Europe and Spain: A timid but clear recovery

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“THE EUROZONE HAS PROVIDED ITSELF WITH INDISPENSABLE TOOLS TO ENSURE THE EURO'S LONG-TERM VIABILITY”

Has Europe turned the corner? Is the euro crisis over? And what about Spain? Is the Spanish economy definitely on the mend? The answer to these questions is a cautious but unquestionable yes.

True, difficult problems remain. In most European countries, economic growth is very weak. Unemployment is at record levels at over 12%. Fewer Europeans are employed today than six years ago.

The large current account surplus of Germany and other EU members hinders the rebalancing for other EU countries and creates a deflationary bias for the euro area. The refusal of surplus countries to accept a more expansionary monetary policy condemns deficit countries to the straitjacket of austerity and internal devaluation.

Fiscal consolidation has resulted in a deep dent to the welfare state, a European Union sign of identity. Healthcare, pension and unemployment benefit cuts have taken a toll on public opinion. The popularity of the Union in core countries like France or Italy is plummeting.

The Eurozone has provided itself with indispensable tools to ensure the euro's long-term viability. But the banking union, a key element of the EU's response to the crisis, is less ambitious than would be necessary. The decision not to set up a common backstop for the Eurozone's banks significantly limits the ability of the banking union as a tool of crisis resolution.

Besides, the ruling by the German constitutional court on the European Central Bank promise to be the buyer of last resort for Eurozone countries' bonds (the whatever-it-takes policy of Outright Monetary Transactions) shows the limits of what the ECB can do to underpin the single currency.

The ageing population remains a real challenge. At the same time, immigration concerns pose a threat to free movement of labour, a key element of the Union. The recent Swiss decision to impose quotas on immigrants from the EU creates a very negative precedent. The impact on the Swiss economy will be significant. Swiss businesses will not benefit from it. Neither will the rest of Europe, where some countries may be tempted to follow suit.

Unemployment will continue to be the main challenge in some countries, where it may take years to reach normal levels of employment. This will undoubtedly have an impact on the public support for the Union and limit the scope for a more integrated economic policy, in a catch-22 that will prevent more effective measures to combat joblessness and generate economic growth, further denting the popularity of the Union.

Populists, anti-EU and far right parties are likely to make big gains in the coming European elections. In some countries this may be a real shock. As Wolfgang Münchau has pointed out, the problem is not only the combined voting power these parties are likely to have, but also their impact on the leading centre-right parties, that are becoming more eurosceptic as well.

But even the most pessimistic will agree that fears of an imminent collapse of the Eurozone have subsided. The landscape has changed. We are very far from the worst scenarios that could have been suggested two years ago.

Confidence is on the rise. Gone are the days when European economic circles discussed rising spreads and sovereign bailouts and Spain and Italy had to explain why they were "not Greece". Ultimately, the euro will not only survive but emerge stronger from the crisis, with an ECB with the powers it needs to make it work.

Whatever the gains of the anti-EU and far right parties in the European elections, the mainstream is likely to remain safely in the hands of a pro-euro and pro-EU majority. European economies will keep on gradually but steadily recovering and the pro-European sentiment will recover too.

The figures are inequivocal. Growth may be sluggish, but the index of industrial activity in the Eurozone has reached its highest level since mid-2011. After declining by 0.6% in 2012 and 0.4% in 2013, the Eurozone gross domestic product is expected to grow by 1.1% in 2014. Some small countries may further contract, but Germany will grow by 1.7%, France is expected to grow by 1% and Italy will return to growth unless politics prevents it. Outside the Eurozone, the UK and Sweden are expected to grow vigourously.

Ireland has successfully exited the European three-year bailout programme. Portugal may leave it soon, and Italy and Spain are able to raise money on capital markets at reasonable rates.

The recovery is hesitant and uneven across Europe. It is too weak to bring down unemployment. But the sentiment among consumers and businesses has improved. All signs point to a slow but steady increase in confidence and economic activity.

What about Spain?

Obviously this recovery will have a positive impact on the Spanish economy. It is already underway. It can already be felt.

After the bursting of the housing bubble, a double-dip recession and two years and one quarter of declining output, with an accumulated loss of 7% of the GDP, Spain returned to growth in the third quarter of 2013.

Exports have played a key role in this recovery. Spurred by increased competitiveness and by a labour reform that helped to boost productivity, they almost doubled their pre-recession weight in the economy. Consequently, the trade balance moved from 10% deficit to almost 2% surplus.

In January this year Spain exited the bank bailout programme it entered 18 months ago. Spanish banks have regained their health. The asset management corporation Sareb, set up to absorb the toxic real state assets of the nationalised savings banks, is up and running. The stock market main index, IBEX 35, gained more than 15% in 2013.

Investor confidence is on the rise. The risk premium is back below 200 basis points, and foreign investment increased by over 20% in 2013. Market appetite for the country's debt and listed shares is increasing. Some of the world's richest businessmen like Bill Gates, Carlos Slim or Warren Buffet have recently announced investments in Spain. Ford announced plans to increase production in its plant in Almussafes (Valencia), and companies who had previously outsourced work to Latin America and Asia are returning to the country.

Spain is undoubtedly a big player in the tourism industry, second in the world after the United States, with very good tourism infrastructure and know-how. The nearly 60 million tourists it receives yearly are likely to grow as cruise holidays gain in popularity and fast speed train networks link Spain with France.

But growth is mainly coming now from very competitive companies in the services sector that are exporting and increasing their presence in world markets. Plenty of little-known start-ups are growing quickly internationally. Spanish businesses are finding new markets world-wide.

The adjustment is very painful for many. The recession has taken a huge toll on the work force, with official unemployment figures over 26%. Over half the under-25s available for work are unable to find a job. However, the number of employees paying into the social security system rose over 0.4% in the last term of 2013, the first rise since 2008.

The government has enough parliamentary support to stay in office until the end of its mandate in autumn 2015. Social unrest remains comparatively low despite the painful austerity measures and the unacceptably high jobless rate.

Of course considerable challenges lie ahead. It is debatable whether exports will keep on growing. According to some figures, the trend was reversed during summer last year and they are now stabilising. The euro's strength is undermining Spanish efforts to increase competitiveness.

Bank lending is at very low levels. Small and medium enterprises encounter great obstacles to get the loans they badly need. Spanish banks find it safer to lend to the government than to businesses, and are heavily exposed to Spanish sovereign debt. Some think they are not yet as healthy as they should be. The quality of their assets still deteriorates due to increasing bad loans.

Official figures of 2013 deficit have not yet been released. But they will probably miss the 6.5% target. In 2014, according to government figures, deficit is going to be 5.8% of GDP and public debt will climb to around 100% of GDP. Unemployment is likely to stay around 25% until 2018.

Even as the economy grows again it will take time before all sectors feel the improvement. The overhang of seven hundred thousand new homes left by the housing bubble will not be cleared in several years. Prices have fallen, but in all probability not enough.

High life expectancy and low natality rates will remain a challenge. The previous government raised retirement age to 67, but some claim that this remains too low. The number of pensioners keeps on growing and the social-security system's losses continue to increase.

The two-year period of elections starting this year will not strengthen political courage for still much needed structural reforms.

It is the old story of the bottle: half full? Or half empty? Both in the Eurozone as a whole and in Spain hopeful signs abound. The Big Recession seems to be behind us. We have definitely turned the corner. However, substantial problems remain.

Europe has gained time to deepen its economic integration. Spain has also gained time to further the reformist agenda. Now European and Spanish leaders need to do more to improve long-term competitiveness and generate a pace of growth capable of bringing down unacceptable unemployment figures. They have an opportunity to do it. It is for them to take advantage of it. ■

“IN JANUARY THIS YEAR SPAIN EXITED THE BANK BAILOUT PROGRAMME IT ENTERED 18 MONTHS AGO”

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