Euler Hermes Economic Research

Country Report

Spain

Back on track

General Information

GDP	USD1393.0402 bn (World ranking 13, World Bank 2013)
Population	46.65 mn (World ranking 29, World Bank 2013)
Form of state	Parliamentary Monarchy
Head of government	Mariano RAJOY (PP)
Next elections	2015, Parliament

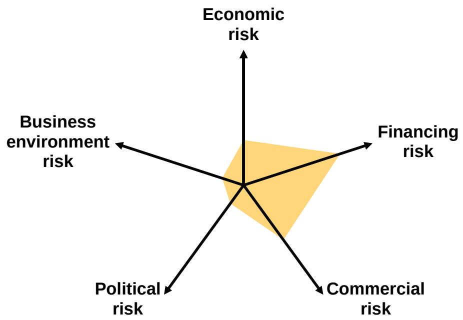
Strengths

- Clear reform agenda
- Improving competitiveness thanks to deep structural reforms (banking sector, pensions, labour market)
- Modern infrastructure network
- Large companies with international presence
- Good performance in some industrial and innovative sectors
- Tourism potential
- Efficient system for R&D, relatively high-skilled labour

Weaknesses

- High fiscal deficit and public debt
- High private sector debt
- Adjustment ongoing in the housing market following the 2006-2007 real estate bubble
- Weak banking system
- Downside pressures on prices
- Very elevated unemployment
- Decreasing long term per capita income

Country Rating A2



Source: Euler Hermes

Trade Structure

By destination / origin (% of total)

Exports		Rank		Imports
France	17%	1	12%	Germany
Germany	11%	2	11%	France
Portugal	9%	3	8%	Italy
Italy	9%	4	7%	China
United Kingdom	6%	5	5%	Netherlands

By product (% of total)

Exports		Rank		Imports
Cars And Cycles	11%	1	9%	Crude Oil
Other Agricultural Prod.	5%	2	7%	Refined Oil Products
Pharmaceuticals	5%	3	5%	Pharmaceuticals
Refined Oil Products	4%	4	4%	Cars And Cycles
Vehicles Components	4%	5	4%	Vehicles Components

Source: Chelem, UNCTAD (2012)

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Economic Overview

Real growth will strenghten, but the recovery begins from very low levels

After 5 years of recession combined with difficult adjustments and reforms, Spain has begun to recover, with positive economic growth in 2014. Real GDP expanded by +1.4%, mainly driven by the strengthening of private consumption (positive contribution of +1.3pps), while investment in machinery and equipment remained resilient (+0.9pps). Surprisingly, investment in construction increased in Q3 and Q4, shaving real growth by only -0.2pps in 2014 as a whole. Real exports continued to show good performance and grew by +4.2%. However, a surge in imports (+7.6%) caused a negative contribution of net exports to real growth of -1pp.

Euler Hermes expects real growth to strengthen to +2% in 2015 and 2016, outperforming Italy, France and Germany. Exports - further boosted by the lower euro - will continue to support productive investment, also reinforced by the fall in oil prices. Households' consumption is expected to slightly accelerate on the back of decreasing unemployment and low inflation. Also, public consumption should become broadly supportive in the wake of the general elections that will be held by the end of the year.

However, the recovery begins from very low levels. Real GDP still stands -6% below the pre-crisis level, while GDP per capita has fallen to 2003 levels. More worrying, both industrial production and retail sales stand approximately at -30% below the pre-crisis level. Public and private debts remain very elevated.

Deflationary pressures to persist

Deflationary pressures persist in Spain. The fall of consumer prices accelerated to -1.1% y/y in February 2015, against -0.5% y/y in August 2014. We expect the Quantitative Easing program announced by the ECB in January will bring inflation back to positive territory by H2 but, on average, consumer prices should contract again by -0.3% in 2015, after -0.2% in 2014. Inflation should come in close to 1% in 2016, still far from the ECB target of 2%. Long-lasting low inflation is an important downside risk as it will weigh on corporates' margins and can obstruct the ongoing deleveraging process. The level of debt, both public and private, is still very high. Despite a steady decline for two years, the debt of households remains among the highest in the Eurozone (around 80% of GDP or 120% of gross disposable income), while indebtedness of companies still accounts for nearly 100% of GDP or 200% of gross value added. Public debt, which is estimated to pass above 100% of GDP in 2014, should continue rising in 2015-2016.

Financing conditions will remain tight, especially for corporates

The credit to non-financial corporations is still contracting and the interest rates remain above European peers, especially for small and medium-sized firms. Although the Quantitative Easing program announced by the ECB in January is expected to gradually end the credit crunch, loans for corporations are not expected to surge in coming quarters as the demand for credit should remain low.

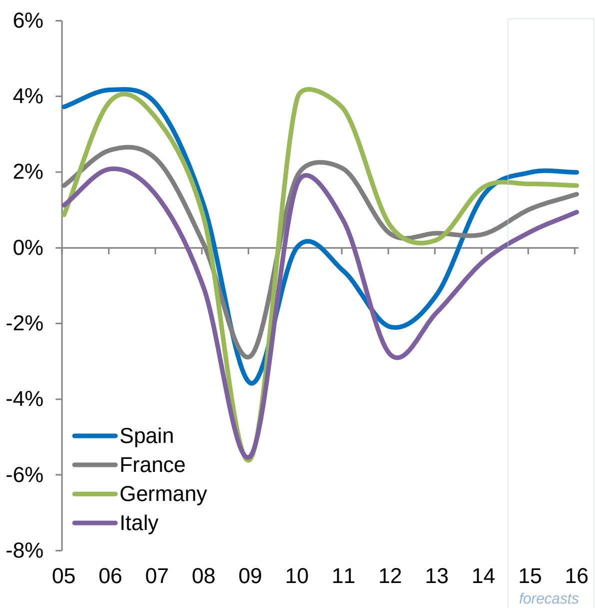
Key economic forecasts

		Weights	2013	2014	2015	2016
GDP		100%	**-1.2**	**1.4**	**2.0**	**2.0**
Consumer Spending		56%	**-2.3**	**2.4**	**2.6**	**2.7**
Public Spending		22%	**-2.9**	**0.1**	**0.6**	**-0.1**
Investment		21%	**-3.8**	**3.4**	**3.5**	**3.6**
Construction		9%	-9.2	-1.5	0.9	1.0
Equipment		12%	0.5	6.9	5.2	5.2
Stocks	*	2%	**-0.1**	**-0.1**	**0.1**	**-0.1**
Exports		32%	**4.3**	**4.2**	**4.7**	**4.3**
Imports		33%	**-0.5**	**7.6**	**4.8**	**4.9**
Net exports	*	-1%	**1.6**	**-1.0**	**0.0**	**-0.1**
Current account (% of GDP)			**1.4**	**0.1**	**0.7**	**0.6**
Employment			**-2.8**	**1.2**	**1.6**	**1.5**
Unemployment rate			**26.1**	**24.4**	**23.3**	**21.9**
Wages			**-0.4**	**-0.4**	**0.0**	**0.3**
Inflation			**1.5**	**-0.2**	**-0.3**	**0.9**
Fiscal balance (% of GDP)			*-7.1*	*-5.6*	*-4.6*	*-3.8*
Public debt (% of GDP)			*93.9*	*100.1*	*103.9*	*106.4*

Change over the period, unless otherwise indicated:
*contribution to GDP growth

Sources: National sources, IHS, Euler Hermes

Real GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Alongside, days sales outstanding (DSO) remain among the highest in the Eurozone (above 90 days), and will even keep increasing in some sectors. Moreover, despite declining, the number or corporate insolvencies remains 500% above pre-crisis levels.

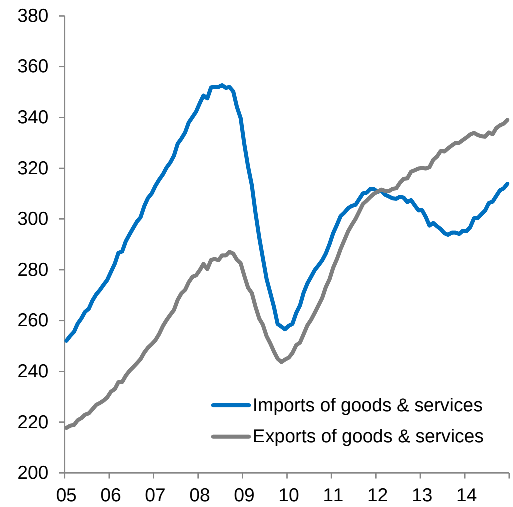
Current account surplus to strenghten thanks to competitiveness gains and low oil prices

Reforms and economic adjustment have advanced over the past years which helped to improve export competitiveness. Labor market reforms implemented in 2012 loosened collective wage-setting mechanisms, allowing high unemployment to exert a downside pressure on wages. Coupled with greater flexibility in the labor market, this has allowed unit labor costs to drop by a full -8% below pre-crisis levels, bringing the manufacturing industry's hourly labor costs down to EUR22.7/hour (Eurostat data), compared with EUR36.8/h in France and EUR37.9/h in Germany.

The country's exports have become a main engine of growth. Exports reached 32% of GDP in 2014 (22% in 2007), accounting for 7% of the Eurozone's total exports, an improvement on 6% before the crisis. Further supported by the EUR depreciation, Euler Hermes expects total Spanish exports will continue this upward trend, benefitting notably the car industry. Spanish car output, after reaching its lowest level at the end of 2012 (1.5 mn private vehicles), increased, falling just short of 1.9 mn units in 2014, resulting in more than +25% growth and the creation of 31 700 jobs during the year. At the same time, production decreased in several other European countries (Belgium, Italy and France), resulting in a low overall European market performance of only +2% growth.

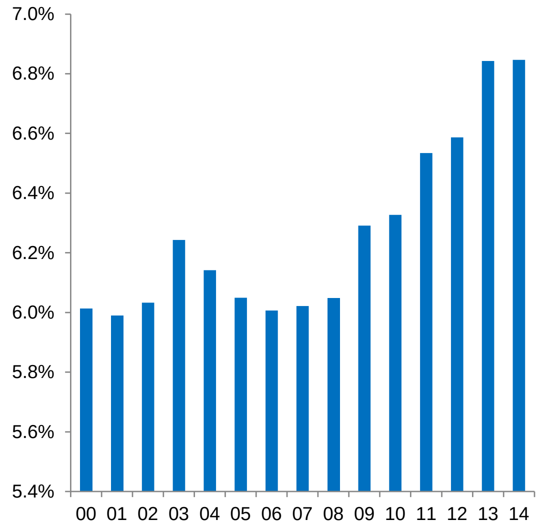
The surge in exports allowed Spain to shift to a surplus in trade of goods and services in 2012, after more than 20 years of deficit. Even if this surplus has overall narrowed since late-2013 with the recovery of imports, we expect exports to continue performing well over the next quarters, helped notably by the lower euro. Alongside, low oil prices should bring down import prices. The current account balance surplus is expected to consolidate in 2015-2016.

Exports of goods and services (over 12 months, EUR bn)



Sources: National sources, IHS, Euler Hermes

Spain: Share in Eurozone's exports



Sources: National sources, IHS, Euler Hermes

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Last review: 2015-03-13
Country Risk Analyst:
Daniela Ordóñez
daniela.ordonez@eulerhermes.com