QUARTERLY REPORT ON THE SPANISH ECONOMY
OVERVIEW

The expansionary phase on which the Spanish economy embarked somewhat more than two years ago continued in 2015 Q4, in which period GDP is estimated to have increased by a quarter-on-quarter rate of 0.8%. This figure matches that for Q3 and is 0.2 pp down on the figure of 1% estimated for Q2, which was the highest rate of increase recorded to date since the recovery began. The modest slowdown in output observed in the second half of the year does not in any event alter the baseline scenario under which sustained GDP growth will be maintained over the coming quarters.

Indeed, economic activity in the final quarter of the year is proving slightly more favourable than anticipated in September, which has led to a 0.1 pp upward revision in the estimated annual average growth rate of GDP in 2015 to 3.2% (see Box 1). Next year activity is expected to continue to be dynamic, although its rate of increase will be somewhat lower than that observed in recent quarters owing to the moderation of some of the expansionary impulses currently prevailing. Specifically, annual average GDP growth in 2016 is expected to reach 2.8%.

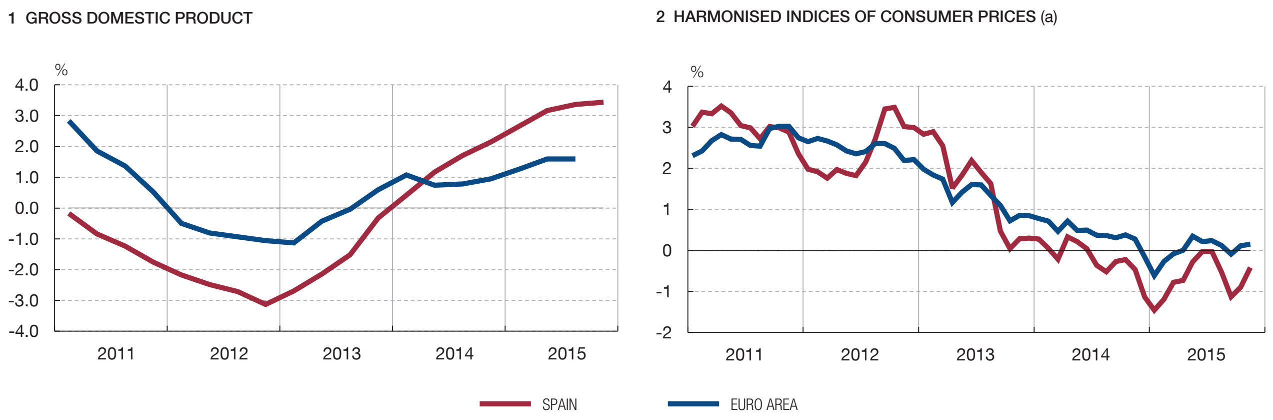
The balance of risks for this baseline scenario is tilted slightly to the downside, owing essentially to the possibility of the projected slowdown in the emerging economies being more pronounced than currently foreseen, which might result from a tightening of their financing conditions in a context of diminished appetite for risk. Domestically, the main source of uncertainty is associated with the course of economic policies, given the influence exerted, in particular, by the reform agenda and budgetary policy on agents' confidence and spending decisions.

The pace of the year-on-year decline in the CPI has slackened in recent months from -0.9% in September to -0.3% in November. Chiefly behind this trajectory has been the effect of oil prices on the energy component of the indicator. In any event, the non-energy CPI and the CPI excluding unprocessed food and energy have continued on the slowly and gradually accelerating path they initiated at the start of the year, posting rates of 1.1% and 1%, respectively, in November. The gap between Spanish and euro area inflation has remained negative. In terms of the CPI excluding energy, the gap between both rates, which in Q3 had held at -0.3 pp, stood at -0.1 pp in November, resuming the narrowing path observed in the first half of the year.

The performance of the inflation rate in the coming quarters is subject to the projected rise in oil prices. Moreover, in the short run it is highly influenced by the fall observed a year ago in the price of this commodity. Accordingly, the rate of change of the headline CPI is expected to turn positive in December and continue increasing during 2016, up to over 1.5% at end-2016. In terms of annual average rates, a fall of 0.5% is projected this year, and an increase of 0.7% in 2016. Stripping out the energy component, consumer prices are expected to continue rising as they have in the current year, in line with the gradual reduction in the degree of cyclical slack in the economy, the strength of household spending and the weakness of the euro exchange rate. The risks to this baseline scenario are moderately skewed to the downside, essentially as a result of the hypothetical materialisation of the less favourable scenarios for economic activity described. In any case, the uncertainty surrounding the inflation projections is high, given that oil prices and the euro exchange rate are likely to continue to show volatile behaviour for some time.

GROSS DOMESTIC PRODUCT AND CONSUMER PRICES (a)

CHART 1



SOURCES: Eurostat, INE and Banco de España.

a Year-on-year rate of change based on seasonally adjusted series in the case of GDP and on original series in consumer price indices.

In recent months, the financing conditions of the resident sectors have broadly remained favourable, against a background marked by the accommodative stance of the Eurosystem's monetary policy, which was further eased following the measures adopted at the ECB Governing Council meeting on 3 December. Both the Spanish 10-year government bond yield and its spread over the German benchmark continued to decline, to 1.7% and 113 bp, respectively. Yields on other markets, such as the interbank and private fixed-income securities markets, also fell further. The reduction in the cost of liabilities for financial institutions has seen interest rates on new lending business hold at very low levels. In turn, these developments in the cost of credit have contributed to the buoyancy of new business volumes and, consequently, to slackening the pace of decline of the non-financial private sector's outstanding credit balance.

Overall, these changes in financial conditions shaped a setting conducive to household and business spending in the autumn months. Household consumption has been further spurred, moreover, by strong job creation and by a series of temporary factors that have contributed to increasing their purchasing power in the short run. These factors include a fresh fall in oil prices, the bringing forward to July of the lowering of the tax burden whose entry into force was initially scheduled for January 2016 and the payment to public-sector employees of one quarter of the extra salary payment suspended in December 2012. Against this backdrop, private consumption is expected to have grown in Q4 at a similar rate to that in Q3, namely 1%, with a matching rate for private productive investment, which will have been boosted by the strength of final demand and the propitious financial conditions.

Net external demand is estimated to have made a neutral contribution to GDP growth in Q4, according to the information available. The informativeness of these data is, however, limited, as they only cover the initial period of the quarter. In quarter-on-quarter terms, the buoyancy of imports is estimated to have eased in relation to the figures obtained in the summer. As regards exports, the growth of goods sales was checked somewhat, despite the strength of euro area markets, while the tourism indicators point to very favourable developments in the final stretch of the year.

Turning to the labour market, employment has remained highly dynamic in recent months and it is estimated it will have grown in Q4 at a quarter-on quarter rate of 0.7%, a similar

EURO AREA ECONOMIC INDICATORS (a)

TABLE 1

	2014	2015	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
National Accounts										
Quarter-on-quarter rate of change, unless otherwise indicated										
Gross domestic product	1.4	3.2	0.4	0.5	0.6	0.7	0.9	1.0	0.8	0.8
Contribution of national demand (b)	1.6	3.6	0.4	0.6	0.5	0.6	1.2	1.0	1.1	0.8
Contribution of net external demand (b)	-0.2	-0.4	0.0	-0.1	0.1	0.1	-0.3	0.0	-0.3	0.0
Year-on-year rate of change										
Employment	1.1	3.0	-0.7	1.0	1.7	2.4	2.9	3.0	3.1	3.0
Price indicators (year-on-year change in end-of-period data) (c)										
CPI	-0.2	-0.5	-0.1	0.1	-0.2	-1.0	-0.7	0.1	-0.9	-0.3
CPI excl. unprocessed food and energy	0.0	0.6	0.0	0.0	-0.1	0.0	0.2	0.6	0.8	1.0

SOURCES: INE and Banco de España.

a Information available to 17 December 2015.
b Contribution to the quarter-on-quarter rate of change of GDP (pp).
c Latest available figure for consumer price indices: November 2015.

rate to Q3. Finally, labour costs have continued on a moderating path in recent months, with wage settlements under collective bargaining agreements standing at 0.75% to November.

17.12.2015.

This update of the macroeconomic projections for the period 2015-2016 takes as its starting point the projections published by the Banco de España last September and, as is the usual practice, the changes since then in the external assumptions on the information available to 11 December (see Panel 1).[1] It also includes the latest Annual (ANA) and Quarterly National Accounts (QNA) estimates by INE, which include significant revisions of the data for the period 2011-2014.[2]

According to the update presented here, the expansionary phase of Spanish economic activity is expected to continue in the final stretch of 2015 and throughout 2016. Specifically, average GDP growth is projected to stand at 3.2% this year and at 2.8% next year (see Panel 2). Foreseeably, this slowdown in the GDP growth rate next year will be associated with an easing in the pace of national demand. Employment will retain its marked momentum, although its rate of increase will slacken in line with the course of output. As regards prices, CPI-based inflation is expected to begin to post slightly positive rates from the end of this year.

Compared with the projections published in September, projected output growth has scarcely changed, since the inclusion of the new QNA series to 2015 Q3 has had virtually no effect on the rates of change of GDP, while the effects of the changes in the external assumptions have virtually offset one another. However, the short-term information suggests that developments in activity in 2015 Q4 might have been more favourable than those projected in September, leading to a 0.1 pp increase in the annual average rate on the previous projection.

Turning to the external assumptions underlying the projections, it is worth noting the greater weakness in the foreseeable course of Spanish export markets compared with the September exercise, owing to the downturn in growth prospects in some emerging regions, which is offset only partially by the positive impulse stemming from the higher growth of euro area imports. Oil prices, meanwhile, have once again been revised downwards, in keeping with the changes in their prices on spot and futures markets. The path of the three-month EURIBOR is holding at minimum levels, with negative rates projected in 2016, and 10-year government bond yields, on the expectations implied by the yield curve, have been revised downwards relative to the September assumptions to 1.7% and 1.8% in 2015 and 2016, respectively. This course of interest rates has led to a downward revision on a lesser scale of the cost of financing for households and firms. Finally, the euro exchange rate is very similar to that used in the September exercise. As regards fiscal assumptions, there are no significant changes from the September forecasting exercise, which already incorporated the effects of the measures included in the draft State Budget.[3]

Overall, the impact on GDP growth of the changes in the projection assumptions is roughly neutral, since the negative impact of the worsening in export markets is offset by the expansionary effects of lower oil prices and somewhat more favourable financing conditions.

1 For the behaviour of Spain's export markets, use was made of the information included in the December 2015 Eurosystem macroeconomic projections based on data available to 19 November.

2 See Box 5 in the original Spanish September 2015 Quarterly Report.

3 See Box 2 of the September 2015 *Quarterly Report*. Box 2 in this report describes recent developments in general government budget conduct.

Panel 1
INTERNATIONAL ENVIRONMENT AND MONETARY AND FINANCIAL CONDITIONS (a)

Annual rate of change, unless otherwise indicated

		Current projection		Change from September 2015 projection	
	2014	2015	2016	2015	2016
International environment					
World output	3.4	2.9	3.4	-0.1	-0.2
Global markets	3.5	1.5	3.5	-0.7	-0.4
Spain's export markets	3.4	2.5	3.3	-0.7	-0.8
Oil price (in USD)	98.9	52.7	45.4	-0.9	-8.0
Competitors' export prices, in euro	-1.0	2.6	1.2	0.1	0.7
Monetary and financial conditions					
Dollar/euro exchange rate (USD per euro)	1.3	1.1	1.1	0.0	0.0
Short-term interest rate (3-month EURIBOR)	0.2	0.0	-0.2	0.0	-0.1
Long-term interest rate (10-year bond yield)	2.7	1.7	1.8	-0.1	-0.5

SOURCES: ECB and Banco de España.

a Assumptions cut-off date: 11 December 2015.

Projected GDP growth continues to be underpinned by the momentum of domestic demand, for which a contribution to output growth of 3.6 pp in 2015 and 3.1 pp in 2016 is estimated, whereas the contribution of net external demand is expected to be negative in both years, as a result of the strength of imports. Among the domestic demand components, household consumption is expected to remain very buoyant, driven mainly by the favourable course of employment, while the expansionary impact on disposable income of the fall in oil prices, the reduction in direct taxation and the refund (part of which in late 2015, and part, foreseeably, at the start of 2016) to public-sector employees of their extra salary payment is projected to continue. It is expected these effects will lose steam over the coming year and, consequently, that private consumption will ease somewhat as the year unfolds. That said, private consumption is expected to grow at slightly over 3% during the two years of the projection period, with a moderate upward revision in 2016 compared with September.

Against the background of the above-mentioned improvement in financing conditions, the current recovery in residential investment is expected to continue, as reflected by the rise in housing starts and the higher transaction figures. Business investment will continue to post robust growth, driven by the strength of final demand, the favourable financial conditions and the need to renew and build on existing capital.

As regards foreign trade, the current buoyancy of exports is expected to continue next year, underpinned by sales to the rest of the euro area and further gains in competitiveness, which are projected to offset the weakness in the emerging economies. It is estimated imports will continue to show notable momentum, in line with final demand. Compared with the previous projections, both exports and imports have been revised upwards in 2015, chiefly as a result of the incorporation of the new QNA estimates up to Q3, which are more favourable than foreseen three months ago.

Against this backdrop, the nation's net lending is expected to be somewhat higher than envisaged in September (2% and 1.7% of GDP this year and next year, respectively), owing mainly to the lesser income deficit, as a result of the reduction in the level of interest rates, and to an increase in the capital transfers balance.

The current projections envisage the continuation of the ongoing job creation observable since late 2013, in a setting of moderately increasing labour costs. Employment growth, similar to that of the previous projections, will entail further reductions in the unemployment

Panel 2
PROJECTIONS OF THE SPANISH ECONOMY'S MAIN MACROECONOMIC VARIABLES (a)

Annual rate of change in volume terms and % of GDP

		Current projection		September 2015 projection	
	2014	2015	2016	2015	2016
GDP	1.4	3.2	2.8	3.1	2.7
Private consumption	1.2	3.1	3.3	3.5	2.9
Government consumption	0.0	2.4	0.4	1.1	0.3
Gross fixed capital formation	3.5	6.2	5.3	6.5	6.6
Investment in capital goods and intangible assets	10.5	9.8	8.6	9.8	9.5
Investment in construction	-0.2	5.5	4.1	5.3	4.9
Exports of goods and services	5.1	5.8	4.6	4.9	5.0
Imports of goods and services	6.4	7.5	5.9	6.3	6.4
National demand (contribution to growth) (b)	1.6	3.6	3.1	3.4	3.0
Net external demand (contribution to growth)	-0.2	-0.4	-0.3	-0.3	-0.3
Nominal GDP	1.0	4.0	3.7	4.1	3.7
GDP deflator	-0.4	0.8	0.9	0.9	1.0
Consumer price index (CPI)	-0.2	-0.5	0.7	-0.5	0.8
Employment (full-time equivalents)	1.1	3.0	2.4	2.8	2.5
National economy's net lending (+)/net borrowing (–) (% of GDP)	1.6	2.0	1.7	1.4	1.2

SOURCES: Banco de España and INE.
Latest QNA figure: 2015 Q3.

a Projections cut-off date: 17 December 2015.
b One-decimal figure difference between the GDP growth rate and the contribution of net external demand.

rate, bringing it down to slightly below 20% of the labour force at the end of the projection horizon.

In the projection period there is expected to be a gradual rise in inflation, prompted by two different factors. On one hand, the gradual stripping out from the year-on-year rates of the effects of past declines in oil prices will lead to a rise in the energy component. On the other, the remaining prices in the consumption basket are expected to quicken gradually, as a result of the diminishing degree of slack in the economy and, to a lesser extent, of the lagged effects of the past exchange rate appreciation. This acceleration will, in any event, be very modest, in a setting of moderately increasing wage costs. Consumer price inflation is expected to post positive rates of change only at the end of this year, which would lead to a decline of 0.5% in the annual average. The subsequent rise would result in an average rate of 0.7% in 2016. It is estimated that the GDP deflator might grow, on average, by 0.8% this year and 0.9% next year, posting similar figures to those in the September projection.

The risks surrounding the baseline scenario for GDP growth remain slightly tilted to the downside, owing essentially to external factors. In particular, there remains considerable uncertainty over the path of recovery of the emerging economies, against a background in which the gradual tightening of US monetary policy might prompt harsher financing conditions in some of these economies. Domestically, the main source of uncertainty is associated with the course of economic policies. In particular, potential structural reform fatigue might adversely affect growth expectations and bear negatively on current consumption and investment decisions. Also, the need to correct potential slippage in the general government budget outturn, fulfilment of which is essential for maintaining agents' confidence, might bear adversely on activity in the short run. Furthermore, it cannot be ruled out that the effects of certain current impulses may extend beyond the timeframe envisaged in this baseline scenario. In this respect, regard must be had in particular to the difficulty in accurately estimating the effects of the non-standard monetary policy measures on variables such as the exchange rate, or the cost and availability of financing.

In terms of deviation from the inflation scenario, the balance of risks is also slightly skewed to the downside, as a result of the possible materialisation of the more unfavourable scenarios for the global economy described in the foregoing paragraph. Ultimately, a greater slowdown in the emerging economies might, in particular, have an adverse bearing on the course of the prices of oil and, in general, commodities. One factor tempering the downside risks to the behaviour of inflation is the extension of the monetary policy measures adopted by the ECB, which have lessened the risk of a potential deanchoring of inflation expectations. Finally, the uncertainty surrounding price projections is heightened by the possible persistence of a high level of exchange rate volatility, against the backdrop of a greater divergence of the main developed economies' monetary policies.

The latest figures on the overall general government sector, in National Accounts (NA) terms, refer to the first half of the year. According to this information, the general government sector posted a deficit of 2.9% of GDP in this period, compared with 3.4% of GDP in the same period a year earlier. More leading information is also available to Q3 on the aggregate comprising central government, the Social Security system and the regional governments. According to these figures (see accompanying table and Panel 1), the aggregates of the sub-sectors posted a deficit of 3.4% of GDP in the January-September period, an improvement of 0.6 pp of GDP on the same period in 2014 (excluding in any case aid to financial institutions). Fulfilment of the deficit target for the overall general government sector for this year (4.2% of GDP) requires an improvement of 1.6 pp of GDP on the previous year.

The performance across the different general government sub-sectors is uneven (see accompanying table). While central government improved its deficit in the nine months to end-September by 0.7 pp of GDP compared with the same period a year earlier, in line with the adjustment required for fulfilment of its annual target, the Social Security system's outturn was 0.3 pp worse, which runs counter to the budgeted improvement for 2015 as a whole of 0.4 pp. The regional governments recorded progress of 0.1 pp of GDP in this period, compared with the annual improvement of 1 pp needed

Table
DEVELOPMENTS IN GENERAL GOVERNMENT ACCOUNTS (a)

	€m	Year-on-year rate of change			
	2014 Jan-Dec	2014 Jan-Dec	2014 Jan-Sep	2015 Jan-Jun	2015 Jan-Sep
1 Total resources (b)	357,269	1.8	2.1	2.9	3.0
Taxes on production and imports	95,067	3.4	3.6	6.7	7.2
Income and wealth taxes	97,197	0.4	1.7	5.2	4.6
Social contributions	129,832	1.5	1.1	1.6	1.5
Other resources (b)	35,173	2.4	2.6	-12.3	-9.6
2 Total uses (b) (c)	410,687	0.1	-0.3	1.1	1.6
Compensation of employees	94,278	0.1	0.1	3.5	2.9
Other final consumption expenditure (d)	63,245	-0.0	0.9	3.5	3.3
Social benefits (not in kind)	170,221	0.0	-1.2	-0.0	0.1
Actual interest paid	34,615	2.2	2.0	-5.1	-6.3
Subsidies	9,901	4.6	24.9	17.5	23.8
Other uses and current transfers (b)	15,702	-4.1	-3.6	-3.6	-5.7
Gross capital formation	16,217	-9.0	-10.0	1.2	15.1
Other capital expenditure (b) (c)	6,508	23.9	19.3	7.5	7.6

	€m	As a percentage of annual nominal GDP (f)			
Net lending (+) or net borrowing (–)	2014 Jan-Dec	2014 Jan-Dec	2014 Jan-Sep	2015 Jan-Sep	Official targets 2015
3 Consolidated aggregate (3 = 3.1 + 3.2 + 3.3) (c)	-66,066	-6.3	-4.0	-3.4	-4.2
3.1 Central Government (c)	-37,018	-3.6	-2.9	-2.2	-2.9
3.2 Social Security funds	-10,866	-1.0	0.0	-0.3	-0.6
3.3 Regional Government	-18,182	-1.7	-1.1	-1.0	-0.7
4 Local Government	5,938	0.6	0.4		0.0
5 Total General Government (5 = 3 + 4) (c)	-60,128	-5.8	-3.6		-4.2
Memorandum item					
Aid to financial institutions (e)	1,191	0.1	0.1	0.0	—
Public debt (EDP)	1,033,737	99.3	98.4	99.3	99.7

SOURCES: IGAE and Budget Plan 2016 (published on 11 September 2015), except gross capital formation (EDP September 2015).

a The revenue and expenditure data refer to the accounts of the Central Government, Regional Government and Social Security Funds consolidated aggregate. Local Government data are therefore not included, since monthly information is not available.
b Consolidated figures for transfers to other General Government tiers (Local Government).
c Excludes aid to financial institutions.
d Includes inputs and market producers' social transfers in kind.
e Capital transfers granted to financial institutions.
f For 2015 the annual nominal GDP envisaged in the 2016 Budget Plan was taken. In the case of debt, GDP at market prices was prepared drawing on the official series of the quarterly SNA published by INE, aggregating the last four quarters for each reference date.

to meet their target for this year. The figures for local government, available to June, are somewhat more lagged and show a surplus of 0.2 pp of GDP, slightly up on the same period in 2014, set against the reduction target of 0.6 pp of the budgetary balance in 2015. On the information available, therefore, the risks of slippage from target would be concentrated in regional government and Social Security, which might be partly offset by a better-than-expected performance by local government and central government.

In terms of items, general government revenue (excluding local government) increased by 3% to September year-on-year (see table). This increase marks a slight improvement on the previous quarter which is due, above all, to tax revenue – despite the negative impact of the recent tax reform – and, to a lesser extent, to non-tax resources. Some further information is available to October on taxes shared by the State, regional government and local government, and to social security contributions in cash-basis terms, where a slight additional acceleration in revenue is discernible. In any event, public revenue should continue rising in the final stretch of the year, meeting the official target of an increase of around 4%. General government (excluding local government) expenditure quickened in Q3, posting a rate of change of 1.6% in the January-September period, compared with 1.1% in the first half of the year. Some partial data available to October appear to point to a slight additional acceleration in expenditure, both in social benefits (owing to the lesser decline in unemployment benefit payments) and in compensation of employees. It should be recalled, moreover, that the last quarter of the year will see the completion of the payment to public-sector employees of a further one-quarter of their extra salary payment suspended in 2012.

General government debt[1] as a proportion of GDP stood in September at 99.3%, similar to the end-2014 level (see table and Panel 2). The official target for 2015 is 99.7% of GDP. The still-high general government borrowing requirements push the debt ratio upwards, but this effect is offsets by the nominal growth of GDP. The improvement in financing conditions is contributing to alleviating the effect of high debt on financial expenses, which as a percentage of GDP have fallen by around 0.2 pp in 2015 to date. In terms of instruments, the bulk of financing has continued to be covered by recourse to medium- and long-term securities issuance. The breakdown by holder shows that the main purchasers were non-residents and, to a lesser extent, financial institutions other than credit institutions (among which the Banco de España is included), whereas credit institutions reduced their holdings of these assets.

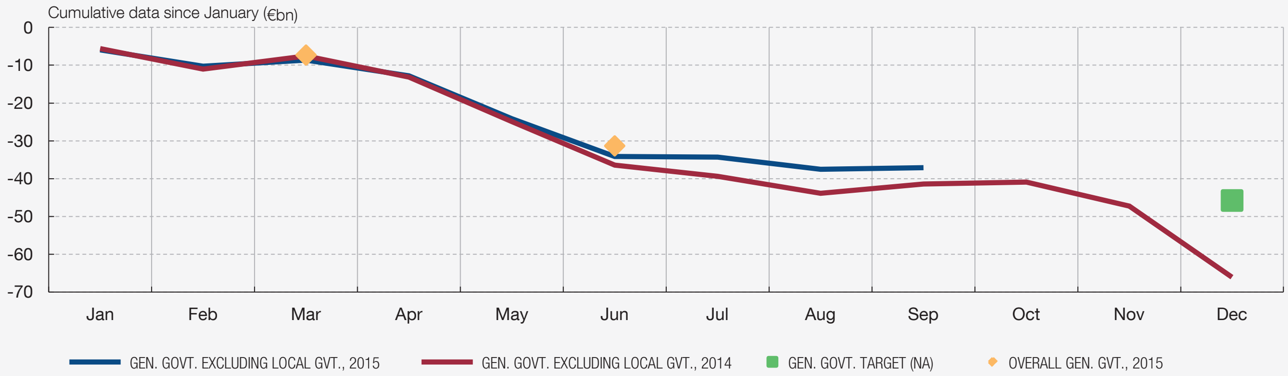
Finally, it should be noted that on 11 September the Government unveiled its General Government Budget Plan for 2016[2], which it forwarded to the European Commission. The plan, in line with the recommendations of the European Council, set budget deficit targets at 4.2% of GDP in 2015 and 2.8% of GDP in 2016, the fulfilment of which would enable Spain to shed its Excessive Public Deficit status (a deficit higher than 3% of GDP) in 2016. The European Commission (EC) in its Opinion[3] dated 12 October 2015, considered that the Budget Plan ran the risk of failing to comply with the provisions of the Stability and Growth Pact (SGP). Specifically, the Commission forecasts a budget deficit of 4.7% and 3.6% of GDP in 2015 and 2016, respectively. Accordingly, the EC urged the Spanish authorities to strictly implement the 2015 budget and to take the necessary measures under the national budgetary procedure framework to ensure that the budget for 2016 complies with the SGP. Also, given that the Budget Plan did not include updated and detailed measures for the regional governments, the EC called on the Spanish authorities to submit an updated Budget Plan including fully

1 Recorded following the Excessive Deficit Protocol (EDP debt) methodology.

2 See the Banco de España September 2015 *Economic Bulletin.*

3 http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/dbp/2015/es_2015-10-12_co_en.pdf.

Panel 1
GENERAL GOVERNMENT BUDGET BALANCE IN NATIONAL ACCOUNTS
(excl. aid to financial institutions)

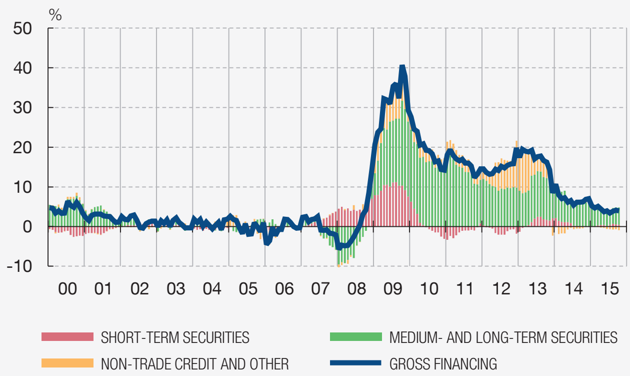


SOURCES: IGAE and Ministry of Finance and Public Administration.

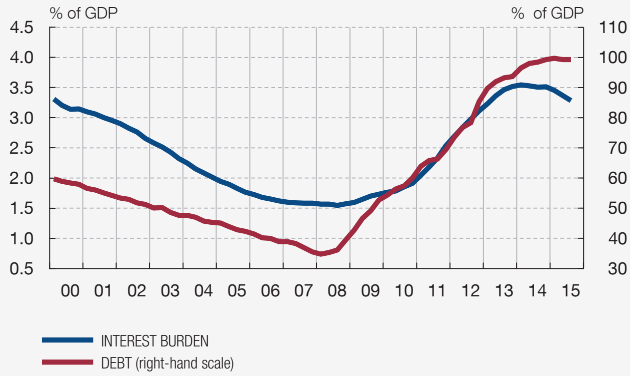
specified regional government measures, as soon as possible. The Commission further considered that Spain has made some headway in complying with the recommendations addressed to it by the Council as part of the European Semester 2015 relating to fiscal governance, and urged the authorities to make further progress.

Panel 2
GENERAL GOVERNMENT FINANCING

1 GROSS FINANCING
Y-o-y rate and contribution by instrument



2 INTEREST BURDEN AND DEBT RATIO
Four-quarter cumulated data



SOURCE: Banco de España.