

**September 2016**

**SPANISH  
ECONOMY  
REPORT**



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DE ESPAÑA

MINISTERIO  
DE ECONOMÍA  
Y COMPETITIVIDAD

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## RECENT EVOLUTION OF THE ECONOMIC INDICATORS

### **Financial markets**

The financial markets in September and early October were mainly conditioned by the monetary policy meetings of the major central banks, as well as by the increase in oil prices and the uncertainty regarding the situation of the European banking sector. As a result, the European stock indices registered mixed results, European public debt yields increased and the euro appreciated slightly against the dollar.

#### ***The Fed maintains the interest rates***

The Federal Open Market Committee (FOMC) of the Federal Reserve (Fed), in its two day meeting held on 20<sup>th</sup> and 21<sup>st</sup> September, decided to maintain the target range for the Federal Funds rate at 0.25% and 0.50%, set on 17<sup>th</sup> December 2015. According to the statement, labour market indicators have continued to improve and the economic activity has accelerated. The FOMC believes that with a gradual adjustment in the stance of monetary policy, economic activity will expand at a moderate pace and labour market conditions will improve, in a context in which the short-term risks for the economic outlook are balanced. Moreover, the FOMC believes that the case for an increase in the Federal Funds rate has strengthened, but decided, for the time being, to wait for further evidence of continued progress towards its targets.

#### ***The BoJ sets a target for long-term interest rates***

On the other hand, in the meeting held on 20<sup>th</sup> and 21<sup>st</sup> September, the Bank of Japan (BoJ), announced a new monetary policy framework, which consists of two major components: first, the control of the yield curve, according to which the Bank will control short-term and long-term interest rates (approximately at a yield of 0% for ten-year bonds); and, second, a commitment to expand the monetary base until inflation, excluding food, stabilises at levels higher than the price stability target, which stands at 2%.

In this context, the BoJ decided to keep the interest rates unchanged after applying in its previous meeting held in January a negative interest rate of -0.1% to current accounts that financial institutions hold at the bank. Similarly, the BoJ decided to keep its asset purchase programme unchanged, expanding the monetary base at an annual rate of 80 trillion yen, and the exchange traded funds programme (ETFs), which was extended to an annual rate of increase in its outstanding balance of 6 trillion yen at the meeting held in July, compared to the previous 3.3 trillion. However, the BoJ does not rule out, if necessary, further reductions in the short-term interest rates and in the target for long-term interest rates, as well as an intensification in the rate of expansion of the monetary base.

#### ***The BoE maintains the interest rates and the asset purchase programme***

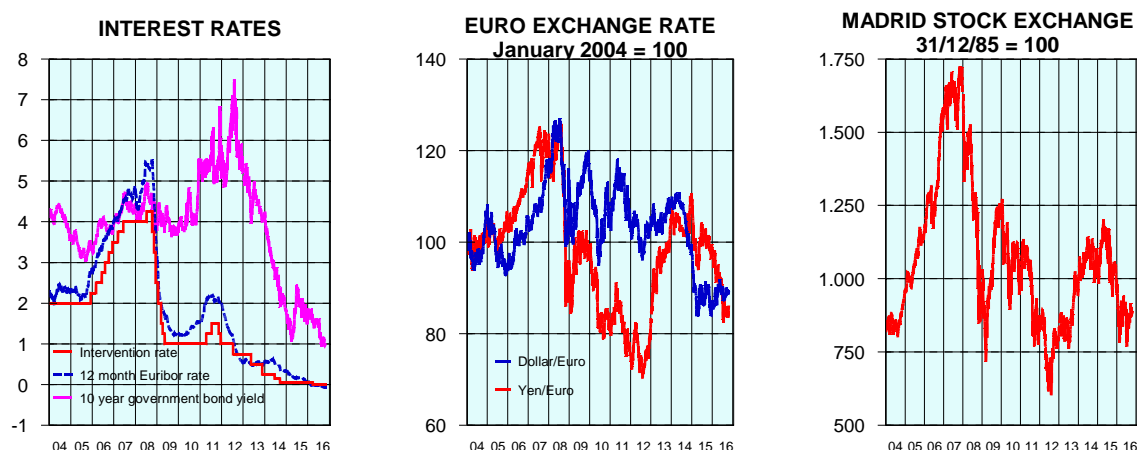
The Monetary Policy Committee of the Bank of England (BoE), in the meeting held on 14<sup>th</sup> September, decided to keep the Official Bank Rate at 0.25% (in force since 3<sup>rd</sup> August this year) and to continue with the public debt and corporate debt purchase programmes, which stand at 435 billion pounds and 10 billion, respectively. In the event that forthcoming indicators are consistent with the BoE forecasts issued in August, further cuts will probably be carried out in the Bank rate, at one of the meetings planned for this year, to levels close to but just above zero. However, the institution announced that the indicators published since early August were better than expected.

### ***The ECB maintains the interest rates and the debt purchase programme***

The Governing Council of the European Central Bank (ECB), on its meeting held on 8<sup>th</sup> September, decided to maintain the interest rates on the main financing operations, the marginal lending facility and the deposit facility at 0.00%, 0.25% and -0.40%, respectively. In the press conference that followed the meeting, Mario Draghi confirmed that, with regard to the non-conventional monetary policy measures, monthly asset purchases are expected to continue until the end of March 2017, or beyond, if necessary. According to the ECB, the policy measures continue to ensure supportive financing conditions and underpin the momentum of the Eurozone economic recovery.

Economic and financial indicators suggest resilience of the Eurozone economy to the global economic and political uncertainty. However, the risks to the euro area growth outlook remain biased to the downside due to the weak external demand, partly associated to the uncertainty following the result of the referendum in the UK. In this context, the ECB will act using all instruments available within its mandate to ensure that inflation rates return to levels below but close to 2%.

#### **G1. MONETARY AND FINANCIAL INDICATORS (1)**



(1) Daily data.

Source: ECB, Banco de España and Bolsa de Madrid.

### ***The 12 month Euribor remains close to zero***

In the interbank market of the Eurozone, interest rates extended the slightly downward path in September and early October. More specifically, the 12 month Euribor stood at -0.064% at the beginning of October, compared to the -0.052% recorded at the end of August. This evolution is due to the slight fall of the risk premiums required in this market (the Euribor-OIS differential stood at 33 b.p. in early October, 1 b.p. below the figure registered on 31<sup>st</sup> August). On the other hand, the expectations about the interest rate evolution remained unchanged, as the Overnight Index Swap (OIS), indicative of the rate expectations, stood at -0.39% in the 12-month Euribor, the same figure as the one recorded at the end of August.

### ***European public debt yields increase***

In the secondary public debt market, the monetary policy decisions announced by the Fed and the BoJ pushed European public debt yields downwards, in a context of higher risk aversion.

**T 1. Public debt yields and differentials**

(in % and basis points)

Countries	Yields (%)					Differentials with Germany (basis points)				
	Dec-31-15	Aug-31-16	Oct-05-16	Variation in spreads		Dec-31-15	Aug-31-16	Oct-05-16	Variation in spreads	
				Period (3)-(2)	Annual (3)-(1)				Period (6)-(5)	Annual (6)-(4)
(1)	(2)	(3)	(3)-(2)	(3)-(1)	(4)	(5)	(6)	(6)-(5)	(6)-(4)	
Germany	0.63	-0.07	-0.01	6	-64					
Holland	0.79	0.04	0.12	8	-67	16	11	13	2	-3
Finland	0.92	0.07	0.14	7	-78	29	14	15	1	-14
Austria	0.91	0.15	0.22	7	-69	28	22	23	1	-5
Belgium	0.97	0.20	0.28	8	-69	34	27	29	2	-5
France	0.99	0.18	0.33	15	-66	36	25	34	9	-2
Ireland	1.15	0.42	0.50	8	-65	52	49	51	2	-1
Spain	1.80	1.01	1.08	7	-72	117	108	109	1	-8
Italy	1.61	1.15	1.36	21	-25	98	122	137	15	39
Portugal	2.54	3.05	3.48	43	94	191	312	349	37	158
Greece	8.35	8.10	8.27	17	-8	772	817	828	11	56

Source: Financial Times.

As a result, the 10-year Spanish bond yield registered record lows, reaching 0.9% on 30<sup>th</sup> September, but picked up slightly in early October, to 1.08% on 5<sup>th</sup> October, 7 b.p. above the figure registered on 31<sup>st</sup> August, due to the uncertainty regarding a possible reduction in the pace of asset purchases by the ECB. On the other hand, the German bond yield rose 6 b.p. in the same period, up to -0.01%, the Spain-Germany differential standing at 109 b.p., 1 b.p. above the level recorded in late August. Meanwhile, the Spain-Italy differential stood at -28 b.p., compared to -14 b.p. re-corded on 31<sup>st</sup> August.

***The stock indices shows mixed results, in a context of volatility***

In the stock markets, the main indices on both sides of the Atlantic registered mixed results between late August and early October, in a context of high volatility. They were affected by the meetings held by the central banks, the uncertainty regarding the situation of the banking sector in Europe and the evolution of oil prices. In Europe, the Eurostoxx 50 index increased by 0.1% during that period (-7.4% compared to late last year), partly driven by the recovery of oil prices, despite the ECB's decision to keep interest rates and the asset purchase programme unchanged, and the heavy losses in banking stocks. In Spain, the IBEX 35 recorded in early October a 0.7% increase in comparison to late August, dropping by 8% compared to 31<sup>st</sup> December last year. In the US market, the S&P 500 index fell by 0.5% between 31<sup>st</sup> August and 5<sup>th</sup> October (it increased by 5.7% compared to the end of 2015), also weighed down by the ECB's decision, despite recovering strongly after the Fed's announcement to keep interest rates unchanged.

***The euro appreciates slightly against the dollar***

With respect to the currency market, the Fed's decision to keep interest rates unchanged, together with the maintenance of the ECB's monetary policy, drove the exchange rate of the euro against the dollar slightly upwards, despite the uncertainty regarding the situation of the European banking sector. Thus, the euro ended the period between 31<sup>st</sup> August and 5<sup>th</sup> October with an appreciation of 0.7%, reaching 1.1211 dollars. In that same period, the euro appreciated by 0.6%

and 3.9% against the yen and the pound, respectively, trading at the end of the 5<sup>th</sup> October session at 115.65 yen and 0.88155 pounds. Likewise, the euro appreciated by 0.8% in comparison to late August in nominal effective terms.

### T 2. International stock exchange

Countries	Index	Level Oct-05-16	% Variation	
			Aug-31-16	Dec-31-15
Germany	DAX	10,585.78	-0.1	-1.5
France	CAC 40	4,489.95	1.2	-3.2
Italy	FTSE MIB	16,476.58	-2.8	-23.1
Spain	IBEX 35	8,778.30	0.7	-8.0
Eurozone	EUROSTOXX 50	3,026.28	0.1	-7.4
United Kingdom	FTSE 100	7,033.25	3.7	12.7
United States	S&P 500	2,159.73	-0.5	5.7
Japan	NIKKEI 225	16,919.24	0.2	-11.1
China	SHANGHAI COMP	3,004.70	-2.6	-15.1
Mexico	IPC	48,141.42	1.3	12.0
Brazil	BOVESPA	60,254.34	4.1	39.0
Argentina	MERVAL	17,070.65	9.1	46.2

Source: Bolsa de Madrid, Infobolsa, Stoxx and Financial Times.

### The M3 broad monetary aggregate increases its rate of growth in August

On 27<sup>th</sup> September, the ECB published the evolution of the monetary and credit aggregates in the Eurozone in August 2016. The M3 broad aggregate rose by 5.1% y-o-y, two tenths more than in July, due to the acceleration of overnight deposits (10%, compared to the 9.4% registered in the previous month), partially offset by the slowdown in marketable instruments (half a point, down to 4.5%) and by the higher decline in other short-term deposits (-1.5%, compared to the -1.4% recorded in the previous month). On the other hand, currency in circulation increased by 3.5% y-o-y, the same as in July.

### T 3. Eurozone monetary aggregates

Monetary aggregates	August 2016 Balance (Billion €)	% Year-on-year variation		
		June 2016	July 2016	August 2016
1. Currency in circulation	1,060	3.9	3.5	3.5
2. Overnight deposits	5,931	9.6	9.4	10.0
<b>M1 (= 1 + 2)</b>	<b>6,992</b>	<b>8.7</b>	<b>8.4</b>	<b>8.9</b>
3. Other short-term deposits (= 3.1. + 3.2.)	3,572	-1.5	-1.4	-1.5
3.1. Term deposits up to two years	1,396	-4.6	-4.4	-4.5
3.2. Deposits redeemable at notice up to three months	2,176	0.6	0.6	0.5
<b>M2 (= M1 + 3)</b>	<b>10,564</b>	<b>4.9</b>	<b>4.9</b>	<b>5.2</b>
4. Marketable instruments (= 4.1.+ 4.2.+4.3.)	662	6.5	5.0	4.5
4.1. Repurchase agreements	83	-2.1	-16.9	-14.8
4.2. Money market funds shares/units	482	10.7	7.8	6.4
4.3. Securities other than shares up to two years	98	-4.0	16.4	17.7
<b>M3 (= M2 + 4)</b>	<b>11,226</b>	<b>5.0</b>	<b>4.9</b>	<b>5.1</b>

Source: European Central Bank.

### *Financing to the private sector in the Eurozone accelerates in August*

The main counterpart to M3, the financing to the private sector in the Eurozone, grew by 1.5% y-o-y in August, one tenth more than in July, due to the moderation in the pace of decline of shares and other equity (-0.3%, compared to the -3.7% registered in the previous month). Furthermore, loans increased by 1.3%, as in the previous month, and securities other than shares slowed down four tenths, down to 4.2%. Within loans, those received by households increased by 2%, the same figure as that registered in the previous month, and those received by non-financial corporations moderated the growth rate one tenth, to 1.2%.

**T 4. Financing of private sector in the Eurozone (1)**

	August 2016 Balance (Billion €)	% Year-on-year variation		
		June 2016	July 2016	August 2016
<b>Credit to the private sector</b>	<b>12,821</b>	<b>1.5</b>	<b>1.4</b>	<b>1.5</b>
<b>Loans</b>	<b>10,667</b>	<b>1.2</b>	<b>1.3</b>	<b>1.3</b>
<b>Households</b>	<b>5,366</b>	<b>1.9</b>	<b>2.0</b>	<b>2.0</b>
<i>House purchases</i>	4,004	2.1	2.2	2.3
<i>Consumer credit</i>	608	3.5	3.2	3.4
<i>Other lending</i>	755	-0.4	-0.5	-0.8
<b>Non-financial corporations</b>	<b>4,293</b>	<b>1.3</b>	<b>1.3</b>	<b>1.2</b>
<b>Insurance companies &amp; pension funds</b>	<b>110</b>	<b>-23.6</b>	<b>-16.1</b>	<b>-14.1</b>
<b>Other financial intermediaries</b>	<b>898</b>	<b>0.0</b>	<b>0.2</b>	<b>0.7</b>
<b>Securities other than shares</b>	<b>1,371</b>	<b>7.3</b>	<b>4.6</b>	<b>4.2</b>
<b>Shares and other equities</b>	<b>783</b>	<b>-3.0</b>	<b>-3.7</b>	<b>-0.3</b>

(1) Assets of the Monetary Financial Institutions (MFI).

Source: European Central Bank.

### *The financing stock to the private sector in Spain falls by 1.1% y-o-y in August*

According to the financing to the non-financial sectors in Spain data, published by the Bank of Spain on 3<sup>rd</sup> October 2016, the financing stock to the private non-financial sector decreased by 1.1% y-o-y in August, the same figure as in the previous month. Financing received by firms maintained its rate of decline unchanged in comparison to the previous month, at 0.7%, because the acceleration in securities other than shares (one point and a half, up to 2.1%) offset the higher decline in bank loans (-1.5% compared to the -1.3% registered in the previous month) and the decline in foreign loans (-0.1%), after the increase observed in the previous month (0.1%). On the other hand, financing received by households recorded a y-o-y rate of -1.7%, the same as the figure registered in the previous month, due to the virtual stabilisation of bank loans for housing (-3.2% compared to the -3.1% of the previous month) and of bank loans for purposes other than housing (3.6%, as in the previous month).

### *New loan and credit operations to households and SMEs continue to grow sharply*

According to data published by the Bank of Spain on 30<sup>th</sup> September, the amount of new loan and credit operations to households, in cumulative terms for the last twelve months, increased by 14% y-o-y in August, 4.2 points less compared to July. This slowdown is due to the lower increase of credits for house purchases and for consumption (19.2% and 26.7% y-o-y, rates 8.2 and 0.5 points lower than in July, respectively), and to the further decline recorded by credits for other purposes (-6.4% versus -4.7% in July). The amount of new loan and credit operations to

SMEs (using as a proxy for these credits those under one million euros) rose, in cumulative terms for the last twelve months up to August, by 6.1% y-o-y, the same figure as the one recorded in the previous month. On the other hand, the amount of new loan and credit operations exceeding one million euros declined 23.9% y-o-y, 2.8 points more than in July.

**T 5. Financing of non-financial sectors residents in Spain**

	August 2016 Balance (Billion €)	% Year-on-year variation		
		June 2016	July 2016	August 2016
<b>Non-financial corporations and Households</b>	<b>1,613</b>	<b>-1.0</b>	<b>-1.1</b>	<b>-1.1</b>
<b>Non-financial corporations</b>	<b>898</b>	<b>-0.5</b>	<b>-0.7</b>	<b>-0.7</b>
<i>Bank loans</i>	524	-1.3	-1.3	-1.5
<i>Securities<sup>(1)</sup></i>	84	1.5	0.6	2.1
<i>External loans</i>	290	0.5	0.1	-0.1
<b>Households</b>	<b>715</b>	<b>-1.7</b>	<b>-1.7</b>	<b>-1.7</b>
<i>Bank loans. Housing</i>	550	-3.4	-3.1	-3.2
<i>Bank loans. Other</i>	166	4.3	3.6	3.6
<b>General Government</b>	-	<b>4.7</b>	<b>5.4</b>	-
<b>Total financing</b>	-	<b>1.2</b>	<b>1.4</b>	-

(1) Other than shares.

Source: Banco de España.

## Spanish economy

### Domestic demand and production

#### *The Bank of Spain improves its growth prospects for the Spanish economy...*

The Bank of Spain (BoS) revised the real GDP growth forecast for this year four tenths upward, up to 3.2% due to the more favourable than expected evolution of the activity in the second quarter, as well as the improvement of the outlook for the rest of the year. For the two-year period 2017-2018, it foresees the continuation of the expansionary trend of the Spanish economy, keeping its growth forecasts unchanged compared to June, at 2.3% for 2017 and 2.1% for 2018. This slowdown is due mainly to the drop in oil prices, the depreciation of the euro or the expansionary fiscal policy, among other factors.

With regard to the composition of growth, the BoS expects a domestic demand contribution of 3.1 percentage points (p.p.) this year and of 2.3p.p. next year, two tenths higher and one tenth lower respectively than the figure estimated in June. For 2018, the domestic demand contribution would stand at 2p.p. On the other hand, net external demand would contribute one tenth to GDP growth in 2016, its contribution being null in 2017 and one tenth in 2018.

For the third quarter of 2016, the BoS estimates a GDP q-o-q growth of 0.7%, one tenth lower than the figure registered in the previous quarter. This growth will keep supported by domestic demand, with a net external demand contribution lower than that of the second quarter.

#### *...as the International Monetary Fund*

The IMF also revised upwards its GDP growth forecast for the Spanish economy in 2016, by half a point, up to 3.1%, and one tenth for next year, up to 2.2%. By components, it expects an



improvement in private consumption of 3.3% in 2016 and 2.3% in 2017. The public consumption growth rate moderated this year in comparison to 2015, an evolution that will continue in 2017, to 0.9% and 0.4%, respectively. Gross fixed capital formation is expected to increase by 4.2% in 2016 and 3% in 2017. On the other hand, the external balance would contribute one percentage tenth to GDP growth in 2016 and 2017.

### ***The Spanish economy increases its net lending vis a vis the rest of the world***

The Spanish economy registered a net lending vis a vis the rest of the world equivalent to 3.2% of the quarterly GDP in the second quarter of 2016, one point and a half higher in comparison to the same period of 2015. This expansion reflects a rise of the balances of foreign trade in goods and services and the balance of primary income and current transfers, while that of the capital balance fell down. By sectors, the private sector recorded a net lending of 12.4% of GDP and the General Government a net borrowing of 9.2% of GDP. Likewise, in the first half of the year, the Spanish economy showed a net lending equivalent to 1.6% of GDP, doubling the figure for the same period last year.

### ***Recent short-term indicators extend the expansionary trend in the third quarter***

Available short-term indicators for the third quarter of 2016 point to an extension of the economic activity dynamism, in an environment where job creation and improvement in financing conditions continues, as shown by the synthetic indicator of activity for the Spanish economy and the Global Activity Composite PMI.

The Economic Sentiment Indicator (ISE, by its Spanish abbreviation) published by the European Commission points in the same direction, rising half a point in September, up to 105 (average 1990-2015 = 100). By components, the industry confidence improved by 2.2 points, and fell in the other sectors: consumer by 2.1 points, construction by 1.3 points, and services and retail by 0.6 points and 0.1 points respectively. Similarly, electricity consumption, after filtering off the calendar and temperature effects, increased by 3.8% in September compared to the same month of 2015, a rate three and a half points higher than that of the previous month and the highest since July 2015.

On the other hand, total large firm sales, at constant population, with deflated, fixed-sample and calendar adjusted data, gained momentum in August, registering a y-o-y growth of 2.6%, 1.7 points higher than that recorded in July. This was due to the acceleration of domestic sales (2.2% versus 1.4% registered in the previous month) and the upturn in exports, which turned from falling a 1% in July to an increase of 3.7% in August.

### ***Private consumption moderated the growth pace***

With regard to private consumption, most published indicators reflect a more contained progress. Thus, retail sales, with calendar and price adjusted data, experienced a y-o-y increase of 3.2% in August, more than two points lower than the figure registered in July (5.3%). By groups, the slowdown in retail sales is explained both by the food component, which recorded an increase of 0.4%, half a point lower than that of the previous month, and by the non-food component, which rose by 4.8%, almost two points and a half less than in July.

In addition, sales of consumer goods and services in large companies showed a lower dynamism in the months of July and August, ending this two-month period with a y-o-y increase of 4.5%, 1.8 points lower compared with the second quarter.

On the other hand, according to the figures provided by the ANFAC (Spanish Association of Vehicles Manufacturers), passenger car registrations continued to grow at double-digit rates, registering a y-o-y increase of 13.9% in September and ending the third quarter with a growth close to 10%, lower than the figure recorded in the second quarter (17.2%).

Consumer confidence pointed in the same direction, as it worsened in September in comparison to the previous month, especially the indicator published by the CIS, which fell 6.3 points, down to 91, below the 100 threshold (indicating a negative perception by consumers) for the ninth consecutive month. This drop was due to a lower valuation of its two components, the current situation and expectations, both falling 6.3 points.

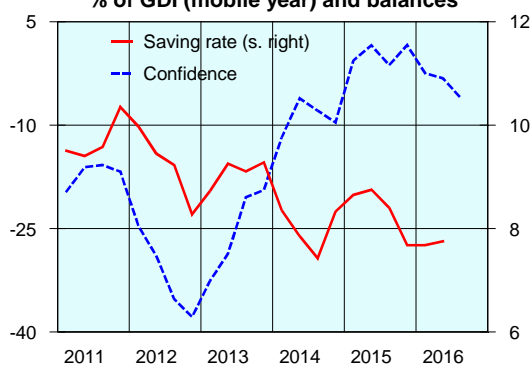
### *Households increase their savings rate slightly*

According to the non-financial accounts of institutional sectors, and after including the 2011-2015 revised results, the gross disposable income (GDI) of Households and Non-profit Institutions Serving Households (NPISHs) grew by 2.7% in the second quarter of 2016. This was the result of the wage income growth (3.4%), the non-wage income growth (2.2%) and net current transfers received (3.3%), together with a slight decrease of the current taxes on income and wealth (-0.1%). On the other hand, net current transfers payments increased by 5.9%.

The higher GDI and the increase in nominal consumption (2.3% y-o-y), set the savings rate at 16.1% of GDI, three tenths above that of a year earlier. The savings rate of the sector, calculated as the mobile average for four quarters, reached 8.3% (8.1% in the previous quarter).

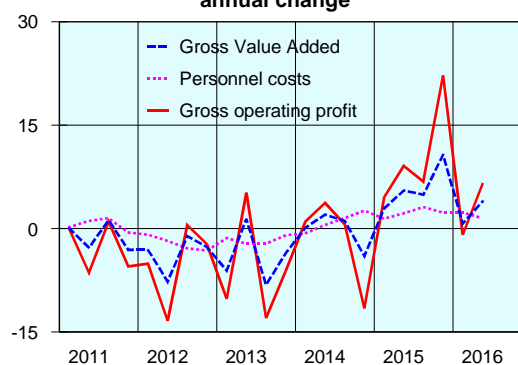
The savings generated by households, together with the positive balance of net capital transfers received was enough to finance the sector investment, so households and NPISH presented a net lending equivalent to 8.4% of GDP in the second quarter, two tenths below the figure registered in the second quarter of 2015.

**G 2. SAVING RATE AND CONSUMER CONFIDENCE**  
% of GDI (mobile year) and balances



Sources: INE and European Commission.

**G 3. CBQ. GROSS OPERATING PROFIT**  
annual change



Source: BE (Central Balance Quarterly).

### *Non-financial corporations generate net lending*

Non-financial corporations showed a net lending position equal to 1.8% of GDP in the second quarter of 2016, compared to the net borrowing of 0.7% of GDP of the second quarter of 2015. GDP disposable income of companies increased by 19.6% y-o-y, mainly as a result of the increase in the gross operating surplus (8.2% y-o-y) and the fall in the corporate tax (-38%) and,

to a lesser extent, by the lower amount paid both from net property income and net current transfers.

Savings of companies, together with the positive balance of net capital transfers received, was enough to finance the volume of investment in the sector, which grew by 2.2% y-o-y.

### ***The productive activity of companies increases***

On the other hand, the Quarterly Central Balance Sheet data published by the Bank of Spain highlights the intensification of the expansionary trend of the productive activity of non-financial companies in the second quarter of the year, improving their economic and financial situation.

Thus, the gross value added (GVA) at factor cost increased by 3.9% year on year in the second quarter, 3.2 points more than in the previous quarter. This advance, together with the biggest drop in financial expenses, which fell 10.4%, one tenth more than in the first quarter, was reflected in the ordinary net result, which rebounded to a y-o-y rate of 15.5%, after the 5.4% decline registered in the previous quarter. The acceleration of the productive activity of all companies, combined with the more moderated increase in personnel expenses (1.5% y-o-y compared to the 2.3% of the previous quarter) resulted in an increase of the gross operating profit (GOP) of 6.4%, compared to the 0.9% fall registered in the previous quarter.

With regard to the profitability ratios, the ordinary return on net assets for all the companies in the sample grew up to 4.4% in the second quarter of 2016, almost one and a half points above the figure recorded in the first quarter (3%). On the other hand, the ratio that measures the financial cost (financial expenses over liabilities) increased by one tenth, up to 2.8%, so the differential between them (which is an indicator of companies' economic incentives,) rose by more than one point, up to 1.6 percentage points.

### ***Equipment investment moderated the growth pace***

With regard to equipment goods investment, the available information provides mixed signals. The availabilities of equipment goods eased the growth rate more than three points in the third quarter of the year, up to 0.8% y-o-y. The industrial climate indicator of investment goods fell by 3.6 points in September compared to August, although it ended the third quarter with an average balance of 5.8 points, almost one point higher than the figure registered in the previous quarter. On the other hand, equipment and software sales in large companies moderated the growth rate in the two month period from July to August, registering a y-o-y rate of 1.6%, almost three points lower than the figure of the second quarter.

Regarding residential investment, housing sales slowed down in the two month period from July to August, scoring an increase of 10.2% over the same period last year, lower than the second quarter (23.8%). Considering the housing age, new housing purchases fell 1.8% y-o-y in the two-month period, in comparison to the 13.1% increase observed in used housing.

In line with this, the number of mortgages on housing interrupted in July the trend of significant increases that began in mid-2014, recording a y-o-y fall of 14.9% (+ 15.5% in June). The average amount per mortgaged house accelerated more than two and a half points, registering an increase of 10.1%, so borrowed capital experienced a 6.3% decline, compared with the 24.2% increase observed in the previous month.

It should be noted that both statistics have been affected by the suspension of some mortgages in July under the jurisprudence of the Supreme Court (sentence 364/2016 of June 2016) on the unfairness of some clauses on the interest rates for late payment. After remedying the defects of the affected mortgages, these shall be included in the Registries in the coming months.

In the same line, credit to households for housing purchases, fell by 3.2% in August in comparison to the same month of 2015, a drop one tenth higher than in July.

### ***Housing prices slowed down***

In the second quarter, the private housing price index, published by the INE, increased by 3.9% compared to the same period of 2015, 2.4 points less than in the previous quarter. This slowdown was due to the lower increase in second-hand housing prices (3.2%, half than between January and March), since new housing prices rose by 8.4%, 2.3 points more than in the previous quarter. In real terms, the private housing price y-o-y increase in the second quarter of this year reached 4.9%, a rate more than two points lower than the previous quarter (7%), ending the first six months of the year with an average annual growth of 5.9% (4.1% in 2015).

### ***Industrial production accelerated in August***

From the supply point of view, and amongst the industrial activity indicators, the Industrial Production Index (IPI), with calendar adjusted data, recorded a y-o-y increase of 4.2% in August, four points more than that of the previous month. This result is explained by the more favourable performance of all its components, where equipment goods stand out, as they grew more than 13% y-o-y, compared with the slight drop observed in the previous month. To a lesser extent, intermediate goods experienced a 3.3% increase, followed by consumer goods (2.7%) and the energy component (2.4%).

The greater dynamism of the activity in the industrial sector was also reflected in the evolution of the other short-term indicators. Thus, domestic sales of industrial goods of large companies increased in August by 2.4% y-o-y, after the slight decline seen in the previous month (-0.1%). Industry confidence, according to the European Commission, increased by more than two points in September compared to the previous month, as a result of the higher valuation of both production expectations and order portfolio and lower stock of finished products. The manufacturing PMI pointed in the same direction, as it rose 1.3 points in September compared with the previous month, reaching 52.3.

However, other indicators show signs of weakness. The Turnover Index in Industry and the Industry New Orders Index, leading indicators of activity in the sector, fell in July at a faster pace (-2.8% and -8.4% y-o-y, respectively) with calendar adjusted data.

### ***Activity in the construction sector continues to grow***

With regard to the construction sector, the recently published information continues to reflect an expansionary trend. The Production Index in the Construction Industry (PICI) experienced a y-o-y growth standing at 12% in July, with deflated and calendar adjusted data. This evolution was reflected both in the building component, which grew by 9.3%, and especially in the civil works, which rebounded up to 27.2%.

The sector leading indicators also reflected a positive trend. Floorage approvals in new construction, according to construction new permits, recorded a y-o-y increase of 2.9% in July compared to the 8.8% drop registered in the previous month, accumulating an annual average increase of 17.8% in the first seven months of the year, close to half the value registered in the same period of 2015 (33.7%). The slight increase observed in July was due to the rise in the residential component, of 14.3% y-o-y vs. the 1.2% fall of the previous month, while the non-residential component continued to fall at a strong pace (-26.2%).

On the other hand, the prospects of the sector are less favourable, according to the construction confidence indicator published by the European Commission. This indicator fell 1.3 points in September in comparison to the previous month, a behaviour explained by the worsening of employment expectations, while the order portfolio assessment was less negative.

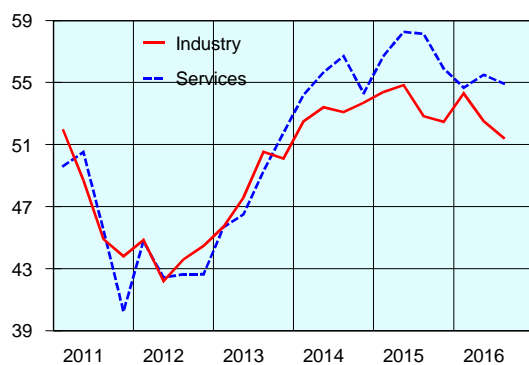
### *The services sector remains the most dynamic*

With regard to the services sector, the sector turnover increased by 4.6% y-o-y in July, one tenth more than in the previous month. This represented the highest rate since the beginning of the year. The slightly more expansionary trend is explained by the trade component, which accelerated four tenths, up to 4.6%, partially offset by the moderation in the pace of increase of other services, which rose by 4.3%, nine tenths lower in comparison to the figure registered in the previous month. On the other hand, both the services *confidence* indicator published by the European Commission, and the services PMI, show less favourable signs, since they slowed down in September compared with the previous month.

### *The tourism sector continued the expansionary trend*

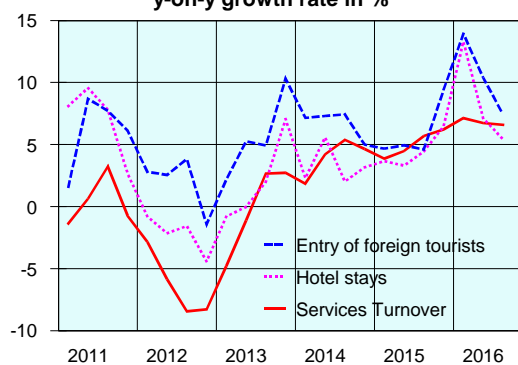
Tourism-related indicators showed the continuation of the favourable evolution of the sector in recent months. The arrival of 10.1 million visitors to Spain in August is striking, a historical high, representing 5.8% more than a year earlier, according to data from the Survey of Tourist Movements on Border (Frontur), published by the INE. The total expenditure by tourists who visited Spain increased by 3.8% y-o-y during the abovementioned month, while the average spending per person fell by 1.9%. Likewise, hotel overnight stays increased by 3.7% year on year in August, due to the behaviour of foreign overnight stays, which rose by 6.3% y-o-y. On the other hand, hotel overnight stays by Spanish nationals decreased slightly (-0.3%). Also, air passenger traffic increased by 7.6% during that month, being the international component (9.2%) more dynamic than the domestic component (3.5%).

**G 4. PURCHASING MANAGERS' INDEX (PMI)**



Source: Markit Group.

**G 5. TOURIST SECTOR INDICATORS**  
y-on-y growth rate in %



Source: INE.

## Prices

### *Spanish inflation continues to rise*

In August 2016, the Consumer Price Index (CPI) increased by 0.1%, compared to the previous month, and its y-o-y variation rate rose half a point, up to -0.1%, continuing the upward trend that began in spring. The foreseeable evolution for September, in light of the CPI leading indicator, suggests that the Spanish inflation becomes positive in that month (0.3%) after more than a year registering negative figures.

Breaking the CPI down by groups of origin, it can be observed that the slowdown in the fall of the general CPI in August is mainly explained by the energy products prices and, therefore, by the evolution of oil products, which continue to condition the evolution of the general inflation. In August, energy products registered a y-o-y rate of -9.1%, a rate almost 3 p.p. higher when compared to the figure recorded in July (-12%). This less contractionary trend was due mainly to the moderation of more than three points in the decline of fuel and lubricant prices, down to -7.4%, as well as electricity prices, which registered a y-o-y rate of -11.3% (-14.9% in the previous month).

Prices of non-processed food rose by 3.7 % y-o-y in August, two points less than in the previous month. This slowdown responded largely to the evolution of prices of fresh vegetables and pulses, which moderated the y-o-y pace of increase by seven points, up to 2.3%, and fresh fruits, which fell from 14.4% in July down to 10.3% in August.

### *Core inflation increased two tenths in August, up to 0.9%*

Core inflation (which excludes the most volatile elements from the general index, non-processed food and energy) and that can be considered as the hard core of prices, rose two tenths in August, up to 0.9%. This rise mainly responded to the acceleration of services and non-energy industrial goods (BINE) prices.

Prices of processed food, beverages and tobacco moderated slightly in August, although less than non-processed food prices, as their y-o-y rate fell one tenth, down to 0.7%. The moderation in the growth rate of oil prices by almost four points, to 6.7%, stood out, although this figure is far from the 25% registered earlier this year. Prices of food as a whole, including beverages and tobacco fell seven tenths in August, down to 1.6% y-o-y.

### *BINE and services prices accelerated*

Non-energy industrial goods (BINE) prices recorded a y-o-y rate of 0.7% in August, three tenths higher than in the previous month. Car prices was the item that contributed the most to this acceleration, as its y-o-y variation rate rose almost two points, up to 4.6%. This rise in car prices reflects the dynamism of private consumption demand and, in particular, of these types of goods.

In the services sector, the prices y-o-y growth stood at 1.1%, two tenths higher than the figure registered in the previous month, with an uneven performance among its components. In particular, hotels, cafe and restaurants prices moderated their y-o-y growth pace by half a point, to 0.2%, while the package holidays prices accelerated almost four points, up to 4.5%, and telephone services increased their annual rate by almost one point, up to 3%. Another item that showed an upward trend was car insurance, which accelerated by three points, up to 3.5%. This fact may be related to the above mentioned dynamism of car demand.

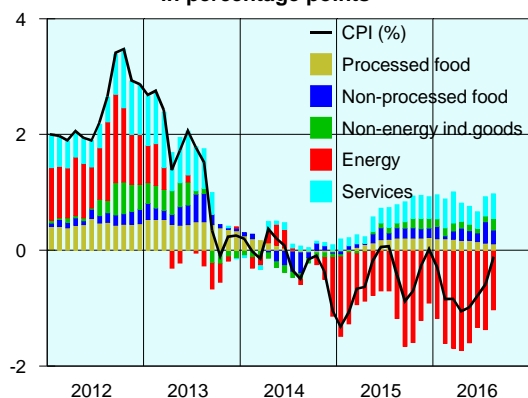
### **General and core inflation in the Eurozone remained stable**

Within the Monetary Union, the y-o-y rate of the Harmonised Index of Consumer Prices (HICP) remained at 0.2% in August 2016, the same figure as the one recorded in the previous month, coinciding with the anticipated rate of the Eurostat in late August. On the other hand, core inflation remained at 0.8% for the fourth consecutive month. Compared to July, the stability of global inflation was due to the fact that the lower drop in energy prices was offset by the slight slowdown in other major groups of the euro area's HICP.

The prices of energy products in the Eurozone moderated the rate of y-o-y decline in August by 1.1 points, to 5.6%, in line with the behaviour of oil prices in that month, this being the only sector registering negative variation rates. In turn, non-processed food prices slowed down four tenths, down to 2.5%.

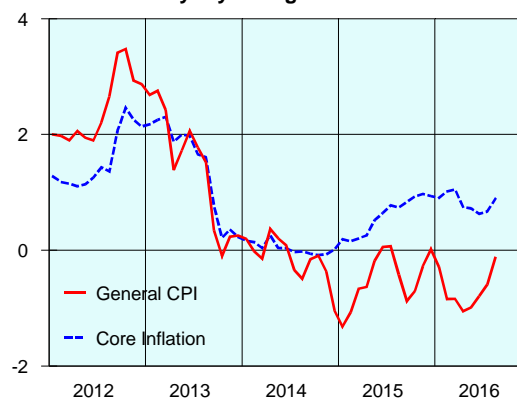
In August, core inflation remained at 0.8% for the fourth consecutive month, as a result of the relative stability of its components. The variation rates of services and non-energy industrial goods (BINE) prices fell one tenth, down to 1.1% and 0.3%, respectively, while the variation rates of processed food remained at 0.5%.

**G 6. CPI GROWTH CONTRIBUTION BY SECTORS**  
in percentage points



Sources: INE and SGACPE.

**G 7. GENERAL CPI AND CORE INFLATION**  
y-o-y change in %



Source: INE.

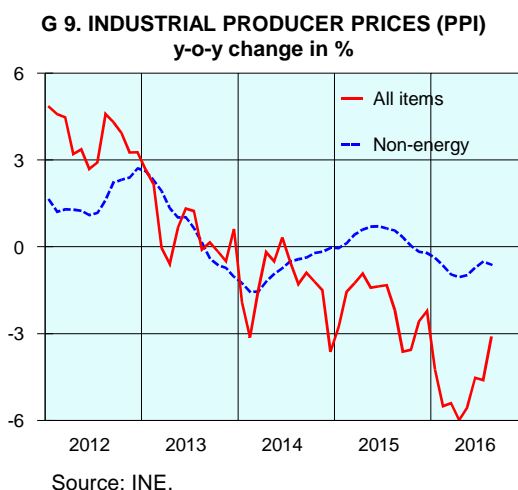
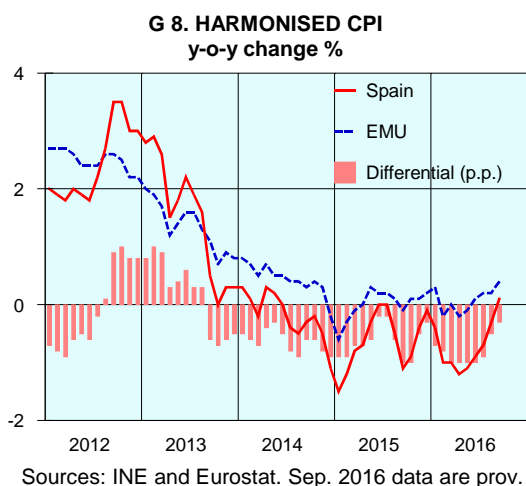
### **The inflation differential continued favourable to Spain**

Spain's HCPI rose four tenths in August, up to -0.3%. As a result, the inflation differential against the Eurozone, which has been favourable to Spain since September 2013, fell four tenths, down to 0.5 p.p. The INE also published the harmonised CPI (HICP) for September, whose annual rate stood at 0.1%, four tenths higher than the figure observed in the previous month. If this rate is compared to the one estimated by the Eurostat for the Eurozone as a whole in that month (0.4%), the inflation differential remains favourable to Spain, reaching 0.3 percentage points.

By sector of origin, the inflation differential favourable to Spain in August continues to rely on energy (-3.4 p.p.) and, to a lesser extent, on services (-0.2 p.p.). The remaining groups show positive differentials. By expense groups, the inflation differentials in August were generally favourable to Spain, except for communications (2.7 p.p.), clothing and footwear (1.7 p.p.) and food and non-alcoholic beverages (0.7 p.p.).

### *The PPI y-o-y pace of decline moderated in August...*

Industrial (PPI) or producer prices fell in August 2016 compared to the previous month (-0.2%) compared to the more pronounced fall (1.7%) observed in the same month of 2015. In y-o-y terms, the PPI fell by 3.1%, which represents a slowdown of the fall by one and a half points.



### *...mainly due to evolution of energy prices*

The lower y-o-y decline of the general index is mainly explained by energy production prices, which moderated the pace of y-o-y decline more than five percentage points, to -10.3%. In particular, the intensity of the price fall for oil refining was reduced by almost a half, down to -12.4% (-21.8% in July). As a result of the evolution of its components, non-energy goods prices fell by 0.6% y-o-y in August, which implies a fall slightly higher (one tenth) to the one recorded in July.

Within the non-energy group, the largest contribution to its fall is mainly explained by consumer goods, whose prices experienced a y-o-y decrease of 0.2%, after the slight increase (0.1%) observed in the previous month. Equipment goods production prices also contributed, although to a lesser extent, to the largest decline of the non-energy IPRI, slowing down one tenth, down to 5.0% y-o-y. On the other hand, intermediate goods prices moderated the drop intensity one tenth, to 1.6% as a result of the evolution of the prices of the chemical industry, which fell by 4.1%, six tenths less than in the previous month, and metallurgy, which registered a more moderate fall (-1% compared to the -1.6% registered in the previous month).

### **Labour market**

Social security covered workers maintained steady its growth rate (3%) in September and ended the third quarter of the year with an average annual increase of 3%, three tenths higher than the figure registered in the second quarter. On the other hand, registered unemployment recorded a y-o-y decrease of 9.1% in the third quarter compared to the 7.9% fall in the second quarter, thus prolonging the recovery process of the labour market.

With regard to costs, wages agreed in the labour agreements maintained up to August their growth at 1.1%, and the wage cost per worker and month remained stable in y-o-y terms in the second quarter according to the Quarterly Survey of Labour Costs.



***Social Security covered workers grew by 3% y-o-y in September***

Social Security covered workers rose by 12,025 people in September compared to August (8,916 in the same month last year), the average number of covered workers reaching 17,712,021.

By activity branches, social security covered workers increased in agriculture (27,868 covered workers more), industry (9,928) and construction (410), while they decreased in services (-26,180).

With seasonally adjusted data, social security covered workers increased by 44,796 people (0.3% m-o-m), after the virtual stabilisation in the previous month (337 social security covered workers more in August than in July).

In y-o-y terms, total covered workers rose by 522,206 people in September, 3.04% in y-o-y terms, which implies a slight acceleration of 2 hundredths compared to the figure recorded in August. Stability in the pace of job creation is due to the slight acceleration in industry (one tenth, up to 2.8%) and construction (two tenths, up to 2.8%), which offset the lower dynamism in agriculture (nine tenths, to 0.1%). On the other hand, social security covered workers in services maintained the growth rate at 3.3%. Excluding agriculture, social security covered workers grew by 3.2%, the same as in the previous month.

By NACE activity sections, with gross data and for all systems as a whole, in terms of y-o-y contribution, all showed a remarkable stability. In the two main sections driving the social security covered workers, accommodation and trade, employment grew at y-o-y rates of 5.5% and 2.4%, respectively, the former being four tenths higher and the latter equal to the figures recorded in August.

According to the professional situation, contracted employees and self-employed social security covered workers maintained in September the y-o-y rate of increase of the previous month, 3.5% and 0.9%, respectively.

More than half (53.5%) of the social security covered workers y-o-y increase in September was of a permanent nature (51.3% in May), with increases of 3.3% in permanent employees and 5.9% in employees with temporary contracts.

With these figures, the average social security covered workers of the third quarter of the year registered a q-o-q increase of 0.68%, two tenths lower than in the second quarter (0.89%) with seasonal and calendar adjusted data. In y-o-y terms, covered workers grew by 3%, three tenths more than in the previous quarter, resuming the pace of growth of the first quarter. In this regard, it is worth noting that the three-tenth slowdown of the second quarter was largely concentrated on the agriculture sector, while non-agricultural social security covered workers grew at a similar pace as that of the first quarter (2.9% in the second quarter, compared with the 3% registered in the first quarter).

***The registered unemployment y-o-y pace of decline remains at 9.1%***

Registered unemployment rose by 22,801 people in September compared to August (26,087 in the same period last year). As a result, the total number of registered unemployed reached 3,720,297.

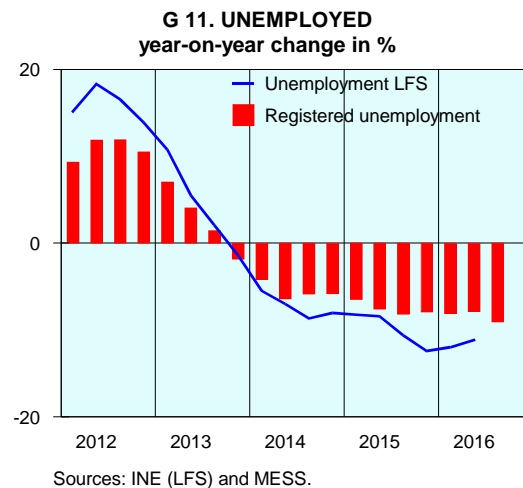
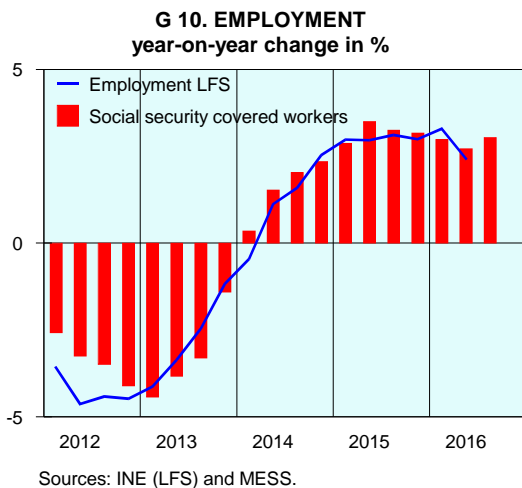
By branch, and with unadjusted data, unemployment fell in agriculture (-12,507 people), construction (-9,984) and industry (-3,345), while it increased in services (39,268). In the group without previous employment, unemployment rose by 9,369 people.

With seasonally adjusted data, the reduction in registered unemployment reached 16,906 people (-24,462 in August), representing a m-o-m rate of -0.4% (-0.6% in the previous month).

Year-on-year, registered unemployment fell by 373,745 people in September, 9.13%, a fall two hundredths higher than in the previous month, the rate of decline remaining virtually unchanged in all branches. This is the largest rate of decline since 1999.

The registered unemployment for people under 25 years old fell by 14% y-o-y in September, a fall eight tenths lower than in August.

In the third quarter of 2016 as a whole, registered unemployment recorded a decline of 3% q-o-q, with seasonal and calendar adjusted data (-2.28% in the second quarter). Compared to a year earlier, registered unemployment fell by 9.1%. This fall is 1.2 points higher than the one registered in the second quarter, largely due to the intensification in the services decline (-7.6% compared to the -6.3% registered in the previous quarter).



### ***The agreed wage increase in collective bargaining agreements remained at 1.1%***

According to the Collective Bargaining Agreement Statistics published by the Ministry of Employment and Social Security, the average agreed wage rise with the information available up to late August of this financial year, remained at 1.1% so far this year.

Of the 6.1 million workers affected by the agreements signed up to August, 83.3% correspond to wage revisions of multi-year agreements with economic effects in 2016 and the remaining 16.7% to new agreements signed in 2016, with a wage increase of 1.1% in the first case and of 1% in the second case.

With regards to the coverage, the rate agreed in company agreements (0.7%) was lower than that signed in other areas (1.1%).

By sector, wage increases remain higher in industry and services (1.1% in both cases) than in agriculture and construction (0.9% in both sectors).

With cumulative data up to August, 1,019 opt-outs were registered affecting 23,324 workers, 19.4% less than in the same period last year. As usual, most of the opt-outs submitted (90.4%) related to salaries.

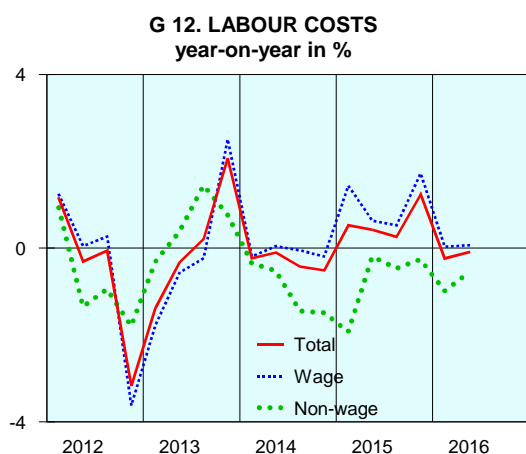
### *The wage cost per worker and month remains stabilised in the second quarter*

According to the Quarterly Labour Cost Survey, in the second quarter of 2016 the average labour cost per worker and month rose to € 2,589, 01% less in comparison to the figure of the same quarter of 2015 (-0.2% in the previous quarter).

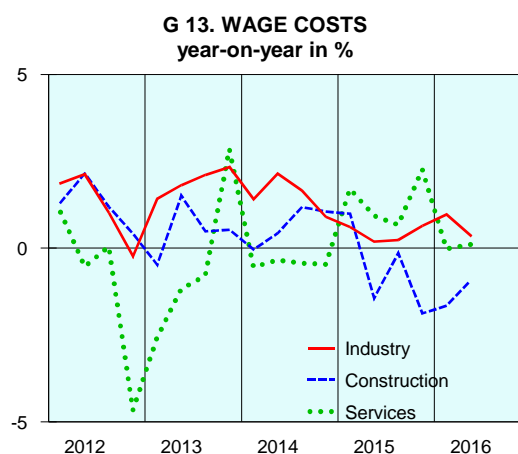
Of the total labour costs € 1,943 (75%) correspond to wage costs, a figure almost identical to the one registered in the same quarter of last financial year (y-o-y variation rate of 0.1%, one tenth higher than in the previous quarter), and the rest to the non-wage component.

Within the wage cost, its main component, the ordinary salary (84% of the total wage cost) fell by 0.3%, one tenth more than in the previous quarter. With regards to the other two components, the extraordinary wage cost fell by 0.9% (-3.7% in the first quarter), and the arrear payments cost grew by 25.2% (-5.6% in the previous quarter), an evolution linked to the refund of half of the extra pay to public employees withdrawn in December 2012.

From a sector point of view, it can be seen that the slight y-o-y decrease of total labour costs (-0.1%) was due to the service sector (-0.1%) and construction (-1.4%), while it grew in industry (0.3%). With regards to the wage costs, its 0.1% increase is explained by the service sector (0.1%) and industry (0.4%), while in construction, the wage cost fell by 0.9%. The 'other costs' component rose in the industrial sector (0.3%), while it fell in services (-0.6%) and, especially, in construction (-2.4%).



Source: INE (ETCL: Quarterly labour cost survey).



Source: INE (ETCL: Quarterly labour cost survey).

Adjusted for seasonal and work calendar effects, the labour cost per worker and month remained stable in the second quarter of 2016 in comparison to the same period a year earlier (-0.1% in the previous quarter) versus the 0.8% rise with seasonally and calendar adjusted data of the compensation per employee of the Quarterly National Accounts in that period. On the other hand, wage cost grew by 0.3%, one tenth more than in the previous quarter and other costs fell by 0.8% (-0.7 in the first quarter of 2016).

In q-o-q terms, the total labour cost rose by 0.2% with seasonally and calendar adjusted data, compared to the 0.4% decrease registered in the previous quarter. The wage cost rose by 0.1%, after falling 0.2% in the previous quarter, and other costs rose by 0.6% (-0.9% in the previous quarter).

## External sector

### *The Spanish economy generates net lending to the rest of the world*

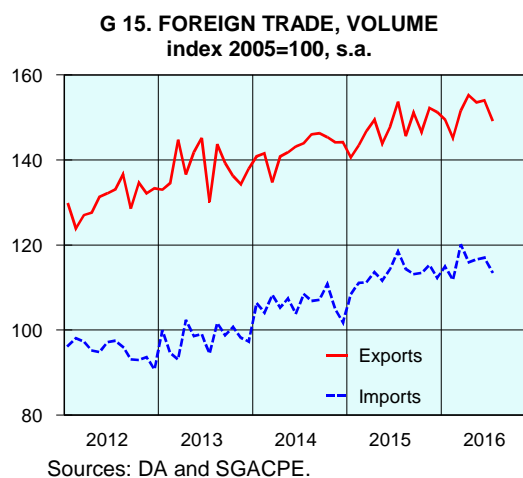
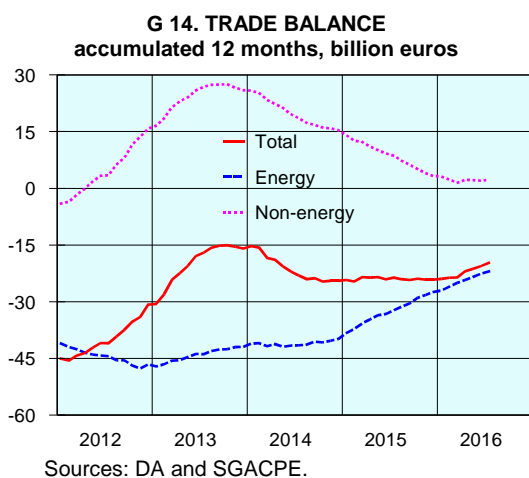
According to the Balance of Payments data, in July 2016, the Spanish economy generated *net lending* to the rest of the world of € 3.6 billion, for the fifth consecutive month, a figure higher to the one recorded one year earlier (€ 3.4 billion).

The current account balance recorded a € 3 billion surplus in July, higher to the figure registered in the same month last year (€ 2.7 billion) as a result of a 19.7% y-o-y increase in the surplus of goods and services, which offset the 27.1% increase of primary and secondary income deficit. Meanwhile, the surplus in the capital account amounted to € 528 million, versus the € 698 million registered in July last year.

### *Significant reduction in the trade deficit in July*

According to Customs data, the trade balance recorded a deficit of € 558 million in July 2016, versus the deficit of € 1.4 billion registered a year earlier. The correction of the external imbalance (of 60%) was due to the energy component, which registered a deficit decrease of 23%, and the non-energy balance, whose surplus rose by 27.2%.

In cumulative terms for the last twelve months, the trade balance recorded a deficit of € 19.7 billion up to July 2016, compared with the €23.6 billion deficit accumulated in the twelve months up to July 2015. The 16.5% improvement in the external balance is exclusively due to the energy balance, which recorded a cumulative deficit of € 22 billion, € 10.3 billion less than that registered a year earlier (€ 32.3 billion). The energy deficit contraction more than offset the deterioration of the non-energy balance, which registered a surplus of € 2.3 billion, lower by € 6.4 billion than the one recorded in the previous year (€ 8.6 billion).



### ***Setbacks of exports and imports in July...***

According to Customs figures, goods exports decreased in July by 9.1% y-o-y, and their prices, approximated by unit value indices, fell by 1.7% (-2% in June), resulting in a 7.6% decrease in real terms, after the 4.2% rise registered in June. The analysis by product groups, in real terms and in y-o-y rates, shows generalised falls in all groups. Sales of food consumer goods fell by 10% (-0.8% in June), non-food consumption by 5.5% (17.3% increase in the previous month), capital goods by 8.3% (increase of 13.1% in June) and non-energy intermediate goods by 6.3% (versus 0.1% in the previous month). On the other hand, sales of energy intermediate goods intensified their fall, from -21.2% in June down to -29.3% in July.

By geographical areas, exports in volume to the European Union decreased by 7.3% in July, after ten months of uninterrupted increases (7.5% in June), and exports to the rest of the world fell by 8.1% in July, 6.3 points more than in the previous month.

Goods imports fell by 12% y-o-y in nominal terms in July, after the -0.9% registered in the previous month, and their prices fell by 3.3%, the same rate as in June. This evolution reflects a price fall in energy intermediate goods of 22% and of 0.1% in the other products. As a result, imports in real terms, fell by 9% y-o-y, following the 2.5% increase registered in the previous month. The analysis by products in real terms and in y-o-y rates reflects generalised falls in all groups, except in purchases of food, which, even though they slowed down 11 points, continued to grow (3.5%). Among the other groups, imports of non-food consumer goods decreased for the first time since early 2015 (by 9.8% versus the 4.9% increase recorded in June), capital goods by 10.5% (after the 11.7% increase of the previous month) and non-energy intermediate goods by 10.2% (3% increase in June). On the other hand, purchases of energy intermediate goods moderated the pace of decline by 8 points, to 8.3%.

By geographical areas and in real terms, imports from the European Union fell by 11.1% y-o-y in July, versus the 1% rise registered in June, and those from the rest of the world went from recording an increase of 4.8% in June to fall by 5.8% in July.

### ***...while the "momentum" of exports remains positive***

The "momentum" (change during the last three months in comparison to the previous three months) of exports in real terms was positive in July (1.1%) for the third consecutive month, due to the positive contribution of the EU countries and the rest of the OECD. By products, the positive contribution of non-food consumer goods and energy intermediate goods stands out. The "momentum" of imports became negative in July (-0.2%), after four months in positive, due to the negative contribution of purchases to non-OECD countries and by product, to the negative contribution of non-food consumer goods and, intermediate, energy and non-energy goods.

### ***The financial account generated net capital inflows in July***

According to the Balance of Payments, in July 2016 the financial account, excluding the Bank of Spain assets, recorded net capital inflows of € 9.5 billion, versus the net outflows of € 14.9 billion recorded a year earlier. This result is explained by the net inflows registered in direct investment (€ 1.9 billion) in portfolio investment (4.4 billion) and in other investments (€ 3.3 billion), while financial derivatives registered net outflows (€ 44 million).

The assets net variation recorded net capital inflows (disinvestments) of € 9.3 billion in July, versus the net outflows of € 13.3 billion registered in the same month of 2015. On the other hand, the liabilities net variation generated net inflows (investments) of € 157 million, versus the net outflows of € 1.7 billion recorded a year earlier.

### ***The net position of the Bank of Spain vis-à-vis the Eurosystem decreased***

The net position of the Bank of Spain vis-à-vis the rest of the world decreased by € 15.1 billion in July, an amount that includes an increase of € 15.7 billion in the net position vis-à-vis the Eurosystem and improvements of € 1.6 billion in the reserves and a decrease of € 2.3 billion in the remaining net assets.

### ***The Net International Investment Position decreases its debit balance***

On the other hand, the Bank of Spain published the Net International Investment Position figures for the second quarter of 2016. This quarter ended with a debit balance standing at € 969.8 billion (88.5% of GDP), compared with the €991.2 billion (94% of GDP) registered in the same period of 2015.

This is the result of the expansion of the net position of the Bank of Spain against the rest of the world, with € 55.1 billion, being largely offset by the reduction of the net position of the other groups, with € 76.5 billion. In turn, the later is due to the decrease of the net debit position of the portfolio investment and other investment, which more than offset the expansion of the direct investment net debit position and derivatives.

Furthermore, the gross external debt rose in the second quarter of 2016 by 4.6% y-o-y, reaching € 1.9 trillion. The ratio of gross external debt to GDP rose one percentage point, up to 171.4% of GDP.

## **Public Sector**

On 30<sup>th</sup> September, the Ministry of Finance and Public Administrations published the data of non-financial transactions of the General Government and its subsectors, in terms of National Accounts, for the second quarter of 2016. Likewise, on 27<sup>th</sup> September, the Ministry published the non-financial transactions of the Central Government, the Regional Governments and the Social Security Funds, with consolidated data and in terms of National Accounts, for July, and the State monthly budget execution data for August, both in terms of National Accounts and Cash. On the other hand, the Ministry of Employment and Social Security published the monthly budget execution data of the Social Security, in terms of Cash, corresponding to August.

### ***The General Government deficit in the second quarter of 2016 stands at 3.07% of GDP***

In the second quarter of 2016, the General Government recorded a deficit, in terms of National Accounts, of € 34.2 billion (3.07% of GDP) 9.7% higher compared to the figure registered in the same period last year (€ 31.2 billion). Excluding the assistance to the financial institutions, the deficit stands at € 32.5 billion (2.91% of GDP), 5.5% higher than the figure accumulated up to June last year. This deficit increase is explained by a rise in non-financial uses (1% y-o-y) and by a decrease of non-financial resources (-0.4% y-o-y).

***The General Government consolidated deficit, excluding Local Governments, stands at 3.27% of GDP up to July***

On a consolidated basis, the Central Government, the Regional Governments and the Social Security Funds recorded up to July 2016 a deficit of € 36.4 billion (3.27% of GDP), 7.9% higher in comparison to the same period of 2015 (3.14% of GDP). Excluding the assistance to the financial institutions, the deficit stands at € 345 billion (3.09% of GDP), 2.3% higher than the figure accumulated up to July last year. This deficit increase is explained by a y-o-y increase of non-financial uses (1.8%) higher than the one recorded by non-financial resources (0.8%).

It should be noted that the final settlement of the financing system corresponding to 2014 was carried out in July. If the effect of the final settlement of Local Governments (the settlement corresponding to the Regional Governments does not affect the overall balance) is excluded, the deficit without financial assistance stands at € 336 billion (3.01% of GDP), 2.7% lower in comparison to the same period of 2015.

The slight increase of non-financial resources is mainly due to the increase of taxes on production and imports (1.5%) and social contributions (2.8%), partially offset by the fall of current taxes on income and wealth (-7%).

Regarding non-financial uses, these mainly increased due to the rise in social benefits other than transfers in kind (1.6%), social transfers in kind of market producers (2.4%), transfers to other administrations (6.2%) and compensation of employees (2.2%). Among the items that fell, intermediate consumption (-1.1%), interests (-5%), subsidies (-15.1%) and gross fixed capital formation (-5.9%) stand out.

The Central Government ended the first seven months of 2016 with a deficit of € 29.8 billion (2.67% of GDP), 29% higher than the figure registered in the same period of 2015 (€ 23.1 billion, equivalent to 2.14% of GDP). This is mainly due to the effect of the final settlement of the financing system corresponding to 2014, both of Regional Governments and Local Governments, which has favoured territorial entities for a total amount of € 8.6 billion.

Non-financial resources of the Central Government fell by 5.9%. Current taxes on income and wealth decreased by 19.6% due to the effect of the final settlement of the financing system of Regional Governments corresponding to 2014; to the increase of approximately 2.4% of the instalment payments of the personal income tax; to the impact of the tax reform; the end in 2016 of the temporary measures affecting the instalment payments of the Corporate Tax; and to the inclusion in the accrued revenue in 2015 of several inspection reports of such tax for an amount exceeding that included in the reports made in 2016, that were appealed.

On the other hand, non-financial uses increased by 0.3%. The expenditure of the Central Government eligible to be included in the calculation of the expenditure rule increased by 1.6% y-o-y, up to € 58.3 billion.

The Regional Governments accumulated a deficit of €830 million (equivalent to 0.07% of GDP) up to July this year, 90.3% lower than in the same period of 2015 (€ 8.6 billion, equivalent to 0.80% of GDP). This lower deficit is explained by a decrease of non-financial uses (-0.8%) and an increase of non-financial resources (8% y-o-y), which in turn is mainly due to the result of the final settlement of the financing system corresponding to 2014. The final settlement balance in favour of the Regional Government increased considerably compared to the settlement of 2013.

In July 2016, the Regional Governments did not receive from the State advanced payments from the financing system resources, while in the same period of 2015 advanced payments amounting to € 610 million were granted. Excluding the effect of these advanced payments, the deficit at the end of July 2015 would have reached € 9.2 billion, 0.82% of GDP, 0.75 points higher than the deficit in 2016. The expenditure of the Regional Governments eligible to be included in the calculation of the expenditure rule in the analysed period increased by 0.9% y-o-y, standing at € 80.6 billion.

As for Social Security Funds, these ended the first seven months of the year with a deficit of € 5.9 billion (0.53% of GDP), versus a deficit of € 2.1 billion in the same period of 2015 (0.20% of GDP). This deficit increase is explained by a fall of non-financial resources (-2.8%), due in turn to the decline of transfers received from other administrations (-25.8%), and to an increase in non-financial uses (1.4%). This evolution is mainly due to the result of the State Public Employment Service, which reduced its surplus by €2.7 billion, to € 1.8 billion, mainly due to the lower transfers received from the State because of the fact that the credits in the State budget in 2016 decreased by 61.2% in comparison to the previous year.

### ***The State's deficit stands at 2.79% of GDP up to August in terms of National Accounts***

Up to August 2016, the budget execution of the State ended with a deficit, in terms of National Accounts, of € 31.1 billion (2.79% of GDP) 16.1% higher than the deficit accumulated in the same period of 2015. This higher deficit was due to a y-o-y decrease in non-financial resources (-5.3%) higher than the one registered by non-financial uses (-1.2%).

In terms of Cash, the State recorded a deficit of €19.5 billion up to August 2016, higher by 53.3% to the figure recorded in the same period of 2015 (€ 12.7 billion). Non-financial revenues decreased by 14.1% y-o-y, reaching € 81.7 billion, while non-financial payments decreased by 6.2%, down to € 101.2 billion.

### ***Tax revenues decrease by 1.7%, in homogeneous terms***

Total tax revenues (including the Regional and Local Governments' share) recorded a slight y-o-y decrease of 0.3% up to August, four tenths lower in comparison to the cumulative decline recorded up to July, due to the fact that the collection of August 2015 already includes part of the effects of the further rate cuts approved in RDL 9/2015, so the impact of the reform on withholdings is reduced, mainly for labour and economic activities. In homogeneous terms, that is, adjusted by the different tax rebates rate in both years, the IVMDH refunds (health cent) and the deferrals of public entities, tax revenues fell by 1.7%. Without including the Regional and Local Governments, and in non-homogeneous terms, the fall stands at 9.1%.

Within total taxes, revenues from personal income tax, including the Regional and Local Governments' share, decreased by 1.8% up to August, mainly due to the impact of the reform in labour and capital withholdings (-1.1% and -9.9%, respectively). However, personal income tax revenues up to August moderated their y-o-y fall rate by one tenth in comparison to the revenues accumulated until July, due to the fact that the revenue of 2015 already included in August some of the effects of the rate cut approved in the RDL 9/2015. In homogeneous terms, the reduction stands at 1.9%.

Revenues from corporate tax stood at € 5.3 billion up to August 2016, compared to the € 7.8 billion registered a year earlier, mainly due to the fall of the payment in instalments (-48%),



and the increase of revenues from the positive differential quota of the annual return for the financial year 2015 (2.3%).

VAT revenues, including the Regional and Local Governments' share, increased by 5.2% y-o-y. In homogeneous terms, adjusted by the different tax rebates rate, the increase stands at 3.1%.

Excise duties collection, including the Regional and Local Governments' share, was 3.5% higher compared to the figure registered in the same period of 2015, mainly due to the increase in the Duty on Hydrocarbons (8.6%, which in homogeneous terms, corrected for the health cent refunds, stood at 2.4%). The Excise on Tobacco Products rose by 0.5%.

### ***The State's non-financial payments decrease***

With regard to expenses, the total non-financial payments decreased by 6.2% up to August, compared to the figure recorded in the same period of 2015, due to the fall of staff expenses (-0.7%), current transfers (-7.9%), real investments (-28.5%) and capital transfers (-17.5%). On the other hand, current expenses on goods and services increased by 8.8%, and financial expenses by 0.5%.

The borrowing requirement up to August 2016 amounted to € 27 billion, compared to the € 31.1 billion recorded in the same period of 2015. This evolution is due to the lower net increase of financial assets (€ 7.5 billion, compared to the € 18.4 billion recorded a year earlier), which in turn is mainly due to the fall in the position in other deposits in the Bank of Spain, partially offset by the higher cash deficit (€ 19.5 billion, compared to the € 12.7 billion recorded a year earlier). The borrowing requirement was mainly financed through mid and long term domestic debt (€ 27.3 billion). On the other hand, the State's debt, according to the methodology of the Excessive Deficit Procedure (EDP), stood at € 940.3 billion at the end of August, compared to € 898.5 billion registered a year earlier.

### ***Social contributions increase by 2.8% y-o-y up to August***

Lastly, up to August 2016, the Social Security System (Managing Entities, General Treasury and Mutual Insurers) recorded a deficit of € 6.1 billion in terms of Cash, 14.5% higher than the figure recorded in the same period of 2015 (€ 5.4 billion). Revenues decreased by 1.1% mainly due to the decline in capital transfers (-73.2%) and, to a lesser extent, to the fall in property income (-25.7%) and in the State's current transfers (-0.3%), partially offset by the 2.8% increase registered in social security contributions. On the other hand, payments fell by 0.2%, mainly due to the decline in capital transfers and current expenses on goods and services (-76.9% and -6.9%, respectively). Expenditure on pensions and temporary disability increased up to August by 3% and 12.2%, respectively. Finally, regarding Social Security's management expenses, staff expenses rose by 1.7%.

### ***The Debt/GDP ratio decreases slightly in the second quarter of 2016***

According to the Bank of Spain, the General Government Debt, following the Excessive Deficit Protocol (EDP) methodology, reached 101% of GDP in the second quarter of 2016 (€ 1.106.7 billion), a percentage one tenth lower compared to the previous quarter.

By subsectors, the Central Government EDP Debt stood at 88% of GDP (€ 964.7 billion), registering a decrease of 0.8 points of GDP compared to the first quarter of 2016 (88.8% of GDP).

On the other hand, the Regional Government EDP Debt reached 24.9% of GDP (€ 273.2 billion, a percentage 0.4 points higher than that recorded in the previous quarter. Regarding the Social Security Administrations, the EDP Debt stood at 1.6% of GDP (€ 17.2 billion), a figure identical to the one registered in the previous quarter. Finally, Local Corporations registered in the second quarter of this year an EDP Debt equivalent to 3.2% (€ 35.1 billion), as in the first quarter.

### ***The General Government EDP debt accelerates in July***

According to the Bank of Spain, the General Government EDP Debt accelerated seven tenths in July compared to June, to 5.4% year on year, reaching € 1,100.7 billion.

By subsectors, the State EDP Debt stood at € 937,482 billion, which implies an increase of 5.6% in comparison to the same period of 2015. On the other hand, the Regional Government EDP Debt reached € 273.1 billion in July, 9.2% higher than that recorded in the same month of 2015. Regarding the Social Security Administrations, the EDP Debt reached € 17.2 billion, a figure almost identical to the one registered in July 2015 (€ 17.2 billion). Finally, Local Corporations registered in July an EDP Debt of € 35.3 billion, 5.2% lower compared to that of the same period of 2015.

October 2016