

Economic Watch

Spain

Madrid,
September 19th, 2013
Economic Analysis

Spain Unit

3Q13: entering the recovery phase of the business cycle

- **3Q13 data suggest that the Spanish economy is on the verge of growth**

The trend shown by the economic variables released to date provides enough evidence to state that the Spanish economy will either remain stagnant or grow slightly in the third quarter of 2013. With 57% of the quarter's variables already published, the MICA-BBVA model points to a 0.0% - 0.1% qoq GDP growth¹, a figure that is in line with both BBVA Research's baseline scenario and consistent with a contraction in Spanish GDP of around 1.4% for 2013.

The mentioned economic stabilisation would be the result of renewed Spanish export vigour thanks to economic growth in Europe, reduced financial stress and a less pronounced fiscal effort when compared to 2012. Domestic demand will continue to undermine growth, despite the fact that the export boom is starting to have a knock-on effect on certain components of private demand (mainly investment).

- **Exports continue their upward trend, while the contraction in private domestic demand is easing**

Exports recovered sharply in the second quarter (6.9% qoq), while the deterioration in domestic demand eased (undermining GDP by 0.3pp qoq). Amongst the components of the latter, it can be highlighted that private spending remained virtually flat meanwhile private productive investment edge up.

Economic activity levels are not expected to drop in the third quarter, although growth in virtually all components of final demand – and consequently in imports – is likely to be less buoyant than the one witnessed at the end of the first half of 2013. Regarding foreign demand, the indicators tracking expectations (industrial export order backlog) suggest that activity levels remain solid in the export sectors, albeit slowing moderately following the uptick registered in 2Q13. Service exports are likely to depict a similar trend, due to the stabilisation in the contribution of tourism after the sharp increase in demand registered in the last quarter (4.2% qoq).

1: For more details on the MICA-BBVA model, see Camacho, M. and R. Doménech (2010): "MICA-BBVA: A Factor Model of Economic and Financial Indicators for Short-term GDP Forecasting", BBVA WP 10/21, which can be downloaded at: http://www.bbva-research.com/KETD/fbin/mult/WP_1021_tcm348-231736.pdf?ts=2542012

In terms of private domestic demand, consumer spending data (i.e. retail sales, passenger car registrations and household confidence) continue to point downwards, albeit some of them showed signs of improvement in the initial months of 3Q13. Both the recovery in industrial confidence and the rise of PMIs in July and August -together with the growth in the capital goods IPI reading for July and the solid export performance- appear to foreshadow consolidating growth in investment in machinery and equipment's investment -albeit at a somewhat lower rate than that observed in 2Q13 (3.0% qoq)-, paving the way for overall economic growth in the quarters to come. In contrast, growth rates for residential investment continue to reveal the effect of the higher tax burden on home purchases. The increased tax burden, nonetheless, has not affected demand from foreign citizens, judging by the healthy recovery in house-buying activity by this segment (27.0% yoy during 2Q13). Supply, meanwhile, continues its adjustment process, albeit at a slower pace.

- **Let-up in labour market deterioration**

In spite of the blip experienced in July, Social Security affiliation topped expectations again in August. If the trend observed in August were to continue the rest of the quarter, the number of affiliates would decline by 0.4% qoq (swda and net of deregistration of non-professional care-givers). Unemployment, meanwhile, dropped for the second month in a row in August. Should this trend continue in September, 3Q13 would mark the first quarterly decline in registered unemployment (-0.2% qoq swda) after 25 straight quarters on the up.

- **Easing pace of fiscal consolidation**

The breakdown of the 2Q13 Quarterly National Accounts (CNTR in Spanish) confirmed the expected slowdown in the pace of fiscal consolidation during the first half of the year. In particular, following a drop in public spending of 0.7pp of GDP between 2H12 and 1H12, this heading increased by 0.3pp of GDP between 1H13 and 2H12. However, data appear to confirm that the downward adjustment in public investment is ongoing, with 1H13 Investment in Other Buildings decreasing by 0.6pp of GDP with respect to that of 2H12 (-0.1pp between 2H12 and 1H12). The decline in the pace of public spending cutbacks partly reflects the host of measures concentrated towards the end of last year and has meant lower downward pressure on internal demand.

The less contractive fiscal stance is also evident in the figure of central government deficit until July, at 5.3% of GDP, 1.3pp above the last month's figure. This increase is mainly due to both the observed deterioration in Social Security figures and the higher central government deficit. In general terms, the increase is explained by the growth in public spending, which was in turn fuelled by higher interest payments, and which offset the observed slight recovery in tax receipts. Going forward, certain risks remain, particularly regarding the need to honour spending cuts. So far, these have been unable to counterbalance the temporary measures taken at the end of last year and the increase in debt service expenses.

- **The Spanish economy kept its net financing capacity in 2Q13, despite a moderate outflow of non-resident capital**

Having registered a surplus in 1Q13, the Spanish economy's financing capacity vis-à-vis the rest of the world continued to widen in 2Q13. The June balance of payments data confirmed the third positive current account balance since 1997: €6.82 billion for the twelve months to June, more than twice the surplus registered in May.

Outlook for 2013-2014

- **Statistical restatements reveal a GDP contraction of 1.6% in 2012**

The quarterly national accounting breakdown for 2Q13 included a revision of the series for 2009-2012. According to the new data, the Spanish economy contracted in 2012 by 0.2% more than initially estimated due to both a more pronounced drop in domestic demand and a somewhat weaker growth in exports.

The most significant downward revisions affected the following demand components: public spending (-1.1pp); exports of goods and services (-0.9pp); private spending (-0.6pp) and, by extension, imports (-0.7pp). With the exception of housing investment (-0.7pp), all investment headings were revised upwards, giving rise to a 2.1pp smaller-than-previously assessed decline in gross fixed capital formation.

- **The revisions published do not imply significant biases to our growth forecasts**

Since the mentioned revisions do not reveal discrepancies with respect to BBVA Research's short- and medium-term outlook for the Spanish economy, they do not have a significant impact on its forecasts for the next two years -other than the purely statistical effects for the composition of growth. As stated in our Spain Economic Outlook for the third quarter of 2013², Spanish economic fundamentals suggest that the return to growth in the coming quarters will not be sufficient to prevent the Spanish economy from contracting by around 1.4% in 2013. The economy is expected to grow 0.9% in 2014, underpinned by a gradual improvement in the global economy, an ease-up in fiscal effort and the conclusion in practice of some of the adjustments related to the Spanish structural imbalances.

- **Foreign demand is set to remain the growth engine, while domestic demand will detract from growth by less**

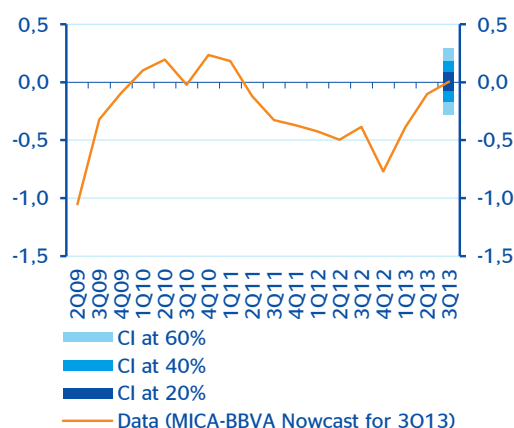
The fiscal consolidation effort is expected to detract from growth once again in 2H13 and, to a lesser extent, in 2014. Real public spending is expected to contract by 1.9% in 2013, with investment in non-residential construction diminishing 12.0%. This contraction in public-sector demand will slacken off in 2014, taking the fall in real public-sector consumption and non-residential construction investment to around 1.7% and 3.3%, respectively.

2: See: http://www.bbvaerearch.com/KETD/fbin/mult/1308_Spaineconomicoutlook_tcm348-398670.pdf?ts=1792013

Regarding private domestic spending, the increase in VAT in 2012 and the weakness in some of the former's drivers suggest a contraction in expenditure of around 2.7% in 2013 and of around 0.2% for 2014. Investment in machinery and equipment, however, is expected to start recovering, despite the relatively high financing costs. In fact, the upward revision to the historic series for this indicator has prompted an increase in our 2013 growth estimate for this heading to 0.8%. Momentum in this investment heading is expected to consolidate in 2014 driven by both a recovery in domestic demand and a continued healthy performance of foreign demand. In particular, our forecast for the latter estimates a growth rate of 5.6% for 2014. A recovery in housing investment, in contrast, will take longer: housing investment is expected to contract 8.7% in 2013. The recovery in construction activity and the expected improvement in demand fundamentals, nonetheless, should prevent sizeable declines in residential investment during 2014 (-0.3%).

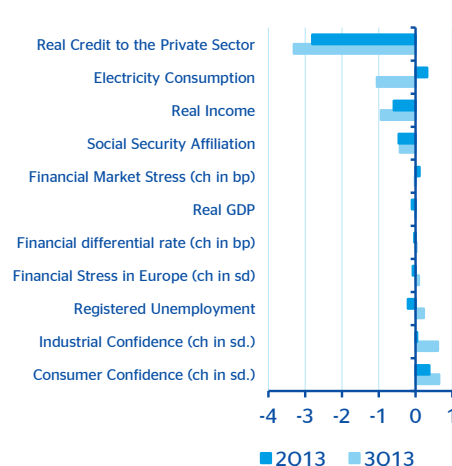
Despite the slowdown in emerging economies, global growth is set to remain high, paving the way for growth in exports of 5.9% on average in 2013-2014. Fuelled by this export boom and stronger internal demand, Spanish imports will stabilise and even renew growth during the forecast period, growing on average 1.5% in 2013-2014. Foreign trade will continue to drive growth -contributing, on average, 1.5pp to GDP growth through 2014 and facilitating current account surpluses in both 2013 and 2014.

Chart 1
Spain: GDP growth and forecasts using the MICA-BBVA Model (% qoq)



Source: BBVA Research

Chart 2
Spain: trends in GDP and the key MICA-BBVA model indicators
(+/-) improvement / (-) deterioration in pp, unless otherwise indicated (SCA figures)



(*) Reported figures as of September and MICA-BBVA model forecasts

Source: BBVA Research based on official data

Table 1

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

	2010	2011	2012	2013	2014
Activity					
Real GDP	-0.2	0.1	-1.6	-1.4	0.9
Private consumption	0.2	-1.2	-2.8	-2.7	-0.2
Public consumption	1.5	-0.5	-4.8	-1.9	-1.7
Gross fixed capital formation	-4.2	-5.6	-6.9	-6.1	1.0
Capital goods	5.0	5.5	-3.9	0.8	5.6
Construction	-9.9	-10.8	-9.7	-10.5	-1.9
Housing	-11.4	-12.5	-8.7	-8.7	-0.3
Domestic demand (contribution to growth)	-0.6	-2.1	-4.1	-3.2	-0.3
Exports	11.7	7.6	2.1	5.0	6.7
Imports	9.3	-0.1	-5.7	-0.8	3.8
Net exports (contribution to growth)	0.4	2.1	2.5	1.9	1.1
GDP at current prices	-0.1	0.1	-1.7	-0.4	1.9
(Billion euros)	1045.6	1046.3	1029.0	1024.3	1043.3
GDP w/out housing investment	0.8	1.0	-1.2	-0.9	0.9
GDP w/out construction	1.8	2.0	-0.4	-0.1	1.2
Labour market					
Employment (LFS)	-2.3	-1.9	-4.5	-3.0	0.2
Unemployment rate (% active pop.)	20.1	21.6	25.0	26.2	25.4
Employment QSNA (equivalent to full-time)	-2.3	-2.2	-4.8	-3.4	0.0
Productivity	2.1	2.3	3.1	2.0	0.9
Prices and costs					
CPI (annual average)	1.8	3.2	2.4	1.7	1.1
GDP deflator	0.1	0.0	0.0	0.9	1.0
Household consumption deflator	1.9	2.5	2.5	1.4	1.3
Compensation per employee	0.4	1.3	0.2	0.0	0.3
Unit labour cost (ULC)	-1.7	-0.9	-2.9	-2.0	-0.6
Foreign trade					
Current account balance (% GDP)	-4.5	-3.8	-1.1	1.0	1.8
General government (*)					
Debt (% GDP)	61.7	70.4	85.9	94.2	98.4
Budget balance (% of GDP)	-9.7	-9.1	-7.1	-6.5	-5.8
Households					
Nominal disposable income	-2.9	-0.5	-2.7	-1.1	0.0
Savings rate (% of nominal income)	13.1	11.0	8.3	8.1	7.1

(*): Excluding financial aid to Spanish banks.

Forecast closing date: September 12, 2013.

Source: official institutions and BBVA Research

Table 2

**Summary of Spain Flash reports
since the publication of the Outlook Spain journal for 3Q13**

Flash Report	Date	Summary	Link
June Industrial Production	08/08/2013	Despite correcting in June, adjusting for seasonal and working day effects, industrial production stagnated in 2Q13	PDF
July CPI	13/08/2013	Inflation slowed down in July due to the tapering off of the base effect from energy price increases and the introduction of the drug co-pay scheme a year ago	PDF
June 2013 trade balance	22/08/2013	The trade deficit for the 12 months to June 2013 totaled €17.9 billion	PDF
June 2013 home mortgages	27/08/2013	Fresh contraction in the mortgage market	PDF
Deposits held by households and businesses decline by €8bn for seasonal reasons	28/08/2013	Adjusting for seasonal factors, resident household and business deposits rose by €2bn in July	PDF
National Quarterly Accounts for 2Q13	29/08/2013	As forecasted in the last edition of our Outlook Spain journal, the Spanish economy verged on a turnaround in 2Q13	PDF
Preliminary August CPI	29/08/2013	Headline inflation eased in August due mainly to the base effect in the energy component	PDF
Real July retail sales: seasonal uptick, as anticipated	30/08/2013	Real retail sales rose in July, driven by seasonal factors	PDF
August industrial and consumer confidence	30/08/2013	Welcome trend in market agents' expectations	PDF
Spain: June 2013 balance of payments	30/08/2013	Spain registers its third current account surplus in a row for the twelve months to June (after 16 years of deficit)	PDF
Central government budget outturn to July 2013	02/09/2013	Spanish deficit to July 2013 amounted to 4.4% of GDP, 0.1pp below that of July 2012	PDF
Passenger vehicle registrations for August: disappointing due to shrinkage of professional sales	02/09/2013	Correcting the gross data for monthly seasonality, BBVA Research's estimates indicate a reduction in the number of registered passenger vehicles in August	PDF
August payrolls: end of holiday season somewhat better than expected	03/09/2013	After a dip in July, employment began to firm once again in August	PDF
July industrial production	06/09/2013	Industrial activity continued to contract in early 2H13, albeit at a slower pace than in 1H13	PDF
July 2013 home purchasing activity: dip after two months of stabilization	11/09/2013	Month-on-month house sales fell back moderately in July	PDF
August CPI	12/09/2013	Inflation slowed in August due mainly to the tapering off of the base effect from last year's energy price increases	PDF
Public Spanish debt (all levels of government considered) amounted to 92.2% of GDP in 1H13, 6.3 percentage points up year-on-year	13/09/2013	Public debt continued to rise in 2Q13	PDF
Central government deficit rises up to 5% as of July 2013	17/09/2013	Spanish cumulative public deficit as of July 2013 surpasses 5% of GDP, around 1.3 pp higher than last month's.	PDF

Source: BBVA Research

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