Spain's economic slowdown in an uncertain context

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Fears of a global recession seem unfounded, but a high degree of financial market volatility still represents significant risks for the global economy. In Spain, one-off growth drivers in 2015 are wearing off, compounded by the worsening of global conditions, which is expected to slow GDP growth this year and next, while downside risks remain considerable.

Financial market tensions have eased since the first few weeks of the year, but the global economy's fundamentals remain weak, and the situation is still marked by uncertainty. Fresh bouts of turbulence cannot, therefore, be ruled out. In Spain, lower expected global growth, in conjunction with the progressive exhaustion of one-off factors that drove economic growth in 2015, point towards a slowdown in 2016 and 2017. The downside risks are also considerable, as global uncertainty is coinciding with domestic political obstacles of forming a new government.

International context

Financial market tensions at the start of the year eased in mid-February, even though concerns about the situation in China and other emerging economies, and the fear of another global recession, have not subsided. The worsening global uncertainties have put expectations of further interest rate rises in the U.S. on hold, while raising the prospects of more robust quantitative easing by the European Central Bank. This was ultimately confirmed at the Governing Council's meeting on March 10th, when the ECB decided to cut the interest rate on its main refinancing operations to zero, lower interest on deposit facilities by 10 basis points to -0.40%, and scale up the asset purchase programme to 80 billion euros a month, while extending it to corporate bonds, and paying financial institutions taking borrowed liquidity under the new targeted longer-term refinancing operations (TLTRO) framework up to 0.4%.

The U.S. economy continued to create jobs at a brisk pace in the first two months of the year, although the progress of certain activity indicators, such as the industrial production index, orders and PMI indices was less positive. In the Eurozone, the poor results obtained on indicators such as the economic sentiment index or the Purchasing Managers' Index (PMI) suggest that the slowdown in the second half of 2015 (with quarter-on-quarter growth of 0.3%) has continued into the start of 2016. However, there are no potentially recessionary signs in any of these economic areas. Moreover, although China's slowdown may

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have a negative impact on developed economies, in Europe's case, this will be offset by the boost from the lower oil price, although the impact of this on the U.S. economy is less clear cut.

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Fears of a global recession seem unfounded. Even if the high degree of financial market volatility, that may be associated with monetary policies based on quantitative easing causing asset bubbles, represents a significant risk. Fresh bouts of turbulence cannot therefore be ruled out. These could lead to bankruptcies or balance of payments crises in some emerging countries, and the consequent heightened uncertainty could further weaken the real global economy.

Recent developments in the Spanish economy

Spain's GDP grew by 0.8% in the fourth quarter of 2015, the same rate as in the previous quarter. In annualised terms, this growth was equivalent to 3.2% (all quarter-on-quarter growth rates below will be given in these terms). Growth in year-on-year terms was 3.5%. This result was in line with expectations, given the results of the indicators for the period, although it was higher than in previous forecasts. Over the year as a whole, GDP grew by 3.2% on the previous year.

The rise in all domestic demand components slowed in the fourth quarter, resulting in a 2.3 percentage-point contribution to quarterly growth, compared to 4.8 pp in the previous quarter. Slower growth of domestic demand was compensated for by a larger positive contribution from the external sector (0.9 pp) after three straight quarters of negative contributions. The change was caused by a sharp slowdown in import growth. Over the year as a whole, domestic demand contributed 3.7 pp, and the external sector -0.5 pp.

Private consumption growth slowed in the fourth quarter to a quarter-on-quarter rate of 3%. Over the year as a whole, this variable rose by 3.1% from the previous year. This growth was mainly driven by employment growth and the increased real disposable income resulting from falling energy prices and tax cuts. With respect to the start of 2016, the indicators available for the month of January, such as retail sales, new vehicle registrations, and sales of consumer goods by large companies, continued to grow without showing any signs of a slowdown. The retail trade confidence indicator for January and February was in line with the results of the last quarter of 2015, although the consumer confidence index fell. This may be partly because of the domestic political uncertainty (Exhibits 1.1 and 1.2).

General government consumption grew by 1.7% in the fourth quarter in real terms, but dropped by 3.9% in current prices. Nevertheless, over the year as a whole, this component of demand grew in real terms by 2.7%, with nominal growth of 3.1%. Real growth contrasts with the drop of 1% forecast in the macroeconomic framework accompanying the State Budget for 2015.

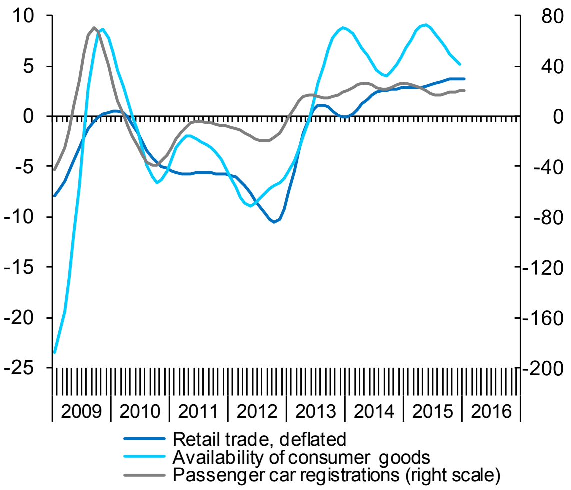
Investments in capital goods and other non-construction products moderated its quarterly progress to 6.8%. This makes 12 uninterrupted quarters of positive rates, and, what is more, at an average rate exceeding that seen in the pre-crisis boom years. Nevertheless, its current level is still 3% below the peak reached in the second quarter of 2008. The annual increase in 2015 was 7.5%. This growth is being driven by the recovery in demand, improved financing conditions, and the need to replace and modernise production equipment in the wake of the severe cut in the rate of business investment during the crisis.

Exhibit 1

Consumption and capital goods investment indicators

1.1 - Consumption Indicators (I)

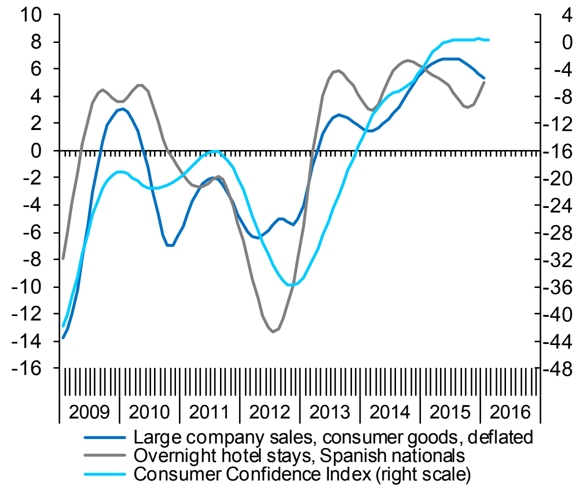
Annualised moving quarterly change in %, smoothed series



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

1.2 - Consumption Indicators (II)

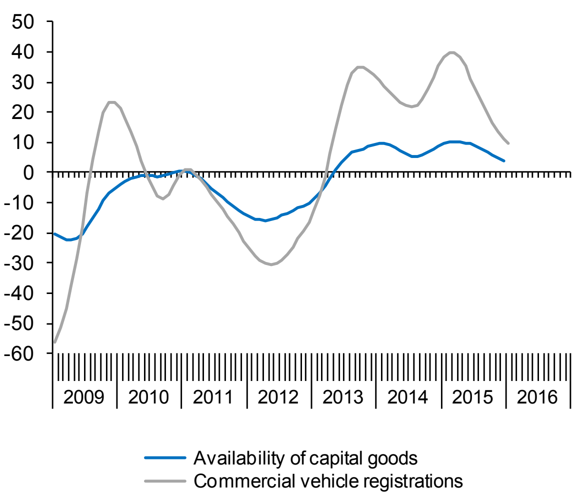
Annualised moving quarterly change in % and index (CCI), smoothed series



Sources: European Commission, INE, AEAT and Funcas.

1.3 - Capital goods GFCF indicators (I)

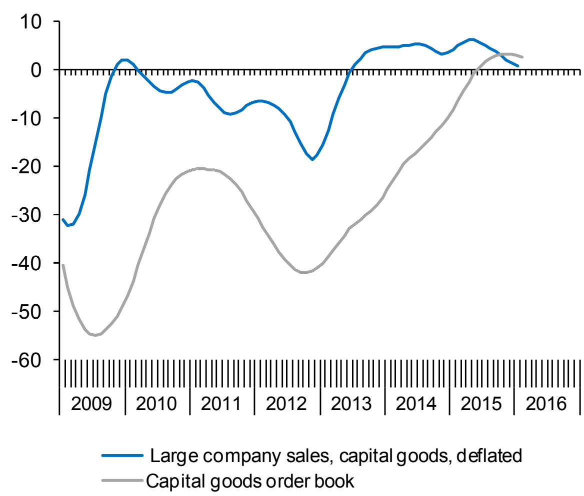
Annualised moving quarterly change in %, smoothed series



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.

Few indicators are available in this segment of demand for the first quarter of 2016. Registrations of goods vehicles picked up in January, although the overall trend was downward. Large corporations' sales of capital goods also rose in January after four months of decline, and the index of orders of capital goods in January and February dropped in comparison with the fourth quarter average, although it remains fairly high (Exhibits 1.3 and 1.4).

The quarterly increase in construction investment was 2.5%, which is the slowest rate in the last seven quarters. Both the housing investment component and other constructions registered positive rates. However, housing investment growth failed to live up to the expectations created by the sharp rise in new housing permits and an accelerating trend. In the case of non-residential construction, on the other hand, the slowdown in growth is in line with the reduction in public contracting following the municipal and regional elections (Exhibit 2.6).

Housing sales grew by 11.1% in 2015, according to the INE's statistics, or 7.4% according to the Ministry of Public Works and Transport. However, both sources registered a drop in the number of transactions in the last quarter, which –according to INE data– became more pronounced in January. This result is consistent with the drop in lending for housing purchases in the fourth quarter of 2015 and in January 2016, after two years of increases. It is unlikely that this deterioration in real-estate activities represents a change in trend. It is more likely to be a transitory dip reflecting current uncertainties. In any event, prices are still rising.

There was a reduction in goods imports and exports in the fourth quarter, while trade in services grew. Over the year as a whole, total exports rose by 5.4% and imports by 7.5% in real terms, equivalent to a rise of 5.8% and 5.9%, respectively, in current prices. In other words, lower prices of energy products and other commodities meant that imports grew more in volume terms than nominal terms. Over the year as a whole, the total trade balance turned a surplus of 2.5% of GDP, the same as the previous year, reducing the energy deficit –due to the drop in the oil price– and reducing the non-energy goods surplus.

From a supply-side perspective, all sectors registered positive growth rates in the fourth quarter, although the only sector in which growth accelerated was construction – which is somewhat inconsistent with the slowdown in investment in housing and other constructions. Over the year as a whole, progress was made in most sectors, particularly construction, with growth of 5.3%, followed by manufacturing, where growth of 3.7% was the best result this sector has seen since 2001.

In January 2016, the industrial production index continued its trend towards deceleration apparent since half way through the previous year, and the industrial climate index worsened in January and February. However, in January and February, the PMI rose to above its level in the last quarter of 2015. The January data for sales of industrial goods by large companies were also positive, while job creation in the sector, according to social security affiliation figures continued to rise at a similar rate to that seen in the final months of 2015 (Exhibits 2.1 and 2.2).

Growth in activity in services weakened in the first few months of the year, as highlighted by the changes in PMI, sales by large services companies and the sectoral confidence indicator. Social security affiliation in the services sector as a whole slowed in January and February. However, this was mainly a result of the public-sector recruitment freeze, as the slowdown was almost imperceptible in the case of market services. Inflows of tourists also continued to grow rapidly in January (Exhibits 2.3 and 2.4).

In the case of construction, the positive trend in new housing permits suggests increased activity in the residential segment, while the drop in official tenders indicates a further decline in public works. The indicator for sales by large construction companies and developers was highly negative in January and the confidence indicator also worsened. Nevertheless, social security affiliation has continued to rise rapidly, with just a slight trend towards a deceleration.

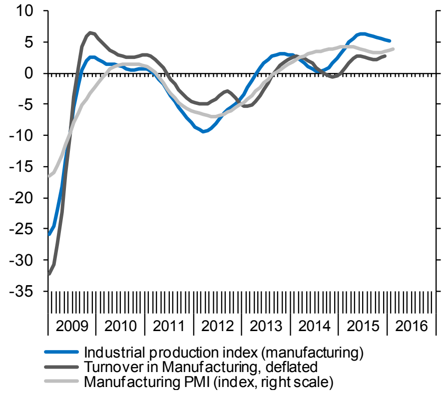
Total employment (in full-time equivalent job terms) rose by 2.4% in the last quarter of 2015, and 3% over the year as a whole, an increase

Exhibit 2

Industrial activity, services and construction indicators

2.1 - Industrial sector indicators (I)

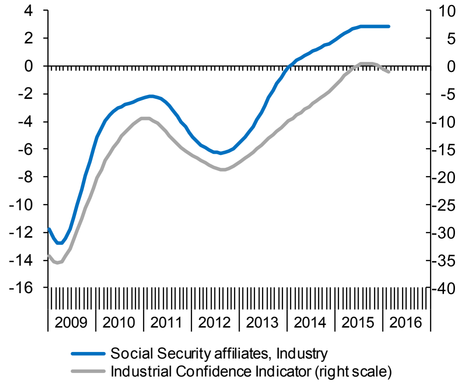
Annualised moving quarterly change in % and index, smoothed series



Sources: INE, Markit Economics Ltd and Funcas.

2.2 - Industrial sector indicators (II)

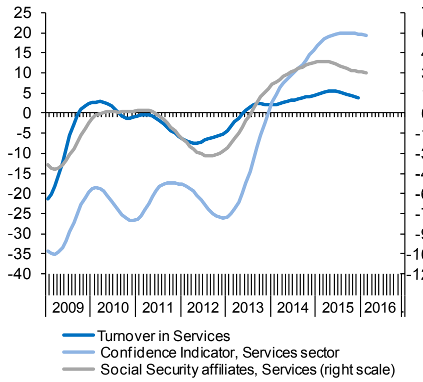
Annualised moving quarterly change in % and index, smoothed series



Sources: European Commission, Ministry of Labour and Funcas.

2.3 - Services indicators (I)

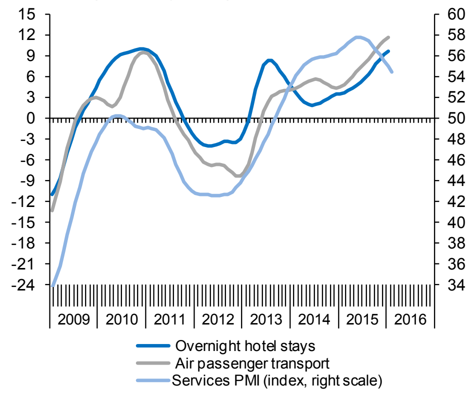
Annualised moving quarterly change in % and index, smoothed series



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

2.4 - Services indicators (II)

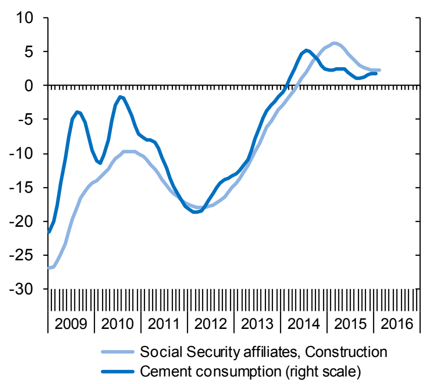
Annualised moving quarterly change in %, smoothed series



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

2.5 - Construction sector indicators (I)

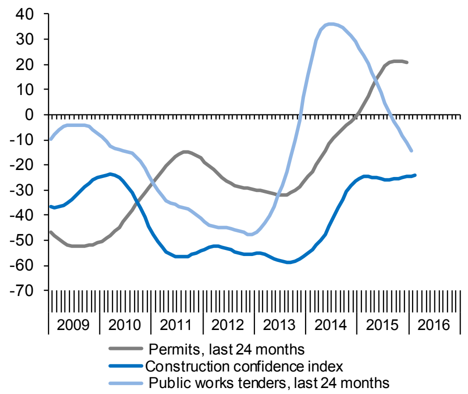
Annualised moving quarterly change in %, smoothed series



Sources: Ministry of Labour, OFICEMEN and Funcas.

2.6 - Construction sector indicators (II)

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



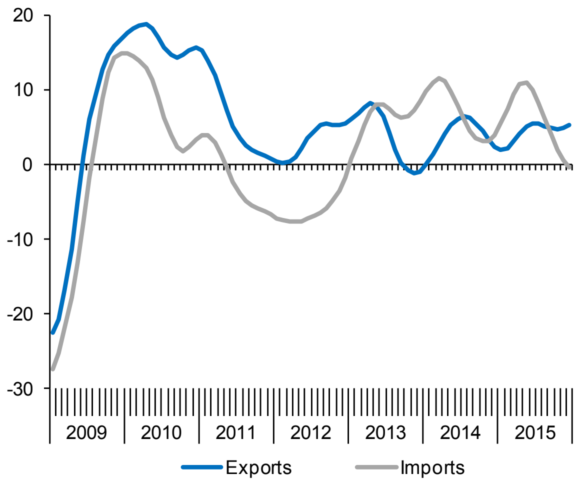
Sources: Ministry of Industry, SEOPAN and Funcas.

Exhibit 3

External sector

3.1 - Exports/Imports at constant prices (Customs)

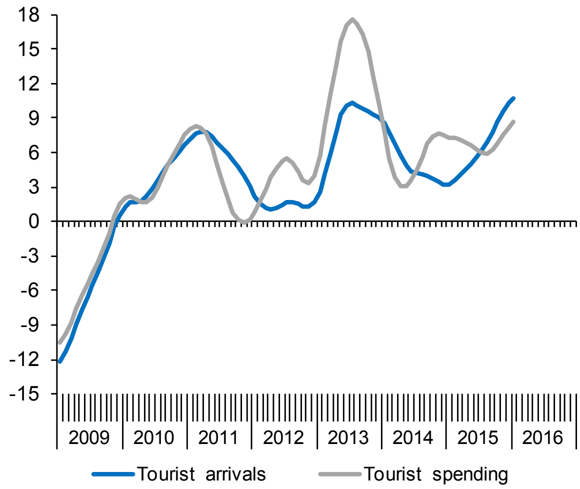
Annualised moving quarterly change in %, smoothed series



Source: Ministry of Economy.

3.2 - Tourist sector

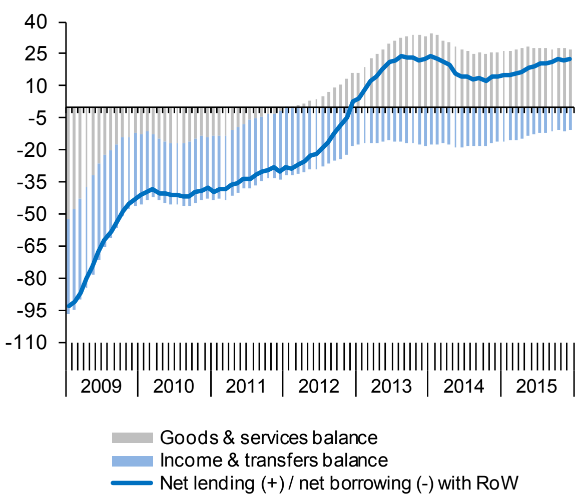
Annualised moving quarterly change in %, smoothed series



Source: Ministry of Industry.

3.3 - Balance of payments (I)

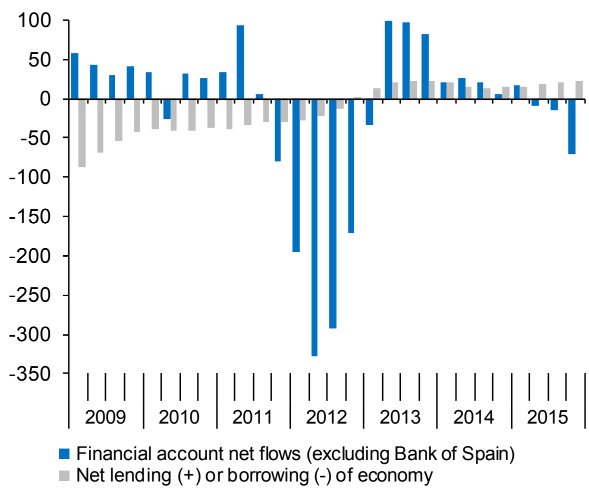
EUR billion, cumulative last 12 months



Source: Bank of Spain.

3.4 - Balance of payments (II)

EUR Billions, moving sum 4 quarters



Source: Bank of Spain.

equivalent to 487.7 thousand jobs. In terms of the Labour Force Survey, employment rose by 522 thousand, although the reduction in unemployment was somewhat larger, at 554 thousand, as the reduction in the working-age population caused the labour force to shrink. The average annual unemployment rate dropped by 2.3 percentage points to 22.1% (Exhibits 4.1 and 4.2).

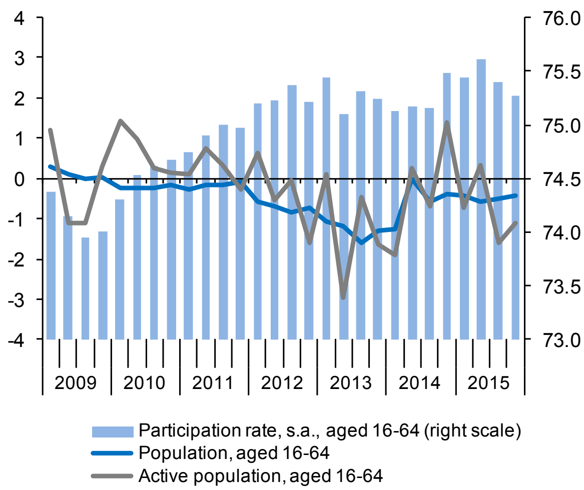
There was a slight drop in employment in the manufacturing industry in the fourth quarter, but this followed strong growth throughout the first half of the year, such that over the year as a whole there was a rise of 2.9%, the best result since 2000. In any event, the sector in which employment increased most in relative terms over the year as a whole was construction. Employment growth in public administration, health and education came to 2%. Growth in the total number of social security affiliates slowed in January and February 2016. However, this was due to the drop in agricultural employment caused by the unusually early end of the olive harvest, and the freeze on public sector recruitment. Excluding these two sectors,

Exhibit 4

Labour market indicators

4.1 - Labour supply

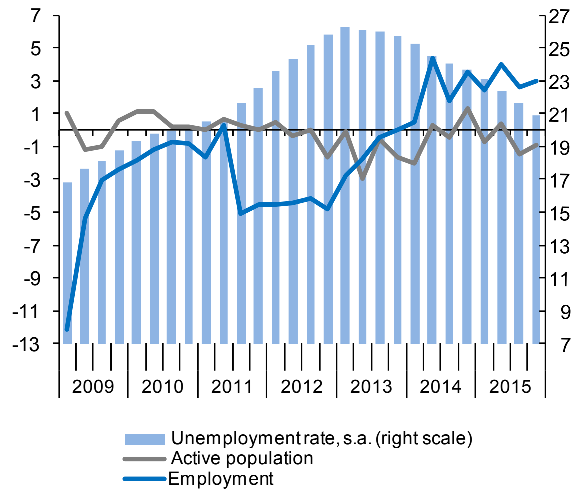
Annualised change q-o-q in % and percentage of population aged 16-64



Source: INE (LFS).

4.2 - Employment and unemployment (LFS)

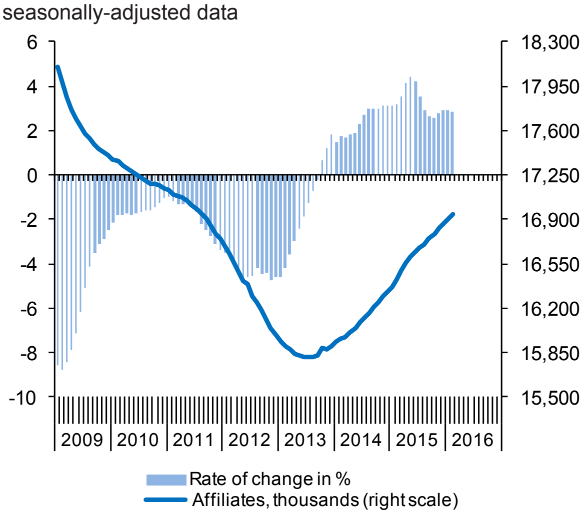
Annualised change q-o-q in % and percentage of working age population



Source: INE (LFS).

4.3 - Social Security affiliates

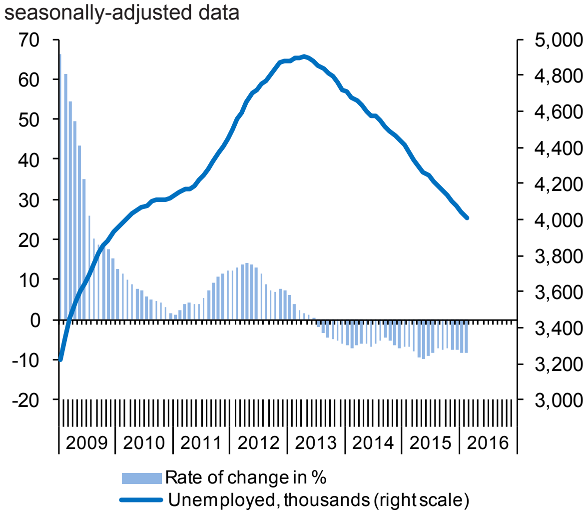
Annualised moving quarterly change in % and thousands, seasonally-adjusted data



Source: Ministry of Labour and Funcas.

4.4 - Registered unemployment

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



Source: Ministry of Labour and Funcas.

affiliation grew at a rate similar to that in previous months (Exhibits 4.3 and 4.4).

In short, the activity and demand indicators for the start of 2016 are giving contradictory signals. However, taken together, using the synthetic activity indicator prepared by Funcas, they suggest a deceleration of the growth rate, which in non-annualised terms, could be somewhere between 0.6% and 0.7% in the first quarter of the year.

Activity and demand indicators for the start of 2016 are giving contradictory signals. However, taken together, using the synthetic activity indicator prepared by Funcas, they suggest a deceleration of the growth rate.

Productivity of the economy as a whole showed positive growth in the fourth quarter, as in the preceding quarters, such that it rose at an annual rate of 0.2% in 2015. Productivity also rose in the manufacturing industry over the year as a whole, at 0.8%, although this was its slowest rise since the start of the crisis. Compensation per employee grew by 0.5% across the economy in 2015 (although this was largely a result of public sector employees being paid Christmas bonuses withheld in the wake of the crisis) and dropped by 0.1% in manufacturing industry. As a result of the foregoing, unit labour costs rose slightly across the economy as a whole in 2015 for the first time since 2009, while ULC continued to fall in manufacturing industry. Wage increases relative to last year agreed through collective bargaining up until February averaged 1.1%, indicating faster wage growth in 2016.

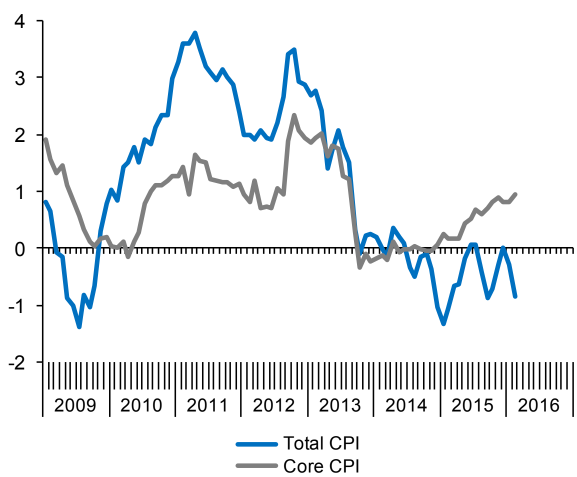
Further falls in the price of energy products have meant that the inflation rate in the first few months of 2016 has been negative and lower than expected. Nevertheless, the core rate has remained at positive levels, with a slow upward trend, as a result of the depreciation of the euro and recovery in domestic demand. Apart from the energy products group, all the other components

Exhibit 5

Price indicators

5.1 - Consumer Prices Index

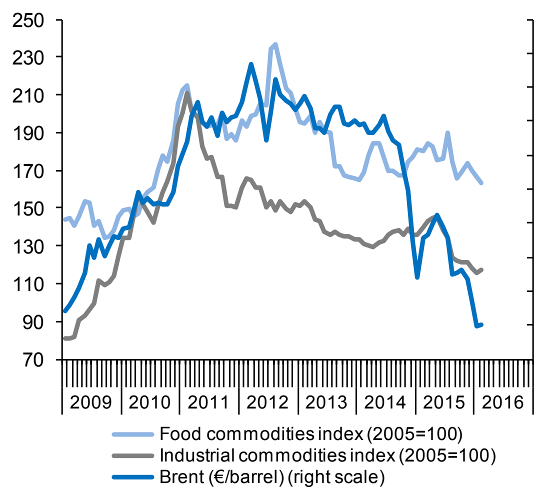
Change y-o-y in %



Source: INE (CPI).

5.2 - Commodities prices in €

Euros and index



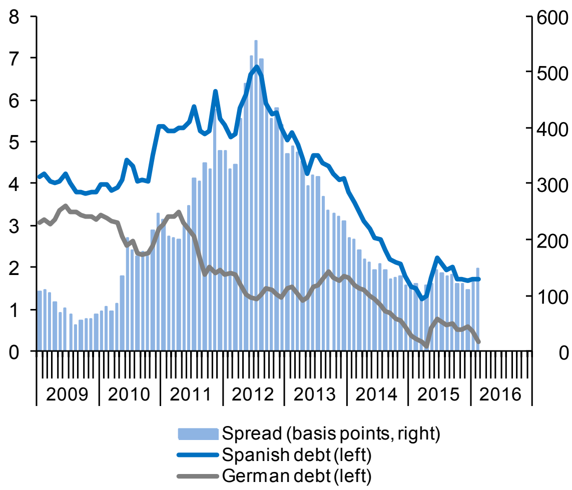
Sources: Ministry of Economy and The Economist.

Exhibit 6

Financial indicators

6.1 - Government 10 years bonds rate

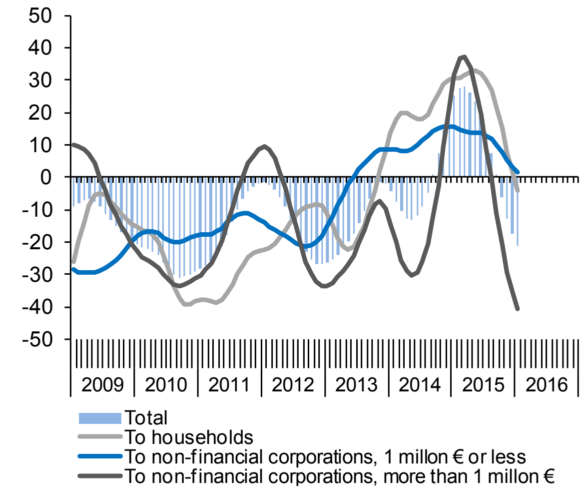
Percentage and basis points



Sources: ECB and Bank of Spain.

6.2 - New business loans

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



Source: Bank of Spain and Funcas.

of the consumer basket have shown positive inflation rates, such that the current situation cannot be considered deflationary (Exhibits 5.1 and 5.2).

The current account of the balance of payments turned a surplus of 1.5% of GDP in 2015, according to provisional figures. This was more than the 1% surplus recorded in 2014, due to the lower energy bill and smaller interest payments abroad. The trade surplus in non-energy goods, by contrast, dropped as a result of faster growth in imports than in exports (Exhibits 3.1 and 3.3). The financial balance, excluding the Bank of Spain, registered net outflows of 70.2 billion euros, as a result of Spanish investments abroad – which rose by 40% – exceeding foreign investments in Spain, which were halved (Exhibit 3.4).

Spain’s net lending position vis-à-vis the rest of the world rose to 2.2% of GDP, compared with 1.6% in 2014, as a result of the national savings rate rising faster than the investment rate. The household savings rate in the period to the third quarter of the year (the most recent period for which data are available broken down by sectors), fell in comparison with the same period the previous year, while the savings rate of non-financial corporations increased, and that of the general government was less negative (Exhibits 7.1 and 7.2).

The deleveraging of private-sector agents continued to progress throughout 2015, in both absolute and relative terms. In the third quarter of 2015, household debt represented 107.7% of their gross disposable income, compared with 114.3% a year earlier. In relation to GDP it represented 68.6% in the third quarter of 2015, compared with 73.6% in 2014. In the case of non-financial corporations, the debt ratio dropped from 116.2% of GDP in the third quarter of 2014, to 107.2% in the same period of 2015 (Exhibit 7.4).

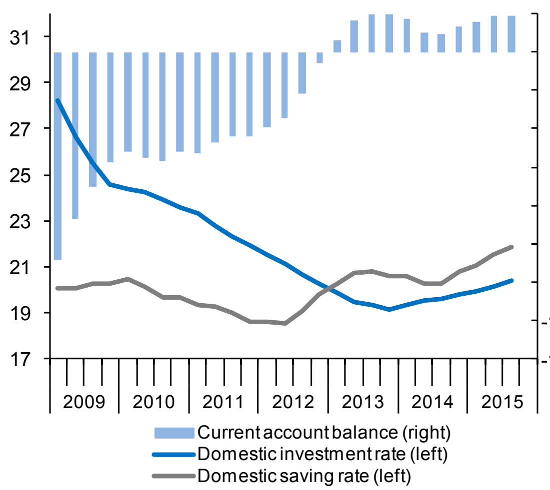
Declining debt volumes are not incompatible with new credit growth, which recovered somewhat in 2015, in the case of lending to both businesses and households. Nevertheless, in the last quarter

Exhibit 7

Financial imbalances

7.1 - Domestic saving, investment and current account balance

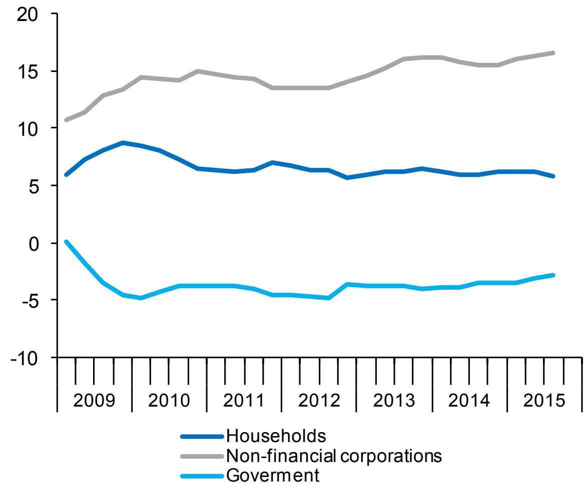
Percentage of GDP, 4-quarter moving average



Source: INE.

7.2 - Saving rates

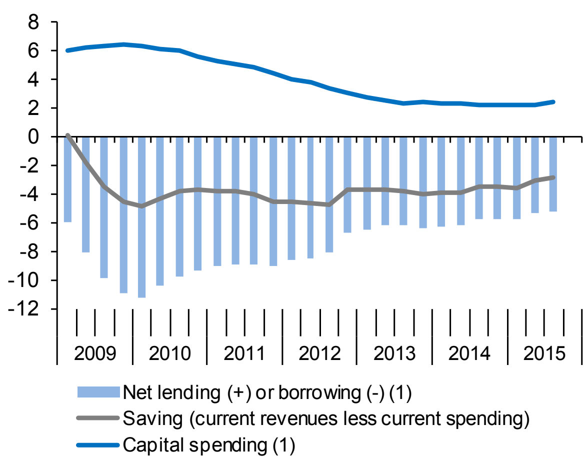
Percentage of GDP, 4-quarter moving average



Sources: INE and IGAE.

7.3 - General Government deficit

Percentage of GDP, 4-quarter moving average

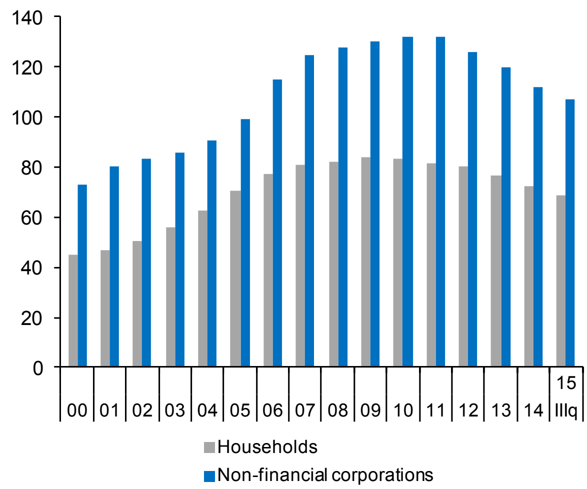


(1) Excluding financial entities bail-out

Sources: INE and IGAE.

7.4 - Gross debt

Percentage of GDP



Source: Bank of Spain (Financial Accounts).

of the year there was a significant drop, which sharpened further in January 2016 (Exhibit 6.2). It is still too early to say whether these declines represent a permanent trend change in the path of this variable's recovery, or a transitory interruption that may be related to international and domestic uncertainties.

In the period to November 2015, the combined deficit of the central government, the social security funds, and the autonomous regions came to 41.8 billion euros, 5.4 billion euros less than in the year-earlier period, a figure equivalent to 3.87% of annual GDP. This result is still under the 4.2% target for the year, but given December's highly negative seasonality, particularly in the case of the social security accounts, the target will be surpassed. The final result is probably very close to 5% of GDP.

The 2015 deficit target of 4.2% will be surpassed and the final result will probably be close to 5% of GDP.

General government debt, in this case based on data to December 2015, rose to 1,070.3 billion euros, 36.5 billion euros more than in December 2014. Nevertheless, thanks to increased nominal GDP growth (3.8%) the ratio to GDP dropped by three tenths of a percent, to 99%. The autonomous regions were responsible for the majority of this increase in debt.

Forecasts for 2016-2017

In the first few months of this year, the price of oil dropped considerably relative the scenario contemplated in the previous forecasts, which would suggest that they should be revised upwards. However, a number of other factors are acting in the opposite direction. These include slower-than-expected growth of the global economy, in the case of both developed and emerging economies, and increased uncertainty deriving from this and other factors, that triggered serious tensions in international financial markets in the first two months of the year. The impact of these factors will be reflected in a sharper slowdown in growth towards the third quarter of the year.

Consequently, the GDP-growth forecast for 2016 has been revised downwards one tenth of a percent to 2.7%. This scenario does not consider the possible impacts of domestic political uncertainty, as these may vary according to how the situation evolves over the coming months. In any event, this represents a significant risk factor that may translate into worse-than-expected economic performance. 2017 should see a return to quarter-on-quarter growth rates in the order of 0.6%, once the current global uncertainty has passed, despite which the annual rate will be below this year's, at 2.3%. The same pattern of contributions to growth of the past two years will be maintained, *i.e.* a positive contribution from domestic demand and a negative contribution from the external sector (Exhibits 8.1 and 8.2).

Growth in private consumption will pick up speed in 2016 to 3.3% thanks to the stimulus from the lower oil price, job creation, and income-tax cuts. This stimulus will run out of steam in 2017, when oil prices are expected to rise slightly, such that this variable is likely to grow by 2.6% next year. As regards public consumption, given the deficit reduction targets, a slowdown is to be expected in both years relative to the sharp rise in 2015 (Exhibit 8.3).

Expected growth in investments in machinery and capital goods in 2016 has been revised downwards as, together with exports, this is one of the components of demand on which the effect on the Spanish economy of slower global growth and heightened international uncertainties will most strongly be felt.

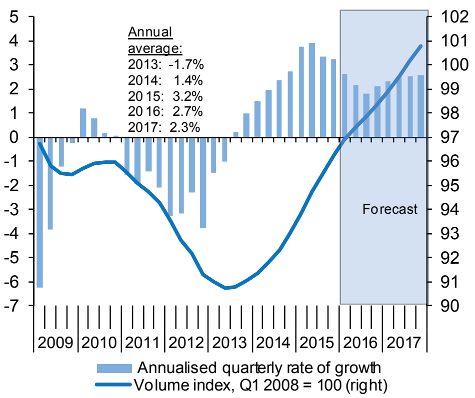
Expected growth in investments in machinery and capital goods in 2016 has been revised downwards to 5.1%, as, together with exports, this is one of the components of demand on which the effect on the Spanish economy of slower global growth and heightened international uncertainties will most strongly be felt. Growth of this component of demand will also be more moderate in 2017 at 4%.

Exhibit 8

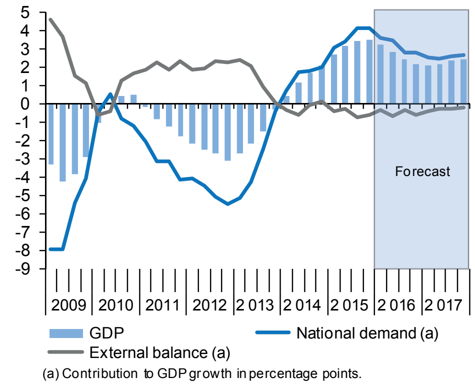
Economic forecasts for Spain, 2016-17

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

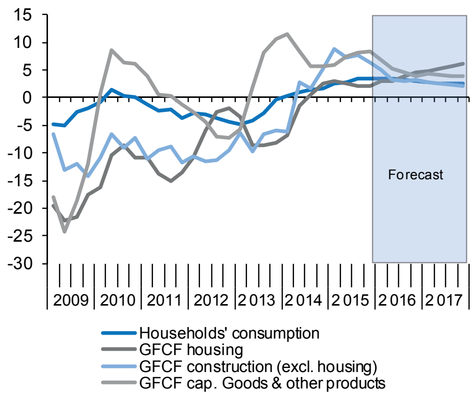
8.1 - GDP



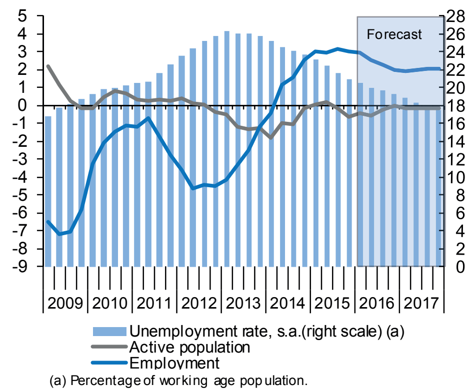
8.2 - GDP, national demand and external balance



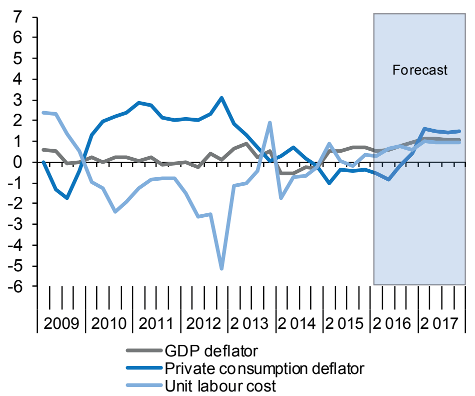
8.3 - National demand aggregates



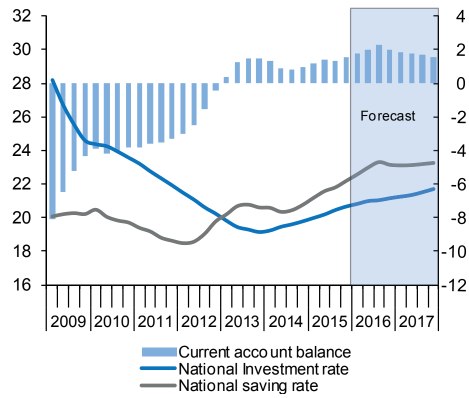
8.4 - Employment and unemployment



8.5 - Inflation



8.6 - Saving, investment and c/a balance (% GDP, 4qt moving averages)



Source: INE (Quarterly National Accounts) and Funcas (forecasts).

Table 1

Economic forecasts for Spain, 2016-2017

Annual rates of change in %, unless otherwise indicated

	Actual data				*Funcas forecasts*		Change forecast (a)
	Average 1996-2007	Average 2008-2013	2014	2015	2016	2017	2016
1. GDP and aggregates, constant prices							
GDP	**3.8**	**-1.3**	**1.4**	**3.2**	**2.7**	**2.3**	**-0.1**
Final consumption households and NPISHs	3.6	-2.2	1.2	3.1	3.3	2.6	0.1
Final consumption general government	4.3	0.7	0.0	2.7	2.0	1.3	0.6
Gross fixed capital formation	6.4	-7.0	3.5	6.4	4.3	3.9	-1.0
Construction	5.9	-9.8	-0.2	5.3	3.6	3.8	-0.9
Residential construction	7.8	-11.2	-1.4	2.4	3.6	5.5	-1.8
Non-residential construction	4.2	-8.2	0.8	7.5	3.7	2.4	-0.2
Capital goods and other products	7.5	-2.4	7.7	7.5	5.1	4.0	-1.0
Exports goods and services	6.6	1.7	5.1	5.4	3.8	4.8	-1.3
Imports goods and services	8.7	-4.1	6.4	7.5	5.7	6.0	-1.2
National demand (b)	**4.5**	**-3.0**	**1.6**	**3.7**	**3.2**	**2.5**	**-0.1**
External balance (b)	-0.7	1.7	-0.2	-0.5	-0.5	-0.3	-0.1
GDP, current prices: - € billion	--	--	1,041.2	1,081.2	1,118.0	1,155.8	--
- % change	7.4	-0.8	1.0	3.8	3.4	3.4	-0.4
2. Inflation, employment and unemployment							
GDP deflator	3.5	0.5	-0.4	0.6	0.7	1.1	-0.2
Household consumption deflator	**3.1**	**1.8**	**0.2**	**-0.5**	**-0.3**	**1.5**	**-1.2**
Total employment (National Accounts, FTEJ)	3.4	-3.3	1.1	3.0	2.4	2.0	0.0
Productivity (FTEJ)	0.4	2.1	0.3	0.2	0.3	0.3	-0.1
Wages	7.5	-1.1	0.9	3.9	3.5	3.4	0.1
Gross operating surplus	6.9	-0.2	0.4	3.1	2.8	2.8	-0.8
Wages per worker (FTEJ)	3.3	2.4	-0.6	0.5	0.8	1.3	0.0
Unit labour costs	2.9	0.3	-0.8	0.3	0.6	1.0	0.2
Unemployment rate (LFS)	**12.5**	**20.2**	**24.4**	**22.1**	**19.9**	**18.2**	**-0.3**
3. Financial balances (% of GDP)							
National saving rate	22.4	19.9	20.8	22.2	23.1	23.2	0.4
- of which, private saving	18.6	23.1	24.3	25.0(c)	24.9	24.0	0.5
National investment rate	26.9	23.2	19.8	20.7	21.2	21.7	-0.1
- of which, private investment	23.0	19.4	17.7	18.5(c)	19.0	19.6	-0.2
Current account balance with RoW	**-4.5**	**-3.3**	**1.0**	**1.5**(c)	**2.0**	**1.6**	**0.6**
Nation's net lending (+) / net borrowing (-)	-3.7	-2.8	1.6	2.2(c)	2.7	2.2	0.7
- Private sector	-2.8	5.8	7.5	7.2(c)	6.6	5.1	0.7
- Public sector (general governm. deficit)	**-0.9**	**-8.6**	**-5.9**	**-5.0**(c)	**-4.0**	**-2.9**	**-0.1**
- General gov. deficit exc. financial instit. bailouts	**--**	**-7.8**	**-5.8**	**-5.0**(c)	**-4.0**	**-2.9**	**-0.1**
Gross public debt	52.2	66.8	99.3	99.0	99.2	98.9	-0.8
4. Other variables							
Household saving rate (% of GDI)	10.2	10.2	9.6	9.0(c)	9.3	8.9	-0.6
Household gross debt (% of GDI)	82.1	127.2	112.1	106.2(c)	100.7	97.7	1.6
Non-financial coporates gross debt (% of GDP)	80.0	127.9	112.2	104.3(c)	97.5	91.5	-0.7
Spanish external gross debt (% of GDP)	90.2	159.7	166.2	168.3(c)	165.0	160.1	-0.7
12-month EURIBOR (annual %)	3.7	1.9	0.5	0.2	0.0	0.3	-0.2
10-year government bond yield (annual %)	5.0	4.7	2.7	1.7	1.7	2.2	-0.1

Notes:
(a) Change between present and previous forecasts, in percentage points. (b) Contribution to GDP growth, in percentage points.
Sources: 1996-2015 except for (c): INE and Bank of Spain; Forecasts 2016-2017 and (c): Funcas.

The forecast for construction investment in 2016 has also been revised downwards, due to the lower-than-expected growth in the residential component in the last quarter of 2015. Nevertheless, this component's growth will continue to pick up speed in 2016, while growth of investment in other constructions will slow significantly with the end of the effect of the electoral cycle on public investment, which is what stimulated this variable last year. In 2017, it is expected that housing construction will continue to gain strength, while the other constructions component will continue to slow.

Exports will slow to 3.8% in 2016, which is significantly down from the last forecast, as a result of worsening global economic conditions. Imports have also been revised downwards to 5.7%, due to the expected slower growth of final demand resulting from the decline in investment and exports. Both these variables are expected to grow somewhat faster in 2017. Consequently, the external sector's contribution to GDP growth will be somewhat more negative that forecast previously in 2016.

Employment, measured in full-time equivalent job terms, is set to grow by 2.4% this year (unchanged from the last forecast) and 2% next year. In terms of the numbers of people in work according to the labour force survey (LFS), employment generation between the two years will be 794,000, and the unemployment rate will drop to an annual average of 19.9% in 2016 and to 18.2% in 2017 (Exhibit 8.4).

Productivity of the economy as a whole is likely to grow in both years at 0.3%, a similar rate to preceding years. In conjunction with faster growth in compensation per employee, this will lead to a rise in unit labour costs of 0.6% and 1% in 2016 and 2017, respectively. This remains below increases in the GDP price index.

As regards inflation, even supposing the oil price recovers to over 45 dollars a barrel during the year, the headline inflation rate will be negative at least for the first half of this year. The core rate will be positive throughout 2016 at around 1% and will accelerate slightly in 2017 (Exhibit 8.5).

The general government deficit will drop to 4% of GDP in 2016 solely as a result of the favourable effect of the cycle. In 2017, the deficit is set to drop to 2.9% of GDP. This is basically due to the smaller cyclical deficit, with the improvement in the structural deficit having only a minor impact.

The surplus on the current account of the balance of payments will increase in 2016 despite the negative contribution of external sector growth, thanks to the lower oil price. With regard to 2017, the starting point hypothesis is that this favourable situation will not be repeated, such that the surplus will shrink as imports grow faster than exports (Exhibit 8.6).

The general government deficit will drop to 4% of GDP in 2016 solely as a result of the favourable effect of the cycle. In 2017, the deficit is set to drop to 2.9% of GDP. This is basically due to the smaller cyclical deficit, with the improvement in the structural deficit having only a minor impact.

To conclude, the impact of the one-off factors that stimulated growth in 2015 is wearing off, and, at least in 2016, this is being compounded by worsening global economic conditions. The outlook in Spain is therefore for slower GDP growth this year and next. The downside risks are considerable. These derive from the possibility of renewed tensions in financial markets and the possible negative impact of the situation of domestic political uncertainty on investment and employment decisions.