

ECONOMIC ACTIVITY

Second quarter 2014

Spain Unit

Second quarter 2014: the expansion of domestic demand temporarily overtakes GDP growth

Recovery continues to make inroads

At the close of this report, the variables confirm the trend of **continuing recovery in the Spanish economy** during the second quarter of 2014. With 48.5% of the information available, our MICA-BBVA model estimates that **GDP growth will be 0.1pp or 0.2pp higher than in the first quarter of the year (0.4% QoQ in 1Q14)¹**. As we saw last quarter, the improvement in activity is being accompanied by job creation, which will probably result in a slowdown in productivity.

The economy improvement still rests on the relaxation of financial tensions, the reduction in the pace of fiscal consolidation and on some of the structural reforms passed in the last two years. Although the volume of foreign sales is still high, **the sector's momentum has faltered in recent months** as a result of lower demand from emerging economies. On the contrary, **the improvement in fundamentals continues to have a positive impact on domestic demand** (mainly on private demand), which continues to surprise to the upside.

For the moment **BBVA Research's growth scenario for 2014 and 2015 (1.1% YoY and 1.9% YoY respectively)² is kept unchanged**. Nevertheless, the most recent data embody an upside bias on domestic demand and a downside one on net foreign demand.

Exports lose strength, but hand the baton to domestic demand

In the first quarter of 2014 there was a fall in goods exports (-1.7% QoQ) which was surprising in view of the resilience shown by the trade balance statistics. Since this fall was not offset by the progress made in services exports (+2.7% QoQ), the quarter ended with a slight downward correction on the total exports figure (-0.4% QoQ). Nevertheless, the start of the year was characterised by the **continuing recovery of domestic demand**, in which the uptick in consumption and private productive investment (0.4% QoQ and 2.5% QoQ in 1Q14) stood out, respectively racking up four and five quarters of growth. This expansive momentum was strengthened in the first quarter by **public consumption**, which, exceeding all expectations, **fully offset the adjustment at the end of 2013** (4.4% QoQ in 1Q14 against -3.9% QoQ in 4Q13).

For the second quarter of 2014, the composition of growth may continue inclining towards domestic demand. Regarding foreign demand, the expectations indicators (industrial exports orders) and expense indicators (foreign sales of goods and services by large corporations) suggest that the downward correction observed in 1Q14 has still not reversed. Similarly, the trend in indicators linked to non-resident tourism (expenditure by foreign travellers and tourists) continues to indicate a moderation in growth, after the steep increase in 2013 (2.6% up on 2012).

On the side of private domestic demand, the recovery is expected to hold, and probably to gain a firmer foothold than expected at the beginning of the year. All the indicators on expenditure in consumption and household expectations (new cars registrations, retail trade, consumer confidence and

1: For more information 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.com/bbvaresearch.com/KETD/fbin/mult/WP_1021_tcm348-231736.pdf?ts=2542012

2 For more information about BBVA Research's economic scenario (2014 and 2015) see: https://www.bbva.com/bbvaresearch.com/wp-content/uploads/2014/05/1405_Spain_Economic_Outlook.pdf

industrial production of consumer goods) show signs of improvement at the beginning of 2Q14. Likewise, the improvement in industrial confidence, in the April-May manufacturing PMIs average and in the equipment goods IPI in April, point to a new uptick in investment of machinery and equipment.

Meanwhile, the data on investment in housing confirm that both supply and demand continue their correction rather more moderately than in recent years. After seasonal and working-day adjustments (swda), the first quarter of 2014 ended with a drop in residential investment of 1.0% QoQ (-6.0% QoQ in housing sale-purchases). For the future, we see no significant changes in the residential investment fundamentals indicating a break in the trend. **2014 will conclude with a more moderate correction to housing investment than the one observed in the last few years (-3.4%), opening the way for the recovery in this investment item in 2015 (4.9%).**

Even so, the biases in both domestic and foreign demand are underpinned by transitory elements which, in the most likely scenario, will gradually reverse, giving way to growth in exports and a weaker recovery of domestic demand. The upswing in the Spanish economy is due, to a large extent, to the recovery in confidence which, nevertheless, is still being affected by the continuity of internal adjustments and the consolidation of the shift in the productive model towards external markets.

Labour market flows are enjoying their best spring since 2005

The number of affiliates to the Social Security system in April and May increased more than in any April-May period since 2005, marking nine consecutive months of (swda) rises. Likewise, the fall in the number of registered unemployed in May noticeably improved the figures from the last five years, reporting eleven consecutive quarters of falls (swda). If this trend is maintained this month, **the number of social security affiliates could rise by 0.8% QoQ swda in 2Q14, while registered unemployment would fall by -2.4% QoQ swda.**

Public demand corrects upward, but no danger yet of not meeting 2014 targets

The breakdown of the Quarterly National Accounts for 1Q14 revealed some **negative surprises in fiscal consolidation**. In particular, after the sharp cut in public consumption in 4Q13 (-3.9% QoQ) – which meant 2013 could be closed with a marginal deviation from the target - in the first quarter of 2014 there was a 4.4% QoQ increase in public consumption. Although this upturn in public expenditure was translated into higher growth of internal demand, it also exerted slightly more pressure in terms of achieving the budgetary goals for 2014.

All in all, **the lower fiscal adjustment required, together with the recovery of activity, suggest that fiscal targets for this year will be met.** The data for budgetary execution to March indicate that the public deficit (excluding local corporations) is around 0.7% of GDP, 0.1% below last year's figure.

The net lending capacity shown in 2013 by the Spanish economy has moderated in the first quarter of this year

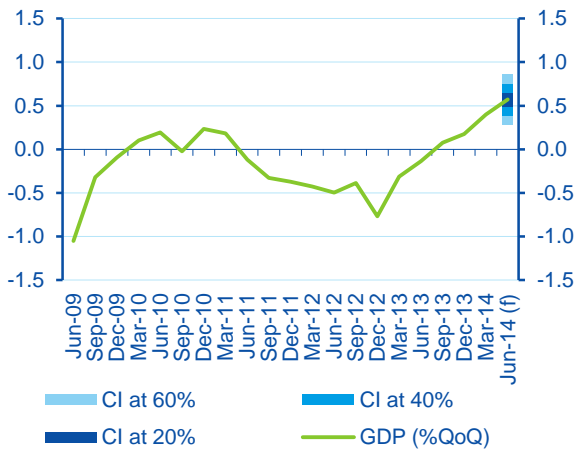
After reaching the first positive figure for more than 25 years at the close of 2013 (0.8% of GDP), **the current account balance remained in surplus in March.** However, the accumulated 12-month surplus fell from its February levels as a result of the adverse performance in the goods balance.

Even so, the current account's correction process relies its structural component³. As a result, **the Spanish economy will show net lending capacity in 2014 and 2015** if the commitment to internal devaluation, to

³. For more information on recent performance and the outlook for the current account in Spain, see the Economic Watch: "An analysis of the performance and determinants of the current account balance in Spain", available, in Spanish only, at: http://www.bbva.com/RESEARCH/observatorio/Cuenta_Corriente_Espa_a_Esp_tcm346-407130.pdf?ts=2112014

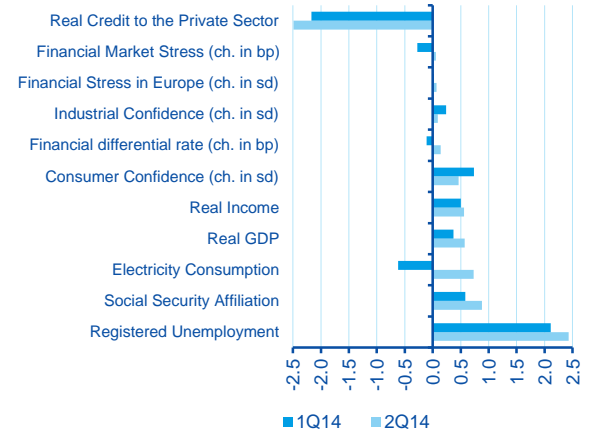
structural reforms and to competitiveness gains remains firm. These are the areas which will contribute to accelerating the creation of stable employment in the coming years.

Figure 1
Spain: GDP growth and MICA-BBVA model forecasts (%QoQ)



(e): estimate.
Source: BBVA Research

Figure 2
Spain: performance of GDP and the key MICA-BBVA model indicators (+) improvement / (-) deterioration in pp unless indicated otherwise (swda data)



Data published until June and MICA-BBVA model forecasts.
Source: BBVA Research based on official institutions

Table 1

Flash Spain publications since the 2Q14 Spain Economic Outlook was published

Title of Flash	Date	Summary	Link
March CPI	11/04/2014	Headline inflation fell due to Easter holiday dates, another fall in energy prices and moderation in fresh food prices	PDF
Housing sales February 2014: sales contract	14/04/2014	After seasonal adjustments, sales contracted 2.9% on the previous month	PDF
Trade balance February 2014	16/04/2014	The accumulated 12-month trade balance deficit to February remained stable at -1.5% of GDP	PDF
Mortgages on housing February 2014: slight contraction	25/04/2014	16,420 housing mortgages were signed in February 2014.	PDF
The public deficit was about 1.0% at the end of February 2014	29/04/2014	The public deficit (excluding local corporations) accumulated to February 2014 was around 1.0% of GDP, in line with last year's figure.	PDF
In March, household and corporate deposits increased by EUR10bn, in line with expectations	29/04/2014	In March household and corporate deposits performance matched expectations	PDF
Labour Force Survey 1Q14: a bucket of cold water	29/04/2014	Disappointing labour market performance according to the 1Q Labour Force Survey when compared to the published figures of Social Security & official unemployment	PDF
Balance of payments February 2014	30/04/2014	The current account surplus accumulated to 12 months fell in Feb over the 12-month accumulated to January	PDF
New credit flows to retail sectors in the first quarter of 2014	30/04/2014	Retail portfolios close 1Q14 with YoY growth of 10%	PDF
April flash CPI estimate: in positive terrain again	30/04/2014	The CPI flash estimaten confirms the increase expected in consumer prices. Both headline and core inflation have returned to clearly positive territory this month	PDF
Flash Quarterly National Accounts : Recovery taking shape, in line with expectations	30/04/2014	Confirming forecasts, the recovery of economic activity gained traction in the fourth quarter of 2013 (0.4% QoQ).	PDF
Retail sales grew in the first quarter despite the negative balance in March	30/04/2014	After seasonal and working-day adjustments, real retail trade sales fell by 0.6% in March, in line with expectations.	PDF
New-build housing construction permits in February 2014: slight contraction	30/04/2014	2,701 permits were signed in February 2014 for new-build housing construction in Spain, in line with expectations	PDF
New car registrations by rental firms account for the positive surprise in April	05/05/2014	After seasonal adjustment of the gross figures, BBVA Research estimates indicate that the number of cars registered in April increased more than expected	PDF
Industrial and consumer confidence in April 2014	05/05/2014	Agents' expectations in the first part of the second quarter of the year were positive	PDF
Labour records in April: the recovery continues	06/05/2014	The number of Social Security affiliates in April continued to grow and registered unemployment to fall in April, even after discounting the positive effect of Easter on contracting	PDF
Industrial production in March	08/05/2014	Even though industrial production corrected slightly downwards in March, the 1Q14 balance was clearly positive	PDF
April CPI: in positive terrain again	14/05/2014	The increase in headline inflation was due to the absorption of base effects, after the calendar changes for Easter and the fall in energy prices a year ago	PDF
Housing sales in March 2014: sales contract	19/05/2014	After seasonal and working-day adjustments, sales contracted 3.4% from the previous month	PDF
Trade balance March 2014	19/05/2014	The trade balance deficit accumulated to 12 months to March worsened by 0.3%, coming in at 1.8% of GDP. The March figure reveals a reduction in the non-energy surplus and an increase in the deficit linked to energy. Should the latter continue, it could negatively affect the trade deficit correction path of the last few years. 1Q14 closed with QoQ expansion in exports and particularly in real imports.	PDF

Continued on next page

Table 1

Flash Spain publications since the 2Q Economic Outlook was published (Cont.)

Title of Flash	Date	Summary	Link
Industrial and consumer confidence in May 2014	28/05/2014	Agents' expectations are changing positively over the course of 2Q14. The improvement in both industrial and consumer confidence supports our BBVA Research scenario: the Spanish economy's recovery continues in 2Q14, and should reach a growth rate at least as high as in the first quarter of the year (+0.4% QoQ).	PDF
Household and corporate deposits slumped EUR10bn in line with expectations	28/05/2014	In April household deposits fell by EUR3bn, very close to expectations. Companies, meanwhile, reduced their deposits by EUR7bn, fairly close to forecasts, and following an atypical March (+EUR11bn).	PDF
Public deficit came in under 0.7% at the end of the first quarter 2014	28/05/2014	Public deficit (exc. local corporations) accumulated to March 2014 will come in at around 0.7% of GDP, 0.1% below last year's figure. By regions, the improvement over the same period in 2013 is mainly due to central government, since the slight improvement in the Social Security surplus has offset the reduced deterioration in the regions.	PDF
Retail sales began the second quarter in positive terrain	28/05/2014	After seasonal and working-day adjustments, real retail trade sales rose by 1.1% in April, slightly more than expected. The uptick in expenditure in durable and semi-durable goods drove this month's positive performance.	PDF
Quarterly National Accounts for 1Q14	29/05/2014	As advanced in the last issue of Spain Economic Outlook, the Spanish economy's recovery continues to consolidate. GDP growth in the first quarter (+0.4% QoQ) is consistent with our scenario in BBVA Research which forecasts a rise of around 1.1% for the whole of 2014 and of 1.9% for 2015. There are few changes in the composition of growth: public consumption is correcting upwards, private demand is growing and there is an unexpected shrinking in goods exports. The recovery in activity was manifested in the second increase in full-time equivalent occupation since the crisis began.	PDF
May CPI flash estimate: low, but positive, inflation	30/05/2014	Both headline and core inflation have remained at historically low, although positive, levels.	PDF
New-build housing construction permits in March 2014: positive surprise	30/05/2014	In March 2014 3,508 permits for new-build housing construction were signed in Spain, more than expected, representing an increase of 12.5% over the previous month. For their part, permits approved for home improvements and extensions fell by nearly 4% over February.	PDF
Spain: balance of payments in March 2014	30/05/2014	The accumulated 12-month current account surplus fell in March from the February 12-month accumulated figure. The trade balance deficit is significantly siphoning off the progress being made on the current account surplus accumulated to 12 months. March closed with large amounts of foreign capital inflows.	PDF
The reduction in new car registrations by rental firms accounts for the slight contraction in May	02/06/2014	After seasonally adjusting the gross figures, our BBVA Research forecasts indicate that the number of car registrations fell in May, in line with expectations. Increased demand from individuals and companies was not enough to offset the severe correction in registrations by rental firms.	PDF
Labour records in May: the best spring since 2005	03/06/2014	In May the number of affiliates to the Social Security grew again, while registered unemployment fell again, even after discounting the period's positive seasonal effects.	PDF
April industrial production	06/06/2014	Industrial activity performed better in April than central forecasts had suggested. Forward indicators point to a consolidation in this upwards trend.	PDF

Source: BBVA Research

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