BBVA Research

Creating Opportunities

Spain Economic Outlook

June 2023

Situation and outlook for the Spanish economy

June 2023

GDP growth for 2023 is revised upward from 1.6% to 2.4% and downward for 2024 to 2.1% from the 2.6% forecast last March. This improvement is partly explained by statistical revisions, but also by a surprisingly positive performance in exports. Although several factors are expected to contribute to reversing the recent decline in domestic demand, there are doubts as to whether the current pace of expansion and job creation is sustainable heading into 2024, in line with the increased uncertainties for next year in the global economy. Although the increase in interest rates is nearing completion, the transmission of monetary policy is occurring with somewhat of a lag. Forecasts of somewhat higher-than-expected inflation in the eurozone and the persistence of its core component are skewing the ECB's interest rates upward, which could remain high for longer. Key sectors such as housing construction, tourism and agri-food will see their progress limited by supply restrictions. Fixed capital formation shows a worrying weakness, despite the support of NGEU funds. Finally, economic policy uncertainty has increased, in a context in which the reduction of the public deficit will have to be accelerated in 2024.

Better inertia during the end of 2022 and stronger-than-expected dynamism in 2Q23 account for half of the improvement in the growth forecast for 2023. On the one hand, the INE revised GDP for the second half of last year upward by almost half a percentage point. On the other hand, it is estimated that the economy could grow by 0.7% in the second quarter of 2023, four tenths of a percentage point more than forecast three months ago. Employment and prices also show a more positive performance than expected in March: companies are creating jobs at a pace that would add almost 500,000 jobs over the year, double what was forecast in March. Likewise, from February through May, inflation has shown data consistent with a decline that can be sustained over time, reaching averages of 3.4% in 2023 and 3.2% in 2024.

Exports are behind the economy's strong performance, with a particularly important contribution from services. Based on data available up to the first quarter of the year, sales to the rest of the world are now almost 13% above the levels reached just prior to the start of the pandemic. Firstly, consumption by non-residents in Spain continues to contribute positively to the advance of the economy: according to data on card purchases by foreigners at BBVA point-of-sale terminals; in the second quarter of the year, spending levels could reach 60% higher than those observed in the same period of 2019. The main beneficiaries are beach destinations and cities that used to have an intense urban tourism traffic. In any case, the contribution to the growth of non-tourist services exports has been more important. These have increased by 30% since the end of 2019 and now account for almost 9% of GDP. Two thirds are destined for Europe and 20% for the Americas, with business services, information technology and telecommunications, and transportation being the most important. Exports of goods are 5.5% above the pre-pandemic level, with a balanced contribution to growth by type of good (consumer, intermediate or capital).

This progress is occurring despite sluggish domestic demand. The cumulative drop in household consumption spending in the last quarter of 2022 and the first quarter of 2023 (nearly 3%) has been more consistent with the recession that was expected at the end of last year than with the expansion in aggregate demand that was eventually observed. Likewise, investment remains 2% below the figures reached in the third quarter of the previous year. The factors behind this contraction are those that were used at the time to justify a possible fall in GDP in Spain. Furthermore, the increase in energy and food prices has undermined the competitiveness of companies and reduced the purchasing power of household income and wealth. Moreover, the increase in official interest rates has increased the cost of financing for the private sector, which has negatively impacted credit-intensive sectors. Lastly, households had brought their saving rate to levels below the historical average in the central months of 2022, which foreshadowed a future correction in consumption.

Fortunately for the domestic producer, households have concentrated part of the adjustment in consumption on foreign travel. Spanish consumption outside the country has fallen by 15% since the third quarter of 2022. Data on card spending by BBVA customers confirm this trend, and also show that travel agencies are among the sectors most affected by this strategy. Moreover, this import substitution has also been reflected in the origin of the energy sources used domestically: the increase in renewable energy production has been replacing non-renewable energy, despite the drought. Furthermore, there has been a pause in the recovery of automobile sales. Nowadays, households buy 28% fewer cars than they did four years ago. The pent-up demand that would have originated during the pandemic remains, and the problem seems to be more on the supply side. Although domestic production and exports in the sector are beginning to normalize, imports have not consolidated the recovery they showed at the end of 2022.

The partial reversal of some of the factors that have limited the growth of consumption and investment anticipates a greater contribution to growth from domestic demand in the upcoming quarters. Lower commodity and, mainly, fuel prices have allowed inflation to fall to around 3% in May. If sustained, it is estimated that the change in the outlook seen over the last six months in the cost of energy could add almost 1.0 pp to GDP in 2023 (compared to a scenario in which prices would have remained relatively high). Moreover, **the downward adjustment in inflation expectations in the EMU suggests that the end of the cycle of increases in the cost of financing is nearing its end.** BBVA Research forecasts that the interest rate could rise by only 50 bps more, reaching 4.25%, after having risen 250 bps in 2H2022 and 375 bps by May this year. Lastly, given the good performance of disposable income and the contraction of private consumption, the saving rate would have increased again above what can be explained by its traditional fundamentals, both in the fourth quarter of 2022 and the first quarter of 2023. These resources accumulated during the last half of the year could be converted into higher spending as uncertainty about the cost of the consumption basket diminishes, confidence in the labor market situation consolidates and the end of the increase in the cost of financing is confirmed.

The signing of the 5th Employment and Collective Bargaining Agreement (AENC for its Spanish acronym), and the decline in inflation, will increase certainty about the performance of incomes and their purchasing power. For one thing, wage increases (4% in 2023, 3% in 2024 and 2025)[1] do not represent a deviation from what had been observed throughout the year: at the end of last year, remuneration per employee was increasing at 4%, while BBVA Research expects it to increase by 3.4% in 2023 and 5.0% in 2024. Furthermore, labor productivity is expected to improve in 2023 and 2024 and its cumulative growth is expected to outpace that of real wages. Therefore, in the most likely scenario, the agreement is expected to be consistent with maintaining business competitiveness, with companies continuing to create jobs and with inflation converging to levels around 2% in 2024. This security may help to encourage investment and release some of the savings held by households. In any case, it will be essential to translate these guidelines into sectoral and company agreements. Social stability and economic growth depend on collective bargaining agreements taking into account the situation of the companies, so that those that have more room to improve the conditions of the agreement, do so, while in those where the situation continues to be delicate, decisions consistent with the preservation of employment are adopted.

The normalization of production chains in the world economy, together with the increase in immigration, are beginning to ease some of the supply-side constraints that were limiting GDP growth. Output in certain industry sectors continues to be below pre-pandemic levels, despite improved demand. Investment in transportation equipment shows figures 22% lower than those observed in 2019. A large part of this drop is

1: With a guarantee clause limited to 1 additional point if inflation in the December of each year exceeds the agreed revaluation.

explained by the lack of vehicles, as a consequence of the disruption in value chains in key sectors. Nevertheless, the available indicators point to an improvement in the coming months, which will allow companies to renew their fleets. Meanwhile, the number of unfilled vacancies in Spain has been increasing over the past year. The lack of adequately trained human capital continues to be one of the main constraints to move growth forward. However, there has been a significant increase in immigration, which more than compensates for the drop in the Spanish labor force. This is allowing further progress in job creation, investment and, to the extent that the number of families and their incomes increase, the potential for growth in domestic demand.

Fiscal policy will continue to be expansionary in the short term. After reaching levels of almost 5% of GDP at the end of 2022, the reduction in the public deficit is expected to be moderate (to 4.2% in 2023 and 3.5% of GDP in 2024) and largely explained by the economy's performance. Most of the measures in place to mitigate the impact of rising inflation could be maintained until the end of the year. In addition, the pace of the execution of projects related to NGEU funds ensures investment is supported. In particular, it is noted that the bidding and awarding of these programs has reached a cruising speed of around 10 billion every twelve months. The impact will not only be seen in expenditure on gross fixed capital formation, but a significant improvement in the competitiveness of companies should begin to be observed over the next two years, as external energy sources are replaced by domestic ones and progress is made in changing the production model.

By 2024, there are doubts about how much longer growth can be sustained in some sectors. Various indicators point to the accommodation and hospitality industry soon reaching the used capacity levels of 2019. Restrictions on the increase in hotel supply make it unlikely that additional increases in demand will be accompanied by an increased availability of beds. The sector faces the challenge of moving toward higher quality products that justify the price increases that may occur and that, in the absence of service improvements, may result in a loss of competitiveness. In addition, there is uncertainty as to how sustainable the recent growth in non-tourist services exports is. Finally, the drought has been a major blow to the agri-food sector. According to BBVA Research estimates, the abnormal lack of rainfall during the first half of 2023 would have reduced quarterly agricultural GVA growth by 2.2 pp each quarter. If these conditions continue over the next few months, the effects could be greater.

Housing investment will continue to be limited by supply constraints and regulatory changes. Fixed capital formation in housing is currently 15% below pre-crisis levels despite a strong rebound in demand. The new housing law does not encourage the construction of new buildings, either to be offered for rent or to be purchased. To the contrary, it introduces disincentives by facilitating price caps; by introducing uncertainty and increasing regulation, especially for large landlords (which goes against the efficiency of the sector and its competition), or by increasing rigidity in rental contracts. The approved tax incentives (or penalties) are not expected to change the picture significantly, as the lack of legal certainty for landlords will continue to be the most important reason behind a reduced supply of rental housing. Announcements to increase public housing inventories are welcome. However, there are doubts about the adequacy of the resources allocated or the suitability of the location of the assets to be acquired or where the public works will be carried out. For example, the accumulation of inventories by regional governments will be discretionary and will depend on the fiscal leeway of each regional government. In the absence of modifications that would allow for a significant increase in developable land near the main urban centers, the price stress is likely to continue for the next few years.

Uncertainty also persists as to how long this episode of high inflation and high financing costs will last. It is possible that the recovery in consumption over the next few months will be limited by the desire of households to increase their saving rate, either because they perceive that they have to rebuild their wealth after the sharp loss of purchasing power, or because of the incentives that the increase in the return on deposits will bring. Accordingly, the transmission of changes in monetary policy has been greater in the cost of financing and slower in the remuneration paid by banks. Over the next few months, there may be a convergence, as high liquidity decreases and it becomes profitable for the financial sector to borrow from savers. In addition, both companies and households have used part of the resources accumulated during the pandemic to reduce their financial costs. This could be behind the acceleration in mortgage loan repayments and the lack of dynamism in new corporate financing operations, despite an environment of higher costs and economic growth. However, unlike households, companies continue to have short-term liquidity needs and will eventually exhaust savings and resort to bank credit, at a higher cost.

Although the arrival of NGEU funds seems to be picking up speed, there is uncertainty about their short-term impact on investment. Despite public works tenders more than doubling the levels of the end of 2019, investment in other construction, which is traditionally directly related to such construction, remains at similar figures to those of four years ago. There are several readings that can be made here. If we look at the historical relationship, an increasingly important part of the investment in other constructions would be linked to public projects. BBVA Research estimates that, in the absence of NGEU funds, investment in other construction and machinery and equipment (excluding transportation equipment) would be 18% below current levels in constant terms. Therefore, either there are other factors that are reducing the remaining investment needs (rising interest rates, inflation, uncertainty, etc.), or there is a substitution of private for public investment. Another possibility is that, unlike in similar historical episodes, investment is now being used to accumulate other assets, such as machinery or intellectual property, or is being spent on services, such as consulting. Finally, there is the possibility that projects are being delayed somewhat longer than normal as a result of the bureaucracy surrounding the granting of subsidies or the processing of tenders.

Fiscal policy could take a contractionary tone next year, as fiscal rules in the EMU become effective again. The public deficit in Spain does not appear to be consistent with the cyclical position of the economy. The last time the unemployment rate was at levels similar to today's (12.9%, on average, in 2022) and the economy was not in recession (as in 2008) was at the turn of the century. At that time, the public accounts showed a primary surplus (excluding interest payments) of 2% of GDP, and general government debt stood at 57% of GDP. Today, the primary deficit is 2.3% of GDP and public debt stands at 113.2% of GDP. Another benchmark to consider is 2019, when the primary balance was 0.6% of GDP and the unemployment rate was 14%. The entire deterioration in the public accounts since then is due to the increase in spending, which rose by 5.5 pp of GDP. Following the announcement of the new fiscal rules by the European Commission (EC), consideration will have to be given to how to make the adjustment over the next few years. The EC proposal requires, as a minimum, measures equivalent to an effort of 0.5% of GDP per year and it is possible that a large part of the effort will have to be made during the first years of the adjustment.

The uncertainty surrounding economic policy increases in the short term with the call for a general election, but shortens over time. This takes the private sector without imbalances, with debt levels even below those of the EMU as a whole. As for the public sector, it is one of the countries to which more NGEU resources have been transferred, having met milestones such as the labor or pension reforms. The nearness of the general elections with respect to their announcement should reduce the period of uncertainty that would have arisen if the deadlines had expired. Although the budgetary processes toward 2024 could be affected by the lack of necessary alignments such as deficit targets, spending caps, etc., the formation of a new central government during the second half of the year could clarify the outlook.

Tables

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

	2020	2021	2022	2023	2024
United States	-2,8	3,7	2,1	1,1	0,6
Eurozone	-6,3	5,3	3,5	0,8	1,3
China	2,2	8,5	3,0	5,7	4,8
World	-2,8	6,4	3,4	2,9	2,9

* 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	1.3	4.7	8.0	4.3	3.1
Eurozone	0.3	2.6	8.4	5.5	2.7
China	2.5	0.9	2.0	1.5	2.0
World	3.6	5.1	9.3	7.4	6.4

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: June 9, 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	3.59	3.53
Germany	-0.48	-0.31	1.18	2.57	2.72

Forecast closing date: June 9, 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	0.92	0.86
USD-EUR	1.14	1.18	1.05	1.09	1.16
CNY-USD	6.91	6.45	6.73	6.90	6.75

Forecast closing date: June 9, 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	3.50
Eurozone	0.00	0.00	2.50	4.25	4.00
China	4.35	4.35	4.35	3.65	3.65

Forecast closing date: June 9, 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**	**3.6**	**0.8**	**1.3**
Private consumption	-7.8	3.7	4.3	0.3	1.6
Public consumption	1.0	4.3	1.4	0.9	0.5
Gross fixed capital formation	-6.4	3.9	3.8	-0.3	2.3
Inventories (*)	-0.3	0.2	0.3	0.0	0.0
Domestic demand (*)	**-5.7**	**4.0**	**3.7**	**0.3**	**1.4**
Exports (goods and services)	-9.3	10.6	7.2	2.0	2.2
Imports (goods and services)	-8.8	8.3	8.1	1.1	2.7
External demand (*)	**-0.6**	**1.3**	**-0.1**	**0.5**	**-0.1**
Prices and Costs					
CPI	0.3	2.6	8.4	5.5	2.7
CPI Core	0.7	1.5	3.9	5.0	3.1
Labour Market					
Employment	-1.5	1.4	2.3	0.9	0.5
Unemployment rate (% of labour force)	8.0	7.7	6.7	6.6	6.7
Public sector					
Surplus (+) / Deficit (-) (% GDP)*	-7.1	-5.3	-3.6	-3.5	-2.7
Public debt (% GDP)*	97.2	95.5	91.6	89.6	89.2
External Sector					
Current Account Balance (% GDP)	1.5	2.3	-1.1	1.3	1.6

Annual rate change in %, unless expressly indicated.
Forecast closing date: June 9, 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**	**2.4**	**2.1**
Private Consumption	-12.2	6.0	4.4	0.7	2.6
Public Consumption	3.5	2.9	-0.7	1.8	2.9
Gross Fixed Capital Formation	-9.7	0.9	4.6	2.7	5.6
Equipment and machinery	-13.3	6.3	4.0	1.6	5.8
Construction	-10.2	-3.7	4.7	3.0	6.1
Housing	-11.4	-4.8	3.1	0.3	4.0
Domestic Demand (contribution to growth)	**-9.1**	**5.2**	**3.1**	**1.6**	**3.3**
Exports	-19.9	14.4	14.4	5.2	2.9
Imports	-14.9	13.9	7.9	3.4	5.8
External Demand (contribution to growth)	**-2.2**	**0.3**	**2.4**	**0.8**	**-1.2**
GDP at current prices	-10.2	7.9	10.0	8.5	6.0
(Billions of Euros)	1118.0	1206.8	1327.1	1440.4	1526.5
Labour market					
Employment, Labour Force Survey	-2.9	3.0	3.1	2.4	2.0
Unemployment rate (% Labour force)	15.5	14.8	12.9	12.3	11.7
Employment, full time equivalent	-6.8	6.6	3.8	1.6	1.6
Productivity	-4.5	-1.1	1.7	0.7	0.5
Prices and Costs					
CPI (average)	-0.3	3.1	8.4	3.4	3.2
CPI (end of period)	-0.5	5.8	5.7	4.0	2.9
GDP deflator	1.1	2.4	4.5	6.2	3.9
Compensation per employee	2.5	-0.8	2.0	3.4	5.0
Unit Labour Cost (ULC)	7.0	0.3	0.3	2.6	4.5
External sector (*)					
Current Account Balance (% GDP)	0.4	0.9	0.6	2.2	2.0
Public sector					
Debt (% GDP)	120.4	118.3	113.2	108.5	106.0
Deficit (% GDP) (*)	-9.9	-6.8	-4.7	-4.2	-3.5
Households					
Nominal disposable income	-2.0	3.1	3.6	5.5	5.6
Savings rate (% nominal disposable income)	17.6	13.7	7.2	6.7	6.2

Annual rate change in %, unless expressly indicated.
Forecast closing date: June 9, 2023.
(*) Excluding financial aid for Spanish banks.
Source: BBVA Research.

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