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Creating Opportunities

Spain Economic Outlook

1Q21

Recent and expected evolution of the Spanish economy

January 2021

Spanish GDP may have contracted by 11.0% in 2020 and could grow by 5.5% in 2021 and 7.0% in 2022. The Spanish economy's progress in the third quarter of last year is estimated to have been somewhat better than expected. However, as forecast, the slowdown in the fourth quarter of 2020 was severe. For the time being, the increase in infections in recent months has not curbed the improved confidence and strong performance of financial markets related to the start of the vaccination process. Various activity indicators point to the impact of uncertainty, the effect of restrictions adopted to prevent further spread of the disease and the exhaustion of some of the public demand policies. Thus, it can be assumed that the recovery in early 2021 will be slower than previously expected. In any case, the economy could see a turnaround this year, with an acceleration in the growth rate, especially in the second half of the year. This is thanks to the potentially positive impact on activity of the vaccination process, the implementation of new fiscal and monetary stimulus measures and the high untapped production capacity. The risks in this scenario will likely shift in emphasis throughout the forecast period, moving away from health-related risks toward economic policy risks.

The upward revision of the expected 2020 GDP variation from -11.5% to -11.0% is explained by the economy's better-than-expected performance in the third quarter. According to the INE (*Instituto Nacional de Estadística* — Spanish National Statistics Institute), GDP is expected to have grown by 16.4% q/q, its biggest variation in real terms in the historical data, and above what was estimated three months ago (BBVA Research: 14.0%). In particular, almost all components of demand advanced more than expected. Of particular significance was the marked increase in domestic demand, the contribution of which explained almost all of the growth (15.1 percentage points). Private consumption increased by 20.3% q/q, almost 4 percentage points (pp) higher than expected (BBVA Research: 16.6%). Among other factors, this recovery can be explained by a greater impact on expenditure by the easing of restrictions on movement and the reduction in uncertainty about the disease, as well as a better-than-expected evolution of income and household wealth. Even more significant was the good performance shown by investment, which increased by 21.7% q/q (BBVA Research: 6.4%). By component, of note was the growth of expenditure on machinery and equipment (45.0% q/q), which has already recovered to the levels seen at the end of 2019 when transport material was excluded. This positive performance can be explained by the promotion of measures that have succeeded in making credit flow to businesses and the increase in public expenditure, particularly in health. It also reflects the strong upturn in goods exports, caused by the increase in demand in the Eurozone and the United Kingdom, the continuation of the momentum in the agriculture and health sectors, and the recovery in the automotive sector. However, the contribution of external demand to growth (1.3 pp) was lower than expected (3.8 pp) due to the surge in imports of both goods and non-tourism services, in line with the greater-than-expected momentum of consumption and investment, as well as a recovery in non-resident consumption that was in line with expectations but that was recovering from exceptionally low levels.

Activity looks to have barely changed in the fourth quarter of last year. On the one hand, household expenditure indicators point to private consumption possibly declining slightly during the latter part of 2020. On the other, public consumption appears to have continued progressing, in line with the role that fiscal policy has to play in fighting recession. On the investment side, the strong rally in the third quarter may have led to a downward correction in the fourth quarter. According to the data available as of the closing date of this publication, goods exports were surprisingly strong, which partially offset the sharp fall in foreign tourism and the subsequent fall in non-resident consumption. Therefore, the contribution of external demand to growth looks to have been marginally positive again.

Average GDP growth in 2021 is revised downward from 6.0% to 5.5%. Firstly, this is a result of the worsening of activity throughout the Eurozone in late 2020 and which could extend into the beginning of this year. This is the result of the deterioration of health indicators and the implementation of social distancing measures and restrictions on the opening of certain establishments. This may have led to a contraction in activity in the fourth quarter of last year in the EMU and could lead to a downward trend in GDP growth during the start of 2021. Although Spain has an increased exposure to the type of services most affected by these measures, mobility has not changed as negatively as it has in neighboring countries. Moreover, for the time being, activity and confidence indicators appear not to have deteriorated to quite the same extent as in other European countries. In the short term, therefore, the impact on GDP may be somewhat less negative than in the rest of the EMU. In any event, it is unlikely that exports could avoid a deterioration in this environment of greater uncertainty, and forecasts for the coming year have a downward bias.

Data on spending with BBVA credit cards and at BBVA Point of Sale (POS) terminals, along with other activity indicators, show a slightly sharper slowdown than expected in the latter part of last year. The first thing to begin to turn following the second wave of COVID-19 was consumption by foreigners, whose tentative recovery up until that point came to an end in August. The increase in infections did not show itself in the data for in-person expenditure by Spanish people until October (+6.0% compared to the same month of the previous year) and November (-8.0%), compared to the good numbers recorded in the third quarter (+10.0%). This was despite an increase in online purchases that was driven by the restrictions, fear of social contact and certain sales promotions, which would have only partially offset the aforementioned deterioration. In any case, the downturn in household consumption appears to have been particularly marked in provinces with the highest cumulative incidence of COVID-19. The services industry—including hospitality, tourism and retail—continues to be the industry most impacted by the restrictions, and has seen similar declines in activity to those recorded in May. This has led to an increase in the use of income protection schemes, such as Furlough schemes (ERTE) and benefits for self-employed workers in the sectors concerned, which has prevented further deterioration of the labor market.

The impact of public policies on domestic demand shows signs of fatigue. First and foremost, demand for credit has suffered as a result of worsening economic expectations and due to the strong increase in financing during the second quarter of the year. This has more than offset the high level of liquidity held by banks and the fact that there are government-backed credit lines that remain unused. Consequently, new business loan transactions have declined since July, as has new consumer financing, affected by the contraction in demand for certain durable goods, such as automobiles, which face high economic, technological and regulatory uncertainty. Finally, the positive evolution of the flow of mortgage loans has been notable, recording levels of new transactions from August to November not seen since 2010.

The public deficit is predicted to have closed 2020 at around 11.5% of GDP, a much lower imbalance than expected a few months ago. In part, this has to do with the temporary nature of the measures applied to sustain the income of families and reduce companies' labor costs. As restrictions on movement relaxed and businesses began to open, the number of workers placed on ERTEs decreased, reducing the need for public support. Although fiscal policy is still expansionary and expenditure continues to rise compared to the previous year, its impact on domestic demand has been declining over the months as the recovery has progressed. In any case, the impact of the crisis on public accounts has not been as high as expected, in part because of the good performance of revenues, the decline of which has been lower than the decrease in GDP. This implies an implicit increase in the tax burden on taxpayers that did not occur, for example, in the 2008–2009 crisis when the reduction in revenue was 50% higher than that of GDP.

Economic activity is expected to accelerate in the second half of 2021, leading to GDP growth of 7% in 2022. An effective, rapid and mass vaccination campaign would boost activity in at least two ways. The first would be that it would reduce health uncertainty. The second would be the easing of restrictions on the movement of workers and families, and the opening up of businesses in the services sector. Both factors would be key to improving income and wealth prospects and unlocking spending that has been blocked due to the fear of infection and supply constraints. In turn, this would reduce a significant portion of the savings that have been accumulated during the crisis. Private consumption growth forecasts for 2021 (+6.6%) and 2022 (+6.5%) reflect these factors.

Funds associated with the Next Generation EU (NGEU) program will have an increasing effect over time, particularly on investment. As stated in the previous edition of this publication, red tape both at the European level and in Spain will mean that some projects are unable to start in the first half of the year. Estimates as to the impact that these funds will have on the economy continue to point to a significant effect this year and the next two: 1.5 pp of GDP on average per year. In general, both public and private investment are expected to benefit from the virtuous circle that expansionary fiscal policy can produce, from improved confidence related to the mass vaccination campaign and from favorable financing conditions. In this regard, gross fixed capital formation would increase by 7.4% in 2021 and 15.9% in 2022. In any case, there is uncertainty as to how quickly the projects will be implemented and what their impact will be on the country's growth capacity. Exactly what investment is to be made needs to be specified, and governance mechanisms need to be established—beyond the European ones—that account for the effects that these resources can have on welfare, inequality and environmental sustainability.

The more the population is inoculated with the vaccine at the European level, the more significant the impact on foreign trade. Even more so if we take into account multiplier effects among countries that have access to funds associated with the NGEU program. These effects would especially favor the manufacturing industry, and could be an integral part of moving toward a more sustainable economy (such as in the automotive sector). In this regard, goods exports are expected to increase by 11.0% in 2021 and 10.1% in 2022, returning to 2019 year-end levels by the middle of this year. In this scenario, the evolution of foreign tourism will be positive and will present high growth rates, although from an already low level of activity and with the caveat that it is still very much uncertain what sort of lasting impact the pandemic will have on peoples' willingness to travel, the reduction of supply in some market segments and the increase in air transport costs.

The timely approval of the 2021 General State Budget is good news that could theoretically expedite the possibility of a consensus regarding structural reforms. Firstly, it provides the various Public Administrations with certainty and guarantees that fiscal policy will continue to be expansionary in the coming months, which creates a much-needed bridge until the NGEU-funded projects begin. In addition, they can pave the way for the approval of measures that are part of the conditions for receiving funds promised from Europe. At any rate, this will not be easy. The consensus must be formed around policies that are endorsed by the European Commission. Failure to achieve this would mean jeopardizing not only the availability of such funds, but also Spain's financial stability, not to mention an historic opportunity to enhance the economy's capacity for growth and improve the well-being of the population.

The European Central Bank's (ECB) monetary policy adjustments, together with changes to the terms of loans backed by the ICO (*Instituto de Crédito Oficial* — Spanish official credit institution), provide a new boost to financing and liquidity for both the public and private sectors. On the one hand, the central bank has sent a strong signal about keeping interest rates at historically low levels and their intention to prevent fragmentation within the Eurozone. It has done this by expanding the size (by EUR 500 billion) and length (at least until March 2022) of the Pandemic Emergency Purchase Programme (PEPP). In order to try to unleash credit toward companies, particularly SMEs, the ECB has recalibrated the terms of TLTRO III liquidity operations. In exchange for paying the banking system an interest rate of 1% for the liquidity taken, it has set the condition that the institutions must maintain the credit at least between October 1, 2020 and December 31, 2021. In addition, the Spanish Government has grouped the two existing ICO lines (liquidity and investment) and has extended the deadline for taking out this type of credit until June 30, 2021. It has also extended the payment period for this financing from five years to eight years, while the grace period for the payment of principal can be extended by twelve additional months, among other changes. In short, it is highly likely that there will be an increase in credit supply in the coming months (compared to the scenario in which these decisions had not been made), as banks try to comply with the ECB's conditions and businesses take advantage of the new terms of ICO-backed loans.

The level of untapped production capacity is high and the private sector does not have significant imbalances. Although the increase in the unemployment rate has not been as significant as in previous recessions thanks to income protection measures, many workers are willing to trade the uncertainty of the ERTE for the security of a job in a company or industry that is benefiting from the recovery. This situation should keep labor costs and, to a large extent, inflation below the levels seen in Spain's main competitors. Likewise, despite the sharp rise in corporate debt, households continue to deleverage. Moreover, the increase in private saving has been such that the current account is expected to remain in surplus for the next two years, despite such a large public deficit. While it is true that the transition of workers from one sector to another presents a challenge for the Spanish economy and that the situation of public accounts and the solvency of some companies is yet to be established, the economy will not be hampered by large imbalances in an environment of growing demand.

In terms of risks, the main one is still health, though those linked to the solvency of some companies and the lack of consensus around reforms may become more prominent in the coming months. Although the process of vaccinating the population has begun, there is uncertainty as to when herd immunity will be achieved and whether it will last over time. In the meantime, social distancing measures may continue to be necessary to limit the spread of the disease, with the economic cost that this brings. In addition, there is also the possibility of different regions in Europe and Spain progressing at different speeds in the immunization process, which would lead to an uneven recovery. Moreover, the measures taken by the ECB and the Spanish Government, together with the agile involvement of the banking sector and the good position of companies, favored the channeling of resources that have managed to save jobs. With the recovery in progress, many companies will be able to cope with the obligations they have taken on. However, some may have debt levels that prevent them from investing or, worse, mean they cannot survive. Moving forward, it will be necessary to focus on bolstering processes that can identify debt that is sustainable, providing debt restructuring mechanisms, streamlining extrajudicial processes to resolve such problems, and incentivizing the inflow of private capital. Corporate support policies involving ICO-backed credit should move toward incentives and recapitalization support for companies that are highly likely to be profitable again and that would be able to pursue investments and job creation if they had a lower debt-to-capital ratio. Finally, in the coming months, the Spanish Government must present a reform agenda, which will have to be approved by the European Commission. There is a lot at stake for Spain. On the one hand, because it is in its own interest to seize this opportunity to create the conditions for a more vigorous and sustainable recovery. Above all, it will be necessary to lay the foundations for ensuring the long-term solvency of public accounts, but also to contribute to reducing the unemployment rate and temporary employment and to invest in productivity improvements (and therefore in wages). On the other hand, because the country's credibility is at stake. With the approval of the NGEU, the EU has taken a step forward in terms of integration. The ECB's intention to prevent the fragmentation of sovereign-debt markets may be disputed if any member of the monetary union fails to meet its commitments. Therefore, there is a need for a cross-cutting consensus on ambitious reforms that follow the recommendations of the European Commission and even improve on them. Otherwise, the recovery may well be short-lived and some of the mistakes of the past may be repeated.

Tables

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

	2018	2019	2020	2021	2022
United States	3.0	3.7	-3.6	3.6	2.4
Eurozone	1.9	1.3	-7.3	4.1	4.4
China	6.7	6.1	2.2	7.5	5.5
World	3.6	2.9	-2.6	5.3	4.1

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: January 8, 2021.
Source: BBVA Research & FMI.

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

	2018	2019	2020	2021	2022
United States	2.4	1.8	1.3	2.6	2.3
Eurozone	1.8	1.2	0.3	0.8	1.3
China	2.1	2.9	2.4	1.6	2.8
World	3.8	3.6	3.4	3.3	3.3

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: January 8, 2021.
Source: BBVA Research & FMI.

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

	2018	2019	2020	2021	2022
United States	2.91	2.14	0.90	0.99	1.08
Germany	0.46	-0.21	-0.48	-0.38	0.00

Forecast closing date: January 8, 2021.
Source: BBVA Research & FMI.

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

	2018	2019	2020	2021	2022
EUR-USD	0.85	0.89	0.88	0.81	0.79
USD-EUR	1.18	1.12	1.14	1.24	1.27
CNY-USD	6.61	6.91	6.91	6.45	6.57

Forecast closing date: January 8, 2021.
Source: BBVA Research & FMI.

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

	2018	2019	2020	2021	2022
United States	2.50	1.75	0.25	0.25	0.25
Eurozone	0.00	0.00	0.00	0.00	0.00
China	4.35	4.35	4.35	3.85	3.85

Forecast closing date: January 8, 2021.
Source: BBVA Research & FMI.

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

	2018	2019	2020	2021	2022
GDP at constant prices	**1.9**	**1.3**	**-7.3**	**4.1**	**4.4**
Private consumption	1.5	1.4	-8.2	3.6	5.1
Public consumption	1.2	1.9	0.6	2.9	1.3
Gross fixed capital formation	3.2	5.7	-10.1	5.4	7.0
Inventories (*)	0.1	-0.5	-0.3	-0.1	0.0
Domestic demand (*)	**1.8**	**1.8**	**-6.7**	**3.6**	**4.5**
Exports (goods and services)	3.6	2.5	-10.8	7.9	5.0
Imports (goods and services)	3.6	3.9	-10.6	7.6	5.6
External demand (*)	**0.1**	**-0.5**	**-0.5**	**0.4**	**-0.1**
Prices and Costs					
CPI	1.8	1.2	0.3	0.8	1.3
CPI Core	1.2	1.2	0.9	0.9	1.4
Labour Market					
Employment	1.6	1.2	-1.8	0.0	1.6
Unemployment rate (% of labour force)	8.2	7.6	8.1	9.2	8.2
Public sector					
Surplus (+) / Deficit (-) (% GDP)*	-0.5	-0.6	-8.5	-6.0	-3.5
Public debt (% GDP)*	85.8	84.1	100.3	102.8	101.8
External Sector					
Current Account Balance (% GDP)	2.9	2.3	2.1	2.3	2.2

Annual rate change in %, unless expressly indicated.
Forecast closing date: January 8, 2021.
(*) Excluding financial aid for Spanish banks.
Source: BBVA Research.

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

(Annual av erage, %)	2018	2019	2020	2021	2022
Activity					
Real GDP	**2.4**	**2.0**	**-11.0**	**5.5**	**7.0**
Private Consumption	1.8	0.9	-13.2	6.6	6.6
Public Consumption	2.6	2.3	3.8	3.5	2.4
Gross Fixed Capital Formation	6.1	2.7	-12.0	7.9	15.4
Equipment and machinery	5.4	4.4	-13.6	9.7	14.8
Construction	9.3	1.6	-14.7	7.0	14.8
Housing	12.4	4.1	-18.2	2.7	10.2
Domestic Demand (contribution to growth)	**3.0**	**1.4**	**-9.3**	**5.6**	**7.2**
Exports	2.3	2.3	-19.9	10.9	13.7
Imports	4.2	0.7	-16.3	11.8	15.1
External Demand (contribution to growth)	**-0.5**	**0.6**	**-1.7**	**0.0**	**-0.2**
GDP at current prices	3.6	3.4	-10.1	6.6	8.5
(Billions of Euros)	1,204.2	1,244.8	1,118.6	1,192.6	1,294.0
Labour market					
Employment, Labour Force Survey	2.7	2.3	-2.8	1.9	4.8
Unemployment rate (% Labour force)	15.3	14.1	15.8	17.0	13.9
Employment, full time equivalent	2.6	2.3	-7.2	4.7	4.5
Productivity	-0.2	-0.3	-3.8	0.8	2.6
Prices and Costs					
CPI (average)	1.7	0.7	-0.3	0.7	1.2
CPI (end of period)	1.2	0.8	-0.7	1.1	1.5
GDP deflator	1.2	1.4	0.9	1.1	1.5
Compensation per employee	1.0	2.1	0.2	0.7	4.2
Unit Labour Cost (ULC)	1.2	2.4	4.1	-0.2	1.6
External sector (*)					
Current Account Balance (% GDP)	1.8	2.0	0.8	1.1	0.9
Public sector					
Debt (% GDP)	97.4	95.5	118.9	120.2	117.2
Deficit (% GDP) (*)	-2.5	-2.9	-11.5	-8.9	-5.6
Households					
Nominal disposable income	3.0	2.6	-4.0	4.0	7.7
Savings rate (% nominal disposable income)	6.0	6.6	14.6	12.0	11.7

Annual rate change in %, unless expressly indicated.
Forecast closing date: January 8, 2021.
(*) Excluding financial aid for Spanish banks.
Source: BBVA Research.

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