Economic Update Spain

6 March 2012

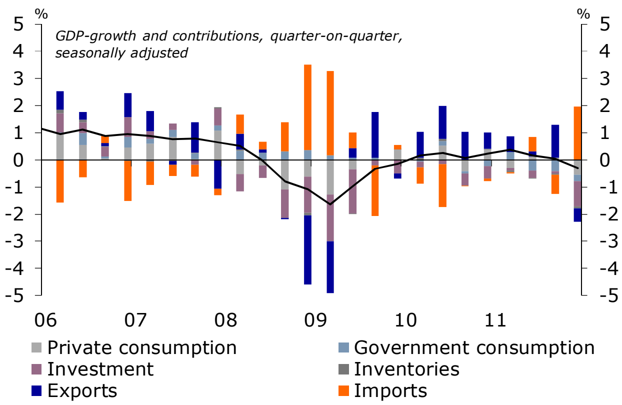
Austerity casts a shadow on the economic outlook

Year-on-year change (%)	'11	'12	'13
Gross Domestic Product	0.7	-¾	¼
Private consumption	0.3	-1½	0
Government consumption	-0.9	-5¼	-4½
Investment	-6.1	-4	½
Exports	9.7	2½	5¼
Imports	1.6	-5	2¾
Inflation	3.3	1¾	1
Unemployment (%)	21.7	23¼	22¾
Government budget (% GDP)	-8.5	-6	-4
Government debt (% GDP)	70	75	78

Source: Reuters EcoWin, Rabobank

The Spanish GDP volume fell by 0.3% q-o-q in the last quarter of 2011. We expect a further contraction in the first quarter of the current year. As a result, within two years from the end of the previous recession, a new one has started. Government spending cuts and tax hikes will have a negative impact on domestic demand this year. To reduce the impact of the austerity measures, the government has adjusted its deficit target upwards. The sizeable liquidity provision by the ECB is providing some much needed breathing space for the government to win back investor confidence through austerity and reform.

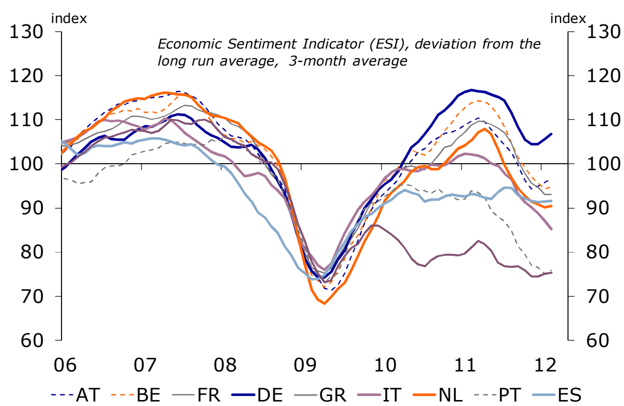
Sharp fall in imports softens the start of recession



Source: Reuters EcoWin, Rabobank

Spanish economic activity fell back in the last quarter of 2011. Both exports and all components of domestic demand declined relative to the quarter before. Exports fell by 1.6% on the quarter, consumer spending contracted by 1% and investment dropped a sizeable 4.3%. But with imports falling by a whopping 6.5%, the contraction of GDP was limited to 0.3% q-o-q. Lower imports also resulted in a small surplus on the trade balance in fourth quarter of 2011. This has not been seen since 1998 and is a very sizeable adjustment from the 7.5% of GDP trade deficit in the last quarter of 2007.

Economic sentiment holds up well for now…



Source: Reuters EcoWin, Rabobank

Despite the new recession, the continued rise in unemployment (to 23.3% in January) and the announcement of further austerity measures, economic sentiment has remained remarkably stable over the past few months. Consumer confidence fell in the first two months of the year, but remains much higher than during the 2008/09 recession. Business confidence in both manufacturing and services rose in the same months. The overall Economic Sentiment Indicator remained relatively stable around the level on which it has been since early 2010. This in marked contrast to Portugal and Italy, where sentiment has fallen rapidly on the back of (the announcement of) government budget cuts.

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Tim Legierse
Tel. +31(0)30 – 2162677
T.Legierse@rn.rabobank.nl

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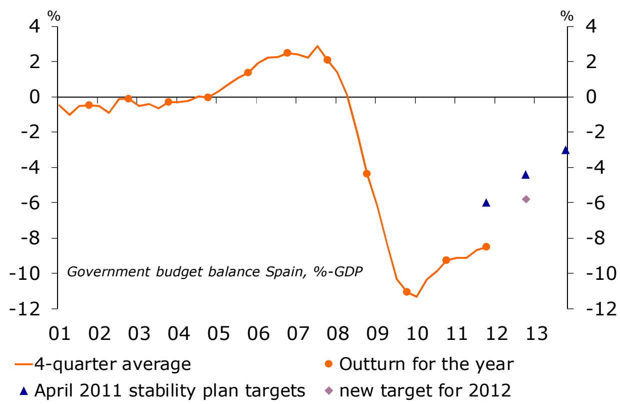
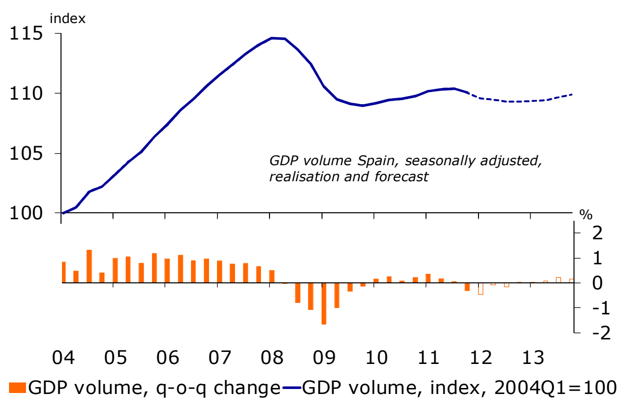
… but the government embarks on austerity…



Source: Reuters EcoWin, Spanish ministries

Despite the recent relative stability in consumer- and producer confidence, we do expect further economic contraction in most of 2012. The Spanish government has announced new austerity measures to make up for the deficit overshoot of 2011. Fortunately, they have decided to lower the target deficit for 2012 to 5.8%-GDP from the 4.4% goal of the previous government. If they had stuck to the original path for the deficit, further large scale budget cuts would have weighed down on economic activity even further. The experience in Greece has shown that this does not always lead to the desired pace of actual budgetary adjustment.

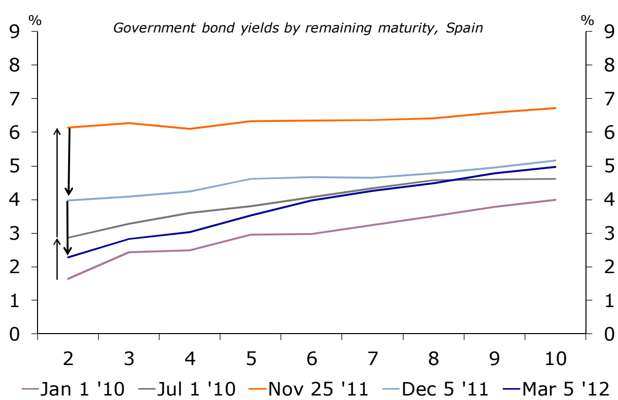
… making the economic outlook rather bleak



Source: Reuters EcoWin, Rabobank

Even with the current budgetary plans, government spending is set to contract quite heavily in the two years to come. Tax hikes will reinforce the impact that rising unemployment is having on disposable income, leading to falling private consumption. The decline in domestic spending will have a negative impact on private investment. The only positive development that we see is an anticipated gradual rise in world trade growth, which should lift Spanish export growth in the course of this year. In all, we expect some modest GDP-growth to return no sooner than 2013. As a result, GDP will still be smaller at the end of 2013 than it was at the end of 2011.

ECB provides some breathing space



Source: Reuters EcoWin

The Spanish government is more pessimistic than we are on the economic outlook. In the budgetary plans, real GDP is assumed to fall by 1.7% in 2012. Realistic and above all not too optimistic growth assumptions are crucial for convincing investors that the budgetary targets are feasible. The provision of three year loans from the ECB to the European banks has resulted in a marked decline of government bond yields on the short end of the curve. Previously, ECB bond purchases had already led to a fall in 10 year yields. The lower interest rates give the government some time to regain investor confidence in the course of the year.

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