BBVA Research

Creating Opportunities

Spain Economic Outlook

3Q21

Recent and expected evolution of the Spanish economy

July 2021

The 2021 growth forecast for the Spanish economy is revised upward by 1 percentage point (pp) to 6.5%, while the 2022 forecast is maintained at 7.0%. In the short term, the risks are balanced. In the medium term, the trend in the scenario will depend on the reforms adopted in the coming months and the speed and efficiency with which European funds are implemented. As expected, Spanish GDP contracted during the first quarter of 2021, albeit somewhat less than had been forecasted. In addition, second quarter data suggests greater acceleration than was expected three months ago. The improvement in health indicators and the easing of restrictions have reduced uncertainty and advanced private spending. The recovery of household consumption has mainly been observed in services and, more specifically, those carried out in a social context. Investment in machinery and equipment has also continued to trend positively. Looking forward, conditions for recovery remain favorable given the speed of vaccination, the immunization of the most vulnerable groups and ongoing demand policies, at the expense of restrictions that may be triggered by an increase in infections associated with new COVID-19 variants. In the coming months, the return of a substantial portion of foreign visitors during the tourist season will be key. At the same time, European funds are also expected to arrive. Both of these factors should have a positive impact, especially on exports of services, consumption of durable goods and investment in construction. Medium-term risks are centered around efficiency in the use of Next Generation EU (NGEU) resources and the reforms that will need to be implemented in order to access funds transfers and, more importantly, reduce vulnerabilities and transform the economy.

In line with the forecast, the Spanish economy registered a contraction of activity during the first quarter of 2021. In any case, the decline in GDP (-0.4%, quarterly, q/q) would have been slightly lower in absolute terms than that anticipated by BBVA Research (-0.9% q/q). The demand components that performed best relative to forecasts were exports of goods, investment in machinery and equipment and household consumption. Here, it is necessary to highlight the high level of uncertainty that existed as of the closing date of the latest forecasts (mid-April), when COVID-19 infections were rising again. This was the case not only in Spain but also in some of the country's major trading partners, such as France and Germany. The foregoing, along with the United Kingdom's departure from the European Union, had resulted in a decrease in exports of goods in January that was expected to extend throughout the quarter. Notwithstanding this, new data has confirmed that the impact of the various COVID-19 waves on economic activity has been decreasing as the percentage of the population that is vaccinated, particularly in the most vulnerable segments, has increased. In this regard, exports of goods recovered on a widespread basis, both by destination and by type of good, during February and March. This did not prevent them from experiencing a moderate contraction as of the end of the quarter, however. The improved international situation and outlook for expansion during the second quarter of the year may also explain the continued growth observed in the accumulation of machinery and equipment. Finally, as expected, household consumption experienced a contraction that reflected the impact on spending of the increase in infections at the end of 2020 and beginning of 2021 and the restrictions that were necessary to contain the spread of the virus. In addition, in some autonomous communities, Storm Filomena would have a lasting effect on consumption. Finally, increases in energy costs and the price of certain commodities must also be taken into account. This led to a rebound in inflation that reduced households' purchasing power.

The demand components that performed more negatively than expected during the first quarter of 2021 included investment in construction, public consumption and exports of services. The accumulation of fixed capital in both housing and other construction projects fell, whereas preliminary data had pointed to growth. This was despite the fact that the mortgage market has been highly dynamic and that the purchase of homes, especially by Spanish residents, is weathering the crisis well. In this regard, there is a risk that the disappointing trends in both components are due to the uncertainty related to both the arrival of European funds and the conditions that will be necessary to access them. In this scenario, companies are likely deferring projects until they are aware of the details surrounding the implementation of these resources. Public administration consumption, for its part, registered just its second decline since 2014, with the variation in this figure coming in significantly below the average growth achieved during the previous year. Exports of services, for their part, were negatively affected by the increase in infections, which stunted the incipient recovery in foreign tourist spending that had been observed prior to October. Finally, imports fell in line with the forecast, impacted by the reduction in both domestic and foreign demand.

During the second quarter of the year, GDP growth could be between 2.3% and 3.3%, q/q. This acceleration is higher than was anticipated three months ago (1.3% q/q). The main factor behind the recovery is an improvement in health indicators in both Spain and other developed countries, as well as in China. The growth observed in the US economy, which is also showing the effects of a strongly expansionary fiscal policy, is of particular importance in this regard. In the EMU, activity data has also been surprisingly positive, which explains the improvement in the Eurozone growth forecast to 4.8% in 2021 and 5.0% in 2022. This more favorable environment for activity and the reduced risk of infection would boost exports of Spanish goods and services during the second quarter of the year (BBVA Research: +1.5% q/q), despite the fact that goods exports would have contracted due to temporary supply issues of intermediate goods in some sectors. Domestic demand, on the other hand, would benefit from rapid vaccination progress and decreased uncertainty regarding the labor market. The progressive elimination of restrictions and the end of the state of alarm have allowed for a recovery concentrated mainly in increased mobility and spending on services, particularly those carried out in a social context. Spending on household consumption could thus have grown by 3.1% (q/q). In fact, purchases made with BBVA credit cards and at BBVA point of sale terminals indicate that, during the first half of the year, spending on services would accelerate to reach levels of about 30% higher in June than it had been during the same month of 2019.[1] Similarly, consumption by Spanish residents outside of their provinces of origin would intensify this recovery, and a return to the levels observed two years ago would be possible in June.[2] Finally, in June, purchases made with foreign cards would increase to represent approximately 60% of those made during the same month of 2019.

Investment in machinery and equipment would continue to grow, while both the accumulation of fixed capital in construction and public spending are expected to have rebounded sharply during the second quarter of the year. Various indicators, such as improved confidence (particularly in the PMI for manufacturing), capital goods imports and the registration of buses and industrial vehicles, suggest that investment in machinery and equipment could have increased again during the second quarter of the year (+2.5% q/q). If this estimate is confirmed, this component of private domestic demand would be the first to recover to its pre-crisis levels. This is excellent news for productivity growth forecasts over the coming quarters in Spain. In addition, positive trends in social security affiliation in the construction sector (+0.6% q/q), together with the progress observed in other indicators, such as cement consumption, housing permits and tenders for public works, anticipate that investment in this component could have increased by 4.1% q/q. It is also foreseeable that the slowdown in growth in public consumption spending was temporary and will recover (+0.8% q/q) during the second quarter. Finally, the increase

1: See Impact of COVID-19 on consumption in real time and high definition, BBVA Research Observatory, June (2021).
2: See Analysis of national tourist flows in real time, BBVA Research Observatory, July (2021).

in imports (+0.6% q/q) will be relatively modest in relation to the strong increase in final demand, due mainly to the concentration of spending on services at the domestic level with a low external component.

Looking forward, the international environment will remain favorable, thanks to progress in vaccination and the implementation of demand policies in the world's major economies. Immunization of the population is progressing in the US, Europe and China. Additionally, current data points to higher GDP growth than was expected three months ago for each of these areas. This positive momentum and these fiscal expansion measures, primarily in the US economy but also in the Eurozone, should support the growth of sales of goods and services at a global level. In the case of Spain, the performance of the tourism sector and the capacity to capture both the domestic and the European markets will be particularly significant. The country guarantees a safe environment from a health perspective and has made more intensive price adjustments than its main competitors within the EU. **If the cumulative incidence of infections remains low and the perception of health-related safety in Spain remains positive, growth could be higher than that contemplated in this publication.** If, on the contrary, the country fails to convey that the virus is under control, recovery could be more limited. With regard to exports of goods, attention must be paid not only to growth in demand but also to the supply problems that have been observed in certain sectors, such as the automotive sector, where bottlenecks persist in production chains, preventing increases in supply.

The European Central Bank (ECB) maintains an accommodative monetary policy and has revised its inflation strategy, changing the inflation target to 2% on a symmetric basis. The long-term funding cost of European countries has remained at around the levels observed three months ago. This is due to the acceleration of net purchases associated with the Pandemic Emergency Purchase Program (PEPP). Liquidity is not an issue, as banks continue to access it in high quantities through targeted longer-term refinancing operations (TLTRO). However, the monetary authority has revised its Eurozone growth forecasts upward and has stated, for the first time since the beginning of the crisis, that the risks presented by the scenario are balanced. In the face of an increase in inflation that is expected to be temporary, due mainly to its root cause (an increase in the cost of energy), the ECB is expected to maintain the monetary stimulus. In this regard, a slowdown in the pace of purchases covered by the PEPP is expected to be announced in September, and the program is expected to end in the first quarter of 2022 (although it would continue to acquire debt to cover maturities occurring up to December 2023). The other asset purchase program (APP) would remain in place until the first quarter of 2023, while short-term interest rates would not begin to increase until after that period. All of the foregoing, together with the good position held by banks and the private sector, should favor the availability of credit at a low cost for companies and households that need it. In addition, the announcement made by the ECB with regard to the change in its monetary policy, targeting a 2% variation in the Harmonized Index of Consumer Prices on a symmetric basis, improves the ability of the monetary authority to deal with environments such as the current one. The same is true of the standardization of instruments that have had to be used in order to keep funding costs low and boost demand. In any event, the change will represent a challenge from a communications standpoint, as it may coincide with divergences in interest rate management in the US and Europe due to the varying magnitude of the fiscal stimuli. The monetary authority must ensure that funding costs remain consistent with the cyclical position of the European economy.

In this liquidity context, inflation rises and, in the short term, higher upward pressure derived from commodity prices, bottlenecks observed in certain production processes and domestic demand recovery cannot be ruled out. However, the economy is far from being at full employment, and an inflationary spiral has been ruled out for the time being. Although the variation in the Consumer Price Index (CPI) reached 2.7% at the midpoint of the year, this is mainly due to the energy-related component. Core inflation remains at 0.2%, which reflects the fact that the increase in production and transportation costs has not yet been passed on to other prices. Companies are currently absorbing shocks through reduced margins in the face of a weak demand environment.

Forecasts suggest that oil prices will remain at around current levels or even begin a moderate decline in the coming quarters insofar as supply begins to react. If this scenario is confirmed, the increase in inflation would be temporary. However, the short-term trend would be upward. On the one hand, production costs suggest that fuel is not the only thing putting pressure on companies' profitability. The cost of intermediate goods and other commodities is also rising in the face of shortages of certain components, high demand in producing countries such as China and disruptions in value chains as a result of restrictions to curb the spread of the virus. Moreover, a recovery in the services sector, particularly in accommodation or travel, could lead to an increase in prices following the significant reductions made in an effort to offset the drop in demand. In any event, it is understood that the second-round effects of these factors will continue to be limited, given that unused production capacity remains high, the unemployment rate is still higher than it was at the start of the crisis, the number of furloughed workers remains high and investment in machinery and equipment has increased. All of the foregoing suggest that significant wage pressures will not be observed at the aggregate level, although occasional frictions cannot be ruled out given that the speed of reallocation of productive factors between sectors may be insufficient to address excess capacity in some and the lack of productive factors in others. Despite this, gains in productivity could partially offset the increase in intermediate costs.

Accumulated savings rose during the first quarter of the year, increasing the likelihood of strong growth in spending after the various uncertainties have been resolved. It is estimated that the reduction in income due to job destruction and the effect of the crisis on the self-employed, together with the negative impact on wealth, reduced household savings by around EUR 98 billion between the fourth quarter of 2019 and the first quarter of 2021.[3] However, those who maintained their jobs or salaries or whose income rose with the crisis have not been able to spend as a result of restrictions on opening and mobility. This is known as "forced savings" and would have increased by EUR 144 billion over this period. Resources saved for precautionary reasons (EUR 23 billion) must also be added to this figure, which yields net accumulated savings of EUR 68 billion. As described above, some of these resources have already begun to be used, and it is estimated that if households recognize this savings as deferred income during these two years, consumption could increase by an additional 1.5 pp on average in 2021 and 2022, as compared to a scenario in which it is maintained as financial wealth. Although the services that have been most affected by the restrictions are those that show the effects of the use of these savings, the consequences are also evident in the purchase of homes. In particular, the low return on risk-free assets and changes in household preferences would redirect part of these funds toward residential investment. This may be observed in the turning point shown in the purchase of single-family homes and the strong growth in new mortgage loan flows.

The government's fiscal stimuli are being progressively withdrawn alongside the recovery. In any case, the extension of the Temporary Redundancy Plan (ERTE) until September, and the continuation of a significant number of workers in it, points to the need for its modification. The improvement in growth forecasts for the Spanish economy suggests that the public deficit (-7.7% of GDP in 2021) can improve on expectations from three months ago (-8.5%), although uncertainty regarding how income will evolve in the face of recovery and how permanent the growth in spending will be is high. Improved activity in services, primarily hospitality, has resulted in a reduction of more than 450,000 furloughed workers since February 1. The foregoing, together with increased affiliation, will progressively reduce the imbalance in public accounts. Moreover, the extension of the ERTE until September will help overcome a still atypical tourist season, especially in the island autonomous communities. Notwithstanding this, the number of people who remain furloughed (449,000 as of the end of June) remains high and threatens to increase at the end of the summer season. Beyond the increase in expenditures that this could entail, the prolongation of the ERTE in its current form presents other disadvantages. One is that the cost could be

3: For more details on the estimation of these figures, see: Spanish household saving in times of the pandemic, BBVA Research Observatory, May (2021).

greater than that necessary to preserve employment if the exemptions and bonuses go to companies and workers who do not need them. On the other hand, a portion of the ERTE would go toward sustaining non-viable businesses and jobs as a result of the significant drop in income in certain sectors and changes in the consumption and mobility habits of the population. The ERTE thus needs urgent modifications aimed at providing the necessary tools to allow workers who remain in this situation and are unlikely to return to their jobs to reorient their careers more easily.

The Recovery, Transformation and Resilience Plan presented by the Spanish government is sufficient, ambitious with respect to its implementation and adequate in its diagnosis. However, it also has weaknesses and omissions. It is sufficient because the nearly EUR 70 billion in funds transfers expected to be received in the coming years accounts for close to 60% of the fall in nominal GDP between 2019 and 2020 (80% if the recovery beginning in 3Q20 is included). It is ambitious in terms of its implementation period due to the fact that it plans to distribute approximately 70% of these transfers toward the end of 2022 and 30% in 2023. The Plan contains an adequate diagnosis of the main problems in the Spanish economy because it takes into account the recommendations of the European Commission. In addition, it includes an allocation of resources that is in line with the NGEU's digitalization and environmental sustainability goals. However, it also has weaknesses and omissions. Specifically, there is no ex ante assessment of what is desired to be done, the implementation goals seem unrealistic and there is no clear, detailed, accessible timetable providing companies with certainty regarding how to take advantage of the Plan. **Thus, the likelihood that resources will take longer to arrive is increasing, while the effectiveness of achieving the goals being pursued is in doubt.** As such, the strong increase in activity owing to the recovery in private spending that is currently being observed may slow sharply if there is no timely shift in public spending and investment, along with improvements in productivity and environmental sustainability.

Finally, what is perhaps most worrying is the vagueness and uncertainty surrounding the reforms to be undertaken in the coming years. The pension system addresses its sufficiency but not the sustainability of the system, and can only be fully assessed once the details of how persisting imbalances and intergenerational equity will be addressed are known. It is positive that a consensus has been reached between the social partners to progress in improving the system. Given what has happened with previous reforms, this seemed essential. In addition, the discouragement of early retirement and promotion of late retirement are welcome and may be a step forward in improving the sustainability of the system, as well as having a positive impact on employment and productivity. However, these changes appear to be insufficient to offset the expected increase in life expectancy over the next three decades. It would have been preferable for these incentives to form part of a comprehensive system that ensured actuarial balance and allowed for flexible retirement. Moreover, pensions will be revalued with inflation, but no compensatory measures have been taken to ensure that the system is financially balanced, as required by the repealed Pension Revaluation Index. The sustainability factor is also replaced by a future intergenerational equity factor, the details of which are not yet known and which will take effect beginning in 2027. If this new factor is to meet its objective, it will mean less generosity in the system. Finally, contrary to the principle of separation of sources, certain contributory benefits are transferred to the State, while part of the unemployment contributions are allocated to the payment of pensions.

Without lasting, ambitious reforms, high growth will be temporary and inconsistent with commitments undertaken in the areas of digitalization and environmental sustainability. The economic recovery that is currently underway is cyclical. The implementation of instruments such as the ERTE and the extension of publicly guaranteed loans has allowed the productive framework to be preserved, preventing the growth potential of the economy from dropping as much as it did in other recessions, although it remains low. The country is subject to a number of conditions that increase the risk that it will not take advantage of the next few years to drive its transformation. Deficiencies in training, company size and functioning of the labor market, among other things, could stand in the way of the expected digitalization of the economy. Given the chronic employment problems, it is essential that the next labor market reforms are successful in designing and implementing measures to achieve a more efficient and flexible framework, while at the same time making it safer and more equitable. In addition, greenhouse gas reduction targets may be incompatible with vigorous growth in the absence of reforms, especially in autonomous communities whose production structure does not favor this goal. Looking forward, a conditional period will begin that must be used to implement reforms that reduce unemployment and temporary employment and increase productivity, while transforming the economy in the areas of digitalization and sustainability. Over the coming months, the funding cost in Spain will remain limited due to ECB intervention. Tax rules have been suspended by the European Commission until 2023. And funds related to the NGEU program are on their way. All of this, together with the recovery that is currently underway, will make resources available to compensate those who will necessarily have to pay to implement measures that are necessary to increase social welfare. This is a historic opportunity that cannot be missed out on.

Tables

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

	2018	2019	2020	2021	2022
United States	3.0	3.7	-3.5	6.7	4.8
Eurozone	1.9	1.3	-6.7	4.8	5.0
China	6.7	6.0	2.3	8.2	5.5
World	3.6	2.9	-3.2	6.3	4.7

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: July 9, 2021.
Source: BBVA Research & FMI.

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

	2018	2019	2020	2021	2022
United States	2.4	1.8	1.2	3.6	2.8
Eurozone	1.8	1.2	0.3	2.0	1.5
China	2.1	2.9	2.5	1.7	2.5
World	3.8	3.6	3.6	4.2	3.6

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: July 9, 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	1.56	2.02
Germany	0.46	-0.21	-0.48	-0.19	0.22

Forecast closing date: July 9, 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	0.83	0.82
USD-EUR	1.18	1.12	1.14	1.20	1.22
CNY-USD	6.61	6.91	6.91	6.46	6.50

Forecast closing date: April 9, 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: July 9, 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**	**-6.7**	**4.8**	**5.0**
Private consumption	1.5	1.3	-8.0	3.3	6.9
Public consumption	1.2	1.8	1.4	2.9	1.2
Gross fixed capital formation	3.2	5.7	-8.4	6.7	6.2
Inventories (*)	0.1	-0.5	-0.3	0.1	-0.1
Domestic demand (*)	**1.7**	**1.8**	**-6.1**	**4.0**	**5.1**
Exports (goods and services)	3.6	2.5	-9.6	8.9	6.1
Imports (goods and services)	3.6	3.9	-9.1	7.6	6.9
External demand (*)	**0.1**	**-0.5**	**-0.6**	**0.9**	**-0.1**
Prices and Costs					
CPI	1.8	1.2	0.3	2.0	1.5
CPI Core	1.2	1.2	0.9	1.3	1.4
Labour Market					
Employment	1.6	1.2	-1.6	0.3	1.5
Unemployment rate (% of labour force)	8.2	7.6	7.9	8.2	7.9
Public sector					
Surplus (+) / Deficit (-) (% GDP)*	-0.5	-0.6	-7.2	-7.0	-3.8
Public debt (% GDP)*	85.7	83.9	98.0	99.6	96.8
External Sector					
Current Account Balance (% GDP)	3.1	2.4	2.1	2.6	2.4

Annual rate change in %, unless expressly indicated.
Forecast closing date: July 9, 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 average, %)	2018	2019	2020	2021	2022
Activity					
Real GDP	**2.4**	**2.0**	**-10.8**	**6.5**	**7.0**
Private Consumption	1.8	0.9	-12.4	7.5	6.7
Public Consumption	2.6	2.3	3.8	2.8	2.5
Gross Fixed Capital Formation	6.1	2.7	-11.4	9.7	16.4
Equipment and machinery	5.4	4.4	-13.0	16.7	12.4
Construction	9.3	1.6	-14.0	5.0	18.8
Housing	12.4	4.1	-16.6	4.0	13.5
Domestic Demand (contribution to growth)	3.0	1.4	-8.8	6.6	7.6
Exports	2.3	2.3	-20.2	12.2	17.2
Imports	4.2	0.7	-15.8	13.6	20.0
External Demand (contribution to growth)	-0.5	0.6	-2.0	-0.1	-0.5
GDP at current prices	3.6	3.4	-9.9	7.7	8.5
(Billions of Euros)	1204.2	1244.8	1121.7	1208.5	1311.5
Labour market					
Employment, Labour Force Survey	2.7	2.3	-2.9	1.9	3.6
Unemployment rate (% Labour force)	15.3	14.1	15.5	15.7	14.2
Employment, full time equivalent	1.0	3.2	2.8	2.9	2.6
Productivity	1.5	-1.2	-13.6	3.6	4.4
Prices and Costs					
CPI (average)	1.7	0.7	-0.3	2.0	1.2
CPI (end of period)	1.2	0.8	-0.5	2.6	1.3
GDP deflator	1.2	1.4	1.0	1.3	1.5
Compensation per employee	0.3	0.6	-0.6	0.7	3.6
Unit Labour Cost (ULC)	-1.2	1.8	13.0	-2.9	-0.8
External sector (*)					
Current Account Balance (% GDP)	1.8	2.0	0.5	0.3	-0.3
Public sector					
Debt (% GDP)	97.4	95.5	119.9	119.2	115.5
Deficit (% GDP) (*)	-2.5	-2.9	-10.1	-7.7	-5.5
Households					
Nominal disposable income	3.0	2.6	-3.3	3.9	4.3
Savings rate (% nominal disposable income)	6.0	6.6	15.1	10.8	7.5

Annual rate change in %, unless expressly indicated.
Forecast closing date: July 9, 2021.
(*) Excluding financial aid for Spanish banks.
Source: BBVA Research.

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