ECONOMIC OUTLOOK

October 2018

- ***The budgetary and fiscal policy mix included in the budgetary plan for 2019 is not the appropriate one to consolidate the Spanish economy's expansive cycle.***
- ***Downward revision of Spain's economic growth for 2018 and 2019.***
- ***Lower momentum in exports is leading to a change in the growth pattern towards a more unbalanced model.***
- ***The number of workers registered with the Social Security continues its progressive slowdown and closes the third quarter with a year-on-year growth of 2.9%, two tenths lower than in the previous quarter.***
- ***Inflation increases one tenth to 2.3% due to the rise in energy products. However, core inflation stabilizes at 0.8%.***
- ***The IMF and the OECD revise downwards their growth forecasts for the global economy.***
- ***The Federal Reserve raises interest rates for the third time this year and sets them within the 2.0% - 2.25% range.***
- ***Oil prices reach the highest level since 2014, driven by sanctions on Iran.***

CONTENT:

OECD (September 2018) **and IMF** (October 2018) **growth forecasts**

	IMF			OECD		
	2017	2018	2019	2017	2018	2019
World growth	3.7	3.7	3.7	3.6	3.7	3.7
Advanced economies	2.3	2.4	2.1			
United States	2.2	2.9	2.5	2.2	2.9	2.7
Japan	1.7	1.1	0.9	1.7	1.2	1.2
Eurozone	2.4	2.0	1.9	2.5	2.0	1.9
Spain	3.0	2.7	2.2			
Germany	2.5	1.9	1.9	2.5	1.9	1.8
France	2.3	1.6	1.6	2.3	1.6	1.8
Italy	1.5	1.2	1.0	1.6	1.2	1.1
United Kingdom	1.7	1.4	1.5	1.7	1.3	1.2
Emerging and developing economies	4.7	4.7	4.7			
China	6.9	6.6	6.2	6.9	6.7	6.4
World trade	5.2	4.2	4.0			

Source: IMF and OECD

INTERNATIONAL SCENE: the OECD and the IMF revise downwards their growth forecasts for the global economy

The main financial markets have shown a mixed behaviour during the month of September, having been affected by trade tensions between the United States and China, Brexit negotiations, uncertainty regarding the budget in Italy and the situation among emerging economies.

In terms of global growth, reports from the OECD and the IMF estimate that it will continue posting a healthy rate in 2018 and 2019. However, they point out that growth is now less balanced than a few months ago and believe that some economies are already showing signs of a slowdown, so they have revised their forecasts slightly downwards to 3.7%, both for 2018 and 2019. They emphasize that world trade has slowed in the first half of 2018 due to trade tensions, which have adverse effects on confidence levels and investment. In addition, they also indicate that downside risks to global growth have increased.

In the United States, activity will continue to be vigorous, although the IMF has revised growth downwards for 2019 by two tenths, to 2.5%, due to the effects of the trade measures adopted, especially the tariffs imposed on China. In the United Kingdom and the Eurozone, growth has been revised downwards for 2018, to 1.4% and 2% respectively, due to the lower dynamism shown in the first part of the year.

Meanwhile, among emerging economies, the rise in oil prices will favour activity and the growth forecasts of energy-exporting countries, while in others, such as Argentina, Brazil, Iran or Turkey, forecasts have been revised downwards due to the difficulties to get financing, the increase in geopolitical tensions and the higher price in oil imports. Moreover, China and other Asian economies are expected to post weaker growth rates for 2019 due to the tariffs imposed by the United States.

Additionally, the IMF believes that from 2020 onwards, growth in many of the advanced economies will decrease progressively towards their potential rates, as the monetary policy becomes normalized. This slowdown in the medium-term will also be due to the lower increase of the active population and a very slight increase in productivity.

Regarding the risks, it is pointed out that some of them have already materialized, such as the increase in trade barriers or the capital outflows from some of the emerging economies. However, the situation could become worse if the monetary policies in advanced economies were to tighten faster than expected, because financing for certain emerging markets would be more difficult. In addition, if trade tensions were to increase, it could dampen investment and hinder international trades. Other risks, such as the possible failure of Brexit negotiations or geopolitical tensions, also increase uncertainty over the evolution of the global economy.

Meanwhile, the confidence indicators being released for the third quarter point to a mild deceleration in activity. In this regard, the global composite PMI index fell six tenths in September to 52.8 points, which, although still showing solid growth for the global economy, is the lowest value in the last two years.

As for central banks, the most relevant event is the Federal Reserve's interest rate hike, which set them between the 2.0% - 2.25% range and marks the third increase so far this year. In addition, the good performance of the economy will allow the Fed to implement an additional increase before the end of the year and progressive hikes throughout 2019 and 2020. Meanwhile, the ECB, the Bank of England and the Bank of Japan kept their monetary policies unchanged. It is also worth noting the sharp rise in rates in Turkey, from 17.75% to 24%, in an attempt to combat its currency crisis and the country's inflation.

On the other hand, oil prices have increased significantly in September. Brent crude stood, on average, at $79.1 per barrel, the highest since November 2014, and almost 10% higher than in the previous month. In year-on-year terms, the price increase was 38.7% in dollars and 41.9% in euros. Reasons for this rise in prices include the proximity of the sanctions on Iran, which will become effective on November 4 and are already causing reduced production in the country. In addition, at the OPEC meeting, the discussion on possible production changes for the remaining countries was postponed until December, so prices are expected to continue under pressure in the short term. In fact, in the first few days of October, the price of a barrel of Brent crude has exceeded $85.

THE SPANISH ECONOMY: downward revision of the forecast for 2018-2019 and budgetary policy mix with expansive social expenditures

Forecasts for the Spanish economy for 2018 and 2019 were revised downwards once again. The Government has lowered GDP growth estimations for 2018 by one tenth, setting it at 2.6%, and for 2019, down to 2.3%. The Bank of Spain and the IMF have also lowered their forecast for GDP growth in 2018, now at 2.6% and 2.7%, respectively, and they both forecast the same rate for 2019, setting it at 2.2%. These institutions base their diagnosis on the maturity of the economic cycle, the need to get on with the reforms process, the environment of economic uncertainty associated with protectionism, the weakening of emerging economies and the expansionary bias of the announced measures regarding budgetary policy.

In this regard, the Budgetary Plan for 2019 presented by the Government is characterized by increased social spending, it makes no mention of expenditures on sectoral and investment policies and it includes a tax increase, especially for the business sector. Therefore, the budgetary and fiscal policy mix is not appropriate to consolidate the Spanish economy's expansive cycle. It is worth noting that, with such high public debt levels, increasing spending that becomes structural is an obstacle to the sustainability of public accounts in the medium and long term, especially within a context of economic slowdown.

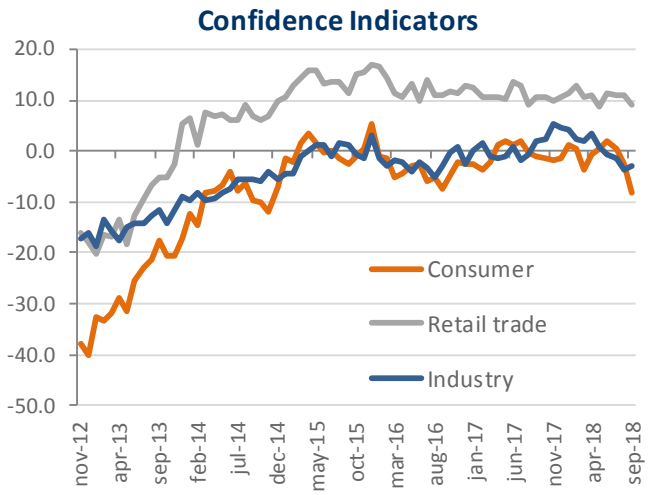
From a cyclical point of view, the National Statistics Institute's last revision of GDP for the second quarter underlines that the slowdown of the Spanish economy had started at the beginning of 2018, with GDP growing 0.6% already in the first quarter. However, the most negative sign is the composition of that growth, with the external sector draining 0.8 p.p. in the second quarter, something not seen since the pre-crisis stage. Exports are losing steam and, for the first time in recent years, they have a lower momentum than the European average. Hence the need to reinstall measures aimed at increasing competitiveness if we wish to maintain the balanced growth pattern that has characterized the current recovery cycle.

DEMAND AND ACTIVITY: the economy's dynamism slows down due to consumption and exports

After posting a growth rate of 0.6% both in the first and second quarters, the Spanish economy should show a similar behaviour in the third quarter. Thus, and according to the available data, consumer spending could have slowed slightly, in line with lower growth in hiring and the significant worsening of consumer sentiment, which has fallen by almost ten points in the last three months. This worsening in household sentiment is due, mainly, to a more negative perception of the evolution of the labour market and of the general economy. In addition, with regards to the sentiment in retail trade, there is less optimism, although this negativity is not as marked, in line with the slight drop in average retail sales in July and August. However, part of this deceleration in household consumption could have been offset by the increase in vehicle registrations in July and August before the entry into force of the new regulation in September. The average for the third quarter shows a year-on-year increase in registrations of 15.9%, despite having registered a decrease of 17% in September.

After the significant growth of investment in capital goods in the second quarter, the data available for the third one is still incomplete and does not show a clear trend. The IPI in capital goods continued to show strong dynamism in July and August. However, the industrial climate index for investment goods fell sharply in the third quarter, as did the Industrial New Orders Index or the Turnover Index.

From the point of view of the foreign sector indicators, their contribution to growth is also lower. Thus, according to the preliminary data on the Balance of Payments until July, the current account surplus was 0.2 billion euros vs. 6.7 billion in the previous year, due to the larger deficit in the balance of goods.

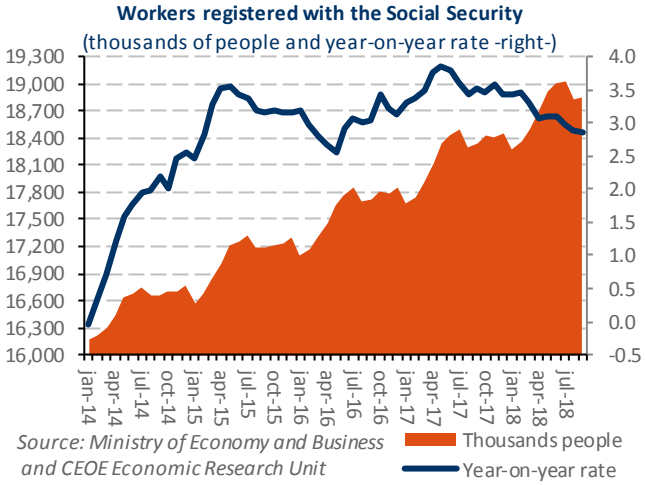


Source: European Commission

THE LABOUR MARKET: the number of workers registered with the Social Security slowed its year-on-year rate of growth in the third quarter, down to 2.9%

The number of workers registered with the Social Security increased by 22,899 in September, the third largest increase in this month's historical series, after the ones registered in 2005 and 2017. By sector, the number of contributors grew in all of them, except for the services sector. In year-on-year terms, there were 526,551 more workers registered and the year-on-year rate remained stable at 2.9%. Thus, in the third quarter as a whole, the rate was set at 2.9%, two tenths lower than in the second quarter.

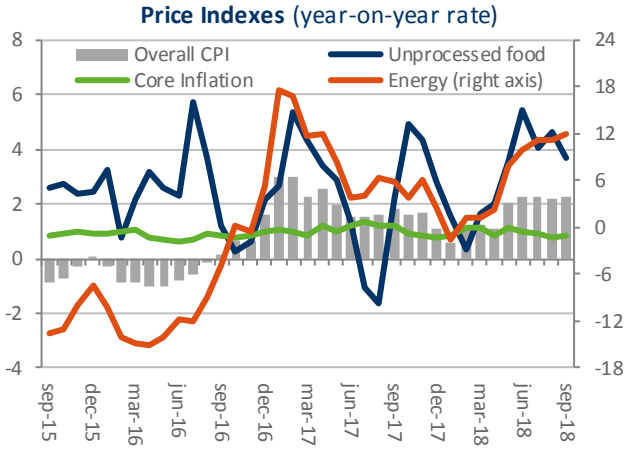
On the other hand, it is worth pointing out the raise of the minimum wage for 2019 to 900 euros per month, which represents an increase of 22.3% in comparison to the 2018 figure. This measure represents an additional barrier for certain groups to enter into the labour market, such as young people and unskilled workers, segments which already have a high unemployment rate.



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

PRICES: inflation increases to 2.3% due to the price of energy products

In September, the year-on-year growth rate of the Consumer Price Index (CPI) rose one tenth to 2.3%. This evolution was due to the inflationary push resulting from higher energy prices, both in fuels and lubricants as well as in electricity and heating oil. On the other hand, core inflation remains at 0.8%, the same rate as the previous month, with all its components registering very slight changes. Oil prices continued their climb in October, reaching around $85 per barrel. If oil prices remain at current levels, the impact of energy products on the CPI will be crucial for the remainder of 2018, and could keep inflation above 2%, although the annual average should be set at around 1.8%.



Source: INE

THE PUBLIC SECTOR: moderate contention of the public deficit in 2018

The State's net borrowing until August 2018 have decreased by 11.9%, which corresponds to 1.6% of GDP vs. the 1.8% of GDP recorded for the same period in 2017. The primary balance is in negative territory, at -0.1% of GDP, lower than in the same period last year. Noteworthy is the strength of non-financial resources, which increased by 8.3%, thanks to the boost in the collection of social contributions (7.0%), of current income and wealth taxes (11.8%) and of the item that comprises the remaining resources (20.6%). On the other hand, non-financial uses accumulate a 5.1% increase due to the greater transfers made to the Autonomous Communities and the Social Security Funds.

With data up to July, the deficit of the Public Administrations, without including the Local Governments, was set at 1.9% of GDP in 2018, half a point lower than the figure recorded up to July of the previous year, within a context in which non-financial resources increased by 6.8%, while uses grew by 4.2%. Therefore, despite the fact that advances on the path towards a reduction of the fiscal imbalance continue, these are taking place very gradually, which seems to indicate that the target of -2.7% of GDP for 2018, it is more feasible to achieve than the initial objective (-2.2% of GDP).