ECONOMIC OUTLOOK

July 2019

- ***The world economy showed signs of deceleration in the second quarter.***
- ***Central banks changed their monetary policy bias, and are considering a return to expansionary measures.***
- ***The European Commission maintained the Eurozone's growth forecasts for the current year at 1.2% and lowered its 2020 growth forecasts by one tenth to 1.4%.***
- ***Oil prices contracted in June, following six months of increases, due to the growing prospects of a slowdown in the global economy.***
- ***In the second quarter, the Spanish economy continued to post a remarkable growth rate, supported mainly by the dynamism of domestic demand. Growth forecasts for 2019 improve slightly.***
- ***The number of workers registered with the Social Security reached an all-time high and stands at over 19.5 million people in June, although its year-on-year growth rate slowed down in the second quarter, being set at 2.8%.***
- ***Inflation decelerated to 0.4% in June, mostly due to lower prices in energy products and unprocessed foods.***

CONTENT:

European Commission forecasts (July 2019)

	GDP			Inflation		
	2018	2019	2020	2018	2019	2020
Eurozone	1.9	1.2	1.4	1.8	1.3	1.3
Spain	2.6	2.3	1.9	1.7	0.9	1.2
Germany	1.4	0.5	1.4	1.9	1.4	1.3
France	1.7	1.3	1.4	2.1	1.3	1.4
Italy	0.9	0.1	0.7	1.2	0.8	1.0
EU-27	2.1	1.4	1.6	1.8	1.5	1.5
United Kingdom	1.4	1.3	1.3	2.5	1.8	2.0
EU-28	2.0	1.4	1.6	1.9	1.5	1.6

Source: European Commission

INTERNATIONAL SCENE: the slowdown in the global economy follows through into the second quarter

In June, the performance of the world's main stock markets was positive, particularly the US ones, which benefited from the agreement on immigration with Mexico and the truce reached with China to resume trade negotiations. Stock markets have also benefited from rising expectations that central banks will take a more accommodative stance with their monetary policy, in light of the prospect that global activity may continue to slow down in the coming months.

In this regard, activity and confidence indicators being released show a slowdown in growth for the second quarter of the year, after the positive surprise of the first. The industrial sectors are the ones showing the strongest momentum decrease, with the June global manufacturing PMI standing at 49.4 points, the lowest level since October 2012 and pointing to a moderate contraction of activity in these sectors. In contrast, the services PMIs, although at somewhat more discrete values than a few months ago, remain clearly above 50 points and are the ones supporting the economy's growth.

Overall, advanced economies are expected to show a deceleration in their growth rates: in the European Union, due to the continued crisis in the automotive sector, mainly in Germany, and with political tensions in Italy, as well as uncertainty about the Brexit; in the United States, due to the loss of the fiscal stimulus effect and the decline in consumer confidence, affected by trade tensions; and in Japan, due to a slight decrease in its current account surplus.

As for emerging economies, China is expected to post slightly lower growth than in the previous quarter, while in Russia the June PMIs, both for manufacturing and services, have fallen below 50 points, which is a level that shows shrinking activity levels. Meanwhile, Brazil improved its PMIs in June and progress was made in reforming the pension system, although the economy's recovery is still very slow and a technical recession cannot be ruled out. In Mexico, growth is also losing momentum, affected not only by the lower dynamism of global activity but also by greater regulatory uncertainty and Pemex's debt problems.

Within this framework, the European Commission has updated its growth forecasts, keeping estimates for the Eurozone this year still at 1.2% and lowering those for 2020 by one tenth to 1.4%. The resilience of domestic demand stands out, while the external sector has suffered from the increase in trade tensions. It also points out that downside risks have increased, including geopolitical tensions in the Middle East, which could influence oil prices, new measures that could affect world trade, or the possibility of a no-agreement Brexit.

With this global economic slowdown backdrop, central banks have shown a change of bias in their monetary policies. The Federal Reserve, at its June meeting, kept interest rates unchanged within the 2.25% - 2.5% range, although it highlighted the increase in uncertainty and that it would closely monitor economic developments with the aim of supporting growth, job creation and inflation rates close to its 2% target. These statements have been interpreted by the markets as meaning that the next rate movement is likely to be downward and could even take place at the meeting being held at end of July.

Meanwhile, the ECB announced the conditions for a new liquidity round for banks, kept rates unchanged and pointed out that the institution is prepared to act in the event of adverse conditions, opening the door to activating a new bond purchase programme or bringing rates below 0%, if necessary.

The Bank of Japan and the Bank of England also left rates unchanged and continued their debt purchase programmes, with the former pointing out that it will maintain its ultra-expansive monetary policy, and the latter that decisions will depend on the timing of the country's exit from the EU and the final terms under which it leaves, as well as the response to this event shown by households, businesses and financial markets.

In June, oil prices broke their upward trend of the last six months, with Brent crude standing at $65.7 per barrel on average, 8.7% lower than in May and 11% lower than a year ago. In euros, the year-on-year decline is set at 7.9%, due to the stronger dollar. The decline in oil prices is mainly due to the growing expectations of a slowdown in the world economy, although other factors, such as tensions in the Middle East or the agreement reached by the OPEC+ countries to extend production cuts for nine more months, until March 2020, should push prices upwards.

THE SPANISH ECONOMY: slight improvement in growth expectations for 2019

According to the Bank of Spain and the European Commission, Spain's GDP could have increased by 0.6% in the second quarter, compared to the previous 0.7%. AIReF is somewhat more positive and points to an increase of 0.7% between April and June. It could be concluded, therefore, that the Spanish economy is still growing at a high rate so far in 2019, higher than its European partners in Q2, for which the European Commission expects a 0.2% quarterly growth rate.

The forecasts for the year as a whole indicate that the Spanish economy will grow at around 2.3%, according to the European Commission, almost double than the growth rate expected for the Eurozone (1.2%), within a context where, despite the improved outlook, the balance of internal and external risks continues to be clearly skewed downwards.

With regard to the correction of macroeconomic imbalances, it is worth noting the absence of inflationary pressures in the Spanish economy as a positive factor, as shown by underlying inflation, which has not exceeded 1% on average since the beginning of the recovery phase back in 2014. The European Commission's forecast points to an average CPI rate of 0.9% for 2019.

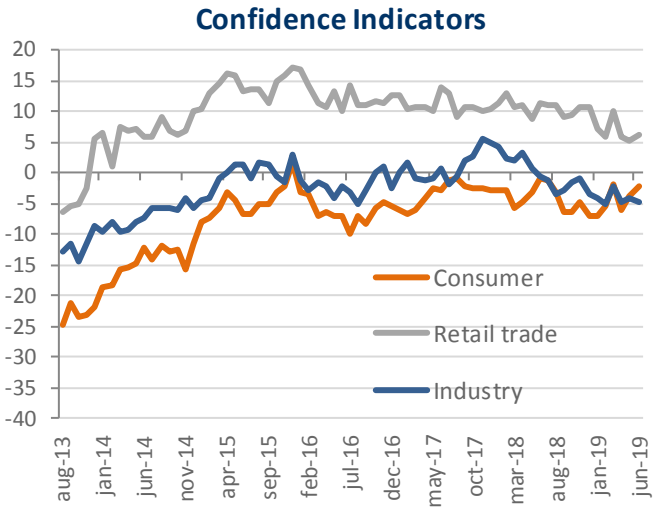
Perhaps the focus should be placed on the foreign sector, since the current account balance continued to decrease at the beginning of 2019 (€ -6 billion until April, compared to € -3.3 billion in 2018). This could change the growth pattern of the Spanish economy, which could go back to incurring in deficits that could hinder the reduction of our high foreign debt. In addition, the international trade war and higher costs are not contributing towards an improvement in the foreign balance.

Finally, it should be noted that the fiscal consolidation process is slowing down and the effort to reduce the public deficit could be lower in 2019 (around 0.4 percentage points to 2.2% of GDP).

DEMAND AND ACTIVITY: the economy continues to grow strongly in the second quarter

According to the information available, the Spanish economy could have recorded slightly lower growth in Q2 than in Q1 (0.6% vs. 0.7%). Domestic demand would continue to be driving the economy, although the external sector could also be showing an improved behaviour. The good performance of the labour market and lower inflation have maintained household and retail trade expectations at very positive levels, even the component related to large purchases, despite the low savings rate, is posting highly favourable levels. However, some indicators, such as the retail trade index or the domestic sales of large companies, have slowed down in comparison to Q1. The number of car registrations is still the one element that shows the worst evolution, although in Q2 the fall was lower than in Q1, as a result of the positive figure for April.

In relation to investment, and despite the progress recorded in the previous quarter, the increase in uncertainty at a global and domestic level is causing indicators for Q2 to show some deterioration in expectations among the different sectors, especially in the case of construction and industry. The available indicators are still very scarce, in many cases only the April figure has been released, and no clear trend can be seen. Some, such as the industrial production index or the turnover figure, are slowing down, while incoming orders show a considerable upturn. From the point of view of the external sector, following a fairly negative first quarter, exports of goods grew at a good pace in April, 3.8% in nominal terms (1.2% in volume), while imports fell by -2%. (6.3% in volume). On the other hand, according to the Balance of Payments, in the first four months of the year the current account deficit practically doubled, mainly due to a less positive balance in the balance of goods and services.



Source: European Commission

CEOE
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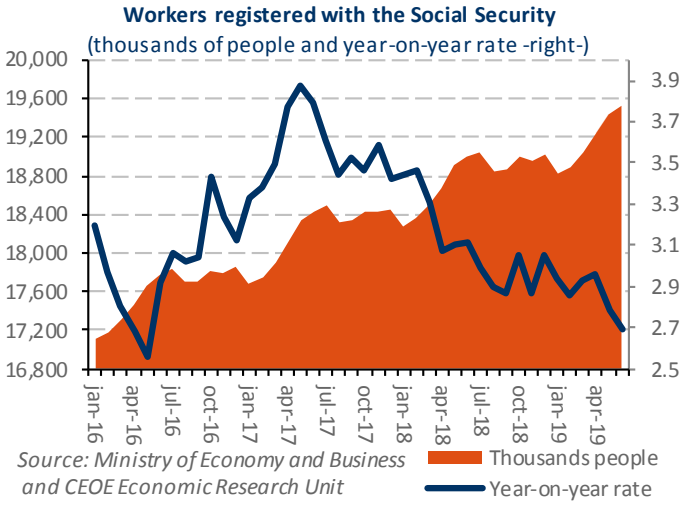
THE LABOUR MARKET: the rate of growth of the number of people registered with the Social Security slowed down one tenth in the second quarter

The number of people registered with the Social Security increased by 75,584 in June, the smallest increase for this month since 2015. The increase is even lower (+64,184) if we exclude non-professional carers. Even so, the total number of people registered with the Social Security exceeds 19.5 million people, an all-time high. In year-on-year terms, contributors grew by 2.7%, one tenth less than in May. In Q2, the rate was 2.8%, also one tenth less than in Q1, which indicates that the gradual slowdown in the number of workers registered is continuing this year.

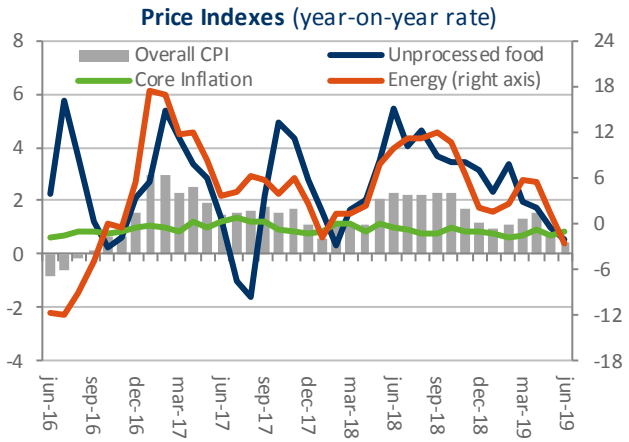
According to the Quarterly Labour Cost Survey, the labour cost per worker per month accelerated its year-on-year growth rate to 2.1% in Q2 (previous 0.9%). The cost of wages as well as the other costs rebounded in this period, up to 1.7% and 3.1%, respectively.



Source: Ministry of Economy and Business and CEOE Economic Research Unit

PRICES: inflation decelerated in June due to falling energy prices

In June, the year-on-year CPI fell four tenths to 0.4%, mainly due to the decline in the price of energy products, in contrast with the increases seen the previous year. This id coupled with a slower rise in the price of unprocessed foods. Core inflation stood at 0.9%, due to the increase in prices of its Services component, especially tourist services (tourist packages, accommodation and restaurants...), while the rest of its components continue to register very contained rates. Inflation is expected to remain below 1% in the coming months, due to the fact that the energy component will continue to show negative changes and supported by very subdued core inflation.



Source: INE

THE PUBLIC SECTOR: the State public deficit increased up to May due to the increase in expenditures and the weakness in revenues

The State accumulated a public deficit of -1.2% of GDP until May, 0.04 percentage points higher than in the same period in 2018. This greater fiscal imbalance on the part of the State is explained by the 2.4% increase in expenditure, vs. the moderate rise in revenue of 1.3%.

The increase in pensions and in the wages of civil servants, coupled with electoral expenses, all of them inexistent in 2018, explain the evolution shown by expenses. However, it should be noted that the rate of growth slowed down in May, compared to the notable growth in the initial months. Other items have also increased, such as the contribution to the EU (17.5%) and current transfers to other public administrations (4.2%). On the other hand, interest expenditure (-4%) and investment (-13.2%) fell.

On the revenue side, it is worth noting the stability of tax resources (0.3%) until May, but with clear differences by the type of tax. Thus, VAT (3.2%), Hydrocarbon Tax (8.2%) and Personal Income Tax (1.3%) increased, while Corporate Income Tax (-9.3%) decreased.

If we consider the Public Administrations as a whole until April, excluding Local Governments, the deficit stands at 0.6% of GDP, compared to 0.5% of GDP for the same period in 2018.