

Economic note

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1. Economics and politics: a persistent divergence

In our previous Note, we spoke of the phenomenon of the "Italianisation of politics", where a country's politics and economy seem to follow divergent trajectories. Politics is characterised by unpredictability and volatility, while the economy follows its course, experiencing growth, generating employment and allowing businesses to operate seemingly independently. Thus, economics and politics are perceived as spheres that speak different languages and evolve separately.

In the last three months, Europe has been the scene of intense political activity. We have had elections to the European Parliament, elections in France (a by-product of the first elections) and in the UK. In addition, developments in the US in the run-up to the presidential elections in November have been closely followed.

The European elections were held under the threat of a significant increase in the presence of the extremes in the EU parliament, especially the far right. In France, President Macron responded to the victory of Marine Le Pen's *Rassemblement National (RN)* in the European elections, where they won almost a third of the vote and more than twice as many MPs as the next party. Although the final results in France will probably not allow for an RN government, their political strength has become clear.

In the UK, the desire to end 14 years of Conservative majorities was clearly expressed: Keir Starmer's Labour won convincingly over Rishi Sunak's Conservatives (410 vs. 121 of the 650 seats contested). The Conservatives scored their worst result since the party was founded in 1834. The Eurosceptic and populist Nigel Farage won representation for the first time with 4 seats. However, the English majority system hides a lot of information and we should not limit ourselves to the final number of seats: Labour won just under 34% of the vote, while the Conservatives were only ten points behind. Farage won more than 14% of the vote (just over 4 million, a six-fold increase on the previous election), which had a major impact on the final result by preventing a Conservative majority in many constituencies.

2. The great discontent: easy solutions to complex problems

Populist alternatives in Europe and the rest of the world offer seemingly easy and painless solutions to complex problems. They exploit a great deal of discontent related to the perception (and reality) of the disappearance of the 'social ladder' in recent decades, the growing problems of youth in emancipating themselves (especially in access to housing), rising inequality and the growing realisation that the system rewards only the fortunate few. This growing difficulty is fertile ground for those who provide painless recipes and quickly identify an "enemy", either external (the *caste*, the *establishment*) or external (immigrants, who would compete for jobs and put downward pressure on wages).

The chainsaw of the recently elected president Milei is the paradigm of all this: something that does not work, is cut at the root with the chainsaw and flourishes healthy and strong after a short time. A full-blown social pruning. An easy and apparently painless solution.

Politics is separated from economics, because never in the last fifty years have we in developed countries achieved a combination of such high levels of wealth, near full employment labour markets in many countries and overall macroeconomic stability.

The risk is not tackling the underlying problems in time (where growing inequality clearly stands out) and trying to implement solutions that do not require a great deal of effort. Despite the rise of populism in recent years, there are still green shoots that emerge from time to time and seem to offer new opportunities. As a wise analyst has said: the British were the first to embrace populism and we hope they will be the first to abandon it.

3. The Spanish economy at a good pace...

The above considerations are also valid for Spain. On the one hand, we see that in the recent European elections almost a third of men under 45 opted for political alternatives at the right end of our political spectrum. Moreover, a significant percentage chose an alternative that did not even exist shortly before.

On the other hand, our economy continues to show a good general performance and has presented a very positive differential in the last three years compared to the countries around us. It is likely to end 2024 exceeding all expectations in terms of growth. The end-2023 forecasts for the GDP growth rate (around 1.4%) have been widely exceeded and it is feasible that it will exceed 2.5%. This compares with rates of less than 1% in the euro area as a whole, highlighting the growth differential.

Our economy has seen a series of positive dynamics in recent years, with limited impact of some mistakes, taking advantage of negative events in other geographies, exogenous population growth and economic policy successes. Among them we can highlight:

- 1) The favourable evolution of the labour market, with the number of employed people at an all-time high (21 million people) and a significant reduction in the temporary employment rate.
- 2) The sound financial situation of the private sector, with household and corporate debt levels well below those observed before the financial crisis and even below those of the euro area. The deleveraging of the Spanish private sector has been of proportions difficult to see in developed countries as a whole. Firms and households have developed a remarkable debt-avoidance, although part of this may be due to the inability of certain sectors of the population to access credit (young people, for example).

- 3) The absence of imbalances in the external sector, with current account surpluses for more than a decade, reflecting the country's financing capacity vis-à-vis the rest of the world and helping to reduce external debt.
- 4) The progressive diversification of foreign tourism, both in terms of deseasonalisation (foreign tourist arrivals in the last quarter of last year grew by nearly 20% compared to previous years) and in terms of destinations (foreign tourists in Asturias, Galicia and the Basque Country, for example, grew by over 25%).
- 5) The progressive deployment of NGEU funds and the dynamism of public spending.
- 6) The limited direct exposure of the Spanish economy to current sources of international vulnerability (Russia, Ukraine, Israel, etc.).
- 7) Immigration-driven population growth, a phenomenon we have discussed in some depth in a previous Note (see, for example, NE RJ October 2023).
- 8) The continuity of the disinflation process, together with the less restrictive tone of monetary policy, which has helped to anchor economic agents' inflation expectations and to anticipate an upturn in activity parallel to the start of the rate cuts.
- 9) A certain dynamism in wages which, together with the increase in employment, allows household disposable income to grow by more than 10%.
- 10) The gradual revival of the European economy.

This is an incomplete list of factors that have positively affected our economy over the last three years and which do not seem likely to run out in the short term. The coming quarters could well maintain this positive dynamic which, to some extent, feeds back on itself.

4. ... but the long term always comes.

Despite this enviable performance, the Spanish economy continues to show a set of weaknesses which, although they may manifest themselves in the longer term, will eventually do so: the problem with the long term is that it always comes in the end. To the "traditional" focuses of attention - the sustainability of the pension system, a fiscal position that can be improved given the growth in revenue and the point in the economic cycle at which we find ourselves - we must add the persistent lack of dynamism in productivity (measured as GDP per hour worked, relative to the rest of the eurozone countries) and the weakness of business investment (in capital goods) since the onset of the financial crisis in 2008.

Low productivity and lack of business investment point to weaker future growth rates than our neighbouring countries and, ultimately, lower relative per capita income. They have complex solutions and origins, but it does not seem that the Spanish economy has been tackling them adequately in recent decades.

5. Eurozone improves, but interest rates are in no hurry

The eurozone countries as a whole are gradually recovering growth rates that are moving away from stagnation and in 2024 the area as a whole could reach 1% in a context in which inflationary tensions are easing. The challenge on the price front will be those of the services sector, which are hindering the disinflation process in some countries by showing more persistent behaviour.

In any case, the European Central Bank has already shown its readiness to cut interest rates as soon as the decline in prices is sustained. However, anticipating policy rates much lower than at present by the end of the year might be premature.