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ECONOMIC & FINANCIAL ENVIRONMENT

FINANCIAL MARKETS

The US credit cycle: how much should it concern us? Part II

INTERNATIONAL ECONOMY

Anatomy of the euro area slowdown: lessons from the second half of 2018

SPANISH ECONOMY

The car, a key sector facing an uncertain future

DOSSIER:

YOUTH, THE DIVINE TREASURE

Young adults in the 21st century, a different approach to life?

How have young adults changed their consumption and savings decisions?

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June 2019

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INDEX

1 EDITORIAL

3 EXECUTIVE SUMMARY

4 FORECASTS

7 FINANCIAL MARKETS

- 9 *The US credit cycle: how much should it concern us? Part II*
Ricard Murillo Gili

12 INTERNATIONAL ECONOMY

- 15 *Anatomy of the euro area slowdown: lessons from the second half of 2018*
Javier Garcia-Arenas

19 SPANISH ECONOMY

- 21 *The car, a key sector facing an uncertain future*
Jordi Singla
- 23 *Spanish labour competitiveness: a history of ups and downs*
Marc Miró i Escolà

26 PORTUGUESE ECONOMY

29 DOSSIER: YOUTH, THE DIVINE TREASURE

- 29 *Young adults in the 21st century, a different approach to life?*
Josep Mestres Domènech and Adrià Morron Salmeron
- 34 *How have young adults changed their consumption and savings decisions?*
Oriol Carreras and Marc Miró i Escolà

Policies for young adults

If there is a stage in which many of the big decisions we make throughout life are concentrated, it is young adulthood. We face decisions concerning our education and professional development; the first steps of our career; whether to leave home... finally!; whether to live with a partner, with friends or simply with flatmates; whether to have children and how many; where to live (perhaps to emigrate), and whether to buy a home or to rent. It is an intense stage of life for those going through it, and a fascinating one for economists and other scientists who study how these decisions are taken, what factors are involved, their implications at a personal and collective level, and what policies would lead to better results.

In the field of education, for example, Spain stands out for its high proportion of young adults with college education, but also for the many young people who only completed compulsory schooling. Both figures are well above the European average and, no doubt, are symptomatic of the lack of appeal in our vocational training system. A modern system of vocational training, which would combine high-quality teaching in the classroom with learning at companies, would attract many students who today abandon their training prematurely or who choose to go to university, perhaps without it being the best option for them.

In the field of labour, young adults are particularly put at risk by the duality of the labour market, which segments it into insiders and outsiders. The insiders have been in work for some time and have a permanent contract – although some are young, most are not. The outsiders, many of whom are young, are unemployed or have a temporary contract. During the financial crisis, outsiders suffered from the adjustment costs disproportionately, both in terms of unemployment and the reduction in wages, and the consequences are still being felt to this day. Solving the duality problem, for instance by making it more attractive to hire people on permanent contracts, would be a good thing for both efficiency and equity.

The precariousness of work, which translates into lower wages, a greater incidence of temporary employment and higher unemployment, tends to delay the age at which young people become independent. In Spain, over 60% of young people between the ages of 18 and 34 still live with their parents, 15 points higher than in the euro area as a whole. Becoming independent at a later age, in turn, has a direct impact on fertility rates: for every 1,000 Spanish women between 20 and 39 years of age, around 120 children are born, 60 less than in France. Changing these dynamics would also require major steps to be made in making the public pension system more sustainable.

In recent years, young people have also endured tighter conditions for gaining access to the housing market. The rise in rents and the difficulties involved in saving enough money to buy a home have been factors which, together with the precariousness of work, have contributed to delaying the age at which young people leave home. On this note, public policy should be aimed at increasing the supply of rental properties, including through the provision of public housing, which is scarce in Spain. Policies such as limiting the price of rents can be counterproductive because they tend to reduce the supply of rental housing, rather than increasing it.

Education, the labour market and housing are three broad areas in which improving public policies would have major benefits for young adults. After all, these are young people who just want a stable job in which to grow personally and professionally, to leave home and become independent as soon as possible, to raise a family and not have to devote half of what they earn to paying for a home. Can we not make it a little easier for them?

Enric Fernández
Chief Economist
31 May 2019

Chronology

MAY 2019

- 10** The US implements the tariff hike from 10% to 25% on 200 billion dollars of imports from China (previously suspended in late February). In response, China announced that it will raise tariffs on 60 billion dollars of imports from the US.
- 23-26** European Parliament elections are held.

MARCH 2019

- 7** The ECB announces a new round of targeted longer-term refinancing operations (TLTRO), due to begin in September.
- 15** The rating agency S&P improves Portugal's credit rating from BBB- to BBB.
- 21** The EU delays Brexit until 12 April 2019.

JANUARY 2019

- 15** The UK Parliament rejects the withdrawal agreement signed between the Government and the EU by 432 votes to 202.
- 25** The longest partial government shutdown in US history comes to an end after 35 days.

APRIL 2019

- 10** The EU delays Brexit until 31 October 2019.
- 28** General elections are held in Spain.

FEBRUARY 2019

- 28** The US suspends the tariff increase on imports of products from China, which was due to come into force on 1 March.

DECEMBER 2018

- 7** OPEC and its partners agree to cut crude oil production by 1.2 million barrels per day between January and June 2019.
- 13** The ECB confirms that it is bringing the net purchases of assets to an end in December 2018.
- 19** The Fed raises the official rate by 25 bps, placing it within the 2.25%-2.50% range.

Agenda

JUNE 2019

- 4** Spain: registration with Social Security and registered unemployment (May).
- 6** Governing Council of the European Central Bank meeting.
- 7** Portugal: international trade (April).
- 18** Spain: quarterly labour cost survey (Q4).
- 18-19** Federal Open Market Committee meeting.
- 20-21** European Council meeting.
- 21** Portugal: coincident indicators (May).
- 24** Spain: loans, deposits and NPL ratio (Q1 and April).
Portugal: quarterly national accounts (Q1).
- 25** Spain: balance of payments and NIIP (Q1).
Portugal: housing prices (Q1).
Portugal: balance of payments (April).
- 27** Spain: CPI flash estimate (June).
Spain: household savings rate (Q1).
Spain: state budget execution (May).
Euro area: economic sentiment index (June).
- 28** Spain: quarterly national accounts (Q1).
Spain: balance of payments (April).
Portugal: CPI flash estimate (June).

JULY 2019

- 2** Spain: registration with Social Security and registered unemployment (June).
- 4** Portugal: Portuguese banking system.
- 10** Portugal: international trade (May).
- 15** Spain: financial accounts (Q1).
- 19** Portugal: coincident indicators.
- 22** Spain: loans, deposits and NPL ratio (May).
- 25** Spain: labour force survey (Q2).
Governing Council of the European Central Bank meeting.
- 26** US: GDP (Q2).
- 29** Spain: CPI flash estimate (July).
- 30** Spain: state budget execution (June).
Portugal: employment and unemployment (June).
Euro area: economic sentiment index (July).
- 30-31** Federal Open Market Committee meeting.
- 31** Spain: GDP flash estimate (Q2).
Portugal: CPI flash estimate (July).
Euro area: GDP (Q2).

The economy keeps the rudder firm despite the dark clouds of protectionism

The global economy is sailing on relatively calm seas despite the change in expectations. In recent quarters, there has been a widespread downward revision of forecasts, of some 0.4 pps in the main economies, due to the surge in global risks such as greater geopolitical uncertainty and trade tensions. This somewhat less optimistic narrative has gradually aligned with the scenario predicted by CaixaBank Research, which anticipates a gentle slowdown of the global economy in 2019 and 2020. For the time being, however, we must not be overly pessimistic, since in the vast majority of cases the expected pace of growth is similar to the average for the past 40 years. We must also not forget that it is natural that, in a more mature phase of the cycle like the current one, growth could lose some momentum. The US and China are two economies in which a slowdown is taken for granted (although both countries have taken a break with the good data of Q1) and the key will be ensuring that they make as smooth a transition as possible.

In spite of everything, there is a risk of heavy seas due to trade tensions. There had been a notable easing off of trade tensions in recent months, with expectations of an imminent agreement between the US and China, but in the last month hostilities have come back with acrimony. In fact, following recent events, it seems unlikely that the two super-powers will reach an agreement in the short term. Both countries have introduced tariff hikes and Chinese technology giant Huawei has been added to the list of companies that require a US government license to acquire components and technology in the country. Underlying all this is a global game of thrones for geopolitical and technological domination, in a context in which China is failing to meet some of the US' demands on intellectual property. The stock markets have been affected by the spike in uncertainty and the rise in risk aversion, especially in China. In the advanced economies uncertainty is also present, but neither the Fed nor the ECB intend to tighten monetary policy in the coming months, providing a major point of support for the financial markets.

The European ship is slowly leaving tempestuous waters, but there are still waves. Despite growing above expectations in Q1, economic activity in the euro area is expected to remain at moderate levels in Q2 (slightly above 1.0% year-on-year), since the headwinds on trade and manufacturing sectors have not yet dissipated.

However, growth could regain momentum in the second half of the year. This scenario, with moderate but reasonably healthy growth, should not lead us to lower our guard, since the risks surrounding Brexit and Italy have not subsided. In the United Kingdom, Theresa May's resignation makes it very difficult to predict whether the country will be able to approve the EU withdrawal agreement before the new deadline set by Brussels (31 October). In Italy, tensions with the European Commission remain high and the possibility of new elections being called in the coming months cannot be ruled out.

Spain and Portugal continue on their course at a comfortable cruising speed. Spain is keeping up the pace and the economic indicators for the first part of Q2 suggest that growth remains dynamic, following the excellent figure for Q1 (0.7% quarter-on-quarter). Domestic demand remains the major force propelling the Spanish ship, with the only blot being the modest performance of the foreign sector, beset by trade tensions and the more moderate growth of the euro area. Of particular note is the strength of the labour market (exceeding even the most optimistic forecasts), the resilience of the tourist sector in a less favourable environment and the sustained expansion of the real estate sector. The reading is quite similar for Portugal, where the figure for Q1 confirmed everyone's high expectations, with quarter-on-quarter growth of 0.5% (1.8% year-on-year) driven by buoyant investment. Furthermore, in the Iberian economies the improvement of the labour market, in terms of both the number of people in work and wages, is also having a very favourable effect on the public accounts by providing a boost to fiscal revenues.

Average for the last month in the period, unless otherwise specified

Financial markets

	Average 2000-2007	Average 2008-2016	2017	2018	2019	2020	2021
INTEREST RATES							
Dollar							
Fed funds (upper limit)	3.43	0.48	1.50	2.50	2.50	2.50	2.25
3-month Libor	3.62	0.70	1.61	2.79	2.70	2.65	2.40
12-month Libor	3.86	1.20	2.05	3.08	2.85	2.80	2.55
2-year government bonds	3.70	0.73	1.84	2.68	2.55	2.60	2.50
10-year government bonds	4.70	2.61	2.41	2.83	2.75	2.80	2.70
Euro							
ECB depo	2.05	0.40	-0.40	-0.40	-0.40	-0.10	0.00
ECB refi	3.05	1.00	0.00	0.00	0.00	0.25	0.50
Eonia	3.12	0.65	-0.34	-0.36	-0.35	-0.10	0.15
1-month Euribor	3.18	0.79	-0.37	-0.37	-0.33	-0.08	0.18
3-month Euribor	3.24	0.98	-0.33	-0.31	-0.28	-0.05	0.20
6-month Euribor	3.29	1.14	-0.27	-0.24	-0.18	0.05	0.35
12-month Euribor	3.40	1.34	-0.19	-0.13	-0.08	0.15	0.50
Germany							
2-year government bonds	3.41	0.69	-0.69	-0.60	-0.40	-0.10	0.35
10-year government bonds	4.30	1.98	0.35	0.25	0.40	0.70	1.20
Spain							
3-year government bonds	3.62	2.30	-0.04	-0.02	0.02	0.19	0.64
5-year government bonds	3.91	2.85	0.31	0.36	0.42	0.56	1.00
10-year government bonds	4.42	3.82	1.46	1.42	1.40	1.50	1.90
Risk premium	11	184	110	117	100	80	70
Portugal							
3-year government bonds	3.68	4.42	-0.05	-0.18	-0.21	0.10	0.72
5-year government bonds	3.96	5.03	0.46	0.47	0.40	0.69	1.27
10-year government bonds	4.49	5.60	1.84	1.72	1.55	1.85	2.35
Risk premium	19	362	149	147	115	115	115
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.30	1.18	1.14	1.15	1.19	1.23
EUR/JPY (yen per euro)	129.50	126.36	133.70	127.89	125.86	126.14	130.38
USD/JPY (yen per dollar)	115.34	97.50	113.02	112.38	109.44	106.00	106.00
EUR/GBP (pounds per euro)	0.66	0.83	0.88	0.90	0.85	0.84	0.83
USD/GBP (pounds per dollar)	0.59	0.63	0.75	0.79	0.74	0.71	0.68
OIL PRICE							
Brent (\$/barrel)	42.3	85.6	64.1	57.7	70.0	66.0	63.0
Brent (euros/barrel)	36.4	64.8	54.2	50.7	60.9	55.5	51.2
Forecasts							

Percentage change versus the same period of the previous year, unless otherwise indicated

International economy

	Average 2000-2007	Average 2008-2016	2017	2018	2019	2020	2021
GDP GROWTH							
Global	4.5	3.3	3.8	3.6	3.3	3.4	3.5
Developed countries	2.7	1.2	2.4	2.2	1.9	1.7	1.6
United States	2.7	1.4	2.2	2.9	2.4	1.7	1.7
Euro area	2.3	0.4	2.5	1.8	1.3	1.5	1.4
Germany	1.6	1.1	2.5	1.5	1.0	1.6	1.6
France	2.0	0.6	2.3	1.6	1.4	1.5	1.5
Italy	1.5	-0.7	1.8	0.7	0.4	0.8	0.7
Portugal	1.5	-0.4	2.8	2.1	1.8	1.7	1.7
Spain	3.8	0.0	3.0	2.6	2.3	1.9	1.7
Japan	1.5	0.4	1.9	0.8	1.0	0.7	0.8
United Kingdom	2.8	1.0	1.8	1.4	1.5	1.5	1.5
Emerging countries	6.5	5.2	4.8	4.5	4.3	4.6	4.6
China	11.7	8.4	6.9	6.6	6.2	6.0	5.8
India	9.7	6.9	6.9	7.4	6.4	6.2	6.0
Indonesia	5.5	5.7	5.1	5.2	4.9	4.8	5.9
Brazil	3.6	1.7	1.1	1.1	1.2	1.8	2.1
Mexico	2.4	2.1	2.1	2.0	1.6	2.1	2.5
Chile	5.0	3.2	1.3	4.0	3.2	3.0	2.8
Russia	7.2	1.0	1.6	2.2	1.2	1.9	1.8
Turkey	5.4	4.8	7.3	2.9	-2.5	2.3	3.0
Poland	4.0	3.2	4.8	5.1	3.5	2.9	2.4
South Africa	4.4	1.8	1.5	0.7	1.6	1.8	2.0
INFLATION							
Global	4.2	3.8	3.2	3.6	3.5	3.5	3.4
Developed countries	2.1	1.5	1.7	2.0	1.6	1.7	1.8
United States	2.8	1.6	2.1	2.4	2.0	2.0	1.8
Euro area	2.1	1.4	1.5	1.8	1.3	1.5	1.8
Germany	1.7	1.3	1.7	1.9	1.4	1.6	1.9
France	1.8	1.2	1.2	2.1	1.3	1.5	1.8
Italy	1.9	1.5	1.3	1.2	0.8	1.3	1.6
Portugal	3.0	1.2	1.4	1.0	0.8	1.4	1.7
Spain	3.2	1.3	2.0	1.7	1.4	1.6	1.9
Japan	-0.3	0.3	0.5	1.0	0.6	1.3	1.3
United Kingdom	1.9	2.3	2.7	2.5	2.0	2.0	2.1
Emerging countries	6.8	5.8	4.3	4.8	4.8	4.6	4.5
China	1.7	2.6	1.6	2.1	2.4	2.4	2.6
India	4.5	8.5	3.3	3.9	3.7	4.9	5.1
Indonesia	8.4	5.7	3.8	3.2	2.5	2.6	2.8
Brazil	7.3	6.4	3.5	3.7	3.8	3.9	4.0
Mexico	5.2	3.9	6.0	4.9	3.9	3.7	3.5
Chile	3.1	3.5	2.2	2.7	2.2	2.8	3.1
Russia	14.2	9.3	3.7	2.9	5.0	4.2	4.0
Turkey	27.2	8.1	11.1	16.2	17.0	13.0	10.0
Poland	3.5	2.1	1.6	1.2	2.0	2.5	2.5
South Africa	5.3	6.2	5.3	4.6	4.2	5.3	5.3

Forecasts

Percentage change versus the same period of the previous year, unless otherwise indicated

Spanish economy

	Average 2000-2007	Average 2008-2016	2017	2018	2019	2020	2021
Macroeconomic aggregates							
Household consumption	3.6	-0.7	2.5	2.3	1.8	1.7	1.6
Government consumption	5.0	0.8	1.9	2.1	1.7	1.5	1.4
Gross fixed capital formation	6.0	-3.4	4.8	5.3	3.5	2.9	2.5
Capital goods	5.3	0.3	6.0	5.4	4.4	3.0	2.6
Construction	6.2	-6.1	4.6	6.2	3.6	2.9	2.5
Domestic demand (vs. GDP Δ)	4.6	-1.2	2.9	2.9	2.1	1.9	1.7
Exports of goods and services	4.8	2.7	5.2	2.3	1.1	3.7	3.6
Imports of goods and services	7.1	-1.0	5.6	3.5	0.3	4.0	3.7
Gross domestic product	3.8	0.0	3.0	2.6	2.3	1.9	1.7
Other variables							
Employment	3.4	-1.3	2.8	2.5	2.3	1.9	1.6
Unemployment rate (% of labour force)	10.5	20.8	17.2	15.3	13.4	11.8	10.6
Consumer price index	3.2	1.3	2.0	1.7	1.4	1.6	1.9
Unit labour costs	3.3	0.2	0.2	0.8	1.7	2.3	2.5
Current account balance (% GDP)	-6.0	-1.6	1.8	0.9	0.6	0.6	0.6
External funding capacity/needs (% GDP)	-5.3	-1.2	2.1	1.5	0.8	0.8	0.8
Fiscal balance (% GDP) ¹	0.4	-7.0	-3.0	-2.5	-2.3	-1.5	-1.1

Note: 1. Excludes losses for assistance provided to financial institutions.

Forecasts

Portuguese economy

	Average 2000-2007	Average 2008-2016	2017	2018	2019	2020	2021
Macroeconomic aggregates							
Household consumption	1.7	-0.2	2.3	2.5	2.0	1.8	1.7
Government consumption	2.3	-0.6	0.2	0.8	0.8	0.3	0.2
Gross fixed capital formation	-0.3	-3.5	9.2	4.4	4.0	4.0	3.8
Capital goods	1.3	0.0	13.7	6.1	5.9	5.9	5.9
Construction	-1.6	-6.3	8.3	3.1	2.5	2.5	2.5
Domestic demand (vs. GDP Δ)	1.4	-1.0	3.1	2.8	2.5	1.9	1.8
Exports of goods and services	5.2	3.5	7.8	3.7	3.8	4.0	4.6
Imports of goods and services	3.6	1.6	8.1	4.9	4.9	4.1	4.5
Gross domestic product	1.5	-0.4	2.8	2.1	1.8	1.7	1.7
Other variables							
Employment	0.4	-1.1	3.3	2.3	0.8	0.5	0.3
Unemployment rate (% of labour force)	6.1	12.2	8.9	7.0	6.5	6.2	6.0
Consumer price index	3.0	1.2	1.4	1.0	0.8	1.4	1.7
Current account balance (% GDP)	-9.4	-4.2	0.5	-0.6	-0.7	-0.5	-0.3
External funding capacity/needs (% GDP)	-7.9	-2.9	1.4	0.4	0.3	0.5	0.5
Fiscal balance (% GDP)	-4.4	-6.3	-3.0	-0.5	-0.4	-0.3	0.1

Forecasts

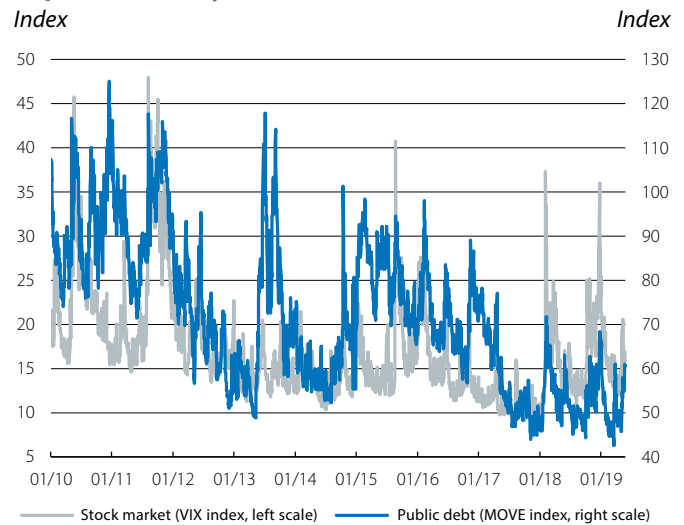
Risk aversion takes hold among investors

Trade tensions destabilise the financial markets. Breaking with the relative calm that had dominated the financial scenario during the first few months of the year, in May risk aversion took hold in the global markets. The optimism among investors seen in the previous months – supported by the trade tensions being steered in the right direction, the easing off on the tightening of monetary policy by the major central banks and favourable economic data – made an about turn when the US Administration announced a tariff hike on Chinese imports. This announcement, which surprised the market, led investors to reassess their expectations and aroused fears that the trade tensions will have a higher price in terms of economic growth. Thus, it resulted in a surge in volatility and risk aversion, which increased the preference for safe haven assets (such as US and German sovereign debt, the dollar and gold). On the other hand, in this context of greater uncertainty the central banks maintained their messages of patience, reiterated their intention not to tighten monetary policy in the near future and offered a relatively positive view of the macroeconomic environment in the medium term, noting, however, that the risks continue to be biased to the downside.

The stock market staggers. During the first four months of the year, investor optimism had resulted in substantial gains in the stock markets (+15.6% in the MSCI global index). In May, however, the tables turned. The rebound in trade tensions between the US and China, coupled with the publication of economic activity data confirming that the global economy is growing at a more moderate pace, diminished investor sentiment. Such was the importance assigned to these aspects by investors that little attention was paid to the positive surprises of the Q1 business profits season in the major economies (led by the consumption and technology sectors). Thus, in an environment of greater uncertainty and volatility, the losses were spread across the global equity markets and the S&P 500, the EuroStoxx 50 and the MSCI index for the emerging markets bloc fell by around 7%. By region, the losses were particularly significant in the Asian stock markets, and the MSCI index for emerging Asia fell by around 9%. In Latin America, meanwhile, the stock markets moved more to the sound of factors specific to the region and the MSCI index for Latin America fell by less than 2.5%.

Sovereign yields reach a low point. In the fixed income markets, the heightened risk aversion resulted in a shift in the preferences of investors, who opted for safer assets such as US and German sovereign debt. This drove down both economies' 10-year sovereign debt yields, which reached a two-year low in the case of US treasury and a three-year low in that of the bund (which once again fell into negative territory). In

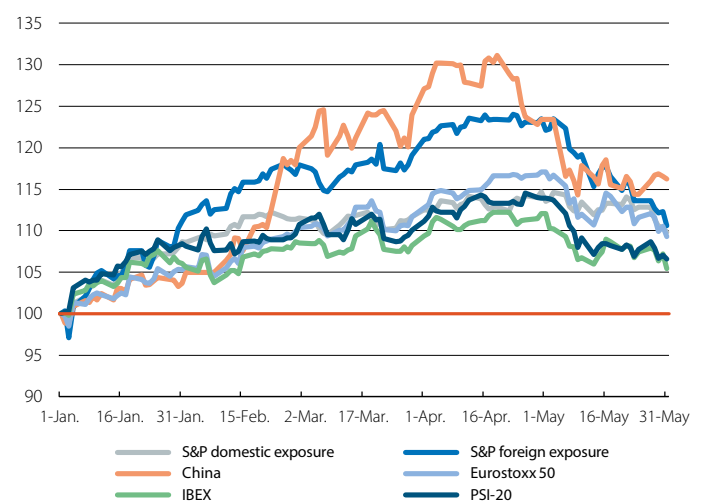
Implicit volatility in the financial markets



Source: CaixaBank Research, based on data from Bloomberg.

Main international stock markets

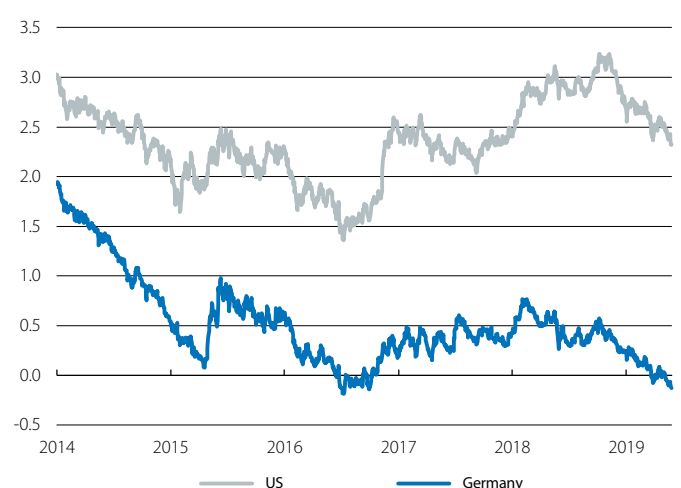
Index (100 = January 2019)



Source: CaixaBank Research, based on data from Bloomberg.

Yield on 10-year sovereign bonds

(%)



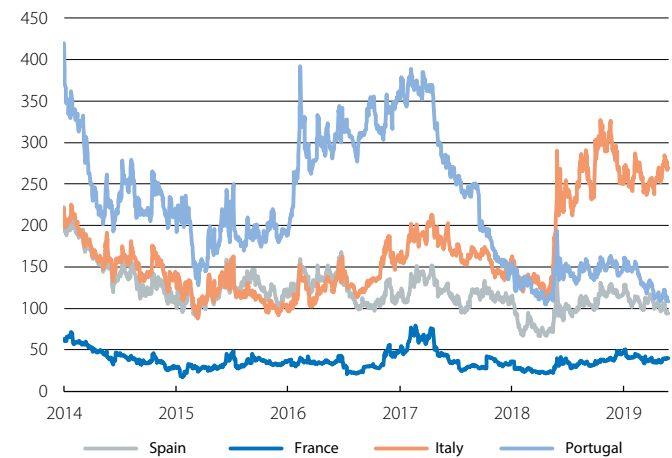
Source: CaixaBank Research, based on data from Bloomberg.

addition, the US sovereign yield curve inverted once again, with the 10-year yield falling below that of 3 months (which has traditionally been an early signal of recession, although there is reason to believe that this time may be different, as we have analysed in previous publications). On the other hand, risk premiums in Spain and Portugal reduced, albeit to a lesser extent than in April, bringing the yield on 10-year bonds to an all-time low and ending the month below 0.80% and 0.90%, respectively. In Italy, in contrast, the rise in tensions surrounding the government's fiscal policy and the contradictory statements in this regard drove the country's risk premium upwards.

The dollar remains strong and the oil price recedes. The increase in fears among investors and their preference for safer assets supported the appreciation of the US dollar against the rest of the major currencies and against the Chinese yuan in particular, in a movement that contrasted with the gradual depreciation of the dollar seen in previous months. Bucking this trend was the Japanese yen, acting as a safe haven in the financial turbulence and appreciating against the dollar, while the pound sterling weakened due to the heightened uncertainty over the future of the British Government and Brexit. In the commodity markets, the price of industrial metals, highly correlated with the business cycle, fell to levels of two years ago due to fears over the effects that the trade dispute could have on global growth. The Brent oil price, meanwhile, was more volatile than in previous months, squeezed between the upward pressures of supply factors (the sanctions imposed by the US on Iran, tensions in the Middle East and the expectation that OPEC could extend its production cuts at its meeting on 25 and 26 June) and the downward pressures of demand (related to the pessimistic shift in investor sentiment in May). In the end, it was the latter that prevailed and dragged the Brent oil price towards 65 dollars per barrel at the end of the month.

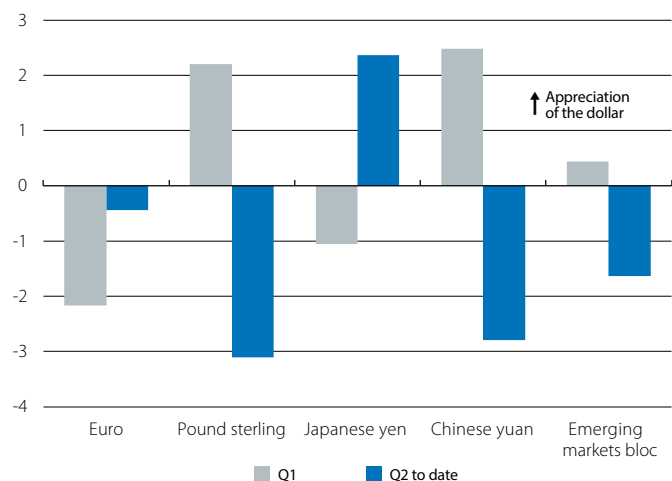
While we await their meetings in June, the central banks reiterate their messages of patience. In the face of the month's financial turbulence, members of the major central banks (which had no monetary policy meetings in May) continued to reiterate, through their various public communications, their intention not to tighten monetary policy in the coming months. Thus, as shown in the minutes of the latest meetings of the ECB (10 April) and the Fed (1 May), the major central banks remain cautious due to the presence of downside risks, although they maintain a positive view of the economic scenario in the medium term. On the other hand, both institutions point out that inflationary pressures remain moderate, which supports a patient attitude over the next few months. However, various members of the Fed argued that the factors that have held back US inflation are temporary and will fade over the next few months, while in Europe, the members of the ECB stressed that the signs of greater buoyancy in wages boost confidence in the recovery of inflation over the medium term.

Euro area: risk premiums of 10-year sovereign bonds (bps)



Source: CaixaBank Research, based on data from Bloomberg.

International currencies against the US dollar Change (%)



Source: CaixaBank Research, based on data from Bloomberg.

Commodity prices

(Dollars per barrel)

Index (100 = January 2015)



Source: CaixaBank Research, based on data from Bloomberg.

The US credit cycle: how much should it concern us? Part II

- While household debt is in a relatively comfortable position, financial vulnerabilities have arisen in corporate debt.
- In particular, we show how investors now hold debt of companies with a higher risk profile and are somewhat less protected.

The US' current expansionary phase is on course to become the longest in history and, so far, there have been no major shocks. However, over the past few years some financial imbalances have arisen, especially in the corporate sector, which could destabilise the wider economy in an adverse macroeconomic scenario.¹ We analyse these imbalances in more detail below.

Corporate debt as the main source of risk

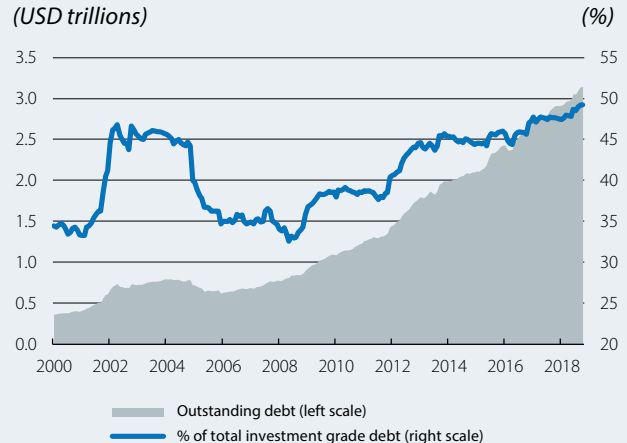
In recent years, the debt of non-financial corporations has increased significantly, reaching levels similar to those of 2007. This increase has partly been supported by growth in business profits, favoured by the tailwinds of global economic expansion, and by the environment of low interest rates, which makes the debt burden more bearable. In this regard, some institutions such as the IMF ensure that corporate balance sheets are generally in good health. However, this broadly positive view coexists with certain signs that indicate a deterioration in the quality of corporate debt and greater risk-taking in some market segments. These include: the indebtedness of companies with a poor credit profile, the decline in the use of clauses that protect the lender and the increase in debt issued by companies already highly leveraged.

There is widespread evidence of rising debt in companies with a poor credit profile. For instance, debt with a credit rating of BBB is currently at an all-time high (see first chart).² This is particularly relevant because usually, when the economy goes into recession, much of this debt sees its rating lowered and ends up classified as high yield. This forces many of its holders, such as investment funds or insurance companies, to sell it, since regulations impose limits on the volume of high yield assets they can hold in their portfolios.³

There are also indications that investors are less protected against risk than in the past. Normally, when a company issues bonds, the lenders are protected by

US: corporate debt rated BBB

(USD trillions)



Note: The category BBB includes debt with a BBB+, BBB and BBB- rating.

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

various covenants (such as the issuer's obligation to maintain debt ratios below a certain threshold or to limit what the debt can be used for). However, as the OECD and the IMF point out, the use of these covenants has declined steadily since 2002, especially in higher-risk assets (such as high yield corporate debt).⁴

Finally, of particular concern is the growing accumulation of debt among companies that are already highly indebted (known as leveraged loans), since this increases the likelihood of default. According to data from the IMF, the outstanding debt of such companies has doubled between 2007 and 2018, from 0.6 trillion dollars to 1.2 trillion. In addition, leveraged loans are usually packaged up to create new assets (known as collateralised loan obligations, or CLOs), which are then sold on the secondary market. This process of leveraged loans being securitised evokes memories of the securitisation of mortgage loans that was at the heart of the 2008 financial crisis, and it reduces the incentive for the lender to perform an exhaustive analysis of the solvency of the debt's original issuer. However, various analyses, such as those performed by the Fed, indicate that the financial structure of CLOs is stronger and that

1. For an overview of the state of the US credit cycle, see «[The US credit cycle: how much should it concern us?](#)» in the MR04/2019.

2. BBB is the lowest rating considered investment grade, which consists of companies considered to be more solvent. Assets with a credit rating below BBB are classified as high yield.

3. See A. Ellul, C. Jotikasthira and C.T. Lundblad (2011). «Regulatory Pressure and Fire Sales in the Corporate Bond Market» *Journal of Financial Economics*, 101(3), 596-620.

4. According to the index developed by the OECD, which measures the use of covenants that protect the lender, the difference in their use between high yield and investment-grade companies has reduced by half over the past 15 years. See S. Çelik, G. Demirtas and M. Isaksson (2019). «Corporate Bond Markets in a Time of Unconventional Monetary Policy», OECD Capital Markets Series, Paris.

they are not a major source of systemic risk (in fact, the CLO market performed relatively well during 2008's financial crisis).⁵

Household debt is not a source of systemic risk

On the whole, household indebtedness is a less worrying source of risk than on previous occasions. Several factors contribute to this view: on the one hand, households have significantly reduced their indebtedness compared to the levels seen during the financial crisis. On the other hand, the quality of mortgage debt – the main component of household indebtedness – has improved, as new mortgages are being granted to households that a priori are more solvent (see third chart). Whereas between 2004 and 2007 the average percentage of new mortgages granted to households with a low or very low credit score⁶ was 23%, in Q1 2019 they accounted for just 10%. Furthermore, mortgages granted to households with a higher credit score currently account for 56% of the total, compared to 25% in the years prior to the financial crisis.

The sources of risk in household debt lie within components that represent a relatively minor portion of the total, such as student loans. These have doubled in size since 2009, reaching 11% of all household debt, and they possess the highest delinquency rate of all types of household debt (10.9% in Q1 2019). However, given their relatively small size and the fact that they are guaranteed by the US Department of Education, they pose less of a risk to financial stability. Rather, they pose a potential restriction for economic growth: several voices are warning that the high levels of debt with which graduates are entering the labour market is acting as a hindrance for consumption and for young people⁷ to access housing.

In short, the vulnerabilities of private debt are mainly to be found in the corporate sector and primarily reflect a deterioration in the quality of debt and greater risk-taking. With a reasonably positive economic outlook, the US is in a position to prevent these vulnerabilities from determining the future economic scenario. However, the fear is that, if the outlook deteriorates more than expected, these vulnerabilities could destabilise the wider economy. What would be the consequences in a more adverse scenario? We shall shortly see in a new instalment of the series «The US credit cycle: how much should it concern us?».

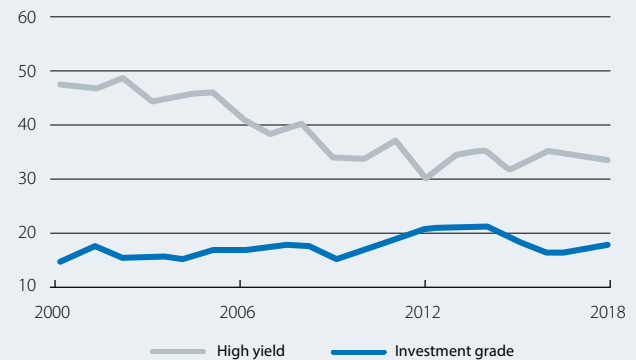
Ricard Murillo Gili

5. See R. Kaplan (2019). «Corporate Debt as a Potential Amplifier in a Slowdown». And the Fed (2019). «Vulnerabilities Associated with Elevated Business Debt», Financial Stability Report for April.

6. A credit score is an indicator used in the US to measure individuals' repayment capacity.

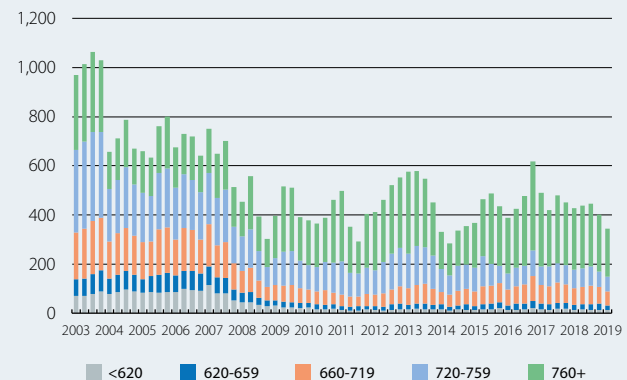
7. WC Dudley (2017), «Opening Remarks at the Economic Press Briefing on Household Borrowing, Student Debt Trends and Homeownership». Federal Reserve Bank of New York.

US: covenant protection index for bonds issued non-financial corporations (%)



Source: Çelik, S. et al. (2019). «Corporate Bond Markets in a Time of Unconventional Monetary Policy», OECD Capital Market Series, Paris.

US: new mortgage lending by credit score (USD billions)



Note: Low credit score values indicate a lower debt repayment capacity.

Source: CaixaBank Research, based on data from the Federal Reserve Bank of New York.

Interest rates (%)

	31-May	30-Apr	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	0.00	0.00	0	0.0	0.0
3-month Euribor	-0.32	-0.31	-1	-1.3	-0.1
1-year Euribor	-0.17	-0.11	-5	-5.1	1.6
1-year government bonds (Germany)	-0.62	-0.53	-9	-4.7	2.2
2-year government bonds (Germany)	-0.66	-0.58	-8	-4.9	-3.0
10-year government bonds (Germany)	-0.20	0.01	-22	-44.4	-58.8
10-year government bonds (Spain)	0.72	1.00	-29	-70.1	-72.6
10-year government bonds (Portugal)	0.81	1.12	-31	-91.2	-107.0
US					
Fed funds	2.50	2.50	0	0.0	75.0
3-month Libor	2.50	2.58	-7	-30.5	18.5
12-month Libor	2.51	2.72	-21	-49.5	-21.4
1-year government bonds	2.20	2.37	-17	-39.6	-5.7
2-year government bonds	1.92	2.27	-34	-56.6	-55.0
10-year government bonds	2.12	2.50	-38	-56.0	-77.8

Spreads corporate bonds (bps)

	31-May	30-Apr	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	71	58	13	-17.4	3.4
Itraxx Financials Senior	92	69	23	-16.7	12.8
Itraxx Subordinated Financials	187	141	46	-41.2	17.0

Exchange rates

	31-May	30-Apr	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.117	1.122	-0.4	-2.6	-4.2
EUR/JPY (yen per euro)	120.960	125.020	-3.2	-3.9	-5.3
EUR/GBP (pounds per euro)	0.884	0.860	2.8	-1.6	1.2
USD/JPY (yen per dollar)	108.290	111.420	-2.8	-1.3	-1.1

Commodities

	31-May	30-Apr	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	416.0	422.1	-1.5	1.7	-6.7
Brent (\$/barrel)	64.5	72.8	-11.4	19.9	-16.0
Gold (\$/ounce)	1,305.5	1,283.6	1.7	1.8	0.9

Equity

	31-May	30-Apr	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	2,752.1	2,945.8	-6.6	9.8	0.6
Eurostoxx 50 (euro area)	3,280.4	3,514.6	-6.7	9.3	-5.0
Ibex 35 (Spain)	9,004.2	9,570.6	-5.9	5.4	-6.5
PSI 20 (Portugal)	5,044.0	5,390.6	-6.4	6.6	-8.6
Nikkei 225 (Japan)	20,601.2	22,258.7	-7.4	2.9	-7.1
MSCI Emerging	998.0	1,079.2	-7.5	3.3	-11.7

The global expansion continues in an environment of uncertainty

The global economy is advancing at a more moderate rate.

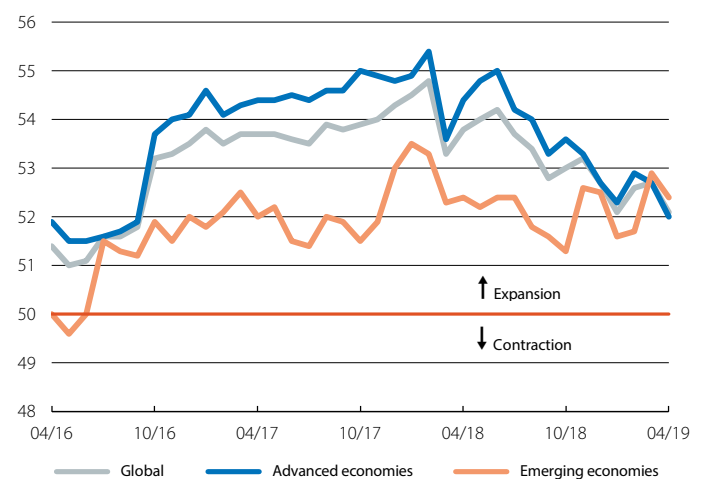
This is reflected in indicators such as the global composite Purchasing Managers' Index (PMI), which has remained slightly above 52 points for the past few months (52.1 points in April), a level below the 53.6-point average for 2018, but still safely above the 50-point threshold that separates the expansionary territory from that of contraction. Thus, indicators confirm CaixaBank Research's macroeconomic scenario, which predicts a mild slowdown in global growth (from 3.6% in 2018 to 3.3% in 2019). Part of this moderation responds to temporary restrictions in some key economies (especially in the euro area), meaning that economic activity could improve as the year progresses. Nevertheless, as the following paragraphs on this month's economic outlook point out, the current environment is demanding and major sources of uncertainty prevail.

Trade negotiations between the US and China are stuck.

In particular, just when it seemed that the US and China were close to reaching an agreement to steer their trade conflict towards a satisfactory conclusion, in May tensions raised again. On the one hand, the US announced a 10% tariff rise, bringing the rate up to 25% on Chinese imports worth 200 billion dollars, after which China responded with tariffs on 60 billion of imports from the US. Furthermore, Trump threatened to impose another round of tariffs (at 25%) on a further 300 billion of imports from China, which would cover the total value of Chinese goods imported annually by the US (see second chart). On the other hand, the escalation of tensions went beyond tariffs after the US added Huawei to the list of businesses requiring government «authorisation» to procure components and technology from the US. Without a doubt, these developments put pressure on China to strive harder to meet some of the US' demands on technology transfer and intellectual property before a trade agreement can be reached – something which today seems unlikely to happen in the immediate future. However, they also underline the risk of tensions between the two countries continuing for longer than initially expected. In addition, the US postponed its decision on tariff measures in the automotive sector until the end of the year, which would particularly affect Europe.

In Europe, pockets of political uncertainty persist. On the one hand, although the European Parliament election resulted in a greater proportion of votes for Eurosceptic parties, support for them was lower than some analysts predicted and their share of parliamentary voted failed to reach the threshold needed to have a material influence on the political and institutional course of the EU. On the other hand, in the United Kingdom, the prime minister Theresa May announced her resignation, with effect from 7 June. Following her resignation, the Conservative Party leadership contest will begin and could extend into the summer. This will add to the existing difficulties to reach a consensus strategy on Brexit in the House of Commons before the new deadline of October 31.

Economic activity indicators: composite PMI Level



Source: CaixaBank Research, based on data from Markit.

Exports of US goods to China

120 billion dollars



Chinese tariffs on imports from the US

Applied

25% on 50 billion dollars
13% (on average) on 60 billion dollars

Exports of Chinese goods to the US

540 billion dollars



US tariffs on imports from China

Applied

25% on 250 billion dollars

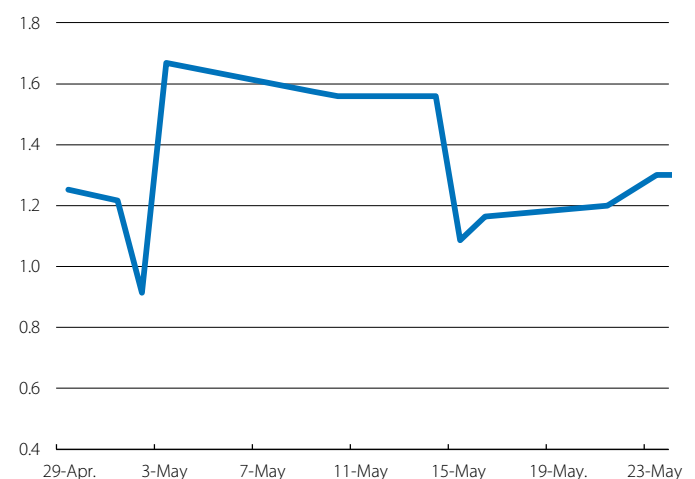
Threat

? on 300 billion dollars

Source: CaixaBank Research, based on US Foreign Trade data (data for 2018).

US: Q2 GDP estimate

Annualised quarter-on-quarter change (%)



Source: CaixaBank Research, based on the Nowcasting model of the Atlanta Fed.

US

The indicators point to a lower rate of growth in Q2. In particular, GDP Nowcasting models of the various federal reserves place growth for Q2 between 1.0% and 1.5% (in annualised quarter-on-quarter terms). This confirms that, beyond the surprise of Q1 (3.1% annualised quarter-on-quarter growth, supported by short-term factors such as inventories), the US economy is moving towards a gradual moderation in its growth rate due to the very maturity of the cycle and the fading of the fiscal stimulus. All in all, with one month to go until the end of the quarter, it is still too early to accurately assess the magnitude of the slowdown. In fact, some economic activity indicators that have been published during the month provided a positive surprise. These included the manufacturing indices for the month of May developed by the New York Fed and the Philadelphia Fed, which showed considerable increases. In addition, the consumer confidence index developed by the Conference Board rose to 134.1 points in May (129.2 in April), much higher than expected and well above the average for 2018 (130.1). Finally, in the field of labour, 263,000 jobs were created in April, a high figure in a context of full employment. In addition, the unemployment rate fell to its lowest level in 50 years (3.6%) and wages rose by 3.2% year-on-year.

Inflationary pressures remain contained and support the patient strategy of the Fed. In particular, inflation in the US rebounded slightly in April and reached 2.0%, 1 decimal point above the figure for the previous month, partly driven by fuel prices. Core inflation, meanwhile, stood at 2.1% (2.0% in March). Looking ahead to the coming months, we expect core inflation to remain at the current levels, in line with the Fed's target rate.

EUROPE

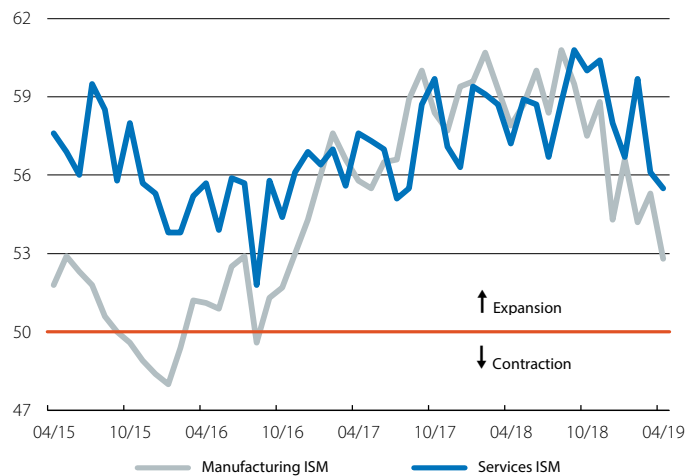
The expansion continues at a moderate pace. Despite higher than expected growth in Q1 (0.4% quarter-on-quarter and 1.2% year-on-year), euro area growth will remain at moderate levels (slightly above 1.0% year-on-year), in the context of a slowdown in global economic activity that is particularly affecting trade and manufacturing. This is reflected in the latest update of the economic scenario by the European Commission. In particular, in its spring forecast update, the institution downgraded its growth forecast for the euro area for 2019 by 1 decimal point, down to 1.2%, and down to 1.5% for 2020 (very similar figures to CaixaBank Research's forecasts). Despite this downward revision, and as the Commission points out, the pace of activity could pick up slightly starting in the second half of the year, reaching rates more in line with the bloc's potential (1.4%). Such an upturn would be driven by the gradual fading of temporary restrictions, such as the automotive sector's slow adaptation to the new emission standards and some pockets of political uncertainty.

Germany and the UK grew more than expected in Q1.

Economic activity in Germany recovered from the bump in the second half of 2018 (–0.2% in Q3 2018 and 0.0% in Q4 2018) and grew by 0.4% quarter-on-quarter (0.7% year-on-year), thanks to the positive performance of domestic demand. GDP

US: economic activity indicators

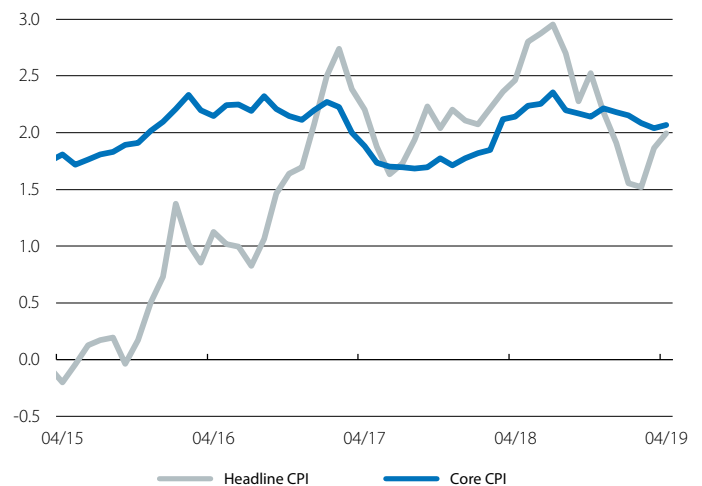
Level



Source: CaixaBank Research, based on data from Markit.

US: CPI

Year-on-year change (%)



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

European Commission GDP forecasts

Annual change (%)

	Forecast		Change relative to the winter 2019 forecast	
	2019	2020	2019	2020
Euro area	1.2	1.5	▼ –0.1	▼ –0.1
Germany	0.5	1.5	▼ –0.6	▼ –0.2
France	1.3	1.5	=	=
Italy	0.1	0.7	▼ –0.1	▼ –0.1
Spain	2.1	1.9	=	=
Portugal	1.7	1.7	=	=
UK	1.3	1.3	=	=

Source: CaixaBank Research, based on data from the European Commission (European Economic Forecast, spring 2019).

growth in the United Kingdom, meanwhile, rose to 0.5% quarter-on-quarter (0.2% in Q4 2018), despite the high uncertainty surrounding Brexit that was experienced in Q1.

The economic activity indicators offer mixed signals. On the downside, the composite PMI index for the whole of the euro area remained virtually flat in May (51.6 points), well below the average for 2018 (54.5 points) but still within expansionary territory (above 50 points). In addition, the breakdown by sector showed that the manufacturing PMI continues to point to contraction (at 47.8 points), reflecting the fact that the drags on the foreign sector and on manufacturing have not yet dissipated. On the upside, the economic sentiment index (ESI) elaborated by the European Commission rose to 105.1 points, after 12 months of declines. Similarly, consumer confidence for the whole of the euro area also picked up in May, reaching -6.5 points (-7.0 points in Q1). On the whole, the indicators suggest that economic activity will maintain a moderate pace in Q2.

REST OF THE WORLD

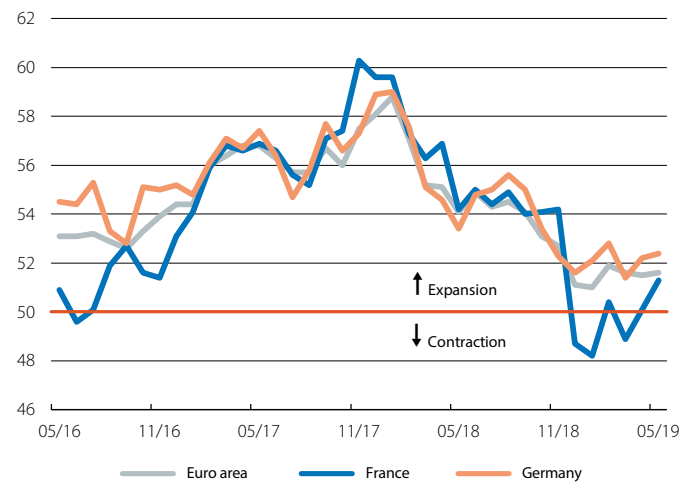
China: lower than expected economic activity indicators.

In April, there was a moderation in the growth of industrial production down to 5.4% (8.5% in March). Retail sales also followed a similar trend, with year-on-year growth of 7.2% (8.7% in March). Chinese exports, meanwhile, fell by 2.7% year-on-year (+13.8% in March). This figure was worse than expected and well below the average for the last 12 months (5.9%). These indicators suggest that the fiscal stimulus measures implemented in Q1 are having a short-lived effect and that, in the absence of new stimulus measures, China's economy will continue to slow down over the coming quarters.

Japan exceeds expectations once again. Japan's GDP showed solid growth in Q1, standing at 0.5% quarter-on-quarter (0.8% year-on-year), above the already considerable 0.4% registered in Q4. However, despite the growth rate exceeding most analysts' predictions, the breakdown by component showed that the growth was supported by short-term factors (such as inventories). In contrast, private consumption (-0.1%) and non-residential investment (-0.3%), which are pillars of domestic demand, proved weak.

Among emerging economies, Mexico and Russia lose momentum. On the one hand, Mexico performed worse than expected in Q1, with a quarter-on-quarter GDP contraction of -0.2% (growth of 1.2% in year-on-year terms). Although part of this weakness is attributed to disruptions in the industrial sector, the trend in the most recent indicators suggests a more contained rate of economic activity. In addition, Brazil's GDP contracted in Q1 (-0.2% quarter-on-quarter, the first negative figure since 2016). The Russian economy, meanwhile, grew by 0.5% year-on-year, significantly below the previous quarter (2.7%), partly due to the detrimental impact of the rise in VAT at the beginning of the year. This figure confirms the slowdown that was anticipated for 2019, with the persistence of geopolitical uncertainty (with the threat of new international sanctions), and the return to growth rates that are more in line with the country's potential.

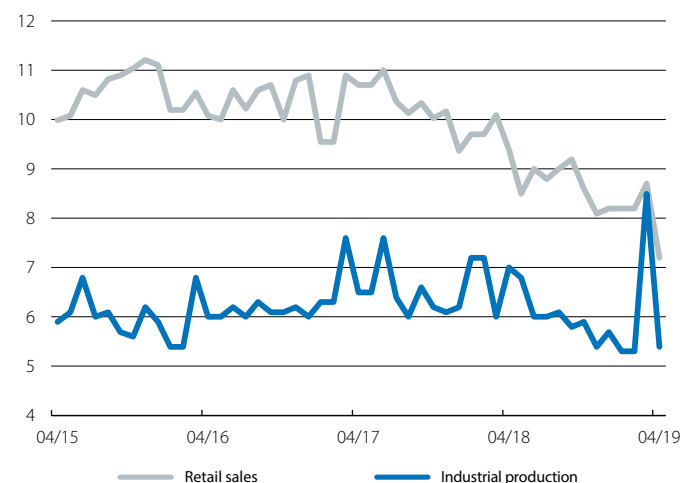
Economic activity indicators: composite PMI Level



Source: CaixaBank Research, based on data from Markit.

China: economic activity indicators

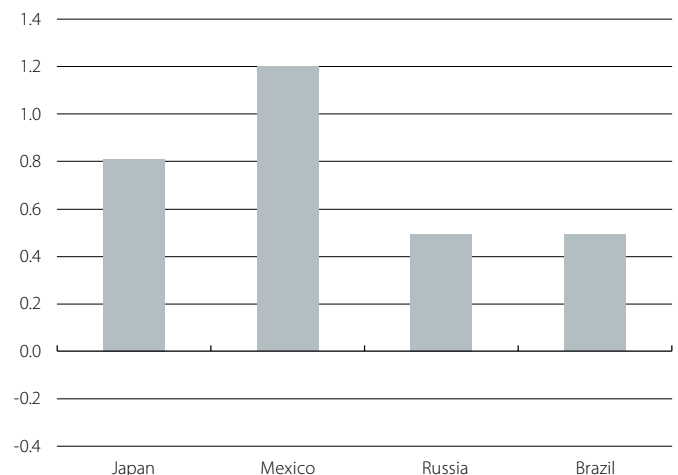
Year-on-year change (%)



Source: CaixaBank Research, based on data from the National Statistics Office of China.

GDP for Q1 2019: other economies

Year-on-year change (%)



Source: CaixaBank Research, based on data from the national statistics institutes.

Anatomy of the euro area slowdown: lessons from the second half of 2018

- In the second half of 2018, the European economy slowed significantly. In this article, we analyse and quantify the role of the three factors behind this slowdown: the lower consumption of cars, the slowdown in trade and political uncertainty.
- We believe that these three factors explain almost all of the slowdown in Europe: 40% of the slowdown can be attributed to the lower consumption of vehicles, slightly more than a third to the slowdown in trade and one fifth to political uncertainty.

What lies behind the slowdown?

The second half of 2018 was a cold shower for the euro area economy. After growing at a reasonable rate of 0.4% quarter-on-quarter in the first half of the year, growth fell to around 0.1%-0.2% in the second half. In this article, we analyse the cocktail of ingredients that led to this slowdown. This exercise takes on a particular relevance following the higher-than-expected growth in Q1 (0.4% quarter-on-quarter, 2 decimal points higher than expected): was this positive surprise temporary, or was what we witnessed in the second half of 2018 a mere bump in the road after which the economy will regain momentum in a sustained manner? To address this question, we take a detailed look at the role of three factors that have been behind the slowdown: the decline in car sales (in a context of difficulties in the automotive sector and poor performance in Europe's manufacturing sector), the slowdown in international trade and the spike in political uncertainty.

In particular, we analyse the behaviour we expected to see from these three factors in the second half of 2018 under normal conditions and compare this with the actual data. Then, it is relatively easy to estimate the impact on GDP of the «deviations» that occurred for each of these factors.

Let us start with car sales in the euro area, which were affected by the regulatory uncertainty caused by the new regulations for vehicle emissions that came into force on 1 September 2018 throughout the EU. We estimate that the growth in new passenger car registrations in the euro area was 4.3 pps lower than expected, which subtracted 0.1 pp¹ from quarter-on-quarter GDP growth.

With regard to the slowdown in international trade in a context characterised by protectionist tensions, the growth of exports was 0.4 pps lower than expected. This reduced GDP growth in the second half of the year by

1. We compared the observed growth with that predicted by an AR(1) model based on historical evidence. We then multiply the deviation obtained by the relative weight of the consumption of cars in the total consumption of European households (4%). Finally, to estimate the impact on growth, we take into account the fact that private consumption accounts for slightly more than half of the euro area's GDP.

2. A year ago, at CaixaBank Research we predicted that the quarter-on-quarter growth of exports in Q3 and Q4 2018 would be 1.2% and 1.1%, respectively, but the observed growth was 0.2% and 1.2%. We multiply the deviation in export growth by its weight in the euro area GDP (28%), subtracting the import content of exports (25.7% according to the OECD).

Euro area: exports (EUR billions)



Source: CaixaBank Research, based on data from Eurostat.

0.09 pps (this estimate takes into account the import content of exports).² Of course, part of the slowdown in exports can be explained by the lower exports of vehicles (we estimate that this accounts for slightly less than half of the slowdown), held back by the cutbacks in production to adapt to the new regulations and by lower global demand.

Finally, political uncertainty also played an important role, affected at the international level by the geopolitical and trade tensions and at the domestic level by the tensions between the new Italian cabinet and Brussels and by Brexit. In particular, we compare the trend observed in the index of political uncertainty in Europe produced by the US academics Baker, Bloom and Davis with the trend that was expected based on the index's historical series. The observed trend in the uncertainty index proved to be 52 points higher than the expected trend (see second chart), a significant difference if we consider that 80% of the central observations lie within a range of 154 points. We estimate that this factor eroded growth by 0.05 pps.³

If we bring all the results together (see third chart), we see that the three factors together reduced the average

3. Specifically, we compare the observed values of the index with those predicted using an AR(1) model. Then, we plot a regression of GDP growth against the index and we make a prediction for GDP growth in the second half of the year using the observed values and those obtained with the AR(1) model.

quarter-on-quarter growth of the euro area by 0.24 pps in the second half of 2018, a figure that represents practically the entire slowdown observed. In particular, 40% of the slowdown can be attributed to the drop in vehicle sales, slightly more than a third to the slowdown in trade and one fifth to political uncertainty.

Besides this breakdown, another way to characterise the slowdown in the euro area is to ask ourselves whether it is due to supply factors (i.e. factors that restrict the economy's productive capacity or potential, such as the appearance of bottlenecks) or demand factors (such as households' willingness to consume). This distinction can also provide clues as to how long the moderation in growth could last. On this note, a detailed quantitative study by the ECB⁴ that focused on manufacturing activity estimates that the slowdown has mainly been caused by weak demand, although the constraints on the supply side have played a more minor role (see fourth chart).⁵

Lessons for the present and the future

This «anatomical» exercise offers us some clues about the economic outlook for the euro area in 2019. With regard to the adjustment observed in the automotive sector, as vehicle manufacturers fully adapt to the 2018 European regulations and consumers know where they stand, vehicle sales can be expected to return to normal. In fact, this is already reflected in the data for the first quarter: the number of vehicles registered has increased by 7.0% quarter-on-quarter, after falling by 11.0% in Q4 2018. However, all things considered, regulatory uncertainty is likely to continue to affect the sector: the EU is preparing new and stricter emission standards that will need to be met by 2021 and more European cities are expected to introduce restrictions on the circulation of vehicles.

As for the slowdown in trade, the balance is mixed: on the one hand, an appeasement in the conflict between China and the US could help to boost trade flows, although there is a risk of the US administration imposing tariffs on European cars. On the other hand, the slowdown in the European economies' main trading partners, in combination with a more uncertain global environment for global trade (less confidence, higher non-tariff barriers and greater pressures on global supply chains), suggests that the foreign sector will continue to make a modest contribution to euro area growth.

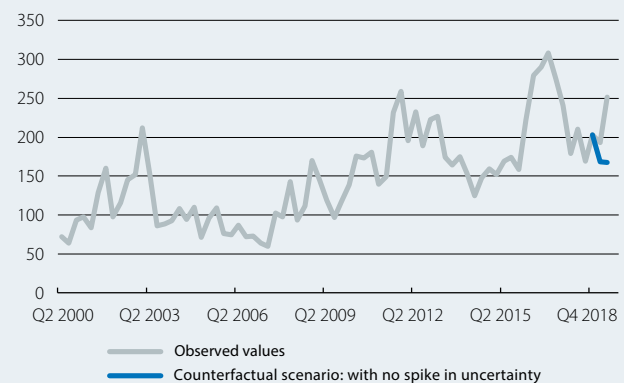
Finally, political uncertainty is likely to remain high and further spikes cannot be ruled out if there are surprises in the European elections, with Brexit or if other sources of tension, such as Italy's fiscal policy, are revived. That said, a source of hope is the fact that in Q1 2019 – a difficult period dominated by the threat of a chaotic Brexit – the political uncertainty index in Europe decreased by 24 points compared to Q4 2018, mostly thanks to a softening of tensions in France and Italy.

Javier Garcia-Arenas

4. See M. Dossche and J. Martínez-Martin (2018). «Understanding the slowdown in growth in 2018». ECB Economic Bulletin, Issue 8.

5. Other studies also come to the same conclusion. See, for example, A. Benito and P. Vernet (2019). «European Daily: Anatomy of a slowdown». Goldman Sachs Economic Research.

Europe: political uncertainty index



Note: Political uncertainty index for Europe based on news reports in newspapers in Germany, France, Spain, Italy and the United Kingdom. The counterfactual values are obtained using an AR(1) model.

Source: CaixaBank Research, based on data from Baker, Bloom and Davis (2016).

Euro area: reduction in growth in the second half of 2018

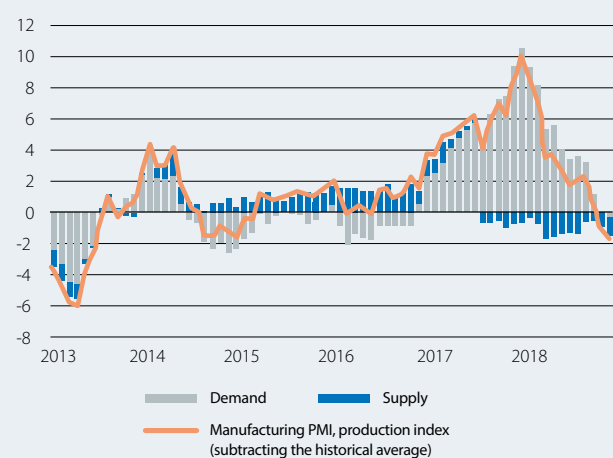
Quarter-on-quarter growth (semester average, %)



Source: CaixaBank Research, based on own estimates.

Euro area: breakdown of manufacturing activity by supply and demand

Contribution (points)



Note: Breakdown of manufacturing PMI based on a structural VAR with production and capacity utilisation to identify supply and demand shocks.

Source: M. Dossche and J. Martínez-Martin (2018), «Understanding the slowdown in growth in 2018», ECB Economic Bulletin, Issue 8.

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

UNITED STATES

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	04/19	05/19
Activity								
Real GDP	2.2	2.9	2.9	3.0	3.0	3.2	–	...
Retail sales (excluding cars and petrol)	4.2	4.6	5.2	5.4	3.5	3.6	3.2	...
Consumer confidence (value)	120.5	130.1	127.2	132.6	133.6	125.8	129.2	134.1
Industrial production	2.3	3.9	3.4	5.0	4.0	2.9	0.9	...
Manufacturing activity index (ISM) (value)	57.4	58.8	58.7	59.7	56.9	55.4	52.8	...
Housing starts (thousands)	1,209	1,250	1,261	1,234	1,185	1,203	1,235	...
Case-Shiller home price index (value)	200	211	211	212	214	215	...	...
Unemployment rate (% lab. force)	4.4	3.9	3.9	3.8	3.8	3.9	3.6	...
Employment-population ratio (% pop. > 16 years)	60.1	60.4	60.4	60.4	60.6	60.7	60.6	...
Trade balance ¹ (% GDP)	–2.8	–2.4	–2.9	–2.9	–3.0	–3.0	...	...
Prices								
Headline inflation	2.1	2.4	2.7	2.6	2.2	1.6	2.0	...
Core inflation	1.8	2.1	2.2	2.2	2.2	2.1	2.1	...

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

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	04/19	05/19
Activity								
Real GDP	1.9	0.8	1.4	0.1	0.2	0.8	–	...
Consumer confidence (value)	43.8	43.6	43.7	43.4	42.8	41.3	40.4	39.4
Industrial production	2.9	1.0	1.3	–0.1	0.5	–1.1	–1.6	...
Business activity index (Tankan) (value)	19.0	20.8	21.0	19.0	19.0	12.0	–	...
Unemployment rate (% lab. force)	2.8	2.4	2.4	2.4	2.4	2.4	2.4	...
Trade balance ¹ (% GDP)	0.5	–0.1	0.4	0.1	–0.2	–0.3	–0.5	...
Prices								
Headline inflation	0.5	1.0	0.6	1.1	0.9	0.3	0.9	...
Core inflation	0.1	0.3	0.3	0.3	0.3	0.4	0.6	...

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

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	04/19	05/19
Activity								
Real GDP	6.8	6.6	6.7	6.5	6.4	6.4	–	...
Retail sales	10.3	9.0	9.0	9.0	8.3	8.5	7.2	...
Industrial production	6.6	6.2	6.6	6.0	5.7	6.4	5.4	...
PMI manufacturing (value)	51.6	50.9	51.6	51.1	49.9	49.7	50.1	49.4
Foreign sector								
Trade balance ¹ (value)	420	352	377	349	352	382	370	...
Exports	7.9	9.9	11.5	11.7	4.0	1.3	–2.7	...
Imports	16.3	15.8	20.6	20.4	4.4	–4.7	4.0	...
Prices								
Headline inflation	1.6	2.1	1.8	2.3	2.2	1.8	2.5	...
Official interest rate ² (value)	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Renminbi per dollar (value)	6.8	6.6	6.4	6.8	6.9	6.8	6.7	6.9

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.

EURO AREA

Activity and employment indicators

Values, unless otherwise specified

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	04/19	05/19
Retail sales (year-on-year change)	2.5	1.6	1.8	1.2	1.7	2.4	...	...
Industrial production (year-on-year change)	3.0	0.9	2.2	0.5	-2.0	-0.3	...	...
Consumer confidence	-5.4	-4.9	-4.7	-5.1	-6.4	-7.0	-7.3	-6.5
Economic sentiment	110.1	111.2	111.8	110.9	108.8	106.0	103.9	105.1
Manufacturing PMI	57.4	55.0	55.5	54.3	51.7	49.1	47.9	47.7
Services PMI	55.6	54.5	54.6	54.4	52.8	52.4	52.8	52.5
Labour market								
Employment (people) (year-on-year change)	1.6	1.5	1.6	1.4	1.4	1.3	-	...
Unemployment rate (% labour force)	9.1	8.2	8.3	8.0	7.9	7.8	...	...
Germany (% labour force)	3.8	3.4	3.4	3.4	3.3	3.2	...	...
France (% labour force)	9.4	9.1	9.1	9.0	8.9	8.8	...	...
Italy (% labour force)	11.3	10.6	10.7	10.3	10.6	10.4	...	...
Real GDP (year-on-year change)	2.5	1.8	2.2	1.6	1.2	1.2	-	...
Germany (year-on-year change)	2.5	1.5	2.0	1.2	0.6	0.7	-	...
France (year-on-year change)	2.4	1.7	1.7	1.4	1.0	1.0	-	...
Italy (year-on-year change)	1.8	0.7	1.0	0.5	0.0	0.1	-	...

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

Prices

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

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	04/19	05/19
General	1.5	1.8	1.7	2.1	1.9	1.4	1.7	...
Core	1.1	1.2	1.2	1.2	1.2	1.1	1.4	...

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

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	04/19	05/19
Current balance	3.5	3.2	3.7	3.4	3.2	3.0	...	...
Germany	8.0	7.3	8.1	7.5	7.3	7.1	...	...
France	-0.6	-0.3	-0.3	-0.5	-0.3	-0.4	...	...
Italy	2.6	2.5	2.7	2.6	2.5	2.7	...	...
Nominal effective exchange rate¹ (value)	96.5	98.9	98.5	99.2	98.5	97.3	96.7	97.3

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.

Credit and deposits of non-financial sectors

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

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	04/19	05/19
Private sector financing								
Credit to non-financial firms	2.5	3.8	3.7	4.2	4.0	3.6	3.9	...
Credit to households ^{1,2}	2.6	3.0	2.9	3.1	3.2	3.3	3.4	...
Interest rate on loans to non-financial firms ³ (%)	1.3	1.2	1.2	1.2	1.2	1.2	...	...
Interest rate on loans to households for house purchases ⁴ (%)	1.7	1.6	1.6	1.6	1.6	1.6	...	...
Deposits								
On demand deposits	10.1	7.9	8.0	7.3	7.1	7.0	7.8	...
Other short-term deposits	-2.7	-1.5	-1.5	-1.4	-1.0	-0.4	0.5	...
Marketable instruments	1.4	-4.5	-3.2	-5.6	-3.4	-3.1	-5.9	...
Interest rate on deposits up to 1 year from households (%)	0.4	0.3	0.4	0.3	0.3	0.3	...	...

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.

The slowdown in Spain materialises at a gentler pace

The Spanish economy postpones its growth slowdown. With the fading of the tailwinds that supported the strong growth of recent years, the Spanish economy faces a transition to more moderate growth rates that are more consistent with the maturity of the cycle. However, this moderation of growth is occurring somewhat slower than expected. For instance, in Q1 GDP grew by 0.7% quarter-on-quarter (2.4% year-on-year), 0.1 pp faster than in the previous quarter. For 2019 as a whole, we expect the Spanish economy to grow by 2.3% (2.6% in 2018), before slowing down to 1.9% in 2020 and 1.7% in 2021. In terms of components, domestic demand will remain the main driver of growth in Spain, especially due to the contributions of domestic consumption and investment. Foreign demand, meanwhile, has been penalised in recent quarters by trade tensions and lower growth in the euro area, and it will probably continue to make a modest contribution while these restrictions continue to weigh down the external environment. A very similar growth scenario can be found in the Government's macroeconomic table, presented in the update of the Stability Plan for 2019-2022. As for the public accounts, the Stability Programme foresees a very gradual reduction of the budget deficit, supported by the cyclical momentum and the new revenue measures that are due to be included in the budgets for 2020. These measures (minimum taxation for corporation tax, digital services tax, tax on financial transactions, etc.) would allow revenues to be increased from 39.1% of GDP in 2019 to 40.7% in 2022, although the details are still too patchy to assess their impact with precision.

The indicators suggest that the growth rate remains steady. In particular, in March, the turnover of the services sector grew by 5.1% year-on-year (three-month moving average) and that of the industrial sector, by 2.2% year-on-year, both higher than in the previous month. In addition, in April the manufacturing and services PMIs stood at 51.8 and 53.1 points, respectively, well within expansionary territory (above 50 points). As such, we expect GDP growth in the second quarter of the year to remain similar to that of Q1. Specifically, our short-term GDP forecast model indicates growth of 0.7% quarter-on-quarter in Q2 2019.

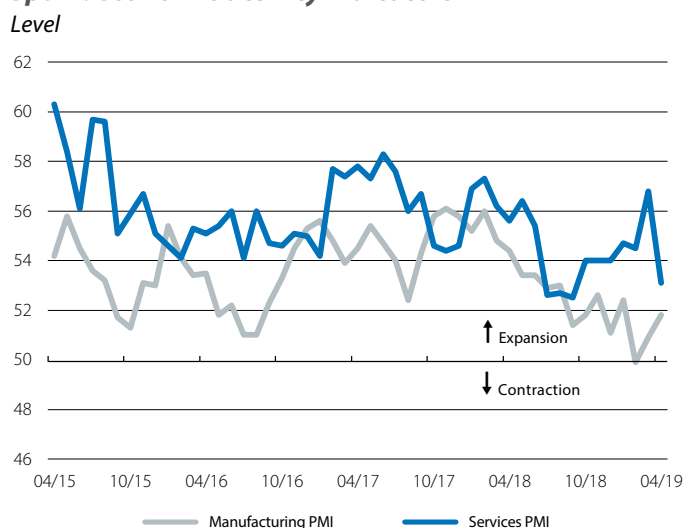
The labour market shows dynamic performance. In the same vein as GDP, in the labour market the anticipated moderation in the growth of employment also continues to be pushed back. In April, employment rose by 2.95% year-on-year (in seasonally adjusted terms), somewhat above the Q1 average (2.9%). The total number of registered workers affiliated to Social Security, meanwhile, reached 19.2 million, the highest figure since July 2008. Registered unemployment fell by 5.2% year-on-year (the same rate as the average for Q1) and the total number of unemployed people stood at 3.2 million. In addition, besides this improvement in employment we are beginning to observe a gradual increase in workers' earnings, which should help to underpin the recovery of household incomes and economic sentiment among consumers. In

Spain: macroeconomic table predicted in the 2019-2022 Stability Programme

	2018	2019	2020	2021	2022
	Actual	Forecast			
GDP (year-on-year change, %)	2.6	2.2	1.9	1.8	1.8
Employment (year-on-year change, %)	2.1	2.0	1.9	1.8	1.7
Unemployment rate (%)	15.3	13.8	12.3	11.0	9.9
Budget deficit (% of GDP)	-2.5	-2.0	-1.1	-0.4	0.0
Public debt (% of GDP)	97.1	95.8	94.0	91.4	88.7

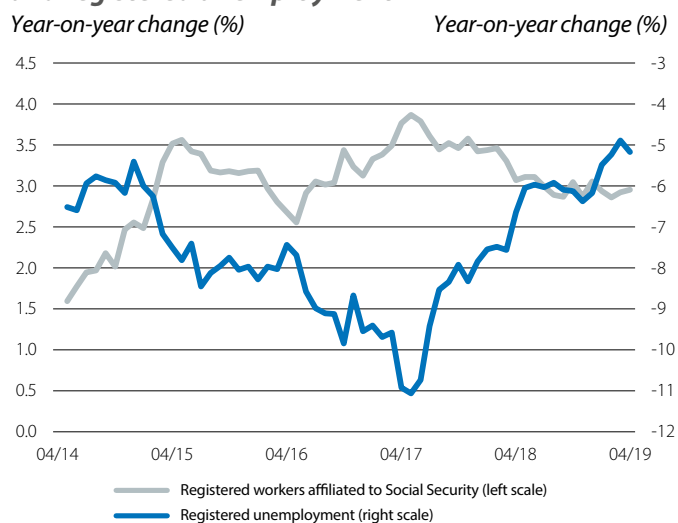
Source: CaixaBank Research, based on data from the 2019-2022 Stability Programme.

Spain: economic activity indicators



Source: CaixaBank Research, based on data from Markit.

Spain: registered workers affiliated to Social Security and registered unemployment



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

particular, in April, the wage increase agreed in collective labour agreements was 2.21% (2.25% in new agreements signed in 2019), higher than the 1.75% registered in December 2018.

Inflation remains contained. Specifically, in May headline inflation stood at 0.8% year-on-year. As such, there was a reversal of the upswing seen in April (when it had increased to 1.5%), a figure that was influenced by calendar effects related to Easter. With regard to core inflation, we still do not know the figure for May, but in April it remained at a contained 0.9% and all the indicators suggest that the recovery of the underlying inflationary pressures will be very gradual. On the one hand, the recovery in wages is proving to be particularly gradual. In fact, it is lower than that experienced in other euro area countries, which allows the Spanish economy to remain competitive (for more details, see the Focus «[Spanish labour competitiveness: a history of ups and downs](#)» in this same *Monthly Report*). On the other hand, the recent moderation in business profits is contributing to the containment of core inflation.

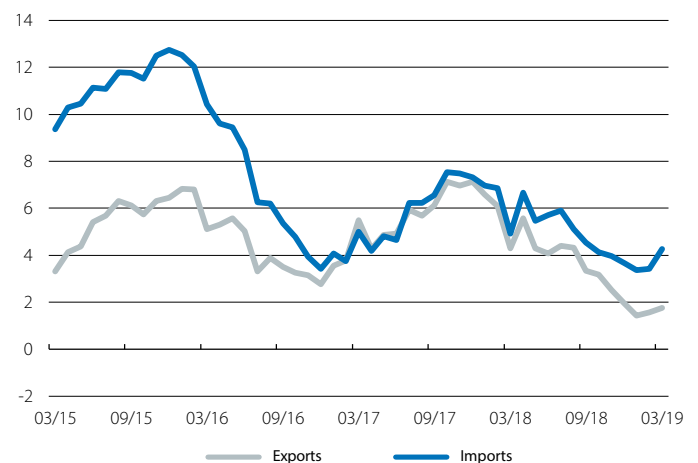
Dark clouds form in the foreign sector, despite the heat of tourism. Trade tensions and the slowdown in the euro area are taking their toll on the Spanish foreign sector and in March the current account balance fell to 0.74% of GDP (12-month cumulative balance), 1.03 pps below the figure for March 2018. Most of this deterioration can be attributed to the decline in the balance of goods (which stood at -3.0% and accounts for 0.9 pps of the deterioration), in particular to non-energy goods (accounting for 0.5 pps of the deterioration). Nevertheless, in this rather less favourable external context, the tourism sector continues to perform well. In March, 5.6 million international tourists entered Spain, 4.7% more than in the same month of 2018. In addition, their total expenditure was 2.7% higher than a year ago.

The real estate sector, experiencing a more sustainable and enduring expansion. The growth in home sales slowed slightly in March, with 8.1% year-on-year growth (12-month cumulative figure) compared to 10.3% in 2018. On the other hand, home valuations rose by 1.1% quarter-on-quarter (4.4% year-on-year) in Q1 2019, consolidating the upward trend that began in 2015. As these figures show, the Spanish real estate sector is entering a more mature phase of the cycle, characterised by an easing of growth in demand and in prices. In this phase, we expect sales and housing prices to continue to grow at a steady pace throughout 2019, albeit at more moderate rates than last year, in line with the slight loss of buoyancy we expect to see in the factors that support the expansion of the real estate market (job creation, favourable financial conditions and high foreign demand).

The strength of economic activity facilitates the reduction of non-performing loans. In particular, the NPL ratio fell by 0.09 pps in March down to 5.73%, continuing the reduction that began four years ago and following a trend that will continue over the coming months. In the last 12 months, defaults have reduced by 1.07 pps, favoured by the good pace of economic growth and the resulting lower rate of new defaults, as well as due to sales of doubtful loans.

Spain: foreign trade in goods *

Year-on-year change in the 12-month cumulative balance (%)



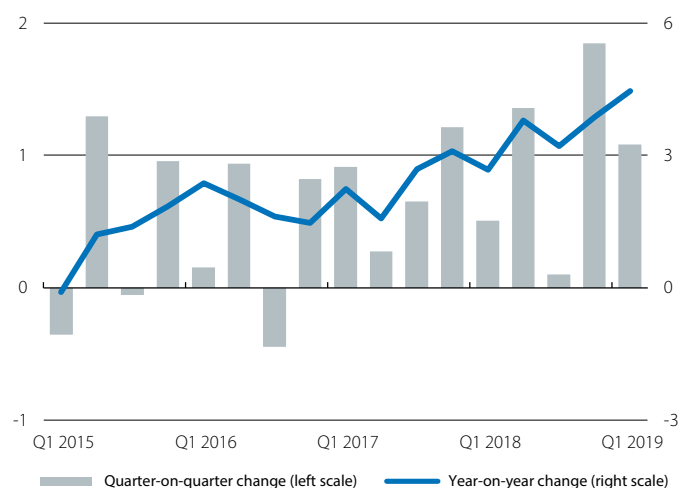
Note: * Nominal data, not seasonally adjusted. Excludes energy.

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

Spain: home prices

Quarter-on-quarter change (%)

Year-on-year change (%)

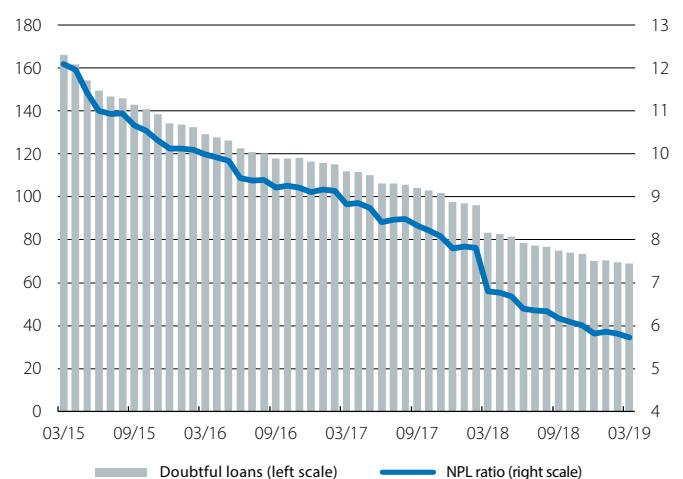


Source: CaixaBank Research, based on data from the Ministry of Public Works.

Spain: NPL ratio and doubtful loans

(EUR billions)

(%)



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

The car, a key sector facing an uncertain future

- In Europe, the automotive sector makes a key contribution to economic activity (both directly and through the spillover effect) and has a strong export component.
- Therefore, in the context of a slowdown in global trade, the sector has held back euro area growth in recent quarters (accentuated by the regulatory disruptions in the sector).
- In the future, the environmental issue and pollution problems in large cities will lead the sector to replace internal combustion engines with electric motors. However, to overcome this challenge, significant technological bottlenecks must be overcome.

The euro area economy slowed down in the second half of 2018 and the main institutions have lowered their growth forecasts for 2019. As an example, whereas in April 2018 the IMF predicted GDP growth for the euro area of 2.0% in 2019, in its most recent forecast (April 2019) this has been reduced to 1.3%. As we have shown in previous analyses,¹ this moderation is partly due to the troubles in the automotive sector, which is adjusting to the new vehicle emissions protocol that came into force on 1 September 2018. In fact, our estimates indicate that the disruption in the automotive sector has imposed a major restriction on growth: without it, quarter-on-quarter GDP growth would have reached 0.5% in Q3 2018 (compared with the observed figure of 0.2%). In view of its importance, we must understand precisely how temporary the disruptions affecting the automotive industry really are and assess the prospects for the medium term.

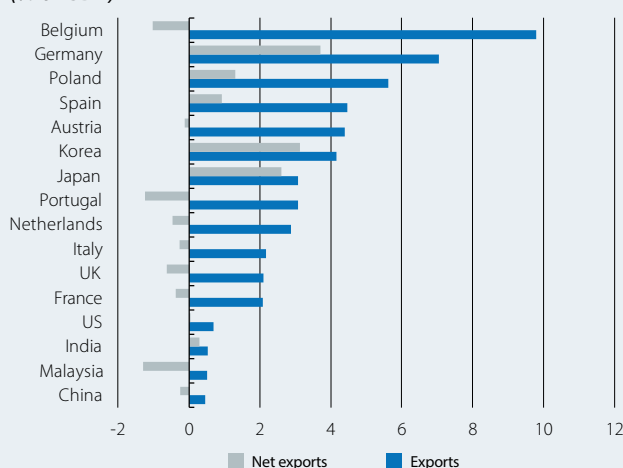
The importance of the sector in the euro area

The importance of the automotive sector for the European economy cannot be understated, and it has even increased in recent years. Its production represents 3.8% of euro area GDP and it is responsible for 12.5% of European exports. These figures exceed those of 2012, when the sector accounted for 3.6% of GDP and 10.5% of exports. The sector's relative weight in Europe is also above the global average. In 2017, the euro area accounted for 15.8% of global GDP, but its car exports, including flows between member states, accounted for 37.6% of the world's total car exports. The breakdown by country highlights the importance of Germany, which in 2017 generated as many car exports as the three major Asian exporters combined (Japan, South Korea and China) and accounted for 47.3% of the euro area's total exports (figures in present-day dollars). Besides the snapshot for 2017, if we look at the trend over the past few years, we see that Germany also stands out: whereas in 1990 the value of German exports was similar to those of Japan, in 2018 it was 74% higher. In Germany, car exports accounted for 7.0% of GDP and net exports (subtracting imports), 3.7%. This explains practically half of Germany's current account surplus (which stood at 8.1% of GDP in 2018 and is the largest in the world in absolute terms).

1. See the Focus «Euro area growth: neither very fast nor particularly slow» in the MR01/2019.

The weight of vehicle exports

(% of GDP)



Source: CaixaBank Research, based on data from the WTO and the IMF.

However, the sector's contribution to the economy goes beyond its own production volume. In fact, the automotive sector generates a significant spillover effect through which car production stimulates the rest of the sectors of the economy. Estimates² indicate that a 1 euro increase in the production of cars generates an increase in the total production of the European economy of 2.4 euros. So, if we measure the sector's contribution in a wider sense, taking this spillover effect into account, in Germany the weight of these «extended» exports of the automotive sector could exceed 15% of GDP. In view of the sector's importance in Europe and its significant export component, it comes as no surprise that in the current environment of deceleration in global trade the sector has acted as a significant restriction for the growth of the euro area.

The challenges of the sector

If the economies of these European countries are so closely linked to the fortunes of the automotive sector, we must pose the question: what is the outlook for the

2. Estimates based on input-output tables of the European Commission. See https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Consolidated_supply_use_and_input-output_tables&oldid=420861.

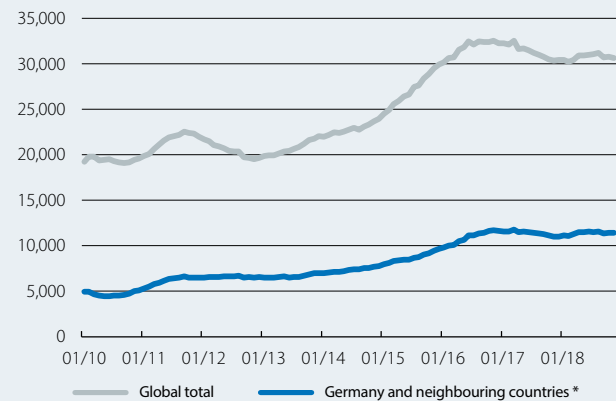
car in Europe (Germany and partners) beyond 2019? In both the short and the long term, the sector will be continually affected by the environmental issue. The recent changes in the anti-pollution regulations, for instance, led to significant decreases in car sales in 2018, although this restriction should subside in 2019. Beyond this juncture, the sector faces major challenges in the medium and long term. The environmental issue and pollution problems in large cities will lead the sector to replace internal combustion engines with electric motors. Some countries are proposing to ban the sale of internal combustion cars by 2040. However, the path towards electrification is likely to be longer and less certain than anticipated. The challenges of electrification in cars include increasing energy storage capacity in batteries, since it is still insufficient for the autonomy of electric vehicles to rival that of petrol vehicles; the lack of battery charging infrastructure, as well as the time it takes to recharge them; and major bottlenecks in the supply of raw materials essential for battery construction, such as cobalt. Thus, unless we see radical scientific advances (such as developments in solid-state battery or hydrogen battery technology),³ electric cars will take off relatively slowly. This view is backed by various analysts, who forecast that in 2030 electric cars will not yet have reached even 10% of global production.⁴ Furthermore, this delay, in conjunction with the environmental imperative, could substantially raise the price of cars and give rise to new models of transport (such as shared vehicles).

In the interregnum between combustion engines and the electric vehicle, we find the hybrid car. Currently, hybrid cars in Europe and the US account for around 2% of total sales, but analysts' forecasts suggest that they could reach 20% within the next 10 years, a proportion already achieved in Japan. In this transition, the European car sector is clearly behind other economies, such as Japan, as illustrated by the fact that the Japanese group Toyota represents 74% of the cumulative sales of hybrids in Europe. A similar view is reflected in the stock prices of the various German automotive groups compared to those of Japan. Germany exports 1.74 dollars in cars for every dollar that Japan exports, and its three automotive groups produce 15 million cars worldwide, with significantly higher prices and margins than the 22.3 million cars produced globally by the Japanese groups. However, the market capitalisation of the four Japanese car firms exceeds that of the three German groups by 15%.⁵

The automotive sector in Spain

In the case of Spain, the sector has experienced strong growth over the last decade, with exports that

Spain: car exports
(EUR millions)



Note: * Germany, Benelux, Austria, Slovakia, Czech Republic, Poland and Hungary.

Source: CaixaBank Research, based on customs data.

represented 4.5% of GDP in 2018, rising from a low of 2.8% in 2009. Spanish car production is clearly geared towards exports, since around 2/3 of the sector's production is exported. Furthermore, in Spain, the sector has exhibited greater integration with Germany and its neighbouring countries, as well as achieving a significant increase in sales to the United Kingdom and the US. According to data for 2016, Spain's car exports represented 23.3% of the euro area total, well above the weight of Spain's GDP in the euro area, which stands at 10.5%. This momentum in car exports led to the exports of Spanish goods maintaining their share of total global exports at a time when most advanced economies were losing ground to the onslaught from East Asia. Since mid-2016, however, Spanish car exports have stopped growing and have remained at the levels achieved. This stagnation, which is not specific to any particular geographic destination, could be due to the significant weight of diesel vehicles in Spanish production.⁶ In addition, in macroeconomic terms, it helps to explain the reduction in the current account surplus seen in recent quarters.

The future is not written. The history of the European automotive sector is marked by successes and the economies of the euro area have relied on them to their advantage. However, as has become all too apparent in recent quarters, when this successful track record falters, the wider economy feels the consequences. It is therefore crucial that the sector adapts to the technological changes that are coming.

Jordi Singla

3. In the last 20 years, no viable solution to incorporate hydrogen into passenger cars has been reached.

4. Goldman Sachs (2018). «The next growth engines: traction motors and inverters».

5. Japanese brands: Toyota, Nissan, Honda and Mazda. German groups: Daimler, BMW and Volkswagen AG.

6. Sales of vehicles with diesel engines have been those most adversely affected by the new environmental regulations.

Spanish labour competitiveness: a history of ups and downs

- The improved competitiveness of Spanish labour has played a key role in making Spain one of the fastest-growing countries in the euro area in recent years.
- While Spain's competitiveness deteriorated in the period 2001-2008 due to wages growing well above productivity, over the next 10 years the country managed to recover lost ground.
- Despite the good performance of recent years, we should not forget that achieving further improvements in competitiveness remains crucial in order to continue to reduce imbalances and to ensure a more sustainable pattern of growth.

The improvement in labour competitiveness has been one of the hallmarks of the Spanish economy over the last decade. Nevertheless, as the economy enters a more mature phase of the cycle, the question arises as to whether this improvement was the result of temporary factors linked to the economic cycle or an underlying change in the Spanish economy. Below, we analyse this question based on recent developments in the main factors that determine labour competitiveness: workers' earnings and their productivity.

Changes in labour competitiveness in Spain and the euro area

In a monetary union, one of the key factors determining the competitiveness of its members is the cost of labour required to produce each good and service. So, if a country in the euro area experiences a sustained increase in its unit labour costs (ULC)¹ above all the other countries (either due to higher wage growth or a slowdown in productivity), it loses competitiveness, without having the ability to resort to a devaluation of its currency in order to regain it. As shown in the first chart, in the last 20 years, Spain's competitiveness² has gone through two very different phases: up until early 2008 there was a sustained loss of competitiveness compared to the rest of the euro area, while since then there has been a recovery.

In particular, up until 2008 Spain's ULC increased far faster than those of the rest of the euro area. This was caused by wage growth per employee in the Spanish economy as a whole (3.5% annually on average between 2001 and 2008) growing at a significantly higher rate than labour productivity (0.1%). This dynamic changed

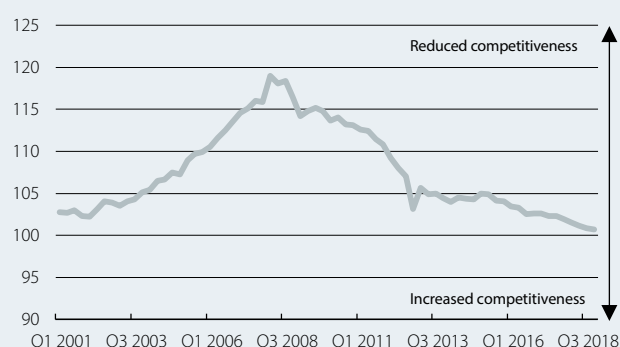
1. The labour costs per unit produced, or unit labour costs (ULC) is the ratio between the real remuneration per employee (w) and the apparent productivity of labour, measured as the ratio between gross value added in constant terms (GVA) and full-time equivalent employment (FTEE). i.e.

$$ULC = \frac{w}{\frac{GVA}{FTEE}}$$

2. Understood as the ratio between the ULC of Spain and the average for the euro area.

Spain: change in unit labour costs in relation to those of the euro area

Index (100 = Q1 1999)



Note: Note: Change in the ratio between unit labour costs in Spain and those of the euro area. The ratio has been normalised to take a value of 100 in Q1 1999.

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

with the recession, when the initial increase in productivity (due to employment falling by more than GDP) and more contained wage growth, especially from 2010, resulted in a decrease in ULC and led to a phase marked by a recovery in competitiveness. This recovery was particularly notable up until 2013 and, since then, Spain has continued to improve its competitiveness relative to the rest of the euro area, albeit at a more gradual pace.

The importance of the link between earnings and productivity

As we mentioned earlier, the evolution of the ULC reflects the relationship between the growth in earnings per employee and that of labour productivity. For example, it is possible to combine a containment of ULC with a rise in earnings, provided that there is growth in labour productivity. As can be seen in the second chart, which breaks down the changes in these two components of the ULC, the initial years of Spain's recovery (2014-2016) were characterised by a closer link between wage growth and that of productivity. In fact, the two were very even and allowed ULC to remain practically stable (in stark contrast to the period 2001-2008, in which there was a

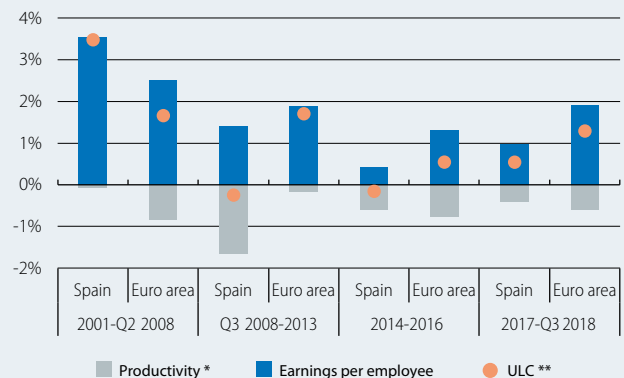
stark misalignment between the evolution of wages and productivity). Furthermore, although recently Spain's ULC have begun to rise for the first time in the past 10 years (in nominal terms),³ they remain below those of the euro area (i.e. Spain continues to regain competitiveness). What is more, there continues to be a closer link between wage growth and that of productivity. The ULC of the euro area as a whole, meanwhile, have also risen in recent years and, as can be seen in the second chart, the euro area has maintained a balance between wage growth and productivity similar to that seen during the previous expansion.

In short, beyond the initial impact of the recession, in recent years the Spanish economy has continued to regain competitiveness vis-à-vis the euro area, and it has done so with a better link between the evolution of workers' wages and productivity. Over the coming quarters, the good performance of the labour market is expected to be reflected in more dynamic wages. Although this will probably have only a moderate impact on inflation, especially in comparison with the previous expansionary phase,⁴ its impact on competitiveness will depend on whether a close link is maintained between wage growth and that of productivity. Therefore, and in view of the fact that productivity has seen limited growth in recent years, we must not forget that improving competitiveness remains key in order to continue to reduce imbalances (such as external debt) and to ensure a more sustainable pattern of growth going forward.

Marc Miró i Escolà

Spain: unit labour costs and their determining factors (earnings and productivity)

Contribution to the growth of ULC in nominal terms (pps)



Notes: * Positive values indicate a loss of productivity (i.e. they contribute to an increase in ULC). ** Average annual change.

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

3. An expected trend, given the strong job creation and the marked reduction in unemployment that has been observed in the Spanish labour market in recent years. For example, according to the most recent labour force survey (Q1 2019), in the last year employment has increased by around 600,000 workers, while unemployment has fallen by almost 450,000 people.

4. See the Focus «[Will greater wage growth lead to higher inflation in Spain?](#)» in the MR01/2019.

Activity and employment indicators

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

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	03/19	04/19	05/19
Industry									
Industrial production index	3.2	0.3	1.1	0.5	-2.7	-0.2	-3.1	...	...
Indicator of confidence in industry (value)	1.0	-0.1	1.2	-2.6	-1.9	-3.8	-2.2	-4.9	-4.1
Manufacturing PMI (value)	54.8	53.3	53.7	52.4	51.8	51.1	50.9	51.8	...
Construction									
Building permits (cumulative over 12 months)	22.9	25.7	28.1	25.8	23.9	25.8	24.8	...	...
House sales (cumulative over 12 months)	14.1	14.0	15.8	13.2	11.1	7.8	8.1	...	...
House prices	6.2	6.7	6.8	7.2	6.6	...	-	-	-
Services									
Foreign tourists (cumulative over 12 months)	10.0	4.0	5.3	1.5	0.9	1.0	0.8	...	...
Services PMI (value)	56.4	54.8	55.8	52.6	54.0	55.3	56.8	53.1	...
Consumption									
Retail sales	1.0	0.7	0.1	-0.4	1.4	1.3	1.4	1.1	...
Car registrations	7.9	7.8	10.0	17.0	-7.6	-7.0	-4.3	2.6	...
Consumer confidence index (value)	-3.4	-4.2	-3.0	-3.7	-6.2	-4.8	-2.0	-6.1	-3.7
Labour market									
Employment ¹	2.6	2.7	2.8	2.5	3.0	3.2	-	-	-
Unemployment rate (% labour force)	17.2	15.3	15.3	14.6	14.4	14.7	-	-	-
Registered as employed with Social Security ²	3.6	3.1	3.1	2.9	3.0	2.9	2.9	3.0	...
GDP	3.0	2.6	2.6	2.5	2.3	2.4	-	-	-

Prices

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

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	03/19	04/19	05/19
General	2.0	1.7	1.8	2.2	1.7	1.1	1.3	1.5	0.8
Core	1.1	0.9	1.0	0.8	0.9	0.7	0.7	0.9	...

Foreign sector

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

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	03/19	04/19	05/19
Trade of goods									
Exports (year-on-year change, cumulative over 12 months)	8.9	2.9	5.2	4.5	2.9	2.4	2.4	...	...
Imports (year-on-year change, cumulative over 12 months)	10.5	5.6	6.9	6.2	5.6	6.1	6.1	...	...
Current balance	21.5	11.3	18.7	15.0	11.3	9.0	9.0	...	...
Goods and services	33.6	23.5	30.3	26.7	23.5	21.8	21.8	...	...
Primary and secondary income	-12.1	-12.3	-11.6	-11.7	-12.3	-12.8	-12.8	...	...
Net lending (+) / borrowing (-) capacity	24.2	17.6	21.9	18.8	17.6	15.5	15.5	...	...

Credit and deposits in non-financial sectors³

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

	2017	2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	03/19	04/19	05/19
Deposits									
Household and company deposits	2.8	3.2	3.0	3.4	3.7	5.1	5.4	....	....
Sight and savings	17.6	10.9	11.0	10.3	10.0	11.1	11.2	....	....
Term and notice	-24.2	-19.9	-20.7	-18.7	-16.8	-13.7	-12.9	....	....
General government deposits	-8.7	15.4	17.6	10.4	16.9	17.8	19.6	....	....
TOTAL	1.9	3.8	3.8	3.8	4.5	5.8	6.2	...	...
Outstanding balance of credit									
Private sector	-2.2	-2.4	-2.8	-2.3	-2.2	-2.1	-1.4	....	....
Non-financial firms	-3.6	-5.5	-6.4	-5.6	-5.7	-5.5	-3.4	....	....
Households - housing	-2.8	-1.9	-2.0	-1.7	-1.4	-1.2	-1.1	....	....
Households - other purposes	3.7	5.1	5.0	5.5	4.7	4.0	3.2	....	....
General government	-9.7	-10.6	-9.4	-8.9	-11.8	-10.3	-8.4	....	....
TOTAL	-2.8	-2.9	-3.2	-2.7	-2.8	-2.6	-1.8	....	....
NPL ratio (%)⁴	7.8	5.8	6.4	6.2	5.8	5.7	5.7	....	....

Notes: 1. Estimate based on the Active Population Survey. 2. Average monthly figures. 3. Aggregate figures for the Spanish banking sector and residents in Spain. 4. Period-end figure.

Source: CaixaBank Research, based on data from the Ministry of Economy, the Ministry of Public Works, the Ministry of Employment and Social Security, the National Statistics Institute, the State Employment Service, Markit, the European Commission, the Department of Customs and Special Taxes and the Bank of Spain.

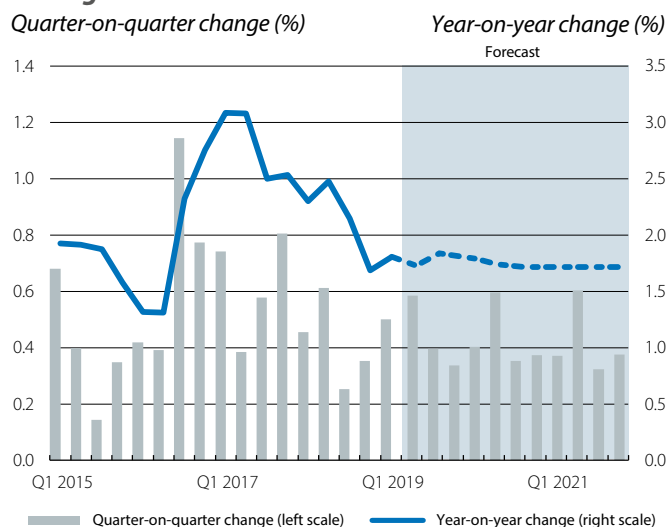
The Portuguese economy shows dynamic growth

Growth remains strong. The estimates published by the National Statistics Institute during the month of May show that Portugal's GDP grew by 0.5% quarter-on-quarter and by 1.8% year-on-year in Q1 2019, both 1 decimal point more than in Q4 2018. In terms of components, domestic demand contributed 4.8 pps to the year-on-year growth, supported by the strength of investment (especially in construction and capital goods). In contrast, foreign demand made a negative contribution (–3.1 pps) due to the strong growth of imports, which was well above that of exports. These growth figures were in line with expectations and reinforce CaixaBank Research's forecast for Portugal's GDP growth in 2019 (1.8%). In the same vein, in the May update of its forecasts, the OECD also predicts growth of 1.8% for Portugal's GDP in 2019, supported by private consumption and investment. As for Q2, the indicators continue to indicate that the economy is on a favourable path. In April, the coincident economic activity indicator developed by the Bank of Portugal stood at 2.0% (1.9% on average during Q1), while the coincident indicator for consumption also stood at 2.0% (in line with the Q1 average). These figures suggest that economic activity has grown at a rate similar to the previous quarter. However, opposing these positive dynamics is the concerning deterioration of the external environment. As we set out below, the rise in the current account deficit is mainly the result of the boost to imports caused by investment, which could be positive for the economy's potential growth in the medium term. However, this deterioration underscores the downside risks related to the foreign sector, given that it is occurring in a scenario of high geopolitical uncertainty and moderate growth across the euro area.

The current account balance continued to deteriorate in March. In particular, the current account deficit stood at 2,414 million euros (12-month cumulative balance), equivalent to –1.2% of GDP and in stark contrast to the surplus for Q1 2018 (0.5% of GDP). This deterioration (1.7 pps) largely reflects the impact that investment is having on imports, given that the balance of non-energy goods (which explains 1.0 pp of the deterioration) was affected by the strong growth in imports of capital goods. Thus, this is not expected to put the correction of the external imbalances at risk in the medium term, although in the short term it may slow down the reduction in net external debt (which stands at a rather high 88.6% of GDP). On the other hand, the deterioration of the balance of revenues related to foreign direct investment explained –0.8 pps of the overall deterioration, while the increase in the energy bill deducted –0.4 pps and the balance of tourist services remained positive (+0.2 pps).

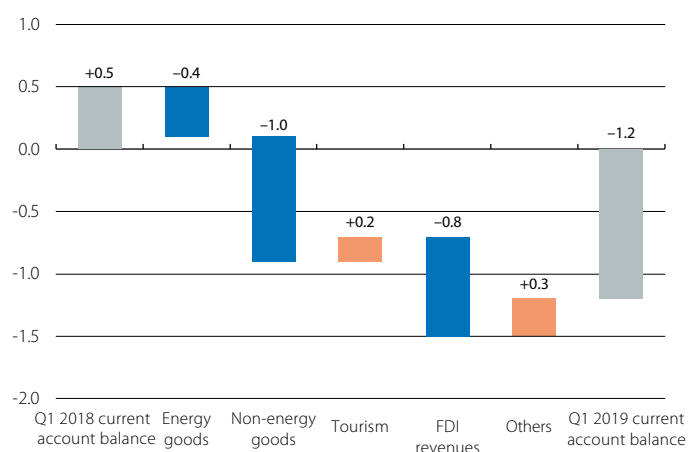
Tourist activity continues to perform well in Q1. In the first quarter of the year, 4.4 million new guests were registered at

Portugal: GDP



Source: CaixaBank Research, based on data from the National Statistics Institute of Portugal.

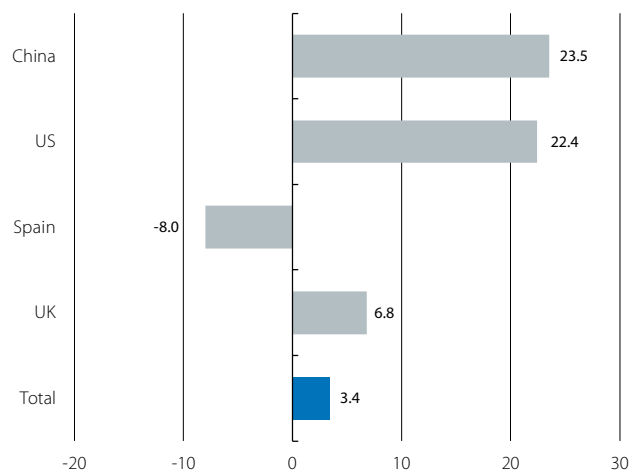
Portugal: deterioration of the current account balance (pps of GDP)



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

Portugal: entry of tourists by origin

Year-on-year change (cumulative figure for January to March 2019, %)



Source: CaixaBank Research, based on data from the National Statistics Institute of Portugal.

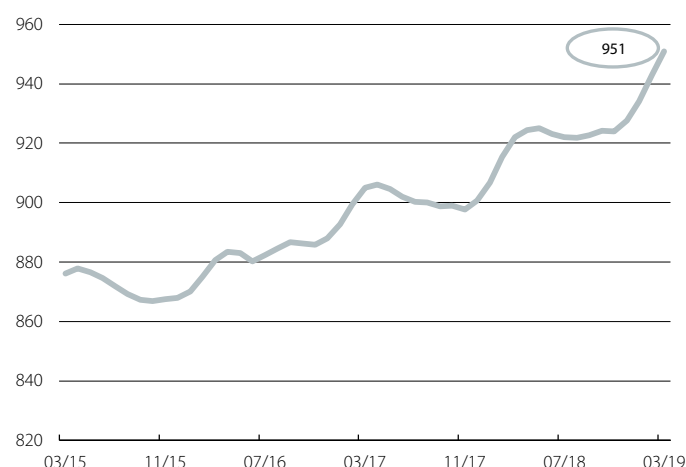
tourist establishments (+4.0% compared to Q1 2018). Of these, approximately 2.5 million were non-residents, an increase of 3.4% year-on-year. Tourists from the United Kingdom registered a year-on-year increase of 6.8% in Q1 (–4.5% in 2018), while those from the US and China registered year-on-year growth rates of 22.4% and 23.5%, respectively. The growth of revenues of tourist accommodation establishments, meanwhile, slowed to 4.9% in Q1 (7.3% in 2018), with a stabilisation of the median revenue per room.

The steady growth of the labour market supports domestic demand. In Q1 the unemployment rate stood at 6.8%, 1.1 pps below the figure for Q1 2018, while the employed population reached 4,880,200 people, representing an increase of 1.5% year-on-year. This trend in the pace of job creation, although favourable, reveals a certain slowdown compared to the figure for 2018 (with a year-on-year growth of 2.3% on average), a predictable development as the economy enters a more mature phase of the cycle. On the other hand, the average monthly gross earnings per employee increased by 3.1% in Q1, as a result of the good performance of the labour market and the rise in the minimum wage from 580 to 600 euros in early 2019.

The public budgetary balance continues to improve. In particular, in the year to date up to April, the public balance stood at –1.8% of GDP (–1.259 million euros), a clear improvement over the –3.0% of April 2018. This was supported by a significant increase in revenues (4.5% year-on-year), which far exceeded that of expenditure (1.1%). The increase in tax and contributory revenues (+6.9% year-on-year) was particularly high, driven by solid economic growth. Of these tax and contributory revenues, the major increase in indirect taxes (+9.4%) was influenced by changes in the timing of tax payments (the deadline for some taxes normally paid at the end of the year was extended until early 2019), but the impact of this factor will dissipate over the course of the year. Direct taxes, meanwhile, grew at a lower rate and below that of the previous month, due to income tax repayments being brought forward. In this context, the risks affecting our forecast (of –0.4% for GDP for the whole of 2019) are balanced.

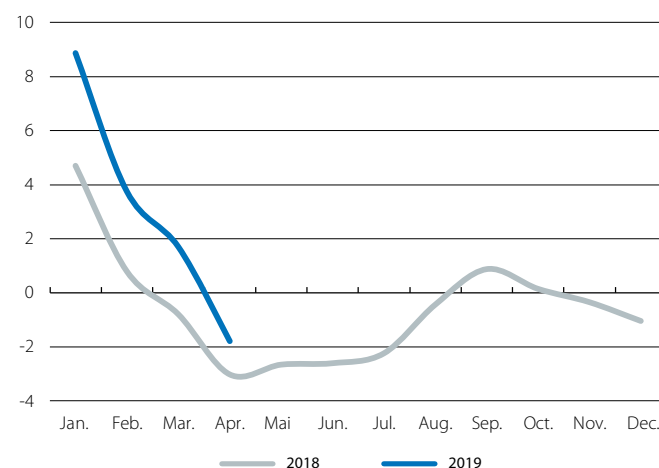
Private sector credit contracted by 2.5% year-on-year in March. Of particular note were the slowdown in consumer credit (from 10.5% year-on-year in 2018 to 8.7% in March) and the contraction of credit lent to corporations (–5.3%), caused by the greater buoyancy of sales of doubtful loan portfolios. Adjusting for this effect, credit lent to companies would have grown by 0.5% in March.

Portugal: average monthly gross remuneration (Euros)



Source: CaixaBank Research, based on data from National Statistics Institute of Portugal and the Social Security institute.

Portugal: central government balance (% of GDP)



Note: The official target (national accounts) for the fiscal balance of 2019 is –0.2% of GDP.
Source: CaixaBank Research, based on data from the DGO and the Portuguese General State Budget for 2019.

Portugal: private sector credit March 2019

	Balance (EUR millions)	Year-on-year change (%)
Credit lent to individuals	119,360	–0.8
Credit for housing	97,005	–1.5
Consumer credit and for other purposes	22,355	2.4
Consumption	15,451	8.7
Credit lent to companies	69,710	–5.3
Non-property developers	64,569	–3.9
Property developers	5,141	–20.0
Total private sector credit *	189,070	–2.5

Note: * Credit lent to the non-financial private sector.
Source: CaixaBank Research, based on data from the Bank of Portugal.

Activity and employment indicators

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

	2017	2018	Q3 2018	Q4 2018	Q1 2019	01/19	02/19	03/19	04/19	05/19
Coincident economic activity index	2.9	2.0	1.8	1.7	1.9	1.8	1.8	2.0	2.0	...
Industry										
Industrial production index	4.0	0.1	-1.6	-1.3	-3.9	-2.6	-2.0	-7.1	-1.6	...
Confidence indicator in industry (<i>value</i>)	2.1	0.8	0.4	-0.8	-1.4	-1.0	-1.2	-2.1	-2.9	-3.7
Construction										
Building permits (<i>cumulative over 12 months</i>)	15.6	20.6	13.9	20.6	20.8	...	...	20.8	...	...
House sales	20.5	16.8	18.4	9.4	...	...	...	...	...	...
House prices (<i>euro / m² - valuation</i>)	5.1	5.8	6.2	6.1	6.9	6.3	6.8	6.9	7.3	...
Services										
Foreign tourists (<i>cumulative over 12 months</i>)	16.0	3.0	6.9	3.5	2.5	3.0	2.8	1.8	...	...
Confidence indicator in services (<i>value</i>)	13.3	14.1	15.9	13.0	15.3	15.4	15.8	14.8	13.7	...
Consumption										
Retail sales	4.1	4.2	2.6	5.2	4.3	5.9	5.0	2.0	9.2	...
Coincident indicator for private consumption	2.7	2.4	2.3	2.1	2.0	2.1	2.0	2.0	2.0	...
Consumer confidence index (<i>value</i>)	-5.4	-4.6	-5.0	-5.4	-8.3	-7.2	-8.3	-9.5	-9.3	-9.0
Labour market										
Employment	3.3	2.3	2.1	1.6	1.5	1.5	1.4	1.1	...	...
Unemployment rate (% labour force)	8.9	7.0	6.7	6.7	6.8	6.6	6.5	6.4	...	...
GDP	2.8	2.1	2.1	1.7	1.8	...	...	1.8	...	...

Prices

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

	2017	2018	Q3 2018	Q4 2018	Q1 2019	12/18	01/19	02/19	03/19	04/19
General	1.4	1.0	1.4	0.8	0.8	0.5	0.9	0.8	0.8	0.5
Core	1.1	0.7	0.8	0.5	0.8	0.8	1.0	0.7	0.8	0.6

Foreign sector

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

	2017	2018	Q3 2018	Q4 2018	Q1 2019	12/18	01/19	02/19	03/19	04/19
Trade of goods										
Exports (<i>year-on-year change, cumulative over 12 months</i>)	10.0	5.3	7.1	5.3	5.6	4.8	4.7	5.6	...	...
Imports (<i>year-on-year change, cumulative over 12 months</i>)	13.5	8.0	8.6	8.0	9.7	8.4	8.7	9.7	...	...
Current balance	0.9	-1.2	-0.4	-1.2	-2.4	-1.4	-1.8	-2.4	...	...
Goods and services	3.5	2.0	3.1	2.0	0.8	1.6	1.1	0.8	...	...
Primary and secondary income	-2.6	-3.2	-3.5	-3.2	-3.2	-3.0	-2.9	-3.2	...	...
Net lending (+) / borrowing (-) capacity	2.7	0.9	1.6	0.9	-0.3	0.7	0.4	-0.3	...	...

Credit and deposits in non-financial sectors

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

	2017	2018	Q3 2018	Q4 2018	Q1 2019	12/18	01/19	02/19	03/19	04/19
Deposits¹										
Household and company deposits	1.7	3.8	4.4	4.2	4.9	5.0	4.7	4.9	...	...
Sight and savings	15.7	14.3	13.6	14.6	14.2	14.9	13.4	14.4	...	...
Term and notice	-5.8	-3.0	-2.1	-3.1	-1.9	-2.0	-1.6	-2.1	...	...
General government deposits	1.3	-1.9	1.0	-9.9	-11.6	-15.7	-12.4	-6.6	...	...
TOTAL	1.6	3.5	4.2	3.4	4.1	4.0	3.9	4.3	...	...
Outstanding balance of credit¹										
Private sector	-4.0	-1.7	-1.4	-1.8	-2.6	-2.7	-2.5	-2.5	...	...
Non-financial firms	-6.5	-3.8	-3.7	-4.5	-5.7	-6.0	-5.6	-5.3	...	...
Households - housing	-3.1	-1.5	-1.2	-1.3	-1.5	-1.5	-1.4	-1.5	...	...
Households - other purposes	0.9	4.5	5.8	5.2	3.1	3.5	3.4	2.4	...	...
General government	9.3	2.4	-12.4	-11.6	-12.5	-13.5	-13.4	-10.4	...	...
TOTAL	-3.5	-1.6	-1.9	-2.3	-3.0	-3.2	-3.0	-2.9	...	...
NPL ratio (%)²	13.3	...	11.3	...	...	...	...	...	...	...

Notes: 1. Aggregate figures for the Portuguese banking sector and residents in Portugal. 2. Period-end figure.

Source: CaixaBank Research, based on data from the National Statistics Institute, Bank of Portugal and Datastream.

Young adults in the 21st century, a different approach to life?

- The current generation of young adults is very different from that of their parents: better prepared, more diverse and with a different set of values.
- Young adults are delaying key milestones such as leaving home, living as a couple and having children, and there is greater diversity in the type of households.
- There are essentially two major forces behind these changes: cultural transformations and the economic environment.
- The cyclical factors that have delayed the decisions taken by today's young adults will lose intensity over the coming years. However, the underlying forces, such as secularisation and economic transformations, will remain ever present and suggest that, broadly speaking, the behavioural changes we see among young people are here to stay.

The young adults of today: a different generation

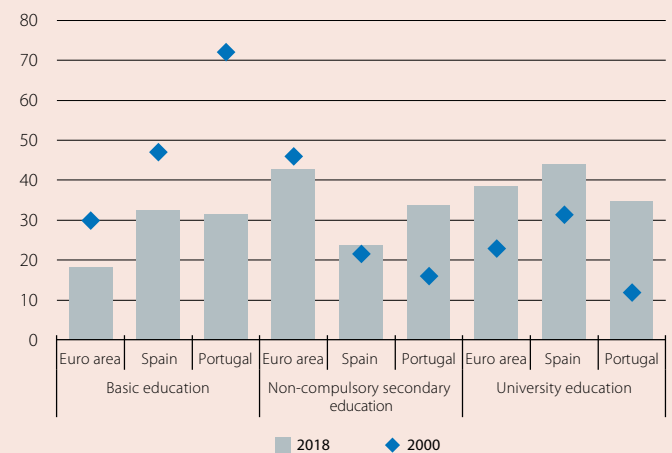
Around 11.2 million Spaniards and 2.4 million Portuguese today are young adults, the population between 20 and 39 years of age that represents the first phase of adulthood (those who have reached «full growth or development» according to the definition by the Spanish Royal Academy). In biological terms this development refers to full reproductive capacity, although in a broader sense it refers to independent decision-making. This population takes the first decisions of the adult phase in life, covering further education (master's degrees, postgraduate courses, etc.), leaving home, forming a family, parenthood, as well as working in a phase in life that is key for their professional development. It is for all these reasons that the future of our society is influenced by the decisions taken by young adults. In this article, we will analyse the socio-demographic changes taking place in our young adults, as well as the factors that are driving them to these changes and the consequences for society as a whole.

Young adults represent a significant portion of the working-age population. In 2018, they made up 37% of the working-age population in Spain (35.8% in Portugal), a significant portion but less than at the beginning of the century, when they accounted for almost half of the working-age population in Spain (48%) and somewhat less in Portugal (44.8%). In the next decade, the weight of young adults in the total population is expected to remain at a similar level, representing 36% of the working-age population in both Spain and Portugal in 2030.

Besides the significant portion of the working-age population that they represent, the current generation of young adults is very different from previous ones. In terms of education, young adults are now a thoroughly prepared generation. In both Spain and Portugal, more than two-thirds have studies beyond the basic education level.¹ This is in stark contrast to the situation in the year 2000, when 47% of young adults in Spain and 72% of those in Portugal only possessed the basic level of education (see first chart). Furthermore, the attainment of education has gone further still, with the proportion of young adults who hold higher university studies and undertake master's and doctoral degrees increasing significantly. Spain even has a higher proportion of university students than the euro area average, in contrast with the situation for secondary education (including vocational training), which is less widespread in Spain than in the euro area as a whole.

Education level of young adults

Percentage (%)



Source: CaixaBank Research, based on data from Eurostat.

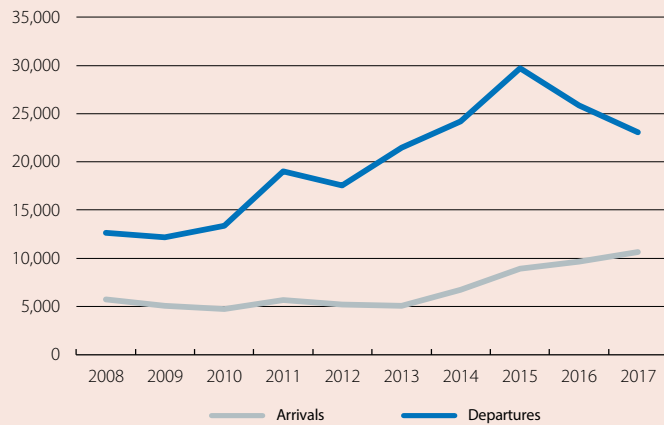
Young adults today are also a more diverse and more mobile generation. One in every five young adults living in Spain in 2018 was born outside the country (in the year 2000 they represented only 5.1% of the population in this age group). This diversity of origin is also well above the average for the population as a whole (9.8%), since the immigration flows are concentrated in the ages of greater participation in the labour market (as is the case for those aged 20 to 39). Out of every four young immigrants, one was born in another EU country and three, outside the Union, above all in Latin America and Morocco. In Portugal, 9.2% of young people were immigrants in 2018, also well above the population average (4.1%).

1. Specifically referring to those who have completed primary education or compulsory secondary education (population aged 25 to 39).

On the other hand, young natives are more mobile than before. Driven in part by the financial crisis, more young Spaniards left the country starting in 2009, reaching a peak of 30,000 young people in 2013 and falling to 23,000 in 2017.² Since the start of the economic recovery, however, the number of young natives returning to Spain (see second chart) has been clearly on the rise. All in all, these figures represent a smaller percentage of the total population of young adults (in 2017, departures represented 0.2% of the population aged 20 to 39 and arrivals, 0.1%).

Arrivals and departures of people born in Spain aged between 20 and 39

Number



Source: CaixaBank Research, based on data from the National Statistics Institute.

Given these changes, it is not surprising that the current generation of young adults behaves very differently to past generations. In particular, they delay key plans which in the past had defined this stage in life, such as leaving home, living with a partner or parenthood. For example, in Spain and Portugal, nearly two-thirds of young people still live with their parents,³ percentage that has increased significantly in both countries and is well above the euro area average (see fourth chart).

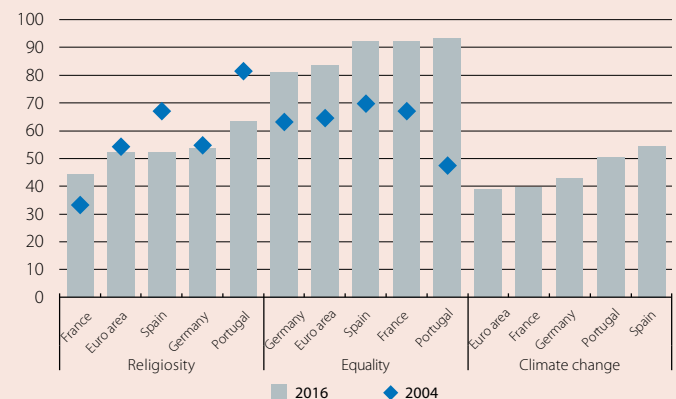
As we discuss later, there are many factors causing young people to delay leaving home. The increased secularisation and individualism of our societies can lead to a relaxation of the social norms relating to when and in what order key milestones like marriage or parenthood take place, but these are also influenced by economic factors. The result is that Spaniards on average marry around 7 years later than they did in 1990 (at 35 years of age for men and 33 years of age for women). In Portugal, men marry at 32 years of age on average and women at 30.4 years, around 6 years later than in 1990. Indeed, this is a trend that can be seen in most advanced countries.

This change has major implications given that, normally, living as a couple favours a more stable lifestyle and the taking of decisions that entail greater long-term commitment. Thus, one characteristic of today's young adults that has significant social consequences is the delay in the age at which people have their first child. This has risen from 28 in 1995 to 31 in 2016 for Spanish and Portuguese women (see fifth chart) and is leading to a reduction in the number of children being born, which was already low in both countries. Specifically, in 2016, for every 1,000 women aged between 20 and 39, 117 children were born in Spain and 125 in Portugal, far below the 157 born in Germany or the 180 in France.

In addition, the current generation of young adults has a very different set of values from their parents (see third chart). Both Spain and Portugal are much more secular countries than just a few years ago. Religious sentiment has fallen markedly among young adults and to a far greater extent than in the rest of the euro area (which was already more secular). In addition, young people place more importance on values such as gender equality. For instance, more and more individuals believe that employment for men should not be given priority over employment for women, an opinion that was not so widespread a few years ago. Moreover, young adults are concerned about other issues such as climate change, particularly in Spain and Portugal.

Change in the values of young adults

Percentage (%)



Notes: Religiosity refers to the percentage of individuals between the ages of 20 and 39 years who claim to be religious. Equality corresponds to the percentage of individuals between the ages of 20 and 39 years who believe that men should not have more priority to get a job than women. Climate change corresponds to the percentage of individuals between the ages of 20 and 39 years who state that they are very concerned about climate change (not asked in 2004).

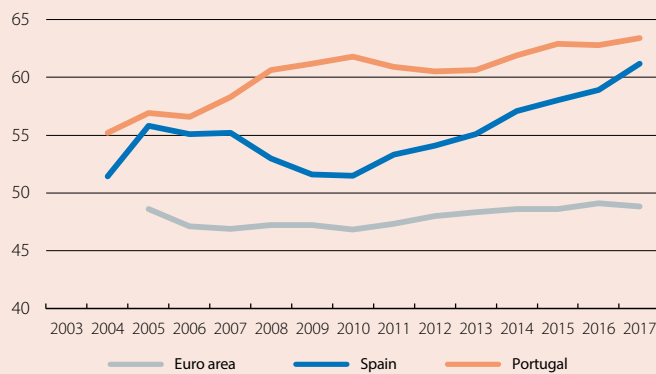
Source: CaixaBank Research, based on data from the European Social Survey (ESS).

2. According to the statistics on migration flows by the National Statistics Institute, drawn up based on the municipal register. These statistics may underestimate the total flows if shorter-term migrations of native Spaniards are not recorded in the register. See A. González-Ferrer (2013), «La nueva emigración española. Lo que sabemos y lo que no», Fundación Alternativas, n° 18/2013.

3. According to Eurostat, in 2017 61.2% of young people aged 18 to 34 were still living with their parents in Spain, and 63.4% in Portugal.

Young adults living in their parents' home *

Percentage (%)



Note: * Between the ages of 18 and 34 years.

Source: CaixaBank Research, based on data from Eurostat.

There are essentially two major forces that have shaped the behaviour of young adults in recent decades: cultural transformations and the economic environment. This is the assessment drawn by studies like the one by Matthias Studer and his co-authors,⁵ which shows that both the shift towards greater secularisation and developments in the labour market have contributed to changes in the formation of households among young adults. In the same vein, Daniel Cooper and María José Luengo-Prado,⁶ economists from the Federal Reserve Bank of Boston, document that much of the delay in young people leaving home and becoming independent can be put down to three key economic variables (regional unemployment rate, the person's employment status and the regional ratio between the price of housing and the income of young people).⁷ On the other hand, both Zachary Bleemer and his co-authors⁸ and Frederick Furlong⁹ show that, in the US, the impact of the great recession of 2007-2009, the increase in the cost of housing and the higher cost of studies have contributed to the delay in people leaving home.

In cultural terms, trends such as the increasing secularisation of society and other changes in values have led experts to postulate the hypothesis that advanced economies are experiencing a second demographic transition.¹⁰ According to this hypothesis, since the 1960s individuals' preferences have evolved towards values that place greater importance on people's self-realisation and individual autonomy. Thus, societies exhibit less willingness to take decisions that entail a long-term commitment. In other words, whereas the first demographic transition was characterised by a decrease in mortality and fertility rates, these changes of values lead to a second transition characterised by a reduction in marriages, an increase in divorces, a postponement of when people have children and a reduction in the number of children being born.

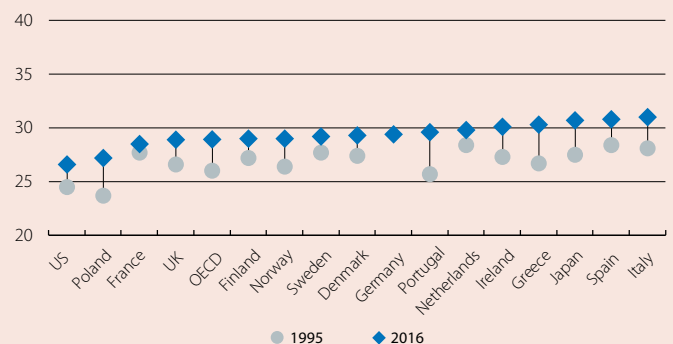
In addition, there is greater diversification in the type of households. In both Spain and Portugal there is an increase in the proportion of couples without children (which represent 22% and 24% of the total number of households, respectively), as well as single parent households (representing 3% in Spain and 4% in Portugal). This greater diversification in the types of household seems to be even more marked among individuals with lower incomes.⁴

What lies behind the new profile of young adults?

It is time to analyse what has led today's young adults both to postpone leaving home and starting a family and to form more diverse household structures. The nature of these causes will give us clues about how temporary or permanent these changes will be.

Average age at which women have their first child

Years



Source: CaixaBank Research, based on data from the OECD («Society at a Glance 2019»).

4. See O. Zimmermann and D. Konietzka (2017). «Social disparities in destandardization. Changing family life course patterns in seven European countries». *European Sociological Review*, 34(1), 64-78.

5. M. Studer, A.C. Liefbroer and J.E. Mooyaart (2018). «Understanding trends in family formation trajectories: An application of competing trajectories analysis (CTA)». *Advances in Life Course Research*, 36, 1-12.

6. D. Cooper and M.J. Luengo-Prado (2018). «Household formation over time: Evidence from two cohorts of young adults». *Journal of Housing Economics*, 41, 106-123.

7. This study analyses differences between two groups of young adults in the US: those born between 1957 and 1965 and those born between 1980 and 1984. In their analysis, demographic (sex, education, race, etc.) and economic variables (unemployment rate, cost of housing, occupational status, etc.) explain 70% of the difference between the two groups (the variable of interest is the likelihood of not having left home).

8. Z. Bleemer, M. Brown, D. Lee and W. Van der Klaauw (2014). «Tuition, jobs, or housing: What's keeping millennials at home». In Staff Report 700. Federal Reserve Bank of New York.

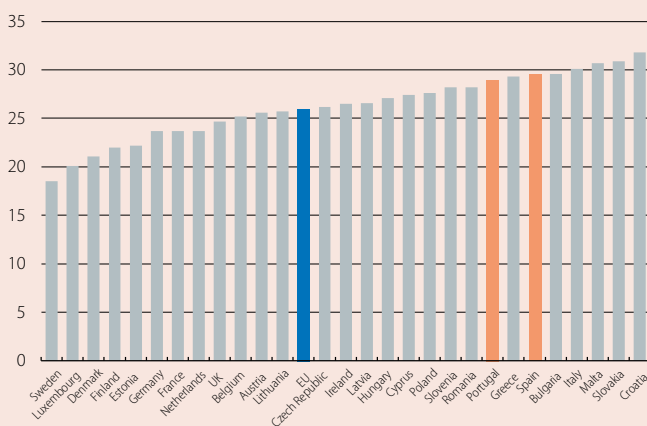
9. F. Furlong (2016). «Household formation among young adults». FRBSF Economic Letter, Federal Reserve Bank of San Francisco.

10. R. Lesthaeghe (2014). «The second demographic transition: A concise overview of its development». *Proceedings of the National Academy of Sciences*, 111(51), 18.112-18.115.

With regard to changes in the economic environment, we must distinguish between phenomena of a cyclical nature and underlying economic transformations. If we focus on the former, the young adults of today are a generation marked by the economic recession that began in 2008: they have had to take their first big decisions as adults (such as the desired level of studies, entering the labour market and starting a family) at the most turbulent economic time in recent decades. This recession particularly penalised young workers, who suffered a bigger rise in unemployment, had greater difficulties in getting a stable job and faced a bigger drop in their incomes. For instance, between 2008 and 2016, the average wage in Spain fell by 14.9% for workers aged between 20 and 24 and by 8.9% for those aged 25 to 29 (compared to a cumulative increase of 5.8% for workers of all age groups as a whole).¹¹ In addition, the unemployment rate among Spanish workers aged 20 to 39 reached a peak of 30% in 2013, with 58% long-term unemployment in this age group (peak registered in 2014) and an incidence of temporary employment above that of the rest of the population. These figures have improved since then, but they remain at relatively high levels.¹² In fact, the recession will probably have long-lasting effects on the incomes of the current generation of young adults: several studies have shown that the conditions under which one enters the labour market (type of contract, salary, sector, etc.) are slow to fade and have an impact on labour conditions well into the future.¹³ Finally, compounding these difficulties in the labour market is the significant rise in the cost of housing, which has grown well above young adults' incomes. In particular, as discussed in a recent article by the Bank of Spain,¹⁴ housing prices have registered a cumulative rise of around 27% (in nominal terms) between early 2014 and the end of 2018, figures which contrast with the aforementioned fall in young people's incomes.¹⁵

Average age at which young people leave home

Years



Source: CaixaBank Research, based on data from Eurostat.

Secondly, there are three major underlying economic trends that have likely contributed to the behavioural changes we see in young adults: globalisation, technological transformation and the increased participation of women in the labour force. As we have already analysed in other articles,¹⁶ in recent decades, globalisation and technological change have facilitated a transformation of employment towards less stable labour relations (i.e. with a greater incidence of short-term contracts and self-employment),¹⁷ as well as rewarding higher education levels.¹⁸ Thus, these phenomena incentivise young people to postpone leaving home and starting a family, as they require more time to be devoted to education and lead to greater uncertainty over the stability of future incomes. The role of greater participation of women in the labour force is also worth highlighting: in Spain, between 2002 and 2018, the participation rate of women between 20 and 39 years of age went from 69.3% to 79.3% (reaching a peak of 82% in 2013-

2014). However, the institutional differences in the type of welfare state allow these latent forces affecting all advanced economies to be dealt with in different ways. As can be seen in the sixth chart, young people in Scandinavian countries, where the environment is more favourable, continue to become independent at an earlier age.¹⁹

11. The data on the incomes of new young adults in the US are also revealing: while the average university graduate who entered the labour market in the 1990s received a cumulative wage increase of 50% between the ages of 23 and 28, for those who entered the labour market in 2008 the cumulative increase was 25%.

12. According to the labour force survey for Q1 2019, in Spain the age group from 20 to 39 years of age has an unemployment rate of 17%, with a fraction of 36% in long-term unemployment, while the percentage of employees aged 20 to 39 with a temporary contract is 37%.

13. See L.B. Kahn (2010). «The long-term labor market consequences of graduating from college in a bad economy». *Labour Economics*, 17(2), 303-316.

14. P. Alves and A. Urtasun (2019). «Evolución reciente del mercado de la vivienda en España». *Economic Bulletin* 02/2019, Bank of Spain.

15. See the article «[How have young adults changed their consumption and savings decisions?](#)» in this same Dossier for an analysis of access to housing for young Spaniards.

16. See the articles «[The sharing economy and the labour market](#)» in the MR07/2018, «[The benefits and costs of globalisation](#)» in the MR09/2018, and «[Teaching to learn: education in the era of technological change](#)» in the MR05/2017.

17. In the EU, so-called «contingent jobs» are held by around 20% of workers between the ages of 15 and 64. See W. De Groen and I. Maselli (2016). «The impact of the collaborative economy on the labour market». CEPS Working Papers.

18. For example, according to the data from the US, whereas in 1980 the average weekly earnings of employees with a college degree were 40% higher than those of workers with secondary education, in 2018 they were 80% higher.

19. Scandinavian countries stand out as they provide a complete package of measures to facilitate independence and fertility (with a combination of financial aid, flexible maternity and paternity leave, and a range of childcare services). This is in addition to the well-known «flexicurity» system of their labour market, which offers highly flexible labour legislation, but with relatively generous unemployment benefits and strong support from active policies to facilitate a successful reintegration into the labour market.

What will the future bring?

In an economic environment like the current one, with sustained growth and improvement in the labour market, the cyclical factors that have delayed the decisions of new young adults should lose strength. An exception, perhaps, will be risk-taking. This is because various studies²⁰ show that households' approach to risk-taking is closely related to the experiences they have lived through (something we illustrate in the last chart). Therefore, it is likely that the experience of the last financial crisis will lead to a reduced preference for risky financial assets. On the other hand, the underlying forces such as secularisation and economic transformations will remain ever present. Thus, it is likely that both leaving home and parenthood will continue to occur later. In addition, we are likely to continue seeing greater diversity in the type of households there are and, in particular, a lower percentage of marriages. For instance, in a 2011 study, the OECD²¹ forecast that by 2030 single-parent households could represent between 20% and 30% of all households with children in countries such as Germany, the US or Japan (15%, 24% and 6.5% in 1990, respectively). The study also indicates that in 2030, between 30% and 40% of households could be made up of just one person in the main OECD member countries.

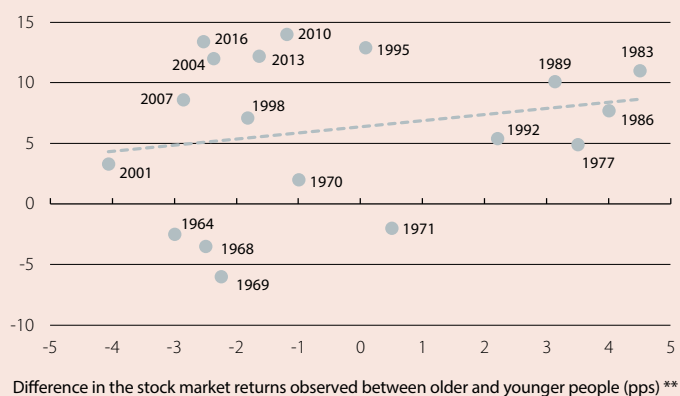
For the case of Spain, household projections by the National Statistics Institute (NSI) suggest that, between 2018 and 2033, the creation of households will be more dynamic than in the last decade but less so than during the previous expansionary phase. In particular, the NSI forecasts that around 1.8 million new households will be created (an increase of 9.6%), with a greater bias towards smaller households. Specifically, in 2033, single-person households will represent 28.8% of the total (25.4% in 2018), while the proportion of households with three or more members will decrease from 44.2% in 2018 to 39.6% in 2033. Finally, in this context, it is not surprising that the most recent projections by Eurostat indicate that fertility will remain below the replacement rate of 2.1 children per couple in the major euro area economies.

The measures required to accommodate these underlying trends go beyond the scope of mere social policies. In particular, helping young people to leave home and become independent, while at the same time allowing them to achieve their desired level of studies and to enter the labour market, is not just a matter of having a wide range of grants or loans to finance those studies. This transition is also favoured by policies that facilitate the passage from education to joining the labour market (for example, with programmes such as dual vocational training, which combine education with participating in productive activity)²² or that reduce the sources of labour instability among young people, such as the high duality of the labour market.²³ With regards to fertility, various studies point out that concrete measures such as parental leave improve the chances of people having a second child and reduce the risk of separation.²⁴ However, it is also key to foster an environment that allows both men and women to balance their working lives with caring for a family (for instance, with a range of childcare services) and that provides protection against fluctuations in household income. Otherwise, historical experience shows that economic insecurity delays the formation of families and reduces fertility rates.²⁵ Accommodating the forces that lie behind the demographic changes described above is a challenge for public policy, but also for society as a whole, since firms and workers also play a key role in deciding upon their organisational models. Facilitating a good work-life balance for families, enhancing education and insertion into the labour market and, ultimately, encouraging fertility helps to mitigate the effects of population ageing. Moreover, the benefits this generates, ranging from spurring economic growth to improving the sustainability of the pension system, have a positive impact on society as a whole.

Josep Mestres Domènech and Adrià Morron Salmeron

US: experience and participation in the stock market

*Difference in participation in the stock market between older and younger people (pps) **



Difference in the stock market returns observed between older and younger people (pps) **

Notes: * Fraction of households that possess stock market assets (over 65-year olds - under 45-year olds).
 ** Real return of the S&P 500 (average of the previous 50 years - average of the previous 20 years).

Source: CaixaBank Research, based on data from the Survey of Consumer Finance performed by the Fed.

20. See U. Malmendier and S. Nagel (2011). «Depression babies: do macroeconomic experiences affect risk taking?». The Quarterly Journal of Economics, 126(1), 373-416.

21. OCDE (2011). «The future of families to 2030: projections, policy challenges and policy options».

22. See S. Bentolila, A. Cabrales and M. Jansen «The Impact of Dual Vocational Education on the Labor Market Insertion of Youth: Evidence from Madrid», FEDEA.

23. See S.O. Becker, S. Bentolila, A. Fernandes and A. Ichino (2010). «Youth emancipation and perceived job insecurity of parents and children». Journal of Population Economics, 23(3), 1047-1071.

24. See Vono de Vilhena and Oláh (2017). «Family Diversity and its Challenges for Policy Makers in Europe». Discussion Paper.

25. See B. Chabé-Ferret and P. Gobbi (2018). «Economic uncertainty and fertility cycles: The case of the post-WWII baby boom», CEPR Discussion Paper.

How have young adults changed their consumption and savings decisions?

Consumption: less spending capacity and changes in consumption habits

Young adults (20 to 39 years of age) in Spain and Portugal have been more severely affected than other demographic groups by a more volatile economic environment and the effects of the Great Recession. In Spain, household consumption has already reached almost pre-crisis levels on average, yet this is not the case among young people.

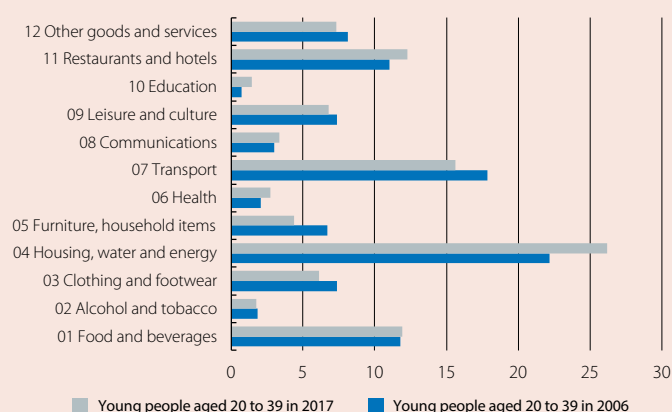
Specifically, according to the Spanish household budget survey, the population's average annual expenditure per household in 2017 stood 4% below that of 2006 (in nominal terms). On the other hand, if we focus on households headed up by young adults, their average annual expenditure was 11% lower in 2017 (30,751 euros in 2006 compared to 27,293 euros in 2017).

Consumption habits have also changed among young adults:

- **The area in which young adults have cut back their spending the most in relative terms is transport** (private and public, including expenditure on maintenance and repairs): its percentage relative to total expenditure has reduced by 2.3 pps between 2006 and 2017. The main reason for this drop is that the percentage of young adult households who had expenses related to cars they owned fell from 25% in 2006 to 13% in 2017 (in contrast, the average expenditure on cars per young adult household who had allocated money to this item remained virtually unchanged). This largely reflects a change in the preferences of young people towards more economical and sustainable modes of transport.
- **On the other hand, the area in which young adults have increased their spending the most in relative terms is housing** (+4.0 pps between 2006 and 2017). This increase can be almost entirely explained by the increase in the aggregate expenditure on rent¹ by young adults. On the one hand, the percentage of young adult households who were renting rose by 17 pps between 2006 and 2017 (from 28.4% to 45.4%). On the other hand, among young adults who rented, their average expenditure on rent increased by 19% between 2006 and 2017.
- In contrast, attributed rents² (homes under ownership) fell by 44% between 2006 and 2017 among young adults. In this case, the percentage of young households that are homeowners fell by 17 pps between 2006 and 2017 (from 71.6% to 54.6%) and, moreover, the average expenditure on this item dropped slightly (7%).

Spain: composition of annual expenditure by age group and year

Percentage of total annual expenditure (%)

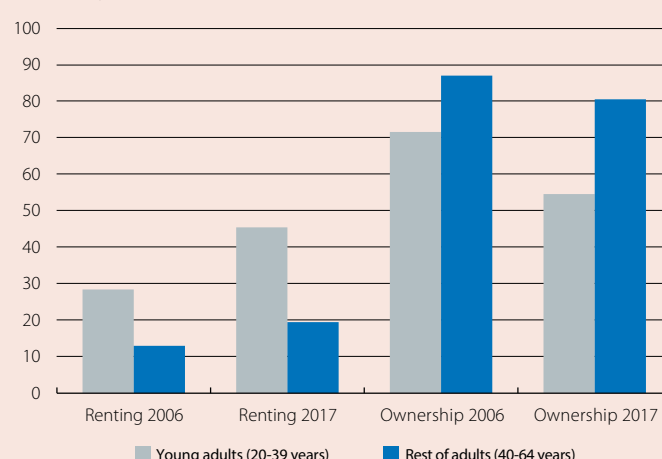


Note: Classification according to the ECOICOP (European Classification of Individual Consumption by Purpose).

Source: CaixaBank Research, based on data from the household budget survey (HBS).

Spain: home ownership versus renting

Percentage of households (%)



Source: CaixaBank Research, based on data from the household finances survey (HFS) by the National Statistics Institute.

1. To calculate this expense, we focus only on rentals at market rates. In contrast, when we look at the percentage of young people who rent, we are also including social rentals.

2. This is the rental value of a home under ownership. It is estimated by calculating what a tenant would pay for the same accommodation, taking into consideration factors such as the location and the facilities in the area, as well as the size and quality of the property itself.

Young adults and housing in detail: from purchasing to renting

The factors that explain the drop in the proportion of home ownership in favour of renting among young adults are economic and sociological.

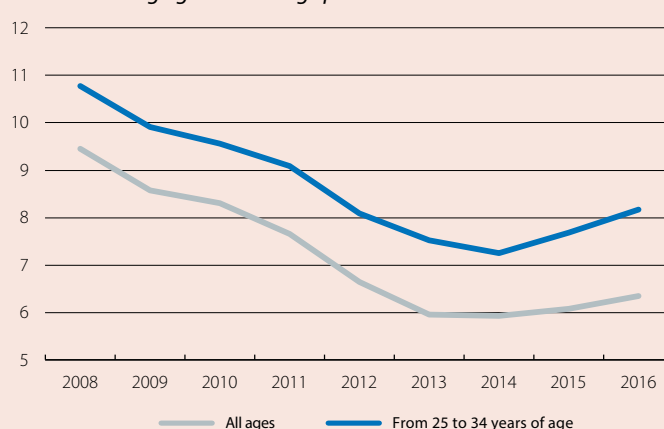
► Economic factors:

- Young adults have been the group most affected by the financial crisis. The average annual income of young people has been particularly penalised following the financial crisis, and this is in addition to the difficult labour conditions for young people, which have not been favourable for getting a foot on the housing ladder. Although the labour indicators at the aggregate level have improved since 2014, but they remain particularly weak for this group, as shown by an unemployment rate of 17% for young adults (20 to 39 years of age) in Q1 2019 or a very contained growth in wages.

- The meagre growth in wages makes buying a home difficult, in a context of a vigorous recovery in housing prices. As an example, the economic effort required from young people aged between 25 and 34 in order to get on the housing ladder has increased markedly between 2014 and 2016. Furthermore, although the effort required in 2016 was lower than before the crisis, it should be borne in mind that the conditions for accessing mortgage credit are now more demanding than they were in the previous expansionary cycle. For instance, households need to save a significant sum of money in order to get a mortgage, as demonstrated by the fact that the proportion of loans with a loan-to-value³ ratio above 80% represents just 13.1% of all mortgages granted in Q1 2019 (17% in 2006). As such, the initial deposit required currently constitutes a significant barrier to entry, amounting to 45,192 euros on average in 2016 according to Spain's Emancipation Observatory, i.e. 2.5 times the average annual income of a person aged between 25 and 34.⁴

Spain: housing accessibility ratio

Ratio between the price of an average property in Spain (93.75 m²) and the average gross earnings per worker



Source: CaixaBank Research, based on data from the annual wage structure survey by the National Statistics Institute.

- The gap in the economic effort required to access home ownership between young people aged 25 to 34 and the total for all workers has increased since 2014, since the recovery in wages has not reached the young adult group. Specifically, the average gross earnings per worker increased by 1.3% in Spain between 2014 and 2016 but decreased by 3.8% for young people aged 25 to 34.
- Taxation has also had an influence due to the tax changes introduced in 2013, which removed the personal income tax deduction for investing in a primary residence and reduced the tax bias that favoured buying over renting.

► Sociological factors:

- There has been a change of preference among young people in favour of a more flexible and footloose lifestyle (greater geographical and occupational mobility could be important underlying factors).
- In addition, the tendency to postpone key decisions, such as the age at which young people leave home or start a family, also leads them to delay the decision to buy a home.

3. This is the ratio between the mortgage amount and the value of the property acquired. The average in Spain for new mortgages stands at 65%.

4. See A.G. Muñoz Fernández (2017). «Juventud y mercado de la vivienda en España: análisis de la situación». Revista de Estudios de Juventud, nº 116.

The financial situation of young adults: fewer savings and more debt

The fraction of households with a young adult as the head of the family (aged 20 to 39) that had bought savings or investment instruments in 2014⁵ was lower than the fraction of adult households aged 40 to 60 (see the table for more details). On the other hand, a larger fraction of young adult households had debts. There are also substantial differences between young households that are homeowners and those that are not. This is due to the fact that buying a home is the most important financial decision a household makes, due both to its value and to the fact that it represents the main instrument for the accumulation of wealth by acting as a form of savings mechanism.

- **Assets:** a higher percentage of young adult households that are homeowners possessed equity instruments and pension funds in 2014, in comparison with young adult households that were not homeowners. This suggests that young households without a home of their own have less savings capacity, since it is precisely these households that tend to have lower incomes.
- **Liabilities:** the percentage of non-homeowner young adult households that had taken out some form of non-mortgage debt in 2014 was 35.6%. This is a relatively high figure (although somewhat below the 40% of 2005) and quite similar to that of non-homeowner households between 40 and 60 years of age (41.6%). Therefore, more than a third of young people who do not own a home do, in fact, have other types of financial needs that lead them into debt, through both consumer loans and business loans (as self-employed workers and entrepreneurs).

Spain: financial situation of young households in 2014

Percentage of households over the total number of households with those characteristics for each age group *

	Age	Total	Non-homeowners	Homeowners
Assets				
Equities	20-39	5.9	3.5	7.2
	40-60	11.1	9.4	11.5
Investment funds	20-39	2.7	2.7	2.7
	40-60	6.5	4.4	7
Pension funds	20-39	22.6	12.7	28.1
	40-60	38.4	22.2	41.9
Liabilities				
Any type of debt	20-39	69.0	35.6	87.6
	40-60	62.1	41.6	66.6
Mortgage debt	20-39	50.1	–	79.4
	40-60	35.5	–	43.2

Note: * For example, 3.5% of households aged between 20 and 39 that are not homeowners possessed equities, while 7.2% of households aged between 20 and 39 that are homeowners possessed equities.

Source: CaixaBank Research, based on data from the household finances survey (HFS) of 2014.

Oriol Carreras and Marc Miró i Escolà

5. Data from the household finances survey (HFS) of 2014, the latest survey available.

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Society has become notably more polarised, but what factors lie behind this phenomenon? How is it manifesting itself and what challenges does it pose?



Medium-term outlook for the European economy: lower growth but with room for improvement

We explore the potential growth of the European economy and the factors that could revitalise it.



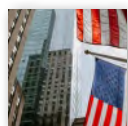
European integration: the next five years... and the following decades

Can we expect progress to be made towards greater European integration? In which areas?



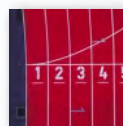
What will be of the US fiscal policy?

We analyse how US fiscal policy can influence the scenario over the coming quarters.



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