Regional Watch 4Q19

Growth forecasts revised downwards due to weaker European consumption and demand, with more impact on the northern Autonomous Communities and tourist destination

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- **Changes in the national accounts, recent activity data and the deterioration in the prospects for the EMU indicate a general downside revision of growth forecasts for Spain and its autonomous communities.**
- **Regions in the north of the peninsula**, along with the Canary Islands, face the sharpest slowdown in economic activity, and consequently the most significant downside adjustments.
- **In terms of components, household spending has suffered the worst impairment during 2019. This has been particularly evident for Spain's island regions, as well as central and northern areas of the peninsula** (Extremadura, Castilla y León, Castilla-La Mancha, Madrid, La Rioja, and certain Cantabrian regions). Conversely, the Mediterranean regions (Murcia, Andalusia and The Valencian Community) have seen domestic tourism underpin economic activity and cushion the slowdown in consumption and employment.
- **Meanwhile, goods exports show erratic behavior**. The anticipated foreign sales growth (indicated in 2Q19) was not consolidated in those regions most dependent on the trade of goods (Cantabrian regions, Castilla-La Mancha). By contrast, the improvement was observed in Navarra, Extremadura, The Valencian Community and Madrid.
- **Exports of tourism services have slowed down due to waning European demand**, among other factors, thus worsening the forecasts for the island autonomous communities. A good trend for business and city tourism were behind Madrid's standout positive performance.
- **Prospects of weak growth in the euro area during 2020 are likely to undermine the dynamism of those regions most exposed to trade and those recipients of European tourists.**
- **Looser monetary policy, with lower interest rates, could partially mitigate the impact of uncertainty, albeit with a heterogeneous impact across the regions.** Those autonomous communities with higher levels of public and private debt should particularly benefit, including The Valencian Community, Catalonia, Castilla-La Mancha and Murcia.
- **Rising uncertainty regarding economic policy is likely to have an impact on economic activity**. The United Kingdom's departure from the EU is one of the relevant focal points of uncertainty, to which the Canary Islands and Balearic Islands are particularly vulnerable. Furthermore, the largest exporting regions are most exposed to the fallout from heightening trade conflicts. Lastly, the political climate could be having an adverse effect on household and business spending.
- **Finally, the dynamism of the real estate market, helped by the expansive monetary policy, will continue to be heterogeneous**. The densest populated areas, such as Madrid and Barcelona, are likely to continue to see a differential evolution.

Recent data suggests that the slowdown is particularly sharp in the islands and the northwest

Revised national accounts and recent activity data point to weaker economic growth than anticipated before the summer. However, while the slowdown is nationwide, not all regions have been affected to the same degree[1]. The latest data for the second and third quarters points to the fastest slowdown occurring in the Canary Islands, the Basque Country, La Rioja and northwest autonomous communities.

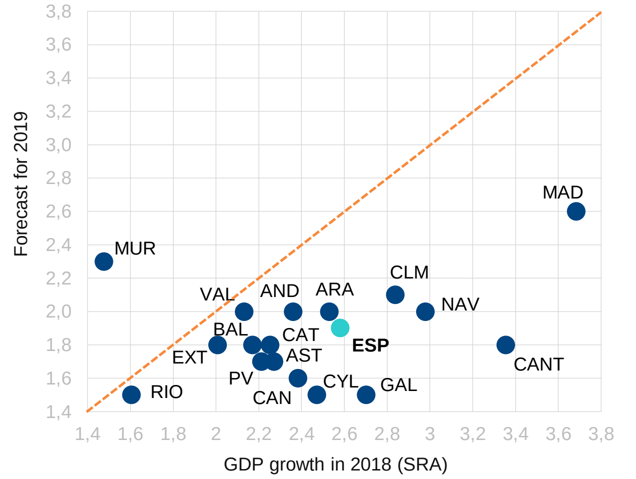
Growth forecasts for 2019 were revised down by 6 tenths for the Canary Islands, Castilla y León, Galicia and Navarra, and 0.5 pp for the Basque Country, Cantabria and La Rioja. The deteriorating outlook for Canary Islands is largely explained by a slowdown in household spending, Social Security affiliation and, above all, due to the lack of recovery of foreign tourism. For the latter group, the revision is largely justified by the weakness of the industrial sector and more sluggish than expected export growth, as a result of the slower expansion of European demand. The slowdown in the industrial sector and weaker domestic demand are also behind the lower forecasts for Castilla-La Mancha, Catalonia and Madrid (projections are revised down by four tenths, in line with Spain as a whole). The forecast for Asturias already incorporated the slowdown in the industrial sector and therefore remains unchanged.

In contrast, some autonomous regions in the south and east of the peninsula have shown greater resilience to the slowdown in the year to date. A sharper slowdown in consumption and a higher dynamism in the industrial sector explain why the downside revision in The Valencian Community is just three tenths. In Aragon, strong exports largely offset the trend of domestic demand. Conversely, in Andalusia good performances of domestic demand and Social Security affiliation offset the lower domestic demand: the revision for 2019 stood at four tenths, while the region could sustain its growth in line with Spain as a whole despite the challenges in terms of tourism. In Extremadura, a rebound in investment justified the revision of just two tenths, matching that of the Balearic Islands, the forecast of which already included the weakness of the tourism sector. Finally, **Murcia was the only region to see the growth forecast revised up, by three tenths**, thanks to better than anticipated trends from consumption, affiliation and above all stronger industrial output linked to energy than had been expected some quarters ago. **This means that Madrid, Navarra, Castilla-La Mancha and regions in the southeast (Andalusia, The Valencian Community and Murcia) are set to spearhead growth in 2019**. Conversely, the Canary Islands, Castilla y León, Galicia and La Rioja are set to post the slowest growth.

Further downside revisions for 2020. The deepest cuts to forecasts are for the Canary Islands, Castilla y León and Galicia (0.5 pp) due to a more challenging climate in terms of a recovery in exports, largely in services for the Canary Islands and goods for the latter two regions. Castilla-La Mancha, The Valencian Community, Catalonia, Aragon and the Balearic Islands will also be more affected by the slowdown abroad. In fact, **the Canary Islands and the Balearic Islands are set to post the weakest growth of all regions in 2020, while the northwest will again expand at below average rates**. Conversely, those regions with exports that are more diversified and destined for countries outside of the EU, the lower debt and the less dependency on tourism may be among the least affected: Extremadura's forecast has been revised down, but only by one tenth, while the cuts for Madrid, the Basque Country, La Rioja and Murcia were of just two tenths.

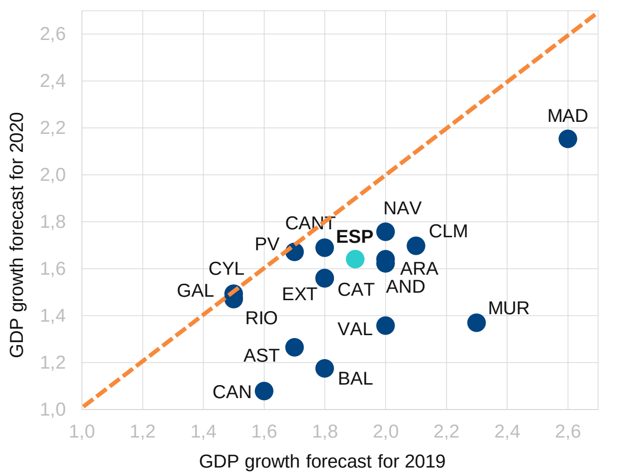
1: Although toward the end of September the INE (the Spanish Office of National Statistics) published its revised annual and quarterly national accounts, which included a shift in trends for the last five years, it will not do the same for quarterly accounts until December. The inconsistency between the data sets (until the correction due in December) makes accurate forecasting very challenging, as it is impossible to identify how trend shifts in the Spanish economy will affect the regions, as well as various macro data components.

Figure 1. **GDP GROWTH IN 2018 (SRA) AND FORECAST FOR 2019** (%)



Source: BBVA Research and INE, Spanish Regional Accounts

Figure 2. **GDP GROWTH FORECASTS FOR 2019 AND 2020** (%)



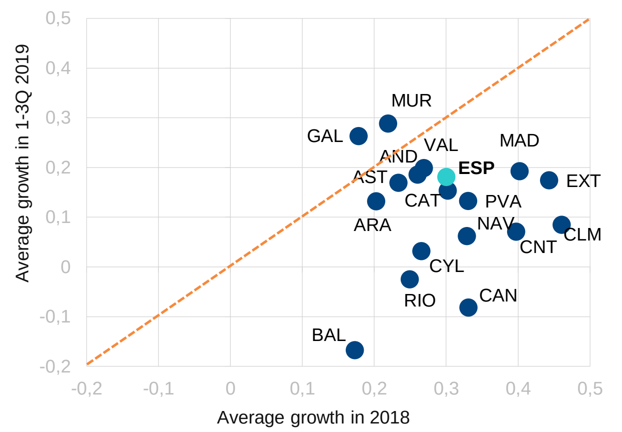
Source: BBVA Research

The slowdown in domestic consumption is chiefly affecting the central and northern regions, as well as the island regions

The most recent data points to greater weakness than previously expected, above all in domestic demand, which may be behind the lower dynamism of the Spanish economy. This slowdown is largely the result of domestic consumption losing traction practically across all the Spanish regions, albeit less intensely in regions in the southeast of the peninsula and certain autonomous communities in the north. The slowdown has been particularly acute for Cantabria, the central peninsula region (Extremadura, Castilla y León, Castilla-La Mancha and to a lesser extent Madrid) and the islands. Spending has even contracted in the year-to-date in the island regions and La Rioja (see Figure 3). Conversely, consumption in Murcia and Galicia has accelerated compared to last year, while the expansion in Andalusia, The Valencian Community and Asturias has been similar to that of 2018. In these five autonomous communities consumption growth has outpaced the national average in the year-to-date and overcomes the downturn experienced in 2018, when growth was weaker than that of Spain as a whole.

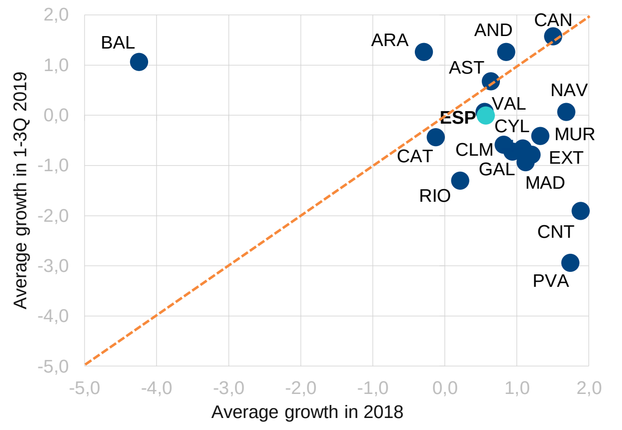
Stronger consumption in the Mediterranean may partly be driven by rising domestic tourism to these destinations. The uptick in hotel overnight stays among domestic tourists in Spain during 2019 was near entirely accounted for by Andalusia and, to a lesser degree, the region of The Valencian Community. Looking at the other more traditional tourist destinations, overnight stays from domestic visitors lost traction in Madrid, while Catalonia is yet to overcome the downturn in tourism seen across the rest of Spain since last year (see Figure 4).

Figure 3. **PRIVATE CONSUMPTION GROWTH ACCORDING TO ISCR-BBVA** (SWDA*[2], AVERAGE QoQ, %)



Source: BBVA Research

Figure 4. **OVERNIGHT HOTEL STAYS AMONG SPANISH RESIDENTS** (SWDA, AVERAGE QoQ, %)

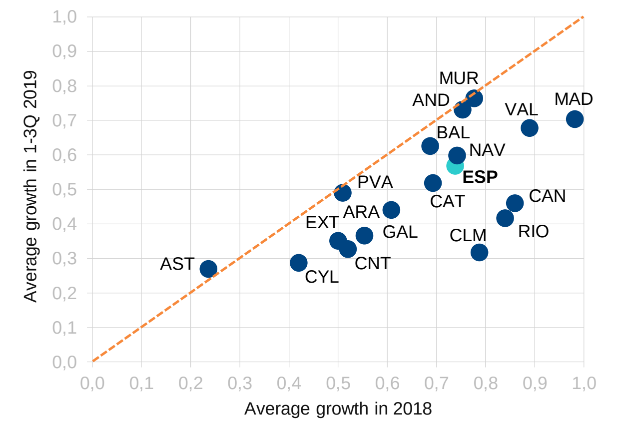


Source: BBVA Research and INE

In line with consumption, the labor market slowdown compared to last year looks fairly widespread across Spanish territory. Only Andalusia, Murcia, Asturias and the Basque Country have grown in line with 2018, while the loss of traction has been most acute in the Canary Islands, La Rioja and the center of the peninsula (Madrid and Castilla-La Mancha).

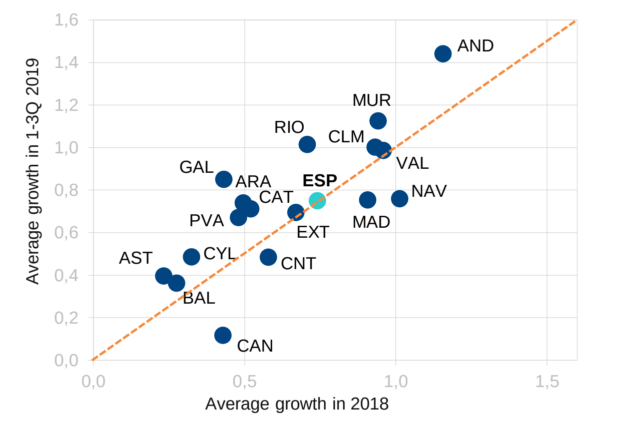
A good trend from domestic tourism in the south and east of the peninsula should sustain strong employment growth, particularly in hospitality, thus cushioning more sluggish activity levels in other sectors. In Andalusia, Murcia, The Valencian Community and Castilla-La Mancha, quarterly employment growth in the hospitality sector stood at over 1% in the first three quarters of the year. This has seen the first three of these regions, together with Madrid, spearhead total affiliation growth in 2019. In contrast, a weakening of the labor market in the Canary Islands was caused by shrinking employment in hospitality (see Figures 5 and 6).

Figure 5. **SOCIAL SECURITY AFFILIATION** (SWDA, AVERAGE QoQ RATE, %)



Source: BBVA Research based on Social Security data

Figure 6. **SOCIAL SECURITY AFFILIATION IN HOSPITALITY** (SWDA, AVERAGE QoQ RATE, %)



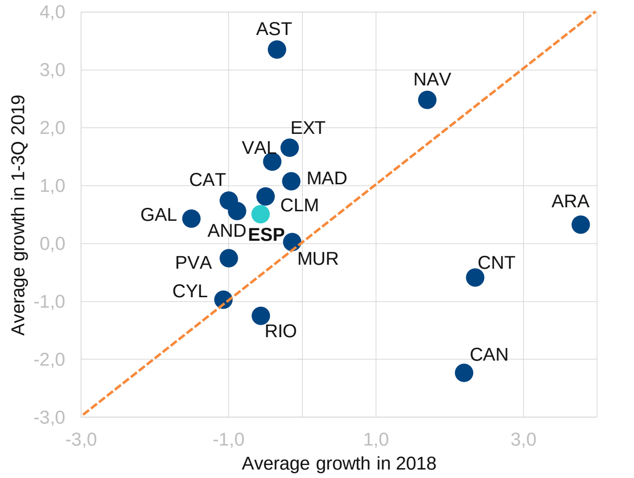
Source: BBVA Research based on Social Security data

[2] SWDA: Seasonally and Working Day adjusted data

Waning European demand has prevented a recovery in exports for northern regions and in tourism for the islands

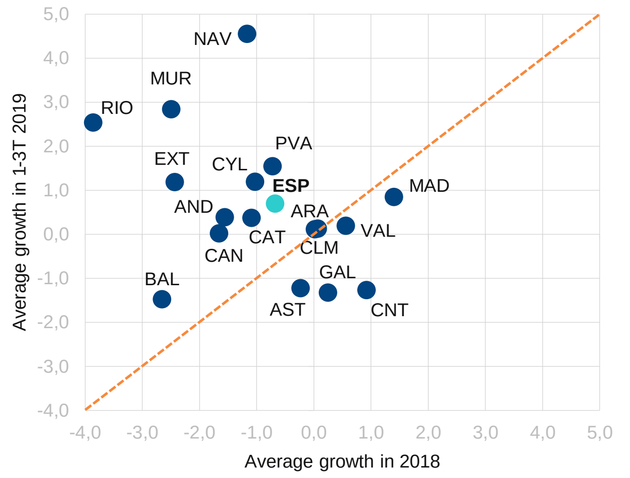
Looking at foreign demand, exports are showing more erratic and varied trends in Spain. In particular, less robust European demand has undermined foreign sales in those regions more dependent on trade of goods (see Figure 7), which is also preventing an improvement in the industrial sector (see Figure 8). Exports are declining in Cantabria, La Rioja, Castilla y León and the Basque Country, although the latest data points to an improvement in industrial output for the latter three communities. In contrast, weak exports growth has been insufficient to support an industrial recovery in Andalusia, Catalonia, Galicia, Aragon and Castilla-La Mancha. Finally, industrial output is reflecting good momentum for sales of goods, particularly in Navarra, but also Extremadura, Madrid and The Valencian Community. The industrial sector is recovering powerfully in Murcia, although this is yet to be felt in exports.

Figure 7. **GOODS EXPORTS (NOMINAL, AVERAGE QoQ RATE, SWDA, %)**



Source: BBVA Research based on DATACOMEX data

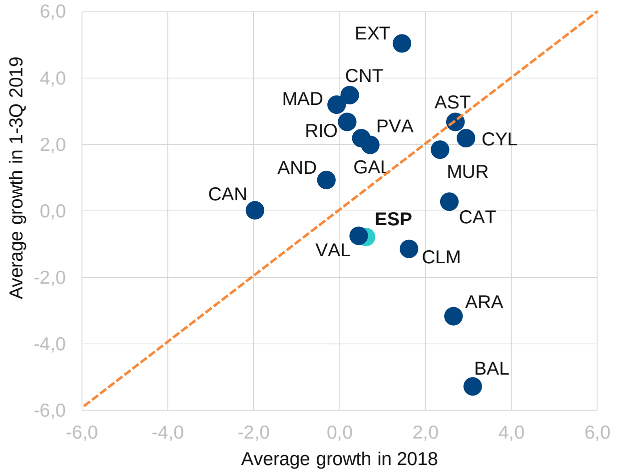
Figure 8. **INDUSTRIAL PRODUCTION INDEX (SWDA, AVERAGE QoQ RATE, %)**



Source: BBVA Research based on INE data

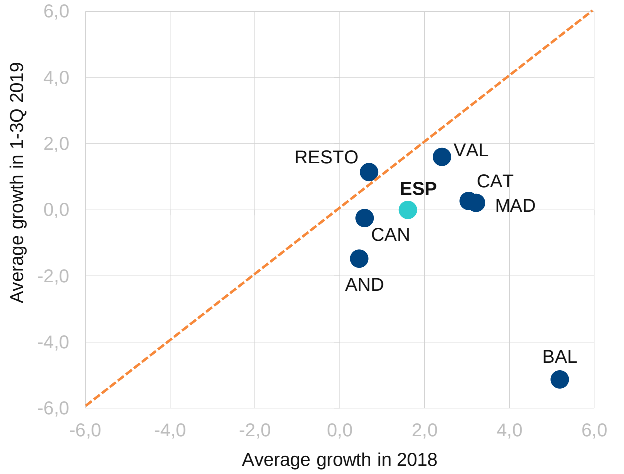
Looking at foreign tourism, the indicators suggest more sluggish growth in overnight stays for the leading Spanish destinations, chiefly as a result of declining European demand and competition from other Mediterranean countries that had lost visitors due to geopolitical tensions. The tourism slowdown in Spain is mainly due to the failure of a recovery in the Canary Islands (following contraction last year), together with recent deterioration in the Balearic Islands. Overnight stays from foreign visitors in Catalonia, The Valencian Community and, to a lesser extent, Andalusia have not been particularly robust. Finally, Madrid continues to perform well in terms of visits and overnight stays thanks to sustained good momentum in business and city tourism. This has led to nil average QoQ spending growth from foreign visitors for Spain as a whole in the year-to-date, hit by declines in the Balearic Islands and Andalusia, as well as sluggishness in the Canary Islands, Catalonia and also Madrid, despite stronger visitor numbers. Only in the Valencian Community the tourist spending has a positive trend.

Figure 9. **FOREIGN TOURIST OVERNIGHT STAYS** (SWDA, AVERAGE QoQ RATE, %)



Source: BBVA Research based on INE data

Figure 10. **FOREIGN VISITOR SPENDING** (SWDA, AVERAGE QoQ RATE, %)



Source: BBVA Research based on INE data

The slowdown in domestic demand (consumption) and European demand is key to understanding the regional distribution of growth in 2020

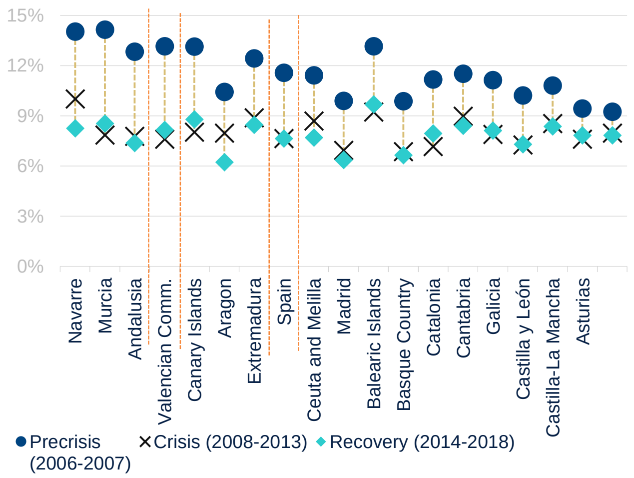
Looking ahead to 2020, the slowdown is set to be ongoing across all autonomous communities, while more sluggish growth anticipated both for Spain and Europe could justify lower forecasts for all regions, particularly those reliant on tourism and certain central and northern industrial regions. Madrid would continue to lead growth in 2020, together with Navarra and Castilla-La Mancha, in line with 2019. This leading group will be joined by the Basque Country, which should overcome the industrial downturn. On the other hand, the islands are set to bring up the rear in terms of growth, affected by a sustained slowdown in foreign tourism.

In terms of domestic demand, trends have varied over recent years[3]. For example, the likelihood of purchasing a new car declined during the crisis years and has failed to return to pre-crisis levels during the expansionary period. As a result, the probability of purchasing a vehicle is substantially lower in Navarra and southern regions, which may see consumption levels affected somewhat more intensely (see Figure 11).

As for foreign demand, the regions of southern Spain (Castilla-La Mancha, Andalusia, Murcia) and some in the north (Asturias, Castilla y León, Navarra) have secured significant improvements in terms of cost competitiveness during the last 8 years, ensuring them a stronger position to face the risks arising from greater volatility in the external sector (see Figure 12). However, foreign demand has been the main factor shaping external sales throughout the expansionary period. The economic slowdown among trading partners accounted for around half of the drop in total Spanish exports growth during 2018. With demand from the country's main trade partners set to remain weak, this growing competitive advantage could be an asset.

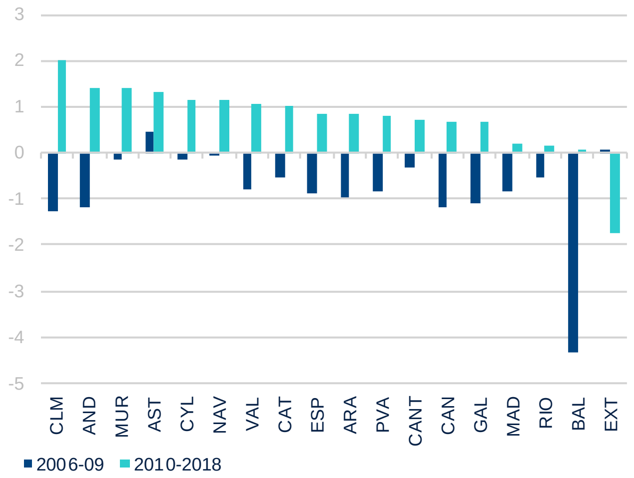
3: For further details, see BBVA Research, 1H19 Consumption Outlook, available here: https://www.bbvaresearch.com/publicaciones/situacion-consumo-primer-semestre-2019/

Figure 11. **PERCENTAGE OF HOUSEHOLDS PURCHASING AN AUTOMOBILE** (AVERAGE FOR EACH PERIOD)



Source: BBVA Research

Figure 12. **SPAIN: IMPACT OF COST COMPETITIVENESS CHANGE ON EXPORTS** (PP, ANNUAL AVERAGE)



Source: BBVA Research based on Datacomex, HAVER and INE data

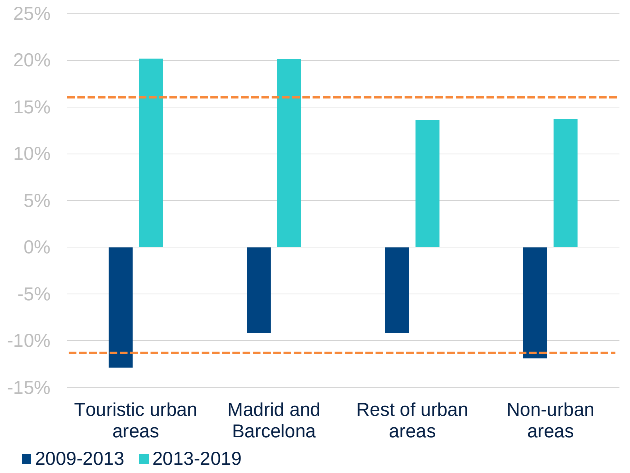
The dynamism of the real estate market, supported by expansive monetary policy, will continue to heterogeneously drive growth. Madrid and Barcelona are again likely to stand apart from the rest. Both cities have secured strong job creation, similar to that of tourist destinations during the last growth period, while job creation has been less robust in other cities and non-urban municipalities (see Figure 13). Going forward, as the slowdown in tourism continues, Madrid and Barcelona may continue to secure stronger job creation than the Spanish average, driven by other sectors. Activity being concentrated in the densest populated cities should support the real estate markets of those areas[4].

The low interest rate environment is set to benefit the most indebted communities, although financial imbalances remain a vulnerability

The ECB's latest expansionary measures and, in general, the low interest rate environment will allow the financial burden to remain very low and investment with high levels leverage (such as in construction) to continue to flow into Mediterranean communities. Autonomous communities such as the Valencian Community, Murcia, and, to a lesser extent, the Balearic Islands, face high levels of public and private debt. However, the northwest provinces have low debt levels. The sizable private debt in Madrid is due to companies being headquartered there (see Figure 14).

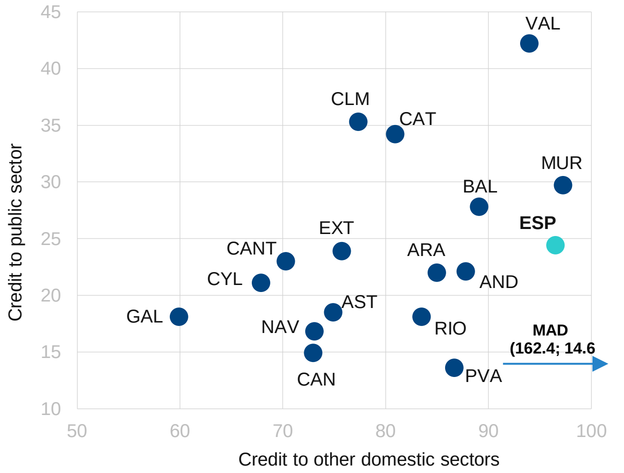
4: Barcelona could be affected by the recent rise in political tensions, should this be ongoing for several quarters.

Figure 13. **SOCIAL SECURITY AFFILIATION** (% ACCUMULATED CHANGE, 2008-2013 and 2013-2019)[5]



Source: BBVA Research based on Social Security data

Figure 14. **CREDIT TO PUBLIC SECTOR AND TO OTHER DOMESTIC SECTORS IN 2018** (% OF GDP)



Source: BBVA Research based on Bank of Spain and INE data

Uncertainty, both foreign and domestic, is the chief risk, albeit with heterogeneous impacts

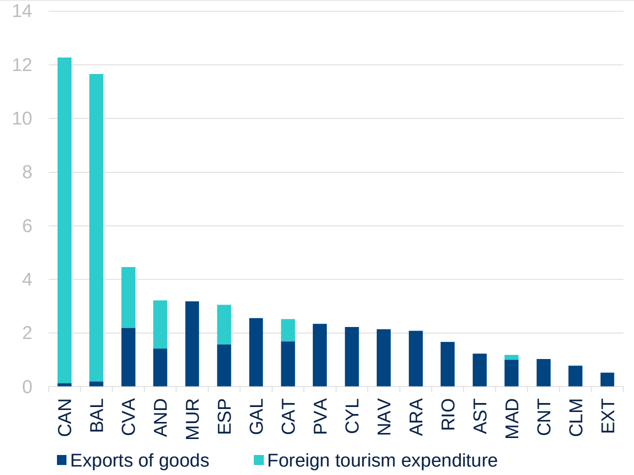
The Canary Islands and the Balearic Islands could be the most affected by the uncertainty related with Brexit. Over the past few months fears have grown over the United Kingdom's departure from the European Union. While the long-term economic impact will depend on the outcome of negotiations, the current uncertainty may have a negative effect on the activity. UK-dependent communities are particularly vulnerable. These include the Balearic Islands and the Canary Islands, where the spending of British tourists accounts for more than 10% of regional GDP. Other affected regions are The Valencian Community, Andalusia and Murcia, where sales of goods and tourism services to the United Kingdom comprise more than 3% of regional GDP (see Figure 15).

Meanwhile, rising trade tensions adds additional pressure on the export sector, on top of the problems faced by the automobile industry. For example, exports of products from Navarra, which have already been affected by the trade war since 2018 (iron, steel, aluminum, automobiles), account for 28% of GDP, while the tariffs imposed on dairy, wine, oils and other products from the EU, in response to the WTO ruling on subsidies to Airbus, have ramped up this proportion by 6.8 pp. These new tariffs could have a greater impact on Murcia, La Rioja, Andalusia and Castilla-La Mancha due to the high proportion of food exports from these regions (see Figure 16).

Domestic aspects will also play a role, such as uncertainty generated by the forthcoming election and the political situation in Catalonia. As shown in Figure 17, although external factors have accounted for much of the uptick in uncertainty so far in 2019, during the last month the uncertainty triggered by domestic factors has also grown sharply, and in recent weeks triggered by tensions in Catalonia.

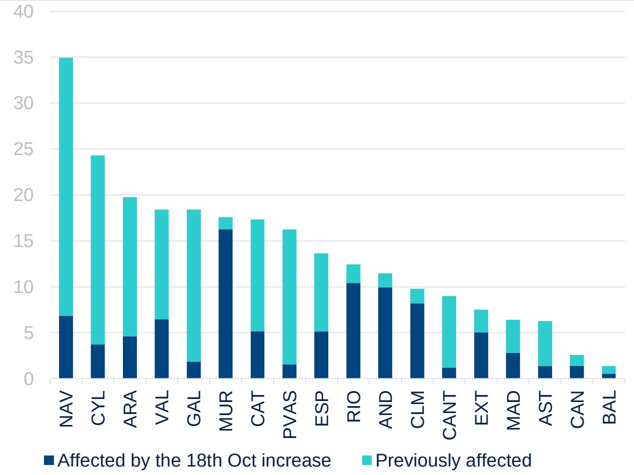
5: The Ministry of Public Works and Transport defines the Large Urban Area (GAU in its Spanish acronym) as a group of municipalities comprising the same. Both the definition methodology and list of the comprising municipalities are available at: https://www.fomento.gob.es/recursos_mfom/comodin/recursos/metodologia_areas_urbanas_2018.pdf

Figure 15. **WEIGHT OF EXPORTS TO THE UNITED KINGDOM** (2018, % OF REGIONAL GDP)



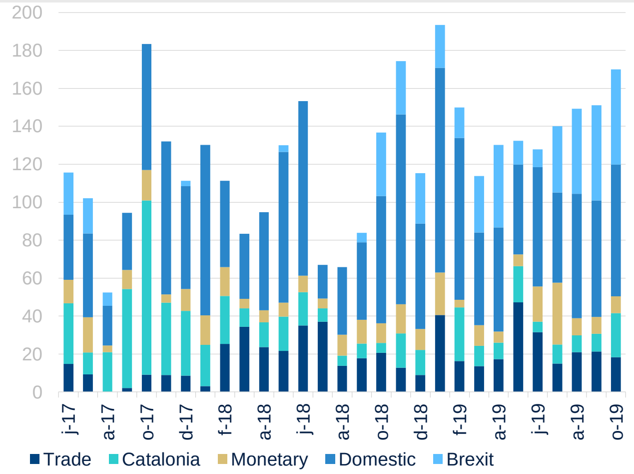
Source: BBVA Research based on INE and Datacomex data

Figure 16. **WEIGHT OF GOODS EXPORTS POTENTIALLY AFFECTED, DIRECTLY OR INDIRECTLY*, BY US SANCTIONS IN REGIONAL GDP** (% OF REGIONAL GDP, 2018)



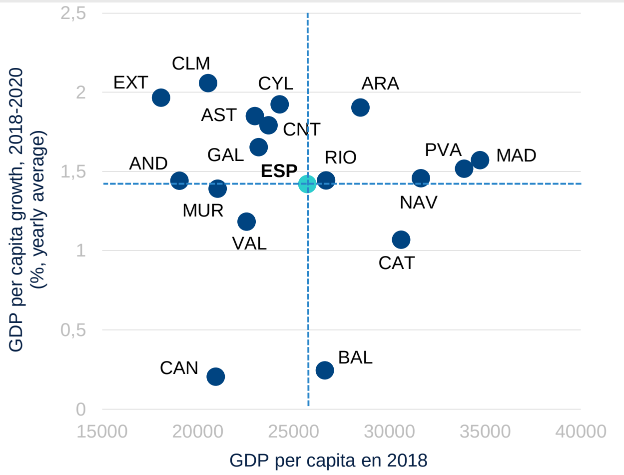
*Indirectly affected products include all those in which there are changes in US trade policy.
Source: BBVA Research based on Datacomex data

Figure 17. **BREAKDOWN OF THE ECONOMIC POLICY UNCERTAINTY INDEX** (100=AVERAGE 2008-2018)



Source: BBVA Research based on national media

Figure 18. **GDP PER CAPITA IN 2018 AND CHANGE BETWEEN 2018 AND 2020**



Source: BBVA Research based on INE data

In short, the BBVA Research scenario points to less generalized growth for all autonomous regions. This mainly means that in the northwest the anticipated recovery will fail to materialize due to difficulties facing the export sector, while weak tourism and domestic demand are set to be the chief drivers of the slowdown for south and east regions. However, demographic decline in northwest regions could justify further convergence in these regions[6], while more tourism-dependent regions could see setbacks in their level of convergence (see Figure 18).

6: INE forecasts suggest that between 2018 and 2020 the population will shrink by more than 0.5% in Castilla y León, Asturias and Extremadura. The decline will be less acute in Galicia, Castilla-La Mancha, Aragon and Cantabria. In contrast, population growth above 2% is expected in the Balearic Islands and the Canary Islands, and above 1% in Madrid and Catalonia.

Table 1. **GDP GROWTH AND FORECASTS** (%, YoY)

	2016	2017	2018	2019	2020
Andalusia	2,9	2,7	2,4	2,0	1,6
Aragon	3,2	3,4	2,5	2,0	1,6
Asturias	1,6	3,8	2,3	1,7	1,3
Balearci Islands	4,4	2,4	2,2	1,8	1,2
Canary Islands	3,4	2,7	2,4	1,6	1,1
Cantabria	2,6	3,4	3,4	1,8	1,7
Castilla y León	3,1	1,7	2,5	1,5	1,5
Castilla-La Mancha	4,2	2,4	2,8	2,1	1,7
Catalonia	3,5	3,2	2,3	1,8	1,6
Extremadura	1,7	2,1	2,0	1,8	1,6
Galicia	3,1	3,1	2,7	1,5	1,5
Madrid	3,2	3,3	3,7	2,6	2,2
Murcia	4,3	3,1	1,5	2,3	1,4
Navarre	3,0	2,8	3,0	2,0	1,8
Basque Country	3,0	3,1	2,2	1,7	1,7
La Rioja	2,6	1,5	1,6	1,5	1,5
Valencian Community	2,8	3,1	2,1	2,0	1,4
Spain	**3,2**	**3,0**	**2,6**	**1,9**	**1,6**

Source: BBVA Research based on INE data

Table 2. **EMPLOYMENT GROWTH AND FORECASTS (EPA - Labor Force Survey)** (%, YoY)

	2016	2017	2018	2019	2020
Andalusia	2,4	4,1	2,8	3,1	2,0
Aragon	2,3	2,2	1,4	2,0	0,8
Asturias	2,7	2,4	-0,9	-1,6	0,4
Balearci Islands	4,2	1,2	4,1	1,7	0,8
Canary Islands	3,2	3,4	6,6	0,4	0,9
Cantabria	3,0	0,9	1,6	0,9	1,2
Castilla y León	2,8	0,8	1,0	0,7	1,1
Castilla-La Mancha	3,2	4,0	2,9	3,0	1,2
Catalonia	3,5	2,9	2,7	2,0	1,4
Extremadura	1,9	0,5	3,7	3,7	1,9
Galicia	2,3	1,2	2,4	1,5	0,5
Madrid	0,9	2,5	2,9	3,1	1,8
Murcia	6,1	3,4	1,9	3,9	1,9
Navarre	1,2	4,2	1,2	2,5	1,4
Basque Country	2,8	0,3	2,2	1,4	1,1
La Rioja	1,7	1,4	2,7	1,7	1,2
Valencian Community	3,1	3,0	2,7	2,0	1,5
Spain	**2,7**	**2,6**	**2,7**	**2,2**	**1,4**

Source: BBVA Research based on INE data

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