

Spain

Resilient growth

In a morose economic environment, Spanish growth stands out as one of the most resilient in the eurozone, and it seems to have entered the year at a very similar pace to the one in H2 2018. The main factors behind this resilience can be found on the household front, where the savings rate has dropped back to the low point of 2008. With only a few days to go before the 28 April general elections, the electoral landscape is still highly fragmented. Regardless of the outcome, the winning party will find it hard to form a sustainable majority coalition.

■ A solid start in 2019

In spring 2019, Spain is still one of the most resilient economies of the eurozone heavyweights. After a very vigorous 3-year recovery, with GDP growth averaging more than 3% a year in 2015-2017, economic activity clearly slowed last year. Nonetheless, Spain continues to stand up well in Europe, with GDP growth of 2.6%, compared to a eurozone average of 1.8% (see chart 2).

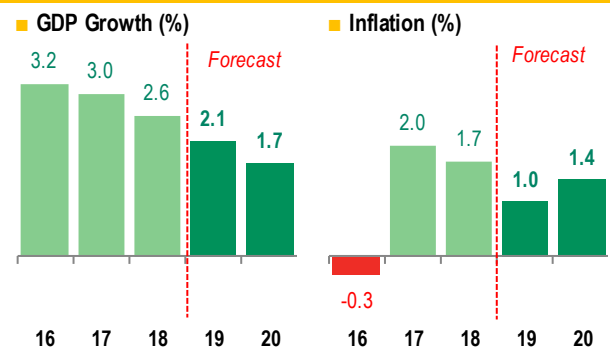
That does not mean that the economy is sheltered from the downturn in the international environment and the slowdown in world trade. To the contrary, merchandise exports have slowed continuously over the past two years and contracted in late 2018 and early 2019 (-2.4% y/y in volume in January). These developments ended up straining productive investment (excluding construction), which stabilised and then contracted in H2 2018.

Other factors have contributed to the resilience of Spanish growth, foremost of which is domestic demand, and household demand in particular. From a sector perspective, another key factor was services, which grew 3% y/y in volume at the end of 2018 (vs -0.5 y/y in the manufacturing sector). The most recent economic statistics and survey data confirm this trend. In manufacturing, production contracted slightly between late 2018 and early 2019. The purchasing managers' index (PMI) verged on 50 in February and March, the threshold that signals a contraction. In services, in contrast, survey data have picked up after briefly stalling last fall, and prospects are looking upbeat (chart 3).

On the whole, these factors reveal that economic growth has levelled off for the moment at a relatively high level, buoyed by stronger domestic demand, and despite the slowdown in foreign trade. At this stage, the most recent estimates by the Bank of Spain and Airef, the independent authority for fiscal responsibility, suggest that quarterly growth trends in Q1 2019 were in line with those reported in 2018 (0.6% q/q). Even if growth were to dip somewhat in the quarters ahead, annual GDP growth would still slightly exceed 2% in 2019.

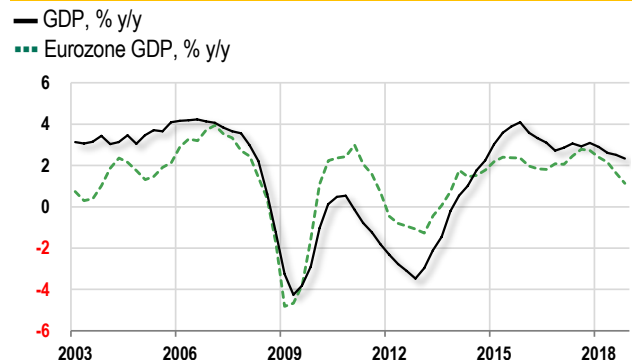
The outcome of the Brexit crisis obviously creates a downside risk, which would materialise "accidentally" in case of a no-deal Brexit, triggering short-term disruptions in trade and accentuating the slowdown in European commerce. After the initial impact, however,

1- Growth and inflation



Source: National accounts, BNP Paribas

2- One of the most dynamic economies



Source: Eurostat

it is worth keeping in mind that in terms of foreign trade, Spain does not rank among the countries with the highest exposure to Brexit.¹

■ Household confidence is (excessively?) strong

Several factors are supporting the dynamic momentum of domestic demand. Job creations, an obvious support factor, are continuing to rise at a rapid pace (+2.3% y/y in Q4 2018), even though nearly 2.3 million people have joined the work force since the market tanked in 2013. In early 2019, the jobless rate fell below 14% of the active

¹ Evaluating the impact of Brexit on the activity of the UK's partners: trade channels, INSEE, note de Conjoncture, March 2019, pp33 to 51. For Spain, the estimated impact is slightly less than for France, at between 0.2 pp. of GDP (soft Brexit) and 0.5 pp. (hard Brexit).

population, and will continue to decline over the course of the year. Another support factor is low inflation, which has shed a point since October, to 1.3% in March 2019, thanks to falling energy prices. Core inflation has held at roughly 1% for nearly the past 18 months, without showing any signs of accelerating. Lastly, fiscal policy remains slightly expansionist, particularly towards households, while at the same time ensuring a nominal reduction in the fiscal deficit, given the economy's strong growth. As a result, after the minimum wage increase at the beginning of the year, and with the approach of legislative elections, Pedro Sanchez's minority government is seeking to beef up its social welfare policy (extension of paternity leave, improvement in unemployment benefits for seniors) in areas where he can act by decree. As things currently stand, and while waiting to know the budget choices of the next government, the Bank of Spain estimates the fiscal deficit at about 2.5% of GDP this year, slightly lower than the 2.7% reported in 2018.

Spanish households are taking full advantage of this rather buoyant environment, and it is surely regrettable that they are not allocating some of the increase in disposable income (+1.3% in real terms last year) to rebuild their savings. Much to the contrary, the dynamic momentum of consumer spending is also being fuelled by a decline in the savings rate, which dropped below the 2008 low to 5% at year-end 2018. Given the exuberance of the housing market², household savings no longer suffice to cover the new residential investment flows of households. If these trends continue, the household debt ratio, which has narrowed sharply in recent years, could end up levelling off near the eurozone average.

■ Seeking a majority

It was Parliament's rejection of the 2019 budget proposal earlier this year that led Pedro Sanchez to call early general elections, which will be held on 28 April.

At this point, the Spanish Socialist Party (PSOE) is leading in the polls, although the number of voting intentions is lower than the votes received by the Popular Party in the 2016 general elections (33%). The second striking feature of the current electoral momentum is the surge in Vox, the extreme right party and the latest arrival on Spain's political scene. Vox currently has about 10% of voting intentions. Lastly, in Spain as in other countries, the breakthrough of the extreme parties is hardening the positions of the traditional parties.

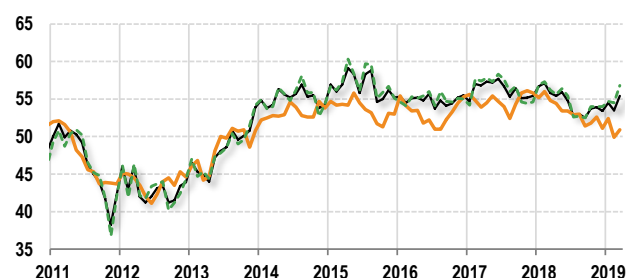
All in all, the fragmentation of Spain's political landscape clearly has not diminished since 2016, much to the contrary. Under the current situation, even if his party wins the elections, Pedro Sanchez will have a very hard time forming a coalition capable of leading the government for any length of time. The big question is whether, in addition to Podemos, he can count on the support of the pro-independence parties, while the Catalan question remains a major source of division in the country. So far, his proposal for in-depth discussions on Catalan autonomy within a constitutional framework has fallen on deaf ears. As to the Popular Party (PP) and its new leader Pablo Casado, the big question is whether he can convince

² Prices, which have risen by more than 6% y/y for the past 18 months and more, are now only 20% below the 2007 peak, compared to 37% at the low of year-end 2013.

3- Manufacturing slows

Purchasing Managers Indices

— composite ; ■■ services ; — manufacturing

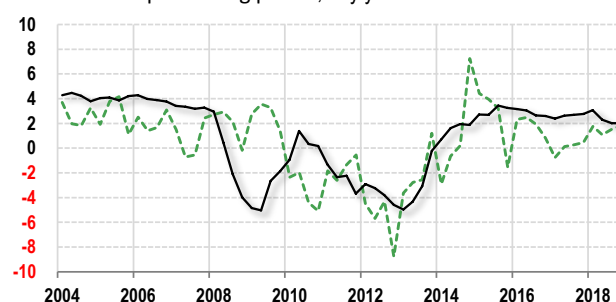


Source : Markit

4- Households' revenues and consumption

— real private consumption, % y/y

■■■ households purchasing power, % y/y



Source : INE, Eurostat

Vox and Ciudadanos to replicate at the national level the alliance they formed last December to win control of Andalusia. Even though none of the parties are currently envisioning such a plan, observers do not rule out the possibility of a PSOE-Ciudadanos alliance.

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