

## The upcoming downturn

Miguel Cardoso

### Diario Expansión (Spain)

The upward trend in Spain's GDP growth in 2016 has been confirmed, while many factors suggest a downward bias in 2017. In particular, at BBVA Research we expect growth to reach 3.1% on average this year and 2.3% in 2017. This means a revision of 0.4 percentage points (pp) in GDP and -0.4 basis points, respectively, compared with the forecasts made three months ago. Although economic activity data show no slowdown so far, the materialization of certain external and internal risks could bring about a downturn in the coming quarters. In any event, the economic recovery and job creation are expected to continue, given the boost of drivers such as monetary policy. However, the Spanish economy's vulnerability is on the increase. It would therefore be highly desirable for the policies to be adopted in the coming years to be defined without delay.

For the time being, GDP growth remains at annualized levels of around 3%, with hardly any signs of slowdown and supported by domestic demand and exports of services. In particular, the data available so far suggests that growth in the third quarter will remain at the same levels as last year.

However, a certain worsening of growth expectations in developed countries can be perceived. In the U.S., the disappointing growth registered in the first quarter has been accompanied by the persistent weakness of non-residential investment, by the uncertainty associated with the November elections and, particularly, by the low increase in productivity. This has confirmed that the economic recovery will only reach rates of around 2.0% in 2016 and 2017, short of the 2.5% expected for both years three months ago. In the EMU, the result of Brexit will have negative effects on GDP in the coming months, reducing the growth forecast for 2017 by 0.4 pp to 1.5%.

In the short term, the effect of Brexit on the Spanish economy will be limited (between 0.3 and 0.4 pp of GDP in 2017), with trade and finance acting as the two main transmission channels. As regards the former, Spain's total exposure is not as high as in other European Union countries. However, some sectors (agri-food, automotive, chemicals and tourism) and regions (Aragon, Balearics, Canary Islands, Valencia Region, La Rioja, Murcia and Navarre) could be especially affected. In particular, the expected decline in British demand and the pound's depreciation against the euro will weigh down on export growth in the coming months. Moreover, Brexit has opened a new episode of volatility in the financial markets, although so far temporary and without becoming a systemic event (such as, for example, the collapse of Lehman Brothers in 2009). Overall, both channels will have a negative impact on economic activity and, primarily, on Spanish exports, which will grow 1.0% less in 2017 as a result of the above. Likewise, the negative impact on GDP next year varies between 0.3 pp for the regions less exposed and 0.5 pp for more exposed ones.

The external risks are compounded by some internal ones and by the exhaustion of tailwinds. This should lead to a slowdown in growth in the coming quarters. Thus, even though the new deficit target at the end of 2016 (4.6% of GDP) is credible, should the policies announced so far be complied with strictly, public spending would be adjusted in the second half of the year and would weigh down on domestic demand growth. More importantly, meeting the target for 2017 will require the implementation of measures amounting to around 0.5% of GDP. Defining the composition of the adjustment will prove crucial for determining the impact on the economy and the sustainability of public accounts in the long term.

To sum up, both the materialization of some external and internal risks and the exhaustion of the stimuli seen in recent quarters could increase the vulnerability of the Spanish economy. Continuing with the reforms, in view of the loss of space facing fiscal and monetary policies, may be the only answer for maintaining growth and job creation in Spain.



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