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Economic Comment

Retail sales and construction below forecast

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Retail sales in May fell by 6.8% y/y (-1.1%m/m sa) and, although its annual growth rate looked better than in April (-7.3% y/y), both we and the market expected a slightly better reading. It is difficult to speak of an improvement here – rather we are still sitting at the trough. We are hoping for a gradual improvement in retail sales in the coming months, supported by improving consumer optimism and wages in real terms. For the durable goods sector, however, it may be more challenging.

Construction output in May fell by 0.7% y/y (-1.1% m/m sa) and was also worse than expected (consensus +0.8% y/y). This was largely due to weakness in the construction of buildings, with engineering work remaining strong. Activity in the housing sector also continued to decline.

These data are another sign of weakness in economic activity in 2Q2023, which does not bode well for GDP growth in 2023. On the other hand, economic and consumer sentiment indicators improved in June, signalling that we can still expect a gradual recovery in activity in the coming quarters.

Third month of industrial output decline in a row, but annual growth went up

Retail sales fell in May be 6.8% y/y in after a decline by 7.3% y/y in April, below expectations (we: -6.3% y/y, market: -5.7% y/y). In seasonally-adjusted terms sales fell by 1.1% m/m. Some improvement was recorded both in durables (-9.4% y/y vs -10.5% y/y in April) and in non-durables (-5.9% y/y vs -6.4% y/y). However, there is no major rebound visible in the data – sales are still sitting at the trough.

Annual headline growth rate was supported by food (-5.4% y/y vs -8.0% y/y in April), fuels (-11.8% y/y vs -14.5% y/y in April) and cars (-2.7% y/y vs -5.1% y/y) in April. We believed that April sales of food were depressed as many refugees from Ukraine decided to spend Easter in their home country. Improvement in May supports this claim. We also think that demand for fuels was supported by a major decline in prices, while cars were benefitting from improved supply chains.

Weaker performances were posted by sales in non-specialised stores (+6.2% y/y vs +10.9% y/y in April) and in clothing (-4.9% y/y vs +0.6% y/y in April). The former comes as a surprise, given this category mostly comprises supermarkets and is usually correlated with food sales.

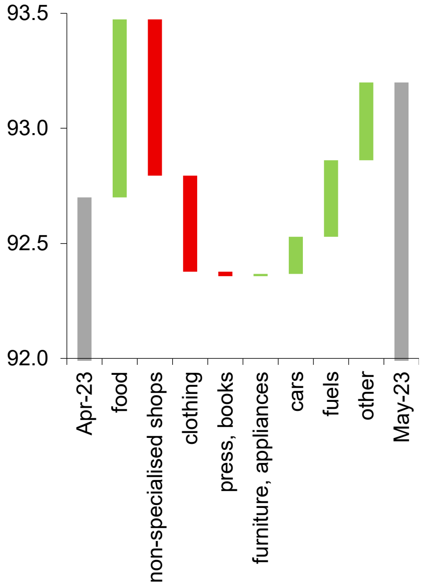
We are expecting retail sales to be gradually improving in the months to come, driven by improving consumer confidence and real wage growth, though recovery in durables may be slow.

Decelerating housing market

Construction output in May fell by 0.7% y/y and was weaker than forecast (consensus +0.8% y/y). Seasonally adjusted production growth was close to zero y/y, following a 3.8% y/y increase in April. The weakness in construction in May was mainly due to a deterioration in building construction, where output fell by 12.2% y/y, the most since early 2021. On the other hand, civil engineering fared quite well, recording a 9.1% y/y increase in output, while specialised works slowed to 0.9% y/y.

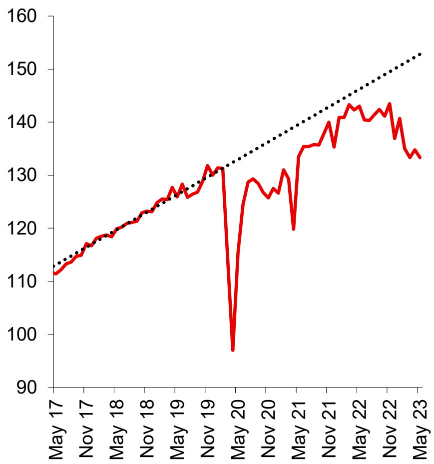
The performance of construction output was pretty much consistent with the housing market data, which showed a 2.5% y/y drop in the number of dwellings completed in May (compared to +10.6% y/y in April). The cumulative number of dwellings completed in the last 12 months was still very high (240k), but this was mainly due to the finalisation of construction started in recent quarters. Meanwhile, the production of new dwellings is clearly decelerating. The number of new building permits has rebounded somewhat, but is

Retail sales, breakdown of change in annual rate, corresponding period of the previous year = 100



Source: GUS, Santander

Retail sales, index, sa, 2015=100



Source: GUS, Santander

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still clearly below last year's levels (-18% y/y vs. -27% y/y in April). The number of house starts fell by -26% y/y in May, and in the last 12 months was 174k, which was the lowest level since 2016. Our estimate of the running projects (the 12M sum of new building permits minus the 12M sum of dwellings completed) fell to the lowest since January 2015. All this foreshadows a marked deceleration in the number of housing completions in the coming quarters.

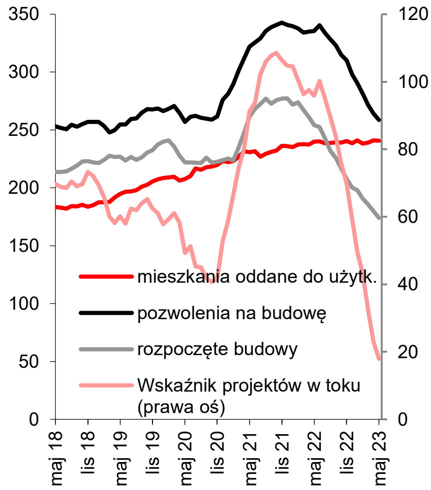
Small improvement in business and consumer sentiment

Business sentiment indicators after seasonal adjustment increased in June across most sectors with largest monthly gains in accommodation and catering though index is still lower in y/y terms. Construction sector recorded highest annual change versus June 2022 with largest improvement of annual change vs. April in manufacturing. Business sentiment point to only gradual recovery in economic activity ahead.

Consumer sentiment data showed increase in most of indicators apart from future purchases of important goods and future saving. Current sentiment index improved to -28.2 pts from -29.9 pts, and the leading sentiment index increased to -14.8 pts from -15.8 pts. Both indicators still remain clearly below long-term average.

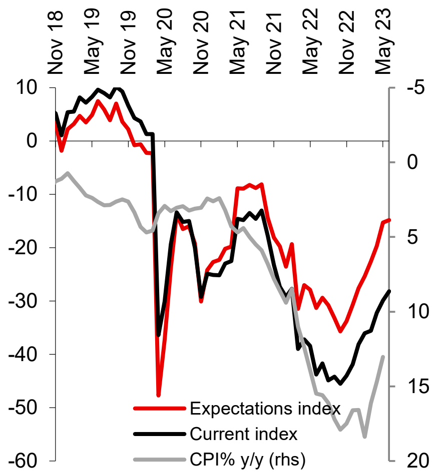
Improvement in consumer sentiment goes along with gradual drop in headline inflation and decline of energy prices. Indicators published by the statistical office showed also decline of expected future inflation but also lower concerns about unemployment. Today's data support our view for some recovery in private consumption though probability of significant rebound in durable goods sales may be difficult.

Trends in housing market, thousands



Source: GUS, Santander

Consumer sentiment, pp



Source: GUS, Santander

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