

# ECONOMIC OUTLOOK

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CONFEDERACIÓN ESPAÑOLA DE  
ORGANIZACIONES EMPRESARIALES

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The strength of activity and world trade continues to be the dominant feature in the international scenario, a trend that will continue in the short term and that has led to an upward revision of economic forecasts. This improvement comes hand-in-hand with subdued inflation and, consequently, the main developed economies will follow a gradual normalization of their monetary policy. In the case of the US, the new president of the Fed (Jerome Powell) has announced that interest rates will continue to rise in 2018 (the market consensus anticipates three increases), due to the strength of activity and the labour market, which is already leading to an increase in wages. Meanwhile, the Bank of England is expected to follow a less intense path of increases in its benchmark interest rate, while other central banks, such as the ECB and the Bank of Japan, are still reducing the amount of asset purchases in 2018, but are not expected to hike interest rates this year.

Despite this favourable environment, starting in February there has been greater volatility in international financial markets, albeit at reduced levels. These movements are due to the different news arising from the political scene, especially from the USA and Europe. On the one hand, there is fear of a possible commercial war following Trump's tariff approval on steel (25%) and aluminium (10%), a measure that will affect key European sectors such as the automotive industry. In the Eurozone, while the social democratic party has backed the formation of a government with Angela Merkel's conservatives, uncertainty lies on Italy, where the centre-right coalition was the most voted, followed by the 5-Star Movement, although none of the two achieved majorities. In addition, within the coalition, the Northern League has overtaken Forza Italia, showing that Italians prefer two anti-European parties. This complicates the Government's options and, once again, raises doubts over the European project. Despite this, the euro is still strong around the 1.2 level against the US dollar.

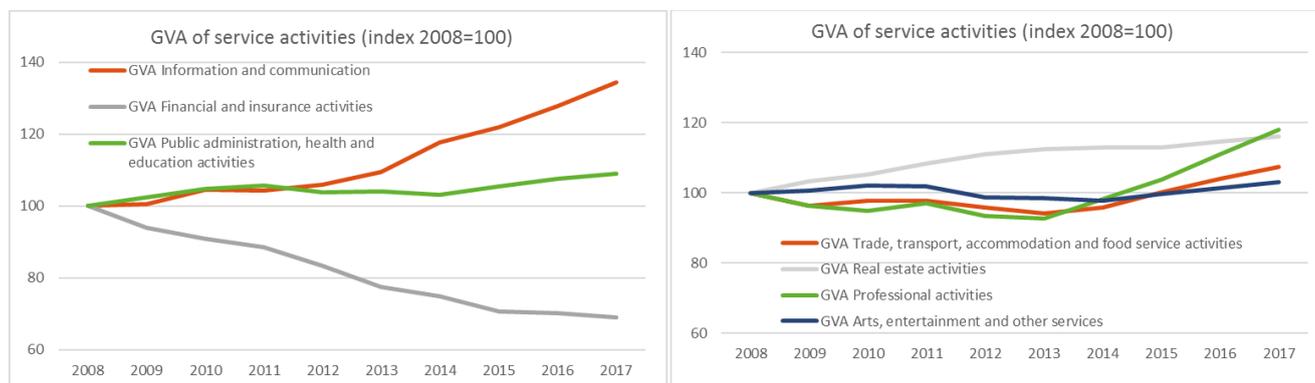
Amidst this backdrop, economic figures in Europe are still very positive. GDP for the Eurozone continued to show strength in the fourth quarter of 2017, posting a quarterly rate of 0.6%. In turn, last year's average annual growth was set at 2.3%. The Spanish economy's growth continues to stand out among the surrounding countries, exceeding quarterly rates posted in Germany (0.6%), France (0.6%), Italy (0.3%) or the United Kingdom (0.4%). Thus, in the fourth quarter of 2017, GDP continued to grow at 0.7% and the year-on-year rate stabilized at 3.1%.

One of the highlights of the Spanish GDP figure for the fourth quarter is that there was hardly any impact of the political uncertainty in Catalonia on activity as a whole, only a mild deceleration in tourism services and in consumption, which slowed down its quarterly growth. It is also worth noting the greater contribution of domestic demand (3.2 percentage points) in this period, while the external sector had a slightly negative contribution (-0.1 pp), with trade flows having lost momentum, especially in the case of exports, and more specifically in the services component.

With regards to domestic demand, favourable financial conditions, together with positive expectations about the Spanish economy and the external environment, continue to support investment strength. In fact, the improvement in investment in capital goods stands out, reaching rates close to 8% year-on-year, as well as the consolidation of the recovery of investment in construction (4.8%), which is also confirmed on the supply side.

In this area, the acceleration of industrial activity also stands out, with a GVA that grew 4.6% year-on-year over this period, while the year-on-year rate for services still stands strong (2.5%). Among the latter, it is worth highlighting the high growth still experienced by Professional Activities and Information and

Communication, both with a rate over 5%. In this way, activity levels for these activities already exceed by 20% and 40%, respectively, their pre-crisis levels.

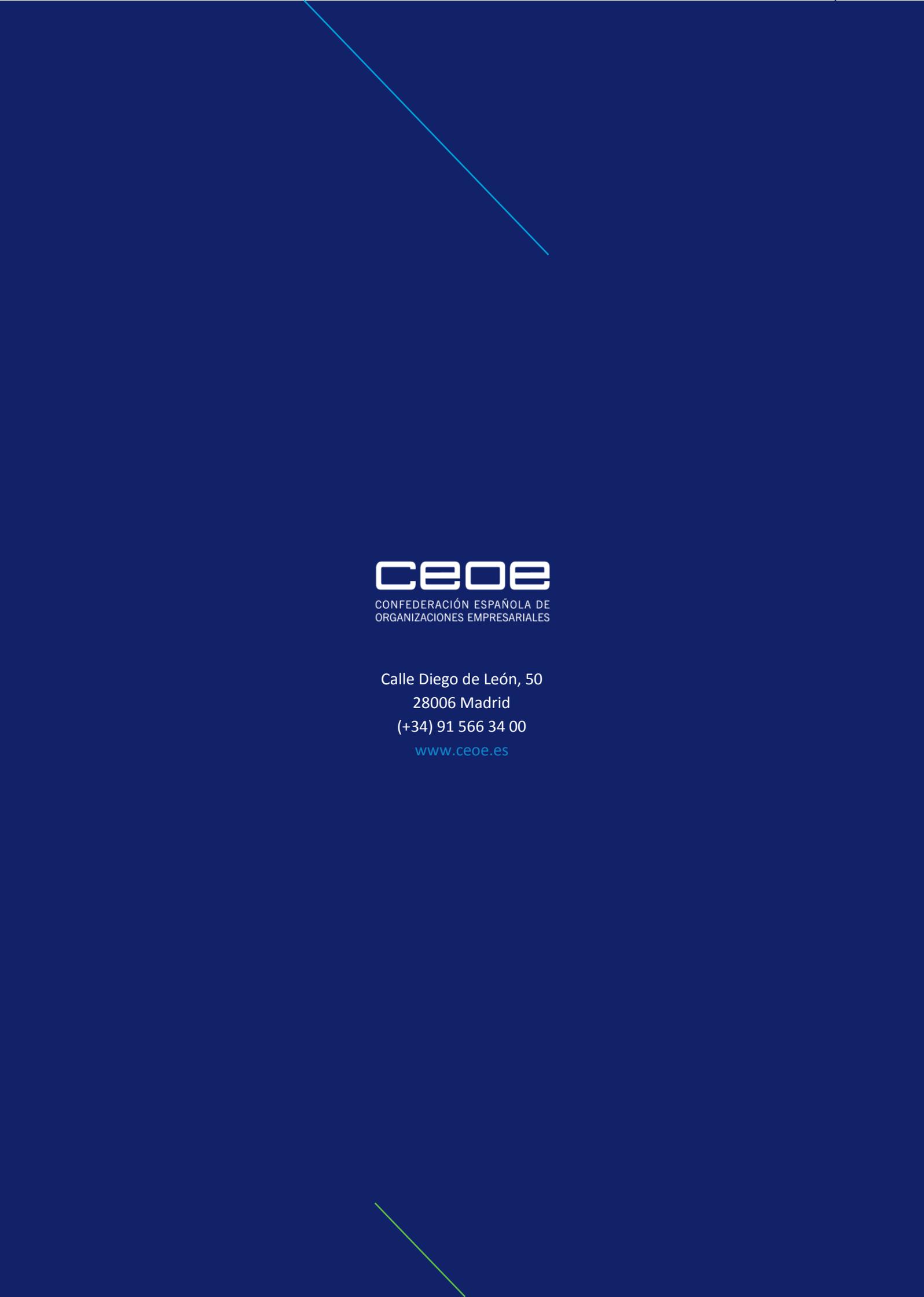


With these results, the economy's real growth reached 3.1% in 2017, two tenths less than in 2016. In addition, the composition of growth has been balanced, with a positive contribution from both, domestic demand and the external sector (2.8 pp and 0.3 pp, respectively). This progress has taken place within an improved international context and with interest rates at a minimum, which have enabled an on-going correction of macroeconomic imbalances: surplus in the balance of payments, containment of the public deficit and reduction of the unemployment rate.

The beginning of 2018 is also showing positive momentum according to data for the first quarter. In particular, the number of workers registered with the Social Security behaved very positively in February, with an increase of 81,483 individuals, which results in a slight increase of the year-on-year rate to 3.5%. In addition, over the last 10 years this is the second best figure for the month of February, following the figure posted in 2015. Meanwhile, tourism continued to perform well, with international tourists increasing by 5.2% year-on-year in January. Overnight stays in Spanish hotels also increased (2.3%) as did vehicle registration, which in the first two months of the year accumulated a 16.4% increase in comparison to the same period of the previous year. However, the consumer confidence indicator decreased from the peak levels reached in 2017. Thus, CEOE's activity indicator estimates quarterly GDP growth between 0.7% and 0.8%.

With this beginning of the year, our outlook for 2018 is moderately positive, with a GDP growth that could reach 2.8% and 2.6% in 2019, in which there will still be a current account surplus, albeit somewhat lower (around 1% of GDP). This growth trend will reflect on employment, with an increase in the number of people employed of around 900 thousand between both years and, consequently, a reduction in the unemployment rate, which could be set at 13.1% in 2019. Inflation forecasts point to a stable rate at around 1.2% for both 2018 and 2019, as long as there are no tensions in oil prices.

This scenario is subject to risks in both directions. The upside risks include, among others, a greater than expected impact of the measures adopted by the ECB on improving financial conditions; a higher than expected growth of the world economy, especially in Europe, which could boost our country's exports; and for the Government to resume the economic policies aimed at strengthening the competitiveness and productivity of the Spanish economy and, thereby, favouring the recovery cycle and employment. Among the downside risks, we must take into account the political uncertainty, especially the one associated with the Brexit process, with Catalonia and with the difficulties in passing the 2018 General State Budget. Another risk is the rise in oil prices, which would affect both, family disposable income and company costs, and harm our trade balance. And finally, the fact that interest rate hikes in the US may generate turmoil in international financial markets.



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