

# Spain Business Forecast Report Q1 2015

<https://marketpublishers.com/r/S906437F5ACEN.html>

Date: November 2014

Pages: 52

Price: US\$ 1,195.00 (Single User License)

ID: S906437F5ACEN

## Abstracts

### Core Views

Spain's economic recovery will gather steam in 2015 and 2016, with real GDP growth set to outperform the eurozone. However, growth rates will remain subdued by a historical point of view, as the country remains stuck in between an export and domestic demand-driven growth model. Sluggish demand from core eurozone economies and recovering domestic demand will see the current account surplus shrink over 2015 and 2016.

The Spanish government will relax the pace of austerity in the run -up to the parliamentary elections scheduled for 2015. Consumer price growth will struggle to pull out of deflationary territory over the coming months amid weak domestic demand and declining commodity prices. We believe rising momentum behind the Catalan secessionist movement will eventually result in Madrid offering the region more powers. This should prevent Catalonia leaving the country altogether.

### Major Forecast Changes

Softening external demand has prompted us to downgrade our real GDP forecasts to 1.6% in both 2015 and 2016, from 1.7% and 1.8% previously.

This trend has also resulted in a downward revision to our current account surplus forecasts for Spain to an estimated 0.4% of GDP in 2014 and 0.7% in 2015, from 1.7% and 1.9% previously.

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The Spanish government will relax the pace of austerity in the run up to the parliamentary elections scheduled for 2015. This poses few risks to debt sustainability as long as bond yields are pinned down by ECB monetary expansion. Rising borrowing costs could eventually force the government into swingeing cuts, derailing the economic recovery.

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Spanish consumer price growth will struggle to pull out of deflation over the coming months amid weak domestic demand and declining commodity prices. However, ECB balance sheet expansion will prevent deflation from persisting over the long term.

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### Banks Cannot Rely On Carry Trade Forever

Spanish banks are on a firmer footing following the sector's bailout, with healthy capital accumulation leaving the sector better protected against external shocks. That said, weak demand and tight credit standards will continue to restrict lending, making banks over-reliant on their sovereign bond holdings for profits.

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### ECB Easing: Signs Of Growing Anxiety

The ECB has embarked on additional monetary easing at the September meeting, earlier than we had expected. The ECB's almost knee-jerk reaction to the longstanding deterioration in headline inflation and macro data suggests that the central bank has started to backpedal fast, having previously played down the risks of deflation. We do not view the new measures as a major new expansion of monetary policy, but believe that the ECB's actions and reference to the size of its balance sheet indicate that the tide is starting to turn, and that far more aggressive monetary stimulus could be on the cards.

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In order to correct for the massive imbalances built up during Spain's decade-long economic boom, the economy is now in the first stages of rebalancing that will result in a lower long-run growth potential. Household spending in particular, which was the primary driver of growth since adoption of the euro, is set to temper significantly amid an

environment of tighter credit conditions and deleveraging. While an internal devaluation will help restore some of Spain's competitiveness over the long run, the process will prove long and painful. Ultimately, compared with the levels of growth enjoyed since euro adoption, the next 10 years are likely to prove a lost decade for Spain.

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