

## Spain: Staying strong

After a stronger than expected first half of the year, we expect a modest easing of growth in Spain. We raised our 2019 GDP forecasts to 2.2% from 2.0%, but we continue to forecast 1.5% for next year



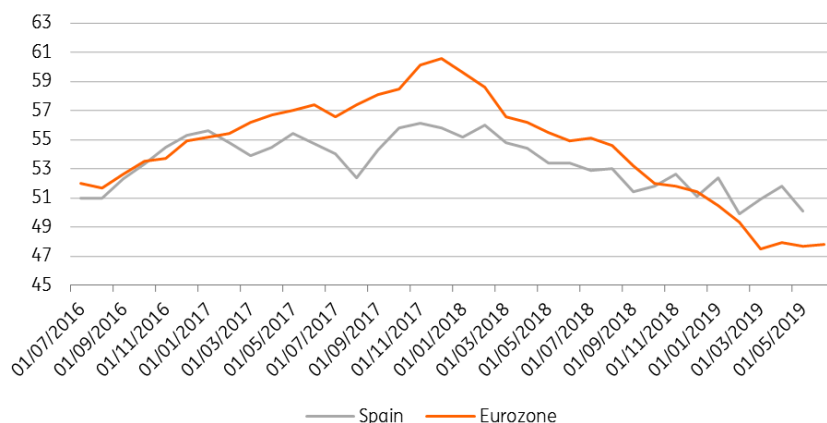
Spanish Prime Minister, Pedro Sanchez, is still trying to form a government

### First-half growth surprised

The first half of the year surprised to the upside in Spain. First quarter growth increased to 0.7% quarter-on-quarter, from 0.6% in 4Q of 2018. High-frequency data of the second quarter also points to solid growth. Unemployment continues to decline, supporting consumption, and consumer sentiment stabilised after a fall at the beginning of 2018.

Businesses, however, see it a little less rosy. The manufacturing sector in particular flirts with contraction as the PMI for the manufacturing sector is close the 50. The weakness mainly lies in the investment goods sector, while growth in the consumer goods sector is still solid. A weaker overall manufacturing sector, however, is not only a Spanish problem as we see this phenomenon in many Eurozone countries.

## A weaker manufacturing sector



Source: Thomson Reuters

## Unemployment, debt and fractured politics

For the second half of the year, we expect an easing of economic growth compared with the first. Confidence in the future by businesses edged lower over the past few months and there are signs of faltering demand. Uncertainty also remains high, given the domestic political situation, Brexit and the trade war. Given the strong start of the year, however, we do revise our annual growth forecast for 2019 to 2.2% from 2.0%. For 2020 we continue to forecast 1.5% growth.

Compared with the eurozone as a whole, the macroeconomic situation in Spain is quite rosy as it remains one of its fastest growing economies.

The two key macroeconomic problems that continue to plague Spain are the high level unemployment and government debt. These two indicators are moving in the right direction, but they're still high compared to other eurozone countries and when you look at pre-2008 levels.

Concerning fiscal policy more broadly, the European Commission recently decided the excessive deficit has been corrected and that Spain now enters the preventive arm of the Stability and Growth Pact. It should therefore continue its efforts to reduce the debt level at a sufficient pace and to respect the expenditure benchmark. Under unchanged policies, Spain is not projected to comply with the requirements of the transitional debt rule in 2019 and 2020. It is therefore important that a new government could tackle this issue. But since the general elections in April, a new government still has to be formed.

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### *We don't rule out another election*

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Currently, Pédro Sanchez, the Socialist Prime minister and the winner of the elections, is talking to other political parties. There are a number of options. He could lead a minority government, with or without Unidas Podemos with case-by-case support. There is also talk of a coalition with the liberal Ciudadanos. This set-up would have enough seats to form a majority, but so far we judge this as unlikely. The Ciudadanos leader, Albert Rivera, said that Sanchez should form a government with his partners, such as Unidas Podemos and small regional parties.

Given all this highly uncertain political environment, we don't rule out new elections should Sanchez fail to form a new government. Businesses don't like this situation but financial markets are yet to appear too concerned. The 10Y government bond spread with Germany, for example, declined fairly substantially after the April elections.

This article is taken from the Eurozone Quarterly, which you can find [here](#)

## 10Y government bond spread with Germany declined



Source: Thomson Reuters

## The Spanish economy in a nutshell (%YoY)

### The Spanish economy in a nutshell

	2018	2019F	2020F	2021
GDP	2.6	2.2	1.5	1.3
Private consumption	2.4	2.2	1.6	1.5
Investment	6.0	3.4	2.3	2.0
Government consumption	2.0	1.7	1.2	0.7
Net trade contribution	-0.3	-0.2	-0.1	-0.2
Headline CPI	1.7	1.1	1.3	1.5
Unemployment rate (%)	15.3	13.6	13.0	12.5
Budget balance as a % of GDP	-2.5	-2.3	-2.2	-2.1
Government debt as a % of GDP	97.1	96.3	95.9	95.4

Source: Thomson Reuters, ING forecasts