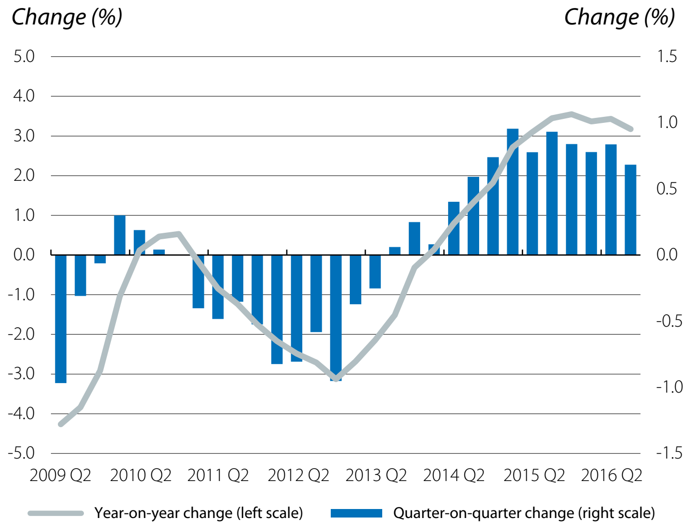
ECONOMIC OUTLOOK · **Economic growth is gradually maturing**

The Spanish economy continues its very positive trend. GDP growth stood at 0.7% quarter-on-quarter in Q3 (0.8% in Q2), a much higher figure than the average for the euro area countries. With its publication of this figure, the INE also revised the historical series of quarter-on-quarter GDP. The latest figures show that growth was slightly stronger in the preceding quarters, leading us to revise our GDP growth forecast for the year as a whole to 3.2%. Without the component breakdown, leading indicators point to this high rate of growth being driven by domestic demand. The consumer confidence index stood at –6.1 points in the average for Q3, a figure that is slightly lower than the average in Q2 (–3.2) but much better than the historical average (–13.6). Retail sales also rose by 3.8% in Q3 (the same figure as in Q2), so private consumption is likely to continue as the main engine for growth. With a view to the coming quarters, we expect the growth rate for economic activity to slow down and the economy to enter a more mature phase of the cycle in which foreign demand is expected to gradually take over. The positive effects of structural adjustments, such as the improvements in competitiveness, the rebalancing of the real estate sector and a healthier banking industry will support this growth in activity as the tailwinds that have boosted Spain's economic growth over the last two years steadily run out of steam.

Job creation remains dynamic. The country's good economic performance is reflected in the rate of job creation, which has grown non-stop for the last two years. This good situation consolidated in Q3, as shown by the rise in the number of workers affiliated to Social Security and confirmed by the labour force survey. Specifically, employment increased by 2.7% in year-on-year terms (2.4% in Q2), reducing the unemployment rate significantly to 18.9%, 1.1 pps lower than the previous quarter. As a consequence of this dynamism, we have revised upwards our job creation forecasts to 2.8% in 2016 and 2.1% in 2017 (from 2.7% and 2.0% previously, respectively). The positive trend in the labour market will continue to boost private consumption and prices. However, and in spite of the number of jobs created over the last few years, the quality of employment in Spain is a source of concern. As described in the Focus «Job quality: Spain within the international context» in this *Monthly Report*, the statistics suggest that job quality in Spain is among the lowest of all OECD countries.

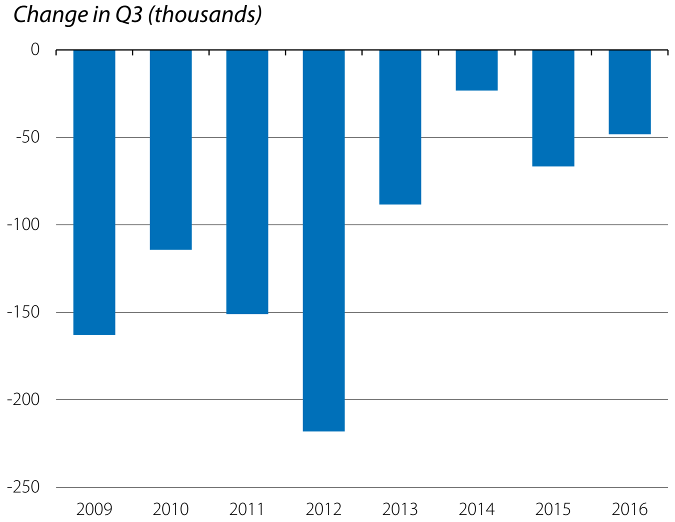
Inflation picks up, in line with expectations. The CPI, boosted by dynamic private consumption, grew by 0.7% year-on-year in October, confirming the start of the upward trend expected for the coming months as the base effect of the slump in oil prices at the end of 2015 and beginning of 2016 disappears. In fact, the price of oil is still low and, although we expect it

GDP



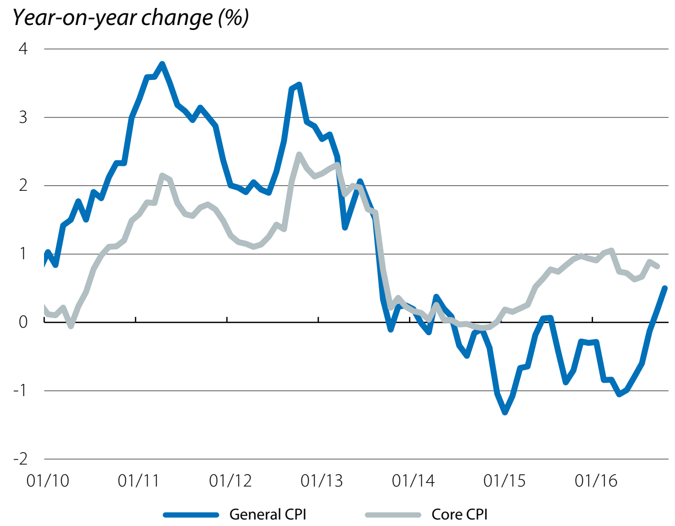
Source: *CaixaBank Research, based on INE data.*

Registered workers affiliated to Social Security



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

CPI



Source: *CaixaBank Research, based on INE data.*

to recover gradually, it will continue to benefit the Spanish economy and particularly the trade balance.

The foreign sector is still a source of good news. In August the balance of trade of goods increased to approximately –11 billion euros in the cumulative figure for the year (an improvement of 5 billion euros compared with 2015). This was due to a larger decline in imports (3.5% year-on-year cumulative over three months) than in exports (–0.4%). This sharp drop in imports can be explained by the lower value of the energy goods imported, thanks to low oil prices. Exports, which in the short term are still being buoyed by the euro's depreciation, will remain dynamic over the coming years thanks to the improvements in competitiveness achieved in the last few years, to the considerable internationalisation efforts made by Spanish companies and the diversification of destinations for exports beyond the euro area. In spite of this good underlying trend, however, there are still some sources of global uncertainty such as Brexit, the slowdown in world trade and the shift of global trade policy towards greater protectionism.

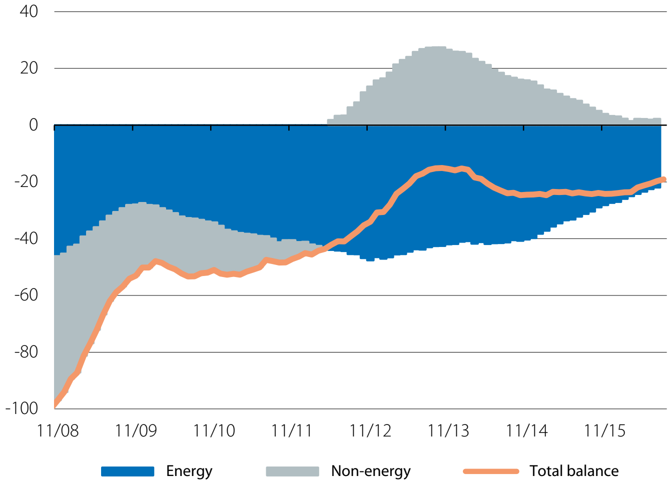
Tourism continues to break records. 60 million international tourists came to Spain between January and September, 10.1% more than in the same period of 2015, while the summer season of 2016 has been historic. As detailed in the Focus «Tourism, an exceptional year?» in this *Monthly Report*, the sector's high competitiveness, the support provided by the euro's depreciation and the geopolitical disturbances occurring in some of the main rival destinations are the major factors behind this good performance by Spanish tourism.

The real estate sector, which has been posting a positive trend for several months now, remains dynamic thanks to a constantly rising housing demand as a consequence of the recovery in employment and household income, better credit conditions and the upswing in demand for housing by foreigners. Specifically, house sales rose by 14.3% in August (cumulative over 12 months). This strong growth in demand is very heterogeneous between provinces, as explained in the Focus «Demand for housing: uneven growth» in this Report. On the supply side, new building permits totalled 60,351 in July (cumulative over 12 months), the equivalent to one tenth of the permits registered in 2007. This unevenness in demand for housing, combined with a limited supply and lack of housing for sale in certain prime zones (for instance large cities), will result in a highly disparate increase in house prices between provinces. For the country as a whole we expect house prices to grow by 2.7% in 2016. The dynamism observed in the real estate sector is having a positive effect on the banking sector.

Spain's banks appear very stable. This is the main conclusion reached by the sixth assessment carried out by the European Commission after the end of the bank bail-out programme. This stability is supported by low financing costs, economic growth and the sector restructuring being

Trade balance

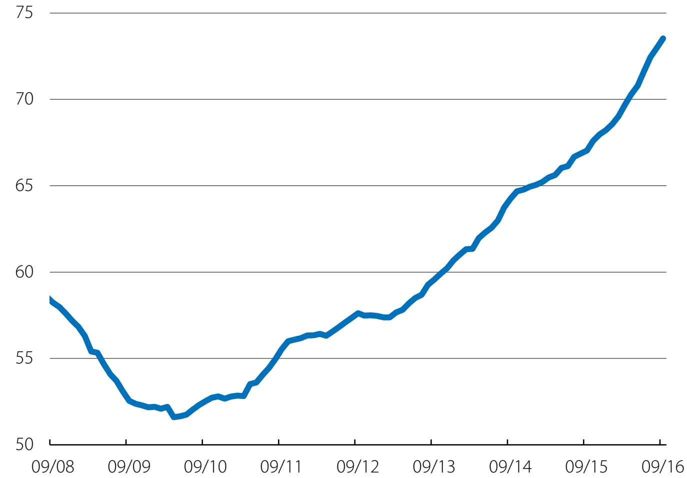
Cumulative over 12 months (billion euros)



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

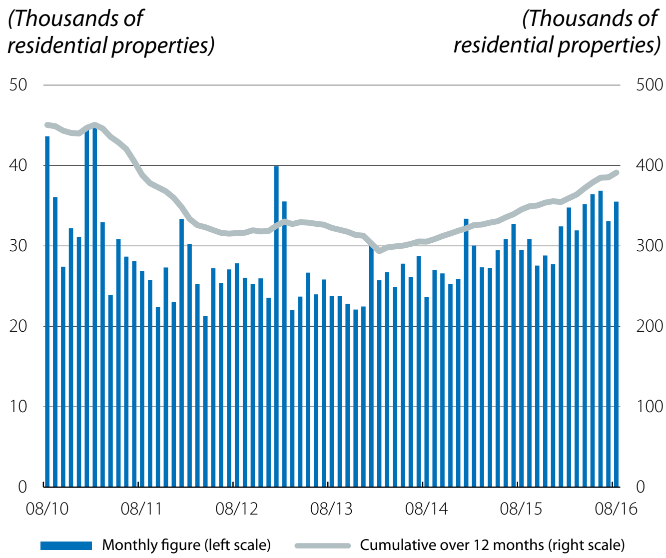
International tourists

Cumulative over 12 months (million)



Source: *CaixaBank Research, based on INE data.*

House sales



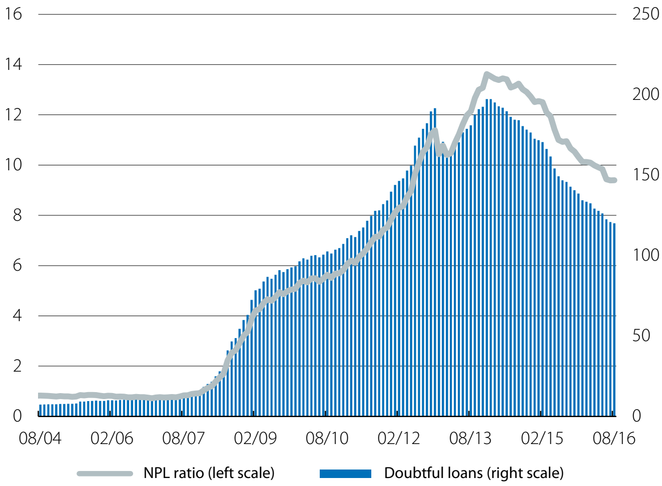
Source: *CaixaBank Research, based on INE data.*

carried out. Regarding this last aspect, however, the European Commission stresses the need to complete the restructuring and carry out the privatisation still pending. The most recent figures for the sector endorse this positive view: in August the volume of doubtful loans fell slightly (–790 million euros) to 120 billion euros, accumulating a decline of 39% since the peak reached in January 2014. At the same time the NPL ratio held steady at 9.4% in August, equalling July's figure. Nonetheless we expect the improvement in the economy, low interest rates and the sale of portfolios of non-performing loans will continue to help push down banks' NPL rates.

The adjustment of public accounts is still pending. In August the budget deficit for public administrations as a whole, excluding local government corporations and losses due to bail-outs, stood at 3.3% of GDP, 0.1 pps below the figure for August 2015. By administration, the central government budget deficit rose to 2.6% of GDP in September, 0.3 pps higher than one year ago. This worse figure is largely due to the transfer of resources to regional governments in August, corresponding to the settlement of the 2014 financing system. Thanks mostly to this transfer of resources, the autonomous communities have improved on their figure for August 2015 by 0.7 pps, posting a deficit of 0.1% in July. Nevertheless the structural problems in Social Security are worsening the deficit, which increased to 0.6% of GDP in August (0.3 pps higher than the figure for the same period in 2015). Consequently, the budget execution figures available to date reflect an insufficient adjustment in the public accounts although the corporate tax reform approved recently by the government should correct this trend in the latter part of the year and help to achieve the budget deficit target of 4.6% agreed with the European Commission. However, the level of public debt, in excess of 100% of GDP, shows that the process of fiscal consolidation must continue.

The central government budget for 2017 does not contain any adjustment measures. The budget proposed, which is an extension of the 2016 budget, is based on reasonable macroeconomic forecasts (2.3% GDP growth and 2.2% growth in employment). According to this budget, the economy's good performance will help to reduce the budget deficit by 0.8 pps, bringing it to 3.6% of GDP in 2017. Consequently, to achieve the target agreed with the European Commission (3.1%), the new government will have to propose an updated budget including some adjustment measures, as the European Commission has demanded.

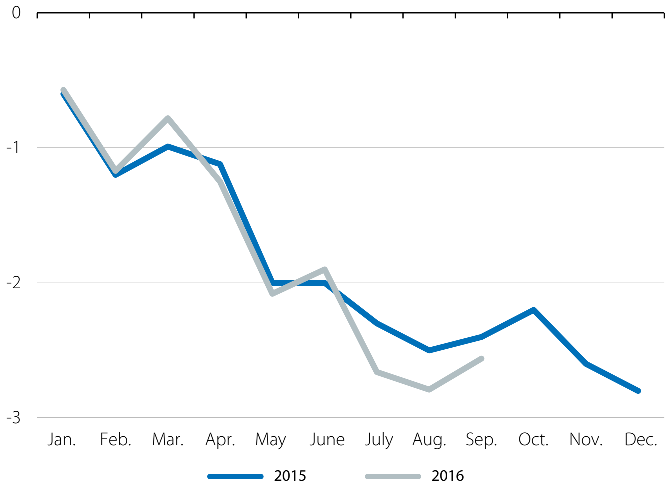
Doubtful loans



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

Central government budget balance

Cumulative for the year (% of GDP)



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

Economic forecasts of the Central Government Budget 2017

Annual change (%)

	2015	Government October 2016		CaixaBank October 2016	
		2016 Forecast	2017 Forecast	2016 Forecast	2017 Forecast
Real GDP	3.2	2.9	2.3	3.2	2.4
Nominal GDP	1.6	2.0	3.2	3.6	3.7
Employment (FTE)	3.0	2.7	2.2	2.8	2.1
Unemployment rate (%)	22.1	19.7	17.8	19.7	18.2
Interest rate (public debt at 10 years)	1.8	1.7	1.9	1.4	1.7

Source: *CaixaBank Research, based on the Central Government Budget 2017.*