# ECONOMIC OUTLOOK

*July 2018*

- ***The forecasts for the Spanish economy remains unchanged at 2.8% of GDP in 2018, according to the consensus from national analysts. The European Commission agrees with this forecast by revising its prior estimation down by one-tenth (2.9%).***
- ***The Government announced it will not meet the deficit targets for 2018 y 2019, established at -2.2% and -1.3 of GDP, respectively. The new objectives are set at -2.7% of GDP for this year and -1.8% for 2019, which implies a delay in the fiscal consolidation process.***
- ***The Ministry of Finance announced the adoption of a package of tax measures still to be defined in detail but that would include a corporate tax hike, the introduction of new taxes on financial transactions and technological companies and a modification of energy taxes with increased taxes on diesel fuel. These announcements are creating uncertainty, with the business sector fearing a loss of competitiveness, as well as legal insecurity.***
- ***The number of workers registered with the Social Security exceeded 19 million people in June for the first time in ten years, although its annual rate of growth slowed down in the second quarter, standing at 3.1%.***
- ***Inflation rebounded up to 2.3% in June due to the increase in the price of energy products and unprocessed foods.***
- ***The global economy is still posting solid growth, although the risks on the downside are on the rise.***
- ***The US increased commercial tensions with China and other partners, including the European Union.***

## CONTENT:



**European Commission forecasts (July 2018)**

| | GDP | | | Inflation | | |
|---|---|---|---|---|---|---|
| | 2017 | 2018 | 2019 | 2017 | 2018 | 2019 |
| Eurozone | 2.4 | 2.1 | 2.0 | 1.5 | 1.7 | 1.7 |
| Spain | 3.1 | 2.8 | 2.4 | 2.0 | 1.8 | 1.6 |
| Germany | 2.2 | 1.9 | 1.9 | 1.7 | 1.7 | 1.8 |
| France | 2.2 | 1.7 | 1.7 | 1.2 | 1.9 | 1.5 |
| Italy | 1.5 | 1.3 | 1.1 | 1.3 | 1.4 | 1.6 |
| EU-27 | 2.6 | 2.3 | 2.1 | 1.6 | 1.8 | 1.8 |
| United Kingdom | 1.7 | 1.3 | 1.2 | 2.7 | 2.6 | 2.0 |
| EU-28 | 2.4 | 2.1 | 2.0 | 1.7 | 1.9 | 1.8 |

*Source: European Commission*

# INTERNATIONAL SCENE: greater commercial tension between the United States and China

During June, the evolution of the main stock markets has been mostly negative and conditioned by the decisions from central banks, the uncertainty about Europe's migration policy and the growing commercial tensions between the United States and China, as well as the Brexit negotiations in the United Kingdom. All this has led to an increase in volatility.

Nonetheless, the world economy remains remarkably dynamic, despite the slowdown in advanced economies during the first quarter, which is expected to improve in the second quarter. On the other hand, the main emerging economies are posting a good performance, with strong growth in India and Turkey and even in China, despite the mild slowdown in this country's activity, although other countries such as Brazil are posting more modest results.

For the second quarter, the global composite business sentiment index for June improved by two tenths and indicates a slight increase in the economy's rate of growth, although, once again, there are differences across the regions. Higher activity is expected from advanced economies in the second quarter, while the PMI indices show a more uneven behaviour among emerging economies, pointing to a certain deceleration in Russia and Brazil, and a greater dynamism in India.

Meanwhile, the European Commission has revised the growth forecast for both, the EU and the Eurozone, downwards by two tenths to 2.1% for the current year and 2% in 2019, as a result of the slowdown seen in the first part of the year and the impact that increased commercial tensions and higher energy prices may have. However, despite this slowdown in growth, it considers that the foundations are still solid and that there are factors that continue to drive activity such as the improvement of the labour market, the lower indebtedness of households, an accommodative monetary policy and high consumer confidence levels. Nonetheless, it should also be noted that the downside risks to global growth have increased, mainly in the geopolitical front and with the growing trade restrictions, together with the change in tone that is taking place in monetary policy.

In this regard, in June, the main central banks took new steps towards normalizing their monetary policy, albeit at very different paces. On the one hand, the Federal Reserve hiked its interest rates again by a quarter of a point, to the interval between 1.75% and 2%, which marks the second increase this year, while it anticipated two additional increases for the remainder of 2018. In contrast, the ECB kept interest rates unchanged, although it announced a reduction in its asset purchase program, from €30 billion to €15 billion per month from October to December, and the subsequent termination of the program.

In the meantime, trade tensions between the United States and China and other countries continue escalating and there is increased risk of a large-scale trade war that could negatively affect global growth. The US Government reintroduced economic sanctions on Iran and Russia, as well as a tariff hike on the EU and China. The United States imposed tariffs of 25% on a series of goods imported from China worth $34 billion and, in turn, the Asian country answered with tariffs on American products for the same amount. Subsequently, the US government announced new tariffs of 10% on imported Chinese products worth $200 billion and China responded with new demands before the WTO and said it will adopt the appropriate countermeasures.

With regards to oil prices, June saw a break of the upward trend followed over the past few months, with Brent crude pulling back 5.1% in comparison to May, following the agreement adopted by OPEC and other producers, including Russia, to increase production from July onwards. Although the agreement does not specify by how much, the increase could amount to a further 800,000 barrels a day, which would partially offset the production problems in Venezuela and Libya. Nonetheless, the price of Brent crude remains high, with the average for June being set at $73.8 per barrel, the second highest since November 2014 and just behind the price reached in May. In comparison to a year earlier, the price has increased by 60.8% in dollars and 54.5% in euros.

# THE SPANISH ECONOMY: new fiscal consolidation path, tax hikes and new Agreement for Employment and Collective Bargaining

The Spanish economy continued to grow at a healthy pace in the second quarter at a quarterly rate of around 0.7%. The Funcas Panel consensus kept its GDP forecast for 2018 unchanged at 2.8%, and no changes are foreseen for 2019 either (2.4%). These forecasts agree with those published by the European Commission in July, although the latter has lowered its growth expectations for 2018 by one tenth, compared to its previous forecast of 2.9%.

In addition, the Government said it will not be able to meet the public deficit targets for 2018 and 2019 of -2.2% and -1.3% of GDP respectively, setting the new goals at -2.7% of GDP for this year and -1.8% for 2019. In addition, the Ministry of Finance has announced the adoption of a package of tax measures still to be defined in detail, but that will imply a rise in corporate taxes, the creation of new taxes on financial transactions and technological companies and a modification of energy taxes with higher taxes on diesel fuels. All of this is creating uncertainty, with the business sector fearing a loss of competitiveness, as well as legal insecurity, and it will likely lead to a decrease in investment and a slowdown in unemployment reduction, although it is right now impossible to estimate the actual impact it will have.

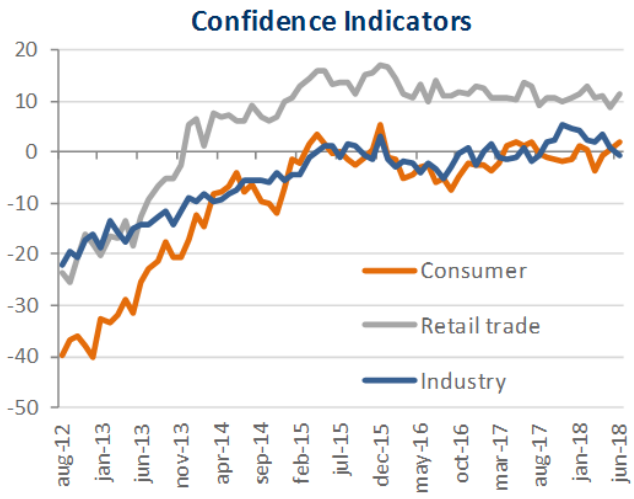
On the other hand, it is worth noting the signing by CCOO, UGT, CEOE and CEPYME of an Agreement for Employment and Collective Bargaining (AENC, for its Spanish acronym) for 2018, 2019 and 2020, which establishes the framework for collective bargaining. In terms of wages, the agreement contemplates an increase of around 2% for each of the years in which it will be in force, with a possible additional 1% based on variables such as productivity, profits or absenteeism, depending on the terms that each specific sectoral/ company agreement may determine. Therefore, in line with the economy's improvement, wages are on the rise and sufficient flexibility is granted so that each sector is able to adapt these higher labour costs to its specific economic situation.

# DEMAND AND ACTIVITY: the economy keeps growing, driven by employment and the recovery in the real state sector

The Spanish economy continued to show remarkable dynamism during the second quarter, with growth rates similar to those registered in the first quarter and, thus, Spain still stand outs as one of the countries with the highest growth in the Eurozone. Favourable financial conditions, gains in competitiveness and the high rate of job creation are sustaining growth and enabling us to continue correcting the economy's imbalances.

According to the available data, consumption continued its positive evolution during the second quarter thanks to the favourable performance of the labour market. Consumer confidence recovered strongly in May and June, after having dropped in March and April, mainly due to an improvement in the general and household economy expectations, although expectations on savings continue to be negative. Car registrations are still growing at a good pace, although rates are slightly lower than the double digits recorded in previous quarters, and domestic sales by large companies showed higher growth.

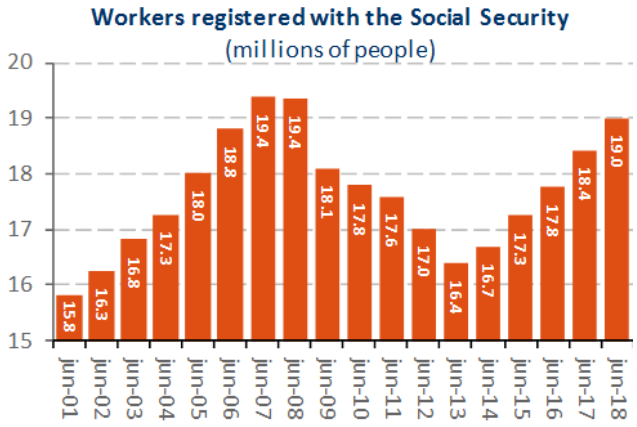
Following the significant slowdown in investment in capital goods seen in the first quarter, data for the second one is still insufficient and does not show a clear trend. IPI for capital goods shows a similar evolution, order entries are slightly up and the industrial climate indicator for investment goods is slightly down. We will need to keep a close eye on the evolution of these indicators. On the other hand, the real estate market continues evolving favourably. Home sale/purchases grew by 13% year-on-year in the first five months, which is also reflected on an increase in prices. In the coming months, the construction sector will continue to contribute very positively to the growth of the economy.




*Source: European Commission*

## THE LABOUR MARKET: the number of workers registered with the Social Security slowed its year-on-year rate of growth in the second quarter, down to 3.1%

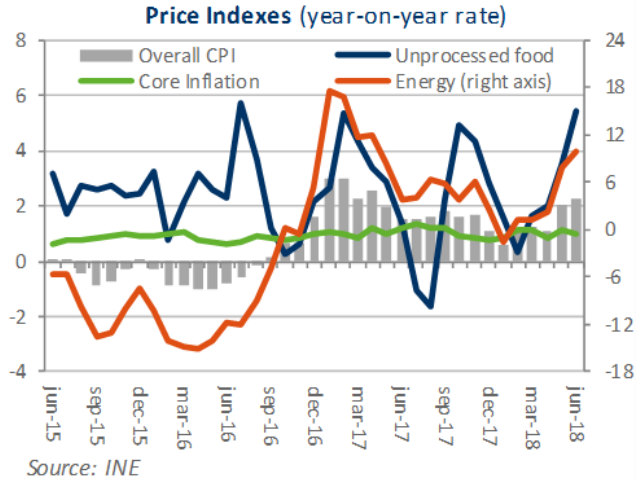
The number of workers registered with the Social Security increased by 91,322 in June, the second best figure for this month in the historic series since 2006. By sectors, the number of workers registered with the Social Security grew across all sectors, except in agriculture. It is worth highlighting the increase in the services sector, with almost 76,000 new contributors, of which more than 67,000 are in the trade and in the accommodation and food service activities. The total number of workers registered with the Social Security exceeds 19 million for the first time since September 2008. In year-on-year terms, the number of contributors grew by 573,884 people (3.1% for the third consecutive month). Therefore, the second quarter posted an increase of 3.1%, three tenths less than the first one.



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

## PRICES: inflation increases to 2.3% due to the price of energy products and unprocessed foods

In June, year-on-year CPI increased by two tenths to 2.3%, mainly due to the increase in energy prices (fuels and lubricants as well as electricity and heating oil) and in the Foods and non-alcoholic beverages segment, in which the increase in the price of fruit stands out. Core inflation decreased one tenth to 1.0%, with its components continuing to register contained evolution in prices. Oil price currently stands at $75 per barrel, still significantly higher than the previous year, which impacts on the price of energy products. This could keep inflation a few tenths above 2% in the next few months, although the annual average should be around 1.6%.



*Source: INE*

## THE PUBLIC SECTOR: the budget execution until may points to strong momentum in the collection of direct taxes

Data on the execution of the State budget until May indicates that there has been a deficit reduction in comparison to the same period in 2017 by 0.2 points to 1.2% of GDP. It is important to highlight the strength of resources derived from taxes (7.4%), due to the dynamism in the collection of Corporate Taxes (10.6%) and Personal Income Taxes (12.9%). In addition, non-financial uses continued to grow at a good pace until May (5.1%), with a larger contribution to the EU (15.9%) and an increase in transfers to the regions (Autonomous Communities) due to higher advance payments on account. Another aspect to note is the increase in expenditure on gross fixed capital formation to €3.669 billion, compared to €1.785 billion in the same period in 2017.

With data until April, the deficit for the whole of the Central Administration, the Social Security Funds and the Autonomous Communities was 0.6% of GDP, two tenths less than for the same period in 2017. The effort to keep the budget balance at bay falls on both the Central Administration and the regional governments of the Autonomous Communities, while the Social Security Funds are still running a small surplus. However, it is worth noting the announcement that the public deficit target for this year (-2.2% of GDP) will not be met, and the actual figure will stand at -2.7% of GDP.