Global Economy / Regional Analysis Spain

Spain: upward forecasts despite the slowdown

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A week ago, BBVA Research revised its GDP growth forecast for 2019 upward one tenth to 2.3%, twice as much as in the eurozone. Days later, the IMF did the same and its forecast was also raised to 2.3%. Spain's performance has been consistently better in recent years than the IMF envisaged, and it has been an example in Europe of the successful reforms. Despite their small magnitude, **these upward revisions contrast with uncertainty about the global economy** and the effects of tariff tensions. These tensions are manifested in the weakness of world exports in recent quarters and that, along with other factors, have led central banks to drastically **change their tone regarding their monetary policies** to become more expansionary once again. In contrast to the expectations a few quarters ago, consensus is now almost unanimous and at least two cuts in interest rates are expected from the Fed. At the same time, against this backdrop of greater uncertainties, weak growth in the euro area and lower inflation forecasts, the ECB has generated expectations in the markets for lower deposit interest rates, delayed rise in refinancing rates and new quantitative expansion measures, if necessary. All this has led to a significant decrease in the interest rate of 10-year public debt in Spain, which barely reaches 0.4%.

Although forecasts point to marginally higher growth in 2019, the **underlying trend of slowdown in the Spanish economy** does not change. A 2.0% increase in domestic demand is expected this year compared with 2.9% in 2018, gradually approaching potential growth. The upward revision in 2019 is mainly due **to the standstill in imports** in the first semester of this year, which results in external demand contributing positively to GDP with three tenths of growth, compared to its negative contribution—also of three tenths—in 2019. This positive contribution of external demand occurs despite the slowdown in Spanish exports, and it draws attention because it occurs with a more advanced and mature economic cycle. The contribution of the foreign sector to growth of the Spanish economy usually worsens as the unemployment rate decreases. The 2019's improvement is a welcome surprise, but it is expected to be **temporary and that in a few quarters the contribution of the foreign sector will once again be negative**.

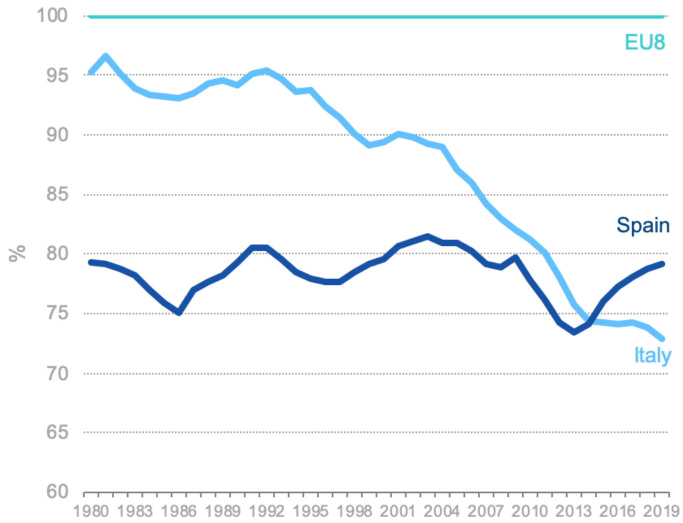
The slowdown in the Spanish economy is also evident in **the affiliation to social security of the private sector**. Once the effects of elderly people caregivers and the agricultural sector (more volatile than the other sectors) were discounted, affiliation grew in June at a year-on-year rate of 2.5% compared to 3.1% at the end of 2018. This slowdown of six tenths in six months contrasts with the acceleration of public employment in central government and regional governments, which grows at year-on-year rates of 5%.

There are still many uncertainties to know to what extent the **increase in the minimum wage** may be behind this slowdown in private sector social security membership. It is certain, however, that it is partially due to the weakness of exports and, in particular, manufacturing. BBVA Research estimates suggest that the increase in the minimum wage is having a limited impact, in the low range of forecasts, between 20,000 and 75,000 fewer jobs in 2019. Part of the minimum wage increase could be absorbed by firm markups. In any case, several factors invite caution. First, these estimates are based on the differential impact by regions, sectors and age groups on job creation in the first half of 2018 and 2017, years when the minimum wage increased 12.3% in cumulative terms. We have been raising the minimum wage for three years, and none of the raises have yet been evaluated to find out what their optimum level is with respect to the median wage and how it affects different groups of workers. Second, these estimates do not take into account the strong increase in **public sector** employment, less exposed to the minimum wage. Third, it is difficult to predict how long **markups** will continue to absorb wage increases if labor productivity continues to decline. It should not be ruled out that firms try to recover margins with price increases or, if they do not, end up negatively affecting investment and job creation.

For the moment, **investment in machinery and equipment** is growing intensely. Forecasts point to an increase of 3.9% in 2019, almost double that of domestic demand. Without a doubt, along with the absence of widespread signs of overheating, it is excellent news: investment is a good indicator of business confidence and growth expectations in coming quarters, particularly exports. One of the factors driving the healthy behavior of investment is the decrease in the financing costs of the Spanish economy.

But complacency must be avoided. In addition to the uncertainty about the world economy, there is also uncertainty about economic policy in Spain. So far, it has had a short-term impact. However, **an increase in external and internal risks** could lead to a drastic change in investment with effects, sooner or later, on job creation. And, in any case, we have been gone too many years without implementing the structural reforms our economy requires to ensure higher quality employment, more sustainable and inclusive growth in the midst of the digital revolution in which we are immersed. Italy is a good example of **the long-term costs implied by the absence of structural reforms**. Just as our gap in productivity, employment, innovation, human capital, equity and well-being with the most advanced European economies is the result of the policies Spain did not adopt in the past or those that did so in the wrong direction, our relative position within a few decades will depend on what we will do now and in the next few years.

GDP PER WORKING-AGE POPULATION, 1980-2019 (EU8=100)



Source: Andrés and Doménech (2015), updated from AMECO and BBVA Research. EU8 = Germany, Austria, Belgium, Denmark, Finland, Netherlands, the United Kingdom and Sweden

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