Economic Watch

Spain

Madrid, 4 January 2012
Economic Analysis

Spain Unit

2011 ends with GDP contraction in the fourth quarter and average annual growth of 0.7%

- **4Q11 data point towards a contraction of GDP**
  If the trends shown by available indicators at the dead line of this Economic Watch persist, GDP growth would have contracted by between 0.1% and 0.2% qoq in 4Q11. This would confirm the deterioration in growth prospects observed since 2Q11.

- **Consumption and investment indicators signal weakening internal demand**
  Domestic demand has been affected by an uncertain environment, the fiscal consolidation process and the persistence of financial tensions, specially in Europe. Particularly, the pace of job destruction in 4Q11 drove down household spending, while the reduction in VAT did not stop housing demand from remaining at historic lows.

- **October trade balance figures suggest a slowdown in exports in the last quarter of the year**
  Slower growth in the developed economies, coupled with the decline in consumer and business confidence among our main trade partners and increased uncertainty in the international financial markets have continued to fuel downside risks.

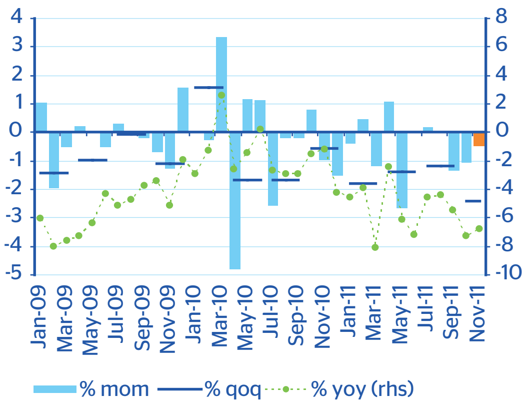
- **The significant deviation (close to 2pp of GDP) from the public deficit target for 2011 is a blow for the announced fiscal consolidation process and means that further adjustments will be necessary**
  The government's determination to address this deviation rapidly is well-received and is necessary to prevent a loss of confidence by investors. If the 2011 target had been met, the government would have only needed to reduce the deficit by 1.5 of GDP in 2012. The current deviation announced means that further measures will be necessary, these will primarily affect the autonomous communities and will have an impact on internal demand growth in 2012. This will probably be reflected in the economic outlook we will describe in our February edition of Spain Economic Outlook.

Consumer spending declined in 4Q11

Once seasonally and working day adjusted (SWDA), real retail sales fell 0.5% mom in November compared to the stagnation expected. All products, except for personal goods (clothing, shoes, cosmetics, etc.), contributed to the negative performance of this indicator. Given the drop registered in October and assuming that December figures will be in line with forecasts, retail sales will have fallen 2.4% in 4Q11 qoq (SWDA).

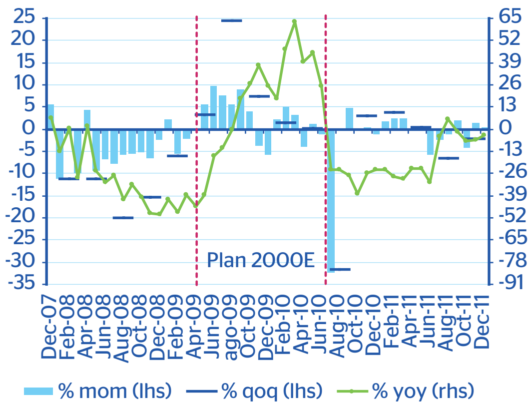
Demand for cars also decreased in 4Q11, although the positive figures seen in November (1.4% mom SWDA) and December (0.5% mom SWDA) have eased the pace of this decline. The number of cars registered also fell 2.1% qoq (SWDA) between September and December compared to the fall of 6.5% qoq recorded in 3Q11. The rise in demand from rental companies (in November) and businesses (October and December) was not sufficient to offset the ongoing drop in purchases of private vehicles in 4Q11.

Chart 1
Spain: retail sales (constant prices. SWDA data)



SWDA: seasonally and working day adjusted
Source: BBVA Research based on INE data

Chart 2
Spain: car registrations (SWDA data)



SWDA: seasonally and working day adjusted
Source: BBVA Research based on ANFAC and Ganvam

Real estate market activity remains at historic lows

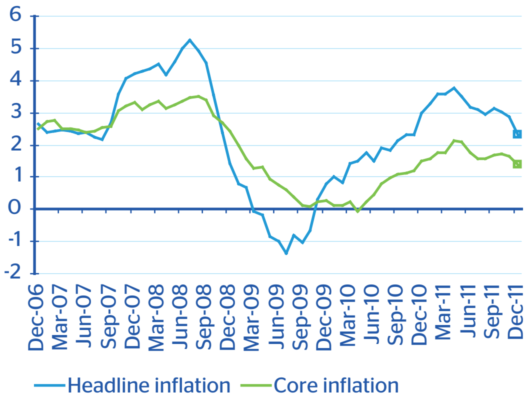
Although in October the decline in purchases (0.7% mom SWDA) was lower than in the two preceding months, housing demand is still not showing any clear signs of recovery. Therefore, home purchases in October remain at historic lows, and are still shaped by the ongoing financial tensions, economic weakness and fiscal uncertainty surrounding property transactions. In the economic context seen in the last quarter of the year, the reduction in VAT is not having a great deal of effect on demand. It is observed in mortgage activity: mortgages granted to purchase homes dropped 7.0% mom (SWDA) in October. Construction activity once again contracted; in October 5.9 thousand of new construction permits were issued, a drop of 21.7% mom (SWDA) and home rehabilitation permits also declined by 6.0% mom (SWDA).

The leading CPI indicator signals a significant slowdown in annual inflation in December

According to the leading CPI indicator, annual inflation has slowed by 0.5 percentage points (pp) to 2.4% yoy[1]. Our forecasts indicate that the main reason for this slowdown is the more moderate growth in energy prices but also the lower increase in processed food prices, while inflation in the services and non-energy industrial goods has held relatively stable. As our result, our base scenario points to a slowdown in underlying inflation of around 0.3pp to 1.4% yoy.

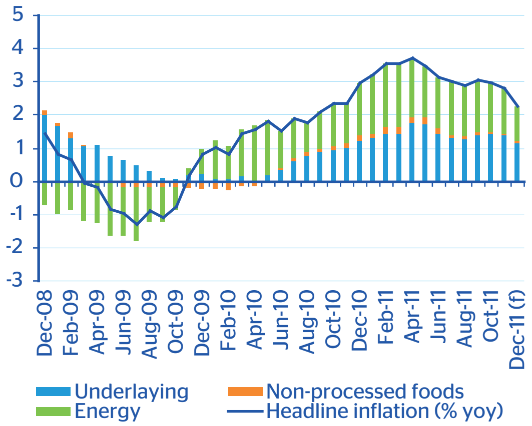
1: Definitive inflation figures published on 13 January could differ from leading data.

Chart 3
Spain: inflation (yoy change)



Source: BBVA Research based on INE data

Chart 4
Spain: contributions to headline inflation growth



Source: BBVA Research based on INE data

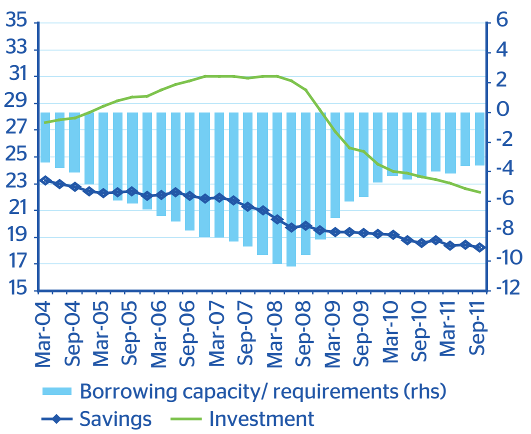
Spain's borrowing requirement in 3Q11 was 3.5% of GDP, 0.1pp less than in 2Q11

Spain's borrowing requirement adjustment continues. At the close of the third quarter, Spain's borrowing requirement was 3.5% of GDP (cumulative annual figure), 0.1pp less than in 2Q11. This difference is the result of the slightly lower fall in investment (from 22.6% of GDP in 2Q11 to 22.4%) compared to savings which fell only 0.1pp to 18.3% of GDP. The borrowing capacity of households was reduced further in 3Q11 (cumulative annual figure), to 4.2% of gross disposable income, from 4.7% in 2Q11 due to the decline in savings (from 12.6% of gross disposable income in 2Q11 to 12.0%) and with investment holding steady at around 8.9% of gross disposable income.

From a business standpoint, a slight uptick in investment is observed (0.1pp to 12.4% of GDP) offset by the increase in savings (0.2pp to 12.8% of GDP). As a result, the borrowing capacity of companies (cumulative annual figures) was largely unaltered at around 1.7% of GDP in 3Q11.

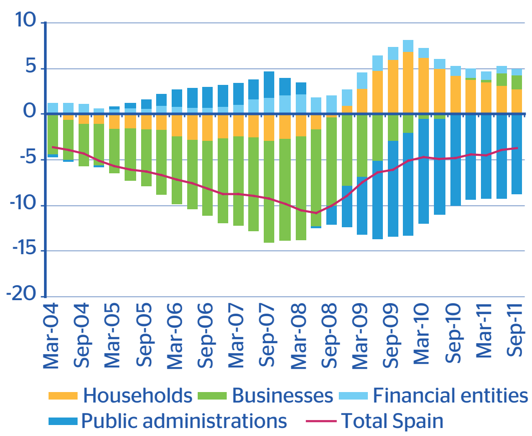
After remaining unchanged for three quarters, the public administration balance was reduced by 0.4pp to 8.8% of GDP in 3Q11. The reduction of the deficit has been caused by two factors: the slight improvement in the savings rate (-4.6% of GDP) and a further contraction in public investment (-0.3pp on the 3.5% of cumulative GDP in 2Q11).

Chart 5
Spain: savings and investment (% GDP, cumulative annual figure)



Source: BBVA Research based on INE data

Chart 6
Spain: borrowing capacity/requirements by agent (% GDP, cumulative annual figure)



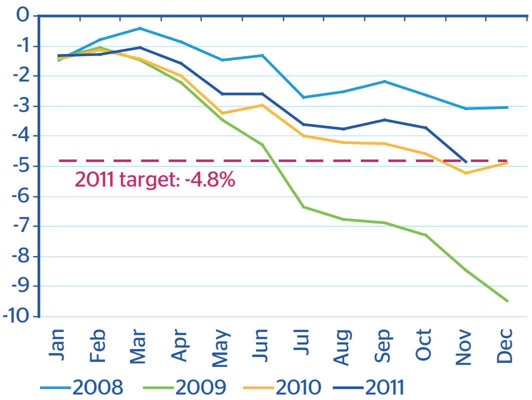
Source: BBVA Research based on INE data

Although the cumulative deficit to November 2011 stood at 4.84% of GDP, the scope of the deviation from the target will depend on the budget outturn in December

The November figure was affected mainly by the negative impact of the change in methodology introduced with the new base 2008, which brings forward investment costs (previously held to the end of the year) and puts back tax receipts to the moment of accrual. In practice, this led to a revenue reduction (by around 1.2pp of GDP), which will have corrected in December when revenues from personal income tax, corporate tax and VAT are included that are receivable in January and February 2012. If these adjustments had not been made, the cumulative deficit to November would have been around 3.28% of GDP but, because of not fulfil 2011 deficit target, December deficit had been particularly important.

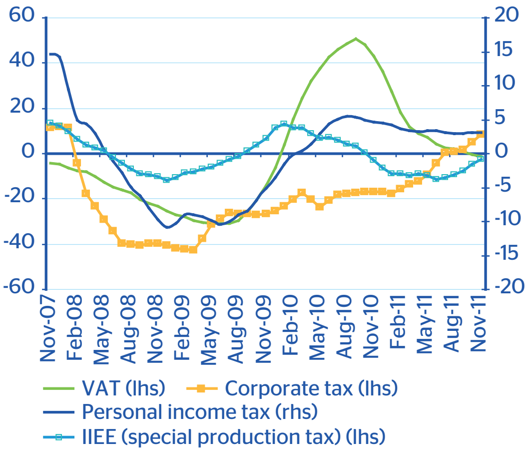
Data to November continue to reflect a sharp adjustment in non-financial expenditure which affects practically all expense items. The largest adjustments were recorded in capital expenditure (down almost 40% compared to the same period in 2010) and in current transfers between public administrations, which fell by around 20%, due to the decline in transfers to autonomous communities caused by fewer down payments in the financing system. At the same time, interest expense continues to mark yoy growth of over 20%. Tax revenue through to November 2011 increased by 0.9% overall yoy in like-for-like terms, performing slightly better than the previous month due mainly to revenues from inspections (1,420 million euros). This is mainly because of the ongoing rebound in personal income tax receipts, some improvement in the VAT base and the slight rise in corporate tax receipts. The improvement in corporate tax receipts was due to the higher revenues from inspections and the positive impact of changes in legislation (tax hikes and limit on the adjustment of goodwill and tax loss carryforwards), that should significantly boost growth in this item in December.

Chart 7
Central government: non-financial balance (cumulative annual, % of GDP)



Source: BBVA Research based on MEH and INE data

Chart 8
Spain: fiscal revenue (yoy change like-for-like in 12m centred moving average)



Source: BBVA Research based on MEH and INE data

Cabinet approves agreement of non-budgetary availability for 8.9 billion euros and 6.1 billion euros tax hike

In anticipation of a potential deviation from the 2011 public deficit target, the Spanish government has announced adjustment measures for a total amount of 15 billion euros. 60% of the required adjustment will be achieved by significantly reducing government spending (8.9 billion euros), and the remaining 40% by raising taxes (mainly direct taxes) which is expected to raise around 6.1 billion euros. Specifically, marginal rates on income and capital will rise substantially (7 and 6 points, respectively).

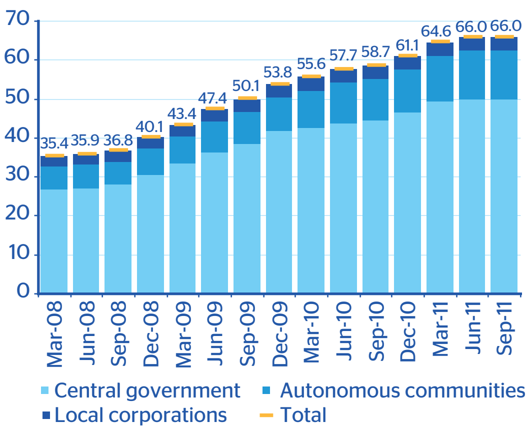
If the 2011 target had been met, the government would have only needed to reduce the deficit by 1.5% of GDP in 2012. The current deviation means that further measures will be necessary and these (approximately two thirds) will primarily affect the autonomous communities. Furthermore, 2012 revenue will also fall short of the targets set in the previous government's Stability Programme (which specified real GDP growth of 2.3% in 2012), requiring further adjustments to meet the deficit target of 4.4%.

Spanish public debt grew at a slower pace in 3Q11, remaining at 66% of GDP

Public debt remained unchanged at 66.0% of GDP in 3Q11, with a cumulative annual increase of 4.9pp on December 2010. This slowdown in the pace of growth was observed in all areas of public administration, although it was particularly evident in central government, where debt scarcely increased, and, above all, in local corporations which reduced their debt by 0.1pp of GDP. The total debt increase seen in the autonomous communities (1.4pp) was in line with the 3Q11 deficit (1.2% of GDP). Although debt increased in all the autonomous communities, the scale of the increase was uneven. Catalonia, La Rioja and Cantabria saw the largest debt increases (significantly higher than their cumulative deficit in 3Q11). Meanwhile, the Canary Islands, Madrid, the Basque Country and Andalusia showed the smallest increases, in line with their registered deficits. As a result, Valencia, Catalonia, Castile-La Mancha and the Balearic Islands are still the regions with the highest relative debt levels (much higher than the average regional figure of 12.6% of GDP). By instrument, loans continue to grow faster than securities issues due mainly to the autonomous communities' limited access to the wholesale markets.

Chart 9

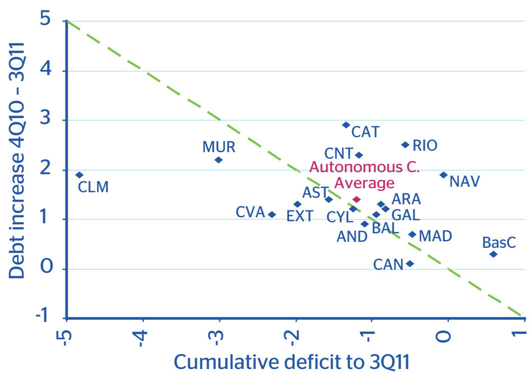
Spain: public debt performance according to the protocol of excessive deficit (% GDP)



Source: BBVA Research based on MEH and INE data

Chart 10

Spain: deficit and debt increases in autonomous communities at 3Q11 (% regional GDP)

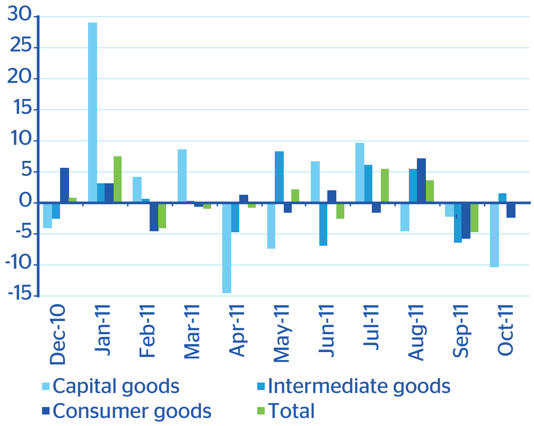


Source: BBVA Research based on MEH and INE data

October trade balance figures suggest a slowdown in exports in the last quarter of the year

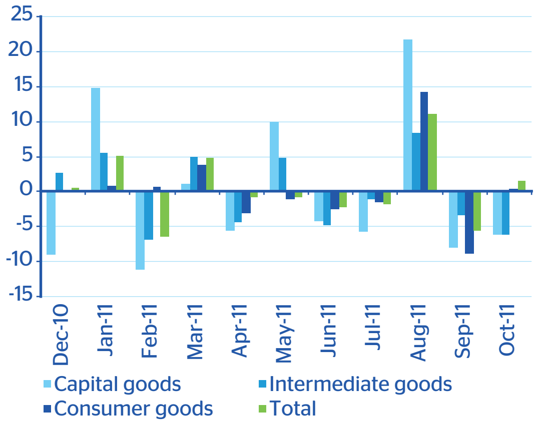
Volumes for October, adjusted for seasonal and calendar effects, reflected a slight contraction in goods exports (-0.1% mom, SWDA) following the downward correction to July and August figures seen in September. In the largest export sectors, weakness owed mainly to the decline in capital goods (-10.2% mom SWDA) and consumer goods (-2.3% mom SWDA). At the same time, imports grew slightly (+1.5% mom SWDA), albeit reversing the slump witnessed in September. Imports of capital and intermediate goods were the poorest performers. Therefore, the October trade balance figure heralds a significant slowdown in exports in the year's fourth quarter following the rebound seen in the 3Q (3Q11: +5.4% qoq SWDA) due to weak global growth and ongoing financing tensions in the eurozone.

Chart 11
Goods exports volumes, large sectors (% mom; SWDA)



Source: BBVA Research based on Customs data

Chart 12
Goods imports volumes, large sectors (% mom; SWDA)



Source: BBVA Research based on Customs data

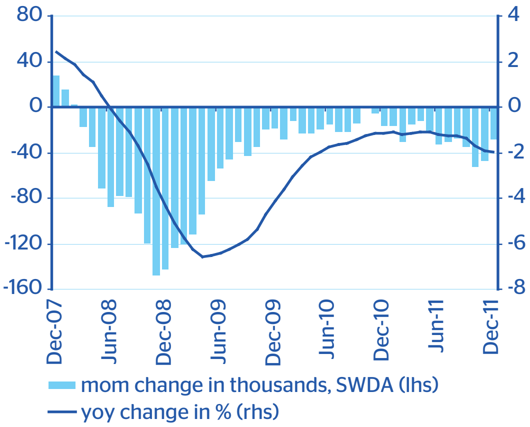
The October current account balance stood at -39 billion euros, 3 billion less than September's figure

The 12-month cumulative current account deficit was reduced by 3.1 billion to October 2011, standing at -39 billion euros. The sharp adjustment in the balance of goods deficit was notable (100 million euros less), in line with the stabilisation observed in the October trade deficit. The 12-month cumulative surplus in services was close to 34 billion euros (up 1 billion euros) in October. The income deficit increased by 300 million euros, offset by the transfer balance deficit which dropped sharply by around 2.2 billion euros.

December job market figures were better than expected but not enough to avoid the pace of job destruction in 4Q11

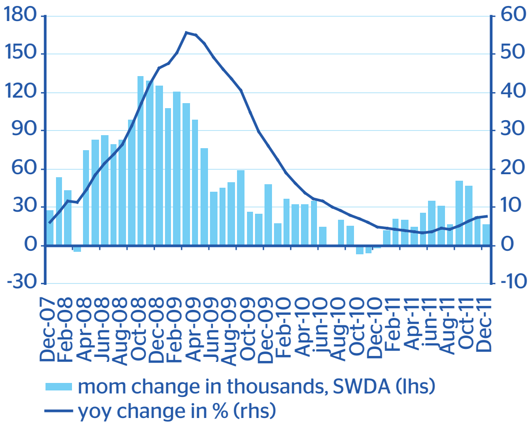
Further jobs were destroyed on the labour market in December but less than in the two preceding months. Correcting for seasonal and calendar effects, forecasts suggest a decline in Social Security affiliations of 28,000 (19,000 less than in November) and an increase of 17,000 in registered unemployment (6,000 less than in November). While all productive sectors marked a better-than-expected performance, corrected data indicate that non-farm activities continued to destroy jobs in December. In 4Q11 as a whole, affiliations fell further (0.7% qoq SWDA), while registered unemployment increased by 2.5% qoq (SWDA), suggesting a decline in activity during the fourth quarter.

Chart 13
Spain: average social security affiliation



Source: BBVA Research based on MTIN

Chart 14
Spain: registered unemployment

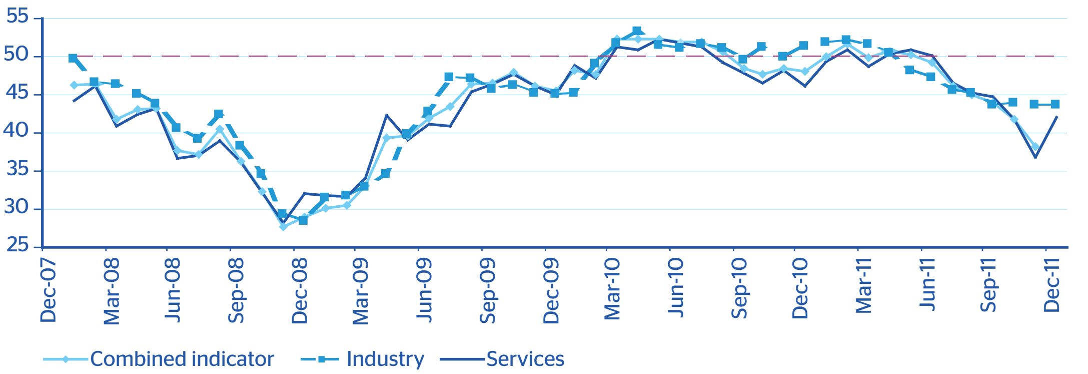


Source: BBVA Research based on SPEE

Despite the slower decline seen in December, purchasing indicators in industry and services confirm the drop in economic activity in 4Q11

While the manufacturing and services price indicators (PMIs) signal a slowdown in the pace of deterioration in activity in December (in line with labour market data), the negative figures observed in October and November will shape economic performance in 4Q11, skewing growth forecasts downwards.

Chart 15
Spain: PMIs*



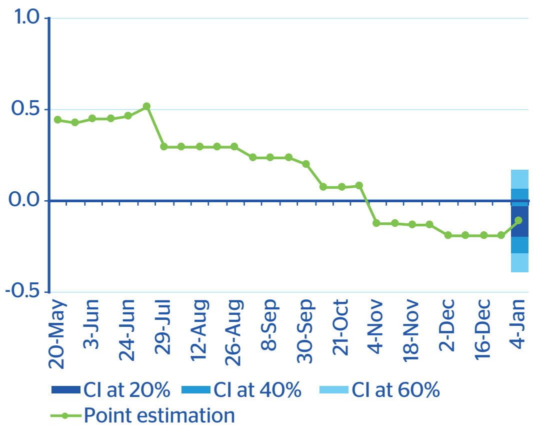
* SWDA data. Levels above 50 indicate expansion.
Source: BBVA Research based on Markit Economics

The probability of GDP contraction in 4Q11 remains high

On around 80% of 4Q11 data, the real time GDP growth forecast for 4Q11 stands at between -0.1% and -0.2% qoq using the MICA-BBVA model developed by BBVA Research. As we mentioned in our last quarterly Spain Economic Outlook report published in early November[2], downside risks have increased. Therefore, the probability of a decrease in Spanish GDP in 4Q11 has risen to 67%. Whether the outlook for lower growth gathers momentum will depend on policies adopted both externally and internally.

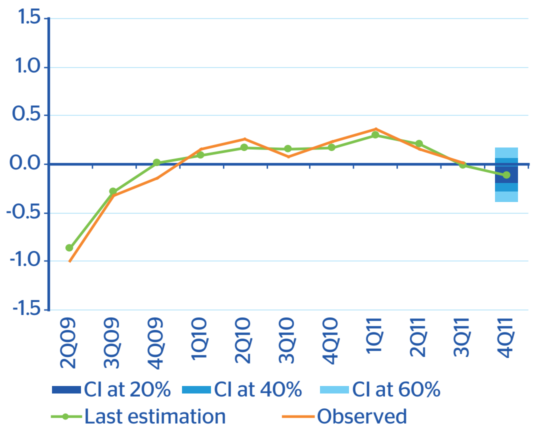
2: Available at: http://www.bbvaresearch.com/KETD/ketd/bin/ing/publi/espana/novedades/detalle/348_235059.jsp?id=tcm:348-176089-64

Chart 16
Spain: 4Q11 GDP growth forecasts using the MICA-BBVA model by forecast date (% qoq)



Source: BBVA Research

Chart 17
Spain: GDP growth observed and forecasts using MICA-BBVA model (% qoq)



Current forecast: 4 January 2012.
Source: BBVA Research based on INE data

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