Regional Analysis Spain

A more intense slowdown than expected

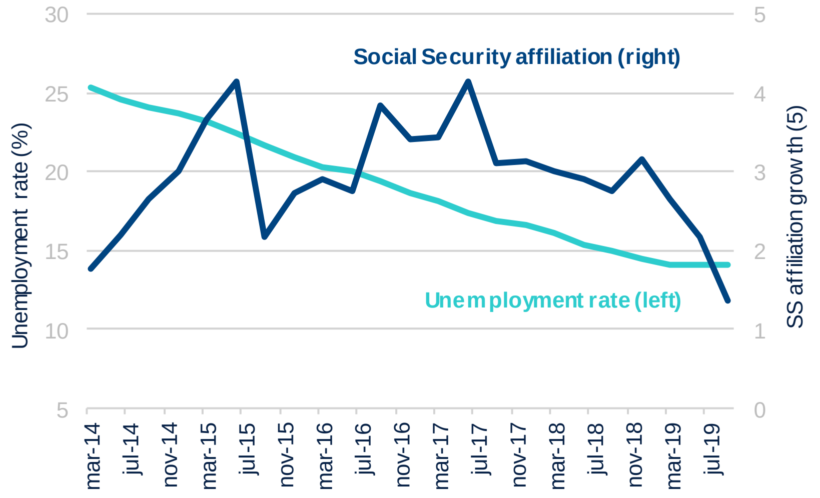
Vozpópuli (Spain)

Rafael Doménech

The recent review by the INE (Spanish Office of National Statistics) of the Quarterly Accounts came as a surprise, with growth in the second quarter falling below previous progress and the forecasts by analysts and experts. The annualized quarterly rate in the second quarter (1.6%) indicates that the slowdown in the Spanish economy is proving more intense than expected in early 2019. In addition, it gives a composition of the aggregate demand that is worse than what we have been dealing with so far. While private consumption stagnated with this downward revision, public consumption grew more than domestic demand, which rose by only 0.4% in annualized quarterly rates. The growth in public spending, together with the slowdown in revenues, led to a further increase in the accumulated public deficit in recent quarters and it returned to close to 3% of GDP. Investment in machinery and equipment, one of the variables that best reflects the prospects and confidence of firms regarding the economic situation, became a negative contribution. However, the quarter-on-quarter variation in employment in the Quarterly Accounts was 2% in annualized rates. Therefore, productivity declined while labor costs increased by 2.8%. The best news came from the positive contribution of the foreign sector, with export growth that almost doubled import growth and thus allowed external demand to contribute 75% to quarterly GDP growth.

With regard to the most recent information, data on Social Security affiliation for September indicate that the third quarter closed with employment growth of 1.2% in annualized quarterly rates (once non-professional caregivers are discounted), compared to 1.6% in the second quarter and less than half what it was a year ago (3.2%).

UNEMPLOYMENT RATE AND QUARTERLY ANNUALIZED GROWTH OF SOCIAL SECURITY AFFILIATION (SA)



Unemployment rate forecast for 3Q2019.
Source: BBVA Research based on SS and INE

In the face of these growth rates, economic consensus forecasts point to growth by 2020 in line with what we are already observing now. In other words, after reducing growth from 4.5% in early 2015 to 1.6% today, the consensus assumes that, from now on, this slowdown will lose momentum, and growth in the coming quarters will remain at current levels and close to its potential. Given the important and numerous international and domestic risks that would explain a continued slowdown, any growth scenario for 2020 above 1.5% can be considered rather benign and more than acceptable, compared to other alternatives. This is despite the fact that this scenario implies that there is little cyclical improvement in activity. If this ends up happening and growth meets its potential, unemployment will remain stable or will decline little, which is bad news for an economy in which the unemployment rate is still at 14%.

In both the forecasts for the global economy and for Europe and Spain, we have started to see downward revisions in growth prospects in recent quarters. This sign does not bode well. Experience tells us that when economies are in the early stages of an expansionary cycle, forecasts tend to be revised upward. On the contrary, when we approach the end of the cycle or, what would be worse, a recession, the revisions are downward, which is what the major central banks and major international agencies have begun to do.

These procyclic forecast errors are basically due to two reasons. First, most of the models we use are characterized by growth rates that revert fairly quickly to their average, so forecasts tend towards the potential growth of the economy, both in expansions and recessions. The result is that forecasts almost always anticipate a smooth landing toward potential growth, rather than a severe adjustment in which the economy grows less or even heads toward a recession. Secondly, economic analysts' own caution encourages prudence and not to contribute to excessive optimism or pessimism. In expansions, this avoids generating overly optimistic expectations that further accelerate activity and contribute to producing bubbles and imbalances. Likewise, in periods of slowdown, it avoids increasing the risks of crisis with negative expectations that give rise to self-fulfilling prophecies. As Federico Steinberg recently recalled, accounts and narratives condition economic decisions. As a result, most analysts try to keep their forecasts from increasing the volatility of an already high economic cycle. In addition, there are also some precedents to defend the argument that the slowdown will not continue in 2020 and there may even be some upturn in activity. This was, for example, what happened in 2001, when the burst of the technological bubble resulted in a short period of increased unemployment, followed by a rapid economic recovery until the beginning of the international financial crisis in 2008.

Could something similar happen in the Spanish economy during 2020 to mean that the risks of recession could be conjured up and economic activity would be accelerated again? It is something that cannot be ruled out, considering that the new estimates for the Quarterly Accounts are now more volatile and that most indicators suggest that private consumption did not seem to be stagnant in the second quarter, so we should see some rebound in the third. In addition, the foundations of the Spanish economy in terms of private sector indebtedness, external competitiveness or current account surplus are much stronger than a few years ago, so the recovery may continue for some time if the appropriate conditions are in place.

But that scenario is becoming less and less likely. We would be wrong to rule out the possibility that economic growth in 2020 may be below what we see now, even if it is not the baseline scenario. Many of the current signs are a bad omen and there are too many risks (the trade and technological war between the United States and China and Europe, Brexit, the geopolitical tensions with Iran, the social protests in Hong Kong, the political uncertainty in Spain, etc.) to trust that none of them will end up materializing. In such a context, uncertainty must be reduced, and economic policy mistakes should be avoided. Or, even better, appropriate measures and reforms for more inclusive growth should be implemented to tackle the challenges of the digital revolution.

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ENQUIRIES TO:
BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 30 25
bbvaresearch@bbva.com www.bbvaresearch.com