BBVA Research

Creating Opportunities

Spain Economic Outlook

November 2023

Situation and outlook for the Spanish economy

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The 2023 growth forecast is maintained at 2.4%, the 2024 forecast is revised downward by 0.3 pp to 1.5% and in 2025 an acceleration to 2.5% is expected. The short and medium-term growth bias is negative as a result of the uncertainty regarding the extent of deterioration in activity in the eurozone, the global geopolitical context and the composition and magnitude of the public policies that may be implemented in Spain over the next few years. The expected reduction in inflation, together with the improvement in households' disposable income, would allow for a recovery of part of the purchasing power lost in the last two years. In addition, interest rates in the U.S. and in Europe have reached a ceiling and may begin to decline during the second half of 2024.

Growth in 4Q23 may be around 0.2% q/q, putting Spain on track to end the year with average growth of 2.4%. This figure is in line with the BBVA Research scenario published in October.[1] The INE has released preliminary 3Q23 data placing the GDP at 0.3% quarter-on-quarter (1.8% year-on-year), which is very similar to what was expected (0.2%). The trend in Social Security affiliation suggests that the pace of job creation should remain steady throughout the rest of the year. This is despite the negative impact that the volatility of the political cycle has had on government hiring, in an environment where both hospitality and manufacturing are holding up. Both quarterly national accounting data and real-time information confirm a change in the composition of growth in recent months, with domestic consumption gaining greater share, to the detriment of exports, which have fallen or stagnated, and private investment, which shows no discernible trend. However, the end of 2023 is leading to a moderation in the growth of household expenditure. These behaviors are not likely to change much in 4Q23, although private consumption (0.4% quarter-on-quarter) is growing more moderate, exports of tourism services are surprisingly strong (0.9%), while both investment (0.6%) and sales of goods abroad (1.0%) could correct upward after the disappointing data observed up to the third quarter of the year.

Geopolitical tension will prevent energy cost reductions over the next few months. After a period of high volatility, oil prices have stabilized at levels around $80 per barrel in recent weeks. However, further increases cannot be ruled out. In fact, the oil price is expected to average $86.50 per barrel over the next year, somewhat higher than what was forecast a couple of months ago ($84.30). The ongoing war in the Gaza Strip will remain a source of uncertainty and will continue to pose the possibility of other countries getting involved, either directly or using oil and gas as a weapon.

The average growth forecast for the EMU economy is revised downward by 0.3 pp in 2024 to 0.7%. Falls in activity persist in several European countries, particularly in industry. The difference in GDP growth between Spain and Germany has to do with the better performance of Spain's services sector and its greater weight in the Spanish economy.[2] Manufacturing has shown a similar stagnation over the past year. In particular, output in energy-intensive sectors fell sharply, which was partially offset by the recovery of output in the automotive sector. Regarding the latter, imports from China to meet the growing demand for electric vehicles could cast doubt on the competitiveness and technological capacity of several European producers in the coming years.[3] In addition to increased electricity, fuel expenditure and Chinese competition, companies face increased financial burdens and growing labor costs. Additionally, the European **fiscal policy** stance in 2024 will be contractionary for the first time since the start of the pandemic. Finally, the European Central Bank will have to ensure that the recent decline in

1: See Spain | GDP grew 0.3% q/q in 3Q23, slightly more than expected, BBVA Research, October 27, 2023.
2: "Quo Vadis Germany? A brief comparison between Spanish and German industry", BBVA Research (forthcoming).
3: See Consumption 2H23, BBVA Research, November 2023.

inflation holds over time. This will prevent monetary policy interest rates from falling before the second half of the year.

Supply problems persist in industry, in some services and in construction. The contribution of external demand to growth will be constrained by the environment of high energy and financial costs, slower progress in key trading partners and a lack of human capital. As the unemployment rate has fallen, companies have found it increasingly difficult to find workers with skills in line with what they need. The positive performance of non-tourist services exports may also be hampered by this lack of skilled workers. The high cost of housing, especially in cities where these high value-added services are expanding the most, is becoming a key factor for the attractiveness of the Spanish economy for investors. In the short term, several factors will prevent the tensions seen in the residential market from reversing. In particular, lack of developable land, labor shortages, insecurity for landlords resulting from recent legislative changes, along with strong employment, indicate that prices will continue to rise in an environment where supply growth will continue to be below demand growth.

Investment may be particularly impacted by an environment of high interest rates, a pull effect from NGEU funds that is less significant than expected and uncertainty about economic policy. New business loans for amounts exceeding €1 million continue to fall at double-digit rates. The deleveraging process of the private sector continues, not only due to the increased financial burden but also the lack of profitable projects. This occurs despite the injection of resources linked to the Recovery, Transformation and Resilience Plan. Given that gross fixed capital formation is barely 2.5% below levels seen at the end of 2019, this anemic performance reflects a very high impact of the increase in the cost of energy on investment prospects or a pull effect of the funds and the reforms implemented so far, well below what was previously estimated. This, together with the slow pace of the bidding and awarding of projects, suggests that the contribution to growth of these resources in the period 2023 to 2025 will be lower than initially estimated. An assessment of what has worked so far in the use of these resources would be desirable, as well as identification of bottlenecks that can be eliminated. Although it seems too late to accelerate the impact of these funds, the discussion of these obstacles can point to the need for administration reforms that will help future programs (such as the loans that will come with the addendum) have a greater impact.

Economic policy adds uncertainty to the future trend in labor costs, the tax burden and the Treasury's funding cost. Economic policy uncertainty does not seem to be increasing, despite the measures announced in the various government agreements. Some of these include new increases in the national minimum wage; amendments to termination benefits; reductions in the work week; the intention of increasing tax collection as a percentage of GDP by around 4 pp; and possible changes in the debt between public administrations without modifying the rules to prevent new future imbalances in the balance sheet of the autonomous community governments. In addition, there has been no agreement at European level on the new tax rules that will apply in the coming years. This is in addition to the likely extension of the measures that were implemented to limit the impact of the increase in energy and food prices on homes and companies. The next general state budgets will probably be approved well into 2024, which will mean that the ambitious fiscal consolidation process will have to occur in less than 12 months, increasing its negative effect on activity.

The reduction in the maximum legal workday proposed for 2024 and 2025 may have significant effects on activity and employment, especially for some sectors and groups. Until details are known, preliminary estimates from BBVA Research indicate that, in the absence of compensatory measures to ease the strain on labor costs (which we estimate could increase by around 1.5% of GDP), the cut in working time could subtract around 0.6 pp from average annual GDP growth over the next two-year period and 0.8 pp from employment growth. Given the estimated magnitude of the potential effects, it would be necessary to conduct a detailed evaluation of the proposal prior to its approval and involve the social stakeholders in the design and future implementation to ensure consensus. In this regard, policies aimed at reducing non-wage costs, such as social security contributions, and encouraging cooperation between companies and workers would help to accentuate the positive effects of the reform, minimize the negative ones and improve the competitive position of the Spanish economy.[4]

Forgiveness of part of the autonomous community debt would introduce moral hazard unless a credible institutional framework is agreed upon beforehand to prevent regional governments from accumulating imbalances in the future. The Autonomous Community Liquidity Fund already puts a limit on the increase in financial costs and represents a de facto reduction for the autonomous communities, given the subsidy it entails for their interest payments. Transferring a portion of its obligations to the state, without the latter increasing its revenues or reducing its expenditures, may lead to a rebound in the central government's net borrowing, which could result in deterioration of the cost at which the Treasury is financed. Additionally, there are regional governments whose accounts show a high structural deficit. Reducing indebtedness without addressing the financing problem would lead to a fruitless exercise that would be costly for the taxpayer. Therefore, it would be advisable to reach a consensus beforehand on the changes needed in the financing system and the institutional framework that will guarantee the sustainability of regional accounts. The result should allow for recurring evaluation, give more monitoring power to independent entities, and introduce flexibility, in addition to giving the autonomous communities a greater degree of decision-making power over the services provided and the resources that finance them.

Improved growth is expected in 2025, in line with what should be observed in the eurozone as a whole. GDP growth in the EMU could rise from 0.7% to 1.7% in 2025 as companies adapt to higher energy costs. These have encouraged measures to improve efficiency in the use of electricity and fuel, in addition to increasing investment in alternative energy sources that should limit future cost increases. The same can be said of the obstacles that have prevented industrial output from being able to respond to increases in demand. Finally, although interest rates are expected to remain high for an extended period of time, the decline in inflation—and especially the risks to activity in 2024—could accelerate the reduction in the cost of financing. BBVA Research now estimates that the first decrease in the monetary policy rate could occur around September of next year. The 12-month Euribor would close at 3.70% and 2.95% at the end of 2024 and 2025, respectively; 25 and 55 bp below what was forecast a couple of months ago. This would ease the cost of corporate and household borrowing needs, especially in the short term, although the reduction will also be apparent in long-term rates.

The tourism sector should be in better shape over the next few months as activity in host countries gathers momentum and thanks to geopolitical uncertainty and the greater scope for growth stemming from investment and immigration. The recovery expected in the eurozone during the second part of 2024 and all of 2025 will sustain the overall growth of exports. It is also possible that the tension in the Gaza Strip will redirect part of the tourism that otherwise would have visited North Africa or the Middle East toward Spain, with effects similar to—although more moderate than—those seen in the wake of the Arab Spring or the coup d'état in Egypt in 2013.[5] Perhaps the most positive news, however, comes from the easing of restrictions that could have limited medium-term growth in the sector. The downward revision of non-resident consumption in the quarterly national accounts suggests that capacity utilization is not as high as previously thought. The influx of foreigners, coupled with a higher participation rate by residents in Spain, has boosted job creation in the sector. Finally, there is more room for growth in the number of 4 and 5-star establishments, which is also precisely where investment is increasing the most.

Household consumption will be supported by the recovery of some of the purchasing power lost in 2022 and 2023. Inflation shows signs that, in the absence of any energy price surprises, the moderation seen will hold. The percentage of goods and services with price growth below 2% has increased from an average of 35% of the

4: "Proposed reduction to the legal maximum work week: incidence and potential impact", BBVA Research (forthcoming).
5: See Do geopolitical tensions in competing markets affect Spanish tourism?, BBVA Research, November 15, 2016.

total during 2022 to 53% in October. This is still a step below pre-pandemic levels (68%), but it represents the consolidation of a shift in trend that is also confirmed by other indicators. For example, other inflation measures, based on removing the impact of volatile components (such as truncated means), already indicate that inflation could gradually converge to 2%. This is coming against a backdrop in which moderate employment growth is expected and a wage increase arranged in collective bargaining agreements should be between 4 and 5%.

Current household expenditure stands to benefit from the increase in household wealth, normalization of the saving rate, reduced balance sheet exposure to interest rate hikes and pent-up demand for vehicles. Growth in housing prices will help real estate wealth to be maintained in real terms, while the shift from sight deposits to term deposits will underpin financial wealth. Currently, saving rate levels exceed the historical average. Thus, households that have accumulated resources over the last three years will be able to access them if they decide to spend more. Spain's aging population is resulting in households with increasingly less debt and more assets. This could explain why higher interest rates are having less of an impact on their expenditure. Finally, decisions to buy cars continue to be delayed because of regulatory uncertainty, the pandemic, supply chain disruptions (particularly the lack of semiconductors), rising fuel prices and doubts surrounding the transition to electric cars. Nearly all of these issues have been or will be resolved in the coming months. This will allow a recovery in car sales, particularly toward 2025.

This year of rainfall has reduced the probability of risk scenarios in the north, central and southwestern parts of the country. This will at least help to halt drought-related job destruction in the agri-food sector and ease the pressure on food prices. If this persists, the availability of water will reduce costs, boost job creation and help inflation converge faster to the target. In any case, weather-related risks are still present, especially in the east of the peninsula, where there has been no rain and the likelihood of greater restrictions is increasing.

Signs are building that reforms are needed to increase investment, reduce unemployment, and improve productivity and wages. Companies, and the Spanish economy as a whole, continue the deleveraging trend that has been seen since before the pandemic. Although partly explained by the need to reduce dependence on external financing, the private sector shows a surplus balance that seems to increasingly point to a lack of profitable investment projects. The same is true for the poor performance of gross fixed capital formation, despite the funds received from the eurozone, which are tied to the measures promised in the Recovery, Transformation and Resilience Plan. Unemployment remains among the highest in the EMU, while the trend in productivity per hour worked has been disappointing. Although the measures implemented during the pandemic have been successful in reducing temporary employment and maintaining employment as a whole, the challenges facing the Spanish economy remain enormous. Reducing the uncertainty that businesses and households face should be a top priority in order to increase investment and create jobs. To achieve this, it is important to reach a consensus on some of the main courses of action required.

A medium-term fiscal consolidation plan, together with investment-friendly regulations and taxation, will be key. There is a need to have a guide as soon as possible on how the imbalance in the public accounts will be reduced, limiting the impact on growth. This requires a comprehensive and ongoing evaluation of expenditure, as well as prioritizing tax measures that have a minimal impact on the economy. It is also necessary to eliminate bottlenecks that may be limiting the increase in the supply of renewable energies, affordable housing (both rental and buying), and the growth of medium-sized companies. The transition to an environmentally and socially sustainable model is at stake. Finally, it is a priority to continue to make progress on agreements that can reduce unemployment by improving education for the unemployed and students so that they have the necessary skills to access well-paid jobs quickly.

Tables

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

	2020	2021	2022	2023	2024	2025
United States	-2.2	3.7	1.9	2.4	1.5	2.3
Eurozone	-6.2	5.9	3.4	0.4	0.7	1.7
China	2.2	8.5	3.0	5.2	4.4	4.2
World	-2.7	6.5	3.4	3.0	3.0	3.3

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: November 24, 2023.
Source: BBVA Research & FMI.

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

	2020	2021	2022	2023	2024	2025
United States	1.3	4.7	8.0	4.1	2.6	2.5
Eurozone	0.3	2.6	8.4	5.6	2.8	1.8
China	2.5	0.9	2.0	0.4	2.0	2.0
World	3.6	5.1	9.3	7.4	6.9	4.5

* Argentina, Brazil, Chile, Colombia, México, Paraguay, Perú and Uruguay.
Forecast closing date: November 24, 2023.
Source: BBVA Research & FMI.

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

	2020	2021	2022	2023	2024	2025
United States	0.90	1.44	2.95	4.05	4.68	4.20
Germany	-0.48	-0.31	1.18	2.51	2.62	2.49

Forecast closing date: November 24, 2023.
Source: BBVA Research & FMI

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

	2020	2021	2022	2023	2024	2025
EUR-USD	0.88	0.84	0.95	0.93	0.91	0.87
USD-EUR	1.14	1.18	1.05	1.08	1.10	1.15
CNY-USD	6.91	6.45	6.73	7.10	7.19	6.90

Forecast closing date: November 24, 2023.
Source: BBVA Research & FMI.

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

	2020	2021	2022	2023	2024	2025
United States	0.25	0.25	4.50	5.50	4.75	3.25
Eurozone	0.00	0.00	2.50	4.50	4.00	3.00
China	3.85	3.80	3.65	3.35	3.35	3.35

Forecast closing date: November 24, 2023.
Source: BBVA Research & FMI.

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

	2020	2021	2022	2023	2024	2025
GDP at constant prices	**-6.2**	**5.9**	**3.5**	**0.4**	**0.7**	**1.7**
Private consumption	-7.8	4.4	4.2	0.4	0.9	1.9
Public consumption	1.0	4.2	1.6	0.1	0.4	0.5
Gross fixed capital formation	-6.2	3.7	2.8	1.2	1.4	2.7
Inventories (*)	-0.3	0.4	0.3	-0.2	0.1	0.0
Domestic demand (*)	**-5.6**	**4.5**	**3.4**	**0.3**	**1.0**	**1.7**
Exports (goods and services)	-9.4	11.4	7.4	-0.1	1.3	2.7
Imports (goods and services)	-8.8	9.1	8.0	-0.4	2.2	2.9
External demand (*)	**-0.6**	**1.4**	**0.0**	**0.1**	**-0.4**	**0.0**
Prices and Costs						
CPI	0.3	2.6	8.4	5.6	2.8	1.8
CPI Core	0.7	1.5	3.9	5.0	2.9	2.2
Labour Market	0.7	1.5	3.9	5.0	2.9	
Employment	-1.4	1.4	2.3	1.1	0.2	0.2
Unemployment rate (% of labour force)	8.0	7.7	6.7	6.5	6.8	6.8
Public sector	-1.4	1.4	2.3	1.1	0.2	
Surplus (+) / Deficit (-) (% GDP)*	-7.1	-5.3	-3.6	-3.3	-2.9	-2.5
Public debt (% GDP)*	97.2	94.8	91.0	89.3	89.1	89.0
External Sector						
Current Account Balance (% GDP)	1.7	2.8	-0.7	1.5	1.7	1.8

Annual rate change in %, unless expressly indicated.
Forecast closing date: November 24, 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, %)	2021	2022	2023	2024	2025
Activity					
Real GDP	**6.4**	**5.8**	**2.4**	**1.5**	**2.5**
Private Consumption	7.1	4.7	2.2	1.7	2.0
Public Consumption	3.4	-0.2	2.7	1.4	1.4
Gross Fixed Capital Formation	2.8	2.4	1.8	4.5	8.4
Equipment and machinery	4.4	1.9	-0.4	5.1	9.8
Construction	0.4	2.6	3.0	3.5	8.0
Housing	0.9	1.4	0.9	2.3	8.3
Domestic Demand (contribution to growth)	**6.6**	**2.9**	**1.9**	**2.1**	**3.1**
Exports	13.5	15.2	0.8	1.8	4.2
Imports	14.9	7.0	-0.3	3.3	6.0
External Demand (contribution to growth)	**-0.2**	**2.9**	**0.5**	**-0.6**	**-0.7**
GDP at current prices	9.2	10.2	8.2	5.1	5.4
(Billions of Euros)	1222.3	1346.4	1456.9	1531.5	1614.0
Labour market					
Employment, Labour Force Survey	3.0	3.1	3.0	2.3	2.2
Unemployment rate (% Labour force)	14.8	12.9	12.2	11.8	11.2
Employment, full time equivalent	7.1	3.7	3.1	1.9	1.9
Productivity	-0.7	2.0	-0.8	-0.4	0.5
Prices and Costs					
CPI (average)	3.1	8.4	3.7	3.5	2.3
CPI (end of period)	5.8	5.7	4.3	3.4	2.1
GDP deflator	2.8	4.4	5.9	3.6	2.9
Compensation per employee	0.3	2.9	4.7	3.8	2.8
Unit Labour Cost (ULC)	1.0	0.8	5.5	4.2	2.3
External sector (*)					
Current Account Balance (% GDP)	0.7	0.7	2.8	2.9	2.1
Public sector					
Debt (% GDP)	116.8	111.6	107.2	105.8	103.9
Deficit (% GDP) (*)	-6.6	-4.7	-4.1	-3.7	-3.5
Households					
Nominal disposable income	4.5	4.1	9.4	5.8	4.9
Savings rate (% nominal disposable income)	13.8	7.6	10.2	10.3	10.3

Annual rate change in %, unless expressly indicated.
Forecast closing date: November 24, 2023.
(*) Excluding financial aid for Spanish banks.
Source: BBVA Research.

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