

Euler Hermes: Spain cautiously taking the bull by the horns

PARIS- 16 OCTOBER 2014 – The Spanish economy is out of recession. Second-quarter growth surprised on the upside as GDP increased by +0.6% q/q, driven by a rebound in domestic demand but especially in household spending. These are the key findings of an Economic Insight into Spain by Euler Hermes, worldwide leader in credit insurance.

The report analyzes the main drivers for the recovery of the Spanish economy, driven by investment and a less austere 2015 budget, among others. Nevertheless, several bottlenecks persist and prevent true acceleration:

- More supportive fiscal policy and a continued strengthening of investment should support activity in the coming months, but consumption growth is expected to slow and net exports' contribution become broadly flat in 2015.
- Euler Hermes expects Spain GDP to grow by 1.2% in 2014 and by 1.3% in 2015. While net exports were the main engine of growth in 2012 and 2013 due to improved competitiveness of the Spanish export sector, export performance should stall in 2014 and 2015. On the other hand, imports should show positive growth rates in line with domestic demand recovery.
- Euler Hermes expects private consumption to grow to 2% in 2014 and to 1.4% in 2015.

Euler Hermes economic forecasts

| Spain | Weights | 2012 | 2013 | 2014 | 2015 |
|--|---------|-------|------|-------|-------|
| GDP | 100% | -1.6 | -1.2 | 1.2 | 1.3 |
| Consumer Spending | 58% | -2.8 | -2.1 | 2.0 | 1.4 |
| Public Spending | 22% | -4.8 | -2.3 | 1.3 | 0.2 |
| Investment | 20% | -7.0 | -5.1 | 0.2 | 1.4 |
| Stocks | * 3% | -0.3 | -0.1 | 0.2 | 0.1 |
| Exports | 33% | 2.1 | 4.9 | 3.0 | 3.0 |
| Imports | 37% | -5.7 | 0.4 | 4.4 | 2.9 |
| Net exports | * -3% | 2.8 | 1.6 | -0.5 | 0.1 |
| Current account | ** | -12 | 8 | -4 | 0 |
| <i>Current account (% of GDP)</i> | | -1.2 | 0.8 | -0.4 | 0.0 |
| Employment | | -4.3 | -2.8 | 0.7 | 0.8 |
| Unemployment rate | | 24.8 | 26.1 | 24.8 | 24.0 |
| Wages | | -5.6 | -3.5 | 0.5 | 0.4 |
| Inflation | | 2.4 | 1.5 | 0.0 | 0.5 |
| General government balance | ** | -109 | -73 | -62 | -52 |
| <i>General gov. balance (% of GDP)</i> | | -10.6 | -7.1 | -6.0 | -5.0 |
| Public debt (% of GDP) | | 86.0 | 93.9 | 100.5 | 104.8 |
| Nominal GDP | ** | 1029 | 1023 | 1031 | 1048 |

Change over the period, unless otherwise indicated:

*Contribution to GDP growth

**EUR bn

Sources: IHS Global Insight, National Sources, Euler Hermes

Fiscal policy to support investment

Labor market reforms implemented in 2012 loosened collective wage-setting mechanisms, allowing high unemployment to exert a downward pressure on wages. This transformed into lower unit labor costs and, thus, more competitive export prices. Equipment and machinery investments were the first component of domestic demand to recover and are expected to remain on an upward trend through 2015.

The Spanish government has presented a less austere budget for 2015. While proposing measures to support growth, it remains committed to narrowing the public deficit to -5.5% of GDP in 2014 and to -4.2% of GDP in 2015.

Downside risks remain important, notably for corporations

Euler Hermes identified several risks preventing increased acceleration of growth activity. Notably, deflationary pressures, still very-high financing conditions and political risk related to Catalanian demands for independence.

Risk 1: Deflationary pressures persist.

Consumer prices fell by -0.5% y/y in August, after registering -0.2% y/y in July. Euler Hermes expects Spanish inflation to strengthen gradually in the upcoming months following conventional and exceptional unconventional measures implemented by the ECB, and the end of the collapse in wages.

However, inflation will remain flat at 0.0% in 2014 and 0.5% in 2015, markedly below the ECB inflation target (2%).

Risk 2: Financing conditions are still tight.

The global credit crunch may be over, but Spain continues to feel its effects. Without notable inflation and/or growth, this will still weigh on the pace of recovery for some time.

Risk 3: Political risk related to Catalonia's potential independence.

Although the risk of Catalan independence seems contained for now, political uncertainty related to the ongoing battle between the Independence Party and the Spanish state could affect investor confidence and weigh on the recovery.

The Catalanian sectors that would be most affected are those that are export-oriented and those most active domestically with the rest of Spain. The automobile and oil refining sectors appear particularly vulnerable, but also medium-to-high technology industries such as chemicals, electronics and pharmaceuticals.

All three risks need to be reduced if Spain is to retrieve a growth pace firmly above 1% in the medium term.

Download the full Economic Insight about Spain at <http://www.eulerhermes.com/economic-research/economic-publications/Pages/economic-insights.aspx>

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