



Global and Spanish Economy Q2 2018 & perspectives

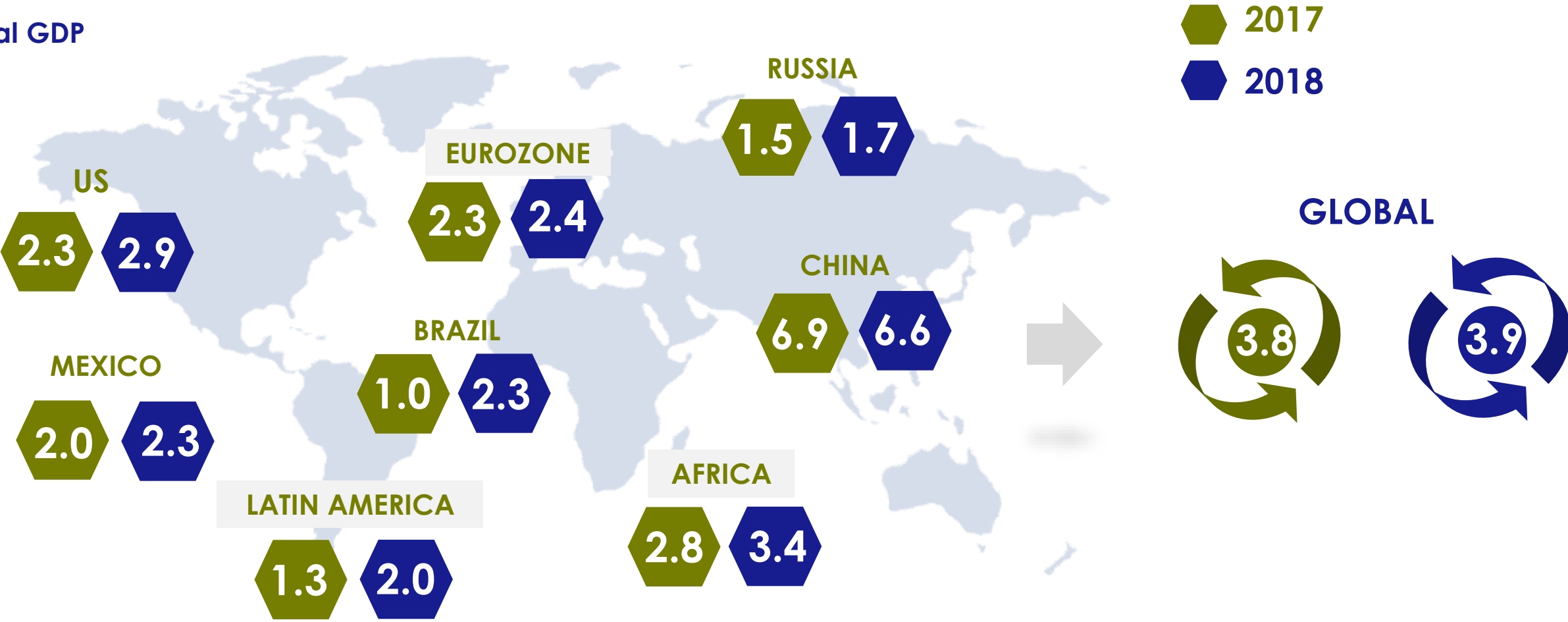
May 2018

GLOBAL

GDP growth in 2017 and forecasts for 2018

Economic growth is achieved in all geographical areas

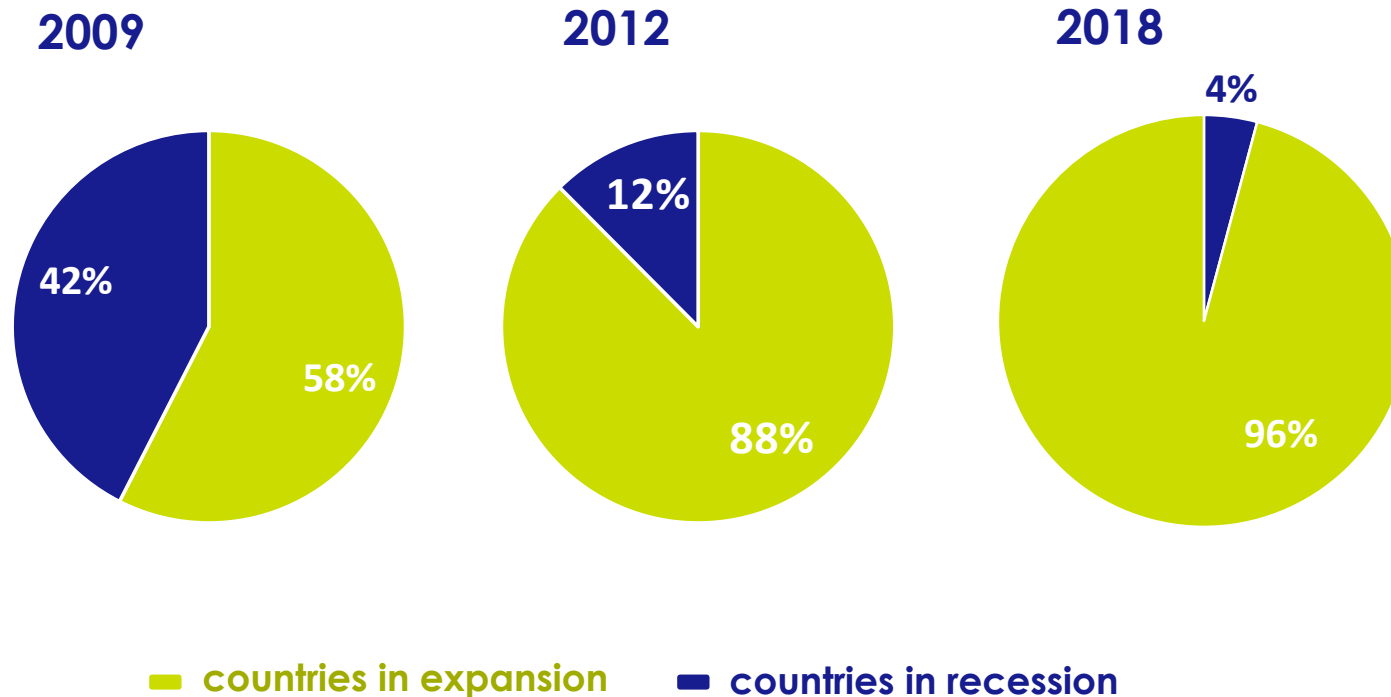
Real GDP
%



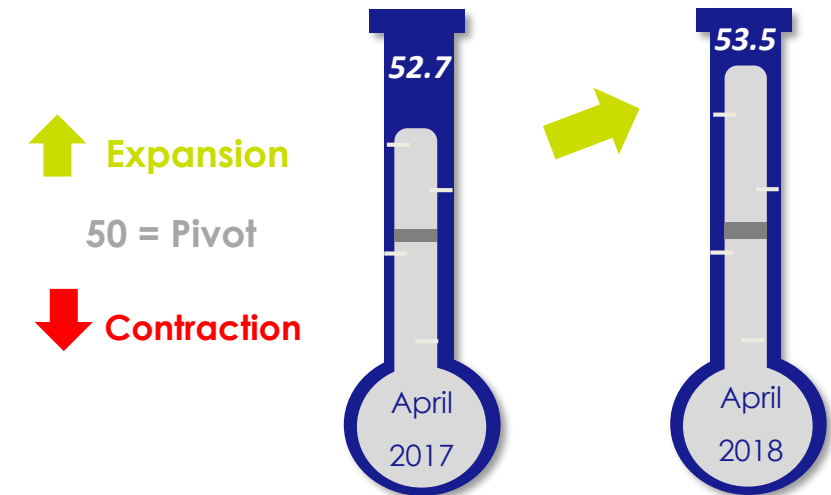
Global growth consolidates

Forecasts point to synchronised growth for 2018

% countries with positive growth vs recession



GLOBAL PMI



Note: The countries in recession in 2018 are Dominica, Equatorial Guinea, Nauru, Puerto Rico, South Sudan, Swaziland, and Venezuela.

Source: Círculo de Empresarios based on IMF, J.P. Morgan, Markit, 2018

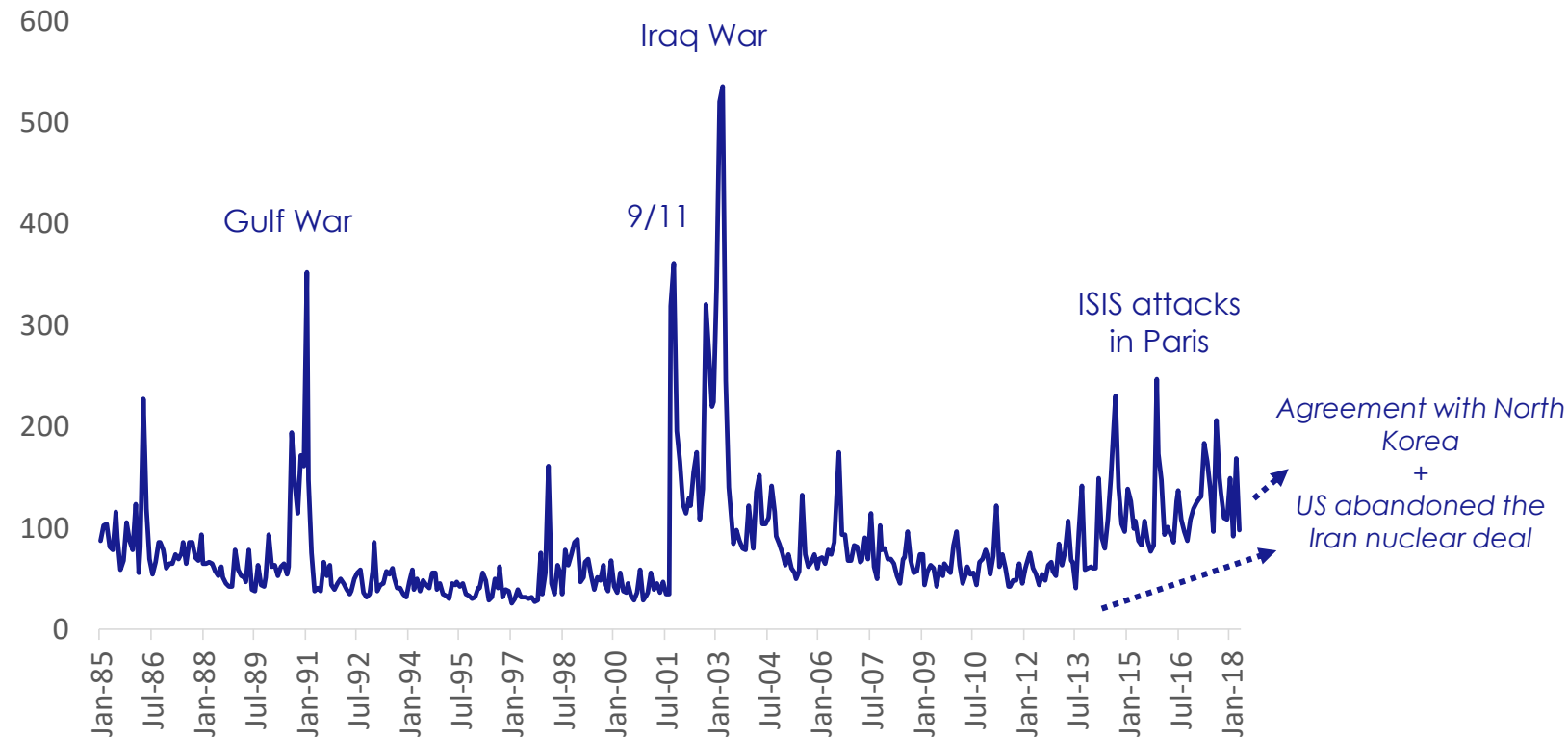
Trends 2018



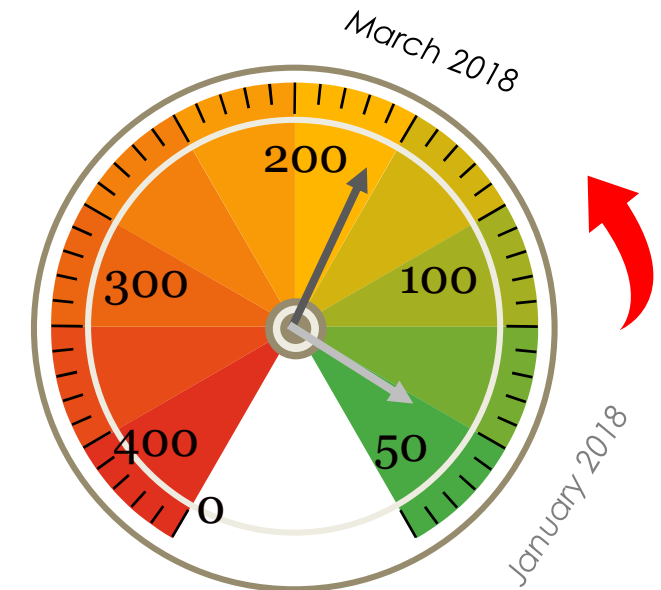
Geopolitical uncertainty

The **escalation in geopolitical tensions** at the military and economic levels is particularly worrying

Geopolitical Risk (GPR) Index

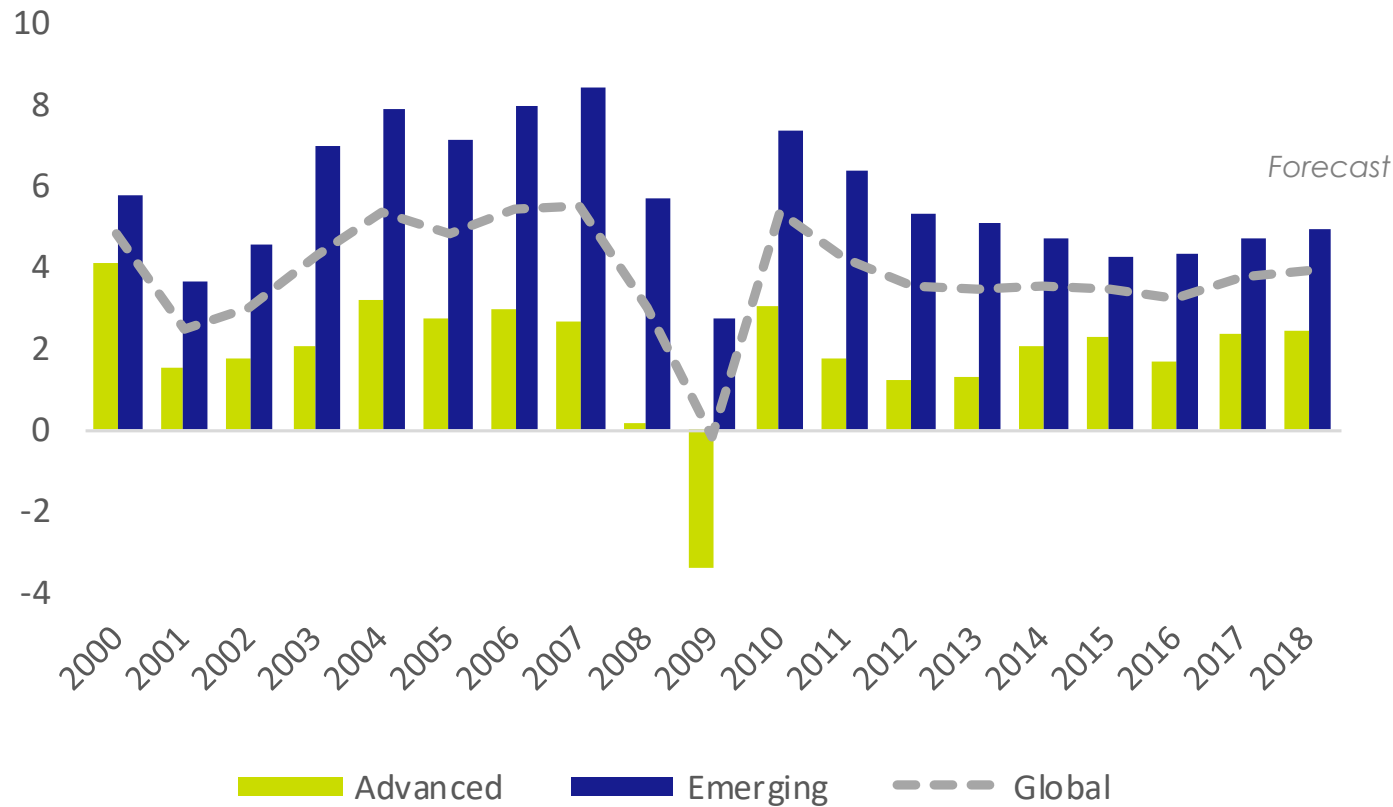


Economic Policy Uncertainty Index



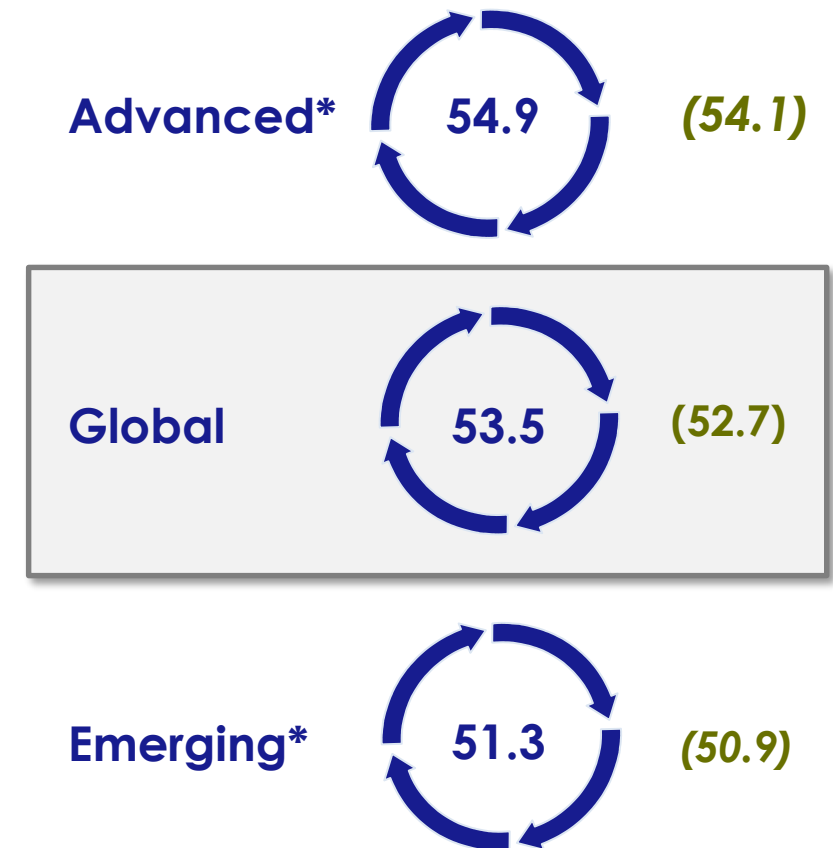
Robust growth in advanced and emerging economies

Real GDP growth %



Source: Círculo de Empresarios based on IMF, J.P. Morgan, 2018

Strength of Manufacturing PMI April 2018 April 2017 value in brackets

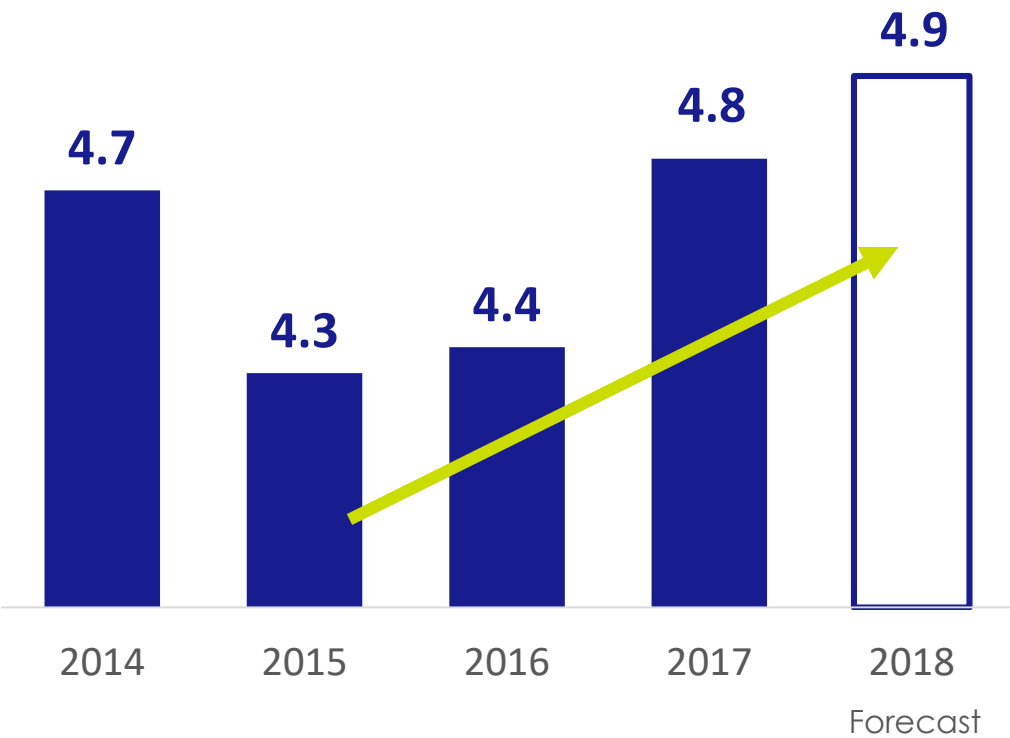


Note: values above 50 indicate expectations of expansion
* February 2018 value

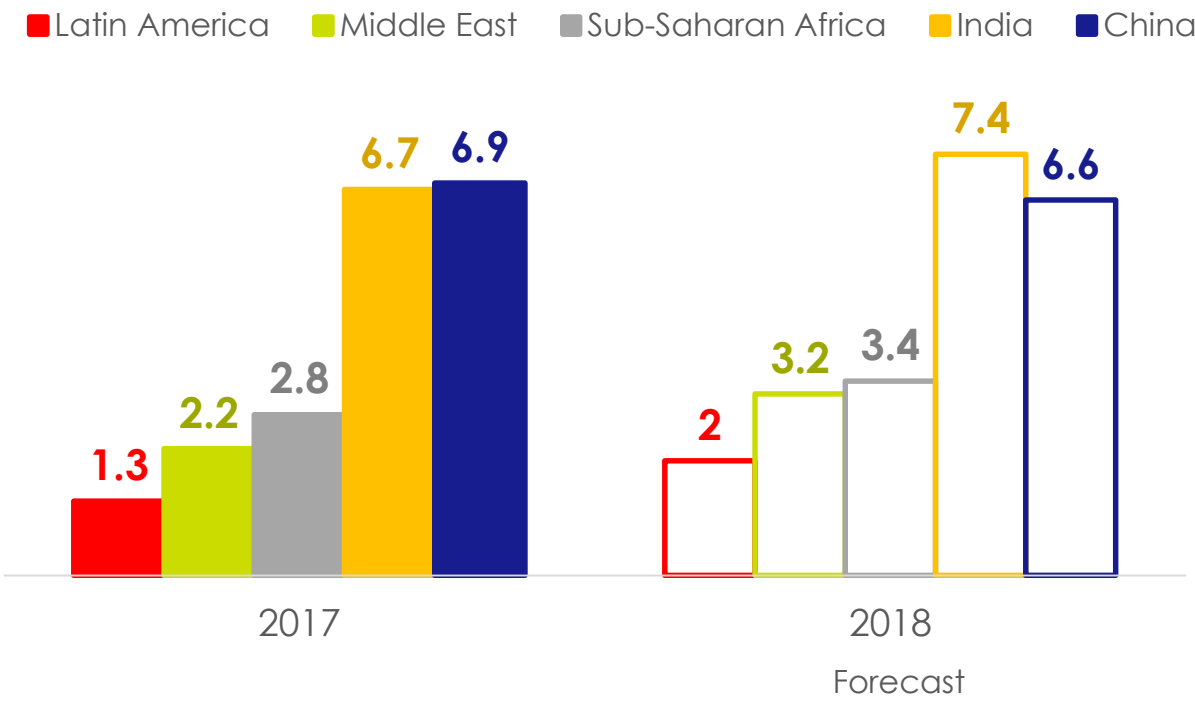
Emerging economies

The **recovery in the price of raw materials** contributes to a boost in economic activity

Real GDP growth in Emerging
Annual variation



Real GDP growth by geographical areas
Annual variation



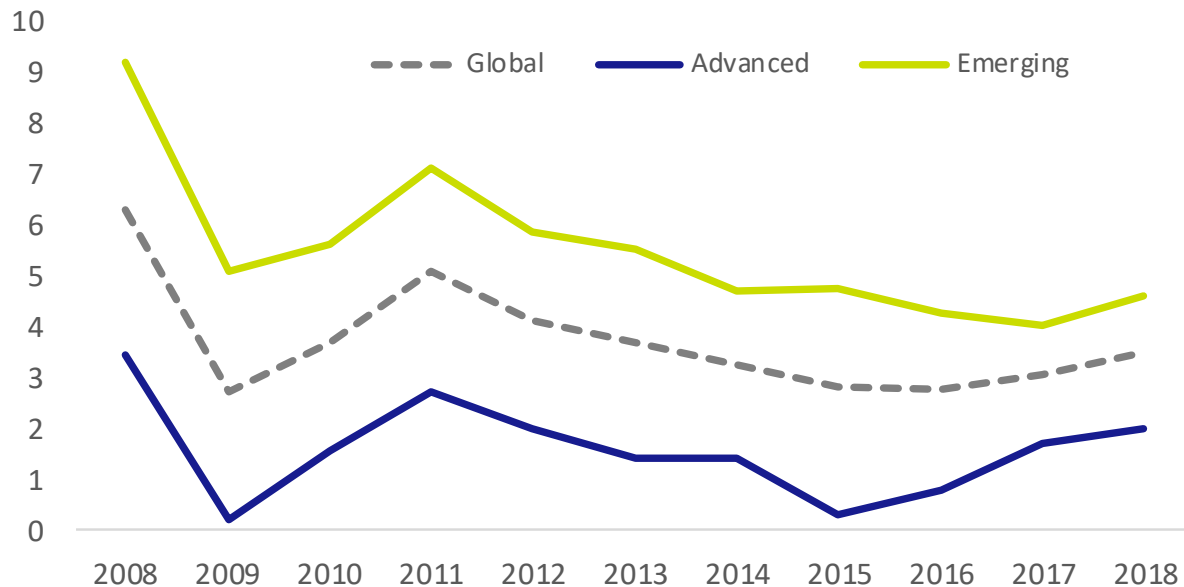
Note: Structural reforms in India boost its GDP growth

Source: *Círculo de Empresarios* based on IMF, 2018

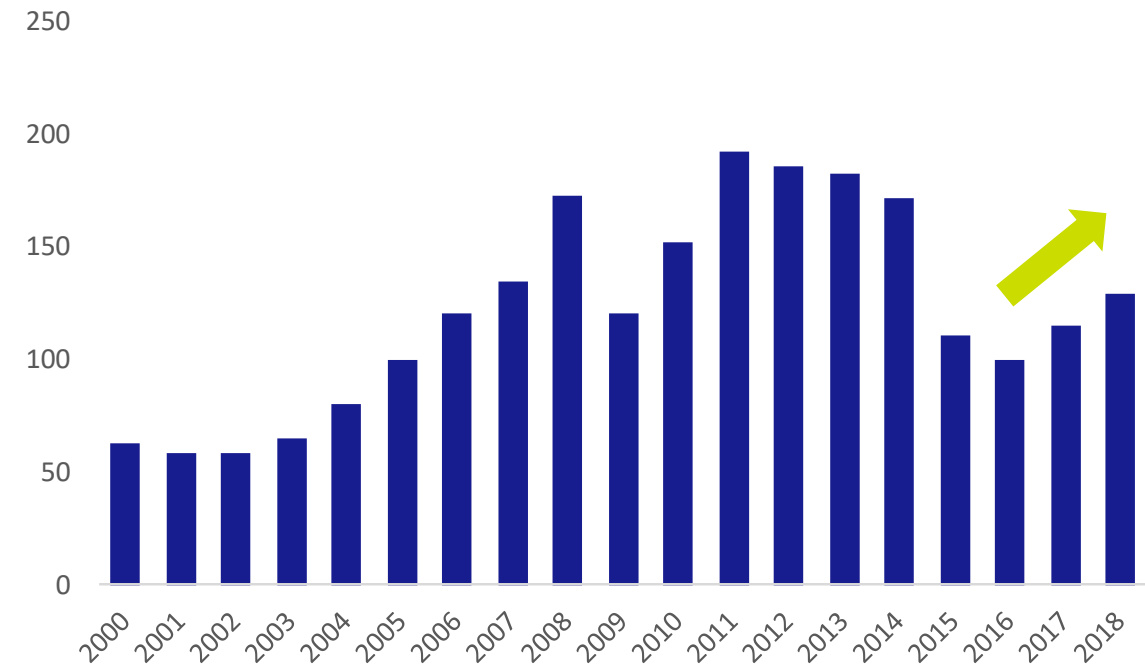
Global inflation

The **increase in oil price** puts an upward pressure on inflation rates, although the underlying inflation remains moderate

Average inflation rate %



Raw Material Price Index 2005=100



Note: The raw material index includes energy and non-energy

Source: Círculo de Empresarios based on IMF, 2018

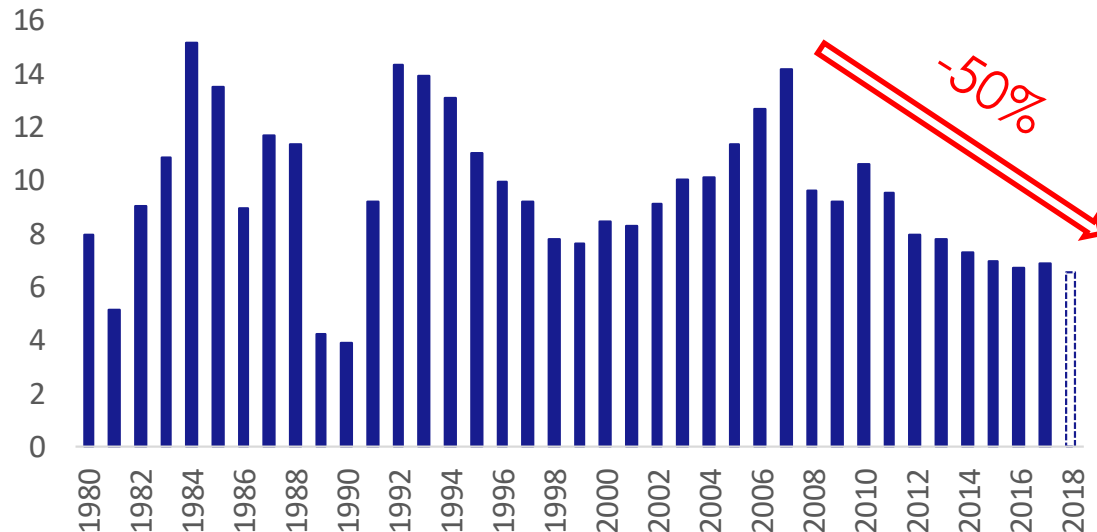
China: moderate slowdown

The latest indicators of economic activity are solid, although **a slowdown in its economy is confirmed for 2018**

Real GDP growth



2017: 6.8% → **2018: 6.6%**



Industrial production

(Jan-Feb 2018)
Year-over-Year

7.2%

Manufacturing PMI

(March 2018)
Year-over-Year

51.5

Retail

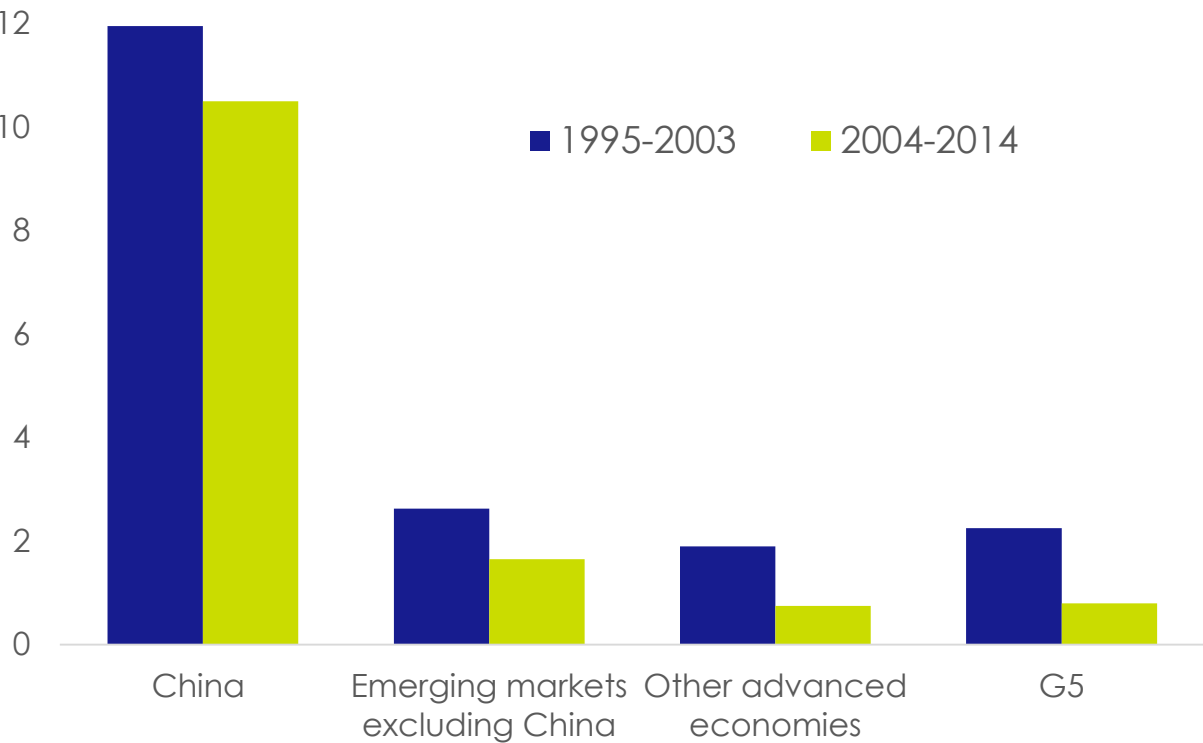
(Jan-Feb 2018)
Year-over-Year

9.7%

China: growth leader in innovation and productivity

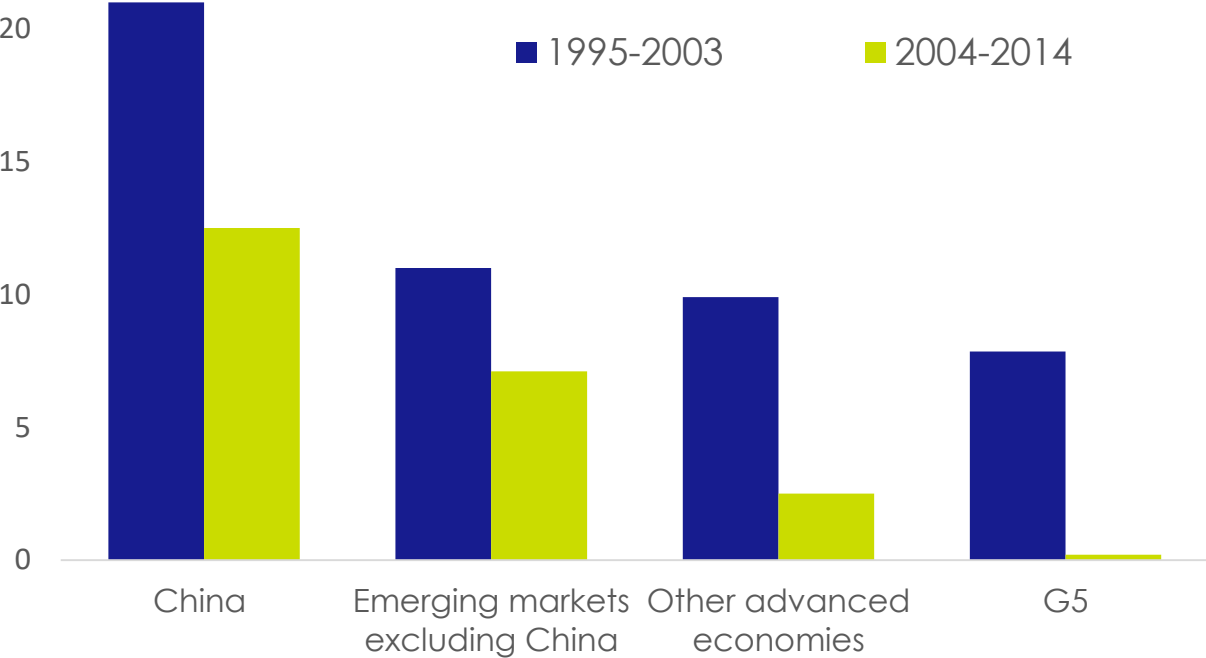
Labour productivity

Annual average growth, %



Patents

Annual average growth, %



G5 = US, Japan, Germany, France and United Kingdom

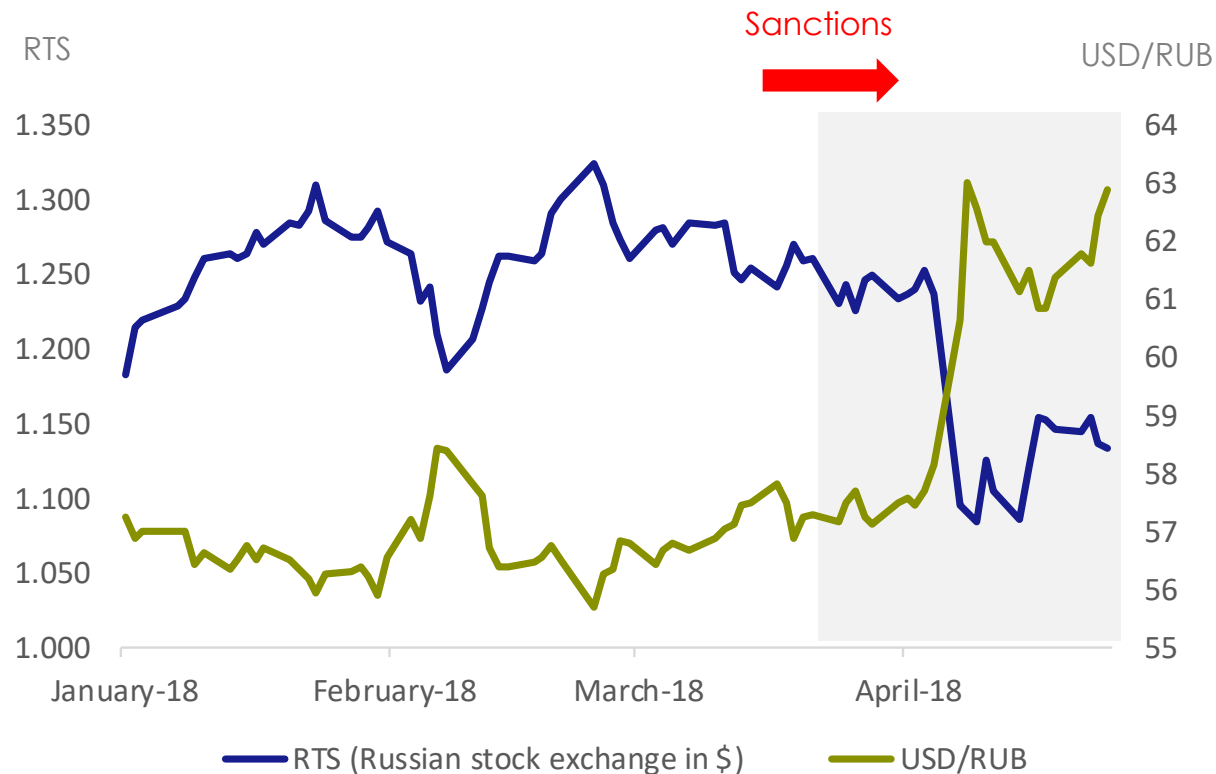
Other advanced economies = does not include the G5

Source: Círculo de Empresarios based on IMF & FT, 2018

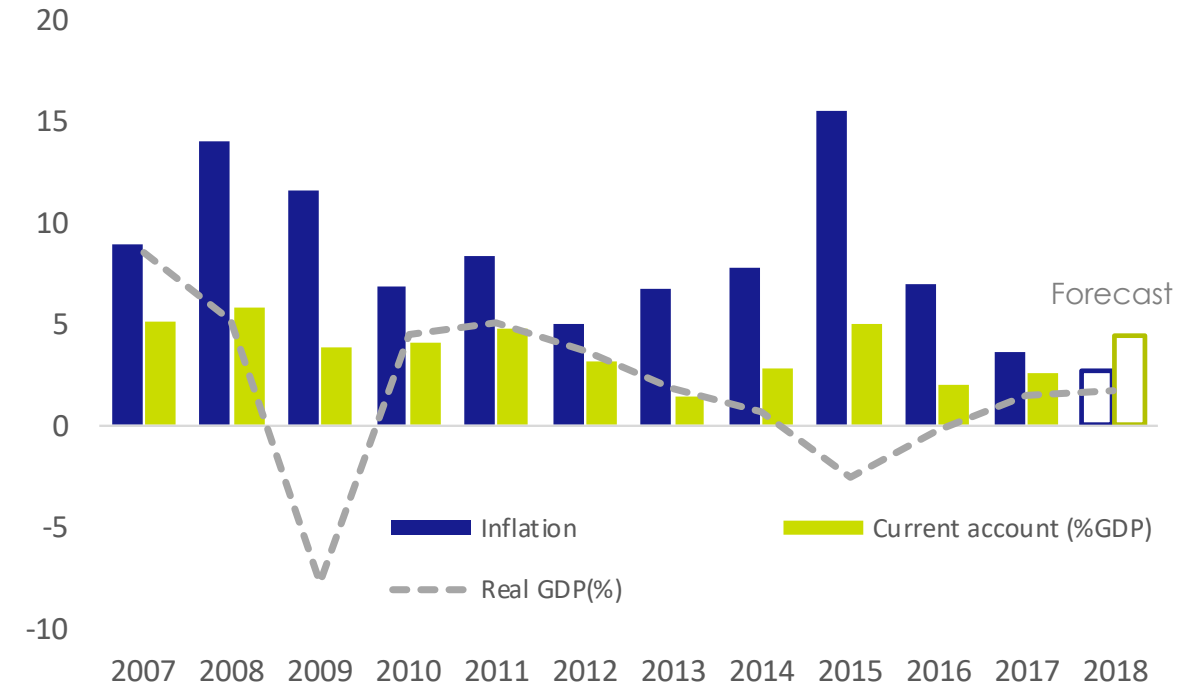
Russia: exit from recession and sanctions

The rise in the price of crude oil propels Russia's **exit from recession**, in a scenario in which the Syrian conflict and US sanctions increase its uncertainty

Russian stock exchange in \$ (RTS) and exchange rate



GDP, inflation and current account of Russia



US: upward trending economic forecasts

Tax reform raises growth estimates for 2018

Real GDP (%)

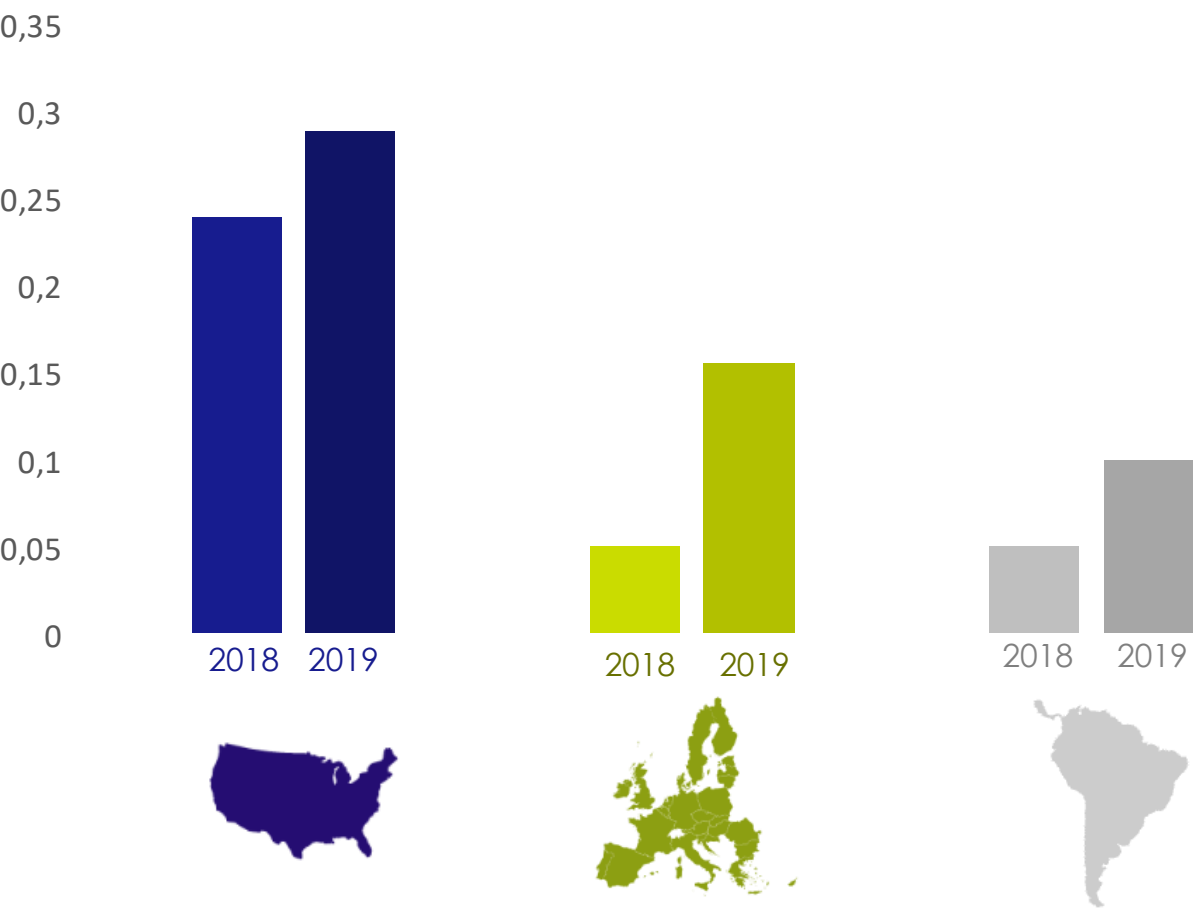


Note: data for manufacturing PMI is at year-end, except for 2018, which corresponds to April

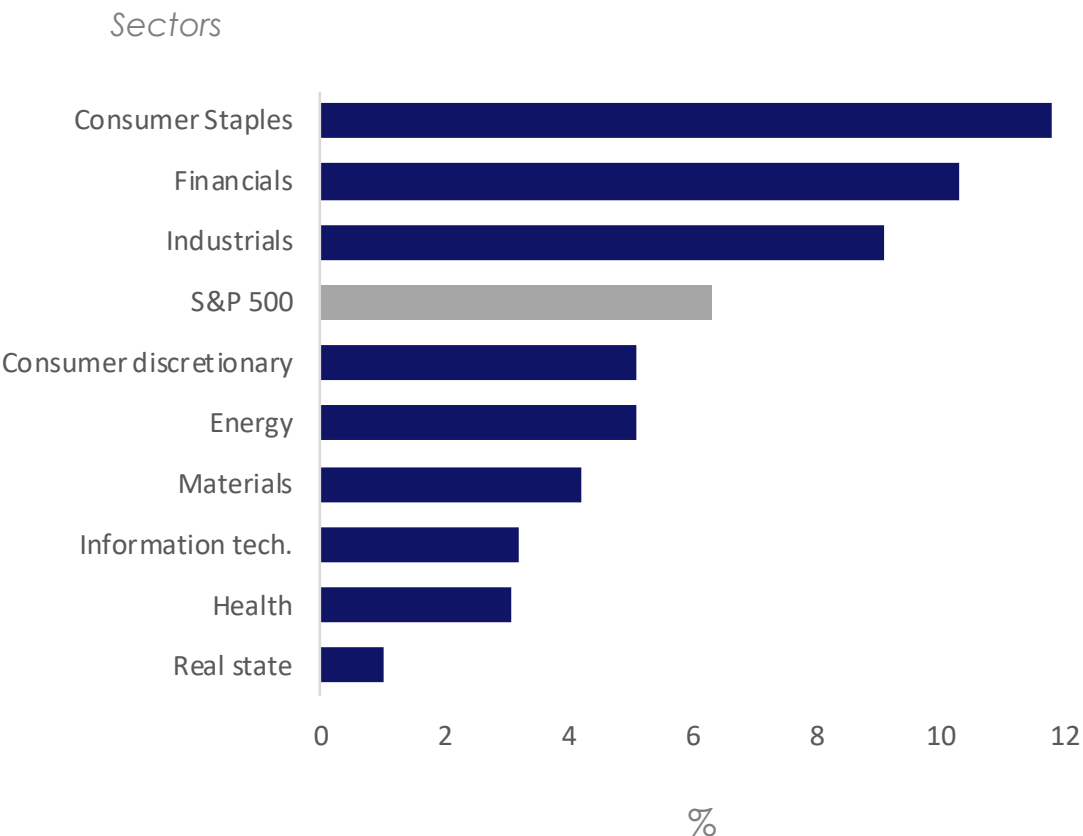
Source: *Círculo de Empresarios* based on IMF & Markit, 2018

US: politics hogs the limelight

Impact of US fiscal reform on growth
GDP percentage points



Impact of fiscal reform on S&P 500 Earnings
Growth Rate in 2018 (%)



US: trade scenario

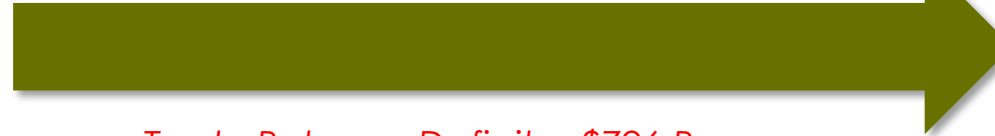
The US runs a **deficit in the balance of trade** of \$796 billion (4.1% of GDP) with its trading partners around the world *

US



Exports of goods

\$1,546 B (8% of GDP)



Trade Balance Deficit: - \$796 B



\$2,342 B (12.1% of GDP)

Rest of the world



Top 5 US trade partners % total exports

- | | |
|------------------|------------------|
| 1 China (16.4%) | 4 Japan (5.3%) |
| 2 Canada (15%) | 5 Germany (4.4%) |
| 3 Mexico (14.3%) | |

Country Ranking by size of trade deficit with the US

- | | |
|----------|-----------|
| 1 China | 4 Germany |
| 2 Mexico | 5 Vietnam |
| 3 Japan | |

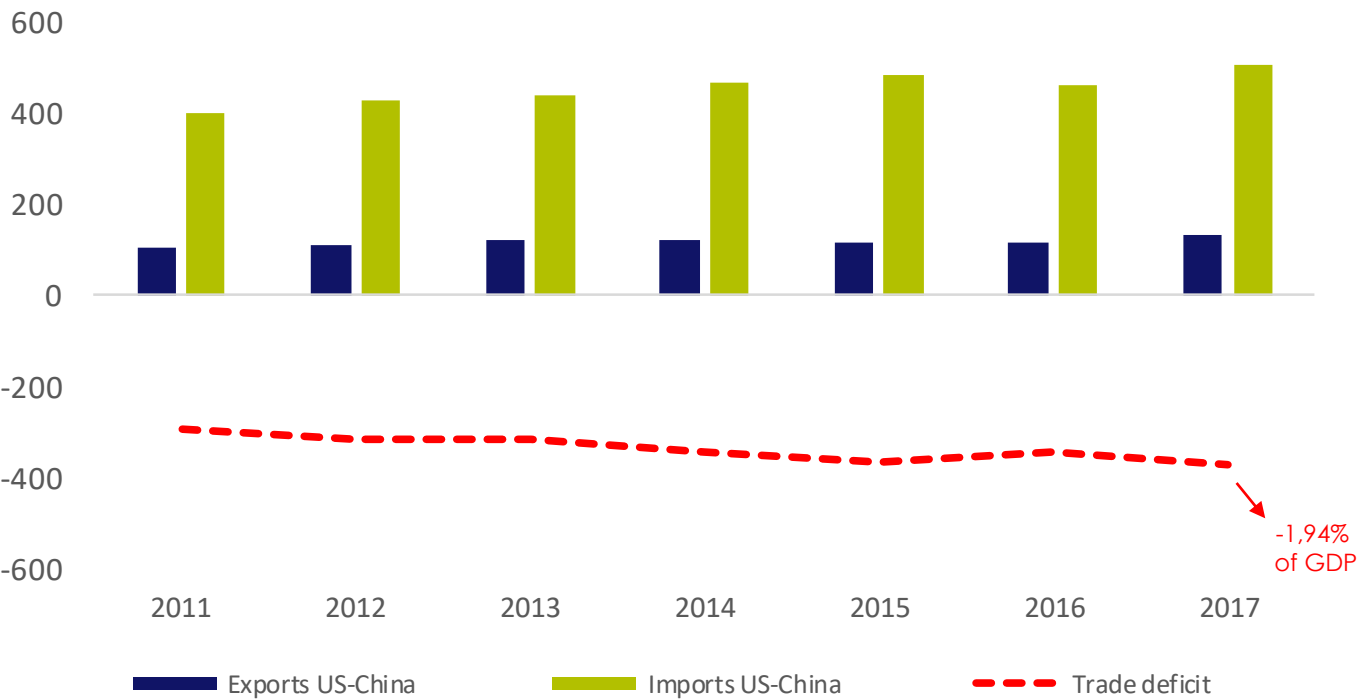
* If services are included, the deficit is reduced to 2.9% of GDP

Source: Círculo de Empresarios based on US Census Bureau, 2018

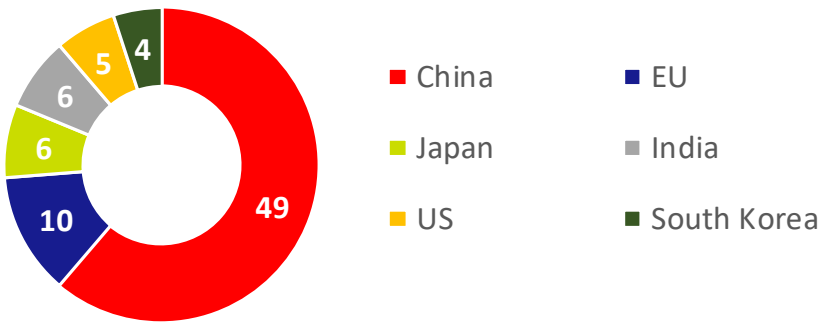
US: trade protectionism (I)

Trump announces the intention of reducing the **trade deficit with China** by imposing tariffs on 1,333 goods worth more than \$60,000 M

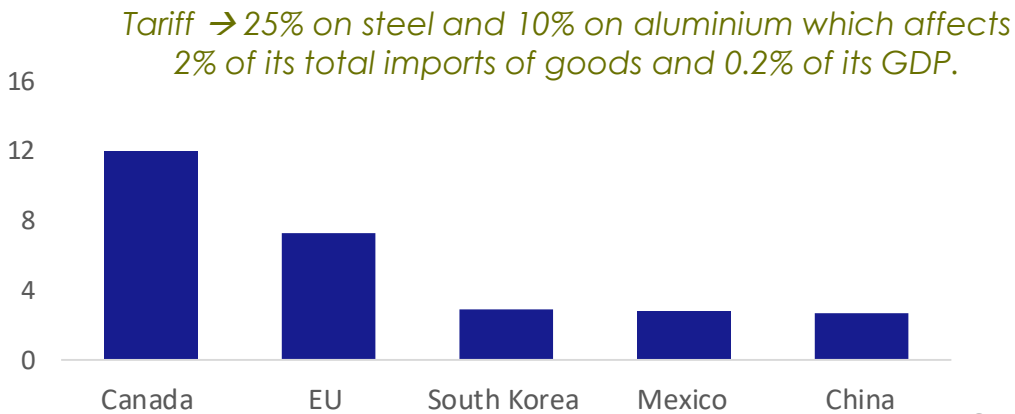
US-China balance of trade
Billion \$



Main world steel producers, 2017
%



US steel and aluminium imports
Billion \$



US: trade protectionism (II)

Trump delays until June decision to impose tariffs on steel and aluminum for the **European Union**

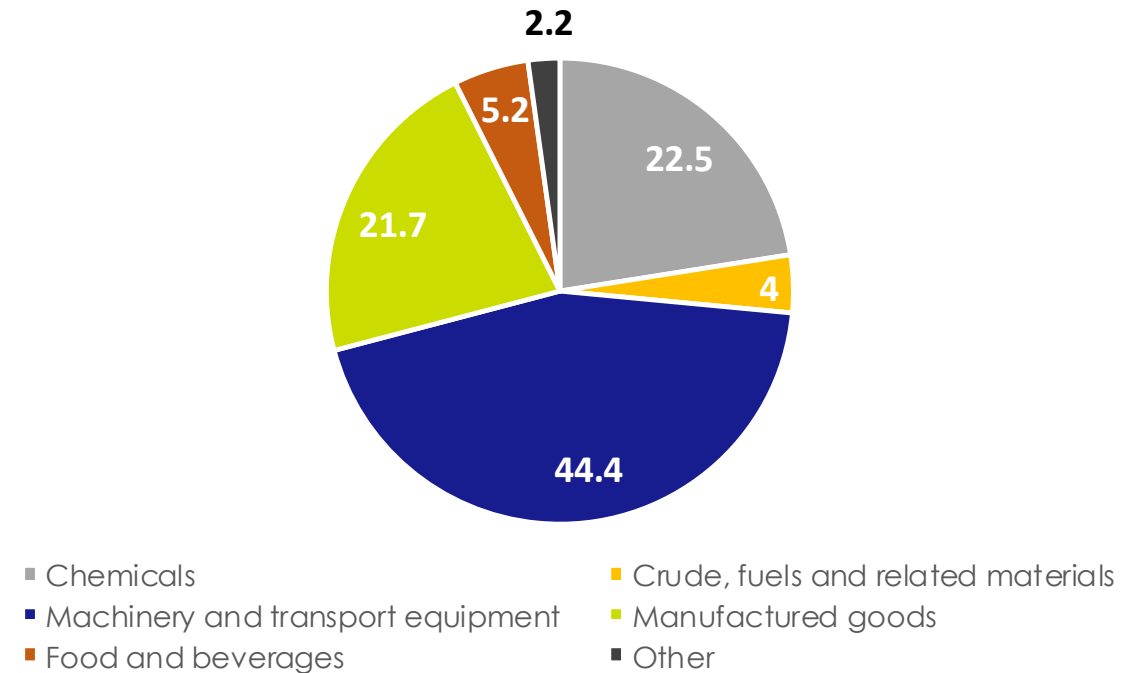
US-EU Exports of goods

Annual change



US-EU Exports of goods, 2017

% total*



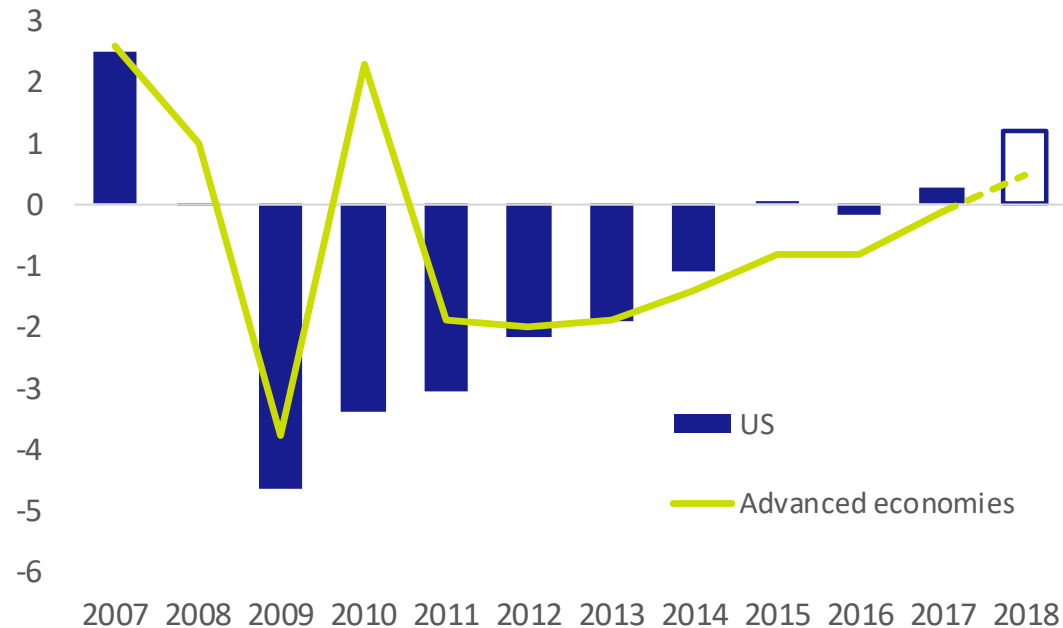
* Percentages calculated based on volumes in €

Source: *Círculo de Empresarios* based on US Census Bureau, & European Commission, 2018

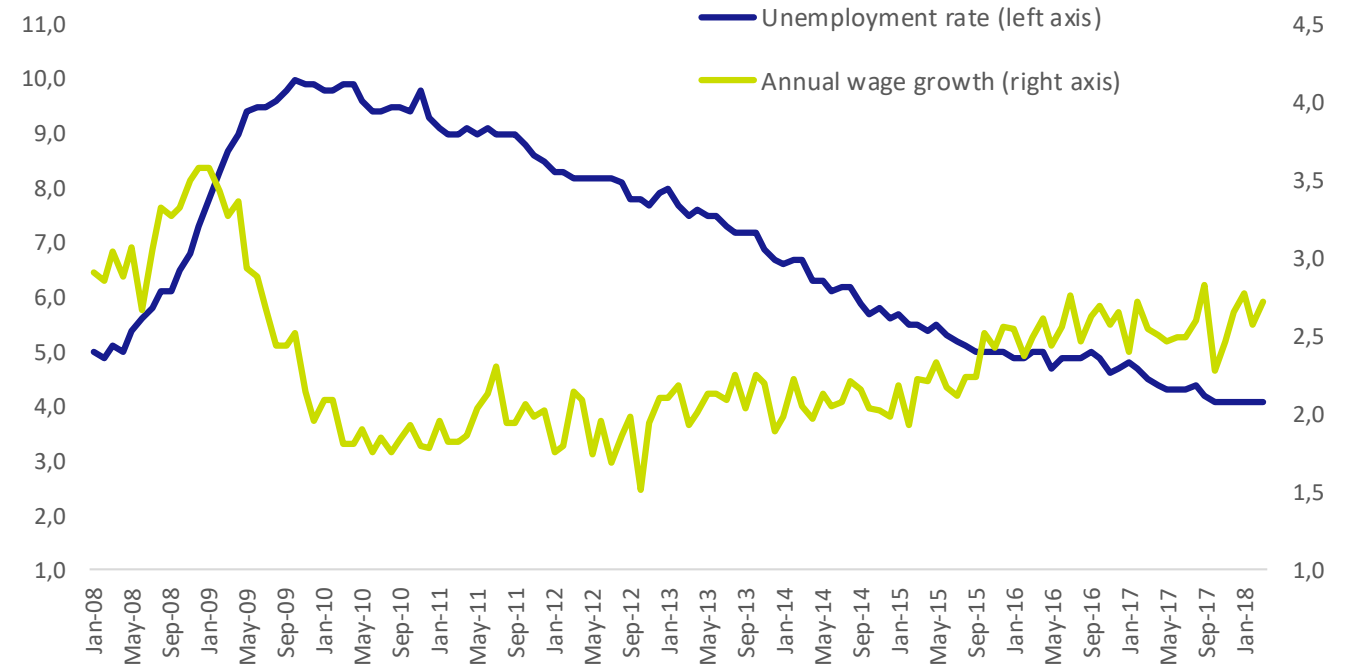
US: above-potential economic growth

Robust economic growth, although the expansionary policy may **overheat its economy**

Output Gap* % Potential GDP



US labour market indicators % active population and annual variation



* Difference between Actual GDP and Potential GDP

Note: OG>0 implies that Actual GDP is more than Potential GDP (full-capacity production)

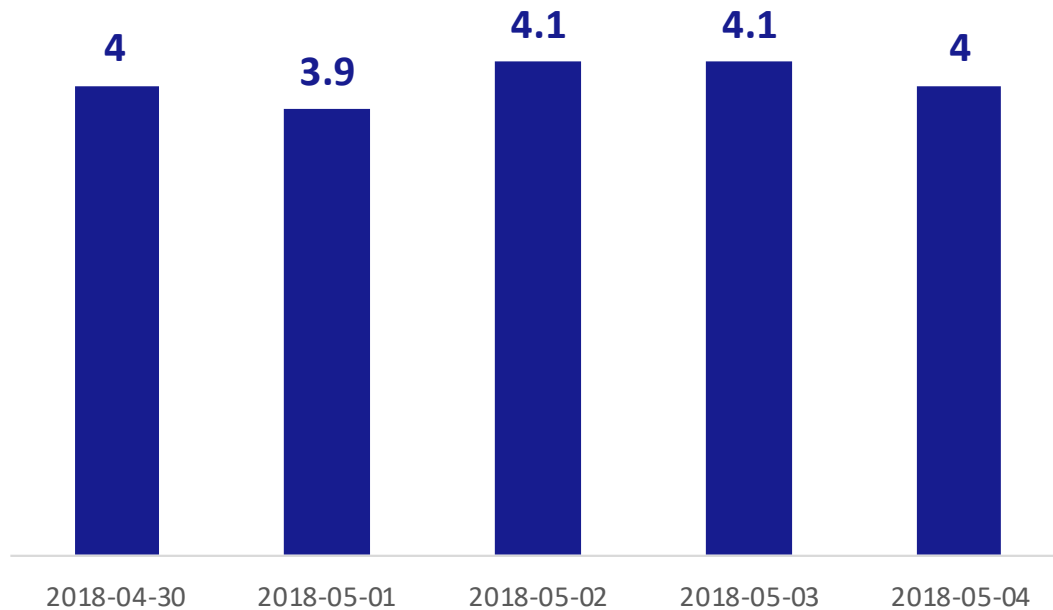
Source: Círculo de Empresarios based on US Bureau of Labour Statistics & St. Louis Fed, 2018

US: overheating risks are looming

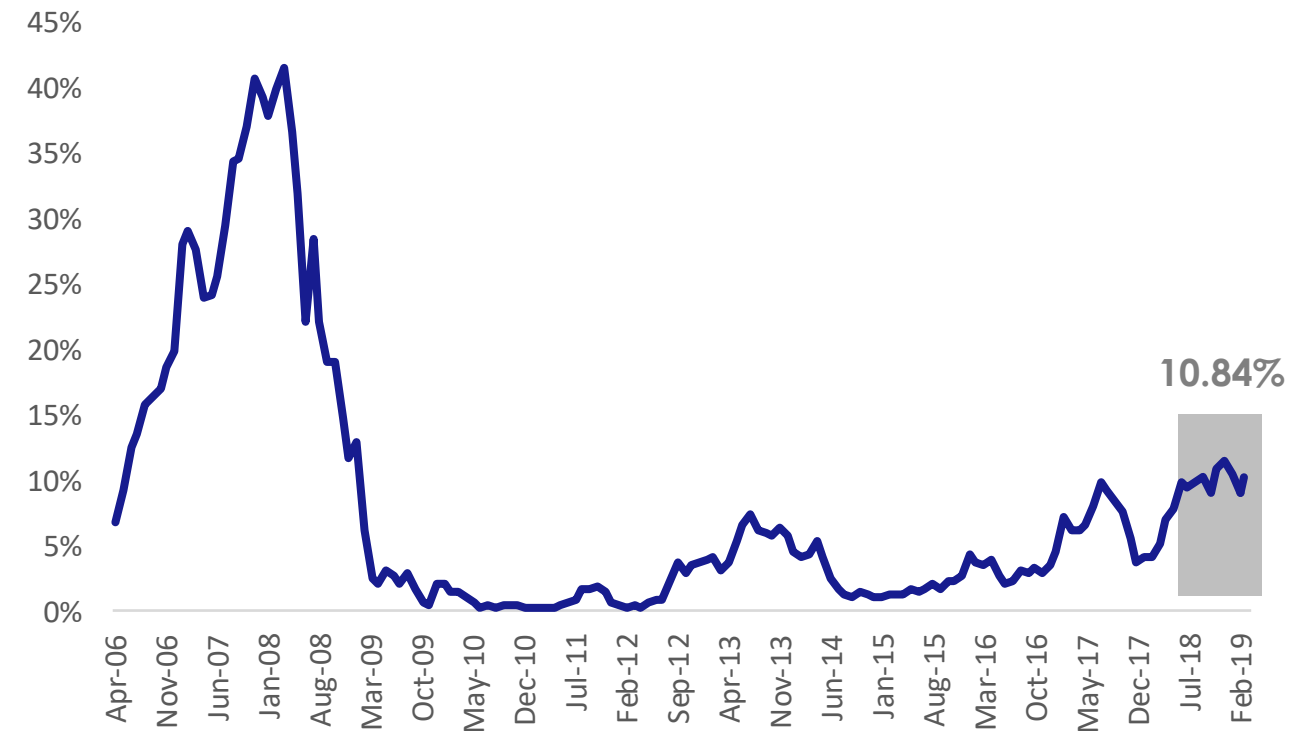
US records **107 consecutive months** of economic growth

US GDP, 2018:Q2 Estimate*

% Year-over-Year



Probability of recession in the US (12 months ahead)



* Real-time indicator (*GDP Now*) developed by the Atlanta Fed based on more than 20 subcomponents of GDP

Note: The probability of recession is calculated based on the spread between the yields on long- and short-maturity nominal Treasury securities

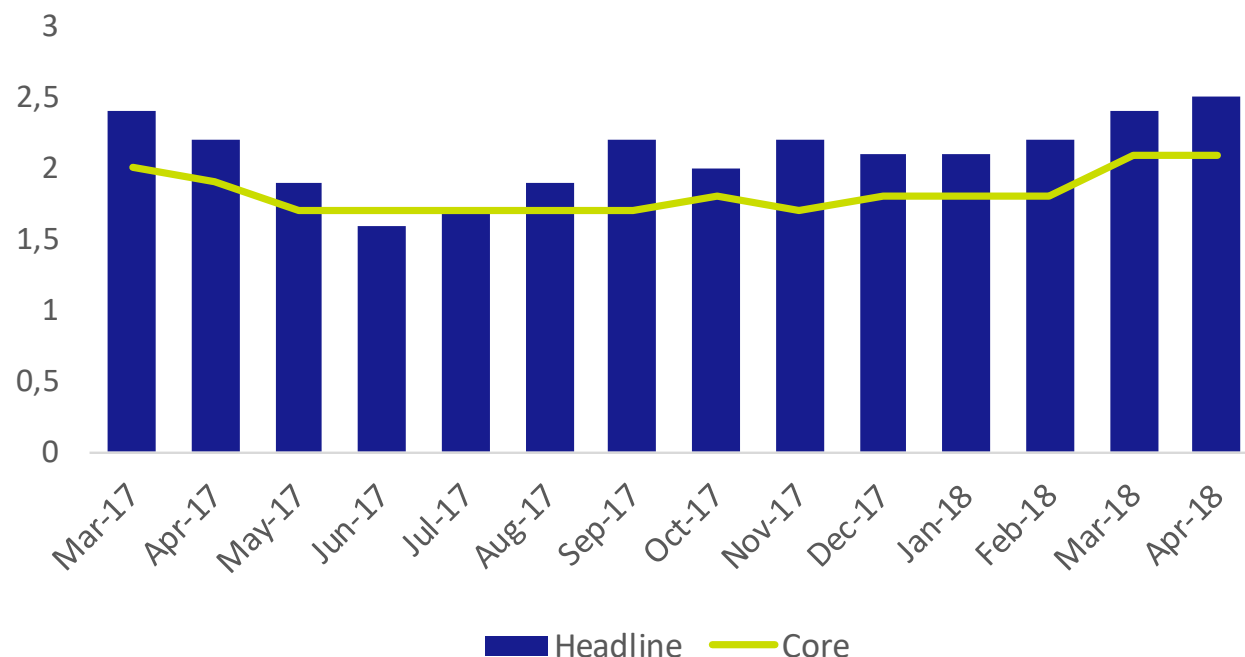
Source: *Círculo de Empresarios* based on the Federal Reserve Bank of Atlanta & NY, 2018

US: inflation above 2%

Estimates indicate that Personal Consumption Expenditure (PCE) prices will overshoot the **objective of the Fed**

Evolution of US inflation

Year-over-Year inflation

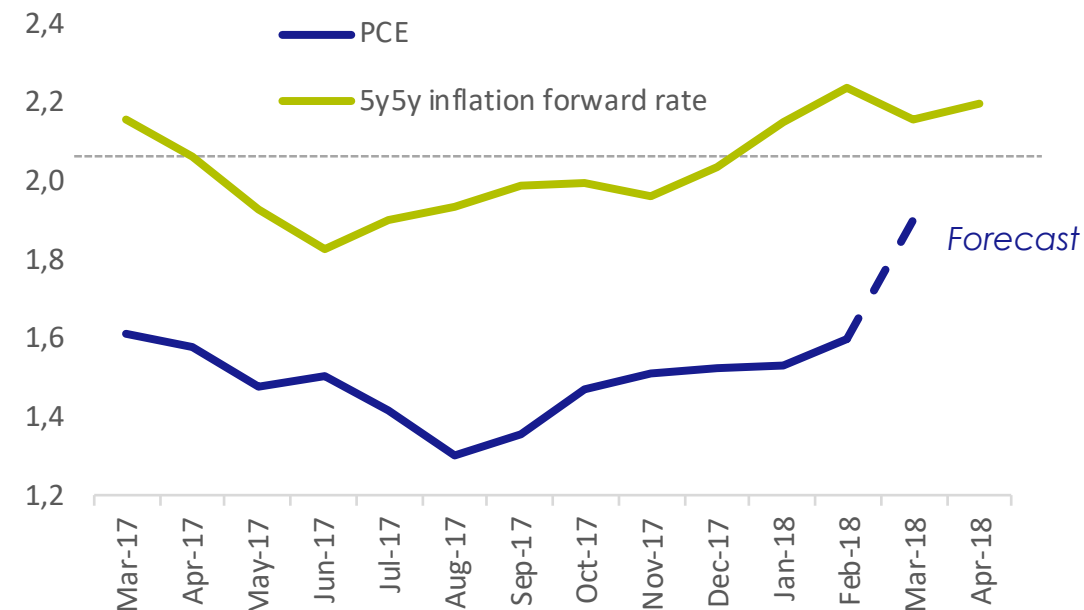


Core: excludes food and energy product prices

Source: Círculo de Empresarios based on US BLS, IMF, 2018

Core PCE price

Year-over-Year inflation



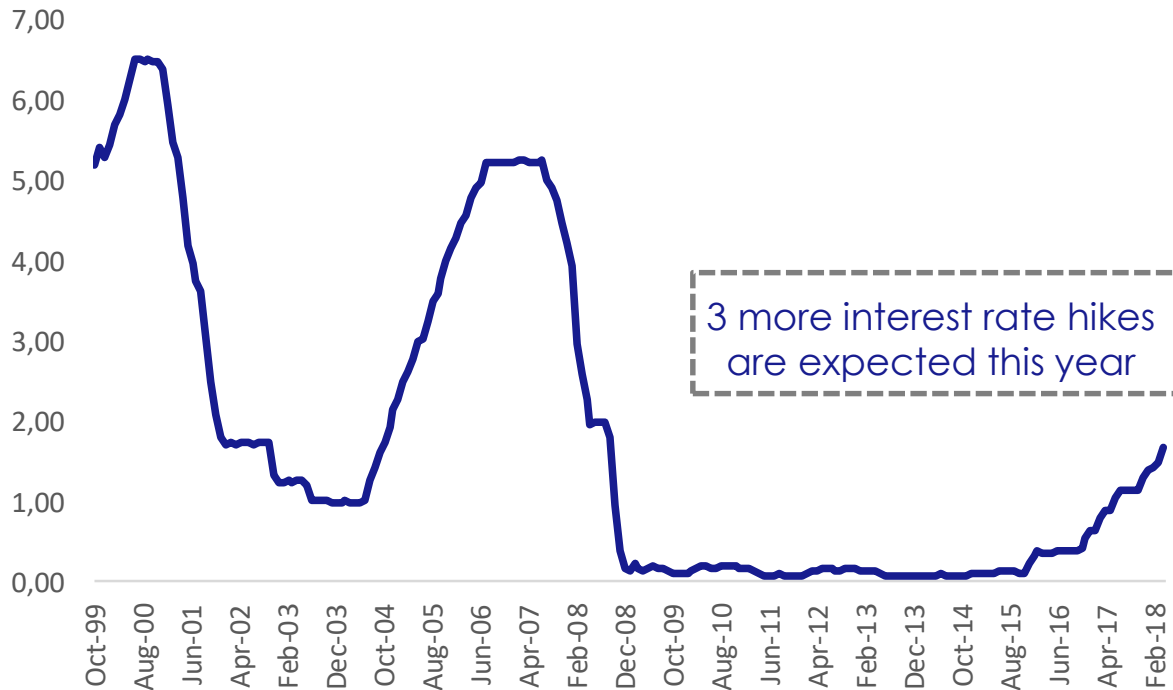
5y5y inflation swap rate: Indicator that measures inflation expectations

Fed: continues with normalisation

Interest rates hike in March, to a range of 1.50% - 1.75%

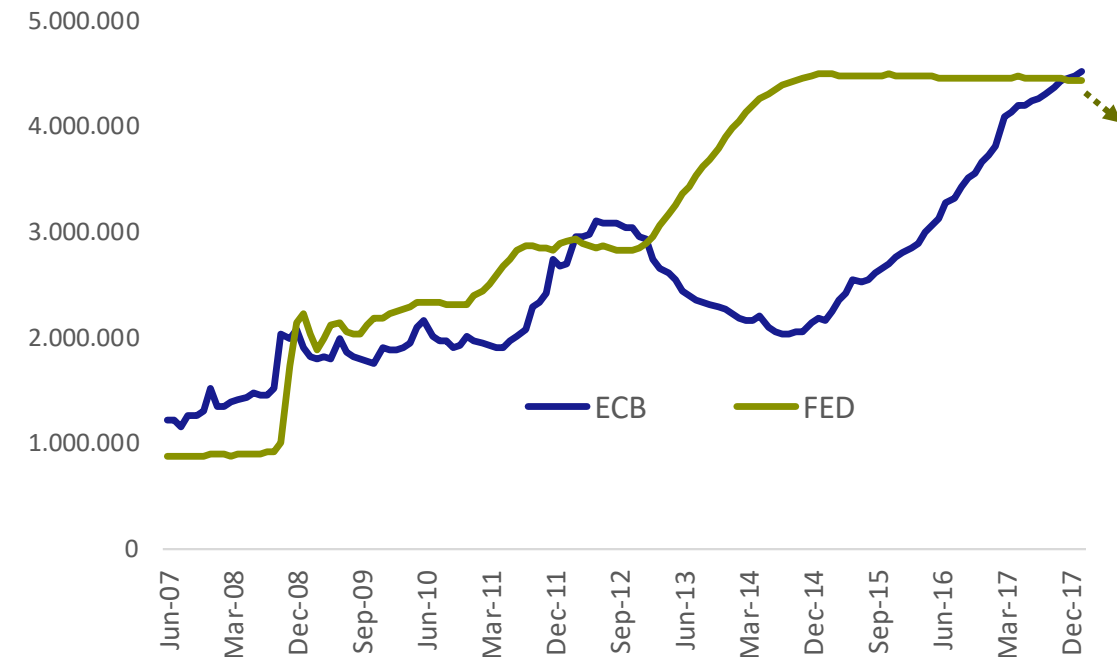
US Effective interest rate

%



Central Bank balance sheet

Millions \$ and €



EU: upward revision of growth by IMF

Continuity in the economic expansion with **signs of growth slowdown in Germany**

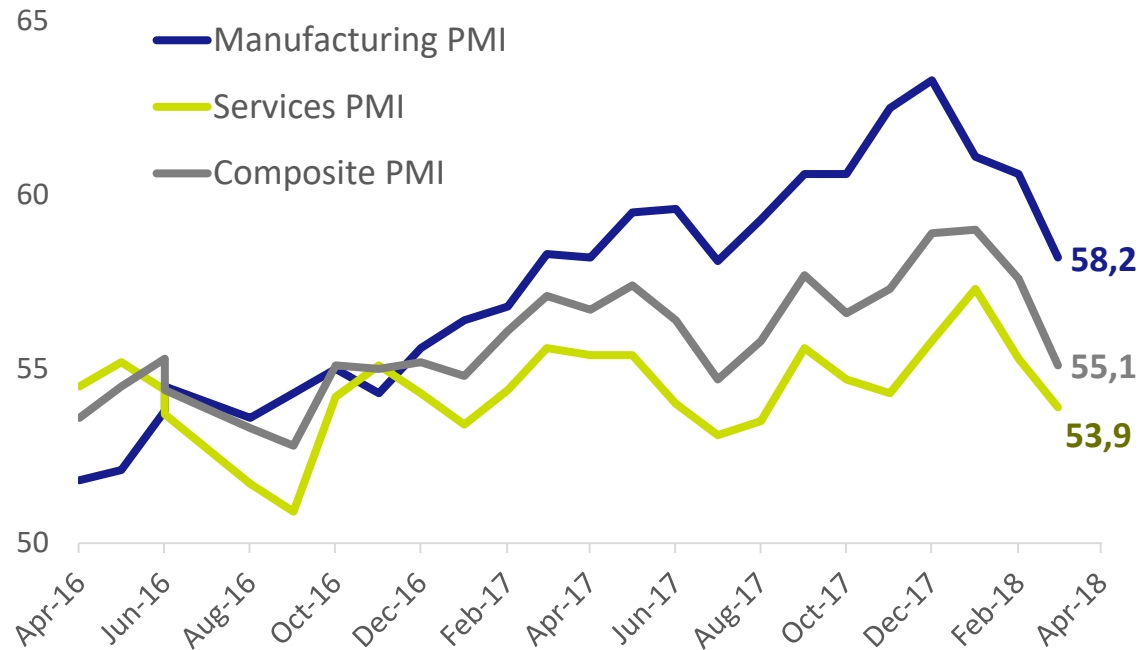
Real GDP growth
%



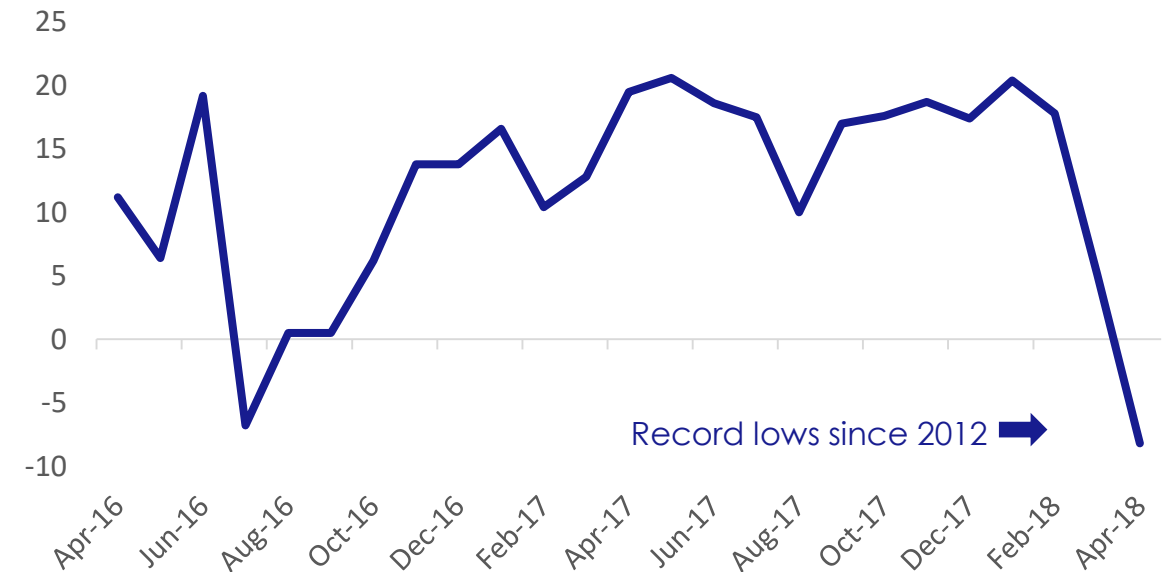
Germany: economic sentiment wanes

Signs of economic activity cooling down: (1) slipping manufacturing **PMIs**, (2) dwindling **investor sentiment (ZEW)**, and (3) declining **industrial new orders**

Germany PMI



ZEW Market Survey (market sentiment)



Note: a positive number means that the share of optimists outweighs the share of pessimists

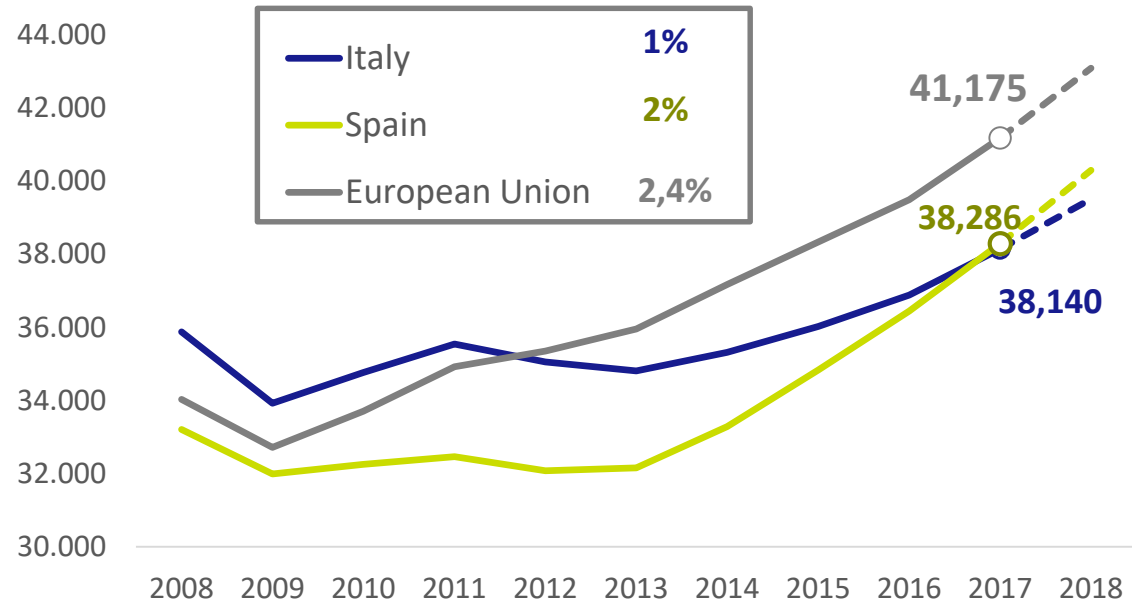
Italy: gradual loss of economic weight

In 2017, Spain surpassed Italy in GDP per capita (\$ PPP)

GDP per capita

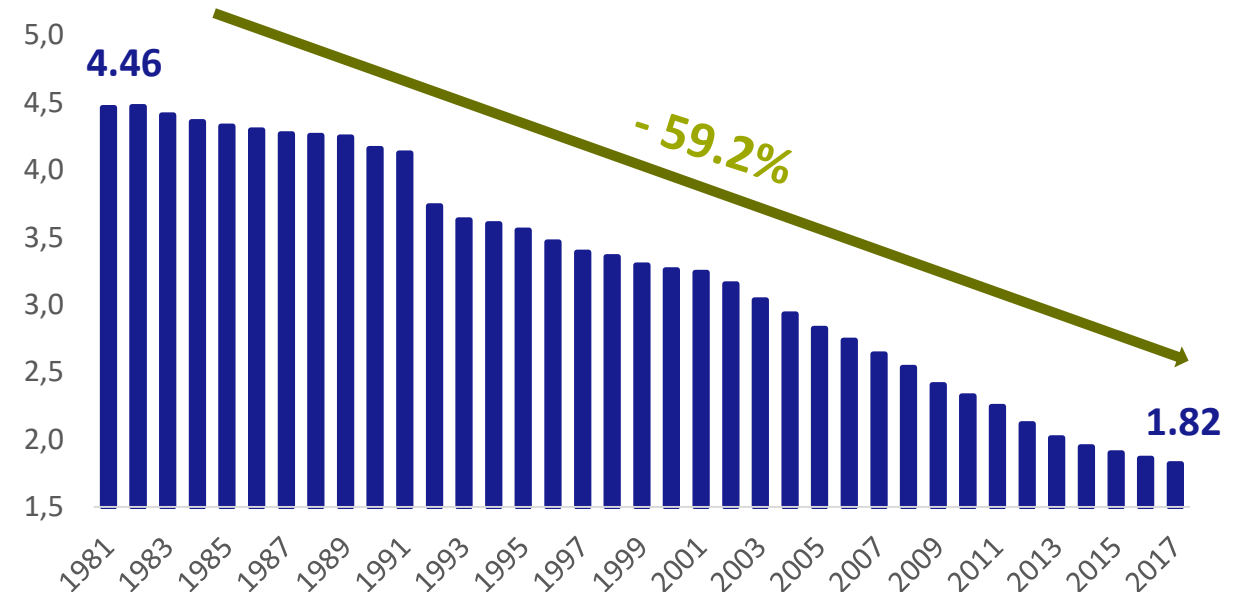
\$ in PPP

Average annual growth rate 2008-17



Weight of the Italian economy in the world

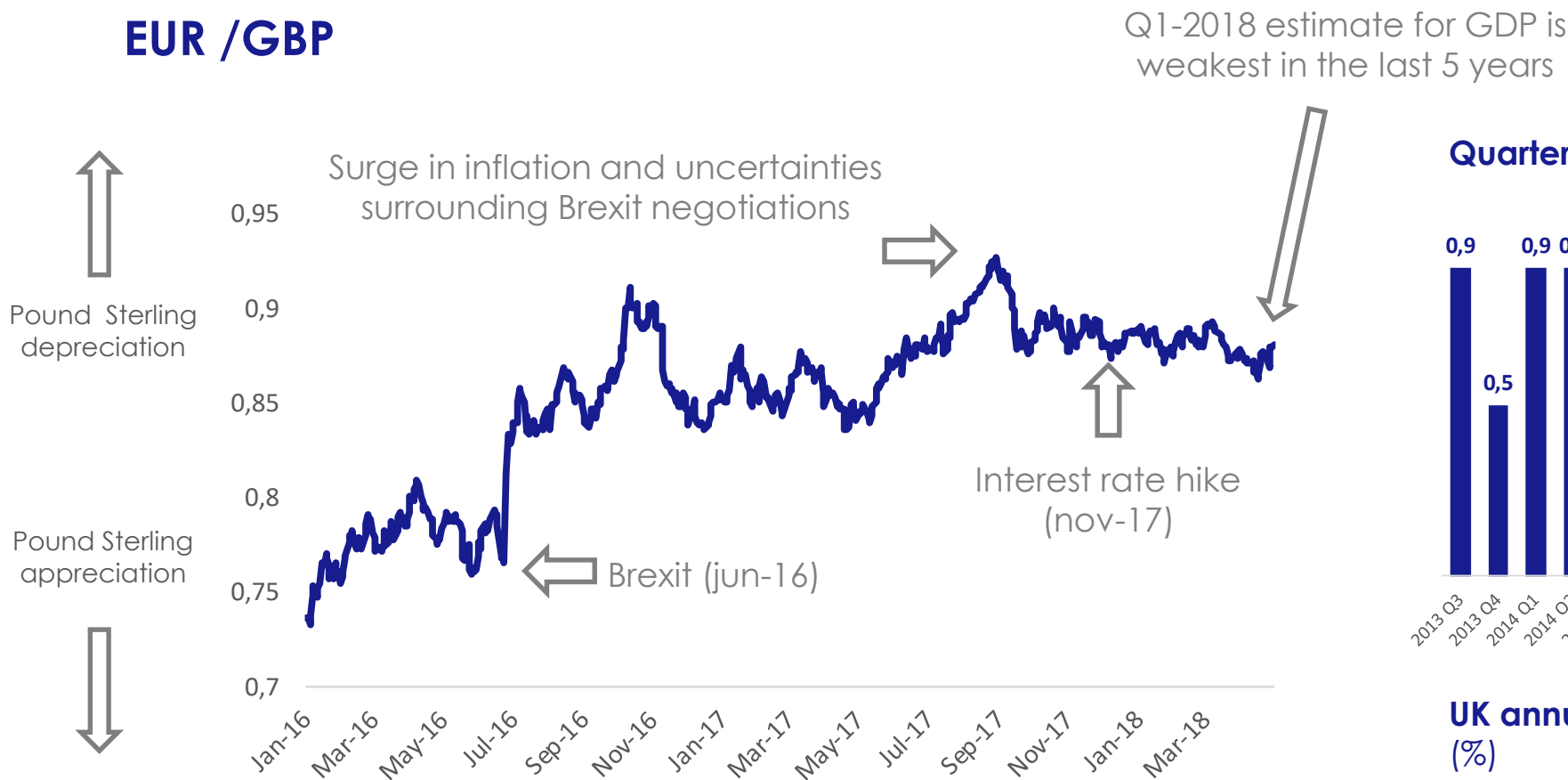
% (in terms of \$ in PPP)



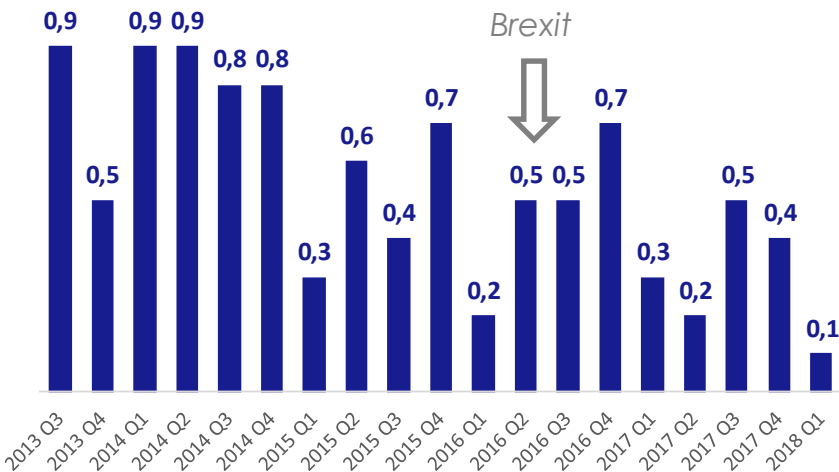
United Kingdom: economic slowdown

Slowdown in economic activity in the United Kingdom

EUR /GBP



Quarterly GDP growth (%)



UK annual growth forecast (IMF) (%)

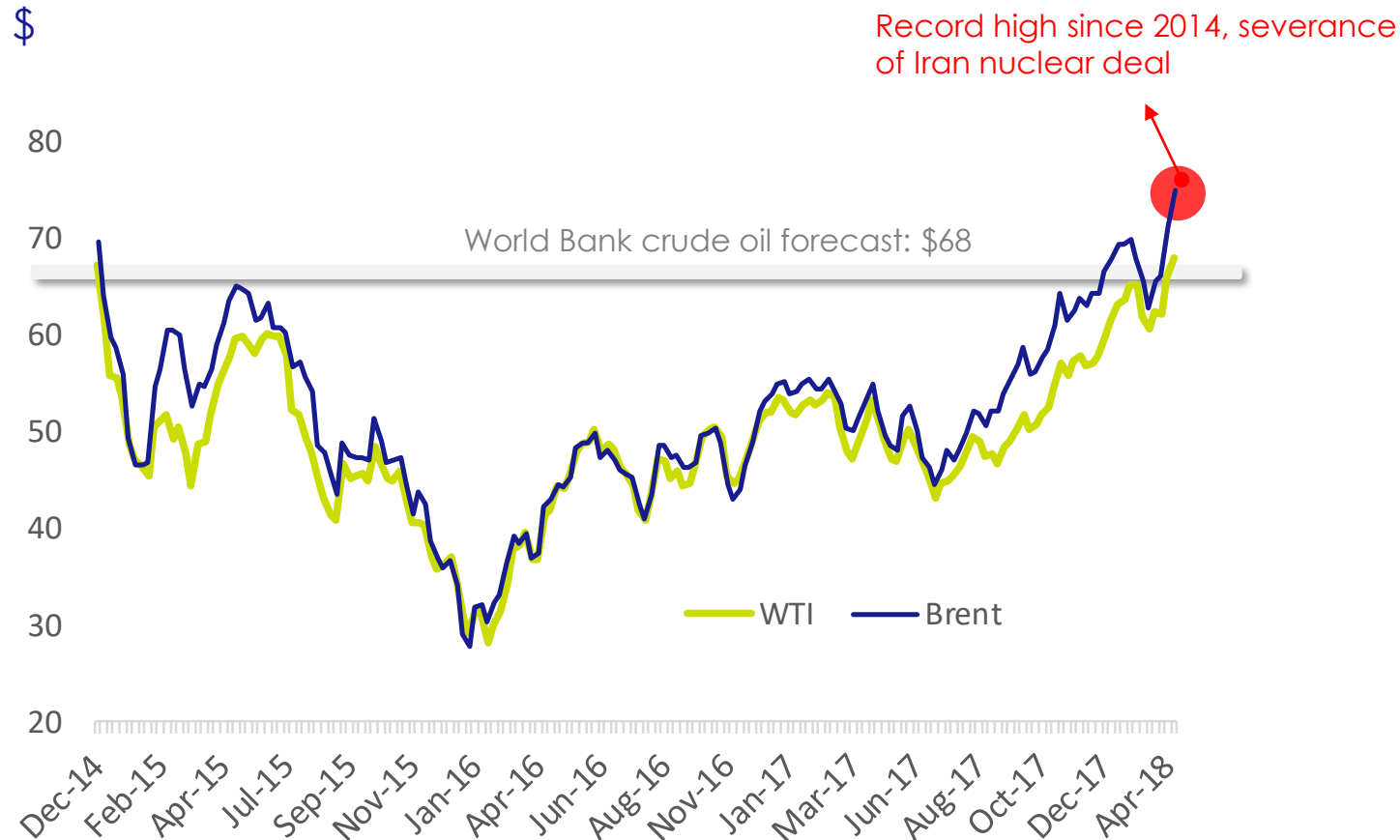


Raw materials (I): rising oil prices

Geopolitical tensions help push up the price of a barrel of oil

Weekly price of a barrel of crude oil

\$



Iran
Sanctions

Upswing in
consumption

Reasons for rise in oil price

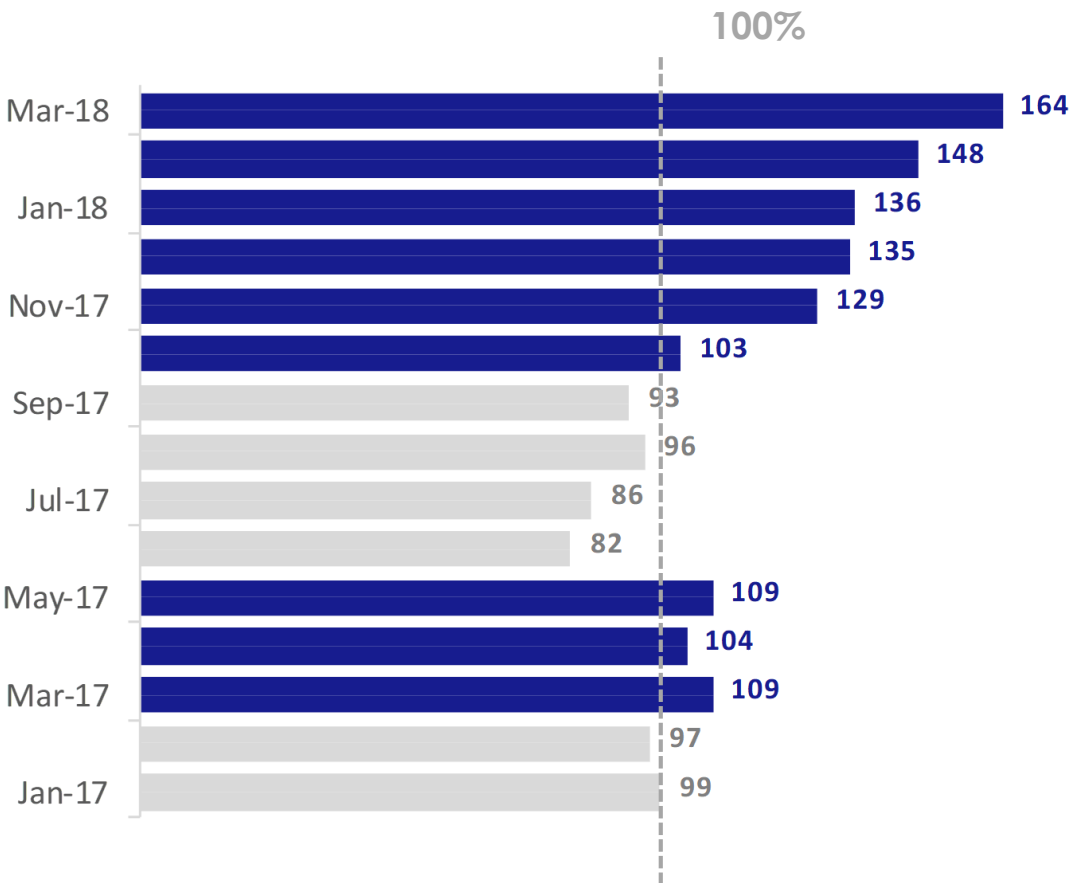
OPEC
supply cuts

US inventory
reduction

Raw materials (II): shale oil

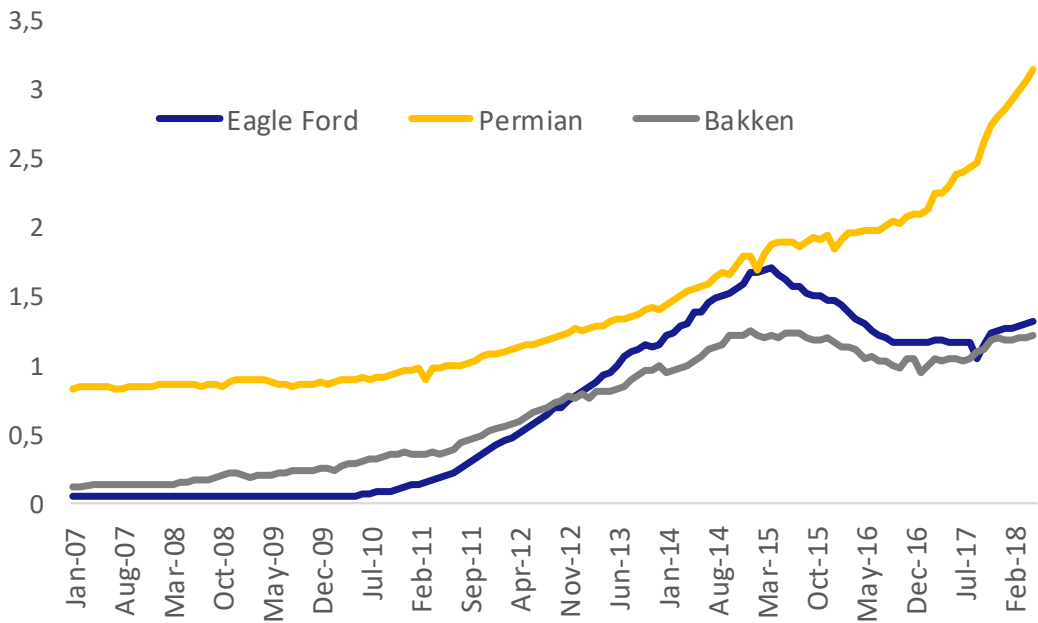
The **high levels of compliance with the OPEC-led output-cut** contrasts with the growing **shale oil** production

% compliance with the OPEC cut



Note: the higher the degree of compliance, the greater the effort in cuts
Source: *Círculo de Empresarios* based on Bloomberg, EIA, 2018

US shale oil production by region
Mbd (million barrels per day)

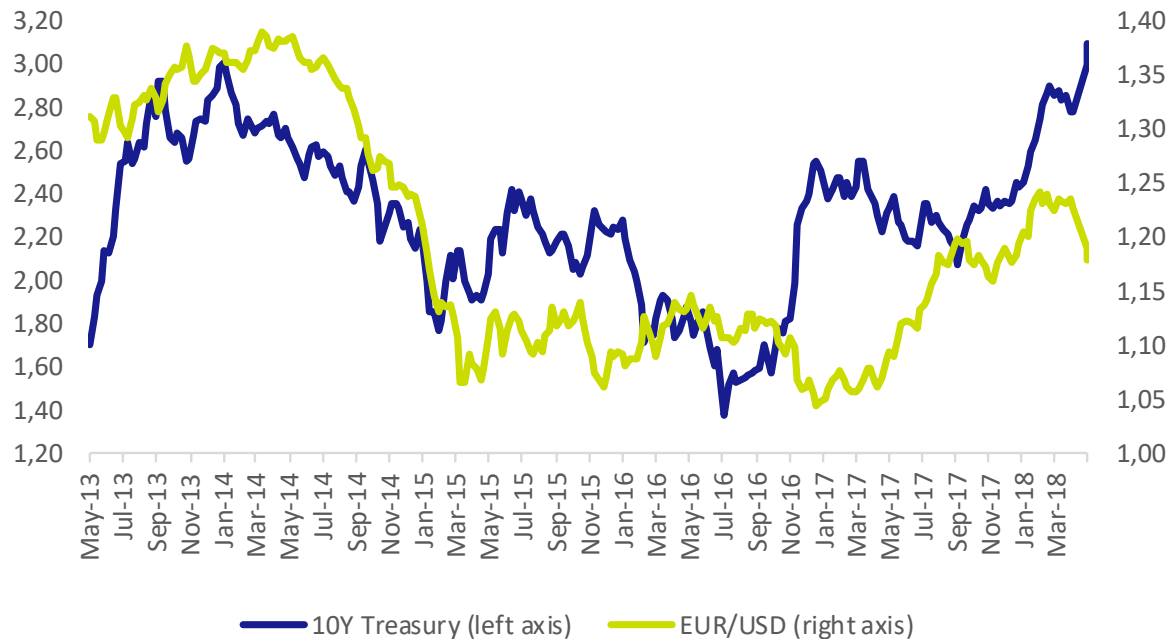


Permian Basin accounts for **≈50% of US oil drilling rigs**, and its oil production has reached more than **3 mbd**

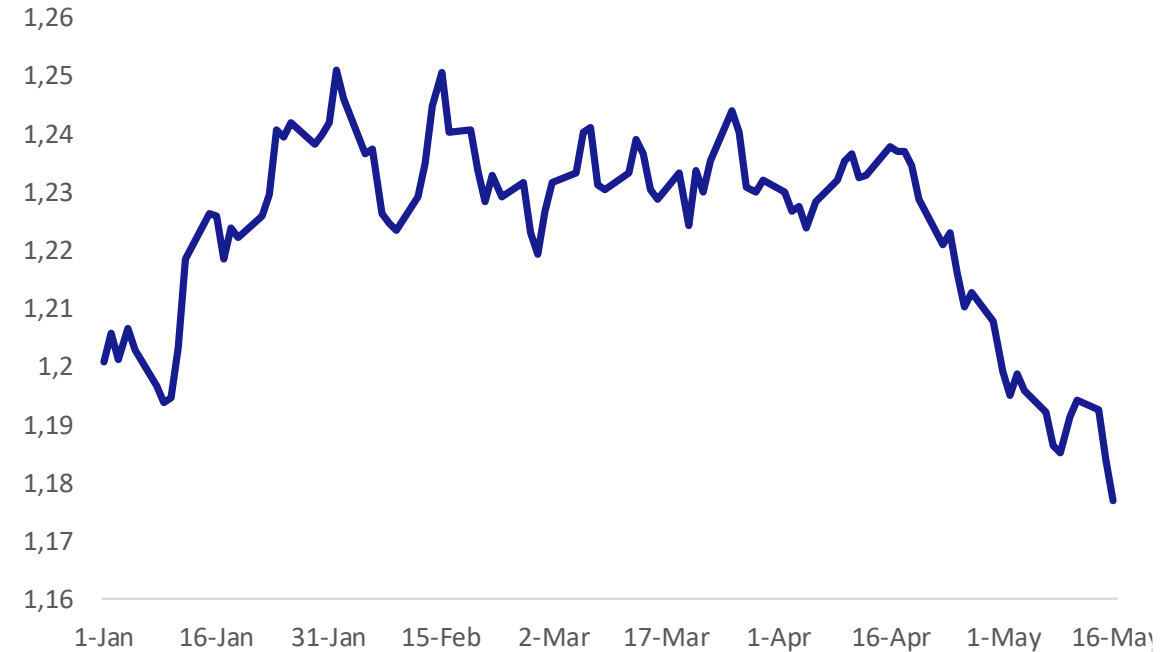
Currency market (I): appreciation of the dollar

Expectations of rising inflation and the normalisation of monetary policy by the Fed puts an upward pressure on the dollar

Evolution EUR/USD & US 10-year Treasury



EUR/USD

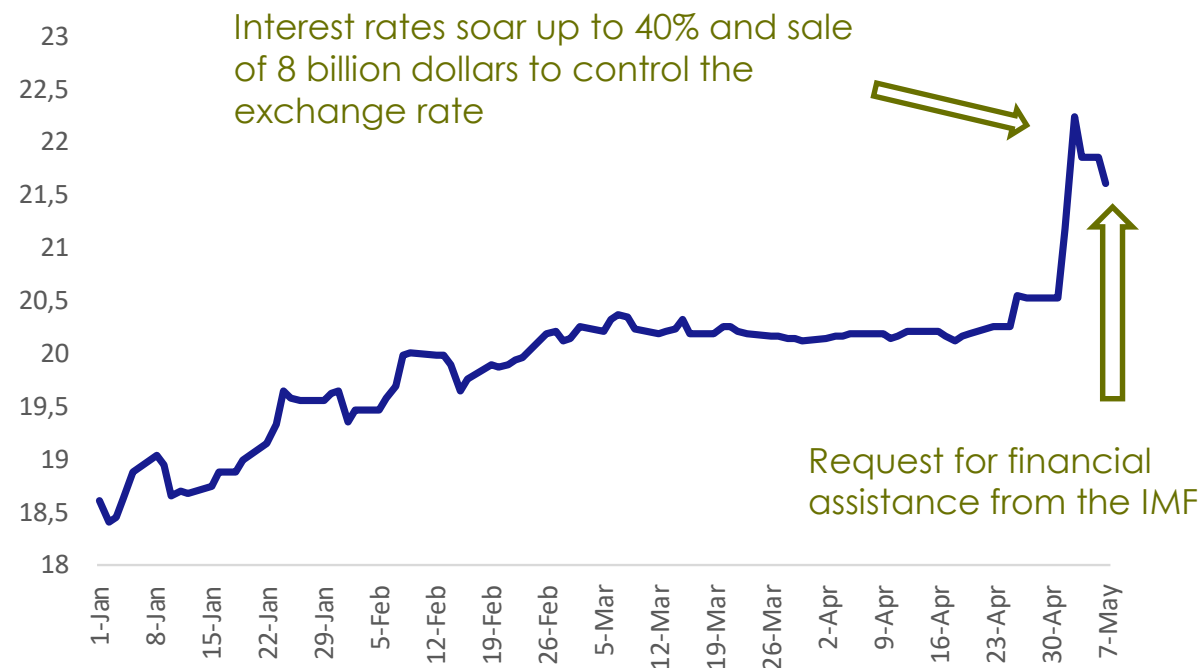


Source: *Círculo de Empresarios* based on ECB & St. Louis Fed, 2017

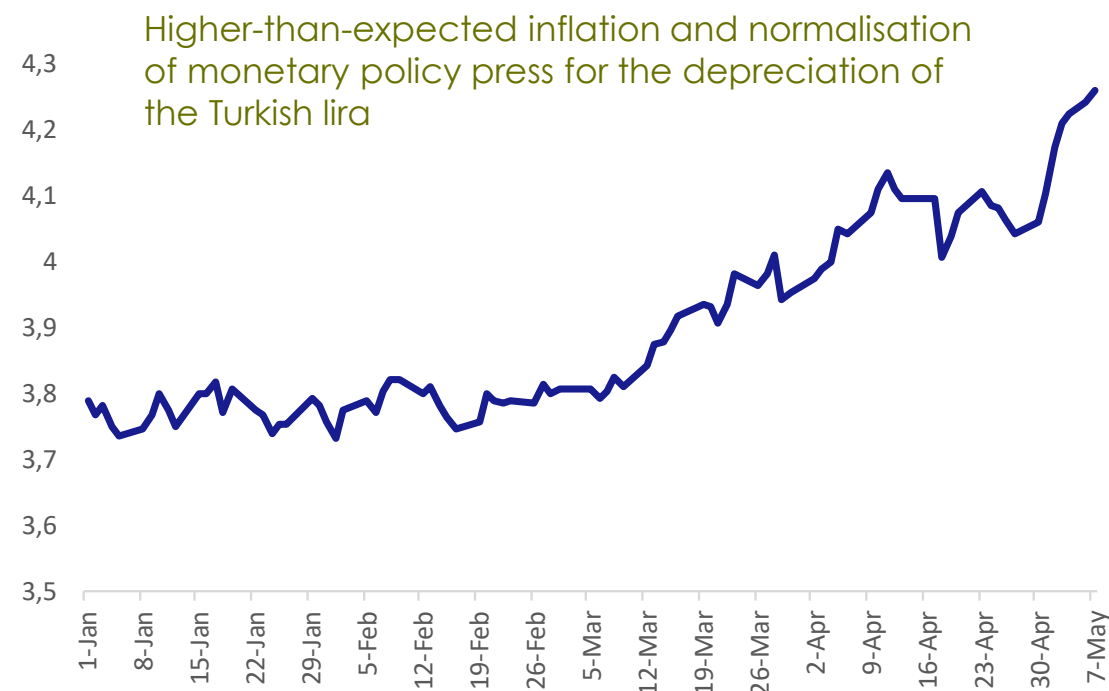
Currency market (II): emerging nations

Financial instability in **Argentina and Turkey** aggravates its depreciation against the dollar

USD/ARG



USD/TRY



Note: The Argentine peso is positioned as the emerging currency that most depreciates in 2018

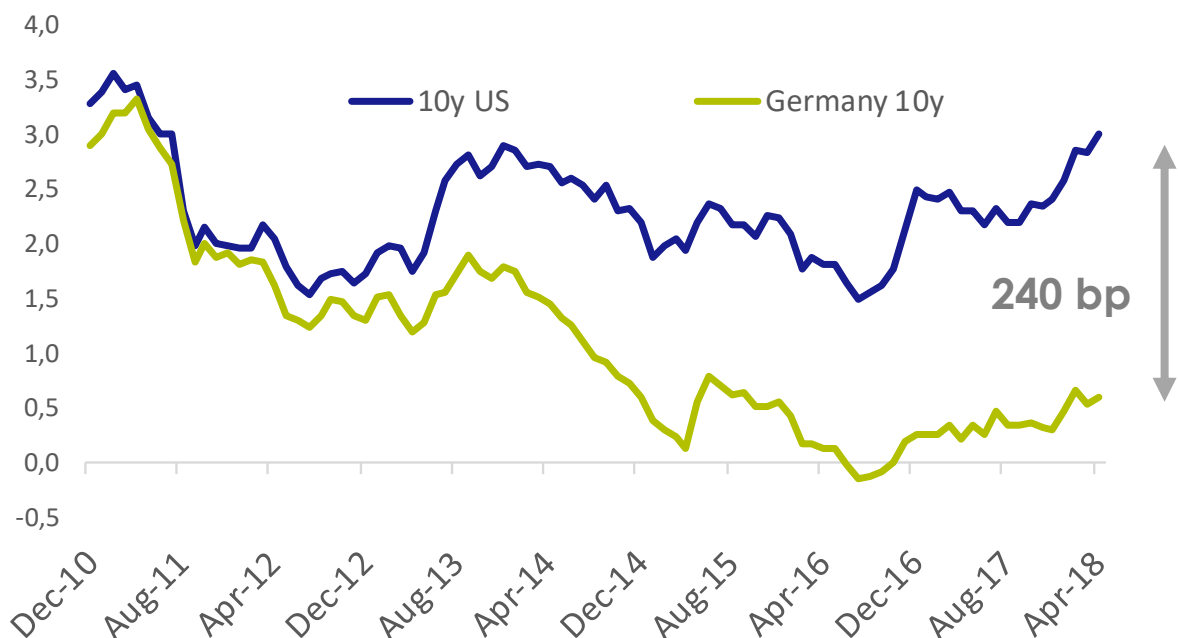
Source: *Círculo de Empresarios* based on Investing, Reuters, Bloomberg, 2018

Financial markets (I)

The **divergence of monetary policy** between the **Fed and the ECB** is reflected in the yield curves

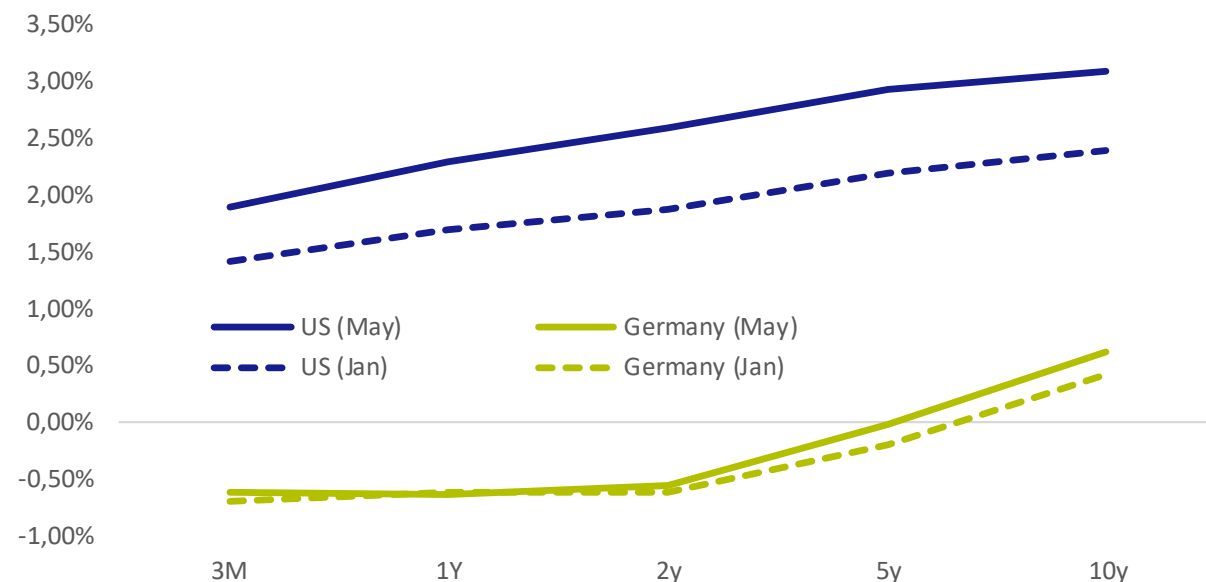
German 10-year Bund vs US 10-year Treasury

%



Germany and US yield curve, 2018

%

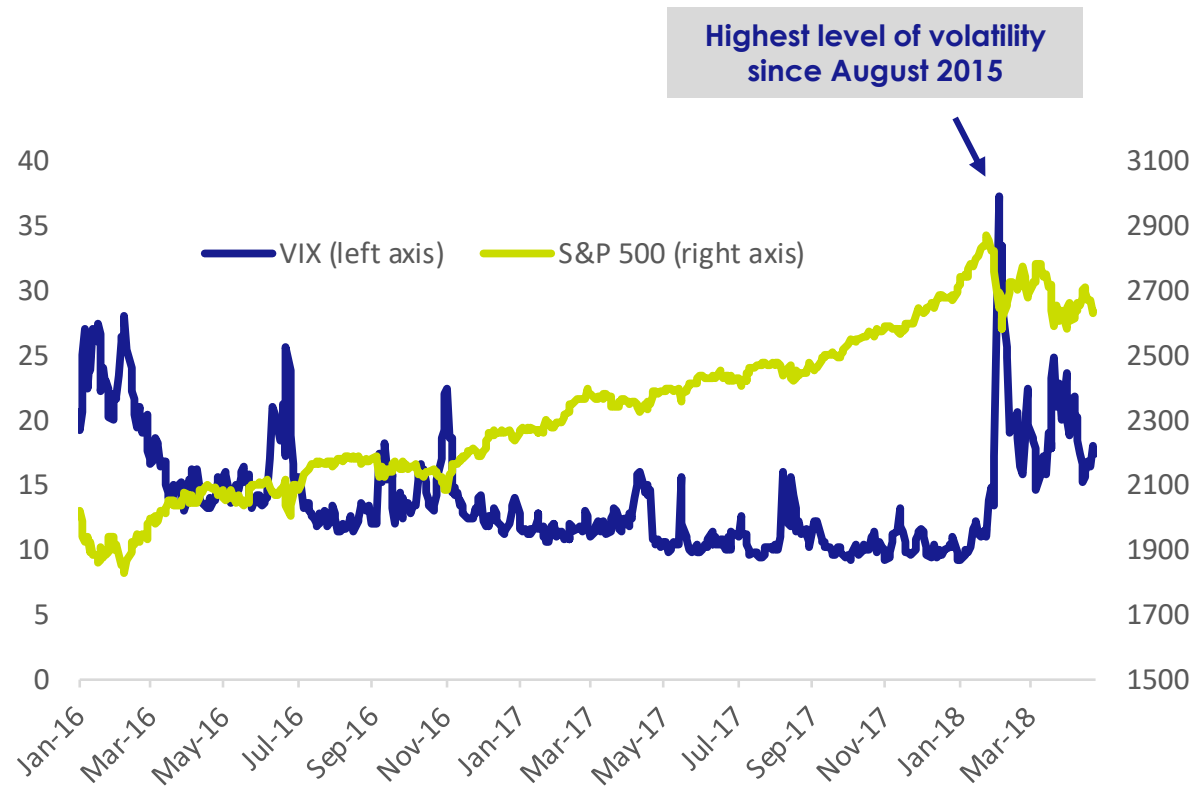


Source: Círculo de Empresarios based on Bloomberg, 2018

Financial markets (II)

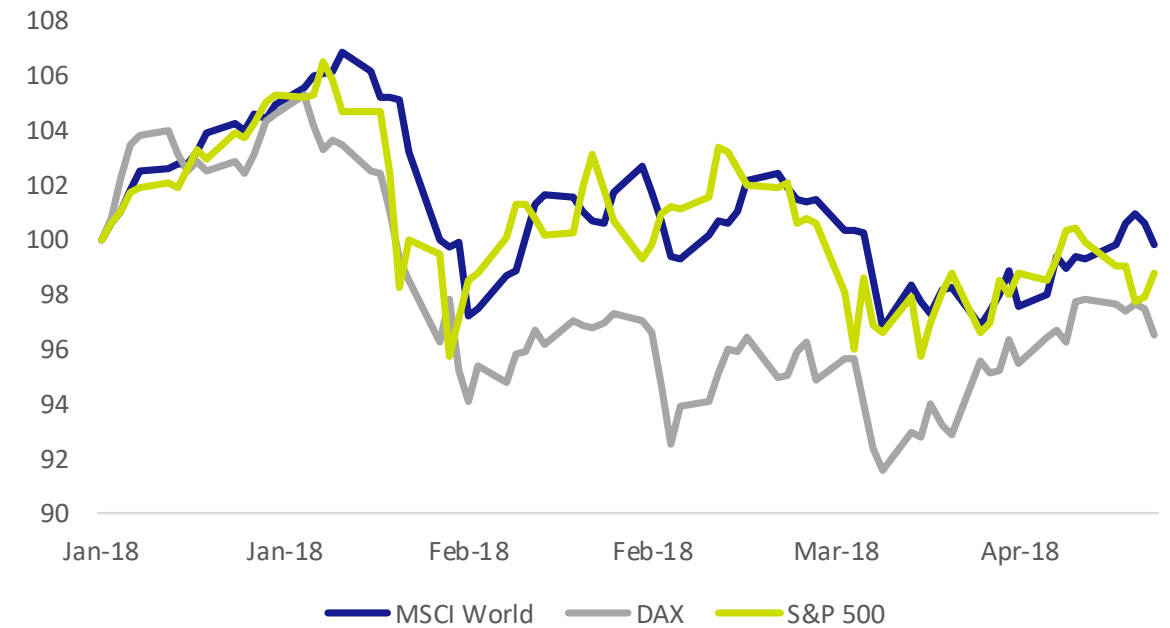
More **volatile** environment

Implied Volatility Index (VIX) and S&P 500



World Stock Exchanges

January 2018=100

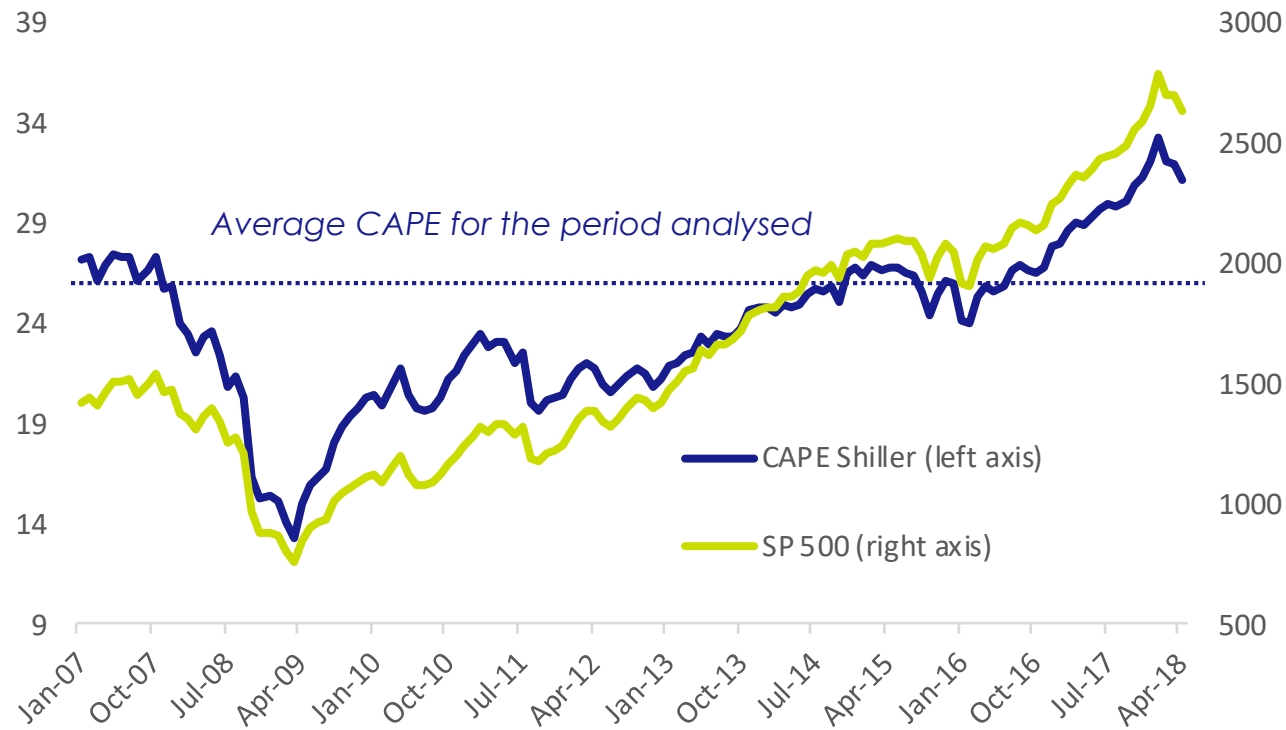


Source: *Círculo de Empresarios* based on Bloomberg, 2018

Financial markets (III)

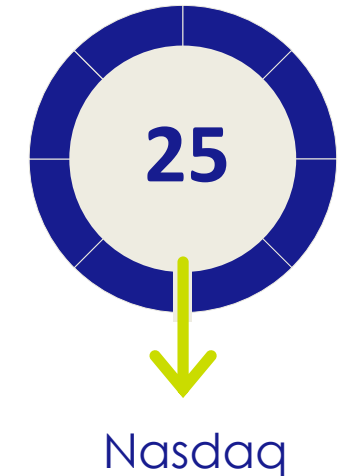
Ratings above their historical averages

CAPE (Cyclically Adjusted Price-to-Earnings)* and S&P 500



US stock markets PER (Price-to-Earnings Ratio)

Based on earnings for the last 12 months



CAPE: relationship between the price of the stock market and the average of EPS over the last 10 years

Source: *Círculo de Empresarios* based on Yale, WSJ, 2018



SPAIN

Forecasts 2018: the expansion protracts...

...although growth slows down

Macroeconomic scenario

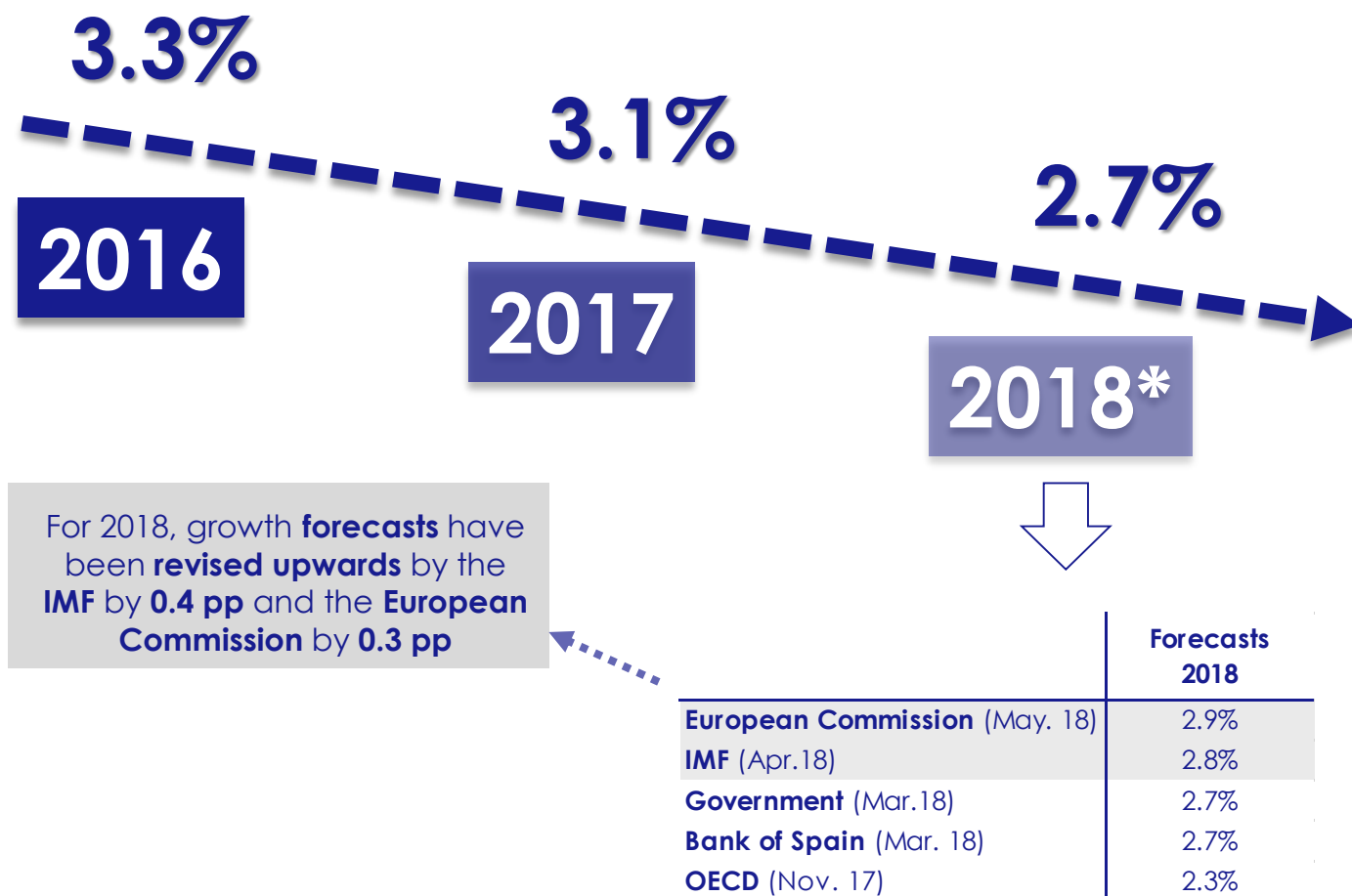
General State Budget 2018

ESA 2010. % actual var. over the same period last year
(unless otherwise indicated)

	2017	2018
Real GDP	3.1	2.7
GDP, current prices	4.0	4.3
Final domestic consumption	2.2	1.8
Private sector ^(a)	2.4	2.0
Public Administrations	1.6	1.1
Gross fixed capital formation	5.5	4.5
Changes in inventories (contribution to GDP growth)	0.1	0.0
Domestic demand (contribution to GDP growth)	2.8	2.3
Exports of goods and services	5.0	4.8
Imports of goods and services	4.7	4.1
External demand (contribution to GDP growth)	0.3	0.4

^(a) Households and non-profit institutions

* Forecast

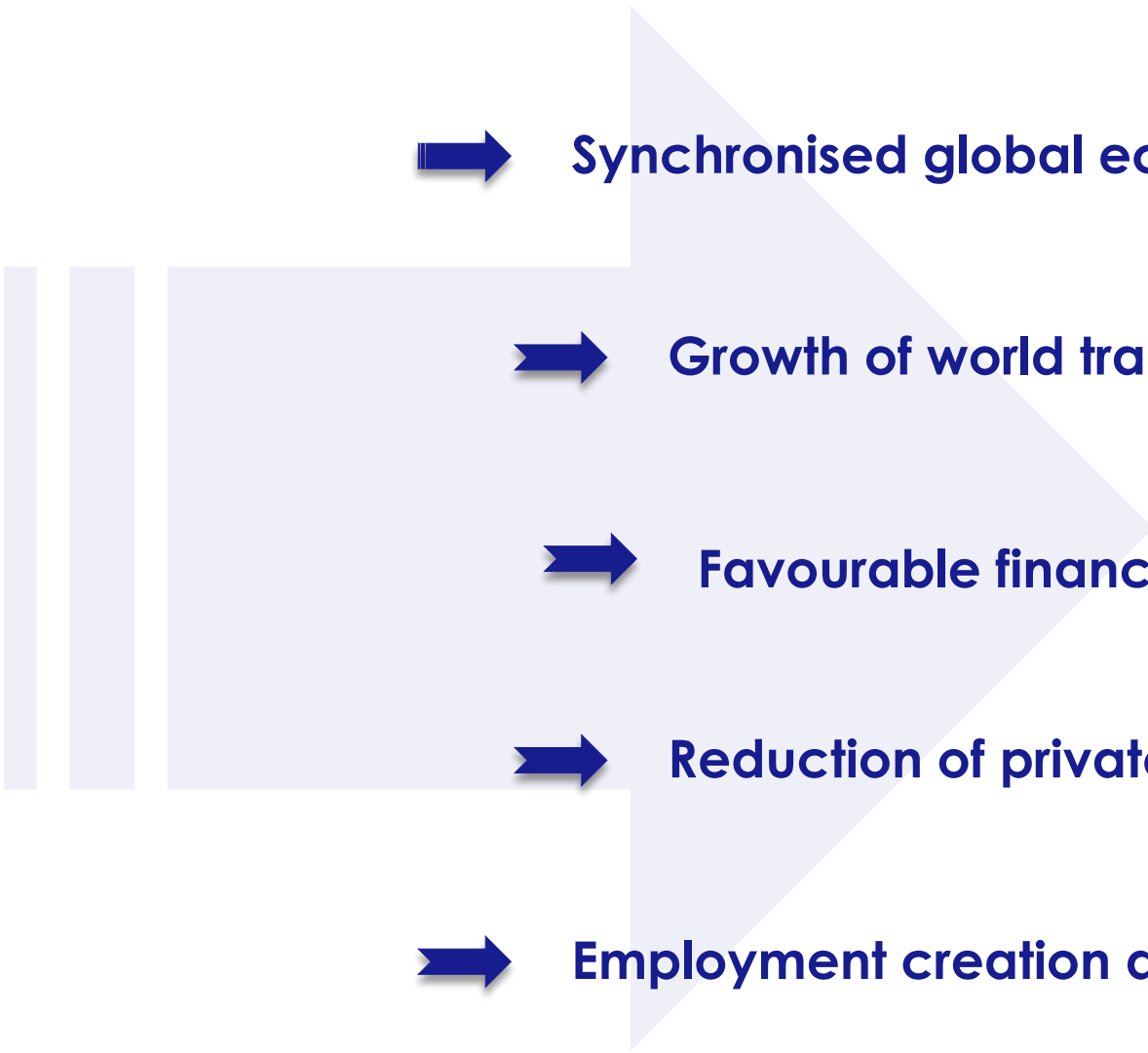


Source: Círculo de Empresarios based on Mineco, IMF & European Commission, 2018

Risks in 2018

- **Dissipation** of the **reformist momentum** in the face of the **demographic challenge** to ensure the **sustainability** of the **Welfare State**
- **Stagnation** of **productivity**
- Persistence of **structural unemployment**
- High **public debt** and **structural deficit**
- Impact of the **gradual reduction of ECB stimulus**
- Effects of the **US protectionist policy**
- **Moderation** of **growth** in **Europe**, mainly in **Germany, France** and the **United Kingdom**
- **European project conditioned by anti-European positions** in Italy and Visegrad countries*
- **Impact** of rising **oil prices** on **domestic demand** and **current account**
- **Political uncertainty**, predominantly in Catalonia

* Visegrad countries: Poland, Hungary, Czech Republic and Slovakia.

- 
- ➡ Synchronised global economic recovery
 - ➡ Growth of world trade
 - ➡ Favourable financial conditions
 - ➡ Reduction of private indebtedness
 - ➡ Employment creation at national level

Economic growth (I): composition

Forecast macroeconomic scenario 2018

GDP growth 2018 = 2.7%

+ 2.3 pp growth contribution

Domestic demand

% year-over-year variation

- Private consumption = 2%
- Public consumption = 1.1%
- Gross Capital Formation = 4.5%

+ 0.4 pp growth contribution

External demand

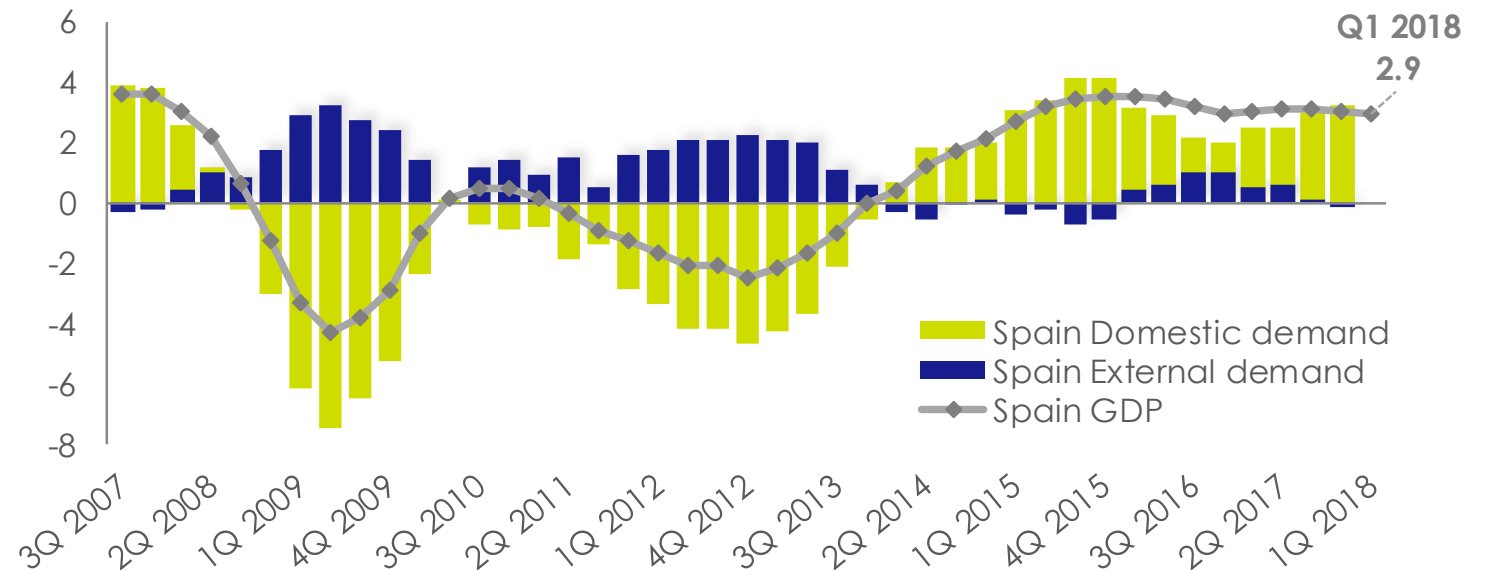
Of goods & services

% year-over-year variation

- Exports = 4.8%
- Imports = 4.1%

In Q1 2018 growth is moderated = 2.9%

GDP (Year-on-Year) and contribution of domestic and external demand (pp)

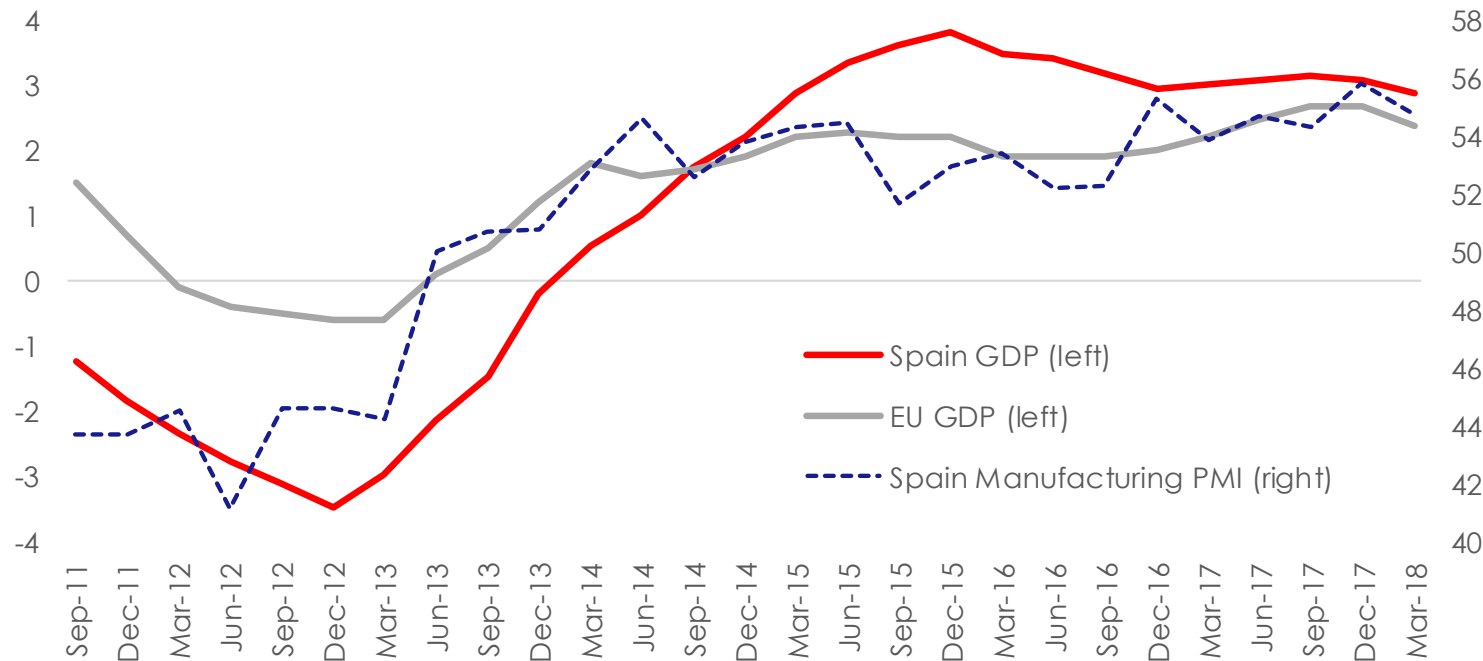


Economic growth (II)

In **Q1 2018**, Spain has a **positive differential with the EU, 2.9% year-on-year vs 2.4%**

Evolution of GDP (Spain and EU) and manufacturing PMI (Spain)

GDP in % var. Year-over-Year and PMI in points



The evolution of the **manufacturing PMI** sets the pace of **GDP growth**, which has moderated to **2.9% year-on-year in Q1 2018**

Growth forecast

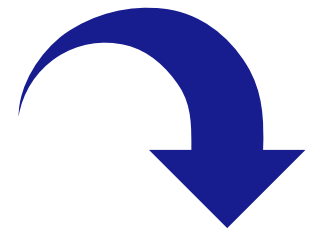
GDP Q2 2018 → 2.8%

Manufacturing PMI for April

In brackets: max value reached in Nov 2017

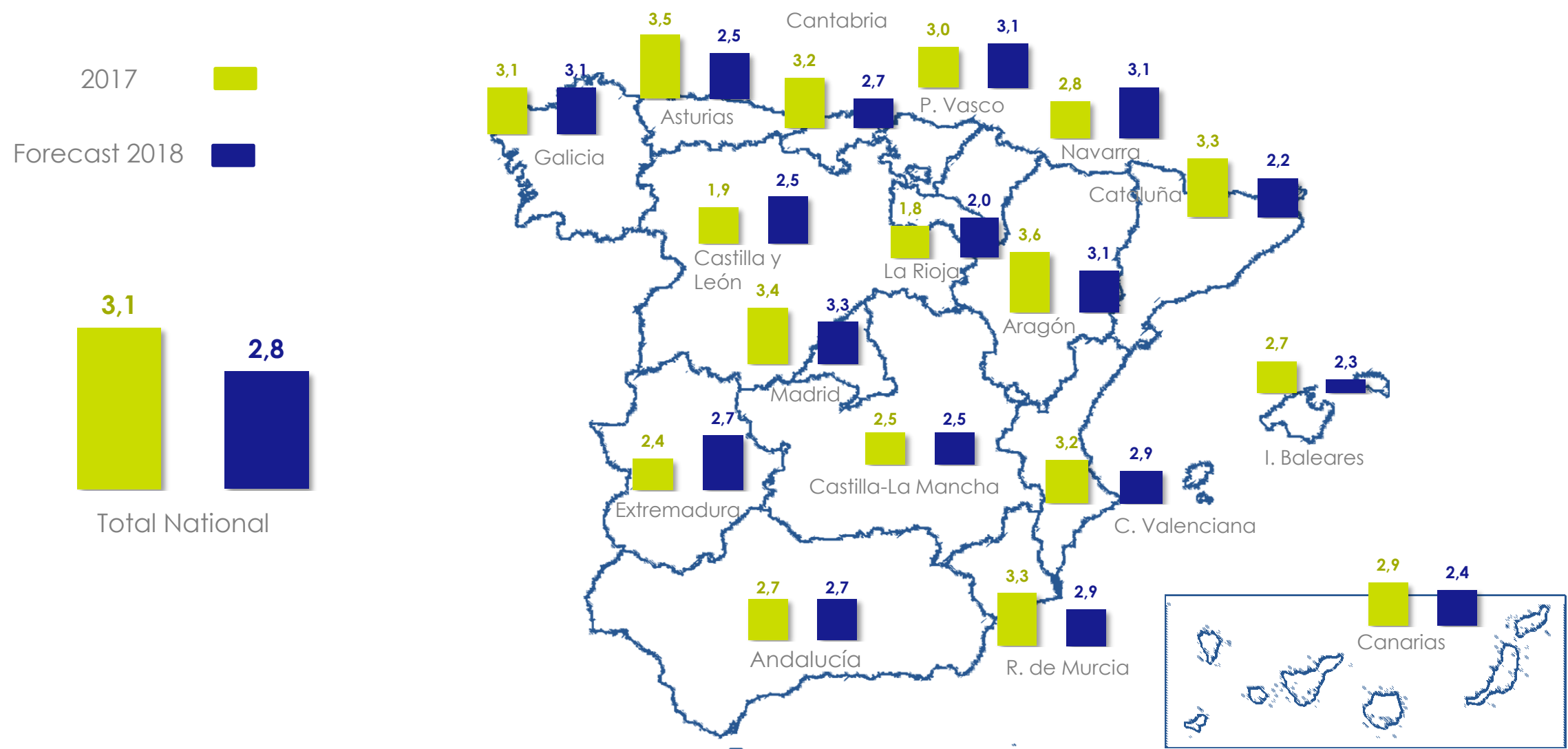
54.4

(56.1)



GDP of Spain's autonomous communities

Catalonia's growth will be **below the national average** owing to **political uncertainty**

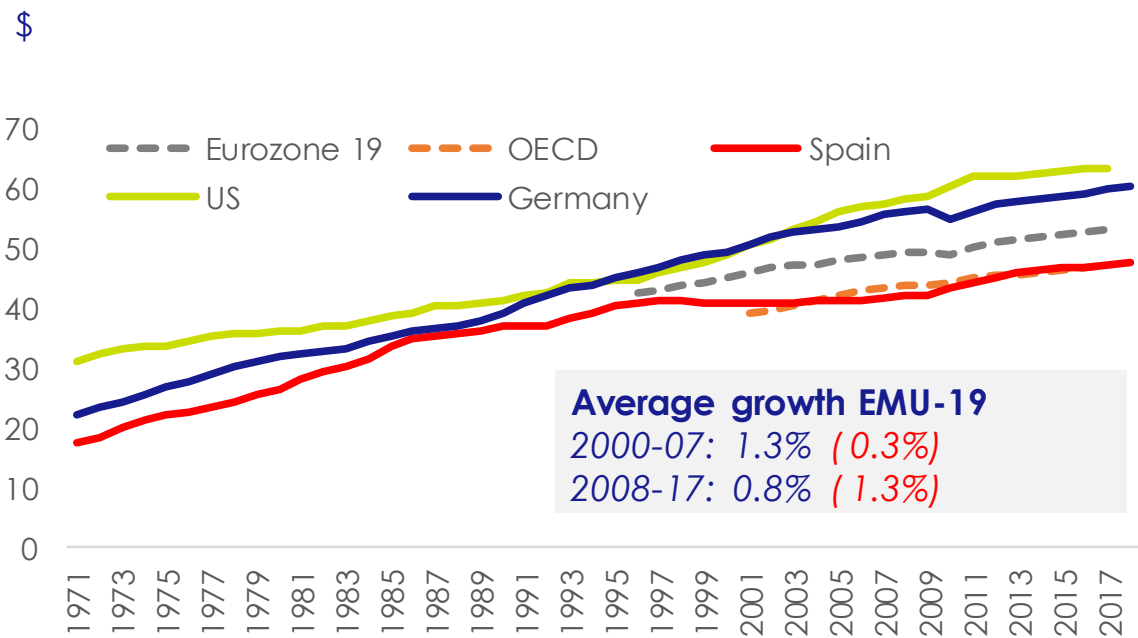


Source: Círculo de Empresarios based on INE & Funcas, 2018

Stagnation of productivity

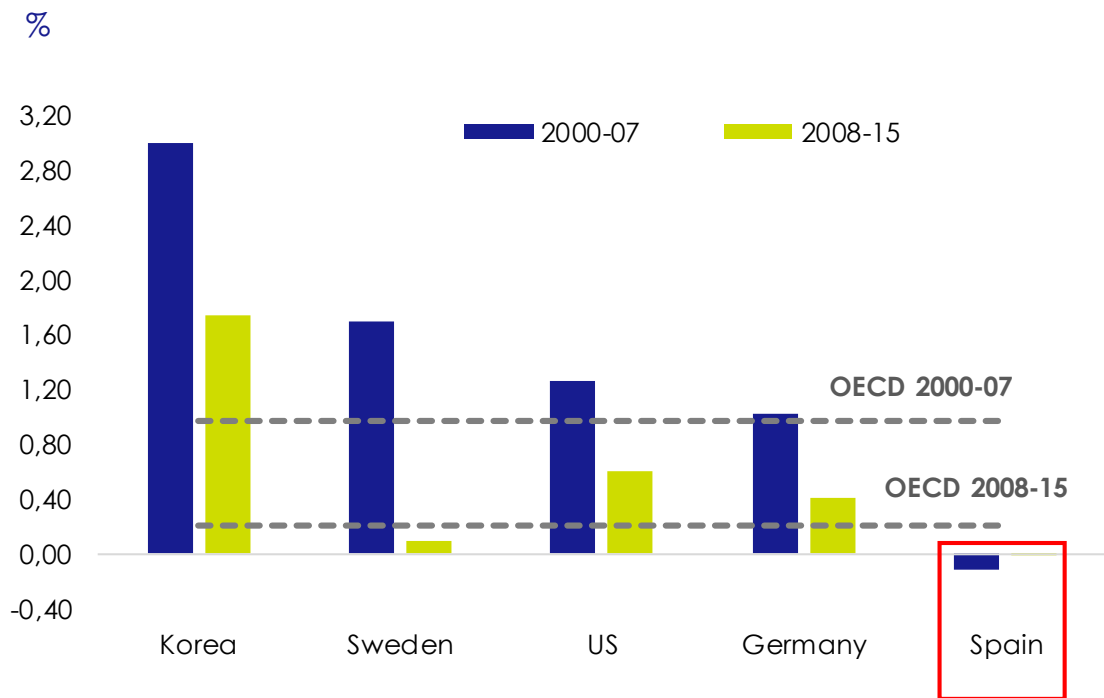
Spain has a **negative differential in labour productivity** with respect to the **main advanced economies** and **total productivity of factors** advances at a **lower rate** than **the average**

GDP per hour worked



Note: Spanish average in brackets

Average TPF growth

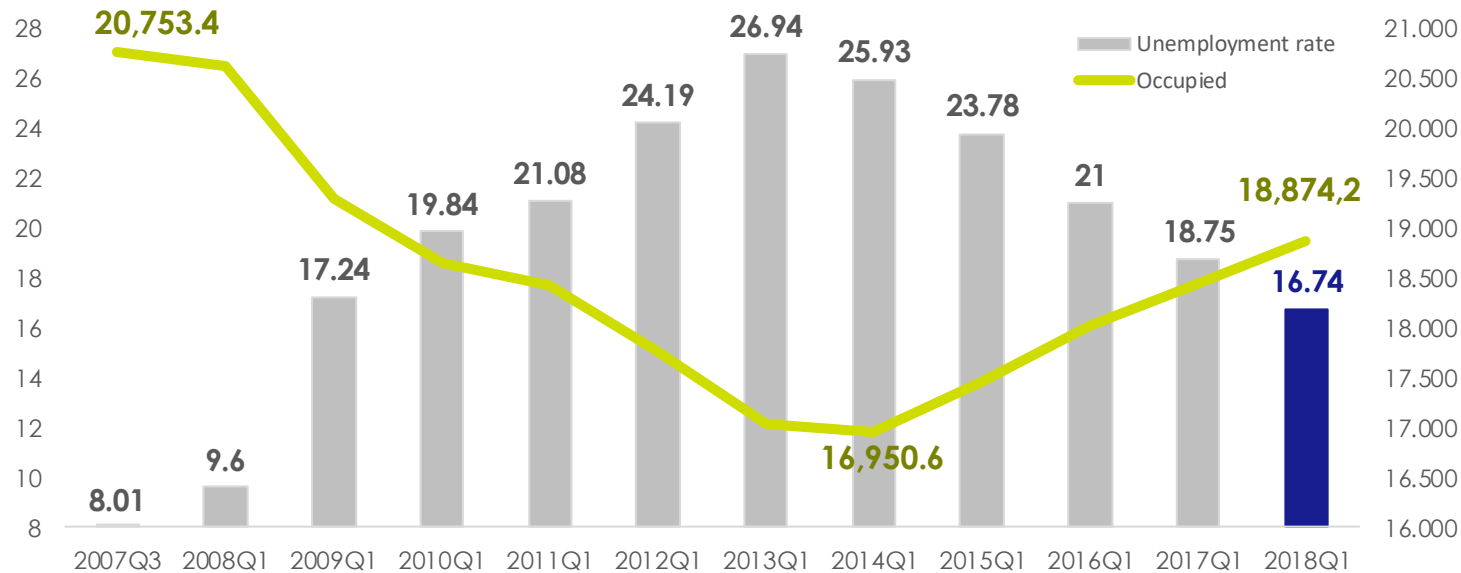


Labour market (I)

In **Q1 2018**, the **unemployment rate increased** to **16.74%**, close to our structural unemployment rate, remaining more than 8 pp above the 2007 minimum (EAPS, INE)

Unemployment rate and evolution of the number of employed

% active population and '000s of people



The number of unemployed increased in **29,400** people, to **3,796,100**

Alarming:

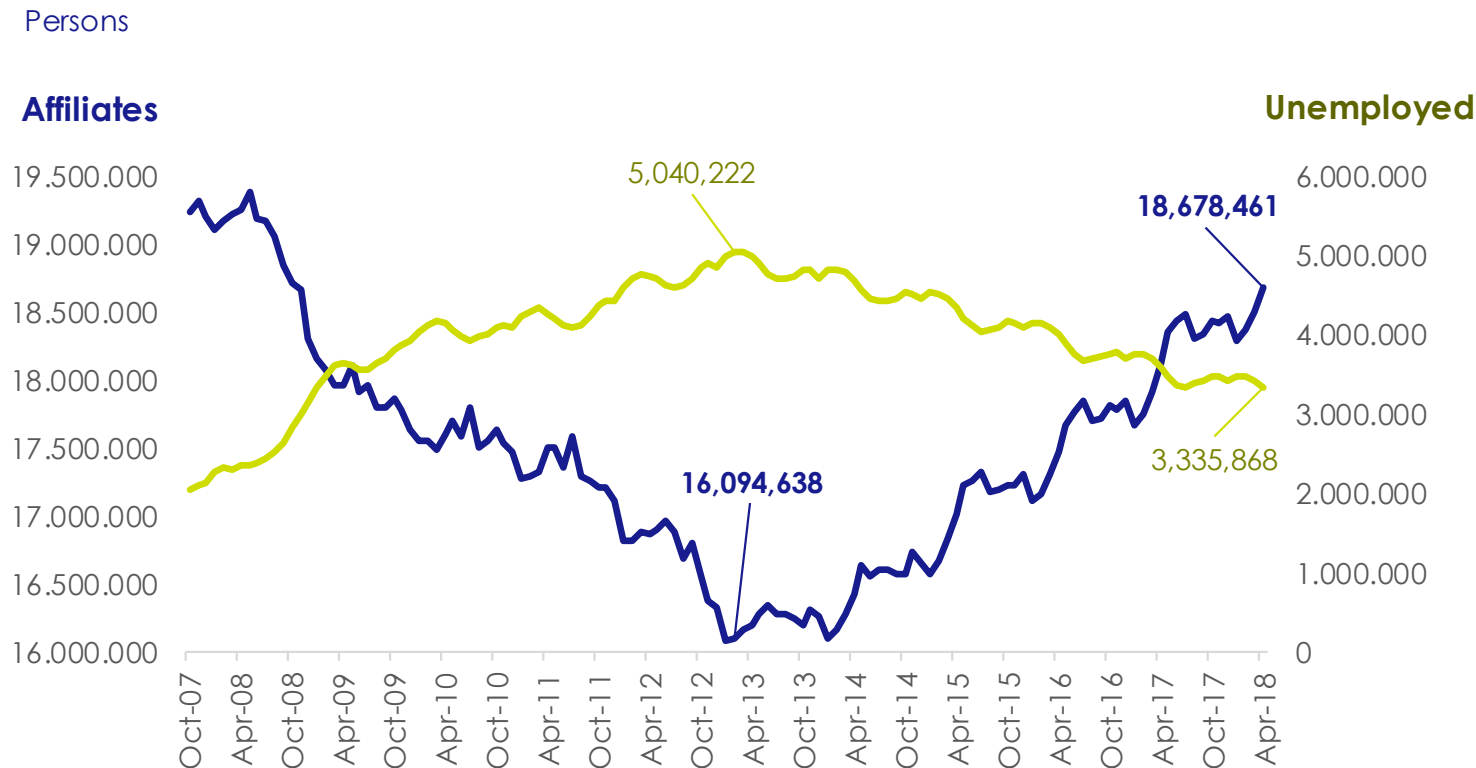
- Falling **activity rate**: up to 58.46%, the lowest in 12 years
- **Youth** unemployment rate: 36.3%
- **Long-term** unemployment rate: 49.8%

In **year-on-year** terms, **unemployment was reduced** by **458,900 people** and **435,900 jobs were created**, **30%** in the **public sector**

Labour market (II): affiliation & registered unemployment

Affiliates and registered unemployment Social Security

(April 2018, SEPE)



Since its **peak** in **February 2013** (5,040,222), the **level of unemployment** has **fallen** by **1.7 million people**.

2.6 million more affiliates than 5 years ago

January - April 2018

Registered unemployment fell by 140,660 people **to 3,335,868**

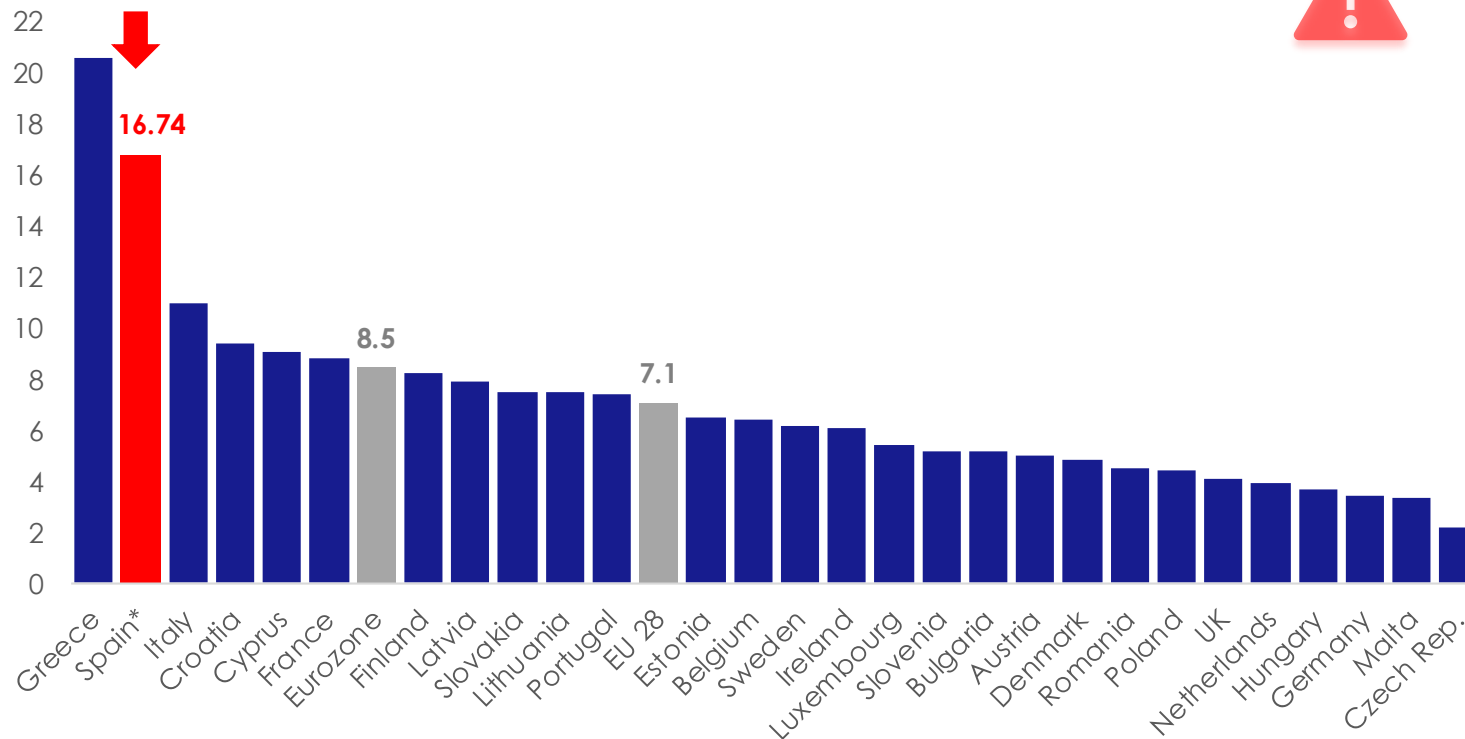
Affiliation increased by 396,430 people **to 18,678,461**

Comparison of unemployment rate with the EU

The **unemployment** rate in **Spain** is **double** the **Eurozone** average

Unemployment EU 28

% over the active population, March 2018



Spain is among the 3 countries with the highest
youth unemployment rates
(<25 years)



Greece **42.3%**



Spain* **36.3%**



Italy **31.7%**

* Spain: data from EAPS Q1 2018, INE

Source: *Círculo de Empresarios* based on Eurostat & INE, 2018

Pension system

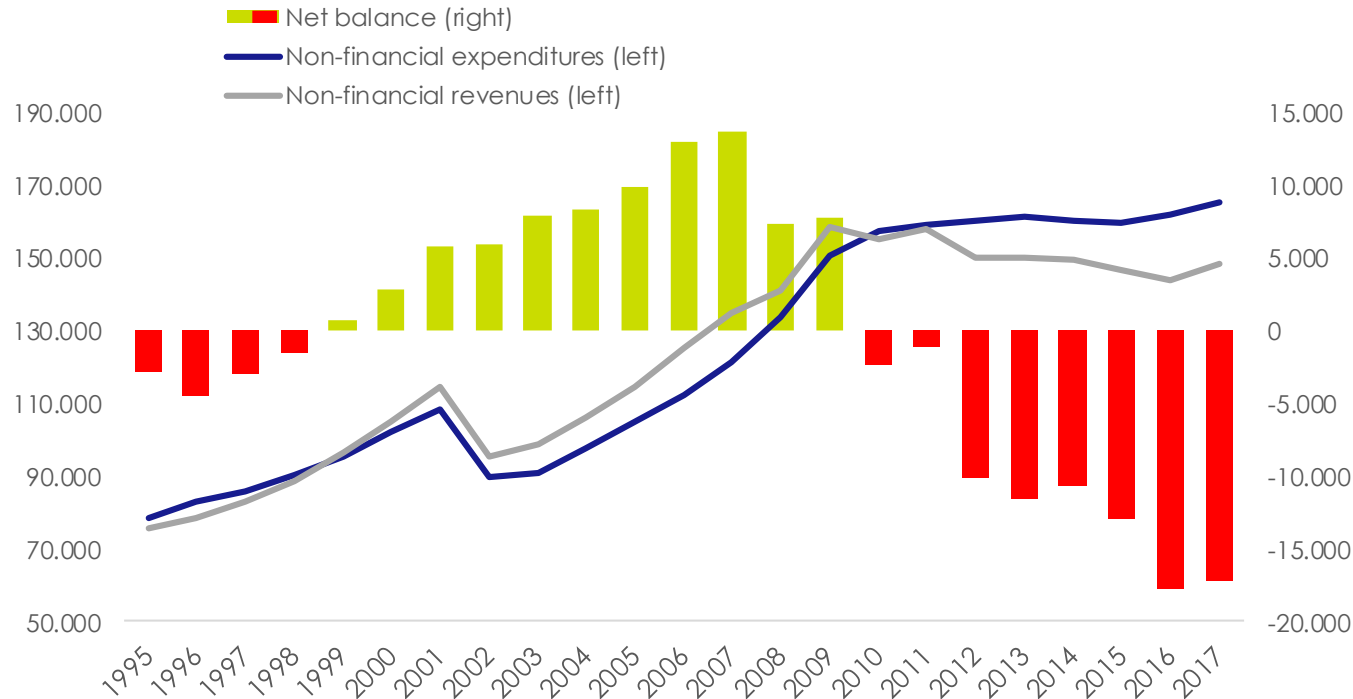
Sustainability of the pension system at risk

2007 - 2017:

- **Non-financial expenses** grew by **3.7%** annual average
- **Revenues** advanced **1.7%** annual average

Financial situation of the Social Security

Millions €



Future sustainability conditioned by:

- Evolution of **payments** to Social Security
- **Aging** of the population
- Evolution of the **active population**
- Improvements in **productivity**

Until **2050**, the Bank of Spain estimates ▲
public spending on pensions, health
and **long-term care**



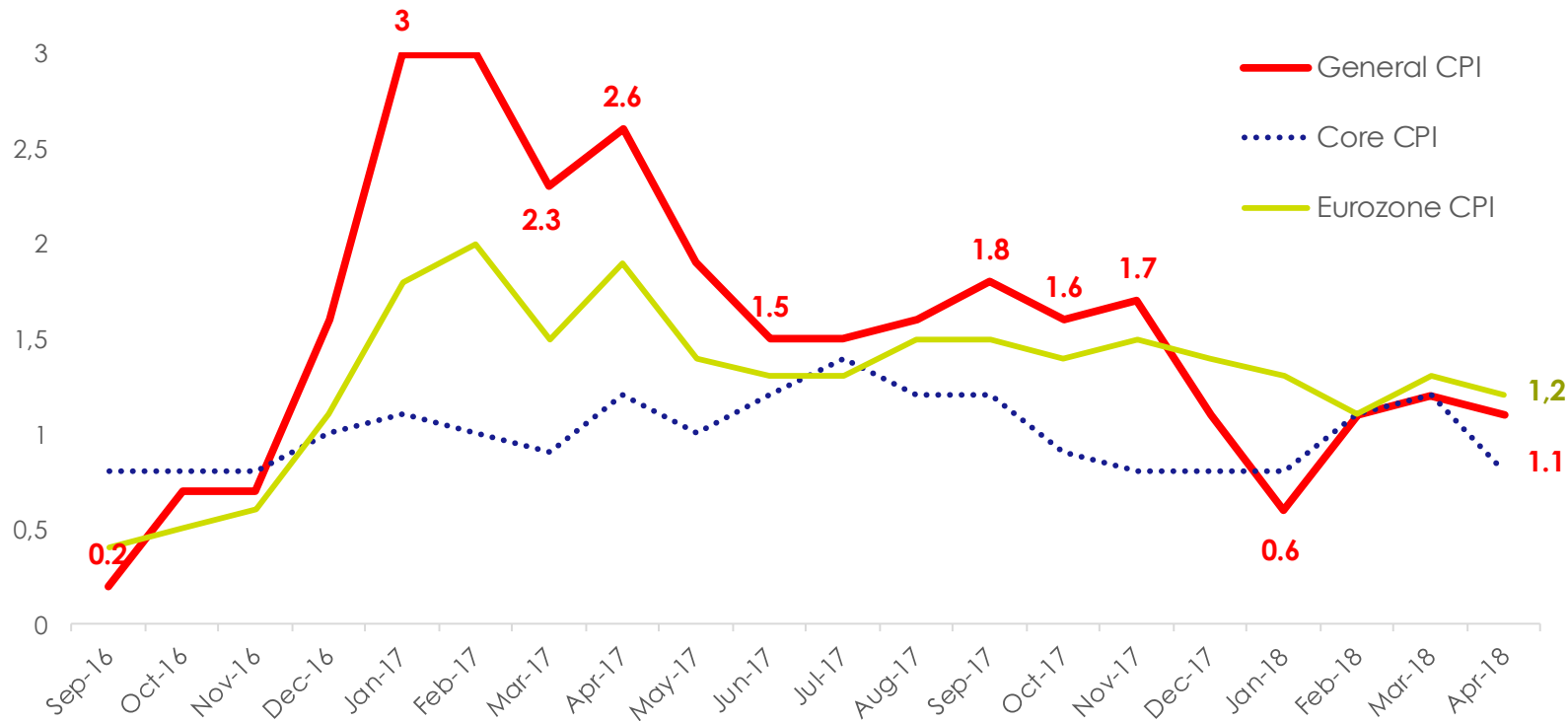
1.5 – 2 pp of GDP ≈ 21% of GDP in 2050

Prices

In April, headline inflation fell to 1.1%, 0.1 pp below the Eurozone

Evolution of prices

% year-on-year var.



* Excluding unprocessed food and energy

Inflation pegged to the future by the evolution of the **oil prices**

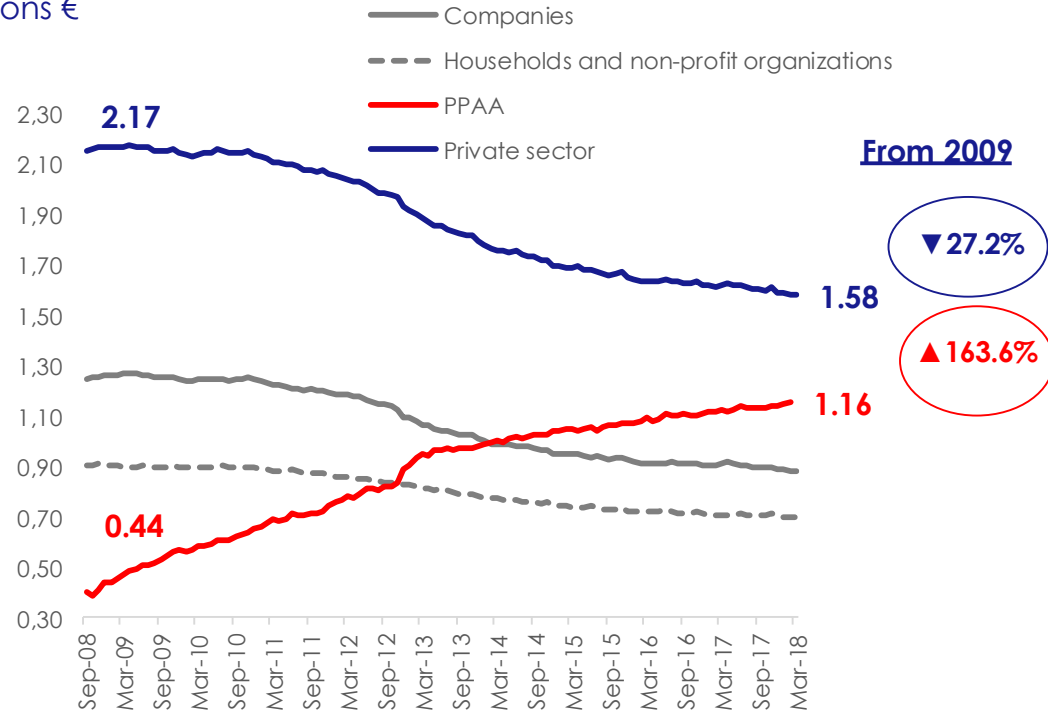
Since January, year-on-year inflation has accelerated by **0.5 pp**

Record reduction in private indebtedness

The **private sector** has reduced its **indebtedness to below pre-crisis levels** while that of the public sector continues to soar

Evolution of the debt of non-financial sectors

Trillions €

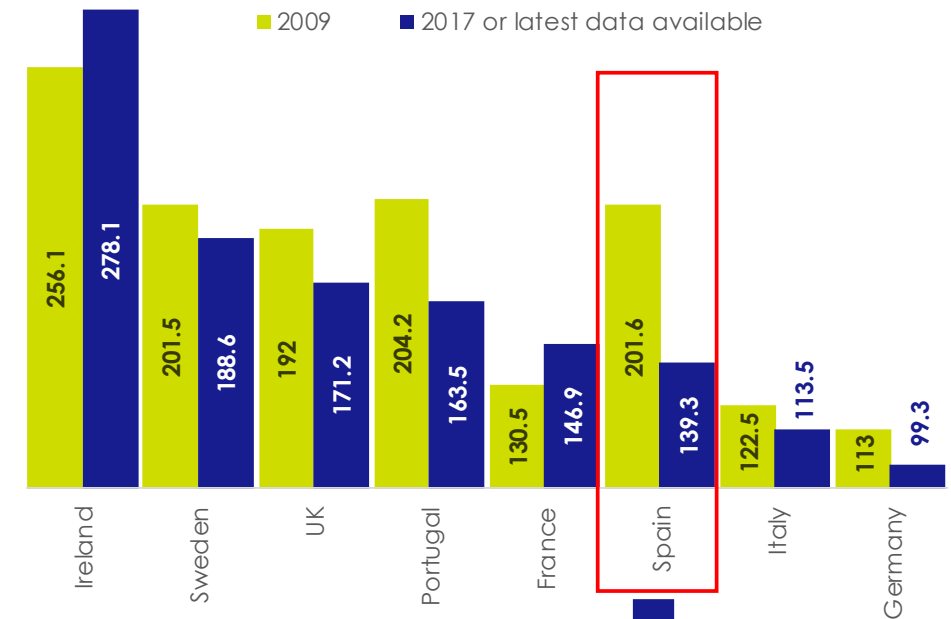


In **2017**, the **rate of reduction of nominal debt of households** slowed down to **1%, the lowest since 2010**

Source: *Círculo de Empresarios* based on Bank of Spain & Eurostat, 2018

Debt of non-financial private sector

% GDP



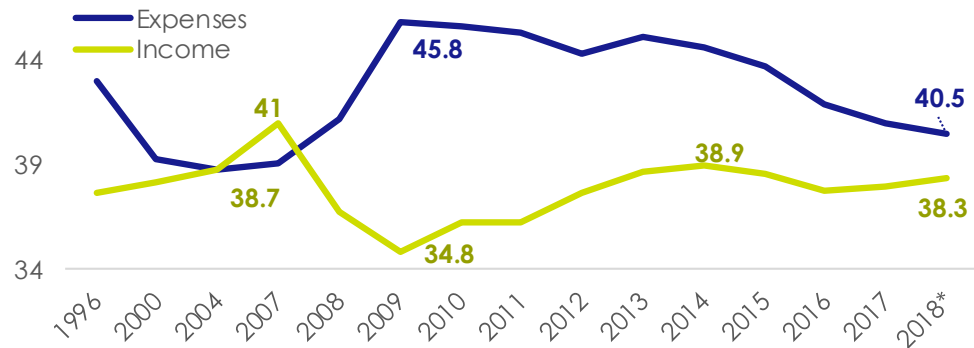
▼ **31%**
since 2009 as % of GDP

Public accounts (I)

The public sector closed **2017** having accomplished the **deficit target** of **3.1%**

Evolution of income & expenses of public administrations

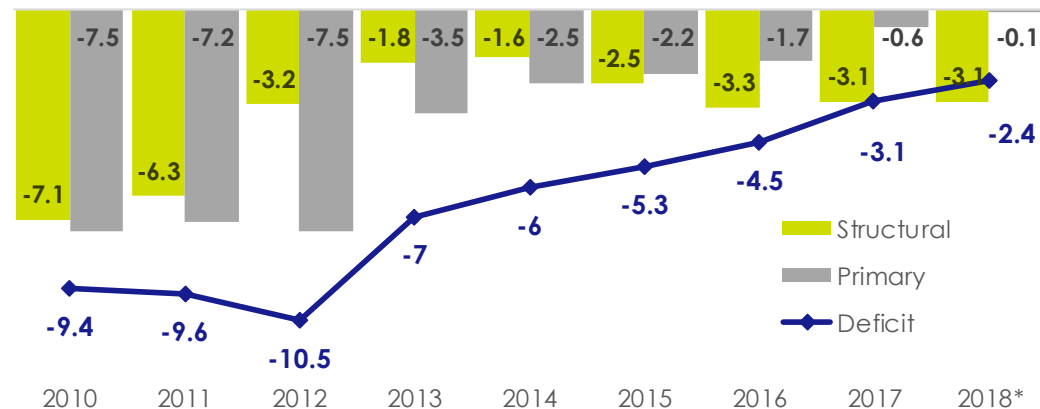
% GDP



Unavailing progress made in **reducing** the **structural deficit** despite the primary having been reduced

Evolution of public deficit

% GDP



* Forecast

Budget balance 2017-2019

Lending (+) / Borrowing (-) of finance
% GDP

Central government
Autonomous Regions
Local Entities
Social Security
PPAA

Balance 2017	Target 2018	Target 2019	Target 2020
-1.89	-0.7	-0.3	0.0
-0.32	-0.4	-0.1	0.0
0.59	0.0	0.0	0.0
-1.48	-1.1	-0.9	-0.5
-3.07	-2.2	-1.3	-0.5

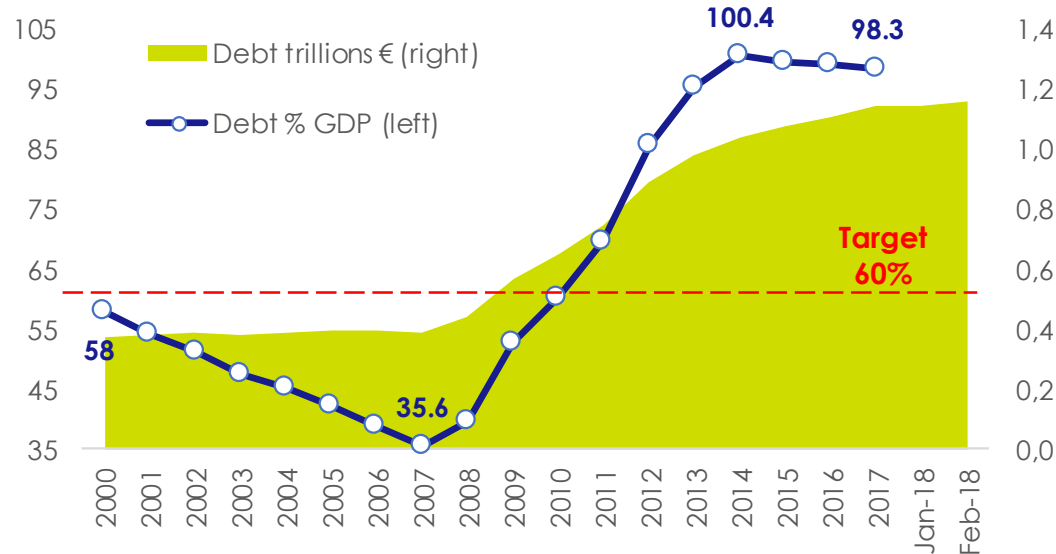
Note: without financial aid

Public accounts (II)

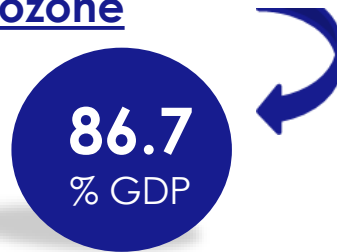
Public debt recedes to **98.3% of GDP**, although its volume continues to rise

Evolution of public debt

% GDP and trillions €

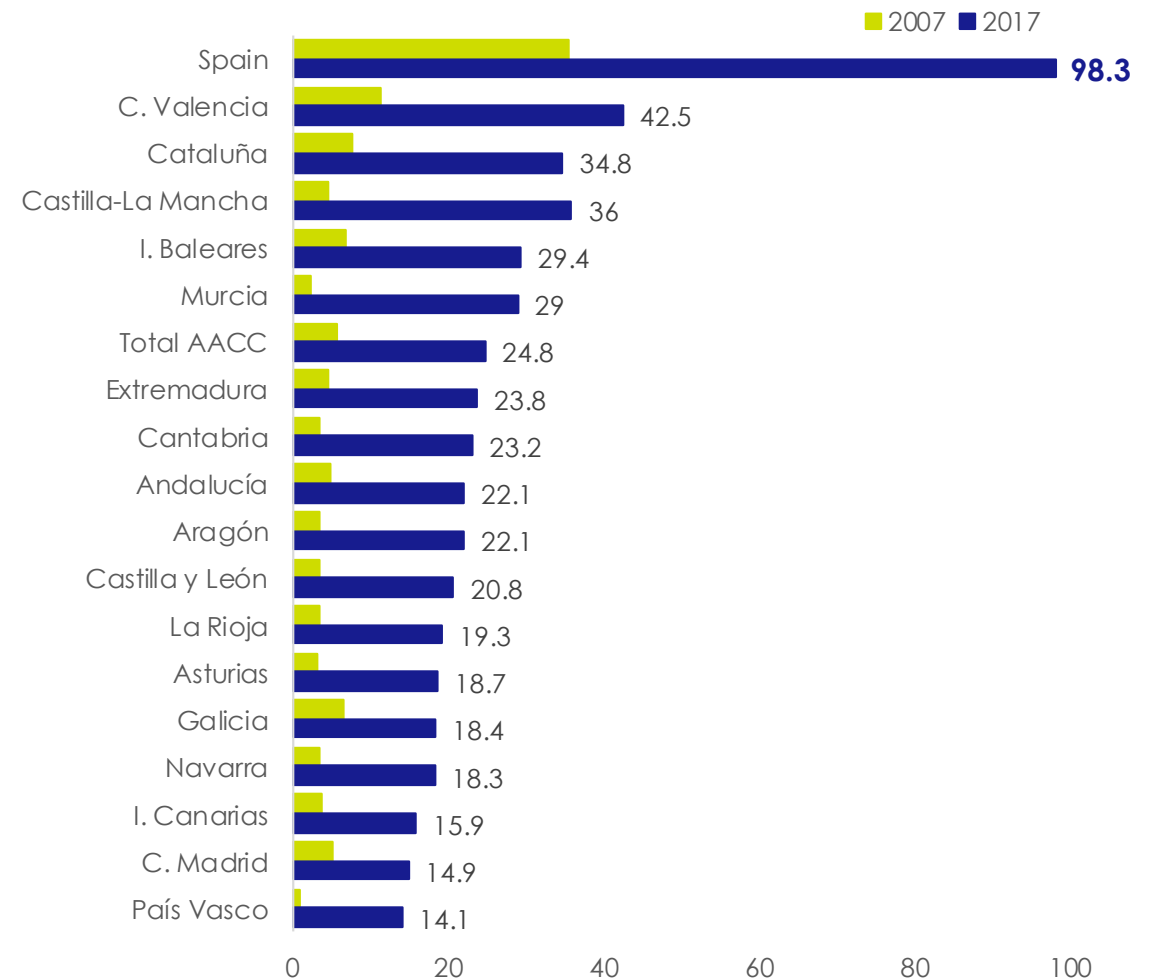


The level of debt remains 11.6 pp above the average for the Eurozone



Evolution of national debt and autonomous communities

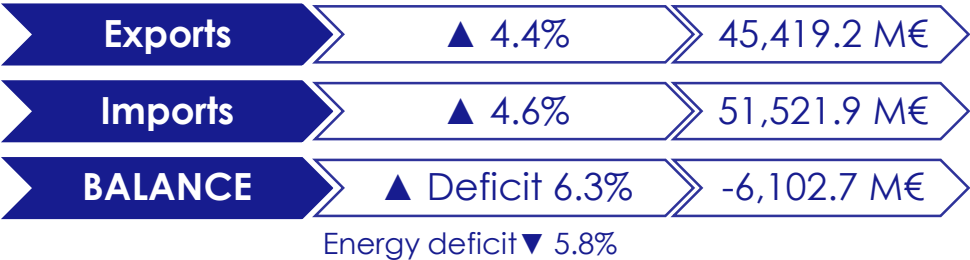
% GDP



Trade balance (goods)

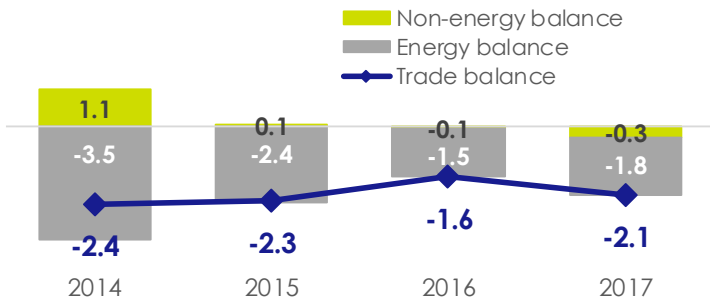
Balance of trade, January – February 2018

(variation with respect to the same period last year)



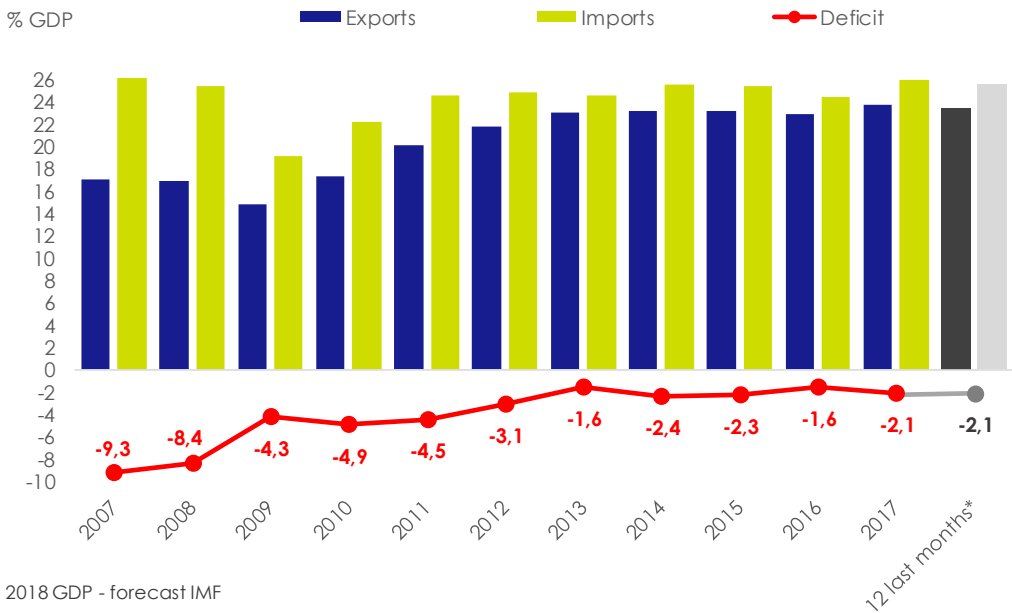
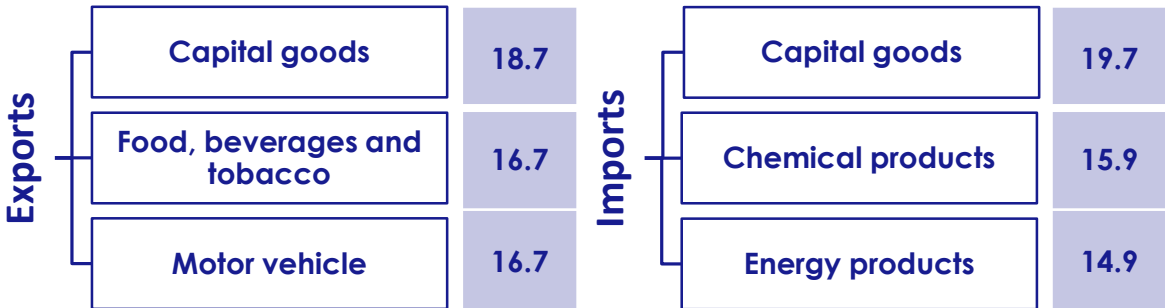
Evolution of energy and non-energy balance 2014-2017

% GDP



Sectorial distribution

(% over the total)



Note: data from the Customs and Excise Duties department of Spain's Tax Agency

Geographical distribution

(% over the total)

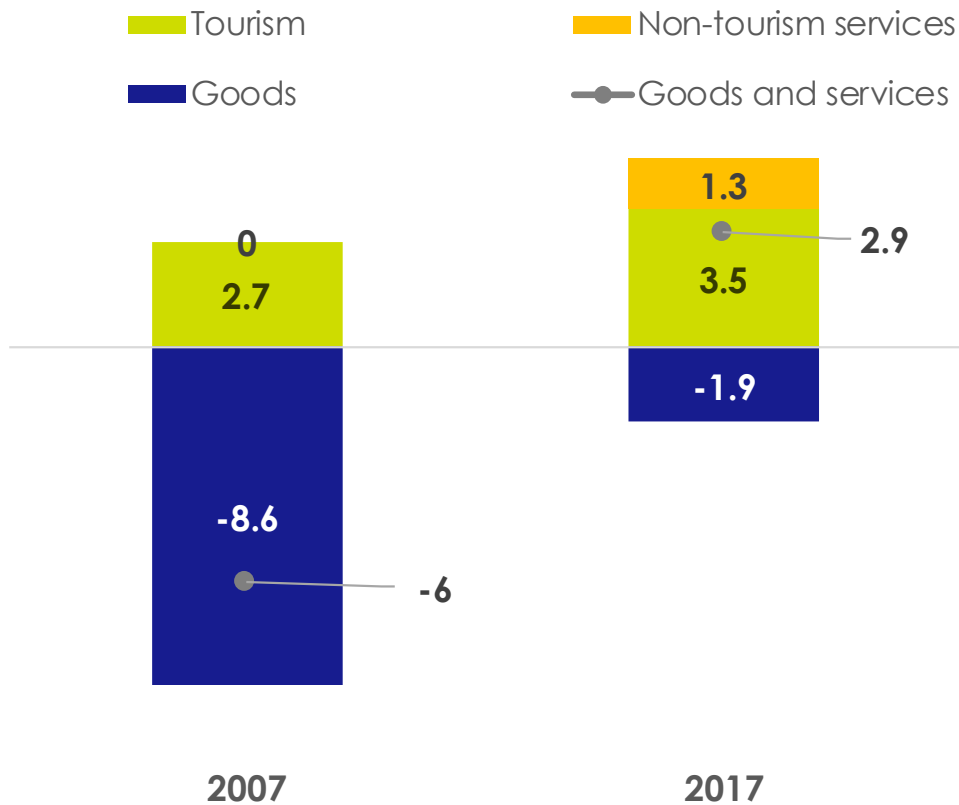
	Exports	Imports
Europe	72.8	59.6
EU	67	53.5
America	10	10.1
Asia	9.1	21.3
China	2.3	8.9
Africa	6.2	8.7
Other	1.9	0.3

Balance of goods and services

Prominent record figures in **tourism** and **increase** in representation of **other services**

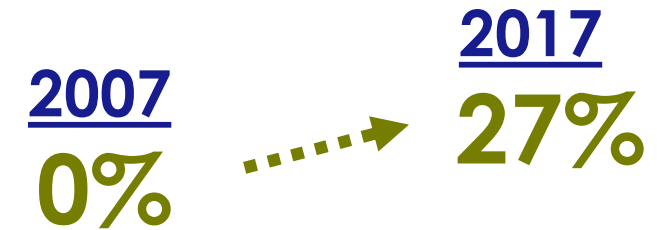
Annual balance of trade on goods/services

% of GDP



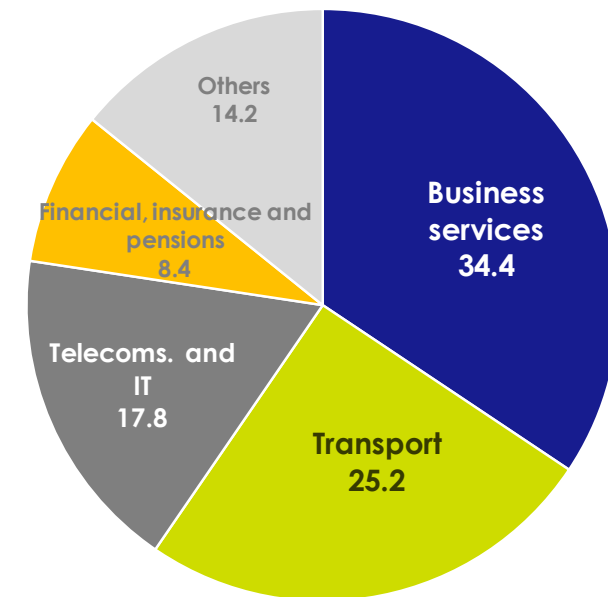
Change in the weight of non-tourist services

% total surplus of services



Exports distribution of non-tourism services

% total non-tourism services



Note: there is a discrepancy in the balance of trade figures between the Bank of Spain and the Ministry of Economy due to the source of the data

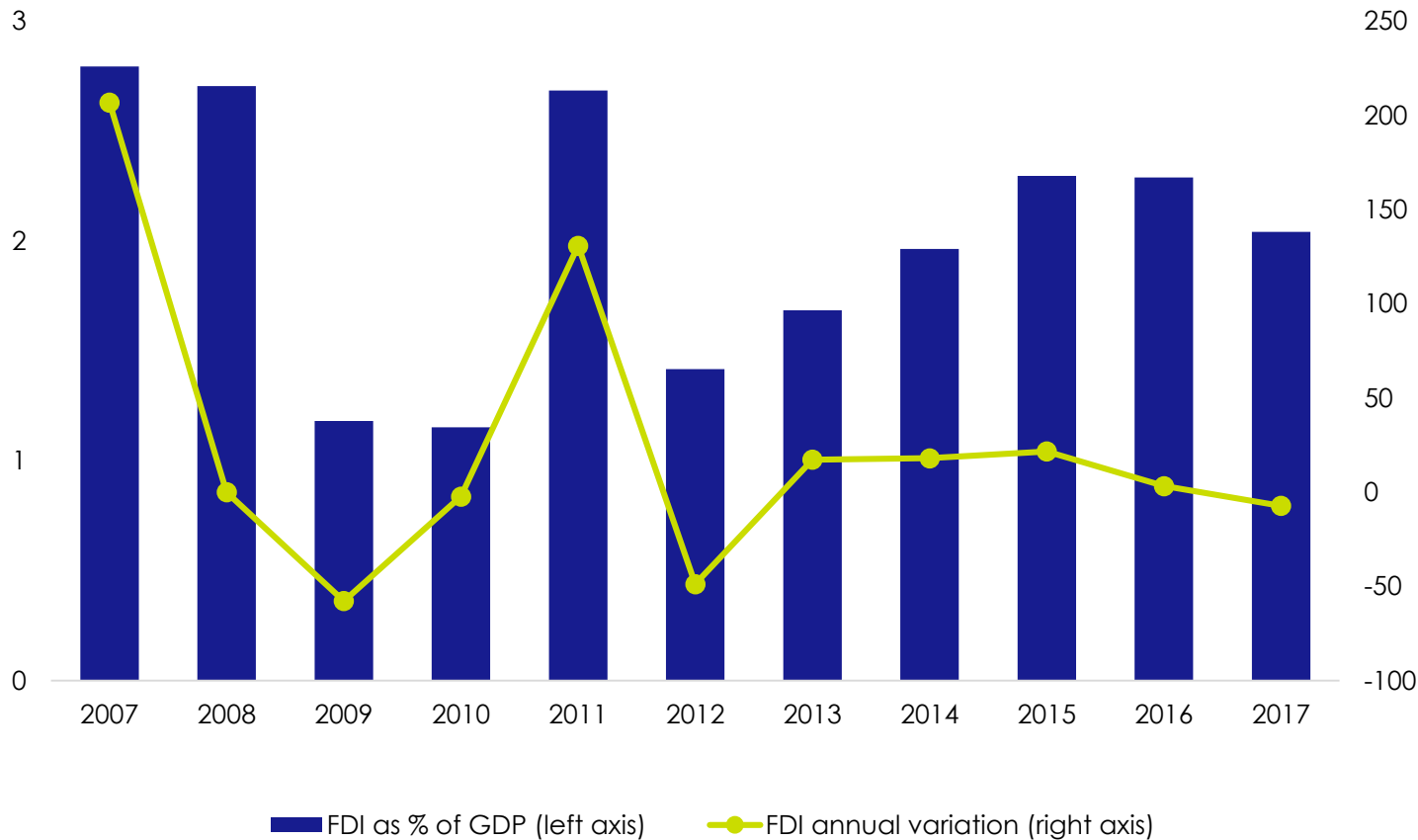
Source: *Círculo de Empresarios* based on Bank of Spain, 2018

Foreign Direct Investment (FDI)

The inflow of FDI in Spain **slows down**

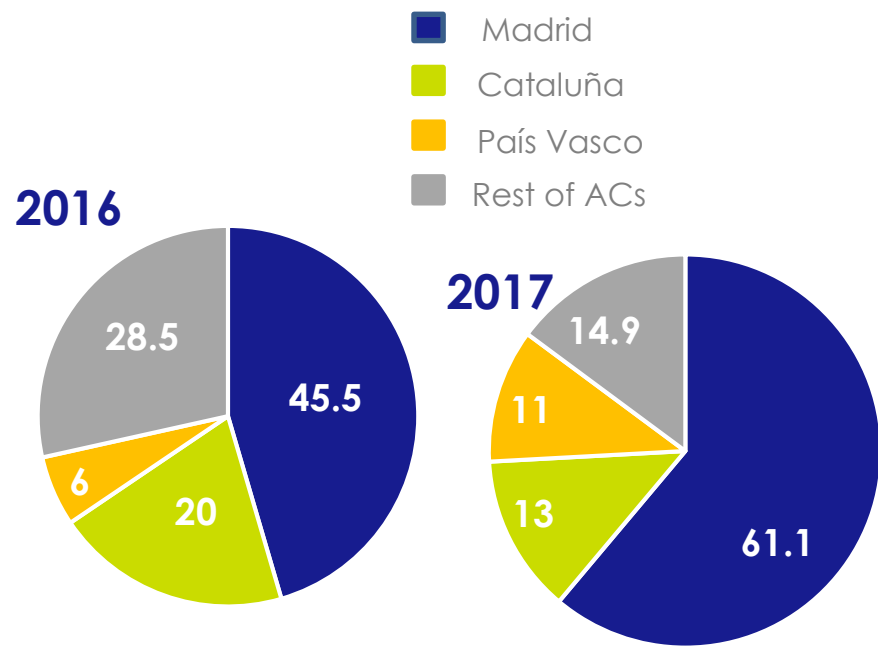
FDI in Spain

% of GDP and % annual var.



FDI by autonomous communities (ACs)

% of total

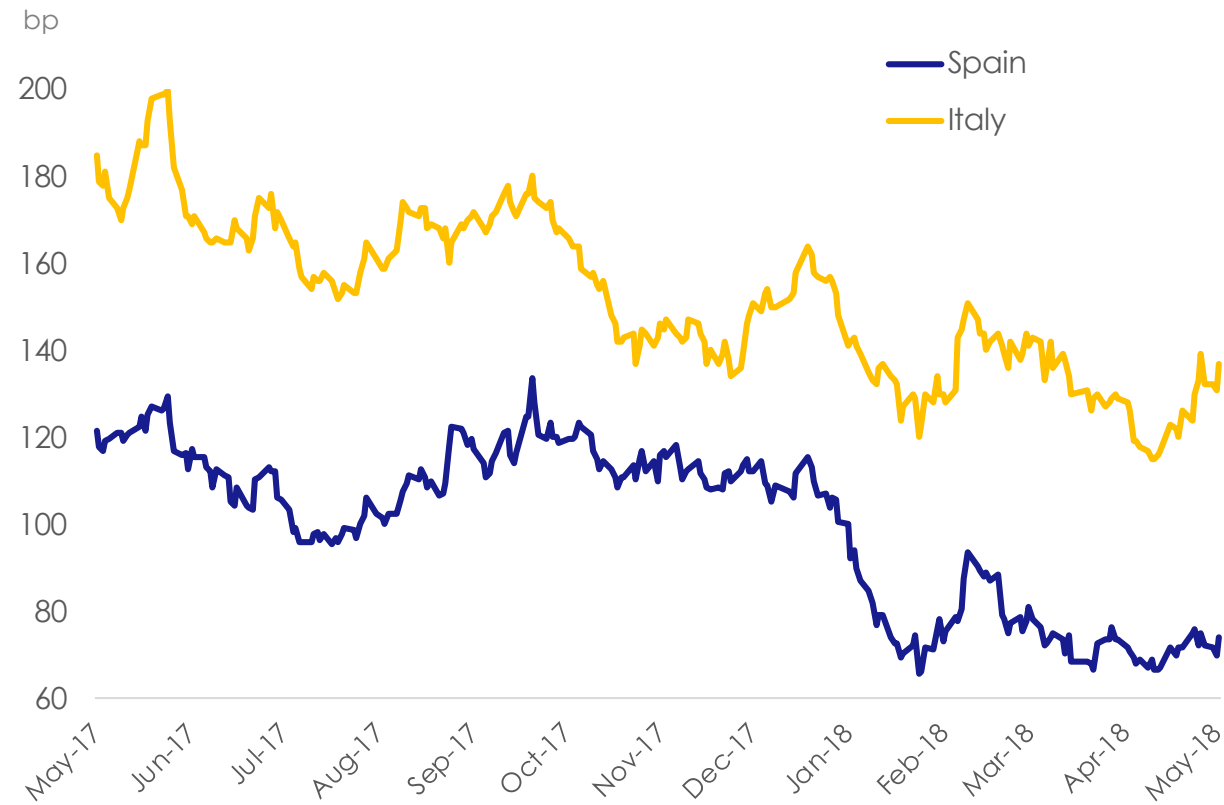


The weight of **Catalonia** in the national FDI has **fallen** by **7 pp** in 2017 compared with 2016. **Madrid** has **increased** by **15.6 pp**

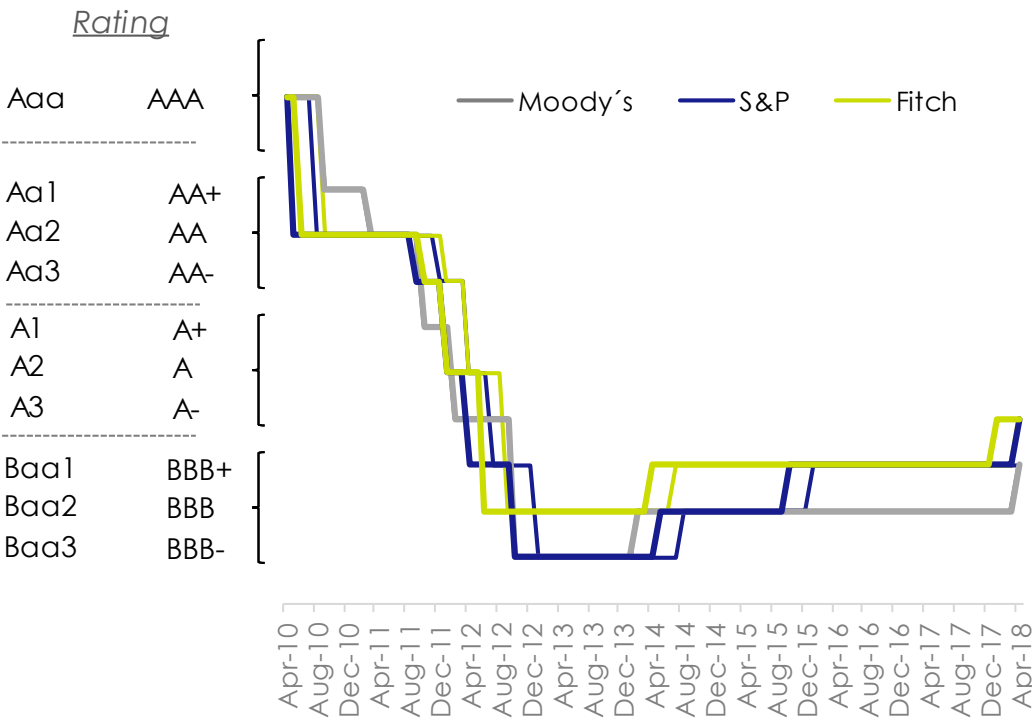
Interest rates and risk premium

The **risk premium** stands at **70 bp**, partly explained by the **upward revision** of **rating agencies**

Spain and Italy risk premium (bp)



Evolution of Spain's credit rating 2010 -2018



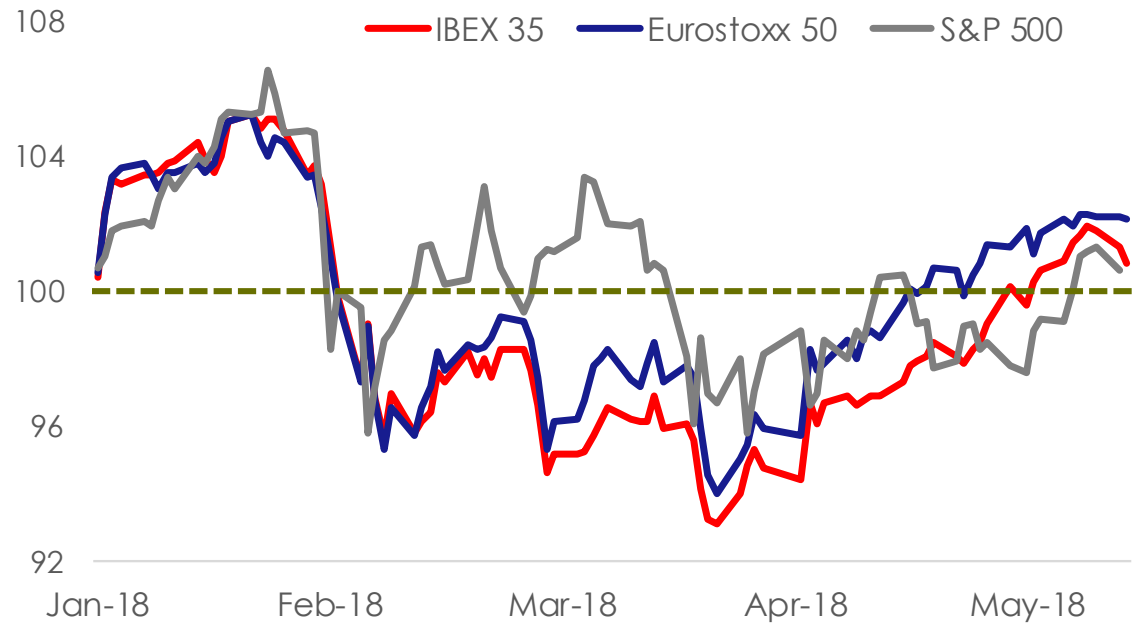
Source: Círculo de Empresarios based on Bank of Spain & Bloomberg, 2018

Financial markets

The stock markets are advancing in a more **volatile environment**

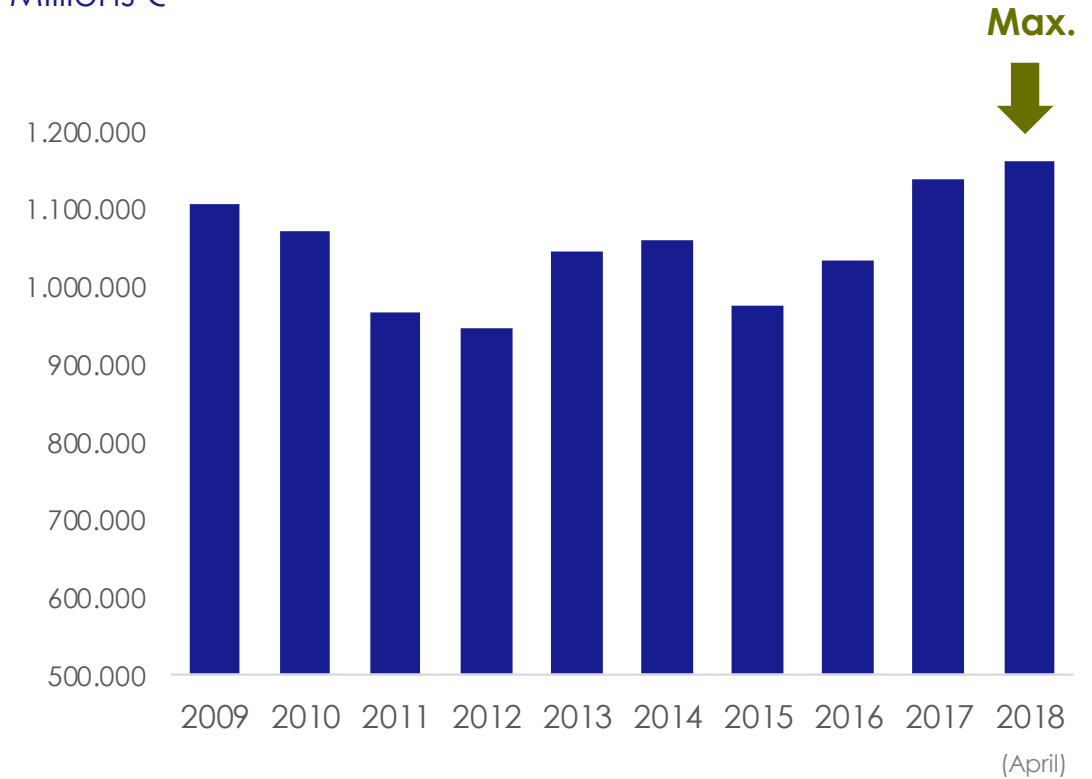
Evolution of stock markets

January 2018=100



Spain's stock exchange Market Capitalization*

Millions €



* Includes: Continuous Market (SIBE), trading pit of the four stock exchanges, Alternative Equity Market (MAB), and Latibex

Source: Círculo de Empresarios based on BME, 2018



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