ECONOMIC OUTLOOK

February 2017

- ***The latter months of 2016 showed signs of improvement in the world economy, as supported by the first indicators being published in 2017.***
- ***Forecasts from the European Commission and the IMF point to an acceleration in global growth for 2017, which will consolidate in 2018, although they point out the great uncertainty surrounding this outlook.***
- ***The Spanish economy will close 2016 with a growth of 3.2%, the same rate as in 2015, posting, in addition, a more balanced growth due to the more restrained behaviour of imports in comparison to other recovery phases.***
- ***The first indicators available for 2017 on the expectations of agents and sectors point to strong momentum in the Spanish economy at the beginning of the year.***
- ***The unemployment rate fell to 18.6% in the fourth quarter of 2016, the lowest since 2009. Meanwhile, the number of workers registered with the Social Security started 2017 on a positive trend, with a recovery of its rate of growth to 3.3% in January.***
- ***Inflation rose significantly in January (3%) due to higher fuel and lubricant and electricity prices.***
- ***Estimations for the Spanish economy in 2017 are still pointing towards a slowdown. The European Commission forecasts a GDP growth of 2.3% for 2017 and 2.1% for 2018.***

Growth forecasts. IMF (January) and European Commission (February)

	IMF				European Commission		
GDP (y-o-y rate)	2015	2016	2017	2018	2016	2017	2018
WORLD	3.2	3.1	3.4	3.6	3.0	3.4	3.6
United States	2.6	1.6	2.3	2.5	1.6	2.3	2.2
Japan	1.2	0.9	0.8	0.5	0.9	1.0	0.5
Euro Area	2.0	1.7	1.6	1.6	1.7	1.6	1.8
Germany	1.5	1.7	1.5	1.5	1.9	1.6	1.8
France	1.3	1.3	1.3	1.6	1.2	1.4	1.7
Spain	3.2	3.2	2.3	2.1	3.2	2.3	2.1
Italy	0.7	0.9	0.7	0.8	0.9	0.9	1.1
United Kingdom	2.2	2.0	1.5	1.4	2.0	1.5	1.2
China	6.9	6.7	6.5	6.0	6.7	6.4	6.2
Advanced economies	2.1	1.6	1.9	2.0			
Emerging economies	4.1	4.1	4.5	4.8			
World trade	2.7	1.9	3.8	4.1			

Source: IMF and European Commission

CONTENT:

INTERNATIONAL SCENE: moderate improvement of the global economy

In January, stock markets showed high volatility, with mixed results, influenced by the generally positive macroeconomic data posted in Europe, but also by the uncertainty created by the upcoming US economic policy measures and by how the UK's exit from the European Union is going to be managed.

As for the main central banks, they all kept their monetary policies unchanged at their meetings in January and early February. The Federal Reserve highlighted the improvement in the US labour market, but did not give indications as to when the next rate hike may take place. Most analysts believe this could happen in June. Meanwhile, the ECB reiterated its intention of maintaining its asset purchase program at least until December of 2017, reducing its monthly volume from April onwards from €80 billion to €60 billion. Likewise, the Bank of England and the Bank of Japan left their interest rates and bond purchase programs unchanged.

Meanwhile, the world economy continues to improve, albeit at a moderate and uneven pace among countries. In the Eurozone, GDP growth in the fourth quarter was set at 0.5% on a quarterly basis (one tenth higher than in the previous quarter) maintaining the year-on-year rate at 1.8% (0.1 percentage points higher than the 2016 average, which stands at 1.7%). In the United States, growth for the fourth quarter was also set at 0.5% on a quarterly basis (1.9% year-on-year), lower than in the third quarter, which was exceptionally high, but better than in the fist half of the year. Thus, the average annual growth rate was set at 1.6%. In addition, in China, growth accelerated slightly in the fourth quarter, posting a yearly rate of 6.7%. In contrast, other economies have seen a slowdown in activity, as in the case of Mexico or Turkey, which have been affected, by US politics in the first case, and, by problems in the tourism industry in the second one. Other countries continue to be immersed in a recession, such as Brazil or Argentina.

January's confidence indicators also reflect this overall improvement in activity, with the Eurozone's economic sentiment index at its highest level since March 2011. Manufacturing PMI indices show a positive behaviour of the economy for the United States and for the Eurozone, and Russia is showing signs of significant recovery, posting its best data in nearly 6 years. In contrast, India experienced a loss of momentum and Brazil continued to show signs of a contracting economy. Overall, global manufacturing PMI for January remained at the same level as in December, when it reached its maximum value in the last 34 months.

In this context, the IMF updated its projections for the global economy. Despite the improvement in activity in the second part of the year, growth in 2016 will be set at 3.1%, one tenth lower than in 2015. However, the IMF does foresee this recovery extending to 2017 and 2018, with growths of 3.4% and 3.6% respectively. The institution maintained the forecasts it published last October, although it slightly modified their composition by improving estimations for advanced economies by 0.1 and 0.2 percentage points for 2017 and 2018, respectively, and subtracting 0.1 percentage points from the growth of emerging and developing countries in 2017. Nonetheless, they pointed out the high level of uncertainty prevailing, mainly in relation to the direction in which the US government's policies will gear and their subsequent international ramifications.

The European Commission also published its winter forecast report, where it estimates that the global economy will gain momentum in 2017 and 2018, although they highlight that the level of uncertainty is high. They expect a fiscal stimulus in the United States, which is supposed to boost the country's growth in 2017, while the recovery in emerging economies is expected to consolidate. For Europe, growth will be more modest, during a year that will see elections in some of the main Eurozone countries and in which negotiations to prepare the UK's exit will have to be initiated. For Spain, growth is expected to remain strong, although some slowdown is foreseen, down to 2.3% in 2017 and 2.1% in 2018. Thus, unemployment will continue to decrease and the unemployment rate will be set at an average of 17.7% for this year and an average of 16% for 2018, while the deficit will be reduced to 3.5% of GDP in 2017 and 2.9% in 2018.

In January, oil prices continued to rise, albeit more moderately than in the previous month, as OPEC's output cut was partially offset by expectations of higher production in the United States. The price of Brent oil stood at $54,40 per barrel on average in January, 75% higher year-on-year, which goes up to 79% if the comparison is made in euros, as a result of the depreciation of the European currency against the dollar.

THE SPANISH ECONOMY: inflation in the spotlight at the beginning of 2017

The National Statistics Institute published its preliminary estimation of GDP for the fourth quarter, which points to a quarterly growth of 0.7%, in line with forecasts by CEOE and the Bank of Spain. The average economic growth for 2016 would be 3.2%, the same rate as in 2015. This means that the Spanish economy stabilized its rate of growth last year, with growth being more balanced: domestic demand remained robust, although at a more moderate pace, and external demand is expected to have contributed positively to the GDP. The key to the improved behaviour of foreign demand is that the deceleration was greater for imports than for exports. The latter had a remarkable evolution, in particular in the services sector, both tourist and non-tourist related.

Figures for the beginning of 2017 emphasize the positive data regarding the number of workers registered with the Social Security in January, which maintained a high year-on-year increase (3.3%). These results differ from the LFS data, with figures for the last quarter of 2016 that point to a certain loss of dynamism in the labour market.

Also noteworthy is the upturn in inflation, which, according to the advanced data for January, could be set at 3% year-on-year. Regarding the CPI, we must bear in mind that the impact of the rise in oil prices since November is coupled with the inter-annual base effect of comparison with the beginning of 2016. Therefore, inflation will resume a more moderate path from June onwards, possibly ending the year around 1% if the upward trend in oil prices does not intensify. In this area, it is worth noting the approval of the ROYAL DECREE that implements Act 2/2015, dated March 30, on the de-indexation of the Spanish economy. Its objective is the prohibition of indexing with the aim of avoiding the so-called "second round effects" and any inflationary inertia.

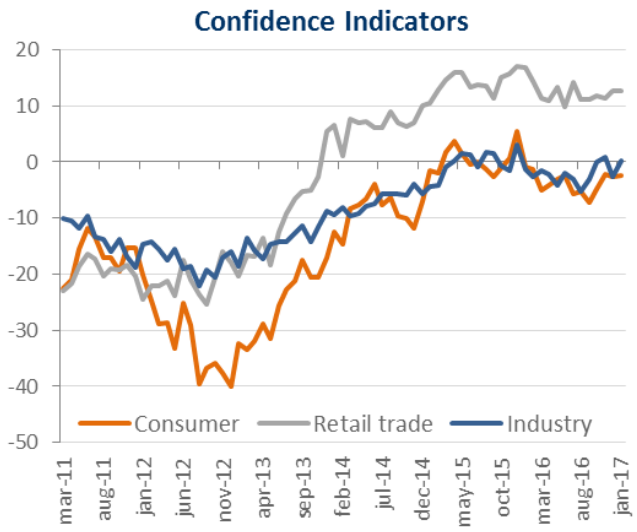
DEMAND AND ACTIVITY: expectations remain very favourable

In the fourth quarter of 2016, the Spanish economy continued to show strong momentum from the point of view of domestic demand as well as in exports. The limited information available for the beginning of 2017 is still positive, although a certain slowdown in some indicators is beginning to show.

In the final stretch of last year, confidence indicators, such as the economic sentiment indicator or the composite PMI, experienced an improvement that was backed by the evolution of activity indicators. Consumer confidence and retail trade confidence indicators have shown an improvement in December and January, in line with the favourable evolution of the labour market and the positive expectations of the economy in general. This is reflected in consumption indicators, such as the retail trade index, which, despite a deceleration in recent months, is still growing strongly, or car registrations, which continue to advance at double-digit rates over the already high figures for 2016.

By sectors, confidence indicators in the construction sector have shown deterioration in December and January, in line with very negative expectations on the evolution of civil works and the slow progress of residential construction. On the other hand, confidence indicators for the industrial and services sectors registered a remarkable improvement in the last months of 2016, with the trend continuing on in January. However, the latest data on the industrial production index shows a certain slowdown, especially in the capital goods and consumer goods components. For its part, the tourism sector showed a very positive behaviour during 2016, reaching record figures on arrival of tourists (75.3 million) and tourist spending.

Regarding the external sector, exports grew by 1.6% until November, while imports fell by -0.9%, which enabled the reduction of the accumulated deficit in the first eleven months by 27.1%. However, the increase in oil prices, given Spain's high energy dependence, will mean an increase in imports in nominal terms, which will put a strain on the current account balance in 2017.



Source: European Commission

THE LABOUR MARKET: the unemployment rate falls to 18.6% in the fourth quarter, and the workers registered with the Social Security rebound in January

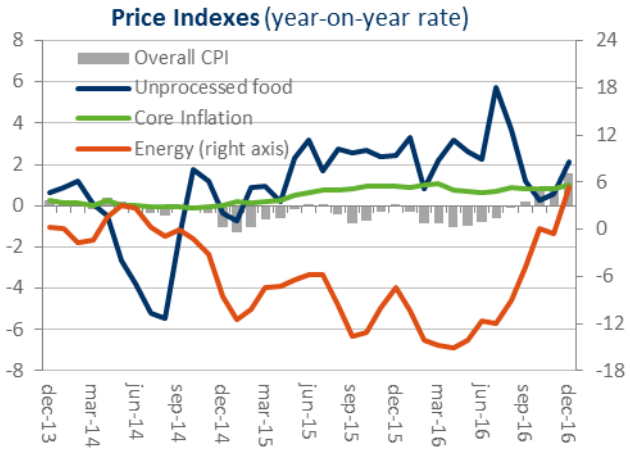
Data on the LFS for the fourth quarter of 2016 reflects a moderation in the labour market's positive trend. The Spanish economy has slowed its rate of employment creation in year-on-year terms to 2.3% (+413,900 new jobs, all in the private sector). By contrast, the number of people unemployed continued to fall, to 4.2 million, and the unemployment rate stood at 18.6%, the lowest since 2009.

This trend contrasts with the rise in the number of workers registered with the Social Security in the last quarter of 2016. In fact, 2017 has also begun with positive data, since registrations increased their rate of growth to 3.3% in January.

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

PRICES: inflation accelerates rapidly due to rising energy prices

According to data advanced by the National Statistics Institute, January inflation will be set at 3.0%, 1.4 points above the figure for December, a rate that had not been seen since October 2012. Inflation is on an upward path which will continue throughout the first months of 2017 and whose intensity will be determined mainly by the differential of oil prices with the previous year. Current levels represent year-on-year increases of more than 50%, which, in turn, significantly increase the price of fuels and lubricants. In addition, electricity prices are also increasing due to, among other factors, the weather conditions, the halt of nuclear power stations in France and the rising cost of gas. Therefore, during the next few months, inflation could remain around 3%.



Source: INE

THE PUBLIC SECTOR: The Central Government increases its deficit moderately until November

With information up to November, the public deficit of all Public Administrations except local governments was set at -3.3% of GDP, representing a difference of slightly more than one point compared to the target for the year as a whole (-4.6% of GDP). Therefore, meeting the 2016 objective seems feasible.

By levels of government, there was a moderate increase in the Central Government deficit in relation to 2015, being set at -2.2% of GDP, although if we take into account the aid devoted to financial institutions, this balance rises to -2.4% of GDP. In spite of the increase in tax revenues provided by the changes in Corporate Income Tax, the increase in refunds in November truncated the upward trend for revenues, which fell in accumulated terms by -2.7%. Payments continued to decline moderately until November (-0.8%).

The negative balance of the Social Security Funds amounts to -0.7% of GDP until November, almost 19% more than in 2015, due to a growth in revenues (2.2%) that was lower than the growth in expenditures (3.3%).

For their part, the Autonomous Regions were the ones that cut their deficit the most in comparison to 2015, 63% year-on-year, down to -0.5% of GDP. However, we should bear in mind that this result is conditioned by the increase in revenues provided by the Settlement System for 2014.