Economic Research Department

BBVA

Spain

GDP Observatory

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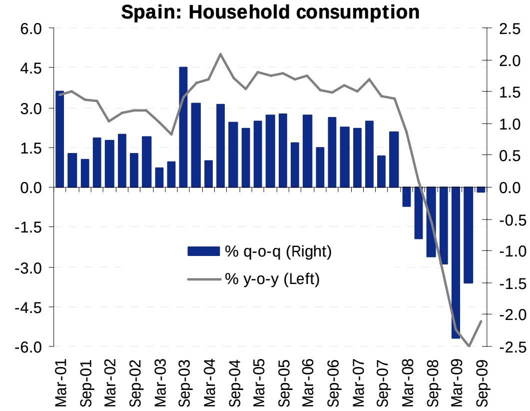
National Accounts for 3Q09 show slowing decline in economic activity boosted by temporary factors

- Spanish GDP declined by a quarterly 0.3% in 3Q09, notably less than the fall in 2Q09 (-1.1%). In year-on-year terms, the decline in GDP was by 4.0%, compared with -4.2% in 2Q09. The GDP decline in this quarter was slightly less than expected (Funcas Panel and BBVA ERD forecast: -4.2% y/y).
- The slowing decline is due to improved consumption, both private and public. Household consumption fell by barely 0.1% q/q due to the effect of fiscal stimuli for car purchase. The adjustments in place may negatively affect private consumption over the coming quarters.
- Investment in capital goods increased after 6 successive quarters of decline. However, the remaining components of investment did not add to the rise, and investment as a whole fell by 2.3%.
- It is worth highlighting the behavior of investment in housing, which barely changed its rate of contraction over the quarter. This could be the result of a number of factors, including the replacement of activity in residential construction by activity related to public works (State Fund for Local Investment).
- Exports have improved their positive performance of the previous quarter. However, the net external demand practically wiped out its positive contribution to growth, given the upturn in imports. This is consistent with the unexpected rise in some of the components of domestic demand.
- Wages per worker are slowing significantly, but their real growth is still higher than productivity, so real unit labor costs are increasing.
- Perspectives: The information in the National Accounts does not contain any permanent elements that affect our scenario. The major easing of the recession is due to the temporary effects of some fiscal stimuli policies, so the contraction in 4Q09 will probably be similar to that in 3Q09. The trend in the adjustment factors pending is in accordance with our forecasts, so we maintain the scenario for 2010.

Spain: GDP	4Q08	1Q09	2Q09	3Q09		
(% q-o-q)				Data	Forecast	Confidence interval
Household consumption	-1.2	-2.4	-1.5	-0.1	-1.0	(-1.6 ; -0.3)
Public consumption	1.6	1.2	0.5	1.6	0.1	(-0.6 ; 0.9)
GFCF	-4.6	-6.3	-4.1	-2.3	-2.0	(-4.3 ; 0.2)
Capital Goods	-7.2	-14.6	-6.3	1.9	-3.9	(-7.6 ; -0.3)
Other Products	-4.3	-5.0	-5.3	-7.0	-1.5	(-3.9 ; 1.0)
Construction	-3.5	-3.0	-3.0	-2.6	-1.5	(-4.2 ; 1.1)
Housing	-5.9	-10.5	-6.4	-5.5	-3.2	(-6.5 ; 0.1)
Non-residential	-1.2	3.5	-0.3	-0.5	-0.3	(-2.0 ; 1.4)
Internal Demand (*)	**-2.0**	**-3.3**	**-2.1**	**-0.4**	**-1.2**	
Exports	-5.4	-8.7	0.6	2.3	0.5	(-1.6 ; 2.7)
Goods	-7.8	-10.2	1.8	6.6	1.6	(-0.9 ; 4.0)
Imports	-6.3	-11.1	-2.4	2.0	-1.2	(-3.6 ; 1.1)
Goods	-6.7	-12.3	-1.7	2.5	-0.5	(-3.3 ; 2.2)
External Demand (*)	**0.9**	**1.7**	**1.1**	**0.1**	**0.6**	
GDP (% y-o-y)	**-1.1**	**-1.6**	**-1.1**	**-0.3**	**-0.6**	**(-0.9 ; -0.3)**
GDP (% q-o-q)	**-1.2**	**-3.2**	**-4.2**	**-4.0**	**-4.2**	**(-4.5 ; -4.0)**

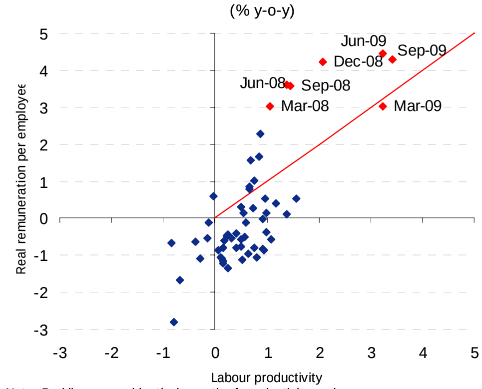
(*) Contribution to growth
Source: INE and BBVA ERD

Spain: Household consumption



Source: INE and BBVA ERD

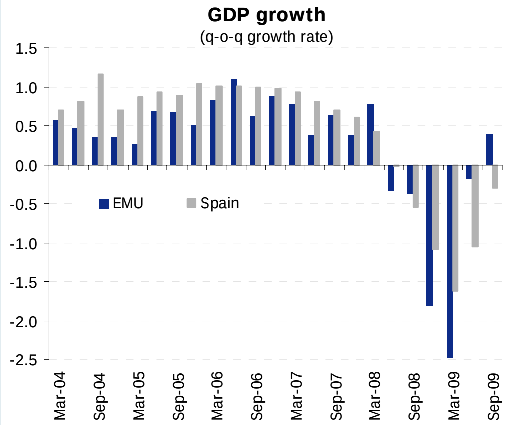
Spain: productivity and real wage growth
(% y-o-y)



Note: Red line means identical growth of productivity and wages
Source: BBVA ERD based on INE data

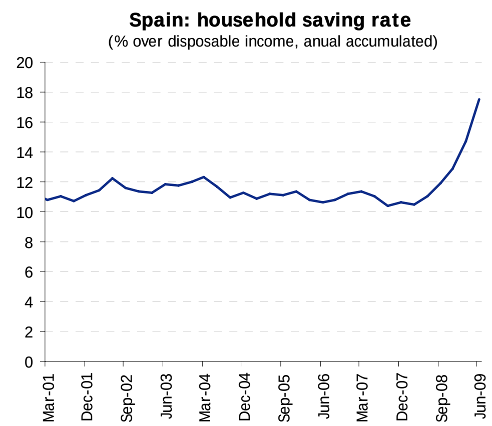
Temporary effects on consumption ease the rate of contraction

The Spanish economy eased its rate of contraction notably in the third quarter of 2009, although it was still the fifth straight quarter in a row of falling output. GDP declined by a quarterly 0.3% in 3Q09, an improvement on the figure of 1.1% the previous quarter. In year-on-year terms, the decline eased by 0.2 points to -4%. The performance of the Spanish economy in the quarter still contrasts with that of the euro zone. The European economy registered growth during the quarter of 0.4% (according to flash estimate), following the slight fall of 0.2% in the previous quarter. Even so, the Spanish GDP figure for 3Q09 was better than expected by the consensus (Funcas Panel and BBVA ERD: -4.2% y/y), although as pointed out below, the details of the components show that this improvement on the forecasts is based on factors that are unlikely to be permanent. Thus we do not consider that the Spanish economy's rate of recovery has actually changed, so we maintain the basic features of our scenario as presented in SpainWatch, November 2009.[1]



Source: INE and BBVA ERD

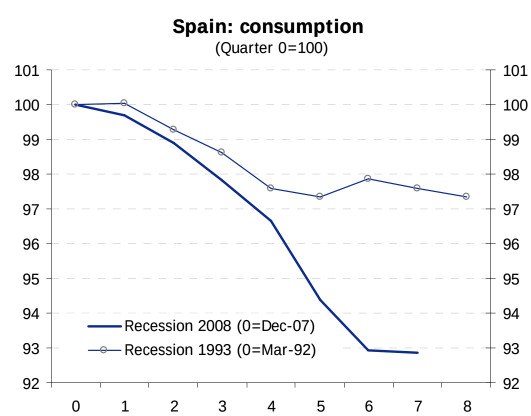
The main component that has led to the easing of the recession is consumption, both public and private. Public consumption increased its rate of growth from 0.5% in 2Q09 to 1.6% q/q, a figure that is greater than the average quarterly growth since the start of the recession (1.3%) and than the average of the previous expansive phase (1.1%). Although we still do not have sufficiently detailed and homogenous information, from the national budget execution figures we can infer that it is not central government that is contributing to this upturn most, as despite the improvement in the quarter, its weight in public spending out of the whole public sector is limited.



Source: BBVA ERD based on INE data

What carries more weight in explaining the intense correction to the rate of contraction is the behavior of household consumption. The contraction in 3Q09 is the 7th straight quarter of decline. This is the result of the major turnaround in conditions as a result of the cyclical change. There has been destruction of jobs, a fall in household financial and real estate wealth and moderation in credit growth, within a process of deleveraging which has been translated into a major upturn in the rate of household saving. Some of these factors eased their downward pressure in the third quarter of the year. This is the case with the rate of job destruction and, probably, with the fall in the net household wealth.

However, after 6 quarters in which consumption barely responded to a number of intense stimuli (the reduction of the debt burden, falling inflation and reduced taxes), in 3Q09 consumption barely fell by 0.1%, after its 1.5% fall between April and June. The reason for this behavior is the stimulus program for car purchase implemented by the Spanish government in May (Plan 2000E) The plan is fairly similar to that introduced earlier in Germany (and ended in September), although less generous in the amount and more restrictive in conditions.[2]



Source: BBVA ERD based on INE data

In the case of the Spanish economy, according to our estimates the number of vehicles registered grew by just over 20% in 3Q09 in quarterly terms (seasonally adjusted figure). There are a number of aspects to analyze further in this figure. First, the weight of this item in total household spending is limited. For example, according to the Family Budget Survey, it is under 6%. We also have to take into account that about 75% of the cars registered in Spain are imported, although the industry in Spain specializes in manufacturing cars eligible under Plan 2000E (in Germany, the percentage is practically the opposite). Finally, it also has to be taken into account that 20% of the registrations correspond to companies, and do not represent household consumption. In all, it is clear that the intense slowdown in the decline in

[1] See SpainWatch, November 2009, downloadable soon on our Web.
[2] The German institute of statistics has estimated the additional growth in consumption in the first half of 2009 compared with the first half of 2008 at 1.1 percentage points.

consumption is basically due to this fiscal stimulus effect, and without it the easing of the contraction in consumption would have been less substantial after the -1.5% fall between April and June.

Investment as a whole has behaved in a way that fits our scenario, although with differences in the individual components. First, we should point out that investment in capital goods grew for the first time since 4Q07, by 1.9%, from -6.3% in the previous quarter, although this was very dependent on the investment in transport materials, in part also as an effect of Plan 2000E. However, the positive performance of investment in capital goods was compensated by the fall in other products item, which dropped by 7% q/q. Investment in housing barely altered its rate of contraction compared with the previous quarter, at 5.5%. It has been hovering around this figure since 2Q08, if we omit the major fall in 1Q09. In the case of 3Q09, this could be the result of switching activity in investment in housing to the projects included in the State Fund for Local Investment. This also appears to be the case with the data on the labor market.[3] It could also be influenced by the completion of housing started towards the end of the previous expansive phase (end of 2007 and start of 2008). Investment in non-residential construction fell in the quarter by 0.5%, although the effects of Plan E can still be felt in year-on-year terms (+1.5% y/y).

In the third quarter, exports not only held up, but improved the good performance of the previous quarter, with a growth of 2.3% (0.6% in the previous quarter). In the case of exports of capital goods there was a quarterly increase of 6.6%, much higher than could be inferred from the data on the trade balance available so far. Undoubtedly, much of this good performance in the quarter is caused by growth in the EMU, our main trading partner, whose GDP increased by 0.4% in 3Q09. In addition, some of the main destinations of Spanish exports are countries with the biggest growth in the quarter, such as Germany (+0.7% y/y) and Portugal (+0.9%). Nevertheless, both tourism and exports of non-tourism services once more registered losses of 2% and 9% respectively.

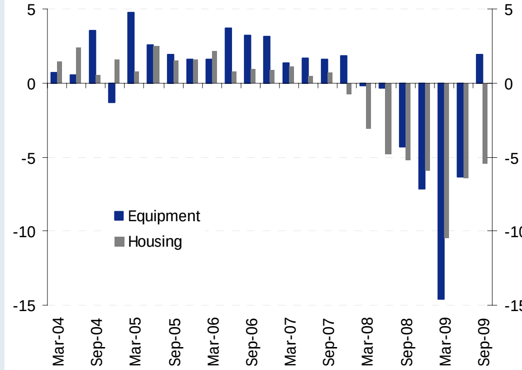
However, the growth in total exports has been balanced by a 2% growth in imports, the first positive growth figure since 4Q07. The surprising rise in imports is consistent with a better than expected performance in consumption and investment in capital goods. Overall, the external sector barely contributed positively to GDP growth in quarterly terms, and notably reduced its contribution to the year-on-year rate to 2.5 points out of a fall of 4% y/y.

Unit labor costs continue to rise

Full-time equivalent employment fell in the quarter by 190,000 (7.2% y/y). This figure is similar to that registered in the Labor Force Survey (just over 200,000, according to our estimates). By sector, employment barely varied its rate of decline this quarter. Nearly 72,000 jobs were lost in industry and energy (-65,000 in the previous quarter), while in construction the fall was nearly 100,000 (-96,000 in 2Q09). Thus the reduction in job losses in this quarter was due to services, which remained almost level (-3,600). This had already been clear from the data of those registered in the Social Security system. With the decrease in employment, the apparent productivity of the labor factor once more increased, this time by 0.2 points (year-on-year) to 3.4%.

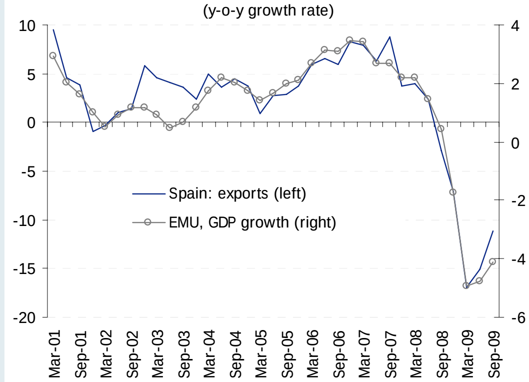
However, the increased productivity was countered by the wage figures. In 2007, wages per worker began to speed up their growth, and this became particularly steep starting in 2008 (6.1% as an annual average). In real terms, which are the relevant ones for this analysis, the effect is even greater, as in 2008 real growth was 3.6%, compared with 1.7% in 2007 and with a fall in real wages of 0.5% as an average over the expansive period 1996-2006. This fact

Spain: investment
(Q-o-Q growth rate)



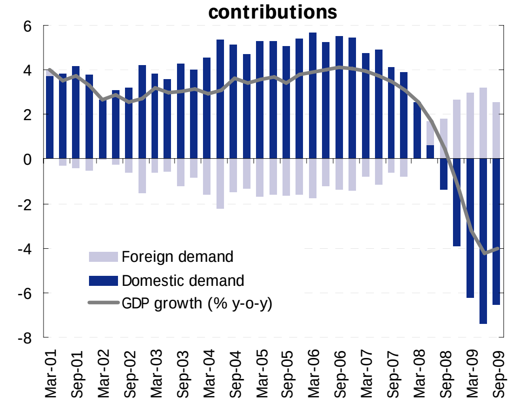
Source: INE

Spain's exports and EMU GDP growth
(y-o-y growth rate)



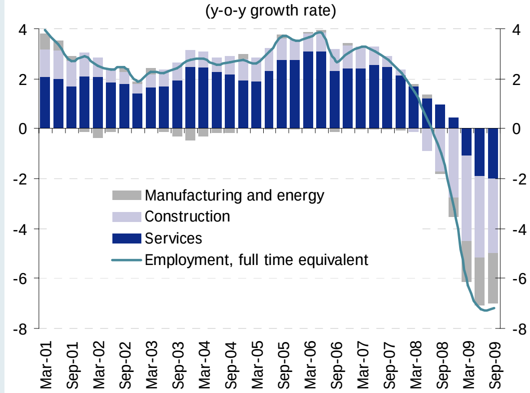
Source: INE and Eurostat

Spain: GDP growth (% y-o-y) and contributions



Source: INE and BBVA ERD

Employment: growth and contribution
(y-o-y growth rate)



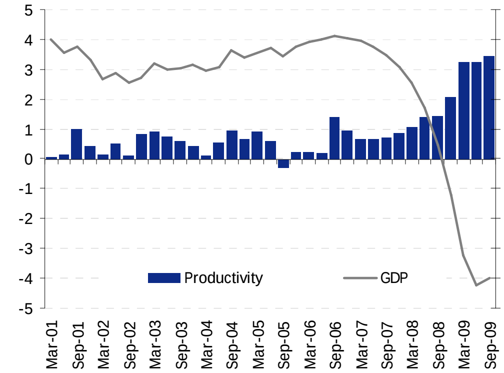
Source: INE and BBVA ERD

[3] See the Labor Market Observatory available via this link.

is often pointed to as one of the pillars on which the previous expansive phase was based. In 3Q09 nominal wages per employee barely grew by 0.2% in the quarter, but in real terms growth was 0.6%.

There is a composition effect behind this growth in wages. Since the start of the crisis most of the reduction in employment has been through an adjustment to the temporary workers on the payroll, who tend to be lower-paid workers, so that *ceteris paribus*, the remaining wage sum increases. However, it is often assumed that these temporary workers are less productive (to which we would have to add the workers affected by the adjustment in the construction sector). The problem, however, is that real wage growth from the start of the recession is far greater than the resulting productivity gains (which are in themselves countercyclical), as can be seen in the chart opposite. This means that real unit labor costs continue to grow. This is an extremely important feature of the Spanish economy, as it makes it difficult for the economy to recover its price competitiveness and, in fact, makes it difficult for it to take full advantage of any recovery in the European economy.[4]

Spain: GDP and labour productivity
(y-o-y growth rate)

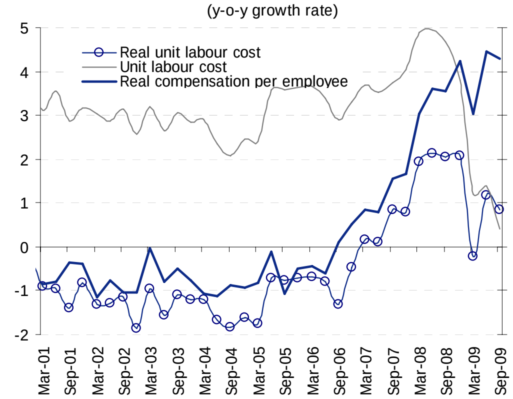


Source: BBVA ERD, based on INE data

Perspectives: Temporary effects that do not change the scenario

Although the quarterly fall has been somewhat smoother than expected by the consensus, and the European economy has grown moderately in the quarter, it is worth wondering whether we are experiencing a change in the trend and recovering quicker than implicit in our scenario.[5] However, the details from the National Accounts published today do not substantially change our scenario, as they are based on aspects that cannot be expected to have permanent effects. First, as was pointed out above, the improved consumption is extremely conditioned by the plan boosting car purchases. Although the plan was extended at the end of October, it had been announced as temporary. Thus it is to be expected that the additional demand from anticipated purchases has already been completed, at least partially, and that in this quarter and the next, the phenomenon will moderate significantly or even go into reverse. Consumption is to a large extent conditioned by uncertainty in the labor market, the intense process of deleveraging facing households and the perspectives of lower growth in permanent income. In addition to this, there are the effects on consumption of the increase in VAT announced for the second half of 2010. For all these reasons, we can only expect weak consumption next year.

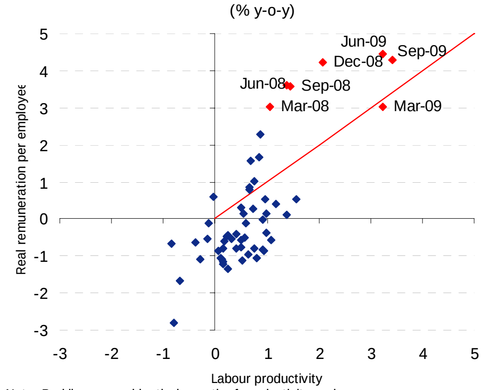
Spain: Labour cost
(y-o-y growth rate)



Source: INE and BBVA ERD

Second, although public consumption continues to grow, the intense process of fiscal consolidation that all the public sector has to face suggests that it will not be possible (or recommendable) for these levels of public consumption to continue into 2010. Investment in capital goods may have benefited from a temporary upturn after an accumulated fall of 28% since 4Q07, but it will continue to be conditioned by weak domestic demand, the sluggish European economy and the capacity of the corporate sector to finance this kind of investment. Equally, investment in housing will continue to adjust in accordance with our scenario and with the excess supply of housing still on the market. Finally, although exports are growing after the collapse of trade at the end of 2008 and the start of 2009, the prospects for the EMU in 2010 are close to stagnation, which means that this is not a factor to boost growth in any significant way.

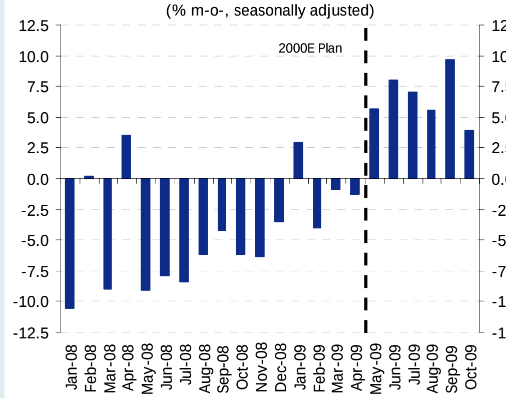
Spain: productivity and real wage growth
(% y-o-y)



Note: Red line means identical growth of productivity and wages
Source: BBVA ERD based on INE data

The economic data available until now on the fourth quarter are still not full enough to evaluate the rate of contraction in the quarter, and this evaluation will not be more definitive for another 2 weeks. Nevertheless, based on contemporary and leading indicators so far available, our BBVA-MICA model

Spain: car sales registrations
(% m-o-, seasonally adjusted)



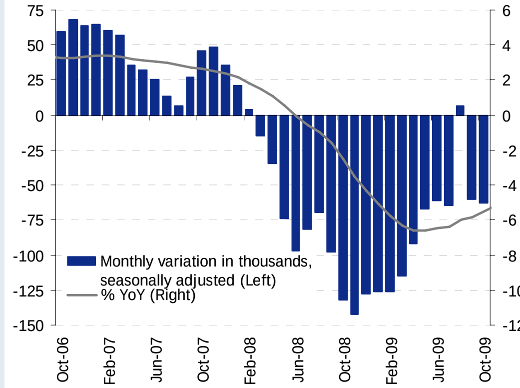
Source: BBVA ERD based on ANFAC data

[4] Even so, the real effective exchange rate of the Spanish economy compared with developed countries is improving as a result of the price differential, thus compensating the nominal component derived from the appreciation of the euro. For more details, see the Inflation Observatory, available from our website.

[5] See SpainWatch, November 2009.

allows us to infer that the rate of contraction in the fourth quarter is so far relatively similar to that registered in the third. The improvement in the external sector may compensate for the conclusion of the Local Investment Fund projects. In the future, the features of the scenario presented in SpainWatch will hold up: the recession will gradually ease and at the end of 2010 there will be positive and sustained rates of quarterly growth.

Spain: Social Security Affiliation



Source: BBVA ERD, using data from the Ministry of Labour and Inmigration