BBVA Research

Spain Economic Outlook

3Q22

Creating Opportunities

Mensajes principales

Inflationary pressures

Inflation remains at unusually high levels. The pressures on prices have recently been reinforced by the impact of the war in Ukraine on commodity prices and the maintenance of supply bottlenecks, in a context of relative strength in demand (despite the recent slowdown). The risk of significant second-round effects and de-anchoring of expectations is moderate, given central bank reaction, but it is increasing.

Central bank reaction

Central banks have accelerated the process of raising interest rates. Their recent tone suggests that they will not hesitate to do what is necessary to control inflation in the medium and long term. The Fed will soon raise rates to restrictive levels, while in the Eurozone, in a context of less robust demand and risk of financial fragmentation, rates will converge to neutral rates.

Economic prospects

The global economy will slow down significantly, with negative growth for more than a quarter in the US and the Eurozone, that will contribute to slow down inflation, which, however, will remain well above central bank targets in the short term. In the Eurozone, GDP contractions are expected in the coming quarters, fundamentally due to the disruptions created by the war, including energy shortages. The sharp monetary tightening makes a (mild) recession in the US likely. The environment is very uncertain due to the co-occurrence of multiple shocks.

Risks

A more persistent inflation could trigger even more severe increases in interest rates, and thus a deeper and more widespread recession. Other risks are a financial fragmentation within the Eurozone, crises in the debt and emerging markets, the persistence of the pandemic (mainly in China), stagflation, social protests, etc.

Key messages. Spain

GDP

The outlook for 2022 remains unchanged (4.1%), but growth for 2023 is revised downward, from 3.3% to 1.8%. Household consumption has been negatively affected by price increases and some supply factors.

Further economic deterioration is expected

Factors that will account for the slower growth include the increasingly likely shortage of some commodities, the increase in their price and the observed impact of this increase in production costs on inflation. In addition, the financial burden on companies and households is expected to spike as the ECB withdraws monetary stimuli.

Signs of resilience

Growth is expected to remain positive and, going forward, there are grounds to support continued recovery. The wealth accumulated by the families has not yet been used. Exports continue to increase and strong growth of investment in equipment could sustain them. Investment in construction will accelerate in the coming months thanks to NGEU funds.

Risks

The short-term bias is downward. A gas restriction scenario is possible in Europe. In addition, the inflation trend is high, despite the measures taken, and could become entrenched, making it difficult to reduce inflation rapidly. The implementation of NGEU-related funds needs to be accelerated. In the medium term, the bias will depend on the reforms that will be implemented over the coming months.

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01

Global Economic Outlook 2Q22

Creating Opportunities

In a complex and uncertain environment, central banks have been forced to accelerate rate hikes in order to tackle inflation

RECENT DEVELOPMENTS IN THE WORLD ECONOMY

COMMODITIES
Energy and food prices under heavy pressure due to war in Ukraine

SUPPLY DISRUPTIONS
Persistent bottlenecks due to war and covid mobility restrictions in China

DEMAND RESILIENCE
Robust employment and accumulated savings; weakness caused by covid in China

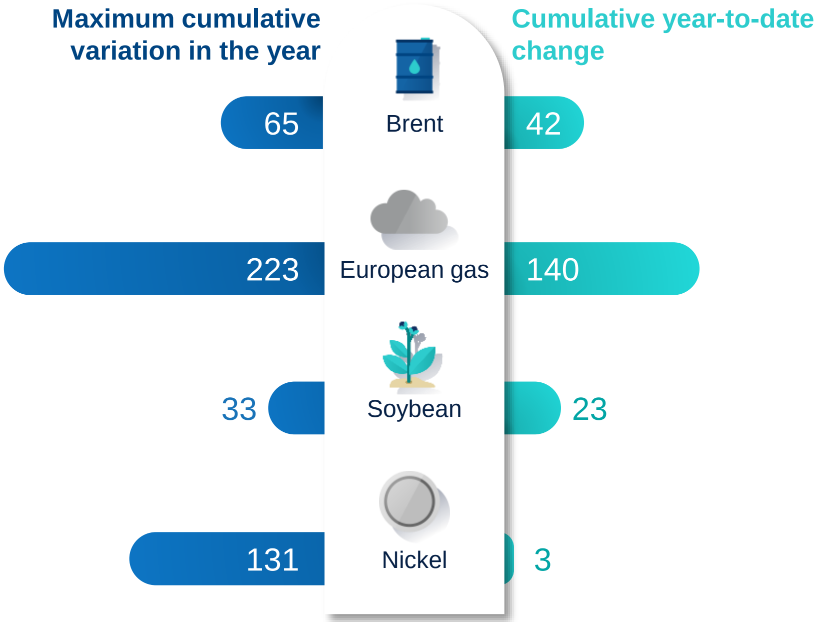
HIGH, PERSISTENT AND GENERALIZED INFLATION
Prices also pressured by incipient second-round effects and structural factors (such as de-globalization), with a risk of de-anchoring expectations.

MORE AGGRESSIVE CENTRAL BANKS AND FINANCIAL VOLATILITY
Stronger and earlier monetary tightening, particularly in the U.S., to reduce demand, which has kept financial volatility high.

Commodity prices have risen more than expected after the war, despite recent global slowdown concerns

COMMODITY PRICES

(ACCUMULATED PERCENTAGE VARIATION IN THE YEAR UP TO JULY 11, 2022)

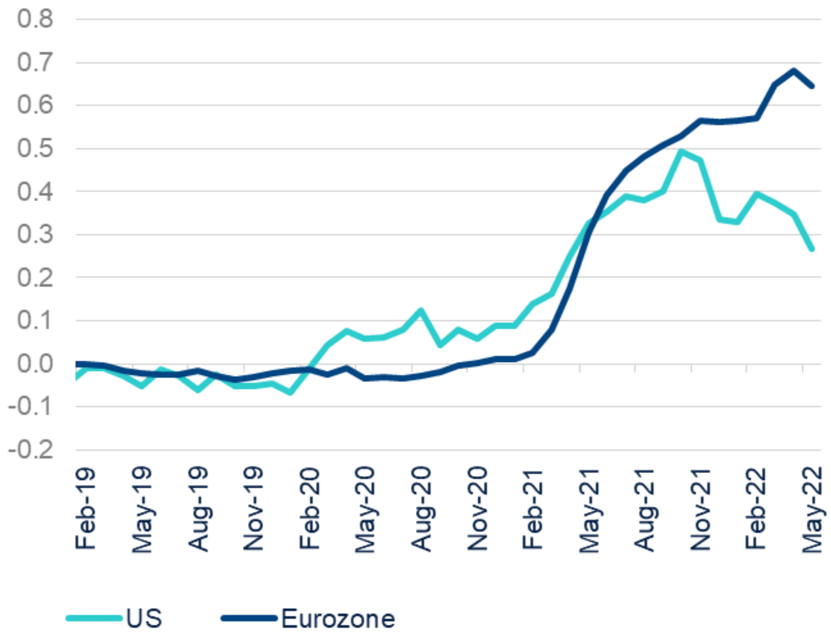


Source: BBVA Research based on data from Haver.

- War and sanctions have pressured commodity prices:
  - oil: affected by sanctions against Russia
  - gas: pressured by fears of supply restrictions by Russia
  - food: impacted by fertilizer prices and disruptions in Ukraine
  - metals: less direct exposure to the war, but pressured by energy transition
- The risk of a sharp global slowdown has recently triggered falls in commodity prices (but not in the gas price in Europe).

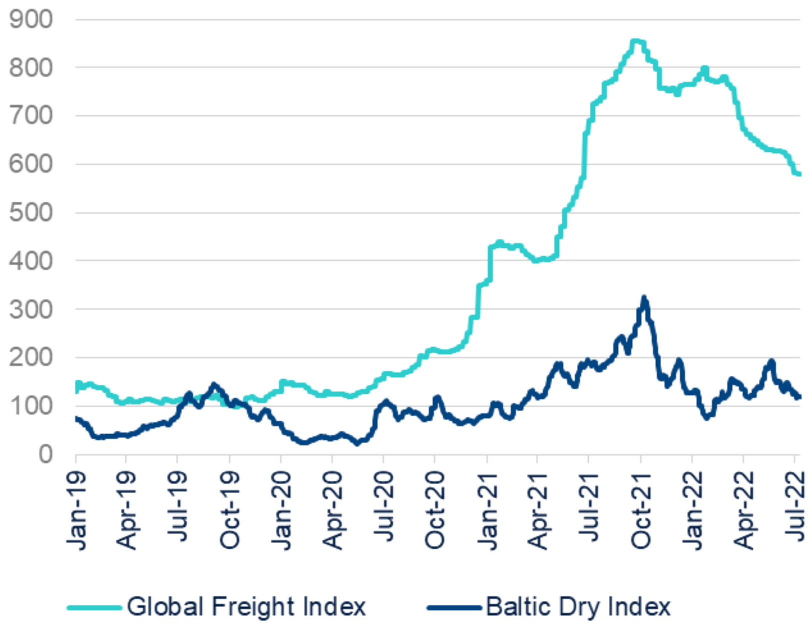
Bottlenecks remain at very high levels, but there are signs of improvement, mainly in the US

BBVA RESEARCH BOTTLENECK INDEX
(INDEX: AVERAGE SINCE 2003 = 0)



Source: BBVA Research.

CONTAINER FREIGHT RATES: GLOBAL AND BALTIC
(INDEX: 2012 = 100)

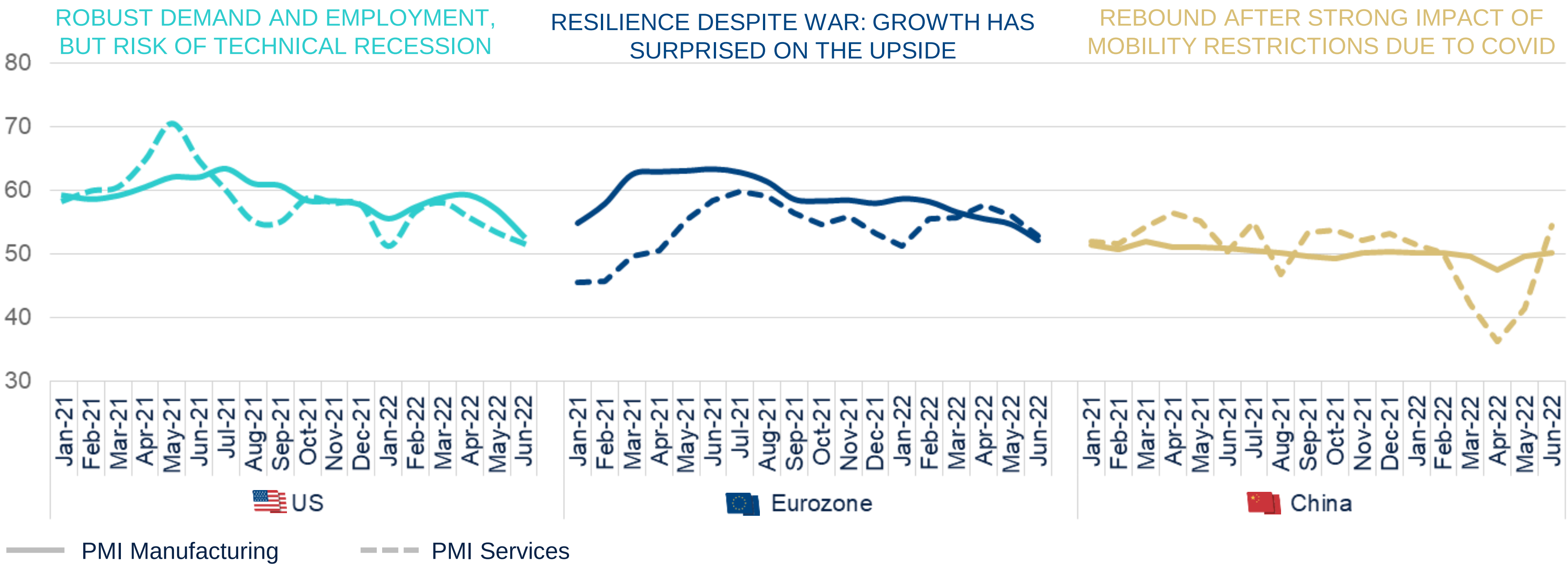


Source: BBVA Research based on data from Haver.

Growth is easing, but demand remains resilient given the high level of accumulated savings and the dynamism of both consumption and services

PMI INDICATORS

(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)

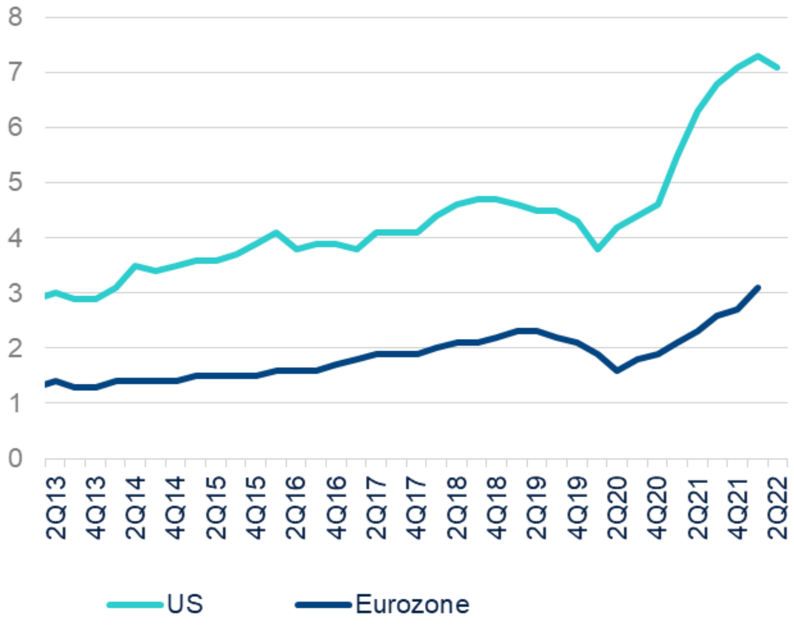


Source: BBVA Research based on data from Haver.

Dynamic labor markets support private consumption, but reinforce concerns about inflationary dynamics

LABOR MARKET: VACANCY RATE

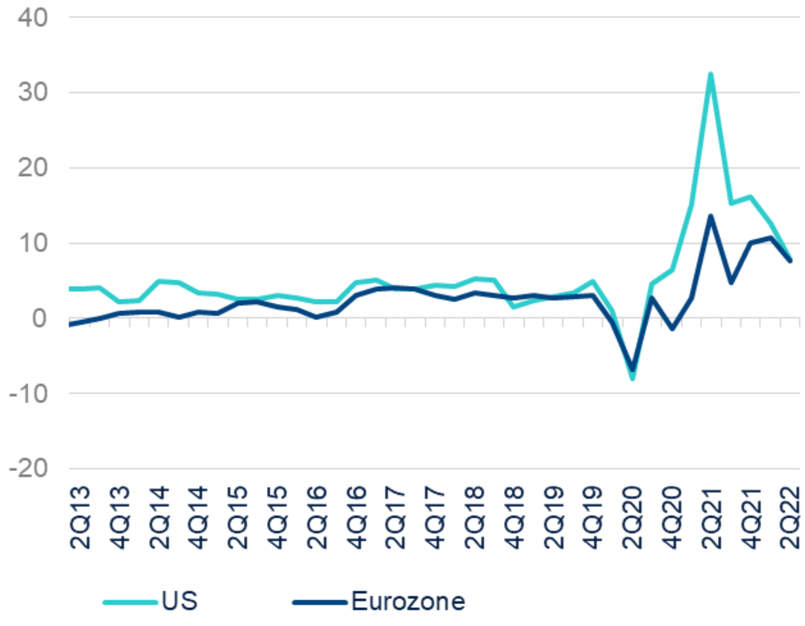
(%, QUARTERLY AVERAGES)



* Vacancies as a proportion of the sum of total employment and the number of vacancies.
Source: BBVA Research based on data from Haver.

PRIVATE CONSUMPTION: RETAIL SALES

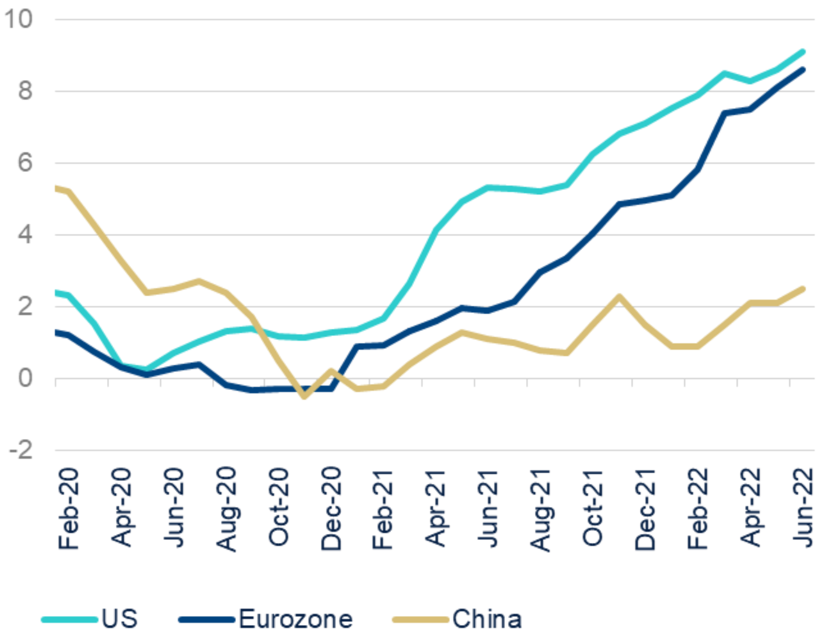
(% Y/Y, QUARTERLY AVERAGES)



Source: BBVA Research based on data from Haver.

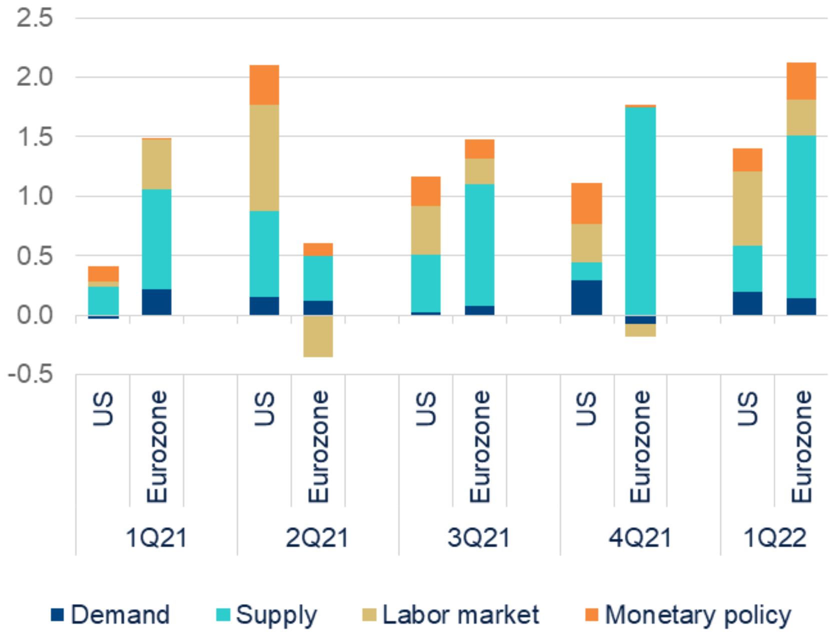
High, persistent and widespread inflationary pressures, largely due to supply-side and labor market-related factors

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on local statistics.

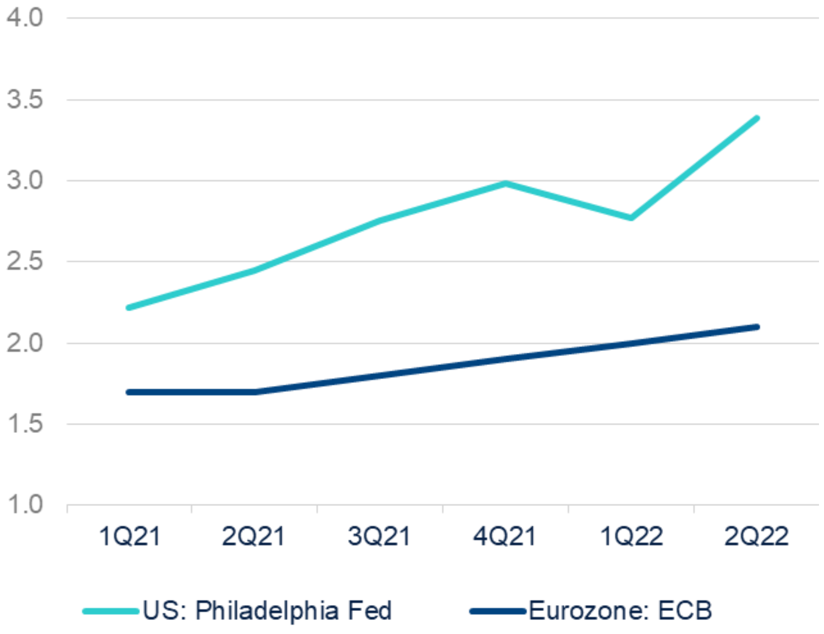
SHOCKS TO CORE INFLATION
(PP)



Source: BBVA Research estimates using a SVAR model.

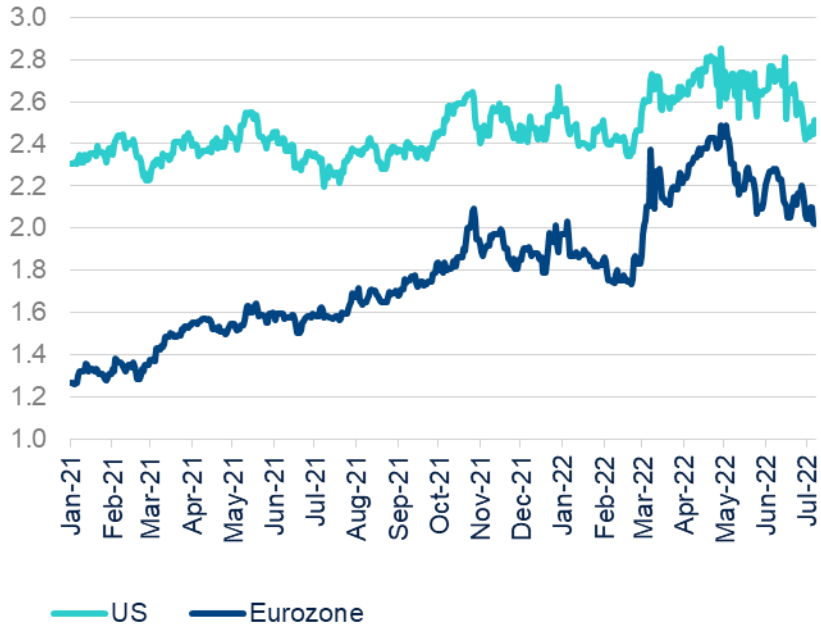
Inflation expectations have risen significantly

5-YEAR INFLATION EXPECTATIONS: ANALYSTS SURVEYS (%)



Source: BBVA Research based on data from the Fed and the ECB.

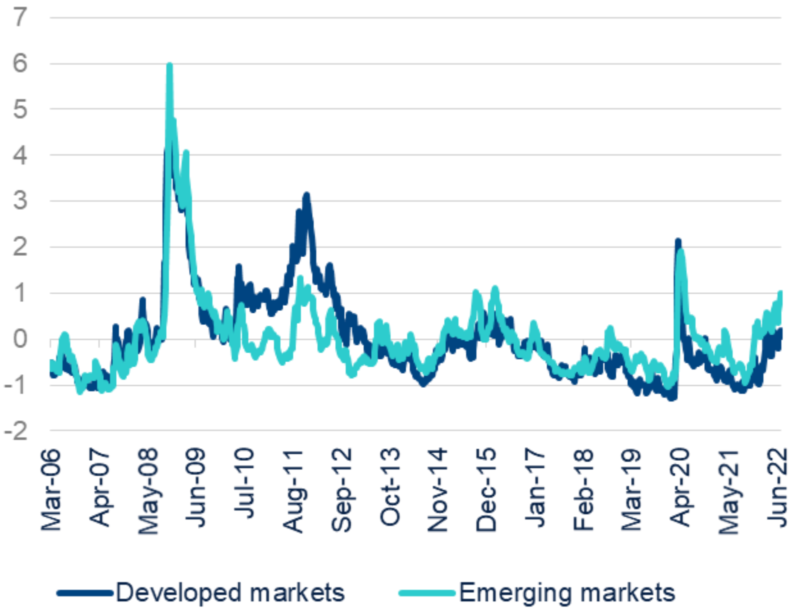
LONG-TERM INFLATION EXPECTATIONS: MARKETS* (%)



* Based on 5Y5Y forward swaps
Source: BBVA Research based on Haver data.

Central banks hawkish tone in response to rising inflation, in a context of activity slowdown, has increased financial volatility

BBVA RESEARCH FINANCIALTENSIONS INDEX
(INDEX: AVERAGE SINCE 2005 = 0)



Source: BBVA Research.

- The Fed has raised rates to 1.75% (+150bp since March) and has indicated further significant adjustments in the coming months.
- The ECB has indicated that its rate hike cycle will begin this month and that it will address the risk of fragmentation with flexible PEPP reinvestment and a new instrument.
- Sovereign bond yields have risen sharply since March, although they have recently moderated due to cyclical risk.
- Stock markets have fallen, risk premia have moved higher and the dollar has appreciated.

The interest rate hikes needed to anchor inflation expectations will have a negative impact on activity and cause recessionary episodes

BBVA RESEARCH CENTRAL SCENARIO

MONETARY TIGHTENING
Impact through demand (consumption/investment), financial burdens/wealth, credit...

GROWTH SLOWDOWN
Mild recessions in the Eurozone, due to gas shortages, and in the U.S., due to interest rate hikes

COMMODITIES
Price pressure will be compounded by gas shortages in the Eurozone (at least in the coming winter).

INFLATION MODERATES SLOWLY
It remains well above inflation target in 2022-23

SUPPLY DISRUPTIONS
In the absence of new negative shocks, supply bottlenecks reduce gradually

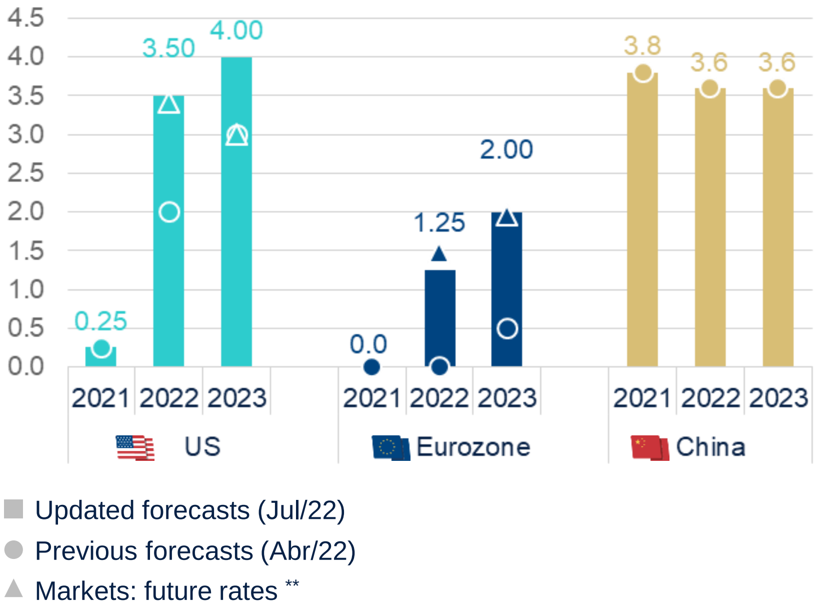
FINANCIAL VOLATILITY
Stronger dollar, higher risk premia, capital outflows from EM

RISKS: BIAS TOWARDS LOWER GROWTH WITH THE POSSIBILITY OF A CRISIS
A more persistent inflation could trigger more negative macroeconomic scenarios

Interest rates will rise more and sooner than expected; they are expected to reach restrictive levels in the US and be close to neutral in the Eurozone

MONETARY POLICY INTEREST RATES*

(%, END OF PERIOD)

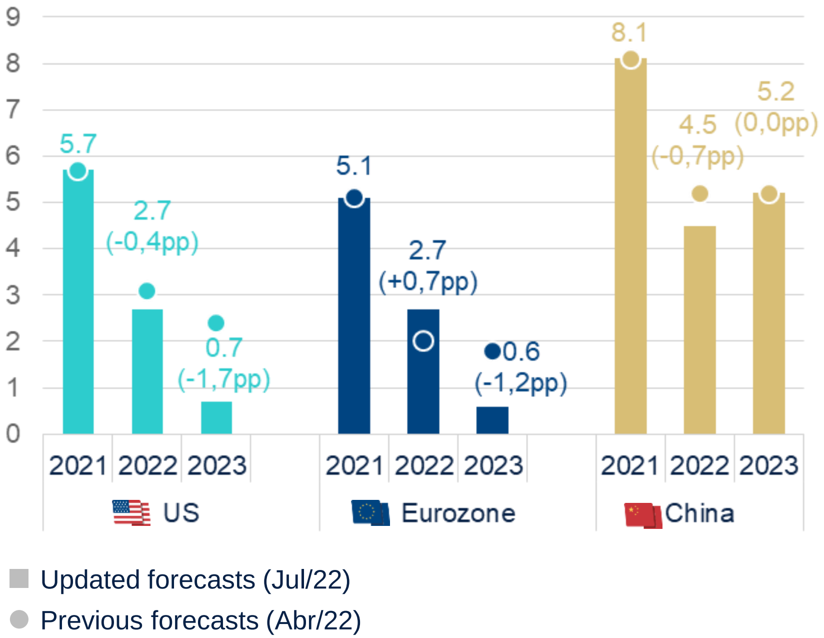


* In the case of the Eurozone, interest rates on refinancing operations.
** Data as of July 11.
Source: BBVA Research based on Bloomberg data.

- The Fed is expected to raise rates to 4.0%, above equilibrium levels (between 2% and 3%), while continuing to sell assets to reduce its balance sheet.
- The ECB is already starting its rate hike cycle, which will be less aggressive than the Fed's due to lower demand pressures and the risk of financial fragmentation.
- Unlike the US, fiscal policy in the Eurozone will focus on growth, through NGEU funds and the suspension of fiscal rules until 2023.
- In China, policies will continue to exhibit a moderately expansionary tone.

Global slowdown: after growing 6.2% in 2021, world GDP will grow 3.4% in 2022 and 2.5% in 2023 (respectively, 0.6pp and 1.1pp less than expected)

GDP: ANNUAL GROWTH IN REAL TERMS
(%)

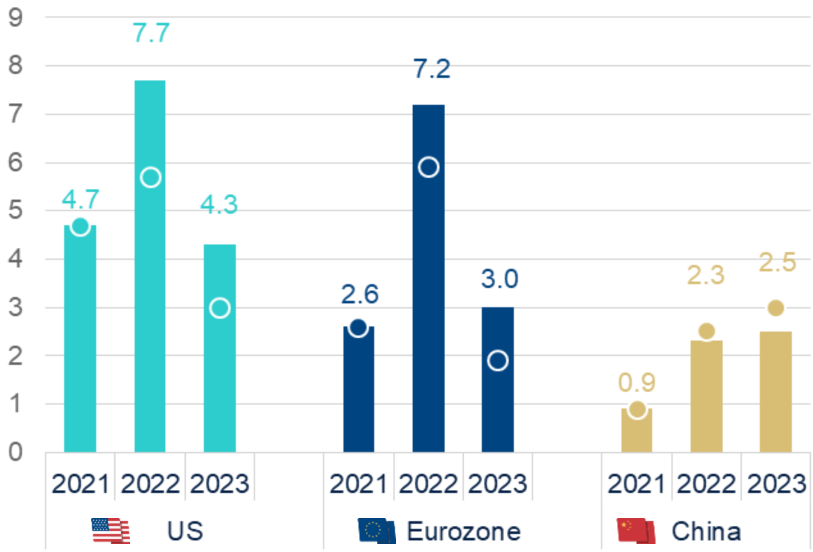


* Forecast change in parentheses.
Source: BBVA Research.

- Rising rates will likely push the US into a recession in 2023, which is expected to be mild given robust employment and sound household and financial system balance sheets.
- In the Eurozone, the impact of the war will be stronger in the coming quarters due to the expected gas restrictions, pushing GDP growth to slightly negative rates.
- In China, growth will recover from the impact of recent lockdowns, but the “zero-covid” policy remains as a potential problem.

Inflation to remain well above central bank targets, mainly in the short term

INFLATION:CPI
(Y/Y %, PERIOD AVERAGE)



Updated forecasts(Jul/22)
Previous forecasts (Apr/22)

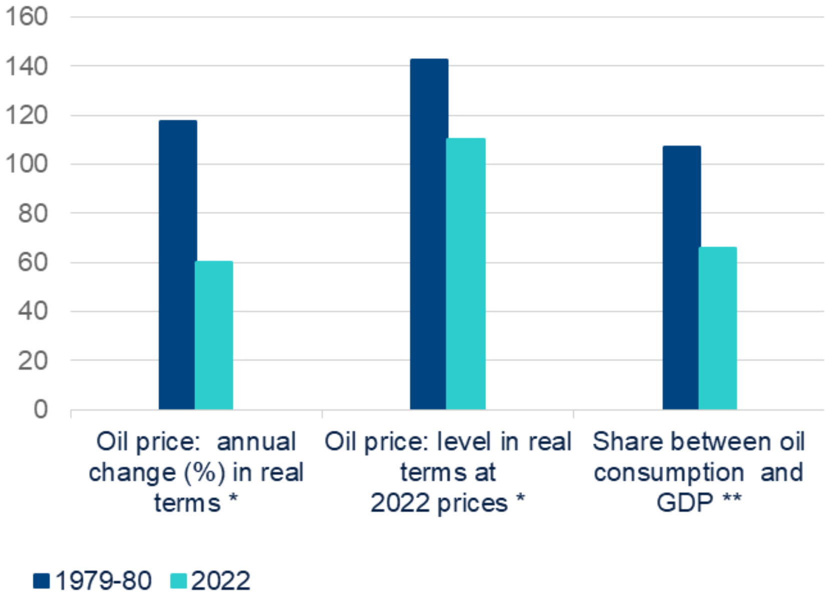
Source: BBVA Research.

- Upward revision of inflation forecasts, mainly due to higher commodity prices.
- Inflation will eventually decline as current shocks lose strength and central banks continue to act.
- Slowing demand will reduce the scope for significant wage increases, making a wage-price spiral unlikely.

The likelihood of a prolonged period of higher inflation has increased, but a return to the inflationary spiral of the 1970s remains far away

OIL: PRICE AND INTENSITY OF USE

(PRICE VARIATION AND INTENSITY: %; PRICE LEVEL: USD/BARREL)



* Maximum observed in each period.
** For the world economy.
Source: BBVA Research based on data from the Fed and Haver.

- A less vulnerable economic structure:
  - less oil-intensive production
  - more open economies and lower levels of unionization make a wage-price spiral less likely
- A more credible monetary policy:
  - independent
  - with explicit inflation targets
  - with exclusive prerogative to fight inflation
  - with effective action and monitoring tools

Risks: further inflationary persistence could trigger more aggressive interest rate hikes and a sharp macroeconomic deterioration

MAIN SHORT-TERM RISKS TO THE WORLD ECONOMY

- Persistent inflation
- More severe recession
- Financial fragmentation in the EZ
- Tension in debt and emerging markets
- Stagflation
- Deterioration of the war in Ukraine or other geopolitical conflicts
- Hard-landing in China
- Covid
- Social tensions and populism

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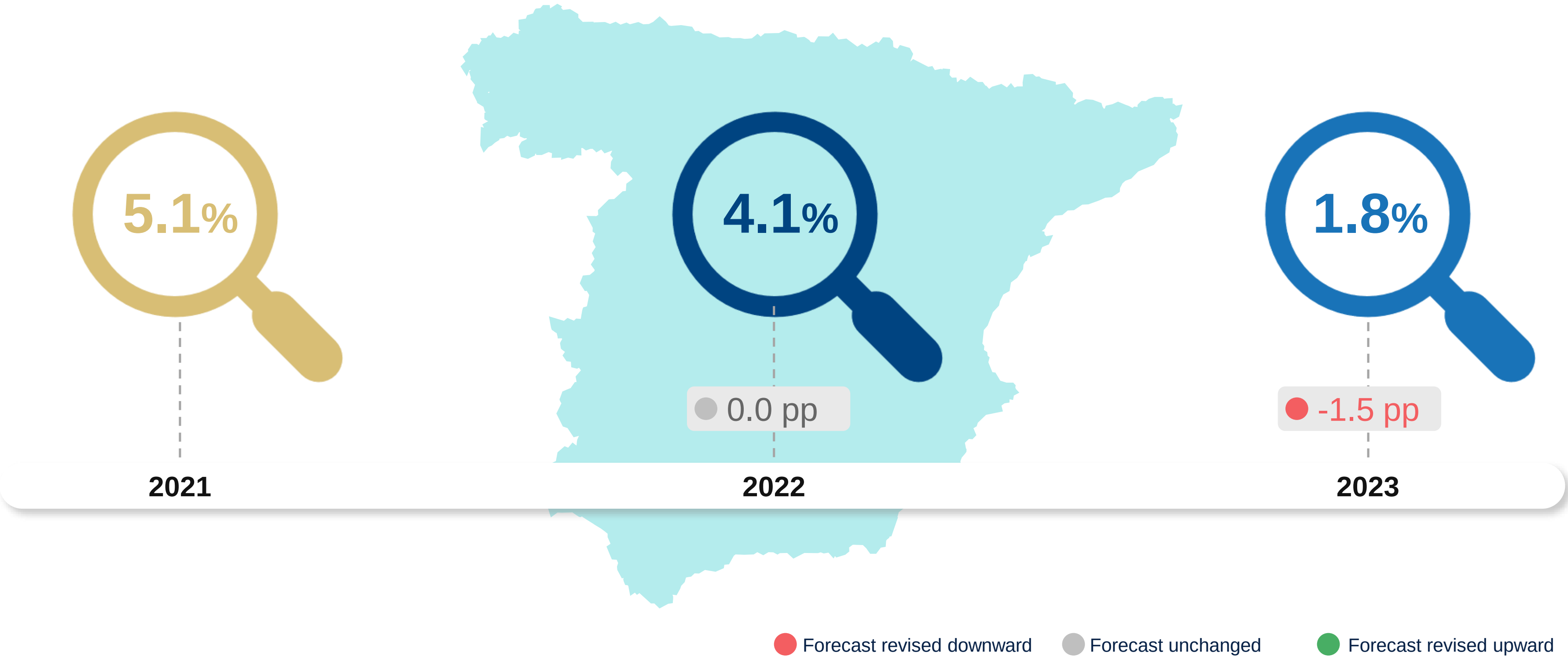
02

Spain Economic Outlook 3T22

Creating Opportunities

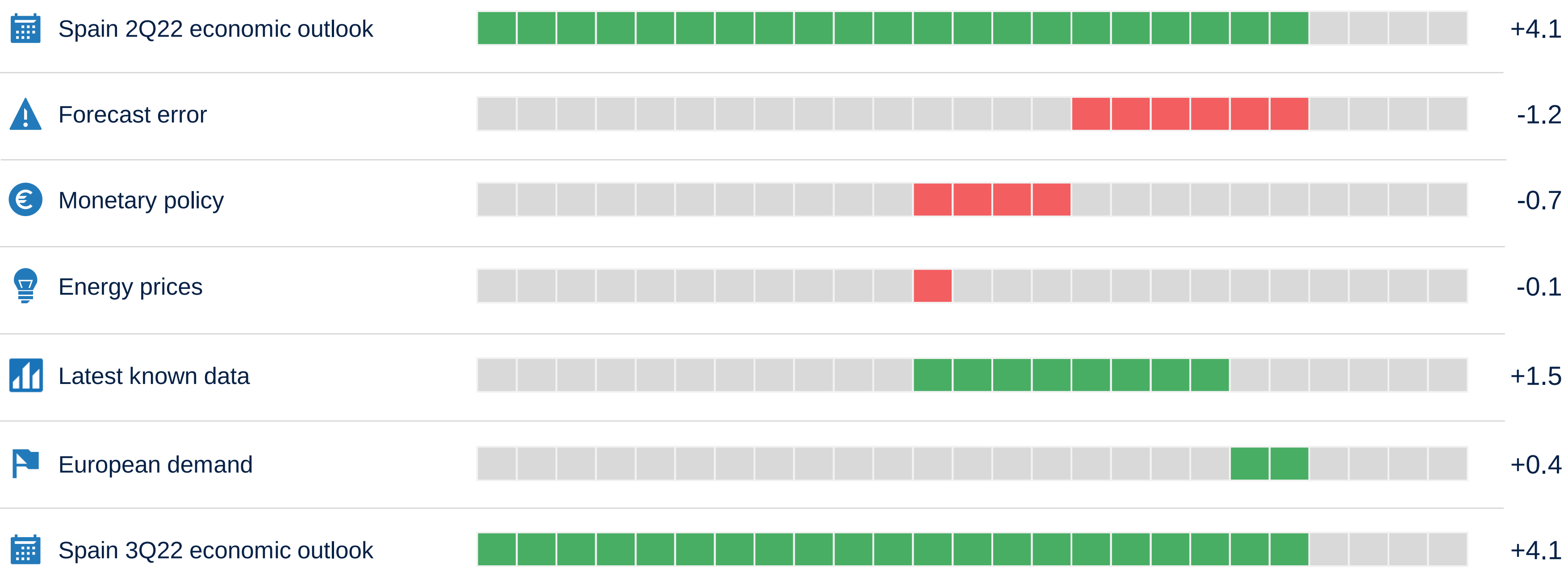
The growth forecast remains unchanged for 2022 and is revised downward for 2023



Source: BBVA Research based on INE.

Growth forecast for 2022 remains unchanged

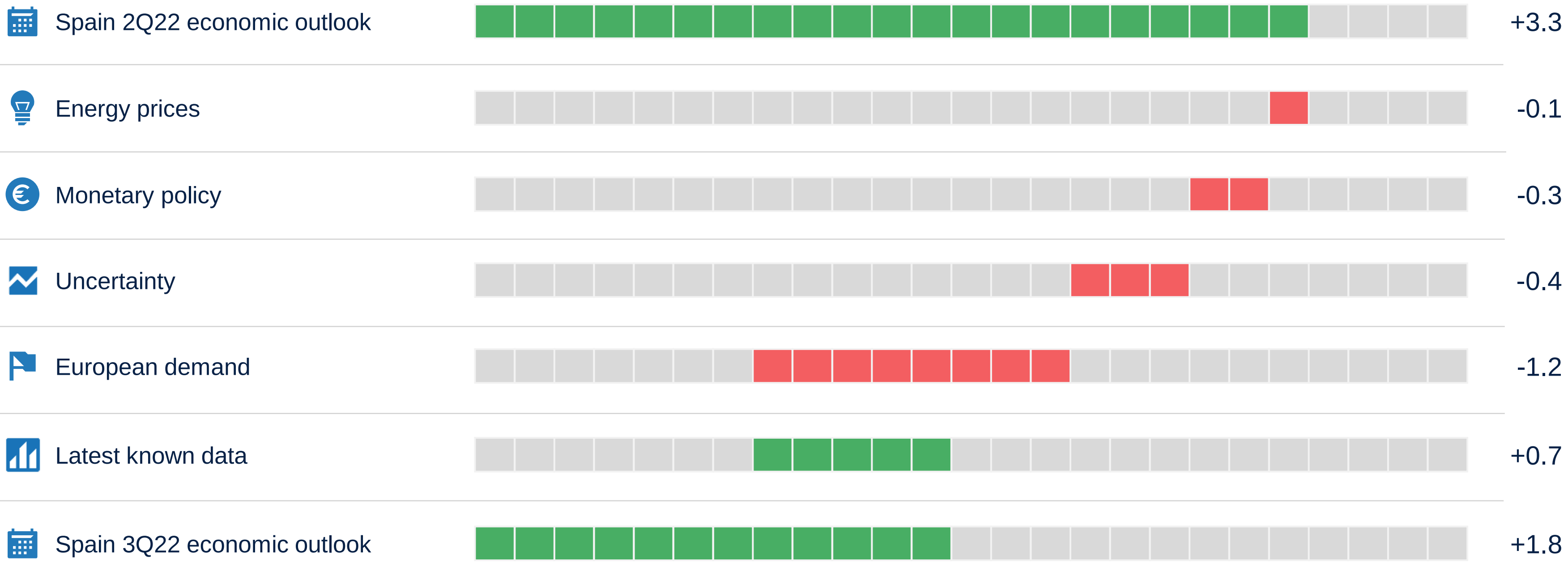
BREAKDOWN OF REVISED 2022 GDP GROWTH FORECAST
(PERCENTAGE POINTS)



Source: BBVA Research.

The growth forecast remains unchanged for 2022 and is revised downward for 2023

BREAKDOWN OF REVISED 2023 GDP GROWTH FORECAST
(PERCENTAGE POINTS)

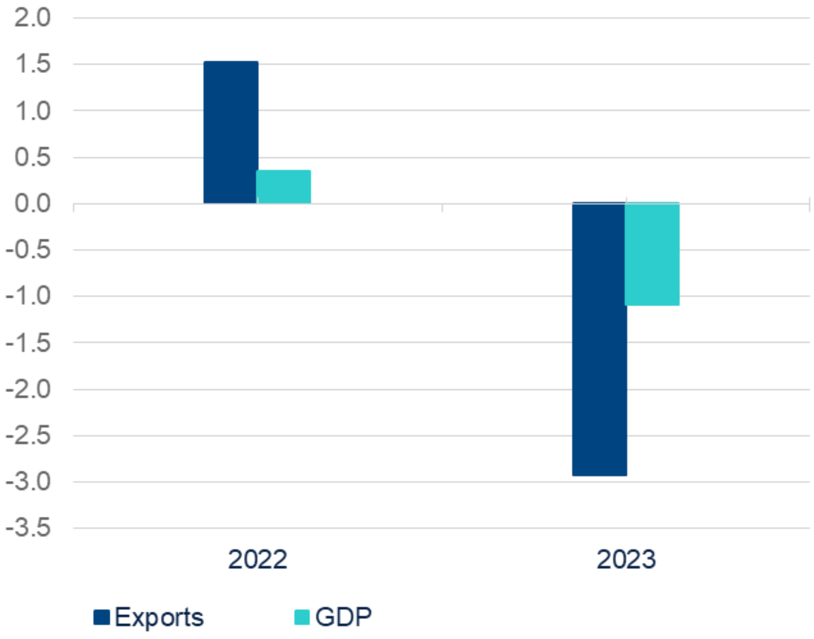


Source: BBVA Research.

2023 growth is revised downward

Negative impact of deteriorating growth forecast in EMU

IMPACT OF THE EMU REVISION ON SPANISH GDP AND EXPORTS (PERCENTAGE POINTS)



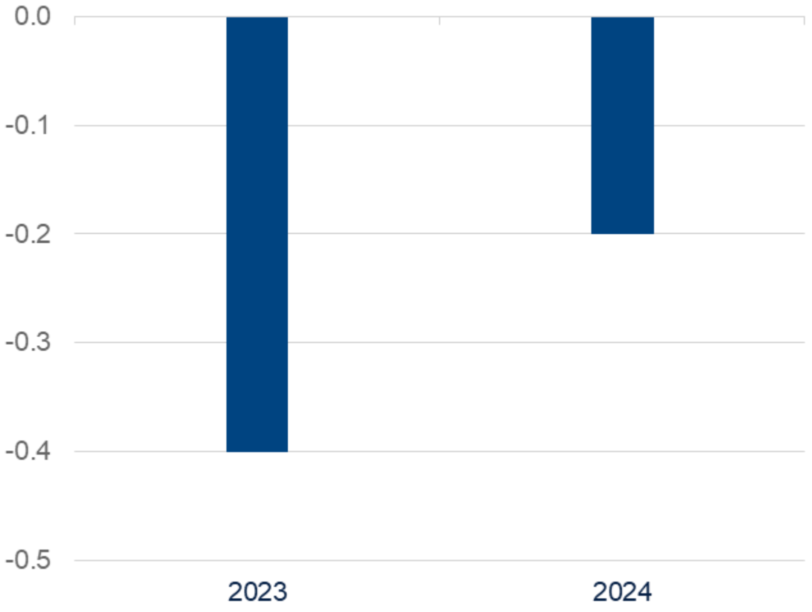
Source: BBVA Research.

- Lower growth in is expected in Europe. This would affect industry, above all, although it could also have consequences for tourism, currently the main engine of growth.
- Input disruptions could have a major impact. The scenario in which Russia interrupts the flow of gas to Europe could be particularly negative for German and Italian industry.
- This lower demand from Europe will reduce the growth of Spanish exports and, therefore, Spanish economic activity.

2023 growth is revised downward

A more uncertain environment will affect private sector confidence

IMPACT OF INCREASED UNCERTAINTY ON SPANISH GDP (VIX) (PERCENTAGE POINTS)



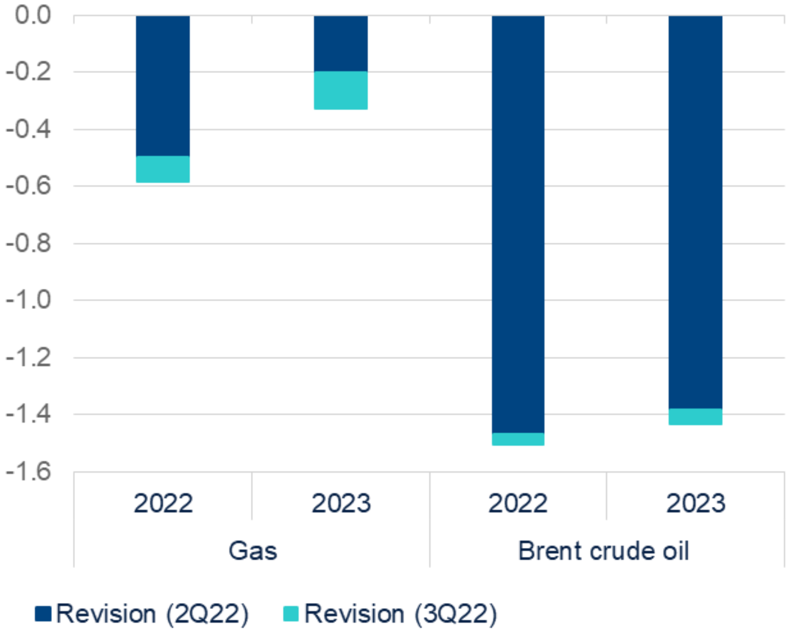
Source: BBVA Research.

- Rising inflation and the response of central banks have led to an adjustment in equity markets.
- The consequent decrease in the financial wealth of families and companies may translate into an increase in precautionary savings.
- The increase in financial volatility is estimated to result in 0.4 pp less GDP growth in 2023.
- Finally, it is to be expected that the positive impact of vaccine effectiveness and of the removal of consumption restrictions may be exhausted by the end of summer.

2023 growth is revised downward

Inflation has been higher than expected, despite government measures

IMPACT OF OIL AND GAS PRICE INCREASES ON SPAIN GDP
(PERCENTAGE POINTS)



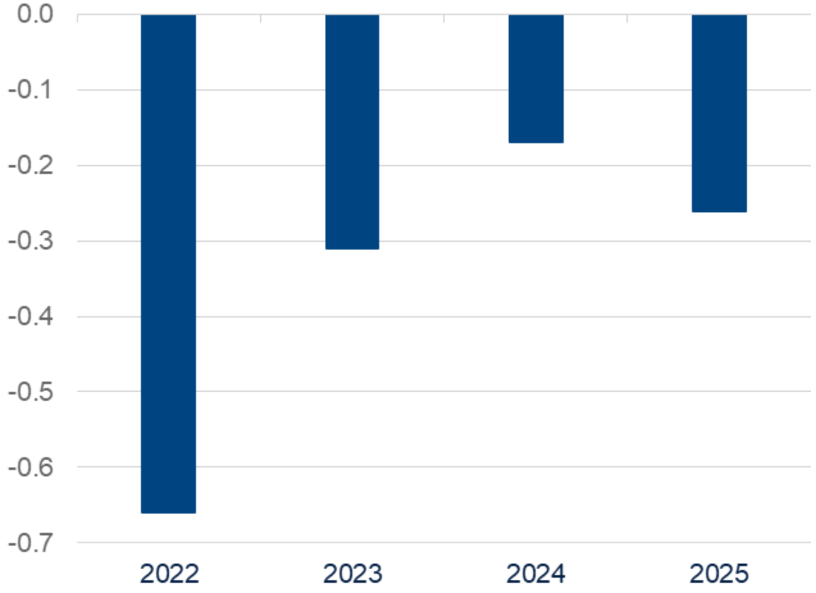
Source: BBVA Research.

- Decoupling wholesale electricity prices from gas prices is a short-term emergency measure with a moderate but positive impact: the decline in electricity prices (between 12% and 33%) could reduce the CPI by around 0.3 to 0.8 percentage points.
- The reduction in the VAT rate on electricity could moderate headline inflation by another tenth of a percentage point.
- Despite these measures, the impact on household spending is significant and negative. The total effect of the increase in oil and gas prices over the last six months is estimated to amount to 2.0 pp of the GDP.

2023 growth is revised downward

Increased financial burden will negatively affect household and business spending

IMPACT ON SPANISH GDP GROWTH OF THE CHANGE IN THE EUROPEAN INTEREST RATE SCENARIO
(%)



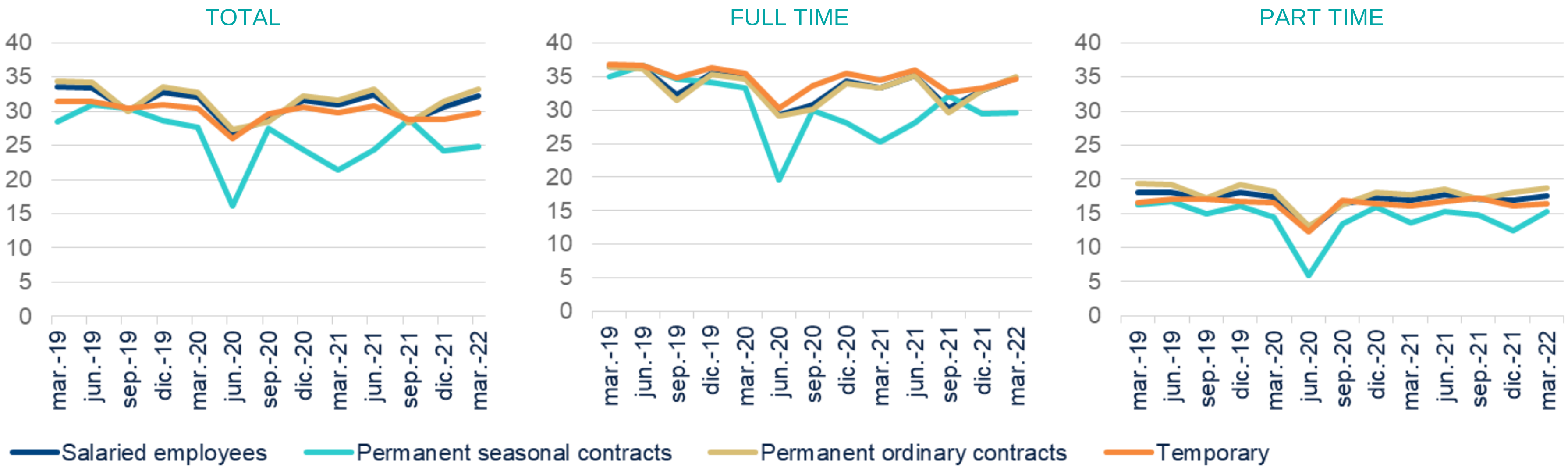
- The increase in inflation expectations has had an impact on the outlook for interest rates.
- Central banks have expressed their intention to withdraw the stimuli introduced over the past few years. The monetary policy rate in the eurozone is expected to end the year at 125 bps.
- This will increase the financial burden on households and companies, reducing the resources available for consumption and investment.

Source: BBVA Research based on Boscá et al (2015), "EREMES 2: an Estimated Rational Expectations Model for Simulation and Historical Decompsition of the Spanish Economy".

2023 growth is revised downward

The reform may have brought about changes in the relationship between employment and hours worked

ACTUAL HOURS WORKED PER WEEK
(NUMBER OF HOURS)



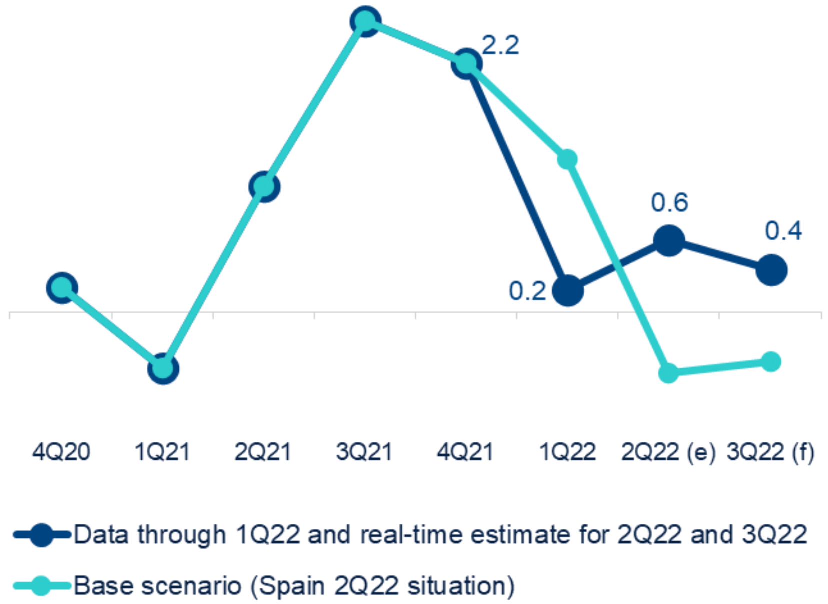
Source: BBVA Research based on INE (EPA).

Permanent employees work fewer hours than other employees, regardless of the type of working day (-12% average 2007-2022). Although a large part of the difference is a composition effect, the increase in transitions from temporary to permanent employment (fixed-term) should not be at the expense of a reduction in working hours. Periods of inactivity?

The economy shows resilience

Growth is sustained, with a virtuous composition

GDP VARIATION
(QUARTERLY GROWTH IN %)



(e): Estimate; (f): Forecast
Source: BBVA Research based on INE.

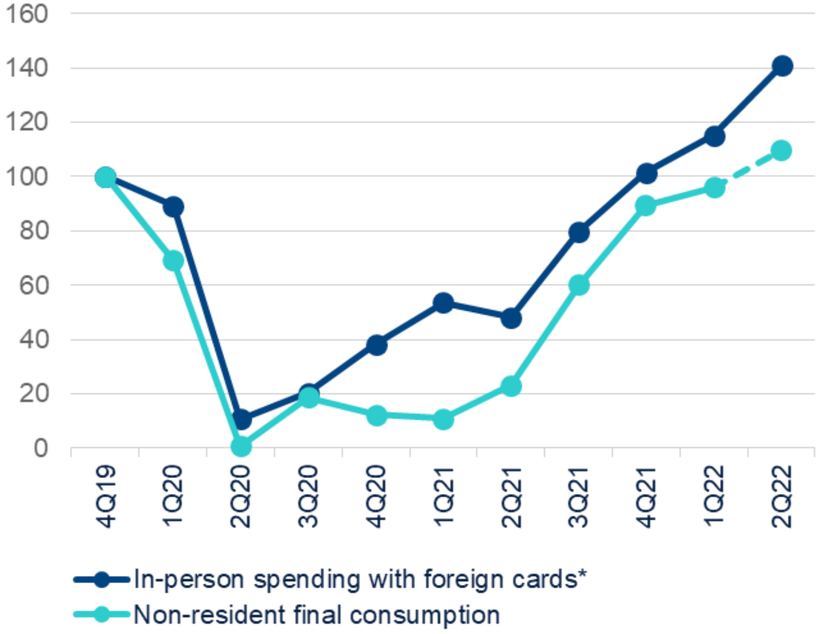
- The inertia is positive for the third quarter of the year.
- Most indicators suggest that growth was positive in 2Q22 and will continue to be positive in 3Q22, despite the headwinds ahead.
- The evolution of credit card spending by BBVA customers suggests that consumption will continue to grow in the services sector, but may be depleted in some goods, such as furniture, technology or those related to health.

The economy shows resilience

Strong recovery of foreign tourism

NON-RESIDENT CONSUMPTION AND IN-PERSON SPENDING WITH FOREIGN CARDS

(NOMINAL, 4Q19=100)



(*) Spending with cards from foreign entities at BBVA POS terminals
Source: BBVA Research based on BBVA.

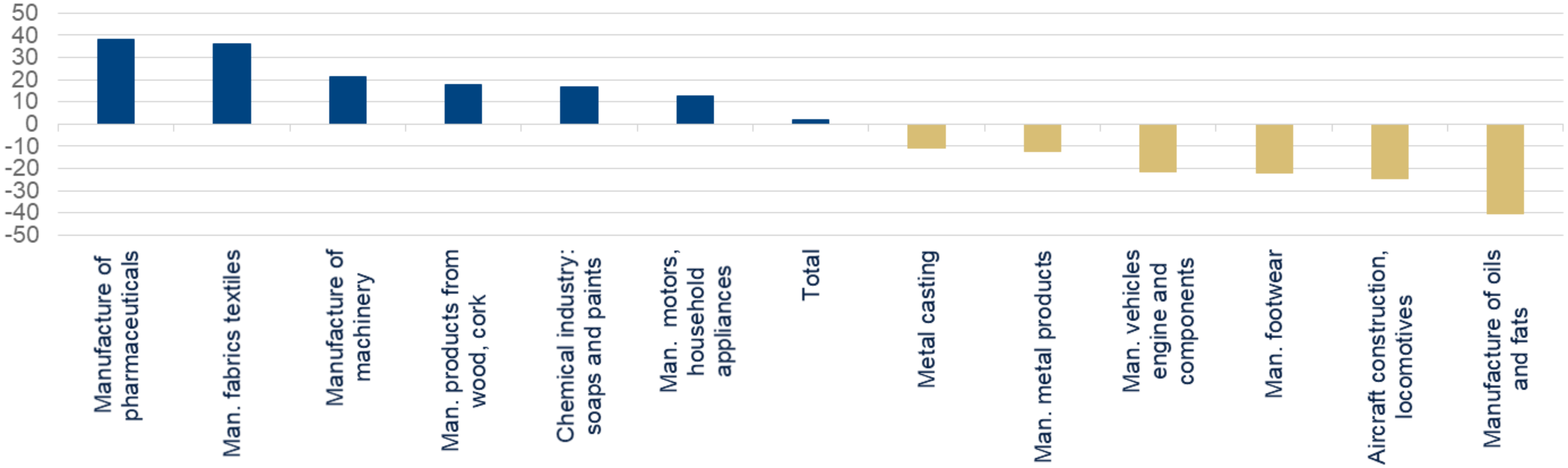
- Consumption by non-residents in the territory is reported to have accelerated in 2Q22, already surpassing pre-pandemic levels. In line with what is observed in the figures of in-person spending with foreign cards in 2Q22, which exceeded 4Q19 levels by 40%.
- Upward bias. Just as Spain suffered greatly from the COVID-19 crisis, it may now perform better relative to the rest of the EMU.

Economy shows resilience

Export industry resilient despite rising costs

VARIATION IN THE IPI OF THE SECTORS WITH THE GREATEST WEIGHT

(CHANGE BETWEEN 1Q19 AND 1Q22, %)



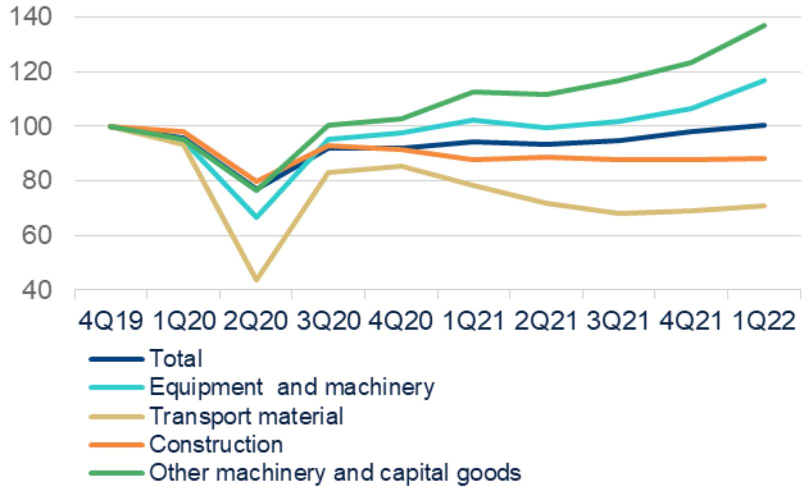
Source: BBVA Research based on INE.

Industrial production would have recovered 2019 levels despite the fact that there are activities that still have supply restrictions. On the other hand, those sectors that have aided post-pandemic recovery, which are reducing their dependence on fossil fuel or increasing their digitalization, would be gaining market share.

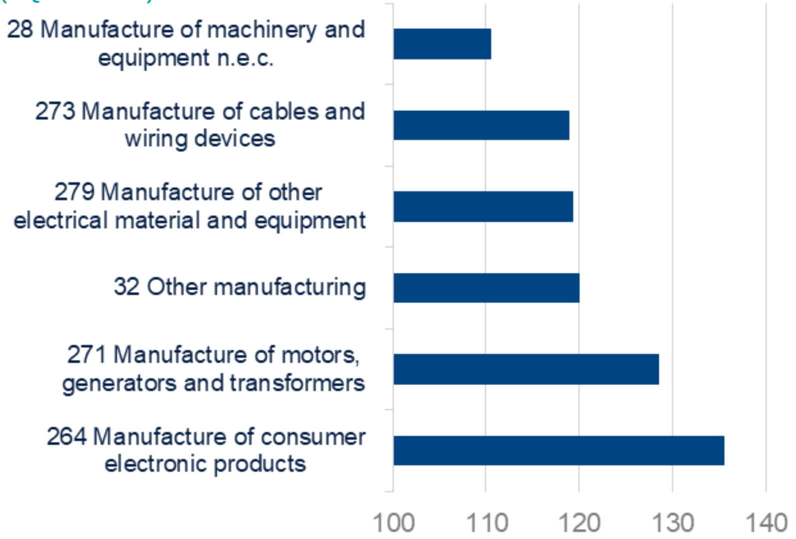
The economy shows resilience

Investment in machinery and equipment continues to rise

INVESTMENT
(GROSS FIXED CAPITAL FORMATION, 4Q19 = 100)



IMPORTS OF OTHER MACHINERY AND EQUIPMENT: BREAKDOWN BY COMPONENTS
(4Q19 = 100)



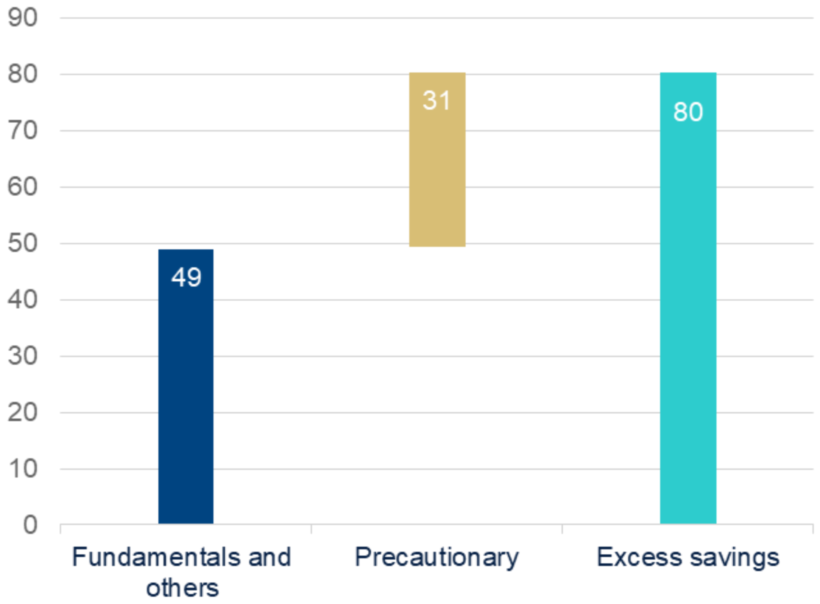
Source: BBVA Research based on INE.

Capital accumulation has reached pre-crisis levels, driven by investment in machinery and equipment, which is 17% above levels recorded in 2019. This good investment performance points to gains in competitiveness, which will support the activity.

2022-2023 outlook: recovery to continue

The excess savings will support the evolution of domestic demand

ACCUMULATED EXCESS HOUSEHOLD SAVINGS FROM 4Q19 TO 1Q22
(BILLIONS OF EUROS)



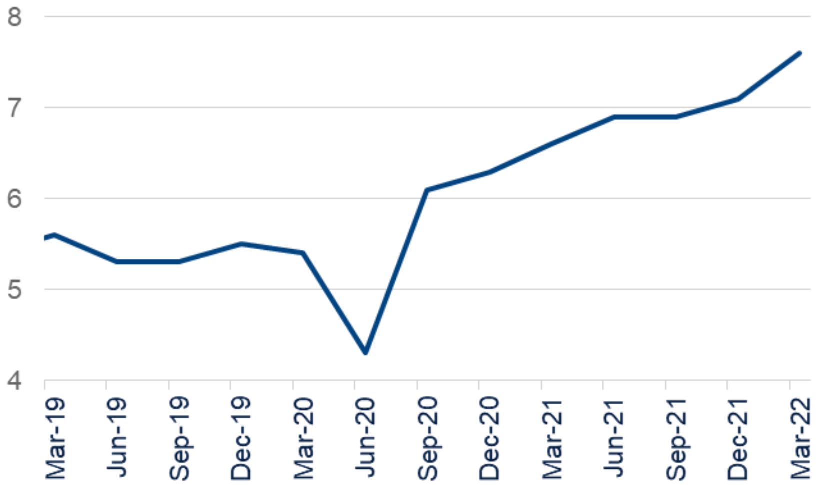
- Excess savings accumulated since 4Q19 are estimated to remain at around at €80 billion.
- For the time being, households continue to have savings rates similar to those observed over the last 15 years.
- It is to be expected that in the second and third quarter of the year, part of the wealth accumulated during the lockdown has been used to finance consumption and investment.

See BBVA Research (2021): Saving during the pandemic. Available at: https://www.bbvaresearch.com/en/publicaciones/spain-saving-during-the-pandemic/
Source: BBVA Research.

Outlook 2022-2023: recovery to continue

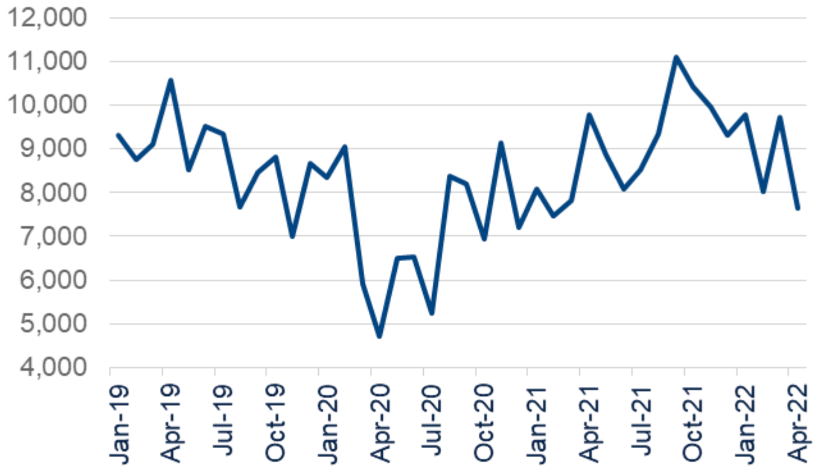
Housing construction could begin to see a turning point

HOUSEHOLD INVESTMENT RATE
(% OF RBD. CVEC DATA)



Source: BBVA Research based on INE.

PERMITS FOR NEW CONSTRUCTION
(NUMBER OF PERMITS, SWDA DATA)



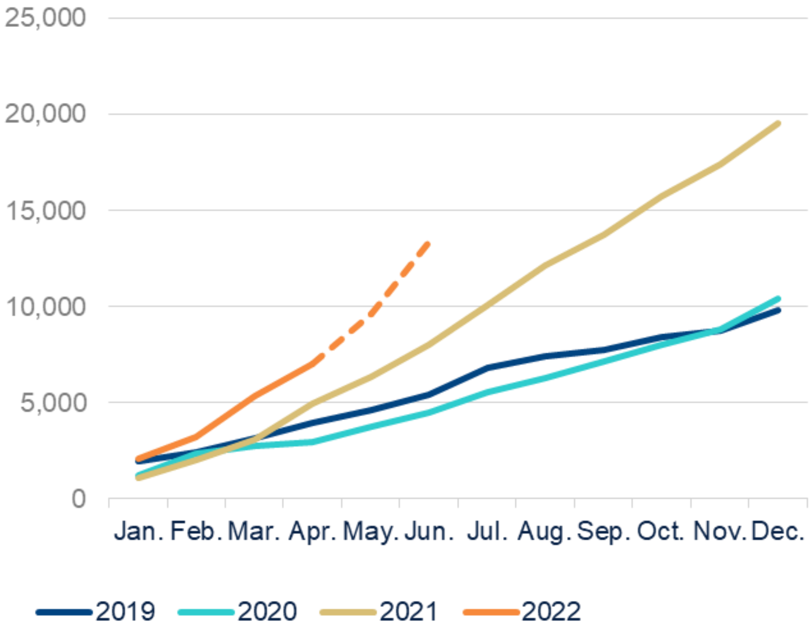
Source: BBVA Research based on MITMA.

The accumulated household savings will not only be used for consumption, but also to buy housing. In addition, a still low interest rate environment and rising inflation will make housing more attractive as an investment asset.

2022-2023 outlook: recovery to continue

Tendering accelerates, but resources will still take time to reach the private sector

OPEN TENDERS
(MILLIONS OF EUROS. ANNUAL ACCUMULATED)



Source: BBVA Research based on MITMA and May and June estimates with PLACSP data.

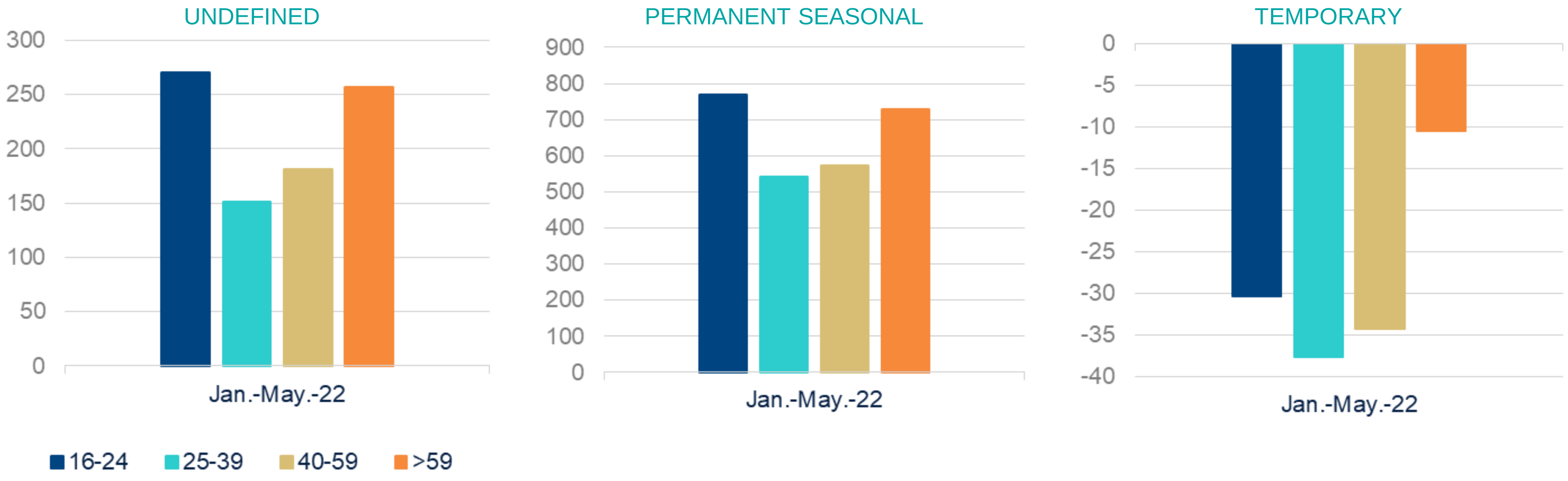
- Open tenders picked up at the beginning of 2022 and have been gaining traction during the second quarter of the year.
- The implementation of the Recovery Plan (more than €13 billion have been tendered up to June 2022) may be behind this acceleration.
- Therefore, it is expected that, in the second half of the year, companies will begin to face greater demand related to the development of these projects.

2022-2023 outlook: recovery will continue

Labor reform may have positive impacts on consumption and productivity

CONTRACTS BY TYPE AND AGE BRACKET

(2022 VS. 2019, VARIATION %)



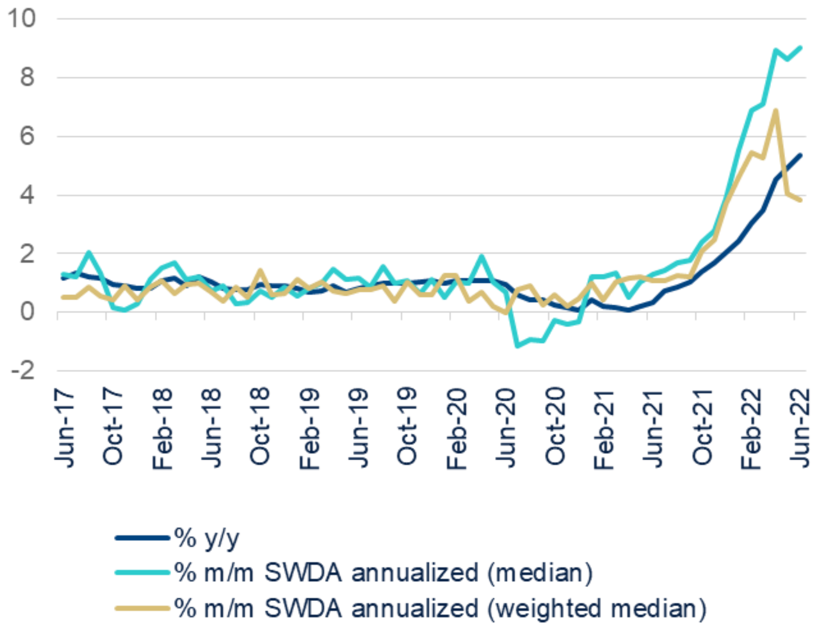
Source: BBVA Research based on Spanish Ministry of Labor and Social Economy.

The growth in permanent contracts has been more pronounced among workers under 25 and over 59 years of age.
The decrease in the number of temporary employees has been greater in intermediate age groups (25-59 years of age).
This may improve consumer expectations, reduce labor turnover and improve productivity.

Risks: upward inflation bias

The increase in prices is already widespread and could continue over time.

UNDERLYING INFLATION
(%)



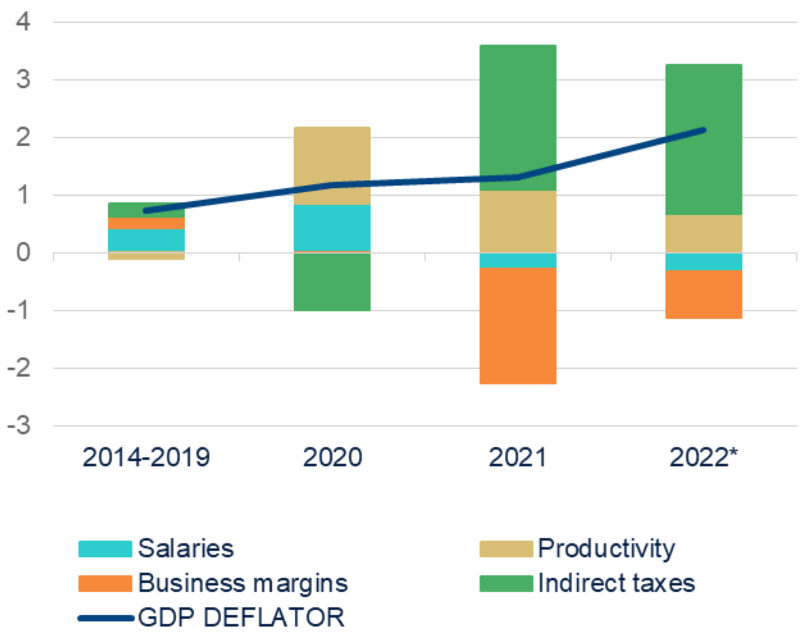
Source: BBVA Research based on INE.

- Core inflation is around 5% year-on-year, and some alternative measures, such as median or annualized monthly inflation, suggest that the trend could be high (even close to 8%).
- In this context, the probability of transitioning to a high inflation regime, with a presence of second-round effects on wages, is increasing.
- It will be crucial for the government to mediate an "income pact" between the social partners to avoid an inflationary spiral between margins and wages.

Risks: upward inflation bias

No progress has been made on the income pact

GDP DEFLATOR
(YEAR-ON-YEAR CHANGE, PERCENTAGE POINTS)



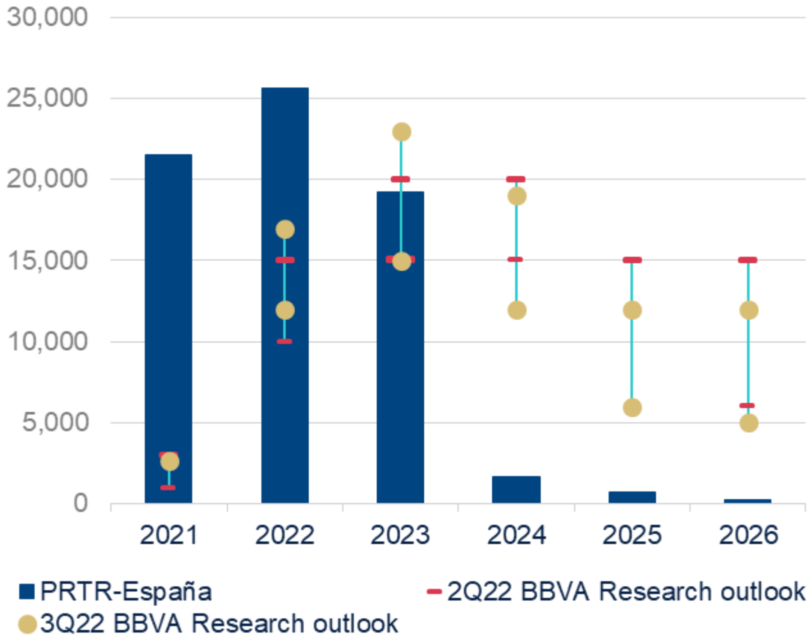
* This is the cumulative figure for the four quarters up to 1Q22.
Source: BBVA Research based on INE.

- The progress of inflation will depend on the impact of the invasion of Ukraine on the price of commodities and problems in supply chains.
- The behavior of corporate margins, the outcome of collective bargaining and the impact of public policies will be decisive.
- The drop in margins in 2021 has been reversed as of 1Q22. The wage growth agreed in the collective bargaining agreement has accelerated, but below inflation and below what would be consistent with the variation in productivity per worker.

Downside risks in the short term

Transfer of funds is progressing, but implementation remains slow

RECOVERY PLAN: PLANNED AND ACTUAL EXPENDITURE (MILLIONS OF EUROS)



Source: BBVA Research based on Spanish Ministry of Finance and Public Function.

- According to the Government, up to June 2022 calls for proposals and programs for expenditure amounting to about 28 billion euros have been launched.
- The administrative procedure means that the granting and awarding of these programs can take around six months, delaying their major impact on activity until the second half of the year.
- However, by June 2022, contracts and grants have already been resolved for an amount equivalent to 20% of the programs announced.

Short-term downside risks

Risk premium

CONTRIBUTION TO THE ADJUSTMENT OF THE PUBLIC DEFICIT (% OF GDP)

Deficit 2021	6.8
Cyclical variation	-2.4
Cycle adjusted	+1.1
Deficit 2022 (f)	5.5
Cyclical variation	-0.5
Cycle adjusted	+0.4
Deficit 2023 (f)	5.4

(f): Forecast.
Source: BBVA Research based on Bank of Spain, INE and Spanish Ministry of Finance.

- The measures implemented to reduce the impact of higher fuel and electricity prices may persist over time, slowing the pace of adjustment of the deficit.
- The development of the ECB's anti-fragmentation mechanism will be key to containing increases in the risk premium. Therefore, it is essential that there be a perceived commitment to comply with the necessary adjustments and reforms.
- The Treasury has managed to secure low interest rates and has lengthened the maturity of debt. Thus, a rise in the average rate of debt of around 100 bps in 2022 and 70 bps in 2023 would not trigger an explosive path of indebtedness.

Risks

Failure to adopt the necessary measures

REFORM AGENDA

The Government must continue to move forward in fulfilling its commitments, with ambitious reforms in accordance with the recommendations of the European Commission.

SPAIN HAS MUCH AT STAKE

Seize the opportunity to create the conditions for a more vigorous and sustainable recovery. It is necessary to maintain an environment of certainty that promotes investment and growth.

CREDIBILITY IN QUESTION

The ECB's willingness to avoid fragmentation of sovereign debt markets may be challenged if any of the members of the monetary union fail to meet their commitments.

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03

Forecasts

Forecasts

% y/y	2020	2021	2022 (f)	2023 (f)
National final consumption expenditure	-8.2	4.2	1.3	2.1
Private consumption	-12.0	4.6	1.9	2.3
Public consumption	3.3	3.1	-0.3	1.6
Gross fixed capital formation	-9.5	4.3	9.8	6.9
Equipment and machinery	-12.9	16.0	17.2	4.4
Construction	-9.6	-2.8	4.5	8.7
Housing	-11.2	-5.3	5.6	3.2
Domestic demand*	**-8.6**	**4.7**	**3.0**	**3.1**
Exports	-20.1	14.7	14.4	3.1
Exports of goods	-9.2	11.1	2.5	2.3
Exports of services	-43.2	27.1	52.2	4.9
Final consumption by non-residents in Spain	-76.0	76.2	126.6	7.9
Imports	-15.2	13.9	11.8	6.7
External demand*	**-2.2**	**0.4**	**1.1**	**-1.2**
Real GDP at market prices (mp)	**-10.8**	**5.1**	**4.1**	**1.8**

* Contribution to GDP growth.
(f): forecast.
Source: BBVA Research based on INE and BdE.

Forecasts

% y/y	2020	2021	2022 (f)	2023 (f)
Employment (full-time equivalent)	-7.6	6.6	3.8	0.6
Employment, based on Labor Force Survey	-2.9	3.0	3.5	0.8
Unemployment rate (% of labor force)	15.5	14.8	13.0	12.9
CPI (annual average)	-0.3	3.1	7.9	3.2
GDP deflator	1.0	2.3	3.2	2.3
Public deficit (% GDP)	-10.1	-6.8	-5.5	-5.4

(f): forecast.
Source: BBVA Research based on INE and BdE.

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Spain Economic Outlook

3Q22

Creating Opportunities