# MR12

**MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK**

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## ECONOMIC & FINANCIAL ENVIRONMENT



## DOSSIER: 2019 OUTLOOK



CaixaBank Research

**MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK**
**December 2018**

The *Monthly Report* is a publication developed jointly by CaixaBank Research and BPI Research (UEEF)

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# 2019 outlook

A year ago, this editorial focused on the political challenges for the year that is about to come to an end. It focused on Trump, Brexit and the Italian elections. We also expressed a wish: that this year's editorial, on the outlook for 2019, would not have to focus once again on populist movements. Unfortunately, we have to do so again: the trade war between the US and China, Brexit and Italian politics remain the three major elements of uncertainty and risk.

The tensions between the US and China have ended up affecting the global economy in recent months. The imposition of tariffs on Chinese imports by the US, and China's response by also raising tariffs on US imports, has been akin to throwing sand into the gears of the global supply chains. Furthermore, we cannot rule out the possibility of the tensions escalating further, despite the truce agreed at the G20 meetings in Buenos Aires. The US feels ready for a (trade) war, with an economy supported by a significant fiscal stimulus that is driving domestic demand, and this strengthens the credibility of its president's threats (which are quite unpredictable, on the other hand). In any case, we expect that an agreement will end up being reached, because there seems to be scope for it and because it is in the interest of all the parties not to prolong the uncertainty. Otherwise, Trump could end up feeling the pressure of the American stock market.

With regards to Brexit, we face a challenging obstacle course ahead. This month, Parliament in Westminster will decide whether to approve or reject the agreement reached between Theresa May and the EU. A rejection would greatly increase the risk of an abrupt and disorderly departure for the United Kingdom on 29 March, which would have serious repercussions for economic activity in the country and would shake the British pound. If an agreed departure is achieved, there will still be the negotiation on the future framework of relations between the United Kingdom and the EU to deal with. Nevertheless, the transitional period currently envisaged, which is due to last until the end of 2020 and could be extended to the end of 2022, seems to provide enough margin to properly negotiate an agreement that will be extremely complex. We are more concerned about the short-term risk than the uncertainty surrounding the negotiation on the future framework of relations.

Finally, there is Italy, a factor with the capacity to destabilise the euro area. If the confrontation between the Italian Government and the European Commission escalates, Italy's risk premium could soar, causing Italy to lose access to the markets. This would be a highly tense situation. The ECB would intervene to limit the contagion to other countries, but it would hardly be in a position to support Italy unless the Government requested a bailout. Faced with this predicament, a likely scenario would be an election in Italy and the formation of a new Government to regain the confidence of the markets. That said, we would still be looking at a few months of enormous uncertainty, which would once again call the integrity of the euro area into question.

To a large extent, how these three major challenges develop will determine the course of 2019. Our central scenario assumes that the worst-case scenario will not materialise in any of these challenges, although we also do not expect to see a speedy resolution to any of the uncertainties. Depending on their outcome, 2019 could turn out to be worse than expected, or then again, perhaps better. Happy 2019!

**Enric Fernández**
Chief Economist
30 November 2018

# Chronology

### NOVEMBER 2018

**5** The US reinstates sanctions on Iran.
**21** The European Commission recommends launching an excessive deficit procedure against Italy.
**25** The EU and the United Kingdom sign a Brexit agreement.

### SEPTEMBER 2018

**24** The US implements a new tariff rise on 200 billion dollars of Chinese imports. China applies a new tariff rise on 60 billion dollars of US imports.
**26** The Fed raises the official rate by 25 bps, bringing it up to the 2.00%-2.25% range.
**30** Canada is incorporated into the preliminary trade agreement between the US and Mexico to replace the North American Free Trade Agreement (NAFTA).

### JULY 2018

**6** The first phase of tariff hikes between the US and China enters into force (on 34 billion dollars of imports, out of the total of 50 billion).

### OCTOBER 2018

**12** The rating agency Moody's improves Portugal's credit rating, from Ba1 to Baa3 (once again investment grade).
**19** The rating agency Moody's downgrades Italy's credit rating, from Baa2 to Baa3.

### AUGUST 2018

**20** Greece completes the third bailout programme after eight years of supervision by the EU, the ECB and the IMF.
**23** The second phase of tariff hikes between the US and China enters into force (on 16 billion dollars of imports, out of the total of 50 billion).
**27** The US and Mexico announce a preliminary trade agreement to replace the North American Free Trade Agreement (NAFTA).

### JUNE 2018

**13** The Fed raises the official rate by 25 bps, placing it within the range of 1.75%-2.00%.
**14** The ECB announces that the net purchases of assets will decrease to 15 billion euros per month starting in October, before being brought to an end in December 2018.

# Agenda

### DECEMBER 2018

**4** Spain: registration with Social Security and registered unemployment (November).
**6** European Council meeting.
**10** Portugal: international trade (October).
**12** Portugal: CPI (November).
**13** Governing Council of the European Central Bank meeting.
**18** Spain: quarterly labour cost survey (Q3).
**18-19** Federal Open Market Committee meeting.
**20** Portugal: loans and deposits (October).
**21** Spain: loans, deposits and NPL ratio (October and Q3).
**26** Spain: net international investment position (Q3).
**28** Spain: household savings rate (Q3).
State budget execution (November).
Spain: CPI flash estimate (December).
Portugal: state budget execution (November).

### JANUARY 2019

**8** Portugal: employment and unemployment (November).
**9** Portugal: international trade (November).
**10** Spain: industrial production index (November).
**11** Portugal: CPI (December).
**15** Spain: financial accounts (Q3).
**22** Spain: loans, deposits and NPL ratio (November).
**24** Governing Council European Central Bank meeting.
**29** Spain: labour force survey (Q4).
**30** Portugal: state budget execution (December).
Portugal: employment and unemployment (December).
Euro area: economic sentiment index (January).
US: GDP (Q4 and 2018).
**29-30** Federal Open Market Committee meeting.
**31** Spain: GDP flash estimate (Q4).
Spain: CPI flash estimate (January).
Euro area: GDP of the euro area (Q4).

# A positive year draws to a close and the outlook for 2019 looks encouraging

**2018: expectations have been met**. As the year draws to its close, we already have all the ingredients needed to make an assessment of how things have gone. What is certainly the case is that the year we are bidding farewell to has been broadly positive, with growth showing remarkable dynamism. Looking back to the end of 2017, we anticipated that global growth in 2018 would be 3.8% and, in the end, it seems that the global economy will grow by 3.7%. In the advanced economies, growth in 2018 could be even slightly higher than we anticipated a year ago. These encouraging figures for the advanced bloc are largely the result of US growth, which has been higher than expected thanks to the notable fiscal boost carried out by the Trump Administration. Looking ahead to 2019, it will be difficult to sustain such a high growth rate in the US, since the fiscal stimulus will gradually wane. The emerging economies, on the other hand, have suffered some setbacks: their growth for 2018 is likely to be around 4.7%, instead of the 4.9% we were forecasting a year ago. The heightened uncertainty caused by the trade tensions between the US and China, as well as the macrofinancial vulnerabilities that some emerging markets (especially Argentina and Turkey) have shown in a context of monetary policy normalisation in the US, have taken their toll, although growth rates remain very strong. The financial markets, meanwhile, have felt the effects of this more demanding environment and have experienced greater volatility. At certain times, this has also been accompanied by significant corrections (especially in the European and emerging stock markets, if we look at the year as a whole).

**2019: a positive outlook, but with downside risks**. The outlook for the global economy in 2019 remains positive, with an expected growth of 3.6%. That said, the downside risks are significant enough to keep us vigilant. On the macrofinancial side, the central banks face the challenge of ensuring that monetary normalisation does not adversely affect the macrofinancial conditions. In the geopolitical sphere, meanwhile, protectionist risks will remain prominent despite the expectation of a certain cooling after the G-20 summit in early December. As for the euro area, let us not forget that two usual suspects, namely Brexit and Italy, will continue to give us much to talk about.

**The euro area confirms a pattern of more moderate growth**. In 2018, 10 years after the start of the Great Recession, the euro area has managed to close its output gap and bring the unemployment rate back down to levels similar to 2006. At the same time, there has been a slowdown in growth, largely due to exports, which have felt the effects of the slowdown in global trade. On the other hand, domestic demand remains strong, supported by the labour market and accommodative financial conditions. It therefore looks set to be the main driver of growth in 2019, and despite the net purchases of assets being brought to an end, the ECB will continue to favour accommodative financial conditions. Not in vain, we still expect to see the first hike in the reference rate by the end of next year.

**Spain continues to grow at a healthy rate**. A slight slowdown in the Spanish economy following three exceptional years was inevitable, considering the vanishing of the strong tailwinds, such as the low price of oil and the depreciation of the euro. In fact, in our forecasts a year ago we already anticipated that the Spanish economy would register a gentle slowdown over the course of 2018 and that it would transition towards more sustainable levels of growth. Nevertheless, the economy remains buoyant, as demonstrated by the encouraging Q3 GDP figure, which rose by 0.6% quarter-on-quarter driven by the strength of domestic demand, especially private consumption. In contrast, exports continue to follow a weaker trend than expected, a phenomenon that we can observe in several other developed countries. The outlook remains positive and, on the upside, the strong recovery in the labour market continues: in the last 12 months, 562,544 new jobs have been created. On the downside, we continue to have a high level of public and external debt, making the Spanish economy vulnerable to potential shifts in global investor sentiment.

**Portugal: tempered growth, but the outlook remains favourable**. In Q3 produced growth was slightly lower than in the previous quarter (0.3% quarter-on-quarter, versus 0.6% in Q2). This was due to a soft patchin private consumption and a less dynamic external sector. Despite the Portuguese economy being affected by the slowdown of the euro area, we expect it to regain strength in Q4 and to continue to grow at levels close to 2% in 2019. After all, we have every reason to remain optimistic: sentiment indicators continue to be encouraging, the labour market is in good health (year-on-year growth of 2.1% in job creation in Q3 and stabilisation in the unemployment rate at around 6.7%) and investment continues to perform well.

*Average for the last month in the period, unless otherwise specified*

## *Financial markets*

| | Average 2000-2007 | Average 2008-2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| **INTEREST RATES** | | | | | | | |
| **Dollar** | | | | | | | |
| Fed funds | 3.43 | 0.48 | 0.64 | 1.39 | 2.50 | 3.00 | 3.25 |
| 3-month Libor | 3.62 | 0.69 | 0.98 | 1.61 | 2.70 | 3.32 | 3.20 |
| 12-month Libor | 3.86 | 1.18 | 1.67 | 2.05 | 3.10 | 3.44 | 3.25 |
| 2-year government bonds | 3.70 | 0.72 | 1.18 | 1.84 | 2.90 | 3.20 | 3.15 |
| 10-year government bonds | 4.70 | 2.70 | 2.49 | 2.41 | 3.10 | 3.50 | 3.40 |
| **Euro** | | | | | | | |
| ECB depo | 2.05 | 0.50 | –0.40 | –0.40 | –0.40 | –0.20 | 0.25 |
| ECB refi | 3.05 | 1.13 | 0.00 | 0.00 | 0.00 | 0.25 | 0.75 |
| Eonia | 3.12 | 0.77 | –0.35 | –0.34 | –0.35 | –0.10 | 0.40 |
| 1-month Euribor | 3.18 | 0.93 | –0.37 | –0.37 | –0.34 | –0.08 | 0.42 |
| 3-month Euribor | 3.24 | 1.13 | –0.32 | –0.33 | –0.32 | –0.04 | 0.44 |
| 6-month Euribor | 3.29 | 1.30 | –0.22 | –0.27 | –0.23 | 0.12 | 0.62 |
| 12-month Euribor | 3.40 | 1.51 | –0.08 | –0.19 | –0.13 | 0.27 | 0.79 |
| **Germany** | | | | | | | |
| 2-year government bonds | 3.41 | 0.85 | –0.76 | –0.69 | –0.52 | 0.08 | 0.73 |
| 10-year government bonds | 4.30 | 2.21 | 0.29 | 0.35 | 0.48 | 1.26 | 1.96 |
| **Spain** | | | | | | | |
| 3-year government bonds | 3.62 | 2.59 | –0.13 | –0.04 | 0.16 | 0.84 | 1.43 |
| 5-year government bonds | 3.91 | 3.16 | 0.30 | 0.31 | 0.62 | 1.29 | 1.86 |
| 10-year government bonds | 4.42 | 4.13 | 1.43 | 1.46 | 1.68 | 2.26 | 2.76 |
| Risk premium | 11 | 192 | 114 | 110 | 120 | 100 | 80 |
| **Portugal** | | | | | | | |
| 3-year government bonds | 3.68 | 4.85 | 0.76 | –0.05 | 0.13 | 0.98 | 1.73 |
| 5-year government bonds | 3.96 | 5.42 | 2.05 | 0.46 | 0.77 | 1.56 | 2.24 |
| 10-year government bonds | 4.49 | 5.90 | 3.75 | 1.84 | 1.93 | 2.56 | 3.11 |
| Risk premium | 19 | 369 | 346 | 149 | 145 | 130 | 115 |
| **EXCHANGE RATES** | | | | | | | |
| EUR/USD (dollars per euro) | 1.13 | 1.33 | 1.05 | 1.18 | 1.15 | 1.23 | 1.24 |
| EUR/JPY (yen per euro) | 129.50 | 127.13 | 122.41 | 133.70 | 127.65 | 129.15 | 131.44 |
| USD/JPY (yen per dollar) | 115.34 | 96.09 | 116.06 | 113.02 | 111.00 | 105.00 | 106.00 |
| EUR/GBP (pounds per euro) | 0.66 | 0.83 | 0.85 | 0.88 | 0.89 | 0.87 | 0.86 |
| USD/GBP (pounds per dollar) | 0.59 | 0.62 | 0.80 | 0.75 | 0.77 | 0.71 | 0.69 |
| **OIL PRICE** | | | | | | | |
| Brent ($/barrel) | 42.32 | 90.70 | 54.92 | 64.09 | 76.00 | 69.00 | 66.00 |
| Brent (euros/barrel) | 36.35 | 67.78 | 52.10 | 54.17 | 66.09 | 56.10 | 53.23 |

Forecasts

*Percentage change versus the same period of the previous year, unless otherwise indicated*

## *International economy*

| | Average 2000-2007 | Average 2008-2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| **GDP GROWTH** | | | | | | | |
| **Global** | **4.5** | **3.3** | **3.3** | **3.7** | **3.7** | **3.6** | **3.5** |
| ***Developed countries*** | ***2.7*** | ***1.1*** | ***1.7*** | ***2.3*** | ***2.3*** | ***2.0*** | ***1.8*** |
| United States | 2.7 | 1.4 | 1.6 | 2.2 | 2.8 | 2.3 | 1.9 |
| Euro area | 2.3 | 0.2 | 1.9 | 2.5 | 1.9 | 1.8 | 1.7 |
| Germany | 1.6 | 1.0 | 2.2 | 2.5 | 1.6 | 1.9 | 1.8 |
| France | 2.0 | 0.6 | 1.1 | 2.3 | 1.7 | 1.9 | 1.6 |
| Italy | 1.5 | –1.0 | 1.3 | 1.6 | 1.0 | 0.9 | 1.0 |
| Portugal | 1.5 | –0.6 | 1.9 | 2.8 | 2.1 | 1.9 | 1.9 |
| Spain | 3.8 | –0.4 | 3.2 | 3.0 | 2.5 | 2.1 | 2.0 |
| Japan | 1.5 | 0.3 | 1.0 | 1.7 | 0.9 | 1.0 | 0.6 |
| United Kingdom | 2.8 | 1.0 | 1.8 | 1.7 | 1.3 | 1.7 | 1.9 |
| ***Emerging countries*** | ***6.6*** | ***5.2*** | ***4.4*** | ***4.7*** | ***4.7*** | ***4.6*** | ***4.6*** |
| China | 11.7 | 8.6 | 6.7 | 6.9 | 6.5 | 6.2 | 6.0 |
| India | 9.7 | 6.7 | 7.9 | 6.2 | 7.4 | 6.9 | 6.2 |
| Indonesia | 5.5 | 5.8 | 5.0 | 5.1 | 5.1 | 4.9 | 4.8 |
| Brazil | 3.6 | 2.3 | –3.3 | 1.1 | 1.3 | 2.1 | 2.0 |
| Mexico | 2.4 | 2.0 | 2.9 | 2.1 | 2.0 | 2.3 | 2.3 |
| Chile | 5.0 | 3.4 | 1.3 | 1.5 | 3.8 | 3.2 | 3.0 |
| Russia | 7.2 | 1.2 | –0.2 | 1.5 | 1.6 | 1.9 | 2.0 |
| Turkey | 5.4 | 5.0 | 3.2 | 7.3 | 3.8 | 0.8 | 3.2 |
| Poland | 4.0 | 3.2 | 3.0 | 4.7 | 4.7 | 3.0 | 2.7 |
| South Africa | 4.4 | 2.0 | 0.7 | 1.3 | 1.1 | 1.3 | 1.6 |
| **INFLATION** | | | | | | | |
| **Global** | **4.2** | **3.9** | **2.8** | **3.2** | **3.7** | **3.7** | **3.4** |
| ***Developed countries*** | ***2.1*** | ***1.6*** | ***0.8*** | ***1.7*** | ***2.0*** | ***1.9*** | ***1.8*** |
| United States | 2.8 | 1.7 | 1.3 | 2.1 | 2.5 | 2.1 | 1.9 |
| Euro area | 2.1 | 1.5 | 0.2 | 1.5 | 1.8 | 1.8 | 1.7 |
| Germany | 1.7 | 1.4 | 0.4 | 1.7 | 1.9 | 2.0 | 1.8 |
| France | 1.8 | 1.3 | 0.3 | 1.2 | 2.2 | 1.9 | 1.7 |
| Italy | 1.8 | 1.4 | 0.0 | 1.3 | 1.3 | 1.6 | 1.5 |
| Portugal | 3.0 | 1.3 | 0.6 | 1.6 | 1.3 | 1.5 | 1.8 |
| Spain | 3.2 | 1.5 | –0.2 | 2.0 | 1.7 | 1.8 | 1.8 |
| Japan | –0.3 | 0.4 | –0.1 | 0.5 | 1.0 | 1.1 | 1.2 |
| United Kingdom | 1.9 | 2.6 | 0.7 | 2.7 | 2.5 | 2.3 | 2.0 |
| ***Emerging countries*** | ***6.8*** | ***6.0*** | ***4.2*** | ***4.3*** | ***4.9*** | ***5.0*** | ***4.4*** |
| China | 1.7 | 2.7 | 2.0 | 1.6 | 2.1 | 2.4 | 2.4 |
| India | 4.5 | 9.0 | 4.9 | 3.3 | 4.0 | 3.5 | 4.6 |
| Indonesia | 8.4 | 6.0 | 3.5 | 3.8 | 3.2 | 3.1 | 2.7 |
| Brazil | 7.3 | 6.2 | 8.8 | 3.5 | 3.7 | 4.1 | 4.1 |
| Mexico | 5.2 | 4.1 | 2.8 | 6.0 | 4.8 | 4.1 | 3.4 |
| Chile | 3.1 | 3.5 | 3.8 | 2.2 | 2.5 | 2.9 | 3.0 |
| Russia | 14.2 | 9.5 | 7.1 | 3.7 | 2.9 | 4.4 | 4.0 |
| Turkey | 27.2 | 8.1 | 7.8 | 11.1 | 15.8 | 18.7 | 12.0 |
| Poland | 3.5 | 2.3 | –0.2 | 1.6 | 1.4 | 2.7 | 2.5 |
| South Africa | 5.3 | 6.1 | 6.3 | 5.3 | 5.0 | 5.5 | 5.1 |

Forecasts

*Percentage change versus the same period of the previous year, unless otherwise indicated*

## *Spanish economy*

| | Average 2000-2007 | Average 2008-2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| **Macroeconomic aggregates** | | | | | | | |
| Household consumption | 3.6 | –1.1 | 2.8 | 2.5 | 2.4 | 2.0 | 2.0 |
| Government consumption | 5.0 | 0.8 | 1.0 | 1.9 | 2.1 | 1.1 | 1.0 |
| Gross fixed capital formation | 6.0 | –4.1 | 2.9 | 4.8 | 6.1 | 3.7 | 2.8 |
| Capital goods | 5.3 | –0.3 | 5.3 | 6.0 | 8.1 | 5.2 | 2.8 |
| Construction | 6.2 | –7.0 | 1.1 | 4.6 | 6.0 | 3.1 | 2.8 |
| Domestic demand (vs. GDP Δ) | 4.6 | –1.6 | 2.4 | 2.9 | 3.1 | 2.2 | 1.9 |
| Exports of goods and services | 4.8 | 2.4 | 5.2 | 5.2 | 1.6 | 2.9 | 4.0 |
| Imports of goods and services | 7.1 | –1.5 | 2.9 | 5.6 | 3.6 | 3.1 | 4.1 |
| **Gross domestic product** | **3.8** | **–0.4** | **3.2** | **3.0** | **2.5** | **2.1** | **2.0** |
| **Other variables** | | | | | | | |
| Employment | 3.4 | –1.9 | 3.1 | 2.8 | 2.5 | 2.1 | 1.9 |
| Unemployment rate (% of labour force) | 10.5 | 21.0 | 19.6 | 17.2 | 15.3 | 13.6 | 12.0 |
| Consumer price index | 3.2 | 1.5 | –0.2 | 2.0 | 1.7 | 1.8 | 1.8 |
| Unit labour costs | 3.3 | 0.3 | –0.6 | 0.2 | 0.9 | 2.1 | 2.5 |
| Current account balance (cum. % GDP) | –6.0 | –2.1 | 2.3 | 1.8 | 0.8 | 0.6 | 0.6 |
| External funding capacity/needs (cum., % GDP) | –5.3 | –1.7 | 2.5 | 2.1 | 1.0 | 0.8 | 0.8 |
| Fiscal balance (cum., % GDP)[1] | 0.4 | –7.3 | –4.3 | –3.1 | –2.7 | –2.0 | –1.4 |

***Note:*** *1. Excludes losses for assistance provided to financial institutions.*

Forecasts

## *Portuguese economy*

| | Average 2000-2007 | Average 2008-2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| **Macroeconomic aggregates** | | | | | | | |
| Household consumption | 1.7 | –0.5 | 2.4 | 2.3 | 2.3 | 2.0 | 1.8 |
| Government consumption | 2.3 | –0.8 | 0.8 | 0.2 | 0.8 | 0.6 | 0.2 |
| Gross fixed capital formation | –0.3 | –4.2 | 2.4 | 9.2 | 4.2 | 4.7 | 4.5 |
| Capital goods | 1.3 | –1.0 | 7.6 | 13.7 | 6.6 | 6.5 | 5.5 |
| Construction | –1.6 | –7.0 | –1.3 | 8.3 | 4.6 | 6.2 | 5.5 |
| Domestic demand (vs. GDP Δ) | 1.5 | –1.4 | 2.1 | 3.1 | 2.4 | 2.3 | 2.1 |
| Exports of goods and services | 5.2 | 3.4 | 4.4 | 7.8 | 6.8 | 5.2 | 4.3 |
| Imports of goods and services | 3.6 | 1.2 | 4.7 | 8.1 | 7.1 | 6.0 | 4.5 |
| **Gross domestic product** | **1.5** | **–0.6** | **1.9** | **2.8** | **2.1** | **1.9** | **1.9** |
| **Other variables** | | | | | | | |
| Employment | 0.4 | –1.4 | 1.2 | 3.3 | 2.4 | 0.9 | 0.5 |
| Unemployment rate (% of labour force) | 6.1 | 12.3 | 11.1 | 8.9 | 7.0 | 6.5 | 6.2 |
| Consumer price index | 3.0 | 1.3 | 0.6 | 1.6 | 1.3 | 1.5 | 1.8 |
| Current account balance (cum. % GDP)[1] | –9.4 | –4.9 | 0.6 | 0.5 | 0.0 | –0.2 | –0.2 |
| External funding capacity/needs (cum., % GDP)[1] | –7.9 | –3.4 | 1.6 | 1.4 | 0.9 | 0.6 | 0.5 |
| Fiscal balance (cum., % GDP)[1] | –4.4 | –6.8 | –2.0 | –3.0 | –0.7 | –0.6 | –0.5 |

***Note:*** *1. Four-quarter cumulative total.*

Forecasts

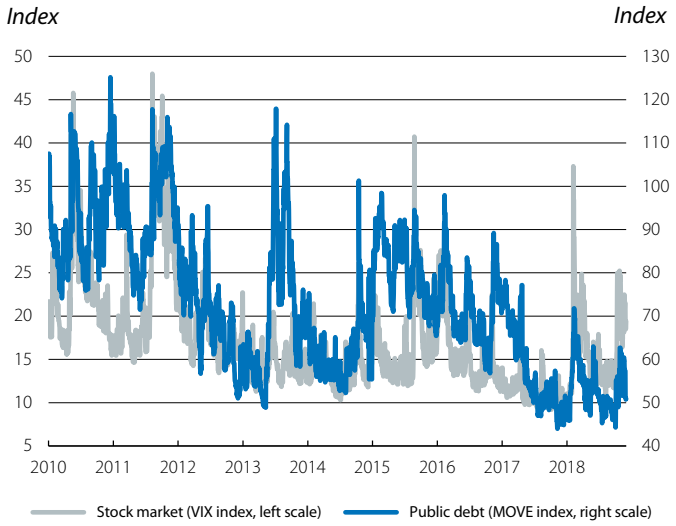
# Instability persists in November

**The financial markets experience volatility in the final stretch of the year**. Following an October marked by losses in the stock markets, above all in the US, in November the markets continued to behave erratically. Trade tensions between the US and China, coupled with political tensions in Europe (concentrated in Italy and in the Brexit negotiations), continue to determine the performance of most financial assets. In addition to these factors, there is the fear among investors that in 2019 the world economy could slow down more than expected (an issue that has particularly affected oil prices). Faced with these concerns in the financial markets, both the Fed and the European Central Bank maintain a positive view of the macroeconomic scenario for their respective regions and are continuing with their strategies of monetary policy normalisation.

**The main international stock markets struggle to shake off the negative tone of October**. The trade tensions between China and the US, and the fear that they could undermine growth in global demand, led to declines in the main international stock markets. In addition, in Europe, the indices were weighed down by somewhat disappointing economic growth data, especially in Germany, and by the tensions between Italy and the European Commission regarding Italy's fiscal policy. Nevertheless, towards the end of the month, trading floors in the US and Europe recovered some of the ground lost over the previous weeks (some even managed to close the month in the black). These recoveries were mostly driven by hope among investors that the trade tensions between China and the US, on the one hand, and the political tensions in Italy, on the other hand, could dissipate. In the emerging economies, meanwhile, the MSCI index for the region as a whole showed highly volatile behaviour and managed to close the month with gains, although the performance was disparate between continents (the Asian indices experienced growth, while the Latin American indices, led by Mexico, registered losses).

**The euro remains weak against the dollar**. The political tensions surrounding Italy and the disappointment of the economic activity indicators in the euro area also impacted the foreign exchange market, where the euro depreciated down to nearly 1.12 dollars, its lowest so far this year. On the other hand, the various developments in the Brexit negotiations led to the British pound depreciating against most international currencies. In particular, despite the Commission and the United Kingdom reaching an agreement on the divorce terms that minimises disruption, the financial markets were more swayed by fears that this agreement may not be approved by the United Kingdom's Parliament, which would lead to an impasse and further uncertainty. In the emerging economies, meanwhile, there was a generalised depreciation among the Latin American currencies, led by the Argentine peso and the Brazilian real, whereas most of the Asian currencies gained ground against the dollar.

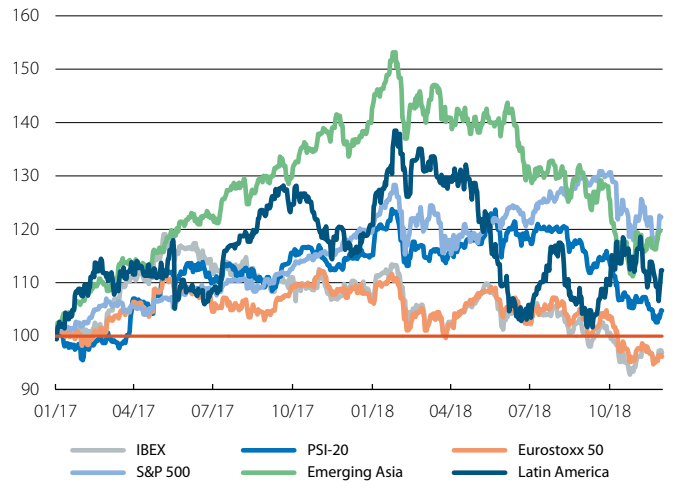
***Implied volatility in the financial markets***




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

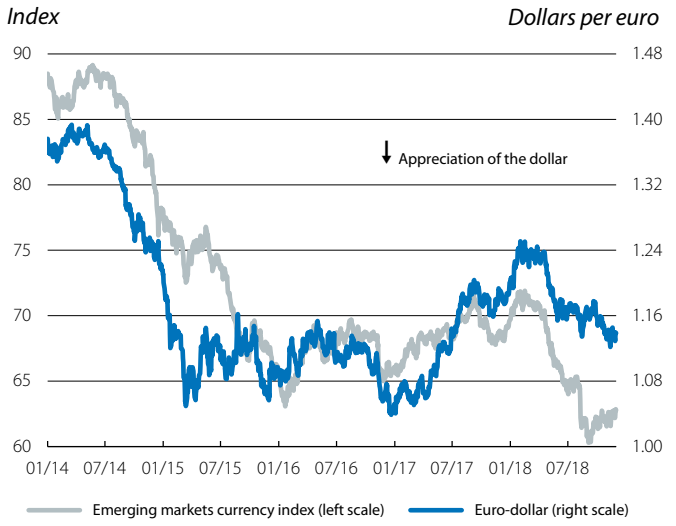
***Main international stock markets***

*Index (100 = January 2017)*




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

***International currencies against the US dollar***




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

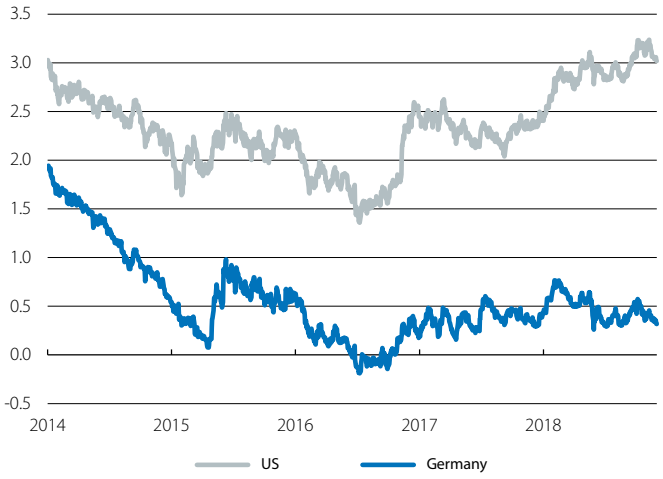
**The major central banks stick to their roadmaps**. In the US, at its meeting held on 8 November, the Fed kept interest rates unchanged in the 2.00%-2.25% range. In addition, the press release issued after the meeting reiterated a positive view regarding the growth in economic activity and stressed that the strength of the labour market, together with an inflation rate lying close to the 2% target, reinforces the strategy of gradual interest rate rises. The ECB, meanwhile, published the minutes of its last meeting (held on 25 October), at which the members of the Governing Council reiterated their positive view of the macroeconomic scenario. That said, some of them expressed concern regarding the external risks to economic growth, which have shifted to the downside. All in all, based on the strength of domestic demand, the members of the Governing Council insisted on their intention to gradually begin to realign monetary policy, with the net purchases of assets being brought to an end in December.

**Yields on safe-haven assets fall**. The turmoil in the international stock markets and the uncertainty surrounding Italy's fiscal policy led to an increase in the demand for bonds that are considered safer. As a result, the yield on the 10-year US sovereign bond contracted by over 20 bps, falling below 3%, while the yield on the German bund fell by 15 bps, ending the month below 0.33%. The risk premiums of the euro area periphery, meanwhile, remained at their highest levels in recent months. Italy's risk premium reached over 325 points, a level not seen since 2013, while the Spanish and Portuguese premiums fluctuated slightly above 120 and 150 points, respectively. Nevertheless, at the end of the month, Italy's premium fell back to around 290 points following news that suggested the possibility of the Italian Government moderating its fiscal deficit target for 2019.

**The oil price collapses in November**. Following the surge seen in the summer, when the price of a barrel of Brent reached over 85 dollars, in November it dropped below 60 dollars (its lowest this year). This decline was due to greater production of crude oil both in the US and among the members of OPEC, which had previously cut supply by more than what had been agreed at its latest meetings. In addition, the US announced exemptions for the sanctions on Iranian exports, making it easier for eight countries (including China, India and Japan) to continue to import Iranian oil temporarily. Finally, expectations of a slowdown in the growth of the global demand for oil over the coming quarters also contributed to driving down the price of a barrel of Brent (for more details, see the Focus «Oil: reflections and outlook for 2019» in this same *Monthly Report*). With all these factors on the table, on 6 December, OPEC will hold a meeting at which it will decide whether to extend production cuts into 2019.

***Yields on 10-year sovereign bonds***

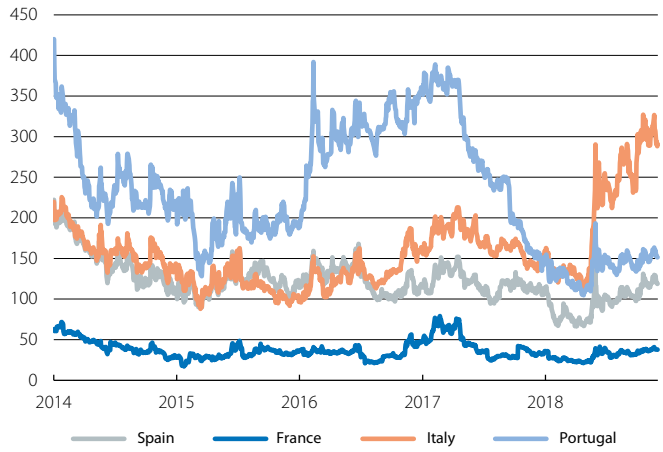
*(%)*




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

***Euro area: risk premiums of 10-year sovereign bonds***

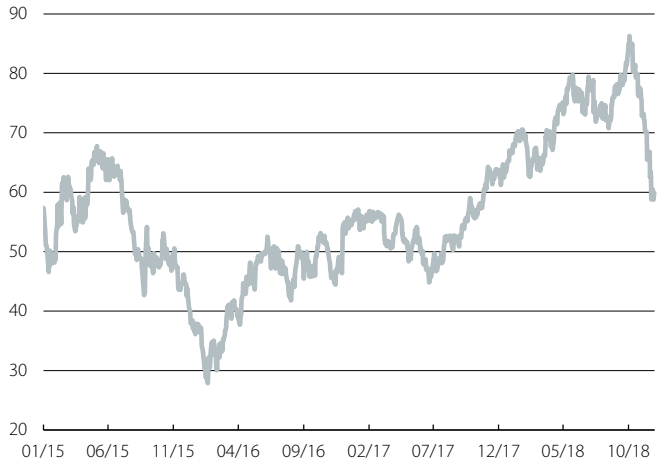
*(bps)*




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

***Brent oil price***

*Dollars per barrel*



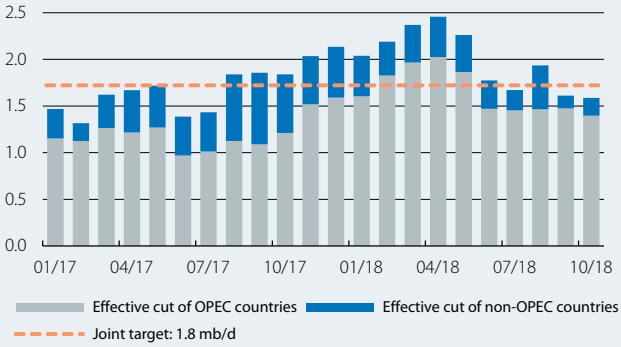

***Source:*** *CaixaBank Research, based on data from Bloomberg.*

# Oil: reflections and outlook for 2019

2018 has been a turbulent year for the oil market. At the beginning of the year, crude oil was trading at around 65 dollars and the main agencies expected prices to remain at around this level at the end of the year. However, by the close of Q3, the price of a barrel of Brent stood above 85 dollars (a cumulative rise of almost 30%), and analysts were revising their forecasts upwards. As an example, early in the year, the US Energy Information Administration (EIA) estimated that the price of a barrel of Brent would be 60 and 61 dollars in 2018 and 2019, respectively. By October, the prediction for 2018 and 2019 had risen to 74 and 75 dollars per barrel, respectively. However, in recent weeks, the price has plummeted 20 dollars from October's high point. In this context, it is well worth reflecting on the recent trends in order to shed light on the key factors behind these sudden changes. This will help us to fine-tune the outlook for 2019.

***Oil production cut agreement: degree of compliance ****

*Million barrels a day (mb/d)*




***Note:*** ** OPEC's target production cut is 1.2 mb/d, while the target cut for the partners that do not belong to the cartel is 0.6 mb/d.*
***Source:*** *CaixaBank, based on data from Bloomberg.*

## Supply pressures

First of all, throughout the year, OPEC and its partners have cut their oil production by more than what was initially agreed (see first chart).[1] A key reason behind this over-compliance is that Venezuela, the country with the largest proven reserves of crude oil, is experiencing a deep economic recession that is forcing it to reduce its oil production:[2] it has gone from producing more than two million barrels a day in early 2016 to just over half this level by the end of 2018. A simple exercise allows us to highlight the decline in Venezuela's oil production: while on average over the past few years OPEC has cut its production by 20% more than what was agreed,[3] it would have reached 98% of its agreed production levels if Venezuela had met its targets. But Venezuela is not the only country experiencing production problems. Crude oil exports from Iran, the third largest producer in OPEC, have suffered as a result of the sanctions imposed by the US. These sanctions were implemented on 5 November but affected both production and exports of crude oil in advance of that date. Specifically, since the announcement of sanctions in May, and up until November, Iran's crude oil production has declined by 10% and exports have fallen by 35%. However, a few days before the sanctions came into force, the US announced the temporary waiving of sanctions on eight countries, including China and India, the two largest importers of Iranian crude oil (together they account for nearly 70% of imports). This eased the tension in the supply of oil and contributed to the recent moderation in prices between October and November.

Faced with the production cuts of Iran and Venezuela, we must ask ourselves who can compensate for their lower production. To answer this question, we focused on the countries belonging to OPEC that are producing below their capacity. One of the indicators that helps us to understand just how restricted the oil market is at any given time is the excess capacity, which the EIA defines as the volume of production that can be brought to market in less than 30 days and can be sustained for at least 90 days. For example, if the excess capacity is zero, producers are operating at their maximum capacity and do not have any margin to increase their production in the short term. Therefore, lower levels of excess capacity indicate greater tension in the oil supply. If we break these values down by country, we note that Saudi Arabia is not only the largest oil producer in the cartel, but that it is also the country with the greatest idle capacity in recent years. It currently has nearly 50% of OPEC's excess capacity. Therefore, it is the only producer with a big enough margin for manoeuvre to compensate for the losses of Iran and Venezuela (see second chart).[4] Indeed, the increase in Saudi oil production observed in recent months suggests that it is now compensating for these losses. However, this

1. For more details on the production agreement, see the Focus «The oil producer agreement: the cartel is back» in the MR01/2017.
2. According to the latest forecasts by the International Monetary Fund, Venezuela's real GDP suffered a cumulative decline of around 30% in the past two years.
3. This has been partly offset by a 24% lower production cut among non-OPEC countries. Thus, on the whole and since January 2017, all the countries involved in the agreement have cut production by 6% more than what was agreed.

4. Due to the sanctions on Iranian oil exports, we exclude Iran from the aggregate of all the other OPEC countries, assuming that its idle production capacity is unlikely to offer a support factor for the global crude oil market.

is at the expense of lower excess capacity which, as can be seen in the second chart, is now at relatively low levels.

Another country that could offset the losses of Iran and Venezuela is the US. However, bottlenecks in the production of shale oil are slowing its growth. These problems are appearing in two areas. On the one hand, there is a short to medium-term logistical problem due to the shortage of pipelines (the network of pipes through which oil is transported over long distances). New pipelines are currently under construction, but they may not be operational until the end of 2019 and, until then, shale oil production is unlikely to be able to reach its full potential. On the other hand, there are problems in the longer term, such as high staff turnover in the sector, the low level of unemployment and the intensive use of water and sand in shale oil extraction. While the unemployment rate in the US was 3.8% in the third quarter of the year, for the oil sector it was 2.3%, which is hindering recruitment and making labour more expensive. In addition, in order to extract more oil from the wells, companies are using more than double the amount of water and earth that they were using in 2014, generating environmental and logistical problems.

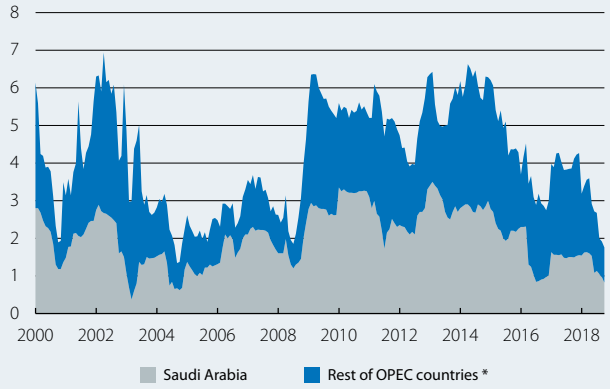
All in all, the lower excess capacity, the reduction of inventories[5] and the bottlenecks in the US indicate that the supply of oil is more vulnerable to other unexpected disruptions now than it was at the beginning of the year, and these factors also add uncertainty and volatility to the crude oil market. This has been reflected in the large fluctuations in the price of Brent oil throughout 2018. For example, the price rose from 62 to 79 dollars between February and May, and from 70 to 86 dollars between August and October, before falling suddenly from 86 to 65 dollars between October and November.

### Demand factors

On the demand side, in 2017 and early 2018, higher than expected global economic growth, led mainly by the emerging economies, supported the demand for crude oil and contributed to the price rise.[6] However, in recent months, the analysts' consensus has revised economic growth expectations for the remainder of this year and the next downwards. Similarly, the EIA has been revising its forecasts for global oil consumption downwards since May (see the third chart). In addition, in mid-November, OPEC also revised its outlook for global crude oil consumption downwards for both 2018 and 2019, further contributing to the drop in the oil price between October and November.

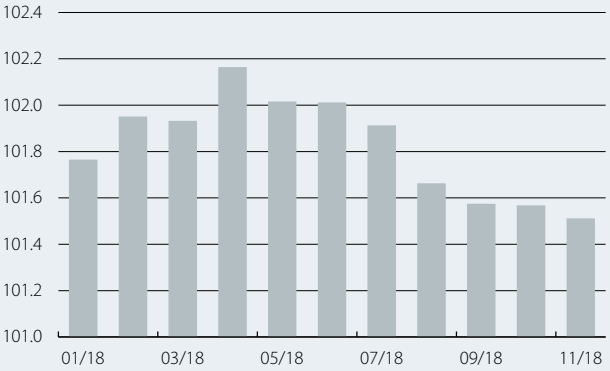
5. See the Focus «What is behind the rise in oil prices?» in the MR07/2018.
6. China was responsible for 40% of the growth in oil demand in the last year.

***Unused crude oil production capacity***
*Million barrels a day*




***Note:*** ** Includes all countries belonging to the cartel, except Iran and Saudi Arabia.*
***Source:*** *CaixaBank Research, based on data from Bloomberg.*

***Oil consumption expectations for 2019 ****
*Million barrels a day*




***Note:*** ** The data reflect how oil consumption expectations for 2019 have fluctuated throughout the year.*
***Source:*** *CaixaBank Research, based on data from EIA.*

### Future outlook

With all these elements, oil prices are likely to remain volatile over the coming months. On the one hand, geopolitical risks and any additional disruption in production could put even more stress on a market that is already turbulent. In this context, on 6 and 7 December, OPEC and its partners are meeting in Vienna to decide whether to impose new production cuts. An agreement to prolong the cuts throughout 2019 would reduce uncertainty surrounding the future oil supply. However, in the medium term, the slowdown in the global economy and a rise in shale oil production will probably exert downward pressure on the price.

## Interest rates (%)

| | 30-Nov | 31-Oct | 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 | –0.32 | –0.32 | 0 | 1.3 | 1.3 |
| 1-year Euribor | –0.15 | –0.15 | 0 | 3.6 | 3.8 |
| 1-year government bonds (Germany) | –0.63 | –0.66 | 3 | 0.8 | 8.7 |
| 2-year government bonds (Germany) | –0.60 | –0.62 | 2 | 2.7 | 8.4 |
| 10-year government bonds (Germany) | 0.31 | 0.39 | –8 | –11.7 | –5.7 |
| 10-year government bonds (Spain) | 1.50 | 1.55 | –5 | –6.7 | 5.4 |
| 10-year government bonds (Portugal) | 1.83 | 1.87 | –4 | –11.3 | –4.2 |
| **US** | | | | | |
| Fed funds | 2.25 | 2.25 | 0 | 75.0 | 100.0 |
| 3-month Libor | 2.74 | 2.56 | 18 | 104.6 | 125.3 |
| 12-month Libor | 3.12 | 3.08 | 4 | 101.3 | 116.8 |
| 1-year government bonds | 2.68 | 2.65 | 3 | 94.8 | 107.3 |
| 2-year government bonds | 2.79 | 2.87 | –8 | 90.7 | 100.8 |
| 10-year government bonds | 2.99 | 3.14 | –15 | 58.5 | 58.0 |

## Spreads corporate bonds (bps)

| | 30-Nov | 31-Oct | Monthly change (bp) | Year-to-date (bp) | Year-on-year change (bp) |
|---|---|---|---|---|---|
| Itraxx Corporate | 81 | 74 | 7 | 35.8 | 32.2 |
| Itraxx Financials Senior | 104 | 92 | 12 | 60.5 | 57.3 |
| Itraxx Subordinated Financials | 211 | 187 | 24 | 106.2 | 100.0 |

## Exchange rates

| | 30-Nov | 31-Oct | Monthly change (%) | Year-to-date (%) | Year-on-year change (%) |
|---|---|---|---|---|---|
| EUR/USD (dollars per euro) | 1.132 | 1.131 | 0.0 | –5.7 | –4.9 |
| EUR/JPY (yen per euro) | 128.440 | 127.760 | 0.5 | –5.1 | –4.1 |
| EUR/GBP (pounds per euro) | 0.887 | 0.886 | 0.1 | –0.1 | 0.8 |
| USD/JPY (yen per dollar) | 113.570 | 112.940 | 0.6 | 0.8 | 0.9 |

## Commodities

| | 30-Nov | 31-Oct | Monthly change (%) | Year-to-date (%) | Year-on-year change (%) |
|---|---|---|---|---|---|
| CRB Commodity Index | 416.2 | 416.1 | 0.0 | –3.7 | –3.1 |
| Brent ($/barrel) | 58.7 | 75.5 | –22.2 | –12.2 | –7.6 |
| Gold ($/ounce) | 1,222.5 | 1,214.8 | 0.6 | –6.2 | –4.1 |

## Equity

| | 30-Nov | 31-Oct | Monthly change (%) | Year-to-date (%) | Year-on-year change (%) |
|---|---|---|---|---|---|
| S&P 500 (USA) | 2,760.2 | 2,711.7 | 1.8 | 3.2 | 4.3 |
| Eurostoxx 50 (euro area) | 3,173.1 | 3,197.5 | –0.8 | –9.4 | –11.1 |
| Ibex 35 (Spain) | 9,077.2 | 8,893.5 | 2.1 | –9.6 | –11.1 |
| PSI 20 (Portugal) | 4,914.1 | 5,030.7 | –2.3 | –8.8 | –8.4 |
| Nikkei 225 (Japan) | 22,351.1 | 22,201.8 | 0.7 | –1.8 | –1.6 |
| MSCI Emerging | 994.7 | 955.9 | 4.1 | –14.1 | –11.2 |

# A positive year draws to an end, but downside risks persist

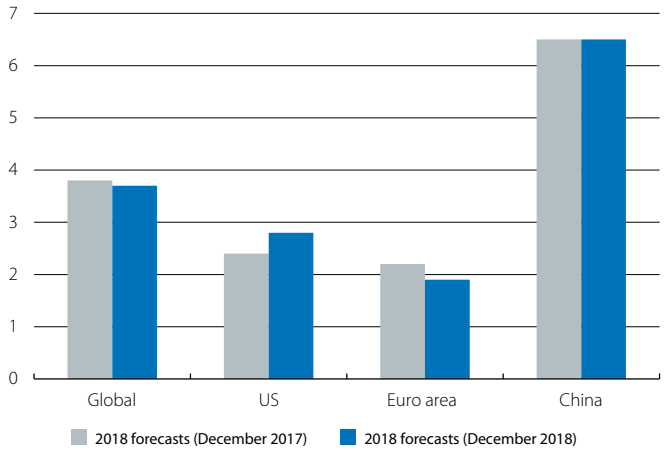
**2018: things are not looking so bad.** The aggregate macroeconomic data paint a picture of a broadly positive 2018, in line with the forecasts made at the end of last year, and everything suggests that global growth will stand at around 3.7% for the year as a whole (only 1 decimal point lower than we expected in December 2017). Thus, despite the fact that there are now more sources of risk, for the time being global macroeconomic health has shown remarkable resilience. The outlook for 2019 has also remained virtually unchanged: we now expect growth of 3.6%, only 1 decimal point below the forecast of a year ago. By country, however, there have been some notable surprises, both positive and negative. Taking the positive surprises first, the North American economy has performed better than expected, with growth that will probably end up being 0.4 pps higher than predicted a year ago. In any case, it is important to emphasise that this is largely due to the fiscal boost implemented by the Trump Administration, rather than structural factors. In contrast, the euro area has been the main negative surprise given that, in all likelihood, growth for 2018 will prove to be lower than expected a year ago. Nevertheless, the shortfall in question is no debacle: the major negative surprise occurred in the growth figures for Q3 (just 0.2% quarter-on-quarter), but this has been mainly due to temporary factors. The outlook for 2019, on the other hand, remains positive and reasonably similar to what we expected a year ago.

**Protectionist risks remain significant.** The US midterm elections did not deliver any major blow to Trump (the loss of the House of Representatives serves as a warning, but the Republican Party retained its majority in the Senate). Therefore, this electoral process is not expected to lead the US Administration to substantially change its position regarding its trade policy. As a result, the trade tensions between the US and China are likely to remain high over the coming months. Nevertheless, a window of opportunity has opened up that could lead to a certain cooling of tensions: the discussions between high-level trade representatives from China and the US that took place in November were a positive step, and the possibility of a trade truce being reached at the G-20 summit in Buenos Aires in early December is now more tangible, following the meeting between Trump and Xi Jinping.

**The preliminary Brexit agreement is reached, but its approval lies in the balance.** Specifically, London and Brussels have reached a preliminary agreement on the United Kingdom's departure from the EU. This agreement allows the transition period to be extended beyond 2020 and establishes that the United Kingdom will remain in a customs union with the EU if no agreement is reached on the future economic relationship between the two parties during the transition period. The latter is a particularly positive element since it

***GDP growth in 2018: current estimates vs. prior estimates***

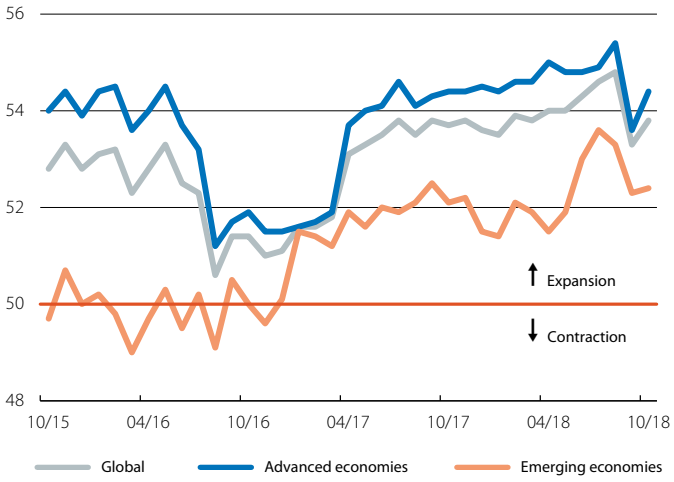
*(%)*




***Source:*** *CaixaBank Research.*

***Activity indicators: composite PMI***

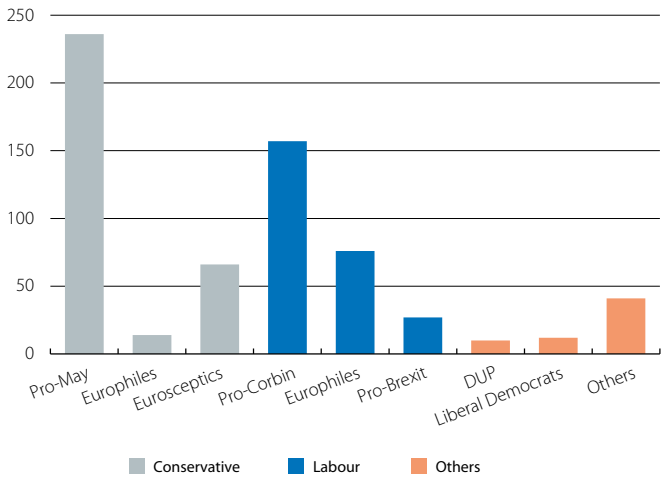
*Level*




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

***Brexit: the blocks in the British Parliament***

*Number of members with voting rights*




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

means that, if no agreement is reached during that period, the instability would be mitigated by the fact that the United Kingdom would remain in a customs union with the EU by default. Now the two parliaments must approve the preliminary agreement, which may prove difficult in the case of the United Kingdom due to the fierce opposition of the Eurosceptic wing of the Conservative Party and the Labour leader's decision to oppose the agreement. The outcome will be known on 11 December when this important vote, which is expected to be tight, is due to take place in Westminster.

## EURO AREA

**In the euro area, the latest indicators suggest a moderate growth rate at the beginning of Q4**. Specifically, the composite PMI index for the whole of the euro area, which measures business sentiment, fell to 52.4 points in November, 5 decimal points below the figure for October and the lowest since December 2014. This, together with a somewhat disappointing GDP in Q3 (0.2% quarter-on-quarter growth), has led us to slightly reduce our forecasts for 2018 (1.9%) and 2019 (1.8%). This environment of growth rates that are more moderate, albeit nonetheless healthy, was also reflected in the European Commission's new growth forecasts. In the autumn update of its economic scenario, the Commission revised its forecast for 2019 down (by –0.1 pp) to 1.9% (1 percentage point higher than our forecast), due to the slower growth expected in the external sector. However, it also noted that the growth of the euro area will continue to rest on the improvements in the labour market and on accommodative financial conditions. With regards to Germany, the disappointing GDP figure for Q3 (–0.2% quarter-on-quarter) confirmed the omens of a temporary slowdown in that quarter due to a negative contribution of net exports and lower car production levels (associated with the new emissions regulations that came into force on 1 September).

**Tensions between Italy and the European Commission remain the order of the day**. After analysing the Italian Government's new draft budget for 2019, the Commission determined that Italy is not complying with the EU's fiscal rules, since it is not reducing its public debt to GDP ratio at the speed that is required. As a result, it decided to kick-start the process for the European Council to implement an excessive deficit procedure against Italy. This procedure would involve a more comprehensive monitoring of the EU's recommendations on fiscal matters, and it could lead to fines of up to 0.5% of GDP being imposed. Nevertheless, this is a long procedure and the tensions and disagreements between the two parties are likely to persist over the coming months.

## US

**The economic indicators in the US show no sign of letting up** and continue to point towards significant growth in the last quarter of the year, following a stronger than expected Q3. In October, the manufacturing business sentiment indices

### *Euro area: GDP forecasts of the European Commission*

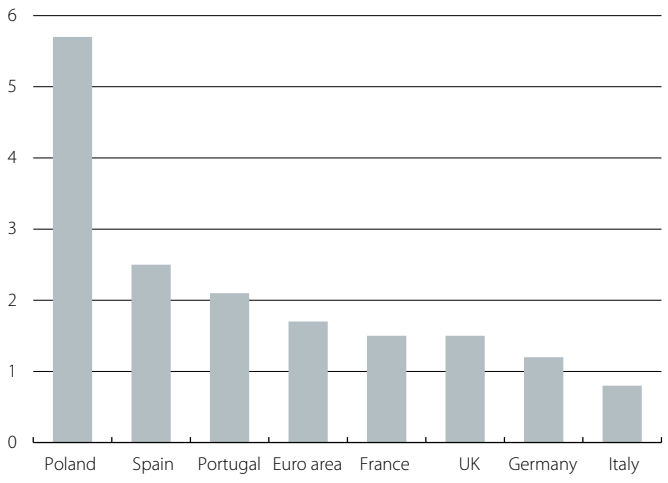
*Annual change (%)*

| | Forecast | | Change vs. summer 2018 forecast * | |
|---|---|---|---|---|
| | 2018 | 2019 | 2018 | 2019 |
| Euro area | 2.1 | 1.9 | = 0.0 | ▼ 0.1 |
| Germany | 1.7 | 1.8 | ▼ 0.2 | ▼ 0.1 |
| France | 1.7 | 1.6 | = 0.0 | ▼ 0.1 |
| Italy | 1.1 | 1.2 | ▼ 0.2 | ▲ 0.1 |
| Spain | 2.6 | 2.2 | ▼ 0.2 | ▼ 0.2 |
| Portugal | 2.2 | 1.8 | = 0.0 | ▼ 0.2 |
| United Kingdom | 1.3 | 1.2 | = 0.0 | = 0.0 |

***Note:*** ** Change in percentage points.*
***Source:*** *CaixaBank Research, based on data from the European Commission (European Economic Forecast, autumn 2018).*

### *European Union: GDP for Q3 2018*

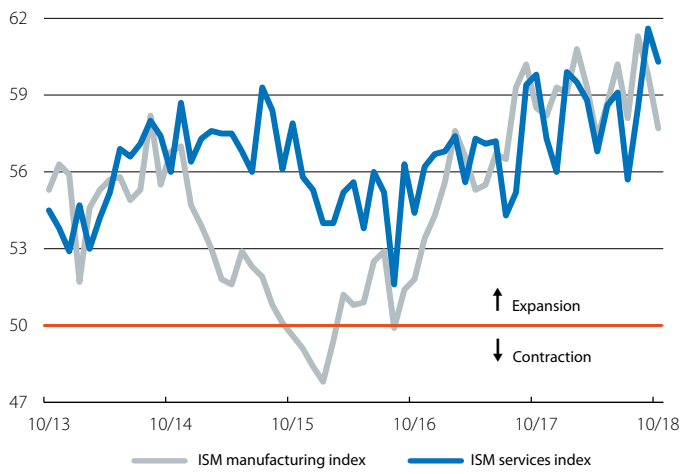
*Year-on-year change (%)*




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

### *US: activity indicators*

*Level*




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

(ISM) remained comfortably within expansionary territory (well above 50 points). In the labour sphere, 250,000 jobs were created. This is a very strong figure, especially in a situation with practically full employment. The unemployment rate, meanwhile, remained at a 3.7% (the lowest level since 1969), and wages increased by a solid 3.1% year-on-year. All this reinforces the view that the US economy will begin 2019 with buoyant growth.

**New political checks and balances.** In the midterm legislative elections for Congress, the Democrats managed to regain a majority in the House of Representatives, while the Republicans retained control of the Senate. As a result, the voices opposing the country's Administration will gain strength in the second half of President Trump's term. This will be particularly significant for domestic policy, making it much more difficult for new tax cuts to be approved and establishing greater control over the president between now and 2020.

## JAPAN

**Japan's growth has taken a respite** with a temporary drop in GDP in Q3 (-0.3% quarter-on-quarter). Although a weak growth figure was expected, due to the disruption to economic activity caused by the floods and the heat wave that hit the country during much of July, the impact has been worse than expected. In the last quarter of the year, despite the impact that the trade tensions could have on external demand, we expect the Japanese economy to return to positive growth rates.

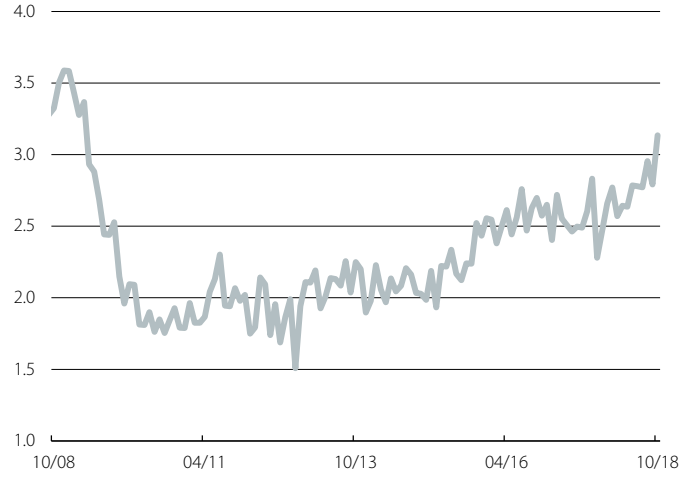
## EMERGING MARKETS

**China's foreign sector is weathering the storm of trade tensions well.** Chinese exports (in dollars) increased by a significant 15.6% year-on-year in October, which also represents a slight improvement on the figure for September (14.4%). As such, China's export sector remains dynamic, including in exports to the US, which have proven resistant despite the tariffs introduced by the US Administration over the course of 2018. The economic activity indicators, meanwhile, continued to support our view that China's economy will keep moving towards a gentle slowdown over the coming quarters.

**Brazil and India: two emerging markets experiencing growth.** The GDP of the Brazilian economy rebounded in Q3 with year-on-year growth of 1.3% (0.8% quarter-on-quarter), following the 1.0% growth registered in Q2 (the upswing in growth was favoured by the fact that a major lorry driver strike, which had weighed down activity in the previous quarter, came to an end). The Indian economy, on the other hand, continues to show strong growth. In Q3, its GDP growth stood at an impressive 7.1%, albeit somewhat lower than that expected by analysts' consensus (7.5%) and lower than that of Q2, which was exceptionally high (8.2%).

### *US: wages*

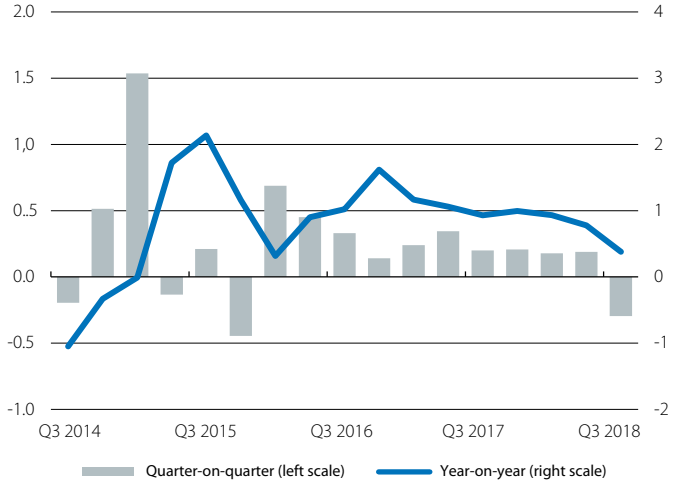
*Year-on-year change (%)*




***Source:*** *CaixaBank Research, based on data from the Bureau of Labor Statistics.*

### *Japan: GDP*

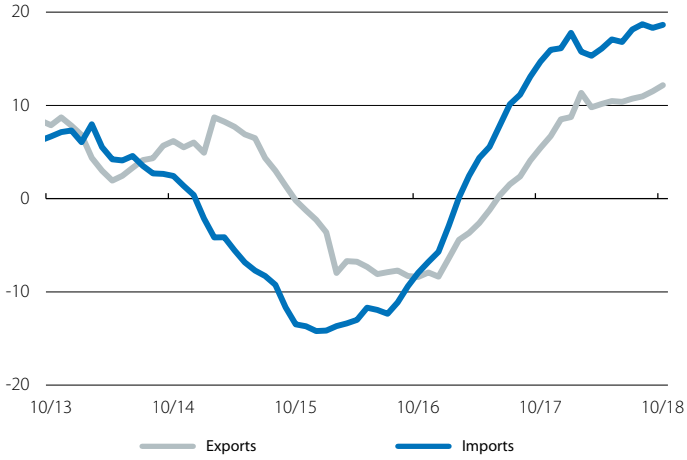
*Quarter-on-quarter change (%)* *Year-on-year change (%)*




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

### *China: foreign trade in goods **

*Year-on-year change in the 12-month cumulative total (%)*




***Note:*** ** Change obtained based on nominal data in dollars*
***Source:*** *CaixaBank Research, based on data from the Chinese Customs office.*

# US: what is going on with the slowdown in the real estate sector?

The US real estate sector has begun to show signs of slowing down in recent quarters. This trend has opened up the debate about whether it poses a significant risk to the current expansive phase of the US economy, which is close to beating its record for the longest period of uninterrupted growth in the last 170 years. This is especially the case given that, as we all know too well, the real estate sector played a decisive role in the economic-financial crisis of 2008.

## Confirmation of the slowdown and economic effect in the short term

Several variables in the real estate market have shown a clear slowdown in recent months. The growth of residential investment has dropped from nearly 3.5% in real terms in 2017 to less than 1.0% in the first three quarters of 2018, while sales of both new and existing homes have fallen since the beginning of the year and price growth has slowed down (see the first and second chart).

This change of trend was foreseeable to some extent, in view of the Fed's monetary normalisation process. As a result of the gradual withdrawal of monetary stimuli, the interest rate on 30-year mortgages has increased by 100 bps in just one year (up to around 5.0%, the highest in the past eight years). This accounts for nearly two-thirds of the slowdown registered in residential investment.[1] In addition, the tax reform approved by the US Congress in December 2017, which lowered deductions for both mortgage interest and property taxes, has also influenced the recent slowdown in the sector.

These downward pressures on the real estate sector will remain in place over the coming quarters, which to some extent will hold back economic activity. In particular, as a result of the slowdown in residential investment and the impact of housing wealth on consumption, the real estate sector will go from contributing around 0.3 pps to annual GDP growth in the US between 2015 and 2017 to probably having a zero contribution in 2018, and one of around 0.15 pps in 2019 and 2020.

In the medium term, we believe that there is unlikely to be a major disruption in the real estate sector with consequences for the financial system and for economic activity, as occurred 10 years ago. In fact, as we shall see below, the current imbalances in the sector appear to be relatively contained, which should help it return to growth over the next few years.

1. As suggested by Goldman Sachs's estimates (2018), in «The Housing Slowdown».

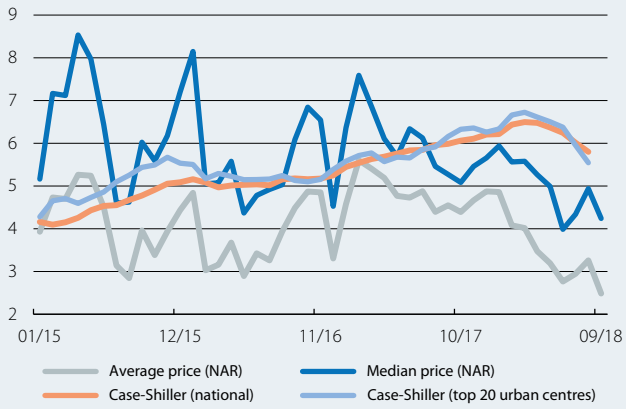
***US: home sales***

*(Thousands of homes)* *(Thousands of homes)*


***Source:*** *CaixaBank Research, based on data from the National Association of Realtors.*

***US: housing prices***

*Year-on-year change (%)*




***Source:*** *CaixaBank Research, based on data from the National Association of Realtors (NAR) and Standard & Poor's.*

## Contained imbalances: prices, supply and indebtedness

After five years of substantial growth (around 6.0% per annum), US housing prices are 50% higher than those recorded in 2012 (their lowest point) and 10% higher than those of early 2007 (their highest peak). However, in order to assess whether housing prices are too high (or low), we must first consider them in relation to other indicators that show the affordability of housing. A common measure is the ratio between housing prices and household income. If we take the case of an average household, between 1980 and 2017 this ratio has varied between 2.5 and 4, with a historical average of 3. Given that it currently stands at 3.3, the accessibility of housing, or the level of effort required for households to purchase a home, does not appear to be terribly

different from what it has traditionally been in the country.[2]

All things considered, at this point, some caution is required. Firstly, in a country as large as the US, national aggregates can be misleading, since the real estate market is highly segmented and sometimes there are noticeable regional differences. As such, although the levels of effort required to access the housing market are generally at reasonable levels, there are certain major metropolitan areas on the West Coast, as well as in the North East, where prices are far less affordable for average-income households (see the third chart).[3] Secondly, it is worth noting that while the effort ratio at the national level is not far off the usual parameters, it has undergone a gradual but uninterrupted increase since 2012 (rising from 2.7 in 2012 to 3.3).

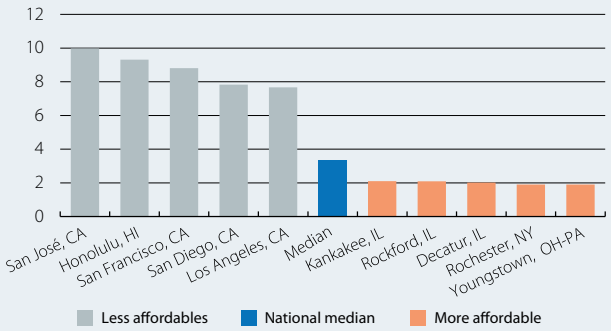
Household indebtedness related to the real estate sector is another element that must be analysed when evaluating the level of imbalances in the sector. In this area we see how, on the one hand, household mortgage debt in relation to household property wealth is slightly below the historical average (35.5% at present, compared to an average of 37.2%).[4] On the other hand, during the real estate boom prior to the bursting of the bubble in 2007, there was a sharp increase in so-called housing equity withdrawal (through which households were obtaining consumer loans, using their home as collateral). This trend led to very high levels of household consumption (which was unsustainable following the sector's collapse). Today, however, these lines of credit have fallen sharply, reaching all-time lows.

Lastly, there is not any imbalance between housing supply and demand arising as a result of the demographic trends in the US. In particular, the pace of construction remains at contained levels in relation to the demand generated by the formation of new households (see the fourth chart), which supports the current expansive cycle of the real estate market that began in 2012.

In short, in this new expansive cycle in the real estate sector, there are no signs of the more significant excesses that were present in the mid-2000s, such as the high levels of construction activity, runaway housing prices and the credit boom supported by the real estate market. Therefore, everything indicates that the current slowdown is not, in a general sense, a source of significant risk for the current expansion of the US economy. Nevertheless, some regions of the country should be closely monitored, since their indicators are somewhat less contained.

### *US: accessibility index by metropolitan area*

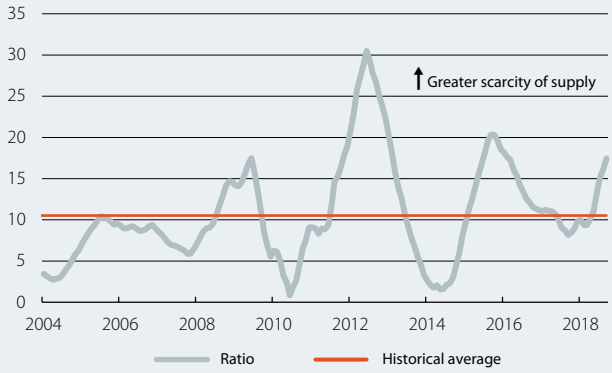
*Price over income **




***Note:*** ** Based on the median household income by metropolitan area and the median housing price by metropolitan area (2017).*
***Source:*** *CaixaBank Research, based on data from the American Community Survey and the National Association of Realtors.*

### *US: ratio between household formation and new homes built*

*Level*




***Source:*** *CaixaBank Research, based on data from the National Association of Realtors and the US Census Bureau.*

2. Ratio between the median housing price and the median household income (according to data from the National Association of Realtors), both at the national level. The results are similar to those indicated by other data sources for the price of housing and household income.
3. Honolulu, the capital of the archipelago of Hawaii, also appears near the top of the lists of the least affordable cities. On the other hand, this is a characteristic that is quite common among large cities on remote islands.
4. Although this ratio is not very informative during periods with unsustainably high property prices, this does not appear to be the case today, as is clear from the ratios indicating the effort required for households to purchase a home.

# The first budget of the 27-member EU

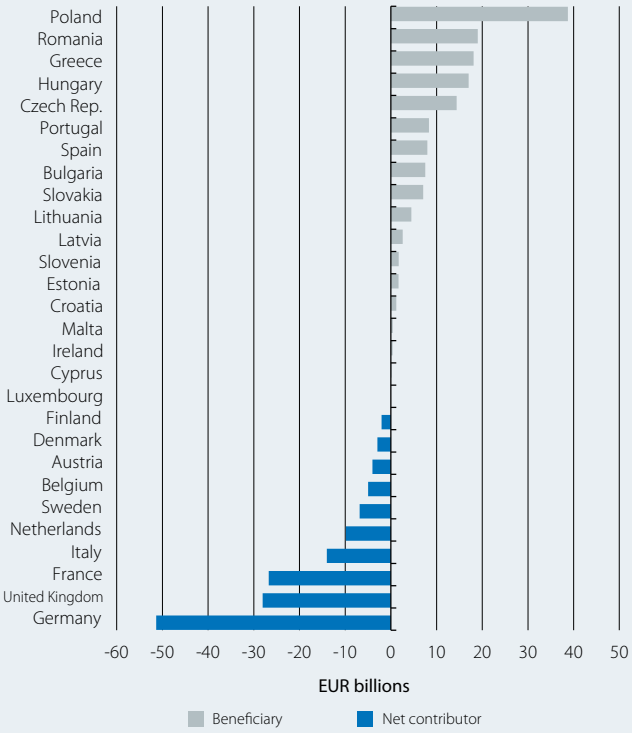
In early 2018, the various countries of the EU and the European institutions began to negotiate the next EU budget (formally known as the multiannual financial framework, or MFF). This budget establishes the annual expenditure limits that the EU can allocate to financing common policies over a seven-year period (2021-2027).[1] In this Focus, we will go over the key points on which the negotiations regarding the EU's financial framework will focus and we will see what can be expected from it.

Although the common budget is somewhat modest - it represents 2.0% of the EU's total public expenditure and 1.03% of the EU's gross national income -, it is an expression of the Union's political priorities, given that it outlines the areas in which the Member States want to dedicate their efforts over the coming years. However, it must overcome significant restrictions to ensure that the composition of the expenditure adequately reflects the EU's vision, as well as to enable it to properly tackle the present and future challenges it faces.

First of all, the next budget will be the first post-Brexit budget. With the departure of the United Kingdom, the EU is losing a net contributor. As shown in the first chart, under the current budgetary framework, the United Kingdom has paid approximately 28 billion euros more than it has received (representing 1.4% of its GDP),[2] cumulatively between 2014 and 2017, making it the largest net contributor after Germany. Therefore, when the United Kingdom ceases to contribute to the common budget,[3] starting from 2021, this will have a considerable financial impact on revenues - some estimates put the financial gap at between 10 and 12 billion euros per year, which is approximately 7.1% of the current budget.[4] This funding gap could hinder the already difficult negotiations between net contributors[5] and beneficiaries of the budget, given that the 27 remaining members must decide whether they want to compensate for this reduction in revenues with an increase in contributions or with a reduction in expenditure. Furthermore, in the event that they agree to increase the contributions, they will have to decide how to distribute the load.

1. Although the current financial framework does not end until the end of 2020, discussions must begin well in advance. This is because the negotiation process is usually complicated and drawn out, as it involves discussion on both the financial aspects and the common priorities for the next few years, and also because the budget must be approved by both the European Parliament and the European Council (unanimously).
2. In real terms.
3. Although the United Kingdom will formally leave the EU in March 2019, in the negotiations on the departure agreement, in which the divorce terms have been agreed, the United Kingdom has committed to meeting its financial obligations until 2020, when the current budgetary framework comes to an end.
4. Besides the revenues, we must also take into account the EU's expenditure in the United Kingdom and the rebate of a portion of the United Kingdom's contributions to the budget that the EU repays it. In addition, any payments that the United Kingdom makes after Brexit, in exchange for taking part in specific programmes, must also be taken into consideration.
5. Each country's contribution is divided into three parts: a fixed percentage of its gross national income (GNI), tariffs collected on behalf of the EU and a percentage of the VAT revenues that countries collect.

***EU budget: net beneficiaries and net contributors (cumulative figures for 2014-2017)***



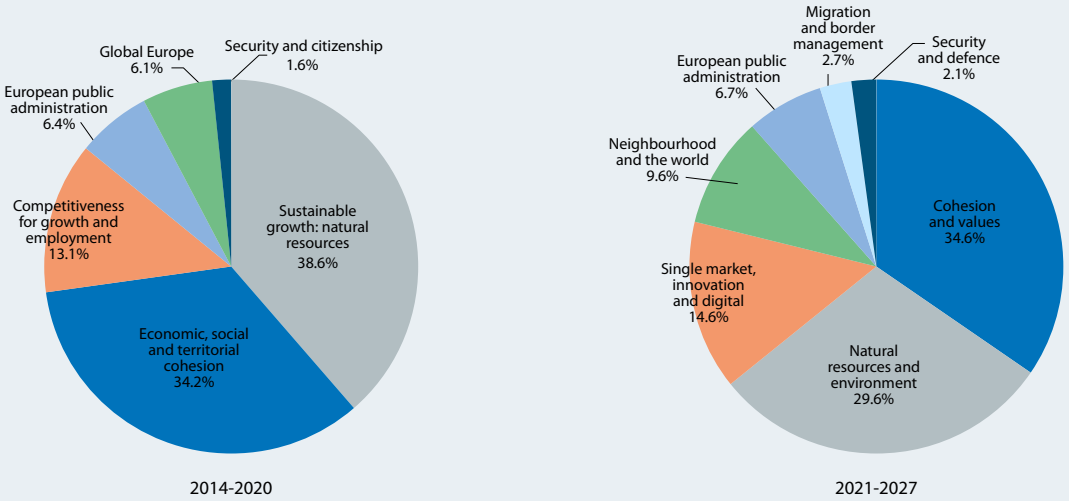

***Source:*** *CaixaBank Research, based on data from the European Commission.*

Furthermore, this reduction in resources because of Brexit coincides with the Member States' desire to devote more efforts to new areas that are considered priorities. In particular, the 27 remaining members recently laid out their vision for the Union for the next 10 years[6] and identified areas in which they are committed to working in order to achieve it. In this regard, the global challenges that have emerged in recent years - including geopolitical conflicts, terrorism and the refugee crisis - have highlighted the importance of greater coordination and European integration on foreign policy, defence and security. To this end, the 27 remaining members want to dedicate more resources, as well as more coordination efforts, to these areas. The challenge lies in determining how to dedicate more resources to these new political priorities while at the same time continuing to allocate resources to other existing areas of the budget that remain important for the Union's economic future, such as research and development, digital transformation and youth mobility.

In this context, and in order to fill the hole that Brexit will leave and to have sufficient resources for the priority areas of expenditure, the European Commission

6. In particular, the Bratislava Declaration (in September 2016), and later in the Rome Declaration (in March 2017), the remaining 27 members set themselves the goal of achieving a Europe that is safer and better protected, more prosperous and sustainable, more social, and one that has a greater presence on the global scene.

### *Comparison between the current and future financial framework*




***Notes:*** *The distribution of expenditure by category in the future financial framework (2021-2027) is based on the proposal put forward by the European Commission in May 2018. Areas with the same colour indicate a relatively similar area of expenditure.*
***Source:*** *CaixaBank Research, based on documents from the European Commission.*

proposes striking a balance between cost-cutting and searching for new revenues. Although the numbers being put forward in the Commission's proposal still have to be debated and agreed upon by all Member States, they serve as a starting point for the negotiations and provide an indication of the challenges and constraints that must be overcome. In particular, the institution proposes a very slight increase of funds from the current 1.03% to 1.14% of the EU's gross national income - an amount that remains modest relative to the size of the EU economy. Nevertheless, some countries, such as Austria and the Netherlands, are opposed to this option and insist that, after Brexit, the size of the budget should be reduced and the remaining members should strive to make it more efficient. The Commission also proposes introducing new sources of revenues, such as environmental taxes, although some member countries have already expressed their reluctance to cede fiscal authority to Brussels. However, over the next few years, progress is likely to be made on the introduction of new sources of revenues, since following the departure of the United Kingdom, those who did not want to move in this direction will lose a staunch ally.

On the expenditure side, the Commission proposes simplifying and reorganising the expenditure commitments to focus on the aforementioned priorities, which have become more important. In addition, it proposes reducing the proportion of resources allocated to the two largest programmes, namely the Common Agricultural Policy (which consumes 39% of total expenditure)[7] and the Cohesion Fund (which accounts for around 27%). However, some countries that are beneficiaries of these funds, such as Ireland and Poland, reject this strategy for fear of suffering cuts. As such, agreeing which items to cut in order to fund new initiatives could lead to a conflict of interests between the various countries and prove to be a contentious point in the negotiations.

There are also other points that could generate debate. On the one hand, the desire of the Commission and some Member States to attach conditions to the budgetary expenditure that a country receives, requiring the recipient country to respect the Union's values and democratic principles, could accentuate the divisions between the countries of the East and West of the Union. On the other hand, the proposal put forward by France and the European Commission to devote resources (2.3% of the budget) to an institution that serves a macro-stabilising function in the euro area,[8] helping the EU to cope with future shocks, is already facing opposition. In particular, the objections are coming from countries such as the Netherlands and Finland - countries that stress the importance of each country being responsible for its fiscal policy.

Therefore, in theory, the discussion on the next MFF offers an opportunity to reform the European finances and to emphasise the principle that the pooling of resources at a European level can add value in some areas and produce results that the expenditure of individual countries alone cannot. However, in order for the composition of the expenditure to adequately reflect the Union's political priorities, major changes are needed in the allocation of common resources, and countries must stop focusing on the net balances - the difference between what countries contribute and receive. The outcome of the negotiations on the next financial framework will reflect the true commitment of the remaining 27 members to firmly proceed with the building of the Union. In this regard, despite the continuing manifestations from Europe's main political leaders to move forward with the European project, and the desire to focus on areas that are considered priorities, it will be difficult to change the dynamics that have guided the negotiations of previous budgets. The risk, in short, is that the Member States could end up adopting a budget that is very similar to the previous ones.

7. Data from the European Commission for 2017.

8. As well as in those countries participating in the European exchange rate mechanism (currently, only Denmark).

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

## UNITED STATES

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|
| **Activity** | | | | | | | | |
| Real GDP | 1.6 | 2.2 | 2.5 | 2.6 | 2.9 | 3.0 | ... | – |
| Retail sales (excluding cars and petrol) | 3.4 | 4.1 | 5.3 | 4.4 | 5.2 | 5.4 | 4.7 | ... |
| Consumer confidence *(value)* | 99.8 | 120.5 | 126.0 | 127.1 | 127.2 | 132.6 | 137.9 | 135.7 |
| Industrial production | –1.9 | 1.6 | 3.0 | 3.4 | 3.4 | 5.0 | 4.1 | ... |
| Manufacturing activity index (ISM) *(value)* | 51.4 | 57.4 | 58.7 | 59.7 | 58.7 | 59.7 | 57.7 | ... |
| Housing starts *(thousands)* | 1.177 | 1.208 | 1.259 | 1.317 | 1.261 | 1.225 | 1.228 | ... |
| Case-Shiller home price index *(value)* | 189 | 200 | 205 | 209 | 211 | 212 | ... | ... |
| Unemployment rate *(% lab. force)* | 4.9 | 4.4 | 4.1 | 4.1 | 3.9 | 3.8 | 3.7 | ... |
| Employment-population ratio *(% pop. > 16 years)* | 59.7 | 60.1 | 60.1 | 60.3 | 60.4 | 60.4 | 60.6 | ... |
| Trade balance [1] *(% GDP)* | –2.7 | –2.8 | –2.8 | –2.9 | –2.8 | –2.9 | ... | ... |
| **Prices** | | | | | | | | |
| Headline inflation | 1.3 | 2.1 | 2.1 | 2.2 | 2.7 | 2.6 | 2.5 | ... |
| Core inflation | 2.2 | 1.8 | 1.8 | 1.9 | 2.2 | 2.2 | 2.1 | ... |

***Note:*** *1. Cumulative figure over last 12 months. Billion dollars.*
***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

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|
| **Activity** | | | | | | | | |
| Real GDP | 1.0 | 1.7 | 2.0 | 1.1 | 1.4 | 0.4 | ... | – |
| Consumer confidence *(value)* | 41.7 | 43.8 | 44.5 | 44.4 | 43.7 | 43.4 | 43.0 | 42.9 |
| Industrial production | 0.2 | 2.9 | 2.7 | 2.0 | 1.3 | –0.1 | 2.5 | ... |
| Business activity index (Tankan) *(value)* | 7.0 | 19.0 | 25.0 | 24.0 | 21.0 | 19.0 | – | ... |
| Unemployment rate *(% lab. force)* | 3.1 | 2.8 | 2.7 | 2.5 | 2.4 | 2.4 | 2.4 | ... |
| Trade balance [1] *(% GDP)* | 0.7 | 0.5 | 0.5 | 0.4 | 0.4 | 0.1 | 0.0 | ... |
| **Prices** | | | | | | | | |
| Headline inflation | –0.1 | 0.5 | 0.6 | 1.3 | 0.6 | 1.1 | 1.4 | ... |
| Core inflation | 0.6 | 0.1 | 0.3 | 0.4 | 0.3 | 0.3 | 0.4 | ... |

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

## CHINA

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|
| **Activity** | | | | | | | | |
| Real GDP | 6.7 | 6.9 | 6.8 | 6.8 | 6.7 | 6.5 | ... | – |
| Retail sales | 10.4 | 10.3 | 9.9 | 9.9 | 9.0 | 9.0 | 8.6 | ... |
| Industrial production | 6.1 | 6.6 | 6.2 | 6.6 | 6.6 | 6.0 | 5.9 | ... |
| PMI manufacturing *(value)* | 50.3 | 51.6 | 51.7 | 51.0 | 51.6 | 51.1 | 50.2 | ... |
| **Foreign sector** | | | | | | | | |
| Trade balance [1] *(value)* | 512 | 435 | 420 | 404 | 377 | 349 | 346 | ... |
| Exports | –8.4 | 8.5 | 9.6 | 13.7 | 11.4 | 11.9 | 15.6 | ... |
| Imports | –5.7 | 16.1 | 13.4 | 19.4 | 20.6 | 20.4 | 21.4 | ... |
| **Prices** | | | | | | | | |
| Headline inflation | 2.0 | 1.6 | 1.8 | 2.2 | 1.8 | 2.3 | 2.5 | ... |
| Official interest rate [2] *(value)* | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | ... |
| Renminbi per dollar *(value)* | 6.6 | 6.8 | 6.6 | 6.4 | 6.4 | 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.*

# EUROPEAN UNION

## Activity and employment indicators

*Values, unless otherwise specified*

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|
| Retail sales *(year-on-year change)* | 1.6 | 2.3 | 2.0 | 1.6 | 1.7 | 1.3 | ... | ... |
| Industrial production *(year-on-year change)* | 1.6 | 3.0 | 4.2 | 3.2 | 2.4 | 0.8 | ... | ... |
| Consumer confidence | –7.8 | –2.5 | –0.2 | 0.5 | 0.0 | –1.8 | –2.7 | –3.9 |
| Economic sentiment | 104.2 | 110.8 | 114.3 | 114.0 | 112.5 | 111.5 | 109.7 | 109.5 |
| Manufacturing PMI | 52.5 | 57.4 | 59.7 | 58.3 | 55.5 | 54.3 | 52.0 | 51.5 |
| Services PMI | 53.1 | 55.6 | 55.9 | 56.4 | 54.6 | 54.4 | 53.7 | 53.1 |
| **Labour market** | | | | | | | | |
| Employment (people) *(year-on-year change)* | 1.4 | 1.6 | 1.6 | 1.5 | 1.5 | 1.3 | – | ... |
| **Unemployment rate: euro area** *(% labour force)* | 10.0 | 9.1 | 8.7 | 8.5 | 8.3 | 8.1 | 8.1 | ... |
| Germany *(% labour force)* | 4.2 | 3.8 | 3.6 | 3.5 | 3.4 | 3.4 | 3.3 | ... |
| France *(% labour force)* | 10.1 | 9.4 | 9.1 | 9.2 | 9.0 | 9.0 | 8.9 | ... |
| Italy *(% labour force)* | 11.7 | 11.3 | 11.0 | 11.0 | 10.7 | 10.3 | 10.6 | ... |
| Spain *(% labour force)* | 19.6 | 17.2 | 16.5 | 16.2 | 15.4 | 15.0 | 14.8 | ... |

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

## Prices

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

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|
| General | 0.2 | 1.5 | 1.4 | 1.3 | 1.7 | 2.1 | 2.2 | 2.0 |
| Core | 0.8 | 1.1 | 1.1 | 1.2 | 1.2 | 1.2 | 1.2 | 1.1 |

***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*

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|
| **Current balance: euro area** | **3.4** | **3.4** | **3.4** | **3.6** | **3.8** | **3.4** | **...** | **...** |
| Germany | 8.5 | 8.0 | 8.0 | 8.0 | 8.2 | 7.8 | ... | ... |
| France | –0.8 | –0.6 | –0.6 | –0.4 | –0.3 | –0.6 | ... | ... |
| Italy | 2.5 | 2.8 | 2.8 | 2.8 | 2.8 | 2.7 | ... | ... |
| Spain | 2.3 | 1.8 | 1.8 | 1.8 | 1.4 | 1.1 | ... | ... |
| **Nominal effective exchange rate**[1] *(value)* | **94.3** | **96.5** | **98.6** | **99.6** | **98.5** | **99.2** | **98.9** | **98.3** |

***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.*

## Credit and deposits of non-financial sectors

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

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|
| **Private sector financing** | | | | | | | | |
| Credit to non-financial firms[1] | 1.8 | 2.5 | 3.0 | 3.3 | 3.7 | 4.2 | 3.9 | ... |
| Credit to households[2,3] | 1.7 | 2.6 | 2.8 | 2.9 | 2.9 | 3.1 | 3.2 | ... |
| Interest rate on loans to non-financial firms[4] *(%)* | 1.4 | 1.3 | 1.3 | 1.2 | 1.2 | 1.2 | ... | ... |
| Interest rate on loans to households for house purchases[5] *(%)* | 1.8 | 1.7 | 1.7 | 1.6 | 1.6 | 1.6 | ... | ... |
| **Deposits** | | | | | | | | |
| On demand deposits | 10.0 | 10.1 | 10.2 | 9.2 | 8.0 | 7.3 | 7.3 | ... |
| Other short-term deposits | –1.9 | –2.7 | –2.4 | –2.2 | –1.5 | –1.4 | –1.0 | ... |
| Marketable instruments | 2.7 | 1.1 | –1.6 | –5.7 | –2.9 | –5.1 | –4.8 | ... |
| Interest rate on deposits up to 1 year from households *(%)* | 0.5 | 0.4 | 0.4 | 0.4 | 0.4 | 0.3 | ... | ... |

***Notes:*** *1. Weighted by flow of foreign trade. 2. Data adjusted for sales and securitization. 3. Including NPISH. 4. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 5. 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.*

# The Spanish economy exhibits a solid performance

**Moving towards a gentle slowdown in growth.** With the year almost at an end, and with official GDP growth data for three of the four quarters of the year, indicators suggest that the Spanish economy will have grown by around 2.5% in 2018, a figure very much in line with the 2.4% projected in our scenario a year ago. This represents a gentle slowdown following three years of exceptionally strong growth – at rates above 3% –, in which the Spanish economy was favoured by a number of factors that gave further impetus to the recovery that was already underway (such as the decline in oil prices, the reduction of interest rates and the depreciation of the euro). This gentle slowdown in growth will continue into 2019, when we expect the economy to grow at slightly above 2%. This is a lower rate than previous years, but higher than that forecast for most developed economies, as well as being more sustainable in the long term. A similar outlook is suggested by the latest forecasts published in November by the International Monetary Fund (IMF), in its annual analysis (the so-called «Article IV»). In it, the Fund predicts a 2.2% growth for 2019 and reiterates that the moderation in growth is a result of reduced momentum in the cyclical support factors, as well as a more adverse international context. The IMF also stresses the need to reduce public debt, which remains high (at around 98% of GDP) despite the reduction of the deficit in recent years. This reflection coincides with the assessments made by the European Commission in relation to the 2019 draft budget submitted by the Government to Brussels.

**Economic activity indicators indicate healthy growth.** In October, the Purchasing Managers' Index (PMI) for the manufacturing sector stood at 51.8 points, a figure very similar to that of September (51.4 points) and close to the average for Q3 (52.4 points). The PMI for the services sector, meanwhile, rebounded up to 54.0 points, 1.5 points higher than the figure for the previous month and slightly above the average for Q3 (52.6 points). On the other hand, industrial production grew somewhat below expectations in September (0.0% year-on-year). Finally, retail sales grew by a significant 1.8% year-on-year in October, well above the figure for the previous month (–0.4%) and the average for 2017 (0.9%). This indicates that the positive tone in private consumption will continue in the last quarter of 2018. On the whole, therefore, indicators suggest that growth in Q4 remains at similar levels to the previous quarter (0.6% quarter-on-quarter).

**Job creation maintains a positive tone.** The number of registered workers affiliated to Social Security rose by 110,567 people in October (seasonally-adjusted data). This represents a 3.1% year-on-year growth in employment (2.9% in September) and brings the cumulative total for the number of jobs created in the past 12 months to 562,544. This is in addition to the encouraging trends exhibited by national accounts data and

### *Spain: GDP*

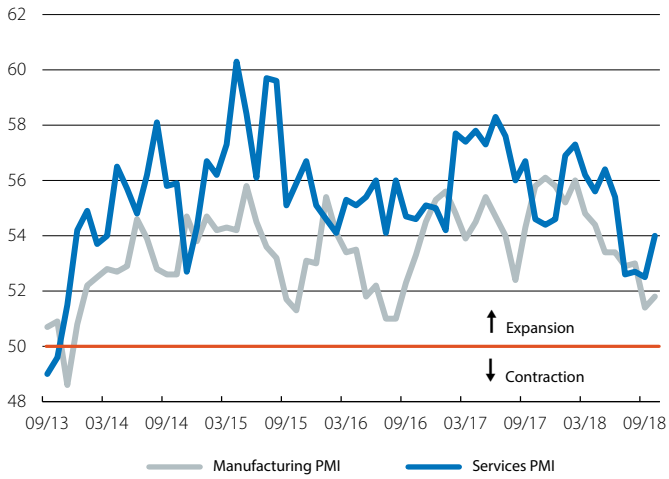
*Quarter-on-quarter change (%)*

| | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 |
|---|---|---|---|---|
| GDP | 0.7 | 0.6 | 0.6 | 0.6 |
| Private consumption | 0.4 | 0.9 | 0.1 | 0.6 |
| Public consumption | 0.3 | 0.8 | 0.1 | 0.8 |
| Investment | 0.6 | 1.1 | 3.5 | 1.0 |
| Investment in capital goods | 0.5 | –0.1 | 6.6 | 2.2 |
| Investment in construction | 0.8 | 2.1 | 2.2 | 0.5 |
| Exports | 1.4 | 0.6 | 0.2 | –1.8 |
| Imports | 0.4 | 1.1 | 1.2 | –1.4 |

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

### *Spain: activity indicators*

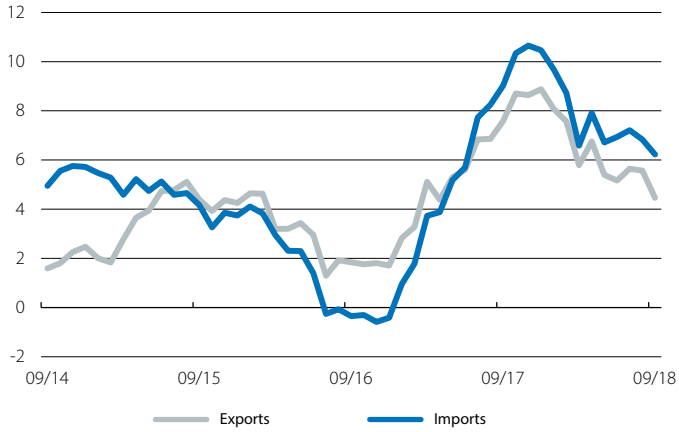
*Level*




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

### *Spain: exports and imports of goods **

*Year-on-year change (%)*




***Note:*** ** 12-month cumulative figures.*
***Source:*** *CaixaBank Research, based on data from the Department of Customs.*

labour force survey (LFS) figures. In particular, in Q3 the unemployment rate stood at 14.6%, its lowest level since Q4 2008, while the remuneration per full-time employee rose by 1.1% year-on-year, a rate higher than the average for 2017 and the first half of 2018.

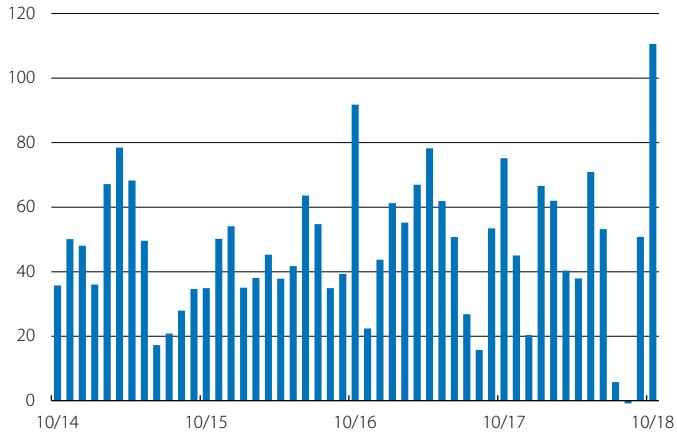
**The external surplus moderates further.** In September, the current account balance stood at +1.1% of GDP (i.e. 13,339 million euros, based on 12-month cumulative data), lower than the 1.8% registered in September 2017. The decrease can be largely explained by the deterioration in the trade balance, in both the energy and the non-energy balance (in equal parts). Furthermore, the decrease in the services surplus also contributed to the deterioration in the current account balance. Looking ahead to the next few months, the indicators suggest that the current account balance will continue to be subjected to downward pressure due to the continued deterioration of the non-energy balance. That said, these downward pressures could be mitigated somewhat by the recent correction in the oil price and by a slowdown in the balance of tourism, which is proving to be more benign than anticipated before the summer season.

**The public deficit benefits from the cyclical momentum.** The data available up to September show that the consolidated fiscal deficit (excluding local corporations) stood at 1.5% of GDP. This represents a 0.5-pp reduction in the public accounts compared to the prior year and should make it possible to achieve the budget deficit target for 2018 (2.7%). On the other hand, general government debt remained at 98.1% of GDP in Q3 2018, very similar to the figure for Q3 2017 (98.4%). In reference to this high level of public debt, which has remained close to 100% of GDP for the past five years, in November the European Commission stressed the need to ensure the structural deficit was reduced as expected, as well as the high level of public debt.

**The growth in housing prices slows down in Q3.** Housing prices based on valuations registered a modest increase in Q3 2018 (0.1% quarter-on-quarter, 3.2% year-on-year) and slowed down compared to Q2 (1.4% quarter-on-quarter, 3.8% year-on-year). Nevertheless, most supply and demand indicators in the sector continue to show an encouraging trend. Together with the improvement in the labour market, as well as the accommodative financial conditions and the support for housing demand from abroad, these indicators support the positive outlook for the sector. On the demand side, in the cumulative 12 months to September there were 506,749 home purchase and sale transactions. This is 12.6% higher than the figure for September 2017 – evidence that the demand for housing continues to experience strong growth. Furthermore, on the supply side, residential investment remained buoyant with year-on-year growth of 6.5% in Q3, a figure similar to that of the previous quarter (7.0% year-on-year).

### *Spain: registered workers affiliated with Social Security **

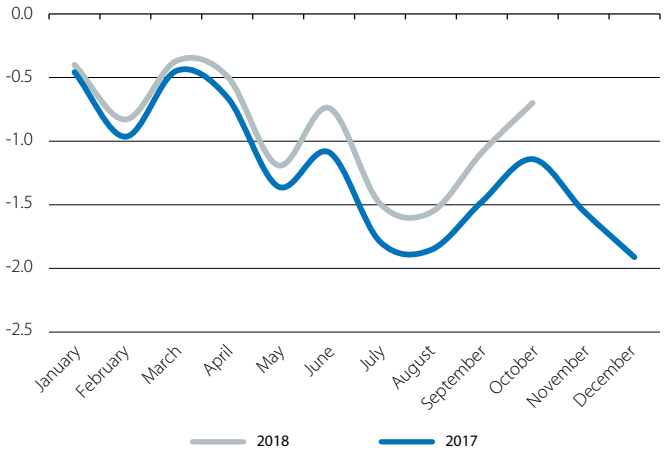
*Monthly change (thousands of people)*




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

### *Spain: government balance*

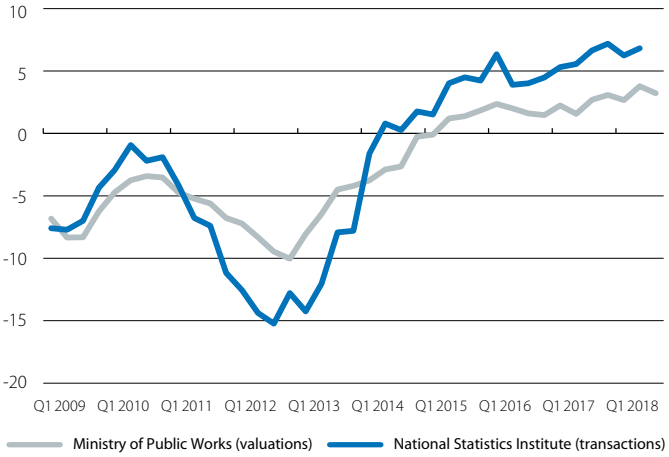
*(% of GDP)*




***Source:*** *CaixaBank Research, based on data from the General Comptroller of the State Administration (IGAE).*

### *Housing prices*

*Year-on-year change (%)*




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

# Wages in Spain, the same moderation for everyone?

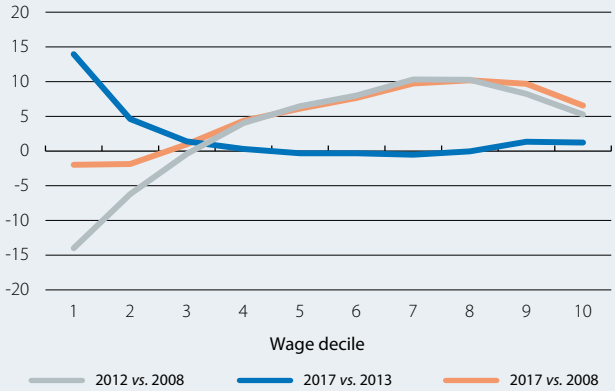
The labour market in Spain has been exhibiting a notable rate of recovery over the past several years. In 2018, for example, there are nearly two million more people in employment than there were in 2013, and the unemployment rate has fallen by around 2 pps per year during this period. Despite this, the pace of wage growth has been relatively contained. According to data from the National Accounts, the remuneration per full-time employee has risen by 0.5% per annum on average between 2013 and 2018. This low wage growth is largely due to the high level of under-utilisation of the labour force, which is reflected both in the high rate of unemployment and in other indicators of underemployment, such as the high rate of involuntary part-time workers.[1] Another factor that has contributed to low wage growth is the fact that inflation expectations have remained relatively low. But has this wage moderation been the same across the board?

If we analyse the trend in wages ordered into deciles,[2] we see that the apparent stability in wages hides differing trends across the spectrum. According to the National Statistics Institute, the median gross monthly wage of a full-time worker - i.e. the wage that half the labour force earns less than and the other half earns more than - was very similar in 2013 and in 2017 in nominal terms.[3] However, the lowest wages followed a more positive trend: in 2017, the wage of the first decile (which marks the lowest 10% of wages) was 14% higher than in 2013, while the second decile was 4.6% higher. Therefore, since the beginning of the economic recovery, workers on lower wages are recovering some of the ground lost during the financial crisis.[4]

For the following deciles, in contrast, wages remained relatively stable between 2013 and 2017 (see first chart). In this case, however, wages had continued to increase during the financial crisis, particularly in the case of wages above the median, so the nominal wages in 2017 are still higher than they were in 2008. Specifically, those with a salary above the median wage saw their wages rise by 8.3% on average.[5] Therefore, if we take the last 10 years as a benchmark, we can see that most of the wage reductions have affected those on lower wages.

***Spain: change in nominal wages by decile***

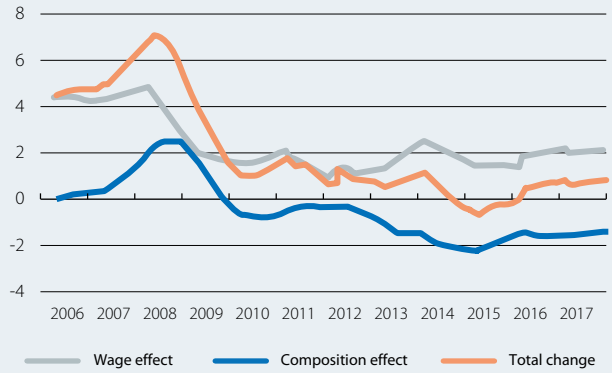
*(%)*




***Note:*** *Wage decile of people's main full-time job.*
***Source:*** *CaixaBank Research, based on data from the wage decile of people's main job according to the labour force survey (LFS).*

***Spain: breakdown of the year-on-year change in the median full-time daily salary***

*Year-on-year change (%)*




***Note:*** *Wage decile of people's main full-time job.*
***Source:*** *CaixaBank Research, based on data from F. Felgueroso and M. Jansen «¿Por qué no crecen los salarios en España?», available on the internet, http://nadaesgratis.es/felgueroso/por-que-no-crecen-los-salarios-en-espana-i*

To better understand these dynamics, we must bear in mind that trends in wages also reflect changes in the composition of the labour force. Thus, another interesting perspective is to differentiate between those individuals who kept their jobs and those who lose or find work. This allows us to break down the change in wages into a purely wage effect (the change in wages for workers with constant characteristics) and a composition effect (the change in wages caused by wage differences between those starting or stopping work). As Felgueroso and Jansen show using data from the Continuous Work History Sample (known as the

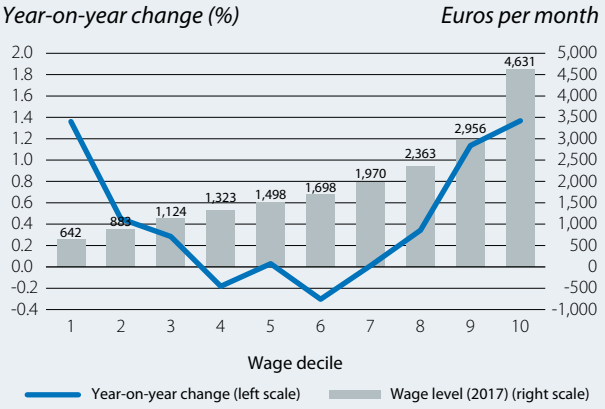
1. For a detailed analysis see, for example, P. Cuadrado and F. Tagliati (2018), «La moderación salarial en España y en la UEM», Economic Bulletin 4/2018, Bank of Spain.
2. That is, ordering workers according to their salaries and dividing them into 10 equally-sized groups. The figures correspond to the wage decile of people's main full-time job according to the labour force survey (LFS).
3. The nominal wage went from 1,503 euros in 2013 to 1,498 euros in 2017, a reduction of 0.3%. In real terms, the median wage fell by 1.4%.
4. In real terms, the loss of purchasing power between 2008 and 2017 was almost 11% for both groups.
5. In real terms, wages above the median have lost 1.1% of purchasing power between 2008 and 2017.

MCVL in Spanish),[6] the median salaries of workers who did not change jobs increased fairly steadily by around 2% per annum between 2008 and 2017 (see the second chart). Therefore, it is the changes in the composition of the labour force, and in particular the entry of workers on wages below the median, which is causing wages to fall overall due to their composition. This also accounts for why the median wage has remained so contained.

If we focus on the most recent period, the trend in wages by decile in 2017 follows a different pattern to that of the recovery years (2013-2016). This change of trend could be connected with the greater polarisation of the labour market in many developed countries, where there is less demand for jobs in medium-wage occupations (usually jobs that are more susceptible to being automated),[7] depressing wages around the median. In other words, wages rise more at the extremes of the spectrum, giving rise to a U-shaped pattern in the trend in wages (see the third chart).

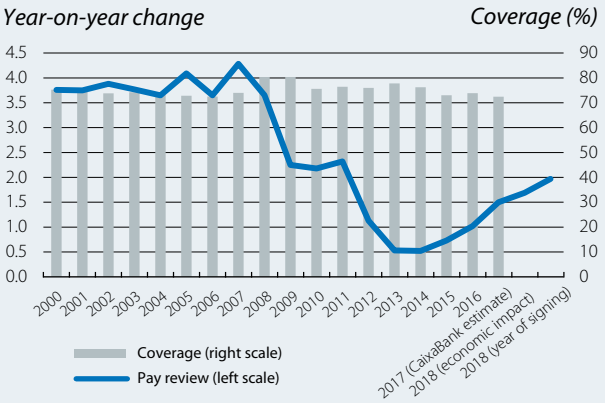
What trend can we expect to see over the next few years? To the extent that the slack in the labour market is reduced and the inflation outlook increases, we can expect to see a gradual recovery in wages. Part of this positive trend can already be observed in the pay reviews agreed in collective agreements. The collective agreements with an economic impact in 2018 include an agreed pay increase of +1.69% on average (based on data up to October 2018), while those signed in 2018 include an increase of +1.97%, in line with what was agreed in the 2018-2020 Employment and Collective Bargaining Agreement (known as the AENC in Spanish).[8] Nevertheless, we will have to closely monitor how this gradual recovery in wages materialises across the wage spectrum, and the most recent trends do not invite optimism.

### *Spain: nominal wages by decile in 2017, change and amount*




***Note:*** *Wage decile of people's main full-time job.*
***Source:*** *CaixaBank Research, based on data from the wage decile of people's main job according to the labour force survey (LFS).*

### *Spain: coverage and agreed pay review * of collective agreements*




***Note:*** ** Coverage refers to the percentage of employees covered in relation to the total number of affiliated workers. Given that it can take up to 18 months for all signed collective agreements to appear in the statistics, the coverage for 2017 is estimated and that of 2018 is not yet available. The change in wages for 2018 is shown both for all the collective agreements that take effect for economic purposes in the year and for those approved in 2018.*
***Source:*** *CaixaBank Research, based on data from the Statistics on Collective Agreements and Affiliation of the Ministry of Employment and Social Security.*

6. F. Felgueroso and M. Jansen «¿Por qué no crecen los salarios en España?», available on the internet, http://nadaesgratis.es/felgueroso/por-que-no-crecen-los-salarios-en-espana-i
7. For further detail, see, for example, the articles «Job polarisation in Spain» in the MR05/2015 and «Job polarisation in the euro area» in the MR07/2017.
8. The 2018-2020 State Collective Bargaining Agreement recommends a fixed wage increase of around 2%, plus a 1% variable increase linked to factors negotiated in the agreement, such as productivity.

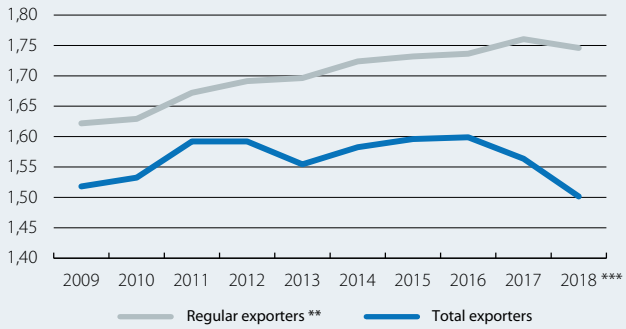
# The geographical diversification of Spanish exporters: some yes, others no

A large part of the slowdown in the Spanish economy in 2018 can be attributed to the loss of momentum in exports, together with the continuing strength of imports. So, we wonder whether this export slowdown is temporary or not. In previous articles, we have seen two trends that give us reason to think positively, as well as another less optimistic trend: on the one hand, in absolute terms, both the number of companies that are starting to export and the number of those exporters that become established (so-called regular exporters, which have been exporting for four years in a row) are steadily increasing. On the other hand, however, the relative proportion of new exporters that become regular exporters has recently fallen.[1] In this article, we analyse how strong these exporters are, using another measure: the geographical diversity of the destinations to which they export. This is a reflection of each exporter's competitive advantage (greater competitiveness should allow a company to export to more markets), as well as its capacity for survival (greater diversification helps to contain the impact of poor performance in specific economies). So, we must ask ourselves, what is the geographical diversity of our exporters?[2]

Just as in ancient times there was talk of the seven seas, today we can distinguish seven distinct geographical regions in the world: the five continents, but disaggregating Asia into the Middle East and the rest (mostly the Far East), and America into North America and Latin America. We began by focusing our analysis at this broad regional level, before delving into the detail by country, since the economic cycles of these seven regions are less synchronised than those of the countries within a particular region. Therefore, a measure of diversification between regions probably provides a better reflection of exporters' degree of protection against idiosyncratic phenomena occurring in each destination. As we can see in the chart, a first positive result is that the geographical diversification of regular exporters shows an upward trend: each regular exporter exported to almost 1.8 regions in 2017, higher than the 1.6 of 2009. Secondly, regular exporters have a greater geographical diversification than the average for all exporters (which stood at 1.6 in 2017). In addition, this gap between regular and non-regular exporters has grown in recent years, suggesting that the regular exporters are in an increasingly strong position. New exporters, meanwhile, naturally begin by exporting to a small number of destinations. However, unlike the regular exporters, the geographical diversity of non-regular exporters has declined in recent years.

***Spain: geographical diversification of export companies***

*Number of regions per company **




***Notes:*** ** The seven regions are: Europe, North America, Latin America, the Middle East, East Asia (Asia excluding the Middle East), Africa, and Oceania and the Polar Regions. ** A company is considered a regular exporter if it has been exporting for four years in a row. *** The data for 2018 are partial (January to June).*
***Source:*** *CaixaBank Research, based on data from the Department of Customs.*

We also performed the same analysis at the country level, considering the main destinations of each company.[3] Among the results of this exercise, of particular note is the fact that the diversity of companies that export to Europe increases, both among regular and non-regular exporters (on average, each exporter exported to 4.8 European countries in 2017, higher than the 4.2 of 2009), whereas diversity decreases outside Europe. In the case of Africa and East Asia, the decline in diversity is due to the increasing importance of Morocco and China-Hong Kong, destinations which in 2017 represented 45% and 42% of the total exports to their respective regions. This is not the case in Latin America, the destination of many of the new export companies. Here, the relative importance of the largest importer (Mexico, representing 30% of the total) shows a decline, and the diversity of destinations is very low (out of a total of five main countries in the region, each exporter exports to between 1.1 and 1.5 countries on average, in the case of regular exporters).

In short, in recent years we have observed a certain polarisation among Spanish exporters. On the one hand, there is an element of strength, sustained by a growing number of regular exporters and an increasing geographical diversity in terms of destinations. On the other hand, among all other exporters we find many new ones that are poorly diversified, which could limit their chances of survival in the export market.

1. See the Focus «New momentum in the export sector» in the MR11/2018.
2. To calculate the geographical diversification, for each destination we add up the number of Spanish exporters and divide this by the total number of exporting companies in Spain.
3. Given the diversity in the size and sophistication of the countries within any given region, the results of this analysis need to be taken with caution.

## Activity and employment indicators

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

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 09/18 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|---|
| **Industry** | | | | | | | | | |
| Industrial production index | 1.9 | 3.2 | 5.2 | 2.7 | 0.9 | 0.4 | –0.5 | ... | ... |
| Indicator of confidence in industry *(value)* | –2.3 | 1.0 | 4.3 | 2.8 | 1.2 | –2.6 | –3.0 | –1.5 | –0.8 |
| Manufacturing PMI *(value)* | 53.2 | 54.8 | 55.9 | 55.3 | 53.7 | 52.4 | 51.4 | 51.8 | 52.6 |
| **Construction** | | | | | | | | | |
| Building permits *(cumulative over 12 months)* | 43.7 | 22.9 | 25.1 | 25.1 | 28.1 | 25.8 | 24.1 | ... | ... |
| House sales *(cumulative over 12 months)* | 13.1 | 14.1 | 15.2 | 15.8 | 15.6 | 13.1 | 12.6 | ... | ... |
| House prices | 1.9 | 2.4 | 3.1 | 2.7 | 3.8 | 3.2 | – | – | – |
| **Services** | | | | | | | | | |
| Foreign tourists *(cumulative over 12 months)* | 8.2 | 10.0 | 9.2 | 8.2 | 5.3 | 1.5 | 0.5 | 0.8 | ... |
| Services PMI *(value)* | 55.0 | 56.4 | 54.5 | 56.8 | 55.8 | 52.6 | 52.5 | 54.0 | ... |
| **Consumption** | | | | | | | | | |
| Retail sales | 3.8 | 0.9 | 0.4 | 1.8 | 0.1 | –0.3 | –0.4 | 1.8 | ... |
| Car registrations | 11.4 | 7.9 | 10.8 | 11.8 | 9.2 | 17.0 | –17.0 | –6.6 | ... |
| Consumer confidence index *(value)* | –3.8 | –0.7 | –1.5 | –0.6 | 0.5 | –3.3 | –8.0 | –7.5 | –6.6 |
| **Labour market** | | | | | | | | | |
| Employment [1] | 2.7 | 2.6 | 2.6 | 2.4 | 2.8 | 2.5 | – | – | – |
| Unemployment rate (% labour force) | 19.6 | 17.2 | 16.5 | 16.7 | 15.3 | 14.6 | – | – | – |
| Registered as employed with Social Security [2] | 3.0 | 3.6 | 3.5 | 3.4 | 3.1 | 2.9 | 2.9 | 3.1 | ... |
| **GDP** | **3.2** | **3.0** | **3.1** | **2.8** | **2.5** | **2.5** | **–** | **–** | **–** |

## Prices

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

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 09/18 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|---|
| General | –0.2 | 2.0 | 1.4 | 1.0 | 1.8 | 2.2 | 2.3 | 2.3 | 1.7 |
| Core | 0.8 | 1.1 | 0.8 | 1.0 | 1.0 | 0.8 | 0.8 | 1.0 | ... |

## Foreign sector

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

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 08/18 | 09/18 | 10/18 |
|---|---|---|---|---|---|---|---|---|---|
| **Trade of goods** | | | | | | | | | |
| Exports *(year-on-year change, cumulative over 12 months)* | 1.7 | 8.9 | 8.9 | 5.8 | 5.2 | 4.5 | 5.6 | 4.5 | ... |
| Imports *(year-on-year change, cumulative over 12 months)* | –0.4 | 10.5 | 10.5 | 6.6 | 6.9 | 6.2 | 6.8 | 6.2 | ... |
| **Current balance** | **25.2** | **21.5** | **21.5** | **20.8** | **17.2** | **13.3** | **14.3** | **13.3** | **...** |
| Goods and services | 36.0 | 33.6 | 33.6 | 33.5 | 29.5 | 25.7 | 26.6 | 25.7 | ... |
| Primary and secondary income | –10.7 | –12.1 | –12.1 | –12.7 | –12.3 | –12.3 | –12.3 | –12.3 | ... |
| **Net lending (+) / borrowing (–) capacity** | **27.8** | **24.2** | **24.2** | **23.8** | **20.4** | **16.6** | **17.4** | **16.6** | **...** |

## Credit and deposits in non-financial sectors [3]

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

| | 2016 | 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 09/18 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|---|
| **Deposits** | | | | | | | | | |
| Household and company deposits | 2.5 | 2.8 | 3.2 | 2.5 | 3.0 | 3.4 | 3.5 | 3.8 | ... |
| Sight and savings | 16.0 | 17.6 | 15.9 | 12.3 | 11.0 | 10.3 | 10.4 | 10.2 | ... |
| Term and notice | –16.0 | –24.2 | –24.6 | –23.1 | –20.7 | –18.7 | –17.9 | –17.1 | ... |
| General government deposits | –14.2 | –8.7 | 13.1 | 16.7 | 17.6 | 10.4 | 10.1 | 14.1 | ... |
| **TOTAL** | **1.2** | **1.9** | **3.7** | **3.2** | **3.8** | **3.8** | **3.9** | **4.4** | **...** |
| **Outstanding balance of credit** | | | | | | | | | |
| Private sector | –3.6 | –2.2 | –1.9 | –2.2 | –2.8 | –2.3 | –2.2 | –2.1 | ... |
| Non-financial firms | –5.3 | –3.6 | –3.3 | –4.4 | –6.4 | –5.6 | –5.4 | –5.3 | ... |
| Households - housing | –3.7 | –2.8 | –2.6 | –2.4 | –2.0 | –1.7 | –1.7 | –1.5 | ... |
| Households - other purposes | 2.0 | 3.7 | 4.5 | 4.9 | 5.0 | 5.5 | 6.2 | 5.2 | ... |
| General government | –2.9 | –9.7 | –11.4 | –12.5 | –9.4 | –8.9 | –8.1 | –12.5 | ... |
| **TOTAL** | **–3.6** | **–2.8** | **–2.5** | **–2.9** | **–3.2** | **–2.7** | **–2.5** | **–2.7** | **...** |
| **NPL ratio** *(%)* [4] | **9.1** | **7.8** | **7.8** | **6.8** | **6.4** | **6.2** | **6.2** | **...** | **...** |

***Notes:*** *1. Estimate based on the Active Population Survey. 2. Average monthly figures. 3. Aggregate figures for the Spanish banking sector and residents in Spain. 4. Period-end figure.*

***Source:*** *CaixaBank Research, based on data from the Ministry of Economy, the Ministry of Public Works, the Ministry of Employment and Social Security, the National Statistics Institute, the State Employment Service, Markit, the European Commission, the Department of Customs and Special Taxes and the Bank of Spain.*

# Portugal: solid growth

**The economy tempers its growth in the second half of the year.** EIn Q3 2018, GDP growth slowed to 0.3% quarter-on-quarter and 2.1% year-on-year (0.6% and 2.4% in Q2 2018, respectively) and was heavily supported by domestic demand (which contributed +2.4 pps to growth). By component, growth in private consumption slowed to 2.3% year-on-year (2.7% in Q2), while investment performed particularly well with a growth of 4.5% (4.1% in Q2). On the other hand, the contribution of external demand remained negative (–0.3 pps) in a quarter in which imports (+3.5%) continued to outstrip exports (+3.1%), although both slowed down compared to Q2. With regards to Q4 2018, the available indicators suggest that the economy is growing at a solid pace, backed by domestic demand and with a slightly negative contribution from the external sector. In particular, both the economic sentiment indicator calculated by the European Commission and the Bank of Portugal's coincident indicator remain close to their historic highs and point towards a GDP growth of around 2%.

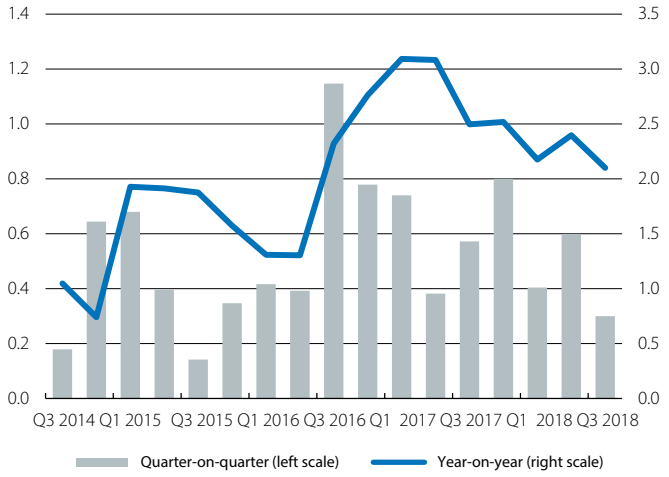
**Encouraging developments in the labour market.** Employment grew by 2.1% year-on-year in Q3 2018, reflecting a good rate of growth, albeit somewhat lower than that of the previous quarter (2.4%). By sector, services were the main driver of job creation (+68,600 people compared to Q3 2017). The activities associated with the public sector also stood out, accounting for more than half of the jobs created in Q3 2018, as did employment in the construction sector, which is beginning to show signs of more buoyancy. The number of people in unemployment, meanwhile, decreased by 20.6% in year-on-year terms in Q3 2018, and the unemployment rate stood at 6.7%. This sets an encouraging trend that will provide continuity to the recovery in the labour market over the coming quarters.

**Inflation remains contained.** In November, headline inflation (measured by the non-harmonised CPI) slowed to 0.9% year-on-year (1.0% in October). This was due to the tempered growth in energy prices (4.9% in November, versus 7.3% in October) and in spite of the rise in the prices of unprocessed food (0.7% in November, following a –0.1% decline in October). Core inflation, on the other hand, remained at moderate levels (0.6%), despite increasing by 0.1 pp since October. Finally, inflation as measured by the harmonised index of consumer prices (which incorporates information relating to the consumption of tourists) rose to 1.0% (0.8% in October).

**The current account remains slightly in the red.** According to the cumulative figures for the past 12 months, the current account balance was once again in the red in September (–389 million euros, representing –0.2% of GDP) and remained at levels relatively similar to August. Compared to the previous month, September produced a slight increase in the balance of services (8.3% of GDP), favoured by the contribution of both tourism (5.9% of GDP) and all other services (2.4%), in addition

***Portugal: GDP***

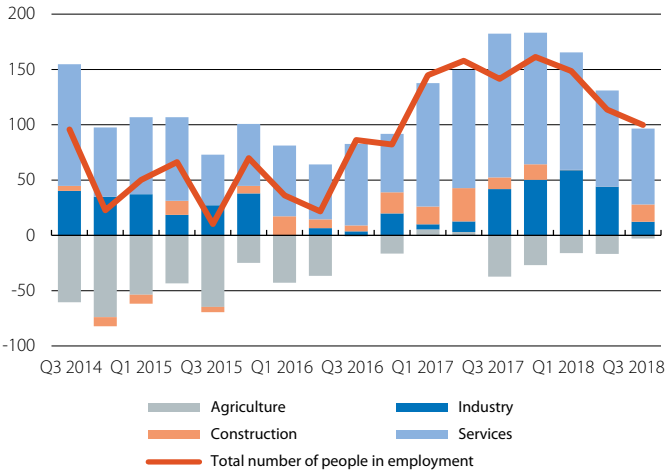
*Quarter-on-quarter change (%)* *Year-on-year change (%)*




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

***Portugal: employment by sector***

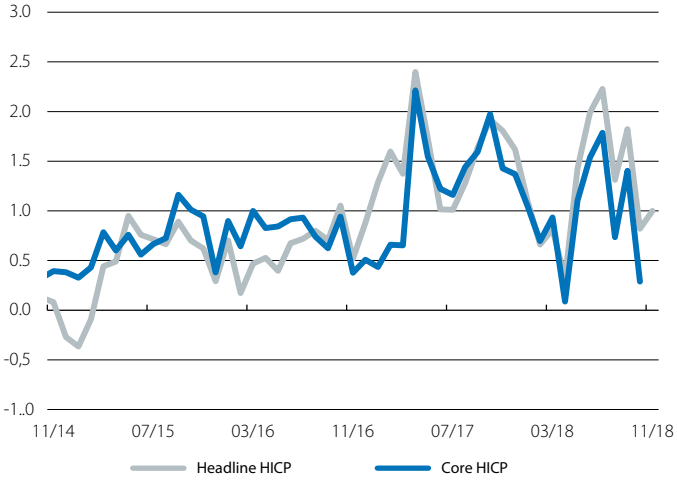
*Year-on-year change (thousands)*




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

***Portugal: HICP***

*Year-on-year change (%)*




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

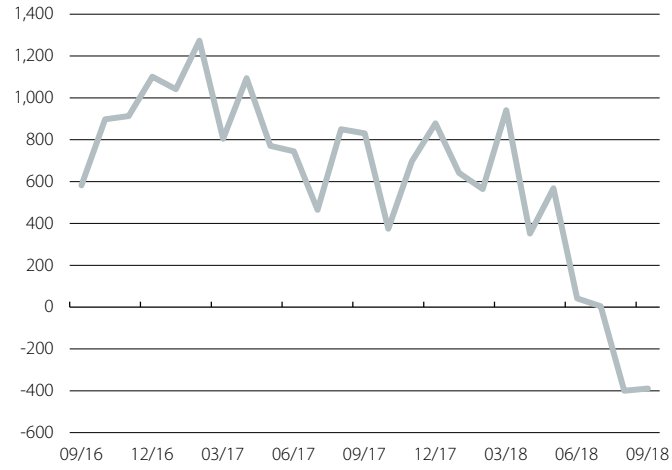
to a decrease in the deficit in the balance of goods. On the other hand, the balance of non-energy goods, which is largely responsible for the deterioration in the current account in recent months, remained at –4.3% of GDP. The deficit in the balance of energy products, meanwhile, avoided any deterioration and stood at –2.4% of GDP. Lastly, with regards to the income balance, in September the deficit rose to 1.7% of GDP (–1.6% in August), continuing the deteriorating trend of recent months.

**The public accounts continue to show improvement.** The data available up to October show that the consolidated general government balance registered a surplus of 0.2% of GDP. This represents a substantial improvement compared to the same period in 2017 (when it stood at –1.1%). This favourable trend partly reflects the current dynamism of economic activity, which continues to push revenues above expenditure. In particular, revenues registered a cumulative growth of 5.4% up to October, backed by strong momentum in both tax and contributory revenues, while expenditure increased by 2.1%. Nevertheless, it should be noted that the lower growth in expenditure has been affected by staff costs, and in particular by a change in how the extra Christmas wage payment is paid to civil servants and pensioners. Specifically, this year it was paid out entirely in November and December (whereas in 2017, half of this payment was paid in 12 parts spread throughout the year, and only the other half was concentrated in November/December). After correcting for this factor, the increase in staff costs comes to 2.5% up to October (versus the observed reduction of –1.2%). As such, the trends noted to date reinforce our view that 2018 will end with a fiscal deficit of –0.7% of GDP (also in line with the Government's projections).

**New bank lending shows solid growth.** With data up to September, new bank lending for the purchase of housing grew by 24.3% (cumulative figure for the year to date), while new bank lending in the form of consumer loans rose by 14.1%. Despite this firm growth, in both segments there was a slight moderation in new bank lending compared to August (when the figures stood at 26.4% and 15.6%, respectively). This reflects the macroprudential measures implemented by the Bank of Portugal since July. Finally, new bank lending to companies showed stable growth of slightly over 13% year-on-year.

### *Portugal: current account balance*

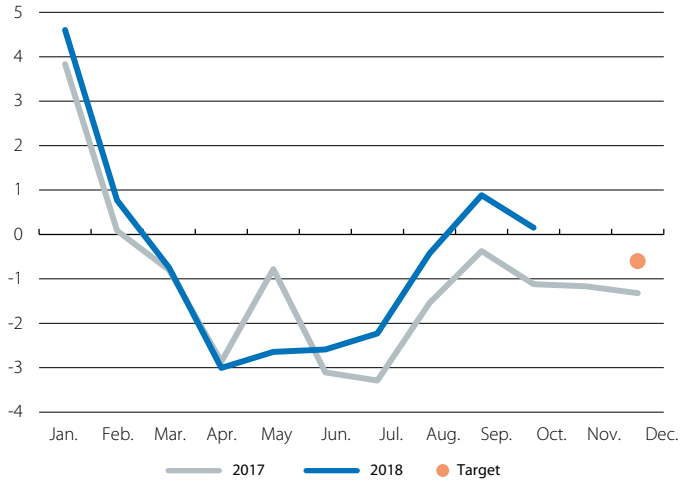
*EUR millions (12-month cumulative figures)*




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

### *Portugal: government balance*

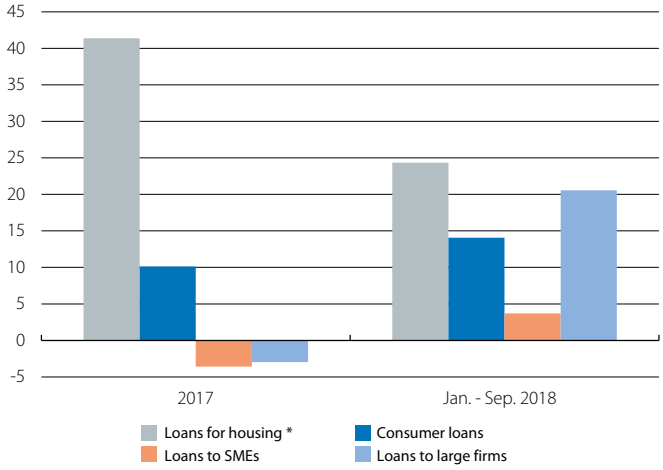
*(% GDP)*




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

### *Portugal: new bank lending*

*Year-on-year change (%)*




***Note:*** ** Loans for housing excludes refinancing.*
***Source:*** *CaixaBank Research, based on data from the Bank of Portugal.*

## Activity and employment indicators

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

| | 2016 | 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 07/18 | 08/18 | 09/18 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|---|---|
| Coincident economic activity index | 1.7 | 2.8 | 2.5 | 2.2 | 1.9 | 2.0 | 1.9 | 1.9 | 1.9 | ... |
| **Industry** | | | | | | | | | | |
| Industrial production index | 2.4 | 4.0 | 2.3 | 0.5 | –1.7 | –1.0 | –3.8 | –0.3 | –0.3 | ... |
| Confidence indicator in industry *(value)* | –0.7 | 2.3 | 2.1 | 0.0 | 0.4 | 0.9 | 1.6 | –1.2 | –1.1 | –0.7 |
| **Construction** | | | | | | | | | | |
| Building permits *(cumulative over 12 months)* | 7.9 | 19.8 | 9.0 | 11.2 | 12.0 | ... | ... | 12.0 | ... | ... |
| House sales | 18.8 | 20.5 | 15.7 | 23.7 | ... | ... | ... | ... | ... | ... |
| House prices *(euro/m² - valuation)* | 3.8 | 5.0 | 5.4 | 6.1 | 6.2 | ... | ... | 6.2 | ... | ... |
| **Services** | | | | | | | | | | |
| Foreign tourists *(cumulative over 12 months)* | 10.9 | 12.3 | 11.2 | 7.6 | ... | 5.0 | 4.0 | 2.4 | ... | ... |
| Confidence indicator in services *(value)* | 7.3 | 13.8 | 13.2 | 14.4 | 16.5 | 18.3 | 14.5 | 16.7 | 8.6 | 11.7 |
| **Consumption** | | | | | | | | | | |
| Retail sales | 2.7 | 4.1 | 5.9 | 2.6 | 2.3 | 2.4 | 3.5 | 1.0 | 5.3 | ... |
| Coincident indicator for private consumption | 1.9 | 2.6 | 2.7 | 2.4 | 1.8 | 2.0 | 1.8 | 1.6 | 1.4 | ... |
| Consumer confidence index *(value)* | –11.1 | 0.5 | 2.0 | 2.8 | –1.4 | –1.4 | –1.3 | –1.5 | –0.4 | –3.4 |
| **Labour market** | | | | | | | | | | |
| Employment | 1.2 | 3.3 | 3.2 | 2.4 | 2.1 | 2.2 | 2.0 | 2.1 | 1.7 | ... |
| Unemployment rate (% labour force) | 11.1 | 8.9 | 7.9 | 6.7 | 6.7 | 6.8 | 6.9 | 6.6 | 6.7 | ... |
| **GDP** | **1.9** | **2.8** | **2.2** | **2.4** | **2.1** | **...** | **...** | **2.1** | **...** | **...** |

## Prices [1]

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

| | 2016 | 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 07/18 | 08/18 | 09/18 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|---|---|
| General | 0.6 | 1.6 | 0.9 | 1.2 | 1.8 | 2.2 | 1.3 | 1.8 | 0.8 | 1.0 |
| Core | 0.8 | 1.3 | 0.9 | 0.9 | 1.3 | 1.8 | 0.7 | 1.4 | 0.3 | ... |

## Foreign sector

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

| | 2016 | 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 07/18 | 08/18 | 09/18 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Trade of goods** | | | | | | | | | | |
| Exports *(year-on-year change, cumulative over 12 months)* | 0.8 | 10.0 | 6.5 | 7.4 | 7.1 | 8.2 | 7.4 | 7.1 | ... | ... |
| Imports *(year-on-year change, cumulative over 12 months)* | 1.5 | 13.5 | 11.0 | 9.8 | 8.6 | 9.8 | 9.4 | 8.6 | ... | ... |
| **Current balance** | **1.1** | **0.9** | **0.9** | **0.0** | **–0.4** | **0.0** | **–0.4** | **–0.4** | **...** | **...** |
| Goods and services | 3.8 | 3.5 | 3.2 | 3.1 | 3.1 | 3.2 | 2.9 | 3.1 | ... | ... |
| Primary and secondary income | –2.7 | –2.6 | –2.3 | –3.1 | –3.5 | –3.2 | –3.3 | –3.5 | ... | ... |
| **Net lending (+) / borrowing (–) capacity** | **3.0** | **2.7** | **2.7** | **1.9** | **1.6** | **1.9** | **1.6** | **1.6** | **...** | **...** |

## Credit and deposits in non-financial sectors

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

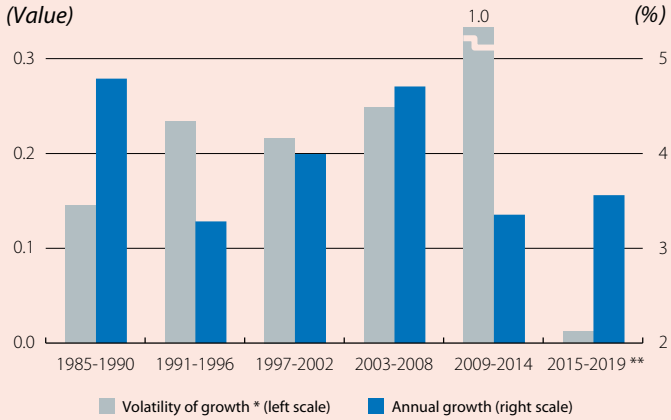
| | 2016 | 2017 | Q1 2018 | Q2 2018 | Q3 2018 | 07/18 | 08/18 | 09/18 | 10/18 | 11/18 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Deposits** [2] | | | | | | | | | | |
| Household and company deposits | 3.7 | 1.7 | 2.6 | 4.3 | 4.4 | 3.6 | 4.7 | 4.7 | ... | ... |
| Sight and savings | 19.5 | 15.7 | 2.6 | 4.3 | 4.4 | 11.4 | 14.6 | 14.9 | ... | ... |
| Term and notice | –3.2 | –5.8 | –4.1 | –2.9 | –2.1 | –1.8 | –2.1 | –2.3 | ... | ... |
| General government deposits | –17.9 | 1.3 | 1.9 | –0.8 | 1.0 | –1.2 | 3.0 | 1.4 | ... | ... |
| **TOTAL** | **2.3** | **1.6** | **2.6** | **4.0** | **4.2** | **3.4** | **4.6** | **4.5** | **...** | **...** |
| **Outstanding balance of credit** [2] | | | | | | | | | | |
| Private sector | –3.9 | –4.0 | –1.8 | –1.8 | –1.4 | –1.5 | –1.4 | –1.3 | ... | ... |
| Non-financial firms | –5.6 | –6.5 | –3.1 | –3.7 | –3.7 | –3.8 | –3.9 | –3.5 | ... | ... |
| Households - housing | –3.3 | –3.1 | –1.9 | –1.6 | –1.2 | –1.3 | –1.2 | –1.1 | ... | ... |
| Households - other purposes | –0.5 | 0.9 | 3.0 | 4.1 | 5.8 | 5.6 | 6.1 | 5.7 | ... | ... |
| General government | –9.4 | 9.3 | 19.0 | 14.8 | –12.4 | –13.9 | –12.2 | –11.2 | ... | ... |
| **TOTAL** | **–4.2** | **–3.5** | **–1.0** | **–1.1** | **–1.9** | **–2.1** | **–1.9** | **–1.8** | **...** | **...** |
| **NPL ratio** *(%)* [3] | **17.2** | **13.3** | **12.8** | **11.7** | **11.7** | **...** | **...** | **...** | **...** | **...** |

***Notes:*** *1. Harmonized indexes. 2. Aggregate figures for the Portuguese banking sector and residents in Portugal. 3. Period-end figure.*
***Sources:*** *CaixaBank Research, based on data from the National Statistics Institute, Bank of Portugal and Datastream.*

# 2019, a perspective from the future

Dear students and teachers of the Faculty of Economics, it is a great pleasure to have the honour of addressing this class of 2029. I have been told that, as is tradition at this event, I must choose a year which I consider contains lessons of interest for understanding the evolution of the global economy. Of course, there is no shortage of candidates. I could have chosen 1997, when the Asian crisis had a punishing effect on the emerging economies. Or 2001, when China joined the World Trade Organization and accelerated the pace of globalisation. Or, of course, 2008, which marked the beginning of the worst financial crisis since the Great Depression. And yet, my choice is 2019. Surprising, isn't it? Because in our eyes it is a year of little consequence. Yet this is only because we have the benefit of hindsight, which puts everything in its place. Furthermore, as I shall try to justify, 2019 contained lessons that we could only read later on. Join me, then, on a journey into the past.

***Growth and volatility of the global economy***




***Notes:*** ** Measured relative to the change in growth compared to its median average, thereby eliminating the effect that variations in the median growth rates have on this change.*
*** Using global growth forecasts starting from Q3 2018.*
***Source:*** *CaixaBank Research, based on data from the IMF and Oxford Economics.*

Let us remind ourselves of what the mood was like at the end of 2018. The forecasts we were projecting at that time were reasonably positive, since we expected a global growth of 3.6% in 2019 and of 3.5% in 2020, falling slightly short of the 3.7% registered in 2017 and 2018. The US was expected to grow by 2.3% and 2.1% in 2019 and 2020, respectively (2.8% in 2018); the euro area, by 1.8% and 1.7% (1.9% in 2018); and the major emerging markets together, by 4.6% in both years (4.7% in 2018). In general terms, the economic outlook indicated that 2019 would confirm the economy's entry into a more moderate phase, but also the consolidation of an environment with lower volatility in growth. With all the necessary nuances, it appeared that, after the impact of the Great Recession, the economy would follow the path of the so-called Great Moderation. In other words, we would see a reduction in the volatility of the macroeconomic cycle that began in the 1980s.

This being the overall picture, what was our view of the position in the cycle at the end of 2018? The debate that concerned us at the time was whether the US was entering the late cycle, and what stage of maturity the euro area and the emerging markets had reached. In the case of the US, the data confirmed that an extended period of expansion was materialising (the longest since 1991), albeit with slightly less intensity than seen on average in previous expansions. This was indicated by the fact that GDP growth, both since the start of the expansion and since GDP exceeded the trend, had been lower than the average seen in the three expansionary periods that have taken place since 1993. However, this situation did not in itself allow the future path of the business cycle to be predicted. To do this, it was necessary to consider the information relating to duration and amplitude together with some other indicator. Indeed, when this information was combined with the pattern in consumption in the US in late 2018, a more complete picture was painted: the expansion in consumption was more dynamic than that observed historically in late cycle periods. Therefore, it was reasonable to assume that there was still some room for future growth. In summary, and recalling the terminology used in 2018, it was clear that the peak cycle of the US was beginning to be left behind, but that the late cycle had not yet been reached.

The cyclical position of the euro area was more difficult to read. It was known that the expansion had taken longer to get started than it had in the US, and that it had been less intense than previous expansions. In addition, in 2018, it had become apparent that the European economy was moving slower than expected and the forecasts pointed towards a slight moderation in the future. Nevertheless, both the duration and the intensity of the expansion suggested that the end of the cycle was still some distance away. Although, in 2018, assuring this to be the case was by no means easy, it was evident that based on the historical evidence, the trend in consumption and investment was stronger than in pre-recession phases. Finally, with regards to the aggregate picture of the major emerging economies, the pattern in terms of the expansion's duration and intensity suggested that, broadly speaking, they were far from reaching the end of the cycle.

But what was of real concern in 2018 was that, while this central scenario was acceptably favourable, the balance of risks was clearly tilted to the downside. It may seem excessive today, with the benefit of hindsight when looking at the past from our standpoint in 2029, but at the beginning of 2019 there had been several years filled with many surprises. In addition, there was

no shortage of candidates for these surprises to reoccur. As an example, it was not clear how the highest level of debt in history was going to be dealt with, and although it was assumed that China's anomaly could be managed, as the country had instruments beyond the reach of any other emerging country, I remember how threatening their debt to GDP ratios were at the time.

China was not the only source of concern. Its accumulation of macrofinancial imbalances and the complicated exercise it was undertaking to change its economic model certainly warranted paying attention to the Asian giant. However, the US was not far behind it. While it had experienced high growth of 2.8%, most analysts knew that this rate was not sustainable, since it was the result of a combination of continued accommodative financial conditions, tax cuts and expansion in public expenditure. For this reason, there were many voices expressing concern that 2019 could end up being far worse than expected, as the fiscal stimulus faded and the financial conditions became less forgiving. In addition, the extent of the protectionist shift of the US could not be gauged at the time, and although a reasonable balance was expected to be reached between the three major powers of the US, China and the EU, the very uncertainty surrounding when and how this balance was going to be struck would end up taking a toll on the rate of economic activity.

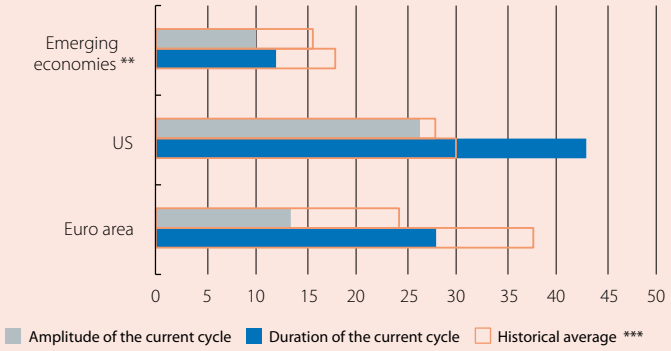
Therefore, the downside risks to US growth were palpable. However, there was also no lack of reputable voices claiming that the real risk laid in the possibility of much higher than expected inflation, which would have required the Fed to react quicker than anticipated, leaving investors exposed to scenarios of greater monetary restriction than had been foreseen.

Furthermore, the domestic politics of many countries and the sources of geopolitical risks did not exactly serve to calm people's nerves. The rise in populism loomed as a growing threat and a worrying trend. In various regions there were questions over whether the traditional leaders were going to remain in place: how could we forget the extremely complicated situation in the Middle East or Russia's yearnings to once again become a major global player?

The cocktail of risks, therefore, was difficult to digest. The central scenario that we were working at the time with was only moderately worse than that of previous years, yet the alternative scenarios were proving to be openly negative and had a higher than usual probability of occurring. Few analysts admitted to being uneasy, but even fewer stated that they were entirely confident of what was to come. And I don't have to remind you all of what end up happening.

***Comparison of the business cycle ****

*Growth (%) and duration in quarters*




***Notes:*** ** Amplitude is defined as the cumulative output up to Q4 2019 since the start of the expansionary phase. The duration is defined as the number of quarters that have passed between the start of the expansionary phase and Q4 2019. For the US and the euro area, the cycles defined by the NBER and the CPER are used. For the emerging markets, the cycle has been identified by estimating output gaps according to the trend, using the Hamilton filter. ** A representative sample of 10 countries (covering 68% of the total GDP of the emerging countries, according to IMF data) has been used to estimate the GDP of all the emerging markets as a whole. *** Average of the last three expansive cycles observed since 1993.*

***Source:*** *CaixaBank Research, based on data from Goldman Sachs.*

Or perhaps I do, as I know that you pay less attention than you should in your economic history classes: fortunately, we got it right with the central scenario. Or at least we got the essentials rights. The world grew by somewhat less than expected, since the hotbeds of risk caused disruption to some extent, but there was no calamity. Common sense prevailed, the impact of protectionism was relatively low, and the commitments made were sustainable in the long term. Geopolitics and politics did not cease to be sources of uncertainty, but in the year of Brexit we could not have asked for much more. The normalisation of monetary policy fully materialised in the US, while in the euro area, the new present of the ECB rose the interest rate for the first time since 2011. The markets digested the new scenario with relative ease: 2018 had given sufficient warnings for investors to be prepared and the worst-case scenarios did not materialise.

In conclusion, as I mentioned at the beginning of my presentation, I chose 2019 because it spoke to us of the future, even if we were not fully aware of it at the time. In the years that followed, people began to understand that 2019 had marked the beginning of a new phase. This new phase would be characterised by the exceptional monetary policy being abandoned, somewhat more moderate but also less volatile growth, and by the ever-present reminder that, while we should not neglect economic issues, political matters would remain a key area for detecting and containing sources of uncertainty.

*Àlex Ruiz*
*CaixaBank Research*

# The central banks, at the helm of a more volatile environment

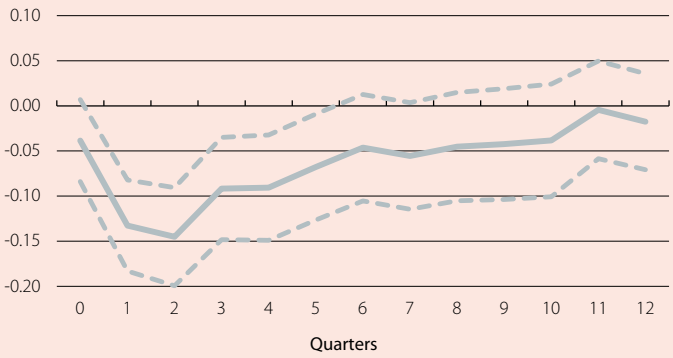
2018 has been an intense year in the financial markets: volatility has rebounded to levels not seen since 2015, there have been multiple episodes of stock market corrections, and risk premiums (both sovereign and corporate) have surged. This picture is in stark contrast to the much more contained volatility seen in 2017 and has been the result of the tightening of monetary policy, led by the Fed. This, in turn, has put the pockets of vulnerability that have accumulated in recent years under the spotlight (such as the high level of global debt and the high valuations of some financial assets). In September, following another rate hike by the Fed, the international press announced «the end of accommodative monetary policy». In this dilemma, we must consider 2019 by analysing the outlook for the monetary policy of the two major central banks, the Fed and the ECB, and the financial conditions of their economies.

### US: the Fed faced with some unusual financial conditions

Delving into more detail in the case of the US, in 2015 the Fed began a strategy of gradual increases in interest rates as part of the process of normalising its monetary policy, which had been extraordinarily accommodative in the years following the Great Recession. Nevertheless, the increase in official interest rates, as well as the reduction in the size of the central bank's balance sheet, has not translated into any significant tightening of the country's financial conditions to date. This is highlighted by the financial conditions index (FCI) produced by the Fed of Chicago, which consists of more than 100 variables that affect the cost of capital, investment decisions and other measures of credit risk.[1] Historically, this indicator has maintained a strong relationship with the official interest rate set by the Fed. Lately, however, the index has stood at levels very similar to – or even below – those seen in 2014 (when rates stood at practically 0% and the central bank had not yet begun to reduce its balance sheet). This is because credit spreads remain restricted, credit continues to be accessible and the impact of the recent stock market corrections has been moderate.

***US: response of GDP to a sudden tightening of financial conditions ****

*Impact on quarter-on-quarter growth (pps)*




***Notes:*** ** Financial Conditions Index of the Federal Reserve Bank of Chicago.*
*The dotted lines represent a 95% confidence interval.*
***Source:*** *CaixaBank Research, based on data from the Federal Reserve Bank of Chicago.*

According to the historical relationship between the FCI and the official interest rate, the FCI should be well above its current level. The decoupling of these two indicators raises a number of possible scenarios. On the one hand, we could see how the financial conditions are gradually increasing without significantly disrupting economic activity. On the other hand, there are other scenarios which could have more damaging consequences for the US economy. These include the possibility of a sudden tightening of financial conditions or, on the contrary, conditions remaining highly accommodative despite the increase in official interest rates. We analyse these scenarios below.

According to our econometric estimates, if financial conditions were to suddenly recover their historical relationship with the official interest rate, economic activity in the US would be adversely affected. Specifically, as we can see in the first chart, the quarter-on-quarter growth of the country's GDP would fall by around 1 decimal point each quarter for at least one year. This would be accompanied by various effects for the financial sector, such as an increase in the NPL ratio.

In the other scenario, with financial conditions remaining at excessively low levels and immune to the Fed's rate hikes, such a turn of events in an economy that is in a mature phase of the cycle – the unemployment rate is currently its lowest in the past 50 years – would raise a not-so-insignificant risk of overheating, which could begin to manifest itself with significant inflationary pressures. Normally, situations involving overheating precede recessions, because the economy is growing at rates that are unsustainable in the long term, leading to bubbles in some markets, among other consequences. To avoid this situation, the Fed is insisting on its current strategy of gradual interest rate hikes, although President Donald Trump has expressed his opposition. Luckily, the US central bank's independence is not in question, and the decisions that will be taken over the coming quarters will continue to be geared towards the normalisation of monetary policy.

1. High values of this indicator suggest that financial conditions in the US are restrictive, which slows economic growth, while low values indicate that the financial environment is accommodative. For more information, see «How financial conditions are withstanding tighter monetary policy» in the MR03/2018.

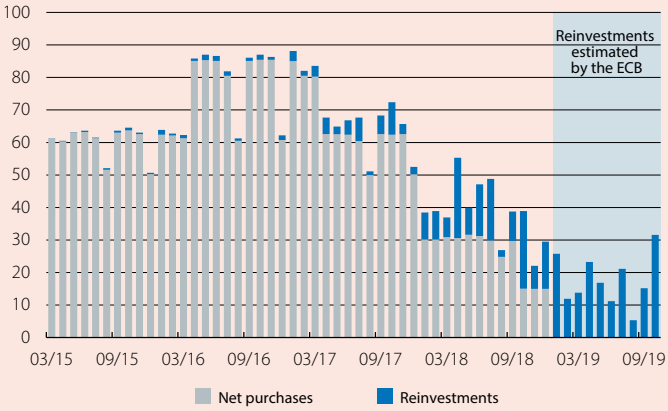
### Europe: faced with the reorientation of the ECB

Shifting the focus to Europe, domestic demand looks set to be the main driver of growth in 2019, and despite the net asset purchases being brought to an end, the ECB will continue to favour accommodative financial conditions. It will have two major levers to do this: the size of its balance sheet and the management of expectations.

The ECB has repeatedly indicated that it will maintain its balance sheet at its current size for a long period of time. Given that the balance sheet tends to decline in size under its own inertia (due to the bonds purchased reaching maturity), the ECB will continue to acquire assets in significant quantities through its reinvestments (see second chart). Moreover, the very act of keeping its balance sheet stable will continue to provide support for an environment of relatively contained interest rates and accommodative financial conditions. The reason for this is that, as the available evidence shows, the asset purchase programmes have a greater effect on financial conditions through their stock effect (the total volume of assets acquired) than through the monthly flows of purchases. As studies that analyse the macroeconomic impact of the programmes show, this is well illustrated by comparing the notable reaction in financial conditions when the central bank announces the total size of its asset purchase programme, compared to the limited movement observed in the market on the day the central bank completes a purchase.

***ECB: asset purchase programme ****

*EUR billions*




***Note:*** ** The programme consists of purchases of public debt assets, as well as various forms of private debt (corporate debt, ABSs and covered bonds).*
***Source:*** *CaixaBank Research, based on data from the European Central Bank.*

Looking ahead to 2019, the ECB's own estimates suggest that a sufficiently large amount of debt has been withdrawn from the market such that the financial conditions will be relatively unaffected when the net purchases are brought to an end. To understand why, we must bear in mind that some bond owners are less willing to sell than others. Initially, the Eurosystem purchased the bulk of the assets from players with a low reserve price (i.e. who were more willing to sell), such as non-resident investors. However, as bonds became scarcer, it resorted to buying from vendors who were less willing to sell, such as pension funds and insurance companies. Nevertheless, if these vendors have a greater preference for these assets (for example, because they want to hold less risky assets with longer-term maturities on their balance sheets), it is likely that in the event of new issues of public debt, these same institutions will be willing to acquire the assets at relatively higher prices (i.e. without requiring substantially higher interest rates). This favours stable and relatively low interest rates, even in the absence of net purchases by the ECB.

Furthermore, the ECB's own communications strive to avoid sudden adjustments to market rates by managing expectations: that is why they spell out their intention to maintain interest rates at their current level at least through the summer of 2019. This approach will probably evolve with the economic scenario, and in 2019 the communications will also have to deal with the renewal of a portion of the ECB's leadership. Mario Draghi, the president, will end his term of office on October 31st. They must also find a substitute for the ECB's current chief economist, Peter Praet, whose term ends on May 31st , as well as for Benoît Cœuré (whose term ends on December 31st). Although the most likely candidates are those in favour of maintaining the status quo,[2] managing these changes will be important in order to prevent them from being perceived as abrupt adjustments to the future evolution of monetary policy.

With these tools, the ECB will continue to favour an accommodative environment. Nevertheless, the scenario will have other determining factors that could tighten financial conditions more than desired. These factors include the economic consequences of geopolitics (such as Brexit, tensions between the EU and Italy, and the trade tensions with the US), the risk tolerance of the markets and the contagion that could be generated by a tightening of global financial conditions.

In short, the US and the euro area are at different stages of their financial cycles: while the Fed's monetary policy is close to becoming neutral or even restrictive, the ECB remains in clearly accommodative territory. However, to some extent, both are facing a common risk: the decoupling between their monetary policy and the financial conditions. The two institutions will try to manage their tools carefully, in order to facilitate a gradual adjustment of the financial conditions in the US and, in the case of the euro area, to keep them in accommodative territory.

*Adrià Morron Salmeron and Ricard Murillo Gili*
*CaixaBank Research*

2. The president of Bundesbank, Jens Weidmann, who has repeatedly and publicly criticised the policies led by Draghi, was favourite in the early stages under the premise that the ECB has never had a German president. However, precisely because of his strong opposition to the ECB's decisions, he appears to have lost support in favour of less radical candidates, such as the governor of the Bank of France, François Villeroy de Galhau.

# Politics is the name of the game: political dynamics and risks in 2019 and beyond

One only has to take a look at the media to realise the rapid changes that are taking place in politics at present. In this context of constant transformation and the cult of the here and now that characterises our society, it is sometimes necessary to take a step back from the intense barrage of news and stop to reflect: what are the characteristics of the current political cycle worldwide, and what are its manifestations? This type of reflection, which is less hurried and more thoughtful, is a necessary exercise to try to understand and contextualise the political dynamics we are witnessing.

The importance of politics in economic analysis became particularly important in 2016 due to the unexpected outcome of the Brexit referendum and the victory of Donald Trump in the presidential elections. Following a relatively calm 2017, in 2018 numerous pockets of tension have arisen at the international level, setting a complicated scene for the beginning of 2019. The onslaught of protectionism in the US, the European authorities' negotiations with the United Kingdom on Brexit and with Italy regarding its budgets, as well as the European elections in May 2019, are some of the most significant challenges for the year to come.

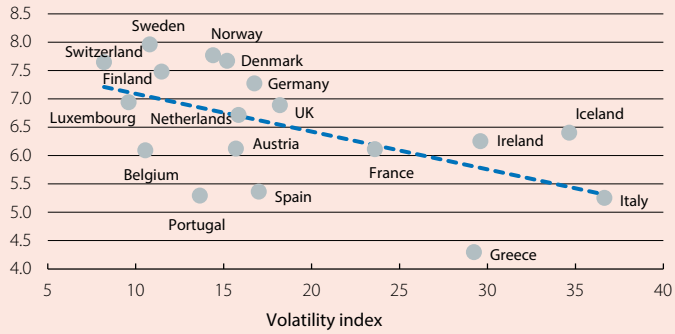
But what factors lie behind these challenges? In this article, we will consider both the general factors (the new state of politics) and the specific factors (some of the specific manifestations of this new arrangement), as well as filling in the gaps in between to analyse how the current status of politics is contributing to today's forms of governance. In particular, in order to characterise the current political cycle in Western countries, we analysed the trend in three key variables: electoral volatility, political polarisation and democratic quality.

### Electoral volatility, polarisation and democracy: evidence and implications for governance

When we analyse electoral volatility, we note a substantial increase in the number of people who have changed how they vote between one electoral process and the next. This is the result of both the switching of votes between existing parties and increased support for new political formations. In fact, between 2010 and 2015, electoral volatility in Western countries has increased by 68%.[1]

***Correlation between voting volatility and public policy performance ****

*Public policy performance (index)*




***Note:*** ** The chart uses the average value for the public policy performance indicator between 2013 and 2016 and the average value of the volatility index between 2011 and 2015. The performance indicator ranges from 1 to 10, where 10 is the most positive rating. The volatility index is a measure of gross flows of votes between parties.*
***Source:*** *CaixaBank Research, based on data from the Quality of Governance Database and the Dataset of Electoral Volatility and its internal components in Western Europe.*

This political environment characterised by greater volatility can have significant repercussions for how those in government act. In particular, greater electoral competition can lead them to propose more nearsighted policies in an attempt to stay in power, even if this leads to adverse consequences in the medium term for the economy as a whole. That said, this could also lead them to focus on policies and reforms that are important for the medium term, if it is clear that they are not going to be re-elected. Which of these two effects dominates? The evidence seems to indicate that it is the former (see first chart). This is not surprising if we consider that it is quite natural for policy-makers to resort to using a wide range of methods to extend their mandate. In effect, the correlation between the Bertelsmann institute's policy performance SGI index, which measures the degree of reforms that countries need in the medium term, and electoral volatility is clearly negative.

The second factor that we analysed is the trend in political polarisation, understood as the degree to which political parties stray from centrist positions. The results leave no room for doubt: political polarisation has increased significantly in the advanced countries since the financial crisis. This is intimately linked to the increase in volatility and the rise of new populist formations with positions skewed to the right and left of the political spectrum.

The most interesting consequences of this greater polarisation arise in the trade-off between nearsighted policies and serious reforms. In this regard, the report by Bertelsmann[2] documents that the increase in polarisation hinders the scope for broad political consensus, thereby hampering the possibility of implementing reforms focused on the medium term. However, this type of conclusion is not entirely novel: back in 2012, a study[3] documented that greater political polarisation was linked to lower

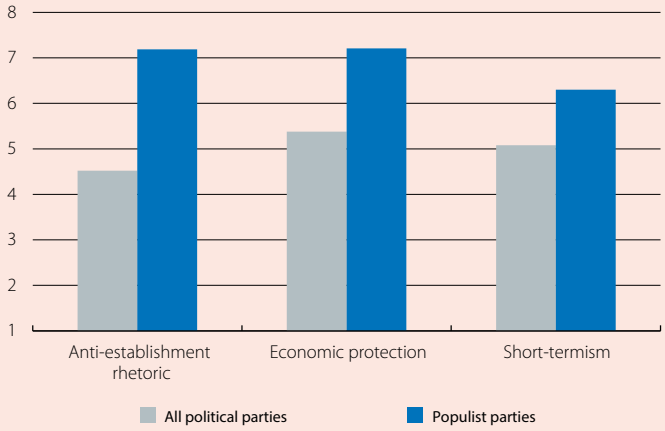
1. The volatility index is a measure of gross flows of votes between parties. It takes three types of volatility into account: volatility explained by flows towards existing parties, that explained by flows towards new parties and that explained by flows to minority parties (with <1% of votes).
2. See SGI 2018 (2018), «Policy Performance and Governance Capacities in the OECD and EU», Bertelsmann Stiftung.

quality of government. This effect seemed particularly important in young democracies.

In addition, the rise of populism is shrinking the room for promoting longer-term reforms, instead favouring an increase in nearsighted policies such as protectionism. In this regard, a recent study builds an index that measures the degree of economic protection in the policies of European political parties (including trade barriers and immigration), and another that measures the extent to which policies that are important for the long term are left out. The results show that, on average, the economic protection index of populist parties was 34% higher than the average for all European parties, while their index for leaving out important long-term policies is 24% higher than that of the total sample (see second chart).

***Characterisation of populism in Europe***

*Index **




***Note:*** ** The indicator for the index ranges from 1 to 10, where 1 is the minimum and 10 the maximum.*
***Source:*** *CaixaBank Research, based on data from L. Guiso* et al. *(2017). «Populism: Demand and Supply», Center for Economic Policy Research Discussion Paper, 11871.*

A final element that seems to define the latest political dynamics is a deterioration in the quality of democracy.[4] For example, between 2006 and 2016, the number of electoral democracies in the world did not increase, while non-democratic forms of government gained support. According to Pew Research, 49% of citizens worldwide would take a good view of a government formed by a committee of experts not approved by the ballot box.

**From theory to practice: the (geo)political risks of 2019**

The risks of a (geo)political nature that we can foresee for 2019 are nothing more than manifestations of this new political environment, which gives rise to a more nearsighted form of governance. Let us start with the rise in protectionist tensions, one of the manifestations that has already accompanied us in 2018 under the «America First» movement and which, for the time being, seems likely to stick around in 2019. Protectionism consists of short-term measures that can increase electoral support among the citizens for whom it provides protection against outside competition. However, in the medium term, isolationist policies tend to have adverse consequences for economic growth. In this regard, global growth could fall by between 0.1 and 0.6 pps over the next few years, and by as much as 1 pp in the case of the US, depending on the magnitude of the protectionist measures that are finally implemented.[5] Looking ahead to 2019, the risks related to the trade tensions between China and the US are a particular cause for concern. Specifically, the tensions could intensify to the point that they end up imposing constraints on investment between the two countries, or the US could end up imposing tariffs on the automotive sector.

In Europe, Brexit and the disputes between the European Commission and the Italian Government on budgetary matters are other examples of geopolitical manifestations brought about by the new political trends, where the emphasis is on immediate political yields. However, the increase in short-term satisfaction, which for many voters means distancing themselves from the EU dynamics emanating from Brussels and, to a certain extent, embracing the slogan «My Country First», is offset by disruptive effects in the medium term caused by a head-on collision with the EU.

Another relevant manifestation of the current political cycle is the way in which politics is questioning the main economic and technical institutions of our economies. There are now even academic articles that are bold enough to propose greater populist political interference in monetary policies. This is particularly counterproductive in a context in which the very objectives of the central banks' monetary policies are being reconsidered.[6]

Finally, it should be noted that, although the new political dynamics are worrisome, we must not let ourselves get carried away with pessimism. We have two good reasons for this. The first is that these dynamics should serve as a warning call for the more established political parties to put policy issues on the table for serious consideration. The second is that this new scenario could be part of a process involving the maturity and redesign of our political-economic institutions, in which case the current dynamics could be the turmoil prior to a new *status quo* that is stronger and more inclusive.

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3. See G. Xezonakis (2012), «Party System Polarisation and Quality of Government», Working Paper Series, University of Gothenburg. The study uses a sample of 39 countries between 1984 and 2009.
4. As stated in the Bertelsmann report specified in footnote 2.
5. The most extreme case would be the result of a 10-pp increase in tariffs between the US and all of its trading partners. Estimates by CaixaBank Research based on measurements by the IMF, the Bank of England and the OECD.
6. See C. Goodhart and R. Lastra, «Populism and central bank independence», Open Economies Review 29, no. 1 (2018): 49-68.

# The Spanish economy in 2019: a year of transition towards more sustainable levels

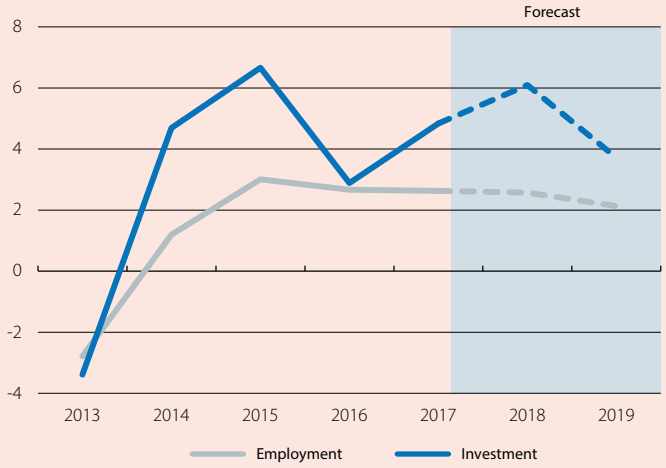
We are approaching the end of 2018 and, as is usual at this time of year, we want to distance ourselves from the everyday questions, take a step back and consider what we can expect for the coming year. As we shall see, we expect that 2019 will be remembered as a year of transition: the year in which the economy took its foot off the accelerator, shifted gear and settled into a comfortable cruising speed.

But before delving into foresight, let us take a small detour. It is not possible to understand where we are heading without briefly reviewing the recent past. The Spanish economy has just experienced three years of very high growth. This high rate of growth has been possible thanks to various factors. Firstly, cyclical momentum: emerging from the recession, many areas of the Spanish economy had a lot of room to grow. Therefore, when the economic outlook improved, the mere recovery of activity from the depths that had been reached during the financial crisis provided a strong boost to growth.[1] The cyclical momentum also benefited from some of the reforms that the Spanish economy carried out in the sphere of labour and in the financial sector, among others. Secondly, the Spanish economy benefited from a series of temporary factors that gave further impetus to the recovery. Among these factors, of particular note were the sharp fall in oil prices that took place at the end of 2014, the reduction of interest rates as a result of the ECB's expansionary monetary policy, and the global economic recovery, which helped to boost Spanish exports and the tourism sector.[2]

However, as early as 2017 these support factors, or tailwinds as they are also known, began to lose strength. In some cases, they even changed direction and became headwinds, such as the oil price, which has gradually recovered since mid-2017.[3] In addition, the international context has suffered a slight deterioration in recent quarters: the normalisation of US monetary policy has begun to have an impact on the markets, while the escalating trade tensions between the US and China have weighed heavily on global confidence in recent months. All these dynamics have been reflected in the latest data available to date regarding the Spanish economy. In particular, the data show that the pace of economic growth has slowed compared to recent years, although it still remains high. So, with this background, what can we expect for 2019?

***Spain: employment and investment***

*Year-on-year change (%)*




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

To begin with, we expect domestic demand to remain the main driver of growth for the economy. This forecast is mainly based on two elements. Firstly, it is based on the positive trend in the labour market, which continues to show rapid job growth. Although the pace of job creation can be expected to moderate in line with economic activity, the favourable outlook for demand and the high degree of slack that persists in the labour market suggest that the economy will continue to generate employment at a rate slightly above 2%. In addition to the positive trend in employment, there has been an incipient recovery in wages, which is now apparent in the latest data and which we expect to continue into 2019.[4] All this will continue to support private consumption. Secondly, investment is expected to remain buoyant, albeit at slightly more moderate levels, thanks to the context of accommodative financial conditions and the favourable outlook for demand (see the first chart).

External demand, meanwhile, will continue with a moderate tone. After growing in recent quarters below expectations due to the increase in uncertainty – caused by the trade tensions between the US and China – and the slowdown in the tourism sector, we expect exports to partially recover. However, despite this recovery, strong domestic demand will drive up imports, which will make the contribution of the external sector virtually nil in the coming quarters.

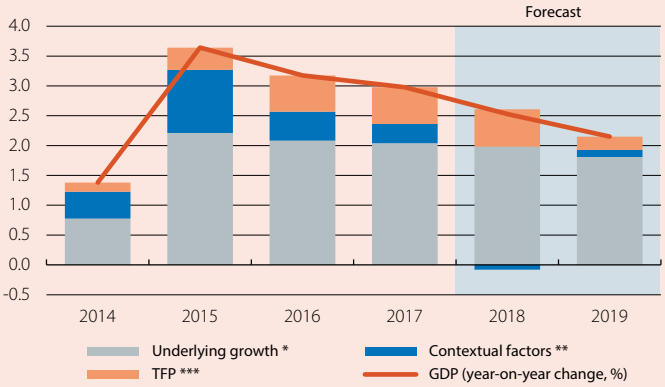
What is the combined effect of all these elements? Well, the positive trends in employment and investment will support economic growth. In the second chart, we show the forecast for GDP growth in 2019 (2.1%), as well as its breakdown according to the contribution of the underlying component – the growth driven by the accumulation of production factors: capital and labour –, contextual factors (oil prices, interest rates, and tourism) and total-factor productivity (TFP).[5] As we can

1. The main example is the labour market: in 2013, the unemployment rate stood at 26.1%, well above the average between 2000 and 2007 of 10.5%.
2. For a more detailed analysis of the contribution of these support factors, see «Should we be concerned about the slowdown of the Spanish economy?», in the MR10/2018.
3. The oil price went from 47.6 dollars in June 2017 to 79.1 dollars in September 2018.
4. For example, the pay reviews agreed under collective agreements up to October 2018 amounted to 1.7%, while those signed a year earlier were 1.4%.

see, the high growth registered between 2015 and 2017 was the product of a strong recovery in underlying growth. This was driven by strong job growth and the recovery of investment, as well as the impetus provided by the tailwinds. In contrast, in 2018 and 2019 we can see how these tailwinds have faded and growth will stabilise. It is expected to stabilise at around the growth level of the underlying component, which itself will remain healthy due to the economy's solid fundamentals (capital and employment), and at the level of the contribution from TFP, which we expect to be modest but in keeping with recent experience.[6] Therefore, despite the fading of the contextual factors, we can see that the economy will continue to grow at a high and more sustainable rate.

### Spain: growth forecasts

*Contribution to growth (pps)*




***Notes:*** ** Underlying growth is defined as the GDP growth that is explained by the accumulation of production, employment and capital factors. ** Contextual factors include contributions to growth that come from changes in the price of oil, interest rates and the balance of tourism services. *** Total-factor productivity (TFP) constitutes the remainder.*
***Source:*** *CaixaBank Research, based on data from the National Statistics Institute and the Bank of Spain.*

By definition, the future is uncertain. As such, an analysis of the economic outlook would be incomplete without considering the possibility that, next year, there could be some unforeseen event that distorts the expected course of events. To reflect this uncertainty, in the following table we show the sensitivity of a series of macroeconomic variables when faced with two scenarios. The first scenario is representative of a negative shock in one of the world's major economies, but with a contained impact at the global level. For example, this could be due to an abrupt slowdown of the US economy after the fiscal boost of the Trump Administration comes to an end, and/or due to the impact of trade tensions with China.[7] The second scenario is more severe and is inspired by a tempered version of the sovereign-debt crisis that occurred between 2010 and 2012. This scenario could arise if tensions between the Italian Government and the European Commission were to take on a more serious tone and the sustainability of Italy's public debt were called into question. As shown in the table, depending on the scenario considered, the Spanish economy would face a more or less pronounced slowdown compared to what is expected. Nevertheless, in both cases the economy would stay well clear of the possibility of a recession, while the unemployment rate would continue to fall, albeit at a slower pace than predicted, and there would be a moderate increase in the risk premium.

### Deviation from the central scenario

*(pps)*

| | 2019 | | | 2020 | | |
|---|---|---|---|---|---|---|
| | Central scenario * | Scenario 1: International shock with limited impact | Scenario 2: Shock originating in the euro area | Central scenario | Scenario 1: International shock with limited impact | Scenario 2: Shock originating in the euro area |
| GDP | 2.1% | –0.3 | –0.8 | 2.0% | –0.2 | –0.4 |
| Unemployment rate | 13.6% | 0.3 | 0.8 | 12% | 0.5 | 1.0 |
| Price of housing (year-on-year change) | 4.2% | –0.5 | –2.2 | 4.5% | –0.4 | –2.5 |
| Risk premium (bps) | 113 | 11 | 63 | 89 | 6 | 43 |

***Note:*** ** Forecast according to CaixaBank Research.*
***Source:*** *CaixaBank Research, based on data from the National Statistics Institute, the Ministry of Public Works and Bloomberg.*

By way of conclusion, the outlook for 2019 is encouraging. The fundamentals that drive growth are well established and the slowdown observed compared to prior years is mostly a reflection of the natural course of the business cycle. Nevertheless, this should not lead us to be complacent. The challenges facing the economy, which include the rather modest trend in the country's productivity, the high public debt and the duality in the labour market, are substantial and we should take advantage of this good phase of the cycle to steer them in the right direction.

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*CaixaBank Research*

5. Total-factor productivity is obtained by calculating the remaining difference between GDP growth and the growth that is explained by the accumulation of production factors and economic factors. According to this definition, the growth that TFP contributes could also be considered part of the underlying growth.
6. According to estimates by the Bank of Spain (see E. Mora-Benito and Chenxu Fu, 2018, «The evolution of Spanish total factor productivity since the global financial crisis»), the contribution of TFP to growth between 2001 and 2007 was –0.4 pps, while between 2008 and 2013 it was –0.7 pps, and between 2014 and 2015 it was 0.8 pps.
7. The historical episode on which we have based this scenario is the dotcom bubble crisis, which occurred between 2000 and 2002 and led to a marked slowdown in the US economy, although it had a moderate global impact.

# The outlook for Portugal: an extended period of healthy growth

At the end of 2018, Portugal's GDP has already returned to the levels of 2008,[1] recovering the ground lost following the international financial crisis 10 years ago and the sovereign debt crisis in the euro area. Let's not forget where we have come from: in a scenario of risk aversion that made it difficult to obtain funding in the market, it was necessary to resort to an external financial assistance programme which lasted between 2011 and 2014,[2] and which forced the correction of existing imbalances. This setting, in turn, led to a cumulative drop in GDP of 6.0%.[3] In 2014, the economy embarked on a period of recovery with increasingly strong rates of expansion, culminating with a growth of 2.8% in 2017. The increase in competitiveness has been one of the major drivers of the recovery and has resulted in exports providing a greater portion of the country's GDP, rising from 34% in 2011 to 47% in 2017. In 2018, growth has remained strong, despite suffering a slight slowdown. This reflects the disappearance of external support factors, which we will analyse below, and the economy's entry into a more mature phase of the cycle. How has the economy behaved recently and, above all, what can be expected in 2019-2020?

The latest data indicate that the slowdown is the result of two factors, namely a negative contribution from external demand and a slowdown in investment. Nevertheless, the economic outlook remains hopeful on the whole.

### *Portugal: macroeconomic table*

*Year-on-year change (%)*

| | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|
| Private consumption | 2.3 | 2.3 | 2.0 | 1.8 |
| Public consumption | 0.2 | 0.8 | 0.6 | 0.2 |
| Gross fixed capital formation | 9.2 | 4.2 | 4.7 | 4.5 |
| Invest. in cap. goods & trans. | 13.7 | 6.6 | 6.5 | 5.5 |
| Invest. in construction | 8.3 | 4.6 | 6.2 | 5.5 |
| **Domestic demand (contrib.)** | **3.1** | **2.4** | **2.3** | **2.1** |
| Exports | 7.8 | 6.8 | 5.2 | 4.3 |
| Imports | 8.1 | 7.1 | 6.0 | 4.5 |
| **External demand (contrib.)** | **–0.3** | **–0.3** | **–0.4** | **–0.2** |
| **GDP** | **2.8** | **2.1** | **1.9** | **1.9** |

***Source:*** *CaixaBank Research.*

The negative impact of external demand is the result of an acceleration in the growth of imports, especially of investment goods, but also of consumer goods including durable goods and cars. Some of these factors are clearly temporary, such as the acceleration in vehicle imports in Q3 2018: the expectation of fiscal adjustments (which did not finally materialise) that would increase the cost of purchasing cars starting in September led households to bring their purchases forward, but this effect is going to dissipate in the coming quarters. However, the acceleration of imports also has a more stable component: investment and household consumption[4] will remain strong, which will continue to fuel imports. This and a lower growth in exports, affected by the slowdown in global demand and a reduction in tourism activity, will result in ongoing negative contributions from external demand.

In this regard, the tourism sector, which has been the main driver of the correction in the external imbalance in recent years, now has less margin for growth. A moderate deceleration in the contribution of tourism activity to growth – the most reasonable scenario – would have an estimated impact on GDP growth of –0.2 pps (compared to this sector's contribution in 2015). A stagnation of the sector would deduct 0.6 pps from growth.

### *The tourism sector: GDP sensitivities table*

*Year-on-year change (%)*

| | 2017 * | Scenario 1 | Scenario 2 |
|---|---|---|---|
| GVA of tourism | 10.0 | 5.0 | 0.0 |
| **Impact on GDP ** (pps) in 2018-2019** | | –0.2 | –0.6 |

***Notes:*** ** Estimate for 2017 based on the latest available data (2015).*
*** The impact on GDP is calculated based on the gross value added (GVA) of tourism as a proportion of the total GVA. Scenario 1 has an 80% probability of occurring and projects a moderate slowdown in tourism activity. Scenario 2 has a 20% probability of occurring and assumes the stagnation of the sector.*
***Source:*** *CaixaBank Research.*

However, even if exports lose some momentum,[5] they will continue to be the main driver of growth for the economy, since they benefit from the improvement in the economy's competitiveness and the greater role of the tradeable goods and services sector.

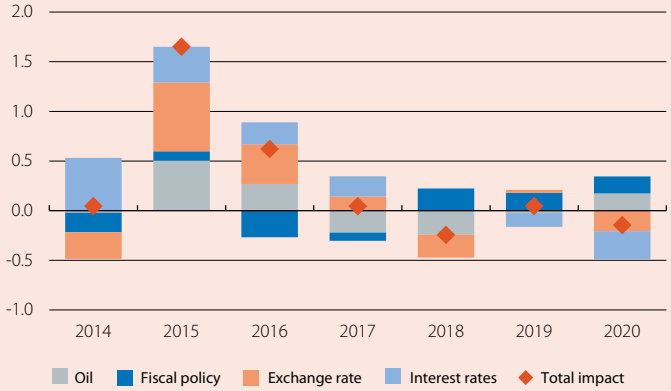
Investment, on the other hand, is the only component that will remain below pre-crisis levels at the end of the year, although it will remain buoyant. Various factors suggest that this component will continue to grow at around 5%, a lower rate than in 2017, but still noteworthy. In particular, the continuity of

1. In 2008, real GDP stood at 181.8 billion euros, and in 2018 it will be 183.8 billion euros.
2. The programme was aimed at achieving the structural correction of imbalances in the public finances and external accounts, the deleveraging of the economy and the implementation of reforms to remove the main structural obstacles to growth.
3. Equivalent to an average annual contraction of 1.5%.
4. The imported contribution of each unit of investment and consumption is 32% and 22%, respectively (Bank of Portugal, Economic Bulletin, December 2017).
5. The import content of exports is high (45%), so a rise in exports results in a higher volume of imports.

accommodative financial conditions could boost investment decisions in a context in which production capacity is already near its maximum levels.

In short, domestic demand will continue to make a substantial contribution to growth, above all thanks to the buoyancy of private consumption, which will continue to be supported by the strength of the labour market. Indeed, employment grew by 2.1% in Q3 2018 and the outlook for the coming quarters remains positive. Nevertheless, consumption could prove to be a little less buoyant than in 2017 and 2018, to the extent that the lower savings rate – which stands at 4.4% of gross disposable income (an all-time low) – will limit households' ability to sustain an increase in their levels of expenditure over the coming years.

***Portugal: impact of the tailwinds and headwinds on growth***
*(pps)*




***Source:*** *CaixaBank Research, based on data from the National Statistics Institute, Eurostat, the Bank for International Settlements and the Bank of Portugal.*

**The factors that determine growth patterns**

The recovery of the economy between 2014 and 2016, following the implementation of the financial assistance programme, would have been slower without the presence of a series of tailwinds that favoured growth. Primarily, these include the trend in the price of oil – between June 2014 and January 2015 it fell from 112 dollars per barrel to 50 dollars –, the decline in interest rates as a result of the ECB's accommodative monetary policies, and the depreciation of the euro against the dollar – falling by 22% between March 2014 and April 2015. These factors were particularly present between 2014 and 2016. However, at the current juncture, many of these tailwinds have faded or have even changed direction to become headwinds. The most obvious examples include the oil price and the exchange rate: the oil price went from 48 dollars in June 2017 to approximately 80 dollars in October 2018, while the euro has appreciated 9% against the US dollar since the beginning of 2017.

In light of this inversion of the tailwinds, we estimated the impact that the aforementioned three factors (oil, interest rates and exchange rate), together with fiscal policy, will have on the expected GDP growth over the period 2018-2020.

As can be seen in the chart, oil prices and the exchange rate are having a substantial negative impact on growth in 2018 and would explain much of the current slowdown in the economy. All in all, the negative effect will not persist in 2019, since the recent depreciation of the euro and the expectation of a moderation in the oil price mean that most of the effect is concentrated in 2018.

The positive impact of the low interest rates, on the other hand, has vanished over the course of 2018, and it will become negative in 2019 when the ECB begins to normalise its monetary policy. These negative effects are clearly being offset by fiscal policy, which between 2018 and 2020 will be relatively expansionary, thus supporting growth.

In short, the negative net impact of the four factors analysed in our simple quantitative exercise will not exceed –0.25 pps of GDP in 2018, it will be practically nil in 2019 (although it could reach –0.2 pps if tourism were to decelerate), and it could reach –0.15 pps in 2020 due to the expectation of a gradual strengthening of the euro and the normalisation of monetary policy. By comparison, these factors had a positive contribution to growth of 1.6 and 0.6 pps in 2015 and 2016, respectively. These estimates therefore reinforce the prospect that growth could be somewhat more moderate over the next few years. All in all, the reduced support from temporary factors will not have an excessively onerous impact on growth, to the extent that the Portuguese economy will take advantage of some of the advances achieved at the structural level (for example, the reduction in public debt and the greater weight of the export sector). Therefore, the slowdown that we are witnessing must be understood as a sign of the economy's entry into a more advanced phase of the cycle, which will materialise in growth rates at a healthy 2.0%.

*Daniel Belo and Teresa Gil Pinheiro*
*BPI Research*

# KEY FIGURES

## CAIXABANK GROUP
### As of 30 September 2018

| | MILLION € |
|---|---|
| Customer funds | 363,621 |
| Loans and advances to customers, gross | 223,465 |
| Profit attributable to Group, YTD | 1,768 |
| Market capitalisation | 23,544 |
| | |
| Customers (millions) | 15,7 |
| Employees | 37,511 |
| Branches | 5,176 |
| Retail branches in Spain | 4,482 |
| Number of ATMs in Spain | 9,422 |

## BPI
### As of 30 September 2018

| | MILLION € |
|---|---|
| Customer funds | 33,153 |
| Loans and advances to customers, gross | 23,422 |
| Profit attributable, YTD | 529 |
| Profit attributable to operations in Portugal, YTD | 324 |
| | |
| Customers (millions) | 1.9 |
| Employees | 4,898 |
| Branches | 496 |
| Number of ATMs | 1,356 |

## "LA CAIXA" BANKING FOUNDATION COMMUNITY
### Projects: Budget 2018

| | MILLION € |
|---|---|
| Social | 307.5 |
| Excellence in research and training | 91.1 |
| Raising awareness of culture and knowledge | 121.4 |
| *Total Budget* | **520** * |

* Of which €10 million are allocated to Portugal.

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### CIBI

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