crédito y caución
Atradius Group

Country Report

Spain – September 2013

Overview

General information

Capital: Madrid
Government type: Parliamentary monarchy
Currency: Euro (EUR)
Population: 46.2 million

Most important sectors (2012, % of GDP)

Services: 70.3 %
Industry: 26.4 %
Agriculture: 3.3 %

Main import sources (2012, % of total)

Germany: 11.8 %
France: 11.5 %
Italy: 6.7 %
China: 5.6 %
The Netherlands: 5.4 %

Main export markets (2012, % of total)

France: 16.8 %
Germany: 10.8 %
Italy: 7.7 %
Portugal: 7.1 %
UK: 6.5 %

Key indicators

	2011	2012	2013*	2014*
Real GDP growth (y-on-y, % change)	0.1	-1.6	-1.2	1.0
Consumer price inflation (y-on-y, % change)	2.5	2.5	1.5	1.5
Real private consumption (y-on-y, % change)	-1.2	-2.8	-2.6	0.3
Public consumption (y-on-y, % change)	-0.5	-4.8	-2.1	-1.6
Gross fixed capital formation (y-on-y, % change)	-5.4	-7.0	-6.2	-2.1
Unemployment rate (% of labour force)	21.6	25.0	26.4	25.8
Export of goods and services (y-on-y, % change)	7.6	2.1	5.6	6.0
Current account (% of GDP)	-4.0	-1.2	1.8	2.9
Fiscal balance (% of GDP)	-9.6	-10.8**	-6.8	-6.0

* forecast **including aid to financial institutions Source: Funcas

Political situation

Stable government

Spain's current government under Prime Minister Rajoy is strongly placed to pursue its economic policy as it holds a comfortable absolute majority in parliament and its term lasts until the end of 2015. New structural reforms have been announced, which should help improve the perception of the Spanish economy's ability to grow, to prove the sustainability of its finances and to restore the confidence of Europe's institutions. The government also needs public support for the successful implementation of austerity and structural measures which are aimed at restoring competitiveness and investor confidence in the country's ability to repay its financial obligations without receiving a bailout.

Strikes and protests have taken place in recent months as people become disillusioned with the high level of unemployment, the state of the economy and continuing austerity measures. However, social unrest has been limited so far, and the government is expected to remain in place for its full term.

Main economic developments

Return to growth in 2014

Spain is in a process of rebalancing its economy away from construction and towards business services, trade, transport and communication. It is manifest in the deleveraging of households and non-financial corporations, banking sector restructuring with accompanying credit constraints, high unemployment falling wages and public finance woes.

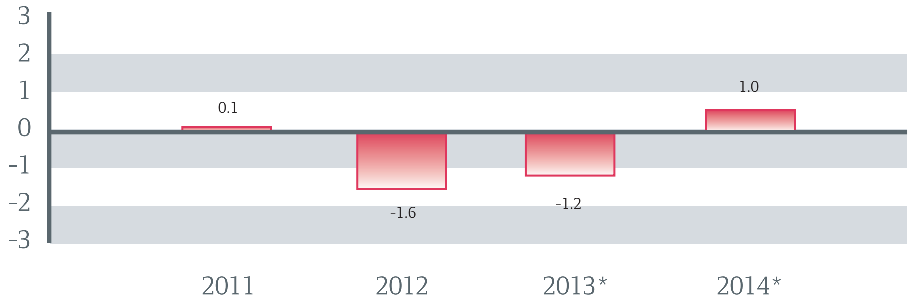
After almost two years of contraction, the latest business indicators available point at Spain's economic situation starting to stabilize. In Q2 of 2013 GDP shrank only 0.1 % compared to the previous quarter, after declines of 0.4 % in Q1 of 2013 and 0.8 % in Q4 of 2012.

Exports of goods and services (up 6 % in Q2 of 2012 after a drop of 3.8 % in Q1) partly helped to stem the output decline in Q2 of 2013, however, domestic demand still contributed negatively to the economic performance. Household and corporate spending continues to be tempered by restrained provision of credit and ongoing deleveraging along with the impact of the government's austerity drive to rein in the public deficit. In 2013 the economy is forecast to record a year-on-year contraction of 1.2 %.

While there are some downside risks such as a further deterioration of public finances and a Eurozone recovery failing to materialise, a rebound of 1.0 % (see chart overleaf) in the GDP in 2014 is forecast as the recession is expected to bottom out, helped by export growth, smaller internal imbalances and structural reforms.

GDP growth

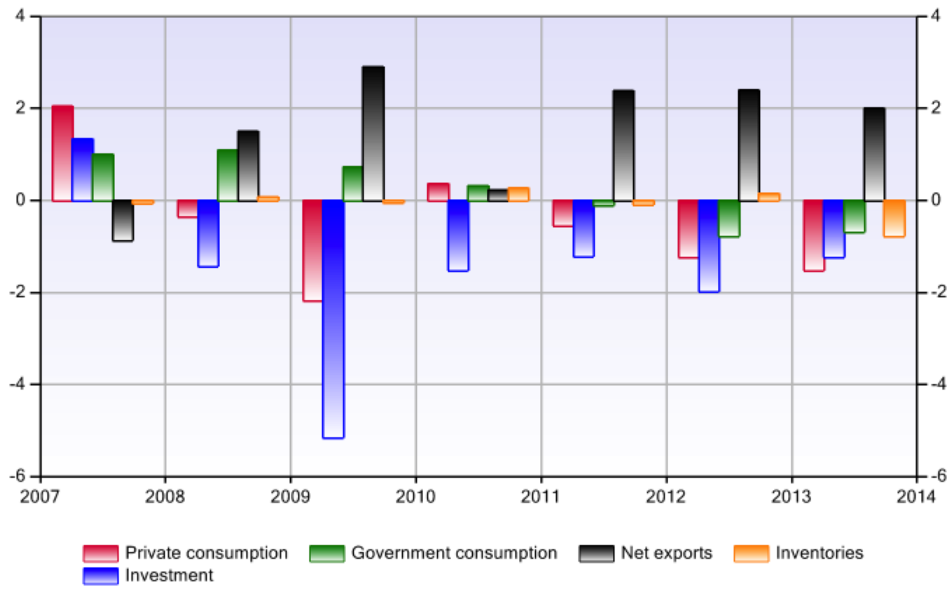
(% change on previous year)



*forecast
Source: Funcas

Contribution to GDP growth: Spain

(Chain-weighted basis: forecast edge 2009)



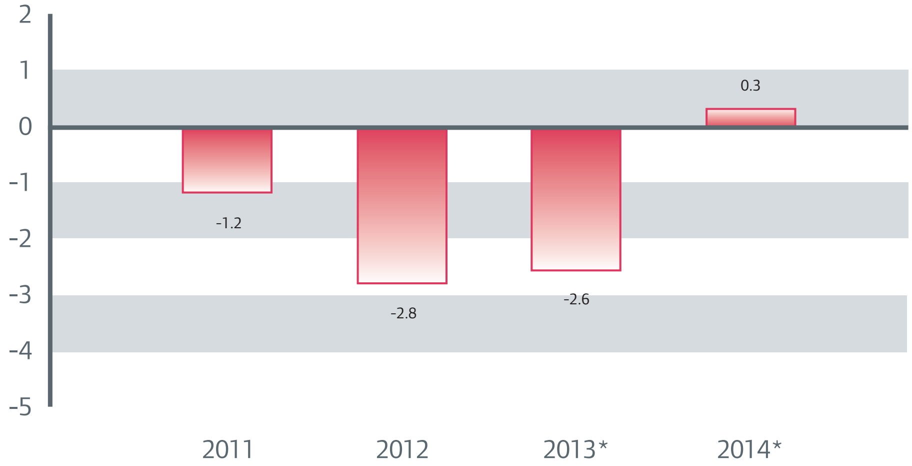
Source: IHS Global Insight

Private consumption continues to decrease

The rebalancing after the construction bubble has dampened internal demand. Household deleveraging, rising unemployment and lower wages have an impact, just as restrained credit provisions of banks and fiscal consolidation do. In 2013 private consumption is expected to decrease 2.6 % year-on-year, however it is forecast to increase again in 2014 (see chart overleaf). The decline in gross capital formation is forecast to slow next year.

Private consumption

(% change on previous year)



*forecast

Source: Funcas

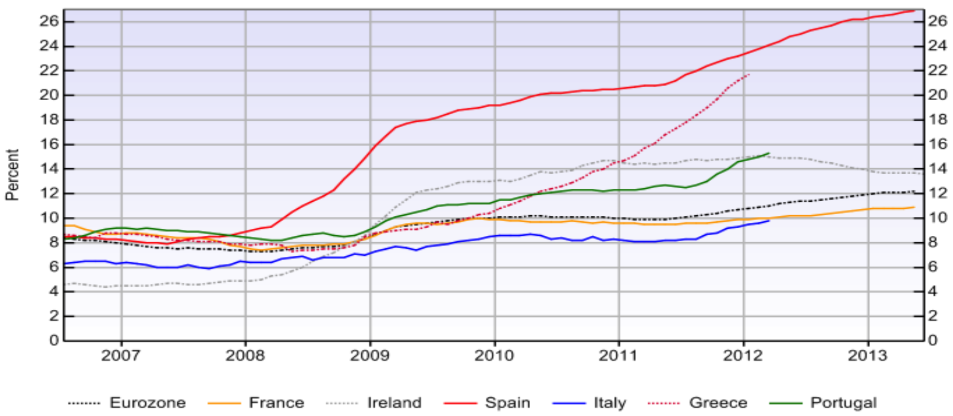
Given the weak internal demand, inflation is less of an issue, consumer prices are expected to increase 1.5 % in 2013 as the year-on-year impact of hikes in indirect taxes and regulated prices disappear in H2 of 2013. In 2014 inflation is forecast to increase again just 1.5 %.

Unemployment decreased for the first time in two years

The Spanish unemployment rate reached a record high of 27.2 % in Q1 of 2013. However in Q2 of 2013 it decreased for the first time in almost two years, to 26.3 %. The unemployment rate is still high, even taking into account that Spain presumably has a higher 'natural rate' of unemployment of 8 %, compared to the average 4 % in other developed economies. However, more job losses will be avoided through ongoing salary moderation in 2013. In 2014 unemployment is expected to decrease slightly.

Unemployment

(Percentage rate of total workforce)



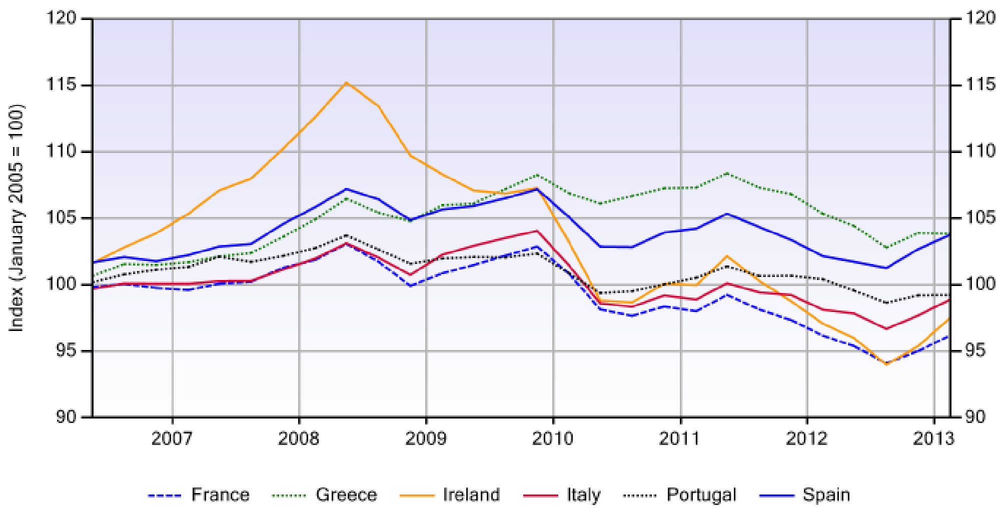
Source: IHS Global Insight

Export performing relatively well

The Spanish export sector is relatively healthy and competitive, and indeed only in 2007 the GDP-contribution of net exports was negative. Nevertheless, a Real Effective Exchange Rate (REER) comparison (which measures a country's international competitiveness as costs and prices change) shows that there is still considerable opportunity for improvement as Spain remains second highest compared to some of its Eurozone peers (see chart below). The REER in Spain is broadly in line with the overall Eurozone peripheral picture.

Real Effective Exchange Rate (REER) fluctuations

(Trade weighted currency baskets adjusted for relative inflation)



Source: IHS Global Insight

On average, a Spanish worker now costs EUR 20 per hour, compared to the EU average of EUR 27.5. Spanish wages, moreover, still remain under pressure given the extreme level of unemployment in combination with more flexible labour laws after reforms. In addition, Spain has been able to diversify its export geographically, e.g. growing to emerging markets. The main limit to future export growth is a general lack of product diversification.

Early 2013 figures show that export performance is strong, but still too modest to compensate for the decreased domestic demand this year. Return to overall growth in Spain should indeed come as factors that lower internal demand fade or at least become less prominent. The rebound of foreign direct investment (FDI) inflow, a moderate but healthy 3.4 % of GDP in January-April 2013, is clearly of help.

Current account surplus in 2013

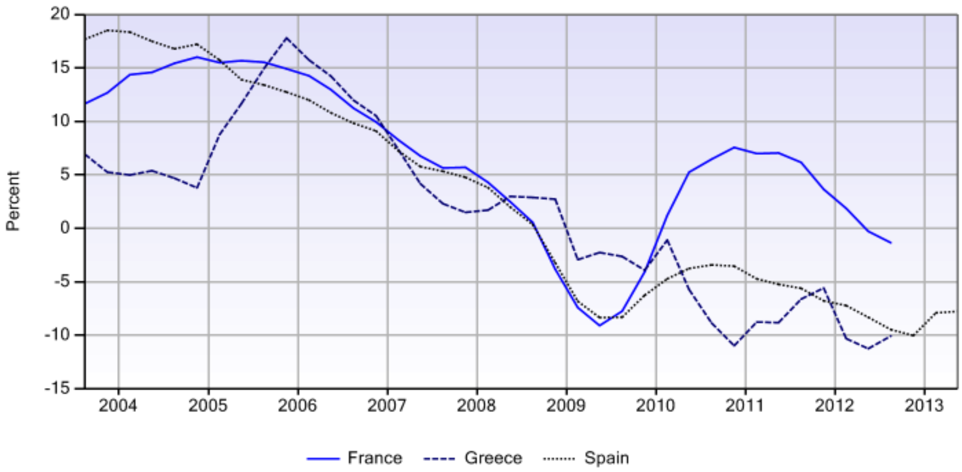
As lower unit labour costs drive export growth and depressed internal demand has led to fewer imports, the Spanish current account deficit has decreased to 1.2 % of GDP in 2012 (from 4.0 % in 2011). Early 2013 current account figures confirmed this trend, although the decrease is losing pace. In 2013 a current account surplus of 1.8 % of GDP is expected, increasing to 2.9 % of GDP in 2014.

Housing market decline has stabilised

Spanish housing prices continue their downward trend, although the pace of the decrease seems to have stabilised at around 7 %. House prices are now 25-35 % lower than prior to the economic crisis. The EIU expects further pressure on house prices as there is a large inventory of unfinished and empty houses and the situation on the labour market remains tense. Moreover, supply may be increased if property transferred by banks that receive state aid is sold by a specially created asset management company.

House price inflation

(Annual percentage change in national level indices)



Source: IHS Global Insight

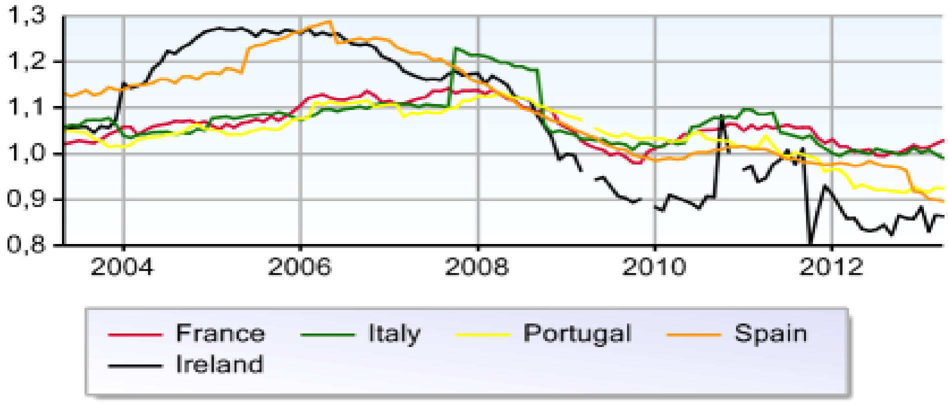
Banking sector reform on track, but lending remains very tight

In the June 2012 Memorandum of Understanding with the EU/IMF/ECB Troika Spain agreed to deepen and accelerate a banking sector recapitalisation, restructuring and reform program. The program consists of a credit line of maximum EUR 100 billion funded by the European Stability Mechanism (ESM), but guaranteed by the Spanish state. A "Fund for Orderly Bank Restructuring" (FROB) has been established to manage bad assets. Shortfalls of capital amounting to EUR 56 billion have been filed thus far for 10 banks, of which EUR 38 billion by ESM funding. In July the IMF considered the program on track, noting that liquidity and solvency of the banking sector have considerably improved.

Nevertheless, given the continued recession, Spanish banks remain under pressure as non-performing loans (NPL) have increased, from 8.4 % in August 2012 to 11.6 % in June 2013, whilst upcoming revaluations might even cause this figure to be higher. Provisioning is increasing, and the Bank of Spain has estimated an additional EUR 10 billion in provisions (other sources mention EUR 30 billion) are needed for premature rollover of EUR 200 billion of loans. This will hit smaller, already weakened, banks disproportionally. Additionally it will affect lending options, which remain under pressure, while conditions on those loans provided remain tight.

Loans to the private sector

(Annual Change in Total Amount Outstanding)



Source: Statistical Office of the European Communities (Eurostat)

Fiscal adjustment continues

Fiscal adjustment is necessary to remain within the boundaries of EU agreements. Despite a successful fiscal adjustment of 4 % of GDP in 2012 (including public sector employment cuts) the budget deficit still increased to 7 % of GDP (including bank capitalisation: 10.8 % of GDP). However, the austerity measures helped to reduce the structural deficit (the financing gap in public budgets that remains after adjustment for business cycle and one-off factors) by more than 3 %. In 2013 another fiscal adjustment programme will achieve a 1.5 %-2 % cut in Spain's structural deficit, while the deficit target is 5.5 % of GDP.

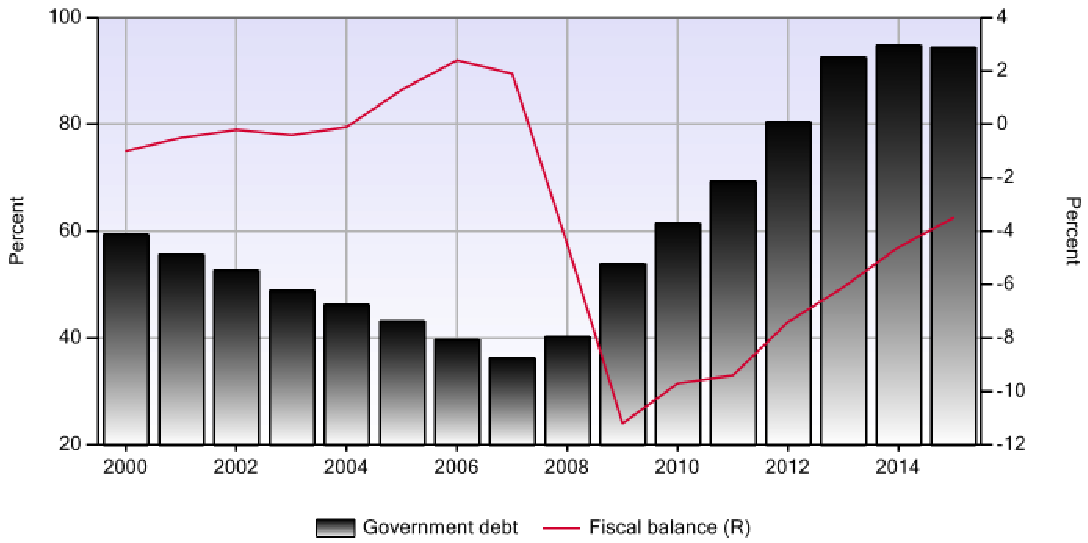
As agreed with the EU, the 3 % of GDP deficit obligation will only be met in 2016, reflecting concerns that additional measures taken to manage the fiscal budget could undermine the economic rebound. Government debt has gone up to 85 % of GDP in 2012, with further increases forecast.

Notable progress has been made in reigning in regional deficits, which improved to 1.8 % of GDP in 2012 compared to 5.1 % of GDP in 2011. Payment arrears have been reduced as well, and local and regional government receivables are increasingly accepted by banks to alleviate liquidity problems of small- and medium-sized businesses.

Budget tightening will slow down the economic rebound that is expected in 2014. Even with a two year extension under the EU's Excessive Deficit Procedure there is still a lot to be done, and the downside risk of a negative growth scenario remains.

Public debt and budget balance: Spain

(Government debt and budget balance in percent of GDP)



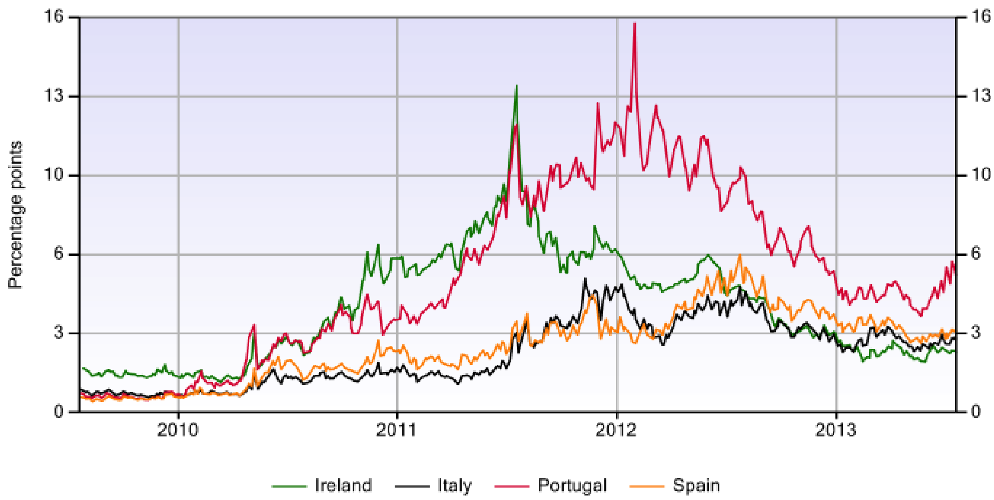
Source: IHS Global Insight

Financial markets calmness remains

The yield on Spanish 10-year bonds has gradually decreased, to the current level of an approximately 3 % difference (spread) with the German Bund. This has been helped by the announcement by the European Central Bank (ECB) in early September 2012 that it will be prepared to purchase an unlimited amount of government bonds in the secondary market if necessary (Outright Monetary Transactions, OMT). The improved liquidity position of Spanish banks has further supported the yield, as they have bought bonds. All this has also led to a gradual return of capital flows and increased resilience to rising risk premiums.

Long bond yield divergence within the Eurozone

(10-year government bond yield spreads over the German Bund)



Source: IHS Global Insight

Insolvency environment

A small insolvency improvement in 2014

Corporate defaults have closely reflected the economic conditions since 2008, with high year-on-year increases of 100 % in 2008 and 50 % in 2009. After a year-on-year decrease in 2010 insolvencies increased again in 2011 (15.4 %) and 2012 (28.4 %, to 8,410 cases), mainly due to the decrease in internal demand and generally high pressure on the liquidity of businesses given the limited options for external financing.

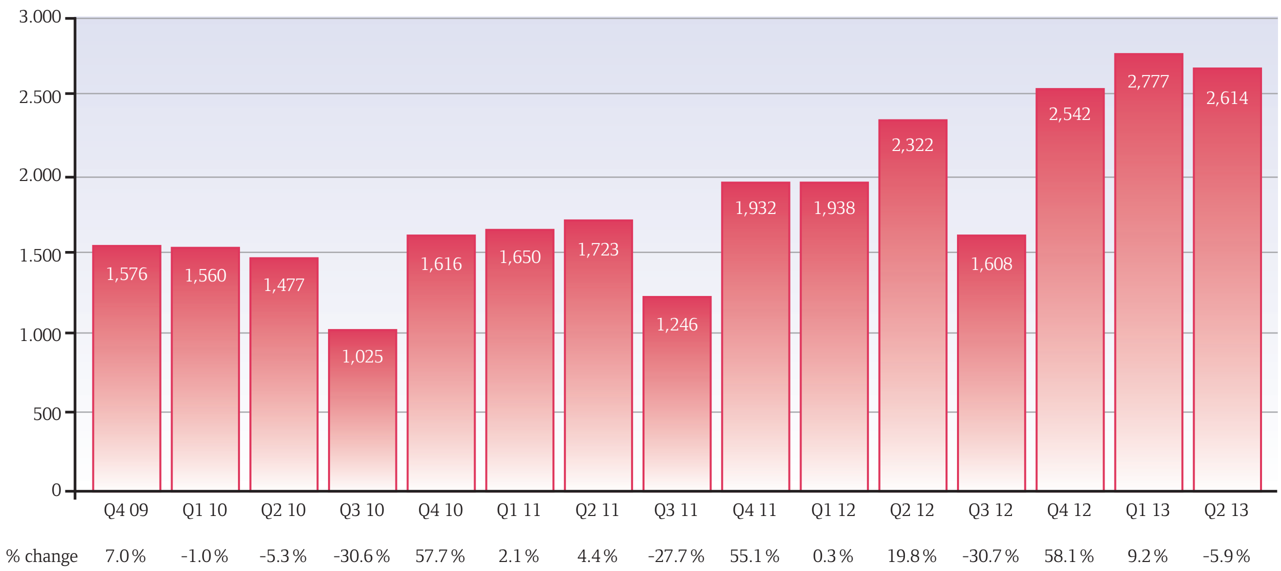
In Q2 of 2013 corporate insolvencies decreased 6 % from the previous quarter. However in H1 of 2013 insolvencies increased 26.5 % year-on-year. Insolvencies of construction and construction-related companies still account for the majority of business failures, followed by the services sector and retail sectors.

Given the high level of insolvencies at present, we foresee no major improvement in the last months of the year, and expect insolvency cases to exceed the 10,000 cases threshold for the first time in 2013. However, we expect a levelling off in 2014 in line with the expected improvement of the economic situation.

In the current business environment continuous monitoring and management of sales channels are paramount to success. The business community around Crédito y Caución, the Atradius credit insurance provider in Spain, where we have maintained a very active risk monitoring program, has seen a significant reduction in the impact of payment defaults of more than 30 %.

Spanish business insolvencies

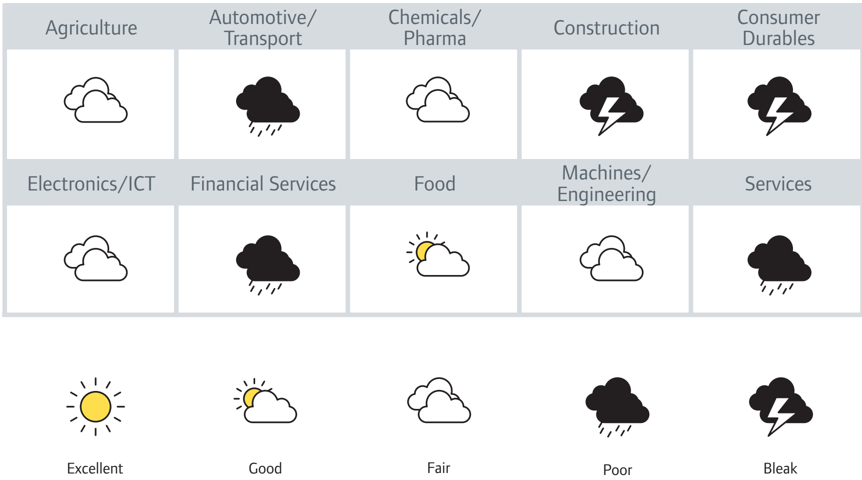
(quarterly changes)



Source: Atradius and Official State Gazette

Spanish industries performance forecast

September 2013



The economic downturn does not affect all companies equally. The general rule is that industries and/or subsectors which are heavily dependent on private domestic demand will underperform compared to those sectors that can offset domestic business losses with additional export sales.

Trade sectors contributing especially to Spanish exports are automotive, food, machinery and services.

In contrast, construction/construction materials, retail/domestic appliances and furniture face far greater problems as they generally depend on public buyers' investment and consumption, as well as on household consumption.

Transport and fuel currently face particularly severe problems due to a high level of indebtedness, decreased cash flows, and high dependency on bank financing.

Disclaimer

Crédito y Caución
Paseo de la Castellana, 4
28046 Madrid
Spain

creditoycaucion.es