

## ACTIVITY

# Spain: economic growth continues but decelerates in the third quarter

Spain Unit

The diminishing strength of tailwinds and the appearance of new headwinds reduce growth in the second half of the year

The trend for the observed variables indicates that **the Spanish economy continues to grow in the third quarter of 2015, although at a slower rate than in the preceding quarters**. With around 50% of the information available for 3Q15, the MICA-BBVA<sup>1</sup> model estimates that **quarterly GDP growth (QoQ) could reach 0.6%**. Even though this figure is 0.1pp below that advanced in our [Spain Outlook of the third quarter of 2015](#), the annual growth forecasts for this two-year period holds (3.2% in 2015 and 2.7% in 2016).

The slowdown of activity in the second half of 2015 is due to the **loss of strength shown by some of the tailwinds** that boosted demand at the beginning of the year, the widening risk premium, which is in part caused by the uncertainty over the imminent election season and, finally, certain **headwinds blowing in from abroad**. Among the factors supporting growth are, notably on the external front, ECB monetary policy and the increase in the oil supply worldwide, whereas at home what stands out is the more-expansionary-than expected nature of fiscal policy in 1H15. Among the headwinds are the **downward correction of growth forecasts for both the developed economies and the emerging markets (specially China)**, the possibility of a **delay in interest rate hikes in several economies (especially the United States)** forced by the lower level of global activity and the consequent upturn in volatility in both financial markets (where the Greek crisis was also a contributory factor) and commodity prices. These factors have led to a smaller depreciation in the euro exchange rate than was being anticipated in the spring, a lower than expected growth in the EMU and a moderate increase in Spain's risk premium, which all together could partly limit the advance pace of trade and investment flows.

To sum up, **the assessment with respect to the expected recovery of activity and employment provided in BBVA Research's central scenario for 2015-16 remains the same, while the likelihood of less favourable scenarios for the Spanish economy has increased** as a result of the uncertainty over global recovery and the possibility of facing a bigger than expected slowdown in the domestic environment.

1: For further details regarding the MICA-BBVA model, see Camacho, M. & 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-research.com/KETD/fbin/mult/WP\\_1021\\_tcm348-231736.pdf?ts=2542012](http://www.bbva-research.com/KETD/fbin/mult/WP_1021_tcm348-231736.pdf?ts=2542012).

## Private demand rises across-the-board, albeit more slowly than at the beginning of the year

The second quarter of the year was characterised by the robust expansion of domestic demand, both private and public, and the recovery of Spanish exports<sup>2</sup>. Looking at private demand, the progress of household consumption was notable (1.0% QoQ) and, above all, the advance in machinery and equipment investment, which brought a positive surprise (3.5% QoQ; BBVA Research: +1.1% QoQ). Similarly, housing investment progressed in a somewhat more dynamic fashion than central forecasts suggested (1.3% QoQ; BBVA Research: 0.8% QoQ), which consolidates the change in cycle started in 2014.

Turning to the third quarter of the year, available information points to a slightly less vigorous growth for most of the demand components. In terms of external demand, spending variables (sales abroad by larger companies and tourist expenditure) and expectations (the orders book) suggest that exports are still growing generally, but at a slower pace than in 2Q15. On the domestic demand side, partial short-term indicators (vehicle registrations, wholesale trade, confidence of economic agents and labour market readings) confirm that household consumption and machinery and equipment investment could continue to lead the recovery in the short term, although this also implies lower growth rates than have been observed in the past six months. Finally, residential investment fundamentals indicate that the second half of the year started positively, although again this is with modest growth and from a historically low level<sup>3</sup>.

## Moderation of public sector demand continues in the second semester

The details of the Quarterly National Accounts (QNA) for 2Q15 did not reveal any surprises with respect to the fiscal consolidation. After the upturn seen in 1Q15, public sector consumption registered a deceleration during 2Q15 in line with forecasts (0.4% QoQ; BBVA Research: +0.45% QoQ). Likewise, the expected slowdown in non-residential construction was confirmed (of 1.1pp to 1.5% QoQ), affected by public works.

With respect to the third quarter, the available budgetary execution figures to July 2015 point to a virtual stagnation of the nominal expenditure in final public consumption compared to the previous quarter. This serves to confirm that the observed fiscal adjustment is being underpinned by the cyclical recovery of both revenues and social welfare benefits.

## Improvements in the labour market lose momentum in the third quarter

The readings for the labour market negatively surprised in August, which confirms the slowdown of the economy. According to BBVA Research estimates<sup>4</sup>, Social Security affiliations practically stagnated last month (-2,000 MoM swda), after two years in a row of job creation. If there is no let-up in this sluggishness over the current month, the number of affiliates should increase by only 0.2% QoQ swda in 3Q15, which would imply a significant slowdown with respect to the first half of the year (1.0% QoQ on average). In line with this, BBVA Research estimates indicate that the pace of fall in registered unemployment slowed sharply in August (to -12,600 swda). If this trend lasts until September, it would bring about a smaller reduction in unemployment than in the previous quarter (-1.8% QoQ swda, compared to 2.4% QoQ on average).

2: An in-depth examination of the figures for the Quarterly National Accounts in 2Q15 is available at: <https://goo.gl/nAf45h>

3: A detailed review of the situation in the real estate sector can be found in the Spain Real Estate Flash of 2 September 2015 at <https://goo.gl/klE7qG>

4: Seasonal and working day adjustment (swda) implemented by BBVA Research is based on univariate time series statistical methods. As a result, estimates in swda series are subject to uncertainty, can differ from estimates made by other organisations and can be amended with hindsight without prior notice.

## Consumer prices fell in August, but core inflation remains positive

**The flash estimate suggested that consumer prices dropped by 0.4% YoY in August** after two months of moving positively. According to the advance offered by the INE, the decline in prices is due to the fall in oil and electricity prices, which have probably been encouraged by the downward correction in the crude price and the recent appreciation of the euro exchange rate. Besides, **core prices rose by 0.8% YoY in July and, according to BBVA Research estimates, they could have repeated this rise in August.**

**Nevertheless, the improvement of trend inflation in the Spanish economy continues to take place in an environment of a recovery in price competitiveness**, where the inflation differential in relation to the euro area remains in Spain's favour. Thus, trend inflation readings are showing similar upturns in Europe and Spain, and are progressively approaching levels of around 0.8% and 0.4%, respectively<sup>5</sup>.

## The Spanish economy's lending capacity expanded in 2Q15

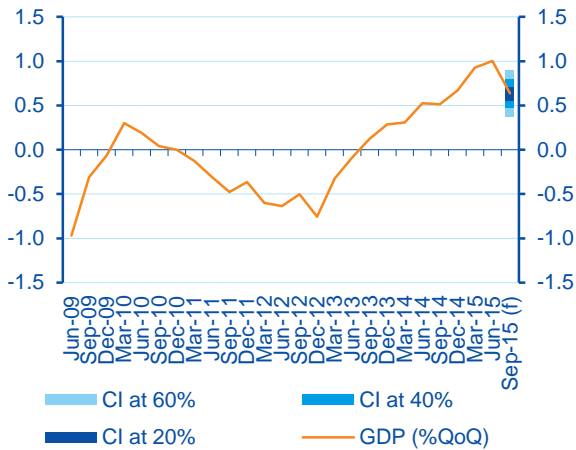
The balance of payments figures indicates that the **current account surplus amounted to EUR12.464bn to June**, a figure which improves the results seen both in the previous month (EUR12.279bn) and at the close of 2014 (EUR8.429bn), and accounts for 1.2% of GDP. Looking ahead, **the Spanish economy will continue to show lending capacity in relation to the rest of the world over the period 2015-16**, given the structural adjustment<sup>6</sup>, exports growth, low interest rates and the cumulative cheapening of oil.

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5: For further details on calculating trend inflation using the trimmed means method, see Box 1 of Spain Outlook, first quarter 2014, available at: <https://goo.gl/acVfDn>

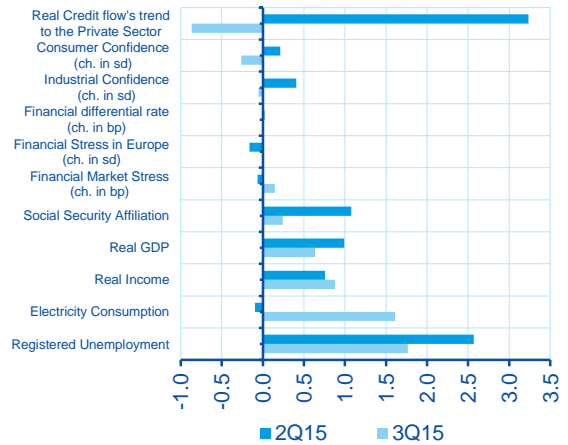
6: The process of correcting the Spanish economy's borrowing requirement is mainly due to the improvement in the structural component. For further information on recent developments in Spain's current account balance and the prospects for it, see the Economic Watch headed: "An analysis of trends and determinants for the current account balance in Spain", available at: <http://goo.gl/qF1qz6>

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



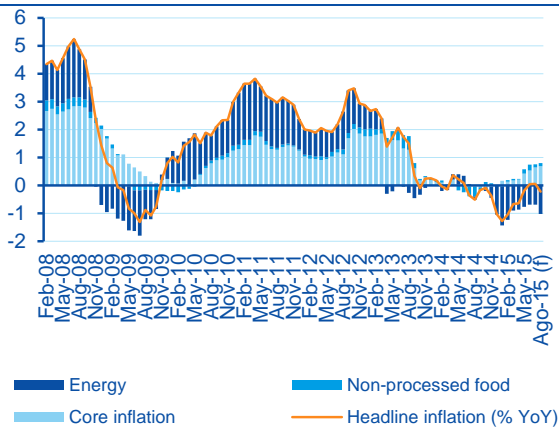
(e): estimate.  
Source: BBVA Research

**Figure 2**  
Spain: Change in GDP and the key components in the MICA-BBVA model (+) improvement / (-) deterioration in pp unless otherwise indicated (swda)



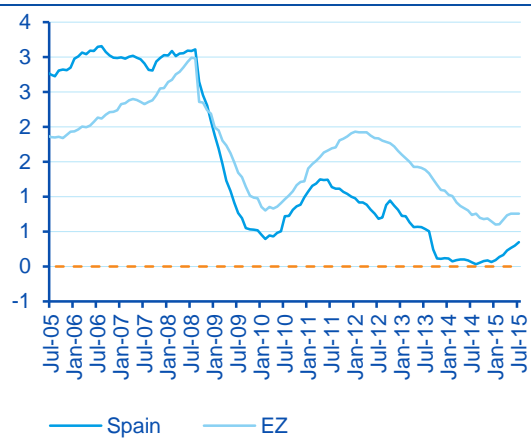
Data published up to 8 September 2015 and MICA-BBVA model forecasts.  
Source: BBVA Research based on official institutions

**Figure 3**  
Spain: contribution to CPI growth (pp, YoY)



(e): estimate.  
Source: BBVA Research

**Figure 4**  
Spain and the EMU: trend inflation (trimmed means method, % YoY)



Source: BBVA Research based on INE and Eurostat

## 2015-16 scenario

### The published figures do not add any significant bias to growth forecasts

The QNA figures for the first semester do not, on the whole, diverge from the BBVA Research diagnosis for the Spanish economy's recovery and, as such, neither do they have a significant effect on growth forecasts for this two-year period. Thus, as was forecasted in the 3Q15 Spain Economic Outlook, **activity will move ahead by around 3.2% this year and will ease up to 2.7% in 2016**, which is enough to create close to one million jobs over the period and bring down the unemployment rate to around 20%<sup>7</sup>.

**The expansion of activity will rest on both domestic and external factors.** The deterioration of growth prospects for the world economy and the smaller than expected depreciation of the euro exchange rate will be partly offset by the increased moderation of the oil price. On the domestic front, the support from fiscal and monetary policies, together with the structural improvement on fundamentals, will continue to ensure **the growth of the domestic demand despite the slowdown**. The increase in final demand will lead to an upturn in imports which, in the most likely scenario, will result in a **negative net contribution of external demand to growth**.

### The improvement in activity will not be enough to meet the deficit target and to offset the effect of certain expansionary policies

As was mentioned in the latest Spain Outlook in August 2015, **public institutions are taking advantage of the economic recovery to implement expansionary fiscal policies**, which condition the fulfilment of stability targets. Public expenditure is therefore expected to continue its growth in the second half of 2015, although at a slower pace. In combination with a smaller recovery of public revenues than was expected early on in the year, this data foresees that **public deficit will end 2015 over the 4.5% of GDP**.

Going forward, the Draft General State Budget for 2016 (PGE2016) takes advantage again of the recovery in order to continue implementing expansionary policies, such as raising the pay of public employees, restoring the traditional extra payment that was withdrawn in 2012 or cutting personal income tax (IRPF). The government is thus hopeful that the increased tax collections, together with the expenditure savings on debt interest and unemployment benefits, will compensate the rises in spending or the reduction of tax rates for families. In this scenario, **in absence of new fiscal consolidation measures and given the foreseeable deviation from the deficit target in 2015, the public deficit is still expected to depart slightly from its target again in 2016**.

In real terms, public consumption will grow by 1.3% over the whole of 2015, while non-residential construction investment (affected by public works) will do so by around 6.6%. In a scenario without changes in economic policy, real growth of public consumption expenditure will ease to 0.6% in 2016, whereas non-residential investment will do so to 3.1%.

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7: In average terms, employment will grow at an annual rate of 3.1% and the unemployment rate will stand at around 20.5% in 2016.

## Private domestic demand will continue leading growth

**Household consumption prospects continue to look promising.** The expected job creation, the reduced tax burden<sup>8</sup> and the absence of inflationary pressures will contribute to the recovery of real disposable income. Forecasted growth of financial and real estate wealth, expectations that official interest rates will stay at historically low levels and the savings adjustment will also boost family spending. Finally, new credit operations for consumption will continue to rise in a context of a deleveraging of the outstanding balance of credit, and they will sustain household spending, above all on durable goods. As a result, **private consumption will grow by around 3.4% in 2015. In 2016**, the temporary factors which incentivised family spending up to the middle of the current year will disappear, such as the PIVE (incentive programme of grants for buying new, more fuel-efficient cars), or will play a merely residual role, such as the tax reduction. On top of this, some of the fundamentals will lose dynamism, which is the reason for the expected moderation of **private consumption growth to 2.5%.**

Despite rising uncertainty, **machinery and equipment investment** will continue to benefit from relatively low borrowing costs and the buoyancy of final demand. However, this segment of demand is expected to slowdown in the short term, which is likely to reverse once the uncertainty over the election schedule is removed and when some of the most risk averse investors accelerate the pace of new projects execution. As a result, **machinery and equipment investment is expected to grow at 8.6% in 2015 and 7.2% in 2016.** On the other hand, **the recovery of housing investment, which began in 2014, should continue during the coming quarters.** After seven straight years of making negative contributions to GDP, **residential investment should grow 3.0% in 2015 and accelerate to 7.2% in 2016.**

## Trade flows are rising despite the loss of momentum of the world economy

The downward revision of world growth expectations, jointly with the smaller depreciation of the euro exchange rate, **depicts a somewhat less encouraging external environment for Spanish exports over the current two-year period.** Nevertheless, the cheapening of transport costs as a result of the bigger drop in the oil price will partly offset the downward pressure on trade flows. **Sales abroad therefore are expected to grow by 4.6% in 2015 and accelerate to 6.9% in 2016.**

Given the expected strong performance exhibited by final demand, imports of **goods and services should continue expanding over the current two-year period.** Buying from abroad is predicted to grow by 5.5% in 2015 and 7.5% in 2016. This will mean that **the net contribution of foreign demand to economic growth will be slightly negative in both 2015 and 2016 (-0.3pp and -0.1pp, respectively).**

## The scenario is not risk-free

**As was stated in the introduction to this section**, even though our opinion regarding recovery expressed in BBVA Research's central scenario holds, the likelihood of less encouraging scenarios for the Spanish economy has risen over the past month.

**On the external front, greater risks are perceived in connection with the slowdown of global growth**, mainly in the emerging markets (China and Latin America) which, if exacerbated, could adversely affect the demand for Spanish goods and services.

**On a domestic level, the probability of occurrence of certain risks has also increased.** Specifically, in the absence of any further measures, the public deficit is expected to stand at 4.5% of GDP at the year-end and thus overshoot the stability target. Although the amount by which it will potentially deviate is not

8: BBVA Research estimates indicate that the bringing forward to July 2015 of the lowering of the personal income tax (IRPF), due to come into effect in 2016, should contribute 0.1pp to private consumption growth over 2015-16.

considerable, it should be remembered that one of the major assets of the Spanish economy over the past few years has been its ability to bring down the structural government deficit. Retaining credibility as regards to the control of public finances, and therefore the confidence of European institutions, is the key to containing borrowing cost of an economy that is overloaded with foreign debt. If the doubts that might arise over the other measures that will be implemented in the next years are added to the uncertainty over fiscal policy, the Spanish economy's vulnerability would escalate considerably.

Table 1

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

Activity	2012	2013	2014	2015(f)	2016(f)
<b>Real GDP</b>	-2.1	-1.2	1.4	3,2	2,7
Private consumption	-2.9	-2.3	2.4	3,4	2,5
Public consumption	-3.7	-2.9	0.1	1,3	0,6
<b>Gross fixed capital formation</b>	-8.3	-3.7	4.2	5,4	6,1
Machinery and equipment	-9.1	5.3	12.2	8,6	7,2
Construction	-9.3	-9.2	-1.5	5,1	4,8
Housing	-9.0	-7.6	-1.8	3,0	7,2
<b>Domestic demand (contribution to growth)</b>	-4.3	-2.7	2.2	3,3	2,8
Exports	1.2	4.3	4.2	4,6	6,9
Imports	-6.3	-0.5	7.6	5,5	7,5
<b>Net exports (contribution to growth)</b>	2.2	1.4	-0.8	-0,1	0,0
<b>Nominal GDP</b>	-1.9	-0.6	0.9	4,0	4,7
(EUR bn)	1055.2	1049.2	1058.5	1101,0	1152,4
<b>GDP w/out housing investment</b>	-1.7	-0.9	1.5	3,2	2,6
<b>GDP w/out construction</b>	-1.1	-0.2	1.7	3,0	2,5
<b>Labour market</b>					
<b>Employment (LFS)</b>	-4.3	-2.8	1.2	3,2	3,0
<b>Unemployment rate (% active pop.)</b>	24.8	26.1	24.4	22,2	20,5
<b>Employment QNA (full-time equivalent)</b>	-4.4	-3.3	1.2	3,0	2,5
<b>Apparent labour productivity</b>	2.3	2.0	0.2	0,2	0,2
<b>Prices and costs</b>					
<b>CPI (annual average)</b>	2.4	1.4	-0.2	-0,4	1,2
<b>CPI (end-of-period)</b>	2.9	0.3	-0.5	0,0	1,6
<b>GDP deflator</b>	0.2	0.7	-0.5	0,8	1,9
<b>Compensation of employees</b>	-0.6	1.7	-0.2	0,8	1,7
<b>Unit labour cost (ULC)</b>	-3.0	-0.3	-0.4	0,7	1,5
<b>External sector</b>					
<b>Current account balance (% GDP)</b>	-0.3	1.4	0.8	1,3	1,4
<b>Public sector</b>					
<b>Debt (% GDP)</b>	84.4	92.1	97.7	98,8	98,0
<b>Budget balance (% GDP (*))</b>	-6.6	-6.3	-5.7	-4,5	-3,0
<b>Households</b>					
<b>Nominal disposable income</b>	-3.0	-0.3	1.4	2,8	3,1
<b>Savings rate (% nominal income)</b>	11.9	9.7	10.7	9,9	9,8

(\*): Excluding aid to financial sector.

Forecast closing date: 4 August 2015.

Source: Official institutions and BBVA Research

Table 2

## Summary of Spain Flashes published since the Spain Economic Outlook in August 2015

Flash	Date	Summary	Link
<b>June closed the best semester for Industrial Production (IPI) in 4 years</b>	07.08.2015	Industrial Production (IPI) chained seven months of increases up to June that consolidate the growth trend registered from late 2014. Thus, June closed the quarter with an overall improvement of Industrial Activity (1.7% QoQ SWDA on average), reaching its highest level since 4Q10.	<a href="#">PDF</a>
<b>Headline inflation remained stable in July, despite improvement in core inflation</b>	13.08.2015	Headline inflation remained in positive territory in July, underpinned by the upward trend in core prices, and despite the downward pressure on the residual component (energy and unprocessed foods). Going forward, we expect the consolidation of the trend, although a marginal and transitory fall in prices in the short term cannot be ruled out.	<a href="#">PDF</a>
<b>June trade balance confirms the expected improvement at the end of 2Q15</b>	18.08.2015	Both real exports and imports of goods grew in June, closing the second quarter in positive. The trade balance deficit increased despite the reduction of the energy bill	<a href="#">PDF</a>
<b>Quarterly National Accounts 2Q15</b>	27.08.2015	As it was anticipated in the last edition of the Spain Economic Outlook, the recovery pace of the economy accelerated in 2Q15, mainly underpinned by the growth of private demand. GDP growth in the second quarter (+1.0 QoQ) is consistent with BBVA Research scenario, which envisage an increase in activity of 3.2% in 2015 and 2.7% in 2016.	<a href="#">PDF</a>
<b>CPI Flash estimate in August shows a fall in prices greater than expected</b>	28.08.2015	CPI Flash estimate shows a decrease in headline prices in August greater than expected due to downward pressure on energy prices. BBVA Research estimates suggest that core inflation remained stable at around 0.8% YoY.	<a href="#">PDF</a>
<b>Retail sales in the third quarter got off to a good start</b>	28.08.2015	After seasonal adjustments, retail sales rebounded in July. All groups of products contributed positively to the rise in turnover.	<a href="#">PDF</a>
<b>Confidence data in August is consistent with lower growth in 3Q15</b>	28.08.2015	Economic agents remained optimistic at the beginning of the third quarter, but show mixed signs in the upward trend of expectations. Thus, data published today is consistent with the diagnosis of BBVA Research, indicating that growth is moderating in 3Q15	<a href="#">PDF</a>
<b>Household and corporate deposits fell in July, in line with forecasts</b>	28.08.2015	The latest figures on deposits published by the Bank of Spain show a drop in the household and corporate components. In spite of this, after seasonal adjustment these have remained practically stable.	<a href="#">PDF</a>
<b>The balance of payments closed the first half of 2015 with favorable figures</b>	31.08.2015	The balance of payments registered an increase of the 12-month accumulated current account surplus up to €12,464 million in June. Both the goods and services balance surplus and the balance of income deficit maintained the trend of improvement. Investment flows from and to the outside also performed positively.	<a href="#">PDF</a>
<b>Budget execution slightly improved</b>	31.08.2015	Public deficit in July 2015 improved by 2,4% of GDP in the annual accumulated, .6pp above the registered last year. The slow rate of the recovery of revenues observed until July requires a tight control of public finances, in order to meet the public deficit reduction target by the end of the year.	<a href="#">PDF</a>
<b>Nuevo crédito en España acelera el ritmo acompañando a la recuperación económica</b>	31.08.2015	El flujo de nuevas operaciones de crédito en España afianza el cambio de tendencia observado a finales de 2014, al crecer aceleradamente en julio un 45,5% interanual (a/a) y un 17,7% a/a en el acumulado de 2015. Todas las carteras evolucionan por encima de sus expectativas.	<a href="#">PDF</a>
<b>Passenger car registrations recovered growth in august</b>	01.09.2015	After seasonal adjustments, BBVA Research estimates indicate that passenger car registrations slightly increased in august. Businesses and private customers offset the loss of momentum in rent-a-car companies.	<a href="#">PDF</a>
<b>The labor market disappoints in August and confirms the expected economic slowdown</b>	02.09.2015	Labor market figures failed to meet expectations in August. After seasonal adjustments, BBVA Research estimates indicate that Social Security Affiliation fell marginally after two years upwards, while the decrease of registered unemployment decelerated.	<a href="#">PDF</a>

Source: BBVA Research



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