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SPAIN 2023-2024 SCENARIO

THE END OF THE REBOUND

January 2023

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GROUP ECONOMIC RESEARCH

CONTENTS

1 | SUMMARY

2 RECENT ECONOMIC TRENDS

3 OUTLINE OF OUR SCENARIO

4 FOCUS: OUTLOOK FOR CUMULATIVE HOUSEHOLD SAVINGS

SUMMARY

SPANISH GROWTH HELD UP WELL IN Q3

After the strong growth seen in Q2 (+2% quarter on quarter), GDP virtually stagnated in Q3 2022 and grew by 0.1%, in line with our forecasts. This change is due to a negative contribution from external demand (-0.4 points of GDP) due to stronger growth in imports (3%) than exports (1.5%). Conversely, domestic demand contributed 0.5% pp, driven mainly by public consumption (+1.4%), while private consumption rose marginally (0.1%) and investment posted a -0.1% decline. As such, Spanish GDP is still 1.4% below the level seen in Q4 2019 and private consumption is still very much lagging behind, at 5.4% lower than in Q4 2019.

The level of activity was slightly negative in Q4 2022. This trend is mainly due to the high level of uncertainty, the decline in business confidence, inflationary pressures and tighter financial conditions. **Weak consumption is one of the main factors behind this forecast.** Indeed, much of the recovery in consumption has already slowed (particularly spending on services related to tourism, leisure and hospitality) and household spending is showing some weakness. This is thought to be linked to the loss of purchasing power caused by inflation and the rise in interest rates, which mainly affects households with variable-rate debt. Moreover, in a context of declining confidence indicators and high uncertainty, **the excess savings accumulated during the pandemic are barely helping to boost overall household spending** (see

Focus). Conversely, activity has been supported, to some extent, by the continued good performance of the labour market and the fiscal stimulus deployed in recent months. **We expect GDP to decline by 0.2% in Q2 2022.**

We have not made any major changes to our forecasts since the last financial year. Various factors are expected to put downward pressure on the economic growth outlook in the coming quarters, including persistent inflation, a decline in economic confidence and severe ongoing uncertainty (some aspects are particularly influenced by the consequences of the current energy crisis and the armed conflict in Ukraine). In addition, tourism is likely to lose momentum once most of the pandemic-deferred demand has been met. Moreover, a weakening of external demand can be expected amid simultaneous tightening of monetary policy at a global level. **Uncertainty will remain very high in 2023, although economic activity could demonstrate greater momentum from next spring.** Throughout the year, a gradual moderation in energy and food prices is expected, as well as a very gradual reduction in bottlenecks and the economic consequences of the war in Ukraine. In addition, a more contained shift from imported inflation to core inflation will limit the negative impact of inflation on activity. **Our growth forecast for 2023 is an annual average of 0.8%.**

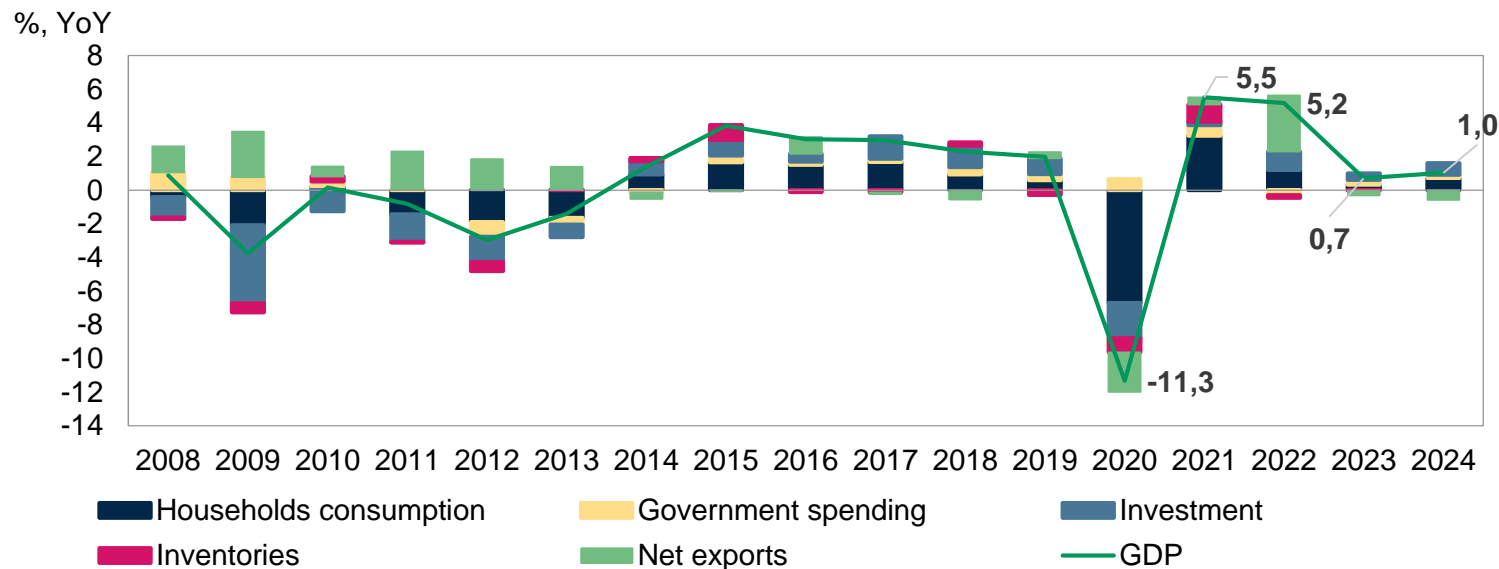
We anticipate growth in private-sector consumption of 2.2% in 2022 and 0.6% in 2023. Investment by non-financial companies will suffer in the short term as a result of rising war-related uncertainties, the negative impact of higher production costs on company margins and continued disruption to supply chains. The impact of rising energy prices may be particularly pronounced in the sectors with the most intensive energy use, such as metals, steel, transportation and the chemical and extractive industries. **According to our latest forecasts, investment is expected to slow down from Q3 2022, but should increase by 5.2% in 2022 and 1.9% in 2023, supported by Spain's recovery plan.**

The 2023 budget forecasts a deficit of 3.9% in 2023, thanks to estimated growth of 2.1% (vs. 0.7% according to our forecasts). Spending, which is very focused on preserving the purchasing power of lower-income sectors and the deployment of NGEU funds, will help support consumption and investment.

SUMMARY

OUR GROWTH FORECASTS

Contributions to annual GDP growth



Sources: Eurostat, Crédit Agricole SA / ECO

Spain	2022	2023	2024	2023				2024			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	5,2	0,7	1,0	0,0	0,2	0,3	0,3	0,3	0,2	0,3	0,3
Households consumption	2,2	0,6	1,4	0,1	0,2	0,3	0,4	0,3	0,3	0,4	0,6
Investment	5,2	1,9	3,2	0,3	0,6	0,5	0,5	1,1	1,0	0,8	0,7
Change in inventories*	-0,2	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Net export*	3,3	-0,3	-0,6	-0,2	-0,1	-0,1	-0,1	-0,2	-0,2	-0,1	-0,2
Unemployment	13,0	13,3	12,8	13,4	13,3	13,2	13,1	13,2	13,1	12,5	12,4
Government net lending	-4,8	-4,4	-3,9								

* Contributions to GDP growth

CONTENTS

1 SUMMARY

2 RECENT ECONOMIC TRENDS

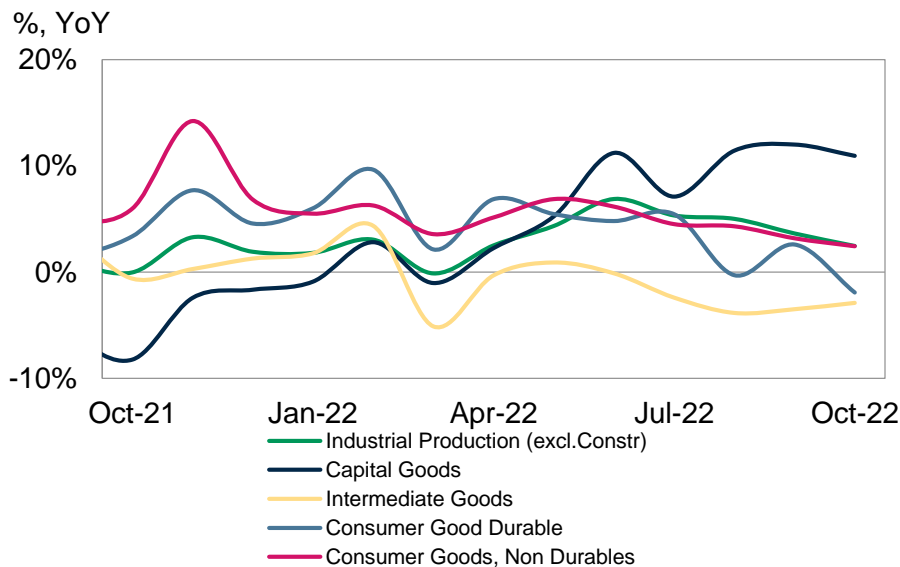
3 OUTLINE OF OUR SCENARIO

4 FOCUS: OUTLOOK FOR CUMULATIVE HOUSEHOLD SAVINGS

RECENT ECONOMIC TRENDS

WEAKER GROWTH IN Q4

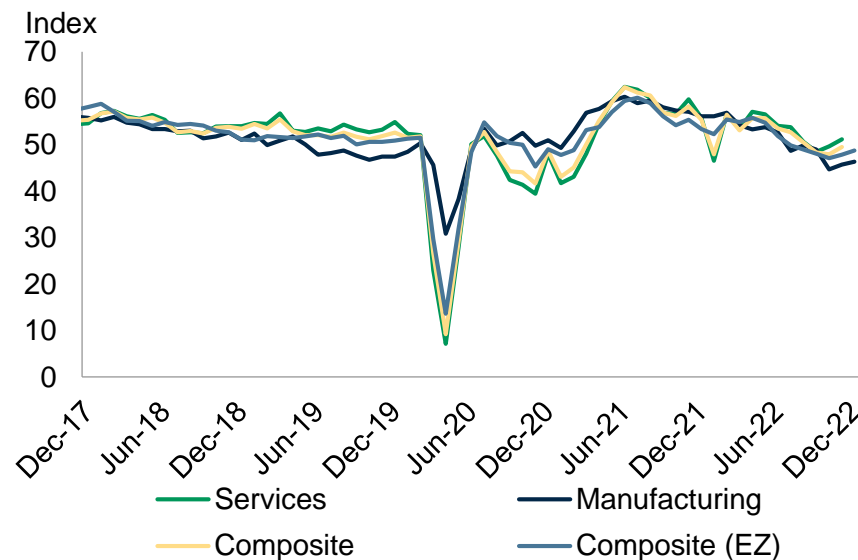
Industrial output



Sources: Eurostat, Crédit Agricole SA/ECO

The level of activity was slightly negative in Q4 2022. This trend is mainly due to the high level of uncertainty, the decline in business confidence, inflationary pressures and tighter financial conditions. Conversely, activity was supported, to some extent, by industrial production, which showed relative stability, partly due to the execution of order books accumulated during periods of a higher impact from bottlenecks in global production and supply chains. Worthy of note in

Purchasing Managers Index (PMI)



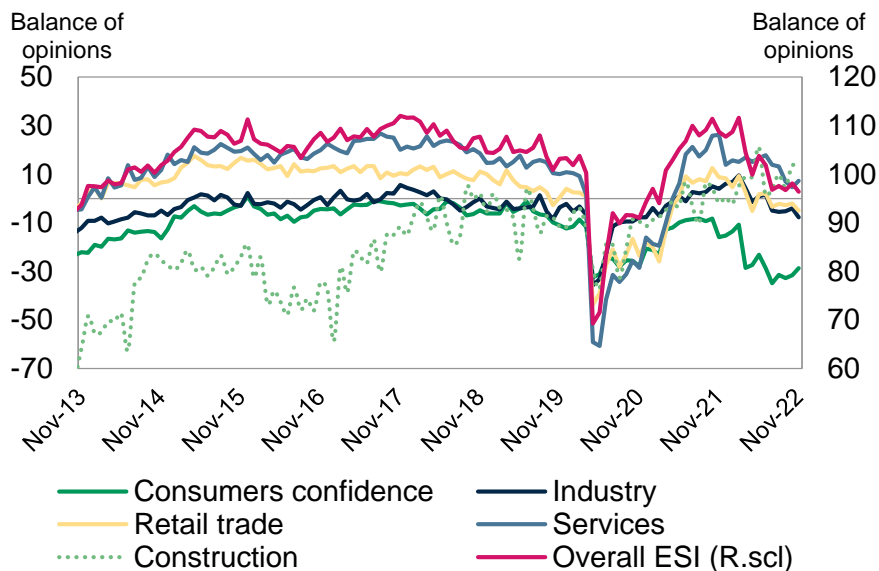
Sources: Markit, Crédit Agricole SA/ECO

the services sector is the improvement in retail sales, which posted a positive growth rate in October and already have the highest annual rate of change over the past five months. It is also worth mentioning the rebound in consumer confidence in this area, although this remains at very low levels; in October, it improved for the first time in a year and a half.

RECENT ECONOMIC TRENDS

CONSUMER CONFIDENCE IMPROVES SLIGHTLY AT THE END OF THE YEAR

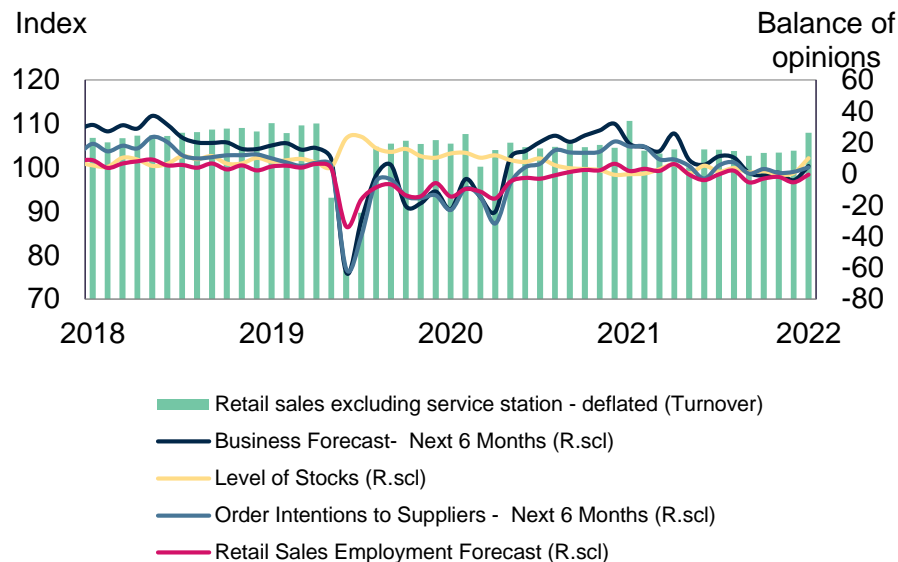
ESI and its components



Sources: Eurostat, Crédit Agricole SA/ECO

The European Commission's economic climate surveys confirm the decline in confidence in all sectors, with the exception of the consumer sector, which is improving slightly over the last two points but is still at very low levels. The results of the Bank of Spain's latest survey on business activity point to stability in the revenue of Spanish companies in Q4, following the slight improvement in Q3. In any event, there is significant sectoral variation: very favourable performances by

Retail sales



Sources: ICI, Crédit Agricole SA/ECO

information and communication services, as well as a recovery in construction and poor revenue growth in agriculture (which had already shown a negative tone in Q3) and the hotel sector (which had been positive in the previous two quarters). In retail and industry, Q4 activity maintained the negative trend of the previous quarter. We therefore expect a slight decline in activity in Q4 2022, at around -0.2% quarter-on-quarter.

CONTENTS

1 SUMMARY

2 RECENT ECONOMIC TRENDS

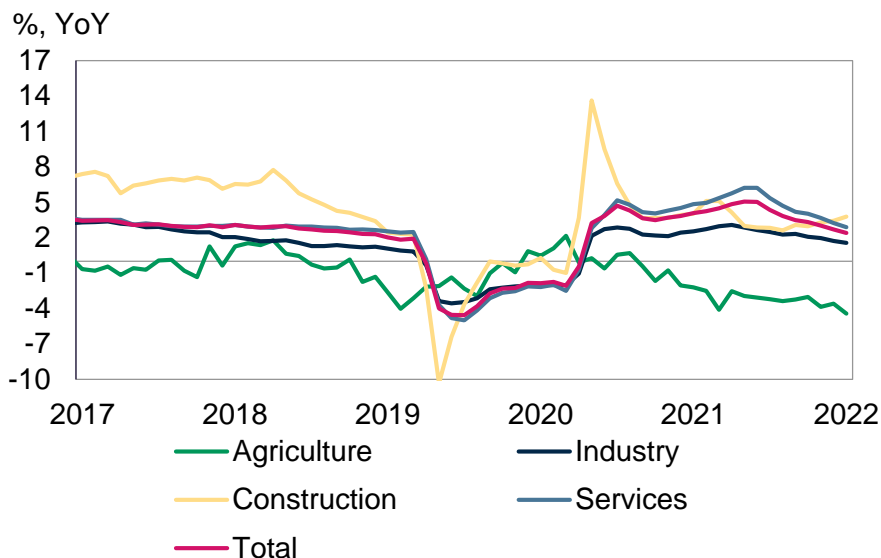
3 | OUTLINE OF OUR SCENARIO

4 FOCUS: OUTLOOK FOR CUMULATIVE HOUSEHOLD SAVINGS

OUTLINE OF OUR SCENARIO

EMPLOYMENT: SLOWDOWN IN Q4

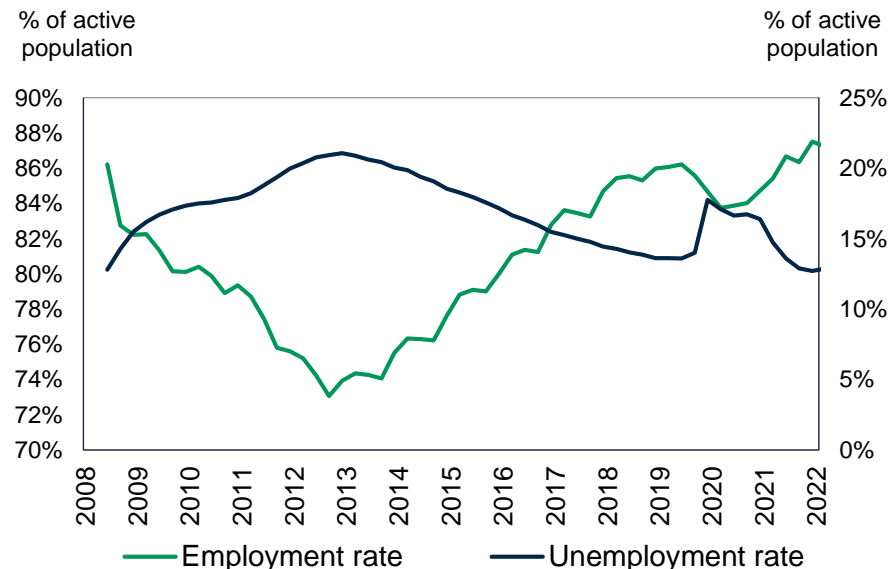
Employment: Social Security enrolment



Sources: Ministry of Labour, Crédit Agricole SA/ECO

Employment growth slowed in the last quarter and the temporary employment rate continued to decline. Social Security affiliation recorded an annual increase of 2.4% in December, indicating slightly lower employment growth in Q4. By sector of activity, there is an increase in employment in construction and continued employment in the merchant service branches, while affiliation was lower in industry and particularly in agriculture. During this period, the momentum in employment continued to focus on permanent employment, which increased 23.8% y/y in November. Conversely, fixed-term contracts

Unemployment rate



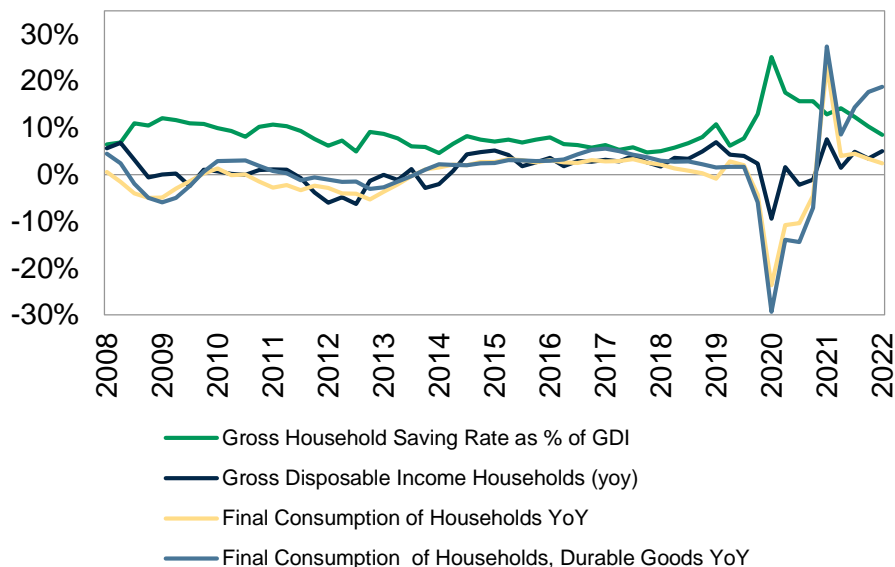
Sources: Ministry of Labour, Crédit Agricole SA/ECO

were down 42.3%. As such, the temporary employment ratio decreased by 13.5 pp compared to November 2021. Of this reduction, 6.6 pp resulted from the increase in permanent full-time workers, 3.7 pp from the increase in permanent part-time staff and 3.2 pp from the increase in intermittent permanent staff. The unemployment rate stood at 12.7% in Q3 (12.5% in Q2). Inflationary pressure and the drop in activity driven by weaker domestic demand suggest a moderate decline in the unemployment rate and an increase in 2023. Our forecasts are 13.3% in 2023 and 12.8% in 2024.

OUTLINE OF OUR SCENARIO

MODERATE CONSUMPTION IN Q3

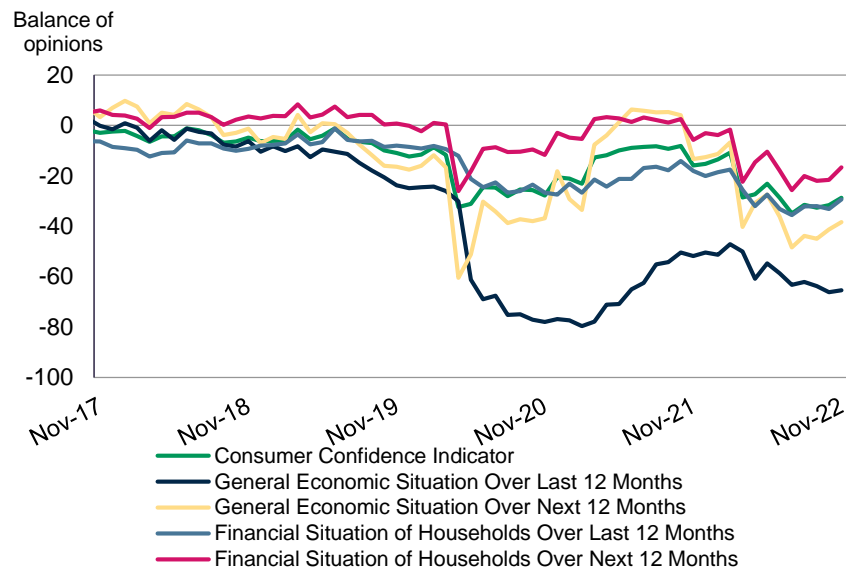
Change in gross disposable income and its components



Sources: Eurostat, Crédit Agricole SA/ECO

Private consumption increased by 0.1% in Q3 2022 compared to Q2. Growth in consumption of non-durable goods and services (+0.9% over the quarter) was similar to that in durable goods consumption (+0.8%). The household savings rate reached 5.7% of gross disposable income, down significantly from 8.4% in Q2 2022. In the last quarter of the year, the consumption momentum was dragged down by inflationary pressures and high uncertainty. Consumption weakened further, in an environment marked by high inflation rates, which are eroding household purchasing power, high uncertainty, tighter financing conditions and very low confidence levels, particularly

Household survey



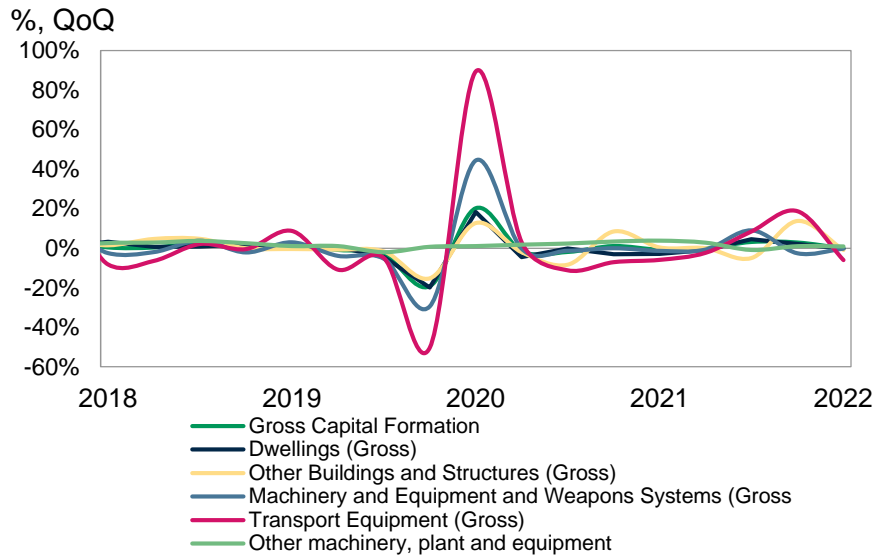
Sources: European Commission, Crédit Agricole SA/ECO

among low-income households. The decline in household spending is thought to reflect, at least in part, the decline in service spending, particularly leisure and hospitality spending. Spending on goods is expected to show a relatively more favourable trend according to the partial information available (including information on registrations of private vehicles to November and the performance of the retail index to November). We expect a 0.5% decline in private consumption in Q4 2022.

OUTLINE OF OUR SCENARIO

INVESTMENT: THE OUTLOOK IS GETTING WORSE

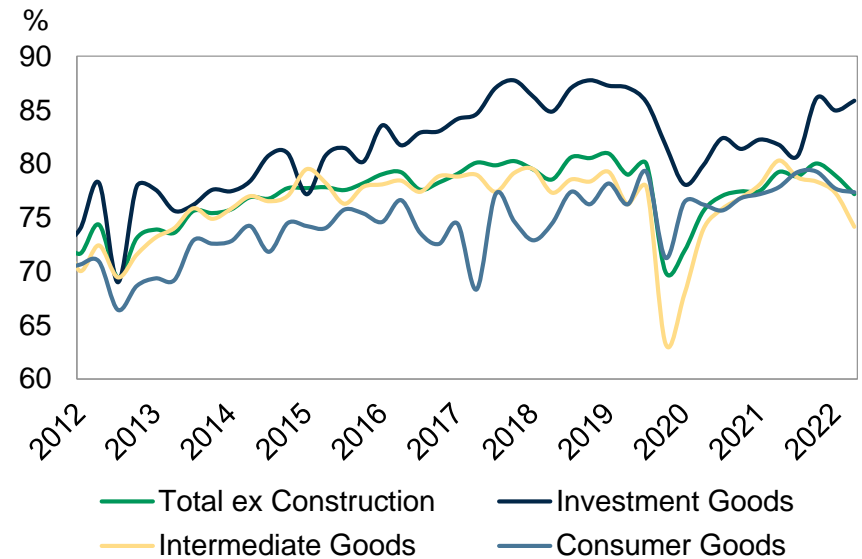
Components of investment



Sources: INE, Crédit Agricole SA/ECO.

Investment fell -0.1% in Q3 2022 over the quarter, following the strong increase in Q2 (+2.9%). All components showed reductions: the decline in construction (-0.6%, including -0.3% for housing) came alongside the decline in goods and equipment (-0.3%) and transport investment (-6%). Recent unfavourable developments in the PMI indicators, deteriorating confidence, the weak global economy and tighter financial conditions point to a reduction in business investment momentum in the short term. However, from a longer-term

Capacity utilisation



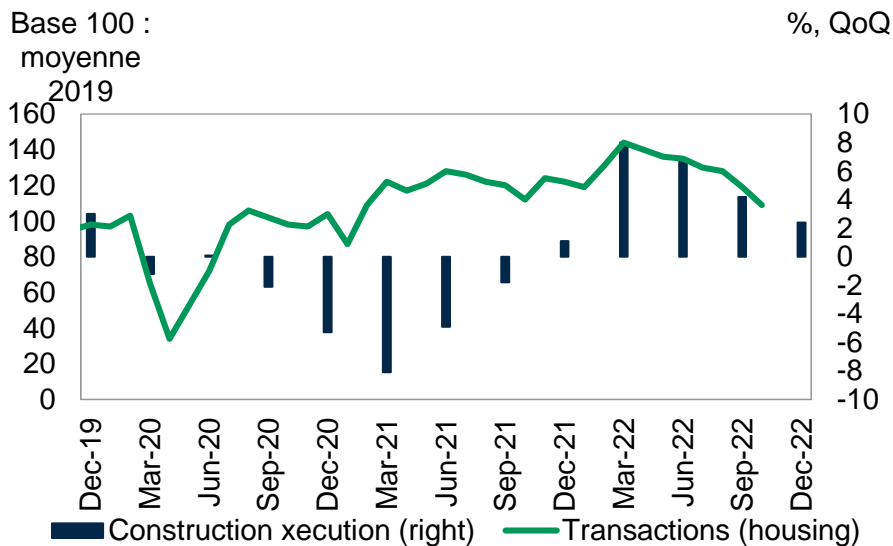
Sources: Ministry of Industry and Commerce, Crédit Agricole SA/ECO.

perspective, it could be expected that the roll-out of NGEU-related projects and the gradual improvement in the factors that have limited economic activity in recent months will be compatible with more robust investment activities. This all comes in a context where there is already significant use of installed production capacity in the capital goods industry. We expect investment to grow 0.1% in Q4 and 1.9% on average in 2023.

OUTLINE OF OUR SCENARIO

HOUSING PRICES ARE HOLDING UP BUT MODERATING

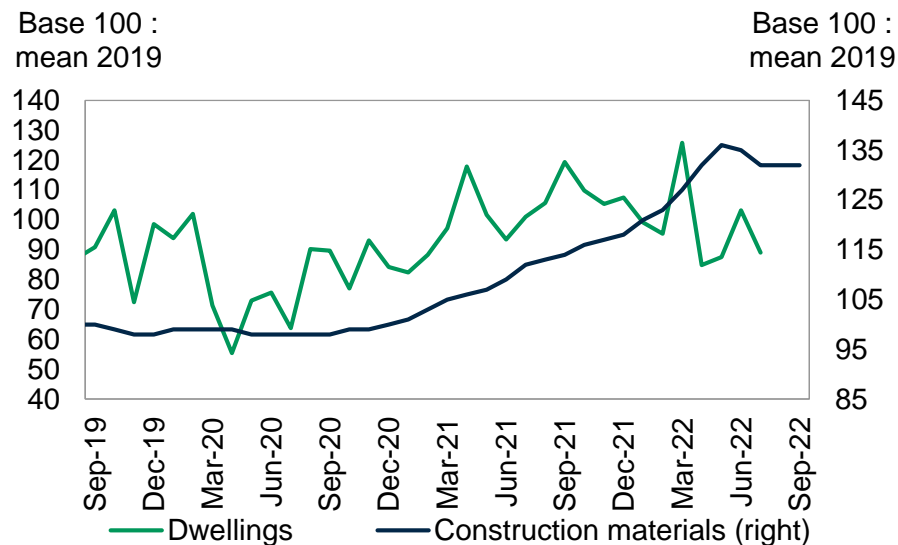
Construction indicators



Sources: INE, Crédit Agricole SA /ECO

Housing investment fell -0.3% in Q3 2022 and continued to slow down in Q4, although prices show some resilience on the downside. The construction execution indicator and transactions have been on a downward trajectory since Q2. Nevertheless, despite their recent slowdown, transactions remain at a relatively high level, well above the level seen in the years before the pandemic. If sustained, this apparent robust demand could provide some support to housing prices

Building permits



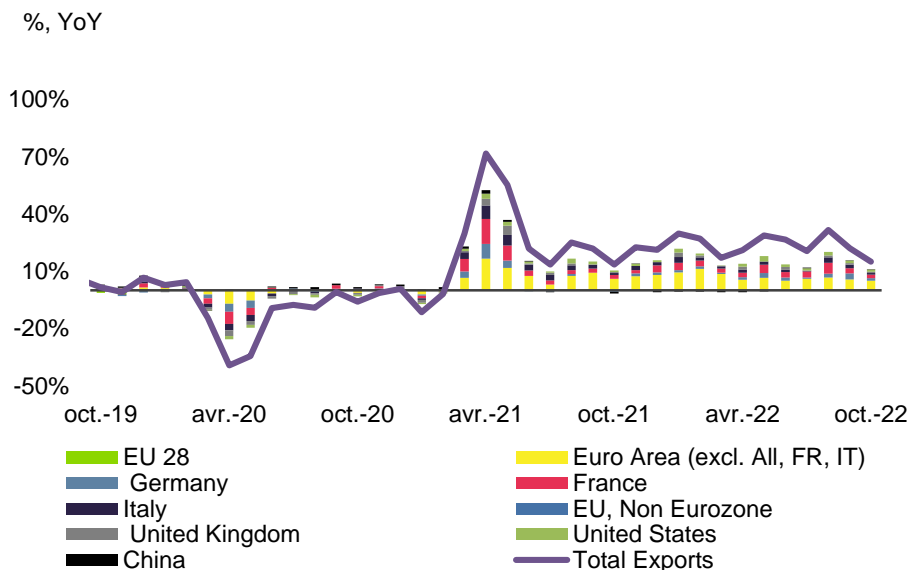
Sources: INE, Crédit Agricole SA /ECO - base 100 = Dec. 2019

in the short term. Housing prices moderated their year-on-year growth in Q3, at 7.6% (8% in Q2), with a slightly more marked slowdown in new properties.

OUTLINE OF OUR SCENARIO

THE EXTERNAL BALANCE IS IMPROVING

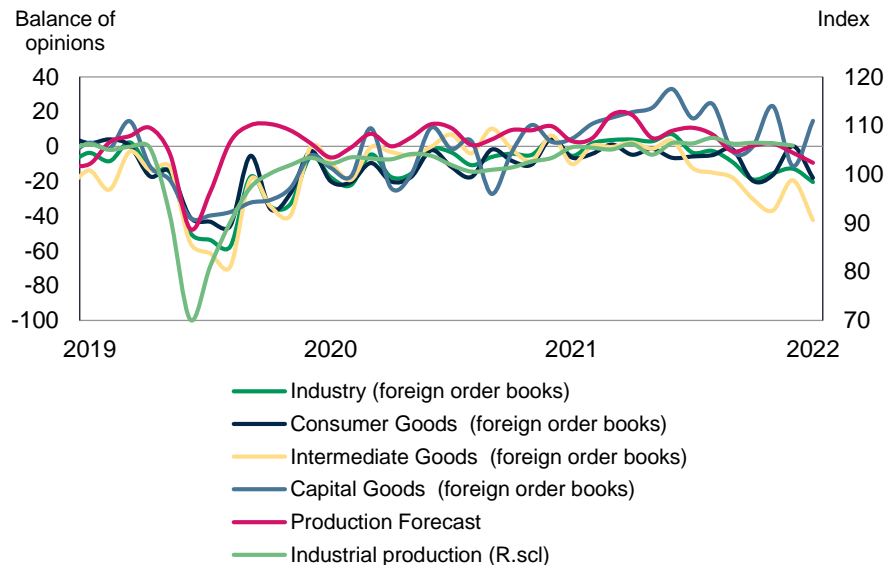
Exports by destination



Sources: Bank of Spain, Crédit Agricole SA/ECO

Net exports moderated their negative contribution to growth in Q4, offsetting the slowdown in the contribution of domestic demand. In a context of slowing domestic demand, the slowdown in imports of goods over the last three months of the year was more pronounced than in exports. The slowdown in purchases, for example, according to the PMI indicators for October and November, is in this sense more intense than the slowdown in the foreign order book. International tourism continued its recovery trajectory in Q4, although the speed of tourist activity convergence towards pre-pandemic levels was

Export order books



Sources: Business confidence survey, Ministry of Industry and Commerce, Crédit Agricole SA/ECO

somewhat lower than in previous quarters. Overall, the contribution of net foreign demand to GDP growth increased in the last months of the year, despite remaining slightly negative, due to the relative strength of Spanish imports (throughout 2022) in a climate of greater momentum in the Spanish economy compared to the rest of the eurozone, particularly in the case of sectors of industry with a higher imported content.

OUTLINE OF OUR SCENARIO

PUBLIC FINANCES, STRONG REVENUE

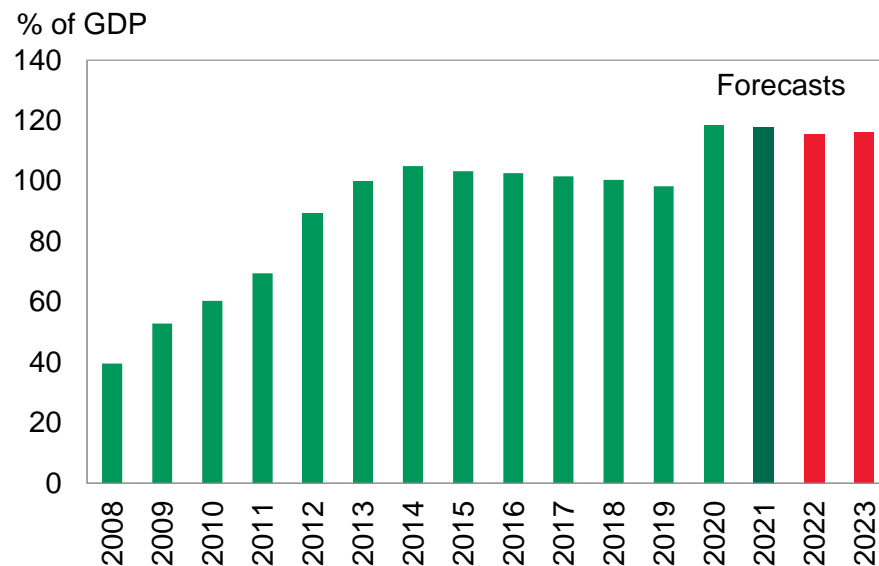
Government deficit



Sources: Stability and Growth Programme, Crédit Agricole SA/ECO

Government revenues continue to show strong momentum and suggest that the general government deficit for the whole of 2022 could be lower than envisaged in the budget plan. Although they slowed slightly in August and September, tax revenues continue to grow at high rates y/y, well above spending levels. Although a growing share of the increase in tax revenues is linked to the rise in prices, around 20% of the recovery in inflows during the first half of 2022 cannot be explained by the usual determinants of this item, which leaves some doubt as to the structural nature of part of these additional revenues. In any event, in September, the general

Government debt



Sources: Stability and Growth Programme, Crédit Agricole SA/ECO

government balance stood at -3.9% of GDP over the past 12 months. This deficit is 3 pp lower than at the end of 2021 and is also 1.1 pp lower than the budget plan benchmark. For the rest of 2022, we expect the improvement in the government deficit to slow, due to the deterioration in the macroeconomic environment and the escalation in measures taken by the authorities to counter the negative effects of rising prices and the consequences of the war in Ukraine. These measures are expected to have a fiscal cost in 2022 equivalent to 1.3 pp of GDP, of which 0.8 pp would be realised from July onwards. Our government deficit forecasts are -4.8% in 2022 and -4.4% in 2023.

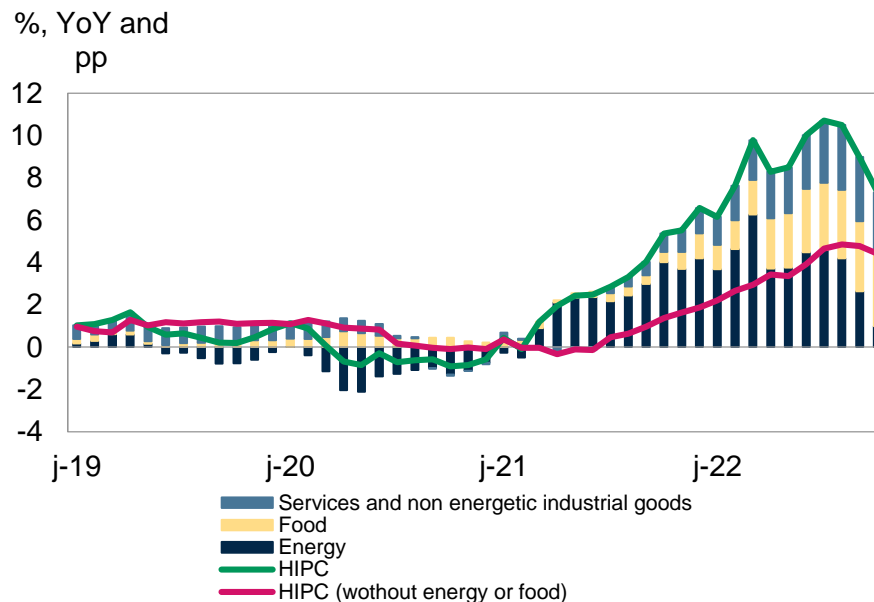
TREND IN INFLATION

INFLATIONARY PRESSURES MODERATE

Inflation has slowed in recent months in Spain, from a maximum of 10.7% in July to 5.8% in December. This is mainly due to lower energy prices, while food prices continued to rise (14% in November), albeit at an increasingly moderate pace. The recent slowdown in energy prices is mainly attributable to the monthly decline in electricity prices (due to lower prices for the gas used in electricity generation) and fuel prices (in line with the observed decline in oil prices). Core inflation (excluding food) has also slowed in recent months – from 4.6% in July to 4% in November – mainly due to the slowdown in service prices. This slowdown is partly due to measures to reduce the cost of public transport and the cap on rent increases introduced by the government.

Moreover, the moderation in inflation in Spain over the past few months has contrasted with the prolonged rise in inflation across the eurozone. As a result, there is a significant reduction in the gap, which reached an all-time low in November, at -3.4 pp. This is attributable to the behaviour of retail electricity prices in Spain, where the regulated tariff results in a rapid transfer of price fluctuations on the wholesale markets to consumer prices, whereas in most eurozone countries this transfer takes place over a longer period of time. This explains the very positive inflation differential observed between Spain and the eurozone for much of 2021 (when wholesale prices increased) and the very negative gap currently observed (when wholesale prices are falling). Conversely, food prices have recorded higher growth rates in Spain since the end of 2021, leading to a positive differential in this component, which has narrowed in recent months.

Inflation: trend and contributions



Sources: INE, Crédit Agricole SA/ECO

However, inflation rates are expected to remain at relatively high levels for several quarters. According to a study by the Bank of Spain, fluctuations in wholesale natural gas prices only start to impact industrial prices after three months and their effects have a high degree of persistence, both in absolute terms and compared with the impact of oil price fluctuations, particularly in the case of intermediate goods industries that produce key inputs for many other branches of industry. In this context, companies participating in the Bank of Spain's latest survey on business activity (EBAE) state that they plan to continue the process of reflecting at least part of the cost increases in their sales prices.

CONTENTS

1 SUMMARY

2 RECENT ECONOMIC TRENDS

3 OUTLINE OF OUR SCENARIO

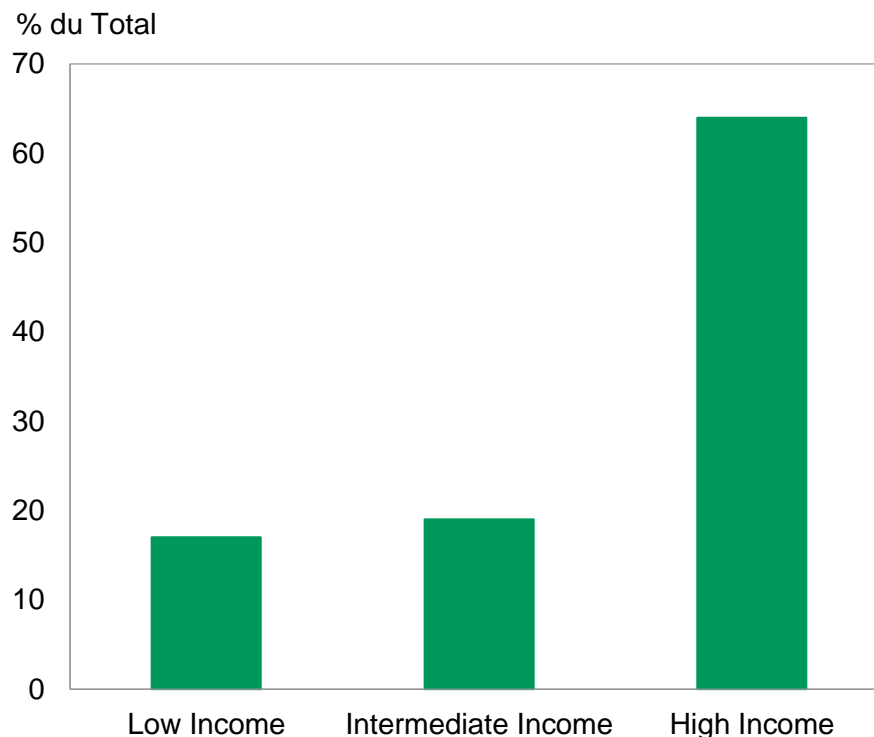
4 | FOCUS: OUTLOOK FOR CUMULATIVE HOUSEHOLD SAVINGS

FOCUS: OUTLOOK FOR CUMULATIVE HOUSEHOLD SAVINGS

CUMULATIVE SAVINGS MAINLY CONCERN HIGH-INCOME HOUSEHOLDS...

During periods when the pandemic had its greatest impact, Spanish households accumulated savings, mainly due to the relatively severe pandemic restrictions. Between January and September 2020, Spanish families' savings were nearly 4 percentage points (pp) of GDP higher, on average, than during the first three quarters of the previous five years. Currently, according to Eurostat data, these savings can be estimated at around €120 billion. Determining to what extent and how quickly Spanish families will use these reserves to maintain or increase their spending levels was one of the main sources of uncertainty when assessing the strength of consumption. This all comes in an extraordinarily changing and complex situation, in which other developments (such as the outbreak of the war in Ukraine, rising inflation and interest rates) have significantly influenced household spending and savings. There are two questions: 1) the extent to which the surplus savings accumulated in the initial phases of the pandemic have helped boost consumption in recent quarters, and 2) what the expectations are for the coming months. The Bank of Spain (BoS) conducted a study using the information in the Consumer Expectations Survey (CES), conducted by the ECB, which enables us to provide an answer to these questions.

Breakdown by income bracket of households that saved between January 2020 and March 2021



Sources: Consumer Expectations Survey and Bank of Spain. High (low)-income households include those with a higher (lower) income than the 60th (40th) percentile of the distribution of this variable. Middle-income households include those with incomes between the 40th and 60th percentiles of this distribution.


FOCUS: OUTLOOK ON CUMULATIVE HOUSEHOLD SAVINGS

... AND WILL NOT MAKE A SIGNIFICANT CONTRIBUTION TO PRIVATE CONSUMPTION

- Firstly, according to data from the CES, of the Spanish households that saved during the initial phases of the pandemic (January 2020 to March 2021), those that report having used savings to finance their spending recently (between July 2021 and July 2022) represent a relatively small group: 15%. Given the small size of this group of households, it would appear that the use of accumulated savings has not had a very significant impact on overall spending levels.
- Regarding the second question, the CES surveys from September suggest that households that saved during the pandemic do not anticipate greater momentum in their consumption (over a year) than households that did not save during the lockdowns. We should therefore not expect the surplus savings accumulated during the pandemic, the value of which in real terms is understood to have already fallen significantly in recent months due to the rise in prices, to give a very significant boost to household spending in the coming quarters. Various factors also point in this direction.
- Firstly, most of the excess savings accumulated during the pandemic are concentrated in high-income families, which have a marginal propensity to spend at lower levels. Secondly, the considerable uncertainty in the current geopolitical and macro-financial situation has contributed to the increase in savings for precautionary reasons.
- Furthermore, the significant rise in the cost of debt in recent months could also encourage households to spend some of their accumulated savings on loan repayments, rather than on consumption.
- In summary, the use of the excess savings that Spanish households accumulated at the start of the pandemic has had a relatively modest impact on the trend in aggregate consumption for the time being. Moreover, various factors suggest that over the coming quarters, we cannot expect these accumulated savings to give a very significant boost to Spanish household spending.

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