Spain´s economic recovery gains speed, but the external balance worsens

Ángel Laborda and María Jesús Fernández[1]

Correction of imbalances, together with structural reform and exogenous factors, supports an optimistic outlook for Spain´s recovery in 2015 and 2016. Deterioration of the balance of payments, however, reflects the need for further reform in order to achieve strong, sustainable growth in the longer-term.

The Spanish economy's recovery has gained strength as a result of progress on the correction of imbalances built up during the growth phase. Other supportive elements include the effects of labour-market reform and a number of exogenous factors, such as falling oil prices and interest rates, cuts in personal income tax, and increased public spending ahead of various elections this year. These factors are stimulating consumption and residential and non-residential construction to a greater extent than anticipated, leading to the GDP growth forecast for 2015 being raised to 3%. Nevertheless, the effect of these factors will be short-lived, and their impact will start to wear off in 2016, such that the forecast for next year is for a slowdown to 2.8%. The downside to this recovery is the deterioration of the balance of payments, which has only avoided entering negative territory this year and next as a result of the drop in the oil price.

International context

The global economic context continues to be characterised by the contrast between the strength of the United States and the weaknesses of the rest of the world. The U.S. economy grew by 2.2% quarter-on-quarter –on an annualized basis– in the last quarter of 2014. Although this figure represents a notable slowdown on the rate of growth registered in the previous quarters, this should not be interpreted as a loss of dynamism, as it forms part of a still highly positive trend, as is highlighted by the strong job creation observed in the first two months of 2015. Average annual growth in 2014 came to 2.4%. The inflation rate was negative in January, but the core rate remains stable at around 1.6%. The Federal Reserve is expected to start raising interest rates around the middle of the year.

The emerging economies continued to show signs of weakness. China grew by 7.4% in 2014, and the official target for 2015 has been cut to 7%, which will be its lowest growth rate in the last 25 years. The Russian economy was stagnant in 2014 and a recession is forecast for 2015 as a consequence of falling oil prices and international sanctions, while its currency, which lost almost 70% of its value against the dollar in 2014, continued to depreciate in the first few months of this year. GDP growth in Brazil in the first three quarters of last year was zero or negative, and

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its exchange rate has fallen by 27% since the middle of last year. The same trend is evident for the currencies of other emerging economies, such as Turkey, Indonesia and South Africa. One of the main uncertainties this year remains the possible impact of rising U.S. interest rates on macroeconomic stability in these countries.

Growth in the euro area picked up in the third quarter, rising to an annualised rate of 1.3%, yielding annual growth of 0.9% over the year as a whole. The indicators available for the first quarter of 2015 indicate that the European economy has continued to gain strength, although the forecasts are still for modest growth, at around 1.5%. The weak economy, together with inflation's falling to negative rates since December, has prompted the European Central Bank to introduce a programme of monetary expansion consisting of the purchase of government or public institutions' debt, and certain private debt instruments, for a value of 60 billion euros a month, initially until September 2016. The programme was launched in early March. The main risk of instability to the area comes from Greece.

Recent developments in the Spanish economy

Spanish GDP grew by 0.7% in the fourth quarter of 2014, a rate equivalent to 2.7% in annualised terms (all the quarter-to-quarter growth rates below will be expressed in this form) above the 2.1% registered in the two previous quarters. Growth in year-on-year comparative terms was 2%. Over the year as a whole, GDP grew by 1.4% on the previous year.

The quarter's growth came from a positive contribution from domestic demand of 2 percentage points (pp) and a positive contribution from the external sector of 0.7 pp. This was the first time since the start of the recovery when the external sector's contribution to quarterly growth was positive, and was a result of the sharp drop in imports in the period. Over the year as a whole the contribution of domestic demand to growth was 2.2 pp, while the external sector contributed -0.8 pp, as a result of import growth outpacing export growth. It is the first year since 2007 in which the external sector made a negative contribution to growth.

Private consumption rose by 3.8% in the fourth quarter. The dynamism of this expenditure component, which has maintained quarter-to-quarter growth rates comparable to those in pre-crisis years over the course of the year, has been one of the most striking features of how the economy progressed in 2014. This variable's growth over the year as a whole was 2.4%. A large share of this growth was driven by spending on consumer durables, which rose by 10.9% on an annual basis in 2014. Much of this was new vehicle purchases, with registrations rising by almost 19%. Nevertheless, most of this spending filtered through to imports rather than national production, as can be seen in the disappointing performance of the consumer durables IPI, which dropped by 1.6%. This explains the strong growth in imports that took place in 2014, which caused an inversion in the contribution of external demand to GDP growth. New vehicle registrations grew strongly in the first few months of 2015, and the consumer confidence index has returned to levels higher even than those before the crisis, while the retail trade confidence index is at an all-time high (Exhibits 1.1 and 1.2).

The housing sector's adjustment can thus be considered to have ended, and much earlier than expected. The indicators for the property market, specifically house sales and prices, also point in this direction, having begun to rise in 2014.

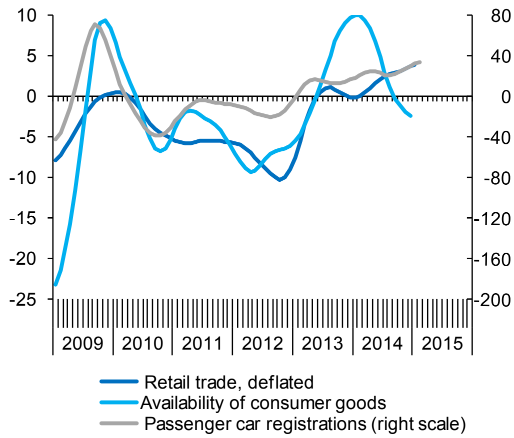
Although government consumption dropped by 3.9% in the last quarter, the result for the year as a whole was a slight increase (0.1%). Nevertheless, the quarter-on-quarter drop was sharper in current

Exhibit 1

Consumption and capital goods investment indicators

1.1 - Consumption indicators (I)

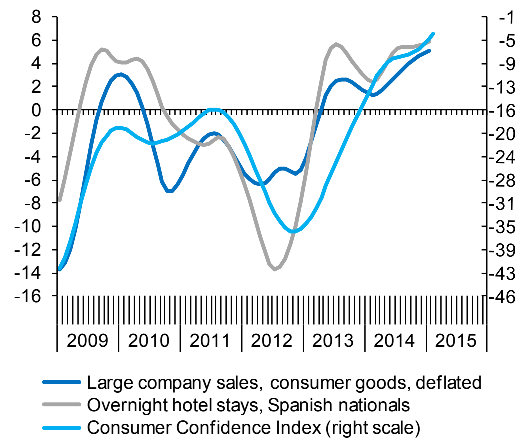
Annualised moving quarterly change in %, smoothed series



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

1.2 - Consumption indicators (II)

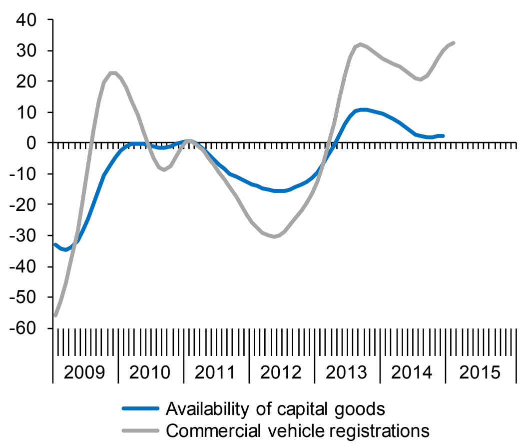
Annualised moving quarterly change in % and index (CCI), smoothed series



Sources: European Commission, INE, AEAT and FUNCAS.

1.3 - Capital goods GFCF indicators (I)

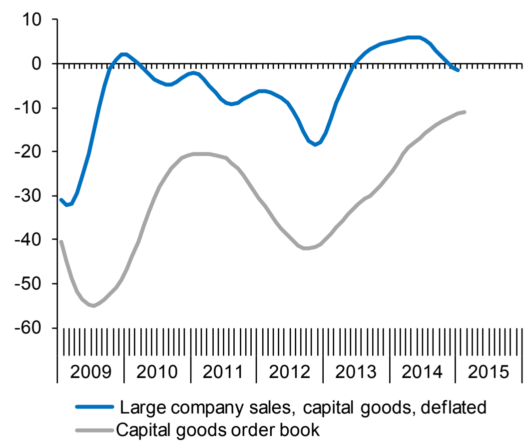
Annualised moving quarterly change in %, smoothed series



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.

prices (15.2%), such that the annual result, in these nominal terms, was a contraction of 0.7%.

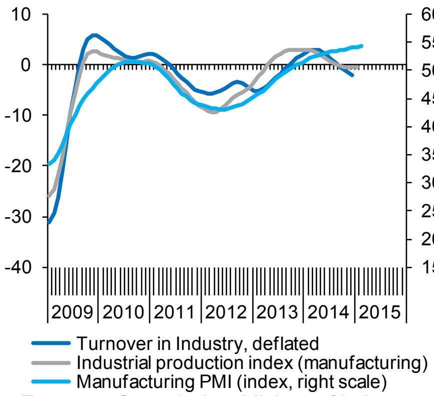
Investment in machinery contracted in the fourth quarter, after seven straight quarters of growth. However, the drop was more than offset by rising investments in transport equipment and other products. Registrations of commercial vehicles continued to grow strongly in January and February 2015, with a recovery in sales by large capital goods companies in January (Exhibits 1.3 and 1.4) following the drop the previous quarter.

Exhibit 2

Industrial activity, services and construction indicators

2.1 - Industrial sector indicators (I)

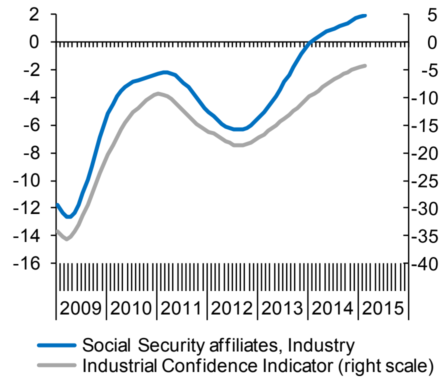
Annualised moving quarterly change in % and index, smoothed series



Sources: European Commission, Ministry of Labour and FUNCAS.

2.2 - Industrial sector indicators (II)

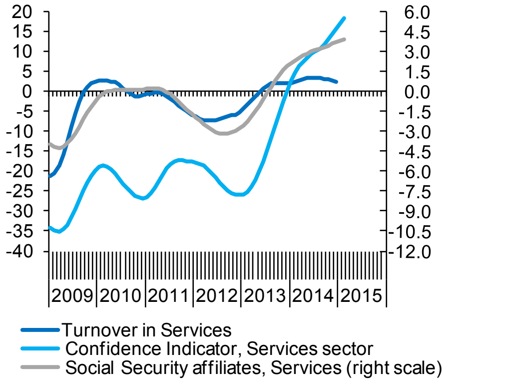
Annualised moving quarterly change in % and index, smoothed series



Sources: European Commission, Ministry of Labour and FUNCAS.

2.3 - Services indicators (I)

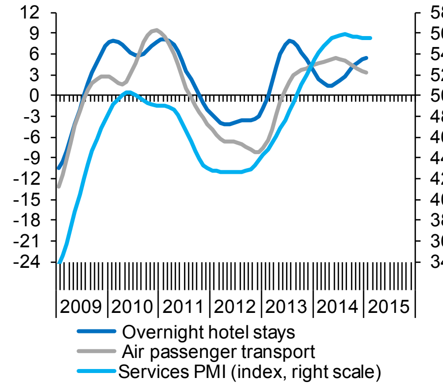
Annualised moving quarterly change in % and index, smoothed series



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

2.4 - Services indicators (II)

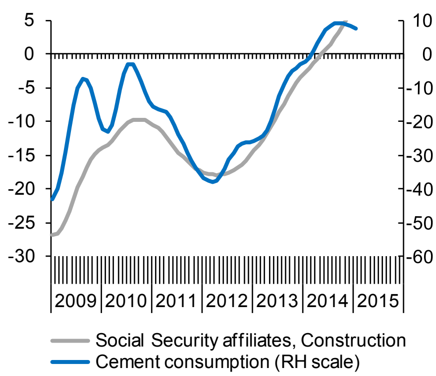
Annualised moving quarterly change in %, smoothed series



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

2.5 - Construction sector indicators (I)

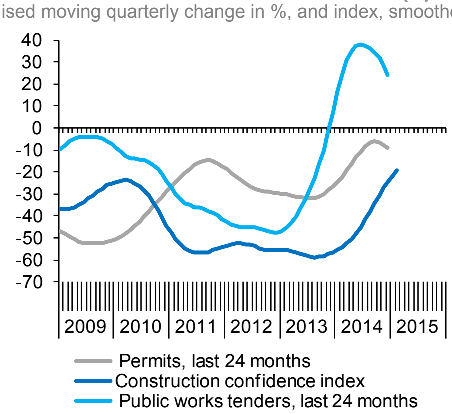
Annualised moving quarterly change in %, smoothed series



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.

Construction investment also grew for the third consecutive quarter. The rise of non-residential construction stands out. This is probably linked mainly to public works, as can be seen from the strong increase in public tenders, although housing construction also grew. The figures for housing construction from the previous quarters have also been revised upwards, such that this component of investment rose, in quarter-on-quarter terms, in all four quarters of 2014. The sector's adjustment can thus be considered to have ended, and much earlier than expected. The indicators for the property market, specifically house sales and prices, also point in this direction, having begun to rise in 2014.

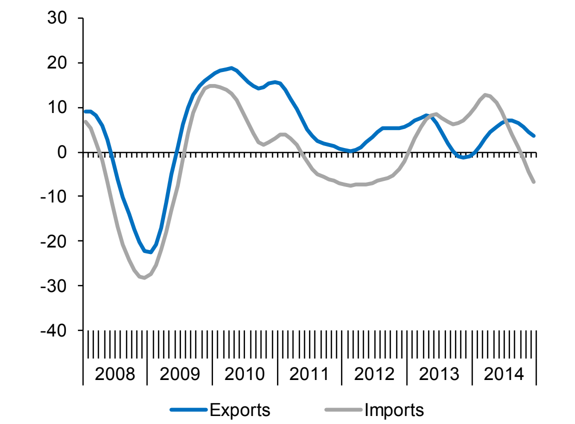
Goods exports declined in the fourth quarter of the year, although this drop was offset by the increase in exports of services, such that total

Exhibit 3

External sector

3.1 - Exports/Imports at constant prices (Customs)

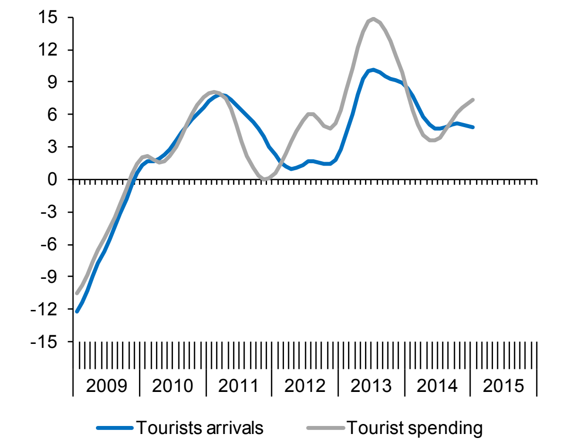
Annualised moving quarterly change in %, smoothed series



Source: Ministry of Economy.

3.2 - Tourist sector

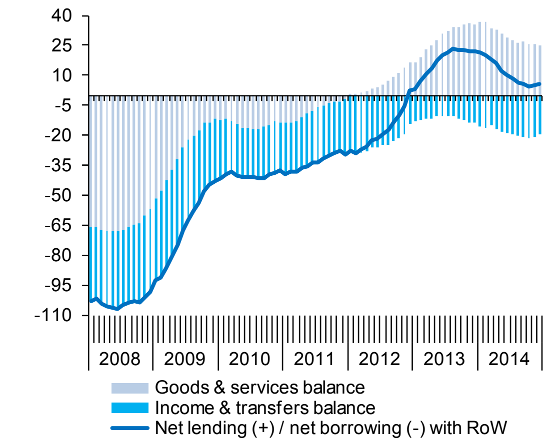
Annualised moving quarterly change in %, smoothed series



Source: Ministry of Industry.

3.3 - Balance of payments

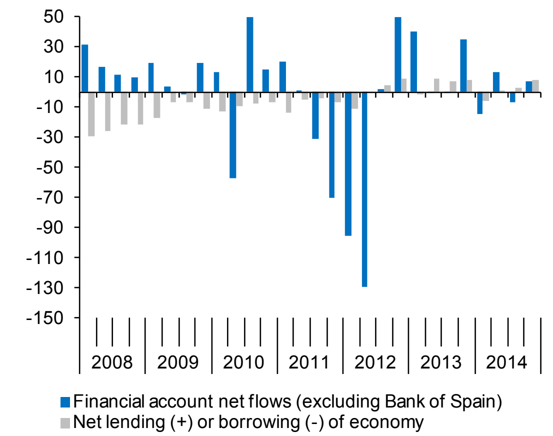
EUR billion, cumulative last 12 months



Source: Bank of Spain.

3.4 - Balance of payments

EUR billions



Source: Bank of Spain.

exports registered virtually no change in the period. Imports of goods and total imports both declined. The decreases in goods exports and imports followed a strong upturn in the previous quarter, such that the result of the last quarter cannot be interpreted as a change in the recent trend. Throughout 2014, exports of goods and services grew by 4.2% and imports by 7.6%. As a consequence, the balance of payments on the current account in 2014 reduced its surplus to 0.1% of GDP from 1.4% in 2013 (Exhibits 3.1 to 3.3).

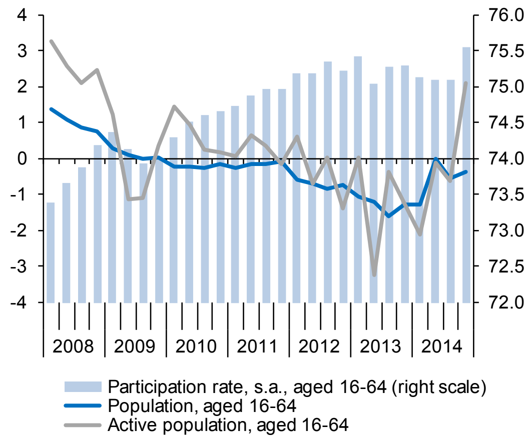
From a supply-side perspective, GVA grew in manufacturing, services not linked to the public administration, and above all, in construction, which posted a quarterly upturn of 13% on

Exhibit 4

Labour market indicators

4.1 - Labour supply

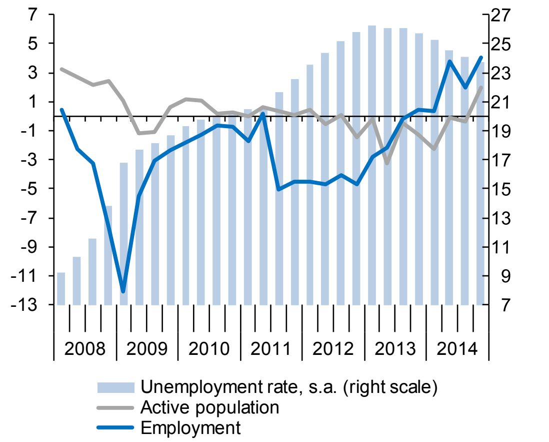
Annualised change q-o-q in % and percentage of population aged 16-64



Source: INE (LFS).

4.2 - Employment and unemployment (LFS)

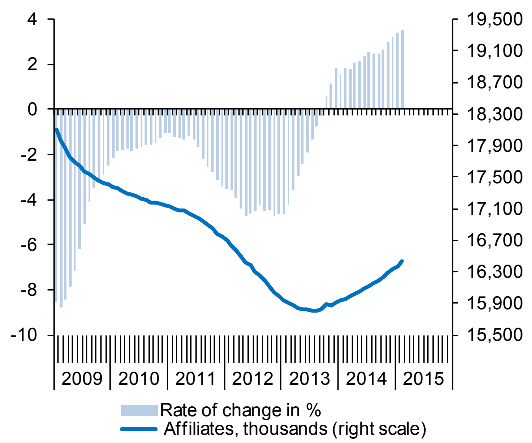
Annualised change q-o-q in % and percentage of working age population



Source: INE (LFS).

4.3 - Social Security affiliates

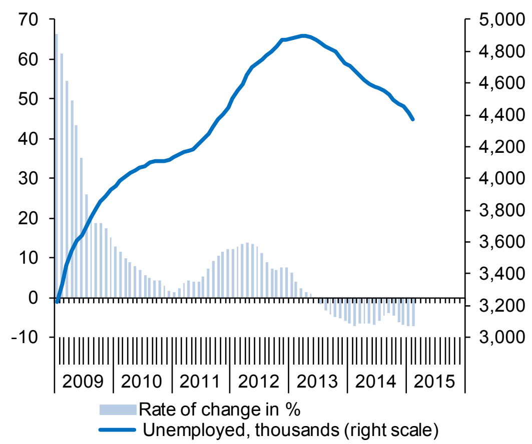
Annualised moving quarterly change in % and thousands, seasonally-adjusted data



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.

an annualised basis, although its year-on-year performance from 2013 to 2014 was negative. The primary sector's GVA dropped, although quarter-to-quarter variations in this sector are highly erratic, and the picture for the year as a whole was one of growth. The indicators for industrial activity and services maintained a positive trend in the first few months of the year, particularly as regards the number of social security system affiliates in each sector, confidence indexes and PMIs, and the strong job creation in the construction sector is particularly striking (Exhibits 2.1 to 2.6).

The number of full-time equivalent jobs accelerated its quarterly growth rate to 2.8% in the last quarter of the year, giving rise to an increase of 1.2% over the year as a whole, this being the first year since 2008 in which employment had increased. The unemployment rate dropped to 23.7% in the last quarter, two percentage points lower than a year earlier. Job creation gained strength in January and February of 2015, according to figures showing an acceleration in the rise in the number of social security system affiliates (Exhibits 4.1 to 4.4).

Productivity dropped slightly in the fourth quarter, both in the manufacturing industry and across the wider economy, although the change in this variable over the year as a whole was positive. Wage increases, also on an annual average basis, were negative in services, particularly those linked to the public administration, and positive in industry. As a result of the trends in productivity and wages, unit labour costs fell by 0.4% in 2014 across the economy as a whole and 0.3% in the manufacturing industry (the fifth consecutive year of decreases, in both cases).

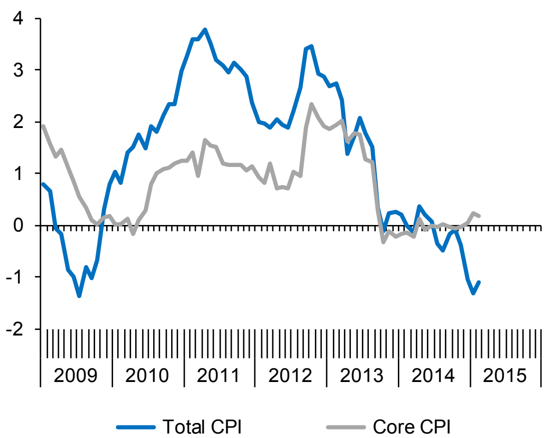
Towards the third quarter of the year, households had produced a net lending position of 1.3% of GDP, well below the 2.8% in the year-earlier period, as a consequence of a drop in savings, which in turn derived from growth in nominal consumption in a context of falling gross disposable income. This surplus was largely devoted to debt reduction, with debt in the third quarter of the year standing at 111.6% of households' gross disposable income, a ratio 5.6 pp lower than that reached a year earlier, and 17 pp lower than its peak in 2010 (Exhibits 7.2 and 7.4).

Exhibit 5

Price indicators

5.1 - Consumer Prices Index

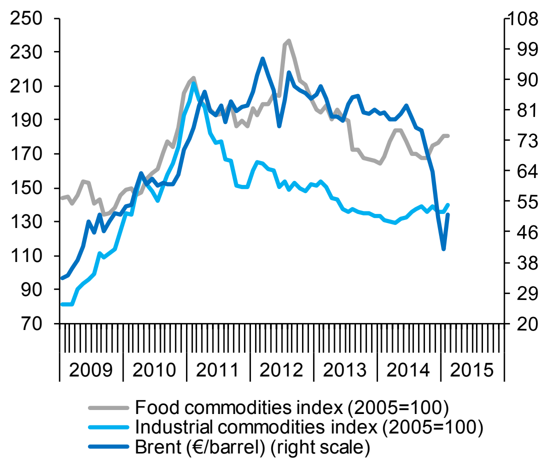
Change y-o-y in %



Source: INE (CPI).

5.2 - Commodities prices in €

Euros and index



Sources: Ministry of Economy and The Economist.

For their part, non-financial corporations posted a financial surplus of 1.7% of GDP for the period to the third quarter of the year, 2.8 pp less than in the year-earlier period. Firms devoted their entire surplus, along with the proceeds of the sale of financial assets, to reducing their debt, which stood at 109.7% of GDP in the third quarter, 5.5 pp less than a year earlier, and 24.4 pp down from its peak (Exhibits 7.2 and 7.4).

In contrast to the private sector's financial surplus, the public sector posted a deficit in the first three quarters of the year. Excluding aid to financial institutions, this came to 4.9% of GDP compared with 5.7% of GDP in the same period the previous year (Exhibit 7.3). Through November, the deficit of all levels of government excluding local authorities –*i.e.,* central government, autonomous regions, and social security funds– came to 4.62% of annual GDP –excluding aid to financial institutions– compared with 5.15% in the same period the previous year. The improvement mainly came from increased revenues, which grew by 1.7%, while expenditure dropped by just 0.9%. The central government and the social security funds reduced their deficit, while the autonomous regions increased theirs. In the case of social security, the improvement in its balance came from the increase in the National Employment Service surplus –unemployment benefits–, while the Social Security System –basically the pensions system– worsened its deficit.

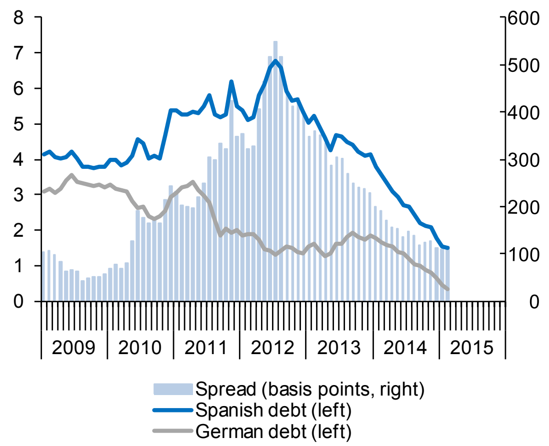
The financial account of the balance of payments –excluding the Bank of Spain– reduced its surplus from the 7.2% of GDP reached in 2013 to 0.1% of GDP in 2014 (on the basis of provisional figures) (Exhibit 3.4). This was not a consequence of a decrease in inflows of resources from foreign investors, which, on the contrary, doubled, but a change in sign in Spanish investors' operations abroad, which turned from negative in 2013 –*i.e.* net inflows from divestments– to positive in 2014 –net outflows. The fact that foreign investors have kept their appetite for Spanish financial assets is shown by the downward slope of yields and risk premiums on Spanish debt over the year, a trend that continued into the start of the current year (Exhibit 6.1).

Exhibit 6

Financial indicators

6.1 - Government 10 years bonds rate

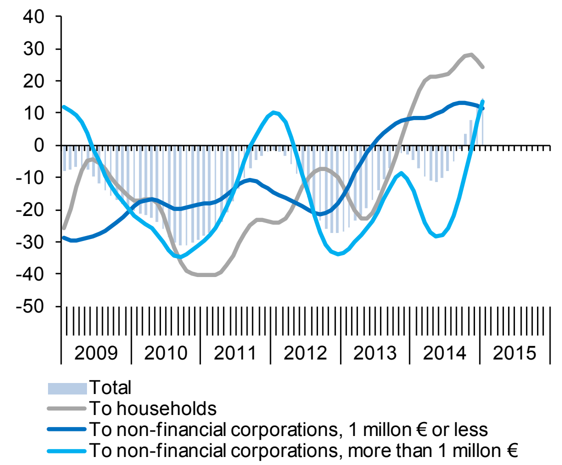
Percentage and basis points



Sources: ECB and Bank of Spain.

6.2 - New business loans

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



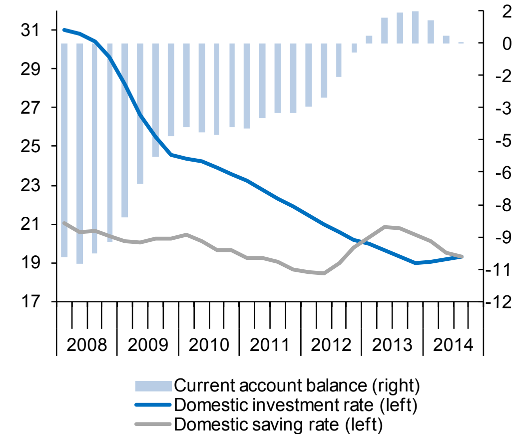
Sources: Bank of Spain and FUNCAS.

Exhibit 7

Financial imbalances

7.1 - Domestic saving, investment and current account balance

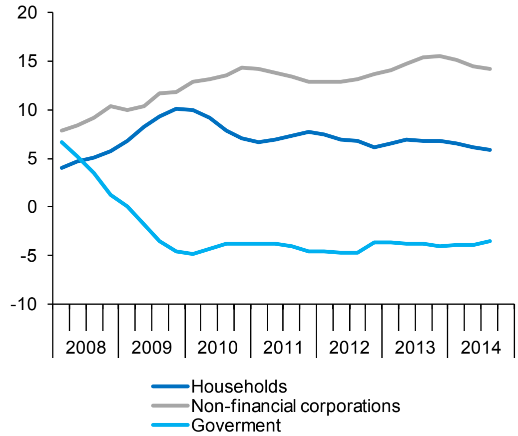
Percentage of GDP, 4-quarter moving average



Source: INE.

7.2 - Saving rates

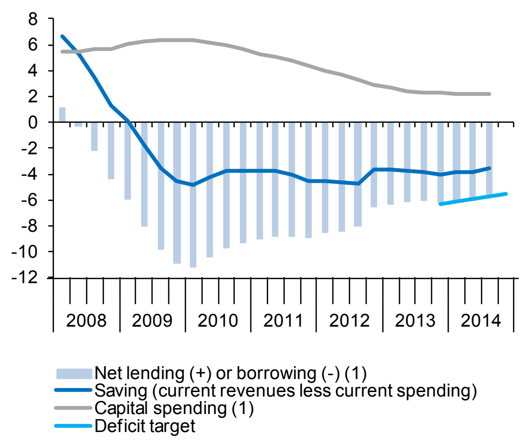
Percentage of GDP, 4-quarter moving average



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, 4-quarter moving average

Source: Bank of Spain (Financial Accounts).

The consumer price inflation rate, which since last July has been negative almost every month, dropped to a minimum of -1.3% in January and rose to -1.1% in February. The negative rate is basically the result of falling energy product prices (Exhibits 5.1 and 5.2). Core inflation, *i.e.* the inflation rate excluding foodstuffs and energy related products, is positive, although low, and slowly climbing. This implies a very much incipient and still very slight upturn in inflationary tensions, and therefore a move away from the deflationary scenario, which is in any case inconsistent with the current context of strong consumption growth.

In January of this year, new lending to small businesses and households, for both house purchases and consumption, remained on the growth trend observed in 2014 (Exhibit 6.2). This positive trend is the result of both the favourable change in conditions on both the supply side, thanks to the recapitalisation and cleaning up of the Spanish financial system, and demand side, with the progressive recovery of solvent demand. Nevertheless, the total stock of credit continues to drop, which is only to be expected given the economy's being in a process of deleveraging.

Forecasts for 2015-2016

The available data for the start of the first quarter of 2015 (including social security affiliates, PMI indexes, confidence indicators, sales by large companies, and vehicle registrations) suggest faster GDP growth than expected, which could reach 3.5% on an annualised basis. Various external and internal shocks, such as the drop in the oil price and interest rates, improved access to credit, the cut in personal income tax, and increased public spending ahead of the various elections due this year, are stimulating consumption and residential and non-residential construction to a greater extent than forecast.

As a consequence of the more vigorous performance of consumption and construction than expected, the GDP growth forecast for 2015 has been revised upwards six tenths to 3.0%.

As a consequence of this more vigorous performance of consumption and construction, the GDP growth forecast for 2015 has been revised upwards six tenths to 3.0%. In the third quarter of the year, the quarter-on-quarter rate will begin to slow slightly due to the progressive moderation of the expansionary impact of the aforementioned shocks, although it will remain vigorous (Exhibit 8.1) In 2016, these effects will continue to lose strength, such that expected growth next year is 2.8%, *i.e.* less than that expected for 2015 (Exhibit 8.1). In both years domestic demand will make a positive contribution while the contribution of the external sector will be negative (Table 1).

Given the Spanish economy's high debt levels and its dependence on external financing, the main risk of this scenario's not being realised comes from the impact on Spain's risk premium and access to external finance due to possible turbulence in financial markets, whether deriving from increased interest rates in the United States or a credit event relating to Greece. Nevertheless, the fact that recent events surrounding the Greek problem have had no impact suggests that the risk is contained. Another risk derives from internal political instability in an election year, bearing in mind the changes that are taking place in the traditional balance of power that have governed the country since the transition to democracy.

Given the Spanish economy's high debt levels and its dependence on external financing, the main risk comes from the impact on Spain's risk premium and access to external finance due to possible turbulence in financial markets.

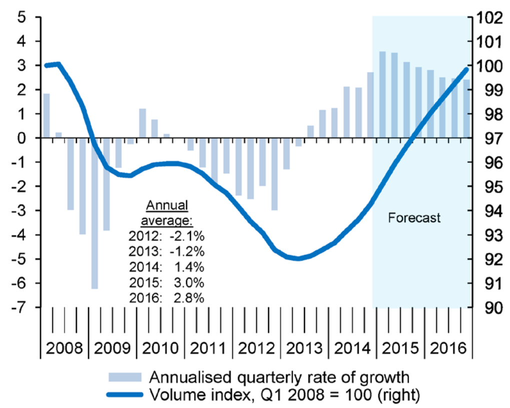
Consumer spending growth in 2015 has been revised upwards to 3.5%. Slower progress is expected in 2016 than is forecast for 2015, reflecting the exhaustion of the expansionary effect of the extraordinary factors affecting this variable this year. Public consumption will

Exhibit 8

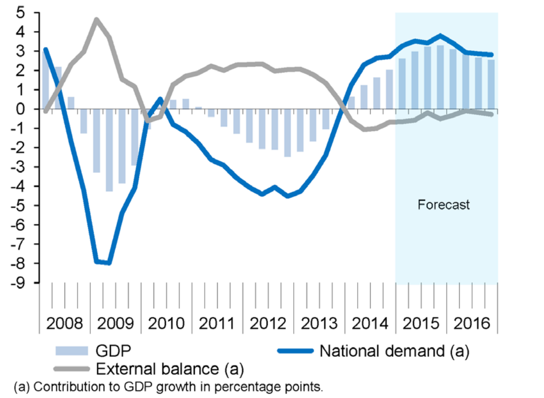
Economic forecasts for spain, 2014-2015

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

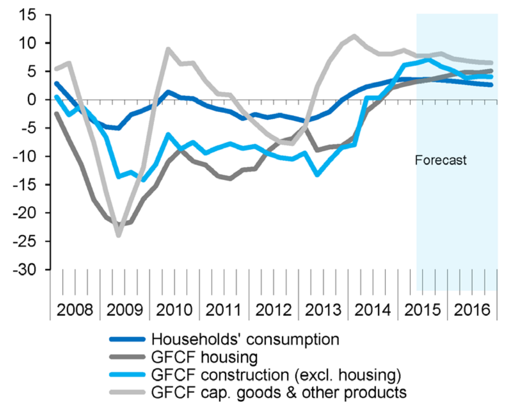
8.1 - GDP



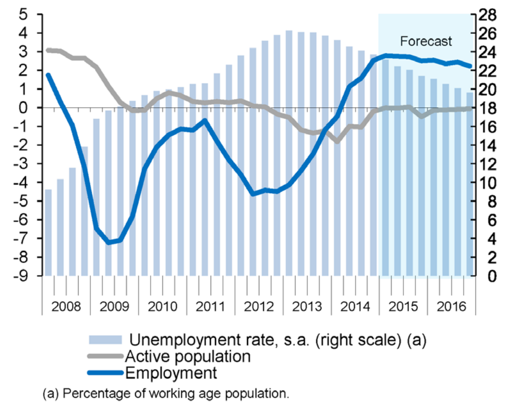
8.2 - GDP, national demand and external balance



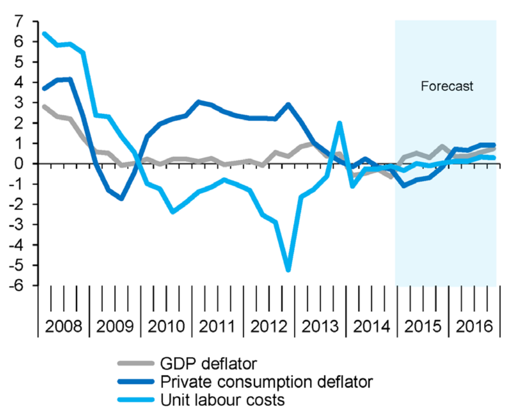
8.3 - National demand aggregates



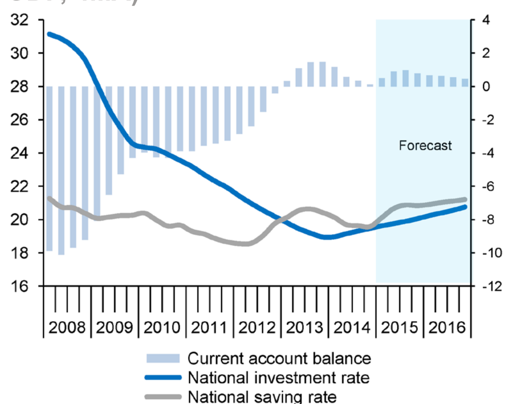
8.4 - Employment and unemployment



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 indicates

	Actual data				*FUNCAS forecasts*		*Change in forecasts (a)*
	Average 1996-2007	Average 2008-2013	2013	2014	2015	2016	2015
1. GDP and aggregates, constant prices							
GDP	**3.8**	**-1.1**	**-1.2**	**1.4**	**3.0**	**2.8**	**0.6**
Final consumption households and NPISHs	3.6	-1.9	-2.3	2.4	3.5	2.9	0.5
Final consumption general government	4.3	0.8	-2.9	0.1	0.6	0.5	0.0
Gross fixed capital formation	6.4	-7.3	-3.8	3.4	6.6	5.6	2.2
Construction	5.4	-10.3	-9.2	-1.5	5.1	4.5	3.3
Residential construction	7.4	-11.9	-7.6	-1.8	3.3	4.8	1.4
Non-residential construction	3.8	-8.4	-10.5	-1.3	6.4	4.3	4.7
Capital goods and other products	8.3	-2.3	3.4	9.1	8.1	6.8	1.2
Exports goods and services	6.6	1.7	4.3	4.2	5.2	5.5	0.6
Imports goods and services	8.7	-4.1	-0.5	7.6	7.3	6.7	1.0
National demand (b)	**4.5**	**-2.8**	**-2.7**	**2.2**	**3.5**	**3.0**	**0.7**
External balance (b)	-0.7	1.8	1.4	-0.8	-0.5	-0.2	-0.1
GDP, current prices: - € billion	--	--	1,049.2	1,058.5	1,095.7	1,131.9	--
- % change	7.4	-0.5	-0.6	0.9	3.5	3.3	0.5
2. Inflation, employment and unemployment							
GDP deflator	3.5	3.5	3.5	-0.5	0.5	0.5	-0.1
Household consumption deflator	**3.1**	**3.1**	**3.1**	**-0.1**	**-0.7**	**0.8**	**0.1**
Total employment (National Accounts, FTEJ)	3.4	3.4	3.4	1.2	2.6	2.3	0.6
Productivity (FTEJ)	0.4	0.4	0.4	0.2	0.4	0.5	0.0
Wages	7.5	7.5	7.5	1.3	3.3	3.1	0.6
Gross operating surplus	6.9	6.9	6.9	-0.1	3.7	2.9	0.4
Wages per worker (FTEJ)	3.3	3.3	3.3	-0.2	0.3	0.7	-0.1
Unit labour costs	2.9	2.9	2.9	-0.4	-0.1	0.2	-0.1
Unemployment rate (LFS)	**12.5**	**12.5**	**12.5**	**24.4**	**22.3**	**20.4**	**-0.2**
3. Financial balances (% of GDP)							
National saving rate	22.4	19.9	20.4	19.6	20.8	21.2	0.5
- of which, private saving	18.6	23.1	24.5	22.9	22.9	22.3	0.1
National investment rate	26.9	23.1	19.0	19.5	20.1	20.8	0.9
- of which, private investment	23.0	19.4	16.8	17.5	18.0	18.7	0.8
Current account balance with RoW	**-4.5**	**-3.3**	**1.5**	**0.1**	**0.8**	**0.5**	**-0.4**
Nation's net lending (+) / net borrowing (-)	-3.7	-2.8	2.1	0.5(c)	1.2	0.9	-0.4
- Private sector	-2.8	5.7	8.9	6.1(c)	5.6	4.1	-0.6
- Public sector (general governm. deficit)	**-0.9**	**-8.6**	**-6.8**	**-5.5(c)**	**-4.4**	**-3.3**	**0.2**
- General gov. deficit exc. financial instit. bailou	**--**	**-7.8**	**-6.3**	**-5.5(c)**	**-4.4**	**-3.3**	**0.2**
Gross public debt	52.2	66.3	92.1	97.7	100.6	102.0	-1.0
4. Other variables							
Household saving rate (% of GDI)	10.8	11.2	10.4	8.7(c)	9.2	9.0	-0.3
Household gross debt (% of GDI)	81.5	125.0	115.4	110.5(c)	104.3	99.7	-0.5
Non-financial coporates gross debt (% of GDP)	80.4	126.8	111.9	107.1(c)	101.1	95.1	-0.3
Spanish external gross debt (% of GDP)	90.2	158.1	153.0	159.2(c)	156.6	151.8	-0.3
12-month EURIBOR (annual %)	3.7	1.9	0.5	0.5	0.3	0.5	-0.1
10-year government bond yield (annual %)	5.0	4.7	4.6	2.7	1.2	1.2	-0.6

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

maintain a moderate rate of growth in both periods (Exhibit 8.3).

The effect of the electoral cycle will mainly be felt in public investment, as may be anticipated from the trend throughout last year in official tenders. This is the main reason explaining the turn-around in investment in other construction in 2015, which is set to grow by 6.4%. Its growth will moderate in 2016 as the cycle comes to an end. The forecast for residential construction investment this year has been raised considerably, due to the more dynamic than expected growth being seen in this sector. Unlike other components of demand it will gain momentum in 2016 as a result of the progress of the economic cycle, as heralded by the trend in new housing permits, which rose in 2014 for the first time since 2006, and particularly permits for renovation and restoration work, which were up by 9.6%.

As regards capital goods investments, expected growth in 2015 has also been revised upwards, largely as a consequence of the improved forecasts for all the preceding variables. In 2016, it will slow due to the foreseeable exhaustion of one of its main components: investment in transport equipment. This made exceptional progress in 2014 and is expected to continue to do so in 2015, partly thanks to the scrappage schemes to replace old vehicles, which this scenario assumes will cease to operate next year.

Export growth will accelerate in 2015 and 2016 as the European economy's recovery gains traction and as a result of the depreciation of the euro. The rate of import growth, on the other hand, will slow due to the change in the composition of domestic expenditure, in which components with the greatest propensity to import, *i.e.* durable consumer goods and capital goods investments, will occupy a smaller share, while non-durable consumer goods and construction investment, with a lower propensity to import, will increase their share.

In line with forecast faster economic growth, the trend in employment has also been revised upwards (Exhibit 8.4). The number of full-time equivalent jobs will grow by 2.6% and 2.3% in 2015 and 2016, respectively. In terms of the number of people in work according to the LFS, over the two-year period around 890,000 jobs will be created. The average annual unemployment rate will drop to 22.3% this year and 20.4% the next (19.6% in the last quarter). Productivity will continue its moderate growth seen in 2014, which, together with the expected slight rise in wages, will slow the drop in unit labour costs in 2015. In 2016, they may rise slightly, although at a rate below the GDP deflator (Exhibit 8.5).

Despite the external sector's negative contribution to growth, the surplus on the current account of the balance of payments will be larger than in 2014 both this year and next as a result of the smaller energy bill. The economy's net lending position will also remain positive. The surplus will derive from private agents, including households and non-financial corporations. Although consumption has picked up, the household saving rate will recover in 2015 thanks to the positive impact on real disposable income of the income tax cut and the drop in the price of energy products. It will drop in 2016, but will remain above the 2014 level (Exhibit 8.6).

The general government deficit will fall to 4.4% of GDP in 2015 and 3.3% in 2016, entirely as a consequence of the favourable effect of the cycle and the increase in the ratio's denominator due to the growth of nominal GDP. However, in structural terms the balance will worsen in both years.

Finally, as regards inflation, the recovery in demand and the depreciation of the euro could exert a degree of upward pressure on prices, although this effect will be partly offset by the reduction in pressure on the supply side deriving from lower labour and energy costs. On the hypothesis that oil prices remain close to current levels, the overall rate will remain negative throughout almost the whole of 2015, while the underlying rate will continue to move slowly upwards, although it will remain low and will not exceed 1% at any time over the period covered by the forecast.

To conclude, the short-term outlook for the Spanish economy has improved considerably. This has partly been a result of the operation of the mechanisms inherent to the cycle, *i.e.* progress made on correcting the imbalances generated during the growth phase, supported by certain economic policy measures, such as labour-market and financial sector reform. It has also been partly the result of transitory exogenous factors, such as falling oil prices and interest rates, and the cut in personal income tax. The impact of these will wear off in time, resulting in lower growth from 2016 onwards. The downside is the deterioration of the balance of payments, which will only avoid a deficit again this year and next thanks to lower oil prices. This highlights the fact that the Spanish economy still has a long way to go in terms of structural change in order to arrive at a more balanced growth model.