

ACTIVITY

Spain: growth would held steady in 2Q16, beating expectations

Spain Unit

The trend in the variables observed indicates that the **recovery of the Spanish economy continued during the first half of 2016**. With nearly 80% of the information available for 2Q16, the MICA-BBVA¹ model estimates that **quarterly GDP growth (QoQ) will have completed one year at around 0.8%**. If confirmed, this stabilisation in the pace of expansion would give an upward bias to the growth envisaged in BBVA-Research's baseline scenario for 2016 (2.7%).

Looking ahead, the recovery of the Spanish economy will continue, despite the high level of uncertainty. On the domestic front, BBVA Research's estimates suggest that, although demand held firm, **economic policy uncertainty continued high until the end of the first half-year, and this could knock 0.3 pp off GDP growth for 2016 and 0.6 pp off that of 2017 relative to a scenario without that uncertainty²**.

Turning to the external scene, **the result of the UK referendum on whether to leave the European Union took centre stage, increasing the fragility of the recovery**. BBVA Research estimates that the increased economic uncertainty and the volatility seen in the financial markets since the UK referendum result was announced **could cost the Spanish economy between three and four tenths of a percentage point of the GDP growth forecast for 2017 (2,7%)**.

Private demand continues to lead the recovery while exports return to positive territory

The information available for the second quarter of 2016 suggests that domestic demand continues to be the main factor underpinning activity, while external demand has again started to make a practically zero contribution to growth.

Private domestic demand, and in particular consumption are still showing no clear signs of weakening in reaction to the climate of uncertainty. This is suggested by trends both in indicators of household expenditure and expectations (new car registrations, retail business and consumer confidence) and in the labour market, which point to similar growth in consumption to that seen in the first three months of the year³. Partial indicators of investment in plant and equipment (industry confidence, production and exports of capital goods) suggest that the pace of growth has quickened relative to 1Q2016, although remaining below the one seen throughout 2015. Lastly, residential investment indicators continue to show signs of the sector's recovery, following the uptick in the first quarter, once again showing growth rates close to those of the second half of 2015.

1: 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 : See Box 1 of the Spain Economic Outlook review for the first quarter of 2016, available at: https://www.bbvarsearch.com/wp-content/uploads/2016/03/Spain_Economic_Outlook_1Q16.pdf

3 : Further details in the Spain Economic Outlook review for the first half of 2016, available at: <https://goo.gl/173wEy>

As for external demand, the expenditure indicators (balance of trade and exports of major corporates) signal that sales recovered across the board in 2Q2016. Thus we expect clearly positive figures, following a first quarter in which good exports stagnated and those of services (in particular, non-tourism) fell unexpectedly. As regards the indicators related to tourism, arrivals and foreign tourists' spending also allow us to anticipate an advance in exports of tourist services in 2Q2016.

The public deficit has not been reduced from 2015

Data available for 1H2016 confirm the slightly expansive context of fiscal policy. Thus adjustments to the public deficit continue to rely on cyclical recovery and low interest rates. In this regard, budget execution data to April show that the public sector deficit (excluding local government) stood at around 0.8% of GDP, just under one tenth of a percentage point above that of one year ago. The data for May indicate that the State recorded a deficit of 2% of GDP, one tenth of a pp better than the deficit observed up to the same month of 2015. In this context, **the probability of budgetary targets being missed again this year remains high.**

The recovery of the labour market gained traction in 2Q16

New Social Security registrations surprised positively in June (70,000 MoM SWDA according to BBVA Research estimates)⁴. Thus the number of people registered with the Social Security at the end of the second quarter was up by 0.9% QoQ swda (0.8% in 1Q2016). In consonance with the foregoing, hiring increased by 0.3pp to 2.3% QoQ swda, both fixed term (2.0% QoQ) and indefinite contracts (5.4% QoQ). At the same time **the unemployment maintained its downward trend in June** (-45,000 persons SWDA according to BBVA Research estimates), ending the second quarter with a **slightly bigger decline in registered unemployment** than that seen in the first three months of the year (-2.4% QoQ swda as against -2.3% in 1Q2016).

Energy exerted less downward pressure on inflation

The leading indicator noted that consumer prices continued to fall in June (-0.8% YoY), albeit at a slightly slower pace than in the previous month (-1.0% YoY). In this regard, BBVA Research estimates suggest that energy is the only component that contributes negatively to inflation, while **core inflation remains positive (at around 0.7%).**

However, these developments in consumer prices continue to take place in an environment of low and stable inflation in Europe, and consequently limit the gains in price competitiveness of the Spanish economy. Thus, although it remains favourable, the differential in trend inflation relative to the euro zone fell by 0.4 pp over the course of the past year to -0.2 pp in May.⁵

The Spanish economy maintains its financing capacity

At the end of the first quarter, **the financing capacity of the Spanish economy held at 2.1% of GDP on an annual cumulative basis, the same level as at the end of 2015.** This was the result of an increase in the rate of savings (to 22.3% of GDP) similar to that in the rate of investment (to 20.9%). Patterns of behaviour among different economic agents were uneven in 1Q2016: whereas financial institutions and businesses improved their financing capacity, households reduced theirs. On the other hand, government authorities held their negative balances steady.

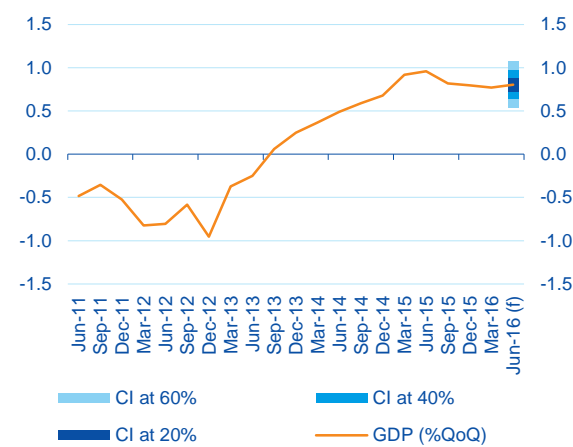
4 : The seasonal and working day adjustments (SWDA) made by BBVA Research are based on statistical univariate time series methods. Consequently, SWDA series estimates are subject to uncertainty; they may differ from estimates by other agencies, and may subsequently be adjusted without prior warning.

5: 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>

Balance of payment data for April indicate that, from the point of view of the financial account, the Spanish economy increased its financing capacity to €34.8 billion in the twelve month aggregate (€63.5 billion if Banco de España is excluded).

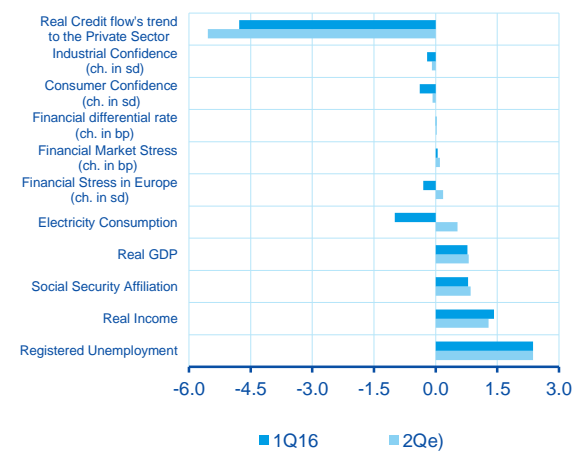
Looking ahead, we expect the Spanish economy to continue to show financing capacity relative to the rest of the world, given its structural adjustments⁶, the expected growth in exports, the favourable financing conditions and the cumulative decrease in the price of oil.

Figure 1
Spain: Observed growth in GDP and MICA-BBVA Model forecasts(% QoQ)



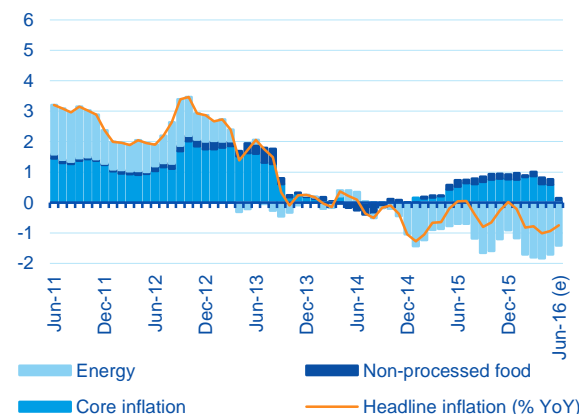
(e): estimate.
Source: BBVA Research

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



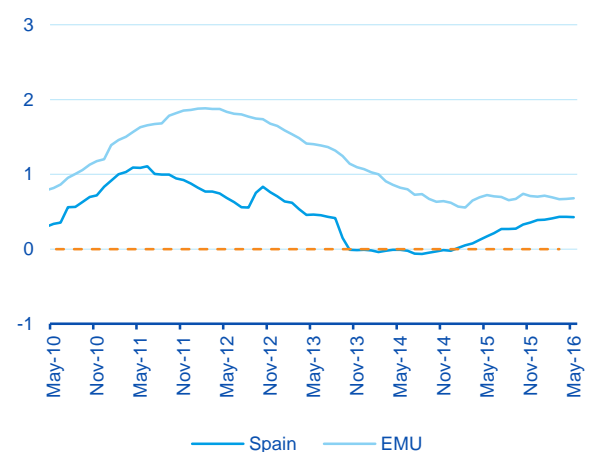
(e): Published data to July and MICA-BBVA model forecasts.
Source: BBVA Research based on data from official institutions

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



(e): estimate.
Source: BBVA Research

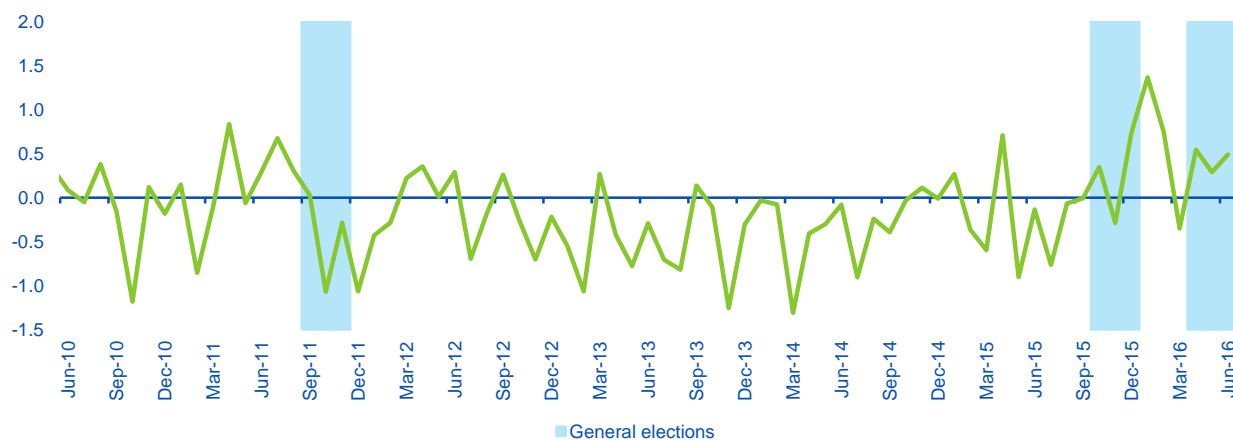
Figure 4
Spain and EMU: trend inflation (trimmed mean method, % YoY)



Source: BBVA Research based on INE and Eurostat

6 : 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 5
Spain: Index of economic policy uncertainty (idiosyncratic component in standard 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 June 2016

Flash	Date	Abstract	Link
Stable core inflation and less downward pressure on energy inflation	14.06.2016	In May inflation slowed its drop to -1% YoY, due mainly to a lower annual decrease of energy prices (-14% YoY). Meanwhile, core inflation remained stable at 0.7% YoY. Forward, we expect that these trends will continue: stability in core inflation and less downward pressure on energy inflation	PDF
Home sales in April 2016: upward bias evolution	14.06.2016	According to the General Council of Notaries, 39,461 homes were sold in April. Seasonally adjusted, 18.7% more than in March. With this evolution, better than expected, in the first four months home sales grew 18.0% over the same period last year	PDF
Expected decline of retail sales in May	28.06.2016	Once corrected for the stationary variations of each month, retail sales turnover was reduced by a monthly 0,9% in May. The rise in fuel and home equipment sales was enough to compensate the decline in the consumption of food and personal equipment goods.	PDF
Public-sector deficit remains at last year levels	28.06.2016	1T16 public-sector deficit rose to 0.8% of GDP, similar to that observed a year ago. The execution until April puts the deficit (excluding local corporations) around 1.2% of GDP. Both the central government and, above all, the regions have improved their balance. Continued deterioration of the Social Security surplus.	PDF
CPI flash estimate points at lower energy downward pressure in June	29.06.2016	CPI flash estimate signals that general consumer prices fell by -0,8% YoY in June, 0,2pp less than what was expected and to the fall in May. Our estimations suggest that energy is the only component that has a negative contribution on inflation, while growth in core prices should have remained stable at around 0,7% YoY.	PDF
The economy's financing capacity is maintained in 1Q16	29.06.2016	The Spanish economy's financing capacity remains at 2,1% of the GDP (in a four quarter accumulate) in March 2016. The rise in the saving rate compensates a similar rise in the inversion rate. In sector terms, the financing capacity of companies improves, while the one from households falls.	PDF
Agents' confidence improved in June, but signals in 2Q16 are mixed	29.06.2016	Despite the improvement in industry and consumer confidence in June (2,1 y 0,6 puntos, respectively) the balance in the second quarter showed mixed signals. Regarding consumers, confidence improved progressively, whereas in terms of industry, only the last month was positive. All in all, confidence remains above pre-crisis levels.	PDF
Permits April 2016: a bigger setback than expected	30.06.2016	4795 permits were signed in April, 20,3% less than the preceding month. The setback was higher than expected which offsets the growth of the previous months. On the other hand, refurbishment works in April remained practically stagnant in regards to the previous month.	PDF
Trade flows improve while financial investment flows worsen in April	30.06.2016	The balance of payments registered a 2671 million of euro superavit, which can be explained through the positive balance in tourism and a lower energetic deficit. Good exports recovered dynamism at the start of 2T16, while imports fell back (2,0% and -2,0% MoM cvec). The fall in investment flows resulted in an influx of capital.	PDF
The growth of passenger car sales accelerated in 2Q16	01.07.2016	BBVA Research estimations show that passenger car registrations fell marginally in June after correcting for monthly stationary effects. All in all, the second quarter of 2016 was closed with a 6.6% quarterly rise of sales, 2,5 pp more than in 1Q16.	PDF
The recovery in the labour market gained dynamism in the second quarter	04.07.2016	Labour marked records were positively surprising in June. After controlling for stationarity, hiring reached historical highs, social security affiliation rose by 70 thousand people and unemployment was reduced by 45 thousand. In 2Q16 the labour market improved progressively: the growth in the number of affiliates accelerated up to 0,9% and unemployment fell by 2,4%.	PDF
The atony in industrial production continued in May	06.07.2016	In May, industrial production fell by 0,5% MoM cvec, confirming the lack of dynamism observed since the beginning of the year. The production components continue to show mixed signals, from which the adjustments in equipment goods (-2,0% MoM cvec) and durable consumption goods evolutions (+2,1% m/m CVEC) stand out.	PDF

Source: BBVA Research

DISCLAIMER

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.