BBVA Research

Creating Opportunities

Spain Economic Outlook

October 2023

Situation and outlook for the Spanish economy

October 2023

The 2023 GDP growth forecast remains unchanged (2.4%), but the 2024 forecast is revised downward from 2.1% to 1.8%, given the moderate deterioration in the global outlook in an environment of high uncertainty. Data that anticipates the performance of activity, particularly in Europe, show a generalized worsening across countries and sectors. The recent increase in oil prices has been added to this. In Spain, productivity per hour of work would have shown an unexpected fall in the second quarter of 2023. In addition, supply problems are perceived in certain sectors, and domestic demand will be constrained by high interest rates and the necessary reduction of the public deficit the following year. Although the bias in this scenario is downward and economic policy uncertainty could increase over the coming months, the recovery may continue thanks to the strength of household and corporate balance, the expected normalization of industrial activity, the support from European funds, and the increase in the working-age population.

The annual revision of the national accounts and recent developments in activity indicators point to economic growth in 2023 in line with what was forecast in the previous edition of this publication. GDP was revised upward in the second half of 2022 and in the first half of 2023. This implies a positive bias of 0.2 percentage points (pp) on the growth outlook for the current year. Consumption, both private and public, and exports of goods have turned out higher than previously estimated by the INE, even though the increase in foreign sales of services has moderated and the accounts now show a more modest recovery in investment. The latter is particularly negative, as it implies a reduction in the future growth capacity of the Spanish economy and a further downward bias on productivity growth over the coming years. The statistical revision pushed forward the return to pre-pandemic GDP levels to the first half of 2022. Total hours worked have also surpassed the 4Q19 threshold, resulting in reduced productivity growth per hour worked over the past four years. Lastly, labor income has now fully recovered while capital income still remains below 2019 levels.

In 2Q23 we observed a drop in productivity per hour worked, in addition to the beginning of a slowdown in job creation, generalized by activity sectors, which coincides with the deterioration of some confidence indicators. The strong increase in total hours worked during the second quarter of the year was not matched by a corresponding increase in GDP. This may indicate diminishing returns in the recovery process, as a result of the convergence of this indicator toward its long-term trend. In any case, the monthly increase in Social Security affiliation has moderated since June, from increases of 76,000 contributors on average per month (after adjusting for seasonality and working-day effects), to 15,000 since then.[1] **This could place GDP growth in 3Q23 at 0.2% quarter-on-quarter (1.8% year-on-year).** Although the weakening in job creation is widespread, the services sector stands out. The slowdown has been of particular importance in jobs related to tourism (restaurant and accommodations services) and public spending (Public Administrations and Social Security). In this respect, some hiring decisions may have been pushed forward to the first half of the year, either as a result of the strong recovery in tourism spending or as a result of the electoral cycle. It is also possible that structural changes are taking place in some sectors or types of companies as a result of the labor reform. Finally, the slowdown coincides with the global deterioration of indicators such as PMIs, which point to a contraction of activity in services. This would reflect both the exhaustion of the effect following the end of the lockdowns and the contagion of stagnation in industry to the rest of the economy.

1: See, for example, Spain | 2Q2023 Quarterly Labor Market Observatory, September 22, 2023.

There is a change in the composition of growth, more focused on the advance of domestic demand and less on external demand. Household consumption has registered two consecutive quarters of growth, weighed down only by spending outside Spain. This recovery corresponds to the decrease in the uncertainty related to the cost of energy, to the good performance of the labor market—supported by foreign tourism—and to the growth of wages. Construction investment has picked up, which may be a reflection of the rollout of Next Generation EU (NGEU) funds, as the largest increase is in non-residential fixed assets. Similarly, although housing demand falls compared to what was observed a year ago, affected by the increase in the cost of funding, levels are still above those recorded in 2019. The tension seen between supply and demand, along with high rental prices, will likely continue to support investment in the sector, although regulation will prevent the contribution from being significant. Finally, exports slow the pace in the wake of the loss of dynamism observed in the eurozone economies and a certain exhaustion after the strong growth of previous quarters.

There is a recent deterioration in the growth outlook for the eurozone, where GDP is expected to increase by only 0.4% in 2023 and 1.0% in 2024 (compared to the 0.8% and 1.3% previously expected). The evolution of the confidence indicators suggest that eurozone activity may be contracting in the third quarter of the year. Industry is suffering from a lag in recovery that is probably more structural than cyclical. The downturn appears to be widespread and is also affecting the services sector. Investment spending is negatively affected by rising costs and uncertainty about future performance in manufacturing. Household consumption is constrained by the loss of purchasing power, the increase in the financial burden and the exhaustion of the effect following the end of lockdown measures. The slower growth of Spain's main trade partners suggests that **the contribution of external demand during the coming quarters could continue to be negative. BBVA Research estimates that the worsening of eurozone growth forecasts since the beginning of the year will subtract 0.3 pp and 0.2 pp from GDP growth in Spain during 2023 and 2024, respectively.**

This situation is coupled with the recent rise in the price of oil. Even though the fall in the cost of fuel during the first half of the year seemed excessive, the measures taken by producing countries to restrict supply have had a greater impact than expected, pushing the value of a barrel of oil to levels that, if consolidated, could pose a major obstacle to recovery. The scenario presented here assumes an oil price of $82 and $84 per barrel, on average, during 2023 and 2024, respectively, which implies a drop compared to 2022 ($99 per barrel). This would prolong the tailwind of the decline in fuel prices over the past year. However, maintaining values closer to those seen in 2022 poses a downside risk to growth over the coming months. Given that the origin of the higher cost has to do with supply restrictions and not with greater demand, the impact on the Spanish economy could be significant: **BBVA Research estimates that for every 10% increase in the price of oil linked to decisions by producing countries to limit the amount of crude oil exported, GDP could suffer by around 0.3 pp**.[2]

At the domestic level, services could begin to show signs of depletion as unused capacity disappears and the outlook for external demand becomes more moderate. Despite the revisions made by the INE, spending by residents of foreign countries in Spain is 21% higher than in 4Q19, and exports of non-tourist services are also 24% above the pre-pandemic level. Different indicators in the tourism sector point to occupancy figures reaching record highs,[3] in an area of the economy where it is difficult to increase supply in the short term, given the restrictive regulations. In addition, significant negative external factors are beginning to be observed, as a result of agglomeration, water use and environmental pollution. The future development of the rest of the services exports is a major unknown, given the lack of information and analysis of the drivers behind their strong performance.[4] In any case, their significance for growth over these two years is notable: their contribution, combined with non-resident consumption, explains 2.7 pp of the average annual increase in GDP in 2022 and 2023, i.e. 65% of the expected

2 The impact of oil prices caused by supply factors is calculated using an identified SVAR model with signs and zeros restrictions, where these shocks are orthogonalized with respect to those caused by global demand, supply in the global gas market and in the domestic electricity market.
3 See, for example, Spain | Analysis of national tourist flows in real time between May and August of 2023.
4: See Spain | Recent trends in Spanish exports, July 27, 2023.

increase in activity. In an environment where European household spending slows down, or where there are supply-side problems leading to losses in competitiveness, **the contribution to growth of both sectors may be zero the following year.**

Inflation again surprises moderately on the upside due to higher fuel costs, although the slow decline in core inflation is in line with expectations. BBVA Research estimates that a 10% increase in the price of a barrel of oil could boost inflation by one to two tenths over the next twelve months. The forecasts presented here are consistent with a correction from current levels to prices more in line with the average expected for the year as a whole ($82 per barrel). Similarly, it is assumed that the drought will not continue to contribute to keeping inflation high due to higher food prices. However, a normal year of rainfall could help contain price growth. In any case, core inflation has stopped falling in recent months. Various leading indicators of the trend in price developments suggest downward rigidity. For example, the percentage of goods and services within the consumer basket whose price increase is below 2% has remained constant since the beginning of the second quarter, at around 40%, while a number consistent with the target would be around 70%. This difficulty in continuing the upward trend reflects the fact that services, which are labor-intensive, are beginning to carry over the increase in labor costs. The latest data show that wages and salaries per employee are growing by almost 6%. Given that, inflation is likely to end the year above 4%, this will mean that the safeguard clause agreed in the 5th Agreement for Employment and Collective Bargaining will have to be applied, with the recommendation being to agree on wage increases of 5% (instead of 4%). In addition to this, there is the increase in Social Security contributions brought about by the pension reform. Among the issues that could begin to contribute to deficit reduction are the measures implemented to limit the increase in transportation and electricity generation costs. The aid that remains should be focused on vulnerable groups or sectors that are particularly exposed to the increase in energy costs. Beyond that, as discussed below, the next government will have to announce measures to reduce the public deficit. In view of the above, it is difficult to foresee a drop in inflation in 2024 toward levels consistent with the ECB's target in the absence of a significant reduction in the price of oil or an economic downturn. **Thus, inflation in both 2023 and 2024 can be expected to average close to 4% (3.8% and 3.7% respectively).**

The tightening of monetary policy continues to be transferred to the economy. The cost of funding continues to increase for households and companies. The private sector has decided to optimize the management of its financial assets and liabilities. One of the consequences is the sharp increase observed in mortgage repayments, which since June last year have risen by 25% above the average for the first part of 2022. In addition to the advance in the payment of liabilities, a fall in demand has been observed as a consequence of the increase in the cost of credit. This is observed both in new mortgage loan operations (-17.5% in the first seven months of the year compared to the same period in 2022) and in financing to companies for amounts over one million euros (-21.1% in the same period). This is despite the fact that liquidity in the Spanish banking sector is abundant, there are no capital problems and non-performing loans are not increasing. BBVA Research expects monetary policy rates to remain at their current levels (4.5% for the refinancing rate). The pause is likely to be prolonged, although the bias continues to be that, if there are short-term changes, they will be in the direction of making credit more expensive. In fact, the scenario presented here is consistent with the refinancing rate starting to fall only at the end of next year. High interest rates, for a prolonged period, with anchored inflation expectations, are slowing the rate at which domestic demand can grow in 2024.

Uncertainty about economic policy may increase in the coming months. So far, various indicators do not show a deterioration in confidence, despite the early elections. For example, the risk premium paid by the Treasury on German debt remains relatively constant at around 100 basis points.[5] Likewise, economic policy uncertainty indicators continue at low levels, without replicating the increases observed in previous electoral cycles. In any

5: See Spain | Regional Government debt, September 25, 2023.

case, there is a delay in the processes to have a government budget for the following year that is consistent with European commitments. The lack of objectives will mean that different government administrations will have to move forward in their income and expenditure planning without any apparent coordination. In the scenario presented in this publication, it is assumed that the general state budget will be extended to 2024. Although at first glance this may seem to help contain spending, experience shows that the structural improvement observed in the imbalance of the public accounts has been marginal during previous years in which the same circumstances were experienced. This becomes important as during the latter part of 2023 there will be an agreement on how tax rules will be re-implemented in Europe. The need to dispel doubts about how the public deficit will be reduced is all the greater, as it is expected that, despite the ongoing recovery, **the imbalance in the accounts will remain constant in 2023 at around 4% of GDP**. Given the slowdown in economic activity expected for the following year, it is possible that the cycle will not be able to contribute much to the reduction of the deficit. Therefore, **the next government will have to announce measures equivalent to about 1.0 pp of GDP if it wishes to comply with bringing the imbalance below 3% of GDP**, in addition to eliminating the policies that were adopted to mitigate the impact of the increase in energy and food prices.

The shift towards lower growth, more supported by private domestic demand, will continue over the coming quarters, thanks in part to the improvement in the terms of trade. While it is true that the cost of a barrel of oil has risen, it is also true that the value of various imported goods has fallen in recent months. One example is gas, which seems certain to be available for the coming winter. **BBVA Research estimates that the progressive downward corrections in gas price expectations since the beginning of 2023 could well be adding just under one percentage point to GDP and limiting inflation by one point.** Also, over the last year, efficiency in energy use has improved, which partly explains why electricity consumption has fallen, even though recovery has continued. Moreover, the production and import of materials needed to increase the supply of renewable energy anticipates a reduced dependence on foreign fuels over the next few years. These trends will mean that, in the medium term, households will recover the purchasing power lost in the last year and a half, while companies will be able to limit the loss of competitiveness and even reverse part of it.

Household consumption has room to recover, supported by accumulated wealth and improved disposable income in real terms. The increase in household savings at the end of last year and the beginning of this year has contributed to further improving their balances. The downside is that consumption remains below the levels reached before the pandemic, despite the fact that both GDP and labor income have now fully recovered. In fact, **Spain stands out as one of the eurozone countries with the greatest difference between the current level of consumption and that of the end of 2019**. Part of the financial wealth accumulated during the pandemic has been used to reduce debt or to buy real estate assets. However, households maintain a cushion that can be used for consumption, which will only be possible in an environment of certainty regarding the performance of the labor market and low volatility in the financial markets. The latter will happen as central banks progressively announce the end of interest rate hikes, and reductions are even expected in the second half of 2024. It is also to be expected that wages will continue to grow above inflation during these two years. The turning point for the purchasing power of wages should allow households to continue to reduce their accumulated "excess" wealth and use it to increase their consumption during the coming quarters. **BBVA Research estimates that household disposable income could increase by just over 2% in real terms in 2024 and that this could account for almost all of the expected growth in private consumption (2.0%).**

The impact of the interest rate hike on households' financial burden is coming to an end. The 12-month Euribor, the main reference for mortgage financing, reached 3.8% in April and has remained at around 4% since then. In a market where most of the balances of home purchase loans are at variable interest rates and the installment is updated every six months, most households would already have a good idea of how much their financial costs will rise. In addition, **BBVA Research estimates that, in 2024, the financial burden on**

households (as percentage of their disposable income) will be similar to what it was before the pandemic. To understand this, despite an environment of higher rates, it is important to remember that 30% of mortgages have been taken out at a fixed rate. In fact, one of the consequences of the greater weight of this type of loan is that interest rates for new operations have not increased as much as in the past: **BBVA Research estimates that the cost of mortgage financing would be more than 1 percentage point above what is currently observed if it were not for the growing significance of fixed-rate debt.** Moreover, as mentioned before, there has been a significant increase in repayments, which has reduced indebtedness. Finally, the way mortgage payments are calculated means that the oldest part of the current balance (where most variable-rate contracts are) repays more and more principal.

The factors hampering recovery in some parts of the industry, beyond energy costs, could gradually disappear. The clearest example is the automotive sector. Since the start of the pandemic and up to July 2022, production remained 22.5% below the level observed during 2019. Since then, supply has increased and was just 6.8% lower through July. One of the causes has been the growth in transportation investment, which, after hitting all-time lows in 4Q21 with levels 35% below what was observed at the end of 2019, has recovered to show relatively similar figures in 2Q23. Going forward, this component's contribution to domestic demand should be positive, especially taking into account the aging of business fleets and the expected transition to electric vehicles. Additionally, the normalization of production chains at a global level, together with the Chinese economy's need to grow, may lead to cost reductions and greater availability of key inputs for manufacturing to function smoothly.

Investment will be underpinned by the Next Generation EU funds and by the expected increase in the use of these funds. So far, the fixed capital accumulation in non-residential construction continues to show levels below what would be expected given the strong growth in tenders for public works. This behavior, weaker than initially expected, may be due to the coincidental timing of the increase in energy prices, its impact on inflation, the structural change experienced by some sectors of industry, the imported component in part of the inputs needed to boost renewable energy production and the rise in interest rates. However, the increased pace of spending authorization has been notable during the first seven months of 2023, reaching around €17 billion, almost double that of the same period in 2022. BBVA Research thus estimates that, in the second quarter of 2023, investment in other construction and machinery and equipment (excluding transport equipment) would have been 15 pp above year-end 2019 levels. However, in the absence of NGEU funds, this investment would be 14 pp below.

Immigration is the main driver of the increase in employment and is propelling GDP growth in the medium term. Almost all of the increase in the labor force in Spain is due to the flow of working-age people from abroad. Although it is true that, the positive momentum in the labor market is attracting a greater number of inactive people to seek employment, the increase is not as significant as that seen in the rest of the eurozone. As mentioned in the previous Spain Economic Outlook, most of the employment being created is for people of foreign nationalities, particularly women. Without this immigration, the growth in labor supply, especially in the services sector, would probably have been limited. The expected aging of the resident population in Spain over the next few years makes it necessary to explore various alternatives to continue creating wealth and improving quality of life. On the one hand, it is necessary to facilitate a longer working life. On the other hand, it would be advisable to improve the skills of those who have been unemployed for a long period of time and to explore incentives to encourage their hiring. It is also a priority to increase the efficiency of the social benefits that different public administrations provide. In any case, this will not be enough, so it will be necessary to adopt an immigration policy that complements the human capital residing in Spain, promotes employment growth and has a positive impact on productivity.

Tables

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

	2020	2021	2022	2023	2024
United States	-2.8	3.7	2.1	2.3	1.5
Eurozone	-6.3	5.6	3.4	0.4	1.0
China	2.2	8.5	3.0	4.8	4.4
World	-2.8	6.5	3.4	2.9	3.0

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: September 28, 2023.
Source: BBVA Research & FMI.

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

	2020	2021	2022	2023	2024
United States	1.3	4.7	8.0	4.0	2.4
Eurozone	0.3	2.6	8.4	5.7	3.0
China	2.5	0.9	2.0	0.5	2.0
World	3.6	5.1	9.3	7.4	7.0

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: September 28, 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	3.92	4.19
Germany	-0.48	-0.31	1.18	2.51	2.72

Forecast closing date: September 28, 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	0.90
USD-EUR	1.14	1.18	1.05	1.08	1.12
CNY-USD	6.91	6.45	6.73	7.09	7.11

Forecast closing date: September 28, 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	5.50	4.75
Eurozone	0.00	0.00	2.50	4.50	4.25
China	3.85	3.80	3.65	3.35	3.35

Forecast closing date: September 28, 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**	**5.6**	**3.4**	**0.4**	**1.0**
Private consumption	-7.8	4.1	4.3	0.3	1.3
Public consumption	1.1	4.1	1.4	0.0	0.4
Gross fixed capital formation	-6.5	3.6	2.9	1.2	2.3
Inventories (*)	-0.2	0.3	0.4	-0.3	0.1
Domestic demand (*)	**-5.7**	**4.2**	**3.5**	**0.2**	**1.3**
Exports (goods and services)	-9.3	11.0	7.2	0.1	1.5
Imports (goods and services)	-8.7	8.7	8.1	-0.5	2.3
External demand (*)	**-0.6**	**1.4**	**-0.1**	**0.3**	**-0.3**
Prices and Costs					
CPI	0.3	2.6	8.4	5.7	3.0
CPI Core	0.7	1.5	3.9	5.2	3.2
Labour Market					
Employment	-1.4	1.5	2.3	1.1	0.4
Unemployment rate (% of labour force)	8.0	7.7	6.7	6.5	6.8
Public sector					
Surplus (+) / Deficit (-) (% GDP)*	-7.1	-5.3	-3.6	-3.3	-2.8
Public debt (% GDP)*	97.2	95.5	91.6	89.3	89.1
External Sector					
Current Account Balance (% GDP)	1.7	2.8	-0.8	1.5	1.9

Annual rate change in %, unless expressly indicated.
Forecast closing date: September 28, 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	**-11.2**	**6.4**	**5.8**	**2.4**	**1.8**
Private Consumption	-12.3	7.1	4.7	2.0	2.0
Public Consumption	3.6	3.4	-0.2	2.7	1.1
Gross Fixed Capital Formation	-9.0	2.8	2.4	2.5	7.1
Equipment and machinery	-12.6	4.4	1.9	-1.0	8.1
Construction	-9.2	0.4	2.6	4.1	4.9
Housing	-9.7	0.9	1.4	1.5	3.5
Domestic Demand (contribution to growth)	**-9.0**	**6.6**	**2.9**	**1.9**	**2.7**
Exports	-20.1	13.5	15.2	2.7	2.2
Imports	-15.0	14.9	7.0	1.5	4.7
External Demand (contribution to growth)	**-2.2**	**-0.2**	**2.9**	**0.5**	**-1.0**
GDP at current prices	-10.2	9.2	10.2	8.7	5.6
(Billions of Euros)	1119.0	1222.3	1346.4	1463.3	1545.0
Labour market					
Employment, Labour Force Survey	-2.9	3.0	3.1	2.5	1.8
Unemployment rate (% Labour force)	15.5	14.8	12.9	12.2	11.9
Employment, full time equivalent	-6.5	7.1	3.7	1.9	1.4
Productivity	-4.7	-0.7	2.0	0.6	0.4
Prices and Costs					
CPI (average)	-0.3	3.1	8.4	3.8	3.7
CPI (end of period)	-0.5	5.8	5.7	4.4	3.5
GDP deflator	1.0	2.8	4.4	6.2	3.8
Compensation per employee	2.8	0.3	2.9	5.1	4.3
Unit Labour Cost (ULC)	7.5	1.0	0.8	4.5	3.9
External sector (*)					
Current Account Balance (% GDP)	0.4	0.9	0.6	3.0	2.6
Public sector					
Debt (% GDP)	120.3	116.8	111.6	106.8	104.5
Deficit (% GDP) (*)	-9.9	-6.7	-4.7	-4.1	-3.4
Households					
Nominal disposable income	-2.0	3.1	3.6	7.5	6.2
Savings rate (% nominal disposable income)	17.6	13.7	7.2	8.3	8.6

Annual rate change in %, unless expressly indicated.
Forecast closing date: September 28, 2023.
(*) Excluding financial aid for Spanish banks.
Source: BBVA Research.

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