Global Economy / Regional Analysis Spain

Spain: greater risks for economic activity

Expansión (Spain)

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The Spanish economy is currently solid, although there seems to be a growing feeling of vulnerability. The growth in GDP remained at around 0.6% per quarter at the start of the year, which in annualized terms means a growth rate of approximately 2.5%. However, both BBVA Research (2.2%) and other institutions (IMF: 2.1%, Bank of Spain: 2.2%) suggest that the yearly average will be lower. The implication is that it is widely perceived that part of this strong growth rate is temporary and that there will be a slowdown over the coming months.

On the one hand, the evidence indicates that the increase in activity is sustained partly due to the rise in transfers from the Central Government or the increase in expenditure at all levels of the public administration due to the electoral cycle. For instance, last year one fourth of the growth in employment took place in public services. Moreover, primary expenditure increased by 0.5 percentage points of Spain's GDP, compared to a 0.2 pp drop in the Eurozone. Therefore, in a context of postponed budgets, without the approval of measures to continue the expansive approach of fiscal policy, the economy could begin to undergo a sort of "fiscal adjustment" during the second half of the year.

Another factor which explains the recent good performance of household expenditure is the rise in the official minimum wage. In the short term, the positive impact on household disposable income is likely to exceed the negative impact on employment. In any event, the increase observed in labour costs without a reciprocal increase in productivity will translate into a drop in job creation, particularly for the more vulnerable population sectors. Although evidence exists that this could already be happening in certain age groups (under 30 years), sectors (hospitality, etc.) and autonomous communities (Andalusia, Canary Islands, Extremadura and Murcia), the data are not conclusive and could be linked to factors that are unconnected to the increase in salaries. In any event, the positive effect of greater salary income will dwindle over the year.

A third factor that could reduce its contribution to growth is the performance of the residential construction sector. The various recent changes in legislation (stamp duty, rental contracts) could have reduced the housing demand, which has fallen by 8% compared to a trend that had prevailed since the start of the recovery and until September of the previous year. Although the sector will continue to increase, it will most likely not perform as it would have done in a more stable environment.

On the other hand, industrial production dropped during most of last year. Furthermore, tourism is showing signs of stagnation. Both sectors reflect the reduced growth of external demand, which has slowed down the rate of expansion in exports. However, it may also be suffering from exhaustion due to the tension created by the imposition of tariffs, regulation or loss of competitiveness. This notwithstanding the possibility that the slump affecting Europe might be of a permanent nature, as a result of low structural growth.

Lastly, the upcoming election may result in an environment that is less conducive to growth. In two of the last three general elections, and after the change of Government last year, the results have been met with increased levels of uncertainty at an internal level and increases in the risk premium of sovereign debt. Should the same happen on this occasion, BBVA Research estimates that the impact could oscillate between 0,1 or 0,2 percentage points of GDP.

In short, there are a lot of reasons to believe that the slowdown will continue in 2019 and 2020. More optimistic scenarios would require a boost in global activity or that a consensus would emerge from the upcoming elections on measures to help increase the growth capacity of the Spanish and European economies.

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