BBVA | RESEARCH

Economic Outlook

Spain

Fourth Quarter 2011
Economic Analysis

- **Global growth slows** and risks hamper expectations.
- **The Spanish economy continues to struggle** with increasing chances of dipping back into recession.
- **Regional growth rates should remain mixed.**
- **Recovery depends both on Europe effectively implementing the decisions reached recently and on Spain meeting its commitments and carrying out the necessary reforms.**

Index

Closing date: November 4, 2011

1. Summary

Global growth slows with risks tilted to the downside

The outlook for the global economy has worsened over the past few months, due mainly to four factors still at play. First, lower than expected economic growth, mainly in developed economies. Second, the sovereign debt crisis in Europe, which has intensified and become more systemic. While decisions announced in last October's summit go in the right direction, key elements are still unresolved, especially regarding the real firepower of the mechanisms for providing sovereign liquidity (a leveraged European Financial Stability Fund or EFSF), the restructuring of Greek debt held by private investors, and a clear roadmap for advancing European governance towards a fiscal union. As these issues were being addressed, more problems cropped up; e.g. major unrest in the wake of the call and subsequent withdrawal by the Greek government for a referendum over the bailout. Third, the feedback between sovereign concerns and the health of the European financial system, which has intensified, increasing the risks of a negative impact on economic activity and further feeding a real-financial vicious circle. Finally, higher global risk aversion, which has increased financial market volatility significantly and spilled over to most risky assets, including those of emerging economies for the first time since 2009. In this context, global GDP growth looks set to be 3.9% in 2011 and 4.1% in 2012, supported by solid growth in emerging economies against lacklustre performance in advanced countries.

These are still robust growth rates, but risks to these projections are now strongly tilted to the downside, hinging in the short term on the evolution of the sovereign-financial crisis in Europe. In particular, a quick reduction of financial stress in Europe is needed to cushion the negative effect on growth in Europe and contagion to other areas.

The October European summits have taken some steps in the right direction, but still leave key elements unresolved

In our view, there were five main issues that needed to be successfully addressed in the October EU summits: (i) tackling definitively the sustainability of Greek debt; (ii) erecting sovereign debt firewalls in the EMU; (iii) pushing for further reforms in peripheral countries; (iv) strengthening the banking sector; and (v) advancing euro area governance. The recent summits have taken important steps in the right direction, but they have not provided definitive solutions to most of these key issues. As we have mentioned in the past, partial solutions will probably just help prevent a further escalation of financial stress, but they will remain high in any event, increasing downside risks for economic activity in the euro area. For instance, the decisions do not address the risks to the sustainability of Greek debt in scenarios of "reform fatigue". Moreover, while there has been an attempt to increase the leverage of the EFSF, it will take some time for it to become operational, whereas the European Central Bank (ECB) will not act as a (permanent) buyer-of-last-resort of European public debt, its ability to act as a stabiliser is reduced. At the same time, the recapitalization of the banking sector is being done inefficiently, compensating a moderate stress testing of banks' balance sheets with a significant increase in capital requirements. This risks a sudden and sharp deleveraging of European banks, with negative effects on the supply of credit without cleaning the balance sheets of banks in the euro area. Moreover, a long term liquidity provision mechanism is not in place yet, even though this is extremely important for banks to obtain financing. Finally, there have been some advances in European governance, but there is no clear roadmap to a fiscal union or Eurobonds, that in our view a key element to make the monetary union more credible in the long run.

Economic recovery in Spain is losing steam

Over the past three months, uncertainties surrounding the global economic outlook and the limited effect of certain structural reforms have undermined expectations of recovery by the Spanish economy. On the domestic front, the imbalances built up before the crisis are still under correction, while the fiscal consolidation process is having a particular impact on some industries. The budding rebound in production in recent quarters has petered out, with growth rates dipping from 0.4% qoq in 1Q11 to stagnation in 3Q11 and the possibility of a contraction in 4Q11.

Going forward, confidence and volatility indicators in European financial markets already suggest activity in Europe will be flat in the latter part of the year, boding poorly for Spanish exports to maintain the strong growth seen until now. More important could be how concerns regarding the solvency of some European financial institutions hinder the provision of credit in Europe, including export activity financing, and, as result, to the whole activity. Within Spain, first, the uptick in the risk premium over the past three months and the spreading perception that it will take longer for it to ease to levels more aligned with the fundamentals of the economy could delay growth until 2012. Second, question marks surrounding economic policy in general, and a definitive solution to the sovereign debt crisis in particular, have already begun dampening business and household expectations. And this could ultimately hurt consumption and investment in coming quarters. Third, regarding fulfilment of fiscal commitments, the increasing probability that budget deficit targets will be missed, let alone downward revisions to 2012 growth forecasts, suggests that fiscal consolidation should be more intense than previously estimated next year. Fourth, the restructuring of the Spanish financial system is still not complete, although progress has been made over the last year. As a result, some institutions may not be ready to weather the adverse scenarios the market is focusing on and could remain vulnerable to rapid swings in market conditions. This would limit their ability to offer credit, especially in light of the high capital requirements. Finally, although we applaud the commitment to fiscal stability shown in the reform made to the Spanish constitution, the disappointing deficits of the autonomous communities could cast doubts on the ability of the government to meet the stability targets in the coming years. What's more, the reforms made over the past year and a half to create growth have been insufficient to tackle the problems facing the Spanish economy.

On the bright side, this increased uncertainty is prompting the ECB to adopt a slightly more accommodative monetary policy, delaying hikes to official interest rates after bringing them forward three months ago. This could be particularly good for Spanish households and businesses, but probably not enough to counteract the most direct effects of the increased uncertainty. At the same time, exports continue to grow rapidly despite the downward pressure caused by the slowdown in growth in Europe. This is especially true for service-related and extra-EU exports, which could go a long way to keeping job losses from mounting further.

In short, given the implications of the deterioration in the global outlook for the Spanish economy, growth could remain low, with an increasing likelihood of more negative scenarios than the one described in this report. In fact, time is running out for Europe as a whole and for Spain in particular, to adopt more ambitious and definitive measures to prevent this risk scenario from arising and dispel concerns regarding European governance in general and Spain's ability to grow and meet its fiscal targets in particular.

In this respect, the new government elected on 20 November needs to carry out immediately substantial and ambitious reforms such as those we have lobbied for in this publication in recent years. Turning to public finances, government actions must bear in mind the structural fall in revenue, curbing expenditure or seeking new sources of funding, but also developing consistent institutions with: i) the new fiscal rule written into the Constitution, ii) increased transparency and planning (multi-year budgets) and iii) incentives to meet the stability targets at all the levels of the public administration. Progress must also be made in restructuring part of the Spanish financial system to allow for a smooth deleveraging and to meet demand for credit when the recovery gains momentum. Next, the necessary reforms must be carried out to reduce the high level of unemployment as soon as possible and favour the reallocation of factors of production towards the fastest growing industries and businesses, and those with the greatest growth potential and capable of creating stable and quality employment. Dual economies like Spain's offer myriad examples of business excellence on an international level, which would explain the resilience of Spanish exports in recent quarters. Immediate challenges include generalizing this behaviour among all other companies and sectors, freeing up the enormous potential growth of the Spanish economy and tearing down barriers to the reallocation and efficient use of resources that are often idle. That said, given the global situation at present, achieving these goals would not be a sufficient condition for guaranteeing economic recovery and an end to a four-year long crisis, although it is a necessary condition. Until the countries in the euro area solve their problems, rather than regretting what Europe had yet to do to improve the situation of the Spanish economy, we should look at what Spain can do to help Europe cope with its problems. This means meeting its fiscal targets and adopting truly ambitious measures to boost growth and create jobs.

2. International environment: Global slowdown and risks tilted to the downside

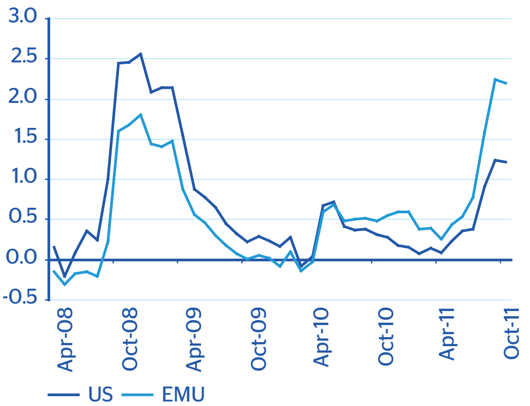
The global economy slowsdown and the outlook is heavily dependent on the resolution of the European debt crisis. Risks are strongly tilted to the downside

The outlook for the global economy has worsened over the past few months, driven mainly by four factors that are still exerting their influence. First, lower-than-expected economic growth mainly, but not only, in developed economies (data had been already disappointing in the US in the first half of the year, which led to some analysts to expect a double recession). Although growth increased in the US in the third quarter, economic activity in Europe, which held very well in the first quarter, is now on a clear decelerating path. Second, the sovereign debt crisis in Europe has intensified and turned more systemic. While decisions announced in the October summit go in the right direction, there are still key elements unresolved, especially regarding the real firepower of the mechanisms for providing sovereign liquidity (a leveraged European Financial Stability Fund or EFSF), the restructure of Greek debt held by private investors, and a clear roadmap for advancing European governance towards a fiscal union. Third, the feedback between sovereign concerns and the health of the European financial system has intensified, and financial tensions in Europe have reached levels in many respects higher that after the fall of Lehman Brothers in October 2008 (see Chart 1). This increases the risks of a negative impact on economic activity, further feeding a real-financial vicious circle. Finally, higher global risk aversion has increased financial market volatility significantly, spilling over to most risky assets, including emerging economies for the first time since 2009.

In this context, we revise downward our global growth forecasts by 0,3pp in 2011 and 2012, relative to August 2011 forecasts, mostly due to lower expected growth in advanced economies (US and Europe, compensated in part by Japan), although emerging markets will also grow slightly less than previously anticipated. Thus, the global economy would grow by 3.9% in 2011 and 4.1% in 2012, supported by solid growth in emerging economies against lacklustre performance in advanced countries (see Chart 2).

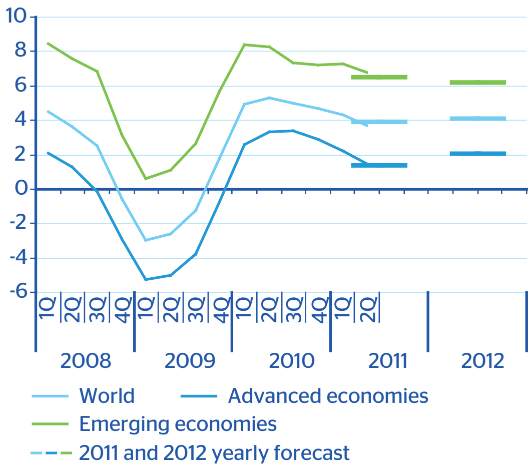
These are still robust growth rates, but risks to these projections are now strongly tilted to the downside, hinging in the short term on the evolution of the sovereign-financial crisis in Europe. In particular, a quick reduction of financial stress in Europe is needed to soft a sharp effect on European growth and contagion to others areas.

Chart 1
BBVA financing stress index



Source: BBVA Research

Chart 2
GDP growth (% yoy)



Source: BBVA Research and IMF

The October European summits have taken some steps in the right direction, but still leave key elements unresolved. This does not bode well for the reduction of financial stress in Europe

In our view, there were five main points that needed to be successfully addressed in the October EU summits: (i) tackling definitively the sustainability of Greek debt; (ii) create sovereign firewalls in the EMU; (iii) pushing for further reforms in peripheral countries; (iv) strengthening the banking sector; and (v) improve euro area governance. Although some of the more technical details still need to be determined, the recent summits have taken important steps in the right direction, but have not addressed definitely most of these points. First, private bondholders of Greek debt are asked to take a voluntary haircut of 50% –much higher than agreed in July– but doubts still linger about participation in the exchange and, even with full participation, about the solvency of Greece, which is still strongly conditional on measures that need to be taken in this country. Second, the EFSF will be leveraged as an insurance mechanism and complemented with outside investors (including possibly the IMF), but it is unlikely that any of the specificities of the functioning of the EFSF are ready before December. Thus, many weeks will be needed to ascertain its effectiveness vis-à-vis private investors, and hence the ECB will still be needed as a buyer-of-last-resort for sovereign debt, against the reticence of core European countries. Third, it is welcomed that more economic reforms are now on the agenda of some countries (notably Italy), and that as the help of the EFSF will be triggered by a request from countries and will be conditional, which increase the likelihood of implementation of economic reforms. At the same time, the recapitalization of the banking sector is being done inefficiently, compensating a moderate stress testing of banks' balance sheets –just using market prices for sovereign portfolios but not for so-called "legacy assets"– with a significant increase in capital requirements (9% core tier1 capital). This risks a sudden and sharp deleveraging of European banks, with negative effects on the supply of credit without cleaning the balance sheets of banks in the euro area. Moreover, a long term liquidity provision mechanism is not in place yet, even though this is extremely important for banks to obtain financing. Finally, there have been some advances in European governance, but there is no clear roadmap to a fiscal union or Eurobonds, in our view a key element to make the monetary union more credible in the long run.

As we have mentioned in the past, partial solutions will probably just help prevent a further escalation of financial tensions, but they will remain elevated, increasing downside risks for economic activity in the euro area. The agreements still leave doubts whether the necessary structure to prevent contagion and a systemic event from a Greek debt restructuring is in place: a large enough EFSF with the ECB as debt-buyer-of-last-resort and cleaned and recapitalized banks' balance with access to financing. Without all of them, markets will continue to factor increased fatigue for reforms in Greece and fatigue for further bailouts in core countries, which increases the probability of a risk scenario of a credit crunch and a recession in Europe, with global implications.

Growth drivers weaken in Europe

Growth of the euro area economy was strong in the first quarter of the year, but tapered off considerably in the second. The slowdown has continued in the second half of the year, pointing to stagnation for 2011 as a whole. Behind this trend were slightly less buoyant global demand, the impact of fiscal consolidation in much of the area and, above all, the financial stress and loss of confidence linked to the heightening of the sovereign debt crisis since the summer and the knock-on effect on the banking sector.

The erosion of confidence triggered sharp declines in the PMI and ESI indicators released by the European Commission to below levels that theoretically separate recession from expansion. Deterioration has been generalized and affected all countries, albeit Germany somewhat less than the area's other large economies. In this respect, the decoupling between core and peripheral countries looks set to continue going forward, but not as much as in the past two years. The poor readings of these "soft" indicators have not been reflected to the same extent in demand and activity data for the third quarter released until now, so negative growth is still expected. Nonetheless, all signs are that this resistance cannot be maintained in the latter months of this year.

Concerns regarding the pattern of growth are also spreading, since net exports remain the main driver despite having lost some steam. Domestic demand, poised to emerge as the main growth driver, has not rebounded as expected, in part because of the withdrawal of fiscal encouragements, but mostly because the confidence crisis has affected the consumption and investment components.

We have cut our GDP growth forecasts for the euro area, which already looked vulnerable three months ago, by 0.3pp for both 2011 and 2012 to 1.6% and 1%, respectively. Even so, these forecasts will depend on whether the financial turbulences in the euro area ease considerably at the end of this year or beginning of 2012. As indicated above, at first glance the outcome of the European summit on 26 October had the right ingredients to trigger this improvement, but risks are strongly tilted to the downside due to concerns in financial markets over the details of the decisions and their implementation, not to mention the additional problems caused by the call (and immediate withdrawal) for a referendum in Greece on the reform measures. In this case, the euro area as a whole could see flat GDP growth in 2012 or even dip back into recession.

On the price front, pressures continue to ease, although the inflation rate moved only a touch lower in the year's third quarter. This was the ECB's take; at its November meeting, the monetary authority shaved 0.25bp off its key interest rate, lowering it to 1.25%, (refinancing rate) and could cut it again to near 1% next time. Our forecasts call for a headline inflation rate below 2% in 2012, with an average inflation rate of 1.6% and an even lower core inflation rate.

Some improvements in Q3 growth, but structural weaknesses remain in US, including from political deadlock

More on the positive side, growth in the US seems to have picked back up in the third quarter, at least according to preliminary estimates. This is not saying much –growth in the first two quarters was low and the output gap is still high– but it seems to have reduced market nervousness about a double dip. Nevertheless, the US economy remains structurally weak, as consumer and business confidence continue low and the housing market could fall further. This means lower resilience in the face of a possible shock from Europe. In addition, political deadlock could impede a "grand bargain" to (i) prevent an unintended fiscal contraction in the short run and (ii) push reforms towards a credible fiscal consolidation in the long run.

Emerging economies are on track for a soft landing, but with increasing external headwinds

Emerging economies continue growing strongly, supported by the resilience of domestic demand. Still high commodity prices for Latin America and export growth in Asia –despite strong corrections in both cases– also contribute to a strong growth outlook, leaving them on track for a much awaited soft landing, which would be welcome in some countries. Renewed turmoil in Europe and the US already represent strong headwinds from financial markets in both regions –reflected in increased market volatility, depreciated exchange rates and reduced capital inflows–. However, many countries also enjoy sizable buffers –stronger public finances and better macroeconomic management than in the past– and are well positioned to introduce policy stimulus to counter weaker external demand. Overall, a more negative external environment has switched the focus in emerging countries from overheating to downside risks and, increasingly, the possible need for policy support.

3. Outlook for Spanish economic growth

Downward bias amid increased uncertainty

Uncertainty regarding global economic prospects has heightened over the past three months, dampening expectations for recovery by the Spanish economy. The slowdown in international trade seen in the second quarter this year was followed by a downward revision to US growth, undermining growth prospects for developed economies in general. Meanwhile, heightened financial tension caused by the sovereign debt crisis is already hurting the European economy and could continue to do so unless more decisive measures are adopted that help definitively shore up confidence among economic agents. At the same time, Spain's economic imbalances continue to adjust, helped in some industries by the fiscal consolidation process.

The incipient rebound in production has not been enough to create employment. This, coupled with the steady decline in household disposable income –amid an overall decline in credit, the end of unemployment benefits and the bank deposit war- continue to drag down private consumption. On the side of investment, both volumes and prices have fallen faster because of the withdrawal of tax incentives (e.g. deduction for home purchases) and ongoing measures to reduce public administration deficits, yet exports picked up (as expected) in the third quarter, lending some support to investment in capital goods. Respect to this,, the contribution by net trade is keeping the Spanish economy from contracting, although data for the third quarter point to stagnation.

Looking forward, confidence and volatility indicators in the European financial markets already suggest Europe's economy could flounder in the latter part of this year, which could dampen the heady growth seen until now of Spanish exports. More important could be how concerns regarding the solvency of some European financial institutions hinder the provision of credit in Europe, and therefore, on activity. Within Spain, the uptick in the risk premium over the past three months and the spreading perception that it will take longer for it to ease to levels more aligned with the fundamentals of the economy could delay growth until 2012. Meanwhile, uncertainty surrounding economic policy in general, and a definitive solution to the sovereign debt crisis in particular, have already begun undermining business and household expectations. And this could ultimately hurt consumption and investment in coming quarters. Regarding fulfilment of fiscal commitments, the increasing probability that budget deficit targets will be missed by Social Security and, especially, the autonomous communities, let alone downward revisions to growth forecasts, suggest fiscal consolidation efforts in the second half of 2011 and throughout 2012 should be greater than estimated three months ago. On the bright side, this increased uncertainty is prompting the ECB to adopt a slightly more accommodative monetary policy, which could be particularly good for Spanish households and businesses, but probably not enough to counteract the most direct effects of the increased uncertainty odf risk premium and financing costs. At the same time, exports continue to grow rapidly despite the downward pressure caused by the slowdown in growth in Europe. This is especially true for service-related and extra-EU exports, which could go a long way to keeping job losses from mounting further.

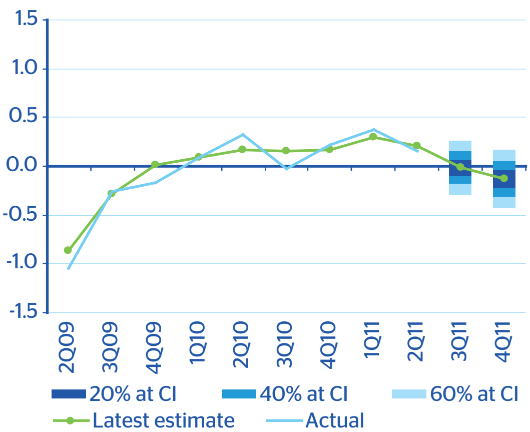
In short, given the deterioration in the global outlook affecting the Spanish economy, growth could remain low, with an increasing possibility of more negative scenarios. This would be if Europe as a whole and Spain do not adopt more ambitious and definitive measures to prevent this risk scenario from arising and dispel concerns regarding European governance in general and Spain's ability to grow.

The Spanish economy in 2011: losing steam

A year ago, we forecast GDP growth for Spain of 0.9% in 2011. This is similar to our current estimate (0.8%), but with a different timeline. At the end of last year, we expected growth to be sluggish in the early part of 2011 and gradually pick up throughout the year. Judging by data available to date, the opposite has occurred: qoq growth rates were slightly higher than expected at the beginning of the year, but have been lower than estimated in the second half.

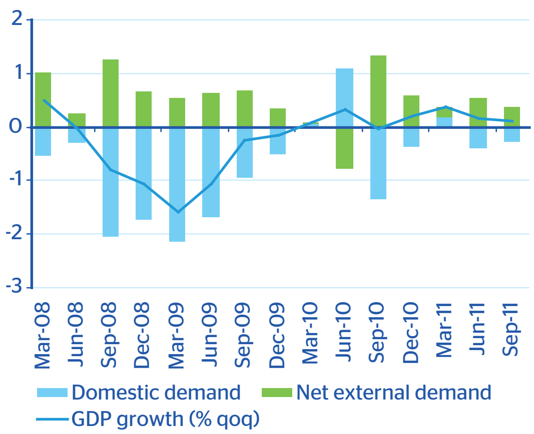
While we await official data, preliminary economic indicators show that the Spanish economy's meagre growth in 1H11 data showed activity was close to stagnation- is losing steam, considerably increasing the probability of contraction in the third quarter. Short-term GDP forecasts using the MICA-BBVA model[1] point to 0.0% qoq growth in the third quarter and contraction in the fourth if signals seen in October prove true (see Chart 3). In addition, 3Q11 economic data released to date indicate that after the fall in trade flows in 2Q11, the composition of growth will once again be heavily skewed to net trade, which should contribute positively to GDP growth again, while domestic demand is likely to continue to be a drag on growth (see Chart 4). However, we recall that coinciding with the publication of the Quarterly Spain's National Accounts (QSNA) report for 3Q11, QSNA will change its methodology, adopting 2008 as its new base year, which would be able to affect our forecasts with some supply and demand aggregates vulnerable to considerable statistical and methodological changes[2].

Chart 3
Spain: GDP growth and forecasts using MICA-BBVA model (% qoq)



Current forecast:3 November 2011
Source: BBVA Research based on INE data

Chart 4
Spain: Contributions to quarterly GDP growth



Source: BBVA Research based on INE data

Private domestic demand has weakened further in the year's second half

After 2010 featured the effects of fiscal consolidation on the spending decisions of households, the first half of 2011 was characterized by stagnation in private consumption. Rises in nominal disposable household income, especially non-wage income, failed to keep pace with rising prices, undermining real income and pushing down consumer spending despite a decrease in savings rates (see Chart 5). In all, growth in expenditure in 2Q11 performed better than expected, since virtually all preliminary indicators show no signs of improving between April and June (see Table 1). In 3Q11, increased uncertainty alongside a steeper drop in real wage income herald lower growth in consumption, as borne out by the poor performance of real retail sales (-1.0% qoq, SWDA) and car registrations (-6.6% qoq, SWDA).

Conversely, the improvement in activity in the services industry and availability in non-durables –mainly food- suggest spending did not fall between June and September. The moderate quarterly increase in consumption growth took the yoy rate to 0.8%, as suggested by both BBVA's synthetic consumption indicator (SCI-BBVA) and the BBVA Model of Indicators Coincident with Consumption[3] (MICC-BBVA). The base effect caused by the VAT hike and the conclusion of Plan 2000E in July last year explain the scale of yoy growth of consumption (see Chart 6).

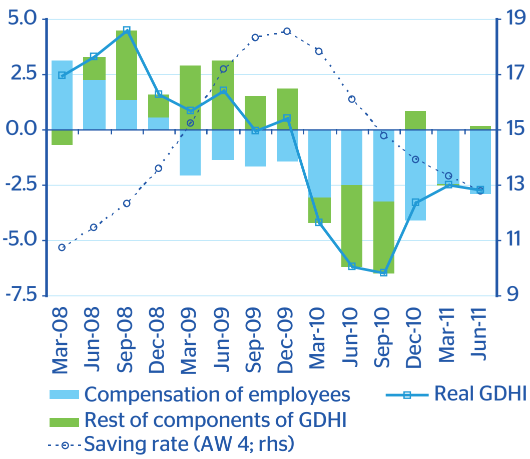
1: For more details on the MICA-BBVA model, see Camacho, M. and R. Doménech (2010): "MICA-BBVA: A Factor Model of Economic and Financial Indicators for Short-term GDP Forecasting", BBVA WP 10/21.
2: Click here for details of the main methodological and statistical changes included in the QSNA following the change in the base year to 2008.
3: For more details on the MICA_BBVA model, see Box 1 in Consumption Outlook in the second quarter of 2010.

Table 1
Spain: consumer spending indicators (SWDA data)

	Consumer goods consumption							
	Totals	Durables	Food	Other non-durables	Car registrations	Domestic sales by large enterprises	Service sector sales index	Retail commerce
% qoq								
1Q10	-2.8	-13.5	-0.3	-0.1	1.6	0.9	0.4	1.7
2Q10	2.1	9.7	-1.1	2.9	0.2	2.0	2.3	-1.6
3Q10	-3.9	-19.3	0.5	-1.9	-31.6	-5.0	-2.5	-1.6
4Q10	-1.1	-10.2	0.8	0.2	3.1	-0.4	-0.2	-0.9
1Q11	0.5	9.5	-0.7	-1.4	3.8	-0.1	0.7	-1.6
2Q11	-1.5	-6.8	0.6	-2.2	0.4	0.0	0.0	-1.2
3Q11	1.8	16.1	0.3	-0.9	-6.6	0.3	0.7	-1.0
% mom								
Jul-11	0.6	4.4	-0.5	0.8	-2.5	0.4	0.1	0.3
Aug-11	3.9	30.6	1.1	-3.0	-1.2	0.3	0.9	0.0
Sep-11	-1.1	-1.2	-0.8	2.5	2.1	-0.8	0.2	-1.4

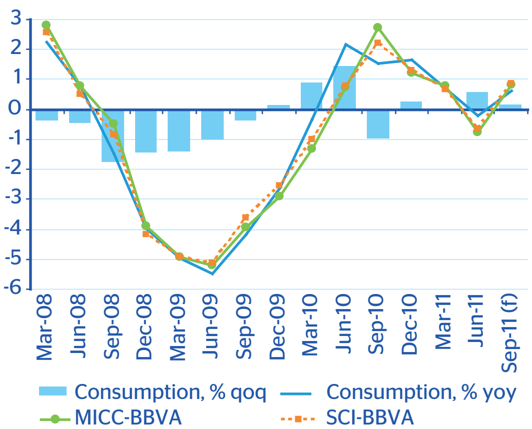
The shaded figures are forecasts
Source: BBVA Research based on MEH, ANFAC, AEAT and INE

Chart 5
Spain: contribution to yoy growth of real* GDHI (gross disposable household income) and household saving rate (%)



* Adjusted for the household consumption deflator
Source: BBVA Research based on INE data

Chart 6
Spain: observed data and real time forecast of household consumption



Source: BBVA Research based on INE data

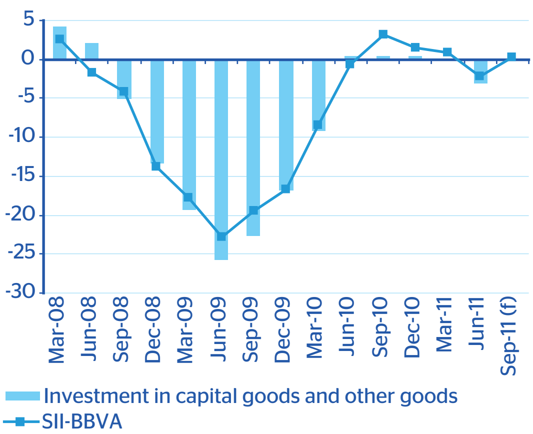
Meanwhile, data on corporate investment –condensed in our synthetic investment indicators –SII-BBVA- suggest that after a disappointing 2Q11, this demand component could have rebounded somewhat in 3Q11 (see Chart 7). Although some signals are still mixed, partial indicators suggest that this rebound is largely underpinned by the solid performance of Spanish exports this quarter after a sluggish 2Q11.

The improvement in capital good producers' confidence compared to the previous quarter (which despite dipping below its long-run average improved by nearly 6 percentage points from 2Q11), higher capital goods imports, a better reading for industrial vehicle sales and qoq growth in the IPI for capital goods point to an improvement in corporate investment compared to the previous quarter.

Residential investment should perform similarly to recent periods, falling again but less so than in the first and second quarters, judging by the synthetic investment indicator for housing SII-BBVA (see Chart 8). Meanwhile, residential activity is still no showing any signs of recovering. Construction permits granted for new homes in the first eight months of the year were down 13.1% yoy. At the same time, the stock of unsold homes continued to fall -and in the areas of strongest economic activity may be being taken up at a faster rate- but remains high, putting a brake on activity. Resident investment is still low and is unlikely to represent more than 3.9% of real GDP, well below the historical average of around 5.5%.

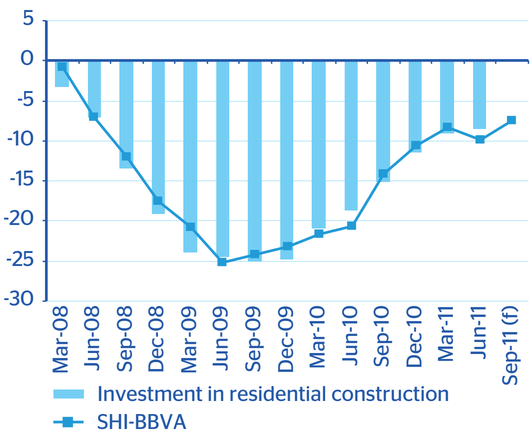
Demand-wise, sales were weak again in July and August and all indications are that, although September's figures have not been released yet and despite the temporary reduction in VAT on new homes from 8% to 4% which took effect on 19 August (and will run until 31 December 2011), we doubt the third quarter will show any recovery in demand for housing. The weakness of the job market, increased financial tensions and, finally, uncertainty among families regarding the potential tax measures that could be adopted regarding the real estate market have all dampened residential demand. As a result, housing prices fell further in 3Q11, as expected, bringing a cumulative decline of 17.7% (24.1% in real terms) from peak levels.

Chart 7
Spain:
investment in capital goods and others and BBVA Synthetic Investment Indicator (SII-BBVA) (%yoy)



Source: BBVA Researach based on INE data

Chart 8
Spain: investment in residential construction and BBVA Synthetic Housing Indicator (SHI) (% yoy)



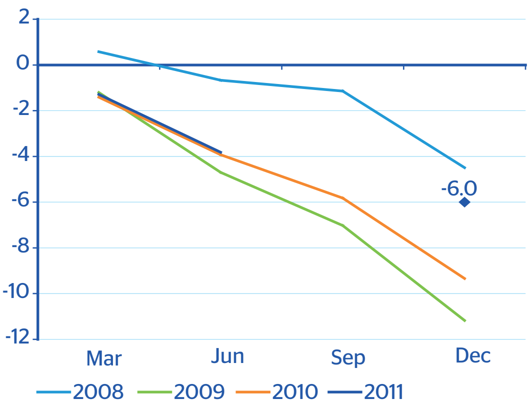
Source: BBVA Researach based on INE data

Adjustment process is still on public demand in the second half of the year, but not tight enough to prevent the budget deficit from exceeding the year-end target

Public consumption rose sharply in 1Q11, before plunging throughout 2Q11. The largest reduction was by the central government, which remains fully committed to fiscal consolidation, followed by the autonomous communities, leaving a general government deficit of 3.8% of GDP at the end of 2Q11 (see Chart 9). Even though budget outturn data for the autonomous communities as of 2Q11 show a decline in expenditure, the sustained fall in income drove up their cumulative deficit to 1.2% of GDP, just one tenth below the year-end target. These numbers, together with public statements by several autonomous communities regarding their intention of meeting annual targets, suggest a sharp over-run of the 1.3% of GDP target at the end of 2011.

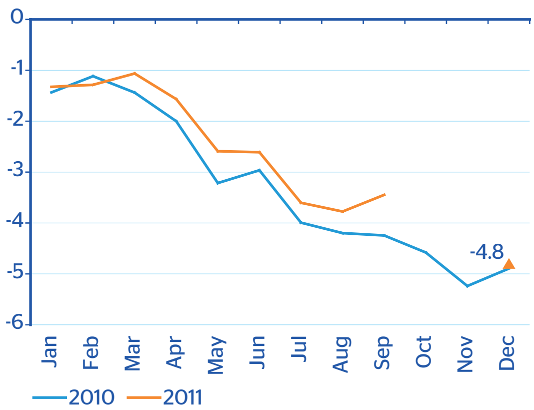
On the contrary, the latest information suggests the central government will stick to its path of fiscal consolidation, heading for a cumulative deficit to September of 3.4% of GDP, 0.8pp below last year's figure (see Chart 10). The cutback in central government spending in virtually all items has offset, in part, the slower income in revenue.

Chart 9
General Government: net lending (+) / net borrowing (-) (2008 base, % of GDP)



Source: BBVA Research based on INE data

Chart 10
Central Government: net lending (+) / net borrowing (-) (2008 base, % of GDP)



Source: BBVA Research based on MEH

Beyond the first half of the year, we expect a tighter grip over current expenditure, causing real public consumption to contract in the second half, albeit probably less so than in 2Q11. In any case, the drive for fiscal retrenchment probably remains focused on cutbacks to investment, so non-residential spending is all likelihood will continue to shrink in both the third and fourth quarters this year. Part of this worsening would be due, besides public cuts, to the sharp adjustment currently sweeping the private construction business.

In this setting, is expected that the central government would be able to meet its 4.8% deficit target easily, making up for the over-runs expected by the autonomous communities and Social Security. In all, unless additional efforts are taken, it is very likely that the public deficit will end 2011 well above 6% of GDP.

Exports have soared since the temporary blip in the year's second quarter

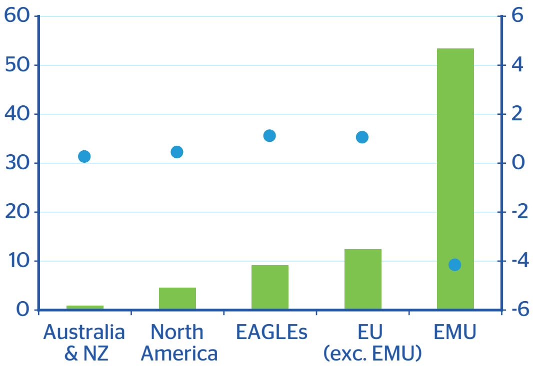
Due to base effects caused by especially robust exports in 1Q11, growth in the export of goods and services waned in 2Q11. This, coupled with the weakness of imports, led to a very large contribution of net exports to GDP growth. In contrast, 3Q11 is likely to have brought a sharp increase in exports of goods and services, fuelled by higher exports of goods and a good performance by services, especially tourism. Solid data through August for exports of goods, especially capital and intermediates (with expectations of strong growth in 3Q), and the increase in the export order book for October anticipate a good performance of exports in the second half of the year. In summary, amid increased uncertainty in Europe, major exporting sectors of goods are differentiating themselves and diversifying into foreign markets (see Chart 11).

Partial indicators for service exports to date point to a fresh rise in consumption by non-residents in Spain in 3Q11. Particularly, tourism indicators shown that on top of good performances by foreign visitors and overnight stays, tourism by national residents rose a further 2% yoy in 3Q11 after a year of continuous declines. This should help the net balance of tourism exports. Certain one-off factors bode well for this performance to continue. First, economic recovery in Europe and Spain in the first half should have triggered a slight increase in both external and internal demand in the summer. Second, conflicts in Northwest Africa persist, diminishing this area's status as a competitor. Third, World Youth Day 2011 had a major impact on tourist arrivals (Spanish and foreign) and total tourist spend in Madrid, although not so much on overnight stays.

There are also signs of structural factors shoring up tourism in 2011. In particular, the problems plaguing the hotel trade caused by the crisis, with prices back at 2008 levels, have been key for Spain's attractiveness as a tourist destination as, while it will take some time for confidence over demand for tourism in Northwest Africa to be restored, other destinations such as the Adriatic Sea are posing stiffer competition. Lower prices led to scant growth in average spending per tourist through September (around 2% yoy), but higher tourist numbers have increased overall tourist spending in Spain by 9.6% in the same period.

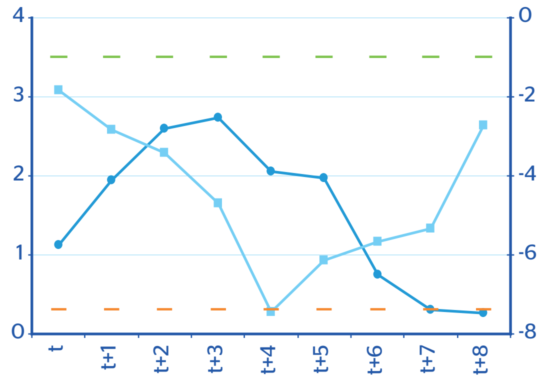
With no signs that the contribution of net trade to economic growth will disappear, exports are providing an escape from the crisis in a context of widespread uncertainty surrounding growth in Europe and moderate price-competitiveness gains compared to recent economic history (see Chart 12). For its part, slack domestic demand continues to drag down the performance of imports. This, coupled with the positive trend in total exports, leaves scope for a further correction in the current account deficit in the year's third quarter.

Chart 11
Composition of exports of goods across large geographical areas during the crisis



Source: BBVA Research based on Datacomex

Chart 12
Contribution of net trade to economic growth and real average effective depreciation in the end-phase of two periods of crisis



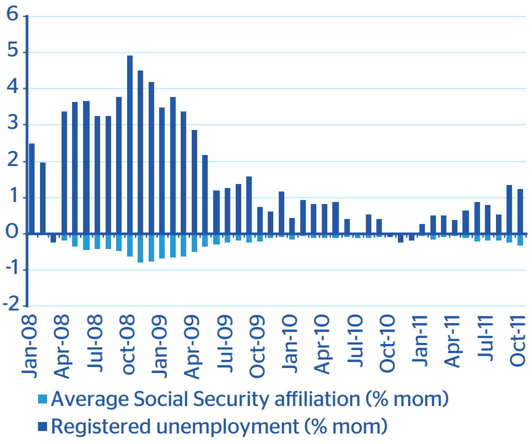
Source: BBVA Research based on INE and Bank of Spain

Further job losses confirm that the Spanish economy stagnated in 3Q11

Job market figures for 3Q11 were discouraging. Adjusting for seasonal and calendar effects, job losses continued to mount. Both the decline in Social security affiliation (-0.5% qoq, SWDA) and the increase in unemployment (+1.7% qoq, SWDA) increased by around 2 tenths between July and September. This was the result of falling employment in industry and construction and unchanged levels in agriculture and services (see Chart 13)[4]. In all, the Labour Force Survey (LFS) for 3Q11 confirmed the same trend, although the scale of deterioration of the labour market gleaned from these figures is greater. Favourable seasonal effects –a contribution of around 60,000 jobs- was not enough to prevent a decline in employment of 146,800 people. Despite the steep fall in employment –concentrated among employees with temporary contract and staff in agriculture, construction and services- the active population decreased by just 2,100 people (+10,300 SWDA), pushing up the unemployment rate by 6 tenths of a point to 21.5% of the active population (21.9% SWDA), while the temporality rate ticked up 5 tenths to 26.0% (see Chart 14).

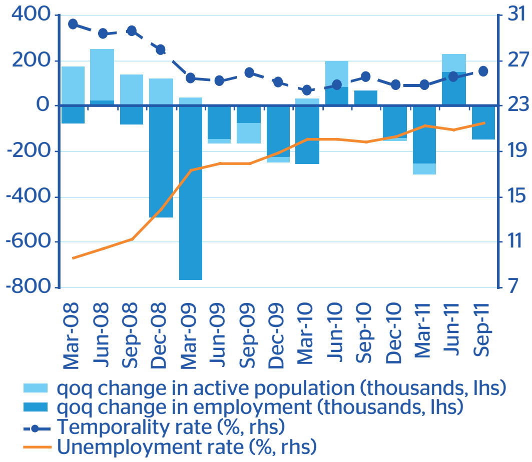
4: October registrations indicate the labour market began the fourth quarter as they ended the third, with a fall in social security registrations and a rise in jobless. Correcting for calendar and seasonal effects we estimate employment fell by around 55,000 people, a similar number to the increase in registered unemployed.

Chart 13
Spain: average Social Security affiliation and registered unemployment (SWDA data)



Source: BBVA Research based on MTIN

Chart 14
Spain: labour market indicators



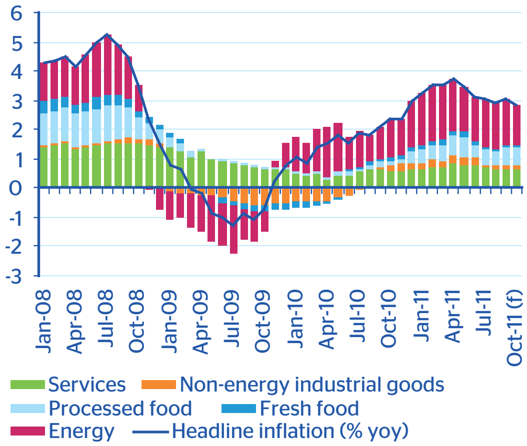
Source: BBVA Research based on INE data

Growth in consumer prices eased further in the third quarter

2Q11 featured low growth in consumer prices -after the local peak in April at 3.8% yoy-. In 3Q11, headline inflation continued to ease gradually, to 3.0% yoy at the beginning of 4Q11 (according to the leading indicator). The latest data show that with no demand-side inflationary pressure, Spain's still high inflation relates to two factors that, as pointed out in previous reports, are not all attributable to any loss in the Spanish economy's price competitiveness relative to its trading partners. The first, which has feed through to consumer prices –directly through final consumption and indirectly through intermediate consumption- is high commodity prices. Of the 3.1% yoy headline inflation rate at the end of 3Q11, 1.7pp can be attributed to energy and non-processed foods, while of the 1.4pp core inflation rate, 0.7pp can be attributed to the items most sensitive to commodity prices (e.g. processed foods and organized travel)[5] ((see Chart 15). The second factor affecting consumer prices was the increases in tax rates in 2H10, especially the VAT hike in July this year. As we can see in Table 2, the latest data show Spain's inflation spread relative to the euro area went from an average of 0.7pp in 1H11 to 0.2pp in 3Q11 (0.0pp in September). At constant tax rates, however, it has remained favourable to Spain since 2H10. To summarise, if upward pressure on consumer prices derived from these factors diminishes, headline inflation could continue to ease in the remainder of the year as demand is not expected to exert any upward pressure.

5: Regarding inflation in processed food prices, the slight upward deviation seen at the end of 3Q11 relates mainly to higher tobacco prices (+4.8% yoy in September), putting an end to the price war which had triggered a decline of around 6.4% at the end of 2Q11.

Chart 15
Spain: contributions to headline inflation growth



Source: BBVA Research based on INE data

Table 2
Spain:
Inflation spread with respect to the euro zone

		Total	At constant tax rate
2008	1H	1.1	1.2
	2H	0.7	0.7
2009	1H	-0.7	-0.9
	2H	-0.4	-0.8
2010	1H	0.4	0.1
	2H	0.4	-0.4
2011	1H	0.7	-0.2
	3Q(*)	0.2	-0.7

*: July-August average figures at constant tax rates
Source: BBVA Research based on INE data and Eurostat

Outlook 2011-2012: the persistence of financial tensions in Europe continues to depress growth prospects

As we noted in the introduction to this section, in a international context worsening, the persistence of a higher risk premium for Spain than its fundamentals and doubts surrounding the autonomous communities' meeting their budget targets, the pace of economic activity has probably slowed iin the short term . As a result, GDP growth in 2011 is likely to be a touch below than our forecast of three months ago (0.8% vs. 0.9%). Qoq growth should be positive over the coming year, albeit slightly lower, leading to a lower full-year 2012 forecast than previously estimated (1.0% vs. 1.3%) (see Table 3). What's more, unless more decisive measures are adopted in Europe and domestically that clear up doubts surrounding governance in Europe and Spain's ability to grow and create jobs, the probability of risk scenarios increases considerably.

Table 3

Spain: macroeconomic forecasts

(yoy %, unless indicated otherwise)	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11 (f)	2010	2011 (f)	2012 (f)
Household consumption	-0.3	2.2	1.5	1.7	0.7	-0.2	0.8	1.3	0.4	0.5
Public Administration's consumption	-1.1	-0.1	-0.7	-0.9	2.6	-1.0	-1.6	-0.7	-0.3	-2.7
GFCF	-10.5	-6.7	-6.7	-6.1	-6.0	-6.7	-4.5	-7.5	-5.1	-0.6
Capital goods and other products	-9.3	0.5	0.2	0.1	0.0	-3.3	0.4	-2.1	-0.5	2.8
Capital goods	-4.6	8.7	2.4	1.2	0.3	-3.7	1.8	1.9	0.1	3.8
Construction	-11.3	-11.3	-11.2	-10.6	-10.4	-9.3	-8.3	-11.1	-8.7	-3.2
Housing	-20.9	-18.7	-15.1	-11.4	-9.0	-8.4	-6.9	-16.5	-7.4	0.9
Other	-4.1	-5.9	-8.7	-10.1	-11.2	-9.8	-9.1	-7.2	-9.4	-5.7
Chg. in inventories (*)	0.0	0.1	0.1	0.1	0.0	-0.1	0.0	0.1	0.0	0.0
Domestic demand (*)	-3.0	-0.3	-0.7	-0.6	-0.4	-1.91	-0.8	-1.1	-1.0	-0.4
Exports	9.4	11.9	9.4	10.5	12.1	8.4	11.7	10.3	10.1	5.1
Imports	2.0	9.6	5.0	5.3	6.3	-1.7	4.9	5.5	3.0	-0.3
Net trade balance (*)	1.6	0.3	0.9	1.2	1.3	2.6	1.7	1.0	1.8	1.4
GDP at mp	-1.4	0.0	0.2	0.6	0.9	0.7	0.9	-0.1	0.8	1.0
Pro-memoria:										
GDP w/o housing investment	-0.2	1.1	1.2	1.3	1.4	1.2	1.2	0.9	1.2	1.0
GDP w/o construction	0.3	1.9	2.1	2.5	2.5	2.2	2.2	1.7	2.2	1.6
Employment (LFS)	-3.6	-2.5	-1.7	-1.3	-1.3	-0.9	-2.1	-2.3	-1.7	-0.8
Unemployment rate (% active pop.)	20.0	20.1	19.8	20.3	21.3	20.9	21.5	20.1	21.5	22.1
Employment (etc.)	-3.9	-2.4	-1.6	-1.4	-1.4	-1.0	-2.1	-2.4	-1.7	-0.9

(*) Contribution to growth
Note: Actual data and forecasts aligned with the QSNA base year 2000
Source: INE, Bank of Spain and BBVA Research forecasts

Regarding the composition of growth, new factors applied in the update our economic scenario for 2011 and 2012 represent further downward pressure on external demand and, above all, domestic demand. First, the increasing likelihood that the failure by the autonomous communities to meet their targets will lead to a moderate over-run of the 2011 budget targets has led to a reduction in consumption and public investment in 2012 as the fiscal consolidation process is unavoidable.

As for private consumption, the 2Q11 figure was slightly above expectations, in part offset by the negative impact of increased uncertainty and the erosion of the job market on expenditure in 2Q11. Accordingly, the outlook for growth for the full year barely changes. Demand for durable goods will continue to be affected by consumers bringing forward purchases to the first half of the year, although the effect should diminish gradually over the forecast period. In 2012, although increasing uncertainty could push up the saving rate for precautionary reasons, the outlook for household consumption is broadly the same as in the previous Spain Economic Outlook report. The weakness of spending factors should cap the growth of expenditure, leaving levels far lower than in 2010, while the benign inflation environment will keep real household disposable income from falling, while the maintenance of low official interest rates should ease the financial burden of households.

On the corporate investment front, trends in domestic and external demand and behaviour by financial markets will largely shape expectations of future profits and, accordingly, the performance of this demand component in coming quarters. No major expansion of production capacity at Spanish companies is envisaged. The fall in public and private demand, coupled with a slower decline in the risk premium than initially expected, thereby hurting funding costs, has prompted us to cut our estimates for corporate investment in the second half this year and in 2012. This, however, will be tempered slightly by the delay to hikes in official interest rates compared to the previous scenario. In all, this item of aggregate demand, which could continue to be driven mainly by the resilience of external demand, could end 2011 virtually flat, contracting slightly more than 0.5% yoy before rising again in 2012 (by 2.8%).

Although external demand could largely underpin the growth of corporate spending, domestic demand must improve for residential investment to rebound. However, in view of the frail job market and tight credit conditions for households amid persistent financial tensions and the need to deleverage, demand for housing looks set to remain weak over the forecast period. In addition, tighter access to credit by industry players will undermine the start-up of new investment projects. At any rate, the absorption of the stock of unsold homes, though slower than desirable, leaves the industry, at least in some geographical areas, poised to embark on a gradually recovery next year. Whereas residential investment should contract in 2011 as a whole (-7.4% yoy), our forecasts call for growth in 2012 (of near 1% yoy), when the sector should begin rebounding slowly, with highly mixed performances across regions.

Finally, as noted in previous editions of this publication, net trade should remain the key medium-term driver of economic growth in Spain, contributing positively to GDP growth in both 2011 and 2012. Robust business activity abroad anticipates strong growth in exports, of around 10% for 2011 as a whole. Conversely, growth of both exports and imports should slowdown considerably in 2012, mostly because of the existing uncertainty surrounding global growth prospects in general, and the outlook for Europe in particular. As a result of the major role of this component of aggregate demand since the crisis began, Box 2 explores the main differentiating features of Spain's small and large exporting firms in a variety of the country's manufacturing industries. It identifies the underlying factors that shape export propensity, quantifying, e.g., the impact of an increase in firm size on the probability of exporting.

At the end of last year, we said that 2011 looked like it would be a year of transition for the economic recovery and that we could see net employment growth by the end of the year. As noted above, while average growth for 2011 is not too far off from initial estimates, the timeline for quarterly growth shows signs of slowing and even contracting, above all with respect to job market indicators. In this setting, our baseline scenario for 2012 entails a one-year delay in the economic recovery. Accordingly, employment levels are likely to continue falling in coming quarters, nudging up the unemployment rate to 22% for the year as a whole. This forecast will certainly depend on active population trends, where growth is particularly difficult to estimate in the current environment.

Ongoing uncertainty requires a greater reform drive

In order to keep from heading toward the risk scenario due to increased uncertainty over the past three months, the Spanish government has adopted new measures to achieve its short-term fiscal targets, achieve the budget stabillity in the medium and long term, and spur on economic activity. Although these measures have either not been ambitious enough and the right ones to remove all doubts surrounding the Spanish economy and lead to a rapid reduction in the risk premium to levels in line with economic fundamentals, they have been well received by the other European members -they have ratified the Spanish government's commitments- and probably explain why Spain has fared better than other peripheral countries, namely Italy, which has taken a severe beating in the recent bout of sovereign debt crisis.

As for meeting the short-term fiscal commitments, the measures contained in Royal Decree-Law 9/2011, of 19 August, and Royal Decree-Law 13/2011, of 16 September, mainly entail lowering pharmaceutical spending, speeding up the collection of corporate income tax and temporarily reinstating the wealth tax (to the end of 2012)[6]. The first measures makes for more efficient spending, which will have a permanent, albeit moderate, impact on the structural deficit. However, the three measures on the whole are not very ambitious –given their scant impact on public finances- and, with respect to the wealth tax, off the mark. As this one implies a double taxation on income, it could distort decisions on saving at a time when saving should be encouraged to prevent the reduction in the financing needs of the Spanish economy coming from cutbacks to investment.

Meanwhile, as regards budget stability in the medium and long terms, the Congress approved a constitutional amendment setting a deficit target for all levels of public administration to be instrumented through an Constitutional Law that should be passed by 30 June 2012. While this is a major step towards both guaranteeing the sustainability of public finances in Spain in the medium and long term and supporting the construction on new governance in Europe to allow the necessary measures to reduce uncertain in sovereign debt markets to be adopted, a certain degree of flexibility –i.e. the possibility to abandon the rule in exceptional cases (e.g. natural disasters, economic recession or emergency situations) by agreement of an absolute majority in Congress-

6: The texts of RD-L 9/2011 and RD-L 16/2011 are available here and here.

it could reduce the credibility of the new fiscal rule. The working of the Constitutional Law will be crucial to define what is understood by exceptional cases, who will determine them and what the consequences will be of not complying with the rule (e.g. sanctions, exit strategy).

Finally, with respect to promoting economic activity, the latest decisions taken by the Spanish government aim to tackle two issues that are tarnishing economic growth prospects: the struggling real estate industry and youth unemployment. As for the real estate market, Royal Decree-Law 9/2011 stipulates that until the end of 2011 deliveries of properties for new homes will pay tax at a 4% rate instead of the usual 8% VAT. We don't think this measure is having any major impact on boosting activity and employment or raising tax take. Since the measure is only temporary, at most it could bring demand for housing forward to the latter part of 2011. However, it probably will not do away with much of the stock of unsold homes, so it can hardly bring about a sustained recovery in real estate or construction activity any faster. What's more, by reiterating this type of incentive to residential demand (e.g. first the elimination of the deduction on the purchase of primary residences, then the reduction in VAT), this could actually hurt the credibility of the temporary measures, limiting their impact by creating new expectations about similar incentives in future.

With youth unemployment, Royal Decree-Law 10/2011 largely contains three measures designed to boost employment among this group[7]. First place, a new vocational training contract that allows people between 16 and 30 years of age to combine their studies at a training centre recognised by the national employment system (25% of the time) with a paid work activity at a company. Second, the temporary elimination (to the end of 2013) of the restriction on consecutive temporary contracts, which did not solve the problem of labour market duality because, as highlighted in several issues of Spain Economic Outlook, the real solution requires bridging the gap between termination benefits (e.g. a single contract with increasing severance based on seniority). Third, it extends the deadline for converting temporary contracts into contracts that encourage employment (33 days' severance), so that the wage guarantee fund (FOGASA) pays 8 days of the severance of these and so that workers who have stopped receiving unemployment benefits receive the 400 euros of aid[8].

As was said in the first paragraph of this section, despite of the implementation of all measures, uncertainty over growth capacity of Spanish economy and over if budget targets will be met have not yet dispelled and is still been a high financing cost which press future growyh expectations to downward. Unfortunately, so negative signals as last registered in market labour, or the scant grade od commitment of budget targets by autonomous communities justify, at least in part, this uncertainty that support the need of a mayor reformer impulse.

7: The text of RD-L 10/2011 is available here.
8: See BBVA (2011) for a detailed analysis of the causes and possible solutions of youth unemployment in Spain

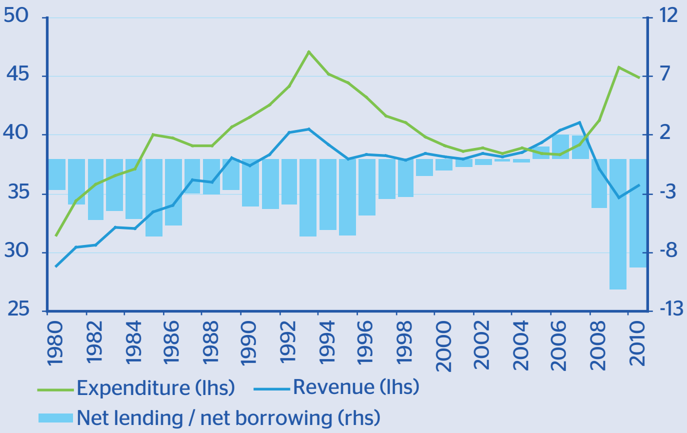
Box 1. Recent trends in public administration non-financial resources: a structural view

The current economic crisis put an end to the major fiscal consolidation process begun in the middle of the 90s, which led to three straight years of surpluses (2005 to 2007). This process focused mainly on curbing public expenditure, which as a percentage of GDP fell by 5.3pp from the mid 90s to below 40% by the end of 2007. During the same period, public revenue rose by 3.1pp, mostly in the last three years of the growth phase. When the crisis arose and countercyclical measures were adopted to cushion its impact, pubic spending return to levels of the early 90s in just three years, while pubic revenue fell to levels of the mid 80s. Public revenue fell far more than nominal GDP, taking the ratio of revenue to GDP from 41.5% in 2007 to 35.7% at the end of 2010. This nearly 5.4pp decline (see Charts 16 and 17) cannot be attributed solely to the tax cuts implemented in recent years, which could have led to a decline in tax take of around 1.5pp of GDP.

Looking at trends in resources of the public administration by component between 2007 and 2009, when the ratio of revenue to GDP reached its local minimum, we see declines across the board in all resources items except social security contributions, which held broadly steady at around 13% of GDP[9]. Most of the fall in general government receipts was in current income tax (which includes, *inter alia*, personal income tax and corporate tax) and taxes on production, which lowered intake by 3.3pp and 3pp of GDP, respectively.

Chart 16

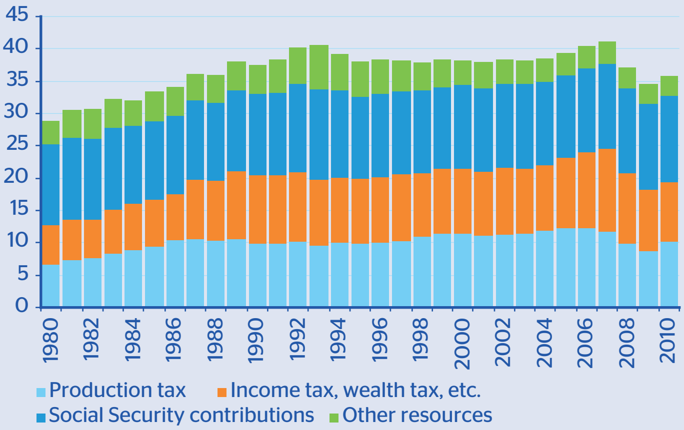
General government: net lending (+) / net borrowing (-) (% of GDP)



Source: BBVA Research based on MEH and INE data

Chart 17

General government: non-financial resources (% of GDP)



Source: BBVA Research based on MEH and INE data

This sharp drop in public income is due in part to the typical operation of automatic stabilizers throughout the business cycle –i.e. when activity declines, taxable income declines, leading to a smaller tax take. More importantly, it is due to the disappearance of certain extraordinary income related to the real estate boom and the discretionary economic policy measures adopted.

To assess the scale of these impacts, public revenues must be divided up into the part linked to discretionary decisions (the structural part) and the part related to cyclical swings in the economy (the cyclical part), identifying both effects on tax base and tax receipts. Thus, tax base income for each tax ($b_{i,t}$) can be divided up into three non-observable components: structural ($b^*_{i,t}$), cyclical ($b^c_{i,t}$), and irregular ($\varepsilon^b_{i,t}$),

$$b_{i,t} \equiv b^*_{i,t} + b^c_{i,t} + \varepsilon^b_{i,t} \quad (1)$$

where, the cyclical component $b^c_{i,t}$ depends on the stage of the economic cycle. Similarly, for every period *t* of collection of each tax ($r_{i,t}$) the sum of three unobservable components is broken down: structural ($r^*_{i,t}$), cyclical ($r^c_{i,t}$) and irregular ($\varepsilon^r_{i,t}$), the first two of which depend on the structural part and the cyclical part of taxable income, respectively[10].

9: This can be explained, at least partly, by prepayments of social security of unemployed who still receive unemployment benefit entitlements. As these benefits expire, social security contributions as a percentage of GDP could decline in the near future.

10: The structural decomposition of the tax bases and tax receipts used in this box is based on a model of unobservable components whose trends are inferred using a Kalman filter and estimated for maximum likelihood. The details and complete results of the assessments will be included in a forthcoming economic outlook report and BBVA Research working document.

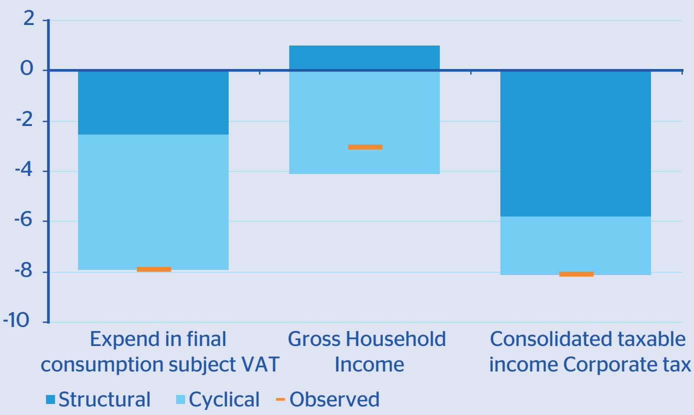
Looking at trends in tax basis for the main taxes (see Chart 18), most of the reduction in VAT revenue is explained by the sharp fall in VAT taxable income, of nearly 8pp of potential GDP between 2007 and 2009, of which around 5.4pp was due to the business cycle and certain one-off expenses in years before the crisis and 2.5pp to a structural fall in expending on final consumption subject to VAT. Most of the fall in spending on final consumption was the result of lower household spending on new homes (which in nominal terms was halved over the course of that period). Similarly, the economic contraction led to a fall of 3.1pp of potential GDP in gross household income, of which 4.1pp are attributable to the cycle. Conversely, the crisis is having a greater impact on corporate taxable income, dragged down by the drop in corporate earnings, as well as by the disappearance of capital gains related to the strong run-up of stock market prices before the crisis. This way, both the cyclic and the structural components of the corporate taxable income declined, by around 2.3pp and 5.8pp of potential GDP, respectively, leading to an 8pp decline in total taxable income between 2007 and 2009.

This performance of the various tax basis has a direct impact on tax take (see Chart 19). The operation of the automatic stabilizers explains, on average, about 2.2pp of the fall of each of the main tax items in terms of potential GDP (VAT, income tax and corporate tax), whereas only corporate tax and other taxes show a sharp decline in structural tax receipts (around 1pp of potential GDP). For the rest of the resources, while trends in the structural component of the respective taxable income have worsened since 2007, this should be offset by the tax hikes, so the structural component of tax receipts as a percentage of potential GDP declined only slightly. However, one should recognise that the scale of the structural adjustment of tax receipts from income tax and social security contributions can be even more pronounced than preliminary estimates call for if the data for the coming years effectively confirm that behind the high job destruction and increase in the unemployment rate is a greater structural deterioration of the labour market.

In all, the structural component of public income as a percentage of potential GDP has fallen by 3.6pp from 2007, whereas it held broadly steady during the economic growth phase (between 2000 and 2007). Conversely, the cyclical component of this income increased by 4.6pp between 2000 and 2007, whereas during the crisis the operation of the automatic stabilizers drained income to the tune of some 5pp of potential GDP, mostly because of the decline in taxable income caused by trends in the real estate market and the steep drop in corporate earnings.

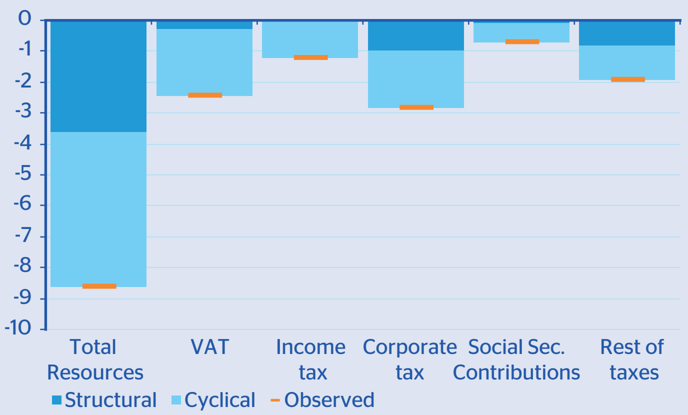
To summarize, the procyclicality of non-financial resources of the public administration reveals that part of the clean-up of public accounts made during the expansive period was not the result of any structural improvement in income. This goes some way to explaining the sharp deterioration in tax take following the change in the business cycle. More worrisome is that whereas during the growth phase there was no evidence of improvement in structural components of non-financial income, during the ongoing recession the deterioration of this income has been accompanied by a relative fall in the structural component. Therefore, it is important that during the current fiscal consolidation process, the public administration bear this structural fall in income in mind and align public spending to structural income or seek alternative funding to increase structural resources. Longer term, discretionary decisions on public expenditure ought to be based on improvements in structural income and not cyclical improvements, as was the case in the previous period. In this respect, action must by consistent with the new fiscal rule written into the Constitution, increased transparency and planning (multi-year budgets) and incentives to meet the stability targets at all levels of the public administration.

Chart 18
General Government: change in tax basis 2007-2010 (% of potential GDP)



Source: BBVA Research based on MEH and INE data

Chart 19
General Government: change in non-financial income 2007-2010 (% of potential GDP)



Source: BBVA Research based on MEH and INE data

Box 2. Sectorial diversity of exporters and drivers of export propensity

With Spain's economy struggling, this Box studies what differentiates Spain's manufacturing exporters by sector using data from the Business Strategies Survey (BSS) for 1990-2009, compiled and published by the SEPI Foundation. Breaking down 20 manufacturing sectors, the analysis focuses especially on differences between large exporting companies and small- and medium- sized enterprises (SMEs). Business size and its relationship with an economy's export trends has been the subject of recent studies. Specifically, the new international trade literature argues that large companies' export performance describes well exports at an aggregate level (Di Giovanni and Levchenko, 2010). In addition, the difficulty that SMEs face trying to gain a foothold in the export market merits detailed analysis, where size matters (Bank of Spain, 2009). After establishing the factors that differentiate large exporting companies from SMEs, at the sectorial level the Box explores the characteristics underlying export propensity[11].

Large exporters have greater experience in the domestic market, are more productive, have higher physical capital per employee ratios and invest considerably more on R&D and training for employees (see Table 4). In many cases, there are noticeable differences between sectors. The productivity gap is particularly marked in the furniture industry, non-metallic mineral products, beverages and other manufacturing industries. The main difference in intensity of physical capital per employee between large exporting companies and SMEs is in ferrous and non-ferrous metals, the furniture industry and the agricultural and industrial machinery sectors. Sample also show the high domestic market experience of large leather and footwear exporters and the relative inexperience of SMEs in the beverage, chemical and pharmaceutical, graphic design, ferrous and non-ferrous metals and other transport materials sectors.

From a financial viewpoint, foreign participation in large exporting firms is around 60% in the motor vehicles, rubber and plastic, machinery and electrical materials, computing, electronics and optics, and chemicals and pharmaceuticals industries. Foreign participation in large exporting firms differs greatly from SMEs in the furniture industry and in the manufacture of leather and footwear. Meanwhile, large exporters generally have greater own funds to finance their activities, although there are exceptions in the other transport materials, computing, electronics and optics, and machinery and electric materials sectors. With regard to business concentration, large exporting firms enjoy significant domestic market share while SMEs exporters on average operate in atomized markets. Lastly, Table 4 shows that the big exporting companies tend to use more qualified workers in their productive structure; however, there is no systemic pattern that demonstrates lower use of temporary staff by the big companies compared to SMEs. Once again, the model shows that sector diversity between large companies and SMEs is a fundamental characteristic of the sample.

11: In this Box, company size equates to number of workers. Specifically, an SME has an average of 200 or fewer workers and a large company more than 200 workers in the related year.

Table 4

Differentiating features of exporters by manufacturing sector, large companies vs. SMEs, 1990-2009

(calculations based on median of the distribution)	Experience (a)	Productivity (b)	Physical capital per employee (b)	Total R&D spend (c)	External spending on training (b)	Foreign investment in capital* (d) (%)	Equity capital (e) (%)	Market share (%)	Proportion of engineers and bachelors (%)	Proportion of blue collar staff (%)	Temporality rate (%)
	Difference	Ratio	Ratio	Difference	Difference	Ratio	Ratio	Difference	Difference	Difference	Ratio
Meat industry	20	1.2	0.9	36	29	0.7	1.4	4	0.7	-3.5	1.7
Food and tobacco products	10	1.4	1.4	136	68	3.1	0.9	15	0.9	8.0	1.0
Beverages	37	1.5	1.2	216	208	3.8	1.3	23	0.6	11.3	1.0
Textiles and apparel	14	1.1	1.6	48	17	4.4	1.0	6	0.1	-2.9	1.4
Leather and footwear	32	1.1	1.6	285	0	39	1.7	23	0.4	0.6	0.2
Timber industry	1	1.1	0.9	19	0	1.3	1.0	10	2.4	1.3	1.0
Paper industry	11	1.3	2.1	60	90	3.5	1.3	19	0.9	7.4	1.3
Graphic design	24	1.4	2.0	0	95	4.8	1.0	11	0.3	1.8	0.7
Chemicals and pharmaceuticals	20	1.4	1.4	1.236	159	2.1	1.1	6	1.5	17.3	0.9
Rubber and plastic products	21	1.1	1.1	243	79	2.9	0.9	17	-0.4	0.4	1.4
Non metallic mineral products	15	1.7	2.6	107	75	3.8	1.3	14	0.9	2.9	0.7
Ferrous and non-ferrous metals	15	1.4	3.4	260	126	1.7	1.4	18	0.3	6.9	0.9
Metal products	11	1.2	1.7	178	72	2.3	0.9	15	1.2	2.7	0.9
Agricultural and industrial machinery	15	1.2	2.4	387	108	2.2	1.2	10	0.4	1.7	1.8
Computing, electronics and optics	9	1.3	1.3	1.556	96	4.9	0.8	10	4.0	16.1	1.2
Machinery and electrical material	15	1.1	1.8	420	80	3.0	0.9	19	-0.3	-0.1	1.6
Motor vehicles	12	1.4	1.8	593	93	2.2	1.0	10	0.9	0.3	1.1
Other transport materials	23	0.9	1.1	1.397	75	2.4	0.5	0	1.6	6.3	0.4
Furniture industry	19	1.8	2.5	191	85	18	1.2	14	3.4	14.2	0.9
Other industrial manufacturers	19	1.5	1.5	146	78	4.1	1.2	23	1.2	2.7	1.7

Notas: (a) difference between the year the company was founded and the average foundation date for all companies in the sample, (b) thousands of euros per employee, (c) thousands of euros, (d) foreign-owned capital as a share of the company's total capital, (e) own funds/ liabilities, * figure is the average.
Difference is calculated as the remainder of the value of the statistic of the large companies minus that of the SMEs (in the Experience variable, the difference is expressed as absolute value); Ratio is calculated as the value of the large companies statistic divided by the SMEs statistic.
Source: BBVA Research bases on ESEE and SEPI Foundation

Once the diverse characteristics of Spanish good exporting companies at sector level have been analysed, the relative role that these characteristics play in the propensity to export is assessed. It is crucial to identify the determining factors that make exporting more probable, not only in order to evaluate the ongoing internationalization process that the Spanish economy embarked on when it joined the common market, but also to define the scope of economic policy to incentivize this process. Table 5 presents a probit model estimate in which export propensity is defined by a binary variable that has a value of 1 if the company is exporting in the current year and 0 if it is not[12]. The qualitative results of the propensity to export calculation indicate that export probability increases with company size, the number of years of experience in the domestic market, the physical capital ratio per worker, internal and external R&D activity, use of blue collar workers, external shareholders in the company's capital, advertising spend, product diversification in more than one sector, and with the perception of the main market being in a growth phase. The higher the temporality rate of workers and non qualified human capital, the lower the propensity to export.

Table 5

Probit estimation of Spanish manufacturers´ export propensity, 1990-2009

Observations, sample 1990-2009	**Coefficient**	**Standard error (robust)**	**p-value**
Size (a)	0.443	0.012	0.000
Experience (b)	-0.003	0.001	0.000
Technology:			
Physical capital per employee (a)	0.212	0.012	0.000
R&D activity (c)	0.333	0.038	0.000
Temporality rate (a)	-0.046	0.013	0.000
Human capital:			
Proportion of unskilled staff	-0.002	0.001	0.064
Proportion of blue collar staff	0.002	0.001	0.030
Financial indicators:			
Foreign capital participation (d)	0.005	0.000	0.000
Own funds availability (e)	-0.001	0.000	0.004
Strategy variables			
Share in main market	-0.002	0.001	0.004
Advertising spend as a share of sales (f)	0.013	0.006	0.032
Product diversification (g)	0.067	0.039	0.086
Domestic cycle indicator (h)	0.086	0.026	0.001
Pro-memoria:			
Sample size	20774		
Psuedo-R2	0.345		
Log pseudo-likelihood	-8769		
Wald chi2(66)	5329	Prob>chi2	0.000
Goodness of fit (Pearson chi2 test)	30622	Prob>chi2	0.000
Success rate	80.17		

Note: The maximum likelihood calculation includes one constant, and regional and temporary sectorial dummies, (a) in logs, (b)difference between the year the company was founded and the sample average year of founding, (c) indicator has a value of 1 if the company carried out internal and contracted out R&D activities during the year and a value of 0 if not, (d) percentage of foreign capital in company's total capital, (e) percentage of own funds over liabilities, (f) advertising spend as a percentage of sales, (g) indicator has a value of 1 if the company has unrelated diversification (i.e. more than one 3 digit product and some of these being in a different sector as 2 digits) and a value of 0 if not, (h) indicator has a value of 1 if the main dynamic is expansive and a value of 0 if it is not.
Source: BBVA Research based on ESEE and SEPI Foundation

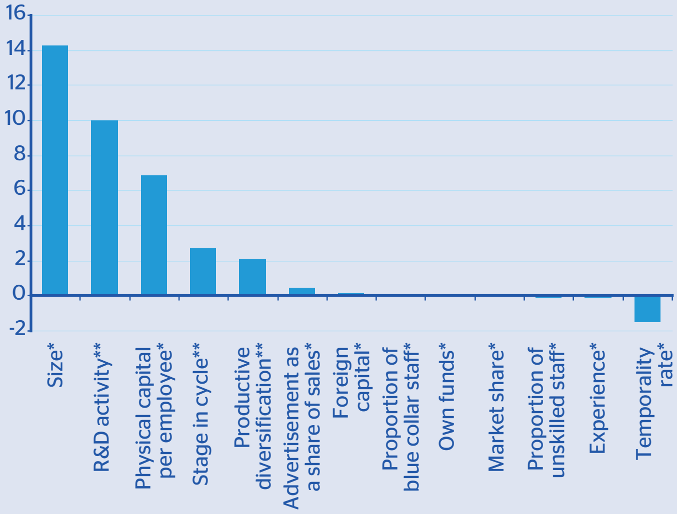
12: The following analysis focuses on the determining factors of the sample set probability of exporting; therefore, it does not aim to calculate the company's transition probability from being a non-exporter, in t=0, to being an exporter, in *t=1*.

The qualitative effects of availability of own funds and market share on export probability deserve special attention. The findings suggest that once the effect of firm size on export probability is accounted for, the higher the share in the main market (i.e. lower degree of domestic competition), the lower the export probability. Once the effects of other factors introduced in the estimation are accounted for, we see that the larger the dependence on own funds to finance corporate liabilities, the lower the export probability, which is in line with recent papers that emphasise the existence and importance of alternative financing schemes for exporters (Manova (2008) and Chor and Manova (2011)).

Lastly, Chart 20 shows the marginal effects of the underlying factors of the propensity to export identified in Table 5. According to the results, company size is the variable with the greatest impact on export probability. To illustrate, a 1% increase in the size of a business increases the probability of export by 14.3%. Accordingly, large companies tend to export more as they are better positioned to assume the fixed costs associated with penetrating new markets (Melitz, 2003). Meanwhile, a 1% increase in physical capital per employee utilisation increases the probability of exporting by 6.8%, while a 1% reduction in the temporality rate increases export probability by 1.5%. With regards to the dummies indicators, R&D spend increases export probability by 10 percentage points and the perception that a main market is growing by 2.7 percentage points. Experience, employee qualifications, depedence on own funds, and market share are some of the least influencing variables when it comes to export propensity.

To sum up, future export expansion will depend largely on the economic policies implemented to facilitate company growth, research and development investment (both internal and subcontracted), physical capital investment and reduction of temporality rates.

Chart 20
Marginal effects on the various factors affecting export probability



*: in % ; **: in percentage points
Source: BBVA Research based on ESEE and SEPI Foundation

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Box 3. Regional growth prospects: differences will remain

Within the context of the stagnating Spanish economy and taking into account that this is closely linked to the performance of domestic demand, the divergences between the autonomous communities are due to two fundamental factors: 1) the pull effect of foreign trade on its own activity, and 2) the additional internal adjustment yet to be made -in which institutional sectors and at what pace- which will cause to a greater or lesser contraction in domestic demand.

From a regional point of view, four basic productive structure factors explain the differences in economic development in recent quarters and those expected going forward: firstly, access to foreign markets, and within this, the larger or smaller orientation to emerging markets, conditions the degree to which the regions have been able to tap the growth in foreign demand. Although in many communities the first part of 2011 featured an increase in foreign trade flows, only those for which foreign trade makes a structurally relevant contribution have benefited noticeably from this dynamic. In particular, regions where foreign demand has a greater weight on the economy (e.g. the Basque Country, Catalonia, Aragon and Galicia) have experienced greater growth.

Similarly, the weight of tourism, and within this, the larger or smaller orientation towards foreign markets, is the second differentiating factor in the autonomous communities' economic performance. Here again, those that have most benefited most are geared more to foreign tourism (the Balearic Islands, the Canary Islands, Catalonia and Madrid, in that order), while those that depend more on domestic demand (Valencia and Andalusia) have shown smaller growth as a consequence of weak domestic demand. One exception in this last group is Galicia, where the impact of Xacobeo in 2010 led to negative yoy growth rates in all sector variables, giving rise to a slightly negative sector contribution. Overall, including in this region, the 10.9% fall in tourism to September is due to the performance of domestic Spanish tourism (13.3% in the same period) compared to virtually flat foreign tourism (-1.2%). This ought to be seen as a positive for the Galician economy as, to a certain degree, it reflects the structural increase in demand achieved by this region. It is also a reflection of the markets that have most energized the sector: those more geared to foreign demand have benefited, and may continue to do so in 2012.

With foreign trade set to continue driving the economy, we could see a repeat performance in 2012, although the contributions could be somewhat smaller given the good performance in 2011 and the outlook for economic slowdown in Europe.

As regards domestic demand, the differences are marked by the two remaining factors already mentioned. Third is the structure of the labour market, namely the different ways in which its deficiencies are seen in the various Spanish regions. The greater the unemployment rate in each community, the more limited income generation, in a context where it is still not clear that there will be enough economic growth to increase employment that would boost confidence, and given that unemployment benefits run out, temporary employment will carry greater weight. From this point of view, it is the communities in the south of Spain that will be affected most, while those in the north, having less temporality rate and unemployment, will be less exposed to further declines in consumption.

The fourth and final differentiating factor in regions' different performances is the importance of regional and local public sector within the economy and, in particular, the different level of austerity required by the sector. Communities with higher debt and public deficits will have to take greater austerity measures. Furthermore, assuming similar needs for austerity, the larger the contribution by the public sector to the aggregate value of the economy and, as such, its importance for business performance and employment in all other sectors, the greater the impact. Communities that have already said they will not meet their budget targets make have to make further cutbacks, if not increase them in 2012, causing domestic demand to contract further. According to available data at present, Castile La Mancha, Extremadura, Valencia and Catalonia should be among the most affected at the end of this year. In the case of Catalonia, this would negate the positive differential impact from foreign trade.

Apart from the previous points, that are those that have led to developments in recent months, there are two long-term factors that affect the adjustment process: 1) excess supply in the housing market, which is hampering growth in construction, the impact of which will be greater and longer lasting where housing is aimed at the second home market; and 2) the level of leverage of private sector, particularly of families, as that means increased financial burden and thus less scope for increased consumption. These two factors will most affect the Mediterranean communities and those in the South.

In short, Spain's economic woes, not to mention the different regional exposure to factors underpinning economic growth and those hindering growth, is causing a wide divergence in growth rates of the different autonomous communities in Spain. That said, our baseline scenario does not show any community contracting in 2011 or 2012 if the overall growth forecasts for Spain is met and no risk factors currently threatening growth arise.

Table 6
GDP growth forecasts by autonomous community (%)

	2011	2012
Andalusia	0,4	0,7
Aragon	0,7	0,8
Asturias	1,0	0,9
Balearic Islands	1,3	1,2
Canary Islands	1,0	1,0
Cantabria	0,5	0,6
Castile & León	0,7	0,9
Castile La Mancha	0,4	0,5
Catalonia	0,8	0,8
Extremadura	0,8	0,7
Galicia	0,6	1,0
Madrid	1,3	1,4
Murcia	0,6	0,7
Navarre	1,2	1,2
Basque Country	0,9	1,2
La Rioja	1,0	1,1
Valencia	0,7	0,8
Spain	**0,8**	**1,0**

Source: BBVA Research

Table 7
Short-term factors shaping regional growth (2011)

	Excess housing supply	Private debt	Unem-ploy-ment	Autono-mous com-munity debt	Public consolida-tion	Opening to foreign markets
Andalusia		X	X		X	X
Aragón						
Asturias		√				
Balearic Islands		X		X		√
Canary Islands	X		X			
Cantabria	√					
Castile & León		√				
Galicia						
Catalonia				X		√
Extremadura	√				X	X
Castile La Mancha	X			X	X	X
Madrid					√	
Murcia	X	X	X			
Navarre			√		√	√
Basque Country	√	√	√		√	
La Rioja	X					X
Valencia		X		X		√

Note: X represents a negative and √ a positive factor
Source: BBVA Research

Box 4. Spain's Financial System: incomplete restructuring in a more demanding European framework

The Spanish financial system has changed considerably over the last two years. The restructuring carried out has reduced installed capacity greatly, with major write-downs of asset portfolios and balance sheet strengthening. Nonetheless, the process is not complete: there are still problems to resolve.

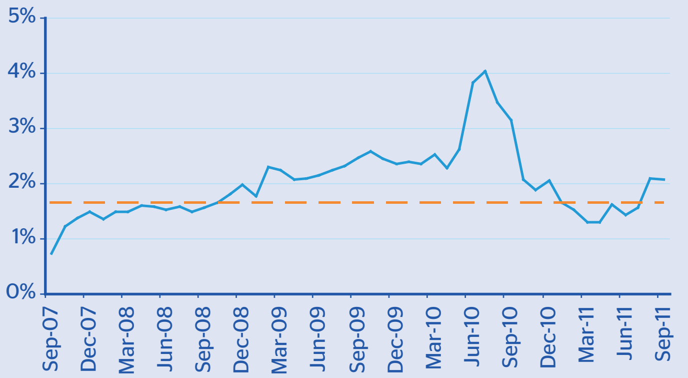
Liquidity: a problem that must be fixed

Before the crisis, investment in Spain was financed by the banking system, which raised funds from foreign investors through debt issuance and on the interbank market. However, funding in the wholesale markets has become much more expensive and limited to only the most solvent institutions. The interbank market decreased to the degree that Spanish banks went to the European repo markets, leading to an increase in liquidity obtained by this method. This type of funding is short term and the underlying asset tends to be public debt – mainly Spanish. Therefore, a haircut on Spanish public debt could be imposed as happened with Ireland and Greece.

Because of the weakness in these sources of funding, financial institutions have tapped the ECB for funds and have resorted to national agents, who have increased their deposits and purchases of bank debt. ECB liquidity is guaranteed over the short and medium term, but excessive use of it may have a stigma effect. Spanish bank's funding by this means, which reached 4% of their assets in 2010, has fallen to 2% today (15% of all funding granted and above the 12% of the Spanish capital key), although this could likely rise in the coming months. As for deposits, high interest rates are not in themselves a problem. The problem is when deposit rates are higher than loan rates in a whole banking system. The deposit war is a problem of financial stability, so individualized supervision of entities' commercial strategy is important especially of entities that have received public aid-. The surcharge imposed by the Deposit Guarantee Fund does not appear to be a sufficient deterrent, so other measures with a more direct impact should be considered, like the penalization in own funds, recently adopted in Portugal.

The latest Summit of EU heads of state and government mandated the European Commission to explore alternatives to alleviate the long-term financing problem, possibly by underwriting issues. In times of uncertainty, finding a solution to liquidity problems is paramount.

Chart 21
ECB liquidity. Net loans (% of system's total assets)



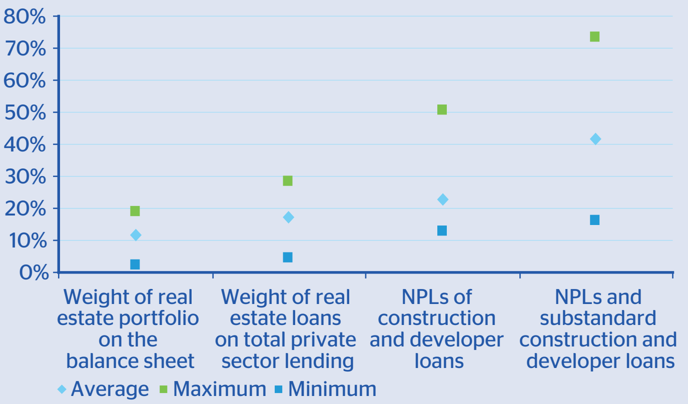
May 2011 calculated using assets as of April 2011, the latest available data
Source: BBVA Research

Solvency: new capital requirements

At the beginning of this year, the Bank of Spain imposed a minimum core capital ratio requirement of 8% or 10% depending on the bank. All Banks had met this objective by September, either through capital increases, intervention by the FROB, IPOs, mergers with a more solvent bank or private investors. However, the recapitalisation demanded at the October Summit means new requirements for systemic European entities. It obliges the five largest Spanish banks to strengthen their Tier 1 capital by 26.2 billion euros (a provisional figure until it can be revised following September balance sheet information, which is expected by mid November) to reach a ratio of 9% by the end of June 2012. Spanish banks' needs are 25% of all European needs and are mainly due to the increase in the minimum capital ratio, not to their sovereign debt holdings. To meet these requirements, Spanish banks have said that they will not need public assistance, but rather they use methods such as organic generation of capital or a reduction of on balance-sheet risks. This strengthening will likely have a positive impact on the way Spanish banks are viewed.

The European exercise has some drawbacks, which will be detailed later. For Spain, the increase in minimum capital requirements is not enough per se to tackle the latent problems on the banks' balance sheets. The problem in Spain is concentrated on the real estate sector, but its weight varies greatly between institutions (see Chart 22).

Chart 22
Features of Spanish bank's real estate portfolios. June 2011

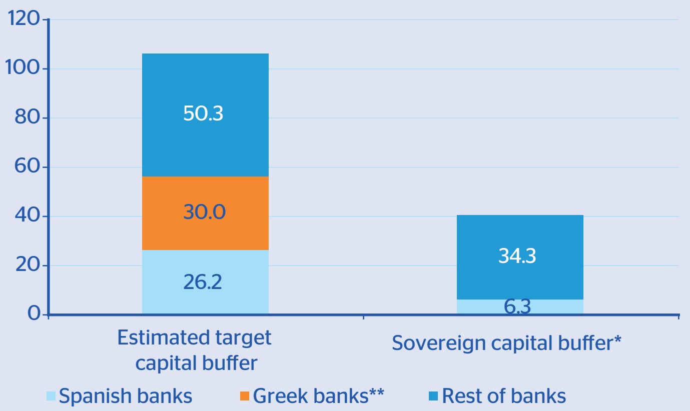


Source: BBVA Research based on personal data

What did the October European Summit decide?

The decisions announced at the Summit cover various issues, but the one having a more direct impact on Spanish banks is the requirement to achieve a minimum core Tier 1 ratio of 9% by 30 June 2012 with sovereign debt and loans to governments valued at market prices.

Chart 23
Estimated capital needs (billion euros)



* The sovereign capital buffer is indicative and can already be covered by existing core tier 1 capital if the ratio exceeds 9%.
** No information on the sovereign capital buffer has been provided by Greek banks, not to conflict with pre-agreed arrangements under the EU/IMF programme.
Source: EBA

First, authorities have not taken measures to curb the perception of sovereign risk in all peripheral countries, which was the underlying problem. The perception of the existence of sovereign risk in Italy and Spain implies that the valuation of sovereign bonds at volatile and pro-cyclical market prices could trigger a new vicious circle between sovereigns and banks. Further country aid could spawn new doubts about the sovereign, and as such lead to banks that hold sovereign debt on their balance sheets being further penalized.

They have not given priority to cleaning up balance sheets ahead of recapitalisation, although recapitalisation does not clear up uncertainty regarding the size of adjustment necessary. The problems facing many European banks have to do with their so-called legacy assets and their real estate exposure, which they need to make provisions for.

The decision to increase minimum capital requirements in difficult times runs contrary to the spirit of Basel III, which proposed a comprehensive implementation schedule to avoid the pro-cyclical effects of the measure.

One of the ways in which banks can increase their capital ratios is to reduce their risk weighted assets (RWAs), which could hinder the flow of credit to the real economy. The summit's statement recommends that banks do not reduce the pace of lending, but they will use all tools at their disposal to increase their capital.

Furthermore, it could be argued that retail banks have been unfairly treated by the EBA exercise compared to the banks that have larger investment banking divisions, as the minimum CT1 ratio requirement is based on RWAs, whose biggest component is credit risk. This could lead to the paradox of demanding more capital from those institutions that already have more capital and are less exposed to financial markets.

The additional capital requirement overlaps with other new regulations. First, within the framework of the European resolution is the possibility of including bail-ins for certain instruments if banks get into difficulties. Given that the aim is to reopen markets, it is important not to shroud these measures with others that could make issued debt less attractive. Second, the measure overlaps with the higher capital ratios required to systemically important financial institutions (SIFIs) at the latest G20, as the biggest banks in Europe were included in the latest exercise. The G20 also discussed the imposition of a financial transaction tax in Europe, which would again affect the same institutions.

Lastly, the requirement to value sovereign debt exposure at market prices, including loans, will be a source of additional volatility on balance sheets, and means that recapitalization using public funds could cause a vicious circle between bank and sovereign problems. If portfolios are re-measured without haircuts in the future, the banks could recognise gains, which could lead to excess capital. It would be desirable for this excess to be used to clean up balance sheets, under the supervision of European and national authorities.

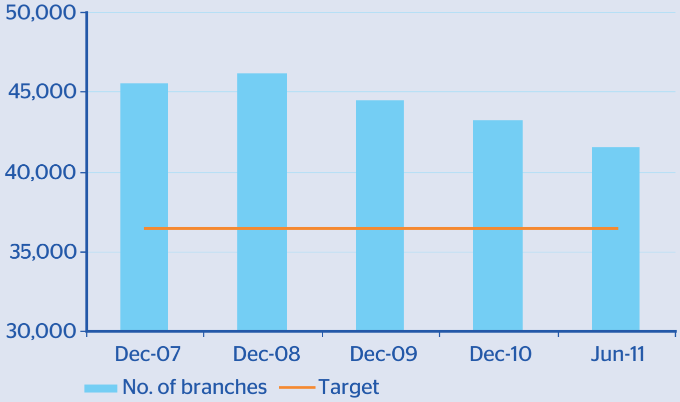
Financial system restructuring: why has it not been completed?

The restructuring of Spanish institutions has not yet been completed, with several major issues unresolved. It is necessary to further reduce installed capacity. From the start of the crisis up until June 2011, 11% of all branches (some 4,000 branches) were closed. We estimate that another 23%, or 9,000 closures, is still needed.

Net expected losses (not provisioned) for the financial system could reach more than 60 billion euros, so the cleaning of the balance sheets must continue. Clear signals are necessary that governance is improving and that managers of institutions with problems are being replaced, eliminating political influence. The public intervention process has not finished, and FROB intervention in those entities with problems ought to speed up the clean up or sale process and the auction of CAM is still pending.

Therefore, several measures still need to be taken. Balance sheets need to be cleaned up and excess capacity reduced at a faster pace. It is crucial to continue fostering transparency in order to restore market confidence. With regards to the actions of the authorities, the FROB ought to replace management at banks in which they have intervened and improve governance, and also act decisively on the deposit war, especially at banks that have received public funds.

Chart 24
Number of branches



Source: BBVA Research based on Bank of Spain

4. Tables

Table 8

Macroeconomic forecasts: Gross Domestic Product

(yoy rates, %)	2008	2009	2010	2011	2012
US	-0.3	-3.5	3.0	1.6	2.3
EMU	0.3	-4.2	1.7	1.7	1.0
Germany	0.8	-5.1	3.6	2.9	1.2
France	-0.2	-2.6	1.4	1.6	1.0
Italy	-1.3	-5.2	1.2	0.7	0.3
Spain	0.9	-3.7	-0.1	0.8	1.0
UK	-0.1	-4.9	3.4	0.9	1.3
Latin America *	5.2	-0.6	6.6	4.5	3.8
Mexico	1.5	-6.1	5.4	3.8	3.3
EAGLES **	6.6	4.0	8.3	6.7	6.5
Turkey	0.7	-4.9	9.2	7.5	4.5
Asia Pacific	5.2	4.1	8.0	5.9	6.4
China	9.6	9.2	10.4	9.1	8.6
Asia (exc. China)	2.3	0.8	6.5	3.7	4.9
World	2.8	-0.6	5.1	3.9	4.1

Closing date: 4 November 2011
* Argentina, Brazil, Chile, Colombia, Peru, Venezuela
** Brazil, China, Egypt, India, Indonesia, Korea, Mexico, Russia, Taiwan, Turkey
Source: BBVA Research

Table 9

Macroeconomic forecasts: 10Y interest rates (average)

	2008	2009	2010	2011	2012
US	3.6	3.2	3.2	2.8	2.5
EMU	4.0	3.3	2.8	2.7	2.6

Closing date: 4 November 2011
Source: BBVA Research

Table 10

Macroeconomic forecasts: exchange rates (average)

US dollars ($) per national currency	2008	2009	2010	2011	2012
US (EUR/USD)	0.68	0.72	0.76	0.71	0.74
EMU	1.47	1.39	1.33	1.40	1.35
UK	1.82	1.56	1.54	1.60	1.57
China	6.88	6.83	6.74	6.42	6.16

Closing date: 4 November 2011
Source: BBVA Research

Table 11

Macroeconomic forecasts: official interest rates (end of period)

	2008	2009	2010	2011	2012
US	0.61	0.25	0.25	0.25	0.25
EMU	2.73	1.00	1.00	1.00	1.00
China	5.31	5.31	5.81	6.56	6.81

Closing date: 4 November 2011
Source: BBVA Research

Table 12
EMU: macroeconomic forecasts (yoy change, %, unless otherwise indicated)

	2008	2009	2010	2011	2012
Real GDP	0.3	-4.2	1.7	1.7	1.0
Household consumption:	0.3	-1.2	0.8	0.5	0.7
Public consumption	2.3	2.5	0.5	0.3	0.1
GFCF	-1.2	-12.0	-1.0	2.4	1.7
Capital goods and other products	0.8	-16.2	3.1	5.0	3.0
Construction	-2.6	-8.7	-4.1	-0.4	-0.4
Housing	-5.3	-11.3	-3.6	1.5	-0.1
Domestic demand (Contribution to GDP growth)	0.3	-3.5	1.0	1.0	0.8
Exports	0.7	-12.9	10.6	6.1	2.5
Imports	0.7	-11.7	8.9	4.7	2.1
Net exports (Contribution to GDP growth)	0.0	-0.7	0.8	0.7	0.3
Pro-memoria					
GDP w/out housing investment	0.6	-3.8	2.0	1.7	1.1
GDP w/out construction	0.7	-3.7	2.4	1.9	1.2
Employment (LFS)	0.9	-1.8	-0.5	0.3	0.6
Unemployment rate (% active pop.)	7.6	9.4	10.4	10.6	10.7
Current account balance (% GDP)	-1.1	-0.8	-0.5	0.0	0.2
Public sector balance (% GDP)	-2.0	-6.3	-6.2	-4.5	-3.4
CPI annual average	3.3	0.3	1.6	2.6	1.6

Closing date: 4 November 2011
Source: official institutions and BBVA Research

Table 13

Spain: macroeconomic forecasts (yoy change, %, unless otherwise indicated)

	2008	2009	2010	2011	2012
Activity					
Real GDP	0.9	-3.7	-0.1	0.8	1.0
Private consumption	-0.6	-4.3	1.3	0.4	0.5
Public consumption	5.8	3.2	-0.7	-0.3	-2.7
Gross fixed capital formation	-4.8	-16.0	-7.5	-5.1	-0.6
Capital goods	-3.0	-21.2	-2.1	-0.5	2.8
Construction	-5.9	-11.9	-11.1	-8.7	-3.2
Housing	-10.7	-24.5	-16.5	-7.4	0.9
Domestic demand (Contribution to GDP growth)	-0.6	-6.4	-1.1	-1.0	-0.4
Exports of goods and services	-1.1	-11.6	10.3	10.1	5.1
Imports of goods and services	-5.3	-17.8	5.5	3.0	-0.3
Net exports (Contribution to GDP growth)	1.5	2.7	1.0	1.8	1.4
GDP at current prices	3.3	-3.1	0.8	3.0	3.3
(Billion euros)	1,088.1	1,053.9	1,062.6	1,094.7	1,130.7
Labour market					
Employment (LFS)	-0.5	-6.8	-2.3	-1.7	-0.8
Unemployment rate (% active pop.)	11.3	18.0	20.1	21.5	22.1
Employment QSNA (equivalent to full-time)	-0.5	-6.6	-2.4	-1.7	-0.9
Productivity	1.4	2.9	2.2	2.5	1.9
Precios y costes					
CPI (annual average)	4.1	-0.3	1.8	3.1	1.2
GDP deflator	2.4	0.6	1.0	2.2	2.3
Household consumption deflator	3.5	0.1	2.8	3.6	0.8
Compensation per employee	6.4	4.1	0.7	2.5	3.4
Unit labour cost (ULC)	5.0	1.2	-1.5	-0.1	1.5
Foreign trade					
Public Administration balance (% of GDP)	-9.6	-5.2	-4.5	-4.5	-3.0
Government sector					
Debt (% GDP)	39.8	53.3	60.1	65.1	67.6
Public Administration balance (% of GDP)	-4.2	-11.1	-9.2	-6.5	-4.4
Hogares					
Nominal disposable income	6.0	1.7	-1.8	0.1	1.7
Savings rate (% of nominal income)	13.5	18.1	13.1	9.7	10.0

Note: observed and forecast data consistent with QSNA base 2000.
Closing date: 4 November 2011
Source: official institutions and BBVA Research

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