BBVA Research

Creating Opportunities

Spain Economic Outlook

1Q22

The Spanish economy: recent performance and outlook

January 2022

Our GDP growth forecasts for 2021 and 2022 are virtually unchanged (5.1% and 5.5%, respectively, with recovery set to continue in 2023 (+4.9%). If this scenario plays out, activity will be back to pre-pandemic levels by the end of this year or the beginning of next year. Unlike GDP, job figures[1] have already returned to pre-crisis levels and should continue rising. On our estimates, by the fourth quarter of 2022 employment will be 4.4% higher than in the last quarter of 2019. Growth should come with headline inflation at around or slightly above 2%, where it has hovered persistently for the first time since before the global financial crisis. This would be against a backdrop in which the current account is near balance in 2022 - due to some extent to the public deficit's cyclical reduction - before showing a moderate deficit in 2023. Lower health uncertainty, coupled with increased mobility, should boost private consumption and exports of tourism services, feeding through to economic recovery. Meanwhile, in the months ahead investment should gather steam as commodity prices stabilize, production chain bottlenecks are resolved, the NextGenerationEU (NGEU) funds are disbursed and expansionary monetary policy is maintained. The pandemic still poses the biggest threat. However, if the impact of each new wave of infections is smaller, growth momentum could be faster than forecast in this report.

GDP growth in the second half of last year was just lower than expected. In the third quarter, GDP grew by 2.6% quarter-on-quarter (Q/Q), below the 4.0% forecast three months ago (4.0%). However, available data indicate that this may have been offset by stronger-than-expected growth in the fourth quarter (2.4% versus 0.6%). So, the average GDP growth forecast for the year was practically unchanged, with a downward revision of just one-tenth of a percentage point (from 5.2% annualized three months ago to 5.1% in this report).

Private consumption continued to recover, but not as fast as expected. Expenditure on services rose sharply, fueled by the ease in mobility restrictions, higher employment and a decrease in the high saving rate. Expenditure on services using BBVA cards or point of sale (POS) terminals was 72% higher in the fourth quarter of 2021 than in the same period of 2019. However, purchases of goods lost steam as the momentum provided by the lockdown for some goods petered out. These include food, durable goods and furniture, which saw demand rise during the lockdown. Meanwhile, consumption was hit by the shortage of certain goods caused by production chain disruptions, the lack of containers and higher fuel prices. Car sales are a prime example. Lastly, household purchasing power eroded on the back of rising electricity prices. This forced families to earmark more to pay for energy and less for other services and certain goods.

Housing was the other domestic demand component to underperform expectations. Sales and prices continue to fare well, but this has yet to feed through to an increase in new building permits or refurbishment. In any event, particularly eye-catching is the divergence between several supply-side indicators (e.g. cement consumption, Social Security registration in the construction sector) and investment in housing. Indeed, one of the main reasons productivity per hour worked in Spain has fallen since the second half of 2020 is precisely this construction indicator's negative performance. We could well see the sector recover over the coming months as the number of projects underway are registered.

1: Based on the Labor Force Survey.

All other GDP components performed in line with expectations, with growth in non-residential investment and exports. Non-residential investment is beginning to show signs of the fiscal stimulus that is due to come. This is evidenced by gross fixed capital formation in other buildings and indicators such as public tenders, which are at their highest in a year since 2008. Disbursement of NGEU funds is coming about much slower than expected and questions over when and how they will be spent could be affecting purchases of machinery and equipment, which have been excessively volatile over the past year. The lack of security in companies' supply chains, higher transport costs, or rising and consistently high electricity prices could also be playing an important role here. This makes the good performance of exports of goods, which are already above pre-pandemic levels, all the more surprising. Lastly, exports of services are still picking back up, although from low levels and with plenty more to go before they get back to 2019 levels.

Economic activity looks set to decelerate in the first half of 2022 as infections spread, but GDP growth should still remain around 5% in both 2022 and 2023. Available real-time indicators suggest that the economic impact of the sixth wave of COVID-19 infections in the second half of December and the first few days of January has been limited. Both Social Security affiliation and BBVA customer card purchase data show minimal changes in trends seen until now. Nevertheless, there has been a slowdown in expenditure by non-resident consumers in Spain. In any case, we cannot rule out a spike in infections putting pressure on the health care system and adversely affecting the economy's productive capacity. This possibility is prompting some regional authorities to impose restrictions and people to change their habits once again. In this risk scenario, the impact on activity would presumably be temporary and smaller than last year, **resulting in low, but positive, growth rates that will pick up each quarter**. Reasons supporting this view include the lengths to which Europe is going to speed up the immunization of the population by either forcing or encouraging vaccination. There have also been advances in the development of drugs to treat the disease, which will probably become available as early as this year. Lastly, available data appear to suggest that the risks of hospitalization and death are lower than in previous waves, especially for the vaccinated.

Lower health uncertainty should trigger activity in onsite consumption sectors. This would give tourism a boost. Indeed, by the end of next year, Spain should be able to recoup roughly 90% of pre-pandemic non-resident consumption. Meanwhile, the wealth accumulated by medium-high income families during the crisis should help to support Spanish household expenditure. The saving rate has ticked down, but still accounted for more than 10% of gross household income in the third quarter, up from an average of 8.5% since 1999. With the saving rate still showing room to drop further and considering the excess wealth accumulated since the onset of the pandemic that has hardly been used (around EUR 70 billion according to BBVA Research estimates), expenditure should be supported. Importantly, as of the second half of 2022, we do not expect inflation to be as high as during most of 2021. While certain prices are unlikely to reverse trend, increases in income (e.g. pensions and civil servant wages), coupled with higher private wage increases than in previous years and job creation, could counterbalance the loss of purchasing power in 2021 to some extent. The energy component was the main inflation driver, so costs are not distributed evenly. Households with lower income and/or older members are bearing the brunt of the loss of purchasing power.

Judging by signs from price growth and the performance of demand, investment in housing should gradually regain momentum. Part of the "forced saving" caused by the lockdown may now be helping to provide access to mortgage loans. What's more, while housing values are on the rise, this growth is coming after a sharp fall, especially in areas away from city centers. Evidence points to a shift in preference toward larger suburban and urban dwellings, underpinned by the new working arrangements put in place by companies to deal with the pandemic. At the same time, funding costs are still at all-time lows and although there is still a level of regulatory uncertainty real estate assets have become profitable again. The Government is also providing aid for refurbishment, using part of the NGEU funds. All this leaves the construction sector poised to be one of the largest contributors to growth over the next few years.

Disbursement of NGEU funds will speed up, reaching an average cruising speed of between EUR 15-20 billion within the following years. The central government has taken several steps to accelerate the pace so funds can especially reach the autonomous communities, but it is taking far longer than expected for these to trickle down to the real economy. There is not much information available in this respect, so it is difficult to know how much of the funds provided have has already been spent. However, looking at allocation of some plans (e.g. MOVES III) or trends in public investment or investment in other buildings, the impact in 2021 appears to have been much lower than the EUR 10-15 billion estimated by BBVA Research last year in its 2021 macroeconomic scenario or the more than EUR 25 billion forecast by the Government. In the baseline scenario, spending will accelerate once several bureaucratic hurdles are overcome, reaching EUR 10-15 billion euros this year. Most likely, a cruising speed of EUR 15-20 billion will be seen starting in 2023. Therefore, investment looks set to gradually take over from private consumption as Spain's main economic growth driver.

Funding costs should remain low, but rise in longer maturities, with prices set to increase, thus raising the appeal of credit. In view of persistently high inflation, central banks are no longer sending a message of caution and patience, but rather taking action. The Fed has said that it will speed up its tapering of monetary stimulus and suggests that interest rate rises will follow soon thereafter. It will probably hike rates by as many as four times both this year and in 2023. The ECB has also signaled the start of its withdrawal strategy: the pandemic emergency purchase program (PEPP) will end in March, while its traditional asset purchase program (APP) will continue - at least until October - with the pace decreasing throughout the year. Rate hikes in Europe should be longer in coming and we are unlikely to see any in 2022. This lag vis-à-vis the US is because the euro area's economy is not as robust, inflation is lower, the job market is not as buoyant, there are no wage pressures and fiscal stimulus is weaker than in the US. With the ECB's current inflation forecasts (headline inflation still below 2% in 2023 and 2024), as things stand now the central bank would not meet the strict conditions it imposed on itself for some time. Long-term interest rates could rise, pushed up by US rates and expectations of rising inflation, not to mention higher risk premiums affected by the end of the PEPP.

Economic recovery in developed economies should continue to drive goods exports growth. Fuel prices will presumably level off, while electricity prices should come down, but are still likely to remain high. Therefore, part of the competitiveness lost since last year will be permanent. Companies have either absorbed these cost increases through markups or been able to keep their prices because of the availability of financing nowadays. Sooner or later, however, they will need to find ways to raise productivity, cut costs or pass on increases in the value of intermediate goods to consumers. Passing on rising costs to consumers will be easier in a growing economy, as forecast for developing countries, or with depreciation by the euro against the dollar. GDP in the EMU is expected to grow above its long-term trend (3.7% in 2022 and 2.7% in 2023). The different stage in the economic cycle between the two sides of the Atlantic suggests that the euro's relative weakness vis-à-vis the dollar lately will continue throughout the forecast horizon ($1.14/€ and $1.16/€ in 2022 and 2023, respectively). Meanwhile, supply bottlenecks will gradually unwind and container availability increase, helping make up for some of last year's losses in competitiveness.

An unusually large part of domestic demand growth is not being covered by domestic production. To some extent, this is because of the redistribution of expenditure from services (produced domestically) to goods. Health- or IT-related goods, which are needed to fight the pandemic or work remotely, have a large import component. Growth in offline and tourism expenditure should temper the response of foreign purchases to rising domestic demand. That being said, as investments are made (NGEU), especially to promote digitalization and environmental sustainability, Spanish companies may become considerably more reliant on imports if they fail to seize the opportunity offered by the NGEU to transform and/or grow. Against this backdrop and assuming we will not see any major structural changes to develop major industries in these sectors, **foreign demand could have a drag on growth in the coming years**.

The smaller public deficit, the faster approval of reforms and the European Commission's positive assessment of the progress made by Spain in executing its Recovery, Transformation and Resilience Plan (PRTR) all bode extremely well for the future. Tax revenue held up better than economic activity in 2020 and is now outstripping nominal GDP. Moreover, momentum is nearly across the board for all taxes. As a result, Spain's tax revenue to GDP ratio has risen from around 38% before the crisis to approximately 42% at present. Since no major tax reforms have been pushed through, much of this improvement is cyclical and could well be due to increased tax compliance. At least it should help bring down the budget deficit to below 7% of GDP in 2022 from the 8.4% forecast by the Government at the beginning of the year. The Government is currently holding two Council of Ministers meetings a week. This shows a sense of urgency and a willingness by the Government to press ahead with its reform agenda and remove obstacles to expenditure. Meanwhile, the European Commission gave the green light to the first disbursement of 10 billion euros after confirming that the 52 objectives undertaken by the Spanish government in its recovery plan (PRTR) had been met. It has also approved the first strategic projects for economic recovery and transformation (the so-called PERTEs) in the automotive, health and renewable energy sectors. Other noteworthy measures include passage of the Draft Startup Law and amendments to ease requirements for recapitalizing companies.

The main risk scenarios are linked to high health uncertainty. Nevertheless, inflation and central bank action are beginning to play a bigger role in the balance of risks. The appearance of the Omicron variant illustrates the danger of having such a high percentage of people in the world who are unvaccinated. Developed countries must take over and help lower-income countries raise their level of immunization. Rising infections have yet to overload the health system, but could well do so over the coming months given how fast the virus is spreading now. There **is still a chance that activity could outperform expectations going forward if the economic impact of infections decreases** and the drugs used to control the pandemic maintain their level of efficacy. Meanwhile, fuel and energy prices continue to rise, making it increasingly likely that inflation will remain high over the next few months. The resolution of bottlenecks in industry and the shift of expenditure back toward services should eliminate some factors driving price growth, but there are still other risks. For instance, the loss of purchasing power will likely prompt workers to demand wage increases, just when uneven job recovery and output suggest a fall in labor productivity since the onset of the crisis. The majority of companies have managed to continue hiring without passing through the relate cost increase to their prices by relying on a mix of state aid, credit and margin sacrifice. However, higher wages on top of other cost increases could start to push up inflation. Also, the fiscal stimulus provided by programs like the NGEU in Europe or the US infrastructure program will surely boost demand for goods required to drive digitalization and environmental sustainability, but this too can create price pressures. Central banks have already said that they are keeping an eye on these scenarios. Nonetheless, their tapering strategies are causing higher volatility in emerging financial markets. Moreover, given the sharp increases in public debt, not to mention the growth of government-backed private sector credit during the pandemic, we are likely to see pressure to limit the increase in funding costs. In this climate, Spain must take positive steps to speed up the disbursement of NGEU funds and make the necessary reforms to comply with the European Commission's recommendations.

Consensus between unions and employers organizations over the reform of the Spanish labor market is good news, as it simplifies hiring and institutionalizes employee Temporary Collective Redundancy Scheme (ERTE). One of BBVA Research's recommends is to reduce the number of employment contracts. This could have a meaningful impact on temporary employment if a portion of fixed-term contracts are switched to fixed-discontinuous contracts, although how much of a deterrent the new penalty will have on short-term contracts is questionable.[2] Meanwhile, given how hard it is for young people to access the job market and evidence that dual training (vocational and university) enhances their employment prospects, the commitment to reforming training or apprenticeship contracts bodes well. In collective bargaining, developments include restricting the priority application of company collective bargaining agreements, which could hinder adjustments to negative shocks. Nevertheless, this barely affects 8% of workers covered by a collective bargaining agreement. More worrisome is the reinstitution of the indefinite ultractivity, which poses a threat in future economic crises if unions prioritize wage conditions over employment. Finally, taking the lessons learned during the health crisis, streamlining the process and time involved to implement employee furloughs due to economic, technical, organizational or productive reasons or force majeure will help promote internal flexibility mechanisms, thereby mitigating the reaction by employment to a worsening of the economic cycle. The creation by the Government in Spain of the so-called RED Employment Flexibility and Stabilization Mechanism in Spain marks a step in the right direction to lessen the job destruction caused by medium-term cyclical shocks, sector-specific structural shocks arising from technological progress, or shifts in consumer preferences. While it has yet to be implemented, the procedure appears complicated and could well be used arbitrarily.

Changes to Spain's pension system result in upward revisions to the projected deficit and will probably reduce intergenerational equity and make job creation more costly. In addition to inflation-based increases, the Sustainability Factor (SF) is replaced by the Intergenerational Equity Factor (IEF) mechanism. The Government has announced an 0.6 percentage point increase in social security contributions over the next decade (equivalent to 0.2 percentage points of GDP), but this might not be enough to offset the increased expenditure looming because of the elimination of the Sustainability Factor it replaces. This is mostly because the IEF means additional adjustments will be delayed until 2033, not to mention the potential impact of longer life expectancy. This would pose a threat to debt sustainability. Meanwhile, the Government has transferred part of the Social Security deficit onto the state. It has not decided how it would cover this deficit, but simply said that it is changing administration. Finally, the changes heighten the risk that the generation gap will widen. First, because using taxes on employment to fund current pensions will reduce job demand. And second, it means that decisions will have to be made suddenly in the future and the impact will be felt by younger generations, with less political clout.

2: Contracts maturing within five days were already subject to a 40% surcharge on the employer's contribution for common contingencies.

Tables

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

	2019	2020	2021	2022	2023
United States	2.3	3.7	5.6	4.2	3.1
Eurozone	1.6	-6.5	5.1	3.7	2.7
China	6.0	2.3	8.1	5.2	5.2
World	2.9	-3.2	6.1	4.4	3.7

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: January 14, 2022.
Source: BBVA Research & FMI.

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

	2019	2020	2021	2022	2023
United States	1.8	1.2	4.7	4.8	2.9
Eurozone	1.2	0.3	2.6	3.0	1.5
China	2.9	2.5	0.9	2.6	3.0
World	3.6	3.6	4.3	4.8	3.9

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: January 14, 2022.
Source: BBVA Research & FMI.

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

	2019	2020	2021	2022	2023
United States	2.14	0.90	1.44	2.27	2.81
Germany	-0.21	-0.48	-0.31	0.15	0.59

Forecast closing date: January 14, 2022.
Source: BBVA Research & FMI.

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

	2019	2020	2021	2022	2023
EUR-USD	0.89	0.88	0.84	0.88	0.87
USD-EUR	1.12	1.14	1.18	1.13	1.15
CNY-USD	6.91	6.91	6.45	6.48	6.60

Forecast closing date: January 14, 2022.
Source: BBVA Research & FMI.

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

	2019	2020	2021	2022	2023
United States	1.75	0.25	0.25	1.25	2.25
Eurozone	0.00	0.00	0.00	0.00	0.00
China	4.35	4.35	4.35	3.65	3.65

Forecast closing date: January 14, 2022.
Source: BBVA Research & FMI.

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

	2019	2020	2021	2022	2023
GDP at constant prices	**1.6**	**-6.5**	**5.1**	**3.7**	**2.7**
Private consumption	1.4	-8.0	3.4	5.6	2.9
Public consumption	1.8	1.3	3.8	1.1	0.9
Gross fixed capital formation	6.7	-7.3	3.7	4.3	4.8
Inventories (*)	-0.1	-0.5	0.3	-0.1	0.0
Domestic demand (*)	**2.4**	**-6.1**	**3.8**	**4.0**	**2.8**
Exports (goods and services)	2.7	-9.4	9.6	4.8	3.9
Imports (goods and services)	4.8	-9.3	7.3	5.9	4.2
External demand (*)	**-0.8**	**-0.4**	**1.4**	**-0.3**	**0.0**
Prices and Costs					
CPI	1.2	0.3	2.6	3.0	1.5
CPI Core	1.2	0.9	1.5	1.8	1.7
Labour Market					
Employment	1.3	-1.5	1.1	1.3	1.0
Unemployment rate (% of labour force)	7.6	7.9	7.7	7.4	7.2
Public sector					
Surplus (+) / Deficit (-) (% GDP)*	-0.6	-7.2	-7.0	-4.3	-2.6
Public debt (% GDP)*	83.6	97.3	98.8	96.9	95.6
External Sector					
Current Account Balance (% GDP)	2.4	1.9	2.5	2.2	2.4

Annual rate change in %, unless expressly indicated.
Forecast closing date: January 14, 2022.
(*) 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, %)	2019	2020	2021	2022	2023
Activity					
Real GDP	**2.1**	**-10.8**	**5.1**	**5.5**	**4.9**
Private Consumption	0.9	-12.2	5.7	6.3	4.1
Public Consumption	2.0	3.3	3.2	2.1	1.7
Gross Fixed Capital Formation	4.5	-9.5	3.0	11.6	19.5
Equipment and machinery	3.2	-12.9	13.1	6.5	20.6
Construction	7.1	-9.6	-3.1	15.5	18.0
Housing	6.6	-11.2	-5.0	13.8	13.3
Domestic Demand (contribution to growth)	**1.6**	**-8.6**	**4.8**	**6.3**	**6.7**
Exports	2.5	-20.1	12.7	15.1	7.8
Imports	1.2	-15.2	12.5	18.3	13.5
External Demand (contribution to growth)	**0.5**	**-2.2**	**0.3**	**-0.8**	**-1.9**
GDP at current prices	3.4	-9.8	6.7	8.0	6.9
(Billions of Euros)	1244.4	1121.9	1197.6	1293.8	1382.9
Labour market					
Employment, Labour Force Survey	2.3	-2.9	3.0	4.0	3.9
Unemployment rate (% Labour force)	14.1	15.5	15.0	13.6	11.4
Employment, full time equivalent	2.6	-7.6	6.7	4.7	3.6
Productivity	-0.5	-3.3	-1.7	0.8	1.2
Prices and Costs					
CPI (average)	0.7	-0.3	3.1	3.2	2.0
CPI (end of period)	0.8	-0.5	5.8	1.0	2.0
GDP deflator	1.3	1.0	1.7	2.5	2.0
Compensation per employee	2.6	1.3	-0.5	2.6	1.1
Unit Labour Cost (ULC)	3.1	4.6	1.2	1.8	-0.2
External sector (*)					
Current Account Balance (% GDP)	2.0	0.6	1.0	-0.2	-1.4
Public sector					
Debt (% GDP)	95.5	120.0	119.2	115.2	110.7
Deficit (% GDP) (*)	-2.9	-10.1	-6.8	-4.8	-3.0
Households					
Nominal disposable income	5.0	-4.9	2.4	4.8	4.4
Savings rate (% nominal disposable income)	8.6	15.4	12.0	8.3	6.5

Annual rate change in %, unless expressly indicated.
Forecast closing date: January 14, 2022.
(*) Excluding financial aid for Spanish banks.
Source: BBVA Research.

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