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Spain fires on all cylinders

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0.9% **Spanish GDP Growth**
Second quarter

A winning combination

The Spanish economy grew 0.9% in the second quarter. We expect growth to exceed the Eurozone average by more than 1 percentage point this year. Spanish GDP growth is not only stronger than initially expected but its resilience across quarters is also impressive. 2Q GDP growth accelerated to 0.9% QoQ (or 3.1% YoY), from 0.8% in 1Q and 0.7% in 4Q16. No detail is available but we think that the mix of robust domestic demand and expanding external demand, notably from the EU, is the winning combination that allows Spain to top the Eurozone average. The cyclical recovery observed in the Eurozone (ING forecasts 2% GDP growth in 2017 for the Eurozone) tends to reinforce the already strong recovery. Other good news is that the harmonised inflation rate increased in July, from 1.6% to 1.7% YoY, partly explained by a fall in gasoline prices in July last year.

A virtuous circle

The positive momentum Spain is experiencing remains mainly driven by it moving into a virtuous circle where job creation boosts purchasing power and demand for goods and services. This calls for new investment, makes private debt more sustainable and reduces social security costs.

> Past structural reforms might have “primed the pump”.

Recent data tends to confirm this. The quarterly labour report showed that unemployment decreased by 660-thousand over the last four quarters. An analysis of Eurozone bank lending also shows that consumer credit increased by 17% YoY in Spain, suggesting the saving rate is declining on the back of growing consumer confidence, further boosting consumption. No wonder that May industrial production of durable consumer goods increased by 13.5% YoY.

Warning signs

The downside risk for this year keeps coming from politics. The Catalonian independence struggle is an important threat that is possibly already negatively affecting business confidence. This week the regional government in Catalonia approved the procedure to fast-track a declaration of independence in 48 hours if a (still hypothetical and illegal) referendum were to end up in favour of it. The decree officially calling the vote should be approved by the regional parliament before the end of August. Looking at a recent poll by the Centre of Opinion Studies, even if the percentage of people supporting Catalonian independence decreased to 41% in June (from 44% in March), only 67.5% of the respondents said they would vote on 1 October. Abstention is more likely amongst opponents of independence and 62% of the people who said they would vote would vote in favour of independence for Catalonia. The risk is therefore not off the table and the situation is expected to drive Spanish bond yields upwards during the autumn.

Still some way to go

All in all, the economy is firing on all cylinders and the acceleration of the trend in the first half of the year leads us to revise our GDP growth forecast for 2017 from 3% to 3.2%. Spain still needs to close the negative output gap (the second largest in the OECD, after Greece, in 2017). Indeed, even if Spanish GDP has now reached its pre-crisis level, it still has to catch up on the accumulated arrears.

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