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Spain: political uncertainty overshadows good economic outlook

Author: Petra Ott-Laubach, phone +49 69 7431-3453, research@kfw.de

After years of crisis, the Spanish economy has pulled off an impressive economic turnaround. This year it will advance to one of the euro area's growth leaders. But its economic track record is not immaculate. The labour market situation in particular remains a cause for concern. The outlook for the future is also being overshadowed by considerable political uncertainty over Catalonia's drive for independence.

Robust growth

With the exception of these political imponderables, the Spanish economy currently presents itself in very good shape. For 2015 real GDP growth is set to exceed 3 % and domestic demand will be the main driver of growth. According to most current forecasts, Spain's economy will lose only little momentum in 2016 and continue expanding at a rate of over 2½ per cent.

Progress in coping with the legacy of the crisis

The continued economic recovery is good news for the labour market, one of Spain's biggest economic worries. It is true that, in comparison with the other euro countries, Spain can boast an impressive decline in the unemployment rate by nearly 6 percentage points since early 2013. But despite this progress, Spain's unemployment rate of more than 20 % is still unacceptably high. The job prospects of young workers in particular remain bleak.

One area in which Spain has made significant progress is in reducing external imbalances. Up to the outbreak of the financial crisis, Spain recorded a chronic current-account deficit that peaked at almost 10 % of GDP in 2007. After continuous improvements in the past years, it generated a surplus for the first time in 2013. This achievement was due not only to import weakness caused by low demand in the years after 2008 but also to improved export performance. Here Spain was able to reap the fruits of improved competitiveness brought about by labour market reforms and moderate wage and salary increases negotiated by the social partners.

The Spanish crisis was triggered by a debt-financed real estate market boom that got totally out of hand. After a lengthy and painful correction, housing prices stabilised and are now trending moderately upwards, in a similar way as the indicators of real construction activity. However, a comparison with pre-crisis levels (Figure 2) illustrates how steep the slump was and how rocky the road to a sustainable recovery is still going to be.

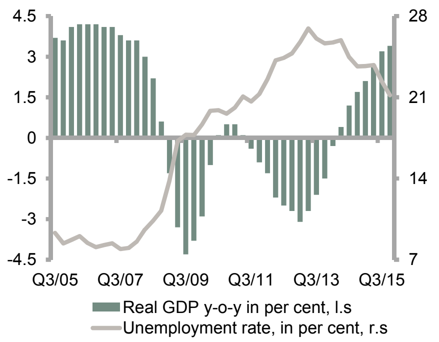
The banking sector, a major victim of the burst real estate bubble, has been stabilised thanks to national and European rescue measures. This is having an increasingly positive impact on lending to the private sector. Nevertheless, the banking sector remains burdened by a high rate of non-performing loans.

Spain, the former fiscal-policy paragon, still has some catching up to do in consolidating its budget. It has noticeably reduced its budget deficit after a significant expansion in the crisis years. For 2015, however, the deficit is still too high, at probably just under 5 % of GDP. It is not likely to fall under 3 per cent before 2017.

Outlook

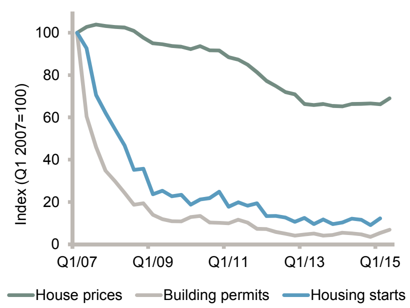
Spain is clearly on a path of economic recovery, even though it will take some time yet to cope with all consequences of the crisis. In order for it to progress on this path it will have to form a stable government after the parliamentary elections which are scheduled for 20 December. The new government will then have to quickly face the real political challenge: dealing with the Catalan separatist movement. Spain's economic success story cannot continue unless it succeeds in finding a viable solution to this issue. ■

Figure 1: Growth and labour market



Source: Bloomberg

Figure 2: Construction indicators (indexed, Q1/2007=100)



Source: Bloomberg