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Business cycle and economic policy in Spain
1959-2015

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Business cycle in Spain and economic policy

L-2 OUTLINE

1. *Business cycle*
2. *The great recession in the eurozone*
3. *Policy response to the crisis*
4. *The Commission diagnostic for Spain*

Business cycle
The large expansion in Spain 1994-2008

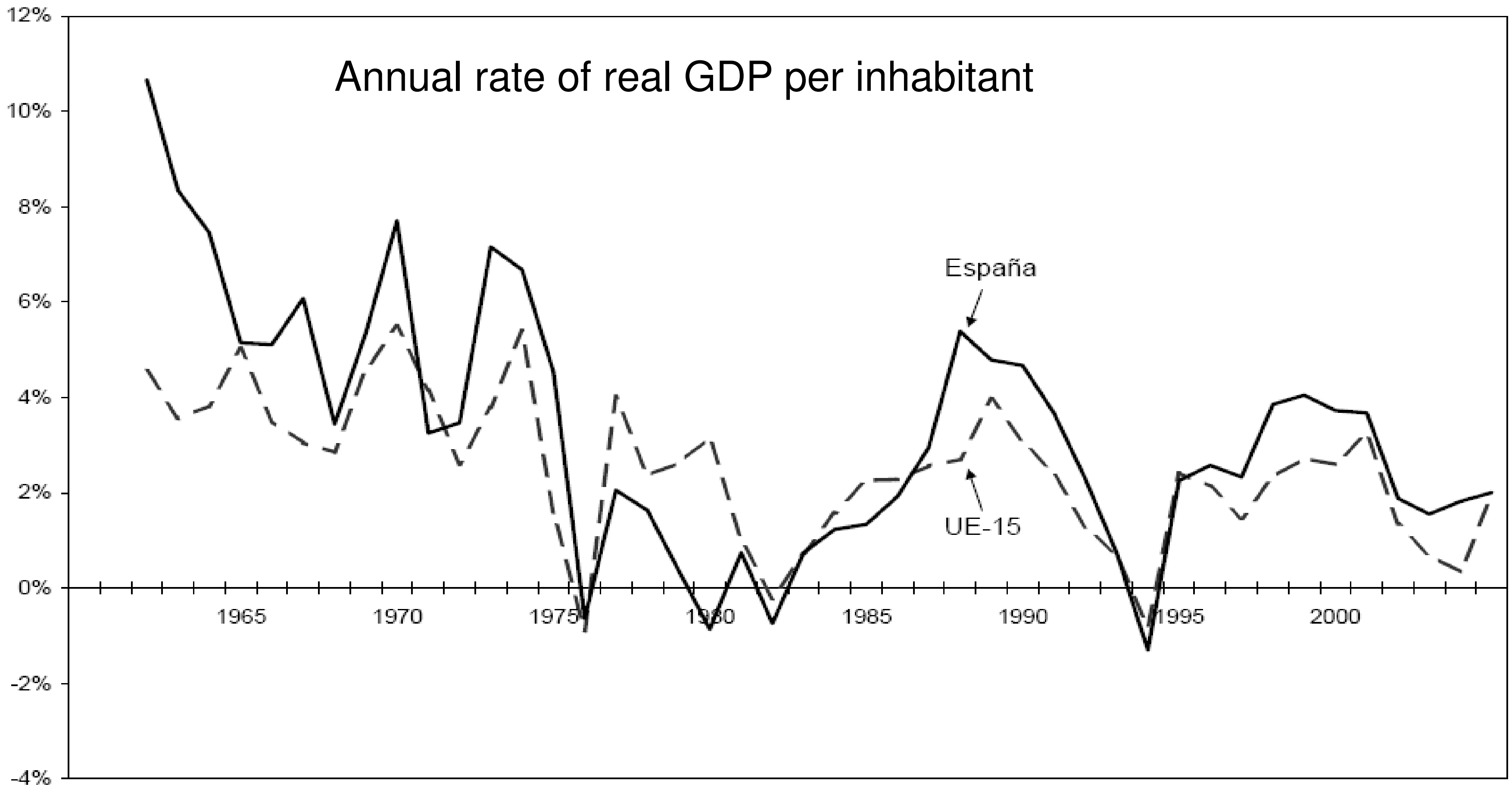
- **Since 1982**
  Spain starts recover from the oil crisis (1973-79) and keep growing until a short but sharp crisis in 1993.
- **1982 a 2007 was a long expansive business cycle, with growth rates over the EU average.**
- Spain converge to EU15 real income *per capita*
- *After the enlargement of the EU to 27 MS* (2007) Spain overpass the EU27 average income.
- Chat-up the level of Italy before the Great Recession

I. **The expansion ends suddenly in 2008**

II. After a long expansive cycle started in 1994, after a short recession in 1993, preceded of a another long expansion since 1982

Business cycle Spain versus EU15

Crecimiento relativo en España y la Unión Europea, 1961-2004
(tasas anuales de variación del PIB real per cápita)



Nota: Desde 1991 se incluyen los datos de la Alemania unificada.
Fuente: Elaboración propia con datos de AMECO (Comisión Europea)

From García-Delgado, Myro, y Martínez-Serrano (2005) Lecciones de Economía Española.

REAL CONVERGENCY OF THE SPANISH ECONOMY*
(EU= 100)

YEAR	SPAIN
1978	76,1
1979	73,1
1980	73,0
1981	72,6
1982	72,6
1983	72,3
1984	71,7
1985	71,5
1986	71,8
1987	73,6
1988	74,3
1989	75,4
1990	76,3
1991	79,0
1992	78,7
1993	79,5

YEAR	SPAIN
1994	77,7
1995	78,2
1996	79,3
1997	79,9
1998	79,3
1999	82,1
2000	81,8
2001	82,8
2002	83,4
2003	83,8
2008	APROX....95

* % EU GDP per inhabitant in ppp €

Source: Eurostat

Structural change in Spain

- **Industrial and service sector expansion** with a relative lagging behind agricultural sector
- Increasing in the international **trade openness**
- Increase in the **educational level** of the population **but not reaching the OECD** average level for the workers.
- **Public sector** participation in the GDP **growing, but below the EU** average level
- **Decreasing** level of **income inequity, but less equal** income distribution than the EU average.

Expansions in the Spanish economy

During thre periods the income per capita **growth faster in Spain than in the EU:**

1. 1959-1974: the GDP per capita increases from 60% to 80% of the EU
   a) **The cycle starts with the Stabilization Plan of 1959 and**
   b) **Follow an increasing level of international trade openness (X+M / GDP)**
   c) **7% average annual GDP rate of growth:** *"Spanish miracle"*
   d) **Industrial growth**
   e) **Services become the main sector, like in developed economies, but**
      i. **Tourism play and important role providing foreign currency supply to finance balance of payment deficits during the expansions**.*"European Miami"*
2. 1985 to 1990 integration in the EU in 1986:
   a) Spain attract foreign investments (US and EU FDI in key sector: food and drinks, automobile, R&D industries, …):
   b) Custom Union: Trade creation and Trade Diversion, Scale Economies
   c) **Transfers from the EU budget reach nearly 1% GDP helping rural development and lagging behind regions**
3. 1997 to 2008: integrating in the eurozone: € since 1999 is the single currency [1].
   a) **Low interest rates**
   b) **Credit easy**
   c) **No problem with the external deficit because Spanish economy is small realted to the Eurozone and so do not affect the exchange rate of the €**
   d) **Better international rank in the EU and the rest of the world**

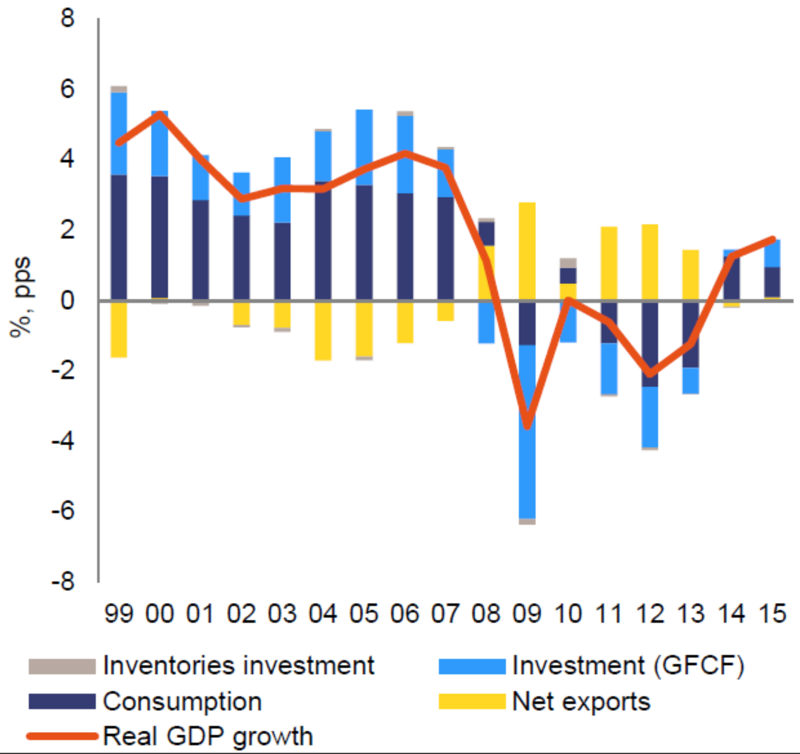
[1] Guillermo de la Dehesa Romero (2003): Balance de la economía española en los últimos veinticinco años. ICE, 811 pp.53-79

The recessions in Spain.

- **1975-1984 divergence from EU: the GDP per inhabitant falls to 70% of the EU15** (1984).
  - Long recession because the political crisis during the transition to the democratic system from Franco dictatorship delayed economic policy response
- Finally the trade unions, the companies representatives and the Government (Enrique Fuentes Quintana, minister of Economics) rich and agreement in the Moncloa Palace (Spanish seat of government) named as **Pactos de la Moncloa**
  - **Adjust wage growth to forecast inflation to cut inflation rates**
  - **Agreement for the industrial reconversion of the new era of energy scarcity (high oil prices)**
- The next crisis wait until **1993**
  - **Short and sharp but less consequences than previous recession**
  - **Caused by the coincidence of several recesive estimulus:**
    - **End of the public works for the Olympic Games in Barcelona and the exhibition commemorating the Fifth Centuries of the Americas Discovery by Cristobal Colon**
    - **Public expenditure cut plus international recession originate the GDP failure**
- September 2008 the Great Recession
  - Double deep recession in Spain because of budget cuts since 2011
  - Long crisis until 2014 do not starts the recovery (will see on detail)

Spain: contributions to the real GDP growth

Graph 1.1: **Real GDP growth and contributions**



Source: European Commission

Jobs creation /destruction. Annual rate

YEAR	SPAIN	EU
1978	–1,7	0,4
1979	–1,7	1,0
1980	–3,0	0,3
1981	–2,4	–0,9
1982	–0,9	–0,8
1983	–0,3	–0,4
1984	–2,2	0,2
1985	–1,0	0,5
1986	2,3	0,8
1987	4,8	1,3
1988	3,5	1,7
1989	3,6	1,8
1990	3,8	1,7
1991	1,2	0,3
1992	–1,4	–1,3
1993	–2,8	–1,5
1994	–0,5	–0,1
1995	1,9	0,6
1996	1,3	0,6
1997	2,9	0,9
1998	3,9	1,8
1999	3,5	1,7
2000	3,4	1,9
2001	2,4	1,2
2002	1,3	0,4
2003	1,8	0,4

Source: Eurostat

Structural change/3 Long run growth determinants

- Increasing openness to international trade since the 1959 Stabilization Plan.
  - Enlarged with the integration in the EU
  - Reinforced with the enlargement up to 27 Member States (MS) of the original EU15
- Integration in the EU in 1986
  - Trade unions (no trade barriers within MS)
  - Single European Market (1992)
  - FDI attraction (Foreign Direct Investments
  - Accelerate real convergence
- 1999 Spain joint the €
  - End of the peseta as a currency (2002)
  - Macro stability for a long period (until 2008)
    - Orthodox fiscal policy of the ECB rules
    - Balance fiscal policy because the Stability and Growth Pact.
    - Smooth business cycle and
    - Cycle synchrony with the EU

Structural change/4
Long run growth determinants

- Technical change: substitution of labor intensive technologies by capital and technology plus relatively inexpensive inputs: **labor saving technical change**
  a) Structural sift from low productive sector (agriculture) to more technological productions and services boost productivity: TFP growth
- **Specific structural characteristics of the Spanish economy:**
  a) Growth propelled by internal demand
  b) External demand only rules economic activity during recessions as a substitute of the internal demand
  c) During the 2001-06 period external demand negatively influence GDP growth systematically
- Conversely, **internal demand in the EU has show a positive impact in the GDP growth**
  – **European economy includes big countries (e.g. Germany, France, UK) and more open to the international trade**
- **The Spanish economy had tend to create more inflation during the expansions and external unbalances in the current account** (de la Dehesa, 2003).

Structural change/4
Long run growth determinants

- Sift from agriculture to the industrial and services sector of the employment: **jobs reallocation**
- Productivity and competitiveness improvements that impulse income rising faster than in the EU15: real income convergence with the EU15
- Labor productivity improvements due to learning by doing and vocational training.
- Technological innovation that push up productivity and the K/L ratio.
  - Educational level increases
  - Long life educational programs in privet companies and public administrations
  - Organizational improvements the increases productivity
  - New technologies in ICT (Information and Telecommunication Companies)
- But R&D investment poor in the private sector with same exception (export companies, multinational firms, …)

Structural change/5
Long run growth determinants

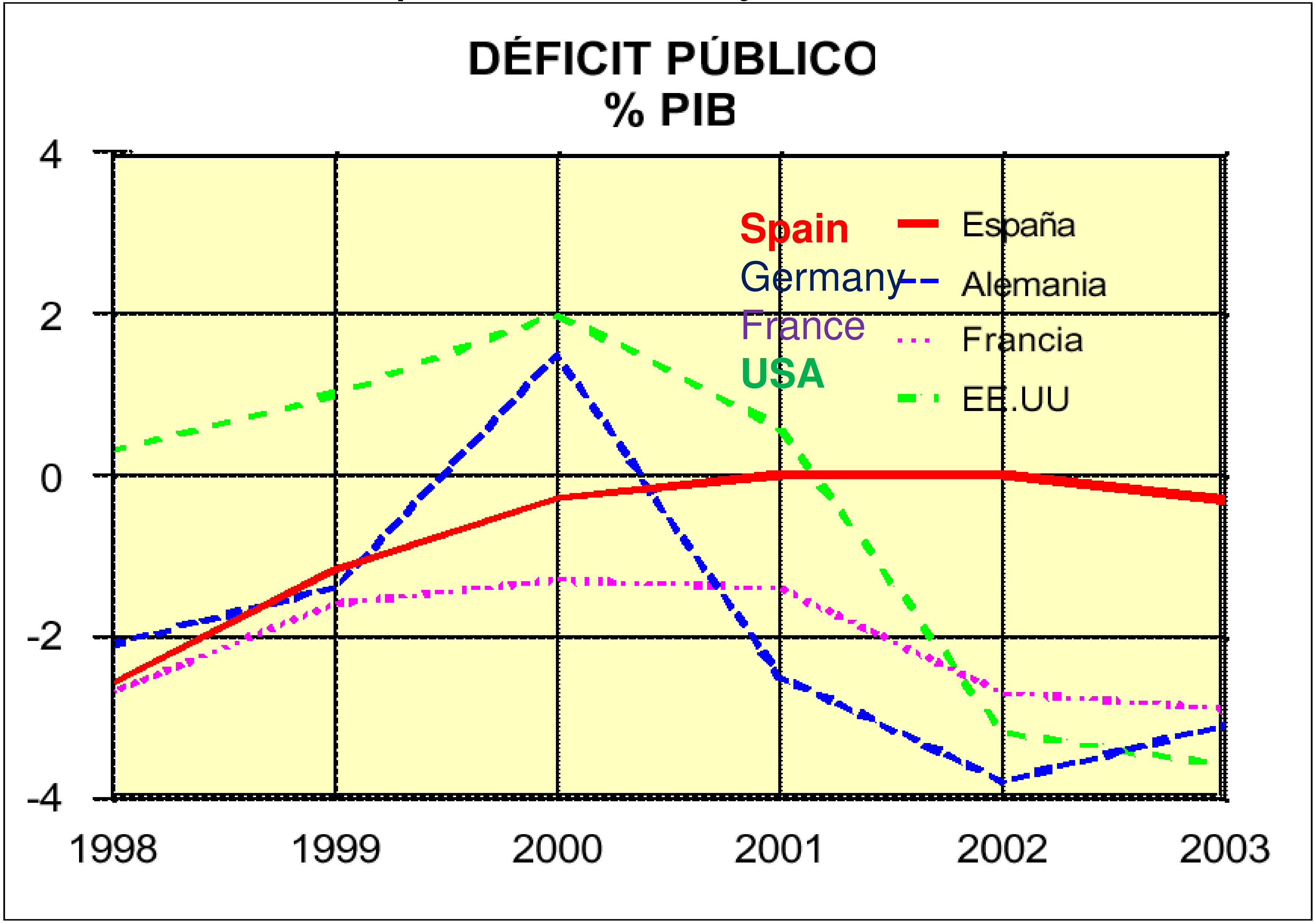
When a society develops very quickly, its economy is usually experimentally essential changes in its productive structure.In the case of the Spanish economy, these structural transformations can be summarized as:

1. ***More significant equity in the distribution of income,***
   - With an increase in the share of income in income and an improvement in the personal distribution of income.

2. ***Commercial opening abroad***

3. ***Mayor importance of public administrations in the economy.***
4. ***Change in the productive structure*** moving the workforce towards more productive sectors such as industry and advanced services,
5. While we must remember that ***tourism services and construction still have a higher relative weight*** in the Spanish economy.

Public déficit / GDP ratio before the Great Recession in Spain, Germany, France and the US



During the socialist administration public finance surplus increases 2003-07

- In the Eurozone the monetary policy is conducted by the ECB
- Consequently the main economic policy tool is the fiscal policy
- The surplus in the public finance granted opportunities for a socialist government to:
  - Increase investment in public infrastructures (highways, railways, airports, irrigation plan, rural development, environmental infrastructures like water purification plants, …).
  - Keep going with productive investments co-finance by the EU in certain areas (agriculture, rural development, environment, defence, R&D,…)
  - Accomplish with the social agenda (income redistribution: SS, pensions, public health system, …)
  - Public budget keep balance

Expansion in macro indicators Spain 2003-07

	2003	**2007**
GDP (%)	*3,1*	***3,8***
Labor market		
Employees LFS (millions)	*17,3*	***20,4***
Unemployed LFS (millions)	*2,2*	***1,8***
Unemployment rate (%)	*11,5*	***8,3***
Prices		
Inflation annual rate (%)	*3*	***2,8***
Oil price ($)	*28,8*	***72,5***
Public Finance (forecast)		
Public finances balance % GDP	*-0,21*	***+2***
Public Debt / GDP ratio (%)	*49,1*	***36,2***
Investment		
Machinery (annual rate) (*)	*4,1*	**12,5**

(*) For 2007, first thre quarters
Source: MEH (2008 Februery)

2 The great recession in the eurozone

The US financial crisis contagion in the EU

External factors causing the Great Recession

1. Liquidity constrain
   I. Impact of the US financial crisis in the EU banks after September 2008
   II. Toxic assets intoxicate certain big EU investment banks
   III. Abrupt disruption of the credit facilities from the privet banks affect privet business and consumption

September 21-28, 2008

Impact of the US financial crisis in the EU banks after September 2008

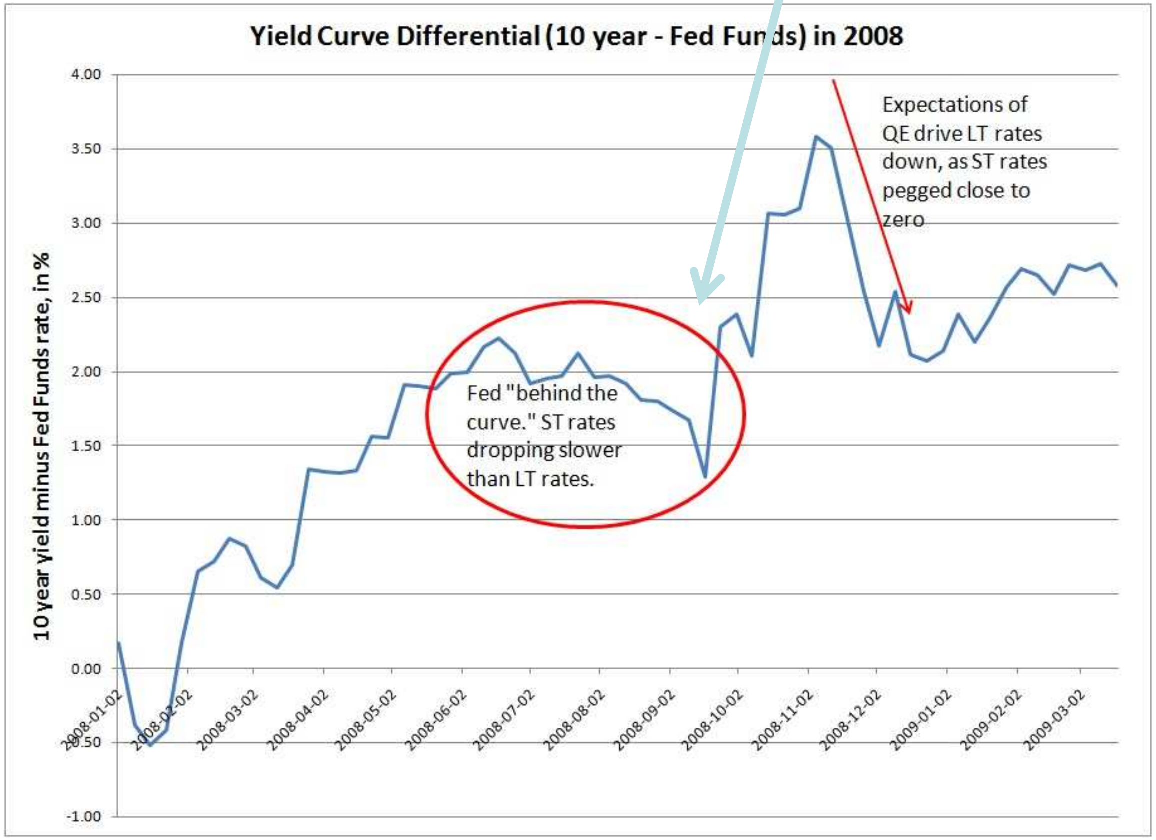
- **Toxic assets:**

the medium by which a contagious disease is transmitted.

- **Timing**: the time US Senators take to include the "pork barrel" in the rescue packet during September 2008 allow the contagion to the EU financial system
- The ECB and Commission **excessive confidence** in the Eurozone **banks supervision**, prove not enough to isolate banks from toxic American assets.

FROM THE ECONOMIST INTELLIGENCE UNIT (2006):
The most significant global economic risks are ***centred on the US economy****, which continues to save very little and rely on* ***foreign capital*** *to fund its investment, leading to a burgeoning current-account deficit.*

The data are always open to interpretations, e.g.: The rally in the long bonds caused the yield differential between the ten year and Fed Funds rate to narrow by 1.5%



What does the divergence between treasury yields and equity prices say about the near future of our economy?

•**One possibility** is that the market is now anticipating and pricing in quantitative easing from the Federal Reserve – and so prices of both equities and bonds are rising.

•**Another possibility** is that expectations of future inflation are falling, which would lower bond rates, all else equal.

•**A final possibility** is that the bond market is signaling another leg down in the economy, and that equity markets are behind the curve. Millar (2010) http://www.financialsense.com/contributors/matthew-millar/long-bond-soaring-sailors-take-warning

Starting the Great Recession, September 2008

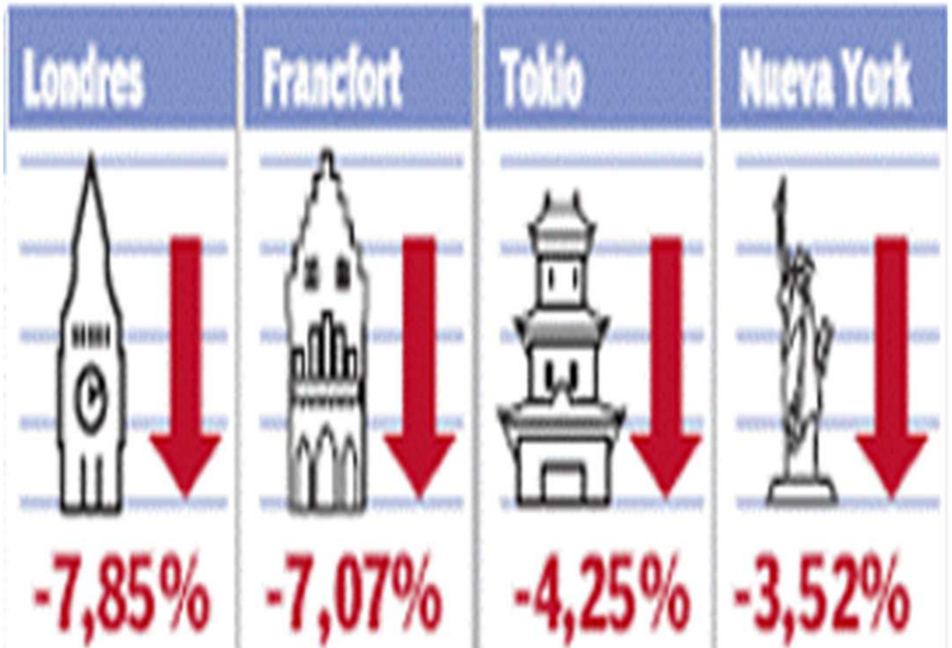
- *Sep. 21:* Goldman Sachs and Morgan Stanley converted in a "bank holding companies"
- *Sep. 22:* President Bush approvals of the rescue plan
  - Buy "toxic assets"
  - 700,000 millions $
    - Public Debt increases sharply
- Sep. 25: The rescue plan is rejected in Congress
    - Dow Jones fall 777 points
- Sep. 28: The Congress Leaders approve the plan (too late, the crisis already reach the EU and the rest of the world)

September 29 to October 6
Centrals banks fight the panic

Dow Jones Industrial Average Last 10 Years: impact of the financial crisis

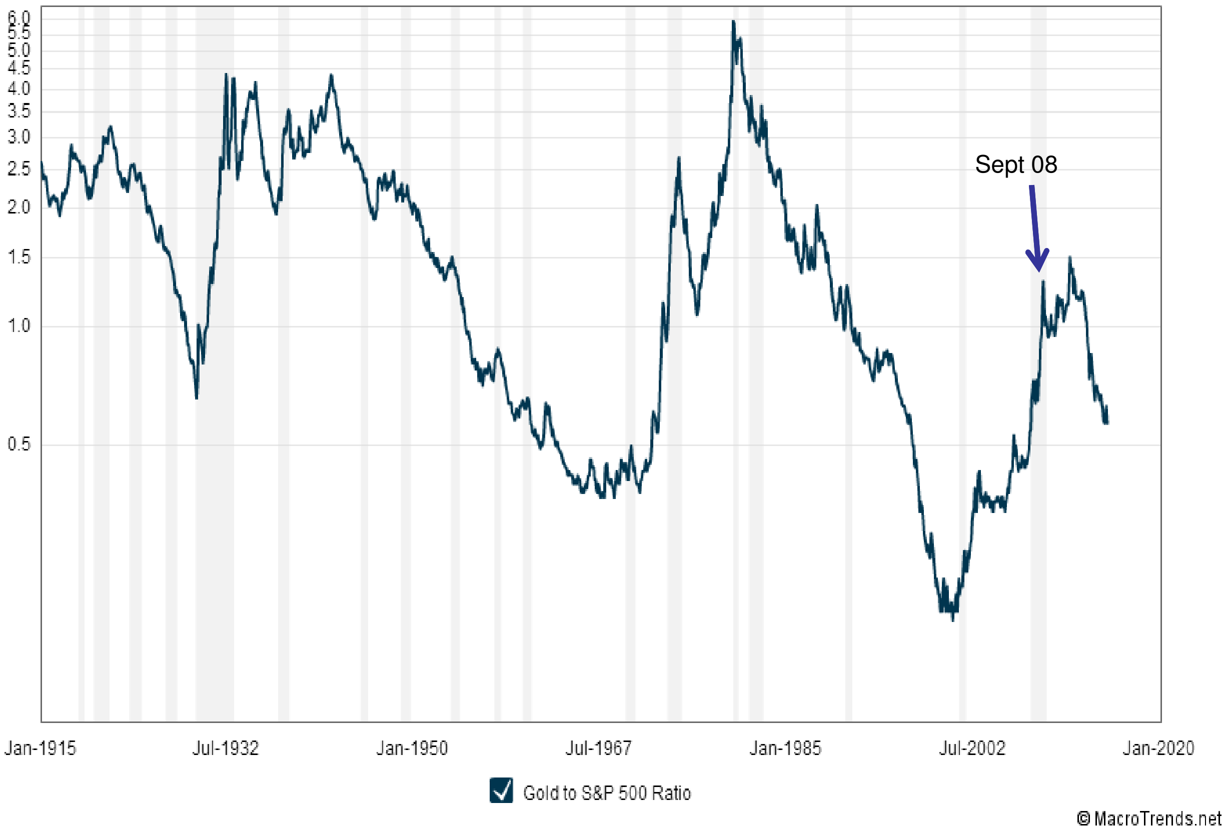
European Stock Market

Monday October 6



http://estaticos.20minutos.es/edicionimpresa/madrid/08/10/MADR_07_10_08.pdf

Gold as a refuge good: gold price & financial panic



This chart shows the ratio of gold (priced in dollars) to the S&P 500 market index. This ratio is a good indicator of investor confidence in the dollar/fiat currency system. A low ratio signifies high confidence (gold low, S&P high) and a high ratio signals a lack of confidence (gold high, S&P low). The ratio hit its peak of 5.94 back in January of 1980 when gold briefly traded over $800 an ounce.

3 Policy response to the crisis

US, EU and Spain

The end of the Neocons ideology?

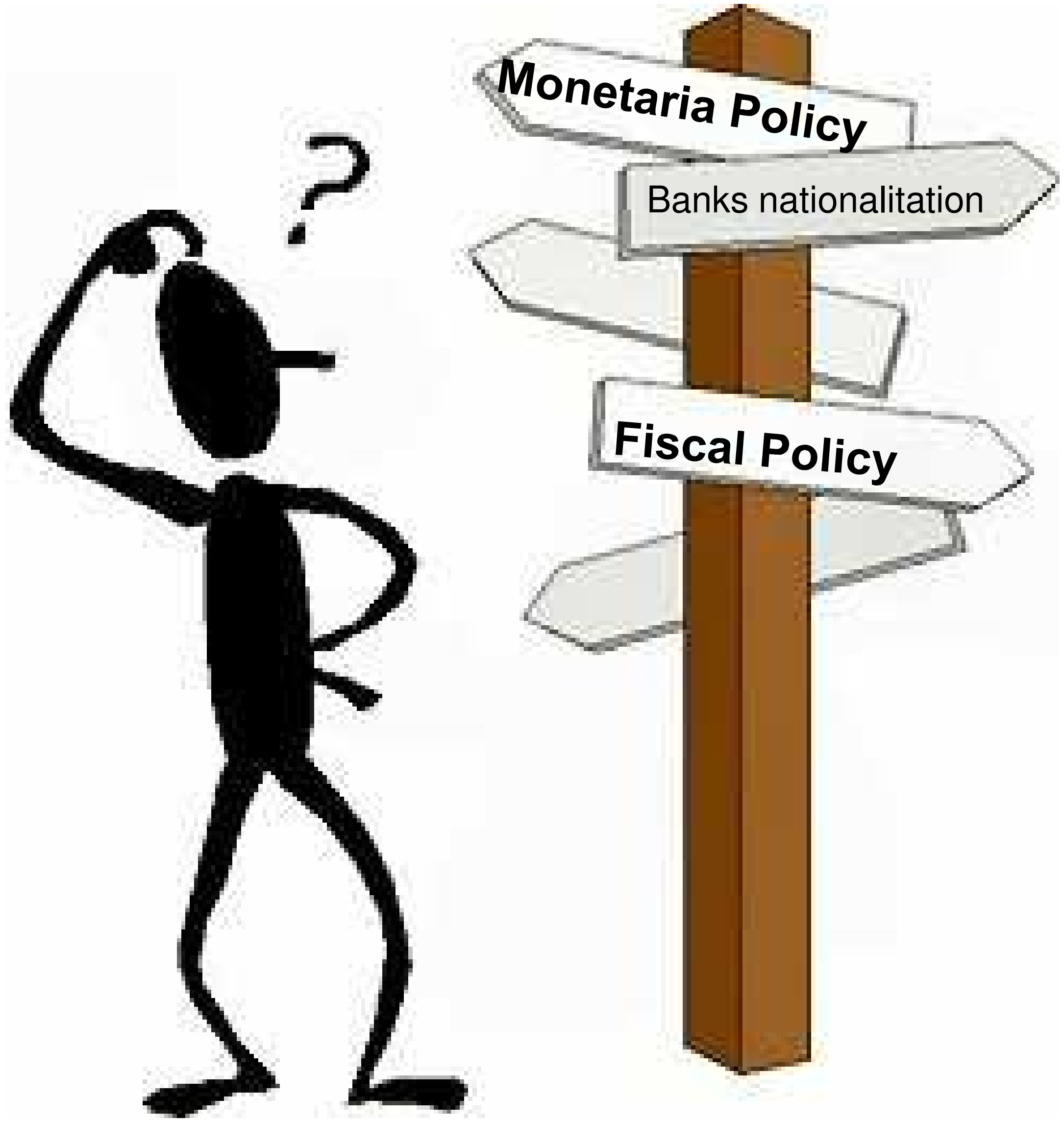
- Washington, 28 sep (EFE).- The Congress leaders close an agreement to support the financial rescue plan for 700.000 millions $ to avoid financial markets chaos and economic recession.
- Presidential candidates, Barack Obama y John McCain, and president George W. Bush, support the plan.

The US banks nationalization

The chief executives of the nine largest banks in the United States trooped into a gilded conference room at the Treasury Department at 3 p.m. Monday.(October 13, 2008).
To their astonishment, they were each handed a one-page document that said they agreed to **sell shares to the government**, then Treasury Secretary Henry M. Paulson Jr. said they must sign it before they left.
Wednesday, October 15, 2008
http://www.marketoracle.co.uk/Topic8.html

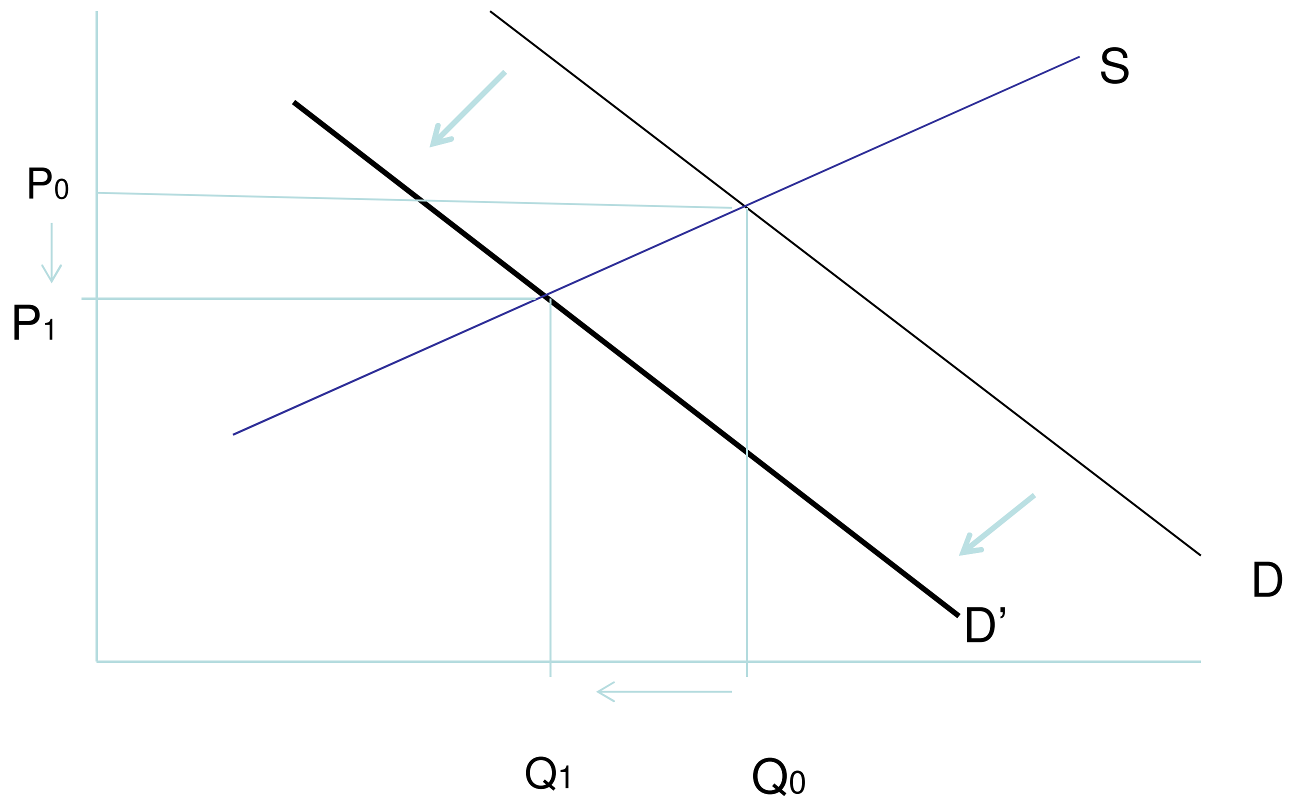
Thursday, October 16, 2008
Debt vs Interest Rates Conundrum / Interest-Rates / US Debt
By: Michael_Pento
I've written before about the dramatic rise in fixed income rates that face investors in the very near future due to the funding issues associated with our entitlement programs coupled with the incalculable measures taken by the government in the past few weeks to stem the credit crisis. **Those efforts ensure the amount of Treasury issuance will explode.**

Solutions?



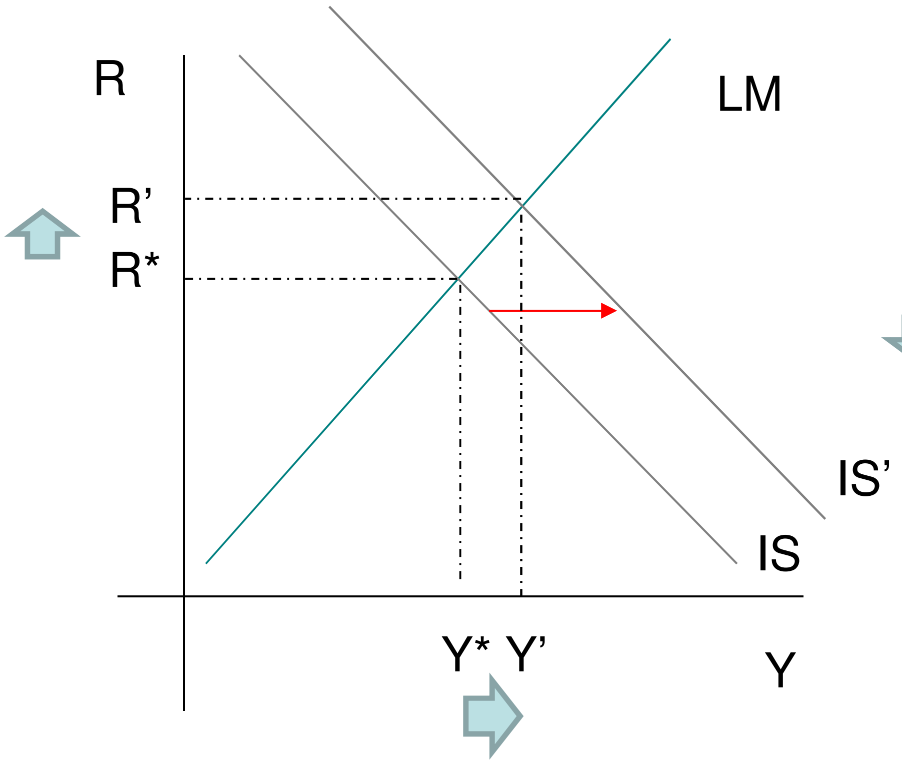
Keynesian demand recession

Unexpected shit of the aggregate demand

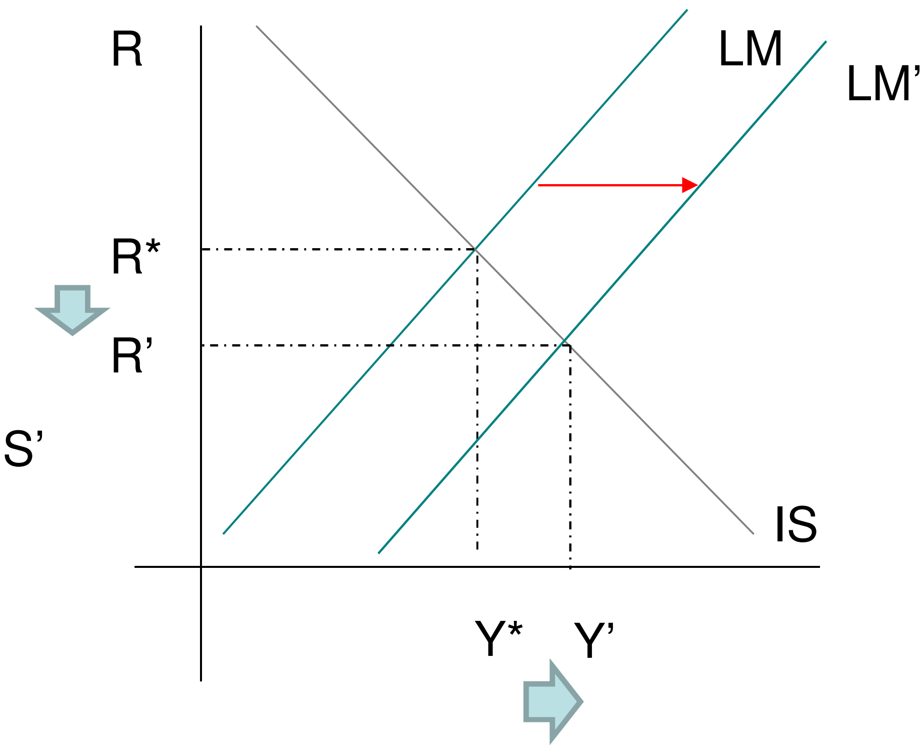


Effects of a Fiscal and Monetary Expansion

Fiscal Expansion



Monetary Expansion



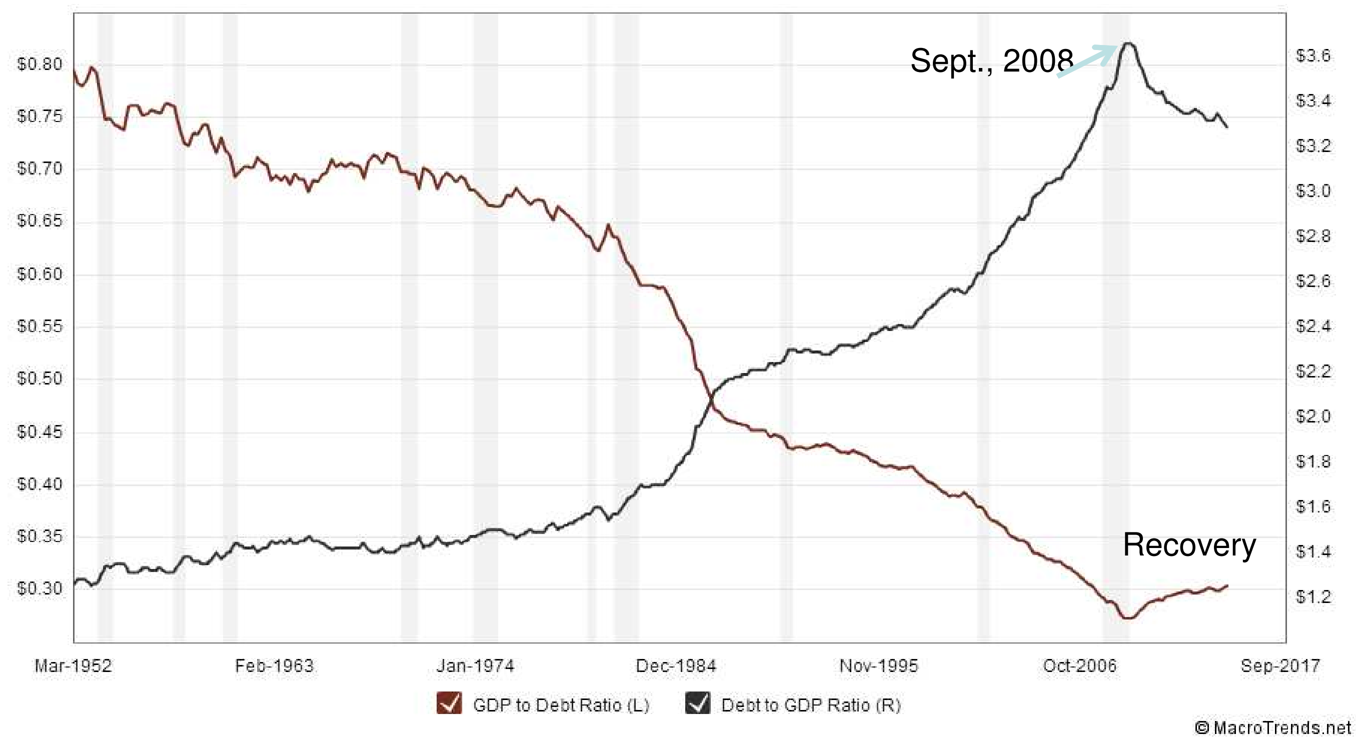
The world economy's crisis

I. The world economy has experienced the most serious shock since the Second World War in September 2008.
II. The ensuing economic policy responses have been on an unprecedented scale.
III. Their **reaction has averted a catastrophic spiral** and has managed to activate the **start of the recovery** in certain countries,
IV. Although the legacy of the crisis will have far-reaching and multi-faceted repercussions.
V. Mediterranean countries like **Greece, Portugal and Ireland the most affected** in the Eurozone.
    a) Also the Spanish and Italian foreign investment flows decreases

(BdE, 2010)

Financial socialism: Robin Hood on reverse way

The rescue: Congress pass the plan to inject 700.000 mill. $ and extract the toxic assets from the system->**more taxes and US Debt to save the banks** (2008)



Debt to GDP Ratio Historical Chart
This chart compares the level of gross domestic product (GDP) with total credit market debt as reported in the Federal Reserve Flow of Funds report. It took roughly **$1.30 in new debt to create $1** of GDP in 1952. Today it takes over **$3.50 in debt** to generate a single dollar of additional GDP. Part of the effects are "exported" importing more inputs

The financial crisis reach Europe

- Frankfort (Germany), 29 sep (EFE).- The biggest German mortgage bank **Hypo Real Estate** has been rescue with a credit line of several billions of Euros because of toxic assets bayed to the US investment banks.
- El Hypo Real Estate shares drop 56,3 % in one session of the Frankfurt stock market in September 28, 2008.
- A German consortium of banks has to provide Hypo Real Estate with credit lines to avoid financial panic

Fortis rescue, ABN needs help.

- 29/09/2008 - 11:25 - MADRID, 29 SEP. (Bolsamania.com/BMS) .- Finaly **Fortis has to be rescue by the Belgium, Ducht and Luxemburg governments, that inyected 11.200** millions of euros to the multinational bank
- Another Benelux bank announced that will shell assets from **ABN Amro. ING bank show** interest in buying.
- The core Z€ MS financial system is shocked by the US financial crisis affecting even countries without real state bubbles like Germany
- The big EU banks are now in danger.

Fortis, ABN Amro faliures drive to an ECOFIN reaction

29/09/2008 - 11:25 - MADRID, 29 SEP. (Bolsamania.com/BMS) .-

- The french Minister of Economy and President of the ECOFIN declare that **no bank with systemic risk will fail.**
- The Council of the EU approve a plan to coordinate the response to the finacial crisis (8/10/08):
  - Minimum of 50.000 € deposit State guarantee, but same MS enlarge to 100.000 €
  - Massive liquidity injections complemented by the ECB to recapitalize banks
  - Spain plans to inject 30-50.000 mill. €

The crisis expand on Europe

- **Belgium, ready to rescue Dexia after saving Fortis**

- The shares of the French-Belgium bank **Dexia** loose **21.55 %** value in the Paris exchange and securities market in just one session (29/09/08)

GDP annual rates Indicadores	1991--2000	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 (p)
Mundo	3,1	4,7	2,2	2,8	3,6	4,9	4,5	5,1	5,2	3,2	–1,3
Países avanzados	2,8	3,9	1,2	1,6	1,9	3,2	2,6	3,0	2,7	0,9	–3,8
Estados Unidos	***3,3***	***3,7***	***0,8***	***1,6***	***2,5***	***3,6***	***2,9***	***2,8***	***2,0***	***1,1***	***–2,8***
Japón	1,3	2,9	0,2	0,3	1,4	2,7	1,9	2,0	2,4	–0,6	–6,2
Canadá	2,9	5,2	1,8	2,9	1,9	3,1	2,9	3,1	2,7	0,5	–2,5
Unión Europea	***2,2***	***3,9***	***2,1***	***1,4***	***1,5***	***2,6***	***2,2***	***3,4***	***3,1***	***1,1***	***–4,0***
Alemania	2,1	3,1	1,2	0,0	–0,2	1,2	0,8	3,0	2,5	1,3	–5,6
Francia	2,0	3,9	1,8	1,1	1,1	2,2	1,9	2,4	2,1	0,7	–3,0
Italia	1,6	3,6	1,8	0,5	0,0	1,5	0,7	2,0	1,6	–1,0	–4,4
Reino Unido	2,5	3,8	2,5	2,1	2,8	2,8	2,1	2,8	3,0	0,7	–4,1
España	**2,9**	**5,1**	**3,6**	**2,7**	**3,1**	**3,3**	**3,6**	**3,9**	**3,7**	**1,2**	**–3,9**
Zona euro	—	*3,8*	*1,9*	*0,9*	*0,8*	*2,2*	*1,7*	*2,9*	*2,7*	*0,9*	*–4,2*
Países en desarrollo y emergentes	3,6	5,9	3,8	4,8	6,3	7,5	7,1	8,0	8,3	6,1	1,6
África	2,4	3,5	4,9	6,5	5,5	6,7	5,8	6,1	6,2	5,2	2,0
Asia	7,4	6,9	5,8	6,9	8,2	8,6	9,0	9,8	10,6	7,7	4,8
China	10,4	8,4	8,3	9,1	10,0	10,1	10,4	11,6	13,0	9,0	6,5
Iberoamérica	**3,3**	**4,1**	**0,7**	**0,6**	**2,2**	**6,0**	**4,7**	**5,7**	**5,7**	**4,2**	**–1,5**
Europa central y oriental	2,0	4,9	0,0	4,4	4,9	7,3	6,0	6,6	5,4	2,9	–3,7
Rusia	**—**	**10,0**	**5,1**	**4,7**	**7,3**	**7,2**	**6,4**	**7,7**	**8,1**	**5,6**	**–6,0**

Inflation, CPI annual rate	Indicadores1991--	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009 (p)**
Países avanzados	2,7	2,2	2,2	1,5	1,8	2,0	2,3	2,4	2,2	3,4	–0,2
Estados Unidos	2,8	3,4	2,8	1,6	2,3	2,7	3,4	3,2	2,9	3,8	–0,9
Japón	0,8	–0,7	–0,7	–0,9	–0,3	0,0	–0,3	0,3	0,0	1,4	–1,0
Canadá	2,0	2,7	2,5	2,3	2,7	1,8	2,2	2,0	2,1	2,4	0,0
Unión Europea	7,6	3,1	3,0	2,5	2,2	2,3	2,3	2,3	2,4	3,7	0,8
Alemania	2,3	1,4	1,9	1,4	1,0	1,8	1,9	1,8	2,3	2,8	0,1
Francia	1,8	1,8	1,8	1,9	2,2	2,3	1,9	1,9	1,6	3,2	0,5
Italia	3,7	2,6	2,3	2,6	2,8	2,3	2,2	2,2	2,0	3,5	0,7
Reino Unido	2,7	0,9	1,2	1,3	1,4	1,3	2,0	2,3	2,3	3,6	1,5
España	4,0	3,5	2,8	3,6	3,1	3,1	3,4	3,6	2,8	4,1	0,0
Zona euro	—	2,2	2,4	2,3	2,1	2,2	2,2	2,2	2,1	3,3	0,4
Países en desarrollo y emergentes	44,5	8,5	7,7	6,8	6,7	5,9	5,7	5,4	6,4	9,3	5,7
África	24,6	11,7	10,9	9,1	8,7	6,6	7,1	6,3	6,3	10,1	9,0
Asia	8,2	1,9	2,8	2,1	2,6	4,1	3,8	4,2	5,4	7,4	2,8
China	7,2	0,4	0,7	–0,8	1,2	3,9	1,8	1,5	4,8	5,9	0,1
Iberoamérica	64,8	8,3	6,5	8,6	10,4	6,6	6,3	5,3	5,4	7,9	6,6
Europa central y oriental	59,4	24,9	24,4	18,9	11,3	6,6	5,6	5,7	6,1	8,0	4,6
Rusia	—	20,8	21,5	15,8	13,7	10,9	12,7	9,7	9,0	14,1	12,9

Unemployment rate

Datos de previsiones económicas de primavera de 2008 de la Comisión Europea.
Fuente: FMI, *Perspectivas de la Economía Mundial,* abril de 2009. Las cifras del Fondo Monetario Internacional no siempre coinciden con las oficiales de cada país.

Paro (tasa)	**1991-2000**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009 (p)**
Países avanzados	6,9	5,7	5,9	6,5	6,7	6,4	6,2	5,8	5,4	5,8	8,1
Estados Unidos	**5,6**	**4,0**	**4,7**	**5,8**	**6,0**	**5,5**	**5,1**	**4,6**	**4,6**	**5,8**	**8,9**
Japón	3,3	4,7	5,0	5,4	5,3	4,7	4,4	4,1	3,8	4,0	4,6
Canadá	9,4	6,8	7,2	7,6	7,6	7,2	6,8	6,3	6,0	6,2	8,4
Unión Europea*	**—**	**8,6**	**8,4**	**8,8**	**9,0**	**9,0**	**8,7**	**7,9**	**7,1**	**7,0**	**9,4**
Alemania	7,9	6,9	7,6	8,4	9,3	9,8	10,6	9,8	8,4	7,3	9,0
Francia	10,7	9,1	8,4	8,9	9,0	9,2	9,3	9,2	8,3	7,8	9,6
Italia	10,4	10,1	9,1	8,6	8,5	8,1	7,7	6,8	6,1	6,8	8,9
Reino Unido	8,0	5,5	5,1	5,2	5,0	4,8	4,8	5,4	5,4	5,5	7,4
España	**19,5**	**13,9**	**10,6**	**11,5**	**11,5**	**11,0**	**9,2**	**8,5**	**8,3**	**11,3**	**17,7**
Zona euro	***—***	***8,1***	***7,8***	***8,2***	***8,7***	***8,8***	***8,6***	***8,4***	***7,5***	***7,6***	***10,1***

The FED drastic drop of reference interest rates

Shah Gilani writes: The truth? You can't handle the truth."

The truth is, the U.S. Federal Reserve does not directly control the Federal Funds rate, and its efforts **to reduce the benchmark rate from 2.0% to 1.5% may do more damage than good** – though for reasons you'd never guess. Attempts to lower the Fed Funds rate could irreparably damage Fed credibility and may actually narrow the Fed's credit-crisis-management options.
http://www.marketoracle.co.uk/Topic8.html
Friday, October 10, 2008

Was the "market oracle" forecast wright?

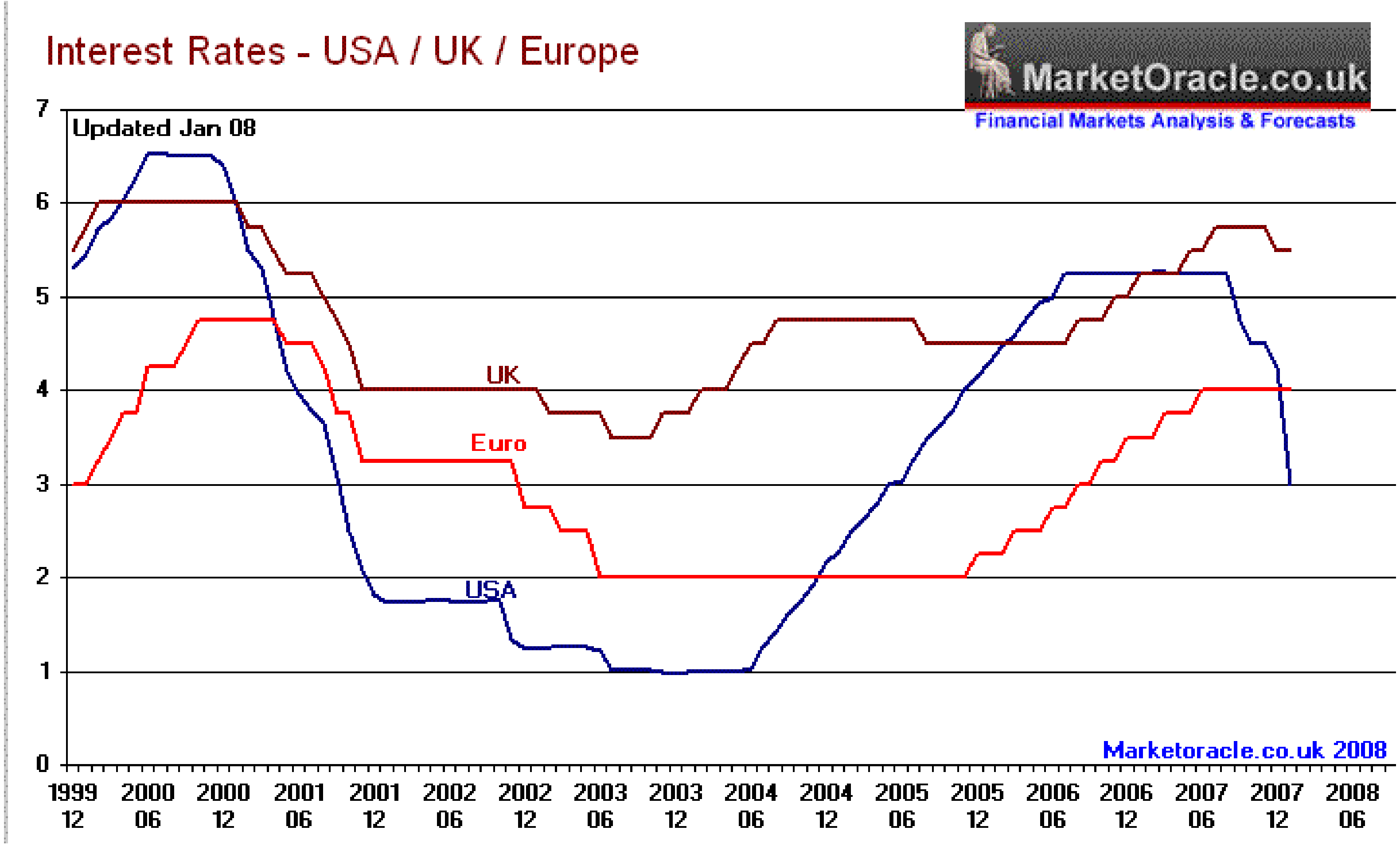
Was the “market oracle” forecast wright?

Now these days is clear that Giliani was wrong and Ben Bernaker (FED) was wright, see the evidence since 2008:

- ✓Check the growth rate in US v EU
- ✓Check the credit failure rate in US v EU
- ✓Check the unemployment rate in US v EU
- ✓Check the inflation rate in US v EU

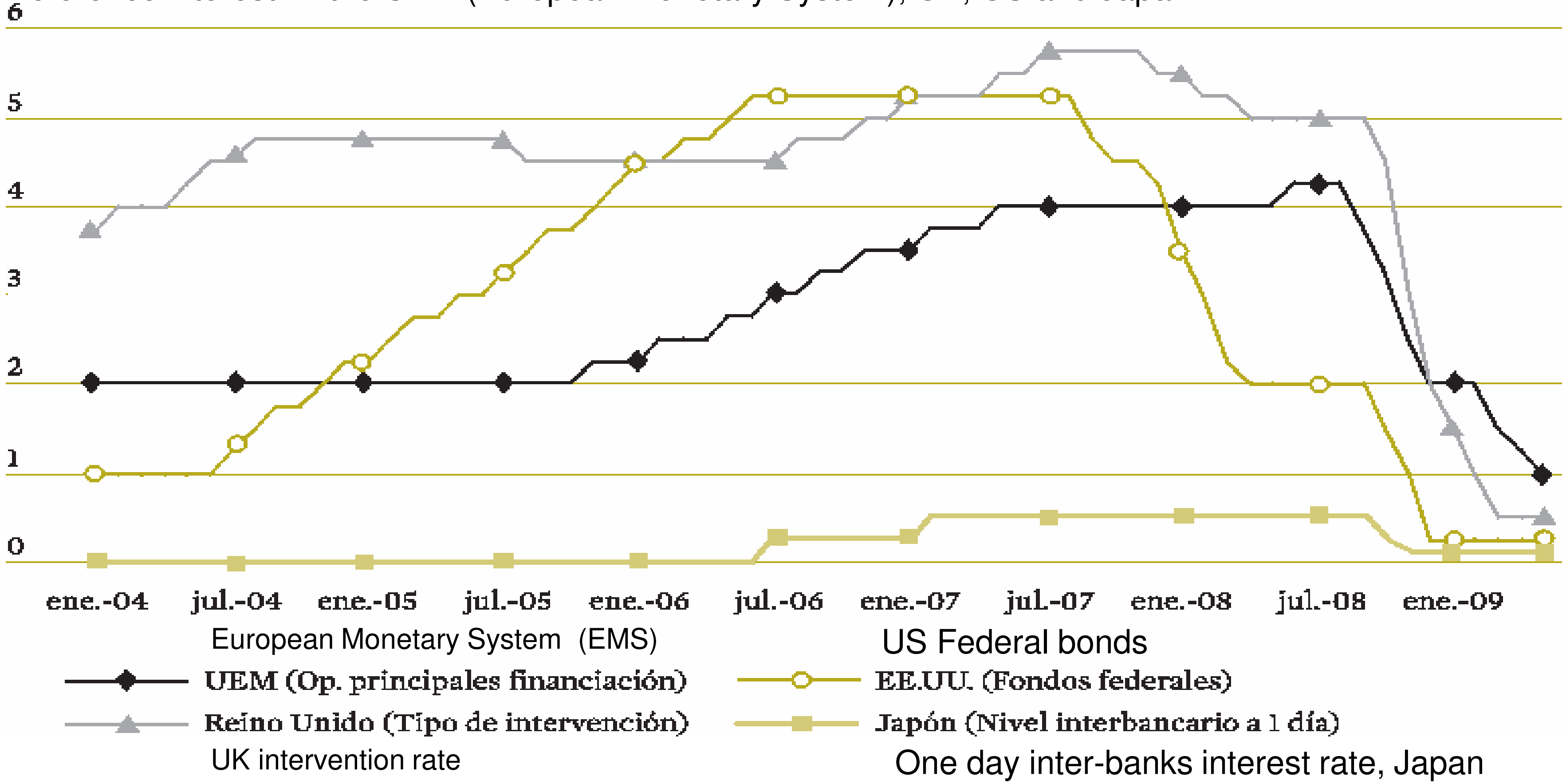
Reference interest rate drop dramaticaly first in the US.

- The ECB reduction is delayed and smaler.
- Risk aversion withing privet banks drive to liquidity constrain for the economy.



Finally all central banks drastically drop interest rates

Reference interest in the UEM (European Monetary System), UK, US and Japan.



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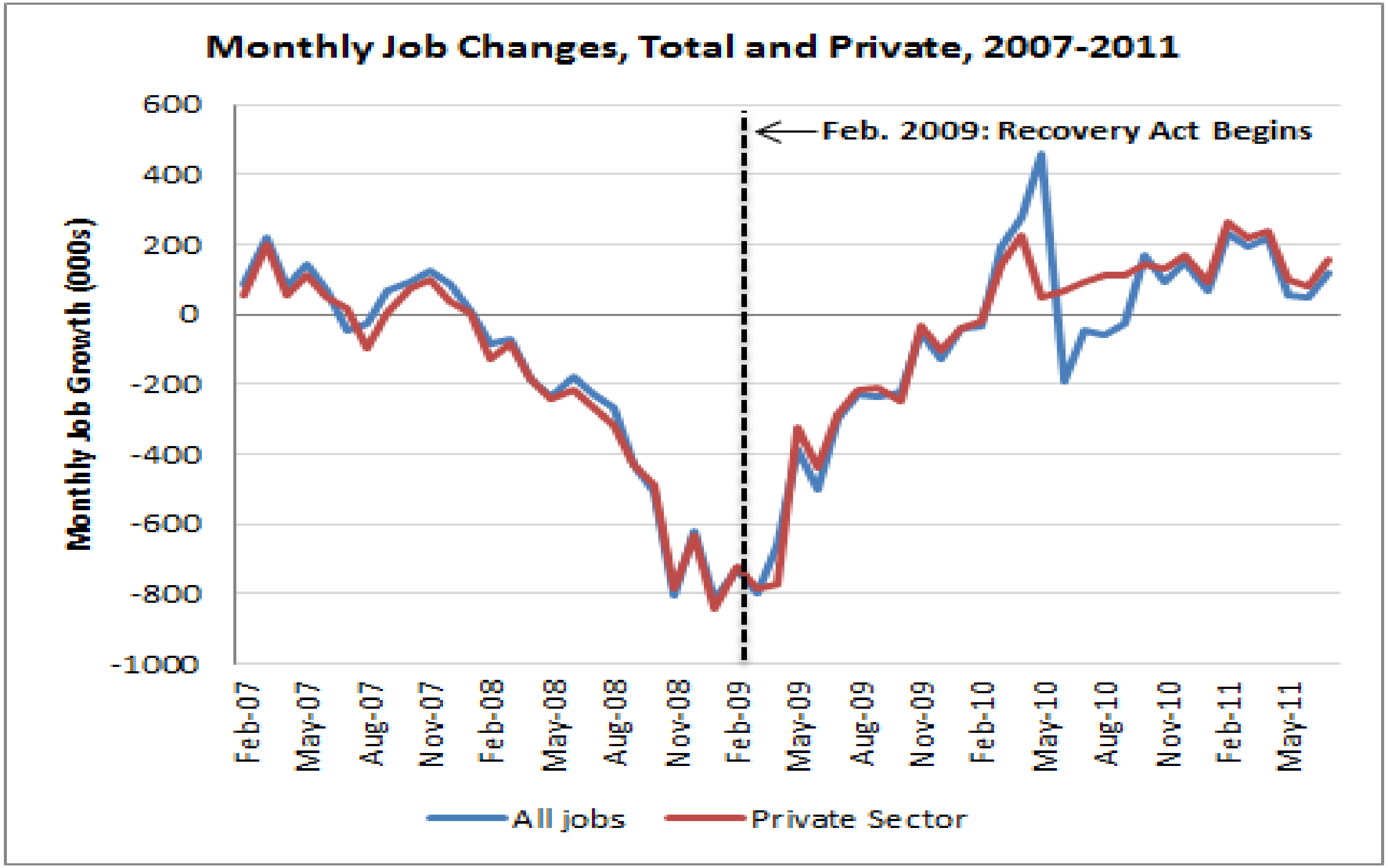
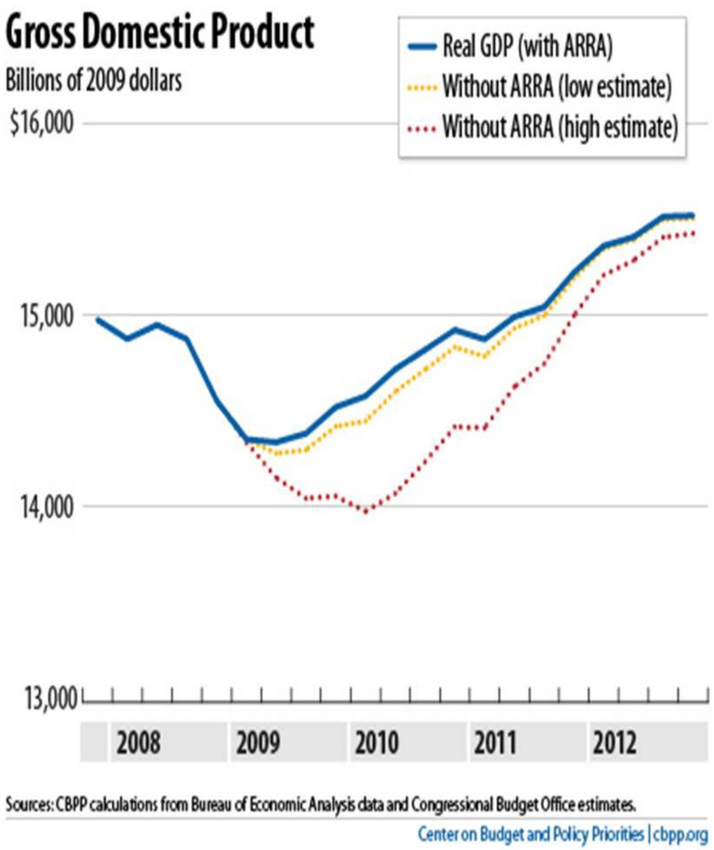
Fuente: Banco Central Europeo.

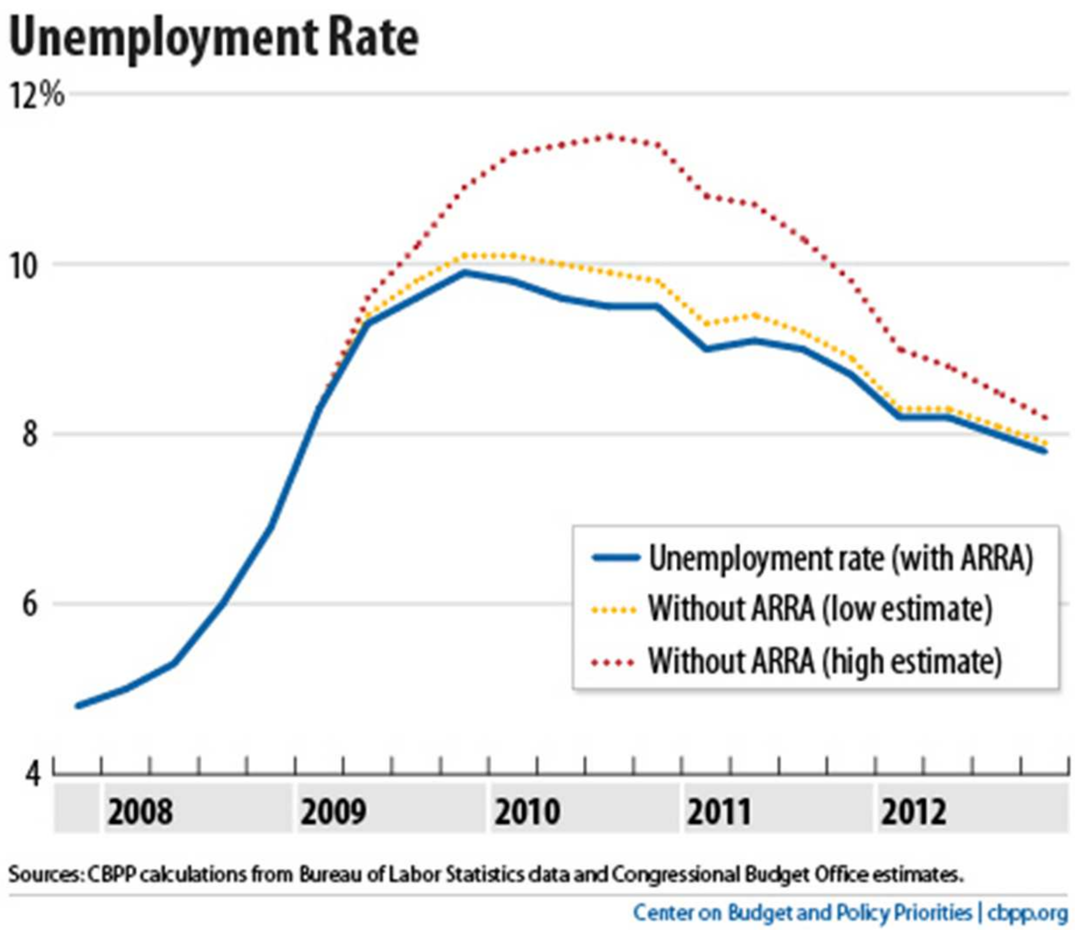
Jobs creation in the US

after the fiscal expansion of the Recovery Act



Impact on jobs simulations: without/with Recovery Act (ARRA)





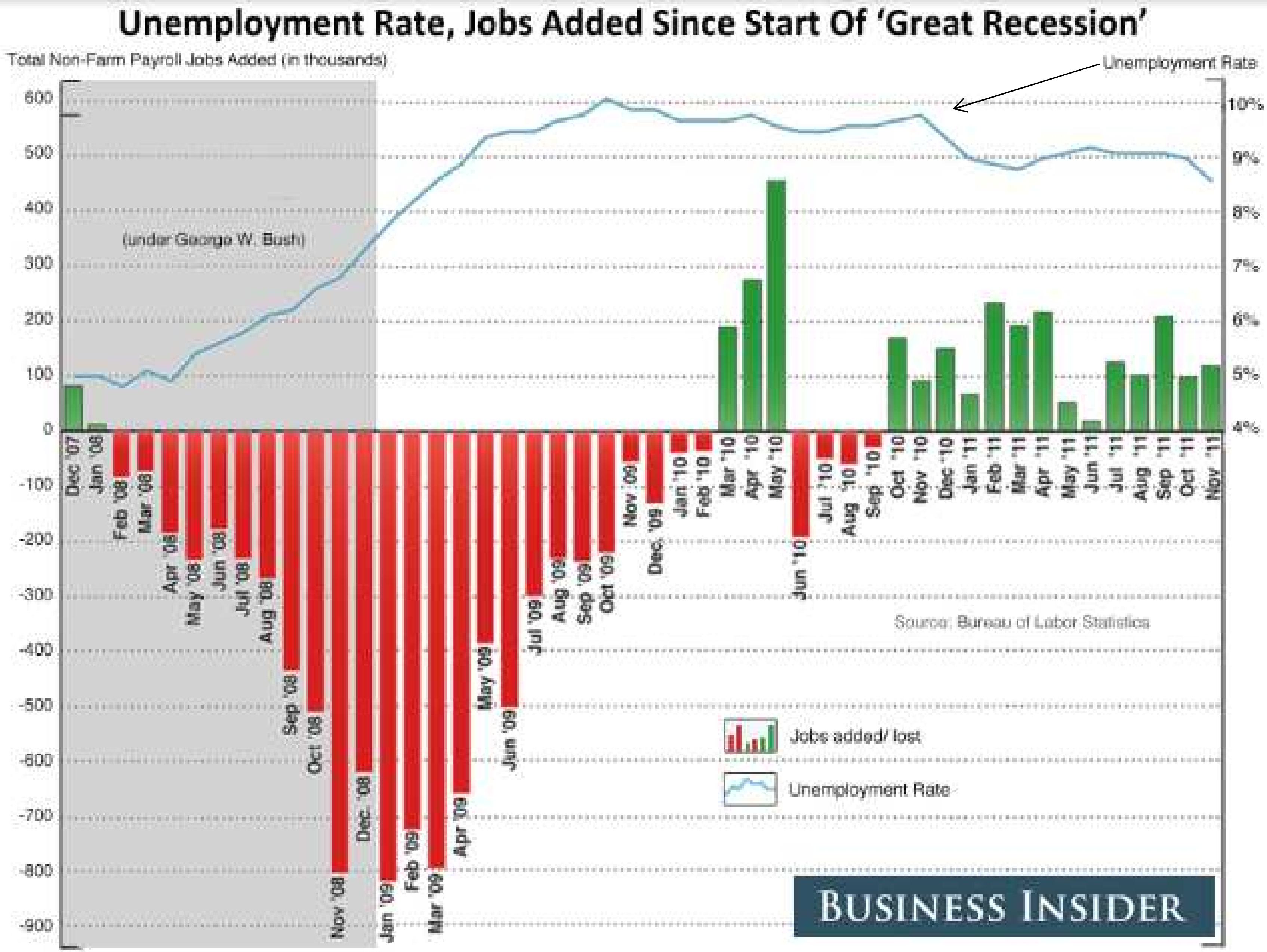
Keynesian policy results in the US

- 88 billions $ for the States in the Medicaid reimbursement program
  - Funds to re-balance States budget
- Different amounts depending on the State situation
- Clear impact on employment of the fiscal expansion:
- A marginal increases of $100.000 **generate 3,8 new jobs per year**
  - **Unemployment rate in 2015 (Feb.): 5.5%**
    - **Full employment is considerer aprox. 5 %**

The Obama program ARRA

1. February 2009
   a) $831 billions for 2009-2019
   b) 90% before 2012
2. Help jobs creation?
   a) $105 billions for infrastructure in the States
   b) $53,6 billions to school districts to prevent teachers firing
   c) $4 billions in vocational education for unemployees
   d) $87 billions to help *Medicaid in the States*
   e) Fiscal benefits for companies

Job creation in the US after the Great Recession



The economic and financial crisis: Europe's response/1

Source: Joaquin Almunia European Commissioner for Economic and Monetary Policy. What moves Europe? Global crisis and the euro. HN Club Discussion Forum. Bratislava, 8 January **2009**

- Global growth has slowed dramatically. The economic situation is deteriorating very quickly.
- The latest GDP data for the third quarter of 2008 showed that growth contracted by 0.2% in both the euro area and the EU.
- Demand for exports is falling as the world experiences a global downturn.
- Across the board, confidence indicators are reaching historically low levels.
- And fragile conditions in the financial sector are continuing to impact the flow of credit to households and businesses.

However, we are not powerless in the face of this crisis.

Europe is taking decisive action to break the spiral of economic contraction and job cuts.

The crisis: Europe's Macroeconomic policy response. Almunia/**2**

- The European Central Bank, together with central banks around the world, has made aggressive interest rates amounting 175 basis points since October.
- But monetary policy alone cannot provide the full stimulus needed by the European economy. **Macroeconomic policies also need to support demand**.
- Realising this, the Commission reacted quickly in November 2008. We proposed an ambitious **economic recovery plan** that brings together a
  - **fiscal stimulus to boost demand in the short term** and
  - **a program of 'smart' investments to strengthen growth prospects in the medium and longer run.**

Fiscal stimulus in the EU, late and not big enough

Member States have agreed to employ a coordinated **budgetary stimulus amounting to 1.5% of GDP.** (Nov., 2009)

Of this figure, **1.2% is to be financed at the Member State level**,(…).

It is crucial for their effectiveness that these plans are **well designed**:

- **timely** so as to counter the downturn;
- targeted for **maximum effect on demand**; and
- **temporary** to avoid the need for **damaging permanent tax increases.**

- **Until 2011 boost recovery in the EU**
- **But budget cuts after 2011 driven to a second recession in the mediterranean countries and Ireland**

External factors of the Spanish recession: financial crisis

1. The financial crisis originated by the failure of the big investments banks
2. The spread of the toxic assets throughout the EU financial system originated by
   1. Trash mortgages
   2. Hedge founds that attract banks with excess liquidity seaking for high profitability
   3. but assuming high levels of risk, thanks to deregulation
3. US big banks failures in September, 2008
   1. Fanny Mae, Freddy Mack, *Leman Brothers*, Merryl Lynch...
   2. Black hold in the Spanish financial sector stimated in 350.000 millions $ and expert forecast that will reach the 700.000 millions $.
   3. Mainly saving banks (*Cajas de Ahorros*): *Caja Madrid, Caixa Catalunya, Caja del Mediterraneo, …*

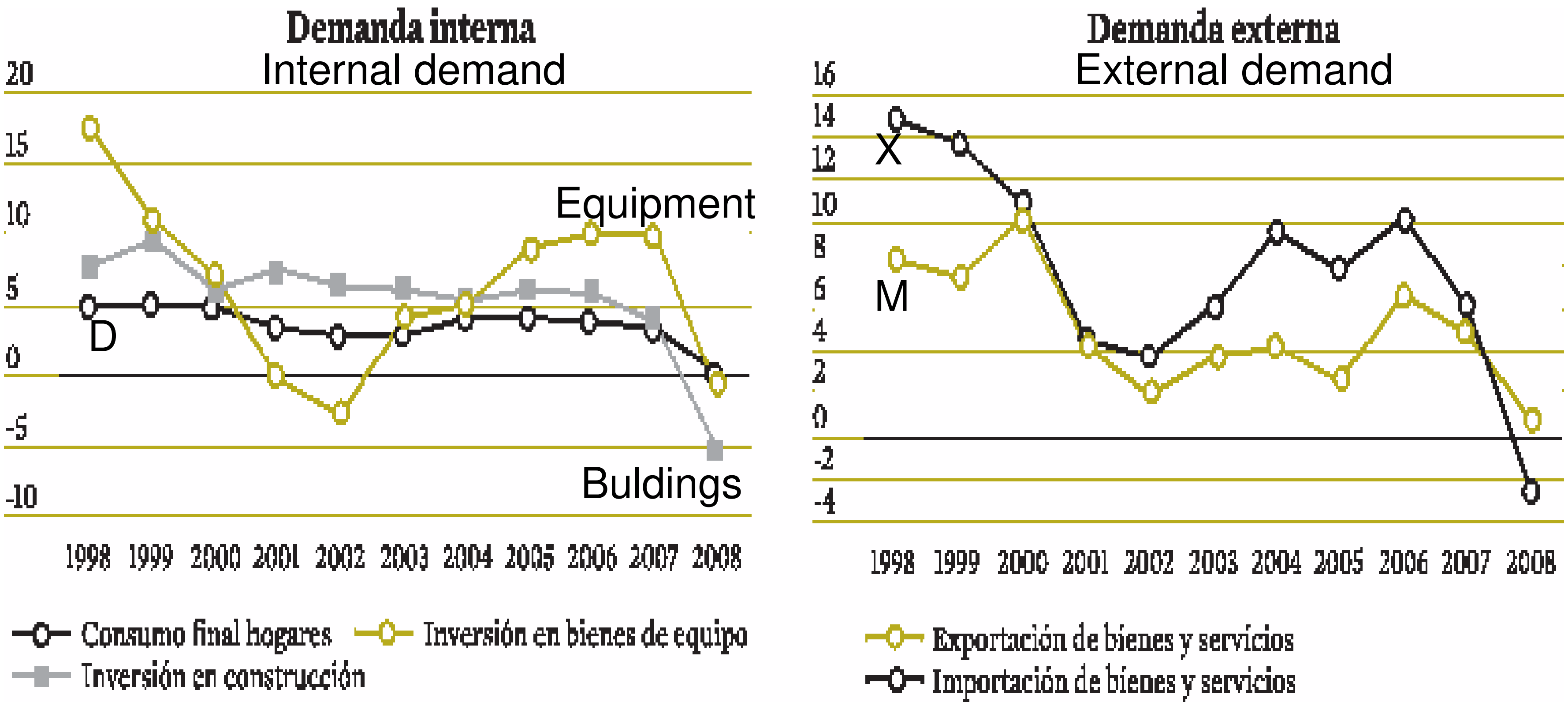
Credit shortage

- Increases in default credits drive to reduce the credit facilities to the privet sector
- Dominique Strauss-Kahn, IMF director:
  - << ***The financial crisis has been catastrophic but with human origin***>>
- Even in a market economy **certain level of regulation is necessary** to ensure the well functioning of the financial system
- These ideas about economic liberation like: a bigger privet sector drive to a more efficient economy prove to be the origin of the recent financial crisis.
- Market is able to solve every problem without regulation
  - <<***Simply look nice in text books but do work in the real economy***>> (Strauss-Kahn El PAÍS, Negocios 20/09/09 p.8)

Internal factors of the Spanish economy driving to the recession

1. End of the real state bubble
2. Building sector recession means rapid increases in the unemployment rate
3. Fall in the touristic demand because of the external recession
4. Impact of the reference interest rate increases of the ECB in 2007
   a) Drop in credit supply
   b) Liquidity constraint
5. Raise of row material in the first semester of 2008
   a) Oil price increase
   b) Food price
   c) Brokers try to diversify portfolios investing in real goods
6. Confuses the diagnostic of the ECB: danger of inflation-> rise interest rate of reference -> deeper recession

Internal (right) and external demand (left), Spain
1998-2008
(Annual rate)

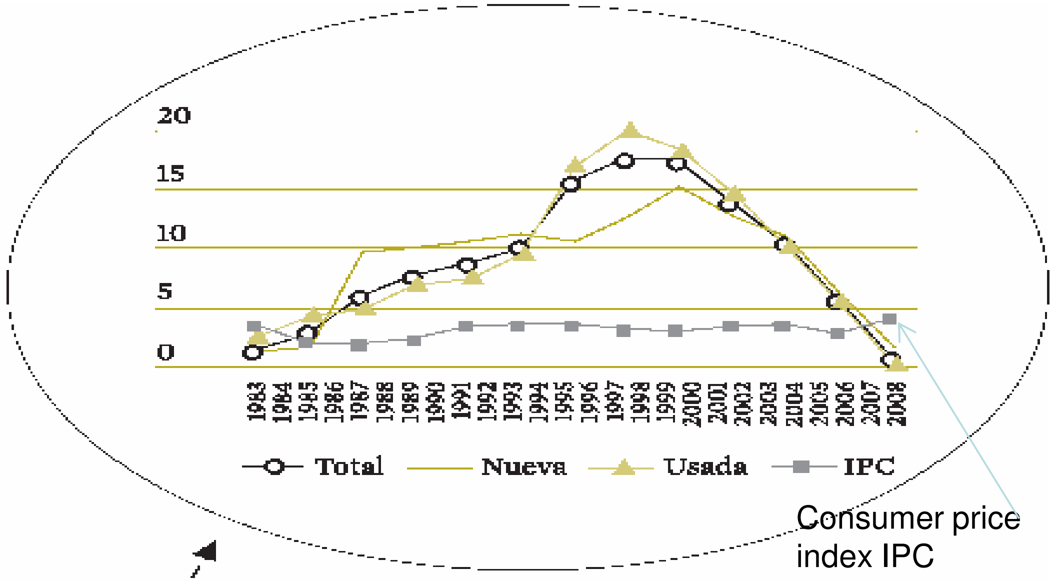


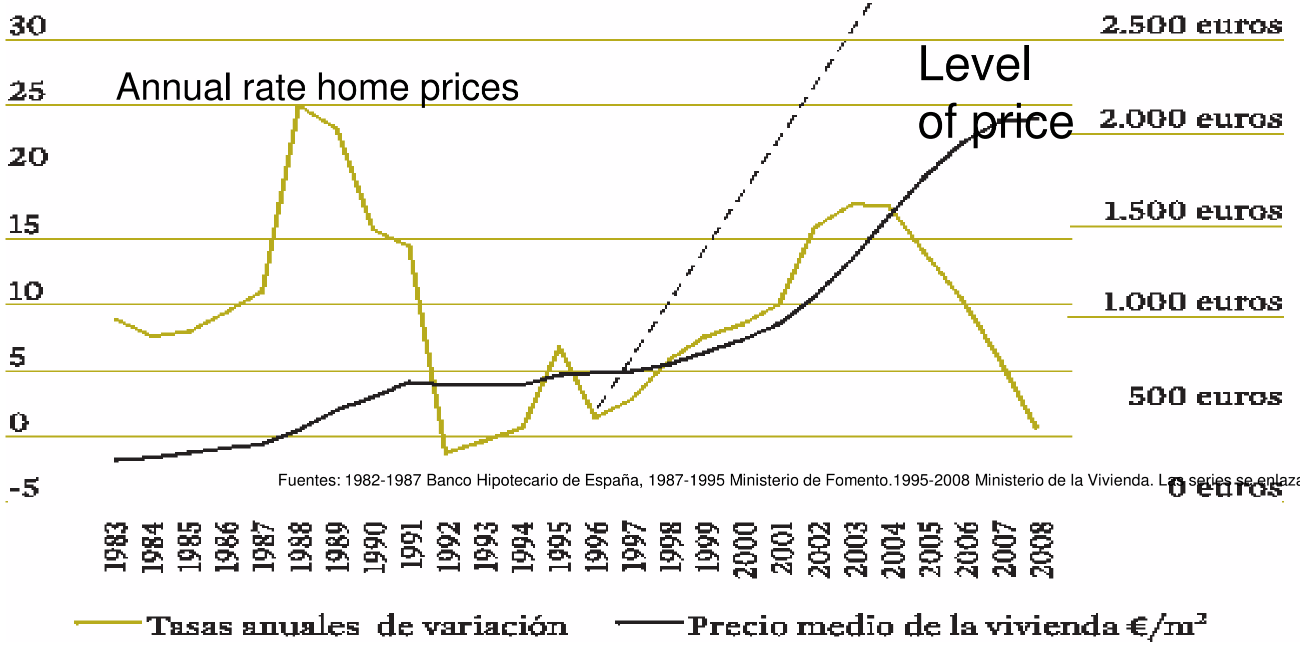
Fuente: INE, *Contabilidad Nacional Trimestral de España*. CES,2009

Annual Rate square meter price of homes in Spain, 1983-2008

END OF THE REAL STATE BUBLE

-Deflation in the homes market

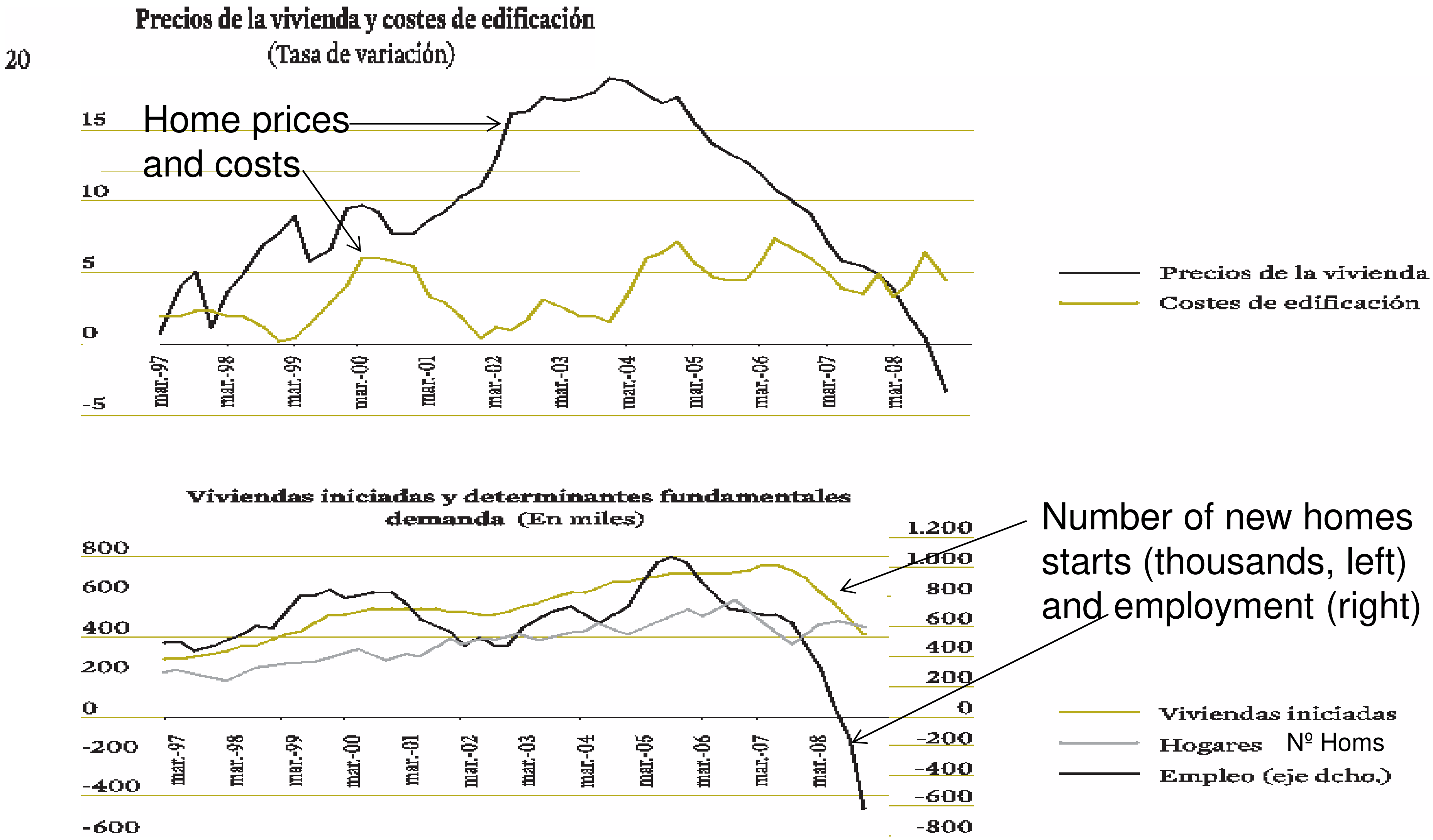




Fuentes: 1982-1987 Banco Hipotecario de España, 1987-1995 Ministerio de Fomento.1995-2008 Ministerio de la Vivienda. Las series se enlazan en medias anuales.

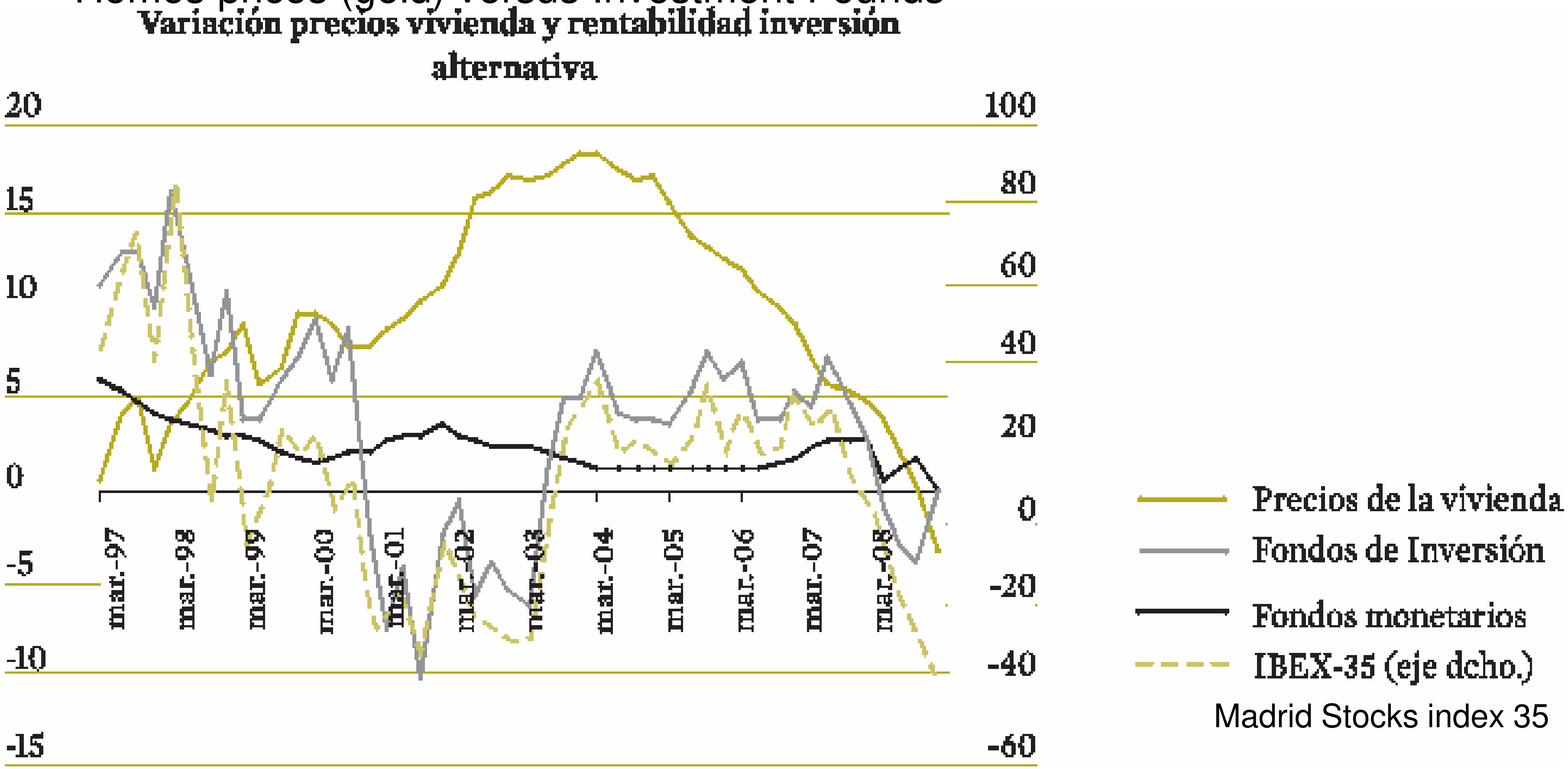
REAL STATE MARKET INDICATORS, 1997-2008 .

1. Prices fall since March
2. Prices start slowdown and the increase is slower than cost of building since
3. Unemployment growth since 2008 (below) Less new homes starts.



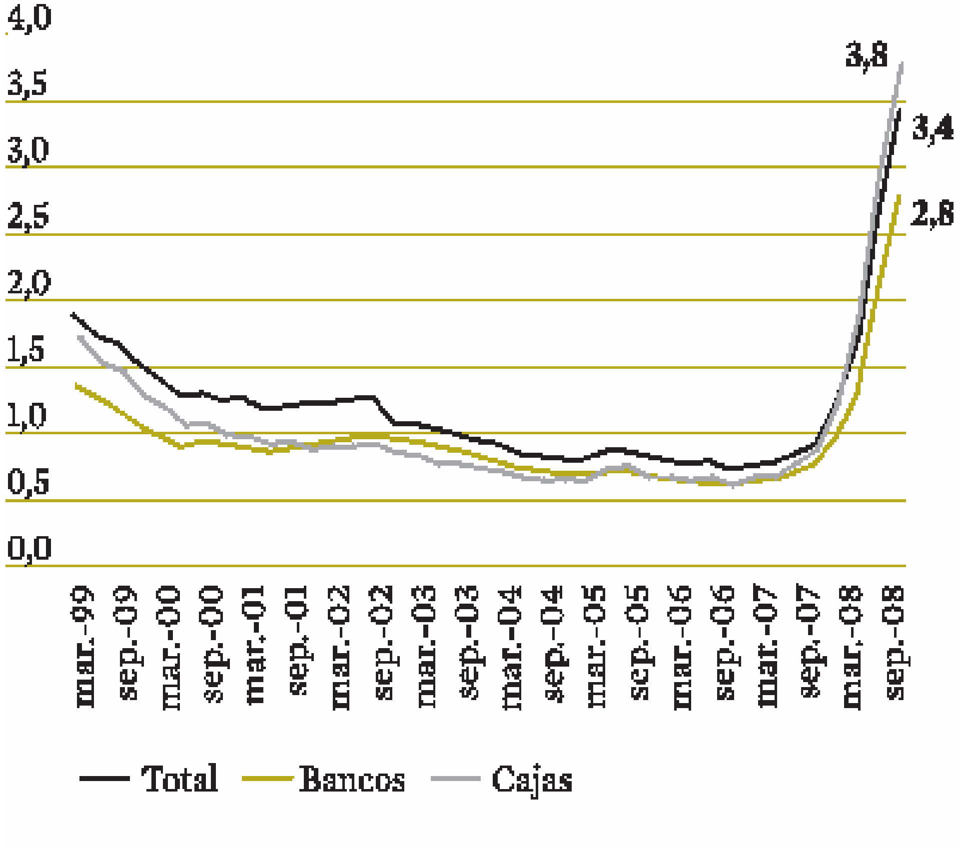
Fuente: Banco de España, CES, 2009

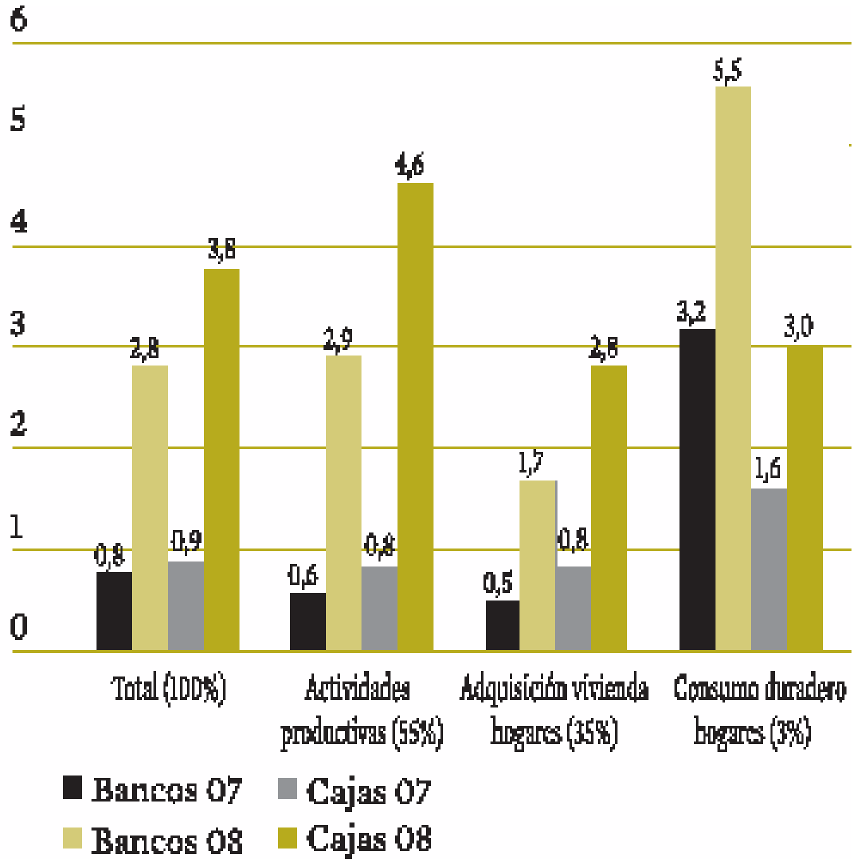
Homes prices (gold) versus Investment Founds



Fuente: Banco de España. CES, 2009

Default credit rate in the private sector, 1999-2008 (*Porcentaje de crédito dudoso sobre total de crédito*)





Fuente: Banco de España, *Boletín Estadístico.* CES,2009

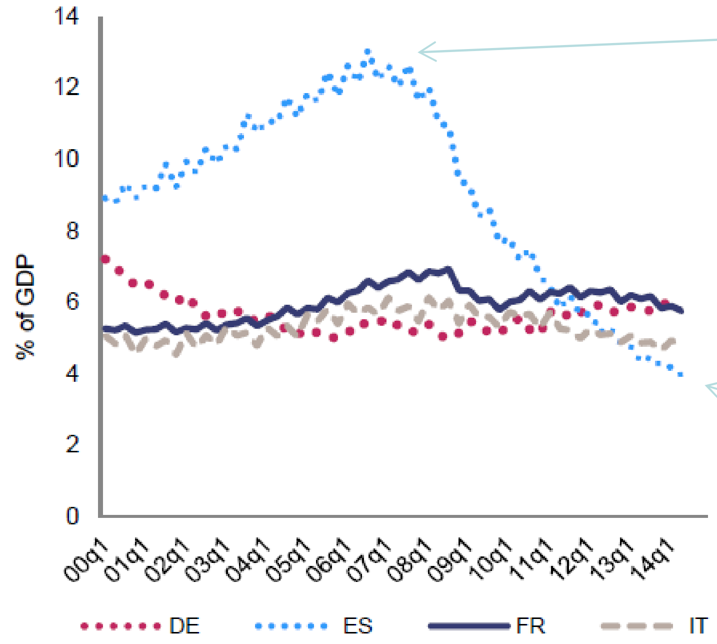
Correction of the Spanish housing market

- The correction of the Spanish housing prices after the burst of the construction bubble has been sharp.

Post-bubble price adjust

Spain below Germany, France and Italy

Graph 2.2.5: **Residential investment as percentage of GDP**



Source: European Commission

Source: COMMISSION STAFF WORKING DOCUMENT. Country Report Spain 2015 Including an In-Depth Review on the prevention and correction of macroeconomic imbalances. {COM(2015) 85 final}

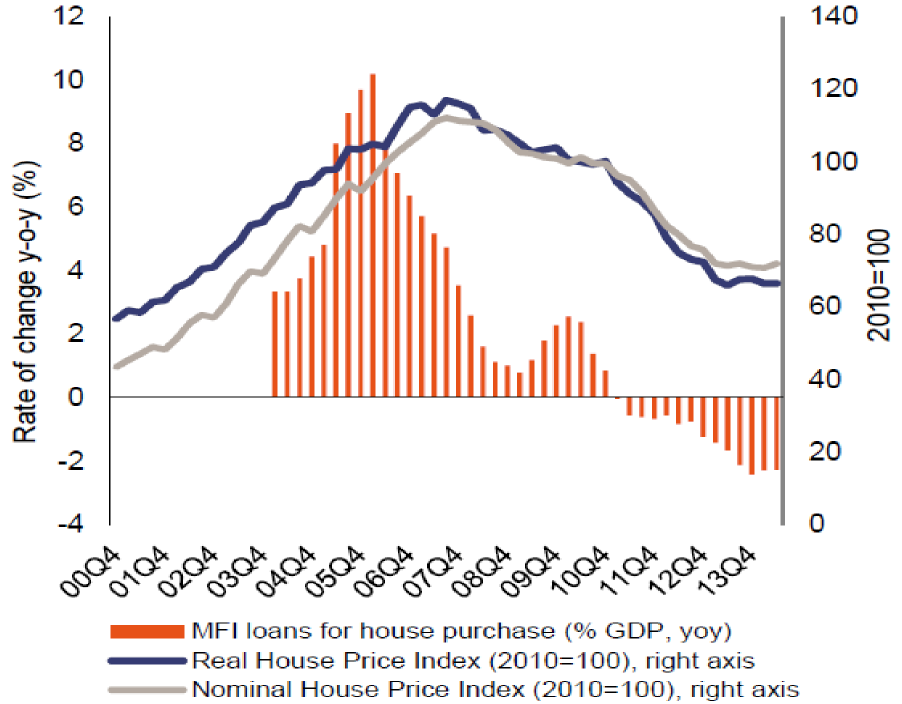
The correction of the Spanish housing market after the burst of the construction bubble has been sharp.

1. **Spain witnessed a construction boom** prior to the crisis.
2. The share of residential investment exceeded 10 % of GDP each year between 2003 and 2008
3. In the crisis, it fell from the peak of around 12.5 % in 2006 to 4.1 % in the first half of 2014 (Graph 2.2.5), and is now lower than the average for the euro area.
4. **Spain has one of the highest ownership rates in the EU**

Housing prices seem to have reached a trough,

but further movements in prices cannot be excluded

Graph 2.2.6: **Evolution of House Price Index and MFI loans for house purchase**



Source: ECB, European Commission

- Nominal house prices have decreased by 36 % from the peak in Q3-2007 (Graph 2.2.6).
- The available studies suggest that the degree of overvaluation is much reduced (18)
- According to the Spanish statistical institute INE,
  - the annual increase in the number of households is projected to **slow down** to around 60 000 in the next 15 years, compared with much higher increases observed prior to the crisis.

Source: (18) Cuerpo, C. and Pontuch, P., *Spanish housing market: adjustment and implications,* Directorate-General for Economic and Financial Affairs, Country Focus, Vol. 10, Issue 8, December 2013. Cited by **COM(2015) 85 final}**

Recent rental market reforms

support the adjustment process in the housing market.

- **In** 2013 Spain amended its legislation to create a larger and more efficient housing rental market.
- Law 4/2013 on the promotion of the rental housing market strengthened the legal rights of owners but also provided **greater flexibility in ending rental agreements**.
- A more flexible and efficient rental market **should facilitate the conversion of vacant units into rental accommodation.**
- Together with the **elimination of tax-deductible mortgage payments** from the beginning of 2013,
  - in the long term it is expected to reduce the bias towards home ownership and the volatility of house prices.

Source: **COM(2015) 85 final}**

Drivers of indebtedness and deleveraging in the households sector

- **Household deleveraging is mainly affected by the stock of mortgage loans.**

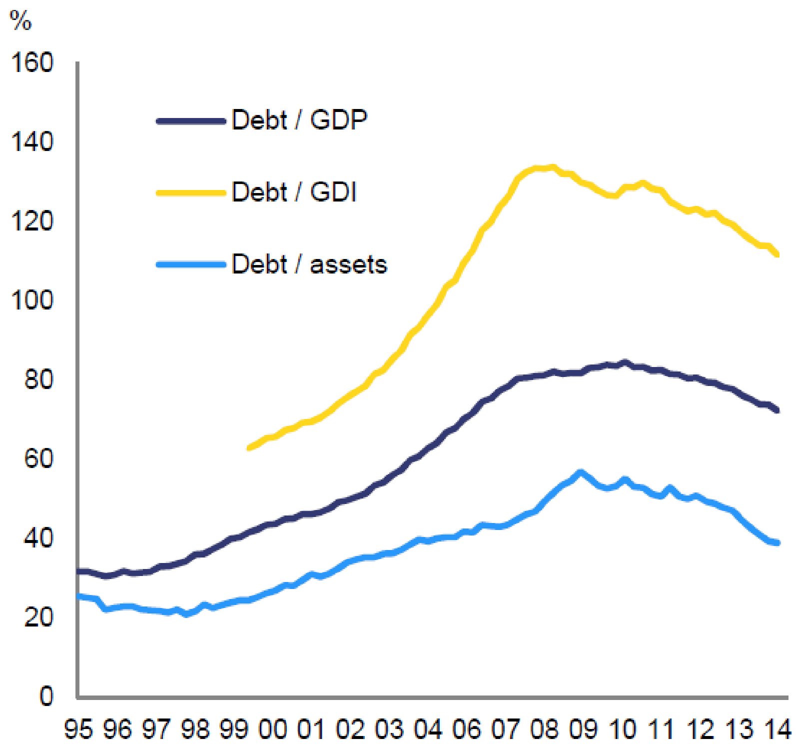
- **The majority of** household loans are **long-term** (around 96 % of the total stock of loans in household liabilities) and **related to housing** (over 78 % of the stock), primarily mortgages.
- The composition of household debt was slightly affected by the crisis,
- as the stock of *short-term loans* **declined by more than a quarter after the peak** in Q2-2008,
- While *long-term loans* reached their **peak only two years later**, and have since declined by 15 %.
- The decline in long-term loans was more muted despite **the prevalence of variable-rate mortgages**, which have helped to make **low interest rates available to households** and thereby contain their interest burden.(19)

(19) *Housing Recoveries – Cluster Report on Denmark, Ireland, Netherlands, and Spain, IMF Country Report no. 15/1,* January 2015. Cites by Cited by **COM(2015) 85 final}**

Source: COM(2015) 85 final}

Household leverage

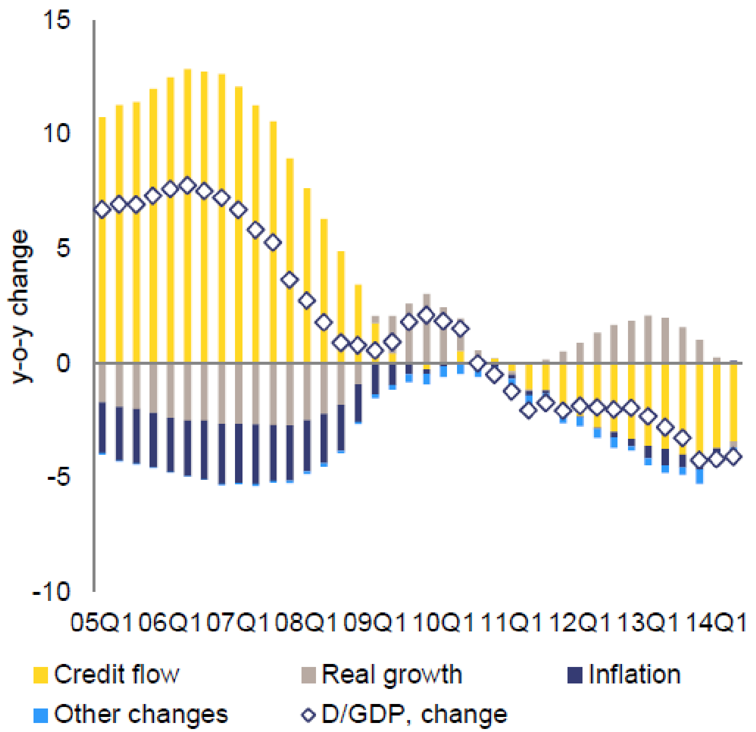
Graph 2.2.8: **Household leverage in Spain**



Source: BdE, European Commission

Indebted households more financially fragile Consequences of the real state bubble in Spain

Graph 2.2.7: **Breakdown of year-on-year changes in debt-to-GDP ratios, households**



Source: European Commission

Negative credit flow after 2010-I shows the credit crunch situation of Spain in the external financial markets (yellow bars)

1. Indebted households in Spain have one of the **highest debt-to-income** ratios in the euro area (at 145.9 %),
   a) and are particularly sensitive to an **interest rate shock**.

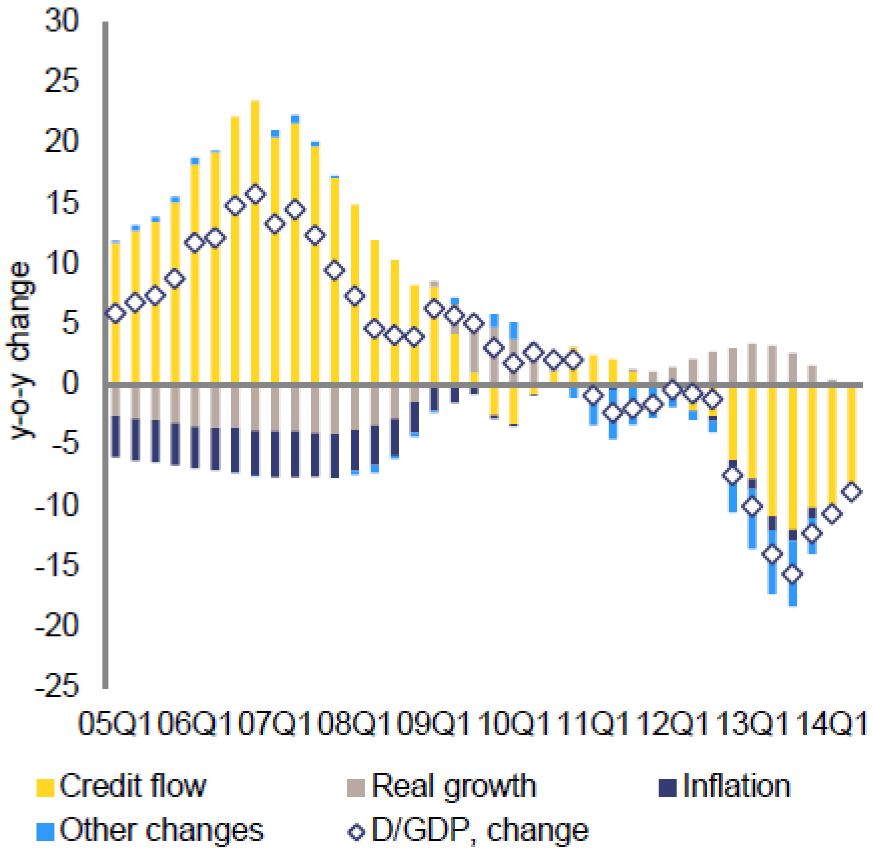
Simulation: hypothetical 300 basis points increase in the interest rate

As adjustable rate loans prevail in Spain,

- after a hypothetical 300 basis points increase in the interest rate,
  - the median debtservice-to-income ratio of indebted Spanish households would increase from around 25 % to
- 30 %, and 36 % of indebted households would face a ratio greater than 0.4.

Deleveraging process in Spain has been successful

Graph 2.2.9: **Breakdown of year-on-year changes in debt-to-GDP ratios, non-financial corporations**



Source: European Commission

- The stock of **domestic** credit to non-financial corporations(NFCs) ↓35% (2009-I to 2014)
- Total financing to **firms** =(loans + liabilities) goes ↓25% (2009-I to 2014)
- Low inflation rates do not easy the deleveraging process of NFCs

The great recession

- Over the course of 2009 the world economy underwent the biggest contraction since the end of the Second World War.
- In annual average terms, global growth stood at around -0.6%,
  - as a result of the **decline in the GDP of the developed** economies (-3.1%) and
  - of the **strong slowdown in output in the emerging economies** (by around 4 pp to 2.3%).
  - **Inflation** rates fell off to more moderate levels, or even turned negative in the case of the advanced economies,

(BdE, 2009)

Rapid and forceful economic policy response

- Rapid and forceful economic policy response in 2009,
- which managed to check the negative feedback loop between:
  - the **real** and **financial** sectors into which the world economy had entered.
- The stabilizing action of economic policies was also discernible in the financial markets
  - governments' and central banks' resolute action managed to head off the more extreme risks.
  - Volatility and risk-aversion declined significantly from their lowest valley in late 2008 during 2009.

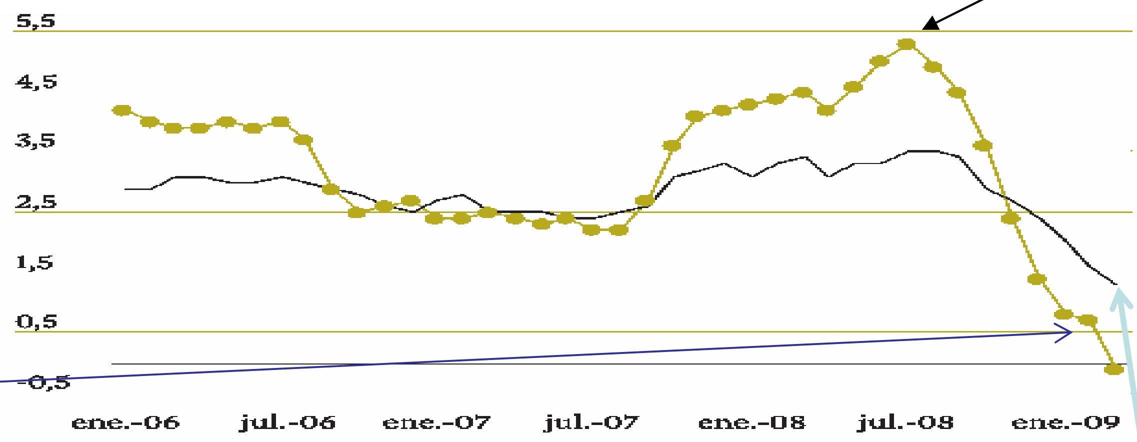
(BdE, 2009)

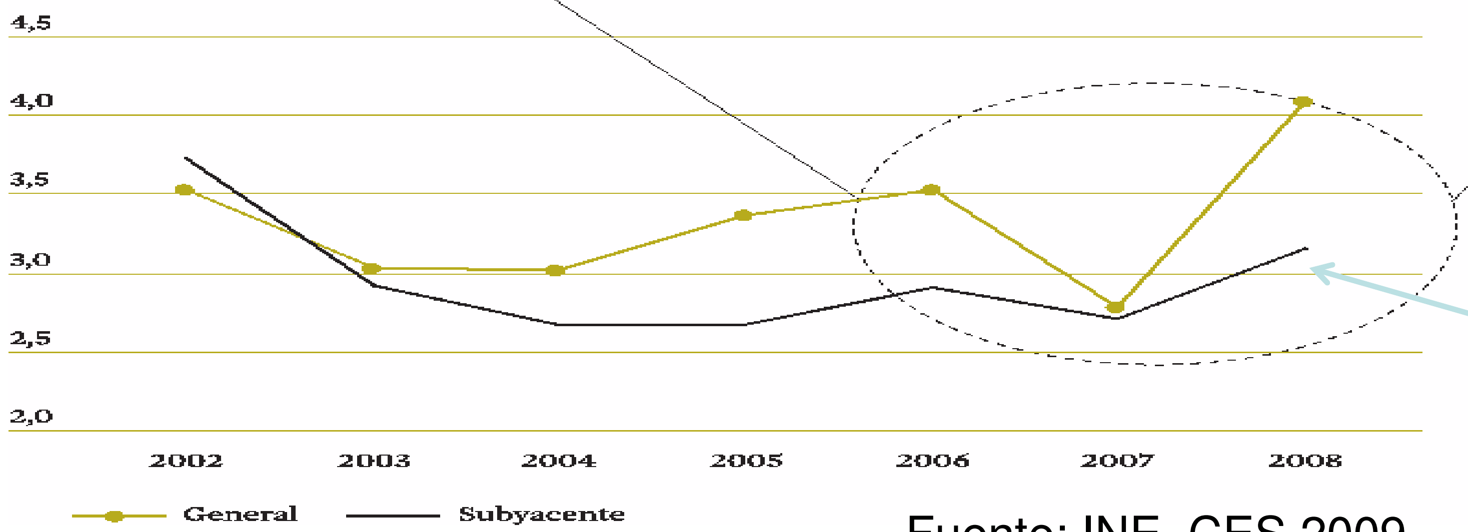
INFLATION IN SPAIN, 2002-2008

Consumer Price Index IPC. Annual (lower panel) and monthly (upper panel)

The oil and food price growth during the first semester of 2008 increase the inflation rates (bellow)

But during the second semester inflation drops suddenly reaching negative values in 2009 (upper panel).



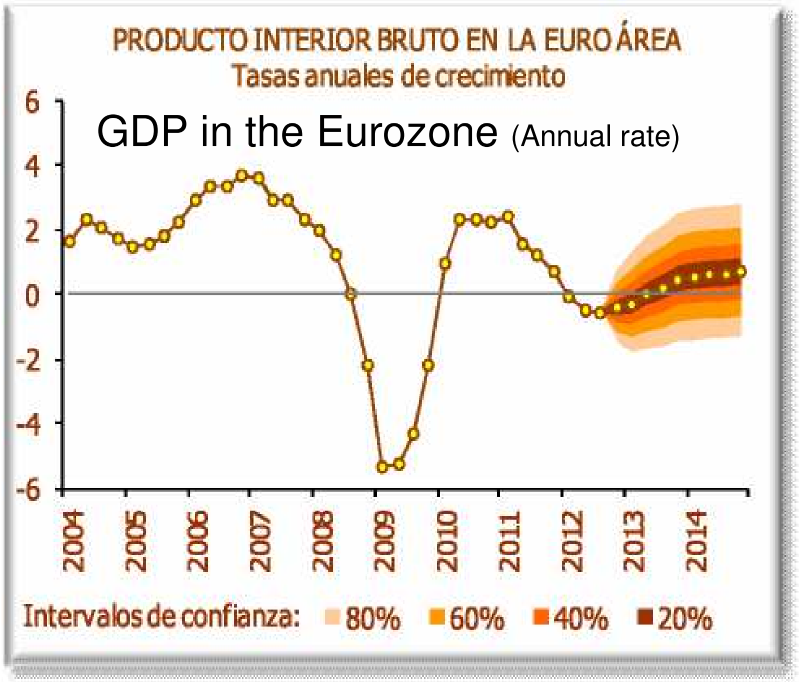


Inflation without food and energy

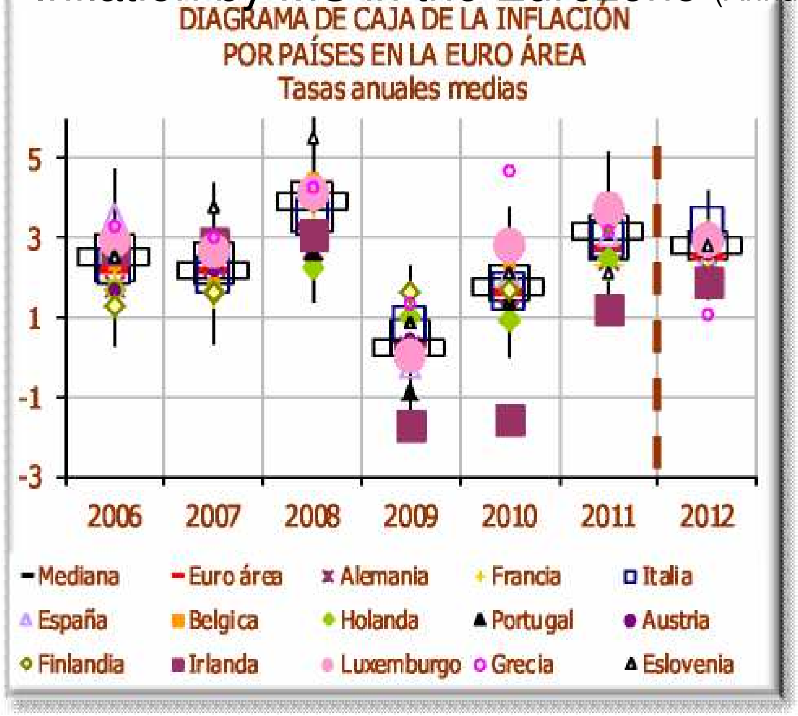
Fuente: INE. CES,2009

THE GREAT RECESSION IN THE EUROZONE

1. After recover from the 2008 the EU Council decide reduce the public déficit of the Memmber State in 2011
2. The budget cut policy generate a doble deep recession and the GDP will not recover until the end of 2013
3. Week GDP growth in 2014, forcast rate of 0.6% (± 1.8) in the eurozone
4. The inflation (right panel) was low in the Eurozone. No risk of inflation tensions
5. In **2013** a week recovery in the **Eurozone (-1.3 a 1.5%)** but in Spain **the recession holds (-2.6 and 0%).**



Inflation by MS in the Eurozone (Annual rate)



Fuente: EUROSTAT & BIAM(UC3M), tomado de BIAM, 220
Fecha: 17 de diciembre de 2012 Fecha: 16 de enero de 2013

Recession in the Spanish financial system

Main financial facts

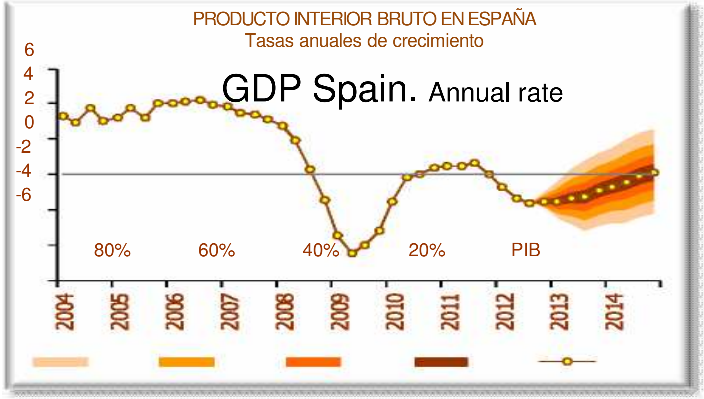
1. Systemic shortage of liquidity
2. Increased credit risk
3. Decrease in trade demand
4. Contraction in investment → rapid unemployment rate growth
5. Public debt crossed the threshold of 50% of GDP reaching more than 90 % (2013)

SPAIN VERSUS THE EUROZONE (Z€) FROM 2008-III TO 2014-IV

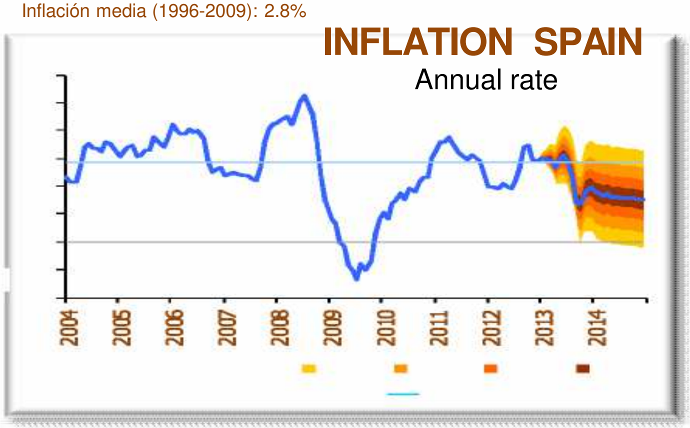
- Until 2014-IV the CRISIS means a drop of **-6,8 in Spain** versus -1,3 in the Z€
- The industrial GVA drop **-12,8 in Spain** versus -2,7 in the Z€
- The Spanish building sector GVA suffer a dramatic **-41,1** versus -19,3 in the Z€

- 3,7 millions disappear from 2008-II equivalent to av**-18,4 % accumulated annual rate.**
- **Unemployment rate rose to 28 %**
- **Inflation under the ECB target of 2 % CPI / IPC**
- CONCLUSIONS:
- Longer and deeper recession in Spain than in the Z€.
- EU error trying to reduce public deficit before the recovery is consolidate

Fuente: INE & BIAM (UC3M) Fecha: 15 de enero de 2013



Intervalos de Confianza: 80 % 60 % 40 % 20 %
Inflación media (1996-2009): 2.8%



Emerging countries overpass Spain during the crisis

In GDP Korea, South and Mexico bigger than Spain (but Spanish GDP per inhabitant is superior)

14ª world economy by GDP

RANK	COUNTRY	GDP (PURCHASING POWER PARITY)	DATE OF INFORMATION
1	European Union	$ 15,480,000,000,000	2011 est.
2	United States	$ 15,080,000,000,000	2011 est.
3	China	$ 11,300,000,000,000	2011 est.
4	Japan	$ 4,444,000,000,000	2011 est.
5	India	$ 4,421,000,000,000	2011 est.
6	Germany	$ 3,114,000,000,000	2011 est.
7	Russia	$ 2,383,000,000,000	2011 est.
8	Brazil	$ 2,294,000,000,000	2011 est.
9	United Kingdom	$ 2,288,000,000,000	2011 est.
10	France	$ 2,214,000,000,000	2011 est.
11	Italy	$ 1,847,000,000,000	2011 est.
12	Mexico	$ 1,667,000,000,000	2011 est.
13	Korea, South	$ 1,554,000,000,000	2011 est.
14	Spain	**$ 1,406,000,000,000**	**2011 est.**
15	Canada	$ 1,395,000,000,000	2011 est.

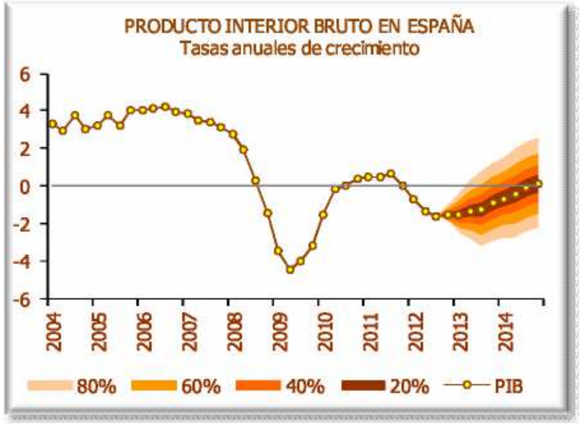
Spanish Industrial Production Index (upper panel) versus US (lower)

		Consumo: Duradero	Consumo: No Duradero	Consumo: Total	Bienes de Equipo	Bienes Intermedios	Energía	Total sin energía	TOTAL
TASAS ANUALES MEDIAS	2008	-5,4	-1,3	-1,9	-0,3	-3,4	0,0	-1,9	-1,7
	2009	-17,4	-3,0	-4,9	-20,9	-19,2	-5,4	-16,1	-14,9
	2010	2,7	3,1	3,0	9,2	10,0	3,8	7,8	7,3
	2011	0,6	0,5	0,5	8,6	4,1	-4,4	4,4	3,4
	2012	**-5,5**	**-2,4**	**-2,8**	**-1,0**	**-3,8**	**-0,2**	**-2,6**	**-2,4 (±0,9)**
	2013	**-3,0**	**-0,4**	**-0,7**	**1,8**	**1,2**	**-0,7**	**0,9**	**0,7 (±2,1)**
	2014	**-2,3**	**0,0**	**-0,2**	**2,8**	**1,5**	**-0,1**	**1,5**	**1,3 (±2,7)**
TASAS ANUALES	2011 TI	2,6	0,5	0,7	13,0	9,0	-2,0	-2,0	6,4
	TII	1,3	1,5	1,5	9,2	4,3	-5,5	-5,5	3,9
	TIII	2,0	0,4	0,5	9,4	3,6	-2,7	-2,7	3,8
	TIV	-3,0	-0,4	-0,7	3,7	-0,4	-7,6	-7,6	-0,3
	2012 TI	-5,0	-2,7	-3,0	1,8	-3,1	-3,4	-3,4	-1,7
	TII	-5,3	-2,7	-3,0	-1,0	-3,9	1,4	1,4	-2,3
	TIII	-5,2	-1,9	-2,3	-0,8	-4,0	0,4	0,4	-2,2
	TIV	**-6,6**	**-2,3**	**-2,8**	**-3,8**	**-4,2**	**1,5**	**1,5**	**-3,1**
	2013 TI	**-5,3**	**-0,5**	**-1,0**	**-1,4**	**-2,6**	**-0,8**	**-0,8**	**-1,8**
	TII	**-3,5**	**-0,6**	**-1,0**	**1,1**	**0,3**	**-0,6**	**-0,6**	**0,2**
	TIII	**-2,9**	**-0,5**	**-0,7**	**2,5**	**3,2**	**-1,1**	**-1,1**	**1,8**
	TIV	**-0,3**	**0,1**	**0,0**	**5,0**	**4,3**	**-0,4**	**-0,4**	**2,8**
	2014 TI	**-1,2**	**0,2**	**0,1**	**3,8**	**2,7**	**0,2**	**0,2**	**2,1**
	TII	**-2,1**	**0,3**	**0,0**	**3,0**	**1,8**	**-0,6**	**-0,6**	**1,5**
	TIII	**-2,6**	**-0,2**	**-0,4**	**2,5**	**1,1**	**-0,1**	**-0,1**	**1,0**
	TIV	**-3,1**	**-0,2**	**-0,5**	**2,1**	**0,4**	**-0,1**	**-0,1**	**0,7**

ÍNDICE DE PRODUCCIÓN INDUSTRIAL Y SECTORES EN EE.UU.
Tasas anuales de crecimiento

	Bienes de consumo: Duradero	Bienes de consumo: NoDuradero	Bienes de Equipo	Bienes de materia l	**TOTAL**
2008	-11,2	-2,8	-3,6	-2,7	**-3,5**
2009	-16,6	-3,9	-14,8	-11,5	**-11,4**
2010	8,2	-0,7	4,8	8,4	**5,4**
2011	7,1	01	4,6	4,6	**4,1**
Predicciones 2012	7,9	-0,5	5,5	3,9	3,6
Predicciones 2013	3,5	-0,2	1,9	1,3	1,2
Predicciones 2014	7,4	00	4,4	04	3,5

•The EU policy of so call "expansive austerity" fail creating a new recession after the implementation in 2011
•Double deep recession in the Spain and unemployment record since
• the US recover because of the expansive public expenditure and the quantitative measures
•Greece, Irland and Portugal has to be rescue by the EU-World Bank and the IMF.



INDUSTRIAL PRODUCTION: SPAIN VERSUS THE EUROZONE

a) Deepest recession in Spain since 2011: Industrial Production Index (IPI)
b) Negative impact of the austerity policy to rebalance public finances
c) W recession in the industrial value added (VAB)
d) **-10,9** points of industrial GDP from 2008-III a 2012-IV in Spain versus
e) -3,9 in the Eurozone industrial GDP

Industrial Production Index IPI and industrial value added VAB Spain.

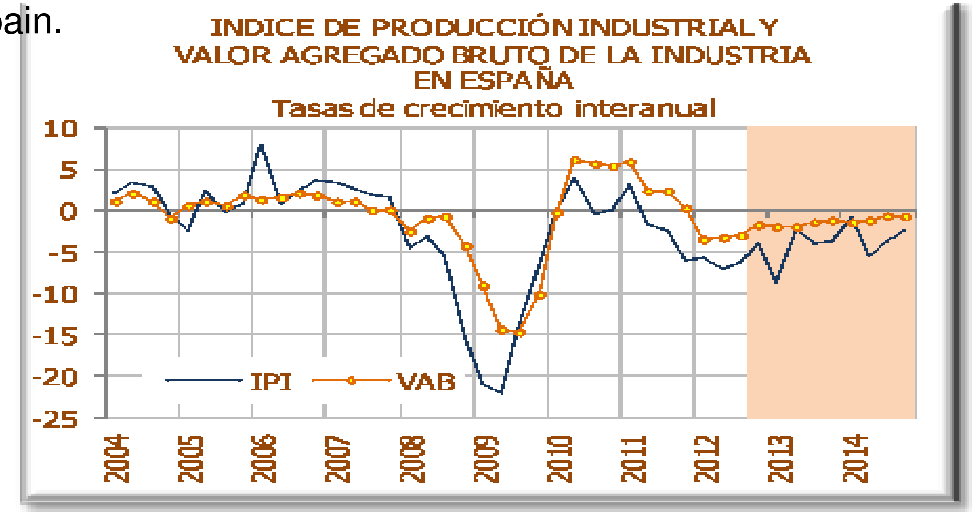
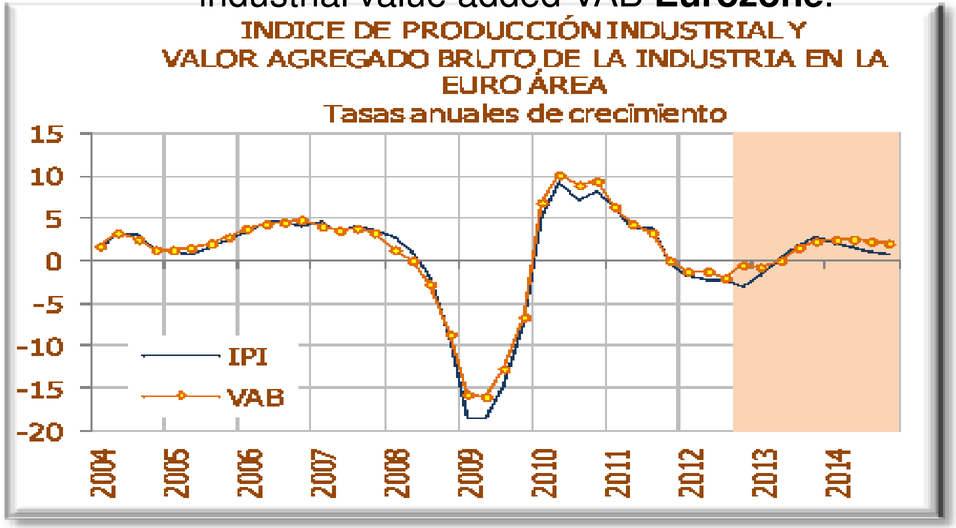


Gráfico 7 Industrial Production Index IPI and industrial value added VAB **Eurozone**.



Fuente: INE & BIAM (UC3M)
Fecha: 20 de diciembre de 2012

Spain versus the Eurozone 2012-14

Contribution to the GDP growth

	2012		2013		2014		
	España	Euro Área	España	Euro Área	España	Euro Área	
Internal demand	-1,7	-1,1	-1,1	-0,4	-0,1	0,3	D
Exports Good and services	-4,1	-0,1	-7,4	0,2	-5,1	1,0	X
Imports Good and services	-9,6	-3,2	-7,6	-1,7	-4,9	-0,8	M
Total External Demand	-11,3	-4,6	-9,2	0,1	-5,6	3,4	Total External Demand

Eurozone growth drive by external demand (emerging economies) since Spain is mainly drive by internal demand: recovery has to wait until 2014-15

Source: BIAM

New institutions to prevent systemic risks

- EBA: European Bank Authority, created in September, 2013.
- Single financial supervision in the EU
- Also at world level: Basil II
  - Prudential supervision
  - Core capital reinforcement

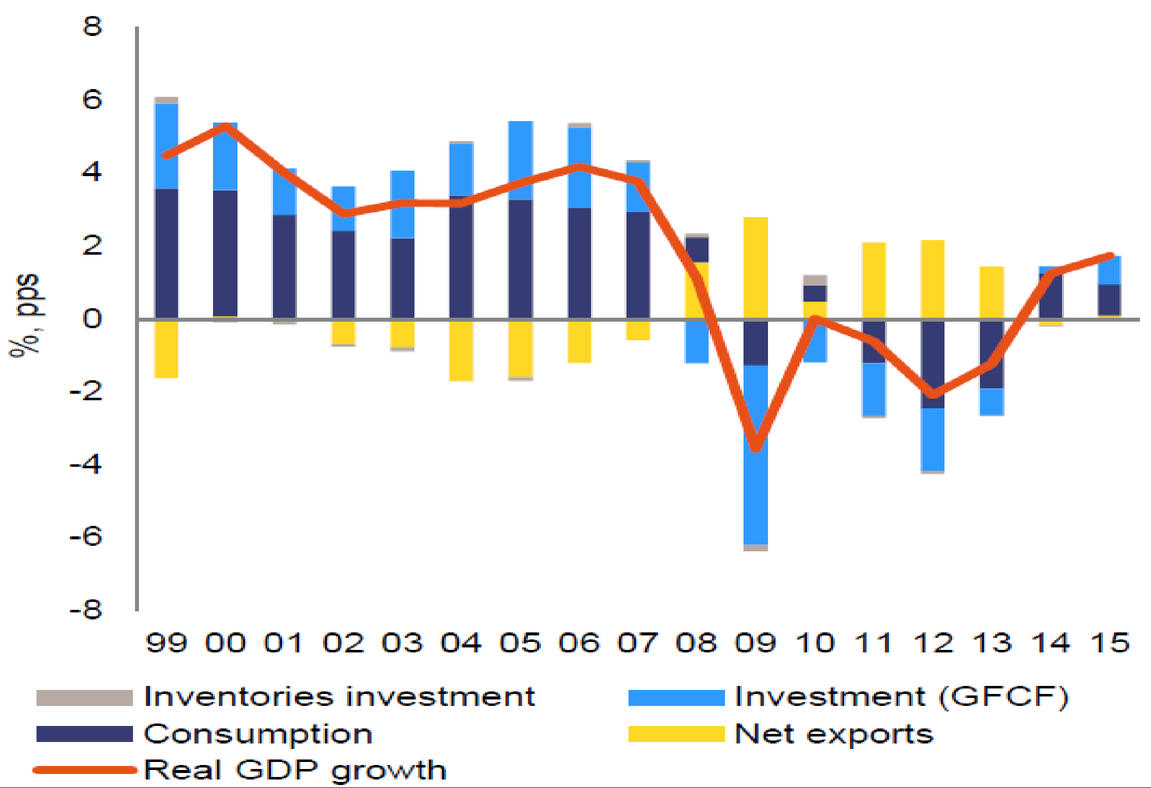
26.11.13

The Commissions diagnostic for Spain 2015

- Entering in an expansive business cycle

Graph 1.1: **Real GDP growth and contributions**

Consumption and investment key factors for the recovery while the export contribution became negative again

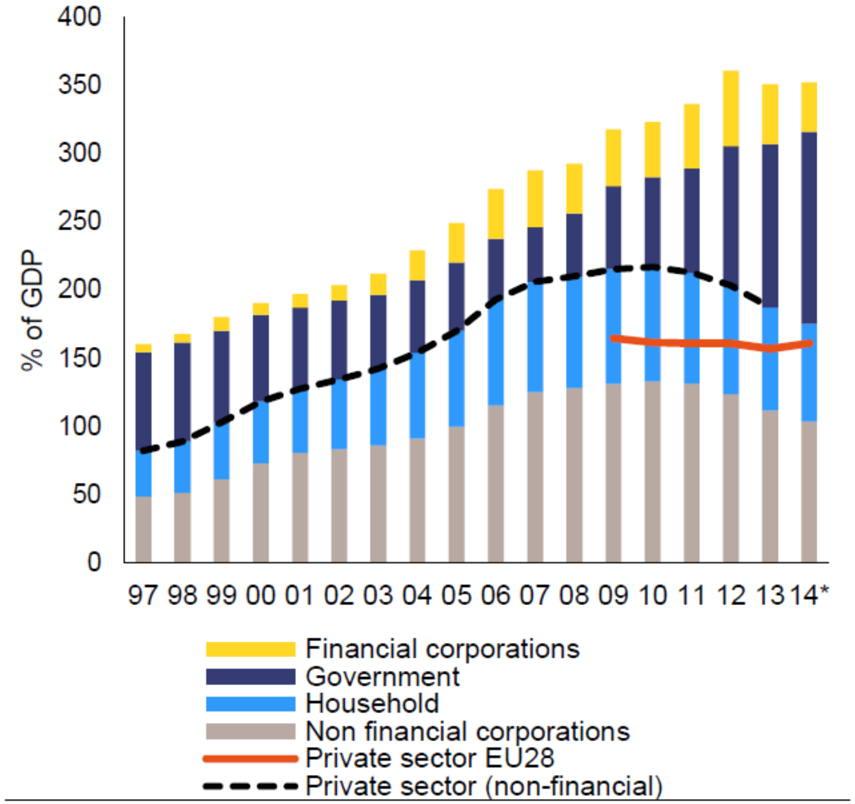


Source: European Commission

Debt by sector

- **Deleveraging by the private sector remains on track, but is far from complete.**
- **Credit contraction** continues to be the main driver behind the reduction in private sector indebtedness,
- **Negative inflation** did impede a faster aggregate adjustment though.
- Data show some **deceleration of credit contraction** and that
- **aggregate deleveraging** is to some extent taking place **selectively,** with the financial sector ready to fund healthier corporations with positive growth prospects (2014).
- While the annual **public deficit** continues on a **declining trend,**
- Overall **public debt will keep rising.**

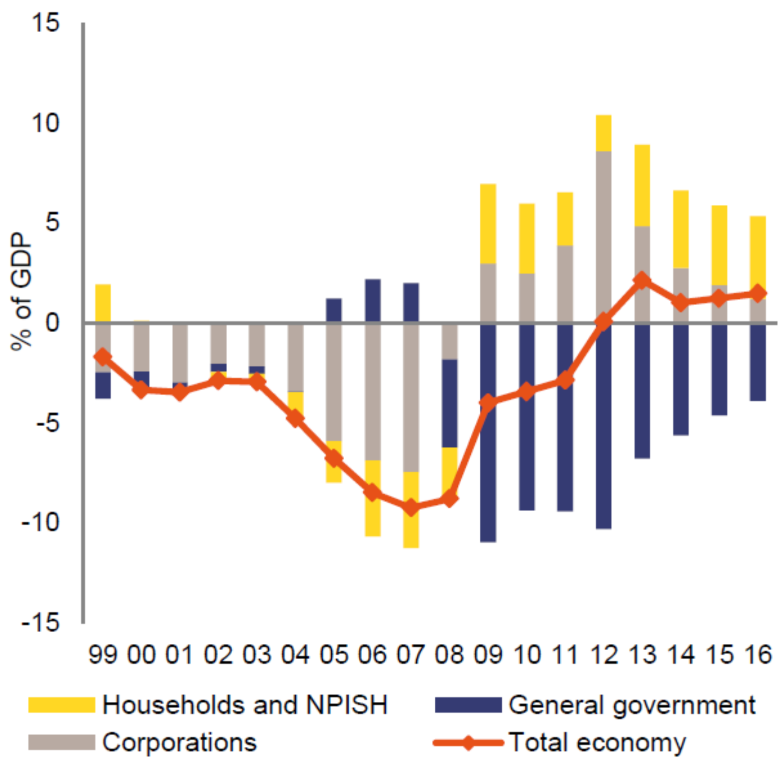
Graph 1.2: **Breakdown of debt by sector (non-consolidated)**



Source: European Commission

Net lending (+) or Borrowing (-)

Graph 1.3: **Net lending (+)/net borrowing (-) by sector**

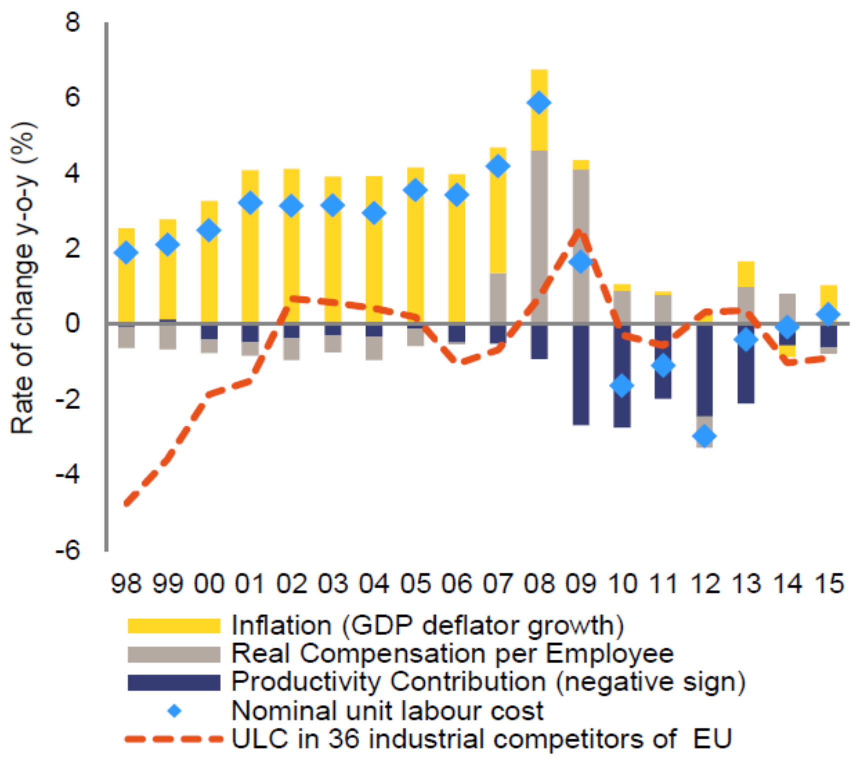


Source: European Commission

- ❑Both households and non-financial corporations are expected to maintain positive net lending positions
- ❑Even when consumption and investment are forecast to keep registering relatively high growth rates.
- ❑Public finances continued to improve in 2014, aprox.: **4.5** % of GDP, **net of bank recapitalizations**
- ❑The **public debt ratio**, which increased very rapidly during the financial crisis , is expected to continue to grow and reach around **102.5** % of GDP by 2016.

Breakdown of change in labor cost

Graph 1.4: **Breakdown of the change of unit labour costs in Spain**



Source: European Commission

The process of internal devaluation continues, resulting in further progress in price and cost competitiveness, but negative euro area inflation is hindering the adjustment.

1. **The fall in** domestic **demand** and soaring **unemployment** experienced during the crisis **eased inflationary** and **wage** pressures,
2. **reversing cost and price competitiveness losses** that accumulated in the boom years vis-à-vis other euro area countries.

3. Since 2009, the **real effective exchange rates** (REERs) **-13.2 %**

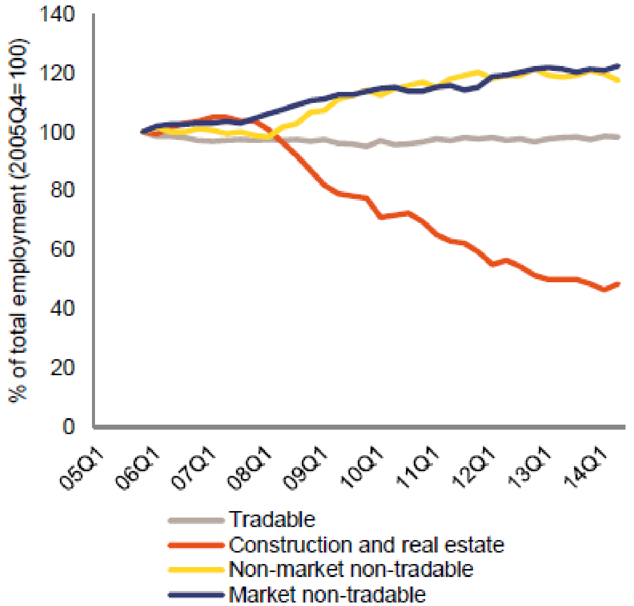
4. nominal **unit labour costs** have fallen by **-4.5 %,**

5. **Productivity gains**, together with ongoing **wage moderation** explain most of progress in **restoring price competitiveness** between 2009 and 2013 (Graph 1.4).

Share of employment by sector

Construction and real estate reduction in relative terms

Graph 1.5: **Share of employment in tradable and non-tradable sectors**



Source: European Commission

The adjustment process has produced a sharp
change in the composition of employment and
value added.

In relative terms, **tradable sectors as** a proportion of value added have **interrupted their long declining trend**

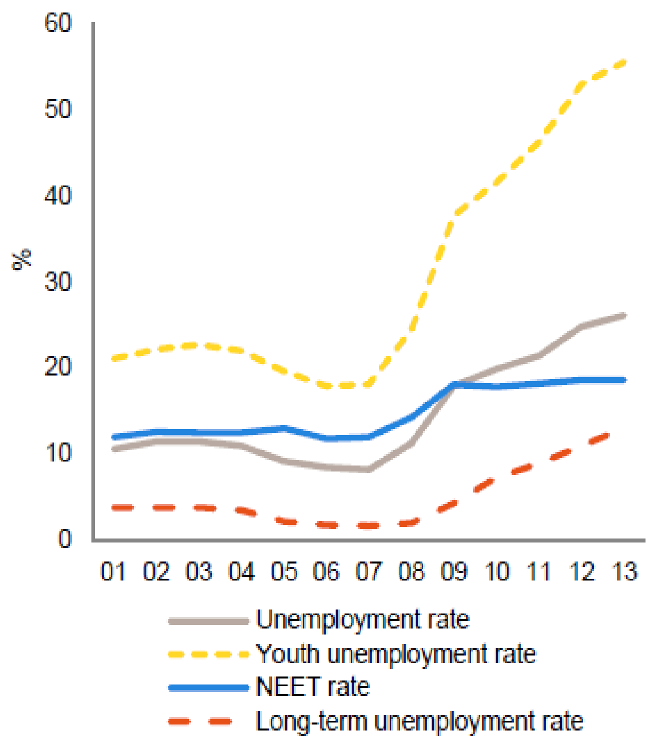
and the same applies when
looking at **total employment** (Graph 1.5).

NON TRADABLE SECTORS EMPLOYMENT SHARE IN 2014 :

- Construction and real estate ↓
- Non market non tradable (STABILIZED 14)
- Market non tradable (STABILIZED 14)

Youth unemployment sky rocket

Graph 1.6: **Labour market indicators**



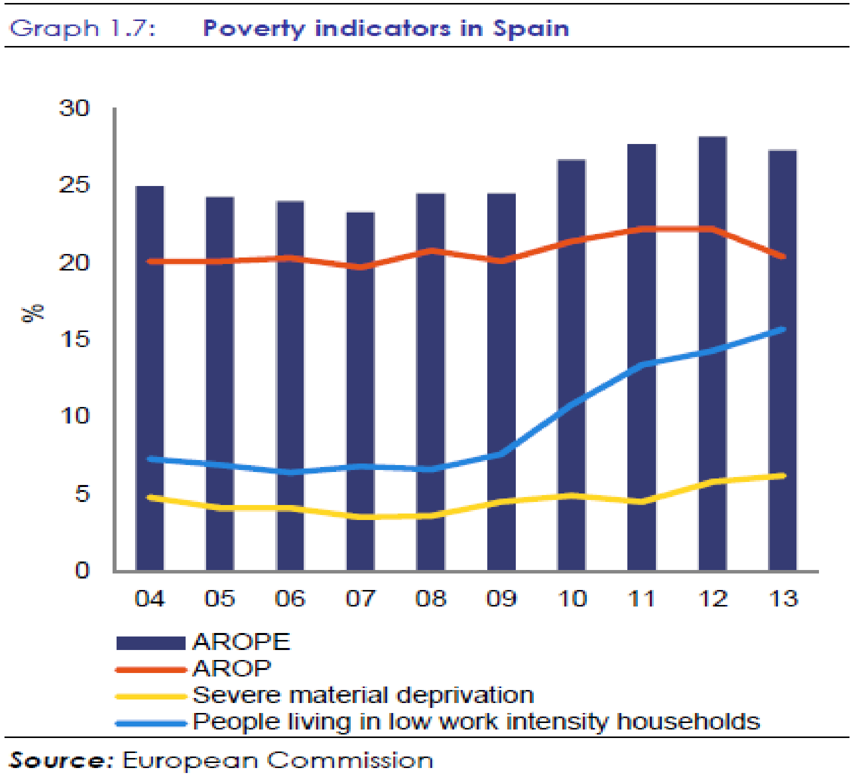
Source: European Commission

Youth NEET rate (% of population aged 15-24)

Employment growth was been stronger than expected during 2014, and the **unemployment rate - although it remains very high – decreased in 2014 for the first time since 2007.**

However, the very high unemployment rate, namely **youth and long-term unemployment,** and **elevated segmentation**, remain major **challenges**.

Population at-risk-of-poverty or social exclusion



Social indicators have seen a drastic deterioration since the crisis,

The percentage of the population at-risk-of poverty:
(1) **and at-risk-of-poverty or social exclusion**
rose sharply between 2007 and 2012 (Graph 1.7).
It is estimated that 12.6 million people were at risk of poverty or social exclusion in 2013(3)

(1) At-risk-of poverty rate (AROP): share of people with disposable income below 60 % of the national median income.
(2) People at-risk-of poverty or social exclusion (AROPE): are individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).

Spain, Commission 2015 forecast (annual rates)

Table 1.1: **Key economic, financial and social indicators**

	2008	2009	2010	2011	2012	2013	Forecast 2014	2015	2016
Real GDP (y-o-y)	1.1	-3.6	0.0	-0.6	-2.1	-1.2	1.4	2.3	2.5
Private consumption (y-o-y)	-0.7	-3.6	0.3	-2.0	-2.9	-2.3	2.3	2.7	2.6
Public consumption (y-o-y)	5.9	4.1	1.5	-0.3	-3.7	-2.9	0.5	0.3	0.1
Gross fixed capital formation (y-o-y)	-3.9	-16.9	-4.9	-6.3	-8.1	-3.8	3.2	4.7	5.2
Exports of goods and services (y-o-y)	-0.8	-11.0	9.4	7.4	1.2	4.3	4.5	5.4	6.0
Imports of goods and services (y-o-y)	-5.6	-18.3	6.9	-0.8	-6.3	-0.5	7.7	6.9	6.7
Output gap	1.4	-3.3	-4.4	-5.5	-7.2	-7.7	-6.1	-3.9	-1.9
Contribution to GDP growth:									
Domestic demand (y-o-y)	-0.5	-6.2	-0.7	-2.7	-4.2	-2.7	2.0	2.6	2.6
Inventories (y-o-y)	0.1	-0.2	0.3	0.0	-0.1	0.0	0.2	0.0	0.0
Net exports (y-o-y)	1.6	2.8	0.5	2.1	2.2	1.4	-0.8	-0.3	0.0
Current account balance (% of GDP), balance of payments	-9.3	-4.3	-3.9	-3.2	-0.3	1.4	.	.	.
Trade balance (% of GDP), balance of payments	-5.1	-1.1	-1.3	-0.2	1.6	3.4	.	.	.
Terms of trade of goods and services (y-o-y)	-2.4	5.1	-2.3	-3.7	-1.5	1.5	-0.7	1.8	-0.2
Net international investment position (% of GDP)	-79.3*	-93.8*	-89.1*	-91.4*	-90.0	-92.6	.	.	.
Net external debt (% of GDP)	76.2*	88.3*	92.0*	94.6*	91.6*	89.7*	.	.	.
Gross external debt (% of GDP)	153.7*	167.9*	164.0*	166.7*	167.9*	159.7*	.	.	.
Export performance vs advanced countries (% change over 5 years)	-4.6	-1.3	-4.4	-0.2	-8.3	-2.6	.	.	.
Export market share, goods and services (%)	2.1	2.2	1.9	1.9	1.8	1.9	.	.	.
Savings rate of households (net saving as percentage of net disposable income)	2.6	9.5	4.6	6.0	3.5	4.9	.	.	.
Private credit flow, consolidated, (% of GDP)	11.9	-1.4	0.9	-4.2	-9.9	-10.8	.	.	.
Private sector debt, consolidated (% of GDP)	196.6	202.4	201.5	195.3	184.8	172.1	.	.	.
Deflated house price index (y-o-y)	-4.8	-5.6	-3.6	-9.9	-16.9	-10.4	.	.	.
Residential investment (% of GDP)	10.4	8.1	6.9	5.7	5.0	4.3	.	.	.

Table 1.1: **Key economic, financial and social indicators**/2

	2008	2009	2010	2011	2012	2013	Forecast 2014	2015	2016
Total financial sector liabilities, non-consolidated (y-o-y)	-3.2	4.6	-3.7	-1.0	-1.7	-3.6	.	.	.
Tier 1 ratio[1]	.	.	.	.	.	.	.	.	.
Overall solvency ratio[2]	.	.	.	.	.	.	.	.	.
Gross total doubtful and non-performing loans (% of total debt instruments and total loans and advances)[2]	.	.	.	.	.	.	.	.	.
Change in employment (number of people, y-o-y)	0.2	-6.3	-1.7	-2.5	-3.7	-2.6	1.5	2.1	2.3
Unemployment rate	11.3	17.9	19.9	21.4	24.8	26.1	24.3	22.5	20.7
Long-term unemployment rate (% of active population)	2.0	4.3	7.3	8.9	11.0	13.0	.	.	.
Youth unemployment rate (% of active population in the same age group)	24.5	37.7	41.5	46.2	52.9	55.5	53.2	.	.
Activity rate (15-64 year-olds)	72.7	73.1	73.5	73.9	74.3	74.3	.	.	.
Young people not in employment, education or training (%)	14.3	18.1	17.8	18.2	18.6	18.6	.	.	.
People at risk of poverty or social exclusion (% of total population)	24.5	24.7	26.1	26.7	27.2	27.3	.	.	.
At-risk-of-poverty rate (% of total population)	20.8	20.4	20.7	20.6	20.8	20.4	.	.	.
Severe material deprivation rate (% of total population)	3.6	4.5	4.9	4.5	5.8	6.2	7.0	.	.
Number of people living in households with very low work-intensity (% of total population aged below 60)	6.6	7.6	10.8	13.4	14.3	15.7	.	.	.
GDP deflator (y-o-y)	2.1	0.3	0.2	0.1	0.2	0.7	-0.7	0.2	1.0
Harmonised index of consumer prices (HICP) (y-o-y)	4.1	-0.2	2.0	3.1	2.4	1.5	-0.2	-1.0	1.1
Nominal compensation per employee (y-o-y)	6.8	4.4	1.1	0.9	-0.6	1.7	0.5	0.7	0.8
Labour productivity (real, person employed, y-o-y)	0.9	2.9	1.8	2.0	1.7	1.4	.	.	.
Unit labour costs (ULC) (whole economy, y-o-y)	5.9	1.6	-1.6	-1.1	-3.0	-0.4	-0.2	0.2	0.3
Real unit labour costs (y-o-y)	3.7	1.4	-1.8	-1.2	-3.2	-1.1	0.5	0.0	-0.7
REER[3)] (ULC, y-o-y)	4.4	-1.0	-3.9	-1.3	-6.6	0.2	-0.9	-2.4	-0.4
REER[3)] (HICP, y-o-y)	0.5	1.1	-4.0	0.4	-1.8	1.5	0.4	-2.3	-0.7
General government balance (% of GDP)	-4.4	-11.0	-9.4	-9.4	-10.3	-6.8	-5.6	-4.5	-3.7
Structural budget balance (% of GDP)	.	.	-7.0	-6.2	-3.5	-2.2	-2.1	-2.3	-2.7
General government gross debt (% of GDP)	39.4	52.7	60.1	69.2	84.4	92.1	98.3	101.5	102.5

(1) Domestic banking groups and stand-alone banks.
(2) Domestic banking groups and stand-alone banks, foreign-controlled (EU and non-EU) subsidiaries and branches.
(3) Real effective exchange rate
(*) Indicates BPM5 and/or ESA95

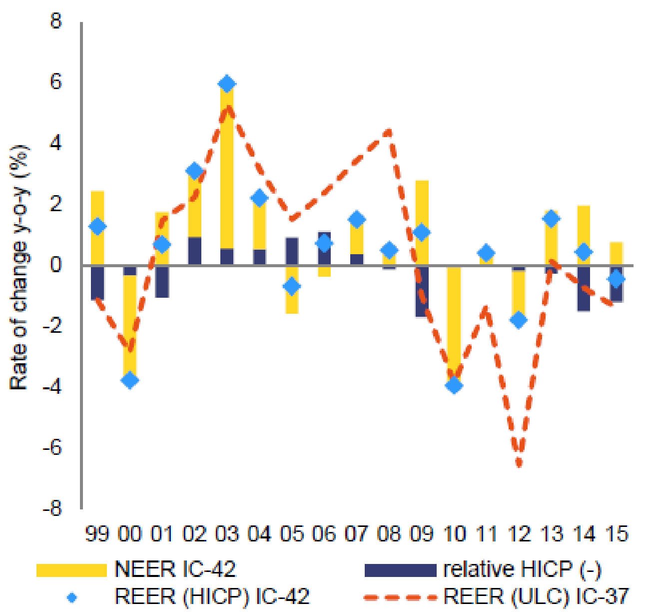
Source: European Commission, 2015 winter forecast; ECB

Commission country report 2015

MAIN UNBALANCES OF THE SPANISH ECONOMY

External sustainability

Graph 2.1.1: **Evolution of price competitiveness in Spain**



Source: European Commission

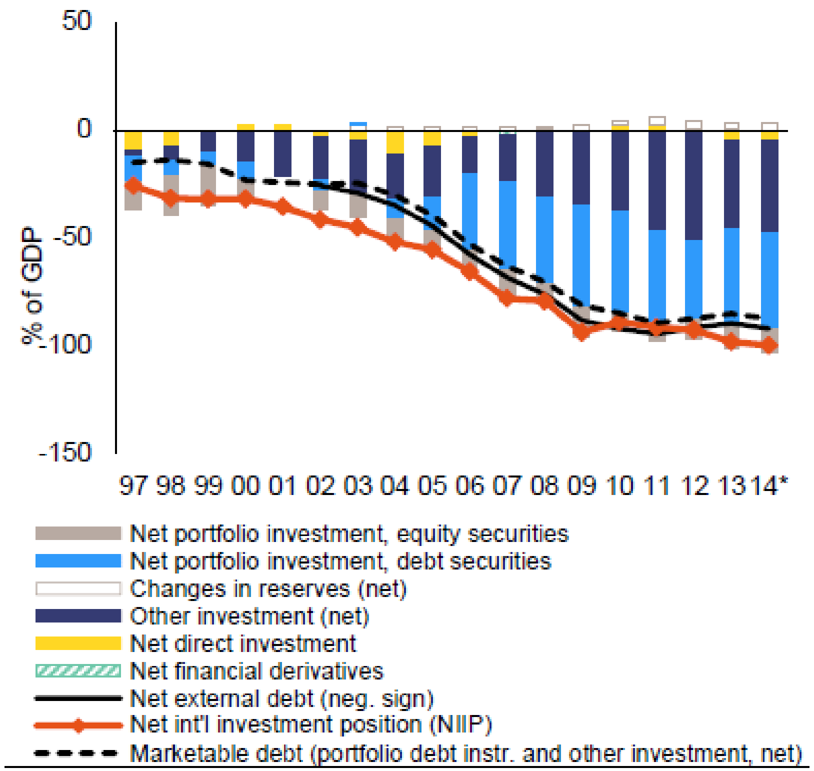
The collapse of domestic demand dragged down Spanish imports of goods and services down from 31.7 % of GDP in 2007 to 28.1 % in 2013.

In turn, **exports** of goods and services, which had already performed remarkably well in the run-up to the crisis despite accumulating price competitiveness losses, **rose from 25.7 % to 31.6 % of GDP**

This was **a result of** both the **contraction of GDP** and the **improvement in competitiveness** indicators, in particular the **drop in unit labor costs** (Graph 2.1.1).

International investment position

Graph 2.1.2: **Breakdown of the net international investment position**



Source: European Commission

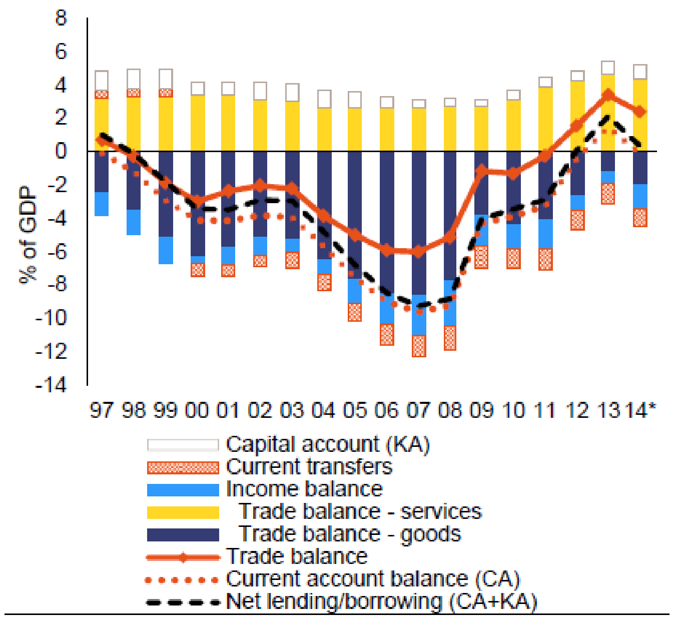
Despite the sizeable adjustment in the current account, the negative net international investment position (NIIP) keeps increasing and remains a major risk.

From a peak deficit of 9.6 % of GDP in 2007, the current account turned into a **surplus of 1.5** % of GDP in 2013.
However, the adjustment in the current account has not yet translated into a reduction of external liabilities.

The **net international investment position deteriorated sharply until 2009** and has remained since then at around 15 percentage points higher than before the crisis (Graph 2.1.2).

Current account adjustment

Graph 2.1.3: **Adjustment in the current account**



Source: European Commission

Despite the overall positive evolution of the external sector in recent years, the current account surplus is forecast to have turned into a deficit of 0.1 % of GDP in 2014.

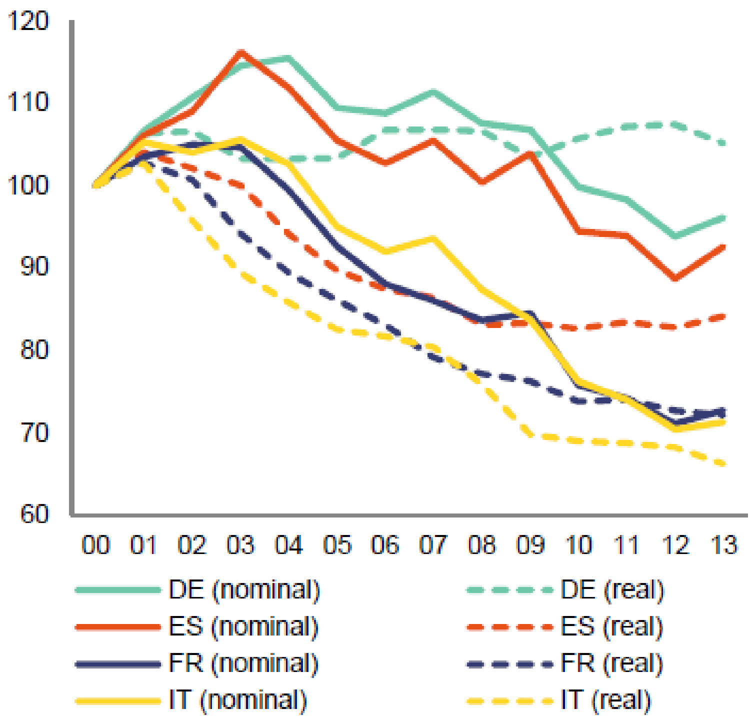
The slowdown in the **euro area**, along with the deceleration of **emerging** economies, has **weakened the external demand for Spanish exports,**

despite which exports keep registering relatively high growth rates (4.6 % year-on-year in Q3-2014).

Given that **more than half of Spanish exports are destined to the euro area,**
with exports to France, Italy, and Portugal combined accounting for almost 30 % of total exports, negative inward spillovers to the Spanish economy from the slowdown of the euro area have been significant.

Market share in world exports

Graph 2.1.4: **Market shares in world exports of goods in the main EU economies in volume and in value (2000=100)**



Source: IMF WEO and European Commission Calculation

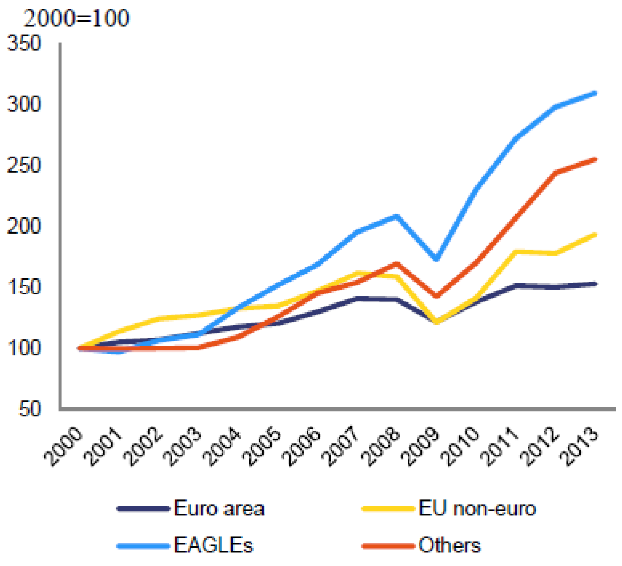
Since the crisis, Spanish market shares of world exports have advanced relatively better in terms of volumes rather than values, outperforming most other major EU economies.

Deterioration of the Spanish terms of trade?

Geographical specialization

Export to EAGLEs have been the **most dynamic**

Graph 2.1.6: **Geographical specialisation of Spanish exports**



Source: DataComex

Emerging and growth-leading economies (**EAGLEs**) have been the **most dynamic**, rising by almost 1.5 percentage points since 2007,

Resilience of exports is closely linked to progressive openness to international trade flows.

At the beginning of the previous decade the European market was by far the main destination for Spanish exports of goods, with **60 % going to the euro area** and around **12 % to other EU**

This geographical pattern started to show **significant changes** towards a **higher degree of international diversification** (Graph 2.1.6) after the outbreak of the crisis.

The share of exports in value going to the **euro area declined by some 7** percentage points since 2007 as other destinations gained prominence.

Exports of services: shares

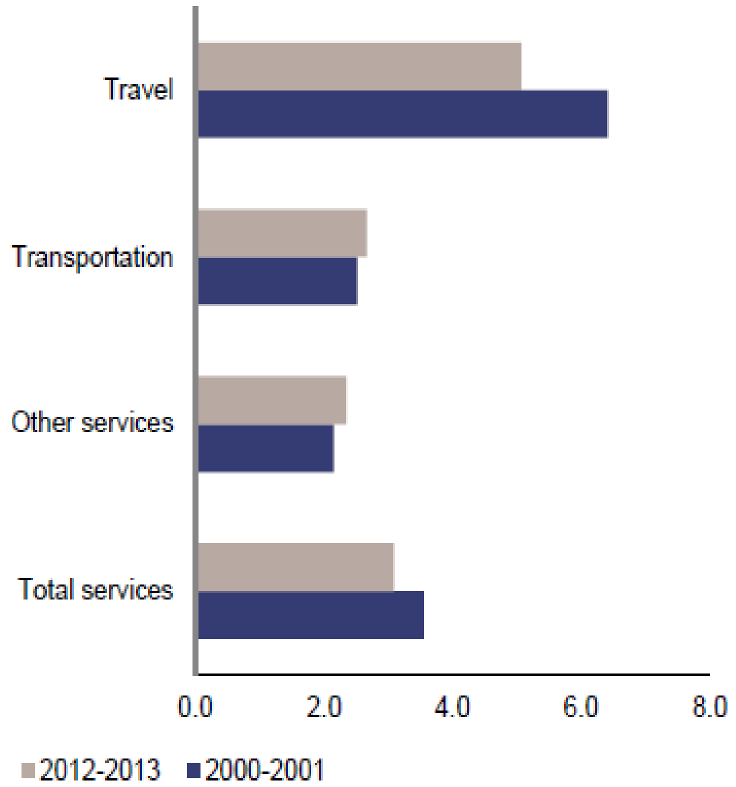
The performance of services exports has also been positive.

Spain's share in global exports of services is significantly **greater** than its share in exports of goods (3.3 % against 1.6 % in 2012), mainly on account of its large **tourism sector**.

The **share** of Spain in world tourism has been **decreasing in the last decade** as its tourism model relies mainly on coastal seasonal tourism, which is subject to increasing competition from cheaper destinations.

However, Spain has been able to expand its world share of exports in other services

Graph 2.1.7: **World market shares for Spanish exports of services**



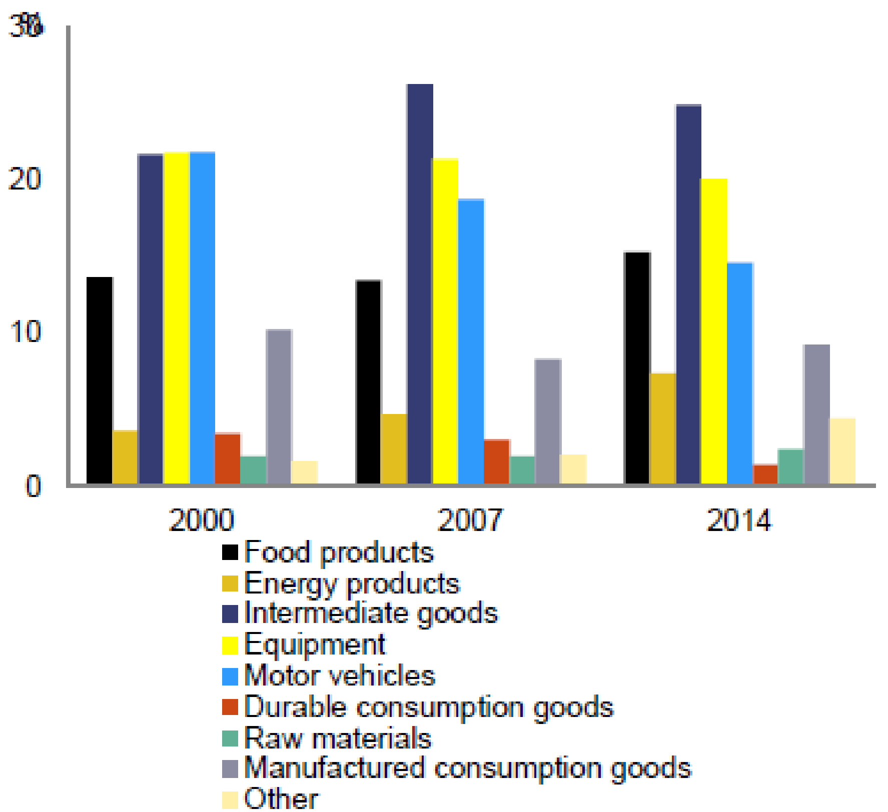
Source: WTO and European Commission Calculation.

Spain has benefited from the growth in world trade

Price competitiveness gains during the crisis have played a positive but limited role to explain recent improvements (Commission, 2015)

The exporting sector is smaller in Spain than e.g. in Germany so the impact in the Spanish economy of the emerging economies growth had a limited impact.

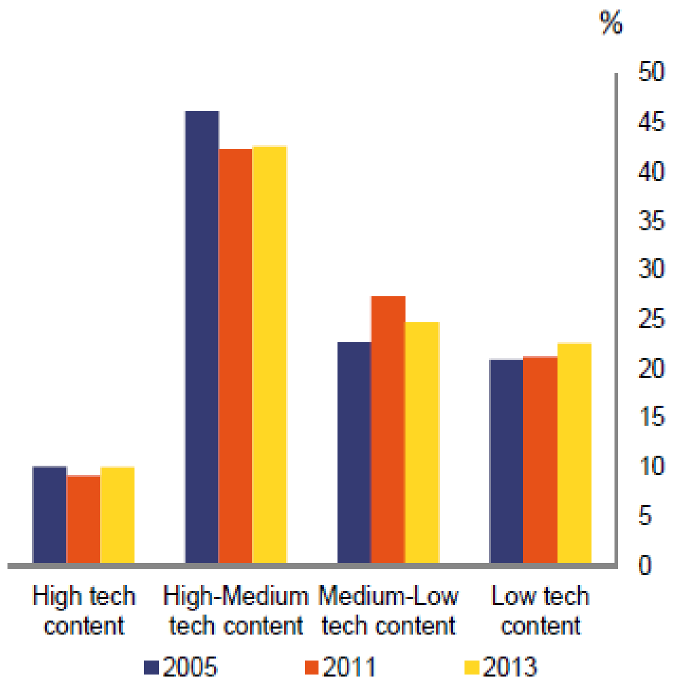
Graph 2.1.8: **Structure of Spanish exports of goods**



Source: DataComex

Spanish exports by technological content

Graph 2.1.9: **Breakdown of Spanish exports by technological content**



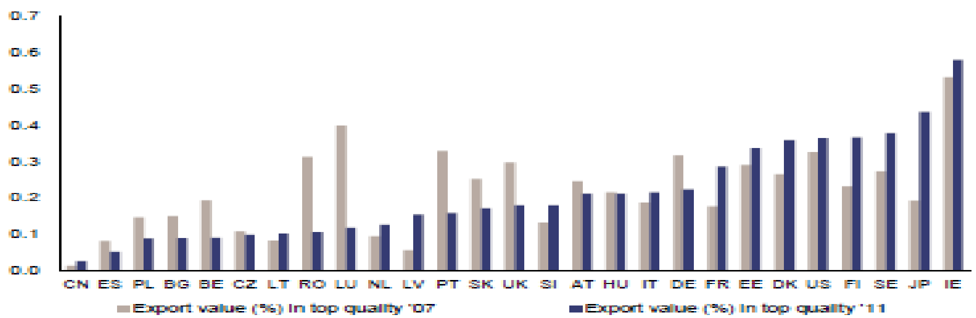
Source: Ministry of Economic Affairs and Competitiveness and Banco de España

The elasticity of Spanish exports of goods with respect to world income growth (which is an important factor behind the growth in world trade) is above 1

In the case of Spain associated with its opening to international trade flows and its **reorientation** to products with medium-high technological content,

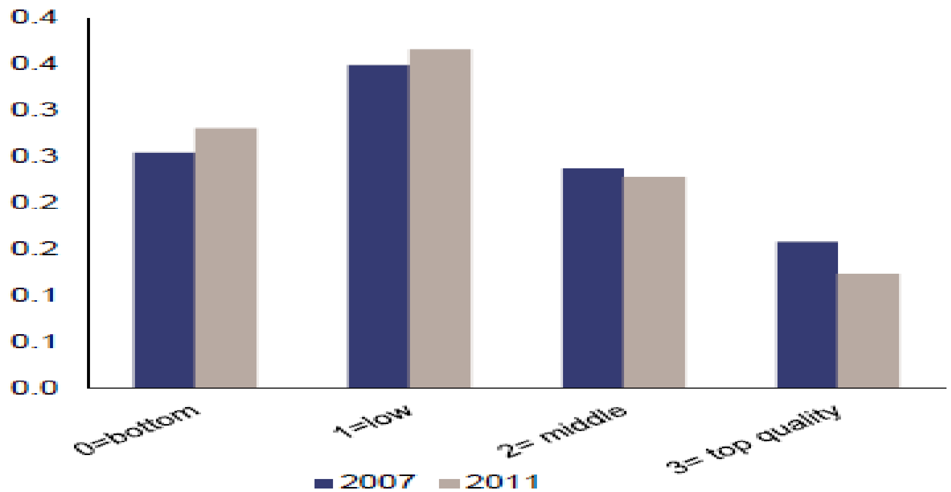
Exports by quality

Graph 2.1.10: **Shares of top-quality exports by country (value)**



Source: European Commission Calculation based on Comext and Orbis data

Graph 2.1.11: **Share of export products by quality rank**

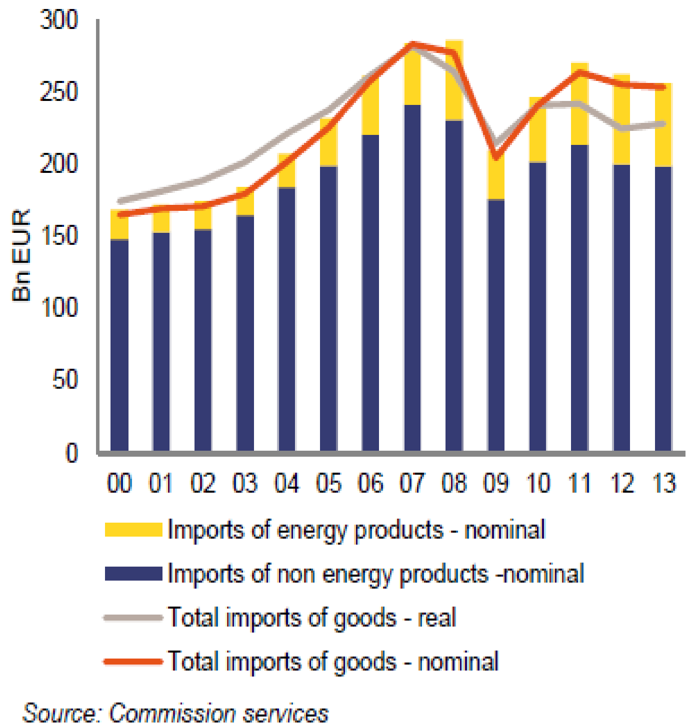


Source: European Commission Calculation based on Comext and ORBIS data.

The Spanish industry is highly dependent both on imports of intermediate and energy goods and on technology,
which are less responsive to relative price developments

Energy dependency

Graph 2.1.12: **Energy dependency of the Spanish economy**



Source: European Commission

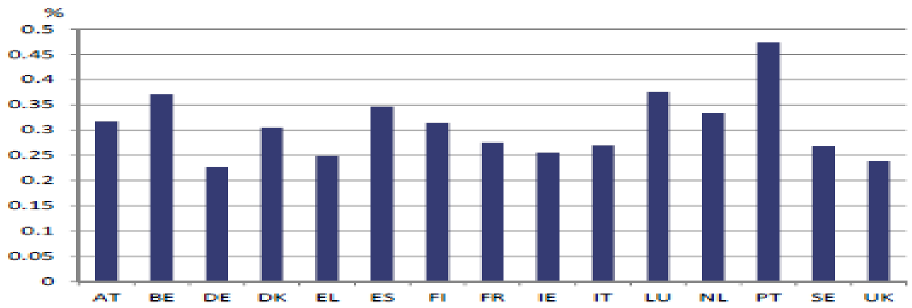
The low sensitivity to prices is consistent with a **high dependency on imports of intermediate goods** and the structurally elevated **dependence on energy products** (Graph 2.1.12),

in particular **oil and gas** as sources of primary energy.

Likewise, Spanish imports **depend considerably on goods involving more advanced technological developments**, for which income elasticity is typically high while price elasticity is low.

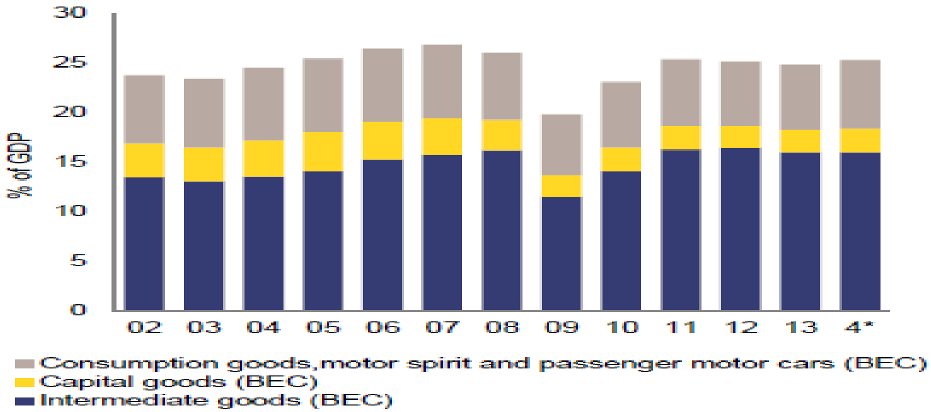
Imports of technology products

Graph 2.1.13: **Import content of exports of medium-high and high technology products**



Source: OECD Stan database

Graph 2.1.14: **Spanish imports by broad economic category**



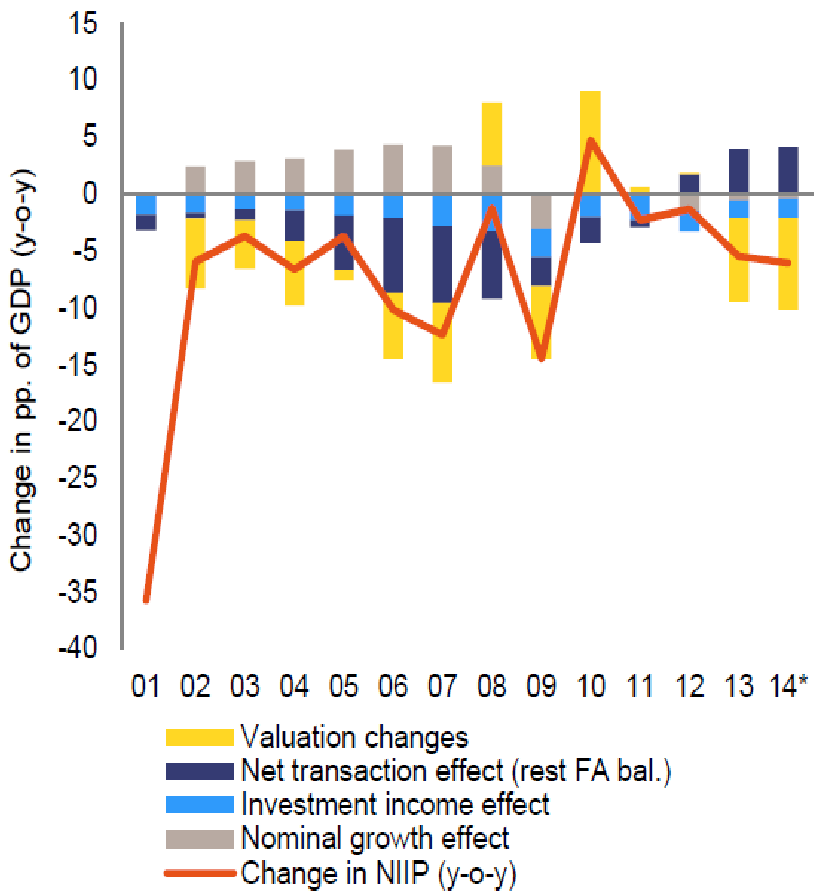
Source: European Commission

In general, **import intensity** in manufacturing sectors is almost **20 % higher in Spain** than in the other main euro area economies.

In particular, **automotive** and **chemical industries**, the main export industries in Spain, have very high import content (**63.3 %** and **54.8 %** respectively), mostly intermediate goods.

Net International Investment Position (NIIP)

Graph 2.1.20: **Contribution to changes in the NIIP**



Source: European Commission

Spain's net international investment position continued to deteriorate throughout 2013, until reaching almost -100 % of GDP in Q1-2014.

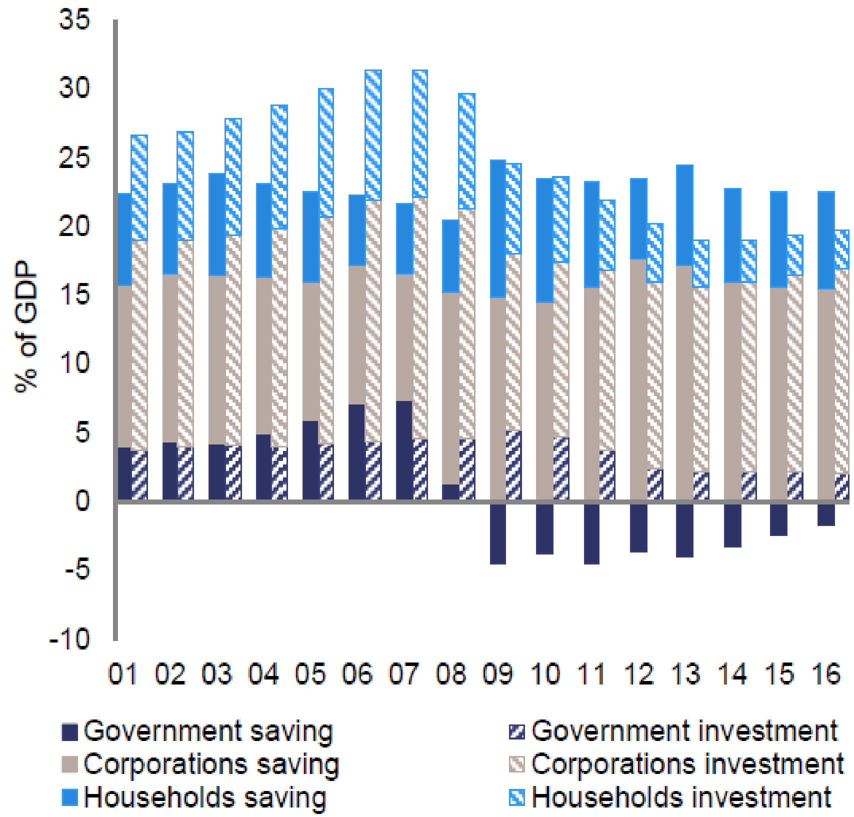
Much of the increase in the net lending position has been achieved through **a reduction in investment, both by corporations and households** (mainly residential).

- These have been partly offset with by a **net lending position** vis-à-vis the rest of the world (see 'net transaction effects' in Graph 2.1.20)

SAVINGS AND INVESTMENT

In terms of financing needs by institutional sector,
both **households** and **corporations** **have recorded a positive net lending position**,
which has been partly offset by a **net borrowing position for the general government** (Graph 2.1.21).

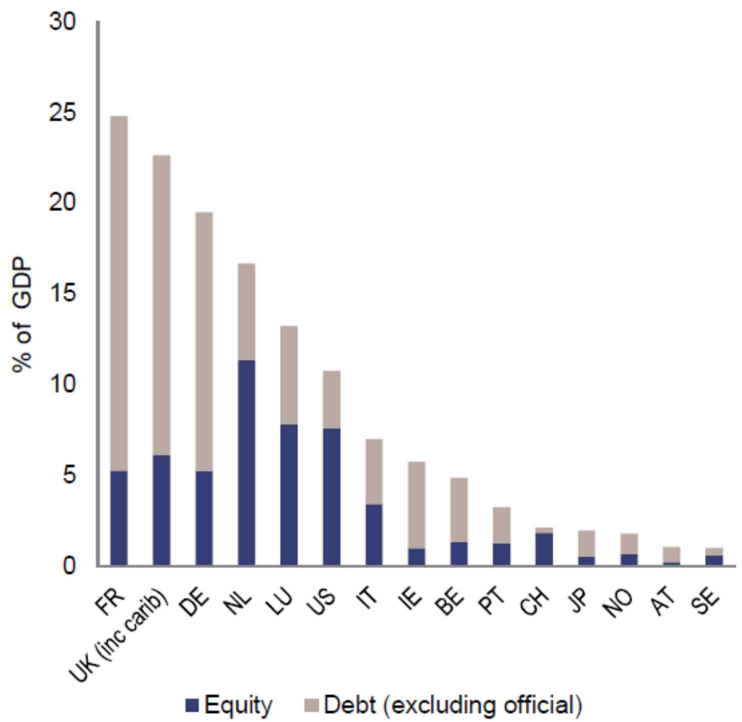
Graph 2.1.21: **Savings and Investment by Sector**



Source: European Commission

Funding dependence and overhaul of the euro area architecture, including the Banking Union

Graph 2.1.22: **Spain's funding dependence on partner countries (2012)**



(1) Gross Spanish foreign liabilities as a % of Spanish GDP
Source: European Commission Calculation

Most of the main investors in Spain are euro area countries, which — given the recent overhaul of the euro area architecture, including the **Banking Union — could be a relative shield from sudden capital flow reversals (Graph 2.1.22).**

The main gross investors in Spain were **France** (25 % of Spanish GDP), followed by the UK (23 %), **Germany** (19 %), the **Netherlands** (17 %, including large equity investments), and **Luxembourg** (13 %).

As regards **financing specifically from foreign banking** sectors, the main players are, once more, **France, Germany** and, to a lesser extent, the **UK [including Caribean]**.

BBVA research outlook

- Of the large economic areas, the **eurozone** is the one which is most likely to have to deal with **a scenario of inflation that is too low for too long**. In addition to the negative surprises on consumer prices, the area **has only a moderate economic growth profile**, in line with expectations.

- Assuming GDP growth reaches around +0.2% in 4Q14, supported by a similar increase in activity in Germany and France and a better relative performance in Spain, our estimate for the eurozone is +0.8% YoY.

- Altogether, we maintain our forecast for growth of **1.3% for 2015**, supported by the **fall in the price of oil**, the accumulated **depreciation of the euro** in recent months and the **relaxation of monetary conditions thanks to ECB actions**.
- **The less restrictive nature of fiscal policy in the peripheral countries** is also an element to take into account, as well as the so-called
- **"Juncker Plan",** designed **to favor investment**, and the first fruits of which are expected in the second half of this year.

BBVA research outlook

- **Some threats arise**,
- including the potential impact of increased tensions in Russia's sphere of influence, both in commercial and (more importantly) financial terms, given the heavy exposure of European banks to those countries.
- A second risk factor is the uncertainty generated by the divergences between some national authorities and the EU institutions as to the most appropriate supply-side reform, the pace of fiscal consolidation and the support of the ECB to foster growth.
- Finally, another **risk is that medium-term inflation expectations continue to fall**, discouraging consumption, and leading to a negative feedback loop. To deal with the latter, the ECB has extended its asset purchase programme to public debt and increased the monthly purchases to EUR60bn.

Source: Mexico Economic Outlook BBVA Q-I 2015