ECONOMIC OUTLOOK

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CONFEDERACIÓN ESPAÑOLA DE ORGANIZACIONES EMPRESARIALES

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The global context continues to show **a certain slowdown in some advanced economies**, although the most significant change is found in **emerging economies**, some of which run a true risk of halting their recovery process. The US monetary policy normalization and the subsequent appreciation of the US dollar, together with the fiscal and external imbalances still present in some emerging economies, have caused bouts of financial turmoil in certain countries. The clearest example can be found in **Turkey**, where the Turkish lira has depreciated close to 40% against the dollar so far this year because of the high current account deficit and its dollar debt. In addition, there has been a contagion effect to other countries, such as South Africa, India, Brazil, Russia and, particularly, **Argentina**, whose currencies have lost significant value in August following a trend that has actually been present since the beginning of the year[1].

In fact, the **IMF,** in its latest July forecast, reviewed downwards the growth estimation for Argentina, Brazil and India, as well as for Japan and the main European economies, including the United Kingdom. Specifically, **GDP was revised downward** by -0.1 points to 2.4% in 2018 for advanced economies, while for emerging economies as a whole the growth forecast remains at 4.9% for the current year, despite the worsening of the outlook in Latin America (-0.4 points to 1.6%). Thus, and as a new feature, we observe less synchronized growth among the different countries.

Increased risks worldwide have increased the degree of uncertainty in **financial markets**, which have registered significant volatility in the summer months, with generalized drops in the main stock markets, including the Spanish one. In the bond market, **Italy** is one of the countries that investors have punished the most, due to the announced budget policy, which could include a notable increase in public spending that would bring the deficit to levels above what Brussels considers acceptable. In fact, the 10-year bond traded at rates not seen since April 2014 (+ 3.2% at the close of this report), with the risk premium around 290 basis points (levels last seen in 2013). However, the contagion to the rest of peripheral countries has been, in general, very moderate. In the case of **Spain**, interest rates for the 10-year bond have gone up by 18 basis points so far this quarter, to 1.55%, while the German bond behaved as a safe-haven asset given the aforementioned conditions, and its IRR was set at levels similar to those posted the beginning of the quarter (+ 0.33%). In the **United States**, the slope of the curve continued to flatten, and the difference is now only 23 basis points between the 2-year bond and the 10-year bond (+ 2.8%).

In **Spain**, the economy is starting to show **signs of a slowdown in momentum** in some of the elements that had supported the current growth stage, such as the low price of raw materials, especially oil, the decline in inflation, the strength of our main trading partners and the remarkable dynamism of the domestic tourism sector. Nonetheless, there are certain factors that continue to favour growth, such as the greater number of people employed, which encourages consumption and investment, as well as good financing conditions.

The Spanish GDP posted a 0.6% quarterly growth rate in the second quarter, one tenth less than the previous quarter, while in year-on-year terms it fell three tenths to 2.7%. It should be noted that the composition has been less balanced, with domestic demand having increased its contribution to GDP by one tenth to 2.9 percentage points, while external demand subtracted two tenths within a context of a slowdown in trade flows with foreign markets, with tourism standing out.

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[1] *For more information, please see the box titled "Analysis of the vulnerability of the main emerging markets to the US monetary policy normalization."*

Within domestic demand, it is worth highlighting **the lower momentum in private consumption**, with a mere 0.2% quarterly increase, in clear contrast to the high growth rates of the previous quarters. It is still too early to venture whether this means a change in trend for this GDP component, bearing in mind that, starting in the third quarter, there will be an income increase in some groups, such as pensioners and civil servants, in addition to the possible effect of the application of the new Agreement for Employment and Collective Bargaining (AENC) on the wages within the private sector. On the other hand, we should highlight the new boost of productive investment and the behaviour of the construction sector, which consolidated its recovery in the second quarter, both in terms of activity and investment, ranking as the most dynamic sector of the economy.

The **slowdown** in activity in the second quarter was reflected in the **labour market**, as shown by the number of workers registered with the Social Security during this period. This loss of strength continued in July and August, with the latter month registering **its worst figure since 2008**, with 202,996 jobs lost. In sharp contrast, the second-quarter LFS surprised on the upside, with an increase in quarterly employment of 469,900 people, the highest in the historical series. However, we must bear in mind that this greater dynamism that emerges from the LFS comes to offset the less favourable results of the first quarter, even though the Holy Week landed in March this year. Thus, in the first half of the year, the number of people employed, according to the LFS, grew by 2.6%, a figure similar to the one recorded in the fourth quarter of 2017.

The **outlook for the economy**, although still positive, is surrounded by **significant uncertainty**, and thus growth is biased on the downside.

- Internally, the political risk in Catalonia, the current minority Government and the proximity of regional and local elections are, in the short term, issues that limit confidence and consumption and investment decisions. In addition, an expansive budgetary policy on expenditures has been announced, which, in a context of economic slowdown, creates uncertainty about the fulfilment of the budgetary objectives, both on the deficit and on the debt ratios. With expectations of a change in the ECB's monetary policy and of possible financial tensions, maintaining budgetary discipline should be a priority.

- Externally, we need to bear in mind that the interest rate hikes in the US are already generating turmoil in some emerging financial markets, which is negatively affecting growth forecasts and hindering capital flows to these countries. In addition, other possible risks include trade tensions and conflicts originating in the United States, the increase in oil prices and the Brexit.

Due to all these conditioning factors, **the forecast for the Spanish economy has been revised downwards. For 2018, GDP growth is estimated at 2.7% (2.8% previously) and for 2019 at 2.3% (2.6% previously).** Therefore, the forecast remains positive, but the expected slowdown is slightly higher for 2018 and more pronounced for 2019. Employment will continue to increase at a remarkable pace, with an expectation of 875 thousand jobs to be created in two years, which would bring the unemployment rate below 13% at the end of 2019. The external surplus is also expected to remain in place in 2018 and 2019, although it will be somewhat lower than in recent years, and inflation should register annual average rates below 2% both years.

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