

# Spain Economic Outlook

Madrid, 09 May 2012

## Key themes

- 1 Despite the **dynamism of the global economy**, Europe is decoupling
- 2 The international context of the Spanish economy will be largely determined by the **outcome of the European crisis**
- 3 Europe needs a **long-term plan** to boost activity and to share sovereign risk in exchange for improved coordination, governance and structural reforms
- 4 **Spain maintains the prospect of a GDP contraction** of 1.3% in 2012 and a slow recovery in 2013, but with increased uncertainty
- 5 Improving confidence depends upon the design, execution and communication of a **credible reform agenda**

# Contents

## Section 1

### **International environment: continued global growth and risks in Europe**

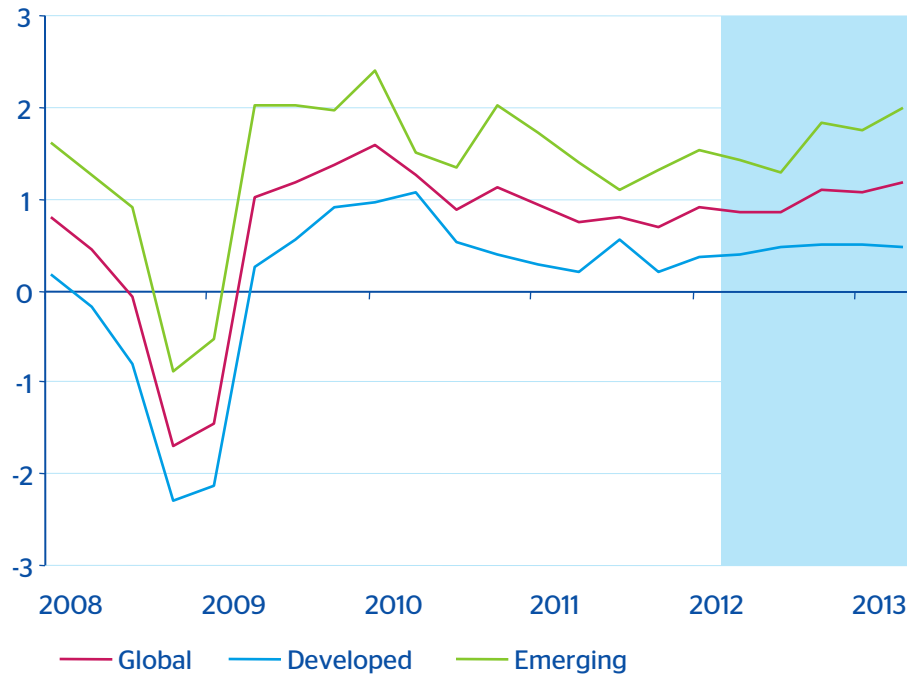
## Section 2

Spain: recession confirmed, yet getting no worse. The reforms introduced will stimulate growth

# Evidence of global growth, although heterogenous

**Global growth** (quarterly %)

Source: BBVA Research and Haver analytics



- Wider growth gap between the U.S. and Japan, on the one hand, and Europe, on the other
- Emerging economies will continue growing faster than developed economies
- Moderate global growth

# The European crisis continues

Significant progress...

Restructuring of Greek debt and bringing forward the ESM

Approval of the Stability Treaty

Reforms in Portugal, Spain, and Italy

Long-term ECB liquidity provision

... but still with challenges ahead

1. Doubts in Greece and Portugal

2. Need for an efficient firewall

3. Greater progress towards a fiscal union

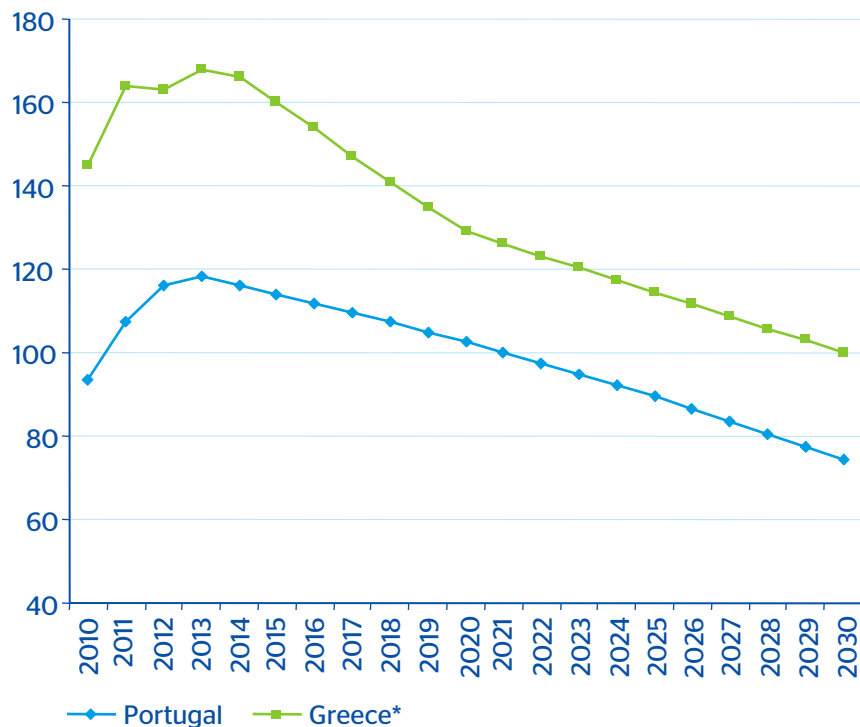
4. Growth agenda

To date, the authorities have been a step behind the events  
→ half measures to overcome the crisis

# 1. Uncertainty in Greece and Portugal

**Greece and Portugal: public debt forecasts (% of GDP)**

Source: BBVA Research and IMF



\* Optimistic scenario for Greece. Assumes 95% participation in the haircut, growth close to 3% as of 2015 and primary surplus of 4.5% of GDP as of 2014 (primary deficit of 2.4% in 2011)

Greece: highly ambitious targets, but uncertainty following the elections, and in a deep recession

Portugal: despite significant progress, there is no guarantee of a return to capital markets in 2013

There is still a high risk of setbacks

## 2. Need for an efficient firewall

The debate is centered around the amount of resources available, but it goes beyond:

New lending capacity: €500Bn  
(in addition to the €200Bn already committed to under the EFSF)

The EFSF can keep on lending until mid-2013, so as to enable the capitalisation of the ESM

The increase in IMF funds  
(€330Bn)

It is more important that the available resources are used efficiently: they shouldn't crowd out private demand

### 3. Greater progress towards a fiscal union

From the Stability Treaty...

Despite difficulties estimating it, the Treaty makes the right emphasis on structural adjustment...

...but it raises doubts about how the extraordinary circumstances clause will be applied

Not ambitious enough for an assertive move from the ECB hardliners and Germany?

...to a fiscal union

Eurobonds: a convenient mechanism for mutualising risk

The "blue" and "red" bond proposal ensures a degree of market discipline

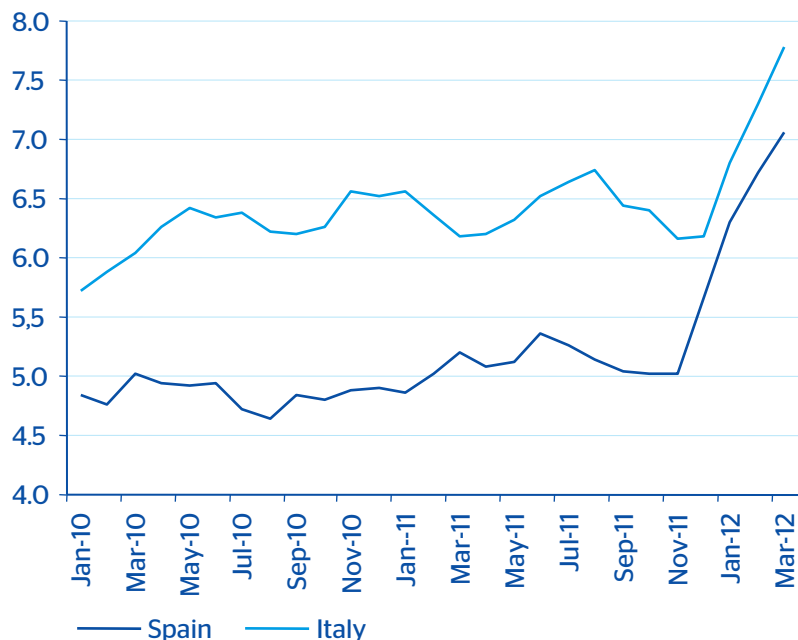
A union with temporary (rather than permanent) fiscal transfers would be sufficient



### 3. Greater progress towards a fiscal union

#### Banking system: Eurozone sovereign bond holdings as % of assets

Source: ECB and BBVA Research



Objective: eliminate the interaction between sovereign risk and bank risk

Indirect ECB intervention in the sovereign bond market via banks

The increased exposure of banks to sovereign debt increases the potential negative feedback between the two

Emphasises the need for a definite solution to the doubts about sovereign solvency

## 4. Growth plan

A growth plan that complements fiscal adjustment

Clear route map for the future of EMU

Balance between growth and austerity:  
reforms in exchange for a growth strategy

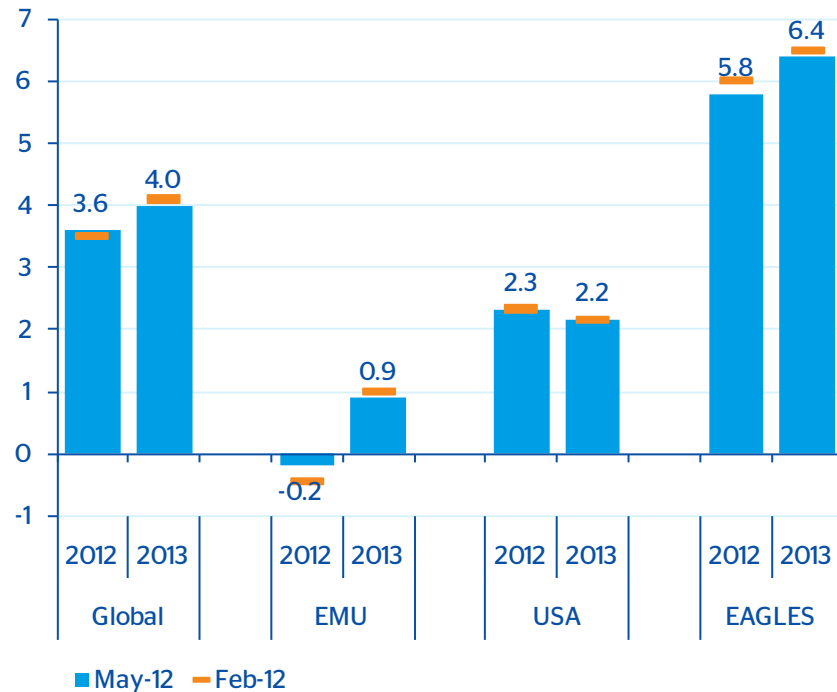
Gradual fiscal adjustment with multi-year plans.  
Focus on structural deficits as the Treaty proposes

Short-term objective: to avoid the risk of an austerity-recession  
vicious circle and the doubts regarding the solvency of  
sovereign debt

# Europe decoupling from global growth

## GDP growth (% yoy)

Source: BBVA Research



The debt crisis continues, with Portugal under the spotlight and concerns about Spain

High levels of financial stress in Europe, with a risk of credit restrictions

Stability Treaty: towards Maastricht 2.0. More emphasis on growth

Expansive, but no homogeneous, monetary policies by the Fed, the Bank of England and the ECB

A slow, heterogeneous and vulnerable recovery

# Contents

## Section 1

International environment: continued global growth and risks in Europe

## Section 2

**Spain: recession confirmed, yet getting no worse. The reforms introduced will stimulate growth**

National environment

# Main changes in the economic scenario in 2012

## Main drivers behind the economic scenario

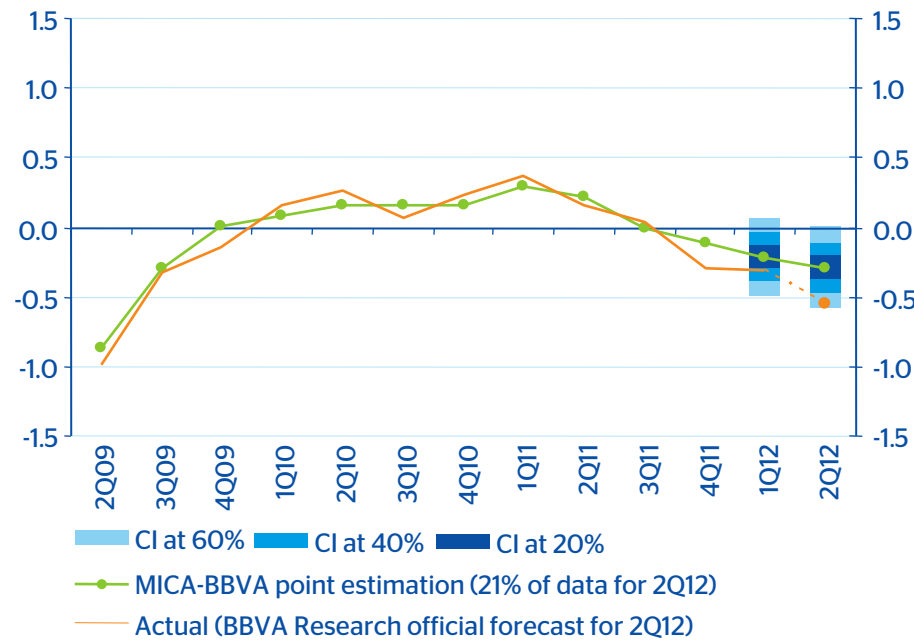
Source: BBVA Research



# 1. Available data confirms the scenario

## Spain: real GDP growth and forecasts based on MICA-BBVA model (% qoq)

Source: BBVA Research  
Current forecast: 4 May



The Spanish economy entered technical recession in 1Q12...

...albeit with no acceleration in the rate of deterioration versus 4Q11

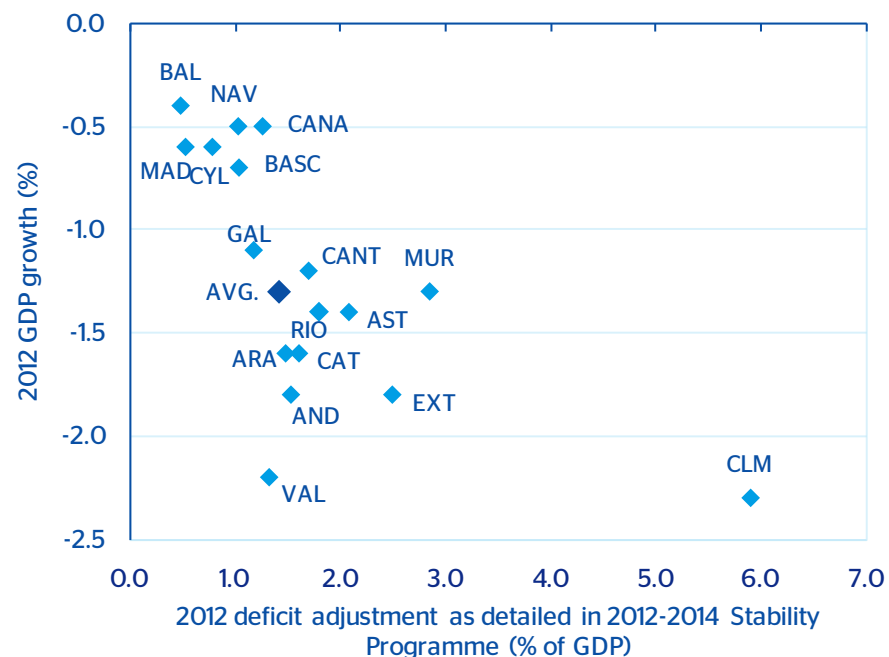
Published data indicates that 2Q12 growth is likely to have remained negative

Employment continues to be hindered by the negative outlook for growth

# 1. Available data confirms the scenario

## Spain: fiscal adjustment and economic growth (%)

Source: BBVA Research



Information published so far has led to small changes in regional forecasts

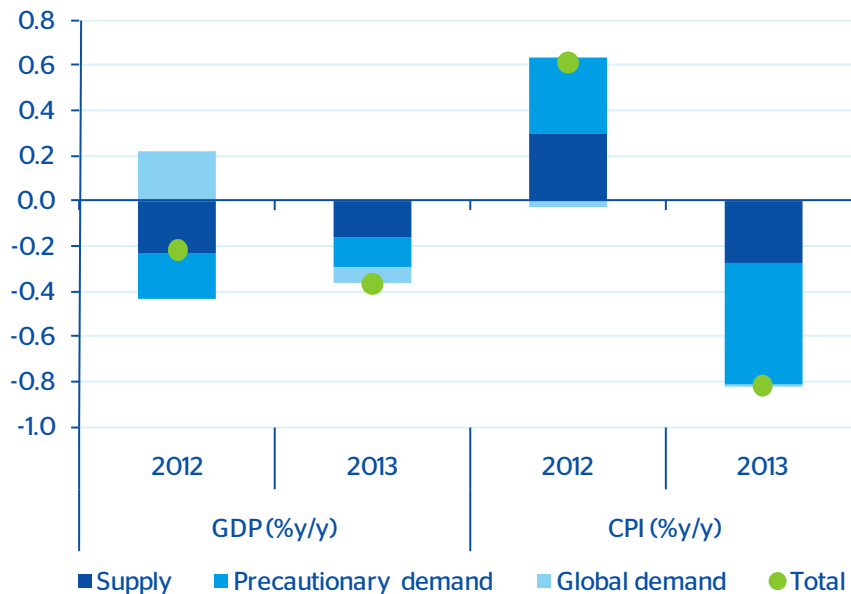
Fiscal adjustment in the autonomous communities, the main cause of the differences

Both tourism and exports support a better performance of some autonomous communities

Lower household savings rate and higher unemployment hinder private domestic demand

## 2. Pick up in oil prices

**Spain: impact on activity and prices of recent oil price increase** (deviation from previous scenario)  
 Source: BBVA Research



Negative, but limited impact

The increase is the result of both supply-side and demand-side factors

Of a transitory nature on its long term trend

No expectations of a contractionary monetary policy response



### 3. Increased financial stress

Despite the ECB liquidity, the progress being made in Europe, and the reforms in Spain, markets are still cautious due to:

The difficulties to reach the 2012 and 2013 deficit targets.  
The fear that fiscal austerity may lead to a vicious circle

The potentially higher cost of bank restructuring as a result of the adjustment in the real estate sector and the slower growth

The higher amount of sovereign debt on banks' balance sheets: negative interaction between sovereign and banking risks

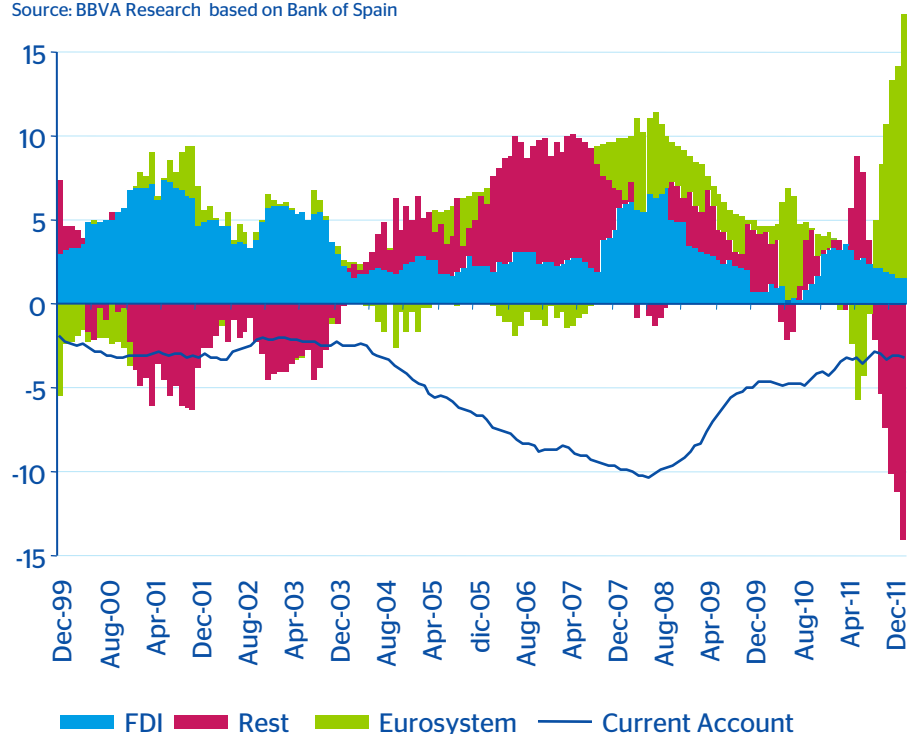
The idea that both Europe and Spain have lacked a medium and long-term strategic plan

### 3. Increased financial stress

#### Spain: balance of payments and capital flows

(12 months cumulative, % of GDP)

Source: BBVA Research based on Bank of Spain



It is liquidity, not solvency

FDI and other capital flows entering the country were financing the current account deficit before the onset of the financial crisis

As of 2007, other capital inflows (bonds, loans, etc.) became highly volatile...

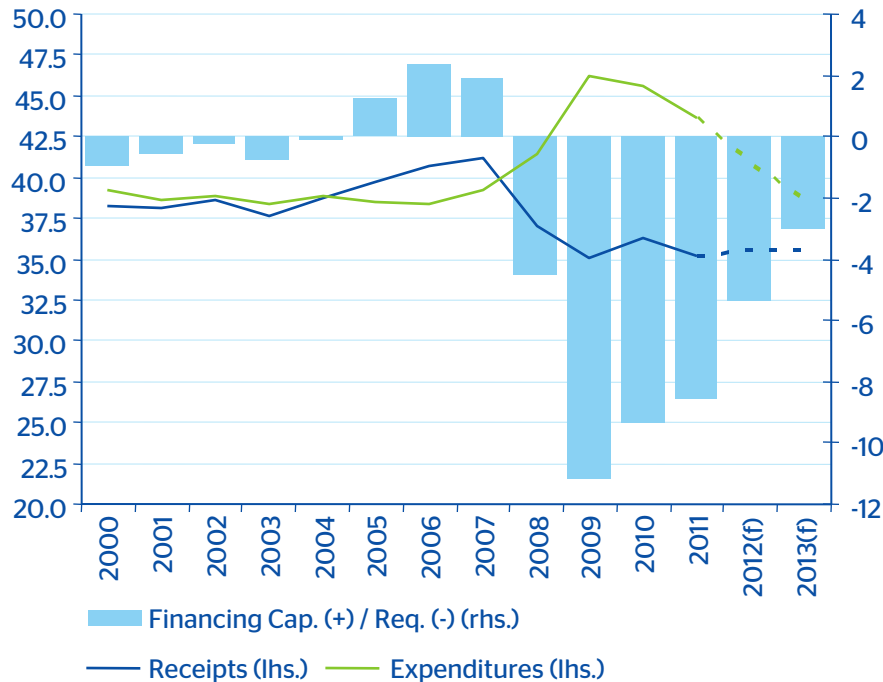
... which affected the economy's dependence on flows through the Eurosystem

Faced with a lack of liquidity, the main risk lies in self-fulfilling expectations

# 4. Unprecedented fiscal adjustment due to the deviation in 2011

## Spain: Public Administration receipts and expenditures (% of GDP)

Source: BBVA Research based on MINHAP and INE



The 2.5pp deviation from the 2011 deficit target was the result of...

a worse-than-expected cyclical slump in receipts, and...

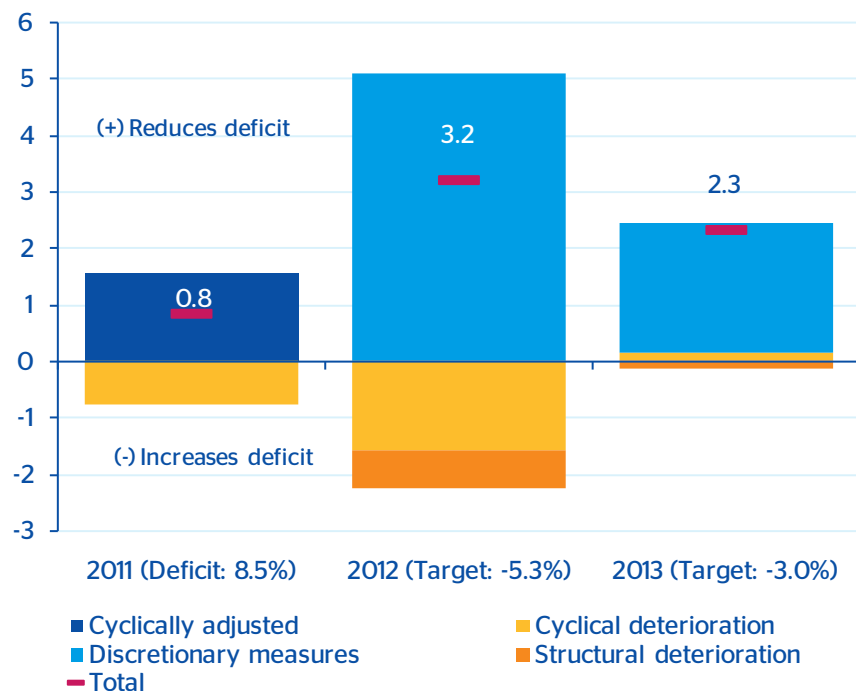
a structural adjustment in expenditure that was insufficient to meet the objective

# 4. Unprecedented fiscal adjustment due to the deviation in 2011

## Spain: adjustment of Public Administration deficit

(% of GDP)

Source: BBVA Research



Fiscal adjustment measures worth 5.1pp of GDP are required in order to reach the -5.3% target for 2012

The 2012-2015 Stability and Growth Pact contains measures that make the central government target credible...

... with the focus of compliance on the autonomous communities

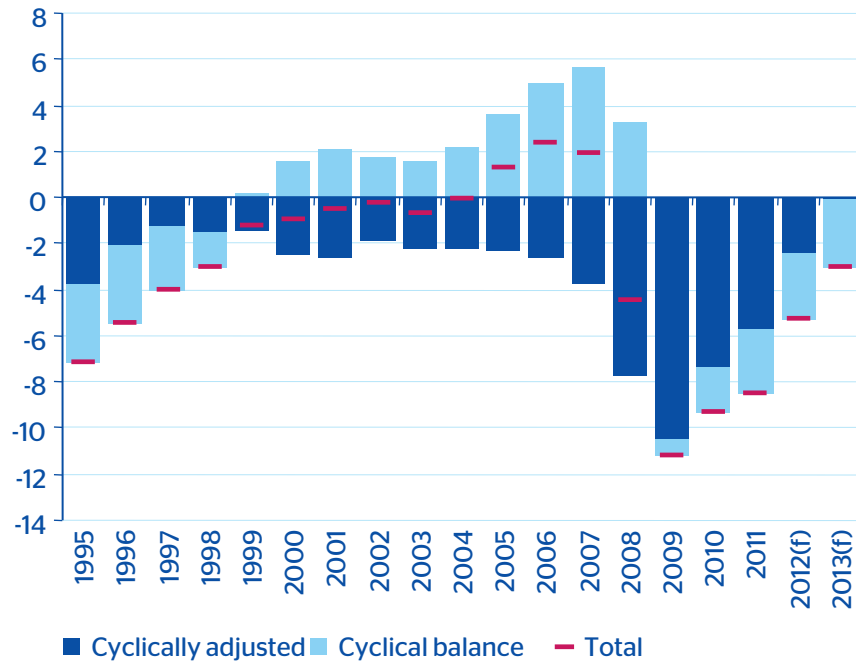
Additional room for manoeuvre: privatisations or other measures not yet announced by the autonomous communities

# 4. Unprecedented fiscal adjustment due to the deviation in 2011

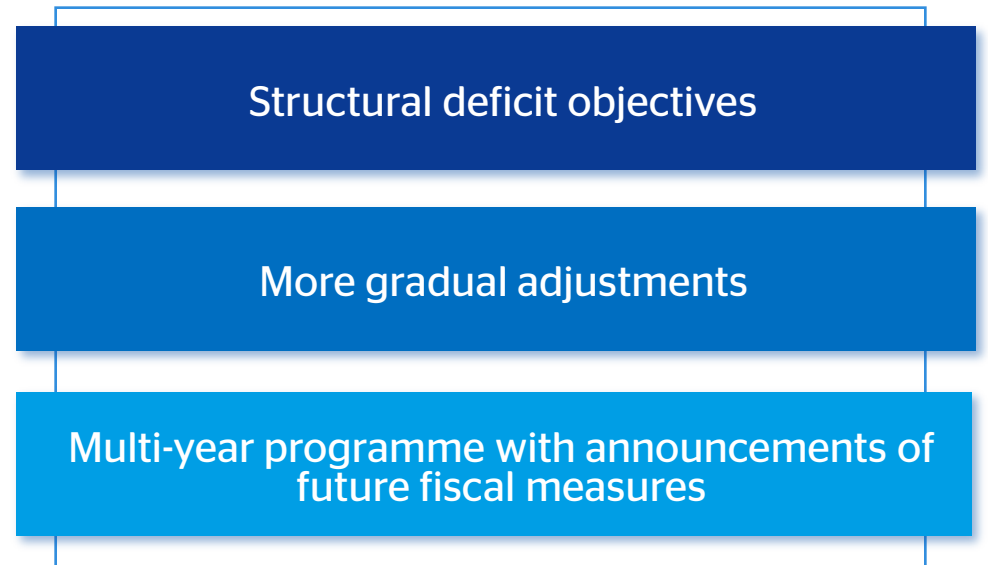
## Spain: Public Administration financing cap. (+) / req. (-)

(% of GDP)

Source: BBVA Research, based on MINHAP



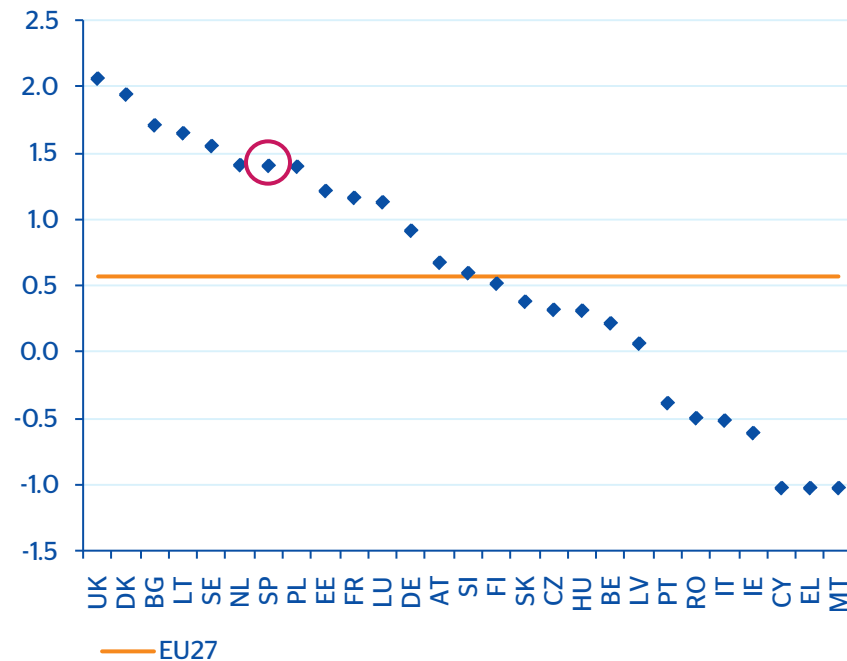
Towards a new European strategy on fiscal adjustment



# 5. The Budget Stability Law

## EU27: index of standardised fiscal rules (2010)

Source: BBVA Research, based on EC data



## Budget Stability Law

Spain has been a pioneer in this kind of legislation

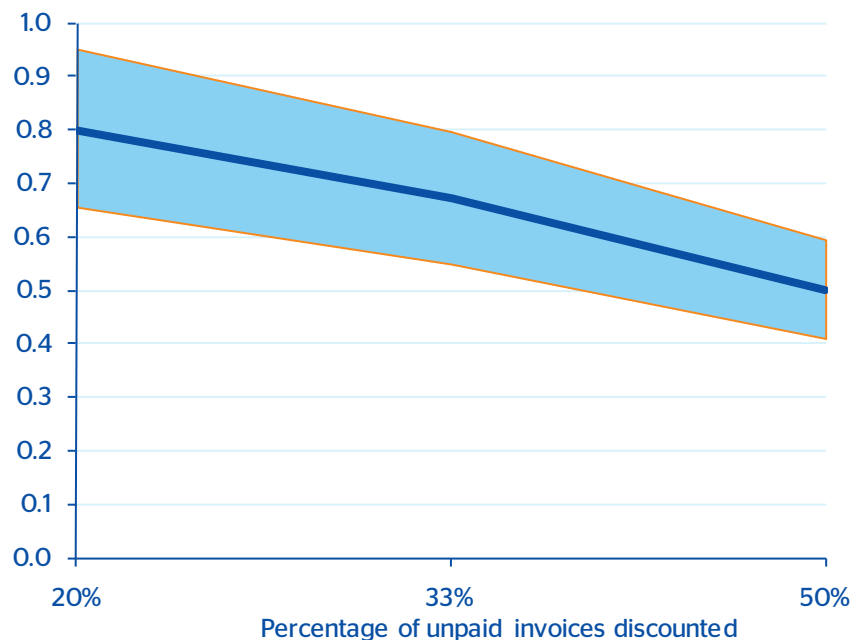
Main improvements: structural targets and control mechanisms for the autonomous communities

This legislation is likely to improve significantly the perception on Spanish institutions

# 5. Supplier Payment Programme

## GDP impact on 2012 from the Supplier Payment Programme (pp of GDP)

Source: BBVA Research based on MINHAP



\*/ Max and Min depend on agents' level of liquidity restriction

### Important liquidity injection

Government will inject 2.5% of GDP (€27Bn) to pay off local and regional government debts with suppliers

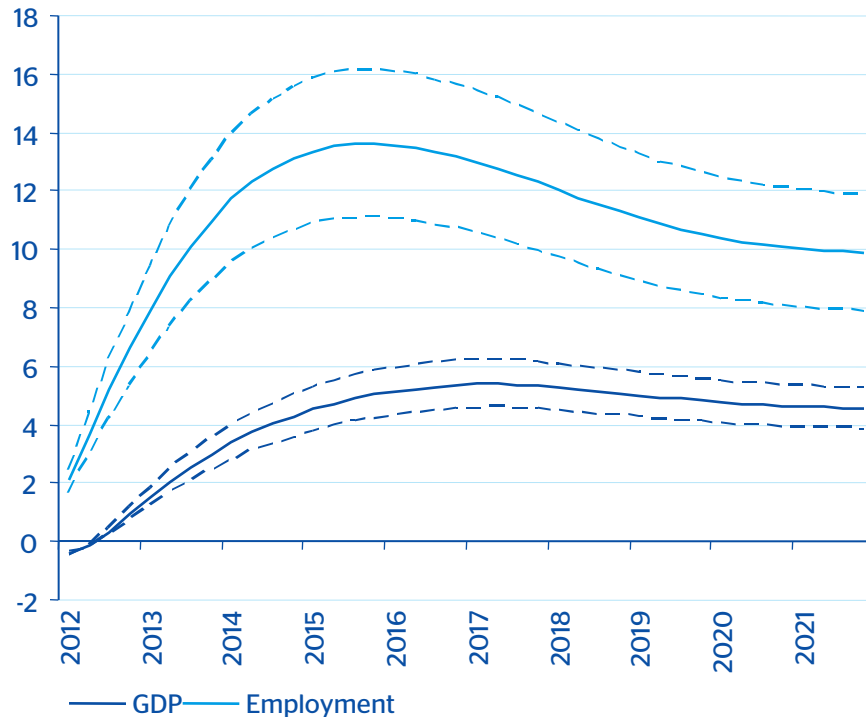
If suppliers are experiencing liquidity restrictions, the impact on growth could be significant

To a large extent, the final impact will depend upon the level of uncertainty

# 6. Labour market reform

## Spain: response to labour market reform

(% deviation from trend)  
Source: BBVA Research



## The challenge: from adjustment to growth

Short-term objective: to prevent further job losses → adjustment via working hours + labour flexibility and a better organization of production

To stimulate growth where it is weak and to take advantage of it in sectors that are buoyant

A redistribution of factor inputs towards the more dynamic firms and sectors (exporting sector)

To eliminate internal growth barriers via a more favourable regulatory framework

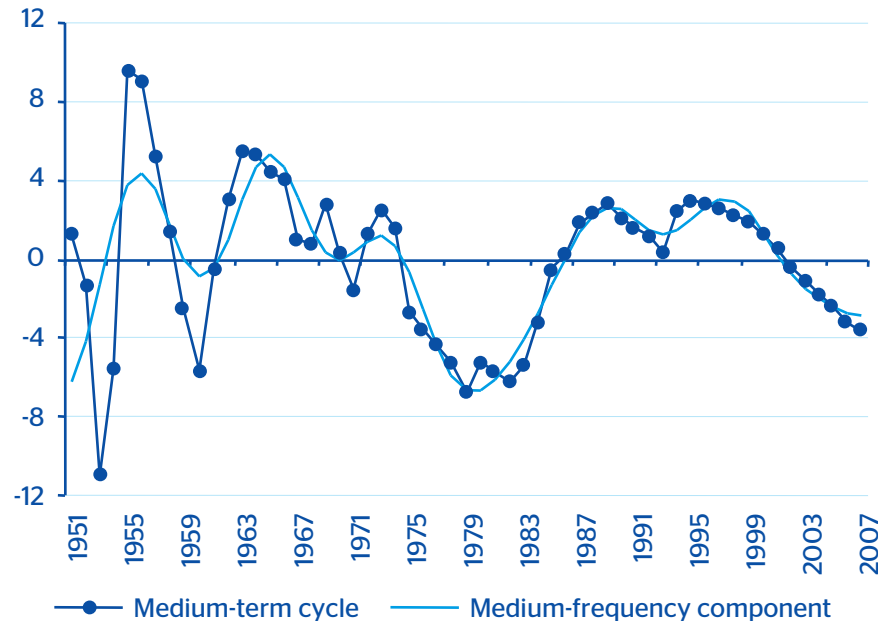


# 6. The challenge of increasing productivity

## Spain: total factor productivity

(Percentage deviation from trend)

Source: BBVA Research based on Correa-López and de Blas (2011)



Spain, an economy dependant on foreign technology

The medium-term challenge is to increase total factor productivity

Following the labour market reform, Spain needs additional reforms to improve competitiveness and make the economy more attractive

It is vital that Spain does not miss the train of technology adoption, through bilateral trade links and FDI

## Conclusions

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- 4 **Spain maintains the prospect of a GDP contraction** of 1.3% in 2012 and a slow recovery in 2013, but with increased uncertainty
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Thank you  
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# Appendix

## Macroeconomic forecasts

Source: BBVA Research, based on INE, Bank of Spain, and Eurostat data  
 (\*) contribution to growth

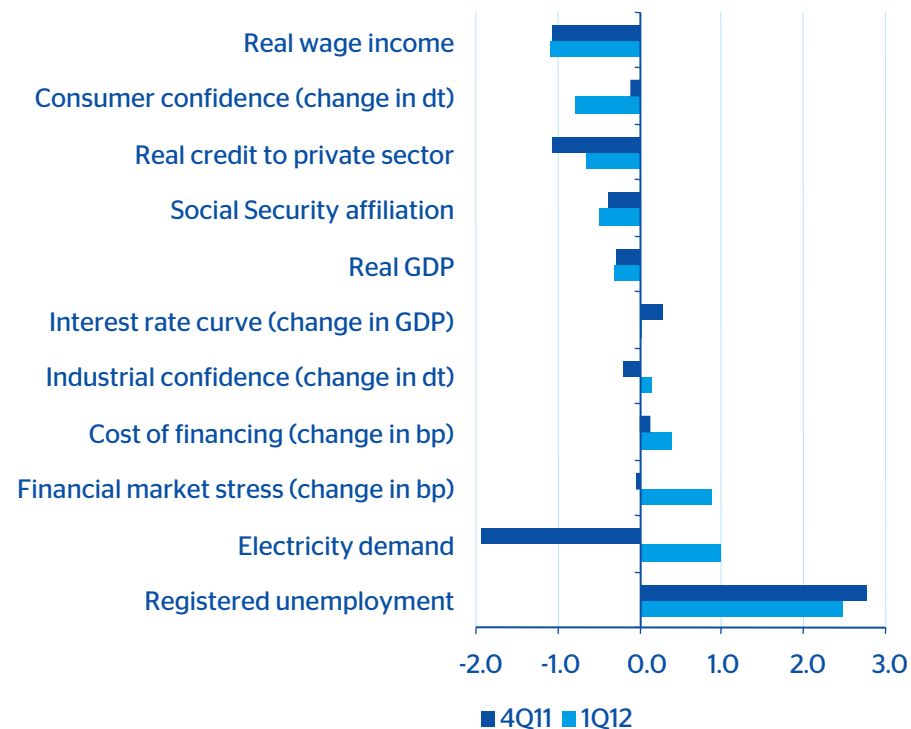
(% YoY)	2010		2011 (f)		2012 (f)		2013 (f)	
	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU
Households final consumption expenditure	0.7	0.8	-0.1	0.2	-2.0	-0.4	-0.9	0.6
General government final consumption expenditure	0.2	0.5	-2.2	0.1	-8.0	-0.6	-5.6	0.3
Gross fixed capital formation (G.F.C.F.)	-6.2	-0.7	-5.1	1.6	-7.4	-2.6	-1.0	1.4
Equipment and cultivated assets	5.3	4.8	1.5	4.5	-4.5	-2.9	2.9	2.0
Equipment and machinery	5.5	4.2	1.6	5.1	-4.6	-2.5	2.8	2.2
Construction	-10.1	-4.3	-8.1	-0.4	-9.2	-2.9	-3.2	0.8
Housing	-9.8	-3.3	-4.9	1.9	-6.6	-1.4	-1.6	1.1
Other constructions	-10.4	-5.4	-11.2	-2.9	-11.8	-4.7	-4.9	0.5
Changes in inventories (*)	0.0	0.5	0.0	0.0	0.0	-0.1	0.0	0.0
Domestic Demand (*)	-1.0	1.0	-1.8	0.5	-4.5	-1.0	-1.8	0.7
Exports	13.5	11.1	9.1	6.3	4.0	2.4	8.9	4.3
Imports	8.9	9.4	-0.1	4.0	-6.2	0.6	1.6	4.1
External Demand (*)	0.9	0.8	2.5	1.0	3.1	0.8	2.4	0.3
GDP mp	-0.1	1.8	0.7	1.5	-1.3	-0.2	0.6	0.9
<b>Pro-memoria</b>								
GDP excluding housing	0.8	2.1	1.2	1.5	-0.9	-0.1	0.7	0.9
GDP excluding construction	2.0	2.6	2.3	1.7	0.0	0.1	1.1	0.9
Total employment (LFS)	-2.3	-0.5	-1.9	0.3	-4.6	-0.5	-2.0	0.0
Unemployment rate (% Active pop.)	20.1	10.1	21.6	10.2	24.6	10.9	24.8	11.0
Current account balance (% GDP)	-4.5	0.2	-3.5	0.4	-1.9	0.8	-0.4	1.2
Public debt (% GDP)	61.2	85.5	68.5	87.3	79.8	89.5	82.3	89.6
Public deficit (% GDP)	-9.3	-6.2	-8.5	-4.1	-5.3	-3.1	-3.0	-2.3
CPI (average)	1.8	1.6	3.2	2.7	1.9	2.4	0.7	1.5
CPI (end of period)	3.0	2.0	2.4	2.9	1.7	2.1	0.7	1.3

# Appendix

## Spain: GDP and main indicators from the MICA-BBVA

**model** (CVEC data, %, qoq unless otherwise stated)

Source: BBVA Research based on official organism



The Spanish economy entered a technical recession in 1Q12...

...albeit with no acceleration in the rate of deterioration versus 4Q11

Published data indicates that 2Q12 growth is likely to have remained negative

Employment continues to be hindered by the negative growth outlook

# Appendix

## 2012 Fiscal adjustment

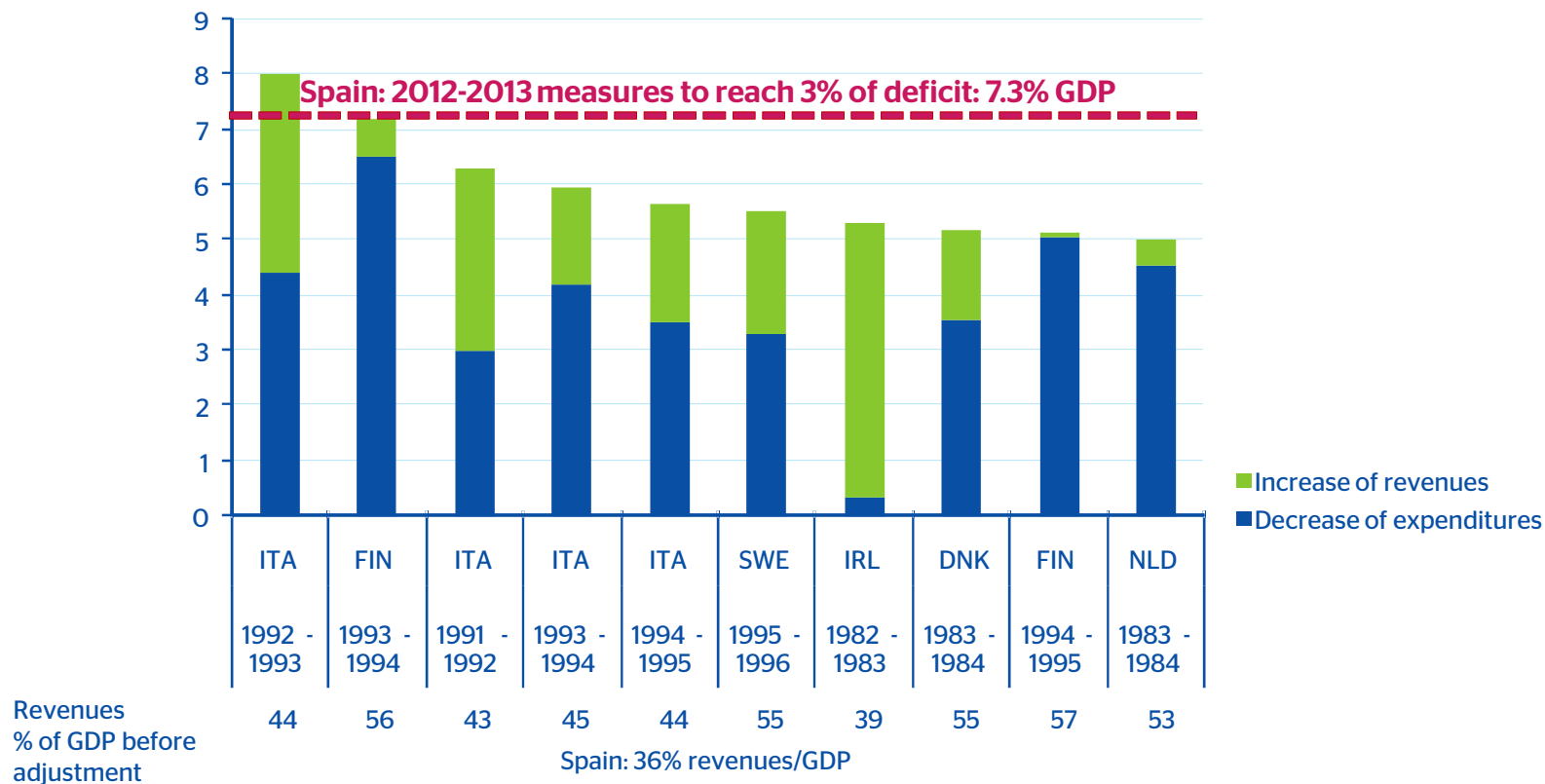
Source: BBVA Research based on MEC

	Bn euro	% GDP
Deficit 2011 (a)	-91.4	-8.5
Objective 2012 (b)	-57.1	-5.3
<b>Difference (c=b-a)</b>	<b>34.3</b>	<b>3.2</b>
Additional adjustment (d)	20.7	1.9
<b>Total necessary adjustment (c+d)</b>	<b>55.0</b>	<b>5.1</b>
<b>Announced measures</b>		
PGE 2012	25.7	2.4
Local Corporations.: increase of IBI	0.9	0.1
Autonomous Communities: more revenues	4.1	0.4
Fight against the Social Sec. fraud	1.9	0.2
Autonomous Communities : education, public health and social services	5.7	0.5
Local Corporations : duplicities and issues on competencies	0.1	0.0
Central Government: less spending	0.3	0.0
Autonomous Communities: spending adjustment rebalancing plans	5.7	0.5
Local Corporations: adjustment rebalancing plans	3.1	0.3
<b>Total measures</b>	<b>47.4</b>	<b>4.4</b>
<b>Promemoria</b>		
Nominal GDP	1,073.9	

# Appendix

## More cumulative fiscal consolidation in two years. OECD, 1978-2009 Descomposition by adjustment

Source: BBVA Research based on Devries et al (2011)



# Appendix

## Economic impact of substituting social security contributions by indirect taxes

(Diference with respect to base scenario, percentage points)

Source: BBVA Research

