

Spain Q4: Still optimistic on 2017, but heightened political risk

Growth may have weakened in the third quarter but could rebound in the next. However, political risks have heightened considerably



Source: Partido Popular de Cantabria

A strong second quarter

In 2Q17, the Spanish economy accelerated further, growing at 0.9% QoQ and outpacing the Eurozone by 0.3ppt. Moreover, with the publication of those figures, Spanish GDP finally breached the level last seen in the first quarter of 2008. The strong growth performance was driven by strong private consumption and a positive contribution from net exports. Private consumption increased by 0.5% QoQ, better than the 0.3% observed in 1Q. Net exports contributed 0.3ppt to growth as exports stagnated and imports decreased by 0.9% QoQ. Investment growth decelerated sharply to 0.4% QoQ, not unusual given the very strong result of 2.5% QoQ in 1Q.

0.9%

Spanish GDP Q2 (QoQ)

up from 0.8% in 1Q

Private consumption on a roll

It is not surprising that private consumption keeps growing fast. Given the declining unemployment rate and low inflation, consumers can enjoy greater spending power. The unemployment rate dropped by a further 0.9ppt to 17.3% in 2Q and inflation declined to 1.7% in 2Q from 2.0% in 1Q. This is also reflected in high consumer confidence.

17.3% Spain unemployment rate (Q2)
Dropped 0.9ppt

Third quarter expected deceleration

Figures for Q3, however, point to a slight deceleration in economic activity. The PMI averages for 3Q for the service and manufacturing sectors for the third quarter fell vs 2Q. Hard data also points to a potential slowdown in this quarter. Industrial production growth, for example, declined from 2.6% YoY in May and June to 1.9% YoY in July and 1.8% in August. Furthermore, the decline in the monthly unemployment rate seems to have stalled. For two months in a row, July and August, the unemployment rate stayed at 17.1%. This hasn't happened since mid-2013.

Even though 3Q could show a deceleration, we remain optimistic for 4Q. While the PMIs declined on average in 3Q, this was mainly due to a sharp decrease in August. PMIs rebounded in September and this is a good sign for 4Q. A big unknown is how the current crisis in Catalonia will affect the final quarter of 2017 and performance of 2018.

Political tensions

The last couple of weeks have seen the relationship between the central government of Spain and the regional government of Catalonia deteriorate severely. At the time of writing, the Catalan crisis still introduces a lot of uncertainty and is obviously an important downward risk for the Spanish economy. Nevertheless, we must not overestimate the potential effects. Spain also had political difficulties in 2016, but the economic recovery continued. We still believe that ultimately compromise will prevail. Growth should, therefore, remain robust in 2018, though we do not believe that a continuation of above-3% growth is sustainable.

Even though political risks have risen sharply over recent weeks, financial markets did not react much and seem already more at ease. The Spanish 10Y bond yield rose towards 1.80% but fell to pre-referendum levels when the sharp statements by the Catalan Government were moderated.