Spain’s economic growth beats expectations

Ángel Laborda and María Jesús Fernández[1]

Over the last few months, the main challenges facing the international economy include: weakness in the European economy, the loss of dynamism in emerging markets, and risks to global stability posed by upcoming U.S. interest rate hikes and the situation in Greece. In Spain, the recovery is exceeding expectations, but is highly vulnerable to market instability and the long-run growth outlook remains subdued.

Since the start of the recovery, the Spanish economy has outperformed expectations with its unexpected vigour, leading to constant upward revisions of growth forecasts by public and private institutions. In the first quarter of 2015, the economy grew by 3.8% quarter-on-quarter (on an annualised basis) and economic indicators suggest that there has been an acceleration in the second quarter. Over the coming quarters, a progressive slowdown is expected as the effects of various external shocks wear off. Nevertheless, Funcas has revised upwards its forecasts for 2015 and 2016. Furthermore, the Spanish economy still remains highly vulnerable to episodes of financial market tensions due to its high level of indebtedness. Above all, in the long-term, growth is expected to remain more moderate.

International context

Over the last few months, the international economy could be characterized mainly by the European economy’s weakness, emerging economies’ loss of dynamism, and the uncertainties and risks to global financial stability posed by rising interest rates in the United States and the situation in Greece.

The U.S. economy contracted by 0.2% on an annualised rate in the first quarter of the year, but this negative performance is assumed to be the result of bad weather during the winter and a strike by port workers, and even weaknesses in the way the national accounts are prepared. Nevertheless, the main economic indicators, such as the industrial production index, PMI, orders, and retail sales, all show signs of weakening since the start of the year. Moreover, average job creation over the first five months of 2015 has been lower than that seen throughout most of 2014. All this has delayed the expected interest rate hike by the Federal Reserve.

China grew at just 7% on a year-on-year basis in the first quarter, its lowest rate in the last seven years. As regards the other emerging economies, the outlook for Brazil, Turkey and Russia has deteriorated markedly. Brazil and Turkey are

[1] Economic Trends and Statistics Department, FUNCAS.

particularly vulnerable to any events that might destabilise the international financial markets, as a result of their macroeconomic instability and current account deficits. Russia is suffering from the impact of the drop in the oil price and international sanctions. As a result, these countries´ currencies have depreciated by 20%-30% against the dollar over the last year.

The eurozone increased momentum somewhat in the first quarter of the year, but its growth remains weak, at 1.6%, and the forecasts for the year as a whole are for growth of a mere 1.5%. Recent months have been marked by the uncertainty caused by the lack of progress on negotiations between the European institutions and the IMF, on the one side, and Greece on the other, in order to release the latest tranche of financial aid to the country. The fear of Greece's possible exit from the euro has increased financial market tensions, leading to capital flight to safer destinations, which has pushed up risk premiums and debt yields in peripheral countries, including Spain.

The fear of Greece's possible exit from the euro has increased financial market tensions, leading to capital flight, which has pushed up risk premiums and debt yields in peripheral countries, including Spain.

Recent developments in the Spanish economy

Spanish GDP grew by 0.9% in the first quarter of 2015 relative to the preceding quarter, equivalent to 3.8% on an annualised basis (the basis on which all growth rates below will be expressed). Growth relative to the same quarter one year earlier was 2.7%. The contribution of domestic demand to annualised quarterly growth was 3.4 percentage points (pp), while the external sector's contribution was 0.4 pp, making two consecutive quarters of positive growth.

Private consumption growth slackened in the first quarter after the high growth rates registered in the preceding quarters, which were comparable to those observed before the crisis. At the start of the second quarter, retail sales continued their strong growth, as did new vehicle registrations, although the pace was more moderate. The consumer confidence index continued its upward trend, reaching its maximum since 2000. The retail trade confidence indicator also rose, reaching its highest level on record. Taken together, all this suggests that the rapid pace of growth in this component of demand will continue in the second quarter of the year (Exhibits 1.1 and 1.2).

Public consumption recovered in real terms after three quarters in negative territory. Growth in nominal terms was 24.6%, which partly resulted from the reinstatement of public-sector employees' extraordinary pay, which was eliminated in December 2012.

Investments in capital goods and other products grew by 4% in the first quarter. At the start of the second quarter, the growth in registrations of goods vehicles slowed somewhat, although it remained strong, while the order book for capital goods improved considerably in April and May (Exhibits 1.3 and 1.4). In the case of construction investment, housing investment growth slowed, while investment in other construction intensified. The recovery in the property market continues, as is indicated by increased housing sales and rising prices. According to the INE's housing price indicator, prices rose by 1.5%, year-on-year in the first quarter, although the Ministry of Public Works' price indicator suggests more of a stabilisation.

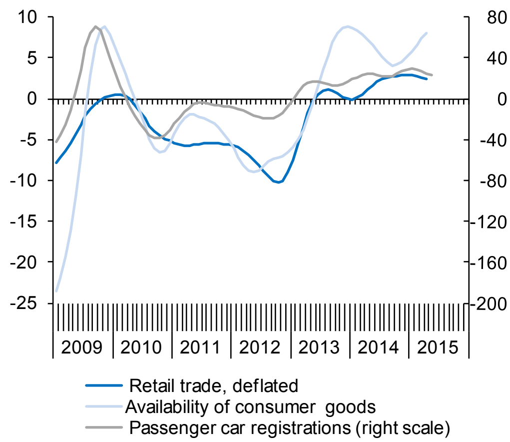
Although goods exports declined, total exports were up by 1% due to strong growth in non-tourism services. This exceptional situation made it possible for the external sector's contribution to quarterly GDP growth to turn positive in the first quarter. However, this was an anomaly and should not be interpreted as a sign of change in the imbalanced pattern of contributions to growth of domestic demand and the external sector that has been habitual since the start of the recovery.

Exhibit 1

Consumption and capital goods investment indicators

1.1 - Consumption indicators (I)

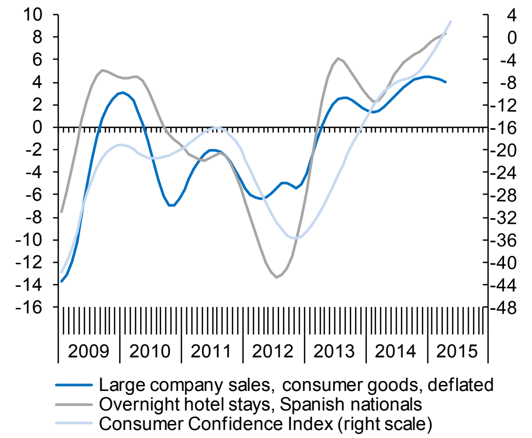
Annualised moving quarterly change in %, smoothed series



Sources: Ministry of Economy, INE, DGT and FUNCAS.

1.2 - Consumption indicators (II)

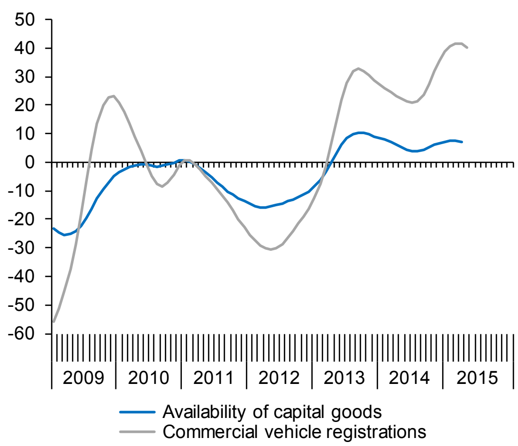
Annualised moving quarterly change in % and index (CCI), smoothed series



Sources: European Commission, INE, AEAT and FUNCAS.

1.3 - Capital goods GFCF indicators (I)

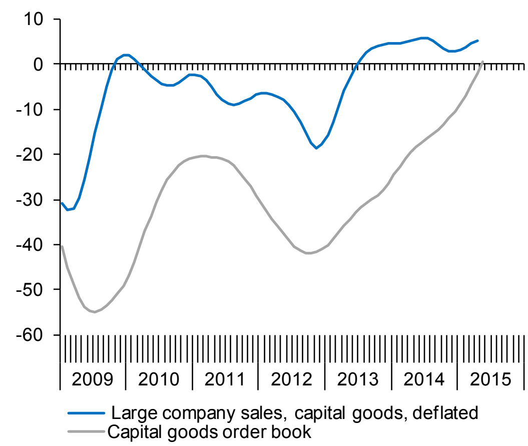
Annualised moving quarterly change in %, smoothed series



Sources: Ministry of Economy, DGT and FUNCAS.

1.4 - Capital goods GFCF indicators (II)

Annualised moving quarterly change in %, smoothed series



Sources: Ministry of Industry, AEAT and FUNCAS.

Imports registered growth, although in the case of goods imports, this growth was less than expected. The April customs data on external trade in goods indicate a trend towards faster growth in imports than exports (Exhibit 3.1).

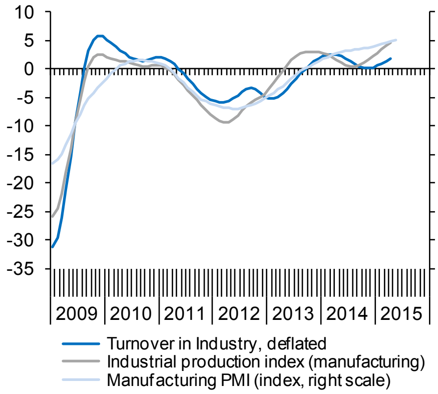
On the supply side, Gross Value Added (VAB) grew in all sectors. The biggest growth was in manufacturing, followed by the construction industry and services. As regards the industrial activity indicators available for the second quarter, the April

Exhibit 2

Industrial activity, services and construction indicators

2.1 - Industrial sector indicators (I)

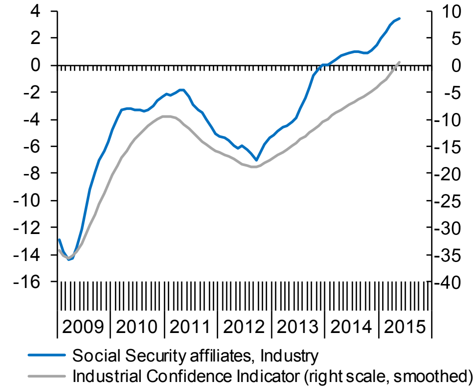
Annualised moving quarterly change in % and index, smoothed series



Sources: INE, Markit Economics Ltd. and FUNCAS.

2.2 - Industrial sector indicators (II)

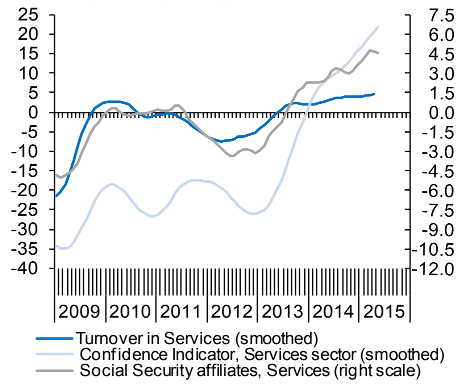
Annualised moving quarterly change in % and index



Sources: European Commission, Ministry of Labour and FUNCAS.

2.3 - Services indicators (I)

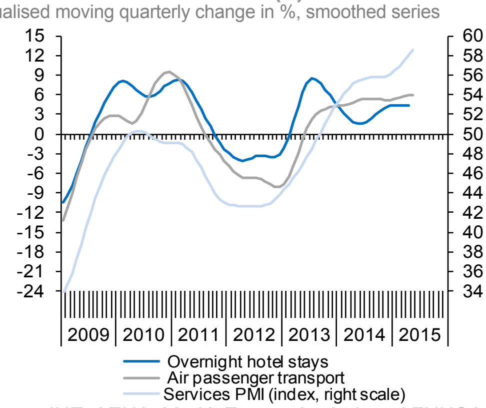
Annualised moving quarterly change in % and index



Sources: European Commission, Ministry of Labour, INE and FUNCAS.

2.4 - Services indicators (II)

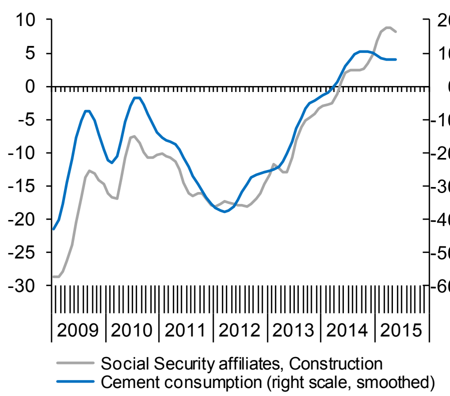
Annualised moving quarterly change in %, smoothed series



Sources: INE, AENA, Markit Economics Ltd. and FUNCAS.

2.5 - Construction sector indicators (I)

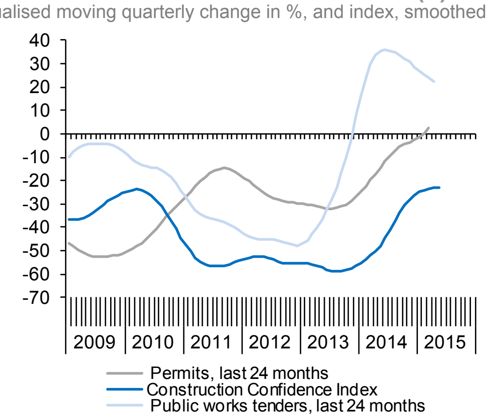
Annualised moving quarterly change in %



Sources: Ministry of Labour, OFICEMEN and FUNCAS.

2.6 - Construction sector indicators (II)

Annualised moving quarterly change in %, and index, smoothed series



Sources: Ministry of Industry, SEOPAN and FUNCAS.

industrial production index remained high following the strong rise in the two previous months, while, in May, the PMI reached its highest level since 2007. The industry confidence index also returned to pre-crisis levels. Based on data to May, the number of social security system affiliates in the sector has grown for 17 consecutive months, something that has not happened since the historical series for this indicator began in 2001. The rates are also the highest in the series (Exhibits 2.1 and 2.2).

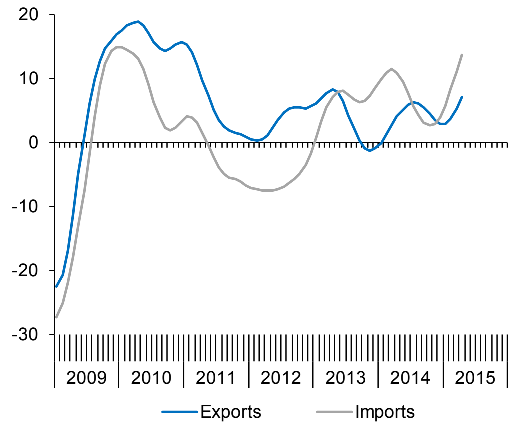
In the case of services, turnover continued to gain speed in April; the PMI shot up to its highest levels since 2000 in April and May, and the confidence index in the sector stood at its maximum since 2002. Growth in inflows of tourists at the start of the second quarter continued to accelerate, and the number of social security system affiliates grew rapidly in April and May, although the pace had moderated somewhat compared to the preceding months (Exhibits 2.3, 2.4 and 3.2).

Exhibit 3

External sector

3.1 - Exports/Imports at constant prices (Customs)

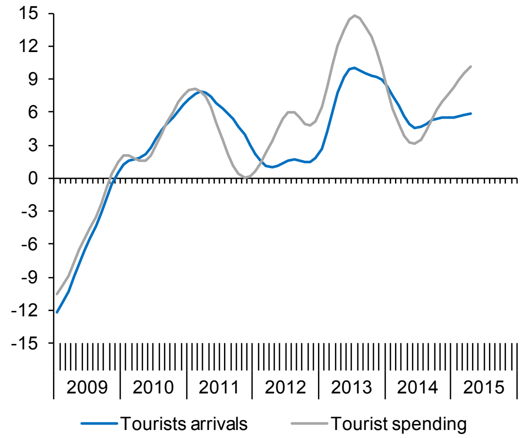
Annualised moving quarterly change in %, smoothed series



Source: Ministry of Economy.

3.2 - Tourist sector

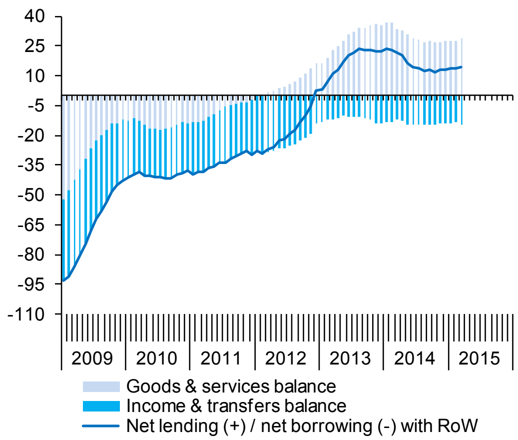
Annualised moving quarterly change in %, smoothed series



Source: Ministry of Industry.

3.3 - Balance of payments

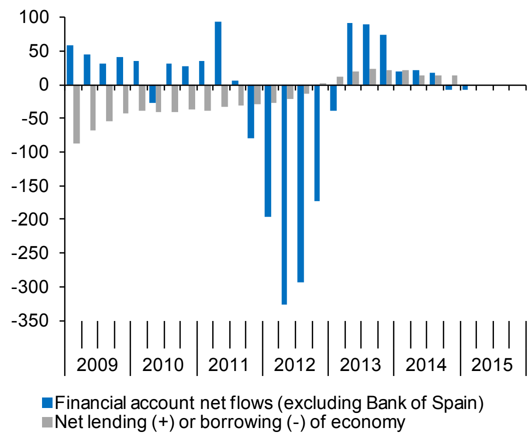
EUR billion, cumulative last 12 months



Source: Bank of Spain.

3.4 - Balance of payments

EUR billions, moving sum 4 quarters



Source: Bank of Spain.

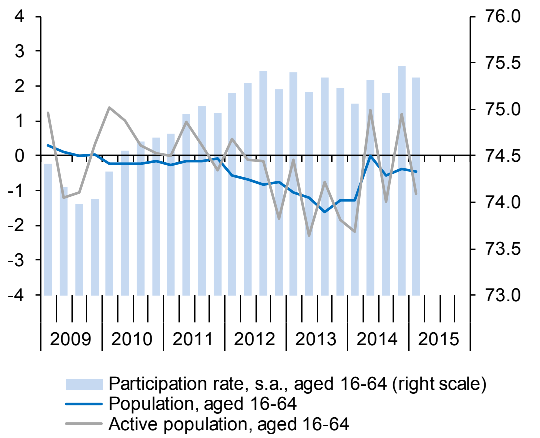
Activity indicators for construction, such as cement consumption, new housing or refurbishment permits, and official tenders suggest a continuation of growth in activity. The sectorial confidence indicator has worsened somewhat recently, but starting from a relatively high level compared to the lows reached during the crisis. The most striking indicator is the growth in the number of social security system affiliates. However, a large part of the strong recovery in construction activity seems to be linked to the increase in public works in the months leading up to the local and regional elections. This can be expected to slacken off in the third quarter, as the social

Exhibit 4

Labour market indicators

4.1 - Labour supply

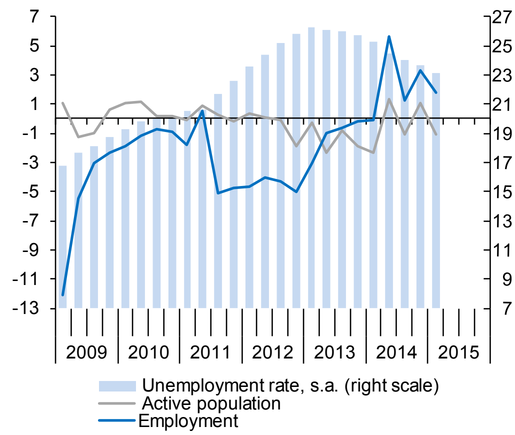
Annualised change q-o-q in % and percentage of population aged 16-64



Source: INE (LFS).

4.2 - Employment and unemployment (LFS)

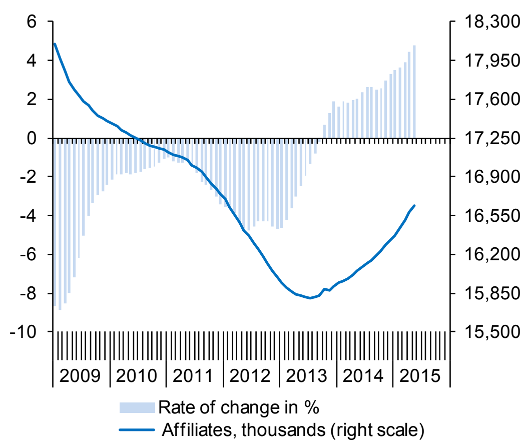
Annualised change q-o-q in % and percentage of working age population



Source: INE (LFS).

4.3 - Social Security affiliates

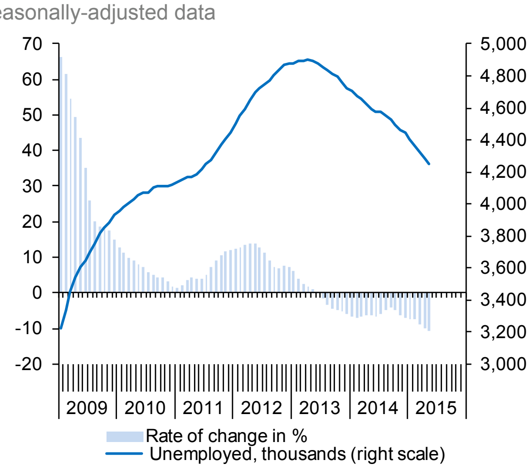
Annualised moving quarterly change in % and thousands, seasonally-adjusted data



Sources: Ministry of Labour and FUNCAS.

4.4 - Registered unemployment

Annualised moving quarterly change in % and thousands, seasonally-adjusted data



Sources: Ministry of Labour and FUNCAS.

security affiliates and official tendering data seem to indicate (Exhibits 2.5 and 2.6).

A large part of the strong recovery in construction activity seems to be linked to the increase in public works in the months leading up to the local and regional elections. This can be expected to slacken off in the third quarter.

Employment, in full-time jobs equivalent terms, increased by 3.1% in the first quarter, with particularly strong growth in the construction industry. This result is in line with the progress of social security affiliation, although the EPA figures for the same period show more modest growth. The seasonally adjusted unemployment rate fell by six tenths of a percent to 23.1%. One of the most striking features of the latest EPA is that youth employment has begun to grow. The employment trend remained favourable in the months of April and May, as can be seen from the number of social security system affiliates and registered unemployment (Exhibits 4.1 to 4.4).

Compensation per employee also rose strongly in the first quarter, but this was due to the reinstatement of public-sector employees' extraordinary pay, referred to above. Excluding services linked to public administration and agriculture, all other sectors', *i.e.* non-agricultural market sectors, compensation per employee rose slightly during the quarter, breaking the slightly downward trend of the last few quarters. Unit labour costs grew for the economy as a whole due to the reinstatement of public-sector employees' extraordinary pay mentioned above. In the third quarter, ULCs fell in the manufacturing industry, although they grew by 1.2% over the past year.

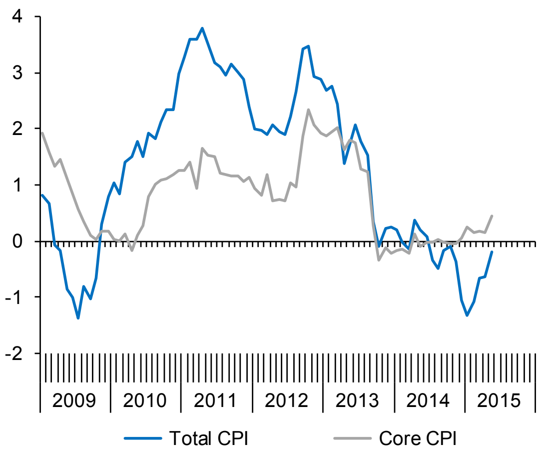
The downward trend in consumer prices bottomed out in January, with a year-on-year rate of -1.3%, which was entirely explained by the fall in the oil price. The subsequent recovery in oil prices raised this rate to -0.2% in May. The underlying rate remained on a modest upward trend from its minimum of -0.1% in November last year to 0.5% in May this year (Exhibits 5.1 and 5.2).

Exhibit 5

Price indicators

5.1 - Consumer Prices Index

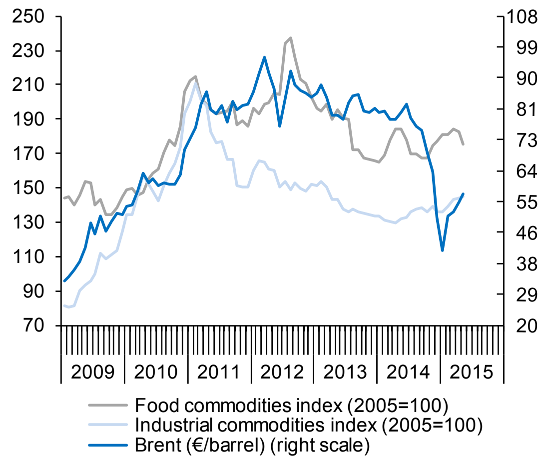
Change y-o-y in %



Source: INE (CPI).

5.2 - Commodities prices in €

Euros and index



Sources: Ministry of Economy and The Economist.

The trade balance surplus in the first quarter of the year was bigger than that in the year-earlier period, helped by falling prices for energy products. By contrast, the trade balance in non-energy goods worsened. The income balance deficit was very similar to that registered in the first quarter of the previous year, such that the current account balance was negative, in the order of 1.5 billion euros, compared with a deficit of 3.7 billion the previous year (Exhibit 3.3).

The financial balance, excluding the Bank of Spain, showed a deficit of almost 15 billion euros in the first quarter, close to the figure obtained in the same period of the previous year. This was despite Spain's outward investment doubling, and is explained by the strong growth in Spanish investments abroad, primarily in the form of portfolio investments (Exhibit 3.4).

The last period for which national savings data are available is the fourth quarter of 2014. The rate for the year as a whole was 20.1% of GDP, three tenths of a percent less than a year earlier, due to the decline in savings by households and non-financial corporations, while the public saving rate rose slightly, turning less negative than in the previous year (Exhibits 7.1 and 7.2).

As a consequence of this slight drop in the national savings rate, in conjunction with an increase in the investment rate, the economy's net lending position (surplus with respect to the rest of the world) dropped from 2.1% of GDP to 1% of GDP. Both households and non-financial corporations registered a financial surplus, albeit a shrinking one. As in previous years, this was largely devoted to reducing debt, particularly by businesses. Thus, household debt ended 2014 at 108.8% of gross disposable income, 6.6 percentage points less than one year earlier. Non-financial corporations' debt stood at 111.1% of GDP, compared with 117.5% of GDP at end-2013 (Exhibit 7.4).

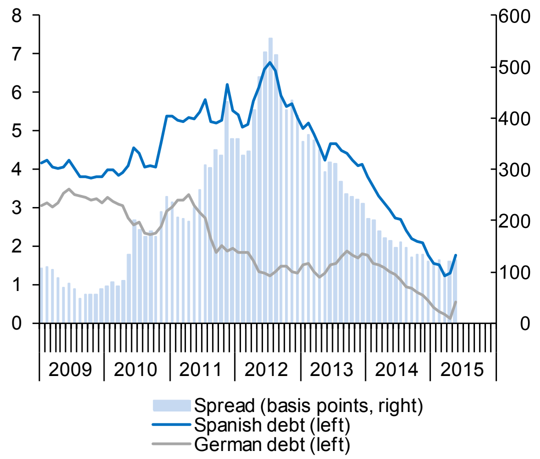
The general government account balance in 2014, excluding aid to financial institutions, was 5.7% of GDP, six tenths of a percent less than the previous year (Exhibit 7.3). In the first quarter of 2015, the consolidated balance excluding local government (*i.e.* central government, autonomous regions,

Exhibit 6

Financial indicators

6.1 - Government 10 years bonds rate

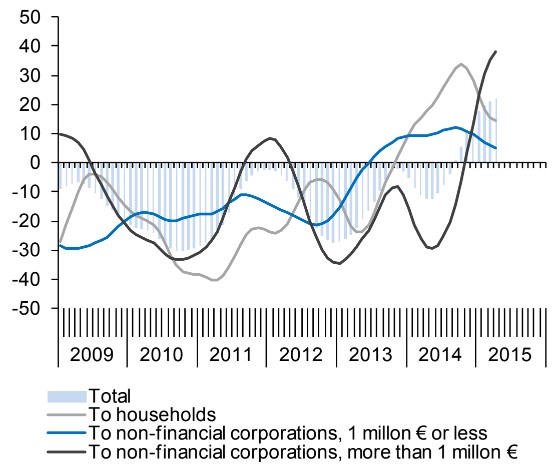
Percentage and basis points



Sources: ECB and Bank of Spain.

6.2 - New business loans

Annualised moving quarterly change in %, smoothed and s.a. series



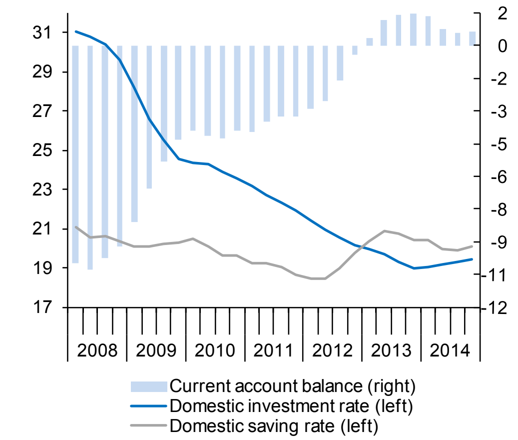
Sources: Bank of Spain and FUNCAS.

Exhibit 7

Financial imbalances

7.1 - Domestic saving, investment and current account balance

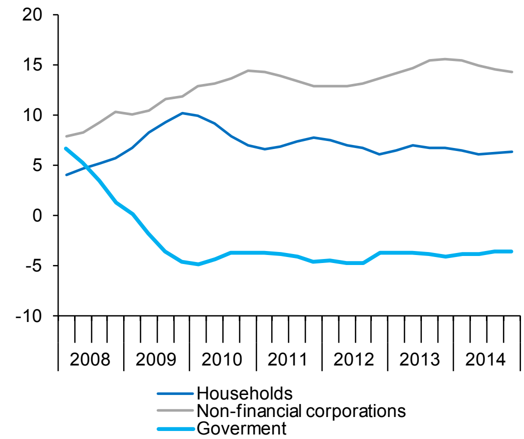
Percentage of GDP, 4-quarter moving average



Source: INE.

7.2 - Saving rates

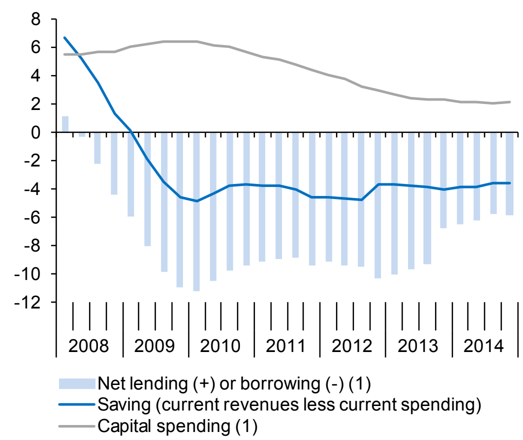
Percentage of GDP, 4-quarter moving average



Sources: INE and IGAE.

7.3 - General Government deficit

Percentage of GDP, 4-quarter moving average

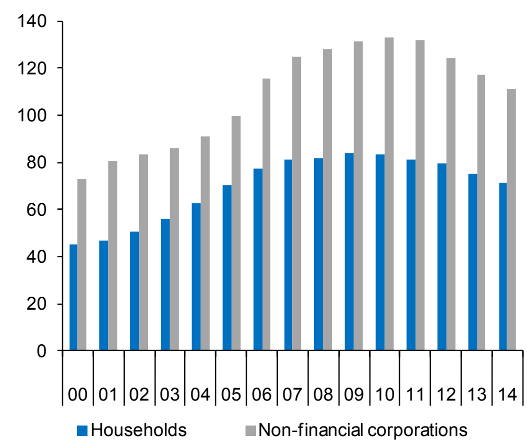


(1) Excluding financial entities bail-out.

Sources: INE and IGAE.

7.4 - Gross debt

Percentage of GDP



Source: Bank of Spain (Financial Accounts).

and social security funds) stood at -0.78% of GDP, compared with -0.69% of GDP in the same period the previous year. The central government increased its deficit and the social security funds reduced their surplus, while the autonomous regions as a whole enjoyed a slight improvement in their results. However, the early months of the year tend not to be very representative.

Financial market tensions caused by uncertainty over the situation in Greece have driven up the yield on Spanish debt from lows of 1.10% in mid-March to 2.45% in mid-June. The risk premium has also risen over this period, from below 100 basis points to around 150 basis points (Exhibit 6.1). Nevertheless, pressures have since eased on both variables.

Although the stock of finance granted to households and businesses continues to decline, as a result of the ongoing process of deleveraging, the flow of new credit grew by 21% in the first quarter of 2015 on an annualised quarter-on-quarter basis, and the figures for April suggest this trend will continue. Lending to households for both home purchases and consumption has been growing since mid-2013, as have loans of less than a million euros to businesses (basically lending to small and medium-sized enterprises). Other lending, *i.e.* loans of more than a million euros to businesses, began to rise later, in the final quarter of last year, although large companies, to which this lending is mainly directed, have used other financing channels as alternatives to bank credit (Exhibit 6.2).

Forecasts for 2015-2016

Although as yet incomplete, the indicators available for the second quarter suggest growth has picked up speed to an annualised 4.3%, which is better than expected in the previous forecast scenario. As a consequence of the better than expected performance, the GDP growth forecast for 2015 has been revised upwards three tenths of a percent to 3.3% (Table 1).

The economy is being driven by endogenous cyclical factors and structural improvements, together with the impact of a series of transitory external shocks. These shocks include the drop in oil prices, the reinstatement of part of public-sector employees' extraordinary pay, which was eliminated in December 2012, income tax cuts, the sharp drop in interest rates, and the relaxation of public spending restraint as a result of the electoral cycle. The expansionary impact of some of these shocks is expected to wear off from the third quarter onwards, such that the growth rate is expected to slow (Exhibit 8.1).

For this same reason, growth of 3.0% is forecast for 2016, which is below the rate expected in 2015, although two tenths of a percent above the rate estimated in previous forecasts. In both years, GDP growth will come entirely from the domestic demand contribution, as the external sector will make a negative contribution of around half a percentage point (Exhibit 8.2).

Due to better than expected performance in the second quarter, the GDP growth forecast for 2015 has been revised upwards three tenths of a percent to 3.3%. Given several favorable shocks are expected to wear off from the third quarter onwards, in 2016, growth is expected to be below that of 2015 at 3.0%.

Since the start of the recovery in the third quarter of 2013, the economy has grown by 3.4%, which means it has recovered 39% of the real GDP destroyed during the recession, and on the basis of the current forecast scenario, it will have recovered all of it by the end of 2016.

Given the Spanish economy's high level of debt and its dependence on external financing, the main risk of the scenario's not being realised comes from a possible rise in the risk premium

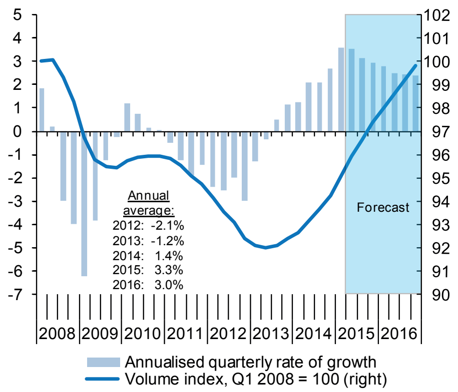
Given the Spanish economy's high level of debt and its dependence on external financing, the main risk of the growth scenario's not being realised comes from a possible rise in the risk premium and constraints on access to finance.

Exhibit 8

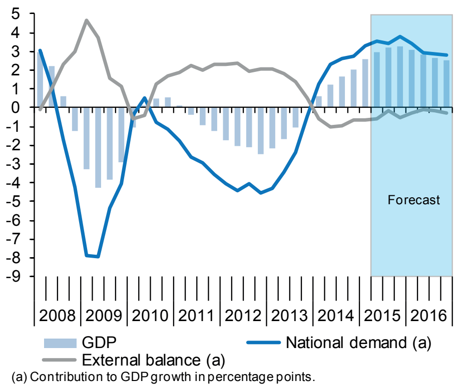
Economic forecasts for Spain, 2015-2016

Change y-o-y in %, unless otherwise indicated

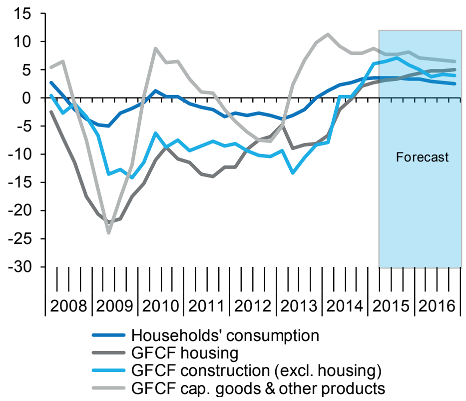
8.1 - GDP



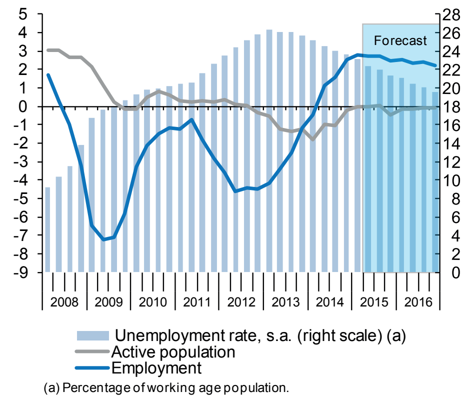
8.2 - GDP, national demand and external balance



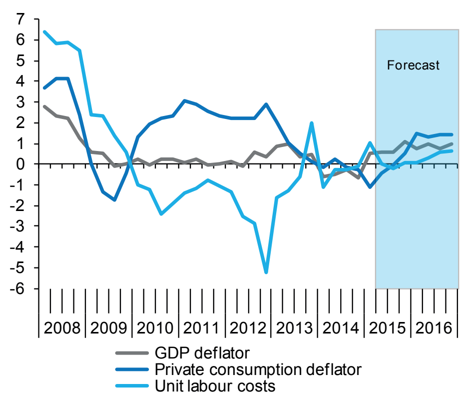
8.3 - National demand aggregates



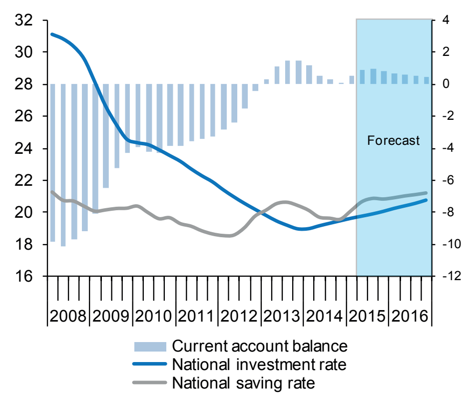
8.4 - Employment and unemployment



8.5 - Inflation



8.6 - Saving, investment and c/a balance (% GDP, 4MA)



Sources: INE (Quarterly National Accounts) and FUNCAS (forecasts).

Table 1

Economic forecasts for Spain, 2014-2015

Annual rates of change in %, unless otherwise indicated

	Actual data				FUNCAS forecasts		Change in forecasts (a)	
	Average 1996-2007	Average 2008-2013	2013	2014	2015	2016	2015	2016
1. GDP and aggregates, constant prices								
GDP	**3.8**	**-1.1**	**-1.2**	**1.4**	**3.3**	**3.0**	**0.3**	**0.2**
Final consumption households and NPISHs	3.6	-1.9	-2.3	2.4	3.8	3.5	0.3	0.6
Final consumption general government	4.3	0.8	-2.9	0.1	1.0	0.8	0.4	0.3
Gross fixed capital formation	6.4	-7.3	-3.8	3.4	6.0	5.7	-0.6	0.0
Construction	5.4	-10.3	-9.2	-1.5	4.9	4.4	-0.2	-0.1
Residential construction	7.4	-11.9	-7.6	-1.8	2.7	5.5	-0.6	0.7
Non-residential construction	3.8	-8.4	-10.5	-1.3	6.6	3.6	0.2	-0.7
Capital goods and other products	8.3	-2.3	3.4	9.1	7.0	7.0	-1.0	0.2
Exports goods and services	6.6	1.7	4.3	4.2	4.6	5.4	-0.6	-0.1
Imports goods and services	8.7	-4.1	-0.5	7.6	6.3	7.2	-1.0	0.5
National demand (b)	**4.5**	**-2.8**	**-2.7**	**2.2**	**3.7**	**3.4**	**0.2**	**0.4**
External balance (b)	-0.7	1.8	1.4	-0.8	-0.4	-0.4	0.1	-0.2
GDP, current prices: - € billion	--	--	1,049.2	1,058.5	1,100.7	1,143.2	--	--
- % change	7.4	-0.5	-0.6	0.9	4.0	3.9	0.5	0.6
2. Inflation, employment and unemployment								
GDP deflator	3.5	0.6	0.7	-0.5	0.7	0.9	0.2	0.4
Household consumption deflator	**3.1**	**1.8**	**1.0**	**-0.1**	**-0.3**	**1.4**	**0.4**	**0.6**
Total employment (National Accounts, FTEJ)	3.4	-3.1	-3.3	1.2	3.0	2.5	0.4	0.2
Productivity (FTEJ)	0.4	2.1	2.1	0.2	0.3	0.5	-0.1	0.0
Wages	7.5	-1.0	-2.3	1.3	3.9	3.5	0.6	0.4
Gross operating surplus	6.9	0.3	0.1	-0.1	4.1	3.6	0.3	0.7
Wages per worker (FTEJ)	3.3	2.4	1.7	-0.2	0.5	0.9	0.2	0.2
Unit labour costs	2.9	0.2	-0.4	-0.4	0.2	0.4	0.3	0.2
Unemployment rate (LFS)	**12.5**	**20.2**	**26.1**	**24.4**	**22.2**	**20.2**	**-0.1**	**-0.1**
3. Financial balances (% of GDP)								
National saving rate	22.4	19.9	20.4	20.1	20.6	20.8	-0.8	-1.0
- of which, private saving	18.6	23.1	24.5	23.6	23.0	22.1	-0.8	-1.1
National investment rate	26.9	23.1	19.0	19.5	20.0	20.7	0.0	-0.1
- of which, private investment	23.0	19.4	16.8	17.5	18.0	18.7	0.0	-0.1
Current account balance with RoW	**-4.5**	**-3.3**	**1.5**	**0.6**	**0.6**	**0.2**	**-0.7**	**-0.9**
Nation's net lending (+) / net borrowing (-)	-3.7	-2.8	2.1	1.0	1.0	0.6	-0.7	-0.9
- Private sector	-2.8	5.7	8.9	6.8	5.6	4.0	-0.8	-1.0
- Public sector (general governm. deficit)	**-0.9**	**-8.6**	**-6.8**	**-5.8**	**-4.6**	**-3.4**	**0.1**	**0.2**
- General gov. deficit exc. financial instit. bailout	**--**	**-7.8**	**-6.3**	**-5.7**	**-4.6**	**-3.4**	**0.1**	**0.2**
Gross public debt	52.2	66.3	92.1	97.7	100.1	100.8	-0.8	-1.7
4. Other variables								
Household saving rate (% of GDI)	10.8	11.2	10.4	9.7	9.9	9.1	-0.1	-0.6
Household gross debt (% of GDI)	81.5	125.0	115.5	108.8	102.0	97.0	-0.6	-1.2
Non-financial coporates gross debt (% of GDP)	80.4	127.8	117.5	111.1	102.8	96.9	-0.4	-0.8
Spanish external gross debt (% of GDP)	90.2	158.4	154.7	160.1	156.9	151.5	-0.2	-0.5
12-month EURIBOR (annual %)	3.7	1.9	0.5	0.5	0.2	0.4	-0.1	-0.1
10-year government bond yield (annual %)	5.0	4.7	4.6	2.7	1.9	2.1	0.7	0.9

Notes:
(a) Change between present and previous forecasts, in percentage points.
(b) Contribution to GDP growth, in percentage points.
Sources: 1996-2014: INE and Bank of Spain; Forecasts 2015-2016: FUNCAS.

and constraints on access to finance, whether due to internal or external factors.

Household consumption has been revised upwards and is set to grow by 3.8%, boosted by households' increasing disposable income in both nominal and real terms. This rise will be driven by several factors, primarily job creation, falling interest payments, tax cuts, and lower prices for energy products. This will also allow a slight upturn in the household savings rate. Next year, income growth in real terms will be more moderate than this year, as the impact of the extraordinary shocks in 2015 comes to an end, and inflation rates turn positive, which will slow down private consumption growth (Exhibit 8.3) and reduce the savings rate.

As regards public consumption, it is assumed that the 1% growth expected this year, which is relatively high due to the effect of the electoral cycle, will moderate to 0.8% next year.

The forecast growth in gross fixed capital formation in capital goods for 2015 has been revised down to 7.0%, as this aggregate was lower than expected in the third quarter. Similar growth to that in 2015 is expected in 2016. Construction investment is expected to grow by 4.9% this year, which is somewhat lower than in previous forecasts. This is also due to the housing component performing somewhat worse than expected in the first quarter. In any event, positive growth rates are expected for both this component and the other components of construction. Construction investment will slow in 2016 due to the end of the electoral cycle's effect on the other components of construction. However, growth is expected to remain positive and housing investment is expected to pick up speed.

Exports will grow by 4.6% this year, and imports by 6.3%, such that the external sector will shave four tenths of a percent off of GDP growth. Both variables will accelerate next year, and the combined contribution to growth will be similar to that in 2015. The same pattern as observed since the start of the recovery will therefore be seen this year and next, with import growth outpacing export growth, due to the vigour of domestic demand in a relatively weak international context, resulting in the external sector's making an overall negative contribution to growth.

Employment is forecast to increase by 3% in 2015 and 2.5% in 2016, in full-time equivalent jobs terms, beating previous forecast estimates in both cases. This represents the creation of over 900,000 jobs over the course of the two years (Exhibit 8.4). This means that whereas 13% of the employment lost during the crisis had been recovered by the first quarter of 2015, by the end of 2016, a third will have been recovered. The average annual unemployment rate will drop by 2.2 percentage

13% of the employment lost during the crisis had been recovered by the first quarter of 2015. By the end of 2016, a third will have been recovered.

points of the labour force in 2015 and a further 2 points in 2016, to 22.2% and 20.2%, respectively. Unit labour costs will increase slightly in both years (Exhibit 8.5).

The absence of cost and demand pressures will maintain the inflation generated by the Spanish economy at moderate levels, with an increase in the GDP deflator of less than 1% expected in both 2015 and 2016. Import prices are such that consumer price inflation will be significantly below this figure this year (-0.2%) and slightly above it next year.

Despite the external sector's negative contribution to growth, the surplus on the current account of the balance of payments will be 0.6% of GDP in 2015, as in the previous year, as a result of cheaper oil (Exhibit 8.6). Given that the effect of lower oil prices will not be repeated next year, the surplus will shrink. This forecast scenario assumes that the oil price will average around 62 dollars a barrel this year (up until May the average price was 57 dollars a barrel) and that it will rise to 69 dollars next year. The average annual euro/dollar exchange rate will be 1.112 this year, dropping to 1.063 next year.

The general government deficit will decline to 4.6% of GDP this year and 3.4% of GDP next year, four and six tenths over the figures forecast in the Stability Programme, respectively. Public debt will come to around 100% of GDP this year, rising to slightly over 100% next year.

To sum up, the Spanish economy´s performance continues to surprise on the upsides, obliging both public and private institutions to continually revise upwards their forecasts for this year and next. In March last year, when FUNCAS first published growth forecasts for 2015, the estimate was for 1.8%, which matched Spanish private analysts' consensus forecast. The IMF's forecast in April was 1% and the European Commission forecast in February was 1.7%. More recent consensus forecasts suggest growth of 3.1%, while the IMF and European Commission estimate growth of 3.1% and 2.8%, respectively. The size of these upward revisions is not just a result of the unexpected positive shocks that have occurred, but the surprising strength with which the economy has progressed in the meantime.

Nevertheless, taking a long-term perspective, it should be borne in mind that the Spanish economy's potential growth rate, once the output gap that has arisen in recent years has been eliminated, will probably fall short of the rates we shall see this year and next. It is therefore the time to put forward an economic policy strategy aimed at confronting the weaknesses and shortcomings of the productive system. These are at the root of the Spanish economy's traditional pattern of imbalanced growth, which appears to be returning, albeit in a milder form, since the start of the current recovery.