

## ACTIVITY

## Spain: the economic recovery continued in 1Q16, despite the uncertainty

Spain Unit

### Activity and employment maintained the pace of growth at the start of 2016

The trend among the variables observed indicates that the recovery of the Spanish economy continued during the start of 2016. With nearly 90% of the information available for 1Q16, the MICA-BBVA model<sup>1</sup> estimates quarterly (QoQ) GDP growth of 0.8%, which, if confirmed, would suggest a steadying in the rate of expansion, in line with BBVA Research's scenario<sup>2</sup>.

The growth in demand has continued during the first quarter, supported by both external and internal factors. The former included cheaper oil and, above all, European Central Bank (ECB)<sup>3</sup> monetary policy.

Regarding domestic factors, data from year-end 2015 indicate that the fiscal policy stance might be being more expansive than expected in the early part of this year. In addition, partial economic indicators suggest that while a slowdown can be observed in some items of domestic demand, aggregate growth in activity and employment was not affected, at least for now, by the environment of heightened uncertainty.

In summary, economic activity data confirm that the recovery continues and the macroeconomic scenario of BBVA Research remains unchanged for now. The Spanish economy will continue growing over the next few quarters, reaching an average annual rate of 2.7% in both 2016 and 2017.

However, the possible risks looming over the scenario remain and some have even increased. Thus, economic policy uncertainty remains high in Spain and could, therefore, have an impact on activity in the coming quarters<sup>4</sup>. Similarly, there has been a greater-than-expected deviation of the public deficit compared to the commitments agreed for 2015 which, in the absence of measures, again raises the likelihood of non-compliance in the next two years.

### Private sector demand continued to grow in the first quarter of 2016, but its components did so at different speeds

For the first quarter of 2016, available information suggests a growth composition similar to that seen in the last quarter of 2015, marked by the positive contribution of both domestic demand and net external demand<sup>5</sup>.

On the side of private sector demand, indicators of consumer spending and households expectations (new car registrations, retail and consumer confidence), along with developments in the labour market, suggest that private consumption has continued to lead the recovery, with growth rates similar to or marginally lower than those observed at the end of 2015. Meanwhile, the moderation in industrial confidence, along with slower growth in industrial production and trade flows of capital goods are bringing forward a new slowdown in machinery and equipment investment, which may be even more pronounced than was expected early in

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/h6bA7l>

3: For further details, please refer to BBVA Research's ECB Observatory of 10 March 2016. Available at <https://goo.gl/4fMqvj>

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

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

the quarter. By contrast, the latest published data on residential investment and housing permits suggest that the recovery of real estate sector continued, albeit modestly, in the early stages of 2016.

On foreign demand, the expectations indicators (industry new exports order) and expenditure (external sales of goods and services by large corporations) point to a moderate growth in exports of goods, after the marginal decrease observed in 4Q15 (-0.2% QoQ). As for exports of services, variables related to foreign tourism (tourist arrivals and spending) suggest rates of growth similar to those observed during the first half of 2015, suggesting a slowdown compared to the strong increase observed in 4Q15.

## The deviation of the public deficit in 2015 was higher than expected and confirms the expansionary stance of fiscal policy

The combined deficit of the public administrations at the end of 2015 decreased by 0.9 percentage points (pp) to 5.0% of GDP, two tenths worse than expected (BBVA Research: 4.8%) and one point above the target agreed with the European Union (4.2%). According to estimates by BBVA Research, the recovery of the economic cycle, falling spending on debt interest and lower unemployment benefits would have contributed 1.9 pp of GDP towards the reduction of the deficit. In contrast, the figure at year-end 2015 represents a deterioration of the cyclically adjusted deficit of 0.9 percentage points of GDP, which was mainly due to discretionary policies undertaken throughout 2015.<sup>6</sup> For the public administrations, the deviation from the budgetary target is explained by the deficit observed both among the autonomous regions, and Social Security (1.0 and 0.3 pp above the target, respectively).

Regarding the start of 2016, the budget execution data for January indicate that the public-sector deficit (excluding local corporations) will come in at around 0.6% of GDP, in line with that recorded in the previous year. Similarly, up to February 2016 the state reported an accumulated deficit of -1.2% of GDP, similar to that observed in the same month last year. On the spending side, BBVA Research estimates indicate that real public consumption continued to grow in 1Q16 at a similar pace to that observed in the second half of 2015 (on average 0.5% QoQ).

## The labour market recovery gained traction during the first quarter of 2016

According to BBVA Research estimates<sup>7</sup> Social Security affiliation increased by 0.8% QoQ swda (seasonally and working-day adjusted), representing an acceleration of 0.1 pp compared to that observed in 4Q15. Thus, 1Q16 marked the tenth consecutive quarter of non-seasonal increase in the number of affiliates. Meanwhile, hiring increased by 2.0% QoQ swda, representing a slight slowdown, despite the upturn in permanent hires (4.3% QoQ).

On the other hand, BBVA Research estimates indicate that the decline in registered unemployment was accentuated by 0.6 percentage points throughout the quarter to -2.4% QoQ swda. Thus, after the slowdown observed in the second half of 2015 (-1.8% QoQ swda on average), the pace of improvement was once again around the level recorded during the first half of that year (-2.4% QoQ swda on average).

6: The discretionary measures taken in 2015 include the reduction of personal income tax and the return of the bonus withdrawal to officials in 2012. On the other hand, non-recurring transactions in 2015 amounted to 0.3 percentage points of GDP, and, as presented by the Ministry of Finance and Public Administration, correspond to capital expenditures associated with public-private collaboration contracts, execution of guarantees, etc. (€2.337 billion); and current expenditures for the purchase of vaccines for Hepatitis C (€1.094 billion).

7: 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.

## Headline consumer prices remain in negative territory, but core inflation trend remains positive

The flash estimate showed that the fall in consumer prices stabilised in March (-0.8% QoQ). According to estimates by BBVA Research, the downward pressure on prices continues stemming from the energy component, while core inflation could even have increased to around 1.1% YoY last month.

All in all, the improvement of the trend inflation in the Spanish economy still has to be seen in a context of a recovering of price competitiveness in which the inflation differential with the euro zone has moderated, but remains in Spain's favour. Thus trend inflation measurements show upturns in prices around 0.7% in the euro zone as a whole and 0.4% in Spain<sup>8</sup>.

## The Spanish economy increased its financing capacity in 2015

For the fourth consecutive year, the Spanish economy showed positive figures in the non-financial accounts for institutional sectors. In particular, the greater growth in the economy's savings rate (up 1.4 pp to 22.1% of GDP) than that of investment (up 0.8 pp to 20.6% of GDP) resulted in an increase in financing capacity to 2.1% of GDP (0.6 pp more than in 2014). Within the private sector, it is worth noting the behaviour of non-financial companies which, by increasing their savings as a result of the improvement in gross operating surplus, managed to increase their financing capacity in 2015. On the other hand, households and financial institutions saw their financing capacity slightly reduced at the end of last year, in the former case due to a greater increase in consumption than gross disposable income and, in the second, due to the fall in the gross disposable income of the sector. Meanwhile, the net borrowing of the public sector decreased to 5.0% of GDP.

For the first month of 2016, the balance of payments data show an increase in external financing, recording net capital outflows of €9.310 billion (€15.978 billion excluding the Bank of Spain). Thus, foreign investment flows do not appear to have been impaired, at least for now, as a result of the context of greater uncertainty. From the non-financial perspective, the current account balance recorded a cumulative 12 month surplus of €14.909 billion, slightly below that observed at the end of 2015.

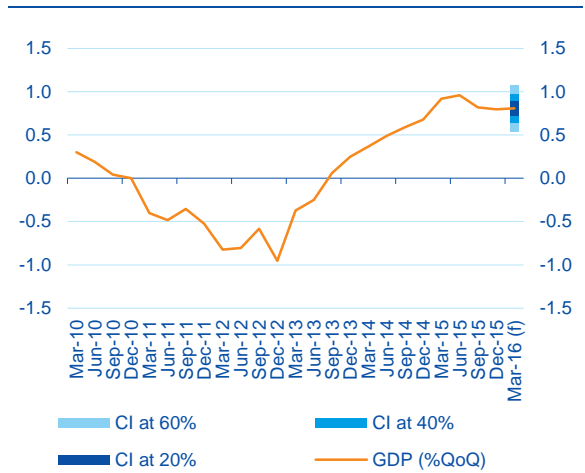
Looking ahead, we expect the Spanish economy to continue to show financing capacity relative to the rest of the world, given its structural adjustments<sup>9</sup>, export growth, the favourable financing conditions and the cumulative decrease in oil prices.

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8: 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: <http://goo.gl/j0rIT8>

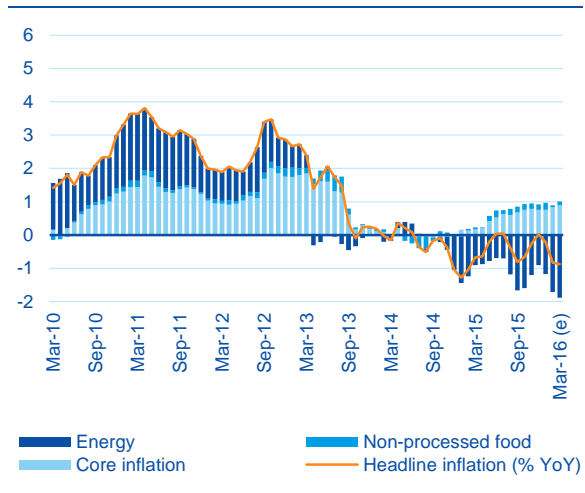
9: The process of correcting the financing requirements of the Spanish economy corresponds mainly to structural improvements. For further information on recent trends and the outlook for the Spain's balance in current account, please refer to the Economic Observatory entitled: "An analysis of the trend 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)**



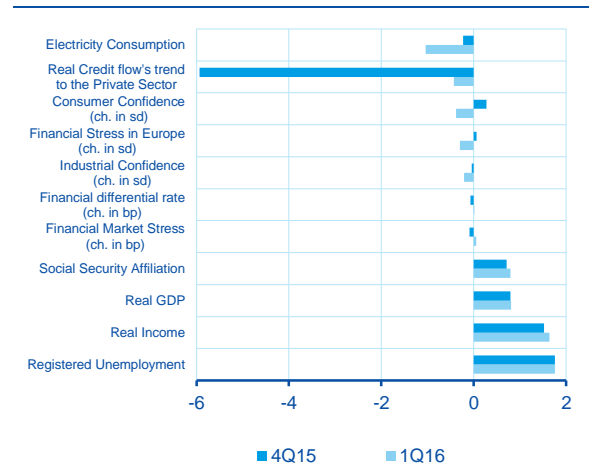
(e): estimate.  
Source: BBVA Research

**Figure 3**  
**Spain: contribution to headline inflation (pp YoY)**



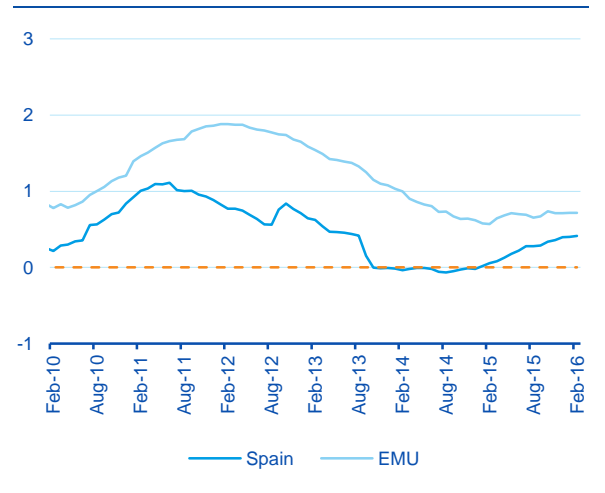
(e): estimated.  
Source: BBVA Research

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



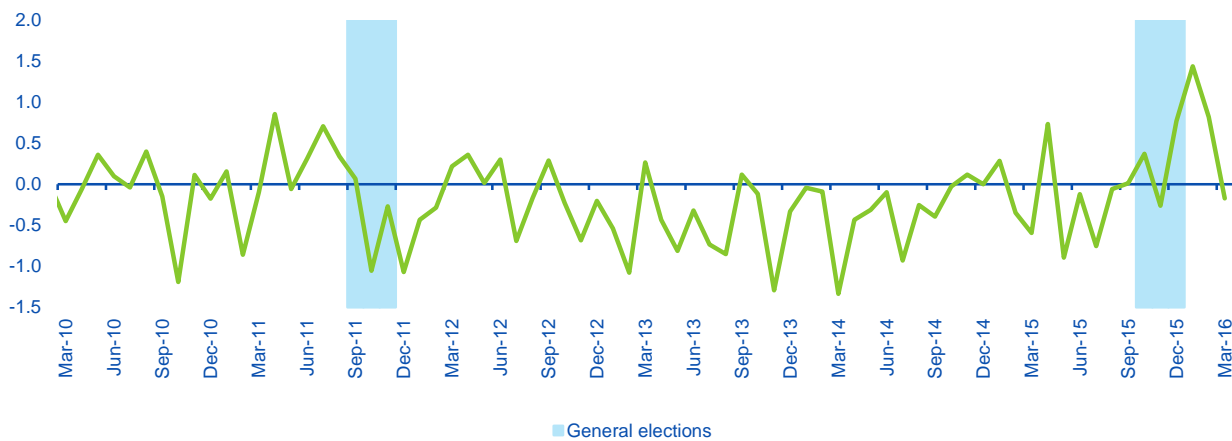
Data out up to March 2016 and MICA-BBVA model forecasts.  
Source: BBVA Research based on official institutions

**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 the economic observatory of March 2016**

Flash	Date	Abstract	Link
<b>Modest rise in retail sales in the beginning of 2016</b>	10.03.2016	Once corrected for the stationary variations of each month, real retail sales grew for a second consecutive month in January, although less than expected. All products, with the only exception of oil, contributed to the rise in billing.	<a href="#">PDF</a>
<b>General inflation fell again in February, but core inflation grew</b>	11.03.2016	Inflation grew in February, but the general part intensified its fall as a consequence of the lower food and energy prices. Looking forward, we expect the positive trend to continue in the core component, but the downwards pressure in the prices of raw materials promises new falls in general prices.	<a href="#">PDF</a>
<b>January 2016 home sales: the year starts with growth</b>	15.03.2016	In January 2016, 27.568 homes were sold according to the General Council of Notaries. After correcting the series of seasonal variations, sales experienced a growth of 20,4%, above what was expected, which translates to an interannual growth of 26,6%.	<a href="#">PDF</a>
<b>Public debt at 99% of GDP in the end of 2015</b>	15.03.2016	During 2015 Spanish general government debt fell 0.3 pp to 99% of GDP. The main reason behind the fall was nominal GDP growing at a higher pace than debt.	<a href="#">PDF</a>
<b>Trade balance starts the year with slightly positive signals</b>	21.03.2016	Good trade flows rose in real terms in January, which compensated the observed atony from the end of 2015. All in all, the accumulated deficit in the last 12 months of the trade balance was reduced marginally despite a strong improvement in the energy balance.	<a href="#">PDF</a>
<b>March closes a first quarter marked by confidence moderation</b>	30.03.2016	Despite mixed signals in March, both household and industry confidence fell slightly during the first quarter (-2,1 y -4,1 pp on average). All in all, confidence levels continue to surpass pre crisis levels, which reinforces BBVA Research's diagnostic, pointing at a continued economic growth in the start of 2016.	<a href="#">PDF</a>
<b>Regional Accounts 2015 shows a more homogeneous than expected growth</b>	30.03.2016	The regional GDP growth in 2015 published by the INE is in line with the scenario of BBVA Research. The activity accelerated in all communities, showing a higher than average growth in the Mediterranean regions basin and in Madrid. and lower in the northwest	<a href="#">PDF</a>
<b>CPI flash estimate points at a stabilization in the fall of CPI in March</b>	31.03.2016	CPI flash estimate signals that, improving on what was expected, general consumption prices fell by -0.8% interannually in March, as they did in February. Our estimations suggest that core inflation might have grown up to 1.1% interannually, while energy keeps pressuring prices downwards.	<a href="#">PDF</a>
<b>Retail sales grew in February for the third month in a row</b>	31.03.2016	Once corrected for the stationary variations of each month, real retail sales in February grew by 0.2% in respect to January, slightly more than expected, boosted by the upturn in service station sales. Sales could grow by 0.6% QoQ in 1Q16, 3 decimal points lower than in the previous quarter.	<a href="#">PDF</a>
<b>Permits in January 2016: a good beginning of the year</b>	31.03.2016	In January 4,774 permits were signed, 10.1% more than in the previous month, representing a start of the year which was better than expected. Meanwhile, refurbishment began the year with a contraction of 3.4% in respect to the last month of 2015	<a href="#">PDF</a>
<b>The economy's lending capacity improves in 2015</b>	31.03.2016	The Spanish economy's lending capacity increased to 2.1% of GDP in 2015 due to a greater recovery of investment than savings. For agents, it was highlighted the increase in corporate savings that improved its lending capacity and the increased in household consumption which resulted in a deterioration of their balance. Government reduced their deficit to 5.2%	<a href="#">PDF</a>
<b>The public-sector deficit closed at 5.2% of GDP in 2015</b>	31.03.2016	The public-sector deficit closed at 5.2% of GDP in 2015, an improvement of 0.7pp from the previous year. However, the deviation from the 2015 target was almost 1pp (-4,2%). The highest breach was observed in regions and Social Security	<a href="#">PDF</a>
<b>Balance of payments shows a rise in external financing in January</b>	31.03.2016	Balance of payments shows a monthly deficit of 1,200 millions of euros at the start of 2016, which is higher than the one observed a year ago (285 millions). Investment flows paid off a net influx of capital of 9.310 millions of euros (15.978 millions excluindo the Bank of Spain). In the annual accumulate, the current account balance keeps showing a surplus.	<a href="#">PDF</a>
<b>The fall in passenger car sales in March took the shine off a positive quarter</b>	01.04.2016	Once the data is seasonally adjusted, BBVA Research estimations show that passenger car registrations were reduced by a monthly 9% in March, which was more than expected. All in all, the first quarter of 2016 closes with a rise in sales of 3,6% QoQ, 5pp more than in 4Q15.	<a href="#">PDF</a>
<b>The good number in March underpins the labour market's positive balance in 1Q16</b>	04.04.2016	In line with what was expected, social security affiliation grew by 53 thousand people in March after controlling for seasonal and calendar effects. Unemployment was reduced by 41 thousand. In the whole quarter, the number of affiliates grew by 0,8% QoQ and unemployment fell by 2,4%, which implies a higher dynamism in the labour market in respect to 4Q15.	<a href="#">PDF</a>
<b>Industrial production did not fulfill the improvement expectatives in February</b>	07.04.2016	Industrial production (IPI) registered a second consecutive marginal fall (-0,2% MoM CVEC) in February, which entails a worse than expected behaviour. The majority of the IPI components evolved negatively, among which the energetic (-1,1% MoM CVEC) stood out, consolidating the negative trend observed since the second semester of 2015.	<a href="#">PDF</a>

Source: BBVA Research

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