

# Economic Outlook

## Spain

Third Quarter 2012  
Economic Analysis

- **Questions surrounding economic policy may cause** the global economic slowdown to deepen.
- **Europe: agreed measures must be implemented quickly and efficiently** to speed up the recovery.
- **Spain: continued financial stress** could cause activity to contract further in 2013.
- **With more credible fiscal targets and decisive measures,** efforts should now be geared towards execution and reforms to boost Spain's potential growth.

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Closing date: August 3, 2012

## 1. Editorial

The real economy deteriorated in the first two quarters of the year, as expected. However, our expectations are now more downbeat than three months ago, as we believe it will take more time before the Spanish economy achieves any sustained recovery. On our current forecasts, Spanish GDP should contract by 1.4% in both 2012 and 2013, leading to further job losses in the coming months. The worse outlook is due to the uncertainties surrounding the policies needed to clear up Europe's solvency and liquidity issues and those required to remove market uncertainty surrounding the risk of a break-up of the single currency. As a result, Europe's economy looks set to struggle in 2012 and 2013 and therefore is unlikely to give any boost or support to the Spanish economy. Meanwhile, confidence in the market over Spain's ability to deliver its fiscal commitments and proceed towards a rapid and definitive restructuring of part of the country's financial system has eroded. Loss of confidence in the eurozone and Spain has brought foreign capital inflows to a halt, causing public sector funding costs to soar and the domestic private sector to rely more heavily on Eurosystem funds. The closure of markets and scale of funding costs: 1) lead to a great deal of uncertainty regarding decisions by economic agents; 2) undermine the positive impact of ECB monetary policy on the Spanish economy, unlike on other economies; and 3) exacerbate the negative impact of fiscal contraction, by preventing the risk premiums from coming down as they would under normal circumstances. All these factors are behind the change in outlook and the prospects of a further decline in activity.

The upside or downside risks to this scenario will depend on how fast and how efficiently the series of instruments and policies announced in recent weeks are implemented. First, amid this scenario, the Spanish government decided -fittingly- to ask its European partners for financial aid so it can recapitalise the country's banks. This aid is good news, as: 1) the volume granted easily surpasses the banking system's capital requirements, 2) is awarded before these needs are disclosed, 3) lends credibility to the process by involving European authorities and 4) sets a pre-defined repayment schedule. More importantly, although the potential liabilities assumed in this respect should be manageable given the level of Spanish public debt, there is the possibility of transferring them to the European Stability Mechanism (ESM) once a single supervisor for banks in Europe is set up. If these transfers are confirmed over the next few quarters, a major step will have been taken towards clearing up one of the main problems affecting Europe in general and Spain in particular: the sovereign-bank risk feedback loop.

Meanwhile, the conditions imposed on the Spanish economy as a result of the aid are reasonable and include measures that we have been proposing in this report since the onset of the crisis. For instance, no further fiscal commitments were required beyond those already assumed, with the European Commission bearing in mind the new economic paradigm in setting deficit targets in line with the outlook for further deterioration by the Spanish economy. That said, given Spain's budget deviation in 2011, the size of fiscal adjustment necessary to meet the 2012 target is still large (around 5% of GDP), while the combined effort for 2013 could amount to over 7% of GDP. The government has unveiled a number of measures that increase the chances of its meeting the 2012 target. Moreover, it has chosen fiscal policy instruments to buffer the negative impact of fiscal consolidation on economic activity, raising indirect taxes, cutting back on current expenditure and announcing a reduction in direct taxes from 2013. At any rate, there are still risks going forward. First, there is the risk of meeting the 2013 budget targets if, as we suggest in this report, the economic recession will be similar to this year's. Second, there is considerable execution risk, related mainly to the ability of the regional governments to comply strictly with the commitments assumed in the 2012-2014 economic-financial rebalancing plans (EFPs). Taking away the Christmas extra pay of civil servants should help the regional governments clarify doubts surrounding the effectiveness of certain policies included in the EFPs (e.g. revenues from privatisations). In addition, certain measures were deemed temporary, where they should be permanent budget adjustments, pushing back part of the fiscal contraction a few years. Even so, the central as well as the regional governments have garnered credibility by implementing the mechanisms and timetables included in the Budget Stability Law.

The government has also announced a schedule for reforms focusing on areas that have traditionally precluded the Spanish economy from making competitiveness gains. The anchor provided by the ambitious labour reform carried out should be reinforced with strong actions to improve the outlook for public finance and the growth of the Spanish economy in the medium term.

In any case, the measures being adopted, while positive, need time to mature, prove their effectiveness and achieve the desired objectives. For instance, in respect of growth, data for the coming quarters should show that the Spanish economy continues to contract. In addition, many of the fiscal measures are concentrated at the end of the year, either because of the delay in the effectiveness of the budgets or the presentation of the regional EFPs or because they were designed to take effect then. As a result, it should take some time before there is a significant improvement in the public deficit.

The measures announced in Europe also need time to produce the desired results. Approval of a single EU bank supervisor is unlikely to come until at least after the end of this year. The start-up of mechanisms to transfer debt from the recapitalisation of Spanish banks to the ESM will not before the first half of 2013 at the earliest.

All this means it will still be some time before the uncertainties surrounding the success of the policies implemented in Spain and Europe are cleared up. A stronger commitment between Spain and Europe's institutions is needed to prevent this from triggering bouts of high volatility in financial markets that feed the vicious circle in which the economy is immersed. The Spanish government has adopted most of the necessary fiscal measures. Now it needs to make further reforms that enable the economy to grow, thereby ensuring a quicker exit from recession when recovery begins. Meanwhile, Europe's institutions need to make major inroads at institutional level to help resolve the debt crisis faster. They also need to back the policies implemented by Spain, making more efficient use of the mechanisms available to lower Spain's risk premium and guaranteeing that it is in line with the fundamentals of the Spanish economy.

## 2. Summary: a slowdown that may deepen unless decisive economic policy action is taken

### Global growth will improve only if key economic policy measures are fully implemented in time. Some of them have already been approved but others are still under consideration

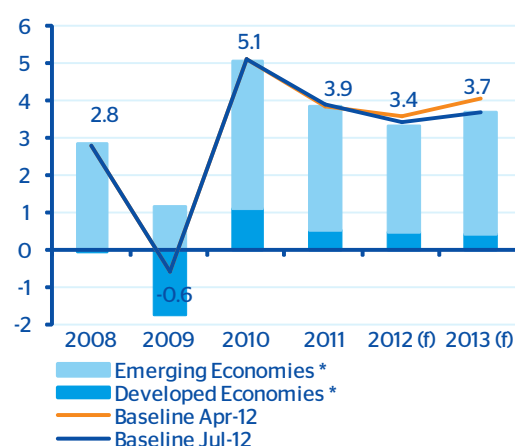
After the deterioration in global economic conditions in the first part of 2012, our current scenario that still envisages a slight economic rebound in 2013 is very dependent on economic-policy issues. Our global GDP growth forecast stands at around 3.5% in 2012-13, but relies on the assumption that several policy measures are implemented around the world. Some of them have already been brought into force but need appropriate implementation; others have been announced but not introduced yet; and, finally, some key measures still have yet to be passed. Policy measures must avoid a financial mess in Europe, an automatic fiscal adjustment in the US in 2013, and help reach higher growth rates in emerging economies. However, if economic policies fail to achieve their goals, the slowdown now in place since 2011 is likely to intensify in 2012 and 2013. That could leave 2013 global GDP growth at its slowest pace in 30 years (except for the 2009 recession).

At a summit in June, the eurozone leaders reached agreements in the right direction to reinforce the currency union: single bank supervision in the euro area, far-reaching plans covering banking and fiscal issues, and growth-supporting measures. However, financial-aid mechanisms that have been approved to ensure financial stability in the eurozone (i.e., EFSF&ESM) must be used in their full capabilities as soon as possible to avoid a financial "accident."<sup>1</sup> This is the only way to make sure that those economies currently struggling to access financial markets have the chance to implement fiscal-consolidation plans and structural reforms. This should include the involvement of the ECB.

In the US, there must be an agreement to prevent that automatic spending-cut measures and the expiration of tax cuts come into force at the beginning of 2013. This "fiscal cliff" would not solve long-term sustainability of the country's public finances and, if all measures materialized, they would push the US economy back into recession in 2013. As the presidential campaign makes any kind of agreement difficult until the election, the surrounding uncertainty over the outcome of this process is likely to play a key role in shaping the economic and financial outlook as we move towards the end of the year.

Chart 1

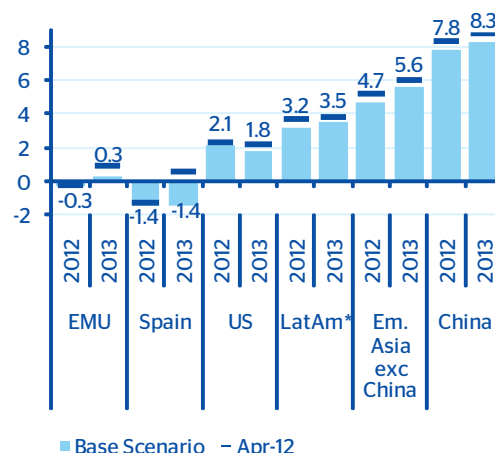
Global GDP growth (%)



(\*) Growth contributions  
Source: BBVA Research

Chart 2

GDP growth by area (%)



(\*) Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela  
Source: BBVA Research

1: The financial "accident" could take various forms, including for example the lack of demand for sovereign-bond issuances of peripheral economies.

Meanwhile, in emerging economies with room for policy stimulus, measures are needed to prop up domestic demand so that the effects of the external slowdown are mitigated. Additionally, volatility of capital inflows could increase due to the ebbs and flows of the eurozone crisis and, on the other hand, flows related to a new round of quantitative easing the US Fed is likely to embark on.

## **Failure to dovetail sovereignty transfer with debt mutualisation at the rhythm that markets demand drags the euro crisis out**

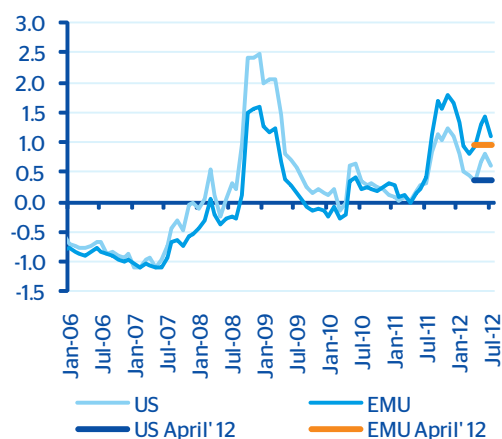
The main uncertainty over the current economic scenario is whether the efforts that the eurozone countries will have to make to reinforce its governance will be preceded by a further deterioration in its financial situation. If this were the case, we think that it will produce massive interventions from EU mechanisms to eventually assure the financial stability of the eurozone. The decisions already taken, if implemented forcefully could suffice but that requires that the measures approved at the end of June are implemented quickly. Those measures aimed to eliminate the risk emerging from the sovereign-banking feedback loop in Spain and to stabilise financial markets across the eurozone with the active use of the EFSF and later on of the ESM actively purchasing bonds in the primary and secondary market. Recent policy measures in Spain to reign in the deficit together with the strongly supportive stance by the President of the ECB are helping to ease tensions.

All in all we have revised downwards our previous forecast (released three months ago) due to continued financial stress stemming from the euro area crisis and ongoing deterioration in global economic confidence. This scenario implies a period of stagnation in the eurozone in 2012-13. Despite this revision, in our view, the balance of risks continues to be tilted to the downside, given the likelihood that approved measures are introduced too slowly due to domestic-policy considerations in some countries. If that were to happen, then the risk of a recession in Europe in 2013 would be relevant, specially in countries such as Spain and Italy.

Eurozone countries have to solve the liquidity squeeze on some markets. Those constraints are a consequence of market participants assigning some chance that a euro break-up may occur. Euro countries are unable to dovetail the transfer of fiscal and banking sovereignty with effective mechanisms of reduction of imbalances at the rhythm that markets demand. As long as this situation continues, the risk of a euro break-up is fuelling the fragmentation of financial flows across the eurozone and impeding funding access for those economies with a net debt position with the rest of the zone. A fast implementation of financial-aid mechanisms and their reinforcement in terms of size and access to ECB's funding are key factors to eliminate the risk of a eurozone break up. However, in our opinion this extreme outcome is a tail risk; sooner or later, the measures needed to set up common institutions for banking supervision, deposit guarantee and banking resolution will be approved. Although there is political will to reinforce European currency-union institutions and governance, the implementation of appropriate measures are lagging behind. In the end, those measures will imply a transfer of national sovereignty to the European institutions and, at the end of the process, some form of liability sharing (debt mutualisation). That will also happen as for the fiscal policy, for example in the form of national consolidation plans having to be submitted to European institutions. If the challenges ahead are met satisfactorily, global growth could gradually gain traction during 2H12.

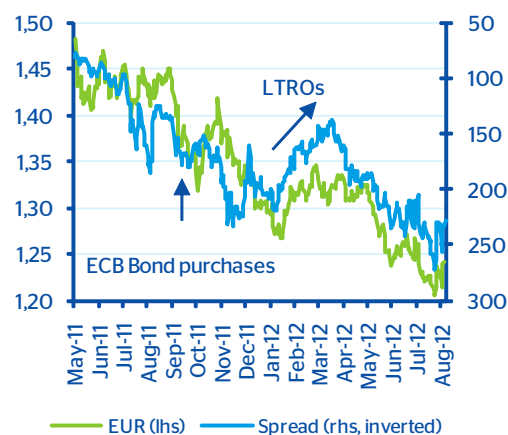
In the case of the US, the downward revision to our outlook for 2012 and beyond has been driven by a combination of disappointing growth figures in 1H12 and the impact of a high financial stress coming from the euro area. As a result, emerging economies are likely to be the main drivers behind the slight acceleration in global GDP we expect for 2013. In Latin America, despite a generalised downward revision in growth forecasts compared with three months ago, estimates for Mexico (3.7% and 3.0% for 2012 and 2013, respectively) remain unchanged thanks to upbeat activity data in 1H12, the continuation of favourable financing conditions in the domestic market, and gains in competitiveness. In Brazil, growth forecasts have been significantly revised downwards (to 2.2% from 3.3% in 2012) due to the impact of the external environment and to some domestic issues such as the slowdown in credit markets and increasing competitiveness problems. Even though activity is still expected to recover in the quarters ahead following the unprecedented softening of monetary conditions, the recent moderation warns against the current growth model and its excessive focus on private consumption and credit expansion.

Chart 3  
BBVA Financial Stress Index (\*)



(\*) Tracks the trend of a series of financial variables, including: stock market volatility; interest rates and exchange rates; sovereign, credit, and corporate risk; and liquidity tensions  
Source: BBVA Research

Chart 4  
Dollar-euro exchange rate and Spanish and Italian risk premiums. Simple average spread vs. 10Y Bund, bp; index 1 Jan 11=100



Source: BBVA Research and EPFR

As for Asia, growth in the first half of the year slowed in China more than expected. In line with the weaker global outlook, we have accordingly revised our projections for 2012-13 down. Nevertheless, monetary and fiscal measures to support growth should lead to a pickup, with growth in 2013 rising to 8.3%, a half percentage point higher than in 2012. Elsewhere in the Asia region there is also room for policy stimulus to support growth. But there are downside risks, including a more severe worsening of external demand and a continued slowdown in China, exacerbated by ongoing domestic financial fragilities.

### 3. Growth prospects for the Spanish economy

The recession will last until 2013

#### **Despite progress in addressing the problems of European governance, bank restructuring and the fiscal consolidation process...**

The economic outlook for Spain has become worse over the last three months. Financial stress in Europe has heightened since mid May, causing Spain's funding costs to rise and hampering access to external finance. This has conditioned economic policy decisions not only in Spain, but in the rest of the eurozone as well. Specifically, a financial aid package was agreed to achieve a definitive restructuring of part of the Spanish banking industry (see Box 1). In addition, a major step was taken to break up the sovereign-bank risk feedback loop, opening the door for direct bank recapitalisation by the European Stability Mechanism (ESM) subject to the creation of a single EU bank supervisor<sup>2</sup>. Lastly, the Spanish government passed a new set of fiscal measures to bring the adjustment to public accounts into line with the new targets agreed with the European Union (see Box 2)<sup>3</sup>. All this, however, has not been enough to dispel doubts surrounding the credibility of the European roadmap, let alone the ability of the Spanish economy to deliver on its commitments. Although the measures adopted may be enough, they need time to produce results. Meanwhile, financial stress will remain high. This, coupled with faster fiscal adjustments, is likely to continue undermining Spain's short- and medium-term growth prospects.

#### **...factors shaping the Spanish economy in the short term indicate it will continue to struggle considerably**

In all, a number of factors indicate Spain's latest economic recession will last until next year. First, access to external finance is likely to remain limited over the coming months, not to mention relatively more expensive for both the public and private sectors than we had forecast in our previous Spain Economic Outlook report. Second, heightened financial stress has hampered growth prospects for Europe, which will mean weaker foreign demand for goods and services produced in Spain. Third, the announcement of new fiscal measures in Spain and the increase in the country's risk premium to all-time levels will exacerbate the potentially negative impact of the contractionary fiscal policy on the economy by limiting the transmission mechanisms of monetary policy or shoring up confidence. Despite the new budget measures –targeting indirect taxes and current spending– this should lend credibility to the adjustment and minimise the adverse impact on growth.

Even so, certain factors will continue to act as a counterbalance. As for external factors, the monetary (and liquidity) policy of the European Central Bank (ECB) should continue to provide support to aggregate demand and financial stability. This, coupled with growth differentials between Europe and the rest of the world, should continue to exert downward pressure on the euro's exchange rate, contributing positively to competitiveness gains for exporters. Elsewhere, while geopolitical tensions are likely to continue posing a risk, oil prices have come down sharply compared to our May forecasts. This should provide Spain's productive system with some break in the short term given its dependence on energy.

Turning to domestic factors, the Supplier Payment Programme –the related funds represent around 2.5% of GDP– should continue to have a positive (albeit temporary) impact on spending in the coming months<sup>4</sup>. In addition, the announced reduction in employer social security contributions, alongside the VAT hike, combine to create a “fiscal devaluation” that should make Spanish companies more competitive vis-à-vis their foreign counterparts. Lastly, the government has unveiled an ambitious schedule of structural reforms for the second half of the year. On top of the labour reform already passed, these could stem job destruction and lay the foundations for a stronger recovery in the medium term.

2: The terms of the agreement are included in the Memorandum of Understanding signed on 20 July and available at: <http://www.mineco.gob.es/portal/site/mineco/menuitem.aa5c961c0709f0fe3e85b782026041a0/?vgnextoid=7c9f2f207c415310VgnVCM1000001d04140aRCRD>

3: Royal Decree-Law 20/2012, of 13 July, on measures aimed at assuring budgetary stability and encouraging competitiveness, available at: <http://www.boe.es/boe/dias/2012/02/14/pdfs/BOE-A-2012-9364.pdf>.

4: For an assessment of the impact of the Supplier Payment Programme, see Box 3 of the Spain Economic Outlook report for the second quarter of 2012 available at: [http://www.bbva-research.com/KETD/fbin/mult/1205\\_Situacionspana\\_tcm346-326621.pdf?ts=2452012](http://www.bbva-research.com/KETD/fbin/mult/1205_Situacionspana_tcm346-326621.pdf?ts=2452012)



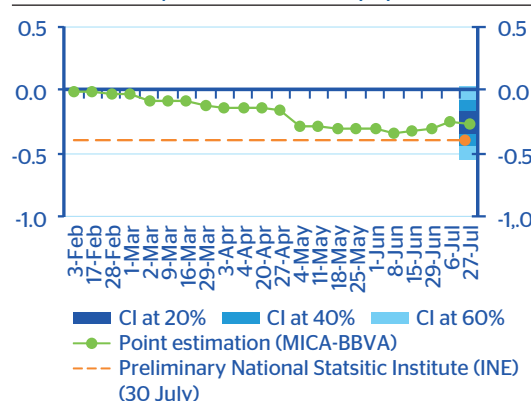
In short, the Spanish economy looks set to remain in recession in the next several quarters, with the most likely scenario showing a contraction by GDP of around 1.4% for all of 2012. What's more, under current circumstances, we are unlikely to see the economy recover until the second half of 2013, with GDP next year set to contract by a similar degree. While the developments in the scenario described above have already prompted us to downgrade our growth forecasts, there is still a strong probability that the contraction will be even greater.

## The Spanish economy contracted for the third straight quarter in 2Q12

Though final breakdowns are still out, the preliminary GDP forecasts released by the National Statistics Institute (INE) indicate that the Spanish economy contracted -0.4% qoq in 2Q12, marking three straight quarters of decline<sup>5</sup>. If these forecasts are confirmed, the performance in the quarter will have been in line with BBVA Research forecasts (-0.4% qoq). Although the published figure was slightly below that of our real time estimates (MICA-BBVA -0.3% qoq)<sup>6</sup>, these provided an early indicator that growth for 2Q12 would be negative again (see Chart 5) and that economic activity would deteriorate further in the third quarter (see Chart 6). Furthermore, preliminary indicators released to date indicate declines in all components of domestic demand in 2Q12 and, accordingly of imports. As a result, the composition of growth should again feature growth in net trade and a negative contribution by domestic demand (see Chart 7).

Chart 5

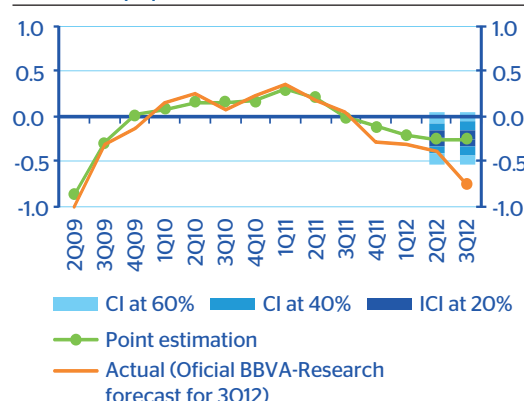
**Spain: 2Q12 GDP growth forecasts using the MICA-BBVA model by forecast date (% qoq)**



Source: BBVA Research based on INE data

Chart 6

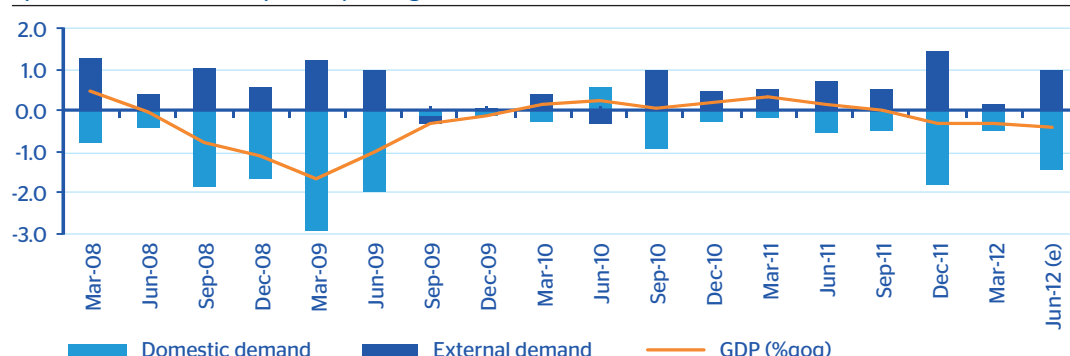
**Spain: GDP growth and forecasts using MICA-BBVA model (% qoq)**



\* Current forecast: 3 August 2012  
Source: BBVA Research based on INE data

Chart 7

**Spain: Contributions to quarterly GDP growth.**



(e): estimation  
Source: BBVA Research based on INE data

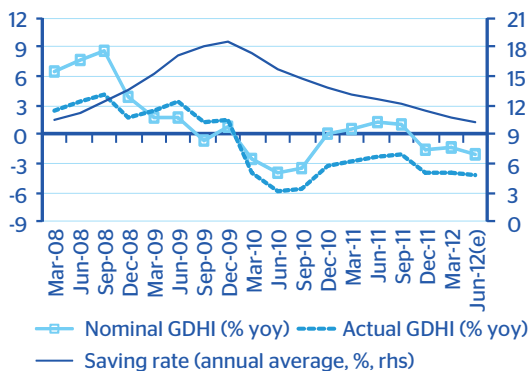
5: The breakdown of Quarterly National Accounts (CNTR) for 2Q12 are due to be released on 30 August. Preliminary data may be revised.  
6: The differences between the estimate in our baseline scenario and the result of the MICA-BBVA model for the quarter are due, in part, to the model not considering the entire adjustment in public sector accounts. 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, available at: [http://www.bbva-research.com/KETD/fbin/mult/WP\\_1021\\_tcm348-231736.pdf?ts=2542012](http://www.bbva-research.com/KETD/fbin/mult/WP_1021_tcm348-231736.pdf?ts=2542012)

## Private domestic demand fall faster

Private consumption was at a standstill during the first quarter of 2012. Preliminary demand indicators -mainly for durable goods and, to a lesser extent, services- show household spending fell between April and June despite the expected decline in the household saving rate (see Chart 8). BBVA's synthetic consumption indicator (SCI-BBVA) and our coincident consumption indicators model (MICC-BBVA) suggest that household spending contracted by a further 1.0% qoq (-1.9% yoy) in 2Q12 (see Chart 9).

Chart 8

**Spain: Gross disposable household income (GDHI) and household saving rate**

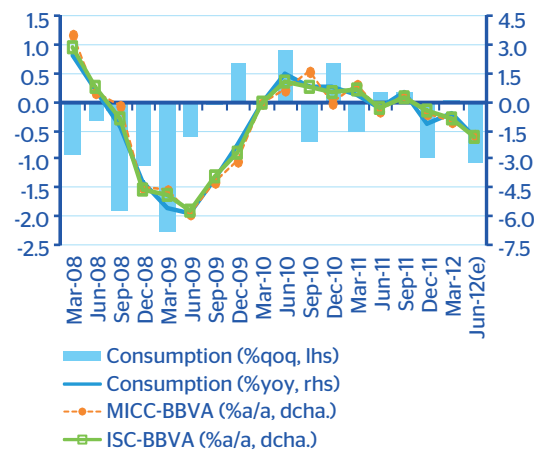


(e): estimation

Source: BBVA Research based on INE data

Chart 9

**Spain: actual data and real time forecast of household consumption**



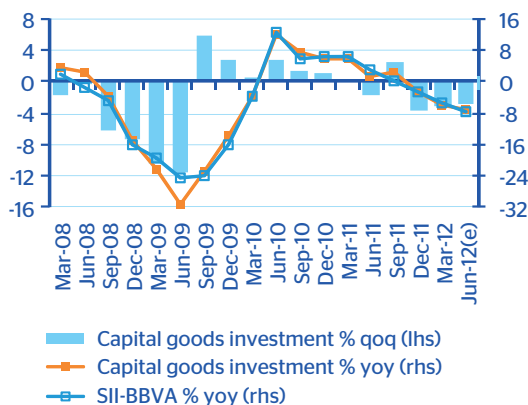
(e): estimation

Source: BBVA Research based on INE data

Private investment data indicate that its main components declined further in the second quarter. Sluggish domestic demand, fiscal adjustment and heightened financial pressures in Europe and the related uncertainties, increase in costs and difficulties accessing finance explain the poor performance by investment in capital goods. The BBVA synthetic investment indicator (SII-BBVA) shows demand contracted further (see Chart 10) between April and June, by around 3.0% qoq (-7.2% yoy). Investment in housing also fell, not only for the reasons explained above, but more importantly because of the continued correction of the main imbalances built up and the cyclical downturn of the Spanish economy. Available data provide no signs of any trend reversal: our synthetic housing investment indicator (SHI-BBVA) points to a slightly stronger contraction in 2Q12 than 1Q12, of -2.6% yoy (-7.2 yoy) (see Chart 11).

Chart 10

**Spain: actual data and real time forecasts for capital goods investment**

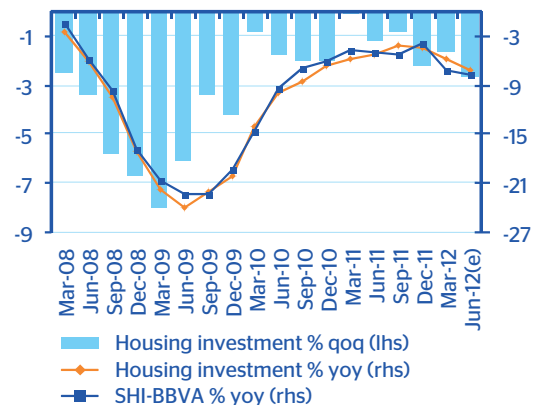


(e): estimation

Source: BBVA Research based on INE data

Chart 11

**Spain: actual data and real time forecasts for housing investment**



(e): estimation

Source: BBVA Research based on INE data

## Budget out-turn data suggest the bulk of the adjustment to public demand will come mostly in the year's second half

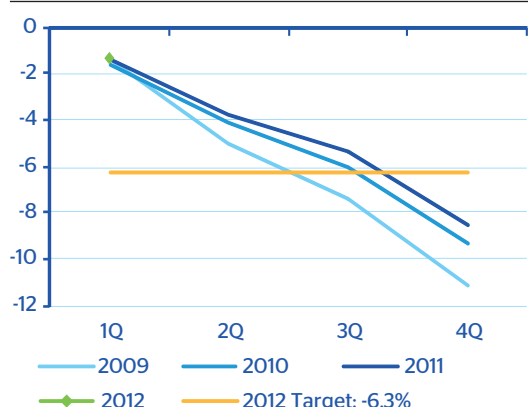
The total public deficit for all Spanish administrations reached 1.4% of GDP in 1Q12 (see Chart 12), owing to the negative impact of the economic downturn on public accounts in general and tax revenue in particular. By level of administration, only the central government reported a deficit in the year's first quarter (-1.9% of GDP), which was partially offset by the slight surplus achieved in the rest of the administrations (balance budget for the regional governments) after the central government brought forward transfer payments.

For the second quarter, central government budget data show a cumulative deficit to June 2012 of 4.0% of GDP (see Chart 13). Although government final consumption expenditure was slightly lower -thanks mainly to the reduction in intermediate consumption- the outcome was due to forward payments to other public administrations -mainly regional governments and the social security- but also to the poor performance of revenues.

In light of this information and until 2Q12 data for the regional governments are released, public consumption looks set to have fallen further in the second quarter, in line with the drop in public employment (-5.5% yoy) showed by the Labour Force Survey (LFS). Since much of the fiscal consolidation measures affecting the regional governments were designed based on the rebalancing plans presented in May, the bulk of the adjustment will be concentrated in the second half of the year. Meanwhile, fiscal consolidation efforts remain focused on cutbacks to investment, so non-residential construction probably shrunk further than in previous quarters.

Chart 12

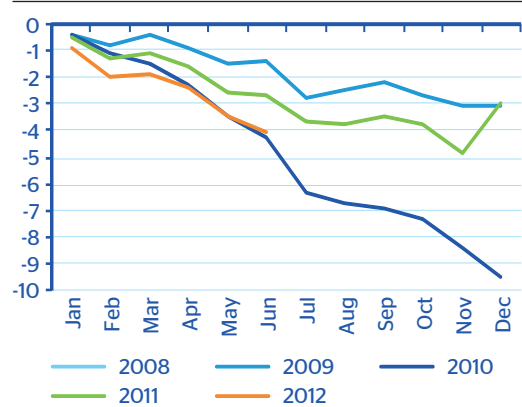
Spain: public administration  
net lending (+)/ net borrowing (-)



Source: BBVA Research based on INE data

Chart 13

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



Source: BBVA Research based on MINHAP data

## After two quarters of decline, 2Q12 should show a slight rebound by exports and a further positive contribution by net trade

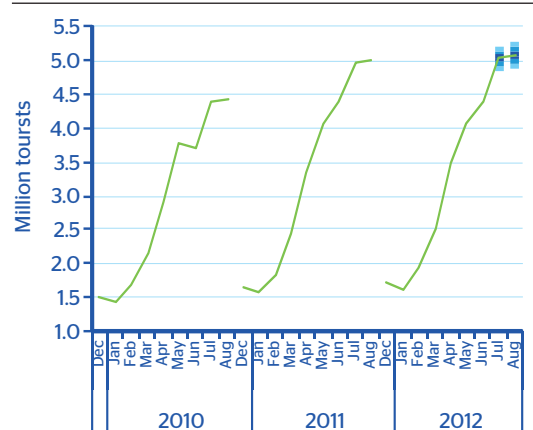
The first quarter of 2012 showed a modest contraction by exports of goods and services and a positive contribution by net trade to growth, fuelled by the persistent weakness of imports. Since the beginning of 2Q12, Spanish exports have faced the same, if not greater, challenges as they did in 1Q12. The new bout of financial instability in Europe bodes well for slightly weaker export demand than we expected a few months ago, although it should remain positive. Similarly, problems raising foreign finance have begun to undermine export supply, which relies heavily on the correct operation of credit markets, insurance and financial derivatives. Downward pressure on the euro's exchange rate and its positive effect on competitiveness-price of exports will have provided a buffer to these changes in 2Q12. Customs export data show a spike in May after a lacklustre start to the quarter. Meanwhile, the goods and services indicator for large companies improved in 2Q12, especially in May. On the negative side, the industrial export order backlog fared worse, ending the second quarter 5 points lower than the first. In summary, available data point to a recovery by goods exports in 2Q12 of 1.1% yoy (3.6% yoy).

Services exports performed similarly (+2.2% qoq; +1.4% yoy). The tourist season overall has been weaker than in 2011, although this is mostly the result of weak domestic demand. By contrast, foreign tourism is performing well, although its contribution to growth is lower than last year, when tourist arrivals were driven by the “Arab Spring”. The higher number of tourist arrivals (2.9% yoy in 1H12) and the slight increase in average spend per tourist (2.7% yoy from January to May) drove a 4.6% yoy increase in total spending by foreign tourists in the first half of 2012.

Prospects for the rest of the summer are good. According to the BBVA-Google<sup>7</sup> model of coincident tourism indicators, foreign overnight stays in Spanish hotels in July and August were up by around 1.5% yoy, implying a new record for incoming visitors (see Chart 14).

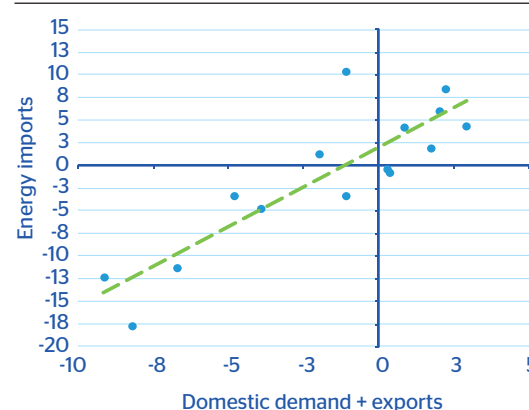
While exports show a modest recovery, imports continue to decline. Preliminary indicators released to date point to further deterioration in purchases from abroad in 2Q12 (-1.9% qoq; 7.3% yoy), in line with the adverse performance of all domestic demand components and despite the positive impact on the drop in oil prices. On this point, we would highlight the drag on economic growth posed by Spain's energy dependence and the country's need for external financing. As Chart 15 illustrates, each percentage point increase in the growth of domestic demand plus exports requires an approximately 1.7pp increase in real energy imports<sup>8</sup>. In short, the aforementioned factors suggest net external demand will have continued to contribute positively to economic growth in Spain in 2Q12.

Chart 14  
**Spain: Tourist arrivals  
and MICT model forecasts (BBVA-Google)**



Source: BBVA Research and Google based on INE data

Chart 15  
**Spain: energy imports and domestic  
demand plus exports, volume (3Q08-1Q12; % yoy)**



Source: BBVA Research based on Customs and INE data

## Labour market indicators still show considerable erosion

Seasonally and calendar-adjusted (SWDA) data indicate that the pace of job destruction accelerated slightly between April and June. Meanwhile, the average number of social security contributors decreased by 0.9% qoq (SWDA) in 2Q12, a tenth of a percent more than in 1Q12 due to the adverse performance in industry and, to a lesser extent, the primary and services sectors. As a result, jobless claims rose further, by 3.4% qoq (SWDA) in the second quarter compared to 2.6% in the first (see Chart 16)<sup>9</sup>. Broadly speaking, the Labour Force Survey (LFS) for 2Q12 confirmed the same trend in social security affiliation and jobless claims. The fall in employment (-15.9 thousand people, -174 thousand SWDA) –mostly service sector employees and temporary government staff– coupled with the seasonal increase in the labour force (37.6 thousand people, -33 thousand SWDA), fed through to a 0.5pp increase in the jobless rate to 24.6% SWDA and a 0.6pp decline in the temporary rate to 23.7% SWDA (see Chart 17).

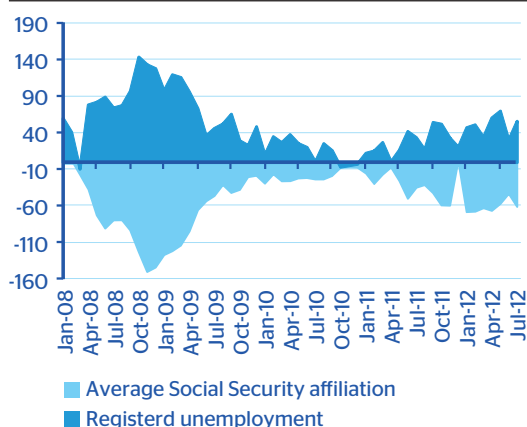
7: For more details, see: [http://www.bbvaesearch.com/KETD/fbin/mult/121116\\_BBVA-GOOGLE\\_TURISMO\\_tcm346-284306.pdf?ts=3172012](http://www.bbvaesearch.com/KETD/fbin/mult/121116_BBVA-GOOGLE_TURISMO_tcm346-284306.pdf?ts=3172012)

8: Real energy imports in Spain fell 5.1% in the second half of 2008, while domestic demand plus exports fell by 6.5%.

9: July unemployment registrations indicate further deterioration in the labour market. Correcting for seasonal and calendar effects, we estimate a decline in the number of social security contributors of 60 thousand and an increase in the number of employed of 56 thousand.

Chart 16

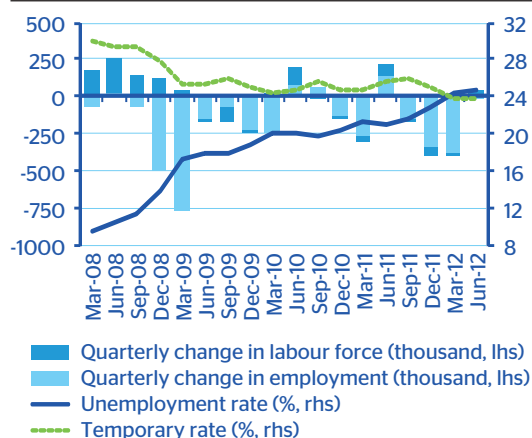
**Spain: average Social Security affiliation and registered unemployment (monthly chg., thousand people, SWDA)**



Source: BBVA Research based on MEySS data

Chart 17

**Spain: labour market indicators**



Source: BBVA Research based on INE data

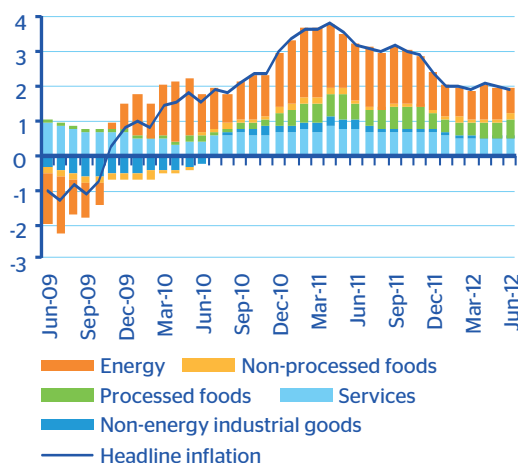
## Despite lower energy costs, prices held steady

Both headline and core inflation remained relatively stable in the second quarter of the year, running at 2.0% yoy and 1.2% yoy, respectively. However, there were considerable changes in the price components of the special groups that make up the consumer price index (CPI). Looking at underlying inflation, the faster growth in processed food prices (spurred by higher excise taxes on tobacco production) was offset by the decrease in non-energy industrial goods prices and stable services prices despite the increase in regulated transport prices. Similarly, in the residual component, the deceleration of energy price inflation despite the uptick in regulated gas and electricity prices was offset by the spike in fresh food prices. Therefore, of headline inflation at the end of the second quarter (1.9% yoy in June), 1.4pp are attributable to energy and food and just 0.5pp to services and non-energy industrial goods, which continue to show an absence of demand-side inflationary pressures (see Chart 18)<sup>10</sup>. Meanwhile, the Harmonised Index of Consumer Prices (HICPI) showed that the inflation spread between Spain and the eurozone average in the second quarter remained favourable to Spain by around -0.6pp, whereas assuming constant taxes, the latest data (May 2012) show a spread of around -0.2pp in 2Q12 (see Table 1).

<sup>10</sup>: The CPI leading indicator for July shows an acceleration in annual inflation to 2.2%, mainly due to higher energy and non-energy industrial goods prices. Pushing up energy prices in addition to higher fuel prices were the increases in regulated prices (gas and electricity) that came into force at the beginning of July. Non-energy industrial goods prices rose on the back of higher medicine and other pharmaceutical product prices following the introduction on the co-payment scheme at the beginning of the month.

Chart 18

Spain: contributions to annual CPI growth (%)



Source: BBVA Research based on INE data

Table 1

 Spain: Inflation spreads  
with respect to the euro zone (pp)

		Total	At constant tax rates
2008	1H	1.1	1.2
	2H	0.7	0.7
2009	1H	-0.7	-0.9
	2H	-0.4	-0.7
2010	1H	0.4	0.1
	2H	0.4	-0.4
2011	1H	0.7	-0.2
	2H	0.0	0.1
2012	1Q	-0.8	-0.4
	2Q (*)	-0.6	-0.2

(\*) Data for constant tax rates to May

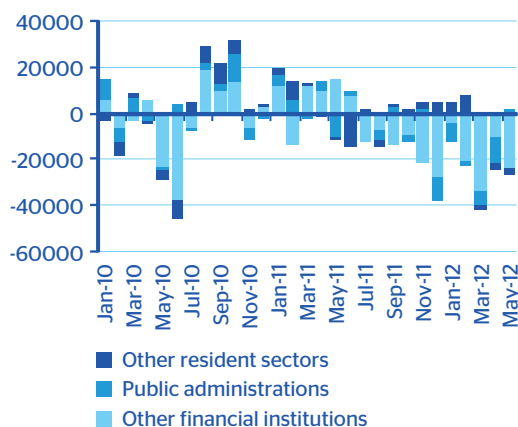
Source: BBVA Research based on INE and Eurostat data

## Outlook for 2012-2013: worse prospects for the Spanish economy in the short term

As we pointed out in the introduction to this section, despite progress in European governance, bank restructuring and the fiscal consolidation process, the main factors shaping the Spanish economy in the short term struggled considerably which, in the most likely scenario, mean the recession will last through to next year. Therefore, risks remain tilted to the downside, with the current situation pointing to an increasing probability of risk scenarios.

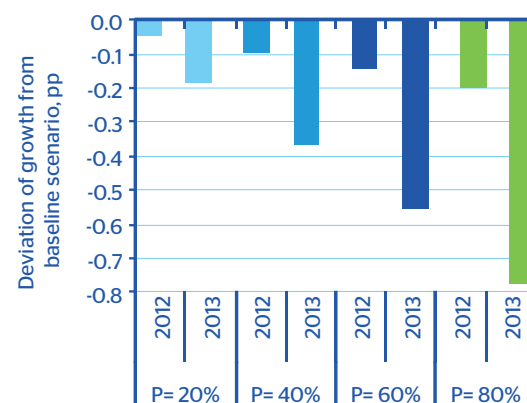
Looking at external factors first, while ECB monetary policy will probably act as a counterbalance in the short term, heightened instability in European capital and sovereign debt markets could mean Spain will continue to find it costly and difficult to raise external financing. As Chart 19 illustrates, the spike in financial stress since the end of 2011 has raised pressure on Spanish debt compared to the rest of the world (see Box 3). Considering that Spanish banks are tapping the ECB to meet their liquidity requirements, short-term external financing problems are concentrated mainly in non-banking institutions. The credit crunch that could arise from the failure to rollover external debt of non-banking financial institutions with forthcoming maturities cause added downward pressure to economic activity (see Chart 20).

Chart 19

 Spain: net monthly change  
in Spanish debt vs. ROW (EUR million)


Source: BBVA Research based on BdE data

Chart 20

 Spain: sensitivity of GDP  
to scenario of failure to roll over maturities


P: foreign debt maturities of non-bank financial institutions not refinanced in 2012

Source: BBVA Research

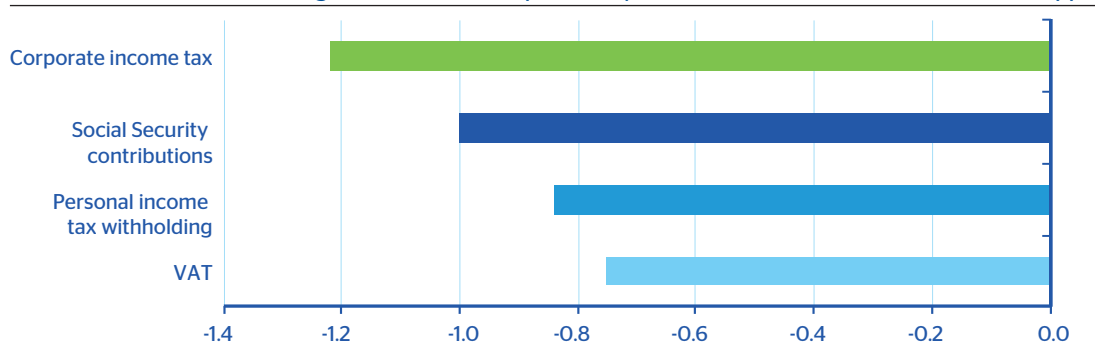
Mounting financial stress has prompted us to cut our growth forecasts for Europe by -0.1 pp and -0.3 pp in 2012 and 2013, respectively, to -0.3% and +0.3%, reducing demand for Spanish exports. In addition, given the import content of Spanish exports and the impact of the slowdown of trade flows on other economic sectors, the downgrade to the growth forecast for Europe is likely to trigger a sharp fall in imports, in turn driving a higher contribution by net trade to growth. That said, a weaker euro than we had expected in May should partly offset the impact of lower growth in Europe.

Lower oil prices than anticipated three months ago should also help temper short-term pressure on Spain's productive system. Nevertheless, the temporary nature of this shock, which is largely due to expectations of a slowdown in global demand, should go a long way to limiting the impact on Spanish economic growth, although it should at least put downward pressure on inflation<sup>11</sup>.

On the domestic front, the main factor still undermining our scenario is the correction of macroeconomic imbalances. While deleveraging and weak fundamentals are keeping private demand and supply from increasing, the spike in the risk premium will exacerbate the impact of a more contractionary fiscal policy by limiting the transmission mechanisms of monetary policy or shoring up confidence. That said, in a scenario of less financial stress, the new budget measures should lend credibility to the adjustment and minimise the negative impact on growth. First, because a focus on indirect taxes causes fewer distortions in the decisions of economic agents and, therefore, in activity (see Chart 21). Second, because fiscal devaluation –reduction in employer social security contributions and VAT hike– should improve Spain's foreign trade balance.

Chart 21

**Spain: impact on GDP**  
of different tax hikes assuming same tax revenue power (2-year difference from baseline scenario, in pp)



Note: all cases simulate a permanent increase in taxes that leads to an increase in tax revenue equivalent to 1% of GDP.

Source: BBVA Research

Nevertheless, as indicated in the previous edition of this report, there are certain domestic factors that could have a positive effect on the outlook for economic growth in Spain. Short term, the Supplier Payment Programme should continue to buoy, albeit temporarily, corporate spending and, as a result, activity, although this metric will depend on the percentage of these obligations that have already been discounted by creditors and their liquidity<sup>12</sup>. In addition, scheduled reforms by the government for the second half of the year, alongside the labour reform already passed, could lay the foundations for a stronger recovery in the medium term.

Once these factors have been discounted, we expect the Spanish economy to continue showing negative quarterly growth in coming quarters. The most likely scenario is a contraction by GDP of 1.4% in both 2012 and 2013 (see Table 2). Prospects for regional economies remain mixed (see Box 4).

11: For more details on the estimated impact of changes in oil prices by type of shock, see Box 1 of the May 2011 Spain Economic Outlook report, available at: [http://www.bbvaerearch.com/KETD/fbin/mult/1105\\_Situacionespana\\_tcm346-256519.pdf?ts=1742012](http://www.bbvaerearch.com/KETD/fbin/mult/1105_Situacionespana_tcm346-256519.pdf?ts=1742012).

12: See Box 3 of Spain Economic Outlook for the second quarter of 2012, available at: [http://www.bbvaerearch.com/KETD/fbin/mult/1205\\_Situacionespana\\_tcm346-326621.pdf?ts=182012](http://www.bbvaerearch.com/KETD/fbin/mult/1205_Situacionespana_tcm346-326621.pdf?ts=182012)



Table 2

## Spain: macroeconomic forecasts

(yoy %, unless otherwise indicated)	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12 (e)	2011	2012 (f)	2013 (f)
National Final Consumption Expenditure (FCE)	0.4	-0.8	-0.6	-1.8	-1.8	-2.5	-0.7	-2.7	-3.2
Private FCE	0.4	-0.3	0.5	-1.1	-0.6	-1.9	-0.1	-2.0	-2.8
Household FCE	0.4	-0.3	0.5	-1.1	-0.6	-1.9	-0.1	-2.0	-2.8
Public Administration FCE	0.6	-2.1	-3.6	-3.6	-5.2	-4.4	-2.2	-4.8	-7.9
Gross capital formation	-4.8	-5.4	-4.2	-6.6	-8.1	-9.5	-5.2	-9.1	-5.5
Gross fixed capital formation	-4.9	-5.4	-4.0	-6.2	-8.2	-9.7	-5.1	-9.4	-5.6
Fixed material assets	-5.3	-5.6	-4.3	-6.5	-8.8	-10.6	-5.4	-10.2	-6.0
Equipment, machinery and cultivated assets	5.5	1.0	2.2	-2.7	-5.9	-6.9	1.5	-8.9	-4.4
Equipment and machinery	5.7	1.1	2.2	-2.7	-6.0	-7.2	1.6	-9.1	-4.6
Construction	-9.2	-8.1	-7.0	-8.2	-10.2	-12.1	-8.1	-10.7	-6.7
Housing	-5.8	-5.2	-4.1	-4.3	-5.8	-7.2	-4.9	-6.7	-8.3
Other buildings and other constructions	-12.4	-10.8	-9.7	-11.9	-14.3	-16.9	-11.2	-14.6	-5.1
Intangible fixed assets	1.5	-3.1	2.0	-0.3	2.2	4.0	0.0	3.5	-0.4
Domestic demand (*)	-0.8	-1.9	-1.4	-2.9	-3.2	-4.1	-1.8	-4.2	-4.4
Exports	13.1	8.8	9.2	5.2	2.2	2.9	9.1	2.6	7.2
Imports	6.0	-1.3	0.9	-5.9	-7.2	-7.3	-0.1	-6.5	-2.1
Net trade balance (*)	1.7	2.7	2.2	3.2	2.8	3.1	2.5	2.8	3.0
GDP at mp	0.9	0.8	0.8	0.3	-0.4	-1.0	0.7	-1.4	-1.4
<b>Pro-memoria:</b>									
GDP w/o housing investment	1.5	1.3	1.2	0.6	0.0	-0.5	1.2	-1.0	-1.0
GDP w/o construction	2.9	2.5	2.2	1.7	1.2	0.9	2.3	0.2	-0.7
Employment (LFS)	-1.3	-0.9	-2.1	-3.3	-4.0	-4.8	-1.9	-4.5	-3.8
Unemployment rate (% active pop.)	21.3	20.9	21.5	22.8	24.4	24.6	21.6	24.9	26.0
Employment (FTE)	-1.6	-1.3	-2.0	-3.3	-3.8	-4.5	-2.0	-4.3	-3.6

(\*) Growth contributions

(e): estimation; (f): forecast

Source: BBVA Research based on INE data

## The worse outlook for Spanish economic growth could cause the labour market to deteriorate further

Employment figures look set to fall further in the second half of 2012 and 2013, causing the unemployment rate to rise to around 26% despite the expected drop in the active population. Although the labour market reform passed in February<sup>13</sup> will not prevent job destruction in the short term, it could: 1) help facilitate the rebalancing needed<sup>14</sup> between the extensive margin (workers employed) and the intensive margin (number of hours worked and wages), 2) reduce segmentation and 3) boost productivity.

Moreover, employment-related initiatives approved in Royal Decree-Law 20/2012 of 13 July on measures aimed at assuring budgetary stability and encouraging competitiveness, could dictate to some extent how the job market performs. First, the decrease in the benefits for newly unemployed –up to 50% of the base pension after the sixth month of benefits– will raise the opportunity cost of remaining unemployed, prompting those out of work to look harder for a job, which should reduce

13: Box 4 of Spain Economic Outlook for the second quarter of 2012 assesses the labour market reform and puts forward suggested improvements (e.g. a reduction in the period for negotiating new collective labour agreements) which were subsequently included in Law 3/2012, of 6 July on urgent measures to reform the labour market (<http://www.boe.es/boe/dias/2012/07/07/pdfs/BOE-A-2012-9110.pdf>).

14: As shown in the February 2012 Spain Economic Outlook report, because of the rigidities facing companies and workers when changing their working conditions –particular working hours– the adjustment to the Spanish labour market has focused on employment rather than on the number of hours worked.



the length of unemployment<sup>15</sup>. Second, raising the minimum age for entitlement to unemployment benefits for people over 52 years, eliminating the special subsidy for people over 45 and imposing stricter requirements to benefits from the active insertion income programme could bring down the number of people out of work, but their impact on wellbeing is questionable since it is harder for beneficiaries of non-contributory benefits to find jobs. Third, the elimination of incentives for hiring, maintaining staff or encouraging self-employed<sup>16</sup> are unlikely to have any meaningful impact on employment since they barely led to job creation when they were in place. In all, it would have been better to shift part of the funds earmarked for hiring incentives over to policies that enhance worker employability, especially of those who lost their job during the structural downturn in the real estate sector<sup>17</sup>. Lastly, the announced reductions in employer social security contributions of 1pp in 2013 and 2pp in 2014 are positive moves despite the 5pp increases in the maximum contribution rate in both years. The competitive disadvantage caused by the reduction in the contribution burden and the VAT hike in September 2012 could lead to cumulative growth in employment of around 0.3% from now to the end of 2014, as shown in Chart 22<sup>18</sup>.

Chart 22

**Spain: impact on activity and employment of a decrease in social security contributions financed with an increase in VAT (deviation from scenario ex-reform, pp)**



Note: Simulation of a 3pp VAT increase from 3Q12 and a 1pp reduction of employer social security contributions y 2013 and 2pp in 2014  
Source: BBVA Research

## Growth in net trade will not be enough to make up for the drop in domestic demand

First, additional consolidation measures to redirect adjustments to the new economic paradigm and the persistence of financial stress indicate that domestic public demand will continue to pose a drag on economic growth. In real terms under Spanish National Accounts, public consumption looks set to fall 4.8% and investment in non-residential construction by 14.6% in 2012. Further decreases in 2013 are likely; our estimates point to an additional fall in public consumption of 7.9% and in other construction investment of 5.1% next year. As a result, the initiatives announced will improve the chances of Spain meeting its new 2012 budget deficit target (6.3% of GDP) considerably. However, there are more question marks over the 2013 deficit target (4.5% of GDP).

What's more, there are not enough details on the measures to be adopted in the coming years, so we cannot quantify the related revenue and expenditure, let alone their impact on economic activity. Meanwhile, the macroeconomic forecasts for 2013 released by the government in mid July are more upbeat than the ones we include in this report. If the economic downturn worsens, the government would be forced to adopt additional measures to achieve its 2013 target (and that of the regional governments).

15: As Acemoglu and Shimer (2000) and Chetty (2008) illustrate, an undesirable effect of reducing unemployment benefits is the decline in the job match quality of unemployed who find work and, therefore, their productivity. For more details, see: Acemoglu, D. and R. Shimer (2000): "Productivity gains from unemployment insurance," *European Economic Review*, vol. 44(7), 1195-1224; Chetty, R. (2008): "Moral Hazard versus Liquidity and Optimal Unemployment Insurance", *Journal of Political Economy*, vol. 116(2), 173-234.

16: Incentives for hiring people with disabilities, young self-employed who substitute workers on maternity leave, victims of domestic violence and beneficiaries of new entrepreneur help contract remain in place.

17: Spain dedicated nearly half of spending on Active Employment Policies (AEP) to encourage hiring and maintaining employment, where the average for the EU 15 was a quarter. Conversely, spending on training, labour integration and professional retraining was comparatively low. Training represented 24.9% of AEP expenditure in 2005-2010 in Spain, compared to 30.4% in Germany and 41.8% in Denmark, while labour integration and professional retraining accounted for scarcely 3.9%, compared to 7.2% in Germany and 50.9% in Denmark.

18: In Section 4 of *Spain Economic Outlook for the first quarter of 2009* we proposed a permanent 3.5 reduction in the effective rate of employer social security contributions in exchange for a 2pp increase in the average effective rate of tax on consumption. The results of the estimates indicate that such a fiscal devaluation would lead to a 0.6% increase in GDP and a 1.4% increase in full-time equivalent employment in the first year of the reform.

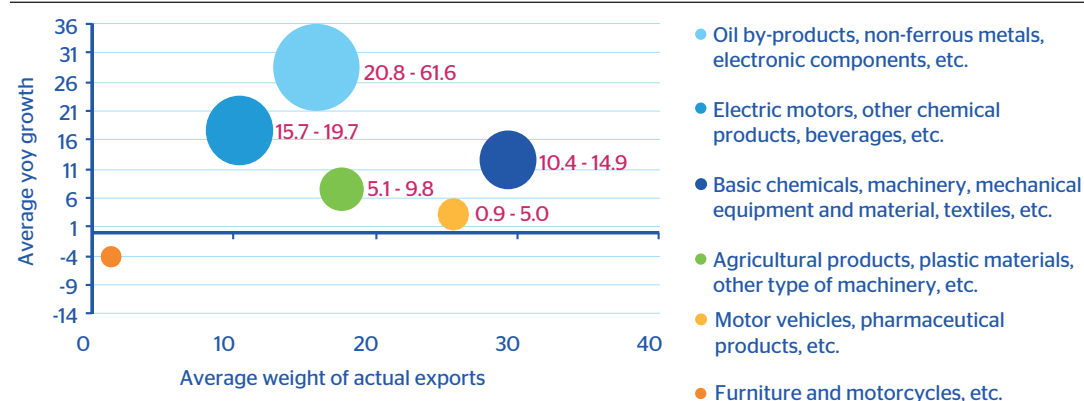
The worse outlook for the factors determining private consumption herald decreases in spending throughout the forecast period (of around 2.0% in 2012 and 2.8% in 2013). The deterioration of employment will trigger a decline in the wage component of household gross disposable income. In addition, the September 2012 increase in indirect taxes should have a considerable negative impact on consumption in the second half of 2012, as seen in Chart 22<sup>19</sup>. However, *ceteris paribus*, the positive implications on employment of the reduction in social security contributions would enable private consumption to return to pre VAT-hike levels in 2013. Net financial wealth is unlikely to recover until 2014, while real estate activity is expected to fall throughout the forecast period. Conversely, the reduction in the household savings rate to its pre-crisis levels, the absence of inflationary pressure on demand and steady official interest rates at low levels will limit the contraction in private consumption over the next two years.

Meanwhile, trends in capital goods investment will continue to be shaped mainly by the weakness of domestic demand and difficulties accessing credit, not to mention the downward pressure derived from the economic slowdown in Europe and heightened uncertainty caused by the spike in financial stress. We forecast a contraction in this demand component of around 9.1% in 2012 and recovery around mid 2013 (-4.6% for the full year) underpinned by improved growth prospects for Spanish exports. Our outlook for housing investment, however, has changed considerably over the past three months. Specifically, in addition to the factors mentioned previously –greater cyclical downturn, finance difficulties and increased uncertainty– and the sector's ongoing struggles, the hike in VAT from September and the elimination of the deduction on the purchase of primary residences from January 2013 could bring forward demand from 1H13 to 2H12. We still expect to see residential investment fall by around 6.7% in 2012, but we have lowered our forecast for 2013 to -8.3%.

Lastly, the outlook for exports in 2012-2013 will continue to depend on EMU growth forecasts. Meanwhile, expectations of a weaker euro and the potentially positive impact that fiscal devaluation could have on export competitiveness-prices should provide a buffer to the negative impact of weaker European demand. Exports of goods and services could now end up growing 2.6% in 2012, which is less than we were expected in May, although a large number of export products could perform well (see Chart 23). Looking ahead to 2013, when Europe moves farther away from recession and the base effect of the increase in 2011 and slowdown in 2012 work their way out of comparisons, Spanish exports should resume their upward trend, growing by as much as 7.2%. Meanwhile, the weakness of components of domestic demand should hold back imports, preventing them from increasing until after 2012-2013. In short, the two-year period looks set to again feature a positive contribution by net external demand to growth and a correction in the current account deficit.

Chart 23

#### Spain: yoy growth of exports and breakdown by product, volume 2010-2012 (%)



Note: The numbers represent the range of average yoy growth rates by sector of each subcategory from Jan-10 to Jun-12

Source: BBVA Research based on Ministry of Economy and Competitiveness data

<sup>19</sup>: The delay in the VAT hike until September could have a positive impact on household consumption in the early part of the third quarter. Box 2 of Spain Economic Outlook for the fourth quarter of 2009 showed how a VAT hike could lead to a temporary increase in consumer spending of up to six tenths between when the hike is announced and when it becomes effective.

## Box 1. Agreement over financial aid to reinforce the stability of the Spanish financial system

The European Financial Stability Facility (EFSF) has granted a credit facility of up to EUR 100 billion to reinforce the stability of the Spanish financial system. This aid will come in the form of an EFSF loan to the Fund for Orderly Bank Restructuring (FROB), which will be taken over by the European Stability Mechanism (ESM), once this institution is fully operational, without gaining seniority status. The ESM will be authorised to directly recapitalise banks, provided that by then a single EU supervisory mechanism has been set up. Meanwhile, the Spanish government is responsible for repayment. The measure is positive for a number of reasons:

- The aid is timely and the amount easily surpasses the banking system's potential capital requirements. Once the outcomes of the next stress tests performed of each bank are out, it is very likely that the maximum requirements of the Spanish financial system will be close to the EUR 62 billion indicated by independent consultants Oliver Wyman and Roland Berger in the aggregate (top-down) stress test. At any rate, only a small portion of the system is vulnerable according to both the independent consultants and the International Monetary Fund (IMF)<sup>20</sup>. In fact, the IMF estimates that troubled Spanish banks manage just 30% of the system's total assets.
- **The involvement of European authorities lends credibility to the restructuring and recapitalisation process.**
- **The required funds are manageable and limited.** Use of the funds will be accounted for as public debt. That said, the amount added to public debt from the planned recapitalisation is relatively low (6% of GDP) and, given the new budget deficit target authorised by Brussels, the Spanish government's debt as a percentage of GDP should stabilise at levels near the EMU average over the next few years.
- **The aid helps break the sovereign-bank risk feedback loop.** The promise of direct recapitalisation by the ESM puts a limit on the contingent liabilities of this process and those that could arise in future from another wave of banking sector restructuring, not only in Spain, but in the rest of the monetary union as well.
- **The EMS' preferred creditor status in Spain's loan has been removed.** This is important as it prevents a distortion in the sovereign debt market and the punishment covering debt already issued. Removing this status should bolster confidence among existing holders of Spanish public debt.
- **The financial-sector policy of conditionality established in the Memorandum of Understanding (MoU) distinguishes between institutions, focusing on those that need aid.** Measures affecting the entire system address liquidity (reporting), solvency (minimum core capital of 9% according to the European Banking Authority (EBA) definition and changes in loan-loss provisioning bearing in mind the two Royal Decree-Laws passed in 2012 and recalibration of dynamic provisions), the institutional framework (greater powers for the Bank of Spain and clarification of the mandate of the FROB-Deposit Guarantee Fund), consumer protection (new legislation on the sale of products not covered by the Deposit Guarantee Fund for unqualified retail investors) and savings banks (changes in their governing bodies and the control they exercise in the banks to which their business was transferred). Banks applying for aid are, logically, subject to stricter conditions, ranging from bail-in and wind-up conditions (voluntary or mandatory absorption of losses on junior debt), creation of a single "bad bank" (no details have been disclosed yet regarding how it will be funded, the transfer price set in the bottom-up stress test or the assets to be transferred), the stock market listing of savings banks (design of a road map), oversight (the European Commission could perform on-site inspections) and other (streamlining of offices and staff, bans on dividend payments, on the payment of coupons on hybrid instruments and on non-organic growth).
- **A specific timeline for solving the recapitalisation problem is included.** The MoU also details the future stages of the recapitalisation process by type of institution. The calendar has been extended, as some institutions may receive public aid in 2013.
- **The additional financial conditionality is reasonable and in line with BBVA Research's recommendations.** Spain must comply strictly with public deficit targets over the coming years after the Eurogroup agreed greater flexibility consistently with the expected erosion of revenue and expenses and the new economic outlook. The MoU also requires reforms to make the tax system more efficient and improve the country's medium-term growth prospects (implementation of labour market reforms, measures to make services more competitive and the elimination of inefficiencies in the energy sector).

20: IMF 2012: Spain: Financial Stability Assessment, June 2012. Washington D.C.

Accordingly, the credit facility marks a clear step forward in the monetary union's integration process in a bid to reinforce financial stability in Europe. In future, a banking union that includes a single regulation (single rule book), integrated supervision, a common resolution framework and a unified guarantee deposit fund are the logical consequence of the monetary union. In the short term, political willingness and a road map are keys to restoring confidence and enabling the European interbank market to begin operating again.

In sum, Spain's financial system remains immersed in a profound restructuring process that is entering its final stage in the midst of an adverse liquidity situation. However, the MoU provides plenty of European funds to address solvency issues and designs a detailed road map. Moreover, the process will enjoy credibility as it will be overseen by leading European authorities and the IMF. The availability

of European funds to complete the bank restructuring and the credibility afforded by the European institutions are unquestionably two huge advantages of the aid and, in general, of Spain's belonging to the single currency, which means the Spanish economy will not have to face such a large problem with its own means and resources. In addition, once there is a single supervisor and the possibility of direct recapitalisation by the ESMS, the public sector's contingent liabilities will be covered. And with the conditionality laid out in the MoU, Europe is supporting structural reforms to do away with the factors precluding the generation of competitiveness gains and the growth of the Spanish economy.

## Box 2. Assessment of the latest government measures

In the wake of the various European agreements adopted, the Spanish government passed a number of measures at the 13 and 20 July cabinet meetings that send a clear message in favour of the sustainability of public finances. Initiatives were announced that go a long way to generating income, but that require considerable, but inevitable, sacrifices.

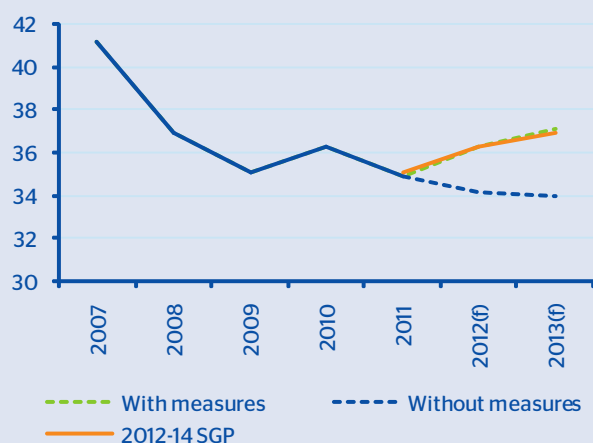
### A new, more realistic path of fiscal consolidation that takes into account the change in the macroeconomic scenario

As a result of the agreements reached at the Ecofin on 10 July, a new path of fiscal consolidation was approved for Spain that includes budget deficit targets of 6.3% of GDP in 2012, 4.5% in 2013 and 2.8% in 2014 (compared to the previous targets of 5.3%, 3.0% and 2.2%, respectively). The change in targets is warranted by the new outlook for the Spanish economy and the commitments of EMU countries to structural, rather than nominal, adjustments. To illustrate the importance of structural reforms, charts 24 and 25 show how much public income and expenditure would have deteriorated if no measures had been taken in 2012. Specifically, the ongoing recession in Spain is expected to cause the public deficit to increase by more than 2pp of

GDP (see Chart 26). In other words, with just the drop in GDP and employment, and the increase in interest rates, Spain's deficit would rise to 11% of GDP this year (from 8.9% in 2011). So, to lower it to 6.3%, income amounting to around 4.7pp of GDP would have to be generated. Through 10 July, all the public administrations had announced measures which combined amounted to a similar figure. Therefore, the credibility of the adjustment depended on the implementation of the measures (see Table 3). Nevertheless, doubts surrounding the effectiveness of certain revenue-generating measures (e.g. the fight against tax fraud, privatisations), implementation risks for certain expenditure measures and question marks surrounding the impact of the recession on the public deficit have necessitated new endeavours to increase the likelihood of achieving the targets by year-end. The government has announced measures on three fronts: (i) additional efforts targeting public revenues and expenditures, (ii) measures to enhance the operation of the public administration and (iii) steps to speed up structural reforms.

Chart 24

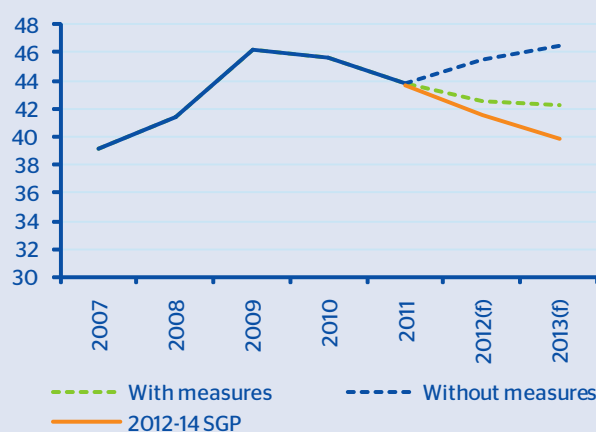
Spain: public administration revenue (% of GDP)



\* 2012 - 2014 Stability and Growth Pact  
Source: BBVA Research based on MINHAP and INE data

Chart 25

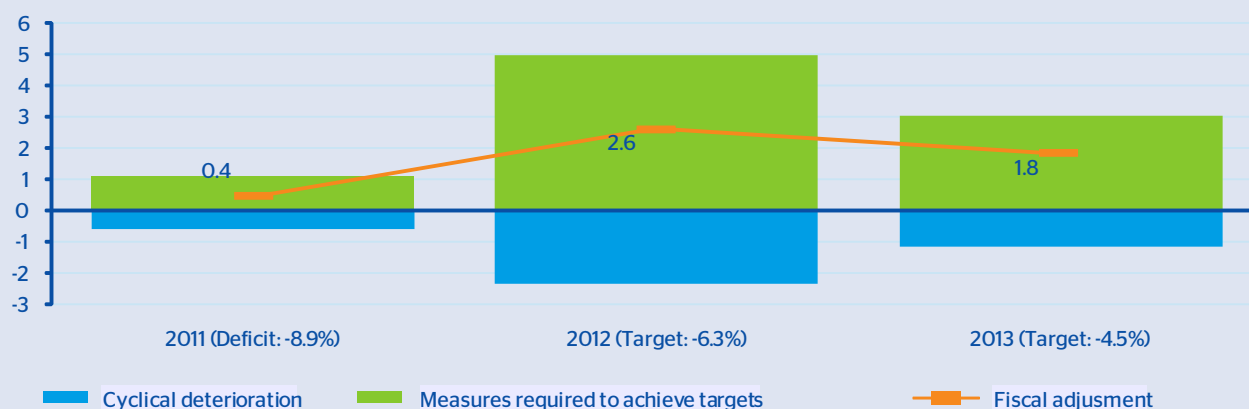
Spain: public administration expenditure (% of GDP)



\* 2012 - 2014 Stability and Growth Pact  
Source: BBVA Research based on MINHAP and INE data

Chart 26

## Public administration fiscal adjustment (% of GDP)



Source: BBVA Research based on MINHAP and INE data

**Fiscal consolidation underpinned by greater efficiency in taxation and spending**

The fiscal measures approved by the Spanish Cabinet on 13 July include increases in indirect taxes –value added tax (VAT), excise duties on tobacco and environmental taxation– and decreases in current spending. Specifically, the government said that the general VAT rate would increase by 3pp to 21% and that the low rate would increase by 2pp to 10% starting in September<sup>21</sup>. The amount of increased revenues the government estimates from these measures is reasonable and in line with the estimates of BBVA Research (EUR 10 billion in two years). However, final intake will depend on the impact of the country's economic woes on consumption over the coming months. The VAT increase comes alongside decreases in companies' social security contributions of one point in 2013 and another point in 2014, in line with the measures BBVA Research<sup>22</sup> has put forward, favouring a "fiscal devaluation" to improve Spain's competitiveness. The reduction in social charges should offset the negative impact of the VAT hike on GDP.

Another measure designed to improve tax efficiency is the elimination of the deduction on home purchases from 2013, which could generate annual savings of as much as EUR 285 million. Under current legislation, home purchases are subject to the super reduced VAT rate (4%). Accordingly, the new tax implies a 6pp increase in the rate from 1 January (approximately 900 million of additional annual revenues). This change marks a step forward in removing some of the incentives that led to the imbalances in residential construction in Spain.

The government also announced additional spending cuts for 2012 amounting to around EUR 4.5 billion, mainly entailing the elimination of the Christmas extra pay to public employees, high-ranking government officials, senators and congressmen. This measure is not permanent, but only applies to 2012, with the government saying it would make up for the losses from 2015 if the situation allowed. Therefore, the required adjustment to public wages has only been delayed, with the risk that this will come by adjusting amounts more than prices, which goes against one of the objectives of the government-led labour market reform.

Other announced measures include reducing expenditure under the dependency system and eliminating a large portion of the incentives given for hiring (except the new contract to support entrepreneurs or incentives for hiring people with disabilities). The amount of unemployment benefits has also been revised, but only for new recipients after six months –from 60% of 50% of the base pension– so it will not take effect until 2013. Lastly, in accordance with European Commission recommendations, a bill is to be submitted to the Toledo Pact to bring forward the application of the sustainability factor and change the legal retirement age in Spain, in line with BBVA Research suggestions<sup>23</sup>.

Elsewhere, to improve the operation of public administrations and guarantee their sustainability, there will be spending cuts at local tax authorities through a reduction of the number of councillors, standardisation in remuneration of mayors and councillors and strengthening of local governments, which will lend support in providing public services in order to resolve the problem of improper powers. The government estimates that these changes could save around EUR 3.5 billion.

21: In addition, the general tax rate has increased the portion of taxable income subject to the general tax rate in detriment to that of the reduced rate.

22: See Spain Economic Outlook, March 2009, available at: [http://www.bbva.com/KETD/fbin/mult/0903\\_situacionespana\\_tcm346-189472.pdf?ts=3172012](http://www.bbva.com/KETD/fbin/mult/0903_situacionespana_tcm346-189472.pdf?ts=3172012)

23: See Spain Economic Outlook, February 2011, available at: [http://www.bbva.com/KETD/fbin/mult/1102\\_Situacionespana\\_tcm346-246265.pdf?ts=3172012](http://www.bbva.com/KETD/fbin/mult/1102_Situacionespana_tcm346-246265.pdf?ts=3172012)



### The regional government's deficit target remains unchanged for 2012, with risks still concentrated on implementing the adjustment policies, especially in 2013

While Brussels has granted Spain flexibility in its total budget deficit target, the targets for the regional government have not changed. This is because the bulk of the regional governments' revenues and expenses are not inherently cyclical. If the European Commission's aim was to ease the deficit target because of the deterioration of the economy, one would assume this would benefit social security or the State. Towards 2013, bearing in mind the further downturn expected in economic activity, regional government revenues would remain unchanged in the best-case scenario, but decline in the most-likely scenario. This, coupled with a more ambitious deficit target (0.7% of GDP compared to 1.5% in 2012), would create the need for additional spending cuts. Therefore, implementation risk is likely to remain high and the government will need to use any instrument in its power to win back credibility over the control of the regional governments.

We also applaud the warnings issued to eight regional governments about trends in their finances, as this shows that the mechanisms included in the Budget Stability Law have begun working. In this respect, the government also announced the creation of a fund to provide liquidity to

the regional governments<sup>24</sup> which will be voluntary, but subject to conditionality. However, it is not clear how this will differ from the one already established through other programmes (e.g. the Supplier Payment Programme) or what how it relates to requirements laid out in the Budget Stability Law.

In sum, the measures announced to meet the 2012 budget deficit would appear to be enough. The same could be said for measures planned for 2013, although their implementation is subject to risks. First, BBVA Research forecasts point to sharper erosion in economic activity than the government is estimating for 2013 (-1.4% vs. -0.5%). Therefore, if BBVA Research's scenario proves accurate, the deficit target would be jeopardised unless additional measures were adopted. This would not be too problematic as the European Commission has already shown there is flexibility to amend targets in the event of a change in economic outlook. Second, there is the risk of implementation by the regional governments. The breakdown of the 2012-2014 multi-year plan includes EUR 20 billion worth of measures in 2013 that relate to policies that are difficult to measure. An example is the public administration reform, expected to generate a saving of EUR 3.5 billion. Accordingly, the central and regional governments need to give details on exactly how they expect to achieve these saving as soon as possible.

Table 3  
**Spain:**  
fiscal measures adopted as of June 2012

Measures adopted	EUR million	% of GDP
Central government: 2012 Budget	25.7	2.4
Local governments: property taxes	0.9	0.1
Social Security: reduction in tax evasion	1.9	0.2
Local governments: elimination of duplications	0.1	0.0
Regional governments: 2012-2014 restructuring programmes	18.3	1.7
Local governments: restructuring programmes	3.1	0.3
Central government: expenditures cuts	0.3	0.0
Total measures	50.3	4.7
Nominal GDP	1,074.7	

Source: BBVA Research based on MINHAP and INE data

### A timetable for structural reforms for the second half of 2012 has been announced, which should lay the foundations for a road map for the Spanish economy in the medium term

The government has said it intends to legislate in areas such as the pension system, market unity, deregulation of services, privatisation of transport-related services, energy or education reform, which are clearly holding the Spanish economy back from becoming more competitive. In fact, a series of reforms are already underway to liberalise

Table 4  
**Spain:**  
fiscal measures adopted (including those of July-August 2012)

	2012		2013	
	EUR million	% of GDP	EUR million	% of GDP
Previously-approved measures	49.4	4.6	10.4	1.0
Uncertain revenue	6.1	0.6		
New measures of July-August	13.0	1.2	16.4	1.5
VAT increase	2.3	0.2	7.8	0.7
Decrease in SS contributions			-1.0	-0.1
Increase in corporate income tax	2.6	0.2		
Increase in personal income tax			1.9	0.2
Decrease in spending on public wages	4.0	0.4		
Other revenue measures	1.9	0.2	3.4	0.3
Other expenditures measures	2.2	0.2	4.3	0.4

Source: BBVA Research based on MINHAP and INE data

domestic commerce which are well aimed, but could have been even more ambitious; e.g. removal of limits on store hours by type of establishment or location in an area of high tourism. If the scheduled reforms for 2H12 are carried out as planned, it would help shore up the perception of the Spanish economy's ability to grow and the medium- and long-term sustainability of its finances. Although execution risk will persist, the Spanish government is taking the right steps to restore the confidence of Europe's institutions.

22: See Box 4.

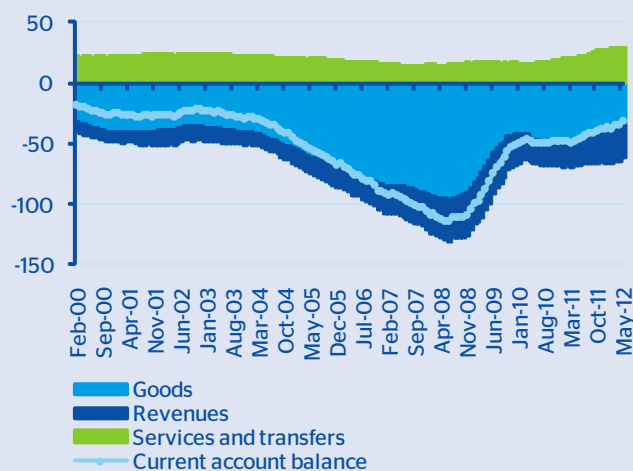
### Box 3. Current account, foreign debt and capital flows: an historical period for the Spanish economy

When the Spanish economy was growing before the current crisis, it built up unprecedented foreign macroeconomic imbalances. The macroeconomic stability attributed to the establishment of the EMU with the disappearance of exchange risk triggered a massive increase in domestic spending in Spain, which resulted in a marked deterioration of the country's current account balance (see Chart 27). In terms of savings and investment flows by agent, the increase in the current account deficit arose because of the high financing needs of Spanish households and, more importantly, of Spanish companies, whose performance was shaped by easy access to credit at lower interest rates than before the advent of the euro (see Chart 28). In 2007 alone, the Spanish economy needed to raise funds in international markets amounting to 10% of GDP in order to finance real activity. This does not include foreign finance required to, for instance, refinance previously issued public and private debt. The global financial crisis and the adjustment of the imbalances in the real estate sector

drove a "reversal" of the current account, especially in 2009, when in just a year the deficit was cut in half, resembling the corrections achieved by Portugal, Ireland or Singapore in the early 1980s (Freund, 2005). Similarly, from 2007 to 2010, the composition of financing needs by agent in the Spanish economy changed considerably: households and companies showed borrowing capacity, while financing needs were limited exclusively to the public sector. After that, the foreign balance adjusted continuously, with forecasts pointing to a surplus starting in 2013 once the public sector made progress in reducing its funding needs. The key for the Spanish economy lies in generating structural current account balance surpluses; i.e. surpluses based on stable and robust exports, which could be extended to a large portion of domestic productive activity, in line with the focus on exports of large companies. Only then would foreign debt be capped and the economy as a whole could embark on an orderly deleveraging in the medium term.

Chart 27

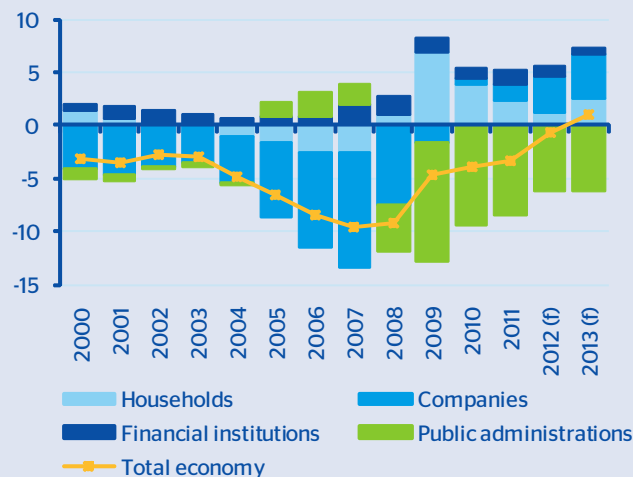
**Spain: current account balance and sub-balances (EUR billion, 12-month cumulative)**



Source: BBVA Research, based on Bank of Spain data

Chart 28

**Spain: financing capacity (+)/requirement (-) (% of GDP)**



Source: BBVA Research, based on INE data

#### Recent stylized factors regarding external debt

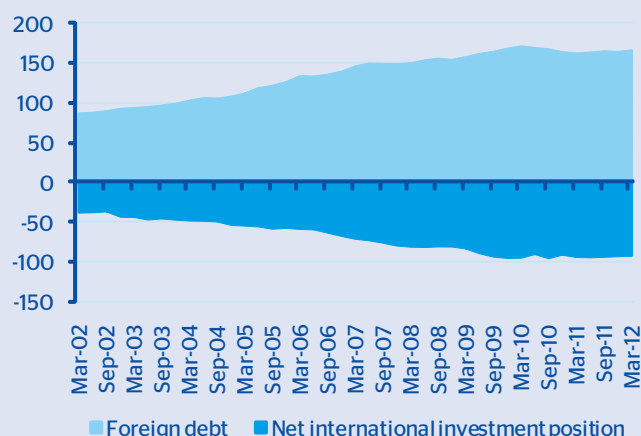
Cumulative gross foreign debt over the last decade amounts to 166% of GDP or, in monetary terms, to EUR 1.78 billion (see Chart 29). Net foreign debt (i.e. stripping out assets abroad held by residents in Spain) decreased to 91% of GDP according to the net international investment position published by the Bank of Spain. Nevertheless, recent economic literature warns about the danger of focusing analysis on net foreign debt data. Specifically, when the economy as a whole is heavily leveraged, foreign

capital flows are high, and the domestic and international environments are unstable, a restructuring of liabilities becomes more likely (see Forbes and Warnock (2011), Alberola et al. (2012), Santos (2012), among others. On top of the marked increase in external debt over the past 10 years, Chart 30 illustrates the absence of progress in aggregate deleveraging of the Spanish economy vis-à-vis the rest of the world, which must be carried out and could undermine economic growth in the years to come.



Chart 29

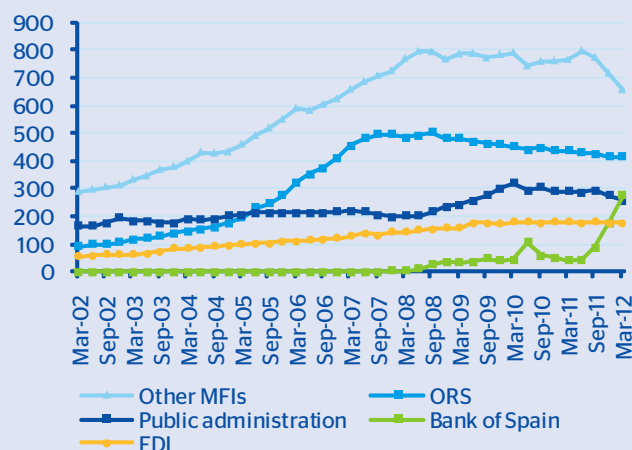
Spain: net international investment position and foreign debt, 1Q02-1Q12 (% of GDP)



Source: BBVA Research, based on Bank of Spain data

Chart 30

Spain: foreign debt (EUR bn)



Source: BBVA Research, based on Bank of Spain data

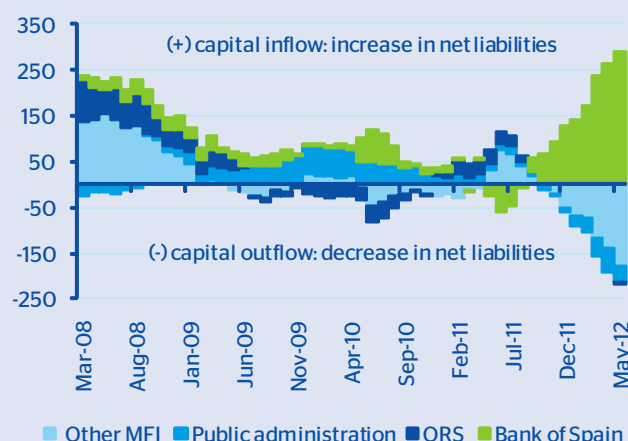
The economic boom led to a sharp increase in the foreign debt of other monetary financial institutions (OMFIs), i.e. monetary financial institutions including the Bank of Spain, and other resident sectors (ORS), especially companies, since household debt vs. the rest of the world is operated through bank balances (see Chart 30). When the economy worsened around mid 2008, the accumulation of liabilities in the private sector came to a halt, and when the automatic stabilisers responded to job destruction, it was the public sector that began accumulating liabilities: between 3Q08 and 3Q10, foreign debt of public administrations increased from 20% to 29% of GDP, whereas non-resident agents still did not show any appetite for acquiring securities issued in Spain. Meanwhile, ORS external debt began falling moderately, with the deleveraging process continuing up to the first quarter of 2012. The recent decline in OMFI external liabilities is merely a reflection of the cumulative increase in indebtedness of the Bank of Spain. Specifically, persistent financial instability in Europe has fed through to a dramatic change in the composition of the Spanish economy's funding sources, especially noticeable since the second half of 2011.

### Capital flows and reliance on the Eurosystem

Until May 2010, when fears of contagion from the Greek crisis sent international markets spinning, the Spanish economy received monthly capital flows from the foreign private sector and public administrations to cover the refinancing of its external debt, interest and the issuance of new liabilities deriving mainly from the current account deficit (see Chart 31). The economy began seeing a gradual decline until it came to a sudden stop in the second half of 2011: foreign investors reduced their positions in financial instruments issued by OMFIs and public administrations, with the Eurosystem emerging as the main counterparty in financial transfers abroad. Since June 2011, the Spanish economy (excluding the Bank of Spain) has accumulated a net decrease in foreign debt of nearly EUR 216 billion. At the same time, net liabilities to the Eurosystem, in the form of other investments in the Bank of Spain, increased by around EUR 292 billion (see Charts 32 and 33). The consequence of this negative trend is the "renationalisation" of Spanish risk since the public, corporate and bank debt held previously by foreign agents is being purchased by residential institutional sectors, specifically financial institutions that, to do so, borrow from the ECB with intermediation by the Bank of Spain.

Chart 31

Foreign investment in Spain: change in net liabilities to the rest of the world by institutional issuer (12-month cumulative, EUR billion)

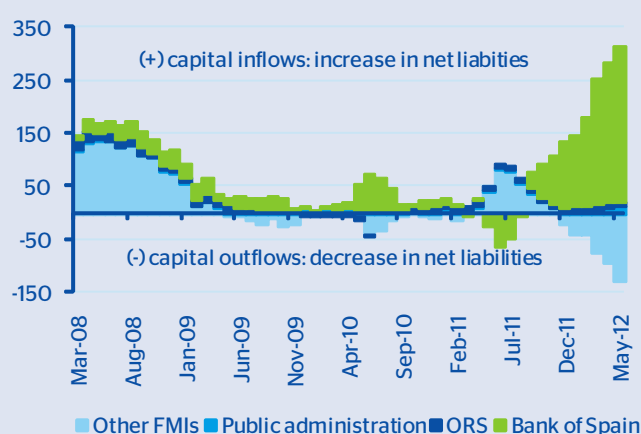


Source: BBVA Research, based on Bank of Spain data

Our analysis of capital flows is rounded off with a look at the behaviour of domestic agents with respect to their investments in foreign assets. Amid the current financial instability, understanding movements in this item of the balance of payments is critical, as it provides a gauge of confidence among resident agents regarding the economy. Since tension in Europe heightened, the net increase in foreign assets has been almost exclusively by OFMIs,

Chart 33

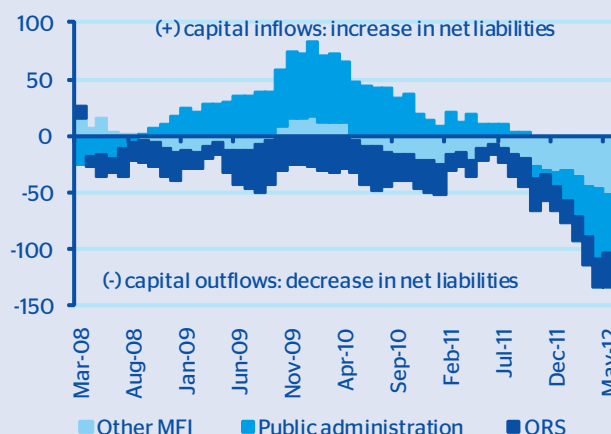
Other foreign investment in Spain by institutional issuer sector (12-month cumulative, EUR billion)



Source: BBVA Research, based on Bank of Spain data

Chart 32

Foreign portfolio investment by institutional issuer (12-month cumulative, EUR billion)

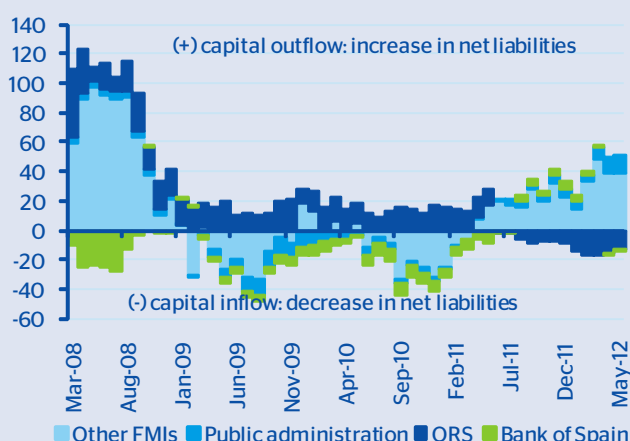


Source: BBVA Research, based on Bank of Spain data

possibly in search of yield and diversification from the massive liquidity injected by the ECB through the 3-year auctions held in December and January. Nevertheless, for all domestic agents together, cumulative net capital outflows since June 2011 amount to a EUR 40 billion, a figure far from the levels typical during bouts of capital flight (see Chart 34).

Chart 34

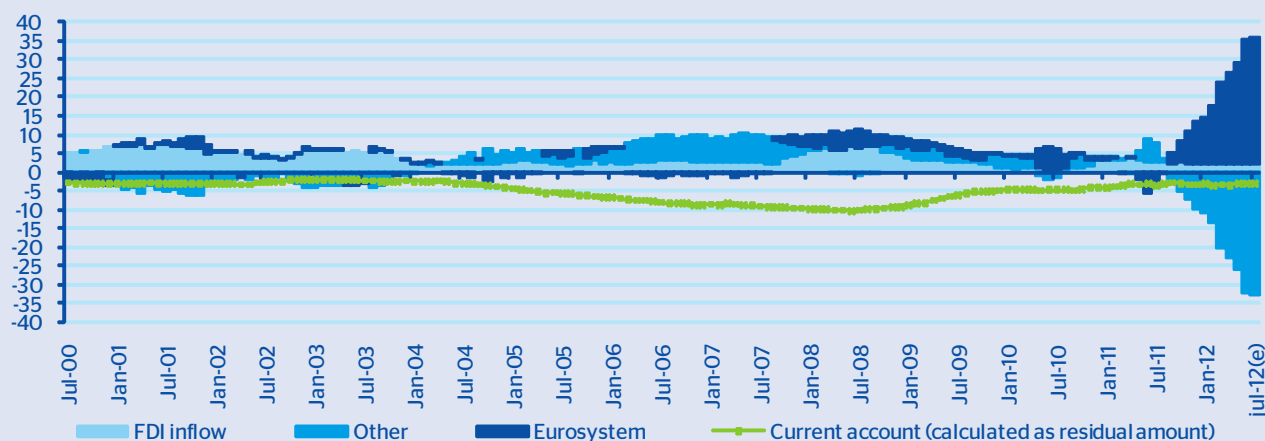
Spanish foreign investment: change in net foreign assets by institutional sector (12-month cumulative, EUR billion)



Source: BBVA Research, based on Bank of Spain data

Chart 35

## Spain: current account balance and net capital flows (as % of GDP)



(e) estimation

Source: BBVA Research, based on Bank of Spain data

In sum, Spain's reliance on flows from the Eurosystem is worrying. Problems accessing international finance through the normal channels and the lack of deleveraging by the economy of external debt, can only lead to an increasing reliance on ECB liquidity (see Chart 35). Against this backdrop, a definitive solution to the main problems behind the wariness of foreign investors must be found quickly, ensuring the sustainability of Spanish debt with medium- and long-term plans guaranteeing a reduction in the public deficit and encouraging the growth of the economy.

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Freund, C. (2005), "Current Account Adjustment in Industrial Countries", *Journal of International Money and Finance*, Vol. 24, pp. 1278-1298.

Santos, T. (2012), "El parón súbito y la renacionalización del riesgo español" on FEDEA blog (<http://www.fedeablogs.net/economia/?p=22847>).

#### Box 4. Diverse regional performances, shaped by fiscal adjustment and foreign trade

The deterioration in the outlook for growth affecting the entire Spanish economy in the past three months also affects the regional outlook. Specifically, the increase in financial stress hurts regional governments particularly, making it impossible for them to issue debt in wholesale markets since the fourth quarter of 2011. The downgrade to forecast growth for Spain as a whole in 2012 (from -1.3% to -1.4%) reflects particularly the outlook for regions that are affected most by the factors placing pressure on the Spanish economy, i.e. weakness of domestic demand and difficulties raising finance. The expected downturn in 2013 is generalised (see Chart 5), affecting the regions with greater fiscal consolidation needs and fewer opportunities to leverage growth abroad the most.

The ease in the deficit targets agreed with Europe focus primarily on the state and social security, which are more vulnerable to the economic cycle through increased spending on unemployment benefits and a decrease in tax revenues. For the regional governments, however, since the deficit is structural, there are no changes in 2012 and a slightly stricter requirement for 2013: the new targets entail a deficit of 1.5% of GDP in 2012 and 0.7% in 2013. Moreover, whereas the regional governments needed to lower their deficits by half a point in 2011, from 2.9% to 2.4% of GDP, the latest data show the deficit actually increased to 3.3% of GDP. As a result, the necessary fiscal consolidation process was pushed back and the opportunity to benefit from growth in 2011 was missed.

The situations vary across region. Catalonia and Valencia show debt upwards of 20% of GDP, while levels in Madrid, Galicia or the Basque Country are closer to 10%. The differences in deficit are also significant: Castile-La Mancha needs to slash its deficit by 6.6 percentage points in these two years, Extremadura, Murcia or Valencia by around 4 percentage points and Galicia by just 1 percentage point. Accordingly, the impact on domestic demand will be different depending on the region (see Chart 36).

Although there are still doubts that the deficit-reduction targets will be met -this explains part of the problem raising finance in the market- the conditions obliging compliance have changed, lending greater credibility in two years' time. In effect, the start-up of the Regional Liquidity Fund in Spain and applications for aid by the regions in the worst shape mean activating new control mechanisms to guarantee, or at least make progress towards, achieving the target. From now, regions eligible for aid must submit an action plan guaranteeing they will meet their fiscal targets, with close

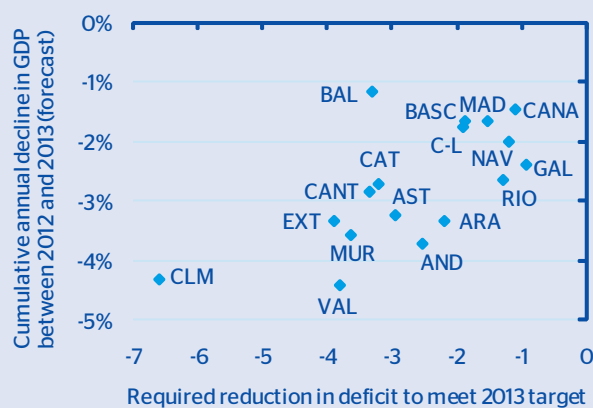
supervision over short periods. In addition, repayment is guaranteed with future income from the share in total state revenues, increasing the chances of compliance. So far, the Valencia, Catalonia and Murcia regional governments have considered tapping the liquidity fund, but other regions could follow suit if financing problems continue over coming months. Operation of this mechanism is crucial for the regions applying for aid bearing in mind the liquidity problems some have been facing all summer.

In addition to fiscal consolidation and implications for domestic demand, foreign demand will also determine the prospects for regional growth over the next two years. Net trade is set to contribute positively in 2012 and 2013, but with Europe's economy virtually coming to a standstill in 2012 and growing only slightly next year, the contribution will almost certainly be smaller than in 2011, when exports rose sharply. In addition, the tourist season last year enjoyed a strong influx of foreigners as competing markets closed due to the "Arab Spring". Data released to date show growth, albeit smaller, of both exports of goods and foreign tourism this year, in line with our scenario. This bodes well for net trade to continue contributing positively to regional growth.

Those regions that are more open internationally stand to benefit most. Services, mainly tourism, should benefit the Balearic Islands, the Canary Islands and Catalonia most, whereas goods exports could be particularly advantageous for the Basque Country, Navarre or Catalonia. Moreover, geographically diverse exports enable regions to gain not only from growth in Europe, but also other areas such as emerging economies, where demand is considerably stronger. Galicia and Castile-León show high degrees of openness, but also high specialisation in their exports. Accordingly, they could receive a temporary boost from the new "car fleet renewal" plan in France. At the end of the spectrum, communities with scant access to foreign markets, such as Extremadura, are likely to profit little in this respect, causing a further negative growth spread with other regions (see Chart 37).

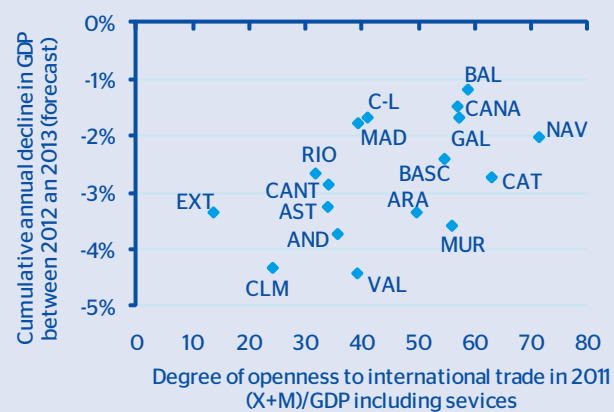
These factors come on top of others explained in previous editions of Spain Economic Outlook: the need to reduce private deleveraging and unemployment is likely to continue hindering a rebound in private consumption, placing a further drag on domestic demand in addition to the impact from the public sector. In short, Spanish regions are likely to continue delivering mixed rates of GDP growth due to differences in the scale and speed of the correction of cumulative (private and public) imbalances.

Chart 36  
Deficit-reduction needs and forecast GDP growth by region



Source: BBVA Research based on INE and MINHAP data

Chart 37  
Degree of openness  
to international trade and forecast GDP growth by region



Source: BBVA Research based on INE and MINECO data

Table 5  
GDP growth

Region	2011	2012 (f)	2013 (f)
Andalusia	0,2	-2,0	-1,8
Aragon	0,3	-1,7	-1,7
Asturias	0,3	-1,5	-1,8
Balearic Islands	1,8	-0,5	-0,7
Canary Islands	2,1	-0,6	-0,9
Cantabria	0,7	-1,3	-1,6
Castile-León	1,3	-0,7	-1,1
Castile-La Mancha	0,8	-2,4	-2,0
Catalonia	0,8	-1,5	-1,2
Extremadura	-0,3	-1,9	-1,5
Galicia	0,3	-1,2	-1,2
Madrid	0,9	-0,7	-1,0
Murcia	0,0	-1,8	-1,8
Navarre	1,5	-0,9	-1,1
Basque Country	1,3	-0,7	-1,0
La Rioja	0,8	-1,5	-1,2
Valencia	0,4	-2,3	-2,2
Spain	<b>0,7</b>	<b>-1,4</b>	<b>-1,4</b>

Source: INE and BBVA Research

## 4. Tables

Table 6

### Macroeconomic forecasts: Gross Domestic Product

(yoy rates, %)	2009	2010	2011	2012	2013
US	-3,1	2,4	1,8	2,1	1,8
EMU	-4,4	1,9	1,5	-0,3	0,3
Germany	-5,1	3,6	3,1	0,9	1,4
France	-3,1	1,6	1,7	0,2	0,7
Italy	-5,5	1,8	0,5	-1,8	-0,1
Spain	-3,7	-0,1	0,7	-1,4	-1,4
UK	-4,0	1,8	0,8	-0,4	1,3
Latin America *	-0,6	6,6	4,5	2,9	3,8
Mexico	-6,1	5,4	4,0	3,7	3,0
EAGLES **	4,0	8,4	6,6	5,4	6,1
Turkey	-4,9	9,2	8,5	3,2	4,1
Asia Pacific	4,2	8,1	5,7	5,4	5,8
China	9,2	10,4	9,2	7,8	8,3
Asia (exc. China)	1,0	6,5	3,4	3,8	4,1
World	-0,6	5,1	3,9	3,4	3,7

Closing date: 3 August 2012

\* Argentina, Brazil, Chile, Colombia, Peru, Venezuela

\*\* Brazil, China, India, Indonesia, Korea, Mexico, Russia, Taiwan, Turkey

Source: BBVA Research

Table 7

### Macroeconomic forecasts: 10Y interest rates (average)

	2009	2010	2011	2012	2013
US	3.2	3.2	2.8	1.8	2.5
EMU	3.3	2.8	2.6	1.6	2.5

Closing date: 3 August 2012

Source: BBVA Research

Table 8

### Macroeconomic forecasts: exchange rates (average)

US dollars (\$) per national currency	2009	2010	2011	2012	2013
US (EUR/USD)	0.72	0.76	0.72	0.79	0.77
EMU	1.39	1.33	1.39	1.27	1.30
UK	1.56	1.55	1.60	1.58	1.66
China	6.83	6.77	6.46	6.31	6.18

Closing date: 3 August 2012

Source: BBVA Research

Table 9

**Macroeconomic forecasts: official interest rates (end of period)**

	2009	2010	2011	2012	2013
US	0.25	0.25	0.25	0.25	0.25
EMU	1.00	1.00	1.00	0.75	0.75
China	5.31	5.81	6.56	5.75	6.00

Closing date: 3 August 2012

Source: BBVA Research

Table 10

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

	2009	2010	2011	2012	2013
Real GDP	-4.4	1.9	1.5	-0.3	0.3
Household consumption:	-1.1	0.9	0.2	-0.6	0.0
Public consumption	2.6	0.7	-0.3	-0.4	-0.5
Gross fixed capital formation	-12.4	-0.2	1.6	-2.9	-0.1
Equipment, machinery and cultivated assets	-18.8	7.0	4.5	-4.3	-0.1
Equipment and machinery	-16.6	5.7	4.2	-4.4	-0.4
Construction	-9.4	-4.6	-0.3	-3.2	-0.8
Housing	-12.1	-3.0	0.8	-2.0	1.1
Other buildings and other constructions	-6.6	-6.2	-1.4	-4.5	-2.8
Change in inventories (contribution to growth)	-0.9	0.6	0.2	-0.5	0.1
Domestic demand (contribution to growth)	-3.6	1.2	0.5	-1.5	0.0
Exports	-12.7	11.0	6.3	2.2	3.4
Imports	-11.4	9.4	4.1	-0.4	2.8
Net exports (contribution to growth)	-0.8	0.7	1.0	1.1	0.4
<b>Pro-memoria</b>					
GDP w/out housing investment	-3.9	2.2	1.6	-0.3	0.3
GDP w/out construction	-3.7	2.7	1.7	0.0	0.5
Employment (LFS)	-1.8	-0.5	0.3	-0.7	-0.2
Unemployment rate (% active pop.)	9.6	10.1	10.2	11.2	11.5
Current account balance (% GDP)	0.1	-0.1	0.0	0.9	1.3
Public sector balance (% GDP)	-6.4	-6.2	-4.1	-3.1	-2.5
CPI annual average	0.3	1.6	2.7	2.3	1.4

Closing date: 3 August 2012

Source: official institutions and BBVA Research

Table 11

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

	2009	2010	2011	2012	2013
<b>Actividad</b>					
Real GDP	-3.7	-0.1	0.7	-1.4	-1.4
Private consumption	-4.3	0.8	-0.1	-2.0	-2.8
Public consumption	3.8	0.2	-2.2	-4.8	-7.9
Gross fixed capital formation	-16.4	-6.0	-5.2	-9.1	-5.5
Capital goods	-22.6	5.5	1.6	-9.1	-4.6
Construction	-15.4	-10.1	-8.1	-10.7	-6.7
Housing	-22.0	-9.8	-4.9	-6.7	-8.3
Domestic demand (contribution to growth)	-6.5	-1.0	-1.8	-4.2	-4.4
Exports	-10.2	13.5	9.1	2.6	7.2
Imports	-16.9	8.9	-0.1	-6.5	-2.1
Net exports (contribution to growth)	2.8	0.9	2.5	2.8	3.0
GDP at current prices	-3.7	0.3	2.1	-0.5	0.0
(Billion euros)	1047.8	1051.3	1073.4	1067.9	1067.4
GDP w/out housing investment	-1.5	0.8	1.2	-1.0	-1.0
GDP w/out construction	-0.8	2.0	2.3	0.2	-0.7
<b>Labour market</b>					
Employment (LFS)	-6.8	-2.3	-1.9	-4.5	-3.8
Unemployment rate (% active pop.)	18.0	20.1	21.6	24.9	26.0
Employment QSNA (equivalent to full-time)	-6.4	-2.6	-2.0	-4.3	-3.6
Productivity	2.7	2.6	2.7	2.9	2.1
<b>Prices and costs</b>					
CPI (annual average)	-0.3	1.8	3.2	2.1	1.5
GDP deflator	0.1	0.4	1.4	0.9	1.4
Household consumption deflator	-1.2	2.4	3.2	2.4	1.5
Compensation per employee	4.3	0.0	0.8	0.7	2.4
Unit labour cost (ULC)	1.6	-2.6	-1.9	-2.2	0.3
<b>Foreign trade</b>					
Current account balance (% GDP)	-4.8	-4.5	-3.5	-1.2	0.7
<b>General government</b>					
Debt (% GDP)	53.9	61.2	68.5	81.7	87.9
Budget balance (% of GDP)	-11.2	-9.3	-8.9	-6.3	-5.0
<b>Households</b>					
Nominal disposable income	0.9	-2.4	0.4	-3.1	-0.3
Savings rate (% of nominal income)	18.5	13.9	11.6	8.7	8.4

Closing date: 3 August 2012

Source: official institutions and BBVA Research



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