BBVA Research

Creating Opportunities

Spain Economic Outlook

March 2023

Situation and outlook for the Spanish economy

March 2023

The Spanish economy continues to hold up better than expected, although the persistence of inflation and the expectation of higher interest rates worsen the growth scenario for the following year. GDP could advance by 1.6% in 2023, 0.4 percentage points (pp) more than expected in December last year, reducing the probability of a contraction associated with the negative effects of the Ukraine crisis. Both the European and Spanish economies have shown resilience in the face of the tensions in the gas market and the increase in energy prices. Partly as a result of this, the prices of these goods are now expected to fall earlier than expected. Furthermore, the bottlenecks that have affected value chains worldwide are disappearing, with output normalizing in key sectors. Added to this is the improvement in growth forecasts for the main economies in the global environment. At a domestic level, the use of savings accumulated during the pandemic and the impact of some public policies are helping to sustain domestic demand. Despite the above, the growth forecast for 2024 is revised downward, from 3.4% to 2.6%, given the expectation of a tighter monetary policy. The strength of activity partly explains why inflation has not fallen further. As a result, the ECB will have to raise interest rates to at least 4%, 125 basis points more than BBVA Research expected last December, and the bias is that additional tightening may be needed between now and the summer. Lastly, some recent measures may slow private investment growth in a year in which elections will increase uncertainty about economic policy.

Far from showing a contraction, as expected three months ago, GDP could increase in the first quarter of the year by 0.3% to 0.5% (0.2% in 4Q22). A higher quarterly growth rate than that of the last quarter of 2022 is what can be inferred from both the activity and confidence figures posted during the beginning of 2023. With data up to February, it is estimated that social security affiliation could be advancing at a rate of 0.8% in the first quarter of the year compared to 0.4% in 4Q22. This strength in employment is coupled with the improvement observed in business surveys, such as that reflected by the PMI indices, which show a recovery at the beginning of 2023 compared to the minimum levels observed at the end of 2022.

The main factor explaining the improved performance of GDP is the ability of the European economy to avoid scenarios of restrictions in energy use and the decrease in the cost to generate it. Although the increase in electricity prices has had a negative impact on European industry, the effects have not been as intense as expected. Firstly, it has been possible to import gas from alternative sources to Russia, partly thanks to the unexpected reduction in Chinese demand, affected by COVID-related restrictions. Secondly, there has been an increase in electricity generation from alternative technologies. In addition, somewhat higher than usual temperatures in winter have reduced the demand for heating. And finally, a major effort has been made to improve energy efficiency, both by households and companies. As a result, uncertainty about the availability of electricity and gas in Europe has decreased considerably.[1]

This resilience is expected to continue and, in the most likely scenario, GDP is expected to grow by 1.6% in 2023, this is also thanks to a somewhat more favorable global environment. The most recent data suggest that the EMU economy is only expected to have stagnated in Q4, despite negative data from Germany. Taking this into consideration, the Eurozone's GDP is expected to increase, on average, by 0.6% in 2023, compared to the 0.1% drop that was forecast three months ago. BBVA Research estimates that each percentage point improvement

1: For more details on the factors behind the build-up of gas inventories in Europe, see BBVA Research (2023): Natural Gas: Winter Target 2024. BBVA Research, February 27, 2023. Available at: https://www.bbvaresearch.com/publicaciones/europa-gas-natural-objetivo-invierno-2024/.

in EMU GDP growth expectations is passed on in the same proportion to Spain's GDP. Meanwhile, China has left behind its confinement and activity seems to be recovering strongly, which now makes it more likely that its GDP will grow by more than 5%. The Asian country has become one of Spain's main trading partners, so its further expansion may be good news, particularly for sectors such as the food and automotive industries. In the US, the GDP growth forecast is also revised upward by 0.5 percentage points to 0.8%. All of the above should provide direct support to the activity of companies focused on foreign trade and indirect support to the rest of the economy.

The disappearance of bottlenecks is another factor that will help the economy continue to show positive growth rates. Container availability has improved considerably, along with reduced delivery times and transportation costs. Companies are beginning to build up inventories and, as a result, value chains are normalizing. One of the sectors where this is most evident is the automotive sector. Between January and July last year, the sector's output was 22% lower than in the same period of 2019. This situation meant that 40% fewer passenger cars were sold than in the first seven months of 2019. However, a turning point has since been observed: between August 2022 and January 2023 the industry manufactured only 8% less than in the same months of 2019 and the gap in cars sold decreased to 27%. This improvement would be in line with BBVA Research estimates, which point to half of the drop in car sales being explained by the lack of availability of passenger cars.[2] Other sectors, such as aerospace, are also beginning to benefit from the increased availability of intermediate goods, and shipbuilding and other transportation equipment should do so soon.

There has been a partial reversal of the deterioration in the terms of trade that improves the short-term outlook. In particular, futures today are discounting gas prices 40% to 50% lower for 2023 and 2024 than those forecast just three months ago. A barrel of oil is trading up to 40% below the peak levels seen in 2022. To this must be added the appreciation of the euro against the dollar observed in recent months, which lowers the cost of imports. Although the price of gas-fired electricity remains at historically high levels, the greater certainty of supply and the expectation of continued or even lower costs in the coming months should add up to 0.6 pp to GDP growth in 2023. This should limit the negative impact on industry, particularly the more energy-intensive ones, and, provided that price reductions continue in 2024, should support a recovery in these sectors over the next year.

There are idiosyncratic factors that seem to be contributing to Spain showing better growth than the rest of the Eurozone. Evidently, the greater fall in GDP during the pandemic and the strong recovery of the services sector (mainly tourism) after the confinement explain much of the positive differential. However, Spain has also continued to show a particularly favorable performance in the export sector. According to Trade Balance data, exports of goods were 5% above that of three years ago. The National Statistics Institute (INE) places total foreign sales at 7% above 2019 values, while neither GDP, private consumption nor investment have been able to recover pre-2020 figures. Spanish companies have been able to gain competitiveness since the beginning of the pandemic thanks to the fact that both business margins and unit labor costs have grown less than in the Eurozone as a whole. Up to the third quarter of 2022, the GDP deflator (the price of what is produced domestically) has increased in Spain since 2019 by almost half a point less, on annual average, than in the EMU. Around 60% of this differential is explained by a lower contribution of margins to price growth. This performance would help explain why the country maintains a positive current account balance, despite the fall in the services sector during the pandemic, the higher public deficit and higher fuel prices in the last year. In fact, BBVA Research estimates that the structural current account balance was positive in 2022 and equal to 0.5% of GDP.[3]

2: See BBVA Research (2022): Consumption. Second half of 2022. BBVA Research, October 2022. Available at: https://www.bbvaresearch.com/publicaciones/espana-situacion-consumo-segundo-semestre-2022/
3: For details on the estimation methodology, see BBVA Research (2013): Spain: An analysis of the performance and the determinants of the current account in Spain. BBVA Research, November 2013. Available at: https://www.bbvaresearch.com/publicaciones/spain-economic-watch-an-analysis-of-the-performance-and-the-determinants-of-the-current-account-in-spain/

Other industries have taken over from those affected by high fuel, gas and electricity prices, taking advantage of the changes in demand brought about by the pandemic and the energy transition. Despite the bad omens, the industrial production index in Spain increased by almost 3%, on an annual average, during 2022. One of the reasons is the steady growth of companies producing items that have increased their share in the household basket as a result of COVID. Here we can find everything from pharmaceuticals and medical equipment to cleaning products. Meanwhile, deconfinement has allowed the recovery of sectors particularly affected by restrictions, the lack of celebrations and teleworking, such as textiles, footwear, jewelry and beverages. Likewise, the digitalization of commerce continues to support the performance of companies associated with distribution. The need to gain competitiveness and continue automating processes is leading to significant growth in the production of machinery and equipment. Finally, the advance of electrification, as well as the lower cost of renewable energies, are driving the supply generated with domestic inputs and the manufacture of engines and power generators.

Savings accumulated during the pandemic are beginning to be absorbed. Faced with rising inflation and interest rates, households have begun to use the excess resources they accumulated during the lockdown. This has allowed households to bring forward decisions to purchase housing, pay off part of their debt or renegotiate it at more favorable terms in the face of rising interest rates. For example, it is estimated that mortgage repayments would have increased from €4.5 billion, on average per month, between May and December 2021 to around €6 billion in the same period in 2022. This behavior is limiting, at least temporarily, the negative impact of a tighter monetary policy. That said, it is estimated that the savings rate could have fallen to 7.5% of household gross disposable income in 2022, considerably below the level reached in 2020 (18.1%) and lower than in 2019 (8.5%). Households seem to accept lower savings rates in order to maintain consumption, probably by drawing on excess wealth accumulated during the pandemic.

Some public policies could be aiding in sustaining domestic demand. First, it is estimated that, between grants and approved tenders, some EUR 13 billion related to Next Generation EU (NGEU) funds could have reached the real economy by 2022. The figures released for the beginning of 2023 are encouraging and could lead to the execution of between EUR 15 and 20 billion during this year. Meanwhile, the autonomous communities are benefiting from the liquidity generated by the transfers made by the Government to finance these expenses, especially in an environment in which interest rates are on the rise. Second, the increase in pensions and the National Minimum Wage (SMI for its Spanish acronym), in line with average inflation in 2022, would have had a positive impact on private consumption, especially for lower-income households within the beneficiary groups. To this must be added the impact that the contribution of 200 euros may have on low-income families to cope with the increase in food prices. Mention should also be made of the extension of tax reductions to contain the rise in the cost of electricity and food, although their generalized and regressive nature raises doubts about the efficiency of the measure. Lastly, the labor reform has reduced the volatility of employment by increasing the cost of hiring and reducing temporary employment. Moreover, for the time being, there is no perceived cost in terms of hours worked.[4] Furthermore, an increase in productivity is expected in the medium term due to the greater investment in human capital that companies and workers will make thanks to the greater stability in contractual relations.

However, several changes in the scenario have been observed that point to a less intense medium-term recovery and explain the downward revision in the growth forecast for 2024 from 3.6% to 2.8%. Although total inflation is decreasing, it is mainly due to the performance of the price of a small number of goods. The drop observed over the last few months is related to the decrease in the price of gas and fuel. Core inflation, which includes more than 80% of the household consumption basket, continues to rise and is at high levels (around 7%).

4: See BBVA Research (2023): Relationship between hours worked and type of contract: has it changed in the wake of the labor reform? BBVA Research, February 2023. Available at: https://www.bbvaresearch.com/publicaciones/espana-relacion-entre-horas-trabajadas-y-tipo-de-contrato-ha-cambiado-tras-la-reforma/

This implies that the loss of purchasing power is widespread and that, given the persistence that price growth in the services sector tends to show, reducing inflation to 2% will be difficult and will take time. This is shown by indicators that anticipate the trend in prices, such as the percentage of goods and services whose annualized monthly inflation is less than or equal to 2% (25%, at a low since the beginning of the pandemic) or higher than 10% (32%, at a high). This trend suggests that companies have begun to pass on part of the increase in costs to final prices. To a large extent, this is a consequence of the resilience shown by domestic demand thanks to the use of the savings accumulated during the pandemic, the increase in the income of pensioners and of the recipients of the minimum wage who keep their jobs. Moreover, this may endure in an environment where the unemployment rate is at levels not seen for almost 15 years, and where labor costs may well accelerate. In the absence of further reductions in energy costs, it is expected that, while total inflation will fall to levels averaging around 4% this year, core inflation will remain between 5 and 6%, with both coming in at 3% the following year.

The ECB is expected to continue to increase the cost of funding to at least 4%-4.25%. This is 125 to 150 basis points more than expected in December as inflation dynamics are proving more persistent than expected. In any case, the effects of monetary policy on the Spanish economy are already beginning to be seen. For example, housing sales have gone from staying, on average, around 63 thousand units per month in the first half of the year to falling to 58 thousand units in the second half of the year. Similarly, the number of mortgages has gone from an average per month of over 31 thousand in the first six months of 2022 to around 28 thousand in the second half of the year. This, together with the aforementioned amortizations, has caused the mortgage balance to fall again. The same has happened with financing to non-financial companies, despite the fact that inflation averaged 8%, that production costs probably increased more than that and that there is a public investment plan of a magnitude not seen in recent years. In fact, new business loans for terms of more than five years fell by 5.5%. Looking ahead, the upward surprise in interest rates may result in the economy failing to advance by more than one percentage point in 2023 and 2024, adversely affected by the negative impact on private sector consumption and investment.

The cushion that had been built up during the pandemic has been drastically reduced, potentially limiting future domestic demand growth. Up to the third quarter of 2022, household net financial wealth in real terms has declined by almost 9% compared to the same period in 2021, when it was close to its all-time high. Part of the observed reduction in wealth has to do with the increase in consumption in the lockdown easing period. In December, the National Institute of Statistics revised Spanish resident household spending upward by approximately EUR 20 billion. Furthermore, households have decided to convert part of their liquidity into real estate wealth given the higher profitability of the sector (this wealth is more difficult to transform quickly into consumption). Beyond the increase in spending, the major cause of the fall in household wealth in real terms was inflation. Prices rose by 8.5% on average over the previous year, considerably reducing the purchasing power of Spanish savings. This may have meant that what was once perceived as an unexpected surplus of resources may now be perceived as inconsistent with what is necessary to supplement labor income, face emergencies or even guarantee an adequate retirement.

As the national minimum wage (SMI) converges to 60% of the average wage, it will be necessary to monitor the possible effects on employment and the competitiveness of certain sectors and companies. With the increase approved for 2023 (8%), it is estimated that the percentage of employees whose contract is linked to the SMI could exceed 12% in Spain as a whole. However, in some regions of the country, such as the Canary Islands, it could exceed 20%. At these levels, it is likely that the increase in wage costs will begin to be significant for the least productive companies and in sectors where the proportion of workers earning the minimum wage is higher. This may lead to greater pressures on inflation, losses in competitiveness and, eventually, lower job creation. Depending on how close it is to this threshold, the impact on job creation of the SMI increase could fluctuate between 2 tenths and 1.2 points less growth in 2023. The benefits of increasing the SMI will have to be weighed against these costs. This is why it is so important that the effects of this measure be monitored, that an evaluation be carried out and that a plan be drawn up to help those groups that may be affected. Decisions on the SMI should satisfy three principles. First, they should be the result of a tripartite agreement between unions, business organizations and the government, the latter being responsible for active employment policies and other income measures, such as wage supplements. Second, be predictable. Insofar as possible, it is preferable to negotiate a multi-year roadmap that reduces uncertainty. And third, they should be designed and continuously evaluated by an independent committee similar to those in some European countries.

Inflation will continue to be one of the main risks to economic activity. While it is true that neither GDP, private consumption nor investment have returned to pre-pandemic levels, other indicators suggest that demand pressures are strong and explain, in part, the recent trend in inflation. Employment has comfortably surpassed pre-pandemic levels. The unemployment rate and unfilled vacancies point to a strained labor market, where it is difficult to quickly find labor. Despite their slowdown, housing sales and the number of workers in the construction sector showed considerably higher levels in 2022 than those observed in 2019. While it is true that some of the supply factors that have caused prices to increase could reverse over the next two years (bottlenecks, drought), the resilience of demand will slow the disinflation process.

The income pact implicitly reached by the social agentsis in danger of breaking down and thus contributing to higher inflation. The increase in margins for much of 2022 is a sign that demand remains strong. In any case, the levels barely reach those observed in 2019. Although real wages fell in the previous year, they fell considerably less than the margins in 2020, before recovering in 2021. Employment, meanwhile, has continued to rise over these three years. This suggests that the cost of the crisis that began three years ago has been spread relatively evenly, albeit with different time sequences. Going forward, unions and business organizations must try to reach an agreement that limits future price growth. This will involve recognizing that, at least in the short term, much of what has been lost in previous years will not be recovered. If this does not happen, there is a risk of losing the competitiveness gained during so many years of sacrifice and which continues to bear fruit in the performance of the Spanish economy's external sector. Furthermore, if Spain is one more of the countries that contribute to the continued high inflation, the ECB will react with a policy that will lead to an intense slowdown of economic activity.

The fiscal policy should contribute to the reduction of inflation in an environment where the unemployment rate is low. NGEU funds will support the development of investment, however, there are doubts about the sustainability of revenues and the deficit continues to be high. The imbalance in the public accounts (around 4% of GDP) seems excessively high given the recent performance of tax revenues (43.9% of GDP in 2022, an all-time high), the decline in the unemployment rate (12.9% in 2022, at its lowest since 2008) and the level of general government debt (113.1% of GDP, 20 pp above the EMU average in the third quarter of 2022). The accumulation of capital and the change in the production model will be supported by transfers from the European Union. In addition, it should be noted that the fiscal rules will apply again during the following year. If this opportunity is not taken to continue reducing the fiscal deficit, the adjustment to be made the following year may have more negative repercussions than if it is carried out over a prolonged period of time. In addition, **correcting the imbalance in the public accounts may help contain inflation.**

The uncertainty about economic policy increased in some of the previous election cycles. For the time being, the risk premium paid by the Spanish Government for financing in the international markets remains stable. This is the result of the fulfillment of the commitments undertaken with the rest of Europe, which have led to the approval of various reforms, such as the labor reform. In any case, it is also a consequence of the ECB's action and its desire in previous years to maintain lax conditions, which would facilitate recovery in a homogeneous manner throughout the Eurozone and the absence of any fragmentation that would make the management of monetary policy more complicated. In a context in which the ECB is beginning to mark the pace toward the reduction of its balance sheet, measures that reassure investors about the medium-term sustainability of public accounts will be key. It is therefore necessary to approve a consensual reform of the pension system that guarantees its permanence over time. It is also important that the changes that are agreed upon ensure the sustainability of the system and that, at the same time, steps are taken to ensure that households and companies make decisions that allow for sufficient resources in retirement. Finally, it is necessary to promote a consensus that includes the minimum common points to generate an agreement on the future of the tax system, education, the regulatory framework for key sectors that encourages investment to promote social and environmental sustainability, as well as access to financing.

Tables

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

	2020	2021	2022	2023	2024
United States	-2.8	3.7	2.1	0.8	1.8
Eurozone	-6.3	5.3	3.5	0.6	1.6
China	2.2	8.5	3.0	5.2	5.0
World	-2.8	6.3	3.3	2.4	3.3

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: March 10, 2023.
Source: BBVA Research & FMI.

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

	2020	2021	2022	2023	2024
United States	1.2	4.7	8.0	4.0	2.7
Eurozone	0.3	2.6	8.4	4.8	2.3
China	2.5	0.9	2.0	2.5	2.0
World	3.6	5.1	9.2	7.1	5.0

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: March 10, 2023.
Source: BBVA Research & FMI.

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

	2020	2021	2022	2023	2024
United States	0.90	1.44	2.95	3.88	3.89
Germany	-0.48	-0.31	1.18	2.65	2.72

Forecast closing date: March 10, 2023.
Source: BBVA Research & FMI

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

	2020	2021	2022	2023	2024
EUR-USD	0.88	0.84	0.95	0.93	0.88
USD-EUR	1.14	1.18	1.05	1.08	1.14
CNY-USD	6.91	6.45	6.73	6.66	6.68

Forecast closing date: March 10, 2023.
Source: BBVA Research & FMI.

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

	2020	2021	2022	2023	2024
United States	0.25	0.25	4.50	5.25	3.75
Eurozone	0.00	0.00	2.50	4.00	3.75
China	4.35	4.35	4.35	3.65	3.65

Forecast closing date: March 10. 2023.
Source: BBVA Research & FMI.

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

	2020	2021	2022	2023	2024
GDP at constant prices	**-6.3**	**5.3**	**3.5**	**0.6**	**1.6**
Private consumption	-7.8	3.7	4.0	0.2	1.7
Public consumption	1.0	4.3	1.3	1.0	0.4
Gross fixed capital formation	-6.5	3.7	3.4	-0.2	3.1
Inventories (*)	-0.3	0.2	0.2	0.0	0.0
Domestic demand (*)	**-5.7**	**4.0**	**3.3**	**0.2**	**1.6**
Exports (goods and services)	-9.2	10.4	7.3	2.3	3.4
Imports (goods and services)	-8.7	8.2	7.6	1.6	3.7
External demand (*)	**-0.5**	**1.3**	**0.2**	**0.4**	**0.0**
Prices and Costs					
CPI	0.3	2.6	8.4	4.8	2.3
CPI Core	0.7	1.5	3.9	4.1	2.6
Labour Market					
Employment	-1.5	1.4	2.2	0.2	0.2
Unemployment rate (% of labour force)	8.0	7.7	6.7	7.1	7.2
Public sector					
Surplus (+) / Deficit (-) (% GDP)*	-7.0	-5.1	-3.3	-3.7	-3.0
Public debt (% GDP)*	97.0	95.4	92.8	92.5	93.0
External Sector					
Current Account Balance (% GDP)	1.6	2.3	-0.8	0.8	1.2

Annual rate change in %, unless expressly indicated.
Forecast closing date: March 10, 2023.
(*) 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, %)	2020	2021	2022	2023	2024
Activity					
Real GDP	**-11.3**	**5.5**	**5.5**	**1.6**	**2.6**
Private Consumption	-12.2	6.0	4.3	1.0	2.8
Public Consumption	3.5	2.9	-0.9	2.0	2.4
Gross Fixed Capital Formation	-9.7	0.9	4.3	3.0	10.5
Equipment and machinery	-13.3	6.3	3.8	0.9	9.9
Construction	-10.2	-3.7	4.2	3.3	11.1
Housing	-11.4	-4.8	2.7	0.9	10.6
Domestic Demand (contribution to growth)	**-9.1**	**5.2**	**2.8**	**1.9**	**4.2**
Exports	-19.9	14.4	14.9	3.2	5.3
Imports	-14.9	13.9	7.7	3.8	9.4
External Demand (contribution to growth)	**-2.2**	**0.3**	**2.6**	**-0.2**	**-1.6**
GDP at current prices	-10.2	7.9	10.1	6.9	5.6
(Billions of Euros)	1118.0	1206.8	1328.9	1420.6	1500.1
Labour market					
Employment, Labour Force Survey	-2.9	3.0	3.1	1.2	2.2
Unemployment rate (% Labour force)	15.5	14.8	12.9	12.6	11.5
Employment, full time equivalent	-6.8	6.6	3.8	1.1	1.7
Productivity	-4.5	-1.1	1.7	0.5	0.9
Prices and Costs					
CPI (average)	-0.3	3.1	8.4	3.9	2.8
CPI (end of period)	-0.5	5.8	5.7	4.4	2.6
GDP deflator	1.1	2.4	4.6	5.2	3.0
Compensation per employee	2.5	-0.8	2.0	4.7	4.2
Unit Labour Cost (ULC)	7.0	0.3	0.3	4.2	3.3
External sector (*)					
Current Account Balance (% GDP)	0.4	0.9	0.8	0.4	-1.3
Public sector					
Debt (% GDP)	120.4	118.3	111.3	108.0	105.6
Deficit (% GDP) (*)	-9.9	-6.8	-3.9	-3.9	-3.3
Households					
Nominal disposable income	-2.0	3.1	4.1	6.4	5.7
Savings rate (% nominal disposable income)	17.6	13.7	7.2	9.0	8.5

Annual rate change in %, unless expressly indicated.
Forecast closing date: March 10, 2023.
(*) Excluding financial aid for Spanish banks.
Source: BBVA Research.

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