WHY TO EXPECT GROWTH SLOWDOWN

- 2016 will display a 3.2% growth, the same level as in 2015. However, 2017 will decelerate, accusing some weak points of Spanish economy.

- The main reason for the slowdown is the public deficit. The incoming government will have to cut its budget, as new goals of deficit were set this summer.

- Lack of a definitive government, Brexit, and the dwindling effectiveness of ECB policies are among other hurdles.

- Lending lending surveys from Spanish banks show that they perceive credit demand in faster expansion.

- Of the three main credit uses (mortgages, consumption, business) the less dynamic has been credit for home buying. This may not be meeting pent-up demand with implications for the real estate sector.

Reasons for less growth in 2017

If one person states that the GDP variation in Spain will change from 3.2% in 2015 to 2.8% in 2016 and asks you if the economy will be smaller, what will you answer? The correct answer is larger: GDP is still growing.

An erroneous interpretation (the economy will be smaller) is common, even in economic media. That makes the last bullet point worthwhile reflecting upon as we explain why the general volume of goods and services produced 2017 will be more than in 2016 (and by extension than in 2015) but at a lesser rate of expansion.

At the beginning of Q4 2016 the consensus forecast for GDP growth in 2017 points to something around 2% to 2.5% while in 2016 will be around 3% to 3.2%. The main reason for a reduction in growth seems to lie with the public deficit. Nevertheless, we can mention other culprits such as the effects of a complete year with no official government, the uncertainties brought by the leave-vote win in the UK and the diminishing effectiveness of the Eurozone monetary policy.

Domestic private drivers

Confidence from consumers and businesses sustains the optimistic trait, which will impact future consumption and capital investment levels. The expectation is that the strong growth in consumption and fixed capital formation will not hold at current levels in 2017, but expansion will remain. Actually, BNP Paribas forecasts point to increases adjusting from 3.4% to 2.1% in consumption and from 4.5% to 3.8% in productive capital investment between 2016 and 2017.
The new Spanish government will have to cut €5.5 billion from the public deficit. If not done, the deficit will be around 3.6% of the GDP half a point ahead of the target. This means that the contribution of public demand to economic growth will be, in a new iteration, held back in the forthcoming two years.

**Lack of official government**

A common question asked by investors is the sacrifice in growth derived from the lack of an official government throughout 2016. The plain estimation from BBVA Research (a Spanish bank) is 0.7% of the GDP. This ‘missed train’ will restrain to some extent Spanish growth in 2017.

**Brexit**

The effective departure of the UK from the European Union will, in theory, be complete sometime in 2019/2020. By that time European trade, capital and people movement will be less intensive, bringing inefficiencies at least at the continental level. But that is beyond 2017 and for the moment, what we can discount are uncertainties brought by the the Leave-vote win.

**ECB Monetary policy**

There are currently piles of analyses that warn ECB’s low interest rates and QE’s and TLTROs are losing steam. That is most probably true as money (electronically) printed is outrightly different than wealth and there is a boundary in 0 for interest rates. Nevertheless the ECB is expecting Euro zone economies to power up in credit and capital markets so the output created inside those markets and their spillovers in the forthcoming years back-up the money already created.

**Credit demand expected by Spanish banks, synchronizes with business cycle**

Since 2003 Euro zone central banks gauge the lending conditions of their respective countries in a quarterly basis. The survey targets the credit markets of both families and businesses and offers a sizable set of dimensions to breakdown the data.

The main variables we look at are the view Spanish banks have in terms of 1) change in credit allocation standards and 2) change in forthcoming credit demand. The first checks if the banking sector restricts or eases the conditions they put to assign credit. The second, checks if they expect (on the next three months) an expansion or contraction in credit demand.

The development of credit demand expectations is classic, in terms of its stickiness to the economic cycle. We may say that it’s pro-cyclical.

The recent behaviour of the demand series clearly show that banks started to discount recovery in both businesses and families credit petitions as early as Q3 2013. (It is generally considered that the beginning of the recovery was somewhere around H2 2013).

Since then the expected ‘hunger for credit’ has been keener on the corporate side than on the family side (save Q4-2015 and Q1-2016). As of end of Q2 Spanish banks assigned a similar expected credit growth to both demand sources.

Mortgage demand (for house purchasing) has increased less than credit for consumption and for businesses. It was at the end of 2015 when banks expected more demand increase for mortgages. Nevertheless, at the end of the second quarter of 2016 the surveyed banks share, in the same tone, an increase in credit demand from both families and businesses.

**No change in Credit allocation standards. Good news?**

The change in credit outstanding in the economy may also come from the tightness or looseness banks may have to allocation. This is why the central banks also measure credit standards changes.

During the crisis period Q3-2006 to Q3-2009 standards became ever more astringent for families and businesses. After 2009 constant increases in restrictions changed to only to slightly harden every two or three quarters.

In the recovery period the Spanish banking sector ‘attitude’ towards lending has displayed divergent trends, depending on the type of credit. Business credit has not seen one quarter of effective relaxation since Q1-2010.
It is worth mentioning that between 2013 and 2014 they forecasted credit standards relaxation, but such expectation was not fulfilled.

A similar pattern may be observed in the families mortgage market. Nevertheless, since Q3-2015 banks have lightened to some extent the credit allocation criteria. In Q2-2016 the outlook for added looseness for home buying credit remains slightly positive.

Standards for consumer credit have relaxed in some quarters since 2013. However, it has only been since Q3-2015 that banks have reported 3 out of 4 quarters of relaxed standards rendering this type of credit the more open to match demand, especially when the main driver of economic expansion is consumption.

All in all, it is good news that banks hold their standards at a high levels to avoid excessive credit risk. On the other hand, added relaxation in mortgage and business credit is desirable in order to grab hold on high-potential sectors in Spain, such as productive capital investment as well as property markets. The latter is of special interest, given the strong tail winds of real estate investment seen in Spain in 2016 and expected for 2017.

**ECONOMIC CALENDAR**

**25 OCT**
- GERMANY: IFO BUSINESS CLIMATE SURVEY
- EUROZONE: MARIO DRAGHI CONFERENCE

**26 OCT**
- FRANCE: CONSUMER CONFIDENCE US: NEW HOMES SALES

**27 OCT**
- SPAIN: LABOUR STATISTICS (SEPT)
- EUROZONE: MONEY SUPPLY (M3)

**28 OCT**
- SPAIN: Q3 PROVISIONAL GDP GROWTH AND CPI

**31 OCT**
- EUROZONE: CPI OCTOBER

**02 NOV**
- EUROZONE AND SPAIN: PMI MANUFACTURES OCTOBER

**03 NOV**
- EUROZONE: LABOUR STATISTICS (SEPT)

**04 NOV**
- EUROZONE AND SPAIN: PMI ALL SERVICES OCTOBER

**CONTACTS**

**INTERNATIONAL RESEARCH**

Samuel Duah, PhD  
Head of Real Estate Economics  
samuel.duah@bnpparibas.com  
+44 (0)20 7338 4207

Sukhdeep Dhillon  
Senior Economist (UK)  
sukhdeep.dhillon@bnpparibas.com  
+44 (0)20 7338 4834

Thomas Glup  
Economist (Germany)  
thomas.glup@dere.bnpparibas.com  
+49 40 348 481 09

Benoit Lefebvre  
Economist (France)  
benoit.lefebvre@bnpparibas.com  
+33 1 55 85 26 92

Ramiro Rodriguez, PhD  
European Economist (Spain)  
ramiro.rodriguez@bnpparibas.com  
+34 91 454 97 84

Stephen Ackroyd  
Senior Analyst (UK)  
stephen.ackroyd@ukre.bnpparibas.com  
+44 207 338 4328

Disclaimer: BNP Paribas Real Estate cannot be held responsible if, despite its best efforts, the information contained in the present report turns out to be inaccurate or incomplete. This report is released by BNP Paribas Real Estate and the information in it is dedicated to the exclusive use of its clients. The report and the information contained in it may not be copied or reproduced without prior permission from BNP Paribas Real Estate.