

Is recovery being watered down?

Spain's economic recovery is being confirmed month by month. The flash GDP figures for 2015 Q1 indicate a quarter-on-quarter growth rate of 0.8%, higher than expected, placing the economy's cruising speed at close to 3%. In fact some analysts are already predicting that average growth for the year will be around this figure. At "la Caixa" Research we have kept our forecast at 2.5% this month, although the dynamism seen in the last few weeks is likely to result in an upward revision.

In addition to the well-known temporary factors that have been boosting growth (such as the euro's depreciation, low oil prices, less restrictive monetary policy and renewed consumer and corporate confidence), a new element has now appeared, namely expectations (and the reality) of more accommodative financial conditions thanks to the quantitative easing programme set in motion by the European Central Bank (ECB). This expansionary cocktail could actually bring us close to 3% growth, especially if the international financial environment remains benign and if public administrations resist taking advantage of this tail wind to reduce their deficits more quickly.

At this point in the economic cycle, and albeit taking the wind out of the sails of a long-awaited recovery, it is important to warn of the major downside risks to growth in the short and medium term.

The first comes from the financial environment in which the Spanish economy operates. As there is no central bank per se, domestic monetary conditions are the result of a combination of two factors: the policy established by the ECB for the euro area as a whole and international investors' perceived risk of investing in Spanish assets, a risk that we can concisely sum up as the spread between the yield on Spanish 10-year bonds and the same kind of bonds from Germany: the famous risk premium.

In the current cycle of recovery, financial conditions have been relaxed both due to direct action by the ECB and also because of reforms and adjustments carried out internally in Spain, which have been welcomed by international investors. It is true that, as far as the ECB's policy is concerned, we are currently in a presumably prolonged period of highly accommodative monetary conditions. But it is also true that, given the total mobility of capital at present, any sharp change in appetite for «Spanish risk» is always a potential threat. For this reason, the utmost caution should be taken and Spain should continue reducing its levels of debt, particularly in the public sphere, bringing these down to more moderate and sustainable levels.

The second big risk concerns inflation and wages. The dynamism of Spain's recovery proves, on the one hand, that it is possible to grow and generate income within a scenario of price and wage stability. Moreover the CPI is falling due to the effect of oil prices but core inflation is stable and moderate wage rises are helping to maintain or even improve the country's competitiveness. Any deterioration in this area would hinder the recovery as Spain's economic improvement would not be sustainable should its external balance deteriorate.

This has been the typical pattern in Spain. Whenever the economy has grown strongly, the foreign sector has quickly entered into deficit. In the current recovery, the challenge is to avoid slipping back into the old habits and not to be misled by any delusions as positive external account figures are almost guaranteed for some time thanks to low oil prices. It would be a serious mistake to become complacent should these positive results mask a deterioration in the country's competitiveness.

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