

# The Outlook for the Global Economy and for Spain

**Rafael Doménech**

[www.bbvarsearch.com](http://www.bbvarsearch.com)

Atlanta, April 8, 2013

## Main messages

- 1 The perception regarding the prospects of the global economic scenario has improved as a result of a relaxation of financial tensions, particularly in Europe, and the agreements to avoid a disorderly fiscal contraction in the US
- 2 However, to sustain the recovery, appropriate policies must be adopted in both the US and, particularly, in the euro area, where risks are more significant
- 3 Without ruling out upside surprises, the risks remain tilted to the downside, although they appear less likely now than until summer 2012.
- 4 Spain: caution due to existing risks. In 2013, conditioned to lower financial tensions, the economy should bottom out. Growth expected in 2014.
- 5 It is crucial to take advantage of the window of opportunity that has opened up in Europe and Spain to push through reforms that shore up the improvement in confidence.

# Contents

## Section 1

## Global economy: economic outlook improves

## Section 2

## Spain: will recovery start in 2013?

# The perception of the global scenario improves

The worst seems to be over

Eurozone: the ECB reduces the risk of an euro break-up, agreement about Greece and Cyprus, approval of the banking union and stabilization signs in economic activity

US: QE3, fiscal agreement, (*fiscal cliff* and the debt limit restriction is delayed three months)

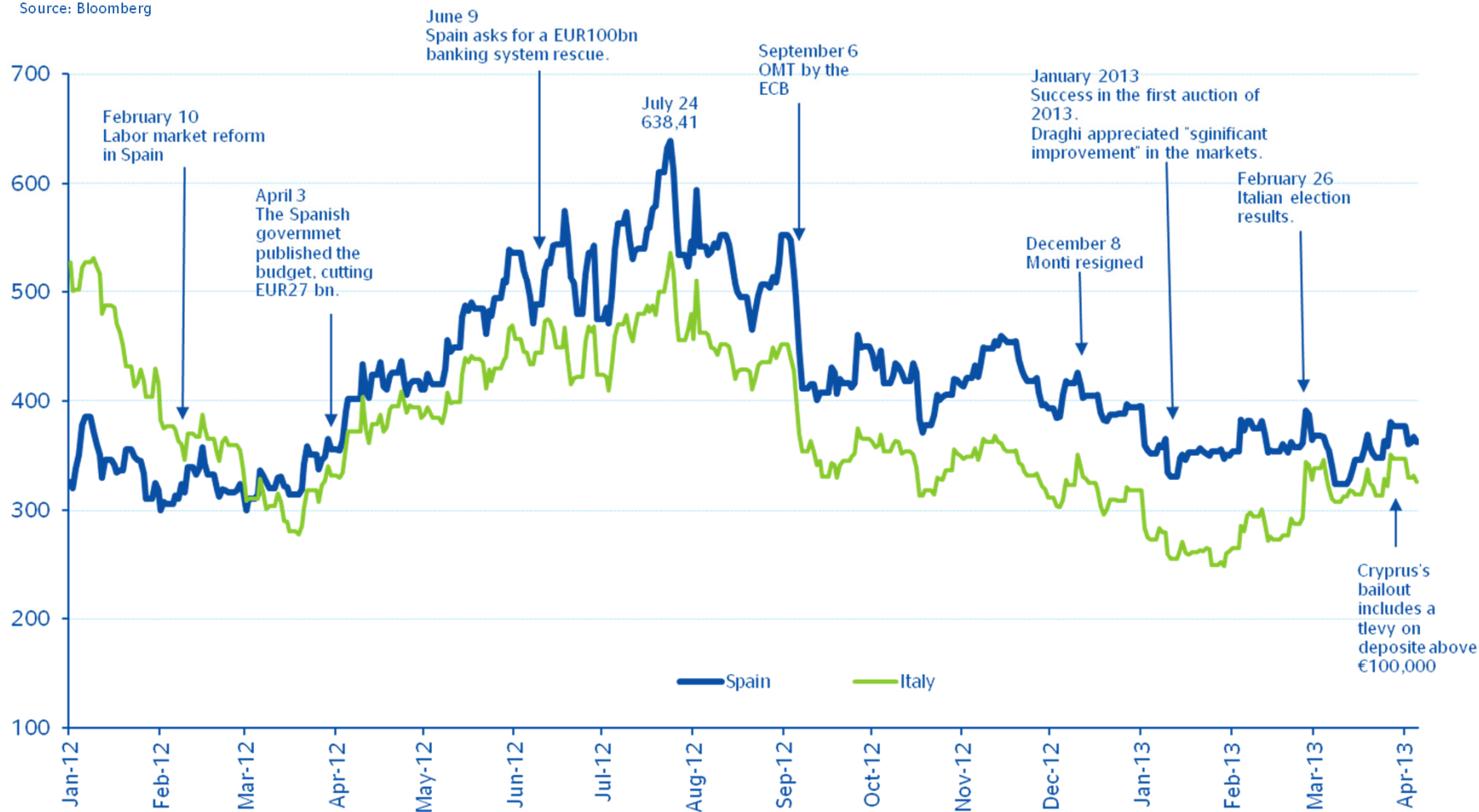
Speeding up GDP in China: growth prospects of 8%

-> significant reductions of financial stress and risk premium, improvement in the stock markets, higher risk appetite, appreciation of the euro, etc.

# The perception of the global scenario improves

## Spain and Italy risk premium Spread against 10Y German bond

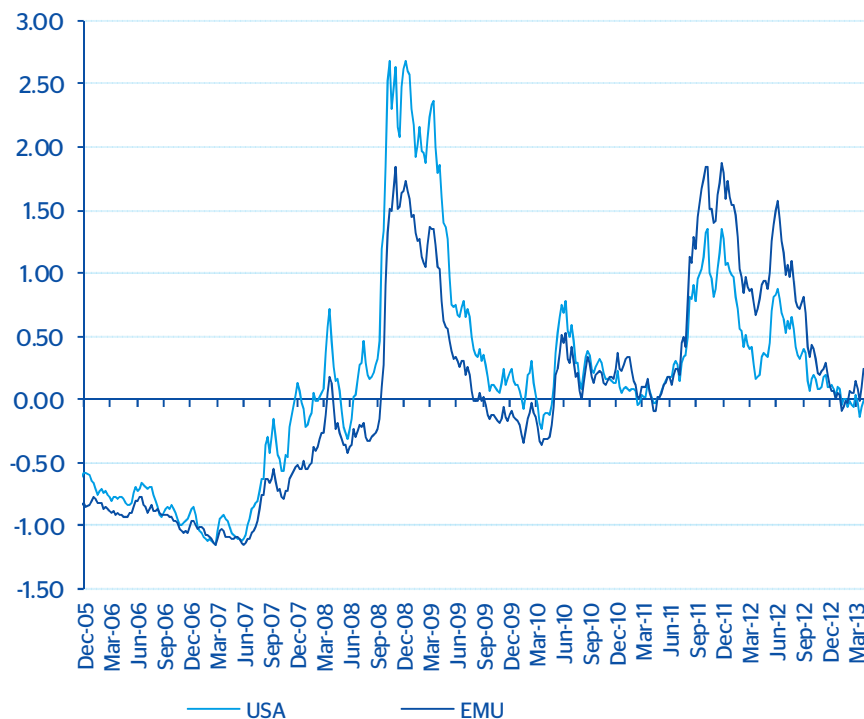
Source: Bloomberg



# EMU: two major advances but not sufficient

## Financial Stress Index

Source: BBVA Research



1. The ECB is ready to do whatever it takes to preserve the euro

Capital flows back to Europe and not only to public debt markets, also for private issuances

Second Greek bailout: a decisive movement against euro break-up risks

Financial stress eased

# EMU: two major advances but not sufficient

## 2. Partial advances in the road towards a more genuine EMU

### Fiscal union

Since the December summit, progress towards a fiscal union has been delayed

The "Treaty on Stability" and the "Six pack" appear to be sufficient for now...

...without debt mutualisation commitments or additional budget controls

### Banking union

Single regulator and supervisory body in 2014

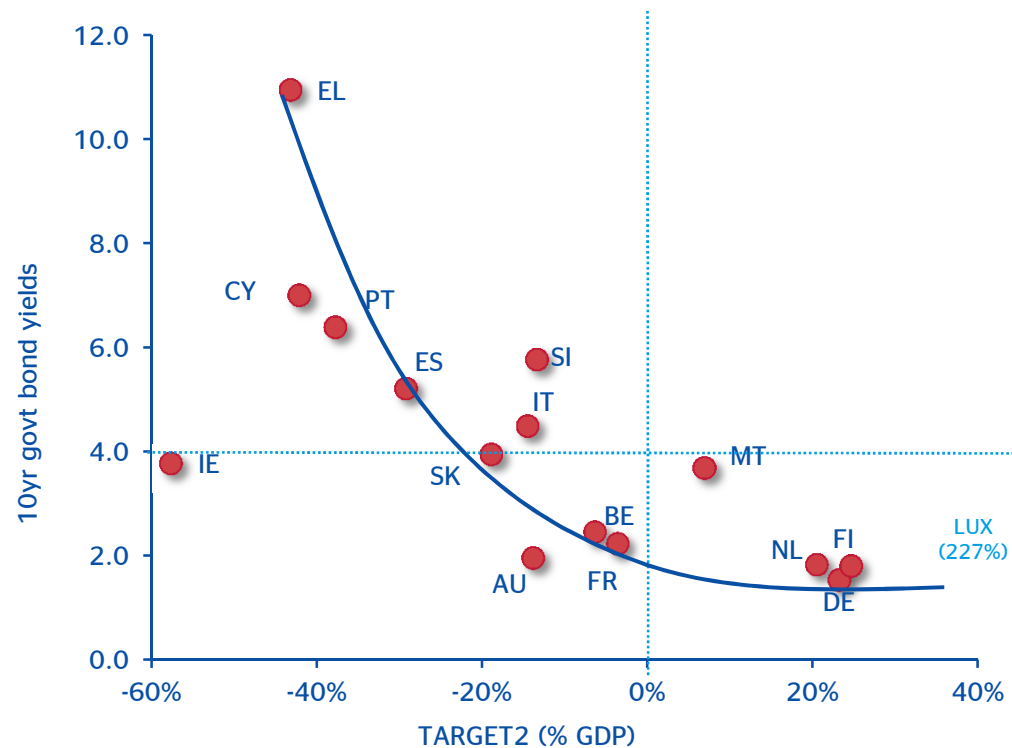
Single resolution mechanism and direct recapitalisation to be developed in 2013...

...without commitments to implement an European deposit guarantee fund

# EMU: two major advances but not sufficient

## Interest rates and TARGET2

(January-February 2013)

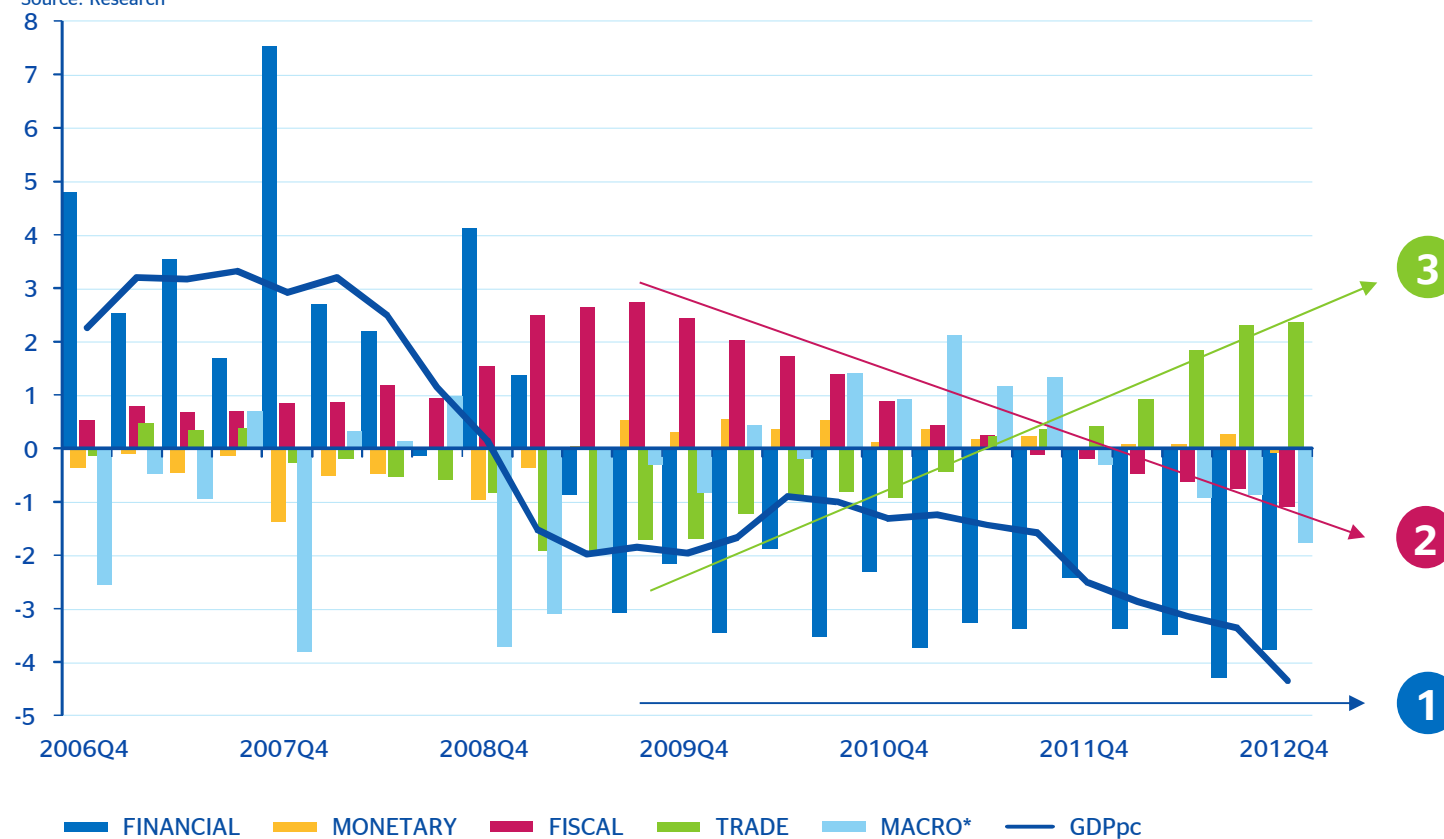




# EMU: two major advances but not sufficient

## Historical decomposition of the out gap (GDP per wap)

Source: Research



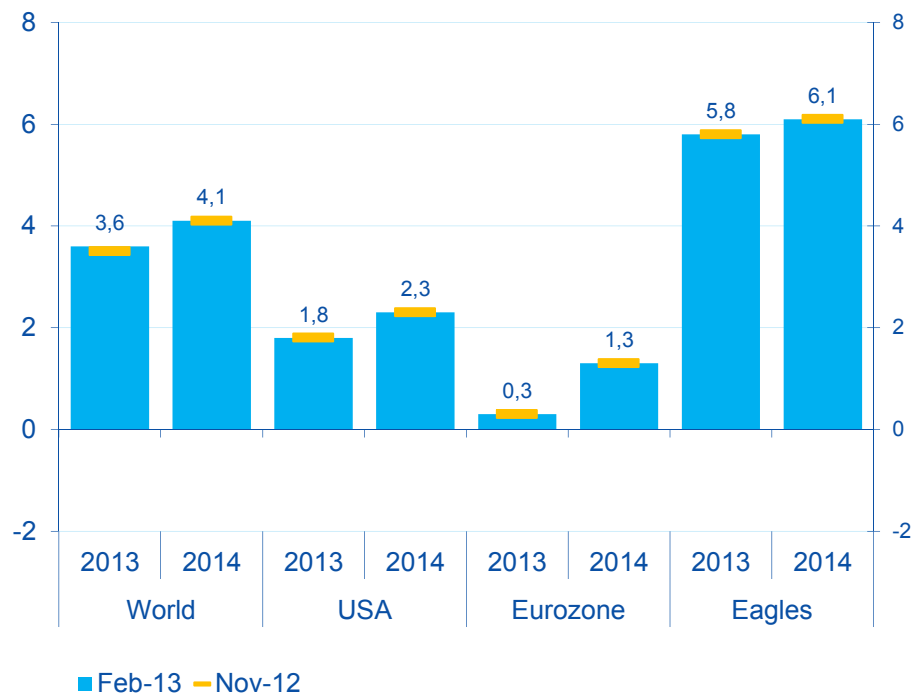
## Still many risk factors in the global scenario

Eurozone	Achievement of budget deficit targets
	Adoption of banking union and Cyprus bailout
	Political uncertainties: Italy, Portugal, Spain, German elections, etc.
US	Agreements pending: automatic public spending cuts (the sequester) and debt ceiling
Other global risks	Geopolitical pressure, especially in North Africa and the Near East
	Currency wars, slowdown in China and other emerging economies

# Growth looks set to remain uneven

## GDP growth (% yoy)

Source: BBVA Research



## A three-speed world

There is still a high dispersion in growth rates

The EAGLEs have proven to be crisis-resistant, reinforcing the "new normal" paradigm

Euro area: brighter prospects, but recovery will be slow, uneven and vulnerable

# Contents

## Section 1

Global economy:  
economic scenario improves

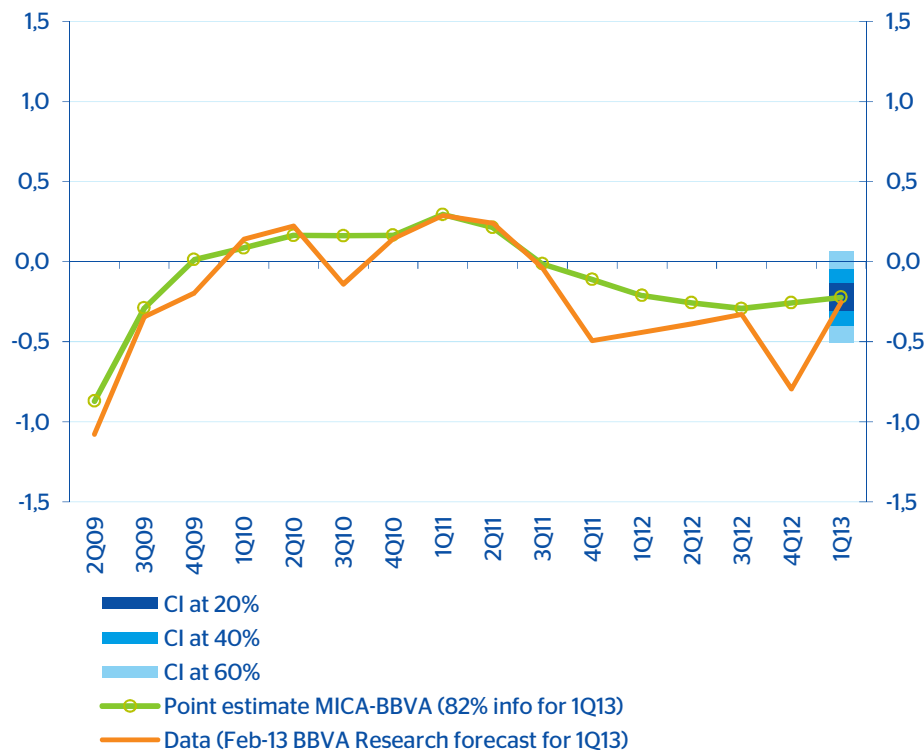
## Section 2

**Spain: will recovery start in 2013?**

# 2012: finally better than spring forecasts

## Spain: GDP growth and MICA-BBVA forecasts (% qoq)

Source: BBVA Research based on INE data



In spring, 28.6% of analysts polled expected Spanish GDP to contract more than 2.1% in 2012 (50% between 1.4% and 1.8%)

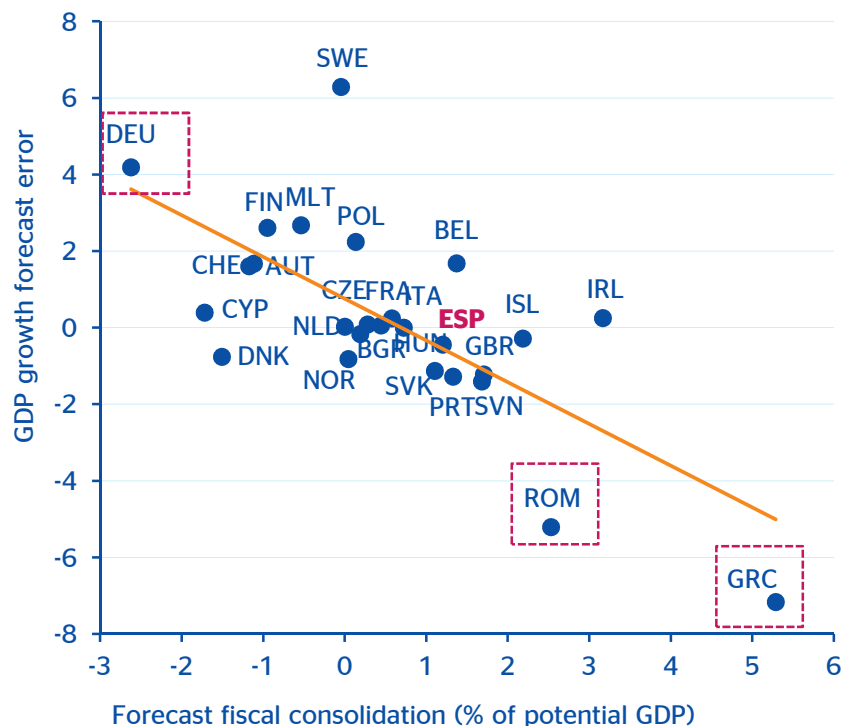
Although the pace of decline accelerated in 4Q12, the second half of 2012 beat expectations

Available data point to a negative growth in 1Q13, but not as severe as in 4Q12

# 2012: finally better than spring forecasts

## Fiscal adjustment and economic growth

Source: BBVA Research based on IMF data



## 1. Lower-than-expected multiplier (I)

Fiscal adjustment has been considerable, but GDP has not responded as expected. Potential reasons:

1. Spending has been cut with a low multiplier at times of financial stress

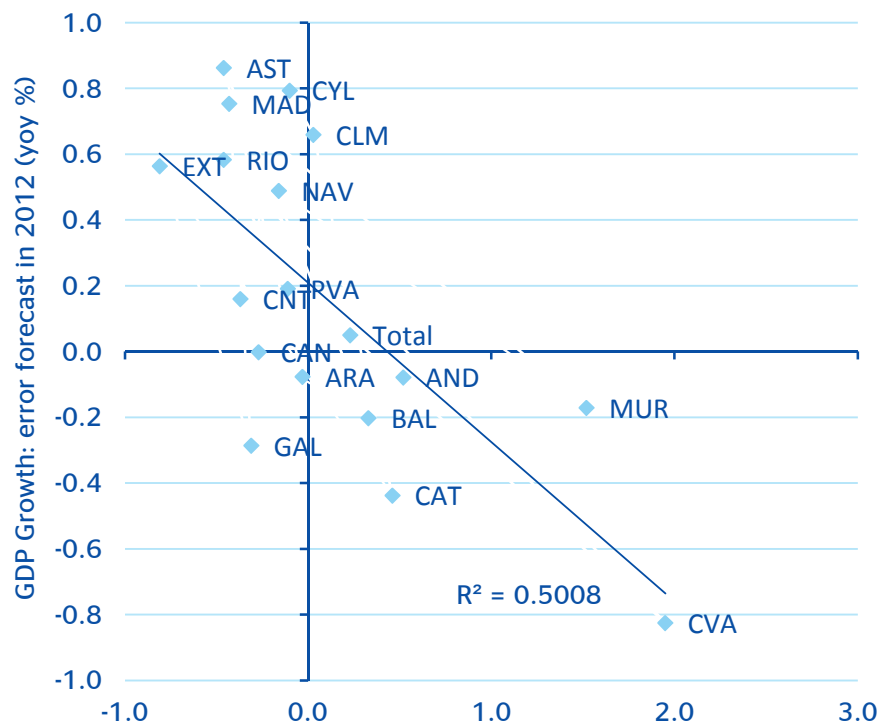
2. Certain measures could have been interpreted as being temporary

3. Fiscal adjustment has come alongside compensatory measures (supplier payment plan)

# 2012: finally better than spring forecasts

## Fiscal adjustment and economic growth

Source: BBVA Research from IMF



Fiscal adjustment in autonomous communities: Forecasted vs. actual adjustment in 2012 (GDP %)

## 1. Lower-than-expected multiplier (II)

Fiscal adjustment has been considerable, but GDP has not responded as expected. Potential reasons:

1. Spending has been cut with a low multiplier at times of financial stress

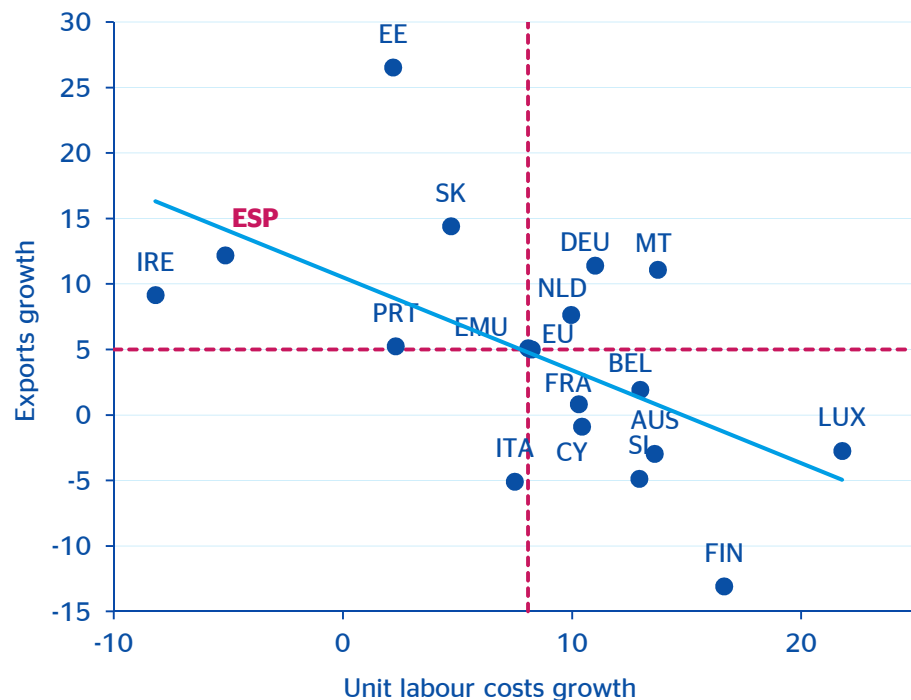
2. Certain measures could have been interpreted as being temporary

3. Fiscal adjustment has come alongside compensatory measures (supplier payment plan)

# 2012: finally better than spring forecasts

## EU: cumulative growth of exports and unit labour costs, 1Q08-3Q12 (%)

Source: BBVA Research based on Eurostat data



## 2. Higher external demand (I)

Exports show increasing diversification of destinations and products

Better price competitiveness explains part of this trend, but other determinants are more important

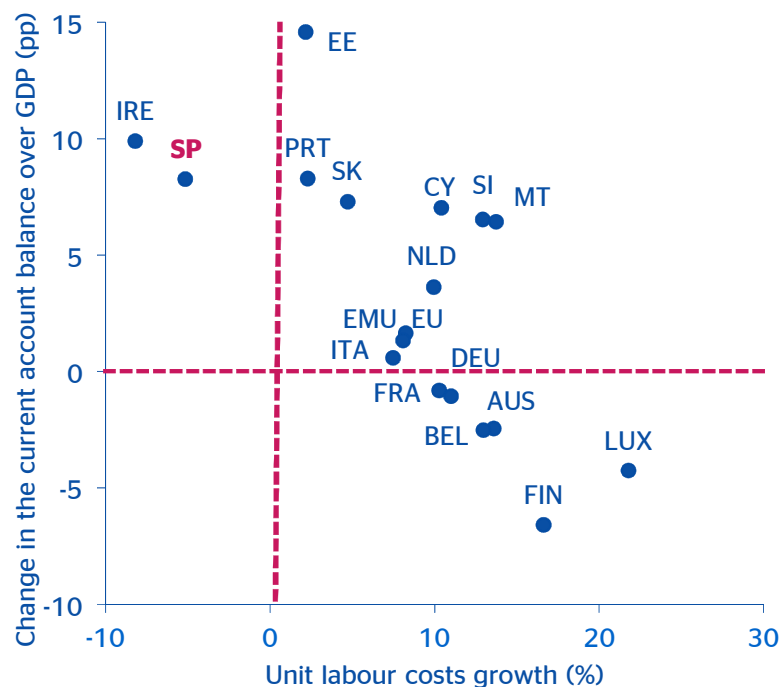
The rise in exports has not been accompanied by any increase in imports, unlike at other times in the past



# 2012: finally better than spring forecasts

## Spain: current account and ULCs, 1Q08-3Q12

Source: BBVA Research based on Eurostat data



## 2. Higher external demand (II)

Higher exports and lower imports have produced a sharp improvement in the external imbalance

Lower ULCs make Spanish products more competitive vis-à-vis imports

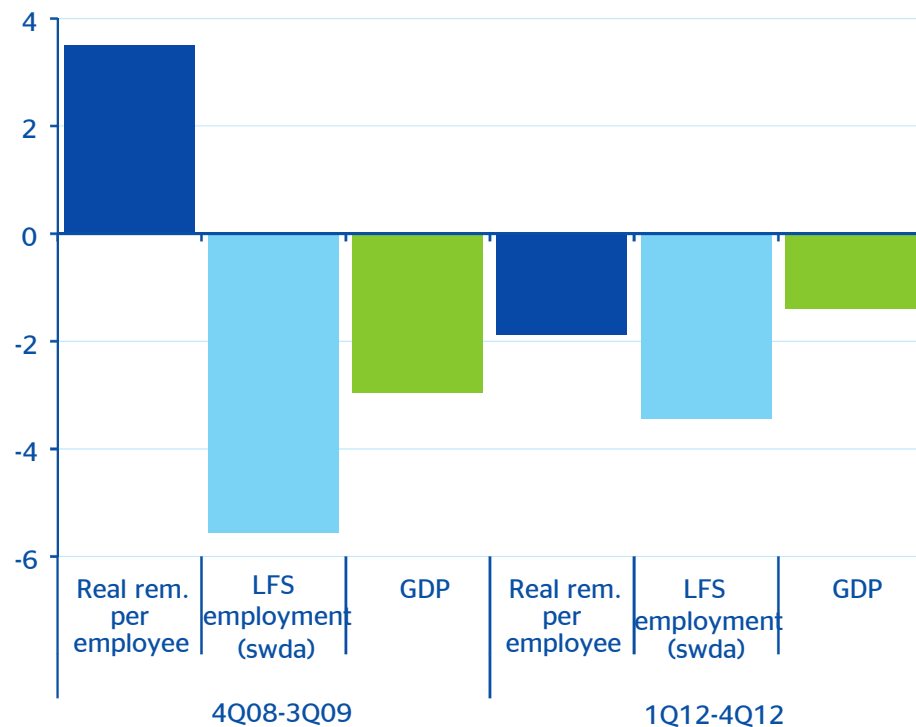
Reinforce the feedback factor: improvement in price competitiveness and the other determinants

# 2012: finally better than spring forecasts

## Spain: real wages, employment and GDP

(cumulative % change, SWDA data, %)

Source: BBVA Research



## 3. A more efficient labour market?

Labour market reform and the 2<sup>nd</sup> Agreement on Employment and Collective Bargaining have prevented further job destruction

While more data are needed to identify the factors undermining employment and GDP...

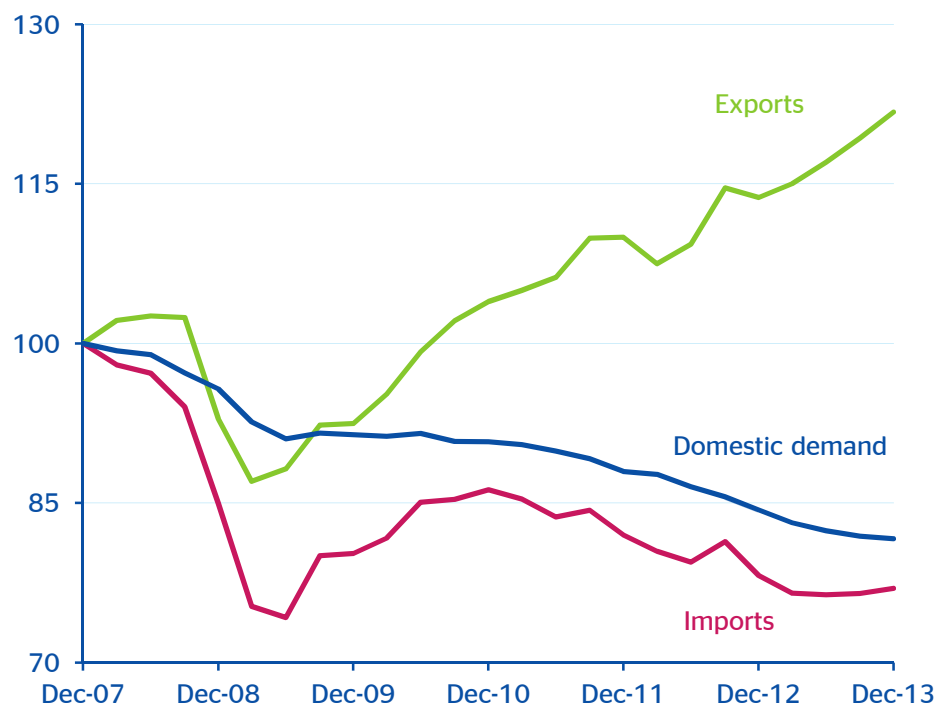
...trends in real wages and other variables are consistent with a more efficient labour market

# 2013: the year the economy should bottom out

## Spain: domestic demand, exports and imports

(4Q2007=100)

Source: BBVA Research based on INE data



Slight improvement in forecast GDP for 2013, with a 1.1% contraction, due to the knock-on effect of 2012

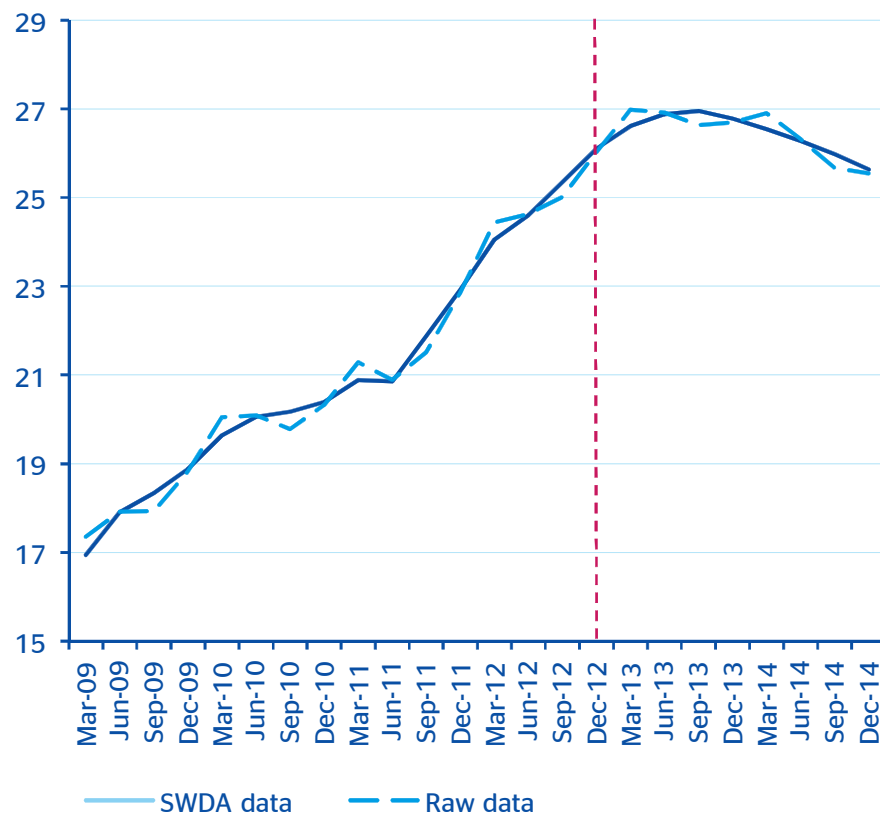
Highly mixed performances by exports, domestic demand and imports  
-> a dual economy for firms

Significant reduction in the current account deficit

# 2013: the year the economy should bottom out

## Spain: unemployment rate (%)

Source: BBVA Research



The unemployment rate should peak during 2013

A smaller active population and improved GDP should allow the unemployment rate to ease slightly in 2014

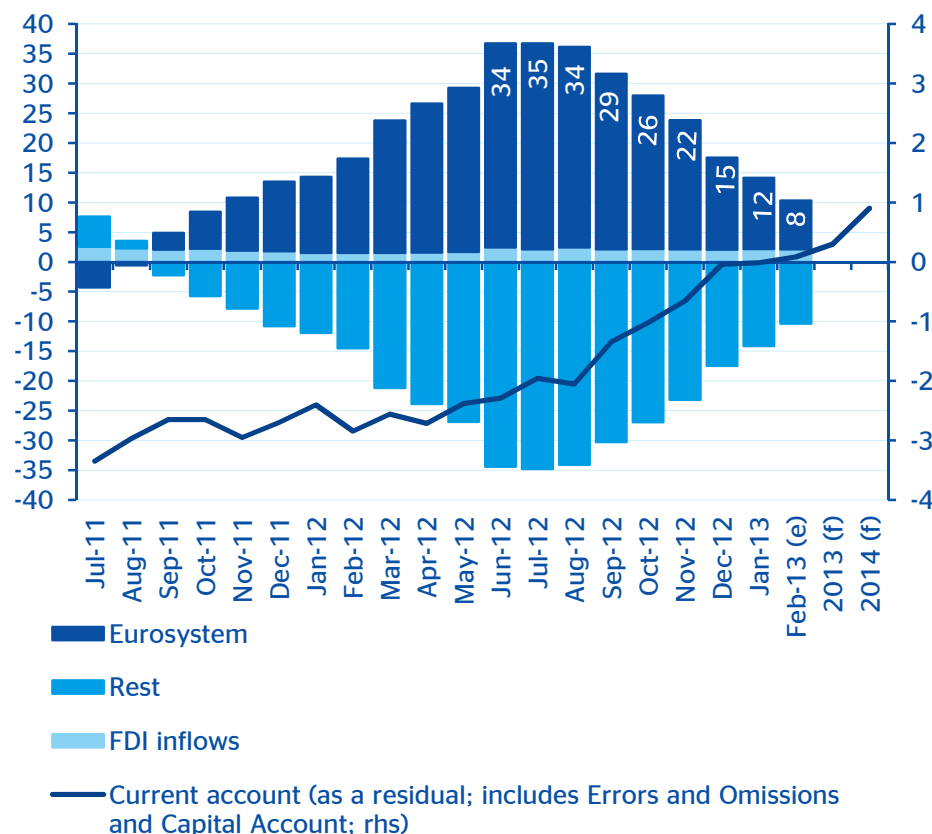
Additional measures and reforms are needed to reduce unemployment faster

# 2014: the start of recovery

## Spain: balance of payments and capital flows

(Cumulative 12-month, % of GDP)

Source: BBVA Research, based on Bank of Spain data



## 1. Gradual improvement in foreign confidence in the Spanish economy

A better current account balance reduces the need for external borrowing...

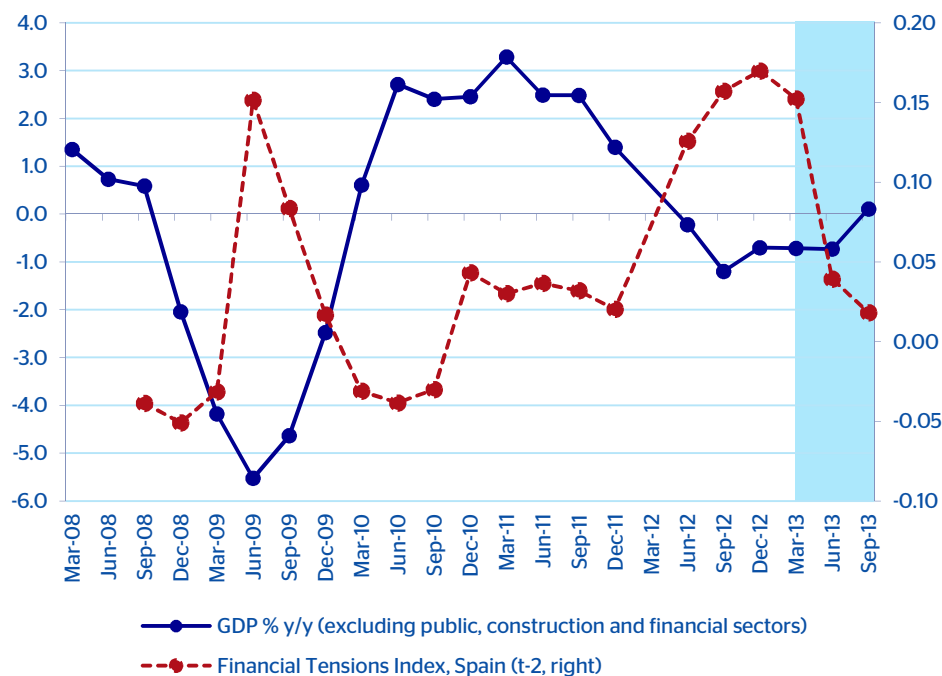
...which should reduce the dependence on ECB finance...

...and improve foreign perception of the Spanish economy, driving down risk premiums

# 2014: the start of recovery

## Spain: financial tensions and growth

Source: BBVA Research



## 2. Higher growth in the EMU

Brighter prospects for the EMU also bode well for Spain:

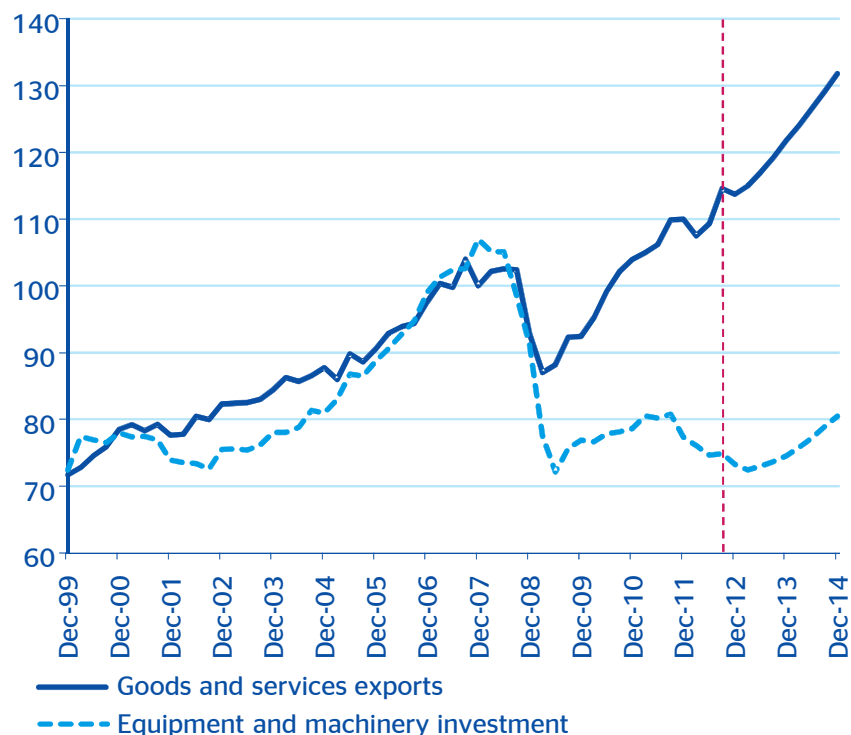
1. Higher confidence and lower financial stress

2. Higher external demand

# 2014: the start of recovery

## Spain: exports and investment in equipment and machinery (2008=100)

Source: BBVA Research based on INE data



## 3. Improvement in private investment

Brighter prospects for the EMU, continued growth in exports...

...and reduced financial stress...

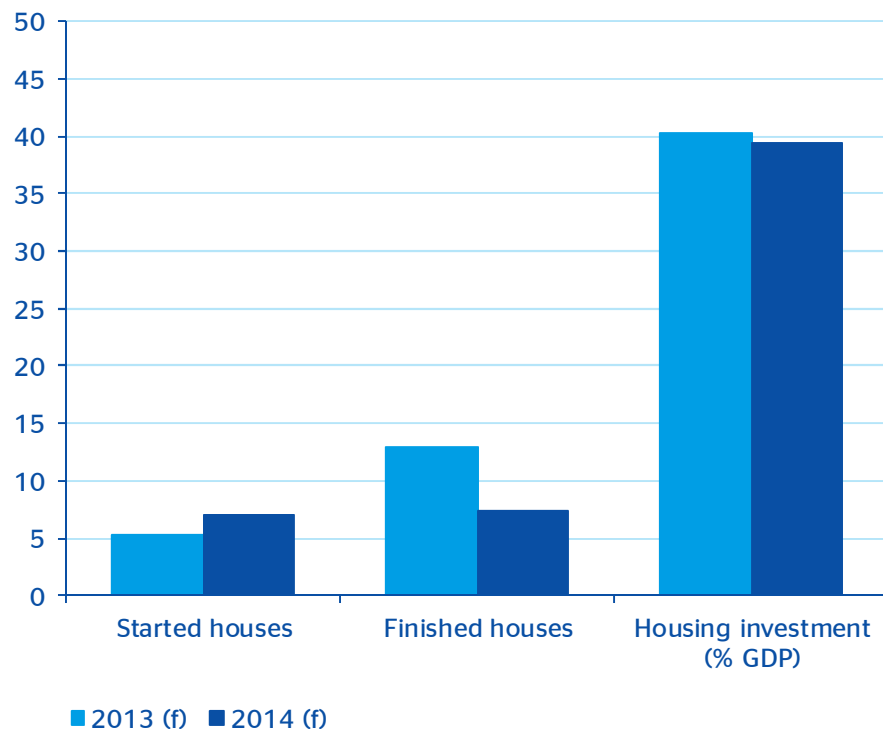
...should feed through to a recovery in private sector investment

# 2014: the start of recovery

## Spain: forecasts for the real estate sector

(% versus average 2004-2007)

Source: BBVA Research based on Works Ministry and INE data



## 4. Smaller negative impact of ongoing adjustments (I):

The supply-side correction in construction should end in 2014

Public sector cuts should be less severe than the undertaken in 2012 and the forecast for 2013

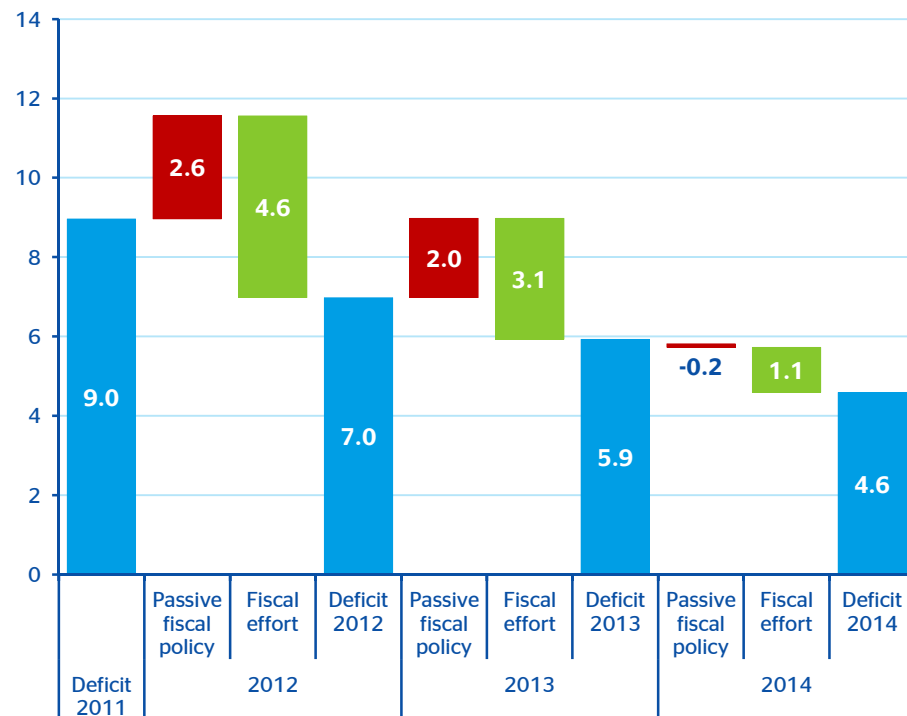
The banking sector restructuring will be further along



# 2014: the start of recovery

## Public administrations: decomposition of the budget deficit excluding financial sector aid (% of GDP)

Source: BBVA Research, based on MINHAP data



## 4. Smaller negative impact of ongoing adjustments (II):

Fiscal consolidation is working: budget cuts in 2012 will surpass 4pp of GDP

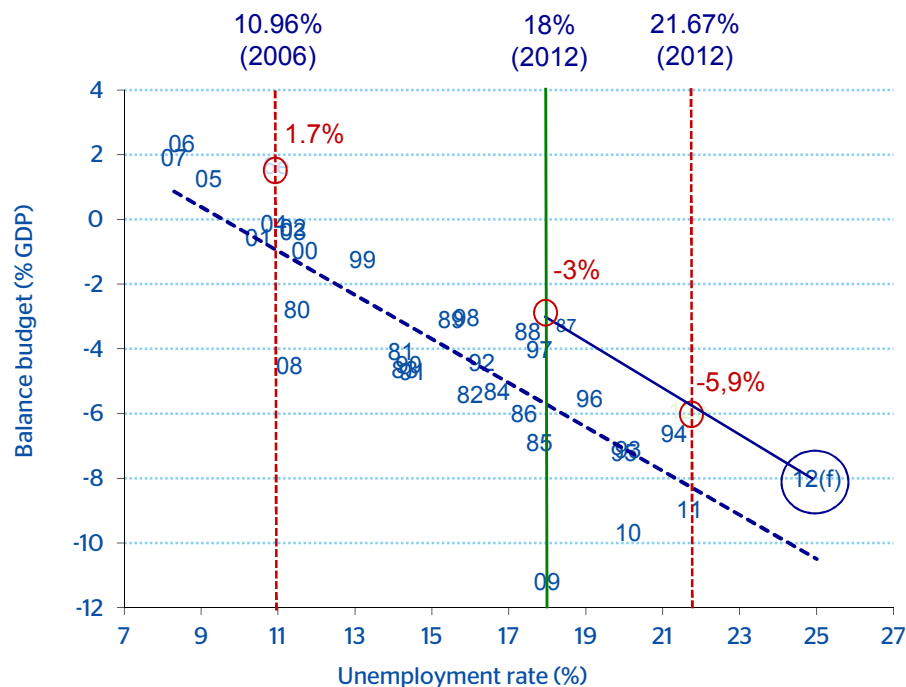
2014 will not require as great an effort as in 2013 and 2012

Overall, there are still major reforms to be undertaken, that would increase the efficiency of the public administrations

## 2014: the start of recovery

## General government balance and unemployment

Source: European Commission



#### 4. Smaller negative impact of ongoing adjustments (II):

## Alternative estimates of the structural unemployment rate (Okun's law) ...

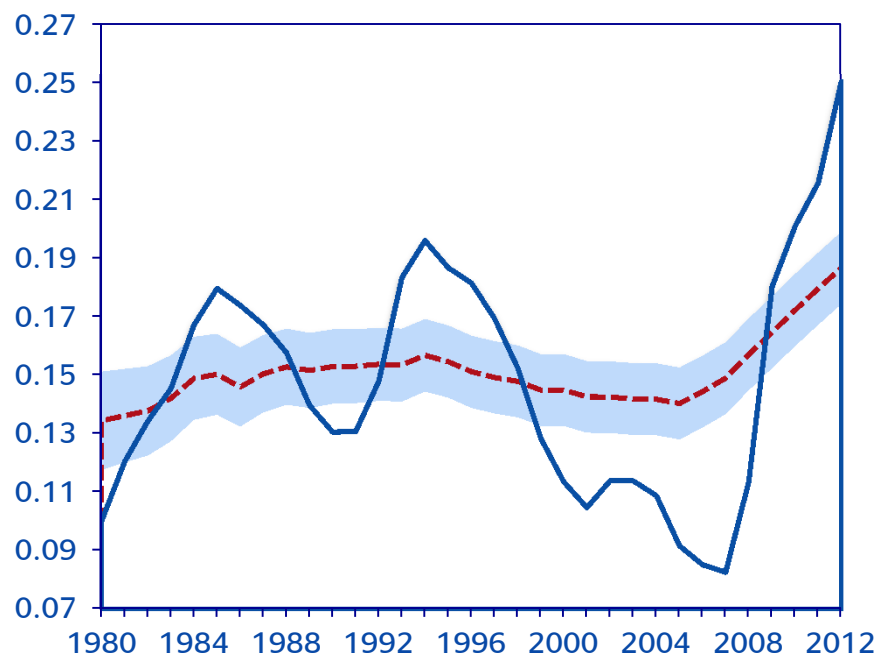
... a of the sensitivity of the budget balance to cyclical unemployment (0.7) ...

... allows us to estimate a lower structural budget deficit for the general government, particularly after the labour market reform in 2012.

# A digression on structural unemployment

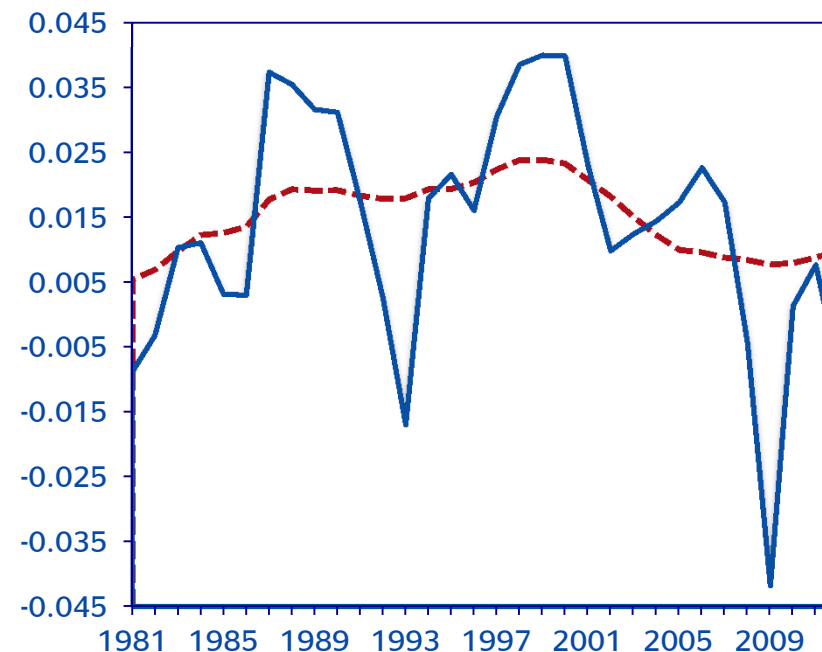
## Spain: unemployment rate and its structural component

Source: BBVA Research



## Spain: growth of GDP per working age population and its structural component

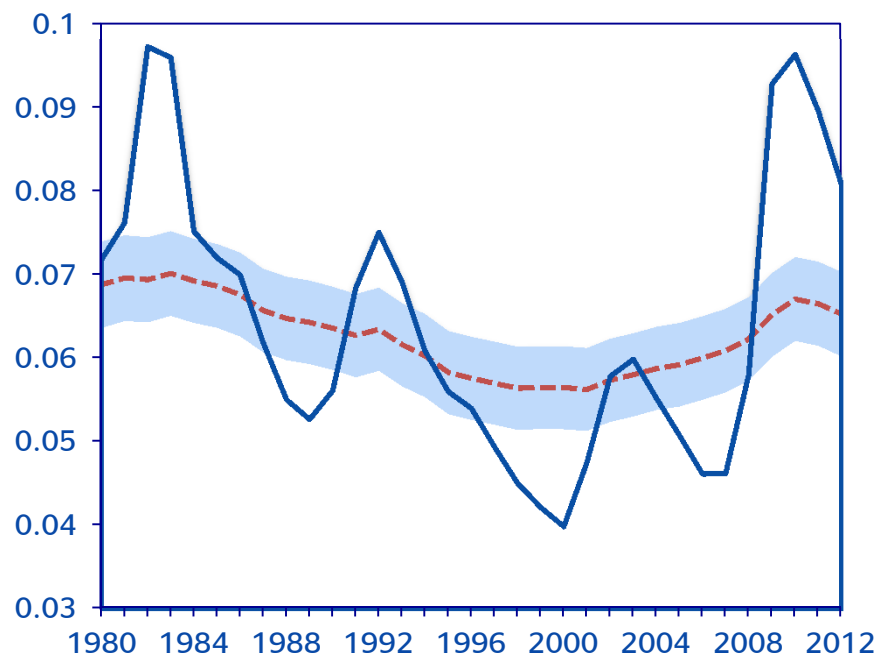
Source: BBVA Research



# A digression on structural unemployment

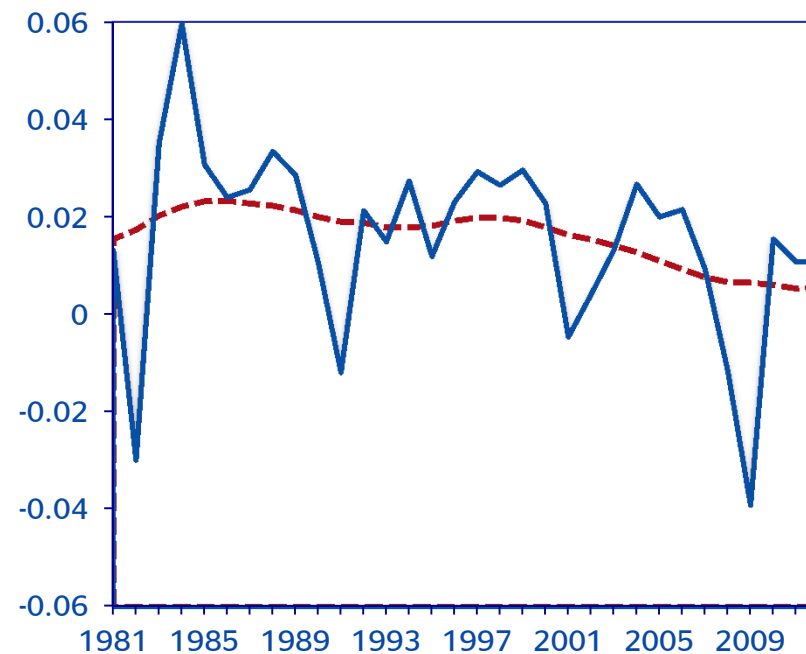
## USA: unemployment rate and its structural component

Source: BBVA Research



## USA: growth of GDP per working age population and its structural component

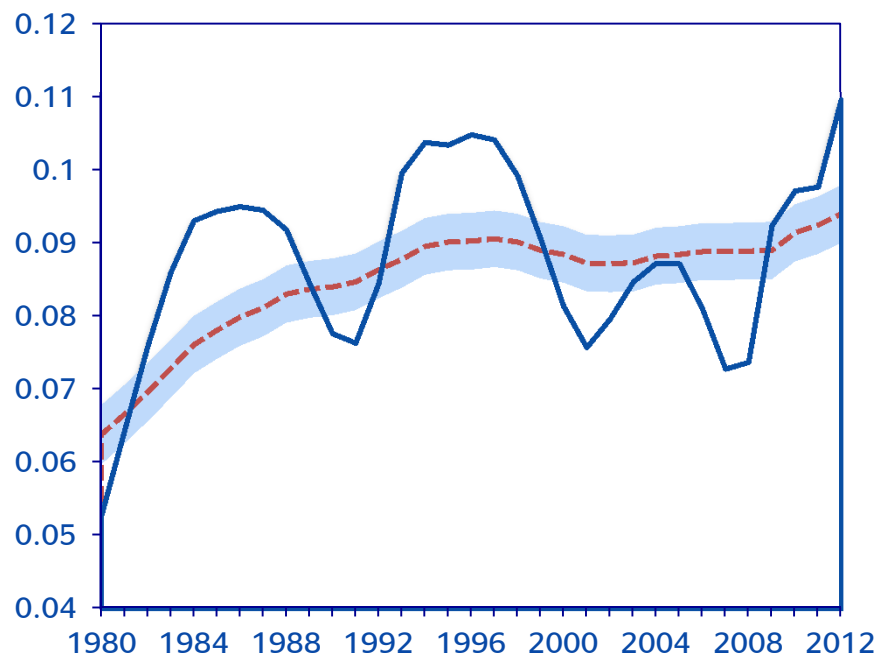
Source: BBVA Research



# A digression on structural unemployment

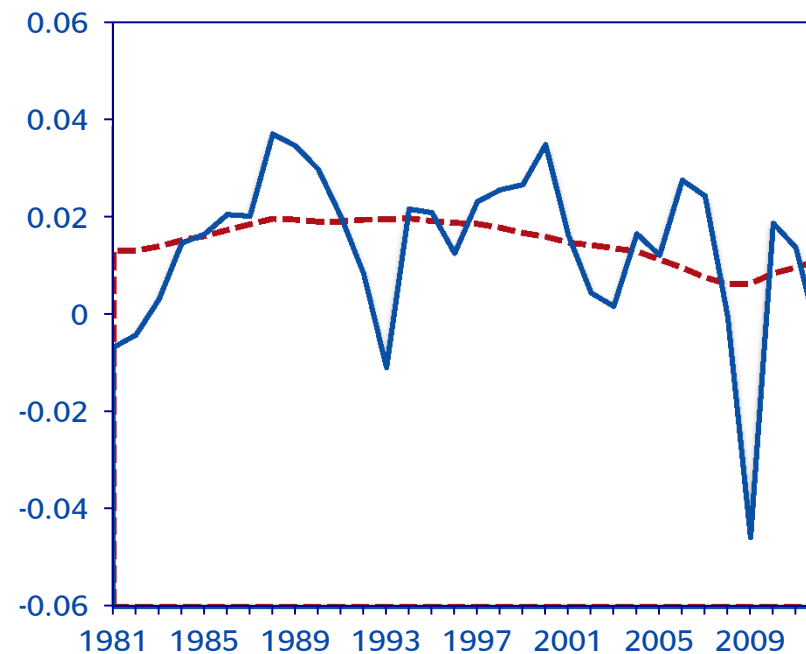
## EMU: unemployment rate and its structural component

Source: BBVA Research



## EMU: growth of GDP per working age population and its structural component

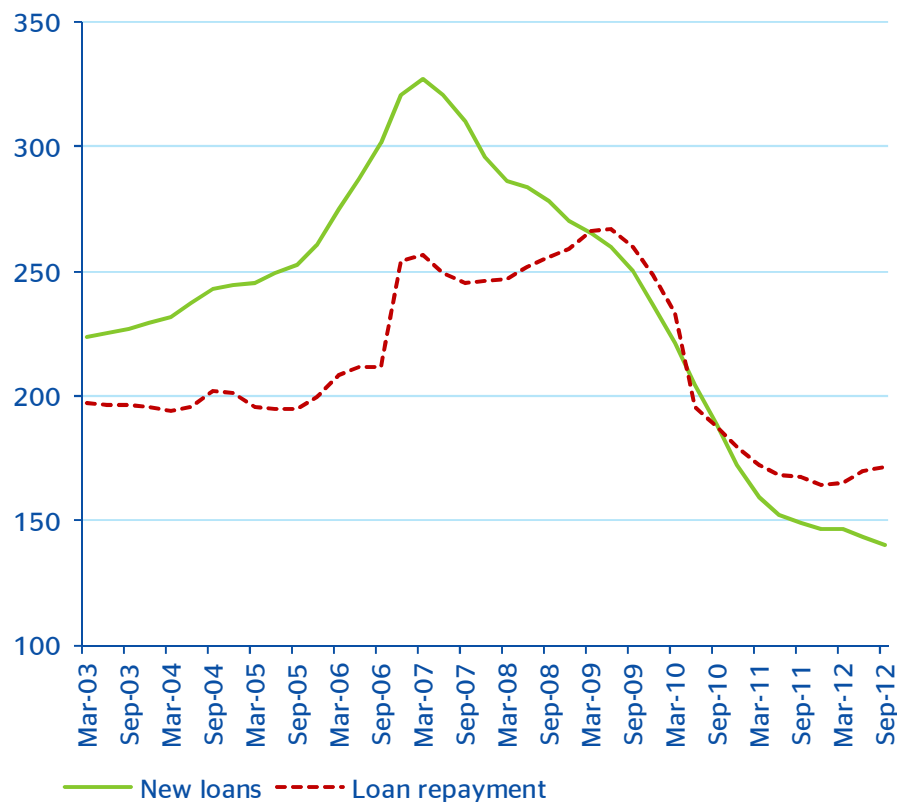
Source: BBVA Research



## 2014: the start of recovery

### Spain: Private sector credit (€Bn, trend)

Source: BBVA Research, based on Bank of Spain data



### 4. Smaller negative impact of ongoing adjustments (III):

Assessment of the MoU: bank restructuring is well underway

Deleveraging and economic recovery: credit for productive investment and job creation

Areas for improvement: (1) lending to SMEs  
(2) increased data on credit flows

## 2014: new announced reforms

### Taxation

- VAT regime for SMEs, self employment, R+D+I allowances, tax benefits
- Public administration reform, pensions and regional financ.

### Credit

- 22 mm in ICO lines
- 10 mm private banks
- Guarantees, payment to suppliers, arrears, SME securitisations. Etc.

### Employment

- Flat rate to the SS
- Subsidies in partial contracts <30 years
- First job for young, TWA learning contracts, etc.

### Growth

- Energy reform, railway transport, etc.
- Single market across regions, smaller administrative burden
- Human capital, R&D, etc.

# A window of opportunity that must be seized

The baseline scenario is highly sensitive to financial conditions in international markets, while numerous risks persist

Efforts to achieve permanent improvement of markets and take advantage of it, unlike in the past

Europe should progress towards a more genuine EMU. For this, progress towards the banking union in 2013 and European funds to promote growth are crucial.

Spain must strengthen efforts with the ongoing adjustments and structural reforms required to boost the competitiveness of its economy



## Main messages

- 1 The perception regarding the prospects of the global economic scenario has improved as a result of a relaxation of financial tensions, particularly in Europe, and the agreements to avoid a disorderly fiscal contraction in the US
- 2 However, to sustain the recovery, appropriate policies must be adopted in both the US and, particularly, in the euro area, where risks are more significant
- 3 Without ruling out upside surprises, the risks remain tilted to the downside, although they appear less likely now than until summer 2012.
- 4 Spain: caution due to existing risks. In 2013, conditioned to lower financial tensions, the economy should bottom out. Growth expected in 2014.
- 5 It is crucial to take advantage of the window of opportunity that has opened up in Europe and Spain to push through reforms that shore up the improvement in confidence.

# The Outlook for the Global Economy and for Spain

**Rafael Doménech**

[www.bbvaresearch.com](http://www.bbvaresearch.com)

Atlanta, April 8, 2013