MR05

MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

NUMBER 390 | MAY 2015

ECONOMIC & FINANCIAL ENVIRONMENT

FINANCIAL MARKETS
Shortage of safe assets in financial markets

INTERNATIONAL ECONOMY
The deterioration in Brazil's outlook: a bad patch or something more deep-rooted?

EUROPEAN UNION
Are labour costs converging in euro area countries?

SPANISH ECONOMY
The "la Caixa" Research real estate thermometer

DOSSIER: THE SUSTAINABILITY OF DEBT AT A GLOBAL LEVEL

Should we no longer worry about the level of debt?

Crisis, debt and economic policy, a controversial triangle

The role of bank credit in Spain's recovery – another phoenix miracle?

Alternative financing is possible, but is it safer?

"la Caixa" Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK

May 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

Date this issue was closed:
30 April 2015

Jordi Gual
Chief Strategy Officer

Enric Fernández
Director, Bank Strategy

Oriol Aspachs
Director, Macroeconomics

Avelino Hernández
Director, Financial Markets

INDEX

The role of debt in the recovery – part of the problem or part of the solution?

One of the main distinctive features of the current economic recovery in the developed world is its lack of dynamism compared with other revivals after recessionary periods. This phenomenon has naturally led to concern among economic policymakers and lively debate among analysts and academics. At the risk of oversimplifying, the issue can be summed up as an intellectual dispute between two paradigms: secular stagnation and the debt supercycle.

Secular stagnation theory claims that the weakness of the current expansionary phase is due to the structural trend of advanced economies towards a fall in the growth potential of per capita GDP. According to this view, the rate of potential growth shrinks with each new expansionary cycle, fundamentally because of three reasons. The first is the absence of new technological opportunities and particularly widely-used technologies such as electricity, vehicles and computing. The second is the ageing population which reduces both the propensity to consume and the willingness to take on risk. And, thirdly, the decrease in investment in physical capital which is obviously related to the two previous explanations and is a trend that has been particularly prevalent in the last 15 years.

Ultimately those endorsing secular stagnation believe that the developed world saves too much which, together with the lack of attractive investment projects, results in a lack of dynamism in the economy with interest rates that, in spite of being very low in nominal terms, are not low enough once inflation has been discounted. According to this analysis, such a situation requires a bigger boost for demand and expenditure from public spending, if necessary financed by central banks directly buying up public bonds.

The economists attempting to explain current phenomena via recurrent debt cycles (a debt supercycle) stress the decisive role of monetary and credit expansion over the last 30 years in creating today's scenario. This is characterised not only by the weak growth, insufficient demand, low interest rates and minimal inflation highlighted by the secular stagnation theorists but also by an unusual creation of liquidity and financial asset prices at record highs in many markets.

According to this point of view the debt supercycle reflects how, over the years, monetary authorities have been unable to withstand political and social pressure to come to the rescue of markets and the economy when successive bouts of financial exuberance have burst asset bubbles and created the risk of economic recession. The debt supercycle has also resulted from the error committed by monetary policymakers for many years, using inflation as their basic guideline, measured via the CPI, while failing to take sufficiently into account how liquidity creation pushed up the price of financial assets with serious repercussions for financial and economic stability. In short: instead of focusing on creating new productive assets they have provided the economy with more financing aimed at investing in already existing assets and increasing their price, operations which often seek capital gains rather than returns within a context of very low interest rates which force investors to search for yield.

Evidently the economic policies proposed by economists who support the debt supercycle theory are substantially different from those extolled by the followers of secular stagnation. Moreover, these are politically less popular proposals in many countries since they emphasise debt and therefore recommend policies that focus on supply rather than demand as well as fiscal consolidation and the gradual reduction of private debt. Such proposals cannot even pretend to provide a quick fix for the problem of weak economic growth as, by their very nature, they attempt to stabilise conditions for more sustainable growth in the long term.

It will take years before we know which way this interesting debate on the intellectual plane will go, although probably less time to witness the practical consequences given the inevitable developments in events. Meanwhile, and just in case, whether one side is right or the other, it is useful for us to realise the implications of high levels of debt for our economies, and the Dossier in this *Monthly Report* focuses on this very issue.

Jordi Gual
Chief Economist
30 April 2015

CHRONOLOGY

APRIL 2015

7 The **Spanish Treasury places six-month bills at a negative interest rate** for the first time in its history.

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.**

AGENDA

MAY 2015

5 Registration with Social Security and registered unemployment (April).
8 Industrial production index (March).
13 Flash GDP of the euro area (Q1).
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).

JUNE 2015

2 Registration with Social Security and registered unemployment (May).
3 Governing Council of the European Central Bank.
5 Industrial production index (April).
10 Quarterly labour cost survey (Q1).
16 Fed Open Market Committee.
18 International trade (April).
Loans, deposits and NPL ratio (April).
25 European Council.
29 CPI flash estimate (June).
Economic sentiment index of the euro area (June).
30 Balance of payments (April).
Net international investment position (Q1).
State budget execution (May).
Household savings rate (Q1).

Global growth is gradually speeding up

The world economy is accelerating, albeit at an uneven rate between countries. This slight acceleration in global growth is being supported by two key factors: the effects of cheaper oil, positive at a global level, and the continuation of accommodative policies by the main monetary authorities, particularly the large-scale public debt purchase programme started by the European Central Bank (ECB) in March. These factors are having a highly positive effect on the economies of the euro area, resulting in the International Monetary Fund (IMF) carrying out a substantial upward revision of most of its growth forecasts for the region, especially for Spain. However, the emerging economies are now into their fifth consecutive year of slowdown, especially due to China's slower rate of economic growth but also because of geopolitical tensions and the negative impact of falling oil prices on those countries that export crude. Nonetheless, the most important change in the panorama outlined by the IMF in its recent spring report is perhaps the reduction in long-term potential growth, both in advanced countries and emerging, with the institution recommending that economic policies should be adopted that support long-term growth.

The Fed's strategy has become particularly important given the (temporary) slowdown in US growth. In 2015 Q1 GDP increased by a moderate 0.1% quarter-on-quarter (3.0% year-on-year), far below the figures recorded in the last few quarters. This setback in activity can essentially be explained by unusually adverse weather during the winter months but the slower rate of growth has led to doubts regarding the solidity of US growth and the impact of the dollar's appreciation, even though the slowdown is markedly temporary in nature. These doubts are reflected, for instance, in the trend observed in the main stock market indices in the US which have been hesitant given the uncertainty surrounding the forecasts for corporate earnings over the coming quarters. All this has once again placed the Fed's strategy at the heart of debate. For the time being, the institution continues to predict moderate growth in the medium term, allowing it to maintain a cautious message that suggests the first interest rate hike will not take place until Q4.

The emerging countries are on pause. The emerging economies have benefitted from the prudent message contained in the Fed's last communication but the general scenario for the emerging bloc is one of weakness. China announced 7.0% GDP growth year-on-year in 2015 Q1, its lowest rate for the last six years, partly reflecting the economy's structural shift towards a more consumption-based model, in which the services sector is gaining in importance to the detriment of industry. Given the confirmation that its slowdown is happening faster than expected, the Chinese authorities continued their strategy of relaxing monetary and financial conditions to prevent a hard landing for the economy. Within the emerging bloc, Brazil and Russia are still the countries representing the greatest risks, unlike India whose economy is performing well.

Growth prospects improve in the euro area in spite of a lack of agreement with Greece. April witnessed marked contrasts in the evolution of European financial markets due to the intensification of Greece's liquidity problems and entrenched negotiations between the Greek and European authorities. Changes in the negotiating team could represent a turning point for this situation although their impact on the euro area's economic recovery has been barely visible. The role played by the ECB's expansionary monetary policy is vital in this respect as it substantially lowers interest rates and supports inflation expectations. Moreover, the measures taken by the institution have also encouraged the depreciation of the euro, boosting Europe's exports.

The Spanish economy speeds up its rate of growth. GDP increased by 0.9% quarter-on-quarter in 2015 Q1, a faster rate of growth than expected, leading us to revise upwards our growth forecast for the whole of the year to 2.8%. In fact, over the last few months the main national and international organisations have considerably improved their growth forecasts for the Spanish economy, now set between 2.5% and 3.0%. The forecasts presented by the government in its Stability Programme are also within this range, specifically 2.9%. It is worthy of note that, in spite of the expected economic improvement, the rate of reduction for the public deficit has remained the same for the period 2015-2018 and has even been relaxed slightly in 2017.

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										
Global [1]	3.4	3.3	3.4	3.7	3.3	3.3	3.2	3.4	3.4	3.5
Developed countries	*1.1*	*1.6*	*2.2*	*2.4*	*1.5*	*1.5*	*1.7*	*2.2*	*2.4*	*2.5*
United States	2.2	2.4	3.1	2.8	2.7	2.4	3.0	3.3	3.0	3.1
Euro area	–0.4	0.9	1.5	1.8	0.8	0.9	1.1	1.5	1.7	1.9
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	1.0	1.4	0.4	0.2	0.6	1.0	1.1	1.3
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	2.8	2.5	1.6	2.0	2.6	2.8	3.0	2.9
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	2.5	2.5	2.8	3.0	2.4	2.3	2.5	2.7
Emerging countries	*6.2*	*5.9*	*5.4*	*5.6*	*5.8*	*5.9*	*5.8*	*5.3*	*5.2*	*5.1*
China	7.7	7.4	6.7	6.5	7.3	7.3	7.0	6.7	6.4	6.5
India [2]	6.9	7.4	7.1	7.2	8.2	7.5	7.4	7.1	7.0	7.2
Indonesia	5.6	5.0	5.4	5.9	4.9	5.0	5.2	5.3	5.5	5.6
Brazil	2.7	0.1	–0.9	0.8	–0.6	–0.2	–1.3	–0.8	–0.9	–0.4
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	3.5	1.0	1.8	1.7	2.7	2.8	3.2
Russia	1.3	0.6	–3.3	–0.8	0.9	0.4	–2.8	–3.5	–3.5	–3.2
Turkey	4.2	2.9	3.3	4.0	1.9	2.6	2.1	3.1	3.9	3.9
Poland	1.6	3.3	3.4	3.7	3.3	3.2	3.0	3.3	3.5	3.6
South Africa	2.3	1.6	2.2	2.7	1.5	1.3	1.8	2.0	2.4	2.4
INFLATION										
Global [1]	3.7	3.3	3.0	3.7	3.4	2.9	2.6	3.1	3.0	3.3
Developed countries	*1.4*	*1.3*	*0.3*	*1.9*	*1.4*	*1.0*	*0.1*	*0.0*	*0.3*	*1.0*
United States	1.5	1.6	0.2	2.2	1.8	1.2	–0.1	–0.1	0.1	0.9
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	1.9	0.8	0.4	–0.2	0.3	0.8	1.4
France	1.0	0.6	0.3	1.4	0.5	0.3	–0.2	0.1	0.4	1.0
Italy	1.3	0.2	0.3	1.4	–0.1	0.1	–0.1	0.1	0.3	0.9
Spain	1.4	–0.2	0.0	1.9	–0.3	–0.5	–1.0	–0.3	0.3	1.2
Japan [3]	0.4	2.7	0.9	1.4	3.3	2.5	2.2	0.2	0.3	0.9
United Kingdom	2.6	1.5	0.4	1.7	1.5	0.9	0.1	0.0	0.5	0.9
Emerging countries	*4.4*	*3.8*	*4.1*	*4.3*	*3.8*	*3.0*	*3.0*	*4.7*	*4.2*	*4.4*
China	2.6	2.0	1.8	2.4	2.0	1.5	1.2	1.8	2.0	2.2
India	10.1	7.2	5.0	6.8	7.7	4.8	5.2	5.1	3.9	5.6
Indonesia	6.4	6.4	6.3	5.2	4.4	6.5	6.5	7.0	6.6	5.0
Brazil	6.2	6.3	7.7	6.1	6.6	6.5	7.7	7.8	7.9	7.5
Mexico	3.8	4.0	3.2	3.1	4.1	4.2	3.1	3.3	3.3	3.2
Chile	2.1	4.4	3.5	3.0	4.7	5.3	4.4	3.6	3.1	3.0
Russia	6.8	7.8	13.7	6.6	7.7	9.6	16.2	16.0	12.5	10.0
Turkey	7.5	8.9	6.7	6.5	9.2	8.8	7.5	6.5	6.4	6.3
Poland	1.2	0.2	–0.2	1.9	–0.1	–0.6	–1.2	–0.5	–0.1	0.9
South Africa	5.8	6.1	4.4	5.6	6.2	5.7	3.9	3.9	4.1	5.5

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

Forecasts

Spanish economy

	2013	2014	2015	2016	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
Macroeconomic aggregates										
Household consumption	–2.3	2.4	3.5	2.1	2.8	3.4	3.9	3.6	3.4	3.0
General government consumption	–2.9	0.1	0.5	0.1	0.3	–0.5	–1.0	0.3	0.7	1.9
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	2.9	2.0	2.6	2.7	3.1	3.0	2.9	2.9
Exports of goods and services	4.3	4.2	5.3	5.9	4.5	4.7	5.9	6.4	3.7	5.2
Imports of goods and services	–0.4	7.7	6.1	5.0	8.6	7.7	8.1	7.3	3.5	5.4
Gross domestic product	**–1.2**	**1.4**	**2.8**	**2.5**	**1.6**	**2.0**	**2.6**	**2.8**	**3.0**	**2.9**
Other variables										
Employment	–3.2	1.2	2.9	2.4	1.7	2.4	3.0	2.8	2.9	2.8
Unemployment rate (% labour force)	26.1	24.4	22.4	20.9	23.7	23.7	23.8	22.4	21.7	21.7
Consumer price index	1.4	–0.2	0.0	1.9	–0.3	–0.5	–1.0	–0.3	0.3	1.2
Unit labour costs	–0.4	–0.4	–0.1	0.7	–0.3	–0.1	–0.1	0.0	–0.3	0.0
Current account balance (cum., % GDP)[1]	1.4	0.8	1.1	1.1	0.7	0.8	0.9	1.0	1.1	1.1
Net lending or borrowing rest of the world (cum., % GDP)[1]	2.0	1.2	1.7	1.7	1.1	1.2	1.5	1.6	1.7	1.7
Fiscal balance (cum., % GDP)[1]	–6.8	–5.8	–4.8	–3.3	–5.7	–5.8				

Financial markets

	2013	2014	2015	2016	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
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	0.43	1.16	0.23	0.24	0.26	0.33	0.49	0.65
12-month Libor	0.68	0.56	0.92	1.68	0.56	0.57	0.66	0.78	1.00	1.23
2-year government bonds	0.30	0.44	0.86	1.77	0.50	0.52	0.58	0.63	0.95	1.27
10-year government bonds	2.33	2.53	2.33	3.26	2.49	2.27	1.97	2.04	2.45	2.85
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	0.02	0.03	0.16	0.08	0.05	0.01	0.01	0.01
12-month Euribor	0.54	0.48	0.20	0.28	0.44	0.33	0.26	0.18	0.18	0.18
2-year government bonds (Germany)	0.13	0.05	–0.24	–0.01	–0.01	–0.04	–0.18	–0.26	–0.26	–0.26
10-year government bonds (Germany)	1.62	1.23	0.20	0.74	1.06	0.76	0.35	0.15	0.15	0.17
EXCHANGE RATES										
$/€	1.33	1.33	1.08	1.04	1.33	1.25	1.13	1.07	1.06	1.05
¥/€	129.65	140.42	131.49	129.77	137.68	142.89	134.30	130.49	130.63	130.54
£/€	0.85	0.81	0.72	0.71	0.79	0.79	0.74	0.72	0.72	0.71
OIL										
Brent ($/barrel)	108.47	99.45	61.30	78.68	103.38	77.03	55.19	59.97	62.50	67.55
Brent (€/barrel)	81.67	74.83	56.87	75.84	78.02	61.68	48.97	55.83	58.85	64.43

Notes: *1. Four quarter cumulative.*

Forecasts

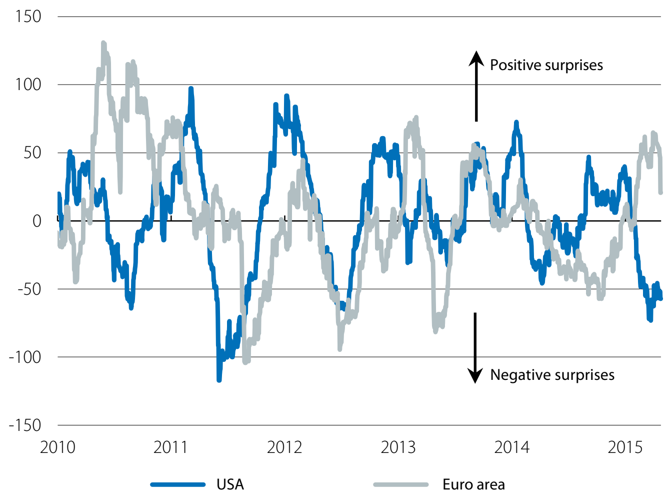
FINANCIAL OUTLOOK · Setbacks on the road: old obstacles and new challenges

The reappearance of instability towards the end of April is raising some questions. April witnessed marked contrasts in the trend of European financial markets. Early in the month the overriding trend was firmly upwards for European risk asset prices thanks to buoyant investor sentiment after the start-up of sovereign QE and positive figures regarding the euro area's growth. However, this favourable pattern which started at the beginning of the year was halted towards the end of the month due to the intensification of Greece's liquidity problems and the entrenchment of negotiations between the Greek and European authorities. In the US, unlike the situation in Europe over the last few months, the weakness of cyclical indicators has been keeping stock markets hesitant. The slightly disheartening outlook for corporate earnings in the next few quarters may limit any revival in the upward momentum of US stock markets in the short term. Given this indecisive situation, the steps taken by the Federal Reserve (Fed) in terms of monetary normalisation have become even more relevant.

This pause in international markets might continue for some time especially if the situation in Greece shows no sign of improving. Although the volatility of financial assets is still low, according to both technical and sentiment indicators we must continue to be cautious, especially in Europe. In our opinion, in the short term we are much more likely to see modest, intermittent changes in European risk assets than a continued rally. On the other hand emerging assets have performed relatively better than developed assets, this constructive climate largely being supported by the involvement of the Chinese authorities in easing monetary and financial conditions, together with the cautious message contained in the Fed's more recent communications. However, the widespread situation in the emerging bloc is one of weakness and the current calm may give way to moderately intensive fluctuations.

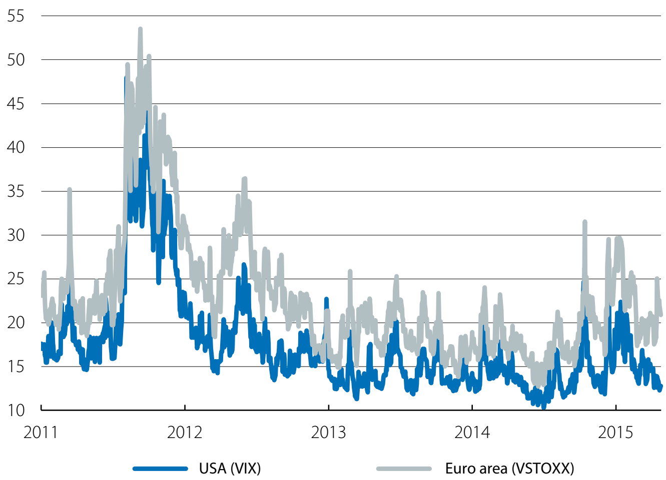
Europe's public debt market is buffeted by contrasting forces. The Greek government's increasingly pressing liquidity problems have increased outflows of capital towards core debt and pressure to sell periphery sovereign debt. The effect on the spread of Spanish, Italian and Portuguese debt has been contained, however. With a view to the coming weeks, this greater volatility will continue due to the difficulties caused by the negotiations between Greece and European institutions. Nevertheless, we do not think there will be a sustained severe deterioration in periphery debt. This view is justified by the good performance by the public debt purchase programme of the European Central Bank (ECB) and the increasingly strong signs of growth in the euro area.

Economic surprises
Index



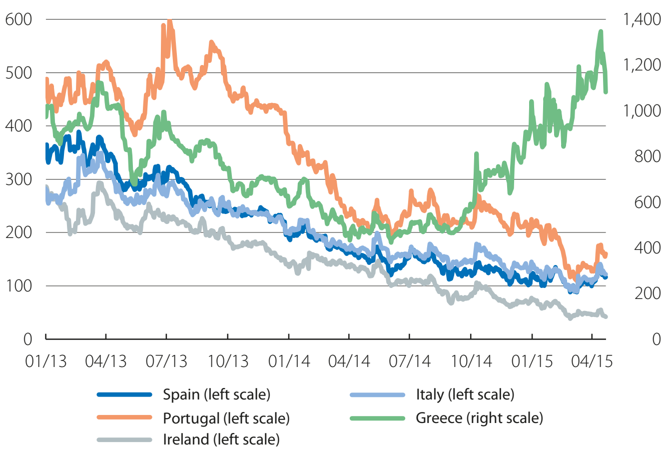
Source: *"la Caixa" Research, based on Bloomberg data.*

Implied volatility in international stock markets
(%)



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

Euro area: risk premia for 10-year public debt *
(bps) *(bps)*



Note: ** Spread compared with 10-year German bond.*
Source: *"la Caixa" Research, based on Bloomberg data.*

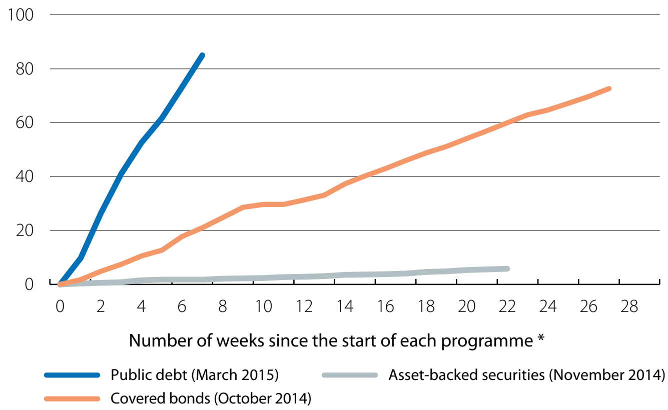
Meanwhile, the ECB repeats that it is firmly committed to implementing sovereign QE. At the last ECB meeting, Mario Draghi stressed that the public debt purchase programme will continue until at least September 2016, at the same time denying that there was a shortage of European bonds in the market and ruling out the possibility of lowering the deposit facility rate. However, it seems clear that the ECB is giving itself room to manoeuvre so that it can be flexible enough to act should the circumstances so require. We believe that sovereign QE ending before September 2016 is highly unlikely but it cannot be completely ruled out if growth and inflation continuously outperform expectations. So far Europe's monetary authority has acquired 85 billion euros in public debt, in line with the monthly target set at around 45 billion.

The Fed continues to convey caution given the weak economic figures in 2015 Q1. At its meeting at the end of April, the Committee presented a less favourable interpretation of the US economic situation. The monetary authority's communication highlights the slowdown in activity over the winter, as well as the recent moderation in the pace of job creation. However, the Fed members have pointed to the temporary nature of this weakness, largely a consequence of meteorological factors and strikes at ports on the west coast of the US, so they continue to predict moderate growth in the medium term. This interpretation reinforces our scenario of a slow, gradual normalisation with the first official interest rate hike in Q4. Nevertheless, the elimination of forward guidance by the monetary authority could make US asset prices more volatile, increasing their exposure to the trend in business indicators. In this respect, we expect the incipient upswing in yield for US public debt to continue in the medium term, especially because of improved inflation expectations, although this might happen intermittently.

The recovery in investor flows pushes up emerging asset prices. April saw a significant rally in emerging risk asset prices, as well as further drops in yields on their public debt. There are three main factors behind this trend. Firstly, the Fed starting to raise official interest rates later than expected, momentarily turning investor appetite back towards emerging assets. Secondly, the upswing in oil has slightly lessened the doubts hovering over the finances of some oil-producing countries. Lastly, the expansionary policies adopted by the emerging countries have also contributed to this situation, particularly the active stance adopted by the Chinese authorities. The People's Bank of China has cut the reserve requirements for its local banks by 100 bps, to 18.5%, the second reduction since March in order to stimulate credit. At the same time the monetary authority has also approved a new credit facility aimed at boosting demand for bonds issued by local Chinese corporations given their difficulty in refinancing their debt. This accommodative stance by emerging central banks has been confirmed by decisions taken in Russia and Thailand while, at the other end of the

Euro area: asset purchases under different ECB programmes

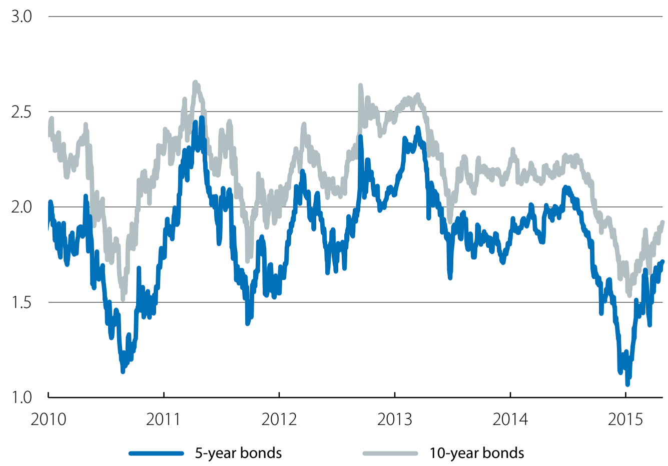
Cumulative volume since the start of the programme (billion euros)



Note: ** In brackets, the date each programme started.*
Source: *"la Caixa" Research, based on Bloomberg data.*

*USA: inflation expectations at 5 and 10 years **

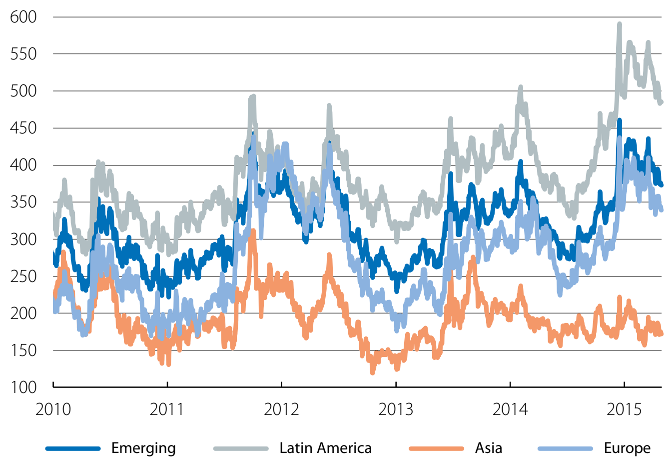
(%)



Note: ** Implicit in inflation-linked bonds.*
Source: *"la Caixa" Research, based on Bloomberg data.*

*Sovereign bond spreads of emerging countries **

(bps)



Note: ** Spread compared with a basket of US Treasury bonds.*
Source: *"la Caixa" Research, based on Bloomberg data.*

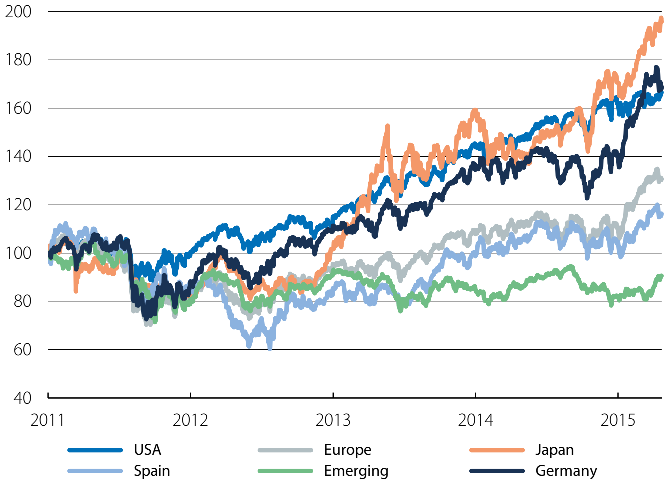
scale, Brazil's central bank has maintained its restrictive policy to control inflationary pressures.

The stock markets of the advanced countries take a break. The optimism prevailing in Europe's stock markets since the start of the year has given way to a predominantly cautious climate, mainly caused by the re-emergence of fears regarding Greece's solvency. On the other hand, the gradual disappearance of the factors originally causing the stock market rally (expectations and start-up of QE, improved economic outlook in the euro area) has also taken the wind out of the stock markets' sails. At the same time, the over-buying shown by European indices and increasingly demanding share price ratios (P/E ratio) have led to stock market losses. Nevertheless, we believe Europe's stock market will pick up again thanks to the growth expected in earnings and a scenario of greater traction for activity. In the US, although it is true that the corporate earnings downgrade will not help matters, the chance of there being some positive surprises is still considerable. A premise that is also valid on the macroeconomic front, especially after the weak growth figures for the US economy in Q1.

The central banks will continue to monitor trends in the dollar and oil price as both will have a notable effect on inflation in 2015. In April, both factors played an important role in the behaviour of prices. Regarding currencies, the turnaround in the dollar's appreciation is worthy of note, falling by 6% against the euro from its peak value reached in March (from 1.05 to 1.12 dollars per euro). This weakening in the dollar has also been seen against emerging currencies, providing temporary relief for those countries with a high level of debt issued in the US currency. However, we expect the dollar to start to appreciate again in the remainder of the year. With regard to oil, April saw a 21% rise in the Brent barrel price, up to 66.8 dollars. The gradual increase in the price of crude forecast up to the end of the year will continue to help inflation pick up worldwide.

Main international stock markets

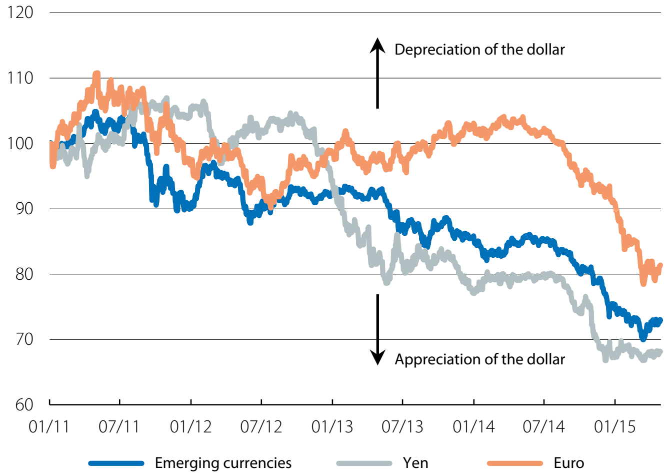
Index (January 2011 = 100)



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

Value of currencies against the dollar

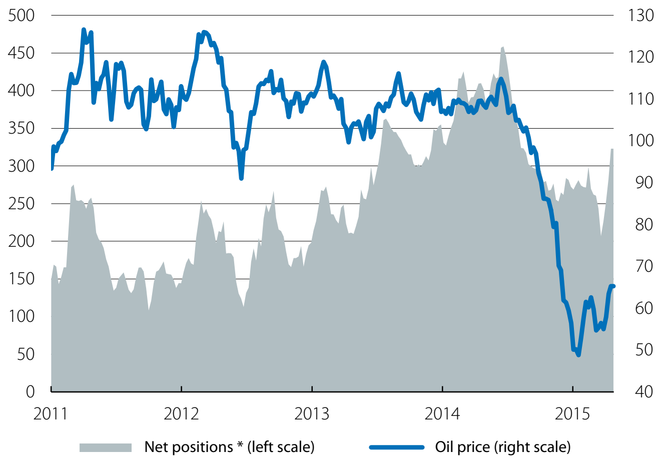
Index (January 2011 = 100)



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

Oil: price and net speculative positions

(Thousands of contracts) *(Dollars per barrel)*



Note: ** Long positions net of short positions in crude oil.*
Source: *"la Caixa" Research, based on Bloomberg data.*

FOCUS · Shortage of safe assets in financial markets

The scarcity of so-called «safe assets» has been an incredibly significant phenomenon on the international financial scene for some years now. The main causes are known but not so much the ultimate effects and, unfortunately, they could be detrimental to financial stability.

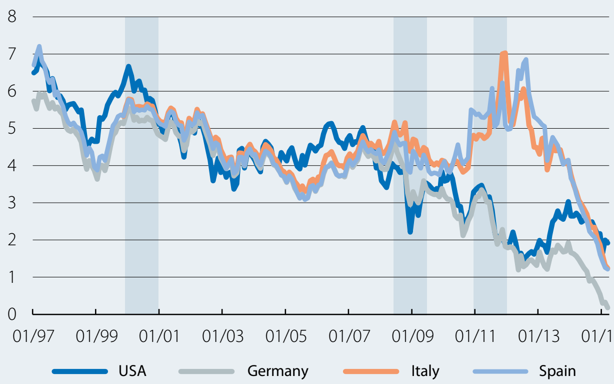
Most safe assets are sovereign debt securities issued by countries of proven solvency and institutional stability. Their common feature is therefore a very low level of credit and liquidity risk. In other words, these are assets that preserve all or almost all their value after adverse shocks hit the economy or during episodes of strong risk aversion in the markets. One clear example of this is the typical drop in yield (or the rise in price, which is the same thing) of public debt considered to be safe during financial storms (see the graph). In addition to providing a stable source of value when investors need it most, safe assets also fulfil other functions, particularly being used as benchmarks to produce and value a large number of bonds, risky assets and derivatives. They also play a crucial role in wholesale funding markets since they are used as collateral, enabling transactions to function normally in these markets. It therefore comes as no surprise that such features give safe assets a remarkable status, or that their price has traditionally been higher than that of other financial assets (known as the price of safety). Unlike risky assets and other sovereign bonds that are not considered safe, the search for yield has less impact on safe assets. However, the different forces of supply and demand emerging after the outbreak of the financial and economic crisis in 2008 have led to a relative shortage of safe assets. The immediate consequence is that their price has gone up; i.e. a fall in the real risk-free interest rate.

Two demand factors stand out from the rest. Firstly, greater macroeconomic risk perceived by economic agents due to the recession and, secondly, the large-scale public debt purchases carried out by the main central banks in the world, while other factors of a structural nature also have an impact, such as the tightening of regulatory criteria regarding liquidity standards in the financial sector. All this has taken place while the supply of safe assets has been in considerable decline. Firstly due to the implosion of securitization markets, resulting de facto in the closure of a significant source of assets considered safe up to 2008. Secondly because of the subsequent sovereign debt crisis in the euro area, entailing the loss of safe asset status held by the debt of many countries, including Spain. In 2006 64% of developed OECD countries held the top credit rating for their sovereign debt (AAA) while, by the end of 2015 Q1, this share had fallen to 34%. One last factor to take into account is the reduction in public sector borrowing and consequently of the supply of safe assets, resulting from the fiscal consolidation policy adopted by most developed countries over the last few years.

Although this shortage of safe assets is likely to ease in the long term, all the evidence points to the phenomenon continuing for the next few years and there are several risks resulting from this scenario, affecting various spheres. First of all, the over-positioning of investors in a search for safety in a shrinking number of issuers could amplify the volatility in their respective public debt markets. The functioning of secured money markets (where lenders demand a guarantee in the form of safe assets as security) could be disrupted should there be a shortage of eligible collateral. Lastly, as analysed by the next Focus «The challenges facing the pension and insurance sector in a context of low interest rates», if this situation of few safe assets and very low real interest rates continues, it will have a significant effect on the management strategy for the assets and liabilities of investors with a long-term investment mandate, such as pension funds and insurance companies.

Yield on 10-year sovereign bonds *

(%)



Note: ** The shaded areas correspond to the bursting of the dot.com bubble in 2000, the collapse of Lehman Brothers in 2008 and the euro area's sovereign debt crisis in 2011.*
Source: *"la Caixa" Research, based on Bloomberg data.*

FOCUS · The challenges facing the pension and insurance sector in a context of low interest rates

In October 2014, the largest pension fund in the world, the Japanese GPIF, announced a sharp reduction in its public debt portfolio and an increase in its exposure to equity. This decision illustrates the turnaround observed in the investment strategy of most insurance companies and pension funds given the scenario of very low interest rates. This factor, together with the regulatory changes affecting this kind of institutional investor, poses an enormous challenge. We must remember that the insurance and pension sectors have become huge over the last few decades (in 2013 the assets of pension funds alone accounted, in OECD countries, for 84% of GDP), and they therefore play a very important role in global financial stability.

Given the nature of their business, life insurance companies and pension funds typically have very long-term payment commitments and it is precisely this feature that can give rise, relatively easily, to mismatches between liabilities and assets in terms of duration and yield. The extent of these mismatches must be controlled and monitored very closely. According to the stress tests carried out by the European supervisor for the sector (EIOPA), in some companies liabilities have a duration (average maturity) and yield exceeding those of assets to an extent that makes them vulnerable, especially if the current scenario of low interest rates continues. In fact, these companies could find it difficult to reinvest in assets whose yield is high enough to cover the future commitments initially acquired. This would be the case of insurance institutions in countries in the lower left-hand section of the graph, especially Germany where the predominance of products with a guaranteed return makes it difficult to adapt to an environment with such low interest rates.

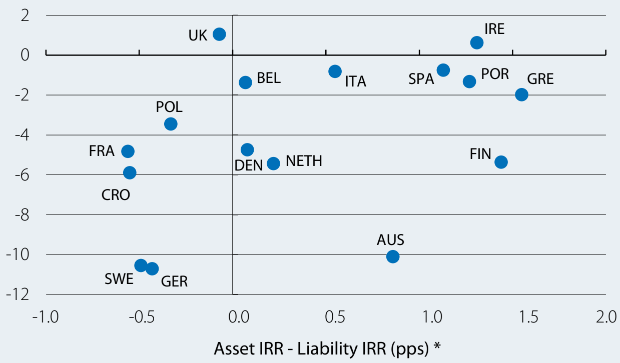
As has already been mentioned, the course of action being adopted by numerous institutional investors in order to reduce such gaps on their balance sheets is to increase the risk profile of their investments in a search for higher yields. Although no aggregate official data are available as yet for 2015, there are many indications that confirm this phenomenon. Perhaps the most notable is the increase in absolute terms and the relative share of equity investments by insurance companies and pension funds in the euro area, as detected by several sources; a trend that, given the stock market performances over the last few months, has continued in the beginning of 2015. Investment in real estate assets and infrastructures is also becoming increasingly common for the pension funds of the main advanced countries, at the same time as reducing the quality of their fixed income portfolio, increasing exposure to corporate or sovereign bonds with lower credit ratings (higher yields).

Nevertheless, in the medium term this turnaround in the strategy of institutional investors may be limited by the regulatory changes facing the sector. This is the case of insurance companies which, as from 2016, will have to adopt a new regulatory framework (Solvency II) that makes riskier investment positions more costly in terms of allowances. Although this regulation aims to reduce the insurance industry's exposure to market volatility, it might pose an additional problem when attempting to narrow the gap in yield observed in some countries. Given this situation, institutional investors are likely to opt for new strategies such as gradually reducing the products they offer with guaranteed returns and increasing the average life of investments, bringing them more in line with liabilities (and thereby reducing reinvestment risk).

In short, after successfully handling the financial crisis of 2007-2012, the pension and life insurance sector is now facing an enormous challenge: balancing more demanding regulations regarding the assumption of risk with a search for yield in a low interest rate scenario. This is undoubtedly a significant challenge that could result in the transformation of an industry that is hugely important, both in terms of the financial stability of markets and in its role as a supplier of basic services to manage consumer risk.

Imbalances in the balance sheets of European insurance companies

Average maturity of assets - Average maturity of liabilities (years)



Note: ** Internal Rate of Return.*
Source: *"la Caixa" Research, based on data from the EIOPA.*

KEY INDICATORS

Interest rates (%)

	30-Apr	31-Mar	Monthly change (bps)	Year-to-date (bps)	Year-on-year change (bps)
Euro area					
ECB Refi	**0.05**	0.05	0	0.0	–20.0
3-month Euribor	**–0.01**	0.02	–2	–8.3	–34.4
1-year Euribor	**0.17**	0.20	–3	–15.5	–44.4
1-year government bonds (Germany)	**–0.26**	–0.21	–5	–19.6	–41.7
2-year government bonds (Germany)	**–0.22**	–0.25	3	–12.2	–36.1
10-year government bonds (Germany)	**0.37**	0.18	19	–17.1	–109.9
10-year government bonds (Spain)	**1.47**	1.21	26	–14.1	–154.5
10-year spread (bps) [1]	**110**	103	7	3.2	–44.3
USA					
Fed funds	**0.25**	0.25	0	0.0	0.0
3-month Libor	**0.28**	0.27	1	2.4	5.7
12-month Libor	**0.71**	0.69	2	8.1	16.1
1-year government bonds	**0.22**	0.23	–1	0.7	11.9
2-year government bonds	**0.57**	0.56	1	–9.5	16.0
10-year government bonds	**2.03**	1.92	11	–14.1	–61.6

Spreads corporate bonds (bps)

	30-Apr	31-Mar	Monthly change (bps)	Year-to-date (bps)	Year-on-year change (bps)
Itraxx Corporate	**61**	56	5	–2.0	–9.2
Itraxx Financials Senior	**70**	66	4	2.9	–8.9
Itraxx Subordinated Financials	**145**	135	9	–4.2	23.5

Exchange rates

	30-Apr	31-Mar	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
$/€	**1.122**	1.073	4.6	–7.2	–19.1
¥/€	**133.990**	128.910	3.9	–7.5	–5.5
£/€	**0.731**	0.724	0.9	–5.9	–11.0
¥/$	**119.380**	120.130	–0.6	–0.3	16.8

Commodities

	30-Apr	31-Mar	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	**421.2**	415.0	1.5	–3.8	–16.0
Brent ($/barrel)	**64.9**	53.3	21.6	16.3	–40.3
Gold ($/ounce)	**1,184.4**	1,183.7	0.1	0.0	–8.3

Equity

	30-Apr	31-Mar	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	**2,085.5**	2,067.9	0.9	1.3	10.7
Eurostoxx 50 (euro area)	**3,615.6**	3,697.4	–2.2	14.9	13.0
Ibex 35 (Spain)	**11,385.0**	11,521.1	–1.2	10.8	8.9
Nikkei 225 (Japan)	**19,520.0**	19,207.0	1.6	11.9	36.5
MSCI Emerging	**1,047.8**	974.6	7.5	9.6	5.3
Nasdaq (USA)	**4,941.4**	4,900.9	0.8	4.3	20.1

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

ECONOMIC OUTLOOK · Winter slump in the US and slowdown in China

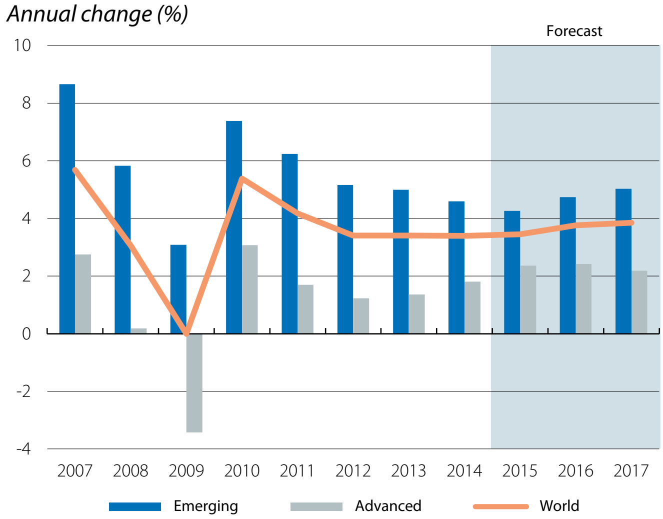
The acceleration in growth will be gradual in 2015 according to the International Monetary Fund (IMF). The institution expects the world economy to grow by 3.5% in 2015 and by 3.8% in 2016, in both cases in line with January's forecast and above the figure 3.4% from 2014. This gradual acceleration will largely be supported by an improvement in the advanced economies. However, the emerging economies will see their fifth consecutive year of deceleration, affected by falling oil prices, geopolitical tensions and especially the slowdown in the Chinese economy whose relative share represents 30% of the emerging bloc in purchasing power parity. Nevertheless the IMF expects these economies to gain traction in 2016 thanks to a more balanced macroeconomic situation (inflation, fiscal and external balance) and the stabilisation in geopolitical tensions. Regarding January's forecast, worthy of note is the downward revision of the United States (3.1% in 2015) although it is still the fastest growing rich economy, and also the upward revision of the forecasts for the euro area (1.5%) and Japan (1.0%). Among the emerging economies, the largest deterioration can be found in Brazil (–1.0%) and Russia (–3.8%). Within this scenario of slow global acceleration the IMF states that downside risks have diminished compared with its previous report although they are still considerable.

UNITED STATES

GDP grew by a subdued 0.1% quarter-on-quarter in 2015 Q1 (3.0% year-on-year), clearly less than in the last few quarters. By demand component, worthy of note is the drop in investment which slumped due to the sharp fall in structural investment and the negative contribution made by the foreign sector after a sharp fall in exports. On the other hand private consumption and stocks contributed positively to GDP growth. This moderate advance is the result of a harsher winter than usual although disruptions in activity because of strikes at ports on the west coast and the dollar's strength have also reduced the figures. Nonetheless, as most of the factors resulting in Q1's weaker growth are temporary, we have maintained our growth forecast at 3.1% for 2015 (we had lowered it last month) and 2.8% in 2016.

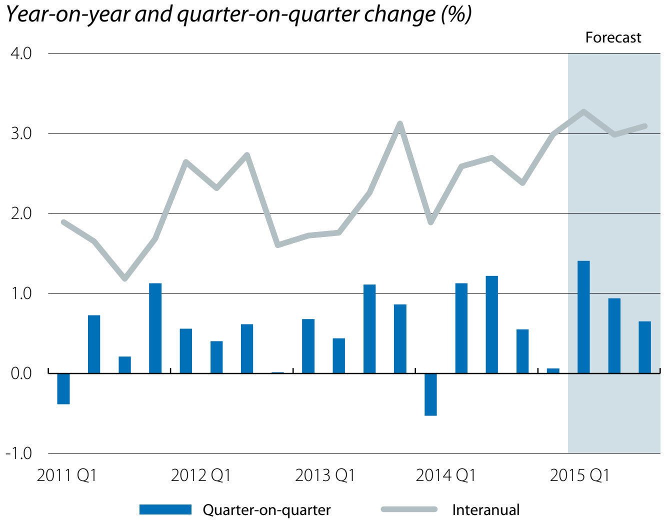
We expect to see the US economy speed up considerably in 2015 Q2, allowing it to continue leading the recovery among the advanced economies. Having got over the winter hiatus, private consumption should now accelerate supported by the improved labour market and the rise in the savings rate over the last few months. Almost all the reduction in expenditure on petrol (due to falling crude prices) has been allocated to savings: the household savings rate went from 4.4% of gross disposable income in November to 5.8% in February, an

IMF: global growth
Annual change (%)



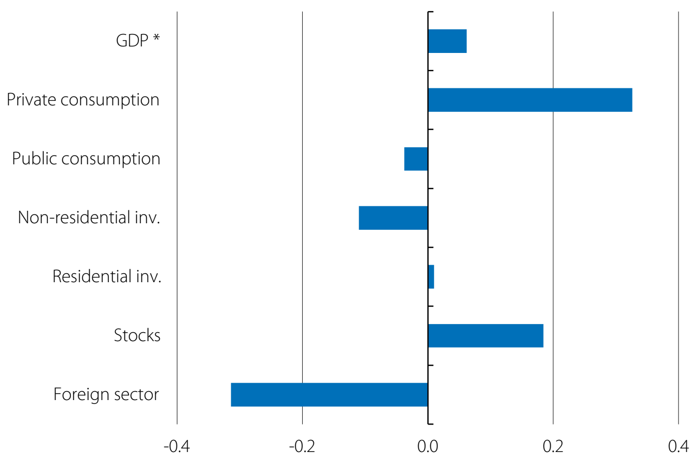
Source: *"la Caixa" Research, based on data from the IMF (WEO, April 2015).*

USA: GDP
Year-on-year and quarter-on-quarter change (%)



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

USA: GDP
Contribution to quarter-on-quarter growth in GDP in Q1 (pps)



Note: ** Quarter-on-quarter change.*
Source: *"la Caixa" Research, based on data from the Bureau of Economic Analysis.*

upswing that leaves plenty of room for a recovery in private consumption over the coming months. We also expect construction to gain traction in Q2. Adverse weather conditions meant that the number of new homes started in February and March dropped compared with December 2014, by 15.3% and 13.6% respectively. However, the trend in second-hand house prices, up by 5.1% in March, and the formation of new households continue to point to a clear recovery in the sector.

The latest business indicators confirm the strength of the US economy. The ISM business sentiment indices remain in the expansionary zone although there is a marked difference between manufacturing and services. The ISM index for manufacturing has continued its downward slide, posting a further decrease from 52.0 points in February to 51.5 points in March. Industrial production, which in the first three months of 2015 fell by 1% when it had risen by 4.6% in 2014, also suggests that manufacturing is weak. But while industry is declining services, which contribute 83.6% of all private employment, are performing well and the ISM services index held steady at 56.5 points (a decrease compared with 56.9 in February). February's retail sales (excluding automobiles, which are more volatile in nature) did not vary compared with January and the Consumer Board confidence index stood at 95.2 points in April, above its historical average of 93.4 points.

The dynamic labour market suffers a temporary halt. In March 126,000 net jobs were created, half the average for the last 12 months, namely 260,000. However, this latest figure should not mar the good performance by the labour market in general. The number of employees grew at a rate of 2.3% year-on-year, the fastest since 2000, and March's unemployment rate remained at a low 5.5% of the labour force. The broad unemployment rate (known as the U6 and including employees working part-time for financial reasons who would like to work full-time) fell by 0.1 pps to 10.9%, a clearly lower figure than the 12.2% of July 2014. The biggest weakness in the US labour market is still the low participation rate which stood at 62.7% in March, far from the 66.0% recorded in 2007.

Inflation is still moderate. March's CPI rose by 0.2% compared with February although it has accumulated a year-on-year decrease of 0.1% due to prices falling over the last few months. Core inflation, which excludes prices for food and energy products, also rose by 0.2% month-on-month in March, 1.8% cumulative year-on-year, but would remain at a more subdued 0.9% year-on-year if the effect of owners' equivalent rent were not taken into account. Given this situation of low inflationary risk, we continue to expect the Fed will wait until autumn to raise the official interest rate.

JAPAN

The Japanese economy will pick up in 2015 supported by monetary and fiscal stimuli, wage improvements, cheap oil

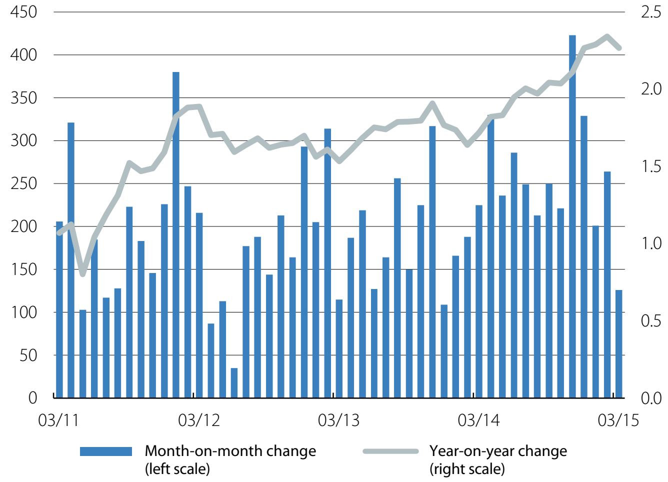
USA: activity indicators

Level

Source: *"la Caixa" Research, based on ISM data.*

USA: employment

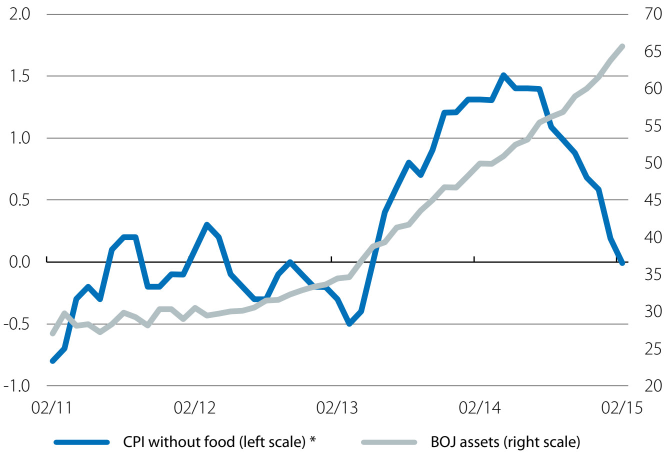
Month-on-month change (thousands) *Year-on-year change (%)*



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

Japan: CPI and central bank assets

Year-on-year change (%) *(% of GDP)*



Note: ** 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.*

and a somewhat more favourable international environment. Nonetheless this process will be slow. Private consumption is still suffering from the effects of the VAT hike in April 2014 (from 5% to 8%) while industrial production fell in February by 3.1% month-on-month and the Tankan business sentiment index for 2015 Q1, produced by the Bank of Japan (BoJ), remained almost at a standstill. The positive figures come from the foreign sector which, thanks to a weak yen and cheap oil, presented its first surplus in March since the Fukushima tragedy in February 2011. We have therefore kept our growth forecast at 0.8% for 2015 and at 1.2% for 2016.

Inflation is still low. The general CPI in February grew by 2.2% year-on-year but only by 0.1% without the effect of the VAT hike. Similarly the CPI without food (but with energy), the BoJ benchmark, grew by 2.0% year-on-year, leading to an effective year-on-year increase of 0.0%, discounting the VAT effect. This figure is very far from the 2% target of the BoJ, which is continuing its quantitative easing with annual purchases, mainly of public debt, totalling 80 trillion yen (16% of GDP).

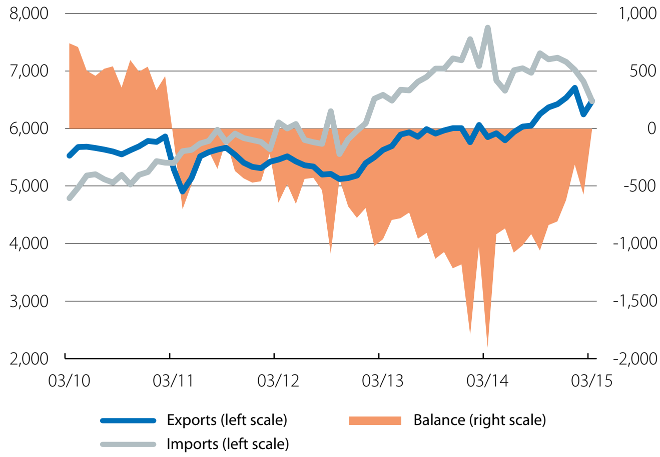
EMERGING ECONOMIES

In 2015 Q1 China's GDP grew by 7.0% year-on-year, its lowest rate for the last six years. This confirms the downside risks we pointed out several weeks ago and has forced us to lower our growth forecasts for 2015 (from 7.0% to 6.7%) and for 2016 (from 6.6% to 6.5%). This slowdown was greater in the secondary sector, which grew by 6.4% year-on-year in Q1, clearly below 2014's average of 7.4%. March's industrial production figures, up by 5.6% (the average in 2014 was 8.3%), confirm the slowdown in industry and the far-reaching change the Chinese economy should undergo, shifting towards growth based much more on services. In fact the tertiary sector advanced by 7.9% year-on-year in Q1, in line with the figures for 2014. On the other hand the stability of inflation, up by 1.4% year-on-year in March, leaves room for expansionary policies. In this respect, and given the confirmation of the country's economic slowdown, the government took action by reducing the cash reserve ratio by 1.0 pps.

Brazil is the emerging country with the greatest risks. Worsening business indicators and its poor budgetary trend (entailing greater fiscal adjustment if the deficit targets are to be met) are in addition to rising inflation due to the liberalisation of electricity prices and the depreciation of the Brazilian real. All this has justified a downward revision of our forecasts: from –0.1% to –0.9% in 2015 and from 1.5% to 0.8% in 2016 (see the Focus «The deterioration in Brazil's outlook: a bad patch or something more deep-rooted?»).

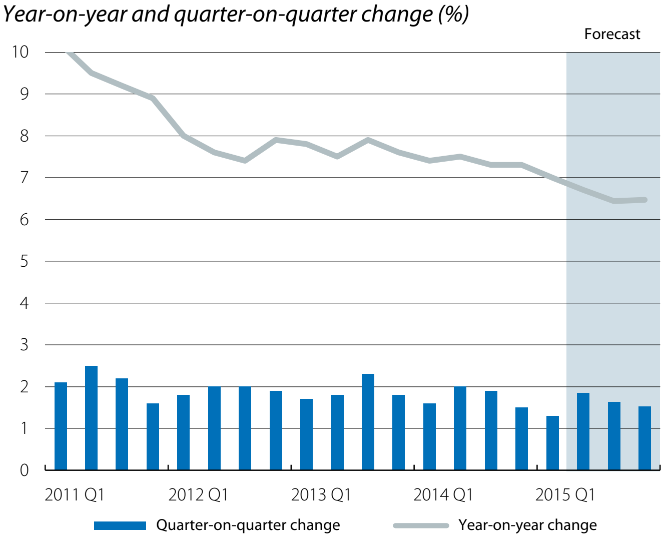
Continued instability in Russia and good performance by India. While there are signs of incipient financial stabilisation in Russia this is still precarious and easily reversible. In India a somewhat more expansionary budget in 2015 and stress on investment have led us to revise upwards our forecast for 2015 from 6.9% to 7.1%.

*Japan: trade balance **
(Billion yen) *(Billion yen)*



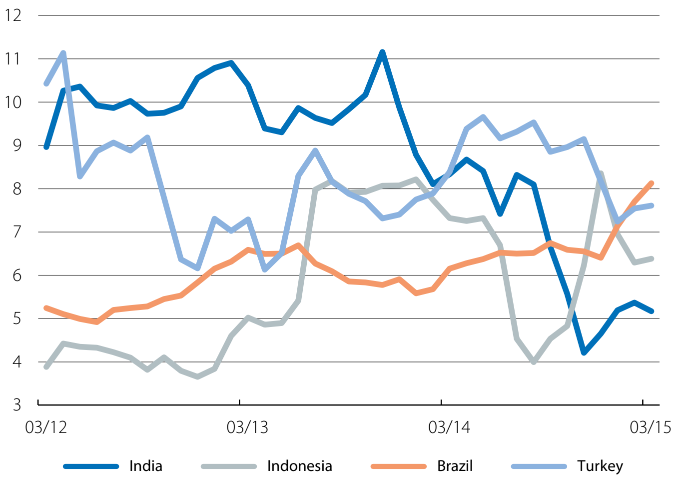
Note: ** Monthly figures.*
Source: *"la Caixa" Research, based on data from the Department of Trade.*

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 respective national statistics offices.*

FOCUS · The deterioration in Brazil's outlook: a bad patch or something more deep-rooted?

At the end of 2014, the analysts' consensus forecasts said that Brazil would grow in the order of 1% in 2015. Just over three months later this figure has fallen to –0.8%. Various temporary factors are creating a growing perception of risk for this Latin American economy: the weakness in activity at the start of the year, the government's difficulty in achieving parliamentary support for its economy policy, citizen protests and current investigations into Petrobras. However, the country's problems go deeper: there is notable uncertainty regarding its ability to appreciably reduce its macroeconomic imbalances and tackle the structural reforms it requires.

Concerning the first of these challenges, the most pressing imbalances are inflation, the public deficit and the current account balance. In March the CPI grew by 8.1% year-on-year, higher than at year-end 2014 (6.4%). The main factors behind this rise in inflation are the impact of the real's depreciation and the fact that certain regulated prices are being raised. Some elements will continue to put pressure on prices in 2015: the real fell by approximately 17% against the dollar in 2015 Q1 and regulated prices will also rise this year, which could lead to more demonstrations in the streets. With regard to public accounts, between 2011 and 2013 the public deficit stood at around 3% of GDP but in 2014 it climbed to 6.3%. This deterioration was mainly due to an increase in expenditure (there were presidential elections last year in Brazil). Lastly, the current imbalance, which in 2011 accounted for –2.0% of GDP, has almost doubled (–3.9% of GDP in 2014) because of falling prices in the many commodities exported by the country (such as soya and iron ore). But apart from the extent of this imbalance, its financing is also a cause for concern: whereas, in 2011, foreign direct investment accounted for 12% of net inflows of capital in portfolio, in 2014 this ratio was 50%. This makes the economy much more vulnerable to any change in investor sentiment.

In such a situation, how much margin does economic policy have? Given the aforementioned imbalances and taking the weak real into account, we expect the central bank to maintain a restrictive monetary policy (we predict a rise of 100 bps this year, to 13.75%). A higher interest rate (albeit limited as this also affects growth), together with the country's comfortable level of reserves, are factors that could help to contain any episodes of financial stress on the real caused by the US Fed's interest rate hikes. Nonetheless a slight depreciation in real terms of Brazil's currency could help to improve the country's external competitiveness without jeopardising the sustainability of corporate bonds, whose dollar exposure is at a contained 5.5% of GDP.

The key element with regard to fiscal policy is a programme of adjustment that aims to achieve a primary surplus of 1.2% of GDP in 2015. Given that 2014 ended with a larger primary deficit than expected (–0.6%) and that tax revenue has fallen since the start of 2015, what had originally been seen as a necessary but viable programme has now become a huge challenge. This, together with the difficulties encountered by the government to secure the necessary parliamentary support, has led to uncertainty regarding its ability to substantially modify its economic policy.

Such doubts affect the second, more fundamental source of uncertainty: the commitment to carry out structural reforms. No-one disagrees that Brazil has good future prospects: its demographics are expansive, a notable middle class has been created over the last few years, its domestic market is considerable and the metropolitan area of São Paulo is among the most dynamic in all Latin America. Nevertheless, this potential cannot be realised without tackling two critical issues: a reduction in production bottlenecks (requiring better infrastructures) and a simpler business environment. According to the World Bank's Doing Business indicator, Brazil ranks 120th (out of 189) for business, too far from its regional benchmarks such as Mexico (28th) and Colombia (34th).

In short, Brazil is at the start of at least two years of macroeconomic adjustments that should help to redress its most serious imbalances. Otherwise, market pressure could become strong as the international macroeconomic and financial environment will be less favourable for the country with the Federal Reserve starting to raise its reference rate and its main trading partner, China, slowing down.

Brazil: main macroeconomic indicators

	Average 2007-2011	2012	2013	2014	2015 (f)	2016 (f)
Real GDP growth (%)	4.5	1.8	2.7	0.1	–0.9	0.8
Inflation CPI (%)	5.2	5.4	6.2	6.3	7.7	6.1
Fiscal balance (% of GDP)	–2.5	–2.6	–3.1	–6.2	–5.3	–4.7
Public debt (% of GDP)	63.0	63.5	62.2	65.2	66.2	66.2
Current account balance (% of GDP)	–1.4	–2.2	–3.4	–3.9	–3.7	–3.4
Gross external debt (% of GDP)	12.5	13.9	13.8	16.0		
Reserves (% external debt)	108.4	119.3	116.3	104.6		

Note: *(f) Forecast.*
Source: *"la Caixa" Research, based on data from Thomson Reuters Datastream.*

FOCUS · On the restructuring of sovereign debt

Barely a year ago, Argentina decided to announce a «selective default» of its debt after the ruling given by US judge, Thomas Griesa. Although this default is far from what is commonly perceived as standard default, it is paradigmatic of the difficulties involved in restructuring sovereign debt and serves as a warning of the need to implement and legislate for a general regime of prevention and resolution of crises in this area. Even more so given the growing trend of indebtedness in many countries.

Broadly speaking, we can assume that a country that has issued debt to finance its spending and investment has certain features in common with a company that has taken out debt to carry out its projects. If things go well, the debt is repaid with the returns from the investment and if things go wrong (either because of bad luck or irresponsibility), there is default. In spite of the similarities, the legislation governing sovereign debt restructuring is not simple as it can easily come into conflict with one of the fundamental principles of international law, namely state immunity to the judicial decisions of other countries.[1] It is not by chance that emerging countries regularly issue debt subject to laws other than their own: in general, US law in the case of debt issued in dollars, and English law if it is in euros.

As has already been mentioned, Argentina's case is paradigmatic of this conflict. When it went bankrupt in 2001, Argentina had debt in its own currency, in dollars and in euros totalling 100 billion dollars (this being the largest default in history until Greece took over in 2012). After restructuring its debt in 2005 and in 2010, it managed to convince 93% of its creditors to accept this but the remainder (mostly speculative funds) decided not to accept the deal and brought the case before the state of New York.[2] In June 2012, Judge Griesa ruled in favour of the litigant funds and, two years later, based on the principle of *pari passu* (equal treatment for all creditors), it forced US financial institutions to cease all Argentina's payments to those creditors that had accepted the debt restructuring until those who had refused it had been paid, resulting in the country declaring a «selective default». This ruling upset the English courts which, in February this year, declared that Griesa's order to stop payments by the Argentine government affected investors who were covered by English law as they had acquired Argentine debt in euros and not in dollars.

This situation encouraged a large number of countries to propose, to the United Nations General Assembly, the need to draw up an international legal framework for sovereign debt restructuring in the case of default. Although this was not the first time this need had been debated, most advanced countries had not supported it in the past whereas, on this occasion, many decided to abstain instead of giving their usual «no» vote, opening the door to a possible entente. The argument that used to be put forward by a large number of developed economies is that collective action clauses (CAC), and the fact that debt was subject to either US or English law, provided a sufficient legal framework. Under CACs, if 75% of bondholders agree, the debt can be restructured for all its creditors.

The United Nations is not the only forum used to promote the development of a legal framework for this type of restructuring. One particularly important attempt has been made by the IMF in designing the Sovereign Debt Restructuring Mechanism (SDRM), which aims to make the restructuring of sovereign debt much easier by giving the majority of bondholders the right to agree on behalf of all the creditors (what is known as the power of the super-majority). The aim is to overcome one of the most common problems of CACs insofar as these require the majority to be negotiated individually for each debt issuance instead of as an aggregate.

However, the SDRM is not necessarily all good. Giving power to a super-majority could increase the risk of vote manipulation, weakening the rights of small investors. In fact, if the new framework allowed this super-majority to fall easily into the hands of interests in line with the country's government, there would be a higher risk of debt restructurings being misused, which could lead to a widespread rise in financing costs for emerging countries.

In short, we are still far from an agreed restructuring framework so it is vital to continue working to counteract the power enjoyed by a minority of creditors in the case of some sovereign defaults. Argentina's example has merely increased this need. Nonetheless, it is still not clear where to draw the line between the efficient, agile restructuring of debt and protecting investors' rights.

1. United Nations. Convention on Jurisdictional Immunities of States, article 24.
2. Most plaintiffs were opportunistic funds that had bought debt on the secondary market after the country had declared a default.

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	–	3.0	–
Retail sales (excluding cars and petrol)	3.5	3.9	2.4	4.1	4.4	4.8	5.7	4.5	3.6
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	4.6	4.4	3.6	2.0
Manufacturing activity index (ISM) *(value)*	53.8	55.7	53.5	55.5	56.9	56.9	53.5	52.9	51.5
Housing starts *(thousands)*	930	1,001	925	985	1,030	1,063	1,072	908	926
Case-Shiller home price index *(value)*	158.2	170.7	169	171	170	173	176	177	...
Unemployment rate *(% lab. force)*	7.4	6.2	6.6	6.2	6.1	5.7	5.7	5.5	5.5
Employment-population ratio *(% pop. > 16 years)*	58.6	59.0	58.9	58.9	59.0	59.2	59.3	59.3	59.3
Trade balance [1] *(% GDP)*	–2.8	–2.9	–2.8	–2.9	–2.8	–2.9	–3.9	–3.8	...
Prices									
Consumer prices	1.5	1.6	1.4	2.1	1.8	1.2	–0.1	0.0	–0.1
Core consumer prices	1.8	1.7	1.6	1.9	1.8	1.7	1.6	1.7	1.8

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	03/15
Activity									
Real GDP	1.6	–0.1	2.1	–0.4	–1.4	–0.7	–	...	–
Consumer confidence *(value)*	43.6	39.3	39.0	38.9	40.5	38.9	39.5	40.9	41.7
Industrial production	–0.6	2.1	7.7	2.7	–0.3	–1.4	–1.1	–2.1	–2.9
Business activity index (Tankan) *(value)*	6.0	13.5	17.0	12.0	13.0	12.0	–	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	–1.8
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	03/15
Activity									
Real GDP	7.7	7.4	7.4	7.5	7.3	7.3	–	7.0	–
Retail sales	13.1	10.3	15.4	12.3	11.9	11.7	10.7	10.7	10.2
Industrial production	9.7	8.3	8.7	8.9	8.0	7.6	6.8	6.8	5.6
PMI manufacturing *(value)*	50.8	50.7	50.3	50.7	51.3	50.4	49.8	49.9	50.1
Foreign sector									
Trade balance [1] *(value)*	258	381	233	254	321	381	409	492	487
Exports	7.8	6.1	–3.4	5.0	13.0	8.6	–3.3	48.3	–15.0
Imports	7.3	0.5	1.5	1.4	1.1	–1.7	–19.9	–20.5	–12.7
Prices									
Consumer prices	2.6	2.0	2.3	2.2	2.0	1.5	0.8	1.4	1.4
Official interest rate [2] *(value)*	6.00	5.60	6.00	6.00	6.00	5.60	5.60	5.60	5.35
Renminbi per dollar *(value)*	6.1	6.2	6.1	6.2	6.2	6.1	6.2	6.3	6.2

Notes: *1. Cumulative figure over last 12 months. Billion dollars. 2. End of period.*
Source: *"la Caixa" Research, based on data from the National Bureau of Statistics of China and Thomson Reuters Datastream.*

ECONOMIC OUTLOOK · The recovery continues at a good rate but there are still risks

The International Monetary Fund (IMF) has confirmed the euro area's improved economy and revised its forecasts upwards. The institution points out that the economic recovery has been boosted by temporary favourable factors such as falling oil prices and the measures carried out by the European Central Bank (ECB). The ECB's expansionary monetary policy is playing a decisive role in the recovery, improving the economy's financial conditions by substantially reducing interest rates and improving inflation expectations. It has also led to the euro's depreciation, boosting the trade balance. These events have led the IMF to raise its growth forecast for the euro area from the estimate announced in January (+0.3 pps to 1.5% in 2015), albeit highlighting the risks of a prolonged period of low growth and inflation. To avoid this, it recommends continuing with expansionary monetary measures, furthering structural reforms and increasing investment, in particular in those countries with greater fiscal margin.

The recovery continues in Q2 but with no signs of accelerating. After a Q1 in which the euro area gained traction, the initial figures for Q2 point to the expansion continuing at a good pace, albeit with some moderation. The composite PMI for the euro area reached 53.5 points in April, slightly above its level in Q1 (53.3 points) but below March's level (54.4 points). The same trend can be seen both in manufacturing and services. By country, Germany has posted the same pattern of strong growth at the start of Q2 but with some moderation both in the PMI and the ZEW (the index of investor and analyst expectations), recording a slight drop compared with March's figure. However, the IFO (business climate index) continued to rise. In France the PMI fell significantly, once again coming very close to 50 points (the usual boundary between expansion and contraction) after posting encouraging figures the last few months. Unlike Germany and France, the PMI for the rest of the euro area countries increased significantly, up to the highest levels seen since August 2007, confirming that most countries are taking part in the recovery.

Private consumption remains healthy. Greater optimism regarding the economic outlook boosted consumption in the euro area in Q1 with February's retail sales growing by 3.0% year-on-year. Private consumption should continue its good performance in Q2 in spite of the slight adjustment in consumer confidence in April, after a notable increase in Q1. The upward trend in wages in Germany, the driving force for the euro area's activity, will continue to support private consumption. In 2014 Germany posted the highest wage increase in 20 years and wages are expected to rise by almost

Euro area: IMF forecasts

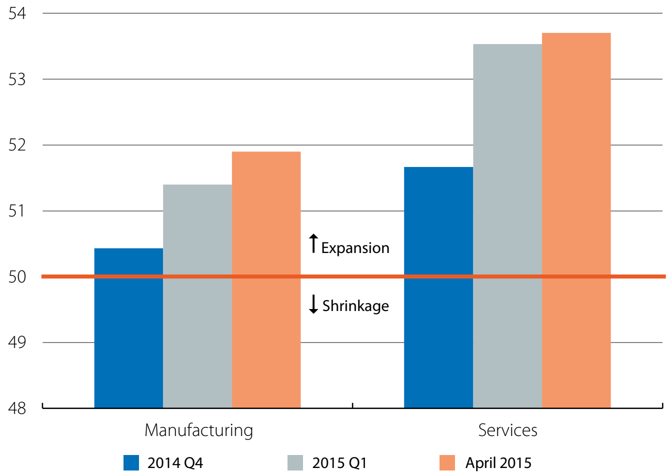
Annual change (%)

		GDP forecast		Change compared with the forecast of January 2015	
	2014	2015	2016	2015	2016
Euro area	0.9	1.5	1.6	▲ 0.3	▲ 0.2
Germany	1.6	1.6	1.7	▲ 0.3	▲ 0.2
France	0.4	1.2	1.5	▲ 0.3	▲ 0.2
Italy	–0.4	0.5	1.1	▲ 0.1	▲ 0.3
Spain	1.4	2.5	2.0	▲ 0.5	▲ 0.2

Source: "la Caixa" Research, based on data from the IMF (WEO, April 2015).

Euro area: PMI activity indicators

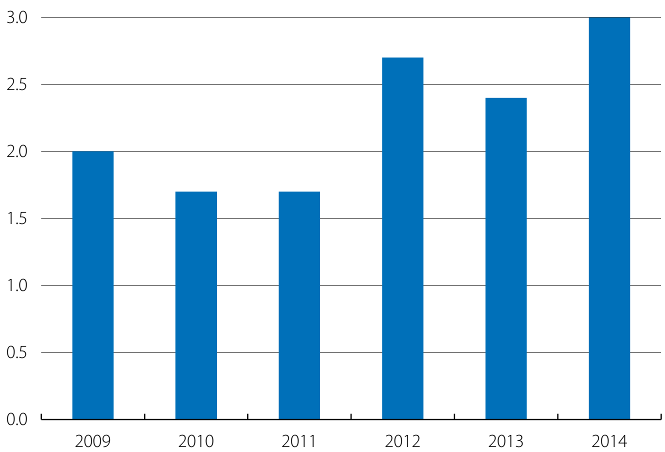
Level



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

Germany: hourly wage

Year-on-year change (%)



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

3% in 2015, partly due to the introduction of a minimum wage as well as the wage rises established in collective bargaining agreements.

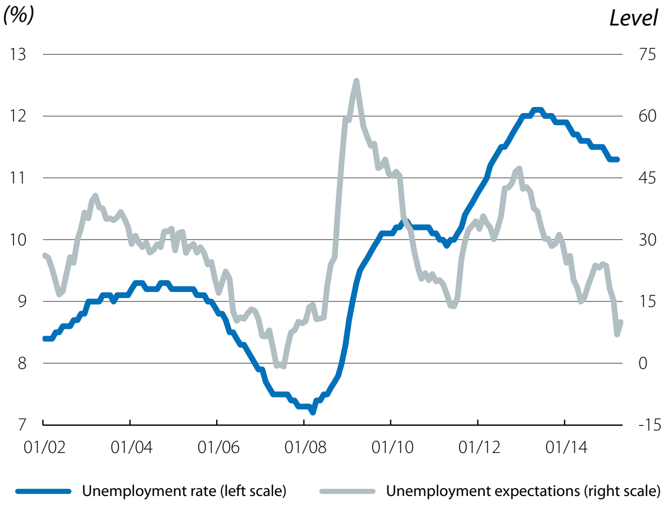
The recovery in economic activity in 2015 Q1 is also reflected in the labour market. In March the euro area's unemployment rate stood at 11.3%, 0.4 pps below the level a year ago. In Q1, the employment expectations recorded by the European Commission advanced notably for the euro area as a whole. Employment is therefore expected to have increased more in Q1 than in Q4, which rose by 0.1% quarter-on-quarter. The outlook for the labour market is still favourable at the start of Q2 although, as with the rest of the supply and demand indicators, a slight slowdown is predicted in the rate of growth in employment. Specifically, in manufacturing and services, April's employment expectations fell by 0.2 and 0.1 pps to –2.7 and 4.5 points respectively. For the moment, however, they are both still above the figures posted on average in Q1.

The euro's depreciation contributes to the trade balance surplus. The foreign sector continues to support the recovery in economic activity, helping growth between domestic and foreign demand to be relatively balanced. Exports of goods, which ended 2014 up by 4.6% year-on-year in Q4, continued to advance significantly at the start of 2015, recording an average annual increase of 3.3% in the first two months of the year. This is partly thanks to the euro's depreciation over the last few quarters. Specifically, the trade balance surplus, which totalled 22 billion euros in February seasonally adjusted (21.2 billion in January), has helped the euro area's current account balance to remain healthy with a surplus of 2.4% of GDP in February (cumulative over 12 months), 0.4 pps above the figure for the same month a year ago. We expect the euro's exchange rate to remain low over the coming months; in fact, further depreciation cannot be ruled out once the Fed starts to raise interest rates towards the end of this year.

The rebound in inflation is gradually being confirmed. In April general inflation in the euro area rose by 0.1 pps to 0.0%, leaving negative terrain for the first time in four months. Over the coming months we expect inflation to continue its upward trend and end the year close to 1.5%. On the one hand growing employment and less wage adjustment, especially in Germany where wages are already growing at a good rate, will boost the euro area's consumption and push up prices. On the other hand the euro's depreciation against the dollar will make imports more expensive, which should also result in higher prices. The upward effect of the euro's depreciation on inflation will continue until the beginning of next year.

Financial integration is getting stronger, by degrees. One of the positive effects of the ECB's quantitative easing programme has been improved confidence in the recovery of the euro area, leading to a reduction in the spread between

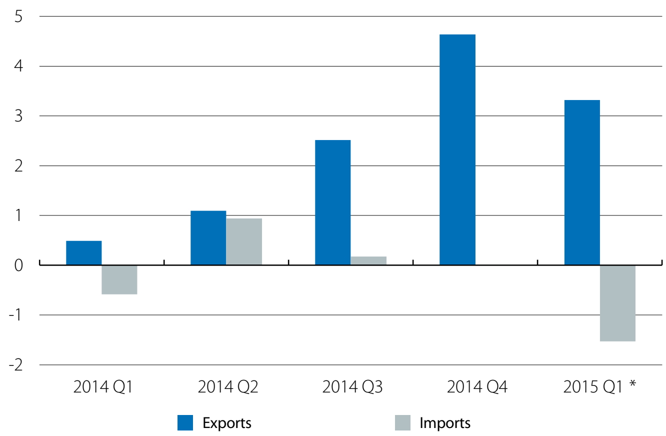
Euro area: labour market indicators



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

Euro area: balance of goods

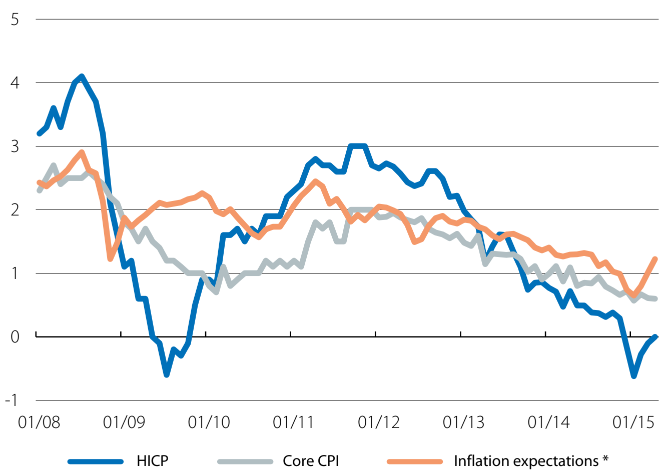
Year-on-year change (%)



***Note:** Nominal data. * January and February compared with January and February a year ago.*
***Source:** "la Caixa" Research, based on Eurostat data.*

Euro area: Harmonised CPI and inflation expectations

Year-on-year change (%)



***Note:** * 5-year inflation swap.*
***Source:** "la Caixa" Research, based on data from Eurostat and Bloomberg.*

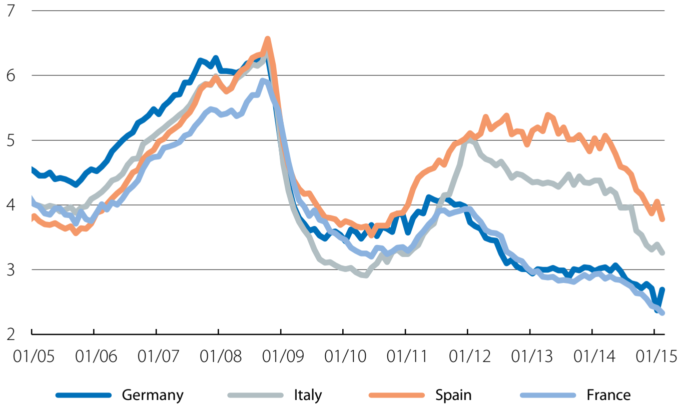
the interest rates charged to firms for financing compared with Germany. In February in Spain and Italy, financing costs for non-financial firms stood at 3.8% and 3.3%, respectively, 1.1 pps below the rate recorded the same month a year ago. In Germany the reduction was smaller, however, namely 0.3 pps, reaching 2.7%. The reduction in financial fragmentation has therefore been considerable although the disparity in financing costs is still high, making it difficult for credit to reach the real economy, especially in the periphery. The significant advances made towards monetary union and structural reforms by some periphery countries have undoubtedly helped to reduce fragmentation. Nonetheless, as the IMF once again stated in its World Economic Outlook in April, for this improvement in the euro area's economic situation to consolidate there must be continuity in the ECB's monetary policy, in strengthening the balance sheets of the euro area's banks, in the fiscal consolidation being carried out by countries with high debt and also in structural reforms.

Greece is still a source of uncertainty. The demanding schedule of maturities for its public debt and lack of agreement with the Eurogroup means that Greece's situation still represents a significant risk for the euro area. For the moment negotiations are continuing between the European institutions and the Greek government to reach an agreement that will release the 7.2 billion pending of the bail-out but without producing any result. However, at the end of April the Greek government announced a change in its negotiating team that might help to redirect this process. From now on, discussions with the European institutions will be led by the number two in the Foreign Ministry instead of the Finance Minister, Yanis Varoufakis, who will nevertheless still supervise the negotiations. This change in interlocutor could help an agreement to be reached if the Greek government ends up accepting the reforms demanded by the institutions.

Disparity in public accounts. The public deficit reached 2.4% of GDP (2.9% in 2013) for the euro area as a whole but this figure hides notable differences between countries. At one end of the scale is Germany, posting a surplus of 0.7% of GDP after two consecutive years of its public accounts remaining practically at equilibrium. At the other end are those countries exceeding the maximum deficit allowed by the European Commission of 3%: France, Greece and Spain, among others. The largest adjustments in national accounts can be seen in some of the periphery countries which started from big deficits. In Spain the deficit stood at 5.8% of GDP in 2014 (6.8% in 2013), in Ireland it was 4.1% of GDP (5.8% in 2013) and in Greece it was 3.5% of GDP (12.3% in 2013). In the euro area as a whole, debt reached 91.9% of GDP in 2014, indicating that fiscal efforts must continue, especially in those countries with high levels of debt.

Financing costs for non-financial firms

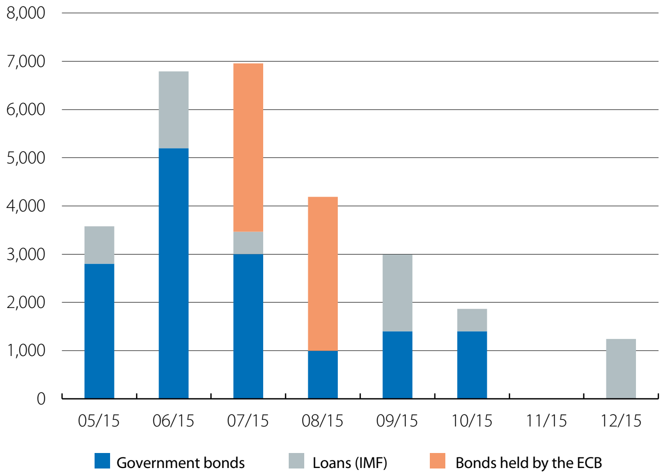
(%)



Note: *Interest rate for loans up to 1 million euros.*
Source: *"la Caixa" Research, based on ECB data.*

Greece: public debt maturities

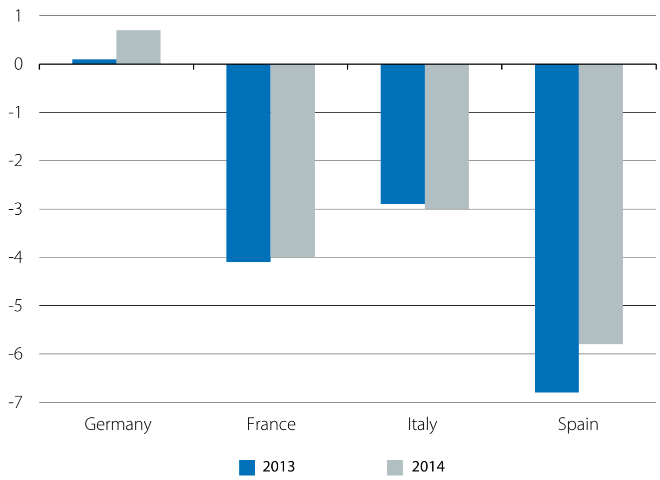
(Million euros)



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

Fiscal balance

(% of GDP)



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

FOCUS · Are labour costs converging in euro area countries?

In a monetary union, labour costs are an important factor in determining the relative competitiveness of its member states. If a euro area country posts a sustained rise in unit labour costs (ULC)[1] greater than the rest of the countries, it loses competitiveness and cannot resort to a currency devaluation its to regain it. This situation is not viable in the long term. Here we analyse the trend in labour costs in the main euro area countries and what might be expected in the near future.

The trend in labour costs in the euro area over the last 15 years reveals a change in the situation before and after the crisis in 2008. Before the crisis, Germany was gaining in competitiveness compared with its trading partners. ULC remained stable in Germany due to wage restraint and also improvements in labour productivity. In Spain and Italy productivity remained at a standstill while real wages rose at an annual rate of 2.6% and 3.0% respectively, increasing ULC. In France, although productivity grew at similar rates to those of Germany, wages rose further.

Over the last few years this situation, unsustainable in a monetary union, has changed substantially. Spain has gained part of the relative competitiveness it had lost as CLU are still stable thanks to wage moderation and improved productivity. However, this has not been the case for France or Italy. Although wage increases have moderated in France they still exceed the country's improvements in productivity while, in Italy, ULC have continued to rise particularly because of losses in productivity. Part of the competitiveness lost by countries in southern Europe is also being recovered thanks to the trend in German labour costs which have been rising after the crisis without its productivity improving.

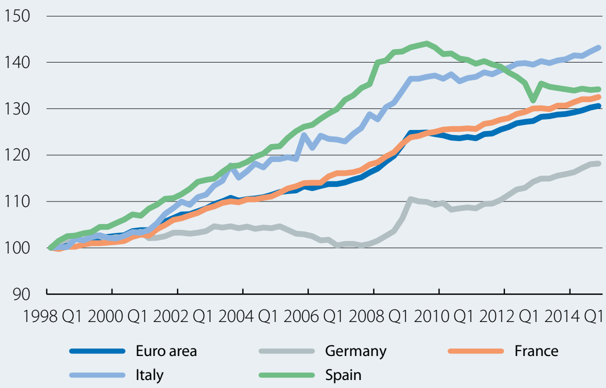
This shift in relative competitiveness might continue due to the differences in the economic cycle between euro area economies. According to IMF estimates, Germany has already closed its output gap, unemployment is at an all-time low and the bulk of the evidence suggests the country will grow at a rate above its potential in the short and medium term. All this should increase pressure on wages. In fact, wages grew by about 1.7% in 2014 and the wage increases agreed for 2015 and 2016 in various collective agreements (such as the metal and chemical industries) are already higher than 3% on average.

Spain, Italy and France are still suffering from substantial excess capacity, which should result in less wage pressure this year if wage developments follow the economic cycle. This has already been the case to some extent, particularly in Spain and Italy where wages rose by 0.7% and 0.4% respectively in 2014. In France, however, the rise was 1.4% in spite of the country's weak economic growth.

In short, the economies of the euro area need to contain and make their ULC converge, both via wages and productivity. A diagnosis by country has shown just how far each economy still has to go. Neither Germany nor its European partners can lose sight of the fact that they need to increase labour productivity and wages only as long as productivity improves. It is also vital that ULC between countries converges. The errors of the past should not be repeated.

*Unit labour costs **

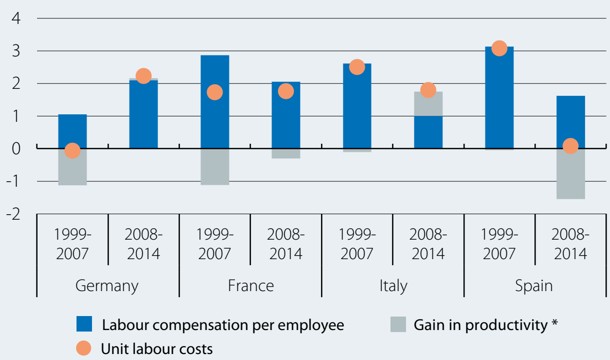
Index (1998 Q1 = 100)



Note: ** Unit labour costs (ULC) correspond to the ratio between labour compensation per employee and labour productivity (measured as GDP in real terms per employee).*
Source: *"la Caixa" Research, based on OECD data.*

Breakdown of the evolution of the unit labour costs

Annual average change in the period (%)



Note: ** Negative values indicate gains in labour productivity (measured as GDP in real terms per employee) and vice versa.*
Source: *"la Caixa" Research, based on OECD data.*

1. Unit labour costs (ULC) correspond to the ratio between labour compensation per employee and labour productivity (measured as GDP in real terms per employee).

FOCUS · Portugal: making good progress but still with some homework to do

This May marks a year since Portugal successfully completed its financial assistance programme. As part of this programme, a series of structural reforms and fiscal adjustment measures were carried out that have helped the country to stabilise its macroeconomic imbalances and exit the recession with favourable economic prospects. However, although the progress made is evident there are still imbalances that could hinder economic growth in the medium term. In this Focus we analyse two of these: the high net external borrowing position and a corporate sector whose leverage is still high.

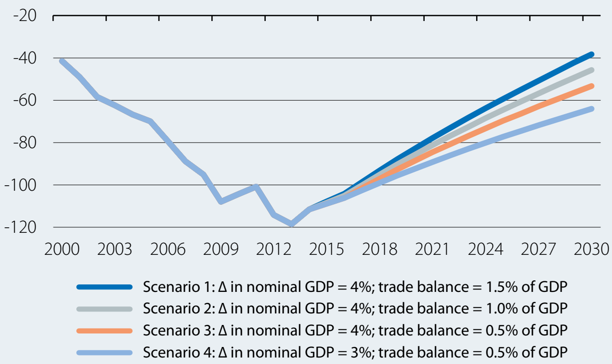
After the euro was introduced, the Portuguese economy continuously posted huge current account deficits. This situation led to a worsening of the net external borrowing position for the country, with its net international investment position (NIIP) reaching –112% of GDP in 2014, making it highly vulnerable to fluctuations in international capital flows. However, the current account balance has been corrected substantially over the last few years. The first surpluses were recorded in 2013 and 2014, particularly thanks to the considerable adjustment in the trade balance. In addition to the logical contraction in imports during a recession, this improvement in the balance of goods and services was also supported by an increase in exports due to significant improvements in competitiveness. Specifically, Portugal's unit labour costs compared with its main trading partners have fallen by 9% since 2007 and exports of goods and services in relation to GDP have increased from 27% in 2009 to 40% in 2014. The country is also managing to lessen the loss of export market share being experienced by most developed countries: between 2007 and 2014 Portugal's share had only fallen by 10% while Germany and Italy have lost 20%. However, in spite of the progress being made, the country still needs to improve its trade balance to ensure its NIIP reaches sustainable levels as soon as possible (see the first graph).

The second obstacle to Portugal's economic growth is the heavy borrowing by firms, limiting investment capacity and job creation and therefore the country's growth.[1] In 2013 the debt of non-financial firms reached 168% of GDP, a level only exceeded in the euro area by Greece, resulting in financial costs totalling 33% of gross operational profit, doubling the figure of Spanish or Italian firms. Although deleveraging took some time to get going due to the difficult economic situation, since 2013 the ratio of debt to GDP has fallen by 14 pps.However, it is important to note that there are marked differences between firms depending on their size. While large firms have moderate levels of debt given their ability to repay and a wider range of possible sources of financing, SMEs, which largely make up Portugal's business fabric and provide employment to 79% of its workers, are still heavily indebted with an average debt to equity ratio of 240%, far above the levels considered suitable by the European Commission.[2] It is therefore important for Portugal to take advantage of the favourable economic climate expected over the coming years to complete its deleveraging.

In summary, Portugal's growth prospects after the bail-out are encouraging. Nevertheless, its imbalances must be corrected decisively and quickly to guarantee the country's growth in the medium and long-term.

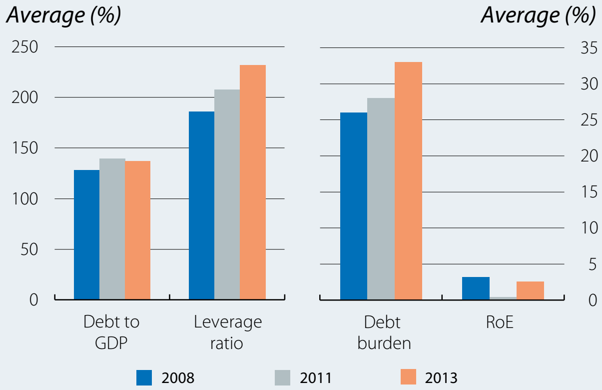
Net international investment position

(% of GDP)



Note: *The following assumptions were made: capital account balance of 1.5% of GDP; interest rate on assets of 3.4% on average; interest rate on liabilities of 2.9% on average; assets as % of GDP are held constant at 190% and without valuation effects.*
Source: *"la Caixa" Research, based on data from the Portuguese National Statistics Institute and the Bank of Portugal.*

Financial ratios of non-financial firms



Note: *The debt burden is equal to the financial costs in relation to the EBITDA, the leverage ratio is equal to the debt to equity ratio and the RoE is equal to the profit as a percentage of equity.*
Source: *"la Caixa" Research, based on data from BACH, the Portuguese National Statistics Institute and the Bank of Portugal.*

1. Household debt was lower and its correction has been considerable, from 95% of GDP in 2009 to 80% in 2014.

2. In general the European Commission believes the optimum ratio is around 100% although this depends on the specific characteristics of the industry and the company itself. Ratios over 200% are seen in firms with excessive debt.

KEY INDICATORS

Activity and employment indicators

Values, unless otherwise specified

	2013	2014	2014 Q2	2014 Q3	2014 Q4	01/15	02/15	03/15	04/15
Retail sales *(year-on-year change)*	–0.8	1.3	1.4	0.8	2.0	3.2	3.0	...	...
Industrial production *(year-on-year change)*	–0.7	0.8	0.9	0.5	0.3	0.4	1.6	...	...
Consumer confidence	–18.6	–10.0	–7.7	–9.9	–11.2	–8.5	–6.7	–3.7	–4.6
Economic sentiment	93.8	101.6	102.6	101.2	100.9	101.5	102.3	103.9	103.7
Manufacturing PMI	49.6	51.8	52.5	50.9	50.5	51.0	51.0	52.2	...
Services PMI	49.3	52.5	53.0	53.2	51.7	52.7	53.7	54.2	...
Labour market									
Employment (people) *(year-on-year change)*	–0.7	0.6	0.6	0.7	0.9	–	...	–	–
Unemployment rate: euro area *(% labour force)*	12.0	11.6	11.6	11.5	11.5	11.3	11.3	11.3	...
Germany *(% labour force)*	5.2	5.0	5.0	5.0	4.9	4.8	4.7	4.7	...
France *(% labour force)*	10.3	10.3	10.1	10.4	10.5	10.6	10.6	10.6	...
Italy *(% labour force)*	12.2	12.7	12.4	12.8	13.0	12.6	12.7	13.0	...
Spain *(% labour force)*	26.1	24.5	24.7	24.1	23.7	23.3	23.1	23.0	...

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 Q2	2014 Q3	2014 Q4	01/15	02/15	03/15
Current balance: euro area[1]	**1.9**	**2.2**	**1.9**	**2.1**	**2.2**	**2.3**	**2.4**	...
Germany	6.5	7.6	6.8	7.4	7.6	7.6	7.7	...
France[1]	–1.4	–1.0	–1.6	–1.3	–1.0	–0.7	–0.7	...
Italy	0.9	1.9	1.3	1.6	1.9	2.0	2.2	...
Spain	1.4	0.8	0.8	0.7	0.8	0.9	0.9	...
Nominal effective exchange rate[2] *(value)*	**101.7**	**102.3**	**103.9**	**101.7**	**99.6**	**95.9**	**94.0**	**91.3**

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 Q2	2014 Q3	2014 Q4	01/15	02/15	03/15
Private sector financing								
Credit to non-financial firms[1]	–2.3	–2.2	–2.5	–2.0	–1.3	–0.9	–0.3	–0.3
Credit to households[1,2]	0.3	0.5	0.5	0.5	0.7	0.9	1.0	1.1
Interest rate on loans to non-financial firms[3] *(%)*	2.2	2.0	2.1	1.9	1.8	1.7	1.6	...
Interest rate on loans to households for house purchases[4] *(%)*	2.8	2.6	2.7	2.6	2.4	2.3	2.1	...
Deposits								
On demand deposits	7.9	6.0	5.2	5.9	7.2	9.1	9.3	10.5
Other short-term deposits	0.0	–2.1	–2.0	–1.7	–2.1	–3.1	–3.2	–3.3
Marketable instruments	–14.8	–7.4	–11.7	–6.1	0.9	0.5	3.2	4.1
Interest rate on deposits up to 1 year from households *(%)*	2.0	1.3	1.4	1.3	1.1	1.0	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 · **Growth speeds up with the support of consumption**

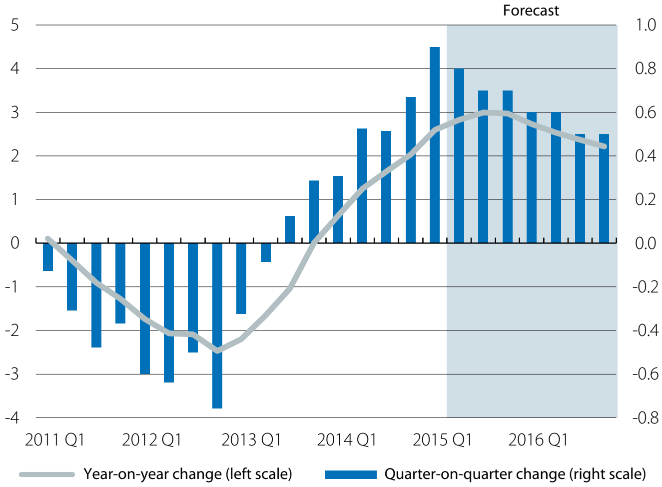
The rate of growth for the Spanish economy increased to 0.9% quarter-on-quarter in Q1, 0.2 pps more than our forecast and the figure posted in 2014 Q4. Pending details by component, early business indicators point to dynamic domestic demand especially in private consumption and corporate investment, while foreign demand is likely to have made a slightly negative contribution due to the strength of non-energy imports. Activity indicators, which already pointed to a faster growth rate in 2015 Q1, suggest the recovery is stronger than expected. This has led us to revise upwards our growth forecasts to 2.8% for 2015 and 2.5% for 2016 (up by 0.3 and 0.2 pps respectively), mainly because of the improved trend in private consumption reflecting the good performance by the labour market and savings thanks to lower oil prices. On the other hand we expect foreign demand's contribution to growth to continue being slightly negative in 2015 due to rising imports resulting from greater consumption, becoming positive in 2016 when the euro's depreciation has its maximum effect.

Widespread improvements in growth prospects for 2015. The good figures recorded over the last few months augur robust growth for the whole of 2015 and the main national and international organisations have improved their growth forecasts for the Spanish economy for this year. In April it was the turn of the International Monetary Fund (IMF) and the Spanish government, improving their forecasts by 0.8 pps and 0.9 pps respectively. The annual growth predicted for 2015 is between 2.5% (forecast by Consensus Economics and the IMF) and 3.0% (Funcas forecast) with the forecasts made by the Bank of Spain and "la Caixa" Research lying between these two figures (2.8%). The warning note comes from the medium-term forecasts which show a clear slowdown in the growth rate as the effect of temporary supports (low oil prices and the euro's depreciation) gradually dwindle. In its spring report, the IMF repeats the need for Spain to continue carrying out reforms and boosting investment to underpin potential growth in the medium term.

Domestic demand is the engine for growth. Demand indicators suggest domestic consumption was healthy in Q1. Retail sales rose by a strong 2.7% year-on-year in March and sales of large firms recorded an increase of 5.7% year-on-year in February, supported by a dynamic domestic market. This good trend is continuing in Q2: consumer confidence rose again in April and reached 3.6 points, a level similar to the one in 2000 (with a historical average of –12.9 points). Spanish consumers are starting to notice the improved economy which, thanks to savings due to lower oil prices, low inflation and improved labour market, is

GDP

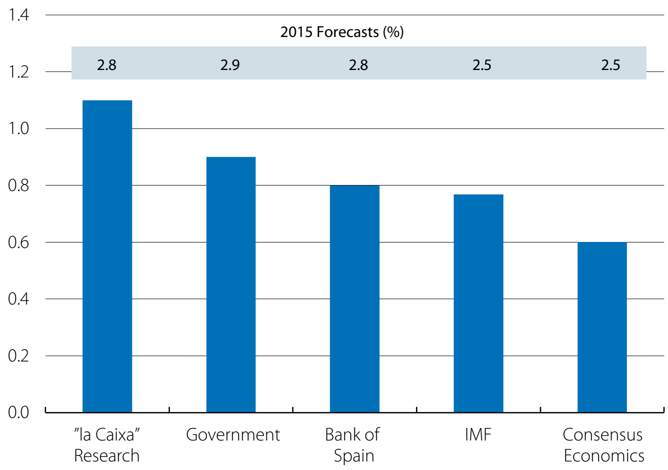
Year-on-year change (%) *Quarter-on-quarter change (%)*



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

Revised growth forecasts for 2015

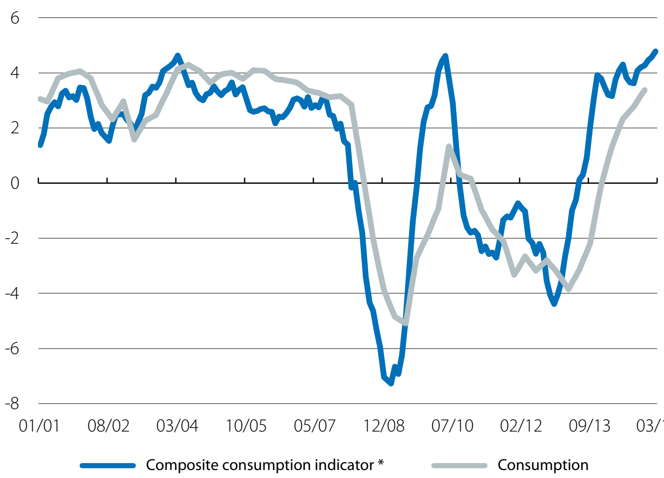
Change compared with the forecasts last autumn (pps)



Source: *"la Caixa" Research, based on data from the IMF, European Commission, Bank of Spain, Ministry of Finance and Consensus Economics.*

Demand indicators: consumption

Year-on-year change (%)



Note: ** Year-on-year change in the moving 3-month average.*
Source: *"la Caixa" Research, based on data from the Ministry of Finance and the Spanish Statistics Institute (INE).*

encouraging them to increase consumption and make purchases postponed during the worst years of the recession. These positive figures are reflected in the composite consumption indicator made up of various demand indicators, showing a clear upward trend and suggesting private consumption will be a key support for growth in 2015.

Inflation picks up although it is still in negative terrain. Inflation increased for the third consecutive month in April; specifically by 0.1 pps to –0.6%, boosted by the increase in electricity prices. We expect this upward trend to consolidate over the coming months and inflation to return to positive figures in the second half of the year.

Good activity figures reinforce the labour market. The Labour Force Survey (LFS) posted its lowest drop in employment in a first quarter since 2008. During the first three months of the year, employment fell by 114,300 people (184,600 in 2014 Q1), placing the year-on-year rate of change in employment at 3.0% (2.5% in Q4). Spain's labour market is highly seasonal due to the importance of the tourism industry, so first quarters are historically weak as a consequence of the end of the summer and Christmas tourism campaigns in Q3 and in Q4. After eliminating this seasonal effect, employment actually grew by 0.4% quarter-on-quarter. The same trend can be seen in the number of registered workers affiliated to Social Security whose year-on-year rate of change speeded up by 0.5 pps in March to 3.3%, accumulating 20 consecutive months of growth.

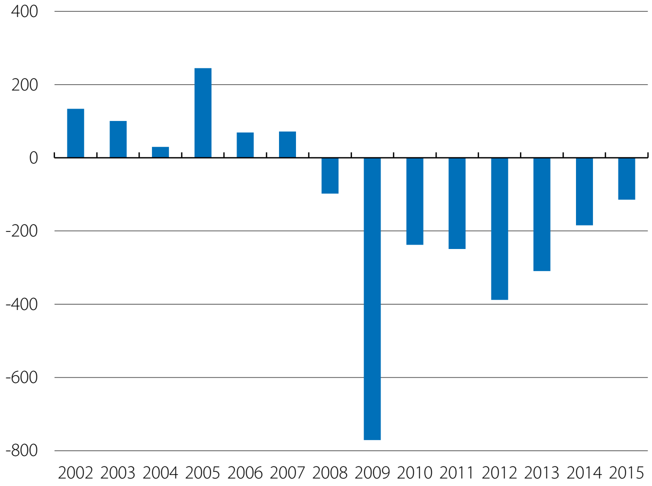
The unemployment rate has risen slightly. In spite of the job losses occurring in Q1, the unemployment rate increased by just 0.1 pps to 23.8% due to a reduction in the labour force in the same quarter. However, in annual terms the labour force recovered for the first time since 2012, specifically by 0.1% year-on-year, representing an increase of 15,500 people. Over the coming months the labour force might continue to grow as the economic recovery consolidates and the effect fades of the discouragement that has affected the labour market over the last few years. This will limit the reduction in the unemployment rate which we place at 21.7% in the last quarter of the year. However, in the longer term the labour force will tend to diminish due to the ageing population.

The real estate market shows signs of improving. Employment in construction grew by 12.6% year-on-year in Q1 (30,000 people) and the sector contributed a quarter of the increase in total employment in that quarter. This change in trend can also be seen in supply and demand indicators for the real estate sector. On the supply side, new building permits rose in January by 7.0% (cumulative over 12 months) while, on the demand side, house purchases were up by 11.2% in February (cumulative over 12 months). All this indicates that the sector's adjustment is complete and augurs a good 2015.

2014 ended with a larger current account surplus than had been predicted. The definitive figures from the Bank of Spain

Employment in Q1

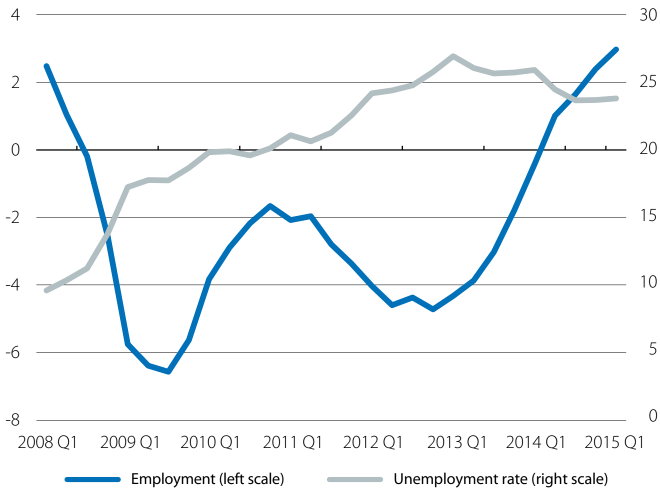
Quarter-on-quarter change (thousands)



Source: *"la Caixa" Research, based on data from the LFS (INE).*

Employment and unemployment rate

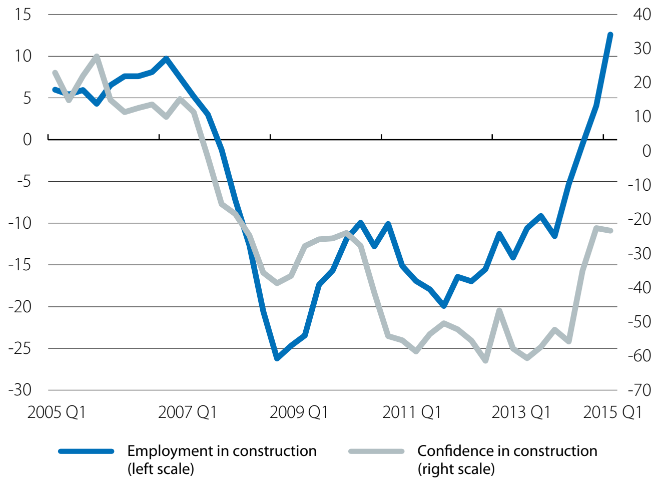
Year-on-year change (%) *(% of the labour force)*



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

Employment and confidence in the construction industry

Year-on-year change (%) *Level*



Source: *"la Caixa" Research, based on data from the Ministry of Finance and the Spanish Statistics Institute (INE).*

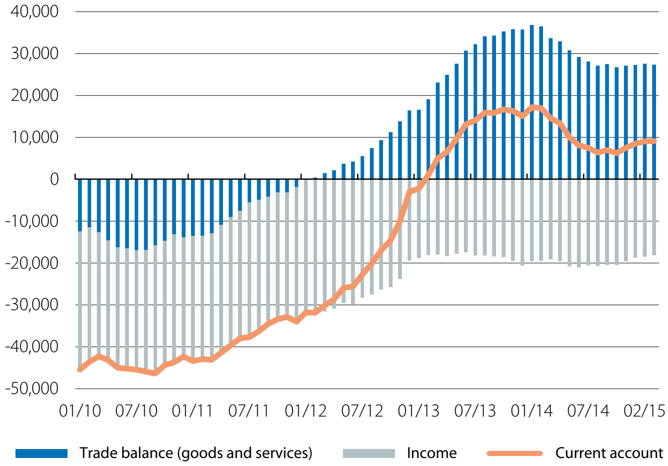
for 2014 were higher than expected, placing the current account surplus at nearly 8.5 billion euros (0.8% of GDP); this figure is an improvement of around 7 billion euros compared with the initial estimate for the balance (1.2 billion euros). The main reason for this revised figure is the balance for primary and secondary income which ended the year with more revenue and less expenditure than initially estimated, closing at –1.8% of GDP (the initial estimate was –2.3%). Nonetheless the new current account figures are still lower than those recorded in 2013 (1.5% of GDP) due to a worsening trade deficit in goods. For 2015 we expect the euro's depreciation and the fall in oil prices to support the balance of trade, in February standing at 0.9% of GDP according to the cumulative figures over 12 months. For its part, tourism continues to perform well. In March the number of tourists, cumulative over 12 months, posted a 6.7% increase year-on-year, exceeding 65.5 million.

The recovery stimulates credit. The recovery in the economy is boosting both the demand and supply of credit to the private sector. New loans granted to households for consumption increased in February by 17% year-on-year and stood at 3 billion euros (34 billion cumulative over 12 months, 16% more than in the same period a year ago). Loans to households for housing also showed a similar trend with 18% growth year-on-year (21% cumulative over 12 months). Similarly, new loans granted to SMEs, also according to the cumulative figure over 12 months, improved by 0.1 pps to 8.9% year-on-year. In addition to these good figures for the last few months, financing conditions also improved as from the start of the ECB's quantitative easing programme. All the evidence therefore seems to suggest that credit will continue its recovery and provide households and firms with extra resources, encouraging consumption and investment and, in turn, bolstering the good tone of the Spanish economy.

The government has published its 2015-2018 Stability Programme with substantial improvements in the macroeconomic area. According to this programme, GDP will grow by 2.9% in 2015 and 2016 and will reach 3.0% in the following two years, a forecast in line with that of "la Caixa" Research for 2015 but quite a lot more optimistic for the subsequent years. This acceleration in growth, together with the upswing in inflation and improved labour market, will help to meet the deficit target in the coming years (–4.2% of GDP in 2015), almost achieving a balanced budget by 2018 (–0.3%). Compared with the programme presented a year ago, of note is the slight relaxation in the deficit for 2017 for the autonomous communities and Social Security, representing an increase of 0.3 pps to –1.4% of GDP. The government also presented the new National Programme of Reforms which contains structural reforms at a European level to encourage investment, growth and employment, as well as measures at a national level, most of them already approved but yet to be implemented.

Current account

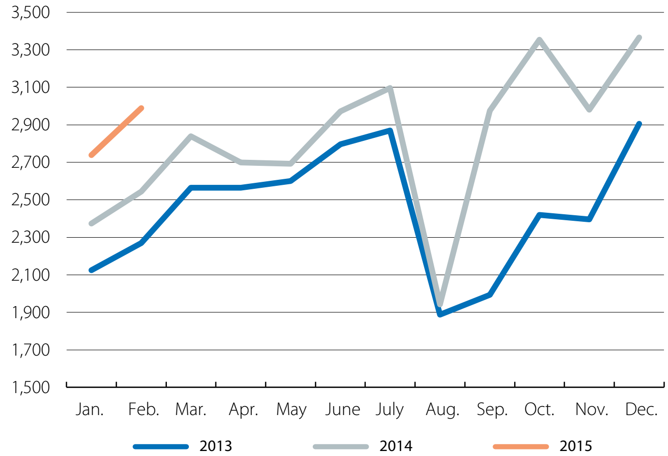
Cumulative figures over 12 months (million euros)



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

New loans granted to households for consumption

(Million euros)



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

Net lending (+) / borrowing (–) by public administrations *

(% of GDP)

	2014	2015	2016	2017	2018
Central government	–3.5	–2.9	–2.2	–1.1	–0.2
Social Security	–1.1	–0.6	–0.3	–0.2	–0.1
Autonomous communities	–1.7	–0.7	–0.3	–0.1	0.0
Local corporations	0.5	0.0	0.0	0.0	0.0
TOTAL	–5.7	–4.2	–2.8	–1.4	–0.3

Note: ** Does not include expenditure resulting from bank sector losses, totalling 0.1% of GDP in 2014.*
Source: *"la Caixa" Research, based on data from the Tax Ministry.*

FOCUS · The "la Caixa" Research real estate thermometer: the vital signs of a sector starting to revive

2014 marked a turning point in the real estate sector. Signs of stabilisation appeared during the first half of the year followed by an improvement in some indicators in the second. With a view to 2015, these advances are expected to gain steam, resulting in the long-awaited consolidation of the sector's recovery. To illustrate the situation of Spain's real estate market and monitor its vital signs, we have developed the "la Caixa" real estate thermometer.[1] This is made up of three sub-indicators (supply, demand and prices), designed to measure the current temperature of each of these three dimensions. If the temperature is below the equilibrium zone, the sector is cooling down; on the other hand, if it is above this zone, it is overheating.

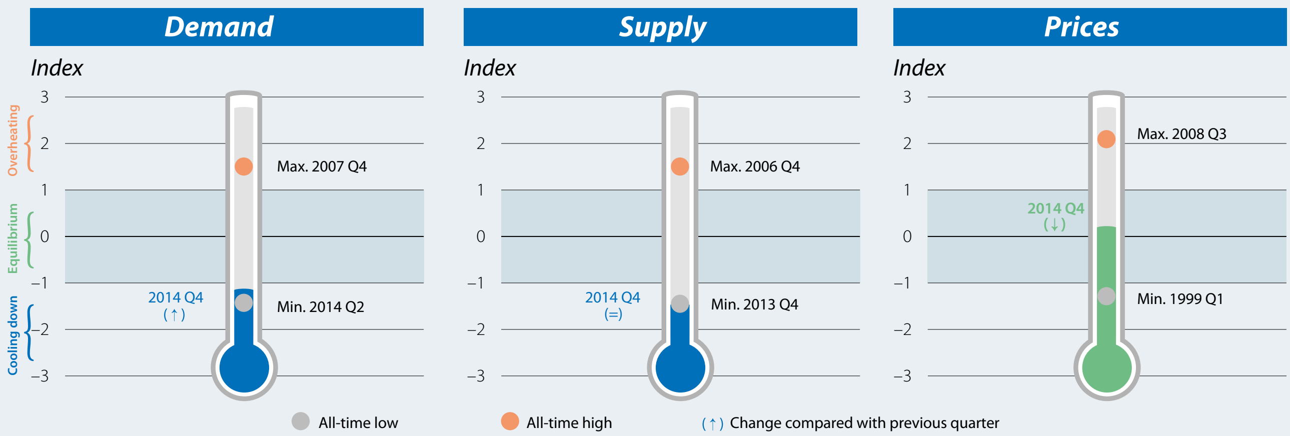
In the case of demand, the thermometer takes into account both domestic demand for first and second homes foreign demand. At present, the overall picture is that, although demand has increased slightly over the last few months, it is still below what is considered to be its equilibrium level. For the moment house purchases by foreigners, which grew by 23.5% in 2014, are driving growth but, in spite of this growth, there is still a long way to go before reaching equilibrium level.

With regard to the trend in supply, the indicator takes both residential investment and completed residences into account, as well as the stock of unsold residential properties. Although this indicator was at rock bottom at the end of 2014, some signs of improvement seen in the last few months augur a good 2015. Worthy of note is the increase in residential investment, in applications for new building permits and employment in the sector. These trends should consolidate in 2015 although the stock of unsold residential properties is still very high in some regions, making the overall recovery quite gradual.

The current situation is also encouraging with regard to prices. In this case the indicator takes the purchase capacity of households into account and therefore combines house prices with data on household income and financing conditions, as well as returns from rental income. As shown by the thermometer, on the whole prices have now returned to their equilibrium level, demonstrating the recent trend in prices which, after falling by 30% in nominal terms since 2008 Q1 (37% in real terms), stabilised in 2014 Q4. Improvements in financial conditions and the labour market are also helping the effort required by households to purchase housing to reach a sustainable level.

In short, the thermometer shows that the real estate sector's pulse is getting stronger and that there is still a lot of potential for growth, both in terms of demand and supply, although the recovery is expected to be gradual for both. In the case of demand, it is vital for the recovery in the labour market to consolidate, now that the measures adopted by the ECB suggest financing conditions will be favourable for quite some time. However, the recovery in supply is still strongly affected by the stock of unsold residential properties. Nevertheless, there are marked differences from region to region; in fact, in some the excess supply is almost non-existent and a recovery can already be seen in activity. The vital signs of this incipient cycle are healthy but the sector's temperature will have to be monitored constantly to make sure the errors of the past are not repeated.

"la Caixa" Research real estate thermometer



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

1. For more information on the methodology behind the "la Caixa" Research real estate thermometer, see the methodological note *Termómetro inmobiliario de "la Caixa" Research.*

FOCUS · Job polarisation in Spain

The progressive loss of jobs in sectors with average wages is known as «job polarisation». In Spain the percentage of employed in these sectors was 29.3% in 2008 compared with 23.0% in 2014.[1] On the other hand, over this same period the share of employment in the low wage band and especially in the high wage band increased (see the first graph). This phenomenon of job polarisation is more or less evident in many developed countries.[2] One of the main theories to explain this is that new technologies have reduced demand for workers carrying out routine tasks that can be easily mechanised (jobs that are mostly in the average wage band) while relative demand has increased for jobs that have a certain advantage over technology, either because they require more creativity or more manual or interpersonal skills (and these tend to be in the high and in the low wage band, respectively).[3]

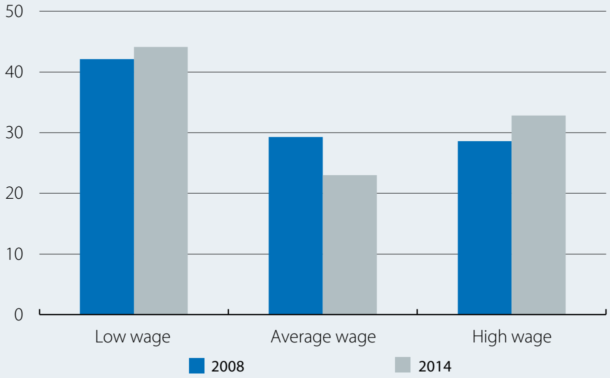
In line with this theory, in Spain it can be seen that job losses occurring over the last few years have affected workers in the average wage band more than in any other. Specifically, the number of employees in this wage group in 2014 Q4 was 35% lower than in 2008 Q1 while the volume of workers fell by just 10% in the low wage band while the high wage band remained constant. The decline in the construction sector, which concentrates a large number of workers in the average wage band, lies behind a significant part of this trend. However, if this sector is excluded from the analysis, the loss of jobs in the average wage band is 20%, a drop that is still significant and much bigger than the job losses in the other two wage bands.

Job polarisation in Spain is not only related to the economic crisis: at the start of the recovery fewer jobs have been created in the average wage band than at the two extremes (see the second graph). If we compare the contribution made by each wage band to the jobs created in 2014 compared with their relative share in 2013, we can see that those economic sectors with a lower average wage contributed relatively more to creating jobs, given their share of the total. This group has therefore regained a significant proportion of the jobs lost during the crisis. Regarding the high wage band, in 2014 jobs were created in line with its relative share, a positive figure considering that this group is the one that has gained most share since 2008.

In short, the data reveal changing employment patterns in the Spanish economy with a significant delay in new jobs earning an average wage. Considering that one of the greatest risks of job polarisation is increased inequality, it is crucial to promote education that helps workers to take advantage of the opportunities provided by new technologies and thereby replace the average jobs lost with other, higher quality jobs.

*Share of employment by wage bracket **

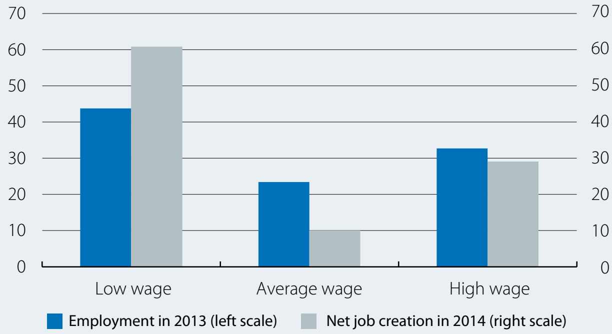
(% of all employment)



Note: ** Excluding CNAE-09 sectors A (Agriculture), T (household activities) and U (activities of organisations and extra-territorial bodies).*
Source: *"la Caixa" Research, based on data from the LFS and the ETCL (INE).*

*Breakdown of net job creation by wage bracket **

(% of total employment in 2013) *(% of net jobs created 2014)*



Note: ** Excluding CNAE-09 sectors A (Agriculture), T (household activities) and U (activities of organisations and extra-territorial bodies).*
Source: *"la Caixa" Research, based on data from the LFS and the ETCL (INE).*

1. The two-digit CNAE-09 economic sectors are classified into three wage brackets according to the hourly wage in the Quarterly Labour Cost Survey (ETCL in Spanish). For 2008, the sectors available in the ETCL (77 in total) are ordered from the lowest to the highest hourly wage, the cut-off value used for the three groups being the 1/3 percentile (corresponding to an hourly wage cost of 11.8 euros) and 2/3 percentile (15.8 euros).
2. See «Drivers of recent job polarisation and upgrading in Europe», European Jobs Monitor 2014, European Foundation for the Improvement of Living and Working Conditions.
3. See Goos, Manning and Salomons (2009), «Explaining Job Polarization: Routine-Biased Technological Change and Offshoring», The American Economic Review.

FOCUS · The use of the Social Security Reserve Fund

The report to the Spanish parliament of the Social Security Reserve Fund (FRSS in Spanish), presented at the end of March, showed that 15.3 billion euros were used in 2014 to cover a deficit of the Social Security system. With this amount, since 2012 withdrawals from the FRSS total almost 50% of the fund's maximum capital, reached in 2011. Has the FRSS been used appropriately? To what extent is it possible to continue to make use of the Fund's resources?

The FRSS was set up in 2003 with the aim of accumulating surplus Social Security revenue to cover payments of contributory pensions and its management expenses in prolonged situations of deficit. These resources can be invested in public debt from Spain, France, Germany or the Netherlands that is issued in euros and with a high credit rating, although only Spanish bonds are held at present. The use of assets from the FRSS was limited to 3% of the total of the aforementioned expenditure, although in 2012 the limit was removed for three years and last year this exception was extended to 2015 and 2016. Almost 34 billion euros have therefore been consumed from the FRSS in three years to finance around 11.2% of all pension payments and a further 8.5 billion is expected to be used in 2015, according to the Social Security budget.

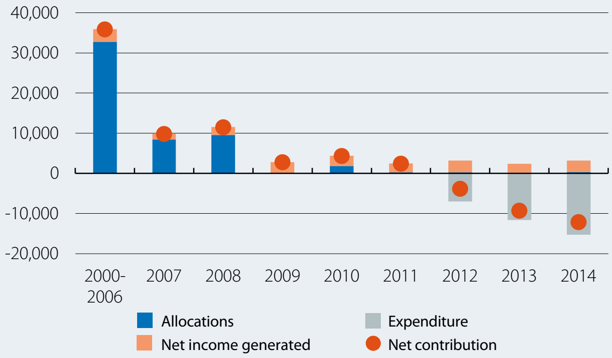
The FRSS balance has fallen from 53.7 billion at the end of 2013 to 41.6 billion at the end of 2014, at purchase prices. But part of this reduction has been offset by growth in the portfolio's value: at the end of 2014 its market value had increased to 47.7 billion euros. Within the current context, with very low interest rates and probably little margin for these to fall any further, selling state bonds seems to be a good financial strategy as it realises the portfolio's latent gains in value.

It should be noted that the FRSS has only invested in Spanish public debt and no other assets since 2014 and that the state transfers resources to Social Security every year (to pay non-contributory pensions, among others). Consequently, in practice there is a unity of cash between Social Security and the state and the purchase of public debt by the former is a way of financing the deficit of the latter. Moreover, using the Fund to pay pensions does not affect the consolidated debt for all public administrations as a whole.[1] The sale of Spanish public debt by the FRSS increases the level of debt of public administrations as debt securities are no longer consolidated if they are not held by Social Security. The alternative to using the FRSS to finance this deficit would have been for the Treasury to issue more debt, which would have increased the level of public debt by the same amount.

The underlying issue is therefore the Social Security deficit per se and not so much how to finance it, in particular considering that part of the deviation of Social Security accounts is due to structural factors. The economic crisis has led to a temporary drop in company contributions but, in addition to this reduction in revenue, there has also been a structural increase in spending on pensions due to the ageing population and the rise in the average pension.[2] The depth and duration of the recession lies behind the more extensive use of funds over the last few years; however, once the economic recovery is fully on track, revenue from contributions should increase in line with employment and the use of the Fund should be more limited. It is advisable to take advantage of this improvement to diversify the assets invested in by the FRSS and thereby provide it with funds that ensure the long-term solvency of the pension system.

Flows to the Social Security Reserve Fund at total price of acquisition

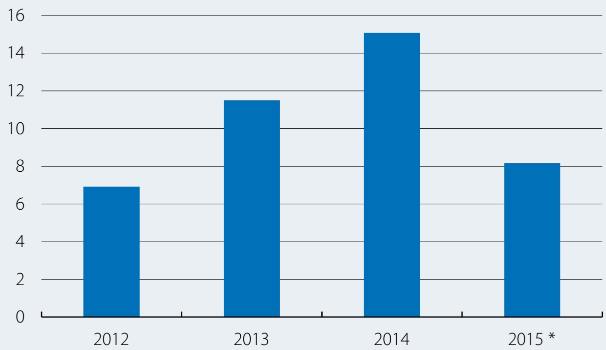
(Million euros)



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

Expenditure of the Social Security Reserve Fund

(% of expenditure on contributory pensions)



Note: ** According to the forecast in the 2015 Social Security budget.*
Source: *"la Caixa" Research, based on data from the Ministry of Employment and Social Security.*

1. This is the level of debt according to the Excessive Deficit Protocol (EDP) used by the European Commission as a benchmark.

2. Part of this increase will ease off over the coming years thanks to recent reforms to the pension system, making it more sustainable over the long term. For more information, see the Focus in the *Monthly Report* of January 2015 «On the sustainability of the pension system».

KEY INDICATORS

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

Activity indicators

	2013	2014	2014 Q2	2014 Q3	2014 Q4	01/15	02/15	03/15	04/15
Industry									
Electricity consumption	–2.1	–0.2	1.0	0.3	–1.7	3.5	1.2	–0.2	...
Industrial production index	–1.5	1.3	2.6	0.6	0.3	–0.1	0.8	...	...
Indicator of confidence in industry *(value)*	–13.9	–7.1	–8.2	–5.7	–5.3	–4.5	–4.3	–0.9	0.2
Manufacturing PMI *(value)*	48.5	53.2	53.4	53.1	53.7	54.7	54.2	54.3	...
Construction									
Building permits *(cumulative over 12 months)*	–36.3	–7.7	–11.2	–2.1	4.0	6.9	17.2	...	...
House sales *(cumulative over 12 months)*	0.4	–5.5	–8.3	–5.0	0.4	6.3	11.2	...	...
Services									
Foreign tourists	5.8	7.2	7.8	7.6	5.4	3.6	5.3	6.7	...
Services PMI *(value)*	48.3	55.2	55.7	56.7	54.3	56.7	56.2	57.3	...
Consumption									
Retail sales	–3.7	1.0	0.7	0.4	2.9	2.9	1.7	2.7	...
Car registrations	5.6	18.4	23.2	17.0	21.7	27.5	26.1	40.5	...
Consumer confidence index *(value)*	–25.3	–8.9	–6.1	–7.9	–9.6	–1.5	–2.1	1.7	3.6

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 Q2	2014 Q3	2014 Q4	01/15	02/15	03/15
Registered as employed with Social Security [1]								
Employment by industry sector								
Manufacturing	–4.3	0.1	0.0	0.6	0.9	1.2	1.5	1.8
Construction	–12.1	–1.6	–2.3	–0.5	1.6	3.4	5.1	5.4
Services	–2.0	2.2	2.2	2.6	2.8	3.2	3.4	3.8
Employment by professional status								
Employees	–3.8	1.4	1.4	1.9	2.3	2.5	3.0	3.5
Self-employed and others	–0.6	2.2	2.3	2.5	2.5	2.5	2.3	2.3
TOTAL	**–3.2**	**1.6**	**1.5**	**2.0**	**2.3**	**2.5**	**2.8**	**3.3**
Employment [2]	**–2.8**	**1.2**	**1.1**	**1.6**	**2.5**	**–**	**3.0**	**–**
Hiring contracts registered [3]								
Permanent	–14.2	18.8	24.0	21.5	23.0	22.2	23.0	27.1
Temporary	6.4	13.1	14.2	11.1	7.7	7.5	11.4	17.6
TOTAL	**4.0**	**13.4**	**15.0**	**11.8**	**8.8**	**8.6**	**12.5**	**18.5**
Unemployment claimant count [3]								
Under 25	–6.2	–8.2	–10.9	–5.5	–6.9	–10.3	–9.6	–9.5
All aged 25 and over	3.7	–5.3	–5.9	–5.9	–5.7	–5.6	–5.9	–6.9
TOTAL	**2.7**	**–5.6**	**–6.4**	**–5.9**	**–5.8**	**–6.0**	**–6.2**	**–7.2**

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 Q2	2014 Q3	2014 Q4	01/15	02/15	03/15	04/15
General	**1.4**	**–0.1**	**0.2**	**–0.3**	**–0.5**	**–1.3**	**–1.1**	**–0.7**	**–0.6**
Core	1.5	0.0	0.1	0.0	0.0	0.2	0.2	0.2	...
Unprocessed foods	3.6	–1.2	–2.3	–4.1	0.8	–0.7	0.9	0.9	...
Energy products	0.1	–0.8	2.4	–0.2	–4.3	–11.4	–10.2	–7.4	...

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

Foreign sector

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

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	01/15	02/15
Trade of goods								
Exports *(year-on-year change)*	5.2	2.5	3.2	–2.0	4.8	4.3	–2.9	2.8
Imports *(year-on-year change)*	–1.3	5.7	7.0	3.7	7.3	5.0	–3.6	4.5
Current balance	**15.1**	**8.5**	**14.5**	**8.1**	**7.0**	**8.5**	**9.0**	**9.1**
Goods and services	35.7	27.2	33.7	29.1	27.5	27.2	27.5	27.3
Primary and secondary income	–20.6	–18.7	–19.1	–21.1	–20.5	–18.7	–18.5	–18.2
Net lending (+) / borrowing (–) capacity	**22.0**	**12.9**	**21.7**	**14.5**	**12.8**	**12.9**	**13.6**	**13.7**

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 Q2	2014 Q3	2014 Q4	01/15	02/15	03/15
Net lending (+) / borrowing (–) capacity	**–6.8**	**–5.8**	**–3.3**	**–3.6**	**–5.8**	**–**	**...**	**–**
Central government [1]	–4.8	–3.8	–2.5	–3.1	–3.8	–0.6	–1.1	–0.9
Autonomous regions	–1.5	–1.7	–1.0	–1.0	–1.7	–0.1	–0.1	...
Local government	0.5	0.5	0.1	0.3	0.5	–	...	–
Social Security	–1.1	–1.1	–0.1	0.0	–1.1	0.2	0.2	...
Public debt *(% GDP)*	**92.1**	**97.7**	**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 Q2	2014 Q3	2014 Q4	01/15	02/15	Balance 02/15 [1]
Financing of non-financial sectors [2]								
Private sector	–8.2	–5.3	–5.5	–4.5	–4.8	–5.6	–4.7	1,677.7
Non-financial firms	–10.6	–5.4	–5.7	–4.0	–4.9	–6.7	–5.2	935.2
Households [3]	–5.0	–5.1	–5.2	–5.0	–4.6	–4.3	–4.2	742.4
General government [4]	16.8	6.9	6.6	5.9	6.7	5.1	4.7	1,040.8
TOTAL	**–1.1**	**–1.2**	**–1.4**	**–0.9**	**–0.8**	**–1.8**	**–1.3**	**2,718.4**
Liabilities of financial institutions due to firms and households								
Total deposits	2.1	–0.9	–0.8	–1.2	–1.7	–2.0	–0.3	1,165.2
On demand deposits	4.2	10.8	7.4	13.6	14.8	14.5	20.9	337.5
Savings deposits	–0.1	5.8	5.9	6.9	6.8	9.6	10.7	225.2
Term deposits	1.7	–7.6	–6.1	–9.4	–11.3	–12.8	–12.9	580.8
Deposits in foreign currency	16.8	1.1	0.1	0.3	5.2	4.7	10.9	21.7
Rest of liabilities [5]	–16.8	–8.2	–8.3	–6.8	–6.8	–12.9	–14.7	112.7
TOTAL	**–0.2**	**–1.7**	**–1.6**	**–1.7**	**–2.2**	**–3.1**	**–1.8**	**1,277.9**
NPL ratio *(%)* [6]	**13.6**	**12.5**	**13.1**	**13.0**	**12.5**	**12.5**	**12.5**	–
Coverage ratio *(%)* [6]	**58.0**	**58.1**	**59.4**	**59.1**	**58.1**	**58.5**	**58.6**	–

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

THE SUSTAINABILITY OF DEBT AT A GLOBAL LEVEL

Should we no longer worry about the level of debt?

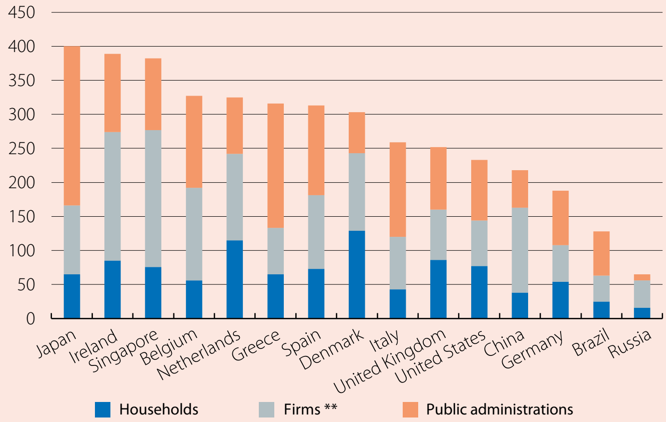
In October 2008, at the peak of the Great Recession, the International Monetary Fund (IMF) confirmed that a reduction of debt at a global level was necessary and inevitable. Inevitable? Recent figures from McKinsey (2015) indicate that the debt levels of most countries in 2014 actually exceeded those of 2007: global debt has gone from representing 269% of GDP to 286%.[1] And if the timeframe is widened, the data suggest that this upward trend in debt has been going on for a long time: according to the Bank for International Settlements (BIS), in the three decades between 1980 and 2010 the most developed countries increased their debt at an average annual rate equivalent to 5% of GDP. And in those countries for which we have a longer historical record, such as the US, a similar trend can be seen in private debt at least since the end of the Second World War. Given this situation, should we be concerned about this secular pattern of greater debt? Because, although the IMF was mistaken to think that deleveraging was inevitable, perhaps it was right to deem it necessary.

To answer this question, first we need to avoid demonising debt *per se*. Debt is a financial instrument related to a fundamental mechanism to create well-being: credit. It fulfils vital functions to ensure modern economies function well: it allows individuals and firms to temporarily adjust their consumption and investment, helps the public sector absorb shocks affecting economies and enables spending capacity to be spread across generations, as well as resulting in the more efficient allocation of capital for different uses in the economy and more efficient assignment of risk, discriminating between those taking on debt who are most able to assume it.

Nonetheless, not demonising debt is different from throwing all caution to the wind when accumulating debt in the long term. In economic terms we should be concerned about the sustainable rate of growth. To examine this question further, we need to make a fundamental distinction between a debt ratio that is compatible with normal growth in the economy and a ratio that creates excessive liquidity, excessive being more liquidity that the level required by the economy. Unlike in the sustainable situation, under certain conditions the undesirable outcome of a predominance of excessive debt accumulation could be unwarranted increases in the price of certain assets (such as harmful financial bubbles).[2] In spite of its importance, in practice it is no easy task to distinguish between a sustainable and excessive rate of growth in debt. Conceptually the long-term factors determining the process of indebtedness differ in nature. The trend in debt critically depends on demographics, economic development, the degree of global economic and financial integration, the quality of institutions, financial innovations (in particular those allowing risk to be shared) and the overall stability of the macroeconomic framework. Although it is difficult to determine cause and effect, it is generally accepted that a positive trend in these variables is accompanied by a long-term trend of increasing debt.[3] As the BIS pointed out: «Without finance and without debt, countries are poor and stay poor». But with too much debt perhaps they begin to be less rich.

Debt by sector in the main economies *

(% of GDP)



Notes: ** 2014 Q2 for advanced economies and China, 2013 Q4 for the rest of the countries. Public debt does not consolidate different levels of government. ** Non-financial firms.*
Source: *"la Caixa" Research, based on data from McKinsey Global Institute (2015).*

Intuitively we can accept that there must be a limit as from which debt no longer strictly fulfils its functions and starts to generate risks and costs. The fundamental risk is that, in a situation of excessive debt, a debtor may be more vulnerable to possible shocks in terms of income, interest rate or uncertainty. An unexpected change in the flow of predicted income, worsening of financing conditions or deterioration in expectations represent a greater risk in a scenario of excessive debt. But even in the absence of such shocks, excessive debt entails costs. For example, there is evidence that companies with too much debt can make less than optimal decisions regarding corporate investment, rejecting profitable projects whose returns would be allocated to serve debt

1. Total debt of households, non-financial firms and general government (not consolidated).
2. Debt is sustainable when its accumulation and use do not generate an excessive burden in relation to future income.
3. Although the text focuses on the link between increasing debt and long-term variables, these also influence how the different stages of deleveraging develop. To cite a relevant example, the quality of institutions plays a vital role in these stages: institutional quality has a decisive impact on how private debt is restructured.

taken out in the past. When such behaviour spreads, the aggregate outcome is less growth. Richard Koo analysed how some Japanese firms went from being maximisers of profit to minimisers of debt and worsened Japan's long recession in the 1990s as they helped to make expansionary monetary policy less effective. Moreover, if the dreaded shock actually occurs, the financial sector might start to limit credit.

Within this general framework, one prominent stream in economics literature has tended to tackle the issue of excessive debt with an aggregate, empirical focus, aiming to determine the debt threshold as from which negative effects occur in economic growth. One of the most widely commented lines of research in the last few years in this area has been the work by Reinhart and Rogoff.[4] According to the authors' estimates, those countries above the public debt threshold of 90% of GDP tend to record growth that is slightly lower than countries below this threshold. Although these figure were subsequently questioned due to errors of calculation (errors which, once corrected, concluded that the threshold in question did not appear), it is true that other authors, using different data and methodologies, still find that thresholds exist.[5]

This line of research can be complemented in at least three directions. The first is the so-called «balance sheet approach». The basic idea underlying this approach is that the capacity to repay debt depends not only on the level of debt but also on its structure (paying particular attention to aspects such as its duration or currency) and the quality of the assets that must generate the capacity to repay the debt or, in short, the relation between assets, debt and equity. This approach, initially designed to explain solvency and credit risk from a company point of view, has proven to be fruitful and has been extended to more aggregate levels. For example, the IMF has developed this approach to improve explanations of why emerging economies have historically had problems in repaying their debts even though these are at relatively low levels. A second approach attempts to find alternatives in order to establish the threshold. One significant example of this approach is a recent study by the IMF (2014) that uses empirical evidence based on historical data from a large number of countries, concluding that it is the trend in debt rather than any hypothetical threshold that conditions the rate of growth.[6] In particular, the authors claim that the growth rate is similar for both countries with low levels of debt and those with higher levels but a downward trend. Lastly, a third variant revises the issue of thresholds by broadening the type of debtor: instead of analysing only public debt, as Reinhart and Rogoff did, it also includes companies and households. This is a useful adjustment for those who agree that the threshold concept should not be abandoned but that greater precision is required to quantify it, arguing that patterns of debt and deleveraging are not uniform between economic agents. One illustrative study from this point of view, carried out by BIS economists (2011) on developed countries and over a timeframe of three decades (1980-2010), has discovered two thresholds: 85% of GDP in the case of public debt and households and 90% for corporate debt. The direct conclusion from these thresholds is that the world economy is significantly at risk due to excessive debt. According to the McKinsey data, in 2014 Ireland exceeded the thresholds in all three sectors while Japan, Singapore, Belgium, the Netherlands, Spain, Denmark and the United Kingdom recorded excessive debt in two of the three types of debtor.

In short, the question of debt, always fundamental, continues to pose considerable challenges of interpretation for economists and, by extension, for society. The aforementioned approaches provide an example of the renewed attention being paid to determining what constitutes an excessive level of debt, a dangerous trend in debt accumulation or the quality of assets as a conditioning factor for debt sustainability. However, the challenges do not end there. From a more general point of view, the limitation stated by Olivier Blanchard in 2012 needs to be overcome (namely that much of modern macroeconomics «assumed that we could ignore much of the details of the financial system»), as well as reclaiming the importance given by authors considered canonical in their day (Wicksell, Hayek and Minsky, to cite three obligatory references) to the links between banking, credit or debt and well-being.

Àlex Ruiz
Macroeconomics Unit, Strategic Planning and Research Department, CaixaBank

4. See Reinhart, C. and Rogoff, K. (2010), «Growth in time of debt», American Economic Review Papers & Proceedings, No. 100, p. 573-578.
5. See, for example, Baum, A., Checheriat, C. and Rother, P. (2013), «Debt and Growth: New Evidence from the Euro Area», Journal of International Money and Finance, Vol. 32 p. 809-821, which estimates a threshold of 95% of GDP.
6. See Pescatori, A., Sandri, D., and Simon, J. (2014), «Debt and Growth: Is There a Magic Threshold?», IMF Working Paper WP/14/34.

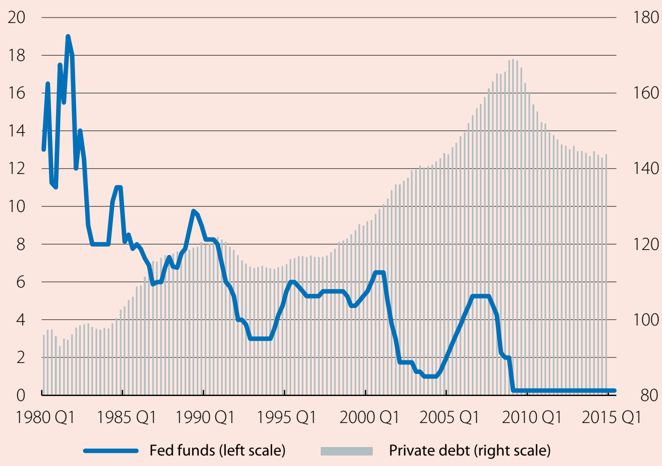
Crisis, debt and economic policy, a controversial triangle

Benjamin Franklin, one of the founding fathers of the United States, said «Rather go to bed without dinner than to rise in debt». Some economists seem to have taken good note of this and are in favour of reducing the high level of debt in numerous countries. They believe that excessive debt is a source of crisis and hinders the chances of recovery, so that reducing it is a prerequisite to establishing the basis for sustainable growth in the long term. Other economists believe that this advice, although perhaps pertinent at an individual level, could be counterproductive at a collective level under certain circumstances. If the situation is one of insufficient demand, high unemployment and deflationary pressure, prioritising deleveraging merely makes a crisis worse. Logically, the economic policies recommended by both groups differ quite widely.

To examine how to tackle recession and recovery in an environment of high debt, we should first present the basic framework accepted by most economists regarding the relationship between crisis, debt and economic policy. In this relationship, financial variables (such as credit) generally move in the same direction as real economic variables (such as GDP and employment). Specifically, when the situation and outlook for activity and employment improve, there is an increase both in the debt capacity of agents and in the availability of financing. In other words, the cycles are synchronous. The problem is that, on some occasions and for various reasons, financial variables move much more sharply than economic variables. In fact, it is not unusual for financial booms characterised by a sharp rise in the level of debt to be decoupled from the economic or business cycle. This situation usually results in significant cost: it can lead to a financial bust which, in turn, pushes the country towards economic recession.

This scenario of decoupling between financial and real variables is not unrelated to the economic policies adopted by a country as these can encourage excessive debt that would affect macroeconomic stability. This is the case of monetary policy which has traditionally focused on moderating the cycle of real economic variables without paying enough attention to the effect on financial variables. A monetary regime that focuses exclusively on controlling inflation in the medium term could be too accommodative in financial terms in a scenario of low economic volatility, significant growth and moderate inflation, as happened between the middle of the 1980s and 2007 (unsurprisingly known as the «the Great Moderation»). By way of example, after the dot.com bubble burst in 2000, the Federal Reserve (Fed) decided to cut the official interest rate to counteract losses in the stock markets and the economic slowdown. Interest rates fell quickly and then remained low until 2004 (see the first graph). The success attributed to the Fed's strategy at that time, given the country's fast exit of the economic crisis, did not take long to be questioned. Economists such as Raghuran Rajan and the Bank for International Settlements (BIS) have been highly critical.[1] In their opinion, the Fed's monetary expansion continued to fuel US debt and pushed up real estate prices which then collapsed years later, turning the financial crisis starting at the end of 2007 with subprime mortgages into the Great Recession, whose effects are still being felt today.

USA: interest rate and debt



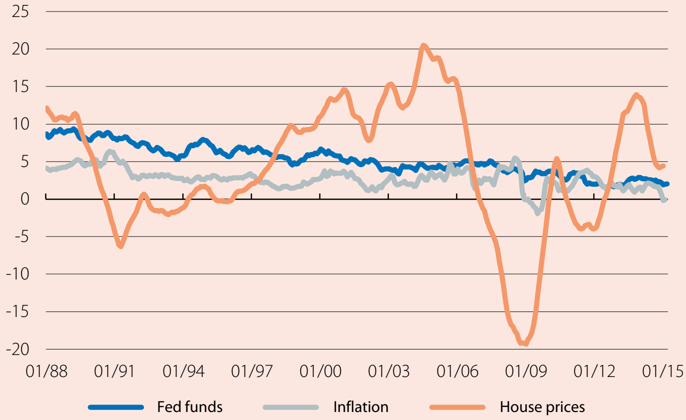
Source: *"la Caixa" Research, based on data from Thomson Reuters Datastream.*

Today critics believe there is once again cause for concern claiming that the ultra-expansionary monetary measures, both conventional and unconventional, carried out by most developed economies have added even more fuel to the fire of debt. The BIS, for example, argues that, although it was initially a good idea to handle the crisis decisively in order to avoid financial collapse, in a second phase efforts should have been (and should be) aimed at sorting out the balance sheets of highly indebted economic agents instead of continuing with additional expansionary measures.[2] The BIS's analysis concludes that many of these measures (such as monetary) have not only lost a large proportion of their capacity to stimulate the economy but are also pushing up the level of debt and reducing incentives to implement the structural reforms which are crucial to achieve sustainable economic growth in the long term.

1. See Claudio Borio (2012), «Financial cycle and macroeconomics: what have we learnt», BIS paper #395.
2. BIS 84th Annual Report, June 2014.

USA: interest rate and inflation

(%)



Note: *Inflation corresponds to the year-on-year change in the CPI. House prices correspond to the year-on-year change from the Case-Shiller index.*
Source: *"la Caixa" Research, based on data from Thomson Reuters Datastream.*

At the other end of the scale, economists such as Nobel prize-winner Paul Krugman and Larry Summers, among others, support measures such as quantitative easing by central banks and other, rather unconventional expansionary policies such as the direct financing of public expenditure by the central bank. They argue that such policies have played a fundamental role and prevented an even worse situation given the exceptional crisis. Moreover, opposing those who believe that US monetary policy was already too accommodative before the crisis erupted in 2007, they claim that, if this had been the case, we would have seen inflationary tensions. Certainly growth in the consumer price index was moderate during the pre-crisis period. However, other prices not included in the basket of goods, such as housing, underwent sharp increases in the US economy (see the second graph).[3] These economists also add that we cannot ignore the fact that today's high level of debt actually restricts the economic measures that are feasible. For example, an excessively fast rise in interest rates could harm the already deteriorated public finances of many countries by increasing financing costs and slowing down growth and tax revenue. It might also push up the NPL ratio within a context of heavy private borrowing, once again putting pressure on the financial sector.

In spite of the many disagreements between one point of view and the other, both acknowledge that macroprudential policy will play a vital role over the coming years. Although the BIS economists are in favour of normalising monetary policy as soon as possible, they admit the process must be gradual. All the evidence therefore points to interest rates remaining low for a long time in the main developed countries. In this scenario, further pressure on some asset prices is very likely. Should this happen, macroprudential policy could be more accurately aimed at the imbalance it is attempting to correct. Specifically, if the aim is to counteract a bubble in a certain type of asset (equity or high-yield bonds) by raising the reference interest rate (the monetary policy tool *par excellence*), this would affect the whole economy while macroprudential policy attempts to affect only the asset with symptoms of overheating in order to deflate it, for example by limiting the level of risk banks can take on with such assets.

In short, there is no consensus regarding how an economic crisis should be tackled in an environment of high debt. While some criticise the use of ultra-expansionary policies, claiming they are sowing the seeds for the next recession, others see them as the only way to support an anaemic economy. This is a fundamental debate and, whatever the measures employed, they must not fall too wide of the mark, given the fragility of the recovery.

Clàudia Canals
Macroeconomics Unit, Strategic Planning and Research Department, CaixaBank

3. The consumer price index contains one housing component based on the cost of rented accommodation but not house prices, so it does not reflect sharp rises or falls in these prices.

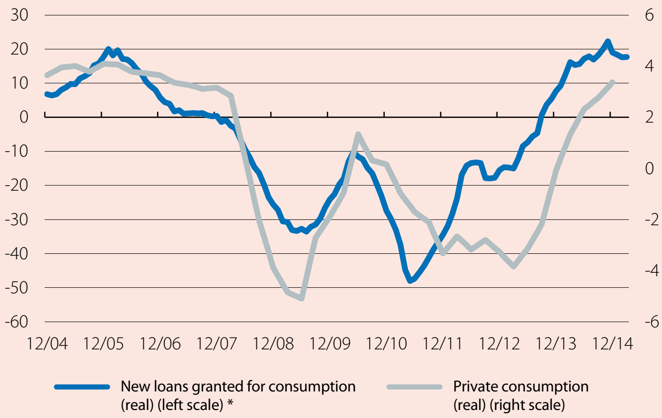
The role of bank credit in Spain's recovery – another phoenix miracle?

The Spanish economy embarked on its current phase of recovery in 2013 Q3 after five almost unbroken years of shrinking GDP. As usually happens with economic recessions preceded by a credit boom and banking crisis, the real economy started to recover while the outstanding credit balance was still contracting, giving rise to a creditless recovery. Calvo *et al.* (2006),[1] in a pioneering study on creditless recoveries in emerging economies, called this kind of phenomenon «phoenix miracles»: like the mythical bird, production seems to rise again from its «ashes» without the help of credit. The «miracle» part of this term refers to the somewhat paradoxical observation that although a lack of credit is an essential component in explaining the depth of the recession after a credit boom, the recovery nevertheless occurs without its support. This Dossier reviews the empirical evidence on creditless recoveries at an international level to establish their main features and understand why they are exceptional in order to analyse the role of bank credit in Spain's current economic recovery and attempt to determine whether we are witnessing yet another phoenix miracle.

Creditless recoveries are not very common and occur relatively infrequently in advanced economies given their high degree of financial development and wider range of sources of financing. Specifically, according to a study by the IMF based on 388 recoveries in 172 countries between 1960 and 2009,[2] 20% of recoveries are creditless, a percentage that halves (10%) in developed countries. However, creditless recoveries are much more likely after a banking crisis and a credit boom, occurring 80% of the time under such circumstances. The depth of the preceding recession also plays an important role in the evolution of credit during a recovery. The IMF study also states that average annual growth during the first three years is one third less in a creditless recovery than in a recovery with credit (3.8% compared with 5.7%, see the table). Nonetheless, it is important to point out that GDP growth is still considerable. Hence the «miracle».

In Spain, therefore, it comes as no surprise that seven quarters after GDP started growing, the outstanding balance of bank credit to the private sector, which started to shrink in 2009 Q3, should still be posting negative rates of change (–4.9% in 2015 Q1) although its rate of contraction has decreased notably since the recovery began. However, although it is true that the outstanding credit balance is still shrinking, it is important to note that the credit variable affecting economic growth is actually the increase in credit growth.[3] Note that GDP is a flow and, as such, its variation is due to variations in other flows such as new loans granted. In this respect the data are highly revealing. New credit operations[4] posted their first positive year-on-year rate of change in June 2014 and are showing a clearly upward trend. This variable, moreover, is very closely related to GDP. By credit type, of note is the good performance by new loans to households for consumption which started growing in September 2013 and posted a 17.7% increase in March 2015, the most recent figure available. These data show that, in effect, growth in GDP and especially in private consumption has been accompanied by growth in credit (see the graph).

Private consumption and new loans granted for consumption



Note: ** Deflated using the implicit deflator of GDP.*
Source: *"la Caixa" Research, based on data from the INE and the Bank of Spain.*

The «miracle» aspect has therefore been somewhat debunked as all the evidence points to credit actually playing an important role in the trend in GDP. Specifically, in the first six quarters of the recovery starting in 2013 Q3, credit grew by 1.6% annualised on

1. Calvo, Izquierdo and Talvi (2006), «Phoenix miracles in emerging markets: Recovering without credit from systemic financial crisis», NBER WP 12101.
2. Abiad, Dell'Ariccia and Li (2011), «Credit-less recoveries», IMF Working Paper 11/58. These percentages are very similar to the ones estimated by Darvas (2013), «Can Europe recover without credit?», Bruegel policy contributory 2013/03. It should be noted that these studies do not identify a causal relationship between the lack of credit and lower growth but restrict themselves to noting the relationship between both variables.
3. Biggs, Mayer and Pick (2009), «Credit and economic recovery», DNB Working Paper, no. 218.
4. We have excluded loans in excess of one million euros as these are usually requested by large firms which are resorting to the bond market.

average. To be able to compare this figure with the existing studies, which cover three years,[5] we have used our forecasts for up to 2016 Q2 and estimate that average annual growth will be around 2.2%. This figure is slightly lower than the IMF's 3.8% but it should be remembered that their study includes recoveries in emerging countries whose growth rates have little in common with those of advanced economies. Darvas (2013) presents a breakdown by income level of the country in question and finds that economies with high incomes grow by 3.2% in creditless recoveries (by 4.1% with credit), a figure more in line with Spain's forecast. At this rate of growth, the Spanish economy will return its pre-crisis level of real GDP by next year, following the usual pattern in this kind of recovery.

The pattern of growth in a recovery is also affected by the availability of credit. Investment, highly dependent on external financing, is more affected than consumption. For the Spanish economy's current phase of recovery, we expect consumption to contribute 1.6 pps to the annual growth in GDP, double the contribution made by investment (0.8 pps). This relationship between the contribution of consumption and investment is very similar to the one documented by the IMF's study. In contrasty, the growth pattern is more balanced in normal recoveries (see the table). With regard to net exports, whose contribution to growth is usually zero, we predict a slightly negative figure in Spain's case.

Growth in GDP and in its components during the first three years of recovery

Annual average (%)

	GDP growth	Contribution		
		Consumption	Investment	Net exports
Recoveries with credit *	5.7	3.7	2.1	0.0
Creditless recoveries *	3.8	2.6	1.2	0.0
Spain: 2013 Q3 to 2014 Q4	1.6	1.6	0.8	–0.7
Spain: 2013 Q3 to 2016 Q2	2.2	1.6	0.8	–0.6

Note: ** Estimates based on Abiad, Dell'Ariccia and Li (2011).*
Source: *"la Caixa" Research, based on data from the IMF and the Spanish Statistics Institute (INE).*

With a view to the coming quarters, several factors related to both supply and demand will strengthen Spain's positive trend in credit. So far, the demand for credit by households and companies has been conditioned by the adjustment in private balance sheets. After a credit boom, especially when accompanied by a bubble in the real estate market, the value of assets falls and existing debt becomes excessive and must be reduced, limiting the capacity to take on more debt. In this respect, the good news is that private deleveraging is now at quite an advanced stage, especially in the case of non-financial firms and its contractive effect should therefore be fairly limited from now on.

On the supply side, there are increasing signs that the factors limiting the granting of private sector loans are also being resolved: the restructuring of the banking sector is now almost complete, banks passed their stress tests with good marks, European banking union is being implemented as planned and regulatory uncertainty is receding. Moreover, in an environment of low interest rates, banks need to grant more loans to increase their profits. In this respect the high demand for TLTROs points to a greater willingness to grant credit on the part of the banking sector.

In short, the current phase of Spain's economic recovery resembles other episodes that have been classified as creditless recoveries, characterised by slower growth and a pattern biased towards private consumption. Luckily, the process of adjustment, both in the supply and in the demand for credit, is almost complete, as can be seen in the rise in new loans granted. We therefore expect the Spanish economy to benefit from this boost to credit over the coming quarters, helping the recovery to gain steam.

Judit Montoriol-Garriga
Macroeconomics Unit, Strategic Planning and Research Department, CaixaBank

5. Economic literature defines a creditless recovery as one in which there is negative growth in credit during the three years following a recession.

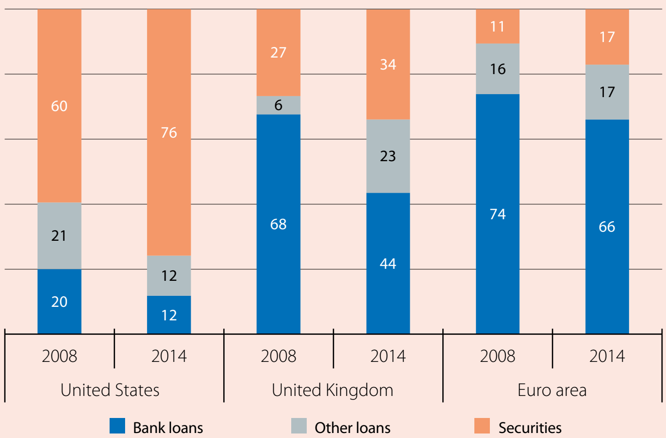
Alternative financing is possible, but is it safer?

Now that banking union has begun, the European Commission is focusing on two figures: European firms get approximately 80% of their external financing from banks and the remaining 20% by issuing bonds, while the figures in the US are, broadly speaking, the opposite. To bring us closer to the US situation the European Commission has set itself the goal of integrating and fully developing the different European capital markets by creating a capital market union. As will be argued in this article, more diversified sources of funding will allow borrowers to make the most of the advantages that each source offers although each alternative entails risks that must be taken into account.

Academic literature tends to distinguish between two basic types of financing channels: one indirect, based on banks acting as intermediaries between depositors' savings and loans to borrowers; and the other via the capital market, where those requiring funds obtain them directly from investors by exchanging different types of securities. The capital market is actually made up of a number of different markets: in addition to the traditional stock and debt markets there are new specialised markets where instruments are traded to better manage risk (derivate markets) or to broaden the base of potential investors (securitization and structured finance markets).

External financing of large firms

(% of total)



Source: *"la Caixa" Research, based on data from the IMF, «Global Financial Stability Report» (October 2014), chapter 1.*

However, in addition to these two basic sources, widespread use of the internet is helping another channel to emerge based on the concept of crowdfunding. Projects are advertised on crowdfunding platforms and obtain funds via a large number of small contributions made directly by investors, mostly individuals. These contributions can take the form of loans (crowdlending), shares in earnings (equity crowdfunding) or even advances on the sale of a new product.

Each channel has its strong points in terms of promoting economic growth, so they are complementary in nature.[1] Since banks establish long-term relations with their customers, they can collect more information on debtors and monitor what their loans are used for. This advantage is crucial in financing firms that do not generate easily transferrable information on their projects, such as SMEs and start-ups. Crowdfunding platforms can also be very useful for such companies if their innovative methods manage to pass on to investors reliable information about the projects being advertised. However, for those companies that do generate easily transferrable information, direct funding via the markets allows funds to be quickly reassigned towards those firms with the best prospects. This helps companies to grow rapidly, which promotes innovation. Moreover, the wide variety of instruments traded on the markets means that risk can be distributed more efficiently among those investors with a greater capacity to assume it.

The European Commission believes that Europe's financial system is too biased towards bank intermediation and therefore, so the argument goes, it is more likely to be unstable and delay economic recovery after an episode of stress. Recent studies point out that the high leverage of banks makes them very sensitive to shocks in asset prices that entail changes in value of collateral or capital, so they usually react by extensively expanding or contracting credit throughout the cycle.[2] In the eyes of the Commission, this high procyclicality of bank credit is what justifies a regulatory effort to promote less procyclical alternative channels. However, encouraging greater use of alternative channels to finance companies could give rise to other risks.

In the case of capital markets, the growing intermediation in credit markets by asset management companies is, according to the International Monetary Fund (IMF), one of the main sources of risk. Intermediation is performed via certain investment vehicles (hedge funds, money market funds, mutual funds, listed funds and venture capital funds) which buy up corporate bonds, profiting from contributions from savers looking for alternatives to deposits and from the tougher regulatory requirements faced by banks

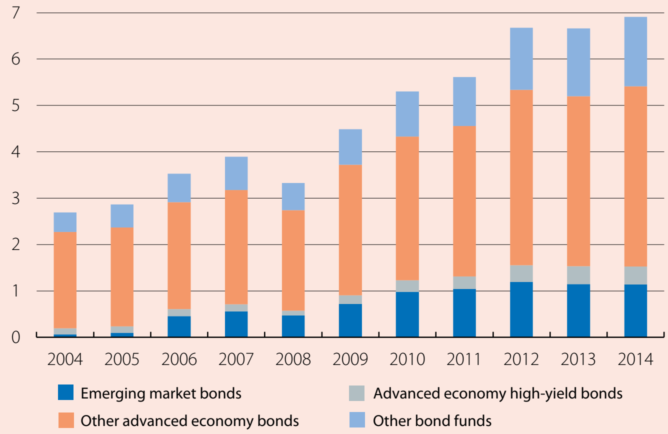
1. See Levine, R. (2002), «Bank-based or market-based financial systems: which is better?», Journal of financial intermediation 11(4), 398-428.
2. Langfield, S. and Pagano, M. (2014), «Bank bias in Europe: effects on systemic risk and growth», Working Paper.

to meet demand for corporate financing.[3] The IMF's concern is that, once the stimuli applied by the different central banks start to be withdrawn, the liquidity sustaining these funds may not decrease gradually but abruptly, giving rise to mass asset sales. The real economy would therefore be affected due to the fall in value of collateral, contagion to the balances of other financial brokers and a reduction in financing in general.

The risk involved in this kind of intermediation comes from certain features of the asset management industry. The main risk is that the vehicles used are exposed to liquidity risk as they offer their investors the chance to redeem their positions with a frequency that might not be in line with the liquidity of the underlying assets. This makes them vulnerable to financial panics that could force them to sell their assets at fire-sale value. Another two features increase the risk of systemic contagion, the first being the importance of the management firm's asset reputation as a selection criterion for investors, reflected in the high concentration of this industry: of the total assets under management by the top 500 asset managers in the world, the biggest 10 control close to 25%. The second feature is the tendency of managers to follow very similar investment policies and react in the same way to any change in expectations. Both features are the result of the difficulty encountered by investors in judging the quality and performance of managers, so they evaluate them by comparing their results with those of the rest.

Assets under management worldwide

(Billion dollars)



Source: *"la Caixa" Research, based on data from the IMF, «Global Financial Stability Report» (April 2015), chapter 3.*

In the case of crowdfunding, the main risk lies in investors taking decisions based on insufficient or inaccurate information. In particular, for this alternative to achieve a critical mass of investors, greater certainty is required regarding the effectiveness of the mechanisms provided by the platforms to pass on truthful information on the management skills of their entrepreneurs, the real destination of the funds and the objective degree of risk of the projects presented.[4] In the same way that banks make use of long-term relations to gather this kind of information, platforms invest in mechanisms aimed at determining the reputation of entrepreneurs: they encourage the disclosure of data about the managers (level of training, professional curriculum or track record of successful projects, for example), allow investors to comment on their experience with the firm and resort to third parties with an established reputation to certify project quality. Nonetheless, responsibility for verifying the information provided still comes down to the investors, which could be problematic as the small size of their investment at stake means that each investor tends to count on another making the effort to verify the data. This could lead to herd behaviour in the investor base: investing if someone else invests and not investing if no-one takes the first step. For this reason it is vital to develop a good regulatory framework that establishes the basic data to be disclosed by companies, requires platforms to invest in detecting fraudulent information and provides investors with some protection. Spain has already drawn up a regulatory framework along these lines although a harmonised framework at a European level will be required.

In short, developing alternative financing channels to bank intermediation involves more than just harmonising national regulations to achieve a single capital market at a European level. It requires greater insight into the information problems inherent in each source of financing and appropriate regulations to minimise the risks involved.

Sandra Jódar-Rosell
Bank Strategy Unit, Strategic Planning and Research Department, CaixaBank

3. These intermediaries are considered to form part of shadow banking, as do dealers (placement agents and providers of wholesale services to other shadow banking segments) and securitisation firms.
4. See Agrawal, A. *et al.* (2013), «Some simple economics of crowdfunding», NBER Working Paper no. 19133.

"la Caixa" *Research*

PUBLICATIONS

All publications are available online at **www.lacaixaresearch.com**
E-mail: **publicacionesestudios@lacaixa.es**

WORKING PAPER SERIES

La internacionalización del renminbi: un largo camino por recorrer
Clàudia Canals, 03/2013

Vulnerabilidad de las economías emergentes
Àlex Ruiz, 02/2013

Sareb: claves estratégicas
Sandra Jódar-Rosell, 01/2013

Ajuste de capacidad en el sistema financiero español
Inmaculada Martínez, 09/2012

El ahorro y la eficiencia energéticos: un impulso para la competitividad de la economía española
Pere Miret, 08/2012

Commodity Cycles: What Has Changed during the Last Decade?
Eduardo Pedreira and Miguel A. Canela, 06/2012

Inversiones financieras en España: impacto de la inestabilidad en los mercados
Inmaculada Martínez, 05/2012

Is There a Property Bubble in China?
Clàudia Canals and Mercè Carreras-Solanas, 04/2012

El sobreendeudamiento de las empresas españolas: ¿problema común o de unas pocas?
Sandra Jódar-Rosell and Inmaculada Martínez, 03/2012

Hungría y la ayuda financiera de la UE y el FMI: ¿cambio en el mapa de riesgos?
Àlex Ruiz, 02/2012

Spanish Public Debt: Myths and Facts
Oriol Aspachs-Bracons and Joan Daniel Pina, 01/2012

¿Cuándo se recuperarán los precios de la vivienda en Estados Unidos?
Jordi Singla, 11/2011

DOCUMENTOS DE ECONOMÍA "la Caixa"

¿Por qué Europa genera poco crecimiento y empleo?
Jordi Gual

La prociclidad del sistema financiero después de las reformas
Sandra Jódar-Rosell and Jordi Gual

Unión Bancaria: ¿de hormigón o de paja?
Jordi Gual

Enseñanzas latinoamericanas para una crisis europea
Àlex Ruiz

Los requisitos de capital de Basilea III y su impacto en el sector bancario
Jordi Gual

Perspectivas de desapalancamiento en España
Oriol Aspachs-Bracons, Sandra Jódar-Rosell and Jordi Gual

Diferencial de inflación con la eurozona: ¿mejora sostenible?
Pere Miret

La recuperación del comercio mundial. Lo que la crisis se llevó
Marta Noguer

Inmigración y mercado laboral: antes y después de la recesión
Joan Elias

"la Caixa" ECONOMIC PAPERS

Banking Union: made of concrete or straw?
Jordi Gual

European Integration at the Crossroads
Jordi Gual

Capital Requirements Under Basel III and Their Impact on the Banking Industry
Jordi Gual

Should the ECB Target Employment?
Pau Rabanal

Integrating Regulated Network Markets in Europe
Jordi Gual

MR MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK

Report on the economic situation (available also in Spanish version)

CURRENT ECONOMY

FINANCIAL SYSTEM

COLECCIÓN COMUNIDADES AUTÓNOMAS

CÁTEDRA "la Caixa" ECONOMÍA Y SOCIEDAD

El tiempo que llega. Once miradas desde España
José Luis García Delgado (editor)

ECONOMIC STUDIES

Europe, Like America. The Challenges of Building a Continental Federation
Josep M. Colomer

El cambio climático: análisis y política económica. Una introducción
Josep M. Vegara (director), Isabel Busom, Montserrat Colldeforns, Ana Isabel Guerra and Ferran Sancho

Academic Advisory Council

Pol Antras
Harvard University

Philippe Bachetta
Université de Lausanne

Ramon Caminal
Institut d'Anàlisi Econòmica (CSIC)

Manuel Castells
Universitat Oberta de Catalunya
and University of Southern California

María Paz Espinosa
Universidad del País Vasco

Josefina Gómez Mendoza
Universidad Autónoma de Madrid

Marta Reynal-Querol
Universitat Pompeu Fabra

Joan Enric Ricart
IESE Business School

Xavier Sala-Martín
Columbia University

Jaume Ventura
CREI - Universitat Pompeu Fabra

"la Caixa" GROUP: KEY FIGURES
As of December 31, 2014

Financial activity	MILLION €
Customer funds	271,270
Receivable from customers	195,809
Profit atributable 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**

Publications

All "la Caixa" Research publications are available online

"la Caixa" *Research* on Twitter @laCaixaResearch

Follow us on Twitter to get the latest news from "la Caixa" Research.

Our aim is to create and spread economic and social knowledge to contribute towards the development of Spanish and European society.

The *Monthly Report* is for information purposes only and CaixaBank assumes no responsibility for any use that may be made thereof. The *Monthly Report* is based on information from sources considered to be reliable. However, CaixaBank does not guarantee its accuracy nor is it liable for any error or omission contained therein. The opinions and predictions given are those of CaixaBank and may change without prior notice.

© CaixaBank, S.A., 2015

The *Monthly Report* may be reproduced in part provided the source is acknowledged appropriately and a copy is sent to the editor.

Design and production: www.cege.es
Legal Deposit: B. 21063-1988 ISSN: 1134-1920

"la Caixa" Research

ELEMENTAL CHLORINE FREE GUARANTEED

FSC
www.fsc.org
MIX
Paper from responsible sources
FSC® C015618