



Economic Update Spain

1 March 2011

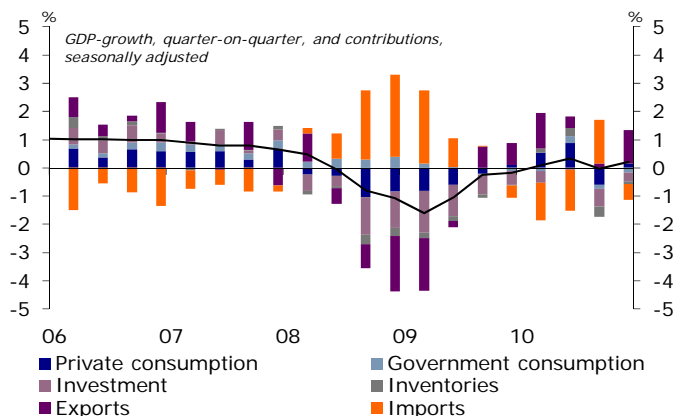
More production, less employment

Year-on-year change (%)	'10	'11	'12
Gross Domestic Product	-0.1	¾	1¼
Private consumption	1.2	0	½
Government consumption	-0.7	-¾	¼
Investment	-7.6	-1	3
Exports	10.3	7	4
Imports	5.4	1¾	1¾
Inflation	2.0	2¾	1¼
Unemployment (%)	20.1	20¾	20¼
Government budget (% GDP)	-9.3	-7	-5½
Government debt (% GDP)	64.4	70	73

Although Spanish GDP in 2010 was marginally lower than in 2009, economic growth during the year was an average 0.15% per quarter. Due to a further fall in employment, production per worker rose, leading to lower unit labour costs. The resulting improvement in price competitiveness is a welcome development, since the economic recovery is highly dependent on foreign demand. A problematic feature of the falling unit labour costs is that they are solely attained by lower employment and not by lower wages. Sadly, the well protected employees on permanent contracts have negotiated a whopping 3% wage growth to compensate for inflation.

Source: Reuters EcoWin, Rabobank

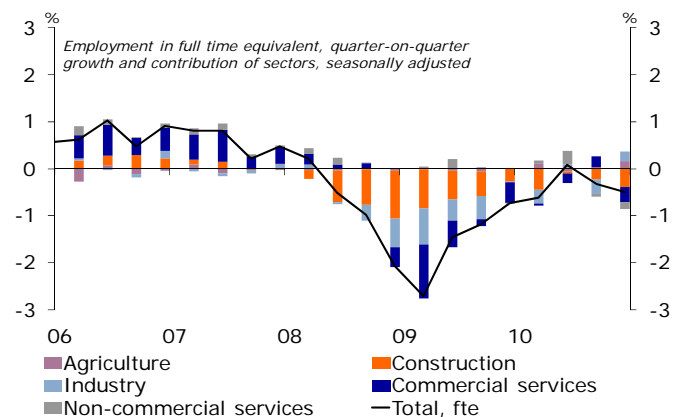
Cautious GDP growth...



After stagnating in the third quarter, GDP resumed its growth path in the fourth quarter, with 0.2% q-o-q. Private consumption rose by 0.25%, but this by no means made up for the sizeable contraction in the quarter before. Investment posted its 12th consecutive quarterly decline. Government budget cuts were clearly visible in the further fall in government consumption. Against the drop of domestic demand, export posted a very strong 3.9% increase on the quarter, leading to the modest GDP increase. The rise of the February European Commission's Economic Sentiment for Spain suggests a further small rise in GDP in the first quarter of 2011.

Source: Reuters EcoWin

...but employment is still in decline...



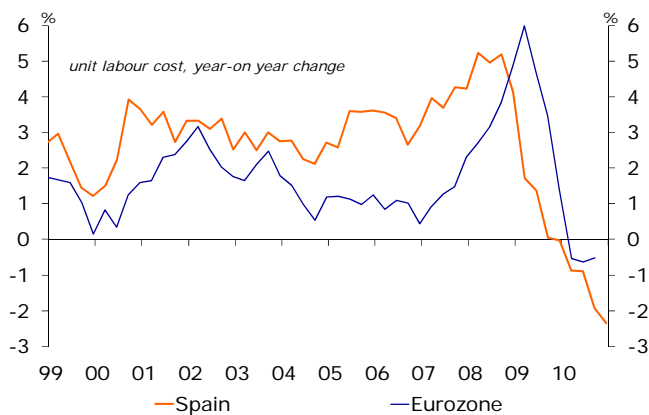
Although GDP rose on average by 0.15% a quarter in 2010, employment still fell by an average 0.35%. In the second half of the year, the employment contraction actually regained traction on the back of a renewed strong fall of employment in the construction sector. This is due to the decline of government infrastructure investment, which has been adding to the continued decline in housing investment. But employment in the industrial and service sectors have also continued to fall on average over the past year. The continued economic recovery should lead to a modest increase in employment going forward, but we doubt this will be strong enough to bring down the unemployment rate back under 20% this year.

Source: Reuters EcoWin

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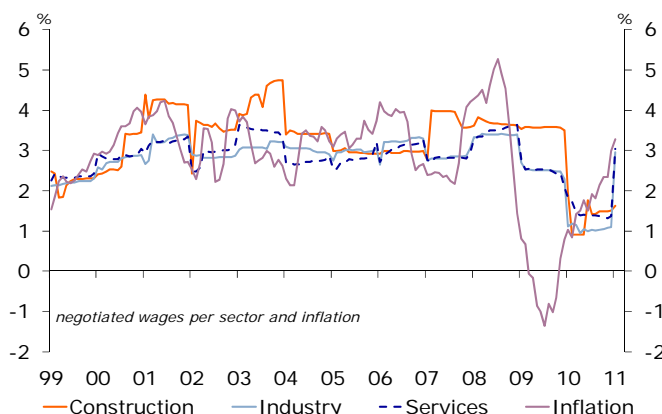
... so unit labour costs continue to fall...



The combination of growing production and falling employment lowered unit labour costs (ULCs), the year-on-year decline of which accelerated to 2.3% in the last quarter of 2010. As this fall in labour costs is larger than the eurozone average, Spanish price competitiveness has improved. This is important, since the economic recovery is highly dependent on exports. In the previous economic update for Spain, we voiced our concern that wage growth might react to the sharp increase in inflation, which will slow down the fall in labour costs and with that the economic rebalancing process. Unfortunately, this is exactly what happened.

Source: Reuters EcoWin

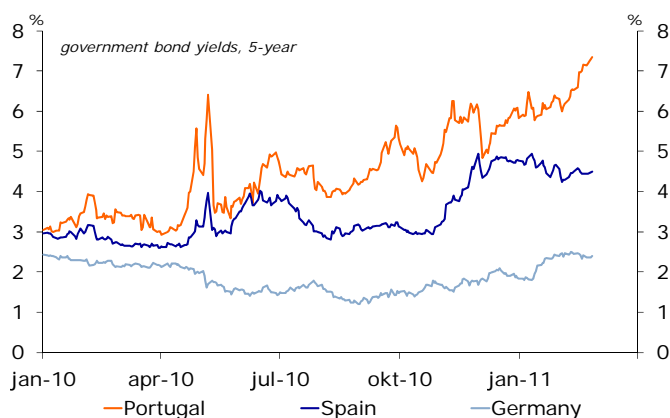
... but wage growth shows strong reaction to inflation



Negotiated wages jumped from 1.3% y-o-y in December to a staggering 3% in January. Wage growth was only kept in check in the construction sector. Of course, the increase in wages is of no use at all to the 4½ million unemployed. The well protected employees on permanent contracts have managed to negotiate this result. They have demanded higher wage growth to compensate for the strong rise in inflation. The labour establishment is more concerned with its own purchasing power than with employment growth. As a result, the unequal distribution of the economic pain is maintained. This is sad in itself, but also bad for social cohesion in a period of considerable government budget cuts.

Source: Reuters EcoWin

Spain sets itself apart from Portugal



Economic growth, attaining the budget target for 2010, more clarity on budgetary developments at regional governments and increased transparency on the financial situation of the saving banks have resulted in a modest fall in government bond yields since December of last year. As such, Spain has managed to distance itself from Portugal. Even so, it is much too early to conclude that the country has definitely won back investor confidence. Interest rates are still relatively high, and both the economy and the financial sector remain in a precarious state. To keep the planned deficit reduction on track, further budget cutbacks are necessary. The moment for the government to sit back relaxed and satisfied is still far far away in the future.

Source: Reuters EcoWin, Rabobank

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