

Box 2. Employment, immigration and housing demand

Ignacio San Martín, Real Estate Unit

Introduction

One of the Spanish real estate sector's main concerns at present is the medium- and long-term trend in demand for housing. In general, demand for housing is closely correlated with demographic variables, more specifically household formation.

The latest long-term demographic projections of the INE, Spain's National Statistics Institute¹², indicate that the country's population will continue to decline in the next few years and that the rate of household formation will decline significantly until 2030, with an average of around 60,000 new households a year, whereas in the past ten years the annual increase has been 240,000.

If these projections are confirmed, building of new residential properties to meet demand from new households would decline significantly relative to the historical average, with repercussion for the real estate industry as regards new construction: the residential property development segment might shrink even further.

Changing the structure of the population pyramid requires increasing the fertility rate or increasing de immigration, given that the other demographic variable, life expectancy at birth, will continue to increase. Even if measures were taken to bring Spain's birth rate up to the replacement rate, the effect would not be immediate: it would take more than two decades for it to have an appreciable effect on the structure of the population. Therefore immigration presents itself as the only possible way of making up the likely shortage of manpower that will arise in the medium and long term. Otherwise we would be artificially limiting the creation of employment, which would hobble the Spanish economy's growth possibilities.

This study sets out to examine the possible development of net migration in Spain in the medium and long term in a scenario of average

economic growth similar to that of the potential Gross Domestic Product (GDP). With this we aim to take an in-depth look at the dynamics of the future population and household formation and to estimate housing requirements in a medium- and long-term scenario.

At present, the employment being generated by economic growth is being covered, to a very great extent, by the large pool of unemployed persons in today's Spanish labour market. In any case, as happened in the last decade, as the economy grows and the unemployment rate declines, net migration will again turn positive, and increasingly so, which will stimulate demand for housing.

Employment and net migration

There is copious academic literature on the effects of migratory flows on the labour market and vice versa¹³. In general, from the point of view of the economy, migration plays a significant role in mitigating the negative effects of ageing populations like Spain's.

Population and household formation are variables which in the medium and long term are affected by, among other things, the economic conditions of a country and specifically the employment that an economy is able to generate. Thus in open economies population growth, and with it an increase in the number of households, comes about both through organic growth and as a result of the incorporation of new immigrants (or the return of emigrants) attracted by the opportunities in the labour market. The immigrants' origin will depend on several factors, prominent among them the determinants of the country of origin, the type of employment offered, and relations or bilateral agreements between Spain and their countries of origin on employment.

In this respect, Spain's experience in the last decade suggests that positive net migration

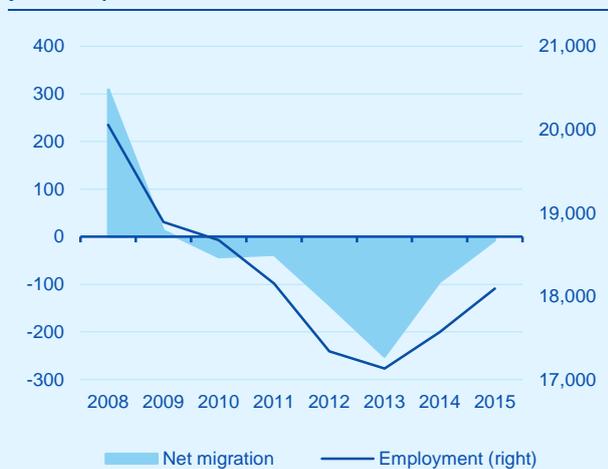
12: Instituto Nacional de Estadística (National Statistics Institute), 2014: Population projections 2014-2064 and Household projections 2014-2029.

13: For an in-depth review of this literature, see: Okkerse, L. (2008). How to measure labour market effects of immigration: a review. *Journal of Economic Surveys*. 22(1): 1-30.

figures as well as mitigating the demographic imbalances inherent in an ageing society, also help meet the needs of an expanding labour market. Thus in the period 2000-2011 the number of foreign residents in Spain increased by 4.7 million, peaking at nearly 5.75 million according to INE data. Since then the foreign population has fallen by nearly a million, to 4.75 million in 2015. In relative terms, the increase in the number of immigrants in Spain was significant, going from 2.3% of the resident population in 2000 to 10.1% in 2015.

Trends in employment and net migration figures for Spain in the past few years highlight the close correlation between the two¹⁴. Thus, from data since 2008, we see that when employment falls, net migration declines, and vice versa. In mid-2015, net migration was negative and close to 7,300 persons, according to the latest INE data. (Figure R.2.1).

Figure R.2.1
Spain: Employment and net migration (000s of persons)



Source: BBVA RE based on INE data

The growth of the Spanish economy in the next few years will lead to a reduction in unemployment and improvements in living standards, making it a more attractive destination for economic migrants and leading to greater dynamism in population and household formation

and generating an additional source of demand for housing. Thus the economic prospects for 2016 and 2017 are positive with GDP growth expected to be around 2.7% average per year, which will make possible a net addition of nearly a million jobs in these two years. This rate of job creation will encourage the arrival of new immigrants, leading, if the current trend continues, to positive net migration as early as 2016.

Long-term growth scenarios

The INE's demographic projections start out from the structure of the Spanish population existing in 2014, which it projects into the long term, assuming net positive migration in the period 2015 to 2030 of nearly 13,000 people a year on average. These projections indicate that by 2030 Spain will have lost a million inhabitants compared with the current population, although it will have gained more than 850,000 households due to the effect of the expected smaller size of households.

Analysing population changes using an approach based more on economic growth (and increasing employment) than on the population pyramid, the results obtained for the medium and long term are radically different from those suggested by the INE: if the Spanish economy grows at the rate of its potential GDP in the next few years, not only will the population not decline, but we will once again see positive net migration figures big enough to affect the property market.

In order to examine the effects of increased employment on migration, we constructed three long-term scenarios¹⁵:

- The first is characterised by potential average annual GDP growth of 1.9% in real terms, with an average annual increase in employment of 1.4%.
- The second scenario is characterised by a slightly bigger increase in activity (2.3% per year) and annual average net job creation of 1.9%.

14: For a more detailed analysis of the link between employment and migration in Spain, see: Izquierdo M., Jimeno J. F. and Lacuesta A.: Spain: from immigration to emigration?. Working document 1503 Banco de España. 2015

15: See note on assumptions at the end of the chapter.

- The third scenario assumes an increase in GDP of 0.5% and an increase in employment of 0.3% a year on average.

We start out from the situation existing in the Spanish labour market at the end of 2015, when the active population was 22.8 million, of whom 18.1 million were in employment and 4.7 million were unemployed.

A positive pace of job creation allows the employment rate of all age groups to be improved, and in the medium term will bring the unemployment rate down to a very low level in the two scenarios with the most economic growth, assuming low immigration. These data highlight the shortage of manpower that the Spanish economy will face in the medium and long term given the current population pyramid, as well as the need for increased immigration if constraints on economic growth are to be avoided.

Based on the proposed scenarios for growth in GDP and employment, and assuming the INE's net migration figure of 13,000 a year, then even in the more moderate growth scenario the estimates show that by 2025 the unemployment rate would fall below 7%, and would be negative by 2030. If economic growth were 2.3% p.a., the unemployment rate would be 12% in 2020 and 2% in 2025. In today's economies unemployment rates of less than 4%-5% are rarely seen; indeed, the greater the stress in the labour market, the easier it is to incorporate immigrants into the economy. (Box R.2.1).

Box R.2.1

BBVA and INE assumptions on changes in unemployment rate and net migration

	Unemployment rate (%)			Net migration (000s)				
	BBVA RE assumptions			INE assumptions	BBVA RE assumptions			
	Average GDP growth (%)				Average GDP growth (%)			
	0.5	1.9	2.3			0.5	1.9	2.3
2015	21	21	21	21	-66	-66	-66	-66
2020	19	15	12	16	-3	-63	123	244
2025	17	8	3	12	32	-26	176	306
2030	16	*	*	8	50	9	91	368

(*) this would correspond to a negative unemployment rate

Note: general assumptions

GDP growth: 0.5%; 1.9% and 2.3% p.a.

Employment growth: 0.3%; 1.4% and 1.9% p.a.

INE assumptions:

Average net migration 2016-2030 = 13,000 persons per year

BBVA assumptions

Immigrant arrivals depend largely on levels of unemployment

GDP growth 0.5%: average net migration 2016-2030 = -50,000

GDP growth 1.9%: average net migration 2016-2030 = 140,000

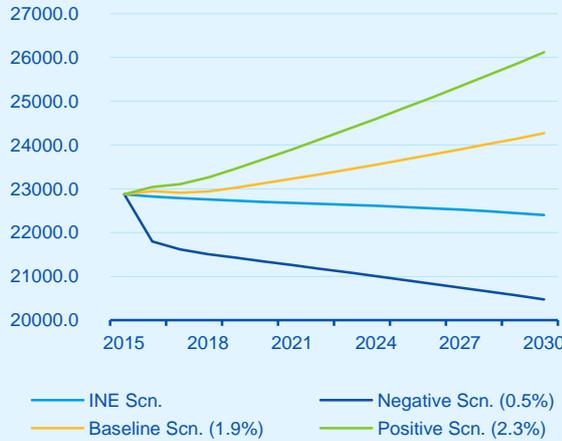
GDP growth 2.3%: average net migration 2016-2030 = 260,000

Source: BBVA RE and INE

The assumption regarding the flow of immigrants is, once again, crucial to the development of these magnitudes. Thus if we take the INE's starting flow, which shows negative net migration between 2015 and 2020, turning positive at the beginning of the next decade, the active population would continue to shrink in the next few years, reaching about 22.4 million in 2030. In the case of average growth of 0.5% p.a., the active population would decline to 20.5 million in 2030.

Varying the assumptions on immigration, and coming closer to the data observed in the past 15 years, the potentially active population would increase to more than 24.2 or 26.0 million in 2030 in the case of average annual GDP growth of 1.9% or 2.3% respectively. (Figure R.2.2)

Figure R.2.2
Spain: projected active population 2016-2030



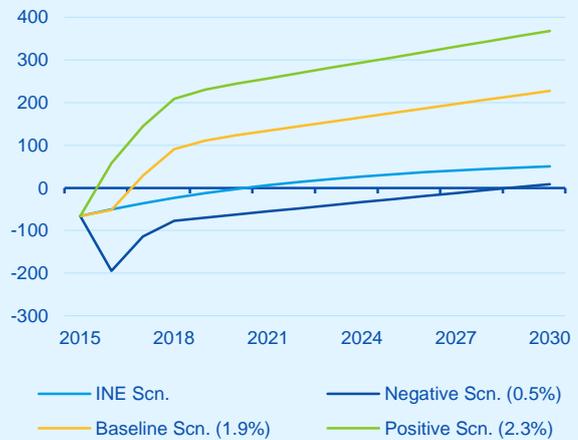
Source: BBVA RE based on INE data

With same growth scenarios, we have estimated the net migration that would allow unemployment rates to be kept at levels more similar to those seen in the last decade. Thus, we consider that when the unemployment rate falls below 18%, the arrival of immigrants will start to intensify. As the economy grows and the more unemployment falls, the greater will be the flow of immigrants. We assume that unemployment will not fall below a certain floor, which we set at 8% (a similar minimum to that seen in the last decade). We assume that the flow of immigrants will be sufficient to keep the unemployment rate at the pre-established level.

The results of the exercise indicate that in 2016 net migration will be positive, with a net increase of around 60,000 persons by the end of 2016 in the 2.3% GDP growth scenario. The balance would be slightly negative in the 1.9% growth scenario, by about -50,000 persons; and it would be around -200,000 persons in the case of GDP growth of 0.5%.

This suggests that if the Spanish economy were to grow at the rate of 1.9% p.a., average net migration between 2016 and 2030 would be around 140,000 a year. With annual growth of 2.3%, average net migration would be about 260,000 a year until 2030. (Figure R.2.3).

Figure R.2.3
Spain: projected net migration 2016-2030



Source: BBVA RE based on INE data

The property market will undoubtedly be favoured by the increase in employment: on the one hand there will be increased demand for residential properties, both primary and secondary, from existing inhabitants as a result of their increased income; and on the other hand the arrival of new immigrants will add to demand for housing.

New housing requirements

The intensity of the migration flows joining the Spanish economy is a political decision, on which immigrant demand for residential properties will largely depend. The greater the flow of immigrants, the greater the impact on the property market. If the flow were to be close to the 13,000 a year estimated by the INE, requirements for new residential properties would be well below historical requirements. If the net inflow were to be around 140,000 a year, the current annual number of new households would double. Given that the process of household formation among Spanish families is already on a declining path, the relative importance of the flow of immigrants will increase over time.

The type, location and mode of tenure of the housing sought by new immigrants will depend on a number of factors such as their level of income, available opportunities for employment, the attractiveness of the area from the tourist point of view and of course how long they intend to stay.

The European retired people who come to Spain in search of a residence in which to spend the greater part of the year usually go for medium-to-high priced detached houses located on the Mediterranean coast or in the Balearic or Canary Islands, generally on a freehold basis. In most cases the type and location of the desired residence is largely determined by these families' wealth.

Highly qualified workers usually settle in the major cities, where the (generally foreign) employers are established. If they do not intend to stay very long in Spain, renting presents itself as the most appropriate mode of tenure. The type of accommodation sought is usually determined by salary; in general, they are high quality and located in high income districts.

The group composed of immigrants seeking a better standard of living and job opportunities, and without any advanced technical qualifications, presents a more complex situation. Most of the people in this group are economic migrants, with no savings to invest in the property market and whose already modest wages are further depleted in many cases by the need to remit part of them to their families who still live in their countries of origin. This group usually opts for rented accommodation in modestly priced districts of the towns or cities where they find work. In cases where they intend to stay in Spain for the long term, some members of this group opt to buy, especially if household income so allows.

Conclusions and recommendations

The Spanish housing market is in a new phase, in which there is no shortage of residential properties as in decades past, the quality of the housing stock is controlled by means of building regulations, there are financial resources for both the development and the acquisition of residential properties and interest rates will be held at lower levels than in the previous decades and can be expected to be more stable. Furthermore, in the past few years the construction and real estate development industry has made intense efforts to become much more professional, while at the

same time joining the European Union meant joining a more open and competitive market with less protectionism.

If the Spanish economy continues to evolve at a pace that allows net job creation, then Spain will continue to be affected by immigration, leading to an increase in the population and in demand for housing.

The process of household formation in Spain is driven by the arrival of new immigrants, which will partly counteract the current Spanish demographic trend which points to significant reductions in the rate of formation of new households in the coming decades. The incorporation of immigrant households could upset the foreseeable and indeed already observable decline in demand for new housing in the medium and long term.

Note on methodology: scenarios

This study was conducted using four scenarios for the growth in immigration. The first one is based on the INE's demographic projections, and the other three are functions of the growth in employment using different assumptions regarding the potential growth rate of the economy. In these cases we assumed that the elasticity of employment relative to GDP is 0.7, which is the average of the past 20 years:

- **INE Scenario:** based on the INE's demographic projections
- **Baseline Scenario: GDP growth: 1.9% p.a.** (starting out from the estimates presented in: Hernández de Cos P., Izquierdo M. and Urtasun A. "*Una Estimación del Crecimiento Potencial de la Economía Española*" (an estimate of the potential growth of the Spanish economy). *Occasional documents 1104*. Banco de España 2015).
- **Positive Scenario: GDP growth 2.3% p.a.** (potential GDP growth with increased immigration).
- **Negative Scenario: GDP growth 0.5% p.a.** (Spain's potential GDP in 2015 as estimated by the IMF).

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This report has been produced by the Spain Unit

Chief Economist for Developed Economies

Rafael Doménech
r.domenech@bbva.com
+34 91 537 36 72

Spain

Miguel Cardoso
miguel.cardoso@bbva.com
+34 91 374 39 61

Ignacio Archondo
ignacio.archondo@bbva.com
+34 91 757 52 78

Joseba Barandiaran
joseba.barandia@bbva.com
+34 94 487 67 39

Ignacio Belenguer
ignacio.belenguer@bbva.com
+34 91 757 52 78

With the contribution of:**Economic Scenarios**

Julián Cubero
juan.cubero@bbva.com

Europe

Miguel Jiménez
mjimenezg@bbva.com

Juan Ramón García
juanramon.gl@bbva.com
+34 91 374 33 39

Félix Lores
felix.lores@bbva.com
+34 91 374 01 82

Antonio Marín
antonio.marin.campos@bbva.com
+34 648 600 596

Myriam Montañez
miriam.montanez@bbva.com
+34 638 80 85 04

Financial Systems

Ana Rubio
arubiog@bbva.com

Financial Inclusion

Alfonso Arellano
alfonso.arellano.espinar@bbva.com

Matías José Pacce
matias.pacce@bbva.com
+34 647 392 673

Virginia Pou
virginia.pou@bbva.com
+34 91 537 77 23

Juan Ruiz
juan.ruiz2@bbva.com
+34 646 825 405

José Félix Izquierdo

jfelix.izquierd@bbva.com

Pep Ruiz
ruiz.aguirre@bbva.com
+34 91 537 55 67

Camilo Andrés Ulloa
camiloandres.ulloa@bbva.com
+34 91 537 84 73

Macarena Ruesta
esperanza.ruesta@bbva.com

BBVA Research**Group Chief Economist**

Jorge Sicilia Serrano

Developed Economies Area

Rafael Doménech
r.domenech@bbva.com

Global Areas

Economic Scenarios
Julián Cubero
juan.cubero@bbva.com

Financial Scenarios
Sonsoles Castillo
s.castillo@bbva.com

Innovation & Processes
Oscar de las Peñas
oscar.delaspenas@bbva.com

Emerging Markets Area

Cross-Country Emerging Markets Analysis
Alvaro Ortiz
alvaro.ortiz@bbva.com

Asia
Le Xia
le.xia@bbva.com

Mexico
Carlos Serrano
carlos.serrano@bbva.com

Turkey
Alvaro Ortiz
alvaro.ortiz@bbva.com

LATAM Coordination
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Julio Pineda
juliocesar.pineda@bbva.com

Financial Systems and Regulation Area

Santiago Fernández de Lis
sfernandezdelis@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Financial Inclusion
David Tuesta
david.tuesta@bbva.com

Regulation and Public Policy
María Abascal
maria.abascal@bbva.com

Digital Regulation
Álvaro Martín
alvaro.martin@bbva.com

Contact details:**BBVA Research**

Azul Street, 4
La Vela Building - 4 and 5 floor
28050 Madrid (Spain)
Tel.: +34 91 374 60 00 and +34 91 537 70 00
Fax: +34 91 374 30 25
bbvaresearch@bbva.com
www.bbvaresearch.com