Regional Watch 1Q19

Export dynamism favors some northern Communities

- **The best tourism and consumption data for Q4 soften the deceleration in eastern Spain and slow down the shift of growth toward the north, but do not change the trend set by the fundamentals.**
- **The depreciation of the euro, the fall in the price of oil and the increase in pensions favour, to a greater extent, the Communities of northern Spain.**
- **Raising public wages and keeping interest rates low for a longer period of time may benefit the Communities in the south.**
- **Residential investment will continue to provide a differential boost in the most densely populated areas.**
- **The effects of the uncertainty in Catalonia are starting to subside, ensuring a return to a positive growth differential in 2019.**

Economic activity continues to lose momentum in eastern Spain, but the most recent data soften the slowdown

The scenario of the Spanish economy contemplates the deceleration already anticipated in previous quarters. 2018 closed with a GDP increase of 2.5% according to the flash estimate of the Spanish Quarterly National Accounts (a tenth less than expected), with continued growth in 2019 (2.4%), and expected growth in 2020 of 2.0%.[1] However, revised growth forecasts in some Autonomous Communities are somewhat more pronounced, although the driving force remains the same: Tourist Communities will experience a greater correction, while this will be lower in those Communities oriented to goods exports. As a result, the focus on growth will continue to shift from eastern Spain and island Communities to the north and northwest. However, there are nuances in this baseline behavior. Firstly, the recovery in goods exports is not happening in all of the Communities in which it was expected. Secondly, data from the tourism sector shows that the slowdown could be less pronounced than expected and would have acted as a driver for consumption and employment in coastal regions over the latter part of the year. Lastly, the fiscal stimulus is allowing the slowdown in household spending to ease off temporarily.

As a result, **for 2018, the revisions in GDP growth estimates are minor, except for Galicia (a three-tenths downward revision); and for La Rioja and the Basque Country, which are revised upward by two tenths and one tenth, respectively**. As such, **the Communities with higher growth in 2018 would have been Madrid, Navarre, Murcia and the Basque Country, while Castile and Leon, Andalusia, Asturias, the Balearic Islands and Catalonia would be in the lower growth group** (see Figure 1).

Looking ahead to 2019, the greatest corrections in the forecast are in the growth forecasts of the Canary Islands, Catalonia and Madrid (a two-tenths upward revision). By contrast, **the increase in GDP forecast for Asturias has been reduced by five tenths, while in Aragon, Cantabria and Castile and Leon, the forecast has been reduced by three tenths**. As a result, **growth will continue to be led by Madrid and the Basque Country**, along with Galicia, La Rioja, Castile-La Mancha and Catalonia. While Asturias, the Balearic Islands and Murcia will be the least dynamic Communities.

1: For more detail, see Spain Economic Outlook, 1st quarter of 2019, available here: https://www.bbvaresearch.com/wp-content/uploads/2019/02/Spain_Economic_Outlook_1Q19.pdf

In 2020, the convergence process in northern regions will continue, and it is expected that these regions will lead GDP growth, supported by the dynamism of its goods export sector. The reduced scope for fiscal expansion in the Communities of eastern Spain, and a less active tourism sector as a result of lower growth in household consumption, in both Spain and in the main tourist countries of origin, will further limit growth in economic activity in these regions (see Figure 2). In terms of GDP per capita, the combination of an increase in GDP growth with more unfavorable demographics will, over the whole period, lead to northern Communities rapidly advancing in their convergence process. For their part, those Communities in the south or the Canary Islands, with higher population growth and lower productivity growth, will see their relative improvement in GDP temporarily stalling.

Figure 1 GDP growth in 2017 according to the SRA (Spanish Regional Accounts) and forecasts for 2018 (YoY, %)

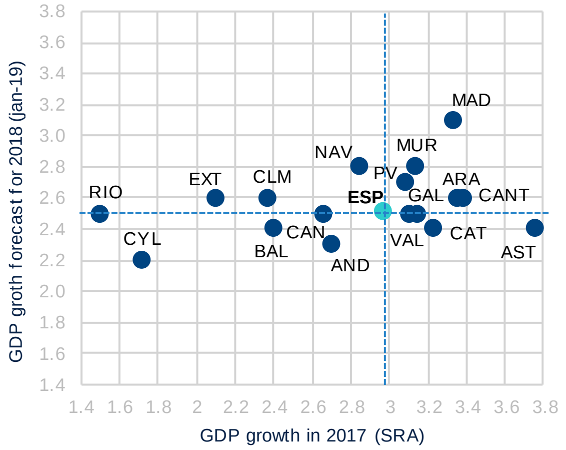

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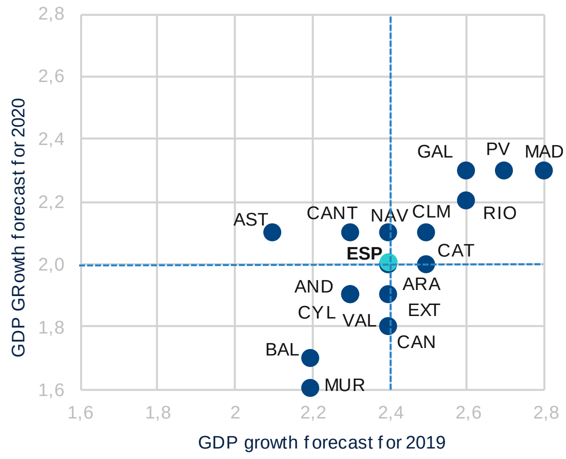
Figure 2 Growth forecasts for 2019 and 2020 (YoY, %)



Source: BBVA Research

The revision of the Spanish Regional Accounts points to a greater dynamism in La Rioja, the Balearic Islands and Murcia between 2015 and 2017 …

The first factor to take into account in the revised forecasts is that past behavioral paths have been affected as a result of the INE review of the Spanish Regional Accounts (SRA) last December for the period 2015–2017 (see Table 1). Highlights include the cumulative changes affecting the GDP of La Rioja, the Balearic Islands and Murcia, which, respectively, would have increased their growth by 1.7, 1.6 and 1.5 pp between 2014 and 2017. At the other end of the scale, in Castile and Leon, and Navarre, GDP would have increased by 0.9 pp less than reported with the previous forecast.

… while the latest available data indicates an overall acceleration in growth in 4Q18, which could continue in the Communities of the north in 1Q19

In addition, following the loss of momentum in Q3, the most recent data indicates that there was an almost universal improvement in Q4. According to the estimates of the MICA-BBVA models, Madrid, Castile-La Mancha and Murcia experienced higher growth in 4Q18, boosted by the drive in consumption (car registrations), domestic tourism and goods exports. The greatest growth at the end of the year was seen in the industrial regions, notably Catalonia, the Basque Country, the Valencian Community or Asturias.

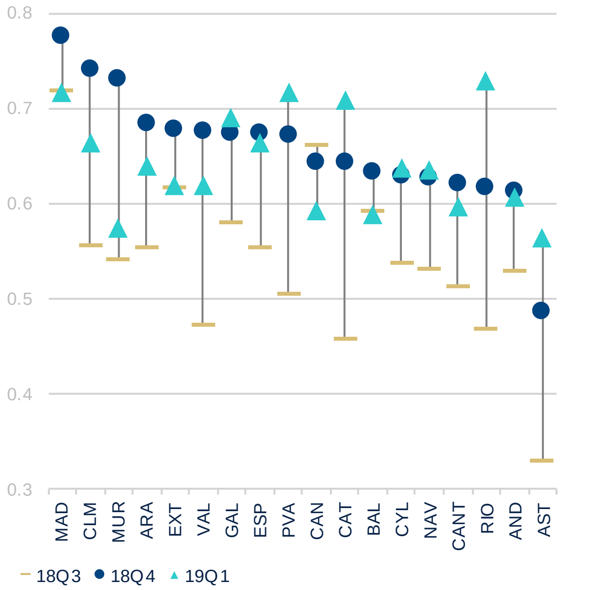
The Spanish economy could grow again at around 0.7% QoQ, in Q1 of this year, but with greater regional heterogeneity, as estimated with the few data already available for the quarter (see Figure 3). As such, a new acceleration in economic activity could be observed in the Basque Country, Catalonia and La Rioja which, along with Madrid, are the regions with the greatest dynamism this quarter. However, the island Communities (Balearic Islands and Canary Islands) and those in the southeast could experience a greater slowdown.

Table 1 Annual GDP growth revisions in the Spanish Regional Accounts, December vs. March 2018 data (pp)

	2015	2016	2017
Andalusia	0.5	0.1	0.0
Aragon	-0.2	0.5	-0.2
Asturias	0.0	-0.2	0.3
Balearic Islands	1.2	0.6	-0.3
Canary Islands	0.6	0.4	-0.2
Cantabria	-0.1	0.2	0.2
Castile and Leon	-0.2	-0.5	-0.2
Castile-La Mancha	0.3	0.7	-0.1
Catalonia	0.0	-0.1	-0.1
Extremadura	0.5	-0.6	-0.3
Galicia	0.1	-0.5	0.0
Madrid	0.4	-0.4	-0.1
Murcia	0.4	1.1	-0.2
Navarre	-0.8	-0.1	0.0
Basque Country	-0.3	0.1	0.0
La Rioja	0.3	1.6	-0.3
Valencian Community	0.2	-0.7	-0.1
Spain	**0.2**	**-0.1**	**-0.1**

Source: BBVA Research and INE (Instituto Nacional de Estadística Spanish National Statistics Institute)

Figure 3 Quarterly GDP growth estimated by the MICA-BBVA models for each Autonomous Community (%, QoQ SWDA)



Source: BBVA Research

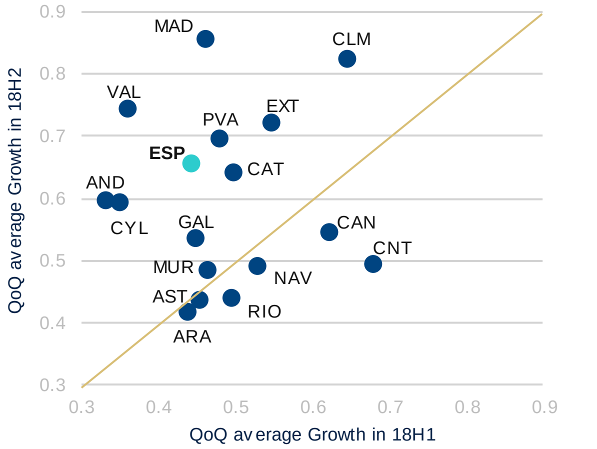
Slight recovery in household consumption in Q4, more apparent in Mediterranean Communities

The most recent data suggests that private consumption once again accelerated in 4Q18, contributing to a more dynamic second half. **Improved employment, lower fuel costs and the fiscal stimulus would have boosted acceleration in household spending.** The greatest acceleration was observed in Madrid, Castile-La Mancha and the Valencian Community (see Figure 4), and only the Canary Islands and Cantabria experienced a noticeable slowdown in the second half of the year.[2] Despite this upward growth, **the trend in recent years has been toward moderate consumption growth.** As such, the depletion of pent-up demand and some tailwinds, along with the slowdown in employment, would have weakened the progress of this segment of the demand in 2018, in particular in Mediterranean Communities and in some Communities in the north (see Figure 5).

Broadly speaking, **Communities with aging populations continue to show a slowdown in consumption**. However, there are two notable exceptions: Extremadura and Cantabria, where the boost in public employment benefitted the dynamism in household spending. This boost would also be behind the resilience of private consumption in the economy of the Canary Islands, despite lower contributions from the tourism sector, which has also affected the Communities in eastern Spain. In so doing, the **Balearic Islands and the Valencian Community** (despite the acceleration of the latter over the last part of the year) **are the regions in which progress in private consumption would have fallen the most** in 2018. They therefore join the lower growth group, which Murcia and Andalusia are still in. A significant slowdown in La Rioja, Navarre and Asturias can also be noted.

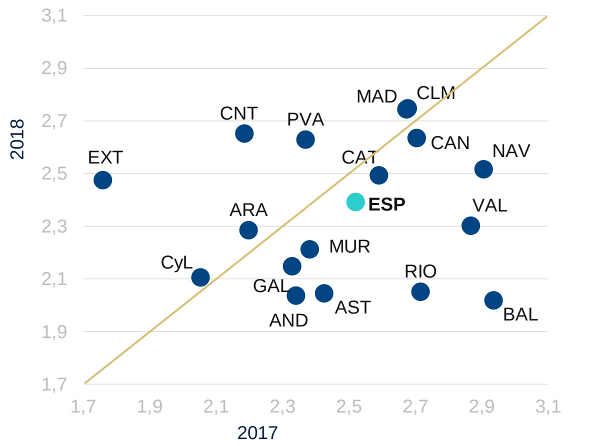
2: See BBVA Research, Consumption Outlook, Second half 2018, available here: https://www.bbvaresearch.com/publicaciones/situacion-consumo-segundo-semestre-2018/

Figure 4 Composite regional consumption indicator (ISCR-BBVA) Growth in private consumption in the first and second halves of 2018 (QoQ, %, SWDA)



Source: BBVA Research, based on DGT, CORES, Datacomex and INE figures

Figure 5 Composite regional consumption indicator (ISCR-BBVA) Growth in private consumption in 2017 and 2018 (YoY, %)



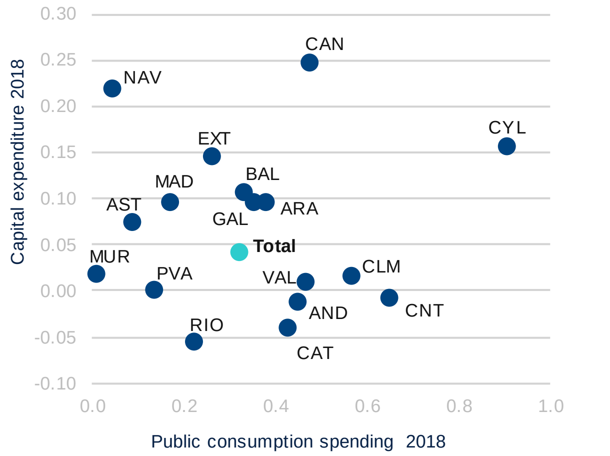
Source: BBVA Research, based on DGT, CORES, Datacomex and INE figures

A more expansive fiscal policy supports growth in central and western Spain, but will limit the future margin in Mediterranean Communities

All Communities have increased public spending in terms of GDP in 2018, a sign that they are easing their consolidation effort. Particularly noteworthy are the increases in public consumption in Castile and Leon, Cantabria, Castile-La Mancha and the Canary Islands, as a result, in part, of the boost to employment in the public sector. This helps to explain why, in those Communities, household spending shows a behavior that is relatively more favorable than that suggested by activity indicators in the private sector.

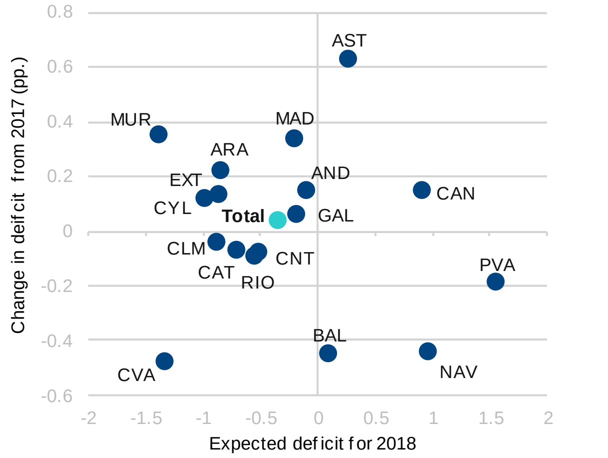
For their part, the investment drive by the Autonomous Governments demonstrates greater dynamism in Castile and Leon, the Canary Islands and Navarre, compared to the slowdown in La Rioja or Catalonia, with increases below the nominal GDP growth rate (see Figure 6). Linked to the boost in spending, and despite accelerated income throughout the year, a minor correction was noted in the non-financial balance of Autonomous Governments. In particular, the data up to November indicates that it may even have worsened in the Valencian Community, the Balearic Islands, Navarre and the Basque Country (see Figure 7). However, **based on information up to November, the 2018 deficit target may not have been met in the Autonomous Communities of Castile-La Mancha, Castile and Leon, Murcia, Navarre, Aragon and the Valencian Community**.

Figure 6 Change in consumer and capital spending of the autonomous governments in 2018 (% of regional GDP)



Source: BBVA Research, based on Ministry of Finance and Public Administration and INE figures Data from public accounts up to November, supplemented with BBVA Research forecasts

Figure 7 Change in deficit in 2018 (% of regional GDP)



Source: BBVA Research, based on Ministry of Finance and Public Administration and INE figures Data from public accounts up to November, supplemented with BBVA Research forecasts

Investment in housing remains dynamic, but only restricted to high-demand territories

Housing prices remain on an upward trend driven by momentum from job creation, greater disposable income, pent-up demand and more profitable rental markets, especially in Madrid, Catalonia and the Balearic Islands. In response, activity in the property construction sector is recovering steadily, albeit at a very uneven pace, with activity centering on high occupation in large urban areas and tourist areas.

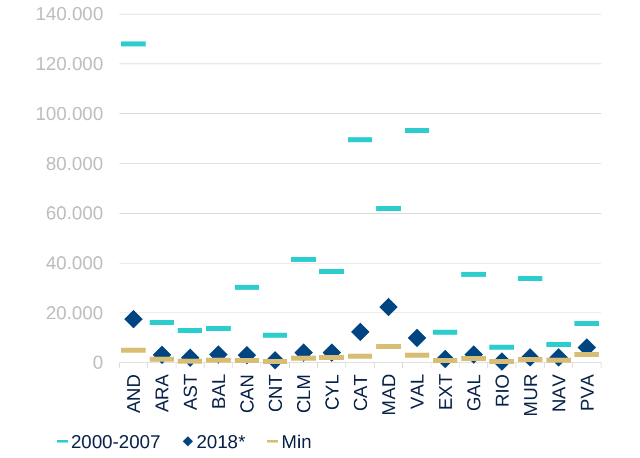
In Madrid, Andalusia, Catalonia, the Valencian Community and the Basque Country, the higher number of new construction permits authorized in the past year would suggest that investment in the residential sector will again contribute to GDP growth in these regions (see Figure 8). However, dynamism may be lower in other regions given the higher availability of supply and less pressure on demand.

Only Navarre manages to accelerate its exports in 2018

With data up to November and in real terms[3], only Navarre experienced an acceleration of international sales of goods, driven by the automobile sector (which explains 60% of this growth). Castile and Leon, is another community that shows better performance than the previous year, reducing the rate of decline in foreign sales, although they are still burdened by difficulties, precisely in the automobile sector (see Figure 9).

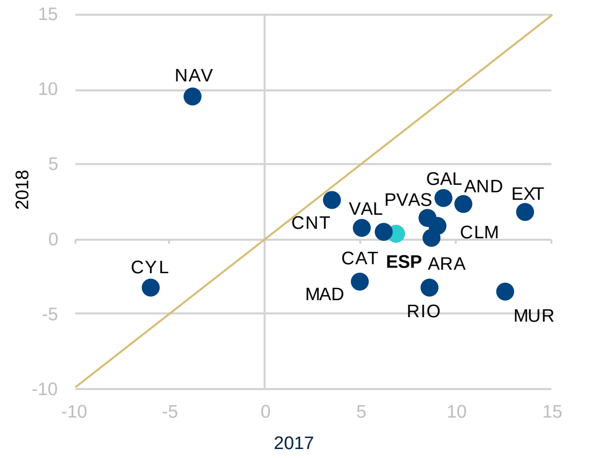
3: With Datacomex data, deflated by unit value indices (UVIs) by Autonomous Community created by BBVA Research with information up to November, completed with forecasts.

Figure 8 New housing permits
(Units)



Source: BBVA Research based on Spanish Ministry of Public Works data

Figure 9 Exports of real assets
(SWDA, YoY, %)



(*) 3 Autonomous Communities are out of scale on the graph: Balearic Islands (+59% in 2017, +1.0% in 2018); Asturias (+27.8%; -9.8%) and the Canary Islands (+22.0%; -6.9%)
Source: BBVA Research and INE (Instituto Nacional de Estadística — Spanish National Statistics Institute)

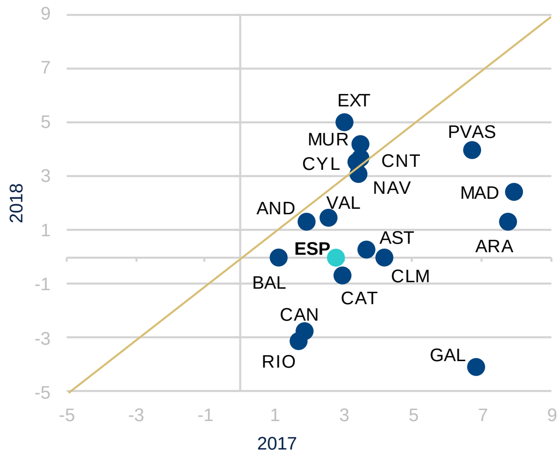
A favorable fourth quarter in tourism, which fails to curb the slowdown in the Mediterranean

Regarding tourism, overnight hotels stays recovered slightly in the second half of 2018 in 14 of the 17 Communities. Only the Canary Islands, Andalusia and Aragon fell behind in the second part of the year, while Galicia, Castile and Leon, and the Balearic Islands experienced greater acceleration. However, this improvement was insufficient to halt the slowdown observed in the year as a whole, which is linked to more structural factors, such as the return of tourism borrowed from the eastern Mediterranean during geopolitical tensions in recent years or the slowdown in consumption in the main European economies.

Thus, **in 2018 as whole, only two Autonomous Communities (Extremadura and Murcia) increased total overnight hotel stays compared to the previous year** (see Figure 10). Among the regions in which tourism is a relevant sector, overnight hotel stays continued to grow (although less than in 2017) in Madrid, the Valencian Community and Andalusia, supported both by continued strong domestic demand and a shift of visitors (particularly domestic tourists) away from Catalonia. In 2018, **overnight stays were flat in the Balearic Islands, while in Catalonia, and especially in the Canary Islands, they were below** 2017 levels.

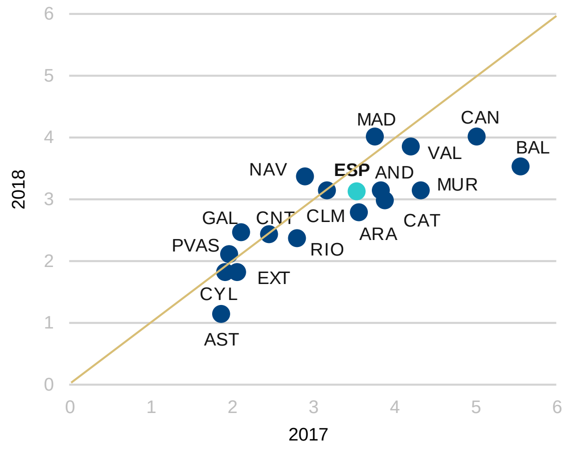
The same dynamic is drawn for employment, with an end of the year in which it accelerates, but not enough to maintain the rate of growth of the previous year, after a bad start of 2018. Tourism and trade picked up in the second half of 2018, especially on the Mediterranean coast (except in the Valencian Community). However, this did not prevent these Communities from experiencing a greater slowdown in Social Security registrations in the year as a whole. Only Madrid, Navarre and Galicia escaped this general trend, most evidently in the Balearic Islands, Canary Islands, Murcia and Catalonia (see Figure 11).

Figure 10 Overnight hotel stays
(YoY, %)



Source: BBVA Research, based on INE data

Figure 11 Social Security registrations
(YoY, %)



Source: BBVA Research, based on Social Security data

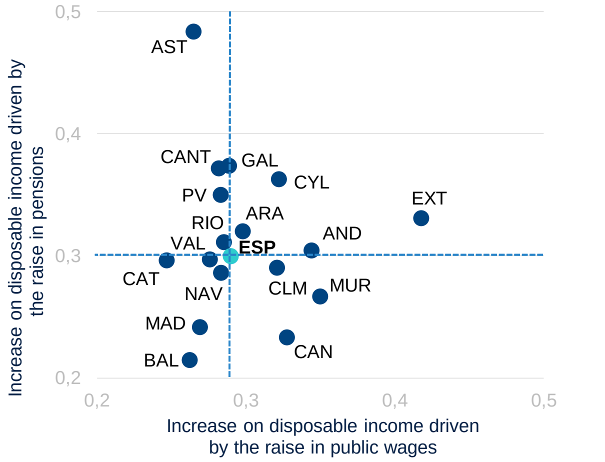
The scenario continues to be more favorable for the Autonomous Communities in the north, but the gap is narrowing slightly

Looking ahead, the fundamentals of the Spanish economy predict continued growth, albeit at a more moderate pace. GDP growth could reach 2.4% in 2019 and slow down to 2.0% in 2020 due to the depletion of cyclical factors, a lower contribution from fiscal policy, problems in specific sectors (automobile, tourism) and persisting uncertainty surrounding economic policy. At the regional level, this means that growth redistribution noted in previous Watch reports will continue, albeit at a slower pace than initially expected. As such, the scenario will be marked by four aspects: a slowdown in private consumption; maintained investments; increased goods exports; and less dynamism in the tourism sector.

The slowdown will continue in private household consumption, although may be partially offset by wage rises in the public sector and pensions (see Figure 12). Wage rises will have a greater impact in the west of Spain, where public employment is stronger. And pension changes will impact the north, where this source of income is more significant.

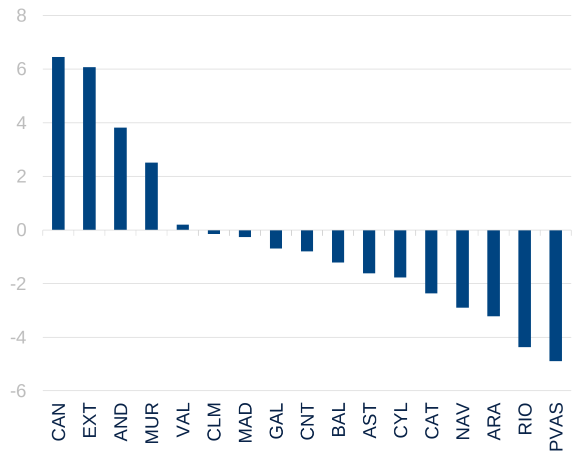
The other measure that could affect distribution of disposable income, but with a less clear impact, is the increase in the statutory minimum wage to €900. On paper, the number of potential beneficiaries of this measure is higher in the Canary Islands, Extremadura, Andalusia and Murcia, whereas the wage correction margin as a result of this measure is lower in the Basque Country and the Communities of the Ebro Valley (see Figure 13). Nonetheless, the labor market too is under less pressure in terms of supply in the former, with more unemployment and seasonal workers, but lower levels of human capital. If pricier labor translates into less demand for employment of low-wage workers, there could be less disposable income to play with in the south of Spain.

Figure 12 Increases on disposable income driven by the raise in public wages and pensions
(% of regional disposable income)



Source: BBVA Research, based on INE and Social Security data

Figure 13 Wage-earners: % located in wage deciles 1 and 2 (Relative to Spain, 2017)



Gross monthly wages, full-time, deciles calculated for Spain as a whole. Source: BBVA Research based on INE and Economically Active Population Survey (EAPS) data

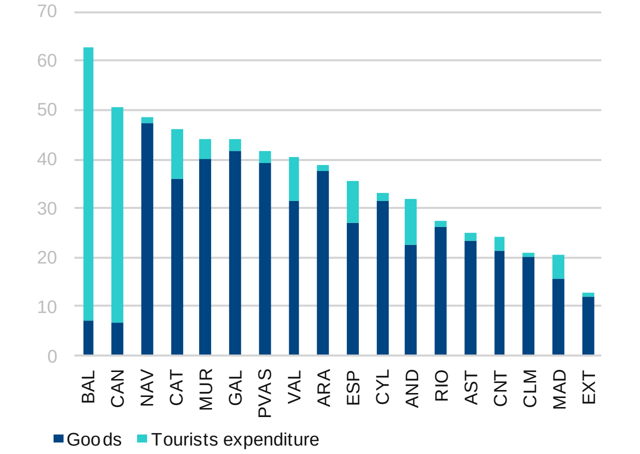
On investment, in addition to the boost in residential construction (mainly in large cities and coastal tourist destinations), it is also worth noting strong investment in equipment. This benefits those Autonomous Communities with more industrial activity, since it allows production chains to be upgraded and modernized, thus putting industry in a strong position to take advantage of the international scenario over the next two years: greater dynamism in international trade and markets outside the EMU; a depreciated euro; and relatively cheap and stable oil prices at around USD 60/barrel, which will boost the export sector.

As a result, **the Autonomous Communities stretching from the Valencian Community and Catalonia to Galicia through the Ebro Valley and the Cantabrian Mountains could see greater dynamism in goods exports**. However, two difficulties should be considered in this scenario. First, some sectors such as the automobile industry are not responding with the expected strength. This occurred in Castile and Leon for instance, or in Aragon and Catalonia to a lesser extent, and largely justifies adjusted estimates for Castile and Leon. Secondly, the slowdown of activity in the main EMU countries leads to less demand in these economies. Therefore, those Autonomous Communities more oriented to markets outside the EU could be favored more by growth in their external sectors (in Andalusia, Asturias, the Valencian Community, Madrid and Murcia sales outside the EU exceeded those within the EU).

Growth in tourism will be limited by the slowdown in the main markets of origin, as consumer growth is forecast to slow down in Germany, United Kingdom, France and Italy. This is all the more true in a context where the competitive markets who had "supplied" visitors are starting to recover them. In addition, the contribution of tourism expenditure means that island Communities are the most exposed to the fluctuations in international demand (see Figure 14). The slowdown in private consumption in Spain also reduces the dynamism of the national tourism demand. However, the regions with the highest occupancy rates in the sector (the Balearic Islands, Canary Island or the cities of Barcelona and Madrid) have accumulated a price margin that could now be exploited to compete if necessary, while other regions (such as the Valencian Community or Murcia) have less room for improvement.

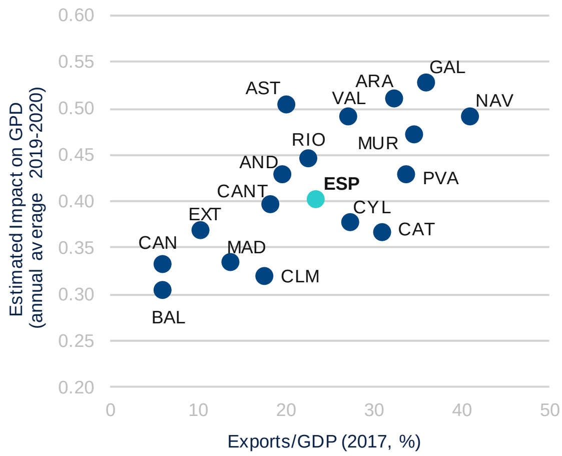
Beyond its direct effect on transportation cost for exports, the fall in oil prices reduces production costs and frees up income available for households, with a more marked effect where the use of this energy source is more intensive. A forecast employing the BBVA-RVAR model[4] shows that the Communities benefiting the most could be those in the north[5], where the impact of this decrease implies, *ceteris paribus*, a boost of around 0.5 pp to GDP compared with the previous scenario (see Figure 15).

Figure 14 Contribution of exports to GDP (2017, %) (*)



Only includes exports of goods (source: Datacomex) and the tourism expenditure of non-residents (source: EGATUR). The graph therefore excludes exports of non-tourist services, for which there is no regional data, but which may be relevant in some Autonomous Communities, such as Madrid and Catalonia.
Source: BBVA Research based on INE and Datacomex

Figure 15 Impact of the downward revision of oil prices in GDP growth (pp of regional GDP, deviation from the baseline scenario) (*)



(*) See the "Regional interdependence in Spain: A GVAR approximation" Watch, forthcoming on the BBVA Research website.
Source: BBVA Research

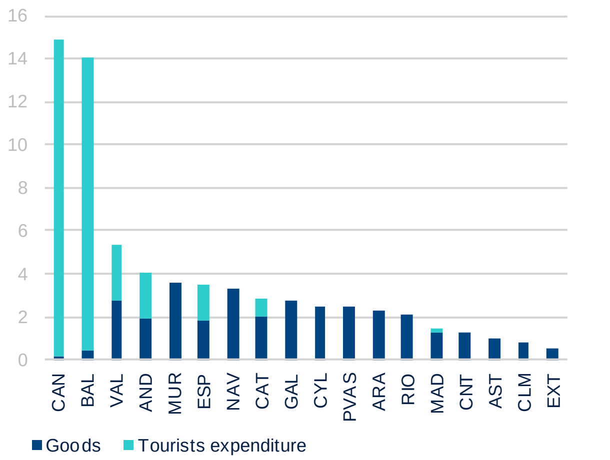
Finally, the effects of political uncertainty on Catalonia's economy are decreasing. As such, the latest data show that as uncertainty linked to idiosyncratic factors drops, and partial indicators correct the negative differential observed over the course of 2018. If this trend continues, factors that support the growth scenario and, in particular, the improvement of residential investment and export support, could help Catalonia to recover a favorable differential with Spain.

In this scenario, two additional risks should be taken into account. Abroad, a possible decline in trade with the United Kingdom associated with its exit from the EU, could affect Canary Island and Balearic Islands to a larger extent (due to the contribution of the tourism expenditure), although the effect on the whole economy is also relevant for the Valencian Community, Andalusia and Murcia (see Figure 16). Domestically, there are still doubts about how to continue the reduction in the public deficit, the measures required to continue ensuring the sufficiency and sustainability of the pension system and the effect of some adopted measures, such as the increase in the statutory minimum wage. As such, the imbalance in public finances will remain between 2.0 and 2.3% of GDP. Together with the political fragmentation and the lack of consensus within the Spanish Parliament on the policies of an inclusive nature needed to bolster growth, this imbalance represents a source of vulnerability within a context that is increasingly uncertain.

4: See the Regional interdependence in Spain: A GVAR approximation, Watch, forthcoming on the BBVA Research website.
5: The case of Murcia is relatively special, due to the contribution of refining activity, with high incidence of added value and exports, but with low employment.

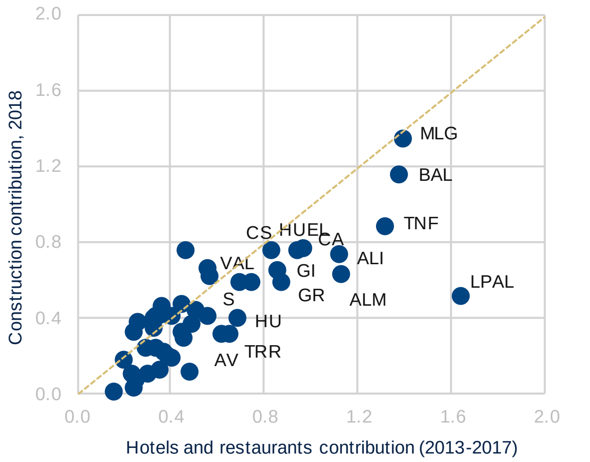
All this in a context, in which the slowdown in tourism and domestic consumption will lead to a lower contribution of the the retail sector and hotels and restaurants industry to job creation than that observed in the past. This slowdown is not being replaced by sectors like construction, in particular within the provinces where tourism has acted as the main catalyst of employment over the course of this expansion (see Figure 17)[6].

Figure 16 Contribution of exports to the United Kingdom to GDP (2017, %) *



(*) Only includes exports of goods (source: Datacomex) and the tourism expenditure of non-residents (source: EGATUR). The graph therefore excludes exports of non-tourist services, for which there is no regional data, but which may be relevant in some Autonomous Communities, such as Madrid and Catalonia.
Source: BBVA Research based on INE and Datacomex

Figure 17 Contribution to growth of hotels and restaurants industry (2013–2017, annual average) and difference relative to construction in 2018, by province (pp)*



(*) See "The Challenge of The Slowdown in tourism employment: detail at the provincial level", Watch, forthcoming on the BBVA Research website.
Source: BBVA Research, based on Social Security data

Higher global risks for regions specialized in the tourism and automotive sectors

In short, **the scenario maintains the same trends of previous quarters. But the transfer of growth toward the north will be more gradual than anticipated**. The boost to the export and the manufacturing industries is ensuring that those Communities exporting goods will benefit the most, but in a context of slower growth in the EMU, differences will be less marked. However, **the slowdown in consumption and tourism are affecting progress in the Mediterranean,** although its correction is not as sharp as anticipated a few quarters ago. In this context, **the convergence in GDP per capita relative to the Spanish average is accelerating in the Communities of the north** (favored by lower demographic growth), while progress is hampered in the Communities of the south.

6: See the Challenge of "The Slowdown in tourism employment: detail at the provincial level", Watch, forthcoming on the BBVA Research website.

Table 2 GDP growth by Autonomous Community

	2016	2017	2018	2019	2020
Andalusia	2.9	2.7	2.3	2.3	1.9
Aragon	3.2	3.4	2.6	2.4	2.0
Asturias	1.6	3.8	2.4	2.1	2.1
Balearic Islands	4.4	2.4	2.4	2.2	1.7
Canary Islands	3.4	2.7	2.5	2.4	1.8
Cantabria	2.6	3.4	2.6	2.3	2.1
Castile and Leon	3.1	1.7	2.2	2.3	1.9
Castile-La Mancha	4.2	2.4	2.6	2.5	2.1
Catalonia	3.5	3.2	2.4	2.5	2.0
Extremadura	1.7	2.1	2.6	2.4	1.9
Galicia	3.1	3.1	2.5	2.6	2.3
Madrid	3.2	3.3	3.1	2.8	2.3
Murcia	4.3	3.1	2.8	2.2	1.6
Navarre	3.0	2.8	2.8	2.4	2.1
Basque Country	3.0	3.1	2.7	2.7	2.3
La Rioja	2.6	1.5	2.5	2.6	2.2
Valencian Community	2.8	3.1	2.5	2.3	1.9
Spain	**3.2**	**3.0**	**2.5**	**2.4**	**2.0**

Source: BBVA Research and INE (Instituto Nacional de Estadística — Spanish National Statistics Institute)

Table 3 Employment growth by Autonomous Community

	2016	2017	2018	2019	2020
Andalusia	2.4	4.1	2.8	2.6	2.2
Aragon	2.3	2.2	1.4	1.4	1.0
Asturias	2.7	2.4	-0.9	1.1	0.9
Balearic Islands	4.2	1.2	4.1	3.5	2.8
Canary Islands	3.2	3.4	6.6	2.7	2.5
Cantabria	3.0	0.9	1.6	1.4	1.1
Castile and Leon	2.8	0.8	1.1	1.9	1.6
Castile-La Mancha	3.2	4.0	2.9	2.8	2.1
Catalonia	3.5	2.9	2.7	2.4	1.9
Extremadura	1.9	0.5	3.7	1.9	1.5
Galicia	2.3	1.2	2.4	1.3	0.9
Madrid	0.9	2.5	2.9	2.2	1.6
Murcia	6.1	3.4	1.9	1.7	1.3
Navarre	1.2	4.2	1.2	1.5	1.2
Basque Country	2.8	0.3	2.2	1.3	1.5
La Rioja	1.7	1.4	2.7	1.7	1.8
Valencian Community	3.1	3.0	2.7	1.8	1.8
Spain	**2.7**	**2.6**	**2.7**	**2.1**	**1.8**

Source: BBVA Research and INE (Instituto Nacional de Estadística — Spanish National Statistics Institute)

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