

## ACTIVITY

# Spain: growth could have reached its top speed in 2Q15

Spain Unit

## The upturn in activity at the close of the first half could give way to a mild deceleration in the last leg of the year

The trend for observed variables confirms that **the recovery of the Spanish economy intensified in 1H15, due to both external and domestic factors**. With around 80% of the information for 2Q15 available, the MICA-BBVA model<sup>1</sup> estimates that **quarterly GDP growth (QoQ) could have reached 1.0%**. Although this figure is 0.1pp below the estimate of a month ago, it remained above the levels registered both in 1Q15 and the average over the expansive phase of the preceding cycle (0.9% QoQ).

Notable among the **external drivers** for growth over the first half are **the containment of the oil price, the improvement in European demand and the more expansive tone of ECB monetary policy**. The latter had been noticed initially mainly via the euro's depreciation and now, through the decrease in interest rates on new loans to the private sector. **On the domestic front**, the reduce of uncertainty, the correction of certain imbalances (for example in the real-estate sector) and the reforms undertaken in recent years have contributed to the improvement of the labor market and the confidence, which has **encouraged consumption and investment decisions by households and businesses**. Moreover, **fiscal policy has ceased to be contractionary**, which has manifested itself in not only a cut in direct taxation, but also in the rise of public sector demand<sup>2</sup>.

Looking ahead, the Spanish economy's fundamentals provide support for consolidation of the recovery. However, the most recent figures suggest that **activity could slow down to 0.8% QoQ in 3Q15 (MICA-BBVA) if the current trend is kept up over the coming months (see Figure 1)**. In any case, the former imply a softer adjustment than that estimated in BBVA Research's central scenario, which was published in early May<sup>3</sup>. **Therefore, it is likely that GDP growth slightly exceeds expectations in 2015 (3.0%)**.

Whatever the case, it should be recalled that, given the available information, the forecast for Q3 is not statistically different from that for Q2. Conversely, **there are still fronts in the frame where solutions must crucially be found to avoid scenarios in which recovery is hampered by uncertainty**. In Europe the overriding concern in the short term centres on negotiations between Greece and the institutions. Beyond that, the election timetable is still shaping developments in at least four European countries. The policies pursued by the new governments will be key to heading off risk scenarios where growth is hit by a decline in confidence and an increase in financial tensions.

1: For further details on the MICA-BBVA model, see Camacho, M. & R. Doménech (2010): "MICA-BBVA: A Factor Model of Economic and Financial Indicators for Short-term GDP Forecasting", BBVA WP 10/21, available at: <http://goo.gl/zeJm7g>

2: The itemisation of the Quarterly National Accounts in 1Q15 revealed higher-than-expected public sector demand growth. Consumption by regional governments rose 1.6% QoQ following the setback of 1.0% QoQ in 4Q14. In similar fashion, a rise in non-residential construction was recorded (affected by public works) of 2.5% QoQ, which was ahead of estimates (BBVA Research: 0.9% QoQ). Detailed analysis of the data is available at: <https://goo.gl/yeCEXT>

3: BBVA Research's economic scenario for the 2015-16 biannual period included a slowdown in growth during the second half of the current year bearing in mind the smaller stimulus expected from certain factors (such as the oil price or lower taxation) and the uncertainty that could be brought by geo-political events. An in-depth description of this scenario is to be found in Section 3 of the Spain Outlook, second quarter 2015, available at: <https://goo.gl/ymzpoU>

## Exports are rising again in line with their fundamentals, while private sector domestic demand remains robust

Looking now at Q2, the available information suggests that the composition of growth could have been more balanced than it was at the start of the year. As regards external demand, expectations indicators (newexport orders) and spending (balance of trade and sales abroad by larger companies) indicate that **sales could have grown across the board, in contrast to events in 1Q15**, when the unprecedented surge in exports of non-tourist services (16.0% QoQ) was overshadowed by declines in the other components. If trade flows consolidate the expected improvement in line with their fundamentals, the temporary nature of the sluggishness observed over 4Q14 and 1Q15 would be confirmed.

On the domestic demand side, a continuation of robust growth is noticeable at the close of H1, propped up by fiscal and monetary policy, the smaller energy bill and reduced employment uncertainty. After rising for two years in a row, spending and expectations indicators show that **household consumption and machinery and equipment investment could continue to lead the recovery in the short term**, with growth rates approaching those observed over the last six months (0.8% QoQ and 1.6% QoQ on average, respectively)<sup>4</sup>. Likewise, **residential investment fundamentals suggest that the past quarter closed with positive growth**, albeit modest and from a historically low level<sup>5</sup>.

## The recent data confirms the change in fiscal policy stance

The data available for 1H15 confirms **an upward trend by public sector demand within a mildly expansionary fiscal policy stance**. Specifically, the correction of the public sector deficit has relied on the cyclical improvement in revenues and certain items of expenditure (unemployment benefits and interest payments for example), but it **appears modest compared to budget targets**. In this respect, budget execution data up to April suggest that the public deficit (excluding local corporations) ought to have been about 1.1% of GDP, only 0.1pp below the figure recorded to March 2014. Meanwhile, the figures for May indicate that the central government registered a deficit of 2.0% of GDP, almost 0.5pp below that observed a year ago.

## The labour market records deteriorated over 2Q15

The labour market records negatively surprised in June, but did not hamper the positive balance for the quarter. According to BBVA Research estimates<sup>6</sup>, the number of affiliates to the Social Security system rose by 1.0% QoQ swda in 2Q15, which represents an acceleration of 0.1pp with respect to 1Q15. Besides, recruitment picked up between April and June (1.8% QoQ swda), in spite of the downward correction of permanent contracts (-2.1% QoQ) after the exceptional increase in 1Q15 (5.9% QoQ). Finally, the reduction in registered unemployment rallied over the quarter as a whole, reaching -2.6% QoQ swda (-2.3% QoQ swda in 1Q15).

## The change in the inflation trend is setting in, but it does not imply a loss of competitiveness

The flash estimate suggested that consumer prices rose by 0.1% YoY in June, which marks the first positive rate in the past year. Since January, we have seen an upward correction in the market price of crude which, together with the depreciation of the euro, accounts for most of the improvement in headline inflation.

4: In 1Q15, the progress in private consumption (0.7% QoQ) and machinery and equipment investment (1.3% QoQ) eased off slightly with respect to 4Q14 (0.9% and 1.9%, respectively).

5: A detailed analysis of the real estate situation can be found in the Spain Real Estate Flash of 3 July 2015. Available at <https://goo.gl/VvuLEp>

6: The adjustment for seasonal variations and for working days (swda) implemented by BBVA Research is based on univariate time series statistical methods. As a result, the estimates for swda series are subject to uncertainty and might differ from those made by other organisations and they may be modified with the benefit of hindsight and without prior warning.

On the other hand, **core prices rose by 0.5% YoY in May. According to BBVA Research estimates, they could have repeated this increase in June**, which is probably not only due to a higher imported inflation, but also to the improvement in domestic demand.

**All in all, the change in trend as regards consumer prices in the Spanish economy continues to take shape in an environment of a recovery of price competitiveness**, in which the inflation differential with respect to the eurozone remains in Spain's favour. Thus, trend inflation readings are showing similar upturns in Europe and Spain, and are gradually approaching levels of around 1.0% in Europe and 0.5% in Spain<sup>7</sup>.

## The Spanish economy increased its financing capacity in 1Q15

At the close of Q1, **the 12-month accumulated financing capacity of the Spanish economy was 1.2% of GDP, which was 0.2pp more than in 4Q14**. This was the result of a higher increase in the rate of savings rather than investment. By type of economic agent, businesses and households headed up the recovery in financing capacity, while the balance for the public administrative bodies held stable.

Looking ahead, BBVA Research estimates suggest that the **Spanish economy should continue to exhibit financing capacity respect to the rest of the world over the 2015-16 period**, underpinned by the structural adjustment<sup>8</sup>, the recovery of exports, expectations of lower interest rates and the saving resulting from the fall in the oil price<sup>9</sup>.

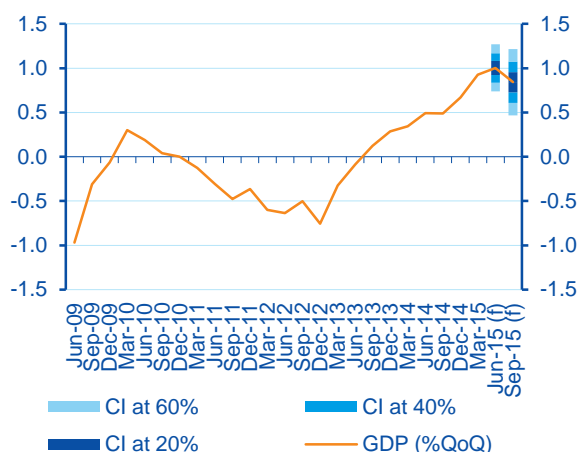
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7: For further details on the calculation of trend inflation using the trimmed means method, see Box 1 of Spain Outlook, first quarter 2014, available at: <http://goo.gl/j0riT8>

8: The process of correcting the Spanish economy's financing requirement mainly involves improving the structural component. For further information on recent trends and prospects for the current account balance in Spain, see the Economic Watch headed: "An analysis of the trends and drivers of the current account balance in Spain", available at: <http://goo.gl/qF1qz6>

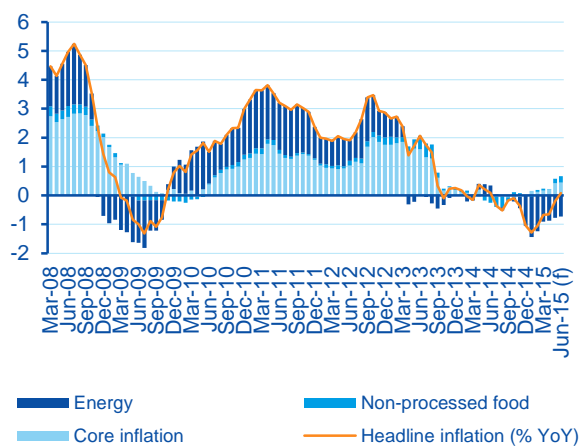
9: BBVA Research estimates suggest that the fall in the oil price in 2015 will improve the current account balance by 1.0pp of GDP.

Figure 1  
Spain: real GDP growth and MICA-BBVA model forecasts (% QoQ)



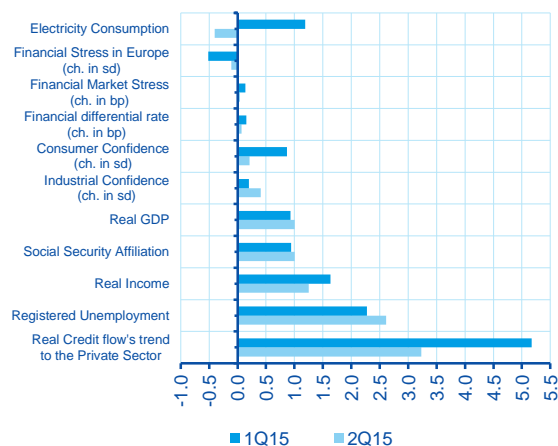
(e): estimate; (p): predicted.  
Source: BBVA Research

Figure 3  
Spain: contribution to CPI growth (pp, YoY)



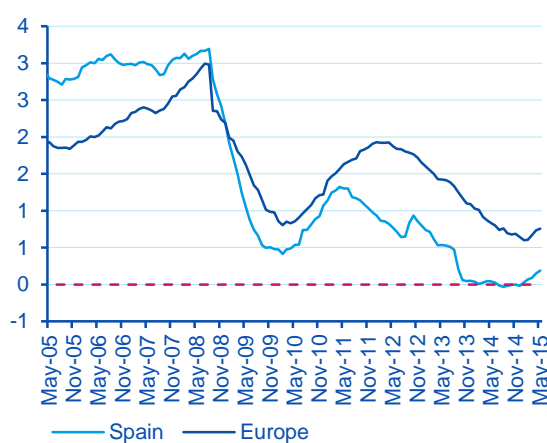
(e): estimate  
Source: BBVA Research

Figure 2  
Spain: Change in GDP and the key components in the MICA-BBVA model  
(+) improvement / (-) deterioration in pp unless otherwise indicated (swda)



Data published up to 6 July 2015 and MICA-BBVA model forecasts.  
Source: BBVA Research based on official institutions

Figure 4  
Spain and the EMU: trend inflation (trimmed means method, % YoY)



Source: BBVA Research based on INE and Eurostat

Table 1

## Summary of Spain Flashes published since the Spain Economic Watch in June 2015

Flash	Date	Summary	Link
<b>Spain   Core inflation accounts for half of the improvement in headline inflation in May</b>	12.06.2015	The fall in headline inflation moderated again in May due to both the upward trend on core prices and the decrease on the base effect derived from lower prices of raw materials than those seen a year ago. Going forward, BBVA Research estimates negative headline inflation rates in the short run, which in the most likely scenario will return to positive ground in 2S15	<a href="#">PDF</a>
<b>Spain   Public debt rises up to 98,0% of GDP</b>	12.06.2015	Spanish government debt rose to 98% of GDP at the end of 1T15. The increase has been concentrated in the regional debt and also on that of central government (including Social Security). The new financial facility has become the main source of funding for the Spanish regions	<a href="#">PDF</a>
<b>Spain   April 2015 home sales: transitory correction</b>	15.06.2015	According to data from the General Council of Notaries, 30,758 homes were sold in April 2015. After seasonal adjustments, sales fell by 2.4% compared to March. The evolution of the fundamental points to a transitory correction	<a href="#">PDF</a>
<b>Spain   Trade balance in April 2015</b>	18.06.2015	The 12-month accumulated trade deficit remained stable in April compared to the previous month (-2,2% GDP). Exports of goods stagnated (-0,1% m/m) after the strong growth registered in February and March. Besides, imports of goods increased again (+0,7% m/m) underpinned by the growth of the internal demand and the strength of exports	<a href="#">PDF</a>
<b>Spain   Retail sales, stable in May after the rebound in April</b>	29.06.2015	After seasonal adjustments, retail sales increased marginally in May after the upward surprise in April. Food and personal equipment offset disappointing developments in household equipment and service stations	<a href="#">PDF</a>
<b>Spain   Permits in April 2015: positive surprise</b>	29.06.2015	Permits in April rose to 3.064, representing an increase of 20% from the previous month. The data was better than expected and more than offset the fall of the previous month. Thus, the aggregate of the first four months shows an increase of visas around 30% YoY. The refurbishment showed a limited increase	<a href="#">PDF</a>
<b>Spain   Industrial and consumer confidence in June: positive balance for 2Q15</b>	29.06.2016	Agent's expectations remained positive at the end of 1S15. Although the consumer confidence slightly adjusted in June and that for industry did not advance, both remained above their precrisis levels. The data published today is consistent with BBVA Research scenario, indicating the recovery continues	<a href="#">PDF</a>
<b>Spain   CPI flash estimate confirms inflation returns to positive</b>	29.06.2015	CPI flash estimate showed consumer prices increased marginally in June. BBVA Research estimates suggest that core inflation remained at around 0.5% YoY	<a href="#">PDF</a>
<b>Spain   Spanish net lending increased in 1Q15</b>	30.06.2015	Spanish net lending increased to 1.2% of GDP in 1Q15 (annual accumulated) as a result of an increase in the saving rate higher than the investment rate. Households and firms led this recovery in the net lending	<a href="#">PDF</a>
<b>Spain   Balance of payments improved in April 2015</b>	30.06.2015	The balance of payments starts the second quarter with a 12 month accumulated current account surplus of €10,806 mn. Both goods and income balance improved slightly in April respect to the previous year	<a href="#">PDF</a>
<b>Spain   Public Administrations: budget execution improved in April</b>	30.06.2015	The Public deficit raised to 0.7% of GDP in 1Q15. Until April, budget execution set the deficit (exc. local corporations) at around 1.1% of GDP. This improvement was due to both central government and regions. Meanwhile, Social Security registered a lower surplus than the previous year	<a href="#">PDF</a>
<b>Spain   Passenger car registrations grew again in June</b>	01.07.2015	After seasonal adjustments, BBVA Research estimates indicate the passenger car registrations increased in June as expected. The demand stabilised in the second quarter after six months of exceptional records	<a href="#">PDF</a>

Source: BBVA Research

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