

# Spain



*Author:* Antoni Espasa,  
Universidad Carlos III,  
Madrid, Spain.\*

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## Perspectives of the Spanish economy at the beginning of 1994.

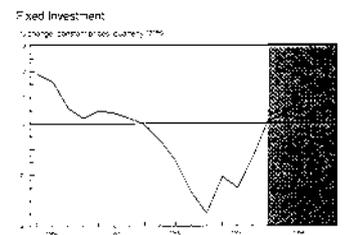
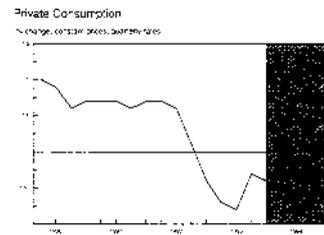
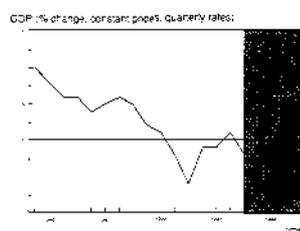
Since the last report — October 1993 — the Spanish National Institute of Statistics has released national account figures for the third quarter of 1993 and has revised the figures of previous quarters. As a result the recession at the end of 1992 appears now more intense and for the first three quarters of 1993 the Spanish GDP experienced a recovery with quarterly rates of growth close to zero. This recovery is due to the contribution of the foreign sector to GDP growth, while the revised consumption and fixed investment components of the domestic demand show less negative quarterly rates of change than those previously published.

From the production side, the figures for the industrial production index have been revised likewise. Thus, one can estimate now that the production of consumer goods has passed from a negative underlying rate of change — annual rate of change of the trend — of 8% in the summer of 1992 to a forecasted negative 2.8% in December 1993. Similarly, equipment production has passed from negative rate of change of about 11% to less negative 5% over the same period. Accordingly with these figures the decline in employment in the whole industrial sector is diminishing, but it will still continue in 1994 with a value around 3%. In the service sector, the employment decline has been highly reduced, and for the fourth quarter of 1993 it can be forecasted that the underlying rate of growth in employment will not be negative. Finally, the building sector registers the highest rate of employment decline at an underlying rate of 8.5% for 1993. Nevertheless the leading indicators for production in this sector indicate a certain recovery all through 1994. In any case, the unemployment rate in the Spanish economy will pass from 24.4% at the end of 1993 to 26.2% in the last quarter of 1994.

The behavior of foreign trade during 1993 has been characterized

| SPAIN                                    |        |
|--|--------|
| Nominal GDP (1992, billions pesetas)     | 58 852 |
| Population (millions, mid 1992)          | 39.1   |
| Exports (1992, billions pesetas)         | 10 358 |
| Imports (1992, billions pesetas)         | 12 024 |
| Dollar exchange rate (end December 1993) | 142.70 |

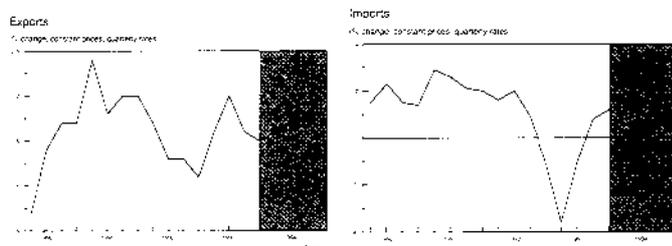
All forecasts by ESRI



by solid growth of nominal exports, which is expected to continue in 1994. Thus the underlying rate of growth in 1994 for exports of goods will be about 12%. On the other hand, nominal imports of goods were still decreasing at the beginning of 1993, with a possible recovery later. Accordingly, with the provisional published figures, this recovery is huge, but all figures corresponding to 1993 could be deeply revised, because with the abolition of customs inside the European Union the measurement of imports has experienced great problems, and not all of them have been adequately solved. In any case, taking into consideration the evolution of prices, the foreign sector has had an important positive contribution to GDP growth in 1993.

Unfortunately the contribution of the foreign sector has been diminishing over 1993, partly due to a less stagnant economy and also to the evolution of relative prices with other countries. In that sense, the underlying rate of growth of the consumer price index has been quite stable during 1993, oscillating around 4.6%. This level in the underlying rate of growth of the CPI is made up by an underlying inflation around 4% in the good markets and near 7% in the service market. The expansions for 1994 are more uncertain than usual due to the difficulty in forecasting the increases in wages and productivity, however it can be said that it is unlikely that the annual rate of growth of the CPI in December 1994 would be less than 4%. With this rate of inflation the competitiveness of Spanish goods and services will be reduced during 1994. At the same time a vigorous export sector and an incipient mild recovery in domestic demand will induce a sustained positive rate of growth for real imports.

The above consideration led to the macroeconomic forecasts for 1993 and 1994 shown in the table. This table indicates that domestic demand has been very depressed during 1993, registering a decline of



3.1% in its annual average level. On the other hand, foreign trade on goods and services has contributed more than two percentage points to the growth of the Spanish economy and as a result the forecast for GDP points to a fall of 1%. Corresponding with the table, during 1993 both consumption and investment have decreased. The predictions for 1994 indicate a mild recovery of investment throughout the year to end up with an average annual rate of growth of 0.4%. On the other hand the recovery of consumption will be smaller and it will not take place from the beginning of 1994. Consequently its annual rate of change for this year will still be negative (-0.6%). All this will cause the annual average domestic demand to decrease by 0.2%. The table also shows that the contribution of the foreign sector to economic growth is declining along these two years, and for the annual average of 1994 will just be over a half of a percentage point. All this implies that for 1994 the rate of growth of GDP will be very modest, around 0.4%.

The figures in the table illustrate how much the recovery of the Spanish economy depends on the foreign sector. However, once the economy starts to recover, more imports are needed to attend production and if the terms of trade move against the Spanish commodities the decline of the contribution of the foreign trade to economic growth can be greater than the contribution from the incipient growth shown by domestic demand. In this case, the whole process of recovery could be aborted. Therefore, the control of inflation in 1994 seems particularly important. At this moment, the available inflation forecasts are over 4%, which, given the published forecasts for other countries, must be taken as the maximum inflation rate that the Spanish economy could afford in 1994, without stopping the mild recovery which is forecasted for the year. On the contrary, if all the economic agents associate possible improvements in their incomes with gains in productivity in their corresponding institutions, the inflation rate could be lower and economic growth greater and much sounder. An inflation rate significantly higher than 4% will probably push the Spanish economy into a longer recession.

The forecasts given for 1994 include a modest but continuous growth in investment. In order to achieve this, the evolution of the real interest rates and expectations and confidence in the Spanish economy play an important role. For these expectations, the economic policy implemented by the government is going to be important. In that sense, one observes that the public deficit for 1993 will be no less than 7.2% of GDP, which means that the net increment of public debt in 1993 is going to be more than three times the corresponding increment in 1992. It is true that with this growth of public debt the Treasury's recourse has been reduced by 1344.6 billions pesetas but

even taking this into account, the debt net increment would still be more than double that in 1992. The budget for 1994 includes a public deficit of 6.7%, which incorporates a considerable increase in investment expenses. This public investment is necessary to reduce costs in running Spanish economic activity and therefore it could help in pushing the recovery. But at the same time it is necessary for the public deficit to be well within 6.7% of GDP at the end of 1994, in order to avoid excessive pressures on financial markets which will prevent a reduction of interest rates.

The fulfillment of this public deficit objective is not going to be easy, but it must be one of the highest priorities for the economic authorities. This achievement will not only help in the evolution of interest rates but will also improve the confidence of foreign investors on the Spanish economy. As a matter of fact the reduction in interest rates is not only important on itself, but also because it is an indicator that some disequilibrium of the Spanish economy is in the way of being cured. The recent financial problems of Banesto, and the solution given, will certainly have an important impact on interest rates.

|                               | Quarterly rates (a) |      |      |      |      |      |     |     | Annual rates |       |      |
|-------------------------------|---------------------|------|------|------|------|------|-----|-----|--------------|-------|------|
|                               | 1993                |      |      |      | 1994 |      |     |     | 1992         | 1993  | 1994 |
|                               | I                   | II   | III  | IV   | I    | II   | IV  | IV  |              |       |      |
|                               |                     |      |      | (f)  | (f)  | (f)  | (f) | (f) |              | (f)   | (f)  |
| Private consumption           | -0.7                | -0.8 | -0.3 | -0.4 | -0.1 | 0    | 0.2 | 0.4 | 2.1          | 1.9   | -0.6 |
| Public consumption            | 0.5                 | 0    | 0.7  | 0.1  | -1.0 | -0.3 | 0.0 | 0.2 | 3.8          | 1.8   | -0.8 |
| Fixed investment              | -2.1                | -2.5 | -1.3 | 0.1  | 0.3  | 0.9  | 0.9 | 1.0 | -3.9         | -9.4  | 0.4  |
| machinery and equipment       | -4.4                | -3.5 | -1.4 | 0.0  | 0.4  | 0.8  | 1.0 | 1.0 | -2.5         | -15.2 | 0.1  |
| construction                  | -0.8                | -2.0 | -1.3 | 0.2  | 0.2  | 0.9  | 0.8 | 1.0 | -4.8         | -5.8  | 0.5  |
| Domestic demand               | -1.4                | -0.7 | -0.1 | -0.2 | -0.4 | 0.2  | 0.4 | 0.6 | 1.1          | -3.1  | -0.2 |
| Exports of goods and services | 1.6                 | 2.0  | 1.6  | 1.5  | 1.6  | 1.8  | 1.8 | 1.6 | 6.7          | 6.1   | 6.8  |
| Imports of goods and services | -3.6                | -1.0 | 0.8  | 1.2  | 0.8  | 1.0  | 1.0 | 1.2 | 6.6          | -3.7  | 3.4  |
| GDP at market prices          | -0.1                | -0.1 | 0.1  | -0.2 | -0.2 | 0.4  | 0.6 | 0.7 | 0.8          | -1.0  | 0.4  |

(a) not annualized rates (f) forecasts

It has been mentioned above that consumption will still be depressed in the first half of 1994 with a very mild recovery in the second part of the year. The possible growth of the Spanish economy will be based on gains in productivity and therefore the effect on employment will be small, which in turn would imply that the recovery of consumption would be slow. In those circumstances it is not going to be possible to push domestic demand from the public sector unless strict measures to increase the efficiency of public expenses are implemented. More efficient public expenditures would imply reducing costs in economic activity and improving social welfare, which will be a good guarantee that a deficit today to increase demand could be paid tomorrow.

It seems that the Spanish economy has problems with the supply and the demand side and both require reforms of the public sector that ensure that it could be possible to push the demand without putting inflation and interest rates at levels which create supply problems and without damaging future expectations on the economy.

The forecasts for the Spanish economy in 1994 show a mild recovery of GDP based on the contribution of the foreign sector and the mild recovery of the construction and the equipment sectors. Both elements depend heavily on the following factors: (1) The reduction of interest rates in order to reduce the rate of private and public debt services, and to stimulate private investment (2) The reduction of the rate of growth of production costs due to salary increases above productivity increases (3) The reduction of inflation rates, in order to preserve the competitive advantage in the terms of trade due to the devaluation of the peseta.

If these conditions improve quite rapidly, domestic demand may not decrease in 1994, but may recover mildly, and then a greater increase of GDP reaching 0.8% could be obtained. However, their satisfaction depends on internal and external factors such as: (1) The stabilization of the European project (2) The increase in competitive pressure on the non-exportable goods and services (3) The solution of the financial crisis generated in Spain by the crisis of Banesto (4) The capacity of the public sector to reduce its demand for resources in the financial markets in order to continue the reduction of interest rates

A negative evolution of these factors would affect the Spanish economy and the GDP then could decrease by about 0.4% in 1994.