SPAIN
2022-2023 SCENARIO

UNDER PRESSURE AT THE BEGINNING OF THE YEAR

19 April 2022

Ticiano Brunello

WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

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SUMMARY

SHARP SLOWDOWN IN THE FIRST QUARTER OF THE YEAR

Economic activity in Spain continued to rally in the fourth quarter of 2021, albeit at a slower pace than in the previous quarter. Spanish GDP grew by 2.2% qoq in Q4 (2.6% in Q3). This expansion can be attributed to the positive contribution of net foreign demand (1 percentage point - pp) and to the contribution of domestic demand (1.2 pp). Exports climbed 7.2%, and imports 4.5%. Consumer spending rose 1.5%, fuelled by consumption of non-durable goods and services, while investment picked up 3.1%, driven by capex. **In the fourth quarter, Spain's GDP was 3.8% below the level reached at the end of 2019.**

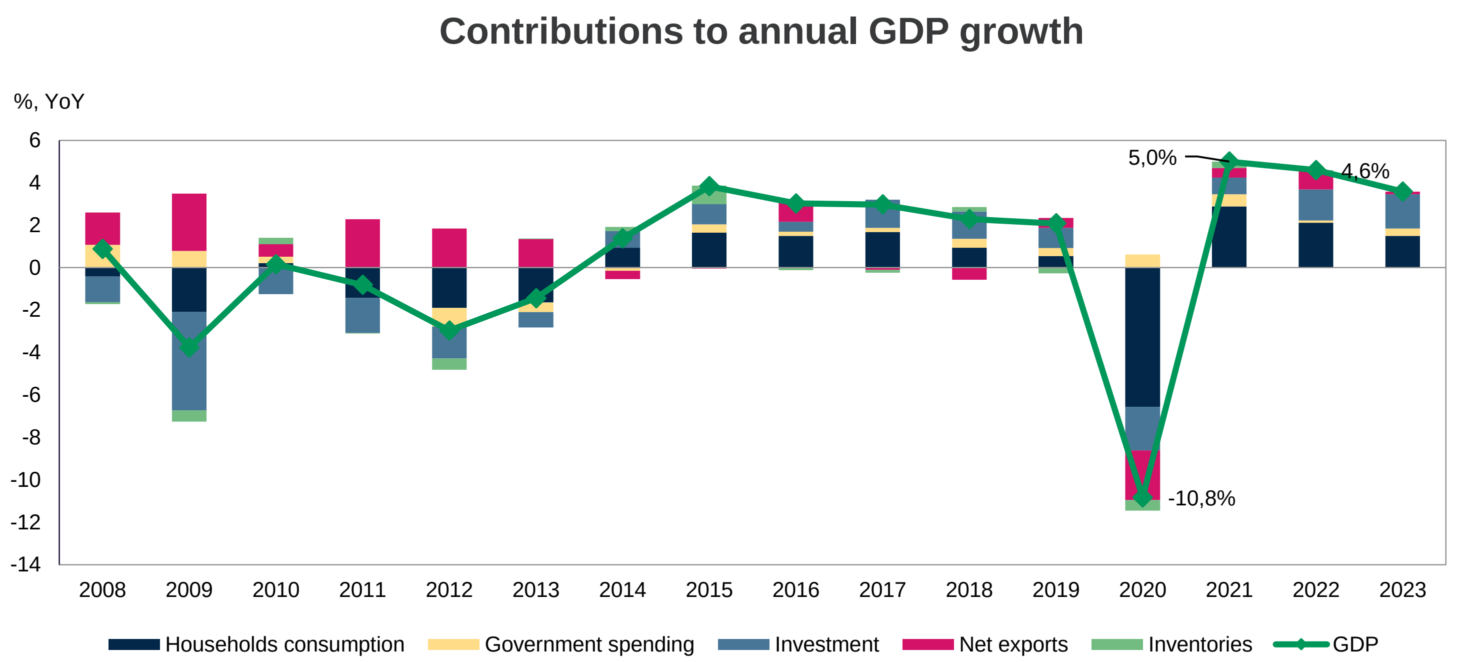
The information available in the first half of Q1 2022 indicated a slowdown in the recovery, due to rising inflation and the persistent bottlenecks in certain supply chains. However, the outbreak of the conflict in Ukraine involves significant economic disruption for Spain. The impact will be felt through various channels. The most important is probably related to the significant weight that Russia and Ukraine have in global energy production. In Spain, the proportion of imports from these countries is relatively low, but the war affects the price of these goods on international markets, regardless of their origin. Beyond energy markets, war affects the supply of certain essential food commodities (such as wheat) and various metals (such as palladium, copper and nickel). These are essential in the manufacture of cars and electronic products. We are therefore seeing a worsening of difficulties in supply chains, which were already present before the war. A second channel is the uncertainty over the duration and development of the armed conflict and, consequently, its impact on private agent income. In such an environment, households and businesses tend to defer their spending decisions on consumer goods and investment, which has a negative impact on economic activity. Third, the impact of the conflict on commodity markets and heightened uncertainty will also be felt in other economies. As a result, the war will have a significant impact (particularly pronounced in Europe) on global activity and, through this channel, on demand for Spanish exports and on growth in activity.

We expect GDP to grow to 0.4% in the first quarter of 2022. In the short term, private-sector consumption will be moderated, by rising uncertainty, further interruptions in supply chains and, above all, by the decline in purchasing power following the rise in inflation. Throughout the year, the gradual reversal of these moderating factors in household consumption will allow private-sector consumption to strengthen, encouraged by the sustained recovery in the labour market and by financial conditions, which, although somewhat less favourable, will remain accommodative. We anticipate growth in private-sector consumption of 3.9% in 2022 and 2.8% in 2023. Investment by non-financial companies will suffer in the short term as a result of rising war-related uncertainties, the negative impact of higher production costs on company margins and continued disruption to supply chains. The impact of rising energy prices may be particularly pronounced in the most consuming sectors, such as metals, steel, transportation and the chemical and extractive industries. According to our latest forecasts, investment is expected to increase by 6.8% in 2022 and 7.3% in 2023, supported by the Spanish recovery plan.

We forecast GDP growth of 4.6% in 2022 and 3.6% in 2023, which are lower than our forecasts made in the last fiscal year (5.6% and 4.1% respectively). Measures such as the indexation of pensions to inflation and the new anti-inflation package will lead to an increase in public spending. According to our current forecasts, the deficit will be -6.6% in 2022 and -3.8% in 2023.

SUMMARY

OUR GROWTH FORECASTS



Sources: Eurostat, Crédit Agricole S.A / ECO

Spain	2021	2022	2023	2022				2023			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	5,0	4,6	3,6	0,4	0,1	1,2	1,0	1,0	1,0	0,6	0,5
Households consumption	5,3	3,9	2,8	0,3	-0,2	1,3	1,0	0,7	0,6	0,4	0,3
Investment	3,6	6,8	7,3	1,7	1,3	2,3	2,2	2,0	1,5	1,2	1,1
Change in inventories*	0,3	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Net export*	0,5	0,9	0,1	-0,2	-0,2	-0,1	-0,1	0,1	0,2	0,1	0,1
Unemployment	14,8	13,9	12,6	13,9	14,3	14,1	13,3	12,8	12,6	12,6	12,5
Government net lending	-6,8	-6,6	-3,8								

* Contributions to GDP growth

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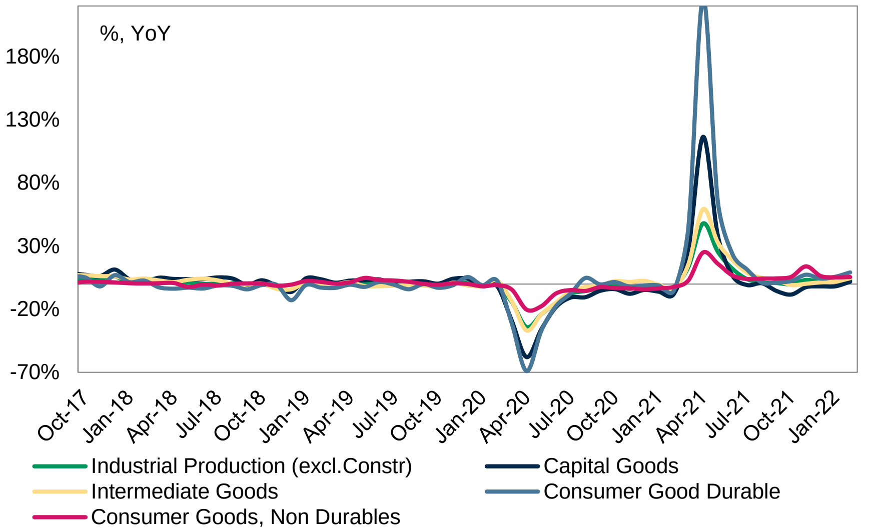
RECENT ECONOMIC TRENDS

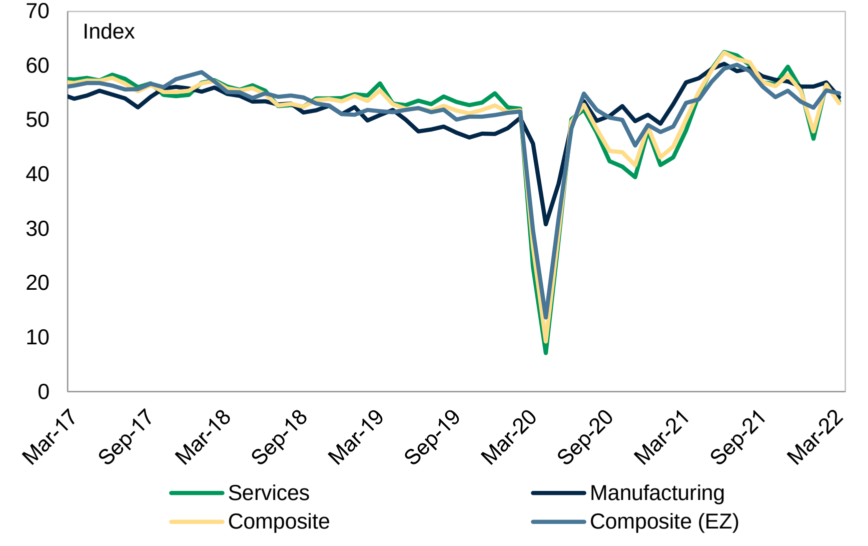
MODERATION IN GROWTH IN Q1 2022

Industrial output



Sources: Eurostat, Crédit Agricole SA / ECO

Purchasing Managers Index (PMI)



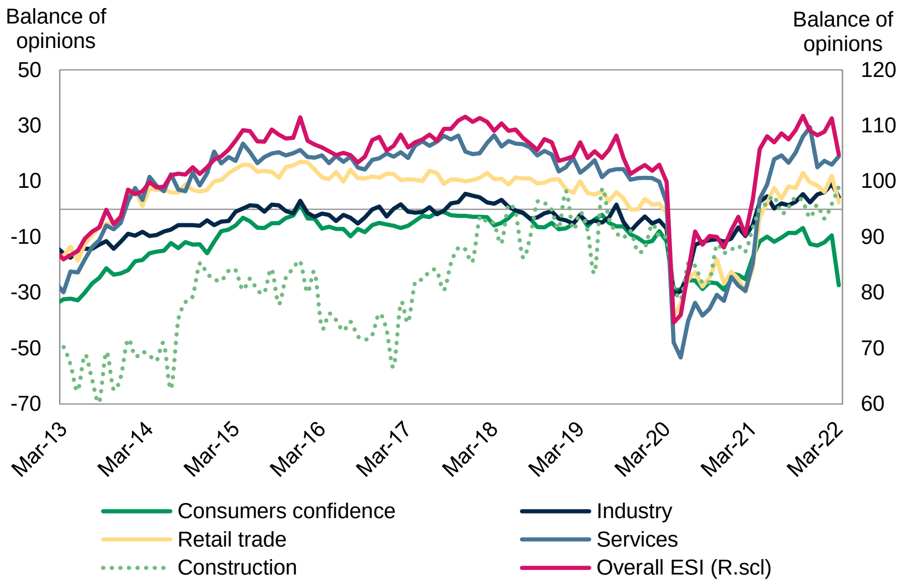
Sources: Markit, Crédit Agricole SA / ECO

In the first quarter of 2022, the Spanish economic growth rate is expected to moderate, mainly due to the economic consequences of the war in Ukraine. Throughout January and February, confidence indicators showed a gradual recovery, in line with the improvement in the pandemic situation. However, following Russia's invasion of Ukraine on 24 February, these indicators deteriorated significantly, reflecting the negative consequences that this war could have on the economy. Indeed, both the war itself and the sanctions imposed on Russia by many governments and international institutions led to a very significant increase in commodity prices and levels of uncertainty, which will have significantly affected consumer and business consumption and investment decisions in March. In addition, in the final weeks of the quarter, strikes in the transport sector led to disruption in commercial distribution chains. Owing to these developments, we have revised down our Q1 growth forecasts from 1.1% to 0.4% qoq.

RECENT ECONOMIC TRENDS

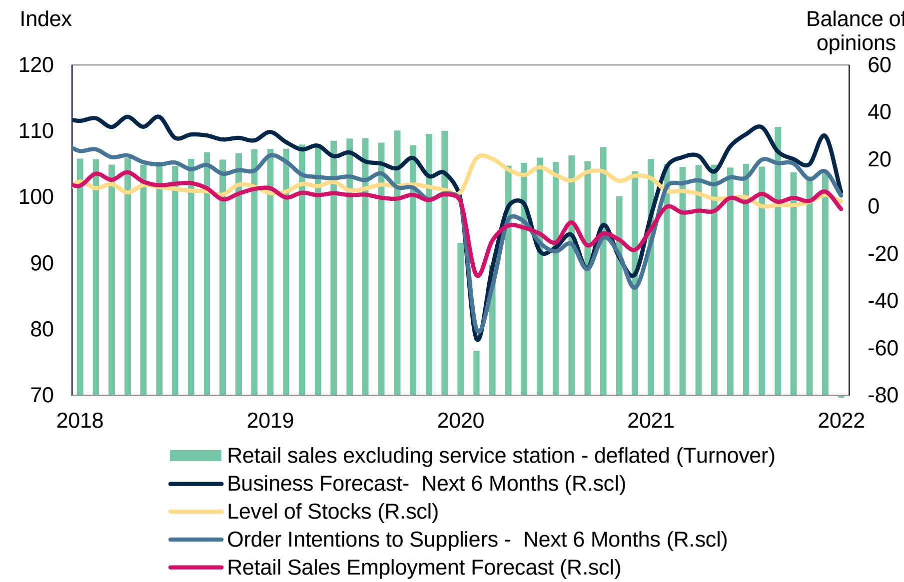
THE WAR IN UKRAINE DAMAGES CONFIDENCE

ESI and its components



Sources: Eurostat, Crédit Agricole SA / ECO

Retail sales



Sources: ICI, Crédit Agricole SA / ECO

The components of the European Commission's Economic Sentiment Indicator highlighted a loss of confidence in all sectors in March, with the exception of services and construction. This decline was felt in particular on consumer sentiment and retail trade. In addition, the companies that took part in the latest edition of the Bank of Spain's business survey forecast that, in the first quarter of 2022, their revenues would be lower than at the end of 2021 and that the bottlenecks affecting their production would be resolved later. With survey responses received between 23 February and 10 March, this deterioration in business expectations reflected the initial effects of the war. Finally, March data on Social Security registrations show some moderation in the job creation trend, in addition to what had already been observed in February. Against this backdrop, the Q1 GDP growth forecast is subject to a high degree of uncertainty. In the absence of available data on the effects of the war on the economy, we should also note the difficulties in measuring the impact of the road freight stoppages.

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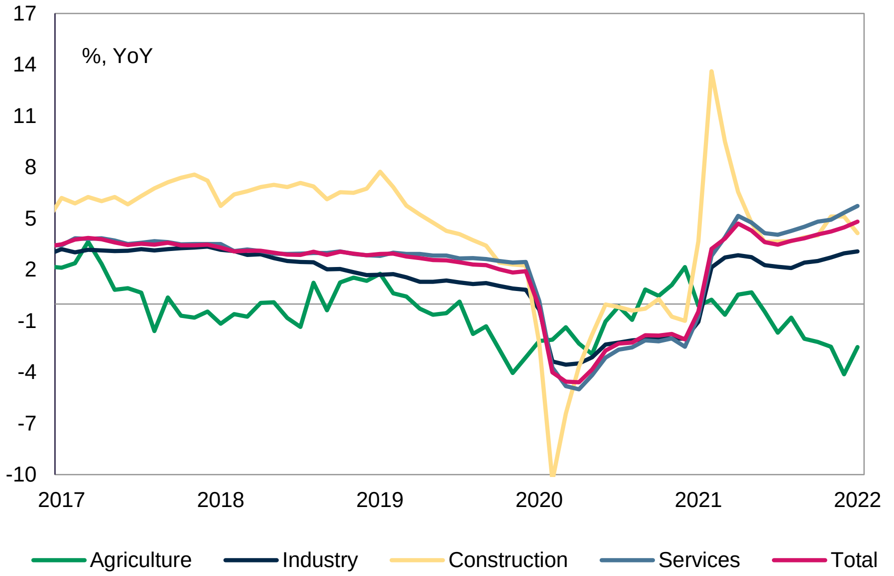
OUTLINE OF OUR SCENARIO

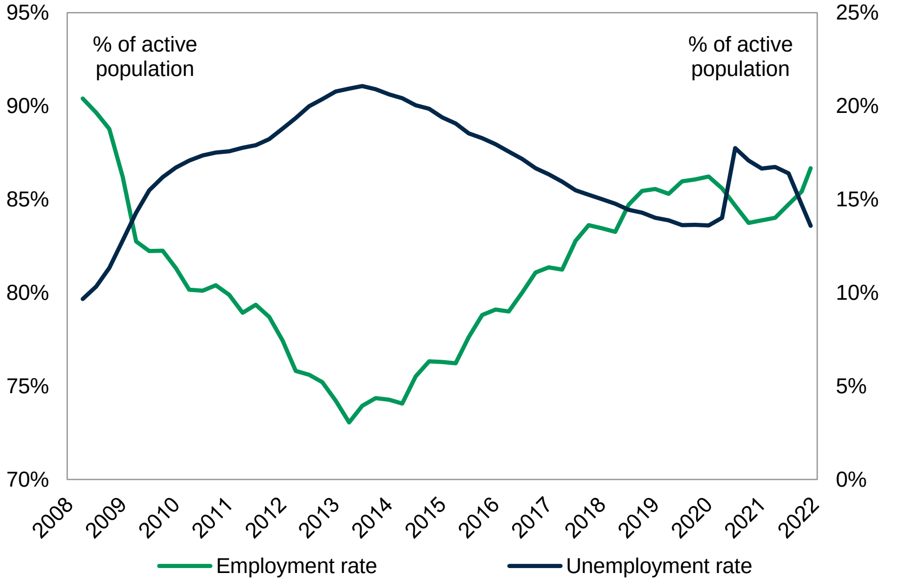
EMPLOYMENT MOMENTUM EASES IN Q1 2022

Employment: Social Security enrolment



Sources: Ministry of Labour, Crédit Agricole SA / ECO

Unemployment rate



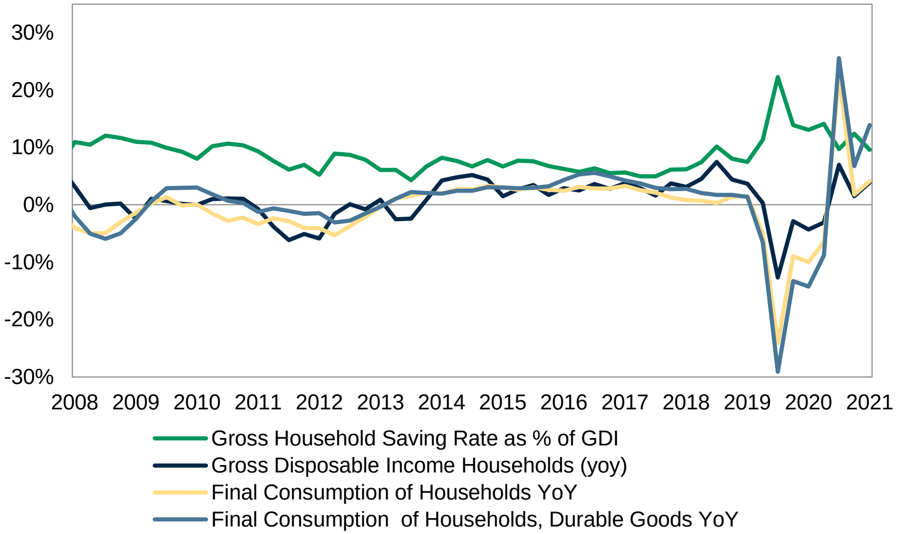
Sources: Ministry of Labour, Crédit Agricole SA / ECO

In February and March, employment growth was slightly below the average of recent months. Moreover, although the number of workers on the ERTE furlough scheme continued to trend downwards in Q1, the rate of decline is much lower than in previous months. In concrete terms, in February 118,900 people were on the ERTE scheme, a figure barely lower than that recorded in December 2021 (129,200). In any case, effective enrolment in February was 1.7% higher than that observed before the pandemic began, a larger positive difference than that recorded in December last year (0.9%). The trend in employment over the quarter as a whole should lead to a further drop in the unemployment rate, albeit more moderate than that observed at the end of 2021, in a context where the activity rate should rebound slightly. The recovery in hours worked and the number of persons employed will continue throughout the projection horizon, even if, during the 2022-2023 period, it will grow less than expected in December. In line with the recovery in employment, the unemployment rate will continue to fall, reaching 13.9% in 2022 and 12.6% in 2023.

OUTLINE OF OUR SCENARIO

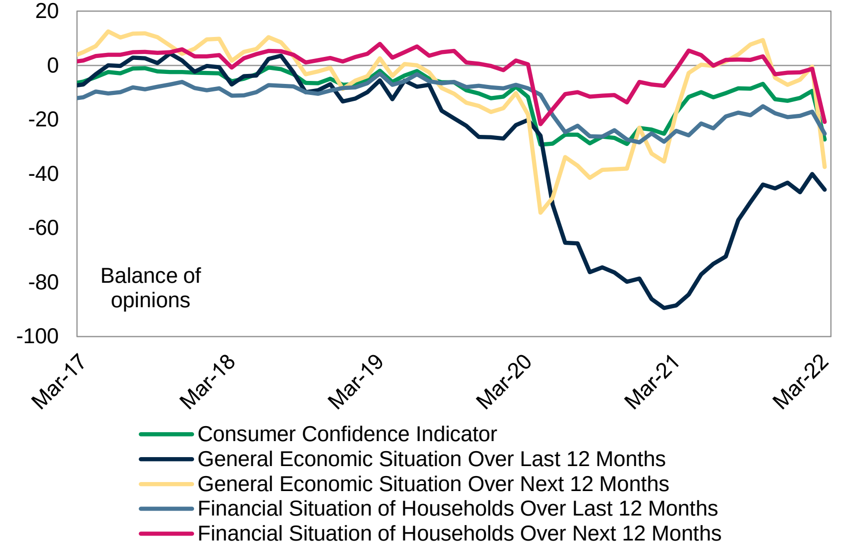
CONFIDENCE WEIGHS ON PRIVATE-SECTOR CONSUMPTION

Change in gross disposable income and its components



Sources: Eurostat, Crédit Agricole SA / ECO

Household survey



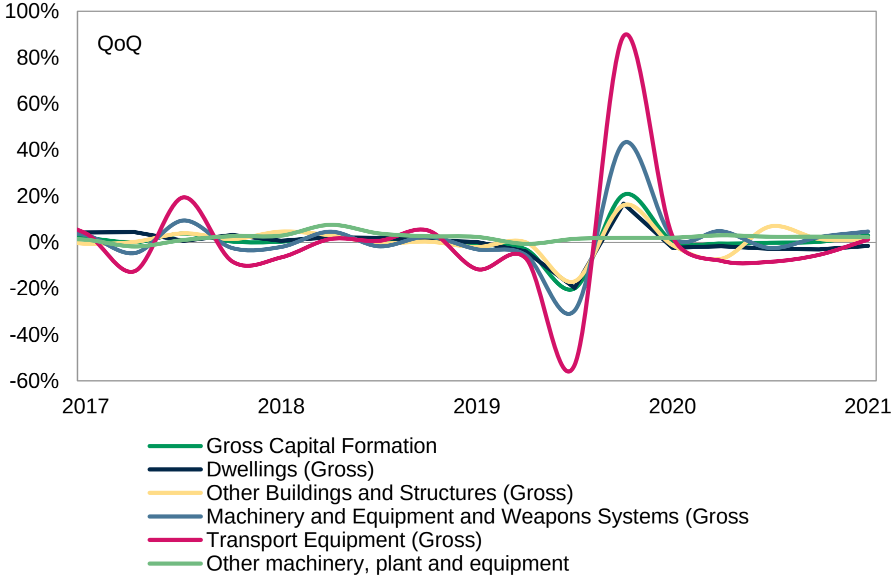
Sources: European Commission, Crédit Agricole SA / ECO

Private-sector consumption picked up by 1.5% in Q4 2021 versus Q3, fuelled by consumption of non-durable goods and services (6%), and durable goods (7%). The household savings rate came out at 13.8% of gross disposable income (18.6% in Q4 2020). Consumption recovered somewhat throughout January and February, but it would have slowed after the invasion of Ukraine. As the pandemic situation improved and global bottlenecks eased, retail sales, vehicle registrations and hotel overnight stays recovered in February. However, while the information available is still scarce, it is expected that household consumption decisions will have deteriorated due to the Russian invasion in Ukraine. Among other negative effects, this has caused an increase in inflation, which will reduce household purchasing power and increase uncertainty. This will make it more difficult for households to anticipate future changes in their real incomes. The collapse in consumer confidence in March confirms this assumption. Against this backdrop, consumer credit to households remained sluggish, in line with the maintenance of a large pool of savings accumulated since the beginning of the pandemic. We expect private-sector consumption to climb 0.3% in Q1 2022, slowing down slightly from Q4 2021.

OUTLINE OF OUR SCENARIO

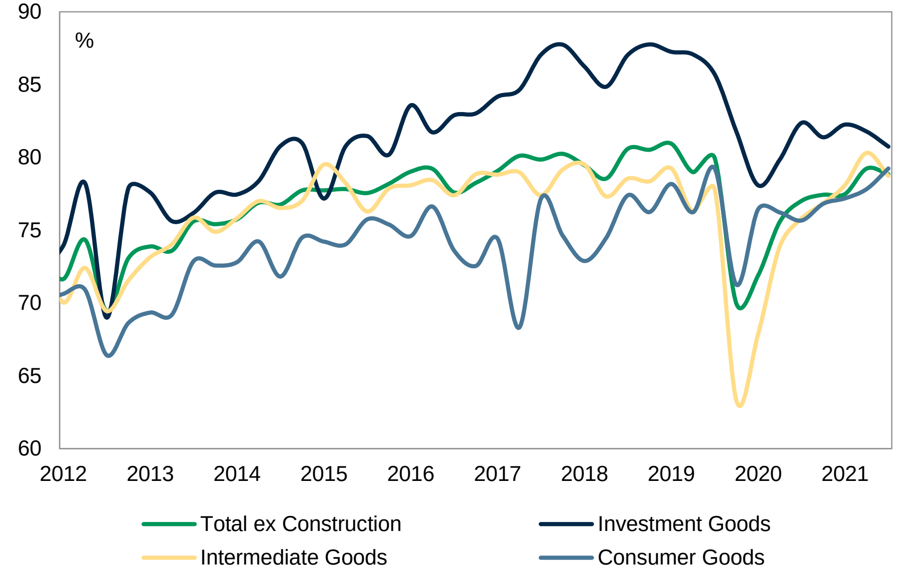
INVESTMENT, SLOWDOWN AFTER Q4 2021

Components of investment



Sources: INE, Crédit Agricole SA / ECO.

Capacity utilisation



Sources: Ministry of Industry and Trade, Crédit Agricole SA / ECO.

Investment increased 3.1% qoq in Q4 2021 (vs. 1.2% in Q3), due to the increase in construction (2.3%), but mainly due to spending on machinery and capital goods, which rose by 5.3%. Corporate investment could reduce the pace of growth throughout the first quarter. In January and February, the trend in the indicators related to this component was positive, although it highlighted some moderation in its growth rate after the strong momentum in Q4 2021. In particular, the qualitative information available up to February showed a positive trend in industry confidence, production expectations and foreign orders. In recent months, new bank lending to non-financial corporations has accelerated, particularly for larger amounts, even though the use of fixed income financing has slowed. In any case, it can be expected that the heightened uncertainty resulting from the war in Ukraine has already started to negatively affect business investment decisions, in a context where they also anticipate higher production costs and a worsening of supply problems as a factor limiting their activity.

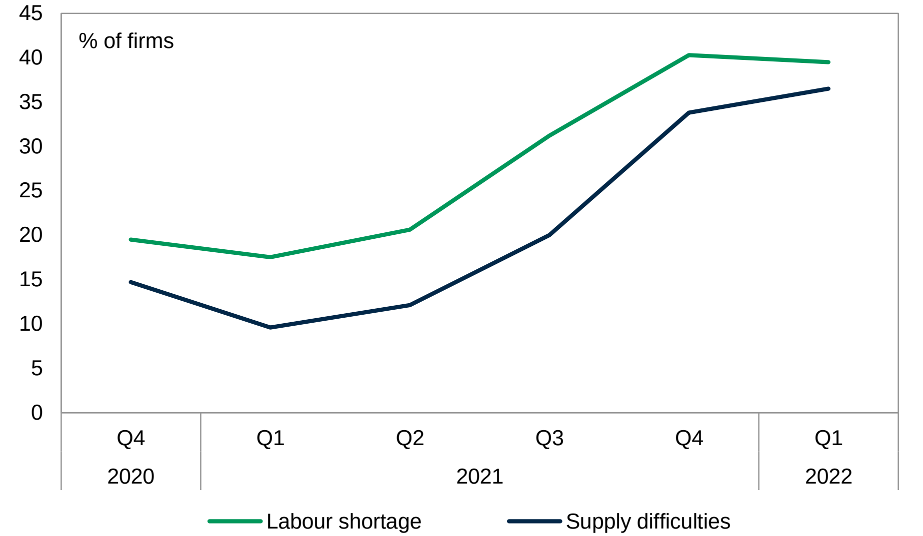
OUTLINE OF OUR SCENARIO

CONSTRUCTION, STILL WAITING FOR NGEU FUNDS

Construction indicators

Sources: INE, Crédit Agricole S.A.

Construction sector surveys

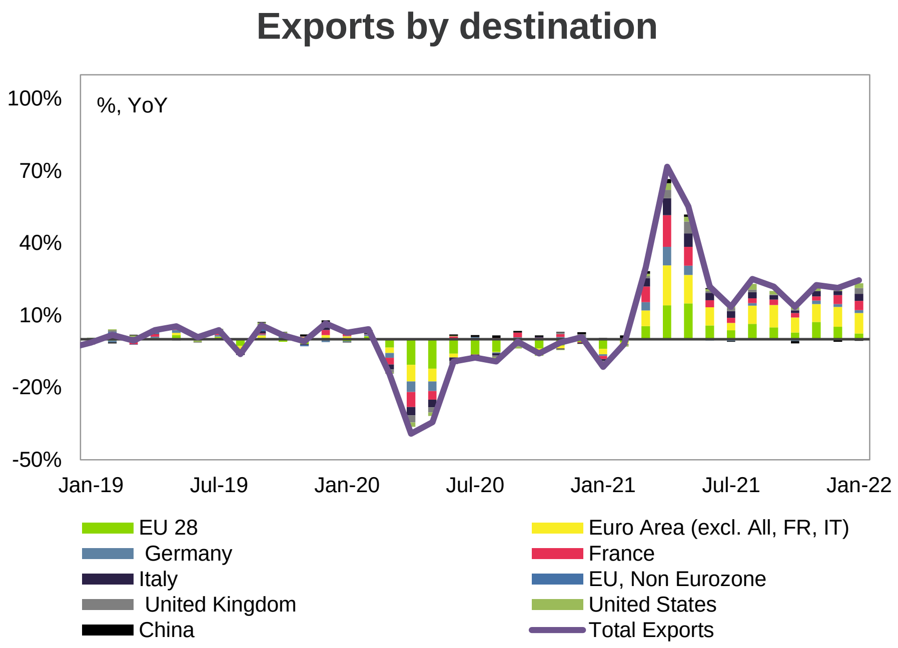


Sources: INE, Crédit Agricole S.A., base 100 = Dec. 2019

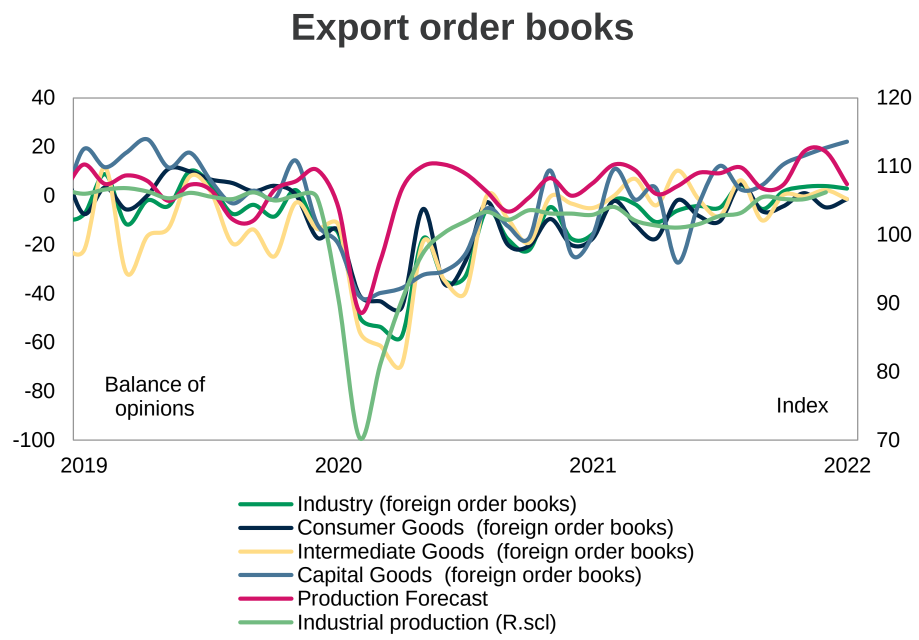
According to the construction execution indicator, investment in housing showed relatively strong momentum during Q1 2022. However, the pace of growth in activity would have been limited by several factors. These include the shortage of labour - related to the slow flow of migrants and the deployment of projects associated with the NGEU programme - and the difficulty in sourcing certain materials, which could worsen as a result of the conflict in Ukraine. In the latter part of the quarter, the consequences of the stoppages in road freight transport must be added to this. Meanwhile, home sales in the second half of 2021 were higher than those seen before the pandemic. Growth in average property prices accelerated in Q4 2021, rising by 6.4% yoy.

OUTLINE OF OUR SCENARIO

INTERNATIONAL TRADE



Sources: Bank of Spain, Crédit Agricole SA / ECO



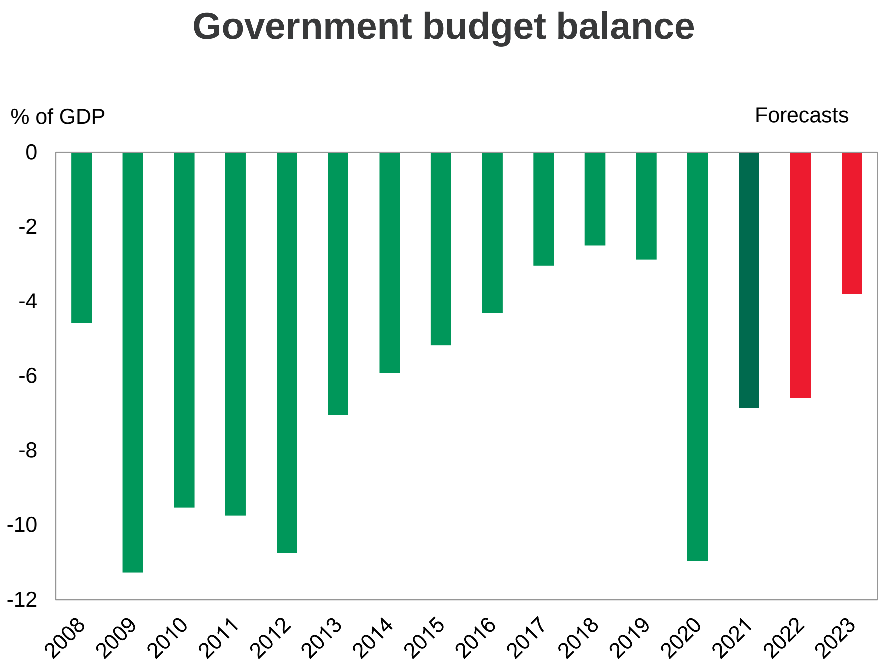
Sources: ICI Ministry of Industry and Trade survey, Crédit Agricole SA / ECO

Foreign trade contributed positively to GDP growth (1%) in Q4 2021, on the back of higher exports (7.2% qoq), while imports recorded a more modest gain of 4.5%. The worsening of global bottlenecks following the war in Ukraine points to a slowdown in trade in Q1 2022. In January and February, foreign trade indicators were consistent with moderate expansion, as bottlenecks in global value chains eased. However, it is possible to anticipate a negative effect of the conflict on exports through global supply chains and the impact on some of the largest European trading partners exposed to both countries at war.

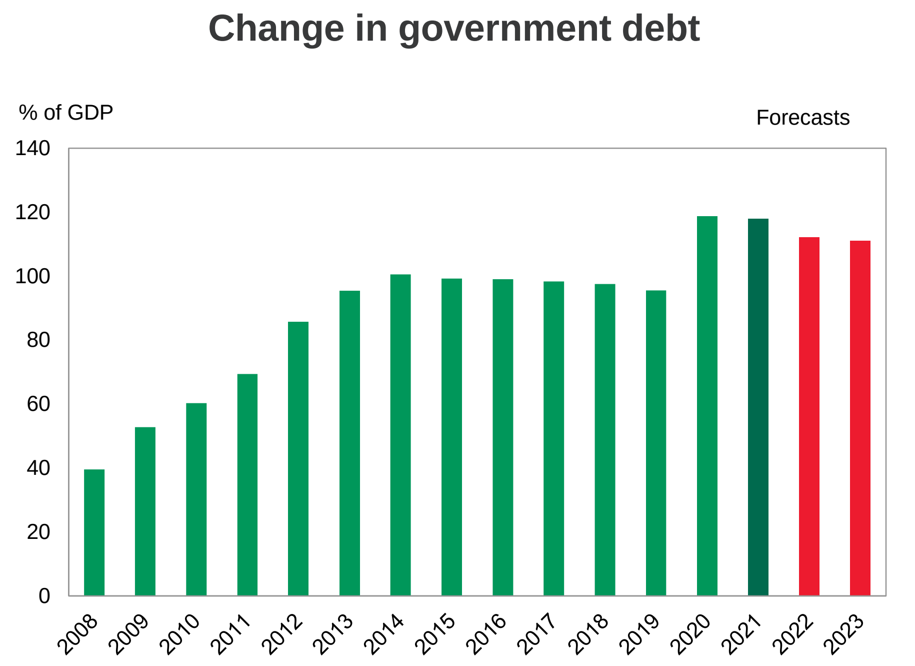
Indicators of international tourist flows showed a significant upturn in February, in line with the positive development of the pandemic situation. The direct impact of the conflict on tourist flows is limited, as the Russian market accounts for a very small share of Spanish tourism exports (1.6% in 2019). However, going forward, the increase in transport costs and the loss of purchasing power, following the rise in inflation in the main countries that send tourists to Spain, could hamper the recovery of tourism.

OUTLINE OF OUR SCENARIO

PUBLIC FINANCE, TOWARDS A LARGER BUT STILL DECLINING DEFICIT IN 2022



Sources: Stability & growth programme, Crédit Agricole SA / ECO



Sources: Stability & growth programme, Crédit Agricole SA / ECO

The public deficit stood at 6.9% of GDP in 2021 (-3.4 pp compared to 2020), an improvement due to both strong revenue growth and the slowdown in spending. Government revenues rose 14% yoy in 2021, accelerating even in the latter part of the year and also showing strong momentum in early 2022. The slowdown in spending (4.8% in 2021, compared to 12% in 2020) is due to the reduction in spending related to Covid-19. For its part, public debt amounted to 118.4% of GDP in December, -1,6 pp compared to 2020, owing to the sharp increase in nominal GDP, which offset the increase in debt caused by the deficit balance. As part of the structural reforms set out in the Spanish stimulus plan, the government approved at the end of 2021 a reform of the public pension system, which includes, among other measures, the revaluation of pensions with inflation, the removal of the sustainability factor and a new intergenerational equity mechanism. In response to the inflationary shock, direct assistance amounting to €6bn will be rolled out. Overall, these measures will lead to an increase in public spending. According to our current forecasts, the deficit will be -6.6% in 2022 and -3.8% in 2023.

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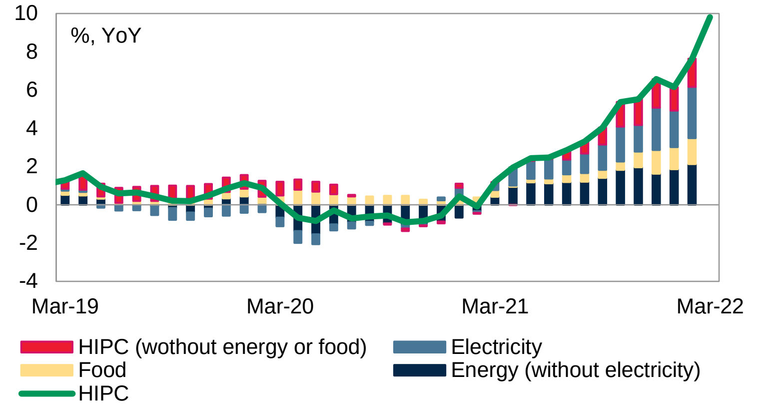
FOCUS: INFLATION ON THE RISE

ENERGY, A DRIVER OF INFLATION

In March, the consumer price index rose sharply to 9.8% yoy, the highest in the series. The rise in inflation is primarily due to energy price trends on international markets and, possibly, the effects of the transport strike on fresh food prices. The contribution of energy to the inflation rate registered in February (7.6%) is 4.8 pp, of which 2.7 pp corresponds to the increase in electricity prices. However, the impact on consumers of high prices on the wholesale electricity market is likely to have been partly offset by the extension, until the end of June 2022, of the reduction of the tax burden and the increase in the social bonus. Food prices have also seen a significant upturn in recent months, contributing 1.4 pp to February's HICP. Core inflation also rose (2.7% in February vs. 1.6% on average in Q4 2021). This increase was mainly due to the increase in the prices of certain industrial goods excluding energy affected by global bottlenecks, such as vehicles and spare parts and accessories. The positive inflation differential that Spain has maintained in relation to the Eurozone for a year responds to rising energy prices in the country and, to a lesser extent, food prices. Conversely, the prices of certain industrial goods excluding energy affected by bottlenecks in global supply chains, as well as the prices of services most affected by the pandemic, have experienced lower growth in Spain than in the rest of the Eurozone.

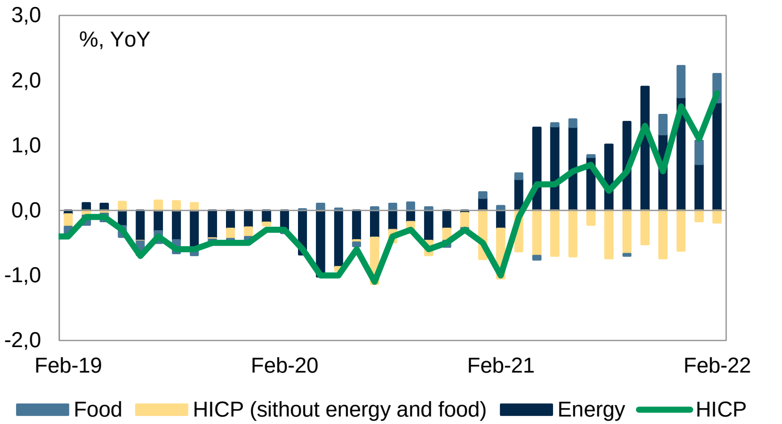
The war in Ukraine has caused a considerable shock to energy commodity prices. Given the importance of Russia in the energy commodity markets, the prices of these inputs have been highly volatile since the start of the conflict. In particular, oil and natural gas prices rose 36% and 178% respectively between 23 February and 8 March. Similarly, prices of other non-energy commodities - such as nickel, aluminium, corn and wheat - also surged in the last few weeks of the quarter.

Inflation: trend and contributions



Sources: INE, Crédit Agricole SA / ECO

Contributions to the inflation differential between Spain and the Eurozone



Sources: Eurostat, Crédit Agricole SA / ECO

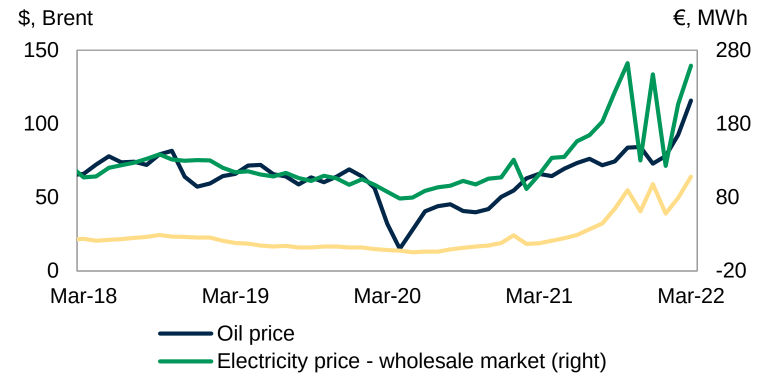
FOCUS: INFLATION ON THE RISE

UPSIDE RISKS

Although uncertainty remains very high, recent shocks are undoubtedly contributing to the persistence of higher inflation than initially estimated. However, it should be noted that commodity futures prices continue to anticipate declines in the coming months. In this sense, in the absence of new shocks, inflation rates are expected to fall from their current high level in the last quarter of this year. In addition, it is expected that the package of measures approved by the government on 29 March will help to mitigate, at least partly, the rise in energy prices. Our inflation forecast stands at 7.3% on average for 2022.

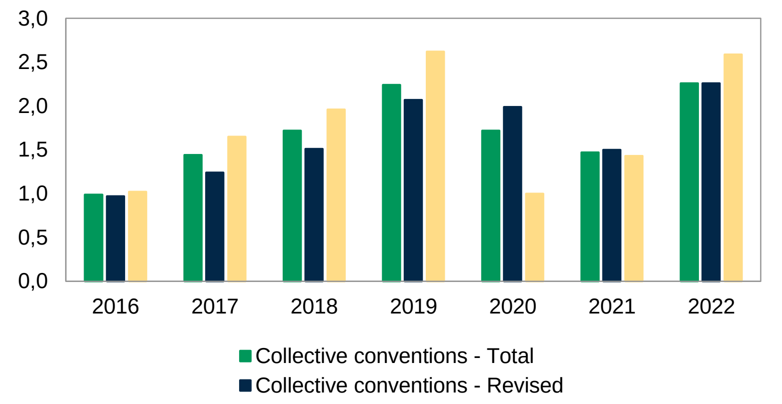
The outlook for the future inflation trend is subject to upside risks. Given the uncertainty surrounding the intensity and duration of the war in Ukraine, we cannot rule out more negative disruption to energy commodity markets, which could exacerbate the rise in their prices. In addition, if the conflict is prolonged over time, rising energy costs could further passed on to consumer prices and, in turn, wages, in a context of loss of purchasing power for workers. This is perhaps the most important risk in the long term, associated with second-round effects that could lead to inflationary spirals between prices and wages. In this sense, according to the data available up to February, collective bargaining agreements showed a moderate increase in wages for 2022 of 2.3%, after an increase of 1.5% negotiated in 2021. However, there are some signs of the impact of rising inflation in recent agreements, as well as an increase in indexation mechanisms.

Oil and electricity prices



Sources: Reuters, MIBGAS, electricity grid of Spain, Crédit Agricole SA / ECO

Wage negotiations



Sources: Ministry of Labour, Crédit Agricole SA / ECO

FOCUS: INFLATION ON THE RISE

GOVERNMENT RESPONSE

Spanish imports from Russia and Ukraine account for only a small share of the country's total imports (1.5%). In the case of Russia, metals and consumable fuels are the most exposed sectors, but do not exceed 6% of the total imports for each product. Imports from Ukraine mainly affect the food industry, and can be easily substituted by other supplier countries. In general**, Spain's suppliers are well diversified geographically, which is an advantage if supply chains are interrupted. Gas and oil imports also reflect this diversification, with Spain importing 10% of its total gas and 6% of its total oil from Russia.** However, the impact of the conflict on commodity prices poses a major threat to Spain.

The Spanish government has finally unveiled its package of measures to offset the impact of rising energy prices. These measures will include €10bn in state-guaranteed loans and €6bn in direct aid and reductions in taxes on electricity. Among the most important measures to preserve purchasing power, the decree provides for **a subsidy of €0.20 per litre on the price of fuel for all consumers, which will be effective from 1 April, as well as a 2% limit for three months on rent increases.** Minimum Vital Income assistance will also be increased by 15% and the electric social bonus (rebate of 60%-70% on electricity bills for the most vulnerable households) will be extended to 600,000 additional households, to reach 2 million households, according to government calculations.

The plan also provides for a reduction of VAT on electricity, the suspension of the tax on power generation and the reduction to a minimum of the special electricity tax, i.e. measures to reduce the cost of bills, in force since the summer of last year. The decree extends these measures until June and increases their cost to €4 billion for six months. The liquidation of the subsidy system for renewable energy producers, who receive a return of more than 7.1% of the funds committed and must therefore pass on revenues, will be brought forward. This will make it possible to use around €1.8 billion to reduce electricity bill costs.

As regards aid to companies, road tolls for industries with high energy consumption will be reduced by 80%. The measure concerns around 600 large companies, at a cost of €500 million. It is also planned to set up a new €450 million fund in direct aid for freight and passenger transport companies. The maturity for state-guaranteed loans and the grace period for the most affected sectors will be extended. The decree also provides for aid of €362 million for the agriculture and livestock sector and €68 million for fisheries. In addition, there will be an exceptional employment protection mechanism during these months, with lay-off limits until June. Companies will again be able to use temporary workforce reduction programmes (ERTE) to prevent large-scale job losses, if the situation worsens.

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