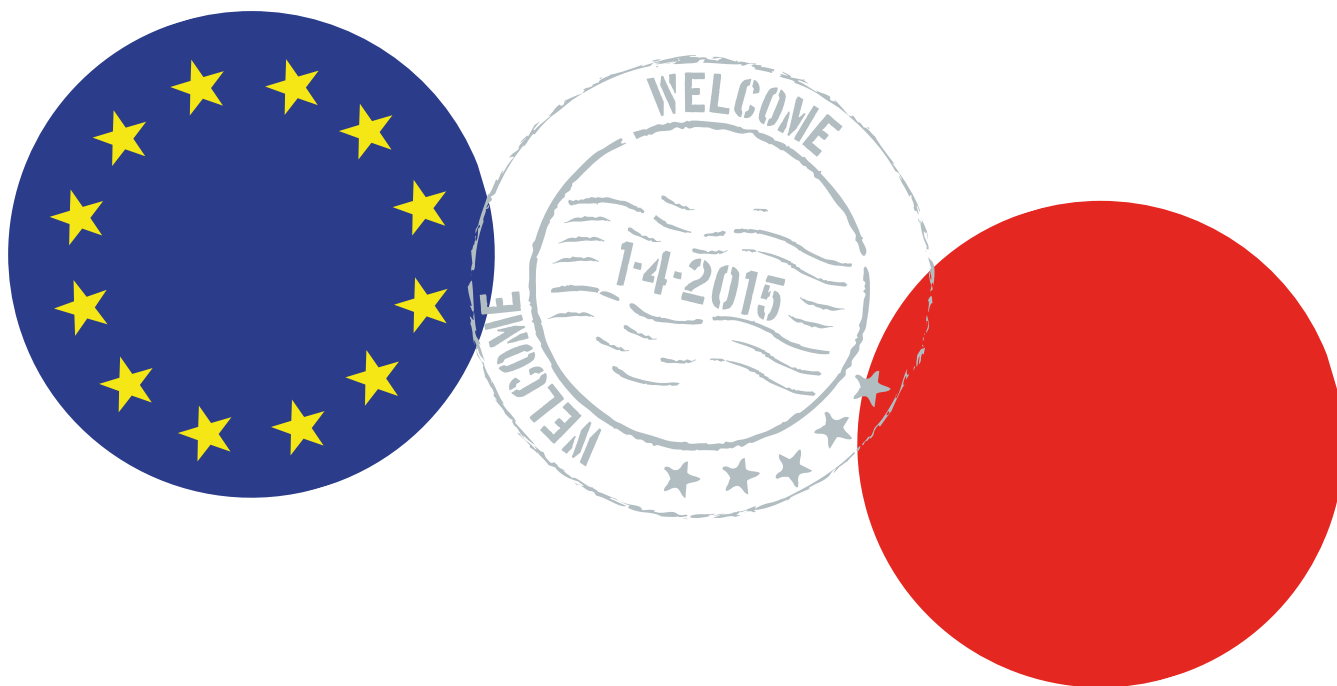


MR04

MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

NUMBER 389 | APRIL 2015



ECONOMIC & FINANCIAL ENVIRONMENT

FINANCIAL MARKETS

*Debt issuances in foreign currencies:
the euro comes to the fore*

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Oil stocks and their effects on the price

EUROPEAN UNION

The Bank of England, at a crossroads

SPANISH ECONOMY

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*Japan's «lost decades»: between myth and
reality*

*Monetary and fiscal tribulations:
the long road towards Abenomics*

*Is the euro area becoming Japanised?:
demographics and productivity*

*An accommodative monetary environment:
the new norm for the private sector*



“la Caixa” Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK

April 2015

CaixaBank, S.A.

Strategic Planning and Research

Av. Diagonal, 629, torre I, planta 6

08028 BARCELONA

Tel. 34 93 404 76 82

Telefax 34 93 404 68 92

www.lacaixaresearch.com

For general information and inquiries:

estudis@lacaixa.es

For subscriptions (new, cancellations, etc.):

publicacionesestudios@lacaixa.es

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Jordi Gual

Chief Strategy Officer

Enric Fernández

Director, Bank Strategy

Oriol Aspachs

Director, Macroeconomics

Avelino Hernández

Director, Financial Markets

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Is recovery being watered down?

Spain's economic recovery is being confirmed month by month. The flash GDP figures for 2015 Q1 indicate a quarter-on-quarter growth rate of 0.8%, higher than expected, placing the economy's cruising speed at close to 3%. In fact some analysts are already predicting that average growth for the year will be around this figure. At "la Caixa" Research we have kept our forecast at 2.5% this month, although the dynamism seen in the last few weeks is likely to result in an upward revision.

In addition to the well-known temporary factors that have been boosting growth (such as the euro's depreciation, low oil prices, less restrictive monetary policy and renewed consumer and corporate confidence), a new element has now appeared, namely expectations (and the reality) of more accommodative financial conditions thanks to the quantitative easing programme set in motion by the European Central Bank (ECB). This expansionary cocktail could actually bring us close to 3% growth, especially if the international financial environment remains benign and if public administrations resist taking advantage of this tail wind to reduce their deficits more quickly.

At this point in the economic cycle, and albeit taking the wind out of the sails of a long-awaited recovery, it is important to warn of the major downside risks to growth in the short and medium term.

The first comes from the financial environment in which the Spanish economy operates. As there is no central bank per se, domestic monetary conditions are the result of a combination of two factors: the policy established by the ECB for the euro area as a whole and international investors' perceived risk of investing in Spanish assets, a risk that we can concisely sum up as the spread between the yield on Spanish 10-year bonds and the same kind of bonds from Germany: the famous risk premium.

In the current cycle of recovery, financial conditions have been relaxed both due to direct action by the ECB and also because of reforms and adjustments carried out internally in Spain, which have been welcomed by international investors. It is true that, as far as the ECB's policy is concerned, we are currently in a presumably prolonged period of highly accommodative monetary conditions. But it is also true that, given the total mobility of capital at present, any sharp change in appetite for «Spanish risk» is always a potential threat. For this reason, the utmost caution should be taken and Spain should continue reducing its levels of debt, particularly in the public sphere, bringing these down to more moderate and sustainable levels.

The second big risk concerns inflation and wages. The dynamism of Spain's recovery proves, on the one hand, that it is possible to grow and generate income within a scenario of price and wage stability. Moreover the CPI is falling due to the effect of oil prices but core inflation is stable and moderate wage rises are helping to maintain or even improve the country's competitiveness. Any deterioration in this area would hinder the recovery as Spain's economic improvement would not be sustainable should its external balance deteriorate.

This has been the typical pattern in Spain. Whenever the economy has grown strongly, the foreign sector has quickly entered into deficit. In the current recovery, the challenge is to avoid slipping back into the old habits and not to be misled by any delusions as positive external account figures are almost guaranteed for some time thanks to low oil prices. It would be a serious mistake to become complacent should these positive results mask a deterioration in the country's competitiveness.

Jordi Gual
Chief Economist
31 March 2015

CHRONOLOGY

MARCH 2015

- 9** The **European Central Bank starts its sovereign bond purchases**. A limit is set on the yield of the bonds acquired, which must be at least equal to the deposit facility yield, currently -0.20% .

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**.

AGENDA

APRIL 2015

- 6** 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. State budget execution (March).
- 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).

MAY 2015

- 2** Registration with Social Security and registered unemployment (April).
- 8** Industrial production index (March).
- 13** Flash GDP of the euro area (Q1).
- 16** Fed Open Market Committee.
- 18** Loans, deposits and NPL ratio (March).
- 20** International trade (March). Flash GDP of Japan (Q1).
- 26** State budget execution (April).
- 28** Quarterly national accounts (Q1). Economic sentiment index of the euro area (May).
- 29** CPI flash estimate (May). Balance of payments (March).

Europe and Spain are gathering speed

Europe is speeding up, the US is slowing down and some emerging countries are losing ground. Recent developments in the financial markets are an accurate reflection of the current state of affairs. Although international stock markets performed well on the whole in March, European shares are the ones showing the greatest drive, boosted by the start-up of monetary expansion (QE) by the European Central Bank (ECB) and by a battery of positive macroeconomic indicators, even though the Greek source of tension has yet to be fully resolved. However, a less expansionary start to the year than expected in the US has led the Federal Reserve to suggest in its communications that it might postpone any hike in official interest rates for longer than the market had been anticipating. In response to this more dovish tone, both US interest rates and the rise in the dollar slowed up. But the greatest market sensitivity has been seen in the downside risks for some emerging countries. Which ones? Judging by increased volatility in the foreign exchange market and the currencies losing most value, Brazil and Turkey are the biggest cause for concern.

Greater downside risks in emerging economies and a slight slowdown in the US and China. Although the world economy is accelerating thanks to the expansionary effects of accommodative monetary policies and lower oil prices, it is doing so at a slightly slower rate than expected a few months ago as the two global engines, the United States and China, have seen their growth in activity slow up at the beginning of 2015. This is no hard landing but is certainly a warning sign, especially in the case of the Asian giant. Nonetheless, we should not forget the factors lessening these risks in both cases. In the US, consumption (supported by labour's good performance), investment and fiscal policy will bolster growth while China's economic policy still has room to become more expansionary (margin which the country's monetary policy is already taking advantage of, with interest rate cuts in November and March). More delicate is the balance of risks for some emerging countries. In March, attention (and financial pressure) turned to Brazil, whose outlook has deteriorated substantially, as well as Turkey. In both cases, beyond certain temporary factors, of greater concern is the persistence of larger macroeconomic imbalances than is desirable.

Europe is taking advantage of short-term supports but still faces the same long-term challenges. European prospects are gradually improving thanks to temporary factors such as falling oil prices and the euro's depreciation. Figures show that this recovery is occurring across the board, in consumption, investment and also the foreign sector although unfortunately there is still disparity between countries: while Germany is growing at an acceptable rate, France is falling behind. Together with growth, the other source of good news has been prices. Inflation picked up by 0.3 pps (to -0.1%) in March and this upswing could mark the start of a more appreciable change in trend. Nonetheless the euro area is still facing considerable challenges. In the short term the lack of agreement in negotiations with Greece is a cause for concern but the long-term challenges undoubtedly pose the biggest threat. In its report on macroeconomic imbalances, the European Commission states that, in spite of the cyclical improvement, the number of countries with excessive or slight imbalances has risen in the last year and only 3% of last year's recommendations were implemented fully.

Spain is speeding up. In its GDP flash figure for 2015 Q1, the Bank of Spain (BdE) presents an economy growing at a considerable pace and somewhat faster than at the end of 2014, thanks to domestic demand. It also shows a country starting two positive years with 2.8% growth in GDP in 2015 and 2.7% in 2016. The factors mentioned by the BdE are illustrative of the current pattern of recovery: the positive effect of the ECB's QE, improved financing conditions, falling oil prices and the depreciation of the single currency. But such a positive diagnosis does not detract from the fact that Spain still needs to continue its ambitious reforms. The same European Commission report on macroeconomic imbalances highlights the work still pending: continuing the external adjustment, furthering fiscal effort and maintaining the agenda of structural reforms. Regarding the second of these areas for improvement, namely public finances, the 2014 public deficit figures (5.7% of GDP compared with a target of 5.5%) remind us of the need to continue the country's fiscal consolidation. Regarding the agenda of structural reforms, this month saw the approval of the new employee training system, introducing a change in active employment policies that is required and in the right direction to improve the long-term sustainability of growth.

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	3.4	3.3	3.5	3.8	3.3	3.3	3.4	3.5	3.5	3.6
Developed countries¹	1.1	1.6	2.2	2.3	1.5	1.5	1.9	2.2	2.2	2.4
United States	2.2	2.4	3.1	2.8	2.7	2.4	3.3	3.2	2.8	3.0
Euro area	-0.4	0.9	1.5	1.8	0.8	0.9	1.0	1.4	1.7	1.8
Germany	0.2	1.6	1.8	1.9	1.2	1.5	1.2	1.8	2.2	2.0
France	0.4	0.4	0.8	1.3	0.4	0.2	0.5	0.9	0.9	1.1
Italy	-1.7	-0.4	0.5	1.2	-0.5	-0.5	-0.1	0.3	0.7	1.0
Spain	-1.2	1.4	2.5	2.3	1.6	2.0	2.4	2.5	2.5	2.4
Japan	1.6	-0.1	0.8	1.2	-1.4	-0.7	-1.4	0.7	1.8	1.9
United Kingdom	1.7	2.8	2.3	2.1	2.8	3.0	2.5	2.2	2.2	2.1
Emerging countries¹	6.2	5.8	5.5	5.7	5.9	5.8	5.7	5.5	5.4	5.5
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	6.9	7.0	8.2	7.5	7.6	7.0	6.9	6.8
Indonesia	5.6	5.1	5.7	6.1	4.9	5.4	5.5	5.7	5.8	5.9
Brazil	2.7	0.1	-0.1	1.5	-0.6	-0.2	-0.5	-0.4	0.1	0.3
Mexico	1.4	2.1	3.0	3.6	2.2	2.6	2.9	3.0	3.0	3.2
Chile	4.2	1.9	2.6	4.1	1.0	1.8	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	4.2	2.9	3.6	4.3	1.9	2.6	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	2.3	1.6	2.4	2.8	1.5	1.3	2.1	2.4	2.7	2.4
INFLATION										
Global¹	3.7	3.4	3.4	3.8	3.5	3.1	3.3	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	1.1
United States	1.5	1.6	0.3	2.5	1.8	1.2	-0.1	-0.1	0.3	1.2
Euro area	1.4	0.4	0.3	1.6	0.4	0.2	-0.3	0.0	0.5	1.1
Germany	1.6	0.8	0.6	2.0	0.8	0.4	-0.2	0.3	0.8	1.6
France	1.0	0.6	0.3	1.5	0.5	0.3	-0.3	0.0	0.4	1.1
Italy	1.3	0.2	0.3	1.4	-0.1	0.1	-0.2	0.1	0.3	1.0
Spain	1.4	-0.1	-0.1	1.9	-0.3	-0.5	-1.0	-0.7	0.0	1.2
Japan ³	0.4	2.7	1.1	1.6	3.3	2.5	2.2	0.3	0.5	1.3
United Kingdom	2.6	1.5	0.5	1.7	1.5	0.9	0.1	0.3	0.6	1.0
Emerging countries¹	4.4	3.8	4.3	4.3	3.8	3.0	4.5	4.6	4.0	4.3
China	2.6	2.0	1.8	2.4	2.0	1.5	1.3	1.8	1.9	2.1
India ⁴	10.1	7.2	4.9	6.8	7.7	4.8	5.2	5.1	3.8	5.6
Indonesia	6.4	6.4	7.2	5.5	4.4	6.5	7.3	8.1	7.5	6.0
Brazil	6.2	6.3	7.0	6.0	6.6	6.5	7.3	7.0	6.9	6.6
Mexico	3.8	4.0	3.3	3.1	4.1	4.2	3.2	3.3	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	13.7	6.6	7.7	9.6	16.4	16.0	12.5	10.0
Turkey	7.5	8.9	6.3	6.5	9.2	8.8	7.0	6.0	6.0	6.3
Poland	1.2	0.2	0.1	1.9	-0.1	-0.6	-1.1	-0.2	0.3	1.2
South Africa	1.1	2.3	4.4	6.1	2.6	3.0	3.8	4.3	4.5	5.0

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. 4. Wholesale prices.

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	2.6	2.3	2.3	2.1
Unemployment rate (% labour force)	26.1	24.4	22.7	21.5	23.7	23.7	24.0	22.6	22.1	22.1
Consumer price index	1.4	-0.1	-0.1	1.9	-0.3	-0.5	-1.0	-0.7	0.0	1.2
Unit labour costs	-0.4	-0.4	-0.1	1.1	-0.3	-0.1	0.1	-0.3	0.0	0.0
Current account balance (cum., % GDP) ¹	1.4	0.8	1.3	1.3	0.7	0.8	0.9	1.1	1.2	1.3
Net lending or borrowing rest of the world (cum., % GDP) ¹	2.1	1.0	1.9	1.9	1.1	1.0	1.5	1.6	1.8	1.9
Fiscal balance (cum., % GDP) ^{1,2}	-6.8	-5.8	-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	0.50	1.16	0.23	0.24	0.26	0.45	0.61	0.68
12-month Libor	0.68	0.56	0.98	1.68	0.56	0.57	0.66	0.90	1.10	1.25
2-year government bonds	0.30	0.44	0.97	1.77	0.50	0.52	0.59	0.87	1.11	1.31
10-year government bonds	2.33	2.53	2.39	3.26	2.49	2.27	1.97	2.25	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	0.23	0.29	0.44	0.33	0.26	0.22	0.22	0.22
2-year government bonds (Germany)	0.13	0.05	-0.20	0.01	-0.01	-0.04	-0.18	-0.21	-0.21	-0.21
10-year government bonds (Germany)	1.62	1.23	0.28	0.78	1.06	0.76	0.35	0.25	0.25	0.28
EXCHANGE RATES										
\$/euro	1.33	1.33	1.08	1.04	1.33	1.25	1.13	1.07	1.06	1.05
¥/euro	129.65	140.42	133.77	130.71	137.68	142.89	134.20	131.92	133.72	135.24
£/euro	0.85	0.81	0.72	0.70	0.79	0.79	0.74	0.72	0.72	0.71
OIL										
Brent (\$/barrel)	108.47	99.45	60.42	78.68	103.38	77.03	55.20	56.68	62.13	67.55
Brent (euros/barrel)	81.67	74.83	56.09	75.84	78.02	61.68	49.00	52.85	58.55	64.43

Notes: 1. Four quarter cumulative. 2. Includes one-off bank restructuring costs.

Forecasts

FINANCIAL OUTLOOK · Steady performance endorsed by improved growth prospects

International markets are consolidating the upward phase started in February. In particular, European stock markets have once again come to the fore on the international financial scene. As happened last month, the continuation of expansionary policies on a global scale together with the increasingly firm pulse of Europe's economy have sustained this favourable dynamic. Regarding the first aspect, of note is the start-up of quantitative easing (QE) by the European Central Bank (ECB) and the Federal Reserve (Fed) repeating that the rate at which it will normalise its monetary policy will be slower than expected. With regard to the second, the fact that expectations concerning monetary actions are helping to improve the euro area's economic sentiment indices is a notable event in itself. However, the current boom in financial markets still has some weak points, the main threat coming from the complex financial situation faced by the Greek government, an as-yet unresolved source of risk. We expect this uncertainty to disappear once an acceptable agreement has been reached for all those concerned.

The Fed removes the word «patient» from its speech but slows up its planned rate of official interest rate hikes.

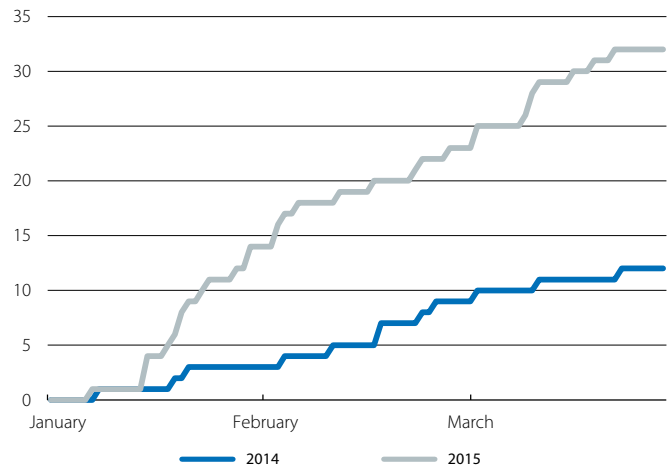
March's meeting of the monetary authority brought about a modification in its forward guidance. As had been expected, the Fed removed the term «patient» and replaced it with the statement that it will be appropriate to raise the target range for the federal funds rate «when it has seen further improvement in the labor market and is reasonably confident that inflation will move back to its 2 percent objective over the medium term». Although this change leaves the door open to a possible interest rate hike in June, the downward revision of forecasts for growth, inflation and the level of the official interest rate for the next three years suggests that the institution will not make a move until after the summer. In this respect, the loss of steam in US activity in the first quarter is in line with a scenario of slow but gradual increases in interest rates.

The ECB starts to buy up sovereign debt in the euro area.

After the March meeting of the ECB's Governing Council, the President, Mario Draghi, provided further details on the euro area's sovereign debt purchase programme. In addition to repeating its commitment to monthly purchases totalling 60 billion euros (among public and agency debt, covered bonds and ABS) up to September 2016, Draghi also announced that purchases would start on 9 March and that bonds with yields below the deposit facility yield (-0.20%) would not be eligible. In the first three weeks of the programme, the ECB acquired 41 billion euros of public debt securities, a figure that is in line with the monthly target set by the institution (close to 45

Interest rate cuts by central banks *

Cumulative for the year to date (number)

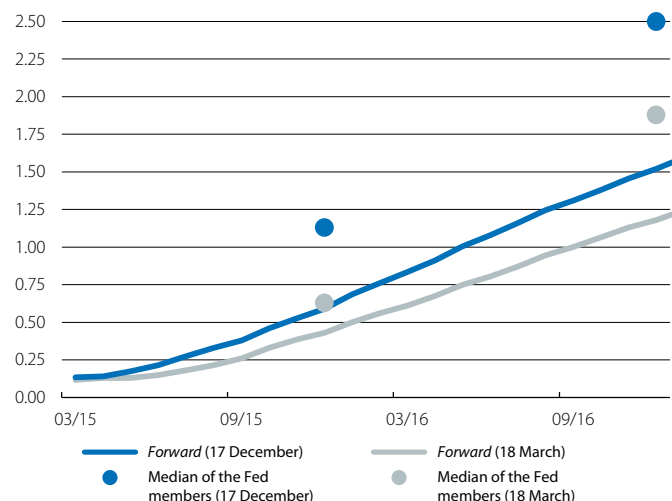


Note: * Made up of a group of 35 central banks.

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

USA: projections for the Fed's official interest rate

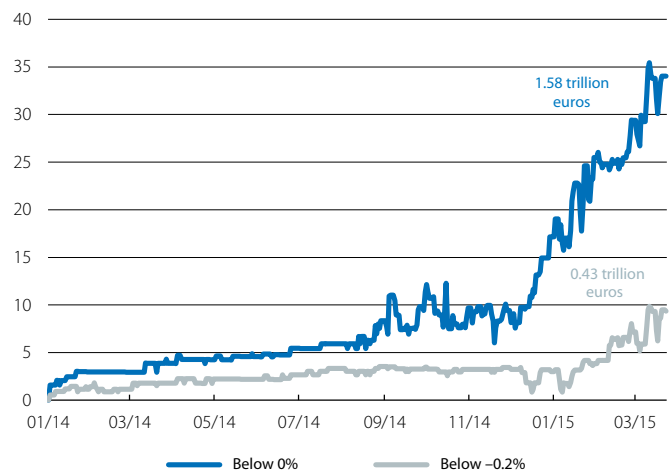
(%)



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

Euro area: bonds with negative yields *

(% of all government bonds between 2 and 30 years)



Note: * Bond value in nominal terms.

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

billion a month). The emergence of a large buyer of bonds such as the ECB has intensified the downward movement of yields on public debt from the euro area. In turn this has led to a sharp increase in the number of bonds with negative yields, up to 1.6 trillion of euros. Approximately 30% of this figure corresponds to German sovereign debt, offering negative yields on maturities of up to the seven years.

At the same time, the ECB also revised upwards its forecasts for growth and inflation. The improved macroeconomic situation suggested by a large number of sentiment indicators notably limits risks regarding the potentially limited supply of bonds in the sovereign market. We believe that, as the recent favourable trend in inflation and growth expectations consolidates, such doubts will start to fade. The signs from monetary and credit aggregates are also encouraging while the good figures posted by requests for funds from banks in the ECB's third TLTRO (98 billion euros) point to a scenario of gradual recovery in the demand for credit.

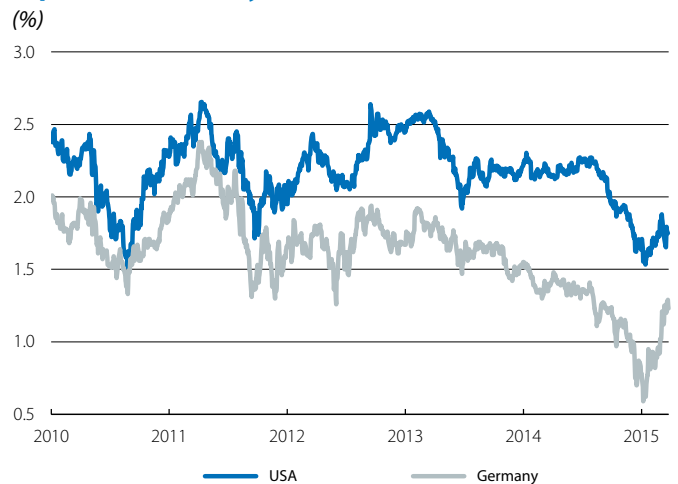
The global expansionary turnaround continues thanks to the emerging economies. The slowdown in developing economies, together with deflationary pressures intensified by low energy prices, have encouraged emerging central banks to turn towards more accommodative policies. Of note is the cut in the official interest rate for loans by China's central bank (to 5.35%) with the aim of keeping its economic slowdown under control. For its part, falling pressure on the rouble has helped Russia to lower its interest rates by 100 bps, down to 14%. However, this strategy will tend to lose ground as the first interest rate hike by the Fed approaches.

The Fed's accommodative tone slows up Treasuries.

The expectation that the institution may postpone its first interest rate hike until after the summer and confirmation that Committee members prefer an environment with lower interest rates pushed down yields on public debt, mainly in the long tranches. The more moderate message regarding growth and inflation pushed the ten-year bond beyond the barrier of 2%. In the medium term, yields on US bonds should recover as debate livens up concerning the normalisation of the reference interest rate and the first signs of recovery in inflation are observed. However, should activity indicators remain sluggish and investment flows arrive in a search for yield (given the effects of Europe's QE), this might delay the upturn in Treasury yields.

The start of QE by the ECB helps to narrow European spreads even further. One of the doubts resulting from the ECB's purchase programme is the possible accentuation of divergences between countries (periphery versus core) and maturities (long versus short tranches). With regard to the former, yields on periphery sovereign debt have also recorded widespread drops, with the ten-year interest rate for Spain and Italy reaching an all-time low in March (1.27% and 1.31%, respectively). However, these picked up slightly in the final part of the month thanks to the improvement in economic

Germany and the United States: inflation expectations at 10 years *

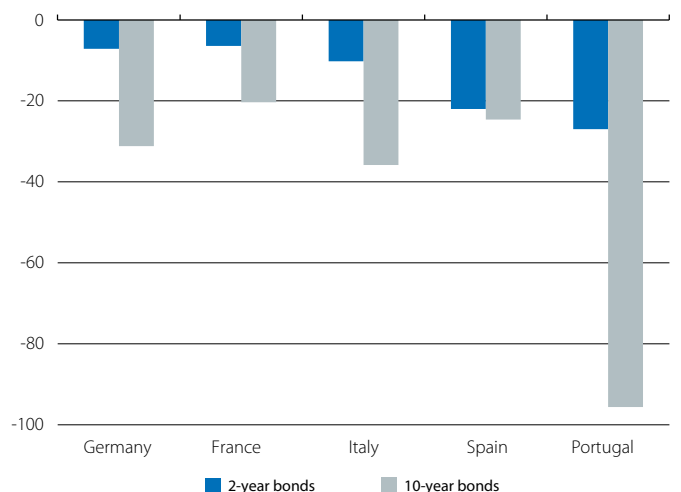


Note: * Implicit in inflation-linked bonds.

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

Euro area: yield on public debt

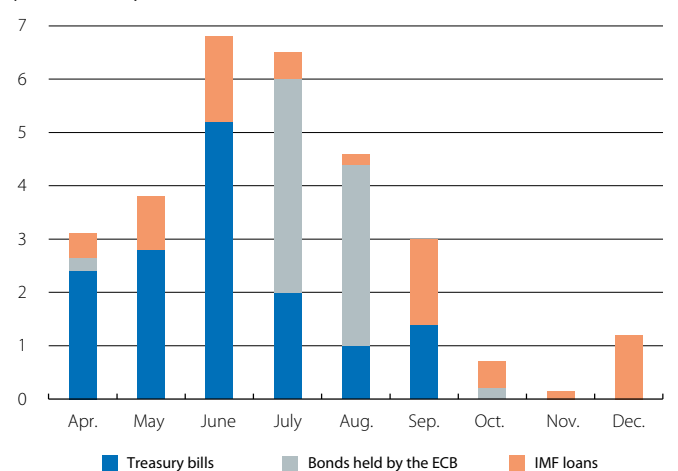
Change between 21 January and 25 March 2015 (bps)



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

Greece: maturities for public sector debt in 2015

(Billion euros)



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

indicators and renewed doubts concerning the Greek problem. Lack of agreement in negotiations on the reforms that Athens must implement is keeping Greek debt under pressure. Given the complex liquidity situation of Greek banking, and with many of its government bonds maturing in the very near future, there is little room to manoeuvre to secure a definitive agreement.

European stock markets are benefiting from a tail wind.

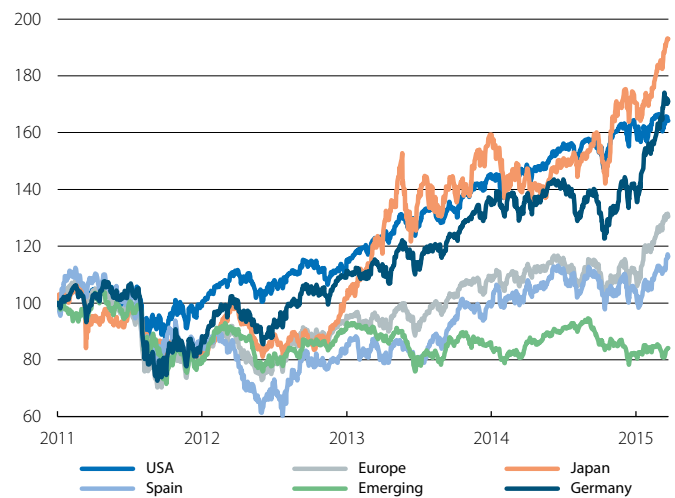
After a somewhat hesitant start to the year, the upward trend in the main stock markets consolidated in March. This context of greater risk appetite has been particularly beneficial for European shares whose gains have been supported by three factors: the start of QE by the ECB, the improved economic outlook for the region and the boost provided for exports thanks to the euro's depreciation. The performance of US stock market indices has been more tenuous, however. Although the Fed's more prudent message regarding interest rate hikes has boosted the market for shares, the strength of the dollar has led to doubts concerning future trends in corporate earnings. Given this situation, the European stock markets are likely to continue performing better than the US stock market. However, this depends on the European economy remaining firm and on a favourable resolution of the Greek issue.

Corporate bond spreads pick up after QE starts in the euro area. Unlike the good performance by Europe's public debt, a less favourable trend has been observed in corporate bond markets. The rise in risk premia for this kind of asset can largely be attributed to the sharp increase in the volumes of debt issued over the last few weeks. Nonetheless, we believe this is only temporary and does not represent a sustained period of deterioration. One aspect that is worth noting in the private debt market is the increase in euro-denominated debt by US issuers (see the Focus «Debt issuances in foreign currencies: the euro comes to the fore»).

Greater instability in the foreign exchange market. The start of sovereign QE has led to a larger depreciation in the euro than expected, its value against the dollar falling to the lowest in 12 years (1.049 dollars). However, this trend switched after the conclusions of the FOMC, helping the dollar to drop against a basket of the main currencies. In the emerging bloc, the adoption of expansionary strategies is increasing tension on their currencies. Of note is the case of the Turkish lira, depreciating by almost 10% against the dollar for the year to date.

Main international stock markets

Index (January 2011 = 100)



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

Spreads of speculative-grade corporate bonds *

(bps)

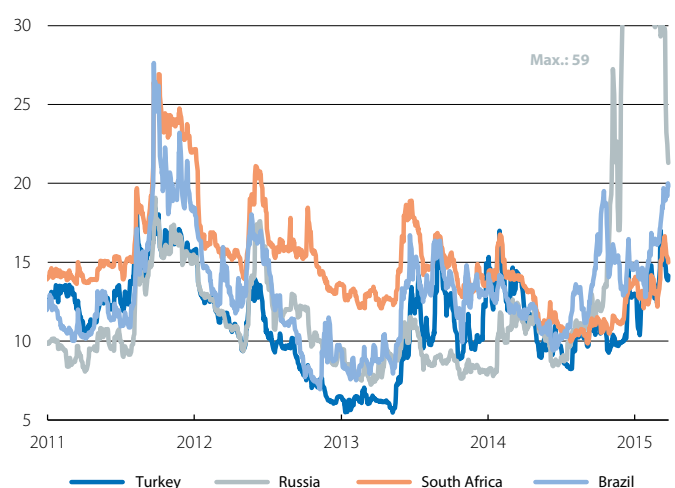


Note: * Gap compared with a basket of government bonds.

Source: "la Caixa" Research, based on data from the Bank of America Merrill Lynch.

Implied volatility of emerging currencies

(%)



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

FOCUS · The breadth of the euro area's sovereign market, a matter for debate

March saw the start of the quantitative easing programme by the European Central Bank (ECB). Its success in stimulating the economy will largely depend on its impact on financial markets and in particular on the sovereign debt market. In this respect, the early signs are promising: yield on government bonds continues to fall to all-time lows at the same time as inflation expectations have started to rise. However, some are concerned that the ECB might find it difficult to buy the volumes of debt announced due to limited supply. A detailed analysis of the factors that might restrict supply throws some light on this issue.

Acquisitions of public debt as part of the QE programme will come to almost 0.8 trillion euros; in other words, almost 14% of all sovereign bonds with maturities between 2 and 30 years. At first sight, this ratio does not seem to suggest the supply of bonds will be an obstacle to implementing QE. On the one hand, it is lower than the ratio observed in other countries with similar programmes (purchases in the US accounted for 17% of all eligible bonds) while it is also sufficiently far from the purchase limits set by the ECB. Specifically, debt acquisitions cannot exceed 25% of the issuance of a specific bond or 33% of all assets with maturities between 2 and 30 years from the same issuer.¹

This margin provided by the large stock of European public debt counters some doubts expressed regarding QE's ability to meet its purchase targets. One of these is the relative small net issuance of public debt planned in the euro area for 2015. Specifically, the nominal value of new bonds issued by euro area Treasuries this year (discounting maturing debt) represents 33% of the total purchases planned by the QE, a smaller percentage than that in the US or in the UK during their respective programmes. Similarly, the possible reticence of some holders of public debt (such as banks or pension funds) to reduce their investments in public debt, although they may be important in determining the trend in bond yields, is not expected to be critical either.

Another restriction that could limit the supply of sovereign bonds is the exclusion from eligible bonds of those whose yield is below that of the ECB's deposit facility (currently -0.2%). Taking data from mid-March as our reference, around 10% of the euro area's public

debt with maturities between 2 and 30 years falls below this threshold.

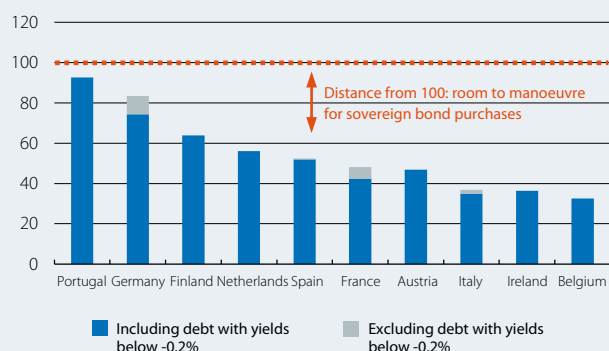
The graph highlights the scope of this new restriction. The countries most affected are France and Germany where, in mid-March, 14% of the government bonds issued with maturities between 2 and 30 years had yields below -0.2% . As can be observed, excluding these bonds from the range of eligible assets, purchases of German bonds (established by the QE according to the capital provided by each country to the ECB's balance sheet) would go from 74% to 83% of the purchase limit (from 43% to 48% in the case of France). Although further falls in sovereign yields would amplify this impact, the large stock of eligible debt observed in most countries provides enough room to manoeuvre.

In fact, only in Portugal are bond purchases close to their corresponding limit.

In short, the euro area's government bond market is broad enough to meet the target of QE purchases. However, the need to extend this programme beyond September 2016 or even the use of other public debt purchase programmes by the ECB such as OMTs (outright monetary transactions), designed to reduce excessive pressure on debt markets, could call this statement into question. That is why the best way to dispel doubts regarding QE is to ensure that its monetary stimulus is effectively passed on to the real economy.

QE public debt purchases for each country

(% of maximum purchases permitted)*



Note: * Takes into account the estimated value of net debt issuances made throughout QE.
Source: "la Caixa" Research, based on Bloomberg data.

1. The 25% limit represents the maximum level of debt a holder may have without blocking debt restructuring. The 33% limit is placed on purchases of all debt issued by one country to minimise any effect on price formation in the markets.

FOCUS · Debt issuances in foreign currencies: the euro comes to the fore

In the first two months of the year, US companies issued debt in euros totalling 33 billion dollars, a figure that breaks all records for this variable and particularly noteworthy when we realise that the total volume in 2014 was 50 billion for the whole of the year. But this rise in issuances of euro-denominated bonds is not limited to US companies; a growing appetite can also be seen in countries such as China and India for debt in the European currency. Several different factors, some cyclical and others structural, lie behind this increased presence of the euro in foreign currency bond markets, suggesting that it might not be temporary.

Of note among the cyclical aspects is the start-up of the large-scale public debt purchase programme in the euro area (quantitative easing). Firstly because it will help to prolong, for a long period, the scenario of very low interest rates and large amount of liquidity in the region. Secondly because of the perception that the euro will remain weak against the dollar and most international currencies. Both circumstances make it more attractive for agents not resident in the euro area to issue bonds in euros. Seen from a different perspective, the gradual tightening up of monetary conditions in the US and the dollar's appreciation are also encouraging issuers to use the euro as the currency for debt. Nevertheless, the dollar's predominance in foreign currency debt issuances is still indisputable. According to the latest data produced by the BIS, at the end of 2013 the outstanding balance of foreign currency debt in dollars amounted to 6.8 trillion dollars, 55% of the total. This percentage falls to 25.3% in the case of euro-denominated debt securities and to 4.9% in the case of the yen.

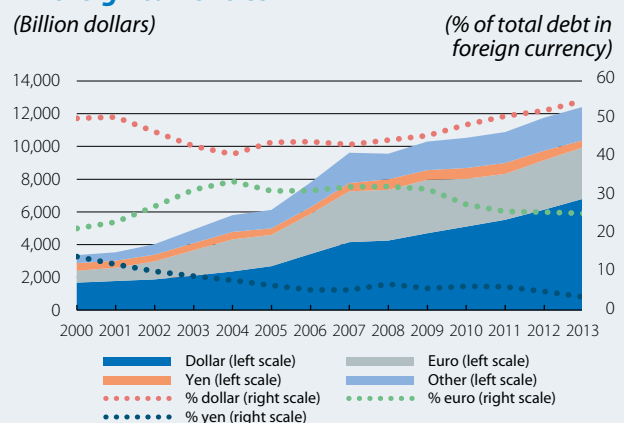
At the same time, some structural factors are also playing an important role. The dollar's predominance over the last few years was accentuated by investors' uncertainty regarding the euro due to the outbreak of the sovereign debt and institutional crisis in the euro area. However, resolving the large degree of financial fragmentation between euro area countries and notable advances in governance of the Union are leading to increased investor confidence in the single currency. This will also be helped by the developments observed in the European corporate bond market in terms of size and liquidity, albeit still at some considerable distance from the standards of the US market.

One necessary condition for the euro to be used even more widely in international debt markets is for emerging countries to increase their issuances in this currency. The difficulties faced by emerging countries

in accessing international markets using their own currencies means that foreign currency debt securities are the usual choice among the few available to obtain financing. The data provided by the European Central Bank are revealing in this respect: in 2013, 60% of all emerging sovereign debt issuances were denominated in foreign currencies. The gradual incorporation of an increasingly larger number of states and companies from the emerging bloc should therefore be decisive in developing a broad, deep market of international bonds denominated in euros.

In short, although the euro is far from ousting the dollar as the benchmark currency, current conditions in the global environment are helping it to become more important as a debt currency. Nonetheless, the consolidation of this trend will ultimately depend on the institutional strength and stability of Europe's economic and monetary union.

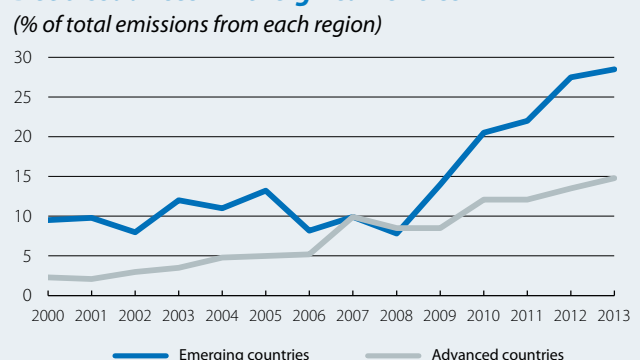
Outstanding balance of debt denominated in foreign currencies



Note: * Data refer to issuances in a currency other than that of the issuer's country of residence.

Source: "la Caixa" Research, based on data from the ECB and the BIS.

Debt issuances in foreign currencies



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

KEY INDICATORS

Interest rates (%)

	31-Mar	27-Feb	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	0.02	0.04	-2	-6	-29
1-year Euribor	0.20	0.23	-3	-13	-39
1-year government bonds (Germany)	-0.21	-0.19	-2	-15	-36
2-year government bonds (Germany)	-0.25	-0.23	-2	-15	-41
10-year government bonds (Germany)	0.18	0.33	-15	-36	-139
10-year government bonds (Spain)	1.21	1.26	-5	-40	-202
10-year spread (bps) ¹	103	93	10	-4	-63
USA					
Fed funds	0.25	0.25	0	0	0
3-month Libor	0.27	0.26	1	2	4
12-month Libor	0.69	0.68	1	6	13
1-year government bonds	0.23	0.19	4	2	12
2-year government bonds	0.56	0.62	-6	-10	14
10-year government bonds	1.92	1.99	-7	-25	-80

Spreads corporate bonds (bps)

	31-Mar	27-Feb	Monthly change (bps)	Year-to-date (bps)	Year-on-year change (bps)
Itraxx Corporate	56	50	6	-7	-20
Itraxx Financials Senior	66	54	12	-1	-27
Itraxx Subordinated Financials	135	122	13	-14	-4

Exchange rates

	31-Mar	27-Feb	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
\$/euro	1.073	1.120	-4.2	-11.3	-22.1
¥/euro	128.910	133.940	-3.8	-11.0	-9.3
£/euro	0.724	0.725	-0.1	-6.7	-12.4
¥/\$	120.130	119.630	0.4	0.3	16.4

Commodities

	31-Mar	27-Feb	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	415.0	420.9	-1.4	-5.2	-15.9
Brent (\$/barrel)	53.3	61.8	-13.7	-4.3	-50.1
Gold (\$/ounce)	1,183.7	1,213.2	-2.4	-0.1	-7.8

Equity

	31-Mar	27-Feb	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	2,067.9	2,104.5	-1.7	0.4	10.4
Eurostoxx 50 (euro area)	3,697.4	3,599.0	2.7	17.5	16.9
Ibex 35 (Spain)	11,521.1	11,178.3	3.1	12.1	11.4
Nikkei 225 (Japan)	19,207.0	18,797.9	2.2	17.9	29.5
MSCI Emerging	974.6	990.3	-1.6	1.9	-2.0
Nasdaq (USA)	4,900.9	4,963.5	-1.3	3.5	16.7

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

ECONOMIC OUTLOOK · Favourable prospects but with downside risks

Thanks to the expansionary effects of cheaper oil and more accommodative monetary policy, the world economy is speeding up its rate of activity at the beginning of 2015 (we estimate 3.4% global growth in Q1 compared with 3.3% in 2014 Q4). Nonetheless, this recovery is far from uniform: the United States and China are leading growth in spite of a recent slowdown, while Japan has barely started to move away from recession. With regard to other important emerging countries, Brazil's difficulties are taking over from the problems of Russia as the main source of tension.

UNITED STATES

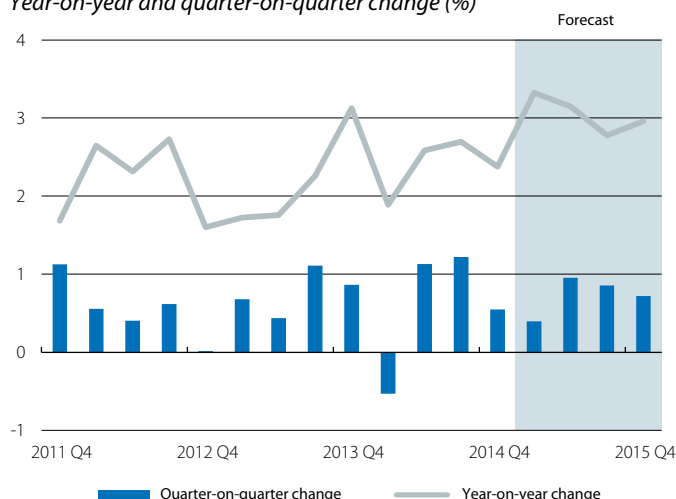
The US ends 2014 and starts 2015 slightly worse than expected. Definitive GDP figures for 2014 Q4 show 0.5% growth quarter-on-quarter, lower than the 0.7% initially published (although the annual figure remains at 2.4%). Some activity indicators have also provided slightly disappointing figures at the start of 2015, particularly in the area of household spending. This temporary bad patch, partly linked to adverse weather and the notably strong dollar damaging US exports, justifies our downward revision of growth for 2015 from 3.5% to 3.1%.

In spite of this temporary weakening, the underlying trends still point to a more than acceptable recovery as the 3.1% growth achieved is the best figure since 2005, clearly above the country's potential growth which the Federal Reserve (Fed) estimates at 2.3%. This good outlook depends on a number of positive trends continuing. In spite of the ups and downs in consumption variables in January and February, household spending continues to be supported by the favourable trend in the labour market, especially in terms of job creation: 295,000 jobs were created in February, accumulating 12 consecutive months of figures above 200,000. That same month unemployment stood at 5.5%, the lowest since May 2008. In spite of this improvement in labour, wage rises, at 2.0% year-on-year in February, are still subdued.

Corporate investment, the upswing in the real estate market and fiscal policy will all help to boost growth in 2015. Corporate investment, which had already recovered appreciably in 2014, will continue to advance at a significant rate thanks to the combination of relatively accommodative financial conditions, high earnings (although they are very likely to be more contained than the figures posted a few months ago due to the impact of the strong dollar) and good prospects for demand. This predicted path for investment is further confirmed by the trend in the ISM business sentiment indices which have remained at levels associated with expansion in activity, in both manufacturing and services. The underlying data for prices and transactions also suggest the upturn in the real estate market is continuing, in spite of

USA: GDP

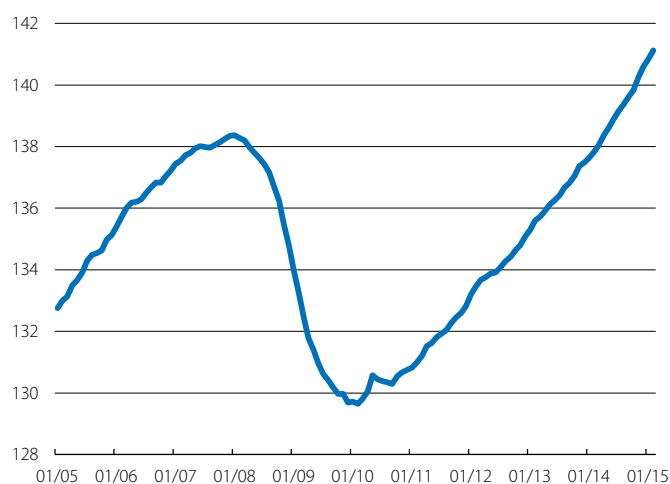
Year-on-year and quarter-on-quarter change (%)



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

USA: number of employees

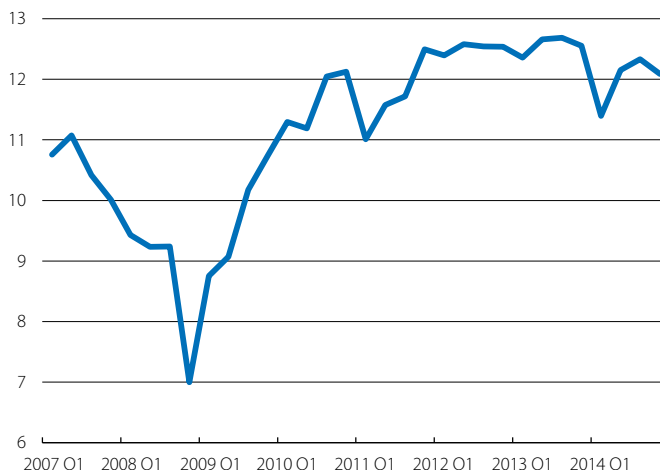
(Millions)



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

USA: corporate earnings

(% of GDP)



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

the bad weather having a negative effect on its indices. Lastly, in 2015 fiscal policy will be somewhere between neutral and expansionary, unlike in previous years.

Inflation is still surprisingly lethargic. Although inflation rose by 0.1 pps in February, it stood at a moderate 0.0% year-on-year. Nonetheless, core inflation (without energy or food) posted a more dynamic increase (1.7%). Given this situation of little inflationary risk (we should note that wages continue to appear contained), we still expect the Fed to wait until autumn to start raising the reference interest rate.

JAPAN

Japan is growing less than announced but with a better composition. Growth in 2014 Q4 was revised downwards from 0.6% quarter-on-quarter initially published to 0.4%, so GDP has fallen by 0.1 pps for the year as a whole. However, the breakdown in growth is more favourable as private consumption has been revised upwards and a large part of the downward revision is concentrated in the accumulation of stock. This good composition, together with the full implementation of monetary and fiscal stimuli underway and the favourable trend expected in wages (an agreement has been adopted to increase the basic wage by 2.5% in 2015, which will help to boost domestic demand), means we have kept our growth forecast for the Japanese economy in 2015 at 0.8%.

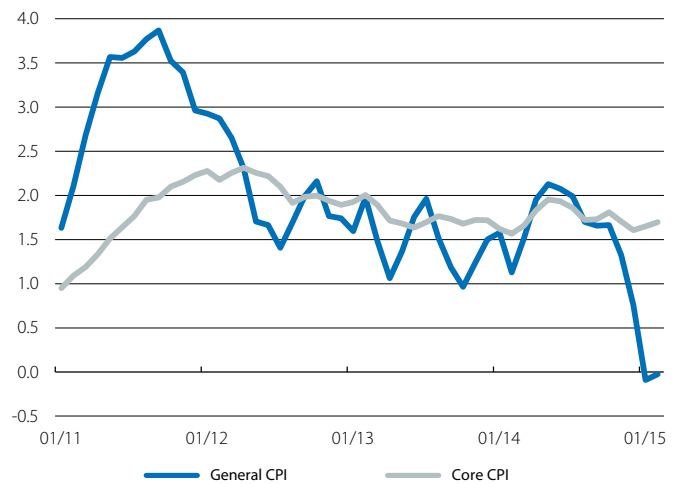
A mixture of good (the foreign sector) and bad (inflation) at the start of 2015. Although the trade deficit increased in February, this was due to the negative effect on exports of the Chinese New Year. Without this impact, exports would have grown by 6.9% year-on-year compared with the actual figure posted of 2.8%. Similarly, the underlying balance of trade (discounting oil purchases) for the last 12 months stood at 0.9% of GDP. The low inflation rate, however, is far from the target set by the Bank of Japan (BoJ). In February the CPI without foods and discounting the effect of the VAT hike stood at 0.0% year-on-year, very far from the central bank's target of 2%. Without deducting the VAT effect, the resulting figure is 2.0%. The general CPI shows a similar trend: 2.2% year-on-year (0.1% without VAT).

EMERGING ECONOMIES

A hard landing in China and the fragile five. Two crucial questions are grabbing the attention regarding the emerging economies: the possibility of a hard landing in China and the situation of the so-called «fragile five». With regard to the current situation for China, the downside risks have increased. This worsening in the balance of risks has essentially been caused by a battery of figures (industrial production, retail and consumer goods and electricity production) that suggest domestic demand might be adjusting its rate of growth. There has been an appreciable improvement in the foreign sector, however, thanks to the combination of more vigorous exports and a drop in imports (partly due to the lower commodities

USA: CPI

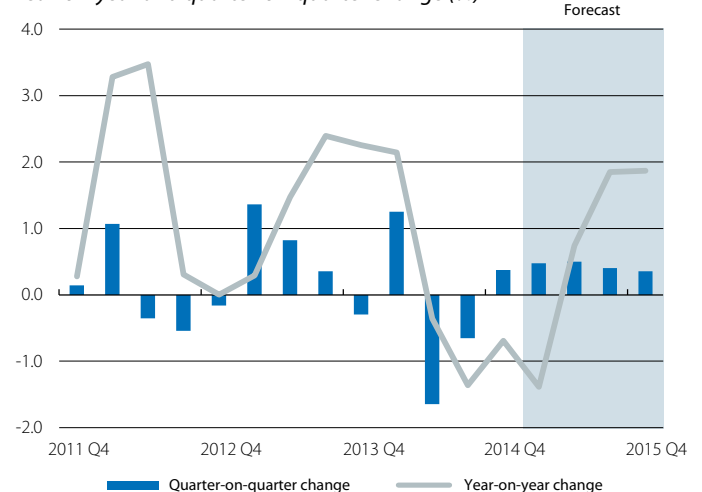
Year-on-year change (%)



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

Japan: GDP

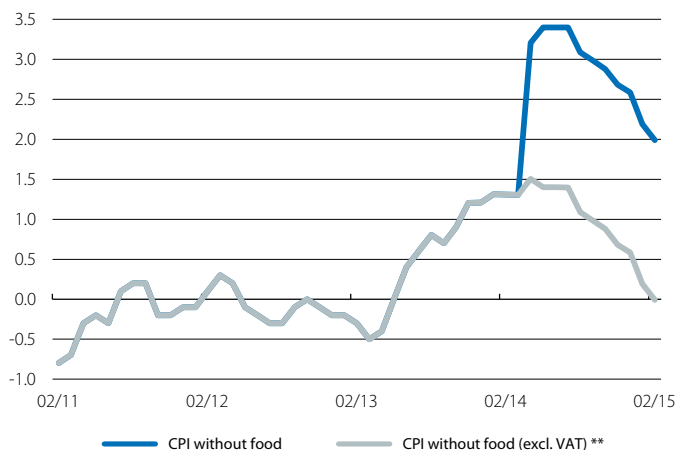
Year-on-year and quarter-on-quarter change (%)



Source: "la Caixa" Research, based on data from the Ministry of the Interior and of Communication.

Japan: CPI without food *

Year-on-year change (%)



Notes: * CPI without fresh food (but with energy). BoJ benchmark.

** Does not include the impact of the VAT hike from 5% to 8% in April 2014.

Source: "la Caixa" Research, based on data from the Ministry of the Interior and of Communication.

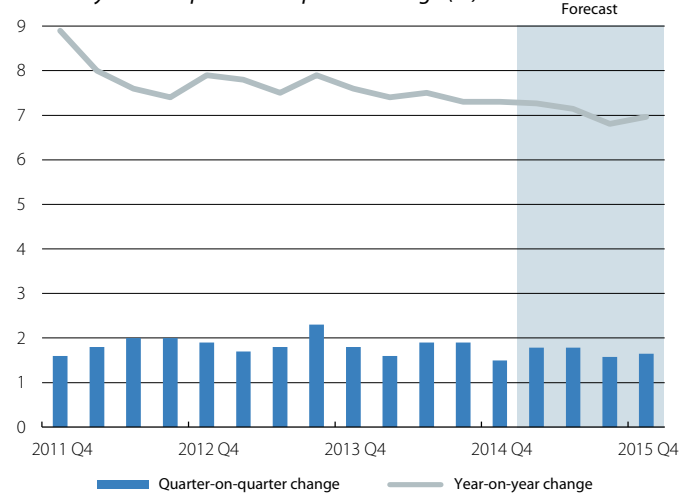
bill). In spite of the country's domestic weakness, the government still has considerable margin to implement accommodative economic policies. Last November the People's Bank of China started to lower the official interest rate, which has gradually gone from 6.00% to 5.35%. This is logical given that inflation is still within a zone of minimal tension: even after a higher upswing than expected in February, the CPI is growing at a moderate rate of 1.4% year-on-year. Measures have also been taken in the last few months to boost investment in infrastructures and the real estate sector. All this points to economic policy attempting to bring growth gradually in line with the new annual target set by China's National Assembly (7.0%).

India takes advantage of the opportunity provided by the improvement of its macroeconomic imbalances. In 2013 the expression «fragile five» was coined to identify those emerging economies whose imbalances (fiscal, inflation and current account) implied a weakness when moving from an international environment of low interest rates and ample liquidity to another, more restrictive environment in monetary terms. Two years later, when the Fed's future actions are now approaching this tighter environment, some of these fragile five have tended to noticeably improve their vulnerabilities. This is the case of India, which has simultaneously managed to improve its public deficit, current account and inflation since 2013 (the trend in prices has helped the central bank to lower its reference rate by 0.5 pps for the year to date). However, other emerging economies such as Turkey and particularly Brazil are still under financial pressure: their currencies are two of the ones depreciating the most against the dollar since January.

Brazil as an exponent of the new emerging risks. The case of Brazil is quite paradigmatic of the doubts surrounding these countries. The loss in value of the Brazilian real has been due to a combination of three factors: less intervention by the central bank to bolster the Brazilian currency, a deterioration in activity (GDP fell by 0.2% year-on-year in 2014 Q4 and we expect it to deteriorate further in the coming quarters) and the uncertainty surrounding the capacity of the new government to implement more rigorous fiscal policies. But, beyond all these factors, what is perhaps damaging the country is the persistence of an imbalanced macroeconomic framework. It is estimated that both the public deficit and the current deficit will have reached the zone of 4% of GDP in 2014 while inflation, the most worrying of these imbalances, climbed to 7.7% year-on-year in February. For its part Turkey continues to have problems in controlling its inflation and its current deficit is still high. And although it is going to benefit from faster growth in the coming months, largely thanks to cheaper oil, it is still vulnerable to investors' reactions to the Fed's interest rate hike and conflict in the region. Given this situation, the Turkish economy grew by 2.6% in 2014 Q4, more than the previous quarter (1.9%) but bringing annual growth for 2014 at 2.9%, lower than the figure of 4.2% achieved in 2013.

China: GDP

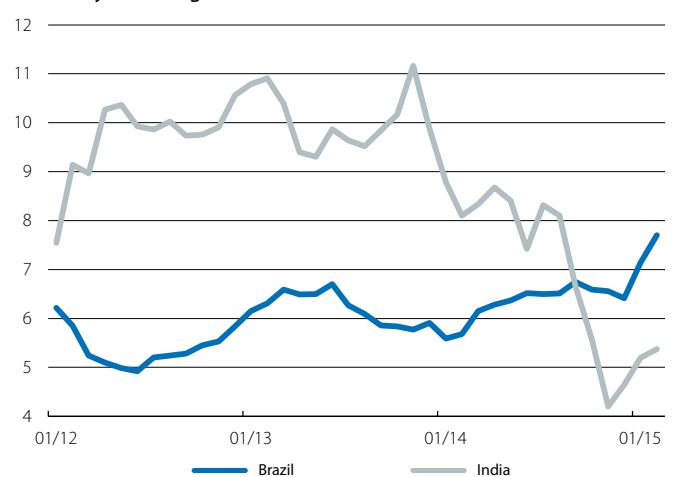
Year-on-year and quarter-on-quarter change (%)



Source: "la Caixa" Research, based on data from the National Statistics Office of China.

Emerging countries: CPI

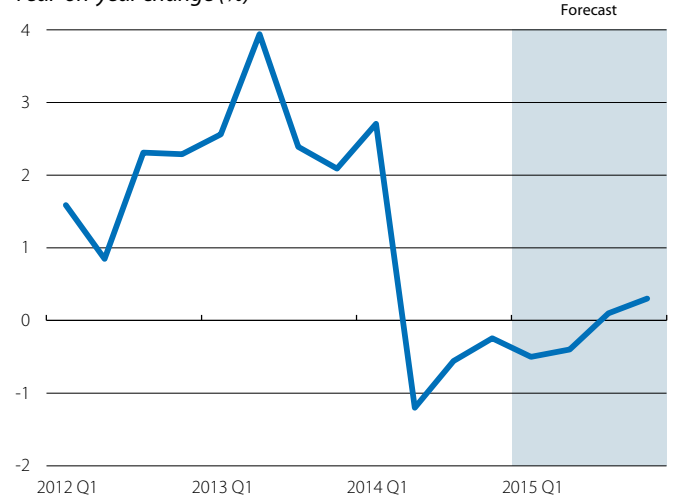
Year-on-year change (%)



Source: "la Caixa" Research, based on data from the Brazilian Institute of Geography and Statistics and from the Ministry of Statistics and Programme Implementation (MOSPI).

Brazil: GDP

Year-on-year change (%)



Source: "la Caixa" Research, based on data from the Brazilian Institute of Geography and Statistics.

FOCUS · Growth in the US breaks free from the dollar

Since the middle of last year, the dollar has appreciated by around 10% compared with a broad basket of currencies (see the first graph).¹ A large part of its strength comes from monetary policy that is comparatively more restrictive in the US than in other regions in the world given the United States' better growth prospects. Nevertheless, this strong appreciation of the dollar has aroused some concern regarding its potentially harmful effect on US exports and consequently on economic growth.

In the medium term, an appreciation in the exchange rate leads to a decrease in exports (because they are less attractive in price terms) and to an increase in imports (for the opposite reason), in turn reducing GDP growth. For example, according to the FRB/US general equilibrium model employed by the Federal Reserve (Fed) for forecasting and the analysis of macroeconomic issues a 10% appreciation in the dollar cuts growth by 0.5 pps after four quarters and by 0.75 pps after the second year.

Although the model used by the Fed is sound, it is notable that members of its own Federal Open Market Committee (FOMC) have recently stressed they expect the effect of the exchange rate on GDP growth to be less than on previous occasions. A variety of factors could lead to the dollar having less impact on economic growth. These include the change in the country's type of exports, which are technologically more advanced and therefore less sensitive to price changes, for example; or exports that are more thoroughly integrated within global value chains and therefore less affected by the dollar's appreciation thanks to imports of cheaper intermediate inputs.

Whatever the reason, a simple exercise confirms that the view of the FOMC members is well-founded and that, in fact, this change in the sensitivity of exports to the exchange rate seems to be considerable in quantitative terms. This can be seen in the second graph which relates the change in exports of goods and services with the change in the exchange rate over two different time periods: 2011-2014 and 1970-2010. To estimate this relationship, other key factors affecting the trend in exports are also taken into account, such as global demand (via GDP growth in OECD countries). As can be observed, not only have exports become less sensitive to the exchange rate but their sensitivity has almost halved.²

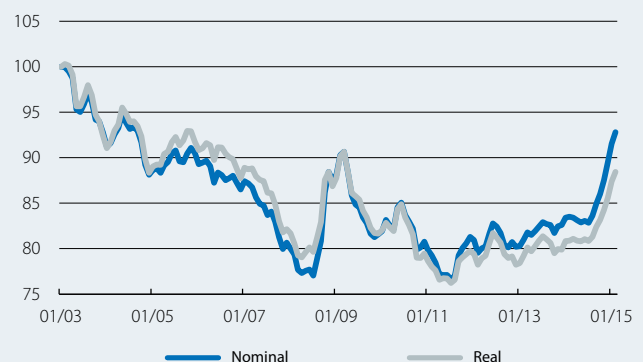
1. According to BIS data, in nominal effective terms there has been an appreciation of between 11% and 14%, depending on whether a more or less extensive basket of currencies is used, respectively. In real effective terms (i.e. controlling inflation differences in various countries), it has appreciated by almost 10%.

2. The change in sensitivity of exports to the exchange rate is statistically significant.

In short, although the dollar's appreciation is due to a relatively more restrictive monetary policy, it also reflects the greater advances in economic activity and better prospects for the US than other regions such as Japan and the euro area. Although the loss of competitiveness resulting from such an appreciation reduces growth in the medium term, the recent decrease in the sensitivity of US exports to its exchange rate will lessen this effect on the economy.

USA: exchange rate *

Index (January 2003 = 100)

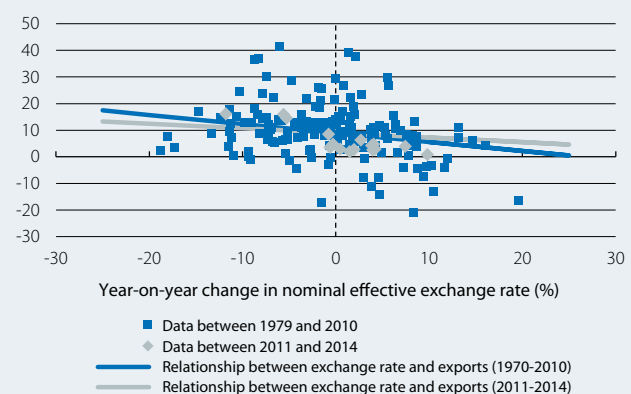


Note: * The nominal rate corresponds to the nominal effective exchange rate constructed using a broad basket of currencies weighted according to US trade flows. The real rate corresponds to the real effective exchange rate using the CPI as deflator.

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

USA: exports and exchange rate

Year-on-year change in nominal exports (%)



Note: Nominal exports of goods and services. The gradient of the lines indicates the relationship between the change in the nominal effective exchange rate and exports taking into account global demand and past variations in exports. The relationship between both variables in real terms is similar.

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

FOCUS · Oil stocks and their effects on the price

At the end of February, oil saw its first monthly price rise since the start of its downward spiral in June 2014. However, although this upswing was notable, it was soon halted by another drop, proof that the oil market is still going through a highly volatile period. The trend in US oil stocks, at their highest level for the last 80 years, is also an indication of the exceptional nature of the current situation.

In a low-price environment (largely due to excess supply) with expectations of price increases in the future, some producers prefer to store part of their crude oil and wait for prices to rise before putting their stocks on the market. Consequently, today's abundant supply of oil has resulted in a significant accumulation of stock in most OECD countries, with the International Energy Agency estimating that stocks will be at an all-time high in OECD countries by mid-2015. However, as these stocks increase, so do storage costs as the cheaper storage facilities fill up, reducing the economic incentive to continue accumulating reserves. This smaller return could encourage some of the supply previously allocated to storage pending price rises to come onto the market, which would push down prices.

One notable fact within the current context of stock accumulation has been the larger amount of stocks amassed by the US compared with the rest of the OECD regions. The market's reaction to this sharper rise in US stocks has been swift. The spread between the Brent price and its US counterpart, West Texas Intermediate (WTI), has once again widened (see the second graph). While in 2014 the Brent price was 6.5 dollars above the WTI price on average, since mid-February the spread has been around 10 dollars.

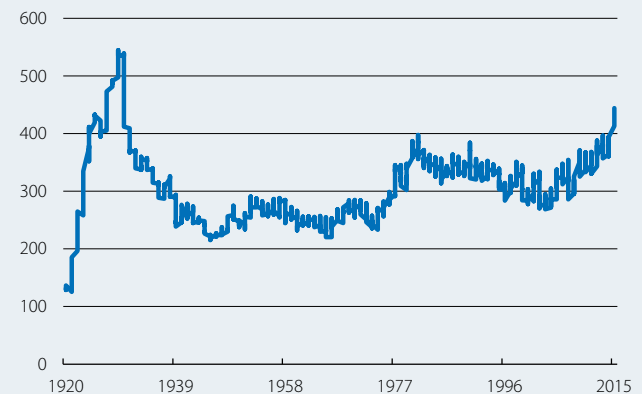
A combination of different factors explain this larger accumulation of stock in the US, one of the main ones being the slow adjustment of US crude production. Although investment in the sector has dropped off sharply in recent months, production, which seems to have more inertia than expected, has continued to increase and is now at its highest level since the 1970s. Another factor also pushing up crude stocks is the fact that the country's oil refining capacity has been temporarily interrupted. It should be noted that US petrol firms cannot export crude (but can export refined products), a restriction that dates back to 1973 when the country was affected by an embargo imposed by numerous oil-exporting countries in retaliation for the US supporting Israel in the Yom Kippur war. Two circumstances lie behind this current interruption in oil refinement. Firstly, the maintenance that most US refineries carry out at the beginning of each year (this

takes place in the second quarter in the rest of the OECD regions). Secondly, the biggest strike seen by US refineries in 35 years, affecting 12 refineries responsible for 15% of the country's oil refining capacity.

In short, the sharp increase in stocks is leading to doubts regarding the trend in oil prices in the short term. That is why we must be cautious in stating that the market has bottomed out and the possibility of further drops in price cannot be ruled out. Nonetheless, it is true that, in the medium term, the readjustment in the supply due to lower investment in the oil industry should help prices to recover.

USA: Crude oil stocks *

(Million barrels)



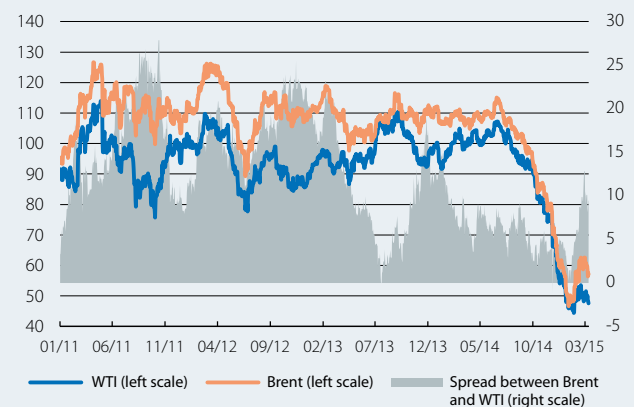
Note: * Excluding strategic oil reserves.

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

Oil prices *

(\$/barrel)

(\$/barrel)



Note: * Benchmark oil price in the European market (Brent) and in the US (WTI).

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

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	03/15
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	4.5	...
Consumer confidence (value)	73.2	86.9	80.5	83.4	90.9	92.7	103.8	98.8	101.3
Industrial production	2.9	4.2	3.3	4.2	4.6	4.5	4.4	3.5	...
Manufacturing activity index (ISM) (value)	53.8	55.7	53.5	55.5	56.9	56.9	53.5	52.9	...
Housing starts (thousands)	930	1,001	925	985	1,030	1,063	1,081	897	...
Case-Shiller home price index (value)	158	171	169	171	170	173	176	...	...
Unemployment rate (% lab. force)	7.4	6.2	6.6	6.2	6.1	5.7	5.7	5.5	...
Employment-population ratio (% pop. > 16 years)	58.6	59.0	58.9	58.9	59.0	59.2	59.3	59.3	...
Trade balance ¹ (% GDP)	–2.8	–2.9	–2.8	–2.9	–2.8	–2.9	–3.9	...	...
Prices									
Consumer prices	1.5	1.6	1.4	2.1	1.8	1.2	–0.1	0.0	...
Core consumer prices	1.8	1.7	1.6	1.9	1.8	1.7	1.6	1.7	...

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	02/15
Activity								
Real GDP	1.6	–0.1	2.1	–0.4	–1.4	–0.7	–	...
Consumer confidence (value)	43.6	39.3	38.8	39.1	40.9	38.5	39.1	40.7
Industrial production	–0.6	2.1	8.3	2.6	–1.1	–1.2	–1.4	–2.6
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	3.5
Trade balance ¹ (% GDP)	–2.4	–2.6	–2.8	–2.9	–2.9	–2.6	–2.3	–2.2
Prices								
Consumer prices	0.4	2.7	1.5	3.6	3.3	2.5	2.4	2.2
Core consumer prices	–0.2	1.8	0.6	2.3	2.3	2.1	2.0	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	02/15
Activity								
Real GDP	7.7	7.4	7.4	7.5	7.3	7.3	–	...
Retail sales	13.1	10.3	13.8	12.3	11.9	11.7	10.7	10.7
Industrial production	9.7	8.3	8.7	8.9	8.0	7.6	6.8	6.8
PMI manufacturing (value)	50.8	50.7	50.3	50.7	51.3	50.4	49.8	49.9
Foreign sector								
Trade balance ¹ (value)	258	381	233	253	321	381	409	492
Exports	7.8	6.1	–3.4	5.0	13.0	8.6	–3.3	48.3
Imports	7.3	0.5	1.5	1.4	1.1	–1.7	–19.9	–20.5
Prices								
Consumer prices	2.6	2.0	2.3	2.2	2.0	1.5	0.8	1.4
Official interest rate ² (value)	6.00	5.60	6.00	6.00	6.00	5.60	5.60	5.60
Renminbi per dollar (value)	6.1	6.2	6.1	6.2	6.2	6.1	6.2	6.3

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 · Better short-term prospects, long-term challenges

The breakdown of GDP for Q4 shows an improvement in the euro area's growth rate. GDP grew by 0.3% quarter-on-quarter with a positive contribution from household consumption (0.1 pps), investment (0.2 pps) and the foreign sector (0.2 pps). Public expenditure contributed zero and inventory changes deducted 0.2 pps from domestic demand. Of note is the good performance by investment, up by 0.4% quarter-on-quarter after spending the last two quarters in negative terrain, as well as the positive trend in exports, boosted by the euro's depreciation. By country, the disparity in growth rates is reflected in the breakdown of GDP for the two largest economies in the euro area: while Germany grew by 0.7% quarter-on-quarter with very good figures for investment and private consumption, France grew by just 0.1%, supported only by public expenditure and with negative investment.

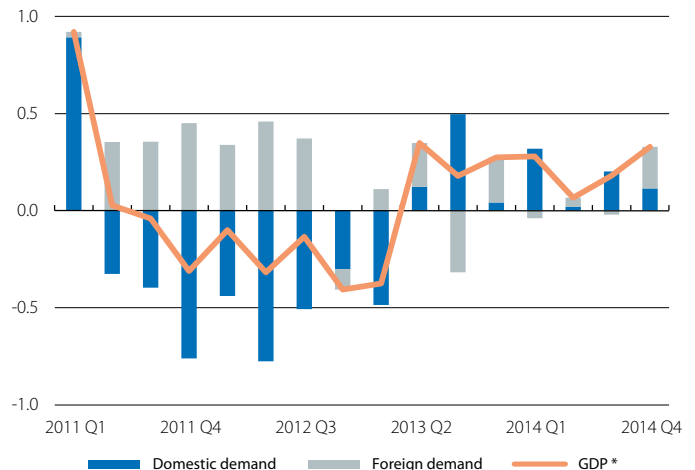
The OECD improves its GDP growth outlook for the euro area to 1.4% in 2015 and 2.0% in 2016, 0.3 pps above its November forecasts. The international organisation revised upwards its growth figures for the main countries especially because of the positive effects of falling oil prices and the expansionary monetary policy of the European Central Bank (ECB). It notes, however, that both factors are temporary, warning that, in order to sustain such growth in the long-term, temporary supports must be accompanied by structural reforms. By country, Germany's revision is particularly significant (+0.6 pps) up to 1.7% in 2015, due to the solidity of its growth in the last quarter and to the boost provided by the aforementioned temporary factors.

Business indicators suggest the recovery speeded up in 2015 Q1. The composite PMI for the euro area saw its highest level for the last four years, reaching 54.1 points in March thanks particularly to good figures from the services sector. The economic sentiment index also maintained a clearly upward trend. The maximum exponent of this positive tone is Germany where both the composite PMI and the IFO (business climate index) and ZEW (index on investor and analyst expectations) indices improved in March, confirming the country as the driver behind Europe's growth. In France the composite PMI is still in the expansionary zone although March's figure halted the upward trend seen in the last two months. In spite of the slight deterioration in some indicators, first quarter figures for the French economy are in line with moderate growth in GDP.

Domestic demand will accompany the improvement in activity. Demand indicators soared in 2015 Q1, revealing strong private consumption. The drop in oil prices is helping households to make appreciable savings, resulting in

Euro area: GDP

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



Note: * Quarter-on-quarter change in GDP (%).

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

GDP growth forecasts by the OECD

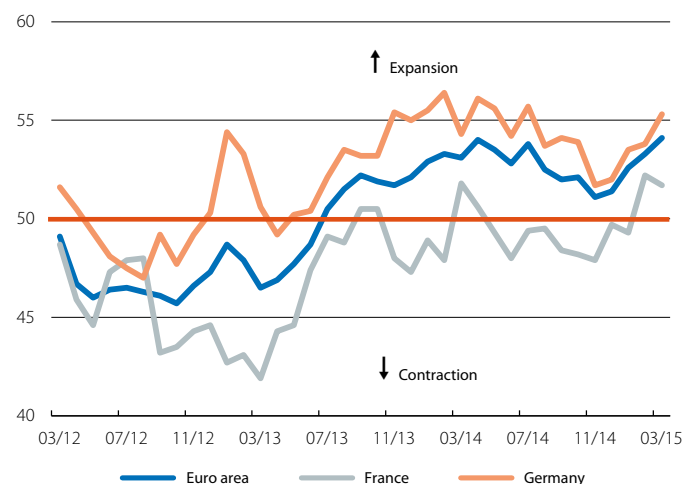
Year-on-year change (%)

	Forecast		Change compared with the November 2014 forecast	
	2015	2016	2015	2016
Euro area	1.4	2.0	▲ 0.3	▲ 0.3
Germany	1.7	2.2	▲ 0.6	▲ 0.4
France	1.1	1.7	▲ 0.3	▲ 0.2
Italy	0.6	1.3	▲ 0.4	▲ 0.3
United Kingdom	2.6	2.5	▼ 0.1	=

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

Composite PMI activity indicator

Level



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

additional consumption in other goods. This can be seen in the euro area's retail sales, up by 3.7% year-on-year in January, the highest figure since 2005. The two largest economies in the euro area are leading this trend with Germany and France recording an increase of 5.4% and 4.1% respectively. This good tone is also reflected in consumer confidence, now back to its pre-crisis level.

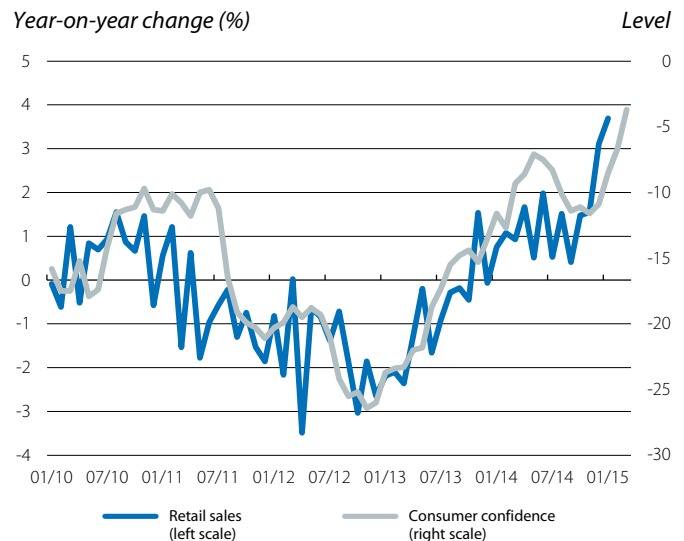
Employment improves in 2014 Q4, boosted by good activity figures. Employment increased in the euro area by 0.1% quarter-on-quarter in the last quarter of 2014. The differences between countries are considerable given the disparate situations of their respective labour markets and growth patterns. In countries such as Spain, where a large number of jobs were lost during the crisis but the recovery has now picked up speed, there is high growth in employment: up by 0.7% quarter-on-quarter in 2014 Q4. In Germany, however, a country already close to full employment, the increase was just 0.2%. France's sluggish growth is also reflected in its employment, which remained unchanged. After a dubious 2014, expectations for the euro area as a whole improved during 2015 Q1, especially in manufacturing. The unemployment rate is following a similar trend, falling to 11.3% in February. By country, of note is Germany's low unemployment rate of 4.8%. Employment expectations suggest the improvement will continue over the coming months.

The situation of the labour market, uneven across the different countries, is reflected in their labour costs.

No upward pressure can be seen on labour costs in those countries with high unemployment. For example, these fell by -0.3% year-on-year in Italy and only grew by 0.1% in Spain. But in Germany, where the economy is close to full employment, there is more pressure to increase wages and this is reflected in its labour costs, up by 2.0% year-on-year in Q4. However, wage moderation continued in the euro area as a whole and labour costs grew by 1.1% in Q4 compared with the same quarter a year ago. Wage containment, together with the trend in the euro-dollar exchange rate which ended the month of March at 1.07 dollars per euro after almost reaching parity, are both boosting exports. In January the current account balance, cumulative over 12 months, stood at 247 billion euros (2.4% of GDP), 23% higher than the figure in January 2014, especially thanks to the improved balance of trade for goods and income balance. With a view to 2015 and 2016, this improvement should continue as the effects of the euro's depreciation really take hold.

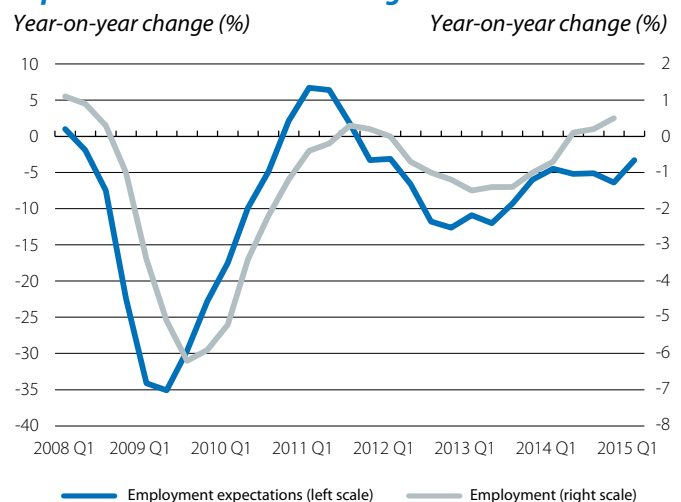
Inflation picks up in March although it is still in negative terrain. The euro area's general inflation rose by 0.2 pps in March to -0.1%, supported by a smaller drop in energy prices (especially fuel). Core inflation, after increasing by 0.1 pps in February, fell again to 0.6% in March. This trend can be explained by the behaviour of core inflation in Italy, down by 0.4 pps in March due to the fall in price for services and industrial goods.

Euro area: demand indicators



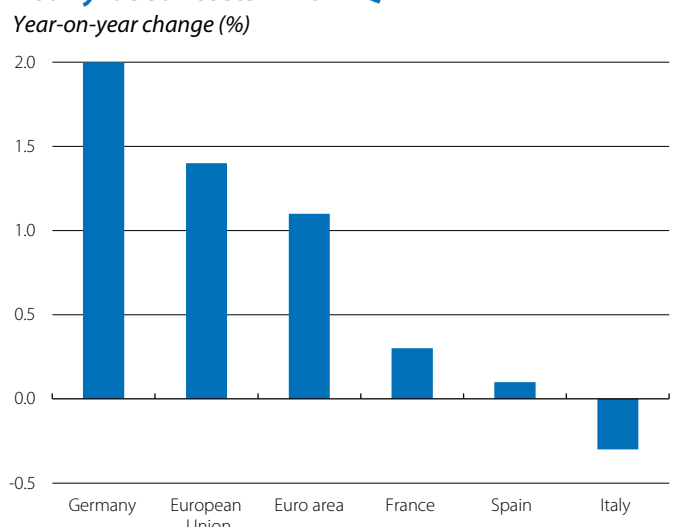
Source: "la Caixa" Research, based on Eurostat data.

Euro area: employment and employment expectations in manufacturing



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

Hourly labour costs in 2014 Q4



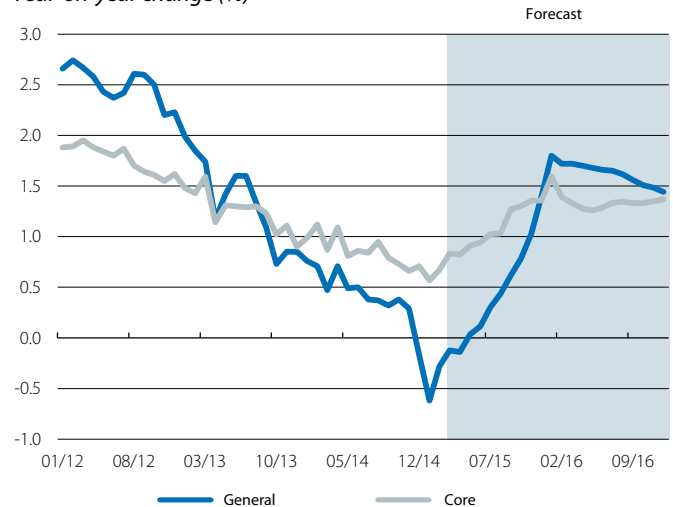
Source: "la Caixa" Research, based on Eurostat data.

The Greek storm refuses to die down and growth prospects are deteriorating. Increased problems in Greece's economy are reflected in the changes made to the growth forecasts by the consensus of analysts. From the time elections were announced in December 2014 up to March, the GDP growth forecast for 2015 has been revised downwards by 0.7 pps. Negotiations between the European institutions and the Greek government are following a tortuous route. Although an extension was agreed for the bail-out programme in February, until a satisfactory agreement is reached on the structural reforms that must be carried out and until the Greek government actually starts to implement them, the 7.2 billion euros remaining from the bail-out will not be paid. Without this payment, the Greek government will find it very difficult to meet its commitments in April. Time is running out and it is important for both parties to continue negotiations to reach a satisfactory conclusion.

In spite of the good figures observed in 2015 Q1, macroeconomic imbalances in the euro area are increasing according to the European Commission. The short-term risks caused by the Greek crisis are on top of the area's long-term challenges. In spite of the improved tone of Europe's economy, The Commission has warned that structural reforms must continue in order to ensure long-term growth. In its recent report on macroeconomic imbalances, the Commission has increased from three to five the number of countries with excessive imbalances requiring decisive intervention in the last year, while the number of countries with slight imbalances has fallen from seven to six. By country, Germany has a slight imbalance because its current account surplus is too big. France and Italy, both with excessive imbalances, have high public debt and deficit and are suffering from a serious loss of foreign competitiveness. It is worth noting that no single country has been identified without imbalances, either in the current report or in the one published last year. The Commission also evaluates how closely its recommendations have been followed and the measures taken to date to correct existing imbalances. Around 47% of the recommendations have been implemented very little or not at all while just 3% have been fully applied. The conclusion is clear: the agenda of reforms must be speeded up to ensure the euro area's growth consolidates in the long term as the temporary supports it currently enjoys will not be around forever.

Euro area: harmonised index of consumer prices

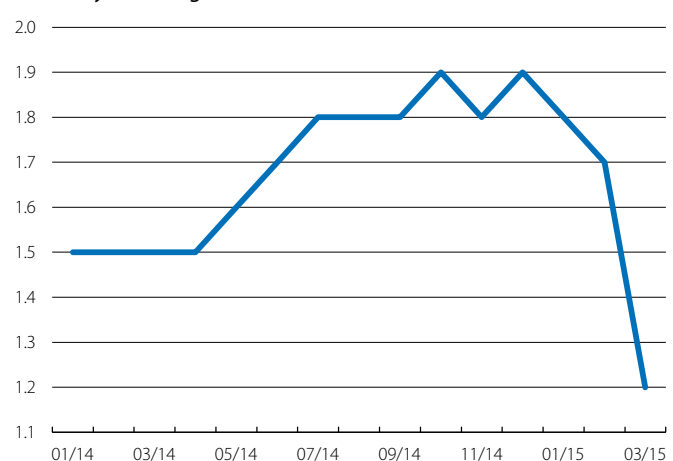
Year-on-year change (%)



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

Greece: trend in the GDP growth forecast for 2015 by the consensus of analysts

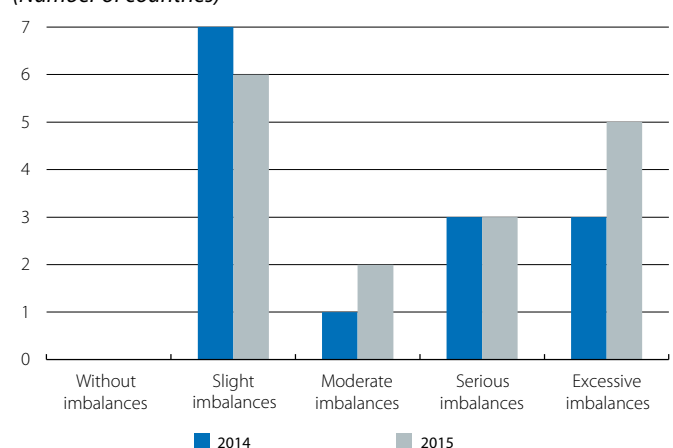
Year-on-year change (%)



Source: "la Caixa" Research, based on data from Consensus Forecasts.

Countries with macroeconomic imbalances according to the European Commission

(Number of countries)



Note: 14 countries analysed in 2014, 16 in 2015.

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

FOCUS · Capital markets union: a first step

After making significant progress in creating the banking union at a European level, the European Commission has now set its sights on capital markets. The free circulation of capital between member states of the European Union (EU), whose origin dates back to the Treaty of Rome in 1957, is a fundamental principle for the single market to function effectively. However, the financial markets of the EU economies are far from integrated. Moreover, compared with other advanced economies, Europe's capital markets are less developed and their sources of financing are not so diversified (see the graph).

Given this situation, the European Commission has opened a public consultation on the report to create a capital markets union (CMU). The aim is to establish a genuine single capital market, developing more diversified sources of funding for business which will boost the creation of jobs and growth at the same time as offering savers additional investment choices and higher returns on their investments.

Although the plan is to achieve CMU by 2019, the European Commission has selected five priority actions to encourage economic recovery in the short term. For two of these measures it has launched a specific public consultation in parallel with the CMU consultation. The aim of the first is to ensure that the prospectuses issuers must publish before starting to sell securities to the public do not represent a barrier to entry. The second aims to define a regulatory framework to promote a simple, transparent and standardised securitisation market for high quality assets. The other three priority measures are to improve information on the credit quality of SMEs (for example by supporting the creation of standardised rating systems for this kind of firm), encourage long-term investment, especially in infrastructures, and develop a European private placement market so that companies can offer securities to individuals or small group of investors instead of a public issue.

In the long term, the European Commission has identified three broad areas to develop and integrate Europe's capital markets. Measures have been defined for each of these areas, as well as measures acting covering various segments. Firstly it aims to improve access to financing with particular emphasis on SMEs and infrastructure projects. For example, it proposes to develop a common accounting model, simplified and adapted to the requirements of SMEs. Other measures proposed to improve access to financing concern the standardisation of some markets, such as covered and corporate bonds, via a common regulatory framework at an EU level.

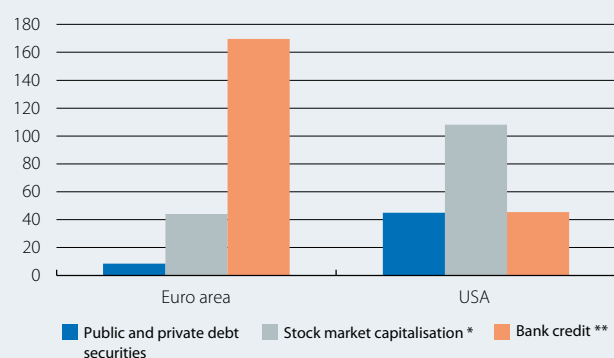
A second area of action aims to diversify sources of financing. Here many initiatives are already underway as part of funds for investment, insurance, personal pensions, private equity and venture capital, among others, but the aim is to boost these further by removing the barriers that still impede greater flows of capital between member states. This will make the European market more attractive for international investors.

Lastly, the third large block of measures aims to improve market efficiency, with particular attention to brokers, market infrastructures and the regulatory framework for corporate governance, bankruptcy laws and tax policy. The implementation of this third area will probably be the most problematic due to significant differences in legislation at a national level. Nonetheless, it is noteworthy that CMU, unlike the banking union, does not require decision-making powers to be centralised at an EU level. In fact, one relevant aspect of this proposal is a preference for market solutions rather than issuing new regulations, whenever possible.

In short, the project to create CMU aims to enhance the role of capital markets in financing investments in the EU. The proposal also stresses the decisive role of banks in capital markets and their complementary role as a source of financing. In any case, an efficient, solid banking system is still, and will continue to be, essential in order to support the economic recovery.

Sources of financing in December 2014

(% of GDP)



Notes: * Stock market capitalisation of S&P 500 for the USA and of Eurostoxx 600 for the euro area.
** Includes bank loans to the public and private sector.

Source: "la Caixa" Research, based on data from Bloomberg, Sifma, the ECB and the Federal Reserve.

FOCUS · The Bank of England, at a crossroads

In the last few months, strong growth in both the economy and employment in the United Kingdom has intensified debate regarding when the Bank of England (BoE) should carry out its first interest rate hike. For the time being Mark Carney, Governor of the BoE, continues to stress that an expansionary policy will be maintained until the economy's spare productive capacity has fallen substantially. This speech is likely to change over the coming months, however. Let us examine why.

GDP has been growing by over 2% for more than a year now and the bulk of the evidence suggests that it will remain at similar levels in 2015 and 2016. The output gap (i.e. the difference between real and potential output, which reached -3% in 2012 according to the IMF) will almost be closed this year. Historically, such a situation increases pressure on prices and monetary policy therefore tends to react by tightening up financial conditions (or at least by becoming less accommodative). Another sign that spare productive capacity is already very limited are the good figures posted by the labour market. Unemployment fell to 5.9% in 2014 Q4, clearly below its historical average of 6.8%. Moreover a large part of this increase in employment corresponded to full-time contracts, indicating growing confidence that the expansionary cycle will continue for some time. Such changes in the labour market should lead to wage rises. In this respect, it is significant that the growth rate for wages was 1.7% year-on-year in 2014 Q4 (1.2% in Q3), breaking the downward slide starting in 2008.

However, although data on economic activity have been surprisingly good in general, inflation has been surprisingly low in the last few quarters. The sharp drop in inflation, standing at 0.0% in February, has not been due merely to the fall in oil prices as core inflation has also shown a marked downward trend over the last few months. The pound's appreciation is playing an important role in this respect. Although inflation is likely to recover in the next few months, the absence of inflationary pressure introduces a large degree of uncertainty regarding the point when monetary policy should start to change its tune.

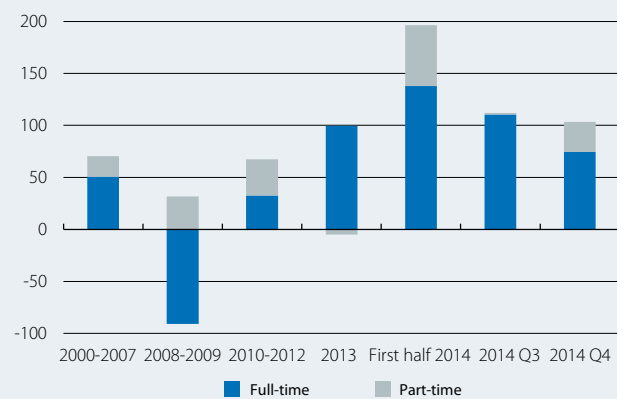
And as if the scenario were not complex enough already, the BoE must also bear in mind the effect of monetary policy on financial stability. The main concern in this area is the trend in house prices, up by 10% last year. The BoE is trying to contain the possible formation of another property bubble by limiting the amount of mortgage risk banks are allowed to take on.¹ However, as Mark Carney

has repeated on numerous occasions, the emergence of a new housing bubble is still one of the main threats to the United Kingdom's stability in the medium term.

In short, monetary policy will be the main focus of debate in the United Kingdom over the coming months. If inflation starts to pick up, as is expected, then discussion regarding the rate of interest rate hikes will also be lively. And if it does not pick up, forcing the BoE to maintain its current accommodative tone, then debate will focus on whether the pressure on house prices can be slowed up in such an environment.

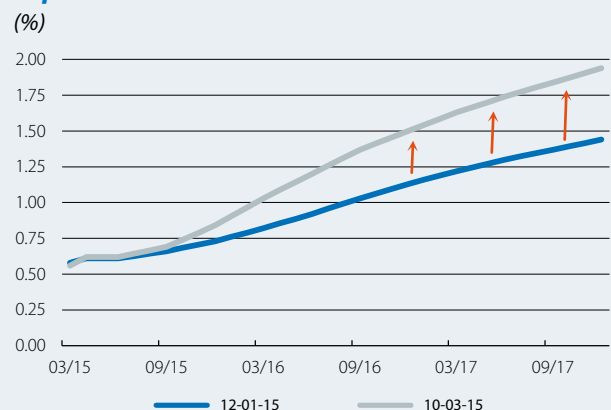
United Kingdom: employment

Quarter-on-quarter change (thousands)



Note: Data seasonally adjusted. Average data except for 2014 Q3 and 2014 Q4.
Source: "la Caixa" Research, based on data from the ONS.

United Kingdom: short-term interest rate expectations *



Note: * Curve for 3-month Libor futures (in pounds).
Source: "la Caixa" Research, based on Bloomberg data.

1. For example, according to BoE regulations, a maximum of 15% of all new mortgages can be more than 4.5 times a borrower's annual income.

KEY INDICATORS

Activity and employment indicators

Values, unless otherwise specified

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	01/15	02/15	03/15
Retail sales (year-on-year change)	-0.8	1.3	0.9	1.4	0.8	2.0	3.7	...	...
Industrial production (year-on-year change)	-0.7	0.7	1.3	0.9	0.4	0.2	1.2	...	...
Consumer confidence	-18.6	-10.0	-11.2	-7.7	-9.9	-11.2	-8.5	-6.7	-3.7
Economic sentiment	93.6	101.6	101.9	102.6	101.2	100.9	101.5	102.3	103.9
Manufacturing PMI	49.6	51.8	53.4	52.5	50.9	50.5	51.0	51.0	51.9
Services PMI	49.3	52.5	52.1	53.0	53.2	51.7	52.7	53.7	54.3
Labour market									
Employment (people) (year-on-year change)	-0.7	0.6	0.2	0.6	0.7	0.9	-	...	-
Unemployment rate: euro area (% labour force)	12.0	11.6	11.8	11.6	11.5	11.5	11.4	11.3	...
Germany (% labour force)	5.2	5.0	5.1	5.0	5.0	4.9	4.8	4.8	...
France (% labour force)	10.3	10.3	10.1	10.1	10.4	10.5	10.6	10.6	...
Italy (% labour force)	12.2	12.7	12.5	12.4	12.8	13.0	12.6	12.7	...
Spain (% labour force)	26.1	24.5	25.3	24.7	24.2	23.7	23.4	23.2	...

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

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	01/15	02/15
Current balance: euro area¹	2.0	2.4	2.1	2.1	2.3	2.4	2.5	...
Germany	6.5	7.6	6.7	6.8	7.4	7.6	7.6	...
France ¹	-1.4	-1.0	-1.5	-1.6	-1.2	-1.0	-0.7	...
Italy	1.0	1.8	1.2	1.3	1.5	1.8	1.9	...
Spain	1.4	0.8	1.4	0.8	0.7	0.8	0.9	...
Nominal effective exchange rate² (value)	101.7	102.3	103.9	103.9	101.7	99.6	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	01/15	02/15
Private sector financing								
Credit to non-financial firms ¹	-2.3	-2.2	-3.0	-2.5	-2.0	-1.3	-0.9	-0.4
Credit to households ^{1,2}	0.3	0.5	0.3	0.5	0.5	0.7	0.9	1.0
Interest rate on loans to non-financial firms ³ (%)	2.2	2.0	2.2	2.1	1.9	1.8	1.7	...
Interest rate on loans to households for house purchases ⁴ (%)	2.8	2.6	2.8	2.7	2.6	2.4	2.3	...
Deposits								
On demand deposits	7.9	6.0	5.9	5.2	5.9	7.2	9.1	9.3
Other short-term deposits	0.0	-2.1	-2.5	-2.0	-1.7	-2.1	-3.1	-3.3
Marketable instruments	-14.8	-7.4	-12.7	-11.7	-6.1	1.0	0.6	4.0
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 · Spain consolidates its recovery

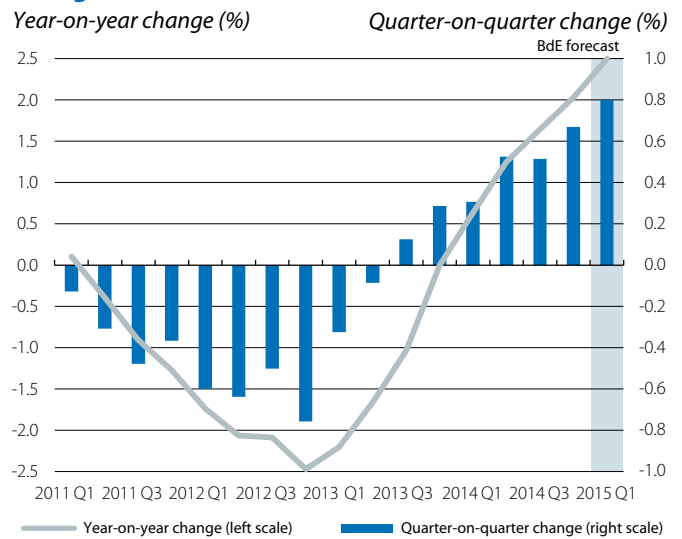
The pace of growth speeded up slightly in Q1. According to the Bank of Spain (BdE), GDP grew by 0.8% quarter-on-quarter in 2015 Q1 (0.7% in 2014 Q4). Following the pattern of preceding quarters, domestic demand would have continued to be the driving force behind this rate of recovery, contributing 0.9 pps to growth, while exports would have made a slightly negative contribution (–0.1 pps). For the whole of the year, the BdE has revised upwards its GDP growth forecast to 2.8%, 0.8 pps higher than its forecast in December, placing the growth forecast for 2016 at 2.7%. This notable revision of growth prospects is due to expected improvements in the foreign sector thanks to the positive effect of QE on the euro area's growth prospects. It will also be boosted by the strength of support factors that have entered the scene more recently, such as improved financing conditions, lower oil prices and the euro's depreciation. However, as the European Commission repeated in its in-depth report on macroeconomic imbalances in the Spanish economy, for this good rate of growth to continue in the long term the country must continue to carry out external adjustments, fiscal consolidation and structural reforms.

Good growth prospects spur on corporate investment.

Supply indicators available since the start of the year point to capital goods investment growing at a good rate in Q1, encouraged by a climate of optimism and confidence regarding the future trend in activity. Specifically, the composite PMI for January and February stood, on average, at 57.8 points (54.5 points in 2014 Q4), representing a comfortable expansionary zone. The same interpretation of sustained recovery in investment can be deduced from the figures for industrial orders, whose year-on-year rate of change stood at 2.2% in January (2.0% on average in Q4), with the increase in orders of capital goods being particularly strong. By geographical zone, the rise in industrial orders in the domestic market (2.7% year-on-year) and in the euro area (3.8% year-on-year) is yet another example of the strength in domestic demand and that the euro area's recovery is starting to boost the Spanish economy.

Good figures for consumption indicators. Judging by the growth in retail and consumer goods, namely 3.0% year-on-year in January (2.9% in Q4) and by the notable increase in consumer confidence, rising to –0.6 points on average in Q1 (–9.6 in Q4), private expenditure continued to grow apace in Q1. Since the start of the recovery, household consumption has risen above its disposable income, thereby reducing the savings rate: in 2014 this stood at 9.7%, representing a decrease of 0.7 pps compared with 2013 and 5.6 pps compared with the peak reached in 2009 Q4 (15.3%). One factor that is probably helping to reduce savings in this phase of the recovery is the fact that, as economic prospects improve and

GDP growth



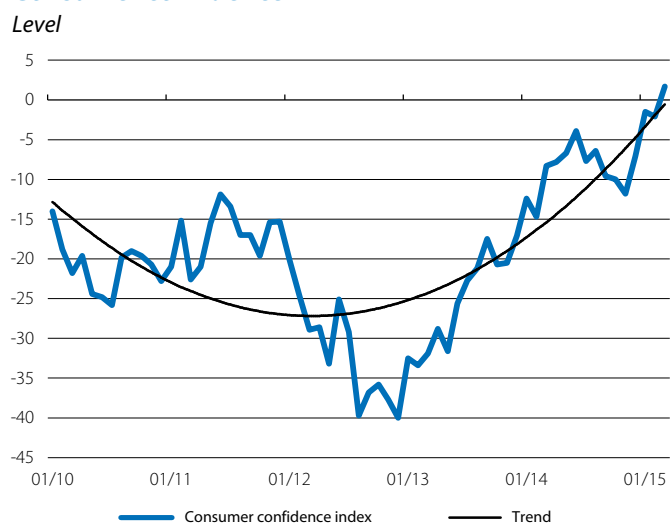
Source: "la Caixa" Research, based on data from the INE and the Bank of Spain.

Activity indicators



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

Consumer confidence



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

uncertainty declines regarding the trend in the labour market, families will have started to use the financial assets accumulated as a precautionary measure during the years of recession.

The fall in prices is slowing up, in line with our forecast of a gradual recovery. Inflation rose by 0.4 pps in March, up to -0.7% year-on-year. Over the coming months we expect the moderate rise in oil prices, improved domestic demand and the euro's depreciation to push up inflation even further.

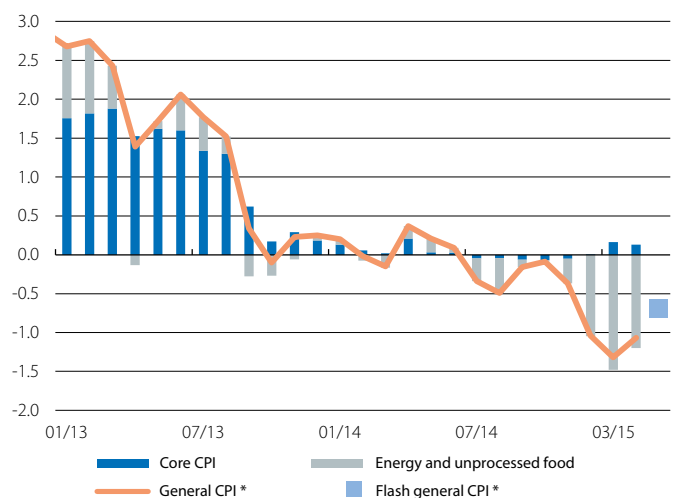
The labour market reflects the good performance of economic activity. The number of workers affiliated to Social Security increased above expectations in February (86,000 in monthly terms, seasonally adjusted). In addition to the dynamism shown by the services sector, which has been performing positively for several months now, significant acceleration can also be seen in the rate of jobs created in industry and especially in construction. The recovery of employment in construction, whose year-on-year rate of change rose in February by 1.7 pps to 5.1%, is clear proof of the change in trend in the real estate sector. Judging by the employment expectations of the European Commission's opinion polls, the labour market's recovery will continue its positive trend over the next few months.

Reform of the training system for the unemployed. The government has passed the Royal Decree-Law 4/2015 to improve the effectiveness, coordination and transparency of vocational training for the unemployed. From now on, trade unions and owner organisations will not be able to give training courses and their function will focus on planning and programming the training available. Also important is the fact that subsidies for training courses will now be put to open tender with mandatory audits for external control. A «training cheque» was also established so that unemployed people can choose the centre where they wish to train. Another important innovation is the creation of a «worker training account», certifying a worker's training record, a very useful tool for more personalised training guidance. As a whole, these measures should resolve some of the shortcomings in the current system and respond better to the training needs of both individuals and business.

Wage containment continues to support gains in competitiveness. According to the harmonised index of labour costs, wage costs in Spain rose by 0.4% year-on-year in 2014 Q4 compared with 1.1% year-on-year in the euro area. This limited growth by wages did not result in a loss of purchasing power for Spanish consumers as inflation was in negative figures but it did help the country to continue making gains in competitiveness compared with the euro area. The fact that, in February, the wage levels in collective agreements increased by a moderate 0.7% year-on-year suggests that wage containment probably continued in Q1. On the other hand, it should be noted that, in addition to wage containment, the decrease in the number of dismissals has also helped to reduce the overall labour costs of firms,

CPI

Contribution to inflation by component (pps)

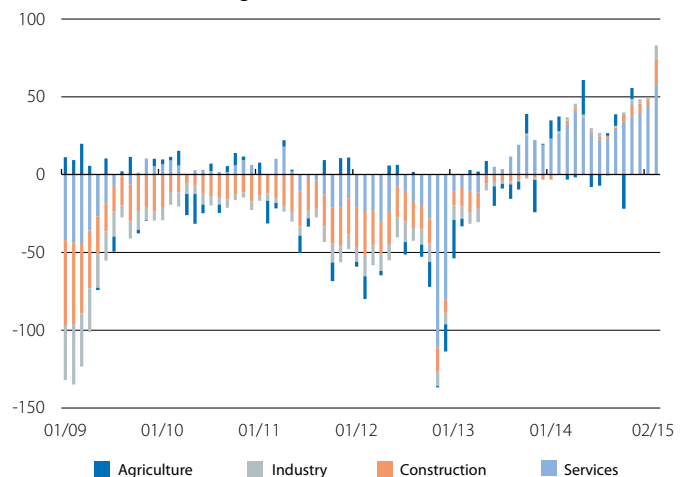


Note: * Year-on-year change (%).

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

Employment by sector *

Month-on-month change (thousands)

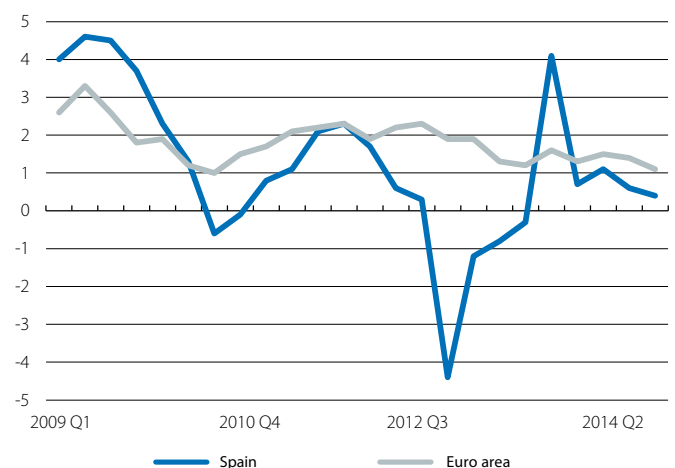


Note: * Series seasonally adjusted.

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

Hourly wage costs *

Year-on-year change (%)



Note: * Data adjusted for calendar and seasonal effects.

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

improving their growth capacity. Specifically, non-wage payments (mostly redundancy pay and severance packages) fell by 18.3% year-on-year in 2014 Q4.

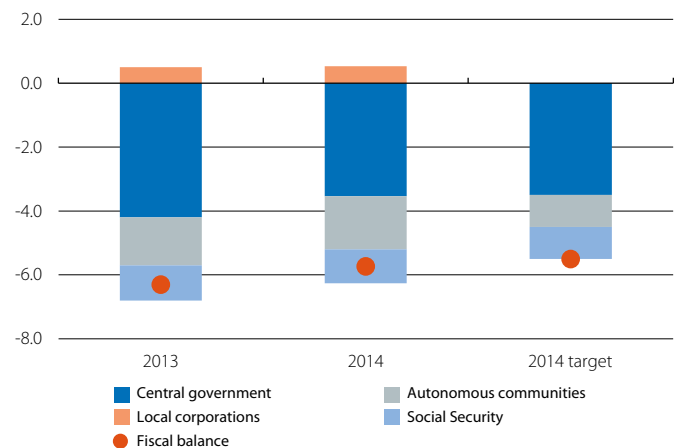
The public sector ends 2014 with a deficit of 5.7% of GDP, slightly off the target (5.5%). By administration, of note is the public administration deviation from the target (1.7% compared with the 1.0% target), partly offset by the surplus achieved by local government corporations (-0.5% compared with the 0% target). Both central government and Social Security deviated very slightly, although the latter used 15.3 billion euros from the Reserve Fund in 2014. The target deficit for 2015 (4.2%) entails a reduction of 1.5 pps. Although the significant improvement in the economic cycle expected for this year will help to improve public administration accounts, the authorities must continue with their efforts to reduce public deficit and ease the burden of public debt.

The diversification of exports will aid the foreign sector.

The breakdown in total exports by sector reveals considerable diversification in Spanish exports which, in turn, reflects the fact that the efforts being made to internationalise Spanish firms are affecting a range of sectors and a wide variety of products. The most evident change has occurred in the services sector where the share of non-tourism services (18%) now more than outweighs tourism services (14%). Throughout the year we expect exports to become stronger, boosted by the improved performance of foreign markets and the euro's depreciation. The tourism figures support this prediction: between January and February 6.5 million foreign tourists came to Spain, a year-on-year increase of 4.5%. However, the figures for goods exports in January were less encouraging, halting the improvement that had begun at the end of 2014. Nonetheless it should be noted that the monthly data for goods exports are highly volatile and projections for the coming months are still favourable.

Bank credit adds to the recovery. In January the number of new loans granted continued to reflect the upward trend starting in 2014, with significant growth in credit to households and SMEs. The breakdown by segment for Q4 shows a lower rate of contraction in outstanding credit thanks to the good performance of some segments such as loans for consumption and financial services, offsetting the notable declines still being seen for construction and real estate developers. Regarding the restructuring of Spain's banking system, the European Commission and the ECB, in their third supervisory visit after the end of the banking sector restructuring programme, valued positively the most recent reforms in the sector such as the recent appointment of Spain's bank recapitalisation fund (FROB) as the national resolution authority and the progress made in implementing the restructuring plans for banks receiving public aid.

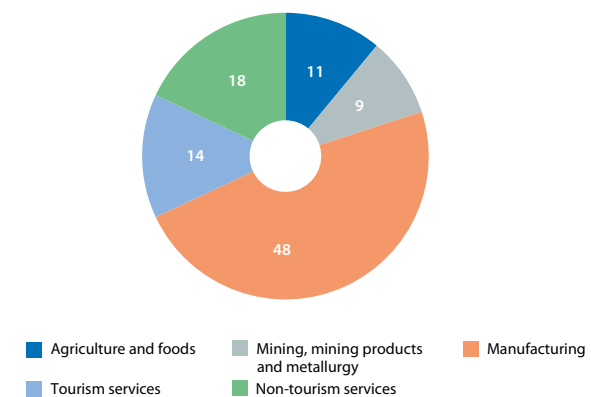
Budget balance of public administrations * (% of GDP)



Note: * Does not include losses caused by bank restructuring costs, namely 0.5% of GDP in 2013 and 0.1% in 2014.

Source: "la Caixa" Research, based on data from the State Public Accounts.

Breakdown of exports by sector (% of total)

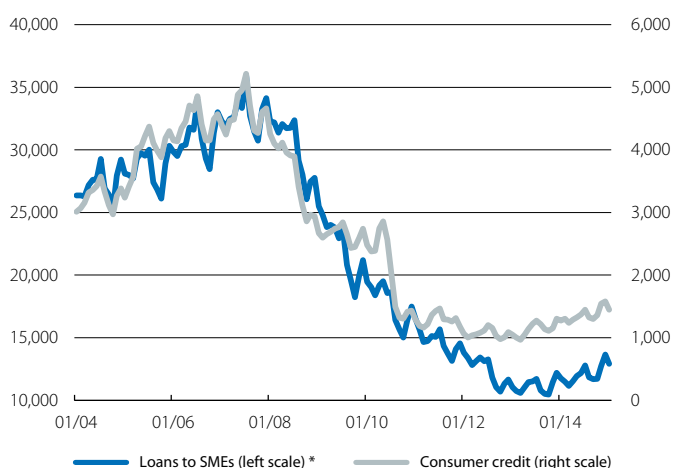


Note: Data for services (2013) and for goods (2014).

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

New loans granted

Moving average of three months (million euros)



Note: * Loans under one million euros.

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

FOCUS · Work pending: the NIIP and the quality of exports

The high and negative net international investment position (NIIP) is one of the areas where the Spanish economy has still a lot of work to do. In 2014 it stood at 93.5% of GDP while the European Commission places the threshold at –35% of GDP. It is not easy to improve the NIIP as this requires a sustained current account surplus for a long period of time. For example, a surplus of 1.8% of GDP, on average, would be necessary for the next 12 years to bring the NIIP down to –35% of GDP.¹

To achieve a current account surplus of this size, the Spanish economy must continue to make gains in competitiveness. Broadly speaking, there are two ways to increase competitiveness: by reducing the price of exports while maintaining their quality, or by increasing their quality while maintaining the price. Although Spain's unit labour costs have fallen quite considerably compared with its trading partners over the last few years, helping the country to recover the price competitiveness it had lost in the years prior to the crisis, it is difficult to continue making gains in price competitiveness in the current climate of low inflation. It is therefore even more pressing to find complementary routes, such as improving the quality of the products exported.

A good way to estimate the quality of a country's exports is via their technological content. In general, countries that export products of higher quality and value added tend to have a greater technological capacity. In Spain, only 10% of all industrial goods exported in 2013 had a high technological component. This figure contrasts with the global demand for technology-intensive goods which, in 2013, accounted for 23% of all goods traded at a global level. At a global level, the high-tech goods segment has grown the most in the last few decades, especially between 1990 and 2000 when it went from accounting for 18% of world trade to 26%. Over the last few years this segment has grown at the same rate as world trade but, according to the IMF,² it will once again take centre stage in the coming years. The trend in Spanish exports in this respect has been very small and there is still a lot of room for improvement.

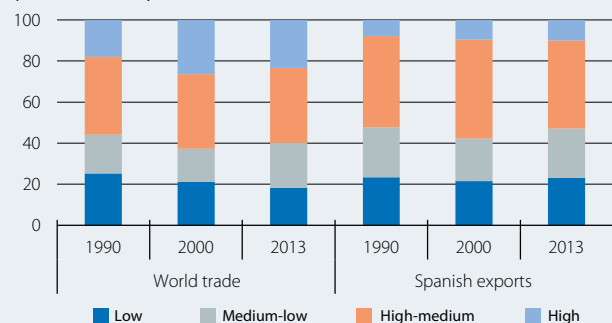
Improving the technological component of products is not only desirable due to the high growth potential it offers. Greater technological development would also increase the value added of products and their differentiation, making demand less sensitive to any price variations. This last aspect is particularly relevant for companies competing at an international level as they are highly exposed to exchange rate fluctuations.

But the benefits for the economy as a whole are much more extensive, ranging from improvements in productivity to, naturally, the creation of higher quality jobs.

One of the key factors that determine a company's capacity to innovate and the technological development it can offer in its products is the size of the firm. In general, to make progress in this respect it is vital to invest heavily and larger companies are usually in a better position to do so. As can be seen in the second graph, small firms tend to be less productive and to invest less in R&D, remaining anchored in lower quality production segments with a smaller technological component. Designing an environment that encourages firms to grow is key to improving the quality of Spanish exports; an essential ingredient to improving the current account surplus and reducing the NIIP.

Technological content of Spanish exports and of world trade

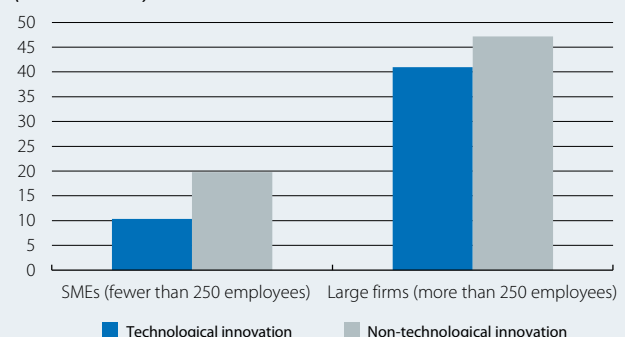
(% of the total)



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

Innovative firms by size in 2013

(% of all firms)



Note: Technological innovation consists of technologically new and also technologically improved products and processes. Non-technological innovation consists of new methods to sell products or business organisation.

Source: "la Caixa" Research, based on data from the «Encuesta sobre Innovación en las Empresas» by the Spanish Statistics Institute (INE).

1. This calculation assumes nominal GDP growth of 4%.

2. IMF, «Changing Patterns of Global Trade», 2011.

FOCUS · The falling price of Spanish exports: a global phenomenon?

In real terms, Spain's goods exports continued to grow at a good rate in 2014: they increased by 4.6%, only slightly below the figure of 5.8% one year ago. However, nominal exports grew by a moderate 2.5% in 2014 (5.2% in 2013). The fall in the price of exports explains the difference between real and nominal exports. The fall in the price of exports of goods is becoming a worrying situation, as it reduces earnings by the export sector at a time when its support for economic growth is essential to ensure its sustainability.

In an environment in which the Spanish economy is gaining in competitiveness, the fall in export prices as this probably reflects the effort being made by exporters to contain costs and squeeze margins. Nonetheless, this trend has become stronger in the last few quarters with export prices accumulating a drop of 4.4% since June 2012. This intensification has largely been caused by the sharp drop in mineral prices (particularly metals) and in products made from these minerals, as well as foods. Specifically, the price of exports from the metal mining sector has fallen by almost 20%, while the sector of products made from these minerals has experienced a 7% drop. These are significant reductions considering that both sectors represent, in total, 13% of all Spanish exports of goods. Along the same lines, also of note is the recent drop in the price of processed food (down 3.2% year-on-year in January 2015), which also accounts for around 14% of Spain's exported goods.

In this respect, the price of exports from other countries with an export situation that is comparable to Spain's, i.e. with the mining, metal or agrifood sectors representing a significant share, should have suffered a similar reduction. This is the case of the United States, where export prices have also been falling for several quarters, pushed down by the drop in price of mining and agricultural products.¹

This trend in the price of minerals and food is related to the end of the so-called «commodities supercycle», a global phenomenon occurring throughout the 2000s which pushed up the price of minerals and farm products to all-time highs. This supercycle was supported by growing demand from China and other large emerging economies as well as by financial factors such as low interest rates, encouraging investors to search for higher returns from alternative assets.

1. The sharpest drop in US export prices in the last few months has been due to the slump in price for certain agricultural and mining products, which have a considerable relative weight in the US.

Far from being an isolated occurrence, the fall in export prices seen in Spain is the consequence of a global phenomenon: a slowdown can also be seen in the rate of growth of export prices at a global level, going beyond the recent drop caused by the slump in oil prices. As commodity prices gradually stabilise, exports in nominal terms are therefore likely to grow again at the same rate as real exports, fostering more balanced and thus more sustainable economic growth in the long term.

Export price index for goods

Year-on-year change (%)

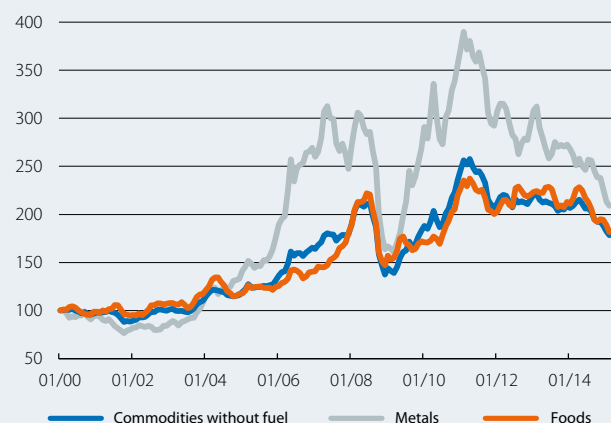


Note: The IPRIX index is used for Spain.

Source: "la Caixa" Research, based on data from the INE, BLS, Datacomex and the WTO.

Commodity prices

Index (January 2000 = 100)



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

FOCUS · The new framework of corporate governance

The separation between ownership and control that characterises listed firms entails an agency problem between those who own the company (shareholders) and its decision makers. On the one hand, shareholders' limited liability reduces the incentive to supervise the decisions taken as their losses are limited to their own particular contribution. On the other hand, ownership of the firm tends to be spread thinly among many different shareholders so that, individually, each one expects the rest to take on the job of supervision (free-riding). Moreover, the free transmission of ownership rights (shares) on the stock market offers the chance to abandon the company should you not agree with its management, without the need to bring about any change in the governance bodies. Consequently, which mechanisms should ensure the quality of decision-making in listed companies is currently under debate. In fact, improving corporate governance has been an issue since the very start of limited liability companies, with the chartered trading companies in 17th-century Great Britain and the Netherlands when separation of ownership and control was viewed with some suspicion.

The Spanish Securities and Investments Board (Comisión Nacional del Mercado de Valores, or CNMV for short) has recently promoted the reform of the Corporate Enterprises Act (LSC in Spanish), which provides mandatory requirements concerning corporate governance, and the adoption of a new code of good governance for listed companies, of voluntary compliance, to replace the Unified Code of 2006. This new code complements some of the legal regulations contained in the LSC. For example, the LSC requires listed companies to include at least two independent members on the audit committee and on the appointments and remuneration committee. For its part, the code of good governance recommends that independent members should account for at least 50% of the board (compared with one third in the old code), with some exceptions for companies that do not form part of the Ibex 35 or that form part of it but have one shareholder who controls more than 30% of the shares.

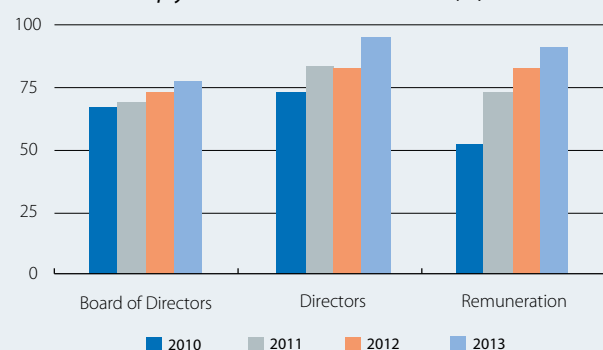
The new code is made up of 25 principles and 64 recommendations and applies to all listed companies irrespective of their level of capitalisation. As in the previous code, it is based on the principle of «comply or explain». Most companies comply with the vast majority of the recommendations (see the first graph), so the new code will force companies to be more transparent in everything related to their corporate governance decisions. Spain has a poor position in international corporate governance rankings and this has worsened in the last few years (see the second graph), so any initiative aimed at good governance is more than welcome.

In this respect, it is very positive that the new code includes measures to improve transparency, control and supervision of the decisions taken, that it encourages the professionalisation of administrators and directors and promotes a long-term view in decision-making. In this last aspect, particular attention is paid to remuneration for directors in order to link this more closely to long-term results, for instance by including clawback clauses (refunding variable payments when they are not in line with the actual performance). Moreover, and as its key addition, it also includes recommendations on corporate social responsibility (CSR), recommending greater involvement by the board in implementing, assessing and supervising CSR policy.

This new code represents a step forward in bringing Spain's corporate practices up to international standards. Achieving this is, ultimately, essentially to attract international investors and improve the competitive position of Spanish firms.

Compliance of the recommendations in the unified code

Firms that comply with the recommendations (%)



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

Corporate governance quality indicators in Spain *

(Ranking out of 144 countries)



Note: * Indicators that form part of the global competitiveness index produced by the World Economic Forum.

Source: "la Caixa" Research, based on data from the World Economic Forum.

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	03/15
Industry									
Electricity consumption	-2.1	-0.2	-0.3	1.0	0.3	-1.7	3.5	1.2	...
Industrial production index	-1.5	1.3	1.5	2.6	0.6	0.3	0.4	...	...
Indicator of confidence in industry (value)	-13.9	-7.1	-9.1	-8.2	-5.7	-5.3	-4.5	-4.3	-0.9
Manufacturing PMI (value)	48.5	53.2	52.5	53.4	53.1	53.7	54.7	54.2	...
Construction									
Building permits (cumulative over 12 months)	-36.3	-7.7	-21.5	-11.2	-2.1	4.0	7.0	...	...
House sales (cumulative over 12 months)	0.4	-5.5	-8.9	-8.3	-5.0	0.4	6.3	...	...
Services									
Foreign tourists	5.8	7.2	8.1	7.8	7.6	5.4	3.6	5.3	...
Services PMI (value)	48.3	55.2	54.2	55.7	56.7	54.3	56.7	56.2	...
Consumption									
Retail sales	-3.7	1.0	-0.1	0.7	0.4	2.9	3.0	1.8	...
Car registrations	5.6	18.4	11.8	23.2	17.0	21.7	27.5	26.1	...
Consumer confidence index (value)	-25.3	-8.9	-11.8	-6.1	-7.9	-9.6	-1.5	-2.1	1.7

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	01/15	02/15
Registered as employed with Social Security¹								
Employment by industry sector								
Manufacturing	-4.3	0.1	-1.3	0.0	0.6	0.9	1.2	1.5
Construction	-12.1	-1.6	-5.3	-2.3	-0.5	1.6	3.4	5.1
Services	-2.0	2.2	1.1	2.2	2.6	2.8	3.2	3.4
Employment by professional status								
Employees	-3.8	1.4	0.1	1.4	1.9	2.3	2.5	3.0
Self-employed and others	-0.6	2.2	1.4	2.3	2.5	2.5	2.5	2.3
TOTAL	-3.2	1.6	0.4	1.5	2.0	2.3	2.5	2.8
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	22.2	23.0
Temporary	6.4	13.1	19.4	14.2	11.1	7.7	7.5	11.4
TOTAL	4.0	13.4	18.2	15.0	11.8	8.8	8.6	12.5
Unemployment claimant count³								
Under 25	-6.2	-8.2	-9.4	-10.9	-5.5	-6.9	-10.3	-9.6
All aged 25 and over	3.7	-5.3	-3.7	-5.9	-5.9	-5.7	-5.6	-5.9
TOTAL	2.7	-5.6	-4.2	-6.4	-5.9	-5.8	-6.0	-6.2

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	03/15
General									
Core	1.5	0.0	0.1	0.1	0.0	0.0	0.2	0.2	...
Unprocessed foods	3.6	-1.2	0.7	-2.3	-4.1	0.8	-0.7	0.9	...
Energy products	0.1	-0.8	-1.0	2.4	-0.2	-4.3	-11.4	-10.2	...

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	2014 Q4	01/15
Trade of goods							
Exports (year-on-year change)	5.2	2.5	3.2	-2.0	4.8	4.3	-2.9
Imports (year-on-year change)	-1.3	5.7	7.0	3.7	7.3	5.0	-3.6
Current balance	15.1	8.5	14.5	8.1	7.0	8.5	9.0
Goods and services	35.7	27.2	33.7	29.1	27.5	27.2	27.5
Primary and secondary income	-20.6	-18.7	-19.1	-21.1	-20.5	-18.7	-18.5
Net lending (+) / borrowing (-) capacity	22.0	12.9	21.7	14.5	12.8	12.9	13.6

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

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	01/15	02/15
Net lending (+) / borrowing (-) capacity	-6.8	-5.8	-0.6	-3.3	-3.6	-5.8	-	...
Central government ¹	-4.8	-3.8	-0.9	-2.5	-3.1	-3.8	-0.6	-1.1
Autonomous regions	-1.5	-1.7	-0.3	-1.0	-1.0	-1.7	-0.1	...
Local government	0.5	0.5	0.1	0.1	0.3	0.5	-	...
Social Security	-1.1	-1.1	0.3	-0.1	0.0	-1.1	0.2	...
Public debt (% GDP)	92.1	97.7	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	01/15	Balance 01/15 ¹
Financing of non-financial sectors²								
Private sector	-8.2	-5.3	-6.4	-5.5	-4.5	-4.8	-5.5	1,681.6
Non-financial firms	-10.6	-5.4	-7.1	-5.7	-4.0	-4.9	-6.5	936.2
Households ³	-5.0	-5.1	-5.6	-5.2	-5.0	-4.6	-4.2	745.4
General government ⁴	16.8	6.9	8.5	6.6	5.9	6.7	5.1	1,035.5
TOTAL	-1.1	-1.2	-1.5	-1.4	-0.9	-0.8	-1.7	2,717.1
Liabilities of financial institutions due to firms and households								
Total deposits	2.1	-0.9	0.2	-0.8	-1.2	-1.7	-2.0	1,160.4
On demand deposits	4.2	10.8	7.4	7.4	13.6	14.8	14.5	332.0
Savings deposits	-0.1	5.8	3.8	5.9	6.9	6.8	9.6	222.6
Term deposits	1.7	-7.6	-3.6	-6.1	-9.4	-11.3	-12.8	584.4
Deposits in foreign currency	16.8	1.1	-1.1	0.1	0.3	5.2	4.7	21.4
Rest of liabilities ⁵	-16.8	-8.2	-11.1	-8.3	-6.8	-6.8	-12.9	111.2
TOTAL	-0.2	-1.7	-1.1	-1.6	-1.7	-2.2	-3.1	1,271.6
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	58.5	-

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.

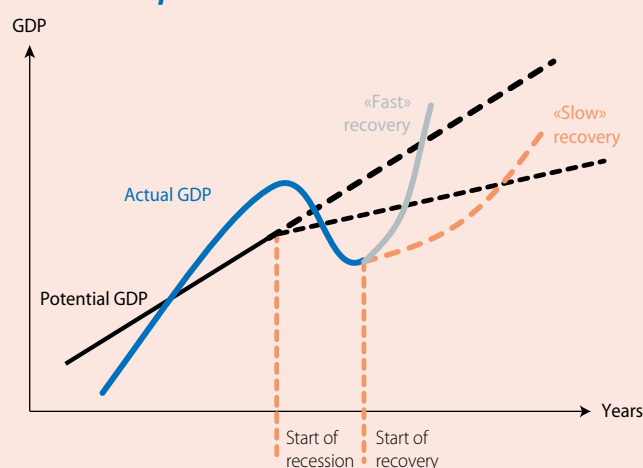
IS THE EURO AREA BECOMING JAPANISED?

Japan's «lost decades»: between myth and reality

For some years now people have been warning about the risk of the euro area becoming «Japanised», a term with clearly negative connotations. In fact, numerous observers perceive Japan's economic development over the last few decades as a series of misfortunes whose cause dates back to the second half of the 1980s with the formation of a huge credit, real estate and stock market bubble. The inevitable bursting of this bubble led to problems which lasted throughout a tortuous hangover plagued with zombie banks, rocketing public debt, persistent deflation and meagre growth in GDP. However, others point to variables in which Japan has performed at least satisfactorily: per capita income that has continued to rise and is among the highest in the world, an unemployment rate that has remained very low, a relatively low inequality rate in income distribution as well as enviable rankings in terms of international competitiveness. Two questions spring immediately to mind: to what do we owe this disparity in perceptions and to what extent does Japan represent a compendium of what the euro area must avoid?

Such warnings of Japanisation are directed at economic policymakers, claiming that the Asian country made several far-reaching mistakes. The strongest complaints refer to anti-cyclical policies whose aim is for the economy to achieve and sustain full production capacity: namely monetary, fiscal and also financial sector policies. But there has also been criticism of policies regarding structural reforms designed to increase the country's potential production capacity. The next two articles in this Dossier examine these areas in detail to cast some light on the euro area's case. We should make two provisos regarding this segmentation of the analysis, however. One relates to form: the decision to ascribe a policy to one area or another seems to be somewhat arbitrary. In particular, the policy related to the financial sector is clearly demand-oriented insofar as it is crucial for monetary measures to be passed on to the real economy. But it also exercises notable influence on supply and potential growth insofar as a healthy financial system is key to mobilising resources precisely towards more productive destinations. The second proviso is more fundamental in nature: the way in which these policies interact is complex; sometimes reinforcing and sometimes counteracting each other before achieving their effects on the different variables in question. Judging each one in isolation could be misleading or lead to an incomplete conclusion, especially when analysed over the short term. That is why it is useful to frame our examination of individual policies within an assessment of the policy mix, taking into account the results achieved in terms of the ultimate proposal to improve and sustain the economic well-being of citizens. To this end, the first graph illustrates the possible alternative paths that could be taken by GDP after the economy receives a shock and a crisis ensues. The spectre of Japanisation refers to the route identified as a «slow recovery». Japanese policy is often criticised in comparison with that of other countries, in particular the United States, which would have been more suitable to position itself along the route identified as a «fast recovery».

Alternative paths for GDP after a crisis



Source: "la Caixa" Research.

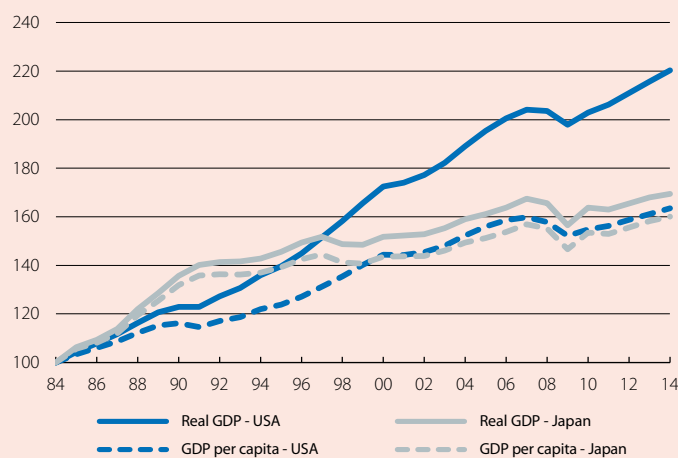
selective in content in order to revive critical economic engines. In Japan, the crisis in the 1990s made the public deficit rocket, which has remained high. A large amount of debt has been built up but there are serious doubts regarding its capacity to stimulate demand and also how efficiently this has been spent, often on public works that have not been very productive. But perhaps the biggest discrepancy occurs in the area of banking sector policy. Here the US also opted to act decisively, forcing the

Japan's economy was hit hard by several shocks in the 1990s. The first, at the very start of the decade, when the aforementioned bubble burst; the second in 1997 when some banks went bust that had been suffering since the initial shock and with the emergence of the financial crisis in several countries in South East Asia. Similar shocks in the US occurred a few years later: the bursting of the dotcom stock market bubble in 2000 and particularly the real estate bubble in 2007, sowing the seed for the dreadful post-Lehman financial crisis. The anti-cyclical policies implemented in these two countries appear to take opposing stances. In the area of monetary policy, the Federal Reserve reacted very aggressively, quickly cutting official interest rates and deploying a large-scale quantitative easing programme while the Bank of Japan was much more timid in the 1990s and 2000s, taking its time to cut interest rates and hardly using quantitative easing at all. In the area of fiscal policy, the US adopted a strategy of stimuli concentrated in time and

prompt recapitalisation of banks in difficulty and openly reserving public money for this. Japan followed a different route, delaying both the acknowledgement of debt and bank recapitalisation. This led to the problem of zombie banks which frequently attempted to provide precarious support to equally moribund companies. According to the widely accepted version of events, such timid, inconsistent anti-cyclical policies by Japan for more than 20 years merely prolonged the problems caused by insufficient aggregate demand, making the situation chronic as well as aggravating the accumulation of public debt. The failure to revive demand, this version continues, has had serious repercussions in the form of deflationary pressures and a reduction in potential GDP given the emergence of so-called hysteresis effects (cancelled investment in production, discouraged workers leaving the labour market or losing skills because they are unemployed for too long, etc.). Some even claim this was further aggravated by the lack of structural reforms substantial enough to transform a far too paternalistic labour relation system and regulations that encouraged rigidity in the goods and services markets. In this case the benchmark, be it explicit or implicit, is also the US with its free, flexible market model.

Trend in GDP and GDP per capita in the US and Japan

Index (1984 = 100)



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

Criticism of Japanese policies is based on the macroeconomic results achieved. A preliminary analysis confirms such criticism: over the last three decades, Japan's cumulative growth in GDP has been slightly lower than the US at the same time as recording persistent deflation. The diagnosis is very different, however, when we look at growth in GDP per capita, a more appropriate variable, in principle, to measure the economic progress of citizens. In this respect the Japanese figure is much closer to that of the US. As is well-known, Japan was the country that first, and most quickly, entered what has been called «demographic transition» (the ageing and slowdown of the population). What is less widely known is that the negative impact of this development on total GDP (direct insofar as the labour force has been shrinking since the early 1990s) has not stopped the trend in GDP per capita which, at least so far, has been reasonably satisfactory. It is also possible, although there are many conceptual and empirical doubts to the effect, that demographics have

influenced the country's situation of persistent but gentle deflation (the Japanese CPI fell by 4% overall between 1998 and 2012, a modest figure compared with the slump of 25% in the US between 1929 and 1933).

The demographic factor seems to have taken the sting out of the criticism but it would be a mistake to become complacent. On the one hand, its trend is not completely exogenous to the economic trend itself, especially over long periods; for example, hysteresis and supply policies, as well as the birth rate or immigration, also have an impact. On the other hand, although Japan's demographic patterns must be seen as a result of individual and collective preferences that are freely exercised, the resulting long-term effects are no less important. Two such effects are particularly worrying from now on: the increase in the burden of public debt on future generations with fewer members and the possible loss of innovative drive and of the willingness to take business risks.

Given the above, it can be concluded that there are several reasons for diverging opinions regarding the Japanese experience mentioned at the beginning. The first is the «elephant in the room» phenomenon; i.e. an obvious factor (demographics) being omitted from the discussion by some, perhaps because it spoils certain analyses and conclusions. The second is less evident and more controversial: different views regarding the best economic and social model and, by extension, the right economic policies. Related to this, a third aspect concerns how the circumstances surrounding the decisions taken at each historical moment are evaluated, in particular the institutional framework and international environment. These last two have been important factors in the shift in economic policy introduced in 2013 by the Prime Minister Shinzo Abe, now actually coming closer to the US formula. In some way, such a shift might acknowledge that previous economic policy had been far from appropriate. As explained in the next two articles in this Dossier, over the last few years Japan has made some mistakes that the euro area would be wise to avoid but the global results reviewed here indicate that it cannot be seen as a total disaster by any stretch of the imagination.

Avelino Hernández

Financial Markets Unit, Strategic Planning and Research Department, CaixaBank

Monetary and fiscal tribulations: the long road towards Abenomics

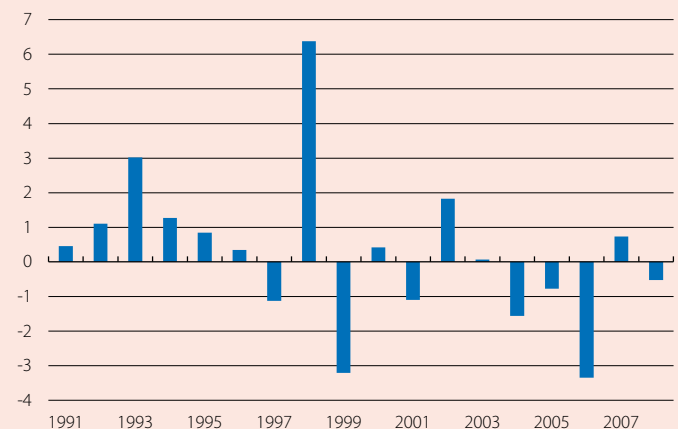
Japan's policies to manage aggregate demand have been immersed in controversy for decades. Although the criticism has sometimes been exaggerated, it is true that, with hindsight, some episodes can be identified in which a better course of action might have been taken. The euro area could learn some useful lessons in this respect.

The root cause of Japan's complications began in the middle of the 1980s. On the basis of excellent economic figures, a trio of bubbles started to form in bank credit, real estate and the stock market. All three reached formidable proportions as the economic authorities passively watched on. This is the first reason for criticism: neither monetary nor macroprudential policy challenged these excesses. Certainly, such blame can also be laid at the door of the United States (in 2000 and in 2007) and of the euro area (in 2008, in various periphery countries). The lesson from all these episodes should be thoroughly learned: it is a good idea to slow up credit booms during economically strong periods. However, there is much more discussion regarding the right response when such bubbles burst and it was in such a situation that Japan became stigmatised.

The Japanese bubble burst in 1990. The slump in the stock market and real estate was of a similar size to the 1929 crash in the United States. The banking sector was the hardest hit, first of all by losses in its industrial stock portfolios and afterwards by non-performing loans and low returns. The non-financial corporate sector was also severely affected with its stock losing value and large debts, while the affect on household finances was less severe but still considerable. On the other hand, the government had a relatively low level of debt at the start of the crisis. A thorough comparison with the overall situation of the euro area in 2008 would identify significant differences between these two episodes which should not be ignored by any detailed analysis. However, there are two similar features that leave their mark: serious problems in bank solvency and high private sector debt: a challenging context for fiscal, monetary and financial regulation policies.

Fiscal stimuli in Japan *

(% of GDP)



Note: * Annual change in public deficit, adjusted to the cycle.

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

Fiscal policy was the first line of defence deployed in Japan. As from 1990 the government had already embarked on ever-increasing budget expansion to revive the economy or at least soften the blow to the private sector. Net public debt was 12% of GDP in 1990, leaving room to increase the government deficit. Stimuli reached their peak in 1993 and then were eased given a few signs of economic recovery in 1995-1996, although in retrospect this incipient improvement led to an error of judgement. In 1997 the government implemented a programme of fiscal consolidation which included a notable VAT hike (with net public debt still at a modest 34% of GDP), which had a huge dampening effect on the economy. It is only fair to mention the emergence of another negative element unrelated to the Japanese authorities: the financial crisis of South East Asia in 1997-1998. Japan entered in recession and its deflationary period began. Since then fiscal policy has lacked definition and any clear strategy, being conditioned by the accumulation of public debt, in turn due to meagre growth and the demographic factor (net debt reached 82% of GDP in 2006 and 139% in 2014). For some analysts the «stop and start» nature of Japan's fiscal policy between 1990 and 2009 made it less effective while other criticisms are directed at the composition of stimuli. In terms of expenditure, Japan made the mistake of allocating a large amount of resources to public works that were not very productive. In terms of taxation the authorities have not managed to design a system that can generate enough revenue whilst also taking care of incentives for companies and households.

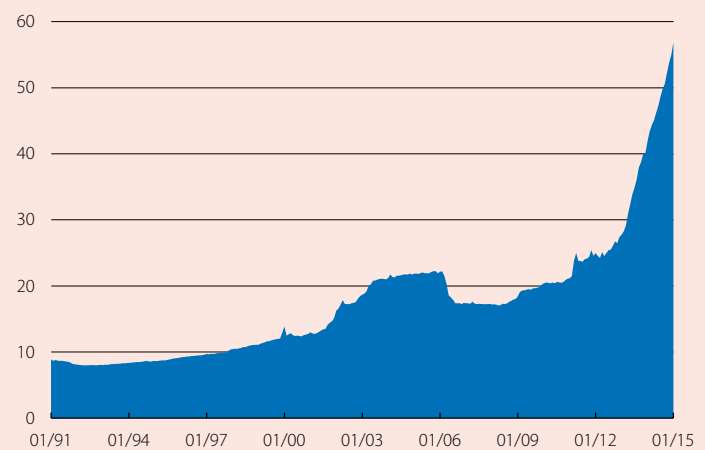
Monetary policy was Japan's second line of defence. With the benefit of hindsight and the experiences of the last few years of the Federal Reserve (Fed) and the European Central Bank (ECB), we can state that Japan's monetary stimuli in the 1990s were timid. It is true that the Bank of Japan (BOJ) reacted quickly to the collapse of the bubbles, starting to lower the official interest rate in 1990, but it did so slowly: from 6% to 0.5% by 1995. Another significant figure is that, between 1990 and 1997, the BOJ's monetary base only went from 8% to 10% of GDP. This contrasts with the extremely aggressive and fast response by the Fed in the US after its bubble burst in 2007, while the ECB's actions since 2008 place it somewhere between both these countries, although it has shifted from a moderate stance in 2008-2012 towards a more aggressive position since 2013.

Several factors help to explain the choices made by the BOJ since 1990: its analysis of the situation, its preferences given the trade-offs and the country's institutional and international environment. But perhaps the biggest mistake was not realising the singular nature and seriousness of a crisis fuelled by bank solvency and liquidity. The BOJ's tolerance of zombie banks turned out to be fatal; it stopped any early monetary stimuli from impacting the real economy sufficiently, while also maintaining a weak layer that finally broke up with the Asian and fiscal shocks of 1997. Several important banks went bust that year but it was not until 2003 that public agencies were set up to restructure bank debt in any centralised way.

Once the bank problem was more or less back on track, monetary policy in the 2000s had to tackle the spectre of deflation. Once again the BOJ decided to err on the side of caution: with the official interest rate already close to zero, it slowly and hesitatingly applied some quantitative easing measures but these were aimed at providing liquidity to convalescent banks and the effects were hardly felt by the private sector. In addition to the doubts expressed by the BOJ itself regarding its diagnosis (based on the possible influence of the demographic factor as a non-monetary cause of deflation), this moderate position taken up by Japan's central bank must be seen within the context of its goals and preferences. In 1998, just before the deflationary period began, a law gave independence to the BOJ, establishing price stability as its prime objective but without setting any concrete, explicit figure. Given a low intensity deflation well-tolerated by Japanese society (together with a very low unemployment rate), the BOJ probably decided that the costs and risks of more aggressive actions outweighed the potential benefits. It was affected by its fear of losing anti-inflationary credibility and of being out of step with an international environment that was moving in a different direction, but this changed radically with the Western crisis of 2007-2008. Given the huge impact of this shock, the Fed's overwhelming response, the yen's appreciation and the support obtained in elections in 2012, the Prime Minister Shinzo Abe instigated an authentic revolution in economic policy, called Abenomics.

Japan's monetary base

(% of GDP)



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

The effective deployment of the three areas that make up Abenomics is uneven at present. Structural reforms are few, at least for the time being. Fiscal policy is still restricted by debt so the initial spending programme in 2013 had to be counterbalanced with a VAT hike in 2014. But the aggressiveness of monetary policy is beating all records. An asset purchase programme has been implemented totalling 80 trillion yen per year (more than 15% of nominal GDP in 2014), which will last until inflation reaches the 2% zone. These purchases cover a wide range of assets but most are government bonds; in fact, it is the country that comes closest to genuine debt monetisation. There can be no doubt that the pros and cons of quantitative monetary policy, so widely debated in general, are going to be put to the test in Japan over the next few years. For the moment, inflation and inflation expectations have risen to positive figures although they are still far from 2%, while the improvement in terms of GDP growth is more debatable.

The euro area can draw some conclusions from Japan's long experience. The first is the need to act with caution during incipient recoveries and the importance of establishing intelligent road maps when removing stimuli. The second is that not all expenditure items are equal. Thirdly, it is expedient to be forceful when acknowledging the need for monetary stimuli (the consensus here is not unanimous but almost), while perhaps the most useful lesson is that resolving problems in the financial sector helps to boost the effectiveness of stimuli. Lastly, the international environment cannot be ignored: Japan's recovery in the 1990s was hit hard by the Asian crisis while the United States' policies since 2007 have acted as a catalyst for the new Abenomics. Only time will tell if this is for the best.

Jordi Singla

Macroeconomics Unit, Strategic Planning and Research Department, CaixaBank

Is the euro area becoming Japanised?: demographics and productivity

The slow rate of growth in Japan's GDP has dragged out a long time, in addition to cyclical factors, underlying or structural forces have also come into play that have a lot of inertia and are difficult to correct. This is the area where the term «Japanisation» becomes particularly relevant insofar as it is aimed at the ultimate causes of low growth and not its transient symptoms. Below we analyse the two main structural factors, demographics and productivity, with a twofold aim: to determine whether the negative view of Japanisation is correct and to evaluate to what extent the slow recovery in the euro area is due to similar factors as those that have affected Japan.

Demographics is a highly significant determining factor in long-term economic growth. And, at times of fast demographic change, its impact can also be felt on the trend in GDP in the short term, such as in the case of a wave of immigration. The transformation undergone by Japan in this area has been extensive and sustained in two respects: longer life expectancy and the fall in the birth rate (migrations are a secondary factor). As a result of this, the population went from growing by 0.6% year-on-year on average in the 1980s to falling by 0.2% in 2014. Even more important is the fact that the working age population went from 85 million in 1990 to 78 million in 2014. The decline in the number of people of working age per elderly person has also been drastic: it fell from 5.7 in 1990 to 3.2 in 2010 and is expected to fall even further, down to 1.6 by 2030.

The best-known consequence of this demographic shift is a drop in the GDP growth rate due to a direct effect via the labour force. Specifically, Japan went from 4% annual growth in the 1980s to 1.0% between 1990 and 2014. Of these 3.0 points of difference, 0.5 are due to the lower rate of growth in the working age population. Moreover, the outlook is not very encouraging given that the population will decrease by an annual rate of 0.7% over the next decade, so the growth capacity of the Japanese economy is likely to continue to shrink if far-reaching measures are not taken. On the other hand, one additional effect of the ageing population on growth, less visible and more difficult to quantify, is the change in the type of financial assets chosen by households for their savings. Older societies tend to be more conservative and savings are therefore placed in less risky instruments (bonds rather than shares, public debt rather than venture capital, etc.) and are ultimately less productive.

One of the main concerns regarding this reduction in the growth rate is whether debt can be sustained, especially public debt. The Japanese economy has the highest public debt of all developed countries: in 2014 this reached 139% of GDP in net terms and 245% in gross terms (without discounting debt held by public sector agencies such as the state pension fund). One argument against such concerns, and which is often mentioned, is that only 8% of this debt is in the hands of foreign investors, although this only partially relieves the problem. Japanese citizens themselves have amassed a large proportion of these bonds to help them in their old age and net demand is therefore likely to fall over the coming years. At the other end of the spectrum, this circumstance could enter into conflict with the need to increase government spending, especially regarding pensions and health, due precisely to the ageing population. All this indicates that, if Japan wants to maintain its current model of public coverage, it must at least offset the impact of ageing by extending working life, expanding female labour force participation or increasing the number of hours worked. All these measures are limited in scope, however.

Sooner or later the euro area is likely to have to take similar measures as its population is also ageing considerably, although the situation is less advanced than in Japan. Specifically, whereas the number of working age people in the euro area was 4.8 to every elderly person in 1990, in 2010 this was 4.1 and it is expected to fall to 2.3 by 2030. However, in addition to the options to reverse the aforementioned demographic phenomenon, in the euro area immigration also looks like being, potentially, a very powerful tool while its effect has been almost neutral in Japan's case to date.

Beyond demographic factors, a second key factor that determines an economy's long-term growth capacity is the trend in productivity. Consequently, first we will look at the trend in labour productivity and then we will analyse in more detail the contribution of the different production factors to growth, with particular emphasis on the evolution of total factor productivity (TFP).

One relatively simple and intuitive way of measuring labour productivity is by breaking down GDP per capita into GDP per

Breakdown of GDP per capita growth

Year-on-year change * (%)

	GDP per capita	GDP per hour	Hours per employee	Employment / population
United States	1.5	1.7	0.0	-0.2
Euro area	1.1	1.2	-0.2	0.1
Japan	0.9	1.6	-0.6	-0.1

Note: * Average 1990-2013.

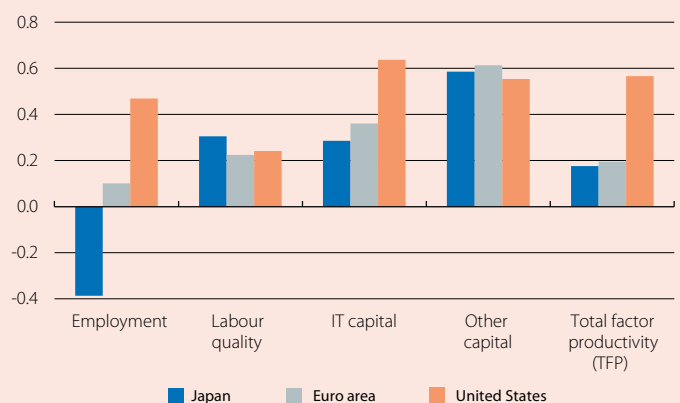
Source: "la Caixa" Research, based on data from The Conference Board Total Economy Database.

hour worked (which measures labour productivity), the number of hours worked per employee and the ratio of the employed population out of the total. Broadly speaking, in 2013 productivity was lower in both Japan (36%) and the euro area (24%) than in the US. The GDP per capita growth rate between 1990 and 2013 shows how Japan has been able to maintain a higher labour productivity growth rate than the euro area, very similar to the one in the US (see the table). In this respect, therefore, the Japanese economy does not seem to have performed badly. However, the reduction in the number of hours worked and in the share of the employed population explains Japan's lower growth in GDP per capita. In the case of the euro area, lower growth in GDP per capita is almost entirely due to the worse trend in labour productivity so that, in this respect, unfortunately the euro area is not becoming Japanised.

More information can be obtained on the trend in productivity by breaking down GDP growth into the different production factors: the contribution to growth of labour and capital, as well as the quality of the labour force, of capital related to information technologies or IT, of the rest of the capital and the total factor productivity. As can be seen in the graph, discrepancies between the three regions occur, firstly, in the differing contribution made by labour. The contribution of the employed population is negative in Japan and low in the euro area when compared with the United States. On the other hand, there does not seem to be any significant difference between the three regions in terms of labour quality or non-IT capital. However, differences reappear with respect to investment in information technologies, a key factor behind the US's advantage over the euro area and Japan. In Japan's case, the innovative capacity of companies decreased after the crisis in the 1990s, in particular in IT industries and something similar might now be happening in the euro area.

Breakdown of GDP growth by input factor

Year-on-year change * (%)



Note: * Average 1990-2013.

Source: "la Caixa" Research, based on data from The Conference Board Total Economy Database.

Finally, the last factor behind the weak performance of the Japanese and European economies compared with the United States is the low total factor productivity (TFP), which measures how efficiently an economy makes use of its input factors. In general, the US manages to exploit the economies of scale of its domestic market better. In the euro area, different regulations and the high degree of state intervention split the planned single market into different sub-markets, reducing efficiency and the competitiveness of its companies (see Gual, 2014).¹ Arnold, Nicoletti and Scarpetta (2008)² also note that the excessive regulatory burden in goods and services markets lies behind the lower efficiency of European and Japanese markets, in particular in the most IT-intensive sectors.³

We have seen how, in spite of the differences, the euro area shares some shortcomings with Japan, both in demographics and also in certain measurements of productivity. The remedies that need to be applied in both cases are also similar albeit with their own particular features. Japan needs to go into its structural reforms in depth (one of the pillars of Abenomics) in order to complement the expansionary policies, both fiscal and monetary, that are being implemented. In particular it is vital to enlarge the percentage of the population in employment, for example by increasing the share of women in the labour market, as well as intensify competition to encourage corporate dynamism and investment, particularly in IT industries. In the euro area the crisis has forced many countries to undertake structural reforms that had been postponed, as in the case of Spain, but there is still some way to go. Moreover, it is essential to continue with the project of constructing Europe: without political agreements to promote the creation of true economic union it will be very difficult to resolve the structural problems of the euro area as a whole.

Josep Mestres Domènech
Macroeconomics Unit, Strategic Planning and Research Department, CaixaBank

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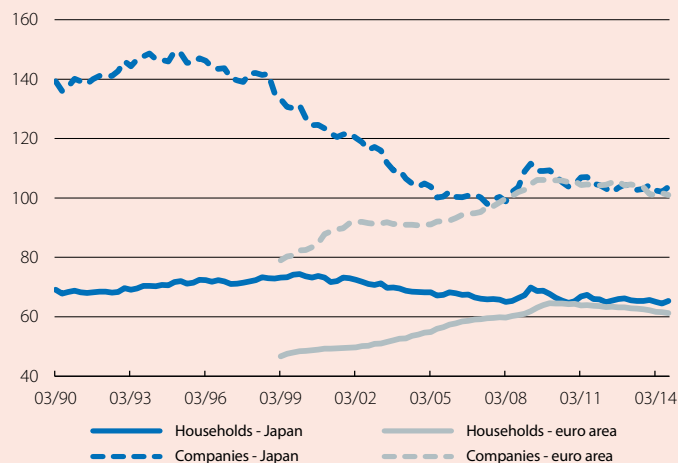
3. Arora, A., Branstetter, L. G. and Drev, M. (2013), «Going Soft: How the Rise of Software-Based Innovation Led to the Decline of Japan's IT Industry and the Resurgence of Silicon Valley», Review of Economics and Statistics, 95(3), 757-775.

An accommodative monetary environment: the new norm for the private sector

The main developed economies have found themselves in an incredibly accommodative monetary environment after more than six years of very low interest rates and the implementation of a wide range of unconventional monetary tools. The ultimate aim of such monetary expansion is to encourage economic activity after the crisis suffered in 2008. Specifically, in the euro area, where the recovery is slow and inflation worryingly low, in March the monetary authority embarked on a large-scale asset purchase programme. This new monetary stimulus has confirmed that interest rates will remain very low for a prolonged period of time, highlighting the need to understand the effects this incredibly accommodative monetary environment may have on economic agents in the private sector (households and firms), which play a key role in guaranteeing the effectiveness of monetary policies designed to generate economic growth by stimulating aggregate demand. To carry out this analysis, we have analysed the behaviour of households and companies in Japan as they have been living with a monetary environment similar to the one in the euro area for more than 15 years.

Private sector debt in Japan and the euro area

(% of GDP)



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

Let us start with Japanese households. When the crisis erupted in 1990, their situation was not excessively critical as Japanese households tended to save (with a savings rate of around 20% of disposable income, 9 pps and 6 pps above that of the US and the euro area at the start of the 2008 crisis) and had moderate levels of debt, namely 69% of GDP. The reasons for this composition of household finances were not only cultural (words such as «austerity» and «frugality» are often related to Japanese culture) but also of a different nature, such as demographic and institutional factors which played an important role as well. Of note among the latter are the tax breaks for savings, an insufficient state pension system and the difficulty in households obtaining credit, forcing them to save for any large purchases or as a precaution against future shocks. Another factor boosting savings was the fact that, at that time, most of the population was fully mature, a stage in the life cycle when people tend to save more. On the other hand, the situation of households in the euro area when the

crisis started in 2008 was considerably different from that of Japan, with moderate savings, high consumption and high levels of debt in the countries suffering most from the real estate bubble,¹ such as Ireland (with a debt of more than 120% of GDP in 2009) and Spain (over 80% of GDP in 2010).

To combat the tough economic recession and deflation, the Bank of Japan implemented an incredibly accommodative monetary policy (see the article «Monetary and fiscal tribulations: the long road towards Abenomics» in this Dossier), cutting official interest rates to minimum levels and keeping them there for more than 15 years. This environment should have stimulated aggregate demand; however, this was not the case as far as households were concerned. Although the savings rate fell by more than half after 20 years, this was not due to higher consumption but because growth in gross disposable income had halted and the population had aged considerably (old age is the stage in the life cycle when savings tend to be used up). Between 1995 and 2014 household consumption stalled, on average growing by a meagre 0.2% year-on-year (compared with 4.5% in the US and the 2.8% in the euro area). Some of the reasons why rock bottom interest rates did not stimulate demand are that real interest rates fell less sharply due to the fact that the inflation rate remained negative and, as some authors have argued,² the monetary transmission mechanism through households was weak. Specifically, the theory of intertemporal consumption suggests circumstances in which cuts in real interest rates can increase savings and reduce consumption, the opposite of what happens, in general, in most economies. This would be the case for agents with large amounts of assets in relation to their income and a limited willingness to exchange consumption over time, who therefore tend towards more stable consumption throughout their lives. A fall in real interest rates in the short term would reduce the return on savings and lead to lower future consumption.

1. In the case of Japan, the real estate bubble in 1990 did not start with households but with companies investing heavily in such assets.

2. Muellbauer, J. and Murata, K. (2009), «Consumption, land prices and the monetary transmission mechanism in Japan», CEPR.

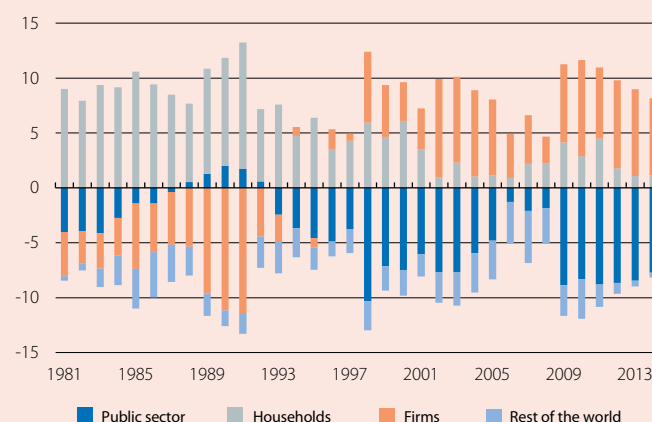
And this would encourage agents to offset these lower returns by increasing their current savings to maintain similar levels of consumption in the future.

In short, the behaviour of Japanese households in terms of their savings has changed radically since the start of the crisis. If households are saving less and the government is borrowing more and more, another agent must have increased its savings capacity. This is due to the fact that one sector of the economy cannot borrow if another does not lend, whether it is another agent in the domestic economy or the rest of the world (in this last case, net borrowing from the rest of the world has remained at moderate levels over time). Consequently, the fall in household savings and the increase in government debt have been offset by the appearance of a new saver, the corporate sector. Several factors explain the fact that, in Japan's accommodative monetary environment of the last 15 years, aggregate demand has not been stimulated by larger investment on the part of the private sector. The first would be due to the considerable over-investment of companies when the crisis erupted, and to their low profitability.³ The second factor would be based on the need for deleveraging as the real estate and financial bubble resulted in companies with huge levels of debt (140% of GDP in 1990). After the price of these assets slumped, they were forced to sort out their balance sheets and deleverage via a strategy of contained expenditure and retained earnings. Once this deleveraging was under control, companies continued with their strategy of retaining profits given the uncertain environment regarding the economic cycle, depressed aggregate demand, a taxation system that encouraged this strategy and, finally, the lack of attractive alternatives to invest their liquidity. All these elements brought about a sharp rise in corporate savings. In the case of the euro area, deleveraging is more moderate as the levels of debt reached were much lower than in Japan (the peak was 106% of GDP in 2009) and companies in the euro area do not seem to be as willing to save as their counterparts in Japan.

By way of conclusion, there are few similarities between the Japanese economy and the euro area regarding the private sector balance sheet and its behaviour. For households, the weakness in the monetary transmission mechanism to the Japanese economy is unlikely to be applicable to continental Europe given the different fundamentals between these two regions. In fact, there has been significant growth in private consumption in most European countries while the financial position of European firms is also more solid in general, helping investment to recover.

Japan: net borrowing/lending by sector

(% of GDP)



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

Ariadna Vidal Martínez

Macroeconomics Unit, Strategic Planning and Research Department, CaixaBank

3. This is due to excess capital which means the rate of return on capital is low.



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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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