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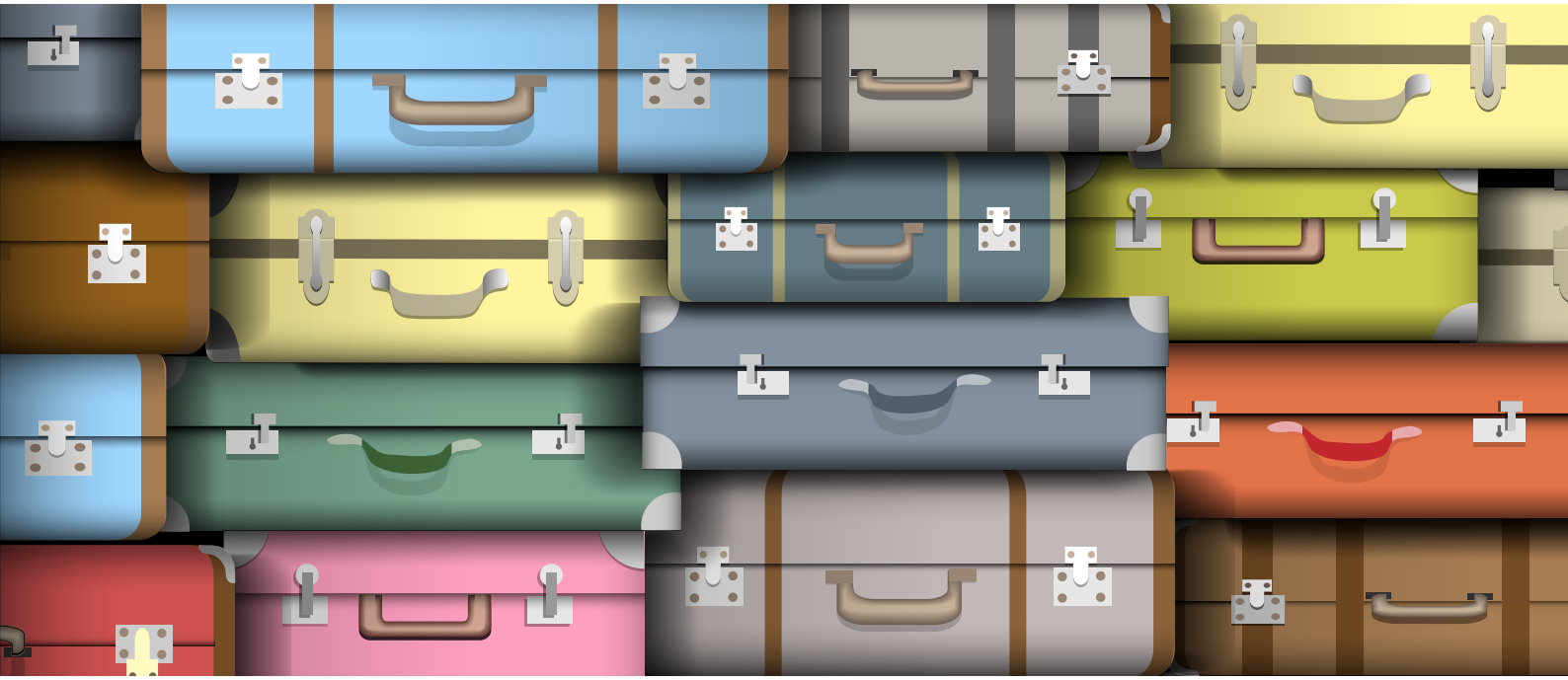
MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

NUMBER 379 | MAY 2014



ECONOMIC & FINANCIAL ENVIRONMENT

FINANCIAL MARKETS
The earnings of Spain's listed companies exit the crisis

INTERNATIONAL ECONOMY
Saudi Arabia: significant challenges on the horizon

EUROPEAN UNION
France: dependent on economic policy

SPANISH ECONOMY
The demand for housing in Spain stabilises

DOSSIER: TOURISM, SECTOR OF THE FUTURE

China and Russia: the new emerging sources of tourism

Recipes for success in the tourism industry: different ways to reach the same destination

The anatomy of Spain's tourism

The economic impact of the tourism industry in Spain

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"la Caixa"

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK

May 2014

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Date this issue was closed:
30 April 2014

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INDEX

1 EDITORIAL

3 EXECUTIVE SUMMARY

4 FORECASTS

6 FINANCIAL MARKETS

9 *Global financial stability: from liquidity to growth*

10 *The earnings of Spain's listed companies exit the crisis*

12 INTERNATIONAL ECONOMY

15 *Saudi Arabia: significant challenges on the horizon*

16 *The IMF points to a definitive recovery in the world economy*

18 EUROPEAN UNION

21 *France: dependent on economic policy*

22 *Proposals to mutualise debt in euro area countries*

24 SPANISH ECONOMY

27 *The demand for housing in Spain stabilises*

28 *The slow correction in Spain's net external debt*

29 *The return on education in Spain*

32 DOSSIER: TOURISM, SECTOR OF THE FUTURE

32 *China and Russia: the new emerging sources of tourism*
Clàudia Canals

34 *Recipes for success in the tourism industry: different ways to reach the same destination*
Joan Daniel Pina and Àlex Ruiz

36 *The anatomy of Spain's tourism*

38 *The economic impact of the tourism industry in Spain*
Maria Gutiérrez-Domènech

The European elections: more important than they seem

In May 2014, citizens of the European Union (EU) have been called to new elections to choose their members of the European Parliament. These elections are often seen as secondary, which is surprising considering that the European Parliament affects legislative issues with a lot of impact on the everyday lives of Europe's citizens. In fact, much more than voters imagine, especially after the Lisbon Treaty came into force in 2009.

This lack of appreciation of just how important the EU's legislative power can be comes from the complexity of its institutions. The European Parliament may also appear to be a relatively insignificant institution because electors do not see a true «European government» coming out of it, unlike the situation in most parliaments of its member states.

But, in this respect, there is a new element to this month's elections that is significant: although it is not a legal requirement, the President of the European Commission (EC) is expected to be chosen based on the election results and, specifically, he or she should be the candidate proposed by the majority group in the Parliament.

But the EC cannot be considered as a European government as it only has executive powers in a limited number of areas. Moreover, apart from the President, its composition depends on political balances at the level of each member state and not at a European level. Most of the EU's executive functions actually correspond to the European Council which, in its different forms (the Councils for different areas), is no more than the sum of its member state governments, with weighting rules for voting depending on the issues in question. The role of figures such as the President of the Council or the High Representative of the Union for Foreign Affairs and Security Policy is, as in the case of the EC, less important.

This vague relationship between votes for the European Parliament and the mechanisms used to decide a large amount of EU legislation (agreements between the Council and the Parliament based on initiatives proposed by the EC) lies at the root of criticism regarding the lack of democratic legitimacy within European institutions.

If we take into account the huge restrictions imposed by this complex institutional framework, the EU's response to the international financial crisis and the subsequent debt crisis in the EU area has been relatively satisfactory. The few executive tools at the Union's disposal have been used to tackle the crisis and progress has been made in creating new institutions to deal with deficiencies in the European and Monetary Union which the crisis itself revealed.

For some of the more important actions (such as improving fiscal discipline and creating bodies to financially support weaker countries), the EU's actions have ended up being implemented outside the sphere of the current European treaties, using new agreements between governments. This phenomenon, perhaps understandable to tackle emergency situations, has made Europe's institutional framework even more complex and has weakened supranational institutions compared with member states.

Over the next five years of legislature, the new European Parliament will face (together with the rest of the institutions) many challenges, especially to ensure a solid economic recovery and to reduce the Union's high unemployment rate. But perhaps the most important challenge will be to embark on the path towards a more comprehensive institutional reform for Europe. It will be impossible to tackle the Union's goals of economic and social progress solidly and credibly without greater political integration, with the corresponding surrender of national sovereignty by the member states. However, this surrender will only be legitimate if the way the Union is governed can be understood by citizens and perceived as democratic and fair, with the necessary checks and balances to ensure the government's actions at a European level are in line with the interests of its citizens.

Jordi Gual
Chief Economist
30 April 2014

CHRONOLOGY

APRIL 2014

29 The **European Banking Authority** publishes the methodology and **macroeconomic scenarios** used to carry out the stress tests on Europe's banks.

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%.

AGENDA

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).

JUNE 2014

2 Savings rate of households (first quarter).
3 Registration with Social Security and registered unemployment (May).
5 Governing Council of the European Central Bank.
6 Industrial production index (April).
13 International trade (May).
17 Quarterly labour cost survey (first quarter).
18 Loans, deposits and NPL ratio (April).
Fed Open Market Committee.
26 European Council.
27 Economic sentiment index of the euro area (June).
Flash CPI (June).
30 Balance of payments (April).
Net international investment position (first quarter).

The advanced countries take over

Little by little the world economy is getting back to normal. Although the main sources of risk have not disappeared, investors believe they have now entered a more stable phase. Having overcome setbacks early in the year, the financial and economic environment has tended to improve in the main emerging countries, the US and the euro area. According to the IMF's new scenario of forecasts, world growth will reach 3.6% in 2014 and 3.9% in 2015, both figures higher than the growth achieved in 2013, namely 3.0%, and than the recent historical average. This acceleration in global growth will mainly result from the revival in the advanced economies but perhaps the most important change in the panorama outlined by the IMF is its belief that another global recession is now less likely.

Relative calm in the financial markets. In developed countries, economic recovery and expectations that accommodative monetary conditions will continue are providing a favourable environment for risk assets in general and sovereign debt in particular. The Fed is still reducing its bond purchases (tapering) and has suggested that official interest rates will be raised around mid-2015, not too far in the future and also likely to be brought forward. In general, financial conditions are progressing well in the emerging markets, leaving behind the tensions seen at the start of the year although there is still very clear discrimination between countries. There are two worrying cases, however. For the second time this year the Brazilian monetary authorities have raised the official interest rate, this time to 11%, in an attempt to slow up inflation. In Russia, immersed in a geopolitical conflict with the Ukraine and exposed to sanctions by the West, the central bank has raised its official rate by half a point to 7.5%. With this measure, the authorities hope to limit the flight of capital and check rising prices. This action was taken after Standard & Poor's had lowered Russia's credit rating to BBB–, one step away from junk bonds. The agency is concerned about its economy's huge dependence on energy exports and the dangers posed to investment and domestic consumption by any further international sanctions.

The US and China announce lower GDP growth than expected in 2014 Q1 but recent activity indicators are favourable. In the case of the US economy, GDP remained practically at a standstill, advancing by a meagre 0.1% in annualised quarter-on-quarter terms. However, a large part of this situation is due to unusually bad weather early in the year. Moreover, the latest business indicators have confirmed the economy is performing well, so it is still plausible to expect growth in activity to pick up this year and reach levels close to 3%. With regard to the Asian giant, its GDP grew by 1.4% quarter-on-quarter, a slightly lower figure than expected but enough to dispel fears of a possible hard landing for the economy. The Chinese government believes this rate of growth is within a reasonable range given the economy's structural transformation towards a more consumption-driven model.

Growth prospects improve in the euro area but pressure on the ECB increases. Strong exports and particularly more solid demand in the euro area underlie the region's improved growth prospects. The IMF, for example, has revised upwards its growth forecasts for 2014 and 2015 by 0.1 p.p., to 1.2% and 1.5% year-on-year respectively. In spite of the improved performance by economic activity, the inflation rate is still at a very low level, fuelling debate regarding the risk of deflation. In fact, pressure has been growing over the last few months for the ECB to act. Added the list of factors pressurising the ECB to employ a more accommodative monetary policy is the euro's appreciation and the upswing in money market rates. For the moment the ECB has limited itself to verbal action but the tone of its statements has become firmer and more specific, to the extent that it has managed to convince agents it will carry out quantitative easing should this end up being necessary, something difficult to imagine just a short time ago.

Spain's activity continues to build up steam but the effect on the labour market will take some time to appear. GDP grew by 0.4% quarter-on-quarter in 2014 Q1, in line with the latest activity figures which already pointed to an increase in the rate of growth. At the other extreme, according to the LFS, in 2014 Q1 employment fell by 0.1% quarter-on-quarter seasonally adjusted, a more negative situation than the Social Security registration figures had originally suggested. However, the good performance figures should end up affecting the labour market over the coming months. This can be seen in the new series of forecasts by the government, in which it has also highlighted the improvement in the public deficit predicted for this 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	3.5	3.5	3.5	3.6
Developed countries										
United States	2.8	1.9	2.6	3.0	2.0	2.6	2.3	2.7	2.5	2.8
Euro area	–0.6	–0.4	1.1	1.5	–0.3	0.5	0.9	0.9	1.1	1.3
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	–0.9	–0.1	0.3	0.7	0.9
Spain	–1.6	–1.2	1.2	1.7	–1.1	–0.2	0.6	1.1	1.4	1.6
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	1.7	2.7	2.1	1.8	2.7	3.1	2.8	2.5	2.3
Emerging countries										
Russia	3.4	1.3	0.8	1.4	1.3	2.0	1.3	0.8	0.5	0.7
China	7.7	7.7	7.5	7.4	7.8	7.7	7.4	7.6	7.3	7.6
India [2]	4.5	4.6	5.6	5.9	4.8	4.7	4.7	5.2	5.5	5.7
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	2.1	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	3.4	3.7	3.6	3.5
Developed countries										
United States	2.1	1.5	1.7	1.8	1.5	1.2	1.4	1.9	1.7	1.8
Euro area	2.5	1.4	1.0	1.5	1.3	0.8	0.7	0.9	1.1	1.3
Germany	2.1	1.6	1.4	1.8	1.7	1.3	1.0	1.2	1.5	1.7
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	0.7	1.4	1.1	0.7	0.5	0.6	0.7	1.1
Spain	2.4	1.4	0.5	1.3	1.2	0.1	0.0	0.4	0.4	1.0
Japan	0.0	0.4	2.7	1.8	0.9	1.4	1.5	3.3	3.0	2.8
United Kingdom	2.8	2.6	1.9	2.1	2.7	2.1	1.7	1.8	2.0	2.1
Emerging countries										
Russia	5.0	6.8	6.1	4.9	6.4	6.4	6.4	6.5	6.0	5.6
China	2.6	2.9	2.8	2.8	2.9	2.3	2.9	3.4	3.1	2.7
India [3]	7.3	6.4	6.2	6.5	7.0	6.4	5.7	5.2	4.1	6.2
Brazil	5.4	6.2	6.0	5.7	6.1	5.8	5.8	6.0	6.3	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	1.3	2.2	1.4	0.9	0.9	1.3	1.2	1.8
Turkey	8.9	7.5	7.9	6.6	8.3	7.5	8.0	8.0	7.8	7.7

Notes: *1. In purchasing power parity. 2. Annual figures represent the fiscal year and factor costs. 3. 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	1.3	0.9	–1.8	0.7	1.4	1.6	1.3	0.9
General government consumption	–4.8	–2.3	–3.3	–0.4	0.2	–3.5	–4.5	–3.6	–4.3	–0.6
Gross fixed capital formation	–7.0	–5.0	2.0	2.3	–5.3	–1.7	0.1	2.7	2.6	2.6
Capital goods	–3.9	2.3	7.9	4.8	2.2	9.6	10.5	7.8	7.1	6.4
Construction	–9.7	–9.6	–1.7	0.7	–9.8	–8.6	–5.7	–1.1	–0.1	0.2
Domestic demand (contr. Δ GDP)	–4.1	–2.7	0.5	0.9	–2.1	–0.6	–0.1	0.7	0.4	0.9
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	3.6	2.8	0.6	2.7	8.2	2.6	1.2	2.5
Gross domestic product	**–1.6**	**–1.2**	**1.2**	**1.7**	**–1.1**	**–0.2**	**0.6**	**1.1**	**1.4**	**1.6**
Other variables										
Employment	–4.8	–3.4	0.8	1.3	–3.3	–1.6	–0.5	0.5	1.4	1.7
Unemployment rate (% labour force)	24.8	26.1	24.8	23.6	25.6	25.7	25.9	24.8	24.1	24.4
Consumer price index	2.4	1.4	0.5	1.3	1.2	0.1	0.0	0.4	0.4	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	0.27	0.75	0.26	0.24	0.24	0.26	0.29	0.31
12-month Libor	1.01	0.68	0.61	1.14	0.67	0.59	0.56	0.58	0.63	0.66
2-year government bonds	0.27	0.30	0.55	1.45	0.36	0.32	0.36	0.45	0.60	0.78
10-year government bonds	1.78	2.33	2.89	3.63	2.70	2.74	2.75	2.77	2.90	3.15
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	0.29	0.27	0.27
12-month Euribor	1.11	0.54	0.58	0.92	0.54	0.53	0.56	0.58	0.57	0.59
2-year government bonds (Germany)	0.08	0.13	0.34	0.97	0.17	0.16	0.14	0.25	0.41	0.56
10-year government bonds (Germany)	1.55	1.62	1.76	2.21	1.78	1.79	1.68	1.62	1.75	2.00
EXCHANGE RATES										
$/euro	1.29	1.33	1.35	1.32	1.32	1.36	1.37	1.36	1.34	1.33
¥/euro	102.71	129.65	141.93	147.69	131.09	136.78	140.98	140.43	142.30	144.00
£/euro	0.81	0.85	0.83	0.85	0.86	0.84	0.83	0.83	0.86	0.82
OIL										
Brent ($/barrel)	111.38	108.47	108.01	109.43	109.24	109.23	107.74	108.08	108.07	108.14
Brent (euros/barrel)	86.61	81.67	79.88	82.79	82.46	80.24	78.61	79.42	80.45	81.10

Note: *1. Four quarter cumulative.*

Forecasts

CURRENT SITUATION · **Slow but firm steps**

Financial markets remain calm during the month of April. Although the main sources of risk have not disappeared, investors believe they have now entered a phase of greater stability. Having successfully weathered a few storms early in the year, the financial and economic environment of the emerging countries is now tending to improve while good news has prevailed in the US and euro area. Of note in the Spanish markets is the further drop in interest rates on the country's sovereign debt.

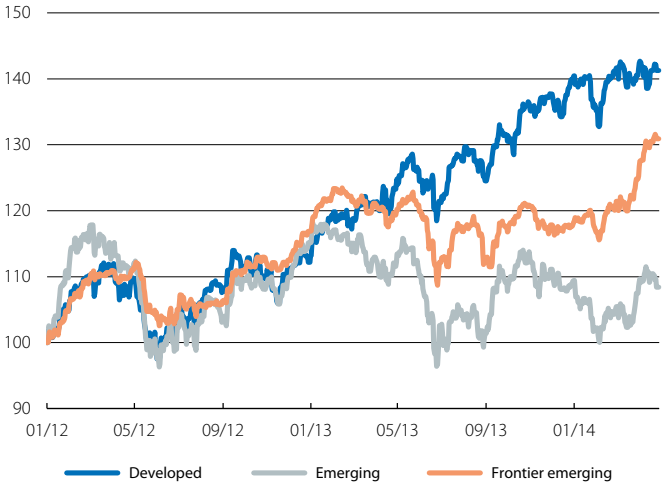
In China, investors' fears of a hard landing for the economy have eased after the publication of the latest indicators. The GDP figure for Q1 was within a reasonable range of deceleration, responding to the rebalancing of the economy towards a model of growth in which domestic demand will play a larger role. The country's monetary, fiscal and macroprudential policies also have a lot of leeway which the government has already started to take advantage of, which will help to contain any setbacks that may arise along the way.

Conditions are developing satisfactorily in the rest of the emerging countries, albeit with some notable exceptions. For the second time this year, the Brazilian monetary authorities raised the official interest rate, this time to 11% in an attempt to slow up inflation. In Russia, immersed in a geopolitical conflict with the Ukraine and exposed to sanctions by the West, the central bank raised its official rate by half a point to 7.5%. With this measure, the authority hopes to limit capital outflows and control rising prices. This movement was after Standard & Poor's reduced Russia's credit rating to BBB–, one step away from a junk bond. The agency is concerned about the economy's great dependence on energy exports and the dangers posed to investment and domestic consumption by any further international sanctions.

Investors appear to trust the central banks in the developed countries. Signs of economic revival in the advanced countries and expectations that easy monetary conditions will continue are creating a favourable environment for risk assets in general and sovereign debt in particular, especially from the periphery of the euro area. The latest data from the US confirm the solidity of the economy's growth, leading to a slight upswing in yields in the short and medium-term tranche of the curve although these are still very low. In fact the Federal Reserve, through its monetary message regarding official interest rates, is managing to keep long-term interest rates below 3%. The trend in sovereign debt in the euro area has been affected by the ECB's willingness to adopt additional expansionary measures, particularly the possibility of buying up public or private bonds, and yields on the German bund and

Stock market trends: developed and emerging

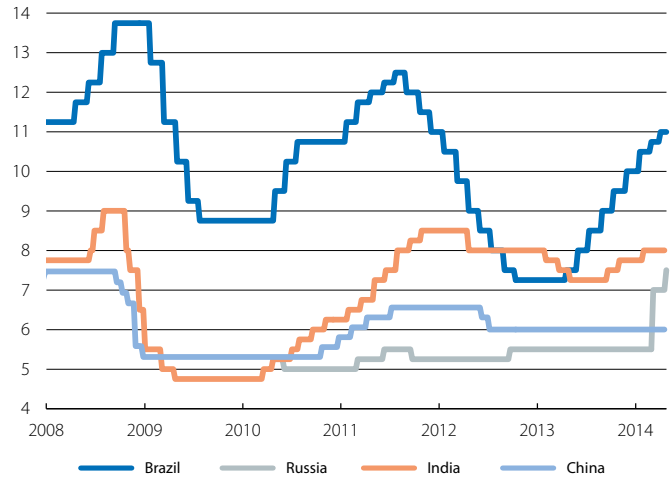
(January 2012 = 100)



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

Emerging countries: official interest rates

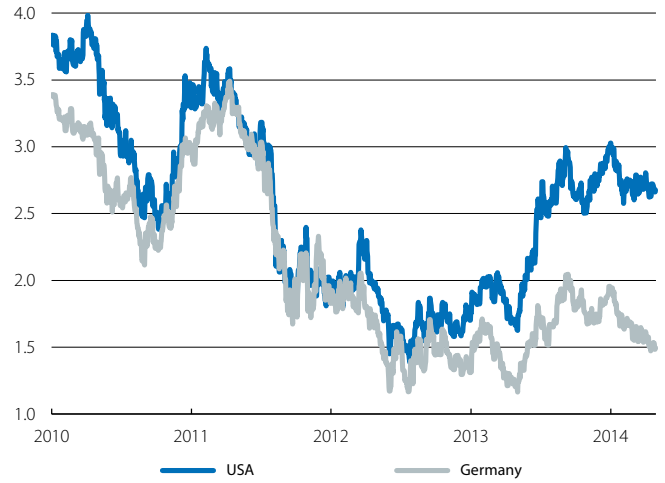
(%)



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

Yields on 10-year public debt

(%)



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

on periphery public debt have fallen given the monetary authority's repeated messages in this direction.

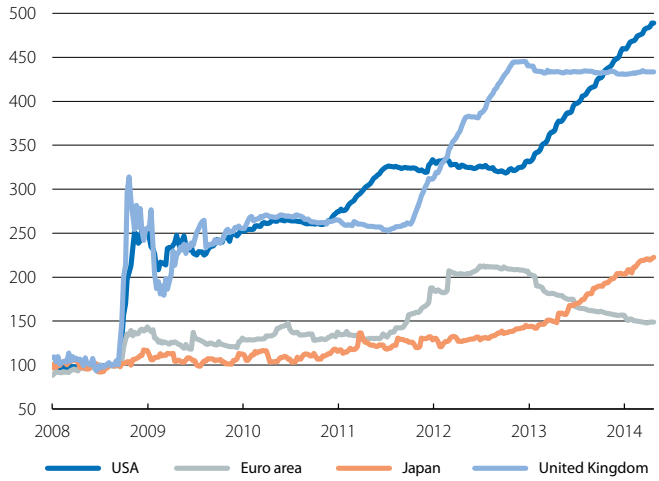
The Federal Reserve maintains the direction of its monetary policy. At its April meeting, the institution decided to continue its strategy of gradually withdrawing monetary stimuli: trimming a further 10 billion dollars off its monthly bond purchases (now at 45 billion) and keeping official interest rates exceptionally low. However, the Fed's latest statements hint that the institution's actions will be in line with the expected trends in two key variables: (i) the progressive rise in inflation towards its medium-term target of 2% and (ii) the unemployment rate moving towards the level of full employment set by the monetary authority (around 5.5%). Projections based on current trends point to mid-2015 being the time when the institution will start to raise interest rates, not too far in the future and, moreover, likely to be brought forward. This will undoubtedly become a key issue in the second half of this year.

Meanwhile investors are focusing their attention on the ECB's potential quantitative easing plans. At its April meeting, the Governing Council decided to keep the official interest rate at 0.25% and refrained from using any unconventional monetary policy instrument. Statements made by several of the institution's members in favour of a hypothetical asset purchase programme (government and private bonds) and Draghi's explicit messages in this respect have heightened expectations of the ECB actually taking action. Although the scenario of economic recovery predicted by the ECB is slowly consolidating, the use of additional expansionary instruments could be warranted depending on the trends in some fundamental factors. Firstly, if inflation remains very low for too long. Secondly, if the euro continues to appreciate. And thirdly, if there's an unwanted spike in interbank rates. In fact, towards the end of April there was an upswing in the money market rate, the EONIA, as a result of banks continuing to reduce their surplus liquidity with the ECB. However, any programme to purchase public and/or private debt (bank securitisation) would entail difficulties and is not without a number of limitations.

Europe's periphery makes further progress. The improvement in the euro area's economic and financial scenario is particularly influential in pushing down risk premia for the region's periphery countries. Some notable events took place in April. On the one hand, the main ratings agencies improved their classification for both Italy's and Spain's sovereign debt, pointing out their economic and financial strengths and the improvement in public accounts, as well as the improved situation of banks. Such news has helped Spain's Treasury auctions even further, if possible, managing to place ten-year debt at a cost of 3.06%, another all-time low. The government has also announced that it will need to borrow less in 2014 thanks to higher tax revenue and lower debt financing costs. On the other hand, Greece and Portugal have successfully returned to the international capital

Central bank balance sheets

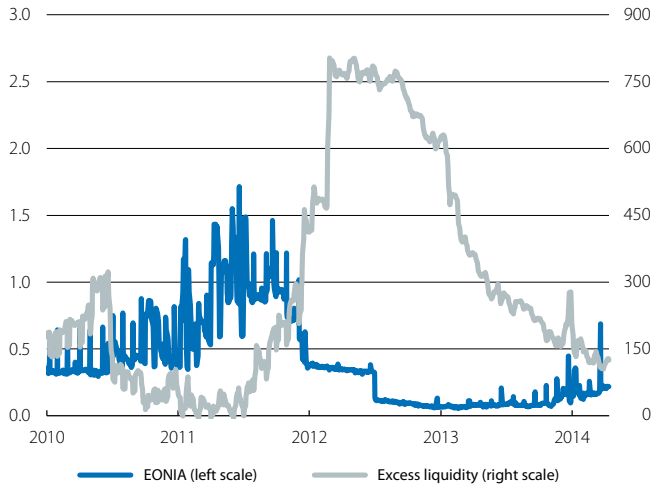
(September 2008 = 100)



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

EONIA interest rate and excess liquidity

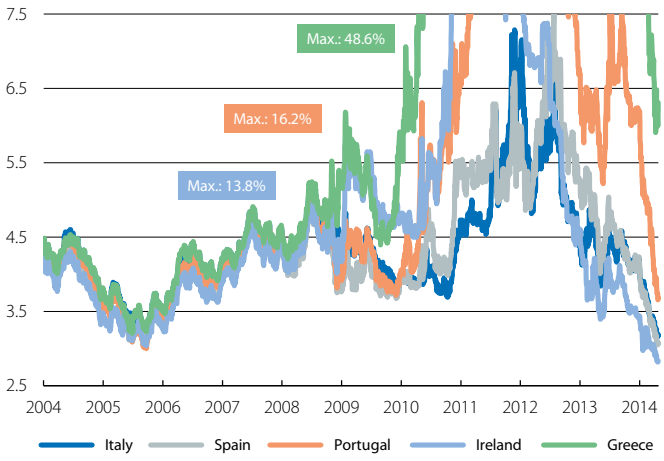
(%) *(Billion euros)*



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

Euro area: yields on 10-year public debt

(%)



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

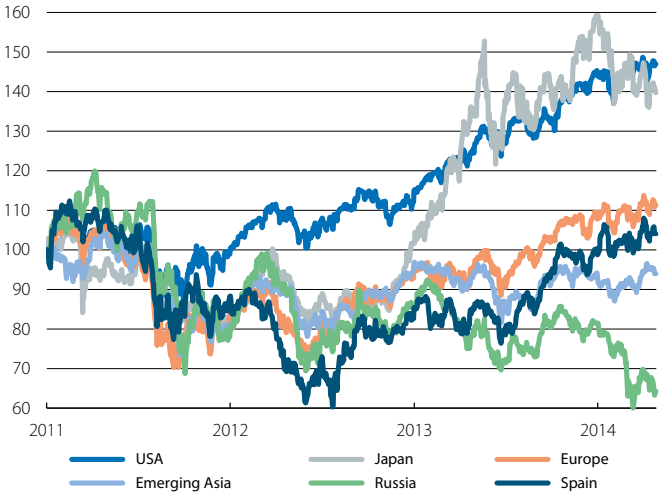
markets with two issuances of five and ten-year bonds, respectively.

Global stock markets remain relatively stable. The risk entailed by the crisis between the Ukraine and Russia (its lower credit rating and the hike in official interest rates) and the high price-earnings ratios (PER) in the main stock markets of the US and Europe have hindered gains in equity. However, several aspects are underpinning the stock markets in developed economies. The first is the confirmation that corporate earnings are in line with business indicators. To date, 71% of the S&P 500 companies that have published their earnings have exceeded analysts' expectations. This trend is similar in Europe although the growth in earnings and sales is somewhat lower. In Spain, the Q1 earnings campaign that is just starting is expected to continue the upward trend shown in 2013 (see the Focus: «The earnings of Spain's listed companies exit the crisis»). The second aspect is the increase in news of global corporate operations (either confirmed or rumoured). The last few weeks have seen an acceleration in the number of potential mergers and also their size, particularly in the pharmaceutical sector. A third aspect comes from investor expectations of the ECB possibly adopting more monetary stimuli. For the emerging economies, financial normalisation has helped their stock exchanges to perform well, with the exception of Russia's stock market.

Corporate bond markets are on the up again. As happened with sovereign debt, once the markets had overcome the upswing in spreads due to tensions between Russia and the Ukraine, credit risk premia have fallen back to very low levels. There are three main reasons for such favourable conditions for the corporate bond markets. First, the good growth prospects in the US and EMU. Second, the reduction in corporate defaults. And third, the large amount of global liquidity and low interest rates. Additionally, in April there were also expectations that the ECB would start a QE programme, which would push down credit premia especially in the current context of a great «search for yield». It therefore comes as no surprise that, given this situation, certain portions of the capital markets, such as high-yield US bonds, are starting to show signs of overheating, something which should be carefully monitored. Albeit to a lesser extent, Europe has also seen its rate of corporate bond issuances speed up. Since the start of the year, the total issued has grown by 15% year-on-year to 45 billion euros, especially among companies in the periphery.

Trends in the main international stock markets

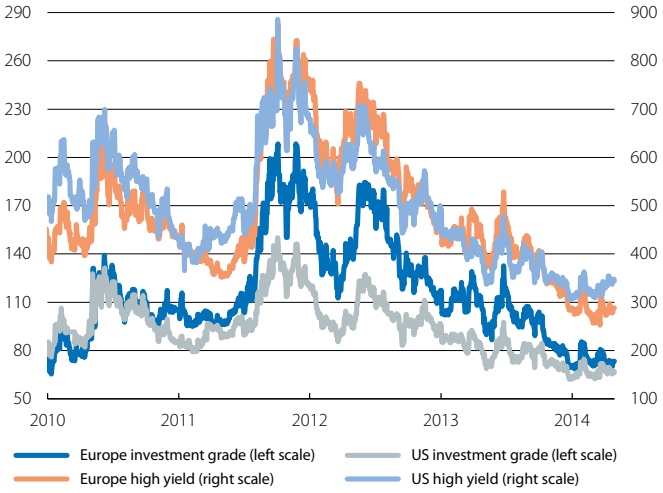
(January 2011 = 100)



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

Corporate bonds: CDS premia

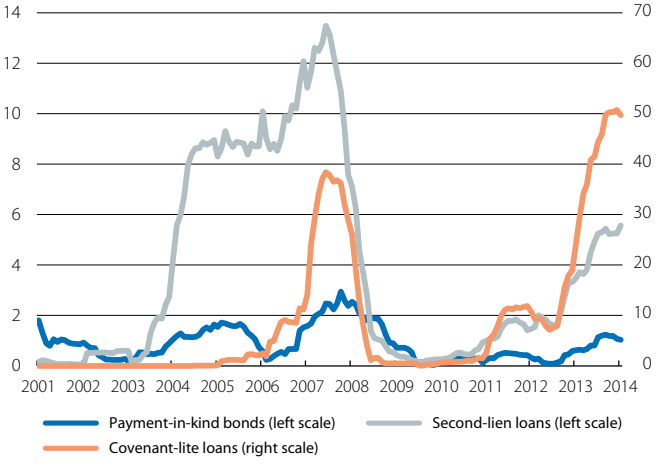
(b.p.) *(b.p.)*



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

USA: high-yield corporate debt instruments

Issuances out of total issued by each market (%)



Source: *"la Caixa" Research, based on data from the Global Financial Stability Report (IMF).*

FOCUS · Global financial stability: from liquidity to growth

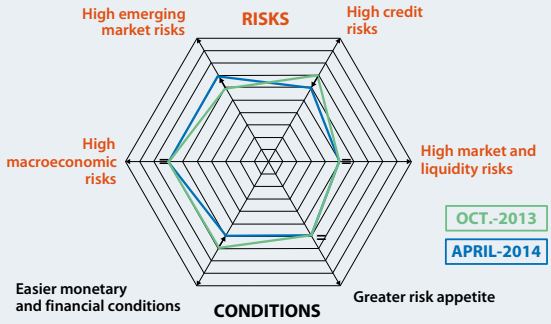
At the beginning of April, the International Monetary Fund published its half-yearly report on the risks threatening global financial stability (GFSR). Its assessment of the situation has not changed greatly since October 2013 but a slight positive shift can be seen. The main areas of improvement correspond to the advanced countries. The IMF has issued an optimistic message, in our opinion justifiably, acknowledging the substantial progress made by the euro area in redirecting the sovereign debt crisis, sorting out its banking sector and constructing the banking union. For the US it notes the (albeit incomplete) clarification of the fiscal situation, as well as the absence of serious tension after the Fed has effectively started its tapering. From now on, the main factor identified by the Fund is, precisely, the challenge posed for international markets by the gradual transition towards a new regime of global liquidity. In its role as guardian, it highlights two weak areas we will comment on here. One has already caused problems: the emerging markets. The other might be creating them: the US corporate bond markets. The key to avoiding further episodes of instability is for the improvement in economic growth (with its positive effect on incomes and solvency) to take over from liquidity as the mainstay of the markets.

The IMF believes that vulnerabilities in the emerging economies have become worse and lists those points requiring the most attention. The first of these concerns the boom in credit and growing levels of corporate debt. More leveraged firms may find it difficult to meet their debt payments, especially if interest rates start to rise. However, we believe the relative importance of this point is not so great as the average debt levels of the emerging block are still substantially lower than those seen in the advanced economies. The second weak point lies in the growing share of external and foreign currency debt out of the total. This makes the emerging countries more vulnerable to possible fluctuations in the global risk appetite, which would reactive capital outflows. However, there are macroprudential instruments to combat this weakness. The third vulnerability is related to the persistence of macroeconomic imbalances (current account deficit, public deficit and/or inflation) in some countries. Fortunately, a large proportion of these (for example India and Indonesia) are adopting measures aimed at correcting these imbalances. Most emerging countries are also firmly committed to reforms, leading investors to discriminate between this heterogeneous group of countries, so we believe that the risk of an episode of financial instability with systemic effects is limited.

The report also points out that the environment of overabundant liquidity generated by the Fed has overheated some parts of the capital markets in the US. There are several signs of this, both in terms of high share prices (low risk premia) and record volumes of debt securities being issued. Low rates for blue chip assets have pushed many investors to search for yield from high-risk instruments, such as high yield bonds, PIK bonds (payment-in-kind), covenant-lite loans and, once again, CLOs (collateralized loan obligations). The IMF does well to warn of this development. It is not alarming for the moment but the US monetary and macroprudential authorities should make sure it does not get any worse. In fact, it is encouraging to observe that they are already doing just that and have even taken measures in this respect. In our opinion, the consolidation of a path of sustained growth in the advanced block, with a key position for the US, accompanied by the continuing but gradual withdrawal of the Fed's extraordinary liquidity measures is actually a robust scenario that can withstand the risk of turbulence in this market.

Global financial stability map

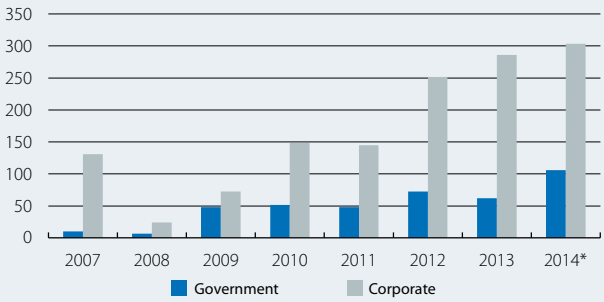
GFSR April 2014



Note: *A greater distance to the centre indicates greater risks, easier monetary and financial conditions and a greater risk appetite.*
Source: *"la Caixa" Research, based on data from the International Monetary Fund.*

Emerging countries: net market debt issued

(Billion dollars)



Note: ** Data annualised at 24 March 2014.*
Source: *"la Caixa" Research, based on data from the Global Financial Stability Report (IMF).*

FOCUS · The earnings of Spain's listed companies exit the crisis

After several years of decline, the profits of Spain's listed companies have embarked on an upward trend. According to the Spanish Securities and Investments Board (CNMV), consolidated earnings went from –8.8 billion euros in 2012 to 25.08 billion in 2013, of which an astounding 92% correspond to Ibex 35 companies. Although this bottom line comparison is somewhat distorted due to extraordinary items, it does show the steady improvement in the business environment. On the one hand, due to factors related to the Spanish economy as a whole: the recovery in the rate of activity, easier financing conditions for both the public and private sector and lower reserve requirements (particularly relevant for banks). On the other, thanks to strong growth in the turnover of companies in international markets, as well as the processes of deleveraging and equity reinforcement, started in previous years, also appearing to continue.

At a sector level, more than half the aggregate earnings for the year came from financial firms, followed by industry and trade. It is useful to highlight some particular sector-related aspects influencing this trend in earnings. In the case of financial firms, net earnings rose to almost 14 billion euros, helped by the reduction in reserves, which were so high in 2012 they resulted in an overall operating loss that year. In the industrial sector, although the different sub-sectors have seen differing trends, the improvement in earnings has been due to an adjustment in operating costs (reductions in workforce, sales of assets, etc.) and financial costs (mainly by restructuring debt). The opposite situation can be found in the energy and construction sectors. In the former, in addition to falling electricity demand in Spain and the adverse impact of macroeconomic variables (such as the price of Brent oil and currency exchange rates), there was also the sector's new regulatory framework for Spain. In combination, these factors meant that, in 2013, net earnings for the sector were considerably lower than the previous year. The drop in earnings for construction was also notable and the reasons underlying this downward trend were the decline in construction work, the slowdown in cement production and slump in property sales.

2013's business scenario was still being affected by an adverse environment for sales, with these falling by 2.8% year-on-year for listed non-financial firms. Shrinking domestic demand, the reduction in activity in most energy and industrial sub-sectors, fluctuating exchange rates for the emerging currencies and the particular situation of some companies lie behind this drop in sales. However, there is a very important positive aspect that is encouraging: the considerable, solid increase in business generated abroad. Since the start of the crisis in 2009, foreign sales have become increasingly important, offsetting the deficit in local turnover. In 2013, Ibex companies produced 62.3% of their income outside Spain (almost 260 billion euros) compared with 61% a year ago.

Another relevant aspect has been the effort made by companies to maintain high dividends for their shareholders. The dividends paid out overall by listed firms in 2013 were lower than in 2012 but the yield dividend for Spain's stock market was still one of the highest in the world. This is the result of increasing shareholder payments through scrip dividends.

Aggregate data by business sector

(Million euros)

Sector	No. companies	Sales		Operating profit		Consolidated profit		Dividends	
		2013	2012	2013	2012	2013	2012	2013	2012
Energy	10	146,617	151,900	13,829	16,968	8,392	10,346	1,746	2,381
Industry	45	35,211	36,211	2,266	1,853	602	31	606	678
Trade and services	40	117,966	120,503	14,213	14,045	5,990	4,716	3,045	5,196
Construction and real est.	28	68,199	70,006	373	2,199	–3,921	–4,933	697	1,603
Credit firms and insurance	12	n.a.	n.a.	13,198	–15,800	13,936	–19,193	2,472	3,015
TOTAL *	131			43,899	19,455	25,078	–8,802	8,553	12,872

Note: ** Includes several adjustments at a sector level and for the overall calculation.*
Source: *"la Caixa" Research, based on data from the CNMV.*

KEY INDICATORS

Interest rates (%)

	30-Apr	31-Mar	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	0.34	0.31	3	4.9	12.9
1-year Euribor	0.61	0.59	2	5.6	10.2
1-year government bonds (Germany)	0.16	0.15	1	–2.8	16.7
2-year government bonds (Germany)	0.14	0.16	–2	–7.7	16.7
10-year government bonds (Germany)	1.47	1.57	–10	–46.6	29.8
10-year government bonds (Spain)	3.02	3.23	–21	–116.7	–105.7
10-year spread (b.p.)	155	166	–12	–70.2	–135.6
Dollar					
Fed funds	0.25	0.25	0	0.0	0.0
3-month Libor	0.22	0.23	–1	–2.3	–5.0
12-month Libor	0.55	0.56	–1	–3.6	–15.7
1-year government bonds	0.10	0.11	–1	–1.5	–0.5
2-year government bonds	0.41	0.42	–1	3.1	21.5
10-year government bonds	2.65	2.72	–7	–40.4	99.9

Spreads corporate bonds (p.b.)

	30-Apr	31-Mar	Monthly change (b.p.)	Year-to-date (b.p.)	Year-on-year change (b.p.)
Itraxx Corporate	70	76	–6	–1.0	–25.7
Itraxx Financials Senior	79	93	–14	–8.3	–61.7
Itraxx Subordinated Financials	121	139	–18	–7.1	–106.4

Exchange rates

	30-Apr	31-Mar	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
$/euro	1.387	1.377	0.7	0.9	6.1
¥/euro	141.760	142.130	–0.3	1.8	–10.0
£/euro	0.822	0.826	–0.5	1.0	2.3
¥/$	102.240	103.230	–1.0	2.7	–4.5

Commodities

	30-Apr	31-Mar	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Index	501.4	493.7	1.6	9.9	5.5
Brent ($/barrel)	108.7	107.0	1.6	–2.1	5.8
Gold ($/ounce)	1,291.6	1,284.0	0.6	6.7	–12.3

Equity

	30-Apr	31-Mar	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500	1,884.0	1,872.3	0.6	1.9	17.9
Eurostoxx 50	3,198.4	3,161.6	1.2	2.9	17.4
Ibex 35	10,459.0	10,340.5	1.1	5.5	24.7
Nikkei 225	14,304.1	14,827.8	–3.5	–12.2	5.6
MSCI Emerging	995.3	994.7	0.1	–0.7	–4.0
Nasdaq	4,114.6	4,199.0	–2.0	–1.5	23.6

CURRENT SITUATION · The world's economic cycle is improving and downside risks decline

The International Monetary Fund (IMF) has outlined a positive scenario for the next few years. In its recent report on the World Economic Outlook (WEO), the IMF has made few changes to the figures for its macroeconomic forecasts. World growth will be 3.6% in 2014 and 3.9% in 2015, in both cases 0.1 p.p. below its prediction in January but significantly higher than the figure from 2013 (3.0%). This notable acceleration is the result of the economic recovery in the US and Europe, helping to offset the decline experienced by some emerging economies (Brazil and Russia being the case in point). Japan's forecast has been reduced by 0.3 p.p. due to the effect of its VAT hike and is now slightly below its figure for 2013. Our scenario does not differ too much from the one proposed by the IMF (see the Focus «The IMF points to a definitive recovery in the world economy»). The report also states that downside risks are now less serious than a few months ago although still significant, particularly the likelihood of deflation in the euro area and potential financial and geopolitical tensions in some emerging countries.

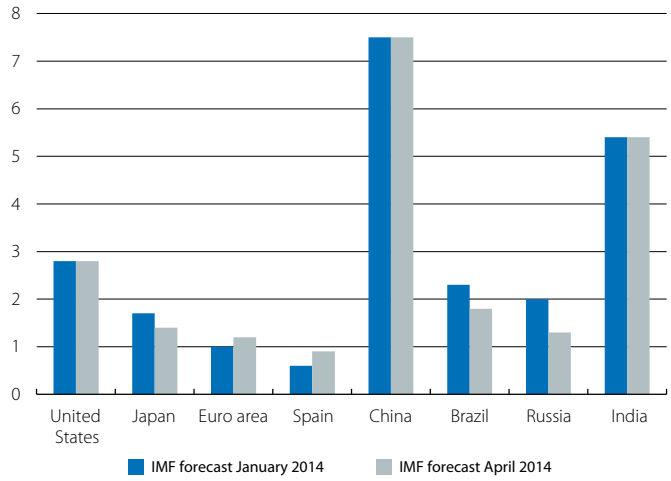
UNITED STATES

The economy's 2.3% year-on-year growth in 2014 Q1 reflects the effects of the bad weather, a phenomenon that should not be repeated in the rest of the year. GDP hardly grew compared with the previous quarter: 0.1% in annualized quarter-on-quarter terms (2.6% in 2013 Q4), far below the consensus forecasts and our own estimates. Of note was the negative contribution by investment (both residential and non-residential) and exports, as well as the lower rate of growth in stock accumulation. Consumption stood its ground although mostly thanks to people's higher healthcare spending due to Obamacare (as they had to take out medical insurance during this first quarter). Nonetheless we estimate that, after this weak first quarter, the US will pick up again and see growth rates above its potential for the next two years (2.6% in 2014 and 3.0% in 2015).

The latest business indicators confirm the good performance of the US economy. According to the field study carried out regularly by the Federal Reserve (Beige Book), the US economy's expansion has not weakened after the winter setback. March's business confidence indices improved both in manufacturing (up to 53.7 points from 53.2 in February) and services (up to 53.1 points from 51.6 in February). The industrial production index also picked up considerably in March (+0.7% month-on-month) and February's figure was revised upwards. Concerning demand, the Conference Board consumer confidence index reached 82.3 points in April. Although still below its latest historical

IMF: GDP growth forecasts in 2014

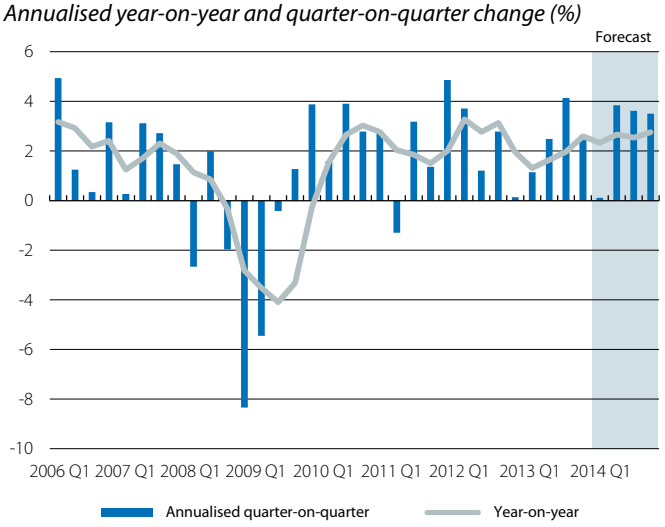
Year-on-year change (%)



Source: *"la Caixa" Research, based on data from the IMF's World Economic Outlook.*

USA: GDP growth

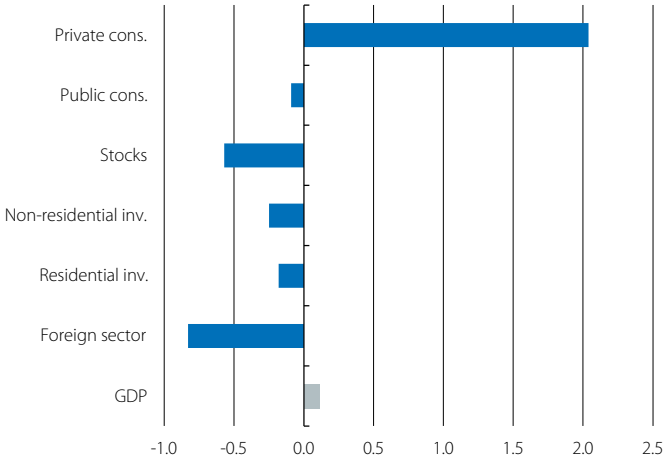
Annualised year-on-year and quarter-on-quarter change (%)



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

USA: contributions to GDP growth in Q1

Annualised quarter-on-quarter change (%)



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

average (around 100 points), this indicator is notably higher than its average for 2013 (73.2 points). Retail sales, growing strongly in March by 1.1% month-on-month, confirm consumption's positive tone. The real estate market also remained steady although its improvement in 2014 is expected to be somewhat less than in 2013. Specifically the Case-Shiller price index, which covers 10 metropolitan areas, rose by 13.1% year-on-year in February compared with 13.7% year-on-year in 2013 Q4.

The labour market continues to recover and inflationary pressures are still at bay. March's good job creation figures and the upward revisions of figures from the first two months of the year suggest a significant improvement in the labour market. The US economy created 192,000 jobs in March, higher than the average for the three previous months (142,000). Although the unemployment rate held steady at 6.7%, the participation rate improved slightly to 63.2% from February's figure of 63.0%, without wages posing any kind of serious threat (remaining flat in March). Consumer prices have also remained moderate; the general CPI increased by 1.5% year-on-year in March (0.2% month-on-month) while underlying inflation (excluding foods and energy) rose by 1.6%.

JAPAN

It's complicated to interpret Japan's data due to the distortions produced by the VAT hike. The country's economy posted a record trade deficit in March. The sharp increase in imports (17.6% year-on-year), much higher than export's growth of 4%, resulted in a trade deficit of 2.8% of GDP (cumulative over 12 months). In addition to the energy bill, a large part of March's jump in imports can be put down to consumers bringing purchases forward to avoid the 3 p.p. effective hike in VAT April (from 5% to 8%). Retail sales therefore grew by a vigorous 11.0% year-on-year in March compared with 3.6% in February. This effect is bound to reverse over the coming months.

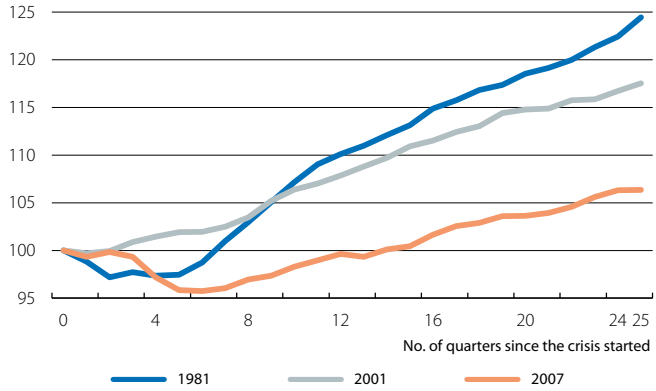
Given this situation, prices continue to rise in Japan but deflationary risks cannot be ruled out as yet. March's CPI accumulated an increase of 1.6% year-on-year (1.5% in February) while the core CPI (excluding foods andenergy) slipped back to 0.6% (0.7% in February). There is still no sustained rise in wages, a key condition for domestic demand to recover.

CHINA

China starts the year with slower growth. China's GDP grew by 7.4% year-on-year in Q1 (1.4% quarter-on-quarter), lower than 2013's figure of 7.7%. This more limited growth has led us to slightly revise downwards our annual forecast for the next two years, namely 7.5% in 2014 (previously 7.7%) and 7.4% in 2015 (previously 7.5%). Nevertheless China's government believes that these figures are within a

Evolution of the US GDP

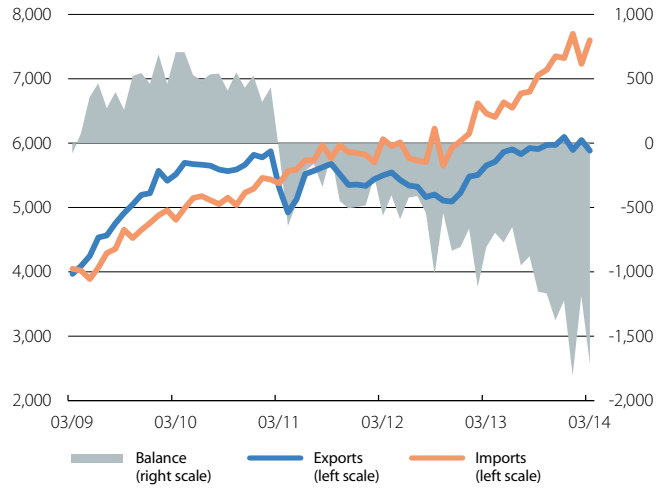
Level of GDP at the start of the crisis (base index = 100)



Base quarters: *1981: Q3 191 = 100; 2001: Q2 2001 = 100; 2007: Q4 2007 = 100.*
Source: *"la Caixa" Research, based on data from the Bureau of Economic Analysis.*

Japan: trade balance

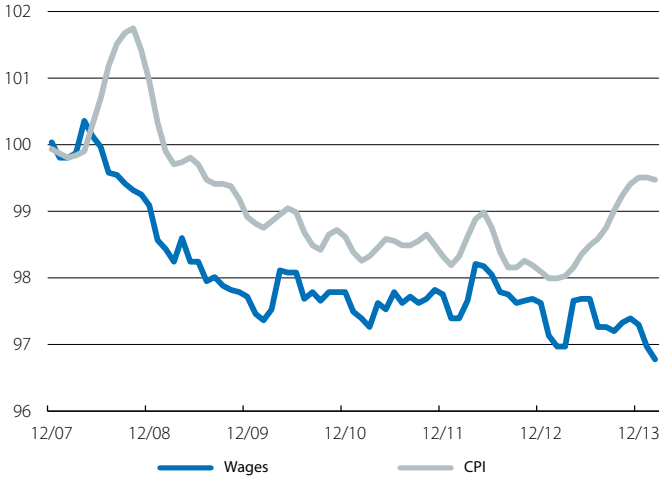
(Billions of yen) *(Billions of yen)*



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

Japan: CPI and wages

Quarterly averages (December 2007 = 100)



Source: *"la Caixa" Research, based on data from the Min. of the Interior and Communications.*

«reasonable range» and due to the rebalancing of the economy from an investor-exporter based model to one based more on consumption. Along the same lines, our main scenario still rules out any extreme scenarios (hard landing, financial crisis) as, in spite of the Asian giant facing significant risks (high government and private debt, the complexity of shadow banking and overheating in the residential sector), the government has a range of levers available. In fact, in mid-April it announced a mini package of fiscal stimuli including further railway investment, the construction of low cost housing and tax cuts for small firms. These new measures are similar to those applied last summer when growth also seemed to flag.

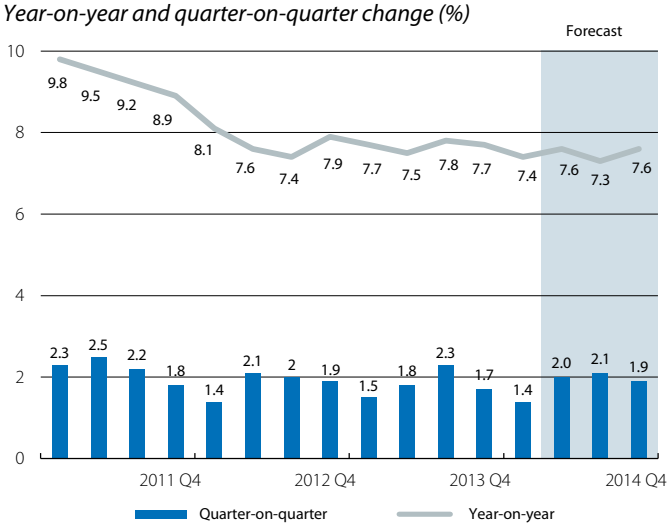
The latest business indicators rule out any sustained deterioration in the economy. In March, industrial production and retail sales grew slightly more than in January and February (8.8% and 12.2% year-on-year, respectively), while investment in urban fixed capital increased by 17.4% year-on-year (cumulative from January to March), only a little below the spectacular figure of 19.6% posted at the end of 2013. In April the flash Manufacturing Purchasing Managers' Index (produced by Markit) was higher than March's figure, indicating a slightly more dynamic economy.

OTHER LARGE EMERGING ECONOMIES

Russia and Turkey ended the year in good health but 2014 looks complicated. Russia grew by 2.0% year-on-year in 2013 Q4 (1.3% on average in 2013) while Turkey saw 4.4% growth in GDP in the same quarter (4% annual growth in 2013). However, growth in 2014 is expected to be smaller for both countries: 0.8% in Russia due to its situation with the Ukraine and 2.0% in Turkey due to the need to carry out adjustments to control its imbalances (especially current account and inflation). In fact, price pressures are an endemic problem in many of the large emerging economies. In addition to Turkey and Russia, of note are the tensions in Indonesia, India (currently immersed in a long election process) and Brazil. Precisely in this last country and in Russia, their respective central banks have once again raised interest rates (to 11% and 7.5%, respectively) given an inflation rate in excess of 6%. The weakness of the latest activity indicators for Brazil also confirms the slowdown affecting Latin America's leading economy (2.0% forecast in 2014 with downside risks). India, in spite of also having considerable external and internal imbalances, is managing to distance itself from this group of weaker emerging economies thanks to a stricter monetary policy and the recent correction in its current account imbalance (5.6% forecast in 2014).

China: GDP growth

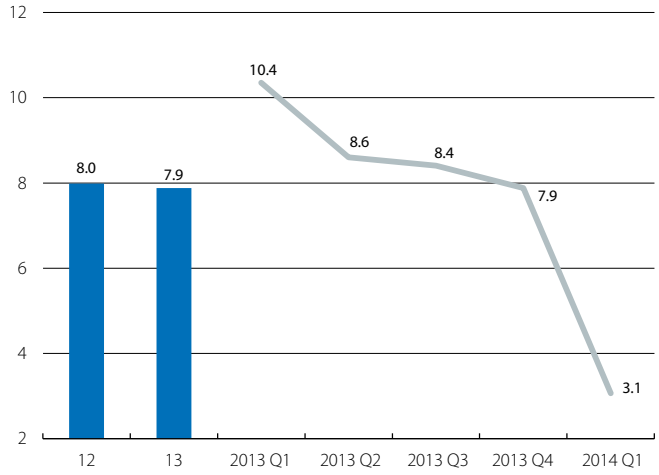
Year-on-year and quarter-on-quarter change (%)



Source: *"la Caixa" Research, based on data from the National Statistics Office of China.*

China: trend in exports

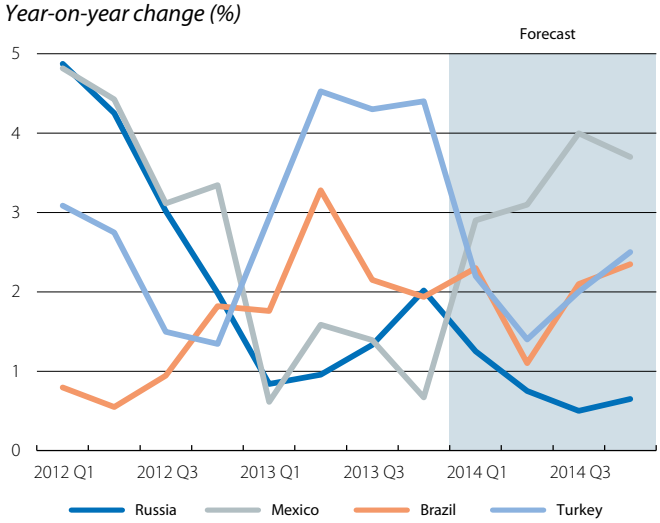
Year-on-year change (%)



Note: *For quarters, cumulative over 12 months.*
Source: *"la Caixa" Research, based on data from the National Statistics Office of China.*

Emerging countries: GDP growth

Year-on-year change (%)



Source: *"la Caixa" Research, based on data from the national statistics offices of each country.*

FOCUS · Saudi Arabia: significant challenges on the horizon

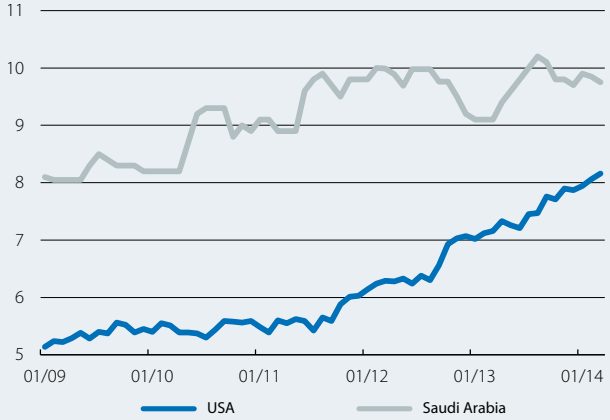
When President Barack Obama visited Saudi Arabia to talk to King Abdullah last 28 March, he met with a concerned monarchy. The Arab country is the world's biggest oil producer (almost 10 billion barrels a day out of a total of 90 billion) and has considerable reserves. For many years this dominance has afforded it the role of regulator for the global price of crude which, together with an 80-year strategic alliance with the US, has provided the theocratic regime of the House of Saud with stability. This privileged situation is now changing, however. The production of shale oil and gas (oil and gas extracted from layers of shale using the technique known as fracking) is the main reason for this change in panorama.

And the US is precisely the top producer of unconventional hydrocarbons, severely reducing its dependence on oil imports. In fact, it might even take over from Saudi Arabia as the world's biggest producer by 2017 and grab, or at least contest the country's role as the regulator of crude prices. This shale revolution means that the supply of oil is becoming more abundant and elastic; i.e. offering more capacity to increase production when demand rises, leading to more stable oil prices. A contained, less volatile oil price than we had become used to is good for the advanced economies: the general CPI will be more in line with core inflation and household and corporate budgets will benefit from lower energy bills. However, this is a huge drawback for the countries on the Arabian Peninsula. Saudi Arabia's public coffers have benefitted from rising crude prices for years and if the price stabilises, its revenue will stagnate, affecting its public accounts. According to the IMF, Saudi Arabia's fiscal balance would go from a surplus of 7.1% of GDP to a deficit of 2.2% in 2019 and its current account surplus would fall from 15.8% to 9.9% of GDP. With such forecasts, the private sector will have to make a significant effort to save in order to finance its desired level of investment.

Added to Saudi's economic problems are three geopolitical issues. Firstly, the Arab Spring stirred a source of instability (particularly with the emergence of groups such as the Muslim Brotherhood in Egypt), jeopardising Saudi Arabia's role as a reference in the Sunni world. A second problem is Shi'a Iran, which could increase its production of 2.8 billion barrels a day, as well as smooth over its differences with the US. This would shift the region's centre of gravity slightly towards Iran. Third is the question of the country's complex political succession. King Abdullah is in his nineties but Crown Prince Salman, his official heir, has health problems, which is why Prince Muqrin, himself in his seventies, has been positioned as the first in line of succession, which would result in an uncertain leadership. Given such challenges, western diplomacy will have to tread very carefully in the Arabian Peninsula over the coming years.

Oil production

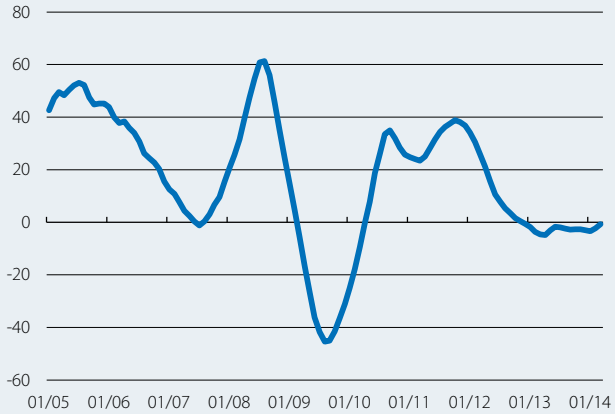
(Billions of barrels a day)



Source: *"la Caixa" Research, based on data from the Energy Information Administration.*

Oil prices

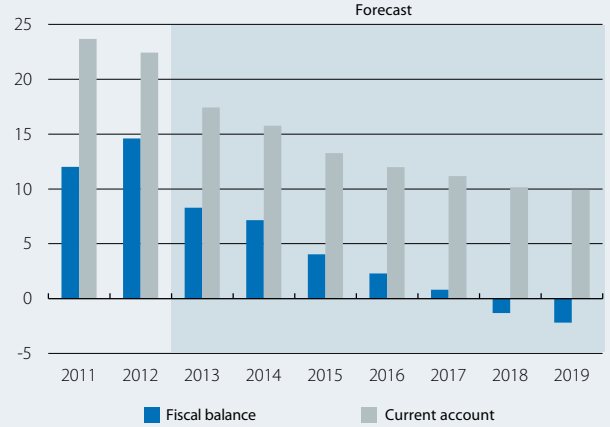
Average for the last 12 months, year-on-year change (%)



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

Saudi Arabia: fiscal and current balance

(% of GDP)



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

FOCUS · The IMF points to a definitive recovery in the world economy

After several long, tortuous years following the financial crisis in 2008, the world economy is finally getting back to normal. This is the opinion, albeit expressed with a large dose of caution, suggested by the latest reports from the International Monetary Fund (IMF).

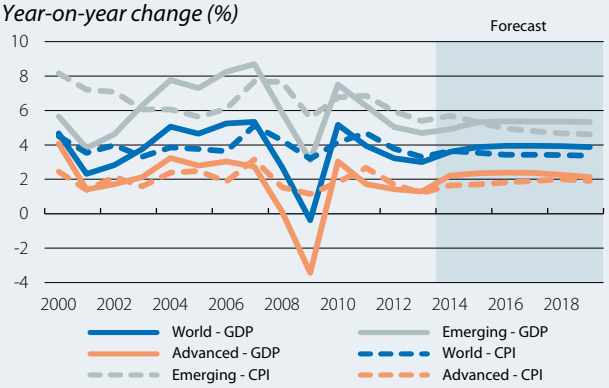
The forecasts provided by the recently published «World Economic Outlook» vary little from those published last October. World growth will speed up from 3.0% in 2013 to 3.6% in 2014 and 3.9% in 2015. Geographically, the upwards revisions for the developed countries and downward revisions for the emerging economies offset each other, almost all of these revisions being slight. Perhaps the most important change in the panorama outlined by the IMF is the sharp reduction in the likelihood of another global recession: a remote 0.1% for 2014 compared with the 6% estimated in October. A detailed analysis shows that the overall environment is evolving positively and the recovery should now be entering a sustainable phase, well-grounded and with a broad base (in geographical and sectorial terms). One important condition in this respect is to control and, as far as possible, correct the macroeconomic imbalances (both internal and external). Recent trends and their projections point in the right direction at a global level, albeit with the logical and inevitable exceptions, reservations and sources of risk.

The current pattern of moderation in emerging countries and acceleration in developed ones should help their respective internal balances in terms of output gap and inflation. We should remember that, just a few quarters ago, there were fears of excessive overheating in the former while the spectre of deflation repeatedly hovered over the latter. Now the IMF calculates that, in 2014-2015, the output gap will remain close to zero in the emerging economies and will shrink (from moderately negative levels) in developed economies. It also predicts that inflation rates will remain low and has reduced the likelihood of deflation to insignificant levels in all regions except the euro area where, although this risk has also subsided, it is still a threat. Regarding external imbalances, the IMF expects corrections to continue in the global current account imbalances that have been seen since 2008. This will be helped by the significant readjustments in real exchange rates over the last year, which have tended to correct deviations from fundamental equilibrium levels. The diagnosis is also one of progressive improvement for financial imbalances (levels of debt, asset prices, etc.), as detailed in the Focus «Global financial stability: from liquidity to growth» in this *Monthly Report*.

Economic policies are crucial to breaking the chain of relapses in growth and financial turbulence seen over the last few years. In addition to helping to control such imbalances, they also need to engage with other challenges such as neutralising geopolitical risks (energy policy, for example), tackling the growing inequalities in the distribution of wealth and increasing the growth potential of economies. Another biannual report by the IMF, «The Managing Director's Global Policy Agenda», identifies, proposes and evaluates the achievements of priority actions in different countries. April's edition provides two notable conclusions. Firstly, the achievement of recommendations has improved substantially compared with two years ago, particularly in the euro area. Secondly, as financial tensions ease, extreme risks weaken and demand improves, the IMF believes the time is approaching to shift the focus of attention away from monetary and fiscal policies to supply policies. Although the formulas for such supply policies are no secret, this message is important because it means the Fund is indeed starting to think in terms of normality.

GDP growth and inflation

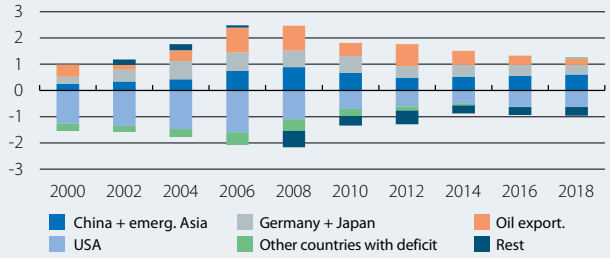
Year-on-year change (%)



Source: *"la Caixa" Research, based on IMF data (WEO, April 2014).*

Global imbalances

Current account (% of GDP)



Note: ***Other countries with deficit*** *= Bulgaria, Croatia, Czech Rep., Estonia, Greece, Hungary, Ireland, Latvia, Lithuania, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Turkey, United Kingdom.* ***Emerging Asia*** *= Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand.* ***Rest*** *= Includes countries such as France, Austria, Sweden, Switzerland, Finland, Brazil, Mexico, Chile and Australia, among others.*
Source: *"la Caixa" Research, based on IMF data (WEO, April 2014).*

KEY INDICATORS

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

UNITED STATES

	2012	2013	2013 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14	04/14
Activity									
Real GDP	2.8	1.9	1.6	2.0	2.6	–	2.3	–	–
Retail sales (excluding cars and petrol)	4.9	4.0	4.2	4.0	3.7	1.8	2.1	3.5	...
Consumer confidence *(value)*	67.1	73.2	75.1	81.0	74.0	79.4	78.3	83.9	82.3
Industrial production	3.8	2.9	2.5	2.7	3.3	2.9	3.5	3.8	...
Manufacturing activity index (ISM) *(value)*	51.8	53.9	50.8	55.7	56.7	51.3	53.2	53.7	...
Housing starts *(thousands)*	783	929	869	882	1,008	903	920	946	...
Case-Shiller home price index *(value)*	141	158	156	161	165	168	169	...	...
Unemployment rate *(% lab. force)*	8.1	7.4	7.5	7.2	7.0	6.6	6.7	6.7	...
Employment-population ratio *(% pop. > 16 years)*	58.6	58.6	58.7	58.6	58.5	58.8	58.8	58.9	...
Trade balance [1] *(% GDP)*	–3.3	–2.8	–3.0	–2.9	–2.8	–2.8	–2.8	...	...
Prices									
Consumer prices	2.1	1.5	1.4	1.6	1.2	1.6	1.1	1.5	...
Core consumer prices	2.1	1.8	1.7	1.7	1.7	1.6	1.6	1.7	...

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	03/14
Activity									
Real GDP	1.4	1.5	–0.1	1.3	2.4	2.5	–	...	–
Consumer confidence *(value)*	40.0	43.6	44.1	44.7	44.0	41.7	40.3	38.5	37.5
Industrial production	0.2	–0.6	–6.6	–3.0	2.0	5.8	10.5	7.1	7.0
Business activity index (Tankan) *(value)*	–5.0	6.0	–8.0	4.0	12.0	16.0	–	17.0	–
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	–2.8
Prices									
Consumer prices	0.0	0.4	–0.6	–0.3	0.9	1.4	1.4	1.5	1.6
Core consumer prices	–0.6	–0.2	–0.8	–0.4	0.0	0.5	0.6	0.7	0.6

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	03/14
Activity									
Real GDP	7.7	7.7	7.7	7.5	7.8	7.7	–	7.4	–
Retail sales	14.3	13.1	12.3	12.5	12.8	13.0	11.8	11.8	12.2
Industrial production	10.0	9.9	9.6	9.1	10.1	10.0	8.6	8.6	8.8
PMI manufacturing *(value)*	50.8	50.8	50.5	50.5	50.8	51.3	50.5	50.2	50.3
Foreign sector									
Trade balance [1] *(value)*	230	260	272	269	252	260	264	226	234
Exports	8.0	7.9	18.3	3.9	3.9	7.4	10.6	–18.1	–6.6
Imports	4.3	7.3	8.7	5.0	8.4	7.1	10.0	10.1	–11.3
Prices									
Consumer prices	2.7	2.6	2.4	2.4	2.8	2.9	2.5	2.0	2.4
Official interest rate [2] *(value)*	6.00	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	6.2

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

CURRENT SITUATION · **Growth builds up steam but pressure increases on the ECB**

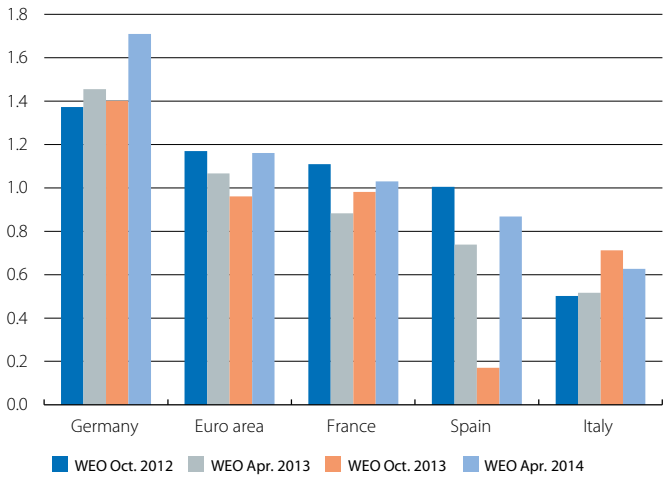
The euro area's growth prospects are improving. Indicators published in April have continued to suggest that economic activity is gradually recovering. Strong exports and especially the greater solidity shown by demand within the EU are helping to improve the region's growth prospects. The IMF, for example, has revised upwards its growth forecasts for 2014 and 2015 by 0.1 p.p. (to 1.2% and 1.5% year-on-year, respectively). The institution points out that domestic demand is more solid although it has noted several factors that still make the current recovery particularly delicate. Among the main changes made to the forecasts by country, of note is the case of Germany whose growth has been revised upwards by 0.3 p.p. since the last World Economic Outlook (WEO). The revision carried out for Spain was also considerable, up to 0.9% year-on-year in 2014. Less positive are the changes made for France and Italy, countries where the IMF highlights the fragility of the economic recovery.

Confidence indicators point to growth gaining ground in 2014 Q1. One sign of this is the trend in the Purchasing Managers' Index (PMI), both for manufacturing and services, which are clearly above 50 points, the threshold as from which positive growth rates are usually seen. In fact the composite index rose to 54.0 points in April, its highest level in the last three years. The trend in the European Commission's economic sentiment indicator is also clearly upward in spite of having stood still temporarily in April. The significant improvement in consumer confidence (–8.7 in April compared with –11.2 in 2014 Q1 on average) also seems to augur an improvement in private consumption over the coming months. All this points to economic growth in the first quarter of the year being greater than in 2013 Q4, namely 0.2% quarter-on-quarter, therefore coming close to the region's historical average of between 0.4% and 0.5%.

The figures for business and consumption also show trends that invite optimism. The industrial production index consolidated its growth in February with an increase of 1.7% year-on-year. Particularly significant was the dynamism seen in the production of intermediate and capital goods, presenting a favourable scenario for increased investment. Once more we should point out the divergence between France and Germany; France's industrial activity disappointed again, down by –0.5% year-on-year in February while in Germany this grew by 4.1%. The trend in retail sales is the most similar between countries: almost all recorded growth. For the euro area as a whole, they grew by 0.8% year-on-year in February, boosted particularly by the upswing in the non-food component.

GDP growth forecasts for 2014

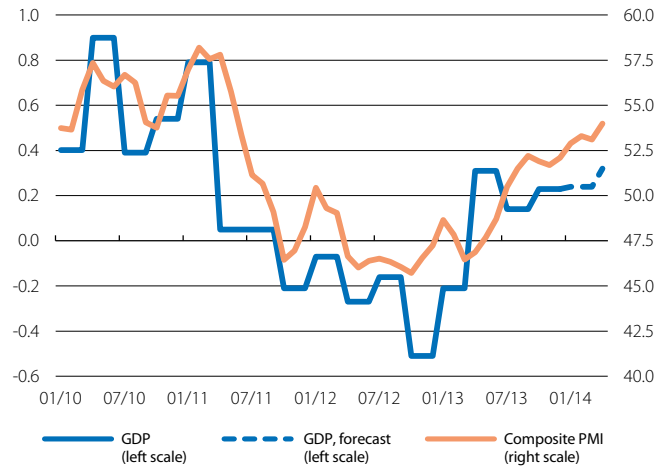
Year-on-year change (%)



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

Euro area: GDP growth and composite PMI

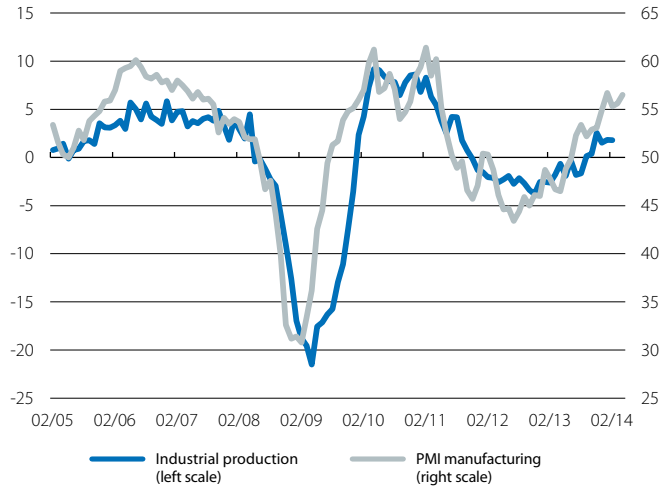
Quarter-on-quarter change (%) *(Index)*



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

Euro area: activity indicators

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



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

Exports remain healthy and imports start to stabilise. Goods exports, which ended the year with good figures, have accelerated their rate of growth slightly in the early part of 2014. Specifically, in the first two months of the year they posted average annual growth of 2.7%, almost 1 p.p. higher than their increase in 2013 Q4. The change in trend is more pronounced in imports, which have been falling for some time but have started to considerably moderate their rate of decline in the last few months: from –1.7% in 2013 Q4 they have gone to –0.4% year-on-year in January and February. This is largely the result of improved domestic demand, especially household consumption and investment in capital goods which have enjoyed positive growth rates for the last three quarters and are gradually affecting imports.

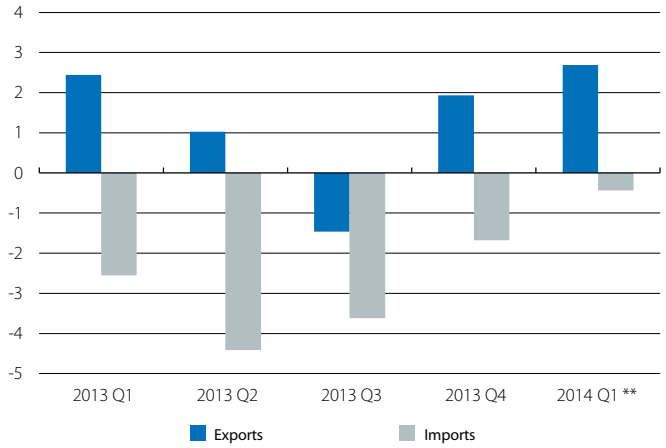
Inflation remains low, increasing pressure on the ECB. The inflation rate for the whole of the euro area is the lowest it has been since 2009. In April it rose by 0.2 p.p. to 0.7% but an important part of this upswing was due to temporary factors such as the effect of Easter. This makes it difficult to judge to what extent underlying factors such as the recovery in domestic demand will turn this increase into an upward trend. While this question remains unanswered, pressure is building on the ECB to take action. In addition to the list of circumstances justifying more accommodative monetary policy, the last few months have also seen an upswing in money market interest rates and the euro's appreciation, which is gradually nearing 1.40 dollars. For the moment, the ECB has limited itself to verbal action but the tone of its statements has become firmer and more specific in the last few months, to the extent that the ECB has managed to convince agents it will carry out quantitative easing if it deems this necessary, something that was difficult to imagine just a short time ago.

The euro area still suffers from financial fragmentation. According to a study carried out by the ECB (Financial Integration in Europe), in spite of improvements in the last two years the region's financial fragmentation is still excessive. This report stresses that the advances made have been particularly the result of monetary policy actions, of the progress made towards banking union and the structural reforms carried out by countries in the euro area, especially in the periphery. However, the ECB warns of the huge variation in financing costs for non-financial firms and notes the importance of ensuring credit reaches the real economy, especially in the periphery. The ECB states that the materialization of the banking union over the coming months will be crucial to restore financial integration.

Different situations in public accounts. Although the public deficit stood at 3.0% of GDP in 2013 for the euro area as a whole, there are still notable differences between countries. At one end of the scale is Germany, whose public accounts have remained practically balanced for the second year in a row. Also of note are Austria and the Netherlands, both with a public deficit that is also clearly below 3% of GDP. France is

*Euro area: balance of goods **

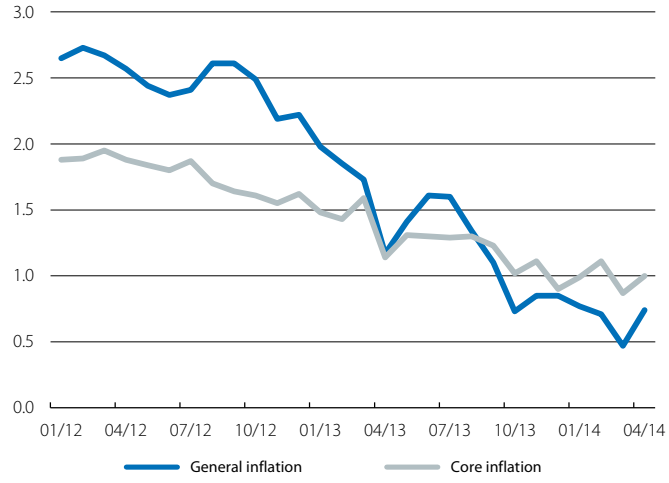
Year-on-year change (%)



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

Euro area: harmonized index of consumer prices

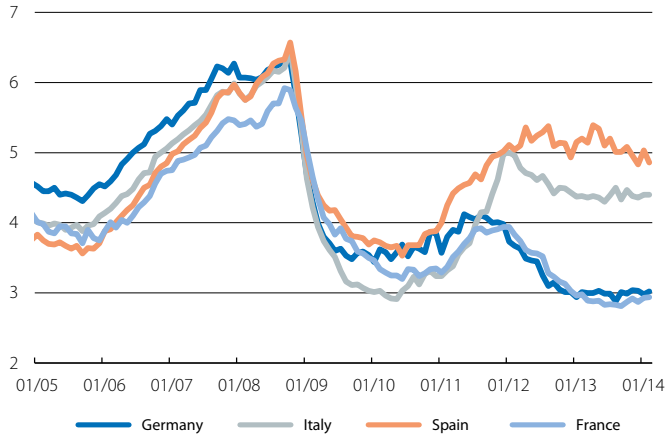
Year-on-year change (%)



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

*Financing costs for non-financial firms **

Interest rate (%)



Note: ** Loans up to 1 million euros.*
Source: *"la Caixa" Research, based on ECB data.*

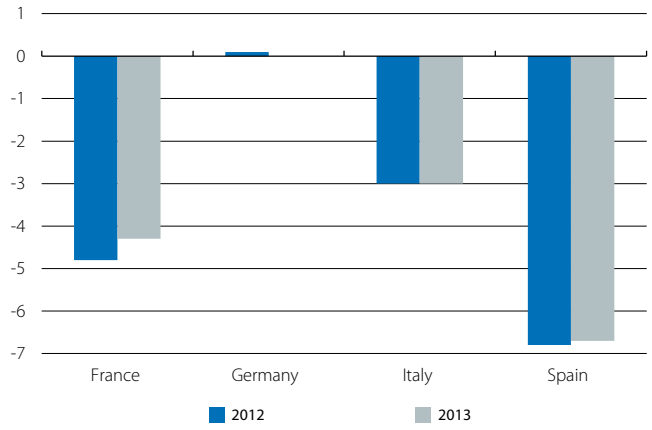
far from achieving such figures and ended 2013 with a 4.3% deficit, just 0.6 p.p. lower than in 2012. The biggest adjustments have been seen in the periphery countries which, although still far from the 3% target, are continuing to correct their fiscal balances according to the planned timeline agreed with the EC. Ireland and Portugal particularly stand out in this respect. Ireland's deficit fell by 1 p.p. to 7.2% while in Portugal this drop was 1.5 p.p., down to 4.9%. In Spain, if we do not include the losses due to aid to the banking sector, the reduction in the public deficit was very small but this does not reflect the fiscal effort made as many of the measures employed in 2012 to adjust the deficit were temporary, resulting in the need for additional measures in 2013.

Portugal will successfully complete its programme with the troika. Except for the government crisis last year, the implementation of the programme agreed with the troika has been characterised by commitment and seriousness on the part of Portugal's authorities over the three years it lasted. The good pace of growth shown by Portugal in the last few quarters has surprised most analysts; its firm commitment to fiscal consolidation, to the extent of reducing its public deficit more than originally planned in 2013, and the scope of some of the structural reforms carried out have helped Portugal regain market confidence. The risk premium for Portuguese debt has fallen substantially in the last few months and its Treasury has taken advantage of this fact to pre-finance its needs for this year and start to cover those of 2015. Nevertheless the Portuguese economy is still delicate and it is vital to remain firm on all three fronts mentioned above.

The rate of growth speeds up in the United Kingdom. The country's GDP grew by a substantial 0.8% quarter-on-quarter in 2014 Q1. Until recently there were serious doubts regarding the solidity of the United Kingdom's recovery as it was largely based on a boom in the real estate market and private consumption. However, these signs of improvement have spread to credit conditions, confidence indicators and especially investment in capital goods. Now the uncertainty relates to when the Bank of England will start to tighten its monetary conditions. In fact, in its forward guidance strategy, the authority announced that the turning point will come when unemployment falls below 7%; and it is currently at 6.9%.

Fiscal balance for different countries in the euro area

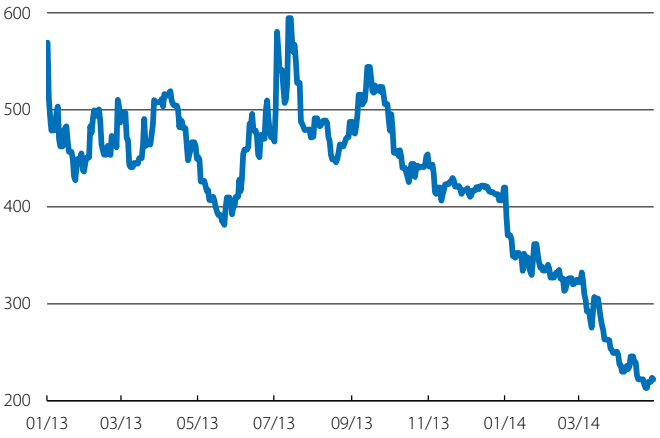
(% of GDP)



Note: *Does not include aid to banks.*
Source: *"la Caixa" Research, based on Eurostat data.*

*Portugal: risk premium **

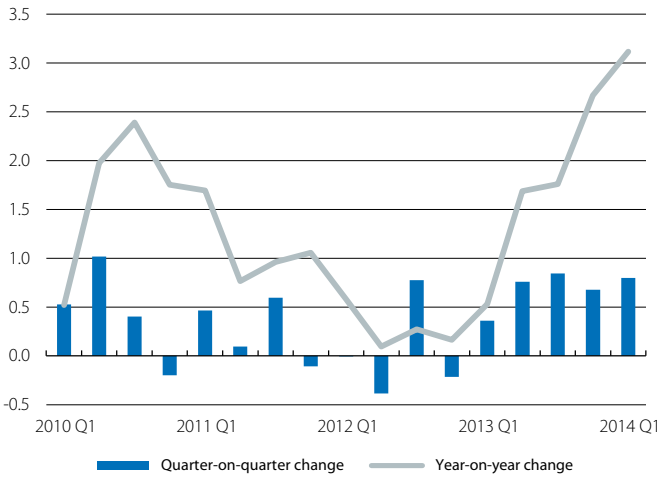
(b.p.)



Note: ** Spread between the yield on Portuguese and German 10-year bonds.*
Source: *"la Caixa" Research, based on Bloomberg data.*

The United Kingdom: GDP

(%)



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

FOCUS · France: dependent on economic policy

The euro area's recovery is almost being led by the Germany economy on its own. France, Europe's other great power, is clearly lagging behind and its growth capacity is very doubtful. This article provides a brief analysis of the underlying reasons as well as the possible effect of the measures proposed by the new executive led by Manuel Valls to revive the economy.

Domestic demand has supported France's growth over the last decade. During the boom period of 2000-2007, GDP grew at an average annual rate of 2.1%, pushing up domestic demand to 2.4%. During the recession, domestic demand plummeted while foreign demand's contribution to growth remained almost the same. In the last few years, domestic demand has once again picked up.

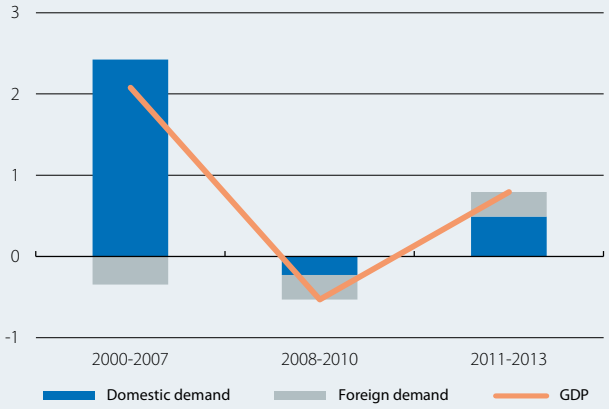
If we analyse the trend in the different components that make up domestic demand, we can see that its growth up to the crisis was particularly due to private consumption, and that its fall between 2008 and 2010 lies behind the economy's weaker performance. It is also interesting to observe that public consumption has remained constant throughout the period, now taking on a leading role in the country's incipient recovery.

However, the support these factors can provide in the short and medium term appears to be quite limited. Public debt stands at 93.5% of GDP, forcing the Prime Minister, Manuel Valls, to centre his economic policy on fiscal discipline. On the other hand, private consumption will not be able to count on extensive growth in credit, as this already stands at 120% of GDP, or on huge pay rises.

Can France's export capacity take over? Competitiveness indicators are not very encouraging in this respect. The country's value added per hour worked compared with other countries in the euro area has followed a negative trend in the last few years and this same trend can be seen in the World Economic Forum's global competitiveness index. For example, in 2006 France ranked 15th but by 2013 had fallen to 23rd. Nevertheless, the French government seems to be aware of the need to turn this situation around: the «responsibility pact», announced by the President, F. Hollande, includes reducing taxes on companies and some deregulation of the economy. Such good intentions, which are still not very explicit, make it difficult to assess whether France is finally giving its economy the turnabout it needs. It does seem to be moving in the right direction, however.

GDP growth: breakdown

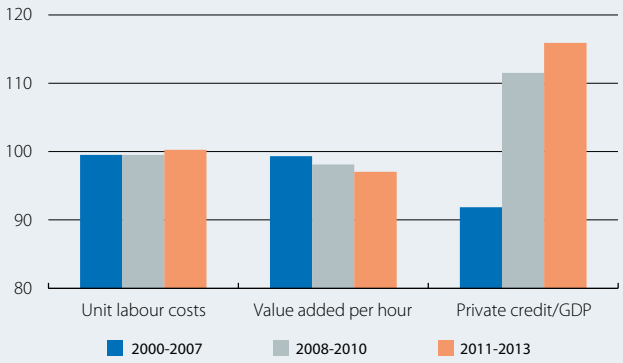
Average annual change (%)



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

Determining factors for domestic consumption

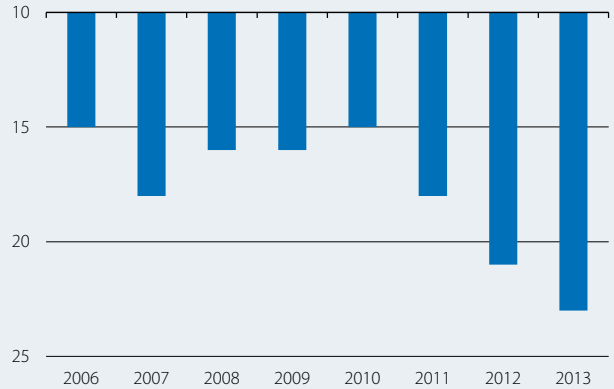
(%)



Note: *France's nominal unit labour costs compared with European OECD countries. Value added per hour worked in France compared with the euro area.*
Source: *"la Caixa" Research, based on data from the OECD and INSEE.*

Competitiveness indicators

Ranking (inverted scale)



Source: *"la Caixa" Research, based on data from the World Economic Forum Global Competitiveness Report.*

FOCUS · Proposals to mutualise debt in euro area countries

The crisis affecting the euro area in the last few years has highlighted significant deficiencies in its institutional design. This is the context, in particular, for the recent steps taken towards banking union and the greater control now exercised by the EC over each country's economic policy. Another issue that has aroused fierce debate over the last few years is whether mechanisms should be designed to mutualise the public debt of different euro area countries, especially when there are still considerable differences in terms of the cost of debt. The EC has recently published a study that examines this issue in depth.

Specifically, in July last year, the EC appointed a group of ten economists to carry out an exhaustive analysis of the possible advantages, risks, requirements and obstacles represented by partially substituting issuances of public debt at a national level with the joint issuance of debt by the different countries in the euro area.[1] The EC asked for two mechanisms to be studied; one by issuing long-term debt and the other issuing short-term debt. In the report published, the group of experts makes it very clear that the decision to implement these mechanisms is strictly political while their analysis is strictly technical. However, in various cases the authors have noted they disagree on several points.

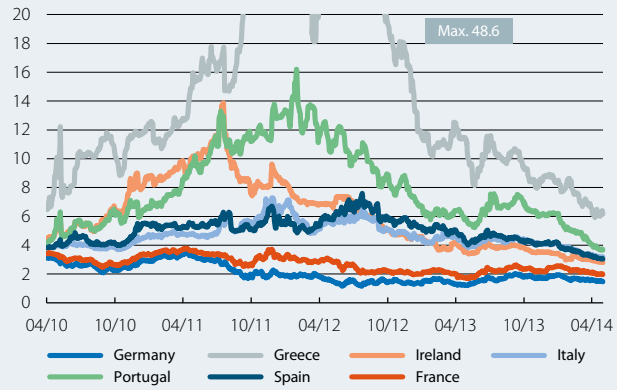
The benchmark used for long-term debt is the proposal by the German Council of Economic Experts, also known as the Debt Redemption Fund and Pact (DRF/P). This mechanism consists of two elements: (i) A fund to which those countries with a public debt greater than 60% of GDP would transfer part of their debt above this threshold. The burden of the fund's debt would be assumed by all countries in the euro area and would be shared out on a pro rata basis according to GDP. (ii) A regulatory framework designed to ensure that all countries transferring part of their debt to the fund take the necessary measures to sort out their public accounts. This fund has been conceived as a temporary mechanism to be used only during the time-line deemed necessary for participating countries to bring their debt back down to below 60% of GDP.

The joint issuance of short-term public debt, known as eurobills, includes debt with maturities up to two years. The case is also analysed of a eurobill issuance limit of 30% of total debt per country. The main aim of issuing eurobills would be to create a safe and liquid instrument which, to the extent issuing limits are not reached, could help weaker countries to access markets at times of greater volatility.

The report's authors disagree as to the scope these measures should take but there seems to be wide consensus that their success depends on the effectiveness of economic governance measures. Here the authors stress that, given the EU's very recent reforms regarding its control over each country's economic policy, it may be considered prudent to collect evidence on the efficiency of such governance before discussing further extensions. This requirement is deemed vital to successfully implement mutualisation instruments for public debt.

Yield on 10-year public debt by country

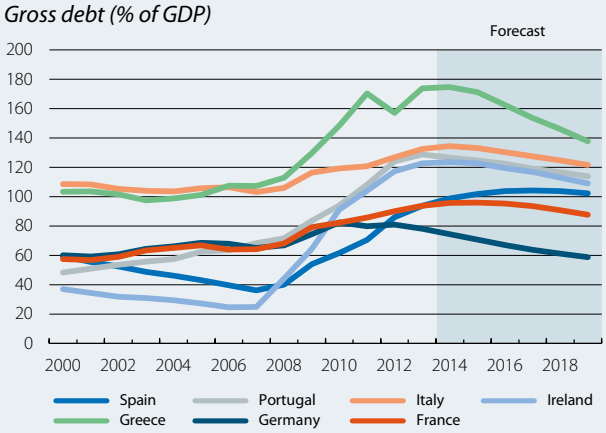
(%)



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

Trend in public debt for the main countries of the euro area

Gross debt (% of GDP)



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

1. «Expert group on debt redemption fund and eurobills», Final Report 31 March 2014.

KEY INDICATORS

Activity and employment indicators

Values, unless otherwise specified

	2012	2013	2013 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14	04/14
Retail sales *(year-on-year change)*	–1.7	–0.9	–1.0	–0.5	0.2	0.8	0.8	...	...
Industrial production *(year-on-year change)*	–2.5	–0.7	–1.0	–1.1	1.5	1.6	1.7	...	...
Consumer confidence	–22.1	–18.6	–20.8	–15.9	–14.4	–11.7	–12.7	–9.3	–8.7
Economic sentiment	90.8	93.8	90.2	95.3	99.1	101.0	101.2	102.5	102.0
Manufacturing PMI	46.2	49.6	47.9	50.9	51.9	54.0	53.2	53.0	...
Services PMI	47.6	49.3	47.5	50.9	51.3	51.6	52.6	52.2	...
Labour market									
Employment (people) *(year-on-year change)*	–0.7	–0.9	–1.0	–0.8	–0.5	–	...	–	–
Unemployment rate: euro area *(% labour force)*	11.3	12.0	12.0	12.0	11.9	11.9	11.9	...	...
Germany *(% labour force)*	5.5	5.3	5.3	5.3	5.2	5.1	5.1	...	...
France *(% labour force)*	9.8	10.3	10.3	10.3	10.2	10.3	10.4	...	...
Italy *(% labour force)*	10.7	12.2	12.1	12.3	12.7	12.9	13.0	...	...
Spain *(% labour force)*	25.1	26.4	26.4	26.5	26.1	25.8	25.6	...	...

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 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14
Current balance: euro area	1.6	2.7	2.3	2.4	2.7	2.8	2.9	...
Germany	7.4	7.5	7.5	7.4	7.5	7.7	7.6	...
France	–2.2	–1.3	–1.6	–1.7	–1.3	–1.3	–1.3	...
Italy	–0.3	1.0	0.4	0.7	1.0	1.2	1.3	...
Spain	–1.2	0.8	0.4	0.8	0.8	0.7	0.7	...
Nominal effective exchange rate [1] *(value)*	97.8	101.6	100.8	101.9	103.1	103.4	103.5	104.6

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 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14
Private sector financing								
Credit to non-financial firms [1]	–0.3	–2.4	–2.2	–2.8	–2.9	–2.8	–3.1	–3.1
Credit to households [1, 2]	1.2	0.3	0.3	0.3	0.3	0.2	0.4	0.4
Interest rate on loans to non-financial firms [3] *(%)*	2.4	2.2	2.2	2.2	2.3	2.3	2.2	...
Interest rate on loans to households for house purchases [4] *(%)*	3.1	2.8	2.9	2.8	2.8	2.8	2.8	...
Deposits								
On demand deposits	4.1	7.9	9.3	7.6	6.6	6.2	6.2	5.5
Other short-term deposits	2.0	0.0	0.1	0.3	–1.5	–2.6	–2.6	–2.3
Marketable instruments	0.5	–14.8	–15.5	–17.2	–16.8	–12.8	–11.6	–13.6
Interest rate on deposits up to 1 year from households *(%)*	2.8	2.0	2.1	1.8	1.6	1.7	1.6	...

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 · **A convincing economic recovery**

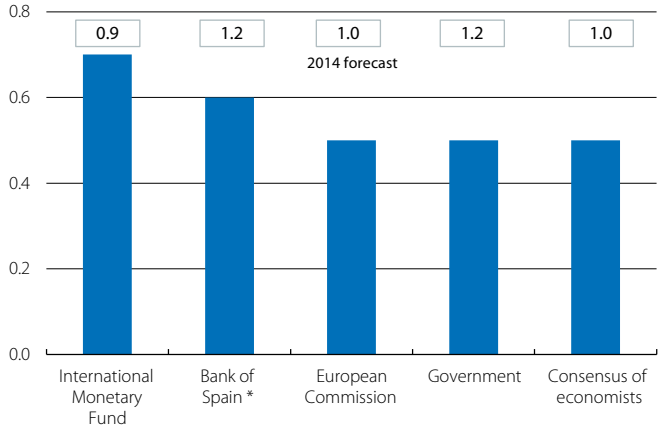
Widespread improvement in growth prospects. The good activity data posted over the last few months, in many cases better than expected, have notably dispelled doubts regarding the Spanish economy's possible relapse. This greater confidence in the recovery can be seen in the higher growth forecasts for 2014 published by the main international organisations over the last few months. In April it was the turn of the International Monetary Fund and the Spanish government, with forecasts 0.7 and 0.5 p.p. higher than those of last autumn, respectively. This scenario contrasts with the one seen in 2011 when, although the first few signs of recovery could be glimpsed, growth forecasts remained almost the same. There are many reasons for the current turnaround but it is particularly due to the improvements in Europe's governance, easier monetary policy and the greater rebalancing of Spain's economy, encouraging growth in domestic demand. This revival is still in its early stages, however, and reforms must continue both at a European and a national level, as they are still vital to ensure the recovery continues.

GDP growth rose by 0.4% quarter-on-quarter in 2014 Q1, 0.2 p.p. higher than the previous quarter's figure. The breakdown by component has yet to be published but estimates by the Bank of Spain point to more dynamic domestic demand in the first few months of the year as the main reason for higher GDP growth in 2014 Q1. Business indicators for the first few months are also in line with this estimate. The increase in industrial production during January and February, namely 2.2% year-on-year, augurs higher investment. Retail sales remained positive albeit growing more tenuously in the same period, corresponding to a rate of growth in consumption in 2014 Q1 of slightly below the quarter-on-quarter figure of 0.5% recorded in the previous two quarters. Lastly, although the process of fiscal consolidation will continue to slow up public consumption, we expect this to have less of an effect in 2014 Q1 than in 2013 Q4, when it decreased by 3.9% quarter-on-quarter.

Private consumption and investment will continue to boost domestic demand throughout the year. Their recent trends give grounds for optimism: household consumption grew by 1% during the second half of 2013 and investment in capital goods ended the year up by 9.6% year-on-year. In both cases the outlook is still favourable. Of note for consumption is the sharp increase in household confidence which, in the first four months of the year, has climbed back up to its 2001 level. Improved expectations for the next 12 months, both in employment and the financial situation of households, lie behind this upswing in the intention to consume. The latest data on investment are also encouraging. One good sign of

Revised growth forecasts (2014)

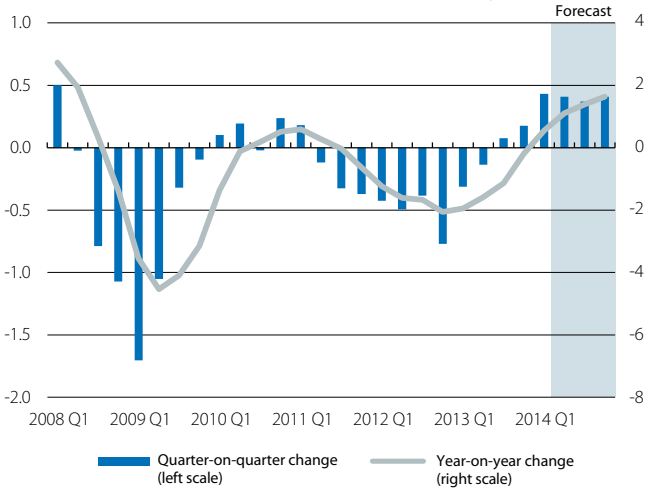
Change compared with the forecasts last autumn (p.p.)



Note: ** Change compared with the forecast of March 2013.*
Source: *"la Caixa" Research, based on data from the IMF, EC, Bank of Spain, Ministry of Finance and Consensus Economics.*

GDP growth

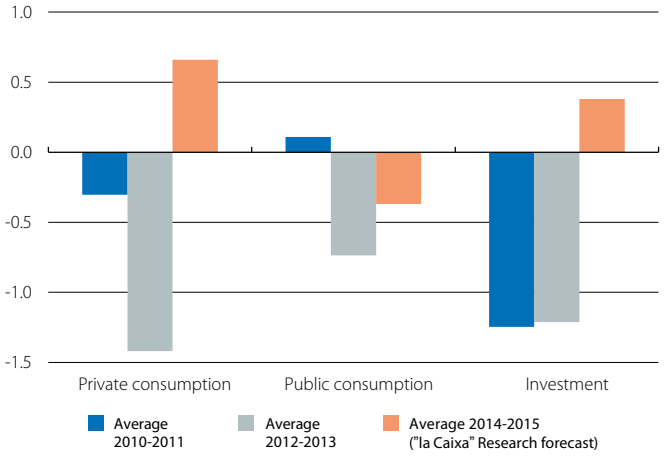
Quarter-on-quarter change (%) *Year-on-year change (%)*



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

Domestic demand's contribution to growth by component

Average contribution over two years (p.p.)



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

this is the performance by capital goods production, up by 4.4% year-on-year in the first two months of 2014.

The improvement in domestic demand is also accompanied by a higher increase in imports, a trend that can be seen in the latest figures for goods imports. In 2013 these dropped by 1.3% year-on-year compared with an advance of 5.2% for exports. However, in the first two months of 2014, imports have grown at a very similar rate to exports: 3.0% and 4.0% respectively, in nominal terms. As most of the evidence available suggests that domestic demand will gradually get stronger throughout the year, we can also expect the foreign sector's contribution to steadily decline as a result of more dynamic imports.

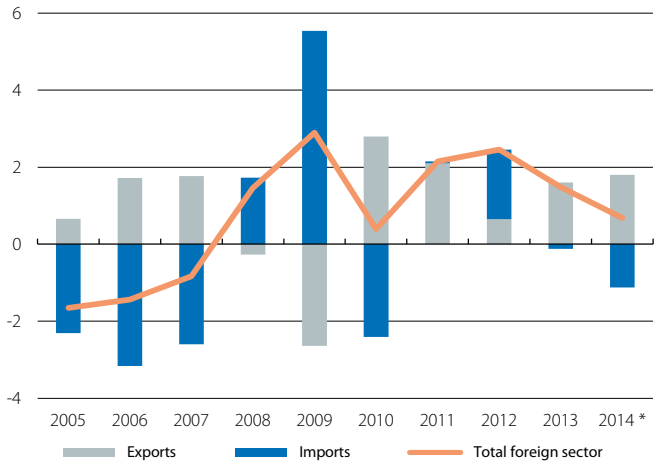
Exports pick up in the first few months of the year. This smaller contribution by the foreign sector should not eclipse the good performance by exports in the first few months of the year, leaving behind the stagnation recorded in the last quarter of 2013 when they only grew by 0.8%. There are basically two reasons for this acceleration: solid demand from Europe, which is continuing to grow as the euro area recovers, and more dynamic demand from outside the euro area, putting an end to the slump suffered in 2013 Q4. Further improvement in industry's export expectations regarding Q2 suggests a favourable scenario with exports remaining dynamic over the coming months. However, it will still be necessary to maintain the rate of gains in competitiveness to consolidate this upward trend in Spanish exports over the long term. To date, this has been fundamental in the relative share of exports increasing from 24% of GDP in 2009 to 34% in 2013. Another figure reflecting the Spanish economy's greater internationalisation is the increase in its number of exporting firms, growing from around 100,000 during the years prior to the crisis to 150,000 in 2013.

The labour market will take some time to recover. According to the LFS, 184,600 jobs were lost in Q1, a more negative figure than expected given the workers registered with Social Security during the first few months of the year. The seasonally adjusted figures did not offer any good news either: employment fell by 0.1% quarter-on-quarter in 2014 Q1, undoing the good figures from the previous quarter (+0.1% quarter-on-quarter). In fact, this decline would have been even bigger without the public sector creating jobs (11,100), the first positive balance since 2011. However, given the good activity figures, this slowdown in labour's recovery in 2014 Q1 will probably end up being a temporary phenomenon. Nonetheless, the unemployment rate only increased by 0.2 percentage points to 25.9% due to a further reduction in the labour force (of 187,000 people).

Spanish banks are facing the stress tests with confidence. One of the key elements in the tests to be carried out by the European Central Bank this year on the main banks in the euro area is the macroeconomic scenario used to analyse their resilience. In the end this document, which was presented in April, did not come as any great surprise. In Spain's case the

Foreign sector's contribution to growth

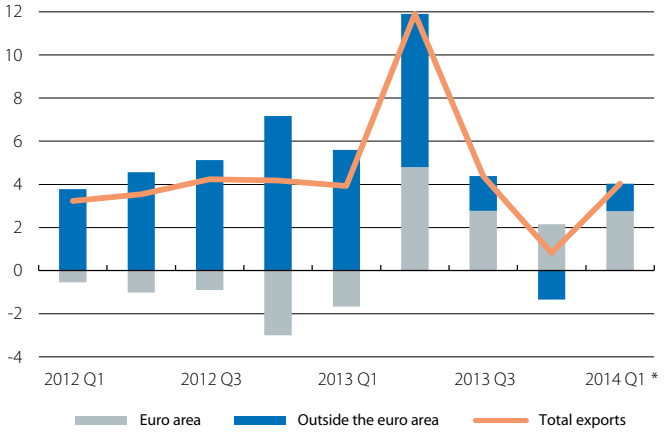
(p.p.)



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

Growth in exports by geographical area

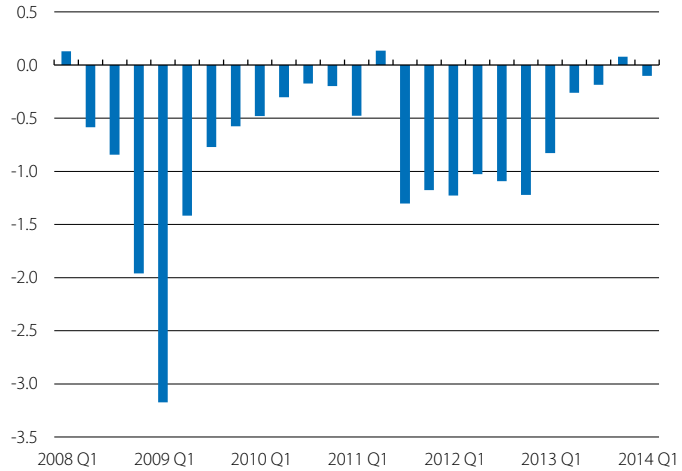
Contribution to growth (p.p.) and year-on-year change (%)



Note: ** Cumulative sum of exports for January and February.*
Source: *"la Caixa" Research, based on INE data.*

Employment evolution

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



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

most adverse scenario used to analyse the trends in solvency and liquidity of the country's main banks is based on the recession continuing until 2016 and an unemployment rate that reaches 27.1% (3.9 p.p. more than in the main scenario). Although this adverse scenario is quite tough, the restructuring and recapitalisation processes carried out by Spain's banks over the last few years are helping them to handle such tests successfully.

The government presents its Stability Programme 2014-2017 with greater fiscal adjustment for this year. Three messages stand out from this new programme. First, the improved economic situation has allowed the government to revise upwards its GDP growth profile. This is now in line with the forecasts by "la Caixa" Research for 2014 and 2015 and is slightly more optimistic in the long term. Second, the government has presented a more demanding fiscal adjustment for this year, lowering the public debt target by 0.3 p.p., down to 5.5% of GDP. This bigger correction is largely due to the improved economic cycle. The adjustment in the structural deficit (what would be observed if the economy performed at 100%) has remained practically the same, at 0.5 p.p. specifically. Lastly, most of the fiscal adjustment is once again concentrated in the accounts of the central government and autonomous communities, with deficit reductions of 0.8 and 0.5 p.p. in 2014, respectively. It is the opposite situation with local government corporations, which are expected to see a 0.4 p.p. reduction in their surplus compared with last year.

It is crucial for the reforms to continue. The improved outlook described above is also reflected in the lower pressure on Spain's public debt, whose yield has now reached historically low levels. However, to guarantee a good rate of growth and job creation in the medium and long term, it is still vital to carry out an ambitious agenda of structural reforms. Along these lines, the government has published its new National Reform Programme which revolves around five key areas: fiscal reform, combating unemployment, promoting competitiveness, modernising public administrations and restoring financing conditions. There can be no doubt that this programme aims to continue the reforming strategy of the last few years.

Adverse scenario given by the EBA

Annual change unless otherwise specified (%)

	2014	2015	2016
GDP	–0.3	–1.0	0.1
Inflation	0.3	0.4	0.8
Unemployment rate*	26.3	26.8	27.1
House prices (nominal)	–7.4	–3.0	0.9
Spanish Treasury 10-year bonds**	5.7	5.5	5.6
12-month swaps**	1.4	1.4	1.4

Notes: ** As % of the labour force. ** Yield.*
Source: *"la Caixa" Research, based on data from the EBA.*

Public deficit targets of the stability programme *

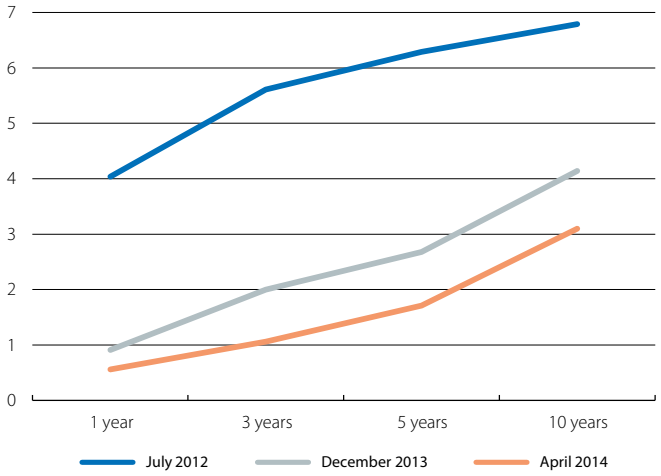
Annual change unless otherwise specified (%)

	2013	2014	2015	2016	2017
Central government	–4.3	–3.5	–2.9	–2.2	–1.1
Social Security	–1.2	–1.0	–0.6	–0.3	0
Autonomous communities	–1.5	–1.0	–0.7	–0.3	0
Local corporations	0.4	0.0	0.0	0	0
Total	**–6.6**	**–5.5**	**–4.2**	**–2.8**	**–1.1**

Note: ** Does not include costs resulting from banking sector losses, totalling 0.5% of GDP in 2013.*
Source: *"la Caixa" Research, based on data from the Tax Ministry.*

Sovereign debt interest rate curve

Annual yield (%)



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

FOCUS · The demand for housing in Spain stabilises

After considerable adjustment in the real estate sector over the last five years, the first signs of stabilisation in housing demand are starting to be seen. For example, the data for last year published by the INE showed an annual drop in real estate transactions of 2.2% compared with 11.5% in 2012. So what factors lie behind this change in trend? And, especially, how far might they go?

One initial factor to consider is the recovery in foreign demand. According to the Ministry of Public Works, transactions carried out by foreigners rose by 12.8% last year, reaching 49,451 in total. Given that domestic demand continued to fall, the relative share of foreign demand has increased considerably, going from 6% in 2009 to 16% in 2013.

This dynamism in foreign demand has occurred mostly in those provinces with a large supply of second homes. 88% of the properties acquired by foreigners over the last two years have been located on the Mediterranean coast or in the Canary or Balearic Islands, helping to reduce the excessive supply in an area that concentrates more than 50% of the total stock of new homes for sale.

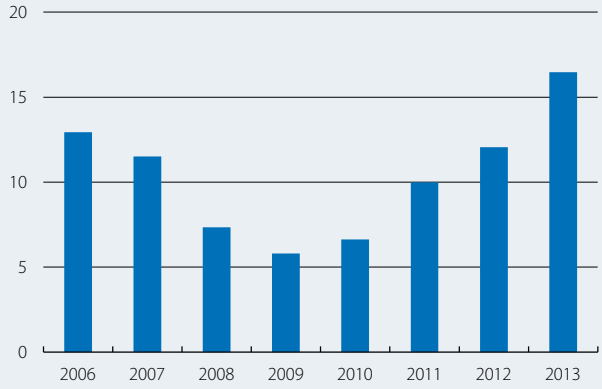
This surge in foreign demand is also helping to slow down the fall in house prices. Both large cities, which have a smaller supply of excess housing, and coastal areas are at a more advanced stage in the real estate cycle. This can be seen by the real estate clock, which places both regions in the stabilisation phase, characterised by an upward trend in transactions and a deceleration in falling house prices. The rest of the country, however, is still lagging behind in the cycle.[1]

The recovery in domestic demand is gradually adding to this good performance by foreign demand. The change in trend in the labour market and particularly better economic prospects should see sales ending the year with positive growth rates. This is suggested by the trend in the intention to purchase a home within the next 12 months among Spanish consumers, which has bottomed out and even seems to be set on a tentative upward path.

1. For more information on the real estate clock, see the Focus «The real estate clock: time to get up?» in the *Monthly Report* from October 2013.

Foreign demand for housing *

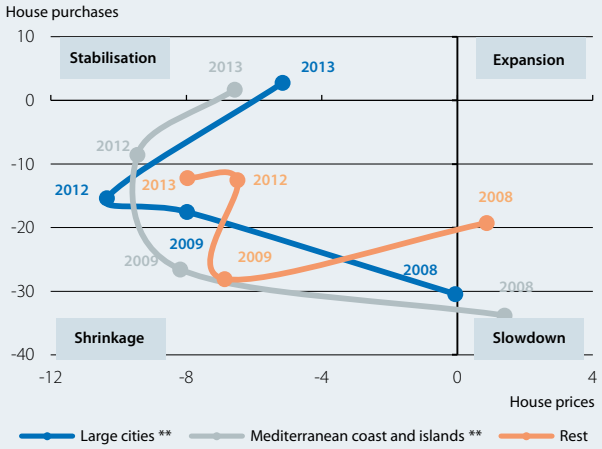
Percentage of total sales (%)



Note: ** Includes the resident and non-resident foreign population.*
Source: *"la Caixa" Research, based on data from the Ministry of Public Works.*

Real estate clock by zone *

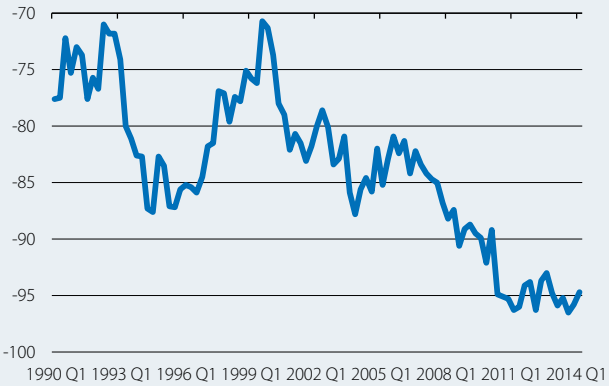
Annual change (%)



Notes: ** The data for 2010 and 2011 are excluded due to the effect of tax incentives on the real estate market. ** The data for the cities of Barcelona and Valencia are included within large cities while the rest of the sales from the province are counted within the Mediterranean coast.*
Source: *"la Caixa" Research, based on data from the Ministry of Public Works and INE.*

Intention to purchase or build a home within the next 12 months

(Index)



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

FOCUS · The slow correction in Spain's net external debt

Among the various imbalances accumulated by the Spanish economy in the years prior to the crisis, one of the toughest to correct must surely be its high external borrowing. A good example of this is the recent trend in its net international investment position (NIIP); i.e. the difference between the foreign assets held by Spanish citizens and Spanish assets in foreign hands. This article briefly reviews the main factors that determine this trend and its prospects.

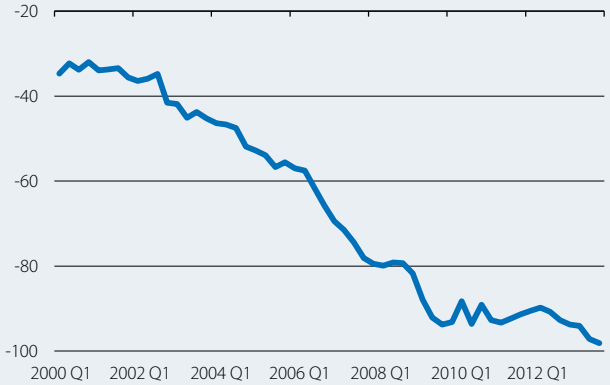
The NIIP fell very sharply between 2000 and 2009, going from –32.0% of GDP to –93.8%. This negative trend has slowed down since then but, although the Spanish economy now has a net lending position, its NIIP has yet to improve. The logic seems simple: if an economy such as Spain's has a positive current account balance, it can either use its assets to pay off its external liabilities or to buy external assets. In both cases, its NIIP would improve. It therefore seems paradoxical that Spain's NIIP should continue to worsen.

However, the NIIP's trend does not only depend on an economy's net stock of financial assets with the external sector; changes in the relative value of its assets and liabilities also play an important role, especially over the short term. The second graph shows each factor's contribution to changes in the NIIP over the last few years. As can be seen, in 2013 Spain's net lending position, namely 1.5% of GDP, helped to improve its NIIP. However, this was not enough to offset the valuation effect, which was negative in 2013. In other words, the price rises in Spain's assets held by foreign citizens were greater than the price rises in foreign assets held by Spanish citizens. This valuation effect was particularly significant among equity. By way of example, in 2013 the Ibex 35 gained 21.4% while the average gain for Eurostoxx 50, MSCI Emerging Markets and S&P 500 remained at 14.0%.[1]

However, it should be noted that, although valuation can have a significant effect in any one year, in the long term the NIIP's trend is determined mainly by an economy's stock of financial assets with the external sector. For example, this lies behind 85% of the change in the NIIP in the last seven years. Assuming the valuation effect is not so important in the long term, if Spain's net lending position remains at 1.5% of GDP in the future and nominal GDP grows by 4%, by 2020 its NIIP will be close to –65%. A significant drop but still keeping the NIIP far from the threshold set by the European Commission, namely –35%. Therefore, in spite of the considerable push by exports over the last few years, efforts to improve the Spanish economy's international position must continue.

Trend in the net international investment position

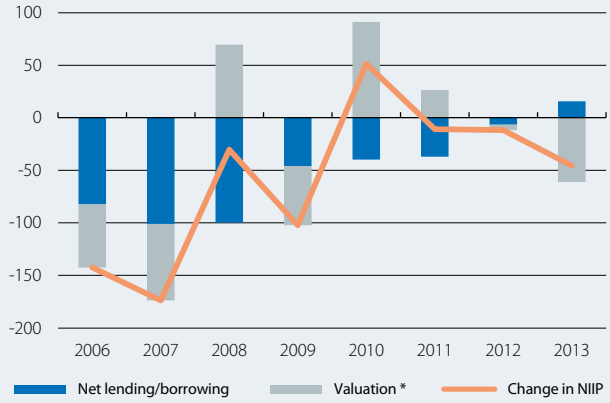
(% of GDP)



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

Contribution to the change in the NIIP

(Billion euros)



Note: ** Valuations include other variations in volume.*
Source: *"la Caixa" Research, based on data from the Bank of Spain.*

1. Eurostoxx 50 rose by 17.9%, MSCI Emerging Markets fell by 5.3% and the S&P 500 rose by 29.6%.

FOCUS · The return on education in Spain

In a market-oriented economy that is working properly, there is a very close relationship between a worker's earnings and their educational attainment. Those attaining a higher level of education are normally more productive and therefore receive a higher wage. In Spain, in 2010 those workers who had completed, at most, lower secondary education received an average annual gross salary of 16,757 euros, while the earnings of an individual with a university education reached 29,548 euros. Education and training therefore tends to have its rewards.

The earnings premium in Spain, however, is lower than that of the main OECD countries. On average, in OECD countries the earnings of a worker with university studies is double that of a worker with basic studies, while in Spain it is just 75% higher. There are many factors influencing the size of the earnings premium but relative supply and demand for each educational attainment segment are key.[1]

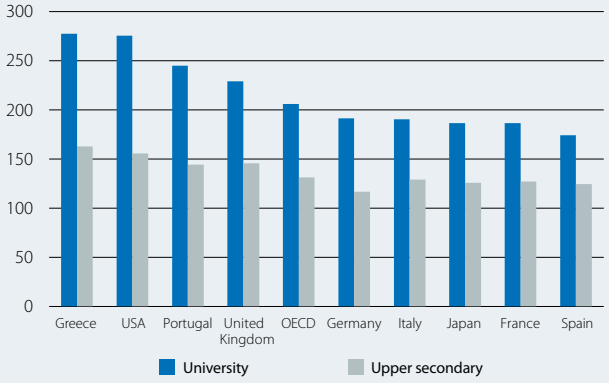
In this respect, Spain's supply of people with a university education seems very similar to that of other OECD countries. In 2000 the share of Spain's population aged between 25 and 64 with a university qualification was 23%, 1 percentage point above the OECD average. In 2011 this ratio was 32%, both in Spain and the OECD average. Consequently, when the supply is equal, if in Spain the earnings premium for universities is lower, part of this is likely to be due to a lower demand for this kind of worker. Another element that helps to explain this phenomenon is the fact that the effective educational level of Spain's universities is lower, as shown by the OECD's survey of adult skills in 2013.[2]

Also of note is the different trend in the earnings premium over the last decade in OECD countries and in Spain. There has been a considerable increase for workers with university qualifications in both cases but this has been more pronounced in the OECD countries than in Spain. Specifically, in Spain the rise is 10 p.p. while in the OECD countries on average it is 23 p.p. The trend in the earnings premium has been the opposite for workers studying until upper secondary education: this has risen in the OECD countries but fallen in Spain. In this case, however, the supply trends have been very different; in Spain the supply has increased considerably while it has remained the same in the OECD. To ensure the rewards from education are not paltry, we should try to resemble more the outstanding OECD students.

1. Other important factors are the minimum wage regulations and institutions governing labour relations.
2. See «OECD Skills Outlook 2013. First Results from the Survey of Adult Skills».

Relative earnings by educational attainment (2011)

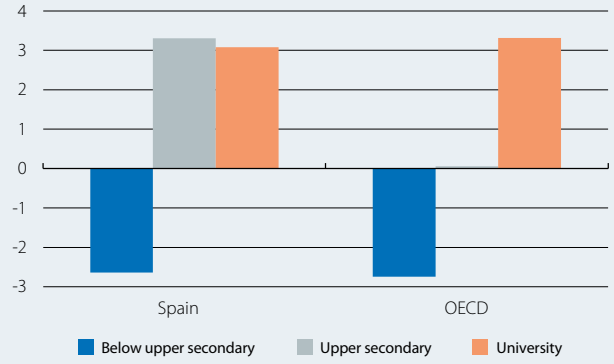
Basic education (below upper secondary) = 100



Note: *Portugal and Spain (2010); France (2009) and Japan (2007). 25-64 years of age. The university level of education also includes higher professional training.*
Source: *"la Caixa" Research, based on OECD data, «Education at a Glance 2013».*

Change in education attainment among the population aged between 25 and 64

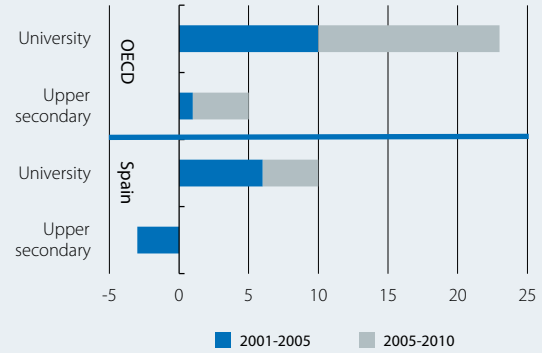
Average annual change between 2000 and 2011 (%)



Source: *"la Caixa" Research, based on OECD data, «Education at a Glance 2013».*

Change in earnings premium compared with workers below upper secondary education

(p.p.)



Note: *25-64 years of age.*
Source: *"la Caixa" Research, based on OECD data, «Education at a Glance 2013».*

KEY INDICATORS

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

Activity indicators

	2012	2013	2013 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14	04/14
Industry									
Electricity consumption	–2.2	–2.1	–2.3	–2.4	0.1	–0.6	–0.2	–0.9	...
Industrial production index	–6.6	–1.5	–2.5	–0.7	1.1	1.3	3.1	...	...
Indicator of confidence in industry *(value)*	–17.5	–13.9	–15.4	–12.8	–11.6	–9.5	–8.1	–9.6	–9.3
Manufacturing PMI *(value)*	43.8	48.5	47.6	50.5	50.1	52.2	52.5	52.8	...
Construction									
Building permits	–42.7	–22.8	–27.2	–24.0	–11.9	–20.3	–37.2	...	...
House sales	–8.7	–2.7	0.6	–9.7	–9.8	–23.2	–27.6	...	...
Services									
Foreign tourists	2.0	5.7	5.3	4.9	10.8	12.3	11.2	0.7	...
Services PMI *(value)*	43.1	48.3	46.5	49.3	51.8	54.9	53.7	54.0	...
Consumption									
Retail sales	–7.1	–3.7	–5.1	–1.8	0.4	0.8	–0.2	–0.9	...
Car registrations	–13.5	5.6	2.5	8.3	22.6	7.6	17.8	10.0	...
Consumer confidence index	–31.7	–25.3	–28.7	–20.5	–19.4	–12.4	–14.7	–8.3	–7.8

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 Q2	2013 Q3	2013 Q4	01/13	02/13	03/13
Registered as employed with Social Security [1]								
Employment by industry sector								
Manufacturing	–5.3	–4.3	–5.1	–3.9	–2.5	–1.8	–1.3	–0.8
Construction	–17.0	–12.1	–13.8	–10.8	–7.9	–6.7	–5.6	–3.6
Services	–1.7	–2.0	–2.5	–2.1	–0.4	0.8	1.1	1.4
Employment by professional status								
Employees	–3.8	–3.8	–4.4	–3.9	–1.8	–0.3	0.1	0.5
Self-employed and others	–1.4	–0.6	–1.1	–0.5	0.4	1.0	1.5	1.8
TOTAL	**–3.4**	**–3.2**	**–3.8**	**–3.3**	**–1.4**	**0.0**	**0.4**	**0.7**
Employment [2]	**–4.3**	**–2.8**	**–3.4**	**–2.5**	**–1.2**	**–**	**–0.5**	**–**
Hiring contracts registered [3]								
Permanent	29.7	–14.2	–29.0	–27.8	–2.1	–2.2	6.8	15.7
Temporary	–4.0	6.4	6.0	7.1	15.0	15.9	15.7	26.6
TOTAL	**–1.6**	**4.0**	**2.0**	**2.7**	**13.5**	**14.3**	**14.8**	**25.5**
Unemployment claimant count [3]								
Under 25	4.5	–6.2	–6.1	–6.4	–8.0	–7.5	–10.7	–10.0
All aged 25 and over	11.7	3.7	5.2	2.3	–1.2	–2.9	–3.9	–4.2
TOTAL	**10.9**	**2.7**	**4.0**	**1.5**	**–1.8**	**–3.3**	**–4.5**	**–4.8**

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 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14	04/14
General	**2.4**	**1.4**	**1.7**	**1.2**	**0.1**	**0.2**	**0.0**	**–0.1**	**0.4**
Core	1.6	1.5	1.9	1.3	0.3	0.2	0.1	0.0	...
Unprocessed foods	2.3	3.6	4.3	6.0	0.7	0.9	1.2	0.0	...
Energy products	8.8	0.1	–1.1	–2.1	–1.1	0.0	–1.7	–1.4	...

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

Foreign sector

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

	2012	2013	2013 Q1	2013 Q2	2013 Q3	2013 Q4	01/14	02/14
Trade of goods								
Exports *(year-on-year change)*	3.8	5.2	3.9	11.9	4.4	0.8	3.1	4.9
Imports *(year-on-year change)*	–2.8	–1.3	–6.9	0.6	–0.6	2.0	–0.6	6.9
Current balance	**–12.4**	**8.0**	**–2.8**	**4.0**	**7.7**	**8.0**	**7.6**	**6.9**
Goods	–27.8	–11.6	–20.9	–14.5	–11.5	–11.6	–10.8	–11.1
Services	37.6	40.9	38.2	38.7	39.3	40.9	41.3	41.5
Income	–17.9	–15.3	–16.3	–15.0	–14.6	–15.3	–16.8	–17.2
Transfers	–4.3	–6.0	–3.9	–5.2	–5.5	–6.0	–6.1	–6.3
Net lending (+) / borrowing (–) capacity	**–5.8**	**15.8**	**4.5**	**12.1**	**15.6**	**15.8**	**15.5**	**14.1**

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 Q2	2013 Q3	2013 Q4	01/14	02/14	03/14
Net lending (+) / borrowing (–) capacity	**–10.6**	**–7.1**	**–3.0**	**–4.5**	**–7.1**	**–**	**...**	**–**
Central government [1]	–8.1	–4.9	–3.5	–4.0	–4.9	–0.6	–1.2	–0.9
Autonomous regions	–1.9	–1.5	–0.8	–1.0	–1.5	–0.1	–0.2	...
Local government	0.2	0.4	0.2	0.5	0.4	–	...	–
Social Security	–1.0	–1.2	0.8	–0.3	–1.2	0.2	0.2	...
Public debt *(% GDP)*	**86.0**	**93.9**	**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	02/14	Balance 02/14 [1]
Financing of non-financial sectors [2]									
Private sector	–4.0	–7.8	–7.5	–8.2	–8.1	–7.4	–6.1	–6.1	1,833.7
Non-financial firms	–4.1	–9.8	–9.7	–10.5	–10.2	–8.7	–6.4	–6.5	1,055.9
Households [3]	–3.8	–4.9	–4.4	–4.8	–5.0	–5.5	–5.7	–5.5	777.8
General government [4]	14.9	17.0	18.8	18.5	17.5	13.1	10.8	8.0	987.9
TOTAL	**0.6**	**–0.9**	**–0.6**	**–0.9**	**–0.9**	**–1.4**	**–0.9**	**–1.6**	**2,821.6**
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	–0.3	1,168.7
On demand deposits	0.2	4.2	0.9	3.2	4.6	8.1	11.0	5.9	279.2
Savings deposits	–2.8	–0.1	–0.6	–1.1	–0.2	1.4	3.4	3.9	203.5
Term deposits	–6.7	1.7	–0.9	1.6	5.7	0.2	–3.0	–3.8	666.5
Deposits in foreign currency	–4.0	16.8	20.5	22.7	24.1	–0.1	3.5	–2.0	19.5
Rest of liabilities [5]	–13.2	–16.8	–20.2	–19.2	–15.3	–12.7	–11.4	–8.4	132.2
TOTAL	**–5.7**	**–0.2**	**–2.8**	**–0.9**	**2.3**	**0.5**	**–0.1**	**–1.2**	**1,300.9**
NPL ratio *(%)* [6]	**10.4**	**13.6**	**10.5**	**11.6**	**12.7**	**13.6**	**13.5**	**13.4**	**–**
Coverage ratio *(%)* [6]	**73.8**	**58.0**	**70.4**	**65.8**	**63.8**	**58.0**	**58.0**	**58.1**	**–**

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.*

TOURISM, SECTOR OF THE FUTURE

China and Russia: the new emerging sources of tourism

The world's tourism industry has stoically resisted the onslaught of the crisis and will continue to perform well: for 2014, the World Tourism Organization (UNWTO) expects growth in both the number of international tourists and how much they will spend to speed up. This is certainly good news for a country like Spain, where tourism is the leading economic sector, employing close to 12% of the entire workforce, and the country ranks among the top tourist destinations in the world today. However, maintaining such leadership means understanding and adapting to the new outbound markets for international tourists. Particularly those from China and Russia which, in just a few years, have climbed to the top of the source markets for tourism and whose growth potential is unparalleled.

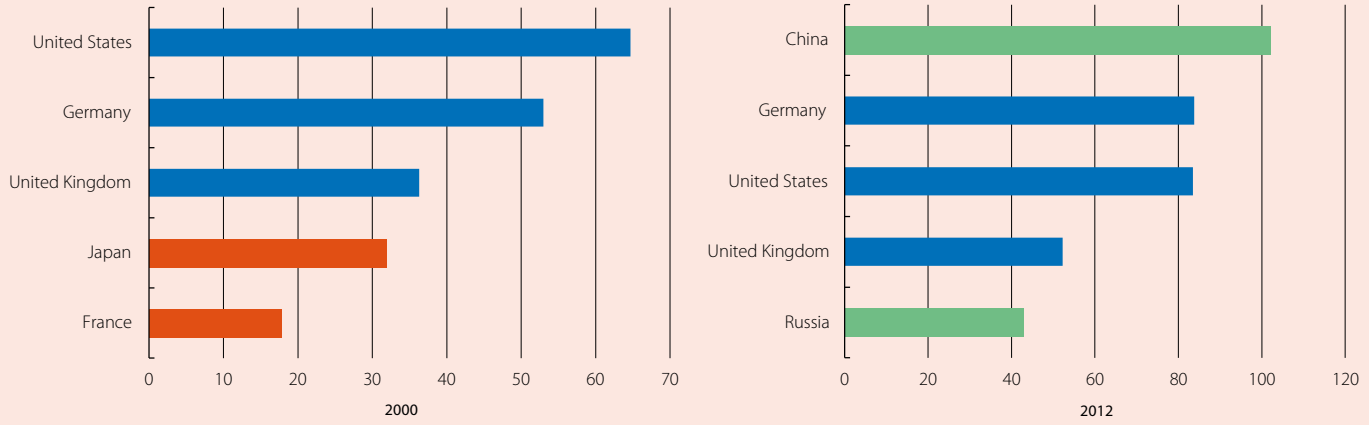
At a global level, the number of international tourists exceeded 1 billion in 2012 [1] compared with just over half a billion in the 1990s and barely 25 million in the 1950s. Within this scenario of extraordinary growth, and as has been the case in numerous economic areas, the emerging countries have been catching up with the more established advanced economies. While the total number of tourists multiplied by 1.6 between 2000 and 2013, in Russia this figure multiplied by 2.3 (going from less than 20 million to more than 40) and the number of tourists from China multiplied by 10 (from barely 10 million to almost 100). Along the same lines, in 2012 China also became the largest source market in terms of expenditure (102 billion dollars), taking over from Germany and the US, which had topped the list for years. Russia, not even in the top 15 in terms of tourism expenditure in 2000, ranked 5th in 2012 and there is no doubt that it will rise further up the ranking in 2013 given the estimated 26% growth in expenditure. Brazil has also made notable progress in terms of outbound expenditure and, although it has entered the group of top 10 source markets (in expenditure terms), it jumped from 29th to 12th in just one year (2012), quite a record. The only one of the famous «BRIC» countries that has failed to join this trend is India, where the number of international tourists among its inhabitants is limited by very low levels of income ($1,504 GDP per capita compared with $4,180 in China, $11,310 in Brazil and $14,818 in Russia).

Naturally China leads the field in terms of magnitude. Four key factors lie behind the incredible rise both in its number of international tourists and their expenditure: (i) exceptional economic growth rates over the last 30 years, 10% annually on average, substantially increasing the per capita income of the Chinese; (ii) gradual liberalisation of government policy regarding their citizens' travel, as well as simpler procedures to obtain visas for many countries; (iii) a larger number of direct flights from China to several tourist destinations; and, of course, (iv) its more than 1.3 billion inhabitants.

In this respect, China's importance as a source market is affecting and will continue to affect the centre of gravity of tourism services, moving it closer to Asia than Europe. The fact is that Chinese tourists, who typically have more classic tastes, tend to prefer destinations that are relatively close to their country of origin. It therefore comes as no surprise that, among the cities most

Top 5 source countries, in terms of expenditure

(Billion dollars)



Note: *The countries that left the Top 5 between 2000 and 2012 are marked in red; the countries that entered the Top 5 between 2000 and 2012 are marked in green.*
Source: *"la Caixa" Research, based on data from the World Tourism Organization.*

1. In 2013, according to the UNWTO's initial estimate, the total number of international tourists was 1,087 million.

visited by China's international tourists in 2013, the top three were Asian: Hong Kong, Singapore and Bangkok, while the fourth place went to London, which just six years ago had topped the ranking.[2] Nevertheless, and albeit acknowledging the present and future importance of the Asian giant as a source market, there is one point in the data on China's international tourism that should be noted: around 70% of its outbound tourism is to the Special Administrative Regions of Hong Kong and Macau. Although these destinations are considered to be international from a statistical point of view, Chinese citizens see them very much as national. Out of the remaining international journeys, 90% are to neighbouring countries such as Japan, Thailand, Vietnam, South Korea, Taiwan and Singapore, while Europe barely manages to attract three million Chinese travellers (3% of the total) and Spain fails to reach 200,000, a very small number in spite of the sharp increase in recent years.

On the other hand, Europe has indeed benefitted from the rise in tourism of Russian origin. While the majority of Russian tourists prefer to visit bordering countries (Finland, Kazakhstan and the currently troubled Ukraine), other destinations such as France and Spain tend to attract the country's wealthier classes. In several European tourist destinations such as Italy, the Netherlands and Greece, the rise in the number of Russian tourists during the crisis has helped to offset the slump in the number of visitors from other, more established markets.

Lastly, although the emerging countries lie behind the sharp rise in global tourism expenditure, we must not forget that the more traditional source countries (i.e. the advanced economies) also grew and still account for the largest proportion of international tourism expenditure. This point should not be ignored when designing tourism policy. In 2012, eight out of the ten top source countries in terms of tourism expenditure were advanced economies, accounting for 35% of the source market compared with 13.5% for China and Russia.

Nonetheless, it is true that China and Russia will continue to advance apace and will impact future growth in the number of international tourists at a global level. Based on a recent study by McKinsey on the trend in China's upper middle class, we can tentatively estimate that, in one decade, the close to 100 million Chinese international tourists of 2013 will have become 380 million.[3] The individuals from this group, whose basic necessities will be amply covered, will be able to afford foreign holidays and will bring about the expected rise in Chinese tourism, accounting for two thirds of the increase the UNWTO expects over the next ten years in the total number of international tourists. Should these projections come about, in ten years' time 25% of all international tourists will be of Chinese origin.

Given this clear «Asianisation» of tourism, it not only seems vital to increase the frequency of direct flights, simplify the still complex visa application procedures (particularly in some European countries such as Spain) and redesign the welcome tourists receive to include certain services in line with Chinese customs, but also to get to know what our new Chinese visitors are really like. The difficulty in this lies in the fact that the Chinese tourist of tomorrow is likely to be very different from the Chinese tourist of today. At present, most foreign trips beyond Hong Kong or Macau are still carried out via package group holidays and the formula most in demand for Europe is still the «10 countries in 12 days» type, including shopping, an essential activity for this tourist segment. However, in addition to this type of holiday, which will no doubt continue to have its enthusiasts, other kinds of products will become essential to attract the attention of the up and coming new generation of tourists, Generation 2 (G2) tourists to use McKinsey's terminology. As well as being born after 1985, G2 tourists will have also grown up in an environment of relative abundance, will have had a big influence on decisions about their families' purchases (as a significant number are the only child) and will be totally connected to new technologies. This new generation of potential consumers and travellers is therefore likely to prefer visiting fewer countries in a single trip, selecting more personalised products and getting a lot of information about possible destinations through digital media and social networks.

In short, in the last few years the rise in Chinese and Russian travellers has been key to the growth in the overall number of international tourists. Far from slowing down, this phenomenon looks likely to go on growing and it will therefore be crucial to gain insight into these «new tourists» and tailor to their needs to continue to attract them. But neither must we lose sight of the rest of the outbound markets, those which appear to be well-established in Spain, as they will continue to make up the vast majority of our tourists and we must therefore cosset them so as not to lose them to an international sector that will strive to adapt to the new times and the «new tourists».

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2. According to Euromonitor.
3. McKinsey (2013), «Mapping China's middle class». This study estimates that, within a decade, the households belonging to the upper middle class will go from the current figure of 36 million to 193 million.

Recipes for success in the tourism industry: different ways to reach the same destination

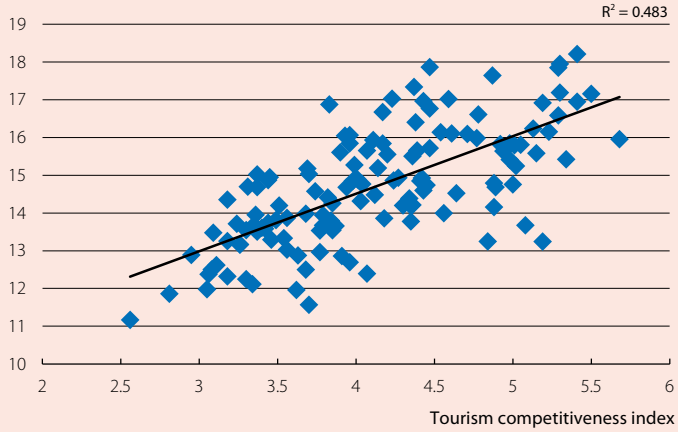
In the long term, the tourism industry is destined to be an important source of economic growth and job creation. Few sectors can expect growth in excess of 60% in just over a decade: the number of international tourists is predicted to rise from 1.09 billion in 2013 to 1.8 billion in 2030.[1] And it cannot be argued that this growth is due to the sector's small size since domestic and international tourism generated 9% of GDP in the OECD in 2012. Given this favourable outlook, can Europe's tourist destinations create some kind of strategy to ensure they do not let this opportunity pass by? Because we must remember that, although Europe attracted 52% of the world's international tourist arrivals in 2012, the emergence of new tourist destinations is making the competition increasingly tough. One clear indication of this is the fact that the average increase in the number of foreign tourists in the European Union between 2005 and 2012 was 1.7% annually while the rest of the world recorded a growth of 5.0%.

Strategies aimed at reinforcing the importance of tourism in an economy usually rely on three key factors: (i) attracting a larger number of tourists; (ii) increasing their average expenditure and (iii) widening the impact of the tourism industry to the rest of the country's economic activities. This being the overall approach, the emphasis placed by a country on each of these factors can vary significantly and economies with a more mature tourism industry will typically focus more on the last two aspects.

In spite of such distinctions, attracting a larger number of tourists is still a decisive factor for the future, especially given the sharp growth predicted in the total volume of tourists. Although other aspects also come into play, the industry's competitiveness is undoubtedly one of the most important in terms of attracting tourists. As can be seen in the graph, this is closely related to the number of foreign tourist arrivals.[2] In fact, those countries with the greatest improvement in competitiveness over the last few years were precisely those that increased their share of tourists the most. However, the range of actions available to a country to improve its tourism competitiveness is very wide, including areas as diverse as infrastructures, regulation, transport, promotion of cultural activities and environmental conservation. What is the right mix?

Relationship between tourism competitiveness and foreign tourist arrivals

Foreign tourist arrivals (log)



Source: *"la Caixa" Research, based on data from the World Bank and the World Economic Forum.*

Let us look at the case of New Zealand, one of the countries that have seen the most progress over the last few years in terms of tourism competitiveness. An analysis of the subcomponents in the competitiveness index shows that, in addition to a privileged natural environment, the country has also become more attractive for tourists due to appropriate regulation which has helped develop its tourism infrastructure. Although this is the first lesson to be learned, it is not the only one: the improvement in New Zealand's tourism industry is the result of a strategy established some time ago in response to a negative shock that had unexpected consequences. In the 1980s, the loss of its privileged trading terms with the United Kingdom led to a significant shift in the country's foreign policy. The need to find new trading partners led New Zealand's producers, in coordination with the public sector, to develop a framework that related product quality with one of the country's key defining features: the rich natural environment in which they were made.

But in addition to benefitting from exports of goods, this campaign also managed to place New Zealand on the international tourism map. In this way, the world's largest exporter of sheep became, gradually and in a unique natural environment, the capital of adventure sport, a type of tourism that boomed in the 1990s. Use of this tourism strategy, together with the media impact of filming the Lord of the Rings trilogy in the country, helped to keep its tourism industry healthy at the start of the 21st century. This can be seen in the sharp rise in foreign tourist arrivals between 1998 and 2004, namely 57.6%, compared with 23.3% for the world as a whole.

1. See UNWTO «Tourism Highlights», 2013.
2. We used the index elaborated by the World Economic Forum to measure a country's tourism competitiveness. This index is computed using 14 subcomponents that cover key aspects of a country's tourism competitiveness. For more information see «World Economic Forum: The travel and tourism competitiveness index 2013».

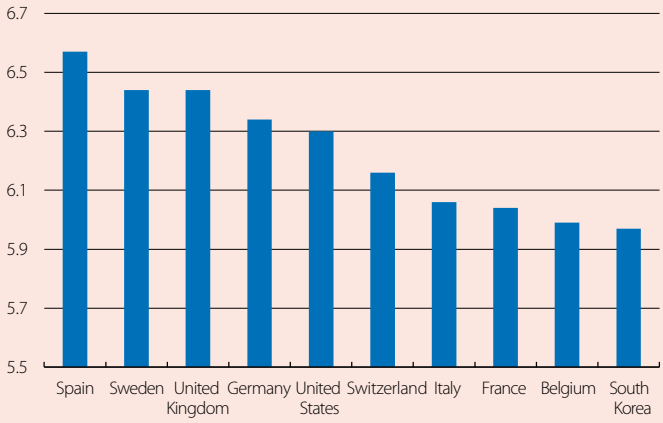
Today, tourism generates close to 9% of New Zealand's GDP (if we also include its indirect impact on the economy), a figure that denotes the maturity achieved by the industry. Nevertheless, the country has made a huge effort, in a very wide range of areas, to keep its tourism dynamic. The measures adopted to preserve its natural heritage are particularly of note. A case in point is the creation of a quality credential (Qualmark) to recognise those tourism firms that respect the environment. Secondly, the public and private sector have continued to support the formula of sports tourism in the heart of nature, creating a network of cycling routes that cover a large part of the country. But they haven not forgotten to promote new forms of tourism, encouraging activities that immerse visitors in Maori culture, helping to extend the industry's effects to new regions. Lastly, measures have also been adopted to help foreign tourists enter the country, such as making visa applications easier and reducing delays at airports while documentation is being checked.

The case of New Zealand, therefore, shows the importance of choosing a model of tourism business that exploits a region's competitive advantages, tailoring them to the preferences of long-term demand. Is there any market segment in Europe that could potentially combine both dimensions, namely competitiveness and the demand expected? One firm candidate is cultural tourism. This takes advantage of a region's tangible and intangible cultural assets (which might be highly disparate in nature, such as architecture, gastronomy, dance, crafts, music and sports events or historical monuments) to differentiate it from other tourist destinations. And Europe is proving to be quite skilful in exploiting its relative competitive advantages in this area. The great cultural attraction of European countries is often acknowledged (heading the list of countries with the most cultural resources). But, as can be seen in the second graph, European countries also top the ranking for tourism competitiveness in the cultural segment. Nevertheless, there is still a lot to be done in terms of competitiveness: although Europe is already in good shape in cultural terms, New Zealand's lesson regarding the importance of improving the regulatory situation should not be ignored.

The second of the elements mentioned, namely long-term demand, is also promising. The trend in tourism demand, with increasingly older tourists with a greater knowledge of culture, indicates a growing preference towards this kind of tourism. One clear example of how healthy cultural tourism is can be seen in the number of annual visitors to the world's three leading museums (the Louvre in Paris, the British Museum in London and the Metropolitan Museum of Art in New York). In 2013, these three museums received 22.3 million visitors, of which approximately 13 million were foreigners, a figure that exceeds the number of tourists visiting the Netherlands or Switzerland.

Main countries with the greatest competitiveness in the cultural area in 2013

(Index)



Source: *"la Caixa" Research, based on data from the World Economic Forum.*

Such figures remind us that the cultural segment particularly fulfills the aim of the first of the aforementioned factors within strategies to promote tourism, namely increasing the number of tourists. But it also proves to be a powerful tool insofar as cultural tourists tend to have a significantly higher expenditure than those in other activities, as well as having the potential to spread to other economic areas. This can be seen in the sector's propensity to create hybrids with other segments, thereby extending the benefits from tourism to new geographical areas that had previously not been able to take advantage of the sector. To mention just one example, this is the case of the combination of tourism-gastronomy-viticulture, of growing importance in significant tourist destinations such as France, Spain, Italy and Portugal. And perhaps this might be Europe's recipe to take advantage of the future growth in tourism: creatively combining innovation and tradition.

Joan Daniel Pina and Àlex Ruiz
European Unit and International Unit, Research Department, "la Caixa"

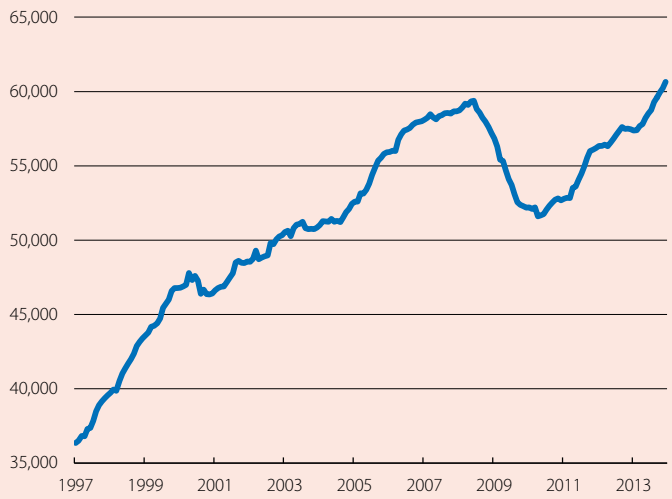
The anatomy of Spain's tourism

It's no news that tourism is one of the pillars of the Spanish economy, in addition to being one of the driving forces behind its incipient recovery. Its share of GDP accounted for 10.9% in 2012, a year which saw a turning point after the continual slide in international tourist arrivals due to the 2008 crisis, while employment directly or indirectly related to tourism also enjoyed an 11.9% share of the total in 2012. Moreover, Spain is a key player on the international tourism stage. According to the latest report by the World Tourism Organization, in 2012 it ranked third in terms of international tourist arrivals (behind France and the United States and equal with China) and second in terms of revenue (behind the United States). Considering the industry's undeniable importance and future, this article aims to analyse the recent growth in international tourists and investigate whether these new visitors are different and better for the country in economic terms.

In the last few decades, the number of international tourist arrivals has risen almost non-stop. Only during the years of the great crisis, namely 2008 to 2010, there was a significant drop in visits. Since then, the pace of growth has picked up and almost returned to its levels prior to the recession: specifically, between 2011 and 2013, international tourist arrivals grew at an annual rate of 4.0% on average, a figure very close to the 4.3% recorded between 2005 and 2007.

International tourist arrivals

Cumulative over 12 months (thousands)



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

However, although these may appear to be similar patterns of behaviour at first sight, a slight change can be observed regarding the origin and habits of these new foreign visitors. The tourists visiting Spain today are still mostly European and the United Kingdom, Germany and neighbouring countries of France and Italy are still the countries providing the most tourists, slightly above 50% of the total. However, non-European tourists are gradually gaining ground and now account for a notable 9% of the total number of visitors, 3 p.p. more than in 2007. Particularly worthy of mention is the role played by Russian tourists. In spite of representing only 2% of all visitors, their increase between 2011 and 2013 was substantial, accounting for an appreciable 16.0% of the overall rise in tourist arrivals in this period. In other words, out of every 100 additional international tourists who visited Spain between 2011 and 2013, 16 were Russian. Given this nationality's prevalence among the new tourists, we can understand the concerns being expressed about the Ukraine's political conflict getting worse and Russia suffering sanctions at the hands of the international community.

Just as the number of tourists is rising, so is their average daily expenditure. While this was 91 euros on average between 2005 and 2007, in the period between 2011 and 2013 it rose to 106 euros. This is partly due to the larger share of non-European tourists, whose expenditure has grown more than that of the Old Continent over the same period. Another sign of the greater purchasing power of these new tourists is the increase in the proportion of visitors staying at hotels, who typically spend more. Specifically this has gone from 63% of the total on average between 2005 and 2007 to 65% currently. We should also note the good performance by cultural tourism, going from a share of 51.3% in 2010 to 53.9% in 2012. As argued in the article in this Dossier entitled «Recipes for success in the tourism industry: different ways to reach the same destination», this tourism category tends to be more profitable and has high growth potential.

Lastly, we should also examine the trend in domestic tourism. For obvious reasons, Spaniards' expenditure on tourism also shrank due to the economic recession. The number of journeys made both within and outside Spain between 2011 and 2013 was 3.6% lower than in the period 2005-2007 but the slump in domestic travel was substantially greater, namely 4.8%. Households with fewer resources were particularly hard hit, precisely those who tended to go on holiday to destinations within Spain. It is revealing

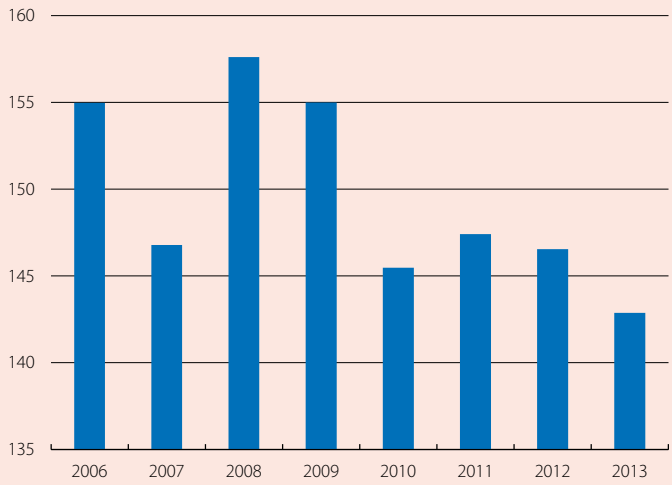
that the kind of accommodation gaining most share during this period was the family's own residence and that of relatives, compared with a reduction in rented accommodation and stays at camping and caravan sites.

However, in the last few months domestic tourism has started to look like it is picking up: in 2013 Q4 there was already a 5.5% annual increase for national trips, an upward trend that has continued in 2014 Q1 with a rise of 2.9%. Seeing as Easter fell in April this year, this figure is especially encouraging.

Endorsing this upward trend, the latest projections by the World Tourism Organization suggest that, between 2010 and 2020, international tourist arrivals to the Mediterranean countries will grow at a rate of 2.6% annually. Consequently, if Spain manages to keep hold of its market share among the region's countries, in 2020 it could receive 72 million international tourists, 12 million more than in 2013. Moreover, as we have seen, these new tourists, with their greater purchasing power and more sophisticated tastes, should be more beneficial for the country from an economic point of view. The industry's future is promising and, given the current state of the economy as a whole, such an opportunity should not be wasted.

Domestic tourism

Number of domestic trips (million)



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

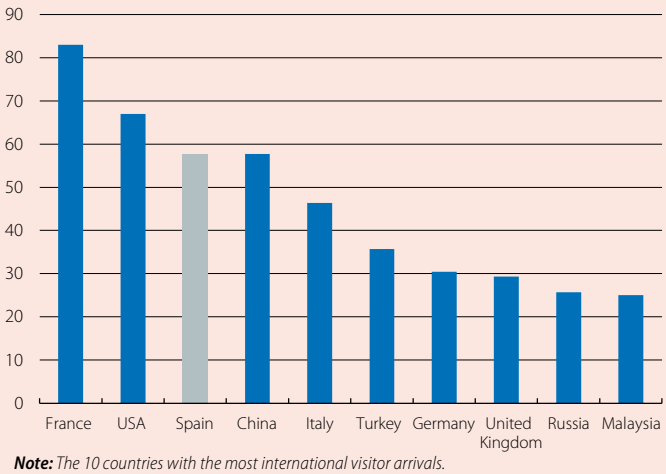
European Unit,
Research Department, "la Caixa"

The economic impact of the tourism industry in Spain

In 2012, Spain consolidated its third position in the world tourism ranking in terms of foreign visitors, and its second in terms of revenue. Tourism therefore appears to be considerably important for the economy as a whole, as further confirmed by a more thorough analysis of data on the sector. Nevertheless this is a highly seasonal industry, resulting in the extensive underutilisation of the resources available throughout the year. Let us look at the details.

Ranking by international tourist arrivals

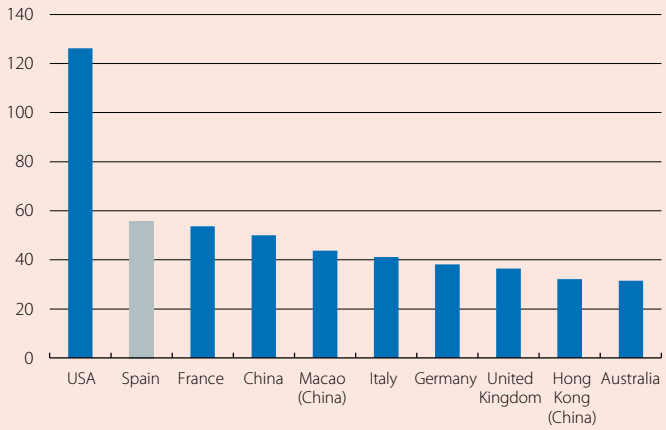
(Millions)



Note: *The 10 countries with the most international visitor arrivals.*
Source: *"la Caixa" Research, based on data from the World Tourism Organization (UNWTO).*

Ranking by tourism revenue

(Billions)



Note: *The 10 countries with the highest tourism revenue.*
Source: *"la Caixa" Research, based on data from the World Tourism Organization (UNWTO).*

In order to assess the overall role played by tourism in Spain's economic activity and employment we need to take into account both the direct or immediate effects and also the indirect or knock-on effects. The former are generated in the production units or companies that supply the goods and services acquired directly by tourists while the latter include the chain effects occurring in the rest of the economic system when the tourism industry demands production inputs and factors to be able to carry out its business. This capacity of an industry, in this case tourism, to lead to the development of other economic sectors by using the intermediate inputs produced by these sectors is called «total backward linkage» or the «diffusion effect». According to INE's symmetrical input-output table (2005), the total backward linkage index for the tourism sector is 1.68, a notable figure.[1] Consequently, if the tourism industry expanded by one unit, the final increase in production for the economy as a whole would be 1.68 units (the indirect effect would be 0.68). More specifically, according to this methodology the tourism industry's direct contribution to GDP was 6.5% in 2012 and, thanks to its knock-on effect, its total contribution reached 10.9%.

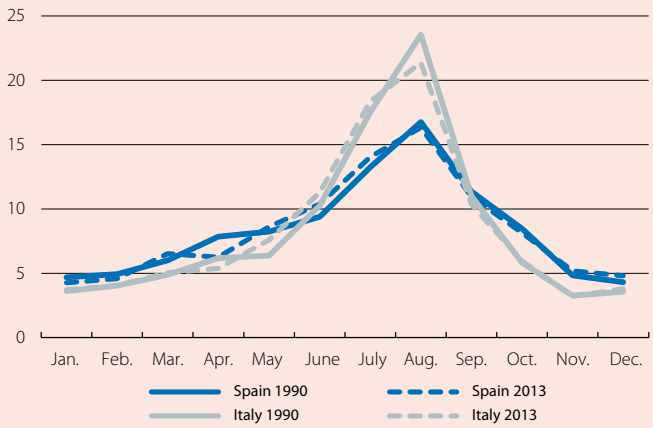
On the other hand, the trend in tourism business also has significant impact on the labour market as the industry is labour-intensive. According to data provided by the INE's Tourism Satellite Account, in 2012 employment in tourism exceeded 2.1 million people, accounting for 11.9% of all employment. Once again, not all employment was generated directly in the tourism industry per se; a proportion was created indirectly in other sectors. For example, according to the input-output table, if GDP in tourism increased by 1%, it would generate around 2,200 new jobs in the commercial sector and around 10.400 new jobs in the hotel and catering sector and would also create employment in other sectors less directly related to tourism (800 in agriculture and 680 in construction). As a benchmark, it should be noted that, historically, a 1% increase in tourism's GDP is usually related to an increase of approximately 3% in overnight stays, which in 2013 rose by 2%.

Tourism therefore has a huge effect on economic activity and employment. However, Spain's large share of «sun, sea and sand» tourism means that the industry is markedly seasonal throughout the year, in turn resulting in the considerable underutilisation of tourism infrastructures. Nonetheless, other countries that offer a similar type of tourism, such as Italy, are even more seasonal, as can be seen in the corresponding graph. The data also show that, in spite of a considerable rise in the total number of tourists

1. For the calculation, tourism is divided into different sectors following the structure of tourism demand provided by Spain's Tourism Satellite Account (see the Tourism Balance for 2012 by the Institute of Tourism Studies), adapting it to the structure of the sectors in the input-output table.

The seasonal nature of tourism

Breakdown of the total number of overnight stays in tourism establishments (%)



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

Breakdown of the number of workers affiliated to Social Security (%)

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

over the last few decades, this pattern has remained very stable. The seasonal nature of tourist service production also extends to the labour market, with employment being more concentrated in the summer months.

There can therefore be no doubt that Spain's tourism industry is still highly seasonal and it comes as no surprise that one of the seven priority objectives set by the Secretariat for Tourism in the country's Comprehensive National Tourism Plan (2012-2015) was to develop specific measures to reduce this feature.[2] With the aim of deseasonalising the flow of tourists as much as possible to avoid both the levels of congestion in the high season (June to September) and also the under-utilisation of resources (facilities and people) in the low season, among other initiatives, the Secretariat asked AENA to introduce a flexible tariff system based on the number of passengers and the capacity of each airport. As commented in the article in this Dossier entitled «Recipes for success in the tourism industry: different ways to reach the same destination», it would also be advantageous to boost the supply of tourism aimed at segments that are less seasonal, more profitable and have a high growth potential, characteristics all enjoyed by cultural tourism, for example.

In conclusion, the tourism industry is one of the Spanish economy's key sectors, both due to its direct impact and also to the considerable knock-on effect it has on the rest of the sectors. Moreover, given the good projections for global growth in tourism (as discussed in the article mentioned previously), it will probably become even more important in the coming years. We should take advantage of this to reduce the industry's extremely seasonal bias and thereby make better use of the infrastructures available.

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2. See «OECD Tourism Trends and Policies 2014».

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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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Design and production: www.cege.es
Legal Deposit: B. 21063-1980 ISSN: 1134-1920

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