

ACTIVITY

Spain: pace of growth maintained as 2016 gets under way

Unit: Spain

Activity and employment continue to grow in the first quarter

The trend among the variables observed indicates that **the Spanish economy will continue to recover in 2016**. With nearly 50% of the information available for 1Q16, the MICA-BBVA model¹ estimates **quarterly (QoQ) GDP growth of around 0.8%**, which, if confirmed, would imply a stabilization of the expansion pace, in line with BBVA Research's scenario². This improvement in activity continues to be accompanied by job creation.

Demand's growth has continued throughout the first quarter of the year, and is underpinned by both external and domestic factors. Among the former are **cheaper oil, moderate growth in global demand and, above all, European Central Bank (ECB) monetary policy**, which continues to promote a favourable environment of nominal euro exchange rates and low interest rates with liquidity being provided³.

With regard to domestic factors, we see that the fiscal policy stance continues to be slightly expansive. Furthermore, **the recovery is underpinned by structural elements** deriving from the economic reforms, such as labour market reform, and also from the structural changes that have taken place in manufacturing, such as the shifting of investment towards machinery and equipment components, and of production towards exports⁴.

To sum up, **economic activity data show that recovery continues, and therefore we are maintaining our assessment of the macroeconomic scenario** for the next two years. The Spanish economy will grow by around 2.7% in both 2016 and 2017, which will allow net job creation of close to a million, bringing the unemployment rate down to 17.5% at the end of the period⁵.

Nonetheless, we are also maintaining our assessment of the risks hanging over the scenario. Spain's economic policy uncertainty remains high following its upturn in January, as we expected. Although at the time of writing real activity and employment data do not show any significant slowing of recovery, if this uncertainty is not resolved quickly and favourably, the impact could be considerable⁶. Moreover, the **risks associated with the slowdown in emerging economies persist, with China and the oil exporting countries as the main sources of uncertainty.**

1: For more details on the MICA-BBVA model, see Camacho, M. and Doménech, R. (2010): "MICA-BBVA: A Factor Model of Economic and Financial Indicators for Short-Term GDP Forecasting" BBVA WP 10/21, available at: <http://goo.gl/zeJm7g>

2: BBVA Research's description of the economic scenario for the two-year period 2016-2017 can be found in section 3 of the Spain Economic Outlook review, first quarter 2016, available from: <https://goo.gl/dDN6jb>

3 For further details, please refer to BBVA Research's ECB Observatories of 3 December 2015 and 21 January 2016. Available at <https://goo.gl/GA306o> and <https://goo.gl/Etwfs0>

4: See Boxes 1 and 2 of the Spain Economic Outlook review for the fourth quarter of 2015, available at <https://goo.gl/vkGb6w>

5: In average terms, employment will grow at an annual rate of 3.0% and the unemployment rate will be around 18.3% in 2017.

6 See Box 1 of the Spain Economic Outlook review for the first quarter of 2016

Private sector demand continues to grow in the first months of the year

For the tenth quarter in a row, activity in 4Q15 was underpinned by domestic demand, which contributed slightly less than forecast to quarterly growth (0.6 pp; BBVA Research: 0.8 pp) and less than in the previous quarter (1.2 pp)⁷. Once again the **solid performance in both household consumption (0.9% QoQ, BBVA Research: 0.8% QoQ) and capital expenditure on plant and equipment**, which slowed its growth by less than it what was expected (**1.9% QoQ; BBVA Research: 1.1% QoQ**) were particularly notable. On the other hand, the increase in residential investment was more moderate than forecast (0.6% QoQ, BBVA Research 1.1% QoQ).

On foreign demand, we saw **the pace of growth slacken, both for total exports** (by 0.9 pp to 0.9% QoQ; BBVA Research: 0.8% QoQ) **and, above all, imports** (by 2.8 pp to 0.3% QoQ; BBVA Research 0.7% QoQ). As a result, the fourth was the only quarter of 2015 in which **net external demand contributed to quarterly growth**, albeit only modestly (0.2 pp).

In terms of the opening months of 2016, available information suggests that the composition of growth could be similar to 4Q15. As for private sector domestic demand, indicators for consumer spending, household expectations and employment (respectively new car registrations, consumer confidence and labour market data) point to **consumption continuing to lead the recovery**, with growth rates similar to or slightly less than those observed at the end of 2015. On the other hand, confidence and industrial production indicators again predict slackening in the pace of **growth in capital expenditure on machinery and equipment investment**. Lastly, the fundamentals of residential investment, although sending mixed signals, continue to show proof of recovery in the sector.

Turning to external demand, the expectations indicators (industry new export order) and expenditure (external sales of good and services by large corporations) point to continuing **flatness in the export of goods** (-0.2% QoQ in 4Q15), and a **slowdown in the export of services** in 1Q16. In this regard, the variables relating to foreign tourism (tourist arrivals and spending) indicate that this demand component will again grow at a similar pace to that seen in the first nine months of 2015, following the sharp increase seen in the previous quarter.

Public sector demand growth was stabilising at the end of 2015, but budgetary targets were not attained

The breakdown of the Quarterly National Accounts (CNTR by its Spanish acronym) for 4Q15 revealed a lower-than-expected growth rate in public sector demand, following the downward revision of the figures for the previous quarter (-0.4 pp to 0.5% QoQ). Thus, following the strong growth observed in early 2015, **public administrations' real consumption stabilised at around 0.5% QoQ** at year-end (BBVA Research 1.0% QoQ). This slowdown was accompanied by confirmation of the slackening growth in non-residential construction (by 0.3 pp to 0.7% QoQ), affected by public works.

Once more, the trend in demand and the public deficit confirm that **the fiscal adjustment continues to fall back on the cyclical recovery and the reduction of interest rates**. However, this **would not be enough to meet the stability target (4.2%)**.

7: The evaluation of the 4Q15 Quarterly National Accounts is available at: <https://goo.gl/1KDz10>

The labour market continues to improve as 2016 gets under way

Social Security affiliation met growth expectations in February (35,000 MoM seasonally and working-day adjusted (swda), according to BBVA Research estimates)⁸. If the positive trend is consolidated this month, the number of affiliates could increase by 0.7% QoQ swda in 1Q16, which would imply a **stabilisation in the job creation rate** (0.7% in 4Q15). **Unemployment figures maintained their downward trajectory in February** (-28,000 swda according to BBVA Research estimates) and if this continues in March, it would give rise to a **faster rate of reduction in registered unemployed** than we saw at the end of 2015 (-2.2% QoQ swda and -1.7% QoQ in 4Q15).

Headline consumer prices are falling, but core inflation remains stable and in positive territory

The flash estimate pointed to an intensified fall in consumer prices in February (-0.8% YoY). According to advance INE data, the fall in prices compared with the same month of last year was due to lower energy and food prices. Nevertheless, **BBVA Research's estimates indicate that core inflation may have held steady** at around 0.9% YoY.

All in all, the stabilisation of trend inflation in the Spanish economy continues within a context of a recovery of price competitiveness, where the inflation differential with respect to the euro area remains in Spain's favour. Thus, trend inflation measurements show upturns in prices of around 0.7% in the euro zone as a whole and 0.4% in Spain⁹.

Spain's economy increased its financing capacity in 2015

The balance of payment figures show that the **current account surplus amounted to EUR16,707 million for the whole of 2015**, which represents a notable increase from 2014 (by 0.5 pp to 1.5% of GDP) as a percentage of GDP, as well as bringing the number of consecutive years with a positive balance to three.

From the financial accounts point of view, **the Spanish economy increased its net lending capacity in 2015**, reaching €70,221 million excluding Banco de España (Spain's central bank). Specifically, **the inflow of non-resident capital was offset by a slowdown in investment** (by 51%, to EUR43,327 million), **whereas foreign investment by resident sectors increased** (by 40%, to EUR114.2 billion). Meanwhile, net foreign liabilities of Banco de España increased by EUR40.6 million in 2015.

All the same, **net capital outflows in 2015 were compatible with healthy investment flows**, facilitated by the liquidity provided by the ECB and increased domestic savings. Favourable financing conditions may also have facilitated the acquisition of assets abroad.

Looking ahead, we expect the Spanish economy to continue to show financing capacity relative to the rest of the world, given its structural adjustments¹⁰, export growth, the favourable financing conditions and the cumulative decrease in oil prices.

8: The seasonal and working day adjustments (SWDA) made by BBVA Research are based on statistical univariate time series methods. Consequently, estimates of SWDA series are subject to uncertainty; they may differ from estimates by other bodies, and may subsequently be adjusted without prior warning.

9: For more details on the calculation of trend inflation using the trimmed mean method, see Box 1 of the Spain Economic Outlook review for the first quarter of 2014, available at: <https://goo.gl/8xxHzO>

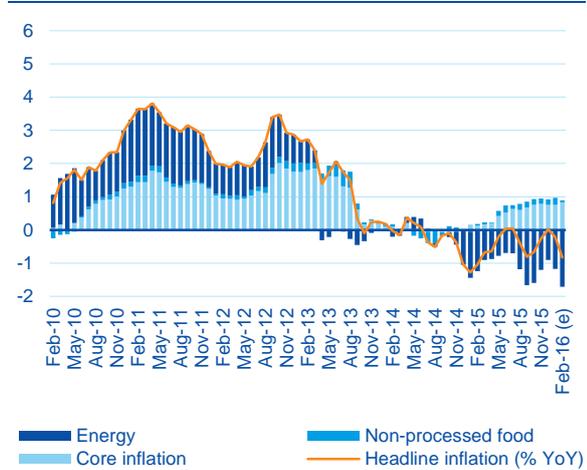
10: The process of correcting the financing requirements of the Spanish economy corresponds mainly to structural improvements. For further information on recent trends and the outlook for the Spain's balance in current account, please refer to the Economic Observatory entitled: "An analysis of the trend and determinants of the current account balance in Spain", available at: <http://goo.gl/qF1qz6>

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



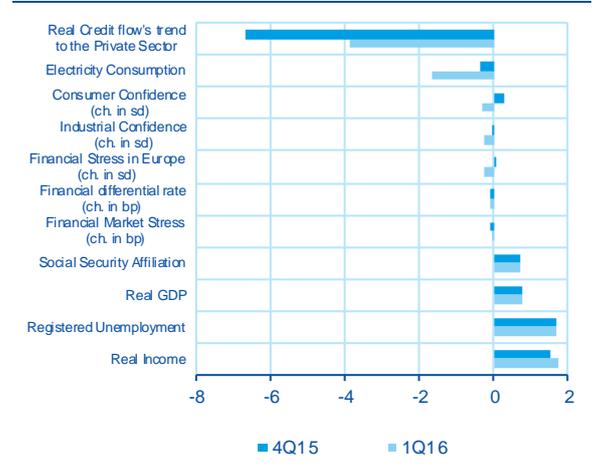
(e): estimated.
Source: BBVA Research

Figure 3
Spain: contribution to CPI growth (percentage points YoY)



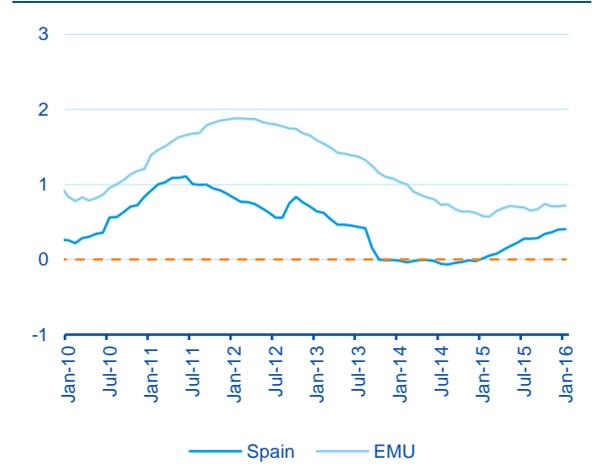
(e): estimated.
Source: BBVA Research

Figure 2
Spain: Trends in GDP and key MICA-BBVA model indicators (+) improvement / (-) deterioration in pp save where otherwise indicated (swda)



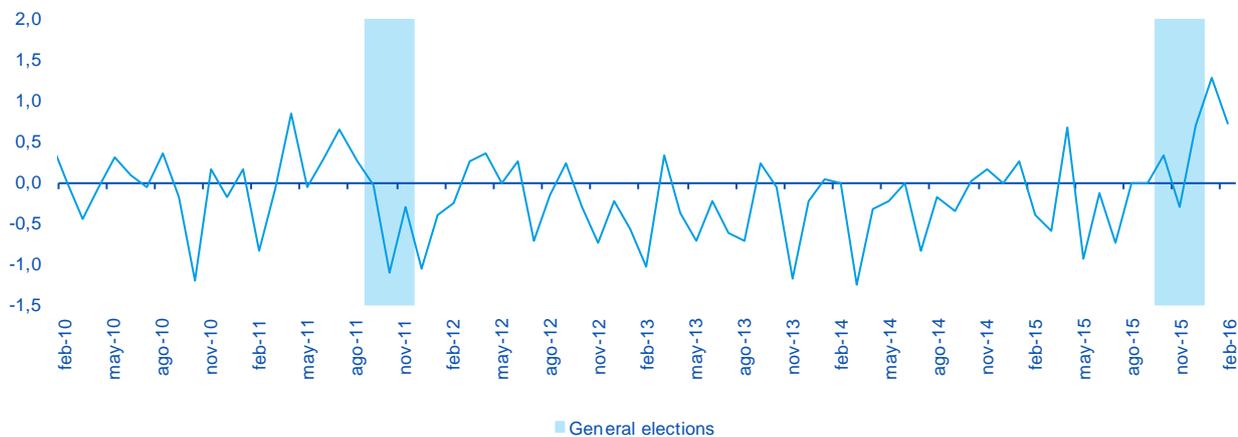
Published data to March and forecasts of the MICA-BBVA model.
Source: BBVA Research based on data from official bodies

Figure 4
Spain and EMU: trend inflation (trimmed mean method, % YoY)



Source: BBVA Research based on INE and Eurostat

Figure 5
**Spain: index of economic policy uncertainty
(idiosyncratic component of typical deviations)**



Source: BBVA Research based on Baker et al.(2015)

Table 1

Summary of Flash Spain publications since the publication of Spain Economic Outlook Q1 2016

Flash	Date	Abstract	Link
Inflation returned to negative ground in January due to the energy	12.02.2016	Core inflation remained positive and stable in January, but headline inflation fell again as a consequence of the smaller energetic costs. Looking forward, we foresee a continuation of the positive trend in the core component, despite downward pressure in the price of raw materials predicting renewed drops in general prices.	PDF
December 2015 home sales: fall in December but positive annual balance	15.02.2016	In December 2015, 41.420 homes were sold according to the General Council of Notaries. After correcting the series of seasonal variations, sales experienced a month fall of 5.0%, which resulted in a quarterly decline of 2.8%. Nevertheless, in 2015 401.236 household transactions were closed, 8.6% more than in 2014	PDF
Trade deficit slightly moderates in 2015	18.02.2016	Both real good exports and imports took a step back in December, which did not stop the fourth quarter and the overall value for 2015 from closing the year with a positive balance. All in all, the trade balance's accumulated deficit barely varied in 2015, despite the improvement in the energy balance.	PDF
National accounts confirm growth stabilization in 4Q15	25.02.2016	As it was anticipated in the last edition of Spain Outlook, Spanish economic growth stabilized at the end of 2015 at around 0.8% QoQ. This development is consistent with BBVA Research's scenario, which contemplated a rise of around 3.2% for the 2015 aggregate, and foresees an average annual growth of 2.7% for the 2016-17 biennium.	PDF
CPI flash estimate points at a bigger fall in general inflation in February	26.02.2016	CPI flash estimate hints that, in line with what was expected, consumption general prices in February fell with a bigger intensity than in January. Nevertheless, our estimations suggest that core inflation remains positive and stable, while energy and foods pressure prices downwards.	PDF
Confidence moderates in February, but less than at the beginning of the year	26.02.2016	Despite household and industry confidence indicators diminishing in February, the moderation in terms of optimism was lower than the one observed at the beginning of the year. Unemployment expectatives explain the fall in consumer confidence, while expectatives concerning order and inventory portfolios illustrate the evolution in industry confidence.	PDF
Permits in December 2015: positive surprise that closes a year of growth	29.02.2016	Permits in December grew to 5,074, representing an increase of 2.7% from the previous month. The data surprised positively and the annual aggregate shows an increase of visas around 42.5% compared to 2015. The refurbishment fell by 0.4% from November and ends the year with an increase of 12.3% from the previous year.	PDF
2015 is confirmed as the third consecutive year of current account surplus	29.02.2016	The balance of payments was positive at the end of 2015. Both the balance of goods and services and the income balance showed surplus in December. Meanwhile, total investment flows to and from abroad declined but less than in the same month of 2014.	PDF
Companies & particulars explain the rise in passenger car sales in February	01.03.2016	After seasonal adjustments, BBVA Research estimates show that passenger car registrations slightly grew in February, which is in line with what was expected. Companies and particulars were responsible for this rise.	PDF
Labour Market sustains a positive tone in February	02.03.2016	Social security affiliations fulfilled growth expectations in January on the back of the service sector. On the contrary, registered unemployment behaved slightly worse than expected, conditioned to the agriculture. All in all, BBVA Research estimations show that job creation and unemployment rate reduction continue to be relevant.	PDF
Housing prices close 2015 in positive	03.03.2016	Housing sales moderating in December, despite the good performance of the fundamentals of demand. Mortgage flow grew in an environment where the price of housing has appreciated in almost all markets. Meanwhile, housing starts rose in December, completing a year in positive.	PDF
Industrial Production does not show significant trend changes in the start of 2016	08.03.2016	Industrial production (IPI) fulfilled its expectatives in January, and maintained the positive interannual trend in its most relevant components. In particular, the behavior of equipment and consumption goods -both durable and non-durable- stood out.	PDF

Source: BBVA Research

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