ECONOMIC OUTLOOK · The Spanish economy continues to advance at a good pace

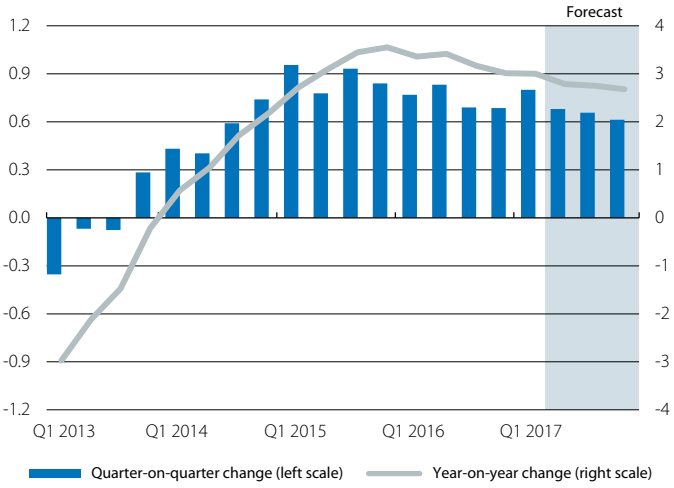
Economic growth accelerated to 0.8% quarter-on-quarter in Q1 2017, 0.1 pp faster than the previous two quarters. In year-on-year terms, growth remained strong at 3.0% and with no signs of slowing down. Pending details by component, available indicators point to private consumption still driving growth, albeit easing slightly. Capital goods investment seems to be picking up, supported by even better business investment sentiment. External demand has also recovered thanks to good export performance and a more subdued increase in imports.

Prospects improve across the board for 2017. Given the Spanish economy's good performance in the first three months of the year, the main national and international institutions have revised up their GDP growth forecasts for 2017. It was the International Monetary Fund's turn in April, raising its forecast to 2.6% (0.3 pp higher than January). The Spanish government also followed suit, presenting the Updated Stability Programme (APE) 2017-2020 with a new macroeconomic scenario predicting 2.7% GDP growth (0.2 pp more than in March). The CaixaBank Research forecast is slightly higher, 2.8%. Nevertheless, the economy might even outperform this figure provided it is not hit by any external shocks. This exceptional performance by Spain's economy, with three years of sustained growth, is thanks to the combination of temporary support factors such as low oil prices and the ECB's expansionary monetary policy, and the positive effect of the structural reforms carried out in recent years. Given these better forecasts, Standard & Poor's has improved its outlook for Spain's sovereign debt from stable to positive, clearing the way for a rating upgrade in the next few months.

The positive outlook boosts public finances. As in the last two years, this solid economic growth will help to reduce the public deficit, mainly by improving taxable bases (increasing public revenues) and decreasing unemployment (lowering spending on unemployment benefit). The low interest rates resulting from the ECB's accommodative monetary policy will also help to contain interest payments even though public debt is close to 100% of GDP. According to the fiscal strategy in the APE for 2017-2020, the budget deficit will continue to fall over the next few years, gradually bringing down public debt. The government expects the deficit to end this year at 3.1% of GDP and to fall below 3% in 2018, helping to end the excessive deficit procedure (EDP) with the European Commission. The current figures for state expenditure up to March show an adjustment of 0.4% of GDP compared with the previous year, supported by revenue and contained current expenditure. See the Focus «Correcting

GDP

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



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

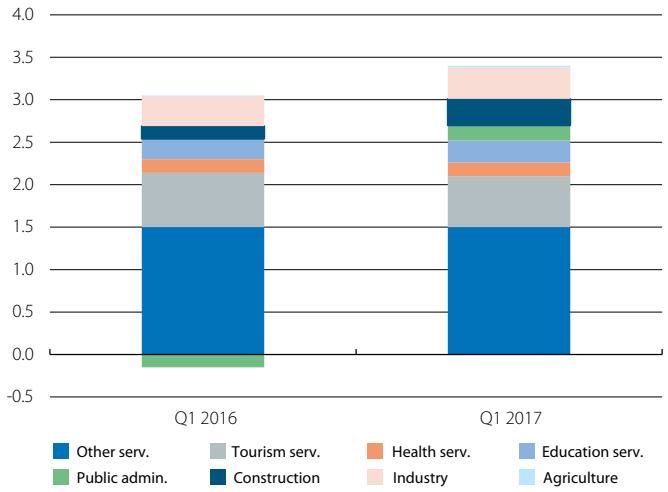
Macroeconomic scenario contained in the Stability Programme (APE) 2017-2020

	2016	2017 APE	2017 CaixaBank Research forecast
GDP (year-on-year change, %)	3.2	2.7	2.8
Employment (year-on-year change, %) *	2.9	2.5	2.4
Unemployment rate (%)	19.6	17.5	17.7
Budget deficit (% of GDP) **	4.3	3.1	3.4
Public debt (% of GDP)	99.4	98.8	98.6

Notes: ** Employed full-time equivalent.*
*** Not including bank restructuring costs.*
Source: *CaixaBank Research, based on data from the Stability Programme 2017-2020.*

Registered workers affiliated to Social Security

Contribution to year-on-year growth by sector (pp)



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

the budget deficit; mission possible» in this *Monthly Report* for more details.

The labour market benefits from growth in activity. Like economic growth, job creation also accelerated slightly in Q1 in seasonally adjusted terms, according to the EPA data. This was 0.7% quarter-on-quarter (0.5% in Q4 2016), suggesting the trend is still positive in the labour market. In year-on-year terms, growth in employment maintained its 2.3% year-on-year rate of increase. Given the seasonal nature of Spain's labour market, the number of employees fell by 69,800 in Q1 2017, similar to the number recorded in Q1 2016, a very good figure if we remember that Easter fell entirely in April this year (and March in 2016). The fact that job creation was largely in the private sector is another sign of the labour market's strength, while public sector employment continues to decline.

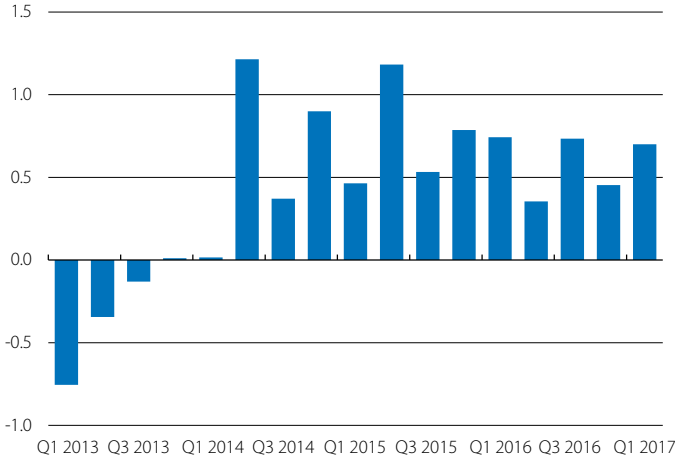
Unemployment, a problem yet to be solved. In spite of these good job creation figures, unemployment is still very high. As is customary in Q1 due to seasonal reasons, the unemployment rate rose slightly to 18.8% (0.2 pp higher than in Q4 2016), while the youth unemployment rate (aged 20 to 24) stood at 38.3%. Such levels are much higher than in other euro area countries, highlighting the need for Spain to get to grips with its unemployment. Job creation is therefore still crucial for the country's recovery.

Job creation boosts household income. Rising employment has helped to push up gross disposable household income (GDHI) by 2.5% in 2016, 0.7 pp more than in 2015. This improvement is stimulating consumption, up by 3.0% in nominal terms in 2016. The household savings rate therefore fell by 0.5 pp to 7.7% in 2016. GDHI growth should continue to be supported by job creation in 2017 as wage rises are still modest. Judging by the good consumer sentiment data for Q1, consumption growth will continue solid so the savings rate is likely to remain low compared with the historical average (9.6%).

Private sector deleveraging continues. The economic recovery is also affecting deleveraging among households and non-financial firms. After falling steadily for six years, household debt stood at 64.4% of GDP in Q4 2016 while the debt of financial firms stood at 101.7% of GDP. Corporate debt has now fallen below the euro area average but household debt is falling more slowly and is still above the average for euro area households. Over the coming quarters, dynamic GDP growth should help this deleveraging to continue as well as boosting the flow of new loans to households and companies. In fact, the bank lending survey for Q1 2017 shows that banks have relaxed their criteria to grant consumer loans, although the criteria to grant company loans have been tightened up slightly. The continued reduction in the bank NPL ratio, down to 9.1% in February, indicates that banks are in an increasingly healthy position. The balance of doubtful loans has fallen by a cumulative 42% since the peak reached

Employment

Quarter-on-quarter change (%)



Note: *Data seasonally adjusted.*
Source: *CaixaBank Research, based on INE data (EPA).*

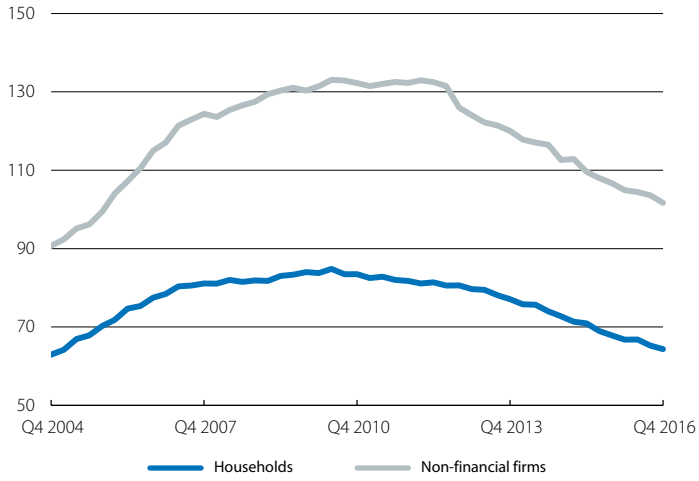
Gross disposable income

Contribution to year-on-year growth of the cumulative figure over four quarters (pp)

Notes: ** Rest of headings used to calculate the gross disposable income, such as gross operating surplus, Social Security contributions, etc. ** Year-on-year change.*
Source: *CaixaBank Research, based on INE data.*

Private sector debt

(% of GDP)



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

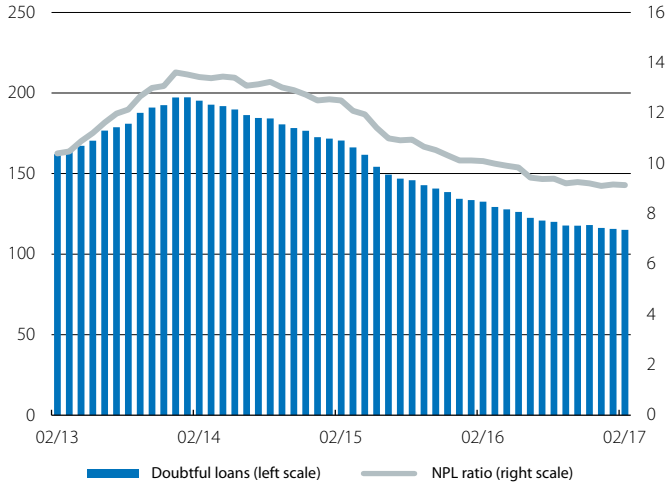
in January 2014, a trend that will also continue over the next few months.

Inflation rises to 2.6% in April (2.3% in March), a temporary upswing resulting from the increase in tourism prices due to Easter falling in April (whereas it was in March in 2016) and also to stable electricity prices compared with the drop last month. Beyond this seasonal spike in prices, headline inflation should moderate over the coming months due to the slowdown in oil prices in year-on-year terms, ending the year at around 1.3%. Average inflation will therefore be 2.2% in 2017, much higher than the negative figures of the last two years (–0.2% in 2016 and –0.5% in 2015). Core inflation remains very subdued (0.9% in March) although it should rise slightly, driven by dynamic private consumption.

The current account reflects rising oil prices. Oil prices had boosted the foreign sector substantially over the past two years but their support is now waning. Rising oil prices pushed up the cumulative energy import bill in January and February to EUR 7,609 million (compared with EUR 4,228 million in the first two months of 2016). But dynamic exports, up by 4.7% year-on-year in February and outperforming the growth in imports of 3.2% year-on-year (both cumulative over 12 months), meant that the current account surplus increased in February to 2.1% of GDP. See the Focus «Dissecting the improvement in the current account» in this *Monthly Report* for a more detailed discussion. This consolidation of the flow of Spanish firms exporting over the past four years augurs well for the export sector.

NPL ratio and doubtful loans

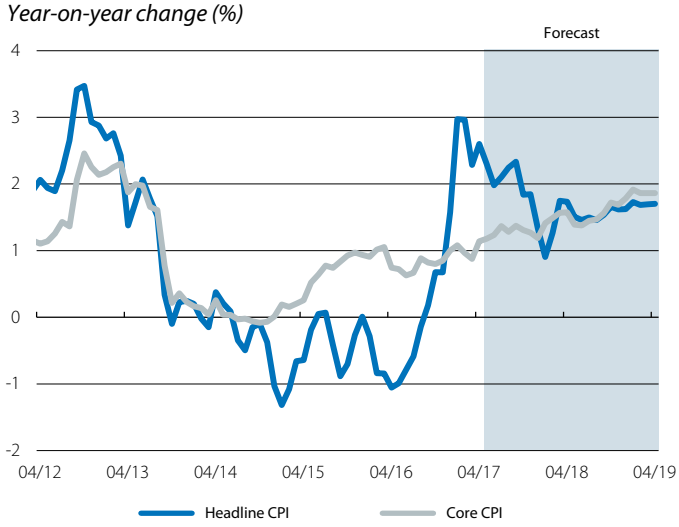
(EUR billion) *(%)*



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

CPI

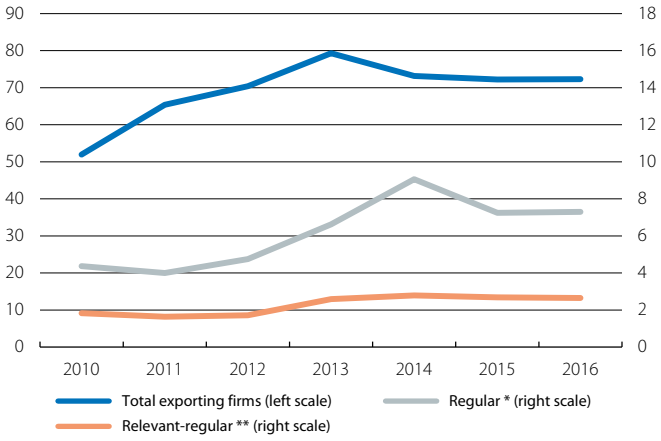
Year-on-year change (%)



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

Flows of new exporting firms

(Thousands of firms) *(Thousands of firms)*



Notes ** Regular: firms exporting in the past four years.*
*** Relevant-regular: firms exporting >EUR 50,000 in the past four years.*
Source: *CaixaBank Research, based on data from ICEX.*