Economic Watch

Spain

Madrid, 7 December 2011
Economic Analysis

Spain Unit

4Q11: increasing likelihood of recession

- **Data for 4Q11 released so far show a far greater probability of contraction in GDP**
  If the trends shown by available indicators persist until the deadline of this Economic Watch, activity could contract by 0.2% qoq in 4Q11. This would confirm the deterioration in growth prospects since 2Q11. Especially worrisome is the persistence of job destruction, with job losses mounting faster in recent months.

- **Consumption and investment indicators still show weak domestic demand**
  This trend reflects still-weak fundamentals that do nothing to change our outlook for a slow recovery in domestic demand. Uncertainty over global growth and heightened financial stress, above all in Europe, could undermine these expectations. Meanwhile, questions surrounding fiscal policy and the budget-deficit reduction process continue to affect the performances of some sectors.

- **Exports are losing steam and there are concerns about future performance**
  Although the slowdown could be short-lived, downside risks have increased due to lower-than-expected growth in developed economies, the drop in consumer and business confidence in these countries and the considerable increase in uncertainty in international financial markets.

- **The trend in the autonomous communities' deficit appears to be shifting, but not enough yet to meet the year-end target**
  The most likely scenario is that the Central government will meet its target and be able to some extent offset the potential budget over-runs by the autonomous communities and the Social Security. In any event, unless additional measures are adopted, the total public deficit target of 6% of GDP will be missed.

National accounts as of 3Q11

As noted in our previous Spain Economic Outlook and earlier publications of Spain Economic Watch, the Spanish economy's tenuous growth in 1H11 stalled in 3Q11. Domestic demand still posed a drag, fully offset the growth of net trade. The breakdown of aggregate demand released by INE (the Spanish National Statistics Institute) was somewhat different to what we had forecast. The numbers should be assessed carefully, since most of the changes were due to normal statistical revisions and the change in the accounting base year to 2008.

Spain's economy stopped growing in the third quarter of 2011

Spain's economy came to a halt in 3Q11, as expected, after six consecutive quarters of weak growth. Compared to last year, GDP rose 0.8% yoy, marking the fifth straight quarter of annual growth since the beginning of the crisis. While activity was unchanged from 2Q11, this was largely the result of the improvement registered in 2Q11 and the base effect of the temporary economic slowdown in 3Q10 (caused by the acceleration of the fiscal consolidation process).

As expected, after the fall in trade flows in 2Q11, the composition of growth was again heavily skewed to net trade, which made a positive net contribution of 0.4pp to quarterly GDP growth (2.0pp to yoy growth), thereby preventing a negative growth rate of Spanish economy. Meanwhile, domestic demand continued to be a drag on growth –shaped by weak fundamentals, ongoing adjustments and a recent uptick in uncertainty- offsetting the entire qoq growth of net trade (contribution to GDP growth: -0.4pp qoq; -1.2pp yoy).

Published data show that the broad demand components performed in line with our forecasts, albeit with slightly lower qoq rates than factored into our baseline scenario. However, the differences between observed data and forecasts for these aggregates (see Table 1) are not due to estimation errors, but rather to statistical revisions of historical series.

Table 1
Aggregate demand and GDP (% yoy)

	2009		2010		2011**	
	Base 2000	**Base 2008**	**Base 2000**	**Base 2008**	**Base 2000**	**Base 2008**
Household final consumption expenditure	-4.3	-4.4	1.3	0.7	0.4	0.0
Public administration final consumption expenditure	3.2	3.7	-0.7	0.2	-0.3	-1.3
Gross fixed capital formation	-16.0	-16.6	-7.5	-6.3	-5.1	-4.3
Domestic demand (*)	-6.4	-6.6	-1.1	-1.0	-1.0	-1.2
Exports of goods and services	-11.6	-10.4	10.3	13.5	10.1	9.3
Imports of goods and services	-17.8	-17.2	5.5	8.9	3.0	1.9
GDP (mp)	**-3,7**	**-3,7**	**-0,1**	**-0,1**	**0,8**	**0,8**

* Contribution to growth.
** Base 2000 corresponds to forecasts of Spain Economic Outlook 4Q11 and Base 2008 includes data released as of today and BBVA forecasts for 4Q11 in Spain Economic Outlook 4Q11.
Source: BBVA Research based on INE data

In line with the economy growth interruption, the job market deteriorated further in 3Q11

As noted in our previous Spain Economic Outlook, labour market data for 3Q11 were disappointing. Data relative to job trend forecast were poor, showing a qoq fall in employment of around 171.9 thousand in full-time equivalent jobs (-1.9% yoy SWDA), higher than indicated by both the Labour Force Survey (our estimate: around 147 thousand, SWDA) and Social Security affiliation (our estimate: around 100 thousand, SWDA). With employment dropping, the yoy growth of apparent labour productivity rose again in 3Q11, to 2.7% (from 2.0% in 2Q11).

The real fall in per head wages, coupled with increased productivity, pushed down unit labour costs further

Prices continue to rise sharply (GDP deflator 1.5% yoy), but nominal wages per employee far less (0.6% yoy). Data at the end of 3Q11 show that per head wages continue to fall in real terms (-0.9% yoy vs. -1.3% yoy in 2Q11). This, coupled with a fresh increase in productivity, pushed down real unit labour costs further, by 3.6% yoy (-2.1% yoy nominal).

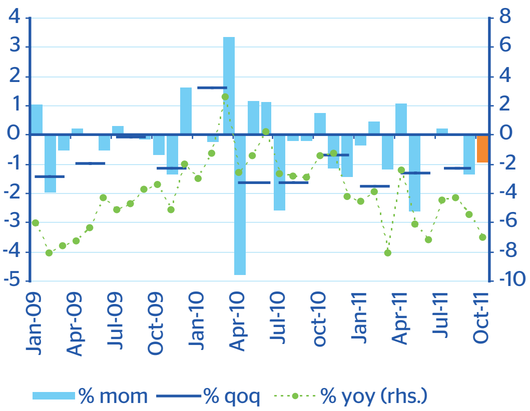
No improvement in consumption spending in 4Q11

Once seasonally and working day adjusted (SWDA), retail sales dropped in October (-0.9% mom, -7.0% yoy) on the back of falls in all components. With a similar decline in September, this indicator could continue to detract from the growth of household consumption again in 4Q11, much like in the rest of this year.

Likewise, demand for cars does not bode well for a good performance in consumption in 4Q11. The November figure (+1.2% mom, SWDA) is a slight improvement after the October decline. Lower demand for private vehicles continued to undermine sales last month. Although car registrations by rental companies rose in November respect to last year (by 7.5%), the contribution was not enough to offset falls in sales to corporate buyers (-4.5% yoy) and private individuals (-9.0% yoy). If the performance in December is as expected, the number of cars registered in the whole of 2011 could be under 810 thousand.

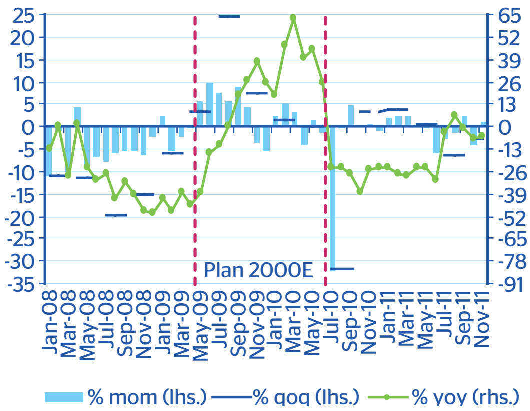
After slipping 2.6 points in October, the relative consumer confidence indicator jumped 4.2 points in November to -15.4 points, slightly below its long-run average (-13.0), due to a better performances by all components. In particular, consumer expectations about the unemployment outlook for the next 12 months improved by 5.4 points, representing 1.4 points of the total improvement in consumer confidence. The next largest rise was in the outlook for savings that after falling by 4.1 points in October, this component rose 5.2 points in November, contributing 1.3% of the overall improvement in confidence. Movements in consumer expectations about the overall economy and expected financial situation also were important (+4.0 and +2.5 points, respectively), they accounted for 1.0 and 0.5 points of the total increase in confidence in November.

Chart 1
Spain: retail sales (SWDA data)



SWDA: seasonally and working day adjusted.
Source: BBVA Research based on INE data

Chart 2
Spain: car registrations (SWDA data)



SWDA: seasonally and working day adjusted.
Source: BBVA Research based on ANFAC and Ganvam data

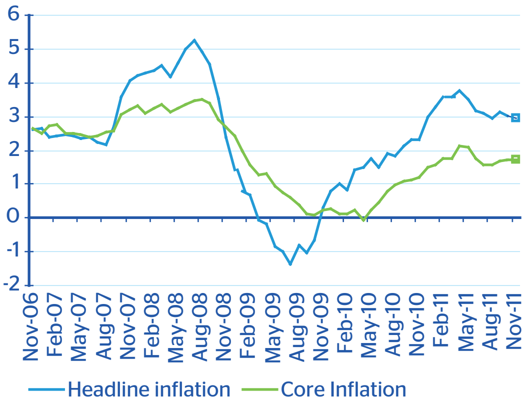
Residential housing investment shows no signs of improving since falling at the start of the year

The number of purchase and sale transactions remains at all-time lows, dropping a further 7.5% mom (SWDA) in September. This was due to uncertainty about some tax incentives (VAT, deduction of home purchases from personal income tax withholding), coupled with the negative implications of financial instability and the weak job market. The same factors were behind the weakness of mortgage activity, with home mortgages dropping 5.1% mom (SWDA) in September. On the supply side, 7,588 construction permits were issued in September for new homes, up 23.7% mom (SWDA). This led to a fairly positive 3Q11, although levels are still far lower than the pre-crisis peak. Figures were also positive for restoration in September (+8.6% mom, SWDA).

Inflation is marginally easing, while the base effect will drive a further decrease in coming months

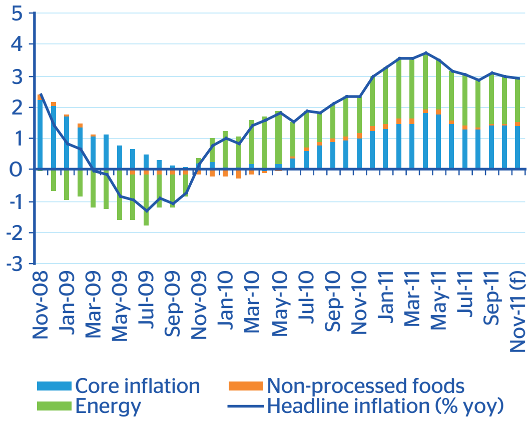
In line with expectations, the headline inflation rate eased slightly in October (to 3.0% yoy) and November (2.9% yoy) according to the leading CPI indicator. In both cases, (upward) trends in food and energy prices considered temporary (e.g. the sharp correction in tobacco prices and the spike in energy prices) were the main drivers. All other inflation components performed in line with our estimates. As a result, despite lingering uncertainty surrounding commodity prices, October and November readings confirm inflation could ease further over the coming months in a context of extremely weak domestic demand.

Chart 3
Spain: inflation (% yoy)



Source: BBVA Research based on INE data

Chart 4
Spain: contributions to headline inflation growth



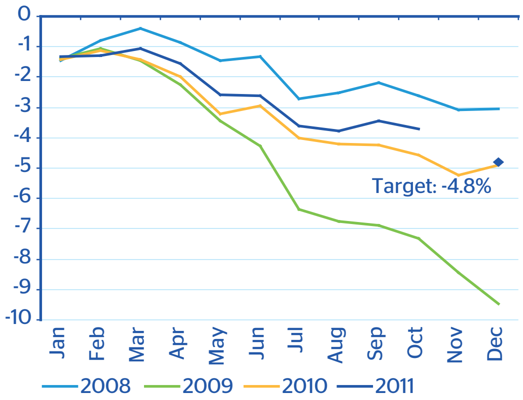
Source: BBVA Research based on INE data

Shift in trend of budget out-turn data for autonomous communities

The cumulative Central government deficit at October 2011 amounted to 3.7% of GDP, nearly 0.9pp lower than the year-ago figure. This decrease raises the chances of meeting the 4.8% deficit target for the year. To do so, the government will have to maintain efforts to curb expenditure, as revenue is not expected to recover more. Cumulative tax receipt at October was up 0.8% yoy in like-for-like terms. The increase was mainly because of the rebound in personal income tax receipts after the negative effect of wage cuts wore off and the slight improvement in the VAT base now that the impact of bring forward sales to the first half of 2010 has partial corrected. Corporate tax, while still shrinking, is faring better thanks to changes in legislation (tax hikes and limit on the adjustment of goodwill and offset of negative bases).

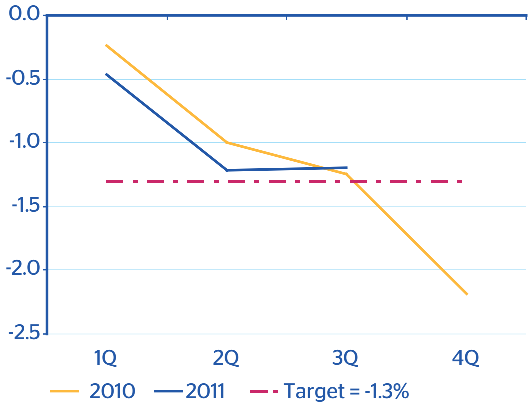
Meanwhile, the autonomous communities showed a cumulative budget deficit through the third quarter of the year of 1.2% of GDP, showing a stagnation respect to previous quarter. This would appear to indicate a reversal in the regional budget out-turn trend, showing above all a sharper reduction in expenditure, -mostly in investment spend but with decreases in virtually all current expenditure items-. The performances across region were mixed, with Andalusia, the Balearic Islands, Extremadura and the Basque Country contributing the most to keeping the deficit from swelling in the third quarter, while Castile-La Mancha, Murcia and Valencia delivered the worse performances. If the trend of control over spending is confirmed in 4Q11, the total deficit for the autonomous communities could end up at around 1pp above target (-1.3%) and in line with our forecasts.

Chart 5
Central government: non-financial balance (12-month cumulative, % of GDP)



Source: BBVA Research based on MEH and INE data

Chart 6
Autonomous communities: non-financial balance (12-month cumulative, % of GDP)



Source: BBVA Research based on MEH and INE data

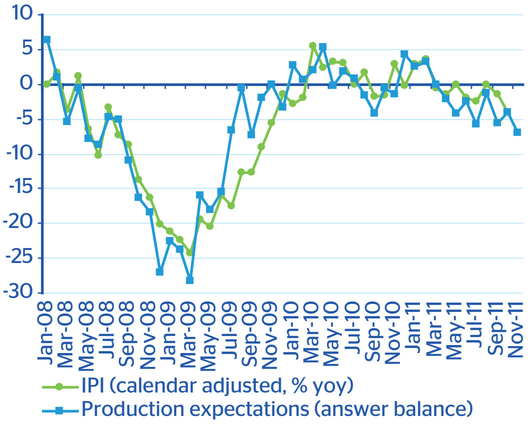
September trade balance figures partially adjust the strong export pace

Exports of Spanish goods slipped 4.7% mom (SWDA) in September after two months of sharp mom growth. All the largest export sectors sustained declines, led by intermediate (+6.5% mom, SWDA) and consumer (-5.7% mom, SWDA) goods. At the same time, import mom growth come back to negative side (-5.5% mom, SWDA) after spiking in August (+11.1% mom, SWDA), dragged down firstly by consumer goods and secondly by capital goods. Volumes of goods exports still rose a healthy 7.8% yoy in September, which adjust the export yoy rate momentum of August. While, volumes of good imports, increased by a more moderate 4.4% yoy in September after surging the month before, in line with sluggish domestic demand.

Industrial production wanes on the back of the slowdown in international trade and the weakness of domestic demand

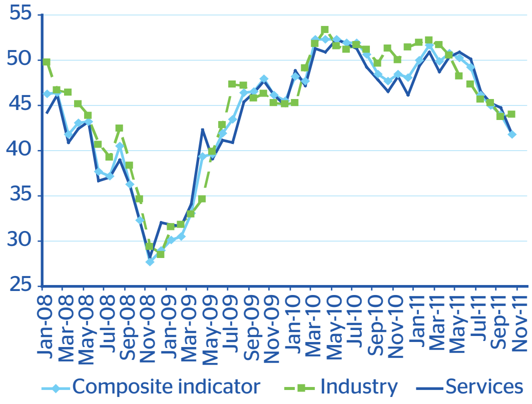
After September downward adjust of industrial production (-1.8% yoy according to preliminary data released by INE last month), our forecasts called for a similar downward correction in October. However, data point to a sharper fall 4.0% yoy, which consolidate a trend that continues to indicate a gradual slowdown of industry production hitting most components. Looking forward, "soft" indicators back this view, with industrial confidence falling 3.1 points in November (+2.2 points in October) to -16.9 points, below its historical average (-9.0 points). Likewise, industrial orders in Spain plunged 7.5 points –this was mostly caused by export orders (-6.4 points)- making a negative contribution of 2.5 points. On the other hand, expectations about future output fell 3.0 points, accounting for 1.0 points of the monthly decline. Conversely, the inventories of finished goods fell by 1.0 point, contributing positively, albeit negligibly, to confidence.

Chart 7
Spain: industrial confidence and production



Source: BBVA Research based on INE and European Commission data

Chart 8
Spain: PMIs
(SWDA data, value above 50 indicates expansion)



Source: BBVA Research based on Markit Economics data

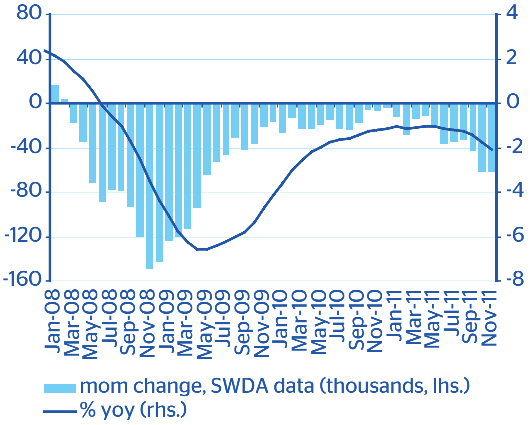
The 12-month cumulative current account balance shrank by just 0.4 billion euros in September

The 12-month cumulative current account deficit shrank by 0.4 billion euros to 43.6 billion euros up to September from 44 billion euros the month before. In this figure, the slight increase in the deficit of goods stands out (0.3 billion euro increase) which, according to trade balance data (source: Customs), was caused by the increase in the energy deficit. This time, however, the improvement in the deficit not related to energy was not enough to fully offset energy deficit. The month's first mitigating factor was the surplus in services. This component ended September showing a 12-month cumulative surplus of 33 billion euros (0.6 billion euros increase). The 12-month cumulative income deficit increased by 0.5 billion euros, while the second mitigating factor, the transfer balance deficit, decreased by 0.6 billion euros.

November figures confirm faster job destruction

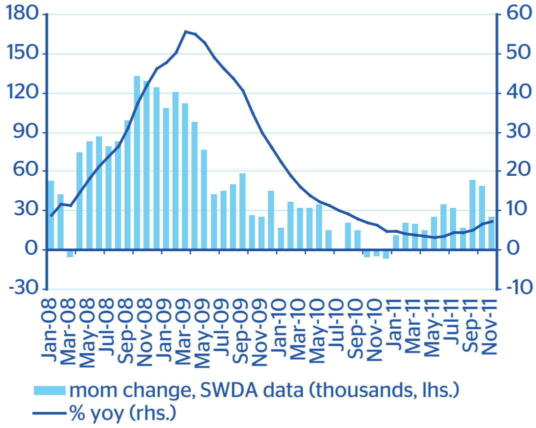
The gross figures point to Social Security affiliation (monthly average) fell by 111.8 thousand of people in November, which was less than estimated (BBVA Research: drop of 96.1 thousand). As anticipated, employment fell sharper in November this year than any other November of the last decade (average: -7.0k, -0.0% mom). Once adjusting for seasonal and calendar effects (SWDA), Social Security affiliation fell by around 62 thousand people in November, similar to October. Employment trends were in line with expectations in all sectors, although the pace of job destruction accelerated in construction and, especially, services. These two sectors accounted for around 54 thousand people of the decrease in affiliation. There was a generalised uptick in unemployment in non-farm productive sectors for the ninth month in a row. The main culprit was the services sector, with an increase of 48.8 thousand of job losses (30 thousand SWDA), followed by construction (5.8 thousand; 6 thousand SWDA).

Chart 9
Spain: average Social Security affiliation



Source: BBVA Research based on MTIN (ministry of labour and immigration) data

Chart 10
Spain: registered unemployment

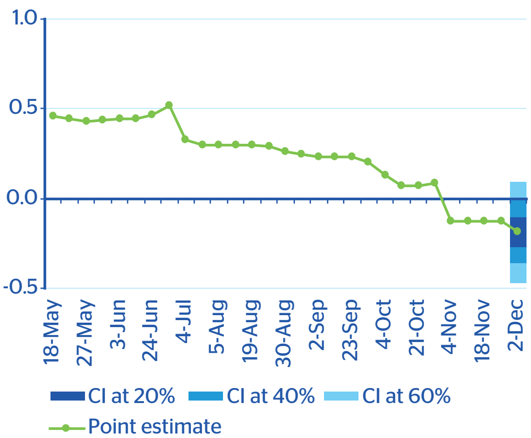


Source: BBVA Research based on SPEE data

Contraction by GDP in 4Q11 considerably more likely now

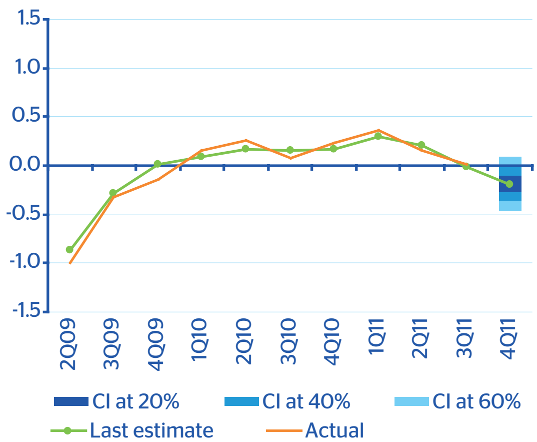
In short, with nearly 50% of the 4Q11 available data, our real-time GDP growth forecast for the fourth quarter is around -0.2% qoq, according to our MICA-BBVA model, figure below the one of our baseline scenario (+0.0% qoq). As we noted in our latest quarterly Spain Economic Outlook released in early November[1], downside risks are greater and more likely. Therefore, consolidation of lower growth scenarios next quarters will depend on policies adopted both externally and internally.

Chart 11
Spain: 4Q11 GDP growth forecasts using the MICA-BBVA model by forecast date (% qoq)



Source: BBVA Research

Chart 12
Spain: GDP growth observed and forecasts using MICA-BBVA model (% qoq)



* Current forecast at 2 December 2011.
Source: BBVA Research based on INE data

1: Available at: http://www.bbvaresearch.com/KETD/fbin/mult/1111_Spaineconomicoutlook_tcm348-275967.pdf?ts=15122011.

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