SPAIN ECONOMIC BRIEFING
ON TRACK TO BEAT GROWTH FORECAST SEPTEMBER 2016
KEY POINTS

- Prices are showing some upward pressure seen through measures such as core inflation and the implicit GDP deflator. This is a response to domestic consumption. On the other hand, producer prices continue to decline, displaying negative annual variations in its monthly measure since 2014.

- Although job creation keeps on vivid, wages remain relatively rigid. It is seen via the salary cost structure of large companies in Spain that report increasing expenses on salaries per employee throughout all the crisis period. Labour cost reduction have come via redundancies rather than on salaries renegotiations.

- In the composition of office employment we find a greater share of managerial job posts created in Madrid than in Barcelona. At the same time there are more non-managerial workers in Barcelona than in Madrid, an insight that certainly gives clues when marketing Barcelona’s 0.7 million sqm and Madrid’s 1.7 million sqm of empty office space.

- Household consumption sustains the activity now recording nine consecutive quarters of annual growth.

- The fiscal deficit will most probably meet EU’s target by year end (4.6% of GDP) but the new government will have to make added efforts to reach those set for 2017 (3.1%) and for 2018 (2.2%).

- Businesses are also confident about their turnover health as capital formation (which can be interpreted as company consumption) has also chained 10 quarters of expansion in Q2 (+1.3%).

- Quarterly growth in Q2 signalled a sturdy economic environment in Spain against a backdrop of more elections and absence of official government plus the added uncertainty from the Leave-Vote win in the UK.

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ECONOMIC ACTIVITY STANDS STRONG DESPITE BREXIT

• The main contributor to GDP growth is internal demand, leveraged on household consumption while deficit control limits contribution from government spending. In this context, imports are expanding offsetting contributions from exports. It is worth mentioning that throughout the crisis period the opposite was the case: Contributions to GDP growth from the external sector were greater than those of domestic demand, though most of the time not sizable enough to actually generate economic growth.

• From a supply side perspective, the service sector keeps its healthy growth of above 3% seen in the last 5 quarters and that will surely impel occupier markets. Industrial activities and construction keep their positive expansion rates (2.6% and 2.2% YoY in Q2, respectively) but at a lesser pace than in 2015. One of the main contributors to growth has been again tourist sector.

• 2016 will set another record of foreign tourist visits with the month of July seeing an all-time monthly high of 9.6 million visits.

• As of July 2016 the Spanish fiscal deficit (currently 5.1% of the GDP) is above EU’s 2016 target (4.6%). Nevertheless, the automatic mechanisms for deficit reduction stemming from economic growth (i.e. increase in tax revenues, less unemployment aid, etc.) are in place and we expect that Spain will meet the target by year end.

• The deficit targets for 2017 (3.1%) and 2018 (2.2%) are expected to be more difficult to reach, and added discrecional measures need to be put in place especially at the level of local administrations. For the moment, the forecast for deficit in the next two years points to 3.6% and 2.8%, both values beyond the target.

• Investment in production capacity has a strong drive in Spain despite the added uncertainties from the Leave-vote win and the yet-to-develope Brexit process.

• Its reflection in the national accounts (Gross Capital Formation) has displayed constant quarterly growth since Q1 2014 averaging +5.8%. Apart from strong growth, the share of productive investment in GDP has stepped up from 6% to 7%. This is interpreted as businesses confidence in future production and increase in turnover, and supports our positive views on growth for 2016 and 2017.

• Capacity utilization has soared from 68%, its lowest level in 2010, to 80% in Q2 2016, close to its maximum value of 82% seen in Q3 2007.

• Although headline inflation remains subject to drag by energy prices, another story is seen with price movements in the general economy from the GDP deflator. This measure of price variation has remained positive in 5 of the last 6 quarters, averaging +0.6% of annual variations and the only non-positive value was 0.0% in Q1 2016.

• This evolution holds strong contrast with headline inflation (CPI variation) and Producer Price Index (PPI) variations which have not reached positive values in their annual variation since August 2015 and July 2014, respectively. The underlying message is that CPI and PPI are capturing volatilities and negative pressures from oil and energy prices while domestic determinants of prices in the aggregate economy are pushing prices up.

• This expectation is extensible for 2017 when price variation will be gently positive pushed by employment generation (added wages to expend with) and also mild salary increases.

DEMAND CONTRIBUTION TO GDP GROWTH

INVESTMENT IN PRODUCTIVE ASSETS (YoY VAR, %)

Source: National Institute of Statistics
INSIGHTS ON BUSINESSES COST STRUCTURE AND OFFICE EMPLOYMENT

BUSINESSES HAVE ADJUSTED THEIR COST STRUCTURE ALMOST EXCLUSIVELY VIA DISMISSALS

- Having positive short term indicators in August such as a decline in registered unemployment and record in tourist visits in July, we may focus on salaries as part of businesses cost structure. In this area, the news is less positive. Using data on income taxes from the Ministry of Finance we analysed the evolution of salaries from the perspective of large firms' cost structures. We tested whether salaries significantly shrank as a result of changing economic and institutional frameworks.

- It is no secret that in the last cycle some 1.4 million employees were made redundant in a span of two years (2007-2009). The scale of job destruction triggered a labour market reform that was belatedly implemented in 2012. The aim of such reform was to facilitate job creation and ease the cost of dismissals. We found out that actually the money spent on salaries shrank in perfect accordance to turnover reduction. The question that remains is whether expenditure reduction came by the via of number of employees lost or from salary reduction or both. When we analysed the salary expenses per employee we found out that they did not stop increasing even during the worst crisis periods.

- That reveals some degree of rigidity that large Spanish companies have to face. The origin of it remains uncertain and saying that it comes from institutional level inflexibilities or from some degree of inefficiency in the management is beyond this research. What remains true is that pay-roll reductions throughout the crisis was almost completely made by reduction in the size of the staff rather than salary renegotiations. Were negotiation a common practice, high unemployment in Spain could have been restrained. Salary renegotiations may work as a strategic tool to avoid surges in unemployment figures.

SIMILAR OFFICE EMPLOYMENT LEVELS IN MADRID AND BARCELONA

- Microdata are the plain answers to poll questionnaires, already processed and anonymised. Using them we are able to analyse new breakdowns of statistical information to get insights different from those published. The microdata from the Spanish Economically Active Population Survey (EAPS) give access to the answers of some 160,000 persons, each quarter since 2005.

- How many office sector employees exist in the provinces of Madrid and Barcelona? To get a relative measure we depart from the fact that in Madrid there are 6.4 million inhabitants while in Barcelona some 5.4 million. The number of persons registered as managers and as office employees give a close proxy of office employment. The number of office employees in Madrid gets to 450,000 while in Barcelona 417,000.

- The relative measure with respect to total population is 7.1% in the first while 7.7% in the latter; a tight figure, despite the population sizes

- What makes a strong contrast is the number of managers. There are in Madrid some 162,000 managers while in 103,000 in Barcelona. 2.6% of Madrid’s population vs. 1.9% in Barcelona. This means that corporate head quarters are more centred in Madrid as it is a business and financial hub. Nevertheless, the number of non-managerial office workers in Barcelona (315,000) exceeds Madrid’s figure (288,000). This is a valuable insight in terms of the type of office stock development and refurbishment if we take into account that there are some 1.2 million sqm of empty office stock against 0.6 million in Barcelona.

SALARY EXPENDITURE GROWTH IN LARGE FIRMS

Companies with annual sales over €6m

OFFICE EMPLOYMENT EVOLUTION

(000 Persons)

Source: Spanish Tax Agency

Source: National Institute of Statistics
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