Atradius

Managing risk, enabling trade

Atradius County Report

Spain – September 2014

Overview

General information

Capital:	Madrid
Government type:	Parliamentary monarchy
Currency:	Euro (EUR)
Population:	46.5 million

Most important sectors (% of GDP, 2013)

Services:	70.3 %
Industry:	26.4 %
Agriculture:	3.3 %

Main import sources (2013, % of total)

Germany:	12.1 %
France:	11.7 %
Italy:	6.2 %
China:	5.6 %
The Netherlands:	5.0 %

Main export markets (2013, % of total)

France:	16.8 %
Germany:	10.6 %
Portugal:	7.8 %
Italy:	7.4%
UK:	7.1 %

Key indicators	2011	2012	2013	2014*	2015*
Real GDP growth (y-on-y, % change)	0.7	-1.6	-1.2	1.2	1.9
Consumer price inflation (y-on-y, % change)	3.2	2.4	1.4	0.3	0.9
Real private consumption (y-on-y, % change)	-0.1	-2.8	-2.1	1.5	1.6
Retail sales (y-on-y, % change)	-4.8	-6.4	-3.7	0.7	1.0
Industrial production (y-on-y, % change)	1.5	-6.6	-1.6	1.7	1.3
Public consumption (y-on-y, % change)	-2.2	-3.7	-2.3	-0.9	-0.5
Gross capital formation (y-on-y, % change)	-5.2	-6.9	-8.7	0.5	2.9
Unemployment rate (% of labour force)	21.6	24.8	26.1	24.9	23.7
Real net exports (EUR billion)	-0.5	23.6	37.8	42.3	52.5
Current account (% of GDP)	-3.5	1.1	1.0	1.2	1.5
Fiscal balance (% of GDP)	-8,5	-10.6**	-6.8	-5.7	-4.8

* forecast **including aid to financial institutions Sources: INE, Funcas (consensus forecast), IHS Global Insight

Political situation

Stable government

Spain's current government under Prime Minister Rajoy is well placed to pursue its economic policy as it holds a comfortable absolute majority in parliament and its term lasts until the end of 2015. The government has passed some structural reforms aimed at restoring competitiveness and investor confidence.

Main economic developments

The economic rebound gains momentum

After two years of contraction, the latest business indicators show Spain‘s economic rebound gaining momentum. In Q2 of 2014 GDP grew 0.6 % compared to the previous quarter: the highest quarterly growth rate since Q1 of 2007. The Spanish economy has now grown for four quarters in a row.

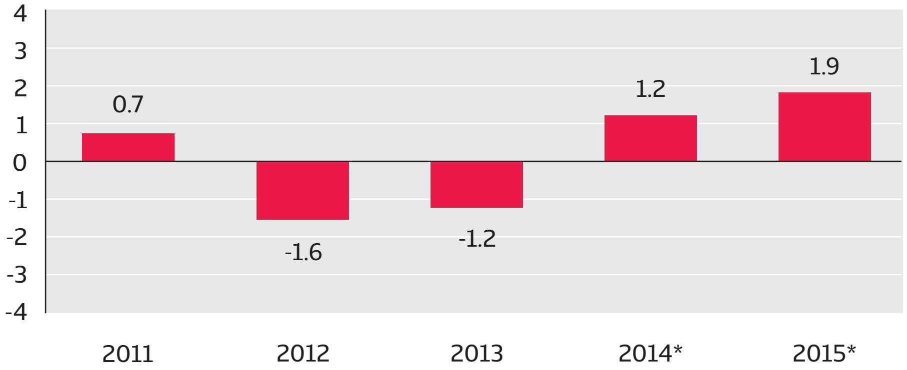
This rebound was initially due to high net exports, but now domestic demand has recovered somewhat from the severe impact of the rebalancing efforts in response to the construction bubble. Increasing foreign demand and higher business confidence have boosted business investment while a recovering labour market, rising confidence, and pent-up demand for consumer durables have boosted private consumption. Private components of domestic demand (essentially consumption and investments) have been the mainstay of GDP growth so far in 2014 and are expected to remain robust in the second half of the year. After three years of negative contributions to GDP, private consumption is forecast to contribute 0.9 % to the economic expansion in 2014.

With the rebound of domestic demand, Spain´s economic performance is now more resilient and sustainable. As the recovery spreads from export and manufacturing industries to more domestically-focused businesses, Spain is currently recovering at a faster rate than its peripheral Eurozone peers.

Growth forecasts have been raised to 1.2 % in 2014 and 1.9 % in 2015, reflecting successful economic reforms and rising domestic demand leading to a reduction in the large output gap. The International Monetary Fund (IMF) predicts that in coming years Spanish GDP growth rates will increase on a yearly basis, reaching 3 % in 2017.

GDP growth

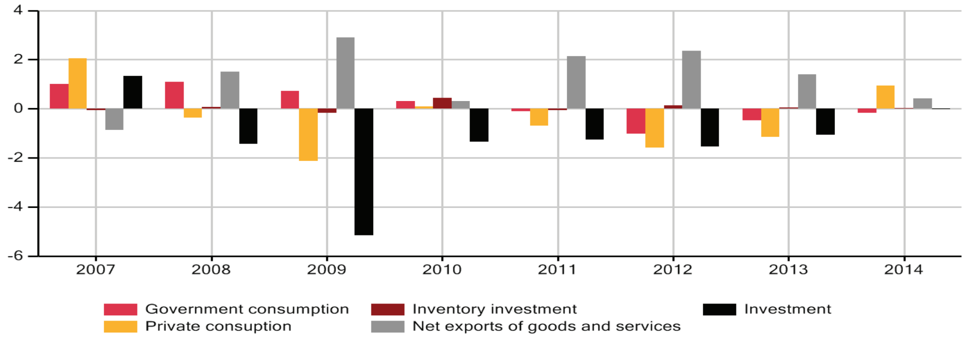
(% change on previous year)



*forecast
Source: Funcas

Contribution to GDP growth

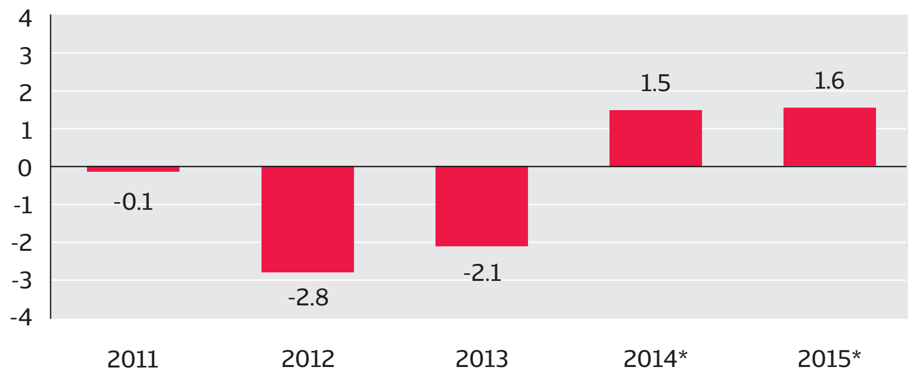
(Chain-weighted basis: forecast data edge 2013)



Source: IHS

Private consumption

(% change on previous year)



*forecast
Source: Funcas

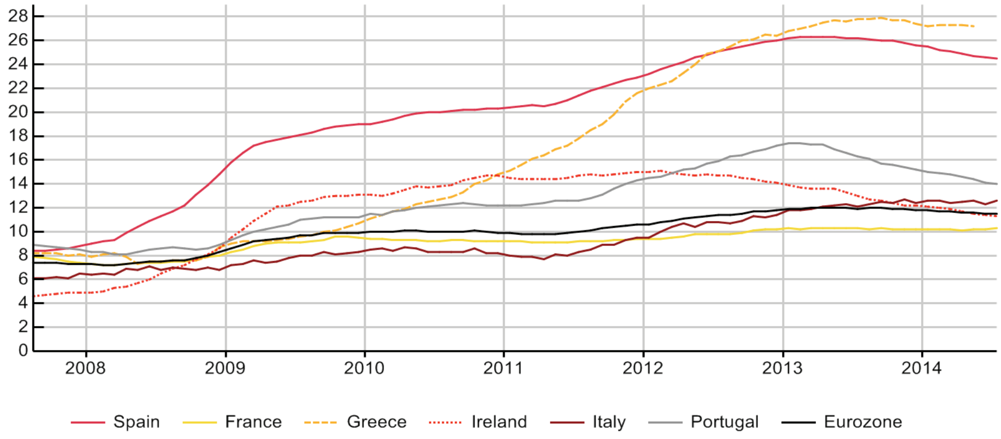
Growth is having a positive impact on the labour market

Labour market conditions have improved since 2013, with unemployment falling from 26.3 % in May 2013 to 24.5 % in July 2014: the largest decrease in unemployment since 2006. The addition of 190,000 jobs in 2013 was the first annual increase in six years. At the same time the decrease in the labour force has also subsided, indicating a robust improvement in the labour market. These developments are also a result of labour reforms in 2012 which gave companies more flexibility to set their own wages and working conditions. Unemployment is forecast to fall further in 2015: to below 24 %.

However, some serious problems remain in the Spanish labour market: 15 % of the labour force has been unemployed for more than a year and youth unemployment remains high, at 55 %. Unemployment is not expected to fall below 20 % for at least another four years and more reforms to address structural labour market weaknesses appear necessary.

Unemployment

(Percentage rate of total workforce)



Source: IHS

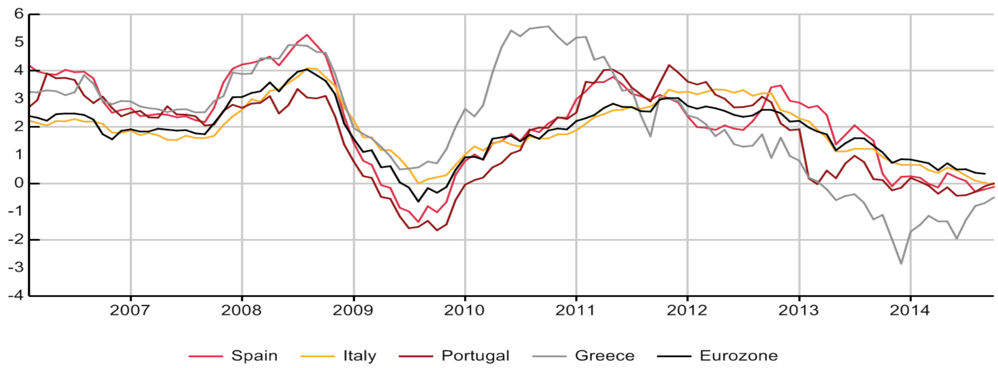
Deflation woes?

The whole Eurozone currently faces decreasing inflation and this is a concern for some of its member states, including Spain, where inflation has fallen below zero in 2014, leading to deflation. Year-on-year, the Spanish consumer price index (CPI) decreased to -0.3 % in July 2014 and to -0.5 % in August. This is worrying because, as prices fall, it becomes harder for Spanish debtors to service their debts fixed in nominal terms. Another issue is that deflation tends to suppress demand, as consumers have an incentive to delay purchases and consumption until prices fall further, which in turn could adversely affect economic activity.

However, in early September 2014 the European Central Bank (ECB) cut interest rates to 0.05 % and announced its plan to buy euro-denominated bonds and asset-backed securities to avoid a vicious circle of deflation in the Eurozone. At the same time, growing domestic demand should lead to increasing consumer prices in the coming months, reversing deflationary trends. Consumer prices are expected to increase again in 2015, to 0.9 %.

Consumer price inflation

(Annual percentage change)



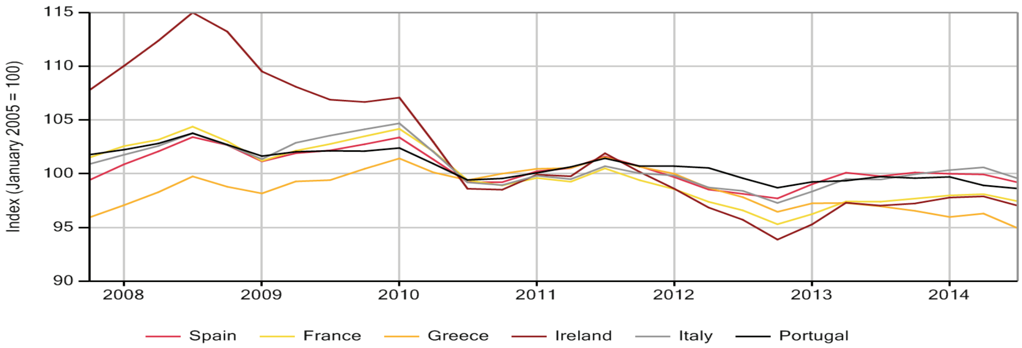
Source: IHS

International competitiveness is improving...

Spain's international competitiveness is improving and its export sector is relatively healthy and competitive. Indeed, 2007 has been the only recent year in which the GDP-contribution of net exports has been negative. Nevertheless, a Real Effective Exchange Rate (REER) comparison (which measures a country's international competitiveness as costs and prices change) shows that there is still considerable room for improvement. While Spain´s REER decreased in the first half of 2014, it is still the second highest of its Eurozone peers (see chart below).

Real effective exchange rate (REER) fluctuations

(Trade-weighted currency baskets adjusted for relative inflation)



Source: IHS

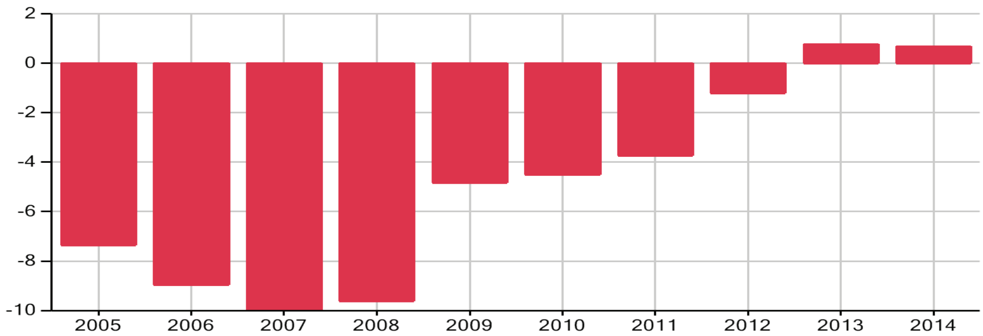
...and is also reflected in current account surpluses

In 2013 the current account balance recorded its first surplus since 1986, at 0.8 % of GDP in 2013, and in 2014 another surplus of 0.7 % of GDP is expected. This turnaround reflects the structural improvements in international competitiveness: Spain recorded strong export performance in 2013 (up 5.2 %), offering a favourable product mix, diversifying export markets and, while France and Germany remain key export destinations, Spain has increased shipments to emerging markets across Africa, Latin America, and the Middle East. In addition, foreign direct investment (FDI) has improved and is currently at a healthy level.

Despite significant improvements in the current account, Spain's net external debt, at 92 % of GDP, makes it one of the most indebted countries in the Eurozone. However, this ratio is expected to decrease in the coming years.

Current account balance

(Current account balance: percentage of GDP)



Source: IHS

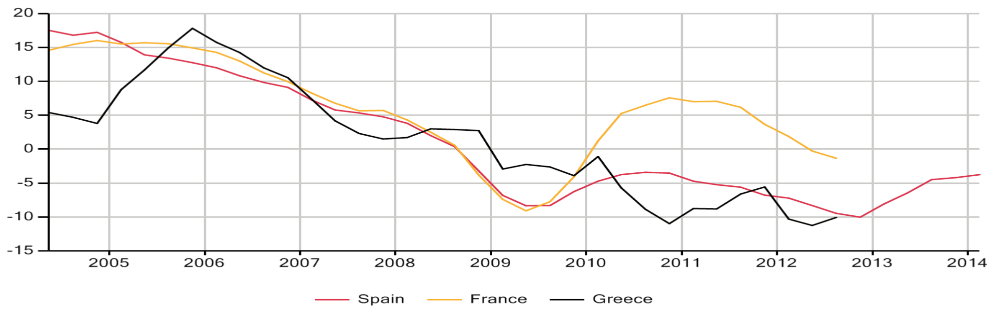
It seems that the economy is on the right track, but current account surpluses underpinned by a significant decrease in the REER will need to continue in future years to improve Spain's external debt position sufficiently and to lower unemployment.

The housing market continues to stabilise

Spanish housing prices continue their downward trend, although the pace of the decline has slowed since the end of last year. House price inflation in early 2014 was -3.75 %, and house prices are still 25-35 % lower than before the economic crisis. There is a large inventory of unfinished and empty houses but, as labour market conditions and private consumption improve, there is optimism that house prices will stabilise further in 2014 and 2015.

House price inflation

(Annual percentage change in national level indices)



Source: IHS

Banking sector reform on track, but lending remains tight

The Financial Sector Assistance Programme supported by the European Stability Mechanism (ESM) was successfully completed in January 2014. Spanish banks had to correct capital shortfalls and put bad assets into SAREB (Company for the Management of Assets proceeding from Restructuring of the Banking System); a bad bank of the Spanish government.

The Programme also revamped the country's framework for bank resolution. The Core Tier 1 capital ratio (the ratio of a bank's core equity capital to its total risk-weighted assets) increased from 9.6 % at the beginning of the programme (June 2012) to 11.8 % by the end of 2013. Provisioning also rose from 36 % to 46 % over the same period. Both deposit and wholesale funding have become cheaper and more stable.

As a crucial sign of the banking sector recovery, Spanish banks' dependence on ECB funding has halved. Market confidence has also returned, with equity prices rising and credit default swap (CDS) spreads falling as a response to the growing international investor confidence in Spanish assets. For the first time since the start of the economic crisis, Spanish banks have seen their bad loan ratios falling.

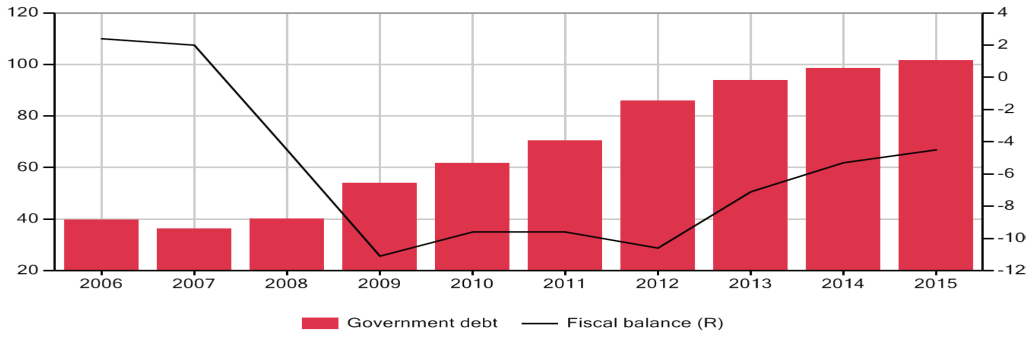
However, some shortcomings remain. In 2013, banks still required capital worth 6 % of GDP from the Spanish state, which further weighed on public debt. Credit is also still contracting due to continuing weak credit demand, elevated default risk, and the deleveraging of the private sector.

Decreasing budget deficits in the coming years

In 2013 Spain´s fiscal deficit amounted to 6.5 % of GDP, while public debt increased to 94 % of GDP. Fiscal consolidation to get public spending under control has continued this year. Fiscal reforms have been employed to enhance the sustainability of the pension system and to establish a fiscal council. Public debt is expected to peak in 2016 (at 104 % of GDP) while the fiscal deficit is forecast to continue to decrease in the coming years. In 2014 a fiscal deficit of 5.7 % is forecast, followed by a reduction to 4.8 % of GDP in 2015. As agreed with the EU, the 3 % of GDP deficit obligation is projected to be met in 2016.

Public debt and budget balance: Spain

(Government debt and budget balance in percent of GDP; data edge 2013)



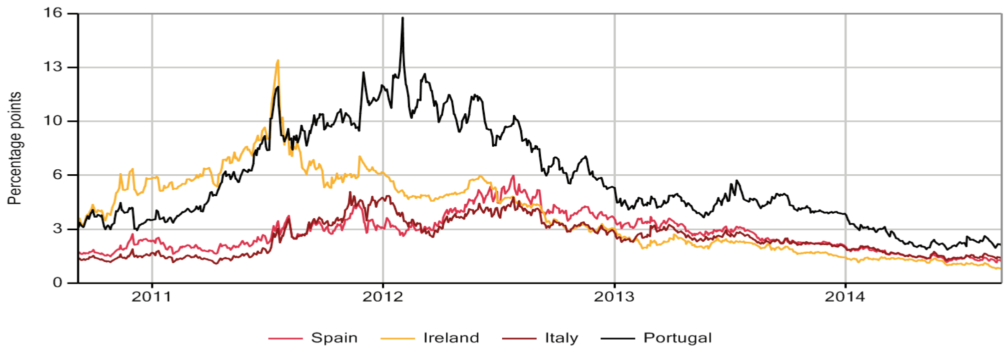
Source: IHS

Increased investors' confidence

The yield on Spanish 10-year bonds has continued to decrease, to a low of 2.6 % difference (spread) with the German Bund at the end of August 2014, compared to a peak of 7.5 % in July 2012. Sovereign yields are currently at an all-time low in Spain and across the Eurozone. The decrease in yields indicates rising international investor confidence in the Spanish economy.

Long bond yield divergence within the Eurozone

(10-year government bond yield spreads over the German Bund)



Source: IHS

Insolvency environment

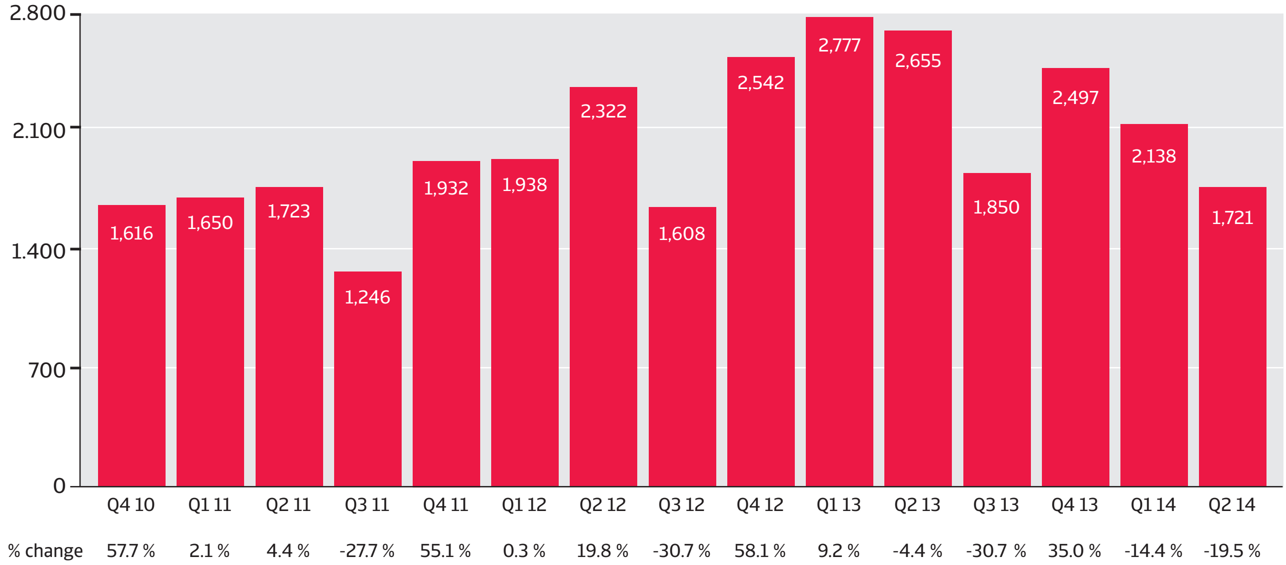
Insolvency improvement in 2014

Since 2008, corporate defaults have closely reflected economic conditions, with high year-on-year increases of 100 % in 2008 and 50% in 2009. After an annual decrease in 2010 insolvencies increased again in 2011 (15.4 %), 2012 (28.4 %) and 2013 (16.3 %, to 9779 cases), due mainly to the drop in internal demand and generally high pressure on businesses' liquidity because of their limited options for external financing.

However, with the economic rebound insolvencies started to fall again: with sequential quarterly declines of 14.4 % in Q1 of 2014 and 19.5 % in Q2. In the first half of 2014 insolvencies decreased 29.0 % year-on-year. Nevertheless, despite this decrease and a further improvement in the second half of the year, business insolvencies will remain at a high level, not yet recovering from the increases since 2008.

Spanish business insolvencies

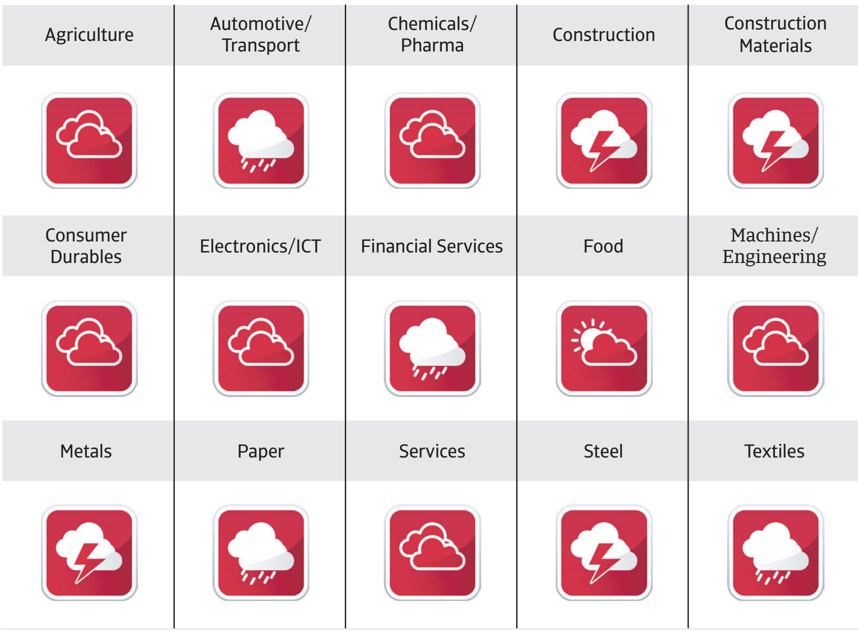
(quarterly changes)

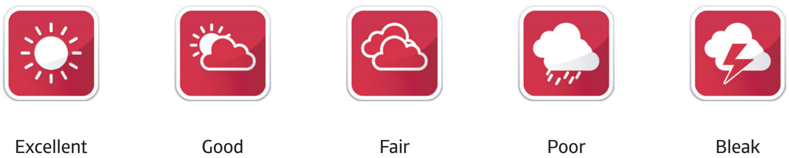


Source: Atradius and Official State Gazette

Spanish industries performance forecast

September 2014





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