



Article

[Recent developments](#)

Strong advances made in economic activity

Content available in
Spanish Catalan

The rate of growth continued high in Q4. The most recent figures show the good expansionary tone of economic activity, slightly above the forecasts from some months ago. For this reason we have revised upwards our forecast for growth in GDP in Q4 by 0.1 pps to 0.8% quarter-on-quarter (in line with the Bank of Spain's estimate), bringing the annual figure for 2015 to 3.2% (compared with 3.1% previously). After a very notable year in terms of GDP growth, in 2016 we expect the rate of increase to dip slightly to 2.7% as the impact from the temporary support received throughout 2015 disappears, such as tax cuts and low oil prices. However, some elements will gradually come to the fore that will help to sustain more balanced growth in the long term. Specifically we expect the improvement in financing conditions to consolidate, the real estate sector to once again make a positive contribution and structural reforms to continue producing results, especially in the labour market where the rate of job creation could exceed

400,000 jobs. Nonetheless there are considerable risks regarding this scenario, especially from outside the country due to a possible slowdown in the emerging economies, so it is vital to continue reinforcing the foundations to be prepared for any eventuality. In this respect the outcome of the recent elections which, as expected, have led to considerable parliamentary fragmentation, is increasing uncertainty regarding the political panorama and, in particular, the country's capacity to continue implementing reforms. The speed with which a new government is formed and its solidity will be key to maintaining this scenario of a robust recovery.

Business indicators suggest the economy remains in a comfortable zone of expansion. According to the business sentiment index (PMI) for November there was solid growth in activity in the last part of the year and other data also verify this improvement. Specifically, the number of businesses in the services sector increased sharply by 5.8% year-on-year in October, confirming that services are leading the recovery. The industrial sector, lagging behind somewhat, is nevertheless posting increasingly positive data: this index, for example, rose by 3.1% year-on-year in the same month. Moreover, the good trend in new industrial orders, especially those from abroad, suggests this sector will continue to perform well in the future.

Bank credit is still flowing at a good rate, helping to underpin the economy's recovery. On the one hand demand for credit is being supported by the good progress being made by household and company deleveraging (see the Focus «The deleveraging of the Spanish economy: a long way to go» in this Report). On the supply side banks are now in a better position to grant loans after thoroughly sorting out their balance sheets (the NPL ratio fell by 0.1 pps, to 10.6%, in October) and the restructuring they have carried out. As a result, from the beginning of the year to October the flow of new loans to households and SMEs grew at a rate of 17%, a trend we expect to speed up in 2016. Of note is the strong growth in mortgage loans, boosted by the recovery in the real estate sector.

Financing conditions are still improving. Little by little, the interest rate spread is narrowing for new loans of under one million euros (those most widely used by SMEs) between Spain and the main European countries. According to the most

recent data, from October, this interest rate was, on average, 3.2% in Spain compared with 2.6% and 2.1% in Germany and France, respectively. Although the Spanish rate is still higher than that of other countries, the spread compared with the German rate, for example, has decreased by 0.9 pps since October 2014. To ensure this process of financial defragmentation does not stop next year, it will be important, at a national level, for uncertainty surrounding the formation of a new government to diminish, helping the short and medium-term risk premium to remain low. At a European level it will be vital to continue reinforcing banking union (see the Focus «Towards the completion of banking union» in this Report).

The recovery in the real estate sector is consolidating. Lower financing costs are helping to stimulate house purchases, up by 11.7% year-on-year in October (cumulative over 12 months). In the short term we expect a rise in the purchase of residential properties by individuals who have been waiting for the real estate market to stabilise (retained demand) and by investors thanks to the higher returns from rents compared with other assets. This strength in demand suggests that the upward trend in prices will continue in the coming quarters although performance will be very heterogeneous as price increases will be concentrated in those regions with a lower stock of new housing for sale.

Wage containment is helping to regain competitiveness. In Q3 hourly wage costs rose by a moderate 0.6% year-on-year in Spain (compared with 2.3% in Germany and 1.6% in France). In Q4 wages will grow slightly above this figure as, in October, almost 25% of the extraordinary pay from 2012 was refunded to civil servants, as happened in Q1. This temporary increase in wages in this sector will be repeated in 2016 when the remaining 50% is returned. Apart from these fluctuations, wage increases will remain contained given the high unemployment rate and low inflation. The support for domestic demand provided by wage rises will therefore continue to be limited. However, what will particularly support consumption will be the high rate of job creation which, although we expect a modest slowdown, will still be at a considerable level. In November the year-on-year rate of change of registered workers affiliated to Social Security held steady at 3.2%. The robust performance by services (not only those related to tourism), industry and construction have offset the lower contribution by public

administration in the second half of the year.

Adjustment of the external balance continues. Improved competitiveness, thanks partly to wage moderation but also to the efforts made by Spanish firms to internationalise, has been crucial to boosting exports. Consequently, from the beginning of the year up to October, exports of non-energy goods increased, on average, by 5.9% year-on-year compared with 2.1% in the same period of 2014. Of note is the excellent performance by exports of consumer goods whose share of all exports is 38% and which posted an increase of 13.5% year-on-year, on average, from January to October. Foreign sales of cars, which represent one third of all consumer goods, have played a very important role, up by 24.8% year-on-year on average. However, energy exports continued to contribute negatively to growth as a result of the sharp fall in oil prices. This year so far imports have grown at a slower rate than exports (3.2% year-on-year on average), so the external balance is likely to continue improving.

Inflation returns to positive figures. According to the CPI flash estimate for December, inflation stood at 0.0%, 0.3 pps above the rate of the previous month due to the smaller drop in energy prices (in year-on-year terms). We expect core inflation, not influenced by the fluctuations in energy or fresh foods, to have risen very gradually thanks to stronger household consumption, which continues to be supported by ongoing improvements in the labour market and in conditions to access credit. The annual average for inflation in 2015 would therefore be -0.5%. We expect inflation to continue to rise in 2016 and reach 1.2% on average, backed by a scenario of a gradual recovery in oil prices.

The public sector continues with its fiscal consolidation but adjustment has yet to be completed. The budget execution up to October indicates that the central government may have some margin to offset part of the deviation from the deficit target by the autonomous communities and Social Security, although it will not be enough to avoid a deviation by public administration as a whole. The correction of the structural deficit is one of the main focuses of attention by the European Commission. Specifically, the follow-up report on the agenda of reforms planned for the Spanish economy published by this public body every six months endorses the progress made to improve public administration efficiency such the

simplification of public bodies. However, the European Commission repeats that fiscal consolidation must continue in order to underpin growth and keep the risk premium low.

