

BBVA Economic Research Department presents “Spain Watch” report

BBVA Economic Research Department: “Ongoing adjustments in the Spanish economy shape recovery against an external backdrop not exempt from risk”

- The main risk facing the global economy is the premature unwinding of stimulus plans and uncertainty over whether private spending can replace public spending as the main driver of recovery once these plans have been withdrawn
- In 2009, Spanish GDP looks set to contract in line with the rest of the euro zone
- BBVA Economic Research Department estimates higher potential growth (of around 2%) for the Spanish economy once the crisis is over than the **EU**. Nevertheless, it believes these growth forecasts can be raised if more structural reforms are adopted faster
- According to BBVA Economic Research Department, job losses will gradually ease in 2010, with unemployment stabilizing at around 20%
- The real estate sector continues to struggle and excess supply could begin dropping at the beginning of 2010. Greater access to home buying, with lower interest rates and possibly lower prices, should help the downturn end
- “A more decisive use of fiscal policy for counter-cyclical purposes and the swift adjustment in net trade have helped slow the recession and prevent the fall from being greater than in the rest of Europe”, stated José Luis Escrivá, Chief Economist BBVA Group
- The degearing of the private sector and the Spanish economy’s reduced need for financing intensified in 2009 and should continue into 2010
- Even though monetary policies remain largely expansive, in 2010 we expect fiscal consolidation

“Contraction of economic activity has eased sharply in Spain. GDP is set to decline by around 4% in 2009, a similar figure to the rest of the EU. Even though there are factors affecting Spanish growth compared to the rest of Europe, such as the greater degearing and the adjustment in the real estate sector, the Spanish economy has been able to head off the harshest stage of

the recession and prevent the fall from being greater than in the rest of Europe for two reasons: a more decisive use of fiscal policy for counter-cyclical purposes and the sharp decrease in imports, which have helped slow the rate of decline of GDP”, declared José Luis Escrivá, Chief Economist BBVA Group. .

This information is included in BBVA Research Department’s latest “Spain Watch” report presented today by José Luís Escrivá, Chief Economist BBVA Group and Chief Economist for Spain and Europe, Rafael Doménech.

According to this report, global economic recovery will be uneven. Recovery in emerging economies is stronger than in developed economies, while the US economy appears poised to recover faster than Europe.

According to BBVA Economic Research Department, fiscal stimulus plans in the US are wider-reaching and will have more of an impact on growth in coming years.

Recovery in activity in Europe is also likely to be longer in coming given Europe’s more rigid labor market, the substantial injections of public aid required for the restructuring of the countries’ banking systems and the lower growth potential in the region compared to the US.

Spain: moving slowly towards recovery

Although the Spanish economy is shrinking more slowly, there are few signs to indicate that 2010 will usher in strong recovery.

According to the BBVA Economic Research Department, the degearing of the private sector and the Spanish economy’s reduced need for financing intensified in 2009 and will continue into 2010. Likewise, lower financial and real estate wealth, increasing uncertainty in the labor market, forecasts of lower income growth and fiscal consolidation set to begin in 2010 and continue thereafter, will all help keep savings rates high and prevent consumption from recovering in the short term.

The second factor is the restructuring of the real estate sector, which will continue into 2010, even though greater access to home buying, thanks to lower interest rates and possibly lower prices, should help shore up demand.

A third factor is that recovery could be hindered by a labor market which is showing a high degree of structural unemployment. Job destruction is expected to ease gradually in 2010, but growth in activity will not be enough to sustain job creation. The Economic Research Department has lowered its estimates for 2010 unemployment from 20.7% to 20.1% as the active population has declined.

And finally, 2010 will see a correction in public accounts, after public funds were used intensively in 2008 and 2009 for counter-cyclical purposes. The long-term benefits of fiscal consolidation far outweigh the negative short-term effects on economic growth. However, close attention must be paid to how and when this policy is implemented

to gauge whether it could undermine the recovery expected to occur at the end of 2010.

Public debt and structural reforms

Turning to public debt, BBVA Economic Research Department expects a decline in public accounts after government funds were used intensively in 2008 and 2009 for counter-cyclical purposes.

Estimates for public debt in Spain for 2009 (54% of GDP) are significantly lower than for the **EU** (approximately 80%) where, unlike in Spain, a substantial amount has been used for bank bailout programs (5.7% of GDP).

With regard to reforms, BBVA Research Department believes structural reforms need to be adopted more swiftly to successfully tackle future challenges.

In this regard, the FROB (fund for ordered bank restructuring) has designed strategies which will help adjustment in the Spanish financial system and which must be adopted promptly. This should lead to an ordered restructuring of excess capacity in the sector and give rise to strong institutions capable of efficiently channelling those resources available to the Spanish economy", stated Rafael Doménech, BBVA Group Chief Economist for Spain and Europe.

Mr. Doménech noted that potential growth forecasts could be revised up if the structural reforms already underway (e.g. Directive on Services) were adopted more swiftly or if those reforms which both Spanish and foreign experts and institutions believe need to be implemented (e.g. labor market) were in fact rolled out. How quickly the Spanish economy is able to pick up once the recovery begins depends largely on the priority given to these reforms.

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