

Economics

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Spain

Deleveraging Implies a Lagging Recovery

- The revisions to Spanish GDP for the past four years and the GDP details for Q2 09 released this morning show that the recession in domestic demand is somewhat deeper than originally reported and it showed only marginal signs of easing in the second quarter. Real GDP contracted by 1.1% QQ in Q2 09 – the worst performance among the largest euro area countries – after an upwardly revised -1.6% QQ drop in Q1 09. Final domestic demand contracted by 1.7% QQ, after falling by 2.5% QQ in Q1, showing the six consecutive drop. Annual revisions also showed that real GDP growth in 2008 was only 0.9%, rather than 1.2% originally reported, due to a more negative contribution from domestic demand (-0.55pp).
- Household consumption was the main surprising factor in today's data, still showing a significant contraction by 1.6% QQ and 5.9% YY in Q2 09. The revisions also point to a much weaker picture for the previous quarters. This contrasts with the information conveyed by monthly indicators (e.g. car registrations, consumer confidence) which pointed to a less severe fall. The residuals from our consumption model have never been so wide: private consumption is bound for a significant payback in Q3 (Figure 1).
- Despite ongoing weakness in labour income due to plummeting employment, households' real disposable income in H1 09 should have been supported by falling inflation, various government support measures and declining interest rates. The latter is especially significant for Spain, given high leverage and high share of mortgages at variable rates. The marked fall in consumption means that the saving rate has continued to shoot higher – a sign that households are trying to make up for the losses in their real and financial wealth and also that they are trying to deleverage by paying back their debt (Figure 2). Data on credit flows show that lending to households has been contracting sharply in the first half of this year, further supporting this view. Overall, we expect this trend to continue: hence, despite a likely pick-up in Q3, the growth rate in private consumption is unlikely to return positive before the beginning of 2010.
- The same holds true for GDP growth. With the revisions to past data, our GDP model now looks much more on track and it suggests that real growth is likely to remain negative in Q3 and Q4, although with much smaller rates of contraction than in the first two quarters of the year (Figure 3). This will make the Spanish recovery much more subdued and lagging relative to the rest of the euro area.

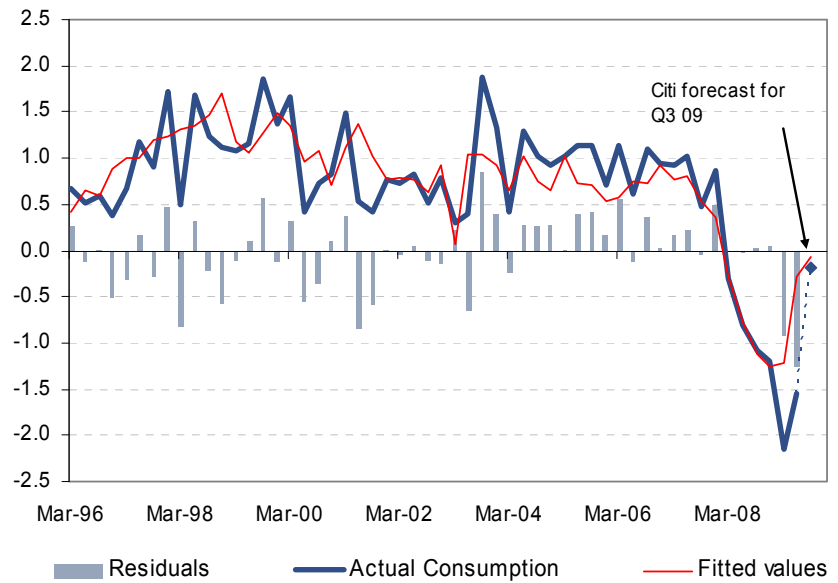
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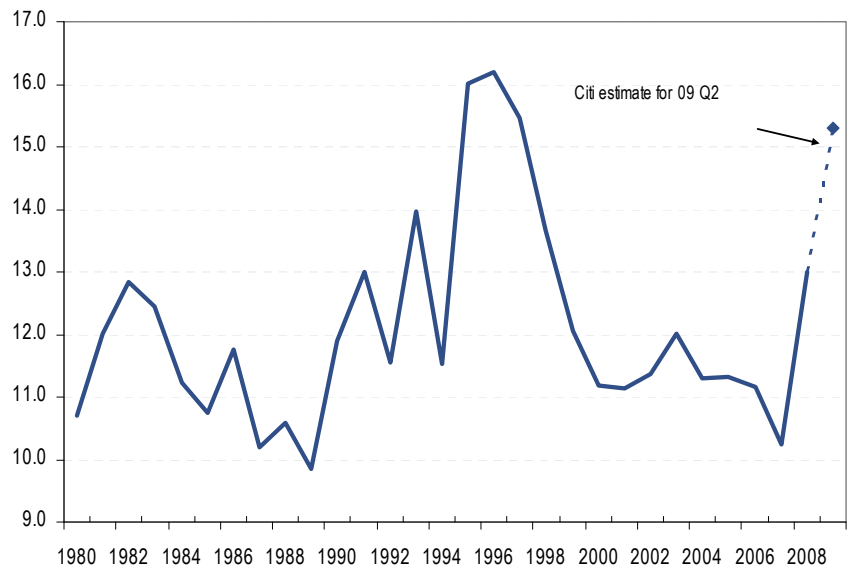
See Appendix A-1 for Analyst Certification and important disclosures.

Figure 1. Spain – Real Household Consumption (Pct. QQ Rate), 1996-Q2 09



Sources: INE and Citi Investment Research and Analysis

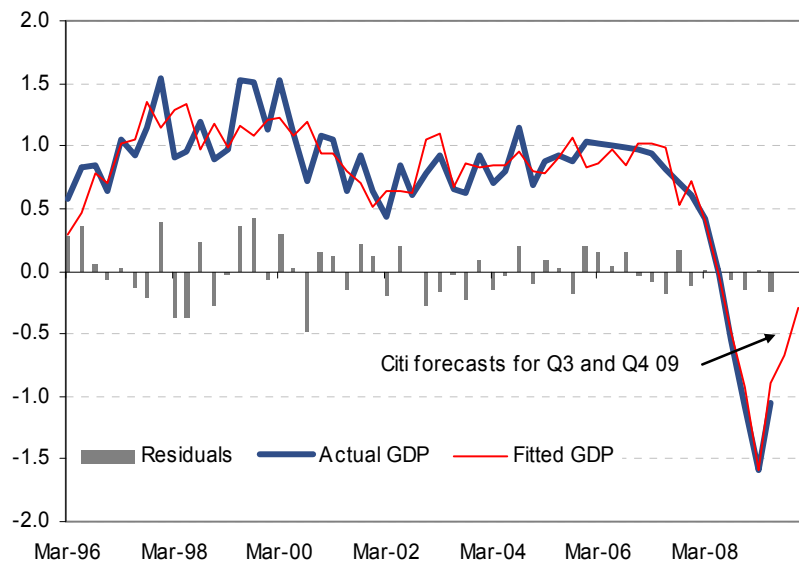
Figure 2. Spain – Household Saving Rate (1980-2009 Q2)



Note: Data before 1999 are based on the OECD series. After 1999, they are taken from the INE Sector Account database.

Sources: INE, OECD, Citi Investment Research and Analysis

Figure 3. Spain – Real GDP Growth: Actual, Fitted Values and Residuals (Pct. QQ), 1996-Q2 09



Sources: INE and Citi Investment Research and Analysis

Appendix A-1

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