

QUARTERLY REPORT ON THE SPANISH ECONOMY

1 OVERVIEW

The global economy sustained a notable growth rate in the second half of 2017. On the latest IMF and ECB projections, global GDP growth for the year as a whole might rise to 3.6%, a rate somewhat higher than that observed in any of the five previous years. This firming of the expansion in activity, common to most of the main geographical regions, has been supported by the continuation of accommodative monetary policies and highly favourable financial conditions, and by a less restrictive fiscal policy stance. Moreover, it has been accompanied by a strengthening of global trade which, at the start of this year, was associated with specific temporary factors and, subsequently, appears to have become more persistent as it has run in tandem with a certain rise in investment globally. As a result, and unlike the case for most of the period in the wake of the Great Recession, trade growth is marginally outpacing output growth.

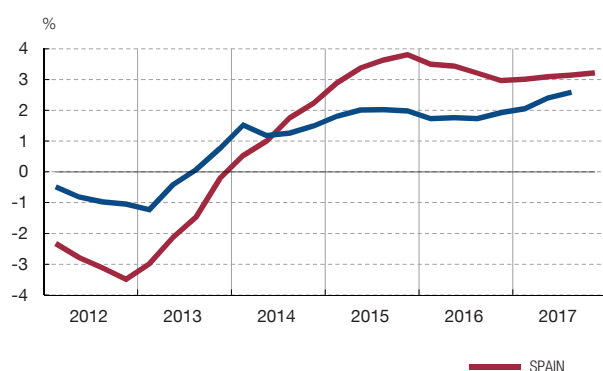
Against this backdrop, it is possible that, in the short term, the various projections available may be underestimating the degree of expansionary inertia of global activity. However, over a somewhat lengthier horizon, a set of risk factors remain in place that mean that the global expansion in output is prone to some fragility. These sources of uncertainty include a hypothetical tightening of global financial conditions (associated, perhaps, with a correction in the high prices of certain financial assets, which, in turn, might be caused by swifter US monetary tightening than expected by global financial market participants), possible setbacks in the ongoing reform of the Chinese economy and a hypothetical resurgence in geopolitical risks. Conversely, some of the uncertainties in place to date appear to have been dispelled, as is the case of the US fiscal reform, the final materialisation of which might add further impetus to global activity in the short term, albeit on a lesser scale than that projected at the start of the current president's term of office.

This favourable outlook for global activity is in contrast to the scant signs of a rise in inflationary pressures, as might be expected in light of the progressive reduction in the degree of cyclical slack. The projections of the main international organisations indicate that those increases in price growth rates will materialise in the coming years, as output gaps become increasingly positive.

Global financial markets have moved on a generally upward trend during the current quarter, against the background of confirmed robust growth in a setting of contained inflation and the simultaneous dissipation of deflationary risks, and of high values in bond and equity markets alike. On the currency markets, the exchange rate of the euro against the dollar has tended to stabilise following its strong appreciation in the first nine months of the year, while fresh price rises have been recorded in the oil markets, assisted both by the improvement in global demand and by the extension, announced by OPEC, of supply cuts to end-2018. Further room for possible oil price rises might, however, be limited, given that the levels attained support the profitability of the alternative production of shale oil in the United States.

In the euro area, GDP growth has remained high. Specifically, the rate observed in Q3 was 0.6%, in a setting in which, moreover, the dispersion of the behaviour of the different economies is diminishing. The latest Eurosystem projections, submitted to the ECB Governing Council on 14 December, show an improved outlook, which has translated into

1 GROSS DOMESTIC PRODUCT



2 HARMONISED INDICES OF CONSUMER PRICES



SOURCES: ECB, INE and Banco de España.

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

a significant revision of expected GDP growth (by 0.8 pp in cumulative terms in the 2017-2019 period).¹

Inflation, measured by the overall HICP, has been relatively stable in the second half of the year, although that masks the differing behaviour of the components of energy goods and unprocessed food, which have risen somewhat, and that of the indicator encompassing the prices of non-energy industrial goods and services which, on the contrary, has slowed to slightly below 1%. The Eurosystem's projections envisage a minor slowdown in overall inflation at the start of 2018 (related to base effects associated with the energy component) and a subsequent gradual rise, driven by the core component. In 2020 on average, overall inflation and core inflation are expected to stand respectively at 1.7% and 1.8%. In light of this information, the ECB Governing Council confirmed, on 14 December, its assessment concerning the need for the area's monetary policy to retain an accommodative stance in order to ensure fulfilment of the price stability objective. This same assessment led it, in October, to decide to extend its asset purchase programme to September 2018, albeit for lower volumes, and to reiterate its readiness to prolong purchases beyond that date were it necessary.

In Spain, the quarter-on-quarter growth rate of GDP in Q4 is estimated to have held at a similar pace to that of Q3, standing at 0.8% (see Chart 1 and Table 1). This stability of the economy's output growth rate is the consequence of two countervailing forces. Specifically, the strength of export markets is expected to have countered the adverse effects stemming from the increased uncertainty over the political situation in Catalonia which, on the – relatively scant – information available, is estimated to have been especially concentrated in this region. From the standpoint of the demand components, the adverse impact of the uncertainty has been manifest above all in the domestic private expenditure components and in tourism exports. Elsewhere, on the supply side, both qualitative and quantitative indicators relating to manufacturing industry have moved on a more favourable trajectory than those for services, which is consistent with a better performance by the external – as opposed to the domestic – demand component. Specifically, the growth rates of both private consumption and investment in capital goods are expected to have fallen in the

¹ The Eurosystem's projections for the euro area as a whole are available at [this link](#). Those for Spain, which are an integral part of the foregoing and were prepared by staff of the Banco de España Directorate General Economics, Statistics and Research, can be viewed at [this other link](#).

	2016	2017	2016				2017			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
National Accounts										
Quarter-on-quarter rates of change, unless otherwise indicated										
Gross domestic product	3.3	3.1	0.7	0.8	0.7	0.7	0.8	0.9	0.8	0.8
Contribution of national demand (b)	2.5	2.6	0.5	0.7	0.4	0.4	0.9	0.6	0.8	0.6
Contribution of net external demand (b)	0.7	0.5	0.2	0.1	0.3	0.3	-0.1	0.3	0.0	0.1
Year-on-year rates of change										
Employment	3.0	2.9	3.4	2.8	3.1	2.7	2.6	2.9	2.9	3.2
Price indicators (year-on-year change in end-of-period data) (c)										
CPI	-0.2	2.0	-0.8	-0.8	0.2	1.6	2.3	1.5	1.8	1.7
CPI excl. energy and unprocessed food prices	0.8	1.1	1.1	0.6	0.8	1.0	0.9	1.2	1.2	0.8

SOURCES: INE and Banco de España.

a Information available to 22 December 2017.

b Contribution to the quarter-on-quarter rate of change of GDP (pp).

c Latest available figure for consumer price indices: November 2017.

closing months of the year, while, on the contrary, the high-frequency information available suggests a possible strengthening of investment in construction. Merchandise trade figures suggest that the contribution of net external demand to GDP growth has been positive. In any event, it should be borne in mind that the information available for the current quarter is still relatively limited, which, in particular, hampers obtaining an accurate assessment of the impact of the increase in uncertainty.

The year-on-year rate of change in consumer prices stood in November at 1.7%, only slightly up on the average rate observed since the summer. The changes have been more marked in terms of the components. Specifically, as has been the case in the euro area as a whole, the most volatile items have tended to quicken, a development closely linked in the case of energy prices to the rise in oil prices. Conversely, the moderation in non-energy industrial goods and services prices has meant that core inflation has slowed significantly, from 1.4% in June to 0.8% in November. Consequently, as in other geographical areas, there are still no signs that the growing increase in capacity utilisation is giving rise to an increase in inflationary pressures.

In the medium term the recovery is expected to continue, spurred by the substantial headway made in redressing the imbalances in the economy. Nonetheless, GDP growth is forecast to lose some momentum in the coming years, as a result, inter alia, of the neutral fiscal policy stance – as opposed to its expansionary stance in recent years – and the additional moderate impact of monetary policy easing on agents' financing conditions. Specifically, on the latest projections, which are the contribution by the Banco de España to the above-mentioned Eurosystem forecasting exercise, GDP is expected to grow by 2.4% in 2018 and by 2.1% both in 2019 and 2020, while the core inflation component will tend to rise gradually to 1.8% in 2020.²

There are a total of seven boxes in this Report: an assessment of the prospect of the recently observed strength of global trade persisting (Box 1); a description of the latest monetary policy measures adopted by the ECB (Box 2); an analysis of the observed effects

² These projections are available at: <https://www.bde.es/f/webbde/SES/AnálisisEconomico/AnálisisEconomico/ProyeccionesMacroeconomicas/ficheros/be1704-proye.pdf>.

of the rise in political uncertainty related to the situation in Catalonia (Box 3); an assessment of the degree of reabsorption of consumer demand postponed during the crisis (Box 4); a description of the budget outturn (Box 5); an assessment of Spanish firms' access to external financing (Box 6); and an analysis of Spain's international investment position (Box 7).

21.12.2017.

International trade in 2015 and 2016 was markedly sluggish in advanced economies and emerging countries alike. However, following this slack period, in late 2016 trading activity worldwide started to expand at a more sustained pace. The volume of trade in goods grew at an average quarterly rate of 1.3% between December 2016 and September 2017, compared with average growth of 0.3% recorded in the two preceding years. This recovery, however, was uneven, with an upturn in Q1, a slight downturn in Q2 and another upturn in Q3 (see Chart 1). Geographically, the acceleration observed in late 2016 and in early 2017 was mainly due to strong growth in the commercial activity of emerging Asian countries. Buoyant US imports and some recovery in Latin America also contributed positively to world trade growth in the early months of the year. However, the rebound observed in Q3 mainly reflects the expansion of imports in the euro area and other advanced economies, although trade in Asian countries also contributed significantly in September (see Chart 2).

The rebound seen in emerging Asia in early 2017 was largely on the back of the buoyancy of China's trading activity and Asian intra-regional trade (see Chart 3). In part, these dynamics are related to the fiscal and financial stimulus implemented by the Chinese authorities to sustain their economy's expansion, which boosted investment and were passed through to the Asian economies as a whole through regional value chains.¹ Other factors that may have contributed to the pick-up in trade in Q1 are the previous appreciation of the dollar and the recovery of consumption and investment in the US energy sector, which is highly sensitive to the increase in oil prices, boosted by US imports. For its part, Brazil's exit from recession contributed to spur commercial activity in Latin America. Also, the upturn in world trade seen from July and August, supported by the strength of activity in the euro area and other developed economies, was driven

1 European Central Bank, "Economic Bulletin", issue 4/2017.

Chart 1
GROWTH IN THE VOLUME OF GOODS TRADE

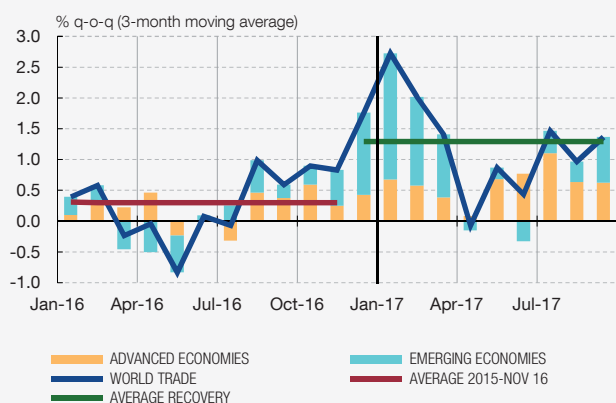


Chart 2
CONTRIBUTION TO TRADE GROWTH

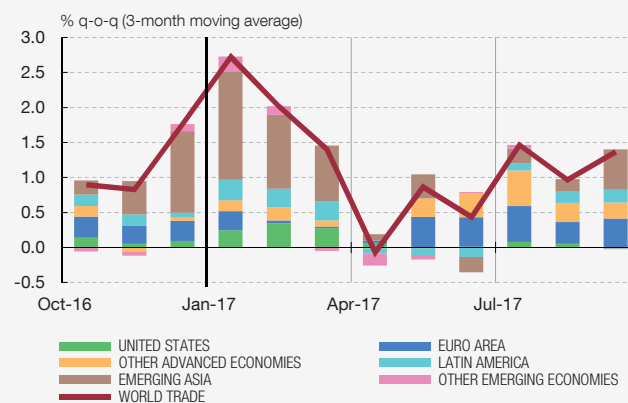


Chart 3
TRADE IN EMERGING ASIA BY TRADE PARTNER

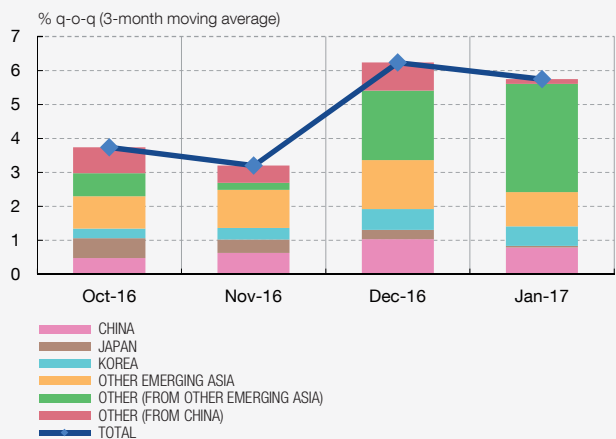
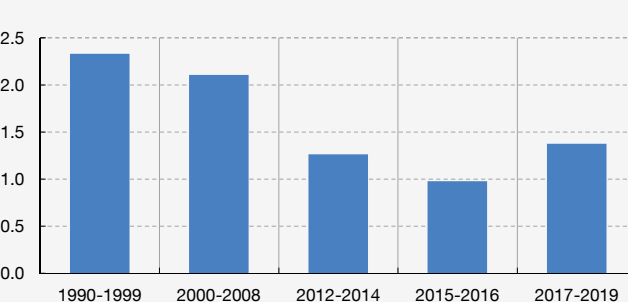


Chart 4
ELASTICITY OF TRADE TO GDP



SOURCES: CPB, IMF DOTS and IMF WEO.

by trade in investment goods, which had been weighing on total trade in recent years. Bilateral trade data suggest that euro area growth also boosted the trading activity of some countries in Eastern Europe through the regional value chains.

The developments seen in the first three quarters of 2017 are consistent with short and medium-term international trade growth projections. In the short term, the significant expansion of world trade is expected to continue, underpinned by the momentum of advanced economies. Among the leading indicators of activity, the Purchasing Managers Indexes (PMIs) relating to changes in production and industry orders remained at high levels in October and November, in line with those recorded in the first half of the year. In the medium term, the projections of different international bodies point to sustained growth in world trade, with annual increases ranging between 3.2% and 4% for 2018. The expansion of trade in advanced economies will benefit from output gaps and ongoing improvement in investment. The pick-up of trade in emerging economies will be favoured by the timid recovery of commodity prices in producing countries, the correction of trade imbalances and sustained growth in China.² In this connection, it is expected that Asian emerging economies will continue to contribute substantially to world trade growth, although without

returning to the exceptionally buoyant pace of the first half of the year.

Thus, the performance of trade in 2017 is starting to be consistent with a progressive recovery in the elasticity of trade to global GDP. After remaining at very high levels from the 1990s until the onset of the global financial crisis, even exceeding a value of two, the elasticity of world trade to global activity moderated substantially from 2012, with particularly low values (below one) in 2015 and 2016 (see Chart 4). According to several studies, this change was driven in part by temporary factors, such as the composition of demand (given the lesser dynamism of investment, a GDP component with a high import content) or geographical factors, as activity in advanced economies, which are characterised by having a higher elasticity, slowed notably. Other explanations point towards structural factors, such as the halting of the process of developing global value chains or the slowing of trade openness processes.³ The latest projections indicate that elasticity could in the medium term return to a value between 1.0 and 1.4, remaining at levels below pre-crisis values. An attenuation of the temporary factors mentioned above, with the recovery of advanced economies crystallising as investment increases, and the growing weight of final demand in emerging economies, which would suggest a greater elasticity of trade to activity in these markets too, should contribute to this recovery.

² See International Monetary Fund, "World Economic Outlook", October 2017; OECD, "Interim Economic Outlook", September 2017; European Commission, "European Commission Forecast, Autumn 2017", November 2017; World Trade Organization, "Trade Statistics and Outlook", press release, 21 September 2017.

³ International Monetary Fund, "Global Trade: What's Behind the Slowdown?", WEO October 2016. IRC Trade task-force, "Understanding the Weakness in Global Trade. What is the New Normal?", European Central Bank Occasional Paper, September 2016.

On 26 October, the Governing Council of the ECB announced its decision to recalibrate the various components defining its monetary policy stance, in view of the imminent expiry, in December 2017, of the minimum period for net asset purchases established earlier. The decisions adopted – and confirmed at the Governing Council’s most recent meeting on 14 December – imply an extended period of monetary stimulus and reveal the simultaneous existence of two opposing elements.

On one hand, the new measures are a reflection of the improved macroeconomic situation in the euro area, with a more robust, entrenched and broad-based recovery. Activity in the euro area has been growing uninterrupted for more than four years and the prospect of maintaining growth is favourable, in line with the sustained easing of financial conditions as a result of expansionary monetary policy, and with strong job creation.

However, on the other hand, the decisions taken in October reflect the need to maintain a substantial degree of monetary stimulus for inflation to resume a path of sustained convergence towards rates that are closer to the medium-term monetary policy target. As is

also the case of other advanced economies, the improvement in activity and in the labour market has not yet had the expected impact on inflation¹. As shown in Chart 1, core inflation, which excludes the more volatile components from the overall index, was expected to stand at 1% on average in 2017, and subsequently to rise gradually towards reference rates that are below, but close to, 2%.

In these circumstances, at its October meeting, the Council extended the minimum period for net asset purchases to September 2018, albeit at a reduced monthly pace of €30 billion as from January 2018, compared with the current monthly volume of €60 billion (see Chart 2). With this nine-month extension, the asset purchase programme (APP) will have been in place for at least three and a half years, since its launch in March 2015. Thus, in September 2018, cumulative asset purchases will amount to

1 The subdued pace of wage growth is one of the factors explaining the low inflation rate. For more details, see box 3, «Wage growth in the euro area», Quarterly Report on the Spanish Economy, *Economic Bulletin* 3/2017, Banco de España.

Chart 1
INFLATION

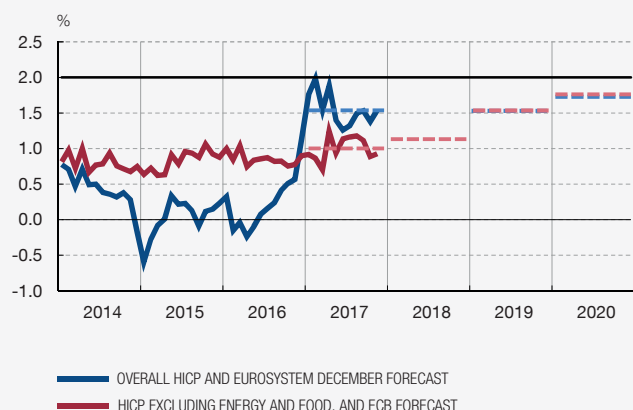


Chart 2
ASSET PURCHASE PROGRAMME (APP).
Monthly net purchases and cumulative purchases

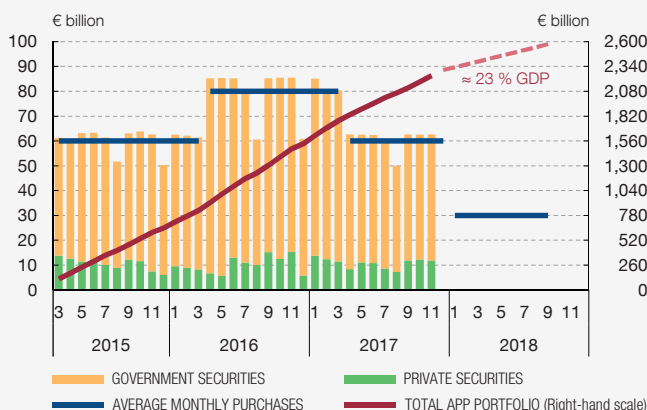


Chart 3
ONE-YEAR OIS FORWARD RATE CURVE

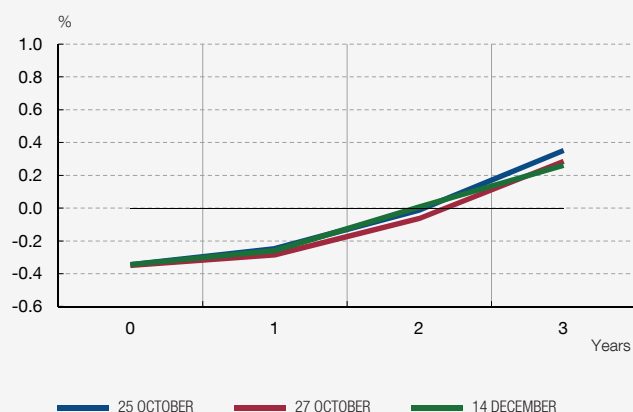
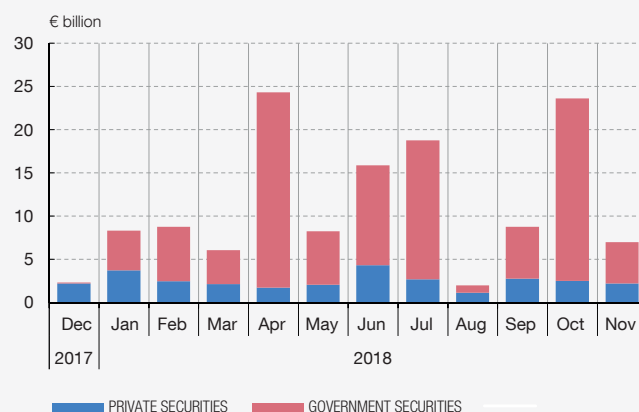


Chart 4
MATURITIES ARISING IN THE APP PORTFOLIO



SOURCES: Datastream, Eurostat and ECB.

almost €2.6 trillion, tantamount to more than 20% of euro area GDP. By type of asset, the ECB has stated that it intends to give an increasingly prominent role in its purchase programmes to private sector instruments over government bonds, which at the end of November accounted for 82% of the total portfolio.²

The Council did not make any changes to the policy rates or to the guidance on the future path of these rates (“forward guidance”). However, removing the uncertainty as to the duration of the APP was key to ensuring the effectiveness of the purchases, in terms of their contribution to supporting the anchoring of inflation expectations at the currently reduced levels, in a context in which the Council’s guidance indicates that policy rates shall remain at current levels for a period extending considerably beyond the end of net purchases. Accordingly, the decisions adopted in October by the Council and confirmed at its December meeting have translated into remarkably stable interest-rate expectations. Policy rate will not foreseeably increase in the near future in the euro area, as reflected by developments in the forward yield curve of the OIS (overnight index swap) shown in Chart 3.

As regards guidance on non-standard measures, the Council left open the possibility of further extensions of the APP in the event of a deterioration in the economic outlook or a worsening of the

financial conditions so that they become incompatible with the monetary policy targets. In addition, the Council made clear its intention to reinvest the principal payments from maturing securities for as long as necessary, i.e. for a prolonged period after the end of net asset purchases. The growing importance of maturities arising in the portfolio, together with their variable profile and the reinvestment flexibility retained by the Eurosystem³ could, nevertheless, lead to some volatility in the effective volume of monthly net purchases. To avoid the incorrect interpretation of net purchase figures, the ECB also decided to publish information on the estimated monthly maturities for the next 12 months (a total of around €134 billion between December 2017 and November 2018) (see Chart 4).

To conclude, the prolongation of net purchases, the size of the purchases already carried under the assets purchase programme, the commitment to continue reinvesting the maturities for a prolonged period and the forward guidance on interest rates all point to an extended period of substantial monetary accommodation, to ensure the gradual convergence of inflation to rates that are more compatible with the medium-term monetary policy target.

² Eligible private assets include asset-backed securities, covered bonds and corporate bonds, purchased, respectively, through programmes known as ABSPP, CBPP3 and CSPP.

³ The principal payments from maturing securities purchased under the public sector purchase programme (PSPP) are reinvested flexibly by the Eurosystem at the appropriate time in the month of the maturity date, as far as possible, or in the two following months, if the liquidity conditions in the market so allow it. During the period of net asset purchases, the principal repayments under the PSPP shall be reinvested in the jurisdiction in which the maturing bond was issued.

At the end of September, in the context of the analysis of the risks to the macroeconomic projections for the Spanish economy published at the time, the Banco de España highlighted that the political tensions in Catalonia might potentially affect agents' confidence and their spending decisions and financing conditions.¹ Subsequently, on 11 November, various hypothetical scenarios were put forward in the *Financial Stability Report*,² based on historical episodes in which significant increases in uncertainty were observed, incorporating various assumptions about the intensity and duration of the current bout of political tension in the region. In particular, the first scenario assumed a temporary and limited increase in uncertainty, which was predicted to cause a cumulative loss of GDP of 0.3 pp up to the end of 2019. A scenario of more intense and prolonged uncertainty was forecast to result in a substantially greater loss of activity.³ More recently, in the projections published on 15 December,⁴ the baseline scenario

factored in the impact of the current political tension, drawing on the latest economic data and the values of the uncertainty indicators on the closing date of the report (30 November), with the impact being in line with the first of the scenarios alluded to above, in which it is of a transitory nature and short lived. However, it was pointed out that the final impact of this risk factor on the Spanish economy as a whole would depend on the magnitude and duration of the uncertainty.

This box reviews the available evidence regarding the trend in the last quarter of the year of a series of financial, economic and uncertainty indicators from the standpoint of the Spanish economy as a whole and of the most important regional economies.

As regards the financial markets, early October saw an intensification of stock-market volatility and the Spanish stock market performed less favourably than the main European markets. This was due, in particular, to the negative trend in bank share prices, especially in the case of banks headquartered in Catalonia. The situation subsequently partly returned to normal (Charts 1 and 2). The volatility in sovereign debt markets, on the other hand, has been much lower, initially registering a widening spread against the 10-year German Bund and a narrowing of the spread against Italian bonds. These changes were small, however, and subsequently reversed, such that in early November levels were again similar to those observed before the onset of the current bout of political tension.

The economic uncertainty indicators rose sharply in October, dropping back somewhat in November (see Charts 3 and 4 for the specific case of the indicators measuring uncertainty in the financial markets and uncertainty about the economic situation and economic policies). If December's level remains the same as that observed in the first two months of the quarter, the average for these indicators over the quarter as a whole will be similar to that in the more favourable of the two scenarios in the box on the

1 See [Macroeconomic projections for the Spanish economy \(2017-2019\)](#).

2 See Box 1.1 ("The Economic impact of uncertainty arising from political tensions in Catalonia") in the Banco de España's November 2017 Financial Stability Report. For a description of the econometric models measuring how economic activity and the components of demand respond to fluctuations in uncertainty, see M. Gil, J. J. Pérez and A. Urtasun, "Macroeconomic uncertainty: measurement and impact on the Spanish economy", Economic Bulletin, 1/2017.

3 For an analysis of the potential impacts of a scenario of a more abrupt and longer-lasting increase in political uncertainty in Catalonia, also see Box 1.1 ("The Economic impact of uncertainty arising from political tensions in Catalonia") in the Banco de España's November 2017 Financial Stability Report. Specifically, this box simulates a scenario assuming the increase in uncertainty in the fourth quarter of the year to replicate the equivalent to the uncertainty registered in the most intense previous episode and to subsequently decline linearly until it disappears at the end of 2019. In this case the estimated negative effect on GDP would be slightly more than 2.5 pp between end-2017 and 2019.

4 See [Macroeconomic projections for the Spanish economy \(2017-2020\)](#): the Banco de España's contribution to the Eurosystem's December 2017 joint forecasting exercise.

Chart 1
GENERAL STOCK-MARKET INDICES

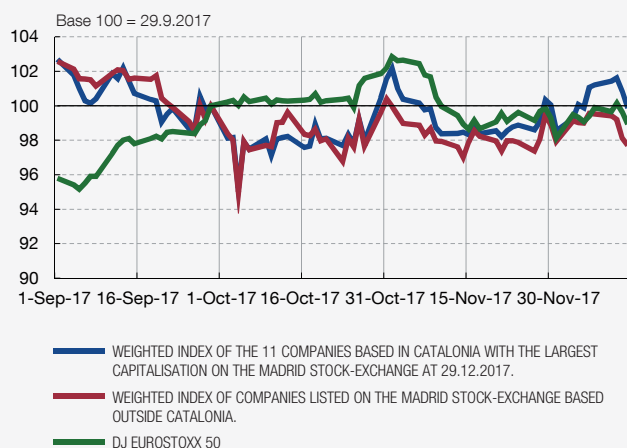
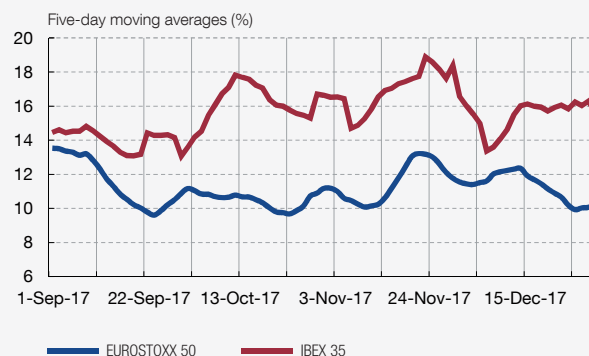


Chart 2
IMPLIED VOLATILITY



SOURCES: Bloomberg and Banco de España.

Chart 3
FINANCIAL MARKET UNCERTAINTY (a)

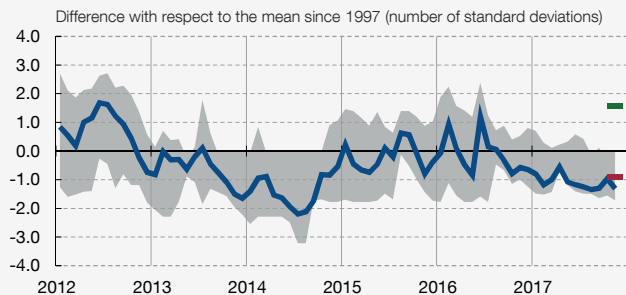
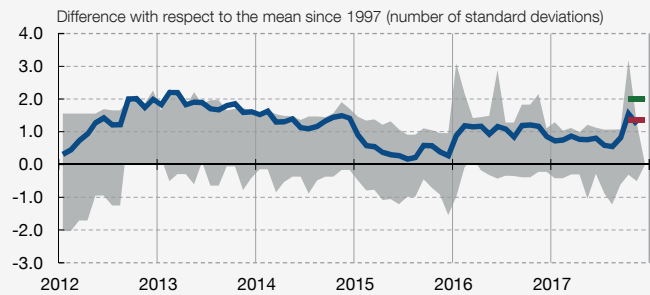


Chart 4
ECONOMIC UNCERTAINTY AND UNCERTAINTY ABOUT ECONOMIC POLICY (b)



— OBSERVED — SCENARIO 1 (c) — SCENARIO 2 (c)

Chart 5
SOCIAL SECURITY REGISTRATIONS - CHANGE IN 2017 (d)

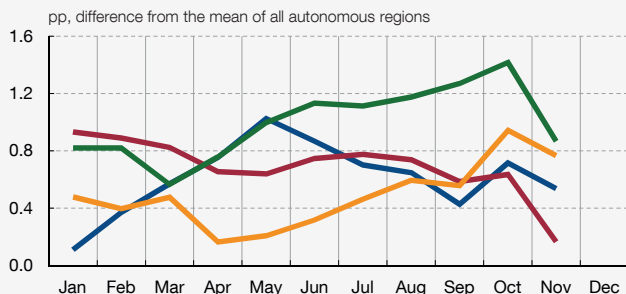


Chart 6
COMMERCIAL VEHICLE REGISTRATIONS - CHANGE IN 2017 (d)

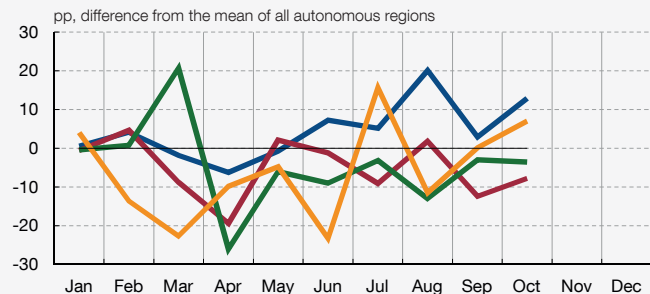


Chart 7
OVERNIGHT STAYS BY NON-RESIDENTS - CHANGE IN 2017 (d)

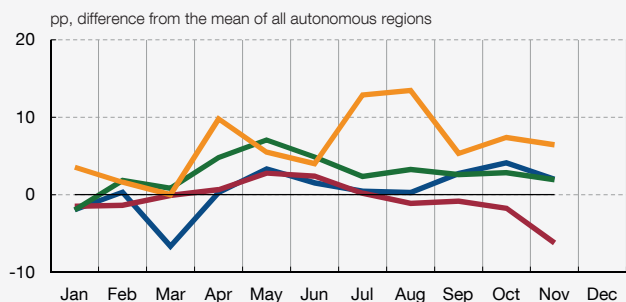
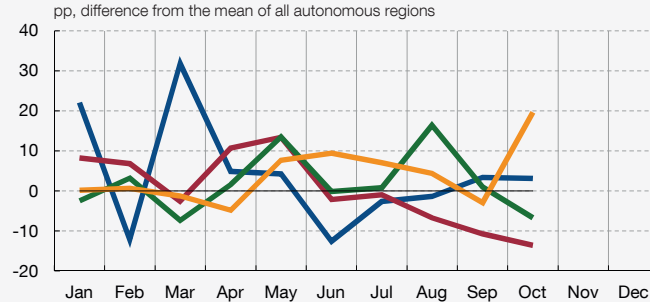


Chart 8
HOME PURCHASES - CHANGE IN 2017 (d)



— ANDALUSIA — CATALONIA — VALENCIA REGION — MADRID REGION

SOURCES: INE, IESE, FUNCAS, CIS Barometer, PRS Group and Banco de España.

- a. Synthetic indicator calculated from indicators of the volatility of the IBEX-35, exchange rates, oil prices, and ten-year bonds. The shaded area represents the indicator range.
- b. Synthetic indicator calculated based on CIS political assessment indicators (current and expectations), political risk indicator (PRS Group), national parliament fragmentation index, indicator of uncertainty regarding economic policies (EPU), and disagreement in the public debt forecasts. The shaded area represents the indicator range.
- c. The scenarios correspond to the hypotheses used in Box 1.1 ("The Economic Impact of Uncertainty Arising from Political Tensions in Catalonia") in the Banco de España's November 2017 *Financial Stability Report*. In scenario 1 it is assumed that the level of uncertainty increases temporarily in 2017 Q4 and returns to the 2017 Q3 level in 2018 Q1. This increase is calibrated based on the statistical distribution of the measures of uncertainty considered, which increase by a magnitude that is in the 90th percentile of each series (i.e. only 10% of the historical changes in each individual indicator are higher than those assumed). In scenario 2 an increase in uncertainty in 2017 Q4 equivalent to that recorded in the historical episode marking the sharpest rise is assumed, on the assumption that following this initial shock the level of the uncertainty indicators decreases linearly over the simulation horizon.
- d. Year-on-year rates from seasonally adjusted series (deviations with respect to average growth of all autonomous regions).

economic impact of the uncertainty deriving from political tensions in Catalonia referred to above.

The information on economic activity in Spain as a whole and in the autonomous regions in the current quarter is still incomplete, but now includes a significant set of indicators, in particular for the months of October and, to a lesser extent, November. This information shows economic activity to have slowed in Catalonia in the final months of the year to a larger extent than the average across the regions considered (Charts 5 to 8). The slowdown was due in particular to the worse performance of a variety of indicators, including those for employment, tourism and the housing market

in this autonomous region, with respect to the average of all the regions and, in particular, the largest regions by economic weight.

The final impact of this risk factor on the Spanish economy as a whole in the fourth quarter will depend on the eventual scale and persistence of the uncertainty. An easing of tensions in Catalonia, as was seen in November and early December, could lead to a scenario of faster output growth than envisaged in recently published forecasts. On the other hand, a hypothetical resurgence of tensions in the coming months could result in a more pronounced impact on agents' consumption and investment decisions than may be inferred from the partial data available.

In accordance with its weight in GDP, private consumption has provided more than half of the total growth during the current Spanish economic recovery, which began in the final stretch of 2013. Specifically, from 2014 to 2016, the increase in this variable averaged 2.5% (consumption per capita growth in this period was 2.6%), accounting for 1.5 pp of the average increase in output, which was 2.7% in this period. Such strength in household spending largely responds to the fact that the current recovery has been job creation-intensive.¹ In addition, also playing a significant role in the dynamism of this spending component is the fact that, during the recovery, decisions on goods and services purchases that had been postponed during the recession have been made. This box analyses the extent to which these postponed purchases (“pent-up demand”) have materialised in the recent expansionary

period and the degree to which the influence of this factor in boosting household consumption might wane in the future.

According to economic theory and the international evidence available, adjustments to household consumption during recessions are not proportionately distributed among the different types of goods and services, with the reduction in this variable bearing down to a greater extent on durable goods.² Moreover, the spending adjustment in the face of an income shock is not uniform either across the different types of non-durable goods and services. For one thing, there are products whose elasticity with respect to changes in income is low, because they respond to the coverage of basic needs (*necessary goods*), such as food, health care, transport

1 See Chapter 2 of the Banco de España 2015 *Annual Report*, which provides evidence that a pick-up in household labour income due to job creation has a greater expansionary effect on consumption than when it is attributable to an increase in real wages.

2 See González Mínguez, J.M. and A. Urtasun (2015), “Consumption dynamics in Spain by product type”, *Economic Bulletin*, Banco de España, September, for a detailed description of the factors underlying the asymmetric adjustment of the different categories of goods and services.

Chart 1
CHANGE IN AVERAGE CONSUMPTION BY PERIOD

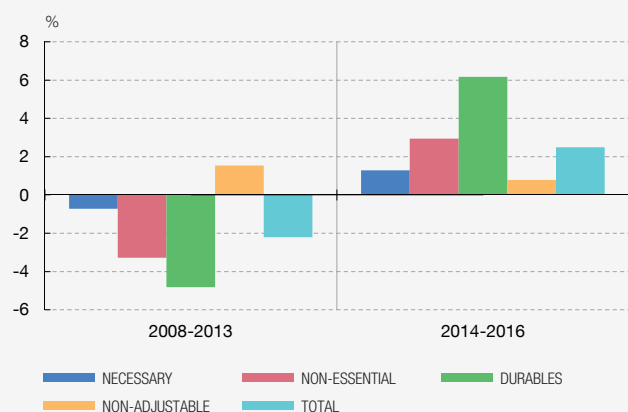


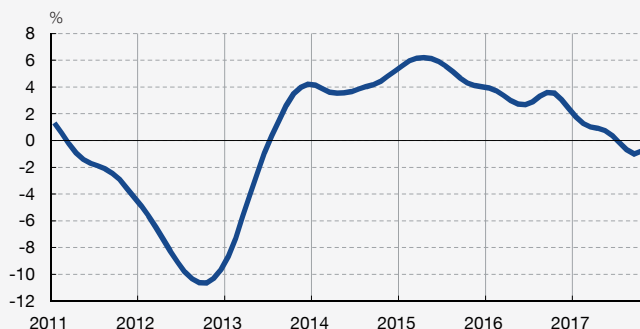
Chart 2
GAP BETWEEN DESIRED AND OBSERVED STOCK OF DURABLE GOODS (a)



Chart 3
RETAIL TRADE IN HOUSEHOLD EQUIPMENT
Trend. Year-on-year rate



Chart 4
NATIONAL OVERNIGHT STAYS
Trend. Year-on-year rate



SOURCES: INE and Banco de España.

a Gap between the desired and observed stock (in percentage points of the observed stock). Positive values for the gap, i.e. when the desired stock is greater than the observed stock, will translate into positive contributions to the growth in spending on durable goods.

and education, while others are more dispensable (*non-essential* goods). Finally, there are expenditures whose downward adjustment evidences, especially in the short term, a high degree of stickiness (*non-adjustable* consumer goods), related essentially to basic supplies (housing, water, electricity and gas). Similarly, in recoveries, the most marked rises in household spending are usually concentrated in durables and non-essential products.

These consumption patterns over the course of the economic cycle have been observed in Spain in the past decade. Chart 1 summarises the course in real terms, from 2008 to 2016, of the four above-mentioned categories of goods and services, distinguishing between the adjustment phase, namely from 2008 to 2013, and the recovery phase, running from 2014 to 2016.³ During the recessionary phase, spending on consumer goods fell off by 4.8%, 2.6 pp more than for consumption as a whole, while in the recovery it increased by 6.2% in annual average terms, outpacing total expenditure by 3.7 pp. Under non-durable consumer goods and services, spending on necessary goods showed much less marked cyclical oscillations, posting annual average rates of -0.7% in the downturn and 1.3% in the upswing, which differ to a much lesser extent than those observed for aggregate consumption. Developments in non-essential, non-durable consumer goods were more volatile, declining by 3.3% during the crisis and posting growth in the subsequent recovery of 2.9%, which was somewhat more robust than that for total consumption. Finally, as was to be expected, non-adjustable non-durables trended more stably over the course of the period considered, averaging growth of 1.5% during the recessionary phase (3.7 pp more than total real household spending), followed by a rate of 0.8% in annual average terms during the recovery (1.9 pp below the rate of increase for consumption as a whole).

Accordingly, a substantial proportion of Spanish households' adjustment to their spending fell on durable goods and, to a lesser extent, on non-essential non-durable consumer goods and services. In the first instance, this is so because households do not derive their utility directly from spending made in the current period, but from the consumer services resulting from the products

acquired in the past. As a result, households may lessen these purchases when their incomes are low (or when uncertainty over such incomes is high) with a relatively small reduction in their utility, postponing them for periods when their incomes have recovered. In the second case, what are involved are goods and services the demand for which is subject to a comparatively higher income elasticity, meaning that households make a more-than-proportionate adjustment to the consumption of this type of product when faced with fluctuations in their income.

In the case of durable goods, and in order to quantify approximately the volume of latent or "pent-up" demand, an empirical model has been estimated in which the stock of durable goods is explained on the basis of their fundamentals (which include most notably income and financial conditions). According to this model, the desired level of durable goods matches that explained by their determinants, meaning that the difference between this level and the observed value can be interpreted as the degree of "pent-up demand".

Chart 2 presents the results of this estimation. In the recessionary phase of the latest crisis, the observed level of the stock of consumer durables stood below the desired level, thereby reflecting postponed spending decisions. In the current recovery phase, the pick-up in the traditional determinants of consumption, along with the need to reduce the significant volume of latent demand, has translated into a strong growth rate of spending on durable goods. According to the model estimated, this rise would have led, by end-2016, to the demand pent up during the crisis being covered, meaning that this factor would not be expected to continue acting as a driver of household aggregate consumption in the short and medium term.

Along these same lines, the latest conjunctural information shows the strong growth of durables consumption to be tailing off, as revealed by the course of retail sales of household equipment (see Chart 3). Likewise, now consumers have regained a higher level of spending on non-essential, non-durable goods and services, a significant slowdown is taking place in the attendant growth rates (as illustrated, for example, by the pattern of residents' overnight hotel stays in Chart 4). Consequently, the stabilisation of the growth rates of spending on specific types of goods and services might augur some slowdown in consumption in the short and medium term.

³ For a detailed analysis of household consumption developments in recent years, see M. Martínez Matute and A. Urtasun (2017), "The recovery of private consumption in Spain by product type and household", *Economic Bulletin* 2/2017, Analytical Articles, 20 June.

The latest figures released on the general government sector in National Accounts terms show that the general government (excluding local government) deficit in the first three quarters of 2017 stood at around 2% of GDP, 1.3 pp less than in the same period of 2016 (see Chart 1). By component, consolidated general government (excluding local government) revenue¹ rose by 5.2% year-on-year in the first three quarters of the year, compared with a decline of 1.1% in the same period of 2016, due to the dynamism of tax revenue and social contributions. However, it should be noted that part of this strong behaviour of direct tax revenue is due to the base effect associated with the change in regulations on minimum corporate income tax prepayments, effective from October 2016.² Indeed, the latest information on revenue from shared State, regional and local taxes shows a certain slowdown in revenue at the beginning of Q4.

Consolidated general government (excluding local government) expenditure declined by 0.1% year-on-year to September, compared with the growth of 0.4% recorded in the same period of the previous year. The moderation was common to all the main items, some of which even showed significant year-on-year decreases in nominal terms in the reference period, particularly investment and unemployment expenditure and public debt interest payments. However, the most recent indicators of the behaviour of general government employment show that it picked up significantly in Q3, according to the Labour Force Survey, and in the October-November period, according to Social Security registration data. According to the latest Banco de España

projections,³ which take into account the most recent budget outturn information and the official budgetary plans, the 2017 general government deficit may stand at around 3.2% of GDP. The 2017 fiscal policy stance implicit in these projections becomes approximately neutral, following the expansionary stance pursued in 2015 and 2016.

Regarding 2018, at the cut-off date of this report the draft State and Social Security budget for next year had not yet been released. If this situation persists at 31 December, the 2017 budget will be extended automatically. In any event, on 16 October the Government, in compliance with the European Semester calendar, sent the European Commission the “2018 Budgetary Plan” which includes the outline of the regional and local government budgets and which, as far as the rest of the general government sector is concerned, is formulated under a “no-policy-change” scenario, i.e. it includes no new economic policy measures. This Budgetary Plan envisages an overall general government deficit for 2018 of 2.3% of GDP, slightly above the target of 2.2% set for 2018 by the EU Council.

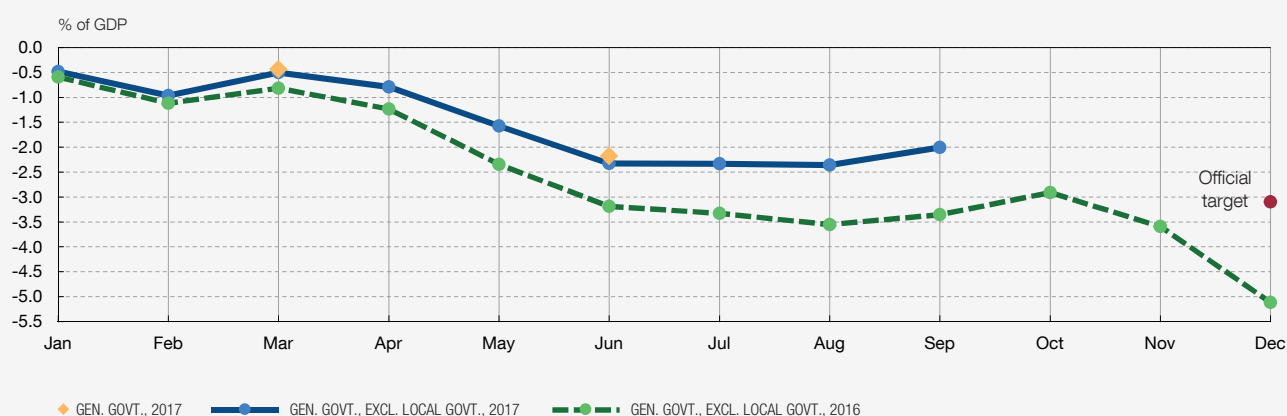
In its assessment of the Budgetary Plan released on 21 November, the European Commission acknowledges that the Spanish government deficit will very likely be below 3% of GDP in 2018. However, it also notes that, under the “no-policy-change” assumption used to formulate the Plan, the European Commission and the Plan itself consider that the deficit will be above the target set by the EU Council (2.2% of GDP). Similarly, the latest Banco de España projections are for a government deficit of 2.6% of GDP in 2018. The European Commission invited the Spanish government to submit an updated Budgetary Plan as soon as it had a draft

1 Net of transfers to/from other general government sub-sectors.

2 Royal Decree-Law 2/2016 of 30 September 2016. This legislation affected payments for the year as a whole, which were thus concentrated in the fourth quarter of the year. Hence the positive impact on tax revenue in January-September due to this measure will be neutralised in 2017 Q4, when the year-on-year comparison will again become homogeneous.

3 See report entitled “Macroeconomic projections for the Spanish economy (2017-2020): the Banco de España’s contribution to the Eurosystem’s December 2017 joint forecasting exercise”.

Chart 1
GENERAL GOVERNMENT BUDGET BALANCE IN THE NATIONAL ACCOUNTS.
Cumulative figures from January



SOURCES: IGAE (Spanish National Audit Office), Council of the European Union.

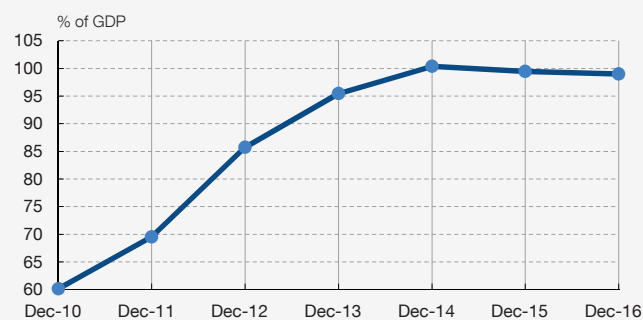
State and Social Security budget for next year, so the Commission could adequately assess Spain's compliance with its fiscal obligations in the European framework.⁴

4 See point 11 of the European Commission opinion (21 November, <https://ec.europa.eu/info/sites/info/files/economy-finance/c-2017-8015-en.pdf>)

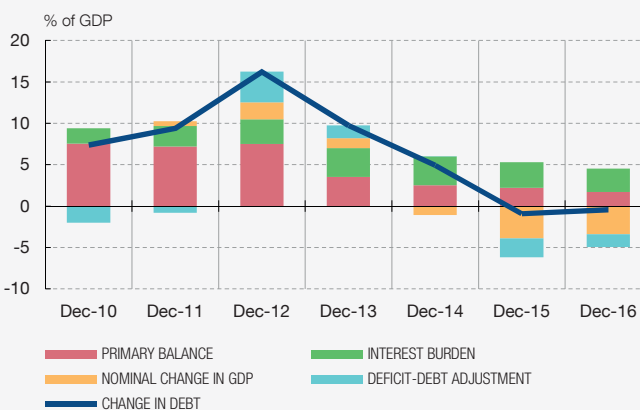
The general government debt, after reaching a record high of 100.4% of GDP in 2014, has edged downward slightly (see Chart 2, left-hand panel) to stand at 98.7% in 2017 Q3. The main reason for the recent fall in government debt seems to have been the growth of nominal GDP (Chart 2, right-hand panel), which more than offsets the impact of the budget deficit.

Chart 2
GENERAL GOVERNMENT DEBT

1 GOVERNMENT DEBT (EDP)



2 DETERMINANTS OF CHANGES IN DEBT



SOURCES: Banco de España and IGAE.

On 29 November 2017 the ECB published the results of the 17th round of the Survey on the Access to Finance of Enterprises (SAFE), covering the period from April to September 2017. The survey asks respondent firms, essentially small and medium-sized enterprises, about the developments in this period in their economic and financial situation, their external financing needs and the conditions under which they have obtained or not such financing.

In the case of Spanish SMEs, the data for this latest round of the survey show, overall, a continuation of the improving trend in their economic situation. Hence, the number of firms that reported an increase in sales once again exceeded those indicating the contrary, as has indeed been the case uninterruptedly since 2014, the relative difference between both groups (net percentage) being in this case 26%, slightly up on the figure in the previous round (22%; see Chart 1) and similar to that observed in the euro area (27%). In terms of profits, developments were somewhat less favourable owing to the increase in both labour and other costs, a circumstance reported by a high net proportion of SMEs of the sample (42% and 47%, respectively, compared with 49% and 48% in the euro area). The percentage of companies that reported an increase in earnings was thus 7 pp greater than those that stated the opposite, 4 pp more than in the previous round. In the euro area this difference was 5 pp, with this figure holding at a positive value for the first time since the survey started (2009).

As regards the most important concern, the lack of customers was that indicated by the highest percentage of SMEs, both in Spain and in the euro area as a whole (29% and 24%, respectively; see Chart 2), although in the case of the euro area, the lack of skilled labour was a factor that concerned a growing number of SMEs (23%). Set against this, access to financing was, among all these factors included in this question, once again that cited by the lowest proportion of companies, 7% of those in Spain and 8% in the euro area, these percentages being somewhat lower than those in the previous round, and the lowest figures recorded in both areas since the onset of the survey.

Against this background, the proportion of Spanish SMEs that applied for bank loans declined by around 9 pp to 29% (see Chart 3), a figure almost identical to that recorded in the euro area. The availability of bank loans continued to improve (see Chart 4). Thus, in net terms, 23% of Spanish SMEs reported an improvement in this aspect, a proportion 5 pp down on the previous survey and 11 pp up on the percentage recorded for their euro area counterparts. Moreover, the firms surveyed perceived that most of the factors affecting credit supply exerted a positive impact on the availability

of financing.¹ Specifically, in net terms, 33% perceived a greater willingness of banks to grant loans (2 pp up on the previous round of the survey), 30% reported a positive influence of the improvement in their specific situation on this propensity (2 pp less than six months earlier), and 24% indicated a positive influence associated with the brighter macroeconomic outlook (4 pp below the figure for the previous period).

Further, the percentage of Spanish SMEs whose bank loan applications were rejected declined by 2 pp to stand at 4%, a similar figure to that recorded in the euro area as a whole. A broader indicator of the difficulties in obtaining bank loans² likewise shows a fresh improvement. Hence, the difficulties affected 9% of these companies, a figure very similar to that for the euro area, and a few tenths of a percentage point down on that recorded in the previous round of the survey, evidencing a continuation of the declining trend apparent in recent years, from the high levels reached in 2014 (see Chart 5).

The net percentage of firms reporting a decline in interest rates was 6%, down on the previous round (11%; see Chart 6). Moreover, the net proportion of companies that indicated an increase in loan amounts and an extension of their maturities remained positive (16% and 3%, respectively). By contrast, 6% of Spanish SMEs, in net terms, perceived tightening in collateral required and 14% in other loan conditions, with these percentages in both cases proving higher than those recorded in the previous period.

In sum, the latest round of the SAFE shows that, from April to September 2017, the access of Spanish SMEs to external financing continued to improve. Against the backdrop of the progressive strengthening of their economic and financial situation, these firms reported, overall, that they detected during this period an increase in the availability of bank loans, assisted by the greater willingness of banks to grant loans and more favourable financing conditions, and by the improvement in the firms' specific situation and in the general economic outlook. Finally, the survey also shows that Spanish SMEs anticipated favourable developments in respect of their access to bank financing in the period from October 2017 to March 2018.

1 The availability of bank loans is the perception that firms have of their access to financing, which is affected by supply-side (related to banks), demand-side (the firm's creditworthiness) and macroeconomic factors (general economic situation).

2 This indicator captures companies in the following situations: those whose applications for funds were rejected, those to which the funds were granted but only in part, companies to which loans were granted but at a cost deemed by the companies to be very high and those which did not apply for financing because they believed it would not be granted to them.

Chart 1
SALES AND PROFITS (a)

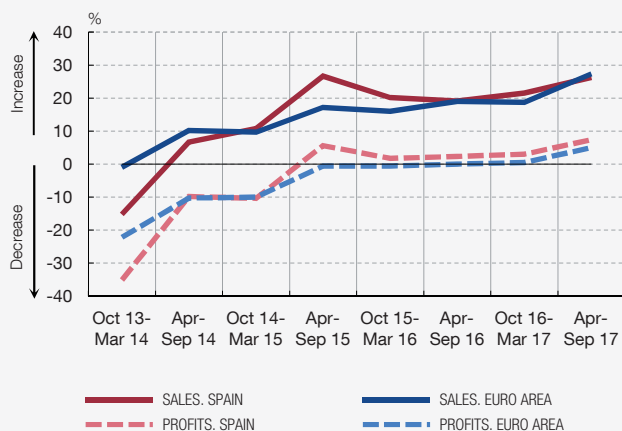


Chart 2
MAIN PROBLEMS AFFECTING ACTIVITY
APRIL-SEPTEMBER 2017

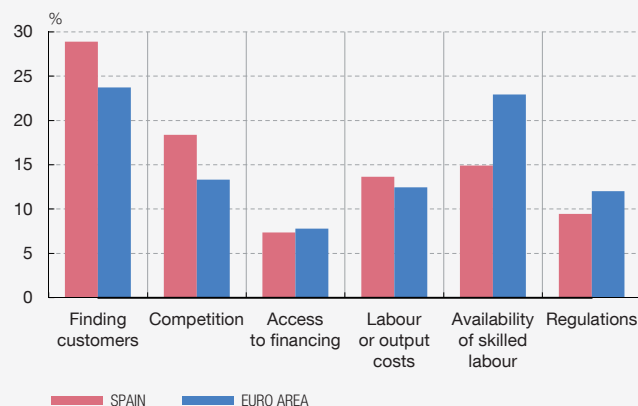


Chart 3
SMEs THAT HAVE APPLIED FOR BANK LOANS

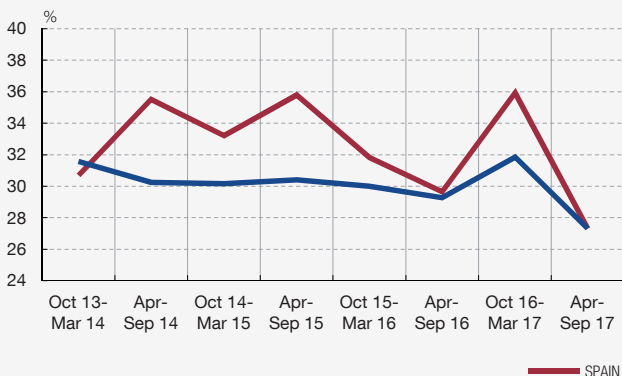


Chart 4
AVAILABILITY OF BANK LOANS (b)

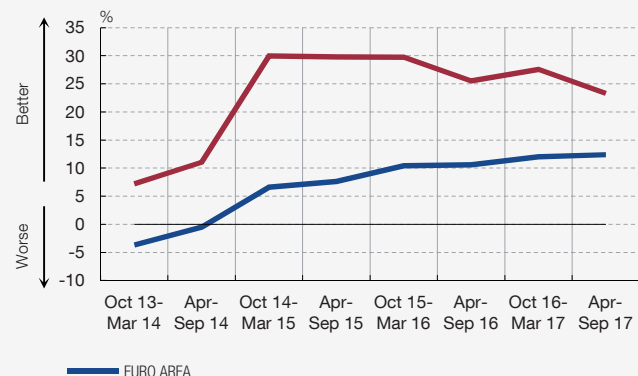


Chart 5
SMEs FACING DIFFICULTIES OBTAINING BANK LOANS (c)

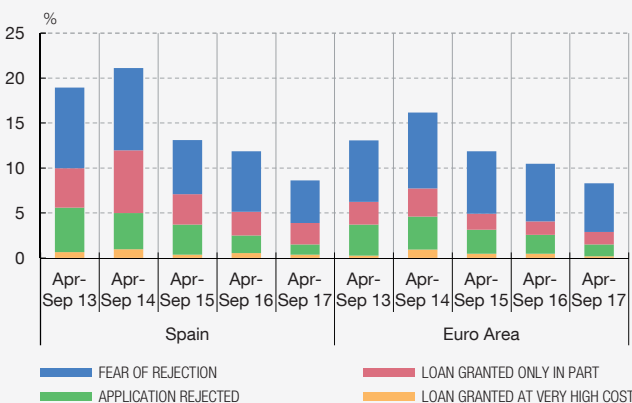
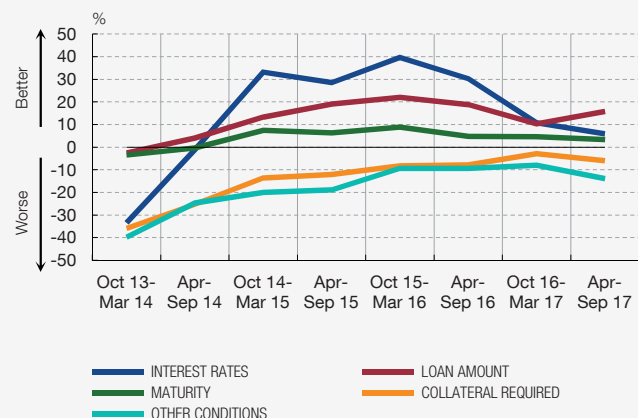


Chart 6
BANK LOAN CONDITIONS. SPAIN (d)



SOURCE: ECB.

- a Percentage of firms indicating an increase less the percentage of those indicating a decrease.
- b Percentage of firms indicating an improvement less the percentage of those indicating a deterioration.
- c This indicator captures the proportion of firms that are in one of the following situations: those whose loan applications were rejected, those whose loans were granted but only in part, those whose loans were granted but at a cost deemed by the firms to be very high and those who did not apply for financing because they thought it would not be granted to them (fear of rejection).
- d Percentage of firms indicating better conditions (lower interest rates, higher amounts, longer maturities, less demanding collateral and other required conditions) less percentage of firms indicating worse conditions.

During the first half of the year, the debit balance of the Spanish economy's net international investment position (IIP) increased by €44.7 billion with respect to end-2016. In terms of GDP, its weight also increased (by 2.3 pp, to 86.2%), despite the growth of output (see Chart 1). This increase was the result of the €47.7 billion increase linked to changes in the valuation of claims on and liabilities to non-residents arising from price and exchange rate movements, which more than offset the decrease associated with the slightly positive balance recorded by net financial transactions (€1.5 billion), in line with the nation's net lending, and other changes in volume¹ (€1.5 billion).

1 The other changes in volume are any change in the value of assets and liabilities that is not due to transactions or revaluations. These include

The breakdown of assets and liabilities shows that, excluding financial derivatives, between January and June 2017 residents once again acquired, in net terms, a high volume of foreign assets (€92.4 billion, €81.2 billion excluding the Banco de España), which, together with valuation changes and other negative, albeit small, changes in volume (–€24.7 billion), resulted in an increase in the asset balances vis-à-vis the rest of the world of 11.8% of GDP in 2017 H1 (see Chart 2). The net change in liabilities was also

variations arising from debt forgiveness and write-offs, economic appearances and disappearances of assets, reclassifications and those arising from agents' change of residence. In practice, this component may also include statistical discrepancies between the IIP and the Balance of Payments (BP) deriving from update timing differences.

Chart 1
COMPONENTS OF CHANGE IN THE NET IIP (a)

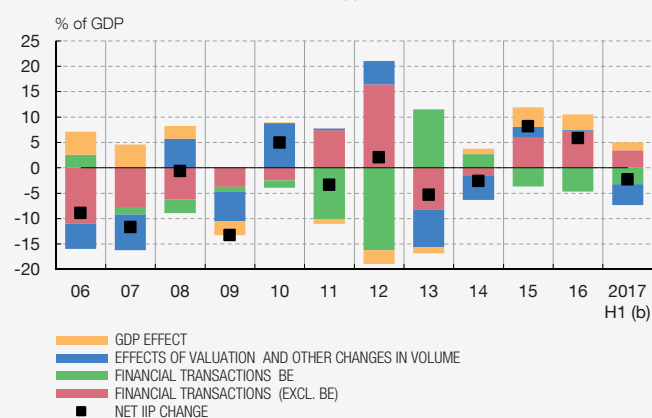


Chart 2
COMPONENTS OF CHANGE IN EXTERNAL ASSETS (c)

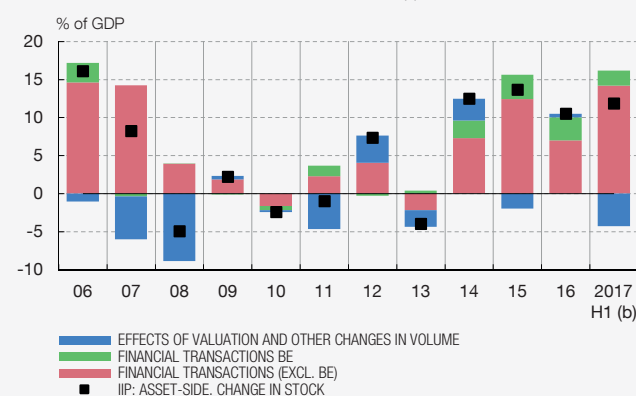


Chart 3
COMPONENTS OF CHANGE IN EXTERNAL LIABILITIES (c)

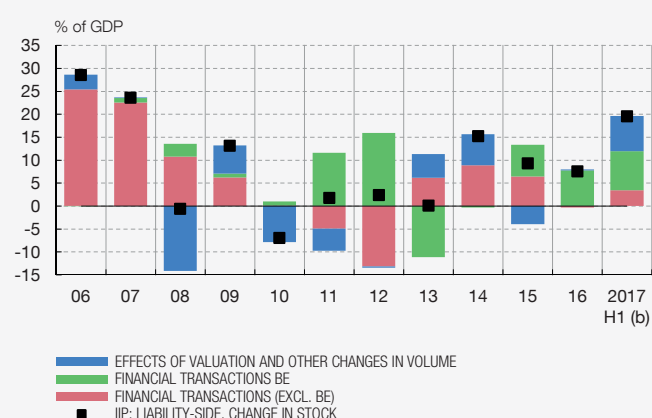
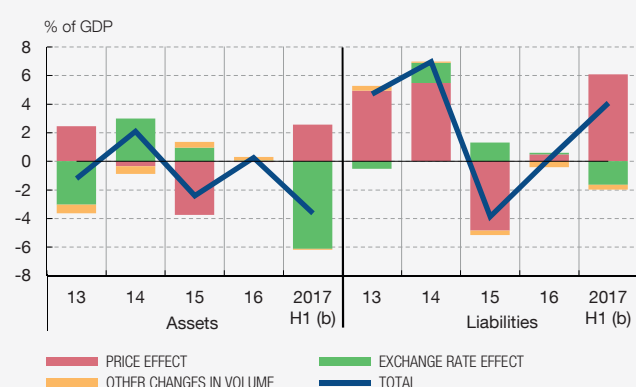


Chart 4
COMPONENTS OF CHANGES IN OTHER FLOWS



SOURCE: Banco de España.

- a The net IIP is the difference between the value of the external assets of the resident sectors and that of their liabilities to the rest of the world.
- b Cumulative change between January and June 2017. In Charts 2, 3 and 4, the GDP relates to H1.
- c Excluding financial derivatives.
- d Excluding the Banco de España and the net position in derivatives.
- e The external debt comprises the balance of all liabilities entailing future repayment of principal, payment of interest or both (i.e. all financial instruments, except own funds and financial derivatives).
- f Including only direct investment in the form of debt.
- g Excluding the Banco de España and direct investment in the form of debt.

positive during the period, reaching 19.6% of GDP in H1 (see Chart 3), both owing to the net positive investment by non-residents in the Spanish economy (€89 billion, €40.5 billion excluding the Banco de España) and to valuation effects and other changes in volume which had a positive impact overall (€23.3 billion).²

The positive balance of net financial transactions (€38.9 billion), excluding the Banco de España, amply exceeded the surplus on the current and capital accounts recorded between January and June (€5.6 billion). This resulted in a very negative net balance of the Banco de España's financial transactions with the rest of the world, standing at 6.5% of GDP in H1 (see Charts 2 and 3), mainly owing to the increase in net liabilities vis-à-vis the Eurosystem. This development continued to be largely influenced by the ECB's quantitative easing policy, which has generated excess liquidity within the euro area, prompting financial flows between euro area countries. In particular, the liquidity generated in Spain from the ECB's quantitative easing measures was largely channelled towards the rest of the world. Thus, since end-2014 the net acquisition of foreign assets by resident agents has increased, while net liability flows vis-à-vis the rest of the world, excluding the Banco de España, have declined, against a background of gradual private-sector deleveraging.³

As mentioned above, the valuation effects contributed to the decline in the Spanish economy's net IIP (increase in debit balance) in H1. This was the outcome of both the fall in the value of assets and the increase in that of liabilities (see Chart 4). The former led to an appreciation of the euro during Q2, which lowered the value of foreign currency-denominated instruments. This impact was only partially countered by the revaluation of assets and, specifically, of shares in equity and investment funds, which took place over the period (debt instruments, however, depreciated slightly), against a backdrop of increasing share prices. The value of liabilities was also affected by these factors, although in this case the positive impact associated with the revaluation of shares in capital and investment funds was higher, owing to the greater increase in the prices of liabilities as compared with those of assets of this kind, since the proportion of foreign currency-denominated liabilities is substantially lower than that of assets.

The breakdown by institutional sector shows that the increase in the debit balance of the net IIP as a percentage of GDP was the result of the increase in the debtor position of the Banco de España, the non-financial private sector and, to a lesser extent,

general government; overall, this more than offset the increase in the credit balance recorded by all other financial institutions (monetary financial institutions other than the central bank and the financial sector of the other resident sectors) (see Chart 5). Excluding the Banco de España, the debit balance of the net IIP relative to GDP had decreased by 1 pp, to 68.2%, although in absolute terms it had also increased (by €3.7 billion, to €777.5 billion).

The breakdown by functional category reveals that, excluding the Banco de España, the Spanish economy's net debtor position, in the form of direct and portfolio investment, increased (by €13.1 billion and €0.4 billion, respectively), while that in other investment decreased (by €10 billion). The decline in direct investment in net terms arose from an increase in external assets lower than the increase in liabilities to the rest of the world. As regards portfolio investment, the increase in the external assets of resident agents was also amply offset by the increase in their liabilities to the rest of the world. These increases (in both assets and liabilities) were posted practically across all sectors and all instruments (except for the balance of debt securities issued by other resident sectors held by foreign agents, which decreased). Lastly, the decline in the net debtor position in other investment arose from both the increase in the assets abroad of residents and the decrease in domestic liabilities held by the rest of the world. In terms of GDP, only direct investment increased its debit balance, which rose by 1.1 pp, to 3.6% (see Chart 6),⁴ while the debit balances associated with other investment and portfolio investment decreased (by 1.2 pp to 13.8% and by 0.9 pp to 50.2%, respectively).

To better assess the degree of vulnerability associated with the Spanish economy's international position, it is useful to supplement the IIP information with other indicators, such as the volume of gross external debt (which includes solely the liabilities entailing payment obligations, which in Spain account for around 75% of the total).⁵ The gross external debt relative to GDP increased by 1.9 pp, to 168.8%, between December 2016 and June 2017, since the increase in the weight of the Banco de España's external debt (by 3.6 pp, to 38.2% of GDP) was higher than the fall relating to other sectors (see Chart 7). The weight of financial institutions other than the Banco de España and of other resident sectors declined, during the same period, by 1.3 pp and 0.7 pp, to 35.1% and 25.7%, respectively,⁶ in line with the deleveraging process these sectors are undergoing. Conversely, the weight of general government increased in absolute terms, although slightly less than the growth of output and, accordingly, there was hardly any

2 In net terms, financial derivatives had a highly marginal negative effect on the IIP, owing to the negative balance posted by net financial transactions, which was not fully offset by the positive impact of the valuation effects and the other changes in volume.

3 For further details, see the article "The Eurosystem quantitative easing measures and the financial account", *Economic Bulletin*, April 2016, Banco de España.

4 The net debit balance of positions in financial derivatives remained unchanged during this period, at 0.5% of GDP.

5 The external debt of a country comprises the balances of all liabilities to non-residents entailing future repayment of principal, payment of interest or both (all financial instruments, except equity and financial derivatives).

6 Excluding direct investment in the form of debt instruments.

change relative to GDP, with the figure remaining close to 49%. Also, the breakdown by maturity continues to evidence a high weight of long-term liabilities – almost 74% of the total, excluding those of Banco de España and direct investment – (see Chart 8), which usually entail lower refinancing risks.

In conclusion, despite the current and capital account surpluses and the growth of output, the Spanish economy's net debtor position in H1 increased in both absolute and GDP terms owing to

changes to the valuation of instruments. Therefore, this indicator remains at high levels, which means that there is an element of vulnerability insofar as the substantial refinancing needs which this position generates expose the Spanish economy as a whole to potential adverse changes in international market financing conditions in the future. A reduction of the international debtor position to more comfortable levels requires maintaining recurring external surpluses, for which purpose it is necessary to persevere in accumulating the competitive gains which make them possible.

Chart 5
NET IIP (a). BREAKDOWN BY INSTITUTIONAL CATEGORY

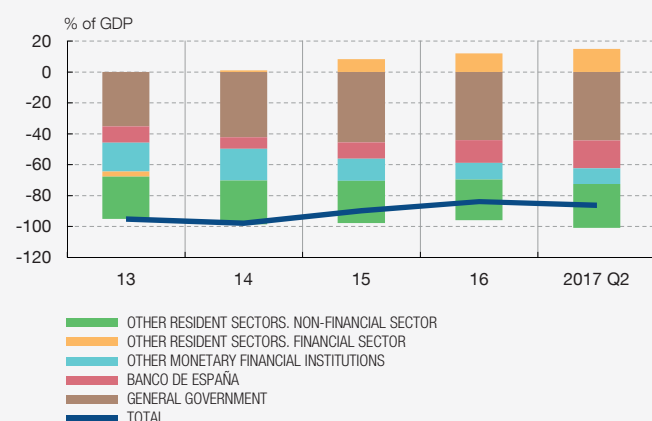


Chart 6
NET IIP (a) (d). BREAKDOWN BY FUNCTIONAL CATEGORY

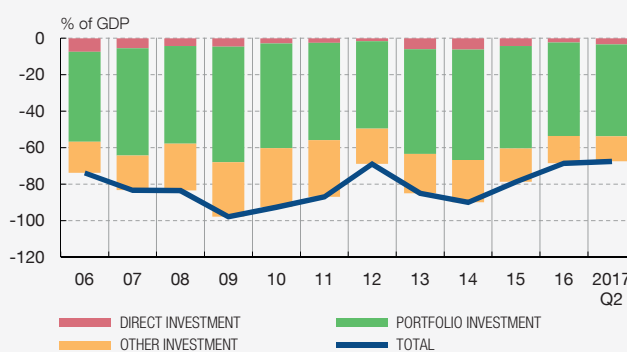


Chart 7
GROSS EXTERNAL DEBT (e). BREAKDOWN BY SECTOR

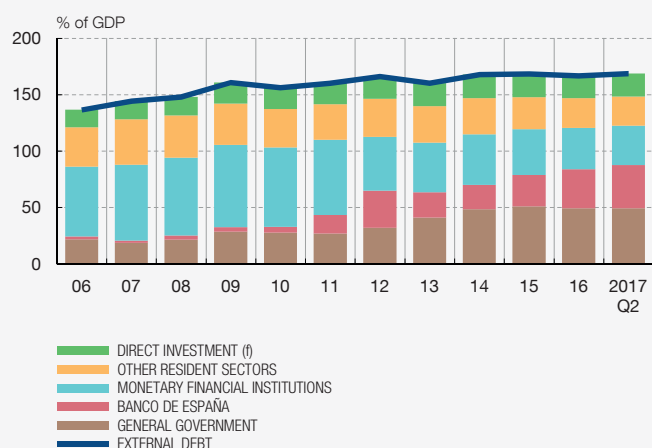
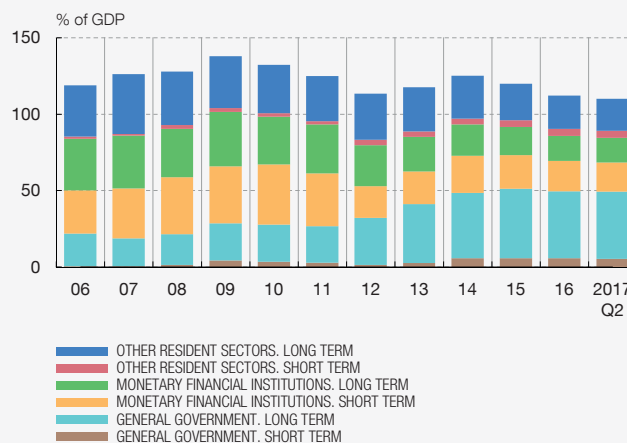


Chart 8
GROSS EXTERNAL DEBT STRUCTURE BY INSTITUTIONAL SECTOR AND MATURITY (e) (g)



SOURCE: Banco de España.

- a The net IIP is the difference between the value of the external assets of the resident sectors and that of their liabilities to the rest of the world.
- b Cumulative change between January and June 2017. In Charts 2, 3 and 4, the GDP relates to H1.
- c Excluding financial derivatives.
- d Excluding the Banco de España and the net position in derivatives.
- e The external debt comprises the balance of all liabilities entailing future repayment of principal, payment of interest or both (i.e. all financial instruments, except own funds and financial derivatives).
- f Including only direct investment in the form of debt.
- g Excluding the Banco de España and direct investment in the form of debt.

2 EXTERNAL ENVIRONMENT OF THE SPANISH ECONOMY

2.1 External environment of the euro area

In 2017 Q4, the recovery in global activity has not only continued to spread but has also intensified, with most economies recording higher growth rates. This has led to upward revisions in the forecasts for the current year and 2018. The improvement in activity contrasts with the performance of inflation in the advanced economies, since its core component remains in most cases below the central bank target rates. In the advanced economies financial markets have tended to perform favourably, with gains and low volatility. In emerging markets, however, there has been greater volatility, with some stock market falls, increases in sovereign spreads and exchange rate depreciation, although these have not been sufficient to cancel out the favourable performance for the year as a whole.

In fact, financial markets in the advanced economies have been characterised in Q4 by a broad-based optimism, against a background of low volatilities, stable long-term interest rates and stock market gains. The dollar has tended to rise, mainly against the yen. All this is in line with strong corporate earnings and the release of positive economic data. The possibility of approval of the tax reform in the United States has provided additional underpinning for valuations in the technology sector. Monetary policy decisions have been taken without producing any significant surprises on the financial markets.

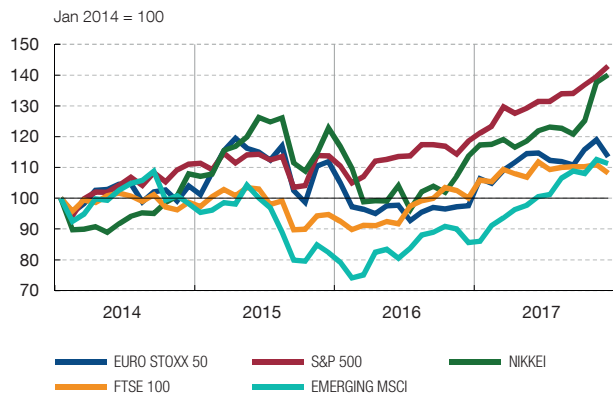
In emerging markets, some currencies have depreciated sharply against the dollar, and sovereign spreads have increased. The stock markets of these economies have been highly volatile, and sharp falls were recorded between the third week of November and the beginning of December, although they have been partially reversed since. In Latin America the decline began a little earlier, in October, as a consequence of specific factors, particularly in Brazil (problems with approval of promised reforms) and Mexico (renegotiation of NAFTA). Of less significance was the fall in Chinese stock markets caused by the uncertainty over future regulations to control indebtedness, together with a possible profit-taking effect. Net capital inflows into debt and equities have slowed, with marginal outflows in the latter case. Even so, the inflows in Q4 have been higher than in the same period a year earlier.

The commodity price index has risen by 0.8% in Q4, owing to the growth of industrial metals prices (0.2%) and especially food prices (2.2%). The price of Brent crude has reached \$64 per barrel, an increase of 12.3%. More buoyant demand (due to the improvement of the world economy), along with the high degree of compliance with the OPEC agreement (which was extended to 2018 as a whole) and certain political tensions (in Saudi Arabia and Iraqi Kurdistan), have contributed to this increase.

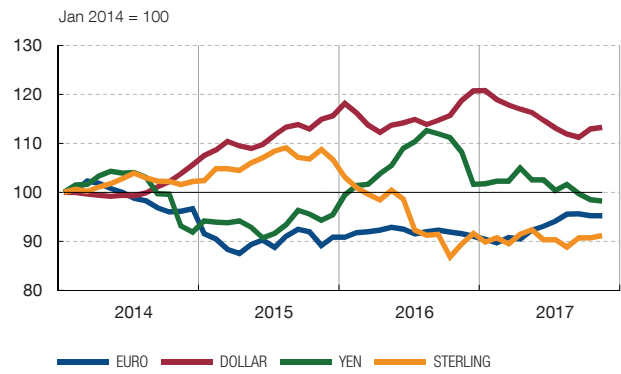
In the advanced economies the Q3 growth data were robust in all cases, especially in the United States (with an annualised quarter-on-quarter rate of 3.2%, up 0.2 pp from the previous quarter, largely as a result of the pick-up in investment) and in Japan (2.5% annualised quarter-on-quarter growth), where growth was above the long-term potential rate. In the United Kingdom the economy picked up slightly from the previous quarter (by 0.1 pp, to 0.4% quarter-on-quarter). Leading indicators for the fourth quarter generally suggest that the rates of growth in these economies have been sustained.

Inflation in the advanced economies has been strongly influenced by food and energy prices. In the United States, CPI inflation stood at 2.2% year-on-year in November (the

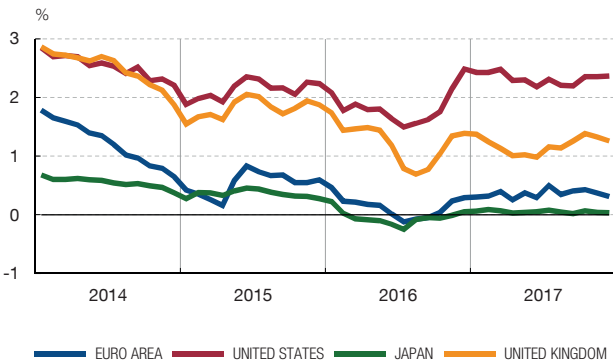
1 STOCK EXCHANGE INDICES



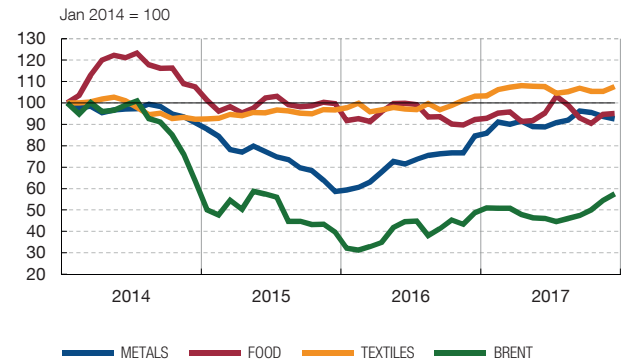
2 CPI-BASED REAL EFFECTIVE EXCHANGE RATES VIS-À-VIS DEVELOPED COUNTRIES (a)



3 LONG-TERM INTEREST RATES (b)



4 COMMODITIES



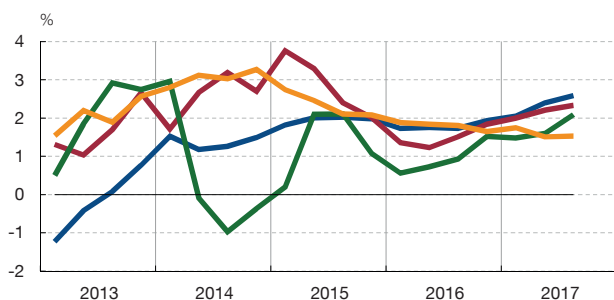
SOURCES: Datastream and Banco de España.

- a An increase in the index represents an appreciation of the currency.
- b Ten-year government bond yields.

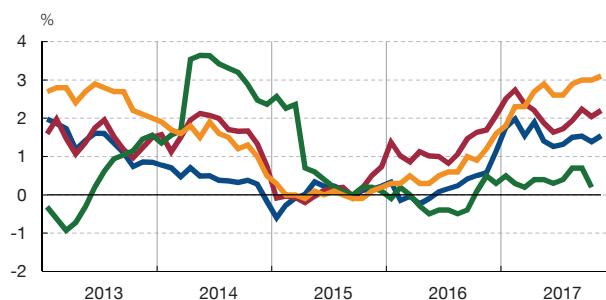
private consumption deflator, which the Federal Reserve System targets, stood at 1.4%), and in Japan it rose by 0.1 pp, to 0.8%, in October. In the United Kingdom, the inflation rate remains above target, and reached 3.1% in November. However, core inflation rates remain distant from central bank targets, except in the United Kingdom. As regards monetary policy decisions, both the Federal Reserve System and the Bank of England have raised official interest rates during the quarter. In the case of the Federal Reserve, the increase was 25 basis points (bp), to a range of 1.25% to 1.5%, in December, reflecting the ongoing decline in economic slack, despite the doubts regarding the persistence of low inflation. The Bank of England raised its official rate by 25 bp (to 0.5%) in November. In the area of fiscal policy, the agreement in both chambers of the US Congress to press ahead with tax reform, which could involve a fiscal stimulus of around 1 pp of GDP, is notable. However, as the reform is focused on the revenue side, with the largest effects on the highest incomes (which have a lower propensity to spend), and is being introduced at a time when the output gap is closed, it is estimated that the fiscal multiplier will be relatively modest. In Japan, a programme of tax incentives for investment in innovation and wage rises have been announced.

In the emerging economies, activity data have been generally positive. The Chinese economy grew in Q3 by 6.8% year-on-year, a slightly lower rate than in the previous

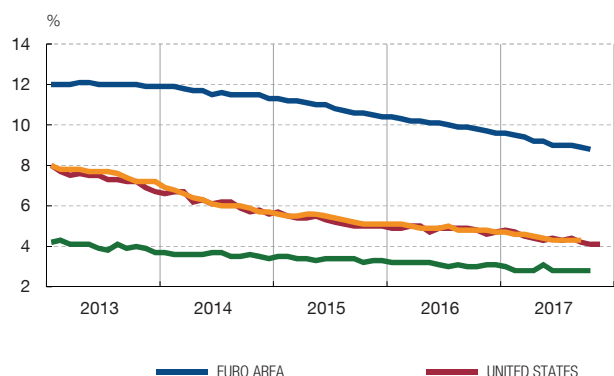
1 GROSS DOMESTIC PRODUCT
Year-on-year rate



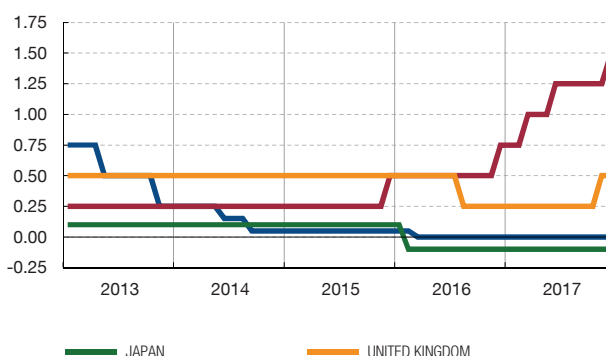
2 INFLATION
Year-on-year rate



3 UNEMPLOYMENT RATE (a)



4 POLICY INTEREST RATES



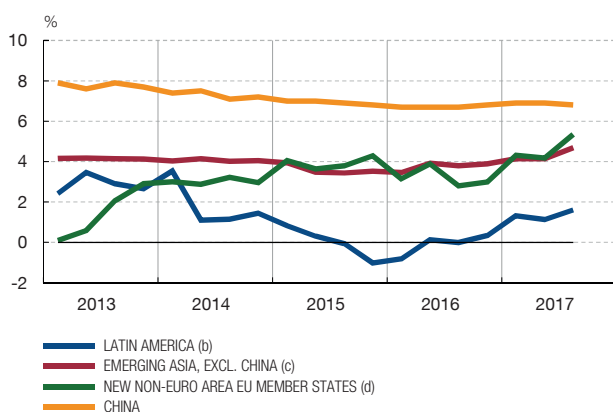
— EURO AREA — UNITED STATES — JAPAN — UNITED KINGDOM

SOURCES: Datastream and Banco de España.

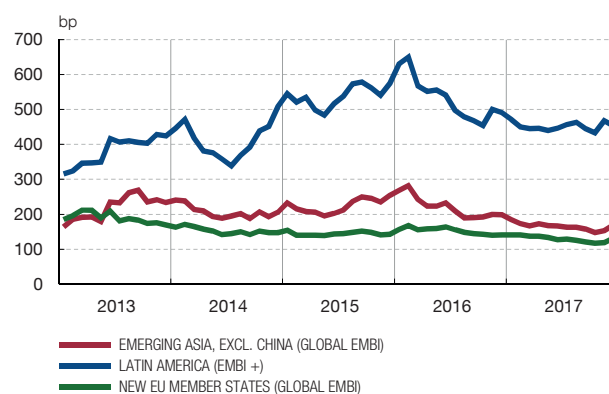
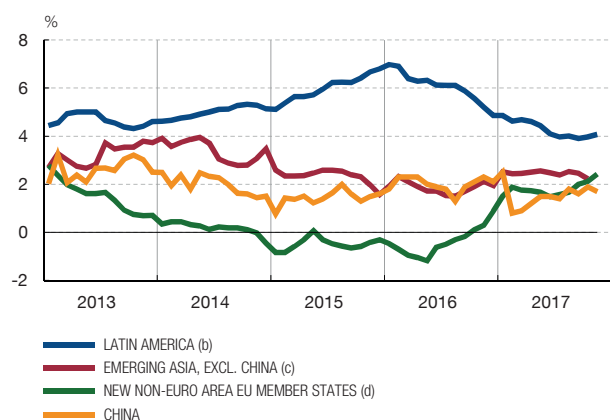
a Percentage of labour force.

quarter, partly due to the smaller contribution of gross capital formation. The 19th Communist Party congress set the target of shifting the focus from the growth rate to the composition of growth. In India, GDP showed signs of recovery and, in the rest of Asia, the trend was also generally positive. In Latin America, the Q3 data were positive, except in Mexico, which suffered the impact of two earthquakes in September. Chile and Colombia recorded higher growth rates (1.5% and 0.8% year-on-year, respectively), while Brazil and Peru were the most sluggish economies. Inflation remained contained in the region, except in Mexico and Colombia. As regards monetary policy, the rate increases in Mexico (of 25 bp, to 7.25%) and Argentina were notable, while in Brazil, the official rate was reduced to 7%, and the rate of reductions was decreased; in Colombia and Peru rate cuts were made unexpectedly.

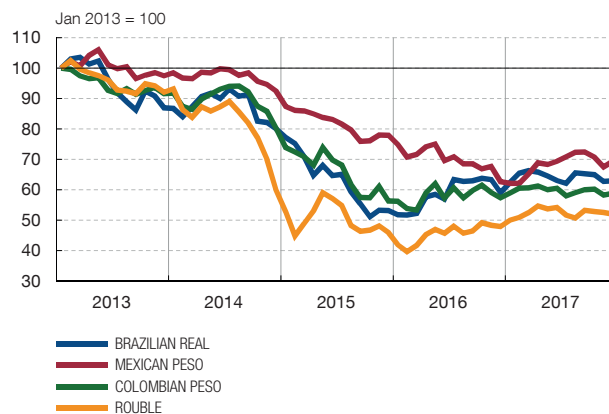
Lastly, economic growth in Eastern Europe has remained solid, especially in Poland and, above all, in Romania (4.9% and 8.8% year-on-year, respectively). Inflation continued to rise, against a background of sharp wage increases. The Czech Republic is the first country in the region to have raised rates. Turkey, meanwhile, recorded growth well above expectations in Q3 (11.1% year-on-year), underpinned by Government-approved stimulus measures and the recovery in tourism. Inflation has also risen to high levels (13% in November) and other imbalances have widened, leading the central bank to raise its late liquidity window rate by 50 bp in December (to 12.75%). In Russia, growth has been disappointing (1.8% year-on-year), down 0.7 pp from the previous quarter, although the central bank continued with its rate reductions, against a background of falling inflation.

1 GROSS DOMESTIC PRODUCT
Year-on-year rate

2 INTEREST RATE SPREADS OVER THE DOLLAR (e)

3 CONSUMER PRICES
Year-on-year rate

4 EXCHANGE RATES AGAINST THE DOLLAR (f)



SOURCES: Datastream, Banco de España, IMF and JP Morgan.

- a The aggregate of the different areas has been calculated using the weight of the countries that make up these areas in the world economy, drawing on IMF information.
- b Brazil, Chile, Colombia, Mexico and Peru.
- c Malaysia, Korea, Indonesia, Thailand, Hong Kong, Singapore, Philippines and Taiwan.
- d Poland, Hungary, Czech Republic, Bulgaria, Romania and, from July 2013, Croatia.
- e JP Morgan EMBI spreads. Latin America includes Argentina, Brazil, Colombia, Ecuador, Mexico, Panama, Peru and Venezuela. Asia includes China, Indonesia, Iraq, Kazakhstan, Malaysia, Pakistan, Philippines, Sri Lanka and Vietnam. The data on the new EU Member States relate to Hungary, Poland, Romania and, since July 2013, Croatia.
- f A decrease in the index represents a depreciation of the currency against the dollar.

2.2 The euro area and the monetary policy of the European Central Bank

The latest National Accounts information and the indicators referring to Q4 confirm that the economic expansion in the euro area is proving to be stronger than expected a few months ago, buoyed by the maintenance of a highly accommodative monetary policy and a favourable global environment. The macroeconomic forecasts of the Eurosystem published in mid-December involve a significant upward revision to the growth expected for the period 2017-2019, to 2.4 %, 2.3% and 1.9%, respectively, with growth of 1.7% projected for 2020 (see Table 3).

The strength of economic activity is still not reflected in inflation developments and wage growth. Core inflation, which excludes the more volatile price components, has edged down, while wage settlements remain anchored at rates of around 1.4% in the euro area as a whole. Indeed, the latest Eurosystem projections revise the path of inflation excluding energy and food downwards, so that it remains at very modest levels, close to 1%, this

	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
National Accounts (quarter-on-quarter rate)								
Gross domestic product	0.5	0.3	0.4	0.6	0.6	0.7	0.6	
Contributions to quarter-on-quarter change in GDP (pp)								
Domestic demand, excluding inventories	0.6	0.8	0.3	0.6	0.3	0.8	0.4	
Change in inventories	-0.1	-0.2	0.1	0.1	-0.1	0.1	0.1	
Net external demand	0.0	-0.3	0.0	0.0	0.5	-0.2	0.1	
Other indicators								
Unemployment rate (b)	10.3	10.2	9.9	9.7	9.5	9.1	9.0	8.8
HICP (year-on-year rate) (c)	0.0	0.1	0.4	1.1	1.5	1.3	1.5	1.5
CPI excl. Unprocessed food and energy (year-on-year rate) (c)	1.0	0.8	0.8	0.9	0.8	1.2	1.3	1.1

SOURCES: Eurostat, ECB and Banco de España.

- a Information available up to 21 December 2017.
b Average for the quarter. Latest figure available, October 2017.
c End of the period. Latest figure available, November 2017.

year and next year, and rises to 1.8% in 2020. However, the expected trajectory of oil prices has prompted an upward revision to the projections for the overall inflation index, relative to the September exercise; it is now projected to remain at around 1.5% over the three-year period 2017-2019 and to rise to 1.7% in 2020.

Against this background of strengthening recovery and a moderate inflation outlook, the Governing Council of the ECB decided to extend the asset purchase programme beyond December 2017, at a rate of €30 billion per month. Specifically, at its October meeting, the Governing Council announced that the purchase programme would be extended to at least September 2018 and, in any event, until inflation resumes a path of sustained convergence towards the medium-term price stability target. It also reiterated its readiness to increase the size and/or the duration of the programme in the event of a deterioration in the economic outlook or a worsening of financial conditions such that they become incompatible with a sustained adjustment of inflation towards levels consistent with its target. In addition, the Governing Council expressed its intention to continue reinvesting the maturities arising in its portfolio relating to the asset acquisition programme for a prolonged period after the end of net purchases and, in any event, for as long as necessary. It also decided to keep interest rates unchanged, confirming its expectation that they will remain at current levels for a prolonged period, beyond the horizon of the asset purchase programme (see Box 2 for a more detailed analysis of the measures taken by the ECB).

ECONOMIC DEVELOPMENTS

In 2017 Q3, euro area GDP grew at a quarter-on-quarter rate of 0.6%, which was somewhat higher than projected but similar to the rate recorded in previous quarters (see Table 2). Growth was once again underpinned by domestic demand and, in particular, private consumption (which, nonetheless, slowed somewhat), supported by the improvement in employment and household confidence, and by the favourable financial conditions. Investment has been growing at higher rates than last year, against a background of high capacity utilisation, a reduction in corporate debt and improved profit expectations. Net external demand, for its part, made a moderate positive contribution to GDP growth, as compared with its negative impact in the previous quarter, as a result of an increase in

	2017		2018		2019	
	GDP	HICP	GDP	HICP	GDP	HICP
European Central Bank (December 2017)	2.4	1.5	2.3	1.4	1.9	1.5
European Commission (November 2017)	2.2	1.5	2.1	1.4	1.9	1.6
OECD (November 2017)	2.4	1.5	2.1	1.5	1.9	1.7
International Monetary Fund (October 2017)	2.1	1.5	1.9	1.4	1.7	1.7
Consensus Forecast (December 2017)	2.3	1.5	2.1	1.4	—	—
Eurobarometer (December 2017)	2.3	1.5	2.1	1.4	—	—

SOURCES: ECB, European Commission, Consensus Forecast, IMF, MJ Economics and OECD.

exports reflecting the increase in world trade during the year, which offset the adverse effects associated with the appreciation of the euro. Solid GDP growth was recorded by all the main euro area countries, with the largest increases seen in Germany and Spain (0.8% in both cases), and more moderate increases in Italy and the Netherlands (of around 0.4%).

The latest data, albeit incomplete, suggest that growth rates have remained high in Q4. The qualitative indicators have recorded broad-based improvements over the quarter, and in many cases currently stand close to their all-time highs. These improvements have been seen in the European Commission's business confidence indicators and Purchasing Managers' Index (PMI) surveys, as well as consumer confidence and employment expectations according to European Commission surveys (Chart 5). As regards external demand, the assessment of foreign orders and export expectations anticipates favourable developments in the final quarter.

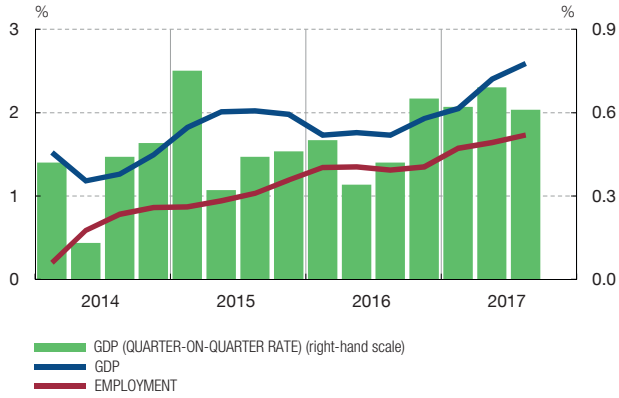
The behaviour of the available quantitative indicators, which collect information with a greater lag, has been more uneven. Retail sales fell in October, after increasing in the previous month, while vehicle registrations rose significantly in November, having declined in the previous month. On the supply side, industrial production increased by 0.2% in October, with respect to September. Finally, the rate of unemployment again fell slightly, to 8.8% in October, its lowest level since January 2009.

Inflation has remained at similar levels to recent months, standing at 1.5% in November. However, the rise in core inflation in Q3 (to 1.3%) came to a halt and it fell to 1.1% in October and November, when services prices were particularly subdued. The moderate growth in unit labour costs, when, despite notable job creation, there is still a large amount of slack in certain segments of the labour market, contributed to this price behaviour. Labour market reforms, low productivity growth and the existence of indexation mechanisms, whereby wage settlements are explicitly or implicitly based on past inflation, also contributed to the low wage growth.

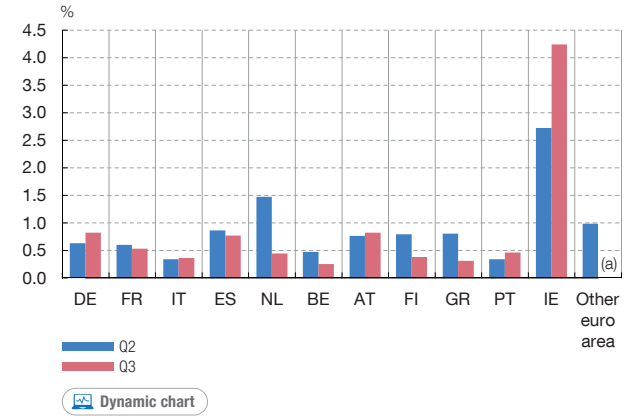
In November, the European Commission announced its economic policy priorities for 2018 within the framework of the European Semester and completed its assessment of the draft budgets prepared by the Member States for that year. Also, the annual edition of the *Alert Mechanism Report* of the Macroeconomic Imbalance Procedure was published.

In the fiscal sphere, the draft budgets for 2018 project a further reduction in the general government deficit for the euro area as a whole, to 0.9% of GDP, from its estimated level of 1.1% in 2017. Public debt is also projected to fall in 2018, to 86% of GDP, from 88% in

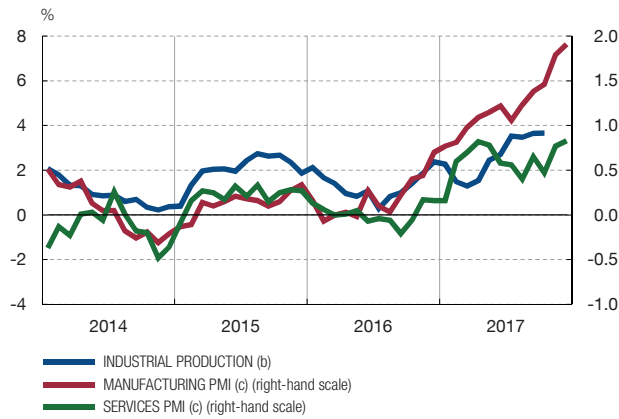
1 OUTPUT AND EMPLOYMENT
Year-on-year rate



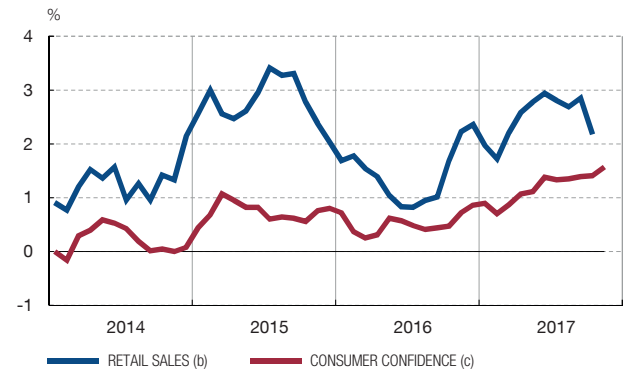
2 GDP BY COUNTRY
Quarter-on-quarter rate



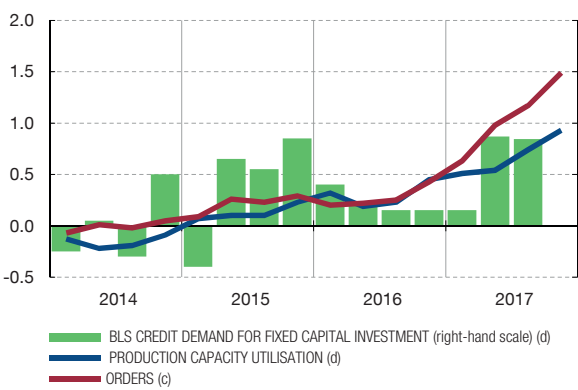
3 INDUSTRIAL ACTIVITY AND SERVICES INDICATORS



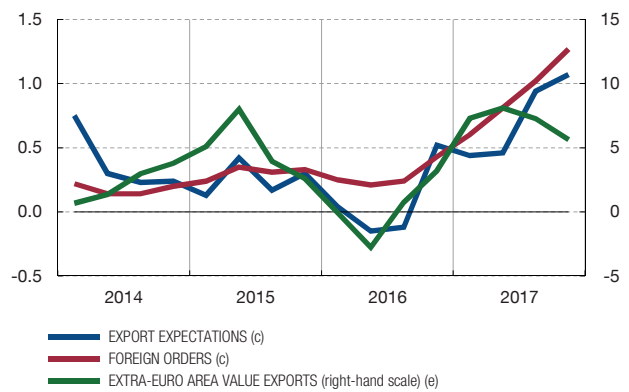
4 CONSUMPTION INDICATORS



5 INVESTMENT INDICATORS



6 EXPORT INDICATORS

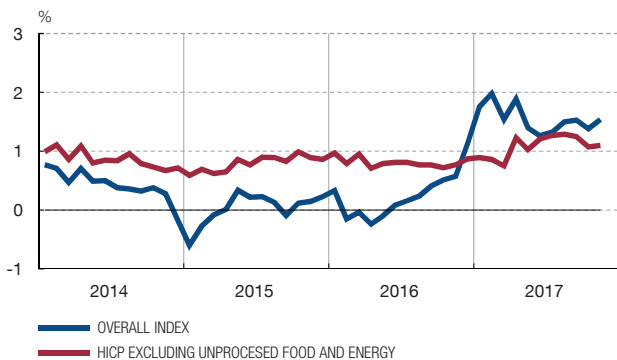


SOURCES: Eurostat, Markit Economics and Banco de España.

- a Q3 figure not available.
- b Year-on-year rates, calculated on the basis of the non-centred quarterly moving average of the seasonally adjusted series.
- c Normalised series for the period represented.
- d Bank Lending Survey. Indicator = percentage of banks reporting a considerable increase + percentage of banks reporting some increase x 0.5 – percentage of banks reporting some decrease x 0.5 – percentage of banks reporting a considerable decrease. A positive value denotes an increase.
- e Year-on-year rates of the original monthly series. Quarterly average.



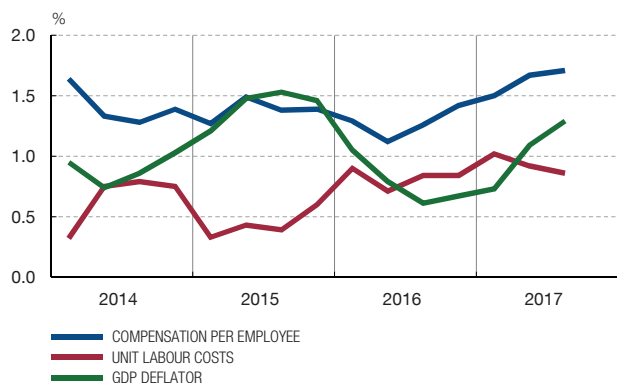
1 HARMONISED INDICES OF CONSUMER PRICES



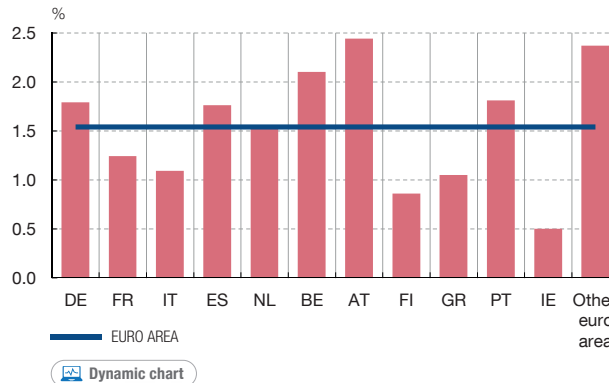
2 INFLATION EXPECTATIONS



3 WAGES AND COSTS



4 OVERALL HICP
November 2017



SOURCES: Eurostat, Reuters and ECB.

a Implied inflation calculated on the basis of inflation swaps.

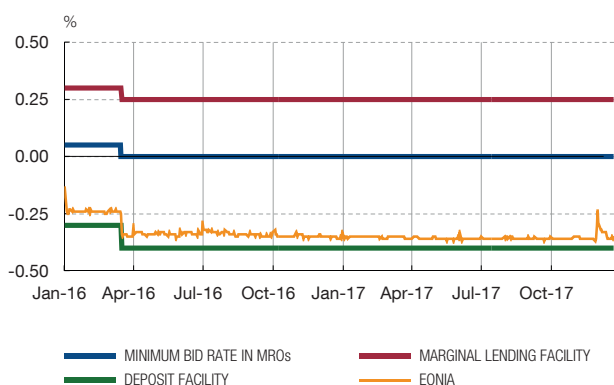


2017. In structural terms, there would be little change in the government balance in 2018, so that the fiscal policy stance would remain practically neutral, which the European Commission considers to be appropriate.

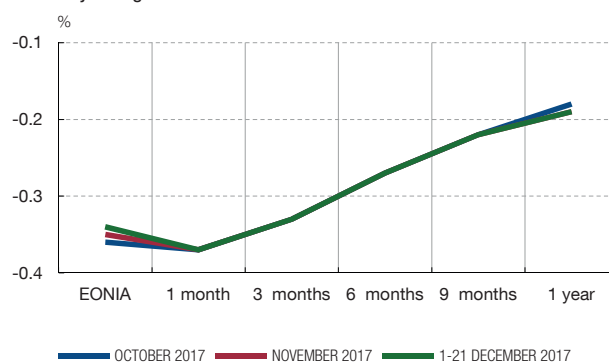
According to the conclusions of the European Commission, subsequently endorsed by the Eurogroup, the assessment of the draft budgetary plans of the euro area countries suggests that Belgium and Italy will fail to comply with their commitment to reduce debt and are at a high risk of recording significant deviations from their medium-term budgetary targets. Of the countries subject to the corrective arm of the Stability and Growth Pact, there are also doubts regarding France's compliance with its commitments, as the structural adjustment planned is less than required for progress towards the medium-term budgetary objective and deleveraging. In the case of Germany, the European Commission considers that its favourable budgetary position affords scope for further spending increases targeted at raising the economy's potential growth rate, on public investment and education, for example.

The *Alert Mechanism Report* of the Macroeconomic Imbalance Procedure foresees a slight reduction in the euro area current account surplus in 2017, to 3%. The report considers

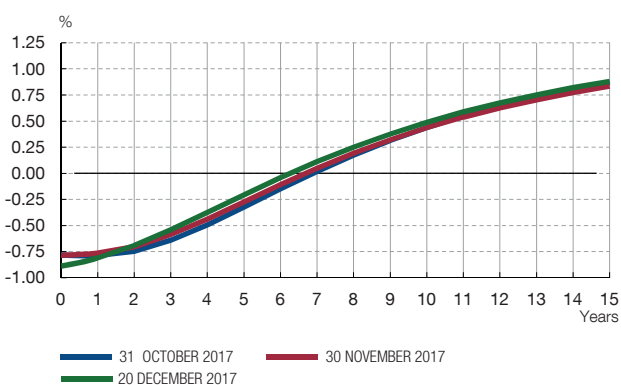
1 EONIA AND ECB INTEREST RATES



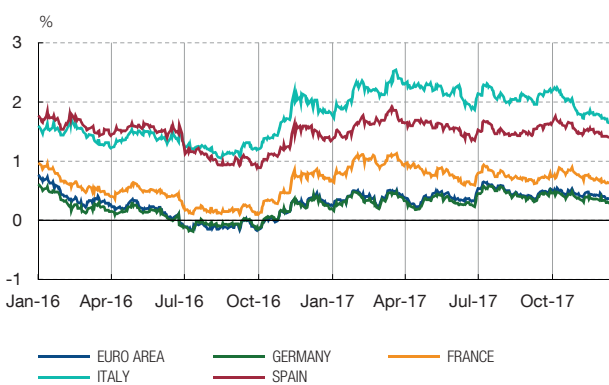
2 INTERBANK MARKET
Monthly average



3 ZERO COUPON CURVE (a)



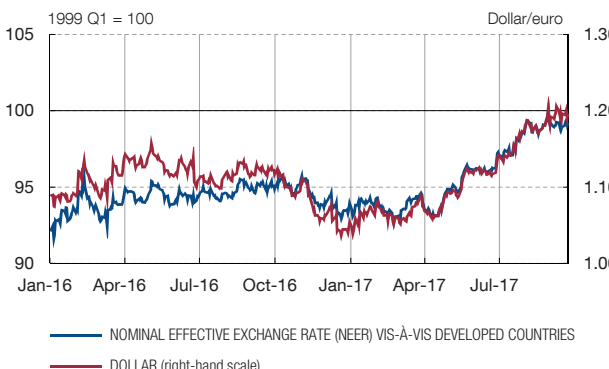
4 TEN-YEAR GOVERNMENT BOND YIELDS



5 EURO STOXX 50 INDEX AND IMPLIED VOLATILITY



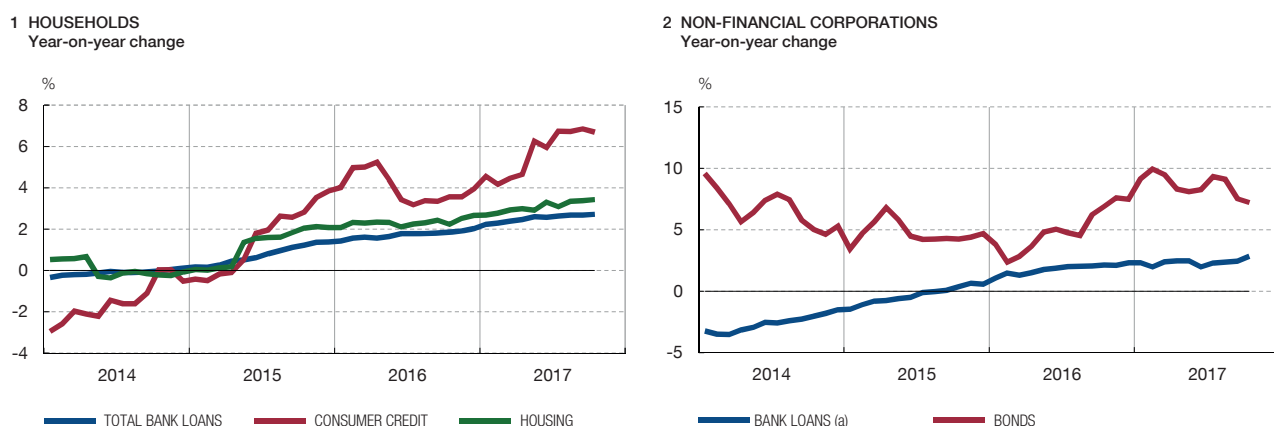
6 NOMINAL EURO EXCHANGE RATES



SOURCES: ECB and Banco de España.

a Estimated by the ECB using swap market data.

that in-depth reviews should be carried out for the nine euro area Member States in which imbalances were identified in the last round of the European Semester, in February 2017. These countries are the five major euro area economies (Germany, Spain, France, Italy and the Netherlands), Ireland, Portugal, Cyprus and Slovenia. Finally, the report states that close monitoring is required for those countries not subject to in-depth reviews, in which sustained increases in house prices (Belgium, Finland and Luxembourg) or in labour costs (Estonia, Latvia and Lithuania) have been observed.



SOURCE: ECB.

a Adjusted for securitisation and other transfers.



Finally, in early December, the European Commission presented new proposals for institutional reform to strengthen the Economic and Monetary Union (EMU). First, the proposals supplement its October Communication, which proposed compromise solutions to complete the Banking Union by 2019, with the creation of a common deposit insurance scheme that (unlike the initial 2015 proposal) does not explicitly envisage full risk mutualisation in the final implementation phase. Second, the Commission proposes setting up a European Monetary Fund (EMF) anchored within the EU's legal framework, to assume the functions and powers of the European Stability Mechanism (ESM). The EMF would also take over the function of last resort lender for the Single Resolution Fund (SRF), by means of a credit line that banks will have to repay to preserve fiscal neutrality. Third, the creation of structural reform incentive mechanisms and investment stabilisation instruments is proposed to tackle asymmetric shocks; these mechanisms could take the form of loans and subsidies financed through the EU budget. In addition, the appointment of a euro area Economy and Finance Minister is proposed, who, depending on the functions eventually conferred thereon, may contribute to improving economic policy coordination. Finally, the Commission proposes incorporating the so-called Fiscal Compact into EU law, along with the elements of flexibility in the application of the Stability and Growth Pact, associated with structural reforms and the economic situation, presented by the Commission in 2015.

FINANCIAL DEVELOPMENTS AND MONETARY POLICY

In Q4, the financial conditions of the economy held relatively stable, at very favourable levels. This was the result of a moderate decline in long-term interest rates and in the spreads vis-à-vis the German Bund, and the notable stability of the euro exchange rate and stock markets, which also recorded low levels of volatility.

The interest rates on government bonds generally fell (see Chart 7.3) in Q4, with the yield on the German Bund down to 0.41% in mid-December, from 0.46% at the end of the previous quarter. With the exception of France and Finland, sovereign debt yields narrowed, especially in the case of Portugal, Italy and, above all, Greece (following the agreement on the third review of the financial assistance programme and the implementation of short-term debt relief measures). The yield spread between ten-year US government bonds and the Bund stands at around 210 bp, above its level at the end of September.

As regards the stock market, there was a small increase in the Dow Jones Euro Stoxx 50 index over the quarter as a whole (0.7%), against a background of low volatility. Since the beginning of the year the index has risen by somewhat more than 8.5%. On the foreign exchange market, the euro exchange rate has fluctuated within a narrow range during the quarter, appreciating slightly in nominal effective terms, by 0.4%, since the end of September, while against the dollar it has also appreciated by 0.4%, and against the pound sterling by 0.7% (see Chart 7.6).

Finally, in relation to monetary and credit aggregates, loans to the private sector continued to recover. The growth rate of loans to non-financial corporations stepped up in October to 2.9%, while that of loans to households held steady at 2.7%. According to the 2017 Q3 euro area bank lending survey loan growth is supported by easing credit standards on loans to households and by unchanged standards for loans to non-financial corporations, as well as by increasing demand across all categories. As for monetary aggregates, the year-on-year growth rate of M3 stood at 5% in October, a level around which it has been fluctuating since spring 2015. The year-on-year growth rate of the narrowest aggregate, M1 (cash and sight deposits), fell by 0.4 pp, to 9.4%.

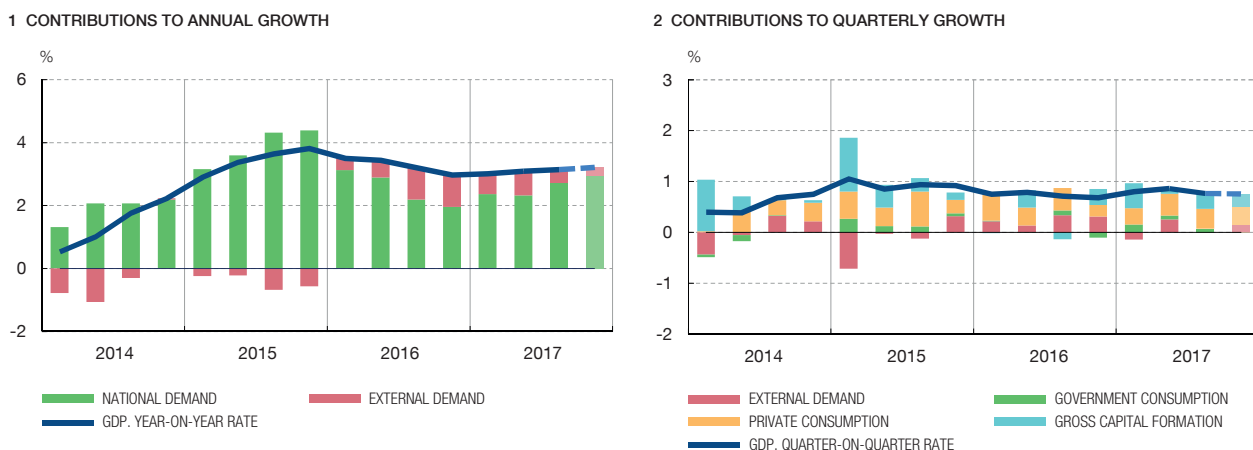
3 THE SPANISH ECONOMY

The quarter-on-quarter growth of Spanish GDP stood at 0.8% in 2017 Q3, 0.1 pp down on the previous quarter (see Chart 9). The increase in output in Q3 was due exclusively to the growth of domestic demand, which made a positive contribution of 0.8 pp, 0.2 pp more than in Q2. The greater dynamism of this aggregate was attributable to the acceleration in investment in equipment and other products, which more than offset the slowdown in investment in construction, while private and government consumption remained buoyant. The contribution of net external demand to aggregate growth in Q3 was zero, following its positive contribution of 0.3 pp the previous quarter. Both exports and imports were flat, following the muted increase in the former and the slight fall-off in the latter the previous quarter. In year-on-year terms, the respective growth rates of GDP and of employment over the course of the quarter were 3.1% and 2.9%.

On the basis of the latest conjunctural information, GDP is expected to increase in Q4 at a similar pace to Q3, at around 0.8%. The expansion in output will mainly be underpinned by national demand, while the as-yet incomplete external sector indicators available would suggest a slightly positive contribution of external demand. Employment is expected to have maintained its growth rate in Q4. The still-scant regional information available for this period points to the emergence of the first adverse effects linked to the increase in uncertainty as a result of the political situation in Catalonia over recent months. These effects have made themselves felt in the indicators of domestic private expenditure and foreign tourism, which might lead to this region posting a lower growth rate in activity in the final stretch of the year than that of the Spanish economy as a whole, in contrast to the Catalanian economy's greater dynamism in previous quarters.

As was the case in Q3, consumer prices in the final quarter of the year have maintained relatively stable growth, following their marked rebound at the start of the year and subsequent slowdown to June. However, some heterogeneity continues to be seen across the different price components. Non-energy industrial goods and services prices slowed from September to November, a development partly countered by an acceleration in food prices, particularly unprocessed food, and, to a lesser extent, in energy prices. As a result, the year-on-year change in the CPI stood in November at 1.7%, 0.1 pp down on the September figure, while the year-on-year growth rate of the CPI excluding unprocessed food and energy, which proxies core inflation, fell to 0.8%, 0.4 pp less than in September.

In Q4 to date, domestic financial markets, in line with the pattern observed in the rest of the euro area, have generally held relatively stable. The increase in uncertainty caused by the political tensions in Catalonia has had relatively limited and short-lived effects on market prices, while the prolongation of the ECB's expansionary monetary policy stance has continued to help support valuations. Hence, as at the cut-off date for this Report, the IBEX-35 stood at 0.7% below its end-September levels, an identical decline to that posted by the EURO STOXX 50 (see Chart 10.1). On the government debt markets, the Spanish 10-year government bond yield has fallen by around 15 bp relative to the end of Q3 to 1.5%. Given that the equivalent German 10-year benchmark has declined to a lesser extent than the Spanish yield in this period, the spread between both has narrowed slightly to 105 bp. The average risk premia on fixed-income securities issued by financial corporations has declined during the quarter, while the related premia for non-financial



[Dynamic chart](#)

SOURCES: INE and Banco de España.

a Seasonally adjusted series.

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corporations have scarcely changed. On the interbank market, the 12-month EURIBOR has fallen back slightly to -0.19%.

In recent months, credit institutions have continued to finance themselves under favourable conditions, which, in turn, has enabled the average costs of bank lending to the non-financial private sector to hold at low levels, close to their historical lows. Against this background the volume of new business continued growing, in year-on-year terms. This pattern of flows has translated into a moderation of the year-on-year rate of contraction of the outstanding bank credit balance of households and non-financial corporations. Finally, the financial position of households and non-financial corporations is expected to have continued strengthening, in a setting in which their incomes are estimated to have increased and their debt to have fallen.

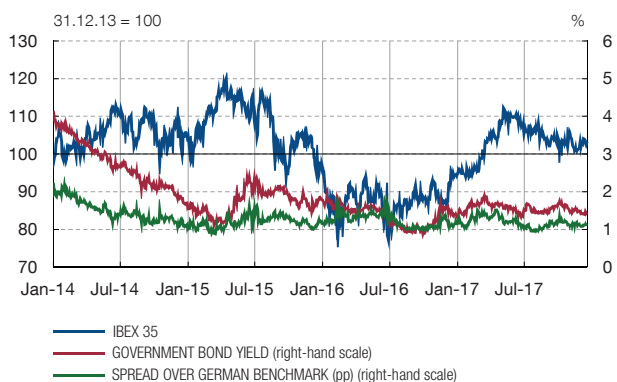
3.1 Household spending decisions

On the latest conjunctural information, the quarter-on-quarter rate of change of household consumption spending is expected to have stood at 0.6% in Q3, behaving similarly to the two previous quarters (see Chart 11). As a result, the quantitative indicators have in the quarter to date generally moved similarly to the previous quarter, as in the cases of Social Security registrations and the industrial production of consumer goods. By contrast, under the qualitative indicators, the consumer confidence and retail trade indices – among others – have lost momentum.

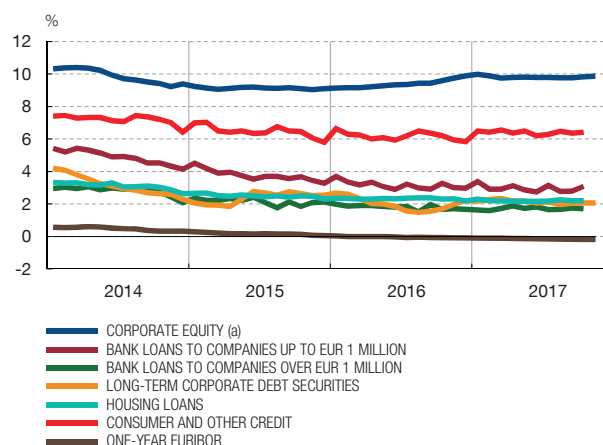
As regards investment in housing, the information available points to an acceleration in Q4, thus sustaining high growth rates, in a setting in which higher growth in the coincident indicators – particularly in employment and the production of construction materials – has been observed. According to the information provided by INE, open-market house prices continued to quicken in Q3, rising to a year-on-year growth rate of 6.7% compared with 5.6% the previous quarter. This greater dynamism was chiefly due to the behaviour of second-hand house prices.

The latest information on household financing costs shows that they have held at low, practically unchanged levels. Thus, from June to October (the latest figure available), the average interest rate on new lending business for house purchases held at around its

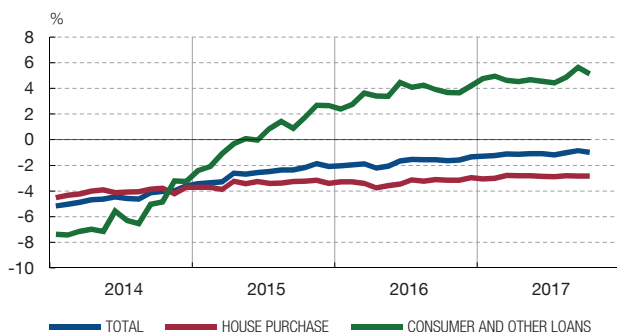
1 EQUITY AND 10-YEAR GOVERNMENT BOND MARKETS



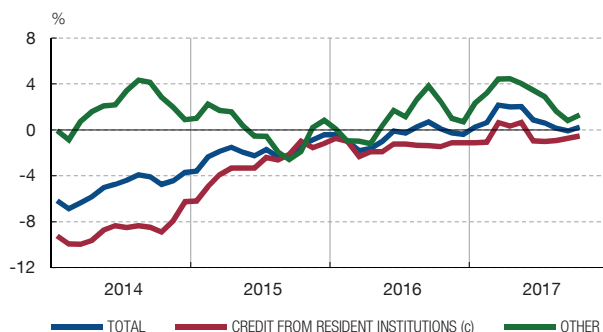
2 COST OF FINANCING



3 LENDING TO HOUSEHOLDS
Year-on-year rates (b)



4 FINANCING TO COMPANIES
Year-on-year rates (b)



SOURCES: Bloomberg, Reuters, Datastream, MSCI Blue Book, INE and Banco de España.

- a The cost of equity is based on the three-stage Gordon dividend discount model.
- b Credit includes off-balance sheet securitisation and loans transferred to Sareb.
- c Loans from resident credit institutions and specialised lending institutions.



historical low (2.2%), while the rate on funds allocated for consumption and other purposes, which shows greater volatility, stood in October at 6.4%, 0.2 pp more than in June (see Chart 10.2).

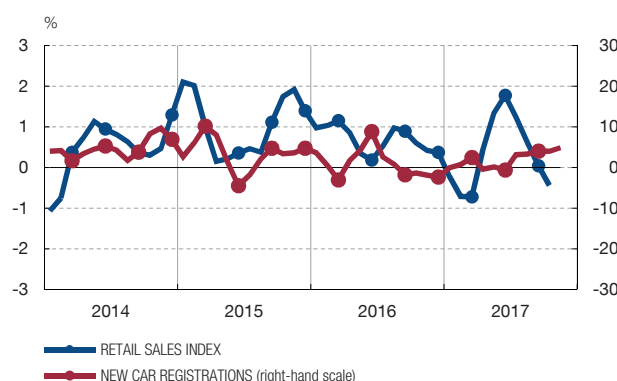
The results of the latest edition of the Bank Lending Survey (BLS), for October, reveal a favourable trend in the supply of credit to households in Q3, since banks eased their lending standards, both for house purchases and for consumption and other purposes. Also, the general conditions applied to loans granted eased once again in both segments, in particular regarding gross margins. According to this Survey, household demand for funds for house purchase held unchanged in this same period, while the demand for consumer and other loans increased. In both segments, banks anticipated increases of some intensity in loan applications and stable supply for Q4.

Between June and October, and on the back of favourable conditions of access to financing, the growth of volumes of new business in lending to households quickened, in year-on-year terms, in both segments (house purchases and consumption and other

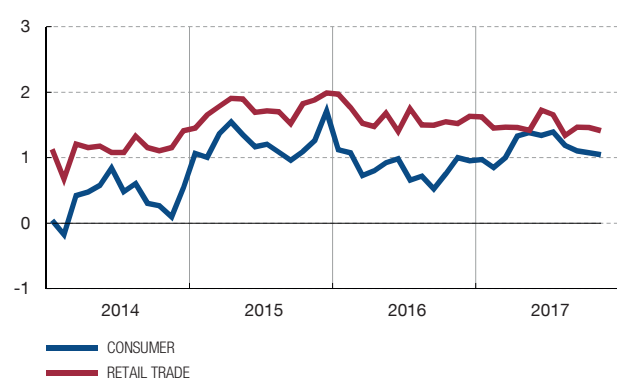
1 HOUSEHOLD SPENDING (QNA) (a)



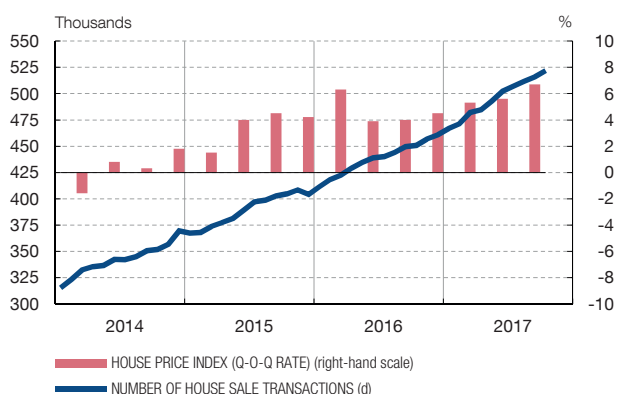
2 CONSUMPTION INDICATORS (b)



3 CONFIDENCE INDICATORS (c)



4 HOUSE PRICES AND TOTAL TRANSACTIONS



SOURCES: INE, European Commission, ANFAC, Centro de Información Estadística del Notariado and Banco de España.

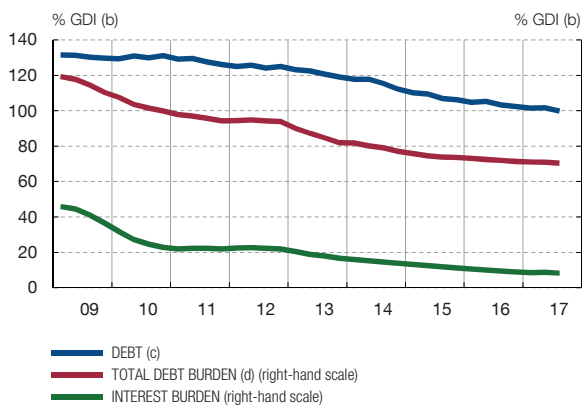
- a Quarter-on-quarter rates calculated on the basis of seasonally adjusted series.
 b Rate of change of moving average of three terms with three time lags, calculated on the basis of seasonally adjusted series. The dots represent quarter-on-quarter rates.
 c Normalised indicators (difference between the indicator and its mean value, divided by the standard deviation).
 d 12-month moving sum.

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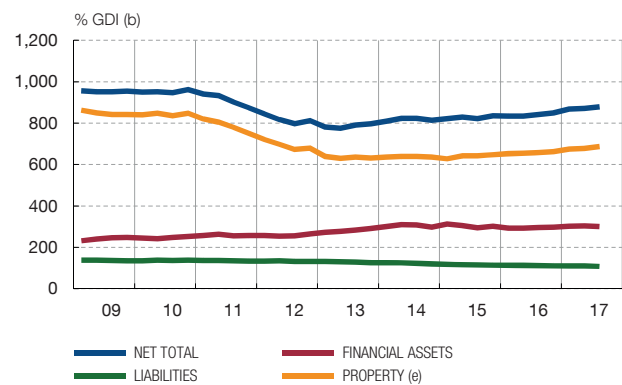
purposes). The greater activity in the credit market contributed to some moderate easing in the year-on-year decline in households' outstanding debt, which stood in October at 1%, 0.1 pp less than the rate in June (see Chart 10.3). By loan type, these developments were the outcome of a 2.8% contraction in credit for house purchase, compared with 2.9% four months earlier, and of greater dynamism in lending for consumption and other purposes, whose growth rate rose from 4.6% in June to 5.1% in October.

On the latest available data, households' financial position is expected to have continued improving in 2017 Q3. Thus, the debt ratio relative to GDI is estimated to have continued declining, as a result both of the fall in the outstanding balance of debt and of the expansion in incomes. Combined with the unchanged average cost of debt, this is estimated to have made for a further decline in the debt burden ratio, which stands at historically low levels (see Chart 12.1). Household net wealth is expected to have increased again in this period thanks to the rise in the value of households' real estate equity, since their financial assets will have held stable owing to the fact that financial assets and liabilities have fallen by similar amounts (see Chart 12.2).

1 DEBT RATIOS



2 WEALTH



[Dynamic chart](#)

SOURCES: INE and Banco de España.

- a The last data point in each series is an estimate.
- b Cumulative four-quarter data.
- c Includes MFI lending and off-balance-sheet securitised lending.
- d Estimate of interest payments and capital repayments.
- e Valuation based on estimated changes in stock of housing, average floor space and price per square metre.

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3.2 Business activity and investment

Business activity, proxied by the real value added of the market economy, is estimated to have held in Q4 at a similar rate of expansion to that observed in Q3, with no notable difference in behaviour from that period for the main sectors of activity.

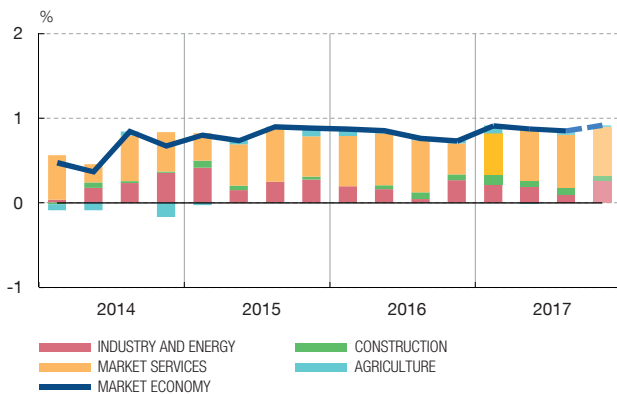
Specifically, analysing the information on the industry and energy sector, there is discernibly higher growth in Q4 than in Q3. In this respect, Social Security registrations in industry moved on a stable path in terms of the rate of increase, similar to that observed in the summer months. The industrial production index shows a slight increase. Among the qualitative indicators, the European Commission's business confidence indicator increased over the two months spanning October and November, interrupting the deteriorating path observed in the previous quarters. As regards the manufacturing PMI, the latest data also evidence an improvement, in line with the trend observed in the case of the euro area.

There has been an estimated expansion in market services in the final stretch of the year similar to that observed in Q3, although signs of this expansion tailing off have been detected more recently. Such is the case of the quantitative indicators where, for example, Social Security registrations in this sector of activity are estimated, in seasonally adjusted terms, to have undergone an increase very similar to that in Q3, although there was some month-on-month slowing in November. Among the qualitative indicators for this sector, both the European Commission's confidence indicator and the PMI have in the period to date in Q4 been at a level lower than their corresponding average for Q3.

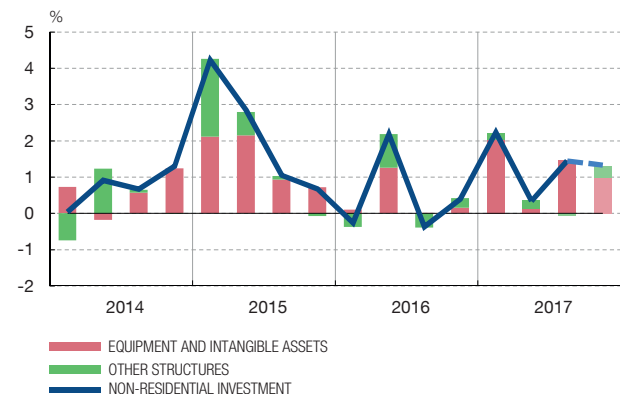
The behaviour of the growth of value added in the construction sector is likewise estimated to have been relatively stable, holding at a high rate. The course of the latest indicators, such as the industrial production index of non-metallic minerals and the number of Social Security registrations in this sector, would confirm this forecast.

Lastly, the increase in investment in capital goods in Q4 is expected to be somewhat below 2%. That would entail the stabilisation of the growth of this demand component at

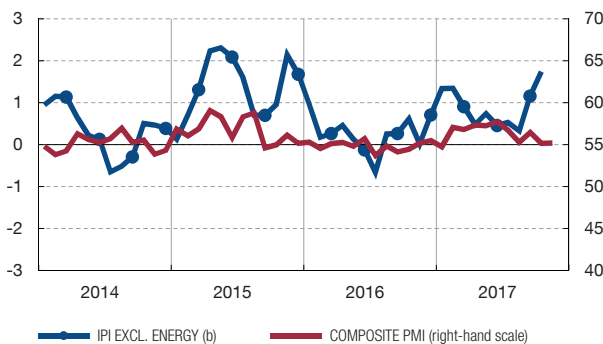
1 MARKET ECONOMY GVA (a)
Quarter-on-quarter rates and contributions



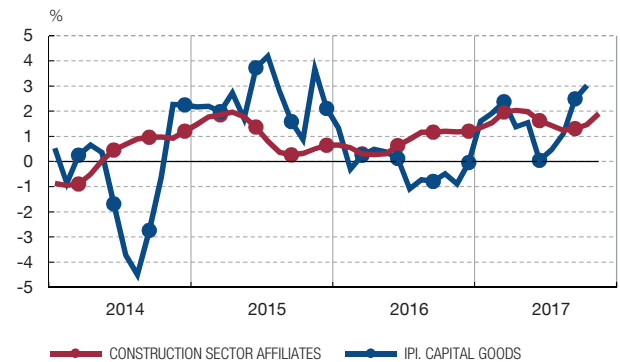
2 NON RESIDENTIAL INVESTMENT (a)
Quarter-on-quarter rates and contributions



3 ACTIVITY INDICATORS



4 INVESTMENT INDICATORS (b)



SOURCES: INE, Ministerio de Fomento, Markit, OFICEMEN and Banco de España.

a Seasonally adjusted series.

b Rate of change of moving average of three terms with three time lags, calculated on the basis of seasonally adjusted series. The dots represent quarter-on-quarter rates.

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rates close to those observed in the first half of 2016, following the erratic profile shown in the second half of last year and the first half of 2017, as a result of the regulatory changes affecting corporate income tax. In this respect, mention should be made of the sound recent performance of the industrial production index of capital goods and of new commercial vehicle registrations. The qualitative indicators also showed some increase, albeit with exceptions.

As in the case of households, the latest information indicates that the average interest rates on new bank loans granted to non-financial corporations have varied slightly, holding at historically low levels. Thus, in October, the average cost of loans for an amount of less than €1 million stood at 3.1% and the rate on those above this amount at 1.7%, figures which in both cases are within the range observed over recent months. The interest rate on long-term fixed-income issues and that on own funds are not expected either to have varied considerably, standing in November at 2.1% and 9.8%, respectively (see Chart 10.2).

According to the October BLS results, banks marginally tightened their lending standards in respect of non-financial corporations in Q3, as they did with general conditions (particularly spreads on higher-risk loans). The demand perceived by banks is estimated to

have held stable. For Q4, banks expected a rise in applications and for supply to hold up. The results of the latest edition of the ECB Survey on the Access to Finance of Enterprises (SAFE), for the period from April to September 2017, signal, by contrast, a further improvement in Spanish SMEs' perception of access to credit (see Box 6). This is affirmed by 23% of them, in net terms, which is 5 pp down on the previous survey but 11 pp up on the percentage recorded by their euro area counterparts. The SAFE also points out that loan applications are expected to have fallen as a result of firms' lower financing needs.

Against this background, the volume of new lending continued to grow in year-on-year terms in recent months, with loans for an amount below €1 million – the segment that essentially covers business with SMEs – accelerating and those for amounts above this figure easing. In terms of outstanding balances, the rate of contraction of loans to non-financial corporations has progressively eased in recent months, standing at 0.5% in October (see Chart 10.4). Financing via fixed-income securities, including those issued by subsidiaries abroad, continued to grow in year-on-year terms, but at a slower pace (4.5% in October against 9.5% in June). The growth of the total debt of this sector has been positive but very moderate (0.2% in October).

Lastly, the financial position of non-financial corporations is expected to have strengthened once again in Q3. The debt ratio and, to a lesser extent, the debt burden ratio as a percentage of GDP continued to fall, assisted by the improvement in profits and the decline in debt (see Chart 14). In the case of the debt burden, this decline came about despite the average cost of the outstanding balance of debt holding steady. According to the sample of non-financial corporations that report to the Quarterly Central Balance Sheet Data Office Survey (CBQ), comprising mainly large corporations, the expansion in activity, along with the favourable behaviour of financial costs and revenues, allowed ordinary profit to grow by 4.8% year-on-year in the first three quarters of 2017, which is a lower rate than that of the same period a year earlier.³ In the period from April to September 2017, the SAFE highlights a positive trend in Spanish SMEs' profits, since the proportion of firms reporting an increase in business profits was 7 pp higher than those reporting a decline (see Box 6).

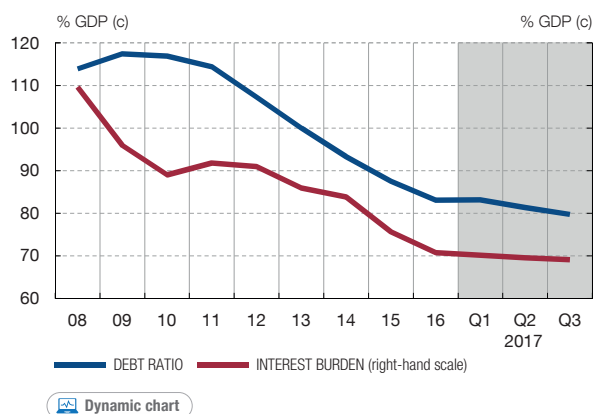
3.3 The external sector and the balance of payments

The partial information available for Q4, referring exclusively to October, points to a moderate increase in the contribution of net external demand to the quarter-on-quarter growth of GDP, following its zero contribution in Q3. This performance has been on the back of an acceleration in external trade in goods and services, in imports and exports alike, following their stagnation in the previous quarter. In year-on-year terms, trade transactions with the rest of the world in Q4 are also estimated to have quickened to some degree (see Chart 15).

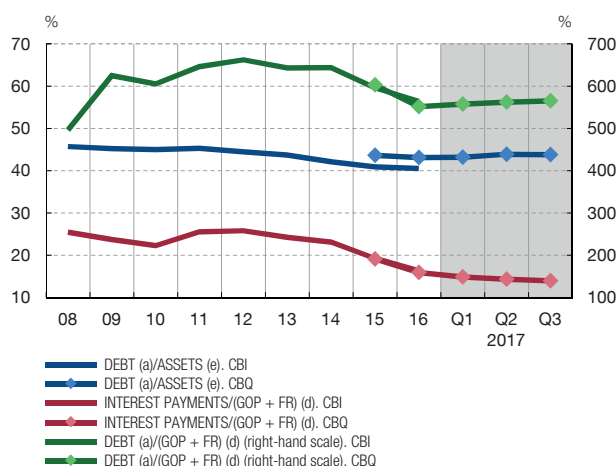
The Customs data for October showed year-on-year real growth of exports and imports of 9.2% and 9.3%, respectively. By type of good, the increases in capital and intermediate goods, in particular energy goods, stood out among exports, while consumer durables exports continued to post declines, as in Q3. From the standpoint of the geographical breakdown, the growth in exports was, as in the previous quarter, sharper in those intended for non-Community markets. Turning to imports, the increase in purchases abroad was chiefly underpinned by intermediate – particularly energy – goods and consumer goods, especially durables, which quickened appreciably.

³ See the Analytical Article “Results of non-financial corporations in 2016 and in the first three quarters of 2017”, *Economic Bulletin* 4/2017, Banco de España.

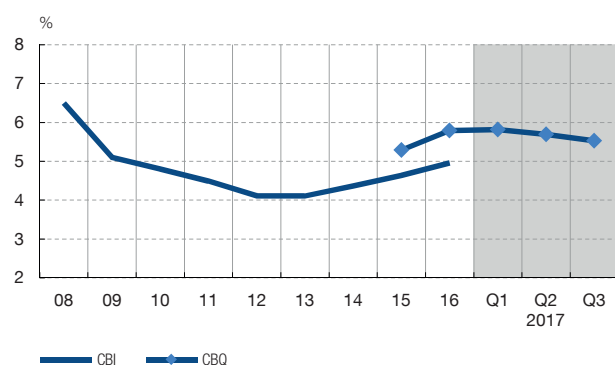
1 DEBT (a) AND INTEREST BURDEN. NATIONAL ACCOUNTS (b)



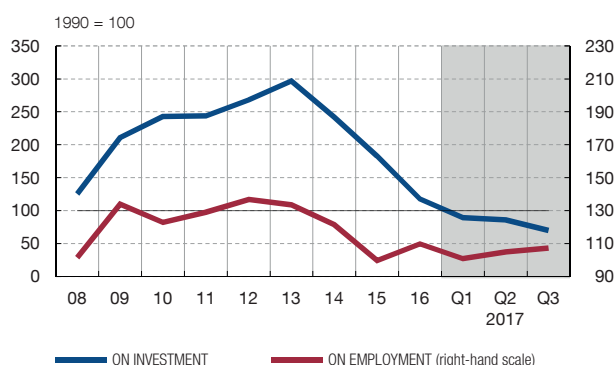
2 DEBT RATIO AND FINANCIAL BURDEN. CBSO



3 RETURN ON INVESTMENT. CBSO (f)



4 SYNTHETIC INDICATORS OF FINANCIAL PRESSURE (g)



SOURCES: INE and Banco de España.

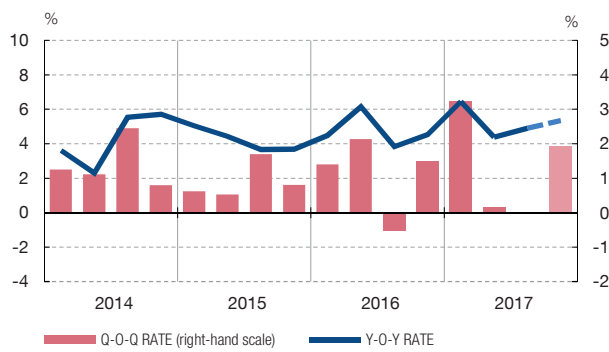
- a Interest-bearing borrowing.
- b The last data point in each series is an estimate.
- c The GDP series is seasonally adjusted.
- d Gross operating profit (GOP) + financial revenue (FR).
- e Defined as total inflation-adjusted assets less non-interest bearing liabilities.
- f Defined as ordinary net profit/net assets.
- g Indicators calculated on the basis of CBA surveys and, where no annual data are available, on CBQ surveys. A value of more (less) than 100 denotes higher (lower) financial pressure than in the base year.

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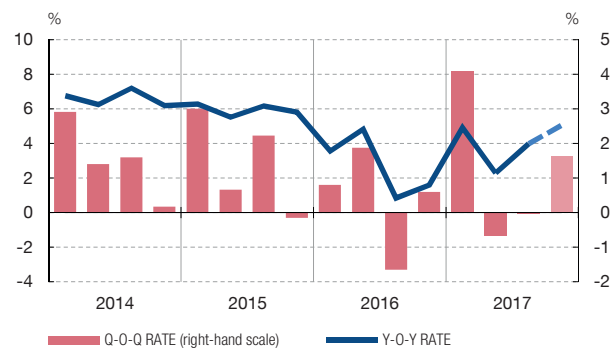
On the latest information, for October, the growth rate of inbound tourism is expected to have eased, apparently affected by the situation in Catalonia where, in October, overnight hotel stays and tourist arrivals declined and the growth rate of tourist expenditure slowed. As far as the indicators for Spain as a whole are concerned, the growth rate of tourist arrivals eased significantly in October, following the strength shown in September, a conditioning factor of which was the decline in tourist inflows from France and Germany, while those from the United Kingdom increased only slightly. Overnight hotel stays maintained a moderate growth rate in October. Against this backdrop, nominal tourist expenditure slowed in October, affected by the deceleration in arrivals, which countered the recovery in average spending per tourist.

The Spanish economy's net lending fell slightly over the recent period. Specifically, in the 12 months to end-September the balance of payments surplus stood at 2% of GDP (0.2 pp less than in 2016 as a whole). This decline is due to the widening of the goods

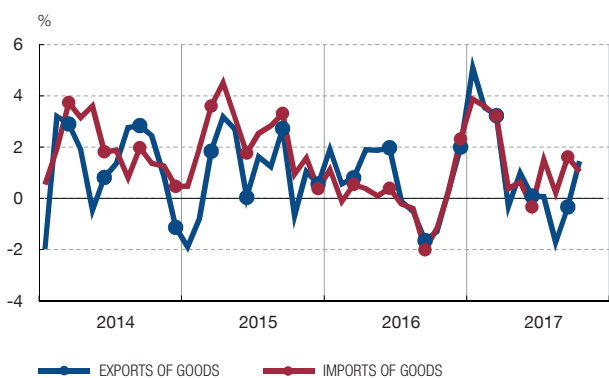
1 EXPORTS OF GOODS AND SERVICES (a)



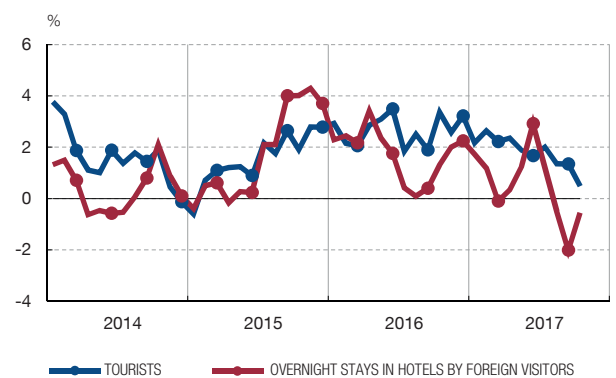
2 IMPORTS OF GOODS AND SERVICES (a)



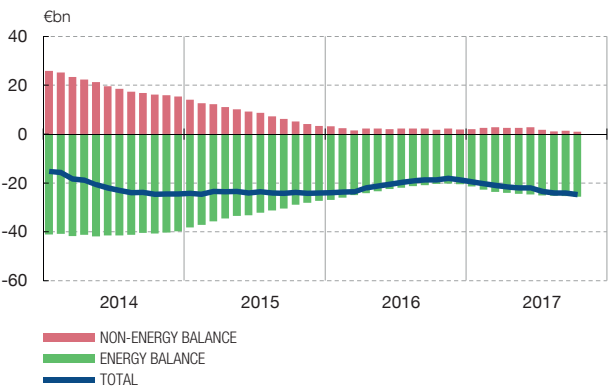
3 CUSTOMS INDICATORS (b) (c)



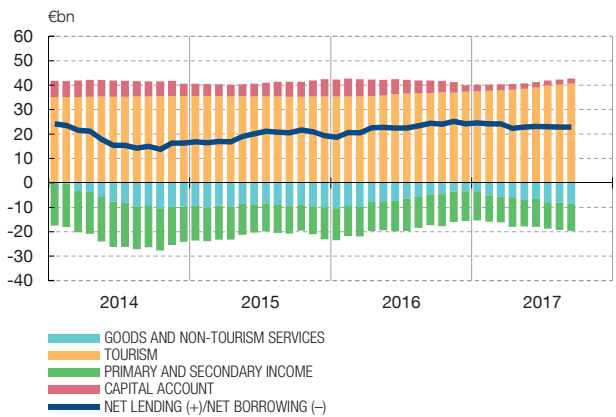
4 TOURISM INDICATORS (c)



5 FOREIGN TRADE IN GOODS
Cumulative figures for the past twelve months



6 BREAKDOWN OF THE CURRENT AND CAPITAL ACCOUNT BALANCE (d)
Cumulative figures for the past twelve months

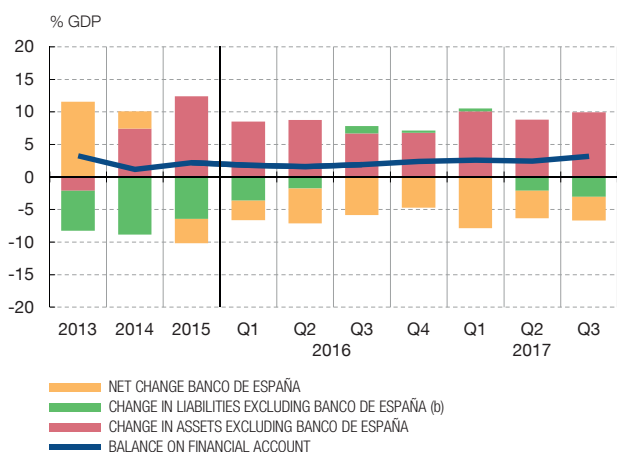


SOURCES: INE, Ministerio de Economía y Competitividad and Banco de España.

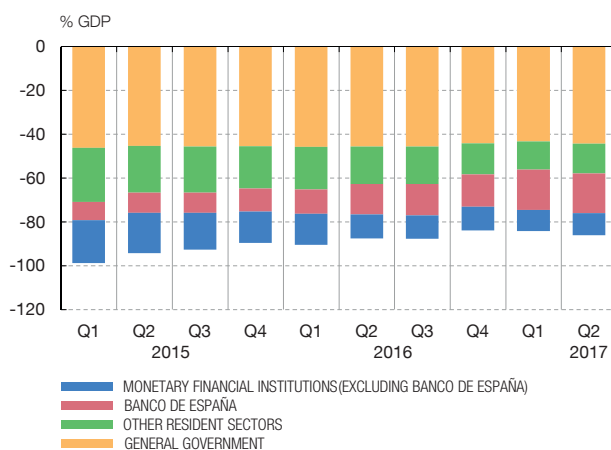
- a QNA data at constant prices. Seasonally adjusted series.
- b Series deflated using export (IPRIX) and import (IPRIM) price indices for industrial products.
- c Rate of change of moving average of three terms with three time lags, calculated on the basis of seasonally adjusted series. The dots represent quarter-on-quarter rates.
- d Data conform to the sixth edition of the IMF's *Balance of Payments and International Investment Position Manual* (BPM6).



1 BALANCE OF PAYMENTS ON FINANCIAL ACCOUNT (a)



2 INTERNATIONAL INVESTMENT POSITION (c)



SOURCE: Banco de España.

- a Four-quarter cumulative quarterly data.
 b Sign changed.
 c Assets minus liabilities vis-à-vis the rest of the world.



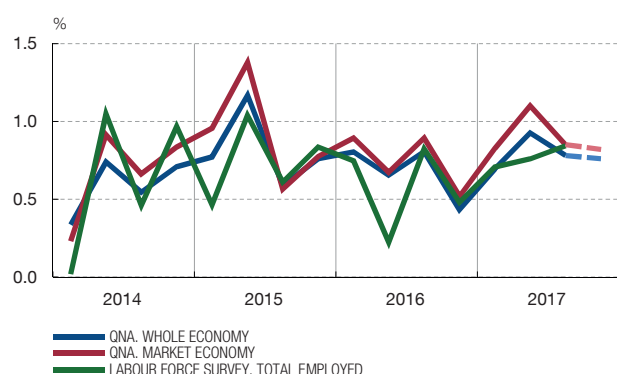
deficit which, in turn, essentially reflects the increase in the energy deficit, linked to the rise in oil prices. These developments offset the increase in the services (tourist and other services alike) surplus and the reduction in the income deficit.

The latest available Balance of Payments information, for 2017 Q3, shows that the rest of the world acquired assets issued by resident agents totalling €2.8 billion during that period. These investments were concentrated under the headings of portfolio investment (€3.2 billion) and, to a lesser extent, direct investment (€1.1 billion), while the figure was negative under other investment (€-1.4 billion). Domestic agents, excluding the Banco de España, increased their positions abroad by an amount totalling €24.8 billion, by means of portfolio investment (€13 billion) and direct investment (€12.1 billion), while they divested slightly under the other investment heading (€400 million). Combined with a low negative net flow of operations linked to financial derivatives (€0.5 billion), this led the financial account, excluding the Banco de España, to post a credit balance amounting to €21.4 billion. With regard to the sectoral breakdown, net flows associated with claims on and liabilities to the external sector (excluding financial derivatives) were positive for the other resident sectors and the general government sector (€30.6 billion and €10.3 billion, respectively), while, by contrast, other monetary financial institutions raised funds from the rest of the world in net terms (€18.9 billion). The Banco de España's net debit position vis-à-vis the rest of the world increased once more, but to a lesser extent than in previous quarters (€215 million). In line with the economy's net lending, net financial operations vis-à-vis the external sector evidenced a credit balance for an amount equivalent to 3.2% of GDP in cumulative 12-month terms. This was the result of resident investment in the rest of the world being higher than that by foreigners in the Spanish economy (see Chart 16.1).

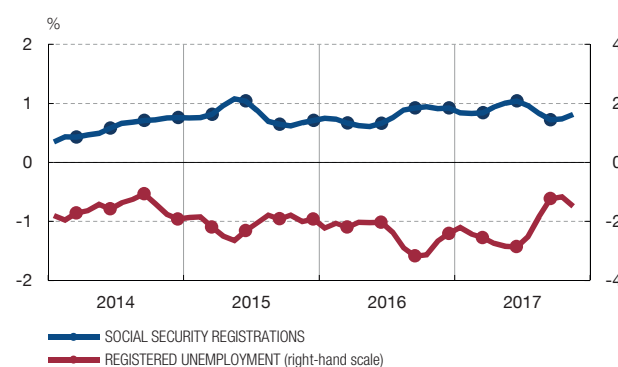
In Q2, the debit position of the nation's net international investment position vis-à-vis the rest of the world increased by €30.7 billion relative to March, standing at 86.2% of GDP, 1.9 pp up on three months earlier and 2.3 pp more than the December 2016 level (see Chart 16.2). The increase in the debit balance in the first half of the year was the outcome of a positive cumulative flow in net financial transactions in that period (€1.5 billion), which

1 EMPLOYMENT

Quarter-on-quarter rates (a)

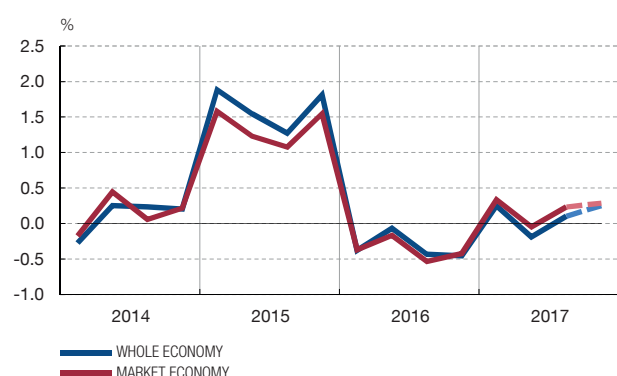


2 EMPLOYMENT AND UNEMPLOYMENT INDICATORS (b)



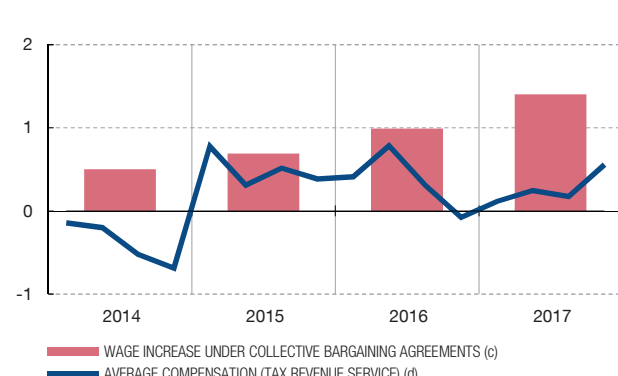
3 COMPENSATION PER EMPLOYEE

Year-on-year rates (a)



4 WAGE INDICATORS

Year-on-year rates



SOURCES: INE, Ministerio de Empleo y Seguridad Social, and Agencia Tributaria.

- a Rates of change calculated on the basis of adjusted series. QNA employment, measured in equivalent job terms.
- b Rate of change of moving average of three terms with three time lags, calculated on the basis of seasonally adjusted series. The dots represent quarter-on-quarter rates.
- c With data to November 2017. Excludes indexation clauses.
- d Gross quarterly data. Last quarter with data only for October 2017.



was broadly offset by the negative amount of other flows (€-46.2 billion). This latter movement is essentially due to the changes in the valuation of instruments and, in particular, to the appreciation of the euro, which had a greater adverse impact on the value of assets than on that of liabilities, and to the rise in the value of equity securities, which was sharper in the case of liabilities than in that of assets (see Box 7).

3.4 The labour market

Following the slight slowdown during Q3, the latest labour market indicators suggest the dynamism of employment has continued in the final stretch of 2017. Specifically, Social Security registrations posted a growth rate in November of 0.8%, in terms of the quarter-on-quarter rate of change of the three-month moving average of the seasonally adjusted series, 0.1 pp above the growth rate in Q3. This slight acceleration was seen in all sectors of activity, although it was sharper in construction which, along with non-market services, was more buoyant. This information reveals that employment, in QNA⁴ terms, is expected to maintain its quarter-on-quarter growth rate at 0.8% in Q4, thereby closing the gap it had

4 In terms of full-time equivalent jobs.

maintained over recent quarters with the growth of Social Security registrations. In the case of the market economy, the rate of expansion of employment is expected to ease by 0.1 pp to 0.8% (see Charts 17.1 and 17.2).

The rate of decline of unemployment registered by the National Public Employment Service (SEPE by its Spanish abbreviation) steepened in November to 1.5%, in terms of the quarter-on-quarter seasonally adjusted three-month moving rate of change, compared with the 1.2% decline in Q3 (see Chart 17.2). Against this background, the new hires registered with SEPE continued to November on the moderate path initiated in early 2017, posting a year-on-year increase of 4.3% in the first 11 months of the year. By type of contract, temporary contracts proved less dynamic than permanent ones, meaning that the weight of the latter in total contracts increased slightly in relation to the same period a year earlier, to 9.4%.

With regard to wages, everything suggests the year 2017 will conclude without any agreement between the social agents marking wage recommendations for this and the coming years. In this setting, the information on collective bargaining agreements recorded from January to November, covering 6.9 million workers, points to an increase in wage rates in 2017 of 1.4%, more than 0.4 pp up on the agreed rise for 2016. Most wage-earners with a settlement concluded for 2017 have signed a multi-year agreement in previous years, with an increase in wage rates of 1.3%. The agreements signed in 2017 increased considerably during the second half of the year, covering more than 2.3 million wage-earners in November. In these agreements, the agreed wage rise is somewhat higher, at 1.8%. Other wage indicators, influenced by the characteristics and wage conditions of net job creation, maintained a more moderate tone in Q3; one such example was average gross compensation at large corporations, which showed a slight increase of 0.2%, although the month of October saw some quickening in this rate to 0.6%. As to QNA-based compensation per employee, in seasonally adjusted terms a small rise was seen in the year-on-year rate in Q3, both in the economy as a whole, to 0.1%, and in the market economy, to 0.2%, resuming in both cases similar growth rates to those observed at the start of the year. A slight acceleration in both indicators is expected in Q4, entrenching the return to positive rates of increase (see Charts 17.3 and 17.4).

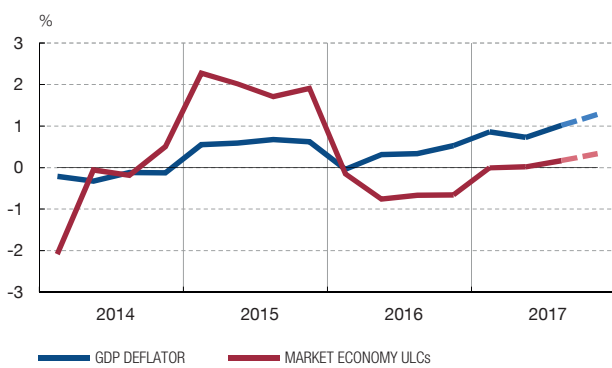
3.5 Prices

In Q4 the year-on-year growth of the import deflator is estimated to have fallen notably, prolonging the slowdown observed in the previous quarters. This profile is in contrast to the forecast for domestic producer prices, proxied by the GDP deflator, which are estimated to have quickened in Q4 (see Chart 18.1).

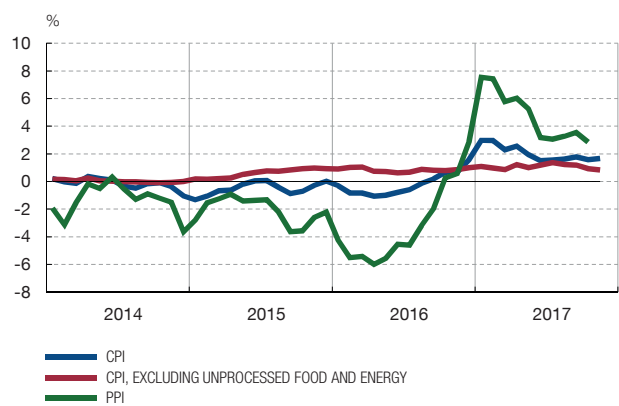
As regards consumer prices, measured by the private consumption deflator, these are estimated to have continued slowing in year-on-year terms in Q4. That would confirm the pattern of lower price growth, following the peak reached in Q1, and is attributable to temporary factors linked to the rise in energy prices and to the comparison effect when set against these prices a year earlier.

The latest information available on the CPI, for November, revealed a slight increase in its year-on-year growth rate (by 0.1 pp to 1.7%). The acceleration in the overall index is in response to the rise in energy prices, whose year-on-year rate increased by 2 pp, since the non-energy component slowed by 0.2 pp to a year-on-year rate of 1.1%. Unprocessed food prices slowed in November following their marked rise in the two previous months. Core inflation, measured by the year-on-year growth rate of the CPI excluding unprocessed food and energy, declined by 0.1 pp to 0.8%. Among its components, the prices of non-

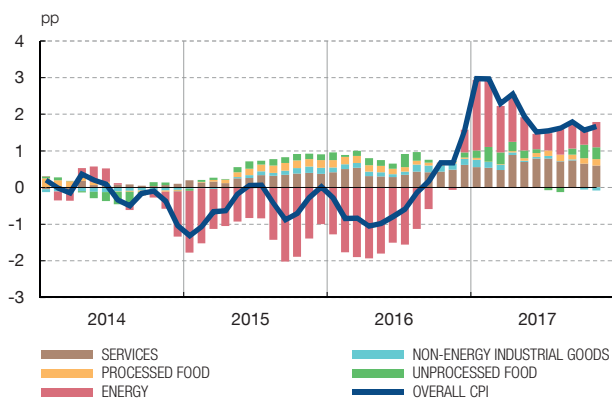
1 GDP DEFLATOR AND UNIT LABOUR COSTS (a)



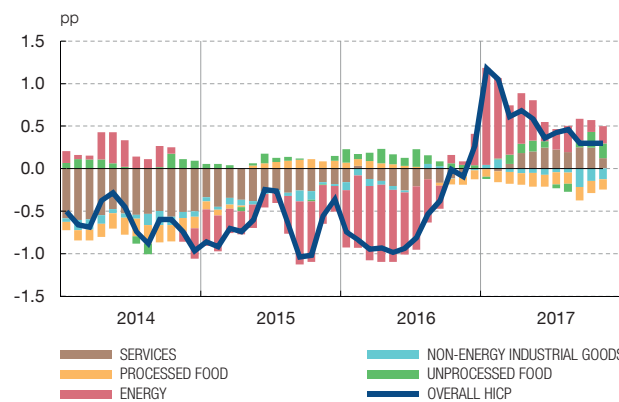
2 PRICE INDICATORS
Year-on-year rates



3 CONTRIBUTIONS TO YEAR-ON-YEAR CPI RATE



4 CONTRIBUTIONS TO SPAIN-EURO AREA HICP DIFFERENTIAL



SOURCES: INE, Eurostat and Banco de España.

a Year-on-year percentage change based on the seasonally adjusted series.



energy industrial goods and of services slowed, both by 0.1 pp, while the year-on-year rate of change of processed food prices increased by 0.2 pp, showing a similar acceleration to that of the previous month.

Finally, the year-on-year rate of change of the harmonised index of consumer prices (HICP) increased by 0.1 pp in November to 1.8%. The year-on-year inflation rate for the euro area as a whole rose by 0.1 pp to 1.5%. As a result, Spain's inflation differential with the euro area remained at 0.3 pp in November.

21.12.2017.