

## Spanish Economy

# Risks facing the Spanish economy in 2019

Expansión

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The Spanish economy will have grown between 0.4% and 0.5% less in 2018 than in 2017 (+3%), with indications that the slowdown will continue in 2019, in a context of increased uncertainty. First, we have the external risks. The past few months have seen a worrying build-up of signs in the international environment. The peak growth point of the expansive cycle of the past few years is behind us, and the world economy, with unemployment rates at their lowest in several decades, is slowing. While global liquidity has started to shrink, the volume of world debt (317% of GDP in Q2 2018) is higher than it was before the last recession.

The slowdown seen in 2018 in the eurozone, which had grown by 2.4% in 2017, will continue in 2019, with barely 1.5% growth, approaching its potential. Every 0.1% less growth in the eurozone means approximately 0.1% less growth in Spain, in the absence of special factors to the contrary. Now that the ECB has brought its quantitative easing to an end, the markets expect interest rate hikes to start in the second half of 2019. Reduced growth in international trade, protectionism, a possible increase in the populist vote in the European Union elections, the renewal of key posts in EU institutions, Brexit and uncertainty about Italy are all significant threats to European growth in 2019.

The slowdown also continues in the Chinese economy, one of those most threatened by protectionism and the possibility of a trade war with the US. These threats are being responded to with monetary and fiscal stimulus measures, even though they delay the necessary deleveraging just as China's economy is in the process of transformation. Experience has shown how difficult it is to reduce high levels of indebtedness without the economy undergoing a hard landing.

In the US, the stimulus from the tax cuts will fade over the course of 2019, while the Federal Reserve will continue to shrink its balance sheet and raise interest rates. Stock markets and some lending segments have already posted significant losses as a result of expectations of the change of climate that is drawing near. How President Trump's administration manages this scenario will be a real test after the uncertainties about economic policy to which it has given rise over the past two years.

Secondly, the Spanish economy has to manage its own risks in an increasingly complex external environment. We can hardly hope that tourism will continue to be one of the drivers of recovery, now that the phenomenon of “borrowed” tourism from countries such as Turkey, Tunisia and Egypt has run its course or even gone into reverse. Private consumption continues on its path of slight slowdown, now that the demand pent up during the crisis has dissipated. The economic cycle in Spain is normalising and moving closer to a neutral position in which the economy's ability to grow without giving rise to imbalances is highly significant. Right now, certain signals are starting to raise doubts. Despite the high rate of unemployment (14.6%), many businesses are finding it difficult to fill vacancies with qualified workers. Wages are growing ahead of productivity, which has now fell for two quarters in a row. External financing capacity has been falling for several quarters, to 1.4% of GDP in Q3 2018, compared with 2.1% in 2017.

There is no end in sight to the uncertainty regarding economic policies. The General State Budget has still not been approved, while the fiscal policy is expansive and the high levels of deficit and public debt constitute a significant vulnerability. Catalonia led Spain's economic growth until the autumn of 2017, since when it has been growing below the national average. In the short term, uncertainty concerning economic policy is having a negative effect on household and business investment decisions. BBVA Research forecasts suggest that without this uncertainty, GDP could grow by some three percentage points more than forecast in 2019, which would involve the creation of some 50,000 more jobs. To these costs must be added the costs of certain measures that may increase the high rate of structural unemployment, such as the flat increase in the legal minimum wage in 2019 and the risk of some of the labour reforms made in 2010 and 2012 being reversed. The repeal of the Pension Revaluation Index will have a negative effect on financing costs if no compensating measures are taken to ensure the sustainability of the pensions system. In the medium and long term, the Spanish economy continues to need reforms to ensure more employment and productivity, as well as more equitable growth with which to incentivise innovation, improve human capital and take advantage of the opportunities provided by the digital revolution.

In summary, although BBVA Research's baseline 2019 scenario is still one of growth and declining unemployment, governments will have to pay close attention to how the many uncertainties evolve and to respond promptly with appropriate economic policies if any of them materialise.

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