

Forecast 2017

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What will we be talking about in 2017? In macroeconomic terms, 2017 will be the fourth consecutive year of growth, and the consensus seems to point unanimously to a slowdown, although activity will be sufficiently dynamic to continue reducing some of the major imbalances in the Spanish economy. Going beyond this, here are six trends that have the potential to determine the strength of the recovery and its sustainability in the next few years.

First, a positive one: house prices will rise faster, especially in urban areas, and the sector will start to position itself as one of the growth drivers for the next few years. Demand will continue to increase as a result of the economic recovery, the availability of credit at low interest rates and purchases by foreigners. Perhaps even more important will be the speculative demand generated by the search for yield in an environment of low interest rates, which will increasingly push savers towards the sector. In view of the foregoing, both prices and investment will increase in areas where employment and household formation increases most and where the oversupply has already been exhausted, i.e. in urban centres with the greatest exposure to the recovery.

Secondly, exports will increase. Thanks to the constant increase in capital expenditure on plant and equipment in the past few years, the supply factors that have kept up gains in competitiveness will continue in 2017. In any case, the increase in exports will be helped mainly by the improvement in world demand, especially that of certain emerging markets - this despite the deteriorating outlook for exports to the UK.

Thirdly, in the labour market average wages will continue to fall and temporary work will remain relatively stable. Part of the fall in wages is cyclical. In any case the medium- and long-term trends are not favourable for either variable, being related to persistent defects in both human capital and in the inefficient labour law.

Fourthly, the public deficit target will be attained, after several years in which governments have failed to meet objectives set at the beginning of the year. The tax increases and the absence of elections will help in this respect. The main effort will be concentrated at central state level. The autonomous regions for their part will see their revenues increased, and will probably use this windfall to increase spending rather than reducing debt. Given the uncertainty about the efficiency of the increase in spending, the cost to the taxpayer of regional governments' failing to take advantage of these particularly propitious circumstances to deleverage may prove high. Moreover, it is important that a plan be developed allowing the regional governments to finance themselves in the markets once more. Prolonging their dependence on central government produces perverse incentives.

Fifthly, the costs of having overshoot previous years' deficit targets will start to make themselves felt. In particularly positive conditions, the risk premium has reached levels that must be considered as minimums relative to those we can expect to see if the next few years. Looking ahead, the slowdown in the economy and the end of the ECB's asset purchase programme will lead to an increase in the risk premium, presaging what might happen after that.

Lastly, it is possible that uncertainty will start to weigh on capital expenditure on plant and equipment. On the one hand the recent changes in corporation tax introduce a greater degree of uncertainty for businesses, as well as increasing operating costs relative to other neighbouring economies. On the other hand the debate in parliament about labour law and the recent court rulings may lead to indecision in view of the lack of clarity about one of the factors that has been fundamental in explaining gross fixed capital formation in Spain in the past few years.

The positive factors will continue to offset the negative ones, but the need to persevere with reforms to improve the operation of the Spanish economy will become ever more evident.

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