

October 2019

SPAIN SCENARIO 2019-2020

Sofia TOZY

“

*Spain toward a
smooth
braking ?*

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Spain

SCENARIO 2019-2020

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The Spanish economy is starting to run into some headwinds. Although its pace of growth is slowing, it remains above the eurozone average. Multiple signs of a slowdown are appearing but they are difficult to interpret and not from the expected sources. Despite the backdrop of the US-China trade war, the contribution of foreign demand has been positive thanks to a rebound in exports, while domestic demand is largely absent.

Revised figures from Spain's National Statistics Institute for 2018 and the first half of 2019 shed new light on this growth profile. The initial signs of a slowdown in household consumption appeared in the third quarter of 2018, a trend running counter to that of disposable income. Investment has held up despite the increased uncertainty inherent in the political climate at home and abroad. Activity has largely been sustained by public spending. Pedro Sanchez and the radical left have not heeded Mario Draghi's call to give in to the siren calls of a procyclical fiscal policy. Public spending went up by 2% between the government taking office in May 2018 and its fall in February 2019, constituting the biggest rise since 2010. While imports have fallen into

negative territory, the revisions have shown—somewhat surprisingly—a better performance from exports, with net exports contributing a quarter of first-half growth.

The outlook for the coming months looks gloomy, and this is not solely attributable to the turbulent international environment. With no government, companies and households are in wait and see mode, with the former postponing investments and the latter increasing precautionary saving. After Pedro Sanchez failed in his attempt to form a government in July, Spain is set to hold its second election of the year. In an already highly fragmented political arena, the explosion of the crisis in Catalonia has destabilised the landscape prevailing at the time of the April 2019 elections.

Consumer spending was very sluggish in the first half of the year. However, it should improve slightly, reflecting pay increases and levels of job creation that remain solid. However, given the slump in confidence and somewhat gloomy outlook, consumer sentiment surveys are providing cause for concern.

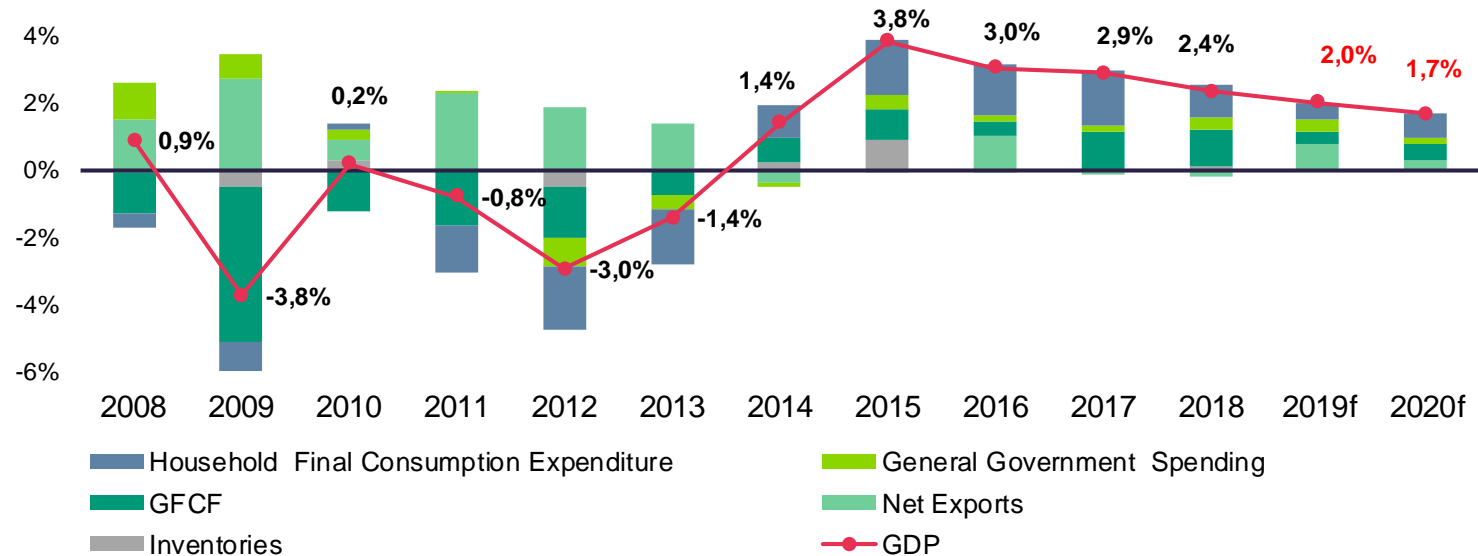
Investment fell in the second quarter, but should pick up, albeit without returning to 2018 levels. Weaker demand should continue to eat into the earnings of exporting firms, which are facing higher labour costs, unlike those focused on the domestic market. Meanwhile, the construction sector is showing signs of a slowdown, hampered by a drop in sales of new housing.

The countercyclical **fiscal policy** implemented in the first half by the Sanchez government helped offset the slowdown in the other demand components. Although it is falling, growth would support a rise in tax receipts, but the measures taken by the socialist government are likely to affect the fiscal balance. The country was recently taken to task by the European Commission, which warned it about the risk of deviation from the required fiscal adjustment. The public deficit, which is estimated at 2.2% could expand further following an increase in pensions. Despite the favourable low interest rate environment, this situation could become more concerning given the electoral timetable. The elections on 10 November will effectively postpone the budget vote to the first quarter of 2020 at best, which gives the country little room for manoeuvre in an environment in which the downside risks are multiplying.

OVERVIEW:

GROWTH IN SPAIN: A CONTROLLED SLOWDOWN?

Contributions to annual GDP growth



Sources : Eurostat, Crédit Agricole S.A / ECO

Spain	2018	2019	2020	2019				2020			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	2,4	2,0	1,7	0,5	0,5	0,4	0,4	0,5	0,3	0,3	0,4
Households consumption	1,8	0,9	1,3	0,3	0,0	0,3	0,3	0,4	0,3	0,3	0,5
Investment	5,3	2,0	2,5	0,9	-0,2	0,7	0,8	0,9	0,6	0,4	0,3
Change in inventories*	0,1	0,0	0,0	-0,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Net export*	-0,2	0,7	0,3	0,1	0,4	0,1	0,0	0,1	0,0	0,0	0,0
Unemployment	15,3	14,0	13,5	14,2	14,1	13,9	13,7	13,6	13,6	13,5	13,4
Government net lending	-2,5	-2,2	-1,9								

* Contributions to GDP growth

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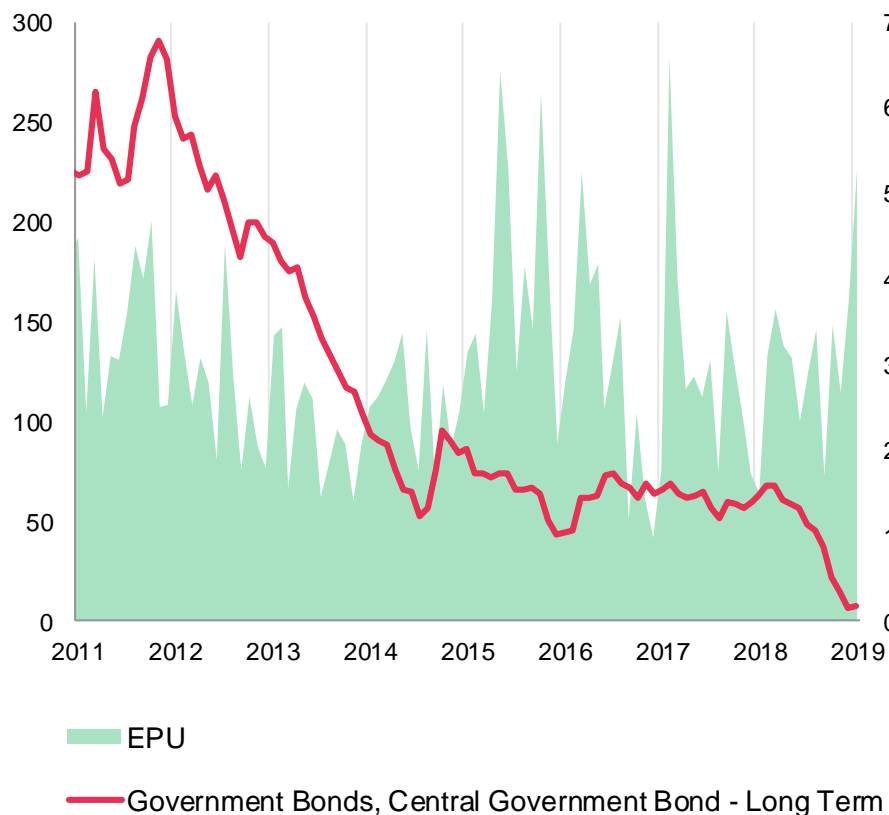
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FOCUS: ELECTIONS AMID RISING TENSIONS

IN THE AFTERMATH OF THE CATALAN TRIALS

Political uncertainty and 10-year bond yields



The events in Barcelona marked a turning point in the 'smile revolution', but had until that point been a non-violent movement. The city has seen nightly clashes following the announcement of the verdict of the constitutional court in the trial of 12 Catalan officials, who were on trial for the events of October 2017 and faced prison sentences of up to 25 years for rebellion, sedition and misuse of public funds. They received sentences ranging from one year to 13 years in prison. Aside from the marches that brought around 500,000 people to Barcelona for a huge protest on 18 October, meetings and escalations of violence have been organised by anonymous networks such as the Committees for the Defence of the Republic and the online platform Democratic Tsunami, which amassed more than 8,000 people to block Barcelona-El Prat airport. These have led to clashes between protesters and the Catalan police.

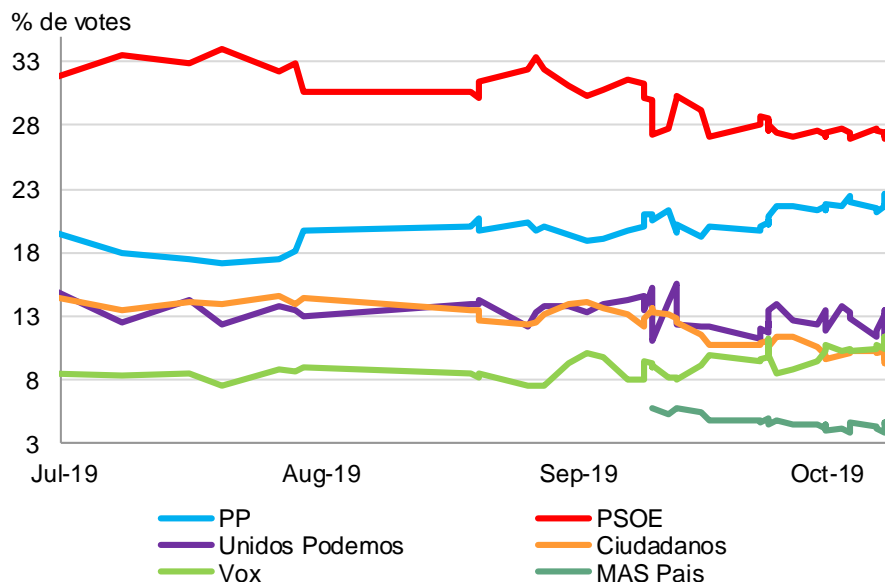
The central government has condemned these incidents in the strongest terms, while defending the sentences and saying the process had been fully transparent. Despite pressure from the PP, which favours a more radical approach, Pedro Sanchez has for now ruled out activating the national security law to take control of the regional police (the Mossos d'Esquadra) or Article 155 of the constitution, which would suspend the region's autonomy. He has also asked Catalonia's president to condemn the violence perpetrated by the radical separatist groups, which Quim Torra has so far refused to do. He remains loyal to Carles Puigdemont, who is maintaining an ambiguous position that is causing rifts among the various separatist groups, with the JxCat (Together for Catalonia) party becoming increasingly isolated. The ERC (Republican Left of Catalonia) would like fresh elections in the region, for example, but without leaving the coalition. Two events could fuel tensions further: Quim's trial for disobedience scheduled for 18 November, and the constitutional court's further arrest warrant for Carles Puigdemont based on new charges. The Belgian courts will give their verdict on 28 October.



FOCUS: ELECTIONS AMID RISING TENSIONS

- Following the unsuccessful investiture of Pedro Sanchez in July, new elections were called for November 10, 2019. The official election campaign should start one week before the vote is held. The televised debate bringing together the leaders of the main parties on 4 November will kick off the campaign.
- The Catalan crisis has reshuffled the cards in the run-up to the election. Although there is a consensus amongst constitutionalist parties around the Prime Minister, the central state's management of the independence movement is one of the dividing lines of Spanish politics. It pits the nationalist constitutionalists, who are rather on the right of the political spectrum, to the federalist constitutionalists embodied by the PSOE and also some regional parties. Both rely on the constitution and defend the sovereignty and integrity of Spanish territory in the face of what they identify as a separatist threat, but they disagree on how these claims should be tackled.
- Constitutionalists advocate a more centralized approach to the management of autonomous communities that would be a solution to annihilate any secessionist will. Federalists favor instead of the establishment of a new autonomy statute that would strengthen state federalism as a means of limiting the rise of independence. The latter is supported by some autonomous communities (Basque Country, Valencia).
- Alongside this political divide is a territorial divide between autonomous communities organized around large metropolitan areas that claim a strong territorial identity and that would benefit positively from federalization unlike the "empty Spain". However, these potential losers, who therefore recognize themselves in a more nationalistic approach although they are less populated area, are more than proportionally represented in the national parliament.
- As a result of these tensions, the crisis in Catalonia has a deep impact on national politics and is poised to disrupt its trends.
- Therefore, the violence of the events in Catalonia and the media coverage by the partisan press on both sides should have a strong influence on the election results. Beyond a legal battle, the Sanchez government is struggling for the moment to win the battle of image and words.

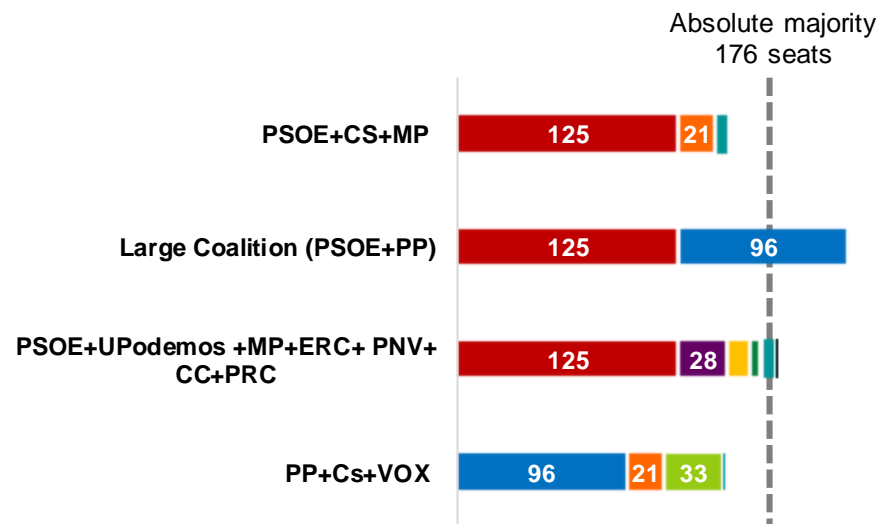
Opinion polls ahead of the 10 November elections



Sources : Electrocracia, Crédit Agricole S.A.

In the lead-up to the election, management of the crisis is crucial for Pedro Sanchez, with the Catalan issue being a key dividing line in Spanish politics. The repercussions of the events in Catalonia are starting to crystallise in the opinion polls, which show a slight change in the trends observed before the summer. PSOE is still on top (27%), but has lost ground since the emergence of Más Madrid (4%). The PP has increased its share (21%) and seems – with Vox (11%) – to have benefited from the Catalan crisis. Advocating a radical approach to Catalonia, Santiago Abascal's party could become Spain's third largest force. Ciudadanos (9%) and Unidos Podemos have not managed to make up lost ground.

The latest polls say a coalition is possible



Sources : Electrocracia, Crédit Agricole SA / ECO

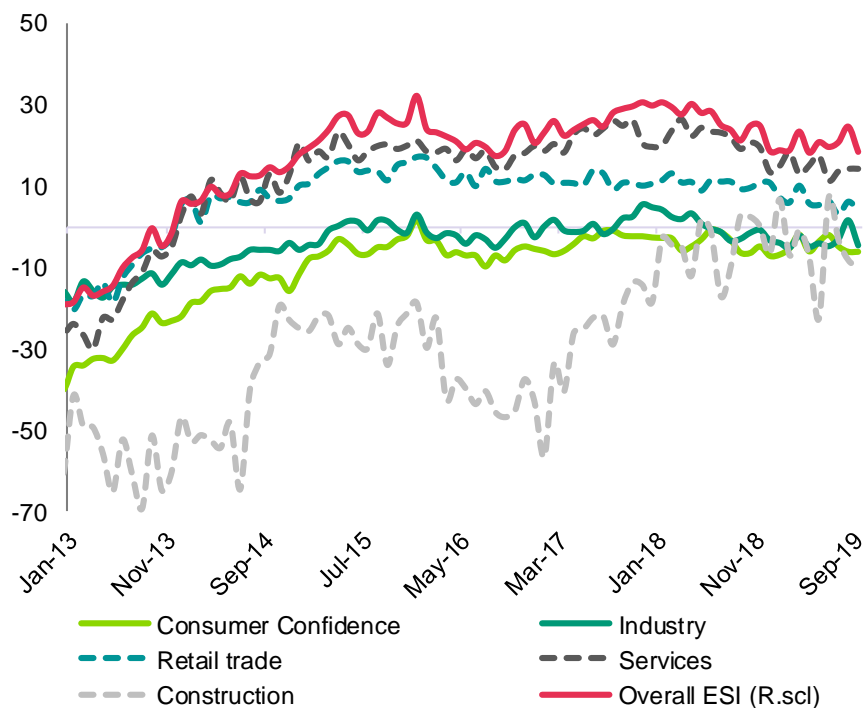
The electoral landscape appears increasingly fragmented a few weeks from the elections, and it is possible that this latest election will produce an even more divided parliament. In this environment, forming a coalition could be more difficult for Pedro Sanchez if he stays on top of the polls. He could try to form a government on a simple majority, but this will only be possible if he provides other parties with firm assurances on the Catalan issue so that they abstain. A grand coalition of constitutionalist parties with the PP could also emerge if the Catalan crisis were to intensify.

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ESI and its components

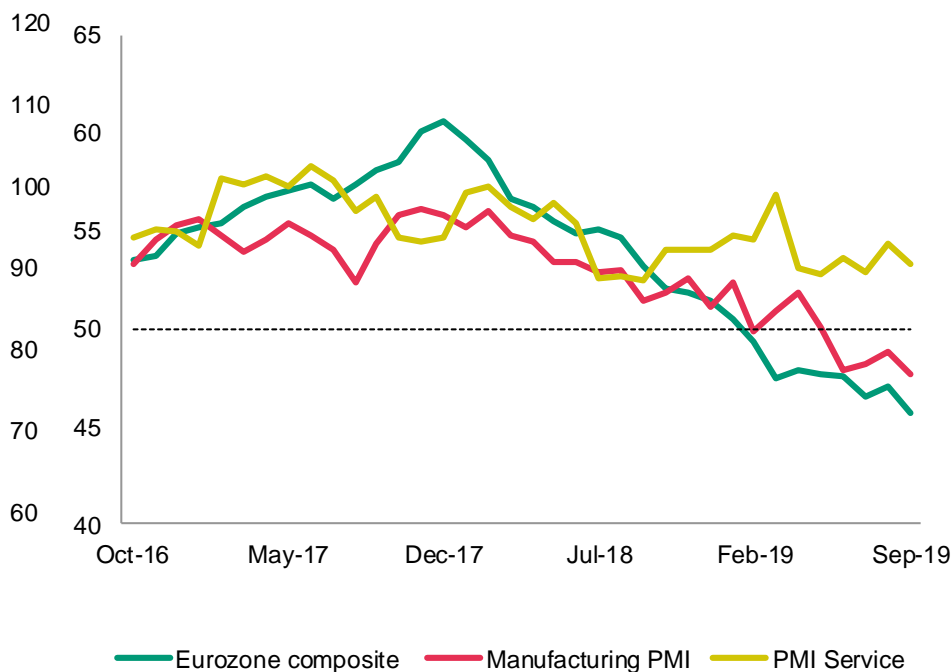


Sources : Eurostat, Crédit Agricole SA / ECO

After a slight improvement in confidence indicators this summer, the autumn is looking less rosy. The overall ESI (Economic Sentiment Indicator) increased to 107.5 in August, then fell back to 104.2 in September. With the exception of services, all the other sub-components of the indicator are deteriorating, with a marked fall in manufacturing and construction.

The manufacturing PMI, meanwhile, continues to plummet. It fell below 50 in May, and reached its lowest level since 2013 in September. Purchasing managers

Purchasing Managers Index



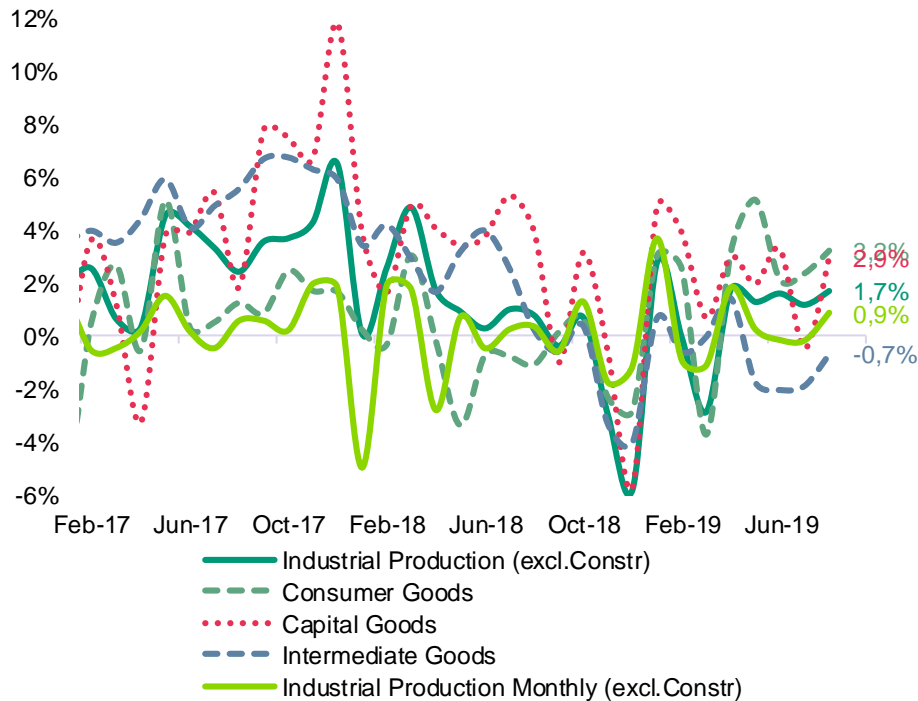
Sources : Markit Crédit Agricole SA / ECO

continue to note a contraction in production, which is leading them to shrink inventory and reduce overcapacity, particularly in terms of labour. The services PMI looks a lot better, but the downward trend started in March has continued due to a deterioration in the economic outlook and higher pay eroding profits. Although firms report that domestic demand remains resilient, they nonetheless note poorer export prospects.

RECENT ECONOMIC TRENDS

INDUSTRIAL OUTPUT AND ORDER BOOKS

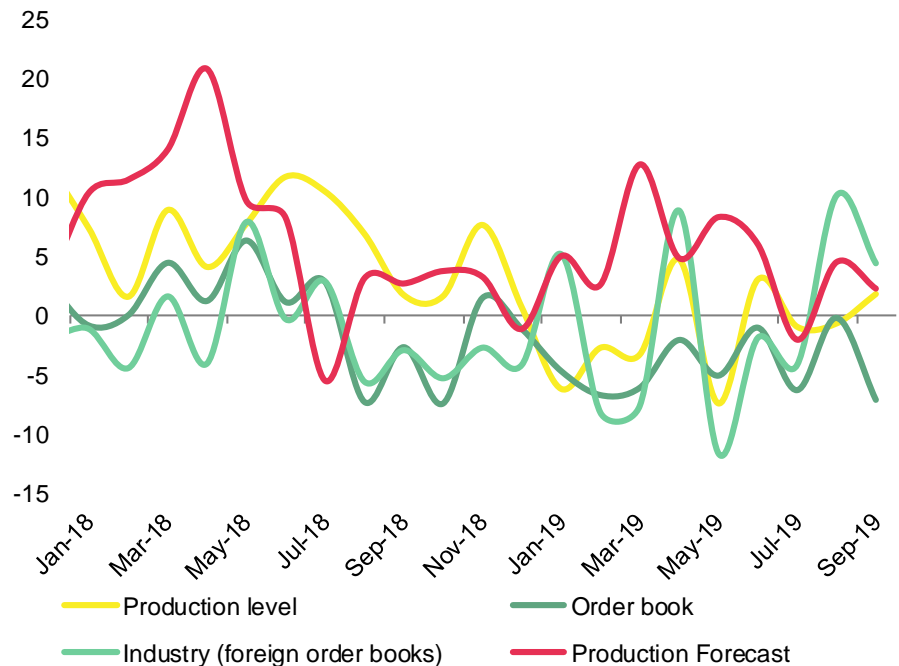
Industrial output



Sources : Eurostat, Crédit Agricole SA / ECO

Industrial output increased in August, to no great surprise, but this does not tell us much. Year-on-year, this was the fifth monthly rise in a row, with output up 1.7% at the end of the summer. On a month-on-month basis, the August increase followed two months of decline. The growth overhang for Q3 is slightly lower than for Q2, at 0.3%. By types of goods, the trends observed since the start of the summer are generally unchanged. Capital goods are continuing to drive the manufacturing sector (+2.9%), and July's dip looks to have been a blip. After a lacklustre start to the year, the uptick in consumer goods is continuing, while intermediate goods are showing signs of stabilisation.

Manufacturing survey



Sources : ICI, Crédit Agricole SA / ECO

By sector, overall we have seen a slight recovery in automotive and machinery and equipment after a somewhat difficult start to the year. The agri-food sector, which accounts for almost 11% of industrial output, continues to show a stable trend, and should maintain output levels to some extent in the coming months thanks to the favourable economic environment (price rises).

However, forecasts for the coming months leave less room for optimism. Apart from export orders, which although slowing remain high, the rest of the survey data is tinged with pessimism. Domestic order books and expected output levels point to a downturn.

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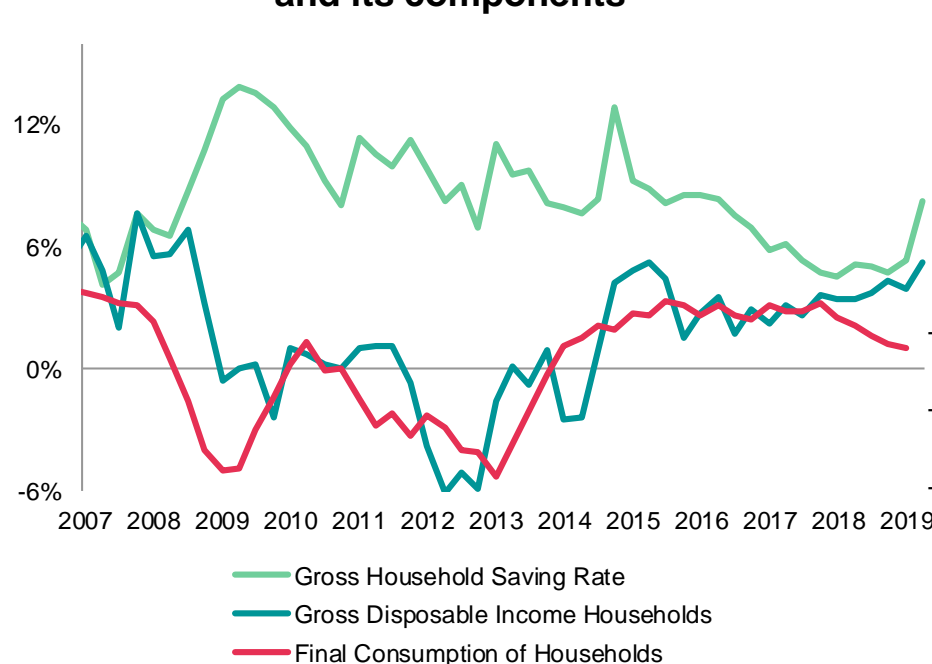
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THE BASIS OF OUR SCENARIO

HOUSEHOLD CONSUMPTION AND WAGES

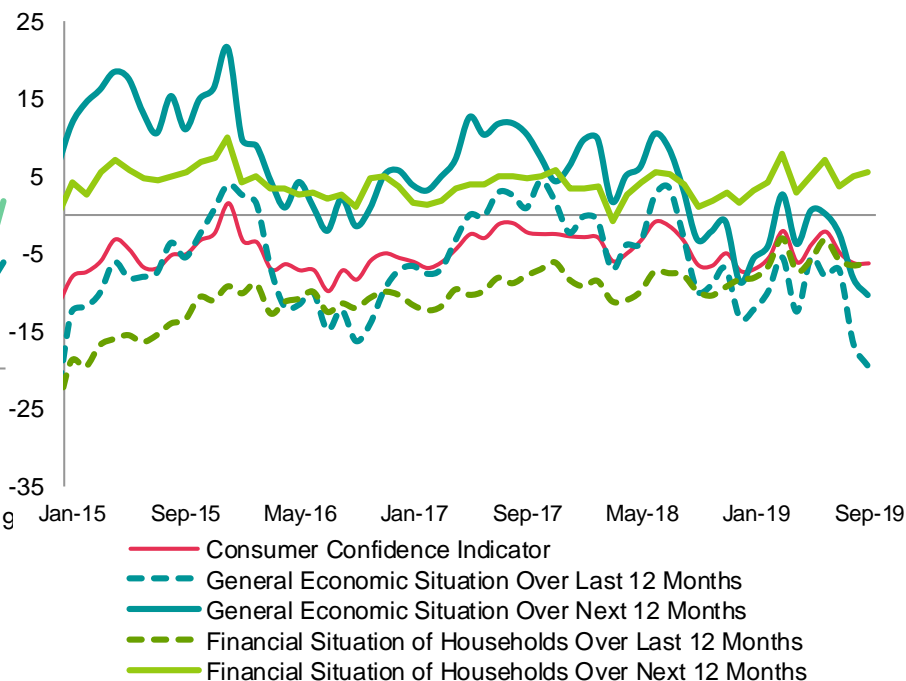
Change in gross disposable income and its components



Sources : Eurostat, Crédit Agricole SA / ECO

The low savings rate and the end of the durable goods cycle partly explains why a growing portion of disposable income is going into savings, but this is at the expense of consumer spending. The drop in household confidence seems to be reinforcing this movement, breaking with the trend seen in recent years. The National Statistics Institute's revisions provide an insight into this trend, which is becoming established. The fall in household consumption began in the second half of 2018, and has accelerated in 2019. After showing minimal growth in the first quarter (+0.2%), household consumption stagnated in the second quarter, despite a rise in disposable income (+5.4%). The savings rate stood at (8.7%) in the second quarter, its

Household survey



Sources : European Commission, Crédit Agricole SA / ECO

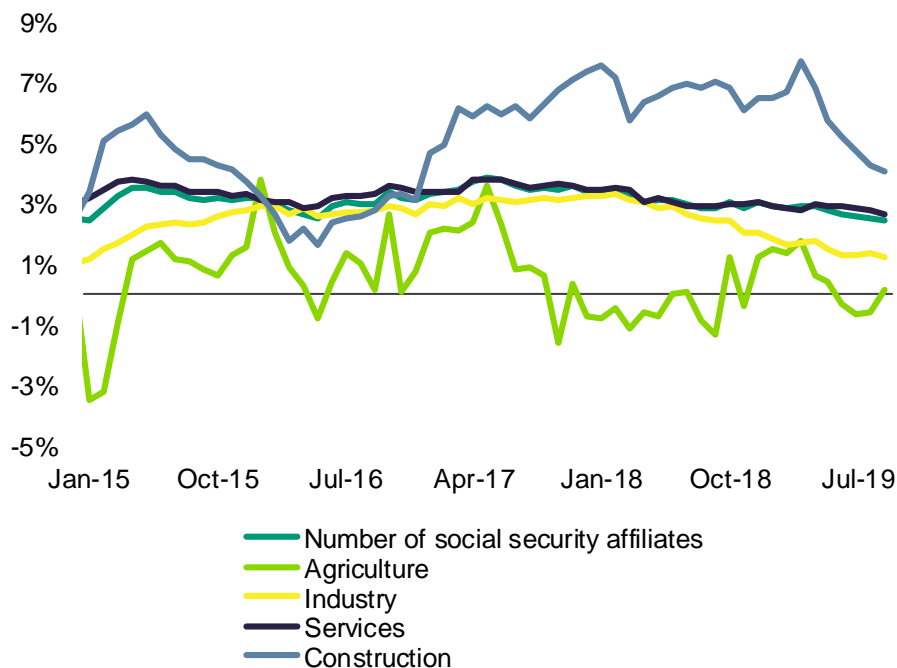
highest level since 2013.

The increase in car sales and robust retail sales data for the last three months nonetheless point to a slight improvement in consumption levels for the third quarter. Consumer credit also picked up during the summer, ending several consecutive months of falls. At the same time, surveys indicate that household confidence remains low. Moreover, the household finance and consumption survey shows financial conditions and household expectations deteriorating over the next 12 months.

THE BASIS OF OUR SCENARIO

JOB MARKET

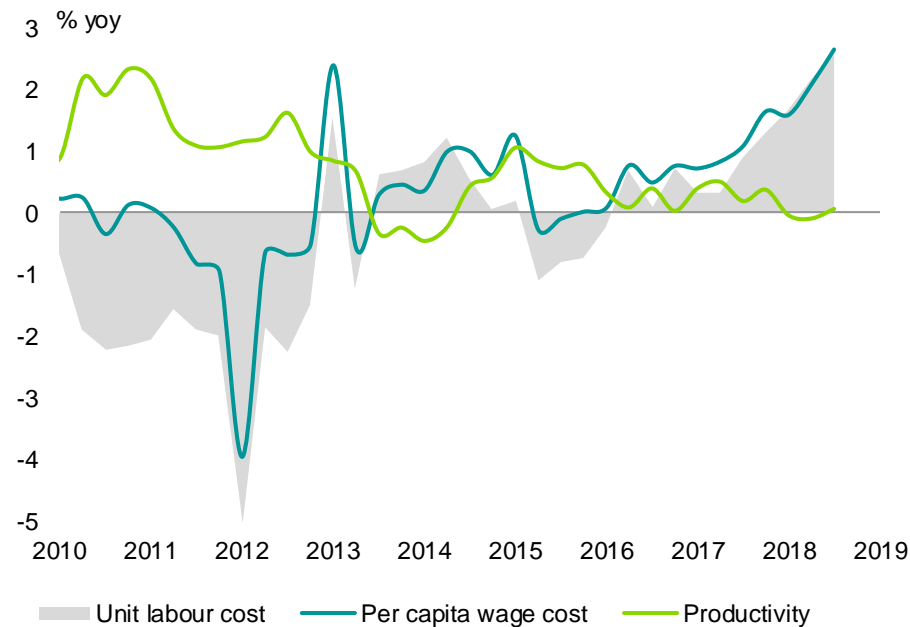
Employment: social security affiliations



Source: Ministry of Labour, Crédit Agricole SA / ECO

The labour market is still robust, although job creation has slowed. In the second quarter, job creation was up 2.4% year-on-year, 0.4% lower than in the previous quarter. There is no sign of this trend reversing in the preliminary data for the third quarter. The number of new social security claimants increased by 2.4% year-on-year in September (after 2.5% in August and 2.6% in July), the smallest rise since 2013. The unemployment rate, which stood at 14% in the second quarter, should nonetheless continue to fall.

Unit wage costs (private sector)



Latest data : June 2019

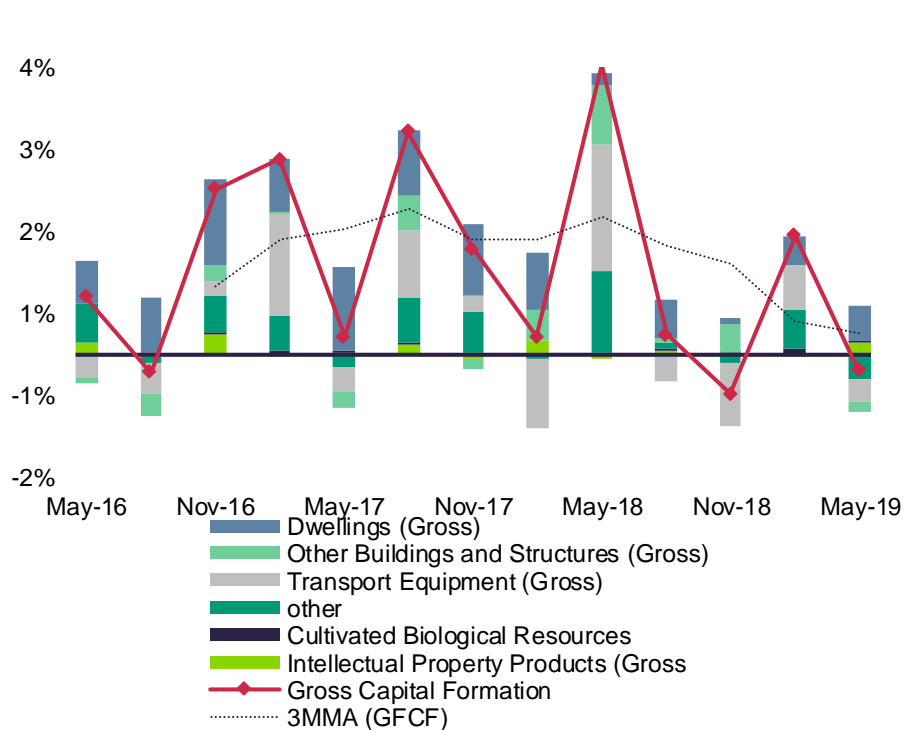
Sources :Eurostat, Crédit Agricole SA / ECO

Real wages rose by 2.5% on average in the first half, and should continue to increase, albeit at a slower pace than seen at the start of the year. Moreover, negotiated pay rises and an increase in the minimum wage explains the growth in wage income. Labour costs have increased as a result, particularly in the service sector. After rising by 2.1% in the first quarter, unit wage costs increased by 2.4% in the second quarter, to EUR 2,664.

THE BASIS OF OUR SCENARIO

INVESTMENT

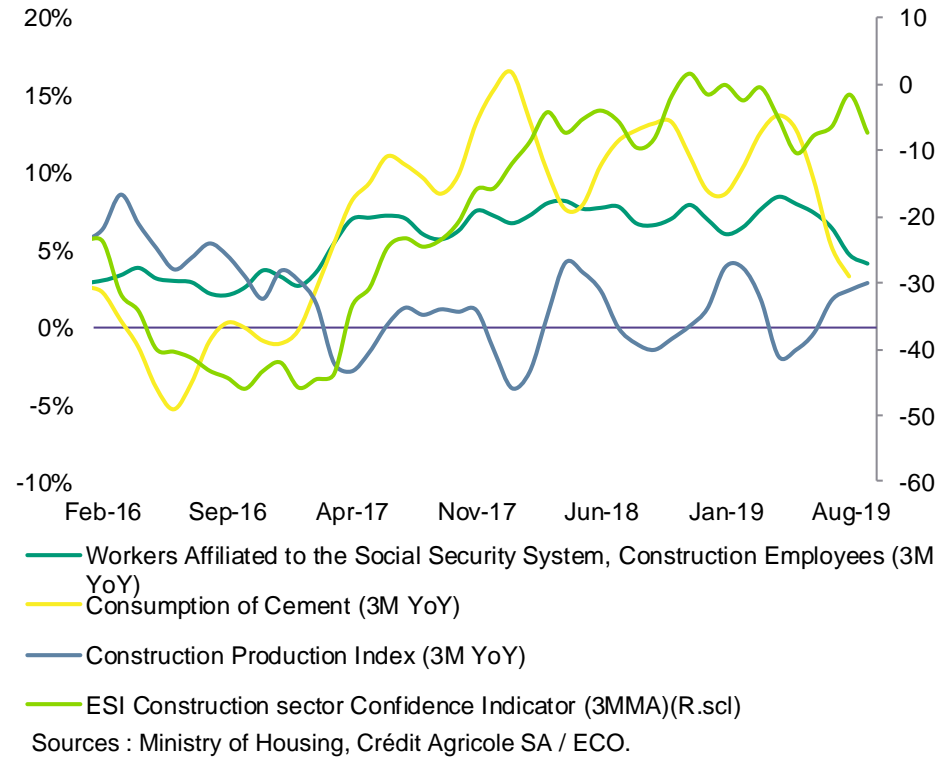
Contributors to investment



Sources : Eurostat , Crédit Agricole SA / ECO

Although investment (GFCF) was expected to slow, the contraction in the second quarter was a surprise. The cause was a drop in investment in transport and capital goods, which was not offset by the performance in housing construction, which remained positive. The rise in imports of capital goods during the summer, combined with an increase in new commercial vehicle registrations, suggests that the contraction in FBCF should be temporary and that investment will pick up in the second half – especially as financial conditions continue to be accommodative for firms.

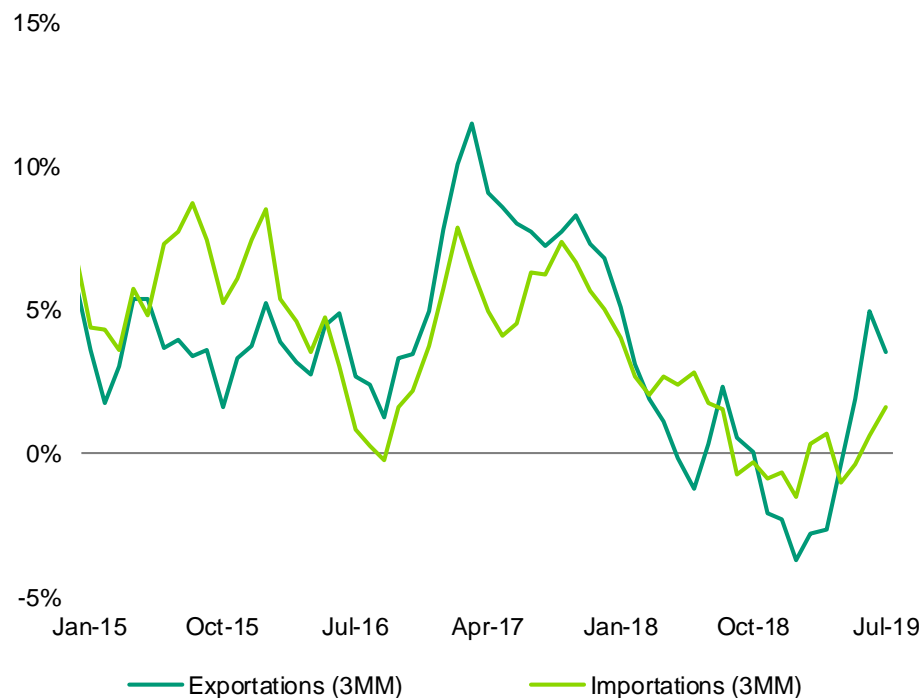
Construction sector



Sources : Ministry of Housing, Crédit Agricole SA / ECO.

Despite encouraging data, the recovery of the real estate market shows signs of petering out. Sales of housing have slowed considerably since the start of the year, and this trend strengthened during the summer. It is partly due to seasonal factors, and partly to the introduction of a new law on real estate loans that imposes stricter conditions for granting mortgages. Real estate transaction prices have also started to fall, although there are major regional differences. These developments could have a negative impact on construction: the construction output index was flat in August.

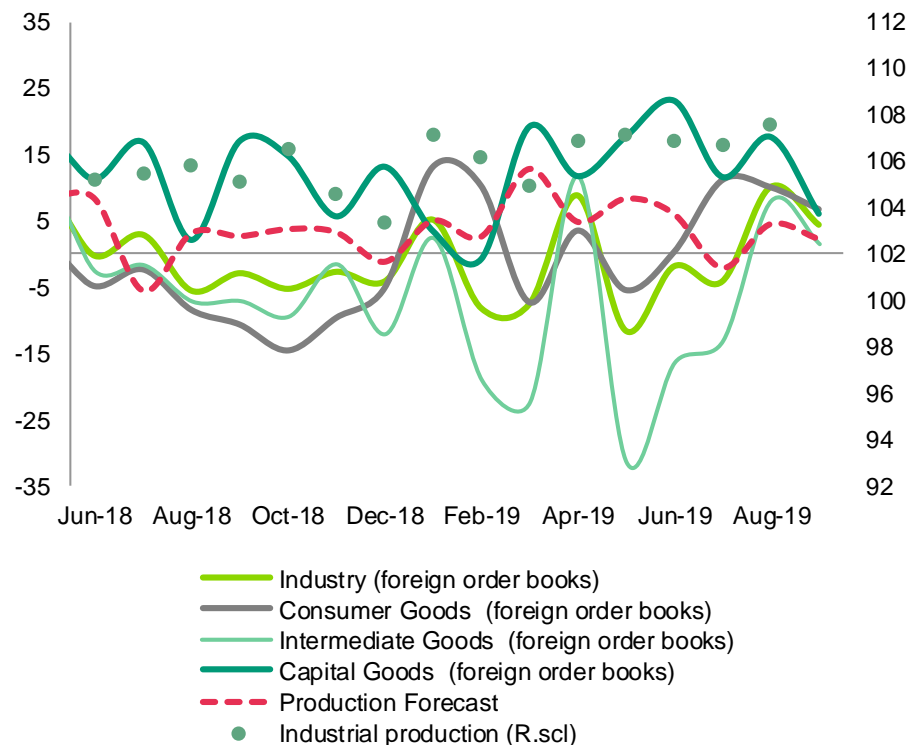
Exports and imports



Sources : Bank of Spain, Crédit Agricole SA / ECO

Although the international environment is not particularly favourable, the contribution of net exports was positive in the second quarter. The slight increase in exports was accompanied by a fall in imports. The improvement in exports should however be short lived. The Ministry of Finance's Synthetic Index of Export Activity points to a marked slowdown in exports in the third quarter, a trend reflected in export order books.

Export order books



Sources : ICI survey Ministry of Industry and Trade , Crédit Agricole SA / ECO

Meanwhile, imports should recover somewhat, with a slight improvement in domestic demand. Net exports should therefore make a smaller contribution than in the first half. A sluggish tourist season is also likely to weigh on service exports.

THE BASIS OF OUR SCENARIO

SCENARIO RISK PROFILE

Risk matrix linked to our scenario

		Probability	Impact
↓	Higher risk of ungovernability.	Moderate	High
	Fragile coalition	High	High
	Implications of Brexit on exports	Moderate	Moderate
	Trade war between China and the United States and higher protectionist risk	Moderate	High
↑	Recovery within the Euro Zone	Moderate	High

Source: Crédit Agricole SA / ECO



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