



Economic Update Spain

3 July 2012

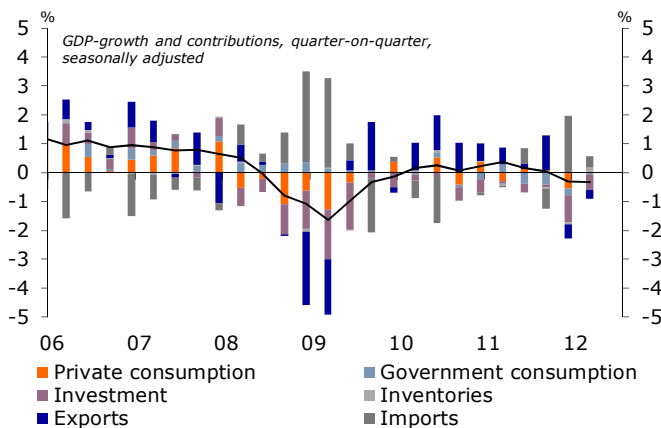
Recession deepens

Year-on-year change (%)	'11	'12	'13
Gross Domestic Product	0.7	-1¼	-1½
Private consumption	0.3	-2	-1½
Government consumption	-0.9	-4½	-3¼
Investment	-6.1	-8½	-1¼
Exports	9.7	1¾	5½
Imports	1.6	-7	1¾
Inflation	3.3	1¾	1
Unemployment (%)	21.8	25¼	26¼
Government budget (% GDP)	-8.5	-6	-4½
Government debt (% GDP)	69	79	85

Following two quarters of a 0.3% q-o-q GDP contraction, the decline in economic activity probably accelerated in 12Q2. This expectation is based on (i) further falls in sentiment indicators during Q2, (ii) retail- and car sales up to May, (iii) exports and industrial production in April. Even so, it is unlikely that the pace of contraction will again reach that seen during the 2008/09 recession. The fall in house prices has accelerated since the start of the year and price declines will probably continue in the coming months. The fact that the government has been unable to reduce the budget deficit up until May is worrying. Corrective action is needed to prevent further slippage.

Source: Reuters EcoWin, Rabobank

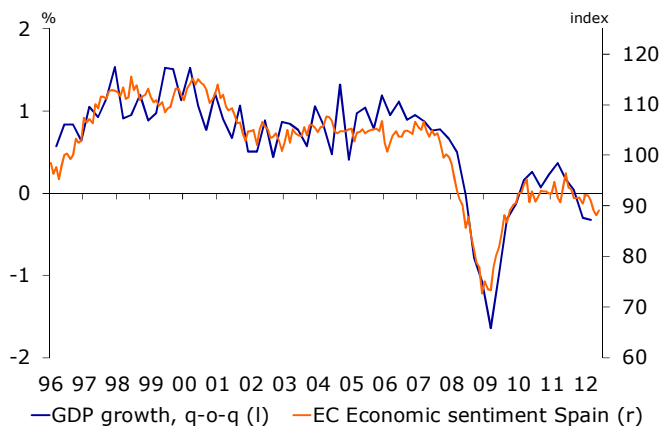
Spending falls less quickly but GDP falls at same pace



Like the flash estimate, the expenditure breakdown for 12Q1 GDP revealed a 0.3% q-o-q contraction. This was the same pace of contraction as seen in 11Q4. But the expenditure breakdown for the first quarter of 2012 was more positive than in the last quarter of 2011. Consumer spending stagnated after having fallen sharply previously. The contraction of government consumption, investment and exports was considerably less pronounced. At the same time, imports fell less sharply as well. As a result, the decline in GDP was equal in both quarters despite the less adverse developments in both domestic and external demand.

Source: Reuters EcoWin

Output decline accelerates



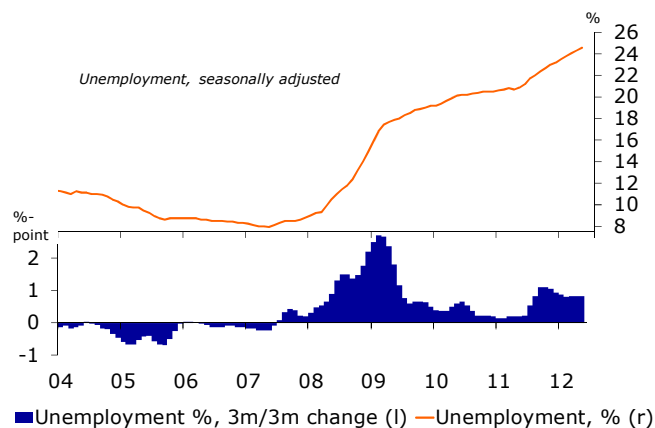
Sentiment indicators deteriorated further in the second quarter. The manufacturing PMI declined in each month from March to June. The services PMI and the European Commissions' Economic Sentiment Indicator improved slightly in June, but only after sharp falls in the previous months. Taken together, these indicators point to continued recession in 12Q2 with GDP probably contracting faster than in the previous quarters. But a return of the sizeable output declines seen in the 2008/09 recession is unlikely. More direct activity data on exports and industrial production up to April and on retail- and car sales up to May support this expectation.

Source: Reuters EcoWin

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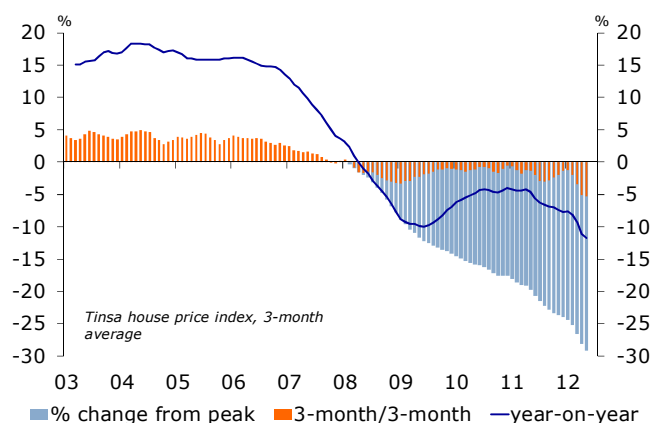
Unemployment continues to rise



Source: Reuters EcoWin

The further rise in unemployment also points to continued recession. Unemployment reached 24.6% of the labour force in May. The monthly rise in the unemployment rate has hovered between 0.2- and 0.3%-point since November 2011. Data from the Labour Ministry point to a further modest rise in June. The relatively modest rise in unemployment may seem inconsistent with our expectation of a deepening recession. But it may well be the case that discouraged job seekers drop out of the labour force and stop being counted as unemployed. In that case, the rise in the unemployment rate underestimates the decline in employment.

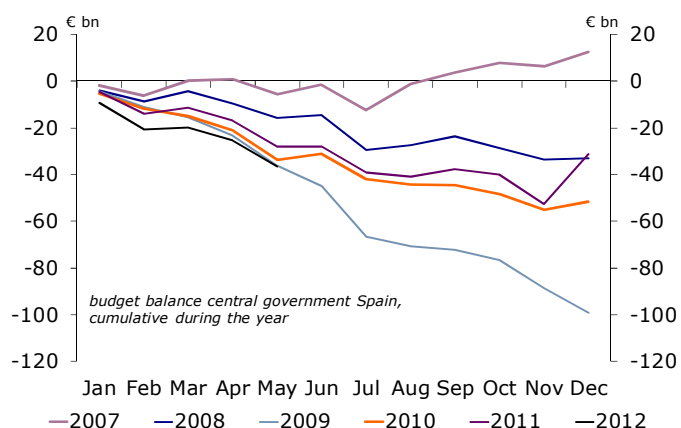
House price decline accelerates



Source: Tinsa

The drop in house prices has accelerated sharply since the start of the year. In 12Q1, the price index compiled by the national statistics bureau recorded the biggest quarterly decline since the start of the crisis. The same is happening in 12Q2 to the price index published by valuation agency Tinsa. Further price falls are likely, meaning that the 2012 price decline will be bigger than the one in 2009 and 2011. The adverse scenario that the IMF used to calculate the capital needs for the Spanish banks assumes bigger declines for both house prices and GDP than are currently likely. As such, the deteriorating economy does not point to even bigger problems for the banks.

Government unable to reduce deficit until now



Source: Reuters EcoWin

The return of recession makes bringing down the budget deficit a very hard task. The regional governments, which were responsible for the majority of last years' deficit overshoot, managed to reign in their spending in 12Q1. But the deficit for the general government as a whole was stuck at the same level as a year ago. Central government data for the first two months of 12Q2 were equally disappointing. The cumulative central government deficit up to May is as high as it was three years ago. Granted, part of the budget 2012 measures announced at the end of March still have to take full effect. Even so, further austerity measures to prevent another sizeable deficit overrun seem necessary.

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