

THE RESILIENCE OF THE SPANISH ECONOMY TO THE DOWNTURN IN THE EXTERNAL ENVIRONMENT

In 2018, Spain's GDP growth (2.6%) was not very different from the Banco de España's December 2017 projection (2.4%) (see Charts 1 and 2). However, its composition did differ notably from the expected one. Specifically, the contribution of net exports to GDP growth was 0.7 pp less than expected, while domestic demand contributed 0.8 pp more, a surprise to which private consumption and public consumption contributed 0.2 pp each, and to which investment in capital goods, in housing, in other

construction and in stockbuilding contributed 0.1 pp each. By contrast, in the euro area, to the more-negative-than-expected behaviour of exports was added a surprise of the same sign in domestic demand, which gave rise to GDP growth of 1.9%, down 0.4 pp from the projection.¹

There are many possible explanations of why activity and domestic demand held up more strongly in Spain, while weakening in the euro area. It is useful to group them into

Chart 1
SPAIN (ES) AND EURO AREA (EA):
GDP AND DEMAND COMPONENTS IN 2018
Annual average growth rates and contributions

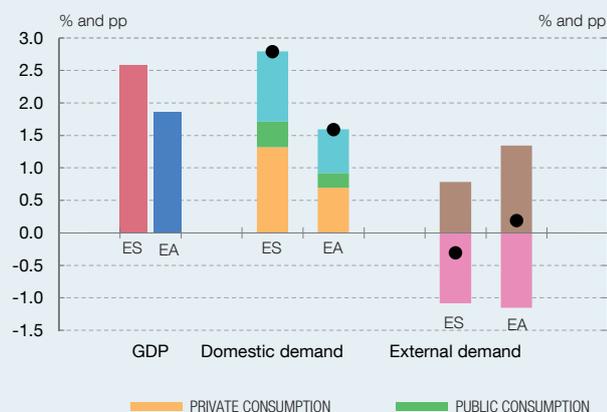


Chart 2
SPAIN (ES) AND EURO AREA (EA):
DIFFERENCES BETWEEN OBSERVED GDP AND DEMAND COMPONENTS
AND THEIR DECEMBER 2017 PROJECTIONS
Annual average growth rates and contributions

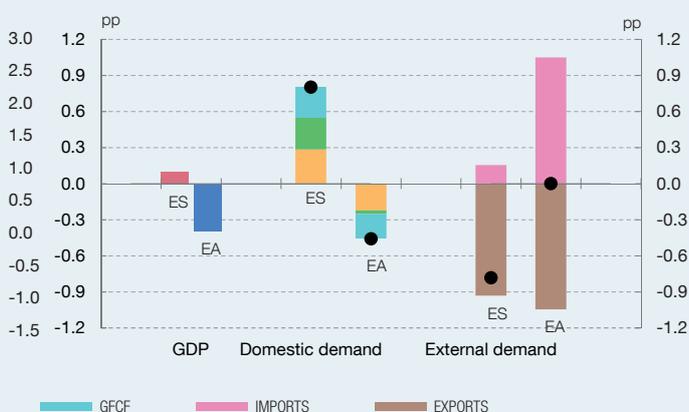


Chart 3
SPAIN AND EURO AREA: BEHAVIOUR OF VARIOUS VARIABLES
Growth rates and levels as a percentage of gross disposable income and of GDP
Real year-on-year rates of change

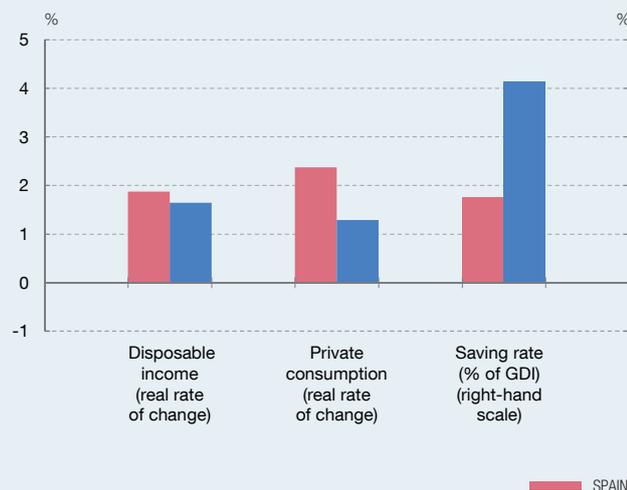
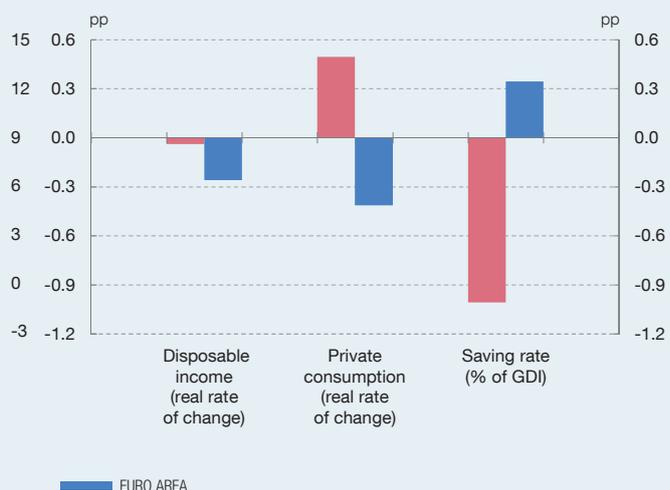


Chart 4
SPAIN AND THE EURO AREA:
DIFFERENCES BETWEEN OBSERVED VALUES AND THE DECEMBER 2017



SOURCES: INE, ECB and Banco de España.

1 See ECB (2019), *ECB staff macroeconomic projections for the euro area, March 2019*, and ECB (2017), *December 2017 Eurosystem staff macroeconomic projections for the euro area*.

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two categories. First, the two economies may have been affected asymmetrically by common shocks. Second, idiosyncratic factors of various types may have acted only on one of them.

Starting with the first type of factors, the observed divergences might be explained partly because the surprises in the set of common assumptions made in the projections affected Spain differently from the euro area as a whole. Among these surprises, last year there was a notable unexpected deceleration in the external markets which, although detrimental to both economies, may have had more severe effects on one of them, either because its exports were comparatively affected to a greater extent or because the internal component of its demand was impacted more severely.

In 2018, Spain's export markets grew 1.9 pp less than projected in December of the previous year (see Table 1). Taking the average of the three largest euro area countries (Germany, France and Italy), that difference was smaller (1.2 pp). This is explained by the greater relative weight, within the Spanish external markets as a whole, of those which surprised by the greater extent of their slowdown. Furthermore, according to the simulations conducted using the models of the related national central banks, the impact on GDP growth of a 1% fall in external demand would be 0.18 pp at the end of one year, both in Spain and in the case of the average of the three countries considered. Therefore, given this elasticity, the worse behaviour of the respective external demands would have given rise to a

decrease in the rate of change of GDP of 0.3 pp in the case of Spain and of around 0.2 pp in the average for the other three countries.² In addition, the negative impact on GDP and domestic demand of the higher oil prices with respect to those anticipated at the end of 2017 was very similar in the four countries considered (see Table 2), while the overall effect of the other surprises on the variables conditioning the projections was practically zero in all cases. Consequently, the asymmetric effects of the common shocks do not seem to be able to explain why GDP and domestic demand were subjected to positive surprises in Spain, in contrast to those of negative sign in the three largest countries of the euro area.

The idiosyncratic factors constitute, by their very nature, a highly heterogeneous category. First, throughout 2018 various unforeseen circumstances crystallised which, in an unexpected and mainly temporary manner, adversely impacted the main economies of the euro area, but did not directly affect Spain.³ Second, Spain's fiscal policy was more expansionary than expected in December 2017. Specifically, the most recent estimates, made in the context of the formulation of the March 2019 macroeconomic projections, point to a worsening of the primary structural balance between 2017 and 2018, compared with the zero change expected in December 2017.

According to the simulations made using the Banco de España quarterly model, the size of the contribution of the expansionary discretionary measures to GDP growth in 2018 was roughly between 0.2 pp and 0.3 pp.⁴

² Additionally, the more-unfavourable-than-expected behaviour of the export markets seems to have had a negative impact of 0.1 pp on the growth of domestic demand both in Spain and in the average of Germany, France and Italy.

³ At the beginning of the year, these factors included bad weather, flu epidemics in northern and central Europe and some sectoral strikes in this specific case of Germany (see Box 2, "Has the slowdown in economic activity in the euro area been a result of permanent or temporary factors?", *Economic Bulletin*, 2/2018, Banco de España). From spring, Italy was affected by uncertainties over the course of its economic policies, the consequence of which was to raise the cost of financing of that economy. Immediately after summer, the difficulties of automobile manufacturers in adjusting their supply to the new pollutant emissions regulations gave rise to a weakening of this industry's production (see Box 4, "Impact of the new emissions regulation on the automobile market", *Economic Bulletin*, 4/2018, Banco de España). However, Spain has not been immune to this latter circumstance, which particularly harmed Germany, while, by contrast, its impact on France was comparatively smaller. In the final stretch of the year, social unrest seems to have lowered GDP growth of the French economy by a few tenths of a percentage point.

⁴ These estimates are sensitive to the assumption made about the propensity to consume of the households which most directly benefitted from the measures to increase employment, wages and public transfers and to reduce certain taxes, included in the 2018 State budget. In any event, an accurate estimate of the impact of the budgetary policy stance on activity in the short term is subject to a high degree of uncertainty, since it depends on numerous factors, including the specific circumstances of the economy. Specifically, the literature reports that the value of the fiscal multipliers tends to be higher in the vicinity of an effective floor on interest rates and tends to be lower in a cyclical upturn. Both these circumstances existed in the Spanish economy in 2018, although it is not easy to determine the net impact of them.

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Third, the behaviour of households in Spain in 2018, in terms of their spending and saving decisions, differed significantly both from that expected before the year began and from that observed in the euro area. Specifically, the private consumption growth of 2.3% in real terms exceeded by 0.8 pp that of income, giving rise to a decrease in the saving rate of 0.6 pp (see Chart 3). These developments contrast notably with the projections made in December 2017, which predicted that the saving rate would rise in 2018 by 0.1 pp, against a background of lower consumption growth (see Chart 4).⁵ By way of

illustration, an exercise using the Banco de España quarterly model – which simulates less expansionary household spending replicating the initially projected increase of 0.1 pp in their saving rate – leads to GDP growth which is around 0.4 pp lower in 2018.

The decrease in the saving rate in Spain, its unanticipated nature and the different behaviour of this variable from that in the euro area may have many distinct causes, some of which suggest the presence of certain limits on the ability of households to maintain in the future the

Table 1
EXTERNAL MARKETS IN 2018: IMPACT ON GDP GROWTH AND CONTRIBUTION OF DOMESTIC AND EXTERNAL DEMAND

	Market growth in 2018 (%)			Impact (pp) on...		
	Expected in December 2017 (1)	Observed in March 2019 (2)	Difference (pp) (2) – (1)	GDP	Domestic demand (contrib.)	External demand (contrib.)
Spain	5.0	3.1	-1.9	-0.3	-0.1	-0.2
Average (Germany, France and Italy)	4.8	3.5	-1.2	-0.2	-0.1	-0.1
Germany	4.5	3.5	-1.0	-0.4	-0.1	-0.3
France	4.9	3.6	-1.3	-0.1	-0.1	-0.1
Italy	4.9	3.5	-1.4	-0.1	-0.1	-0.1

SOURCES: INE, ECB and Banco de España.

Table 2
IMPACT (IN PERCENTAGE POINTS) OF VARIOUS FACTORS ON GDP GROWTH AND CONTRIBUTIONS OF DOMESTIC AND EXTERNAL

	Oil prices			Other variables (a)		
	GDP	Domestic demand (contrib.)	External demand (contrib.)	GDP	Domestic demand (contrib.)	External demand (contrib.)
Spain	-0.06	-0.10	0.04	0.02	0.00	0.02
Average (Germany, France and Italy)	-0.06	-0.09	0.03	0.01	-0.01	0.03
Germany	-0.09	-0.13	0.04	0.03	0.00	0.03
France	-0.03	-0.05	0.02	0.01	0.00	0.01
Italy	-0.06	-0.10	0.04	0.01	-0.03	0.03

SOURCES: INE, ECB and Banco de España.

a Including exchange rates, interest rates and stock market prices.

⁵ Although the income growth of households in the three main economies of the euro area was similar to that in Spain, their consumption was much lower, giving rise to an increase of 0.4 pp in their saving rate, somewhat higher than the projection a year earlier.

dynamism recently shown by their consumer spending.⁶ Moreover, the decrease in the saving rate throughout the recovery has been accompanied by an increase in the proportion of consumption financed by credit⁷ and hence paid for out of future income. This points to the possibility that some agents may perhaps be overestimating somewhat their future income, which in turn increases their vulnerability to potential adverse shocks.

In conclusion, the factors underpinning growth in Spain in 2018 included an expansionary budgetary policy stance and a high household propensity to spend. This analysis

thus advises caution in extrapolating to the future the stronger behaviour of the Spanish economy relative to its main partners in the euro area. First, the achievement of higher short-term growth at the expense of putting off the required consolidation of public finances (observable basically from 2015) may entail certain additional costs in the future, as noted in Section 4.2.2 of this chapter. Second, the low saving rate, the fact that the household sector is a net borrower (i.e., its saving is insufficient to finance its investment) and the high growth of consumer borrowing point to a possible future moderation in the rate of growth of household spending.

6 The more benign explanations include a possible greater impact in Spain of the composition effects. These are associated with the fact that new labour market entrants have a higher propensity to consume or the possibility that the persistence of the process by which the pent-up demand during the crisis was being satisfied may be higher than had been supposed. These factors probably have a lower impact in other economies of the euro area. See [Chapter 1 of the 2017 Annual Report of the Banco de España](#) for a description of the factors explaining the behaviour of the household saving rate in the past decade.

7 See Box 7, “Recent developments in the consumer credit market in Spain”, *Economic Bulletin*, 3/2018, Banco de España.