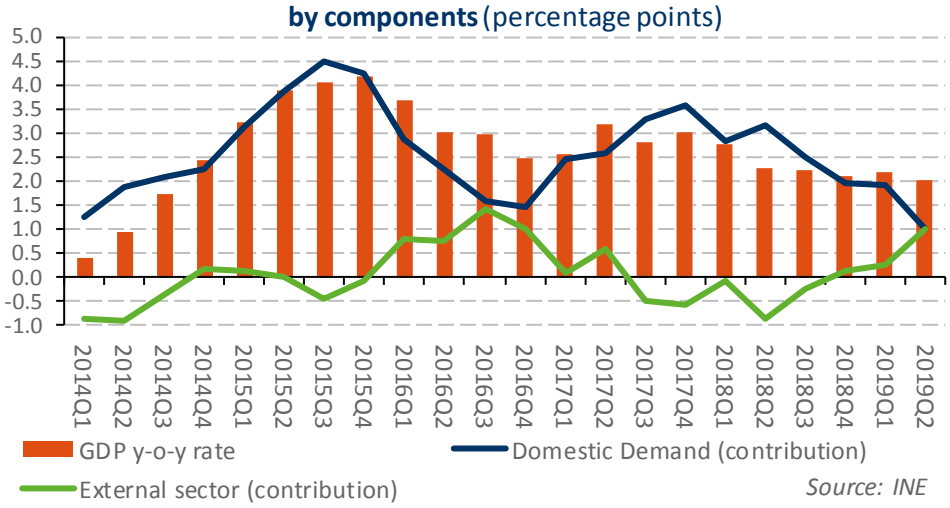
ECONOMIC OUTLOOK

October 2019

- ***The global economy is pointing to a slowdown in most countries, while major central banks are easing their monetary policies even further.***
- ***Oil prices rose in September following the attack on some facilities in Saudi Arabia, although they have eased again since then.***
- ***The Spanish economy is slowing down at a higher pace than foreseen at the beginning of the year. As a result, growth forecasts for the year have been revised downwards to 2% and to 1.6% for 2020, according to CEOE estimations. The Government estimates 2.1% in 2019 and 1.8% in 2020.***
- ***The Spanish economy is not only growing less, but its composition has also changed, with domestic demand now holding a lower weight due to decreased investment and slowed consumption, and the external sector contributing more due to a decline in imports.***
- ***Within this backdrop of slower activity growth, the number of people registered with the Social Security continues to slow down, while labour costs experience a rebound.***
- ***Inflation remained at a low in September (0.1%). For 2019, its average annual growth is expected to be 0.7%.***

CONTENT:

GDP (year-on-year rate in %) **and contribution to GDP growth by components** (percentage points)



Source: INE

INTERNATIONAL SCENE: overall slowdown in the global economy

In September, the main world stock exchanges posted positive results, following the significant drops seen in August. Prices rose on the back of the expansionary measures taken by central banks and a return to negotiations between China and the United States. However, volatility in markets is quite high and October has started particularly volatile, due to the signs of a slowdown in the global economy, the uncertainty about Brexit and the growing tariff tensions between the United States and the European Union.

Globally, the slowdown seems to be spreading and, according to the new director of the IMF, Kristalina Georgieva, in 2019 growth is expected to decline in almost 90% of the world. For its part, the OECD also revised downwards its growth forecasts for 2019 by three tenths, to 2.9%, and for 2020 by four tenths, to 3.0%. In Q2, the main advanced economies also posted lower growths. The United States, the European Union and Japan slowed down, and some countries, such as the United Kingdom and Germany, also had negative quarterly rates.

Growth is also expected to continue its slowdown in Q3. The global manufacturing PMI for September remains below 50 points, despite a two-tenth improvement in August, underlining a global contraction in this sector as a consequence of the significant slowdown in global trade. Specifically, the World Trade Organization (WTO) has lowered its forecast for worldwide trade growth in 2019 to 1.2%, due to increased trade tensions and the weakness of the global economy. Meanwhile, the global services PMI remains above 50 points, albeit declining gradually, and the global composite PMI posted its worst figure since 2016.

The IMF is even more pessimistic about the evolution of global trade and believes it may have stalled, with manufacturing activity and investment having deteriorated significantly. It warns about the risk of these poor results spreading to the services sector and the consumption in the coming months. It has also analysed the effects of the trade war, differentiating between the direct costs of the three tariff rounds, either applied or announced, for businesses and consumers and the secondary effects that may occur due to the loss of confidence and the market reactions, which are significantly greater than the direct ones. As a whole, they estimate that the cumulative effect could result in a loss of about $700 billion by 2020, or about 0.8% of global GDP.

In light of this situation, the international organization insists on the need to reach agreements and promote a more modern trade system, warning that trade wars are negative for all the parties involved. Furthermore, faced with the possibility of the world economy deteriorating even further, it is important to offer coordinated solutions, not just in terms of monetary policy, where there is very little wiggle room, but also through fiscal policies in those countries that could afford it, and encouraging the implementation of structural reforms to increase productivity and favour growth in the medium and long term.

Meanwhile, central banks have opted to make their monetary policies even more expansive, given the moderate inflation and weak growth rates. To this end, the ECB, after lowering growth forecasts for the Eurozone to 1.1%, as the OECD had also done, announced a new stimulus package, resuming, as of November, their asset purchases in the amount of €20 billion each month. It also reduced the deposit facility interest rate by 10 basis points to -0.5% and improved the conditions for injecting liquidity into banks, with longer maturities and lower costs.

In addition, in September the Federal Reserve cut interest rates by 25 bps for the second time in a row, setting them in the 1.75% - 2.00% range. The decision was not unanimous and was justified by the weak inflation and the risk of a global slowdown.

As for oil prices, the downward trend followed in recent months was broken in September, as a result of the attacks that occurred to some oil facilities in Saudi Arabia. This situation created a decline in oil supply and an increase in geopolitical tensions in the region, which led to a sharp rebound in crude oil prices. They have subsequently eased, once production levels are being progressively restored. In September, Brent crude stood at an average of $63.6 per barrel, 7.9% higher than in August, although in year-on-year terms the price is 19.6% lower than a year ago.

THE SPANISH ECONOMY: downward revision of forecasts for 2019 and 2020

GDP grew 0.4% in Q2-2019, one tenth lower than in Q1. On the year-on-year rate, growth slowed down by two tenths to 2.0%. Both rates are the lowest since 2014.

These results, together with the downward revision of the National Accounts series, leave the previous forecasts, which foresaw a GDP growth slightly above 2%, somewhat out of reach and thus, they have been revised downward to 2%, according to CEOE estimations. There is even the possibility that GDP will be lower than 2% if the current risks become a reality. Among these, it is worth mentioning a Brexit without an agreement, a new escalation of the trade war or greater tensions in the Middle East. Expectations for 2020 point to GDP growth of 1.6%. The Government estimates 2.1% in 2019 and 1.8% in 2020.

In addition to the downward revision of expectations, the composition of the GDP figure has two distinct traits: the weakness of domestic demand due to the slowdown in consumption and the decline in business investment. The former is reflecting the precautionary effect affecting household spending. The latter is due to the cyclical slowdown, as well as to the increase in uncertainty at a national and international level, which leads to lower investment in capital goods.

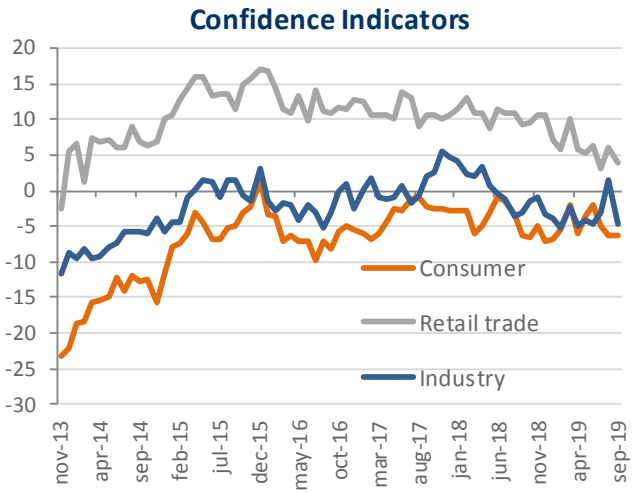
It is also worth highlighting the acceleration that both labour costs components, wage-related and non-wage-related, recorded in recent quarters. This behaviour, in a context of particularly low inflation (0.7% annual average rate in 2019 according to CEOE estimations) and negative productivity per occupied person, may harm the competitiveness of the Spanish economy via unit labour costs. In fact, ULCs rebounded to 2.8% in the Q2, compared to an average rate of 1.2% in 2018.

DEMAND AND ACTIVITY: the economy keeps advancing at a moderate rate along the gradual slowdown trend

According to the information available, in Q3 the Spanish economy would have grown at a similar to or slightly lower rate than in the previous quarter (0.4%). Taking into account updated data from the National Accounts, there has been some recovery in the household savings rate, which may be reflecting worse expectations among families within a context of greater uncertainty, and which may be why private consumption is holding back, despite the fact that its fundamentals continue to be positive (employment growth, low interest rates, higher wages and very low inflation). This deterioration can also be seen in retail trade confidence, but it is yet to have an impact on the retail trade index or in domestic sales of large companies, which continue to show remarkable progress. Car registrations are still the item that shows the worst evolution, even through it posted positive rates in September due to the base effect of being compared with the previous year, when sales plummeted.

Despite increased uncertainty domestically and internationally, investment could show a somewhat more positive trend in Q3, after the significant setback recorded in Q2. In general, sectors expectations remain very similar to those of Q2, and the indicators available for Q3 continue to show differences in behaviour between the services sector and the industrial sector. Thus, while the September manufacturing PMI stood at 47.7 points, still below the growth threshold of 50 points, the services PMI reached 53.3 points.

With regard to the external sector, after a fairly positive Q2, which enabled a significant correction in the current account balance, exports of goods in July grew at a strong pace, 3.8% in nominal terms (1.5% in terms of volume), while imports grew by 0.6% (falling by -2.2% in terms of volume).

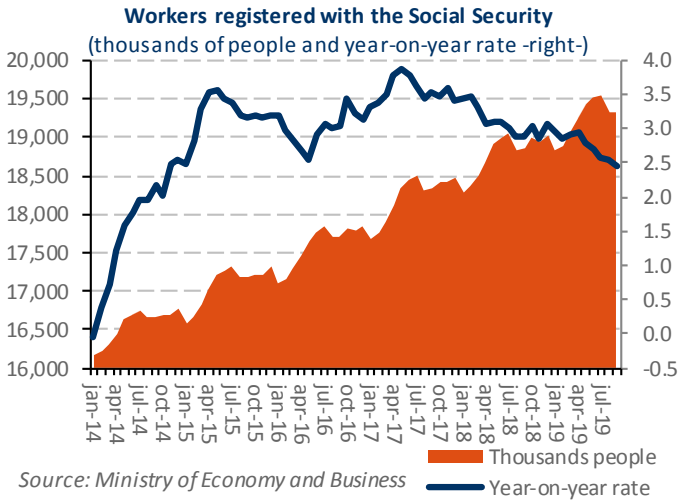


Source: European Commission

THE LABOUR MARKET: the number of people registered with the Social Security continues losing growth momentum while labour costs rebound

The number of people registered with the Social Security grew by 3,224 in September, the lowest increase for this month throughout the current recovery period. In year-on-year terms, the number of workers registered with the Social Security was up 2.4% (2.2% without non-professional caretakers), one tenth lower than in August. In Q3, as CEOE anticipated, the quarter-on-quarter rate of the seasonally-adjusted number of people registered with the Social Security was 0.3%, less than half of 0.7% registered in Q2. The year-on-year rate was 2.5% in Q3, three tenths lower than in Q2, confirming that the slowdown in contributors continues.

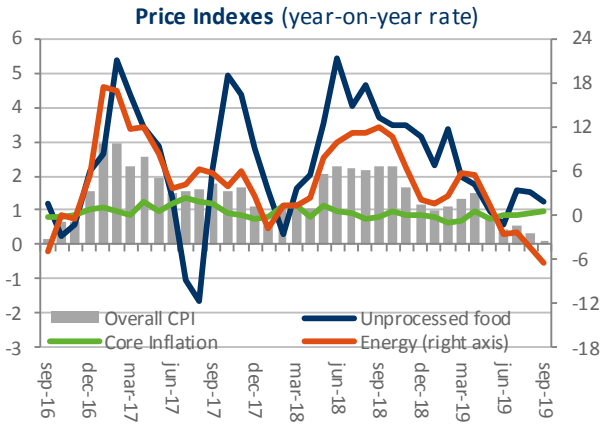
According to the Quarterly Labour Cost Survey, the labour cost per worker per month accelerated its year-on-year growth rate to 2.4% in Q2 (previous 2.1%). The cost of wages as well as the other costs rebounded in this period, up to 2.1% and 3.4%, respectively.



Source: Ministry of Economy and Business

PRICES: inflation hits lows again at 0.1%

In September, the annual CPI rate fell by two tenths to 0.1%, the lowest level since August 2016, mainly due to the decline in energy product prices, which fell by -6.6%, and the slower rise in unprocessed food prices, which were up by 1.3%, two tenths lower than the previous month. For its part, core inflation also remains subdued, despite having increased one tenth, to 1%, due to the increase in the Services component, which stood at 1.5%, a tenth more than in August. For the next few months, inflation will remain very contained, with a slight upturn expected at the end of the year, which would set the average CPI for 2019 at around 0.7%.



Source: INE

THE PUBLIC SECTOR: revenues rebound slightly in comparison with the stagnation seen at the beginning of the year while expenditures slow down

Up to August, the State deficit stood at -1.2% of GDP in National accounting terms, which is 0.35 percentage points lower than in the previous year. These results are due to revenues (up 4.4% year-on-year) showing more dynamism than expenditures (up 1.2% for the same period). In addition, the State continues to run a primary surplus, although it is small (0.16% of GDP).

Among the revenues, it is worth pointing out the strength in the figures related to accumulated collection of direct taxes up to August (5.4%) and the higher current transfers received from other public administrations (17.9%), especially those from the Autonomous Regions and the Central Administration Bodies. On the expenditure side, compensation of public servants, electoral expenses and the entry representing social benefits increased due to greater spending on passive class pensions and an increase in personal income tax deductions of 40.7%. All this is partly offset by the decrease in transfers to the Social Security System, in investment, in interests and the lower coverage of the cost of the electricity system.

With data up to July, the total public deficit of the Public Administrations, minus the Local Government, is equivalent to 2.02% of the GDP, a percentage somewhat higher than the one recorded in the same period of 2018.