

# Economic Watch

## Spain

Madrid, 6 September 2011  
Economic Analysis

Spain Unit

## 3Q11: stagnation, with risks on the downside

- **Third-quarter data released so far suggest a slowdown in economic growth in Spain**

If the trends shown by the indicators released to date persist, qoq growth in 3Q11 would come in at 0.1%, slightly lower than in preceding quarters and not enough to create jobs on a seasonally adjusted basis.

We would like to point out that from November onwards, coinciding with the publication of the Quarterly Spanish National Accounts (QSNA) for the 3Q11, Spanish National Accounts change its methodology, adopting 2008 as its new base year. As a result, historical series could undergo significant backward revisions that would affect our projections throughout the forecast period.

- **Consumption and investment indicators continue to reflect the tenuous recovery of private domestic demand**

This trend reflects still-weak fundamentals that do nothing to change our outlook for a slow recovery in domestic demand. Expectations could be undermined by the uncertainty over global growth and heightened financial stress. The performances of some sectors are being shaped by the withdrawal or adoption of fiscal incentives and public deficit-reduction measures.

- **Meanwhile, growth in exports is easing from relatively high levels**

Although the slowdown could be short-lived, downside risks have increased substantially due to lower-than-expected growth in developed economies, the drop in consumer and business confidence in these countries and the sharp increase in uncertainty in international financial markets.

- **A reversal of fuel price trends, as well as sluggish domestic demand, points to a decline in inflation towards the end of year**

Inflation should remain contained and, in the most likely scenario, the Spanish economy should begin showing competitiveness gains again in 2012.

- **Lower growth in public revenues could jeopardise the deficit targets unless expenditure is reined in considerably**

The last available data show that the slowdown in taxable income is causing the rebound in the main tax receipt items to lose steam.

**National Accounts data for 2Q11 in line with BBVA Research’s estimates**

In line with our estimates, the Spanish economy posted moderate growth again in the second quarter of 2011 of around 0.2% qoq (0.7% yoy), a decline of 0.2pp from 1Q11. The breakdown of national account shows that although trade flows were lower, as expected, the main growth driver was once again net export demand, while domestic demand continuing to have a drag on economic growth. Particularly noteworthy was the fall in public consumption, offsetting the overrun in 1Q11 and indicating an acceleration in the fiscal consolidation process. The 0.6% qoq increment in household consumption does not appear sustainable given the negative trends in fundamentals (except prices, mainly fuel) and it could be due to a drop in saving, which suggest this pace is unlikely to be repeated going forward. Meanwhile, exports fell for the first time qoq since June 2009, partly due to one-off factors (e.g. Japan, cucumber crisis), but also because of the global downturn in activity.

Though small, this increase led to the first quarterly rise in full-time employment (91 thousand jobs) -which, however, is still in the negative side in annual figures (-1% yoy)- meaning a fresh increase in apparent productivity in the work factor. This, coupled with moderate growth in compensation of employees, has driven down unit labour costs further.

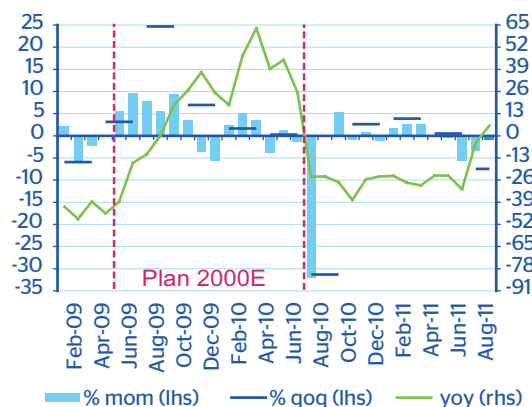
**Figures for July and August do not herald any turnaround in household consumption trends, although risk is on the downside**

SWDA (seasonally and working day adjusted) data show moderate growth in real retail sales in July (of 0.4% mom, 5.1% yoy) after remaining virtually stagnant in June and even after SWDA quarterly falls in 2Q10 were around 1%-2%. The August and September readings will be crucial to gauging whether the levels remain stable as in June and July.

As for other indicators, new car registrations in August remained weak, falling 0.9% mom (SWDA). Car registrations by individuals hurt sales by falling 6.0%, marking a negative contribution to total yoy growth in sales of 3.8pp. Although sales data show that demand by firms and rental companies remains weak (with 18.2 thousand and 2.2 thousand registrations, respectively) these numbers marked increases of 30.4% and 4.9%, respectively, over August last year.

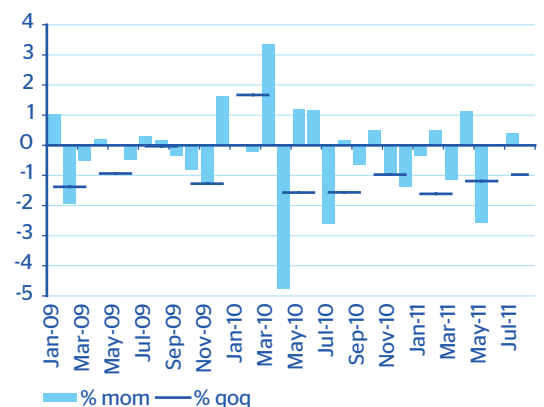
Another indicator that illustrates the weakness of private consumption is household confidence. In particular, consumer expectations regarding the overall economy for the next 12 months worsened by 6.3 points, resulting in a 1.6 point decline in consumer confidence. The next largest negative contributors to the decline were the unemployment outlook and expected financial positions (+4.6 and 3.8 points), explaining -1.2 and -1.0 points, respectively. Expectations of saving improved marginally (+0.4 points), making a positive contribution to the change in consumer confidence (0.1 points). Although the trend is negative, confidence levels have not eroded nearly as much as, for instance, three years ago.

Chart 1  
Spain: car registrations (SWDA\*)



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

Chart 2  
Spain: retail sales (constant prices. SWDA data)

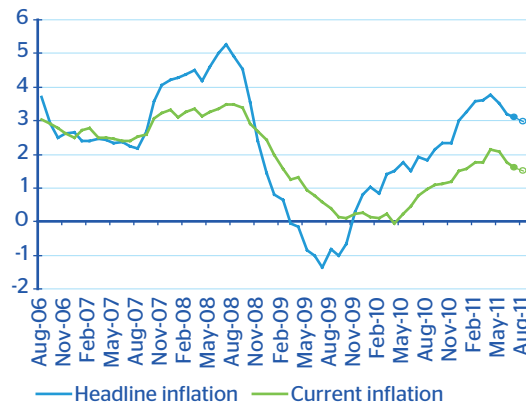


\* SWDA: seasonally and working day adjusted  
Source: BBVA Research based on INE data

### Inflation continues to trend lower, mainly thanks to the moderation in fuel prices

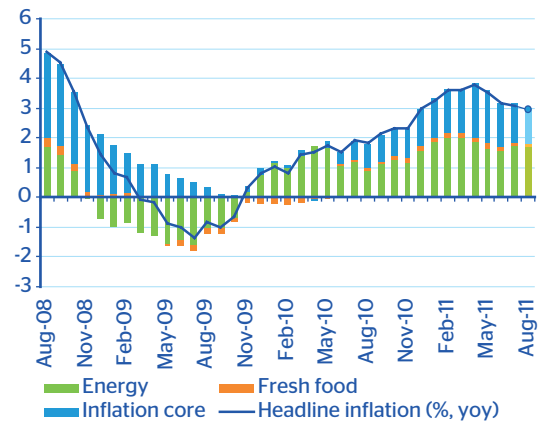
According to the CPI leading indicator, annual inflation slowed 0.2pp in August to 2.9% yoy, trailing just below our base case forecast (3.0% yoy). Annual inflation measured by the HICP eased 0.3pp to 2.7% yoy. Pending release of the detailed breakdown, our estimates point to a decline in core inflation of 0.1pp to 1.5% yoy. Should current trends hold, the yoy headline rate could continue to edge lower, in line with our forecasts of an average yoy increase in prices next year of around 1.5%.

Chart 3  
Spain: inflation (% yoy)



Source: BBVA Research based on INE data

Chart 4  
Spain: contributions to headline inflation growth



Source: BBVA Research based on INE data

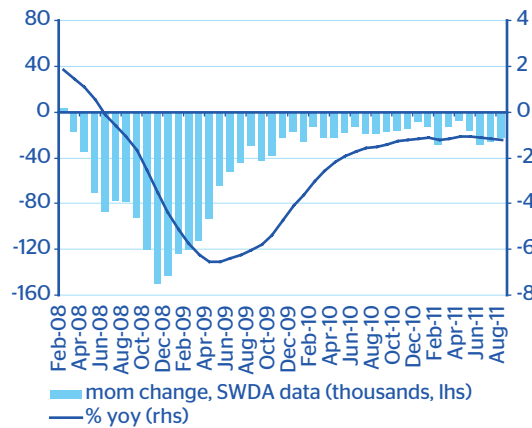
### Adjustment continues in the current account deficit, driven by improvement in both the balances of goods and services

The 12-month cumulative current account deficit at June stood at 45 billion euros, with a reduction in the foreign deficit of nearly 1.5 billion euros. This figure includes a considerable improvement in the balance of goods (0.5 billion euros less), in line with the data gleaned from the June trade balance, and is a result of the good performance in the non-energy deficit. Similarly, the services surplus rose sharply, with the 12-month cumulative surplus at end-June at 31 billion euros (an increase of 1.2 billion euros).

### August numbers indicate no major change in the short-term outlook for the job market

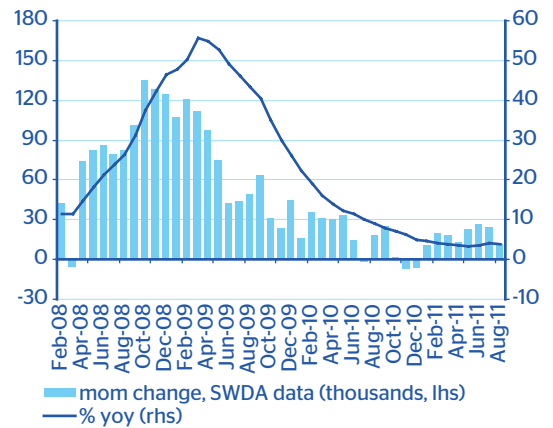
SWDA data show a decline in average social security affiliation of 22 thousand people in August, in line with forecasts and the scale of decreases registered in June and July. Therefore, although the job market is not deteriorating any further, there is a steady pace of job destruction at worrisome levels. Once again, the main culprits of job destruction (SWDA data) were industry and, especially, construction, with hardly any changes in agriculture and services. At the same time, unemployment rose mainly due to seasonal factors, with SWDA data pointing to an increase in the number of jobless of around 12 thousand people, mainly in the services sector.

Chart 5  
Spain: average social security affiliation



Source: BBVA Research based on MTIN

Chart 6  
Spain: registered unemployment



Source: BBVA Research bases on SPEE

### Lower growth in public revenue could jeopardise the deficit targets unless expenditure is reined in considerably

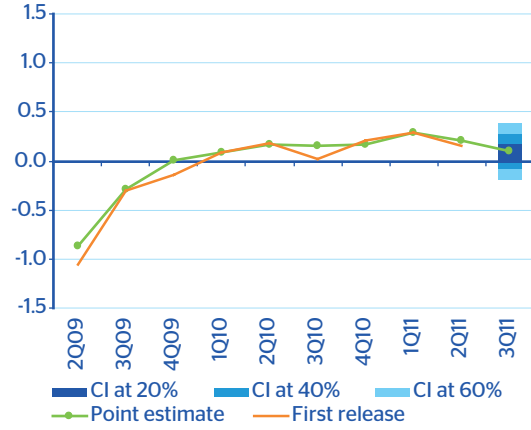
The cumulative government deficit at July 2011 stood at 2.09% of GDP, 0.34pp lower than the year earlier. Most of the spending cuts are still in capital expenditure and transfers among public administrations, although scissors have been taken to virtually all items barring debt interest payments, which continue to rise rapidly. Tax take data for July show a slower recovery due to the decline in taxable income. In short, the data confirm that revenues are performing in line with expectations and that the government is applying the adjustment necessary to meet its year-end targets. That said, just meeting targets might not be enough to offset the potential budget shortfalls of other public administrations. Uncertainties are mainly on the regional governments' budget targets achievement (as we go to print only 1Q11 data have been released) and, to a lesser extent, the Social Security's.

### Growth in 3Q11 less than in 1H11

In short, with nearly 46% of the 3Q11 data we use for our MICA-BBVA model available, our real-time GDP growth forecast for the third quarter is 0.1% qoq, a touch below our baseline scenario estimates (0.2% qoq) and the growth registered in the two previous quarters. As we noted in Spain Economic Outlook: Third quarter 2011 released in early August, economic recovery remains extremely weak, incapable of forestalling job destruction once the quarterly figures have been seasonally adjusted. In any event, growth is consistent with our baseline scenario which calls for GDP growth of around 0.9% for 2011.

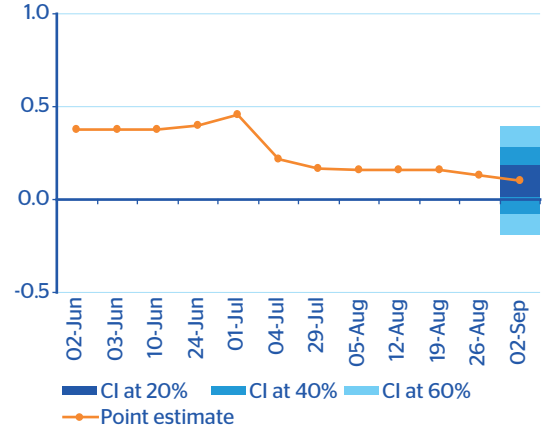
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Chart 7  
Spain: GDP growth observed and forecasts using MICA-BBVA model (% qoq)



Current forecast: 2 September 2011  
Source: BBVA Research based on INE data

Chart 8  
Spain: 3Q11 GDP growth forecasts using the MICA-BBVA model by forecast date (% qoq)



Source: BBVA Research

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**BBVA Research Spain:**

Chief Economist  
**Miguel Cardoso**  
+34 91 374 39 61  
miguel.cardoso@bbva.com

**Mónica Correa**  
+34 91 374 64 01  
monica.correa@bbva.com

**Juan Ramón García**  
+34 91 374 33 39  
juanramon.g@bbva.com

**Félix Lores**  
+34 91 374 01 82  
felix.lores@bbva.com

**Leticia Riva**  
leticia.riva@bbva.com  
+34 91 374 62 66

**Miguel Pérez**  
+34 91 374 75 28  
m.perezvillaseca@bbva.com

**Virginia Pou**  
+34 91 537 77 23  
virginia.pou@bbva.com

**Pep Ruiz**  
+34 91 537 55 67  
ruiz.aguirre@bbva.com

**Camilo Andrés Ulloa**  
+34 91 537 84 73  
camiloandres.ulloa@bbva.com

**BBVA Research**

*Group Chief Economist*  
**Jorge Sicilia**

*Emerging Economies:*

**Alicia García-Herrero**  
alicia.garcia-herrero@bbva.com.hk

Cross-Country Emerging Markets Analysis

**Álvaro Ortiz Vidal-Abarca**  
**Álvaro Ortiz Vidal-Abarca**  
alvaro.ortiz@bbva.com

Asia

**Stephen Schwartz**  
stephen.schwartz@bbva.com.hk

China

**Daxue Wang**  
daxue.wang@bbva.com.hk

India

**Sumedh Deorukhkar**  
deorukhkar@grupobbva.com

South America

**Joaquín Vial**  
jvial@bbvaprovida.cl

Argentina

**Gloria Sorensen**  
gsorensen@bbvafrances.com.ar

Chile

**Alejandro Puente**  
apuente@grupobbva.cl

Colombia

**Juana Téllez**  
juana.tellez@bbva.com.co

Peru

**Hugo Perea**  
hperea@grupobbva.com.pe

Venezuela

**Oswaldo López**  
oswaldo\_lopez@provincial.com

Mexico

**Adolfo Albo**  
a.albo@bbva.bancomer.com

Macroeconomic Analysis Mexico

**Julián Cubero**  
juan.cubero@bbva.bancomer.com

*Developed Economies:*

**Rafael Doménech**  
rdomelech@bbva.com

Spain

**Miguel Cardoso**  
miguel.cardoso@bbva.com

Europe

**Miguel Jiménez**  
mjimenezg@bbva.com

United States

**Nathaniel Karp**  
nathaniel.karp@bbvacompass.com

*Financial Systems & Regulation:*

**Santiago Fernández de Lis**  
sfernandezdelis@bbva.com

Financial Systems

**Ana Rubio**  
arubio@grupobbva.com

Pensions

**David Tuesta**  
david.tuesta@bbva.com

Regulation and Public Policy

**María Abascal**  
maria.abascal@bbva.com

*Global Areas:*

Economic Scenarios

**Juan Ruiz**  
juan.ruiz@bbva.com

Financial Scenarios

**Sonsoles Castillo**  
s.castillo@bbva.com

Innovation & Processes

**Clara Barrabés**  
clara.barrabes@bbva.com

*Market & Client Strategy:*

**Antonio Pulido**  
ant.pulido@grupobbva.com

Global Equity

**Ana Munera**  
ana.munera@grupobbva.com

Global Credit

**Javier Serna**  
Javier.Serna@bbvauk.com

Global Interest Rates, FX

and Commodities

**Luis Enrique Rodríguez**  
luisen.rodriguez@grupobbva.com

**Contact details:**

**BBVA Research**  
Paseo Castellana, 81 - 7 floor  
28046 Madrid (Spain)  
Tel: +34 91 374 60 00 y 91 537 70 00  
Fax: +34 91 374 30 25  
bbvaresearch@bbva.com  
www.bbvaresearch.com