

Economic Update Spain

1 November 2011

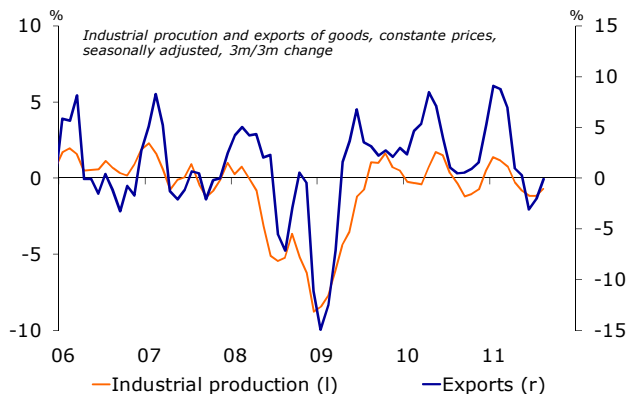
Labour market taking a new hit

Year-on-year change (%)	'10	'11	'12
Gross Domestic Product	-0.1	½	1
Private consumption	1.2	½	½
Government consumption	-0.7	-¼	-1¼
Investment	-7.6	-5½	1
Exports	10.3	8¼	5
Imports	5.4	2	2
Inflation	2.0	3	1¾
Unemployment (%)	20.1	21	20¼
Government budget (% GDP)	-9.2	-6½	-5½
Government debt (% GDP)	60.1	68	71

The available production-, sales- and sentiment indicators for the third quarter of the year point to slowing economic growth. Exports seem to be recovering from the 11Q2 contraction but domestic demand is falling back faster. Government austerity measures play an important role and were probably also partly responsible for the big drop in employment in the third quarter. This pushed up the seasonally adjusted unemployment count to over 5 million people. Falling economic sentiment up to November clearly points to the risk of a new recession. But the likely contraction in output will by no means be as big as that seen during the 2008/2009 recession.

Source: Reuters EcoWin, Rabobank

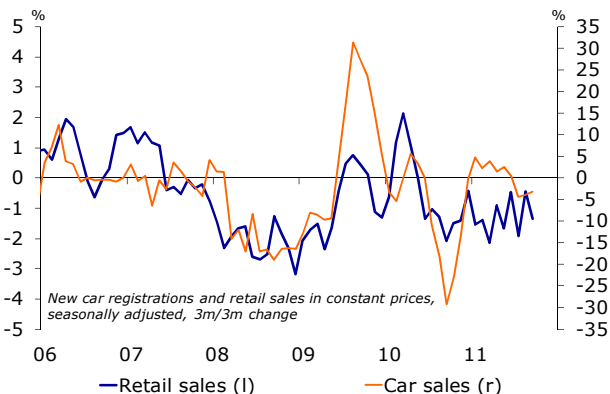
Exports recover from bad second quarter...



After a disappointing second quarter, exports seem to be recovering in 11Q3. The volume of goods exports increased by a whopping 10.9% m-o-m in August. Even if exports drop back sharply in September, as is likely after such a strong rise, export growth for the third quarter as a whole will be more than enough to make up for the contraction in 11Q2. Given the slowdown in world trade and the intensification of the European debt crisis, the outlook for export growth in the rest of the year is not favourable. Still, even a weak figure in the final quarter of this year will not alter the impressive performance for the year as a whole, which made exports post a sizeable contribution to overall economic growth.

Source: Reuters EcoWin, Rabobank

... but consumer spending is weakening



Because of a continued contraction in domestic demand, industrial production (IP) has only partly benefitted from strong export growth. IP rose 1.3% m-o-m in August. But this was insufficient to compensate for the contraction in the two preceding months. Given the further deterioration of producer confidence in September, industrial production will likely have fallen in the third quarter as a whole. Retail sales continued to fall in 11Q3 while car sales fell back into negative territory after some modest growth in the first half of the year. Coupled with recent falls in consumer confidence and continued government austerity, this points to a contraction of consumer spending in the second half of the year.

Source: Reuters EcoWin

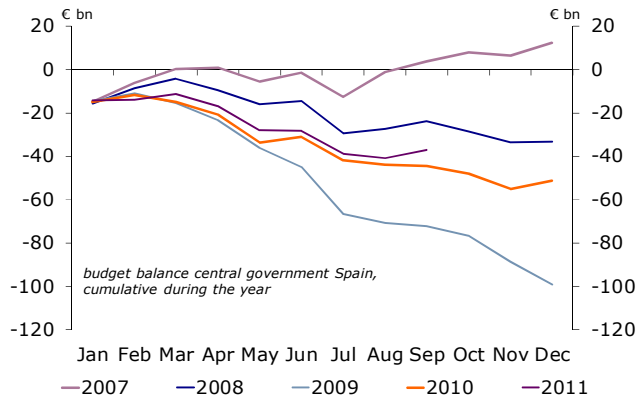
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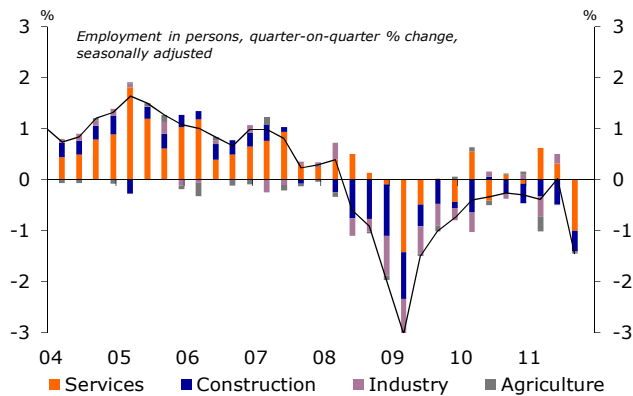
Government broadly on track with deficit reduction...



Source: Reuters EcoWin

The central government deficit came in better than planned in the year to September. The 0.8% of GDP improvement relative to last year seems very modest. But due to a change in the division of tax income between Madrid and the regional governments, the central government will have to reduce its deficit by only 0.2% of GDP this year. Unfortunately, the better than expected outcome at the central level is more than undone at the regional level, where the deficit target for the year as a whole was already reached in the first half of the year. As a result, the desired overall deficit reduction from 9.2%-GDP in 2010 to 6%-GDP this year is probably out of reach. But a 6½% deficit is still feasible.

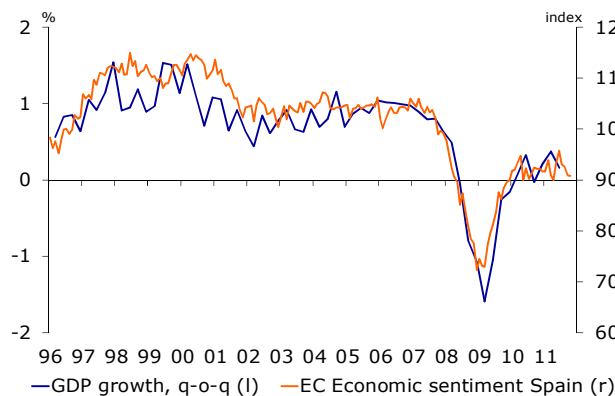
... but austerity is biting into employment



Source: Reuters EcoWin, Rabobank

Regional government efforts to contain the budget overruns by firing staff seem to be one of the factors in the steep decline in third quarter employment. Adjusted for seasonal effects, employment fell by 1.5% q-o-q, which pushed up the unemployment count to over 5 million people. The contraction in employment was concentrated in the services sector. Apart from regional and state level budget cuts, the weakness of private domestic demand discussed above plays a role here. Also, overnight stays by foreign tourists grew more modestly in the summer than during spring, probably leading to less job creation in the tourism sector in the third quarter.

On the brink of recession



Source: Reuters EcoWin

The available production-, sales- and sentiment indicators for the third quarter of the year point to slowing economic growth. With a 0.2% expansion in 11Q2 as a starting point, such a slow-down will easily lead to stagnation or even contraction of output. The broad Economic Sentiment Indicator (ESI) for Spain and a first estimate by the Banco de España suggests that GDP stagnated in the third quarter. On balance, we expect output to slightly fall back in the second half of the year. The lacklustre recovery coupled with the steep recession of 2008/2009 means that at the end of next year GDP will probably still be more than 2% smaller than it was in the first quarter of 2008. As a result, unemployment will remain very high for some time to come.

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