BBVA Research

Creando Oportunidades

Spain Economic Outlook

2Q20

Expected evolution of the Spanish economy in light of the COVID-19 crisis

April 2020

Spain's GDP could fall by about 8.0% in 2020 as a result of the measures implemented to curb the spread of coronavirus and the uncertainty generated by the pandemic. This adjustment is already in progress, as shown by several available indicators. In any case, the forecasts are made in a highly uncertain environment, especially in relation to the duration of the restrictions imposed and their differentiated impact by sectors, which make possible more negative alternative scenarios. The baseline scenario assumes that during the second half of May, a gradual normalization of economic activity will begin. This, together with the expected recovery of the global economy and policies promoted by the European institutions and the Spanish Government, would allow a significant rebound of activity to be observed from the second half of the year.

GDP growth could reach 5.7% in 2021, but the pre-crisis level of activity is not expected to be reached until 2022. This is because the recovery will be limited by the high and persistent destruction of jobs and by the exposure of the Spanish economy to sectors that will be particularly affected by restrictions of movement and gatherings. The high proportion of small businesses within the Spanish production framework and the strong reliance on temporary employment are additional vulnerabilities.

The trend of these forecasts is downward, especially if the confinement is extended beyond what is expected. In this context, a broad consensus is needed to take measures that will help overcome the health emergency as soon as possible, protect the production framework and contain the negative economic impact, particularly on the most vulnerable groups. Whenever activity begins to recover, more targeted support measures can be taken, preferably in coordination with the partners in the eurozone.

The contraction of economic activity has been very intense, as shown by the expenditure data using BBVA cards. Since the second week of March, coinciding with the beginning of several measures to restrict the movement and concentration of people, a significant deterioration in economic activity has been observed. This has been particularly important in the "social consumption" sectors, which are mainly affected by the confinement measures. Thus, hospitality, transport, tourism and entertainment, among others, have been recording declines between 60% and 100% in expenditure over the last month compared to the same weeks of the previous year. On the other hand, food, some goods and health services and certain online purchases have benefited from the highly uncertain environment, as well as from a change in consumption habits driven by confinement. In any case, this will not prevent a contraction when household consumption data for the first quarter of the year are known. Beyond the adjustment observed on the demand side, other available indicators such as Social Security affiliation during March, the massive use of the Temporary Redundancy Plan (ERTE, for its acronym in Spanish) by companies, and electricity consumption show that the drop on the supply side is significant. **All of the above indicates that, although the crisis began at the end of the first quarter, GDP could have fallen by 3% in that one quarter alone (12% YoY),** and the evolution will be even more negative in the second quarter.

Going forward, the evolution of the Spanish economy will depend on the duration of the restrictions, the degree of impact they have on the different sectors, the effect of the public policies implemented and the recovery observed worldwide. The confinement of the population in Spain is succeeding in reducing the spread of the virus, and the pressure on medical services is expected to continue to decline in the coming weeks. Given the recent developments and the experience of other countries that have taken such measures earlier, it is assumed that restrictions on the economy could be gradually relaxed starting in the second half of May. In any case, Spain has suffered a stricter and longer-term confinement than most other European countries. This has led to the fact that during the period in which all non-essential activities had to close, the percentage of employment and gross added value affected by the restrictions could have reached up to 40% of the total. This number masks a significant heterogeneity among sectors, given that in some of them related to "social consumption", activity has virtually disappeared, while in others, such as those that have been classified as "essential", and those that can be performed remotely, production capacity has remained high.

Public policies are aimed at combating the disease and facilitating the construction of bridges that prevent a precipitous drop in demand, a disproportionate job destruction and the bankruptcy of companies in this lockdown for health reasons. In the fiscal environment, funds for just over one point of GDP have already been mobilized to deal with the emergency and expand the welfare state umbrella to vulnerable groups. Here, it is worth highlighting the effort to ensure that unemployment benefits cover workers who in other circumstances would not have been entitled to receive them. The Government has also increased incentives to encourage the use of mechanisms that can ensure the preservation of employment (ERTE) and prevent the destruction of valuable capital formed by the relationship between companies and workers. Finally, among the most significant measures is the provision of 100 billion euros in guarantees for funding companies. This, together with the tax credits granted, should help ensure that the drop in companies' income does not become a solvency problem for them, or eventually, for the financial system. Helping companies survive and restart their business as soon as possible is vital to maintaining the organizational capital that must help in the recovery. **Overall, it is estimated that if these measures had not been implemented and if they had not been supported by European institutions to keep risk premiums tight and to relax deficit targets, the decline in GDP in Spain would have been around 3.5 percentage points higher than expected at the time of this publication.**

A global recession is inevitable, but policy actions will reduce the contraction of activity and support a partial recovery in 2021. In the eurozone, GDP is expected to decline by 5.2% in 2020. The measures taken in Europe, both on the monetary policy and fiscal sides, should prevent more persistent negative effects. In this regard, most notable was the ECB's announcement of a new Pandemic Emergency Purchase Programme (PEPP) for a significant amount (750 billion euros) and introducing great flexibility in its use. Furthermore, the ECB has anchored forward interest rate expectations and has indicated that it will not tolerate any risk to the transmission of the monetary policy within the eurozone. Finally, it has adopted a comprehensive set of temporary measures to support banks' liquidity and has given banks flexibility to avoid pro-cyclical measures that could lead to a credit crunch. On the fiscal front, the stimulus in the eurozone, after adding country-specific measures, could reach 2% of GDP. Liquidity facilities of at least 13% of EMU's GDP must be added to this. For this additional deficit, EMU has relaxed its fiscal rules, as well as state aid rules. More importantly, the Eurogroup has agreed on an immediate joint emergency plan (4% of EMU's GDP) and the need for a recovery program, although there is still uncertainty about how this coordinated stimulus would be financed. This plan will be essential in order to support the recovery at the European level, to increase its symmetry between countries—particularly benefiting those most affected and/or with lower tax margins—and to strengthen the European project.

The decline in activity will be historically intense and recovery will be significant, but the economy will take a while to return to the levels of late 2019. BBVA Research estimates indicate that the percentage of employment affected by the restrictions ranged from 20% in the second half of March to 40% in the first half of April when activity was only permitted in essential sectors and in those where work can be conducted remotely. This fall in the economy's usage capacity, plus the assumption that the state of alarm will remain in place until the first half of May, and the anticipation of a gradual easing of the restrictions from then on, would point to a decline in GDP in the second quarter of the year that could be around 15% compared to the previous quarter, although uncertainty is very high. After that, there would be a recovery in activity. The lifting of supply constraints would be accompanied by dampened demand during this period of uncertainty, the impact of household income support measures, and the rebound in global trade.

In any case, the speed of recovery of the Spanish economy will be restricted by two particular characteristics. The first is the high job losses, greater than in other countries, resulting from the dependence on temporary employment. Much of the job loss observed during March was due to temporary contracts not being renewed: three out of ten contracts had a duration of one week or less until the end of March. The second is the high dependence on sectors particularly affected by the restrictions. Here, the impact on the tourism sector must be highlighted. Revenue related to foreign visitors was around 6% of GDP in 2019, 63% of which was recorded between April and September. The gradual lifting of the restrictions and the situation that can be observed in the countries of origin of these tourists will prevent a significant recovery of the sector.

The uncertainty for these forecasts is particularly high and the bias is clearly negative. Of particular importance will be the effectiveness of the exit strategy put forward by the Government to limit future outbreaks of the disease, while allowing for the normalization of economic activity. Uncertainty as to whether it will be possible to achieve both objectives over the next few months and the need to prioritize the health of the population are a major source of pressure for production. Given the above, the magnitude and correct design of measures that are taken in situations where the fall in activity is more intense or lasts longer are of particular significance. In this respect, the high level of debt that the public sector is taking on is a burden that limits the mitigation efforts of fiscal policy. For example, the stimulus for domestic demand has been more aggressive in countries that had built a space to be used precisely in these scenarios. Moreover, it is expected that even in an environment where much of the announcements made have a temporary effect on the accounts of public administrations, the deficit could rise to almost 11% of GDP and debt could reach about 115% of GDP in 2020. This could limit the Spanish Government's capacity to respond if additional support measures are required. It is therefore essential to make progress on agreements that leave no room for doubt about the support that all eurozone countries will give to each of their members in scenarios where prioritizing the health of the population can lead to a further deterioration of activity.

Demand policies will not be sufficient and a broad consensus is needed around measures that help to overcome this health emergency and the fall in activity as soon as possible. Unlike previous economic crises, this one is not only caused by a lack of demand, but also by supply constraints. This causes fiscal and monetary policies to have a lower than normal impact. The stimuli, which are essential for containing the damage resulting from closure, serve little to increase consumption in sectors that are currently closed by law or that may suffer a reduction in future demand due to user's precautionary decision-making. This also prevents multiplier effects that can broaden the scope of the policies implemented. As a result, it will be crucial to work on extending the space available to implement such measures, which will have to come at different times, in accordance with the plans for re-opening and, above all, to adopt reforms that increase the economy's capacity to grow. Here, it is important to soften over time part of the inevitable fiscal effort that will have to be made in the future. This could be done by reforming the pension system, which will ensure its sustainability over the next few years. In addition, measures to support the income of families will have to remain dependent on the situation of the person receiving them and compatible with participation in the formal labor market and should be evaluated frequently. If an ambitious public investment program is needed, it will have to be accompanied by a system for assessing the costs and benefits of such spending. The aid granted to the private sector must be transparent and always strive for the minimum impact on the taxpayer. While also protecting the survival of companies when the confinement is lifted, attention should also be paid to insolvent companies not hoarding the resources that could go into new sectors and entrepreneurship. It would be desirable to favor increasing the size of companies, which would generally make them more resilient, and more productive. Likewise, the crisis will again show evidence of the inequality that the functioning of the labor market generates and how it would be desirable to incentivize indefinite contracts. Active and passive employment policies should be modernized to ensure that the increase in unemployment that will necessarily occur does not turn into long-term unemployment, with all the social costs involved. Companies will need flexibility to adapt and ensure their survival. The answer to these problems cannot be a permanent increase in firing, but rather to facilitate agreements within the production unit that can help to maintain employment. Investment will need a favorable environment and one that provides certainty, especially in sectors where changes in regulation may be discouraging, such as real estate. Carrying out economic activity in an environment of greater health security also requires progress in the digital transformation of companies and society in general. New technologies have been particularly useful not only for maintaining the activities of some sectors and companies, but also for facilitating the mobility of people by minimizing health risks, and controlling and containing outbreaks of the disease. The efficiency of public administrations on these fronts will be essential to reduce, as much as possible, the negative impacts of the disrupted supply that come along with living with COVID-19, at least until an effective vaccine is available. In short, the risks and challenges have been magnified by this crisis. The situation requires ambitious, well-targeted and well-evaluated responses, and for them to be supported by a large part of society.

Tables

Table 1.1. **GROSS DOMESTIC PRODUCT** (ANNUAL AVERAGE, %)

	2017	2018	2019	2020	2021
US	2.4	2.9	3.7	-4.4	3.4
Eurozone	2.7	1.9	1.2	-5.2	4.1
China	6.9	6.7	6.1	2.2	5.5
World	4.0	3.7	3.0	-2.4	4.8

Forecast closing date: April 17, 2020
Source: BBVA Research and IMF

Table 1.2. **INFLATION** (ANNUAL AVERAGE, %)

	2017	2018	2019	2020	2021
US	2.1	2.4	1.8	-0.1	0.8
Eurozone	1.5	1.8	1.2	0.1	0.8
China	1.5	2.1	2.9	3.6	2.5
World	3.2	3.9	3.7	3.2	3.2

Forecast closing date: April 17, 2020
Source: BBVA Research and IMF

Table 1.3. **INTEREST RATE ON TEN-YEAR PUBLIC DEBT** (ANNUAL AVERAGE, %)

	2017	2018	2019	2020	2021
US	2.33	2.91	2.14	0.79	0.74
Germany	0.37	0.46	-0.21	-0.45	-0.05

Forecast closing date: April 17, 2020
Source: BBVA Research and IMF

Table 1.4. **EXCHANGE RATES** (ANNUAL AVERAGE)

	2017	2018	2019	2020	2021
EUR-USD	0.89	0.85	0.89	0.88	0.83
USD-EUR	1.13	1.18	1.12	1.14	1.20
CNY-USD	6.76	6.61	6.91	6.98	6.87

Forecast closing date: April 17, 2020
Source: BBVA Research and IMF

Table 1.5. **OFFICIAL INTEREST RATES** (END OF PERIOD, %)

	2017	2018	2019	2020 (f)	2021 (f)
US	1.50	2.50	1.75	0.25	0.25
Eurozone	0.00	0.00	0.00	0.00	0.00
China	4.35	4.35	4.35	3.50	3.50

Forecast closing date: April 17, 2020
Source: BBVA Research and IMF

Table 1.6. **EMU: MACROECONOMIC FORECASTS** (YoY) (ANNUAL AVERAGE, %)

	2017	2018	2019 (e)	2020 (f)	2021 (f)
GDP at constant prices	**2.7**	**1.9**	**1.2**	**-5.2**	**4.2**
Private consumption	1.8	1.4	1.3	-4.1	3.7
Public consumption	1.3	1.1	1.6	2.0	1.6
Gross fixed capital formation	3.7	2.3	5.5	-14.1	8.9
Inventories (*)	0.2	0.0	-0.5	0.0	0.0
Domestic demand (*)	**2.2**	**1.5**	**1.7**	**-4.8**	**4.2**
Exports (goods and services)	5.7	3.3	2.5	-6.2	4.8
Imports (goods and services)	5.2	2.7	3.8	-5.9	5.3
External demand (*)	**0.5**	**0.4**	**-0.4**	**-0.4**	**0.0**
Prices					
CPI	1.5	1.8	1.2	0.1	0.8
Underlying CPI	1.1	1.2	1.2	1.0	1.0
Labor market					
Employment	1.6	1.5	1.2	-1.4	0.7
Unemployment rate (% of active population)	9.1	8.2	7.6	9.2	8.5
Public sector					
Deficit (% of GDP)	-0.9	-0.5	-0.8	-4.9	-2.6
Debt (% of GDP)	87.8	85.9	83.8	92.6	90.5
Foreign sector					
Balance of payments on current account (% of GDP)	3.1	3.1	3.0	3.0	2.8

Annual rate change in %, unless expressly indicated.
Forecast closing date: April 17, 2020.
(*) Excluding financial assistance for Spanish banks.
Source: BBVA Research

Table 1.7. **SPAIN: MACROECONOMIC FORECASTS**
(ANNUAL RATES OF CHANGE IN %, UNLESS OTHERWISE INDICATED)

(Annual average, %)	2017	2018	2019 (e)	2020 (f)	2021 (f)
Activity					
Real GDP	2.9	2.4	2.0	-8.0	5.7
Private consumption	3.0	1.8	1.1	-8.7	3.4
Public consumption	1.0	1.9	2.3	2.6	0.9
Gross capital formation	5.9	5.3	1.8	-28.9	7.9
Equipment and machinery	8.5	5.7	2.6	-28.6	13.0
Construction	5.9	6.6	0.8	-31.6	1.9
Housing	11.5	7.7	2.9	-29.2	2.7
Domestic demand (contribution to growth)	3.0	2.6	1.5	-11.0	4.7
Exports	5.6	2.2	2.6	-26.6	9.3
Imports	6.6	3.3	1.2	-38.3	4.4
External demand (contribution to growth)	-0.1	-0.3	0.4	3.0	1.0
Nominal GDP	4.3	3.5	3.5	-9.1	7.1
(Billions of euro)	1,161.9	1,202.2	1,244.8	1,131.9	1,212.4
Labor market					
Employment, based on Labor Force Survey	2.6	2.7	2.3	-6.9	4.2
Unemployment rate (% of labor force)	17.2	15.3	14.1	20.5	17.3
Employment (full-time equivalent) based on Spanish Quarterly National Accounts	2.8	2.5	2.3	-6.8	4.1
Apparent labor productivity factor	0.0	-0.2	-0.3	-1.2	1.5
Prices and costs					
CPI (annual average)	2.0	1.7	0.7	-0.6	0.7
CPI (end of period)	1.1	1.2	0.8	-0.3	0.5
GDP deflator	1.4	1.1	1.6	-1.1	1.5
Pay per salaried employee	0.7	1.0	2.0	3.6	-7.5
Unit labor cost	0.7	1.2	2.3	4.9	-9.1
Foreign sector					
Balance on current account (% of GDP)	2.5	1.8	1.9	1.4	1.2
Public sector (*)					
Debt (% of GDP)	98.6	97.6	95.5	115.8	114.8
Public administration balance (% of GDP)	-3.0	-2.5	-2.6	-10.8	-6.7
Households					
Nominal disposable income	2.9	3.7	3.9	0.5	-0.4
Savings rate (% of nominal income)	5.9	6.3	7.7	16.4	12.7

Annual rate change in %, unless expressly indicated.
(e) Estimate. (f) Forecast.
Forecast closing date: April 17, 2020.
(*) Excluding financial assistance for Spanish banks.
Source: BBVA Research

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