SPAIN
2023-2024 SCENARIO

SLUGGISH GROWTH RETURNS

April 2023

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WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

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SUMMARY

SPANISH GROWTH HELD UP WELL IN Q4 2022

Spanish GDP maintained a positive growth rate in Q4 (0.2% quarter-on-quarter). This trend is explained by a positive contribution from external demand (+1%) due to the more pronounced decline in imports (-4.2% over the quarter) than exports (-1.1%) and the contribution of changes in inventories (+0.5 points of GDP). Domestic demand contributed negatively to growth (by -1.3 points): private consumption fell 1.8% and investment dropped 3.7% over the quarter. In 2022, Spanish GDP increased by 5.5%, replicating the same growth rate as in 2021. Net exports and private consumption were the main pillars of growth, both linked to the end of travel restrictions – once the most acute phases of the pandemic were overcome – and the rebound in tourism and leisure activities. In line with these developments, merchant services accounted for most of the growth in 2022. The strong momentum in activity throughout 2022 reflected very different trends in each half of the year. As such, although GDP rose 7.3% year-on-year in H1, growth slowed to 3.7% in H2.

The indicators available for the first quarter of 2023 suggest that activity is likely to have maintained similar momentum to the last months of 2022. This trend is mainly due to the prevailing high level of uncertainty, the decline in business confidence, persistent inflationary pressures and tighter financial conditions. The easing of supply shocks with the downward correction in energy prices and the release of bottlenecks, combined with fiscal support measures and the solid labour market, contributed to slightly higher growth in activity in Q1 than at the end of 2022. However, as rate hikes trickle through the economy and financial conditions are expected to tighten further, growth will be slower in 2024.

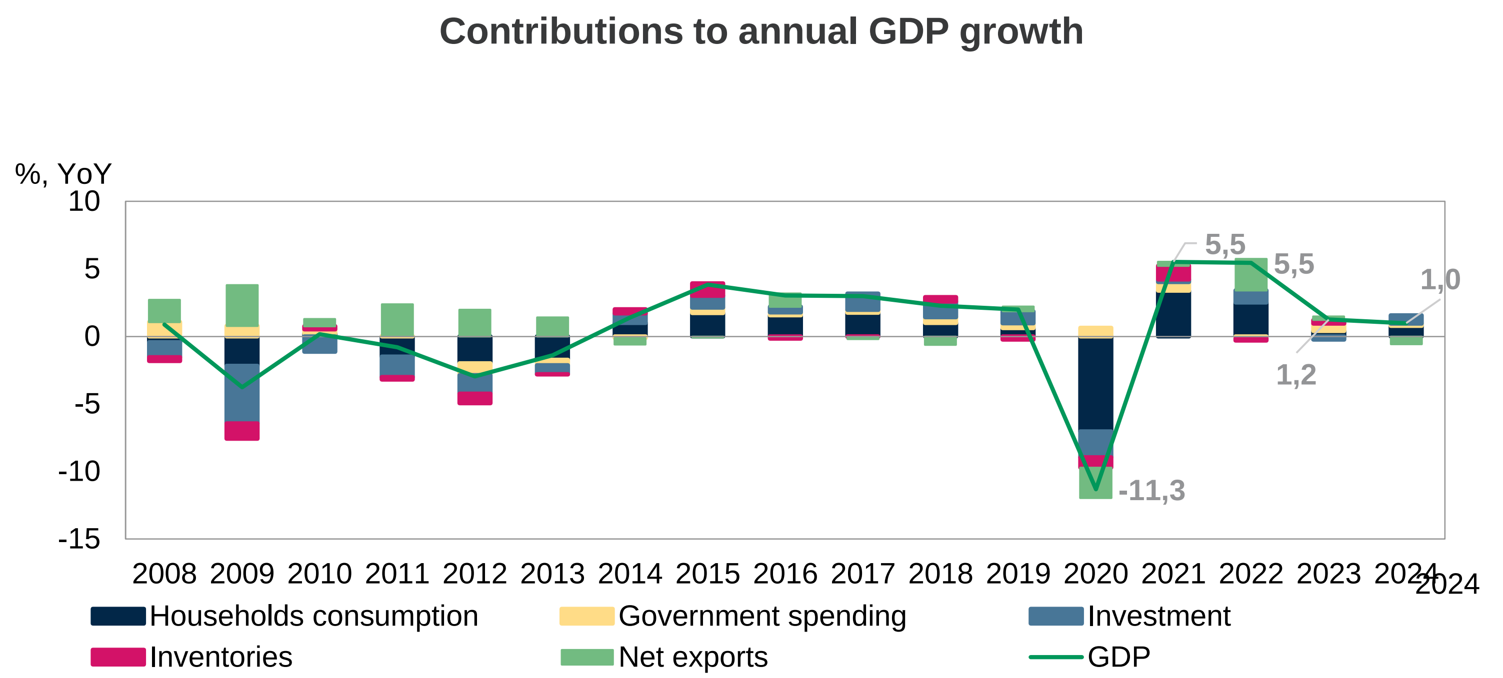
We have not made any major changes to our forecasts since December 2022. Stronger-than-expected data for the first quarter present upside risks to our forecasts for the first half of 2023, offset by greater uncertainty over the second half of the year. The impact of tighter financial conditions could prove stronger and further curb growth. Our growth forecasts are 1.2% in 2023 and 1% in 2024.

We expect inflation to average 4.5% in 2023 and fall to 2.4% in 2024, as the decline in energy prices spreads to the other components. Regarding the non-volatile components of the consumer price index and food, we expect stickier inflation in 2023.

The public deficit was 4.8% of GDP in 2022, below the government's target of 5%, but above our forecasts based on budget implementation figures until November. Government revenues increased by 8.1% compared to 2021 (tax revenues increased 11.4% and social security contributions by 4.8%) and public spending increased by 3.1% (public wages by 4.2% and pensions by 4.8%). The 2023 budget forecasts a deficit of 3.9% in 2023, thanks to estimated growth of 2.1%. Spending, which is very focused on preserving the purchasing power of lower-income households and the deployment of NGEU funds, will help support private-sector consumption (0.7% in 2023 and 1.4% in 2024) and investment.

SUMMARY

OUR GROWTH FORECASTS



Sources: Eurostat, Crédit Agricole SA/ECO

Spain	2022	2023	2024	2023				2024			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	5.5	1.2	1.0	0.1	0.3	0.2	0.3	0.3	0.2	0.2	0.3
Private-sector consumption	4.4	0.7	1.4	0.2	0.2	0.3	0.4	0.3	0.3	0.4	0.6
Investment	4.6	-1.2	3.2	0.3	0.6	0.5	0.5	1.1	1.0	0.8	0.7
Inventory changes*	-0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports*	2.3	0.3	-0.6	-0.2	0.0	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2
Unemployment rate	12.9	13.2	12.8	13.3	13.3	13.3	12.9	13.1	13.1	12.6	12.2
Public deficit (% of GDP)	-4.1	-4.2	-3.9								

*Contributions to GDP growth

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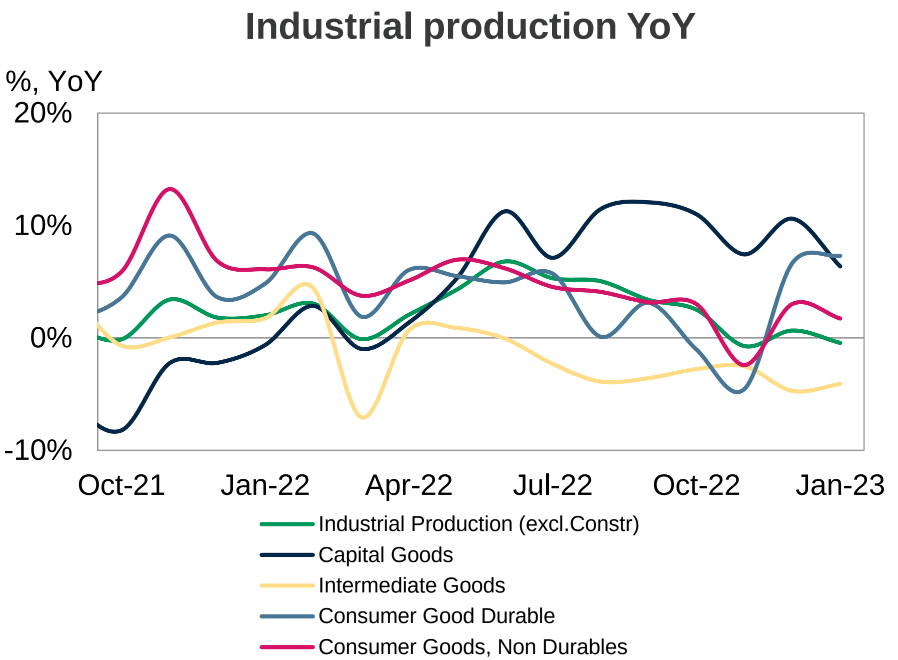
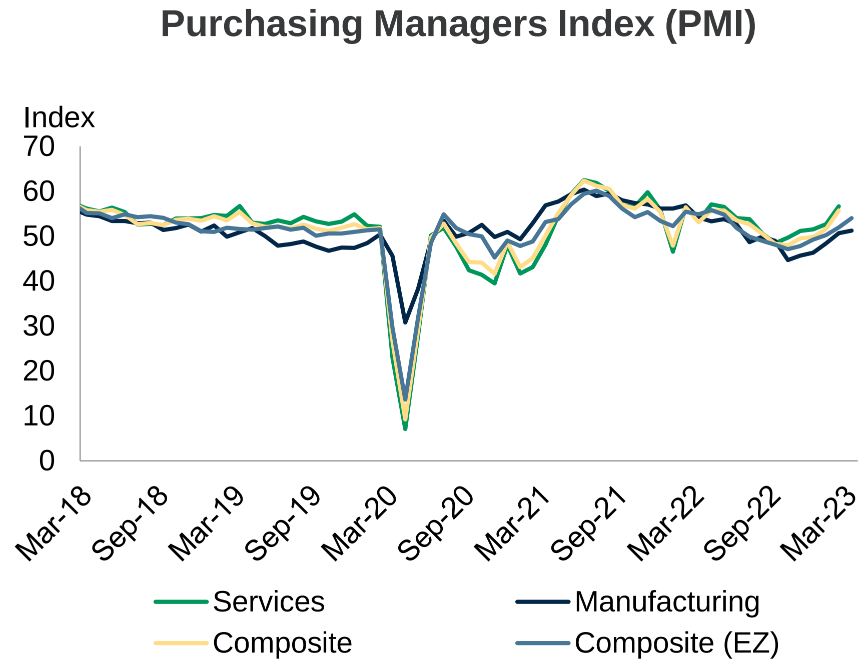
RECENT ECONOMIC TRENDS

PERSISTENTLY SLUGGISH GROWTH IN Q1



Sources: Eurostat, Crédit Agricole SA/ECO

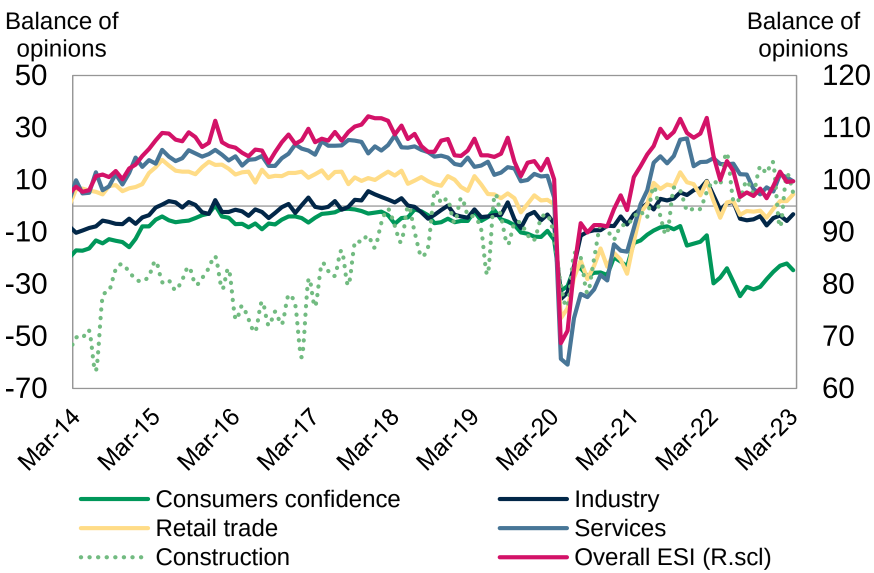


Sources: Markit, Crédit Agricole SA/ECO

The indicators available for the first quarter of 2023 suggest that activity is likely to have maintained similar momentum to the last months of 2022. This trend is mainly due to the prevailing high level of uncertainty, the decline in business confidence, inflationary pressures and tighter financial conditions. The combined analysis of the various indicators – including employment, consumption and confidence – which provide partial information on activity in the first quarter of the year, suggests that the GDP growth rate over this period could be 0.1% quarter-on-quarter. All the components of the PMI surveys improved in Q1 with the exception of industry. This is also reflected in industrial output, which slowed year-on-year to -0.8% in February.

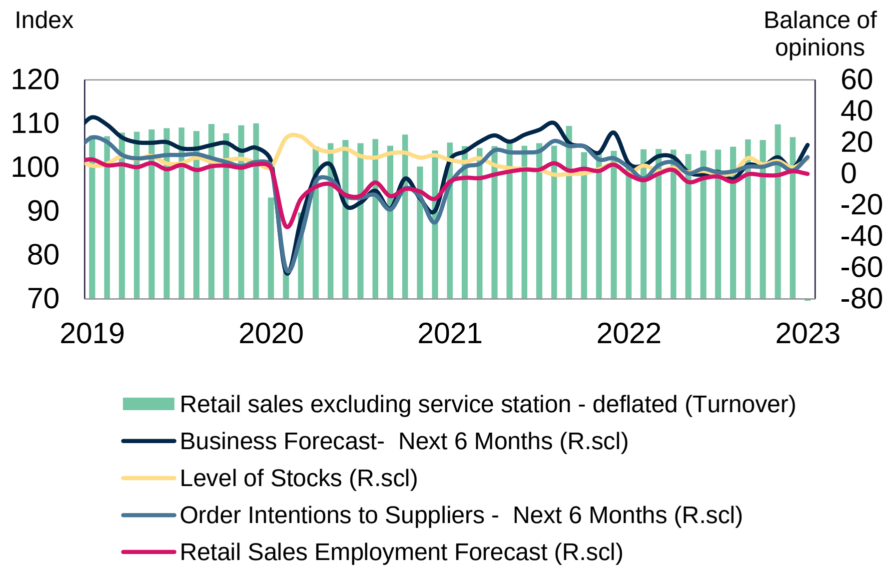
PERSISTENTLY SLUGGISH GROWTH IN Q1

ESI and its components



Sources: Eurostat, Crédit Agricole SA/ECO

Retail sales



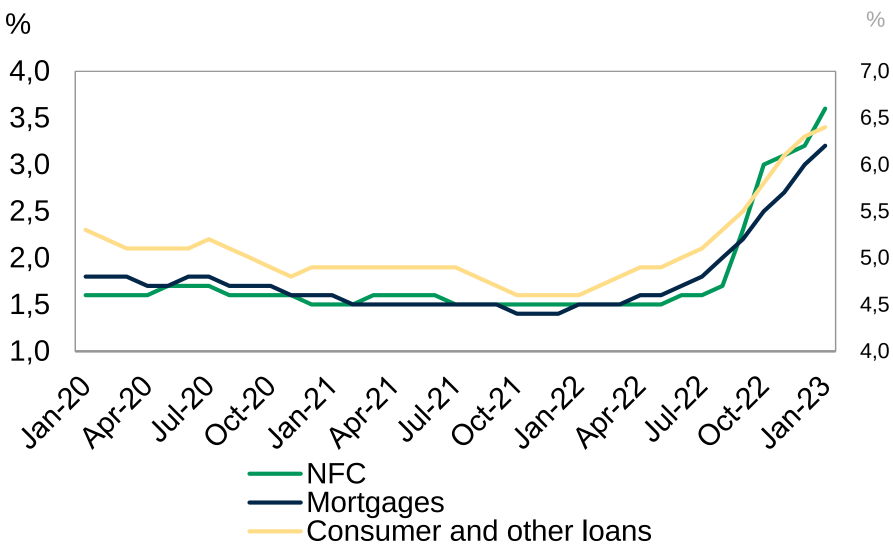
Sources: ICI, Crédit Agricole SA/ECO

The European Commission's economic sentiment surveys confirm a recovery in confidence across all sectors. The results of the Bank of Spain's Business Activity Survey (EBAE) suggest that, for the first quarter as a whole, activity is expected to remain as weak as in the second half of last year, although companies now expect a smaller decline in sales for the current quarter than they expected three months ago. In any event, there is significant sectoral variation: very favourable performances by 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 Q4) and the hotel sector (which had been positive in the previous two quarters). In retail and industry, Q1 activity maintained the negative trend of the previous quarter.

RECENT ECONOMIC TRENDS

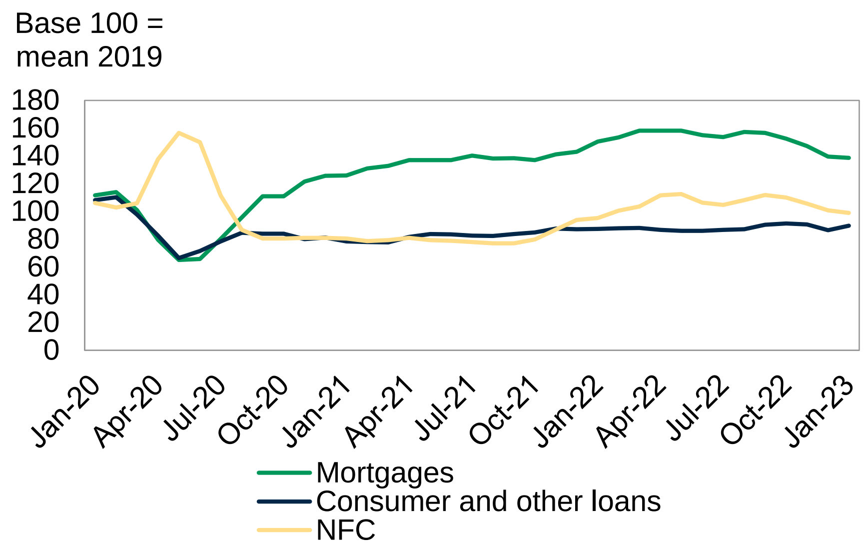
FINANCIAL CONDITIONS HAVE TIGHTENED FURTHER

Cost of new bank loans



Sources: Bank of Spain, Crédit Agricole S.A.

New credit transactions: three-month cumulative seasonally adjusted flows



Sources: Bank of Spain, Crédit Agricole S.A.

In recent months, the impact of the rise in key interest rates on the cost of new bank loans has become increasingly acute in all segments. According to the Bank of Spain's Bank Credit Survey, lending standards tightened in all areas in Spain in the fourth quarter of 2022 for the third consecutive quarter, although to a lesser extent than banks had expected a quarter earlier. At the same time, demand for credit declined in both segments of household credit (mortgages and consumer and other loans) while demand from businesses rose slightly due to increased inventory and working capital financing requirements. Overall, these trends have led to a slight contraction in new financing volumes granted to households and businesses in recent months. For the first quarter of 2023, banks are expecting a further contraction in supply and a widespread decline in credit demand.

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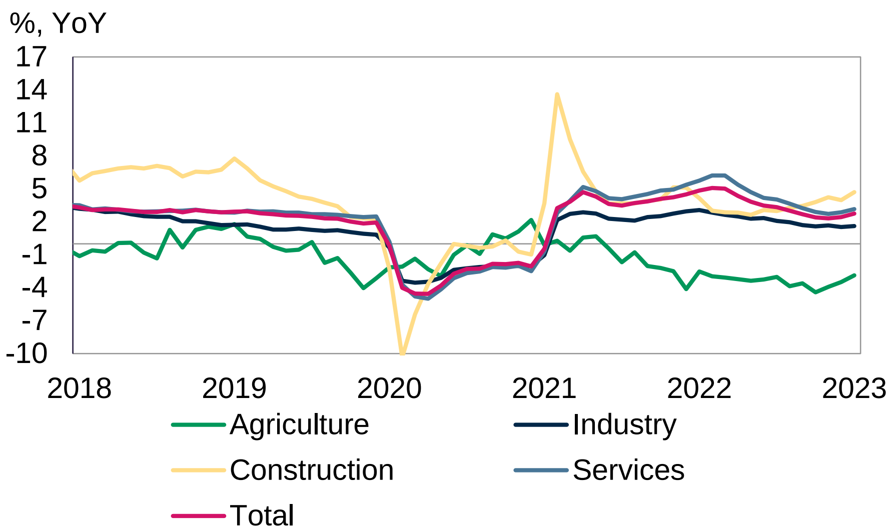
OUTLINE OF OUR SCENARIO

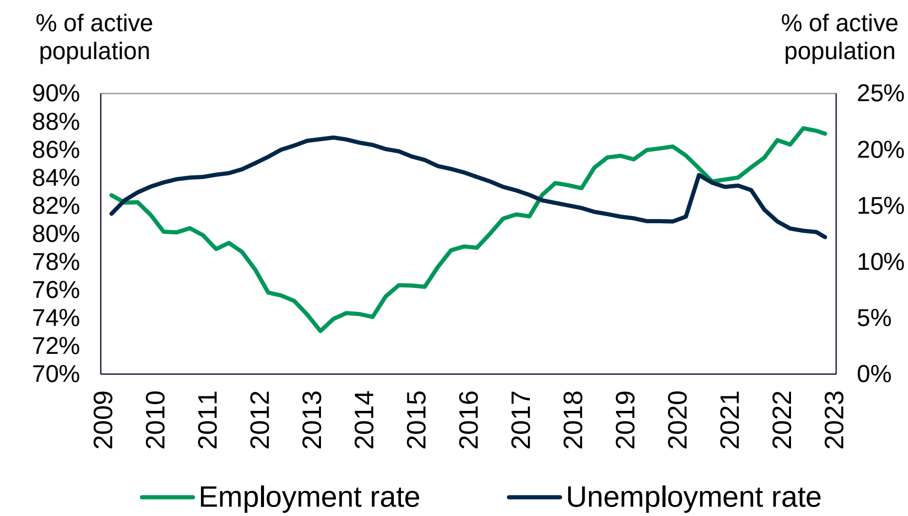
EMPLOYMENT ROSE IN Q1 2023

Employment: Social Security enrolment



Sources: Ministry of Labour, Crédit Agricole SA/ECO

Unemployment rate



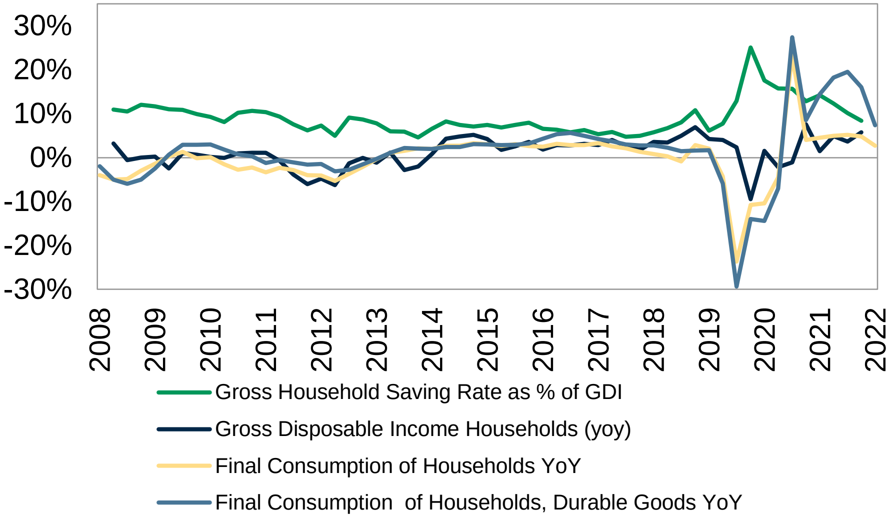
Sources: Ministry of Labour, Crédit Agricole SA/ECO

Job creation accelerated in early 2023 as the number of hours worked per employee decreased. Social Security registrations recorded an annual increase of 2.4% in February and 2.7% in March, higher than the rates observed in Q4 2022. By sector of activity, this stronger-than-expected increase in employment was fairly widespread, particularly with solid levels of social security enrolment in the construction sector in January and in the service segments in February. The average unemployment rate stood at 12.2% in Q1 2023 (12.7% in Q4 2022). The latest data from the national accounts show a slight decline in hours worked in the second half of 2022, which contrasts with the relatively robust employment trend in terms of persons employed during the same period. Inflationary pressure and the drop in activity driven by weaker domestic demand suggest that the decline in the unemployment rate will moderate before rising slightly in 2023. Our forecasts are 13.2% in 2023 and 12.8% in 2024.

OUTLINE OF OUR SCENARIO

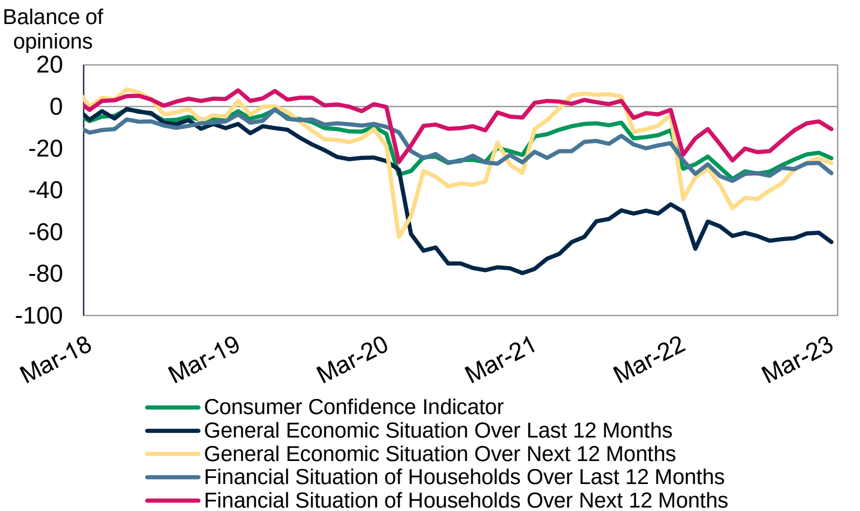
SLIGHT REBOUND IN PRIVATE-SECTOR CONSUMPTION IN Q1 2023

Change in gross disposable income and its components



Sources: Eurostat, Crédit Agricole SA/ECO

Household survey



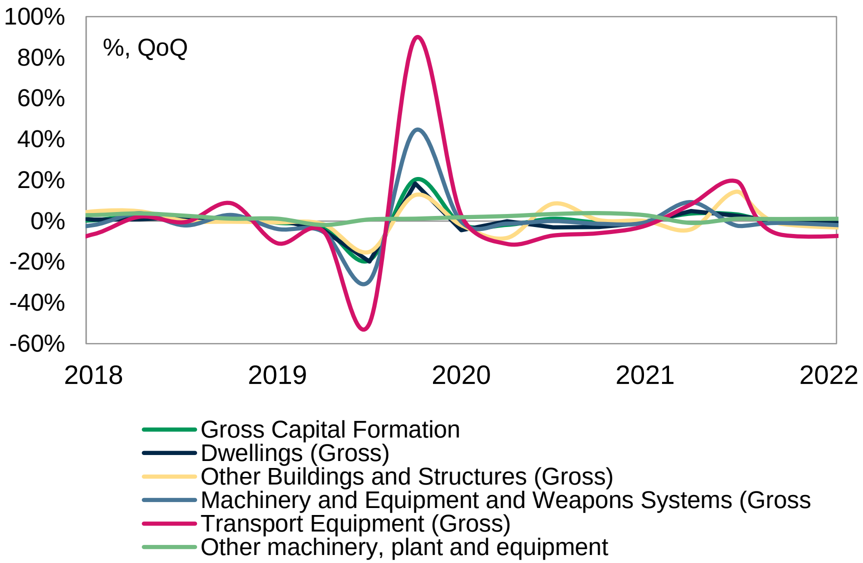
Sources: European Commission, Crédit Agricole SA/ECO

Private consumption fell by 1.8% in Q4 2022 compared to Q3. The decline in consumption of non-durable goods and services (-2.6% over the quarter) was not offset by growth in durable goods consumption (+3.9%). The household savings rate reached 9.1% of gross disposable income, up significantly from 3.3% in Q3 2022. The recovery in job creation and some recent indicators – such as private vehicle registrations up to February – suggest that household consumption could be stronger in early 2023 than in last quarter of 2022. In any event, this component of demand is likely to continue to show significant weakness, hampered by still high inflationary pressures, the continued tightening of financial conditions – the effects of which on real activity are yet to fully materialise – and the reduction in excess available savings. As such, we expect a slight rebound in consumption in Q1 2023, of around 0.2% quarter-on-quarter.

OUTLINE OF OUR SCENARIO

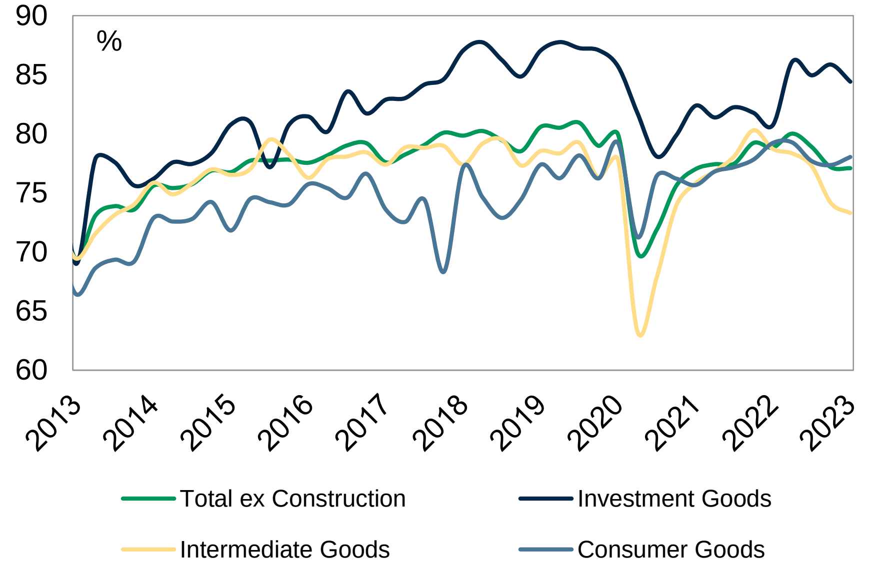
INVESTMENT: THE OUTLOOK IS GETTING WORSE

Components of investment



Sources: INE, Crédit Agricole SA/ECO.

Capacity utilisation



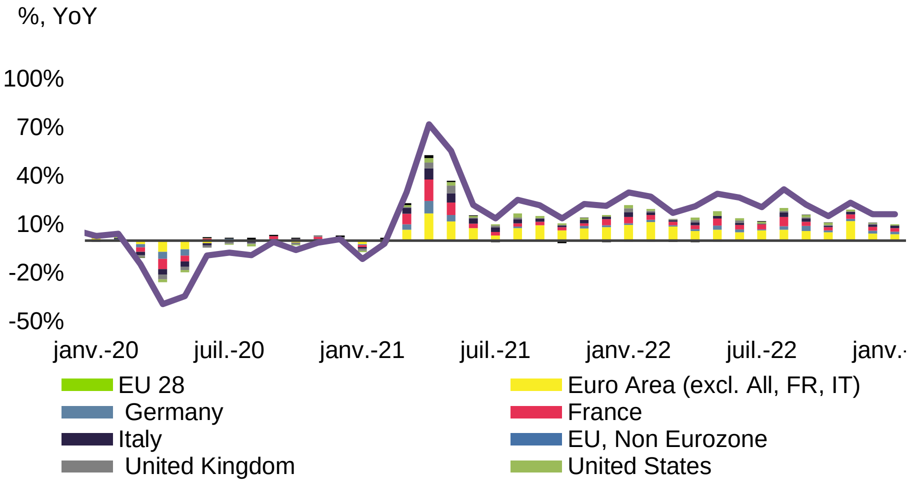
Sources: Ministry of Industry and Commerce, Crédit Agricole SA/ECO.

Investment fell 3.7% in Q4 2022 after dropping 0.5% in Q3. All components fell, with the drop in construction (-2.6%, including -1.5% for housing) occurring alongside the decline in goods and equipment (-6.1%) and transport investment (-0.3%). Business investment could rebound slightly in Q1. Business investment has been very weak throughout 2022 and some factors will continue to significantly dampen its growth going forward (such as continued tightening of financial conditions and ongoing high levels of uncertainty). However, from a short-term perspective, some recent indicators – specifically, the reduction in delivery times observed, the trend in PMI indicators in January and February, the improvement in expectations for order levels and the gradual roll-out of NGEU projects – are expected to support a moderate rebound in business investment in early 2023. We expect investment to increase by 0.3% in Q1 2023.

OUTLINE OF OUR SCENARIO

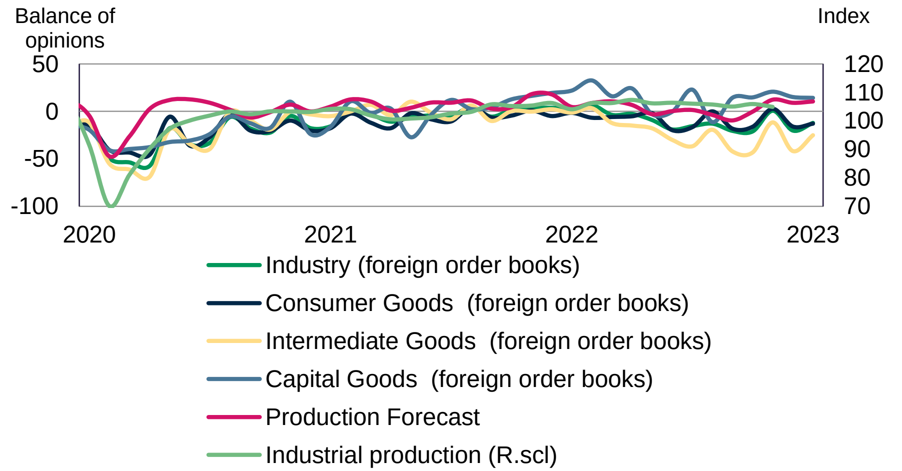
TOWARDS A REDUCTION IN THE INTERNATIONAL TRADE BALANCE IN 2023

Exports by destination



Sources: Bank of Spain, Crédit Agricole SA/ECO

Export order books

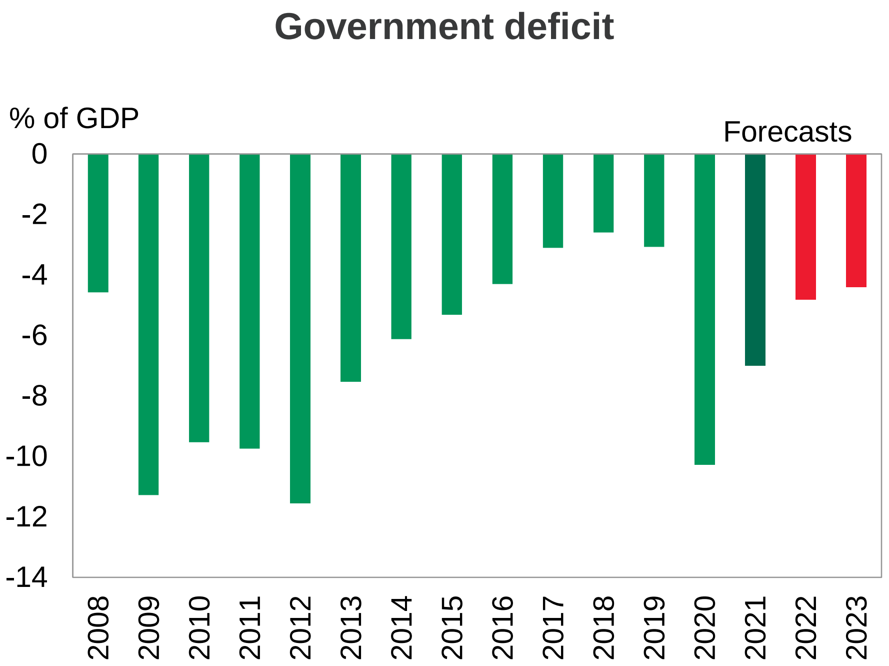


Sources: Business confidence survey, Ministry of Industry and Commerce, Crédit Agricole SA/ECO

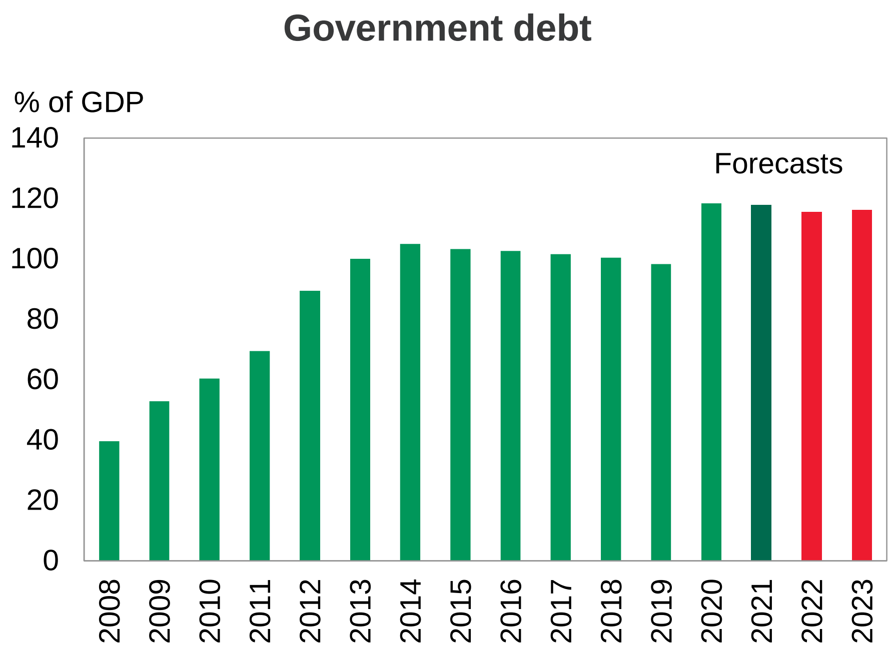
Net exports are expected to have moderated their contribution to growth in the first quarter of the year, after their strong contribution in late 2022. The recovery in PMI indicators for new international orders until February points to a recovery in goods exports in the first months of the year, amid a gradual easing of global supply chain bottlenecks. However, the expected recovery in business investment (high import content) and the start of the euro's appreciation against its main trading partners is likely to boost import demand (after the weakness observed in late 2022), which could reduce the contribution of net exports to GDP growth in the first quarter. January and February's PMI indicators for purchase volumes in Spain are moving in this direction.

OUTLINE OF OUR SCENARIO

PUBLIC FINANCES – LOWER REVENUES IN THE SECOND HALF OF THE YEAR



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



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

The trajectory of reducing the public deficit is likely to have been partially reversed in the latter part of 2022, due to the drop in government revenues. The government deficit for the 12-month period stood at -3.8% of GDP in November, the same level as in September and smaller than the -5% forecast by the government in the latest budget. In H2 2022, until November, the relative stability of spending momentum contrasted with the marked slowdown in government revenues. In particular, there was a significant drop in indirect taxes, which posted negative rates year-on-year in October and November, with inflows below what would be justified by the approved tax cuts and changes in the bases for these taxes. As for the end of the year, the data expected for Q4 2022 published by INE, although still temporary, is expected to confirm the contraction in indirect taxes, while pointing to a recovery in public consumption and subsidies in the latter part of the year.

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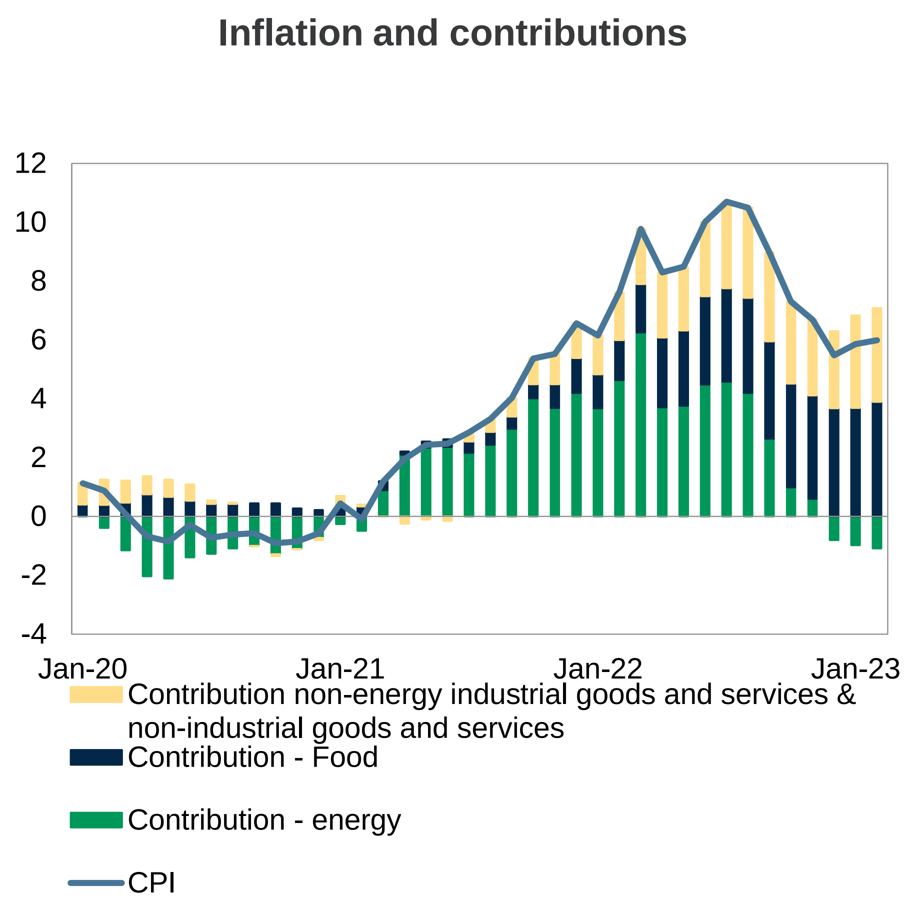
FOCUS: INFLATION

AT THE BEGINNING OF 2023, INFLATION INCREASED AGAIN

- The prevailing downward trend in inflation since mid-2022, mainly due to the decline in energy prices, was interrupted in early 2023 as inflation rebounded slightly, from 5.5% in December 2022 to 6% in February.

- This rebound is mainly due to the impact of the fuel premium for non-professional consumers being eliminated at the end of 2022. This is likely to have pushed up January's year-on-year inflation rate by around 0.7 pp. Another factor is the various methodological changes introduced by the INE in the calculation of the HICP starting in January 2023. These changes include the incorporation of gas and electricity prices into the free market. On the other hand, the annual review of weightings included the change in household consumption during the pandemic, with a higher weighting of components more impacted by higher inflation.

- Food price growth accelerated slightly in early 2023, despite the impact of the VAT cut on some basic foods in place since the beginning of the year, which is likely to have reduced headline inflation by around 0.2 pp in January, according to the Bank of Spain's calculations.

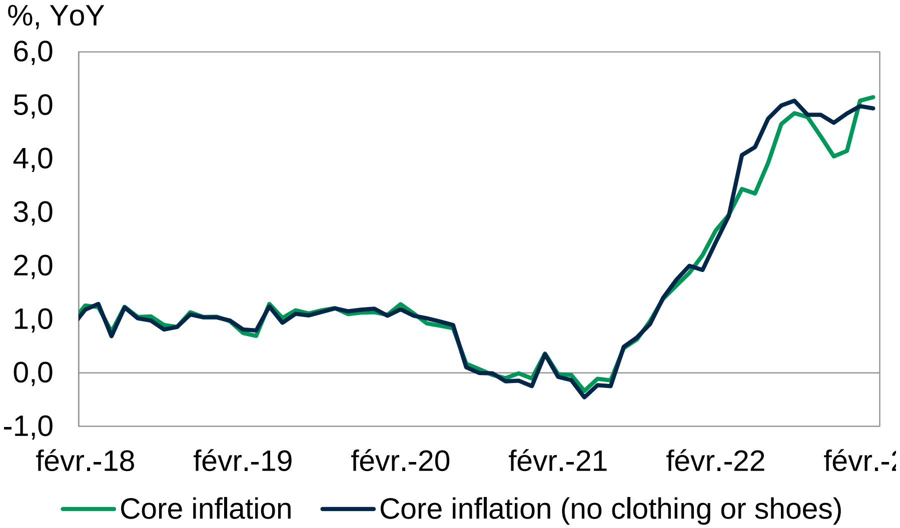


Sources: INE, Crédit Agricole SA

FOCUS: INFLATION

UNDERLYING INFLATIONARY PRESSURES REMAIN HIGH

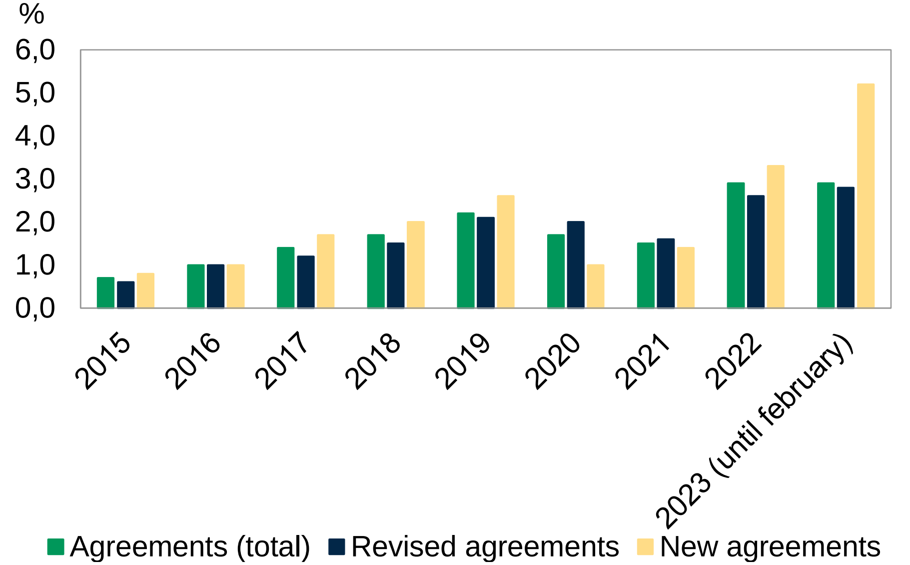
Core inflation



Sources: INE, Crédit Agricole SA

Core inflation (excluding food and energy) reached its all-time high in February at 5.2%, despite the impact of measures to moderate transport prices and rents. The trend in core inflation over the past few months has been heavily influenced by clothing and footwear prices, due to the effect of a methodological change introduced by the INE in January 2022. Excluding this component, core inflation has remained relatively stable since mid-2022. Although the slowdown in energy costs since autumn 2022 could reduce inflationary pressures in the coming quarters, inflation will remain very high in the short term.

Agreed salary increase



Sources: INE, Crédit Agricole SA

Based on the information available up to February, the average wage increase agreed in collective bargaining agreements effective in 2023 reached 2.9%, in line with what had been agreed for 2022. However, this figure essentially reflects what had been agreed in the agreements signed in previous years, while the new collective agreements signed in the second half of 2022 indicate an average wage increase of 3.3%. The agreements signed during the first two months of 2023 call for an increase of 5.2%, but they only involve 245,000 workers and are not very representative of all employees.

FOCUS: INFLATION

NEW PLAN TO MITIGATE THE IMPACT OF INFLATION IN 2023: € 10BN (0.7% OF GDP) BUT THIS HAS ALREADY BEEN INCLUDED IN THE BUDGET

Businesses

- Transport: discount of 20 cents/litre for professional carriers using diesel (through a monthly fuel tax credit) until 31 March. Between 1 April and 30 June, the discount will be 10 cents/litre. Direct assistance (€ 107m) to approved carriers (buses, taxis, ambulances and freight vehicles) of between € 300 and € 3,690 depending on their estimated consumption over six months.
- Primary sector: € 300m in direct aid to the agriculture sector due to soaring fertiliser prices. In addition, 20 cents/litre subsidies for farmers will be in place until 30 June (€ 240m in total) depending on fuel consumption in 2022. Additional aid will be allocated to the fishing industry (€ 120m).
- Industry: € 500m for gas-intensive industries, managed by ICO, including a public guarantee of up to 90% to mitigate current liquidity problems and decarbonise the sector. Direct assistance of € 450m to the ceramics sector.

Households

- The 20 cents/litre discount on fuel has been eliminated.
- Low-income households: one-time transfer of € 200 to households with income of less than € 27,000 in 2022 and assets not exceeding € 75,000, excluding housing (6 million people, i.e. 4.2 million households).
- Food: reduction in VAT from 4% to 0% on basic fresh food and from 10% to 5% on pasta and oil. This policy will remain in place until 30 June 2023, as long as core inflation is above 5.5%.
- Public transport: between January and June, the central government will grant a 30% reduction on transport services provided by regional and local governments as long as they apply their own discounts to bring the overall reduction to at least 50%. Cost: € 380m. In addition, “Cercanías, Rodalies and Media Distancia” multi-trip tickets will be free in 2023.
- Pensions and minimum living wage: 15% increase in non-contributive pensions and minimum living wage.
- Rent: the rent increase will be capped at 2% in 2023. In addition, it will be possible to extend the terms of an expiring lease by six months until 30 June if a lease contract ends during the period.

Electricity market

- Extension of 2022 tax breaks on electricity bills to 2023: VAT on gas and electricity reduced from 21 to 5%, special electricity tax cut from 4.11% to 0.5% and electricity production tax eliminated. These tax cuts caused tax revenue to fall by over € 6bn in 2022.
- Price cap of € 19.55 on butane bottles until 30 June 2023.
- Extension of the ban on cutting electricity to essential services, as well as reductions in electricity bills of vulnerable households.

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