ECONOMIC OUTLOOK

April 2018

- ***Higher risk of a trade war between the US and China, following the rise in tariffs between both countries.***
- ***The world economy is still growing at a healthy pace. The IMF increases growth for 2017 to 3.8% and sets estimations for 2018 and 2019 at 3.9%.***
- ***The Federal Reserve raises interest rates in March to the 1.5% -1.75% range, and at least two additional increases are expected throughout the remainder of the year.***
- ***The Government raises its GDP growth forecast to 2.7% in 2018.***
- ***The State budget for 2018 is expansionary in social spending.***
- ***The public deficit goal of -2.2% of GDP for 2018 seems difficult to attain, due to the fiscal consolidation effort it would require from the Central Government.***
- ***The labour market continued to show great momentum in the first quarter: the number of people registered with the Social Security grew at an annual rate of 3.4%, one-tenth less than in the last quarter of 2017.***
- ***Spain's rating has been revised upward by Moody's, from Baa2 to Baa1, still one notch below Standard & Poor's and Fitch's rating.***

CONTENT:

IMF growth forecasts (April 2018)

	IMF			dif. from Jan.		dif. from Oct.	
GDP (year-on-year rate)	2017	2018	2019	2018	2019	2018	2019
World growth	3,8	3,9	3,9	0,0	0,0	0,2	0,2
United States	2,3	2,9	2,7	0,2	0,2	0,6	0,8
Japan	1,7	1,2	0,9	0,0	0,0	0,5	0,1
Euro Area	2,3	2,4	2,0	0,2	0,0	0,5	0,3
Germany	2,5	2,5	2,0	0,2	0,0	0,7	0,5
France	1,8	2,1	2,0	0,2	0,1	0,3	0,1
Spain	3,1	2,8	2,2	0,4	0,1	0,3	0,2
Italy	1,5	1,5	1,1	0,1	0,0	0,4	0,2
United Kingdom	1,8	1,6	1,5	0,1	0,0	0,1	-0,1
Advanced economies	2,3	2,5	2,2	0,2	0,0	0,5	0,4
Emerging economies	4,8	4,9	5,1	0,0	0,1	0,0	0,1
China	6,9	6,6	6,4	0,0	0,0	0,1	0,1
World trade	4,9	5,1	4,7	0,5	0,3	1,1	0,8

Source: IMF

INTERNATIONAL SCENE: hike of tariffs between the United States and China

The global stock markets had a negative behaviour during the month of March, marked by the elections in Italy, the Brexit negotiations, the rate hike by the Federal Reserve and tariff tensions between the United States and China.

With regards to the Brexit negotiations, it is worth noting that the United Kingdom and the European Union have agreed to establish a transitional period of 21 months once the United Kingdom leaves the EU on March 29, 2019. The transitional period will be extended until December 31, 2020, and will enable further negotiations on the future relationship between the parties.

Meanwhile, on March 8, the United States approved to increase tariffs on steel imports to 25% and on imported aluminium to 10%, initially exempting imports from Mexico and Canada. Subsequently, imports from other trading partners, such as the European Union, Australia, Argentina, Brazil and South Korea, have also benefited from the exemption, with China being the main country affected by these measures.

These decisions came hand-in-hand with a whole array of tariffs on Chinese imports to the United States, with the aim of counteracting the high trade deficit between the two countries. In addition, the United States accuses the Asian country of not respecting intellectual property rights of US technological companies. On the other hand, China has also responded with new tariffs to a series of American products and complaints to the World Trade Organization. This situation has led to increased fear of an escalation of the tariff hikes that could end up in a trade war between the two main world economies.

However, despite these tensions and the protectionist risks involved, global activity continues to show a positive behaviour, although in March there was a slight decline in the overall composite PMI. In spite of this, advanced economies continue posting strong growth figures, favoured by the very lax financial conditions that persist in most countries. In addition, oil prices remain at moderate levels, and emerging countries such as Russia and Brazil are showing recovery signs, coupled with greater dynamism in India. Also, China activity rate remains stable and its foreseen slowdown is delayed for the time being.

Within this context, the IMF presented its World Economic Outlook report in mid-April, raising the world growth rate in 2017 to 3.8%, one tenth more than the previous number, and maintaining that it expects a smooth acceleration up to 3.9% in both 2018 and 2019, supported by the greater dynamism of world trade and a rebound in investment. However, although the risks are balanced in the short term, the IMF points out that, for the medium term, risks on the downside are predominant. These include the possibility of a drastic tightening of financial conditions as monetary policies are normalized, possible increases in trade tensions and changes towards protectionist policies, or an increase in geopolitical tensions, among others.

With regard to central banks, it is worth highlighting the new rate increase implemented by the US in March, with rates being set between 1.5% and 1.75%, thus continuing the normalization process initiated in December 2015. The Federal Reserve is expected to implement at least two additional increases throughout the current year, while continuing to reduce its balance. Meanwhile, other central banks, such as the ECB, the Bank of England or the Bank of Japan, maintained their monetary policies and asset purchase programs unchanged.

Meanwhile, in March, oil prices went up slightly in comparison to February, with Brent crude standing at $66.0 per barrel on average. In April, the price has continued to rise to over $70 per barrel in the second week. Reasons that contributed to the price increase included renewed tensions in the Middle East, which were partially offset by the March OPEC report, where expected crude oil supply from non-OPEC countries was revised upwards, specially from the United States. In year-on-year terms, the price increase was remarkable, 28.6% more than in March 2017, although in euros the increase was 11.4% due to the appreciation of this currency against the dollar over the past year.

THE SPANISH ECONOMY: upward revision of the Government's forecasts for 2018

The outlook for the Spanish economy is positive for 2018. The Government, in its presentation of the State Budget for 2018, estimates a 2.7% increase in GDP in 2018, in line with the consensus estimations among analysts and the Bank of Spain. It should be noted that the growth of the Spanish economy is expected to remain balanced (domestic demand should continue to grow at a slower pace, while the contribution of the foreign sector to GDP should be positive for the third consecutive year), there will be no inflationary tensions (private consumption deflator set at 1.4%) and the net lending will remain at around 1.8% of GDP. Within this scenario, the prospects for the labour market in 2018, with an expected creation of 475,000 jobs in terms of the LFS, are reasonable, as is the fall in the unemployment rate, which may reach 15% at the end of the year.

The factors that support the dynamism of the Spanish economy are diverse. Among them, a prosperous international context, with a new rebound in the growth of the global economy and world trade. Also, the economic policy mix is expansionary. On the one hand, financing conditions will continue to be very favourable due to the stability of the ECB's monetary policy. On the other hand, fiscal policy is clearly expansionary in social spending, according to the State Budgets. The achievement of public deficit goal of –2.2% of GDP for 2018 is based on a difficult balance where non-financial expenditure increases by 3% and tax collection is overestimated, whose level could exceed that of 2007, where the historical highs were reached.

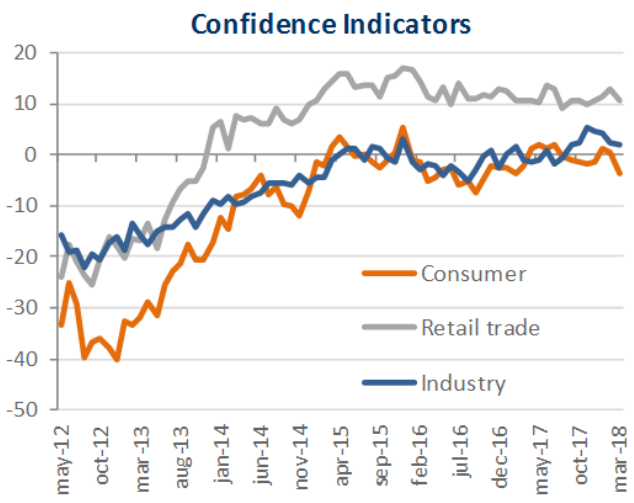
Finally, Spain´s rating has been revised upward by Moody´s from Baa2 to Baa1, still one notch below Standard & Poor´s and Fitch´s rating. Both agencies have also upgraded the Spain´s rating in recent months.

DEMAND AND ACTIVITY: the economy could accelerate in Q1

The Spanish economy closed 2017 with significant growth (a quarterly 0.7% in Q4). With this figure, growth for the whole of 2017 was set at 3.1%, a rate above 3% for the third consecutive year. It is worth pointing out that in the latter part of the year there was a decrease in the positive contribution of the foreign sector while domestic demand continued to show strong momentum, both in consumption and in investment.

The favourable evolution of the Spanish economy, together with lower uncertainty with regards to the political situation in Catalonia, is leading national and international institutions to revise upwards their forecasts for the Spanish economy in 2018. Thus, the IMF, on April 17, published its new forecasts, with expected growth for Spain increasing by four tenths up to 2.8%, in line with CEOE's forecasts and above the Government's forecasts.

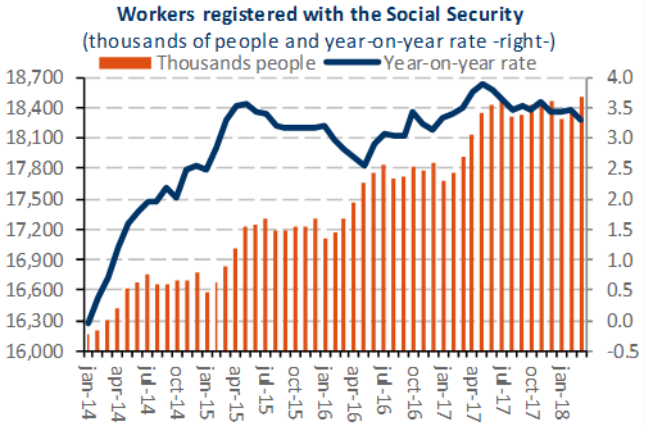
In the first months of 2018, the indicators continued to show very positive progress, and therefore, growth for the Spanish economy could continue and even accelerate in Q1 (forecasts point to a quarterly increase of 0.8%). Expectations have shown a more favourable behaviour. Thus, the consumer confidence indicator registered a significant improvement in January and February, although it worsened again in March due to less favourable expectations on employment and the economy in general, even though, on average, expectations are more positive than in Q4. In addition, the confidence indicators for the retail and service sectors broke the downward trend they had been showing and increased in Q1, with the construction confidence indicator posting the most drastic improvement. Moreover, the international scenario is also positive, with exports expected to continue growing at a good pace at the beginning of 2018 and boosting industrial activity and employment.



Source: European Commission

THE LABOUR MARKET: job creation remains high in Q1, with a 3.4% y-o-y growth rate in the number of workers registered with the Social Security

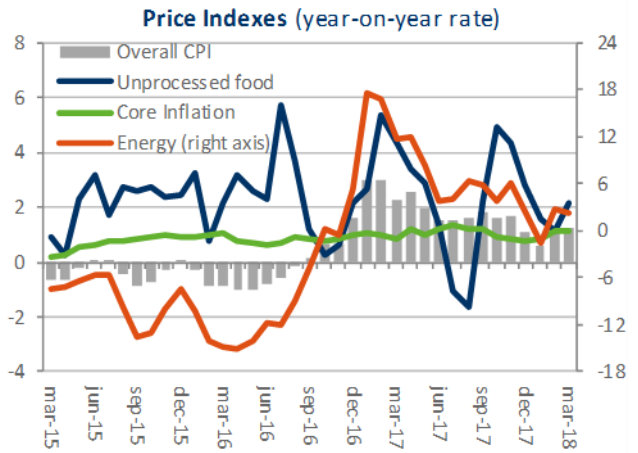
In March, the number of workers registered with the Social Security increased by 138,574, a lower figure than the one registered for this same month in 2017. Agriculture, industry and construction all registered in March a less favourable evolution than in the same month of the previous year. However, the services sector has reflected the boost from the Accommodation and food services activities over the Easter break. Thus, the total number of people registered with the Social Security exceeds 18.5 million for the first time since December 2008. In year-on-year terms, the number of contributors slowed down by two tenths, to 3.3%. Nevertheless, for Q1, job creation remained high, with a year-on-year rate of 3.4% in terms of Social Security contributors, only one tenth lower than in the previous



Source: Ministry of Economy, Industry and Competitiveness and CEOE Economic Research Unit

PRICES: inflation rebounds up to 1.2% due to the acceleration of core inflation and prices for non-processed foods

In March, the y-o-y CPI rate increased by one tenth to 1.2%. Core inflation also increased one tenth to 1.2%, which is in line with the headline CPI. This evolution was mainly due to the increase in the price of tourist packages and accommodation services, influenced by the Easter season effect, which fell in March this year (whereas in 2017 it fell in April). In addition, the prices of non-processed foods went up by 1.6% y-o-y, posting a strong rebound from the 0.3% recorded in February. However, if we analyse the components of core inflation, we can see that, had it not been for the Easter effect, there would have been a moderation in core inflation. This will be transferred to the month of April, when a slowdown in the headline inflation is expected.



Source: INE

THE PUBLIC SECTOR: the public deficit goal was met in 2017 and the budget for 2018 is expansionary

The public deficit of all the Public Administrations closed 2017 within the forecasted goal, -3,1% of the GDP, which brings us closer to the GDP level marked by the EU to initiate our exit from the excessive deficit procedure (budget balance somewhat below -3% of GDP).

The State Budget for 2018 falls within the framework of a budget consolidation policy, whereby a new decrease in the public deficit is set as a goal. The Government estimates that in 2018 the public deficit of all the public administrations will be -2.2% of GDP. When broken down by tiers, the largest cut should be made by the Central Administration, which is expected to reduce its negative balance of -1.9% of GDP in 2017 to -0.7% of GDP in 2018, more than a 50% cut, which a priori seems very difficult to achieve given the results of recent years at this level of the Public Administration.

Meanwhile, the Social Security Funds will be the Public Administration tier with the largest deficit in 2018 (-1.1% of GDP). It is expected that the Regional Governments will slightly increase their deficit to -0.4% of GDP and Local Administrations will go from a surplus to a balanced budget.