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ECONOMIC & FINANCIAL ENVIRONMENT

DOSSIER: LABOUR MARKET: STRUCTURAL CHANGES AND ECONOMIC CRISIS

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"la Caixa"

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
April 2014

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The labour market: structural changes and economic crisis

Over the last decade, labour markets the world over have been under considerable pressure: in addition to the structural changes caused by globalisation and information and communication technologies (ICTs) there has also been a strong recession, especially in the developed countries.

Although a comparative analysis of wage levels is no easy task, the latest data provided by the International Labour Organisation show that, in spite of the crisis, real wages in the world are still tending to grow. This is particularly the case in the emerging regions and the gap between salaries in the different countries of the planet is therefore gradually narrowing, although there is still a long way to go.

In the emerging world, however, the progress being made is highly diverse. The Asian continent offers a highly positive note while improvements are more meagre in Africa and South America. The most acute growth is occurring in countries where, as in China, there is a combination of a gradual freeing up of economic activity, a predictable institutional environment and a stable macroeconomic framework, at least in terms of public deficit and inflation.

The crisis has not affected all countries equally in the developed world either. Macroeconomic stability has also been important in these economies, since those that have been able to maintain financial equilibrium have suffered less from the recession, avoiding the excessive accumulation of public and private debt. Nevertheless, the nature of labour market institutions has been the most decisive factor. The effects of the crisis in terms of job losses have been harsher in those countries with a more rigid labour market. This lack of flexibility in labour legislation has meant that any adjustments required due to a drop in demand have been carried out by reducing the number of employees and not via alternative measures with less negative structural and social effects, such as reducing the number of hours worked or altering other employment conditions.

More flexible labour market institutions also help sectors to readjust; a process which many advanced economies must inevitably carry out. These changes in the distribution of employment by sector are partly due to the Great Recession itself, which originated in the excessive expansion of some economic sectors but was further boosted by the persistent effects of the aforementioned structural trends: globalisation and ICTs. Exiting the Great Recession, the majority of new jobs will be created in the most dynamic economies, especially in those that provide their workers with continued training and flexible employment conditions.

Lastly, flexible labour institutions are also crucial to ensuring that growth in real wages is sustainable over time and thereby becomes a factor of social progress. In the face of structural changes and macroeconomic disturbances, this flexibility must help the economic system to bring about an evolution in real wages that is in line with each country's improvements in productivity. In a globalised world, all open economies are subject to this restriction, whether they are developed or not, and a well-designed labour market is fundamental to their successful adaptation.

Jordi Gual
Chief Economist
31 March 2014

CHRONOLOGY

MARCH 2014

7 The Spanish cabinet approves a **Royal Decree-Law** for the **refinancing and restructuring of corporate debt** with the aim of enhancing the survival of viable companies with a heavy financial burden.

20 The European Council and European Parliament reach an agreement to amend the initial proposal for the **Single Resolution Mechanism** (the periods of time established for setting up the single resolution fund are shortened and decision-making is simplified).

FEBRUARY 2014

3 **Janet Yellen** is sworn in as chairwoman of the Federal Open Market Committee of the United States' **Federal Reserve.**

JANUARY 2014

15 **Spain** successfully completes the **financial aid programme** to recapitalise its banks.

DECEMBER 2013

18 The Federal Reserve starts to **withdraw its monetary stimuli**, reducing its debt purchases by 10 billion dollars per month.

19 The European Council approves the general approach on the **Single Resolution Mechanism**, one of the key pieces in the Banking Union.

NOVEMBER 2013

7 The **European Central Bank** lowers the official interest rate to 0.25% and the marginal lending facility rate to 0.75%.

OCTOBER 2013

23 The European Central Bank establishes the schedule to **assess bank balance sheets** prior to assuming its single supervisory tasks. Three exercises will be carried out (risk assessment, asset quality review and a stress test), which will start in November 2013 and whose findings will be published in October 2014.

AGENDA

APRIL 2014

2 Registration with Social Security and registered unemployment (March).
Household savings rate (fourth quarter).

3 Governing Council of the European Central Bank.

7 Industrial production index (February).

16 International trade (March).

21 Loans, deposits and NPL ratio (February).
Financial accounts (fourth quarter).

29 Economic sentiment index of the euro area (April).
Labour force survey (first quarter).

30 GDP flash estimate quarter-on-quarter (first quarter).
Balance of payments (February).
CPI flash estimate (April).
Fed Open Market Committee.
GDP flash estimate of the United States (first quarter).

MAY 2014

6 Registration with Social Security and registered unemployment (April).

8 Governing Council of the European Central Bank.
Industrial production index (March).

15 GDP flash estimate of the euro area (first quarter).
GDP flash estimate of Japan (first quarter).

19 International trade (April).
Loans, deposits and NPL ratio (March).

28 Economic sentiment index of the euro area (May).

29 Quarterly national accounts (first quarter).

30 Balance of payments (March).
CPI flash estimate (May).

Contained risk in some emerging countries

Further setbacks on the emerging front. The geopolitical conflict that has broken out between Russia and the Ukraine and increased doubts regarding China's economic growth dominated the economic news in March and led to an upswing in risk aversion among investors. However, any contagion to the international scene has been relatively contained. The medium-term outlook is still encouraging, essentially supported by sustained improvement in global growth, the continuation of favourable monetary conditions and a gradual recovery in the euro area's growth prospects.

Investors discriminate between emerging risks. The effect of tensions in the Crimean peninsula was restricted to losses on Russia's stock market and the depreciation of the rouble and Ukrainian hryvnia against the dollar, while the effect on the rest of the emerging financial environment was also limited. Doubts regarding whether China can sustain its growth have failed to have any huge repercussions either. The likelihood of a serious decline for the Asian giant cannot be ignored but it has a lot of room to act in terms of monetary, fiscal and macroprudential policy should there be a pronounced slowdown in growth.

The Federal Reserve updates its forward guidance. The latest activity indicators in the USA are starting to recover from the effects of the bad weather at the start of the year. The business sentiment index is now at a level compatible with moderate growth in the economy and consumer confidence has reached its highest level since January 2008. The recovery in the labour market is still the area that causes most doubts. Although 175,000 jobs were created in February, the average for the last three months is only 129,000, the lowest figure since July 2012. Given this situation, after the last meeting of the Federal Open Market Committee, Janet Yellen announced that interest rates would remain below their historical average even after the inflation and unemployment targets that had been set a few months ago are reached. The Fed thereby abandoned its quantitative forward guidance strategy and introduced qualitative variables related to the labour market, inflation and financial conditions. The Fed's new communication policy, less precise and somewhat changeable, is likely to lead to episodes of volatility, especially if inflation starts to pick up within the current context of rising wages.

The economic recovery is consolidating in the euro area. The flow of indicators published in March continues to point to a scenario of gradual recovery. The trend in domestic demand is particularly noteworthy, especially investment which is looking relatively more robust than anticipated. The recovery in the periphery countries is also slightly better than expected. Based on this progressive recovery, the ECB continues to choose not to act although it acknowledges that inflation will remain low for a prolonged period of time and has repeated that it will not hesitate to intervene should deflationary risks intensify. In spite of its apparent inaction, the ECB's discourse appears to be increasingly aware of the risk of deflation. In this respect, the declarations made by the President of the Bundesbank and member of the Governing Council of the ECB, Jens Weidmann, came as some surprise as he did not rule out the ECB buying up public and private debt in order to reactivate the economy and allay deflationary pressures. Little by little, the ECB's intention to carry out quantitative easing, as carried out in the USA, is becoming more credible. Perhaps, once this warning has been fully accepted by the market, it will no longer be necessary to carry it out.

The Spanish economy ended 2014 Q1 with figures that encourage optimism. Available indicators for the first few months of the year point to the rate of growth accelerating. This was the case of "la Caixa" Research's economic activity index, which places quarter-on-quarter growth in GDP between 0.3% and 0.6% in 2014 Q1, higher than the figure of 0.2% recorded in 2013 Q4. Moreover, the map of risks is also moving towards more benign territory. In this respect, the latest report on macroeconomic imbalances published by the European Commission highlights the significant advances being made by the Spanish economy to correct its main imbalances. Although there is still a long way to go, this places the country in a more advantageous position to ensure the recovery steadily picks up steam throughout the year.

FORECASTS

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

International economy

	2012	2013	2014	2015	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4
GDP GROWTH										
Global [1]	3.2	2.9	3.6	3.9	3.0	3.2	3.7	3.6	3.6	3.6
Developed countries										
United States	2.8	1.9	2.8	3.0	2.0	2.6	2.9	3.0	2.7	2.8
Euro area	–0.6	–0.4	1.1	1.5	–0.3	0.5	1.0	1.0	1.1	1.2
Germany	0.9	0.5	1.5	1.8	0.6	1.4	1.8	1.4	1.5	1.5
France	0.0	0.3	0.9	1.1	0.3	0.8	1.0	0.7	1.0	1.0
Italy	–2.6	–1.9	0.5	1.0	–1.9	–0.8	–0.1	0.4	0.7	0.8
Spain	–1.6	–1.2	1.0	1.5	–1.1	–0.2	0.5	0.9	1.2	1.3
Japan	1.4	1.5	1.3	1.4	2.4	2.5	2.6	0.9	0.7	0.9
United Kingdom	0.3	1.8	2.2	2.0	1.9	2.7	2.7	2.4	2.0	1.8
Emerging countries										
Russia	3.4	1.3	0.8	1.4	1.2	1.4	1.3	0.8	0.5	0.7
China	7.7	7.7	7.7	7.5	7.8	7.7	7.8	7.9	7.5	7.6
Indi [2]	5.0	4.7	4.8	4.9	4.8	4.7	4.6	4.4	4.4	5.1
Brazil	1.0	2.3	2.0	2.5	2.2	1.9	1.1	2.1	2.4	2.2
Mexico	3.9	1.1	3.4	3.6	1.4	0.7	2.9	3.1	4.0	3.7
Poland	2.0	1.5	2.7	3.1	1.8	2.2	2.6	2.7	2.7	2.9
Turkey	2.1	4.0	2.0	3.7	4.3	4.4	2.2	1.4	2.0	2.5
INFLATION										
Global [1]	4.0	3.4	3.5	3.3	3.4	3.2	3.3	3.6	3.5	3.5
Developed countries										
United States	2.1	1.5	1.7	1.8	1.5	1.2	1.4	1.8	1.7	1.8
Euro area	2.5	1.4	1.0	1.5	1.3	0.8	0.7	1.0	1.1	1.4
Germany	2.1	1.6	1.4	1.8	1.7	1.3	1.0	1.5	1.5	1.6
France	2.2	1.0	1.3	1.7	1.1	0.8	0.9	1.2	1.4	1.5
Italy	3.3	1.3	0.8	1.5	1.1	0.7	0.4	0.7	1.0	1.2
Spain	2.4	1.4	0.5	1.3	1.2	0.1	0.0	0.4	0.5	1.0
Japan [1]	0.0	0.4	2.5	1.7	0.9	1.4	1.5	3.2	2.9	2.6
United Kingdom	2.8	2.6	2.3	2.4	2.7	2.1	1.9	2.3	2.5	2.5
Emerging countries										
Russia	5.0	6.8	5.6	4.9	6.4	6.4	6.1	5.8	5.3	5.1
China	2.6	2.8	2.8	2.8	2.9	2.3	2.7	3.2	2.9	2.5
India [4]	7.6	6.3	5.0	5.4	6.6	7.0	6.0	6.4	3.8	3.9
Brazil	5.4	6.2	6.0	5.7	6.1	5.8	5.9	5.9	6.4	5.9
Mexico	4.1	3.8	3.9	3.3	3.4	3.7	4.2	3.6	4.0	3.9
Poland	3.7	1.2	1.4	2.2	1.4	0.9	1.0	1.5	1.4	1.8
Turkey	8.9	7.5	7.5	6.5	8.3	7.5	7.8	8.0	7.2	7.0

Notes: *1. In purchasing power parity. 2. Annual figures represent the fiscal year and factor costs. 3. Takes into account the consumption tax hike planned for April 2014. 4. Wholesale prices.*

Forecasts

Spanish economy

	2012	2013	2014	2015	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4
Macroeconomic aggregates										
Household consumption	–2.8	–2.1	1.1	0.8	–1.8	0.7	1.4	1.4	1.1	0.7
General government consumption	–4.8	–2.3	–3.6	–0.5	0.2	–3.5	–4.8	–4.0	–4.7	–1.1
Gross fixed capital formation	–7.0	–5.0	1.0	1.4	–5.3	–1.7	–0.4	1.7	1.5	1.2
Capital goods	–3.9	2.3	6.6	3.6	2.2	9.6	9.6	6.3	5.7	4.7
Construction	–9.7	–9.6	–2.4	0.0	–9.8	–8.6	–5.9	–1.7	–1.0	–1.0
Domestic demand (contr. Δ GDP)	–4.1	–2.7	0.1	0.6	–2.1	–0.6	–0.2	0.4	0.0	0.4
Exports of goods and services	2.1	4.9	5.4	4.9	3.5	3.7	9.6	3.5	4.1	4.5
Imports of goods and services	–5.7	0.4	3.2	2.6	0.6	2.7	7.9	2.1	0.7	2.0
Gross domestic product	**–1.6**	**–1.2**	**1.0**	**1.5**	**–1.1**	**–0.2**	**0.5**	**0.9**	**1.2**	**1.3**
Other variables										
Employment	–4.8	–3.4	0.6	1.2	–3.3	–1.6	0.1	0.5	1.0	1.0
Unemployment rate (% labour force)	25.0	26.4	25.2	24.1	26.0	26.0	26.4	25.2	24.6	24.7
Consumer price index	2.4	1.4	0.5	1.3	1.2	0.1	0.0	0.4	0.5	1.0
Unit labour costs	–3.1	–1.6	0.0	0.5	–1.7	1.3	0.6	0.0	–0.1	–0.5
Current account balance (cum., % GDP)[1]	–1.2	0.8	1.3	1.6	0.7	0.8	1.0	1.1	1.2	1.3
Net lending or borrowing rest of the world (cum., % GDP)[1]	–0.6	1.5	1.9	2.2	1.4	1.5	1.6	1.7	1.8	1.9
Fiscal balance (cum., % GDP)[1]	–10.6	–7.1	–5.8	–4.2	–10.3	–7.1				

Financial markets

INTEREST RATES										
Dollar										
Fed Funds	0.25	0.25	0.25	0.50	0.25	0.25	0.25	0.25	0.25	0.25
3-month Libor	0.43	0.27	0.28	0.75	0.26	0.24	0.24	0.26	0.29	0.31
12-month Libor	1.01	0.68	0.60	1.14	0.67	0.59	0.56	0.58	0.63	0.66
2-year government bonds	0.27	0.30	0.57	1.45	0.36	0.32	0.36	0.50	0.65	0.79
10-year government bonds	1.78	2.33	2.98	3.63	2.70	2.74	2.75	2.88	3.05	3.19
Euro										
ECB Refi	0.88	0.54	0.25	0.42	0.50	0.33	0.25	0.25	0.25	0.25
3-month Euribor	0.57	0.22	0.28	0.53	0.22	0.24	0.30	0.27	0.27	0.27
12-month Euribor	1.11	0.54	0.57	0.92	0.54	0.53	0.56	0.57	0.57	0.59
2-year government bonds (Germany)	0.08	0.13	0.36	0.97	0.17	0.16	0.14	0.29	0.43	0.56
10-year government bonds (Germany)	1.55	1.62	1.77	2.21	1.78	1.79	1.68	1.65	1.75	2.00
EXCHANGE RATES										
$/euro	1.29	1.33	1.35	1.32	1.32	1.36	1.37	1.36	1.34	1.33
¥/euro	102.71	129.65	142.50	147.69	131.09	136.78	141.10	142.22	142.88	144.00
£/euro	0.81	0.85	0.83	0.85	0.86	0.84	0.83	0.83	0.86	0.82
OIL										
Brent ($/barrel)	111.38	108.47	107.87	109.43	109.24	109.23	107.73	107.62	107.98	108.14
Brent (euros/barrel)	86.61	81.67	79.81	82.79	82.46	80.24	78.60	79.08	80.38	81.10

Note: *1. Four quarter cumulative.*

Forecasts

CURRENT SITUATION · **Signs of strength in the face of adversity**

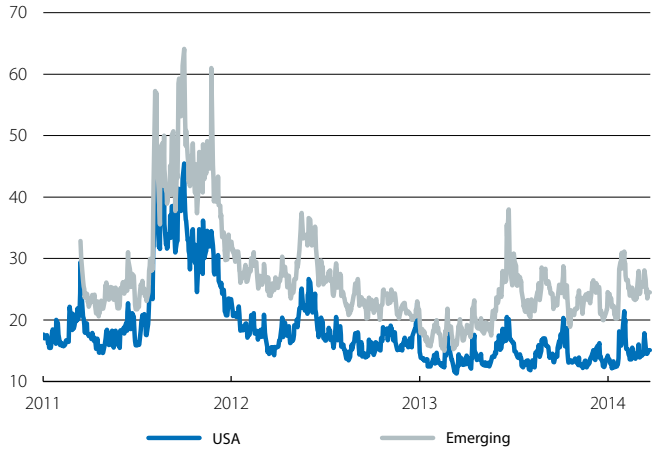
The recent trend in the markets has been marked by the appearance of new setbacks originating in the emerging economies. Firstly, the geopolitical conflict that has broken out between the Ukraine and Russia and the Crimea becoming annexed to the latter. Secondly, growing doubts regarding China's economic growth. And, lastly, the imbalances observed in Chinese capital markets. In spite of this, contagion to the international scene has been relatively contained, mainly affecting the stock markets in Russia and China. In general, the developed financial markets have seen gains by bonds (public and private) compared with an abrupt halt in equity gains. This situation could lead to moderate corrections in the short term given that several technical indicators and indicators for flows are now at worrying levels. However, overall we believe that these obstacles related to the emerging countries will tend to be limited in terms of intensity and frequency, clearing the way for global markets to function properly.

Investors discriminate between emerging risks. The tensions resulting from the territorial dispute on the Crimean peninsula were reflected in losses on the Russian stock market and the depreciation of the rouble and Ukrainian hryvnia against the dollar. Meanwhile, it seemed as if the rest of the emerging financial environment had only been slightly affected, as seen in the trend in some currencies such as the Indian rupee and the Turkish lira. However, China's negative economic news and the instability of its financial system represent a source of concern among investors. The recent bankruptcy of several investment vehicles and the Chinese central bank's conformity to this have increased doubts regarding the solidity of its credit system. Nonetheless, the Chinese economy is unlikely to deteriorate to any great extent. The Asian authorities have a lot of room to manoeuvre in the area of monetary, fiscal and macroprudential policy should there be a pronounced slowdown in growth.

The medium-term outlook is more encouraging. Although the aforementioned events have increased risk aversion among investors, it is also true that sentiment regarding the medium and long term has recovered. Among others, there are several aspects supporting such expectations: (i) the sustained improvement in global growth, (ii) the continuation of favourable monetary conditions, (iii) the reinforcement of the euro area, and (iv) the correction of imbalances in Europe's periphery. However, although the list of identifiable risk factors has shortened over the last few quarters, some significant ones still remain. One of these results from the new indications given by the Federal Reserve (Fed) as part of its forward guidance, where the lack of precision in terms of targets could destabilise the markets. Another factor is the growing attention being given to the risk of deflation in the euro area.

Implied volatility of the US and emerging stock markets

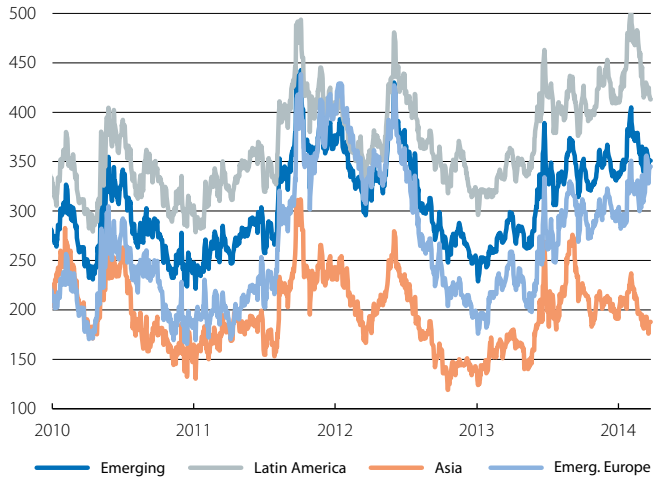
(VIX for the USA and VXEEM for the emerging countries)



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

Sovereign bond spreads of emerging countries

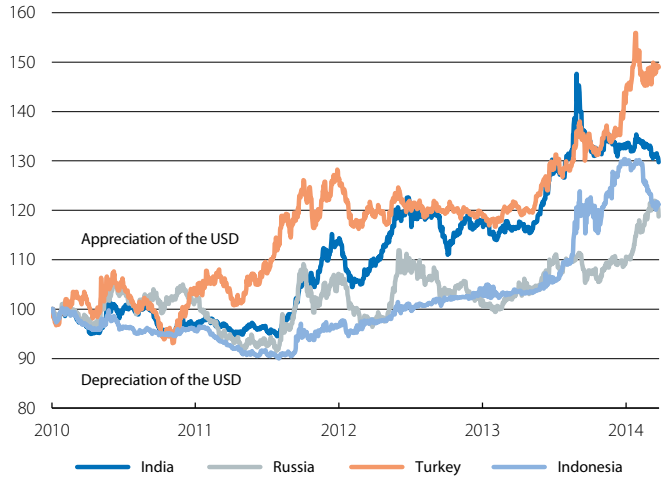
Compared with a basket of US bonds (bps)



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

Dollar exchange rate against the emerging currencies

(January 2010 = 100)



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

The Federal Reserve updates its forward guidance. After the last meeting of the Federal Open Market Committee, Yellen announced that interest rates will remain below their historical average even after inflation and unemployment reach their targets. Without referring explicitly to the 6.5% threshold for unemployment, unlike on previous occasions, the Fed has given up its strategy of quantitative forward guidance and has introduced qualitative variables related to the labour market, inflation and financial conditions. At the same time, it was also decided to maintain the rate of tapering, cutting back bond purchases by 10 billion dollars a month. Yellen also noted that the first hike in federal interest rates might occur six months after the end of QE3. However, the Fed's new communication policy, less precise and somewhat changeable, could cause episodes of contained volatility, especially if inflation picks up within the current context of wage rises.

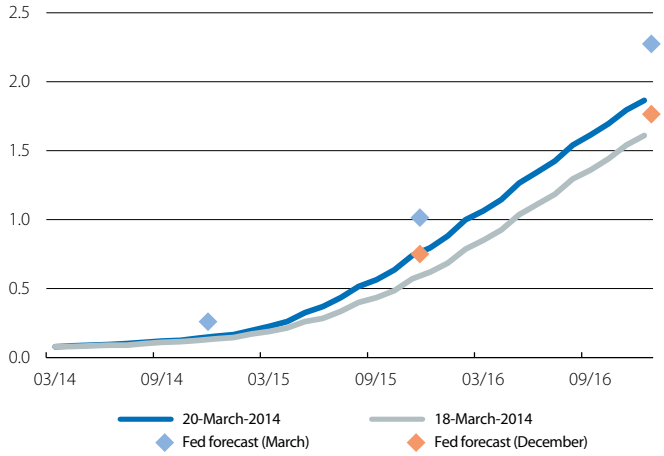
Meanwhile, at its March meeting the ECB decided not to act. The institution has maintained its strategy based on a gradual recovery in domestic demand in the euro area and the correct functioning of the region's monetary markets. It also expects inflation to remain low for quite a long time but will not hesitate to act should deflationary risks intensify (see the Focus: «Inflation expectations and financial instruments: a valuable duo»). It has also ruled out possible action in the capital markets, encouraged by the strength of the euro's exchange rate against the dollar, in order to avoid adding any downward pressure on inflation, which is already very low. In this respect, of note is the more open approach seen in declarations by some members of the German Bundesbank regarding a possible programme of bond purchases by the ECB.

Steps towards European banking union. The European Council and European Parliament have reached an agreement on the creation of the second pillar of the banking union: the Single Resolution Mechanism and the Resolution Fund for insolvent banks. This agreement must be endorsed by the European Parliament in April.

Periphery debt is progressing satisfactorily. The crisis between Russia and the Ukraine has helped yields on 10-year bonds from the USA and Germany to remain relatively stable, acting as a safe haven. In the short term, however, a more aggressive tone in the Fed's messages than the one initially perceived by the market and improvement in the Russian conflict could push up yields on both countries' debt. For its part, periphery sovereign debt has continued to show great resistance to any external problems. In March, the yields to maturity or YTMs fell in all tranches of the curves, helping to place Spanish and Portuguese debt issuances at very low interest rates. As a result of this situation, the sovereign risk premia of the periphery countries have evolved positively, boosted by increased expectations of further liquidity measures by the ECB given the risk of deflation.

USA: forward curve of the Federal Funds rate

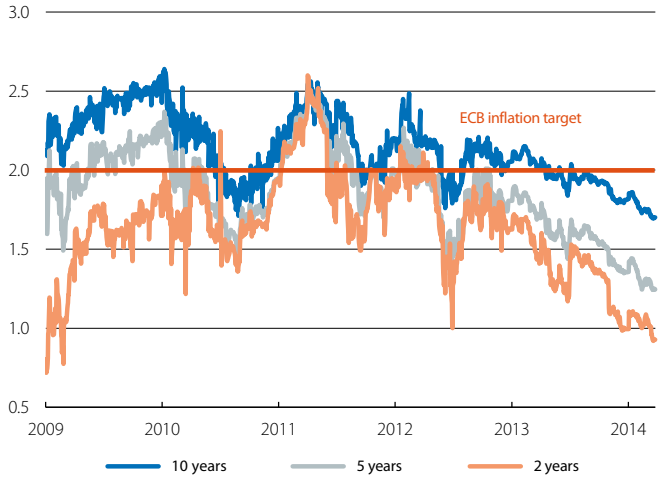
(%)



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

Euro area: inflation expectations

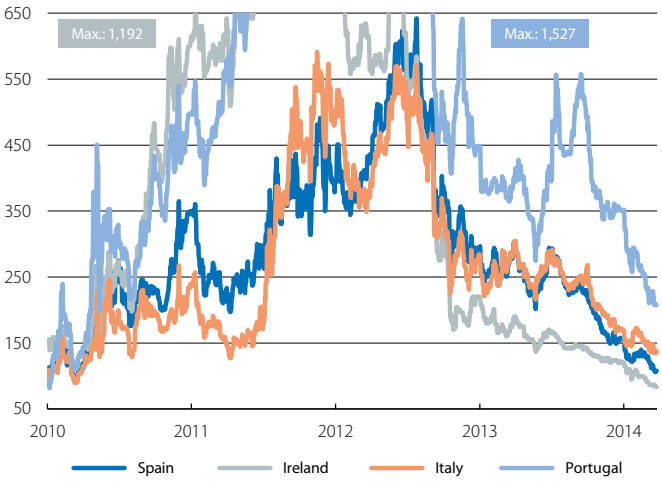
Inflation swap rates (%)



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

Sovereign debt risk premia

(CDS in bps)



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

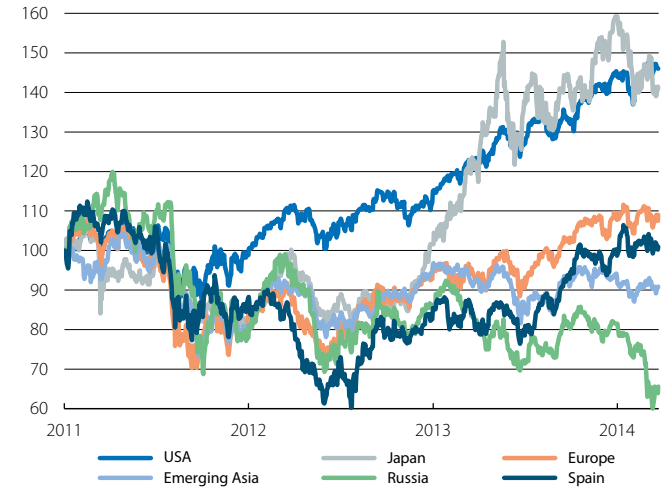
Stock markets remain firm but keep a close eye on events in the Ukraine. Although, at first, the news from China and the Ukraine weighed heavy on international stock markets, stabilisation on the different fronts has ensured their recovery continues. Key factors such as low levels of volatility, attractive prices and large volumes of liquidity in search of returns are boosting western stock markets. Many companies are taking advantage of this situation to take their first steps on the stock market (see the Focus: «The resurgence of IPOs»). The US stock market has remained around its all-time high although signs can be seen of over-buying in stocks linked to the technology sector and small caps. In Europe, the Eurostoxx has also performed well. However, in the short term the exposure of several of its companies to the Ukraine and Russia could lead to certain corrections. For its part, the Ibex has returned to above 10,000 points, supported by the improvement in business indicators and the positive trend in sovereign risk.

The euro remains strong against the dollar. The exchange rate between both currencies has reached levels close to 1.40 dollars. Two factors have been decisive for this situation to arise: (i) the escalation in military tension in the Crimea, and (ii) the market's disappointment given the absence of expansionary measures by the ECB. However, greater expectations regarding possible interest rate hikes by the Fed in the first half of 2015 have helped to push the strong euro down to 1.37 dollars. The other relevant news on the foreign exchange market has been the enlargement of the yuan's fluctuation bands against the dollar to ± 2%. This decision, which responds to the Chinese authorities' attempt to allow market forces more leeway, has led to a fall in the yuan against the dollar. However, the Chinese currency is likely to appreciate over the year as a whole.

Commodities: reflecting the economic turbulence. The «flight to quality» caused by the conflict between Russia and the Ukraine has increased demand and therefore pushed up prices for safe haven assets. Gold's value is a clear reflection of this, with gains of around 8% this year so far. On the other hand, uncertainty regarding China's economic growth capacity has affected cyclical commodities: copper and iron, closely linked to industrial production, saw notable losses whereas the oil market continues to show remarkable stability, remaining within the band of 105-110 dollars/barrel.

Trends in the main international stock markets

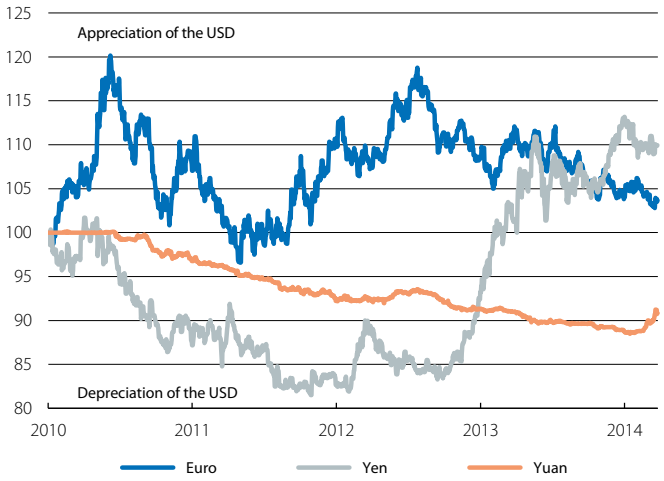
(January 2011 = 100)



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

Value of the USD against different currencies

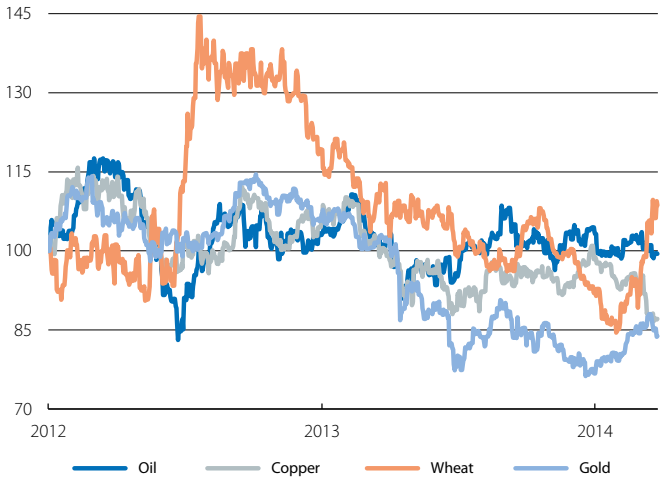
(January 2010 = 100)



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

Trends in commodities

(January 2012 = 100)



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

FOCUS · Inflation expectations and financial instruments: a valuable duo

Fears of a possible deflationary episode in the euro area are bringing to the fore a variable that usually remains in the background: inflation expectations. In fact, it is crucial to know the range of price scenarios being considered by economic agents in order to gauge the risk of inflation or deflation and hence the right monetary policy strategy. Although direct observation of «real» inflation expectations in the private sector is not possible, reasonable estimates are offered by various financial instruments, either explicitly or implicitly.

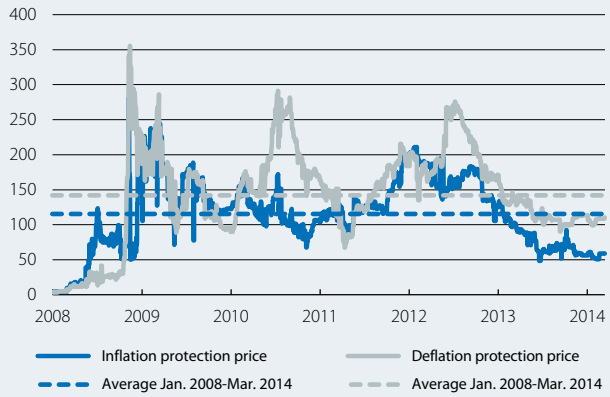
The sovereign bond market provides very useful information when there are inflation-indexed bonds as well as ordinary nominal bonds. This is the case of key countries such as Germany and France. Indexed bonds offer protection against inflation by revising their face value at the same rate as the increase in each country's official price index. In this way, the spread in yields between a nominal and indexed bond with the same term and by the same issuer, called the breakeven inflation rate (BEIR), informs us of the average inflation rate expected by bond holders for this term. More accurately, the BEIR can be broken down into three different elements: (i) agents' expectations regarding the average inflation rate during the term of the pair of bonds; (ii) a risk premium associated with possible deviations from these expectations compared with the actual rate of inflation that will eventually occur, and (iii) premia associated with the lower liquidity of indexed bonds and other institutional aspects. Using statistical techniques to eliminate this last component, we are left with a very valuable measure of the expectations and risk premia for inflation of the large group of agents that take part in the bond market.

Swaps and options (caps and floors) on inflation are instruments explicitly designed to operate on this variable. A swap is an agreement between two parties to exchange interest rate cash flows based on a specified notional amount on concrete dates. The particular feature of inflation swaps is that one of the parties undertakes to pay a fixed interest rate (swap rate) on the notional amount of the contract in exchange for receiving the inflation rate observed during the instrument's term (floating swap rate). In this way, the swap rate is a good indicator of the expected average inflation rate and of the risk premium for deviation required by operators in this market throughout the life of the swap. Here it is also necessary to make a small technical adjustment, in this case for the counterparty risk inherent in the operation with over-the-counter (OTC) derivatives. The advantage of swaps compared with bonds is the existence of a larger universe of maturities and countries (including Spain) while the disadvantage is that this is a smaller and less liquid market.

Inflation caps and floors also offer protection against the adverse effects of inflation and deflation, respectively. In the case of caps, the buyer will receive, on each settlement date and after paying a premium on the notional amount, the difference between actual inflation rate and the ceiling or cap rate established in the contract, should this be higher. Floor options cover their buyers against a possible deflationary situation, paying them the difference between the agreed minimum or floor rate and the actual inflation rate, should this be lower. The price or premium for these options will tend to be higher the greater the degree of protection being offered. The last few months have seen the five-year floor price, which protects should inflation fall below 0%, go above the cap price of 4% over the same horizon. In terms of the ECB's inflation target of 2%, this suggests that investors are more concerned about actual inflation being lower rather than higher, not surprising given the current context. What is surprising is that, unlike in the three previous «deflationary scares» of the last few years, the floor premium has not shot up. This indicator therefore seems to support the interpretation that agents expect a long period of very low inflation for the euro area (clearly below 2%) but a low risk of sustained deflation.

Euro area: cap and floor premia for inflation at five years

4% cap and 0% floor (annual payment period) (bps)



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

FOCUS · The resurgence of IPOs

The cold that paralysed western stock markets during the years of crisis is continuing to lessen. The first symptoms of improvement could be seen in share prices, which have been on an upward trend for some time now (highly pronounced in the USA and moderate in Europe). A reactivation could then be observed in other vital signs of the stock market. One of the most notable signs relates to the number of companies deciding to take the step of joining the market. On the two sides of the Atlantic, both demand and supply factors are coming together to boost initial public offerings or IPOs. On the one hand, the improvement in economic growth prospects and the relatively good performance of corporate earnings, together with rock-bottom interest rates, have stimulated investors' appetite for risk. This is crucial for those companies starting out in stock markets, which are often small and not very well-known and therefore perceived as investments with a higher risk. On the other hand, attracted by rising share prices, companies themselves can find stock markets an appealing alternative to increase their capital, just at a time when solvency is highly appreciated and access to external financing is not as easy as it used to be.

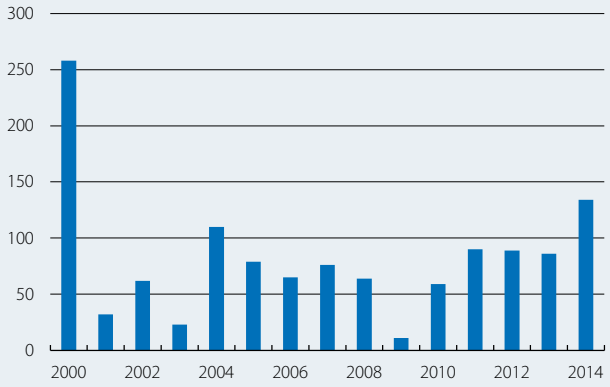
The USA took the lead over Europe in IPOs and has maintained it. The number of operations and their value has been growing for some time and has now reached standard figures. According to Bloomberg's data, during the first three months of this year 130 firms have gone public, recording a total of almost 11 billion dollars in the subscription period, a figure close to the record achieved in the same period in 2007. At a sector level, particularly significant are IPOs among biotechnology firms, followed by energy companies and those from the financial sector. Many analysts expect the rate of IPOs in this country to achieve levels not seen since 2000, a date when the stock market reached its peak prior to the financial crisis.

The improvement is more incipient in Europe but has started strongly. According to PwC's figures, IPOs were weak until mid-2013 but the last quarter of last year witnessed a dramatic rise, bringing it close to the levels of 2007 Q4, i.e. before the crisis. The partial figures from 2014 suggest that this performance is continuing.

Spain is lagging behind somewhat in this process but looks like it will soon pick up. In 2012, 2013 and so far in 2014, operations have been limited to a handful of small firms on the Alternative Stock Market (MAB in Spanish) and a few real estate investment trusts (socimis). However, there are several firms that are likely to extend Spain's stock market universe very soon. Recently, the Spanish Securities and Investments Board (CNMV) itself has been optimistic, announcing that it expects to end the first third of the year with five new companies on the Spanish stock market although it has not specified which ones. All the evidence suggests that these companies will be varied. For example, in terms of the business sectors. And also in terms of their reasons: to enhance their businesses, culminate privatisation processes and/or meet their borrowing needs. Among those companies with the most advanced plans to go public are Applus, Odigeo, Edreams, Globalia, Loterías y Apuestas del Estado and Aena.

USA: PLO market

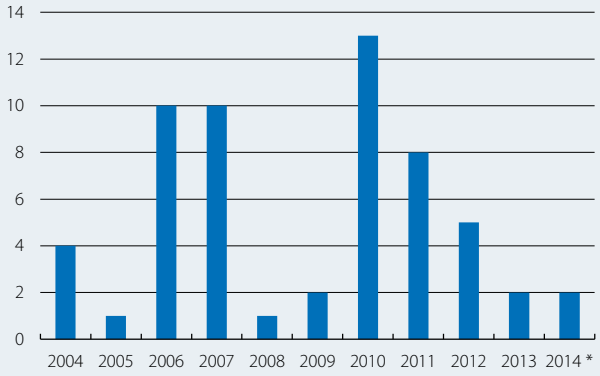
(Number of initial public offerings)



Note: *Period between 1 January and 20 March every year.*
Source: *"la Caixa" Research, based on Bloomberg data.*

Spain: PLO market

(Number of initial public offerings)



Note: ** Number of PLOs up to 20 March 2014.*
Source: *"la Caixa" Research, based on BME data.*

KEY INDICATORS

Interest rates (%)

	31-Mar	28-Feb	Monthly change (b.p.)	Year-to-date (b.p.)	Year-on-year change (b.p.)
Euro					
ECB Refi	0.25	0.25	0	0.0	–50.0
3-month Euribor	0.31	0.29	3	2.6	10.2
1-year Euribor	0.59	0.55	4	3.4	4.3
1-year government bonds (Germany)	0.15	0.12	3	–3.2	13.2
2-year government bonds (Germany)	0.16	0.13	3	–5.4	18.2
10-year government bonds (Germany)	1.57	1.62	–5	–35.1	28.9
10-year government bonds (Spain)	3.23	3.51	–28	–91.6	–182.5
10-year spread (b.p.)	166	188	–22	–56.5	–211.3
Dollar					
Fed funds	0.25	0.25	0	0.0	0.0
3-month Libor	0.23	0.24	–1	–1.6	–5.2
12-month Libor	0.56	0.55	1	–2.5	–17.3
1-year government bonds	0.11	0.10	1	0.0	–1.5
2-year government bonds	0.42	0.32	10	5.4	19.6
10-year government bonds	2.72	2.65	7	–28.2	91.5

Spreads corporate bonds (p.b.)

	31-Mar	28-Feb	Monthly change (b.p.)	Year-to-date (b.p.)	Year-on-year change (b.p.)
Itraxx Corporate	76	70	5	5.5	–50.3
Itraxx Financials Senior	93	87	7	4.9	–102.0
Itraxx Subordinated Financials	139	129	10	9.7	–173.6

Exchange rates

	31-Mar	28-Feb	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
$/euro	1.377	1.380	–0.2	0.4	7.4
¥/euro	142.130	140.490	1.2	1.5	–16.0
£/euro	0.826	0.824	0.2	0.2	1.8
¥/$	103.230	101.800	1.4	1.9	–9.8

Commodities

	31-Mar	28-Feb	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Index	493.7	478.5	3.2	8.2	2.9
Brent ($/barrel)	107.0	109.3	–2.1	–3.7	–3.4
Gold ($/ounce)	1,284.0	1,326.4	–3.2	6.8	–19.5

Equity

	31-Mar	28-Feb	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500	1,872.3	1,859.5	0.7	1.3	19.9
Eurostoxx 50	3,161.6	3,149.2	0.4	2.2	21.1
Ibex 35	10,340.5	10,114.2	2.2	4.3	30.6
Nikkei 225	14,827.8	14,841.1	–0.1	–9.2	21.9
MSCI Emerging	994.7	966.4	2.9	–0.8	–3.5
Nasdaq	4,199.0	4,308.1	–2.5	0.5	29.6

CURRENT SITUATION · **Panorama of contrasts**

The scenario remains of improvement in global economic activity but with some disparities and nuances: the USA seems to be starting to overcome the effects of a tough winter and is consolidating its growth, China is still immersed in a soft landing without any significant inflationary tensions and Japan is awaiting the effects of its VAT hike in April. Among the emerging economies, of note is the situation of Russia whose political conflict with the Ukraine will hit its growth hard in 2014. Brazil is failing to slow up its inflation but India, Indonesia and South Africa are reducing their imbalances.

UNITED STATES

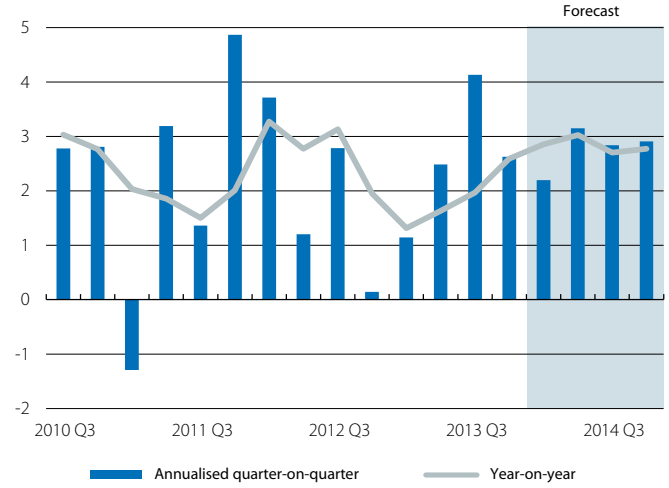
The slightly upward revision of GDP growth in 2013 Q4 does not alter our scenario of a moderate recovery. The rate of 2.6% annualised quarter-on-quarter (also in year-on-year terms) has not affected overall growth for 2013 of 1.9%. By demand component, of note is the upward revision for private consumption and confirmation of the good tone in capital goods investment, which we expect to continue throughout 2014. The adverse weather at the beginning of 2014 has made us lower slightly our growth forecast for 2014 from 3.0% to 2.8% but at the same time downside risks have fallen given the good tone of the latest private consumption indicators.

The greatest risk for our scenario is the labour market, which is recovering quite sluggishly. Although 175,000 jobs were created in February, the average for the last three months is only 129,000, the lowest figure since July 2012. The unemployment rate picked up slightly to 6.7% but the underlying problem is the persistently low participation rate. This means that the ratio of people in employment to the population aged over 16 is 58.8%, just 0.6 percentage points above the minimum of 2011 but more than 4 points below the level at the end of 2007. The greatest concern for economic policy is to reduce the cyclical part (not due to demographic effects) of this gap (see the article on the participation rate of the US labour market in this Dossier).

The latest business indicators are starting to recover from the effects of the bad weather. In February the business sentiment index for manufacturing (ISM) recovered some of its sharp drop in January and rose from 51.2 to 53.2 points, while the ISM for services fell from 54.0 to 51.6 points, the greatest weakness being in the employment component. These levels are indicative of moderate growth rates in the economy. Concerning demand, March's consumer confidence index produced by the Conference Board reached 82.3 points, still below its historical average close to 100 but at its highest level since January 2008, before the crisis. Elaborating further on this relatively good tone shown by consumption, retail sales, without cars or petrol, rose by 2.3% year-on-year in

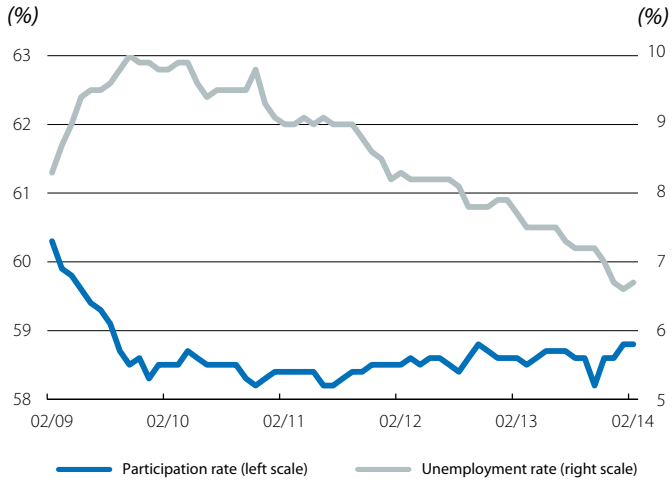
USA: GDP

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



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

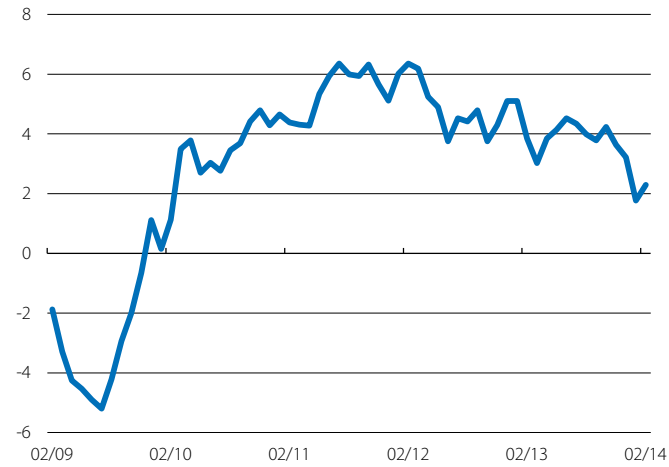
USA: employment



Note: *Participation rate defined as the proportion of employed people to the working-age population.*
Source: *"la Caixa" Research, based on data from the Dept. of Labor.*

USA: retail sales

Year-on-year change (%)



Note: *Without cars or petrol.*
Source: *"la Caixa" Research, based on data from the Dept. of Trade.*

February, a figure that, although not excessively robust, represents the first month-on-month growth after two consecutive months of decline.

The housing market is toning down its recovery. The Case-Shiller index for existing home prices in 20 metropolitan areas has completed two consecutive years of uninterrupted monthly rises, with a cumulative increase of 22.6%. However, once the effect of inflation is discounted, this index is still 29% below the average for 2006. Continued improvement in the real estate market depends on a more robust recovery in the labour market and household income. In this respect, new homes saw a flat trend in 2013 and early in 2014 and the National Association of Home Builders' sales index for March remained at 47 points, far from the figure of 58 in August 2013.

Consumer prices continue to moderate. February's CPI rose by 1.1% year-on-year (0.1% month-on-month), below the 1.6% of January and the Fed's 2% target. The core CPI (without energy or foods) stood at a 1.6% year-on-year and, without the contribution of rents, would have been 0.8%. The persistence of inflation below 2% gives the Fed room to prolong its low interest rate policy, at the same time as representing an additional problem for households in debt.

JAPAN

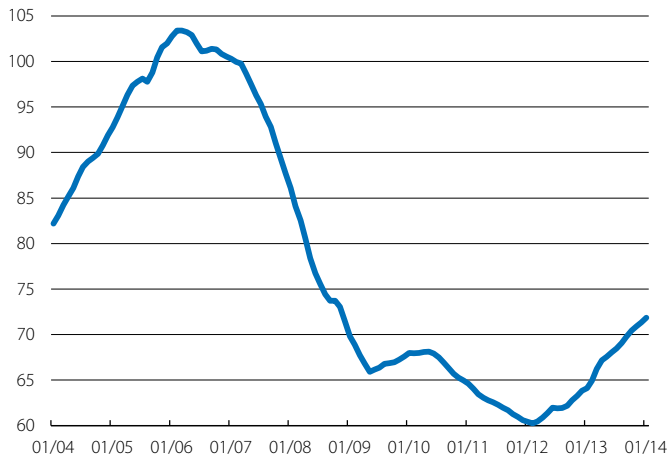
Japan grew by 2.5% year-on-year in Q4, awaiting its VAT hike. This figure was something of a disappointment as private consumption and investment had benefitted from an increase in spending before April's VAT hike (from 5% to 8%). The ultimate effects of this measure will set the pace for the Japanese economy in 2014. To date, it seems that Shimzo Abe's expansionary policies have effectively boosted growth. Industrial production (which, in Japan, is very closely linked to the trend in GDP) and machinery orders (a leading indicator for business investment) saw an upward trend throughout 2013. Similarly, land prices in the Tokyo area posted growth of 0.7% for the whole of 2013 after five years of reductions. These positive figures mean that, in spite of the disappointing GDP figure from Q4, our forecast for the whole of 2014 has only been minimally revised, remaining at 1.3%.

The foreign sector is still in deficit with February's trade deficit being greater than expected. The cheap yen has yet to boost exports and is contributing to a growing energy bill that accounted for 36.4% of all imports in 2013 (23.7% in 2010).

In the area of prices, deflation has yet to be eradicated. CPI stood at 1.5% year-on-year in February but this rate of increase has lost steam over the last few months. Core inflation (without energy or foods) advanced by a timid 0.7% year-on-year in spite of the upward effect of the weak yen. Wages, the touchstone for consolidation in the necessary growth in domestic demand, rose by 0.2% year-on-year in January after 16 months of falls. This is an encouraging figure but it is still not enough. This faltering by inflation, as well as

USA: Case-Shiller index *

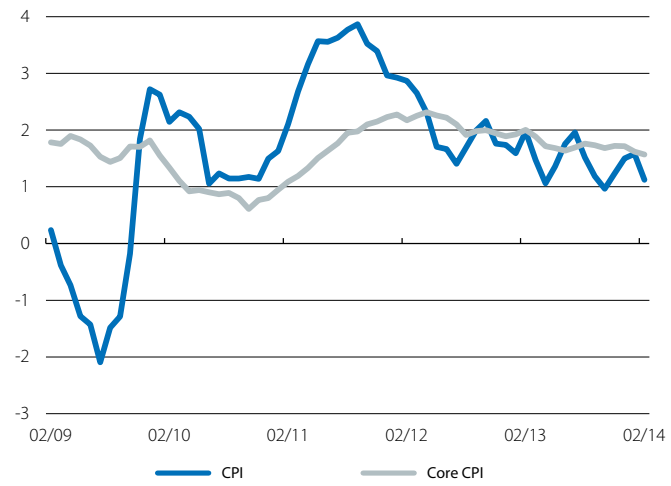
(Index)



Note: ** In real terms, base 100 = average 2006.*
Source: *"la Caixa" Research, based on data from Standard & Poor's.*

USA: CPI

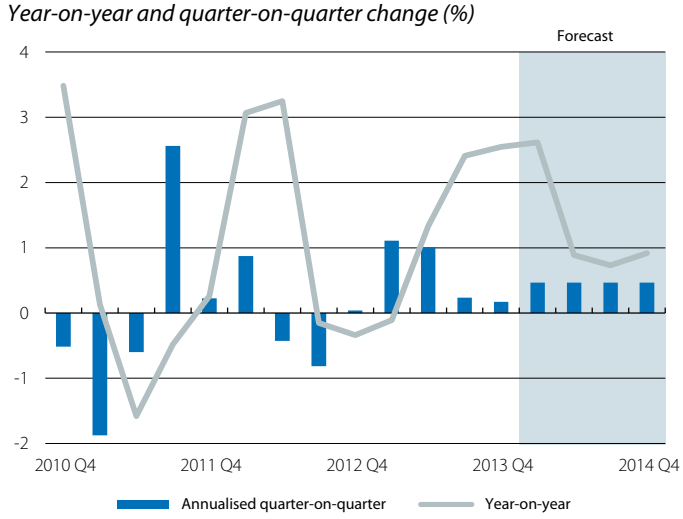
Year-on-year change (%)



Source: *"la Caixa" Research, based on data from the Dept. of Commerce.*

Japan: GDP

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



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

the weakness of exports, mean that the Bank of Japan will probably decide to increase its quantitative easing, more than likely throughout the summer.

EMERGING

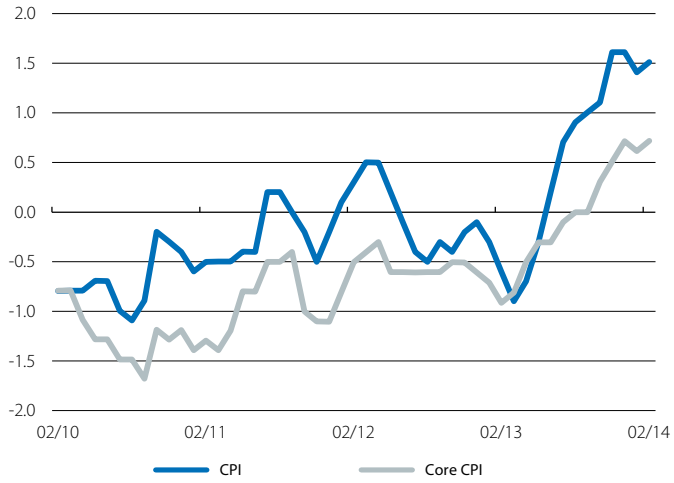
China's slowdown seems bearable. Industrial production, retail sales and other leading indicators were below their average for 2013 although they may have been distorted by the break for the Chinese New Year. Such moderate prices give the monetary authority room for policies to boost demand (see the Focus on the slowdown in China).

Imbalances are being corrected in the rest of the emerging countries except for Brazil and Turkey. In February India once again recorded a drop in inflation thanks to food prices. The same thing happened in Indonesia, although to a lesser degree. Similarly, the current account deficits of India, Indonesia and South Africa, three of the emerging economies considered to be the weakest, have shrunk. The other side of the coin is provided by activity indicators, which are growing at a slower rate than in 2013. Mexico provided the positive note with an economy that is steadily consolidating, at the same time as reducing its inflation. Among the large emerging countries, Brazil is the one with the greatest decline, with persistent inflationary tensions and declining economic growth. For its part, Turkey provided a pleasant surprise by growing 4.4% year-on-year in 2013 Q4 (4.3% in Q3), supported by its domestic demand. This figure was positive but the country's significant imbalances in its current account and prices augment the need for macroeconomic adjustments. In this respect, the recent local elections have strengthened the government and reduced uncertainty regarding the direction of economic policy.

The conflict between Russia and the Ukraine is affecting the economic prospects of both countries. The fall of Ukraine's pro-Russian regime and its replacement by a government closer to the European Union led to a politically complicated process of the Crimea segregating from the Ukraine and its subsequent integration with Russia. At the time of writing this report, the international community had accepted this step de facto, without the risk of military conflict but with the adoption of (mild) sanctions against Russia. Russia's current situation is dominated by a complicated combination of a low rate of activity and inflationary tensions (in February inflation stood at 6.2% year-on-year). This political conflict has intensified financial uncertainty and led to a negative reaction by international investors (capital outflows). Such events have made us revise downwards our forecast for Russia with an expected growth in GDP of 0.8% in 2014 (1.9% previously) and 1.4% in 2015 (2.5% previously). Regarding the Ukraine, the risk of a possible balance of payments crisis has diminished after the recent agreement for financial aid reached with the IMF. The Ukraine will receive a total of 27 billion dollars from international donors, 14-18 billion of which will be provided by the IMF.

Japan: CPI

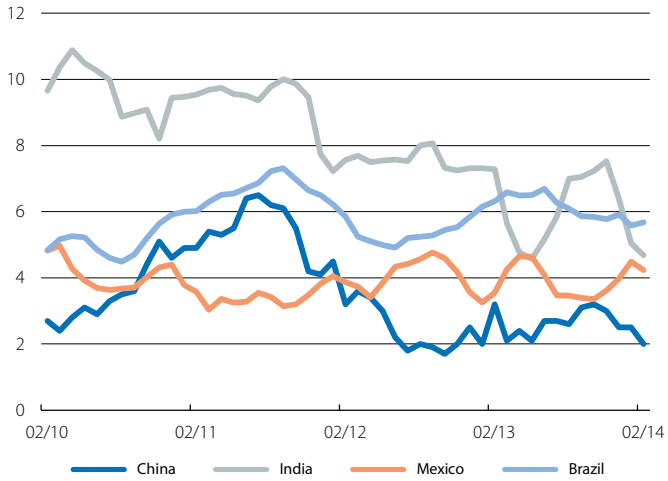
Year-on-year change (%)



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

Emerging countries: inflation

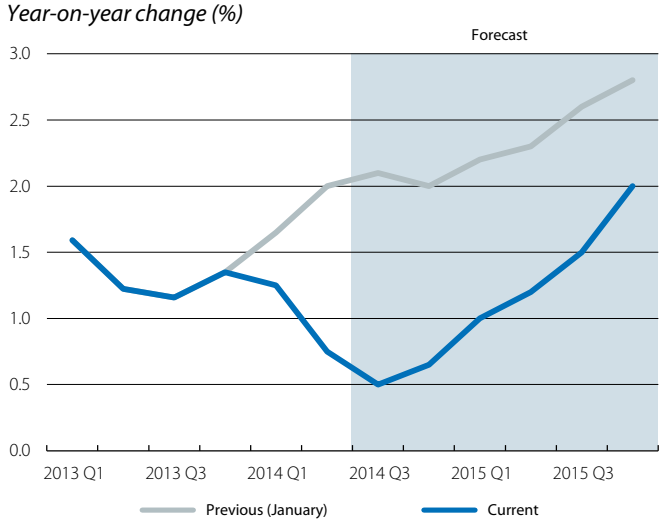
Year-on-year change (%)



Source: *"la Caixa" Research, based on data from national statistics institutions.*

Russia: GDP

Year-on-year change (%)



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

FOCUS · Asia, an indebted but dynamic region

Monitoring the map of weaknesses of the different emerging countries has become more important after the tensions they've suffered over the last year. Debt takes pride of place in this assessment. The region of Asia (India and the Far East, except Japan) notably increased its total level of debt between 2007 and 2013: from 149% to 211% of GDP, taking into account all households, non-financial firms and government. Assessing just how far this might be a weakness requires the examination of certain details.

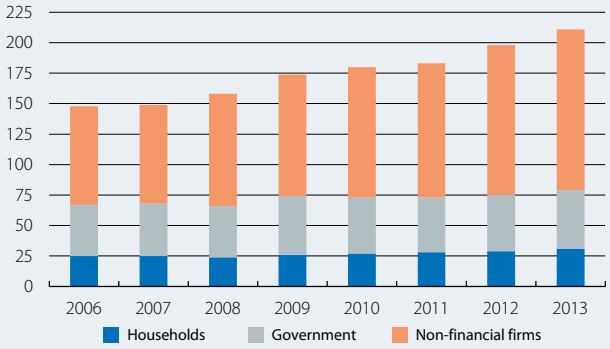
The Asian economies, with a growth model based on exports, were hit hard when global demand weakened due to the crisis starting in 2007. Their response to this shock was to stimulate domestic demand by increasing their debt. The initial conditions were favourable for embarking on such a path: excess savings (reflected in a current surplus of 7.4% of GDP) and a fiscal deficit that was practically zero. Between 2009 and 2012, this indebtedness was supported by relaxed financial conditions and low real interest rates, resulting from easy monetary conditions worldwide encouraged by the US Federal Reserve but also by the emerging countries themselves.

Asia's debt is concentrated mostly in the sector of non-financial firms. In GDP terms, firms went from 81% debt in 2007 to 132% in 2013, equivalent to 51 points of the aforementioned 62. This is a high level in historical terms and also in comparison with other countries. The great risk of this situation lies in the fact that this corporate debt is not helping to improve the productivity of capital. Without such improvements, growth is likely to moderate somewhat which, together with an ageing population, would make it difficult to reduce the debt. A probable rise in real interest rates, encouraged by the Fed's change in policy, would complicate the scenario even further.

However, the situation is not the same in each country. The relatively positive note is that the highest figures in terms of debt and its recent trend are concentrated in the region's «strong» economies: China, Hong Kong, Singapore and South Korea. However, those economies considered to be «weaker», namely India and Indonesia, have more moderate debt levels, even taking their lower per capita income into account. Although India has the region's largest public debt (67% of GDP), high inflation and pending structural reforms, it is encouraging to note that its total debt (firms, households and government) remained at 136% of GDP in 2013, slightly below the average for the region and only 7 points higher than its 2007 level. For its part, Indonesia recorded a total debt of 74% in 2013, the lowest in the group of countries analysed. The demographic factor is also in their favour, as India and Indonesia are avoiding the general ageing trend of the predominant population in the region. The most striking figures correspond to China, whose total debt went from 148% to 244% of GDP (from 97% to 173% in the case of non-financial firms). The risk this entails must be evaluated within the context of the rebalancing and transformation of the Chinese economy, as well as the peculiar way such a system operates, dominated as it is by the state. Hong Kong, Singapore and Korea also have high debt but in the context of much higher per capita income and a more developed financial system. In any case, we must not forget the strengths inherent in the region, especially its high growth potential. Moreover, overall governments and households are maintaining a relatively subdued level of debt.

*Asian economies: trend in debt by sector**

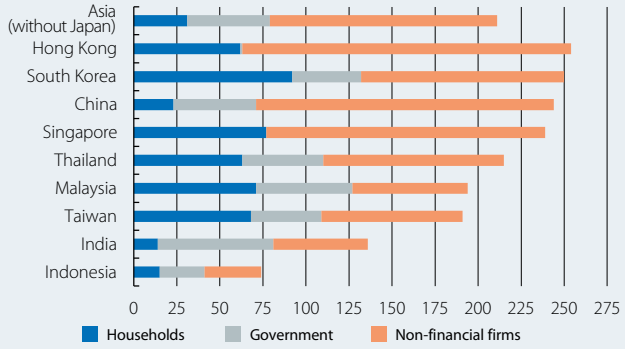
(% of GDP)



Note: ** Estimate for 2013. China, Hong Kong, Singapore, Malaysia, Indonesia, Thailand, India, Taiwan, South Korea.*
Source: *"la Caixa" Research, based on data from MS Research and the IMF.*

*Asian economies: debt by country and sector**

(% of GDP)



Note: ** Estimate for 2013. China, Hong Kong, Singapore, Malaysia, Indonesia, Thailand, India, Taiwan, South Korea.*
Source: *"la Caixa" Research, based on data from MS Research and the IMF.*

FOCUS · Back to a hard landing for China

It is now becoming relatively normal for the press and quite a few analysts to use the expression «hard landing» every time China publishes weaker figures than expected. This March was no exception. Given this context of recurring alarm bells, it is advisable to carry out a calmer analysis that helps to put these figures into perspective, so as not to enter a spiral of gloom.

First of all, we should look at the indicators that have caused the current commotion. Indeed, the growth rates of industrial production, investment in urban fixed capital and retail sales have fallen for the January-February period compared with 2013 (in year-on-year terms: 8.6% compared with 9.7%, 17.9% compared with 19.6% and 11.8% compared with 13.1%). However, several mitigating factors should be taken into account. Firstly, the calendar of festivities for the lunar New Year has distorted this comparison to the detriment of the current year. Secondly, month-on-month growth rates are still positive and excellent in all three indicators. And thirdly, the upward revision of growth in retail sales and sales of consumer goods for the whole of 2013 (from 11.4% to 13.1%) has been a positive point ignored by most media articles. On the external front, the strength of exports in January, up by 10.6% year-on-year, was dimmed by their weakness in February (–18.1%). But once again it is difficult to make out whether the export figures for January and February as a whole were actually poor since the distortion produced by the New Year celebrations must be added to suspicions of overbilling for exports during the first four months of 2013. Imports, on the other hand, were strong in both January and February (+10% year-on-year), which still comes as a surprise, albeit a positive one, given the somewhat weaker context for demand we ourselves expected. The purchasing managers' index (PMI) for manufacturing fell in February for the third consecutive month but remained above 50, the threshold for expansion, while the PMI for the services sector rose to 55.0 points, its highest in three months.

Given this situation, the decision to slightly devaluate the currency, the recent relaxation in monetary conditions, the first bond default by a Chinese company and the words of the Prime Minister, Li Keqiang, acknowledging that this will be a difficult year are all additional elements that numerous analysts have highlighted when talking about an imminent hard landing. However, in our opinion these events must not be interpreted negatively but rather the opposite. The devaluation has been accompanied by a widening in the range of fluctuation of the yuan, in line with the financial liberalisation announced by the new government and which, together with the relaxation of monetary interest rates, will act as a stimulus. The first corporate default is another sign of the country's shift towards a «more market-oriented» model whose corrective effect should serve to improve the efficiency of resource allocation. Moreover, the Prime Minister has approved a substantial GDP growth target for 2014: 7.5%. Given the hegemonic role still played by the state on the levers for growth (at least in the short and medium term), this target should be taken very seriously.

Undoubtedly, it is difficult to gauge the appropriate growth rate for activity within a situation of unprecedented structural change such as the present. The Chinese economy has been undergoing a soft landing for some time, so far with notable success. This moderation is taking place within a transformation of the growth model where consumption and services are becoming increasingly important compared with the foreign sector and investment in infrastructures. It is true that the country is facing significant risks, created during the years of strong growth such as the debt of local administrations and other local organisations, the rise in shadow banking and possible asset bubbles. The government's strong determination to shift towards a new model of development, less distorted and more sustainable, as well as its capacity to ensure this transition is gradual, are crucial elements that must be watched closely. There cannot be many doubts regarding the government's intent: the categorically reformist statements issued during the Communist Party's Third Plenum last November have already been confirmed by specific steps in the right direction. Our opinion is favourable regarding the economic authorities' capacity to act in the short term. The country's low inflation means that expansionary monetary policy measures can be applied (in spite of the prudence announced by the central bank), while the relatively controlled level of public debt, together with the large reserves accumulated, leaves significant room to manoeuvre in the fiscal sphere. Moreover, China has shown skill in using macroprudential policy to put a halt to any potential financial instability. All this suggests that the announcement of an imminent collapse seems premature.

Relative weakness of the Chinese economy

Year-on-year change (%)

	Latest figure	2013
GDP	7.7	7.7
Industrial production	8.6	10.2
Retail sales	11.8	13.1
PMI manufacturing (index)	50.2	50.8
Exports [1]	4.4	7.9
Imports [1]	8.0	7.3
Investment [2]	17.9	19.6
Bank credit	14.2	14.5
Consumer prices	2.0	2.6
Real estate prices [3]	10.8	11.5

Notes: *1. Cumulative over 12 months. 2. Cumulative investment in urban fixed capital; 3. Average new house prices 100 cities.*

Source: *"la Caixa" Research, based on data from national statistics offices, Thomson Reuters Datastream and the China Real Estate Index System (CREIS; SouFun.com).*

KEY INDICATORS

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

UNITED STATES

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14
Activity									
Real GDP	2.8	1.9	1.3	1.6	2.0	2.6	–	...	–
Retail sales (without cars or petrol)	4.9	4.0	4.0	4.2	4.0	3.7	1.8	2.3	...
Consumer confidence *(value)*	67.1	73.2	62.8	75.1	81.0	74.0	79.4	78.3	82.3
Industrial production	3.6	2.6	2.4	2.0	2.6	3.3	2.9	2.8	...
Manufacturing activity index (ISM) *(value)*	51.8	53.9	52.3	50.8	55.7	56.7	51.3	53.2	...
Housing starts *(thousands)*	783	929	957	869	882	1.008	909	907	...
Case-Shiller home price index *(value)*	141.3	158.2	150	157	161	165	168	...	...
Unemployment rate *(% lab. force)*	8.1	7.4	7.7	7.5	7.2	7.0	6.6	6.7	...
Employment-population ratio *(% pop. > 16 years)*	58.6	58.6	58.6	58.7	58.6	58.5	58.8	58.8	...
Trade balance [1] *(% GDP)*	–3.3	–2.8	–3.1	–3.0	–2.9	–2.8	–2.8	...	...
Prices									
Consumer prices	2.1	1.5	1.7	1.4	1.6	1.2	1.6	1.1	...
Underlying consumer prices	2.1	1.8	1.9	1.7	1.7	1.7	1.6	1.6	...

Note: *1. Cumulative figure over last 12 months.*
Source: *"la Caixa" Research, based on data from the Department of Commerce, Department of Labor, Federal Reserve, Standard & Poor's, ISM and Thomson Reuters Datastream.*

JAPAN

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	02/14
Activity								
Real GDP	1.4	1.5	–0.1	1.3	2.4	2.5	–	...
Consumer confidence *(value)*	40.0	43.6	44.1	44.8	44.0	41.7	40.5	38.3
Industrial production	0.2	–0.6	–6.5	–3.1	1.9	5.7	10.4	7.0
Business activity index (Tankan) *(value)*	–5.0	6.0	–8.0	4.0	12.0	16.0	–	...
Unemployment rate *(% lab. force)*	4.3	4.0	4.2	4.0	4.0	3.9	3.7	3.6
Trade balance [1] *(% GDP)*	–1.5	–2.4	–1.7	–1.9	–2.1	–2.4	–2.6	–2.6
Prices								
Consumer prices	0.0	0.4	–0.6	–0.3	0.9	1.4	1.4	1.5
Underlying consumer prices	–0.6	–0.2	–0.8	–0.4	0.0	0.5	0.6	0.7

Note: *1. Cumulative figure over last 12 months.*
Source: *"la Caixa" Research, based on data from the Communications Department, Bank of Japan and Thomson Reuters Datastream.*

CHINA

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	02/14
Activity								
Real GDP	7.7	7.7	7.7	7.5	7.8	7.7	–	...
Retail sales	14.3	13.1	12.3	12.5	12.8	13.0	11.8	11.8
Industrial production	10.0	9.9	9.6	9.1	10.1	10.0	8.6	8.6
PMI manufacturing *(value)*	50.8	50.8	50.5	50.5	50.8	51.3	50.5	50.2
Foreign sector								
Trade balance [1] *(value)*	230	260	272	269	252	260	264	226
Exports	8.0	7.9	18.3	3.9	3.9	7.4	10.6	–18.1
Imports	4.3	7.3	8.7	5.0	8.4	7.1	10.0	10.1
Prices								
Consumer prices	2.7	2.6	2.4	2.4	2.8	2.9	2.5	2.0
Official interest rate [2] *(value)*	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Renminbi per dollar *(value)*	6.3	6.1	6.2	6.2	6.1	6.1	6.1	6.1

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

CURRENT SITUATION · **Steps towards more balanced and robust growth in Europe**

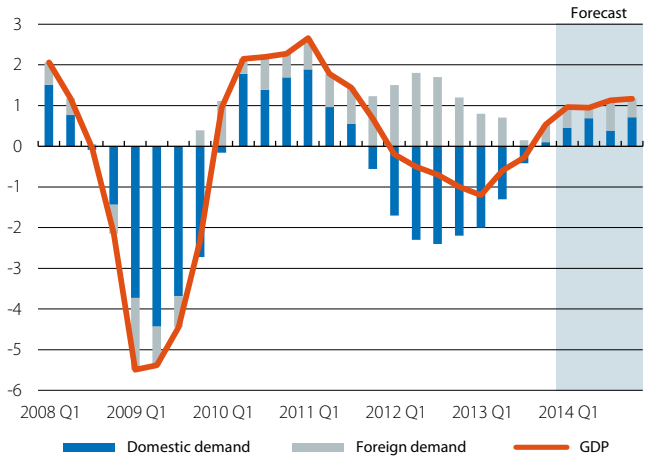
The economic recovery is consolidating. The flow of indicators published during the month of March continues to present a scenario of gradual recovery but with some nuances to bear in mind. Domestic demand, and particularly investment, is looking a little more robust than expected. The recovery in the periphery countries is also slightly better than forecast. Of note is the good trend in business indicators for the Portuguese economy which is likely to successfully complete its bail-out programme with the troika this June. At the same time, the recent advances made to reinforce the euro area's financial integration, with agreement regarding the bank resolution mechanism, once again show the commitment of European institutions to continue moving towards a greater level of integration. Nonetheless, the deleveraging still required by Europe's economy's and particular episodes of volatility related to the emerging countries remind us that this recovery is progressing along a narrow path that is not without its risks.

The economic rate of growth in the euro area accelerated in 2014 Q1. The PMI manufacturing index rose considerably this quarter up to 53.4 points. In addition to the usual solidity of Germany is a slight revival in France. The economic sentiment index produced by the European Commission also ended the first quarter of the year with a notable advance and now stands at 101.5 points. Once again, of note is the considerable progress being made by the periphery countries: Italy, Spain and Portugal have achieved values close to their historical average. However, although picking up in March, France's economic sentiment index is still below its long-term level. On the whole, France's indicators are still fluctuating in line with a recovery that has yet to really pick up.

Domestic demand is taking on a more central role. Its contribution to GDP growth was positive for the first time in two years, specifically 0.1 p.p.. Of particular note is the advance made by household consumption and especially by investment (0.1% and 1.1% quarter-on-quarter, respectively). Moreover, available indicators for 2014 suggest that investment's rate of growth has not slowed up. For example, in January industrial production grew by 2.1% year-on-year thanks largely to the dynamism seen in the production of intermediate goods and also capital, up by 3.7% and 5.8%, respectively. A geographical breakdown shows that this trend is widespread among Europe's countries except for France, which is also lagging behind in this aspect. The development in production expectations for industry, which is continuing to improve and is now posting figures higher than its historical average, leads us to believe that this trend will continue over the coming months. The only element in domestic demand

Euro area: contribution of domestic and foreign demand to GDP growth

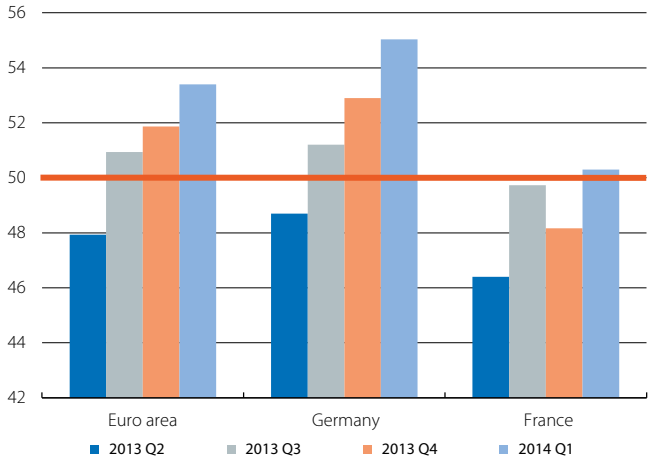
Year-on-year change (%)



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

PMI manufacturing index

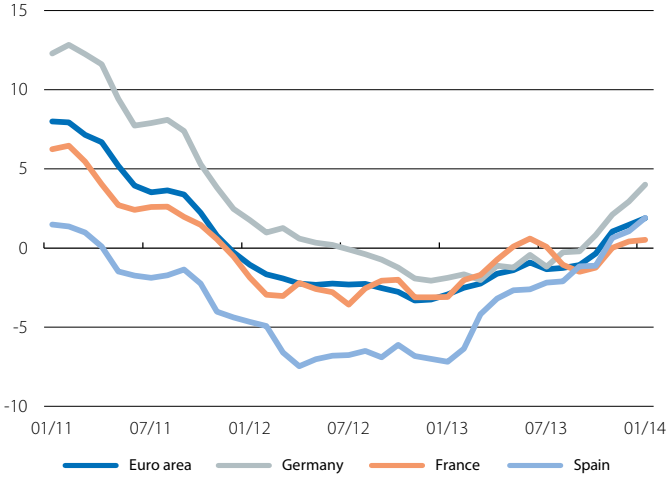
Quarter-on-quarter average



Note: *Values above 50 points are usually related to positive growth rates in GDP.*
Source: *"la Caixa" Research, based on Markit data.*

Industrial production index

Year-on-year change, moving average of three months (%)



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

showing a negative trend is public expenditure, still suffering from the need to contain heavy public borrowing.

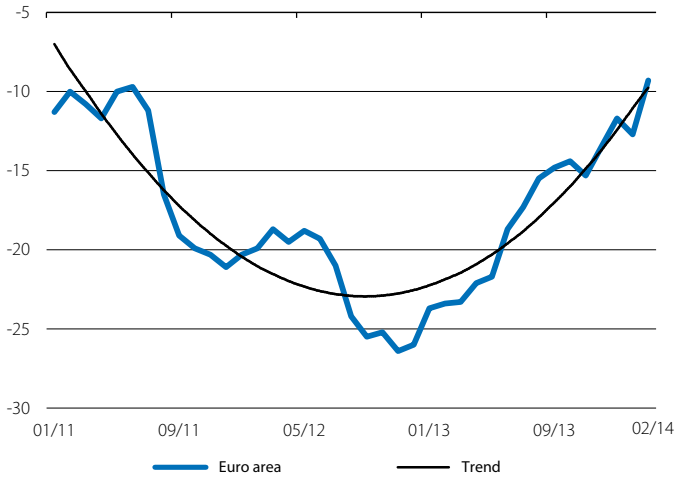
Household consumption continues to be positive. Consumer confidence advanced significantly in the month of March, placing the average for the first quarter of the year clearly above the figures recorded at the end of 2013. Moreover it is worth noting that, for the first time since mid-2011, consumer confidence has returned to levels above its long-term average. Once again this trend has been accompanied by a reduction in gaps between countries, with highly significant advances in the periphery which, until now, had been lagging behind. The recovery in household consumption has also been reflected in the trend in retail and consumer goods, growing in January by 1.1% year-on-year. In principle, over the coming months this upward trend in household consumption will be supported by the labour market, so it should not slow down: the index of employment expectations increased significantly during the first quarter of the year, particularly in the services sector; and confidence in the labour prospects of consumers has reached the levels of almost three years ago.

Portugal is leaving its political crisis behind and gaining ground to successfully complete its bail-out programme. The trend in Portugal's economic activity has pleasantly surprised analysts over the last few months. Overall, indicators show a clear positive path (industrial production, for example, increased by 4.2% in January). Particularly relevant is how Portuguese exports rallied in 2013, rising in real terms by 6.9% year-on-year (2.2% in Germany). This arrival of more positive news has started to provide credibility to the agenda of structural reforms carried out over the last few years and has particularly helped confidence to improve in the Portuguese economy's capacity to grow in the medium term. This has allowed Portugal to regain access to international financing markets and meet its gross borrowing needs predicted for this year. All the evidence therefore points to Portugal being able to successfully complete its bail-out programme with the troika by mid-2014.

Contained labour costs support the periphery's improved competitiveness. In Spain and Portugal, hourly labour costs, seasonally adjusted, shrank in 2013 Q4 by 0.2% and 0.6% quarter-on-quarter, respectively. Italy, however, is experiencing a different trend from the rest of the periphery countries with its index increasing by 0.5% quarter-on-quarter. France and Germany, however, remain at clearly positive quarter-on-quarter rates of change, namely 0.9% and 0.6%, respectively. This disparate performance between the core and periphery countries can also be seen in inflation. In the euro area as a whole, this slowed down again, reaching 0.5% in March (compared with 0.7% in February) although it is likely to start rallying soon as a result of the recovery in domestic demand. In Spain and Italy, March's inflation rates, namely –0.2% and 0.3%, respectively, were lower than those of the euro area as a whole.

Euro area: consumer confidence

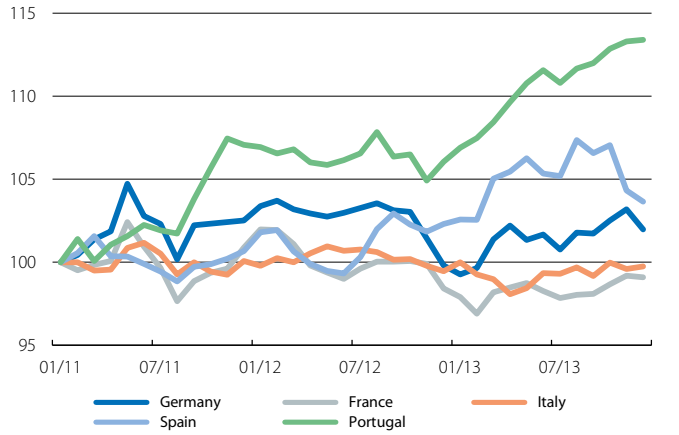
(Index)



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

Trend in goods exports in real terms

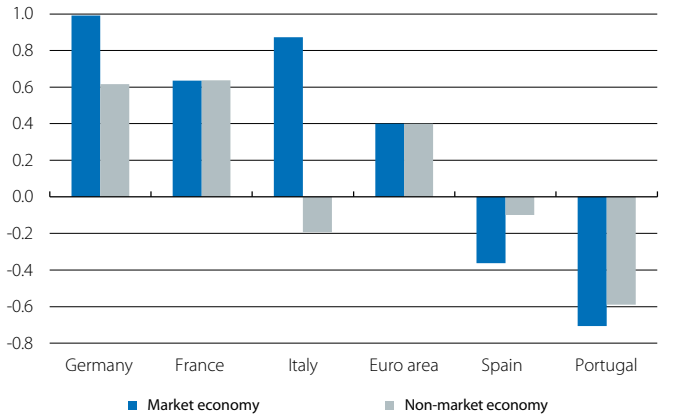
(Index, January 2011 = 100)



Note: *Moving average of three months.*
Source: *"la Caixa" Research, based on Eurostat data.*

Euro area: labour cost per hour

Quarter-on-quarter change in 2013 Q4 (%)



Notes: *Series seasonally adjusted and adjusted for calendar effects.*
Non-market economy includes public administration education, healthcare and social and artistic activities.
Source: *"la Caixa" Research, based on Eurostat data.*

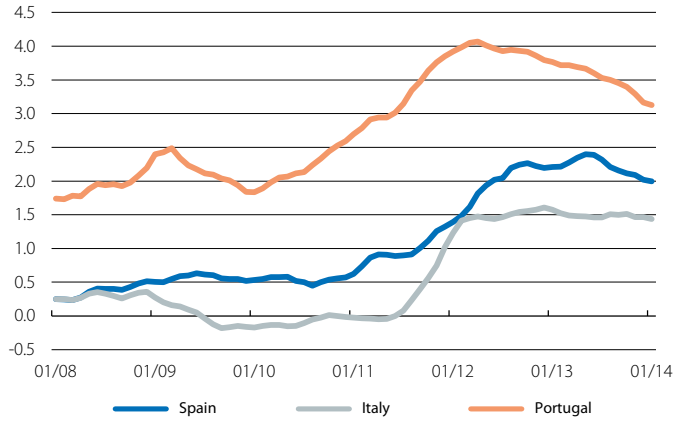
The fragmentation of financial markets: pending resolution but on the right track. The interest rate spread for loans to companies of less than 1 million euros between Spain and the average of the core countries has gradually narrowed since June 2013; Portugal has also seen a narrowing trend. In Italy, this spread has remained at 1.5% but has not widened in spite of the political instability the country has seen in the last few months. It therefore appears that the measures taken by the European Central Bank (ECB) and improved confidence in the growth capacity of the periphery are helping to slowly reduce the fragmentation of financing terms between the countries of the euro area. However, pressure on the ECB has increased over the last few months, particularly due to the downward trend in inflation and the recent appreciation of the euro against the dollar. In this respect, the declarations made by the President of the Bundesbank and member of the ECB's Governing Council, Jens Weidmann, came as some surprise insofar as he did not rule out the ECB buying up public and private debt to reactivate the economy and diminish deflationary pressures.

The euro area once again attracts investors. Over the last few months, the constructive tone dominating the debate regarding the process of constructing Europe and improved confidence in the growth capacity of the periphery countries are presenting a macroeconomic scenario that is once again attracting investors, who are attempting to readjust the composition of their portfolios after risk-return trade-off in the emerging countries has altered. Net inflows in portfolio products are a good reflection of this. After reaching very low levels by mid-2012, they have now regained the levels of the last few years.

The agreement on the Single Resolution Mechanism strengthens the Banking Union. With this agreement, Europe's new system has been defined to restructure or close problematic banks through a central authority. Negotiations between the European Council and Parliament have introduced amendments to the initial proposal: the time given to provide the Single Resolution Fund with its funds totalling 55 billion euros has been shortened (from 10 to 8 years) and the rate of mutualisation has been speeded up (60% constituted after 2 years, 100% after maximum 8 years); decision-making has been streamlined; and, during the transition period, the fund will be able to borrow from the markets. Each bank will contribute to the common fund according to its risk-weighted assets and proportion of wholesale funding, although the details have yet to be specified. This agreement represents a fundamental pillar in the process of banking union, together with the sole supervision that will be carried out by the ECB as from November this year. These new steps are positive and help to forge, little by little, a more robust economic and monetary union that is essential in order to re-establish the mechanisms to pass on monetary policy and put an end to the fragmentation of financial markets.

Interest rates for credit to firms

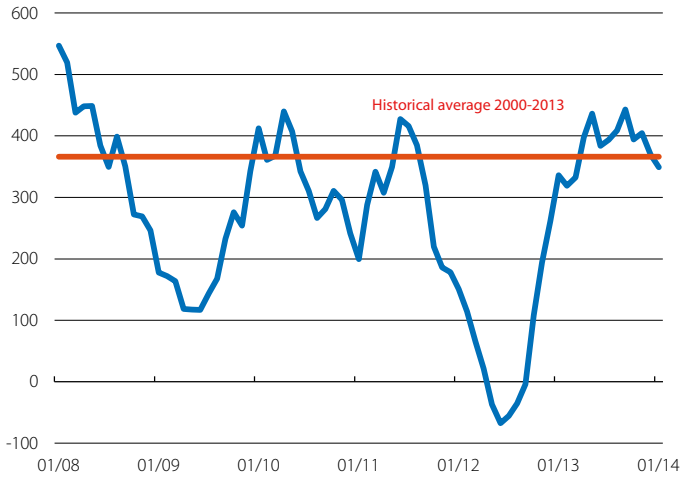
Spread compared with the core countries, moving average of three months (%)



Note: *Core includes Austria, Germany, Finland, France and Netherlands. Interest rate of loans under 1 million euros.*
Source: *"la Caixa" Research, based on data from the European Central Bank.*

Euro area: net inflows of portfolio investment

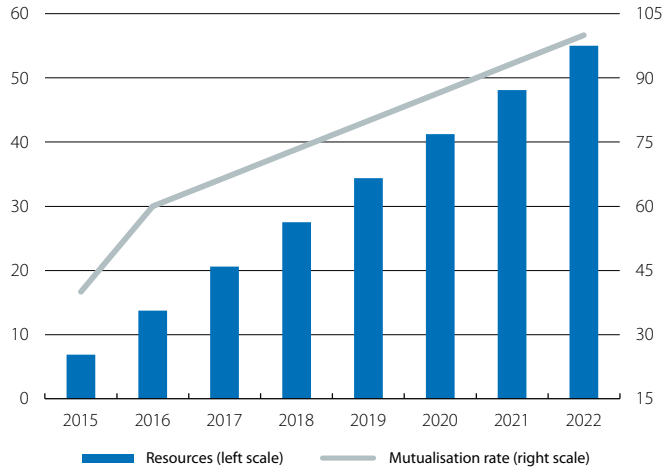
(Billion euros)



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

Contributions to the Bank Resolution Fund

(Billion euros) *(%)*



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

FOCUS · The ECB's strategy under discussion

In the same way that, during a football match, many fans feel capable of designing the best strategy to beat their rival team from the stands, the same thing happens with the monetary policy that needs to be implemented by the ECB: there are as many opinions as articles written about it. The intensity acquired by this debate reflects the importance of monetary policy when taking investment and consumption-related decisions. Moreover, in the last few years the disparity of criteria also reflects the perplexity caused by the exceptional nature of the economic situation.

The range of instruments available to the ECB to establish the direction of monetary policy has recently widened but the official interest rate for the main refinancing operations (also known as the refi rate) is still the most important. One relatively simple way to determine whether the current refi rate is at an appropriate level consists of analysing whether inflation and the output gap are good references to predict it. As argued by J. Taylor at the beginning of the 1980s, the direction of monetary policy must be set, above all, based on the following two variables: generally speaking, the interest rate should go up when inflation rises and when production is above the economy's potential production capacity. As can be seen in the first of the graphs contained in this article, the predictive capacity of these two variables has been high over the last few years. More interesting is the fact that the current refi rate can be explained by the ECB's behaviour to date. In other words, the only time when the interest rate deviated from this general pattern was in 2001, when it was higher than the economic conditions would suggest.

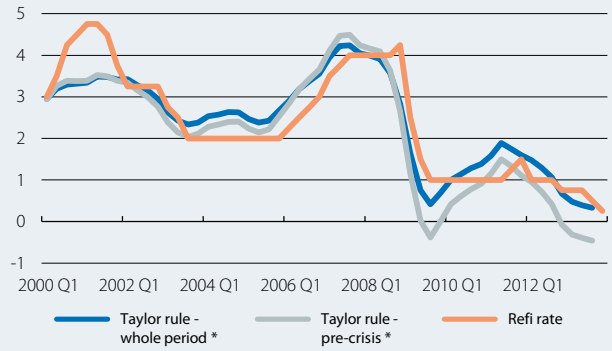
Another way of analysing whether the ECB has modified the criteria used to set the refi rate consists of estimating how it has responded to changes in inflation and in the output gap up to 2007 and extrapolating this behaviour to the current situation. As can be seen in the first graph, if the ECB had responded to inflation and to the output gap in the same way as before the crisis, the refi rate would be at a slightly lower level than at present, between –0.25% and –0.50%.[1] Although technically possible, for the time being the ECB has avoided setting negative interest rates. To offset what, a priori, appears to be a more restrictive monetary policy than the one required by the economic conditions, the ECB has set up other instruments, such as forward guidance, that have helped to lower long-term interest rates.

1. This result is obtained from estimating the same Taylor rule as in the previous case but with data up to 2007 Q4 and using the coefficients estimated to determine the interest rate that would be predicted with data up to 2013 Q4.

Therefore, although it could be argued that the ECB could implement a monetary policy that is a little more relaxed, the refi rate does not appear to be very much above the level demanded by the economic conditions of the euro area as a whole. Discrepancies emerge due to the divergence of economic conditions among the different countries. If the peripheral countries as a whole had a central bank that responded to inflation and the output gap as the ECB does for the euro area as a whole, then the refi rate would be clearly below its current level. However, the official interest rate required by the core countries is more similar to the current level, although this is fairly normal as these countries have a greater relative weight than those on the periphery.

Refi rate and predictions according to the Taylor rule

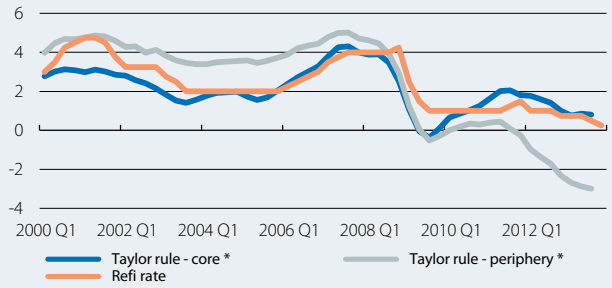
(%)



Note: ** To predict the refi rate, a Taylor rule is estimated using core inflation and the output gap. In the «Whole period» case, this is estimated with data from 2000 to 2013. For the «Pre-crisis» case, this is estimated using data from 2000 to 2007.*
Source: *"la Caixa" Research, based on data from the ECB, OECD and Oxford Economics.*

Refi rate and Taylor rule predictions for the core and periphery

(%)



Note: ** In «Taylor rule - core», the coefficients used are estimated in the Taylor rule for the euro area as a whole and are applied to the core countries. The same process is carried out for the «Periphery» case.*
The core is Germany, Austria, Belgium, Finland, France, Luxembourg and Netherlands. The periphery is Spain, Greece, Ireland, Italy and Portugal.
Source: *"la Caixa" Research, based on data from the ECB, OECD and Oxford Economics.*

FOCUS · The EC cautions Italy

The periphery of the euro area has received both good and bad news in the latest report on macroeconomic imbalances published by the European Commission. On a positive note, Spain no longer belongs of the group of countries with excessive imbalances. The adjustment process carried out by Spain's banking sector and the correction of its current account deficit are two of the examples used by the EC to demonstrate the rebalancing of the Spanish economy. On the other hand, Italy has replaced Spain on the «blacklist», sharing this role with Croatia and Slovenia.

Since 1990 the trend in Italy's economic activity has been worse than that of the euro area as a whole. The EC points to heavy public borrowing and persistent losses of competitiveness as the main burdens on the economy. Regarding the former, public debt stood at 132.9% of GDP in 2013 Q3, a level that forces the Italian public administration to allocate 5% of its annual GDP to paying interest on its debt, keeping its sovereign debt rating at a lower level than that of the rest of the developed countries, eventually affecting the financing costs of Italian firms.

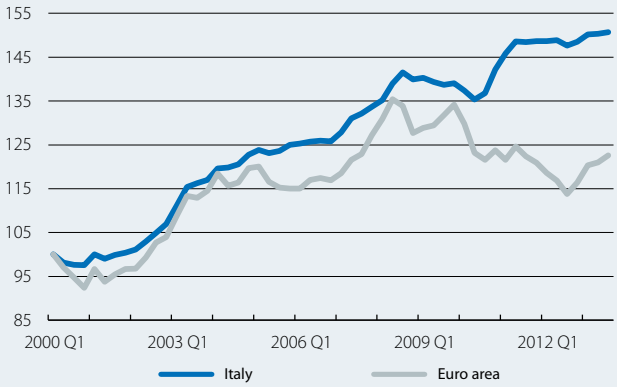
The country's loss of competitiveness is equally worrying as it jeopardises its capacity to grow in the medium and long term. As an example, we can look at the trend in unit labour costs compared with its main trading partners, one of the key determining factors of a country's competitiveness: since 2000 these have increased by 51% while the rise has merely been 24% in the euro area as a whole.

The decline in market share of Italian exports worldwide is one of the main consequences of the aforementioned loss of competitiveness. Since 2000, this market share has shrunk by 27.6% while the reduction has been 16.5% for the whole of the euro area. A highly significant part of the goods exported by Italy consists of products with an intensive use of low-skilled labour, making them more vulnerable to competition from emerging countries. Specifically, 35% of its exports of manufactured goods are low-skilled labour-intensive compared with 22% in the case of the euro area. Most European countries have taken advantage of the last few years to redirect their production towards goods that require a higher qualified workforce. For example, this kind of product has gone from accounting for 20% of Italy's total exports of manufactured goods in 2007 to 24% in 2012. For the euro area as a whole, however, this increase has been from 36% to 38%.

The challenge facing Italy's economy in the future is not minor. According to the EC's report, in order to regain a similar growth rate to that of its European neighbours, Italy must carry out an extensive and far-reaching agenda of reforms that includes all the key elements for the economy to function properly: from the labour market to the judicial system and public administration. The new government, led by Matteo Renzi, seems to have taken this to heart and has included in its agenda many of the reforms mentioned by the EC, such as reforming electoral legislation, which should provide greater political stability. However, given what has happened with previous governments, there is reason for caution.

Unit labour costs *

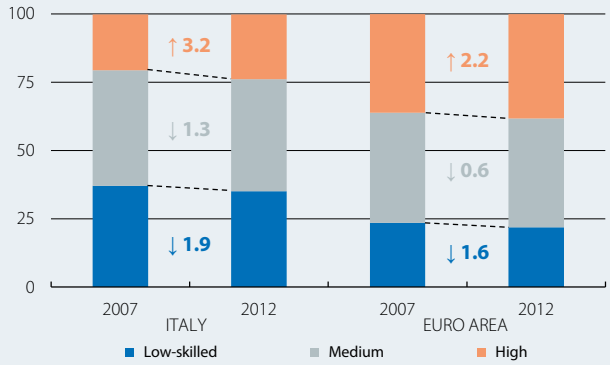
(Index, 2000 Q1 = 100)



Note: ** Unit labour costs compared with main trading partners.*
Source: *"la Caixa" Research, based on IMF data.*

Exports of manufactured goods by the skill of labour used

(%)



Note: *UNCTAD classification used.*
Source: *"la Caixa" Research, based on UNCTAD data.*

KEY INDICATORS

Activity and employment indicators

Values, unless otherwise specified

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14
Retail sales *(year-on-year change)*	–1.7	–0.9	–2.2	–1.0	–0.5	0.2	1.3	...	...
Industrial production *(year-on-year change)*	–2.5	–0.7	–2.3	–1.0	–1.1	1.5	2.1	...	...
Consumer confidence	–22.1	–18.6	–23.5	–20.8	–15.9	–14.4	–11.7	–12.7	–9.3
Economic sentiment	90.8	93.8	90.5	90.2	95.3	99.1	101.0	101.2	102.4
Manufacturing PMI	46.2	49.6	47.5	47.9	50.9	51.9	54.0	53.2	53.0
Services PMI	47.6	49.3	47.6	47.5	50.9	51.3	51.6	52.6	52.4
Labour market									
Employment (people) *(year-on-year change)*	–0.7	–0.9	–1.1	–1.0	–0.8	–0.5	–	...	–
Unemployment rate: euro area *(% labour force)*	11.4	12.1	12.0	12.1	12.1	12	12.0	...	...
Germany *(% labour force)*	5.5	5.3	5.4	5.3	5.3	5.1	5.0	...	...
France *(% labour force)*	10.2	10.8	10.8	10.8	10.9	10.8	10.9	...	...
Italy *(% labour force)*	10.7	12.2	11.9	12.1	12.3	12.7	12.9	...	...
Spain *(% labour force)*	25.0	26.4	26.5	26.4	26.5	26.1	25.8	...	...

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

Foreign sector

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

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	02/14
Current balance: euro area	1.5	2.5	1.8	2.2	2.2	2.5	2.6	...
Germany	7.4	7.5	7.3	7.5	7.4	7.5	7.7	...
France	–2.2	–1.3	–2.1	–1.7	–1.7	–1.6	–1.7	...
Italy	–0.4	0.8	0.1	0.3	0.6	0.8	0.9	...
Spain	–1.1	0.7	–0.3	0.4	0.8	0.8	0.7	...
Nominal effective exchange rate [1] *(value)*	97.8	101.6	100.7	100.8	101.9	103.1	103.4	103.5

Note: *1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated.*
Source: *"la Caixa" Research, based on data from the Eurostat, European Commission and national statistics institutes.*

Financing and deposits of non-financial sectors

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

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	02/14
Private sector financing								
Credit to non-financial firms [1]	–0.3	–2.4	–1.4	–2.2	–2.9	–3.0	–2.9	–3.1
Credit to households [1, 2]	1.2	0.4	0.4	0.3	0.4	0.3	0.2	0.4
Interest rate on loans to non-financial firms [3] *(%)*	2.4	2.2	2.1	2.2	2.2	2.3	2.3	...
Interest rate on loans to households for house purchases [4] *(%)*	3.1	2.8	2.9	2.9	2.8	2.8	2.8	...
Deposits								
On demand deposits	4.1	7.9	7.9	9.3	7.6	6.6	6.2	6.2
Other short-term deposits	2.0	0.0	1.0	0.1	0.3	–1.5	–2.6	–2.7
Marketable instruments	0.5	–14.8	–9.7	–15.5	–17.2	–16.8	–12.9	–11.5
Interest rate on deposits up to 1 year from households *(%)*	2.8	2.0	2.4	2.1	1.8	1.6	1.7	...

Notes: *1. Data adjusted for sales and securitization. 2. Including NPISH. 3. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 4. Loans with a floating rate and an initial rate fixation period of up to one year.*
Source: *"la Caixa" Research, based on data from the European Central Bank.*

CURRENT SITUATION · **Favourable growth prospects for Spain**

The Spanish economy ended 2014 Q1 with figures that encourage optimism. Available indicators for the first few months of the year point to the rate of growth accelerating. This was the case of "la Caixa" Research's economic activity index, which places quarter-on-quarter growth in GDP between 0.3% and 0.6% in 2014 Q1, above the figure of 0.2% recorded in 2013 Q4. Our forecast of 0.3% remains within an acceptable range of probabilities but the final figure looks like it might be a little higher. In fact, most institutions have recently revised their growth forecasts upwards. The Bank of Spain, for example, has increased its GDP growth forecast for 2014 by 0.6 percentage points, up to 1.2%, and has placed 2015's growth at 1.7%. Moreover, the map of risks is also moving towards more benign territory. This was the conclusion of the latest report on macroeconomic imbalances published by the European Commission, highlighting the significant advances that have been made by the Spanish economy in correcting its main imbalances. Although there is still a long way to go, this places the country in a more advantageous position to ensure the recovery steadily picks up steam throughout the year.

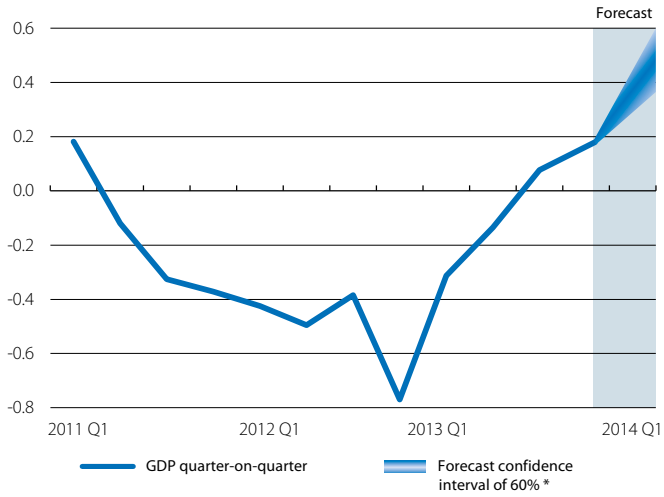
Investment is making up the ground it lost. Already in 2013, growth in investment in capital goods was surprisingly high, with a year-on-year growth rate that ended the year at 9.6%. In the first few months of 2014, the figures for industrial activity have not disappointed and both the PMI manufacturing index and the industrial production index have continued to post significant progress. All this is reflected in the good performance by the composite index of investment in capital goods in Q1. In turn, this dynamism is resulting in an increase in production capacity utilization for manufacturing, which in 2014 Q1 reached 75.5%, coming ever closer to its historical average of 80%.

Household consumption falters after a burst at the end of 2013. Although during the second half of 2013 household consumption provided a pleasant surprise with 0.5% quarter-on-quarter growth in Q3 and Q4, its rate of growth seems to have eased in the first few months of 2014. This is suggested by the trend in retail and consumer goods, which slowed up their rate of growth to 0.3% year-on-year during the first two months of the year compared with the figure of 0.9% posted between September and December 2013. This contrasts with the good performance by consumer confidence, in March reaching heights it had not seen since 2004. In fact, underlying factors such as the labour market trend are still pointing to a recovery in household consumption, so this slowdown in retail and consumer goods should be interpreted as a temporary phenomenon.

Job creation intensifies. The improvement in household consumption is largely in response to a change in trend in

GDP leading indicator: "la Caixa" Research

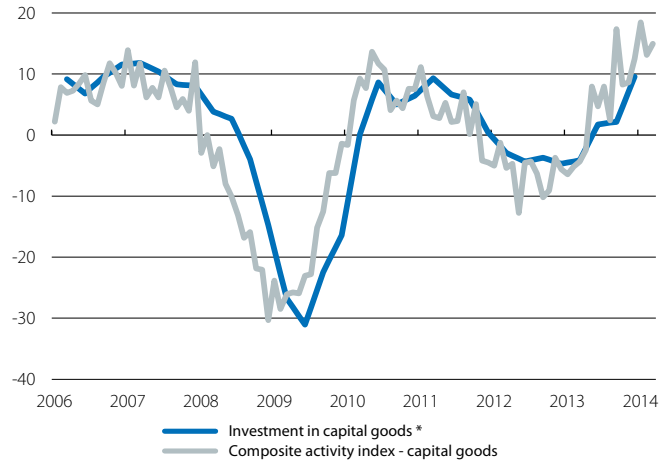
Quarter-on-quarter change (%)



Note: ** There is a 60% probability of GDP in 2014 Q1 being within this range.*
Source: *"la Caixa" Research.*

Investment indicators

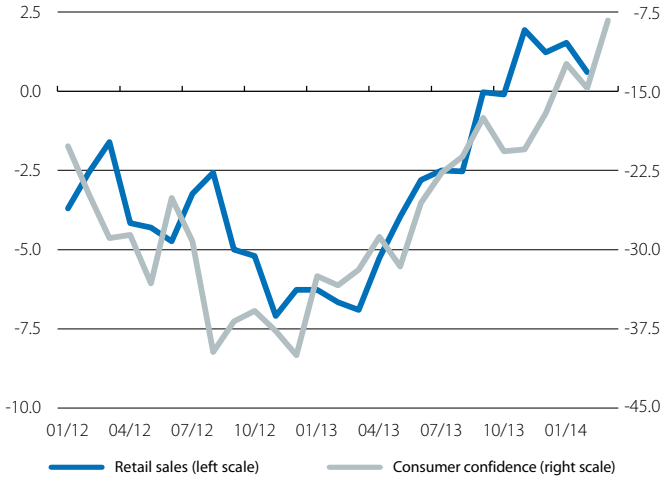
Year-on-year change (%)



Note: ** Quarter-on-quarter data.*
Source: *"la Caixa" Research, based on data from INE and the Ministry of Finance and Competitiveness.*

Consumption indicators

Year-on-year change, moving average of three months (%) *(Index)*



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

the labour market. By way of example, in seasonally adjusted terms there have been positive net job creation rates for the last six months. The services sector, which employs more than 75% of workers, is still the driving force in the labour market although clear signs can also be seen of improvement in the industrial sector. Similarly, the incipient revival in the labour market is reflected in the number of new employment contracts. As is customary, in the initial phase of a recovery most of these new contracts are temporary. In the first two months of 2014, these grew by 15.8% year-on-year, compared with a 2.1% increase in permanent contracts. However, such differences could diminish over the next few months with the coming into force of new incentives for permanent employment contracts promoted by the government.

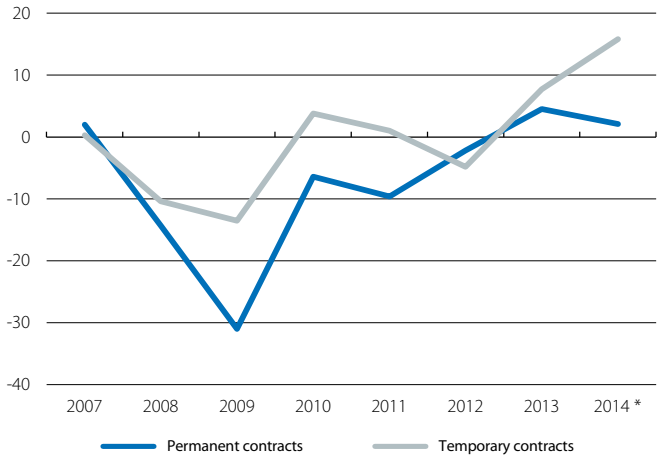
Wage adjustment remains stable in 2013 Q4. Gains in competitiveness have been key to boosting the internationalisation of the Spanish economy over the last few years. This has contributed to the fact that, in just five years, exports of goods and services have gone from accounting for 27% of GDP to 34%. The recent trend in labour costs suggests that gains in competitiveness are consolidating (in 2013 Q4 they fell by 0.3% quarter-on-quarter). However, the rate of growth in labour costs in the rest of the euro area countries has also moderated in the last few months, for the moment halting any further gains in competitiveness. The trend in inflation in Spain and the euro area is a good reflection of this. In Spain it remains at a very low level: in March it decreased by 0.2 percentage points and stood in negative terrain, specifically –0.2%. This latest drop is partly due to predictable, temporary factors such as the year-on-year decrease in tourism prices, taking into account the fact that Easter falls in April this year. However, as the recovery consolidates in domestic demand, inflation should start to move upwards. Nevertheless, the differential compared with inflation in the rest of the euro area stands at 0.7 p.p.: there inflation was 0.5% in March and no significant upswing is expected.

The change in trend is confirmed for granting new loans to firms and households. February's figures show an increase both in the granting of loans to SMEs (6.0% year-on-year) and for household consumption (6.3%). This upswing, although moderate, is helping to slow up the fall in the stock of credit, which went from 9.8% in January to 9.7% in February (without taking into account the methodological change introduced recently, which includes loans granted to financial credit establishments). However, a breakdown of the credit balance at the end of 2013 shows significant differences between different business sectors. Of note is the trend in credit to the services sector which, in 2013 Q4, only fell by 0.4% quarter-on-quarter compared with 4.4% for construction credit.

Exports of goods are picking up, and so are imports. Although over the last few months the volume of exports grew in fits and starts, the outlook is still favourable,

Trend in registered employment contracts

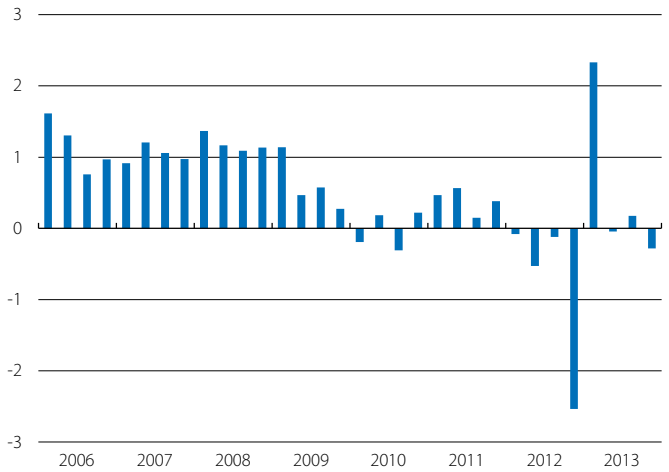
Year-on-year change (%)



Note: ** The data for 2014 correspond to the cumulative change from the first two months of the year.*
Source: *"la Caixa" Research, based on data from the Ministry of Employment and Social Security.*

Labour costs per worker

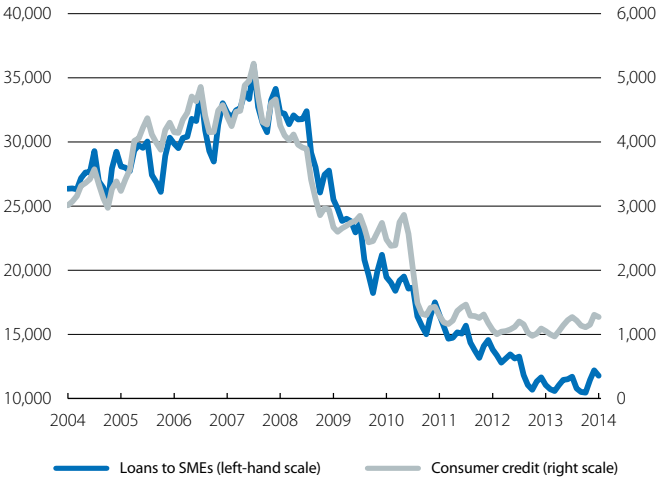
Quarter-on-quarter change, data seasonally adjusted (%)



Source: *"la Caixa" Research, based on data from the Quarterly Labour Cost Survey (INE).*

New loans granted

Moving average of three months (million euros)



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

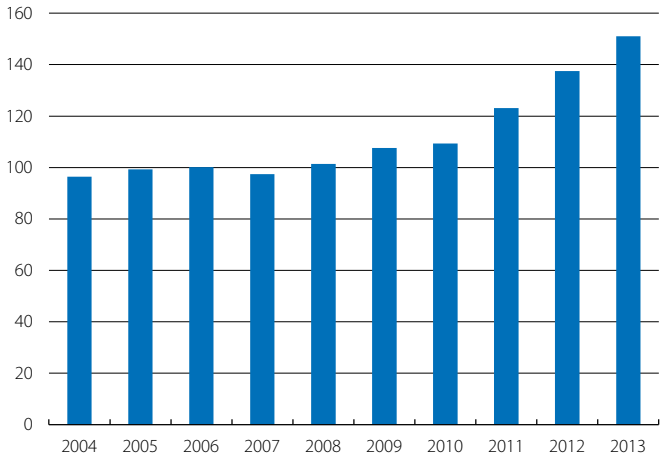
particularly supported by the good performance shown by demand from countries in the euro area. This good performance by the foreign sector is also reflected in the increase in the number of Spanish firms that export, which has gone from 97,100 in 2007 to 151,000 in 2013. However, unlike in previous years, the recovery in imports will slow up the foreign sector's contribution to GDP growth. January's trade flows help to illustrate this new scenario. During this month, exports of goods in real terms rose by 5.4% year-on-year, a figure slightly lower than that of 2013. January's growth in imports, however, stood at 6.5%, close to double its average growth recorded in 2013.

The public sector ended 2013 with a deficit of 6.6% of GDP, 0.1 percentage points above its target. In the end, 2013's fiscal balance only deviated slightly from the target set by the European Commission. The notable contraction in public consumption in 2013 Q4, namely 16.3% year-on-year, intensified the adjustment in the balance over the last few months of the year and reduced the final deficit to 6.6% of GDP. If we take into account the losses due to the bank restructuring, this figure rises to 7.1%. In any case, although the correction of just 0.2 percentage points (6.8%) with regard to 2012's deficit may seem small, it is important to remember that part of the deficit adjustment in 2012 (approximately 1% of GDP) was achieved by adopting temporary measures that consolidated in 2013. A breakdown in the balance of the different administrations does not provide any particular surprises either: the autonomous communities and central government did not achieve their deficit targets set by the EC, of 1.3% and 3.8% of GDP, respectively. On the other hand, local government corporations and Social Security met their limits, helping to offset part of the deviation by the rest of the administrations. With a view to 2014, the new deficit target established an adjustment in the fiscal balance of 0.8 percentage points, down to 5.8% of GDP. This correction seems achievable given the budget plans presented by the different administrations.

The government continues to take measures to guarantee sustained growth in the medium and long term. In March it approved a Royal Decree-Law in order to avoid the closure of viable firms that nonetheless have problems of liquidity and a high financial burden (see the Focus «Royal Decree Law 4/2014: incentives for restructuring corporate debt» in this *Monthly Report* for a more exhaustive analysis). Similarly, in March it also presented the expert report that should set the pattern for tax reform, expected before the summer and which should come into force as from 2015. The aim of this reform is to establish an efficient fiscal framework that helps to adjust the public deficit and stimulates growth. Broadly speaking, the report suggests reducing Social Security contributions and, in exchange, increasing indirect taxation and modifying direct taxation, simplifying it and widening the taxable bases.

Trend in the number of exporting firms

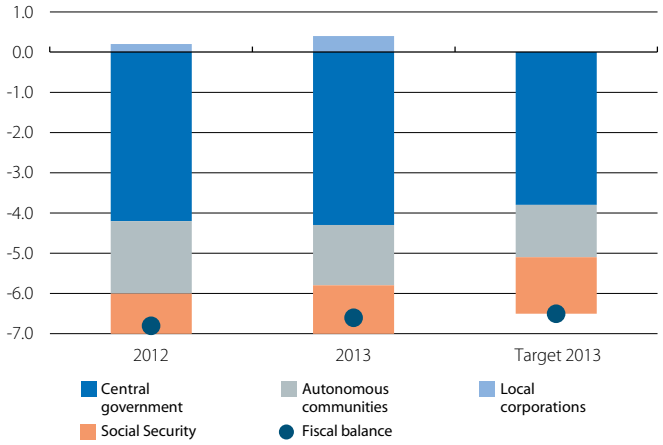
Number of firms (thousands)



Source: *"la Caixa" Research, based on data from the Ministry of Finance and Competitiveness (ICEX).*

*Breakdown of the fiscal balance **

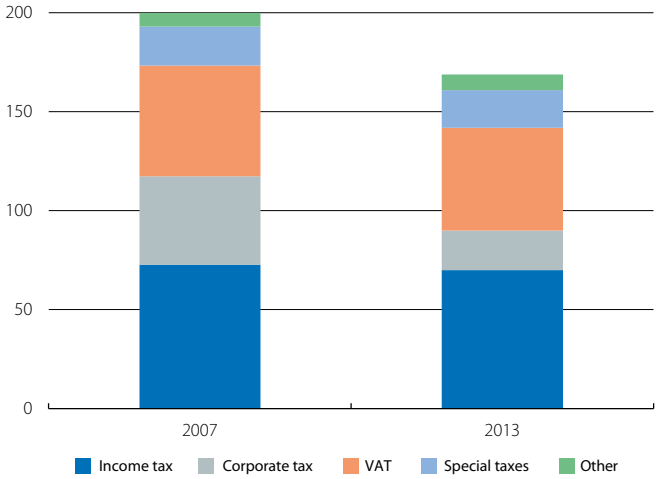
Annual balance (% GDP)



Note: ** Does not include losses caused by bank restructuring, namely 3.8% and 0.5% of GDP in 2012 and 2013, respectively.*
Source: *"la Caixa" Research, based on IGAE data.*

Tax revenue

(Billion euros)



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

FOCUS · The importance of unseen capital

One recurring concern in recent times has been the supposed investment crisis in the main western economies. By way of example, between the 1980s and 1990s, in the main developed countries the growth rate for machinery investment was, on average, close to 6% year-on-year which, since then, has remained below 3%. To understand up to what point this trend should be of some concern, it is useful to analyse what is understood by investment and how it is measured.

Economic theory defines investment as what a company spends today to increase its profits tomorrow. One classic example is machinery investment: a firm makes a payment so that, thanks to the new machines, the workers will be more productive. Can spending on specific training offered by a company to its employees be classed as investment? Following the above reasoning, it seems evident that it should be: the company spends money today and, in the future, will produce more goods because the workers will be more productive. However, expenditure on firm-specific human capital and other kinds of capital is not included in national accounts.

Corrado et al. (2006) were among the first to attempt to identify and calculate the investment in such capital (called intangible capital) for the USA.[1] Since then, several initiatives have been created to extend this study to other countries.[2] The new types of intangible capital are grouped into three areas: (i) patents, (ii) brand and (iii) organisational capital. The first group includes expenditure on scientific R&D, new financial products and technical designs. The second group contains expenditure on advertising campaigns that strengthen the brand and also market studies. Lastly, organisational capital consists of spending on changing the firm's organisation (either by using its own resources or by acquiring them) and investment in firm-specific human capital. If we compare the breakdown of investment in these assets between countries, we can see that investment in organisational structure (out of the total) is much lower in Spain whereas investment in advertising in Spain is much higher.

Investment in these intangible assets is significant: in 2005 it accounted for 5.0% of GDP in Spain and 10.2% in the United Kingdom. The relative weight of these assets also increased between 1995 and 2005, a trend that is likely to have continued. Lastly we should also note that, although the ranking of countries that invest the most (as a percentage of GDP) changes when we include these intangible assets, the gaps between countries narrow.

1. Corrado, C., Hulten, C., Sichel, D. (2006): «Intangible Capital and Economic Growth», NBER working paper No. 11948.
2. See, for example, Haskel and Westlake (2014): «Look to the intangibles», Free Exchange, The Economist, 20 February 2014.

In short, it seems reasonable to play down the unease produced by falling investment as this can partly be explained by an increase in the relative weight of intangible assets.

Breakdown of intangible assets not included in national accounts

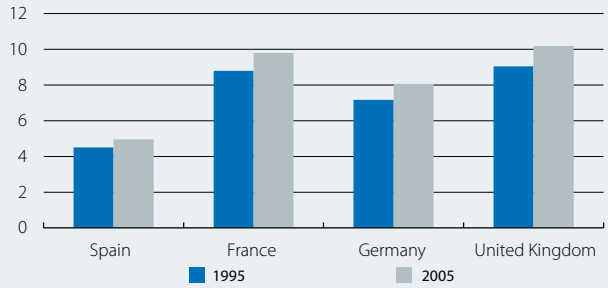
Relative share of each component in total, average 1995-2005 (%)

	Spain	France	Germany	United Kingdom
Patents				
Scientific R&D	14.0	21.6	29.3	14.7
New product development: industry finance	7.7	8.5	7.7	8.2
New architectural and technical designs	17.9	14.9	15.0	13.0
Brand				
Market research	7.4	5.0	3.6	4.7
Advertising	18.9	8.3	12.6	10.9
Organisational capital				
Firm-specific human capital	14.1	13.9	9.9	7.2
Own-account organisational structure	12.5	11.9	9.6	27.9
Purchased organisational structure	7.7	15.8	12.3	13.2
Total	100	100	100	100

Note: *Latest figures available.*
Source: *"la Caixa" Research, based on Innodrive data.*

Trend in intangible assets not included in national accounts

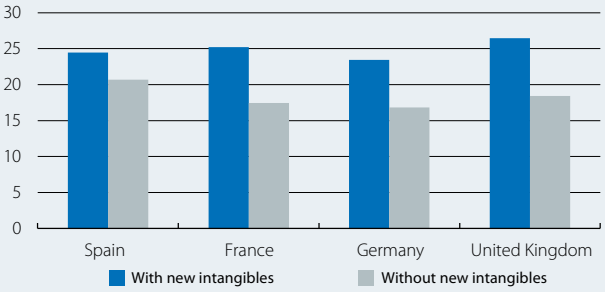
(% of GDP)



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

Effect of intangible assets on investment

Average 1995-2005 (% of GDP)



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

FOCUS · Foreign firms are trusting the Spanish economy again

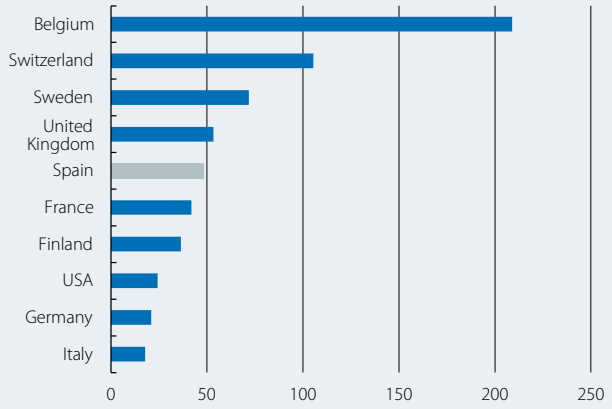
In Spain, the long-term investment in productive capital carried out by foreign firms (foreign direct investment or FDI) plays a vital role. In 2012, the stock of FDI accounted for 47.9% of GDP and, for some years now, Spain has ranked among the developed economies that receive most FDI, ahead of the USA and the main countries in the euro area and slightly behind the United Kingdom. On a global scale, although having increased by 11% in 2013, flows of foreign direct investment have yet to achieve the all-time highs of 2007. Given this context of less activity and continued uncertainty regarding the recovery of the periphery countries, it is important to note Spain's achievement by remaining in the top ten developed countries in terms of FDI received. To understand the solidity and scope of this position, we will analyse the performance of foreign investment in Spain, focusing particularly on productive foreign investment. In other words, we will exclude from our analysis operations that lack direct economic effects on the country such as the tax optimisation strategies of corporate groups.

Foreign investment increased by 8.8% in 2013 after falling substantially in 2012. Looking at the origin of these investments we can see that the euro area continues to be the main source (72.8% in 2013) and that, moreover, it contributed positively to the increase in total investment. Outside the euro area, of note is the larger role played by Latin American countries, representing 7.1% of the total in 2013, boosted by investment from Mexico. If we analyse the data by sector we can see that three industries attracted almost half of all investment: finance (19.9%), manufacturing (16.7%) and real estate (11.3%). Although investment in manufacturing decreased, this reduction can be interpreted as a temporary break after the huge influxes of 2011 and 2012. Banking investments grew but these can be explained as necessary consolidations that were postponed during the crisis and are being carried out now. It is also worth noting the positive trend in real estate investment which, in 2013, reached absolute maximums (more than double the figure in 2007).

Lastly, an analysis of divestments also reveals the improved confidence of foreign firms in Spain. Divestments increased during the crisis but, in 2013, this trend reversed and they fell by 33.4%. In other words, the increase in gross foreign direct investment (8.8%) understates the rise in net foreign investment (36.3%). In short, the data confirm the good health of the Spanish economy as a receiver of foreign investment.

Stock of foreign direct investment

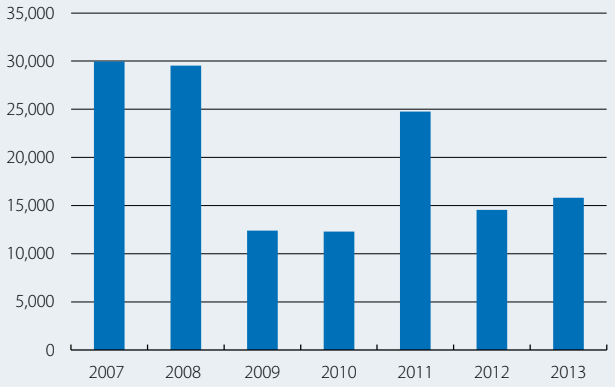
(% of GDP, 2012)



Source: *"la Caixa" Research, based on data from UNCTAD and the IMF.*

Flows of foreign direct investment

(Million euros)



Source: *"la Caixa" Research, based on data from the Ministry of Finance and Competitiveness. Investments are included without operations by foreign securities holding companies (ETVE in Spanish).*

Foreign direct divestment

(Million euros)

Source: *"la Caixa" Research, based on data from the Ministry of Finance and Competitiveness. Investments are included without operations by foreign securities holding companies (ETVE in Spanish).*

FOCUS · Royal Decree Law 4/2014: incentives for restructuring corporate debt

On 7 March, the government passed a Royal Decree Law (RDL) that reforms insolvency legislation and aims to improve the refinancing and restructuring of debt among those companies with an excessive financial burden but which are viable from an operational point of view.

The existing insolvency legislation did not promote such processes, leading to many firms in a delicate financial situation becoming involved in a meeting of creditors even though, in some cases, they may be viable in the medium or long term. Moreover, most of the firms undergoing a meeting of creditors are finally wound up with the consequent liquidation costs, losses for their creditors and the social costs resulting from the loss of jobs when the company closes.

To illustrate what kind of situation this RDL hopes to remediate, we shall use the balance sheet and profit and loss account of «Viable Firm, SA», below. Its balance sheet shows a large imbalance in assets (high proportion of debt compared with net assets) and negative working capital (higher short-term debt than working capital). The profit and loss account shows an operating profit before interest and tax but not enough to meet its debt payments (assuming an interest rate of 10%). The final outcome for the firm is therefore a loss, further damaging its net worth. Given this situation, one alternative would be to restructure the company's liabilities, for example by applying a debt remission or by converting part of this into capital. This new law aims to facilitate such restructuring processes. More specifically, the RDL:

Illustrative balance sheet of «Viable Firm, SA»

Assets	Liabilities
Fixed assets 70	Net assets 10
	Long-term debt 50
Working capital 30	Short-term debt 40

Illustrative profit and loss account of «Viable Firm, SA»

Income	100
Cost of sales	60
Gross margin	40
Operating costs	25
EBITDA	15
Amortisation and depreciation	10
EBIT	5
Financial costs	9
Loss before tax	–4
Tax on earnings	0
Net loss	–4

(i) *Helps to suspend enforcement proceedings on a debtor's assets* required for the company to continue operating. All that is required is notification to the court of the start of negotiations between the debtor and its creditors. This suspension can affect all the debtor's assets if requested by at least 51% of the company's creditors.

(ii) *Reinforces non-rescindable refinancing agreements should the company begin insolvency proceedings*. To this end it has eliminated the need for an independent expert report on the firm's viability plan. A new classification of agreements has also been established that does not require a majority of creditors and can even be with a single creditor provided the refinancing improves the debtor's equity position.

(iii) *Encourages loan capitalisation*. An insolvency may be regarded as «guilty» if the debtor does not accept the capitalisation offered by the creditors provided there is an independent expert report. In turn, the Spanish Securities and Investments Board (CNMV) will dispense with the need to launch a public offering (OPA) should these operations be designed to guarantee the company's long-term sustainability.

(iv) *Widens the sphere of pre-insolvency agreements that are legally «homologated»* (may not be subject to a claw-back action should the company become insolvent) and the majority required has been reduced to 51% (from 55%). In addition, these agreements will also apply to dissenting creditors if at least 60% (depending on the agreement type) of the creditors with financial liabilities support this before the court. Homologated agreements will also be applied to loans with security interest, both for the guaranteed part of the loan and also for the amount exceeding the security.

(v) *It encourages the injection of new money*. Temporarily, over the next two years, 100% (previously 50%) of any fresh money will be regarded as an estate claim (paid out ahead of all other claims). With this measure, the RDL aims to encourage, in the short term, the restructuring of debt in excessively leveraged firms.

The text approved by the government also contains other measures to encourage loan restructuring, including the exemption for property transfer tax of haircuts contained in refinancing agreements and the Bank of Spain treating restructured loans as «normal risk».

KEY INDICATORS

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

Activity indicators

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14
Industry									
Electricity consumption	–2.2	–2.1	–3.9	–2.3	–2.4	0.1	–0.9	–0.6	...
Industrial production index	–6.6	–1.5	–4.0	–2.5	–0.7	1.1	1.2	...	...
Indicator of confidence in industry *(value)*	–17.5	–13.9	–15.9	–15.4	–12.8	–11.6	–9.5	–8.1	–9.6
Manufacturing PMI *(value)*	43.8	48.5	45.7	47.6	50.5	50.1	52.2	52.5	...
Construction									
Building permits	–42.7	–22.8	–28.0	–27.2	–24.0	–11.9	–20.3	...	...
House sales	–8.7	–2.8	7.9	0.6	–9.7	–9.8	–22.7	...	...
Services									
Foreign tourists	2.0	5.7	1.7	5.3	4.9	10.8	12.3	11.2	...
Services PMI *(value)*	43.1	48.3	45.7	46.5	49.3	51.8	54.9	53.7	...
Consumption									
Retail sales	–7.1	–3.7	–8.4	–5.1	–1.8	0.4	0.9	–0.3	...
Car registrations	–13.5	5.6	–11.1	2.5	8.3	22.6	7.6	17.8	...
Consumer confidence index	–31.7	–25.3	–32.6	–28.7	–20.5	–19.4	–12.4	–14.7	–8.3

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

Employment indicators

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/13	02/13
Registered as employed with Social Security [1]								
Employment by industry sector								
Manufacturing	–5.3	–4.3	–5.8	–5.1	–3.9	–2.5	–1.8	–1.3
Construction	–17.0	–12.1	–15.8	–13.8	–10.8	–7.9	–6.7	–5.6
Services	–1.7	–2.0	–3.0	–2.5	–2.1	–0.4	0.8	1.1
Employment by professional status								
Employees	–3.8	–3.8	–5.1	–4.4	–3.9	–1.8	–0.3	0.1
Self-employed and others	–1.4	–0.6	–1.4	–1.1	–0.5	0.4	1.0	1.5
TOTAL	**–3.4**	**–3.2**	**–4.4**	**–3.8**	**–3.3**	**–1.4**	**0.0**	**0.4**
Employment [2]	**–4.5**	**–3.1**	**–4.6**	**–3.6**	**–2.9**	**–1.2**	**–**	**...**
Hiring contracts registered [3]								
Permanent	29.7	–14.2	2.3	–29.0	–27.8	–2.1	–2.2	6.8
Temporary	–4.0	6.4	–2.4	6.0	7.1	15.0	15.9	15.7
TOTAL	**–1.6**	**4.0**	**–2.1**	**2.0**	**2.7**	**13.5**	**14.3**	**14.8**
Unemployment claimant count [3]								
Under 25	4.5	–6.2	–4.3	–6.1	–6.4	–8.0	–7.5	–10.7
All aged 25 and over	11.7	3.7	8.4	5.2	2.3	–1.2	–2.9	–3.9
TOTAL	**10.9**	**2.7**	**7.1**	**4.0**	**1.5**	**–1.8**	**–3.3**	**–4.5**

Notes: *1. Mean monthly figures. 2. LFS estimate. 3. Public Employment Offices.*
Source: *"la Caixa" Research, based on data from the Ministry of Employment and Social Security, INE and Public Employment Offices.*

Prices

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14
General	**2.4**	**1.4**	**2.6**	**1.7**	**1.2**	**0.1**	**0.2**	**0.0**	**–0.2**
Core	1.6	1.5	2.2	1.9	1.3	0.3	0.2	0.1	...
Unprocessed foods	2.3	3.6	3.3	4.3	6.0	0.7	0.9	1.2	...
Energy products	8.8	0.1	4.8	–1.1	–2.1	–1.1	0.0	–1.7	...

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

Foreign sector

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

	2012	2013	2013 Q1	2013 Q2	2013 Q3	10/13	11/13	12/13	01/14
Trade of goods									
Exports *(year-on-year change)*	3.8	5.2	3.9	11.9	4.4	1.8	–2.2	2.9	3.1
Imports *(year-on-year change)*	–2.8	–1.3	–6.9	0.6	–0.6	1.1	–0.4	5.6	–0.6
Current balance	**–12.4**	**8.0**	**–2.8**	**4.0**	**7.7**	**9.1**	**9.2**	**8.0**	**7.6**
Goods	–27.8	–11.6	–20.9	–14.5	–11.5	–11.1	–11.1	–11.6	–10.8
Services	37.6	40.9	38.2	38.7	39.3	39.9	40.6	40.9	41.3
Income	–17.9	–15.3	–16.3	–15.0	–14.6	–14.5	–14.8	–15.3	–16.8
Transfers	–4.3	–6.0	–3.9	–5.2	–5.5	–5.2	–5.5	–6.0	–6.1
Net lending (+) / borrowing (–) capacity	**–5.8**	**15.8**	**4.5**	**12.1**	**15.6**	**16.6**	**16.2**	**15.8**	**15.5**

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

Public sector

Percentage GDP, cumulative in the year, unless otherwise specified

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	02/14
Net lending (+) / borrowing (–) capacity	**–10.6**	**–7.1**	**–0.6**	**–3.0**	**–4.5**	**–7.1**	**–**	**...**
Central government [1]	–8.1	–4.9	–1.0	–3.5	–4.0	–4.9	–0.6	–1.2
Autonomous regions	–1.9	–1.5	–0.2	–0.8	–1.0	–1.5	–0.1	...
Local government	0.2	0.4	0.2	0.2	0.5	0.4	–	...
Social Security	–1.0	–1.2	0.3	0.8	–0.3	–1.2	0.2	...
Public debt *(% GDP)*	**86.0**	**93.9**	**90.0**	**92.2**	**93.3**	**93.9**	**–**	**...**

Note: *1. Includes measures related to bank restructuring but does not include other central government bodies.*
Source: *"la Caixa" Research, based on data from the IGAE, Ministry of Taxation and Bank of Spain.*

Financing and deposits of non-financial sectors

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

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	Balance 01/14 [1]
Financing of non-financial sectors [2]								
Private sector	–4.0	–7.9	–8.1	–8.3	–8.1	–7.0	–5.6	1,852.2
Non-financial firms	–4.2	–9.9	–10.6	–10.7	–10.3	–8.1	–5.5	1,070.8
Households [3]	–3.8	–4.9	–4.4	–4.8	–5.0	–5.5	–5.7	781.5
General government [4]	14.9	17.0	18.8	18.5	17.5	13.1	10.7	979.3
TOTAL	**0.6**	**–1.0**	**–1.0**	**–1.0**	**–0.9**	**–1.1**	**–0.5**	**2,831.5**
Liabilities of financial institutions due to firms and households								
Total deposits	–4.5	2.1	–0.1	1.8	4.7	2.2	1.3	1,184.1
On demand deposits	0.2	4.2	0.9	3.2	4.6	8.1	11.0	290.1
Savings deposits	–2.8	–0.1	–0.6	–1.1	–0.2	1.4	3.4	203.1
Term deposits	–6.7	1.7	–0.9	1.6	5.7	0.2	–3.0	670.5
Deposits in foreign currency	–4.0	16.8	20.5	22.7	24.1	–0.1	3.5	20.4
Rest of liabilities [5]	–13.2	–16.8	–20.2	–19.2	–15.3	–12.7	–11.4	127.6
TOTAL	**–5.7**	**–0.2**	**–2.8**	**–0.9**	**2.3**	**0.5**	**–0.1**	**1,311.7**
NPL ratio *(%)* [6]	**10.4**	**13.6**	**10.5**	**11.6**	**12.7**	**13.6**	**13.5**	**–**
Coverage ratio *(%)* [6]	**73.8**	**58.0**	**70.4**	**65.8**	**63.8**	**58.0**	**58.0**	**–**

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

LABOUR MARKET: STRUCTURAL CHANGES AND ECONOMIC CRISIS

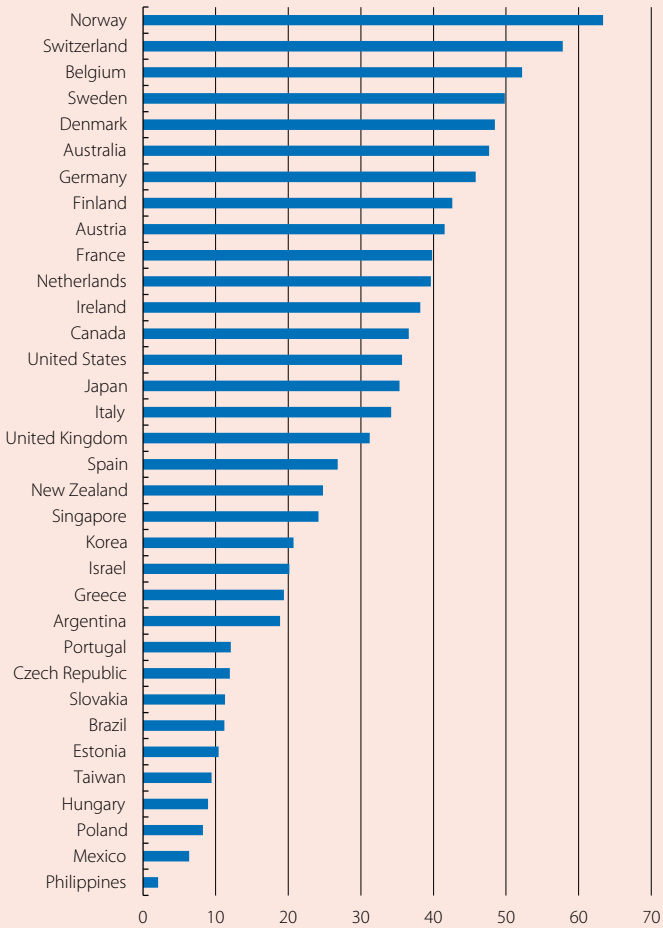
Global wage trends: will we get back to normal after the crisis?

The global trend in wages, and in particular the marked wage rise in certain countries, is leading to opposing positions regarding what has sometimes been called «the end of cheap labour» in the emerging countries. Are these opinions well-founded? In order to answer this question, this article will first compare the wage levels between countries and then analyse their trends during the period 2000-2011, paying particular attention to the effects of the recession in 2008-2009. Lastly, to complete this examination of global wage trends, we will review the link between growth in wages and in competitiveness.

The US Bureau of Labor Statistics (BLS) provides data that help to analyse the issue of relative wage levels. According to these data, in 2012 the total hourly labour cost for manufacturing in countries such as the Philippines, Taiwan, Mexico, Poland and Hungary was below 10 dollars an hour, while in Spain this figure was 27 dollars, 36 in the United States and 46 in Germany. The BLS does not offer equivalent figures for China for 2012 but, in another study by the same institution, this country's hourly wage level was around 1.4 dollars in 2008. The distance between industrialised countries and many of the emerging countries is therefore very wide.

Hourly labour cost* in the manufacturing sector

2012 (dollars)



Note: ** Includes wages, Social Security contributions and other work-related taxes paid by the company.*
Source: *"la Caixa" Research, based on data from the Bureau of Labor Statistics (BLS).*

Nonetheless, these distances have tended to shrink, as a general rule, over the last decade. Between 2000 and 2007, the real average wage in emerging economies generally tended to rise, accumulating notable increases in some regions.[1] According to the International Labour Organisation (ILO), during this period the emerging economies of Eastern Europe and Central Asia as a whole saw real average wages increase by 134%, and the emerging countries in the rest of Asia recorded an increase of 60%. Although other emerging zones saw smaller increases (8.5% in Latin America, 5.3% in Africa), the figures for the developed economies were even lower (4.5% increase).[2] This being the general situation before the Great Recession, we should ask ourselves whether the convergence of emerging country wages towards advanced economy wages has continued after the crisis of 2008-2009.

The ILO data show that wages, as a global aggregate, were undoubtedly hit by the world economic shock in 2008. Before the crisis (2000-2007), the annual growth in global wages was 2.2%, whereas in the two years affected directly by the Great Recession (2008 and 2009) this rate slowed up to 1.2% year-on-year. After the crisis, in the period 2010-2011, annual growth stood at 1.6%. As a result of this situation, the average global wage in 2011 was 6% higher than in 2007. However, this general view must not ignore the fact that the rate of growth varies considerably between regions and in particular between the emerging economies and the group of advanced economies. Before, during and after the crisis, advanced economies have seen clearly lower growth rates in wages than the emerging regions. Wage convergence is therefore still continuing. Given its economic importance, one case that

1. Global average calculated as the weighted total of six economic regions: Africa, Latin America and the Caribbean, Asia, developed countries, Eastern Europe and Central Asia and the Middle East.
2. To measure wages, the ILO uses the national monthly wage (without transfers or tax), measured in real terms and adjusted for purchasing power parity. The data in this article come from the Global Wage Report, 2012/13, ILO, 2013.

Real wage growth by economic region

Cumulative annual change (%)

	2000-2007	2008-2009	2010-2011
Africa	0.74	1.55	4.15
Asia	6.83	4.86	5.65
Eastern Europe and Central Asia	12.91	2.22	5.36
Developed economies	0.63	0.19	0.05
Latin America and the Caribbean	1.17	1.15	1.83

Note: *The following data are provisional: Africa from 2008 to 2011 and Asia in 2011.*
Source: *"la Caixa" Research, based on data from the Global Wage Report 2012/13, ILO.*

demands particular attention is China. Since the regional and global averages are calculated as a weighted average, the Asian giant affects our interpretation of the aforementioned trends. The data corroborate this intuition, although probably to a greater extent than expected. While wages in Asia were 22% higher in 2011 than in 2007, if we exclude China from this calculation the result is that the wage in 2011 in the region would have been 1% lower than the initial figure. The effect of China is not only significant at a regional level but is also truly global: the increase, between 2007 and 2011, of the average global wage goes from 6% when China is included to just 1.8% when it is excluded.

Given this situation, are the fears still valid that the emerging countries are gradually losing one of their competitive advantages, namely low wages, before they have fully completed their modernisation and achieve the levels of relative prosperity enjoyed in the advanced countries? First of all, we must remember that the trend in wages, by itself, does not help us to determine whether a country's competitiveness is being eroded or not: if its growth in productivity is greater than the growth in wages, a country's competitiveness will improve. The ILO data suggest that, between 2008 and 2011, this was indeed the case in quite a few economies in Asia, Latin America and Africa. Therefore, on numerous occasions we could say that their wage growth is «healthy». However, one of the most notable exceptions is China. In the period 2008-2011, still according to the ILO data, real wage growth was around 11% year-on-year. Given that China's growth in productivity during this period was in the order of 8%, the country's competitiveness has diminished when measured in unit labour costs.

In summary, from this review of the situation we can conclude three fundamental ideas. Firstly, the wage gap between the advanced and emerging countries is still wide. Nonetheless, and this the second conclusion we should bear in mind, wage convergence has been occurring for years and the Great Recession of 2008-2009 has not brought about any substantial change to this trend. Lastly, it should be noted that, on numerous occasions, the wage growth of the emerging countries is taking place within what we have called a «healthy» context, i.e. with productivity rising faster than wages.

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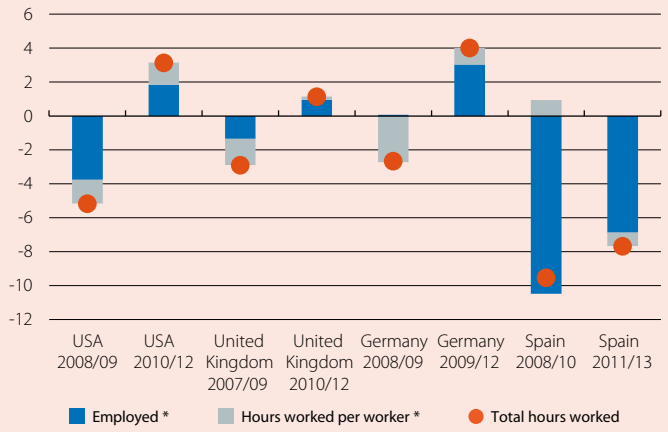
Mechanisms to adjust employment

The impact of the economic crisis on the labour market has been one of the main concerns in developed countries over the last few years. The loss of jobs, particularly when long-term, decapitalises a country, increases the risk of poverty, demotivates the people affected and their environment and entails significant costs for the public coffers. Therefore, when there is a slump in economic activity, insofar as possible it is preferable to minimise the effect on the employed population as a whole. This article analyses the trends in the labour markets of Spain, the USA, United Kingdom and Germany, highlighting some of the factors that help to cushion the recession's impact on the labour market.

Trend in the total hours worked

Year-on-year change, average by period (%)



Note: ** Contribution to the year-on-year change of the total hours worked.*
Source: *"la Caixa" Research, based on data from Eurostat data, the OECD and Thomson Reuters Datastream.*

The decline in GDP suffered by these countries during the crisis was not very disparate: in the United Kingdom this fell by 7.2% between 2007 and 2009, and in the USA and Germany by 4.3% and by 5.9% between 2008 and 2009, respectively. Neither has this drop been much greater in Spain, even though the recession has lasted longer: specifically 7.0% between 2008 and 2013. Except in Spain, the trend in the total of hours worked was not very different either. In the USA they fell by 5% while in the United Kingdom and Germany the reduction was around 3%. In Spain, however, the decline has reached 16.5%.

Significant differences between countries do occur in how the total number of hours worked has been adjusted. In Spain, this reduction was mostly by decreasing the number of workers, especially during the first few years of the recession, as the number of hours worked per worker increased. Over the last few years, however, the number of hours worked per worker has helped to moderate the impact of the recession. In Germany, the number of employees remained almost constant during the recession while the number of hours worked per worker fell by 2.7%. This adjustment in the USA and the United Kingdom was somewhere between these two situations: most was carried out by reducing the number of employed but the role played by the decrease in the number of hours worked per worker is also quite significant.

Adjustment through the hours worked per worker is useful when it occurs within a temporary slump in activity. In the USA and Spain, given that the recession has been particularly intense and long-lasting in the real estate sector, it is to be expected that this kind of adjustment would be less effective to ease the impact of the recession. However, it is worth analysing in more detail the factors that allowed the reduction in hours worked per worker to have such a successful effect in Germany. According to Schmitt (2011) [1], this was achieved mainly via four instruments. Firstly, 25% of the drop in hours occurred thanks to the subsidy for part-time employment. With this formula, for example, if a firm reduces an employee's work day by 20%, the worker receives 20% of the unemployment benefit. Secondly, numerous agreements were adopted between workers and managers that established temporarily shorter working days. According to the study, this last measure accounts for 40% of the reduction in hours per worker recorded in Germany during the crisis. A further 20% of the adjustment was achieved using a «working time bank» system. Specifically, entrepreneurs reduced their workers' work day on account against the hours they had accumulated previously. Lastly, the rest of the reduction in hours can be explained by a decrease in overtime.

Making working time more flexible is not the only way to mitigate a drop in the number of employees during a recession; this can also be carried out through wage adjustments. Inflation reduces real wages insofar as the nominal wage rises more slowly than the CPI. Albeit to a greater or lesser extent, in all the aforementioned countries the growth in wages per hour worked has been less than the rise in inflation over the last few years. In the USA, the growth in nominal wages per hour in manufacturing between 2007 and 2013 was relatively subdued (2.0% year-on-year, on average) but so was inflation (2.1%). However, in the United Kingdom, in addition to a relatively moderate growth in nominal wages (2.4%), inflation was also quite a lot higher

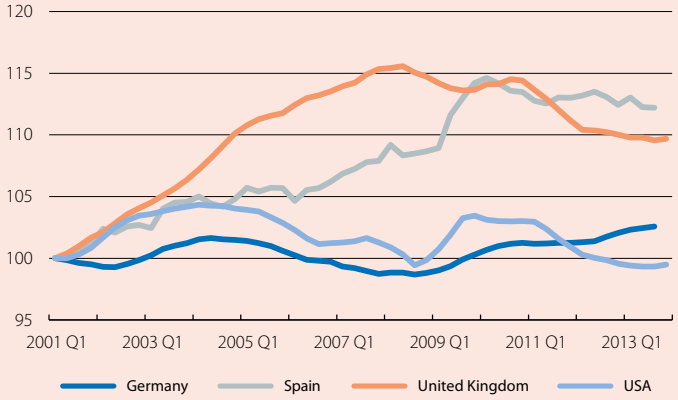
1. Schmitt, J. (2011), «Labor Market Policy in the Great Recession. Some Lessons from Denmark and Germany», CEPR.

(3.4%). In Spain, during the first few years of the recession nominal wages in industry continued to grow at a high rate (3.7% between 2007 and 2011) but, as from 2012, there was a very noticeable change: between 2012 and 2013 Q3 the growth in wages was 1.8% year-on-year on average while inflation stood at 2.2%.

It used to be assumed that wages were more rigid and that it was therefore difficult to lower them. Given that negative changes in wages do not normally occur for the whole of the employed on average, it was supposed that inflation was the main means of adjustment. However, a recent study for the USA and United Kingdom shows that a significant proportion of workers saw a nominal reduction in their wage. Specifically, Elsby et al.[2] observed that, in the USA, 25.5% of those surveyed reported a drop in nominal wages in 2012. The data for the United Kingdom are similar: in 2011 23.1% of the changes in nominal wages were negative.

Trend in real hourly wages

(Index, 2001 Q1 = 100)



Note: *Moving average of three months. Data seasonally adjusted. Manufacturing.*
Source: *"la Caixa" Research, based on data from the OECD.*

In conclusion, the experience of the last few years must serve as a lesson to improve the institutions that govern labour relations in all developed economies. It is necessary to identify those factors that have more effectively helped to ease the impact of the last recession in each country so as to handle the next one more successfully. There is a lot of room to manoeuvre.

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2. Elsby, M. W., Shin, D. and Solon, G. (2013), «Wage Adjustment in the Great Recession», NBER Working Paper No. 19478.

Recessions and technology adjustments

«[...] depressions are not simply evils, which we might attempt to suppress, but [...] forms of something which has to be done, namely, adjustment to [...] change.»

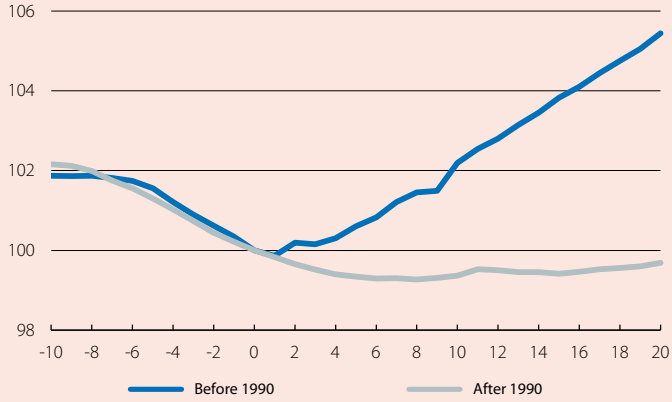
Schumpeter (1934)

It is obvious to state that, when an economy enters into recession, jobs are lost: some companies go bankrupt and others, suffering from a drop in sales, are forced to reduce their number of workers. In this article we will analyse whether there is a positive (or less negative) side to recessions. To be precise, we will investigate whether it is true, as hinted by Schumpeter during the Great Depression (1929-1939), that firms take advantage of periods of recession to adopt new technologies.

We will focus our attention on the last few recessions in the USA, which is where the best studies have been carried out, assuming that these conditions can be extrapolated to countries with similar political and economic characteristics. The first thing we observe is that the employment trend has been very different in recessions after 1990 (1991, 2001 and 2009) if we compare this with the three previous recessions (1970, 1975 and 1982). Jaimovich and Siu show that, while employment took no longer than 6 months to recover after the first three recessions, after the last three it needed at least 17 months.[1] How can we explain this difference? Why, in these later recessions, has it taken longer to create employment?

US employment around the recessions

Number of employees, index (100 = final recession)



Note: *The recessions prior to 1990 are an average of the recessions in 1970, 1975 and 1982. Those after 1990 are the average of 1991, 2001 and 2009. The message is qualitatively the same without the last recession. See Jaimovich and Siu (2013).*
Source: *"la Caixa" Research, based on data from BLS and NBER.*

One possible answer is that companies have taken advantage of the last three recessions to adjust their technology, thereby reducing the number of employees and increasing the productivity of each worker. This could explain why companies, having changed their production or type of good, now need fewer workers and why these, as they have had to move to other firms (or even change industry), take longer to find another job. Before confirming this hypothesis, we must verify two premises: (i) that this phenomenon has taken place particularly in the last three recessions, and (ii) that those workers more likely to be replaced by new technology are precisely those that have taken longer to find another job. To do so, we need to find a technology that was not present before the 1990s and check whether it is true that those workers carrying out tasks that are more easily replaced by this technology are the ones that lost their jobs.

The best candidate is the revolution in Information and Communication Technologies (ICTs), which started at the end of the 1980s. Think of the times you have taken money out of a cashpoint, bought a plane ticket or booked a hotel room online or marked a series of keys on your mobile phone to report an incident to your customer service. All these automated processes, which are now so familiar to us, have substantially transformed the work of employees at banks, travel agents and telephone operators, just to give a few everyday examples. Less visible but nevertheless just as notable is the restructuring, both internal and external, resulting from the adoption of these technologies in firms. Before the internet, companies would have to replicate information centres (such as data on sales, orders, stocks, etc.) in different departments because it was difficult to access the information required to take decisions. However, thanks to the internet, now they centralise the information in such a way that all departments can share it easily. One example of restructuring is the possibility of moving one or more departments to another country. In short, adopting ICTs has led to the loss of many jobs because they are carried out either in another country or by computers.

Having identified a suitable technology to verify our hypothesis, we have to determine the kind of worker who is more likely to lose their job. To do so, it is very useful to break down the content of each occupation into three types of tasks: routine, manual and abstract. The best way to understand this composition is by simplifying it through examples. Let us start with the job of a

1. Jaimovich, N. and H. Siu (2013): «The Trend is the Cycle: Job Polarization and Jobless Recoveries», Duke Mimeograph.

physician, whose work is highly abstract and not very routine or manual, since physicians need to study each case presented to them (one single rule cannot be applied in all cases) and, in general, they do not need to manipulate objects. The job of a taxi driver is not very routine, abstract or manual because they need to be at the wheel, monitoring the other cars, taking notice of traffic signs and changing the route if necessary. Another example is that of a supermarket checkout employee, a highly routine, manual and not very abstract job which is basically limited to passing the products in front of the barcode scanner, stating the total price and returning the change. Analysing this breakdown, it appears that the type of task that can best be carried out by ICTs is the routine one because it follows a highly standardised, unambiguous procedure, a conclusion confirmed by the studies of different economists for the USA. For example, Autor and Dorn document that the metropolitan areas most specialised in routine jobs in the 1950s are those that have most adopted ICTs and those that moved their workers on routine tasks to non-routine, low-skilled services.[2] Note that, out of the three jobs we have examined, the one with the largest proportion of routine work and therefore the most likely to be carried out by a computer is that of a checkout employee, a characteristic shared with the rest of the examples from our everyday lives that are now carried out by computers (cashpoints, online travel agencies and telephone operators). In fact, in Spain there are now mass consumption outlets where customers can pay for their shopping without help from anyone else. Note also that, in all cases, we are referring to work that can be carried out today by computers, not to tasks that computers may carry out in the near or distant future, such as driver-less cars, robots carrying out medical diagnoses, computers writing economic reports...

Examples of jobs by the importance of routine tasks

Highly routine	Not very routine
Butcher	Taxi driver
Secretary	Waiter
Accountant	Fireman
Bank clerk	Policeman
Typist	Doctor

Source: *Autor and Dorn (2013) construct the index and offer these examples of jobs.*

Having identified the technological change (ICT revolution) and the type of task (routine) that is most exposed to new technologies, the next step is to check whether, in the last few recessions, companies have eliminated the most routine jobs and that these have not been recovered. We refer once again to Jaimovich and Siu, who have looked in detail at the employment trend over the last six recessions in the USA. The authors show that, in the recessions prior to 1990, routine jobs started to be recovered seven months after the recession ended. However, in the last three recessions, the routine jobs lost were not recovered but are still lost. In other words, while the economy picks up and employment in abstract and manual jobs increases, routine jobs continue to disappear. From this analysis we can deduce that there is a tendency to replace employees with ICTs to carry out routine tasks but it is during the last few recessions that this trend has intensified and the largest adjustment has been made.

To conclude, we would like to stress that we only have indirect evidence for the Schumpeterian theory that companies took advantage of the last few recessions to adopt ICTs and, consequently, this is only one of the possible explanations of the facts documented by Jaimovich and Siu. In any case, there is evidence that the adoption of ICTs is associated with the loss of routine jobs and that this loss has intensified in the last three recessions. As we explained in «Globalisation and the redistribution of wealth» in the Dossier of February's *Monthly Report*, the implications for society of this analysis revolve around the fact that, in order to minimise the negative effects of recessions and to ensure society is better prepared to take advantage of new technologies, it is necessary to invest in education. In particular, in an educational system that focuses on reinforcing more abstract abilities, the field in which we humans can still beat the machines.

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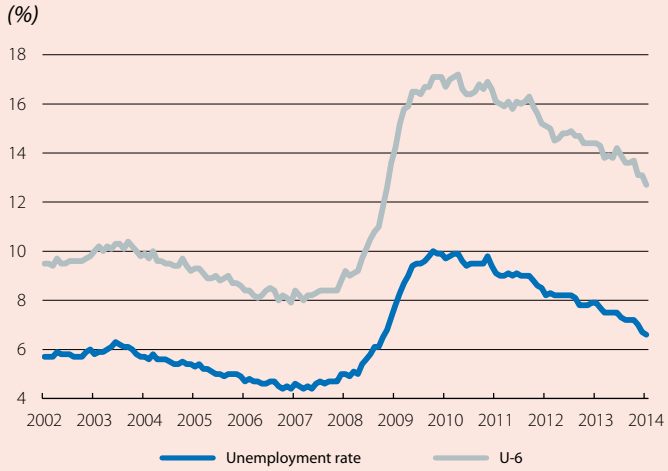
2. Autor, D., Dorn, D. (2013): «The Growth of Low-Skill Service Jobs and the Polarization of the U.S. Labor Market» American Economic Review, 103(5), pp. 1553-1597.

The reduction in the US labour force: retired or discouraged?

The recovery in the US labour market after the last big crisis is turning out to be a long, tortuous process. Many have raised doubts regarding its flexibility, which had been praised formerly. Between January 2008 and March 2010, close to 9 million jobs were lost and the unemployment rate shot up from 5.0% to 9.9%, a level that had not been reached since the recession early in the 1980s. In the last four years, the unemployment rate has slowly improved, falling to 6.7% last February, a figure close to the target (6.5%) set by the Federal Reserve (Fed) at the end of 2012 in order to start its normalisation of reference interest rates. However, an examination of other vital signs for the labour market shows that this improved unemployment rate exaggerates the positive nature of the diagnosis. So much so that, at its last meeting, the Fed's Open Market Committee withdrew the numerical target of 6.5% from its monetary forward guidance. The room left for the labour market to improve is a crucial variable to gauge whether the expansionary monetary measures run the risk of causing problems of overheating.[1] If this margin is considerable, the recipe of low interest rates for a prolonged period of time announced by the Fed should not be any cause for concern. But if there is little room for improvement, the upward pressure on wages will be a serious threat.

A more detailed analysis of the unemployment rate (the ratio between the unemployed population and the labour force, understood as those who are employed or actively seeking employment) shows that the good news of its reduction has been overshadowed by the fact that this is largely due to a shrinking labour force and not because the unemployed have found work. In particular, the participation rate (the ratio between the labour force and the population aged over 16) has gone from 66.4% before the crisis to 63.0%, an unprecedented decrease among the rest of the developed countries over the same period. Given the size and importance of this phenomenon, many studies have attempted to explain it and make forecasts.[2]

Measures of labour underutilisation



Note: *Unemployment rate = (unemployed/labour force). U-6 = (unemployed + marginally attached to the labour force + employed part time for economic reasons)/(labour force + marginally attached to the labour force).*
Source: *"la Caixa" Research, based on data from the Bureau of Labor Statistics.*

Broadly speaking, the participation rate is determined by three groups of elements. First, demographic factors, mainly the proportion of adults out of the total population. Second, socio-economic preferences such as the inclusion of women in labour market, which led to the upward trend in the rate as from the 1960s. And third, cyclical factors (compared with the previous, more structural factors), in particular the discouragement effect that occurs when economic conditions are so adverse some people decide to stop looking for work (and the opposite when there are cyclical improvements in economic activity).

Demographics appear to have played a significant role in the recent reduction in the labour force. Specifically, the ageing of the US baby boomers (those born 1946 and 1964) should have been pushing the participation rate down since 2000, when the first wave of baby boomers started to approach retirement age. However, there is notable disparity in results from empirical studies regarding the demographic factor's degree of relevance: while analysts from the Philadelphia Federal Reserve estimate that the retirement of baby boomers lies behind a surprising 66% of the decrease in the participation rate, those from the Chicago Federal Reserve calculate that this is only responsible for a modest 25%.[3] One aspect that supports the theory that demographics are only moderately responsible is the fact that the participation rate has also fallen substantially since 2000 in the group of adults aged between 25 and 54 (prime-age workers), precisely the group with the highest participation rates among the population as a whole.

Consequently, other factors apart from an ageing population are also important in explaining this drop in the participation rate. The most noteworthy of these is the discouragement caused by the harshness of the recession among those unemployed people who, after months of fruitless searching, have thrown in the towel and consequently no longer form part of the labour force, simultaneously lowering both the participation rate and unemployment. In this respect, during the current crisis the percentage

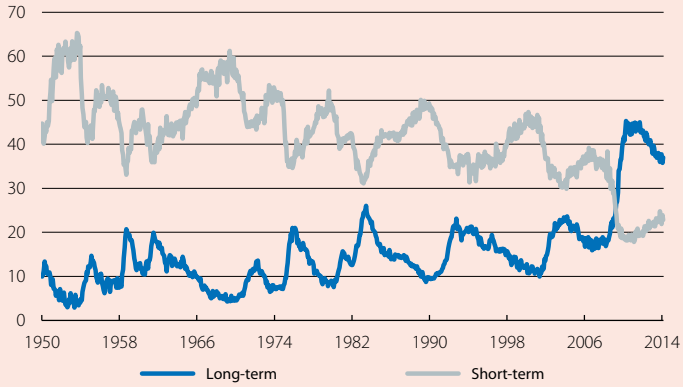
1. By margin of improvement in the labour market we mean the margin regarding idle resources.
2. This article uses the concept of «participation rate», as used by the Bureau of Labor Statistics. Note that this rate is often also calculated as the ratio between the labour force and the population aged between 16 and 64.
3. Chicago Fed Letter (2012), «Explaining the decline in the U.S. labor force participation rate»; Special Report Federal Reserve Bank of Philadelphia (2014), «On the Causes of Declines in the Labor Force Participation Rate».

of long-term unemployed out of all those without work has reached an all-time high in the US labour market (45%). And although this share has now fallen to 37%, the drop can be attributed, once again and to a great extent, to the discouraged people in this group.

The large number of discouraged potential workers requires us to look at other measures of the underutilisation of employment apart from the unemployment rate if we want to know the real state of the labour market. Among these, one series published monthly by the Bureau of Labor Statistics includes, in addition to the unemployed, those discouraged people who have stopped actively looking for work and those who are forced to work part-time due to the current situation but who would like to work full-time. Looking at the first graph, we can immediately notice a much weaker improvement in employment than the one suggested by the unemployment rate alone.

Long and short-term unemployed

Percentage share out of total unemployed



Note: *Long-term equals those unemployed who have been looking for work for more than 27 weeks; short-term equals those unemployed who have been looking for work for less than 5 weeks.*
Source: *"la Caixa" Research, based on data from the Bureau of Labor Statistics.*

Regarding the discouraged, and although we can expect many of them to return to the ranks of the labour force as the economy recovers, of concern is how capable these people really are of working again after such a long period of inactivity. This would suggest that one factor we initially thought to be cyclical actually has a more permanent component. This contingency is known as «risk of hysteresis» and, together with the demographic factor, could have reduced the growth potential of the US economy in the medium-term.

In addition to discouragement, the harshness of the recession has also affected the labour force by forcing young people to join the labour market later. This phenomenon is particularly visible in the high number of women who have decided to prolong their studies or to start a family at an earlier age. As with discouraged workers, this delay is mainly a cyclical factor with secondary structural aspects. However, on this occasion the structural component could have a positive effect on potential growth insofar as the labour force will be better trained in the future.

Another element that has received particular attention from the specialist media is the extraordinary increase in the number of applications for disability pension. Whichever way you look at it, this figure is higher than the ageing population seems to warrant. Such an increase is due to the fact that those unemployed with some kind of partial disability, having used up all their unemployment benefit entitlement, have decided to try their luck via disability benefit with the hope of receiving some kind of compensation to help them survive. Although this is surely a much less relevant factor than those mentioned previously, its structural nature warrants some consideration as those people whose disability is unlikely to be accepted will return to work once the economic cycle improves.

Lastly, together with the USA's internal factors, globalisation has also helped to lower the participation rate. Between 2000 and 2007, the severe blow for workers in the manufacturing sector as a result of China joining the World Trade Organization was offset by a prosperous real estate sector which was able to absorb a large proportion of workers laid off from industry, mostly in low-skilled jobs. However, the bursting of the real estate bubble, which set off the Great Recession, broke this bridge between jobs.[4] We are familiar with the rest of the story: these workers, most of them low-skilled, have stopped actively looking for work as they have become discouraged.

In short, empirical studies point to both structural and cyclical factors (i.e. discouragement) behind the fall in the participation rate. However, the precise extent of each of these is still a matter of controversy. A controversy that can be seen not only among the Fed's analysts but also among those at the top of the institution, including members of the Monetary Policy Committee. Hence, among others reasons, the disparity of opinion regarding whether the rate of monetary normalisation should be fast or slow. So far, the Fed has opted for the second option but it would be advised to watch for signs that might indicate a smaller margin of improvement in the labour market than estimated, such as the rate of wage rises.

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4. Charles, K. K., Hurst, E., and Notowidigdo, M. J. (2013). «Manufacturing decline, housing booms, and non-employment» (No. w18949). National Bureau of Economic Research.

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"la Caixa" GROUP: KEY FIGURES
As of December 31, 2013

Financial activity	MILLION €
Total customer funds	304,636
Receivable from customers	206,479
Profit atributable to Group	745

Commercial activity and resources	
Customers (million)	13.6
Staff	33,291
Branches	5,730
Self-service terminals	9,597

Community projects: budget for activities in 2014	MILLION €
Social	335
Science and environmental	66
Cultural	64
Educational and research	35
TOTAL BUDGET	**500**

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