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ECONOMIC & FINANCIAL ENVIRONMENT

FINANCIAL MARKETS
Crude oil prices: the puzzle of the impact of OPEC's cut

INTERNATIONAL ECONOMY
Trump-style tax reform

EUROPEAN UNION
Tracking core inflation: the pricing chain

SPANISH ECONOMY
Spain's sovereign debt rating: slowly but surely

DOSSIER: TOURISM: TRAVELLING TOWARDS THE FUTURE

Tourism: an important industry on the crest of a wave

Tourism, a new El Dorado *for the Spanish economy*

Quality of tourism supply: the challenge of keeping the leadership

Tourism 2.0: opportunities and challenges

CaixaBank Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
June 2017

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Tourism: a driving force for growth

This month the Dossier in our *Monthly Report* looks at one of the most important sectors for Spain's economy: tourism. A sector that provides more than 11% of the country's gross domestic product and 13% of its jobs, which has been one of the pillars of its economic recovery over the past few years and will continue be a driving force for growth in the medium and long term... if we look after it properly.

The latest figures posted by Spain's tourism industry highlight its dynamism. The country received 20 million international tourists in the first four months of 2017, a record figure and up 10.3% compared to the same period last year. At this rate, more than 83 million tourists will come to Spain this year, almost taking over France as the world's foremost tourist destination. The number of tourists will have increased by over 40% since 2007. And domestic tourism is also starting to show signs of picking up.

In the past few years, Spain's tourism industry has undoubtedly seen its demand increase as a consequence of security problems in North Africa and the Middle East. But the keys to its success go far beyond safety issues, as shown by the World Economic Forum ranking which places Spain's travel and tourism sector (T&T) as the most competitive in the world, ahead of France and Germany. The main reasons: a unique combination of natural and cultural environment and good transport and T&T service infrastructures. Spain has repeated its top ranking although, just a few years ago, it was not even among the first five. Someone has been working hard.

Aware of the advantages brought by differentiation, the sector has made a particular effort to increase the quality of its supply. More than 50% of Spain's hotel accommodation is currently four or five stars, its accomodation firms are more productive than their European peers and the country has more restaurants than ever on the most famous lists of top eateries. But there is still plenty of room for the sector to improve, in hotels, restaurants and also other T&T services. The larger companies in the T&T sector (and in general in any other sector) can take better advantage of economies of scale, tend to be more professional, enjoy better financing conditions, can invest more to spread their business across all seasons and offer higher quality jobs.

There are clear opportunities for the sector to grow in the long term. By its very nature, tourism is a sector of the future since the proportion of expenditure allocated by households to tourism tends to increase with their income level. Consequently, it is very likely that emerging countries will represent a growing source of tourists, as we are starting to see with China. On the other hand, the ageing population in Europe and other advanced economies is creating a very attractive demand since older people have relatively high incomes and tend to travel outside the peak tourist seasons. Finally, new technologies also offer a world of opportunities, for instance to improve client experience by providing personalised local experiences.

In fact, new technologies and their associated new types of business represent one of the biggest challenges for the sector in the short term. The sharing economy can help to improve competitiveness and complement the traditional T&T supply. But a legislative framework is urgently needed that offers legal certainty and fair rules for all T&T players, at the same time as promoting sustainable growth for the sector and promoting good coexistence between locals and tourists.

Enric Fernández
Chief Economist
31 May 2017

CHRONOLOGY

MAY 2017

7 Emmanuel Macron is elected President of France.
24 Moody's downgrades China's sovereign credit rating by one notch, from Aa3 to A1.
25 OPEC agrees to extend its oil production cuts until March 2018.

APRIL 2017

16 Turkey ratifies its proposed constitutional reform in a referendum.
19 The British parliament votes in favour of an early general election on 8 June.

MARCH 2017

1 The European Commission presents its White Paper on the future of Europe, proposing five possible scenarios for the EU-27 in 2025.
16 The Federal Reserve raises the fed funds rate by 25 bp to 0.75%-1%.
29 The UK triggers article 50 of the Lisbon Treaty to begin negotiations to leave the EU.

JANUARY 2017

23 Donald Trump signs an executive order formally withdrawing the US from the Trans-Pacific Partnership (TPP).

DECEMBER 2016

4 Italy holds a referendum, resulting in the rejection of the proposed constitutional reform. The Prime Minister, Matteo Renzi, resigns and is replaced by Paolo Gentiloni.
8 The ECB prolongs QE up to December 2017 and reduces its monthly asset purchases from 80 to 60 billion euros as from April.
14 The US Federal Reserve raises the fed funds rate by 25 bps to 0.50%-0.75%.
22 The Italian bank, Monte dei Paschi di Siena, fails in its attempt to increase its capital by 5 billion euros and the Italian government creates a 20 billion bailout fund to prop up the country's banking sector.

AGENDA

JUNE 2017

2 Registration with Social Security and registered unemployment (May).
7 Industrial production index (April).
8 Governing Council of the European Central Bank.
14 Fed Open Market Committee.
16 Quarterly labour cost survey (Q1).
19 Loans, deposits and NPL ratio (Q1 and April).
20 International trade (April).
22 European Council.
27 State budget execution (May).
29 Economic sentiment index of the euro area (June).
CPI flash estimate (June).
30 Household savings rate (Q1).
Balance of payments (Q1 and April).
Net international investment position (Q1).

JULY 2017

4 Registration with Social Security and registered unemployment (June).
7 Industrial production index (May).
14 Financial accounts (Q1).
18 Loans, deposits and NPL ratio (May).
20 Governing Council of the European Central Bank.
21 International trade (May).
26 Fed Open Market Committee.
27 Labour force survey (Q2).
28 Flash CPI (July).
GDP flash estimate (Q2).
Economic sentiment index of the euro area (July).
US GDP (Q2).
31 State budget execution (June).
Balance of payments (May).

Global activity maintains its positive momentum

World growth continues to be strong. According to the latest business activity and sentiment figures, economic activity is growing apace both in the advanced and the emerging economies. All this supports the CaixaBank Research scenario of global growth accelerating from 3.1% in 2016 to 3.5% in 2017. More importantly, these good macroeconomic figures have been accompanied by continued calm in the financial markets. Stocks have performed well, particularly in a Europe that is relieved to see political risk on the wane in France. Financial assets are also enjoying a period of very low volatility. This situation has only been marred by the recent volatility shown by oil. Nonetheless, we expect this source of instability to diminish after the agreement reached by the OPEC countries and other large producers such as Russia to extend production cuts until March 2018. This should help to push up the price of crude oil again, albeit very gradually.

Global risks remain, however. As is becoming customary, the advanced countries will have to keep a close eye on the political uncertainty currently affecting the US. The controversies that, on a daily basis, surround the Trump administration are a constant source of instability that threatens to erode support for Trump from the Republican Party. Increasing doubts regarding the new administration's ability to carry out its promised reforms could also dampen investors' reflationary expectations. Some emerging countries such as Brazil, Turkey and South Africa are facing significant risks related to macroeconomic and political imbalances. Another downward risk, China's large corporate debt, is again in the limelight after the first downgrade of the country's sovereign credit rating since 1989, carried out by Moody's.

The US economy picks up speed after a dip in Q1. Q1 GDP growth (0.3% quarter-on-quarter) shows a slowdown in the US economy due to less growth in private consumption. But the latest economic activity indicators point to significant acceleration in Q2. Against the backdrop of an economy close to full employment, the Fed has adopted a «glass half-full» approach, stressing these positive factors over and above the first-quarter slowdown. This makes a June interest rate hike more likely and supports the continuation of monetary normalisation.

Europe's economic expansion is consolidating. The euro area's GDP grew by a significant 1.7% year-on-year in Q1 2017 and sentiment indicators are now firmly placed in the expansionary zone. Given this torrent of good figures, CaixaBank Research has upgraded its growth forecasts for the European economy in 2017. The recovery is relatively widespread although three countries have performed particularly well in the first part of the year: Portugal, Spain and Germany. This positive scenario will continue over the coming months thanks to solid domestic demand, a gradual recovery in the labour market and the continuation of accommodative financial conditions. However, such positive short-term prospects should not give rise to complacence. Rather governments should take advantage of this favourable environment to implement the reforms required to ensure the region's growth is long-lasting and balanced. Among such necessary reforms is greater European integration, a process which could be revitalised after the election of the pro-European Emmanuel Macron as the new French President. Brexit is still a source of risk for this integration but the EU authorities are expected to make use of all their diplomatic skills and negotiating position to reach an agreement with the UK that guarantees a smooth and orderly transition.

Spain's economy is gaining traction. The notable growth in Q1 has been confirmed (0.8% quarter-on-quarter and 3.0% year-on-year) and the latest business activity indicators show no sign of a slowdown; in fact quite the opposite. Spain's good economic performance over the past three years is starting to bear fruit: GDP returned to its pre-crisis level in Q2. Spain's strong growth is due to both external and internal factors. The economy is benefitting from the euro area's recovery, a still relatively low price for oil and favourable financial conditions. The structural reforms carried out over the past few years have also had a positive effect. Importantly, growth is much more balanced than in the previous expansionary period. Domestic demand has remained strong, contributing 2.2 pp to year-on-year growth in GDP in Q1 2017. There has been a particularly strong recovery in business investment, more than offsetting the lower growth in private consumption. External demand also contributed 0.8 pp to GDP growth thanks to exports' strong performance.

FORECASTS

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

International economy

	2015	2016	2017	2018	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
GDP GROWTH										
Global	3.4	3.1	3.5	3.6	3.1	3.3	3.4	3.5	3.5	3.5
Developed countries	*2.1*	*1.7*	*2.0*	*2.0*	*1.7*	*1.9*	*2.0*	*2.1*	*2.0*	*2.0*
United States	2.6	1.6	2.2	2.4	1.7	2.0	2.0	2.3	2.1	2.2
Euro area	1.9	1.7	1.9	1.8	1.8	1.8	1.7	1.9	1.9	1.9
Germany	1.5	1.8	1.8	1.7	1.7	1.8	1.7	1.7	1.9	1.9
France	1.0	1.1	1.4	1.6	0.9	1.2	1.0	1.5	1.7	1.6
Italy	0.7	1.0	0.9	0.9	1.0	1.0	0.8	1.0	0.9	0.9
Portugal	1.6	1.4	2.5	1.8	1.7	2.0	2.8	2.8	2.3	2.0
Spain	3.2	3.2	3.1	2.5	3.2	3.0	3.0	3.0	3.1	3.0
Japan	1.1	1.0	1.4	0.9	1.1	1.7	1.6	1.4	1.3	1.2
United Kingdom	2.2	1.8	1.6	1.4	2.0	1.9	2.0	1.7	1.5	1.1
Emerging countries	*4.2*	*4.1*	*4.5*	*4.8*	*4.1*	*4.3*	*4.5*	*4.5*	*4.6*	*4.6*
China	6.9	6.7	6.6	6.1	6.7	6.8	6.9	6.6	6.5	6.4
India	7.5	7.9	7.0	7.6	7.5	7.0	6.1	7.1	7.3	7.6
Indonesia	4.9	5.0	5.3	5.5	5.0	4.9	5.0	5.2	5.4	5.5
Brazil	–3.8	–3.6	0.7	2.1	–2.9	–2.5	–1.1	0.3	1.1	2.3
Mexico	2.7	2.3	1.8	2.1	2.0	2.3	2.3	2.0	1.5	1.3
Chile	2.3	1.6	1.9	2.6	1.8	0.5	1.5	1.9	2.1	2.2
Russia	–2.8	–0.2	1.3	1.6	–0.4	0.3	0.5	0.9	1.6	1.9
Turkey	6.0	2.9	2.5	3.0	–1.3	3.5	1.3	2.0	3.2	3.3
Poland	3.9	2.7	3.5	3.1	2.2	2.9	4.1	3.4	3.4	3.1
South Africa	1.3	0.4	1.1	1.6	0.7	0.5	1.2	0.7	1.0	1.4
INFLATION										
Global	2.8	2.8	3.4	3.4	2.7	2.9	3.2	3.2	3.4	3.8
Developed countries	*0.3*	*0.8*	*1.9*	*1.9*	*0.7*	*1.2*	*1.9*	*1.8*	*2.0*	*1.9*
United States	0.1	1.3	2.3	2.3	1.1	1.8	2.5	2.2	2.3	2.1
Euro area	0.0	0.2	1.8	1.6	0.3	0.7	1.8	1.7	1.9	1.8
Germany	0.1	0.4	1.9	1.7	0.4	1.0	1.9	2.0	2.0	1.8
France	0.1	0.3	1.7	1.6	0.4	0.7	1.5	1.3	2.0	1.8
Italy	0.1	0.0	1.5	1.4	–0.1	0.2	1.4	1.7	1.6	1.5
Portugal	0.5	0.6	1.7	1.6	0.7	0.8	1.4	1.8	1.7	1.7
Spain	–0.5	–0.2	2.0	1.4	–0.2	1.0	2.7	2.1	1.9	1.3
Japan	0.8	–0.1	0.6	1.0	–0.5	0.3	0.3	0.5	1.0	0.7
United Kingdom	0.0	0.7	2.6	2.6	0.7	1.2	2.1	2.5	2.9	3.0
Emerging countries	*4.7*	*4.4*	*4.6*	*4.5*	*4.3*	*4.1*	*4.2*	*4.3*	*4.4*	*5.3*
China	1.4	2.0	2.1	2.3	1.7	2.2	1.4	2.0	2.1	3.0
India	4.9	4.9	4.9	5.4	5.2	3.7	3.6	3.7	6.2	6.0
Indonesia	6.4	3.5	4.0	4.5	3.0	3.3	3.6	4.2	3.9	4.1
Brazil	9.0	8.8	4.2	4.3	8.7	7.1	4.9	3.9	3.6	4.5
Mexico	2.7	2.8	5.2	3.6	2.8	3.2	5.0	5.5	5.4	5.0
Chile	4.3	3.8	2.9	3.1	3.5	2.8	2.8	2.8	2.9	3.0
Russia	15.5	7.1	4.3	4.6	6.8	5.7	4.6	4.2	4.2	4.1
Turkey	7.7	7.8	10.0	7.9	8.0	7.6	10.2	11.0	10.0	8.8
Poland	–0.7	–0.2	2.0	2.3	–0.4	0.4	1.7	2.0	2.1	2.1
South Africa	4.6	6.3	5.9	5.5	6.0	6.6	6.3	5.7	5.6	5.9

Forecasts

Spanish economy

	2015	2016	2017	2018	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
Macroeconomic aggregates										
Household consumption	2.8	3.2	2.3	2.1	3.0	3.0	2.5	2.3	2.4	2.1
General government consumption	2.0	0.8	0.7	0.8	0.8	0.0	0.1	1.0	0.7	1.1
Gross fixed capital formation	6.0	3.1	4.5	3.7	2.6	2.2	3.8	3.7	5.0	5.4
Capital goods	8.9	5.1	5.7	3.8	4.3	2.7	5.0	4.6	5.9	7.1
Construction	4.9	1.9	3.5	3.6	1.6	1.9	3.0	3.0	3.9	4.2
Domestic demand (contr. Δ GDP)	3.3	2.8	2.4	2.1	2.5	2.2	2.2	2.4	2.5	2.4
Exports of goods and services	4.9	4.4	7.9	4.6	2.9	4.4	8.4	6.3	9.0	8.0
Imports of goods and services	5.6	3.3	6.4	3.6	1.0	2.3	6.4	4.7	7.8	6.9
Gross domestic product	**3.2**	**3.2**	**3.1**	**2.5**	**3.2**	**3.0**	**3.0**	**3.0**	**3.1**	**3.0**
Other variables										
Employment	3.0	2.9	2.5	2.2	2.9	2.7	2.5	2.5	2.4	2.7
Unemployment rate (% labour force)	22.1	19.6	17.5	16.1	18.9	18.6	18.8	17.7	16.8	16.8
Consumer price index	–0.5	–0.2	2.0	1.4	–0.2	1.0	2.7	2.1	1.9	1.3
Unit labour costs	0.2	–0.4	0.5	1.2	–0.3	–0.2	–0.1	0.3	0.6	1.1
Current account balance (cum., % GDP)[1]	1.4	2.0	1.8	1.6	1.8	2.0	2.1	2.1	2.0	2.0
Net lending or borrowing rest of the world (cum., % GDP)[1]	2.0	2.2	2.4	2.2	2.2	2.1	2.3	2.7	2.6	2.6
Fiscal balance (cum., % GDP)[2]	–5.1	–4.3	–3.1	–2.4						

Financial markets

INTEREST RATES										
Dollar										
Fed Funds	0.26	0.51	1.18	1.94	0.50	0.55	0.79	1.08	1.33	1.50
3-month Libor	0.32	0.74	1.34	2.16	0.79	0.92	1.07	1.23	1.44	1.64
12-month Libor	0.79	1.37	1.94	2.59	1.46	1.62	1.75	1.83	2.00	2.17
2-year government bonds	0.67	0.84	1.52	2.63	0.72	1.00	1.23	1.32	1.61	1.89
10-year government bonds	2.13	1.84	2.58	3.41	1.56	2.13	2.44	2.37	2.62	2.87
Euro										
ECB Refi	0.05	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month Euribor	–0.02	–0.26	–0.32	–0.21	–0.30	–0.31	–0.33	–0.33	–0.31	–0.30
12-month Euribor	0.17	–0.03	–0.10	0.05	–0.05	–0.07	–0.10	–0.12	–0.10	–0.07
2-year government bonds (Germany)	–0.24	–0.58	–0.69	–0.29	–0.64	–0.71	–0.78	–0.73	–0.65	–0.58
10-year government bonds (Germany)	0.53	0.10	0.46	0.85	–0.12	0.11	0.34	0.37	0.53	0.62
EXCHANGE RATES										
$/€	1.11	1.11	1.08	1.10	1.12	1.08	1.07	1.08	1.08	1.09
¥/€	134.33	120.30	122.76	127.10	114.26	117.96	121.05	121.41	123.10	125.47
£/€	0.73	0.82	0.86	0.85	0.85	0.87	0.86	0.85	0.86	0.87
OIL										
Brent ($/barrel)	53.64	45.04	55.70	61.71	46.98	51.13	54.68	53.60	56.50	58.00
Brent (€/barrel)	48.33	40.73	51.65	56.05	42.09	47.46	51.35	49.63	52.25	53.37

Note: *1. Four quarter cumulative. 2. Cumulative over four quarters. Does not include aid to financial institutions.*

Forecasts

FINANCIAL OUTLOOK · **Calm in the markets after Macron's victory**

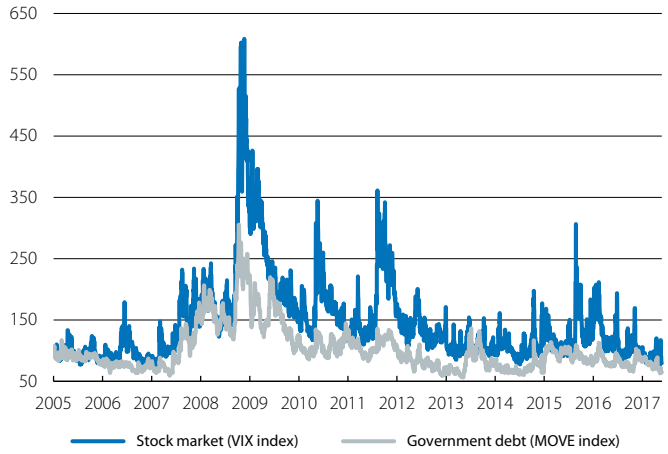
The global financial climate is still calm. In general, risky assets (stock markets and corporate bonds) have performed well in month-on-month terms, especially in Europe. Volatility in financial assets has continued to fall, reaching levels not seen for some time. The main reason for this situation has been the favourable outcome of the French elections, putting an end to a significant tail risk for the euro area's future. But it has also been helped by other factors, such as growth speeding up in the euro area and the positive corporate earnings reported for Q1 2017. On the negative side, commodities have looked unstable and Brazil is also a cause for concern. Towards the end of May Brazilian assets were hit hard by an outbreak in political instability. The impact from this episode has been limited in scope, mostly affecting Brazil's stock market and currency.

The factors underlying the present boom will remain in force, albeit with some provisos. The combination of controlled inflation rates (both current and expected) and support from central banks has been vital in sustaining the good performance by asset markets. These factors are likely to remain in the short term but their impact will tend to fade over the medium term, especially regarding central banks. Known sources of risk seem to be under control, such as the rise of populism and fears of a hard landing for the Chinese economy. However, we should still keep a close eye on less well-known or emerging risks. The list is long but at the top are signs of the financial cycle weakening in the US and its overvalued stock market.

Regarding central banks, the Federal Reserve (Fed) has not altered its guidance in spite of the weak GDP figures in Q1 2017. The official statement from the Fed's last meeting adopted a «glass half-full» approach. Although the institution noted the poor GDP figures in Q1 2017 and recent slowdown in inflation, it classed the first development as «transitory». The Fed also stressed that inflation was still close to its objective (2%), in spite of recent weakness. The central bank's positive view of fundamentals and risks to the US macroeconomic scenario suggest the next interest rate hike will take place in June, as predicted by the CaixaBank Research forecasts. This likelihood became even stronger after the publication of the FOMC meeting's minutes. These also disclosed information on the next steps to be taken regarding the Fed's balance sheet. Specifically, most Fed members believe it is appropriate to stop reinvesting all principal payments from its bond portfolio this year, reducing securities holdings «in a gradual and predictable manner». Given this situation, we expect this change in approach to the Fed's balance sheet to be announced in Q4 2017.

Implied volatility in financial markets

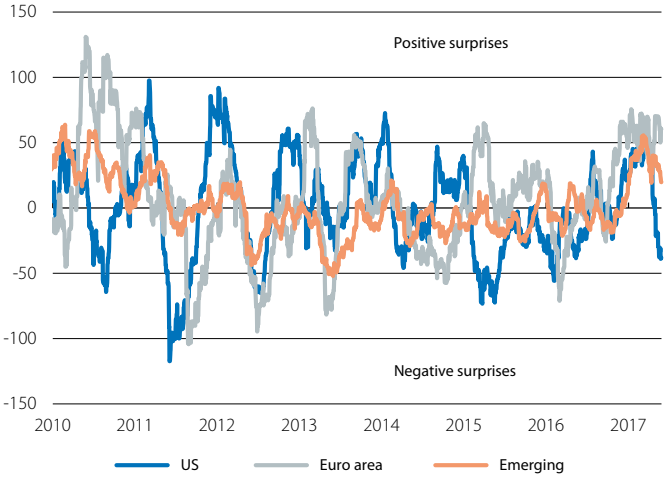
Index (100 = January 2005)



Source: *CaixaBank Research, based on data from Bloomberg.*

Index of economic surprises

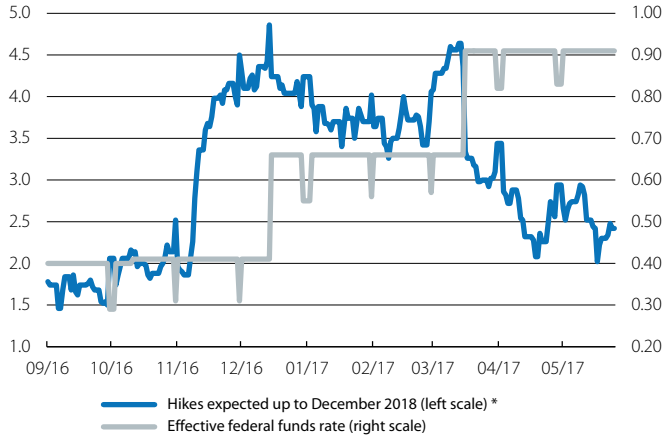
Index



Source: *CaixaBank Research, based on data from Citigroup and Bloomberg.*

US: effective federal funds rate and expected hikes

(Number of hikes) *(%)*



Note: ** Calculated based on fed funds futures. Hikes of 25 bp each are assumed.*
Source: *CaixaBank Research, based on data from Bloomberg.*

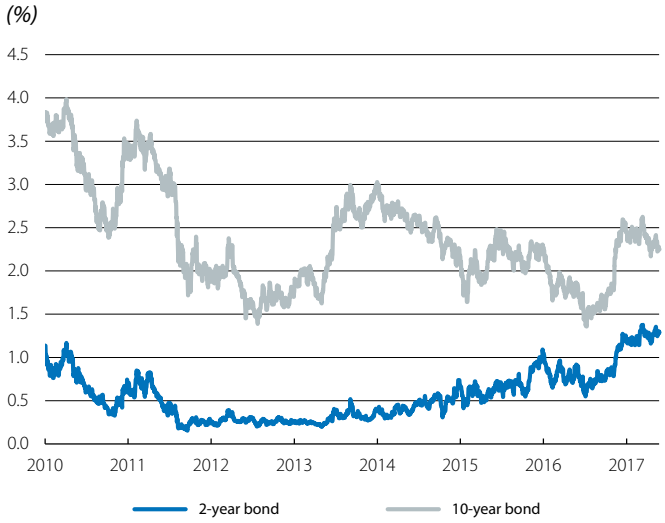
The US Treasury bond market remains unclear. The Fed's firm messages did not alter the Treasury bond market to any great extent. In fact, yields on the 10-year Treasury note slipped to 2.20% while 2-year bonds, more affected by official interest rate expectations, remained at around 1.30%. There seem to be several reasons for the recent apathy observed in Treasury yields. On the one hand, increasing doubts regarding the ability of Trump's administration to implement its agenda of reforms. On the other, the somewhat weaker trend than expected in inflation. The doubts of bond market agents can also be seen in their expectations of official interest rates. Fed funds futures contracts assume between two and three cumulative hikes up to December 2018. A scenario which, according to the CaixaBank Research forecasts, should gradually converge until the market prices in four or five fed funds hikes.

The ECB is getting ready to shift towards an increasingly balanced stance but will nevertheless keep the scale of monetary stimuli unchanged. At its April meeting, the ECB's Governing Council noted the signs pointing to a stronger recovery for the region. It also improved its assessment of the risks surrounding the economic scenario, although these are still tilted to the downside. But there can be no doubt that the reduction in political risk thanks to the outcome of France's election has reduced the uncertainty of the ECB's main scenario being achieved. The monetary authority will therefore probably improve its view of the configuration of risks and suggest they are «balanced». This is likely to be a precursor to announcing a gradual withdrawal of bond purchases, which we expect will occur in December.

Storm clouds clear from Europe's sovereign debt market thanks to waning political risk. The victory of the central Macron candidate in France's presidential elections has clearly boosted periphery debt. In the last month and a half Spain's risk premium has fallen from 150 bp to 120 bp, Italy's from 210 bp to 170 bp and France's from 75 bp to 40 bp. Yields on the German bund, the euro area's safe haven par excellence, gained almost 10 bp up to 0.40%. The current expansion in the euro area, together with doubts regarding the US political scenario, has led to the euro appreciating considerably over the past month, both against the dollar (3%) and other currencies as a whole (1.5%).

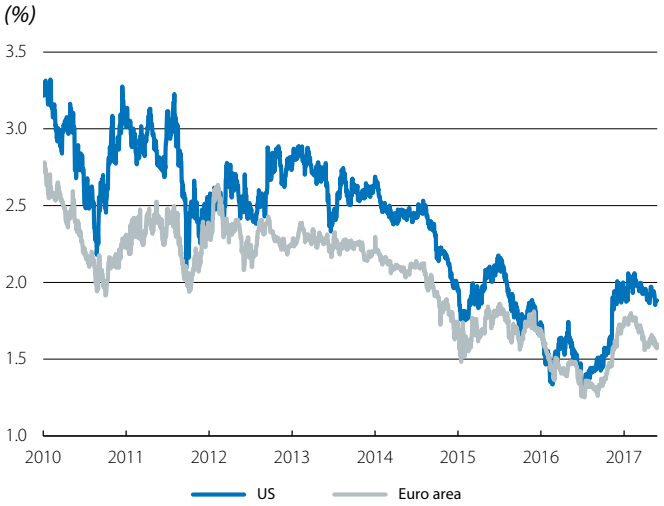
The Old Continent's shares stand out on international stock markets. Stock exchanges such as Europe's (Eurostoxx 50) and Spain's (Ibex 35) enjoyed cumulative gains for the year (up to May) of 10% and 17%, respectively. Their performance has also been good in comparative terms as the US stock market performed less well over the same period (7%). In addition to the aforementioned factors behind this stock market surge are the solid corporate earnings reported for Q1 2017. The good figures presented by the energy and banking sectors were particularly surprising. Plus the absence of any notable shocks (implied volatility is at an all-time low) has helped emerging stock markets to more or less follow the same pattern.

US: yield on sovereign debt



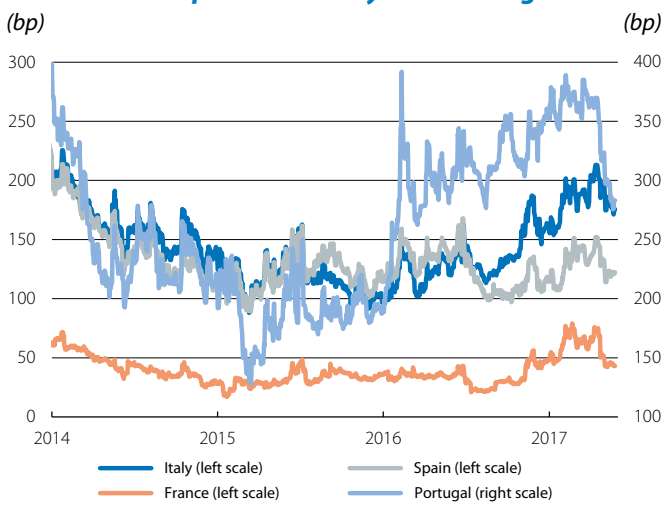
Source: *CaixaBank Research, based on data from Bloomberg.*

*Inflation expectations: * US and euro area*



Note: ** Inflation swap forward 5Y5Y.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Euro area: risk premia on 10-year sovereign debt



Source: *CaixaBank Research, based on data from Bloomberg.*

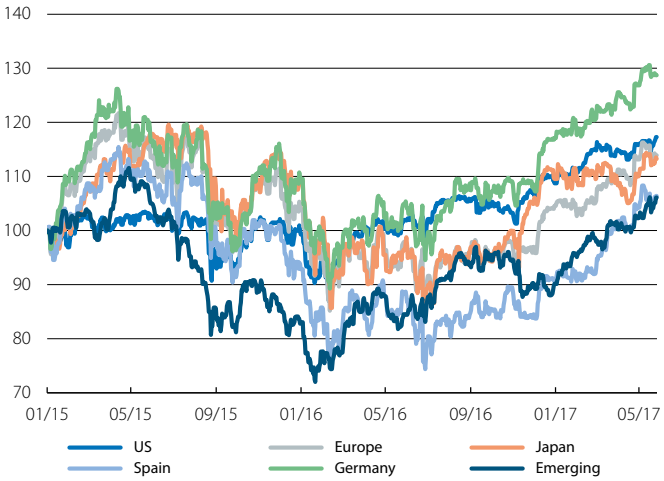
Specifically, the emerging MSCI performed particularly well, up by 16% YTD. The US stock market's performance has been more hesitant, although it is still at an all-time high. Investor doubts regarding reforms with the most potential to affect the stock market have weighed heavily on investors, as well as the ever-rising share prices in the US. Should the Fed make explicit warnings about stock market complacency or decide to speed up its normalisation strategy, the US stock market will be vulnerable.

The emerging financial environment is solid but has its weak spots. In addition to the stock markets, emerging spreads and currencies have also performed well on the whole. Looking more closely at this positive situation we can see that internal factors such as good business activity indicators are not the only reason. The dollar's loss of steam and market expectations of a very prudent normalisation of US interest rates are also having an effect. However, this context of stability was marred slightly towards the end of May by an outbreak of political instability in Brazil. The country's financial assets suffered: the São Paulo stock market plummeted by 10% and the real lost 7% against the dollar. It is difficult to predict the implications and extent of this episode although it looks like having a very limited effect on the rest of the emerging economies. Moody's downgrading of China's sovereign debt rating by one notch, from Aa3 to A1, created less of a stir and the country's financial markets were undisturbed by this decision.

Oil looks volatile both before and after the OPEC meeting. During the weeks prior to the oil cartel's biannual meeting in Vienna, the Brent barrel price rose by 10% to USD 54 given expectations of OPEC extending its production cuts. However, the price of crude fell again, by almost 5%, after the oil-producing countries decided to prolong output caps until March 2018. In spite of this initial reaction, we believe the cartel's decision will be effective in the medium term and act as a moderate boost for oil prices. The Focus «Crude oil prices: the puzzle of the impact of OPEC's cut» in this *Monthly Report* examines this view more closely.

Main international stock markets

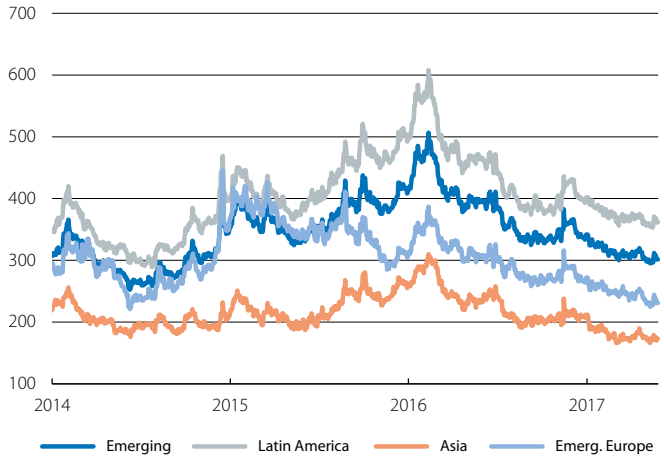
Index (100 = January 2015)



Source: *CaixaBank Research, based on data from Bloomberg.*

*Spreads on emerging sovereign bonds **

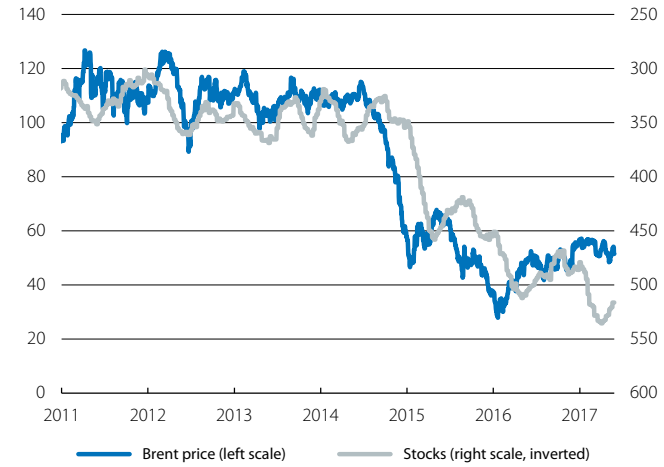
(bp)



Note: ** Compared with basket of US bonds.*
Source: *CaixaBank Research, based on data from Bloomberg.*

*Crude oil prices and US stocks **

(USD per barrel) *(Million barrels)*



Note: ** Excluding strategic reserves.*
Source: *CaixaBank Research, based on data from Bloomberg.*

FOCUS · Crude oil prices: the puzzle of the impact of OPEC's cut

The recent fall in oil prices, placing a barrel of Brent oil temporarily below USD 50 and close to its level before OPEC announced its agreement in November 2016, has revived doubts regarding the impact of the latter and, more generally, the oil cartel's ability to sustain a higher price for crude oil. In fact, although OPEC agreed in May to extend its production cut until the beginning of 2018, the price has remained within a range close to USD 50.

Doubts regarding the impact of OPEC's cut are mainly due to the fact that US crude oil stocks are still at an all-time high (over 500 million barrels). According to the market, this means OPEC's cap on its output has not managed to reduce the excess supply (there have been no significant changes in demand over the past few months). In general, three arguments are used to explain the OPEC agreement's limited impact.

First, whether the cuts are being effectively implemented. However, the degree of compliance has been very high so far (90% in April, albeit varying across OPEC members). Crude production by OPEC therefore fell below 32 million barrels per day (mbd) in April (compared with 34 mbd at the end of 2016). This level is in line with last November's agreement (see the first chart). The other large oil-producing countries that do not form part of OPEC but signed the agreement, such as Russia, have also broadly complied with the target.

The second argument used to explain the limited effect of OPEC agreement's is the increase in US production, especially unconventional oil, which might have neutralised the organisation's cutback. However, although this argument may become extremely valid in the long run, in the short term the increase in shale production is unlikely to totally offset the output cuts implemented by other large producers. Since January, the production of oil products[1] in the US has «only» risen by 270,000 barrels per day. In comparison, OPEC has reduced its crude oil production by more than 1.2 mbd from the benchmark set in the agreement, and by more than 2 mbd since the peak reached at the end of 2016, just before the cuts were implemented. Nevertheless, from now until the end of 2018, the US Energy Information Administration expects US oil production to increase by 1.63 mbd.

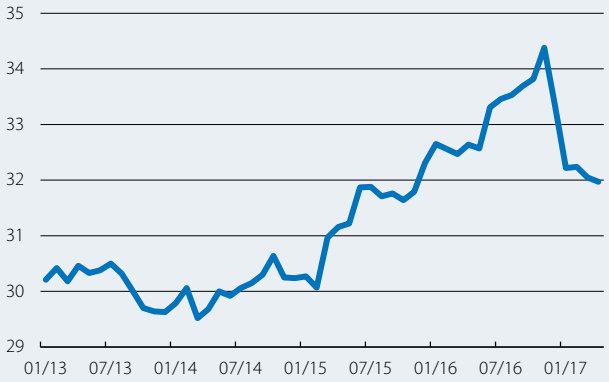
1. Oil products are those resulting from the processing of crude oil, natural gas and other hydrocarbon compounds. In addition to petrol, they also include, for instance, liquefied petroleum gas, kerosene and lubricants.

Finally, one last explanation is that, in spite of the production cuts, OPEC exports have remained stable. In fact, between January and April OPEC's crude exports only fell by 460,000 barrels per day on average, compared with the same period in 2016 (see the second chart).

Nevertheless, OPEC's crude oil exports are likely to fall over the coming months as stocks in its member countries decrease. This should help to push up oil prices. In fact, a drop of 1.12 mbd could already be seen in April in OPEC's crude oil exports. Although the effect of these cuts should start to push up crude oil prices in the short term, in the long run supply factors, and especially the increase in US shale production, still point to a gradual and relatively limited rise.

Crude oil production by OPEC members

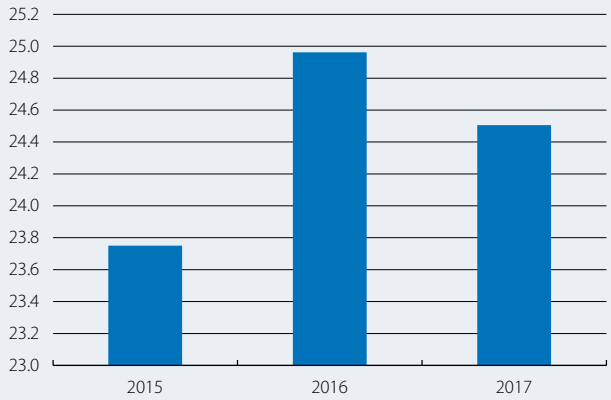
(Million barrels per day)



Source: *CaixaBank Research, based on data from Thomson Reuters Datastream.*

Average crude oil exports by OPEC members between January and April

(Million barrels per day)



Source: *CaixaBank Research, based on data from Thomson Reuters Datastream.*

FOCUS · China's new economy: stock market transition and sector performance

The entire international community is closely monitoring China's change in its economic production model. This is a fundamental step for the Asian giant to enjoy more sustained and balanced growth in the long term. And if the country is successful, some aspects of this process could serve as a reference for other emerging countries aspiring to take similar steps and join the group of advanced economies.

This change in the model of production is based essentially on two areas. In terms of supply, the tertiary sector is becoming more important in detriment to the secondary. In this case the figures are astounding: the services sector has increased its share by 11.8 pp in the past 16 years and accounted for 51.6% of GDP in 2016. In terms of demand, household consumption is expected to take over from investment. A case in point is the change in trend observed since 2007 in the relative weight of household consumption. After a sharp comparative drop due to the incredible growth in investment over the past few decades, it has stabilised at around 37% of GDP and seems to be embarking on a slightly upward trend.

Another area that clearly shows the far-reaching transformation of the Chinese economy is the composition of its stock market index. Looking at the trend in the relative weight of different industries, we can see considerable readjustment.

Comparing the six main sectors for China's stock market, since the start of the 2000s consumer industries have enjoyed the most growth. The industrial sector, on the other hand, has seen the least growth over the same period, in line with the country's shift towards deindustrialisation (see the second chart).

These trends should get stronger in the future. In particular, the performance by the industrial sector is likely to get worse. On the other hand, the health and IT sectors should improve their performance as the Chinese economy becomes more tertiary. Consumer-related sectors should also become relatively stronger, particularly the consumer discretionary sector,[1] which is likely to gain in importance at a more advanced stage of the country's economic transition.

Of note is the exceptional performance by financials in China's share index. In this case, however, we need to be cautious as one of the major challenges facing the Chinese economy is precisely how to reduce its ballooning levels of debt.

China's equity market is still relatively unimportant compared with developed economies (48% of GDP compared with 146% in the US). The kind of companies included in stock market indices can also produce biases. However, the broad trends that characterise China's economic transition are also reflected in the changes occurring in its stock market's sector composition. This trend should get stronger as its equity market gains in importance and the economy becomes increasingly open to foreign investment.

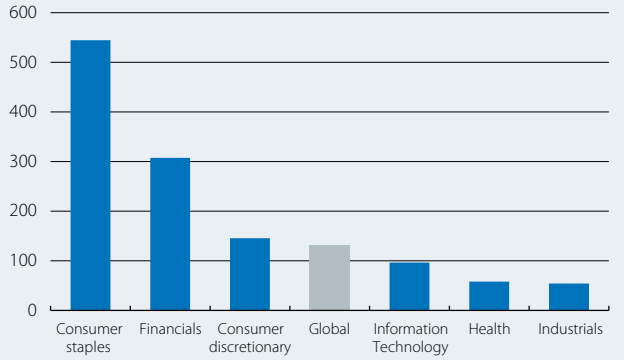
Shanghai Stock Market Index

(Points)

Source: *CaixaBank Research, based on data from Bloomberg.*

Growth of key sectors in the Chinese stock market since 2000

(%)



Note: *Change in the sector index between May 2000 and April 2017.*
Source: *CaixaBank Research, based on data from Bloomberg.*

1. The consumer discretionary sector is made up of non-essential goods and services that can be acquired by consumers (sports apparel, restaurants, automobiles, hotels, leisure, etc.).

KEY INDICATORS

Interest rates (%)

	31-May	28-Apr	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	0.00	0.00	0	0.0	0.0
3-month Euribor	–0.33	–0.33	0	–1.0	–6.8
1-year Euribor	–0.13	–0.12	–1	–4.8	–11.5
1-year government bonds (Germany)	–0.75	–0.73	–2	5.1	–21.7
2-year government bonds (Germany)	–0.71	–0.73	2	5.6	–19.6
10-year government bonds (Germany)	0.30	0.32	–2	9.2	16.1
10-year government bonds (Spain)	1.55	1.65	–10	16.6	7.7
10-year spread (bps) [1]	125	133	–8	7.2	–8.6
US					
Fed funds	1.00	1.00	0	25.0	50.0
3-month Libor	1.20	1.17	3	20.4	51.6
12-month Libor	1.72	1.77	–5	3.6	38.4
1-year government bonds	1.15	1.06	9	33.9	47.8
2-year government bonds	1.28	1.26	2	9.2	40.3
10-year government bonds	2.20	2.28	–8	–24.4	35.4

Spreads corporate bonds (bps)

	31-May	28-Apr	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	62	67	–4	–10.0	–10.0
Itraxx Financials Senior	70	74	–5	–23.7	–19.8
Itraxx Subordinated Financials	158	167	–10	–63.7	–35.9

Exchange rates

	31-May	28-Apr	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
$/€	1.124	1.090	3.2	6.9	1.0
¥/€	124.560	121.530	2.5	1.3	1.1
£/€	0.872	0.841	3.7	2.2	13.5
¥/$	110.780	111.490	–0.6	–5.3	0.0

Commodities

	31-May	28-Apr	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	434.2	424.5	2.3	2.6	5.3
Brent ($/barrel)	50.3	51.7	–2.7	–11.5	1.2
Gold ($/ounce)	1,268.9	1,268.3	0.1	10.1	4.4

Equity

	31-May	28-Apr	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	2,411.8	2,384.2	1.2	7.7	15.0
Eurostoxx 50 (euro area)	3,554.6	3,559.6	–0.1	8.0	16.0
Ibex 35 (Spain)	10,880.0	10,715.8	1.5	16.3	20.4
Nikkei 225 (Japan)	19,650.6	19,196.7	2.4	2.8	14.0
MSCI Emerging	1,005.3	978.0	2.8	16.6	24.5
Nasdaq (USA)	6,198.5	6,047.6	2.5	15.1	25.3

Note: *1. Spread between the yields on Spanish and German 10-year bonds.*

ECONOMIC OUTLOOK · **Solid growth in economic activity**

Global economic activity indicators continue to post sizeable increases in Q2. In April, the (PMI) business sentiment index for manufacturing for the advanced economies as a whole was comfortably in the expansionary zone at 54.1 points (above the 50-point threshold). The activity indicator for all the emerging economies produced by the IIF also continued to indicate a high trend of growth in spite of a month-on-month dip. All this endorses the CaixaBank Research scenario which predicts moderate acceleration in world growth from 3.1% in 2016 to 3.5% in 2017.

However, high uncertainty is tilting the balance of risks slightly to the downside. Among the strictly economic risks, high global debt has grabbed the limelight this month. Moody's downgrading of China's sovereign debt rating, due to the increase in the Asian country's level of debt while its growth is actually slowing down, is a case in point. Regarding the political risks, this month has seen both positive and negative events. Emmanuel Macron's victory in France, who beat Marine Le Pen in the presidential elections on 7 May, reduced uncertainty at a European and global level. But political uncertainty increased on the other side of the Atlantic, especially after controversies concerning President Trump and increasing doubts about the new administration's ability to implement the promised reforms. The health reform bill finally passed by the House of Representatives will require significant adjustments to be approved by the Senate. The tax proposals presented at the end of April will also need to be changed considerably to appease the strong fiscal conservatism of a large part of Trump's own Republican Party (see the Focus «Trump-style tax reform» in this *Monthly Report*).

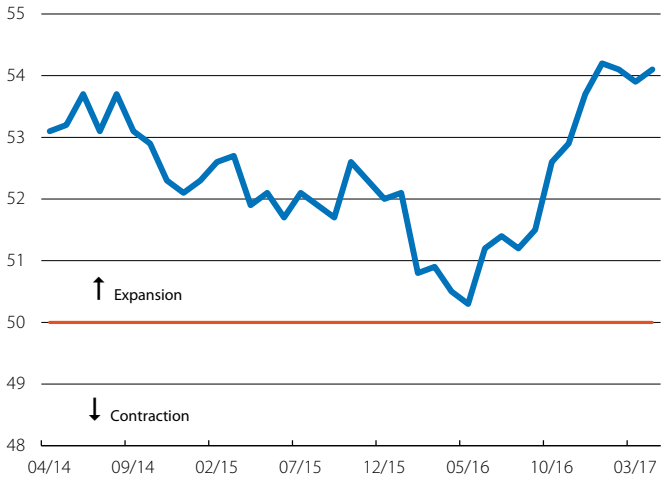
OPEC's agreement reduces one of the risks in 2017. OPEC and other large oil-producing countries (such as Russia) agreed to extend the oil production cuts until March 2018. This supports the CaixaBank Research scenario of an increase in the price of crude oil, albeit a very gradual one. Such a recovery will help both oil-exporting economies by relieving fiscal pressure, and importing economies since it reduces their deflationary pressures without hindering growth to any great extent.

UNITED STATES

Q1 GDP growth was slightly upgraded although it was still lower than in Q4 2016. In Q1 the US economy grew by a moderate 0.3% quarter-on-quarter (2.0% year-on-year). This loss of steam was due to a notable slowdown in private consumption in spite of the previous month's estimate being upgraded. Inventories also made a significant negative contribution to GDP growth, deducting even more in the second estimate: –0.3 pp from the quarter-on-quarter rate. However, the latest indicators point to GDP growth speeding

Advanced economies: PMI manufacturing

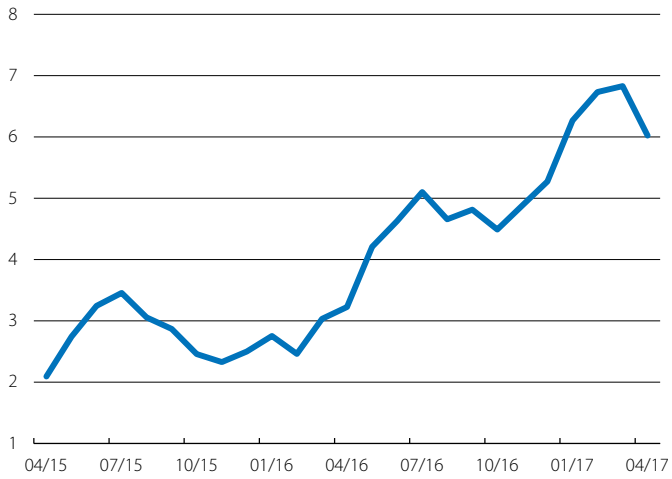
Level



Source: *CaixaBank Research, based on data from Markit.*

Emerging economies: IIF growth indicator

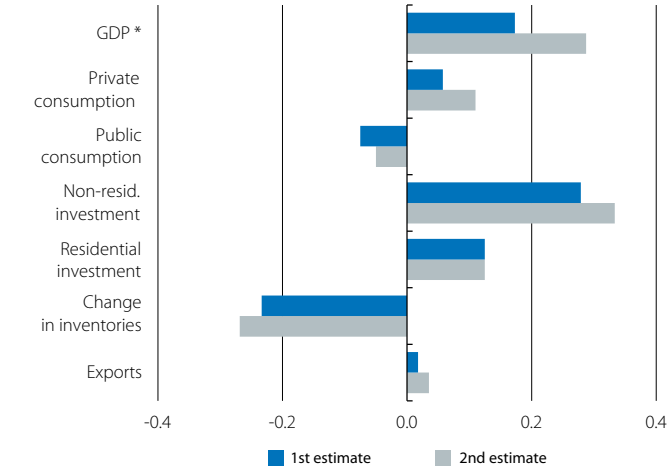
Annualised quarterly growth, three-month average (%)



Source: *CaixaBank Research, based on data from the IIF.*

US: GDP

Contribution to quarterly GDP growth in Q1 2017 (pp)



Note: ** Quarterly change.*
Source: *CaixaBank Research, based on data from the Bureau of Economic Analysis.*

up significantly in Q2. The Atlanta Fed's GDP Now model forecasts 3.7% growth in annualised quarterly terms (compared with 1.2% in Q1).

The Fed is ready for another hike after keeping its benchmark rate target at 0.75% to 1.00% at its May meeting. The minutes from the last meeting revealed that most members of the Federal Open Market Committee believe «it would soon be appropriate» to take another step in removing some monetary stimuli. This points to a hike in the fed funds rate at its June meeting, as predicted by CaixaBank Research. The institution believes that the slowdown observed in Q1 was transitory. It also deemed that March's lower inflation than expected was not significant and confirmed the strength of the labour market.

The fact that the US economy is close to full employment suggests the Fed will continue with monetary normalisation. April's labour market figures were strong: 211,000 jobs were created, the unemployment rate fell slightly to 4.4% and wages rose by a considerable 2.5% year-on-year. Some claim the US labour market still has significant room for improvement given the low employment rate. However, a large proportion of today's lower levels (compared with pre-crisis figures) are due to the ageing of the working-age population (see the chart). The CaixaBank Research scenario assumes two additional hikes in the fed funds rate in 2017 (June and September), an announcement that reinvestment from its bond portfolio will stop by the end of 2017, and three further hikes in 2018.

JAPAN

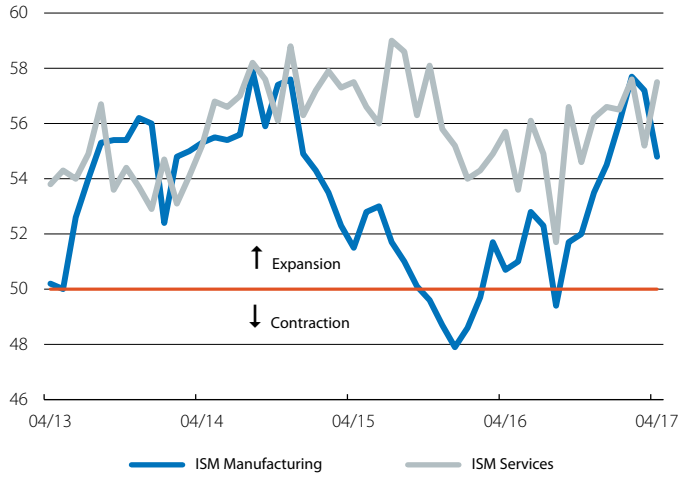
The latest figures from Japan are relatively encouraging. In particular, Japan's GDP was surprisingly good in Q1, up by 0.5% quarter-on-quarter (1.6% year-on-year). With this advance, Japan has now enjoyed five consecutive quarters of positive figures, the longest growth strech in 11 years. Once again growth was supported by the contribution from exports which, in turn, were helped by a weak yen. Private consumption also performed well in the first quarter. But this is still too weak, in spite of a healthy labour market (2.8% unemployment). Japan's sluggish prices are undoubtedly affected by this weak consumption, a reminder of the dangers entailed by deflationary pressures. Japanese inflation rose slightly in April, up to 0.4%, but is still very low.

EMERGING ECONOMIES

Uncertainty has yet to affect portfolio flows towards the emerging countries. In spite of controversies surrounding President Trump and the Fed's normalisation strategy, the emerging economies enjoyed significant inflows of foreign capital in April and May. In both months, inflows totalled USD 21 billion according to IIF figures, representing four consecutive months above USD 20 billion, the best record since 2014.

US: economic activity indicators

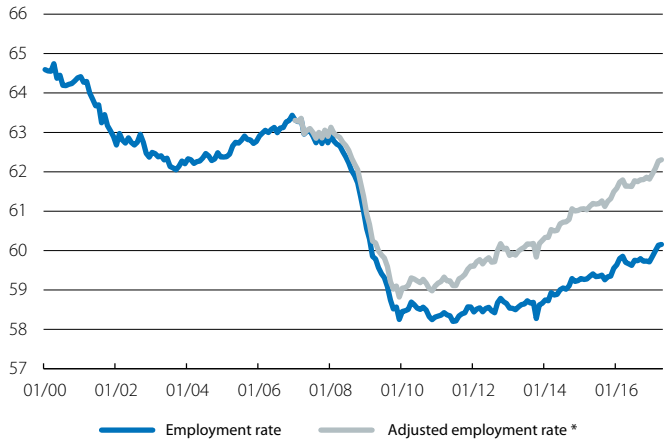
Level



Source: *CaixaBank Research, based on data from the ISM.*

US: labour market

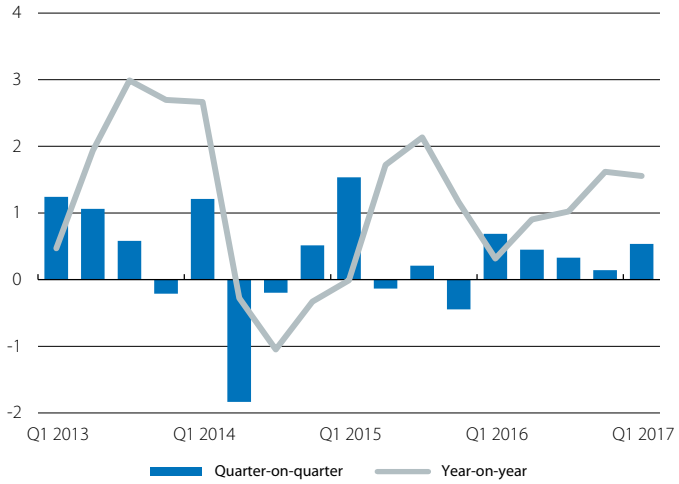
Employment rate (%)



Note: ** In the adjusted employment rate we have kept the share by age of the population constant at the level of January 2007.*
Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics.*

Japan: GDP

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



Source: *CaixaBank Research, based on data from the Ministry of Internal Affairs and Communications.*

But China's rating downgrade is a warning sign of the risks still in play. Moody's downgraded the country's sovereign credit rating from Aa3 to A1 due to its high and growing level of debt. In the past 8 years, debt has risen by more than 100 points of GDP from 250% of GDP in 2016, mainly due to the heavy debt of its corporate sector. This situation is not limited to China but can be applied to numerous emerging economies. It is therefore a significant source of risk should financing costs increase.

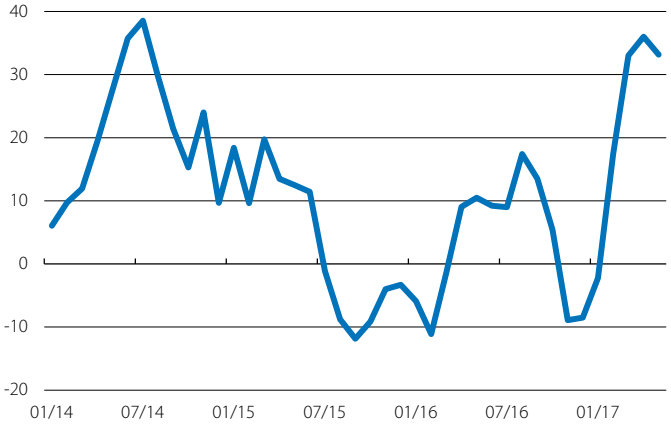
Nevertheless, China is still moving towards a soft landing. April's economic activity data moderated but remained strong. Industrial production grew by a considerable 6.5% year-on-year, 0.4 pp more than the average over the past two decades but lower than March's figure (7.6%). Retail and consumer goods increased by 10.7%, a slight slowdown compared with the previous month (10.9%). Inflation stood at 1.2% in April, a modest figure although slightly higher than in March (0.9%).

India grew less than expected but this is merely temporary. In Q1 2017, GDP increased by 6.1% year-on-year, significantly lower than the 7.0% posted the previous quarter. Pending more detailed figures, it appears that demonetisation, the withdrawal of the highest denomination banknotes carried out in November 2016, has had a delayed effect on the economic growth figures. This is a temporary dip, however, as recent figures suggest India's economy is recovering and moving away from its monetary shock once and for all.

Emerging political uncertainty came from Brazil while Russia's economic growth accelerated. Possible proof of criminal practices allegedly involving Brazil's current President, Michel Temer, has sparked another episode of political uncertainty in the country. But the Brazilian parliament is unwilling to get rid of yet another President. As the influence of the PT (the party of Lula and Rousseff) has been strongly eroded, the government is likely to remain in place until the presidential elections in 2018. The latest figures still point to a very slow exit from the recession (0.7% growth in 2017 after –3.6% in 2016). Meanwhile Russia, the other large emerging country in a recession in 2016 (–0.2%), has seen its rate of GDP growth speed up moderately. GDP increased by 0.5% year-on-year in Q1 2017 compared with the 0.3% of the previous quarter. Pending a breakdown by component, economic activity indicators suggest that the trends observed towards the end of 2016 are still in play: less deterioration in domestic demand combined with a positive contribution by exports. The CaixaBank Research scenario for the Russian economy therefore predicts 1.3% growth in 2017 as a whole.

*Emerging economies: capital inflows **

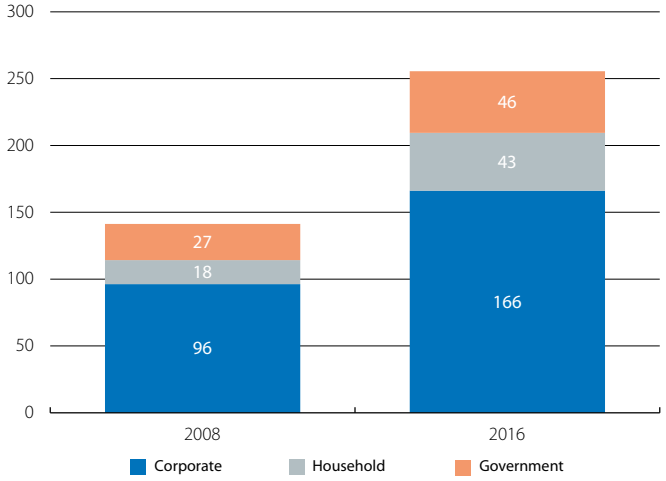
Moving three-month average (USD billion)



Note: ** Monthly portfolio flows (debt and shares) of non-residents to emerging countries. Countries included: Brazil, Chile, China, India, Indonesia, Mexico, Poland, Russia, South Africa and Turkey. The minus sign indicates outflows.*
Source: *CaixaBank Research, based on data from the IIF.*

China: debt

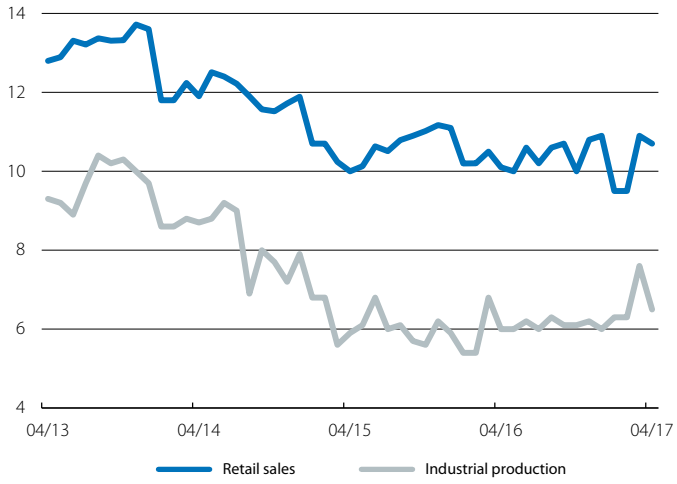
(% of GDP)



Source: *CaixaBank Research, based on data from the BIS.*

China: economic activity indicators

Year-on-year change (%)



Source: *CaixaBank Research, based on from the Chinese National Statistics Office.*

FOCUS · Malaysia: Southeast Asia's weakest link?

Malaysia's economy has been remarkably strong with average annual growth of 4.8% between 2006 and 2016. And the situation looks like continuing. The IMF estimates the Malaysian economy will continue to enjoy growth rates of 4% to 5% over the next five years. The country also boasts solid macroeconomic fundamentals. Inflation is moderate at around 2% and the country has a large current account surplus (about 2% of GDP). Its fiscal deficit (3% of GDP) has also remained small in spite of a dip in revenues resulting from the slump in oil prices (the country is one of Asia's major producers of gas and oil). Nevertheless, Malaysia is one of the countries most sensitive to episodes of financial volatility at a global level. A case in point occurred after Trump's election in November 2016. Two weeks after his victory, the ringgit had depreciated by almost 6% against the dollar, one of the largest reductions for emerging currencies, while capital outflows were considerable. The gap between what appears to be a solid macroeconomic situation and investor sensitivity warrants investigation to shed light on how concerned should we be about this relatively unknown and small country in Asian terms (30.8 million inhabitants).

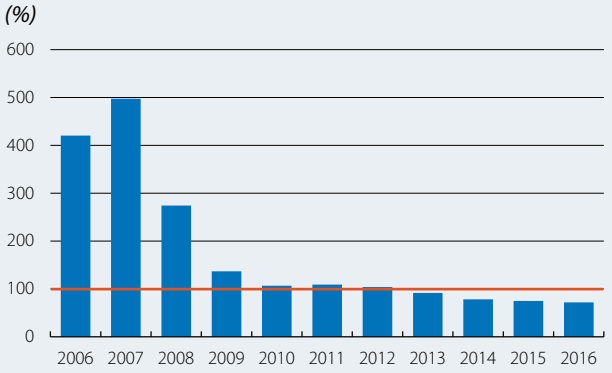
International investors seem to be most swayed by the country's high exposure to economic and monetary policy in the US. According to the IIF, Malaysia is the fourth emerging country with the highest exposure (after Mexico, Korea and China).[1] In particular, a sharper-than-expected rise in the fed funds rate would tighten up the financial conditions of some Malaysian companies as it could push down the ringgit and many firms have a considerable amount of debt in dollars. Looking at corporate debt in dollars as a percentage of GDP, Malaysia ranks second in Southeast Asia with 6.1%, only exceeded by Singapore with 6.7% and not very far behind Mexico or Brazil with 11% and 7.8%, respectively. It is therefore important to examine how the country might respond to such episodes. Malaysia's response capacity depends on its exchange rate, whose fluctuation is controlled, and on its level of international reserves. This could once again be a source of concern for investors as the country now has less leeway. According to the IMF, its ratio of reserves to short-term external debt (remaining maturity under one year) is now below 1, suggesting a more limited response capacity in the short term.

Although any risk assessment must include such considerations, there are factors which might alleviate the most exaggerated concerns. It is true the country has a relatively high level of foreign currency debt. Gross external debt has risen sharply and now stands at 70% of GDP, very close to the typical thresholds of vulnerability for emerging economies. However, internationally Malaysia is a net creditor with a net international investment position (PIIN[2]) of 6% of GDP. It should also be remembered that many Malaysian companies benefit from natural hedging since they are exporters paid in dollars. And the central bank helps those companies without such hedging by offering financial products such as derivatives.

So the problem related to external financing is therefore minimal. But could the country be at risk from its excessive national debt, albeit not directly as a result of tougher international monetary conditions? Here the difference between a superficial glance and a more thorough examination is crucial. Total non-financial debt represents 191% of GDP, the highest figure in Southeast Asia. Household debt, representing 89% of GDP, is above the generally recommended threshold of around 60% of GDP.[3] Nevertheless, when analysed in more detail we can see that the financial assets of households come close to 180% of GDP. Moreover, non-financial corporate debt is controlled thanks to the aforementioned natural and financial hedges, and the corporate sector exhibits a low NPL ratio. Public debt is relatively contained (56% of GDP) although one third is held by foreign investors, a larger share than in most emerging countries.

In conclusion, the country has solid macroeconomic fundamentals and prospects. Debt has certainly increased but, when studying the overall situation of the economy, there seems to be no cause for alarm. And although we must certainly keep a close eye on developments regarding the link between tighter international financial conditions and national impact, any episodes of doubt should be temporary and the positive long-term outlook should prevail.

Malaysia: international reserves compared with short-term external debt *



Note: ** Short-term external debt is based on the remaining maturity; i.e. it includes debt with an original maturity longer than one year but with less than one year left.*
Source: *CaixaBank Research, based on data from the IMF.*

1. See the Capital Flows Report, February 2017, «Eye of the Trumpstorm».
2. The NIIP is the difference between assets held by Malaysian residents in the rest of the world and assets held by the rest of the world in Malaysia.
3. See Lombardi, M., Mohanty, M. and Shim, I. (2017), «The real effects of household debt in the short and long run», BIS Working Paper No. 607.

FOCUS · Trump-style tax reform

As Donald Trump had promised during his electoral campaign, at the end of April his administration presented its proposed tax reform which includes extensive tax cuts. However, to the surprise of many, this included almost no measures to offset the drop in federal revenue brought about by such cuts, if approved.[1] The country has a high level of public debt and a moderate budget deficit (4.4% of GDP in 2016). Given the strong fiscal conservatism of a significant faction of the Republican Party, this means that lengthy discussions and, very probably, important changes are in store for the original proposal.

The reform proposes an ambitious reduction in tax rates both for individuals and businesses. For instance, the corporate tax rate would go from the current 35% to 15%. A regional tax would also be imposed, so that profits earned by companies abroad would not have to pay tax again in the US, which would encourage large multinationals to repatriate their earnings. Regarding individuals, as well as cutting the highest marginal rate (from 39.6% to 35%) and reducing the number of brackets, the so-called alternative minimum tax would also be repealed. This alternate taxation establishes a minimum rate for those people who might be entitled to a range of deductions.

The proposed change is therefore markedly regressive. By way of example, and according to the analysis by the Tax Policy Center, while the median citizen would enjoy an average tax cut of 1.8%, those citizens with incomes in the top quintile (the 20% top earners of the population) would enjoy an average cut of 6.6%. This reduction would increase to 14.2% for the top 0.1% of citizens.[2]

On the other hand, the proposal would entail a significant increase in federal debt. The net revenue cost would be around USD 5.5 trillion over the next 10 years, around 3% of GDP yearly. And this would come mainly from companies (approximately 70% of the total) as the elimination of a large number of tax deductions would offset part of the cost of the large cut in tax rates for individuals. Consequently, if the Trump administration's proposal is passed, net public debt could go from 77% of GDP to 111% by 2027. By comparison, the country's debt level was 45% of GDP before the big crisis.[3]

Defenders of the plan argue that this extra cost would be compensated by higher revenue from greater economic growth, as a consequence of more incentives to work, save and invest. However, a simple calculation shows that, to offset the aforementioned fiscal cost, the US economy would have to grow by 4% every year over the next 10 years. This figure is much higher than the long-term growth estimated by the Fed, namely 1.8%, higher than the average growth achieved by the US economy since 1960, namely 3%, and even higher than Trump's own growth forecast.

Moreover, in the current situation of almost full employment, it would be very difficult for the US economy to significantly speed up its growth rate without policies to promote gains in productivity. In fact, given the current environment, expansionary fiscal policies such as the one proposed by the Trump administration with its tax reform would very likely push up inflation, forcing the Fed to speed up its monetary normalisation and, consequently, limiting the impact of the reform on investment.

US: the Trump administration's tax reform

		Current	*Proposed*
COMPANIES	Business rate	35%	15%
	Corporate foreign income rate	35% when earnings are repatriated	Territorial tax (tax exemption)
	Special rate for imports and exports	No	No crossborder adjustment (revision is possible but unlikely)
	Net interest expenditure	Unlimited deduction	Not spec.

		Current		*Proposed*
INDIVIDUALS	Maximum marginal rate	39.6% (7 brackets)		35% (3 brackets)
	Taxation on capital	Capital gain rate Dividend rate Rate on interest income	50% 40% 30%	20% 20% Not spec.
	Standard deduction (for marriage)	USD 12,600		USD 24,000
	Deduction for state and local taxes	Unlimited		Repeal
	Alternative Minimum Tax[1]	Applied		Repeal

Note: *1. Alternative Minimum Tax (AMT) is a tax code applied to a certain type of person with high income which usually involves them paying more.*
Source: *CaixaBank Research, based on information from the White House and the Committee for a Responsible Federal Budget.*

1. At the end of May, the administration presented a budget proposal for the 2018 fiscal year that specified significant reductions in certain items of expenditure. However, several of these have already caused controversy among the members of the different Houses.
2. See Tax Policy Center (2016), «An Analysis of Donald Trump's Revised Tax Plan». This analysis, however, assumes a reduction in the maximum marginal tax rate for individuals from the current 39.6% to 33%.
3. See the note produced by the Committee for a Responsible Federal Budget in April («How Much Will Trump's Tax Plan Cost?»). According to estimates by the Congressional Budget Office - CBO (2017), «The Budget and Economic Outlook: 2017 to 2027», if the plan is not passed, net public debt will increase to 89% in 2027.

KEY INDICATORS

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

UNITED STATES

	2015	2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	04/17	05/17
Activity								
Real GDP	2.6	1.6	1.3	1.7	2.0	2.0	–	...
Retail sales (excluding cars and petrol)	4.3	3.8	4.3	3.4	3.4	3.9	3.7	...
Consumer confidence *(value)*	98.0	99.8	94.8	100.7	107.8	117.5	119.4	117.9
Industrial production	–0.7	–1.2	–1.3	–1.2	–0.1	0.6	2.2	...
Manufacturing activity index (ISM) *(value)*	51.4	51.5	51.5	51.1	53.3	57.0	54.8	...
Housing starts *(thousands)*	1,107	1,177	1,158	1,150	1,248	1,242	1,172	...
Case-Shiller home price index *(value)*	179	189	188	189	192	197	...	...
Unemployment rate *(% lab. force)*	5.3	4.9	4.9	4.9	4.7	4.7	4.4	...
Employment-population ratio *(% pop. > 16 years)*	59.4	59.7	59.7	59.8	59.7	60.0	60.2	...
Trade balance[1] *(% GDP)*	–2.8	–2.7	–2.7	–2.7	–2.7	–2.7	...	...
Prices								
Consumer prices	0.1	1.3	1.0	1.1	1.8	2.5	2.2	...
Core consumer prices	1.8	2.2	2.2	2.2	2.2	2.2	1.9	...

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

JAPAN

	2015	2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	04/17
Activity							
Real GDP	1.1	1.0	1.0	1.1	1.7	1.6	–
Consumer confidence *(value)*	41.3	41.7	41.2	42.1	42.2	43.4	43.2
Industrial production	–1.2	–0.2	–1.5	1.0	2.8	3.9	7.2
Business activity index (Tankan) *(value)*	12.8	7.0	6.0	6.0	10.0	12.0	–
Unemployment rate *(% lab. force)*	3.4	3.1	3.2	3.0	3.1	2.9	2.8
Trade balance[1] *(% GDP)*	–0.5	0.7	0.1	0.5	0.7	0.7	0.9
Prices							
Consumer prices	0.8	–0.1	–0.3	–0.5	0.3	0.3	0.4
Core consumer prices	1.0	0.4	0.6	0.2	0.1	–0.1	–0.3

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

CHINA

	2015	2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	04/17
Activity							
Real GDP	6.9	6.7	6.7	6.7	6.8	6.9	–
Retail sales	10.7	10.4	10.2	10.5	10.6	10.0	10.7
Industrial production	6.1	6.0	6.1	6.1	6.1	6.8	6.5
PMI manufacturing *(value)*	49.9	50.3	50.1	50.2	51.4	51.6	51.2
Foreign sector							
Trade balance[1] *(value)*	608	513	576	554	513	469	468
Exports	–2.3	–8.3	–7.5	–7.0	–5.2	8.2	8.3
Imports	–14.2	–5.7	–7.1	–4.7	2.1	24.0	11.8
Prices							
Consumer prices	1.4	2.0	2.1	1.7	2.2	1.4	1.2
Official interest rate[2] *(value)*	4.35	4.35	4.35	4.35	4.35	4.35	4.35
Renminbi per dollar *(value)*	6.3	6.6	6.5	6.7	6.8	6.9	6.9

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

ECONOMIC OUTLOOK · **A more solid outlook for the euro area's economic activity**

The recovery picks up speed and uncertainty eases. After the growth figures for the euro area were revised upwards by the European Central Bank (ECB) in March and by the International Monetary Fund in April, in May the European Commission also improved its outlook for the euro area, predicting growth in economic activity of 1.7% in 2017 and 1.8% in 2018. This series of upgrades reflects the decrease in downside risks for the euro area's economy (especially domestic risks) and the consolidation of the improvement in the economic sentiment indicators, remaining at their highest level for several years since the end of 2016. In a similar fashion, CaixaBank Research has also improved its outlook for euro area economic activity to 1.9% in 2017 and 1.8% in 2018. The upgrade is widespread across countries and rests on the solidity of domestic demand, the gradual improvement in the labour market and accommodative financial conditions. However, as noted by the Commission, Europe's economy is still facing an uncertain environment and significant global risks. Other factors are also hindering faster growth in the medium term, such as high debt and limited gains in productivity. One important goal that has yet to be achieved is therefore greater European integration. France's President, the pro-European Emmanuel Macron who was elected after the second round of presidential elections with over 60% of the votes, could help to spur on this process.

Stronger growth in the euro area. Eurostat's preliminary estimate suggests that euro area GDP grew by 0.5% quarter-on-quarter in Q1, the same rate as the previous quarter, and by 1.7% in annual terms. This positive performance was shared across different countries, with particularly good GDP quarterly growth figures in Portugal (1.0%) and Spain (0.8%), but also positive figures in Germany (0.6%) and France (0.4%). On the downside, Italy once again recorded weak growth (0.2% quarter-on-quarter). Beyond the euro area, the countries of emerging Europe also posted good Q1 figures, accelerating their growth rates. Romania grew by 5.6% year-on-year and Poland and Hungary recorded higher-than-expected growth rates, both up by 4.1% year-on-year.

Economic activity indicators point to solid growth continuing in Q2. For the euro area as a whole, the composite business sentiment index (PMI) stood at 56.8 points in May, the same as in April. Therefore, the sentiment indicator comfortably remains in the expansionary zone for economic activity, now at its highest level since April 2011. By country, the figures for France and Germany have been published, also at their highest since 2011: 57.6 points in France, the highest

GDP forecasts by the European Commission

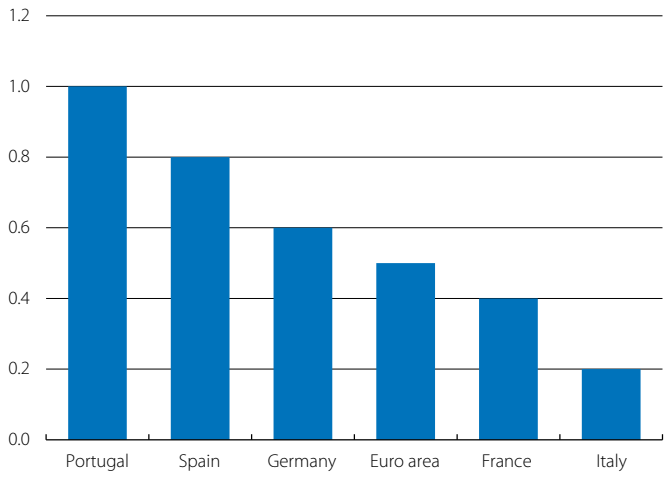
Year-on-year change (%)

	Forecast		Change compared with the February 2017 forecast (pp)	
	2017	2018	2017	2018
Euro area	1.7	1.8	▲ 0.1	=
Germany	1.6	1.9	=	▲ 0.1
France	1.4	1.7	=	=
Italy	0.9	1.1	=	=
Spain	2.8	2.4	▲ 0.5	▲ 0.3
Portugal	1.8	1.6	▲ 0.2	▲ 0.1
UK	1.8	1.3	▲ 0.3	▲ 0.1

Source: *CaixaBank Research, based on data from the European Commission (European Economic Forecast, Spring 2017).*

Euro area: GDP in Q1 2017

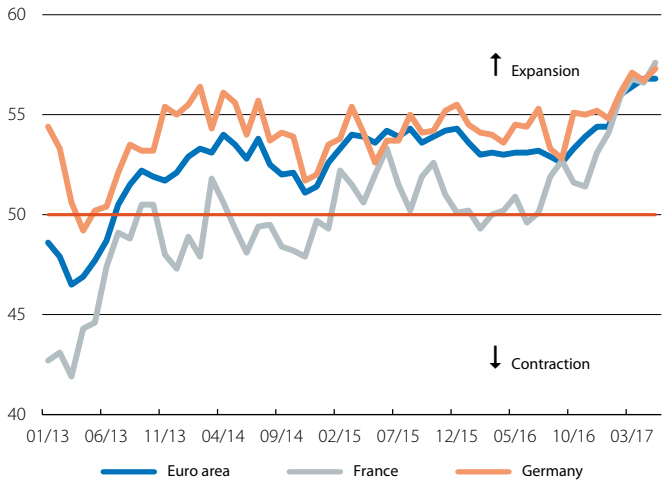
Quarter-on-quarter change (%)



Source: *CaixaBank Research, based on data from the BIS.*

Euro area: composite PMI economic activity indicator

Level



Source: *CaixaBank Research, based on data from Markit.*

since May 2011, and 57.3 points in Germany, the highest since April 2011. Although somewhat more delayed in their publication, other indicators also point to more solid economic activity. In March, industrial production increased by 1.9% year-on-year in the euro area thanks to widespread growth in the region's main countries (1.3% in Germany, 2.0% in France, 2.8% in Italy and 0.4% in Spain).

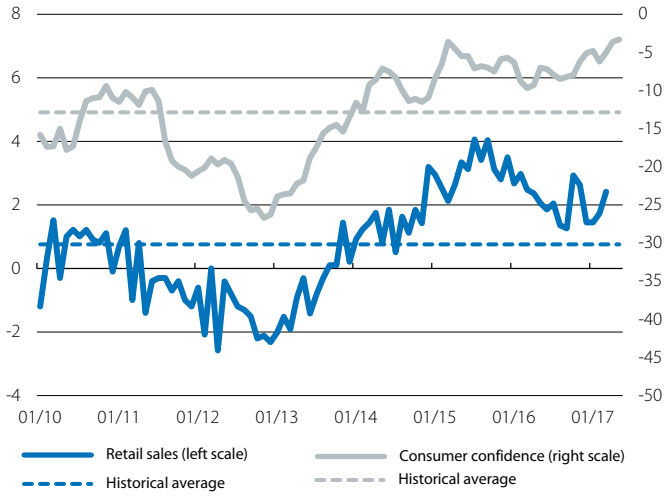
Household consumption supports economic growth. Euro area retail sales rose by 2.4% year-on-year in March, ending Q1 with a faster growth rate than in January and February. The consumer confidence index for the euro area as a whole has maintained the improvement observed since mid-2016, standing at –3.3 points in May, slightly above April's figure and the highest since 2007. This good tone in private consumption has been helped by the accommodative financial conditions, boosted in the short term by the ECB's expansionary monetary policy and in the medium term by the improved labour market (the unemployment rate stood at 9.3% in April, its lowest since March 2009).

Accommodative financial conditions are helping companies to access credit. As shown by the latest Survey on the Access to Finance of Enterprises, produced by the ECB, between October 2016 and March 2017 the demand for external finance by SMEs increased moderately in the euro area as a whole. In the report, SMEs signal that this increase in their external financing needs was accompanied by an improvement in the availability of bank loans and lower interest rates. Along these lines, they believe that access to external finance is not among the most pressing problems facing SMEs. This reflects two developments. The consolidation of the recovery, improving the economic prospects for companies and their solvency. And the transmission of the ECB's expansionary monetary policy, resulting in accommodative financial conditions that support the euro area's recovery.

Inflation continues to normalise. In May, the euro area's headline inflation, measured by the harmonised index of consumer prices (HICP), stood at 1.4%, –0.5 pp compared to April's figure. This is due to lower contributions both by the energy component, influenced by the gradual disappearance of the base effect of oil prices, and also by services. Core inflation, which excludes the volatile components (energy and unprocessed food), stood at 1.0%, –0.2 pp compared with April. This is because of the disappearance of the calendar effect of Easter which, as it fell entirely in April this year (in March last year), had temporarily pushed up the prices of services related to package holidays. Once these temporarily volatile movements have passed, core inflation should continue its gradual rise over the coming months, supported by the improved labour market. Headline inflation should also gradually converge towards core inflation as the base effect disappears of the slump in oil prices in 2014 and 2015 and their subsequent recovery throughout 2016.

Euro area: consumption indicators

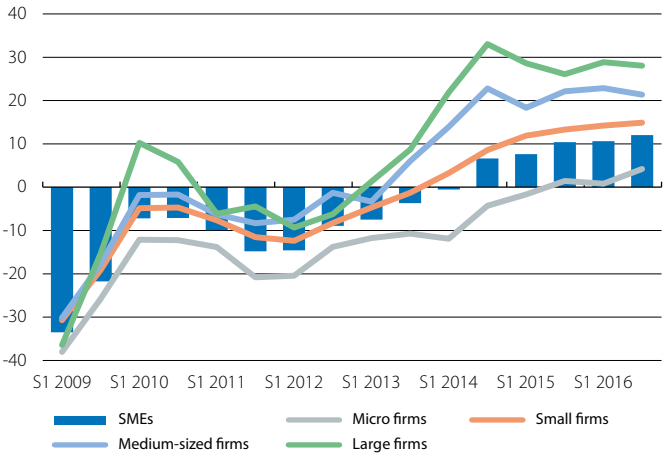
Year-on-year change (%) *Level*



Source: *CaixaBank Research, based on data from Eurostat and the European Commission.*

Euro area: availability of external financing for enterprises by company size

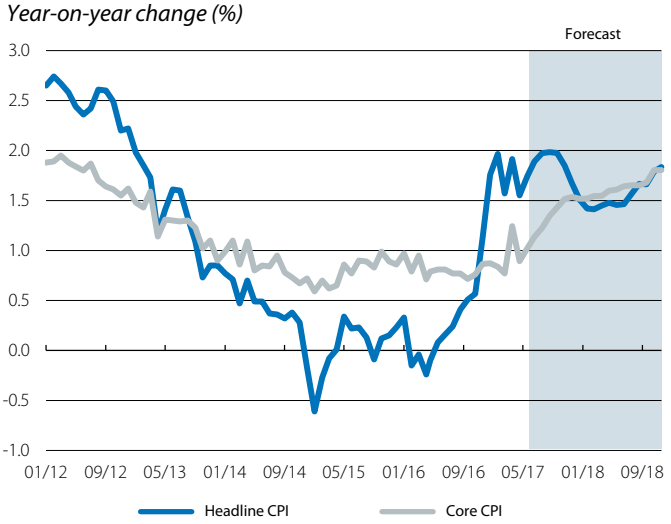
(% of enterprises reporting improvements compared with previous period)



Source: *CaixaBank Research, based on data from the ECB.*

Euro area: Harmonised CPI

Year-on-year change (%)



Source: *CaixaBank Research, based on data from Eurostat.*

PORTUGAL

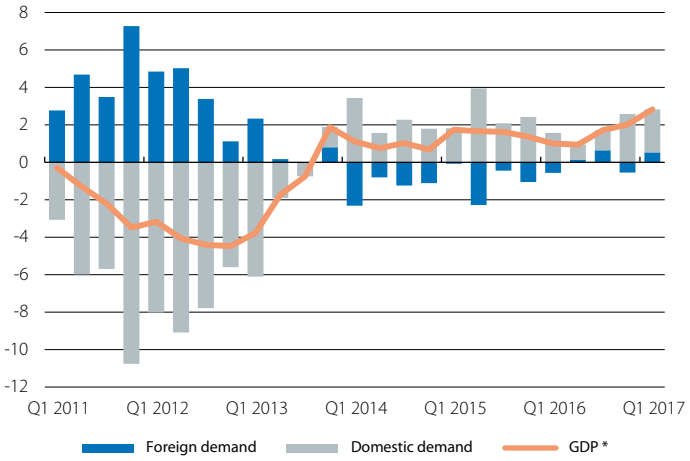
A better economic outlook for Portugal. The Portuguese economy accelerated its GDP growth in Q1 to 1.0% quarter-on-quarter (compared with 0.7% in Q4), lifting year-on-year growth to 2.8%. By components, domestic demand made a significant contribution (+2.3 pp), boosted by higher private consumption (2.2% year-on-year) and investment (8.9%), while inventory changes deducted 0.5 pp from year-on-year growth. Foreign demand also made a positive contribution (+0.5 pp) with a big increase in exports (9.7% year-on-year) and imports (8.0%), reflecting the country's solid domestic demand. Given these good Q1 figures and the fact that economic activity indicators point to higher growth in 2017, CaixaBank Research has revised its forecast for 2017 up to 2.5%, and for 2018 up to 1.8%. The Portuguese economy is therefore expected to post solid increases over the coming months based on a more balanced pattern of growth between domestic and foreign demand.

The European Commission recommends Portugal should exit its excessive deficit procedure. The Commission approves of the Stability Programme for 2017-2021 submitted by the Portuguese government at the end of April. This predicts a general government deficit of 1.5% of GDP and government debt-to-GDP of 127.9% in 2017, slightly lower figures than in 2016 (2.0% deficit and 130.4% debt). The Stability Programme also expects the general budget to gradually reduce its deficit up to the end of 2021, when it should achieve a surplus of 1.3% with government debt at 109.4% of GDP. In its recommendation, the Commission notes that Portugal's government deficit ended 2016 below the 3%-of-GDP Treaty reference value. It also believes the Stability Programme presented ensures the Portuguese government will keep its fiscal account within the bounds established in European treaties. The European Council is therefore expected to follow the Commission's recommendation and cancel the Excessive Deficit Procedure for Portugal. This will help the Portuguese economy to benefit from better financial conditions as it improves its reputation among investors.

Inflation is gradually getting back to normal. After inflation fell in 2014, 2015 and 2016 because of the slump in oil prices, headline inflation was boosted in Q1 2017 by rising energy prices, reaching 1.4%. In April this contribution by the energy component was joined by the calendar effect of Easter, with higher prices for goods and services related to transport, hotels and restaurants. Headline inflation consequently rose sharply to 2.4%. These temporary effects will disappear over the coming months and inflation will rise more gradually, supported by the improved labour market and increase in global prices for imports of intermediate goods.

Portugal: GDP

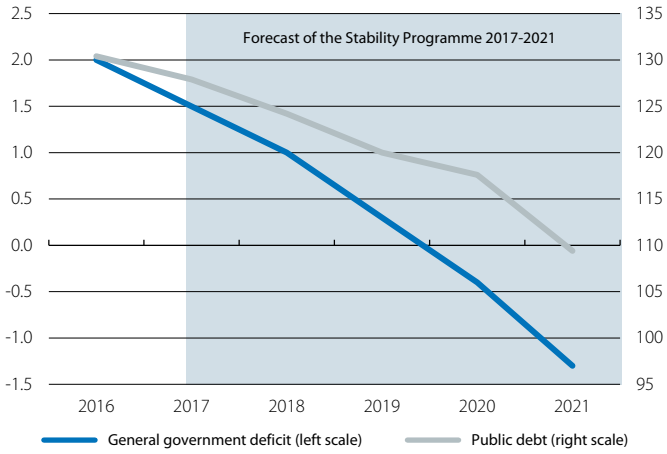
Contribution to year-on-year growth (pp)



Note: ** Year-on-year change (%).*
Source: *CaixaBank Research, based on data from Eurostat.*

Portugal: general government deficit and debt according to the Stability Programme

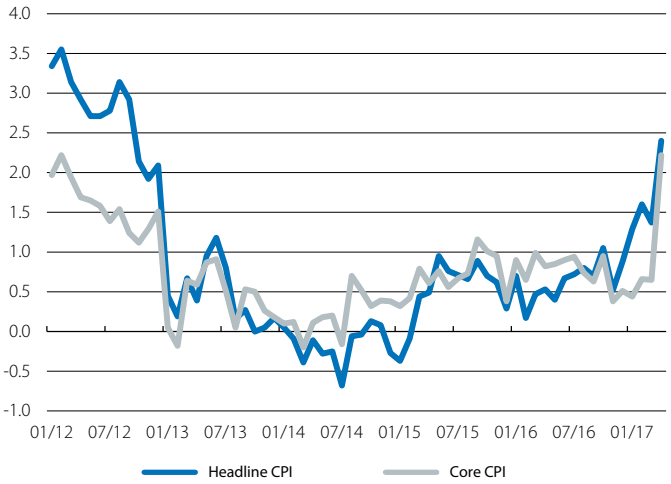
(% of GDP) *(% of GDP)*



Source: *CaixaBank Research, based on data from the Portuguese government.*

Portugal: Harmonised CPI

Year-on-year change (%)



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

FOCUS · Tracking core inflation: the pricing chain

The prices of energy and unprocessed food have been volatile recently. The ECB has therefore turned its attention to the trend in core inflation, which excludes these components, in order to analyse the underlying price dynamics. Previous Focus articles[1] have examined how the trend in core inflation is related to developments in the labour market. One reason is that the main component of core inflation, services with 54% of the basket, is particularly labour-intensive. Another important component receives less attention, however: non-energy industrial goods (NEIG), with a 32% share of the basket.[2] As can be seen in the first chart, NEIG inflation is much less tied to the cyclical position of the economy. So what are its main determinants and outlook?

NEIG are manufactured goods[3] and their prices are formed throughout production chains involving commodities, production factors, imports and intermediate goods, giving rise to indicators for producer prices.[4] The second chart shows the link between NEIG prices and the main indicators of producer prices. Two of these indicators are particularly informative: the prices of intermediate goods, indicative of early stages in the chain, and non-food consumer goods for the later stages. As can be seen, NEIG prices are especially associated with the producer price of non-food consumer goods. Changes in producer prices also take some time to achieve their maximum impact on NEIG prices: the lag is eight months for non-food consumer goods. If we go back one step in the production chain, there is also a strong link between the prices of intermediate goods and non-food consumer goods, reaching maximum impact with a lag of around seven months.

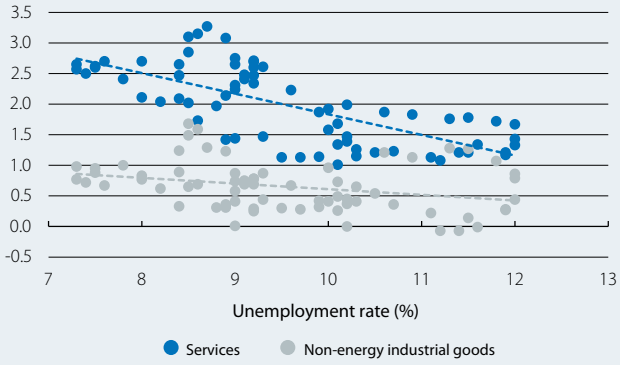
As can be seen in the third chart, since the end of 2016 inflation for intermediate goods has recovered notably, coming particularly from imported intermediate goods. This reflects the recovery in global producer prices, affected at least in part by commodities. Such relationships suggest that NEIG inflation will recover over the coming months.

As higher producer prices are passed on down the chain or «pipeline», this will help core inflation to recover, in addition to the effect of the improved labour market. As we have seen in this and previous Focus articles, both processes point to a gradual upturn in core inflation, a situation that will influence the ECB's next few meetings.

1. See « Core inflation scenarios: activity, periphery and oil», in MR12/2016.
2. The remaining 14% corresponds to processed food.
3. The NEIG basket contains a range of goods, such as pharmaceutical and personal care products, cars, computers, clothing and footwear.
4. The difference between producer and consumer prices corresponds to distribution and retail margins.

Prices of goods and services and economic activity *

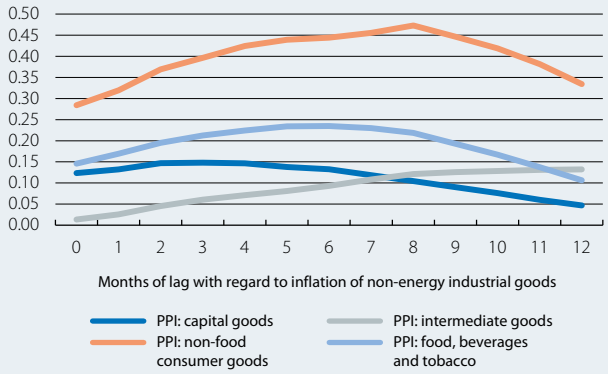
Inflation (%)



Note: ** Each point represents the values for inflation and unemployment at a moment in time (quarter) between Q1 2000 and Q1 2017.*
Source: *CaixaBank Research, based on data from Eurostat.*

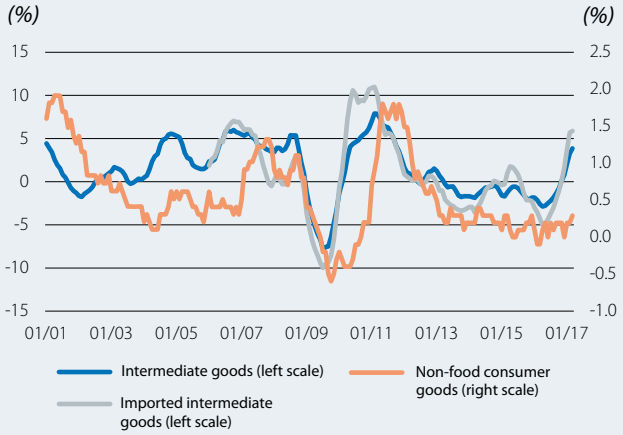
Consumer prices of non-energy industrial goods and producer price index (PPI)

*Degree of association (R-squared) **



Note: ** R-squared regression of inflation for non-energy industrial goods (NEIG) with regard to a lagged value of the inflation component for industrial prices.*
Source: *CaixaBank Research, based on data from Eurostat.*

Inflationary pressures on industrial producer prices



Source: *CaixaBank Research, based on data from Eurostat.*

FOCUS · The growing productivity divide between firms

A phenomenon that is causing a lot of debate among academics and policymakers is the low productivity growth in most advanced economies. Although this is a global trend, substantial heterogeneity across firms is observed (see the enclosed chart).

For instance, the so-called «frontier firms» in 2003 (those who exhibited higher productivity) also managed to maintain a higher growth rate in productivity than other companies in subsequent years.[1] Proof of this is that, between 2003 and 2013, OECD «frontier firms» in the manufacturing sector averaged 2.7% growth year-on-year while growth for the rest was just 1% (the difference is even larger in the services sector).

The increasing productivity gap between firms is mainly explained by two factors: technological advances and globalisation.

Regarding the first factor, it is worthwihile noticing that technological improvements are not only related to robotics and the automation of production processes but also to organisational improvements, the development of new ideas, etc. Although, historically, new technologies have always been taken on board initially by a small number of companies (think of the looms in textile factories, the first computers, etc.), these improvements have gradually spread to other firms. However, several academic articles suggest this «spreading» of technology has stagnated in the past few years. This would explain the increasing dispersion in companies' levels of productivity.[2] Such stagnation can be attributed to two factors: the increasing complexity of technological advances and the limited number of workers capable of taking advantage of such improvements.

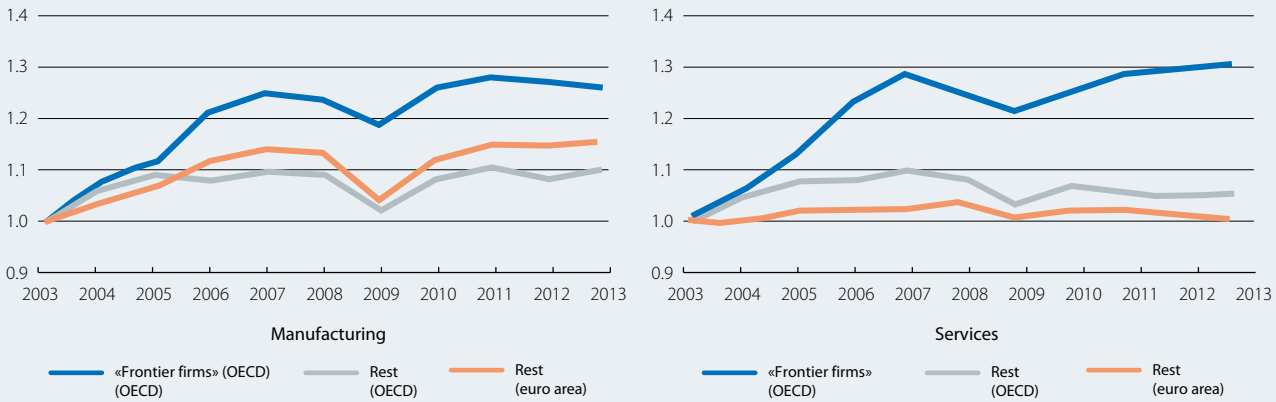
Another feature which might also help to explain the growing productivity gap is the fact that technology is helping the more productive companies to expand. A case in point are the new online platforms that compare the price and quality of a wide range of products (insurance, flights, hotels, etc.). Such sites help the more productive companies to gain market share and enjoy higher growth rates. They can therefore take more advantage of economies of scale, helping them to maintain a higher rate of growth in productivity.[3]

Globalisation is another factor which may have increased the disparity between productivity levels in companies. A globalised environment encourages certain firms (typically the largest and most internationalized) to become more commercially interrelated (in economic jargon, more active in global value chains). This greater interconnectivity fosters the exchange of ideas and technological advances between the more productive companies, allowing them to incorporate these improvements in their production processes. Globalisation has also helped certain firms to decentralise part of their production (for instance, offshoring to lower income countries) and concentrate on those productive segments with higher added value, also with higher growth in productivity.

This increasing disparity between firms in productivity terms is not trivial, as it has important social and economic repercussions. For example, it can result in a greater disparity in corporate earnings and wages.[4] It is therefore crucial to promote a framework that encourages the spreading of technology. It also needs to ensure that the benefits provided by a more international economy at the aggregate level are available to as many companies and workers as possible.

*Productivity * by company type*

Index (1 = 2003)



Note: ** Apparent labour productivity is defined as the added value per hour worked (euros per hour).*
Source: *ECB (Economic Bulletin, May 2017).*

1. See OECD (2016), «The Productivity-Inclusiveness Nexus».
2. See ECB, «The slowdown in euro area productivity in a global context», Economic Bulletin, No. 3/2017.
3. See OECD (2016), «The global productivity slowdown, technology divergence, and public policy: A firm level perspective»
4. See OECD (2017), «The Great Divergence(s)».

KEY INDICATORS

Activity and employment indicators

Values, unless otherwise specified

	2015	2016	Q2 2016	Q3 2016	Q4 2016	01/17	04/17	05/17
Retail sales *(year-on-year change)*	3.2	2.2	2.0	1.5	2.4	1.9	...	...
Industrial production *(year-on-year change)*	2.1	1.4	1.0	1.0	2.3	1.2	...	...
Consumer confidence	–6.3	–7.8	–7.9	–8.3	–6.5	–5.5	–3.6	–3.3
Economic sentiment	104.2	104.8	104.2	104.2	106.9	108.0	109.7	109.2
Manufacturing PMI	52.2	52.5	52.0	52.1	54.0	55.6	56.7	57.0
Services PMI	54.0	53.1	53.1	52.6	53.4	55.1	56.4	56.2
Labour market								
Employment (people) *(year-on-year change)*	1.0	1.3	1.4	1.2	1.2	...	–	...
Unemployment rate: euro area *(% labour force)*	10.9	10.0	10.2	9.9	9.7	9.4	9.3	...
Germany *(% labour force)*	4.6	4.2	4.2	4.1	3.9	3.9	3.9	...
France *(% labour force)*	10.4	10.0	10.1	10.0	10.0	9.6	9.5	...
Italy *(% labour force)*	11.9	11.7	11.7	11.6	11.8	11.6	11.1	...
Spain *(% labour force)*	22.1	19.6	20.2	19.3	18.6	18.2	17.8	...

Source: *CaixaBank 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

	2015	2016	Q2 2016	Q3 2016	Q4 2016	01/17	02/17	03/17	04/17
Current balance: euro area	**3.4**	**3.6**	**3.7**	**3.7**	**3.6**	**3.5**	**3.6**	**3.6**	**...**
Germany	8.6	8.3	8.9	8.6	8.3	8.3	8.3	8.3	...
France	–0.2	–0.9	–0.8	–1.2	–0.9	–1.2	–1.2	–1.2	...
Italy	1.4	2.6	2.2	2.5	2.6	2.5	2.5	...	...
Spain	1.4	2.0	1.7	1.8	2.0	2.0	2.1	2.1	...
Nominal effective exchange rate[1] *(value)*	**92.3**	**94.7**	**94.8**	**95.1**	**94.8**	**94.3**	**93.8**	**94.4**	**94.1**

Note: *1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated.*
Source: *CaixaBank 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

	2015	2016	Q2 2016	Q3 2016	Q4 2016	01/17	02/17	03/17	04/17
Private sector financing									
Credit to non-financial firms[1]	–0.3	1.8	1.7	2.0	2.1	2.2	1.9	2.3	2.4
Credit to households[1, 2]	0.7	1.7	1.7	1.8	1.9	2.2	2.3	2.4	2.4
Interest rate on loans to non-financial firms[3] *(%)*	1.6	1.4	1.4	1.3	1.3	1.3	1.2	1.4	...
Interest rate on loans to households for house purchases[4] *(%)*	2.1	1.9	1.8	1.8	1.8	1.8	1.8	1.7	...
Deposits									
On demand deposits	11.1	10.0	10.1	9.5	9.3	9.3	9.2	10.1	10.1
Other short-term deposits	–3.8	–1.8	–1.8	–1.2	–2.0	–2.2	–2.1	–2.5	–2.8
Marketable instruments	2.6	2.8	2.3	5.4	4.5	7.0	3.5	9.0	1.5
Interest rate on deposits up to 1 year from households *(%)*	0.8	0.5	0.6	0.5	0.4	0.4	0.4	0.4	...

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: *CaixaBank Research, based on data from the European Central Bank.*

ECONOMIC OUTLOOK · The Spanish economy is gaining ground in a more favourable external environment

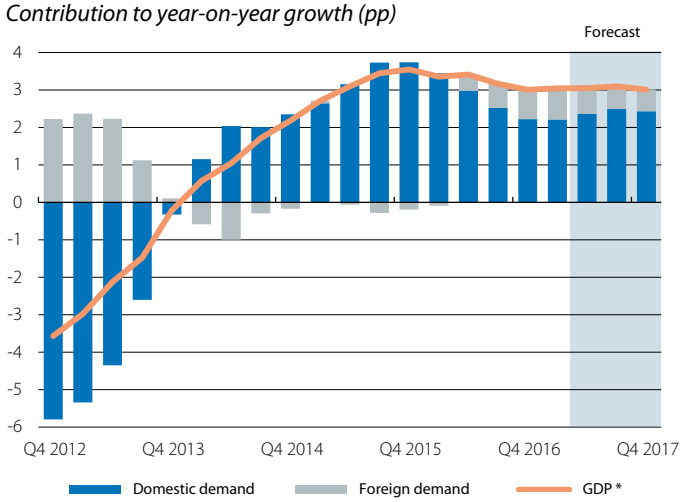
Economic growth accelerated to 0.8% quarter-on-quarter in Q1, 0.1 pp higher than the rate in Q4 2016. The year-on-year figure remained at a high 3.0%. Spain's economy is still showing no signs of slowing down; in fact, quite the opposite. Early indicators for April and May point to growth continuing at a similar pace to Q1 or even slightly faster. Given this good performance, CaixaBank Research has revised its growth forecast for 2017 from 2.8% to 3.1%, and for 2018 from 2.4% to 2.5%. These figures are noticeably higher than the forecasts for most advanced economies. The high growth rate recorded in the past three years has also helped Spain's GDP to regain its pre-crisis level. In nominal terms this landmark was reached in Q1 2017 while, in real terms, it was achieved in Q2 2017. This growth is also more balanced than in the previous expansionary period. In Q1 2017 domestic demand contributed 2.2 pp to year-on-year GDP growth while foreign demand also made a positive contribution of 0.8 pp.

Improvements in the external environment. Spain's faster economic growth is thanks to several factors, both external and internal. The tail winds that have boosted economic growth over the past two years are taking longer than expected to disappear: oil prices are only rising gradually and financial conditions are still very favourable. Monetary normalisation is also expected to be very measured in the euro area. The news from our main trading partners, other euro area countries, are also encouraging. Their growth prospects are improving, political uncertainty is easing (especially after Emmanuel Macron's victory in the French elections) and Brexit negotiations are not as disruptive as feared, at least for the moment. Regarding domestic factors, the structural reforms implemented in the past few years and gains made in competitiveness are also helping the economy to perform well. Moreover, the cyclical position of the Spanish economy means there is still ample room for solid expansion in both 2017 and 2018. For instance, private consumption and investment have yet to return to the peaks reached in 2008.

Private consumption goes through a temporary dip in Q1. Household consumption increased by just 0.4% quarter-on-quarter in Q1 2017, its lowest figure since Q3 2014. Nevertheless, the good trends shown by consumer confidence and retail sales in April suggest private consumption will liven up again in Q2. Improvements in the labour market and more favourable credit conditions, helped by the ECB's accommodative monetary policy and banks' improved lending capacity, will continue to act as key supports for household consumption.

GDP

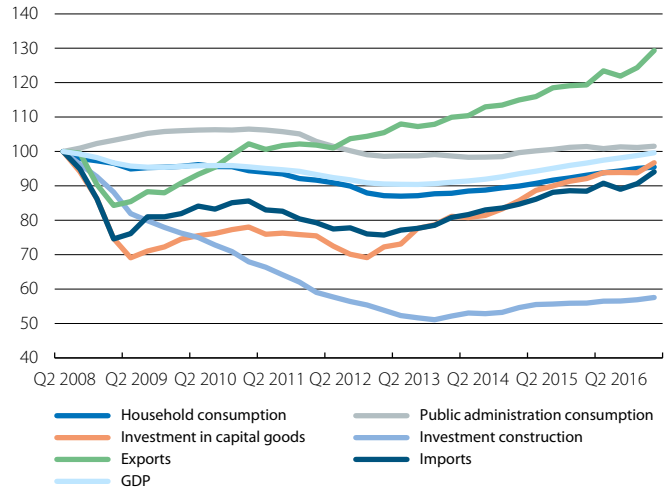
Contribution to year-on-year growth (pp)



Note: ** Year-on-year change (%).*
Source: *CaixaBank Research, based on data from the INE.*

GDP components

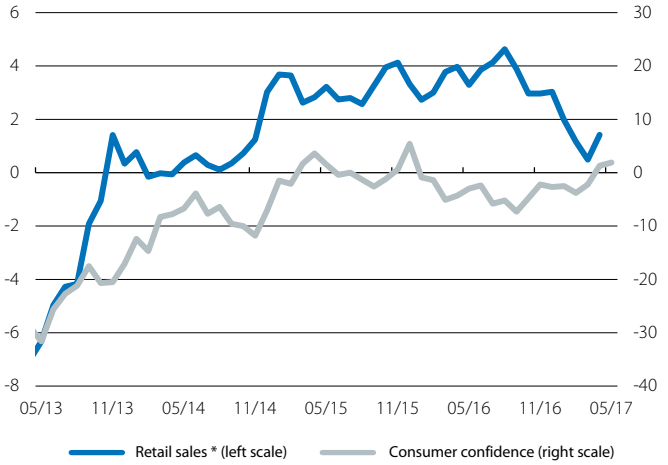
Index (100 = Q2 2008)



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

Retail and consumer goods and consumer confidence

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



Note: ** Moving average of three months.*
Source: *CaixaBank Research, based on data from the INE.*

Corporate capital expenditure is shaping up. The sharp upswing in investment in capital goods offset the dip in private consumption in Q1. The component saw strong growth of 3.1% quarter-on-quarter, leaving behind its sluggish performance in the previous two quarters. This strength has been reinforced by business sentiment indicators suggestive of robust expansionary phases. The upswing in Q1 is therefore likely to go much further in the future. The economic sentiment index (ESI) published by the European Commission stood at 108.4 points in April, above the average for 2016 (106.3). The PMI manufacturing index stood at 54.6 points while the services index reached 57.4 points; both also above the 2016 average.

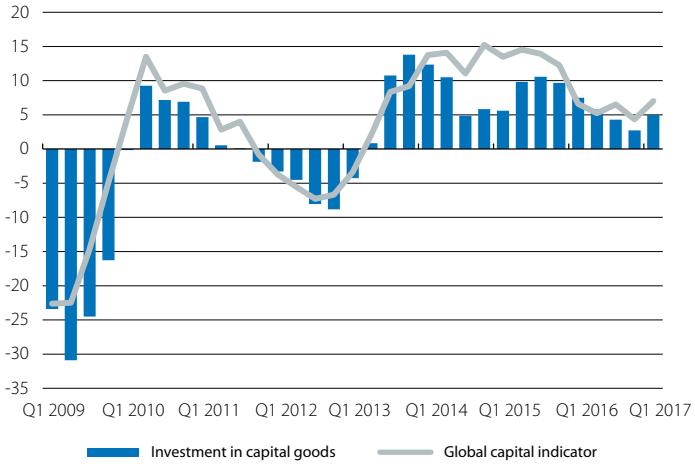
Real estate activity is on the rise. According to national account data, in Q1 2017 residential investment grew by an impressive 2.7% quarter-on-quarter (5.5% year-on-year), indicating the recovery in the real estate sector is taking hold. New building permits grew by 20.3% in March (cumulative over 12 months) although they are still at a relatively low level. This indicates the sector still has a lot of room for growth but without incurring the excesses of the past. Regarding demand, house sales were buoyant, up by 15.1% year-on-year in March (cumulative over 12 months). This higher demand is pushing up prices, rising by 2.2% year-on-year in Q1 2017 (0.9% in quarter-on-quarter terms) according to the Ministry of Public Works, above the 2016 average. This acceleration in the price index calculated by the Ministry of Public Works coincides with the acceleration shown by the INE price index in the second half of 2016. House prices will continue to rise over the coming quarters, albeit disparately across segments. Pressure from increased demand will be felt particularly in prime zones (large cities) where the supply is limited, while the market will still lag far behind in other areas.

The foreign sector posts strong growth thanks to dynamic exports. According to national account data, exports in real terms increased by a considerable 4.0% quarter-on-quarter (8.4% year-on-year). This growth can be seen both in exports of services, still benefitting from the tourism boom, and also in goods. Imports in real terms also increased, albeit to a lesser extent, growing by 3.8% quarter-on-quarter (6.4% year-on-year). Customs data for March, in nominal terms, confirm the trends shown by the national accounts, with goods exports growing by 5.1% year-on-year (cumulative over 12 months). Goods imports rose by a notable 3.8% year-on-year, although this is partly due to higher oil prices in Q1. The current account now stands at 2.1% of GDP, setting a new record.

The labour market continues to outperform expectations. The number of registered workers affiliated to Social Security rose by 212,216 in April, a considerably higher figure than the CaixaBank Research forecast (+155,000). The job creation rate therefore picked up to 3.8% year-on-year (3.5% in March). Although good figures were expected since Easter fell entirely in April this year (falling in March in 2016), the trend has outdone all expectations. For example, the increase in the

Capital goods investment

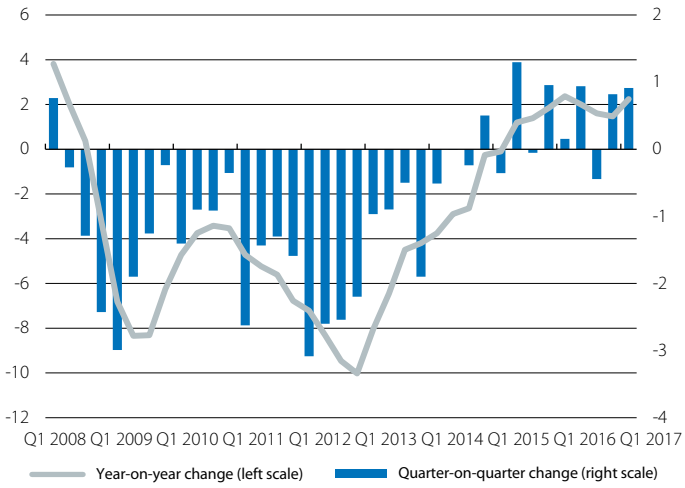
Year-on-year change (%)



Source: *CaixaBank Research, based on data from the INE and the Ministry of Economy, Industry and Competitiveness.*

House prices

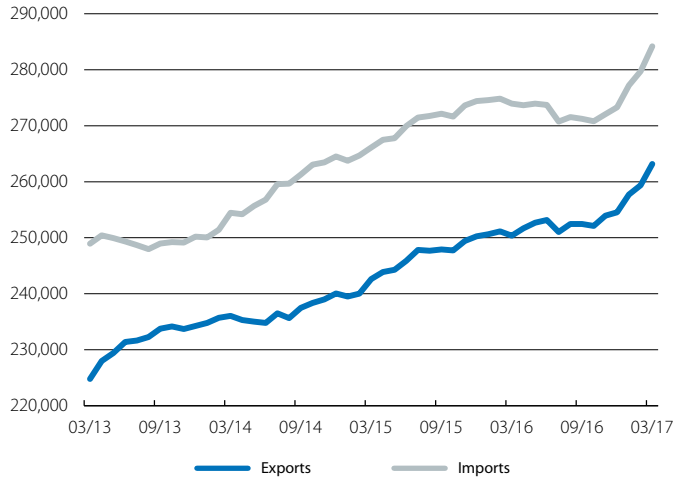
Change (%) *Change (%)*



Source: *CaixaBank Research, based on data from the Ministry of Public Works.*

Exports and imports of goods

(EUR million)



Source: *CaixaBank Research, based on data from the Customs Department.*

number of people affiliated to Social Security, without the seasonal component, was 101,006, an exceptionally high figure. Although the hotels and restaurants sector increased by 8.8% year-on-year, the rest of the sectors also posted a positive trend, especially construction and education. Registered unemployment fell by 129,281 people, pushing its rate of descent to –10.9% year-on-year, the fastest reduction in the whole history of the series. The national account data on equivalent full-time employment posted an increase of 2.5% year-on-year in Q1 and all the evidence suggests this good tone will continue over the coming quarters.

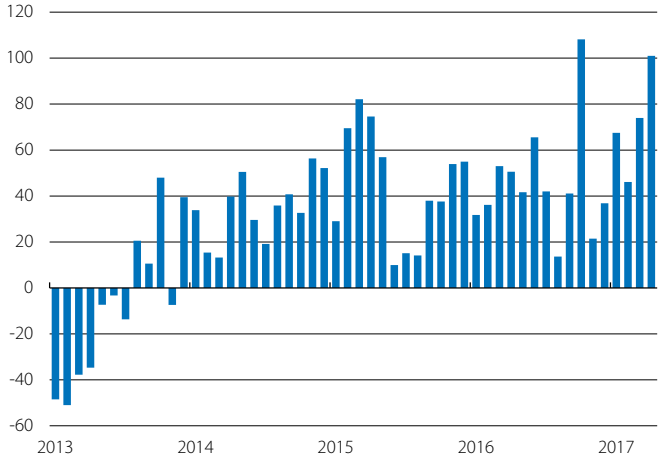
Inflation slackens. The CPI posted a 1.9% rise year-on-year in May, 0.7 pp less than in April. This was because of the fall in fuel prices compared with the increase last year, as well as the drop in prices for tourism packages after the increase over Easter. Core inflation (headline inflation without energy or unprocessed food) was also affected by Easter, with higher tourism prices pushing it up by 1.2% in April (pending more recent figures). The moderation in headline inflation should reverse in May, at least in part, due to the recent upswing in oil prices. Nevertheless, the trend is likely to moderate again in the second half of 2017 as growth in the price of crude slows down in year-on-year terms. Core inflation will tend to rise steadily, helped by dynamic private consumption.

The economic situation is also improving the national accounts. The public administration deficit fell to 0.5% of GDP in Q1 2017, 0.3 pp below the figure for Q1 2016. According to April's figures, the central government deficit fell to 0.7% of GDP (1.3% in April 2016). This corresponds to an adjustment of 0.3 pp out of the total adjustment of 1.2 pp required to achieve the deficit target of 3.1% in 2017. The current environment of low interest rates means that interest payments are still decreasing in spite of the high level of public debt (100.4% of GDP in Q1 2017).

The good economic climate is helping credit to expand, also boosted by the ECB continuing its expansionary monetary policy. In cumulative figures from January to March, credit to buy housing rose by 23.5% year-on-year, reflecting the recovery in demand in the sector, while consumer credit also grew strongly by 22.5% year-on-year. In terms of business credit, loans to SMEs also improved on 2016, up by 9.6% year-on-year. Loans to large companies are still feeling the effect of the rise in corporate bond issuances, albeit to a lesser extent than in 2016.

Registered workers affiliated to Social Security *

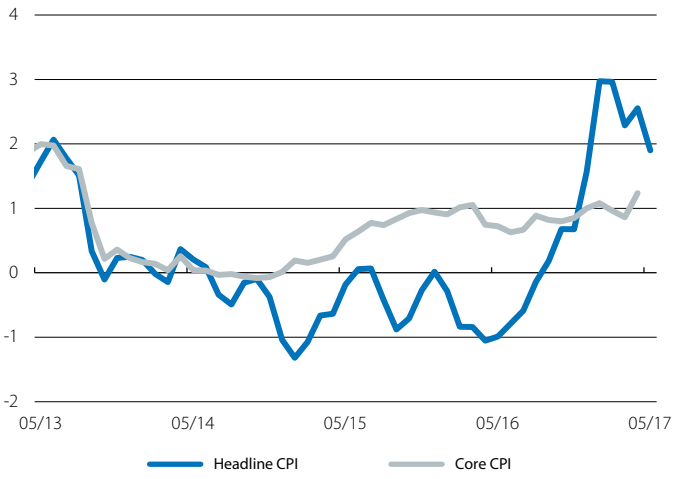
Month-on-month change (thousands of people)



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

CPI

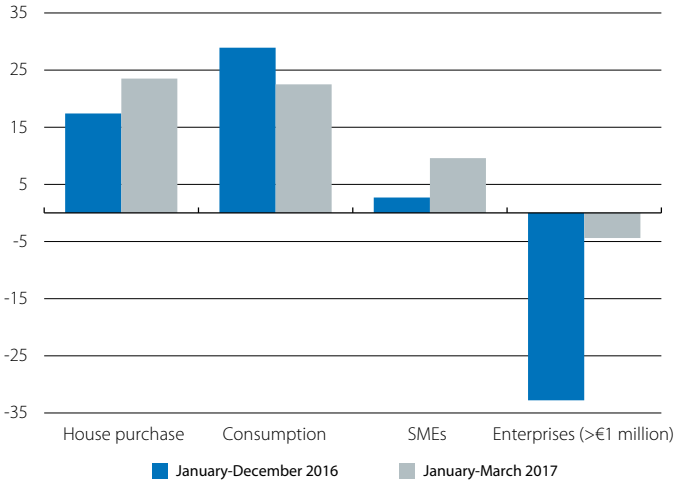
Year-on-year change (%)



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

New loans granted

Year-on-year change (%)



Source: *CaixaBank Research, based on data from the Customs Department.*

FOCUS · The Spanish economy's dependence on external financing

Spain's economy has made considerable progress in the past few years in correcting the major macroeconomic imbalances resulting from its previous expansionary period. But one task still pending is its overdependence on external financing. Although the economy as a whole has started to reduce its level of debt, gross external debt has hardly changed. In particular, it stood at 167.5% of GDP in Q4 2016, a very similar level to 2012 (see the first chart).[1] However, as we will see below, what have significantly changed during this period is the sectoral composition of external debt.

The main reason for the whole economy's external debt not falling over the past few years is the evolution in public debt. Between 2007 and 2016, public debt increased by 63.8 pp of GDP and approximately half of this increase (32.2 pp) is held by foreign creditors. Nevertheless, the rise in external public debt has not been constant over this period. In fact, it decreased sharply in 2012 as Europe's sovereign debt crisis spoiled the appetite of international investors for government bonds from the periphery. But since then, the share of public debt in foreign hands has grown considerably, up to its present figure of approximately 50% (see the second chart).

In clear contrast, private sector deleveraging has progressed markedly.[2] Between Q2 2010, when it was at its peak, and Q4 2016, the debt of non-financial companies fell by 31.4 pp of GDP. Most of this deleveraging has been domestic since external debt only decreased by 9.9 pp over the same period in the private sector. Consequently, the share of corporate debt held by foreigners is at an all-time high (around 39%).[3] This is due both to the evolution of firm's credit and also of corporate bonds. Regarding credit, which makes up most corporate debt, the share of external financing is increasing. In 2016, 26% of loans to companies had foreign counterparties compared with 21% in 2012. Although corporate bonds only account for 2.7% of all non-financial frim's debt, these are gaining weight, both due to the larger volume of issuances and also the increase in purchases by non-residents. The share of corporate bonds held by foreigners rose from 9.1% in 2012 to 35.7% in 2016.

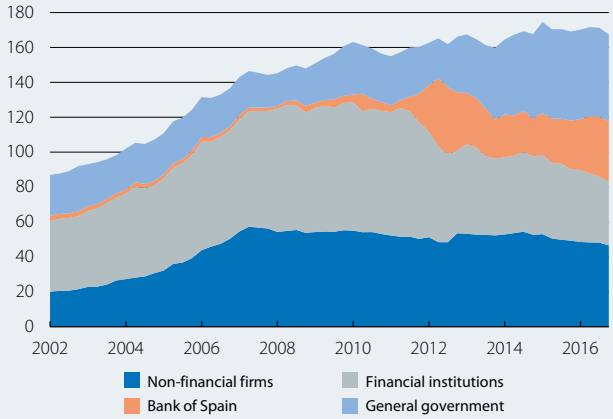
1. This article looks at external debt in gross terms. An economy's external situation is also often evaluated via its net international investment position (NIIP). See the Focus «The economy's external position: how can it be corrected?» published in MR09/2016.
2. Private external debt corresponds almost entirely to non-financial firms' debt. Household external debt is very limited (only 0.2% of its debt takes the form of loans from the rest of the world).
3. In addition to corporate bonds and credit, non-financial firms' external debt also includes foreign direct investment in the form of intragroup loans.

Lastly, Europe's sovereign debt crisis also led to financial institutions reducing their external debt considerably between Q2 2011 and Q4 2012 (–26.2 pp of GDP). This process has continued more gradually up to Q4 2016, reducing debt by a further 11.1 pp. The total debt of financial institutions has also fallen over this period and at a similar rate. Consequently, the share of external debt for the financial sector has remained stable at around 45%. It should, however, be remembered that a significant part of the financial sector's funding comes from the ECB thanks to the policies implemented over the past few years, channelled via the Bank of Spain.

Although total debt started decreasing in 2012, it is still very high for the economy as a whole and external debt has hardly changed at all. However, Spain is expected to continue reducing its dependence on external financing in the future, helping it to become less vulnerable to any changes in investor sentiment.

External debt

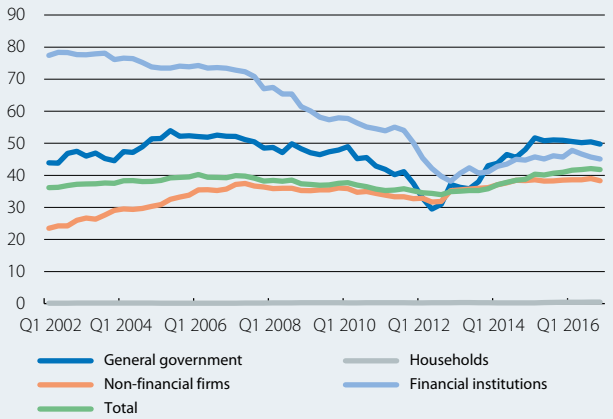
(% of GDP)



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

External debt by institutional sector

(% of the total debt of each sector)



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

FOCUS · The real estate industry: a two-speed recovery

In the two years between 2015 and 2016, Spain's GDP grew by 3.2% year-on-year and over one million jobs were created, boosting the gross disposable income of households. This favourable trend in a low interest rate environment has stimulated house purchases, which have posted double digit growth figures.[1] The property business is therefore booming. In fact, in 2016 there were 7% more firms operating in real estate activities, a similar growth rate to the one posted by employment in this subsector in 2015-2016.[2]

Although house sales are enjoying a very positive trend, the recovery in housing starts is much more gradual with numbers still at historically low levels. The legacy of the real estate crisis, in the form of a large stock of new properties, is undoubtedly acting as a brake on growth in residential construction. In fact the number of companies involved in constructing properties is still declining, albeit at an ever-slower rate.[3] But the employment figures are somewhat more encouraging. In 2016 employment rose by 5.3%, although this subsector still has fewer than half the number of Social Security affiliates it had in 2009.

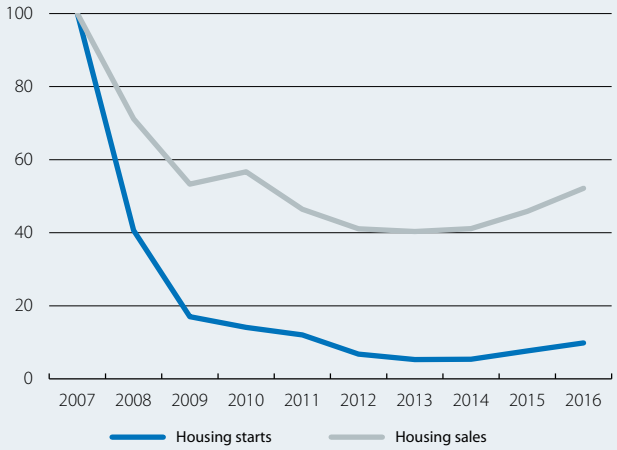
The disparate trend among those sectors aimed at selling and those at building properties can also be seen in their earnings. The aggregate profits of listed construction companies rose by 18% in 2016, although they are still in the red. Meanwhile those companies involved in the commercial side of the real estate sector earned four times more than in 2015.[4] Nevertheless, firms in the real estate sector as a whole are enjoying higher profits.

In the medium term, housing starts will become more important as the stock of new properties for sale dwindles. This should boost construction and will help to reduce the current disparity between the sellers and builders of residential properties.

1. House sales grew by 15.1% year-on-year in March, cumulative over 12 months.
2. Data for CNAE group 68: Real estate activities (sale and rental of property for own use and third parties).
3. Data for CNAE group 41: Building construction (real estate development and building construction).
4. Data for all companies set up before 2015 and listed on the Madrid stock market from category 5.5 (real estate) and 5.10 (SOCIMI - real estate holdings or investment trusts).

Housing starts and sales

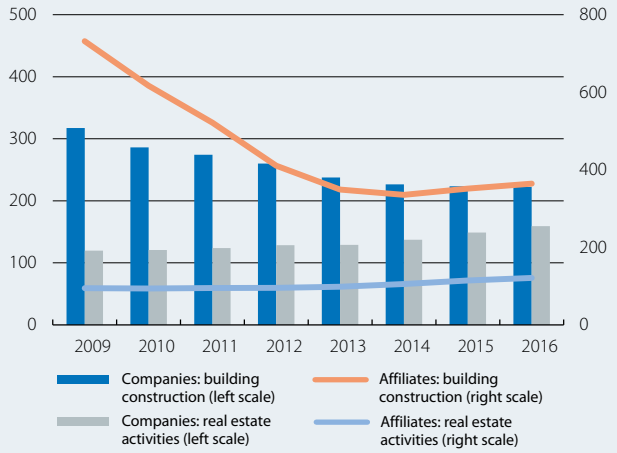
Index (100 = 2007)



Source: *CaixaBank Research, based on data from the INE and Ministry of Public Works.*

Number of companies and Social Security affiliates by activity

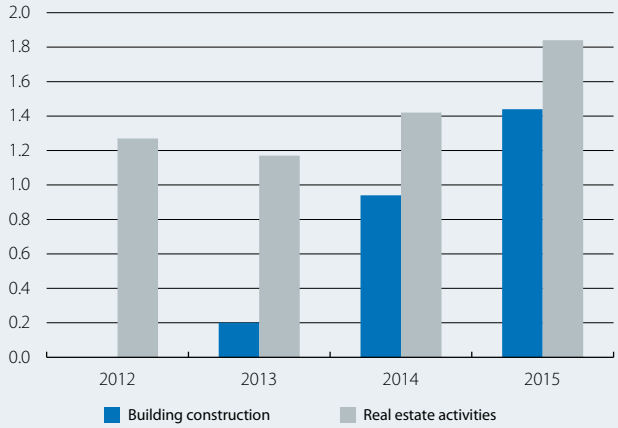
(Thousands) *(Thousands)*



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

Profitability of real estate firms

Profit before tax/equity (ratio)



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

FOCUS · Spain's sovereign debt rating: slowly but surely

On 31 March the ratings agency Standard & Poor's (S&P) improved the outlook for Spain's sovereign debt from stable to positive. The US agency has therefore taken the first step towards improving the country's credit rating over the next two years, which has remained at BBB+ since October 2015.[1] Should the CaixaBank Research forecasts for the Spanish economy be accurate, the rating is likely to be upgraded sooner rather than later.

There are various reasons why sovereign debt credit ratings are especially important. Firstly, because they provide investors with valuable information on the risk associated with the country issuing the debt. In turn, this has a direct effect on the interest rates a public treasury must offer to secure financing. Secondly, because they directly influence the rating of the country's companies. This is because a sovereign credit rating usually acts as a *de facto* floor when assessing the risk of a firm. In Spain, for instance, the average credit rating of Ibex 35 companies is between BBB and BBB–, two notches below the country's rating (BBB+). A change in sovereign rating therefore has a direct effect on companies' financing costs.

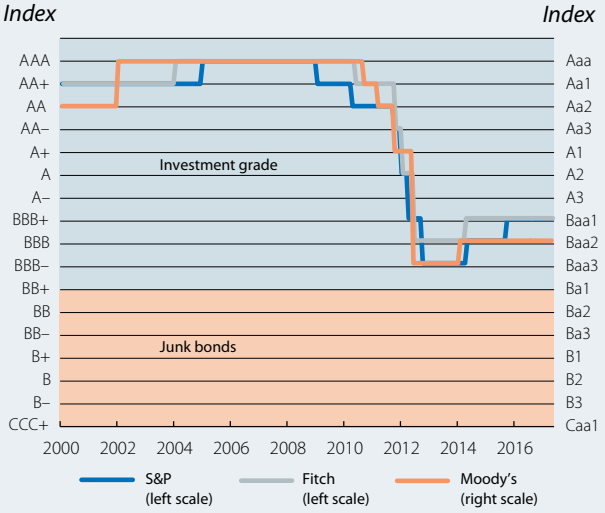
The start of Spain's economic recovery in the second half of 2013 marked a shift in trend in the evolution of its sovereign rating. S&P successively downgraded its rating during the recessionary period of 2008-2012: from the dizzy heights of AAA to the threshold for junk bonds (BBB–). Since then, Spain's credit rating has moved steadily back up, although it still has a long way to go to regain its pre-crisis level (see the first chart).

Over the coming quarters, the country's favourable economic outlook suggests this positive trend is here to stay. On the one hand, the Spanish economy will continue to enjoy strong growth and may even outperform the expectations of the S&P ratings agency itself. CaixaBank Research forecasts expect GDP growth of 3.1% in 2017 and 2.5% in 2018, compared with S&P's forecast of 2.5% and 2.1%, respectively. On the other hand, the country's macroeconomic imbalances, both internal and external, are being corrected. CaixaBank Research predicts that Spain's public deficit will continue to fall, reaching 3.1% of GDP in 2017 and 2.4% in 2018, somewhat more optimistic projections than those by S&P (3.3% and 2.9%, respectively). It is obviously crucial for Spain to continue improving its national accounts in order to convince investors of the medium-term sustainability of its public debt. Positive surprises in the fiscal sphere would surely be well-received by credit ratings agencies. Externally, the Spanish economy has been able to correct its large current account deficit thanks to the sizeable gains made in competitiveness.

Given this situation of solid performance and favourable macroeconomic prospects, the financial markets have begun to price in a sovereign rating upgrade. In particular, CDS rates (credit default swaps) for Spain's sovereign debt have remained around 70-80 bp, a level comparable to that of sovereign debt rated Baa 1; in other words, one notch higher than the current rating (see the second chart).

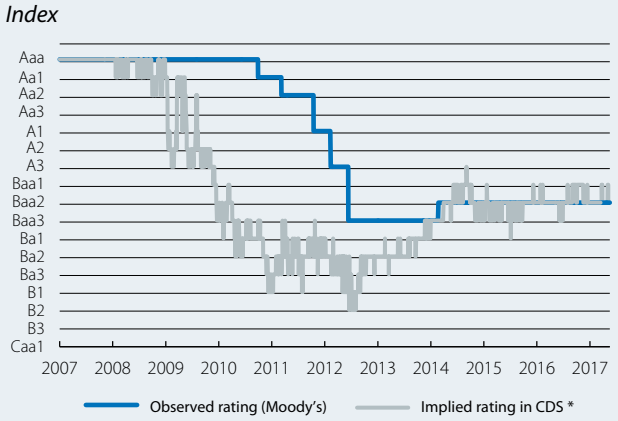
Although Spain still has a relatively low credit rating, financing costs for both the public and private sectors have remained unusually low thanks to the ECB's accommodative monetary policy. To avoid any upswings in financing costs, it would be useful for the sovereign rating to have regained the ground lost once monetary normalisation begins.

Spain: sovereign debt rating



Source: *CaixaBank Research, based on data from S&P, Moody's, Fitch and Bloomberg.*

Spain: observed and implied rating in CDS rates



Note: ** Calculated based on CDS rates (credit default swaps) for 5-year Spanish sovereign debt.*
Source: *CaixaBank Research, based on data from Moody's.*

1. In the case of Moody's and Fitch, Spain's sovereign rating has been Baa2 and BBB+ since February and April 2014, respectively.

KEY INDICATORS

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

Activity indicators

	2015	2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	04/17	05/17
Industry								
Electricity consumption	1.7	0.1	0.8	0.3	–0.1	1.2	–1.1	...
Industrial production index	3.3	1.9	1.4	1.9	1.9	1.8	...	...
Indicator of confidence in industry *(value)*	–0.3	–2.3	–2.8	–3.8	–0.6	0.3	–1.3	–1.0
Manufacturing PMI *(value)*	53.6	53.2	52.5	51.4	54.4	54.8	54.5	...
Construction								
Building permits *(cumulative over 12 months)*	20.0	43.7	48.1	44.8	36.9	24.5	...	...
House sales *(cumulative over 12 months)*	10.9	13.0	14.2	13.4	13.7	14.9	...	...
House prices	1.1	1.9	2.0	1.6	1.5	2.2	–	...
Services								
Foreign tourists *(cumulative over 12 months)*	5.6	8.2	7.5	9.3	10.1	9.9	9.7	...
Services PMI *(value)*	57.3	55.0	55.5	54.9	54.9	56.4	57.8	...
Consumption								
Retail sales	3.0	3.6	3.9	3.8	3.0	0.5	1.7	...
Car registrations	21.3	11.4	17.8	11.0	8.9	7.8	1.1	...
Consumer confidence index *(value)*	0.3	–3.8	–3.2	–6.1	–3.2	–2.8	1.3	1.9

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

Employment indicators

	2015	2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	03/17	04/17
Registered as employed with Social Security [1]								
Employment by industry sector								
Manufacturing	2.2	2.8	2.7	2.7	2.8	3.0	3.2	3.0
Construction	4.7	2.6	2.1	2.7	3.3	5.3	6.2	5.9
Services	3.5	3.2	3.0	3.3	3.5	3.4	3.4	3.8
Employment by professional status		3.5						
Employees	3.5	3.5	3.1	3.5	3.8	4.0	4.1	4.4
Self-employed and others	1.9	1.0	1.0	0.9	0.9	0.9	0.9	0.9
TOTAL	**3.2**	**3.0**	**2.7**	**3.0**	**3.3**	**3.4**	**3.5**	**3.8**
Employment [2]	**3.0**	**2.7**	**2.4**	**2.7**	**2.3**	**2.3**	**–**	**–**
Hiring contracts registered [3]								
Permanent	12.3	14.2	17.4	17.9	13.3	15.4	18.4	3.8
Temporary	11.2	7.2	9.1	7.1	6.6	12.1	14.4	4.1
TOTAL	**11.3**	**7.8**	**9.8**	**7.9**	**7.1**	**12.4**	**14.8**	**4.1**
Unemployment claimant count [3]								
Under 25	–11.0	–12.6	–12.0	–14.4	–13.2	–13.3	–13.7	–17.9
All aged 25 and over	–7.2	–8.2	–7.5	–8.6	–9.0	–9.2	–9.2	–10.3
TOTAL	**–7.5**	**–8.6**	**–7.9**	**–9.1**	**–9.4**	**–9.6**	**–9.6**	**–10.9**

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

Prices

	2015	2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	04/17	05/17
General	**–0.5**	**–0.2**	**–0.9**	**–0.2**	**1.0**	**2.7**	**2.6**	**1.9**
Core	0.6	0.8	0.7	0.8	0.9	1.0	1.2	...
Unprocessed foods	1.8	2.3	2.7	3.5	1.0	4.1	3.4	...
Energy products	–9.0	–8.4	–13.6	–8.6	1.6	15.3	12.0	...

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

Foreign sector

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

	2015	2016	Q1 2016	Q2 2016	Q3 2016	Q4 2016	01/17	02/17	03/17
Trade of goods									
Exports *(year-on-year change)*	4.3	1.7	0.2	4.3	–1.1	3.2	17.4	8.3	16.9
Imports *(year-on-year change)*	3.7	–0.4	–0.7	–0.3	–3.7	3.0	19.0	11.4	19.1
Current balance	**14.7**	**21.8**	**15.5**	**18.5**	**20.0**	**21.8**	**22.6**	**23.5**	**23.8**
Goods and services	26.2	32.9	26.1	29.3	31.2	32.9	32.8	32.4	32.3
Primary and secondary income	–11.5	–11.1	–10.6	–10.8	–11.2	–11.1	–10.2	–8.9	–8.5
Net lending (+) / borrowing (–) capacity	**21.7**	**23.6**	**21.8**	**24.0**	**24.3**	**23.6**	**25.1**	**25.7**	**26.1**

Source: *CaixaBank 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

	2015	2016	Q1 2016	Q2 2016	Q3 2016	Q4 2016	01/17	02/17	03/17
Net lending (+) / borrowing (–) capacity [1]	**–5.1**	**–4.5**	**–0.7**	**–3.0**	**–2.8**	**–4.5**	**–**	**–**	**...**
Central government	–2.6	–2.7	–0.8	–1.9	–2.6	–2.7	–0.5	–1.0	–0.5
Autonomous regions	–1.7	–0.8	–0.1	–0.6	–0.1	–0.8	–0.1	–0.1	–0.1
Local government	0.5	0.6	0.1	0.1	0.5	0.6	–	–	...
Social Security	–1.2	–1.6	0.2	–0.6	–0.6	–1.6	0.1	0.1	0.1
Public debt *(% GDP)*	**99.8**	**99.4**	**101.2**	**101.1**	**100.4**	**99.4**	**–**	**–**	**100.4**

Note: *1. Includes aid to financial institutions.*
Source: *CaixaBank 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

	2015	2016	Q1 2016	Q2 2016	Q3 2016	Q4 2016	01/17	02/17	03/17	Balance 03/17 [1]
Financing of non-financial sectors [2]										
Private sector	–3.9	–2.6	–3.2	–2.9	–2.0	–2.1	–1.5	–1.3	–0.7	1,622.3
Non-financial firms	–4.0	–2.7	–3.4	–3.2	–2.1	–2.2	–1.4	–0.9	0.0	913.9
Households [3]	–3.6	–2.3	–3.0	–2.5	–2.0	–1.9	–1.7	–1.7	–1.6	708.5
General government [4]	4.0	3.9	3.5	4.2	4.6	3.2	3.9	3.3	3.0	1,129.4
TOTAL	**–1.0**	**–0.1**	**–0.6**	**–0.2**	**0.5**	**0.0**	**0.6**	**0.5**	**0.8**	**2,751.7**
Liabilities of financial institutions due to firms and households										
Total deposits	–1.0	–0.3	–0.4	–0.3	–0.3	–0.1	–1.0	–1.4	0.6	1,151.8
On demand deposits	18.5	16.6	16.2	16.0	16.4	17.8	17.3	18.6	20.0	475.4
Savings deposits	12.9	12.4	13.4	12.1	11.5	12.5	13.9	14.9	15.4	295.9
Term deposits	–15.3	–17.2	–15.4	–16.4	–17.4	–19.7	–23.0	–25.1	–23.8	359.4
Deposits in foreign currency	5.6	–1.1	–4.0	1.6	–1.9	0.1	–1.5	–7.4	1.5	21.1
Rest of liabilities [5]	–13.0	–15.7	–16.7	–16.3	–11.3	–18.6	–18.9	–13.4	–17.8	81.2
TOTAL	**–2.2**	**–1.6**	**–1.9**	**–1.7**	**–1.2**	**–1.6**	**–2.4**	**–2.2**	**–0.9**	**1,233.0**
NPL ratio *(%)* [6]	**10.1**	**9.1**	**10.0**	**9.4**	**9.2**	**9.1**	**9.2**	**9.1**	**8.8**	**–**
Coverage ratio *(%)* [6]	**58.9**	**58.9**	**59.0**	**58.7**	**59.3**	**58.9**	**58.8**	**58.9**	**59.1**	**–**

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

TOURISM: TRAVELLING TOWARDS THE FUTURE

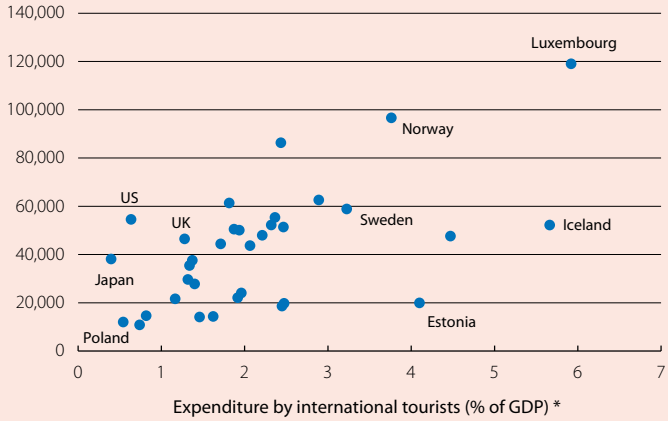
Tourism: an important industry on the crest of a wave

Travel and tourism (T&T) is a key industry in the world's economic activity in terms of its size and dynamism and also because of the effect it can have on other sectors. In size terms, the numbers speak for themselves: the sector accounted for 3.1% of the world's GDP in 2016. This rises to 10.2% when we include the indirect and induced impacts of T&T on other sectors.[1] This is a larger share than sectors as important as the motor vehicle industry, chemical manufacturing or mining. T&T also generates 9.6% of the world's jobs, six times more than the motor vehicle industry, five more than chemical manufacturing, four more than mining and double that of communications. Expenditure by international tourists also accounted for 6.6% of global exports in 2016.

T&T is also a dynamic industry, growing at a faster rate than the global economy as a whole. International tourist arrivals to OECD and associated countries surpassed 1.1 billion in 2014 (the latest figure available), with annual growth of 6.6%. The amount they spent (excluding transport costs) increased by 4.8% in current dollars. The long-term outlook is also encouraging: the WTTC 1 estimates real average annual growth of 3.9% pa up to 2027, higher than the 3.7% forecast by the IMF for global GDP growth in the period 2017-2021. For its part, the OECD expects international tourist arrivals to reach 1.8 billion by 2030.[2]

Outbound tourism and income per capita

Average income per capita of the country (USD)



Note: ** Expenditure at the destination by outbound tourists from a country (the country's tourism imports). Data from 2014.*
Source: *CaixaBank Research, based on data from the OECD and IMF.*

Regarding the third aspect, its impact on other economic sectors, T&T presents both opportunities and challenges. Travel and tourism are investment-intensive (the sector attracted 4.4% of the world's investment in 2016, higher than its direct impact on GDP). Other sectors in the economy can also make use of a large part of this investment (e.g. transport and communications infrastructures). But T&T produces negative externalities as well. For example, it affects the conservation of natural and cultural resources and can affect the lives of those living in tourist destinations. The emergence of new technologies and, more recently, the upsurge in the sharing economy mean that legislation needs to be adapted to handle this new situation (see the article «Tourism 2.0: opportunities and challenges» in this Dossier).

The recent boom in global T&T is due to a combination of two factors: cheaper travel, especially by air, as the sector has become more liberalised, and higher income per capita in global terms. 54% of international tourists reach their destination by plane. According to the International Civil Aviation Organisation (ICAO), between 2002 and 2012 the number of passengers grew at an annual rate of 5.8%, reaching 3 billion travellers per year. The growth in international passengers is even faster, doubling their figure (from 0.6 to 1.2 billion) with an average annual increase of 7.2%. The ICAO also expects this growth rate to remain high, predicting 2.8 billion passengers on international flights by 2030.

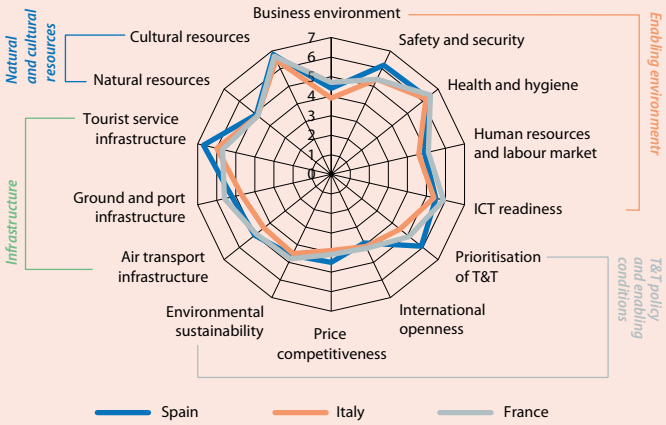
Regarding income per capita, empirical evidence suggests a positive correlation between the share of expenditure on T&T and GDP, since people spend money on leisure once most of their basic needs are met. For the OECD and associate countries as a whole, doubling the income per capita multiplies the share of GDP devoted to international tourism by 1.5 to 2.[3] Although this tendency is affected by size, geography and cultural customs, a case in point is that of the four largest economies in the euro area. In Germany, France, Italy and Spain, the share of international T&T expenditure is 2.21%, 1.71%, 1.34% and 1.32% respectively, exactly in the same order as their income per capita. This correlation between tourism and income per capita has important implications. When world GDP increases, T&T grows via two sources: due to the economic growth *per se* and also because of the growth in income per capita, which increases tourism's share of GDP.

1. World Travel & Tourism Council, «Economic Impact 2017, World».
2. OECD (2016), «OECD Tourism Trends and Policies 2016».
3. The expenditure by tourists from a foreign economy (imports) as a share of that country's GDP.

In the short term, the advanced economies are likely to continue dominating this growth in international travel and tourism as they enjoy higher per capita incomes. And Europe has the added advantage that its geography permits land travel, as well as benefiting from the deviation of tourism from rival destinations in the Middle East due to safety concerns. The medium and long-term scenario is different, however. The emerging economies are growing more quickly than the advanced and many will achieve income levels that will allow their T&T expenditure to rocket. The OECD predicts that, by 2030-2040, international tourists will start to come mainly from the emerging economies, especially emerging Asia. The IMF forecasts 6.3% average growth for the region in the period 2017-2021, higher than the 4.9% for the emerging economies as a whole and the 1.9% for the advanced economies.[4]

So where does Spain fit into this scenario? Like other European countries, Spain benefits from Europe's prime position in tourism demand and from the safety concerns of its Middle Eastern rivals. This European dominance is reflected in the composition of expenditure by international tourists according to their country of origin, where British tourists take pride of place (see the article «Tourism, a new *El Dorado* for the Spanish economy» in this Dossier). This composition has contributed to Spain's tourism boom as the countries that send most tourists to Spain increased their numbers more than the average.

Tourism competitiveness index



Note: *Scale of 0 (least competitive) to 7 (most competitive).*
Source: *CaixaBank Research, based on data from the World Economic Forum (Travel and Tourism Competitiveness Report, 2017).*

But this good performance by Spanish T&T is not only due to a favourable situation or composition effect. There is a correlation between foreign tourist arrivals and the competitiveness of the T&T industry of the destination country[5] and Spain truly stands out in this respect. According to the World Economic Forum in 2017, Spain is once again the most competitive country in the world in T&T terms,[6] in a ranking of 136 countries and ahead of France, Germany, Japan, the UK, US, Australia and Italy. The ranking's 14 pillars are divided into four indices. Spain is very strong in natural and cultural resources as well as infrastructures, reflecting the sector's investment intensity (see the article «Quality of tourism supply: the challenge of keeping the leadership» in this Dossier). Specifically, Spain ranks second in T&T service infrastructure (hotels, ATMs and availability of car rental services) and ninth in air transport connectivity. It is also competitive in ground transportation but lags behind France and Germany with denser networks. Spain also has an advantage over its direct rivals (France and Italy) regarding its enabling conditions for T&T. Its only weakness appears in the enabling environment index: the business environment (ease of start-ups and tax system) and the labour market (pay and productivity), where it ranks 100th.

The favourable economic situation and competitive strength of Spain's T&T industry ensure the country can continue to take advantage of the tourism boom worldwide for some time yet. But there are also significant challenges. The sector needs to adapt to changing demand in the future and must also coordinate better with other industries. Legislation also needs to be adapted to prioritise investment in infrastructure, promoting the sector's sustainability and ensuring a systematic development of new models of business that take advantage of new technologies.

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4. See the article «China and Russia, the new emerging sources of tourism» in the Dossier of MR05/2014.
5. See the article «Recipes for success in the tourism industry: different ways to reach the same destination» in the Dossier of MR05/2014.
6. World Economic Forum (2017), «The Travel & Tourism Competitiveness Report 2017».

Tourism, a new *El Dorado* for the Spanish economy

Spain has made travel and tourism (T&T) one of its key economic sectors. Over 75 million tourists came to the country in 2016, visited cities, beaches and mountains, attended sports events and professional congresses, ate, drank and enjoyed all kinds of experiences. But T&T is not the only industry to gain from their arrival. The rest of Spain's economic sectors are also benefiting from the tourism boom. Nevertheless, in the medium term it is important to encourage demand in quality T&T in order to sustain this growth. In this article, we examine this in more detail.

Both foreign and domestic T&T goods and services[1] (accommodation, catering, transport, travel agencies, cultural services, etc.) are making an increasing direct contribution to GDP: from 5.9% in 2010 to 6.4% in 2015. But this contribution to the economy is not limited exclusively to those subsectors most directly related to T&T. We can also see indirect or knock-on effects on other economic sectors. These come from economic activity brought about by the purchases made by the T&T sector from its suppliers. In order to meet this demand, in turn suppliers increase their purchases from their own suppliers, which also contribute to GDP. To calculate this knock-on effect, input-output tables are used for the Spanish economy by the Spanish Statistics Institute (INE) for the year 2010. This shows that, for each EUR 100 of added value generated directly by the T&T sector, an additional EUR 73 are generated indirectly by the economy as a whole. This indirect effect has increased: five years ago it was EUR 68. Tourists enjoying paella next to the beach are not only benefiting the restaurant where they are eating but also all the restaurant's suppliers, the establishment's interior designer, its accountant, etc. Logically, those services directly linked to T&T demand reap the most benefit but other sectors apparently less related to tourism also benefit, such as industry and the primary sector (see the enclosed table).

Economic impact (direct and indirect) on different sectors produced by the T&T sector per EUR 100 of added value

(Euros)

Sector with direct T&T demand	Accommodation, food and beverages	44.0	
	Transport	25.7	
	Retail	22.9	
	Real estate services	16.8	
	Culture and entertainment	4.6	
	Travel agencies	5.3	
			119
Rest of the economy	Primary sector	2.9	
	Agrifood industry	10.6	
	Energy industry	4.0	
	Construction industry	2.7	
	Rest of industry	7.2	
	Professional services	5.0	
	Financial and insurance services	4.5	
	Security, safety and administrative services	2.8	
	Rest of services	14.1	
			54
Total			**173**

Note: *Relative shares are used in T&T demand for sectors belonging to the T&T sector. The (direct and indirect) impact of the T&T sector is higher than 100 as several T&T sectors use intermediate inputs produced by the T&T sector itself.*
Source: *CaixaBank Research, based on data from the INE.*

T&T's direct and indirect contribution to GDP totalled EUR 119 billion in 2015 according to the INE's Cuenta Satélite del Turismo, the equivalent of 11.1%. Around half this contribution was due to foreign tourism, which has increased its relative weight over the past few years.

Those involved directly and indirectly in T&T carry out expenditure in the rest of the economy that generates an additional induced economic effect (the private consumption of the restaurant's waiters, decorator or accountant). If we add in this contribution, which is spread even further among the different economic sectors, T&T's global impact would reach 16% of GDP in 2015, steadily increasing since 2010 and much higher than the European average (9,6%).[2]

The T&T industry therefore has a huge impact, especially when we take the indirect and induced effect into account as well as the direct. These figures might even underestimate the total impact of T&T on GDP as there is a growing problem with its calculation. An increasing number of T&T services are not provided by the traditional tourism sector, such as private accommodation rental and the goods and services required to provide it. Although these should be included in the calculation, the official statistics do not reflect them in their entirety and they therefore end up being underrepresented. For example, according to Exceltur, the places advertised on P2P platforms in the 22 top Spanish towns and cities totalled 362,000 in 2016, exceeding the volume of official accommodation.

1. The United Nations defines tourism as «the activities of persons travelling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business and other purposes» INE (2004), «Cuenta Satélite del Turismo en España: Nota Metodológica».
2. See World Travel & Tourism Council (2016), «Travel & Tourism Economic Impact 2016: Spain».

T&T also creates a significant number of jobs. Directly and indirectly, T&T provided employment to 2.5 million people in 2015, 13.0% of the total jobs (1.4 pp more than in 2010). If we add in the employment created by the induced effect, then this contribution rises to 16.2% of total employment, a much higher share than the European average (9.1%).[3] Moreover, all the signs point to the sector continuing to create jobs. Social Security affiliation in mostly T&T-related sectors is growing at a much faster pace than in the rest of the economy. This rate was 4.7% year-on-year in April (cumulative over 12 months) while the rest of the sectors posted 3.0% growth.

It is also worth noting that T&T has helped to correct some imbalances in the Spanish economy in recent years. The rise in T&T service exports has pushed the balance of T&T services from a surplus of 2.6% of GDP in 2010 to 3.3% in 2016. This means that 11% of the current account's correction was due to the larger surplus achieved by the balance of T&T services.[4]

As we have seen, the T&T industry is crucial for the Spanish economy. But we should now look at external T&T demand in the medium term, essential to ensure the sector withstands the rapid social and technological changes occurring. In spite of increasing diversification, international tourist arrivals in Spain (75.6 million in 2016) are still very concentrated in terms of country of origin, type and season. External T&T demand is largely European (80% in 2016) for reasons of geographical proximity, mostly from the UK, France and Germany. Most visitors to Spain also come for leisure (85.3%) and between June and September (50%). The trend in arrivals points to increasing diversification, however. Tourist arrivals from the rest of the world are posting above-average growth (+15.3% annually). This is particularly encouraging because future increases in demand are likely to come from these markets, in particular Asia (see the article «Tourism: an important industry on the crest of a wave» in this Dossier, for an explanation of the global T&T trends). Tourist arrivals for reasons other than leisure and business, such as health or pilgrimages, rose by 22.6% and totalled 6.5 million.[5] Lastly, the cooler months (October to May) have posted larger annual increases in international tourist arrivals (+11.5%) than June to September (+9.5%), indicating that the T&T industry is gradually becoming less seasonal.

The record number of international tourist arrivals in 2016 led to record figures in income (EUR 77,625 million), although the average expenditure per tourist fell slightly and is lower than for our neighbouring countries such as France and Italy. There therefore seems to be some room for improvement in expenditure per tourist. But to take advantage of this, there needs to be a corresponding increase in quality and the T&T supply needs to be more diversified (as explained in detail in the article «Quality of tourism supply: the challenge of keeping the leadership» in this Dossier). Such diversification also needs to take into account the future trends in T&T demand.

T&T demand is changing and becoming increasingly segmented, even in the case of holiday tourism. Tourists demand more specific and individualised experiences and are prepared to pay more for them. The considerable ageing of the population, in particular in Europe, our main client, will also increase T&T demand by this segment. In addition to holiday tourism, health tourism could also be increased, a less seasonal industry with huge potential that makes a significant economic contribution to a wide range of sectors.[6]

Finally, sustainability is also crucial, both in urban and natural terms, in order to guarantee future demand. Public institutions play an important role in ensuring a balanced regulation for the industry since T&T generates both positive externalities (such as its considerable economic contribution) and negative. In the short term, the upsurge in the sharing economy, particularly in some cities, poses a significant challenge (see the article «Tourism 2.0: opportunities and challenges» in this Dossier). In the long term, an uncontrolled increase in tourism could jeopardise the natural environment. There is growing discussion on mitigating some of the negative externalities that can be produced by tourism via specific taxes. This could take the form of a tourist tax to finance specific investment in associated infrastructure, which can also be used to compensate people or areas affected by tourism. In some cases it is also seen as a means of helping to manage tourism flows, with different rates depending on the destination or time of year. We may have found our El Dorado in tourism but we must monitor and look after it to ensure its potential can be developed sustainably in economic, social and environmental terms.

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3. See World Travel & Tourism Council (2016), «Travel & Tourism Economic Impact 2016: Spain».
4. See the Focus «Dissecting the improvement in the current account» published in MR05/2017.
5. Performance was worse in terms of arrivals for business, falling slightly to 4.6 million.
6. EOI (2013), «Turismo de Salud en España».

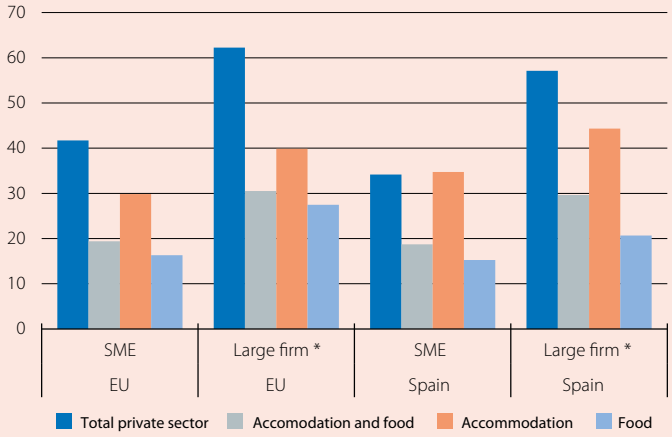
Quality of tourism supply: the challenge of keeping the leadership

Spain ranks first in the Travel & Tourism Competitiveness Index. Like gold medal-winning athletes, this prime position can only be achieved by a combination of many different factors. Obviously genetics play a key role: climate, natural resources and culture are all fundamental aspects to Spain's success as a tourist destination. But genetics are not everything. As elite athletes know only too well, remaining at the top requires constant training, ensuring you have the best equipment and surrounding yourself with the best trainers. Here we take a brief look at the main ingredients that should help the country to continue improving the quality of its travel and tourism (T&T) supply, such as firm size and investment, both in physical and human capital.

Spain's T&T sector is made up of around 400,000 firms from different spheres such as accommodation, food, transport, vehicle rental and travel agencies. The sector is highly atomised with a large number of small firms and relatively few large ones. According to the Tourism Satellite Account produced by the INE in 2015, 78.7% of T&T firms had two or fewer employees and only 1,108 firms (0.3% of the total) had 100 or more. SMEs therefore dominate the T&T landscape. A landscape in which very different situations coexist side by side in the industry's various subsectors. The accommodation sector is particularly successful in company size terms with 0.5% large firms (more than 250 employees), higher than the total economy's figure of 0.1%.[1] Large hotel companies employ 25.2% of the sector's workers in Spain compared with 18.7% in the EU. The subsector of food, on the other hand, tends to have few large firms and is much more biased towards small companies: only 10.7% of employees in the food subsector work in large establishments compared with 16.8% in the EU.

Labour productivity in the T&T industry

(Value added by employee, in thousands of euros)



Note: ** Large firms have at least 250 employees. Data from 2014.*
Source: *CaixaBank Research, based on data from Eurostat.*

Firm size is important because it is related to aspects that determine a firm's productivity, such as professionalisation, economies of scale, access to different sources of financing and the possibility to offer workers continued training. In fact, labour productivity data by firm size are very revealing:[2] large T&T firms are almost 30% more productive than small firms while both large and small are more productive in Spain than their European peers. Given that Spain also has a bigger share of large firms, the productivity gap for the Spanish T&T sector as a whole compared with the European sector is considerable, almost 20%.[3]

In the past few years, the hotel industry has invested significantly in renewing its facilities and modernising the hotel supply to reposition itself towards demand segments with more purchasing power. The supply of T&T accommodation in higher categories has increased significantly (4 and 5 stars),[4] and these are also enjoying increasingly higher occupancy rates, boosting the return on their investment. Earnings per room available have actually posted positive growth continuously since 2013 and, in the last year, have increased by 10.8% year-on-year (figure from April 2017, cumulative over 12 months). The sector has also improved its balance sheets and reduced its debt levels, increasing its capacity to develop new projects.

A wide range of investors, both national and international, are also finding Spain's hotel industry very attractive: in 2016 the sector attracted over EUR 2 billion in investment for the second year in a row.[5] International investors contributed 64% of the total investment by volume, showing a preference for urban hotels in large cities. An increasingly wide range of instruments are also being used to channel investment: real estate investment vehicles (SOCIMI, REIT and specialised funds) were the most popular with 48% of the total, although international hotel groups have also become more interested. The emergence of this kind of investor is encouraging a trend towards separate hotel management and property ownership.

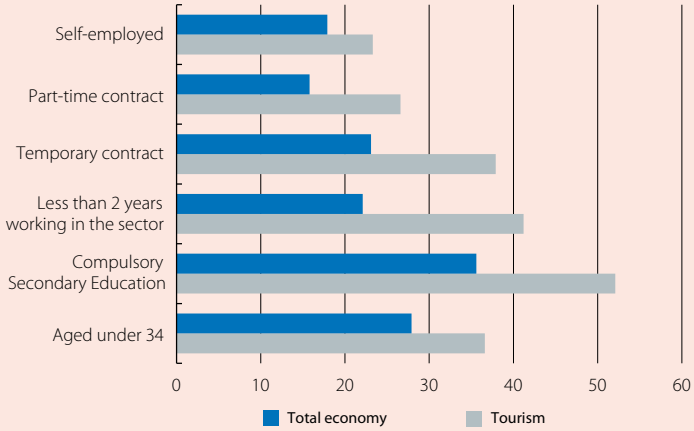
1. Data from Eurostat (2014), «Structural business statistics».
2. Apparent labour productivity of work is defined as gross added value divided by the number of workers.
3. Accomodation sector productivity in Spain and the EU is 44.3 and 39.9 for large establishments and 34.7 and 29.9 for small establishments, respectively. But it is the opposite for food establishments which are less productive in the Spanish case, irrespective of firm size.
4. 41.4% of hotel places were 4 or 5 in 2007, and 49.9% in 2015.
5. Deloitte report, (2017), «Expectativas 2017: The Experience Revolution. Travel, Hospitality, Leisure & Transport».

Large Spanish hotel chains listed on the Spanish stock market also boast considerable presence abroad: around 75% of their income comes from the rest of the world. However, T&T firms only account for 1% of total stock market capitalisation in Spain, a very small figure compared with the sector's importance for the economy (see the article «Tourism, a new *El Dorado* for the Spanish economy» in this Dossier). In the medium term, if the sector continues to consolidate, company size should also increase, making it easier for them to access foreign investment and capital markets.

Another crucial factor to improve T&T quality of supply is training for human capital. The quality perceived by the client largely depends on the people providing the service.[6] Consequently, remaining at the top of the competitiveness ranking not only means having the best physical equipment but also a better team. And here there is a lot of room for improvement. A typical worker in the T&T industry has lower qualifications and less work experience than those in the rest of the sectors. This is because T&T very often offers employment to young people with no work experience or low qualifications, with few options in other sectors.

Profile of tourism employees

(% of all employees)



Note: *Data from 2013.*
Source: *CaixaBank Research, based on data from the OECD, (2015), «Supporting Quality Jobs in Tourism».*

The fact that the industry is very seasonal also means that a larger proportion of jobs are temporary and part-time. High job turnover also makes it difficult to improve employee skills and participation in continued training. The sector is also going through a far-reaching digital transformation, with the potential to change the nature of many of the services offered and the skills required by workers (see the article «Tourism 2.0: opportunities and challenges» in this Dossier). There is consequently still a long way to go to improve the skills of T&T workers by offering an attractive professional career within the sector, improving the specific training provided and attempting to combine better employment conditions with the flexibility required to adapt to the new technological paradigm.

In short, Spain's T&T sector has made a considerable effort to reorient its supply towards segments that generate the most value, as can be seen in its larger size and productivity, as well as the international presence of important Spanish groups. Like elite athletes, continued success is not guaranteed: the sector must go on making a constant effort in order to keep its international leadership.

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6. See OECD, (2015), «Supporting Quality Jobs in Tourism».

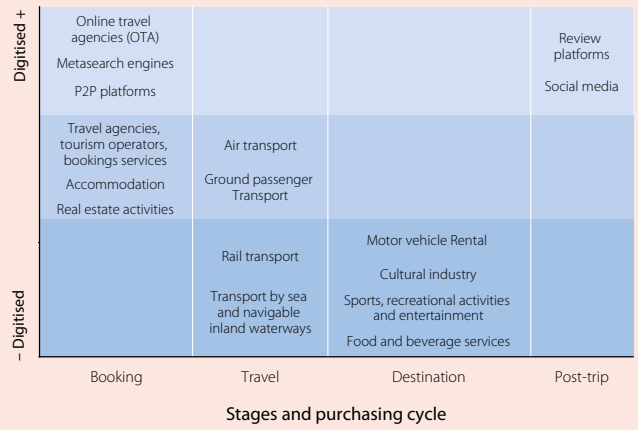
Tourism 2.0: opportunities and challenges

The development of new technologies and the widespread use of the internet are revolutionising the way we work, consume and interact with each other. The economy's digitalisation is also affecting the tourism sector, which is transforming itself to respond to a more connected world, where the division between online and offline channels is becoming increasingly blurred. This article looks at the impact of technological advances on the tourism industry and the way they might transform it in the future.

The technological advances of the past few years are having a considerable effect on tourism. As new technologies emerge, new firms spring up in the digital sphere, radically transforming part of the sector's value chain (see the first chart). The impact has been particularly noticeable on the initial phase of the customer journey, where digital platforms such as online travel agencies and search engines have considerably changed the way tourism services are bought. These new players are gradually «revolutionising» the industry, forcing incumbent companies to change their production processes in order to remain competitive. Traditional tourism service providers have drastically changed the way they operate in order to reach the online customer, for instance through online advertising campaigns and social media. Sectors such as transport and accommodation have taken advantage of the opportunities offered by digitalisation and automation to streamline their production processes. Self check-ins at airports and accommodation services are just one example of how the adoption of new technologies can help reduce operating costs for companies and waiting times for customers.

Structure of the tourism sector by the extent of digitalisation of different activities

Extent of digitalisation



Note: *Branches of tourism activity include metasearch sites (Google, SkyScanner); online travel agencies (Booking.com, Expedia); peer-to-peer platforms (Airbnb, Homeaway) and review platforms (TripAdvisor, Google Reviews).*
Source: *CaixaBank Research.*

Conversely, digitalisation is having a much more limited impact at destination, given that the services provided are very labour-intensive, especially at the customer touchpoint, and the very nature of the final good that is being provided. Nevertheless, in the medium term, advances in the «Internet of Things», robotics, and artificial intelligence have the potential to revolutionise the sector even further, given that they will allow companies to redefine how they supply goods and services, simplifying operations and improving the customer experience, for example via more personalised services.

Despite the fact that technology offers many different opportunities, its adoption is often regarded with suspicion due to its potential disruptive effect on the labour market. Tourism is a main engine for job creation and there are increasing concerns it will stop being so as the use of new technologies becomes more widespread throughout the sector. To gauge the extent of this impact, we have estimated the risk of automation for the industry in the medium term. We have based our estimate on a study carried out by the Oxford University professors, Carl Frey and Michael Osborne,[1] who analysed the probability of automation of each occupation, based on current technology and the technology that will be developed over the next 20 years. We also used the estimates produced for the Spanish case in the Dossier «New technologies and the labour market».[2] We have therefore applied the risk of automation for each profession to the different branches of the Spanish tourism industry.

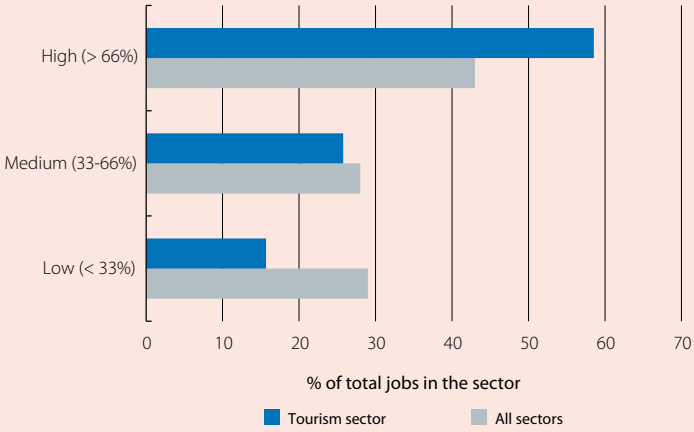
According to these estimates, 58% of the current jobs in the Spanish tourism sector have a high risk (with a probability above 66%) of being automated over the medium term. This is higher than the figure for the rest of the economy. Regarding the rest of the jobs in the tourism sector, 26% have a medium risk (between 33% and 66%) and 16% a low risk (below 33%). Among the professions that have a highest risk of being automated are accountants, office clerks, and customer service employees. At the other end of the spectrum are the professions that require greater creativity (such as food critics) or social interaction (managers and recreational activities instructors).

1. Frey, C. and Osborne, M. (2013), «The Future of Employment: How susceptible are jobs to computerisation?» Working Paper.
2. See the article «Will the Fourth Industrial Revolution come to Spain?» in the Dossier of MR02/2016.

Our analysis shows that Spain's tourism-related labour market will almost certainly undergo a profound change over the coming years. However, the automation of some professions does not necessarily mean that jobs will be lost in net terms. Firstly, because the adoption of new technologies depends on their cost in relation to other production factors such as labour. Secondly, because automation makes it possible to change the nature of some jobs in the sector and can generate new employment opportunities. The adaptation and flexibility of the labour force will therefore be crucial in this transition, given that the set of skills that will be required in the future are different to those in demand today.[3] Lastly, the speed at which new technologies are adopted is not clear as this will also depend on legal and institutional factors.

Share of employment by risk of automation

Probability of automation



Note: *Employment data for 2016.*
Source: *CaixaBank Research, based on data from Frey and Osborne (2013) and the INE.*

The digitalisation has also made the sharing economy more visible and accessible. This is having a marked impact on the tourism industry. In general, digital platforms have made it easier to create «online» markets for the temporary use of goods and provision of services between private individuals (peer-to-peer). This increase in supply has been positive for consumers as it has enhanced the range of goods and services available on the market and/or lowered their price. In the case of tourism, sharing has become popular as it offers the chance to buy unique, personalised local experiences - a service that is increasingly in demand.[4]

Nevertheless, the sharing economy and its fast growth in recent years pose a significant regulatory challenge as many of these activities are not currently covered by law. This makes them difficult to control and means that a suitable degree of consumer protection cannot be guaranteed, nor the safety and quality of the service provided. Incumbent firms can also suffer from unfair competition as, unlike the new market players, they have to follow stricter rules. Tax avoidance is also harder to prevent. On the one hand because the lack of any well-defined regulatory framework could encourage some online firms to become resident in other countries with more favourable tax laws. On the other, because there is the risk that some of these transactions remain in the black economy. A well-defined regulatory framework is also particularly important for the tourism industry because many of these activities generate negative externalities. Specifically, such regulatory loopholes can have an impact on urban development and the coexistence of tourist and residential properties.

Therefore, it is important that the legal framework responds to this new situation, without restricting innovation or the adoption of new technologies. Nor should it constitute an unreasonable barrier to entry in the market for new players. An harmonised regulatory framework at a European level would represent an improvement in this respect, making it easier to control such activities and collect tax revenue since all transactions would be recorded. Greater legal certainty would also help the industry to fully develop its potential.[5]

In short, the digital «revolution» is transforming a large number of sectors, including tourism. It provides a wealth of opportunities but also creates new challenges such as the handling of the impact of automation on jobs and the adjustment of the legal framework to such a fast-changing environment.

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3. See the article «How to take advantage of the positive impact of technological change on employment?» in the Dossier of MR02/2016.
4. OECD (2016), «Tourism Trends and Policies 2016», OECD Publishing.
5. European Commission (2016), «European agenda for the collaborative economy - supporting analysis», Commission Staff Working Document.

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	MILLION €
Customer funds	303,895
Loans and advances to customers, gross	204,857
Profit atributable to Group	1,047
Market capitalisation	18,768
Customers (million)	13.8
CaixaBank Group employees	32,403
Branches in Spain	5,027
Self-service terminals	9,479

"la Caixa" BANKING FOUNDATION COMMUNITY PROJECTS: BUDGET 2017

	MILLION €
Social	304.2
Excellence in research and training	79.6
Raising awareness of culture and knowledge	126.2
TOTAL BUDGET	**510**

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