

Debating the Economic Conditions of the Spanish Economy

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EUI-nomics 2015

Debating the Economic Conditions in the Euro Area and Beyond

Firenze, 24th of April, 2015

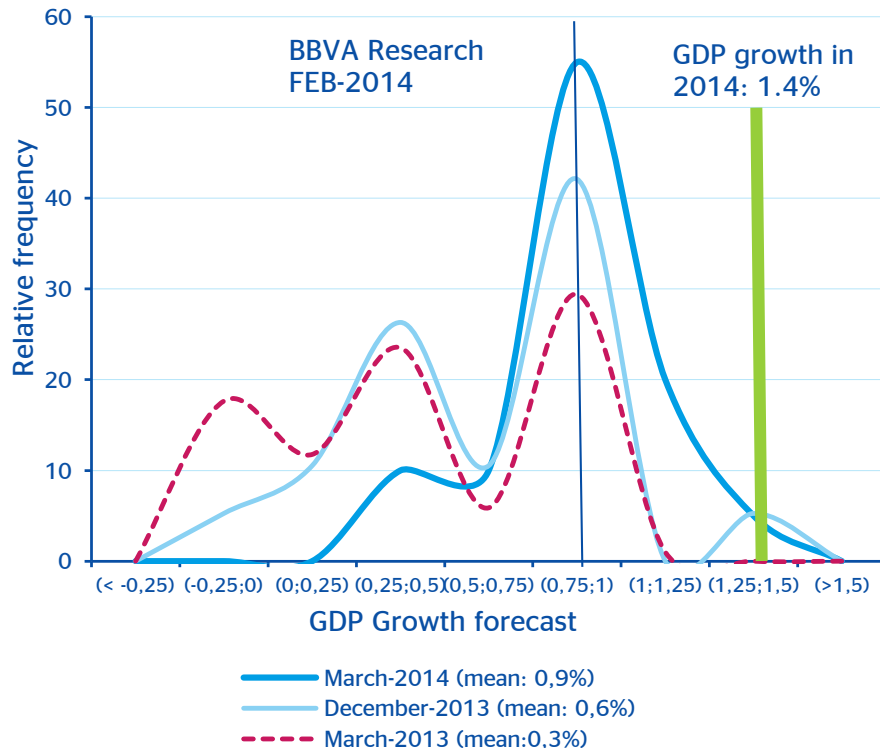
(Updated the 7th of May, 2015)

The outlook in April 2014: the risks were to the upside for the first time

Spain: GDP growth forecasts in 2014

(% YoY)

Source: BBVA Research based on Consensus Forecast Inc



Economic policy decisions have eliminated the risk scenarios

The differential performance of the Spanish economy confirms this improvement in the trend

If this trend is confirmed, GDP growth could be even stronger than our forecasts: slightly above 1% in 2014 and close to 2% in 2015

Main messages in April 2015

1

Incoming data roughly as expected, strong domestic demand and no signs of slowdown. If trends hold, positive bias towards 2Q15

2

Policies having stronger impacts, **data revisions** have shown better fundamentals than previously thought, **risks** are not materializing

3

Further tailwinds: mild recovery in EMU growth, oil prices, exchange rates depreciation and expansionary monetary policy

4

Neutral balance of risks: downside (political uncertainty and external factors), upside (stronger impact of policies or weaker uncertainty)

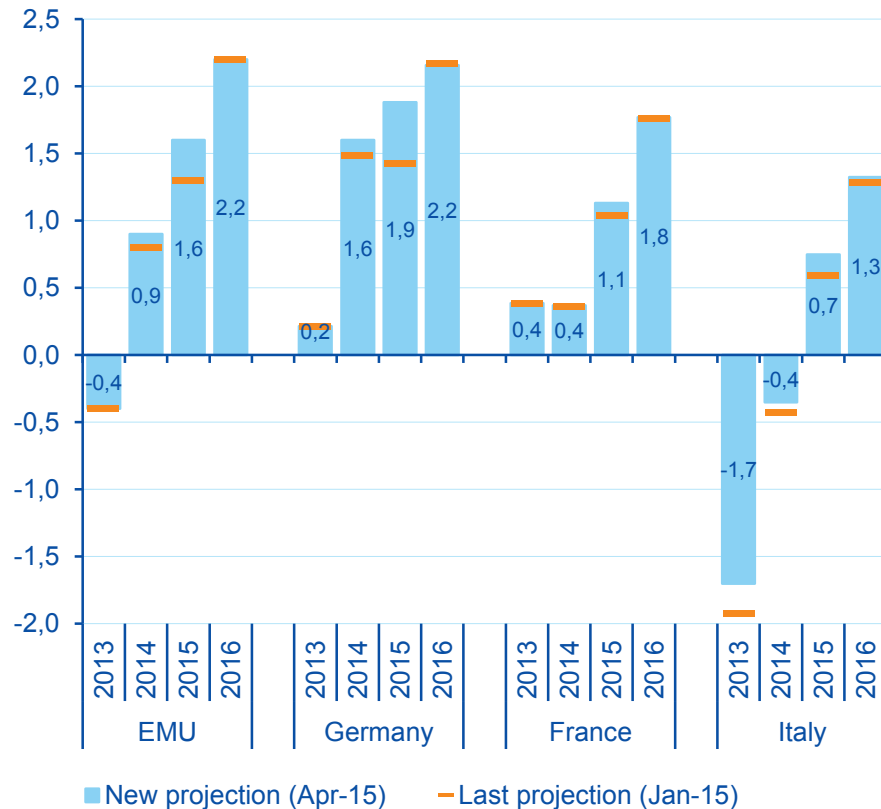
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GDP growth could be around 3% in 2015 and 2,7% in 2016, but with uncertainties about potential growth

EMU: more solid growth expected for 2015

GDP forecast by country (%)

Sources: Eurostat and BBVA Research



Germany: strong growth will continue to be driven by domestic demand

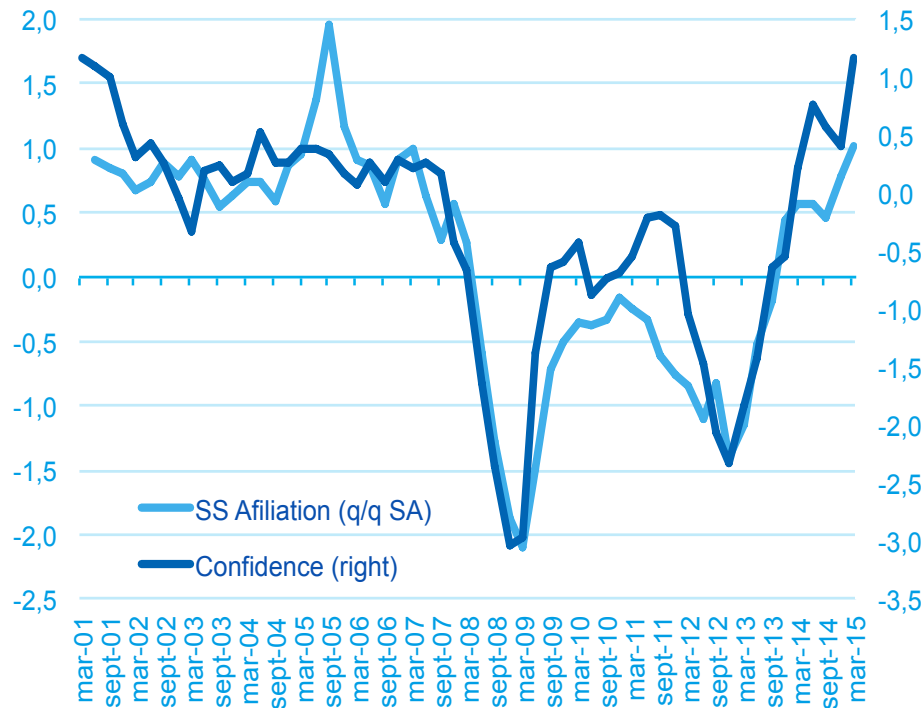
France: the pace of recovery depends on continued structural reforms and reinforcing competitiveness

Italy: finally out of recession in 2015, though the recovery is slow and mainly exports driven

Signs of GDP acceleration in the Spanish economy

Spain: consumer confidence and Social Security affiliation

Source: BBVA Research based on ME&SS and European Commission



Consumers confidence at 2001 levels

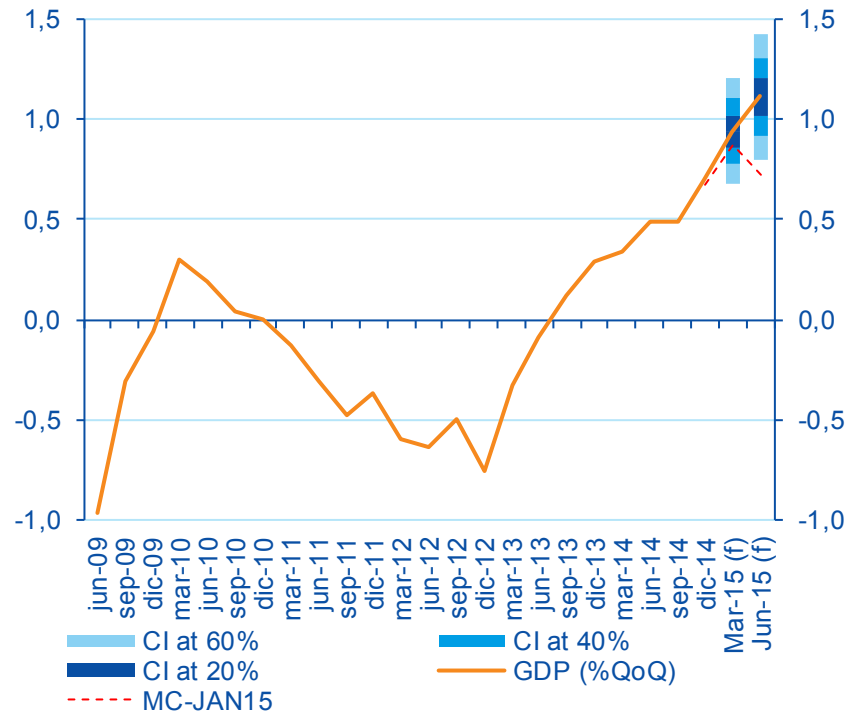
Employment growth (1.1% q/q in 1Q2015) as high as in pre-crisis period

Sectors that have been dragging the recovery (e.g., construction) are now growing

Signs of GDP acceleration in the Spanish economy

Spain: GDP growth observed and forecasts using MICA-BBVA model (%QoQ)

Source: BBVA Research



Confidence and employment indicators point to a further acceleration of growth in 1Q15: 0.8-0.9% q/q

If trends hold, GDP growth in 2Q15 expected to be again close to 1% q/q

Which are the factors behind this acceleration?

Factors behind GDP acceleration

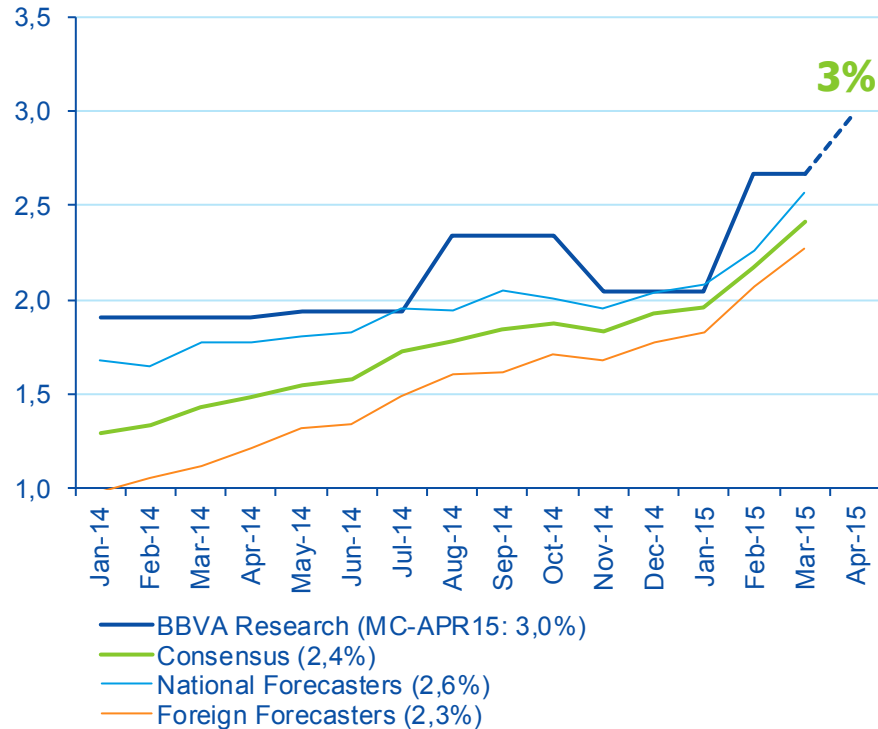
1. **Expansionary monetary policy:** TLTRO and QE are reducing cost of financing, boosting profits and confidence more than expected
2. **External factors:** euro depreciation, EZ recovery, banking union and lower oil price
3. **Improvement of new credit flows** to SMEs (+7.1% y/y) and households (+17,7% y/y)
4. **Fiscal policy slightly expansionary:** slow structural adjustment, lower direct taxes (tax reform), lower debt service (lower r), commercial arrears program
5. **Labour market policies:** (1) flat rate -> (2) 500 € exemption of social s. contributions for open-ended contracts, part-time employment, +incentives to job search
6. **Better consumption fundamentals:** increases in wealth and disposable income
7. **Private sector deleveraging:** the differential with EMU has been halved
8. **Perception in financial markets of lower political risks**

Spanish GDP consensus forecasts

GDP consensus forecasts continue converging towards BBVAs. The upward trend in consensus growth expectations came back

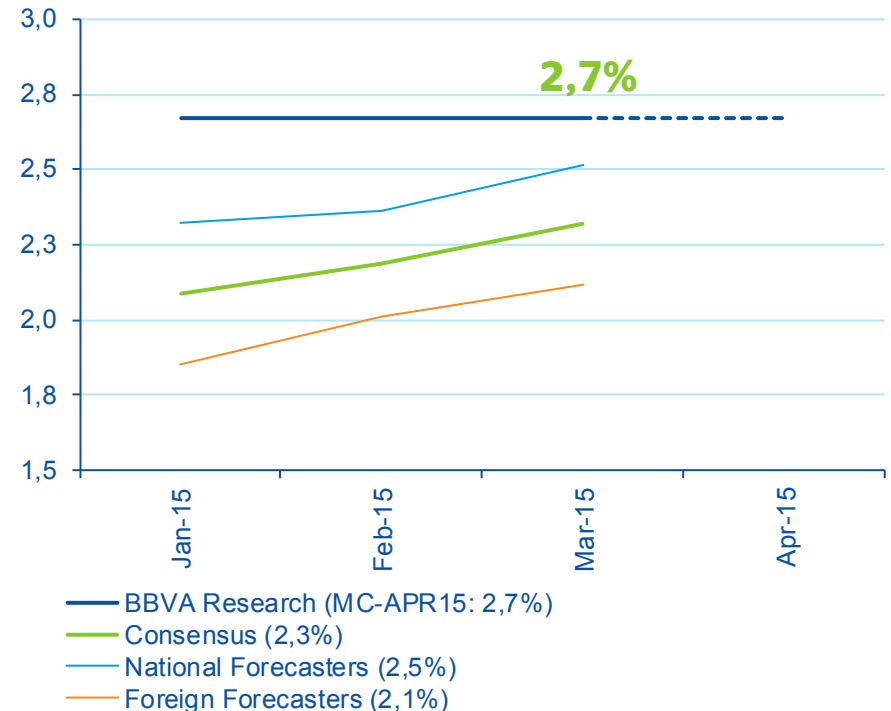
Spain: 2015 GDP growth forecast (YoY)

Source: BBVA Research based on Consensus Forecast Inc.



Spain: 2016 GDP growth forecast (YoY)

Source: BBVA Research based on Consensus Forecast Inc.



Macroeconomic forecasts

YoY	2014	2015 (F)	2016 (F)	2015 (r)	2016 (r)
Final consumption expenditure	1,8	2,5	1,9	0,3	0,3
Household and NPISHs	2,4	3,1	2,4	0,7	0,7
General government	0,1	0,8	0,6	-0,7	-0,8
Gross fixed capital formation	3,4	5,7	6,4	0,6	0,0
Equipment and machinery	12,2	7,8	6,7	0,6	0,4
Construction	-1,5	4,3	5,4	1,1	-0,2
Housing	-1,8	4,5	9,0	-0,6	-0,5
Domestic Demand (*)	2,2	3,0	2,7	0,3	0,3
Exports of goods and services	4,2	6,1	7,5	0,0	0,3
Imports of goods and services	7,6	6,5	7,8	-0,3	0,8
External Demand (*)	-0,8	0,0	0,1	0,1	-0,2
GDP mp	1,4	3,0	2,7	0,3	0,1
Nominal GDP	0,9	3,8	4,9	0,4	0,3
Pro-memoria					
Total employment (LFS)	1,2	3,5	3,1	0,3	0,3
Unemployment rate (% Active pop.)	24,4	22,4	20,7	-0,1	-0,2
Total employment (F.T.E)	1,2	2,8	2,5	0,2	0,2
CPI (average)	-0,2	-0,2	1,4	0,3	-0,1

(*) contribution to GDP Growth
f. forecast; r. revision

We still think exports will keep on accelerating, on the back of tailwinds, offsetting import growth

Investment in M&E still going strong and along with consumption will explain most of the increase in domestic demand

Increasing probability of seeing unemployment rates below 20% at the end of 2016

Risks going forward

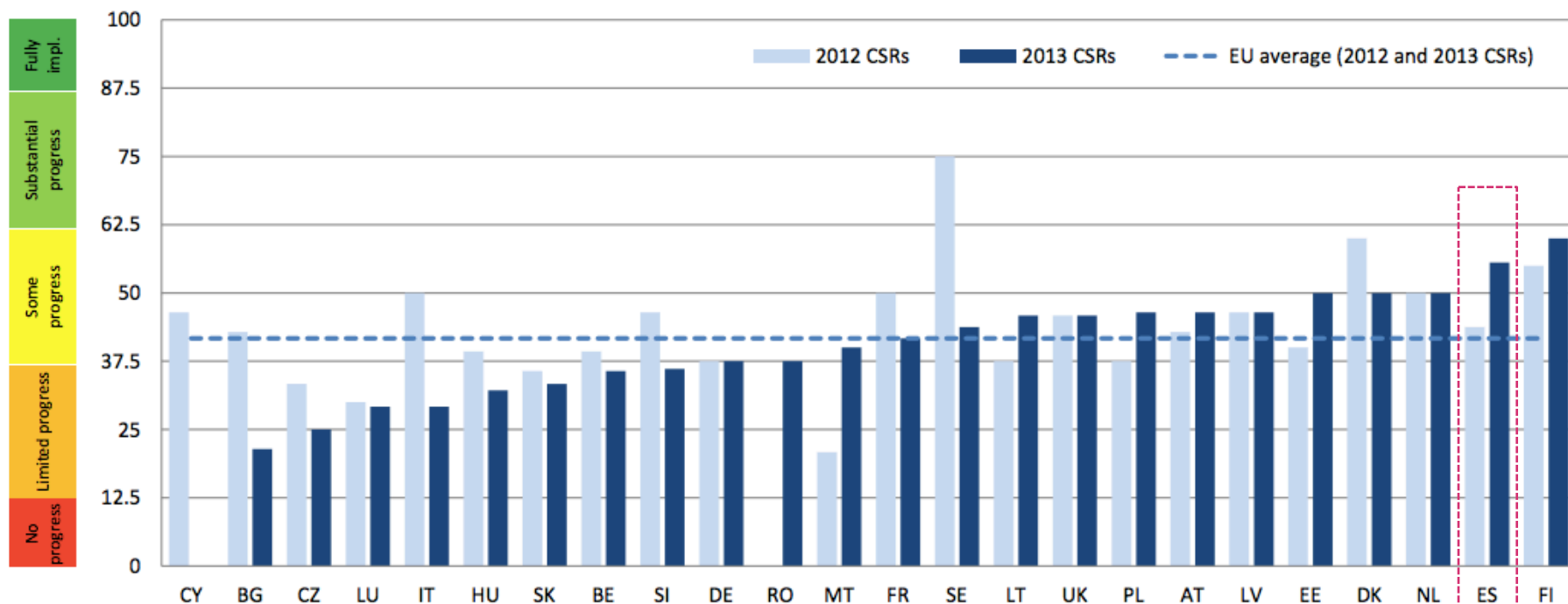
	Driver	What's behind?	Bias on GDP scenario going forward
Risks	Political uncertainty	<ul style="list-style-type: none"> • Can coalition governments be formed? • How will local elections affect Catalanian and national elections? 	Slightly better than 3/6 months ago
	Reform fatigue sets in	<ul style="list-style-type: none"> • Debtor relief reform • New subsidy to “permanent” contracts 	Neutral
	Fiscal slippage	<ul style="list-style-type: none"> • Increasing likelihood of not meeting 2015 target could mean a contractionary fiscal policy in 2016 	Neutral (no big changes expected)
	Export slowdown?	<ul style="list-style-type: none"> • Worrying stagnation (structural?) over last 6m 	Neutral (too early to tell)
	Stronger than expected impact of policies	<ul style="list-style-type: none"> • ECB actions in particular, could be having stronger impacts than previously thought 	Positive



Implementation of country specific recommendations

Synthetic indicator of progress on implementation of 2012 and 2013 CSRs

Source: ECFIN Economic Brief, 37 (2014) <http://goo.gl/KMuN10>



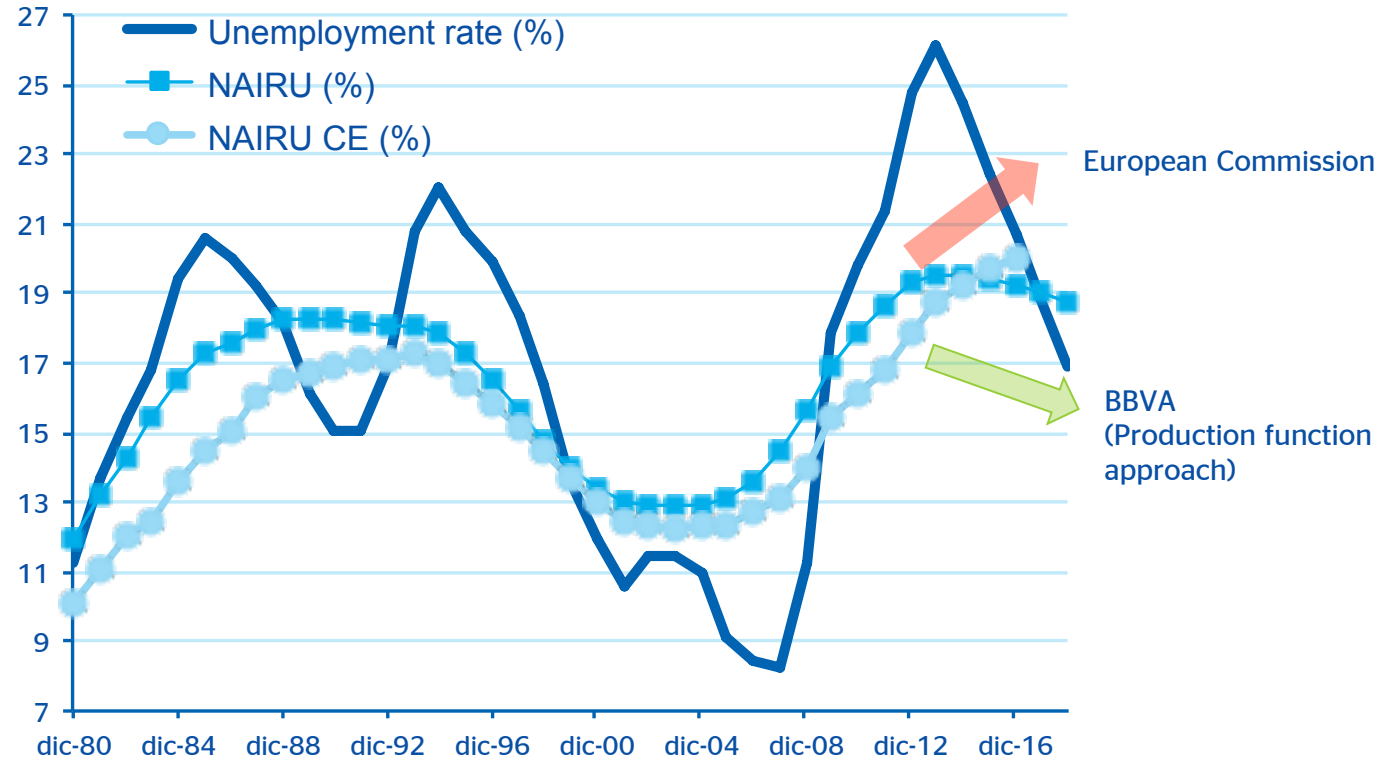
Source: European Commission European Semester SWDs 2013 and 2014.

Note: Bars show the synthetic indicator of CSR implementation per Member State on the basis of equal weights for each CSR per country. The dotted line (EU average) is based on equal weights for each CSR regardless of the country to which it was addressed; thus, countries with a larger number of CSRs have greater weight in the EU average than countries with fewer CSRs. Member States in a macroeconomic adjustment programme linked to EU financial assistance do not receive CSRs and therefore neither appear in the chart nor feature in the EU average (see Footnote 2 for details).

Effects of structural reforms on structural unemployment

Spain: unemployment rate and NAIRU (%)

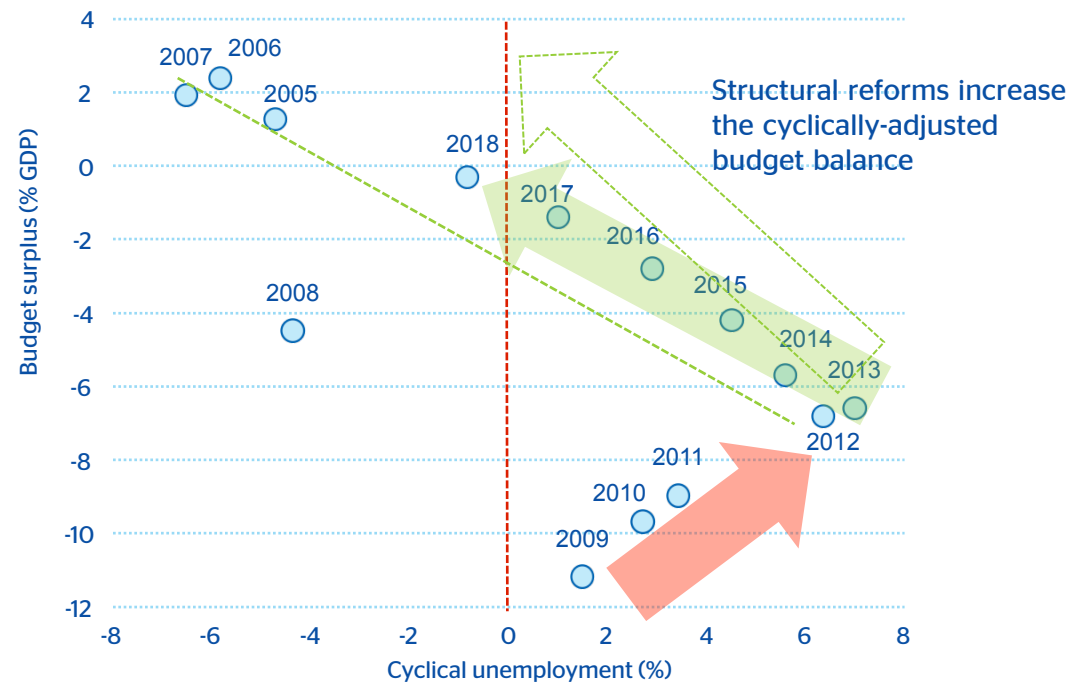
Source: BBVA Research based on INE and European Commission. Annual data.



Effects of structural reforms on the fiscal adjustment

Spain: unemployment rate and budget balance of general government, 2005-2018

Source: BBVA Research based on INE and Updated Stability Program (2015)



Note: Structural unemployment assumed to remain constant at 18% from 2014 onwards in the dots representing the Updated Stability Program. A reduction of the structural unemployment rate increases the slope of the fiscal adjustment path, as in the arrow with a dashed line.

Inflation differential with EMU continues

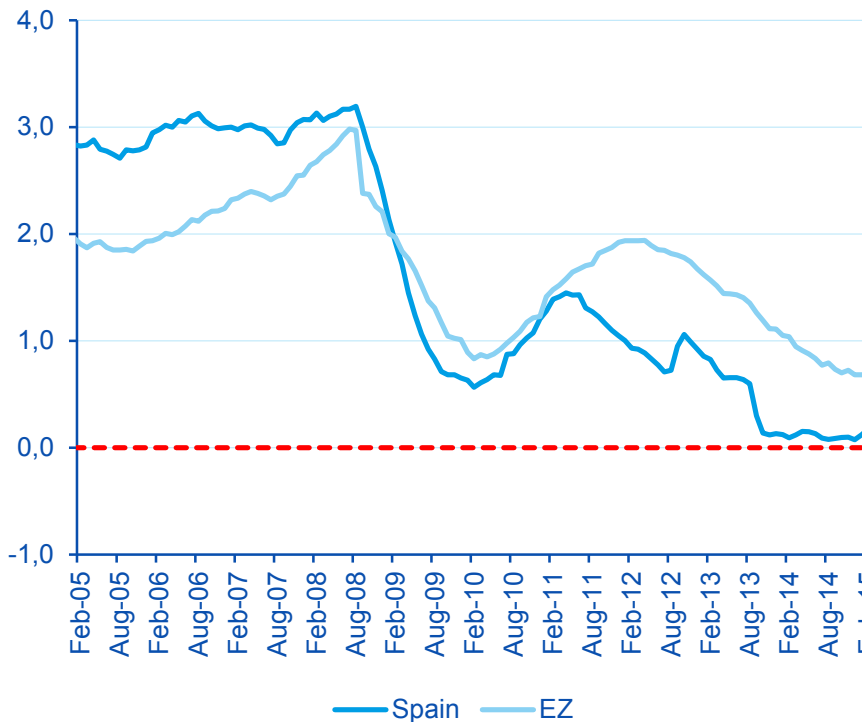
Spain and EMU: trend inflation

(% YoY, Trimmed mean method)

Source: BBVA Research based on INE and Eurostat

A deflation process continue to be outside the baseline scenario

Negative growth rates in Spain continue to have a non negligible probability



Trend inflation in Europe might remain below ECB target, both in Europe and Spain

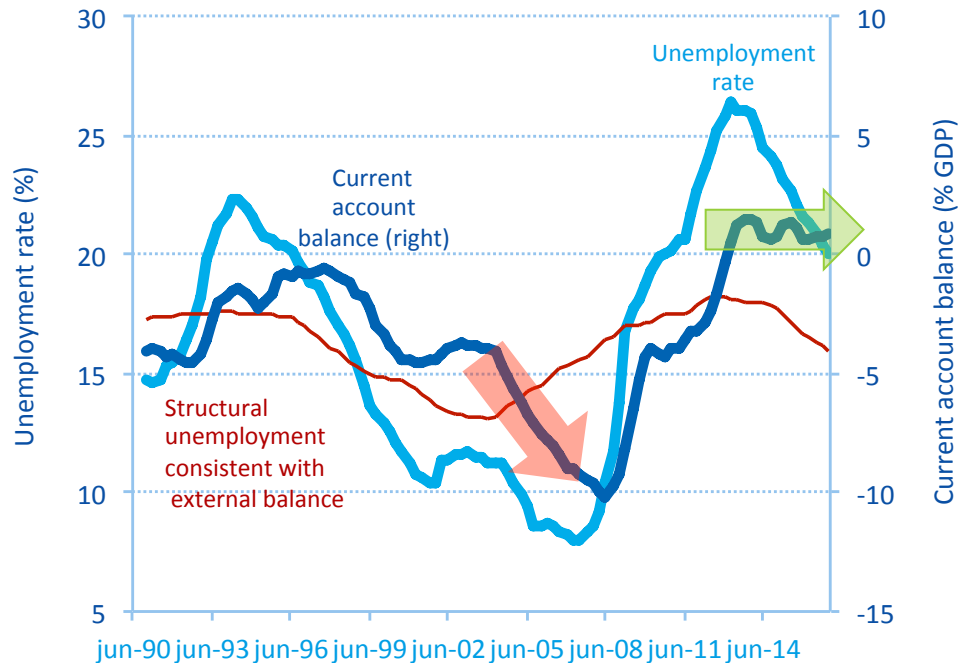
Competitiveness gains buffer

Trend inflation in Spain is close but above zero

Effects of structural reforms on structural unemployment

Spain: current account balance and unemployment rate

Source: BBVA Research



In the past, job creation implied an increase of external debt

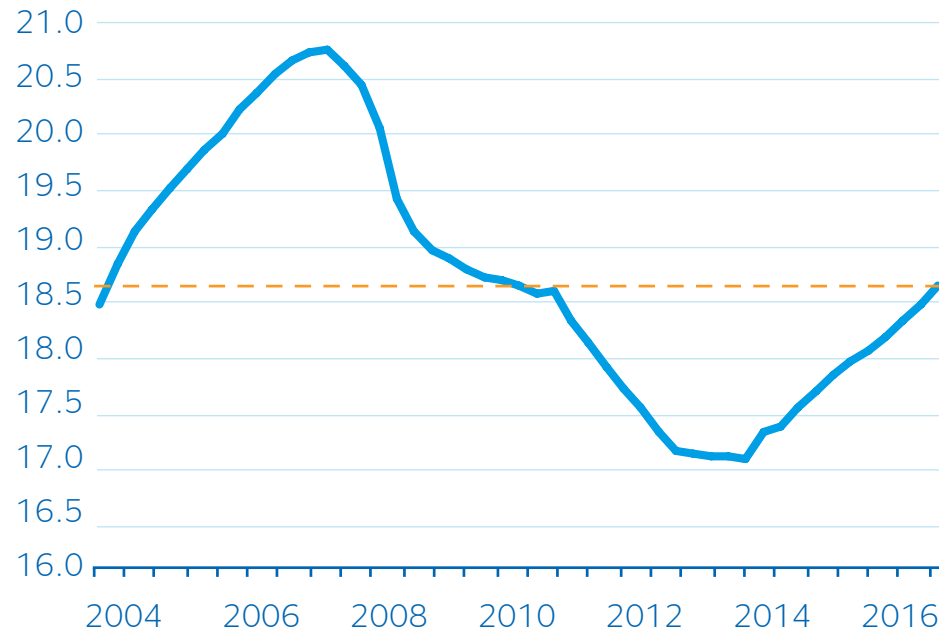
The challenge now is to reduce unemployment without increasing the current account deficit

Better performance of ULC so far:
 2003-7: 3.5% (ESP) vs 1,5% (EMU) y/y
 2014-16: 0.2% (ESP) vs 0.6% (EMU) y/y

Conclusions

Employment (LFS, millions)

Source: BBVA Research and INE



Consistent with GDP growth close to 3%, by 2016 employment could be back to the levels observed in 2004

Could this recovery be sustainable in following years in order to reach the employment levels previous to the crisis?

The sustainability of this recovery will depend on the ambition and the scope of the structural reforms still needed

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