

ECONOMIC OUTLOOK · Strong growth in the Spanish economy

The outlook for 2018 is favourable. After posting growth in excess of 3% for three consecutive years, Spain's economy continues to enjoy solid GDP growth. Moreover, all the evidence points to this high growth rate continuing over the coming quarters. This optimistic forecast is due to several factors. Externally, the euro area economies are also expected to perform well (with 2.5% growth forecast for this year). This should help exports to continue increasing at a good rate. The fall in Spain's risk premium is also benefitting the economy. On the domestic front, the good job creation rate is expected to continue, vital for household consumption to remain one of the main supports for the current expansionary business cycle. Given the strong economic activity growth in 2017 (3.1%) and the aforementioned context, CaixaBank Research forecasts 2.8% growth in GDP for the whole of 2018, a clearly higher figure than the average for the advanced economies.

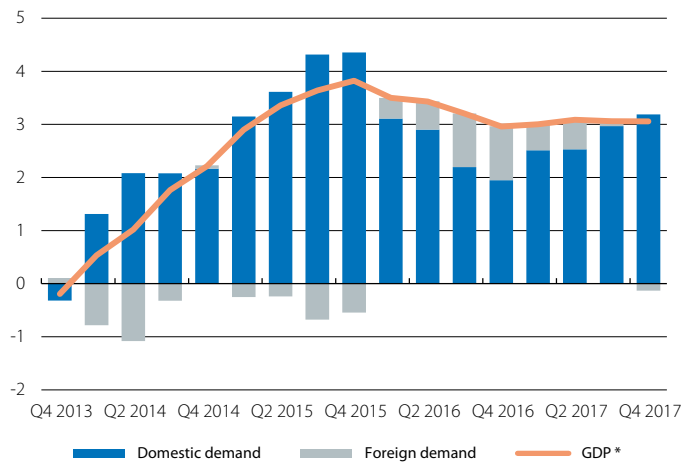
Domestic demand drives growth. National account data confirm the Spanish economy continued to enjoy solid GDP growth in Q4 (0.7% quarter-on-quarter). This was due to the 0.6 pp contribution made by domestic demand (0.8 pp in Q3), the main supports being consumption and investment. Consumption will continue to boost growth in 2018, helped by dynamic job creation and continuing favourable credit conditions. In fact, the first data available for 2018 confirm this trend. In fact, consumer confidence returned to positive figures in the first two months of the year, averaging 0.9 points, far above the average of -0.7 points posted in 2017.

External demand picks up and offsets a slight slowdown in domestic demand. In fact, net external demand contributed 0.1 pp to GDP growth in Q4 (-0.1 pp in Q3). The favourable global environment has undoubtedly benefitted exports, up by 5.0% for the whole year in real terms. Given the considerable gains in competitiveness achieved over the past few years and the economic strength of euro area countries (the destination of 51.5% of Spain's exports), exports should remain dynamic in 2018. Together with the contained increase in imports, this dynamism will help to keep the foreign sector's contribution to GDP growth at similar levels to those recorded in the last part of 2017.

Economic activity looks robust at the start of the year. Leading indicators confirm that economic activity continues to grow strongly in Q1 2018. January's business sentiment indices remained in a clearly expansionary zone. The PMI business sentiment index for services recorded a significant rise in January, reaching levels close to those of last September and thereby ending three months of continued falls. The production sector also provided optimistic indicators. The manufacturing PMI stood at 55.2 points in January, slightly higher than the average recorded in 2017.

GDP

Contribution to year-on-year growth (pp)



Note: * Year-on-year change (%).

Source: CaixaBank Research, based on data from the National Statistics Institute.

GDP

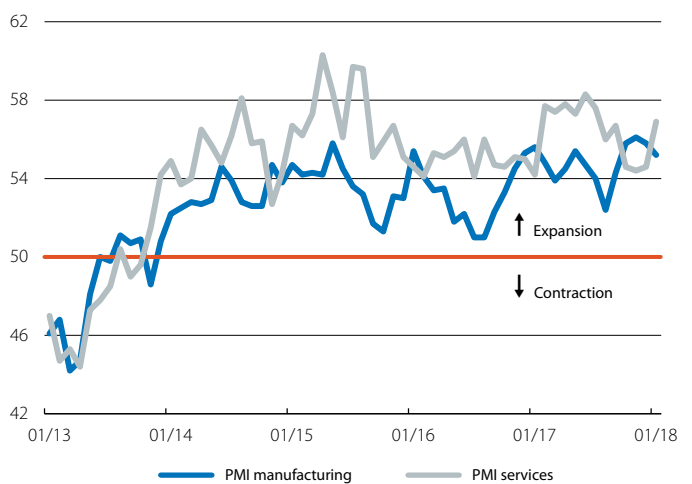
Quarter-on-quarter change (%)

	Q1 2017	Q2 2017	Q3 2017	Q4 2017
GDP	0.8	0.9	0.7	0.7
Private consumption	0.5	0.8	0.7	0.6
Public consumption	1.1	0.5	0.4	0.4
Investment	2.8	0.6	1.4	0.7
Capital goods investment	3.7	0.1	2.8	0.9
Investment in construction	2.5	1.0	0.2	1.0
Exports	2.4	1.0	0.6	0.3
Imports	3.7	0.5	1.0	0.0

Source: CaixaBank Research, based on data from the National Statistics Institute.

Economic activity indicators

Level



Source: CaixaBank Research, based on data from Markit.

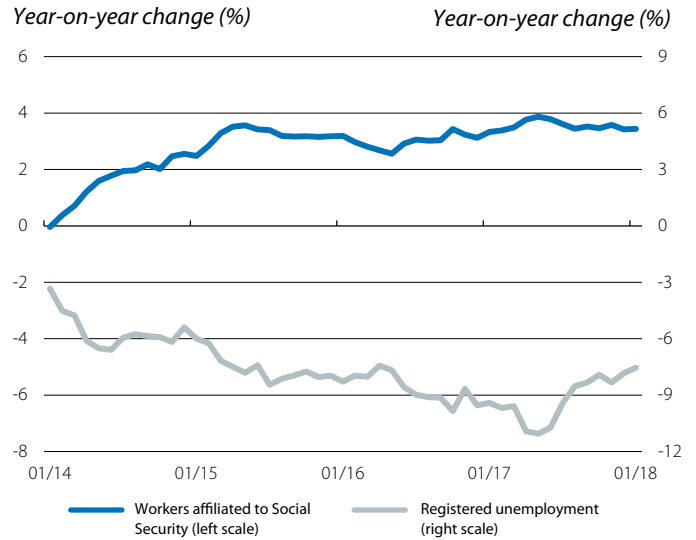
The employment trend is still favourable. National account data indicate that equivalent full-time employment rose by 2.8% in 2017 as a whole, representing 506,000 more full-time jobs, a similar figure to the one posted in 2016, indicating that the labour market is still very dynamic. Throughout 2018 we expect the job creation rate to be a strong 2.4%, in line with the favourable trend in economic activity. In fact, the latest data indicate that this dynamism is continuing. In January, the number of registered workers affiliated to Social Security rose by 3.4% in year-on-year terms while registered unemployment totalled 3,476,528 people in January. Although this figure has fallen by 1.5 million in the past five years it is still a cause for concern, especially given the high long-term and youth unemployment rates. Because of this, the approval of Spain's new Employment Strategy represents a step in the right direction towards a better system to manage active labour market policies (for more details, see the Focus «Active labour market policies: a results-based evaluation» in this *Monthly Report*).

Prices rise slightly. In February inflation rose to 1.1%, up by 0.5 pp compared with January's figure. However, it should be noted that January's figure was quite weak, namely 0.6%, as a result of the base effect of electricity prices since these increased dramatically in January 2017 and then fell notably the following month. This fact explains the increase posted by inflation during February 2018. Core inflation remained stable at 0.8%, showing that inflationary pressures are still contained for the moment. We therefore predict core inflation will continue to rise very gradually, largely supported by an equally progressive improvement in wages. Headline inflation is likely to increase more sharply, however, pushed up by its energy component.

The current account ends its fifth consecutive year of surpluses although declining slightly due to higher oil prices and growth in non-energy imports. Imports of consumer durables and capital goods increased considerably in December, driven by household consumption and investment. Non-energy imports therefore rose by 7.3% year-on-year (in nominal terms) according to Customs figures. However, exports performed particularly well, up by 7.1% in December in year-on-year terms and thereby helping to maintain the current account surplus. Oil prices are expected to stabilise in 2018 and exports are likely to remain dynamic. This and the good outlook for the tourism industry will help to support a current account surplus of around 1.8% of GDP, 0.1 pp higher than 2017's figure (1.7%).

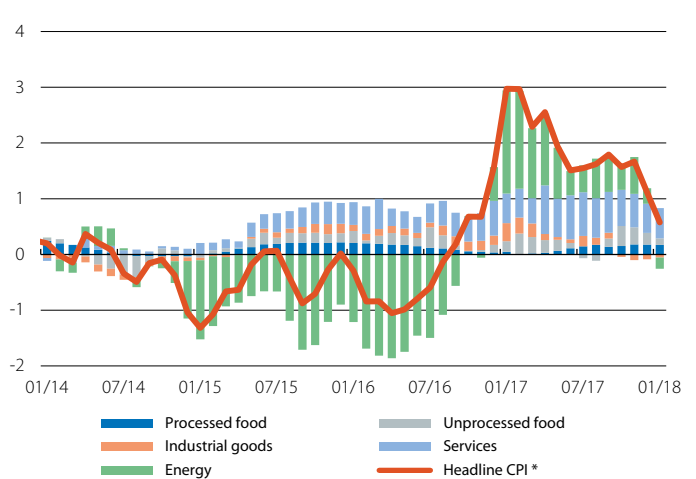
Public accounts are boosted by the dynamic economy and improved employment. The notable growth in the Spanish economy over the past three years has helped to significantly reduce the general government deficit. This is very likely to have fallen to 3.1% of GDP by the end of 2017 thanks to the improved performance by the income account and moderation in spending. The dynamic labour market is particularly making its mark on Social Security contributions,

Registered workers affiliated to Social Security and registered unemployment



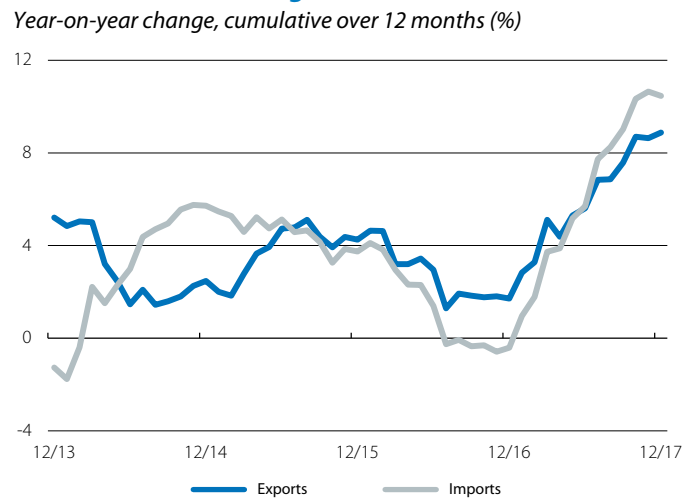
Source: CaixaBank Research, based on data from the Ministry of Employment and Social Security.

Contribution to inflation by component (pp)



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

International trade in goods *

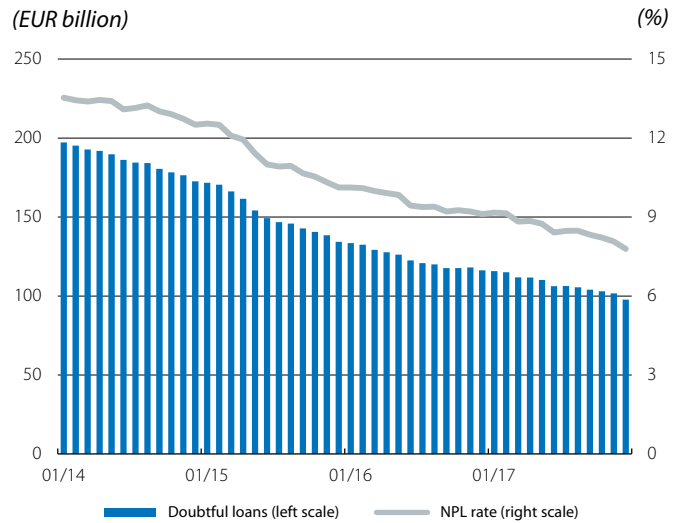


Note: * Nominal data, series not seasonally adjusted. Source: CaixaBank Research, based on data from the Customs Department.

up by a notable 5.6% in November compared with the figure one year ago. In 2018, we expect the favourable economic outlook to continue reducing the public budget deficit, which could fall to 2.5% of GDP. This would be a considerable achievement and would allow Spain to leave its excessive deficit procedure. However, it is still important to focus on improving public accounts given the country's level of debt, now 98.3% of GDP after five years of being close to 100%.

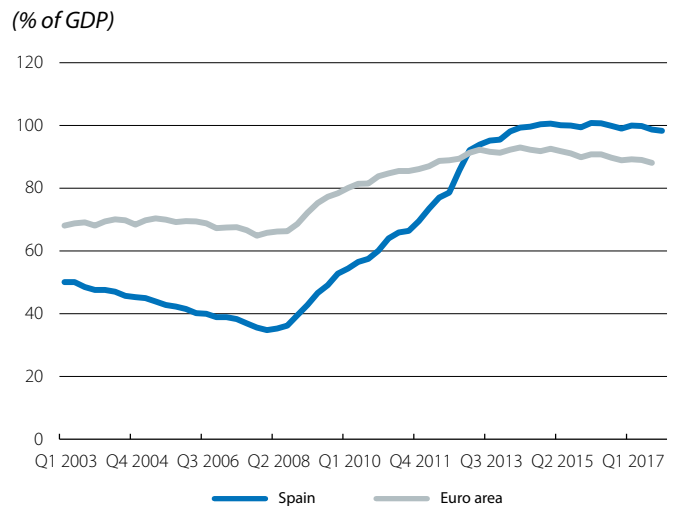
The consolidation of the upward trend in real estate is another sign of the economy's health. House purchases rose by 14.6% in 2017, exceeding the total of 460,000 for the first time since 2008. Strong housing demand is undoubtedly having an effect on prices, up by 2.4% in 2017 (appraised value) in a context where supply remained relatively limited. However, new building permits grew by 26% year-on-year in the cumulative figure for the year up to November. The outlook for the real estate market will continue positive for 2018. Housing demand is expected to remain strong with house purchases increasing at a rate of around 8% (see the Focus «House purchases in 2018: what can Google tell us?» in this *Monthly Report* for more information). This higher demand will be reflected in mortgage loans and house prices, which are expected to continue rising. In fact, January's figures confirmed this positive trend. New mortgage loans granted grew by 13.9% in January, as did the rest of credit which also posted a positive trend, especially new consumer loans (26.0%). The economic recovery and active management of bank balance sheets is helping to improve credit quality and push NPL rates down to more sustainable levels. In 2017 the bank NPL ratio fell by 132 bp to 7.79%, explained by the considerable reduction in doubtful loans of 16% year-on-year in December 2017.

NPL ratio and doubtful loans



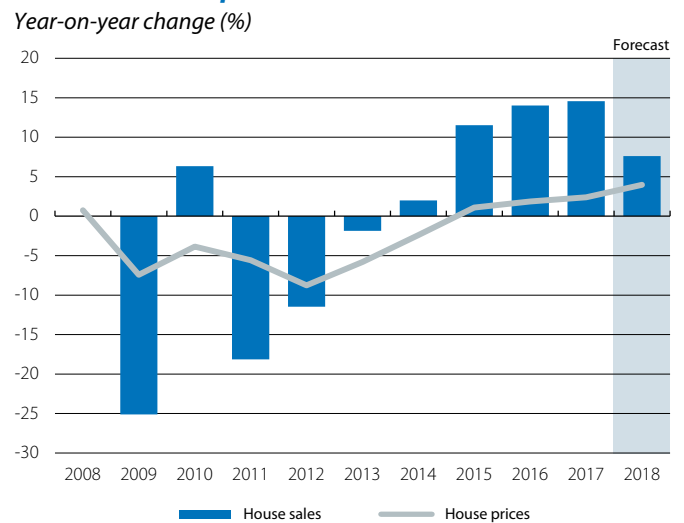
Source: CaixaBank Research, based on data from the Bank of Spain.

Public debt



Note: Data for the euro area up to Q3 2017. Source: CaixaBank Research, based on data from the Bank of Spain and Eurostat.

House sales and prices



Source: CaixaBank Research, based on data from the National Statistics Institute and Ministry of Public Works.