grant credit and the reality of a still-fragile demand.

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"la Caixa" GROUP: KEY FIGURES

As of December 31, 2014

Financial activity

MILLION €

Customer funds	271,270
Receivable from customers	195,809
Profit attributable to Group	622

Commercial activity and resources

Customers (million)	13.4
Staff	32,590
Branches in Spain	5,251
Self-service terminals	9,544

Community projects: budget for activities in 2015

MILLION €

Social	336
Science and environmental	56
Cultural	67
Educational and research	41

TOTAL BUDGET

500

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