Rabobank

# Economic Update Spain

## 8 May 2012

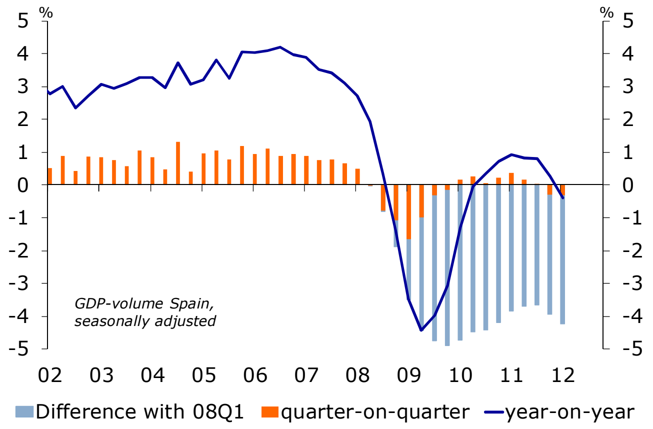
### First quarter GDP data set the stage for a tough 2012

| Year-on-year change (%) | '11 | '12 | '13 |
|---|---|---|---|
| Gross Domestic Product | 0.7 | -1¼ | -¼ |
| Private consumption | 0.3 | -1¾ | -¼ |
| Government consumption | -0.9 | -5¼ | -4½ |
| Investment | -6.1 | -6 | -2 |
| Exports | 9.7 | 2½ | 5¼ |
| Imports | 1.6 | -5 | 2¾ |
| Inflation | 3.3 | 1¾ | 1 |
| Unemployment (%) | 21.7 | 25¼ | 26 |
| Government budget (% GDP) | -8.5 | -6 | -4½ |
| Government debt (% GDP) | 70 | 79 | 84 |

Source: Reuters EcoWin, Rabobank

The Spanish economy contracted by 0.3% q-o-q in 12Q1 – exactly matching the decline in the previous quarter. As a result, after less than two years of a very timid recovery since the 2008/09 contraction, Spain is back in recession. Harsh austerity measures will further weigh on domestic spending this year. Export growth will not be able to compensate fully, leading us to expect that the recession will continue until the end of the year. This will push up the already worryingly high unemployment rate. We hope that the European Commission will follow both the text and the spirit of the fiscal agreements by giving Spain more time to bring down its budget deficit.

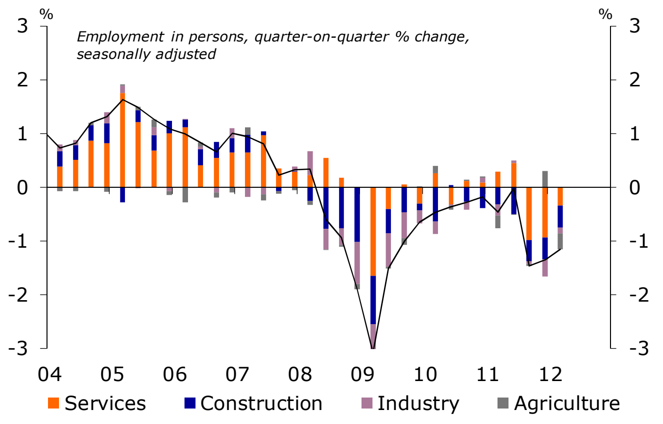
### Back in recession, as expected




Source: Reuters EcoWin

As we expected, the Spanish GDP volume contracted for the second quarter in a row in the first quarter of the year, meaning the economy is back in recession. Domestic production fell by 0.3% q-o-q in both quarters. Compared to the sharp declines seen during the previous recession, this is a rather modest pullback. But we should put this new recession in the context of a very sluggish and incomplete recovery from the former period of falling production. The recent declines have brought output back to its 10Q4 level, which is 4.2% below the peak level of GDP reached before the economic crisis struck.

### Employment continues to fall back sharply




Source: Reuters EcoWin, Rabobank

In the 7 quarters between the two recessions, GDP growth has never been high enough to lead to an increase in employment. The number of people employed in construction and manufacturing has fallen almost continuously since the second quarter of 2008. After some modest growth of employment in the services sector, this sector was also hit hard by employment losses in recent quarters, pushing up the pace of overall job losses severely. The increase in the unemployment rate has picked up significantly since the middle of 2011 as a result. In one year, the unemployment rate rose from 20.8% in March 2011 to 24.1% in March 2012.

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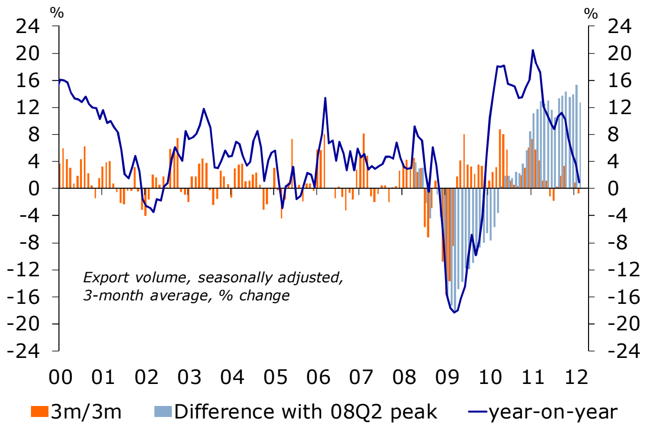
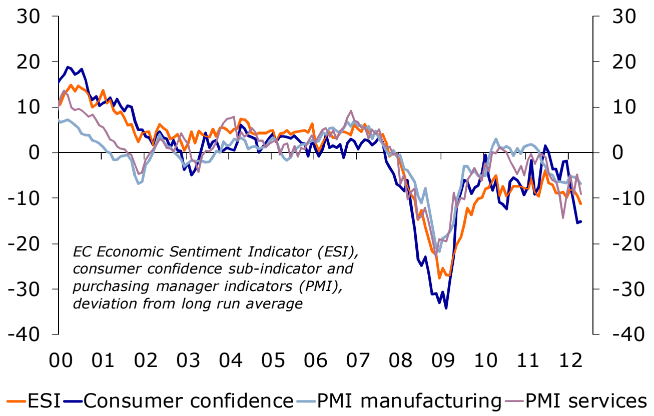
### Exports unable to continue supporting the economy




Source: Reuters EcoWin

The return of recession is not just caused by the continued fall of domestic demand. The lacklustre economic recovery since early 2010 had been underpinned by a sharp rise in exports. For some time, the rise in foreign demand was enough to compensate for the contraction of domestic spending. But in 11Q4, the export volume fell for the first time in two years. Monthly figures for goods exports up to and including February point to a further fall in 12Q1. We expect a renewed pick-up in exports in the second half of the year on the back of growing world trade. But this will not be enough to pull the economy out of recession.

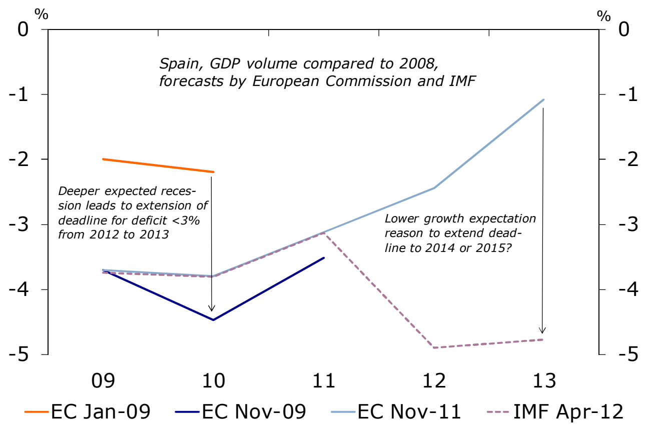
### Recession set to continue




Source: Reuters EcoWin, Rabobank

The decline in sentiment indicators has been relatively modest up to April. But we do expect the recession to deepen in the coming months. Households will see their real disposable income fall due to (i) lower employment, (ii) a contraction of real wages (iii) higher taxes and lower government transfers. The government is set to embark on further sizeable spending cuts. The renewed rise in government bond yields and pressure from Brussels mean the government has precious little room to go easier on austerity. Businesses will cut down on investment spending. Meanwhile, banks are hardly in a position to provide credit to the few households and firms that will ask for it.

### Some breathing space please




Source: European Commission, IMF, Rabobank

The recently announced austerity measures will have a sizeable negative impact on Spanish economic growth both this year and next. This while most of the European countries are also currently in recession. As such, we deem it highly unlikely that the government can reduce its budget deficit to 3% next year, as has been agreed with the European Commission (EC). That agreement dates back to November 2009. Since then, economic prospects have deteriorated sharply. As in 2009, this should be sufficient reason for the EC to give Spain more time to adjust its budget. Note that this would not constitute changing the fiscal rules as some suggest. It will simply be about applying the fiscal rules in an appropriate manner.

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