

Economic Watch

Spain

Madrid, 7 June 2011
Economic Analysis

Spain Unit

2Q11: No significant change in trends

- **Released figures for the second quarter anticipate a moderate improvement in activity with respect to the first quarter**

If current trends persist, q/q growth in the second quarter would stand at 0.3% which is still not enough to create employment without the aid of seasonal trends.

- **Consumption and investment indicators continue to reflect the sluggish recovery of private domestic demand**

Weak fundamentals are behind this trend and there is no change to the forecast of slow recovery for domestic demand. The start or end of fiscal incentives and public deficit reduction measures continue to shape the evolution of some sectors.

- **Meanwhile, exports continue to grow at high annualised rates**

There are no signs of a slowdown although this could ease over the coming months.

- **The stabilisation of energy prices would confirm that their effects will be limited**

If second round effects are avoided, the high price of oil could have a limited effect on activity and inflation, although it would have halted the adjustment of the current account deficit.

- **The improvement in public revenue will be sufficient to meet deficit targets only if spending targets are rigorously met**

Unlike the central government, Autonomous Communities were unable to stick to their budgets in the first quarter, showing a significant deviation from their objective. They will now have to slash spending even further in the coming quarters.

National accounts data for the first quarter in line with BBVA Research’s estimates

Spanish economic growth was once again moderate in the first quarter at around 0.3% q/q. This is in line with our real-time GDP growth estimates (MICA-BBVA: 0.3% q/q) and slightly above our base case scenario (0.2% q/q) due to public consumption which rose 1.4% q/q. However, external demand, with exports rising at an annualised 21%, performed better than expected.

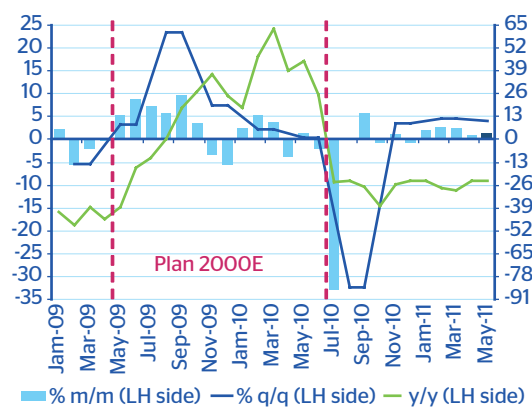
First quarter growth remained relatively timid and not enough to generate employment (-109,500 full-time jobs), triggering an increase in the apparent labor productivity which, together with the evolution of wages per employee, pushed down unit labour costs. Therefore, national accounts data for the first quarter do not significantly affect our general view of a gradual recovery of the Spanish economy which will basically be characterised by slow growth and no job creation which, in spite of strong exports, will be dragged down by weak domestic demand.

Figures for April and May do not indicate a change in household consumption trends

There was still no clear improvement in private consumption in May although there is positive growth. In particular, seasonally and calendar adjusted (SWDA) car registrations rose 1.3% m/m in May, largely due to corporate demand, indicating that private demand remains weak. Also, real retail sales in April were higher than expected (1.2% m/m SWDA), which offsets the poor figures for March. This could indicate a positive contribution from retail sales to household consumption growth in the second quarter.

Chart 1

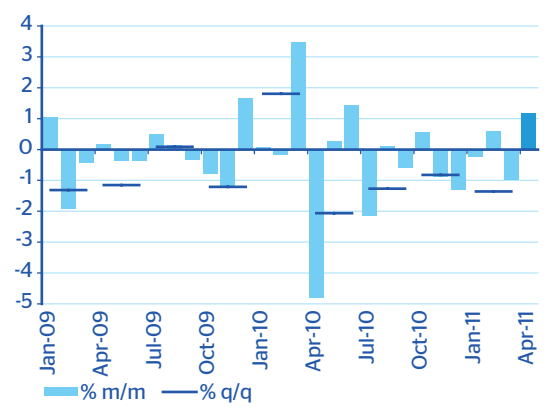
Spain: car registrations (SWDA data)



Source: BBVA Research based on ANFAC and Ganvam data

Chart 2

Spain: retail sales (SWDA data)

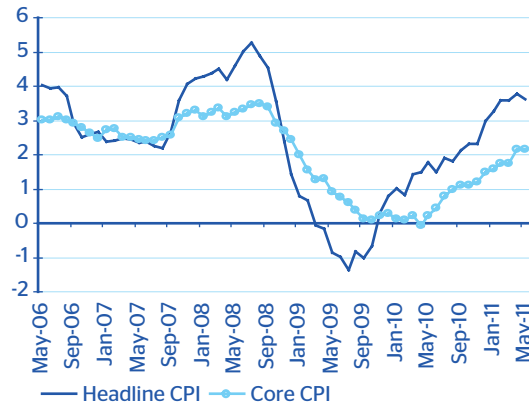


* SWDA: seasonally- and calendar-adjusted. Source: BBVA Research based on INE data
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If energy prices consolidate at these levels, inflation looks set to decline

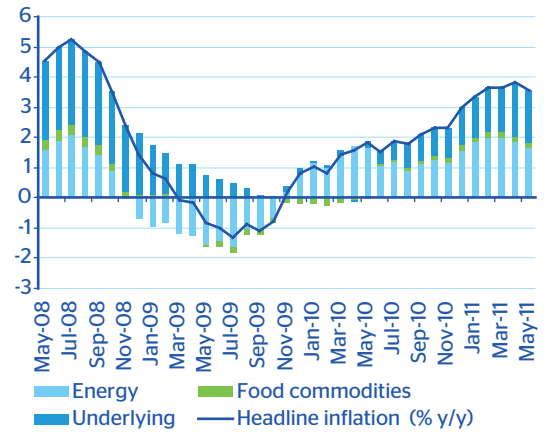
According to the CPI flash indicator, annual inflation slowed 0.3pp in May to 3.5% y/y, slightly below our estimates (BBVA Research: 3.6% y/y). Annual inflation, measured by the HICP, also slowed 0.1pp to 3.4% y/y. The slowdown in May is largely due to lower energy inflation as anticipated by the lower fuel prices. However, high inflation rates are mainly due to commodity prices. Our estimates point to core inflation remaining relatively stable at 2.1% y/y. However, leading figures indicate that the easing in prices after Easter, particularly for organised tours, may be higher than expected.

Chart 3
Spain: inflation (y/y change)



Source: BBVA Research based on INE data

Chart 4
Spain: contributions to headline inflation growth



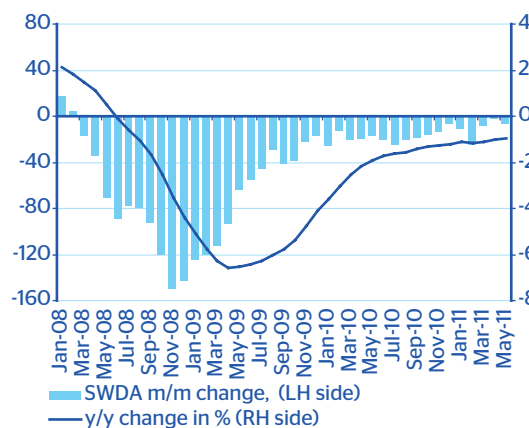
Source: BBVA Research based on INE data

Even though Social Security affiliation has declined, economic growth is not enough to create employment

Figures for May confirm the stagnant trend in the Spanish job market. Social Security affiliation rose again in May due to seasonal factors to around 118,000 people, roughly in line with our estimates of 128,000. However, SWDA figures show a decline of 7,000 people, similar in average to the trend of the past six months. Once seasonally adjusted, job creation was seen only in services and agriculture while job destruction in the construction sector picked up, probably due to public spending adjustments.

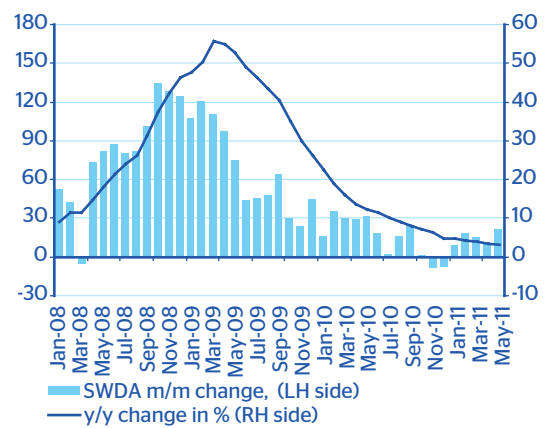
Meanwhile, jobless claims fell by 80,000 people, also due to seasonal factors and in line with our estimates of -95,000. Even though unemployment fell in all the productive sectors, the decline in the services sector was only half than expected and only due to seasonal factors. SWDA unemployment growth data was around 17,000 people. The growth in temporary contracts offset the decline in permanent contracts, pushing up the SWDA temporary rate to 92.3%.

Chart 5
Spain: social security affiliation (monthly average)



Source: BBVA Research based on finance ministry and INE data

Chart 6
Spain: registered unemployment



Source: BBVA Research based on Ministry of Economy and Finance data

Activity in the housing sector was shaped by fiscal incentives

In March the number of home sales was 33,106, down 11.9% y/y. SWDA figures for March show a m/m decline of 7.0%, the highest since 2008. As reported in our previous Economic Watch, figures for March appear to reflect the decrease of the effect of homeowners bringing forward their purchases before the elimination of the deduction for primary home purchases for homeowners with annual income above EUR 24,100 which was reflected in the maintenance of sales in January (due to the delay between acquiring property and registering it in the Property Register).

On the supply side, according to figures from the Ministry of Public Works, 6,840 new home permits were granted in March. This is lower than forecast, indicating that the figure for the year will be around 100,000. The number of home improvements carried out in March also improved with the number of home addition and reform permits rising 4.2% m/m (SWDA). This trend looks set to continue in the coming months with the onset of the new housing reform tax rebate which has been raised from 10% to 20% of the total cost of the work. At the same time taxpayers with incomes of up to EUR 70,000 p.a. will also be eligible for progressively reduced rebates (up from EUR 50,000).

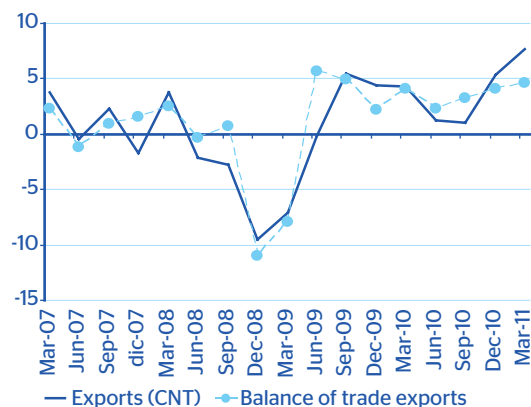
The domestic demand offsets the good performance of the external demand

As forecasted by industry confidence indicators, April SWDA IPI figures contracted 1.6% y/y, in line with our estimates although slightly below our base case scenario (BBVA Research: -1.1% y/y). Most of this is due to the base effect of withdrawing fiscal stimulus measures in Europe, and mainly in Spain (i.e. VAT hike, end of cash-for-clunkers plans in Europe), which drove demand in the first six months. Corrected figures would indicate positive, albeit moderate, IPI monthly growth. Looking forward, the index tracking the outlook for future production indicates that the slowdown in y/y IPI growth looks set to continue, at least in the short term. However, the continuing trend of strong exports order books shows a positive trend in those branches of industry which focus on exports.

Exports remain strong and are a key support for the slow recovery

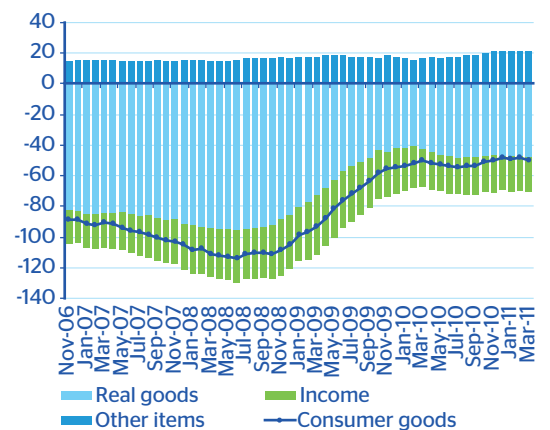
SWDA m/m volume figures for March show that exports have fallen (-1.2% m/m SWDA) mainly because of capital goods (-15.8% m/m SWDA) which remain very volatile and more than offset the growth in exports of intermediate goods (+3.4% m/m SWDA). Imports have increased across the board with intermediate goods recording the strongest growth (+6.7% m/m SWDA). After various months of declines or stagnation, consumer goods imports are picking up (+3.6% m/m SWDA), as observed in February.

Chart 7
Real goods exports (% q/q, SWDA)



Source: BBVA Research based on Customs data

Chart 8
Current account balance, annual accumulated (Euros)



Source: BBVA Research based on Bank of Spain data

Higher oil prices and risk premiums hamper an improvement in the current account deficit

As we have noted in previous months, the annual accumulated figure of the current account deficit has stabilised at around EUR 47,500-50,000 millions, although a slight deterioration was recorded in March with respect to the previous month. The figure of the first quarter stood at -4.7% of GDP, two tenths higher than in the previous quarter.

The improvement in public revenue will be sufficient to meet the deficit targets only if spending targets are rigorously fulfilled

The combined deficit for Autonomous Communities was 0.47% of GDP in 1Q11 (nearly two tenths of a percentage point above the Central Government's forecasts). While regional revenue has fallen y/y, albeit more moderately than in previous quarters, spending has raised 5% y/y, being personnel costs the only area with contained spending

There is still a huge gap between regions with Castilla-La Mancha, the Balearic Islands and Murcia recording the highest deficit at around 1pp, while Aragon, La Rioja and Galicia are the only ones enjoying a slight surplus. Even though the figures for the first quarter are not representative for the whole year, they do indicate that over half the Autonomous Communities must step up their fiscal consolidation efforts to reduce their deficits.

Once these figures are confirmed, we estimate that the combined deficit will be around 0.6% of GDP for the first quarter.

Meanwhile the Central Government's accumulated deficit in April 2011 was EUR 2.45 bn, nearly half the amount up to the same period in 2010. Central Government accumulated revenue in April shrank 8.6%, dragged down by tax revenue (which represents nearly 90% of the total) which declined 14.4%. It is worth remembering that this is because the autonomous financing system is being comprehensively applied for the first time this year which implies a decline in the transfer payments to autonomous regions and less central government tax revenues given the higher percentage being collected by autonomous regions. Spending continues to adjust with declines in nearly all items compared to last year. Spending cuts continue to focus on capital expenditure and were down by nearly 40% accumulated in April. Civil servants' wages are still being cut and have fallen 31%. Current transfers between public administrations have declined 21.8% y/y, largely due to fewer down payments of the financial system.

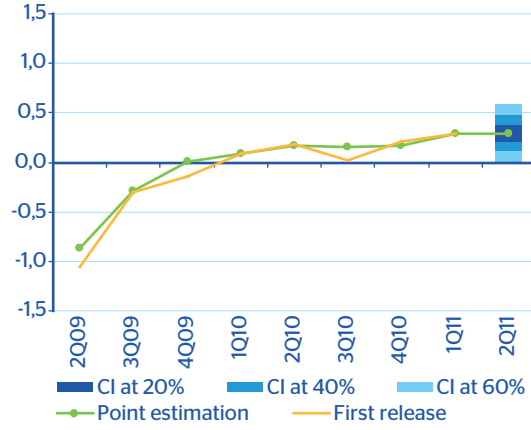
If we look at tax revenue we can see some signs of improvement in most items which rose 4.2% to April 2011. This improvement in tax revenue is once again due to higher VAT, which has raised 8.8% like-for-like, and which has been shaped by last year's increase which more than offset the slowdown caused by swifter tax refunds. Personal income tax recovery is easing, due to lower withholdings and the negative performance of SME and public administration withholdings. After the first instalment, corporate tax growth is still negative largely due to the worsening of payments by freer repayments and higher provisions. Finally, special taxes continue to fall, largely hit by the decline in taxation on fuels and tobacco.

Second quarter growth will be similar to the first quarter

In short, based on nearly 50% of the information for the second quarter of 2011 which we use for our MICA-BBVA model, real time GDP growth forecasts for the quarter are around 0.3% q/q, in line with the estimates of our core scenario (+0.2% q/q). As we noted in May's Spain Economic Outlook¹, economic recovery remains extremely weak and unable to avoid job contraction once the quarter's figures have been seasonally adjusted. In any event, growth is consistent with our core scenario where we expect GDP growth of around 1% for 2011.

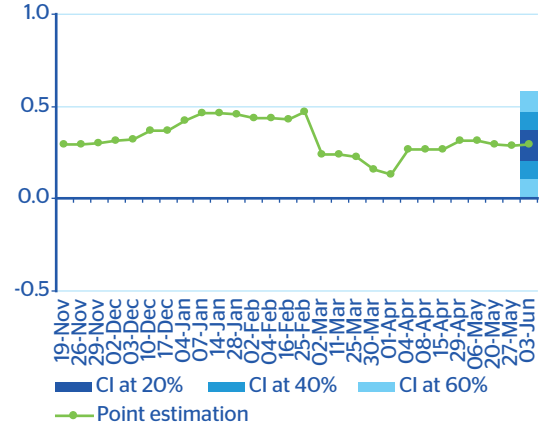
¹: Available at: http://www.bbvarresearch.com/KETD/ketd/Descargas?pais=ESPA&canal=web&tipocontenido=AFON&idioma=ESP&pdf=/fbin/mult/1105_Situacionespana_tcm346-256519.pdf&ididoc=es&tipopublicacion=Situacion_Espana&tematica=/MACR/RVSE/

Chart 9
Spain: GDP growth and forecasts using MICA-BBVA model (% q/q)



Current forecast: 3 June 2011
Source: BBVA Research

Chart 10
Spain: 2Q11 GDP growth forecasts using the MICA-BBVA model by forecast date (% q/q)



Source: BBVA Research

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