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GLOBAL MACRO

Bright Spots in an Otherwise Lackluster Recovery, Part 3: Consumer Spending in Spain

With most EMU members still nursing their wounds from a six-quarter recession, it's understandable that so many people find it hard to get excited about the recent good news on Eurozone economic trends. The trouble, however, is that knee-jerk skepticism may well blind us to the changes under way. Granted, the return to growth currently taking shape is nothing to write home about. But it creates a very different environment from the one we faced a short time ago, when every new sign of a deepening recession translated into higher unemployment, further sovereign debt stress, and fresh doubts about the future of the countries feeling the greatest pinch—and ultimately of the entire euro area.

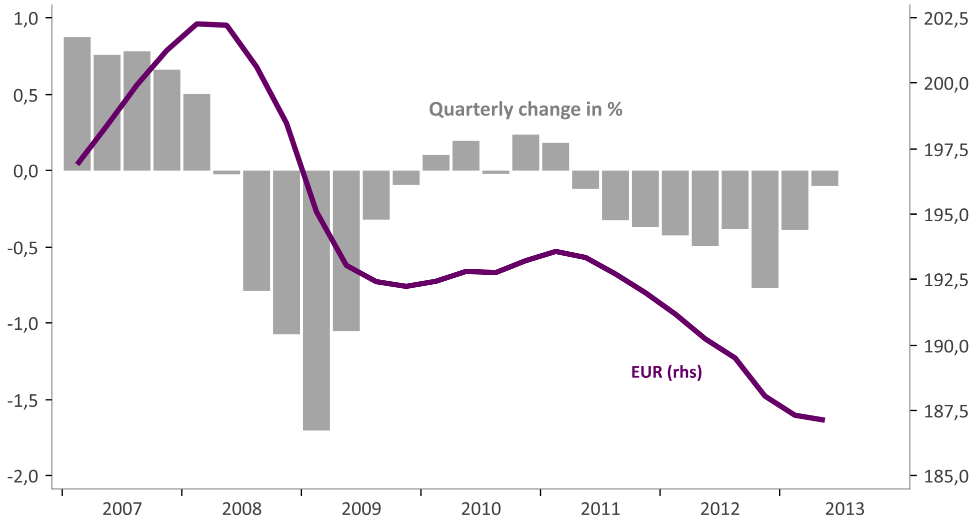
Now that an improved growth outlook has made it possible to avoid the disaster scenario in Europe, we are confronted with a changed global economic and financial landscape. If anything, the danger at this stage is that we will underestimate the implications of that change. Can anyone imagine, for example, that the waning of fears about an EMU break-up will have no effect on the Fed's future decisions? We certainly can't. That's why today's article actually touches upon a lot more than its primary focus—consumer spending in Spain.

Seventeen Quarters of Spanish GDP Contraction Since 2008

In the second quarter of 2013, Spain's gross domestic product shrank for the ninth quarter in a row, according to the revised accounts published in late August. More significantly, this marks the seventeenth quarter of falling output since the start of 2008. Spain has had only four quarters of growth—and weak growth at that—over the past five years, while GDP has decreased by a total of 7.5 percent.

Spain's GDP, Absolute Value and Quarterly Change

Constant prices, base year = 2008

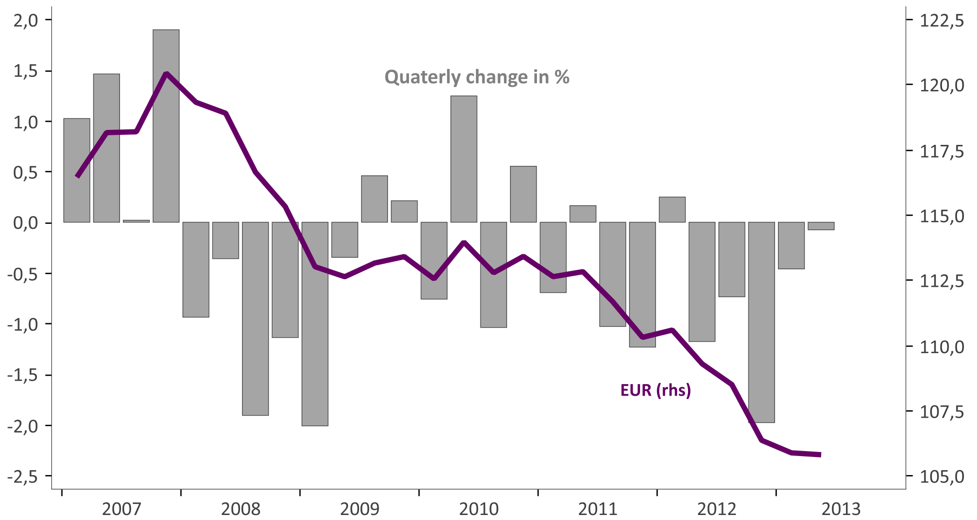


Sources: RichesFlores Research, Macrobond

All but two-tenths of this entire contraction is attributable to a fall in household consumption, which has declined for sixteen quarters and is down 12 percent from its high in late 2007. Spain's consumers have taken quite a beating.

Spanish Household Consumption, Absolute Value and Quarterly Change

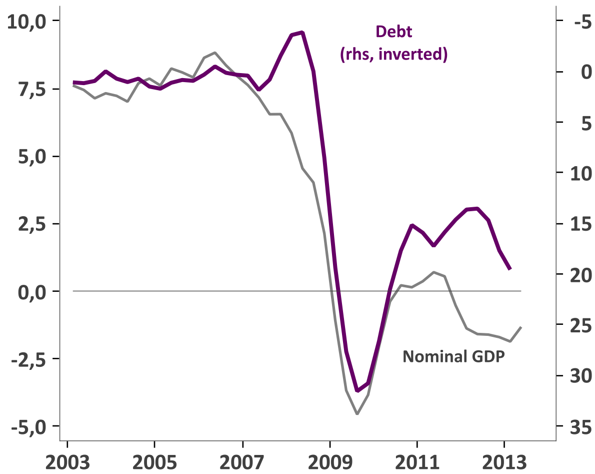
Constant prices, base year = 2008



Sources: RichesFlores Research, Macrobond

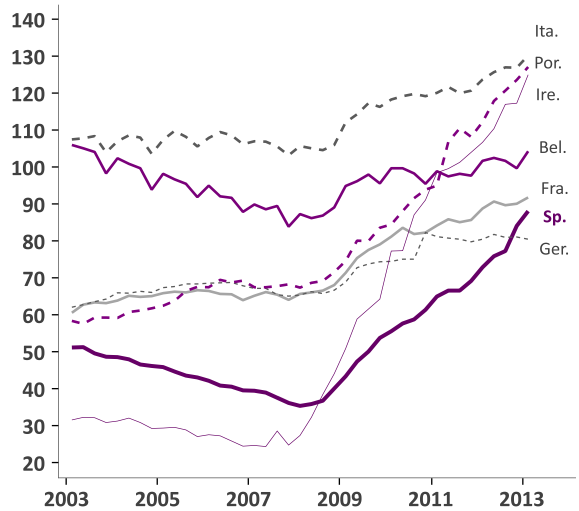
Moreover, this hemorrhaging has done severe damage to the country's public finances. With its national debt rising by an average of 20 percent a year from 2009 to 2013, its debt-to-GDP ratio has increased by more than 50 points. The Spanish economy—widely celebrated as a Eurozone poster child before the crisis—is now considered one of the currency bloc's highest-risk members.

Annual Growth in Spain's Nominal GDP and Government Debt



Sources: RichesFlores Research, Macrobond

Eurozone Government Debt, % of GDP



Sources: RichesFlores Research, Eurostat, Macrobond

An End to Austerity Means Less Pressure on Consumers

Spain, where consumer spending accounts for 56 percent of GDP, had no chance whatsoever of reversing its debt buildup unless its consumers began opening up their wallets. In fact, the most objectionable aspect of the austerity policies urged by Brussels and implemented by Spain's leaders over the past three years is they deprived the country of the means to exit the sovereign debt crisis.

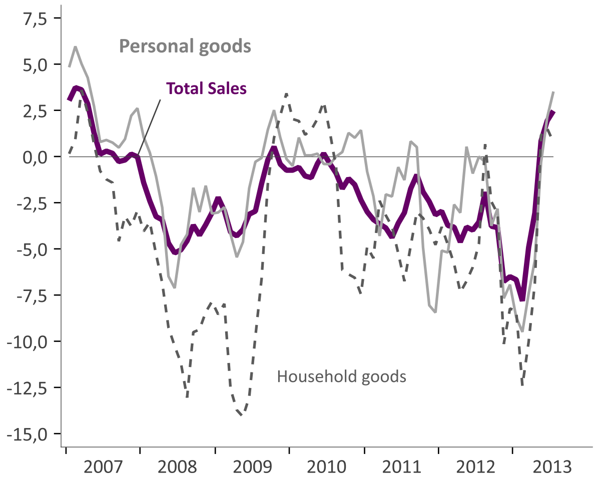
Consumers were affected dramatically by the last austerity package adopted by the Rajoy administration in July 2012—and they will continue to feel the burden for some time to come. The good news is that with the government's reform drive on the back burner and no new fiscal retrenchment measures in the works, the stranglehold on Spanish households has begun to loosen. This change has resulted in a much brighter outlook. Not only did personal expenditure show only a slight decrease in the second quarter—just 0.1 percent in real terms, versus an average of 1.1 percent in the four preceding quarters—but unmistakable signs of a consumer spending recovery have been gathering since the start of the summer:

- Retail sales, which recorded an unprecedented annual slide of over 15 percent at year-end, have picked up sharply in recent months. From January to July, they scored their highest six-month gain since early 2007—2.5 percent. Even better, this trend reversal can be observed across all retail categories.

- After hitting a low last November, new car registrations have also bounced back. They rose 25 percent between December 2012 and June 2013, whereas they fell by at least as much during the darkest days of last year.

Retail Sales Growth by Volume

6-month growth rate in %, 3MMA



Sources: RichesFlores Research, Macrobond

New Car Registrations

6-month growth rate in %

Sources: RichesFlores Research, Macrobond

These gratifying figures are further supported by a number of recent trends that point to a lasting consumer spending upturn:

- **Consumer confidence,** a reliable leading indicator of spending, has rebounded in the last few months, suggesting that all other things being equal, the current recovery is almost guaranteed to continue in the upcoming quarters.

Consumer Confidence and Retail Sales Growth

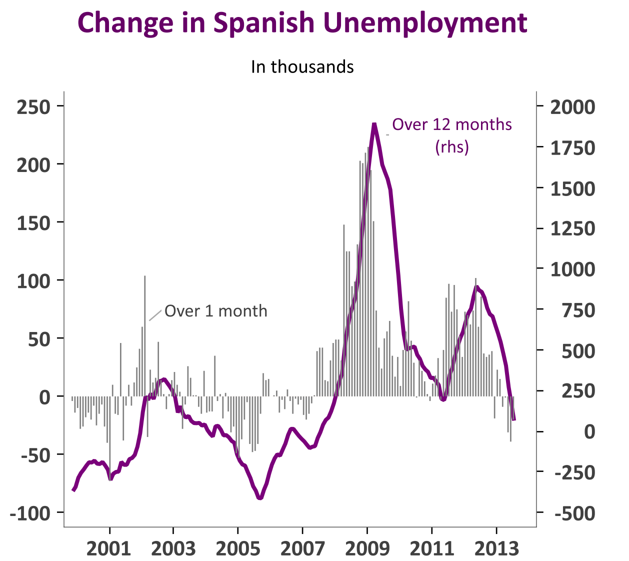
Annual change in % and in percentage points

Sources: RichesFlores Research, Macrobond

- **Manufacturers' new orders** for consumer goods, which rarely reflect trends sooner than orders for non-consumer products, are comparatively quite high at present, registering a noteworthy uptick in the past several months.

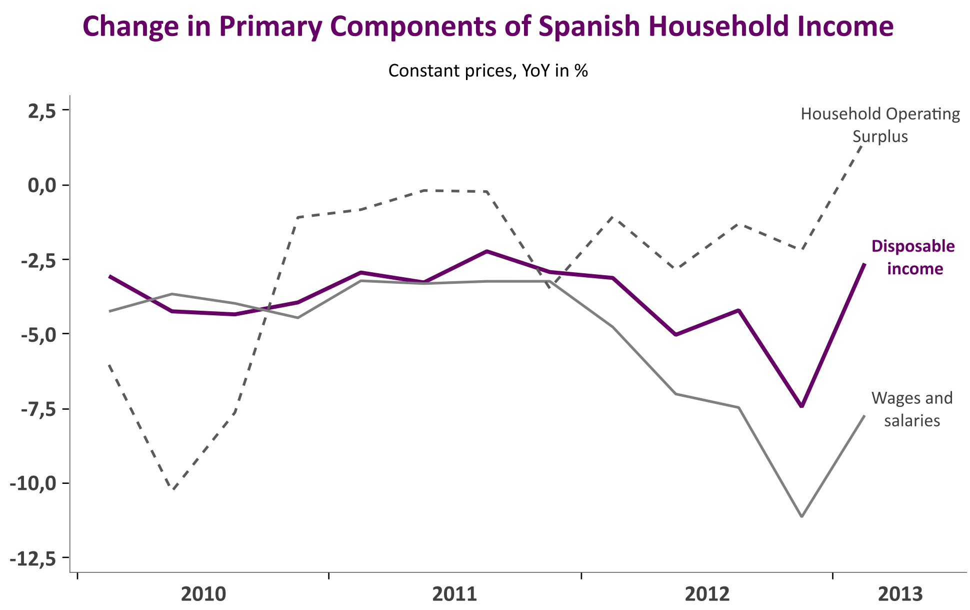
- **The jobless rate has eased.** This improvement—without which consumer sentiment can't possibly hold up for very long—is confirmed by the latest polls of employers' hiring intentions.

Sources: RichesFlores Research, Macrobond



Sources: RichesFlores Research, Macrobond

- Lastly, **disposable income,** which was falling at an annual pace of over 7 percent at the end of last year, is edging back up—the most compelling evidence that improvement is under way. Even though total wages and salaries have continued strongly downward, disposable income has gotten a boost from lower taxation and rising household operating surplus, which account for a large share of total household income in Spain: more than one fourth, compared with 15 percent in France and Germany.



Sources: RichesFlores Research, Macrobond

The prerequisites for a genuine upswing in personal consumption are basically all there. In effect, they herald the end to a recession which, if it had continued, would have represented an incalculable threat—both to Spain and to the euro area as a whole. Just a few months ago, a good many market-watchers were betting that the country would ultimately be unable to meet its financial obligations. The recent good news has taken a lot of the sting out of that prospect.

What needs to be stressed at this stage, however, is that for the time being at least, the improved outlook in Spain results less from the alleged benefits of a more competitive economy than from somewhat lower pressure on the country's consumers. Rising sales to other EU 28 countries, chiefly to the United Kingdom and France, account for 90 percent of the rebound in Spanish exports since the beginning of the year, and we may reasonably assume that the key ingredient here is higher demand in those countries rather than efforts to build competitive strength.

This leads us to two conclusions: 1) as before, economic developments in Spain will depend largely on government policy toward households; and 2) any recovery in domestic demand is likely to drive the country's current account deficit up once again. Why? Because Spain will be unable to leverage its improved cost competitiveness without a major catch-up campaign in industrial investment—the only kind that can boost potential output. While such a campaign is clearly not in the cards today, the current environment offers greater incentives for companies to step up capital spending.

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