

Spain

# Economic Watch

Madrid, 7 April 2011

## Economic Analysis

*Spain Unit*

## 1Q11: Recovery remains slow

- **The information released in the first quarter of 2011 points towards a moderate improvement in the economic outlook with respect to the fourth quarter of 2010**

We expect quarter-on-quarter growth in 1Q11 between 0.2% and 0.3%, levels that are still too low to create employment.

- **Consumption indicators continue to reflect the weak recovery in private spending**

This trend is due to certain fundamentals that remain weak, confirming expectations that any recovery in domestic demand will be slow.

- **Meanwhile, exports continue to increase, registering high year-on-year growth rates**

- **During the past few weeks, we have seen a significant improvement in investors' perception of the Spanish economy, which is reflected by the decrease in Spain's sovereign risk premium**

The impact of this improvement on the economic environment will depend on its persistence. In this regard, and for the time being, confidence indicators are not yet showing a significant recovery. The Spanish economy should take advantage of the window of opportunity presented by this improvement in the perception of international financial markets, and carry out a rapid, ambitious and thorough restructuring of the banking system and implement the reforms necessary to accelerate growth and job creation.

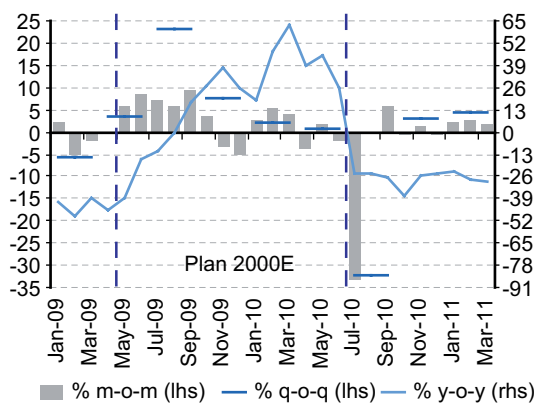
- **The increase in energy prices has triggered a spike in inflation, which may have increased 3.6% (year-on-year) in March**

If second-round effects are avoided, the increase in oil prices will have a limited effect on economic activity and inflation, although it could hinder improvement in the current account deficit.

### The trend in household spending remains unchanged

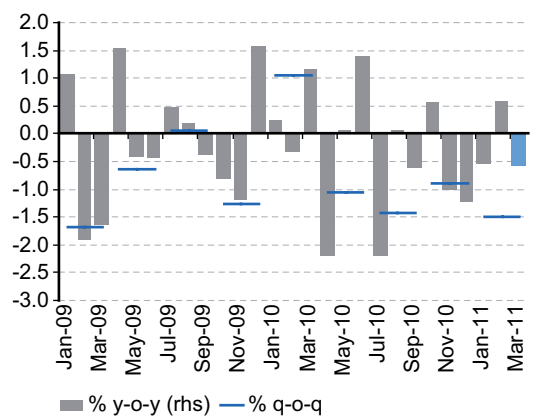
Private consumption indicators continue to show scant improvement. In particular, car registrations increased 4.2% quarter-on-quarter in 1Q11 once seasonal adjustment and calendar effect (SWDA data) corrections were made. This increase was due to the positive performance of demand from companies, which continues to partially offset the decline in the retail channel. Furthermore, although retail sales grew in real terms in February (SWDA data) driven by the positive performance of personal spending on equipment and other goods, its contribution to domestic demand will remain negative in the 1Q11, due to the negative performance seen in January and forecasted for March. Lastly, consumer confidence stabilised in 1Q11, and the trend does not suggest any pick-up in household consumption for the coming months.

Chart 1  
**Spain: car registrations (SWDA data)\***



\* SWDA: Seasonally- and calendar-adjusted  
Source: BBVA Research based on ANFAC and Ganvam

Chart 2  
**Spain: retail sector constant prices (SWDA data)\***

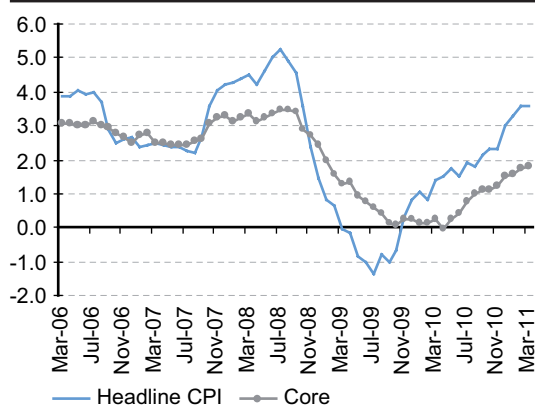


\* SWDA: Seasonally- and calendar-adjusted  
Source: BBVA Research based on INE

### Uncertain outlook of spending fundamentals continues to slow down its recovery

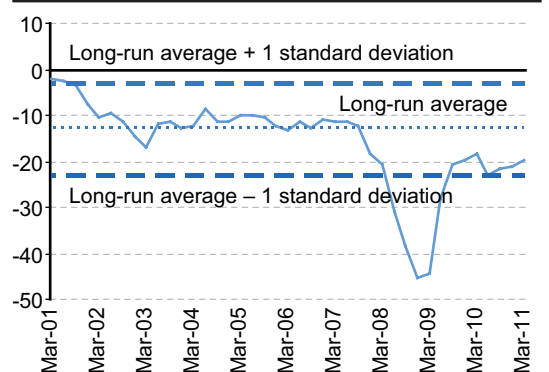
According to the CPI leading indicator, annual inflation rates stabilised in February, at 3.6%, a figure in line with our forecast (BBVA Research: 3,6%). The annual inflation rate measured through the HICP slowed down 0.1pp until a 3.3% year-on-year rate. In any event, the sharp increases in prices pose a threat to any recovery in private spending, especially against a backdrop of falling wages, the result, in part, of declining employment. According to data provided by the Bank of Spain, wages fell 1.9% year-on-year in nominal terms during 4Q10, representing a 0.5% drop in gross disposable income for the same period. This performance was made possible by an increase in other income components, which are expected to be temporary. In any case, this scenario will produce an average households' real income decrease again in 2011.

Chart 3  
**Spain: inflation (year-on-year change)**



Source: BBVA Research based on INE

Chart 4  
**Spain: consumer confidence (quarterly average of net responses)**



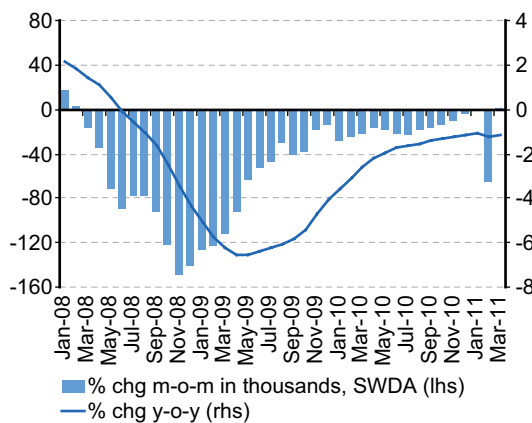
Source: BBVA Research based on European Commission figures

**Although the decline in social security affiliations has slowed significantly, economic growth is still too weak for job creation**

Labour market data for March, slightly positive for social security affiliations but negative in terms of unemployment, closed the first quarter of 2011 repeating a stagnant situation. Once the seasonal effects of the period are accounted for, it appears that the economy is still unable of creating jobs, despite the fact that the increase in unemployment has gradually slowed down. Particularly noticeable was the increase recorded in the average number of social security affiliations, which jumped by 46,000 people, higher than our main forecast (BBVA Research: +17,000), although after correcting this figure for seasonal variations, employment stayed flat. Only the service sector created jobs, beating forecasts and offsetting the deterioration of employment in the agricultural sector.

Chart 5

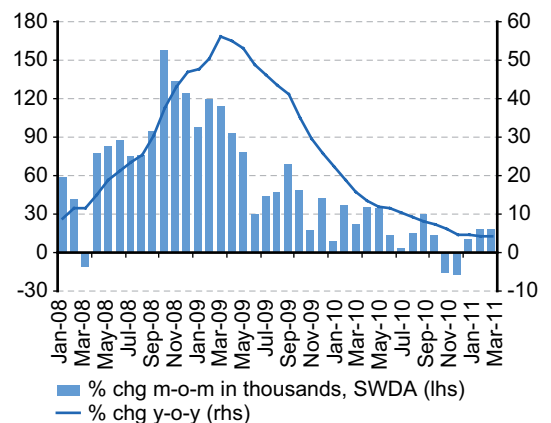
**Spain: average social security affiliations**



Source: BBVA Research based on MEH and INE

Chart 6

**Spain: registered unemployment**



Source: BBVA Research based on MEH

**The pick-up in housing transactions at the end of 2010 might be only temporary**

According to the Ministry of Transport and Public Works real estate transaction data, home sales jumped 14.2% year-on-year in the fourth quarter of 2010, an increase that was mainly driven by sales of existing homes. In 2010, home sales increased 5.9% with respect to 2009, the first increase after three years of declines. The increase in VAT and the elimination of the deduction for home purchases combined with economic agents' improved expectations, played major roles in this temporary improvement.

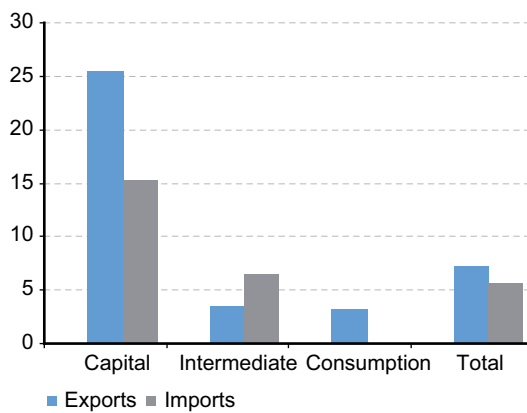
This more robust demand was accompanied by a slight recovery in supply. In January, 6,784 permits for new housing were issued, a figure that, while higher than our main forecast, was in line with our base scenario. Although residential building continues to fall, it is doing it at a slower rate. Meanwhile, the remodelling of existing housing stock has declined.

**Exports remain strong, providing further support to the slow recovery process**

Despite the sustained financial tensions in Europe and rising oil prices, industrial production had a good performance in the first two months of 2011. During this period, the qualitative indicators for this sector are pointing in the same direction: industrial confidence consolidated at levels higher than its historical average and the foreign order book stood at levels above its average pre-crisis level. However, the slowdown of trend growth rates in most of the components of the industrial output index (IOI) persists, which coupled with the confidence fall in March anticipates a slower recovery rate of economic activity in the short term, which is mainly linked to weakness of domestic demand. In contrast, the foreign order book confirms that external demand has not lost steam, and as a result, industrial production of intermediate and capital goods should continue their gradual recovery.

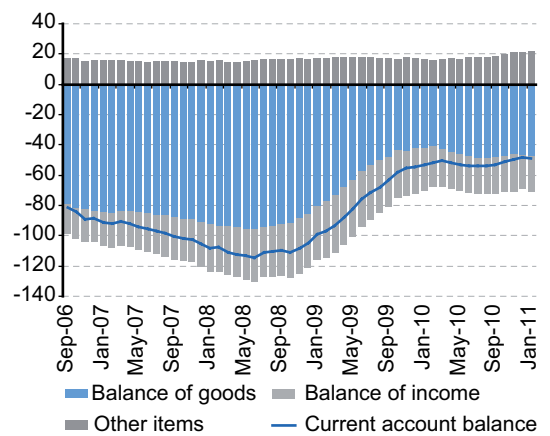
In line with the industrial production performance, foreign trade volume data in January (SWDA) shows robust growth in exports (+7.2% m-o-m SWDA) with capital goods posting the strongest performance (+25.5% m-o-m SWDA). This increase in sales abroad was accompanied by a sharp increase in imports of capital and intermediate goods (+15.2% m-o-m and +6.5% m-o-m, respectively, SWDA). Meanwhile, in line with the subdued tone we are seeing in domestic demand, imports of consumer goods still stagnated.

Chart 7  
**Exports, Imports in January, volume m-o-m SWDA (%)**



Source: BBVA Research based on Customs data

Chart 8  
**Current account balance, 12 month cumulative (Euros)**



Source: BBVA Research, based on Bank of Spain data

### Rising oil prices and the high risk premium hinder improvement in the current account deficit

The current account deficit started 2011 at a slightly higher level than in December 2010, at EUR 49,200 million (12 month cumulative). Although this deterioration was in line with our forecasts, it was slightly worse than expected, mainly due to the greater than expected deterioration in the income balance.

### The current context of weak economic growth requires spending cuts in order to meet the 2011 stability targets

At the end of February 2011, the accumulated government surplus stood at 0.2% of GDP, compared to 0.3% registered in the first two months of last year. This result is shaped by the autonomous region financing system, which was applied comprehensively for the first time in 2011. According to the government, without this effect the surplus would have been greater than 0.2% of GDP. The spending adjustments continue, entailing cuts across the board with respect to last year, except in interest expenses. Most of the spending cuts were in investment (30% of cumulative at February, with respect to previous year), and in the remuneration of salaried workers. The transfers between public administrations decreased (13.9% with respect to February 2010), mainly as a result of fewer transfers to autonomous regions due to the lower down payments of the financing system.

Government revenues fell with respect to the same period in 2009, as a result of the aforementioned increased participation of autonomous regions in government tax collection. However, analysis of tax receipts shows signs of improvement in these revenues, the recovery of which is once again being driven by the hike in VAT, which is showing a uniform year-on-year increase of 9.2%. In regard to other tax revenues, personal income tax receipts were boosted by the elimination of the EUR 400 deduction, which more than offset the effects of the rise in unemployment. Although corporate tax receipts appear to be gradually recovering, this item continues to show a negative growth rate. Lastly, on a more anecdotal level, the sale of cigarette packs registered a historic drop in February, which caused a decrease in receipts from the special tobacco tax.

In general, the data confirms an improvement in revenues. Should this trend continue over the course of the year, it should allow the scheduling spending cuts (if carried out in a rigorous fashion) to be implemented and the government to meet the financial stability objectives it set for this year.

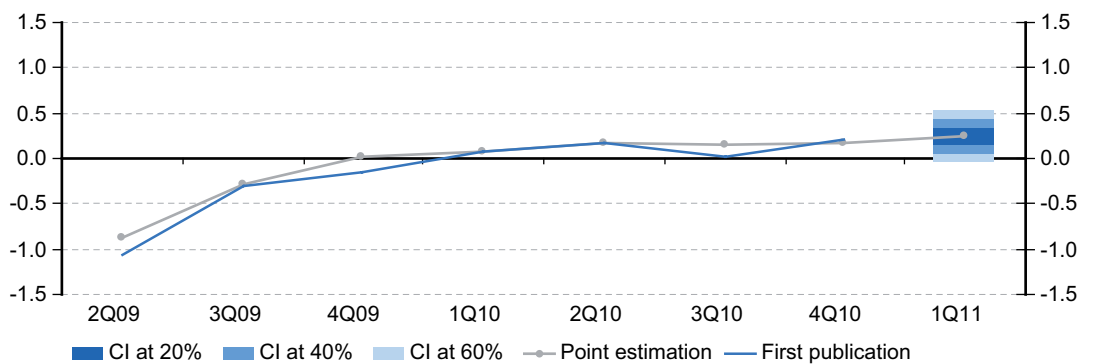
**Growth in the first quarter should be between 0.2% and 0.3% q-o-q**

In summary, the analysis based on our MICA-BBVA model, with slightly over 87% of the data for the first quarter available, shows a real-time forecast for GDP growth for this quarter, between 0.2% and 0.3% q-o-q. This figure is in line with the growth forecasted by our main scenario (+0.2% q-o-q). As we noted in the last edition of our quarterly publication, *Situación España*, at the beginning of February<sup>1</sup>, the economic recovery remains weak and incapable of preventing a contraction in employment. We believe that Spanish economic growth will stay in line with our main scenario, and expect GDP to increase about 0.9% for the whole 2011.

Chart 9

**Spain:**

**Observed GDP growth, and GDP growth forecasts of MICA-BBVA model (% q-o-q)**



\* Forecast conducted April the 7th 2011  
Source: BBVA Research based on INE

1: Available at: [http://www.bbva.com/KETD/fbin/mult/1102\\_Situacionespana\\_tcm346-246265.pdf?ts=232011](http://www.bbva.com/KETD/fbin/mult/1102_Situacionespana_tcm346-246265.pdf?ts=232011)

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