



Conjuncture Observatory

January 14th, 2009

The Spanish economy falls faster and stronger than expected: recent indicators point to a 0.2% GDP drop y-o-y in Q408

The indicators released throughout the past weeks related to late 2008 are showing that the Spanish economy's current retrenchment is not only aggravating but it is doing so beyond the forecast of a few months ago. The slump is especially evident in consumption and employment indicators, which do not cast any signs that the worst part of such decline may be over yet. In addition, some recent data indicate that certain economic segments that so far had remained untouched by the economic downturn might also be undergoing some adjustment, as in the case of services and exports. Nevertheless, the evolution of Spanish exports compares favourably against the significant drop of exports in the rest of the EMU.

The information available so far points to an interannual 0.2% GDP drop in the fourth quarter (from +0.9% of growth in the third quarter). This implies a two tenth fall below our November's forecasts. The decline foreseen for the fourth quarter is lower than expected for the EMU (-0.7% y-o-y), and it would be consistent with a non-construction economy's growth of approximately 1%. In quarterly terms, this implies that in the fourth quarter the fall will be stronger than in the third (i.e. 0.2%). Based on the data available, the estimated quarterly recession equals 0.4%. However, some pending information on December's scenario (specifically, industrial output and retail data) might eventually lead to a quarterly result of -0.5%.¹

It should be noted that the fast-paced adjustment of the Spanish economy also implies that a portion of its unbalances are being fixed faster than foreseen some quarters ago. That is the case of the current account and deficit and inflation, which might eventually close below previous forecasts.²

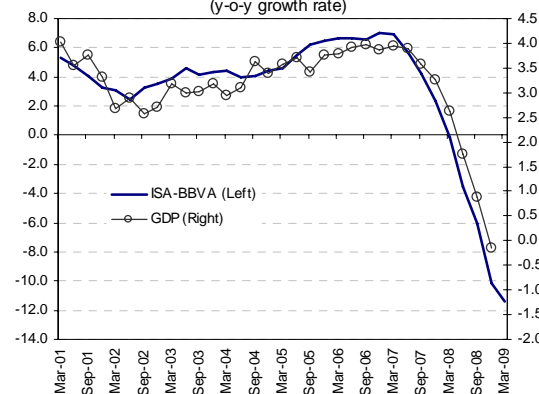
➤ Labour market: the worst part of the adjustment

The results shown by Social Security affiliation and registered unemployment data relative to December are similar to those of previous months: dramatic employment drop and unemployment increase. In the case of affiliation, it is falling above expectations, claiming the steady number of 150 thousand seasonally-adjusted jobs.³ Thus, in Q408 Social Security affiliation dropped by 3.4% yoy. **There are no signs that the labour market's decline will stop, at least in the short haul.**

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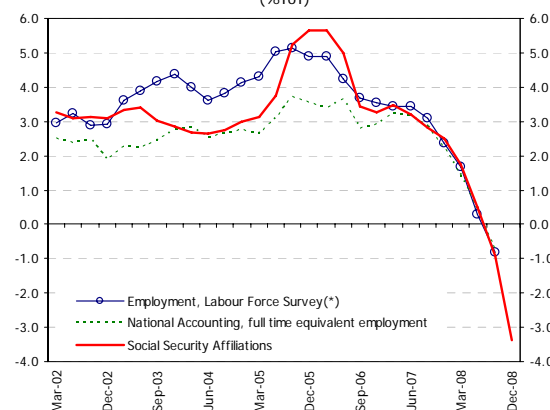
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Spain, GDP growth and Synthetic Activity Indicator
(y-o-y growth rate)



Source: INE and BBVA ERD

Labor market, different measures
(%YoY)



Source: INE, MTIN and BBVA

(*) LFS, adjusted of the methodological change in 2005

¹ The flash estimate of Q109 growth will be released next February 12th.

² See our autumn scenario described in Spain Watch, November 2008.

³ See Labour Market Observatory from Spain, January 8th

(http://serviciodeestudios.bbva.com/TLBB/fbin/IEUES_090114LabourMarketObservatory_13_tcm268-185692.pdf).

Affiliation data are aligned with a sharp employment decline in terms of the Labour Force Survey.⁴ Based on our forecasts, nearly 475 thousand jobs (300 thousand seasonally-adjusted jobs) might have disappeared in the fourth quarter. The estimated growth of Active Population will cause the unemployment rate to rocket up to 13.4% from 11.3% the previous quarter.

➤ **Industrial output in November: manufacturing was sharply adjusted by the end of 2008**

The Industrial Production Index (IPI) falls for the seventh consecutive month and is gaining strength each month. In November, the seasonally-adjusted IPI **dropped by 15.1% yoy, well below expectations**, as it had already occurred in the two previous months (ERD BBVA forecast: -11.4%; Consensus of analysts: -11.4%). In November, all the components of this indicator fell again, although data are even more negative if we consider that **the biggest surprise was caused by the most leading component of the indicator, i.e. intermediate goods** (which in November dropped by 23.7%), **and by the portion that was more closely tied to investment, i.e. equipment manufacturing**, which in November shrank by 16%, after a 3.8% fall in Q308. The scenario described above casts signs of the slowdown of investment in equipment in late 2008 and early 2009. Discouraging output data are consistent with the strong adjustment of employment in this sector at the end of 2008.

➤ **The confidence of consumers and the manufacturing sector in December: a new decline**

Last Thursday 8th, the European Commission released its economic data. The current adverse economic environment has affected the confidence of both consumers and the manufacturing sector, which dropped in December in both cases. Consumer's confidence –which was already at its lowest level– slightly deteriorated falling by two points, down to -46%. However, this month **manufacturing experienced the worst fall in confidence, heading swiftly towards the minimum historical level** of -43.5 points back in 1993, as it went down five points in December down to -37.6%.

➤ **November retail sales: continued falls without signs of having hit bottom**

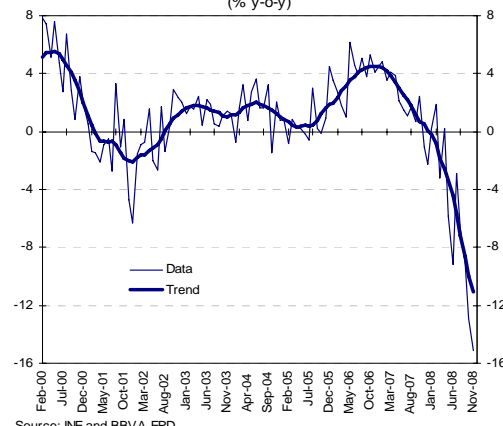
In November, the Retail Sales Index (deflated and seasonally adjusted) went down by 8% yoy, in line with our forecast. However, adding this month, this indicator fell for 12 consecutive months and, **based on the latest data, falls seem to find no boundaries**. All the components of this indicator show falling growth rates (the breakdown by components includes no working day adjustment), although the downturn of “home appliances” should be particularly highlighted, due to both increased consumers' aversion to consumer durables expenditure, and the strong adjustment to the Spanish housing sector. The drop of this consumption item was near 20% in November.

➤ **Car sales registrations in December: sharper falls than in late 2008**

The decline of consumption is particularly evident in the indicators of consumer durables, such as car sales. Throughout the year, they had been showing an increasingly dramatic trend. This is the case of **car registrations in December that caused another surprising negative impact** (as it had occurred in November) with a fall above forecasts, down to 49.9%. All in all, 2008 closes at an average rate of 28% fewer registrations than in 2007 (somewhat above 450 thousand vehicles), thus going back to 1997 figures.

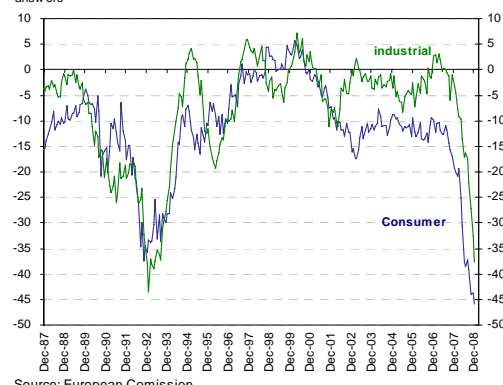
⁴ LFS data for the fourth quarter will be released on January 23rd.

Spain: Industrial output, working day adjusted
(% y-o-y)



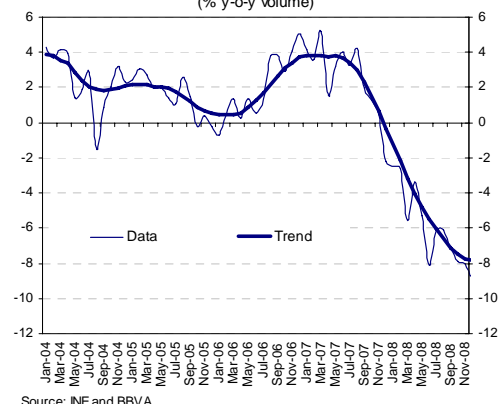
Source: INE and BBVA ERD

Spain: industrial and consumer confidence
net answers



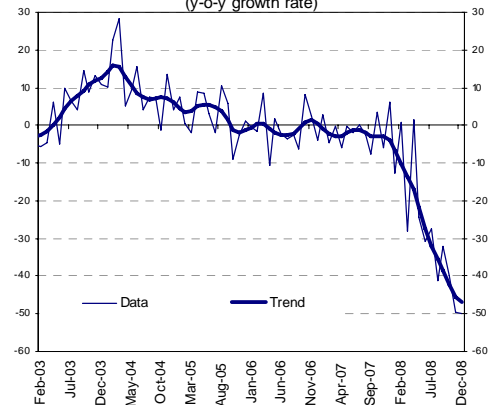
Source: European Commission

Spain: retail sales (working day adjusted)
(% y-o-y volume)



Source: INE and BBVA

Spain: car sales registrations
(y-o-y growth rate)



Source: ANFAC and SEE BBVA

➤ Households' saving rate in Q308: tax cuts fail to boost consumption substantially

Last Thursday 8th, the National Institute of Statistics published the Non-Financial Accounts of Institutional Sectors relative to the third quarter of 2008. Said Accounts reflected the first fall of the need of financing of the Spanish economy since 2003, up to 22,213 million euros, a 13.4% less than one year ago. From the standpoint of the current scenario, **the upturn of the households' saving rate up to 12% of their disposable income** – on an annual accumulated basis– should be highlighted, which implies 1.2 pp above the previous quarter. In the third quarter, the households' income growth rate accelerated up to 10.4% y-o-y due to the impact of its non-wage component, which entails lower related direct taxes, resulting mainly from the annual 400 euros rebate per taxpayer. In this quarter, such payments fell virtually 17% yoy (which implies 4 billion less than one year ago). This transfer of financing capacity towards households from Public Administrations led the latter to claim financing (for the first time since the fourth quarter of 2004) for 1.6% of the gross national disposable income (annual aggregate). However, households' consumption did not recover on a par with income, but rather it remained steady at the figure reached in Q208, i.e. 4.7% yoy. Although the behaviour of consumption in the absence of the 400 euros return is unknown, apparently, **Spanish households allocated most of this tax incentive to saving rather than consumption**. This resulted in a significant reduction of their financing needs, down to 0.8% of the gross national disposable income.

➤ October's external sector: external deficit corrected faster than expected

In the past months, the current account deficit **was corrected swiftly** and more strongly than foreseen. Thus, until October, the current account deficit (annual aggregate) comes down for the fourth consecutive month, down to 109.6 billion. Behind such adjustment **mainly lies the trade deficit drop, particularly the non-energy goods deficit decrease**. Based on October data, the energy deficit has come to a standstill, although the drop of oil prices occurred since then leads to consider that future data will add the energy deficit fall to the non-energy goods deficit, thus pushing down the current account deficit even further. The income and transfer balances, by contrast, showed more deficit than expected over the past months.

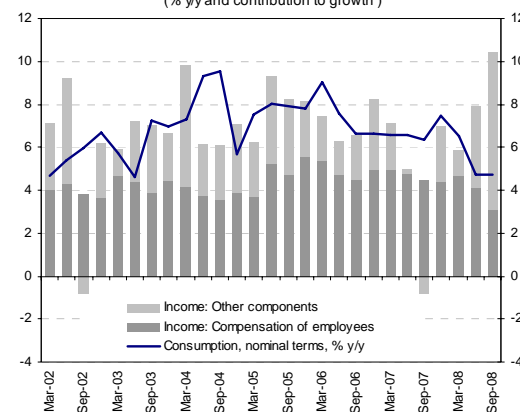
Regarding the trade balance, the adjustment stems mainly from a drop of imports, which show a strong downtrend (in October, they fell by 13.5%), in alignment with the domestic demand adjustment. Even though in October they dropped 0.3% yoy, **exports, in turn, show a slight upturn and surprising resistance**, especially if we compare them with their counterparts in the EMU, as shown in the graph attached. However, big companies' latest export data reflect a more significant adjustment in November.

All in all, should this trend continue, 2009 current account deficit might be lower than estimated in our autumn forecasts, which placed it at around 8.2% of GDP from 9.9% forecasted for 2008.

➤ Sales of big companies in November: first signs of the end of decoupling

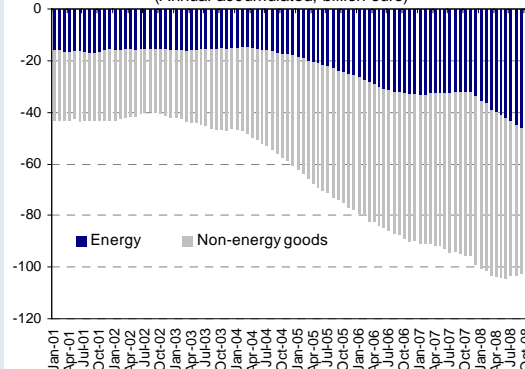
Last week the data on the sales declared by big companies to the Tax Authority in November were released. In general, domestic market data match the signals triggered by other activity and expenditure indicators. Thus, domestic sales would continue a major downtrend (specifically, down to -13.4%). However, November's indicator spotlights the fact the Spanish economy's external sector might already be affected by the global activity decrease. Until the third quarter, this indicator showed a clear-cut dichotomy between domestic sales –with a downtrend– and foreign sales, which were

Households: consumption and disposable income
(% y/y and contribution to growth)

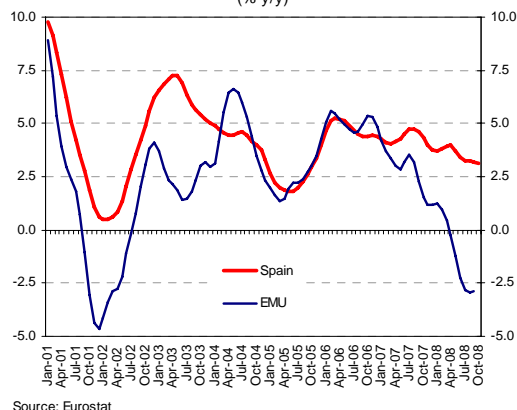


Trade balance

(Annual accumulated, billion euro)

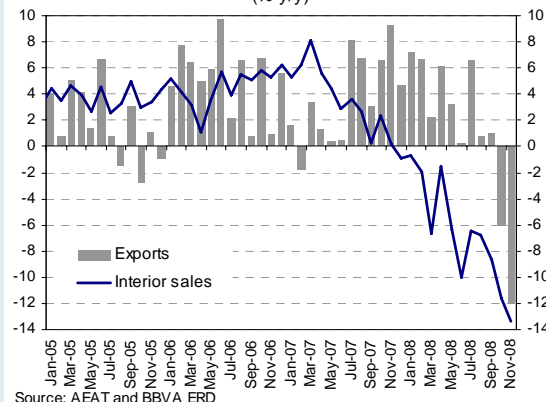


Trade balance: exports of goods, trend (deflated)
(% y/y)



Spain, big companies sales

(% y/y)



still dynamic at the time. Data from the past two months show a plunge of exports (in November down to 12%). In summary, they trigger alert signals about the resistance still shown by external sector's indicators and **seem to anticipate a less dynamic behaviour of exports in the upcoming months within the trade balance** (which reflects October's data), in alignment with the strong adjustment undergone by the economies of our main trade destinations.

➤ **Service sector's turnover indicator in October: services cannot resist either?**

By contrast with manufacturing and construction, so far services had shown relatively dynamic figures. In fact, Q308 National Accounting data reported that this sector was still showing a considerable growth of 2.4%, with a slight slowdown against previous quarters. This scenario seems to change in the light of the latest data on the sector's situation. Thus, in October services recorded a downturn of 8.4% and are already heading towards a strong decrease. As shown in the graph attached, even within certain volatility, the fall is increasingly steeper since mid 2008. These data would then suggest that **this sector's growth in previous quarters will slow down markedly in the forthcoming quarters**.

➤ **Prices of December's consumption and November's manufacturing: surprising slump of inflation**

On Monday 5th, December's Harmonised Consumption Prices Index flash estimate were disclosed. For the second consecutive month, **it showed a surprising slight fall of down to 1.5%**, from 2.4% in November (ERD BBVA forecast: 1.7%; Consensus of analysts: 1.8%). Should such data be confirmed, the Spanish inflation would have reached its lowest level in 10 years, yet closing at 4.1% on average for 2008.

The disinflation pace is being faster in Spain than in the rest of the euro zone. This week the EMU's flash estimate was released as well, showing that inflation dropped down to 1.6%. Thus, since July last year, when the maximum annual level was reached, the growth of prices in the EMU might have come down by 2.4 pp against 3.8 pp in Spain. Lower oil by-products taxation in Spain partly accounts for such differences. As a result, in December **the inflation differential between Spain and the EMU was negative**, for the first time since August 2001. However, there are no signs that this situation will continue during 2009.

So far, the fall of inflation has been the result of decreased energy and food prices, in the case of the latter due to the base effect. The extent of this month's drop leads to the assumption that the price of the core components, services and/or non-energy industrial goods –which had so far remained out of energy and food disinflation– will slow down.

In any case, the recent fall of inflation is being sharper than forecasted a few months ago, **implying an additional bullish trend regarding our inflation forecast for 2009**, so far at 1.9%.

On the other hand, **manufacturing prices cast the same signs**. November's latest data on the Industrial Price Index also showed surprising strong disinflation. Thus, between October and November, its growth decelerated from 5.9% down to 2.5% yoy. Behind each fall we find not only the decrease of energy prices, but also the reduction of consumption industrial goods. However, even more outstanding is the drop of intermediate goods prices, which came down by 4.1 points (from 7% in September down to 2.9%) within two months only. There is week evidence about the link between manufacturing and consumption prices. Yet, in any case, such data point to the fact that **producers' prices will not create inflationary tensions in the short term**.

