

ACTIVITY

Spain: high growth in 2Q16, but with signs of a slowdown

Spain Unit

Activity is increasing and in line with expectations

The trend in the variables observed indicates that the **recovery of the Spanish economy continues at the close of the first semester**. With nearly 50% of the information available for 2Q16, the MICA-BBVA¹ model estimates a **quarterly GDP growth (QoQ) of 0.7%**, marginally lower than the observed in 1Q16 (0.8% QoQ in 1Q16).

The data known to date are consistent with the valuation of BBVA Research on the macroeconomic scenario². The Spanish economy will continue to grow, until it reaches an average annual rate of near to 2.7% in both 2016 and 2017. However, these estimates may vary slightly because of the greater strength being shown by some of the demand indicators, particularly by private consumption (upward bias), or by the persistence of some risks, domestic and external (downward biases).

Domestically, BBVA Research estimates suggest **that uncertainty about economic policy remains high. The uncertainty observed between January and May could subtract 0.3 pp in 2016 and 0.6 pp in 2017 from GDP growth³**. On the other hand, the budgetary implementation data known to date indicate that, pending the impact of the announced measures, **the probability that all the Public Administrations will not comply with the new budgetary targets proposed is significant, unless there is a major adjustment during the rest of the year**.

Externally, **the risks associated with the fragility of the global recovery and, in particular, with the slowdown in emerging economies remain**. The prolongation shown in the sluggishness of exports at the end of 2015 and the start of 2016 cannot, therefore, be ruled out.

Private demand continues to lead the recovery while exports show signs of weakness

In the first quarter of 2016, activity continued supporting domestic demand with a slightly higher than expected contribution to growth (1.0 pp QoQ), it was also higher than that registered at the end of 2015 (0.6 pp QoQ)⁴. Particularly notable were the advancement in household consumption (0.9% QoQ; BBVA Research: 0.7% QoQ), investment in machinery and equipment (1.3% QoQ; BBVA Research: 1.2% QoQ) and residential construction which grew at a higher rate than expected (1.2% QoQ; BBVA Research: 0.8% QoQ).

With regard to foreign sales, negative values surprised everyone. Negative values were recorded in the case of exports of services (-1.7% QoQ) and sluggishness in goods (0.0 QoQ) was prolonged. The unexpected fall in total exports (-0.5% QoQ) with the modest advance of imports (0.3% QoQ), resulted in a

1: See Camacho, M. and Doménech, R. (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: BBVA Research's description of the economic scenario for the two-year period 2016-2017 can be found in section 3 of the Spain Economic Outlook review, second quarter 2016, available from: <https://goo.gl/h6bA7I>

3: See Box 1 of the Spain Economic Outlook review for the first quarter of 2016

4: A detailed evaluation of the data from the Quarterly National Accounts for 1Q16 can be found at: <https://goo.gl/5Z6Tu2>

negative contribution of net external demand to GDP growth in 1Q16 (-0.3 pp QoQ; BBVA Research: 0.1% QoQ).

For the second quarter of 2016, the information available suggests that the composition of growth will not vary significantly in relation to what has been observed in the first months of 2016. With regard to private domestic demand, all the partial indicators (new passenger car registrations, confidence and labour market records) confirm that **consumption will continue to lead the recovery, growing at rates similar to those observed at the beginning of the year** and, therefore, higher than expected rates at the start of the quarter. Meanwhile, industrial confidence, as well as the PMIs for manufacturing and industrial production suggest that the **slowdown in investment in machinery and equipment will continue in 2Q16, although in positive figures**. Finally, residential investment indicators continue to show signs of recovery in the sector, which would register growth rates similar to those of the second half of 2015, after the good figures for the first quarter.

On foreign demand, expectations indicators (industry new exports order) and expenditure (external sales of goods and services from large corporations) are giving mixed signals. Although the most likely scenario points to a recovery in exports following the fall during 1Q16, we can not rule out an extension of the sluggishness in overseas sales, particularly of goods. On the other hand, border entry records and expenditure by foreign tourists allow us to look ahead to an acceleration in exports of tourism services in 2Q16, which, if confirmed, could reach new records throughout 2016.

The main items of public demand are growing, in line with a slightly expansionary fiscal policy

Details from the Quarterly National Accounts (QNA) for **1Q16 revealed an above expected growth in the rate of public demand**. Thus, after having grown by around 0.5% QoQ during the second six months of 2015, **the actual consumption of Public Administrations accelerated** to 0.8% QoQ in the first quarter of the year. In contrast, **investment in non-residential construction, which includes public works, continued the trend towards deceleration verified since 2Q15**. In fact, 1Q16 registered the first negative rate of growth in 9 quarters (-1.2% QoQ).

This evolution of public demand is framed in a slightly expansionary fiscal policy context, in which the adjustment of the public deficit remains tied to the cyclical recovery and to low interest rates. In this regard, budgetary implementation data until March indicate that the Public Administrations' deficit (excluding local corporations) stood at around 0.8% of GDP, matching the level reached a year ago. Also, the April data indicate that the State recorded a deficit of 1.2% of GDP, showing no change compared with the deficit observed to the same month of 2016. Thus, **the probability a new breach of budgetary targets this year remains high**.

The labour market recovery has suffered a marginal slow down

Social Security affiliation met growth expectations in May (40,000 MoM SWDA according to BBVA Research estimates)⁵. If this trend continues during the current month, affiliation could increase by 0.7% QoQ SWDA in 2Q16, which would, in any event, imply a **marginal deceleration in the rate of job creation** (0.8% in 1Q16). In line with the foregoing, **unemployment continued its downward trend last month** (-40 thousand people SWDA according to BBVA Research estimates), and, if this continues in June, it will lead to **slightly less of a fall in registered unemployment** than that observed at the start of the year (-2.2% QoQ SWDA as against -2.3% in 1Q16).

5: The seasonal and working day adjustments (SWDA) made by BBVA Research are based on statistical univariate time series methods. Consequently, SWDA series estimates are subject to uncertainty; they may differ from estimates by other agencies, and may subsequently be adjusted without prior warning.

Core inflation remains positive

The advanced indicator noted that consumer prices continued to fall in May (-1.0% YoY), albeit at a slightly slower pace than in the previous month (-1.1% YoY). In this regard, BBVA Research estimates suggest that energy is the only component that contributes negatively to inflation, while **core inflation remains positive (at around 0.7%)**.

However, this evolution in consumer prices continues to take place in an environment of low and stable inflation in Europe and consequently limits the gains in price competitiveness of the Spanish economy. Thus, although it remains favourable, the differential in trend inflation relative to the euro zone fell by 0.4 pp over the course of last year to -0.2 pp in April.

The Spanish economy reduced its financing capacity in 1Q16

At the end of the first quarter of 2016 the balance of payments reached an accumulated annual surplus of 21.118 million euros. As a percentage of GDP, this implies a significant increase from that registered a year ago (0.5 pp to 1.9% of GDP), which is based primarily on the good performance of the current account balance. In that case, the accumulated surplus to 12 months reached 15,452 million euros in March (1.4% of GDP, 0.3 pp more than the accumulated surplus in 1Q15).

From the point of view of the financial accounts, in the accumulated account to 12 months, the Spanish economy moderated its financing capacity with respect to that observed at the close of 2015, reaching €18.7 thousand million (51.4 thousand million excluding the Bank of Spain). In particular, the entry of non-resident capital was 24.6 thousand million euros to 1Q16, well below the investment of residents outside national territory, which accumulated 77.8 thousand million euros in the same period of time.

Looking ahead, we expect the Spanish economy to continue to show financing capacity relative to the rest of the world, given its structural adjustments⁶, the expected growth in exports, the favourable financing conditions and the cumulative decrease in oil prices.

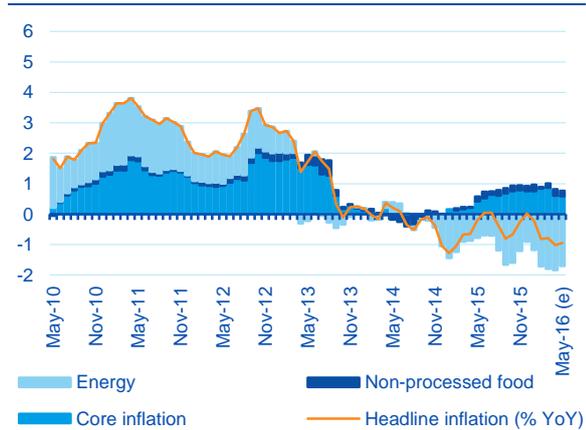
6: The process of correcting the financing requirements of the Spanish economy corresponds mainly to structural improvements. For further information on recent trends and the outlook for the Spain's balance in current account, please refer to the Economic Observatory entitled: "An analysis of the trend and determinants of the current account balance in Spain", available at: <http://goo.gl/qF1qz6>

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



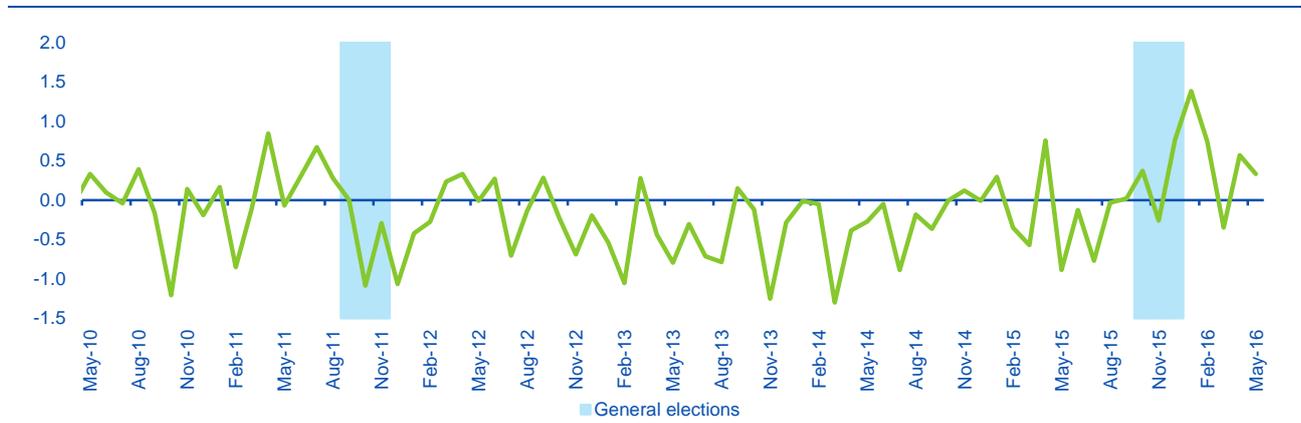
(e): estimate.
Source: BBVA Research

Figure 3
Spain: contribution to headline inflation (pp YoY)



(e): estimated.
Source: BBVA Research

Figure 5
Spain: index of economic policy uncertainty (idiosyncratic component of typical deviations)



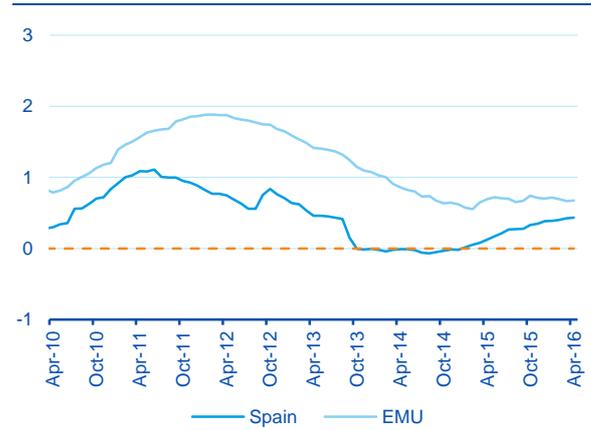
Source: BBVA Research based on Baker et al (2015)

Figure 2
Spain: Trends in GDP and in the key MICA-BBVA model indicators (+) improvement / (-) deterioration in pp save where otherwise indicated (data SWDA)



Data out up to June 2016 and MICA-BBVA model forecasts.
Source: BBVA Research based on official institutions

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



Source: BBVA Research based on INE and Eurostat

Table 1

Summary of Flash Spain publications since the publication of Spain Economic Outlook Q2 2016

Flash	Date	Abstract	Link
The lower core inflation sharpens overall drop in April	13.05.2016	In April inflation rate of decline deepened to -1.1% YoY, as the increase in core inflation moderated to 0.7% YoY and the energy continued pushing down hard (-15 , 1% YoY). Forward, we expect the positive trend in the core component to be maintained, and that the pressure on the price of raw materials attenuate progressively	PDF
Home sales in March 2016: the end of a quarter that decreased progressively	17.05.2016	In March 2016 38.352 homes were sold according to data from the General Council of Notaries. Seasonally adjusted, 11.2% less than in February. With the end of March, a quarter where the sales performance decreased progressively concluded. However, home sales grew at a 8.5% QoQ in the first quarter of the year.	PDF
Trade flows grew in 1Q16, despite the monthly volatility	20.05.2016	BBVA Research estimates that, in seasonally adjusted terms, both real imports and exports of goods grew in 1Q16 (0,6% y 1,4% QoQ, respectively). The improvement in the energy bill balance in March casued a smaller deficit in the trade balance (23.514 millions of euros in the 12 month accumulate).	PDF
National Accounting validates the stabilization of growth in 1Q16	26.05.2016	As it was anticipated in the last issue of our Spain Outlook, the growth of the Spanish economy remained at 0,8% QoQ during 1Q16, despite the uncertainty. While internal demand continued to be the driving force behind GDP growth (1,05pp QoQ), net external demand reduced dynamism from activity (-0,28 pp QoQ).	PDF
Retail sales continued to grow in April, but less than expected	27.05.2016	Once corrected for the stationary variations of each month, retail sales grew in April by 0,6% MoM, which was lower than expected. The fall in the prices of fuel and home equipment limited the expenditure rise in food and personal equipment goods.	PDF
Flash estimate points at a moderation in the fall of CPI in May	30.05.2016	CPI flash estimate points at a fall in general consumer prices in May of -1,0% YoY, 0.1pp lower than expected. The number is also smaller than the fall in the previous month. Our forecasts suggest that core inflation remained stable at 0,7% YoY, while energy was the only component that contributed negatively.	PDF
Permits March 2016: Growth ends a positive quarter	30.05.2016	6.176 permits were signed in March, el 9,4% more than in the previous month. The number is better than expected and ends a positive quarter in the housing market. On the other hand, rehabilitation works went back in March and dragged the quarter to a 1,5% quarterly fall.	PDF
The agents' confidence continues to show mixed signals in May	30.05.2016	Opposing movements in the confidence indicators were observed in May. That of the consumers grew (1,3 pp) because of the improved expectatives about the economic situation and unemployment. That of the industries fell (2,0 pp) principally due to the less positive production expectatives. All in all, confidence remains above pre crisis levels.	PDF
Surplus in March consolidates the balance of payments' positive trend	31.05.2016	The balance of payments registered a surplus of 1.144 millions of euros in March (369 millions less than the value registered in the same month of 2015) which in principle can be explained by the positive current account balance (836 millions of euros). Investment flows registered a net capital income of 601 millions of euros.	PDF
Public-sector deficit, 0.8% of GDP in March	01.06.2016	Public-sector deficit (excluding local corporations) stood at 0.8% of GDP in March. A figure that is equal the level reached a year ago. Central government improved their records of 2015, while Social Security achieved less superavit. The regions kept their deficit at around 0.1% of GDP.	PDF
The professional channel held passenger car registrations up in May	01.06.2016	After adjusting for stationarity, BBVA Research estimations show that passenger car registrations stabilized in May, in line with what was expected. Sales of companies and rent-a-car businesses, which grew by 7% in respect to April, compensated the fall in private demand.	PDF
Affiliation grows again as unemployment drops under the 4 million mark	02.06.2016	Labour market records continued to have a positive trend in May, in line with what was expected. After controlling for stationarity, social security affiliation grew by around 40 thousand affiliates, the same number in which registered unemployment was reduced. The growth in employment continues to rely on the service sector.	PDF
Industrial production stagnated in April, but not in all its components	07.06.2016	In line with what was expected, industrial production registered no growth in April after the positive adjustment in March (1,3% MoM cvec). Nevertheless, production components continue to show mixed signals out of which equipment goods stands out positively (1,7% MoM cvec) while durable consumption goods does it negatively (-1,7% MoM cvec).	PDF

Source: BBVA Research

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