



# Spain: Macroeconomic and financial outlook

CaixaBank Research

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7<sup>th</sup> January 2020

### A gradual deceleration is taking place

- ▶ **Activity is expected to expand by 1.9% in 2019 and 1.5% in 2020** (+2.4% in 2018). This gradual growth deceleration is consistent with a maturing expansion but will remain above Euro area levels. Domestic demand will continue as the main engine of activity amidst an adverse external environment. The banking sector continues to support the economic recovery and the real estate sector, after a significant adjustment, is expanding more sustainably.
- ▶ **On the political front**, a coalition government between *PSOE* and *Unidas Podemos* has been formed after the general elections delivered a fragmented Parliament. This coalition government has agreed on a broad program of measures, although the exact content has not been specified yet. However, the government has reaffirmed its commitment towards fiscal sustainability.

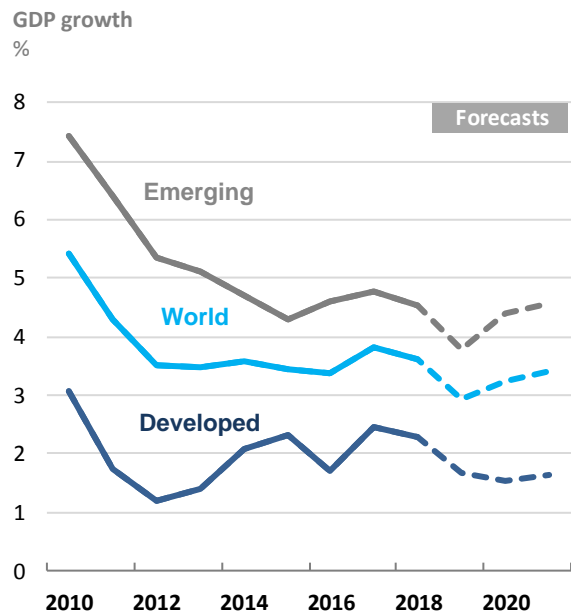
### More solid economic fundamentals

- ▶ Over 5 years of **continuous growth without increasing economic imbalances**.
- ▶ **Dynamic employment creation** (~400K new jobs expected in 2019) and **moderate wage increases** (+2,3% in 2019) will sustain domestic demand.
- ▶ **Structural reforms** and **substantial competitiveness gains** have permitted a boost of the export sector.
- ▶ **Solid financial position on the private sector side** after a substantial reduction of indebtedness.
- ▶ **More sustainable growth of the real estate sector**, aligned with structural housing demand.
- ▶ **Spain exited the EU excessive deficit procedure in 2019**, as its public deficit fell below the 3% threshold in 2018.
- ▶ **The banking sector** remains a support factor to Spanish economic growth.

### Some remaining challenges

- ▶ **On the macroeconomic front**, bigger productivity gains will be necessary to sustain higher GDP growth.
- ▶ **On the financial front**, efforts to reduce public debt and external debt should be continued as their levels remain high (97.6 and 168.4 % of GDP in 2018 respectively).
- ▶ **On the social front**, a more inclusive labour market will be required to display stronger resilience in case of a future crisis. Reducing the duality between permanent and temporary workers as well as increasing the employability of all workers remain key objectives.
- ▶ **In the banking system**, the main challenges are recovering sustainable profitability levels above cost of capital in a context of low interest rates and strong competition, accelerating the digital transformation, adapt business models to changes in consumer expectations and dealing with litigation risks and low reputation.

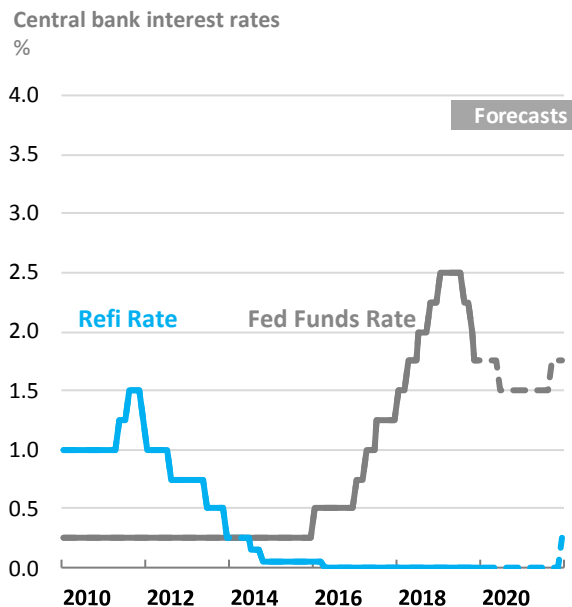
## Global growth shifts down a gear



Source: CaixaBank Research.

- ▶ Growth is being dragged down by a deteriorating external environment (esp. trade tensions uncertainty). **The global economy will moderate but preserve positive growth levels** as it undergoes a soft patch.
- ▶ **Drivers:** a maturing expansion and the drag of uncertainty will be partially offset by policy responses and resilient domestic demand.
- ▶ **Risks:** geopolitical and macro-financial factors.

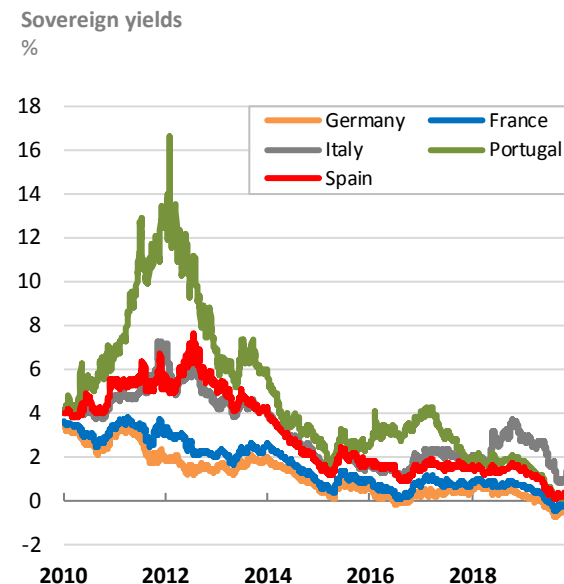
## Central banks exhibit dovish reaction functions



Source: CaixaBank Research.

- ▶ **The Fed cut rates three times** and –given the balance of risks- it will keep a dovish bias in the future (it could imply one more cut in H1 2020).
- ▶ **The ECB will sustain a low interest rate environment for a long time.** The package unveiled in September is open-ended and pursues a sustained improvement in inflation which will materialize very gradually.

## Financial markets operate in a volatile environment

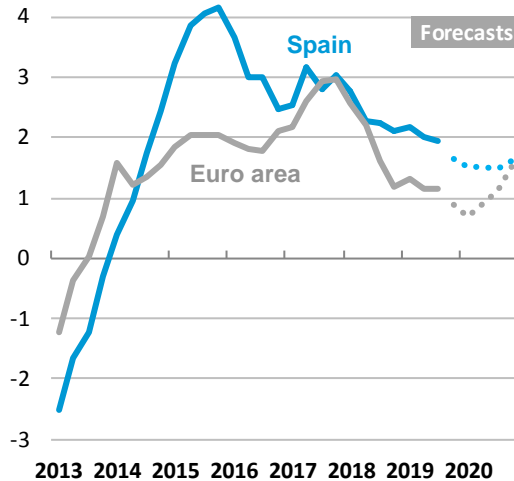


Source: Bloomberg and CaixaBank Research.

- ▶ **Sovereign yields will remain at low levels** due to expectations of easier monetary policy and higher downside risks. As uncertainties surrounding the economic outlook recede, yields could pick up.
- ▶ **Financial markets will exhibit renewed bouts of volatility** reflecting investors' sensitivity to geopolitical events, readjustments in monetary policy expectations and doubts on growth.

## Economic growth well above the Euro area average

GDP growth  
% YoY change

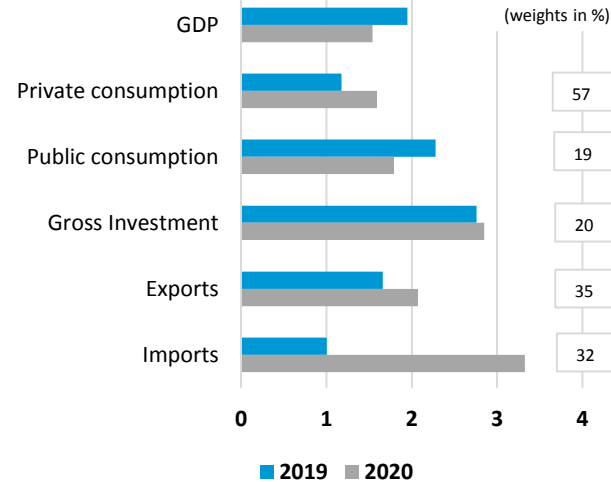


Source: INE and CaixaBank Research forecasts.

- ▶ **GDP grew +0.4% qoq in 2019Q3** (2.0% yoy), at the same pace as in the previous quarter and above the euro area rate (0.2% qoq).
- ▶ **Growth will converge to more moderate but more sustainable rates**, as the cyclical rebound loses some of the initial steam. The fundamentals, however, remain solid, as the economy taps into the competitiveness gains achieved in recent years and benefits from lower macroeconomic imbalances.

## Domestic demand as the main driver of growth

GDP components  
% YoY change

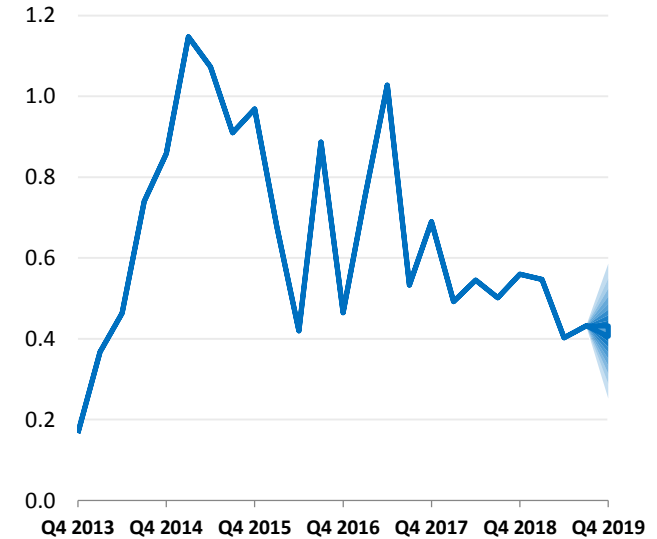


Source: INE and CaixaBank Research.

- ▶ **Domestic demand will remain the main engine of growth.** An active labor market, accommodative financial conditions and elevated sentiment will support growth in private consumption (exp. +1.4% in 2019-20) and investment (exp. +2.8% in 2019-20).
- ▶ **The external sector will remain subdued** as a result of intensified trade tensions, lower euro area growth and the risk of brexit.

## Nowcasting: activity decelerates

GDP growth  
% QoQ change



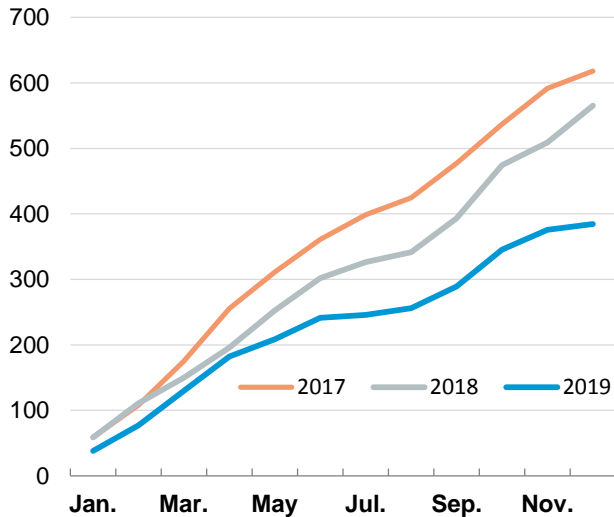
Note: 90% confidence band.

Source: CaixaBank Research, based on data from INE.

- ▶ **Activity indicators underpin a gradual slowdown.** Retail sales increased by 2.9% YoY in November (3.3% in 2019Q3) and Services PMI ticked up to 54.9 points in December (53.2 points in Nov.). Trade tension uncertainties weigh on Manufacturing PMI, keeping it below the 50-point mark at 47.4 points.
- ▶ **The CaixaBank Research GDP forecast model predicts QoQ growth of 0.4% in 2019Q4.**

## Employment creation moderates

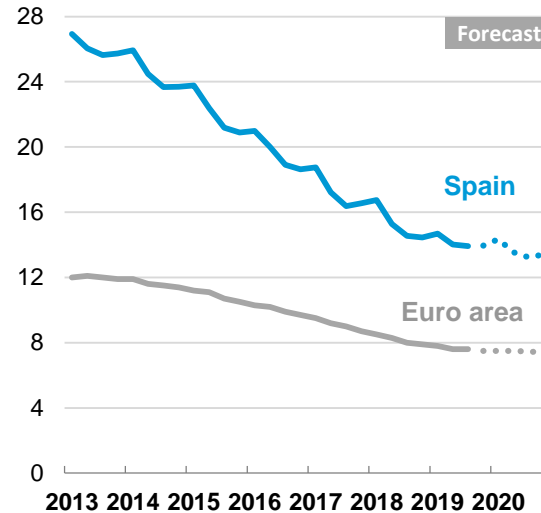
Affiliation to Social Security  
Cumulative increase (in thousands)



Source: CaixaBank Research, based on data from MEySS.

## Unemployment rate is falling more gradually

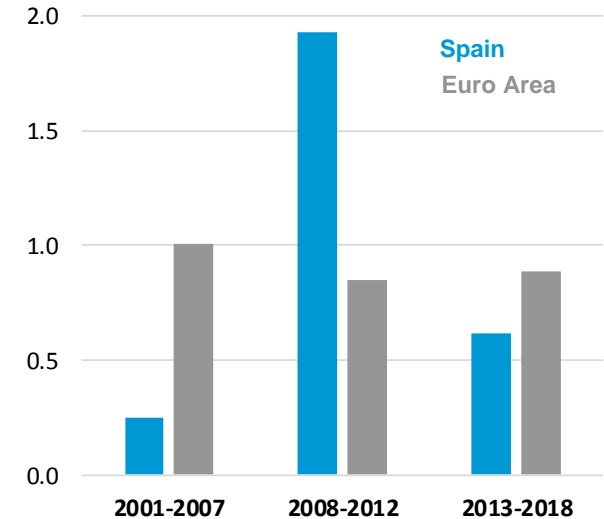
Unemployment rate  
% of active population



Source: INE (EPA), EC and CaixaBank Research.

## Labour productivity gains

Labour productivity  
% YoY change



Source: INE and CaixaBank Research forecasts.

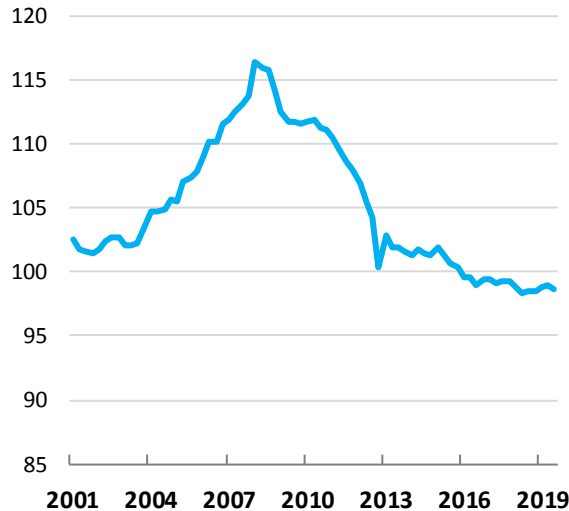
- ▶ **Employment grows at more sustainable levels.** Social security affiliates grew by 2.6% in 2019 and is expected to grow by 2.0% in 2020.
- ▶ Despite a high temporality rate (26.7% in 2019Q3), **employment quality is increasing among new affiliates** (+440K permanent vs. +75K temporary employment in H1 2019).

- ▶ **Unemployment rate fell to 13.9% in Q3 2019**, -0.6 p.p. below the same quarter of the previous year and -13.0 p.p. below the crisis maximum.
- ▶ Unemployment remains high, in particular for the young (~24.8%, population under 30).

- ▶ **Labour productivity growth in Spain is higher now than prior to the crisis**, despite the secular decline in productivity growth in most advanced economies.
- ▶ Nevertheless, **bigger productivity gains would be necessary** to sustain higher GDP growth.

## Competitiveness recovery

Unit labor cost relative to euro average  
Index (1999Q1 = 100)

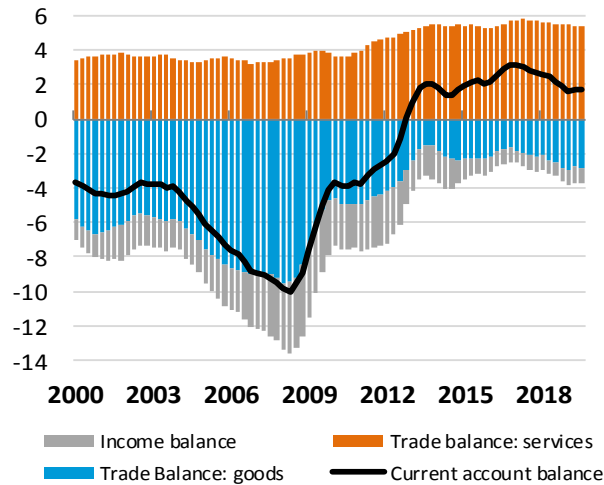


Source: Bank of Spain and Thomson Reuters Datastream.

- ▶ **Competitiveness lost in 1999-2008 has been recovered** through productivity gains (1.6% per year since 2006) and wage moderation.
- ▶ Enhanced competitiveness has fuelled exports, which currently stand above 34% of GDP, compared to 26% in 2008.

## Current account in surplus

Current account balance  
% of GDP



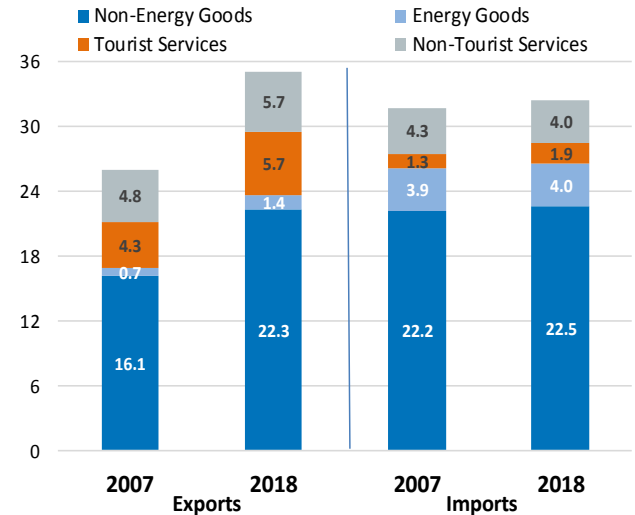
Note: Four-quarters accumulated.

Source: Bank of Spain and Thomson Reuters Datastream.

- ▶ The **current account maintains its surplus since 2013**, although it **decreased to around 1.6% of GDP in 2019** due to a worse trade balance reflecting uncertainties in European industry. Tourism surplus remains resilient.
- ▶ **Current account surplus will be smaller in 2020 and 2021**, dragged down by ongoing trade tensions and lower euro area growth.

## Export boost

Exports and imports of goods and services  
% of GDP

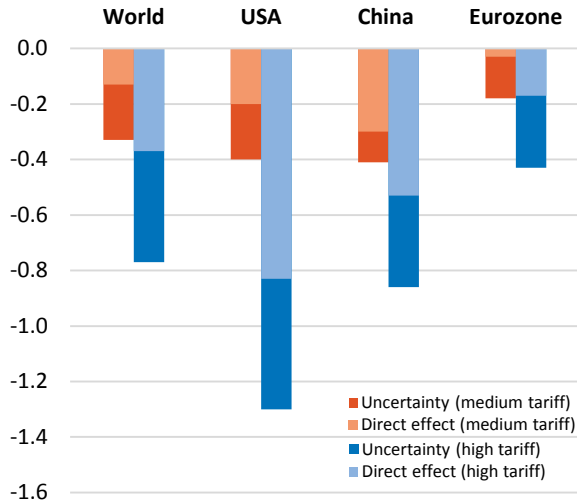


Source: Bank of Spain and Thomson Reuters Datastream.

- ▶ **Openness** increased from 57% of GDP in 2007 to 67% in 2018, mostly through goods exports.
- ▶ **Over 25,000 firms export regularly** from more sectors and towards more destinations, including extra-EU (21,000 firms in 2012).
- ▶ **Export performance will remain robust**, underpinned by competitive gains and a diversification of partners.

## Trade tensions could impact GDP growth

Trade tensions impact on GDP  
% change in GDP level

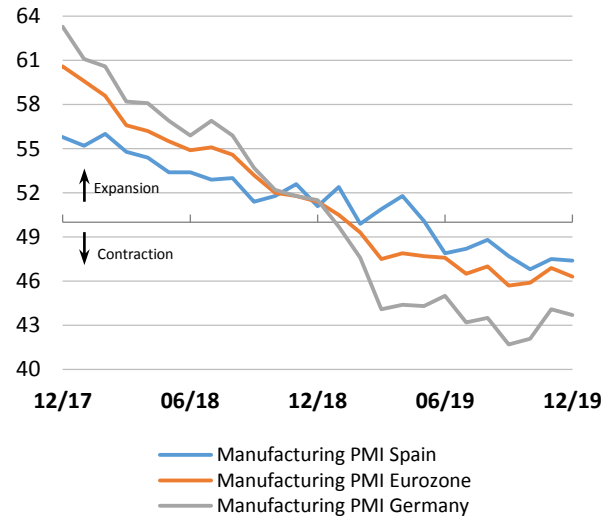


Source: CaixaBank Research, based on data from Bank of Spain, Bank of England and IMF.

- ▶ **U.S.- China:** A First Phase trade agreement was reached at the end of 2019 (with gradual tariff rollback).
- ▶ Nonetheless, **trade tensions will remain an important source of risk to the global outlook in 2020**, since we have seen in the past how this conflict re-escalated after cooling down. Therefore, **confidence will be restored only gradually in 2020**.

## European industry downturn, in particular auto

PMI levels

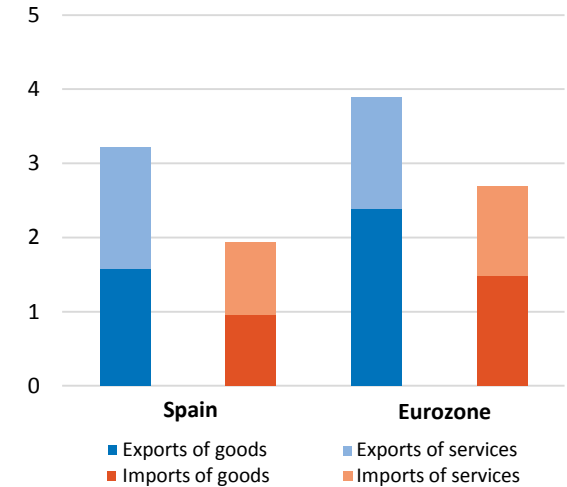


Source: CaixaBank Research, based on data from Markit.

- ▶ **Manufacturing slowdown** is more intense in the rest of the Eurozone, in particular in Germany, but the impact on Spain will intensify if the slowdown is prolonged.
- ▶ Spain shares the **European overexposure to the auto industry**, affected by environmental concerns and technological uncertainties.

## Brexit could affect Spain-UK close trade relationship

Exports and imports of goods and services to/from the UK  
% of GDP

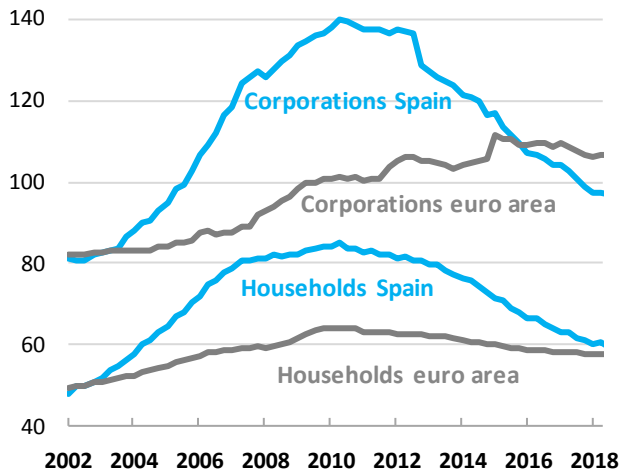


Source: CaixaBank Research, based on data from Bank of Spain and Eurostat.

- ▶ **The UK is the 5<sup>th</sup> destination for Spanish exports of goods** and the main issuing country of tourists for Spain (22% of all inbound tourism).
- ▶ **Brexit's impact on Spain should be slightly below Eurozone average**, as Spanish exports of goods and services to the UK (3.2% of GDP) are just beneath Eurozone average (3.9%), but concentrated in **tourism** and **real estate**.

## Private indebtedness has fallen significantly

Gross private debt  
% of GDP



Source: ECB, Eurostat.

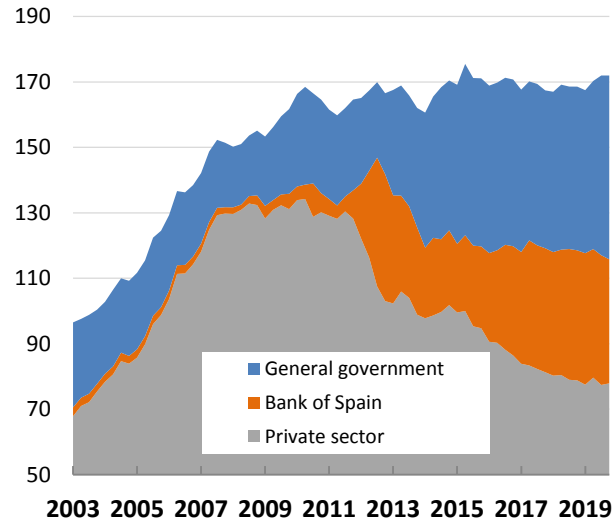
### ► Solid financial situation of the private sector.

Corporate deleveraging has come a long way and debt levels are well below euro area average.

- Household deleveraging will continue over the medium term, albeit at a more gradual pace now that debt levels are approaching Euro area levels.

## Gross external debt remains a challenge

Gross external debt  
Quarterly data, in % of GDP



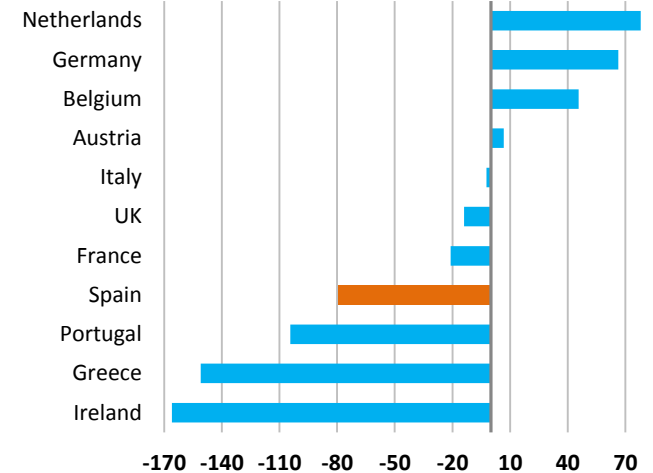
Source: Bank of Spain and Thomson Reuters Datastream.

- Gross external debt stands at 172.0% of GDP in 2019Q3, and is expected to steadily decline thanks to the current account remaining in surplus.

- Private sector external debt has fallen considerably from peak levels (131% of GDP in 2010 to 77.9% of GDP in 2019Q3).

## Net international investment position improves

Net international investment positions  
% of GDP, Q2 2019\*



Note: (\*) Data for Spain refers to Q3 2019.

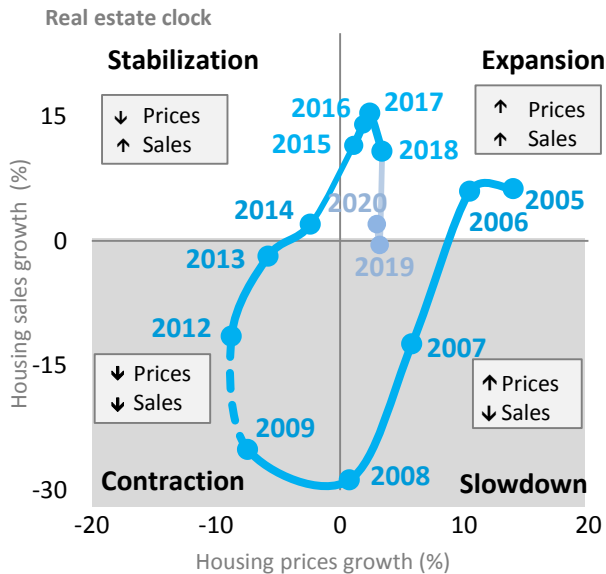
Source: Bank of Spain, IMF, Eurostat and CaixaBank Research.

- The negative net international investment position (NIIP) has improved by 21 p.p. since 2014Q2 but remains high at 79.6% of GDP in 2019Q3.

- A current surplus of 1.3% of GDP and nominal growth of 3% (1,6% and 3.7% in mid 2019, respectively) would lift the NIIP to -35% of GDP in 15 years, below the indicative threshold given by the EC (-35%).



## Moderate price increases, stable sales

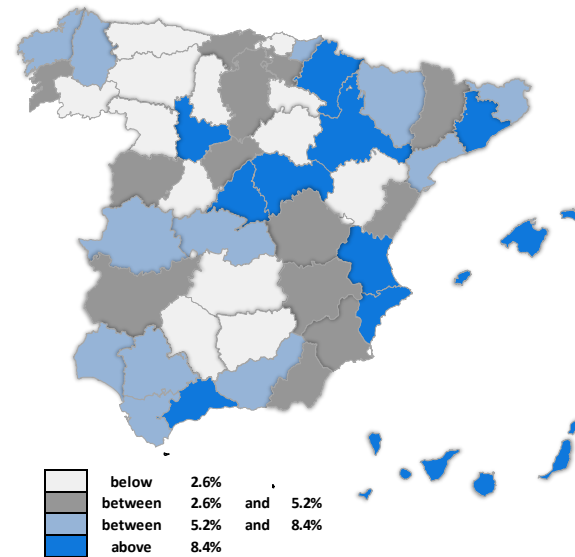


Source: Fomento, INE and CaixaBank Research forecasts.

- ▶ **The current expansion in the real estate sector is more sustainable than in the past.**
- ▶ **Housing sales stabilized** at ~520K units per year, supported by growth in employment and income, easier credit conditions and foreign demand (forecast +2% in 2020).
- ▶ **Housing building permits** increased +12.6% in Sept. 2019 (~108K units 12 months-accum.), still below new household creation (120K).

## An uneven housing recovery

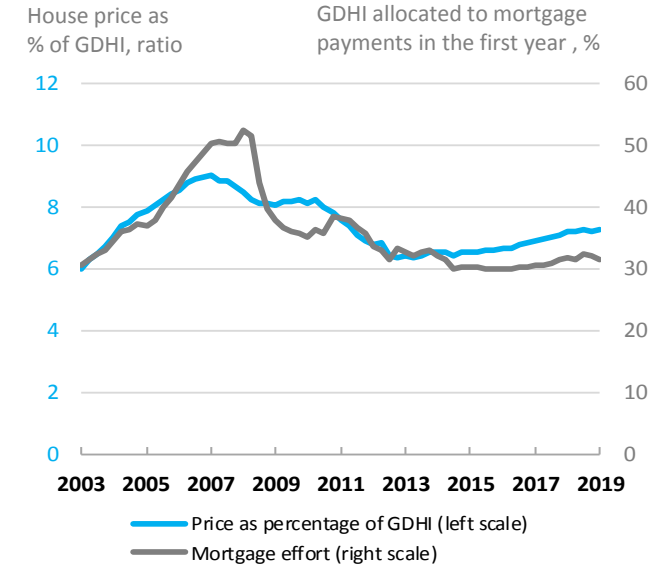
Housing prices (appraisal value)  
Cumulative increase since minimum up to 2019Q3



Source: Ministry of Public Works.

- ▶ **Housing prices are on the rise**, increasing by 3.1% (appraisal value) and 4.7% (transaction prices) in Q3 2019.
- ▶ **Housing prices among the biggest cities and in touristic destinations are increasing at a higher pace** than in other areas, where price increases are more modest.

## Housing affordability

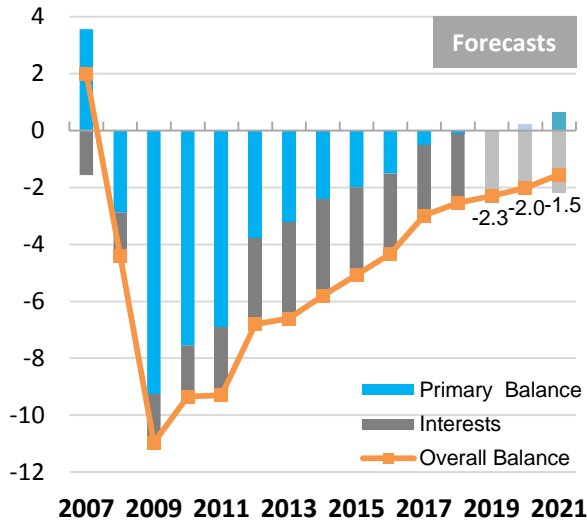


Note: GDHI is the Gross Disposable Household Income (median).  
Source: Bank of Spain

- ▶ Despite recent price increases, **housing affordability ratios remain well below previous maximums** thanks to the improvement in household income and low interest rates.
- ▶ Nevertheless, **housing affordability remains a challenge in some areas** (city centers, touristic destinations, etc.).

## Fiscal deficit has been steadily declining

Fiscal deficit  
% of GDP

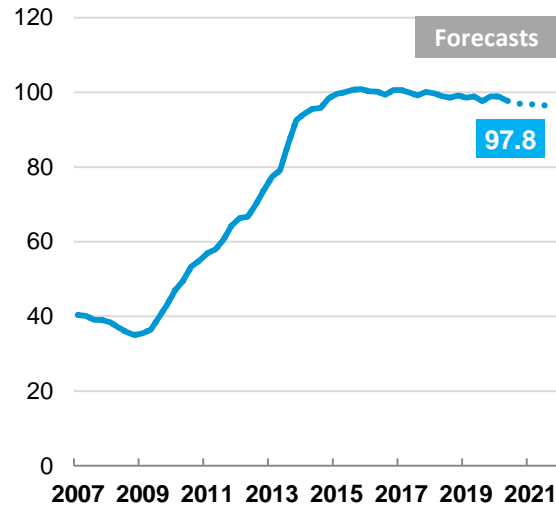


Source: Ministry of Finance and Civil Service and CaixaBank Research forecasts.

- ▶ **Public accounts have improved** significantly over the last six years. **In 2019, the public deficit is expected to attain 2.3% of GDP**, higher than forecasted in the Stability Plan (1.1%) but below the 3% threshold.
- ▶ A budget for 2020 will be presented soon including measures similar to those outlined in the 2019 draft and that should continue the adjustment of the public accounts.

## Public debt stabilized around 100% of GDP

Public debt  
% of GDP

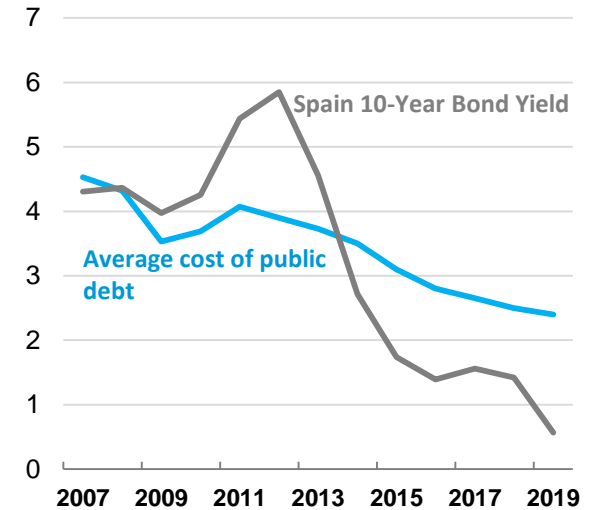


Source: Ministry of Finance and Civil Service and CaixaBank Research forecasts.

- ▶ **Public debt remains high at 97.8% of GDP in 2019Q3**, ~12 p.p. above the Euro area average.
- ▶ In the coming years, **public debt is expected to slowly decrease at an approximate annual pace of 1 p.p. of GDP**, thanks to the budget deficit adjustment.

## Cost of debt is at its minimum

Average cost of debt  
%



Source: Ministry of Economy, Industry and Competitiveness, Industry and Competitiveness and Reuters Datastream.

- ▶ **The average cost of debt has gone down to 2.4% in 2019**, significantly lower than the 4.1% recorded in 2011.
- ▶ **The cost of debt is expected to remain contained**, facilitated by low interest rates and relatively high average debt maturity (7.5 years).

## Stock of bank credit still falls, except for consumption

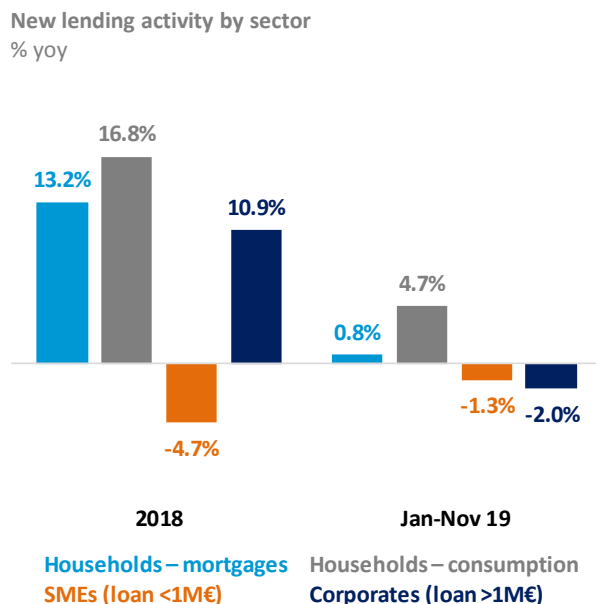
Private domestic credit (gross exposures)	Dec-18	Nov-19 (latest)	
	% yoy	€ Billion	% yoy
<b>Total credit</b>	<b>-2.6%</b>	<b>1,142</b>	<b>-1.4%</b>
<b>Households</b>	0.0%	704	-0.4%
Housing mortgages	-1.4%	509	-1.5%
Other purposes	4.2%	195	2.7%
Of which consumption	11.8%	97	8.3%
<b>Businesses</b>	<b>-6.5%</b>	<b>439</b>	<b>-3.1%</b>
Non-real estate developers <sup>1</sup>	-1.0%	341	0.3%
Real estate developers <sup>1</sup>	-21.6%	97	-11.9%

Note: (1) latest available data Sep-19

Source: Bank of Spain.

- ▶ **Loans to households stabilized** thanks to the strong growth of consumer credit and the gradual recovery of mortgages.
- ▶ **The stock of loans to corporates** appears to recover from the impact of the NPL portfolio sales (-1.3% adjusted vs -3.1% non-adjusted).

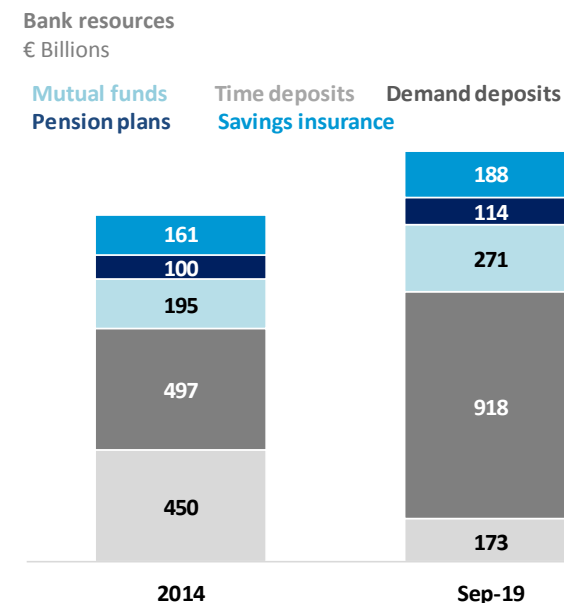
## New lending activity has been growing



Source: Bank of Spain

- ▶ **New lending activity** has decelerated during 2019.
- ▶ New **mortgages** have been temporally impacted by the new mortgage law but it should recover gradually in the following months.
- ▶ **New lending activity to SMEs fell in 2018** but is stabilizing gradually this year.

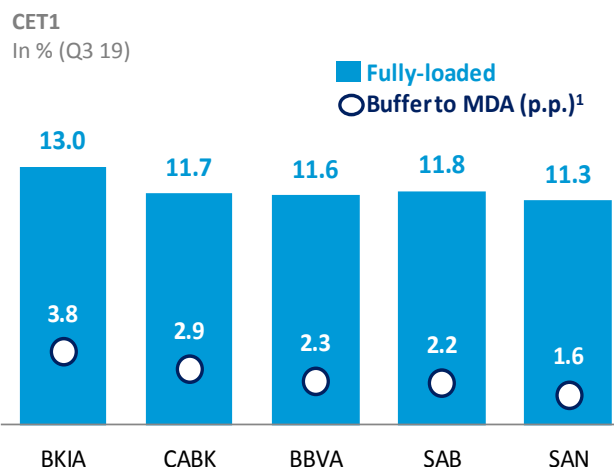
## Increase in customers funds



Source: INVERCO, Bank of Spain and ICEA.

- ▶ **Migration from time deposits** to demand deposits and off-balance sheet funds continue due to low yields.
- ▶ **26% increase** in mutual funds, pension plans and savings insurance since 2014.
- ▶ **There is still room for improvement** in pension plans and savings insurance: 16% of households fin. assets vs 33% for euro area.

## Banks solvency position is robust



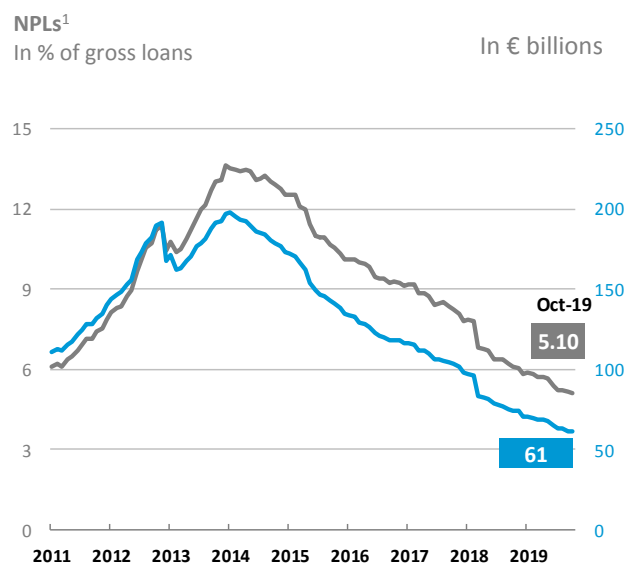
Note: (1) Difference between CET1 ratio fully-loaded and SREP requirement 2019.

Source: bank's financial statements, Bank of Spain.

- ▶ **Spanish banks maintain a solid solvency position** in 2019 Q3 as a result of active capital management and resilient profitability levels amidst a very low interest rate environment.
- ▶ The **aggregated industry CET1** ratio (11.6% fully loaded as of Jun-19<sup>1</sup>) is well above the regulatory minimum.

Note: (1) Latest available data published by EBA Risk Dashboard.

## Non-performing loans continue to fall



Note: (1) Under new definition of credit, which includes credit received by Credit Financial Intermediaries. Source: Bank of Spain.

- ▶ **The disposal of non-performing assets is well advanced.** Foreclosed assets fell by 50% since 2014 and NPLs went down by 60%.
- ▶ **NPLs ratio is already at 2010 levels.** NPLs have declined significantly last year, impacted by real estate business deconsolidation strategies and other portfolio sales.
- ▶ **We expect the reduction of NPL will continue** in the coming months, but at a lower speed.

## Main challenge: achieving sustainable profitability

**P&L**  
In % of average total assets (Q3 19; trailing 12M)

	CABK	BBVA	SAN	BKIA	SAB
<b>Net interest income</b>	<b>1.2</b>	<b>1.0</b>	<b>1.1</b>	<b>1.0</b>	<b>1.5</b>
Net fees	0.6	0.5	0.6	0.5	0.7
Gains on financial assets/liab. and others	0.1	0.1	0.2	0.1	0.0
Other operating income	0.2	0.0	0.1	-0.1	-0.1
<b>Gross income</b>	<b>2.1</b>	<b>1.6</b>	<b>2.0</b>	<b>1.5</b>	<b>2.2</b>
Operating expenses	-1.4	-0.9	-1.1	-0.9	-1.2
Impairment losses, tax and others	-0.3	-0.3	-0.5	-0.4	-0.5
<b>Profit</b>	<b>0.3</b>	<b>0.4</b>	<b>0.4</b>	<b>0.3</b>	<b>0.4</b>
<b>ROTE (%)<sup>1</sup></b>	<b>6.8</b>	<b>4.2</b>	<b>3.9</b>	<b>3.7</b>	<b>8.1</b>

Note: Domestic businesses. ROTE based on internal calculations. (1) Group ROTEs for CABK and SAB. ROTE of CABK is 10.1% excluding extraordinary expenses in 2Q19. BBVA and SAN include Corporate Centre (only proportion applicable to business in Spain). SAN also includes Portugal and SGP. Source: Bank's financial statements.

- ▶ **Lower cost of risk and cost-containment** have helped to improve the bottom line. Yet the profitability of the industry still does not reach the cost of equity (~8%-9%).
- ▶ **Net interest income is expected to increase over the medium term** as interest rates raise and business volumes gradually recover.

% , yoy	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>GDP</b>	-3.0	-1.4	1.4	3.8	3.0	2.9	2.4	1.9	1.5	1.5
<b>Private Consumption</b>	-3.4	-2.9	1.7	2.9	2.6	3.0	1.8	1.2	1.6	1.3
<b>Public Consumption</b>	-4.2	-2.1	-0.7	2.0	1.0	1.0	1.9	2.3	1.8	1.4
<b>Gross Fixed Capital Formation (GFCF)</b>	-7.4	-3.7	4.1	4.9	2.4	5.9	5.3	2.8	2.8	2.4
<b>GFCF - equipment</b>	-7.1	2.7	5.7	9.1	1.8	8.5	5.7	5.1	5.3	2.6
<b>GFCF - construction</b>	-10.4	-8.2	3.0	1.5	1.6	5.9	6.6	1.4	1.1	2.3
<b>Exports</b>	0.9	4.4	4.5	4.3	5.4	5.6	2.2	1.7	2.1	3.0
<b>Imports</b>	-5.8	-0.2	6.8	5.1	2.7	6.6	3.3	1.0	3.3	3.1
<b>Unemployment rate</b>	24.8	26.1	24.4	22.1	19.6	17.2	15.3	14.2	13.6	13.2
<b>CPI (average)</b>	2.4	1.4	-0.2	-0.5	-0.2	2.0	1.7	0.7	1.0	1.4
<b>External current account balance (% GDP)</b>	0.1	2.0	1.7	2.0	3.2	2.7	1.9	1.6	1.3	1.4
<b>General Government Balance (% GDP) <sup>1</sup></b>	-7.0	-6.7	-5.8	-5.1	-4.1	-3.0	-2.5	-2.3	-2.0	-1.5
<b>General government debt (% GDP) <sup>2</sup></b>	85.7	95.5	100.4	99.3	99.0	98.1	97.6	97.0	96.5	95.3
<b>Housing prices</b>	-8.8	-5.8	-2.4	1.1	1.9	2.4	3.4	3.2	3.0	3.0
<b>Risk premium (vs. 10Y Bund, bps, Dec.)</b>	429	295	149	120	124	120	97	88	80	75
<b>Bank credit (to the private domestic sector)</b>	-9.9	-9.4	-7.1	-4.3	-2.9	-1.9	-2.6	-0.2	1.2	1.9

Note: All GDP figures are based on ESA-2010 methodology.

1/ The general government deficit excludes one-off bank restructuring costs of 3.7% of GDP in 2012, 0.3% of GDP in 2013, 0.1% in 2014, 0.05% in 2015, 0.2% in 2016, 0.04% in 2017 and 0.01% in 2018.

2/ General government debt includes ESM/FROB related borrowings equivalent to 3.9% of GDP in 2012.

Source: CaixaBank Research.

% , yoy, unless otherwise specified	Average 2000-2007	Average 2008-2016	2017	2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Oct.19	Nov.19	Dec.19
<b>Activity indicators</b>											
Industrial production index	1.6	-3.1	3.2	0.3	-2.9	0.0	1.7	1.1	-1.4	...	...
Manufacturing PMI ( <i>value</i> )	51.9	46.4	54.8	53.3	51.8	51.1	49.9	48.2	46.8	47.5	47.4
Services PMI ( <i>value</i> )	54.5	45.9	56.4	54.8	54.0	55.3	53.2	53.5	52.7	53.2	54.9
Retail sales	2.6	-2.8	1.0	0.7	1.4	1.3	2.2	3.3	2.9	2.9	...
Consumer confidence index ( <i>value</i> )	-8.3	-22.4	-3.4	-4.2	-6.2	-4.8	-4.0	-5.8	-9.1	-10.3	...
Foreign Tourists ( <i>% yoy, cumulative over 12 months</i> )	3.3	1.9	10.0	4.0	0.9	1.0	1.5	2.1	1.6	1.6	...
<b>Labour market</b>											
Employment <sup>(1)</sup>	4.3	-1.2	2.6	2.7	3.0	3.2	2.4	1.8	-	-	-
Unemployment rate ( <i>% labour force</i> )	10.5	20.8	17.2	15.3	14.4	14.7	14.0	13.9	-	-	-
Registered as employed with Social Security <sup>(2)</sup>	3.5	-0.9	3.6	3.1	3.0	2.9	2.8	2.5	2.3	2.3	2.0
Wages (collective agreement)	3.0	1.7	1.3	1.6	1.7	2.2	2.2	2.3	2.3	...	...
<b>Prices</b>											
General	3.2	1.5	2.0	1.7	1.7	1.1	0.9	0.3	0.1	0.4	0.8
Core	2.8	1.2	1.1	0.9	0.9	0.7	0.8	0.9	1.0	1.0	...
<b>Real estate</b>											
Building permits ( <i>% yoy, cumulative over 12 months</i> )	6.9	-26.7	22.9	25.7	23.9	25.8	21.9	13.0	11.8	...	...
Housing sales ( <i>% yoy, cumulative over 12 months</i> )	-	-8.0	14.1	14.2	11.5	8.3	5.5	1.3	-2.0	...	...
Housing prices	12.4	-4.0	2.4	3.4	3.9	4.4	3.1	3.1	-	-	-

Note: (1) Estimation EPA; (2) Monthly averages

Sources: CaixaBank Research, Ministerio de Economía, Ministerio de Fomento, Ministerio de Empleo y Seguridad Social, Instituto Nacional de Estadística, Servicio Público de Empleo Estatal, Markit, Comisión Europea, Departamento de Aduanas e Impuestos Especiales and Banco de España.