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Spain: Short-Term Prospects Addendum on the Economy

The Spanish economy, which grew a spanking 6% annually in 1970-74, is experiencing a sharp deceleration precipitated by slumping exports. Because of high inflation and a looming payments problem, the government has proceeded cautiously in efforts to revive activity. As a result, the increase in real GNP this year probably will be only 2%, roughly half that of 1974 -- a poor year by Spanish standards.

Industrial production began to falter in the summer of 1974, plunging steeply after October as export orders dried up. In first quarter 1975, seasonally adjusted output fell at a 23% annual rate before rebounding somewhat in April. Since then industrial activity reportedly has revived somewhat, while remaining well below last year's levels. During first half 1975, industry operated at only about 80% of capacity.

Although the 1977 budget expenditures are slated to rise 19.6% in nominal terms to a record $14 billion the real increase in spending will be only 3%. This will not be sufficient to restore Spain to its long-term growth path. Both the armed forces and law enforcement received 20% increases to $2.1 billion and $1.7 billion, respectively, reflecting Madrid's concern over domestic unrest and com-licated foreign problems such as in the Spanish Sahara.

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Unemployment is officially listed at 4%, compared with 2% last year, and could become a pressing concern to Madrid. There are 1.4 million Spaniards working in other countries -- 275,000 in France, 140,000 in West Germany, and 75,000 in Switzerland. In the past 12 months more than 70,000 have returned from these three countries alone, following 60,000 who came back last year. The trend is likely to continue into 1976. Returning workers must be added to much disguised unemployment and many who are now on part-time at home.

While Madrid has increased spending and lowered the tax on capital gains to bolster output and reduce unemployment, it increasingly has focused policy attention on price control. Consumer prices are increasing at a 17.5% annual rate, forced up slightly from the 1974 rate by 20%-25% wage gains so far this year. New anti-inflation measures introduced for 1975 have included a 15% tax on interest-earnings from savings deposits and a 10% tax surcharge on investment dividends and profits. Wage increases may not exceed the rate of increase in the cost of living. Rents and profit margins have been frozen, and the prices of goods will be allowed to rise only enough to cover increases in the cost of labor and material inputs.

The foreign sector is a major constraint on economic expansion. The value of imports is more than double that of exports, and the trade deficit has widened so far this year. The deficit is expected to rise from $8.3 billion in 1974 to more than $9 billion in 1975. Heavy continued demand for imported oil, compounded by the latest OPEC price increases, will push Spain's oil bill to more than $3.5 billion this year. The broad nuclear program and exploration efforts in the Mediterranean will not free Spain from heavy dependence on imported oil. Despite the world recession, tourist revenues and worker remittances have done well and the deficit on current account may be held at slightly more than $3 billion -- about the same as last year. Spain's foreign reserves are adequate at $6.26 billion, but Madrid has preferred to borrow abroad to cover the current account gap.

Madrid blames its poor trade performance on what it considers unfair treatment by the EC and the United States. The execution of terrorists last month apparently hardened European attitudes towards Madrid. Spanish-EC trade negotiations have been deadlocked since last year and are not likely to resume soon. Madrid also is unsatisfied with the results of attempts to gain more favorable tariff preferences from the US and will continue its drive for concessions in this area.