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SpainWatch

Economic Research Department

October 2007

Spanish economy: slowdown underway...

...in a more uncertain global environment...

...but with significant supports:

a solid and efficient financial system...

...and a dynamic labour market

Index

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1. In summary

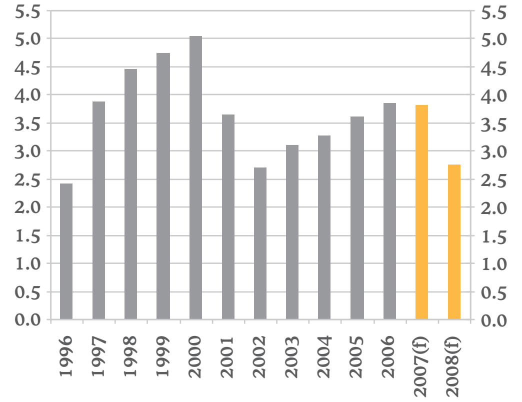
At the beginning of the fourth quarter of 2007 the Spanish economy is in the midst of a slowdown which has gradually increased in intensity since it began in the second quarter of the year. GDP growth reached its peak for the current cycle in the first quarter of 2007, with a y-o-y increase of 4.1%, the sharpest since 4Q00. Following growth of 4.0% in the second quarter, SEE BBVA's forecasts call for GDP growth of 3.8% and 3.4% in the third and fourth quarter, respectively. Additionally, following average growth of 3.8% in 2007, the slowdown is likely to continue until GDP stands at 2.5% at the end of 2008, leaving average 2008 growth at 2.8%.

The slowdown underway in the Spanish economy began prior to the turbulence which started this summer in international financial markets. The intensity and duration of the liquidity crisis are proving to be more severe than initially expected, and the financial shock is lowering the real economy's growth outlook, which we have incorporated into our new forecasts scenario. The impacts of this financial episode on the economy are a reduction in agents' confidence and in their wealth, factors that will dampen their spending impulse. On top of this, we add the less available credit given the uncertainty over the size and distribution of the losses which will ultimately result from a re-evaluation of the price of different credit instruments. This puts the Spanish economy in a vulnerable position given its high levels of domestic and foreign investment (non-financial and financial) which, because they are higher than domestic savings, will mean relying on savings from the rest of the world.

As we have already seen, all of the above leads to Spanish economic growth forecasts of 3.8% and 2.8% in 2007 and 2008, respectively. These growth rates, even allowing for the cut of 0.3 points made to the 2008 forecast, are still relatively high. This is a reflection of the supports the Spanish economy enjoys to help it weather a less dynamic and increasingly uncertain global environment. In particular, it is worth noting that Spain has a very efficient financial system, with a high level of provisions and diversified sources of financing and business. The situation of companies may be considered favourable in general, following sustained ordinary earnings growth and large-scale industrial and geographic diversification. Now is the time to find out whether the foreign investment strategy implemented in recent years has been the right one.

Spanish households also have sufficient strength to overcome the current situation, both from the perspective of their own assets and of the economy's ability to generate income. This will permit them to continue to manage the debt they have taken on, especially mortgages, which will be a focus of attention given the lower availability of credit and lenders' greater sensitivity to risk. In our opinion, positive expectations for income generation are supported by the fact that the Spanish economy will continue to create jobs in 2008. Estimates call for the employment (Spanish Labour Force Survey) in Spain to climb by slightly more than 2% in 2008 (3.4% is the forecast for 2007), with the unemployment rate increasing slightly, to 8.2%. This positive diagnosis is based on the fact that expected activity growth rates are only slightly lower than potential GDP, levels at which the economy has no problem creating jobs. In addition, the BBVA Economic Research Department has estimated incoming and outgoing flows into the labour market, both

Chart 1.1.
Spain: GDP growth rate



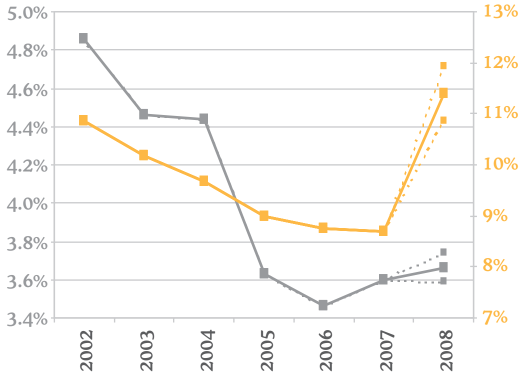
Source: INE and BBVA Economic Research Department

Table 1.1. Spain: Macroeconomic scenario

Growth rate, unless otherwise indicated	2005	2006	2007	2008
HOUSEHOLDS				
Consumption	4.2	3.7	3.2	2.8
(*)			-0.1	-0.1
Employment (LFS)	5.6	4.1	3.4	2.1
(*)			0.0	-1.0
BUSINESSES				
Investment in capital goods	9.2	10.4	10.8	4.5
(*)			0.3	-2.2
Exports	2.6	5.1	4.4	4.0
(*)			-0.7	-0.9
REAL ESTATE SECTOR				
Investment in residences	5.9	6.4	3.5	0.0
(*)			-0.3	-1.0
Housing starts (thous)	786	912	675	550
(*)			-25	-100
GDP	3.6	3.9	3.8	2.8
(*)			0.0	-0.3

Source: INE, Housing Ministry and BBVA Economic Research Department
(*) Difference from earlier forecasts (Jul-07)

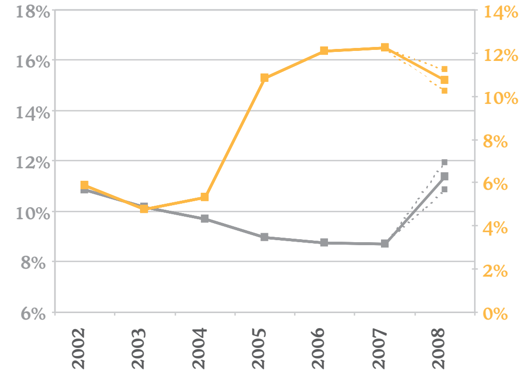
Chart 1.2.
Probability of becoming unemployed for those in work in the previous year



■ CONSTRUCTION, right
■ TOTAL, left

Source: BBVA Economic Research Department

Chart 1.3.
Probability of becoming unemployed and changing sector for those employed in construction in the previous year



■ Transition to another industry, right
■ Transition to unemployment, left.

Source: BBVA Economic Research Department

between employment and unemployment, and between employment and inactivity, as well as changes of sector as in the case of construction. The study shows that an employed person is significantly less likely to lose his job than he is to change industry, both in the economy as a whole and in construction. That is to say, not all working people who lose their jobs as a consequence of the slowdown in the economy will become unemployed; rather, a significant percentage of them will change industry. In the scenario expected for 2007 and 2008, the effect of the economic slowdown on job creation should be contained, both of the high inter-sector mobility rate, and because of improvements in the characteristics of the labour force in recent years (for example, education) which enhance their versatility.

While it is true that the current global scenario is less solid and more uncertain, especially with regard to the availability of liquidity, the Spanish economy has specific strengths and supports which lead us to expect a slowdown which while somewhat more intense than in other areas, will be contained in scope and likely to unfold in an orderly manner.

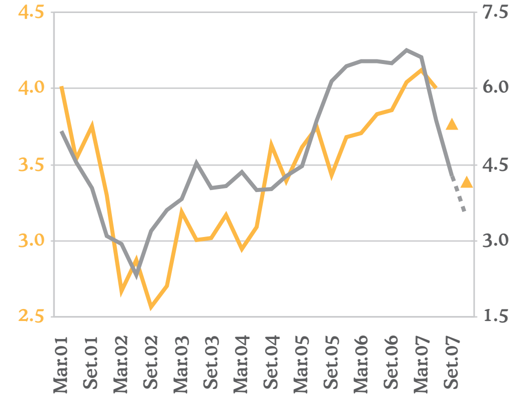
2. The Spanish economic slowdown intensifies

2007: cyclical turning point in the first half prompted by trends within the Spanish economy…

Based on available information, we conclude that the slowdown in the Spanish economy has intensified. According to our estimates, GDP growth in the third quarter which has just ended would stand at 3.8%, 0.2 points less than in the second quarter, which is in line with the forecasts put forward in our last *Situación España* report. There are no factors which lead us to expect significant changes in this trend for the rest of the year, which would bring fourth quarter GDP to 3.4% y-o-y. GDP growth for 2007 is now slated at 3.8%, scarcely one basis point less than average growth last year, while it is likely to slow more notably in 2008, to 2.8%.

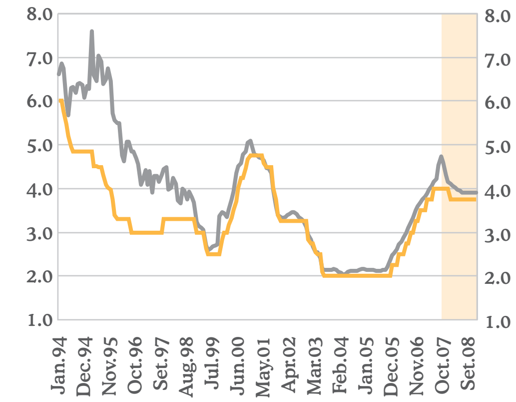
The most recent economic figures, from the second quarter of 2007, confirmed the start of a slowdown in the Spanish economy, continuing a trend toward more balanced growth in domestic and foreign demand. The GDP slowdown, of one basis point to 4.0% y-o-y, was fuelled by cooling domestic demand, since the contribution from foreign demand remained at -0.9pp. The downturn in domestic spending was especially pronounced in household spending on consumption goods and housing. Nevertheless, company investment in equipment, underpinned by sustained corporate earnings and expectations for foreign demand, maintained its pace with historically high growth rates of 13%, which offset the slowdown in investment in construction. Meanwhile, both exports and imports posted higher growth rates compared with the first quarter, with exports growing at a faster pace, but falling short of forecasts. The answer to this may be found in the international environment, since growth in the quarter throughout the euro zone (2.5%) was likewise lower than expected. The beginning of a downward trend is understandable given tighter financing conditions following a period of exceptionally low interest rates (see chart 2.2). The Spanish economy

Chart 2.1.
Spain: GDP and BBVA Synthetic Activity Indicator
(y-o-y growth %)



Source: INE and BBVA Economic Research Department

Chart 2.2.
Interest rates in the euro zone
(monthly average)



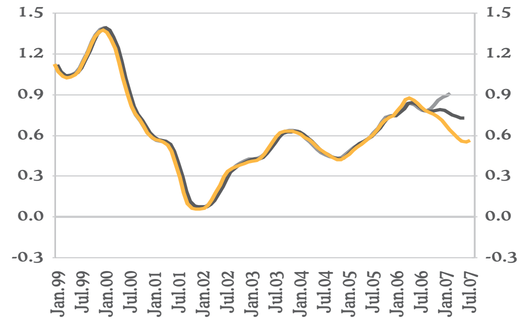
Source: BBVA Economic Research Department

Table 2.1. Spain. Base GDP 2000

Y-o-y rate Q	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	2005	2006	2007	2008
Household consumption	4.1	3.5	3.7	3.7	3.4	3.3	3.2	3.0	3.0	2.9	2.7	2.5	4.2	3.7	3.2	2.8
Government consumption	4.9	4.0	4.8	5.7	5.7	5.5	5.2	5.2	5.5	5.0	5.0	5.0	5.5	4.8	5.4	5.1
GFCF	7.8	5.7	6.8	7.0	6.6	6.6	5.6	4.2	3.5	3.0	2.7	2.2	6.9	6.8	5.8	2.9
Capital Goods and Others	8.9	6.0	8.3	9.5	9.1	9.8	7.7	5.6	4.8	4.0	3.7	3.0	8.1	8.2	8.0	3.9
Capital Goods	10.0	7.4	11.0	13.0	13.3	13.0	10.1	6.9	5.7	4.6	4.3	3.2	9.2	10.4	10.8	4.5
Other Products	7.1	3.8	3.7	3.8	2.3	4.3	3.5	3.2	3.0	2.9	2.7	2.6	6.4	4.6	3.3	2.8
Construction	7.1	5.5	5.9	5.5	5.2	4.6	3.9	3.1	2.4	2.1	1.8	1.5	6.1	6.0	4.2	1.9
Housing	7.8	6.2	6.5	5.3	4.0	3.7	3.5	3.0	1.0	0.3	-0.4	-1.0	5.9	6.4	3.5	0.0
Other	6.2	4.9	5.4	5.7	6.4	5.7	4.2	3.2	3.7	3.7	3.7	3.7	6.3	5.5	4.9	3.7
Chg in inventories (*)	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.1	0.0	0.0
Domestic demand (*)	5.5	4.5	5.1	5.3	5.0	4.9	4.6	4.1	3.9	3.6	3.4	3.2	5.3	5.1	4.6	3.5
Exports	5.7	4.9	4.2	5.7	3.7	4.8	4.5	4.4	3.9	3.8	4.0	4.2	2.6	5.1	4.4	4.0
Goods	5.2	3.9	4.5	4.8	3.6	4.8	4.3	4.5	4.0	3.8	4.1	4.4	1.1	4.6	4.3	4.1
Imports	10.6	6.1	7.5	8.9	5.9	6.7	5.5	5.0	5.1	4.9	4.8	4.7	7.7	8.3	5.8	4.9
Goods	10.4	4.7	8.0	9.1	5.6	6.3	5.6	5.3	5.0	4.7	4.6	4.5	7.1	8.0	5.7	4.7
Trade balance (*)	-1.8	-0.7	-1.2	-1.3	-0.9	-0.9	-0.8	-0.7	-0.9	-0.8	-0.7	-0.6	-1.7	-1.3	-0.8	-0.8
GDP avg	3.7	3.8	3.9	4.0	4.1	4.0	3.8	3.4	3.0	2.8	2.7	2.5	3.6	3.9	3.8	2.8
Total employment. National Economic Accounting													3.2	3.2	2.9	1.5
Pro-forma. Households																
Real Disposable Income, y-o-y													3.2	3.1	4.0	2.3
Nominal Disposable Income, y-o-y													6.5	6.5	6.5	4.5
Savings Rate (income)													10.6	10.1	10.8	10.4

(*) contributions to growth
Source: INE and BBVA forecasts

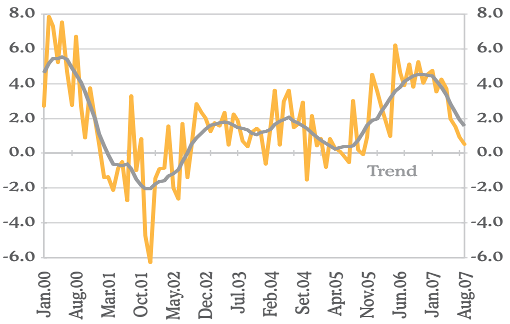
Chart 2.3.
BBVA Activity Indicator
(trend)



Mar-07
Jun-07
Set-07

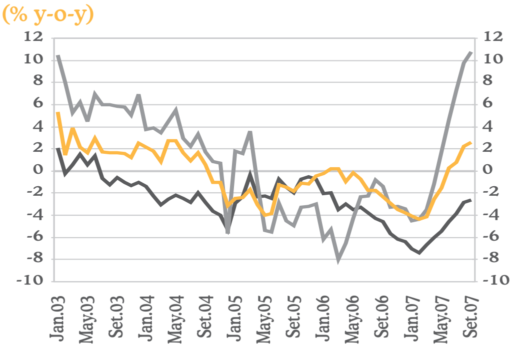
Source: BBVA Economic Research Department

Chart 2.4.
Spain: Industrial production (wda)
(% y-o-y)



Source: INE and BBVA Economic Research Department

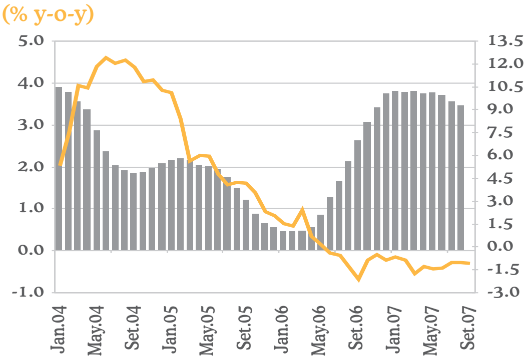
Chart 2.5.
Registered jobless by sector
(% y-o-y)



Total
Manufacturing
Construction

Source: INEM and BBVA Economic Research Department

Chart 2.6.
Spain: expenditure indicators for 3Q07
(% y-o-y)



Retail sales, calendar corrected, trend (left)
New car registrations, trend (right)

Source: BBVA Economic Research Department

thus enjoyed a highly dynamic first half, but which was tipping into a downturn that was expected to continue in 2008, even before the downward revision of expectations for the global outlook were announced following the start of the current episode of financial turbulence.

…and a downturn in the second half of 2007, aggravated by a less dynamic global economy

The economic data received to date is not yet complete enough to allow us to define the third quarter, a period which in part preceded the full flowering of the liquidity crisis stemming from financial turbulence. However, data trends seen so far point to a slowing pace of economic activity in the second half of 2007, as illustrated by the BBVA Activity Indicator, which includes information through to September. The cooling dynamism of the Spanish economy has intensified as a result of the credit crisis episode, with increased vulnerability among households and companies, which need to take on more financial liabilities in order to finance their investments, both financial and real.

In short, the Spanish economy is likely to continue its downturn in line with BBVA Research Economic Department forecasts, especially in the property market. Indicators show that real estate for sale has started to show unmistakable signs of a slowdown, and that housing demand will continue to drop off (see Box attached). It is also worth noting that up to now, the manufacturing sector has not shown itself to be sufficiently buoyant to replace construction as the driver of the economy. Although in the second quarter it reported the sharpest growth in gross added value (excluding agriculture), the manufacturing is not immune to the general downturn. The most recent performance indicators reflect a continuation of this process, as may be seen in the performance of the industry's registered jobless figures or the industrial output index.

The performance of labour market indicators is perhaps one of the clearest signs of the steady cooling in the Spanish economy. Though 3Q07 employment data has yet to be released, figures for registered jobless and Social Security claims as of September clearly point to slowing job creation, in line with an economic downturn. The increase in Social Security registrants in the third quarter was 2.7%, 0.60pp less than the previous quarter. Meanwhile, registered jobless data reflected the deterioration seen since the beginning of the year, and in part of the second quarter and all of the third quarter it continued to show positive y-o-y growth, which has gradually accelerated. As the chart shows, the sharp deterioration in construction has not been offset by the unemployment trend in the industry, where the positive growth rate has been steadily declining.

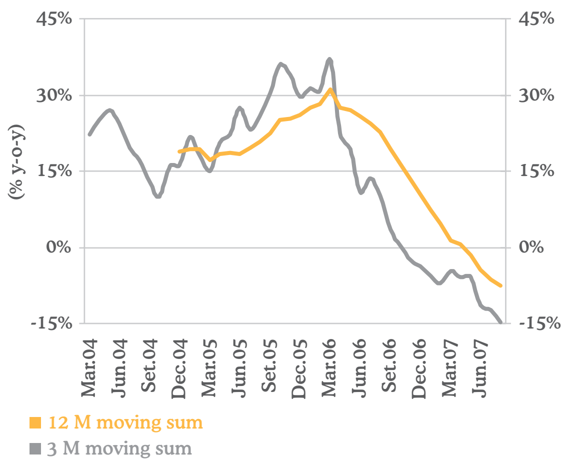
The downturn trend also applies to expenditure indicators. These have oscillated between moderation and retreat, as evidenced by automobile registrations and retail sales. Meanwhile, information on the export sector is still scarce, but appears to indicate a more dynamic 3Q trend for exports and imports, as suggested by customs data (to July) and large companies' export and import figures (to August). In any event, signals released by these indicators still rule out the possibility that any change in export sector will be able to offset the obvious drop in domestic demand.

The adjustment underway in the property market gains in intensity, in line with expectations

The slowdown in the property market in the past three years gathered pace this year.

Residential demand has continued to suffer on the progressive deterioration of affordability ratios, reflected in the decrease in housing transactions and in the demand for housing loans. Mortgage rates have climbed 2pp and in August stood at 5.43%, a level not seen since late 2001, which increased the net financial burden for households to acquire a home to 26% of average wages.

New business, loans for house purchaising

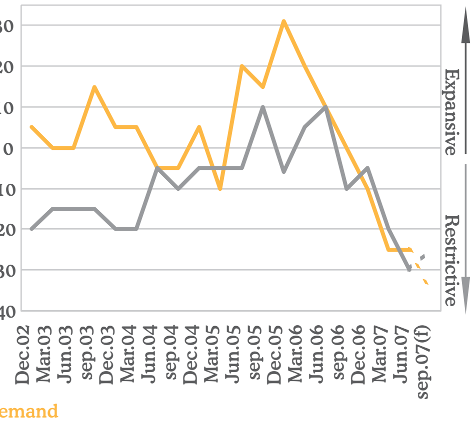


Source: Bank of Spain

Although this figure is unlikely to further deteriorate in the next two years, given that interest rates have reached their peak and that housing prices are likely to continue to fall, other factors should sustain current demand trends. For one thing, household income is expected to increase at a slower pace in coming years as a consequence of the Spanish economy's downturn. Secondly, as a result of this change in economic growth trends and of the revaluing of credit risk which is a consequence of the liquidity crisis, banks are tightening their lending conditions. As reflected by the Bank of Spain's Bank Lending Survey and the more recent survey published by the European Central Bank, lenders have begun to demand greater guarantees when granting loans for house purchases. This will partly offset improvements in affordability due to interest rates, which will be seen in coming months.

Bank Lending Survey

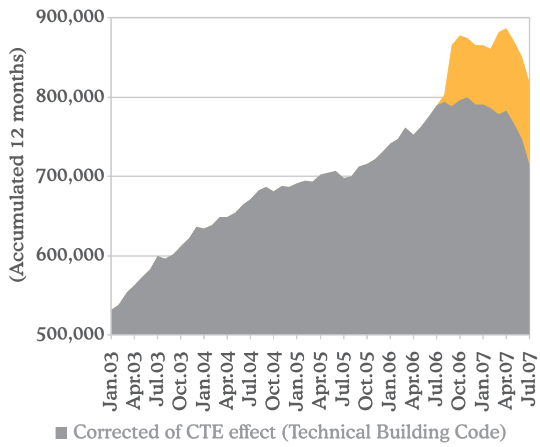
Home loans for house purchaising



Source: Bank of Spain

On the supply side, in recent months the drop in applications for building permits has intensified. In the first seven months of the year, the number of permits dropped 10% from a year earlier. In addition, this decrease occurred across the board, with a drop seen in three out of every four Spanish provinces, and was more pronounced in the biggest Spanish cities. This slowdown is expected to gain pace during the rest of the year and to continue into 2008, since, in addition to a weaker demand, developers face more restrictive financing conditions. Because of these factors, building permits for new homes are expected to total 675,000 in 2007, significantly below the 911,000 permits issued a year earlier, and are unlikely to exceed 550,000 in 2008.

New housing building permits



Source: Housing Ministry and BBVA

Nevertheless, this slowdown in activity was necessary for the orderly adjustment in the market to continue, given that housing starts showed a relative delay with regard to the slowdown seen in demand.

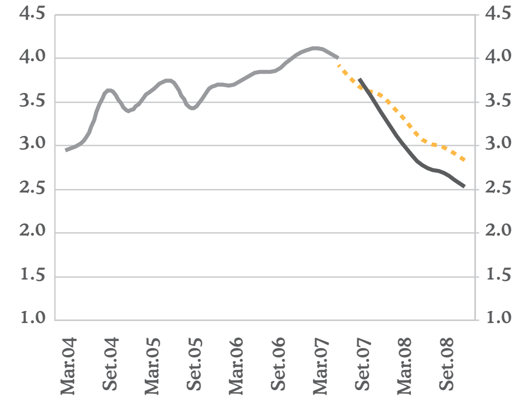
For next year, in a context of lower growth in household income, but with net job creation and an environment marked by a sharper slowdown in construction activity, it is likely that prices will continue their orderly downturn, after ending the year with growth in line with inflation, and will show further deceleration, being average growth 1.4%.

In this short-term context, the factors that are making this slowdown orderly remain in place, given that households' payment ability is not expected to deteriorate, and that supports still exist in the medium term. Therefore, the adjustment will not be permanent in light of the industry's long-term fundamentals, particularly potential demand for homes from residents and non-residents. The average number of new homes in the past two years was nearly 500,000 pa, two times the number registered at the beginning of the decade. This is a clear indicator of the potential demand for housing in Spain, to which we must add the second home segment for residents and the holiday tourist home segment for non-residents. The demographic outlook for Spain and Europe calls point at a sustained increase in the overall number of resident households in Spain (native and non-native) and an increase in Europe's elderly population, who are the main buyers of holiday homes.

Chart 2.7.

Spain: GDP growth

(% yoy)



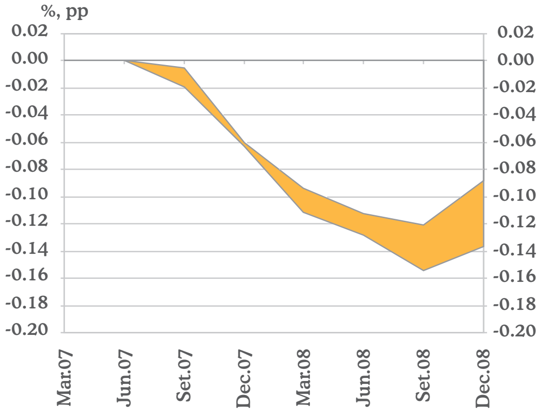
■ Forecast Set-07

■ Forecast Jul-07

Source: INE and BBVA Economic Research Department

Chart 2.8.

Spain, impact on growth of the change in the outlook for GDP and interest rates in the euro zone



Source: BBVA Economic Research Department

And in 2008? The economic downturn will continue in a more bearish global environment, with lower interest rates but tighter availability of credit

As we can see from the attached chart, BBVA's current growth forecasts for the Spanish economy are lower than estimates from only a few months ago. The episode of financial turbulence which started last summer, which is more intense and has lasted longer than initially expected, has lowered global growth expectations. As a result, the cooling trend seen in the Spanish economy through to August has been aggravated by changes in the global outlook.

The new global outlook includes a 0.30 pp reduction in the forecast for Spanish economic growth in 2008, from 3.1% to 2.8%. A significant factor to be taken into consideration is the lower lending availability as a result of a re-evaluation of risk. If this factor had not been accounted for, growth forecasts would have been lowered less, as seen in chart 2.8. It reflects the result of simulating[1] the impact on Spanish growth of lowering forecasts for European growth and interest rates between July and September this year, but does not account for the additional element of the degree of liquidity restriction in the financial markets. In the model, the effects of interest rate cuts are offset by the international slowdown, so that the net effect is a reduction that is less than half that generated if we include liquidity restrictions. On the other hand, the final revision is contained due to recognising specific strengths in our economy which allow it to overcome the new environment. These consist of supports, which are analysed in the third chapter of this report, linked to the financial system's efficiency and strength and to households' sustained capacity for income generation in an economy which will continue to create jobs.

[1] For this, we use a dynamic stochastic equilibrium model (DSGE). The chart represents the confidence range for the estimates.

The lowered forecast for 2008 Spanish economic growth is based on a sharper slowdown in household expenditure, especially in housing but also in consumer goods, and on lower expected growth in exports and capital goods investment. Households will continue to spend less on consumer goods, with this effect likely to be more severe than expected. Two factors lie behind the decision to lower forecasts. For one thing, consumer confidence, which has been deteriorating since the beginning of the year, is likely to suffer further in coming months and to pair its intensity with industrial confidence, which has sharply dropped since the second quarter. Secondly, the worse performance by equities, along with lower home price increases (definitively, a lower wealth effect) will put additional pressure on demand growth. Altogether, the impact would be of only a basis point compared with previous forecasts, given that the economic situation of Spanish families enjoys significant supports. The job creation expected in coming years, as we will see in the third section, should ensure strong growth in earnings, though it will be more moderate than in previous years. Meanwhile, household indebtedness has gradually increased, reaching 127% of disposable income in the first quarter of 2007, families have used debt to fund an increase in wealth helping to maintain healthy assets, and, in fact, financial debt compared to the net wealth of Spanish families is among the lowest of any country in the region, as reflected in the attached chart.

Slower global economic growth directly affects the sale abroad of Spanish goods and services and the corporate investment cycle, which had benefited noticeably from the strong international economy. The current uncertainty has begun to hurt confidence, and has exposed a considerable weight on capital goods investment indicators, for example, industrial production of capital goods or capital goods imports. Forecasts call for a second half of 2007 which is far from the first half's dynamism, which will give way to an additional decline in 2008, ending the year with average growth that is less than half that seen in 2007, and ending the intense capitalisation process the Spanish economy has undergone since 2005. As for growth in exports, they have also been revised lower by 0.70 points in 2007 (to 4.4%) and by almost one point for 2008 (to 4.0%). A slower EU growth outlook following a disappointing second quarter has been crucial to lowering these forecasts.

Finally, it is worth noting that liquidity tensions in financial markets raise the possibility that, in addition to the slowdown in spending on residential property, some downturn could also be seen in the supply of homes, linked to the re-evaluation of investor risk preferences which would at the same time restrict access to credit. This would mean the gradual adjustment underway in the property market would intensify, as reflected in the forecast table for residential spending and number of housing starts.

Table 2.2. Spain: Macroeconomic scenario

Growth rate, unless otherwise indicated	2005	2006	2007	2008
HOUSEHOLDS				
Consumption	4.2	3.7	3.2	2.8
(*)			-0.1	-0.1
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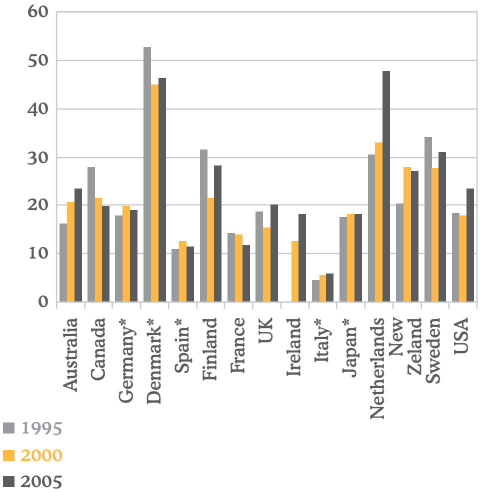
(*)			0.0	-1.0
BUSINESSES				
Investment in capital goods	9.2	10.4	10.8	4.5
(*)			0.3	-2.2
Exports	2.6	5.1	4.4	4.0
(*)			-0.7	-0.9
REAL ESTATE SECTOR				
Investment in residences	5.9	6.4	3.5	0.0
(*)			-0.3	-1.0
Housing starts (thous)	786	912	675	550
(*)			-25	-100
GDP	3.6	3.9	3.8	2.8
(*)			0.0	-0.3

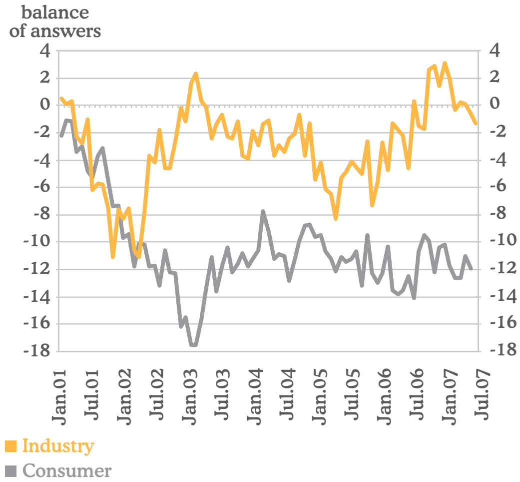
Source: INE, Housing Ministry and BBVA Economic Research Department
(*) Difference from earlier forecasts (Jul-07)

Chart 2.9.
Household indebtedness
(Financial debts over net wealth)



*most recent data 2004
Source: BBVA Economic Research Department

Chart 2.10.
Spain: industrial and consumer confidence



Source: European Commission and BBVA Economic Research Department

The persistence of financial turbulence and liquidity problems diminish the global economy's strength

Since the end of July, financial markets have seen a sharp rebound in risk aversion, with a flight to quality on the part of investors and widening corporate credit spreads and emerging sovereign securities, as well as a severe decline in yields, shortage of commercial paper and decreasing maturities. The lack of confidence among agents regarding the quality of assets has generated tensions in the main inter-bank markets, and raised preferences for liquidity. Central banks have resorted to liquidity injections at times that are not programmed as a method for curbing this situation. The Fed also cut rates by 50 basis points.

Although it is too early to see evidence of the effects of this liquidity crisis on real economic activity, we would note that, as of the date of publication of this report, the measures taken by central banks have not prevented liquidity shocks from persisting longer than expected, which has increased banks' preference for liquidity.

The channels via which a liquidity or credit problem comes to affect the real economy may be clearly identified: first, a cooling equity market and home prices will generate a less intense wealth effect; second, it appears reasonable to believe that agents will have bleaker expectations, which will put a damper on demand; third and finally, a more appropriate valuation of assumed risk on the part of banks will lead to lower availability of credit than that seen until now.

Overall, expectations are that the global economy will grow less than expected until now. Nevertheless, the scope of this reduction in growth expectations is limited given the support provided by the generalised decrease in interest rate expectations. The US economy is expected to grow 1.9% this year and 2.2% next year. In Europe, the forecast cut for 2008 growth, from 2.4% to 2.0%, is the result not only of financial turbulence, but also of the negative surprise derived from GDP forecasts in the first half of the year.

In the group of emerging economies, the changes are quite limited. Latin America, which now enjoys better macroeconomic supports than in previous episodes of financial turbulence, has seen its growth forecast lowered by only 0.20 points in 2008. Meanwhile, China's economy will continue to expand rapidly. Thus, even though global growth will slow, it will continue to grow at more than 4.0%.

GDP growth forecasts

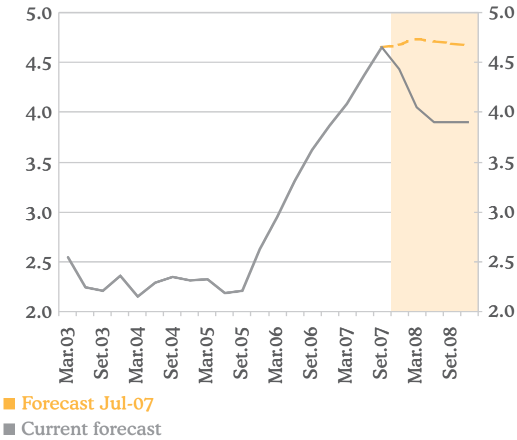
	Current (%)		Change (%)	
	2007	2008	2007	2008
US	1.9	2.2	-0.4	-0.6
EU	2.5	2.0	-0.2	-0.4
Spain	3.8	2.8	0.0	-0.3
Latam	5.1	4.6	0.0	-0.2
Latam ex-Mexico	5.7	5.0	-0.1	-0.1
Mexico	3.0	3.4	-0.2	-0.5
China	10.9	9.9	-0.1	-0.3
World	4.6	4.4	-0.2	-0.3

Source: BBVA Economic Research Department

Within this scenario there is also a change in expectations for monetary policy among the leading central banks. Following the Fed's rate cut on 18 September, we can rule out new rate cuts before the end of the year, including at the meeting on 31 October. For its part, the ECB in September put a stop to the cycle of interest rate rises at 4%. In a scenario of sharp euro appreciation, lowered growth forecasts and downward risks, forecasts point to a process of official rate easing, which could even start at the January meeting. Thus, forecasts for rates, for example the 1Y Euribor shown in the chart, are lower than previous forecasts. This is a support factor for economies such as Spain's, which are in a cyclical slowdown with relatively high levels of financial indebtedness.

EU: 12-month Euribor

(quarterly average)



Source: BBVA Economic Research Department

3. A solid and efficient financial system and a still dynamic labour market are key supports for the Spanish economy.

The solvent and efficient Spanish financial system is a key strength against financial turbulences

The current financial uncertainty is placing all international banking systems in a vulnerable position. However, the Spanish financial system enjoys considerable strengths, compared to its neighbour countries, which it is important to emphasise.

First, the Spanish financial system can claim to be the most efficient in Europe. According to the standard measure of efficiency, the ratio of operating costs to operating income, the Spanish financial system achieves 48%, compared to an average of 60% across the European Union. This efficiency is partly the result of a major drive to reduce costs. Although Spanish banks' branch and ATM networks tend to be extensive and therefore expensive, the industry has implemented some ambitious cost-cutting programmes, frequently involving the introduction of new technology. The system's efficiency also owes much to the still reasonable levels of profitability generated on banking business, despite stiffer competition in financial markets and narrowing spreads that have squeezed margins.

Second, as is well known, the Spanish banking system is highly diversified. Banks follow a universal banking model, offering a broad range of products and services to companies and households. This makes for more diverse sources of profit generation, which makes results more stable. But Spanish banks are also diversified geographically, with the biggest groups having a strong business presence in other markets, particularly emerging markets, which have been less hard hit by the recent crisis. In 2006, Spanish credit institutions and consolidated groups' held 22% of their balance sheets in foreign assets, 35% of these in Latin America. On the liabilities side, the sources of finance for Spanish banks are very solid. Deposits cover 77% of the system's lending.

Third, the Spanish banking system remains solvent, having been able to offset the sharp rise in assets with the maintenance of adequate capital. In addition, the Bank of Spain has pursued a particularly rigorous policy on solvency issues, and the industry enjoys a solid level of provisions, with current reserves equivalent to 273% of non performing loans in 2006.

Exposure to the subprime end of the US mortgage market, either directly or through structured products that incorporate these risks, is virtually non-existent. A CNMV[1] survey showed minimal exposure to the US subprime market by some funds and sicavs[2] of Spanish financial institutions. Spanish banks, unlike the industries of other European countries, have no major concentration on conduits, investment vehicles that raise finance by issuing short-term commercial paper and invest long-term in more risky products, linked in some cases to the US subprime market.

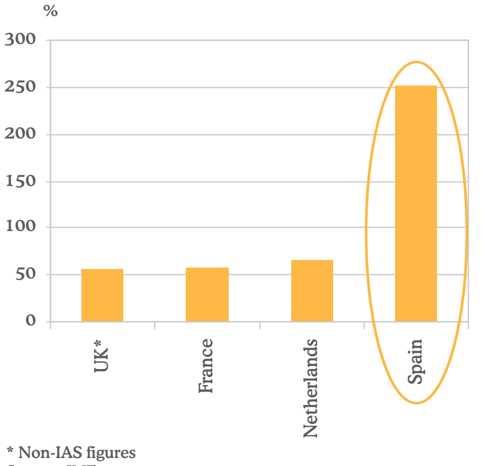
[1] Securities Market Commission
[2] Close-end investment fund

Table 3.1. Spanish and European banks

Dec-06	Solvency ratio	ROE	ROA	Capital ratio
EU*	60.45	16.1	0.63	11.38
Spain	48.30	19.60	1.44	11.90

* 2005
Source: ECB and Bank of Spain

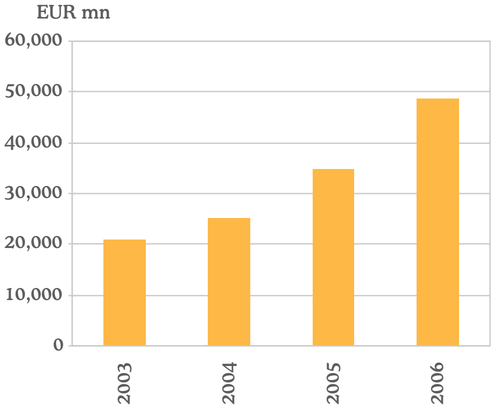
Chart 3.1.
Provision / Non Performing Loans, 2005



* Non-IAS figures
Source: IMF

Chart 3.2.

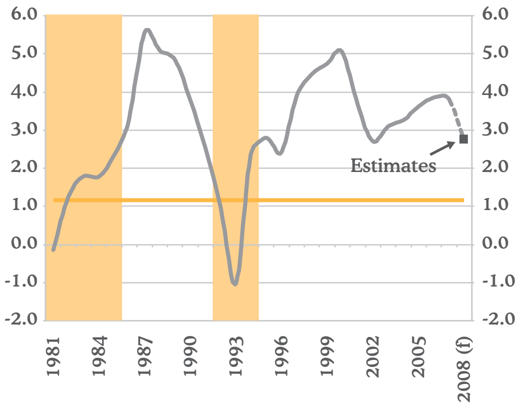
Spain: mortgage-backed securitisation issues



Source: Bank of Spain Report on Banking Supervision, 2006

Chart 3.3.

Spain: economic growth and job destruction

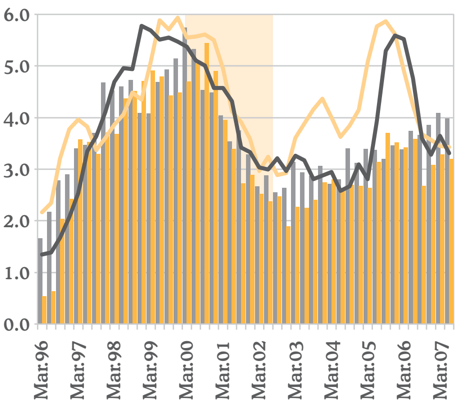


- Average growth in periods of job destruction
- GDP growth
- Years when the Spanish economy destroyed jobs.

Source: INE (Spanish National Statistics) and BBVA Economic Research Department

Chart 3.4.

Employment indicators and GDP



- GDP
- Employment (Labour force survey)
- Full-time equivalent employment (quarterly national accounts)
- Social security subscribers (y-o-y, quarterly average)

Source: INE, INEM (Spanish National Employment Institute) and BBVA Economic Research Department

Spanish credit portfolio also show a high in credit quality. Subprime lending as defined in the US does not exist in Spain. Products offering low initial interest rates that reset or grace periods play only a marginal role in the Spanish market. Default rates per product are actually lower in Spain than in the US, totalling around 1% of the total mortgage portfolio.

The institutions most likely to grant riskier products, the *Establecimientos Financieros de Crédito* (Credit Institutions) are not major players in the Spanish market, accounting for 2.2% of outstanding loans to finance home purchases.

Securitisation techniques are relatively recent in the Spanish economy. In any case, they do not incentivate banks to ease their lending standards. In the first place, the volume of securitised debt taken off banks' balance sheets (as the banks no longer make gains or losses on the loans) is just 5% of total lending in Spain, compared to 60% in the US. In the second place, the sophistication of the mortgage securitisation industry in other countries such as the US creates incentives to grant high risk mortgage loans, as even the riskiest tranches of the issue can be easily placed on the market. However, in Spain, institutions remain exposed to the first-loss tranche of their issues and it is therefore important that they keep the risk of their portfolios within bounds.

Employment as a support. The Spanish economy will continue to create jobs allowing households to preserve their income and meet their financial commitments.

> The Spanish economy will continue to create jobs. The scale of the forecast slowdown is modest in historical terms and workers are highly mobile between sectors. Also, the upskilling of the Spanish workforce means employees are less likely to become unemployed.

Clearly, the economic slowdown under way will reduce the pace of job growth, a trend already apparent in published data. That said, in our view, the dip in the labour market will not be dramatic. There will be no net destruction of employment in 2008 but rather a near 400,000 increase in jobs as measured by the Labour Force Survey (EPA for its initials in Spanish), 250,000 fewer that those expected to be created in 2007. We base our analysis on three factors, which are summarised below.

By the standards of the Spanish economy, we are in a scenario of modest slowdown.

Activity is set to slow, but Spain should avoid recession. Comparing the current economic position with previous slowdown phases (1981-1985 and 1992-1994), we find that the 2.8% growth projected for 2008 is substantially higher than the average during these phases (1.2%).

Room for manoeuvre on fiscal policy

The 2008 budget projections maintain Spain's commitment to fiscal stability and are designed to meet the target set in June by the Spanish parliament for 2008-2010: a 1.15% of GDP surplus across all Government bodies over the three years. Central government and its autonomous agencies are supposed to achieve a surplus of 0.3% of GDP with a further 0.6% coming from the social security system. The regional autonomous communities have a target surplus of 0.25% and local authorities must balance their budgets. The stability target does not, however, take account of the additional deficit allowed to the communities to fund productive investment[1] and in practice this means any surplus is will be lower than the 1.15% laid down by parliament.

Table 1
General Government Budget Balance
As percentage of GDP

	2008	2009	2010
Central government (incl. autonomous agencies)	0.30	0.30	0.30
Social security	0.60	0.60	0.60
Autonomous communities (*)	0.25	0.25	0.25
Local authorities	0.00	0.00	0.00
Total General Government	1.15	1.15	1.15

(*) Excludes additional deficit for investment.
Source: Economy and Taxation Ministry

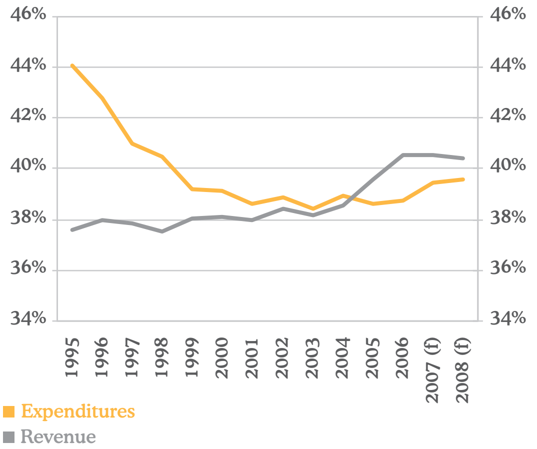
The surplus targeted by the government is relatively unambitious given the scenario of 3.3% GDP growth assumed in preparing the budget, although this growth figure is looking rather optimistic given the economic environment that followed the recent financial turbulence and still persists.

In an economic climate such as that forecast by the BBVA Economics Research Department, it is more than likely that revenue growth will slow, mainly because household incomes will be held back by dwindling growth in employment, corporate earnings and consumer spending. Meanwhile, public spending will be pressured higher by an uptick in unemployment and increased commitments to social welfare programmes[2].

In light of the above and given that the cap on government spending for 2008 was set in June, along with the target of balancing the budget across the whole public sector, the introduction of these new measures has merely brought a reorganisation of priorities for 2008, with social spending increased at the expense of other policies. That said, these measures will eat into future spending, constraining plans for the next few years.

[1] Article 3.1 of Law 5/2001, supplementing the Fiscal Stability Law allows autonomous communities to incur an additional deficit up to a maximum of 0.25% of their regional GDP to fund investment programmes with a productive purpose.
[2] Based on government forecasts, the latest measures to be announced will cost a total of EUR2.7bn (0.2% of GDP).

Chart 1: Public revenue and expenditure
(as percentage of GDP)



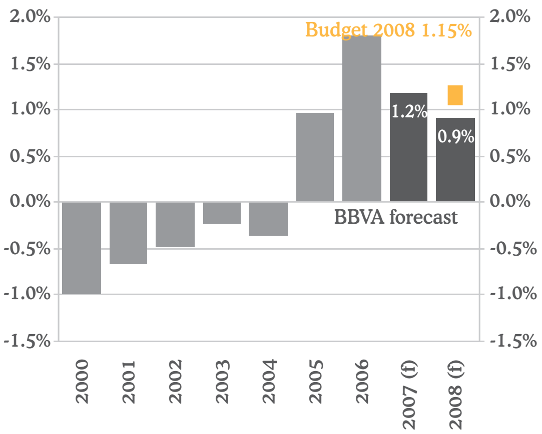
Source: BBVA Economic Research Department

Under the economic scenario projected by BBVA economic research and factoring in recently announced spending measures, we expect the public sector surplus to narrow in 2007 and 2008 to 1.2% and 0.9% of GDP, respectively. In the longer term, the budget should move towards balance. These figures allow for a more than 6 pp reduction in debt, to less than 35% of GDP by the end of 2008.

This healthy outlook for the public accounts means Spain will go into the coming economic slowdown with considerable room for manoeuvre on fiscal policy. Its public sector accounts and national debt are in far better shape than the average for EU countries (estimated deficit for 2007[3] of 1%, and debt at 66.9% of GDP) and well within the limits set by the Protocol on Excessive Deficit. In these circumstances, assuming a scenario without structural changes, the country can support an annual deficit of around 1.5% without pushing the national

[3] Based on European Commission forecasts, May 2007 (AMECO database).

Chart 2: General Government Budget Balance (as percentage of GDP)



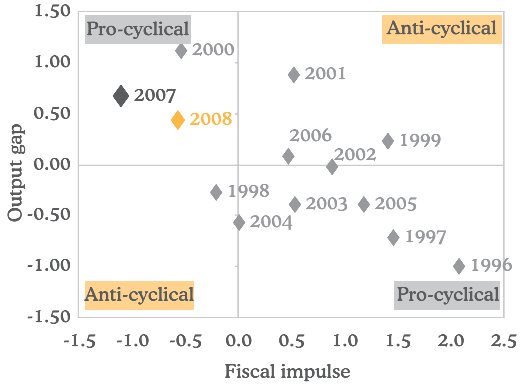
Source: BBVA Economic Research Department

debt as a percentage of GDP beyond the level projected for 2007.

While there is some flexibility, fiscal policy should nonetheless seek to ensure government accounts are sustainable over the long term. Spain made a good start by making policy neutral with regard to the economic cycle. However, the group of measures announced recently (tax cuts, and especially social spending commitments), have tended to undermine the neutrality of fiscal policy. Using BBVA Economic Research Department's growth estimates, the output gap and budget balance for 2007 and 2008 should see an expansive fiscal impulse[4], of -1.1pp and -0.06pp, respectively.

It is therefore worth asking whether, with the same potential growth, in practice, budget planners should not be a little more ambitious in achieving higher surpluses. This would give Spain more room for manoeuvre in fiscal policy to face

Chart 3: Fiscal policy and the economic cycle

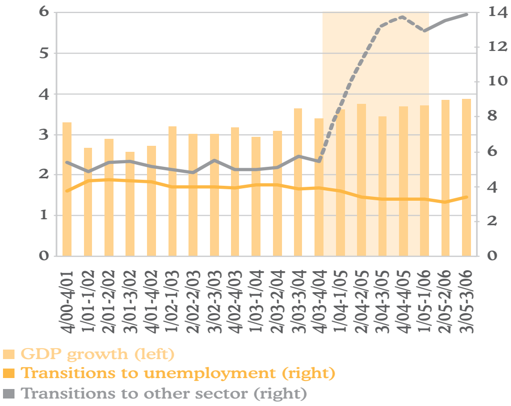


Source: BBVA Economic Research Department

pressure on public spending stemming not only from a sharper economic slowdown, but also from future ageing of the country's population.

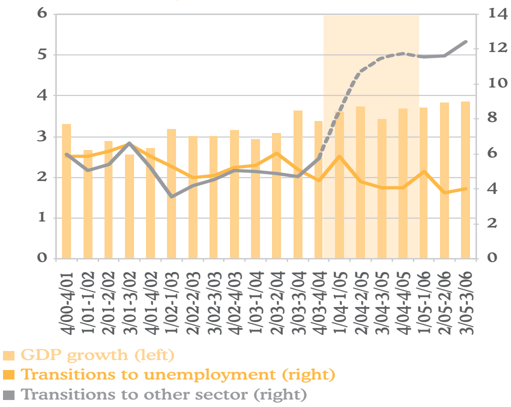
[4] Fiscal impulse is measured as the year-on-year change in the structural balance of the public sector accounts.

Chart 3.5.
Spain: Probability of becoming unemployed or changing sector in four quarters' time
(for those employed in first quarter)



Note: Movements before and after the shaded area are not directly comparable due to the changes made to the EPA in 2005 (see footnote 2).
Source: INE and BBVA Economic Research Department

Chart 3.6.
Construction: Probability of becoming unemployed or changing sector in four quarters' time
(for those employed in first quarter)



Note: Movements before and after the shaded area are not directly comparable due to the changes made to the EPA in 2005 (see footnote 2).
Source: INE and BBVA Economic Research Department

Looking more closely at the last economic slowdown, which ran from 2Q00 to 3Q02, we find that employment as measured by the Labour Force Survey grew consistently faster than GDP. This suggests, given the likely trend in the Spanish economy over the next year, that job destruction is highly unlikely.

Employees that stop working in a particular sector and job do not necessarily become unemployed. There is high inter-sector mobility.

Not all workers who lose their jobs as a result of the slowdown in activity will become unemployed. Many will move on to another company or another sector. When the fallback in growth has an unequal impact on the different sectors of the economy, as is the case now, inter-sector mobility can palliate the negative consequences for employment.

Chart 3.5 shows the likelihood that workers currently in employment will have become unemployed or have moved into a different sector in four quarters' time, based on micro data from Labour Force Survey flows[1]. The y-o-y chance of becoming unemployed in each quarter is positive and fluctuates between 3% and 5% over the period analysed (4Q00 - 2Q07). In other words, out of every 100 workers in employment in the starting quarter, between 3 and 5 will be unemployed a year later. Also, as would be expected, the trend is slightly counter-cyclical and seems to show some inertia, with a lagged reaction to changes in

[1] Unlike the anonymous quarterly EPA data, the flows files include a key that allows you to track registrations (individuals) in the EPA results through different quarters. Although the EPA flows data allows us to calculate the likelihood of an individual changing employment status (from employed to unemployed or vice versa or from employment to inactive, etc.), it should be remembered that the EPA is a rotating survey, i.e., each individual will only remain in the survey for six quarters or less. Therefore, no individual can undergo more than five quarterly changes or two annual changes while remaining in the survey.

economic trend. This is one factor that suggests the danger of becoming unemployed will not increase as soon as the economic cycle passes its peak and, therefore, will not be particularly high in 2008.

But the key information in Chart 3.5 is that workers may change their sector of activity, that they are significantly more likely to do so than to become unemployed, and that the likelihood of this occurring follows no clear cyclical pattern: the proportion of workers moving into new sectors has barely varied over the last decade[2]. This suggests that workers are versatile enough to have a good chance of being able to change professions. Construction is the sector where employment is likely to be hardest hit by the economic slowdown, and so the flexibility of construction workers is deserving of particular attention. Chart 3.6 shows that, since 1Q05 - when the EPA changed its methodology and design - the likelihood of construction workers moving into another sector was far higher than that of them becoming unemployed[3] although slightly lower than average for the wider economy. The latest available data shows that out of every 100 workers in the Spanish economy, 14 had moved to new sectors of activity a year later compared to 12 in the construction sector.

Breaking the figures down by sector of origin we find that, out of every 100 industrial workers that switched sector, 27 went into the wholesale and hostelry sector, 24 into other services, 17 into construction and the remaining 32 into different activities within the industrial sector. Workers leaving the wholesale sector, meanwhile, showed a greater dispersion in the jobs they moved into, a sign of their greater versatility. A total of 46.7% moved into other services, 39.6% went into industry and the primary sector and 13.7% into construction. The main destination for ex-construction employees was the service sector, especially wholesale and hostelry (18%). But the largest outflow of those working in construction was into the extractive industries (21%).

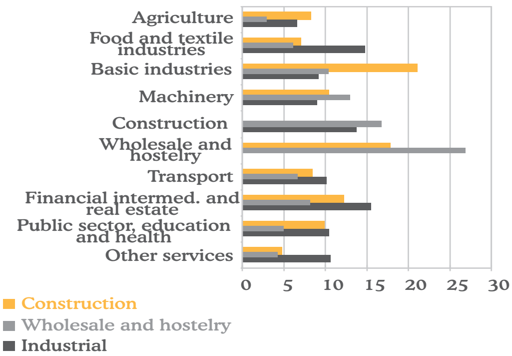
In summary, we expect slowing growth in 2008 to have a relatively limited impact on job creation, notably because of the high level of inter-sector mobility among the Spanish workforce. In addition, employees working in construction, the sector most affected by the current slowdown, show significant levels of mobility into other areas of activity and this should mitigate the impact of job destruction in the sector.

A better educated workforce and stable levels of temporary working also help reduce the likelihood of becoming unemployed

The third factor that suggests we can expect a limited impact on job destruction in the current economic climate is related to the improved individual characteristics of workers and their jobs. If the characteristics of the workforce that affect their likelihood of becoming unemployed have improved since the last economic slowdown, other things being equal, the current slowdown should have less of an impact. We therefore analysed the most significant differences between now and the last

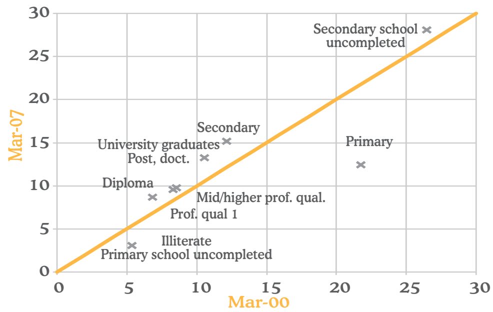
[2] The jump in the likelihood of changing job in 1Q05 is caused by changes to the EPA. These changes, mainly the use of the 2001 census as the new population benchmark and changes in the questionnaire and methods of gathering information have a significant impact on employment figures. Specifically, the improved capture of short-term working led to a significant rise in the number of employed and the scale of inter-sector mobility, as well as a fall in people classed as unemployed or inactive. The sector breakdown of employment also changed: construction lost ground compared to industry and, particularly, services.
See García, M. A. (2005), "*Cambios en la Encuesta de Población Activa en 2005*", index, 6-10, INE, for a fuller account of the changes to the Labour Force Survey in 2005 and their impacts.
[3] See footnote 2.

Chart 3.7.
Destination of people in work who change sector, by original sector. Average 1999-2006



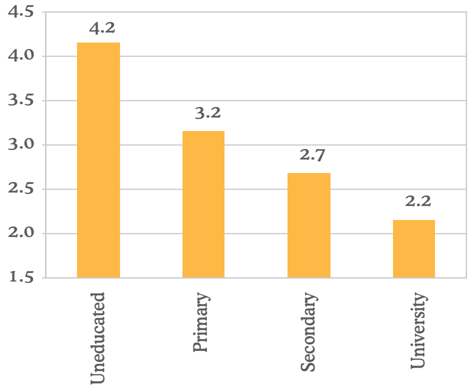
Source: INE and BBVA Economic Research Department

Chart 3.8.
Workforce composition by level of education.
1Q00 vs. 1Q07 (%)



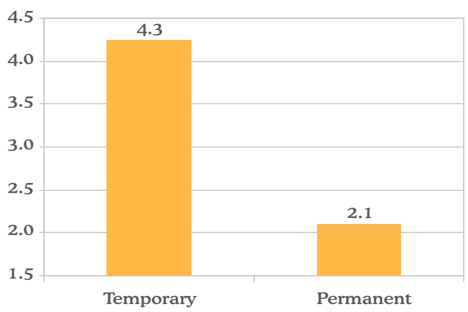
Source: INE and BBVA Economic Research Department

Chart 3.9.
Predicted probability of becoming unemployed in four quarters' time by level of education (%)



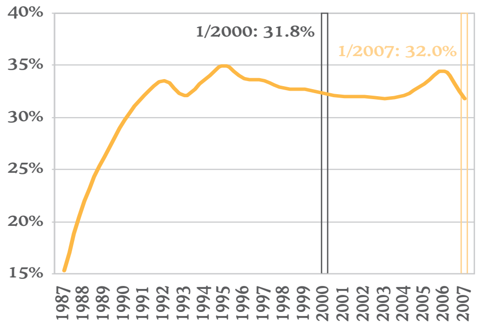
Source: BBVA Economic Research Department

Chart 3.10.
Predicted Probability of becoming unemployed in four quarters' time by type of contract (%)



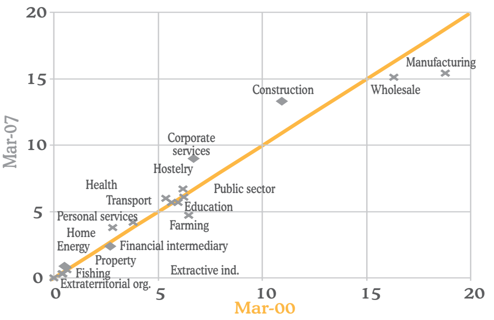
Source: BBVA Economic Research Department

Chart 3.11.
Temporary working in Spain



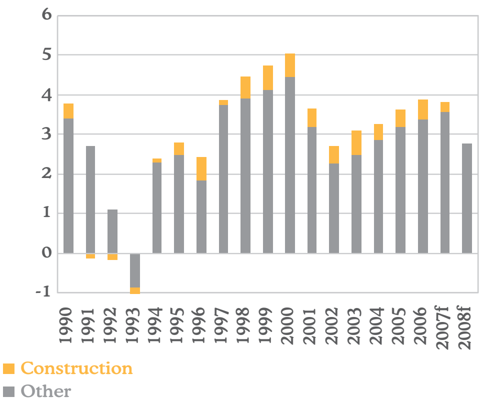
Source: INE

Chart 3.12.
Employment composition by economic activity.
1Q00 vs. 1Q07 (%)



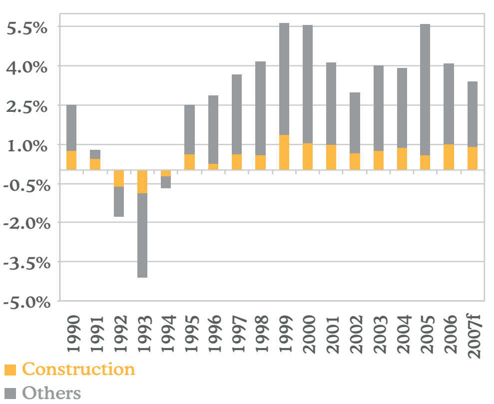
Source: INE and BBVA Economic Research Department

Chart 3.13.
Contribution of the construction sector to economic growth (%)



Source: INE and BBVA Economic Research Department

Chart 3.14.
Contribution of the construction sector to job creation (%)



Source: INE and BBVA Economic Research Department

slowdown, comparing the quarters where the economy turned down in each phase: 1Q00 and 1Q007.

Chart 3.8 traces a general rise in the **education level** of the Spanish working population between the first quarters 2000 and 2007. It seems intuitively likely that better qualified employees will have less chance of becoming unemployed. To check this hypothesis we estimated a discrete choice model that would allow us to determine the probability of an individual transferring between sector on the basis of different factors: socio-economic (sex, age, marital status, level of qualifications etc.), employment-related (type of contract, sector of activity, profession, etc.) or related to the economic cycle. Results were in line with intuitive expectations. Education has a positive and increasing effect on the likelihood of remaining in employment. As a result, uneducated employees are nearly twice as likely to become unemployed as graduates (4.2% vs. 2.2%), while employees with primary or secondary education have probabilities of 3.2% and 2.7%, respectively.

The estimates also showed that the **type of contract** is one of the most influential variables in the likelihood of becoming unemployed, for both men and women. *Ceteribus paribus*, being on a temporary contract increases the chance of becoming unemployed to 4%. Given the high levels of temporary work in Spain, this is not a positive result. That said, the percentage of employees on temporary contracts has barely changed since the last slowdown (see Chart 3.11) and has actually been falling steadily since the end of 2006. If this trend continues, the net destruction of temporary jobs as a result of slowing economic growth could be less severe than in the last slowdown.

Analysing the change in the **sector breakdown** of the working population, we find that the two activities that increased most between 1Q00 and 1Q07 were corporate services (up from 6.7% to 9% of the total labour force) and construction (up from 11% to 13.3%). The primary and commercial sectors and, particularly, manufacturing industries saw the biggest shrinkage with their share of employment falling from 18.8% in 1Q00 to 15.4% in 1Q07. The biggest rise in the share of employment by any sector over the period was in construction and this is also the sector likely to be most affected by the current slowdown. However, our estimates suggest there is barely any difference between sectors of activity as regards the conditional probability of becoming unemployed.

Construction is not the whole story, either for the economy or for employment

The **fourth reason to believe the slowdown will have only a limited impact on employment** is the relatively minor importance of the construction sector for activity and jobs. True, the contribution to growth made by construction, and particularly by residential construction, has been important over the last decade. Nonetheless, the weight of these two activities in the total economy remains fairly limited: at 16% and 7.5%, respectively. As regards employment, construction employs just 14% of the working population and although there are also indirect employment impacts, via knock-on effects to other industries, overall these effects are limited and less significant than in other sectors.[4]

[4] See BBVA Situación Inmobiliaria, June 2007, pp.16-17.

By analysing labour market flows we can approximate the volume of employment created in 2008…

Although slowing growth will affect job creation, we have seen that the labour market has fundamentals that will help offset this impact. To quantify the scale of the impact on employment, we used micro data on employment flows drawn from the labour force survey.[5]

Results suggest that the likelihood of becoming either unemployed or inactive will increase slightly in 2007 and 2008, confirming the slightly counter-cyclical profile highlighted above. The biggest changes will be felt by those seeking to enter employment. The likelihood of unemployed or inactive people moving into employment falls off in 2007 and 2008, reflecting a weakening in the Spanish economy's capacity to create jobs. So, how does this shift in the chances of changing work status translate into new jobs created? In 2007, we estimate net job creation at 667,000 posts, a 14% fall on the net number of jobs created in 2006. In 2008, the pace of job creation should fall further, but the number of jobs created (net of job destructions) will still range between 375,000 and 435,000.

…also in the construction sector

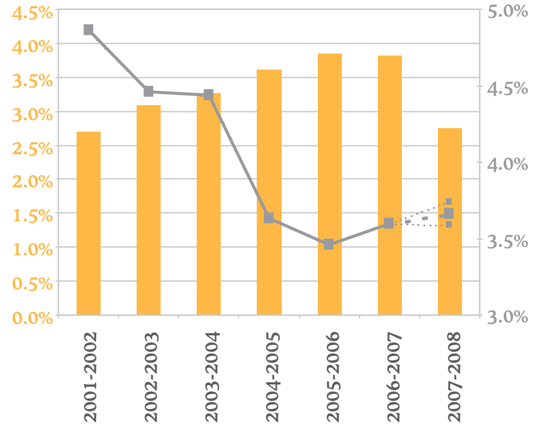
As construction is a labour intensive sector and will be more severely affected by the economic slowdown, we have conducted a detailed analysis of the inflows and outflows to and from the sector. To assess the part played by inter-sector mobility we added an additional category: changes in employment from construction to other sectors and vice-versa. We therefore considered all the possible origins and destinations for an employee in the construction sector: remaining in the sector, changing sector, unemployment and inactivity. The results of these estimates show a significant fall in the likelihood of a change of employment in 2008, from 12.2% in 2007 to 10.7% in 2008. Also, as would be expected in times of slowing growth, inflows to employment in the construction industry fall off, particularly inflows from other sectors which are already low in any case. These results, coupled with the increased probability of becoming either unemployed or inactive in 2008 (out of every 100 construction workers in 2007, 11.4 will become unemployed or inactive in 2008 compared to 9.8 in 2006), translate into an estimated net destruction of between 71,000 and 94,000 jobs in 2008, compared to 178,000 net jobs created in 2007.

Therefore, although the expected economic slowdown will have a negative impact on the pace of job creation by the Spanish economy, especially in construction, the scale of the impact will not be dramatic. First, because when the economy has been growing at the pace forecast for 2008 (2.8%) in the past it has never destroyed employment. Second, because employees have improved their characteristics, which will reduce the likelihood of their becoming unemployed. And thirdly, because employees show a degree of versatility in their work skills which tends to protect them from unemployment through inter-sector mobility.

[5] These data are used to estimate two models. The first model is used to identify the factors that determine the likelihood of a change from unemployment or inactivity into employment. The second provides information on movements in the opposite direction, i.e. the factors determining transitions from employment to unemployment or inactivity. By looking at the difference in the probabilities forecast by the two models we can infer the Spanish economy's capacity to create employment.

Chart 3.15.

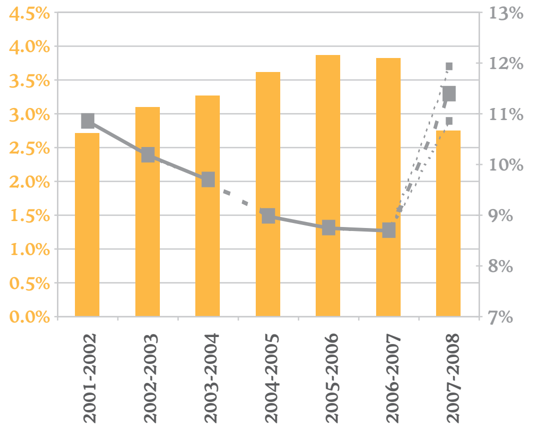
Probability of individuals in employment becoming unemployed in the next year



Source: INE and BBVA Economic Research Department

Chart 3.16.

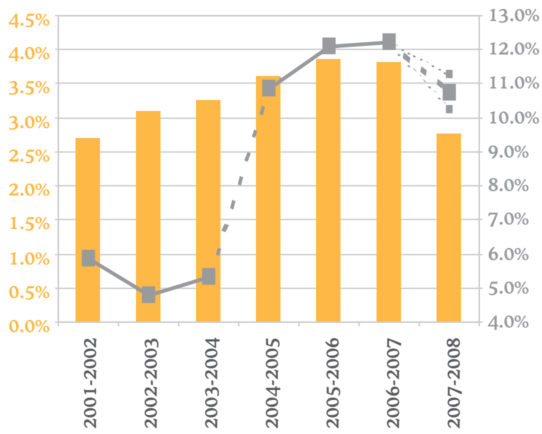
Construction: probability of individuals in employment becoming unemployed in the next year



Source: INE and BBVA Economic Research Department

Chart 3.17.

Construction: probability of individuals working in construction moving to a new sector in the next year.



Source: INE and BBVA Economic Research Department

4. Summary of forecasts

EMU (% y-o-y change, unless otherwise stated)

	2002	2003	2004	2005	2006	2007	2008
Real GDP	**0.9**	**0.8**	**1.8**	**1.6**	**2.9**	**2.5**	**2.0**
Private consumption	0.8	1.2	1.5	1.5	1.8	1.4	1.9
Public spending	2.4	1.8	1.3	1.4	1.9	1.9	2.0
Gross fixed capital formation	-1.5	1.2	1.9	2.8	5.3	4.5	2.3
Change in inventories (*)	-0.3	0.2	0.2	0.1	0.1	0.0	0.0
Domestic demand (*)	**0.4**	**1.4**	**1.6**	**1.8**	**2.6**	**2.1**	**2.0**
Exports (goods and services)	1.6	1.1	6.4	4.5	8.2	5.4	3.4
Imports (goods and services)	0.3	3.1	6.3	5.3	7.8	4.6	3.7
External demand (*)	**0.5**	**-0.7**	**0.1**	**-0.3**	**0.2**	**0.4**	**-0.1**
Prices							
CPI	2.2	2.1	2.1	2.2	2.2	2.0	1.9
Core CPI	2.5	2.0	2.1	1.5	1.5	1.9	2.0
Industrial prices	-0.1	1.4	2.3	4.1	5.1	2.5	2.3
Labour market							
Employment	0.7	0.4	0.9	1.0	1.6	1.5	1.0
Unemployment rate	8.1	8.7	8.8	8.5	7.8	7.1	6.9
Public sector							
Deficit (% GDP)	-2.5	-3.0	-2.8	-2.5	-1.6	-1.0	-0.8
Export sector							
Current account balance (% GDP)	0.9	0.5	0.8	0.0	0.0	0.2	0.1

* Contribution to growth
** Includes impact of German VAT rise

International environment (% y-o-y change)

	Real GDP growth (%)				Inflation ** (%)			
	2005	2006	2007	2008	2005	2006	2007	2008
US	3.1	2.9	1.9	2.2	3.4	3.2	2.6	2.1
Japan	1.9	2.2	1.9	2.2	-0.3	0.1	0.0	0.5
Latam *	4.7	5.5	5.1	4.6	6.0	5.1	5.4	5.3

*Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay and Venezuela
** Latam forecasts are for end of period

Financial variables (end of period)

	Official rate (%)				10Y interest rate (%)*			
	15/10/07	Dec-07	Jun-08	Dec-08	15/10/07	Dec-07	Jun-08	Dec-08
EMU*	4.00	4.00	3.75	3.75	4.42	4.20	4.30	4.30
US	4.75	4.25	4.25	4.25	4.67	4.30	4.40	4.50

* 10Y interest rates based on German Bund

	Exchange rate (vs euro)*				Brent crude (dollars per barrel)*			
	15/10/07	Dec-07	Jun-08	Dec-08	15/10/07	Dec-07	Jun-08	Dec-08
US dollar	1.42	1.41	1.40	1.38	83.3	68.5	66.3	58.3

* Average over period

Summary of forecasts for the Spanish economy

(% y-o-y change, unless stated otherwise)

	2001	2002	2003	2004	2005	2006	2007	2008
GDP at 2000 prices	**3.6**	**2.7**	**3.1**	**3.3**	**3.6**	**3.9**	**3.8**	**2.8**
Private consumption	3.4	2.8	2.9	4.2	4.2	3.7	3.2	2.8
Public consumption	3.9	4.5	4.8	6.3	5.5	4.8	5.4	5.1
Gross fixed capital formation	4.8	3.4	5.9	5.1	6.9	6.8	5.8	2.9
Capital goods	-0.3	-2.9	4.1	5.1	9.2	10.4	10.8	4.5
Construction	7.6	6.3	6.2	5.4	6.1	6.0	4.2	1.9
Residential	7.5	7.0	9.3	5.9	5.9	6.4	3.5	0.0
Other	7.7	5.6	3.5	5.0	6.3	5.5	4.9	3.7
Other products	5.8	5.0	7.2	3.8	6.4	4.6	3.3	2.8
Change in inventories (*)	-0.1	0.0	-0.1	0.0	-0.1	0.1	0.0	0.0
Domestic demand (*)	**3.9**	**3.3**	**3.9**	**4.9**	**5.3**	**5.1**	**4.6**	**3.5**
Exports (goods and services)	4.2	2.0	3.7	4.2	2.6	5.1	4.4	4.0
Imports (goods and services)	4.5	3.7	6.2	9.6	7.7	8.3	5.8	4.9
Net external balance (*)	**-0.2**	**-0.6**	**-0.8**	**-1.7**	**-1.7**	**-1.3**	**-0.8**	**-0.8**
GDP at market prices	8.0	7.1	7.4	7.4	8.0	8.0	7.0	5.3
EUR mn	680.678	729.206	782.929	841.042	908.450	980.954	1.049.847	1.105.114
Prices and costs								
GDP deflator	4.2	4.3	4.1	4.0	4.2	4.0	3.1	2.4
Household consumption deflator	3.4	2.8	3.1	3.6	3.4	3.4	2.5	2.2
CPI	3.5	3.5	2.9	3.0	3.4	3.5	2.6	2.6
Inflation gap with EMU (p.p.)	1.2	1.3	0.8	0.9	1.2	1.3	0.6	0.7
Remuneration per employee	3.6	3.3	3.6	3.0	2.8	3.0	2.9	2.8
Unit labour cost (ULC)	3.2	2.9	2.9	2.4	2.5	2.7	2.0	1.6
Labour market								
Active population (LFS)	0.3	4.1	4.0	3.3	3.5	3.3	2.8	2.3
Employment (LFS)	4.1	3.0	4.0	3.9	5.6	4.1	3.4	2.1
Change in thousands of persons	640	484	666	675	1002	774	667	435
Employment (national accounts, FTE)	3.2	2.3	2.4	2.7	3.2	3.2	2.9	1.5
Unemployment rate	10.6	11.5	11.5	11.0	9.2	8.5	8.0	8.2
Productivity	0.4	0.4	0.7	0.6	0.4	0.7	0.9	1.3
Public sector								
National debt (% GDP)	55.6	52.5	48.9	46.4	43.2	39.7	36.6	34.3
Public sector surplus/deficit (% GDP)	-0.5	-0.3	0.0	-0.1	1.1	1.8	1.2	0.9
External sector								
Balance of trade (% GDP)	-6.3	-5.8	-5.9	-7.2	-8.6	-9.1	-10.0	-9.7
Current account balance (% GDP)	-3.9	-3.3	-3.5	-5.3	-7.3	-8.8	-8.9	-8.6
Households								
Real disposable income	3.1	3.7	3.0	3.2	3.2	3.1	4.0	2.3
Nominal disposable income	6.5	6.5	6.2	6.8	6.5	6.5	6.5	4.5
Savings rate (% nominal income)	11.1	11.4	11.9	11.4	10.6	10.1	10.8	10.4

Source: official statistics and BBVA Economic Research Department
(*) Contribution to GDP growth

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