BBVA | RESEARCH

Economic Watch

Spain

Madrid, 6 March 2012

Economic Analysis

Spain Unit

1Q12: The Spanish economy in recession

- **1Q12 data released to date suggest a further slowdown in economic activity**
  If the trends shown by the available indicators persist, GDP growth could contract by between -0.2% and -0.4% qoq in 1Q12. This would mean a second consecutive quarterly deterioration in GDP.

- **Consumption and investment indicators confirm that domestic demand worsened further in 1Q12**
  Domestic demand has been affected by the climate of uncertainty, the fiscal consolidation process and the persistence of financial tensions, particularly in Europe. Specifically, the faster rate of job destruction pushed down household consumption, while fiscal incentives have not been sufficient to change the trend of deterioration in housing demand.

- **Trade balance figures reflect a slowdown in exports during the last quarter of 2011**
  Slower growth in developed economies, coupled with the decline in the main confidence indicators of our main trade partners and the increased uncertainty in international financial markets have continued to fuel downside risks. However, January data on international sales by large companies suggest a more positive start in 2012 compared to the end of last year.

- **The Government announces a new deficit target that is more in agreement with the current economic scenario**
  The Government will implement a fiscal consolidation process of 2.7pp of GDP (from 8.5% in 2011 to 5.8% at year-end 2012). According to BBVA Research, the deviation from the figure of 4.4% of GDP (1.4pp of GDP) is smaller than the one that would result as a consequence of a more adverse growth scenario than the one presented in Brussels a year ago as part of the Stability Programme. With the Government forecast of a 1.7% contraction of the economy, any deficit below 6.25% would imply a higher fiscal effort in structural terms in 2011 and 2012 than that stipulated in the Stability Programme. Instead of "nominal" targets, structural deficit targets should be the anchor for European fiscal policy, in line with the new governance adopted recently by Spain and the EU.

GDP contracted in 4Q11, with a sharp fall in domestic demand

As mentioned in our last edition of Spain Economic Outlook, the Spanish economy contracted by 0.3% qoq in 4Q11, evidencing deterioration in activity compared to the stagnation recorded in 3Q11 similar than the observed in this quarter respect to 2Q11. The Spanish economy would have grown 0.3% yoy (0.5pp less than in 3Q11), signalling average growth of around 0.7% for the full year, in line with the projections we made at the beginning of 2011. The observed figure reflects a slightly greater decline than our base case estimate (BBVA Research: -0.14% qoq). As a result, our forecasts for the Spanish economy do not vary significantly from preliminary 4Q11 National Accounts and are in line with the 1.3% yoy contraction expected for 2012.

The composition of growth did not show relevant surprises on its basic features, yet some components adjusted more markedly than anticipated. Therefore, economic trends were once again marked by net trade, despite the expected fall in exports, which contributed 1.5pp to GDP growth in the quarter (3.2pp yoy), outstripping our forecasts (BBVA Research: between -0.4% and 1.2% qoq). Meanwhile, domestic demand continued to act as a drag on growth (contribution of -1.8pp qoq; -2.9pp yoy), although to a much greater extent than we had expected (BBVA Research: between -0.4% and 1.2% qoq) and significantly higher than the figures seen in previous quarters, thereby fully compensating the whole qoq rise in net trade.

The breakdown of national accounts reveals some negative details. Firstly, the sharp fall in private consumption (-1.0% qoq), which was in the lower part of our forecast range (BBVA Research: between -1.1% and +0.4% qoq). Additionally, the contraction in trade flows was much more significant than our base case estimate, particularly the decline in imports (-6.5% qoq) which far exceeded the fall in exports (-1.6% qoq)., this explains the high contribution of net trade to growth. Lastly, public sector demand was lower than expected, which has a negative reading for growth but is positive in terms of fiscal consolidation. This, in addition to the announced deviation of the public deficit compared to the targets set at the end of last year, points to a significant decline in public revenue as a result of the drop in internal demand.

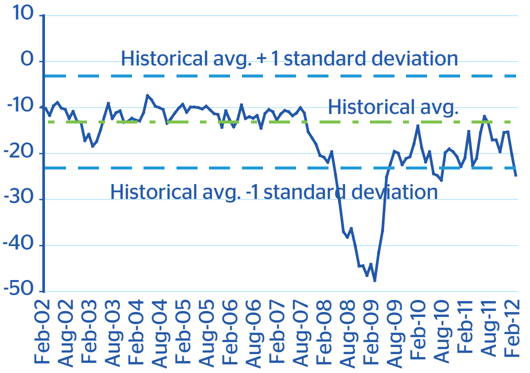
The slight decrease in real employee remuneration, coupled with increased apparent labour productivity, pushed down unit labour costs further. Nominal wages per employee grew slightly below prices (1.1% vs 1.2% yoy of implicit GDP deflator), producing a further drop in employee remuneration in real terms (-0.1% vs -0.2% yoy in the previous quarter) and this fact, coupled with the sharp rise in productivity, triggered a further reduction in unit labour costs (3.6% vs -2.5% yoy nominal).

Consumer expectations suggest a further contraction in private consumption in 1Q12

Following the decline in January (4.9 points to -20.2 points), consumer confidence deteriorated further in February (4.5 points to -24.7), lower than its historical average (-13.5) and the limit of the historically atypical values recorded in the first stage of the recession (-19.4). Consumer expectations in relation to unemployment in the next 12 months worsened by 18.0 points, accounting for virtually all the decline in consumer confidence in that month (contribution: -4.5 points). This was mirrored, albeit to a significantly lesser extent, by expectations for the overall economy (-2.3 points), accounting for 0.6 points of the decline in confidence. In contrast, the outlook for savings, and, more significantly, the outlook for the financial situation, were positive (+0.3 and +2.0 points, respectively), contributing 0.1 and 0.6 points.

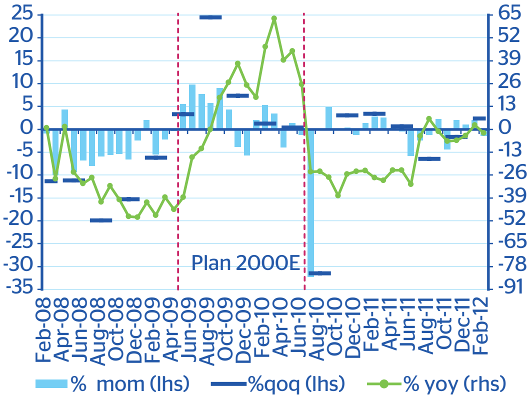
Overall, demand for cars has not worsened dramatically at the beginning of this year. Car registrations fell in February after increasing slightly in January (see Chart 2). In the same way as last year, the unfavourable performance of demand for cars in 1Q12 can be largely attributed to lower purchases made by private individuals.

Chart 1
Spain: consumer confidence
(net responses balance)



Source: BBVA Research based on European Commission

Chart 2
Spain: car registrations (SWDA data)



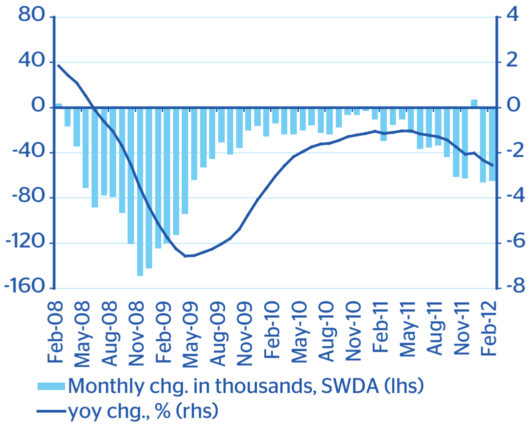
Source: BBVA Research based on ANFAC and Ganvam data

The downturn in the labour market persisted in February

Gross data show that Social Security affiliation (monthly average) fell by 49.7 thousand in February, in line with expectations (BBVA Research: -53 thousand). The fall in employment contrasted with the average increase seen in the month of February over the past ten years (+73.3 thousand; +0.5% mom), and was only slightly better than the figure observed in February 2009 (-69 thousand). Once correcting for calendar and seasonal effects, affiliations fell by around 65 thousand, in line with the previous month. Employment levels fell in all sectors: industry (-8.2 thousand) and, above all, construction (-9.8 thousand) saw higher-than-expected job losses in February (-0.3 and +7.2 thousand, respectively). However, this was fully offset by job destruction in the services sector (-12.6 thousand) which were lower than our base case estimate (-36.4 thousand). Corrected for calendar and seasonal effects, data reflected that all sectors destroyed jobs in February. While job losses in industry (-13 thousand), construction (-25 thousand) and services (-19 thousand) remained fairly stable, less jobs were lost in agriculture.

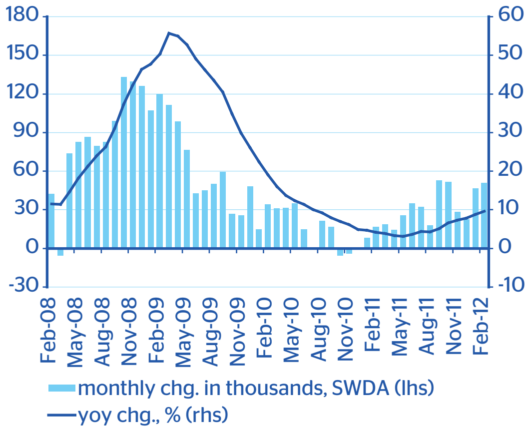
Despite the sharp deterioration in consumer expectations for unemployment, the increase in registered unemployment recorded in February (+112.3 thousand) was in line with expectations (BBVA Research: 93.6 thousand). In tandem with Social Security affiliation, the rise in the number of unemployed was higher than the average growth seen in February over the past ten years (+40.2 thousand; +1.1% mom). Correcting for seasonal effects, unemployment reached 51 thousand, 4 thousand more than in January.

Chart 3
Spain: average Social Security affiliation



Source: BBVA Research based on MTIN

Chart 4
Spain: registered unemployment

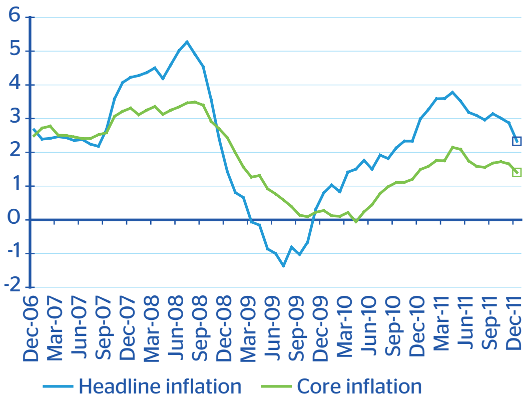


Source: BBVA Research based on SPEE

Inflation is stabilising, alert to risks relating to energy prices

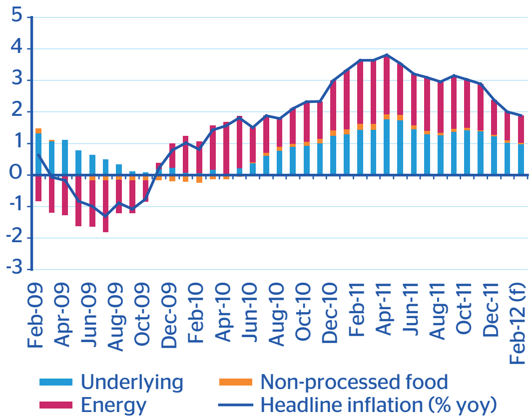
In line with our expectations, the leading CPI indicator signalled a pause in the pace of slowdown of annual inflation in February, remaining stable at 2% (BBVA Research: 2.0% yoy). Inflation measured by the HICP eased 0.1pp to 1.9% yoy. Our forecasts show that the rise in fuel prices in the last few weeks of the month is the main cause of this break in the downward trend. However, given that the weakness in demand and high unemployment rate, our central estimate suggests a further slowdown in underlying inflation in that month (around 0.1pp to 1.2% yoy).

Chart 5
Spain: inflation (% yoy)



Source: BBVA Research based on INE data

Chart 6
**Spain:
contributions to headline inflation growth (%)**



Source: BBVA Research based on INE data

Real estate market activity remained weak in 4Q11, showing no sign of recovery

Available activity indicators for the real estate sector further confirm the two main trends observed over the last few months: generalised weakness but unevenly spread across Spain's autonomous communities. Therefore, demand figures at the end of December 2011 reflected a decline in both the number of housing purchased (-3.8% mom, SWDA), and the number of mortgages (-1.1% mom, SWDA). On the supply side, while the number of permits rose almost 22% mom (SWDA) compared to November, the 4Q balance was a drop of around 20% SWDA compared to the previous quarter.

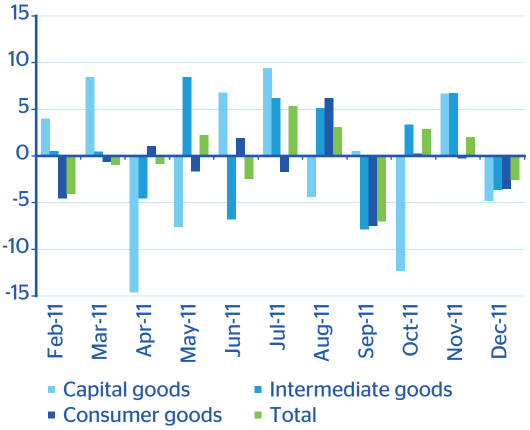
December trade balance data reflect the sharp reduction in imports and the non-energy deficit

December 2011 data put the 12-month accumulated trade deficit at -46.3 billion euros, lower than the accumulated annual figure for the previous month (November: -47.1 billion euros). The improvement in the trade deficit was due to the sharp reduction in the non-energy deficit (-1.5 billion euros) that amply offset the higher energy deficit (+0.7 billion euros). This puts the non-energy trade deficit slightly above 5 billion euros, a figure unseen since the end of the 1980s. The trade deficit as a percentage of GDP was -4.3% at year-end 2011, slightly lower than the prior month's figure (November: -4.4%) and 0.7pp below the 2010 figure.

Volume figures for December reflected a 2.6% SWDA decrease in goods exports compared to the positive figure observed in the prior month (November: +2% mom, SWDA). By sectors, the slowdown in exports was noted in all the main items, especially capital goods (-4.8% mom, SWDA). Aggregate import volumes grew 2.1% mom, SWDA, partly offsetting the contraction seen in the previous three months. In the large sectors, highlights included the increase in intermediate goods imports (+5.9% mom, SWDA) and the drop in capital goods imports (-9.4% mom, SWDA) and, to a lesser extent, consumer goods imports (-1.5% mom, SWDA) marking two consecutive months of decline (see Charts 7 and 8).

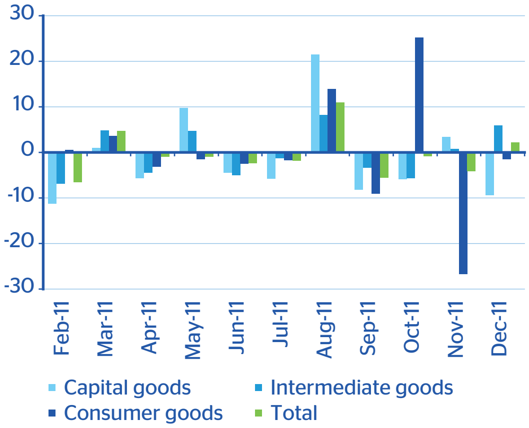
The December trade balance figure closed a quarter in which exports slowed slightly (4Q11: -0.6% qoq, SWDA) after rising in the third quarter (3Q11: +4% qoq, SWDA). This slowdown was due to the weakness of global growth and financial tensions affecting the euro zone. By sectors, the qoq slowdown in exports was due mainly to the decline in capital goods exports (4Q11: -10.9% qoq, SWDA) and, to a lesser extent, consumer goods exports (4Q11: -4.2% qoq, SWDA). Imports also dropped significantly qoq (4Q11: -3.3% qoq, SWDA), headed by the lower imports of capital goods (4Q11: -6.3 qoq, SWDA) and intermediate goods (4Q11: -3.1% qoq, SWDA). However, it is worth pointing out the discrepancy between trade balance figures and the breakdown of goods exports and imports published in the Quarterly National Accounts for the fourth quarter, where the qoq contraction was much higher – especially for imports. As opposed to the negative year-end 2011 figures, exports made by large companies in January could be anticipating a more positive start of the year. Meanwhile, imports by large companies in January appear to suggest a fresh dip, and therefore the contribution of the foreign sector to growth should remain positive.

Chart 7
Goods exports volumes, large sectors (% mom; SWDA)



Source: BBVA Research based on Customs

Chart 8
Goods imports volumes, large sectors (% mom; SWDA)



Source: BBVA Research based on Customs

The higher risk premium and capital market tensions are negatively affecting the balance of payments

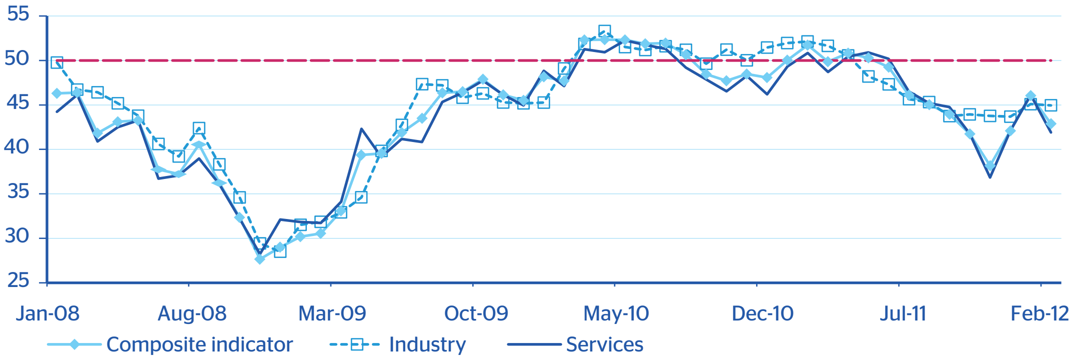
The 12-month cumulative current account deficit of December increased by one billion euros to -39.8 billion euros in 2011 from -38.7 billion euros the previous month. The sharp adjustment in the balance of goods deficit was notable (-0.7 million euros), reflecting the reduction observed in the December trade deficit. The 12-month cumulative surplus in services was close to 35.3 billion euros (up 0.7 billion euros). The 12-month cumulative figure to December reflected a substantial worsening in the income deficit (+2.5 billion euros), while the transfer balance deficit was virtually unchanged. The current account deficit at year-end 2011 was -3.7% of GDP, slightly lower than expected, and in parallel with the economic slowdown seen in the latter part of the year, especially in relation to imports.

The financial account of the balance of payments at December 2011 showed a 33.7 billion euro net decrease in resident sector liabilities, significantly higher than the figure recorded in November, and due mainly to the reduction in liabilities associated with monetary financial institutions (excluding the Bank of Spain) compared to the rest of the world. However, the Bank of Spain financial account reflected a net increase in liabilities of 34 billion euros in December, due to the increase in net liabilities in comparison with the Eurosystem. In relation to investment made by monetary financial institutions (excluding the Bank of Spain) overseas, the 6-month cumulative figure to December 2011 once again showed a decline in foreign assets held by these institutions, especially assets in the form of overseas portfolio investments.

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

After falling sharply in October and November, industrial production rose in December (+1.0% mom, SWDA), closing the year with an average annual decline of 1.4 with respect to 2010. Further, in contrast to the consumer confidence indicator, industry increased slightly in February (0.6 points to –14.3 points), still below its historical average (-9.1), although higher than the limits of historically atypical values recorded between the second quarter of 2008 and the third quarter of 2009 (-19.9). While the qualitative data observed in February were slightly more positive for industrial activity compared to the data seen in the past few months, they are still extremely volatile and do not suggest any widespread economic improvement in the short term. The sharp adjustments to monthly inventories have significantly shaped industrial sector confidence, fuelling its volatility over the past few months. Additionally, expectations for future output remain compatible with further deterioration in industrial activity, while industrial orders were less healthy than they were in the first half of 2011 in terms of domestic and external demand.

Chart 9
Spain: PMIs (SWDA, levels above 50 indicate expansion)



Source: BBVA Research based on Markit Economics

The Government has presented a macroeconomic table for 2012 which features a sharp adjustment in public consumer spending

According to this table, the economy is expected to contract by 1.7% (BBVA Research -1.3%). The most significant difference compared to our forecast is the public spending figure (-11.5% yoy). This adjustment is ambitious and would imply that around 2pp of GDP in the adjusted budget would be achieved by reducing current expenditure.

Table 1
Spain: macroeconomic forecasts

	2012 (f)		2013 (f)
(% chg, yoy)	BBVA Research	Spanish Government	BBVA Research
National Final Consumption Expenditure (FCE)	-2.3	-4.0	-1.1
Private FCE	-2.0	-1.4	-0.9
Public Administration FCE	-3.1	-11.5	-1.8
Gross capital formation	-6.2	-6.9	-1.9
Fixed material assets	-6.6	na	-2.1
Equipment, machinery and cultivated assets	-5.0	-5.3	2.1
Construction	-7.3	-7.8	-4.0
Housing	-6.5	na	-1.5
Other buildings and other constructions	-8.0	na	-6.5
Intangible fixed assets	-2.3	na	1.7
Change in inventories (*)	0.0	na	0.0
Domestic demand (*)	-3.2	-4.6	-1.3
Exports	1.6	3.4	8.2
Imports	-4.8	-5.9	2.1
Net trade balance (*)	1.9	2.9	1.9
GDP at mp	-1.3	-1.7	0.6
Pro-memoria:			
GDP w/o housing investment	-0.9	na	0.8
GDP w/o construction	-0.3	na	1.3
Unemployment rate (% active pop.)	24.4	24.3	24.6
Employment (FTE)	-3.8	-3.7	-1.9
Public debt (% GDP)	72.5	na	74.4
Public sector balance (% of GDP)	-5.3	-5.8	-3.0

(*) contribution to growth
Source: BBVA Research based on Spanish Government, INE and Bank of Spain

The Government has announced that only the structural part of the public deficit will be reduced and the deterioration deriving from lower growth expectations will not be covered

The Government will implement a fiscal consolidation process of 2.7% of GDP (from 8.5% in 2011 to 5.8% at year-end 2012). According to BBVA Research, the deviation from the figure of 4.4 pp (1.4% of GDP) would be attributed to the expected deterioration in deficit figures due to a more adverse growth scenario than the one presented in Brussels a year ago as part of the Stability Programme. In other words, while under the previous scenario measures equivalent to 4.6% of GDP between 2011 and 2012 would have been sufficient to meet the target of 4.4% at the end of this year, they would now only be sufficient to cut the deficit to levels of around 6% of GDP. Instead of “nominal” targets, structural deficit targets should be the anchor for European fiscal policy in line with the new governance adopted recently by Spain and the EU.

Table 2
Spain: Growth and public debt estimates

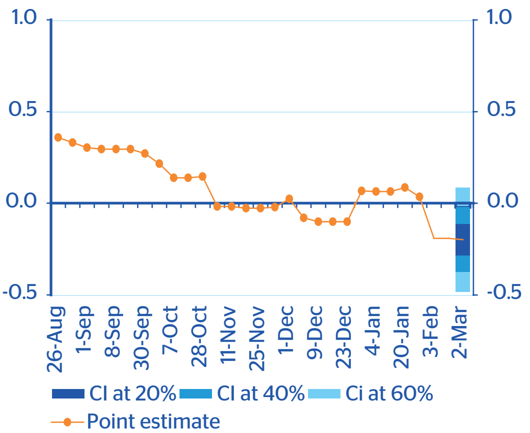
	GDP growth	Public sector balance	Changes in the cyclical component	Changes in the structural component
		Stability Programme (2011)		
2010	-0.1	-9.2	0.0	0.0
2011	1.3	-6.0	-0.1	3.4
2012	2.3	-4.4	0.4	1.2
Reduction in the structural deficit in 2011 and 2012				4.6
		Government scenario (2012)		
2010	0.1	-9.2		
2011	0.7	-8.5	-0.1	0.8
2012	-1.7	-5.8	-1.3	4.0
Reduction in the structural deficit in 2011 and 2012				4.8

Source: BBVA Research

The probability of a further fall in GDP in the first quarter of 2012 is high

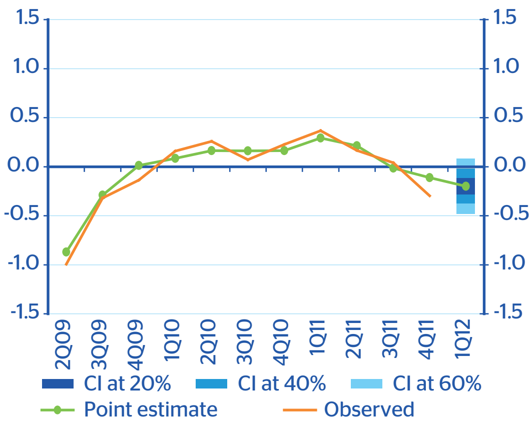
Based on around 45% of 1Q12 data, the real time GDP forecast stands at around -0.2% qoq using the MICA-BBVA model developed by BBVA Research. This forecast does not fully include the additional fiscal adjustment process carried out over the past few months, on which there is a higher uncertainty, and this explains the deviation compared to our base case estimate (-0.4% qoq). As we stated in the last issue of our quarterly publication, Spain Economic Outlook, at the beginning of February[1], this would be consistent with a decline of 1.3% for the full year. Therefore, the probability of the Spanish economy reporting negative quarterly growth in 1Q12 remains at around 70%.

Chart 10
Spain: 1Q12 GDP growth forecasts using the MICA-BBVA model by forecast date (% qoq)



Source: BBVA Research

Chart 11
Spain: GDP growth observed and forecasts using MICA-BBVA model (% qoq)



Source: BBVA Research based on INE data

1: Available at: http://www.bbvaresearch.com/KETD/ketd/bin/ing/publi/espana/novedades/detalle/348_235059.jsp?id=tcm:348-183215-64

DISCLAIMER

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.gl@bbva.com

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

Antonio Marín
antonio.marin.campos@bbva.com
+34 91 374 62 66

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

Miguel Pérez
+34 91 374 75 28
m.perez.villaseca@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
alvaro.ortiz@bbva.com

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

Latam Coordination
Juan Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Alejandro Puente
apuente@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Oswaldo López
oswaldo_lopez@bbva.com

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

Macroeconomic Analysis Mexico
Julián Cubero
juan.cubero@bbva.bancomer.com

Developed Economies
Rafael Doménech
r.domenech@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@grupobbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Pensions
David Tuesta
david.tuesta@bbva.com

Regulation and Public Policy
María Abascal
maria.abascal@bbva.com

Global Areas:

Economic Scenarios

Fianacial 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 - 7th floor
28046 Madrid (Spain)
Tel.: +34 91 374 60 00 and +34 91 537 70 00
Fax: +34 91 374 30 25
bbvaresearch@bbva.com
www.bbvaresearch.com