ECONOMIC OUTLOOK

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Economic Research Unit
Economic & European Affairs Department

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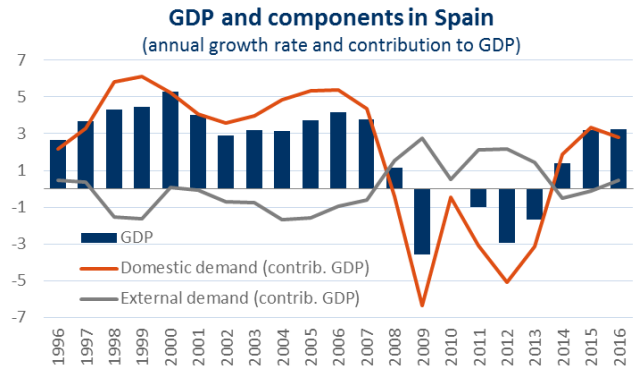
International financial markets have continued to perform positively, despite the Fed being expected to raise interest rates sooner than initially foreseen, maybe even this current March. The major stock indexes on either side of the Atlantic continued their upward trend, guided by Wall Street, with the Dow Jones posting a string of historical records. In Europe, the rise in stock markets was milder. The IBEX kept its bullish trend and reached the 10,000-points level at the beginning of March, and already accumulates an increase of more than 5% in 2017.

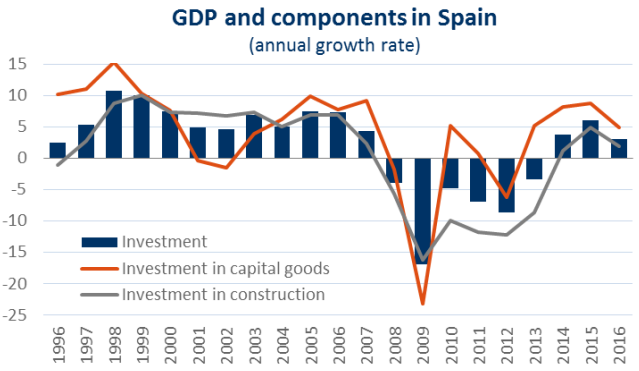
The Fed's monetary policy shift, which could intensify the process of monetary normalization in the coming months, contrasts with the ECB's policy. In this respect, the OECD, in its latest economic outlook report, warns that market projections point to a "wide divergence" in interest rates between major advanced economies, which could jeopardize the stability of financial markets and exchange rates. In addition, it points out that the financial markets' response to the increase in interest rates, following a prolonged period of non-conventional monetary stimulus and unprecedentedly low yields, may not be smooth.

Meanwhile, the ECB kept its monetary policy trend unchanged at its last meeting on March 9, maintaining the planned purchase program and insisting on the message that interest rates will remain at current lows at least throughout 2017. The main change was the upward revision of its forecasts, with a more solid growth for the Eurozone in 2017 (1.8%) and greater inflation (1.7%). With regards to inflation, it warns that the current rebound is due to oil prices and that core CPI remains at very moderate levels (1.1%). By 2018 it expects a price increase of 1.6%, while it has maintained its forecasts of 1.7% for 2019.

Within this context, the Spanish economy grew at a higher pace than the average for its European partners in 2016 (the GDP for the Euro Zone increased by 1.7%). Specifically, 2016 closed with an average GDP growth of 3.2%, the same as in 2015. The most outstanding trait in activity behaviour throughout 2016 was the significant slowdown in domestic demand, which went from a growth of 3.5% in the first quarter of the year to 2.2% in the fourth quarter. This loss of momentum is due to a slowdown in investment in construction and capital goods and, to a lesser extent, a slowdown in household consumption, although it still remains robust.



Source: National Statistics Institute and CEOE Economic Research Unit



Source: National Statistics Institute and CEOE Economic Research Unit

In the case of business investment, its tendency towards moderation in 2016 has been more pronounced in its machinery and capital goods component than in the transport equipment component. This leads us to infer that the uncertainty associated with the international and national contexts, together with the increase

in taxes and other costs, has influenced the investment drive of the private sector, which has slowed significantly in the second half of 2016. Meanwhile, investment in construction slowed down the recovery process shown in 2015, with a rate of growth lower than 2% in 2016, and with the public works segment being practically stagnant in comparison to 2015, at an average rate of 0.4% in 2016.

The behaviour of the external demand components also stands out, showing a positive export performance (with an annual average of 4.4%), while imports have slowed down since the summer, posting a 3.3% growth rate in 2016. This is why GDP growth for 2016, set at 3.2%, was more balanced, with domestic demand contributing 2.8 percentage points and the external sector contributing 0.4 percentage points.

Prospects for 2017 continue to point to a slowdown, albeit somewhat less intense than the one contemplated a few months ago. In fact, CEOE has revised its growth forecast for 2017 up to 2.5% (2.3% previously), while it foresees a 2.3% in 2018 (first estimate). This will have a positive impact in employment, with an expected job creation of around 420,000 (an annual increase of 2.3%), lower than the 475,000 created in 2016. However, data corresponding to January and February still points to significant job creation, with year-on-year rates set at an average of 3.4% in January and February, according to the number of workers registered with the Social Security.

Although the outlook is moderately optimistic, the European Commission[1] has published its European Semester Winter Package, which includes Country Reports on the Member States. The Report on Spain provides a comprehensive review on the evolution of macroeconomic imbalances related to public finances, private indebtedness and unemployment. In this way, it continues to emphasize the need to correct the high level of public debt and net external debt, it insists on the low productivity increase, on the high probability for part of the unemployment to become structural and on the need to intensify the fiscal consolidation path and increase potential growth.

With regard to the external sector, the European Commission points out that some of the factors responsible for the improvement of the external balance have been temporary and, therefore, cannot be expected to last in the medium and long term. However, it is worth highlighting the favourable balance of payments in 2016, which, according to preliminary estimate of the Bank of Spain, could have reached a net lending of around 2% of GDP. In addition, the external surplus is estimated to continue in 2017, although it will be somewhat lower.

On the other hand, inflation remained at 3% year-on-year in February, according to the flash estimate of the National Statistics Institute. These high rates are due to the increase in energy prices, derived largely from the rise in the oil price, which in January was 79% higher than in January 2016 (data in euros). From March onwards, a progressive CPI deceleration is expected as the contribution of the energy segment is diluted[2], and it is expected to end the year at rates close to 1%. For 2017, it is estimated that average inflation will be around 2%.

[1] See Box "Results of the comprehensive review of the European Commission on the correction of macroeconomic imbalances in Spain".
[2] See Box "The impact of oil price on the inflation: forecasts and scenarios for 2017".

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