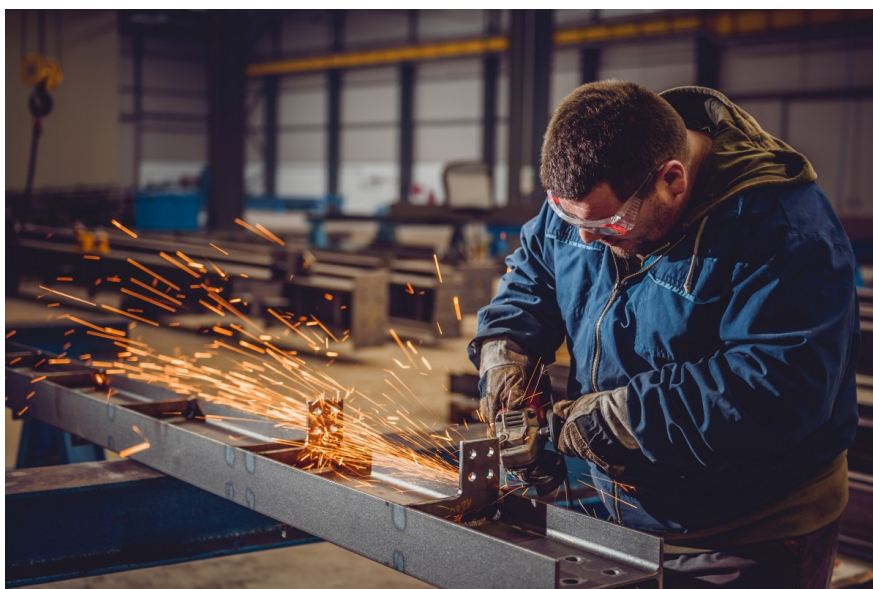


## Spain: Manufacturing sector recovers, but future upward potential limited

The sustained decline of activity in the manufacturing sector stopped, but we do not see many reasons for a sustained upward trend in the coming quarters. Four-quarter growth, on the other hand, surprised to the upside. Growth picked up due to a temporary blip in export growth

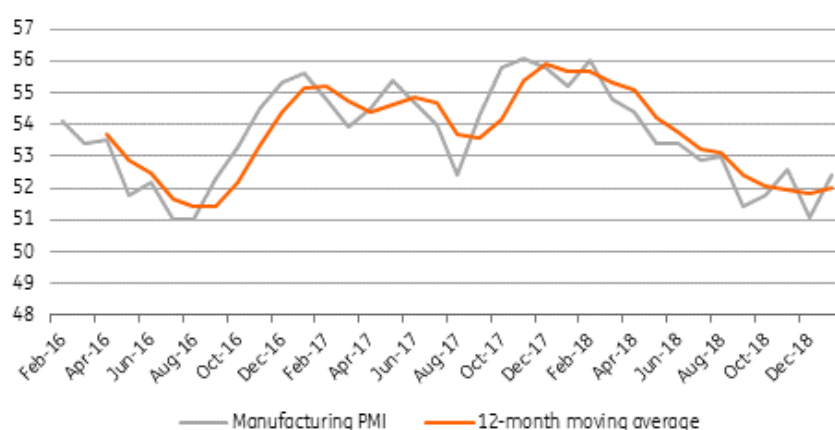


### The manufacturing sector recovers

The Purchasing Managers' Index (PMI) for the manufacturing sector recovered from 51.1 in December to 52.4 in January. Companies reported gains in production and new orders. The increase in demand came from both at home and abroad.

The indicator is quite volatile since the end of 2018 and so it is hard to read much in the January pick-up. But there is evidence that the sustained decline that started at the end of 2018 has halted. Indeed, the three-month moving average is nearly flat since October 2018.

## Downward trend is halted



Source: Thomson Reuters

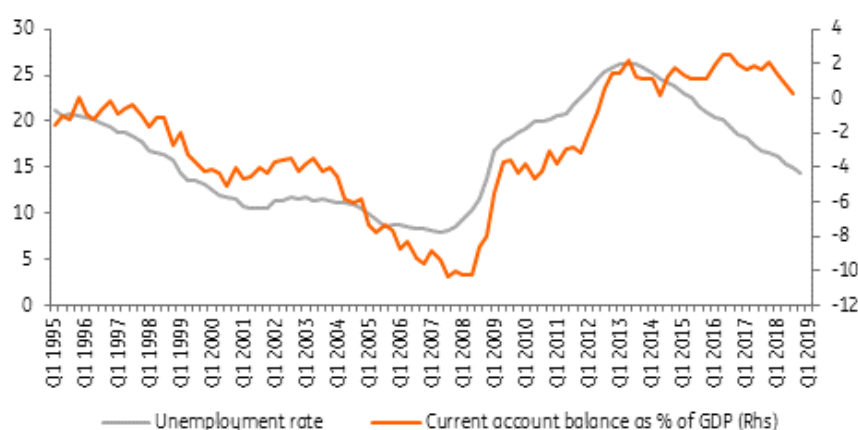
## 4Q growth surprises to the upside

The final GDP growth reading of 2018, at 0.7% quarter-on-quarter, was better than expected. It also implies an acceleration compared to the third quarter where quarter-on-quarter growth equalled 0.6%. Compared to a year ago, however, growth slowed from 3.1% in 4Q 2017 to 2.4% in 4Q 2018.

This good quarterly growth figure mainly comes from a surge in export growth, which accelerated from -0.9% quarter-on-quarter in 3Q to 1.9% in 4Q. This is surprising as Spain has faced a number of headwinds coming from abroad such as the slowdown in emerging countries and the Eurozone and uncertainty related to the trade war and Brexit. This effect, however, does show up in the year-on-year figures as export growth slowed quite significantly, from 4.2% in 4Q 2017 to 1.8% in 4Q 2018. We, therefore, regard the jump in quarterly export growth in 4Q as a one-off rebound after the contraction in 3Q. Domestic demand, on the other hand, decelerated in the fourth quarter, due to slower consumption and investment growth. Investment growth even turned negative.

Slower export growth in 2018 also caused a deterioration of the current account, but it is still in positive territory. Interestingly, the correlation between unemployment and the current account balance as a percentage of GDP broke down after the Eurozone crisis, implying gains in competitiveness (Spain rose from 36th place on the global competitiveness index in 2012 to 26th in 2018). Indeed, during the crisis, the current account balance turned positive, but this was mainly due to less import on the back of a contraction of domestic demand. After the Eurozone crisis and while Spain was growing at a fast pace, the current account balance remained positive and hovered around 2% of GDP.

## A structural improvement of the current account balance



Source: Thomson Reuters

Looking ahead, we continue to expect slower growth in 2019. The world economy is already slowing. On top of that, the trade war could intensify and Brexit uncertainty will probably continue for some time with a possible hard Brexit still on the table. Domestically, we see that labour is increasingly seen as a limiting factor to production in the services industry. The 2019 budget is also still not approved by parliament, limiting the government to stimulate the economy.

All in all, we continue to forecast 2% growth in 2019 and 1.6% in 2020.