

Spain

Economic Outlook

1Q20

Key messages



/ **The way is paved for a stabilization of global growth** as a result of reduced trade tensions between the USA and China, less uncertainty about Brexit and the effect of monetary accommodation, although it is necessary to be attentive to the evolution of the tensions in the Middle East. Global GDP will grow by 3.2% in 2020 and 3.3% in 2021.



/ **The slowdown of the Spanish economy could stop in 2020.** GDP growth could slow down to 1.6% in 2020 from 1.9% in 2019 and show a moderate acceleration in 2021 to 1.9%, given the slight improvement expected in the European economy. Developments in domestic spending and the exports sector could have reached a turning point, while fiscal policy would be procyclical. Despite some existing imbalances, the Spanish economy is better prepared to face a potential environment of higher volatility.



/ **In any case, the bias on the economic scenario continues to be downward. Future developments will depend on the resolution of various sources of uncertainty and the policies to be implemented.**

Certain sectors continue to reflect negatively on the implementation of regulatory changes and the uncertainty about economic policy has not been reduced.



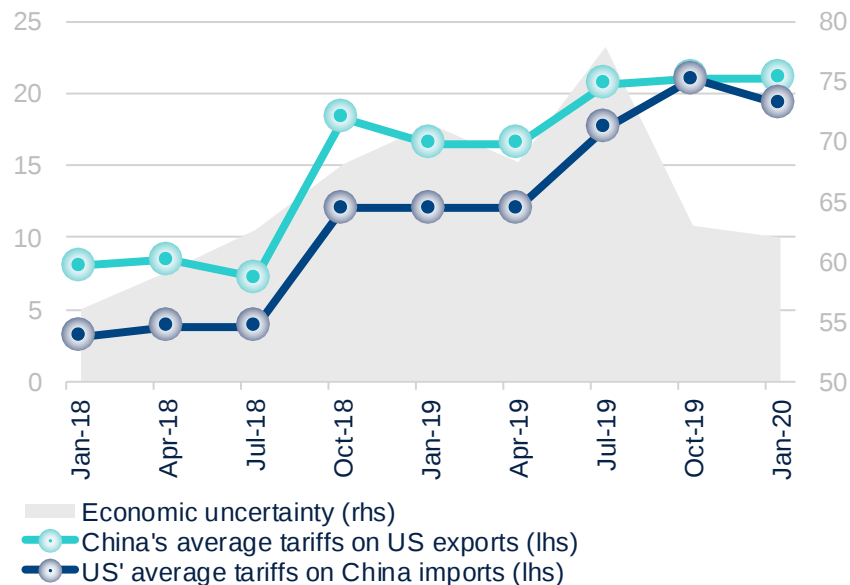
/ **The growth trend of the Spanish economy will be converging at significantly lower levels than those observed at the beginning of the century.** Reforms need to be implemented to increase growth capacity, fostering an investment-friendly environment and helping to reduce the main imbalances faced (public finances, unemployment, precariousness, inequality, climate change).

01

Global Economic Outlook 1Q20

The trade agreement between the USA and China significantly reduces uncertainty, but not protectionism

TARIFFS AND ECONOMIC UNCERTAINTY (*) (% AND INDEX BETWEEN 0 AND 100)



(*) Average tariffs at the beginning of each quarter. BBVA Research Index of Economic Uncertainty: The tone of press articles on economic uncertainty; quarterly average (except Mar-20: average up to January 9, 2020).

Source: BBVA Research, PIIE

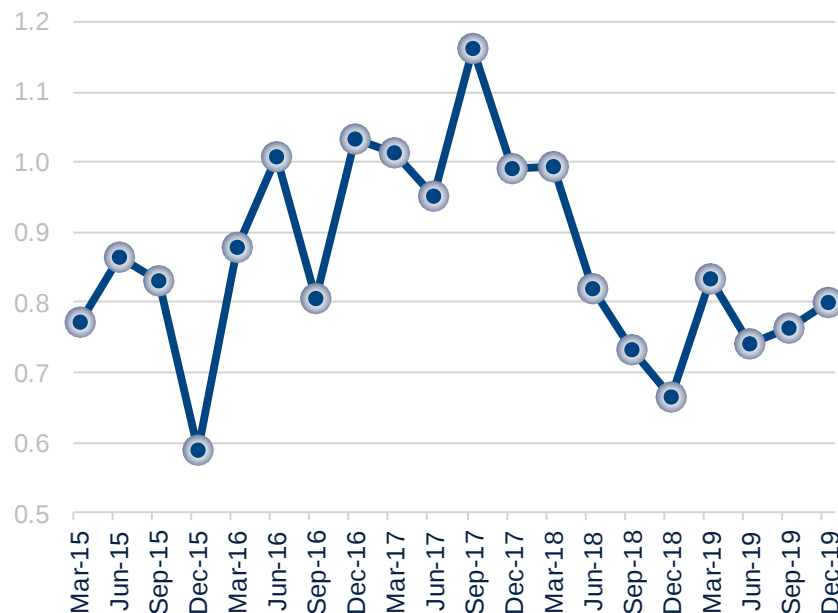
■ The first phase of the agreement between the USA and China is **positive** despite being limited:

- Tariffs on imports will remain high despite the announced reductions.
- We are still far from a definitive solution to the structural problems.

■ The risk of a short-term, disorderly Brexit **has disappeared**, which has helped to decrease global uncertainty, but this may re-emerge in the second half of the year.

Global growth has remained relatively low throughout 2019

GLOBAL GDP GROWTH * (% QoQ)



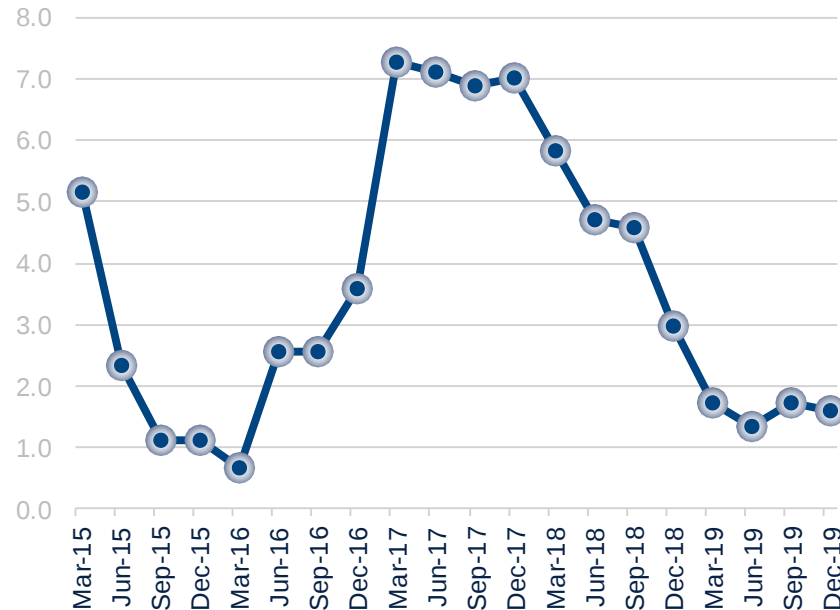
* Forecasts based on the BBVA-GAIN model.
Source: BBVA Research

- The global economy expanded at a quarterly rate of close to 0.8% in 2019, below the levels observed in previous years.
- As well as high levels of uncertainty there has been influence from China's structural moderation and the cyclical slowdown in the USA and the decrease in European growth.
- In any case, global growth was slightly higher than expected in the second half of the year.

There are signs of stabilization: the contraction in manufacturing and the slowdown in services and exports have decreased

EXPORTS*

(% YoY, AVERAGE ANNUAL GROWTH IN EACH QUARTER)

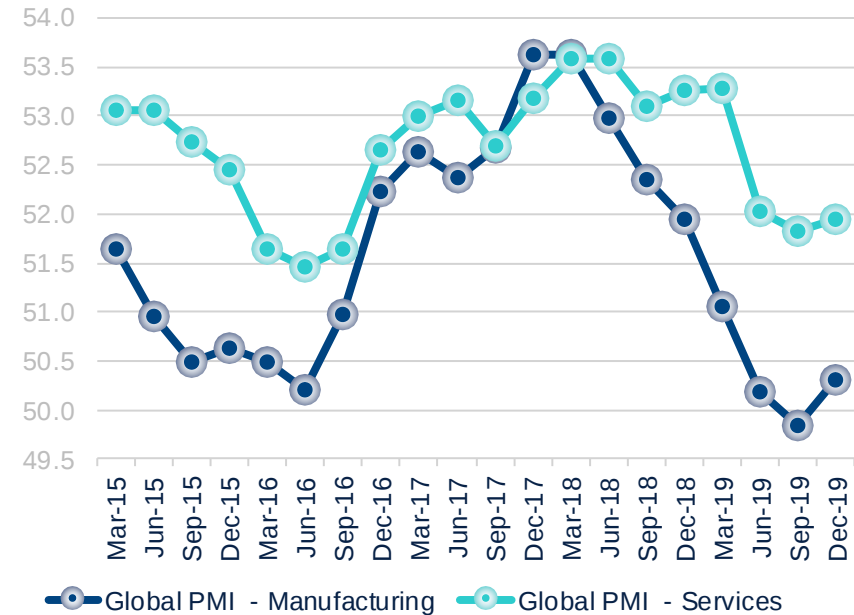


* For Dec-19, only data for October and November.

Source: BBVA Research

PMI INDICATORS FROM MANUFACTURES AND SERVICES

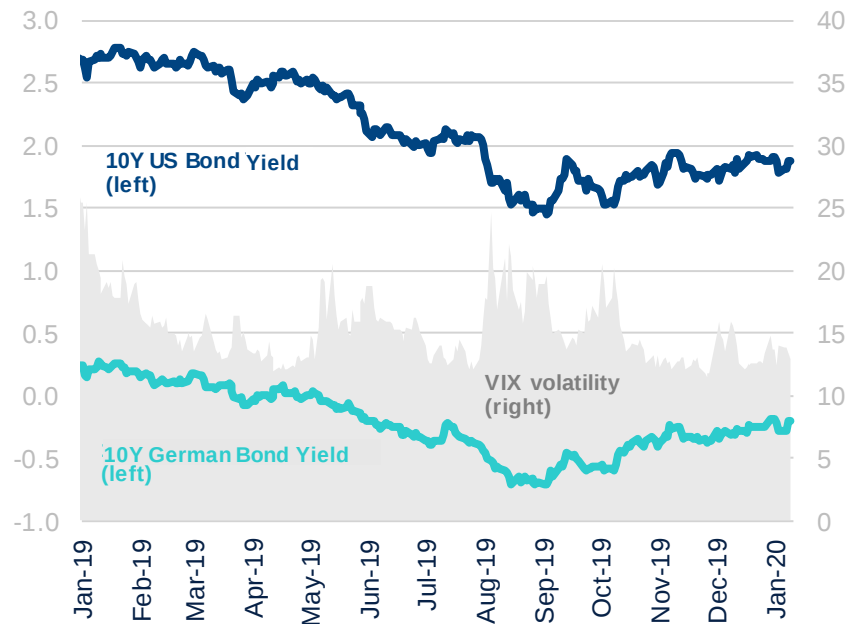
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



Source: BBVA Research based on data from Haver

Financial markets are showing again an improvement

SOVEREIGN DEBT YIELDS AND VOLATILITY (%, INDEX)



■ The perception that there is some improvement in the global environment has led to **greater optimism in the financial markets:**

- Reduced volatility
- Long-term rate recovery
- Improvement in the stock markets
- Increased risk appetite

The environment will favor a soft landing of global growth



TRADE TENSIONS: PAUSED

- **Agreement between the USA and China.**
- **Protectionism** will continue to be a concern in other regions as well. Attention to potential tensions between the USA and Europe.
- **A less** disruptive Brexit in the short term.



COUNTER-CYCLICAL POLICIES

- The expansionary tone of **monetary policy** will **remain**, following recent cuts in interest rates.
- **Fiscal stimulus** will be limited in Europe and somewhat higher in China.



LIMITED FINANCIAL VOLATILITY

- As a result of **central banks** action.
- A moderate **risk appetite**.

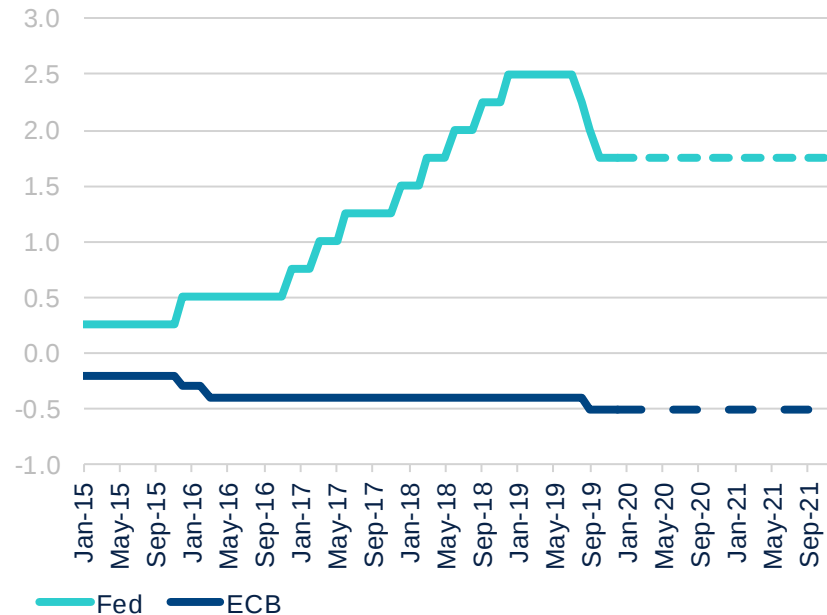


LIMITED COMMODITIES PRICES

- The price of **oil** will be moderated (USD 61 per barrel in 2020-21), if the risks in the Middle East do not materialize.
- The relative **weakness of demand** and the increase in supply in "non-OPEC" countries.

The pause at the Fed and the ECB: there are no prospects for an interest rate change on the horizon

FED & ECB: INTEREST RATES * (%, END OF PERIOD)



- Fed:** The relative resilience of the economy has improved the risk balance and created the conditions for a long monetary policy pause.
- ECB:** The stabilization of growth and the continuing signs of the new presidency reinforce expectations of interest rate stability.

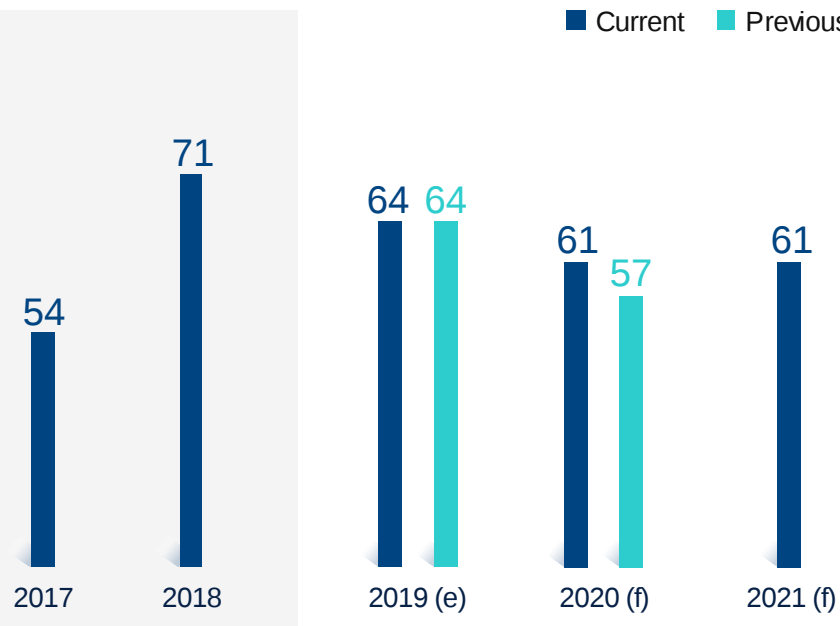
* Deposit interest rates in the case of the ECB. Forecast from Jan-20.
Source: BBVA Research

Oil: Prospects for price moderation, despite rising geopolitical tensions in the Middle East

PRICE OF OIL

(DOLLARS PER BARREL, ANNUAL AVERAGE)

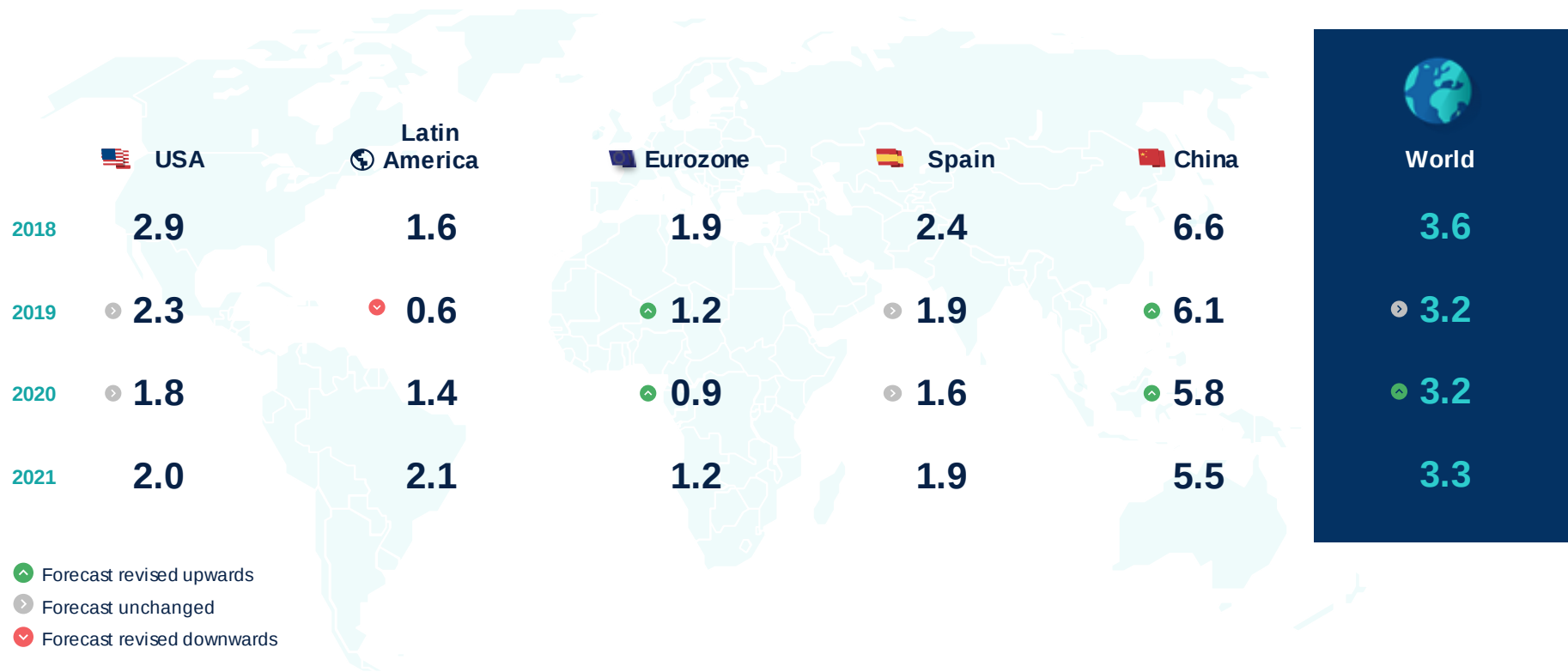
■ Current ■ Previous



(e) Estimate. (f) Forecast.
Source: BBVA Research

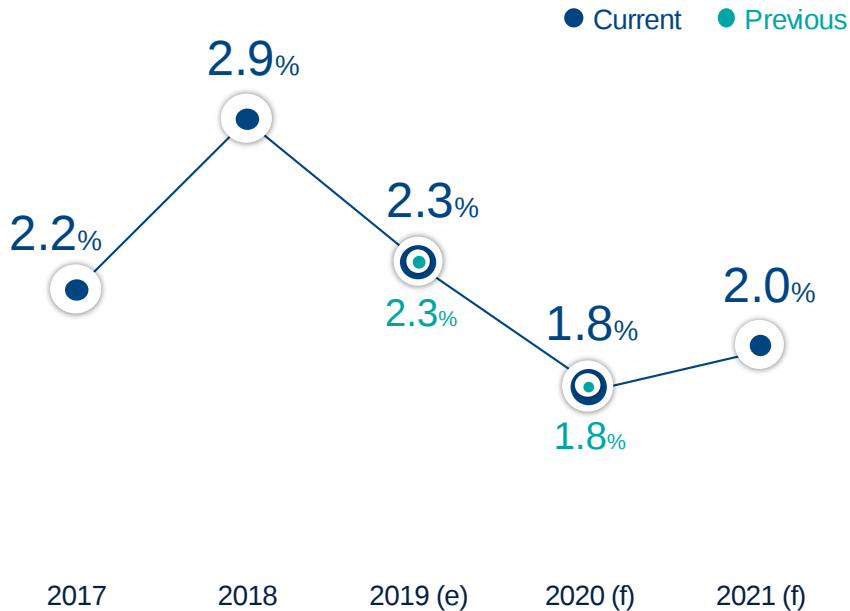
- Higher supply in “non-OPEC” countries in a context of lower demand supports the **viewpoint for price moderation**.
- The forecast for 2020 is adjusted upward by new OPEC production cuts.
- Escalating tensions in the Middle East pose a risk: the price of crude oil of 70 USD/bbl in 2020 could reduce global growth by one to two tenths, with Europe feeling the strongest impact.

Global growth will stabilize at 3.2% in 2020 and 3.3% in 2021



USA: prospects for mild growth moderation are maintained

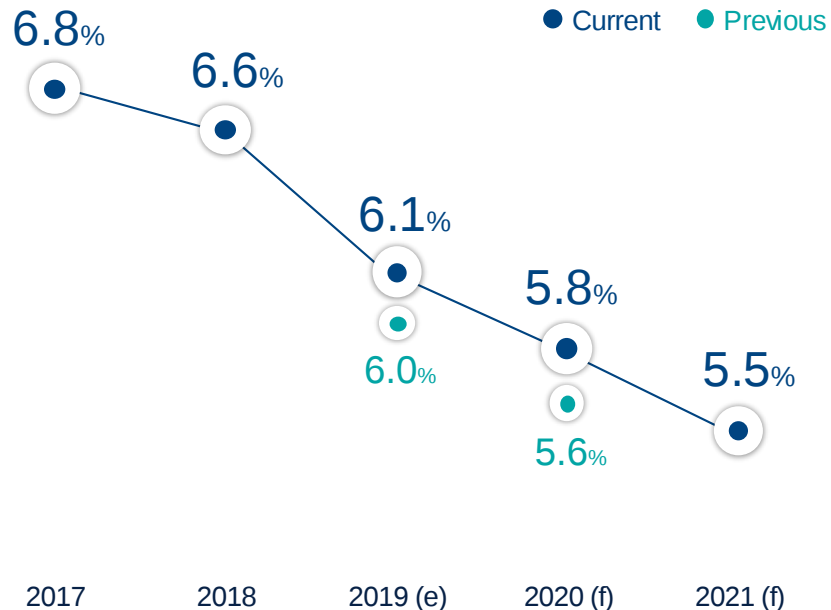
GDP GROWTH (%)



- Private consumption shows strength, but investment weakness is a concern.
- Inflation will remain close to 2.0%, with more balanced risk.
- Lower probability of recession.
- The 2020 presidential election can increase political and geopolitical tensions and even change the dynamics of economic policies.

China: a slowdown in growth, somewhat slower than expected

GDP GROWTH (%)

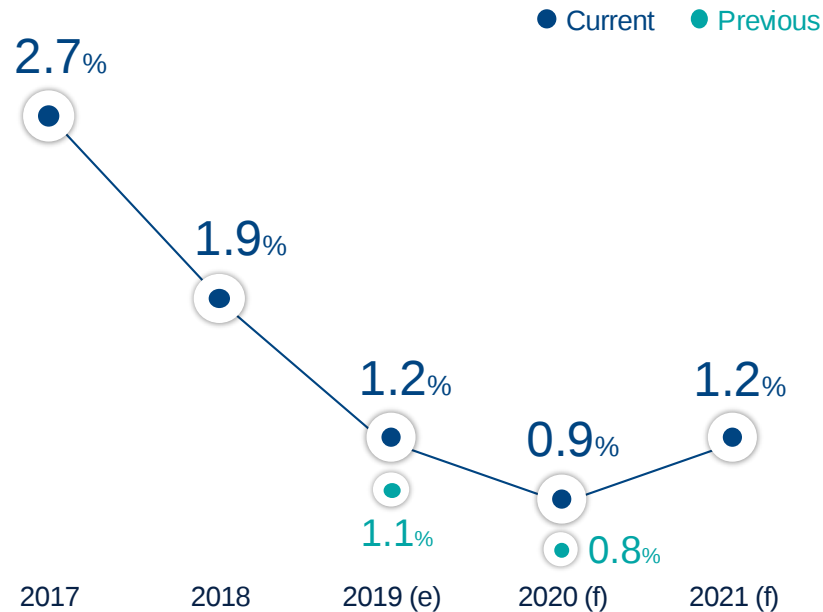


(e) Estimate. (f) Forecast.
Source: BBVA Research

- The **economy continues to moderate** widely.
- The forecast is revised upward for **2019**: the recent slowdown has been smoother than expected.
- A slight improvement in growth forecast for 2020:
 - An improvement in the tone of **relations with the USA**
 - A greater willingness to increase **fiscal stimulus**
- **Monetary stimulus**: Gradual progress in an environment of a (temporary) increase in inflation.

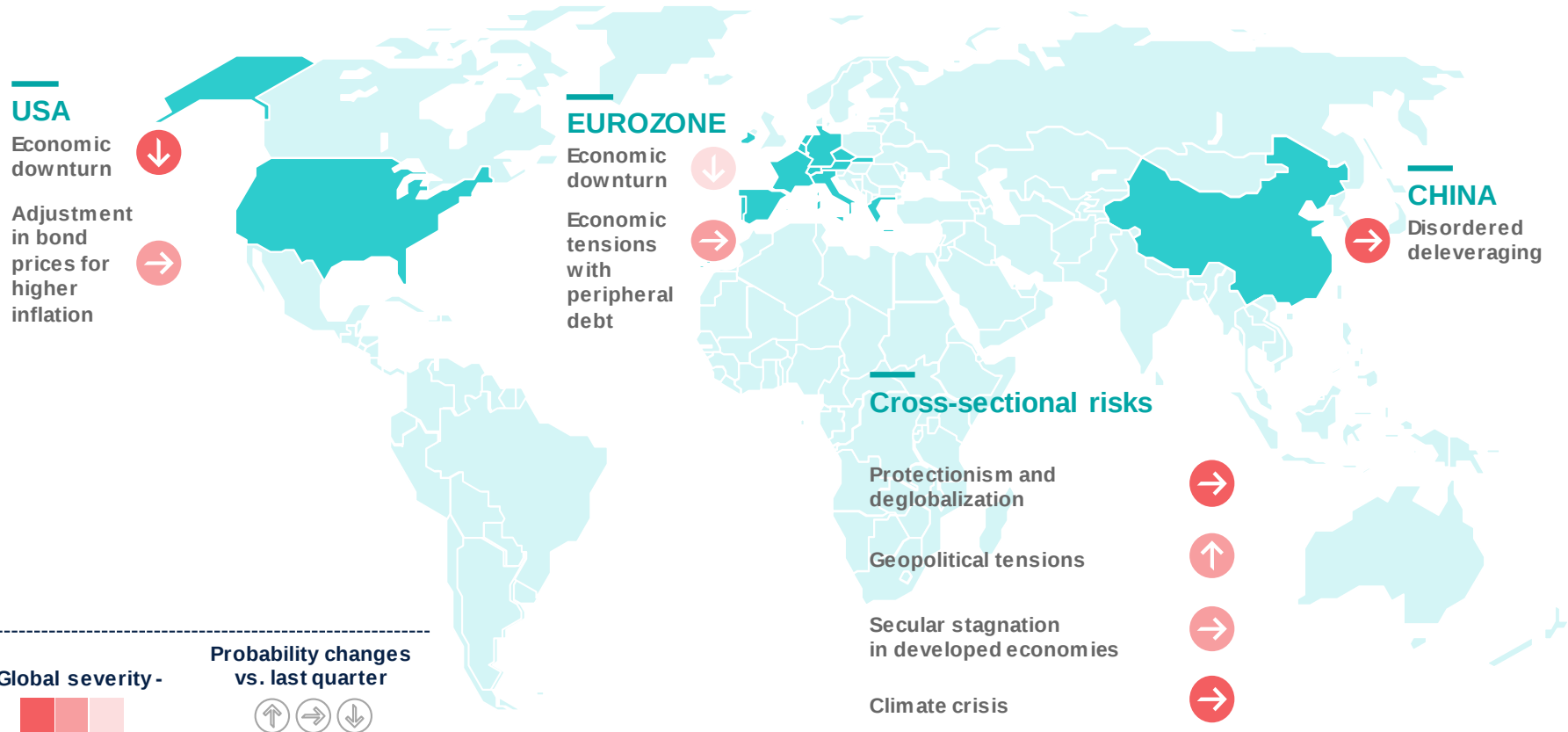
Eurozone: a slight upward revision of growth forecasts due to better than expected data

GDP GROWTH (%)



- Growth is **stabilizing** at low levels.
- Economic dynamism will increase from **mid-2020**, partly due to higher exports.
- The **divergence between the large countries** will decrease with higher growth in Germany.
- **Inflation** will remain too low, despite strong monetary stimulus and modest fiscal support.

Global risks: cyclical risks were reduced, but structural ones remained high



02

Spain
Economic Outlook
1Q20

The slowdown in activity growth could stop in 2020 and benefit from greater growth in Europe in 2021

GDP ›
SPAIN

2019

1.9%



2020

1.6%



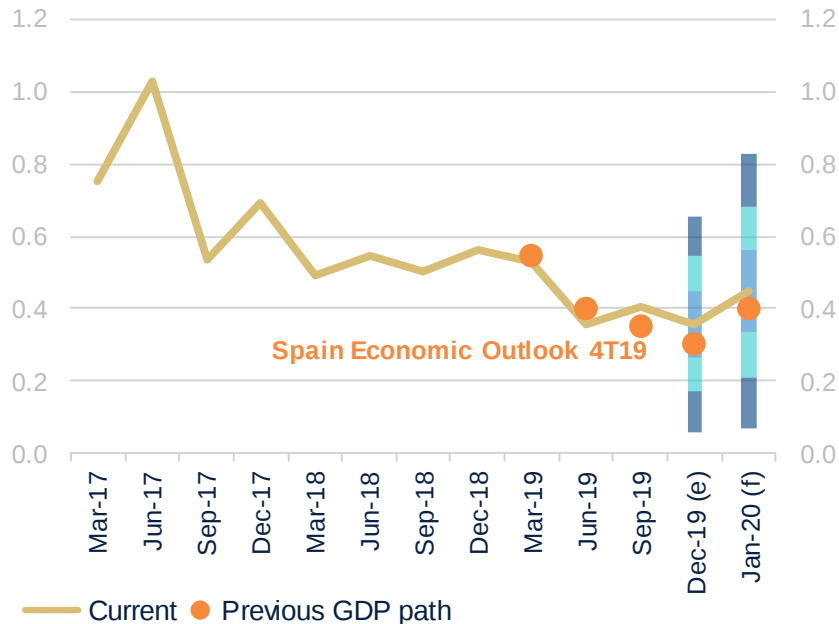
2021

1.9%

The slowdown in activity could be bottoming out

GDP growth stabilizes

SPAIN: GDP GROWTH (% QOQ, SWDA)



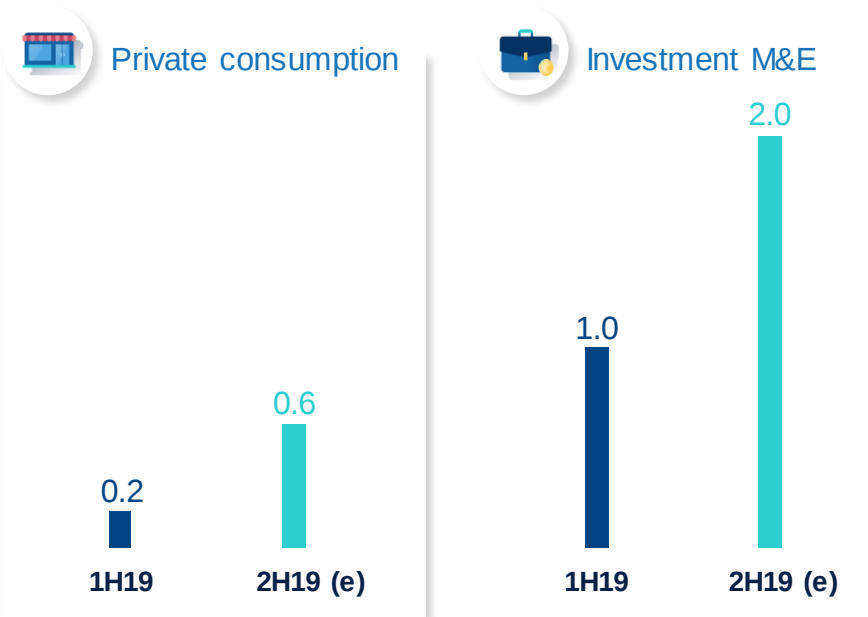
(e) Estimate. (f) Forecast.
Source: BBVA Research, based on national sources

- The economy's loss of traction in 2H19 (0.4% QoQ) was less severe than expected three months ago. The INE's downward revision in 1H19 cancels out the improvement in performance in 2H19.
- Furthermore, the growth rate is expected to remain the same at the start of 2020 (forecast: around 0,4% QoQ).
- The sluggishness of the labor market could be coming to an end. If we exclude variations due to seasonal factors, Social Security affiliation increased 0.4% QoQ in 4Q19, in line with the third quarter.

The slowdown in activity could be bottoming out

1. Limited impact of uncertainty on demand

SPAIN: PRIVATE CONSUMPTION AND INVESTMENT (%, AVG QOQ SWDA)

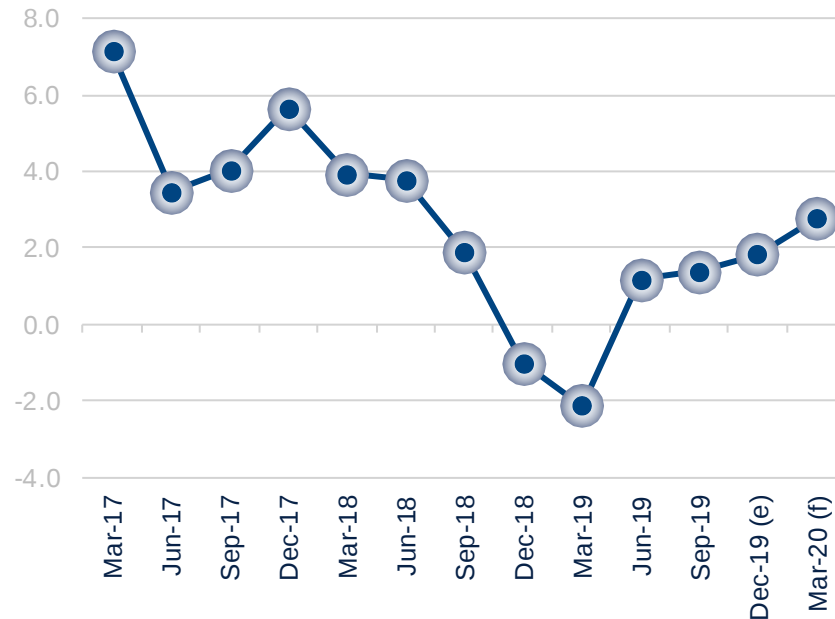


- Household consumption seems to have moved forward from the weakness shown in the first semester.
- The increase in precautionary saving would have been partially reversed, in the context of an increase in income and wealth and low interest rates.
- Investment in machinery and equipment would have accelerated in the last six months, in a particularly complicated environment.

The slowdown in activity could be bottoming out

2. The export sector shows a turning point

SPAIN: EXPORTS OF GOODS (% YOY)

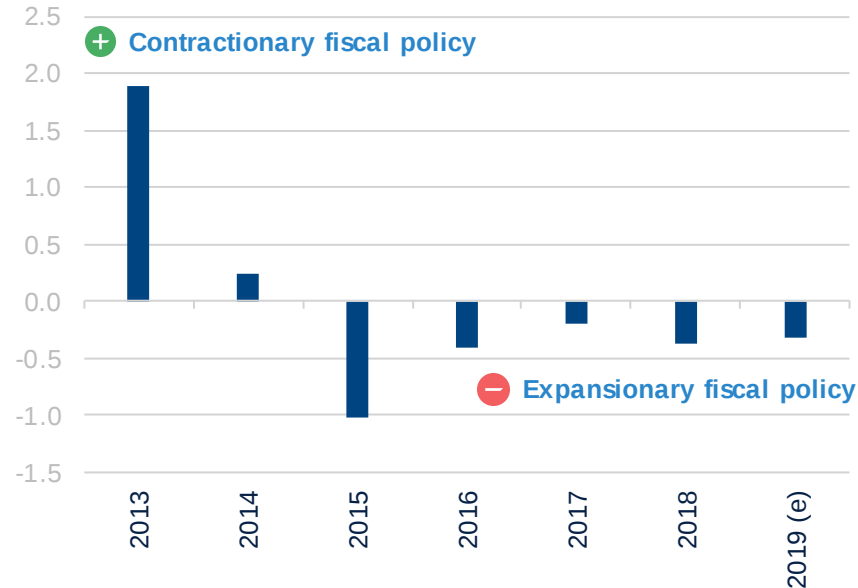


- Preliminary data from the fourth quarter points to a slight increase in the sale of goods abroad.
- Similarly, exports of services would be resuming a positive growth path, albeit below the trend observed in recent years.
- The positive trend of investment in machinery and equipment, together with the emerging stabilization in international trade, are considered to be behind this dynamic.

The slowdown in activity could be bottoming out

3. Five consecutive years of procyclical and expansionary fiscal policy

SPAIN: CHANGES IN THE GOVERNMENT PRIMARY BALANCE ADJUSTED TO THE CYCLE (PP OF GDP)



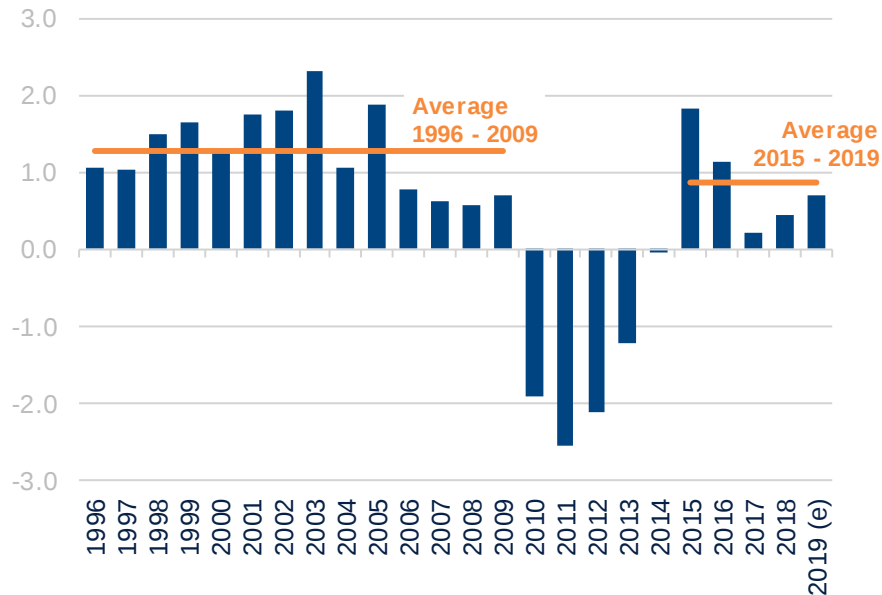
(e) Estimate.
Source: BBVA Research based on Ministry of the Treasury and INE data

- Growth in domestic demand has been supported particularly by an **increase in public consumption and transfers**.
- This year, once again, the space provided by the economic recovery and interest rate reduction has been used to implement an **expansive fiscal policy**.
- While **this is bad news in terms of the objectives** of reducing the imbalance in public accounts, **in the short term, it is a pillar of support** for growth in domestic demand.

Factors that support a better growth environment

1. The positive differential with Europe remains

**YEAR ON YEAR GDP GROWTH DIFFERENTIAL
IN SPAIN VERSUS EUROPE**
(PP, AVERAGE PER YEAR)

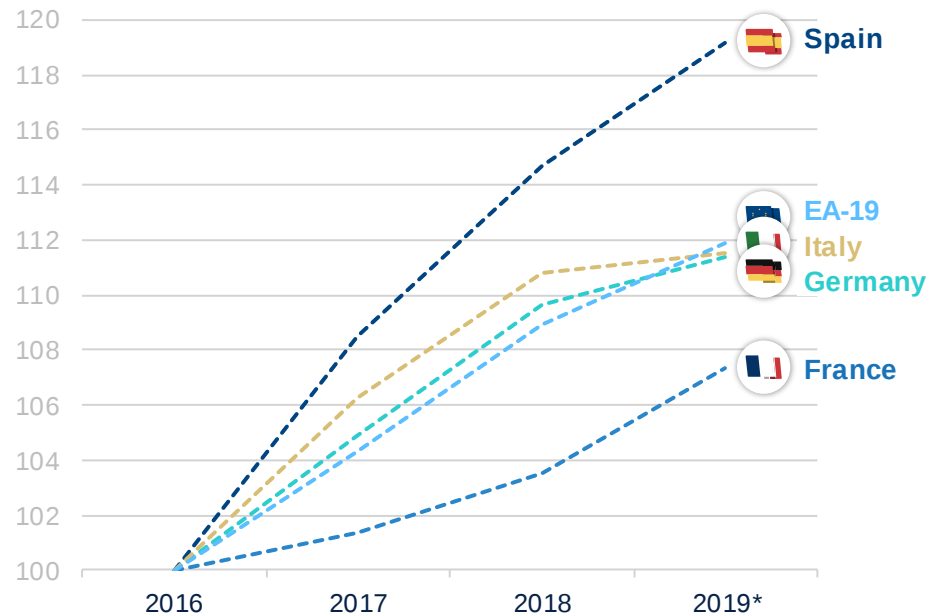


- During the current slowdown, Spain has maintained a positive differential with respect to the European economy.
- In an environment of deceleration, Spain has managed to maintain its position as a powerhouse in the Eurozone and not a hindrance.
- It is estimated that for each percentage point of GDP acceleration in the eurozone, the Spanish GDP would increase by the same proportion.

Factors that support a better growth environment

2. The impact of reforms

INVESTMENT IN MACHINERY AND EQUIPMENT (ACTUAL INDEX 2016=100)



* Data up to 3Q19.

Source: BBVA Research based on Eurostat and INE data

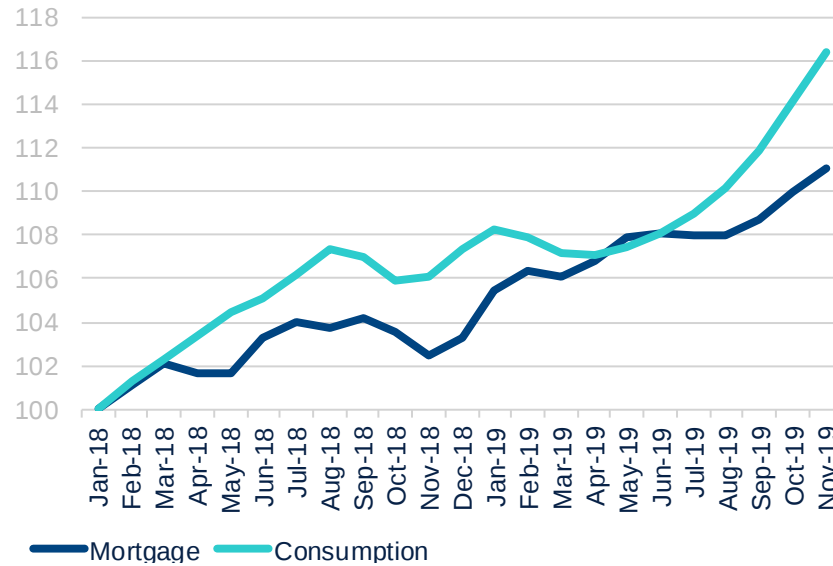
- Investment in machinery and equipment in Spain has shown **greater dynamism** than in the major European economies.
- Since 2016, this type of investment has increased by 19.2%, compared to 11.9% in the EA-19, **in an environment of high uncertainty**.
- It is important to maintain a climate that continues to encourage growth in **investment**. Evaluating the reforms that have been implemented and retaining the most positive aspects of these reforms should be a priority.

Factors that support a better growth environment

3. The impulse of monetary policy

SPAIN: NEW FAMILY CREDIT OPERATIONS

(TREND, JAN18=100)

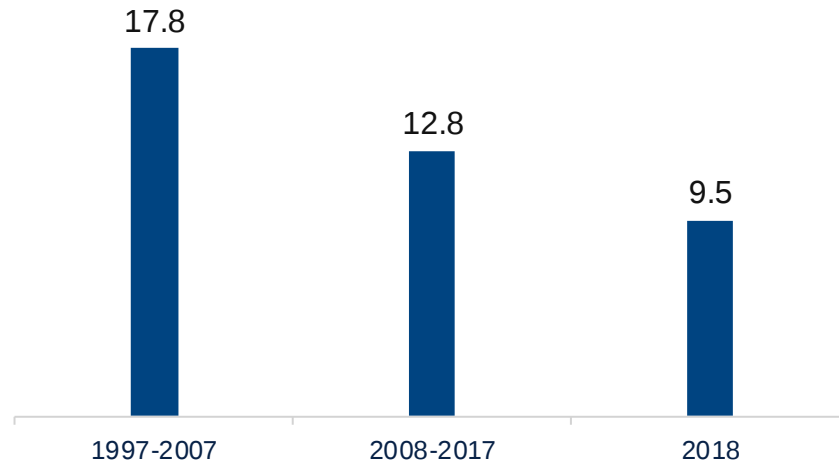


- After a period of high uncertainty, there is a **perceived normalization in the growth of flows of new credit** to families.
- Looking ahead, the environment of low rates, high liquidity and competition in the banking market is expected **to continue to boost financing**.

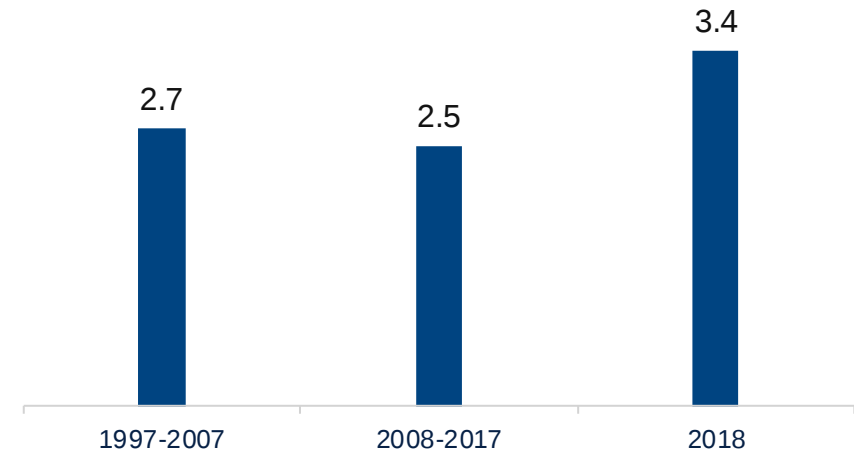
Factors that support a better growth environment

4. Adjustments made by families and companies

CREDITS/ASSETS OF THE TYPICAL SPANISH FIRM
(AVERAGE PER PERIOD AND YEAR-END 2018, %)



ROA OF THE TYPICAL SPANISH FIRM*** (AVERAGE PER PERIOD AND YEAR-END 2018, %)



*The typical Spanish company is represented by the statistical median of the ratios.

** ROA: Return on assets

Source: BBVA Research based on SABI data.

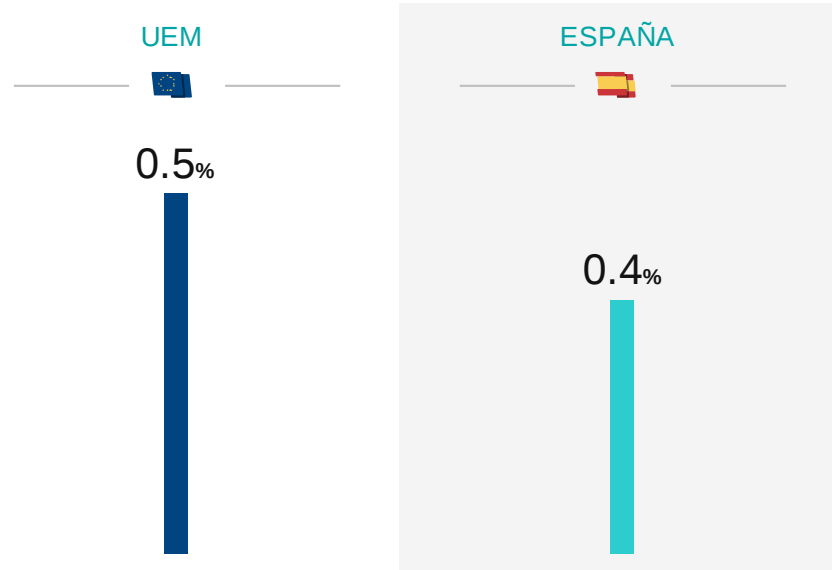
Today, the financial position of families and businesses, particularly SMEs, is more robust and they are better prepared to face an environment of higher uncertainty.

The future will depend on the solution of the key sources of uncertainty

1. Related to the global environment

WEIGHT OF EXPORTS OF GOODS SUBJECT TO INCREASED US TARIFFS

(AVERAGE 2016 -2018, % OF TOTAL)

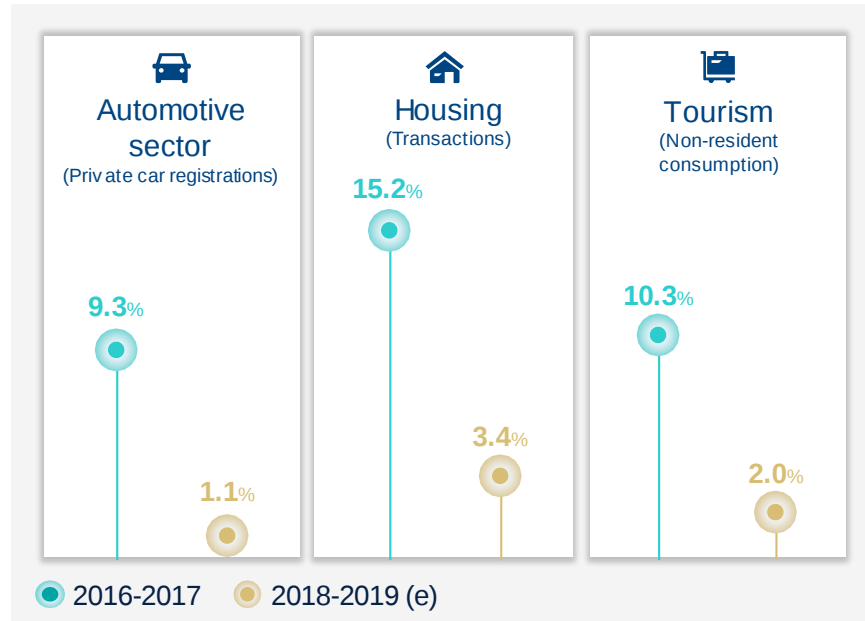


- Exports of goods exposed to increased tariffs from the USA have a **marginal influence in both the EMU and Spain.**
- In any case, **uncertainty remains** over measures that may affect strategic sectors such as the **automobile sector in the future.**
- Doubts also remain over the **details of the final deal for the departure of the United Kingdom** from the European Union.

The future will depend on the solution of the key sources of uncertainty

2. Related to certain productive sectors

SPAIN: EVOLUTION OF DEMAND IN SELECTED SECTORS (AVERAGE YEAR-ON-YEAR GROWTH)

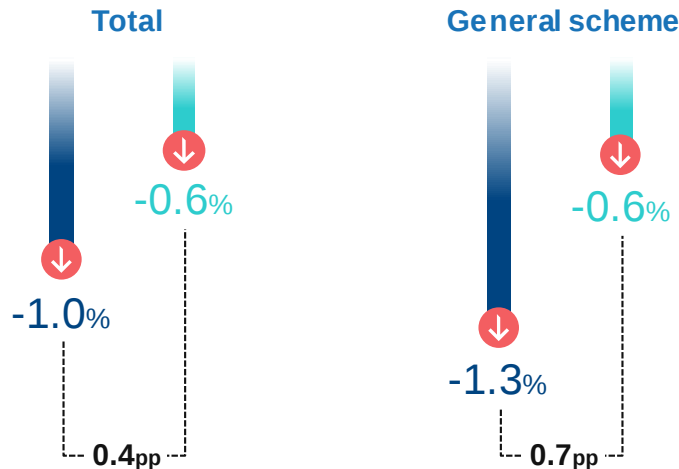


- The uncertainty is particularly affecting some sectors that have undergone regulatory changes, such as the automotive and real estate sectors.
- Tourism suffers from depletion as a result of:
 - the slowdown in the growth of the economies of the main countries of origin, and
 - the recovery of alternative destinations that have been affected in the past by geopolitical tensions.
- So far, contagion to other sectors has been limited.

The future will depend on the solution of the key sources of uncertainty

2. Related to certain productive sectors

SOCIAL SECURITY REGISTRATION: DIFFERENCE BETWEEN THE VARIATION IN 2019 AND THE AVERAGE FOR 2017-2018 (PP)



■ Groups with the highest incidence of SMI* ■ Other

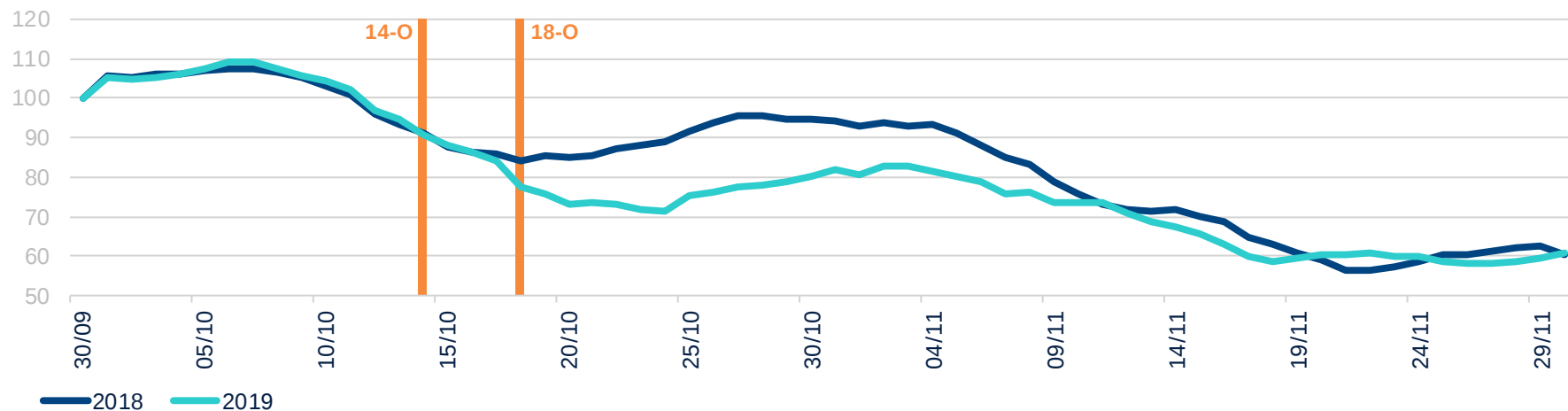
* People under the age of 30.
 Trade, hospitality, real estate activities, professional, administrative and artistic activities and other services.
 Canary Islands, Extremadura, Andalusia and Murcia.
 Source: BBVA Research based on MITRAMISS data.

- The Social Security affiliation in the groups with the highest legal minimum wage (SMI) coverage has increased by between one and four tenths more in 2019 in the absence of an increase in the SMI (up to 45,000 contributors).
- A detailed analysis of the costs and benefits of recent changes in the housing sector and the increases in the SMI should guide future actions.

The future will depend on the solution of the key sources of uncertainty

3. Related to tensions in Catalonia

CATALONIA: SPENDING AT BBVA'S POINT-OF-SALE TERMINALS WITH FOREIGN CARDS (LAST WEEK OF SEPTEMBER OF EACH YEAR = 100, WEEKLY MOVING AVERAGE)



Note: Spending at BBVA POS terminals by customers and non-customers of BBVA plus spending by BBVA customers at non-BBVA POS terminals Data up to November 30, 2019.

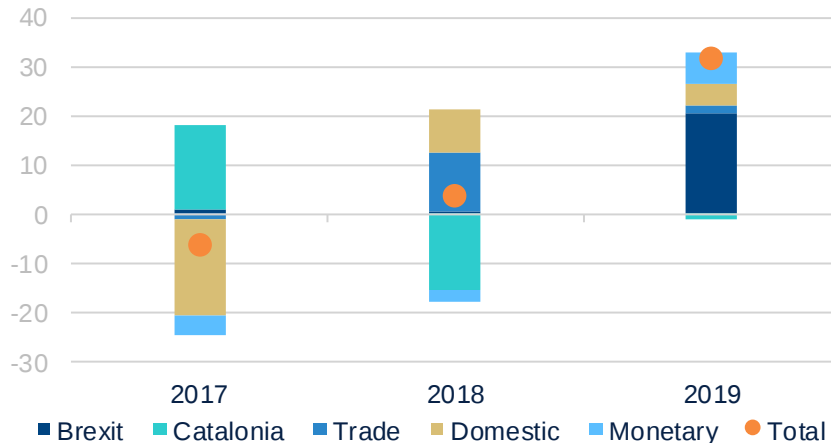
Source: BBVA Research based on Redshift data

A negative impact of the tensions in Catalonia, but limited and temporary. The trend change in the evolution of the Catalan economy since 2H17 has been a hindrance on growth in Spain as a whole.

The future will depend on the solution of the key sources of uncertainty

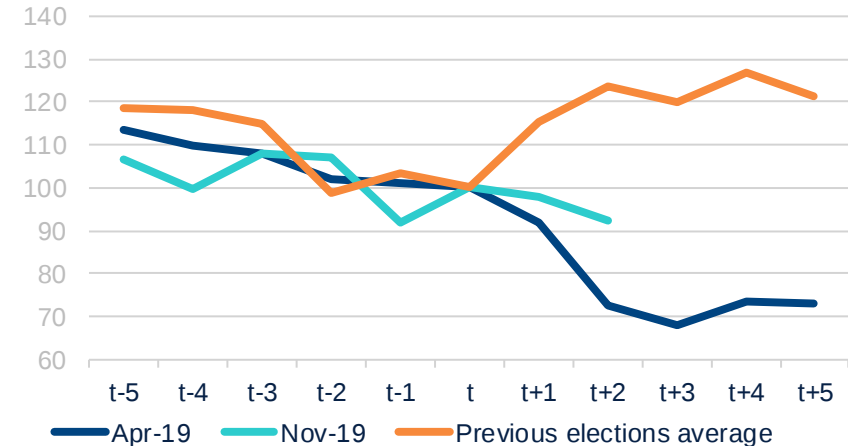
4. Related to uncertainty over economic policy

**SPAIN: INDEX OF ECONOMIC POLICY
UNCERTAINTY AND DECOMPOSITION**
(ANNUAL VARIATION, INDEX POINTS)



Source: BBVA Research based on press articles

SPAIN: RISK PREMIUM
(AVERAGE T: MAY-15, DEC-15, APR-18;
APR-19 = 100 AND NOV-19 = 100)



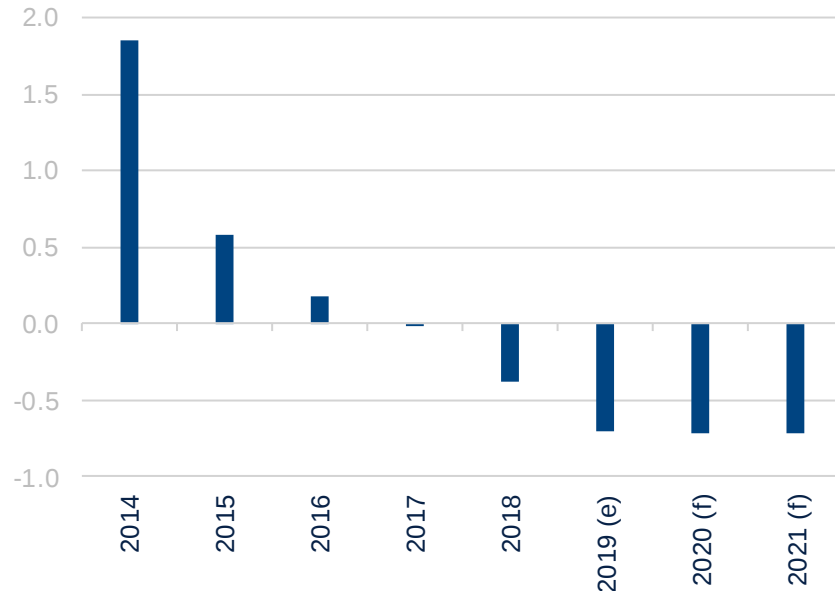
t: month of election: May-15, Dec-15 and Apr-18.
Source: BBVA Research based on Bloomberg data

While Brexit explains the surge in uncertainty in 2019 as a whole, **the domestic component has increased in the last months of the year**. However, **there is a disconnect** with the perception of the markets. This situation must be exploited to reduce the vulnerability of the Spanish economy.

The future will depend on the solution of the key sources of uncertainty

4. Related to uncertainty over economic policy

SPAIN: THE GOVERNMENT PRIMARILY BALANCE ADJUSTED TO THE CYCLE (% OF GDP)



(e) Estimate. (f) Forecast.
Source: BBVA Research based on Ministry of the Treasury and INE data

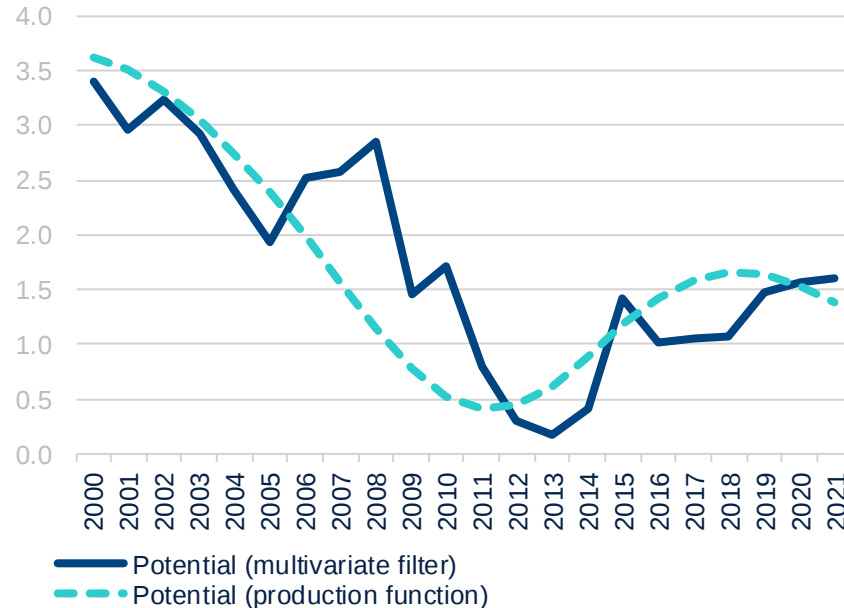
- **The starting point is not the best:** in 2019 the deficit reduction would have been almost zero, despite the recovery and low interest rates.
- **We need to move toward an efficient imposition** that limits the negative effects on growth, innovation and employment and offers certainty on revenue collection capacity.
- Furthermore, it should encourage savings and investment, considering intergenerational fairness, and not endanger the competitiveness of companies, in general, or of certain sectors, in particular.

To promote reforms that efficiently tackle the major challenges

The need to raise potential growth

SPAIN: POTENTIAL GDP ESTIMATES

(% YOY CHANGE)

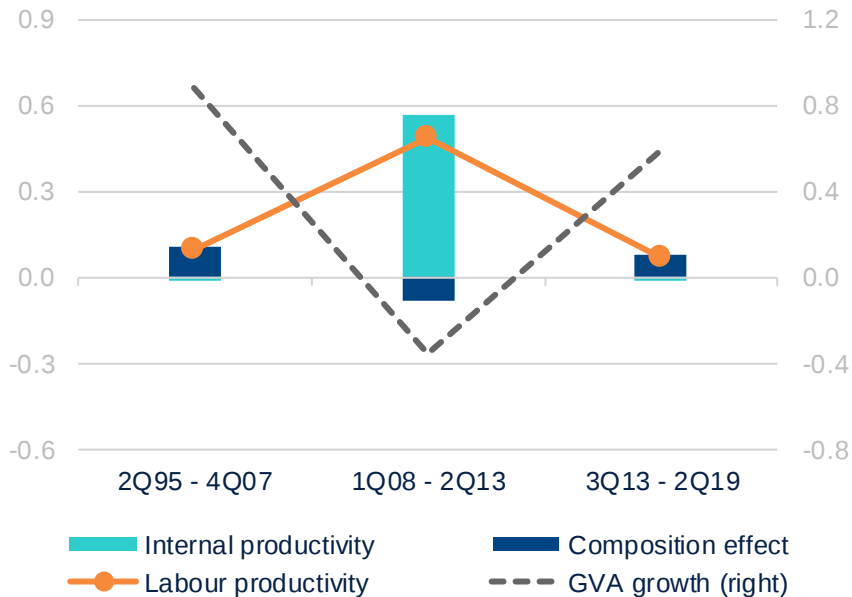


- The trend growth of the Spanish economy would be converging at significantly lower levels than those observed at the beginning of the century.
- Unemployment and the use of temporary contracts remain structurally high, which has a particularly negative effect on inequality.
- The aging population will be a major challenge for activity over the next few years.

To promote reforms that efficiently tackle the major challenges

The lack of growth in productivity in Spain

SPAIN: BREAKDOWN OF QUARTERLY LABOR PRODUCTIVITY GROWTH
(AVERAGE OF EACH PERIOD, PP AND %)



- Recent growth in labor productivity is **anaemic**, despite the structural reforms carried out at the beginning of the recovery period.
- This development is in line with the **counter-cyclical behavior**, which has been observed since the mid 1990s and responds largely to deficiencies in the labor market.
- New measures need to be implemented** to facilitate flexicurity, improve training, help business growth, and promote efficient resource allocation.

03

Forecasts

Forecasts

The recovery will continue, although the slowdown will be consolidated

% YoY	2018	2019 (e)	2020 (f)	2021 (f)
National Final Consumption Expenditure	1.9	1.4	1.5	1.6
Private consumption	1.8	1.2	1.4	1.6
Public consumption	1.9	2.2	1.7	1.8
Gross Fixed Capital Formation	5.3	2.7	2.6	4.5
Equipment and Machinery	5.7	3.9	3.2	5.1
Construction	6.6	1.7	1.4	3.8
Housing	7.7	2.6	2.4	5.0
Domestic demand*	2.6	1.7	1.7	2.1
Exports	2.2	2.0	2.6	3.4
Exports of goods	2.1	0.5	2.5	3.7
Exports of services	2.3	5.3	2.9	2.7
Final consumption of non-residents in Spain	1.7	3.1	1.7	2.0
Imports	3.3	1.6	3.0	4.5
External demand *	-0.3	0.2	-0.1	-0.3
Real GDP at market prices	2.4	1.9	1.6	1.9

* Contribution to GDP growth (e) Estimate. (f) Forecast.
Source: BBVA Research based on INE and BdE data

Forecasts

The recovery will continue, although the slowdown will be consolidated

% YoY	2018	2019 (e)	2020 (f)	2021 (f)
Employment (full-time equivalent) based on Quarterly National Accounts	2.5	2.1	1.4	1.6
Employment, based on Labor Force Survey	2.7	2.1	1.4	1.7
Unemployment rate (% of labor force)	15.3	14.2	13.5	12.5
CPI (annual average)	1.7	0.7	1.0	1.5
GDP deflator	1.1	1.4	1.0	1.7
Public Deficit (% GDP)	-2.5	-2.4	-2.2	-2.0
Current account (% GDP)	1.8	1.7	1.2	0.9