BBVA | RESEARCH

Economic Outlook

Spain

Third Quarter 2011
Economic Analysis

- **Strong, if asymmetric, global growth** but political uncertainty is keeping risks on the downside.
- **Financial tensions threaten to turn** sovereign debt troubles into a systemic crisis.
- **Spain: no change in the pace of adjustments and reforms** which mitigate the worsening international financial tensions.

Index

Closing date: August 3, 2011

1. Summary

Global growth tending to ease

The global economy slowed slightly in the first half of this year due to a number of factors, most of which look to be short term. The likeliest scenario is for continued solid growth (4.2% in 2011 and 4.4% in 2012). But risks to this outlook seem now to be tilted to the downside. First, because the recovery in developed countries remains weak and prone to soft patches. Second, because fiscal problems in the US and Europe pose substantial political and economic challenges. For instance, despite the undoubted solvency of the US federal government, risks that negotiations over the public debt ceiling would yield only a short-term fix rather than a credible and sustainable plan for fiscal consolidation, have increased the chances of a sudden jump in long-term interest rates.

Also, in recent weeks resurgent tensions on Europe's sovereign debt market have hit Spain and Italy hard, boosting the likelihood of a systemic crisis in Europe with effects rippling out beyond the EU's borders. In this environment, the Eurogroup on 21 July agreed measures to deal with the liquidity and solvency issues that are afflicting its different economies in different ways. To tackle potential liquidity problems it was decided to upgrade the European Financial Stability Fund (EFSF) so that it could lend pre-emptively to solvent countries without conditionality and buy sovereign bonds on the secondary markets. To deal with the solvency issue, the terms of official loans to bailed-out countries (Greece, Portugal and Ireland) were eased and a deal struck with the private sector to write down the net present value of their Greek debt holdings by 21%.

These were unquestionably important and, in some cases, unexpected steps in the right direction. But the problem is not fully resolved, as is clear from the modest falls in the risk premia of peripheral countries that followed the announcements. Markets are still waiting to see the scale of the announced measures and their implementation in practice. Besides, three more things still need to be done if the crisis is to be finally resolved. First, the EFSF's resources need to be raised to a level where it can effectively take over the ECB's role in bond-buying and provide liquidity to all countries that need it. Second, the programmes in bailed-out countries and an ambitious agenda of reforms and adjustments developed for the rest of Europe, (especially those economies most at risk of being locked out of international financial markets) must be pursued. Third, Europe needs to move to a closer fiscal union, one that includes both the issue of Eurobonds and the implementation of strict fiscal rules and control over national budgets.

For this to work, countries need to develop a consensus and political leadership which would inevitably involve concessions. For their part, the peripheral countries will have to cede some of their sovereignty over economic policy to EU institutions so that the process of fiscal consolidation and structural reforms would be seen as wholly credible. In exchange, the other countries will have to expand the EFSF, move towards issuing Eurobonds in the future and support and develop solutions that ensure the debt of bailed-out countries remains sustainable. Although this grand bargain comes with costs and sacrifices, the benefits it brings would be far greater, both in economic and political terms, by strengthening and reinvigorating the European project.

In Spain, doubts about the scale of some reforms and adjustments coupled with current uncertainty suggest recovery will remain anaemic

After beginning the year with 0.3% growth in the first quarter, Spanish GDP seems to have maintained in the second quarter the weak recovery begun in early 2010, with qoq growth of around three tenths. Once again, economic indicators available at the publication date suggest growth will continue to show a marked duality between slack domestic demand and a strong pull from net export demand. It is noteworthy that exports are the only aggregate demand component so far to exceed their pre-crisis levels and are recovering in line with what was seen in the early-90s recession (this, even though Spain can no longer devalue its currency as it did then). As we explain in this report, export companies are characterised by their larger size, better productivity and stronger investment in human, physical and technological capital, all features that it would be good to extend to the rest of the economy. Reflecting this dual trend in domestic and export demand, employment and labour force participation remained virtually stagnant.

The likeliest scenario is that the Spanish economy will continue to grow for the next few quarters, although uncertainties as to its outlook have increased. Uncertainty has risen even though some of the risk factors we were highlighting three months back (rising oil prices and interest rates) continue to evolve in line with our forecasts and, as expected, are having a moderate impact on activity. However, the latest surge in tension on European sovereign debt markets, the upturn of doubts about whether Spain's autonomous communities can meet their fiscal targets and whether reforms to collective bargaining go far enough could add to the downward pressure on confidence and expectations of growth in domestic demand, particularly as we move into 2012.

The latest bout of tensions in financial markets will have a negative impact via direct contagion now being felt on the Spanish risk premium. Until now, domestic agents have met their financing needs through a combination of stronger cash flow and tapping foreign markets, although funding from the latter source has been on far less favourable terms than before the crisis. The longer this phase of costlier foreign finance and restricted supply on international markets persists, the greater the impact on cost of borrowing will be, adding to worries about the recovery of domestic demand in coming months.

On the domestic front, there have been no major changes in economic policy over the last three months. The process of restructuring Spain's financial system has continued in accordance with the route map laid out by the Bank of Spain. The stress tests showed that actions over the last year have bolstered the weakest parts of the Spanish financial system and that doubts about such institutions' capital requirements are being steadily, if slowly, dispelled. Nevertheless, much remains to be done to clean out and restructure some institutions. The sooner this process is complete, the sooner Spain will have more solvent and efficient lenders with access to international markets.

Secondly, since fiscal consolidation cannot be put off, it is better that the disappointing overrun in public sector spending of 1Q11 (and probably 2Q11) should be corrected decisively in the second half of the year. Specifically, the autonomous communities must seriously address their undertakings for 2011 and subsequent years, meanwhile, central government must continue to deploy all the weapons in its armoury to incentivise them to comply. Revenues are on a healthy trend and if spending limits can be met the country will hit the agreed targets. Solutions such as the implementation of fiscal rules for all autonomous communities, similar to those we proposed in the last Spain Economic Outlook three months ago, will be positive in the medium and long terms. That said, circumstances probably demand new fiscal adjustment measures with immediate short-term effects.

Similarly, doubts persist as to the scale and effectiveness of some structural reforms now under way. While the passing of the pension reforms was a major step to bolster the financial system in future years, markets continue to harbour doubts about other reform measures. The Royal Decree Law concerning urgent measures to reform collective bargaining fails to fully address problems with previous arrangements. Although it makes advances in some areas, it makes no change to the existing mechanism for setting salaries, allows higher level collective agreements to block negotiations at company level and curtails – but does not abolish – the principle that collective agreements remain in force until a new deal is struck to supersede them. With unemployment running close to 21% it is vital that the proposed reforms are improved during the drafting stage in parliament to decisively incentivise the creation of stable jobs and eliminate companies' uncertainties about what tools are available to them and how much flexibility they will have to deal with future problems.

To sum up, there has been no change in the pace of adjustment and reform which offset rising tensions and uncertainty on international financial markets. Against this background, the current situation calls for decisive and ambitious actions that dispel doubts about whether the fiscal targets will be met, complete the restructuring of the financial system and incentivise economic growth, thereby ensuring Spain's recovery is strong, sustained and job-creating.

2. International environment: politics takes centre stage in the economic debate

The world economy should continue its strong growth following its first-half blip

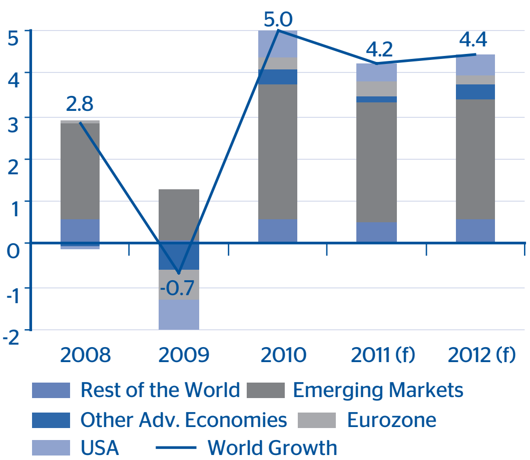
The global economy slowed slightly in the first half of this year, mainly in the US but also in some emerging market countries. However, most of the factors behind the slowdown are short-lived in nature (high oil prices, disruption to the Japanese supply chain and bad weather) and global economy looks set to continue growing at a solid pace, 4.2% in 2011 and 4.4% in 2012 (see Chart 1).

That said, risks to the above forecasts are for the moment tilted toward the downside. Although the US slowdown should be temporary as oil prices peak and international supply chains are restored, recovery is likely to remain weak and prone to slipbacks, as was only to be expected after a financial crisis that caught consumers heavily indebted. The recent blip in the US has reminded markets of this and could affect consumer and producer sentiment in the future.

In Europe and the US alike, fiscal worries pose serious challenges for the political class. The failure fully to resolve the solvency problems has allowed the sovereign debt crisis in peripheral European countries to intensify (see Chart 2), with the risk that it could go systemic as market tensions spill out beyond Greece, Portugal and Ireland to Spain, Italy and, potentially, Belgium. Although there is no doubt as to the solvency of the US, it faces the challenge of severe fiscal retrenchment in the short term, with a risk that political negotiations may only yield a set of short-term fixes rather than a long-term consolidation plan. This would boost the chances of a sudden rise in US long-term interest rates.

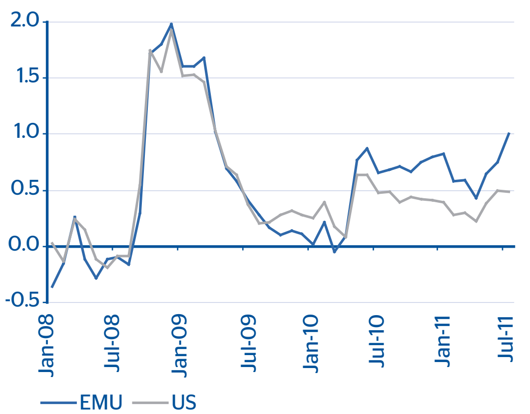
Finally, in emerging economies, worries about overheating have eased slightly as tightening measures work gradually to slow the pace of growth in Asia and Latin America, although with fiscal policies still broadly accommodative, which place too much reliance on monetary authorities in these countries at a time of ongoing concerns about appreciation of their currencies.

Chart 1
Global GDP growth and breakdown (%)



Source: BBVA Research and IMF

Chart 2
BBVA financial stress index



Source: BBVA Research

Support for growth still there in Europe

GDP in the euro zone has been slowing in recent months, not because of any major change in the underlying growth drivers but rather because of a return toward its potential growth rate following a temporary and unsustainable surge in 1Q11.

Growth in the region as a whole continues to benefit from the strength of global demand, particularly in the central countries of the euro zone and particularly Germany. But, also, the zone's general rise in activity is pulling in exports from peripheral countries and this is acting as the main driver for these economies.

As a result of the rise in commodity prices, inflation across the whole zone rose steeply, mainly due to direct impacts on the consumer price of energy but with some indirect effects, too, on other products. These developments, coupled with a slightly firmer than expected pace of recovery, emboldened the ECB to start tightening monetary policy. However, given the fragile nature of recovery and the financial and sovereign debt problems of several countries, we continue to foresee only a very gradual pace of rate increases. Further, regional disparities in monetary policy, with the ECB ahead of the Fed in its tightening cycle, are likely to make themselves felt via a stronger euro, clearly above its equilibrium level.

In general, factors underlying growth have performed in line with the forecasts made in our last report and there are therefore no major changes to our outlook for the euro zone economy. Global growth has been revised modestly downward, while the pattern of ECB rate hikes is effectively unchanged (merely brought forward by one quarter). Finally, the processes of fiscal consolidation should generally proceed as announced, albeit with some tweaks to correct any slippage from targets. Taken together, all these factors should curtail growth in 2011 and 2012 by not much more than one tenth of a point (in each year). The big story, however, is the European sovereign debt crisis, to which we now turn.

Now is the time to tackle worries about European solvency, a task that demands courageous and sustained policy-making by Europe's politicians

In recent weeks, a fresh wave of tension on Europe's financial markets has rolled through Spain and Italy, increasing the chances of a systemic crisis involving the whole of Europe and spilling over the EU borders. This situation has arisen because of delays in granting Greece's second bail-out and the insistence that private bondholders should bear part of the costs, as well as the failure to find a comprehensive solution to Greece's underlying solvency concerns. Indecision over Greece has had repercussions for countries without solvency problems such as Spain and Italy (see Chart 1), and, as a result, for Europe's financial sector which has seen its liquidity dry up.

In this environment, with so much at stake, the Eurogroup reached a deal on 21 July to tackle the concerns about liquidity and solvency. On the liquidity front, it was decided to upgrade the European Financial Stability Fund (EFSF) so that it could lend pre-emptively to solvent countries with liquidity problems – on similar lines to the IMF's Flexible Credit Line – and buy sovereign bonds on secondary markets. To deal with the solvency issue, the terms of official loans to Greece (and subsequently other countries in the programme) were eased and a deal struck with the private sector to write down the present net value of their Greek debt holdings by 21% via debt swaps and buybacks.

These measures undoubtedly represent major and, in some cases, unexpected, progress in the right direction to resolve Europe's financial crisis. But Europe still has problems, as is evident from the hitherto modest fall in risk premium on Europe's peripheral countries. Subject to the clarification of some technical details of the 21 July accords, four main lines of action need to be defined for the future. First, the EFSF needs to be expanded and pre-funded in a way consistent with its new powers to buy bonds in secondary markets and provide liquidity (including on a preventative basis) to countries outside EU/IMF programmes. Secondly, Europe needs to work towards greater fiscal integration, ultimately including the issuance of Eurobonds, and lay down general fiscal rules and strict control of national budgets. Thirdly, economic reforms must be applied credibly in countries currently subject to adjustment programmes and credible reform agendas should be adopted for the rest of the EU, especially countries at risk of being locked out of markets. Fourthly, the EU authorities must reach a final decision on how to reduce Greece's debts to a level that the country can sustain and how to settle once and for all the concerns about its solvency whether via a public bailout involving a consensus with the private sector or an orderly default.

Unless these four measures are applied, Europe will face high sovereign spreads (not just in peripheral countries) and a more drastic restructuring of debt further down the road. Meanwhile, Europe will remain prone to accidents that could trigger disorderly debt restructuring and have a negative impact on the world economy.

What we need is a political consensus in which parties and countries make clear commitments. First, peripheral countries must put forward totally credible plans to reduce their imbalances and push through the structural reforms needed to boost their potential growth. However, it seems most likely that credibility can only be achieved by ceding some sovereignty over economic policy to EU institutions. In exchange for these commitments, core euro zone countries should support the expansion of the European Financial Stability Fund (EFSF) to act as a genuinely prophylactic barrier for countries under threat, since now its functions have been upgraded, and promote the creation of a Eurobond with a concomitant reduction of fiscal sovereignty in countries that benefit from it.

Such a grand bargain among the core and peripheral countries will come at a cost, but its benefits will undoubtedly be far greater and will benefit all countries in the EU: greater financial stability and a better-balanced and more sustainable recovery.

US budget consolidation dominates political scene

In the US, the political argument between two opposing (and sharply polarised) views on how to cut the US budget deficit brought confusion aplenty but so far no increase in market pressure on US yields. This reflected the belief that a solution would be found to increase the debt ceiling and avoid default. However, a deal to raise the debt ceiling without a credible plan to bolster the budget over the long term will not address concerns about long-term sustainability. For a deficit reduction plan to be seen as sustainable and credible it must (i) involve sharp reductions in the early years, (ii) have bi-partisan support and (iii) force Democrats to cut rights to spending and Republicans to accept tax rises. Here, as in Europe, the risks lie in the temptation to kick the can down the road, in other words, put off the solution until after the 2012 elections and so increase the chances of a rise in long-term interest rates.

Politics is also affecting the outlook for many Latin America countries

To a lesser extent, many Latin American countries also face uncertainties deriving from the future direction of their politics. In some countries, this is based on the perceived weakness of governments beset by charges of corruption or mass protests. In others, it is the result of recent changes of government or uncertainty about impending elections. While there is no doubt that the region's electoral cycle has had less impact on the economic cycle over the last decade, it is fundamental that the capital built up is not dissipated by radical political changes that disrupt ongoing economic reforms.

Worries about overheating have eased slightly in many emerging economies, although global risks and appreciating currencies may result in a more cautious approach to policy-tightening

Emerging economies continue to show risks of overheating, although these have generally faded somewhat as a result of tightening measures and continued problems (in Asia) traceable to higher commodity prices and the Japanese earthquake. It is important to emphasise that the risks of a hard landing for the Chinese economy have fallen as 2Q2011 growth showed only a slight slowdown, putting it on track for a soft landing. That said, inflation in emerging economies remains a concern and there is the risk that political leaders will remain behind the curve in some cases, either by being overly cautious about the global environment or by worrying too much about an excessive rise in their currencies.

Box 1. Estimating country risk

In recent months, risk premia in some developed European economies have shot up while those in emerging economies have remained low relative to their historical averages. Part of this asymmetry is the result of changes in fundamentals, with a relative deterioration in the sustainability of western public finances compared to the more solid budgets of emerging economies. Many emerging countries have significantly improved the solvency of their external accounts and now enjoy far more solid levels of international reserves than in previous crises. The global risk landscape also seems to be changing with greater contagion in some of the more advanced economies.

To analyse the impact on country risk of changes in global market conditions and idiosyncratic fundamental factors we have developed a dynamic econometric panel-data model. Analysing the results helps clarify the importance of different variables in explaining divergences between current levels of country risk (in our case represented by credit default swaps) and their long-term equilibrium.

BBVA Country Risk Model

The model's specifications include representative of global market character explanatory variables and a set of variables that approximate the idiosyncratic vulnerability of each economy. This is a common approach in the academic literature since the pioneering work of Calvo et al (2001) as well as in some of the models developed by international agencies and central banks (see Table 1).

Table 1

Country Risk Model: some examples of international agencies and central banks

	Dependent variable	Type of model	Global variable	Idiosyncratic variables
IMF	EMBI spreads (levels)	Panel (static, long-term)	Fed Funds, Fed Funds volatility and VIX	Rating
BID	EMBI spreads (differences)	Panel (dynamic and error correction)	US 10Y bond and US corporate bonds (high yield)	Rating
Bank of England	EMBI spreads (differences)	Pooled mean estimator	US 10Y and 30Y bonds, Baa Spread S&P500	Public deficit, Openness, Redemptions/reserves, Current account deficit, Short-term foreign debt/reserves
ECB	Sovereign ratings	Probit		GDP per capita, Growth, Inflation, Public deficit, Public debt, Foreign debt, Current account, Reserves, Previous default

Source: BBVA Research

Specifically, the specification for the model developed by BBVA Research is as follows:

$$\Delta log(CDSwap)_{i,t} = \beta\Delta log(CDSwap)_{i,t-1} + \varphi\Delta log(Global)_{t-1} +$$
$$+ \lambda(log(CDSwap)_{i,t-1} - \theta log(Global)_{t-1} - \gamma X_{i,t-1} - FEff_i) + v_{i,t}$$

where:

Δlog(CDSwap) = Logarithmic Difference in Credit Default Swap

Δlog(Global) = Logarithmic Difference in Global Risk Component

Log(CDSwap) = Logarithm Credit Default Swap

Log(Global) = Logarithm Global Risk Component

X = Set of idiosyncratic variables

FEff = Fixed effects

λ = Adjustment parameters to long-term equilibrium

The model's key features are summarised below:

- The model distinguishes between short- and long-term dinamic. The short-term dinamic is determined by the track record of CDS and by the change in the representative variable of the global market factor[1].
- The long-term includes an error-correction mechanism for CDS relative to their equilibrium. These are based on the relationship between the global factor levels and the variables representing idiosyncratic risk.
- The vulnerability of economies is specified by variables reflecting the general character (growth, inflation), the solvency of the public accounts (public debt as a share of GDP) and external accounts (foreign debt as a share of GDP), international liquidity (foreign reserves compared to imports) and a synthetic variable representing institutional factors.

1: A common factor extracted from spreads through a Kalman filter.

Main results

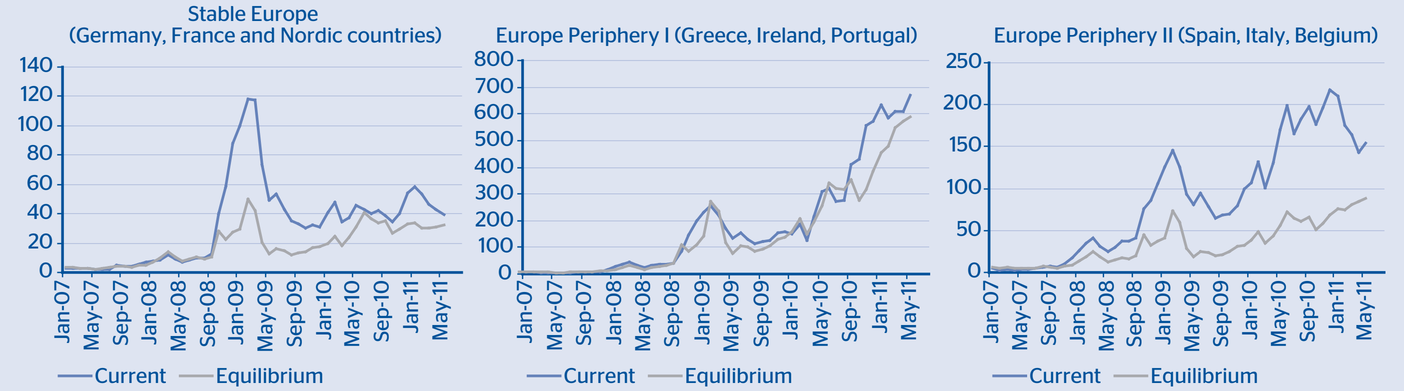
The results of our estimation exercise show that the long-term explanatory factors are significant and with the right sign except for GDP growth[2]. Therefore, increases in global risk aversion, inflation, public debt and foreign debt translate as increases in CDS. Also increment the risk perception, the deterioration in the liquidity ratio (rise in the ratio of imports to international reserves) and the worsening of the institutional factors. In addition, the variable coefficient representing global market risk is also significant in both short and long terms. Finally, the parameter for adjustment to long-term equilibrium is significant and close to -0.06. This means that over a full year the cumulative adjustment of the long-term equilibrium is around 75%.

In line with the conclusions of previous studies (Rozada and Levi-Yeyati, 2006, and García-Herrero and Ortiz, 2006), one of the conclusions from model estimation is that market conditions matter and can ultimately determine countries' solvency. For instance, the average contribution of global market risk can be high even over the long term. For the set of countries included in the model, the contribution of the global factor can be around 50%.

As for the idiosyncratic factors, the results show the primary importance of public solvency (public debt/GDP) and, to a lesser extent, external accounts (solvency or foreign debt/GDP and liquidity or reserves/imports). One interesting result is the asymmetric contribution of institutional factors, which suggests that coexist a "stability premium" in developed economies and a penalisation in emerging countries.

Finally, estimates of the equilibrium levels also threw up some interesting conclusions. Developed European countries can be split into three groups (see Chart 3). The first consists of the most stable countries in the euro zone and the Nordic countries (stable Europe). This group is marked by low equilibrium CDS, close to the levels currently being traded. Among the peripheral countries we find two distinct groups of countries. The first (Europe Periphery I) includes Greece, Portugal and Ireland and is marked by high equilibrium CDS and close to the levels currently being traded. Finally, there is an intermediate group (Europe Periphery II) composed of Belgium, Italy and Spain. These have higher equilibrium levels than the stable Europe countries but the market values of their CDSs are well above their equilibrium values. To summarise, it seems that these economies are being especially strongly affected by non-fundamental factors in a situation which we can identify as one of contagion.

Chart 3
CD Swaps: current values and long-term equilibrium in developed Europe

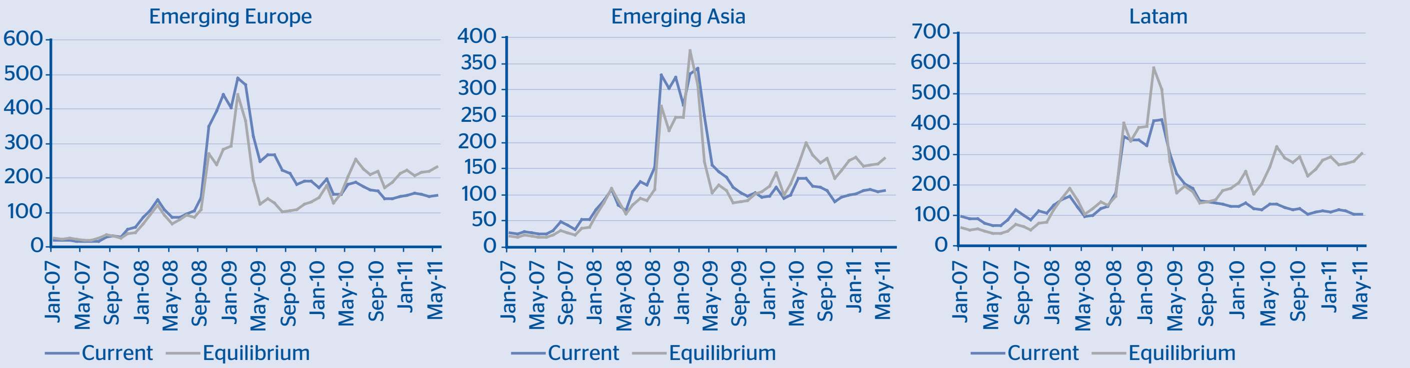


Source: BBVA Research

In emerging market countries, however, the spreads between market and equilibrium values lead to opposite conclusions than before (see Chart 4). In general terms, market values are trading below equilibrium, suggesting over-exuberance on the part of markets. There could be many reasons for this, ranging from the hyper-lax international monetary conditions (sustained over time by injections of money in developed countries) to a bullish mood among investors which is not fully justified by fundamentals.

2: Probably due to a multicollinearity problem given the connection between growth and the improvement of public solvency and of external accounts.

Chart 4
CD Swaps: current values and long-term equilibrium in emerging economies



Source: BBVA Resarch

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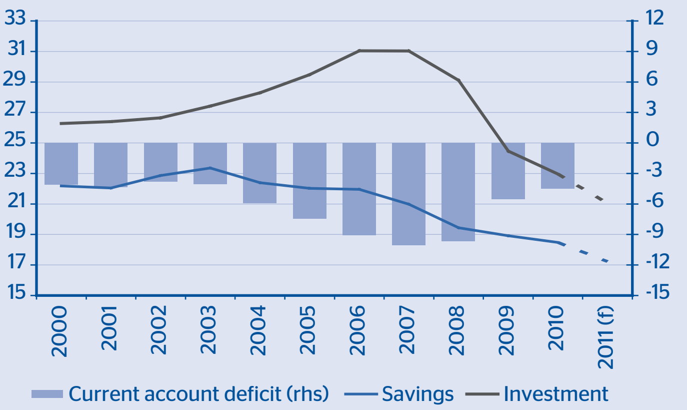
Box 2. Spain: less reliant on foreign finance than other peripheral countries

During the last phase of economic expansion, the private sector took advantage of the extraordinary access facilities to finance to significantly increase national investment rates, despite a gradual fall in savings rates. Meanwhile, government bodies benefited from economic growth, recording an increase in their savings rate that nonetheless failed to offset the fall in private saving. As a result, the current account deficit in the Spanish economy rose to near 10% of GDP between 2000 and 2007, well above the deficits of other close European countries (see Chart 5).

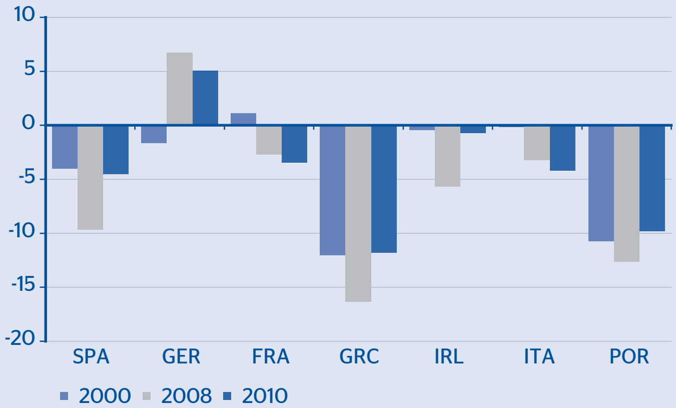
However, since 2008, there has been a sustained reduction in the investment rate which has almost halved the financing requirement of the Spanish economy. This slashing of the Spanish current account deficit (5.1pp of GDP) was one of the highest in Europe, comparable only to Ireland (4.9pp) and, to a lesser extent, Greece (4.6pp), although its current account deficit started off much higher. So, Spain has brought its current account deficit down to levels comparable with Italy and France, and well below Portugal and Greece, which are still running deficits of around 10% of GDP (see Chart 6).

Chart 5
Spain: current account, savings and investment (% GDP)



Source: BBVA Research based on INE data

Chart 6
EMU: Current account (% GDP)



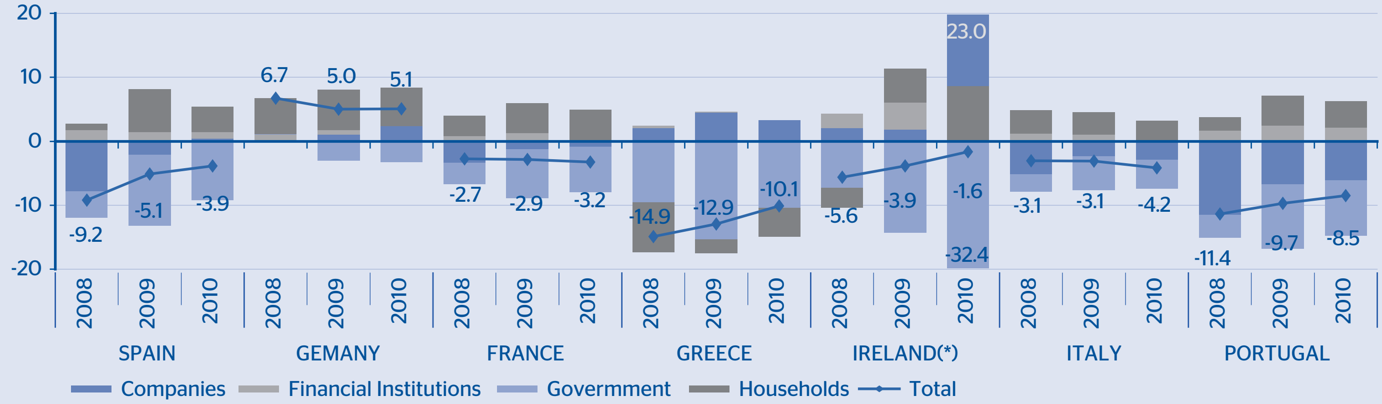
Source: BBVA Research based on AMECO data

Within this process of adjustment, the behaviour of Spain's economic agents has varied: high levels of private savings more than offset the steep fall in public savings while the reduction in investment rates was led by the private sector, mainly households (see Chart 7). A similar behave is apparent in the savings rates of Germany, France, Ireland and Portugal, while in Greece and Italy private saving has held steady. Meanwhile, investment rates have also fallen in all countries amid a general retreat of private investment, except in Germany, where investment has been broadly constant for two years.

Accordingly, the adjustment in the financing requirements of these countries has largely come from the private sector, coupled with a reduction in government deficits as a result of the severe programmes of fiscal consolidation launched in the course of 2010. This fiscal consolidation is not happening in Ireland where the public deficit is more than doubled in 2010 due to the creation of the NAMA, an instrument through which the government bought up the toxic assets of Irish banks on a scale of close to 20pp of GDP. Stripping out this programme, the public deficit would be 12.8% of GDP, little changed respect to 2009.

Chart 7

EMU: Financing capacity (+)/requirements (-) by agent (% GDP)



(*) Irish data series for government and Companies are truncated
Source: BBVA Research based on AMECO data

In recent years financial flows between the Spanish economy and the rest of the world have fallen off for two reasons: lower financing requirements and financial tensions. During the last phase of economic expansion, monetary financial institutions (MFIs) and other resident sectors (ORS)[3] were the main recipients of capital from the rest of the world, but this changed from 2008. Now ORSs, far from bringing in foreign finance, have turned to divesting foreign assets to bypass problems raising finance in traditional ways. The Bank of Spain, for its part, has become a debtor with the rest of the world, mainly because Spain's financial institutions have been making greater calls on European Central Bank finance. This source of financing peaked in summer last year and has been falling since. Meanwhile, the different tiers of government have been able to sustain their position as international borrowers. This contrasts with Greece, where not even the government has been able to raise international finance on market terms. In Greece, the instability of its sovereign debt led to its lock-out from international markets and subsequent bailout. This forced all agents, except the central bank – through which the bailout was channelled –, to unwind their international positions to raise finance (see Chart 8).

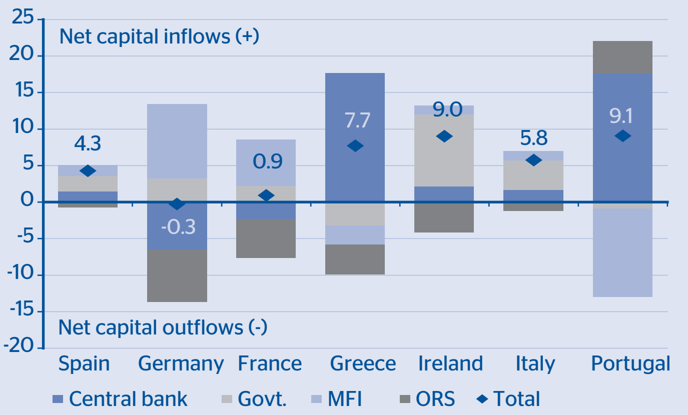
Ireland and Portugal were the other two economies to be bailed out. In Ireland's case, the government was able to continue raising finance in 2010. Portugal, though, found that the market shutdown preceding the bailout left it with no other source of international finance than its central bank.

In a different situation are Germany and France, whose central banks are in credit with the ECB. In both, MFIs and, to a lesser extent, government, are the real channels for cross-border inward investment. ORSs in both countries, which can raise domestic finance, are maintaining an active international investment position. In Italy, where all sectors have been able to raise finance on international markets, there has been a marked change in the position of the Bank of Italy, which has gone from being an ECB creditor to a borrower.

Unlike other European countries, Spain's gross external debt fell by more than 4pp of GDP in 2010 to 163%, this, despite the country running a current account deficit. Although this external deleveraging of Spain has been apparent in almost all agent categories, it was the MFIs that contributed most, due to the financial difficulties remarked on above, and this has increased the Bank of Spain's external debt position. The same process of external deleveraging of the financial sector has also been in evidence in countries hard hit by financial turbulence, such as Ireland and Portugal. Meanwhile, the Spanish public sector has maintained a constant level of debt with the rest of the world, unlike Greece and Portugal whose public sectors were forced to reduce their external borrowings, and Ireland, whose foreign public debt has risen sharply. As Chart 9 shows, in 2010 Spain's external debt to GDP ratio was one of the lowest in the euro zone periphery, higher only than Italy's and well below the levels of Ireland (1,105.1%) and Portugal (229.6%).

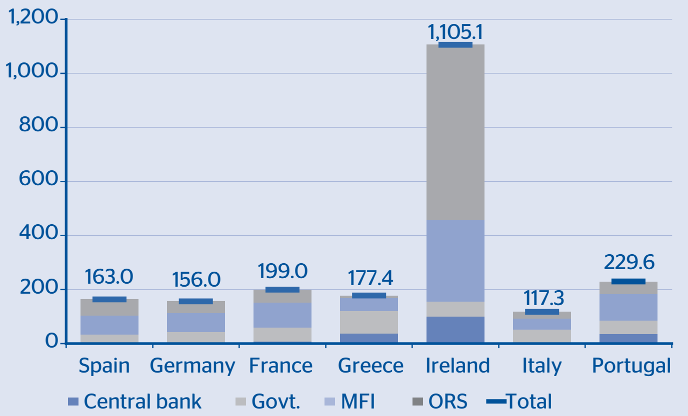
3: The other resident sectors include homes, corporations and non-monetary financial institutions.

Chart 8
EMU: net capital inflows 2010 (% GDP)



Note: a net rise in financial liabilities or fall in financial assets results in net capital inflows, while opposite movements give rise to net capital outflows
Source: BBVA Research from Haver data

Chart 9
External debt by agent (% GDP)



Source: BBVA Research from Haver and BIS data

3. Growth outlook for the Spanish economy

After starting the year with a quarterly GDP growth slightly higher than expected (0.3% vs. 0.2%e), the Spanish economy looks to have continued its modest improvement in the second quarter, growing by around two tenths of GDP qoq, confirming that we are still in the sluggish recovery phase that began in early 2010. Once again, projections based on economic indicators available at the publication date of this report suggest growth will continue to show a marked duality between slack domestic demand and a strong pull from net export demand. Domestic demand, under weak fundamentals and one-off factors that continue to inhibit its recovery, continues to drain economic growth. External demand is contributing positively to growth despite some tailing off of exports after the sharp expansion in prior quarters. In line with these developments, employment and labour force participation were broadly stagnant resulting, despite positive seasonal effects,in a modest fall in unemployment to 20.8% of the active population.

Looking ahead, the likeliest scenario is that the Spanish economy will continue to grow, although uncertainties as to its outlook in the next few quarters have increased. This has happened even though some of the risk factors we were highlighting three months back continue to evolve in line with our forecasts[4] and, as expected, are having a moderate impact on activity. However, the latest bout of uncertainty to afflict European sovereign debt markets coupled with doubts about whether Spain's autonomous communities can meet their fiscal targets and the lack of ambition in reforms to collective bargaining. This could add to downward pressure on expectations for domestic demand growth leading us to modestly downgrade our 2012 GDP growth forecast (by -0.3pp).

First, regarding the risks we saw three months ago, both high crude prices and the expectation of a gradual correction to the ECB's accommodative monetary policy have occurred on a scale in line with our forecasts and seem to be having the expected impact.

Secondly, though, financial tensions in Europe have re-emerged on a significant scale, driving up financing costs for governments, financial institutions and the corporate sector and now even starting to affect Europe's core states. This worsening in the financial markets, coupled with weaker outlooks for countries like Italy, Portugal and Greece, has led us to slightly downgrade European growth forecasts for 2012 (-0.2pp to 1.3%). This will tend to hamper exports which we nonetheless expect to remain high given their current strength.

Looking beyond its real economy impacts, the new bout of tension in financial markets is also likely to have a negative impact via direct contagion on the Spanish risk premium. Given the financing needs of the economy, this rise in perceptions of risk will further slow the recovery of private domestic demand, already limited by weak fundamentals and the gradual correction of imbalances built up during the expansion phase.

Finally, on the domestic front, there have been no major changes in economic policy. Given that the Spanish economy's fiscal consolidation process cannot be postponed, the overrun in public spending during the first quarter will be progressively corrected over coming months and this is likely to hit public investment hardest, such that demand from this sector will continue to drag back growth. Similarly, there have been no changes to the implementation of structural reforms that we had not already factored into our macro scenario. As expected, the draft Royal Decree-Law concerning urgent measures to reform collective bargaining contained nothing that would allow an upward adjustment to job creation and economic recovery.

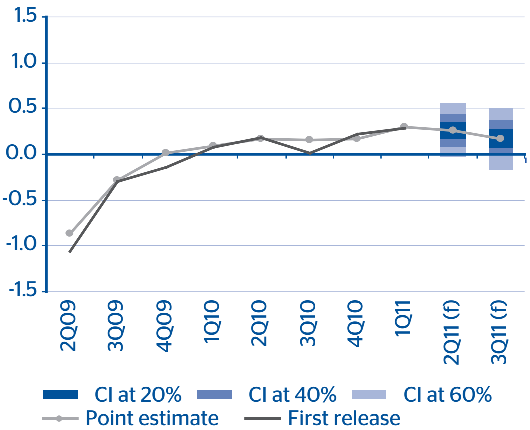
Overall, we expect the pace of growth in the Spanish economy to remain slow in the short and medium term, with full-year growth of around 0.9%. As we discussed in the last two reports, the economy could generate sustainable jobs in the final quarter of 2011, with 2012 bringing the start of a gradual decline in unemployment. Even though the worsening of some driving factors Spain's economy have led us to slightly reduce our growth forecasts for 2012, by 0.3pp to 1.3%, we would stress that our overall diagnosis of the economy's recovery has not changed significantly. The economic environment is hardly distinguishable from stagnation and the growth outlook over coming quarters remains bleak. As a result, it is crucial that reform measures to strengthen potential growth are implemented along with policies aimed at correcting the imbalances built up both before and during the economic crisis.

4: See Spain Economic Outlook for 2Q11.

The Spanish economy continues to grow at a modest pace

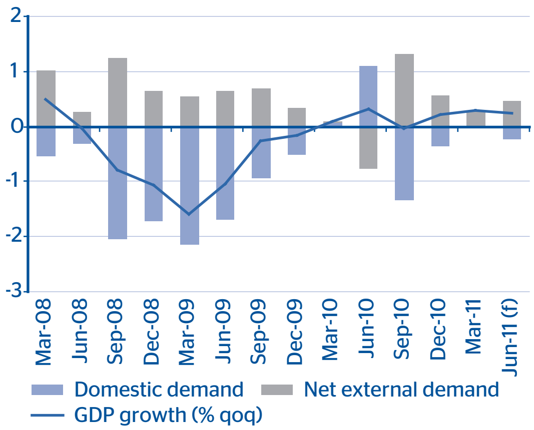
While we await official data, preliminary economic indicators show that the Spanish economy's meagre growth during 2010 continued through the first half of this year, with 2Q11 ending on a 0.3% qoq rise. Short-term GDP forecasts using the MICA-BBVA[5] model suggest that qoq growth in the second half of 2011 will be similar, confirming that the economy is close to stagnation (see Chart 10). In addition, 2Q11 economic data released to date indicate that the composition of growth will once again be driven by net external demand, while domestic demand is likely to contribute negatively again (see Chart 11).

Chart 10
Spain: GDP growth and forecasts using MICA-BBVA model (% qoq)



* Current forecast: 4 July 2011
Source: BBVA Research based on INE data

Chart 11
Spain: Contributions to quarterly GDP growth



Source: BBVA Research based on INE data

Private domestic demand continues to hold back growth as its components still show clear signs of weakness

After a year conditioned by the effects of fiscal consolidation on the spending decisions of households, the beginning of 2011 was characterized by stagnation in private consumption. Rises in nominal disposable household income, especially non-wage income, failed to keep pace with rising prices undermining real income and impairing consumer spending despite a plunge in savings rates (see Chart 12). Breaking down consumption shows that the favourable contribution of spending on durable goods and services was not enough to offset a falling spend on non-durables in 1Q11. However, 2Q11 figures show the opposite pattern: a slowing decline in demand for non-durables and a weakening of demand for durables and services, in line with the wider EMU trend (see Table 2)[6]. Fundamentals remained persistently weak and household consumption barely grew in 2Q11, as suggested by both BBVA's synthetic consumption indicator (SCI-BBVA) and BBVA Model of Indicators Coincident with Consumption[7] (MICC-BBVA) (see Chart 13).

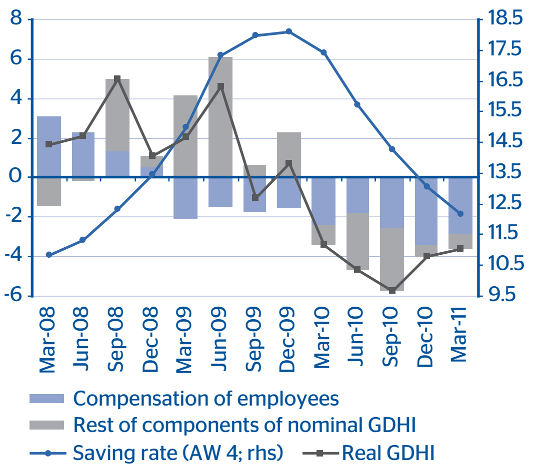
5: For more details on the MICA-BBVA model, see Camacho, M. and R. Doménech (2010): "MICA-BBVA: A Factor Model of Economic and Financial Indicators for Short-term GDP Forecasting", BBVA WP 10/21.
6: See Box 4 of the ECB's Monthly Bulletin published July 11, available here.
7: For an explanation of the MICC-BBVA see Box 1 in Consumption Outlook in the second quarter of 2010.

Table 2
Spain: consumer spending indicators (SWDA data)

	Consumer goods consumption							
	Totals	Durables	Food	Other non-durables	Car registrations	Domestic sales by large enterprises	Service sector sales index	Retail commerce
% qoq								
1Q10	-2.9	-13.3	-0.3	-0.5	2.1	0.8	0.3	1.6
2Q10	2.8	7.6	-1.0	6.4	0.6	1.9	2.2	-1.6
3Q10	-4.5	-17.2	0.7	-5.2	-32.3	-4.5	-2.4	-1.4
4Q10	-1.0	-11.8	0.6	1.6	3.2	-0.7	-0.1	-1.1
1Q11	0.6	11.7	-0.8	-1.8	4.4	-0.3	0.6	-1.7
% mom								
Apr-11	0.4	-1.7	0.6	1.0	0.0	1.4	0.1	1.1
May-11	-1.4	-5.8	0.1	-1.7	0.3	-1.7	-0.6	-2.6
Jun-11	0.4	3.2	-0.5	1.3	-4.2	0.3	-0.1	0.1

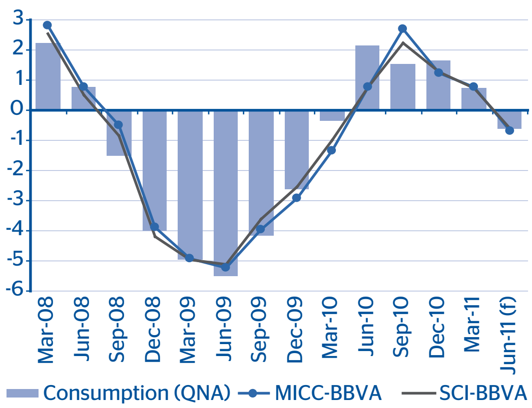
The shaded figures are forecasts
Source: BBVA Research based on MEH, ANFAC, AEAT and INE data

Chart 12
Spain: contribution to yoy growth of real* GDHI (gross disposable household income) and household saving rate (%)



* Adjusted for the household consumption deflator
Source: BBVA Research based on INE data

Chart 13
Spain: observed data and real time forecast of household consumption (% yoy)



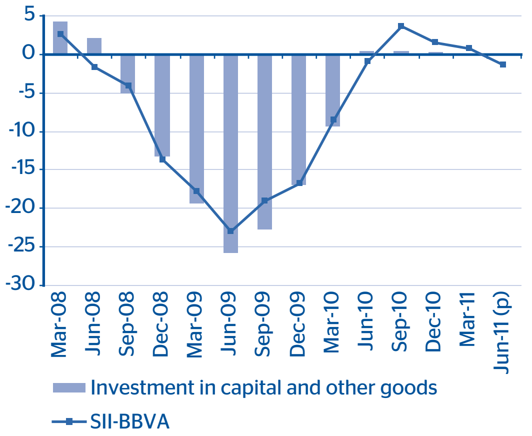
Source: : BBVA Research based on INE data

Data on corporate investment and residential construction in 2Q11 again flagged up the persistent weakness of both demand components which, as our Synthetic Investment Indicators (SII-BBVA and SHI) showed registered again negative growth rates in 2Q11 (see Charts 14 and 15). In contrast to previous quarters, capital investment was held back not only by lacklustre domestic demand but also by a short-term correction in exports. Among the indicators linked to corporate investment, we would highlight the near 3% qoq (SWDA) fall in the order book position and a steeper decline in capital equipment producers' confidence. In similar vein, we expect a contraction of around 3.7% qoq (SWDA) in capital good imports, far sharper than anything seen in the previous two quarters.

Residential investment in 2Q11 fell in line with the previous quarter, although this is still a slower pace of decline than in preceding quarters. Residential activity, estimated via the granting of construction permits for new homes, was again at lows. Also, while the stock of unsold housing has continued to fall – and in the areas of strongest economic activity may be being taken it up at a faster rate – it remains high in many places, underlining the varied nature of the Spanish housing market.

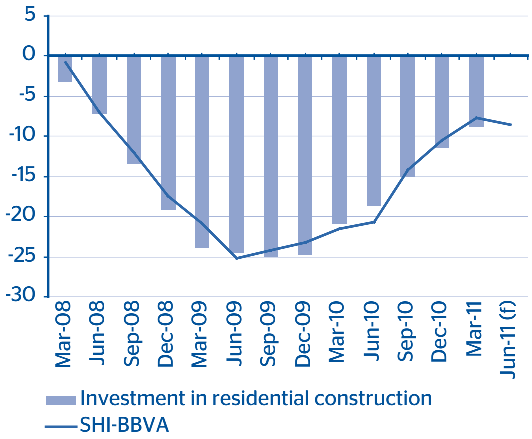
Demand-wise, home sales in 2Q11 were well below the numbers seen in 1Q11. This was not wholly due to the end of the personal income tax deductions for home purchases – which had encouraged buyers to bring forward their purchases to 2010 – but also to the weak labour market and tougher lending terms caused, at least in part, by the rising financial tensions of recent months. Once again, prices reflected weak demand with fresh falls which, as expected, were sharpest in the first quarter.

Chart 14
Spain: investment in capital goods and others and BBVA Synthetic Investment Indicator (SII) (%yoy)



Source: BBVA Research based on INE data

Chart 15
Spain: investment in residential construction and BBVA Synthetic Housing Indicator (SHI) (% yoy)



Source: BBVA Research based on INE data

The public spending overrun during 1Q11 and the latest data on the budgetary out-turn herald a tougher clamp-down on public demand in the second half of the year

The uptick seen in public consumption in 1Q11 was mainly the result of higher spending by autonomous communities. This, together with the yoy fall in regional revenues, meant that the autonomous communities posted budget deficits in the period to March 2011 of nearly 0.5% of GDP. There was again a huge gap between regions with Castille La Mancha, the Balearic Islands and Murcia again recording the highest deficits at around 1pp, and Aragon, La Rioja and Galicia the only ones enjoying a slight surplus.

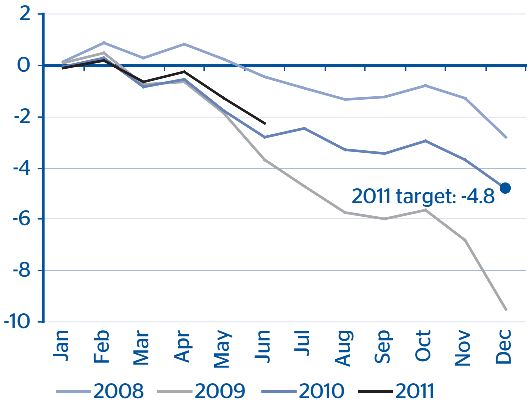
Latest information suggests the government will stick to its path of fiscal consolidation heading for a cumulative deficit to June of 2.2% of GDP, 0.6pp below than last year figure (see Chart 16). While revenues to the central government will still depend on what happens in the autonomous financing system[8], the spending cuts are again concentrated on capital spending and current transfers between branches of government, mainly due to recent changes in the autonomous financing system.

Tax revenue data for June confirm their improvement, driven by VAT –still affected by last year's rise in the VAT rate– and, to a lesser extent, personal income tax, where the take was slightly up thanks to improved capital withholdings and lower requests for rebates (Chart 17).

In these circumstances, even assuming government revenue continues to recover at the same pace, further fiscal tightening measures will need to be taken if this year's stability target is to be met, particularly by the autonomous communities. In this respect, Parliament's approval of next year's stability targets and government spending limits for 2012 (nearly 4% lower than this year) is a positive sign of the commitment to fiscal consolidation.

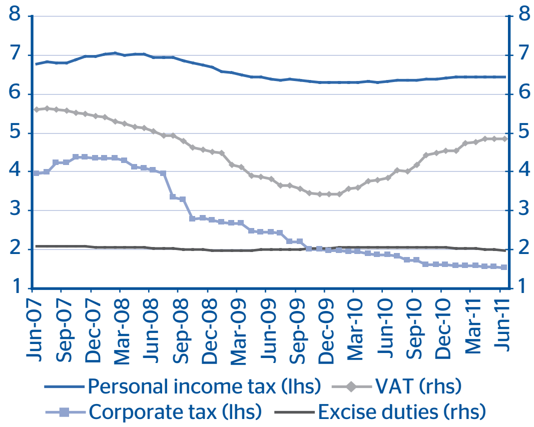
8: The new autonomous financing system is being comprehensively applied for the first time this year and implies a decline in the transfer payments to autonomous communities and lower central government tax revenues as autonomous communities collect more of their own personal income tax, VAT and companies tax.

Chart 16
Central government: non-financial balance (cumulative annual, % of GDP)



Source: BBVA Research based on MEH data

Chart 17
Tax revenues in like-for-like terms (cumulative annual, % of GDP)



Source: BBVA Research based on AEAT and INE data

Accordingly, the uptick in public consumption during 1Q11 is likely to be offset by stricter cuts in current spending over subsequent quarters, particularly in the second half of this year. As a result, public consumption was probably again virtually flat in 2Q11 and is set to fall once more in the second half of 2011. The drive for fiscal retrenchment will continue to focus on investment, so non-residential spending in all likelihood continued to shrink in 2Q11, although part of this worsening would have been due to, besides public cuts, the sharp adjustment currently sweeping the private construction business.

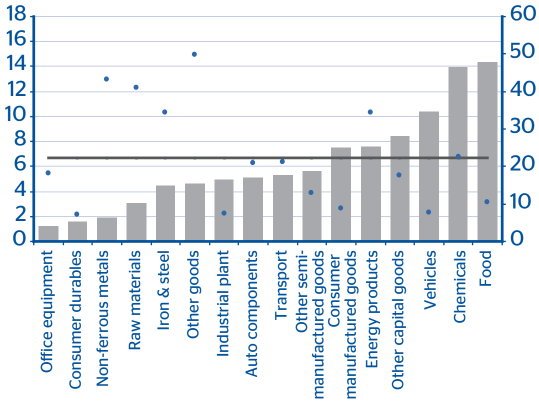
Exports remain in rude health, making a net contribution to GDP growth despite a temporary correction

Since the beginning of 2010, the export drive has spread through all industrial sectors, with strikingly strong showings from areas already central to Spain's export trade, such as chemicals, and an expansion in sectors that have traditionally exported less, such as auto components and the iron and steel industry (see Chart 18). However, during 2Q11, there was a downward correction in exports of goods, chiefly due to unflattering base effects after the previous quarter's peak. On this point, there are no signs in this quarter of a tailing off in exports from specific sectors as the above-mentioned correction looks to have been evenly spread across most industries.

The partial indicators we have for exports of services point to a fresh rise in consumption by non-residents in Spain during 2Q11. Over the first half of the year, and pending data for the summer, the sector seems to have had a good season. This was undoubtedly helped by the situation in North African countries which were unable to compete for tourists, but we would also highlight the cumulative adjustment of prices in the hotel trade, which have fallen by 9% since 2008 and are now virtually back to 2005 levels. This is in sharp contrast with wider service prices (see Chart 19). In recent months, these two factors have combined to produce a stabilisation of spending per tourist, but this has been offset by a substantial rise in tourist numbers (+7.2% over the period, to 19 million), prompting an 8% increase in the total spend. Indicators available for June, and the numbers of arrivals on low-cost carriers (+12.8% yoy in June) suggest the start of the high season could confirm expectations of strong growth in foreign overnights for the year as a whole.

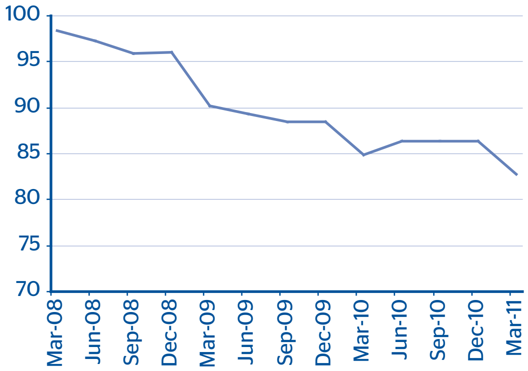
In summary, the healthy performance of both goods and services exports as we move out of the current crisis continues to surprise on the upside given that there have been no supportive devaluations as happened in the 1990s (see Chart 21) but rather a seizing of opportunities in international markets against a bleak domestic economic background. For its part, slack domestic demand and the correction in exports of goods herald a decline in imports, something that, coupled with the trend in total exports, is likely to mean a slight correction in the current account deficit for the current quarter despite high oil prices.

Chart 18
Composition of Spanish exports and growth in nominal goods exports (%)



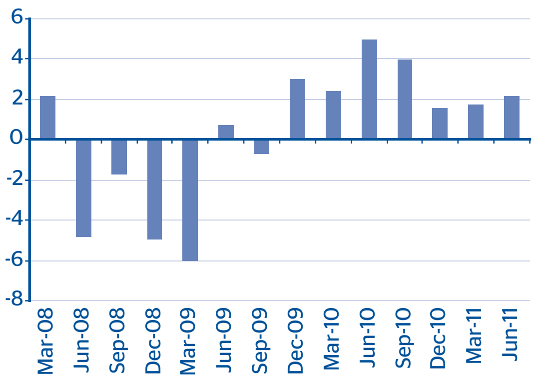
Source: BBVA Research based on Datacomex

Chart 19
Spain: hotel prices index (Base 100=2007, adjusted by services inflation)



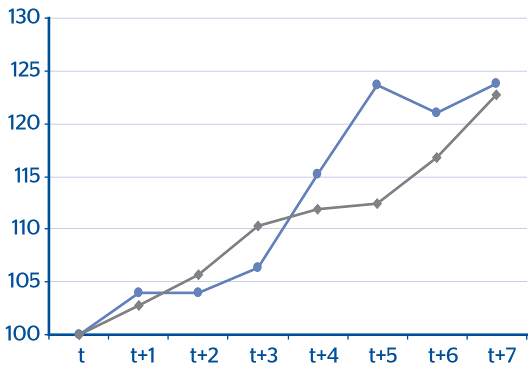
Source: BBVA Research based on INE data

Chart 20
Spain: foreign tourist arrivals (qoq, % SWDA)



Source: BBVA Research based on INE data

Chart 21
Spain: qoq change in real goods and services exports during the end-phase of two periods of crisis



Note: t is the quarter that recorded the local cyclical low
Source: BBVA Research based on INE data

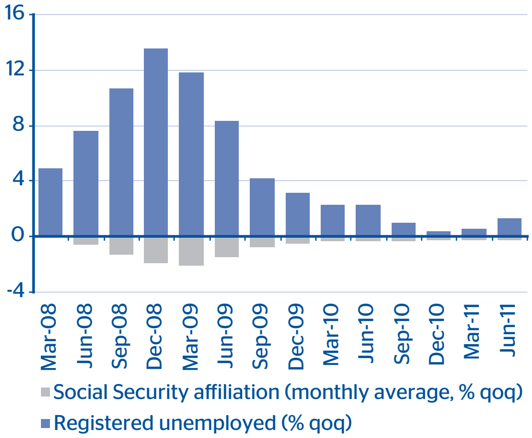
At midsummer the labour market remains virtually stagnant

Job market figures improved barely at all in 2Q11. Adjusting for seasonal and calendar effects, the economy was still unable to create jobs in significant numbers. Social security affiliation fell at virtually the same pace as in the previous quarter (-0.3% qoq SWDA), while the registered unemployed rose faster at 1.3% qoq according to SWDA (from 0.5% qoq in 1Q11), due to a further dip in construction and a stalling of job creation in the services sector (see Chart 22)[9].

9: July registrations indicate the labour market began the third quarter as it ended the second, with a fall in social security registrations and a rise in jobless. Correcting for calendar and seasonal effects we estimate employment fell by 28,000 people, a similar number to the increase in those registered unemployed.

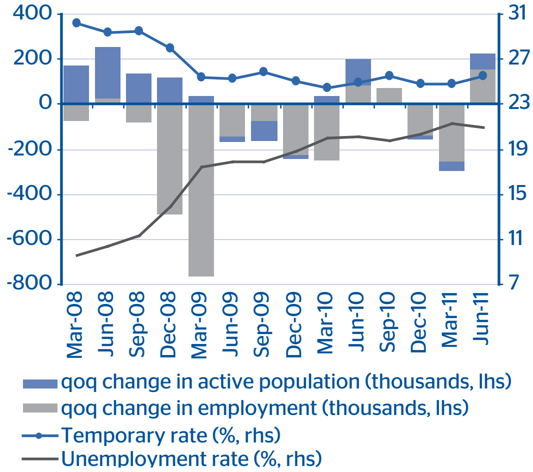
The Labour Force Survey (LFS) for 2Q11 confirmed the same trend. Employment rose for largely seasonal reasons (151,300 gross jobs, 9,900 SWDA). Growth in job numbers –concentrated among temporary contract staff and service sectors– was enough to offset the slight seasonal increase in active population (74,900 people in gross terms, 21,300 SWDA), so that the unemployment rate fell by 4 tenths of a point to 20.9% of the active population (20.8% SWDA), while temporary rate upticked 7 tenths to 25.5% (see Chart 23).

Chart 22
Spain: average Social Security affiliation and jobless claims (SWDA data)



Source: BBVA Research based on MTIN (Ministry of Labour and Immigration) data

Chart 23
Spain: labour market indicators



Source: BBVA Research based on INE data

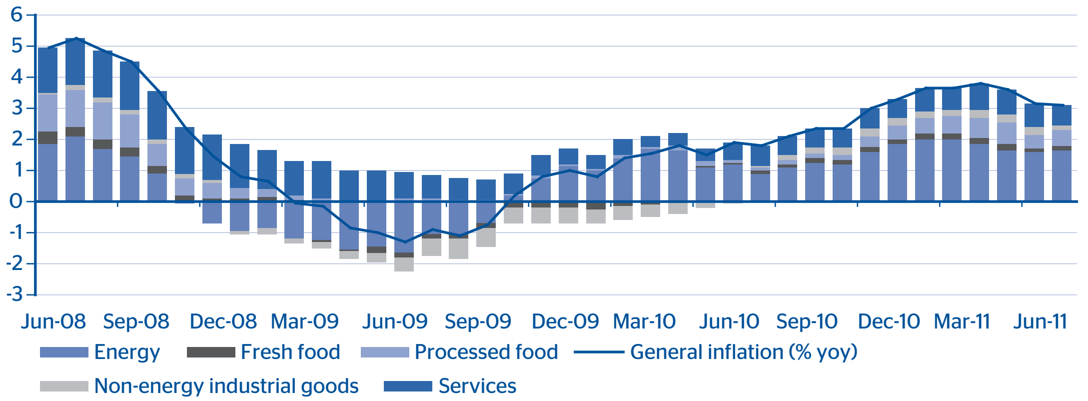
Rising consumer prices started to fall back in the second quarter

As expected, 2Q11 brought a gradual slowing of the rise in consumer prices. Therefore, headline inflation, having hit its local peak in April at 3.8% yoy, fell back to 3.2% yoy by the quarter's end, of which 1.8pp can be attributed to energy and food products and 1.4pp to core inflation (see Chart 24). As we anticipated in our last issue, although persistently high prices of commodities have fed through to consumer prices – directly through final consumption and indirectly through intermediate consumption – high unemployment prevented real wage rises (the average salary rise agreed under collective bargaining to June was 2.7%) and there is still no clear evidence of second-round effects. So, if we set aside the components of core inflation most sensitive to commodity prices (i.e. processed food and package holidays), growth in the prices of services and non-energy industrial goods remains modest, contributing 0.7pp and 0.3pp, respectively to headline inflation.

Also, 2Q11 data reveals no sign of a significant loss in the Spanish economy's price competitiveness. The inflation differential against the euro zone in June was 0.3pp on headline inflation and -0.2pp for the core figure, largely reflecting the tax rises brought in 2H10. As can be seen in Table 3, while the inflation differential, after taking into account the higher tax rates, stood at about 0.7pp on average in 1H11, according to data published by Eurostat, at constant tax rates, it would have remained favourable to Spain (at around -0.1 pp)[10].

10: The methodological changes in the calculation of harmonized CPI introduced at the beginning of the year have resulted in increased volatility for this series. As a result, monthly data should be interpreted with caution.

Chart 24
Spain: contributions to headline inflation growth



Source: BBVA Research based on INE data

Table 3
Spain: Inflation spreads with respect to the euro zone

		Total	At constant tax rate
2008	1H	1.1	1.2
	2H	0.7	0.7
2009	1H	-0.7	-0.9
	2H	-0.4	-0.7
2010	1H	0.4	0.1
	2H	0.4	-0.4
2011	1H*	0.7	0.1

* January-May average figures at constant tax rates
Source: BBVA Research based on INE and Eurostat data

Outlook 2011-2012: the resurgence of financial tensions in Europe has slightly depressed growth expectations for the coming year

In the past quarter, peripheral risk re-emerged to trouble European financial markets and came close to triggering a systemic debt crisis as Europe's governments failed to come up with a comprehensive solution to the sovereign debt crisis. This time around, its most prominent feature was the massive contagion to Spain and Italy. This has led to a toughening of financial terms, which during the last quarter made it harder to raise finance, even for agents living in countries with better macro-economic and financial fundamentals. Spain was one of the main victims of this market deterioration, leading the Spanish government to pay high rates on its debt issues and much of the private sector, even companies with strong fundamentals, to stay away from the markets altogether.

This latest upsurge in uncertainty by Europe's sovereign debt markets, which shows no sign of being resolved imminently, will impact Europe's domestic demand and this will make it harder to step up the pace of growth in the short term. Besides the above, the Spanish economy's inability to differentiate itself further from other peripheral, due to a lack of ambition in some reforms and doubts as to whether the autonomous communities can meet their year-end fiscal targets is further reason to believe that growth will remain weak in 2011 (0.9%) and slightly lower than expected three months ago in 2012 (1.3%).

Table 4
Spain: macroeconomic forecasts

(yoy %, unless indicated otherwise)	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	2010	2011	2012
Household consumption	-0.3	2.2	1.5	1.7	0.7	-0.6	1.3	0.3	0.6
Public Administration's consumption	-1.1	-0.1	-0.7	-0.9	1.1	-0.3	-0.7	-0.2	-1.3
GFCF	-10.5	-6.7	-6.7	-6.1	-5.8	-6.8	-7.5	-4.9	-0.4
Capital goods and other products	-9.3	0.5	0.2	0.1	0.1	-2.1	-2.1	0.6	3.0
Capital goods	-4.6	8.7	2.4	1.2	0.3	-4.4	1.9	0.6	4.1
Construction	-11.3	-11.3	-11.2	-10.6	-10.2	-10.3	-11.1	-9.1	-2.9
Housing	-20.9	-18.7	-15.1	-11.4	-8.9	-8.9	-16.5	-7.5	0.9
Other	-4.1	-5.9	-8.7	-10.1	-10.9	-11.2	-7.2	-10.0	-5.2
Chg. in inventories (*)	0.0	0.1	0.1	0.1	0.1	0.0	0.1	0.0	0.0
Domestic demand (*)	**-3.0**	**-0.3**	**-0.7**	**-0.6**	**-0.6**	**-2.0**	**-1.1**	**-1.0**	**0.0**
Exports	9.4	11.9	9.4	10.5	11.2	9.5	10.3	11.0	6.0
Imports	2.0	9.6	5.0	5.3	5.2	-0.9	5.5	3.7	1.0
Net trade balance (*)	**1.6**	**0.3**	**0.9**	**1.2**	**1.4**	**2.7**	**1.0**	**1.8**	**1.3**
GDP at mp	**-1.4**	**0.0**	**0.2**	**0.6**	**0.8**	**0.8**	**-0.1**	**0.9**	**1.3**
Pro-memoria:									
GDP w/o housing investment	-0.2	1.1	1.2	1.3	1.3	1.2	0.9	1.3	1.3
GDP w/o construction	0.3	1.9	2.1	2.5	2.4	2.3	1.7	2.3	1.9
Employment (LFS)	-3.6	-2.5	-1.7	-1.3	-1.3	-0.9	-2.3	-0.8	0.5
Unemployment rate (% active pop.)	20.0	20.1	19.8	20.3	21.3	20.9	20.1	20.8	20.7
Employment (FTE)	-3.9	-2.4	-1.6	-1.4	-1.4	-1.5	-2.4	-1.2	0.3

(*) Contribution to growth
Source: INE and BBVA Research forecasts

Regarding the composition of growth, new factors identified in the update of our economic scenario for 2011 and 2012 represent a further downward pressure on domestic demand primarily. First, the public spending overrun in 1Q11 imply the current contractionary fiscal policy stance should be intensified in coming months if the government is to meet its fiscal targets. In order to fulfil it, as explained in our last issue, is necessary a strengthening of fiscal discipline mechanisms at different levels of government to avoid uncertainty dragging on. Given the critical importance of fiscal consolidation[11], this will inevitably mean a downward revision to public consumption and investment in 2012.

In regard to private consumption, the 1Q11 figure was slightly below expectations, prompting a slight downward revision to our 2011 forecast. Consumers brought forward purchases of goods and services to the first half of last year, which might otherwise have happened in the current year and this created a negative base effect for household spending in the first half of 2011, which should gradually fade out over the forecast horizon. Despite rising uncertainty about possible increases in financing costs following the resurgence of financial tensions in Europe, our outlook for household spending over the next two years is unchanged from the forecasts in the previous issue of Spain Economic Outlook. The weakness in the main factors that determine spending levels will limit its growth to levels below those registered in 2010. Although inflationary pressures and the rise in official interest rates will tend to limit growth in private consumption, the negative impact on spending from both these factors will be most evident in 2012. And although we have revised slightly upward the growth of real gross disposable household income for next year, slower job creation, steeper falls in the housing wealth and, particularly, persistently high

11: As we said above, Parliament's approval of next year's stability targets and government spending limits for 2012 is a positive sign of this commitment.

uncertainty will continue to drag down consumption in 2012. Overall, we see no significant changes in household savings rates compared to the previous scenario, running at around 10.5% of gross disposable income this year and 12.0% next year.

Corporate investment looks set to remain unimpressive for several reasons over much of our forecast horizon. These include a weak outlook for domestic demand in 2012 and rising uncertainty as a result of a higher risk premium, forcing us to downgrade our growth forecasts for this demand component. Specifically, given the Spanish productive system's reliance on foreign finance and the liquidity squeeze on part of Spain's financial system we are likely to see upward pressure on the real usage cost of capital. This, in the absence of robust domestic demand that might lend greater certainty to future profits, seems to rule out any major increase in productive capacity and, hence, corporate investment in the short and medium term. As a result, it is likely that, driven mainly by external demand, this component of aggregate demand is set to rise by just 0.6% in 2011 before returning to slightly higher rates of around 3.0% in 2012 after three years of sharp falls and one of virtual stagnation.

Meanwhile, excess supply of new housing is being slowly absorbed, particularly in the main centres of economic activity, and this is likely to encourage a gradual recovery in residential investment over the medium term. That said, the latest updates to the macro-economic scenario have a negative impact on housing supply and demand as both households and businesses will probably face higher financing costs. On top of this, the economy's problems in creating jobs and so reducing unemployment significantly will continue to influence household's decisions on home buying. In 2011 we therefore expect another reduction in residential investment (-7.5% yoy) although this is much smaller than in the past two years. It will not be until the second half of 2012 that we start to see qoq growth in this component of aggregate demand, with the growth forecast for the full year at around 1%.

Finally, the medium-term driver of economic growth in Spain will continue to be exports. As explained in Box 3, it is the structural differences in export companies compared to the mass of Spanish businesses that accounts for their earlier and firmer recovery. So, if we set aside any possible impact on activity from current uncertainties about the sovereign debt crisis in Europe, European and global growth expectations point to a sharp rise in exports in 2011 of around 11%. In 2012, export and import growth alike should tend to slacken, mainly as a result of slower global growth, although the net contribution of the export sector will continue to sustain GDP growth over this period.

The reform drive must continue

The scenario changes lead a reduction of growth forecast in 2012 of 0.3% to 1.3%, although our overall diagnosis of the Spanish economy's recovery is unchanged. As it stands, the economy is close to stagnant and the growth outlook remains tenuous in the short and medium terms. In this environment, it is essential to push ahead with the reform agenda embraced by the Spanish economy in 2010 to shore up confidence in international markets and achieve the kind of growth figures that can start to reduce unemployment. It is, therefore, especially disappointing that Royal Decree-Law 7/2011 of 10 June concerning urgent measures to reform collective bargaining[12], improved little on the previous rules.

The proposed measures lack the ambition to tackle the deterioration in the Spanish Labour Market. First, they make no changes to the mechanism for determining wages and allow only a small measure of flexibility for firms to opt out of the pay scales set by higher tier collective bargaining agreements when their economic situation and prospects are likely to be harmed.

Secondly, despite establishing the priority of company-scope agreements in certain areas, the higher tier agreements (national or autonomous community agreements covering specific sectors) can continue to block in-company negotiations, making it harder for firms to adapt to changing economic circumstances and so preventing them adjusting their intensive margins (working hours, pay, etc.). It would have been better to see a firm move towards decentralisation of the negotiating system, maintaining a multi-tier system but defining which issues should be dealt with at each level. To encourage company level negotiations, it could have opted to limit the principle of automatic general applicability of collective bargaining agreements and give each company the option of signing up to the higher tier agreement (opting-in clauses) or signing a company agreement.

12: The draft of RD-L 17/2011 is available here.

Third, the obligation to seek arbitration in the event of conflict restricts, but does not eliminate, the continuation in force of expiring agreements. The reform requires that every collective bargaining agreement should stipulate a deadline for its renewal (8 or 14 months depending on whether the previous agreement runs for more or less than two years). If no agreement can be reached, the parties must put their differences to an arbitration procedure. Accordingly, while expired agreements can still remain in force beyond their terms, the length of time this applies is shortened, giving firms more scope to adjust working conditions to economic circumstances than under previous law, but less than they need given the current precarious state of the Spanish labour market.

To sum up, the reforms fail to resolve the weaknesses of the current collective bargaining system. If changes made during its passage through parliament fail to correct the shortcomings of the draft law published in June, its effectiveness will be limited and will depend on the good faith of the parties involved in negotiating national and regional agreements. Accordingly, we expect the labour market to remain weak, with only feeble numbers of new jobs in 2012, while the active population remains unchanged and unemployment falls only slightly toward the end of the forecast horizon.

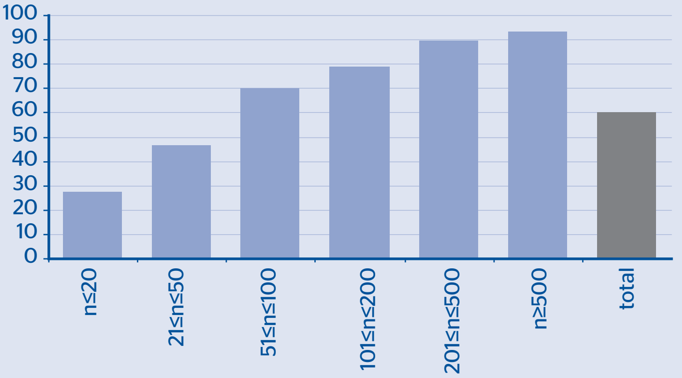
It is important that measures to improve the transparency of public finances are pursued, that central government maintains the effectiveness of the current fiscal consolidation process and that other tiers of government embrace this process more decisively in the next few years. On the whole, the Spanish economy's debt level is sustainable, but it is must stay on track to achieve its deficit targets to prevent any unnecessary prolongation of tensions in sovereign and autonomous community debt markets. The government has taken a step in the right direction here by proposing a fiscal rule similar to that discussed in our last Outlook three months ago, which would tie government spending to nominal trend GDP growth. That said, such a rule would make little sense if it was not also applied to the autonomous communities. This would require a national agreement that would extend the commitment to regional governments and reinforce confidence in the fiscal policy targets more firmly than the measures announced so far.

Box 3. Differentiating features of Spain's exporters

Based on new trade theory (Melitz, 2003), this analysis explores what differentiates Spain's exporting companies from their non-exporting peers and, specifically, looks at the variety of business models in the manufacturing sector using data from the Business Strategies Survey (BSS) for 1990-2009, compiled and published by the SEPI Foundation. Identifying the features that underlie Spain's export success over recent decades is key to understanding the good performance of exports both as a mitigating factor during the depths of the crisis and as a driver of growth during the current phase of emergence from recession. Also, knowing what these features are will throw light on the challenges facing the sector in the next few years.

Chart 25

Percentage of exporting firms by company size (average 1990-2009)



* n is the number of employees
Source: BBVA Research based on BSS data (SEPI foundation)

In general, aggregate exports can be broken down into their two margins: extensive (exporting companies as a percentage of all companies) and intensive (value of exports as a percentage of all sales by exporting companies). Charts 25 and 26 show that both margins are positively correlated to company size (approximated as the headcount). Specifically, the likelihood that a company will be an exporter, reflected in the extensive margin, is greater among large companies which are better able to bear the fixed costs of entry into new markets (Melitz, 2003). The intensive margin too depends on company size. There is a gap of more than 15pp between the smallest and largest groups in the data set. Size is a determining factor for companies in processes of internationalisation, albeit not the only one (Navaretti et al., 2010)[13].

Una vez se analiza un número amplio de variables, los resultados sugieren que las empresas exportadoras cuentan con unas características que las sitúan en una posición más competitiva que las no exportadoras (véase el Cuadro 5). En concreto, acumulan un mayor número de años de experiencia en el mercado doméstico, presentan niveles de productividad y, especialmente, de capital físico por empleado mayor, y son más proclives a invertir en actividades vinculadas a la investigación y el desarrollo. En promedio, un 20% más de empresas reporta innovaciones durante el año, bien en producto bien en proceso, si éstas pertenecen al club de las exportadoras frente al de las no exportadoras. Además, las empresas exportadoras tienden a registrar tasas de temporalidad menores, invertir más en educación y depender en mayor medida de trabajadores cualificados en su estructura productiva.

Chart 26

Value of exports as a share of total sales by company size (average 1990-2009, %)

* n is the number of employees
Source: BBVA Research based on BSS data (SEPI foundation)

13: Under some conditions of business distribution, aggregate exports are good approximated through big size enterprise exports. (Di Giovanni y Levchenko, 2010) , which show the importance of this variable in recent literature.

Table 5

Features of companies in the Spanish manufacture sector: exporters versus non-exporters and stable versus non-stable exporters (average 1990-2010)

			Exporters	
(median of the distribution)	**Exporters**	**Non-exporters**	**Stable**	**Non-stable**
Size (a)	173	21	417	133
Experience (b)	-1	8	-2	5
Technology:				
Labour productivity (VA per employee) (c)	39.0	24.2	39.7	31.7
Physical capital per employee (d)	64.3	23.8	66.7	45.1
Total R&D spend (e)	6.7	0.0	18.0	0.0
Patents filed by company in Spain*	0.4	0.0	0.4	0.3
Patents filed by company abroad*	0.4	0.0	0.4	0.1
Human capital:				
External spending on training per company (f)	21.7	0.0	25.1	2.2
Proportion of engineers and bachelors* (%)	5.5	2.9	5.8	4.1
Proportion of other undergraduate staff* (%)	6.8	4.1	7.0	5.4
Proportion of unqualified staff* (%)	87.7	93.0	87.3	90.6
Proportion of white collar staff (%)	28.5	21.7	28.9	25.0
Proportion of blue collar staff (%)	71.5	78.3	71.1	75.0
Financial indicators:				
Foreign investment in capital* (%) (g)	26.7	3.2	28.3	16.4
Access to equity capital (%) (h)	42.0	38.7	42.5	37.0
Temporary rate (%)	**9.8**	**14.3**	**9.6**	**10.7**
Share of main market* (%)	**14.5**	**8.0**	**15.0**	**10.5**
Advertising spend as a share of sales (%)	**0.4**	**0.1**	**0.4**	**0.3**

Stable exporting companies have been exporting for a consecutive period of at least four years. (a) Number of employees. (b) difference between the year the company was founded and the average foundation date for all companies in the sample, (c) (d) and (f) thousands of euros per employee (e) thousands of euros, (g) foreign-owned capital as a share of the company's total capital, (h) equity capital/equity and liabilities, * figure is the distribution average

Source: BBVA Research based on BSS data (SEPI foundation)

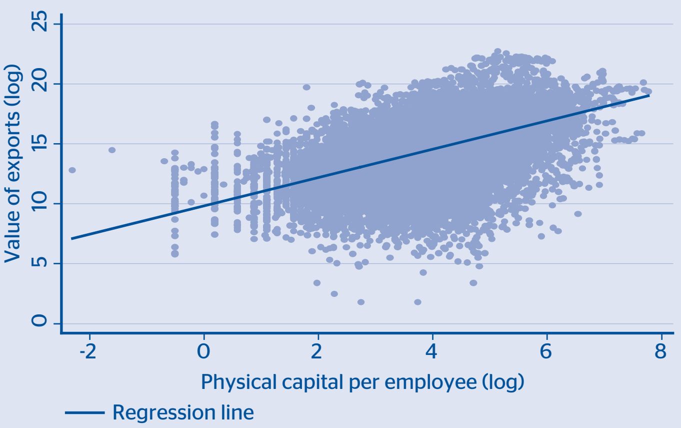
From a financial perspective, a major differentiating factor is the entry of foreign capital into Spanish manufacturing. Foreign participation in exporting companies is on average nine times higher than non-exporting companies (26.7% versus 3.2%). Another route to internationalisation, and another form of business diversity, is the acquisition of stakes in foreign companies: between 2000 and 2009, the number of exporting companies saying they owned stakes in non-Spanish companies increased 4 percentage points to 20.5% of exporter companies, while among non-exporters the figure was unchanged at 1%. Exporters also have bigger equity bases to fund their business, enjoy a larger share of their domestic market and are more flexible in their marketing strategies (see Chart 27), this last being a key point in a globalised market[14]. Finally, Table 5 shows how the differentiating features identified can be extended by splitting our sample into stable and non-stable exporter companies (stable exporters being those that have been exporting for at least four consecutive years).

14: The situation of a larger share of domestic market and, therefore, of less competition, would be explain for leaving of less productive enterprises due to the commercial release (see Bernard and Jenseen, 1999 y Trefler, 2004).

Chart 27
Reasons for price changes in main market: exporters vs. non-exporters (average 1990-2009)

Source: BBVA Research based on BSS data (SEPI foundation)

Chart 28
Relationship between exports and physical capital per employee (average 1990-2009)



Source: BBVA Research based on BSS data (SEPI foundation)

An initial approximation of the determining factors for exports makes clear the importance of spending on training, the qualifications of employees, activities related to research and development and fixed capital investment per employee as the key business factors affecting exporting performance (see, for instance, Chart 28). In this way, future export growth and the associated boost to industrial productivity will depend, to a large extent, on the structural reforms that are put in place to promote these factors and increase the competition in domestic markets.

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Box 4. Stress test: a more transparent exercise in Spain

The European stress tests coordinated by the European Banking Authority (EBA) sought to gauge the resilience of 90 European banks in an adverse scenario. This time round, the tests were more harmonised than those of a year ago and imposed higher demands on the banks tested with a stricter definition of capital and some harsher scenarios. As with last year's tests, there was a greater effort of transparency by Spanish financial institutions where virtually the whole system underwent stress tests compared to just over 50% on average across the EU. However, against a deeply negative backdrop in financial markets, such transparency failed to restore confidence as it had done in 2010.

Banks' resilience was measured according to the Core Tier 1 ratio, which had to reach 5% of risk weighted assets (RWA), rather than the 6% Tier 1 ratio used in 2010. To insure cross-border standardisation, the EBA strictly defined the instruments that qualified as capital. In many cases this tight definition was at odds with current practice in some member states. For instance, the EBA ruled out some instruments such as generic provisions, convertible bonds[15] and hybrid instruments that were not underwritten by the government. In Spain, however, the Bank of Spain allowed institutions to include more instruments than the EBA in defining the Royal Decree-Law of February 2011 (see table below).

Table 6
Instruments included in the definition of Core Tier 1

		"Core Capital (RDL)"	"Core Tier 1 (EBA)"
	Common shares	x	x
	Stock surplus (share premium)	x	x
	Retained earnings	x	x
+	Interim Profits	x	x
	Unrealised gains on available-for-sale assets	x	Filters
	FROB instruments	x	Yes, government
	Convertible debt due to 2014	x	Yes, if conversion is before 2012
	Treasury shares	x	x
	Interim Losses	x	x
	Goodwill	x	x
	Other intangible assets	x	x
	Unrealised losses on available for sale assets	x	Filters
-	Deductions from original own funds:		x
	Deduction of participations and subordinated claims		x
	Securitisation exposures not included in RWA		x
	IRB provision shortfall		x
	IRB equity expected loss amounts (before tax)		x

Source: BBVA Research based on Bank of Spain and MEH and EBA data

15: Except if its conversion was foresee before 31 December of 2011, and the decision had been adopted before 30 April of 2011.

The adverse macro-economic scenarios applied in Spain were conspicuously tough, involving GDP falls of 1.1% in 2011 and 2012, far worse than any existing forecast. They also assume falls in land and housing prices of 46.7% and 21.9% in 2011 and 2012, a 20.7% slump in stock market indices and a 165 basis point rise in long-term interest rates. The macro-economic scenario for Spain also included a more pessimistic forecast of profit after impairment provisions and taxes than the average for the main EU countries, not including Greece.

Sovereign risk was included in a number of ways: losses from haircuts on sovereign holdings in the trading book, provisions for sovereign risk in the banking book and an additional 130 basis point rise in the cost of wholesale finance. However, sovereign risk was also a source of some of the criticisms levelled at the exercise: the stress scenario on sovereign portfolios could have been more thorough and the spreads used could have been higher than those we are seeing at the moment. Despite this, there is plentiful information on sovereign exposures which allows analysts to run their own studies.

One of the improvements on the 2010 tests is that this year's tests incentivised the raising of capital in advance. As a result, many European banks took specific measures in the first four months of the year, including the retention of €50bn in earnings at end-2010, to put them over the minimum threshold for the year. Without such steps, 20 European banks would have fallen below the 5% limit.

In the 2011 stress test eight institutions failed to meet the 5% threshold: 5 Spanish, 2 Greek and 1 Austrian. Their combined capital requirement was €2.5bn. The reason most of the failing entities were Spanish was that Spain extended the tests to include virtually 100% of the financial system. If Spain had limited its testing to entities making up 50% of its market (the average scope of the sample in EU countries) no Spanish entity would have come out below the EBA threshold.

In conclusion, the results of the 2011 stress test are very similar to those of the previous year – although they include some methodological flaws – and again stricter with Spanish institutions.

Box 5. 2009 regional financing system settlement: an initial analysis

Ángel de la Fuente - Instituto de Análisis Económico (CSIC)

The Ministry of the Economy and Finance (MEH) has published details of the regional financing system for 2009 (MEH, 2011). This is an important and complex document that sets the starting point for the new financing system for the autonomous communities which is still in the process of being implemented. While awaiting a more detailed analysis, for the moment this box previews the results of the settlement and some of its implications.

Table 7

Main items in the regional financing system settlement for 2009 in millions of euros and millions of people in the adjusted population

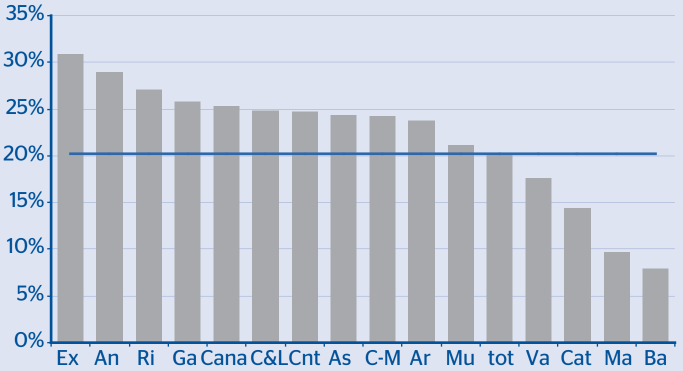
	Theoretical financing			
	All responsibilities (1)	Comparable responsibilities (2)	Central government balance (3)	Adjusted population (4)
Catalonia	17,201	15,394	2,478	7,386,015
Galicia	6,215	6,035	1,601	2,966,939
Andalusia	15,992	15,422	4,637	8,170,226
Asturias	2,419	2,376	588	1,125,121
Cantabria	1,473	1,397	364	587,943
La Rioja	749	717	203	325,824
Murcia	2,755	2,744	582	1,416,295
Valencia	9,702	9,512	1,707	4,999,176
Aragón	3,034	2,985	722	1,415,057
C. La Mancha	4,260	4,253	1,034	2,197,556
Canary Is.*	4,347	4,204	1,102	2,177,856
Extremadura	2,481	2,476	764	1,168,363
Balearic Is.	2,250	2,188	178	1,094,408
Madrid	13,748	13,134	1,336	6,010,813
C. & León	5,796	5,788	1,439	2,749,329
Total 2009	92,421	88,626	18,736	43,790,921
Total 2007	115,091	110,903		
Change since 2007	-22,671	-22,276		
Change %	-19.7%	-20.1%		

(*) Data for the Canary Islands include resources under the Economic and Fiscal Regime (EFR).
Source: de la Fuente, A. based on MEH data.

Table 7 shows some of the key items in the settlement of financing system. The first two columns show the total financing of each autonomous community, calculated on the theoretical basis – i.e. using the theoretical tax take used in the system's calculations, which is not necessarily the same as the real tax take but generally not too far off. Column (1) shows the total financing assigned to each region, while column (2) shows the financing allocated for the responsibilities shared by all regions, which is the best item for making inter-regional comparisons. Column (3) shows the balance of the settlement, it is the amount that each region owes the central government for taking payments on account in 2009 exceeding the actual volume of resources they were entitled to once taxes for the period were in. Finally, column (4) shows the adjusted population for each region in 2009. This indicates the spending requirements by weighting the actual population of each region by a correct factor which collect the estimated differences in the local unit cost of providing the main services delegated to the regions.

Chart 29

Balance owed in 2009 as a percentage of total financing to each region

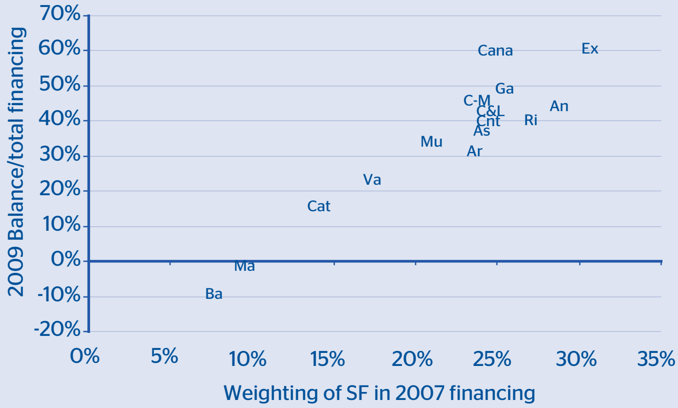


Key: Ex = Extremadura, An = Andalusia, Ri = Rioja, Ga = Galicia, Cana = Canary Is, C&L = Castille & León, Cnt = Cantabria, As = Asturias, C-M = Castille La Mancha, Ar = Aragón, Mu = Murcia, tot = total normal-regime regions, Va = Valencia, Cat = Catalonia, Ma = Madrid and Ba = Balearic Is.
Source: de la Fuente, A. based on MEH data

Dividing the balance owed by each region by its total financing gives an indicator of the adverse impact of the settlement for its finances. Chart 29 shows this indicator with the regions ranked in order of least financial pressure. On average, the regions need to return slightly over 20% of their total 2009 financing to the central government[16]. Individual amounts vary widely though, from 8% in the Balearic Islands to 31% in Extremadura. As Chart 30 shows, the financial pressure indicator for each region is closely correlated with weight of the Sufficiency Fund in the financing of each region under the previous financing system. Due to the dramatic collapse of this Fund, partly as a result of discretionary fiscal stimuli that undermined government revenues, the regions most dependent on it will have to make greater repayments than others.

Chart 30

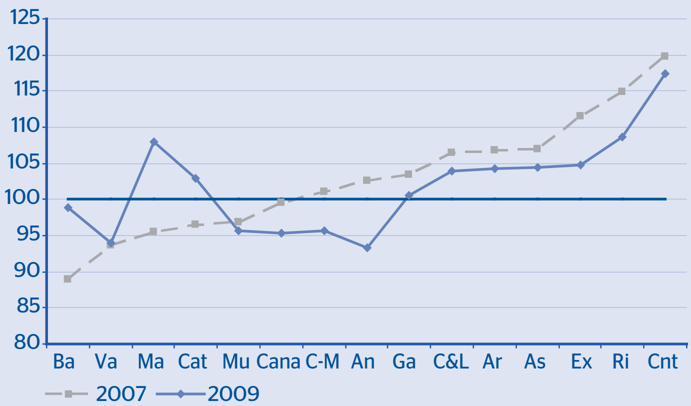
Balance owed in 2009 as a percentage of total regional financing vs. weighting of Sufficiency Fund in 2007 theoretical financing



Source: de la Fuente, A. based on MEH data

Chart 31

Theoretical finance on comparable responsibilities per adjusted pop, 2007 vs. 2009



Note: 2007 data come from the Source (2010).
Source: de la Fuente, A. based on MEH data

16: Given that the settlement will be paid in equal periods in five years with one of shortcoming, the value of this indicator will have to be divided in five into order to calculate the "real weight" of 2009 settlement in next years regional budgets.

Chart 31 shows the expected change in the relative position of each region between 2007 and 2009 adjusting for the effects of reforms to the system and the performance of the different regional economies. The new system has reduced the variation in theoretical finance to comparable responsibilities per adjusted head of the population compared to 2007. The changes in the upper part of the distribution are heading in the right direction and tend to reduce the differences between regional financing per unit of need, which translates as a flattening of the line illustrating the distribution of finance. The rest of the data set however shows a mixed picture, with sharp downward changes that could threaten the sustainability of the new system. Some of the worst-funded regions in 2007 saw significant improvements but not all of them. Valencia and Murcia were unchanged in relative terms, while Madrid and Catalonia moved well above the 100 line and the Balearic Islands virtually reached 100. Madrid is also striking as it would gain 12.5 points and become one of the best-funded regions having been close to the bottom in 2007. The changes are also problematic for the Canary Islands, Castille La Mancha and, especially, Andalusia, which stand to lose between 4.1 and 9.5 points and would join Valencia and Murcia as among the lowest-funded regions per adjusted pop. The regions least reliant on the Sufficiency Fund have been the biggest winners (in relative terms) from the change in the system.

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4. Tables

Table 8

Macroeconomic forecasts: Gross Domestic Product

(YoY rates, %)	2008	2009	2010	2011	2012
US	-0.3	-3.5	3.0	2.1	2.6
EMU	0.3	-4.1	1.7	2.0	1.3
Germany	0.7	-4.7	3.5	3.3	1.8
France	0.1	-2.5	1.4	1.9	1.5
Italy	-1.3	-5.1	1.2	0.8	0.7
Spain	0.9	-3.7	-0.1	0.9	1.3
UK	-0.1	-4.9	3.4	1.3	1.6
Latin America *	5.2	-0.6	6.6	4.8	4.4
Mexico	1.5	-6.1	5.4	4.1	3.8
EAGLES **	6.6	4.0	8.3	7.0	6.9
Turkey	0.7	-4.7	8.2	6.3	4.2
Asia Pacific	5.2	4.1	8.0	6.2	6.7
China	9.6	9.2	10.3	9.4	9.1
Asia (exc. China)	2.3	0.8	6.5	4.1	5.2
World	2.8	-0.7	5.0	4.2	4.4

Closing date: 1 August 2011
* Argentina, Brazil, Chile, Colombia, Peru, Venezuela
** Brazil, China, Egypt, India, Indonesia, Korea, Mexico, Russia, Taiwan, Turkey
Source: BBVA Research

Table 9

Macroeconomic forecasts: 10Y interest rates (average)

	2008	2009	2010	2011	2012
US	3.6	3.2	3.2	3.3	4.0
EMU	4.0	3.3	2.8	3.2	3.5

Closing date: 1 August 2011
Source: BBVA Research

Table 10

Macroeconomic forecasts: exchange rates (average)

US dollars ($) per national currency	2008	2009	2010	2011	2012
US (EUR/USD)	0.68	0.72	0.76	0.71	0.75
EMU	1.47	1.39	1.33	1.40	1.34
UK	1.82	1.56	1.55	1.63	1.66
China	6.95	6.83	6.77	6.46	6.15

Closing date: 1 August 2011
Source: BBVA Research

Table 11

Macroeconomic forecasts: official interest rates (end of period)

	2008	2009	2010	2011	2012
US	0.61	0.25	0.25	0.25	1.25
EMU	2.73	1.00	1.00	1.75	2.00
China	5.31	5.31	5.81	6.81	7.31

Closing date: 1 August 2011
Source: BBVA Research

Table 12

EMU: macroeconomic forecasts (y-o-y change, %, unless otherwise indicated)

	2008	2009	2010	2011	2012
Real GDP	0.3	-4.0	1.7	2.0	1.3
Household consumption:	0.4	-1.1	0.8	1.2	1.3
Public consumption	2.3	2.5	0.3	0.6	0.1
GFCF	-1.0	-11.3	-1.0	3.3	2.7
Capital goods and other products	1.1	-15.0	3.1	6.1	4.0
Construction	-2.2	-7.2	-3.9	0.0	0.8
Housing	-4.7	-10.3	-2.9	0.6	1.0
Domestic demand (Contribution to GDP growth)	0.3	-3.3	0.9	1.5	1.2
Exports	0.7	-13.1	11.1	6.4	3.2
Imports	0.6	-11.8	9.3	5.6	3.2
Net exports (Contribution to GDP growth)	0.1	-0.8	0.8	0.5	0.1
Pro-memoria					
GDP w/out housing investment	0.6	-3.7	1.9	2.1	1.3
GDP w/out construction	0.6	-3.7	2.3	2.2	1.4
Employment (LFS)	0.9	-1.8	-0.4	0.5	0.7
Unemployment rate (% active pop.)	7.6	9.5	10.2	9.8	9.5
Current account balance (% GDP)	-1.1	-0.7	-0.4	-0.2	-0.1
Public sector balance (% GDP)	.2	-6.3	-6.0	-4.4	-3.6
CPI annual average	3.3	0.3	1.6	2.7	1.8

Source: official institutions and BBVA Research

Table 13

Spain: macroeconomic forecasts (y-o-y change, %, unless otherwise indicated)

	2008	2009	2010	2011	2012
Activity					
Real GDP at market prices	0.9	-3.7	-0.1	0.9	1.3
Private consumption	-0.6	-4.3	1.3	0.3	0.6
Public consumption	5.8	3.2	-0.7	-0.2	-1.3
Gross fixed capital formation	-4.8	-16.0	-7.5	-4.9	-0.4
Capital goods	-3.0	-21.2	-2.1	0.6	3.0
Construction	-5.9	-11.9	-11.1	-9.1	-2.9
Housing	-10.7	-24.5	-16.5	-7.5	0.9
Domestic demand (Contribution to GDP growth)	-0.6	-6.4	-1.1	-1.0	0.0
Exports of goods and services	-1.1	-11.6	10.3	11.0	6.0
Imports of goods and services	-5.3	-17.8	5.5	3.7	1.0
Net exports (Contribution to GDP growth)	1.5	2.7	1.0	1.8	1.3
GDP at current prices	3.3	-3.1	0.8	3.5	3.7
Billion euros	1088.1	1053.9	1062.6	1100.3	1140.9
Labour market					
Employment (LFS)	-0.5	-6.8	-2.3	-0.8	0.5
Unemployment rate (% active pop.)	11.3	18.0	20.1	20.8	20.7
Full-time equivalent employment (QNA)	-0.5	-6.6	-2.4	-0.9	0.4
Productivity	1.4	2.9	2.2	1.7	0.9
Precios y costes					
CPI (annual average)	4.1	-0.3	1.8	3.0	1.4
GDP deflator	2.4	0.6	1.0	2.7	2.4
Household consumption deflator	3.5	0.1	2.8	3.6	0.8
Compensation per employee	6.4	4.1	0.7	3.0	3.1
Unit labour cost (ULC)	5.0	1.2	-1.5	0.9	2.1
Foreign trade					
Public Administration balance (% GDP)	-9.7	-5.5	-4.5	-4.0	-1.6
Government sector					
Debt (% GDP)	39.8	53.3	60.1	64.5	67.1
Public Administration balance (% GDP)	-4.2	-11.1	-9.2	-6.0	-4.4
Hogares					
Nominal disposable income	6.0	1.7	-1.8	0.7	3.2
Savings rate (% of nominal income)	13.5	18.1	13.1	10.4	12.0

Source: official institutions and BBVA Research

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This report has been produced by the Spain and Europe Unit:

Chief Econmist for Developed Economies
Rafael Doménech
+34 91 537 36 72
r.domenech@bbva.com

Spain
Miguel Cardoso
+34 91 374 39 61
miguel.cardoso@bbva.com

Mónica Correa
+34 91 374 64 01
monica.correa@bbva.com

Juan Ramón García
+34 91 374 33 39
juanramon.gl@bbva.com

Félix Lores
+34 91 374 01 82
felix.lores@bbva.com

Leticia Riva
leticia.riva@bbva.com
+34 91 374 62 66

Miguel Pérez
+34 91 374 75 28
m.perez.villaseca@bbva.com

Virginia Pou
+34 91 537 77 23
virginia.pou@bbva.com

Pep Ruiz
+34 91 537 55 67
ruiz.aguirre@bbva.com

Camilo Andrés Ulloa
+34 91 537 84 73
camiloandres.ulloa@bbva.com

Europe
Miguel Jiménez
+34 91 537 37 76
mjimenezg@bbva.com

Agustín García Serrador
agustin.garcia@bbva.com
+34 91 374 79 38

Economic Scenarios
Juan Ruiz
+34 91 374 58 87
juan.ruiz@bbva.com

Financial Systems
Carlos Corcóstegui
+34 91 3748599
carlos.corcostegui@bbva.com

Cross-Country Emerging Markets Analysis
Álvaro Ortiz
+34 630 144 485
alvaro.ortiz@bbva.com

BBVA Research

Group Chief Economist
Jorge Sicilia

Emerging Markets:
Alicia García-Herrero
alicia.garcia-herrero@bbva.com.hk

Cross-Country Emerging Markets Analysis
Álvaro Ortiz Vidal-Abarca
alvaro.ortiz@bbva.com

Asia
Stephen Schwartz
stephen.schwartz@bbva.com.hk

China
Daxue Wang
daxue.wang@bbva.com.hk

India
Sumedh Deorukhkar
deorukhkar@grupobbva.com

Latam Coordination
Joaquín Vial
jvial@bbvaprovida.cl

Argentina
Gloria Sorensen
gsorensen@bancofrances.com.ar

Chile
Alejandro Puente
apuente@grupobbva.cl

Colombia
Juana Téllez
juana.tellez@bbva.com.co

Peru
Hugo Perea
hperea@grupobbva.com.pe

Venezuela
Oswaldo López
oswaldo_lopez@provincial.com

Mexico
Adolfo Albo
a.albo@bbva.bancomer.com

Macroeconomic Analysis Mexico
Julián Cubero
juan.cubero@bbva.bancomer.com

Developed Economies:
Rafael Doménech
r.domenech@bbva.com

Spain
Miguel Cardoso
miguel.cardoso@bbva.com

Europe
Miguel Jiménez
mjimenezg@bbva.com

United States
Nathaniel Karp
nathaniel.karp@bbvacompass.com

Financial Systems & Regulation:
Santiago Fernández de Lis
sfernandezdelis@grupobbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Pensions
David Tuesta
david.tuesta@bbva.com

Regulatin and Public Policy
María Abascal
maria.abascal@bbva.com

Global Areas:

Fianacial Scenarios
Sonsoles Castillo
s.castillo@bbva.com

Economic Scenarios
Juan Ruiz
juan.ruiz@bbva.com

Innovation & Processes
Clara Barrabés
clara.barrabes@bbva.com

Market & Client Strategy:
Antonio Pulido
ant.pulido@grupobbva.com

Equity Global
Ana Munera
ana.munera@grupobbva.com

Global Credit
Javier Serna
Javier.Serna@bbvauk.com

Global Interest Rates, FX and Commodities
Luis Enrique Rodríguez
luisen.rodriguez@grupobbva.com

Contact details:

BBVA Research
Paseo Castellana, 81 – 7th floor
28046 Madrid (Spain)
Tel.: +34 91 374 60 00 y 91 537 70 00
Fax: +34 91 374 30 25
bbvaresearch@bbva.com
www.bbvaresearch.com
Legal Deposit: M-31254-2000