

MR12

MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

NUMBER 396 | DECEMBER 2015



ECONOMIC & FINANCIAL ENVIRONMENT

FINANCIAL MARKETS

A federal funds rate hike: this time is different

INTERNATIONAL ECONOMY

The impact of China on commodities

EUROPEAN UNION

Quantitative Easing: the ECB is going shopping

SPANISH ECONOMY

An analysis of the employability of Spain's labour force

DOSSIER: OUTLOOK 2016

Political challenges on the horizon for the advanced countries

Outlook and doubts for the emerging economies

2016: challenges and opportunities in a demanding global financial environment

The recovery in Spain: a qualitative step forward

**MONTHLY REPORT -
ECONOMIC AND FINANCIAL
MARKET OUTLOOK**
December 2015

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Date this issue was closed:
30 November 2015

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The Spanish economy in 2016

We usually devote the Dossier in December's *Monthly Report* to an analysis of the outlook for the year beginning in a few weeks' time. This year such an analysis is particularly tricky in the case of the Spanish economy since, at the time of writing, we are still unaware of the political stance taken by the new government that will be formed after the elections on 20 December. Consequently, in addition to macroeconomic forecasts it is also useful to take into account some considerations regarding Spain's economic and financial framework which will have to be handled by those taking over the helm of the country, as well as providing a brief summary of the possible priorities for economic policy in 2016.

The overall context will be characterised by highly accommodative monetary conditions in the euro area with large amounts of liquidity, low interest rates and a weak euro. The international economic situation should be reasonably favourable in terms of growth in our markets, with low oil prices and little impact from the potential problems which some emerging countries will most likely encounter. However, in political terms this international framework could lead to instability given the many different geopolitical fronts with potential financial repercussions.

To cope with this international situation, the Spanish economy has several strengths but also a number of weaknesses. Highlighting the strong points would be good for our self-esteem but here I will focus on the weaknesses as that is obviously where the challenges lie.

Spain's main weakness is undoubtedly its high unemployment. Moreover, this unemployment rate can only partly be explained by the severity of the economic crisis because it has a chronic component that will not disappear with the recovery. Such an exceptional problem demands exceptional measures. Some progress was made during the crisis years but modernising our labour market is the first social and political challenge the new government must tackle successfully.

Spain's public accounts pose another challenge. Allowing the country's debt to go beyond 100% of GDP, as is already happening, makes it more vulnerable to changes in the international financial sentiment. However, there are two other reasons why Spain's public finances need to be reformed without delay. The excessive cyclical instability of tax revenue should be corrected to counteract the effect of rising rigid expenditure while reforms also need to be made at a territorial level as the current financing system for the autonomous communities does not encourage efficiency and represents a source of uncertainty and political instability.

Lastly, the third big challenge is the foreign sector. As a member of the euro area, Spain needs to continue improving its external surplus to reduce the external debt and, to do so, we have to control our unit labour costs compared with our competitors. This requirement is not incompatible with a strong domestic market since, ideally, the latter's expansion should not come from unit wage rises but from the wage bill as a whole, as an increasing number of workers leave the ranks of the unemployed to join the labour market.

Mario Draghi is very likely to foster a beneficial financial environment for 2016, pushing down Spain's risk premium and providing a favourable tail wind for its economy. The challenge for the country's new economic policymakers will be not to get too used to this comfortable situation. An economy such as Spain's, which operates in the demanding environment of the euro area, must continue with reforms to achieve reductions in its risk premium on its own merits. Such improvements are the only guarantee of relative protection from the markets should any serious episodes of instability occur in 2016.

Jordi Gual
Chief Economist
30 November 2015

CHRONOLOGY

NOVEMBER 2015

- 23** The European Commission urges the Spanish government to present **an update of its 2016 Budget**, incorporating measures to reduce the public deficit in line with the agreed path.
- 30** **The IMF announces the inclusion of the Chinese yuan** in the basket of currencies with special drawing rights (SDR), together with the US dollar, the euro, the Japanese yen and the pound sterling. The approval of the yuan as a reserve currency will come into effect as from October 2016 and marks an important milestone in the internationalisation of the Chinese currency.

OCTOBER 2015

- 2** The ratings agency **S&P raises Spain's credit rating** to BBB+ from BBB and keeps its outlook stable.
- 5** **The free trade agreement is signed between the US and several Pacific countries** including Japan, Mexico, Australia and Canada.
- 29** The Chinese Communist Party announces the **end of its single child policy** and allows two children per couple to combat the country's ageing population.

SEPTEMBER 2015

- 20** **Syriza wins the elections in Greece** and secures the necessary support to implement the programme agreed with the institutions.

AUGUST 2015

- 11** The People's Bank of China announces a new mechanism to determine the exchange rate of the yuan and **this depreciates by 3.0% against the US dollar in one week**.
- 19** The **third programme of financial aid for Greece** is approved, totalling 86 billion euros and without the initial participation of the IMF. The Greek Prime Minister, Alexis Tsipras, calls an **early general election**.

JULY 2015

- 5** **The Greek referendum rejects** the agreement plan proposed by the European institutions.
- 14** **Iran reaches an agreement** with the five members of the United Nations Security Council and Germany in which it undertakes to reduce its nuclear programme in exchange for lifting the sanctions imposed.
- 31** The Spanish government brings forward its presentation of the **State Budget** for 2016.

JUNE 2015

- 26** The **Greek government calls a referendum** on whether to accept the latest proposal offered by European institutions for 5 July.
- 30** Greece does not pay the 1.6 billion euro **due to the International Monetary Fund**.

AGENDA

DECEMBER 2015

- 2** Registration with Social Security and registered unemployment (November).
- 3** Governing Council of the European Central Bank.
- 4** GDP of the euro area (Q3).
- Industrial production index (October).
- 15** Fed Open Market Committee.
- 17** Quarterly labour cost survey (Q3).
- European Council.
- 18** Loans, deposits and NPL ratio (October).
- 21** International trade (October).
- 22** State budget execution (November).
- Household savings rate (Q3).
- 30** Flash CPI (December). Balance of payments (October).
- Net international investment position (Q3).

JANUARY 2016

- 11** Industrial production index (November).
- 15** Financial accounts (Q3).
- 18** Loans, deposits and NPL ratio (November).
- 21** Governing Council of the European Central Bank.
- 26** Fed Open Market Committee.
- 27** Economic sentiment index of the euro area (January).
- 28** Labour force survey (Q4).
- 29** Flash GDP (Q4).
- CPI flash estimate (January).
- Balance of payments (November).
- US GDP (Q4).

A positive end to the year

2015 looks like it might end on a positive note. As the year comes to a close, the macroeconomic situation seems to be stronger. Among the emerging economies all eyes are still focused on the bloc's most systemic country, namely China. The figures provided by indicators for the Asian giant have been mixed but analysts and investors believe the situation is more stable than in previous months, a diagnosis that is also due to the country's central bank continuing to take accommodative monetary measures. But China is not the only country to ease fears regarding the emerging economies with Mexico and Chile also posting more acceleration than expected in Q3, demonstrating their capacity to grow in spite of an international environment of contained commodity prices. Another important emerging economy, India, also exceeded the forecasts, growing by a dynamic 7.4% year-on-year in Q3. However, there are certainly contrasting cases to these success stories and here we can mention Brazil, whose recession has worsened, and Turkey, under pressure from the combination of a slump in activity and greater geopolitical risks. Nevertheless, the emerging bloc as a whole has managed to dissipate the worst fears arising in the complicated summer months.

Among the advanced economies, the US is growing strongly while Japan has entered a technical recession. The world's first and fourth economies are once again at opposite ends of the spectrum. While the US is growing at a comfortable rate (2.2% year-on-year in Q3) thanks to robust domestic demand, the Japanese economy has entered its fifth recession since 2008. This is a salutary reminder that Japan's growth problem is unlikely to be resolved solely via policies to stimulate demand and that the time has come to decisively tackle what is known as the third pillar of Abenomics. This pillar consists of reforms, repeatedly announced but not implemented, which need to improve agricultural productivity, ease the tax burden of companies and improve women's participation in the labour market. For the time being, however, a new round of fiscal and monetary stimuli are expected, whose effectiveness is uncertain given the recent track record of such measures. While the Bank of Japan is preparing to extend its bond purchase programme, in December the Federal Reserve will raise the federal funds rate for the first time since 2004, a key step in the full normalisation of its monetary policy.

The euro area is accelerating but the ECB is preparing further stimuli. The euro area grew by 1.6% year-on-year in Q3 thanks to the improvement shown by its main economies. Although the rate of growth is relatively moderate (especially compared to exits from previous recessions yet not so much when we consider that growth is already at a level that is even slightly higher than the potential growth figure), it is also true that growth is sustained and looks like continuing as the full impact of several support factors has yet to be felt, such as the euro's depreciation and the expansion of the ECB's quantitative easing. In fact, one of the surprises over the last few months, taking into account the context of recovery, is precisely in the monetary area with the ECB announcing possible additional expansionary measures, for which further details will be announced in December. Given that the recovery is firmly on track (as confirmed by the Q4 figures which point to an acceleration in activity), these measures are unlikely to be very extensive and will probably be aimed more at reaffirming the ECB's commitment to fulfilling its mandate. For the time being, and reflecting these expectations of greater monetary expansion, yields on European bonds fell and the euro depreciated.

Spain continues to grow at the end of the year. Activity figures for the beginning of Q4 suggest that the rate of growth will remain at similar levels to Q3; i.e. around 0.8% quarter-on-quarter. The underlying trends supporting the Spanish economy's momentum have not changed substantially from those we have seen over the last few quarters. Domestic demand is still the main engine for activity, fuelled by an increase in household purchasing power (in turn boosted by the good rate of job creation and the drop in energy prices). The ECB's monetary expansion and healthier banking sector are also helping credit to get back to normal. One of the sectors where the effects of improved financial conditions can be observed is real estate, with demand for housing recording a significant recovery. Regarding the foreign sector, the notable rise in imports resulting from higher consumption driven by domestic demand is preventing this from making a positive contribution to growth. Nevertheless, this should not detract from the good performance of real exports whose rate of growth in Q3 more than doubled the average rate observed over the last few decades. A remarkable result, especially as it has occurred during a slight slump in world trade.

FORECASTS

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

International economy

	2014	2015	2016	2017	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3
GDP GROWTH										
Global	3.4	3.1	3.6	3.8	3.2	3.1	3.1	3.5	3.6	3.6
Developed countries¹	1.8	2.0	2.2	2.2	2.1	1.9	2.0	2.1	2.1	2.2
United States	2.4	2.5	2.5	2.4	2.7	2.2	2.4	2.8	2.4	2.5
Euro area	0.9	1.5	1.8	1.7	1.5	1.6	1.6	1.6	1.7	1.9
Germany	1.6	1.5	1.8	1.8	1.6	1.7	1.5	1.7	1.7	1.8
France	0.2	1.1	1.4	1.4	1.1	1.2	1.3	1.0	1.4	1.5
Italy	-0.4	0.7	1.2	1.2	0.6	0.9	1.2	1.1	1.1	1.2
Spain	1.4	3.1	2.7	2.1	3.2	3.4	3.4	3.2	2.7	2.6
Japan	-0.1	0.6	1.0	0.8	1.0	1.1	1.3	0.5	0.9	1.3
United Kingdom	2.9	2.4	2.3	2.3	2.4	2.3	2.2	2.3	2.2	2.3
Emerging countries¹	4.6	4.0	4.5	4.9	4.0	3.9	3.9	4.5	4.6	4.6
China	7.3	6.8	6.5	6.3	7.0	6.9	6.3	6.6	6.5	6.3
India ²	7.3	7.1	7.2	7.3	7.0	7.4	7.1	7.1	7.2	7.2
Indonesia	5.0	4.8	5.5	6.0	4.7	4.7	5.0	5.2	5.4	5.7
Brazil	0.1	-2.3	-0.6	1.7	-2.6	-3.0	-2.2	-2.4	-0.5	0.0
Mexico	2.2	2.5	3.3	3.4	2.3	2.6	2.6	2.9	3.2	3.4
Chile	1.9	2.2	3.2	3.5	1.9	2.2	2.2	2.0	3.5	3.5
Russia	0.6	-3.7	-0.2	1.5	-4.6	-4.1	-3.8	-1.5	-0.2	-0.2
Turkey	3.0	3.0	2.9	3.4	3.8	3.0	2.6	2.0	2.5	3.5
Poland	3.4	3.6	3.7	3.6	3.5	3.7	3.4	3.7	3.6	3.6
South Africa	1.6	1.7	2.4	2.7	1.5	1.1	2.1	2.2	2.3	2.4
INFLATION										
Global	3.5	3.3	3.4	3.6	3.3	3.2	3.3	3.6	3.6	3.5
Developed countries¹	1.4	0.3	1.2	1.7	0.3	0.2	0.6	1.5	1.4	1.6
United States	1.6	0.2	1.8	1.9	0.0	0.1	0.6	1.9	1.7	1.8
Euro area	0.4	0.1	1.3	1.4	0.2	0.1	0.4	1.1	1.1	1.5
Germany	0.8	0.2	1.4	1.7	0.4	0.0	0.6	1.3	1.3	1.5
France	0.6	0.1	1.3	1.4	0.3	0.1	0.4	1.2	1.2	1.4
Italy	0.2	0.2	1.2	1.1	0.1	0.3	0.3	0.9	1.1	1.4
Spain	-0.2	-0.5	1.3	1.4	-0.3	-0.4	-0.1	1.2	0.9	1.4
Japan ³	2.7	0.9	1.3	2.0	0.5	0.2	0.7	1.4	1.1	1.4
United Kingdom	1.5	0.1	1.4	2.0	0.0	0.0	0.2	0.7	1.3	1.6
Emerging countries¹	5.1	5.6	5.1	4.9	5.6	5.5	5.5	5.2	5.2	4.9
China	2.0	1.4	2.0	2.2	1.4	1.7	1.5	1.4	2.2	2.0
India	6.6	5.0	5.7	5.5	5.1	3.9	5.8	7.0	6.2	5.1
Indonesia	6.4	6.6	5.4	5.3	7.1	7.1	5.6	5.2	5.7	5.3
Brazil	6.3	8.8	6.4	5.6	8.5	9.5	9.6	7.6	6.5	5.5
Mexico	4.0	2.9	3.3	3.2	2.9	2.6	3.0	3.3	3.5	3.4
Chile	4.4	4.5	3.7	3.2	4.2	4.8	4.5	4.5	4.0	3.5
Russia	7.8	15.0	6.6	5.7	15.8	15.7	12.5	8.0	7.0	6.0
Turkey	8.9	7.3	6.5	6.3	7.7	7.3	6.8	6.5	6.2	6.5
Poland	0.2	-0.7	1.7	2.5	-0.8	-0.8	0.2	1.4	1.5	1.7
South Africa	6.1	4.7	5.4	5.0	4.6	4.7	5.5	6.4	5.1	4.9

Notes: 1. As from December 2015, the aggregate figures for «Developed countries» and «Emerging countries» include all the countries in each group. Only the main countries were included previously.
2. Annual figures represent the fiscal year. 3. Takes into account the consumption tax hike introduced in April 2014.

Forecasts

Spanish economy

	2014	2015	2016	2017	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3
Macroeconomic aggregates										
Household consumption	1.2	3.0	2.6	1.7	2.9	3.5	3.3	3.4	2.8	2.2
General government consumption	0.0	2.5	0.6	-0.6	2.1	3.0	3.7	1.4	1.3	-0.1
Gross fixed capital formation	3.5	6.2	4.4	3.7	6.3	6.5	6.0	5.6	4.1	4.0
Capital goods	10.7	9.6	5.9	3.6	9.9	10.7	9.7	8.7	5.9	4.6
Construction	-0.1	5.5	3.8	3.8	5.5	5.5	4.9	4.6	3.2	3.6
Domestic demand (contr. Δ GDP)	1.6	3.5	2.5	1.6	3.3	3.9	3.9	3.3	2.7	2.1
Exports of goods and services	5.1	6.1	6.6	5.0	6.2	5.6	6.8	7.2	7.3	6.0
Imports of goods and services	6.4	7.8	6.4	3.9	7.0	7.7	9.3	8.3	7.9	4.9
Gross domestic product	1.4	3.1	2.7	2.1	3.2	3.4	3.4	3.2	2.7	2.6
Other variables										
Employment	1.1	3.0	2.5	2.0	3.0	3.1	3.1	2.9	2.5	2.4
Unemployment rate (% labour force)	24.4	22.2	20.3	18.9	22.4	21.2	21.3	21.6	20.4	19.6
Consumer price index	-0.2	-0.5	1.3	1.4	-0.3	-0.4	-0.1	1.2	0.9	1.4
Unit labour costs	-0.8	0.6	1.0	1.0	0.2	0.1	1.2	0.1	1.6	1.1
Current account balance (cum., % GDP) ¹	1.0	1.9	1.7	1.8	1.4	1.6	1.9	1.8	1.8	1.7
Net lending or borrowing rest of the world (cum., % GDP) ¹	1.4	2.5	2.3	2.4	1.8	2.2	2.5	2.4	2.4	2.3
Fiscal balance (cum., % GDP) ¹	-5.8	-4.8	-3.3	-1.8						

Financial markets

INTEREST RATES										
Dollar										
Fed Funds	0.25	0.25	0.79	1.56	0.25	0.25	0.25	0.50	0.75	0.92
3-month Libor	0.23	0.31	0.86	1.79	0.28	0.31	0.38	0.54	0.75	0.97
12-month Libor	0.56	0.78	1.28	2.14	0.73	0.83	0.88	1.02	1.19	1.37
2-year government bonds	0.44	0.68	1.45	2.35	0.59	0.67	0.87	1.12	1.34	1.56
10-year government bonds	2.53	2.18	2.80	3.41	2.16	2.21	2.37	2.57	2.72	2.88
Euro										
ECB Refi	0.16	0.05	0.05	0.07	0.05	0.05	0.05	0.05	0.05	0.05
3-month Euribor	0.21	-0.02	-0.05	0.13	-0.01	-0.03	-0.07	-0.08	-0.07	-0.04
12-month Euribor	0.48	0.17	0.15	0.46	0.17	0.16	0.10	0.08	0.10	0.17
2-year government bonds (Germany)	0.05	-0.24	-0.24	0.33	-0.22	-0.24	-0.33	-0.35	-0.33	-0.21
10-year government bonds (Germany)	1.23	0.52	0.72	1.83	0.53	0.69	0.50	0.40	0.43	0.79
EXCHANGE RATES										
\$/€	1.33	1.11	1.03	1.08	1.11	1.11	1.09	1.04	1.02	1.02
¥/€	140.42	134.46	129.00	129.87	134.25	135.89	133.40	131.37	128.65	127.96
£/€	0.81	0.72	0.68	0.68	0.72	0.72	0.71	0.70	0.68	0.67
OIL										
Brent (\$/barrel)	99.45	54.79	62.84	69.31	63.43	51.10	49.43	58.17	63.20	64.40
Brent (€/barrel)	74.54	49.44	60.96	63.89	57.32	46.00	45.36	55.74	61.90	62.91

Note: 1. Four quarter cumulative.

Forecasts

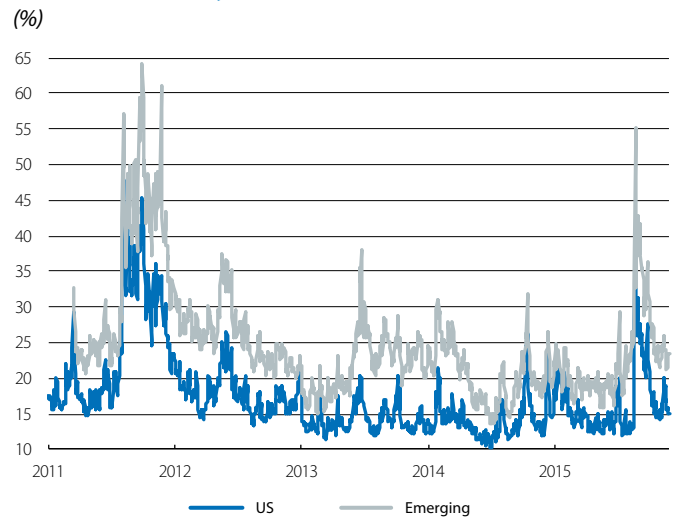
FINANCIAL OUTLOOK · Reflection by the stock markets before the interest rate hikes

Constructive tone in the markets while they prepare themselves for the decoupling between the Fed and ECB.

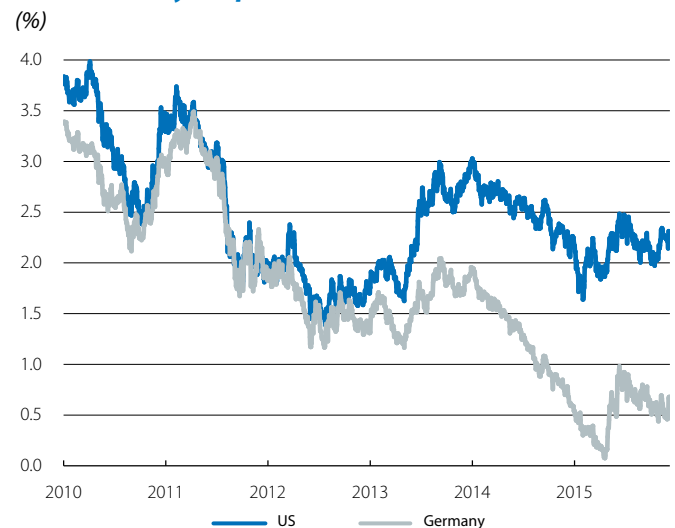
The risk aversion of the last few months has diminished thanks to less uncertainty concerning growth in the emerging economies and the Fed's more specific message regarding its monetary normalisation strategy. The latest macroeconomic figures in the US have notably boosted expectations that the US central bank will finally decide to raise the federal funds rate at its December meeting. In turn, the ECB has repeated its willingness to approve more monetary stimuli at the start of December, consolidating the strength of the dollar. This apparent divergence in monetary policy on both sides of the Atlantic is likely to materialise in the ECB and Fed meetings in December (on the 3rd and 16th, respectively), resulting in further decreases in the dollar/euro exchange rate and widening the gap between yields on 10-year US and German bonds. We expect monetary normalisation to be very gradual with a limited impact on share prices, which are high at present but not necessarily overvalued. Although the environment for US stocks still has some room for gains, more moderate yields are expected than in previous cycles, with some acceleration in Europe (see the Dossier article «2016: challenges and opportunities in a demanding global financial environment»). For the emerging countries, attention remains on China where there are still downside risks in the economic scenario. Nonetheless, we believe that the active role played by local authorities in economic policy throughout 2016 will continue to effectively limit the sources of risk threatening the Chinese economy.

The dominant factor in the US will be the pace of interest rate hikes as the actual date of the start of normalisation becomes relatively less important. In addition to the healthy macroeconomic figures announced recently is the publication of the minutes from the Fed's October meeting revealing that the majority of members are in favour of beginning monetary normalisation. Given this situation, the markets have significantly increased the probability assigned to this event, going from 35% in October to 76% by the end of November. Investors are now focusing on the speed at which the rest of the increases will take place until the equilibrium interest rate is reached, which the Fed places at 3.5%. The consensus of analysts expects a markedly more gradual path than in previous cycles when monetary conditions have been tightened. Specifically, the Fed's projections show an annual increase in the federal funds rate of 0.9 pps compared with an annual average increase of 1.7 pps (on this issue, see the Focus «A federal funds rate hike: this time is different»).

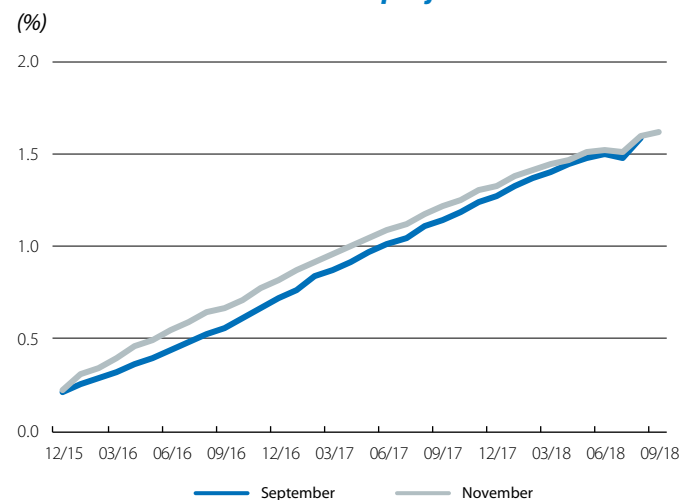
Implied volatility in financial markets



Yields on 10-year public debt



US: Fed official interest rate projections *



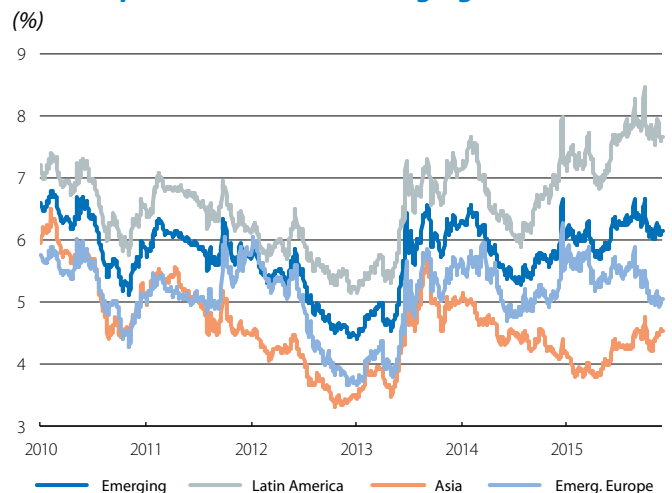
Investors are keeping an eye on inflation in the euro area while waiting for the ECB to act. Although underlying fundamentals continue to point to a gradual economic recovery in the euro area, inflation expectations are still below the ECB's target. For this reason, and although the institution might refuse to act before 2016, investors increasingly expect an announcement of greater stimuli at the next meeting on 3 December and the derivatives market is discounting a cut of 10 bps in the deposit interest rate. It should be noted that, although any substantial changes in the quantitative easing programme are very unlikely, the ECB might extend the scope of QE by including regional and local debt securities.

The ECB effect can be seen in Europe's sovereign debt market after the upswing in yields caused by the Fed's plans. Concern for the response by the long part of the US interest rate curve has eased to some extent. The yield on 10-year US bonds seems to be reacting flexibly to the different events that tend to affect its performance, rising in November by 6 bps up to 2.23%. This upswing in US bond yields also pushed up yields on European sovereign bonds. However, the effect of Mario Draghi's announcement, and subsequent messages from various ECB members regarding possible additional stimuli, ended up widening the spread between the German bund and its US peer to 1.8 pps, one of the largest since the crisis. In turn, peripheral risk premia have relaxed slightly, as well as the spread between Spanish and Italian 10-year bonds which has shrunk from the 25 bps observed mid-November to 10 bps. Nevertheless the relative trend in Spanish debt is likely to be less favourable in the days prior to the country's general elections although we do not expect any great tensions to appear once the results have been announced.

Volatility has eased in emerging markets but they are still being closely watched by investors. Although China's transition towards an economic model that is based more on consumption and services has provided mixed activity data, most indicators have stabilised considerably. Given this situation of an orderly slowdown, the Chinese central bank is very likely to opt for more accommodation with additional cuts in official interest rates, especially if inflation remains at a low level, which seems probable. On the other hand the IMF has approved the inclusion of the yuan in its basket of benchmark currencies. This decision by the institution represents, on the one hand, recognition of the measures taken by the Chinese government to promote market forces and, on the other hand, it provides a clear incentive for the Chinese authorities to continue moving along these lines.

International stock markets slow up their gains in October, raising doubts as to the achievement of their annual maximums. The stock markets sailed through November with slight advances and some volatile episodes. October's rally was followed by doubts regarding the mixed data from

Yield on public debt of the emerging countries *



Note: * Bonds in dollars.

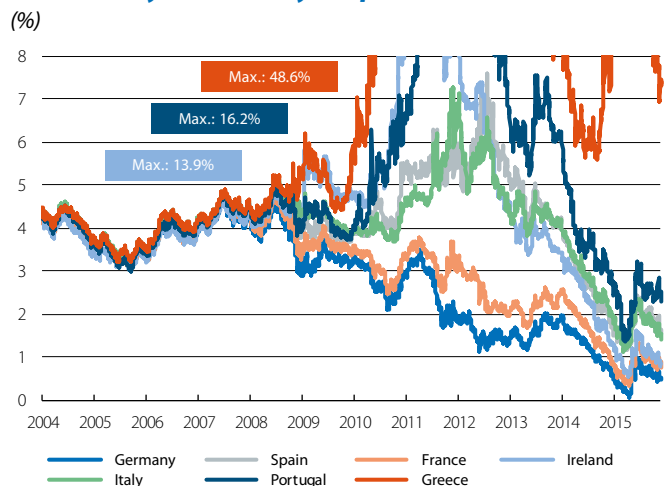
Source: CaixaBank Research, based on data from Thomson Reuters Datastream.

Euro area: 5-year forward inflation expectations rate at 5 years



Source: CaixaBank Research, based on Bloomberg data.

Euro area: yield on 10-year public debt



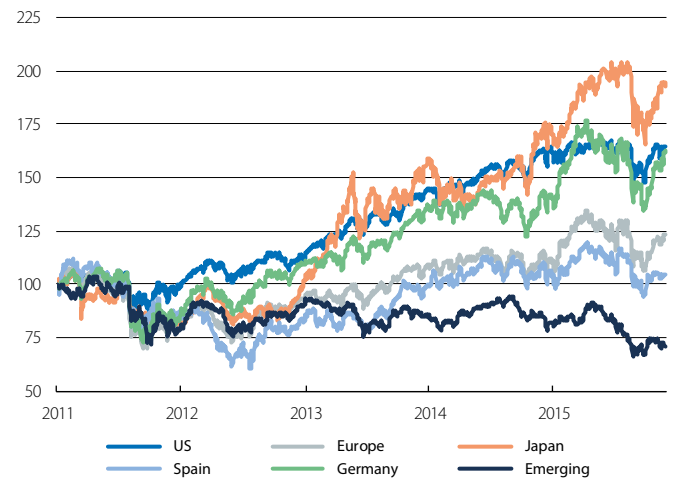
Source: CaixaBank Research, based on data from Thomson Reuters Datastream.

China and uncertainty caused by the Paris attacks and, as of today, the annual peaks reached by the developed stock markets in spring have yet to be regained. Shares are still suffering from considerably larger corrections in the emerging bloc than in developed stock markets. The end of the earnings season confirmed that the commodities crisis has affected profits significantly, both in Europe and especially in the US. Here the earnings per share (EPS) fell by 5% year-on-year but, without the energy sector, they rose by 2%. Euro area companies recorded the strongest growth in EPS of all advanced economies (2% or 6% without the energy sector) and continue to auger a solid cycle of stock market gains in the future. For the rest of the year some positive impact is expected from the announcements of important dividend payments. The high share prices for US assets compared with European stock continue to make European markets more attractive than the US.

The strength of the dollar and distress of commodities are affecting the trend in emerging currencies. In November the euro reached its lowest level against the dollar since the summer and came close to its lowest value in 10 years, reaching 1.06 dollars. Short positions on the euro in the futures and options market increased considerably in October and November, in line with expectations of divergent strategies by the Fed and ECB. Emerging currencies are still keeping an eye on the evolution of commodities and on US interest rate hikes. In the commodities market, the rally by the main commodities (oil, copper and zinc) in October was brief and these have now returned to their particular downward cycle.

Main international stock markets

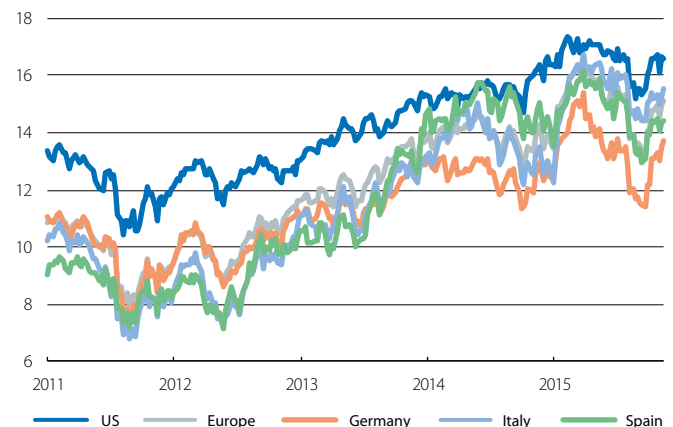
Index (100 = January 2011)



Source: CaixaBank Research, based on Bloomberg data.

International stock markets: price/earnings ratios (P/E ratio) *

(Ratio)



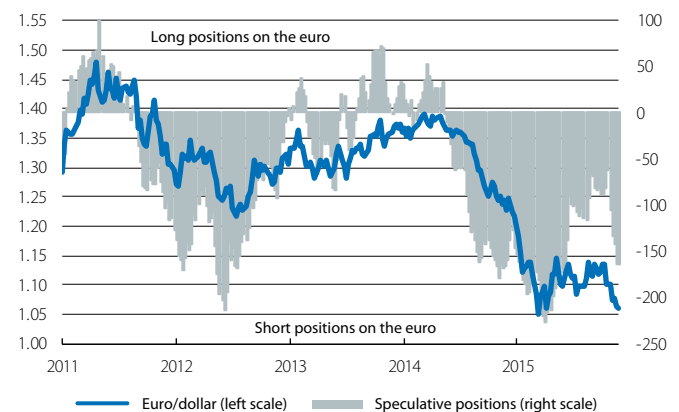
Note: * Ratios calculated with earnings estimated by the consensus of analysts at 12 months.

Source: CaixaBank Research, based on Bloomberg data.

Currencies: speculative positions on the euro/dollar

(Dollars per euro)

(Thousands of contracts)



Source: CaixaBank Research, based on Bloomberg data.

FOCUS · Is the tide turning for the US stock market?

From the spring of 2009 up to last August, the S&P 500 saw incredible gains resulting in the index tripling its value, reaching a level 30% above the one achieved during the peaks of 2000 and 2007, both being preludes to sharp, prolonged losses. With this track record, the weak performance of shares since the middle of the summer is making both analysts and investors uneasy. Some fear we are about to witness another prolonged downward turn while others believe this is merely a lull in the upward trend, although opinions differ among the latter regarding the duration of this correction, its intensity and especially the rate of possible subsequent gains.

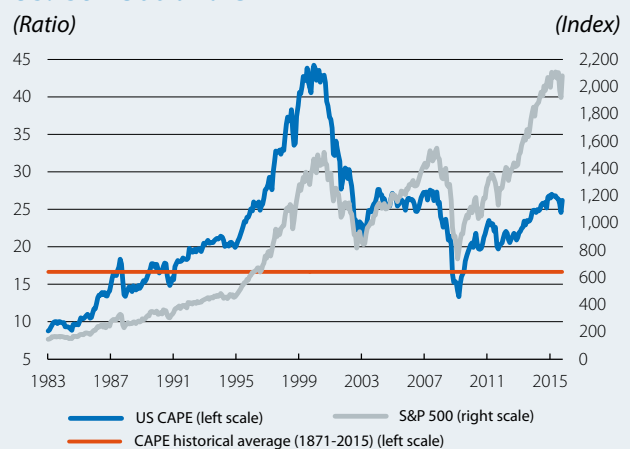
One very useful exercise to clarify the uncertain future for stocks and shares is to examine whether there were any signs of a bubble in the middle of the year. Logically the resulting scenarios would differ greatly depending on our diagnosis. Unfortunately there are no precise instruments to measure the phenomenon of overheating or bubbles in financial markets but a combined analysis of various relevant indicators can provide a reasonable guide. There tend to be three factors present in bubbles, albeit to varying degrees. First, one fundamental factor: when the market price deviates notably from the price indicated by the asset's intrinsic fundamentals. Second, a speculative factor: investor mood is typically euphoric, stimulating speculative, less rational purchases. Third, a risk factor: high leverage which can lead to instability.

One of the most reliable tools to evaluate the fundamental factor is the CAPE or cyclically adjusted price-to-earnings ratio, which measures the relationship between share prices at a specific point and average corporate earnings over the last ten years. By the middle of the year, this indicator was above its historical average but far from the level recorded before the big stock market crises of 1929, 2000 or 2007. Moreover two other elements may have pushed up the CAPE ratio: the low level of interest rates (which is not taken into account by this indicator) and regulatory changes that penalise earnings by counting provisions for losses in assets. These two elements may have distorted any possible historical comparison. For their part, the various indices used to measure the speculative factor do not seem to suggest the stock market is particularly overheated. For example, the share turnover, which measures the volume of shares traded and tends to increase when speculative activity grows, was far below the level it reached in 2000. The so-called «dividend premium» also points in the same direction, namely the difference of the average market-to-book ratios between companies that pay out

dividends and those that do not. Given that the former are safer, under normal conditions this premium tends to be positive but can become negative at times of speculative fever, as happened at the peak of the dot.com bubble in 2000. This premium was positive mid-summer, suggesting there was much less speculative activity than on that previous occasion. Lastly, if we look at the margin debt to measure the level of risk in the stock market we can see this is at a higher level than before the crisis in 2000 and similar to the level in 2007, certainly encouraged by low interest rates. One attenuating circumstance is the fact that this indicator has been high for some time now and, over the last few months, has not shown any sign of increasing sharply, unlike the bursting of bubbles in the past.

Consequently, a combined interpretation of these indicators and other, similar signals,¹ moreover within a context of moderate growth (both in GDP and corporate earnings) and the gradual monetary normalisation planned for the next two or three years in the US, provides several valuable elements for the debate we mentioned at the beginning. On the one hand, the absence of sufficiently clear signs of a bubble should allay fears that we are witnessing a potentially sharp downward turn in the market due to a hypothetical bursting of the bubble. But, on the other hand, share prices are at relatively generous levels and we can therefore expect much more modest returns in the medium term than over the last five years. In summary, the most plausible scenario points to a moderation in the upward trend of the last few years.

US: S&P 500 and CAPE *



Note: * Adjusted P/E ratio with average earnings over the last 10 years.

Source: CaixaBank Research, based on data from Bloomberg and Robert J. Shiller.

1. See the Focus «The implied equity risk premium: a clearly imperfect indicator that needs to be taken into account» in MR11/2015.

FOCUS · A federal funds rate hike: this time is different

Last 17 October the US Federal Reserve (Fed) made it very clear that it is extremely likely to raise the federal funds rate at its next meeting on 16 December. Given the imminence of the start of monetary normalisation, two issues have now come very much to the fore: how fast and how much the rate will rise over the coming years. Looking back at upward cycles in the past could provide us with some clues but we must remember that today's context is different and highly idiosyncratic.

Since the mid-1950s, the fed funds rate has undergone 12 upward phases. During these upward cycles the rate has typically risen over a period of more than two years on average and with an increase of almost 5 pps. If we calculate a «speed index» for monetary normalisation by dividing the rise in the interest rate by the duration of the upward cycle, the average speed would be 2.4 pps per year. However, this historical average is biased upwards since it includes the 1980s and 1990s when there was substantial monetary adjustment and when the Fed transformed how it implemented monetary policy. So, if we focus on the last four cycles, the federal funds rate rose, on average, by slightly more than 3 pps in under two years, bringing our speed index closer to 1.7 pps per year.

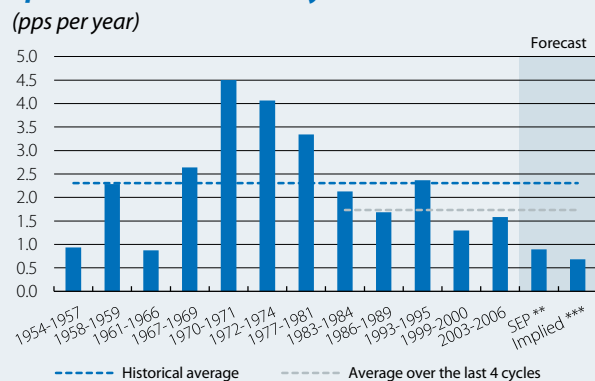
The upward path in the federal funds rate is expected to take, as forecast by members of the Fed's Monetary Policy Committee, suggests it will normalise even more slowly at a rate of 0.9 pps per year (see the graphs). This projection may seem highly conservative but there are several factors that suggest the rate of increase should be particularly gradual on this occasion. Firstly, the US macroeconomic situation means the Fed must act with caution: unlike the situation at the start of the adjustments mid-1990s and 2000s, today inflation and inflation expectations are still below the 2% target and, in spite of the economic recovery over the last few years, observed GDP is still below the estimate for potential GDP. On the other hand, taking into account the fact that the ECB is considering an even more flexible stance, excessive divergence between the monetary policies on both sides of the Atlantic could push the dollar up too high.

Moreover, the current situation of some of the main emerging economies does not only allow but even encourages the Fed to take its time with its monetary normalisation. In particular, fast adjustment in US interest rates could result in episodes of financial instability in those emerging countries with more vulnerable macroeconomic and financial situation, such as Brazil.

Lastly, we should also remember that, on this occasion, the Fed has another instrument apart from the federal funds rate to influence interest rates: the active management of its balance sheet. Should the Fed deem it necessary, it could sell off some of the bonds acquired over the last few years. Should the other tools fail which the monetary institution has at its disposal (see the Focus «US monetary normalisation: the Fed's new toolbox» in MR07/2015), this more aggressive strategy would make interest rate hikes effective in all parts of the curve.

In short, the factors that usually influence the Fed's decision are, this time, at levels that suggest that the most appropriate normalisation strategy required at present is more gradual than on other occasions. This is also being confirmed by the market whose implied expectations point to a somewhat more cautious approach than the one indicated by the Fed's members.

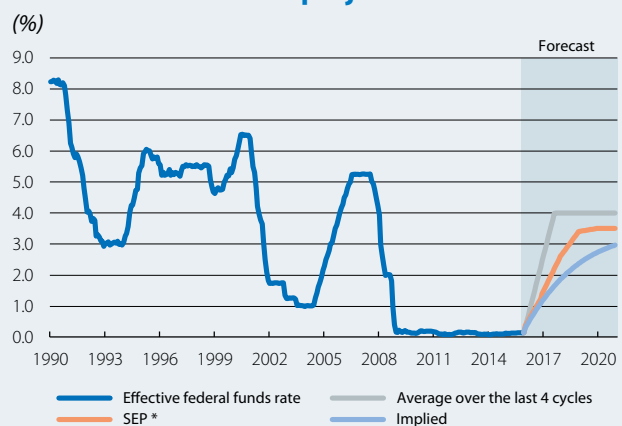
Speed index for monetary normalisation *



Notes: * Measured as the increase in the interest rate divided by the duration of the upward cycle, on an annual basis. ** SEP (Summary of Economic Projections): medians of the projections given by the Fed's members on 17 September 2015. *** Estimated based on rates implied from the interest rate curve of 6 November 2015.

Source: CaixaBank Research, based on data from the Federal Reserve and Bloomberg.

US: federal funds rate projections



Note: * SEP (Summary of Economic Projections): medians of the projections given by the Fed's members on 17 September 2015.

Source: CaixaBank Research, based on data from the Federal Reserve and Bloomberg.

KEY INDICATORS

Interest rates (%)

	30-Nov	30-Oct	Monthly change (bps)	Year-to-date (bps)	Year-on-year change (bps)
Euro area					
ECB Refi	0.05	0.05	0	0.0	0.0
3-month Euribor	-0.11	-0.07	-5	-19.2	-19.6
1-year Euribor	0.05	0.11	-6	-27.5	-28.1
1-year government bonds (Germany)	-0.38	-0.35	-3	-31.6	-31.4
2-year government bonds (Germany)	-0.42	-0.32	-10	-32.2	-38.8
10-year government bonds (Germany)	0.47	0.52	-5	-7.1	-23.0
10-year government bonds (Spain)	1.52	1.67	-15	-9.1	-37.5
10-year spread (bps) ¹	105	115	-11	-2.2	-14.7
US					
Fed funds (upper limit)	0.25	0.25	0	0.0	0.0
3-month Libor	0.41	0.33	8	15.4	17.6
12-month Libor	0.97	0.87	10	34.1	40.5
1-year government bonds	0.48	0.32	16	26.7	36.3
2-year government bonds	0.93	0.72	21	26.6	46.2
10-year government bonds	2.21	2.14	7	3.9	4.6

Spreads corporate bonds (bps)

	30-Nov	30-Oct	Monthly change (bps)	Year-to-date (bps)	Year-on-year change (bps)
Itraxx Corporate	70	71	-1	7.0	12.2
Itraxx Financials Senior	68	69	-1	0.7	8.6
Itraxx Subordinated Financials	142	148	-5	-6.5	5.1

Exchange rates

	30-Nov	30-Oct	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
\$/€	1.057	1.101	-4.0	-12.7	-15.2
¥/€	130.050	132.750	-2.0	-10.2	-12.0
£/€	0.702	0.713	-1.6	-9.6	-11.8
¥/\$	123.110	120.620	2.1	2.8	3.8

Commodities

	30-Nov	30-Oct	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	384.2	395.2	-2.8	-12.2	-15.5
Brent (\$/barrel)	42.8	47.6	-10.1	-23.2	-37.9
Gold (\$/ounce)	1,064.8	1,142.2	-6.8	-10.1	-8.8

Equity

	30-Nov	30-Oct	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (US)	2,080.4	2,079.4	0.1	1.0	0.6
Eurostoxx 50 (euro area)	3,506.5	3,418.2	2.6	11.4	7.9
Ibex 35 (Spain)	10,386.9	10,360.7	0.3	1.0	-3.6
Nikkei 225 (Japan)	19,747.5	19,083.1	3.5	21.2	13.1
MSCI Emerging	814.3	847.8	-4.0	-14.8	-19.0
Nasdaq (US)	5,108.7	5,053.7	1.1	7.9	6.6

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

ECONOMIC OUTLOOK · Expansion continues in the US while China holds firm

While the advanced countries continue in the expansionary zone, Brazil is still a source of concern among the emerging economies. Purchasing manager indices (PMI), for services for the advanced economies and for manufacturing for the emerging economies, show the dichotomy between these two blocs. The US services index rose to 59.1 points, a level that coincides with GDP growth of around 4.5%, while Brazil's index continued to fall and is now significantly below the threshold of 50 points. Meanwhile China's index remained stable close to 50.

EMERGING ECONOMIES

China's mixed activity figures help to temporarily appease the alarmist voices. The slowdown was noticed in industry but consumption remained solid. In October, industrial production grew by a moderate 5.6% year-on-year, 0.1 pps below the growth figure for September, while retail sales came as a positive surprise posting year-on-year growth of 11.0%. The real estate sector also continued its improvement started in 2015 Q1. In particular, house prices rose again in October according to the index produced by the Economist Intelligence Unit. For its part October's general inflation stood 0.3 pps below the previous month's figure (at 1.3%), although this moderation was largely due to decreases in food prices, which represent a very significant part of China's basket of goods. Given this situation the government continues to support the economy. In November the country's central bank announced a cut in the interest rates on loans granted via its permanent credit facility.

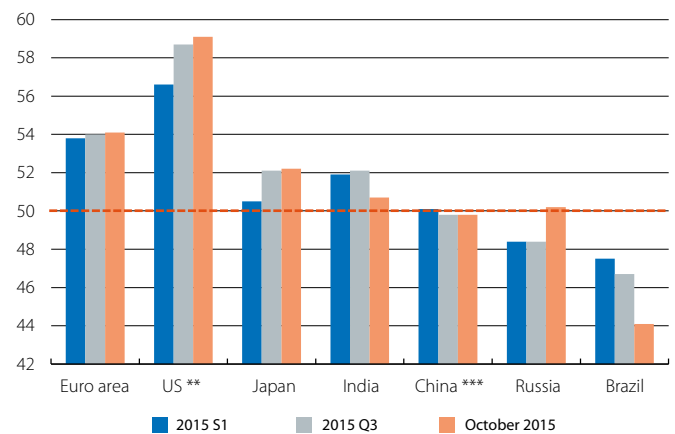
The renminbi becomes part of the IMF's special drawing rights (SDR). On 30 November the IMF decided to include the Chinese currency in its SDR basket, a measure which will become effective as from October 2016. This decision has been interpreted as recognition for the monetary and financial market reforms carried out by the Asian giant, as well as evidence that the country intends to continue with its liberalisation process.

India continues to make solid progress. India's GDP speeded up to 7.4% year-on-year in 2015 Q3, 0.4 pps higher than the previous quarter's growth and slightly above our forecasts. Of note in the breakdown by component for demand are the good investment figures while, for supply, this acceleration has been strongly supported by the improvement in manufacturing. The agricultural sector, however, has continued to post tenuous advances given the weak monsoon. Our main scenario predicts 7.1% growth for 2015 (tax year) and 7.2% for 2016.

Latin America, Mexico and Chile are resilient, unlike Brazil. In 2015 Q3 Mexico grew by 2.6% year-on-year, 0.3 pps above

PMI activity indicator *

Level



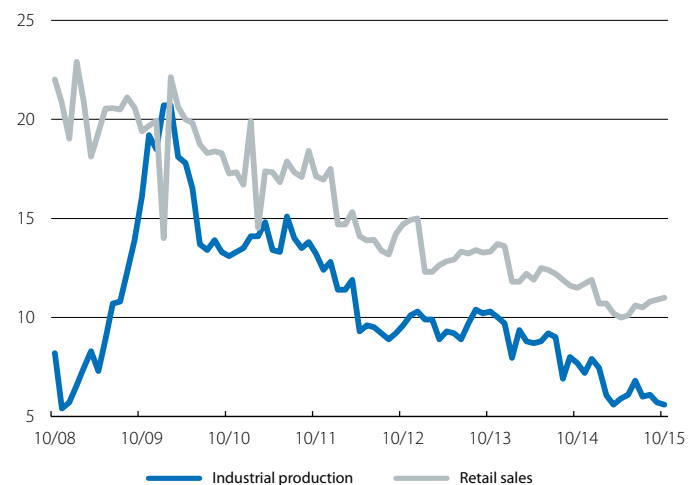
Notes: * PMI services for advanced countries and PMI manufacturing for emerging.

** The ISM index is used for the US. *** The official PMI is used for China.

Source: CaixaBank Research, based on data from Markit, ISM and China's Statistics Office.

China: activity indicators

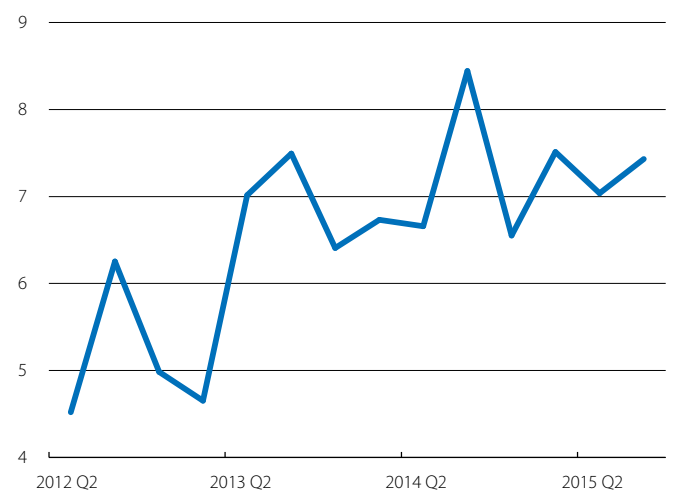
Year-on-year change (%)



Source: CaixaBank Research, based on data from China's Statistics Office.

India: GDP

Year-on-year change (%)



Source: CaixaBank Research, based on data from India's Statistics Office.

its growth figure for Q2. Although the details by component have yet to be published, indicators point to this acceleration being due to the push provided by domestic demand which is recovering from its temporary glitch in Q2. Chile seems to be in a similar situation, speeding up to 2.2% year-on-year in Q3 (1.9% in Q2) thanks to a recovery in investment and public consumption. Both countries have therefore confirmed their capacity, based on good domestic performance, to overcome the current difficult period for exports, affected by falling oil prices in the case of Mexico and copper prices for Chile. Brazil still fails to show any sign of improving, however. Indicators for Q3 suggest that its recession did not diminish in this period and that most of the adjustment is taking place in domestic demand. Moreover inflation, far from contained, accelerated up to 9.9% in October, higher than expected. The relative stability of the Brazilian real since early October is the only good news offered by the country's financial and economic situation. We have therefore maintained our forecasts of a fall in GDP of -2.3% in 2015 and -0.6% in 2016, with high downside risks.

Russia's recession appears to be stabilising. The preliminary estimate for GDP in 2015 Q3 shows a fall of 4.1% year-on-year, less than the drop in Q2 (4.6%). In this recessionary environment, inflation (15.5% in October) is moving according to expectations although it is still high. Our main scenario predicts a fall in GDP of -3.7% in 2015 and -0.2% in 2016. Nonetheless the country's geopolitical problems, which have merely increased after its aviation incident with Turkey, represent significant downside risks to our forecasts.

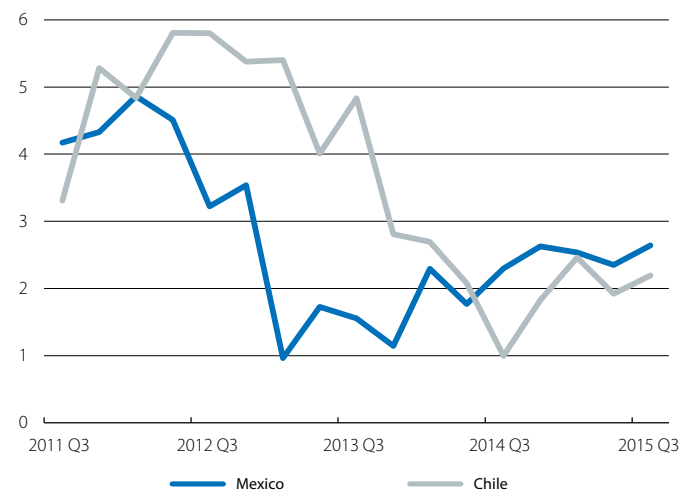
UNITED STATES

The US continues to post significant growth. According to the second estimate for GDP produced by the Bureau of Economic Analysis, the US economy grew by 0.5% quarter-on-quarter in Q3, which is an improvement on the initial estimate (0.4%). GDP grew by a considerable 2.2% in year-on-year terms. This upward revision is mainly due to the inventories component whose negative contribution to quarter-on-quarter growth eased (from -0.4 pps initially to -0.1 pps). Private consumption saw solid growth (0.8% quarter-on-quarter) and non-residential investment also advanced, although its progress was more contained (0.6% quarter-on-quarter). Given this situation, we have kept our growth forecasts at 2.5% annually, both for 2015 and 2016, a rate which would be slightly above the country's potential growth figure (between 2.1% and 2.3%).

Consumption and investment will be the key components of the US expansion. Our main scenario predicts an improvement in non-residential investment after several quarters of weak performance, and also the continuation of solid residential investment. The Case-Shiller index for house prices also shows solid growth (5.5% year-on-year in September). Moreover, consumption will continue to benefit from a healthy job creation rate, which once again provided

Mexico and Chile: GDP

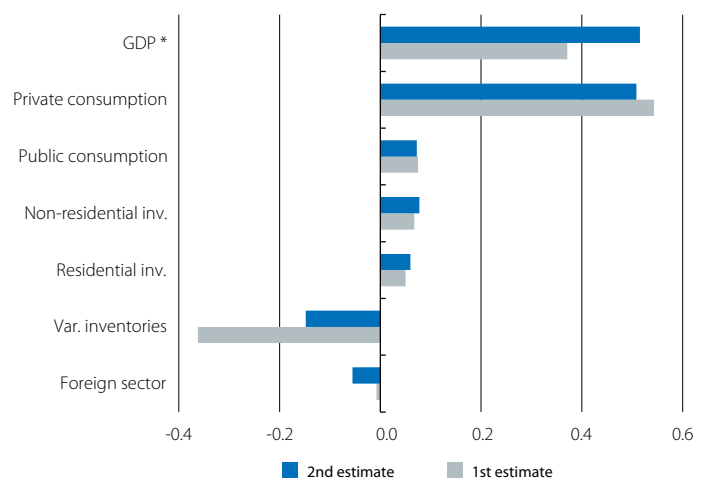
Year-on-year change (%)



Source: CaixaBank Research, based on data from the countries' Statistics Offices.

US: GDP

Contribution to quarter-on-quarter growth in GDP in 2015 Q3 (pps)

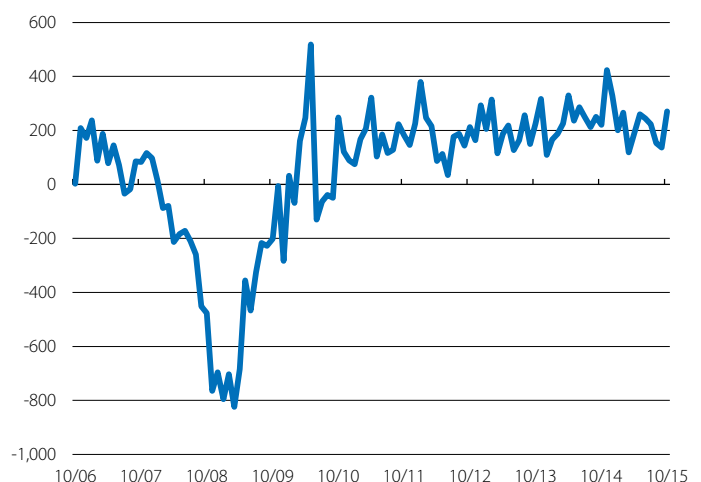


Note: * Quarter-on-quarter change.

Source: CaixaBank Research, based on data from the Bureau of Economic Analysis.

US: job creation

Monthly change (thousands of people)



Source: CaixaBank Research, based on data from the Bureau of Labor Statistics.

a positive surprise in October: 270,000 jobs were created, confirming that the slump seen in August and September was just a lull. Unemployment fell marginally to 5.0% and wages rose by a notable 2.5% year-on-year.

These data support the announcement of interest rate hikes this December, so now the dilemma focuses on the speed at which the Fed will raise interest rates over the coming months (see the Focus «A federal funds rate hike: this time it is different» in this *Monthly Report*). The good figures posted for the labour market and inflation in October make it more likely that Fed will start to raise interest rates in December. General inflation stood at 0.2%, 0.2 pps above September's figure, while core inflation remained at a healthy 1.9%. The CPI also grew by 0.2% in month-on-month terms with particularly strong growth in the energy component of 0.3% (compared with the 4.7% drop the previous month).

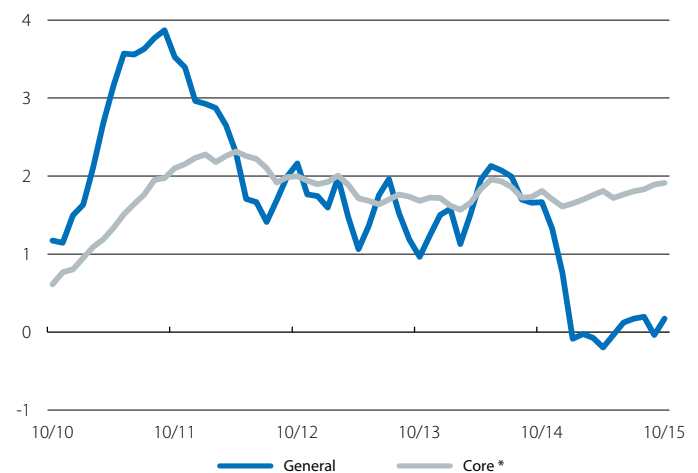
JAPAN

Japan enters a technical recession. Japan's GDP fell by 0.2% quarter-on-quarter in 2015 Q3 after falling by the same amount the previous quarter. This places Japan in recession as it has seen two consecutive quarters with negative quarter-on-quarter growth. In year-on-year terms, GDP grew by 1.1%. By demand component, stocks and investment were the weakest. In particular, inventory changes subtracted 0.5 pps from quarter-on-quarter growth and production investment 0.2 pps. On the positive side private consumption picked up with growth of 0.5% quarter-on-quarter (and a contribution of 0.3 pps) while the foreign sector also contributed positively after three quarters of deducting from growth. Nonetheless, given the disappointing GDP growth for Q3, we have revised downwards our forecast for the whole of 2015 (from 0.9% to 0.6%) and for 2016 (from 1.1% to 1.0%). Given this recessionary situation, a new package of fiscal stimuli will probably be announced and the monetary stimuli provided by the Bank of Japan might also be stepped up, although we have doubts regarding the effectiveness of such actions. The Asian country's policies should focus on the third pillar of Abenomics, namely reforms of a structural nature which, among other elements, should tackle productivity in agriculture, the tax burden for companies and encourage more women to enter the labour market.

Japan's inflation is still in negative terrain. Given this weak situation, the CPI without food but with energy (the Bank of Japan's benchmark) fell in October by 0.1% year-on-year (equalling the drop in September) while core inflation (without foods or energy) stood 0.1 pps below the previous month's figure (+0.7%). Weak consumption, which shrank again in October, suggests that prices will not pick up until well into 2016.

US: CPI

Year-on-year change (%)

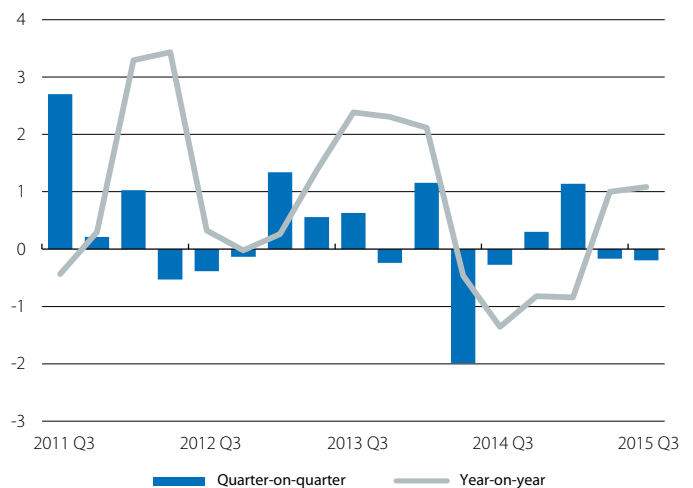


Note: * Core: general index without energy or food.

Source: CaixaBank Research, based on data from the Bureau of Labor Statistics.

Japan: GDP

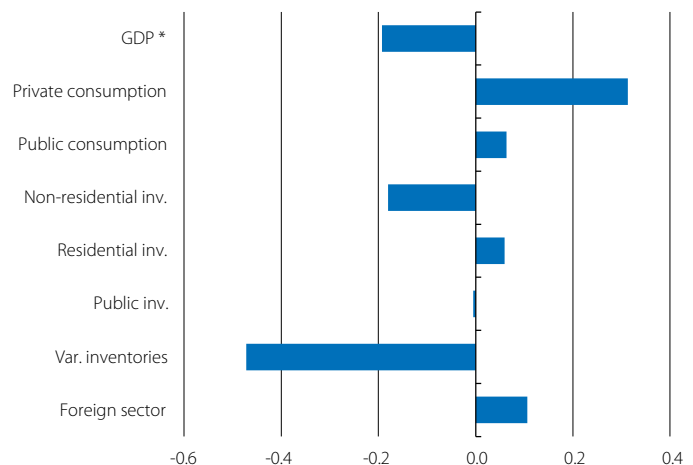
Year-on-year and quarter-on-quarter change (%)



Source: CaixaBank Research, based on data from the Ministry of the Interior and Ministry of Communications.

Japan: GDP components

Contribution to quarter-on-quarter growth for 2015 Q3 (pps)



Note: * Quarter-on-quarter change.

Source: CaixaBank Research, based on data from the Ministry of the Interior and Ministry of Communications.

FOCUS · Is Turkey still a fragile emerging economy?

In May 2013, when the first indications of how US monetary normalisation would take place were announced, risk asset prices were hit very hard in a number of emerging countries. This group was called the «fragile five» and one of them was Turkey. Since then, every time aversion to emerging risk has grown, the composition of the group of problematic emerging economies has varied but Turkey, together with South Africa and Brazil, has always remained a member. Is this a true reflection of Turkey's balance of risks or a mostly unsubstantiated negative bias?

Turkey has grown considerably over the last five years, more than 5% as an annual average. Although the economy slumped towards 3% in 2014, by 2015 Q2 its GDP had grown by 3.8% year-on-year, setting Turkey apart from other emerging economies such as Brazil and Russia which have now entered a recession. Nevertheless, although this GDP growth figure is high it is not very solid, as well as being the result of a relatively unsustainable pattern of growth. First of all because the acceleration seen in the first half of 2015 is to no small degree due to the full effect of lower oil prices (the country imports huge amounts of oil, representing 6% of its GDP). But especially because this strong growth has been accompanied by notorious imbalances in its current deficit (–5.9% of GDP in Q2) and inflation (7.6% year-on-year in October). Faced with this situation, the country's economic policy has not been very decisive. Although fiscal discipline has remained relatively firm, monetary policy has not been very appropriate and, while the upswing in prices has taken inflation away from the 5% target set by Turkey's Central Bank, the official interest rate has gone from 10% in mid-2014 to today's figure of 7.5% (implying a negative real interest rate).

We can therefore understand the doubts of investors as the pattern of growth and the response provided by economic policy have aggravated Turkey's vulnerabilities. Firstly, on the domestic front, analysts are concerned about how abundant liquidity injected by the country is being used and, more specifically, the sharp rise in private loans and rising house prices: in the period 2010-2014 the average annual growth was 20% and 13%, respectively. However, attention is mostly focused on the country's external vulnerabilities. The persistent current account deficit (more than –7% of GDP on average in the period 2010-2014) has led to a notable increase in external debt, going from 44% of GDP in 2009 to 58% currently. Moreover the share of short-term external debt has increased and now accounts for one third of the total. Unlike other emerging countries, Turkey's level of international reserves does not significantly offset this

weakness as it hardly covers one third of the country's external debt. The financial situation of companies regarding their external risks is also a cause for concern: between 2009 and 2015 corporate debt held in foreign currencies has risen from 50 billion dollars to 180 billion (equivalent to 22% of GDP).

The panorama becomes even bleaker when geopolitical uncertainty is added to these macroeconomic and financial weaknesses. As a result of growing regional conflict, Turkey has been forced to increase its level of involvement in the Syrian war. These conflicts have also had internal repercussions, including the need to tackle a greater terrorist threat than in the past and handle a large number of refugees (more than two million since 2011). Fortunately, the uncertainty regarding the country's internal governability has dissipated after November's general election, resulting in a clear majority for the government. In short, although Turkey's potential fragility does not mean the aforementioned risks will necessarily materialize, the economic and political uncertainty explain why the country has remained among the emerging economies of concern for both investors and analysts.

Turkey: main macroeconomic indicators

	2005-2012	2013	2014	2015 (f)	2016 (f)
Real GDP growth (%)	4.5	4.2	2.9	3.0	2.9
Inflation CPI (%)	8.4	7.5	8.9	7.3	6.5
Current account balance (% GDP)	–5.7	–7.9	–5.8	–4.5	–4.7
Fiscal balance (% of GDP)	–1.9	–1.6	–1.5	–1.4	–1.3
Public debt (% of GDP)	42.7	36.2	33.5	31.8	30.4

Note: (f) Forecast.

Source: CaixaBank Research, based on data from Thomson Reuters Datastream.

FOCUS · The impact of China on commodities

China is the world's main consumer of commodities. It consumes more steel and iron than the rest of the world in aggregate and its expenditure on oil is second only to the US, outdoing the Middle East and euro area. Apart from these huge figures, however, China's consumption of each commodity is uneven. Chinese demand for iron ore, for example, accounts for 59% of the world's total, of refined nickel, 50.3%, refined copper, 43.8% and copper ore, 26.9%, but in other cases, although it is still a large consumer, China's share in the global total is smaller. For example its demand for wheat accounts for 16.3% of the world's total demand, for oil, 13.7% and for natural gas, 4.7%.

The influence exercised by China over commodities comes from two effects: one related to growth and the other to the composition of this growth. More or less growth in the Chinese economy will result in more or less growth in the demand for commodities. If China grows less, so will the demand for a certain commodity, even more so when China is a major consumer of this material.

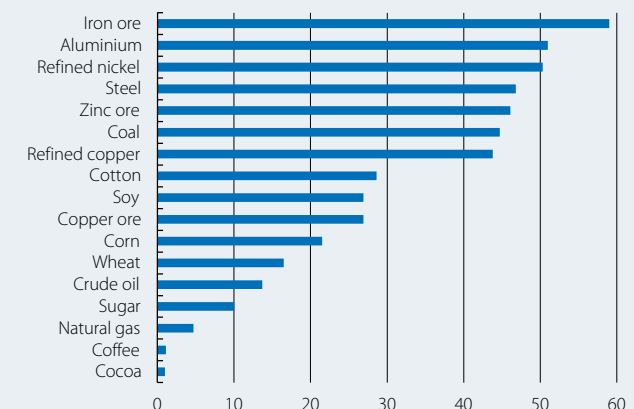
In addition to this growth effect is a second effect related to composition, which we will call capex-opex (capital expenditure and operational expenditure). It is a fact that China is evolving away from an investment-intensive model of growth towards a more consumption-based model. In this respect, we need to differentiate between commodities more closely associated with expenditure on investment (capex) such as cement, iron and steel, used to build infrastructures, and other commodities more closely associated with spending on consumption (opex), such as aluminium, used for transport goods and packaging, oil used in transport and plastics, and nickel. Copper stands halfway between these two groups.

This second effect means that some commodities win while others lose. One sign of this is the trend in China's commodity imports in terms of volume, in which iron is falling and foods and fuels are rising. Regarding the demand for basic metals which are associated with capex, such as iron and steel, there is the contractive effect of China's lower growth and the change in its model of growth, both intensified by the country's huge importance for world demand and the doubts hovering over its economy. This is largely the reason for the current downward cycle in basic metals: since February 2011, iron and steel prices have accumulated a drop of 73.4% and 59.9% respectively, and this slump has intensified in 2015 (with losses of 29.3 and 28.4%). For copper, affected by lower growth and not so much by the capex-opex effect, supply factors (lower costs) help to explain its 24.3% decrease in 2015.

In the case of opex commodities the composition effect (which is expansionary due to the increasing weight of operational expenditure in China) is moving in the opposite direction to the effect of lower growth and China's influence is therefore not so evident. It should be noted here that the slump in oil prices since 2014 is more the result of global supply factors (due to shale, increased production by Saudi Arabia, the treaty with Iran, etc.) than to the country's demand (the slowdown in China has been partly offset by a type of growth more favourable to oil consumption). We should also remember that gains in opex commodities can take some time to appear and that the consumption of a specific material starts to climb once a certain threshold is reached of per capita income, which a large part of the Chinese population has yet to achieve.

China: share of global demand *

(%)

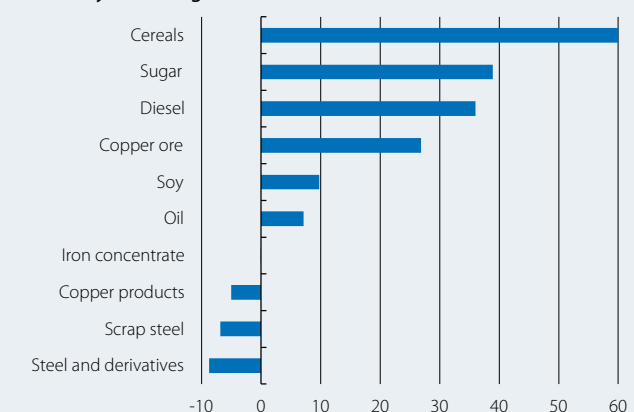


Note: * Estimated annual total from the latest data available.

Source: CaixaBank Research, based on data from Goldman Sachs.

China: commodities imports *

Year-on-year change (%)



Note: * Total over the last 12 months up to September 2015, in volume.

Source: CaixaBank Research, based on data from the Chinese Customs.

KEY INDICATORS

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

UNITED STATES

	2013	2014	2014 Q4	2015 Q1	2015 Q2	2015 Q3	10/15	11/15
Activity								
Real GDP	1.5	2.4	2.5	2.9	2.7	2.2	–	...
Retail sales (excluding cars and petrol)	3.4	3.9	4.8	4.8	3.7	4.0	3.5	...
Consumer confidence (value)	73.2	86.9	92.7	101.3	96.2	98.3	99.1	90.4
Industrial production	1.9	3.7	4.5	3.5	1.5	1.1	0.3	...
Manufacturing activity index (ISM) (value)	53.8	55.7	56.9	52.6	52.6	51.3	50.1	...
Housing starts (thousands)	928	1.001	1.055	978	1.158	1.153	1.060	...
Case-Shiller home price index (value)	158	171	173	177	179	179	...	...
Unemployment rate (% lab. force)	7.4	6.2	5.7	5.6	5.4	5.2	5.0	...
Employment-population ratio (% pop. > 16 years)	58.6	59.0	59.2	59.3	59.3	59.3	59.3	...
Trade balance ¹ (% GDP)	–2.9	–2.9	–2.9	–3.0	–2.9	–2.9	...	...
Prices								
Consumer prices	1.5	1.6	1.2	–0.1	0.0	0.1	0.2	...
Core consumer prices	1.8	1.7	1.7	1.7	1.8	1.8	1.9	...

Note: 1. Cumulative figure over last 12 months.

Source: CaixaBank 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 Q4	2015 Q1	2015 Q2	2015 Q3	10/15
Activity							
Real GDP	1.6	–0.1	–0.8	–0.8	1.0	1.1	–
Consumer confidence (value)	43.6	39.3	38.9	40.7	41.5	40.9	41.5
Industrial production	–0.6	2.1	–1.4	–2.2	–0.5	–0.4	0.3
Business activity index (Tankan) (value)	6.0	13.5	12.0	12.0	15.0	12.0	–
Unemployment rate (% lab. force)	4.0	3.6	3.5	3.5	3.3	3.4	3.1
Trade balance ¹ (% GDP)	–2.4	–2.6	–2.6	–1.8	–1.4	–1.0	–0.9
Prices							
Consumer prices	0.4	2.7	2.5	2.3	0.5	0.2	0.3
Core consumer prices	–0.2	1.8	2.1	2.1	0.4	0.8	0.8

Note: 1. Cumulative figure over last 12 months.

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

CHINA

	2013	2014	2014 Q4	2015 Q1	2015 Q2	2015 Q3	10/15
Activity							
Real GDP	7.7	7.3	7.2	7.0	7.0	6.9	–
Retail sales	15.5	12.0	14.0	10.5	10.2	10.7	11.0
Industrial production	9.7	8.3	7.6	6.4	6.3	5.9	5.6
PMI manufacturing (value)	50.8	50.7	50.4	49.9	50.2	49.8	49.8
Foreign sector							
Trade balance ¹ (value)	258	382	382	488	541	577	593
Exports	7.8	6.0	8.6	4.6	–2.2	–5.8	–6.9
Imports	7.3	0.4	–1.8	–17.6	–13.5	–14.3	–18.8
Prices							
Consumer prices	2.6	2.0	1.5	1.2	1.4	1.7	1.3
Official interest rate ² (value)	6.00	5.60	5.60	5.35	4.85	4.60	4.35
Renminbi per dollar (value)	6.1	6.2	6.1	6.2	6.2	6.3	6.3

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

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

ECONOMIC OUTLOOK · The euro area retains its tone in spite of global risks

The recovery continues in the euro area, where new factors of support come to the fore. In 2015 the euro area will have consolidated a slow recovery thanks to several favourable tail winds: the ECB's monetary policy, low oil prices and the euro's devaluation. The region is therefore managing to deal with its external risks such as the slowdown of the emerging economies which accentuated in 2015 but whose impact seems to be limited. As these temporary supports disappear, and in an environment of accommodative monetary policy and neutral fiscal policy, other factors will support growth in 2016: the recovery in global activity, the results of structural reforms already implemented and higher public spending as a consequence of the inflow of asylum seekers. The European Commission estimates that GDP will grow by 1.6% in 2015, 1.8% in 2016 and 1.9% in 2017. By country, of note is the slight worsening of growth forecasts for the core countries (Germany and France) and the improvement in the periphery (Italy and Spain).

The euro area's GDP grew by 1.6% year-on-year in 2015 Q3 (1.5% in Q2). The region's recovery still appears to be sustained with the largest economies improving their year-on-year growth rates: Spain (3.4%), Germany (1.7%), France (1.2%) and Italy (0.9%). The rate is slow, however: quarter-on-quarter growth was 0.1 or 0.2 pps less in Q3 than in the previous quarter, with the exception of France which has once again returned to positive growth. The German economy is growing solidly by 0.3% quarter-on-quarter thanks to strong domestic demand which contributed 0.5 pps to growth. However, exports deducted 0.4 pps from this growth due to a slowdown in exports and acceleration in imports (the change in inventories contributed 0.2 pps). The French economy also advanced by 0.3% quarter-on-quarter but the composition of its growth was more fragile: domestic demand contributed 0.3 pps and change in inventories 0.7 pps, entirely offsetting the negative contribution made by foreign demand (-0.7 pps). Although the breakdown of GDP growth by demand component has yet to be published for the rest of the euro area countries, the data point to a similar pattern: domestic demand adding to growth and foreign demand deducting due to a larger increase in imports than in exports.

Economic activity speeds up in Q4. The data available for Q4 point to a slight improvement in economic activity. The composite PMI has reached its highest level since May 2011, clearly in an expansionary phase (above 50 points) and the increases in the manufacturing and services indices suggest this is a generalised recovery. The economic sentiment index for the euro area also remained stable in November at 106.1 points. By country, of note is Germany posting PMI and IFO

Euro area: GDP forecasts of the European Commission

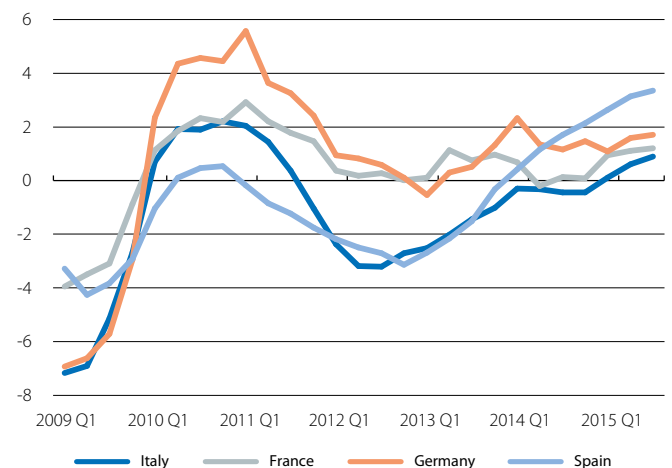
Annual change (%)

	Forecast			Change compared with the Spring 2015 forecast	
	2015	2016	2017	2015	2016
Euro area	1.6	1.8	1.9	▲ 0.1	▼ 0.1
Germany	1.7	1.9	1.9	▼ 0.2	▼ 0.1
France	1.1	1.4	1.7	=	▼ 0.3
Italy	0.9	1.5	1.4	▲ 0.3	▲ 0.1
Spain	3.1	2.7	2.4	▲ 0.3	▲ 0.1

Source: CaixaBank Research, based on data from the European Commission (European Economic Forecast, Autumn 2015).

GDP growth

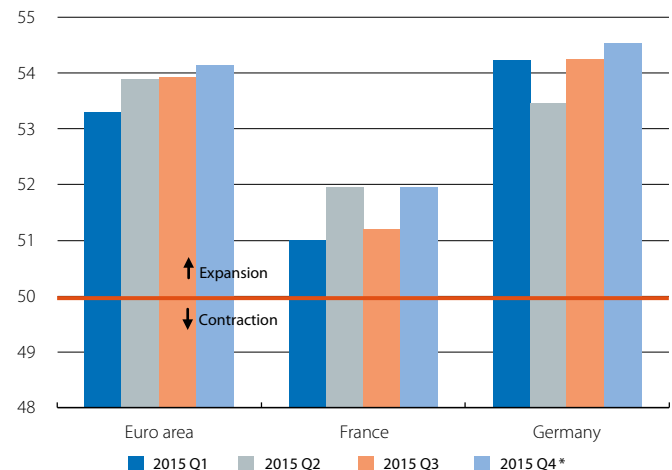
Year-on-year change (%)



Source: CaixaBank Research, based on Eurostat data.

Euro area: composite PMI activity indicators

Level



Note: * 2015 Q4 includes data from October and November.

Source: CaixaBank Research, based on data from Markit.

activity indices that are compatible with faster growth in Q4 while the increases were more modest in France, particularly in November. Nevertheless the impact of the terrorist attacks on the rate of activity is expected to be slight and concentrated in the services sector.

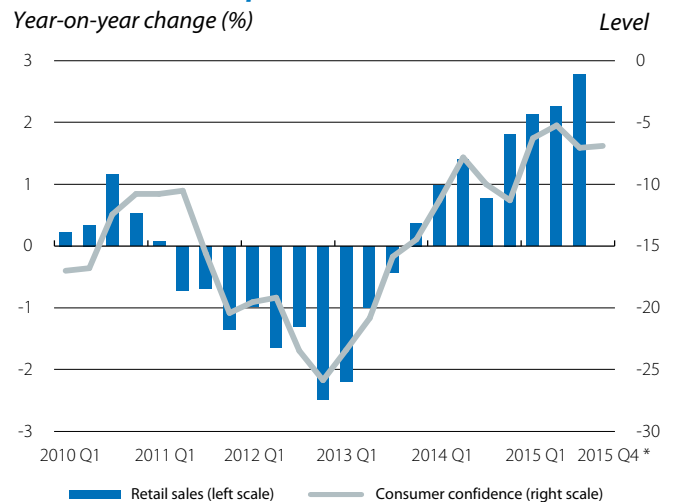
Consumption is also making good progress at the end of the year. The consumer confidence indicator reached –5.9 points in November (compared with –7.5 in October), above the figures posted in the last four months and indicating a good trend in private consumption in the euro area. There are no signs of the terrorist attacks affecting consumption although we cannot rule out a slowdown for France, albeit limited in scope and time, as happened in Madrid and London after their attacks a decade ago.

The improvement in activity is being reflected in inflation. General inflation rose by 0.2 pps in October up to 0.1% in spite of the continued slump in the energy component while core inflation reached an annual peak of 1.0%. The improvement recorded that month was the result of the firm progress seen by prices of industrial goods and services, as shown in the upward path of core inflation. In 2016 we expect general inflation to quickly align with core inflation once the effects of falling oil prices disappear and especially when they start to pick up again. Our forecasts also reflect improved activity via a continual rise in inflation for 2016 and 2017, which should reach 1.6% by the end of 2017, a figure in line with the European Central Bank's target (which is below but close to 2%).

Europe's banking sector is better prepared to support economic activity. The EBA's transparency exercise has analysed the capital, risk exposure and asset quality of 105 European banks, the results indicating an improvement in bank solvency thanks to retained earnings and the capital increases carried out. The capital ratio under the current criteria of Basel III (CET1 phase-in) reached 12.8% in June 2015 while the fully-loaded ratio (if all the Basel requirements were in force) would be 11.8%. Banks have also reduced their non-performing loan rate albeit with great disparity between countries and banks of differing sizes. The improved solvency of Europe's banks is enabling more loans to be granted, which is supporting the economic recovery.

Members of the euro area must continue working on economic convergence between countries to consolidate the recovery. The European Commission has started the European Semester by publishing its Annual Growth Survey 2016, rightly pointing out the importance of correcting imbalances between countries. Member States must implement measures that increase their productivity and competitiveness, especially those with a high level of private and external debt. However, the implementation of ambitious agendas of structural reforms looks complicated, in particular regarding the construction of the single market, in a Union where national interests seem to prevail over those of the

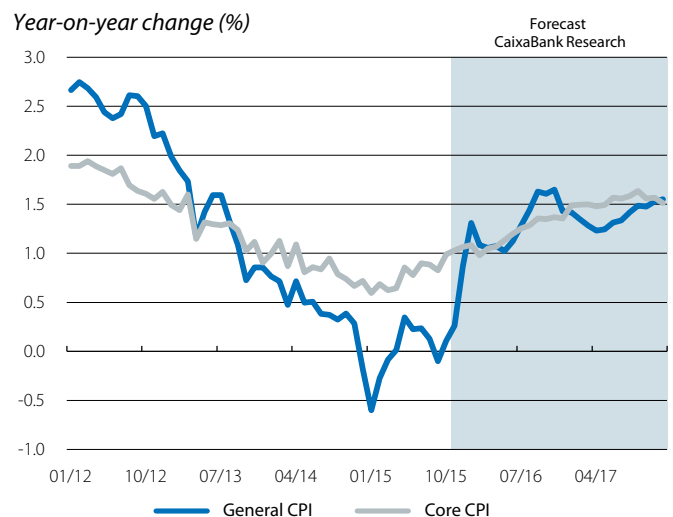
Euro area: consumption indicators



Note: * 2015 Q4 includes data from October and November.

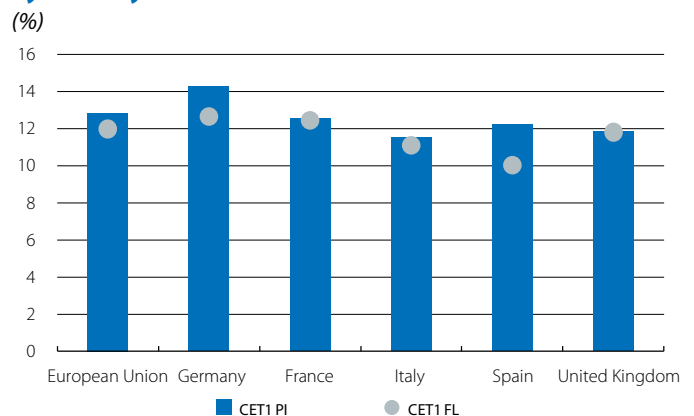
Source: CaixaBank Research, based on data from Eurostat and the European Commission.

Euro area: harmonised CPI



Source: CaixaBank Research, based on Eurostat data.

Capital ratio (CET1 phase-in and fully loaded) by country



Note: Common equity tier 1 (CET1) phase-in corresponds to the capital ratio with Basel III criteria in force and CET1 fully-loaded to the ratio if all Basel requirements were in force; calculated according to the RWA data published by the EBA, according to the phase-in criteria.

Source: CaixaBank Research, based on data from the European Banking Authority (EBA).

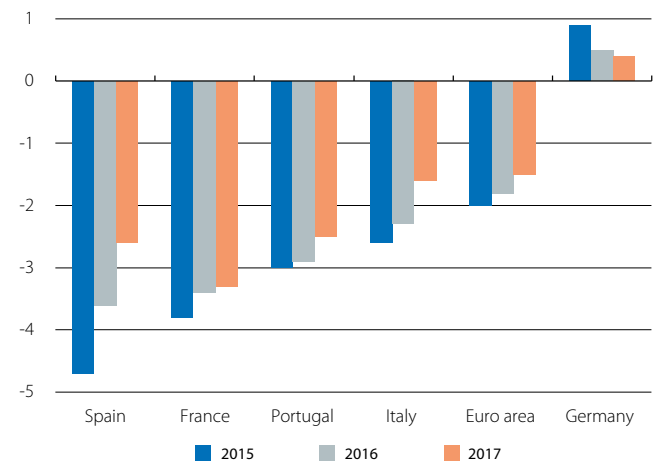
group. Another aspect which the Commission is keeping a particularly close eye on is fiscal policy, which will be neutral in the euro area as a whole in 2016 and will not represent an obstacle to the recovery's consolidation. The public deficit of the euro area will fall from 1.9% in 2015 to 1.7% in 2016 and public debt will drop from 91% of GDP in 2015 to 90% in 2016, according to the European Commission. It should be noted that the Commission, on analysing the budgets of member States, has urged Spain to update its budgets due to the high risk of the country not meeting its targets, while it has asked Portugal's new government to present a public budget as soon as possible.

The refugee crisis adds an element of risk to the macroeconomic scenario for the coming year. The European Union is seeing unprecedented numbers of asylum seekers coming to Europe. UNHCR predicts that almost one million refugees entered in 2015 and that a further million will do so in 2016. It is too early to produce a reliable estimate of the economic impacts entailed by this migration as the final number of refugees is very uncertain. Moreover, the impact on each country will differ not only depending on the number of refugees it ends up receiving but also on their skillset, whether the country in question is a transit country or for settlement, access to the labour market, etc. However, the European Commission has provided a tentative estimate of their economic impact which is highly revealing. Firstly, the influence of all refugees on the level of activity will be positive, increasing the level of aggregate GDP by several tenths of a percentage point, especially by increasing public expenditure. Some of the refugees will also join the labour market which will raise the level of aggregate employment and may offset part of the effects of Europe's ageing population in the medium term. In any case the impact will largely depend on how successfully the refugees are handled and integrated. European countries certainly have a difficult task ahead of them.

Emerging Europe's recovery is becoming stronger. GDP figures for Q3 show that the region's countries are maintaining a high level of growth in line with their long-term potential, albeit somewhat lower than the rate in Q2. It is worth noting the positive surprise provided by the growth figures for the Czech Republic, Slovakia and, to a lesser degree, Romania while Hungary disappointed with lower growth than expected. In line with the scenario of moderate but continued acceleration in growth for the euro area, the outlook for activity in emerging Europe over the coming months is positive and most of the region's countries will see growth in excess of 3% in 2015 and 2016.

Public surplus (+) or deficit (–) (European Commission forecasts)

(% GDP)



Source: CaixaBank Research, based on European Commission data.

Euro area: European Commission estimate for the economic impact of the refugee inflow

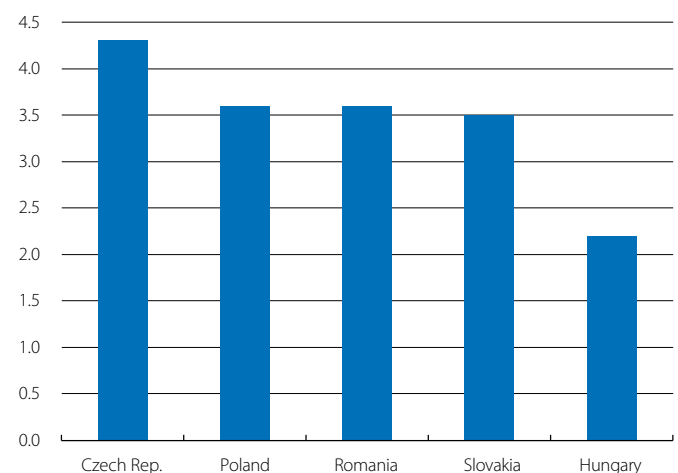
Level difference compared to baseline scenario (%)

	2015	2016	2017
GDP	0.09	0.21	0.26
GDP per capita	-0.11	-0.15	-0.06
Employment	0.06	0.22	0.30
Real wages	-0.08	-0.2	-0.25
Gov. debt (% of GDP)	-0.05	-0.08	-0.03
Gov. balance (% of GDP)	0.0	-0.04	-0.04

Source: CaixaBank Research, based on estimates by the European Commission (European Economic Forecast, Autumn 2015).

Emerging Europe: GDP for 2015 Q3

Year-on-year change (%)



Source: CaixaBank Research, based on Eurostat data.

FOCUS · Why is the euro area growing less than the US?

Europe's growth prospects are not encouraging over the medium to long term. Although it is true that the euro area is recovering, with a 1.5% growth forecast in 2015 and 1.8% in 2016, we should remember that part of this recovery is being supported by favourable tail winds: low oil prices, expansionary monetary policy and the euro's depreciation. In fact, growth forecasts beyond 2016 provided by the main central banks and international organisations are considerably lower than those for 2015 and 2016. The IMF, for example, estimates potential growth over the medium term to be just 1%.¹ To identify more precisely the reasons why the euro area is facing such a dismal future, this article breaks down the growth of the last 15 years into the contribution made by two production factors, capital and labour, at an aggregate level and also the contribution of productivity.

Starting with an analysis of productivity, defined here as total factor productivity (TFP),² limited growth is a problem for euro area as a whole but particularly for its periphery, a region that has seen a continual decline in this variable (average TFP growth in the periphery was -0.7% in the period 1999-2014). Nevertheless the core is not without its difficulties either as, since 2007, it has also witnessed a deterioration in productivity, albeit less severe (see the first graph).

Capital's total contribution to growth can be divided into ICT and non-ICT capital. The latter has contributed to growth in the euro area as much as or even more than in the US. This is not the case of ICT capital, however, a factor in which European countries have not kept up with the US. This difference is a key reason for the gap in growth between US and euro area GDP (both in the core and the periphery), particularly in the pre-crisis period (1999-2006).

The contribution of the labour factor has also been important, in particular the number of hours worked. In the pre-crisis period the contribution to growth of the quantity of labour was higher in the euro area than in the US and UK, boosted especially by the periphery. Since the crisis started, however, the number of hours worked in the periphery has plummeted, bringing down the figure for the euro area as a whole. On the other hand, although the contribution of labour quality in the period 1999-2014 was not exceedingly large (around 0.2 pps), this was both stable and similar between the different countries.

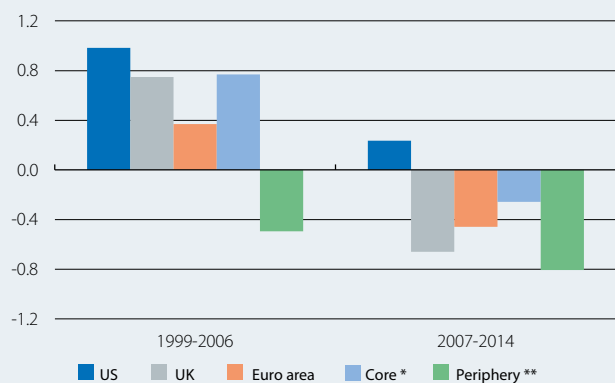
The gap in growth between the euro area and the US is therefore mainly explained by lower growth in total factor productivity and, to a lesser extent, to the lower

contribution of ICT capital (see the second graph). The trend in the quantity of labour in the pre-crisis period managed to contain these differences in GDP growth caused by the TFP and ICT capital but, since 2007 and particularly in the periphery, massive job losses have merely widened this gap.

Now that we have detected the causes of the differences in growth potential in the past, we should look to the future to correct them. On the one hand labour quality needs to make a larger contribution while, on the other, Europe's policies should foster an environment that encourages economic agents to invest more in ICT capital. With regard to TFP, the recommendations point in two directions: improving the regulatory framework to boost competition and reducing market fragmentation. Both the European Commission and the IMF, for example, suggest moving towards a single market for capital, transport, energy and the digital economy.

Total factor productivity

Average year-on-year change (%)



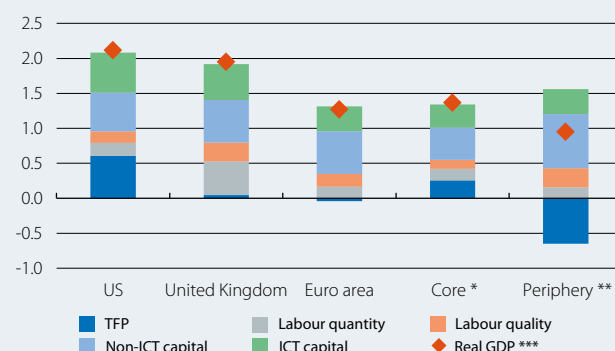
Notes: * Core: Germany, Austria, Belgium, France and Netherlands.

** Periphery: Spain, Greece, Ireland, Italy and Portugal.

Source: CaixaBank Research, based on data from The Conference Board.

Breakdown of GDP growth by input factor

Average contribution to growth in 1999-2014 (pps)



Notes: * Core: Germany, Austria, Belgium, France and Netherlands.

** Periphery: Spain, Greece, Ireland, Italy and Portugal.

*** Average year-on-year change.

Source: CaixaBank Research, based on data from The Conference Board.

1. IMF Country Report No. 15/204 «Euro Area Policies», 2015.

2. TFP is calculated as the difference between an economy's growth and the contribution made to growth by labour and capital factors.

FOCUS · Quantitative Easing: the ECB is going shopping

Almost one year after announcing quantitative easing (QE), the euro area as a whole is undergoing moderate but sustained growth with inflation around 1% (excluding the price of energy). Although there are differences between countries, this scenario resembles the forecasts provided by the ECB itself once QE had started. So why is Draghi going to expand the programme? Is it because, in its current format, it is not being implemented as initially planned? Is it because its impact has not been as expected?

After adopting heterodox monetary policies in 2014 via TLTROs and the private sector purchase programmes known as ABSPP and CBPP3,¹ in January 2015 the ECB introduced its public sector purchase programme (PSPP).² The ECB thereby undertook to buy up the sovereign bonds of countries in the euro area of up to 50 billion euros a month (plus 10 billion a month on securities in the ABSPP and CBPP3 programmes).³ Purchases began in March 2015 and will continue, at least, till September 2016, although the programme is open-ended and depends on inflation achieving a path towards its target of 2%. As can be seen in the graph, the purchases have met their target volume every month except in August, so the programme is being implemented as per the ECB's plans.

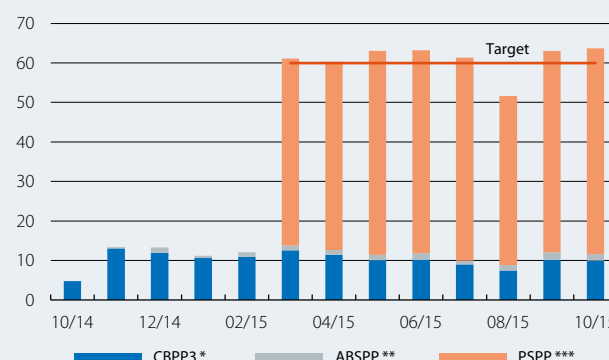
Moreover, the impact seems to be positive. As we can see in the table, the ECB's purchases have managed to push down sovereign rates in general, mainly benefitting the periphery countries. This decrease in interest rates has also helped to reduce the cost of credit for companies and households, while the euro has depreciated against the main currencies (mainly in the first half of the year) and inflation expectations have improved. Growth in activity is still moderate and inflation remains weak but the experience of other countries suggests that the effects of QE on these variables will emerge in the medium term. In any case part of the weakness in inflation comes from low oil prices and one positive note is that this has not caused any widespread deflation in other goods or services. Lastly, the announcement of QE also led to gains in the stock market.

Nevertheless, new external risks have emerged (specifically the slowdown in emerging countries and

the effect of the upcoming interest rate hike in the US, in which case the ECB may wish to emphasise the divergence between monetary policies) which could slow down the recover of inflation towards its long-run goal. The ECB may therefore decide to expand QE at its next meeting in December with the aim of reinforcing the positive performance shown by domestic demand and to counteract the weaker push expected from the foreign sector should risks materialise. This expansion of QE could take several directions: a longer period of implementation, a higher volume of monthly purchases or by expanding the list of eligible assets. The ECB might also lower the deposit facility rate even further. In any case, given that QE is progressing according to plan and the economy is behaving as expected, no huge expansion seems required. In this respect, the ECB's decision should take into account its self-imposed limits to purchases and how effective any expansion might be in an environment where interest rates are already very low.

ECB monthly purchases

(Billion euros)



Notes: * Covered bonds purchase programme 3. ** Asset-backed securities purchase programme. *** Public sector purchase programme.

Source: CaixaBank Research, based on data from the ECB.

Before and after QE: change in selected indicators

	December 2014	October 2015	Change
GDP forecast 2016	1.1% ¹	1.7% ²	0.6
HICP forecast 2016	0.6% ¹	1.1% ²	0.5
Exchange rate \$/€	1.2331	1.1235	-8.89%
10-year periphery debt interest rate ³	1.92%	1.72%	-20 bps
10-year German debt interest rate	0.64%	0.55%	-9 bps
Cost of credit for firms (euro area)	2.45%	2.22% ⁴	-23 bps
Eurostoxx 50	3,159.8	3,275.5	3.66%

Notes: 1. Consensus of 8/12/2014. 2. Consensus of 12/10/2015. 3. Weighted average of sovereign debt for Spain, Ireland, Italy and Portugal. 4. Data from September 2015.

Source: CaixaBank Research, based on data from Consensus Economics, ECB and Eurostoxx.

1. Targeted long-term refinancing operations (TLTRO), asset-backed securities purchase programme (ABSPP) and covered bonds purchase programme 3 (CBPP3).

2. Public sector purchase programme.

3. Limits were also set of 25% for each issuance (increased in September 2015 to 33% for most assets) and 33% of total issuances in order to prevent the ECB from being able to form a blocking coalition in the case of restructuring and to limit its influence on price formation.

KEY INDICATORS

Activity and employment indicators

Values, unless otherwise specified

	2013	2014	2014 Q4	2015 Q1	2015 Q2	2015 Q3	09/15	10/15	11/15
Retail sales (year-on-year change)	-0.8	1.2	1.8	2.1	2.3	2.8	3.0	...	...
Industrial production (year-on-year change)	-0.7	0.8	0.3	1.6	1.3	1.9	1.7	...	...
Consumer confidence	-18.5	-10.0	-11.2	-6.2	-5.1	-6.9	-7.0	-7.5	-5.9
Economic sentiment	93.8	101.6	100.9	102.6	103.7	104.6	105.6	106.1	106.1
Manufacturing PMI	49.6	51.8	50.4	51.4	52.2	52.2	52.0	52.3	52.8
Services PMI	49.3	52.5	51.7	53.5	54.1	54.0	53.7	54.1	54.6
Labour market									
Employment (people) (year-on-year change)	-0.7	0.6	0.8	0.8	0.9	...	-	-	...
Unemployment rate: euro area (% labour force)	12.0	11.6	11.5	11.2	11.0	10.9	10.8	...	...
Germany (% labour force)	5.2	5.0	4.9	4.8	4.7	4.5	4.5	...	...
France (% labour force)	10.3	10.3	10.5	10.4	10.4	10.7	10.7	...	...
Italy (% labour force)	12.2	12.7	12.8	12.3	12.4	11.9	11.8	...	...
Spain (% labour force)	26.1	24.5	23.7	23.1	22.5	21.8	21.6	...	...

Source: CaixaBank 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 Q4	2015 Q1	2015 Q2	2015 Q3	09/15	10/15
Current balance: euro area	2.0	2.5	2.5	2.7	3.0	3.1	3.1	...
Germany	6.5	7.3	7.3	7.5	7.8	8.1	8.1	...
France ¹	-0.8	-0.9	-0.9	-0.5	0.0	0.0	0.0	...
Italy	0.9	1.9	1.9	2.0	2.1	2.0	2.0	...
Spain	1.5	1.0	1.0	1.2	1.4	1.5	1.5	...
Nominal effective exchange rate¹ (value)	101.2	101.8	99.0	93.0	91.1	92.7	93.8	93.6

Note: 1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated.

Source: CaixaBank 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 Q4	2015 Q1	2015 Q2	2015 Q3	09/15	10/15
Private sector financing								
Credit to non-financial firms ¹	-2.6	-2.6	-1.7	-0.8	-0.4	0.1	0.1	0.6
Credit to households ^{1,2}	-0.2	-0.1	0.1	0.2	0.5	1.0	1.1	1.2
Interest rate on loans to non-financial firms ³ (%)	2.2	2.0	1.8	1.7	1.6	1.5	1.5	...
Interest rate on loans to households for house purchases ⁴ (%)	2.8	2.6	2.4	2.2	2.0	2.1	2.1	...
Deposits								
On demand deposits	7.9	6.1	7.3	9.8	11.8	12.5	12.4	12.5
Other short-term deposits	-0.1	-2.0	-2.0	-3.1	-4.0	-4.7	-4.7	-4.3
Marketable instruments	-14.9	-7.2	1.2	3.8	5.6	1.9	0.7	3.4
Interest rate on deposits up to 1 year from households (%)	2.0	1.3	1.0	1.0	0.9	0.7	0.7	...

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: CaixaBank Research, based on data from the European Central Bank.

ECONOMIC OUTLOOK · A good end to the year for the Spanish economy

The Spanish economy's rate of growth is still strong in the final part of the year. After a slight slowdown in the quarter-on-quarter rate of growth in Q3, to 0.8% (in Q2 it was 1.0%), recent indicators have been better than expected and point to this pace continuing in Q4. The increase in household purchasing power thanks to job creation and falling energy prices is helping consumption to remain firm. The rise in credit also confirms that monetary stimuli are having the desired effect. The euro's depreciation due to the divergence between the ECB and Fed's monetary policies is also helping to boost exports in spite of the slight downturn in the world economy. With a view to 2016, GDP will continue to grow at a high rate although somewhat lower than the previous year, in the order of 0.6% quarter-on-quarter, providing an annual rate of 2.7% compared with 3.1% in 2015 (see the article «The recovery in Spain: a qualitative step forward» in the Dossier).

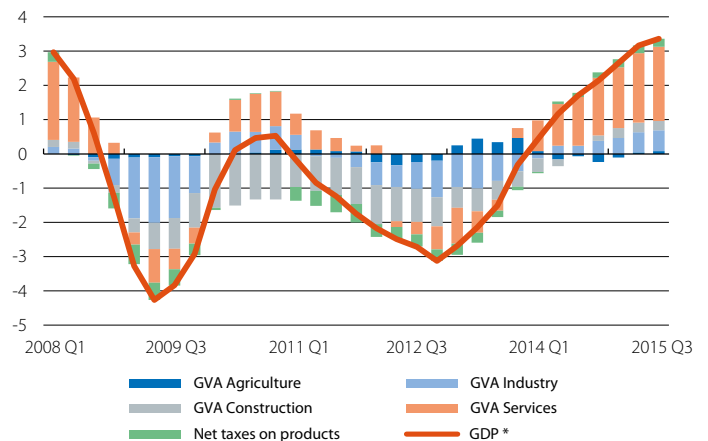
All activity sectors contribute to growth. The breakdown of GDP for Q3, up by 3.4% year-on-year, shows that services led the recovery on the supply side with a contribution of 2.2 pps in the last quarter. The role played by industry was also notable and the positive contribution of 0.3 pps made by construction for the third consecutive quarter confirms that this sector's recovery is consolidating.

Indicators show that services continue to lead the way and that industry has maintained its tone in Q4. The purchasing managers sentiment index (PMI) rose slightly in October to 55.0 points compared with 54.6 in September and growth in the services sector has offset the slight moderation in the manufacturing index. Although October's figures are a little lower than the average for Q3, both indices (manufacturing and services) are well within the expansionary zone so we expect the rate of growth to remain high in Q4. The outlook for industry is favourable thanks to improved activity in the euro area. This can be seen, for instance, in September's industrial orders: those from the euro area increasing significantly by 6.5% year-on-year although the rest of foreign orders grew by a subdued 2.0% year-on-year.

Domestic demand: the main engine of growth. The breakdown of GDP by demand component shows that domestic demand contributed 1 pp to quarter-on-quarter growth in Q3 thanks to the good performance by private and public consumption. Although capital goods investment maintained its good tone, investment in construction was more subdued after the upswing in the first quarter of the year. The increase in domestic demand pushed up imports so that foreign demand deducted from GDP growth (–0.2 pps) in spite of the notable increase in exports. Over the coming

GDP

Contribution of supply components to year-on-year growth (pps)

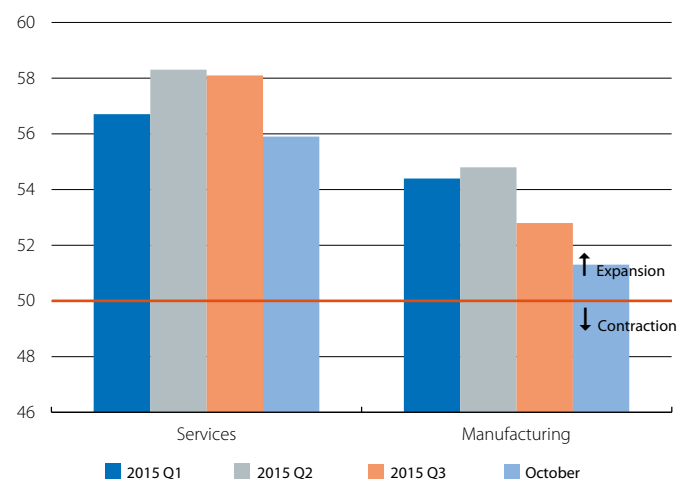


Note: GVA: gross value added. * Year-on-year change.

Source: CaixaBank Research, based on INE data.

Activity indicators (PMI)

Level



Note: Values above 50 points are usually related to positive GDP growth rates.

Source: CaixaBank Research, based on data from Markit.

Breakdown of GDP and forecasts

Quarter-on-quarter change (%)

				Forecast		
	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2
Private consumption	0.7	0.9	1.0	0.6	0.7	0.4
Public consumption	1.7	0.7	0.9	0.4	–0.5	0.5
Investment	1.5	2.4	1.1	1.0	1.0	0.9
Capital goods investment	2.2	3.7	2.3	1.3	1.2	1.0
Investment in construction	1.3	2.2	0.6	0.8	0.9	0.9
Exports	1.1	1.4	2.8	1.4	1.4	1.5
Imports	2.2	1.6	4.0	1.3	1.2	1.2
GDP	0.9	1.0	0.8	0.7	0.6	0.7

Source: CaixaBank Research, based on INE data.

months, however, we expect imports to slow down once consumption and investment start to run out of steam. In 2016 the foreign sector will therefore provide a positive contribution to GDP growth and domestic demand will lose some of its relative importance.

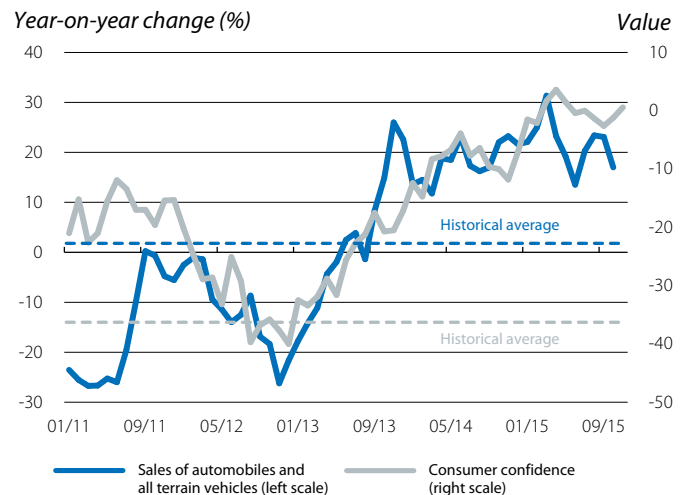
The strong growth in domestic demand continues in Q4.

After a period in which household consumption increased strongly (1.0% quarter-on-quarter in Q3), indicators point to this continuing its vigorous rate of growth. Of note is the excellent performance by automobile sales with rates much higher than the historical average, largely supported by the Efficient Vehicle Incentive Programme (PIVE) whose aim is to encourage people to replace their vehicles with others that consume less energy. The fact that the government has extended this plan until July 2016 suggests automobile sales will continue to be high, at least during the first half of the coming year. Consumer confidence data also confirm the good tone of consumption: October and November's average figure of -0.3 points (-1.3 in Q3) is at a very high level historically. Other data related to investment are also advancing strongly. Specifically, of note is the acceleration in the rate of growth for industrial production, up to 4.1% year-on-year in Q3 (3.5% in Q2), and the higher consumption of electricity by industry, up by 2.2% year-on-year in Q3 compared with 3.6% in October.

Jobs are still being created at a dynamic rate. The number of workers affiliated to Social Security grew in October by 35,230 people, seasonally adjusted, maintaining the year-on-year rate of change at a high level (3.2%). The positive contribution of industry, construction and non-tourism services is ensuring a solid recovery in the labour market. Moreover, the strong increase in the number of Social Security contributors over the last few months (over one million since the start of the recovery in 2013 Q2), which looks like continuing, is extending employment to an increasing number of households, which is crucial for boosting spending. On the other hand, although wages have remained contained (the wage rise established in collective agreements was 0.8% annually in October compared with 2.4% for the historical average), in general workers have gained purchasing power over the last few months because of low inflation (forecast at -0.5% for the whole of 2015) and the population's greater purchasing power should boost private consumption at the end of the year. With a view to 2016 we do not expect wages to grow above inflation as this will continue its upward trend (see the Focus «Inflation expectations for 2016: rising» in this *Monthly Report*), so consumption will not enjoy so much support from this front. However, the increase in the number of employed people throughout 2016, which might reach 400,000, should continue to be a very important factor in maintaining high growth rates for spending.

The real estate market is definitely expanding. Thanks to the improved labour market and better financing conditions,

Demand indicators

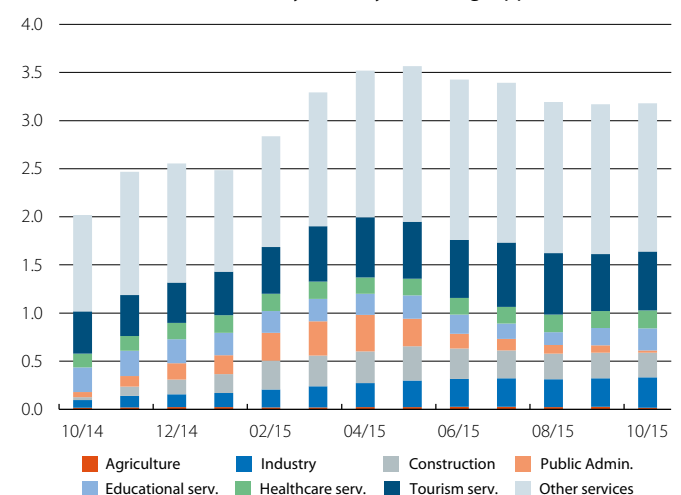


Note: * Moving average of three months.

Source: CaixaBank Research, based on data from ANFAC and the European Commission.

Registered workers affiliated to Social Security

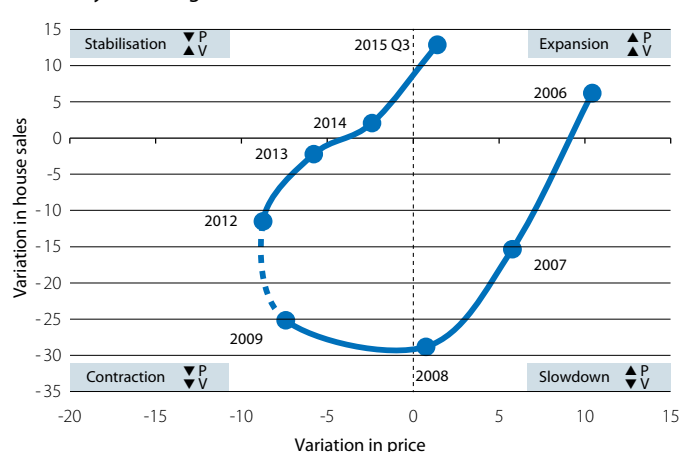
Contribution of sectors to the year-on-year change (pps)



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

Real estate clock

Year-on-year change (%)



Note: Data for 2010 and 2011 have been excluded due to the effect of tax incentives on the real estate market.

Source: CaixaBank Research, based on data from the INE and the Ministry of Public Works.

demand for housing is steadily growing. In September house sales advanced strongly by 12.9% year-on-year (cumulative over 12 months), a figure that confirms that the upward trend started in 2014 is gaining traction. Given that construction is recovering more slowly, this vigorous demand is helping to reduce the excessive stock of new residential properties for sale. On the other hand house prices rose by 1.4% year-on-year in Q3 (1.2% in Q2). The trend in both variables therefore confirms that the real estate market is leaving behind its stabilisation phase and, at least in some prime areas where there are stock shortages (for example large cities), is already in an expansionary phase.

Exports: at record highs. Although foreign demand deducted from quarter-on-quarter growth in GDP, it is important to note the good figures for real exports, up by 2.8% quarter-on-quarter in Q3, a much higher rate than the average for the last two decades, namely 1.2%. However, the vigorous growth by imports of 4.0% quarter-on-quarter held back the trend in the foreign sector. The recovery of the euro area, which represents close to half Spain's exports, has contributed in the last few quarters to the good tone in exports and, as the euro area's economy continues to improve, we should see exports to this trading partner increase. Thanks to the support provided by the euro's depreciation, sales to the US should also grow. Exports to the emerging countries could also increase as a consequence of the slight acceleration predicted for these economies. We therefore expect exports to continue growing significantly as a whole.

Probable deviation from the target public deficit for 2015.

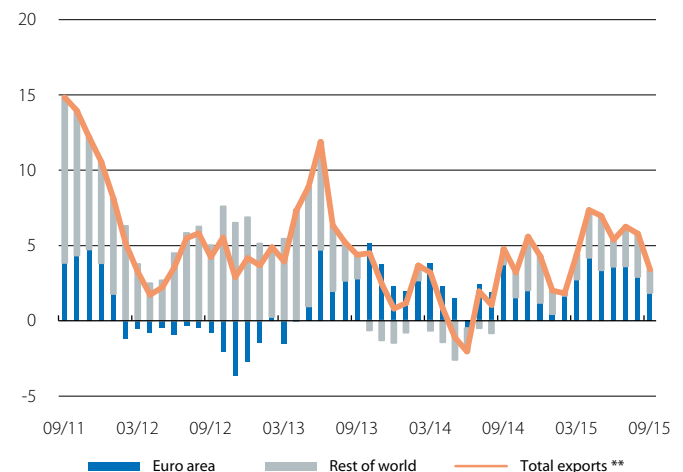
The improvement in the state budget execution in October will not be enough to offset the worse figures posted by Social Security and the autonomous communities. It will therefore be very difficult to meet the fiscal deficit target for public administrations by the end of the year, namely -4.2%. Given this risk of deviation, the European Commission has urged the government the present an update for its 2016 Budget, incorporating measures to reduce the public deficit in line with the path agreed. Regarding the trend in debt, our forecasts expect this to reach 100.6% of GDP in 2015, a level at which it will stabilise in 2016 and then embark on a path of moderate reductions.

Lots of room for improvement in the ease of doing business.

According to the Doing Business 2015 report for Spain, most of the autonomous communities are below the European Union average in the four criteria evaluated: starting a business, dealing with construction permits, getting electricity and registering property. There is great divergence between regions in terms of regulatory efficiency and the good practices of those in a better position should be copied. Some of the recommendations that can be deduced from this report would be, among others, the need to consolidate and eliminate red tape to start up a business, a reduction in electricity costs and extending online administration to make processes easier.

Exports of goods *

Contribution to year-on-year growth in the cumulative 3-month figure (pps)

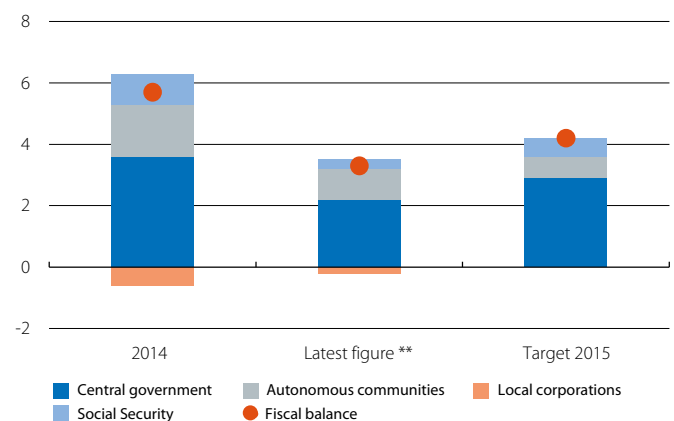


Notes: * Nominal data. ** Year-on-year change.

Source: CaixaBank Research, based on data from the Customs Dept.

Budget balance of the public administrations *

(% of GDP)



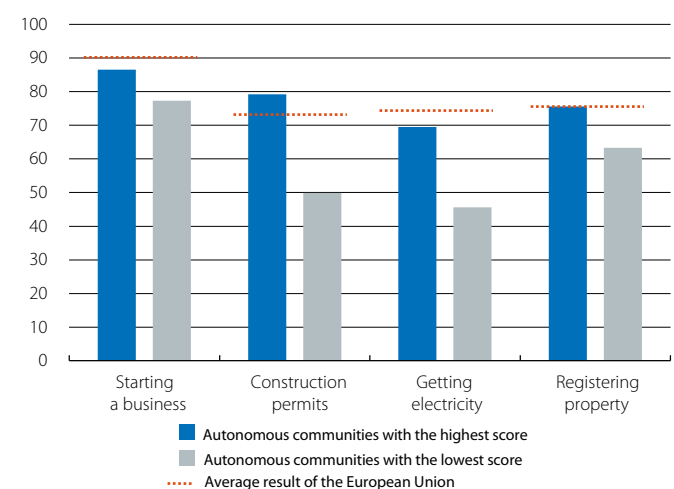
Notes: * Does not include losses generated by bank bail-outs, namely 0.1% of GDP in 2014.

** October 2015 (Central government); September 2015 (Social Security and autonomous communities); June 2015 (local government corporations).

Source: CaixaBank Research, based on data from the State Public Accounts.

Classification by autonomous community in the Doing Business 2015 report for Spain

Distance to frontier (score)



Source: CaixaBank Research, based on data from the World Bank.

FOCUS · Inflation expectations for 2016: rising

After two years of negative price changes resulting in a lively debate regarding the risks of deflation, we are about to embark on a period of rising inflation. This change in direction, which began already in October, will gain in intensity over the coming months, the year ending with inflation clearly positive and climbing to 1.3% in 2016. This recovery in inflation is mainly due to three factors, which we will now discuss.

Firstly, between November and January the base effect will have disappeared from the sharp fall in oil prices occurring during these months one year ago, so that general inflation will rise quite sharply (we believe it will reach 0.6% in December 2015). It should be noted that this increase will still occur even if oil prices remain at their current level or fall slightly (see the first graph). In fact, we expect oil prices to increase throughout 2016, also playing their part to push up inflation.

A second element that will boost prices in 2016 will be the euro's depreciation against the dollar as a consequence of the divergence between monetary policies on both sides of the Atlantic: while the ECB is expected to take its expansionary policies even further, the Fed will embark on monetary normalisation. The euro's depreciation will mean that Spain will import inflation from countries outside the euro area. A depreciated euro therefore affects the general consumer price index (CPI) by making imports more expensive, pushing up the cost of all intermediate goods bought abroad such as, for example, oil and other commodities. Moreover, the relationship between the exchange rate and some imported industrial products, especially those used for consumer durables which have a significant relative weight of 11% of the whole CPI, is strong and negative. In other words, when the euro depreciates, the import price of these goods rises (see the second graph). Depending on the capacity of companies to vary their operating margin, this impact will be passed on more or less to the consumer price. Based on a study by the ECB,¹ we can expect the euro's depreciation against the rest of the currencies of Spain's main trading partners, totalling about 3% in 2015, will have an effect in the short and medium term. Specifically, this depreciation of the nominal effective exchange rate, caused mainly by the dollar gaining strongly in value, could push up inflation by almost 0.2 pps in the next two years. Moreover, given that the euro is expected to go on depreciating quite considerably against the dollar in 2016, this channel will continue to boost inflation.

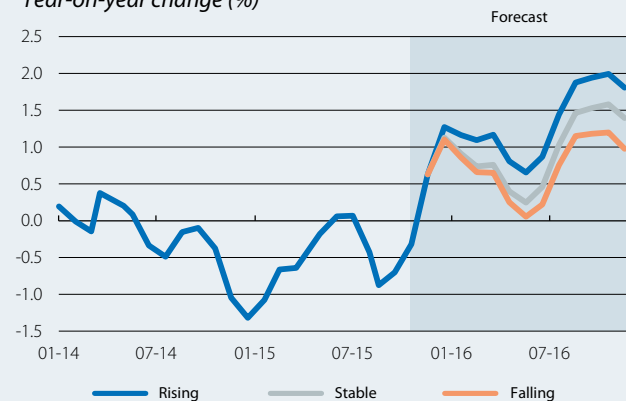
1. See Di Mauro, F., Rüffer, R. and Bonda, I. (2008) «The changing role of exchange rate in a globalised economy», ECB Occasional paper series.

Finally there is also the improvement in the labour market, with an expected increase in the number of employees of close to 400,000 in 2016 (after 900,000 between 2014 and 2015), which will have a favourable effect on household income and confidence, in turn stimulating consumption and consequently prices. We therefore predict that core inflation will continue to recover and reach 1.3% in 2016 compared with 0.6% in 2015.

In summary, we expect inflation to come back in 2016 and gradually approach the ECB's target. The next phase will therefore be one of rising inflation.

CPI according to the trend in oil prices *

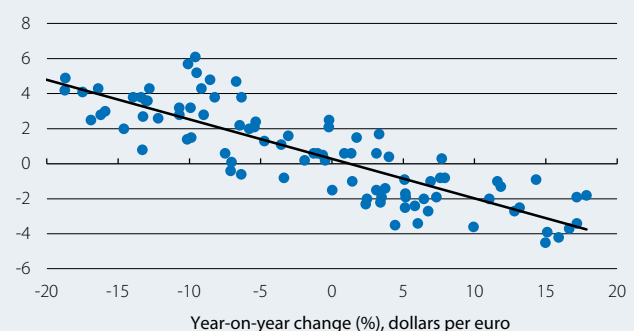
Year-on-year change (%)



Note: * Assuming that, in 2016, the oil price rises by 2.1% month-on-month on average (our baseline scenario), remains constant, or falls by 0.5% month-on-month on average.
Source: CaixaBank Research, based on INE data.

Relationship between the import price of industrial products used for consumer durables and the exchange rate *

Year-on-year change (%), import price



Note: * Data between January 2008 and September 2015.
Source: CaixaBank Research, based on data from INE and Bloomberg.

FOCUS · An analysis of the employability of Spain's labour force

The capacity of individuals to get a job and progress professionally, in other words their employability, will be decisive in reducing Spain's high unemployment rate, which stood at 21.2% in 2015 Q3. This Focus analyses the employability of the Spanish labour force in order to detect the main areas for improvement.

One key factor in increasing the likelihood of those joining the labour market finding a job is for their training to be in line with the market's demand. In this respect, it would be advisable if those university degrees attracting a higher number of students had a lower unemployment rate. However the most recent data, from the 2014-2015 academic year, show that this is not the case: almost 30% of undergraduates are concentrated in the areas of education within the highest unemployment tercile, such as architecture and art whereas degrees with relatively low unemployment, such as mathematics or statistics, receive less than 1% of the enrolments (see the first graph). It therefore seems that better coordination between the supply for places in higher education and the demand for labour could help to improve the employability of those entering the labour market.

Another fundamental factor that determines employability is for the training received to develop the skills required to carry out a specific job. According to OECD data from 2015, 41% of adults with higher qualifications achieved a low result in the professional skill test, compared with 27% for the OECD average (see the second graph). The level of knowledge of the adult population therefore seems to be limited, even among those holding third cycle degrees, warranting a review of the educational programmes imparted.¹

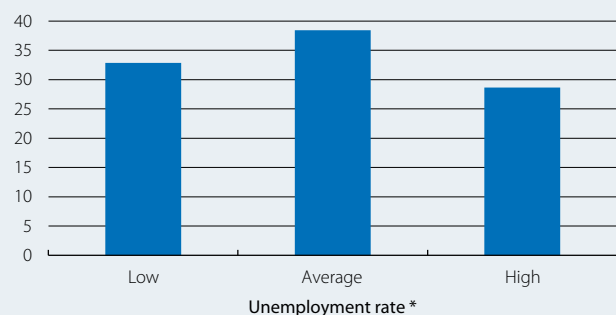
The situation becomes even more worrying if we consider that, in the last few years, the population has become polarised into two groups: those who have not completed medium level studies and those graduating from higher education, resulting in a significant deficit of workers with medium-level qualifications. This bipolar distribution of educational attainment contrasts with the situation observed in other countries. In 2015 Q2, while only 22% of Spaniards aged between 25 and 64 had medium-level qualifications, this percentage was 59% in Germany. However, 43% of Spain's population in this age group had a low level of educational attainment compared with 13% in Germany.

1. See García Perea, P. and Molinas, C. (2015), «Acabar con el paro ¿queremos? ¿Podremos?», Fundación de Estudios Financieros.

The low percentage of individuals with medium-level qualifications in Spain is the result of the high school drop-out rate and low use of the vocational education (VE). On the one hand, the percentage of «NEET» (young people who are not in education, employment or training) is still very high in Spain (27% compared with 15% on average for the OECD). On the other hand, the share of VE is low and, consequently, so is the share of the population with job-specific skills. In this respect, the reform of VE in 2011 (Royal Decree 1147/2011) took some steps in the right direction by making it easier, for example, to move from academically-focused secondary education (ESO) to VE, which should help to reduce the number of people leaving school without any qualifications. However, the medium-level VE still has problems matching the demand for labour, largely due to the limited collaboration between those designing the programmes and companies. In short, focusing on policies that help to increase the employability of the labour force will be crucial to reduce the country's high unemployment.

Undergraduate students enrolled in the 2014-2015 academic year by the unemployment rate of university graduates

(% of total)

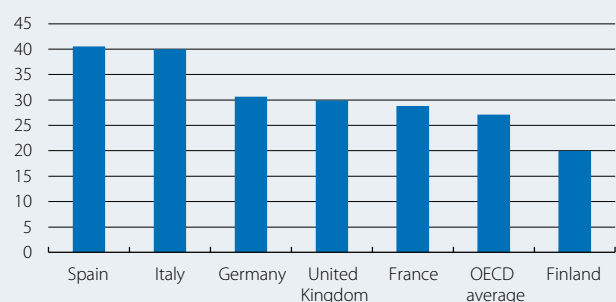


Note: * University degrees (21 in total) are ordered from the lowest to the highest unemployment rate in 2014 and the cut-off values for the three groups are percentiles 1/3 (14.2%) and 2/3 (17.6%).

Source: CaixaBank Research, based on data from the Ministry of Education, Culture and Sport and the INE (LFS sub-sample variables).

University graduates with a low level of knowledge according to the OECD adult test *

(%)



Note: * Individuals aged 25 to 64.

Source: CaixaBank Research, based on data from the OECD (Skills Strategy Diagnostic Report Spain, 2015).

FOCUS · External vulnerability and valuation effects

One of the key macroeconomic variables used to determine an economy's external vulnerability is its net international investment position (NIIP). An economy's capital inflows and outflows, contained in the financial accounts of its balance of payments, largely determine the change in the NIIP. However, changes in the valuation of assets and liabilities, reflecting variations in their market price in local currency and the exchange rate effect, among others,¹ can also play an important role. This Focus analyses the impact of valuation effects on the evolution of the Spanish NIIP.

The NIIP deteriorated significantly during the years prior to the crisis, going from a debt position of 31.2% of GDP in 2000 to 91.5% in 2012, one of the highest in the world. This deterioration was particularly due to the trend in the current account balance whose deficit steadily increased, reaching 9.6% of GDP in 2007. However, almost one third of the deterioration in the NIIP can be explained by valuation effects (see the first graph).²

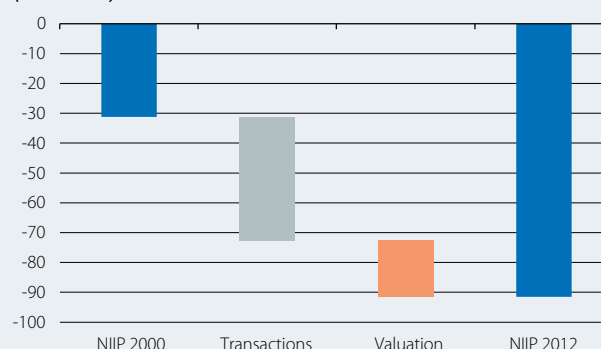
This valuation effect has not helped in recent years either. Although the current account balance has been in surplus since 2013, it is noticeable that the debt position has not shown any sign of improvement up to 2015 Q2. This must be entirely due to valuation effects as cumulative financial transactions over this period would have reduced the debt position from 90.0% in 2012 to 83.3% of GDP in 2015 Q2, instead of the actual figure of 92.6% (see the second graph). If we analyse the changes in the value of assets and liabilities by instrument we can see a notable increase in the value of liabilities, specifically portfolio investment, and a slight decrease in the value of assets held by Spaniards abroad. Given that more than 70% of the liabilities from portfolio investment are debt instruments, mostly public, this change in value can be explained by lower interest rates and their impact on the price of bonds. The ECB's accommodative monetary policy has particularly reduced financing costs for the public and private sectors in Spain so that portfolios of Spanish assets in foreign hands have been revalued, especially bonds, which impairs Spain's NIIP. Moreover the gains seen in the Spanish stock market over this period have also helped to push up the value of shares and investment funds held by foreign investors.

1. Valuation effects also include other changes in volume. See «Balanza de pagos y posición de inversión internacional de España», Bank of Spain, 2014.

2. With the aim of quantifying the importance of valuation effects, our starting point is the NIIP in 2000 and, as from that year, we have accumulated the financial transactions to obtain the NIIP without valuation effects.

The bulk of the evidence available suggests that interest rates will remain more or less at the same level over the coming year so no great changes are expected in the valuation of Spanish assets held by foreigners. However, we should see an improvement in the valuation of foreign assets held by Spaniards thanks to the global economic recovery. With a view to 2017, the contribution made by the valuation effect to the reduction in the NIIP will be greater. According to our forecasts, the ECB will start to raise interest rates by the end of that year. Therefore, as we approach this date, the medium and long-term interest rates for assets will gradually increase so that bond portfolios will lose value, undoing the negative valuation effect observed over the last few years. In any case, it is important to remember that a sustained reduction in external vulnerability necessarily involves maintaining a current account surplus.

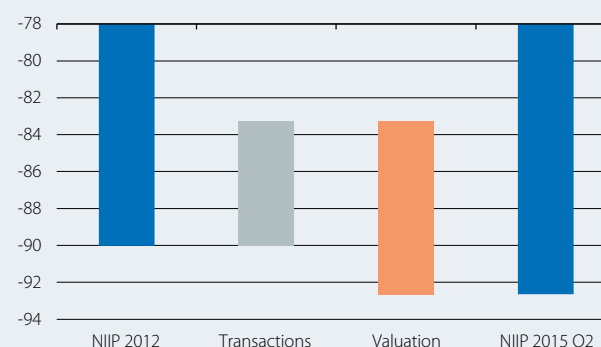
Change in the NIIP between 2000 and 2012
(% of GDP)



Note: The change in the NIIP is broken down into (1) net cumulative financial transactions on the financial balance sheet and (2) the valuation effect, which includes variations in the market price of assets and liabilities and the exchange rate effect, among others.

Source: CaixaBank Research, based on data from the Bank of Spain (MBP5).

Change in the NIIP between 2012 and 2015 Q2
(% of GDP)



Note: The change in the NIIP is broken down into (1) net cumulative financial transactions on the financial balance sheet and (2) the valuation effect, which includes variations in the market price of assets and liabilities and the exchange rate effect, among others.

Source: CaixaBank Research, based on data from the Bank of Spain (MBP6).

KEY INDICATORS

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

Activity indicators

	2013	2014	2014 Q4	2015 Q1	2015 Q2	2015 Q3	09/15	10/15	11/15
Industry									
Electricity consumption	-2.1	-0.1	-1.6	1.2	-0.2	2.4	-0.7	3.6	...
Industrial production index	-1.5	1.3	0.3	1.5	3.5	4.1	4.0	...	...
Indicator of confidence in industry (<i>value</i>)	-13.9	-7.1	-5.3	-3.2	0.9	0.7	1.4	-0.7	-1.5
Manufacturing PMI (<i>value</i>)	48.5	53.2	53.7	54.4	54.8	52.8	51.7	51.3	...
Construction									
Building permits (<i>cumulative over 12 months</i>)	-36.3	-7.7	4.0	12.1	17.0	19.6	21.0	...	...
House sales (<i>cumulative over 12 months</i>)	0.4	-5.6	0.3	8.9	10.2	12.2	12.9	...	...
Services									
Foreign tourists (<i>cumulative over 12 months</i>)	3.2	7.2	7.5	6.6	5.9	4.9	4.2	4.4	...
Services PMI (<i>value</i>)	48.3	55.2	54.3	56.7	58.3	58.1	55.1	55.9	...
Consumption									
Retail sales	-3.7	1.0	2.8	2.5	2.9	3.3	3.9	5.4	...
Car registrations	5.6	18.4	21.7	31.4	13.6	23.1	22.5	5.2	...
Consumer confidence index (<i>value</i>)	-25.3	-8.9	-9.6	-0.6	1.6	-1.3	-2.6	-1.2	0.6

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

Employment indicators

	2013	2014	2014 Q4	2015 Q1	2015 Q2	2015 Q3	08/15	09/15	10/15
Registered as employed with Social Security¹									
Employment by industry sector									
Manufacturing	-4.3	0.1	0.9	1.5	2.2	2.4	2.4	2.4	2.6
Construction	-12.1	-1.6	1.6	4.6	5.6	4.6	4.5	4.5	4.3
Services	-2.0	2.2	2.8	3.5	3.7	3.5	3.4	3.4	3.4
Employment by professional status									
Employees	-3.8	1.4	2.3	3.0	3.8	3.6	3.5	3.5	3.6
Self-employed and others	-0.6	2.2	2.5	2.4	2.2	1.7	1.7	1.6	1.5
TOTAL	-3.2	1.6	2.3	2.9	3.5	3.3	3.2	3.2	3.2
Employment²	-2.8	1.2	2.5	3.0	3.0	3.1	3.1	-	-
Hiring contracts registered³									
Permanent	-14.2	18.8	23.0	24.1	7.7	9.7	10.1	10.4	1.9
Temporary	6.4	13.1	7.7	12.2	11.2	9.7	10.0	9.8	3.6
TOTAL	4.0	13.4	8.8	13.2	10.9	9.7	10.0	9.9	3.4
Unemployment claimant count³									
Under 25	-6.2	-8.2	-6.9	-9.8	-9.3	-13.4	-13.4	-12.4	-11.3
All aged 25 and over	3.7	-5.3	-5.7	-6.1	-7.4	-7.7	-7.6	-7.5	-7.4
TOTAL	2.7	-5.6	-5.8	-6.5	-7.6	-8.2	-8.1	-8.0	-7.7

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

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

Prices

	2013	2014	2014 Q4	2015 Q1	2015 Q2	2015 Q3	09/15	10/15	11/15
General	1.4	-0.1	-0.5	-1.0	-0.3	-0.4	-0.9	-0.7	-0.3
Core	1.5	0.0	0.0	0.2	0.5	0.8	0.8	0.9	...
Unprocessed foods	3.6	-1.2	0.8	0.3	1.9	2.3	2.6	2.7	...
Energy products	0.1	-0.8	-4.3	-9.7	-6.4	-9.7	-13.6	-13.1	...

Source: CaixaBank 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	2015 Q1	2015 Q2	2015 Q3	08/15	09/15
Trade of goods											
Exports (year-on-year change)	5.2	2.5	3.2	-2.0	4.8	4.3	4.4	5.4	3.4	-0.8	1.1
Imports (year-on-year change)	-1.3	5.7	7.0	3.7	7.3	5.0	2.5	5.8	3.3	1.5	1.8
Current balance	15.6	10.2	14.2	8.2	7.5	10.2	12.1	15.0	16.3	15.8	16.3
Goods and services	33.5	26.0	30.9	26.9	25.6	26.0	27.4	27.6	27.6	27.9	27.6
Primary and secondary income	-17.9	-15.7	-16.7	-18.7	-18.1	-15.7	-15.3	-12.6	-11.3	-12.1	-11.3
Net lending (+) / borrowing (-) capacity	22.3	14.7	21.4	14.7	13.4	14.7	15.6	19.1	22.1	21.1	22.1

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

Public sector

Percentage GDP, cumulative in the year, unless otherwise specified

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	09/15	10/15
Net lending (+) / borrowing (-) capacity	-6.9	-5.9	-0.6	-3.4	-3.7	-5.9	-0.7	-2.9	...	...	...
Central government ¹	-4.9	-3.9	-0.9	-2.6	-3.1	-3.9	-1.0	-2.1	-2.4	-2.4	-2.2
Autonomous regions	-1.6	-1.7	-0.3	-1.0	-1.0	-1.7	-0.2	-0.9	-1.0	-1.0	...
Local government	0.6	0.6	0.1	0.1	0.4	0.6	0.1	0.2	...	...	...
Social Security	-1.1	-1.0	0.3	-0.1	0.0	-1.1	0.3	-0.4	-0.3	-0.3	...
Public debt (% GDP)	93.8	99.4	96.7	98.2	98.6	99.4	99.8	99.5	...	...	...

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

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

Financing and deposits of non-financial sectors

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

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	08/15	09/15	Balance 09/15 ¹
Financing of non-financial sectors²												
Private sector	-7.5	-6.2	-7.0	-6.2	-5.7	-5.9	-4.8	-4.2	-4.2	-4.4	-4.2	1,654.8
Non-financial firms	-9.3	-7.0	-8.1	-7.0	-6.2	-6.9	-5.4	-4.6	-4.7	-5.1	-4.6	926.2
Households ³	-5.0	-5.1	-5.6	-5.2	-5.0	-4.6	-4.1	-3.7	-3.6	-3.5	-3.7	728.6
General government ⁴	16.8	6.9	8.6	6.6	5.9	6.7	5.1	4.2	3.9	4.0	4.1	1,062.5
TOTAL	-0.5	-1.8	-2.0	-1.9	-1.7	-1.5	-1.2	-1.1	-1.2	-1.3	-1.1	2,717.3
Liabilities of financial institutions due to firms and households												
Total deposits	2.1	-0.9	0.1	-0.8	-1.2	-1.7	-1.3	-1.2	-1.1	-1.4	-1.1	1,156.7
On demand deposits	4.2	10.8	7.4	7.4	13.6	14.8	17.9	19.5	18.8	17.4	19.2	373.2
Savings deposits	-0.1	5.8	3.8	5.9	6.9	6.8	10.5	12.3	13.7	13.1	14.4	245.2
Term deposits	1.7	-7.6	-3.6	-6.1	-9.4	-11.3	-13.5	-15.5	-16.3	-15.9	-16.8	516.5
Deposits in foreign currency	16.8	1.1	-1.1	0.1	0.3	5.2	8.9	10.5	5.1	5.0	4.4	21.8
Rest of liabilities ⁵	-16.8	-8.2	-11.1	-8.3	-6.8	-6.8	-11.4	-11.5	-14.0	-16.3	-9.6	103.9
TOTAL	-0.2	-1.7	-1.1	-1.6	-1.7	-2.2	-2.3	-2.2	-2.3	-2.7	-1.8	1,260.6
NPL ratio (%)⁶	13.6	12.5	13.4	13.1	13.0	12.5	12.1	11.0	10.7	10.9	10.7	-
Coverage ratio (%)⁶	58.0	58.1	58.6	59.4	59.1	58.1	58.5	60.0	60.6	60.5	60.6	-

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

Source: CaixaBank Research, based on data from the Bank of Spain.

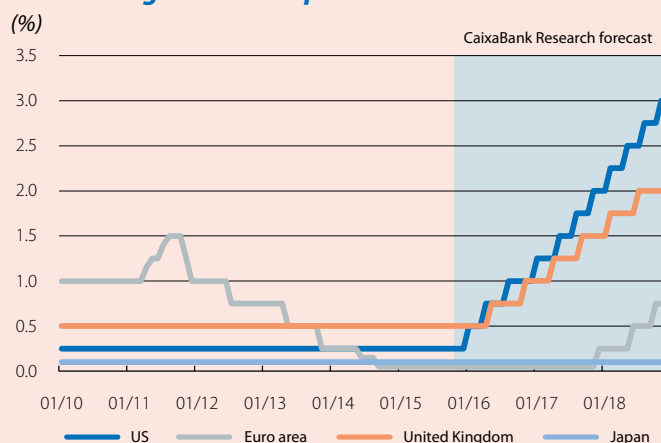
OUTLOOK 2016

Political challenges on the horizon for the advanced countries

In 2015 there was a change around in the economic cycle between the advanced and emerging economies: growth speeded up considerably in the former but slowed down in the latter. In 2016 growth in the developed economies will consolidate and reach 2.2% (compared with 2.0% in 2015) while totalling 4.5% in the emerging economies (compared with 4.0% in 2015). The United States and United Kingdom are already in a phase of consolidated growth with expected rates of 2.5% and 2.3% in 2016, respectively, but the euro area and Japan are still lagging behind a little: the euro area's recovery is going according to plan, moderate but sustained, and GDP is expected to grow by 1.8% in 2016 while Japan, whose activity is advancing more slowly, will grow by 1.0% in 2016. These are positive economic prospects for the advanced countries as a whole, moreover within a context of low inflation that provides the leeway for monetary policy to remain expansionary in general. However, we must not forget there are significant risks on the horizon with a strong political component. Let us analyse them in more detail.

Firstly, the different position of advanced countries in the economic cycle will lead to monetary divergence with significant effects both for their own economies and also globally. In the United States, the start of interest rate hikes by the Federal Reserve (Fed) will represent an important step in normalising its monetary policy, beginning in 2013 with the institution reducing its level of asset purchases (tapering). The pace and size of these hikes will depend on the US economy's resilience and particularly the trend in its labour market over the coming year but, for the time being, activity is advancing apace and the unemployment rate fell to 5.0% in October, coming close to its equilibrium level, although wage increases and general inflation are still contained and labour participation is still weak. The United Kingdom should also start normalising its monetary policy in 2016 given its economic recovery, with interest rate hikes that could be slower and more gradual than on previous occasions. The governor of the Bank of England (BoE) has warned, however, that this increase might be delayed a few months due to increasing global economic risks and low inflation. Both central banks appear to be concerned about the impact of their hikes not only on their own economies (now in an expansionary phase) but also on other countries and on global financial stability.

Trend in official interest rates in the US, euro area, United Kingdom and Japan



Note: Including forecasts up to 2018.

Source: CaixaBank Research.

While these two economies will start to normalise their monetary policy in 2016, the euro area and Japan will continue with their accommodative policy and may even intensify it. The ECB will keep its reference rates close to zero and has announced that it might even expand its quantitative easing programme if deemed necessary (see the Focus «Quantitative Easing: the ECB is going shopping»). In Japan the central bank might also accelerate its already high rate¹ of asset purchases in order to put an end to deflation and increase nominal GDP.

This monetary divergence between Anglo-Saxon and European-Japanese policies will continue to affect exchange rates, resulting in appreciation for the currencies of those countries normalising their monetary policy (and depreciation for the currencies of those which are not), and will have repercussions in the financial markets (for more details see the Dossier «2016: challenges and opportunities in a demanding global financial environment»). It will also lead to changes in capital flows between countries including the emerging economies, which in the last few years had benefitted from expansionary policies via an increase in demand and significant capital inflows.

The aim of the accommodative and unconventional monetary policies implemented over the last few years of crisis has been bring to a definite end the problems of high unemployment and low inflation after the Great Recession. However, the short-term gains such policies may provide can become long-term costs, with the resulting excessive liquidity and the rise in global

1. In the last 12 months, up to September, the Bank of Japan has bought assets totalling 80 trillion yen, the equivalent of 16% of its GDP (at its peak, the Fed's asset purchase programme represented 6.5% of US GDP).

indebtedness of particular concern. Excessive liquidity has obviously helped to push up the price of some assets: in the US the S&P index has gained more than 100% since 2009 while real estate prices have risen considerably in the United Kingdom, the Netherlands and Sweden. Private debt (one of the initial causes of the crisis) has also continued to grow as a consequence of these monetary policies, perhaps encouraging investors to take on too much risk.

Interest rate hikes in the advanced countries must begin when there are signs that the recovery is starting to firm up, especially as we know that the impact of such policies takes several quarters to be felt. In any case the central banks will take into account the movements made of the rest of the central banks to adjust their policies. Monetary policies are so interrelated that, in relative terms, the ECB's expansionary policy would be comparatively less expansionary if normalisation by the Fed or BoE were delayed. We should remember that monetary policy has been taken to its limit and that, if growth does not consolidate, particularly in the euro area countries and Japan, it is unlikely to be able to make any further contribution. The alternatives are not very encouraging, however. Fiscal policy does not have much leeway in those euro area countries that might need it. Nor in Japan which, in short, has a high deficit and high levels of public debt. On the other hand significant progress must also be made in creating the single European market. Although important advances have been made, in particular in constructing banking union, important reforms are still pending, as indicated by the «Five Presidents' Report» in 2015. For its part Japan must make headway with structural reforms for its economy, the highly incomplete third pillar of Abenomics; reforms which would also have more long-term effects.

Apart from these challenges related to economic policy, the advanced countries will also need to tackle critical political risks in 2016, both internally and externally. The US is facing the end of President Obama's mandate, whose agenda has accelerated on several fronts. It is particularly important to complete commercial treaties such as TIPP and TPP² to boost world trade at a time when this might slow down. Also important is the renewal of diplomatic and commercial relations with Cuba, as well as closing an agreement with Iran to put an end to trade restrictions, especially Iranian exports of energy goods.

For its part the European Union will first of all have to manage a serious humanitarian crisis in 2016: according to UNHCR, the number of refugees entering Europe could exceed one million, in addition to a similar number entering in 2015. In the short term this migration will entail a rise in public expenditure although, as refugees integrate, it will increase the labour force. The European Commission has tentatively estimated that this could increase the level of GDP by 0.2 or 0.3 pps in the next two years. The challenge will be to manage the arrival of refugees given the already battered relations between countries in the European Union that are more or less against taking them in. Nevertheless, successfully integrating these refugees is crucial for the continent's political stability and to ensure they can contribute to the euro area's economic growth in the long term.

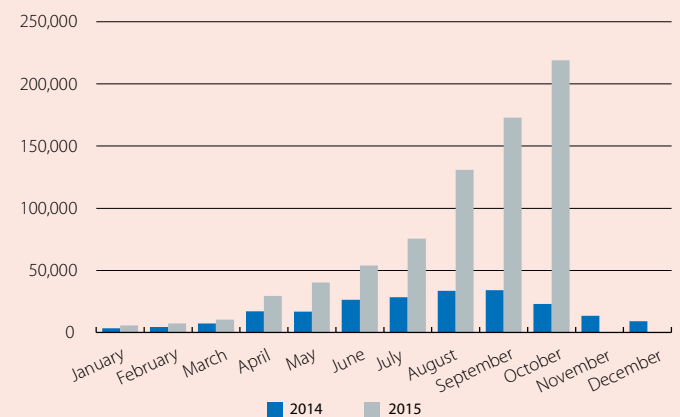
Other political risks are also present in this context, such as the fragmentation of public treasuries in several countries, including Spain, the rise of populist parties (anti-euro and anti-immigration) and the referendum on the United Kingdom staying in the European Union, which could lead to «Brexit». Given this situation, it will be complicated to advance in constructing economic union in the euro area. Externally, there are additional risks for the advanced economies caused by the slowdown in emerging countries (see the Dossier article «Outlook and doubts for the emerging economies») and, more acutely, geopolitical conflicts (Ukraine, Middle East) and terrorism, other volatile sources of instability with serious consequences.

As we have seen, the risks faced by the advanced countries in 2016 will be critical and varied. Firstly, they will be related to monetary policy and the consequences of growing monetary divergence among advanced economies. But secondly, and importantly, we will also be facing risks associated with political challenges, both internal and external, that are bound to be difficult to handle. However you look at it, 2016 will not be a quiet year.

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Sea arrivals of immigrants to Europe

Monthly figure



Note: Sea arrivals include both refugees and other types of immigrants, although most are from areas of conflict such as Syria (53%), Afghanistan (18%) and Iraq (6%).

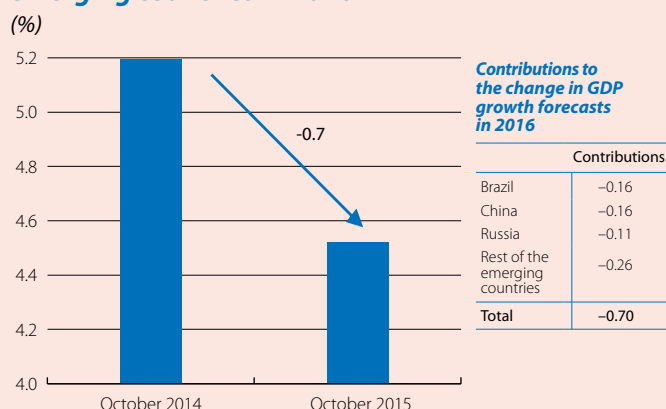
Source: CaixaBank Research, based on data from UNHCR.

2. TIPP: Transatlantic Trade and Investment Partnership; TPP: Trans-Pacific Partnership.

Outlook and doubts for the emerging economies

Growth will speed up in the emerging bloc in 2016 and, what is more, will do so from already considerable levels. But the emerging bloc will grow less than forecast a few months ago, because it will have to handle a threefold shock: China's slowdown (the largest emerging economy of all), low commodity prices and tougher financial conditions due to the start of the US interest rate hike. Many of the emerging countries are confronting these shocks from a healthier position than a few years ago and with a larger number of macroeconomic tools available to tackle them so it is unlikely that the bloc as a whole will enter a phase of widespread turbulence but we cannot rule out some temporary setbacks which, if they occur in large economies, could be noticed beyond their own borders.

GDP growth forecasts for the emerging countries in 2016 *



Note: * Forecasts from October 2014 and October 2015. GDP measured in purchasing power parity has been used to calculate the aggregate figure for all emerging and less developed countries. Specifically, China accounts for 30%, Russia 5.3% and Brazil 5.0%.

Source: CaixaBank Research, based on IMF data (WEO).

In general, growth prospects for the emerging bloc in 2016 are positive. On aggregate it will go from growing 4.0% GDP in 2015 to 4.5% in 2016:¹ a considerable advance but less than had been estimated at the end of 2014 (namely 5.2%).² This is a cut of no less than 0.7 pps which is precisely the consequence of the aforementioned shocks. Although the deterioration in all the emerging economies' growth prospects for 2016 has been quite widespread, three of them lie behind a large proportion of the region's worsening outlook: Brazil, Russia and China (see the first graph). Three large emerging economies with three different stories.

The case of Brazil is certainly one of the most worrying.³ Its growth prospects for 2016 have gone from +2.2% to -1.0% in just under a year, reducing growth for the emerging bloc as a whole by 0.16 pps as the country represents a 5% share of the total. Latin America's largest economy has entered recession due to the combined effect of weak exports and falling

domestic demand. The shock provided by commodities and China's slowdown lie behind these trends as Brazil is a large exporter of minerals and foods (representing almost 50% of all its exports) and their main destination is precisely the Asian giant. The likelihood of a tougher international financial environment due to the Fed's imminent interest rate hike could also hit the country hard: Brazil's corporate debt has multiplied by 12 since 2007. The government is also facing political difficulties in carrying out far-reaching reforms, including the fiscal adjustment announced for 2016 and improving macroeconomic imbalances, both internal (inflation stood at 9.9% in October) and external (the external deficit stood at 4.3% of GDP in 2015 Q2).

Russia is another emerging economy in full recession and this situation will continue in the coming year. Like Brazil, Russia's growth prospects have worsened over time: for the whole of 2016 they have gone from +1.5% in October 2014 to -0.6% in October 2015, subtracting 0.11 pps from the growth of the emerging group. Undoubtedly the drop in oil prices has been a fundamental factor in the country's recession, whose public revenue and exports are excessively dependent on the energy sector. There is also the country's entrenched geopolitical tension with Ukraine and sanctions by the US and EU following Russia's military intervention. Nevertheless, in spite of the recessionary panorama predicted for Russia in 2016 it is true that the rouble's strong depreciation (one of the largest drops among the emerging currencies in the last 12 months) has helped to temper the weakening in the fiscal and external areas. The currency's greater flexibility, implemented at the end of 2014, has managed to absorb part of the energy shock affecting the country. The latest activity figures also seem to suggest that its economic decline is slowing down: GDP fell by 4.1% year-on-year in Q3, less than the -4.6% in the previous quarter.

Lastly, China's worsening outlook has deducted 0.16 pps from growth for the emerging bloc as a whole, although the case of the Asian giant is very different from that of Russia or Brazil. Firstly, China is still expected to grow significantly in 2016 (+6.3% compared with +6.8% a year ago). Secondly, the shocks facing the Chinese economy are mostly domestic and come as no surprise. Specifically, the waning investor-exporter pattern of growth and the need to shift towards an economic model in

1. According to IMF estimates for all emerging and less developed countries.

2. Comparison of the IMF estimates in its World Economic Outlook in October 2014 and October 2015.

3. See the Focus «Brazil awakens the spectre of financial contagion in Latin America» and «Brazil in recession, contagion to Latin America?» in MR11/2015.

which consumption and services play a more important role. Lastly, the country has a wide range of economic policy tools and buffers to tackle any potential surprises (more than in the past and than the other emerging economies). In particular there is margin for greater expansionary measures on the fiscal and monetary front, the country's international reserves are still slightly above 30% of its GDP in spite of the recent drop, it has a considerable current account surplus and its exchange rate is more flexible today than a year ago. Nonetheless, in spite of the country's considerable tools to tackle potential adversities, these are also greater than a few years ago. By way of example, in just seven years corporate, household and public debt has increased by more than 100 points of GDP (from 158% to 283% of GDP).

Turkey, Mexico and especially India are the other large emerging economies whose economic growth prospects have also changed over the last few months: worse for the first two countries (from 3.7% to 2.9% for Turkey and from 3.8% to 2.8% for Mexico) and better for the third (from 6.5% to 7.5%). Turkey and Mexico may have suffered a similar decline but their problems and buffers are different. Certainly both countries will be helped by the good growth prospects of the two largest advanced economies, the euro area and US, respectively. However, Turkey must tackle the threefold emerging shock in a much less favourable context than Mexico: with inflationary tensions (inflation reached 7.6% in October), a considerable current account deficit (6% of GDP in 2015 Q2), high corporate debt in foreign currency (close to 50%)⁴ and numerous unresolved geopolitical conflicts (Turkish Kurdistan, Syria and the management of refugees, among others).⁵ On the other hand Mexico's inflation stood at 2.5% in October and its external deficit was 2% of GDP. But, like Turkey, Latin America's second economy is suffering from heavy corporate borrowing in foreign currency and its buffer of reserves, although much larger than both countries had at the end of the 1990s, is still far from the level enjoyed by most of the emerging economies in South East Asia (see the second graph).

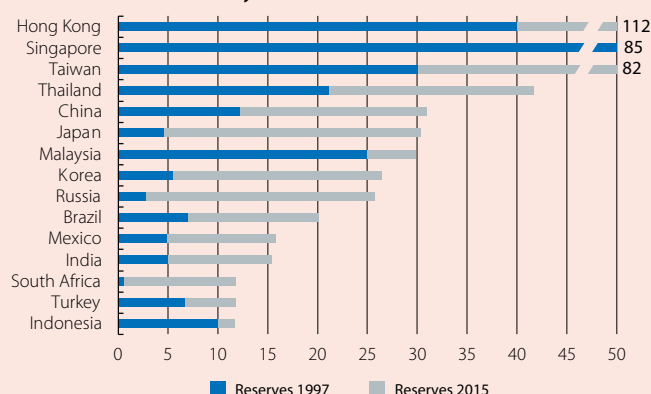
India is different from all the previous cases as its economic growth prospects have improved since October 2014. However, one very important point should be made regarding this improvement: India corrected its historical series of GDP for 2012-2014, revising growth upwards by 1.5 pps, which has naturally led to an upward revision of all GDP estimates produced for the country. This change in growth prospects for 2016 is far from merely technical, however, as it shows that the Indian economy has grown and will grow more than estimated in the past, which is always good news, even more so when China is slowing down and India is the only comparable economy in terms of size. The country's macroeconomic context has also improved recently, which will help the growth forecasts to be met: inflation stood at 5.0% in October (compared with 10.7% in 2013), the current account deficit fell to 1.2% of GDP (from 2.5% in 2013) and the fiscal deficit was better than expected in the period between April and August (3.7% of GDP compared with the forecast of 5.5%).

In conclusion, the outlook for growth in the emerging countries is clearly favourable although they will be the focus of attention and concern in 2016 due to the considerable risks represented by China's slowdown, falling prices for numerous commodities and the likelihood of tougher financial conditions. These circumstances could cause more than one emerging economy to catch a cold and it might pass this on to its near neighbours, although such an ailment is unlikely to turn into a systemic malady.

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Trend in the international reserves of the main emerging countries *

% of GDP of each country



Note: * Gold reserves are included for some countries.

Source: CaixaBank Research, based on data from the IMF, central banks and Thomson Reuters Datastream.

4. See IMF (October 2015), «Global Financial Stability Report: Vulnerabilities, Legacies and Policy Challenges. Risks Rotating to Emerging Markets».

5. See the Focus «Is Turkey still a fragile emerging economy?» in this *Monthly Report*.

2016: challenges and opportunities in a demanding global financial environment

The divergence between the monetary policy applied by the US on the one hand and by the euro area and Japan on the other will undoubtedly be a very important factor for developments in the financial markets in 2016. The speed adopted by the cycle of interest rate hikes in the US will be particularly important, although we expect this to be slow. A second, highly influential factor for the coming year will be how China's economy performs. Attention will mainly focus on the Chinese government's ability to handle the economic slowdown and transition. Given these factors, the outlook for financial assets in the advanced world (stock and bond markets) is reasonably positive for the coming year. The acceleration in world growth, which we expect to reach 3.6% in 2016, and the continuation of large amounts of liquidity globally will provide a considerable boost. Nevertheless, the high prices of many financial assets suggest the expected rates of return over the next 12 months will be significantly lower than those recorded in the last five years, both for risky assets and particularly for sovereign bonds.

Thanks to highly accommodative monetary conditions, financial asset prices have enjoyed a favourable environment over the last few years but in 2016 this pattern will probably be tempered by investors' growing focus on underlying macroeconomic fundamentals (growth and inflation) as drivers of financial asset prices and considerations such as companies' ability to generate earnings will become more important. It is therefore useful to determine just how high these international financial assets have risen.

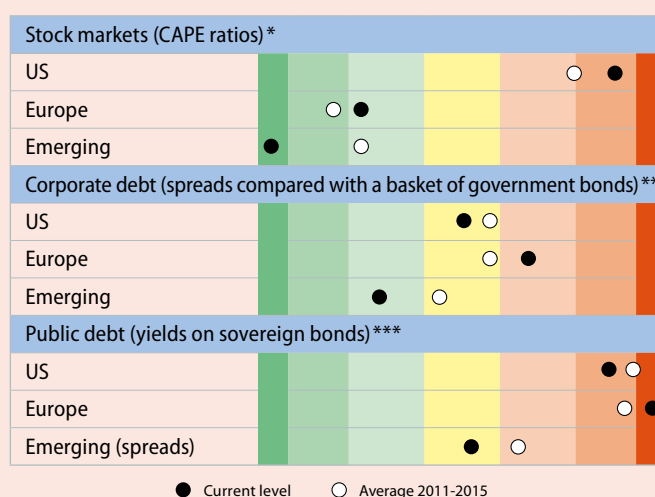
A preliminary diagnosis allows us to draw three conclusions. Firstly, prices in the stock and corporate bond markets in the advanced bloc are still within the higher range of their respective historical series, especially in the US and this will tend to limit the expected rates of return for both types of assets over the coming quarters. The outlook for stock and corporate bond markets in the euro area is more encouraging thanks to less inflated valuation ratios than in the US and the fact that the region is still in the early stages of its economic cycle. The key factors supporting the recovery in earnings in the euro area should be the euro's depreciation, which we expect to continue in 2016 although not as sharply as in 2015, continued low energy prices and highly favourable financing conditions thanks to the continuation of the ECB's bond buying programme.

The second conclusion is related to the high asset prices (and resulting low expected rates of return) dominating the whole spectrum of public debt in advanced countries. In fact, these valuations have been distorted by successive sovereign bond buying programmes (QE) adopted by the world's main central banks over the last few years. In the US the imminent start of the cycle of interest rate hikes will help to gradually normalise prices in the Treasuries market while, in the euro area and Japan, nominal interest rates will remain very low. However, towards the end of 2016 investors are very likely to believe that asset purchases in the euro area are coming to an end, resulting in a gentle upward trend in the region's sovereign yields. According to the forecasts of CaixaBank Research, the yield on 2-year US bonds is expected to increase by about 100 bps next year, in contrast to the 30 bps rise expected for 2-year German bonds, up to 1.85% and 0.0% respectively.

An analysis of the emerging countries provides us with our third conclusion. Unlike the situation in the advanced markets, prices in the emerging stock and corporate bond markets have remained very depressed, dropping to levels only seen during periods of great uncertainty such as the Asian financial crisis in 1997 and the Great Recession in 2008. Undoubtedly the tightening up of external financial conditions for most emerging economies, plummeting commodity prices and internal imbalances yet to be corrected by some emerging countries pose considerable challenges. However, we believe that the balance of risks for the

Valuations of international financial assets

(In percentiles of the historical distribution for each series: red/green indicates over-buying/over-selling)



Notes: * Historical series since 1945 for the US, 1982 for Europe and 1997 for emerging countries.

** Historical series of the spreads of speculative-grade debt since 1998 for the US, Europe and emerging countries. BofAML corporate bond indices.

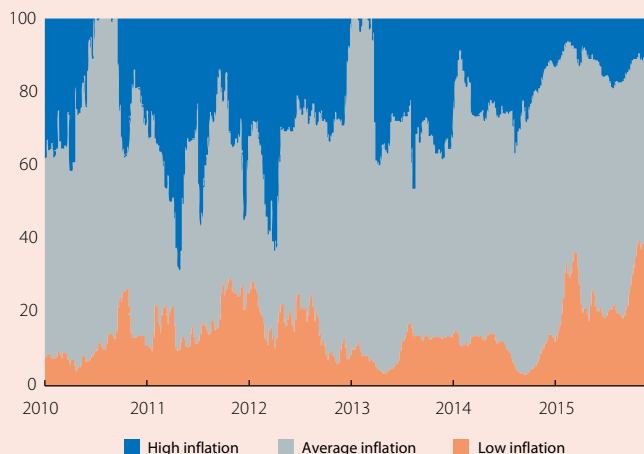
*** For the US and Europe, historical series since 1986 of BofAML government bond indices. For emerging countries, historical series since 1998 of the spreads of the EMBI Global Diversified index by J. P. Morgan.

Source: CaixaBank Research, based on data from Bloomberg, BofAML and J. P. Morgan.

emerging bloc can be handled (see the article «Outlook and doubts for the emerging economies» in this Dossier for further discussion). For this reason, the macroeconomic situation we expect for this heterogeneous group of countries in the coming years is generally positive and we therefore predict a relatively favourable outlook for emerging financial assets and their currencies. However, the extent to which this scenario will come about will vary and depend on international investors gradually recovering their confidence, something which will surely become more evident in the second half of 2016.

The constructive panorama for international markets in 2016 is not without risk. One initial source of uncertainty comes from how successfully the Fed will be able to manoeuvre the normalisation of interest rates. Several issues could cause problems: for example, the appearance of a negative shock that interrupts the expansionary phase of the US economy, a potential delay, caused by the country's political situation in an electoral year, in the Fed's plans to toughen up monetary conditions, or a communication strategy by the central bank that is vague or erratic. Although unlikely, the effects of such events could be potentially disruptive for global financial markets. Should a negative shock occur in the US economy, long-term sovereign yields would plummet while, in the last two cases, they would increase. A second potential source of instability comes from the risk associated with a change in expectations of a deflationary environment being maintained for a long time (see the graph). The tiny inflation risk premium shown by the US bond market could reverse its downward trend abruptly should US price and wage indicators post surprisingly high figures. This would lead to an upswing in Treasury yields while the impact on stock markets would be less adverse a priori. Should this risk come about, there would be a marked deterioration in the emerging financial environment as capital outflows would probably increase and emerging currencies depreciate.

US: inflation expectations at five years *
(%)



Note: * Options-implied inflation probability.

Source: CaixaBank Research, based on data from Goldman Sachs Global Investment Research.

Lastly, China represents another source of financial risk for the coming year. Should the slowdown in the Chinese economy become more pronounced (the so-called hard landing), this would initially lead to sharp increases in global risk aversion, substantial declines in higher risk markets and investors turning to safer assets. At the same time the growth prospects of the emerging economies would be particularly hard hit which, in turn, would make the emerging markets unstable. Nonetheless we believe that this risk scenario is unlikely given that the Chinese authorities would not hesitate to increase the scope of their monetary stimuli to put a stop to such tail risks.

In short, the trend in the international financial environment in 2016 will be characterised by risky assets outperforming sovereign debt in the advanced countries as well as lower yields than in preceding years for both types of assets. Although we do not expect the doubts hovering over the global environment to upset the positive scenario predicted, deteriorating liquidity in a large number of markets will amplify any risk-off episodes that are likely to occur in 2016. Caution will therefore be a valuable companion on our journey throughout the coming year.

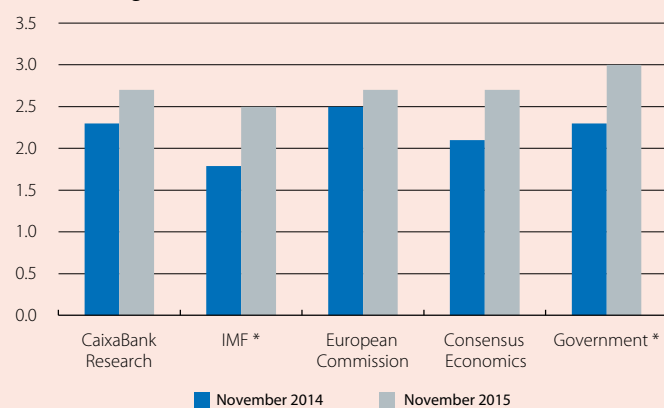
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The recovery in Spain: a qualitative step forward

The outlook for 2016 is favourable for the Spanish economy. The projections of most international organisations place Spain at the head of the larger European countries with GDP growth forecasts ranging between the IMF's 2.5% and the government's 3.0%. Our forecast of 2.7% is based on domestic demand continuing to drive growth although losing some of its strength, with foreign demand starting to contribute positively to growth. Although this growth figure is somewhat lower than the one expected for 2015, 3.1% according to our forecasts, we must remember that temporary supports such as low oil prices have been decisive in achieving the current rate of growth. In 2016, as the impact of these supports diminishes, the speed of growth is likely to moderate. However, the underlying factors supporting more balanced growth in the long term will gradually come to the fore. After a year which has undoubtedly been exceptional both in terms of growth and also for job creation, we predict that 2016 will not be as brilliant in quantitative terms but will be good in qualitative terms. This article looks at those elements we expect to support the consolidation of Spain's economic growth in the coming year.

GDP growth forecasts for 2016

Annual change (%)



Note: * The IMF forecasts correspond to October every year and the government's forecast of November 2014 corresponds to the 2014-2017 Stability Plan.

Source: CaixaBank Research, based on data from the IMF, European Commission, Ministry of Finance and Consensus Economics.

One initial underlying factor that has been sustaining the economic recovery and will pick up steam in 2016 is bank credit. Demand for credit will increase as the deleveraging carried out by households and companies, which had been restricting growth in consumption and investment, is now at a very advanced stage. The private sector's debt ratios will continue to fall to more sustainable levels but this drop will be compatible with higher growth in new loans as we also expect household disposable income and corporate earnings to grow more quickly. Moreover not all agents have the same level of debt: those with credit capacity and profitable projects should be able to resort to loans to consume and invest. On the supply side banks are also in a better position to grant loans than in the past, thanks largely to the restructuring and consolidation of the industry which has helped to strengthen the solvency and liquidity of the remaining banks. The vitality of credit can be seen in the most recent data on new operations: loans to households for consumption and to companies for amounts

below 1 million euros (usually requested by SMEs) grew by 19.6% and 14.6% respectively between January and September compared with the same period in 2014, while mortgage loans, which took longer to pick up, have recently become the fastest growing segment. The ECB is also implementing more monetary stimuli which will encourage easier financing conditions.

A second factor that will boost Spain's economic performance in 2016 is the real estate sector which, after eight years of adjustment, will once again contribute positively to growth. Demand for housing has already shown clear signs of recovery during 2015 thanks to the influence of several factors including the creation of more than half a million new jobs and the positive impact this has had on household income and confidence in general, as well as better access to credit, as mentioned above. Moreover house prices grew again in 2015 after six years of contraction, which might have opened the floodgates for demand that had been postponed until the housing price adjustment had been completed. However, although investment in non-residential construction picked up in 2015, especially thanks to tenders for public works in the first half of the year, residential investment was still sluggish due to the high stock of residential properties for sale. With a view to 2016 we expect this to wake up. As this stock of residential properties is distributed very unevenly throughout Spain, a certain lack of housing can already be observed in some zones where there are most sales (see the Focus «The upswing in demand for real estate is stirring activity in construction» in MR11/2015). Consequently, residential construction will increase considerably in order to meet the growing demand in these zones, so the rate of growth of investment in residential construction will speed up from 3.5% in 2015 to 6.1% and its contribution to GDP growth will increase by just over 0.1 pps to 0.3 pps. These figures are very significant when compared with the negative contribution of 0.9 pps posted, on average, between 2008 and 2014. Given this situation we expect the trend in house prices to vary greatly between regions and temporary upward pressure can already be seen on house prices in those zones where the number of new builds are not meeting the demand. Naturally it is not advisable to return to the pattern of growth of the past but, for the time being, there are no signs that this is the case: construction is now concentrated in those regions that need housing.

In any case the improvement in the quality of economic growth will come from the structural reforms implemented over the last few years. In 2016, jobs will continue to be created at a good rate, partly thanks to the greater flexibility introduced by labour reforms although Spain's high unemployment will ensure wage rises are contained. We therefore expect the recovery in domestic demand to be supported by a larger number of people in employment and not by any significant increase in wages per worker. This will help to maintain the gains in competitiveness achieved over the last few years although it should be noted that the improvement in unit labour costs compared with Spain's trading partners cannot be taken for granted. Rather it is vital to continue implementing structural reforms to preserve the country's competitive position internationally. It is true that, in the short term, low oil prices and the euro's depreciation are helping to correct the external imbalance. With a view to 2016, while we expect oil prices to gradually recover the euro is likely to depreciate even further given the ECB's readiness to adopt greater monetary stimuli as the Fed begins its monetary normalisation. However, when the exchange rate stops helping, further reforms will be needed in both the labour and product markets to make them more efficient, focusing on innovation and training for the unemployed. In fact, given the length of time required for structural reforms to take effect, accommodative monetary policy should be seen as providing some breathing space for their implementation.

We must not forget that one of the greatest vulnerabilities of Spain's economy is its high international debt position and that, to push this down to sustainable levels, the country must continue to make gains in competitiveness and increase its current account surplus. It is also crucial for international investors to remain confident in the Spanish economy's capacity for growth in order to attract even more foreign capital and investment. In this respect one domestic risk that might affect economic activity is political uncertainty. Greater parliamentary fragmentation could make it difficult for far-reaching structural reforms to be adopted and for fiscal stability to be achieved.

However, the greatest risks facing Spain's economy come from outside its own borders. The main risk is a sharp slowdown in growth in the emerging countries although the country's economic activity seems to have managed to withstand the lower growth recorded in 2015. One good indication of this is the fact that the drop in industrial orders from outside the euro area has been more than offset by an increase in European orders. Although most of the emerging countries have a relatively balanced macroeconomic situation and enough margin for economic policy to tackle any eventualities (see the article «Outlook and doubts for the emerging economies» in this Dossier), of concern is the delicate situation faced by some of the main Latin American countries as the Spanish economy has strong connections with this region. Although commercial ties are moderate (Spain's exports of goods and services to Latin America account for around 7% of all the country's exports), direct investment is very strong. Specifically 33.3% of Spain's direct investment abroad is located in Latin America and, in 2014, the region generated 37.4% of the country's investment revenue received from the rest of the world.¹

In conclusion, in 2016 we should witness underlying factors taking over and boosting growth in the Spanish economy. The structural reforms implemented are starting to produce results but we need to continue shoring up the foundations before the next storm hits and the risks hovering over the economy are far from trivial.

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Forecasts of key variables for 2016

Annual change (%), unless otherwise specified

	2015	2016
<i>Bank credit</i>		
Households - consumption	1.5	4.6
Non-financial firms	-3.3	1.0
<i>Real estate sector</i>		
Residential investment	3.1	5.4
House prices	2.0	3.0
<i>Households</i>		
Jobs created (no.)	537,600	414,000
Gross disposable income	2.8	3.2
<i>Foreign sector</i>		
Real exports	6.1	6.6
Current account balance (% GDP)	1.9	1.7
Risk premium (bps)	121	100

Source: CaixaBank Research.

1. «Balanza de pagos y posición de inversión internacional de España», Bank of Spain, 2014.

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CAIXABANK GROUP: KEY FIGURES

As of June 30, 2015

	MILLION €
Customer funds	296,412
Receivable from customers	211,559
Profit attributable to Group (January-June 2015)	708
Market capitalisation	23,961
Customers (million)	13.8
Staff	33,157
Branches in Spain	5,345
Self-service terminals	9,724

"la Caixa" BANKING FOUNDATION COMMUNITY PROJECTS: BUDGET 2015

	MILLION €
Social	336
Science and environmental	56
Cultural	67
Educational and research	41
TOTAL BUDGET	500

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Design and production: www.cegeglobal.es

Legal Deposit: B. 21063-1988 ISSN: 1134-1920

