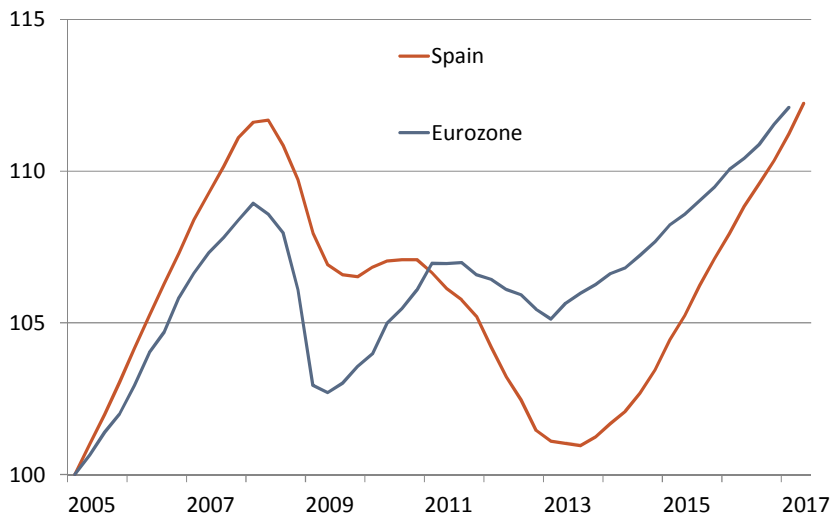


28 July 2017

## Southern comfort – Spain is catching up fast

Spanish and Eurozone real GDP, rebased to Q1 2005=100



Real GDP rebased to Q1 2005 = 100; Eurozone GDP corrected for the one-off bounce in Irish GDP in 2015 caused by asset transactions of multinational companies in Ireland. Source: Eurostat, INE

- **Spanish rollercoaster:** Like the US and the UK, Spain lived through a credit-fuelled real estate boom in the years before 2008 only to suffer a sharp correction afterwards. Unlike the US and the UK, it went through a deep secondary crisis when the ECB hesitated to take on the role of lender of last resort, which the US Fed and the BoE had assumed by making major asset purchases in 2009. The turmoil of 2011 and 2012 pushed the entire Eurozone into recession, with Spain and other countries at the Eurozone periphery falling far behind the average for the region.
- **Better late than never:** Five years ago, in late July 2012, ECB president Mario Draghi finally stopped the rot by vowing to do “whatever it takes” to preserve the euro. With the usual lag for major monetary impulses, Spain and the Eurozone started to recover from mid-2013 onwards.
- **Spectacular rebound:** Supported by serious domestic reforms and ongoing progress in stabilising the banking system, Spain continues to rebound at a fast pace. The 0.9% qoq gain in Q2 2017 GDP adds to a string of positive surprises. As a result, we raise our forecast for Spanish GDP growth from 3.0% to 3.1% for 2017 and from 2.8% to 2.9% for 2018.
- **Stronger growth throughout the Eurozone:** The good news is not confined to Spain. The further rise in the European Commission’s Economic Sentiment Index for the Eurozone in July 2017 to its best level since August 2007 indicates further solid growth ahead for the region as a whole.
- **Forecast changes:** Following a string of positive sentiment indicators and an encouraging result for Q2 GDP in **France** (0.5% qoq), we lift our growth calls by 0.1ppt pa for France, projecting 1.7% for this year, followed by 1.8% in 2018 and 1.9% in 2019. If Emmanuel Macron delivers a full set of economic reforms, France could do even better than that. For **Germany**, we now expect 2.0% instead of 1.9% growth in 2017. For the **Eurozone**, we now look for 1.9% instead of 1.8% growth in 2018. The risk to our 2.0% growth forecast for the region for 2017 remains tilted to the upside.
- **Gradual healing:** On current trends, Spain will have made up all the ground it had lost relative to the Eurozone average since early 2005 by late 2018. Of course, it will take time for the scars to heal. At 17.7% in May 2017, Spanish unemployment is still far above the 9.9% rate of early 2005, whereas the 9.3% unemployment rate in the Eurozone is almost back to where it was 12 years ago at 9.2%. For good reasons (no more housing bubble, please), the labour-intensive construction sector remains much smaller in Spain than it was in 2007. However, following the upswing in the real economy, with a lag, Spanish unemployment is at least coming down fast. Having peaked at 26.3% in early 2013, the rate is now declining by almost 2.5ppt pa.
- **Beyond Spain:** With the sad exception of Greece where the government is still not implementing required reforms as diligently as it should, all other countries at the Eurozone periphery that had once asked for help (Spain, Portugal, Ireland and Cyprus) are now among the growth leaders in the Eurozone. Despite some serious flaws including some excessive upfront austerity, the recipe of reforms and fiscal repair has worked in the end.

# Economics

## Chart of the week



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