

»» In its fourth year, Spain's recovery has overcome many crisis effects



No. 135, 13 June 2017

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Spain is growing at a strong pace

At the beginning of 2017 the Spanish economy exceeded expectations once again. Its fast pace of growth continued in the first quarter. Spain has already grown by more than 3% in each of the past two years – roughly twice as fast as Germany, which is perceived mostly as the growth engine of the euro area. What is more, investment in machinery and equipment grew at a faster pace than at any time in the past two years – a clear sign of a healthy economy.

Much ground to make up since the crisis

However, our KfW Research Business Cycle Clock shows that a large portion of the growth generated in the past three years is a recovery following a crisis that was disproportionately deep and long – both in comparison with earlier phases of weakness and in comparison with other euro area countries. In the past ten years Spain's economy went through a very pronounced business cycle and, from 2010, suffered a second, serious setback during the debt crisis after the financial crisis. Overall output fell by nearly 10% during these

two periods. At the same time, unemployment peaked at a rate of more than 26%, almost twice as high as in Greece.

The output gap, the difference between actual and potential economic output with normal utilisation of production factors, confirms that the most recent upswing was primarily a recovery of the losses caused during the crisis. Despite a reduction in the output gap by 8.5 percentage points since the end of 2013, it was not until last year that Spain was able to catch up with the euro area on this indicator. The country has now overtaken its European partners and may be able to close the output gap in this quarter for the first time in over eight years.

Growth achievements should be used for consolidation

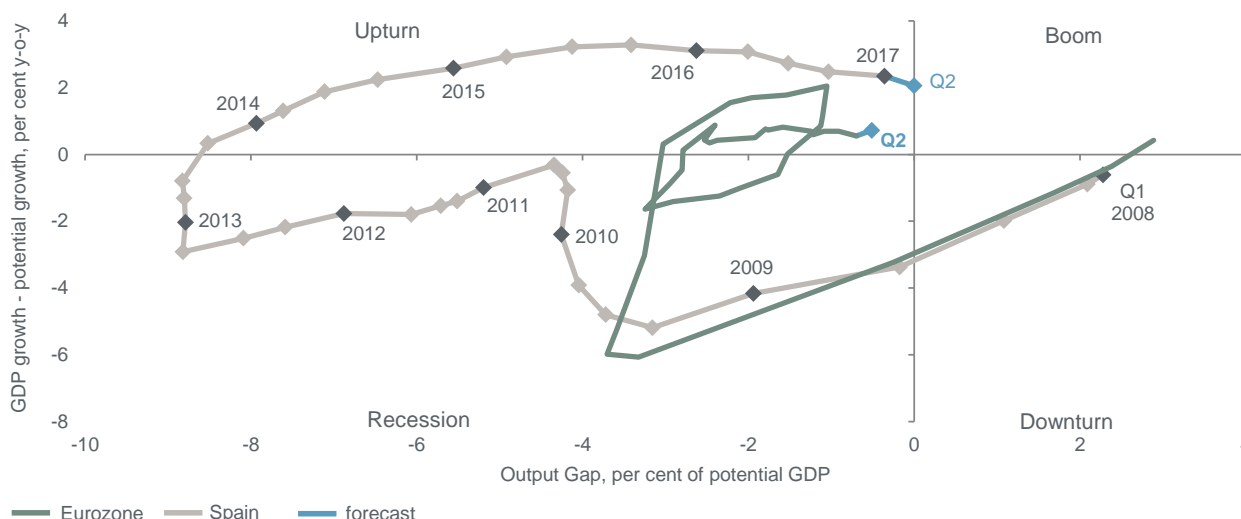
Reducing unemployment is a tedious process, and the rate is still at 18%. Nevertheless, it would be wrong to expect miracles after five years of recession. Under pressure from the financial markets, Spain initiated reforms during the crisis and made progress, for

instance in unit labour costs and its current account balance. But some of the reforms will be slow to take effect and will further benefit the Spanish labour market in particular.

One consequence of the dual crisis in particular still needs action: the last time Spain remained within the 3% deficit limit was ten years ago. In the light of the severe recession, this has not been a priority in the past, and rightly so. But debt levels have tripled in the past ten years, and now that the economy has healed policymakers should take decisive steps to consolidate the budget. After all, when the ECB normalises its monetary policy in the foreseeable future, the markets will take an even closer look at the states' financial situation.

Once that happens, it would be important for concrete steps towards further consolidation to have been initiated, or at least for the plans to be on the table – not an easy task given the narrow majority in parliament, but one that is destined to become increasingly urgent. ■

Figure: KfW Research Business Cycle Clock



Sources: Ameco, Eurostat, KfW Research

Note: This paper contains the opinion of the authors and does not necessarily represent the position of KfW.