Article

Recent developments

# Strong growth thanks to temporary factors

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GDP advanced by 0.7% quarter-on-quarter in 2014 Q4. The Spanish economy grew at a good pace, more than expected, accumulating six consecutive quarters of expansion. The year-on-year rate of change in GDP for 2014 as a whole was therefore 1.4%. Although the breakdown of GDP is still not available, the bulk of the evidence suggests that the driving force for growth is once more domestic demand, especially household consumption and investment in capital goods. The most recent figures also suggest that the change in trend in construction investment is consolidating.

Improved growth prospects for GDP in 2015. The ECB's large-scale programme to purchase public and private debt could help to revive Europe's economy. For the time being, its impact has already been felt on the exchange rate with the euro depreciating by 6.8% in January against the dollar. This will boost the trend in exports and promote growth in Spain's economy over the coming quarters. There are, moreover, other elements that will also temporarily support the economic recovery this year: the fall in oil prices, which has already accumulated a 58.4% drop since June, will reduce the energy bill, increasing the disposable income of both households and companies and, in turn, encouraging consumption and investment. This has led us to revise upwards our GDP growth forecast for 2015 to 2.3% (previously 1.9%). In 2016, however, diminishing support from these factors will result in a certain slowdown in GDP growth, which will be in the range of 2.1%. These growth forecasts are similar to the ones provided by the IMF, which estimates growth of 2.0% and 1.8% for 2015 and 2016, respectively.

Confidence indicators point to a good start to the year. Judging by the European Commission's economic sentiment index in January, economic activity has continued to improve considerably 2015 Q1. Specifically, this index stood at 106.6 points, more than two points above the average in 2014 Q4 and clearly above its historical average (100.7). Of the different factors that make up this index, of note is the sharp rise in consumer confidence, in line with the more favourable trend in the labour market. We therefore expect household expenditure to continue making a strong contribution to GDP growth throughout 2015.

The drop in oil prices will support the recovery in the current account surplus in 2015. November's figures for goods exports were favourable as nominal exports grew by 3.2% year-on-year, thereby maintaining the upward trend that started in mid-2014. However, imports slowed down their rate of year-on-year growth to 2.0% (7.7% in October) due to the reduction in the bill for energy imports. This contributed to the slight improvement seen in the current account balance that month. However, it is crucial to continue policies to promote energy savings and efficiency and to encourage exports as the support provided for the current account by falling oil prices is bound to be temporary.

Tourism ended 2014 with a record number of international tourists. Exports of tourism services therefore continued to support the improvement in the current account balance. Specifically, Spain received almost 65 million tourists from other countries in 2014, 4.3 million more than in 2013. Most of the European countries increased their number of tourists to Spain except for Russia, which was down by 10% year-on-year. Moreover, with the recent depreciation of the euro, foreign tourist arrivals are likely to keep on growing. On the one hand, destinations outside the euro area will be more expensive for European tourists, boosting destinations such as Spain. On the other hand tourism is also likely to increase from outside the euro area over the next few months as the euro's depreciation will make most European destinations more competitive at an international level. This is therefore good news for the tourism industry.

Falling oil prices keep inflation in negative terrain. According to the flash figures provided by the INE, inflation shrank by 0.4 pps in January, pushed down by the drop in oil prices, reaching –1.4%. Given the outlook for oil prices, which are likely to remain low for the first half of the year and then gradually pick up, the inflation rate will still be negative for a few more months and the average inflation rate for 2015 will be –0.3%. Spain will end the year with inflation below the average rate predicted for the euro area, namely 0.5%, allowing it to continue making gains in competitiveness. However, in 2016 inflation will rise to 2.0% on average due particularly to the effect from the energy component levelling off.

The good figures from the labour market confirm the economy's recovery. In 2014 Q4, the number of employed grew more than expected, by 1.0% quarter-on-quarter seasonally adjusted. This means employment has now grown for five consecutive quarters. Apart from the services sector, rising employment is also consolidating in industry and construction, now posting three quarters of growth. 2014 therefore ended with net creation of jobs in all sectors except agriculture. The increase in employment in construction is yet another indication that the adjustment in the real estate sector is coming to an end while other real estate indicators are also showing signs of improvement. Cumulative house purchases over 12 months increased in November by 0.7% year-on-year, the first positive growth since 2013 Q3 and permits for new builds rose by 4.7% in October (cumulative over 12 months).

The improvement in activity could start to weaken the effect of discouragement. The sharp rise in the labour force in Q4, totalling 95,200 people and higher than expected, led to an increase in the participation rate of 0.3 pps, to 59.8%. Over the next year the economic recovery should slow up the downward trend in the labour force which, in the last two years, reduced the participation rate from its highest level of 60.4%, reached in 2012, to 59.6% in 2014. Nonetheless, unemployment increased slightly in spite of the rise in employment, so that the unemployment rate remained at 23.7% in Q4. Over the coming months, the upward trend in employment expectations in the different sectors suggests that the recovery in the labour market will continue to spread, albeit gradually, throughout all economic sectors. Of particular note are the improved employment expectations in industry, reaching levels they have not seen since summer 2007.

2014 will end with a public deficit very close to the target set of 5.5% of GDP. The general government's budget execution figures up to November show that the deficit target for 2014 might be met. Improved activity is helping the correction in the public deficit thanks particularly to higher tax revenue. Social Security revenue also grew, supported by increased employment while expenditure fell as a consequence of the drop in social benefits, mainly for unemployment. However, the autonomous communities will very probably end the year with a significant deviation from their target, although this will be offset by the good figures from central government, local government and Social Security.

Private sector deleveraging continues, albeit slowly. The debt of households and non-financial firms fell once again in Q3: it now represents 72.4% and 109.7% of GDP and has accumulated a drop of 12 pps and of 24 pps respectively since the peak reached in 2010. But the process of reducing private debt has not ended, as seen in the substantial reduction still affecting the outstanding balance of credit (–6.9% year-on-year in December). Nevertheless, the pace of its descent slipped back 0.5 pps compared with the previous month and the rate was lower than expected. Moreover, the figures for new loans indicate that the recovery in credit is gradually building up steam. For 2014 as a whole, new loans granted to households to buy residential properties posted strong growth (23.5%) while loans to SMEs also increased (8.6%). However, new loans to large firms are still below the levels of 2013, partly because these companies have opted for other sources of financing. Bank balance sheets also continued to improve: the NPL ratio fell slightly in November to 12.98% thanks to the decrease in doubtful loans for the tenth consecutive month.