# CURRENT SITUATION · A good end to the year for the Spanish economy

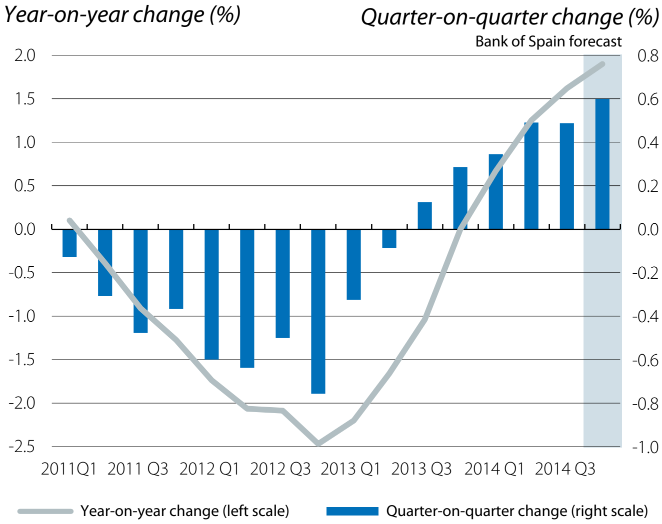
**Spain's economy continues to grow at a good rate.** According to the Bank of Spain, GDP grew by 0.6% quarter-on-quarter in Q4. Should this figure be confirmed, 2014 will end with 1.4% growth in GDP. Regarding the new year, the most recent forecasts of the consensus of analysts, from December, point to 1.9% growth for 2015. This figure represents a substantial improvement on January's forecast a year ago, which placed growth at 1.2% for 2015. The improvement in the outlook throughout 2014 is thanks to more confidence in the Spanish economy's growth capacity, which has also been reinforced by two additional factors: the slump in oil prices, deeper and longer lasting than initially expected, and the greater depreciation of the euro because of the actions carried out by the ECB throughout the year.

**These good prospects for the Spanish economy contrast with the worsening of the euro area.** In the second half of the year, the consensus of analysts revised downwards its growth forecasts for the euro area in 2015, going from 1.6% in July to 1.1% in December. Given the weak, uneven recovery in the euro area and the decrease in inflation expectations, we expect the ECB to implement additional quantitative easing measures in 2015 Q1 (see the Focus «The ECB finds itself in an alley with just one exit: QE»). More accommodative monetary policy has led us to reduce and flatten out the interest rate curves, which will boost financing conditions for the public sector. Specifically, we have revised downwards our yield on Spanish 10-year bonds by an average of 20 bps for 2015, down to 1.6%. Nonetheless, given that the increase in monetary supply will take some time to have an effect on the real economy, we have maintained our annual GDP growth forecast for 2015 at 1.9%, albeit revising it upwards to 2.2% for 2016 (previously 2.0%) as we expect exports to grow slightly more than originally predicted thanks to the euro's depreciation. On the other hand, we have maintained our forecast for the current balance as an increase in imports (due to the recovery in oil prices expected for 2016) will offset this effect.

**Supply indicators look promising.** The PMI manufacturing index rose strongly in November, reaching its highest level since March 2007. Industrial production also increased, by 1.2% year-on-year in October. The PMI for services, however, corrected part of the advance made over the last few months and stood at the 52.7 points, albeit still comfortably in the expansionary zone. Billing figures for firms and industrial orders also point to a sustained recovery, posting positive growth in October (2.0% and 3.7% year-on-year, respectively). One of the main industries for the Spanish economy, namely automobiles, continues to look strong (registrations rose by 17% year-on-year in November and turnover by 9.1% in October).

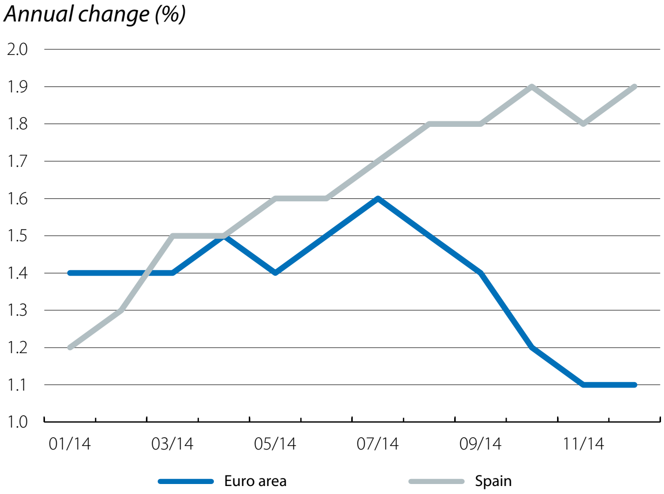
**A positive balance for employment.** The number of registered workers affiliated to Social Security grew more than expected in

### GDP growth



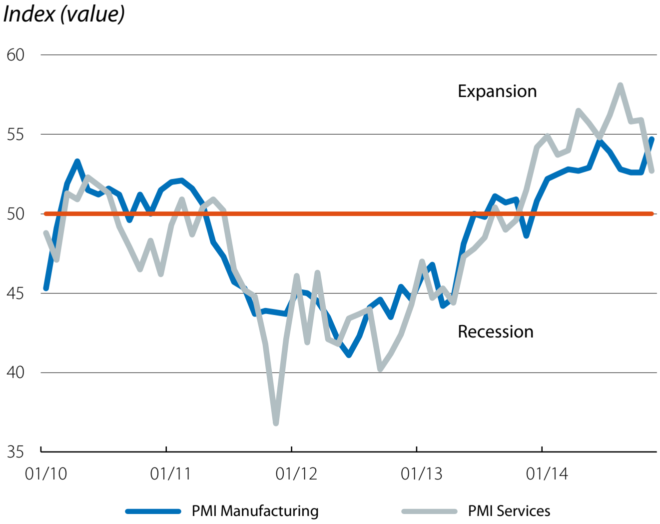

**Source:** *"la Caixa" Research, based on data from the INE and the Bank of Spain.*

### Trend in GDP growth forecasts of the consensus of analysts for 2015




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

### Activity indicators




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

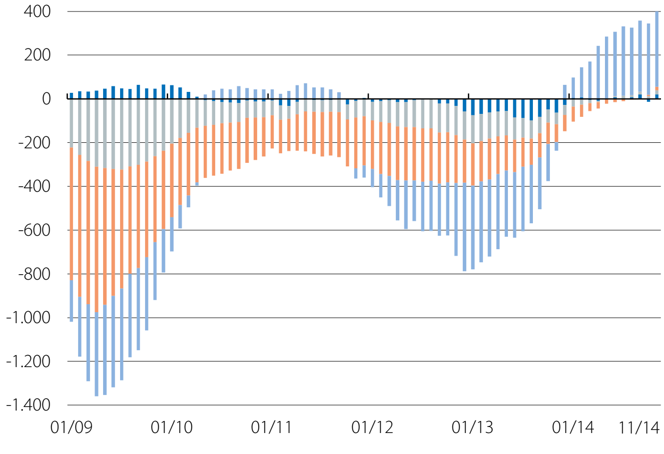
November (95,040 seasonally adjusted). This notable increase was down to the services sector which has been creating jobs for several months, as well as to the fact that the improvement in industry and construction is gradually consolidating. Judging by employment expectations in the European Commission's opinion polls, the labour market should continue to recover apace over the coming months. On average, expectations are better than in Q3 and with highly significant growth in the construction sector, yet another example that the real estate market is stabilising. One particularly important aspect is the increase in new building permits, up by 2% year-on-year in September and the first positive rate since July 2007. This should improve the trend for the number of homes started in the last quarter of the year. There are also signs of real estate demand recovering with house purchases up by 16.0% year-on-year in October (13.7% in September).

**Moderate wages continue.** In 2014 Q3, wage costs grew by 0.1% quarter-on-quarter according to the harmonised index of labour costs (0.4% in Q2 and –0.1% in Q1). These survey data therefore corroborate that wages are still adjusting, as shown by last month's figures from the National Accounts system. The moderate rise established in wage agreements in November, namely 0.6% year-on-year, suggests that wages will remain contained over the coming quarters. Moreover, given that inflation will be considerably lower in 2015 than previously expected, there will be no pressure from this source to increase wages. Because of this, we have revised downwards our growth forecasts for compensation per employee in 2015, so that unit labour costs can continue their adjustment but without incurring any loss in purchasing power. Consumption will also be strengthened by the improvement in household disposable income thanks to growing employment and the income tax reduction introduced in the tax reform.

**Oil offers no respite to the CPI.** In November, inflation fell to –0.4%, particularly as a result of falling prices in energy products, both oil and electricity, and also in fresh foods. On the other hand core inflation has remained at a standstill since May, between 0.0% and –0.1%. Over the coming months we expect general inflation to remain in negative terrain as oil prices are falling further and longer than initially predicted. In fact, December's growth in the CPI places inflation at –1.1%, a negative rate that has not been seen since 2009, also because of falling oil prices. However, while the 2009 drop in oil prices was mostly due to demand factors because of the world recession, this time around it is largely a result of supply factors. In any case, the slump in oil prices (–48.6% year-on-year at the end of year) has meant that inflation in 2015 has undergone a sharp downward revision, from 0.9% to 0.3%.

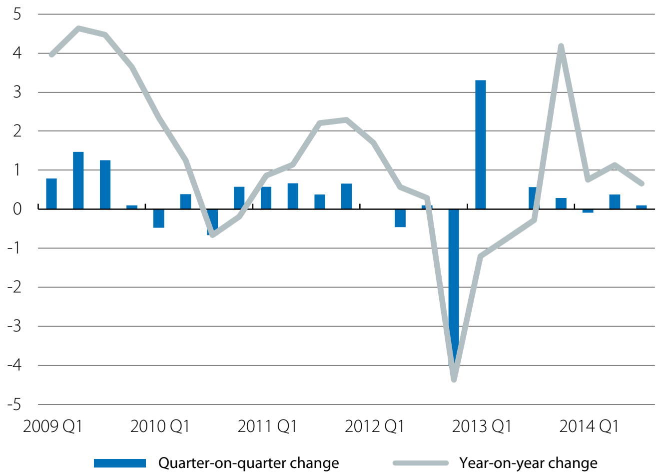
**Signs of improvement in the foreign sector after a weak first quarter.** Exports of goods grew significantly by 4.1% year-on-year in October. If we take the average from the last three months, this increase is higher than the one for the first half of the year, although it has eased slightly. Exports therefore continue to grow, although they cannot offset the

### Employment
*Year-on-year change (thousands)*



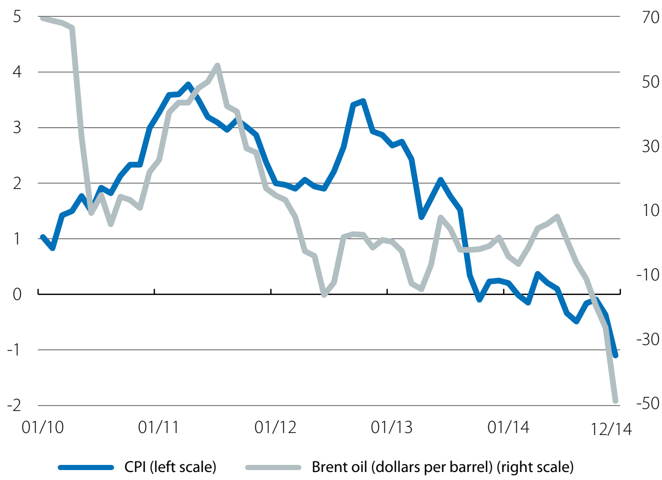

**Source:** *"la Caixa" Research, based on data from the Ministry of Employment and Social Security.*

### Hourly wage cost
*(%)*




**Note:** *Data seasonally adjusted.*
**Source:** *"la Caixa" Research, based on data from the ICLA (INE).*

### CPI and oil prices
*Year-on-year change (%)*




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

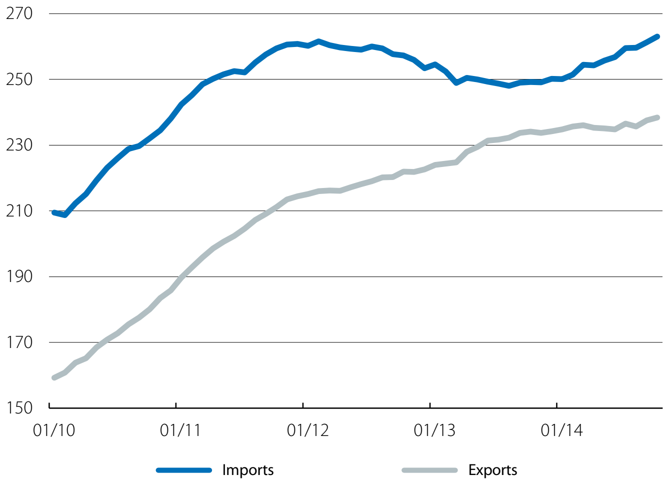
strength of imports at present, boosted by the recovery in consumption and strong investment in capital goods. With regard to the export of services, November's increase in the number of foreign visitors, namely 2.9% year-on-year, should help to offset part of the deficit in the balance of goods and income balance. The good tone observed in tourism's outbound markets, except for Russia which fell by 32.6% but only represents a small share of the total (1.3%), means that this favourable outlook for the sector should continue.

**The AIReF warns of the risk of autonomous communities not meeting their deficit targets in 2014.** The estimated deviation, more than 0.3 pps of difference from the 1% target, is mainly due to the large share of interest payments in financial costs, as well as expenditure being over budget and deviations in revenue. Given that a significant deviation has now been predicted for 2014, the AIReF insists that preventative measures be taken in seven communities to ensure they meet their deficit target in 2015, namely 0.7% of GDP. Specifically, according to this institution, deviation is very likely and extensive (a deficit above 2.0% of GDP) in Extremadura, Catalonia, Valencia and Murcia; and very likely but smaller (a deficit above 1.3% of GDP) in Castile-La Mancha, Andalusia and the Balearic Islands. The AIReF's report adds fuel to the debate on the financing system for autonomous communities and the need to reform it. Given this situation, on 26 December the Spanish government approved a Royal Decree to improve financing for the autonomous communities and local government corporations in the short term. Specifically, new financing funds were set up at zero interest for 2015. This zero interest rate will continue for two more years for those communities that meet their deficit target or for those that do not meet their target but present an adjustment plan to achieve this. On the other hand, public sector debt increased once again and reached 96.8% of GDP in 2014 Q3 (96.4% in Q2). The economic recovery and fiscal adjustment planned will help public sector debt to stabilise in 2016 around 101% of GDP, while it is expected to fall very gradually as from 2017.

**A favourable trend for the banking sector.** Although the outstanding balance of credit is still at a historically low level and the NPL rate is still high, the most recent figures show clear improvement in both areas, although not widespread in all segments. In October, credit for consumption and to acquire residential properties increased significantly and, should this continue, it will support the recovery in consumption and the real estate sector. With regard to corporate financing, new loans to SMEs increased again, up by 14.3% annually (cumulative from January to October), while new loans to large firms posted a drop, with figures that are still far from the levels reached in 2013. However, part of this fall is due to the replacement of bank loans with other sources of financing, such as capital markets. On the other hand, the non-performing loan (NPL) ratio fell once again in October, down to 12.9%. Nonetheless, the breakdown for Q3 shows a disparate trend by segment, with decreases in the NPL rate, for example, in loans to households to buy housing but increases in the NPL rate for loans to households for consumption.

### *Balance of goods*

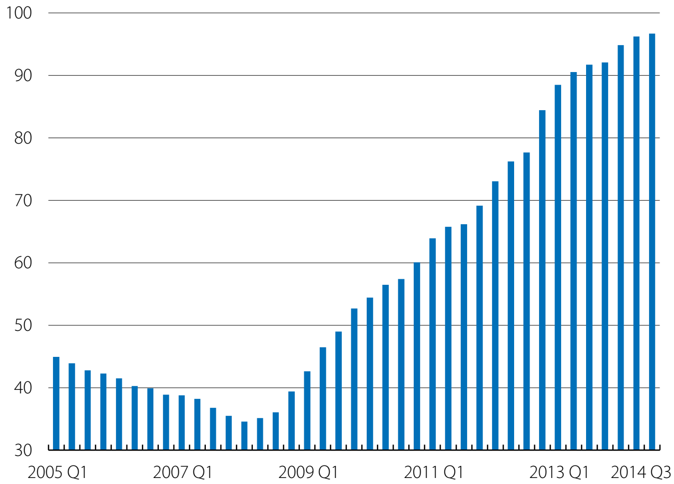
*Cumulative over 12 months (billion euros)*




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

### *Gross public debt*

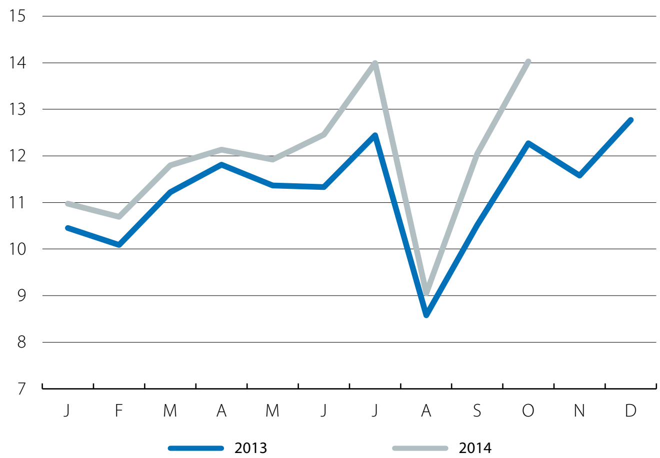
*(% of GDP)*




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

### *New loans granted to SMEs **

*(Billion euros)*




**Note:** ** Loans under one million euros.*
**Source:** *"la Caixa" Research, based on data from the Bank of Spain.*