SPAIN
2023-2024 SCENARIO

TOWARDS A SOFT LANDING

20 July 2023

Ticiano Brunello

WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

CONTENTS

SUMMARY

GDP FINALLY REACHES ITS PRE-CRISIS LEVEL IN Q1

Spain's GDP grew 0.6% quarter-on-quarter in Q1 2023, driven by the contribution of net external demand (1.4pp), while the contribution from domestic demand was negative (-0.8pp), amid robust investment that was not enough to offset the decline in private consumption. The best performing businesses during the first quarter were those related to the primary sector and to the retail, transport and hospitality sectors. In contrast, the financial and insurance businesses posted the steepest declines, while the industrial-related segments showed some weakness. This dynamic growth meant that Spain's GDP was just 0.1% off of its Q4 2019 level. However, this figure lags the eurozone, where GDP is already 2.2% higher than its pre-pandemic level.

The indicators available for Q2 are mixed and indicate a slight loss of momentum. Overall, data suggests that the economy continued to grow, but at a slower pace than in the previous quarter. On the one hand, industry is showing further signs of weakness (PMI at 48.0 in June) and industrial output fell over the April-May period (-0.5% vs. Q1). Consumer confidence remains very low. However, the services PMI remains well above the expansion threshold, and the tourism sector continues to show signs of strength in anticipation of a very positive summer season.

In a still complex and highly uncertain environment, the expansion of activity is expected to continue over the coming quarters. The resilience of the labour market (which will support the recovery in household consumption), the easing of inflationary pressure and the projected ramp-up of projects under the NGEU are expected to contribute to this progress. In addition, goods exports will be boosted in the coming quarters by the disappearance of persistent distortions in global supply chains and lower energy costs. On the other hand, tighter financial conditions will continue to slow the pace of growth in consumer and corporate spending. In addition, although the outlook for foreign tourism is positive in the short term, tourism exports will contribute less and less to GDP growth in the future, once this variable has returned to pre-pandemic levels. Finally, the gradual abandonment of measures implemented in response to the energy crisis (which helped mitigate the impact of the crisis on private agents and therefore supported activity since inflation started to rise) will also slow growth momentum.

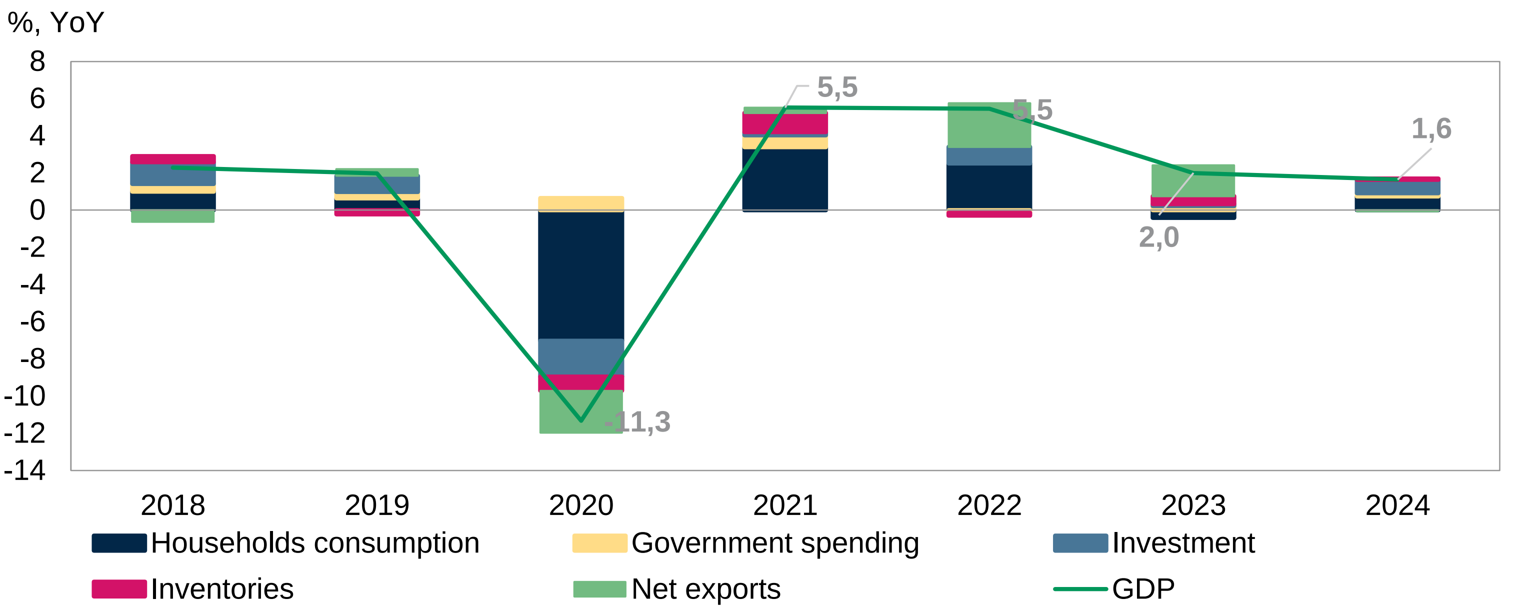
We expect GDP to grow by 2% in 2023, supported by strong external sector and investment performance. On the other hand, private consumption is expected to be sluggish in Q2 and therefore detract from growth. Business momentum will moderate slightly in 2024 to 1.6% and will be made up differently, with growth driven by domestic demand instead of net exports.

As for public finances, solid revenues reduced the public deficit in Q1. According to our current growth forecasts, which are more moderate than the government's (see Focus), the government balance is expected to be slightly below official figures, at 4.1% in 2023 and -3.3% in 2024.

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	5,5	2,0	1,6	0,5	0,3	0,2	0,3	0,5	0,6	0,4	0,3
Households consumption	4,4	-0,7	1,3	-1,3	0,1	0,1	0,3	0,3	0,5	0,4	0,6
Investment	4,6	0,6	3,8	1,9	0,6	0,5	1,0	1,3	1,0	0,8	0,7
Change in inventories*	-0,2	0,4	0,1	0,0	0,1	0,1	0,0	0,0	0,0	0,0	0,0
Net export*	2,3	1,7	-0,1	1,1	0,0	-0,1	-0,1	0,0	0,1	0,0	-0,2
Unemployment	12,9	12,6	12,2	12,8	12,4	12,8	12,4	12,7	12,2	12,1	11,7
Government net lending	-4,8	-4,1	-3,3								

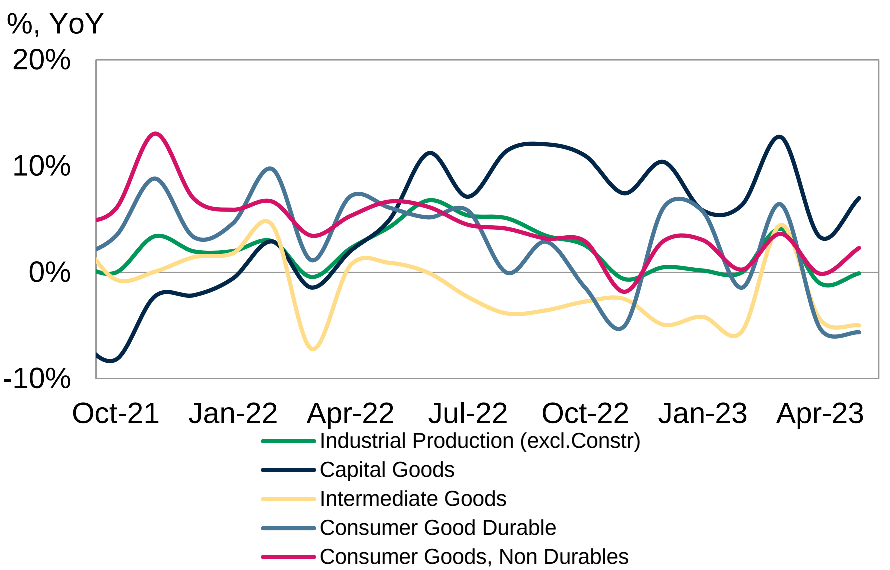
* Contributions to GDP growth

CONTENTS

RECENT ECONOMIC TRENDS

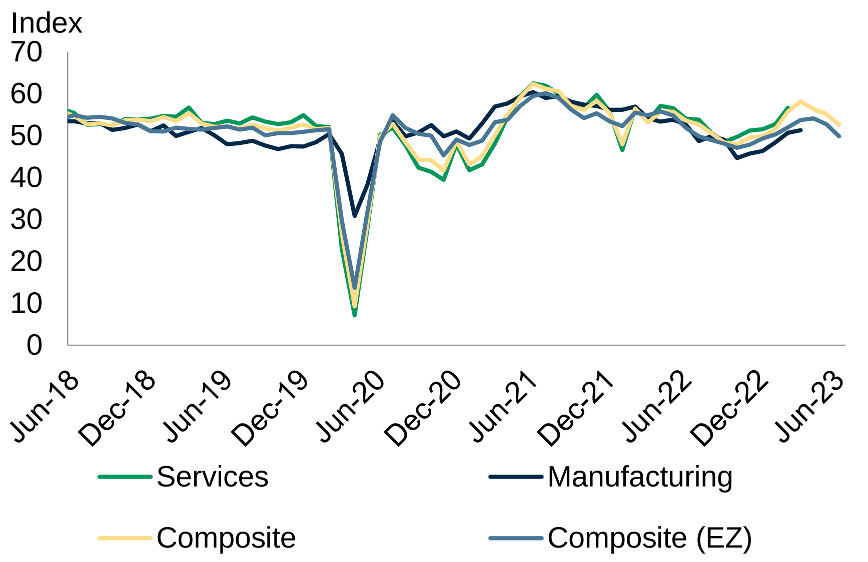
MORE MODERATE GROWTH IN Q2

Industrial output



Sources: Eurostat, Crédit Agricole SA/ECO

Purchasing Managers Index (PMI)



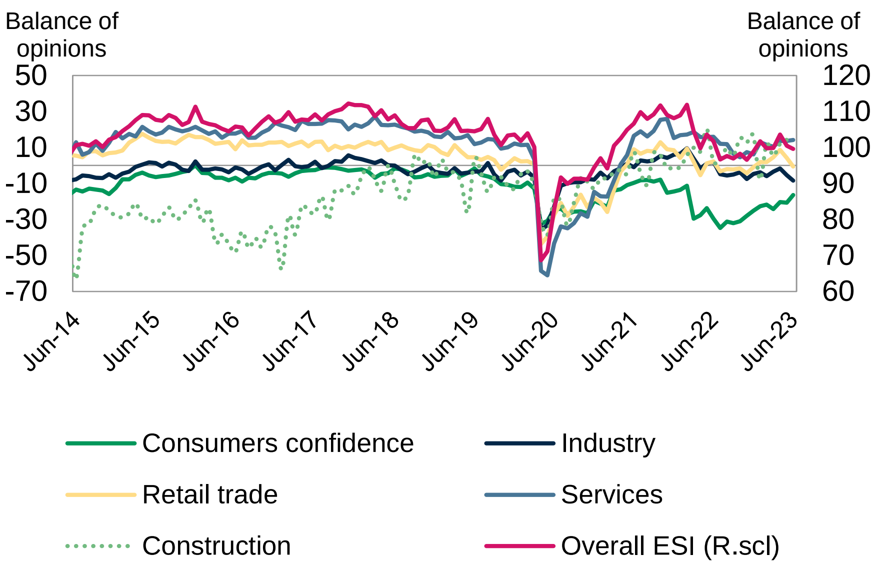
Sources: Markit, Crédit Agricole SA/ECO

Overall, the most recent data suggests that the economy continues to grow, but at a slower pace than in the previous quarter. On the one hand, industry is showing further signs of weakness, as evidenced by the decline in the manufacturing business climate index (PMI) to 48.0 in June – below the level that defines the expansion zone (50) and the lowest level in six months – and the drop in industrial output in April-May (-0.5% compared to Q1). On the other hand, the services PMI remains well above the expansion threshold, and the tourism sector continues to show signs of strength in anticipation of a very positive summer season. The number of foreign tourists exceeded 8.2 million in May – 3.8% more than the same month in 2019 (+1.2% in April and -3.5% in the first quarter of 2023) – and spent almost €8.5 billion, surpassing May 2019's record by 19.5%.

RECENT ECONOMIC TRENDS

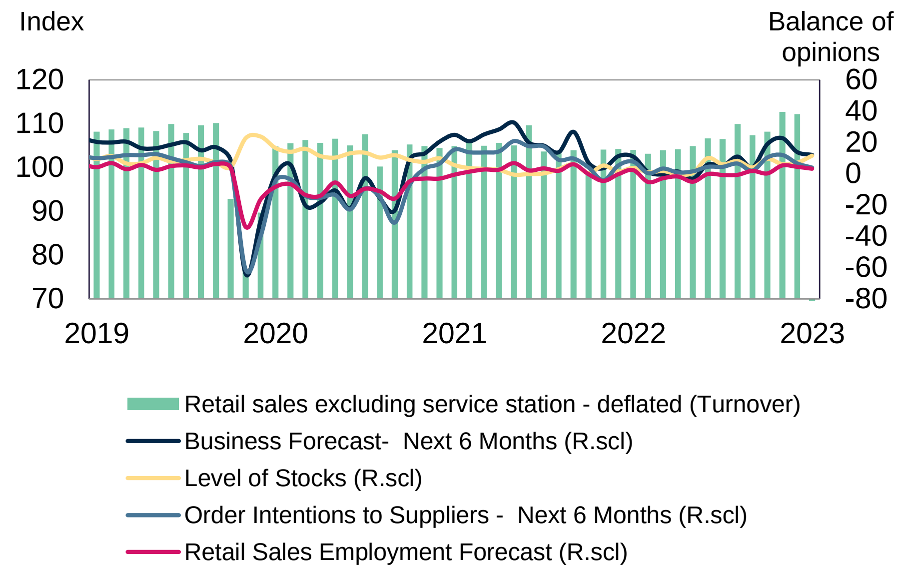
MORE MODERATE GROWTH IN Q2

ESI and its components



Sources: Eurostat, Crédit Agricole SA/ECO

Retail sales

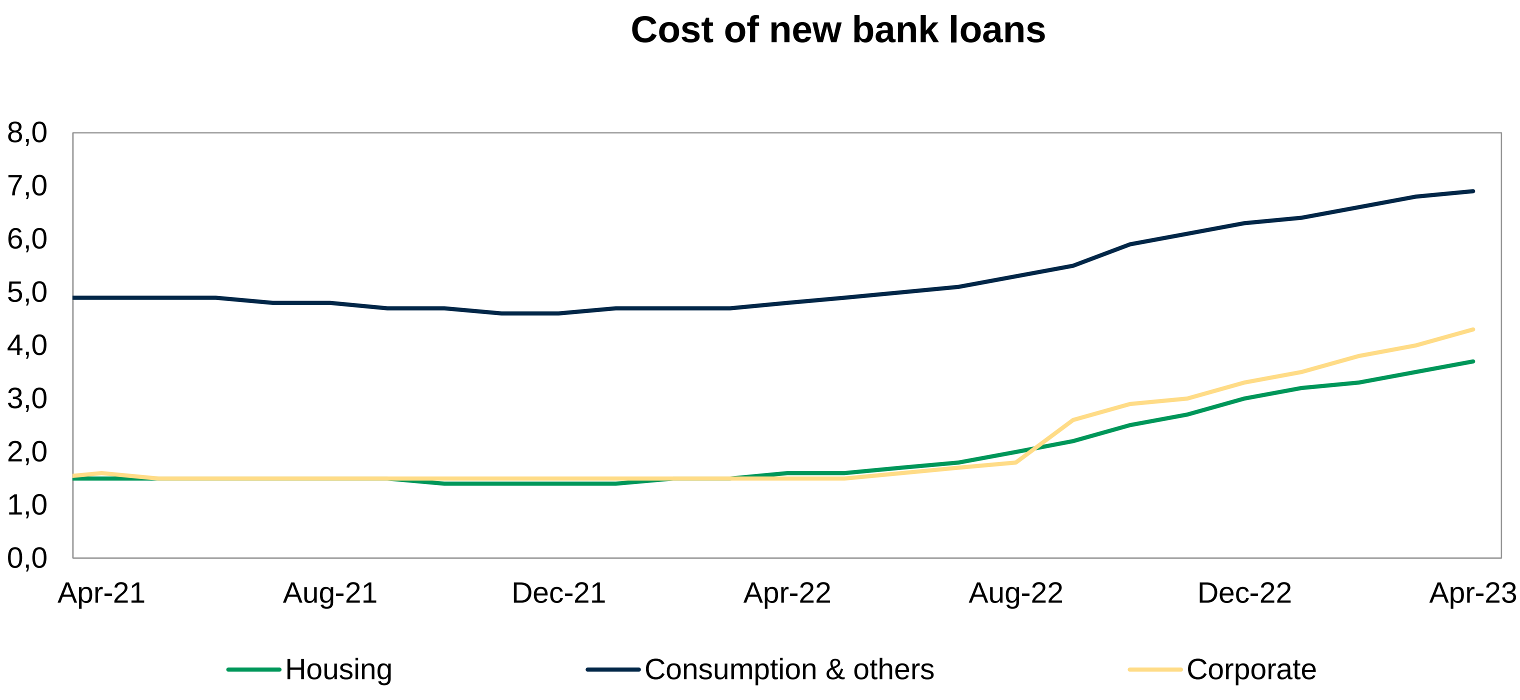


Sources: ICI, Crédit Agricole SA/ECO

The European Commission's economic climate surveys show an improvement in consumer and service-sector confidence, while the outlook for industry and retail has deteriorated. The results of the Bank of Spain's Business Activity Survey (EBAE) paint a similar picture, with Spanish companies posting higher revenues in the second quarter of the year than the first. However, some of the most recent indicators – for example, those referring to job creation – point to some moderation in activity in the latter part of the second quarter. We expect GDP to grow by 0.3% in Q2 2023.

RECENT ECONOMIC TRENDS

FINANCING CONDITIONS CONTINUED TO TIGHTEN



Sources: Bank of Spain, Crédit Agricole SA/ECO

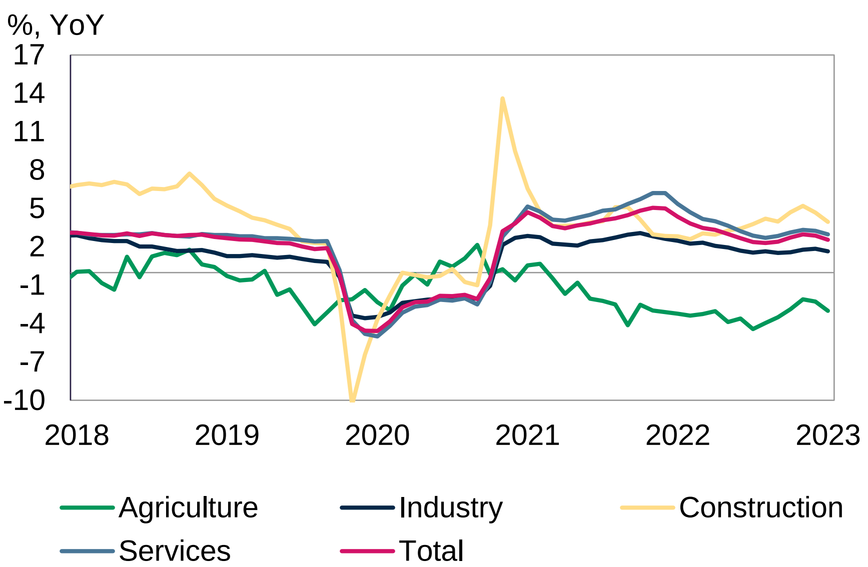
Higher key interest rates have been increasingly passed through to new lending rates in recent months, albeit more slowly in the housing segment than during previous episodes of monetary policy tightening. In addition, according to the Bank Credit Distribution Survey, standards and conditions for new lending tightened for the fourth consecutive quarter in the first quarter of 2023. Demand for credit declined across all segments and was particularly pronounced in the case of mortgages. Banks are expecting credit supply and demand to fall further in the second quarter. This trend continued to translate into a contraction in new financing volumes for households – particularly for home purchases – and, to a lesser extent, for businesses.

CONTENTS

OUTLINE OF OUR SCENARIO

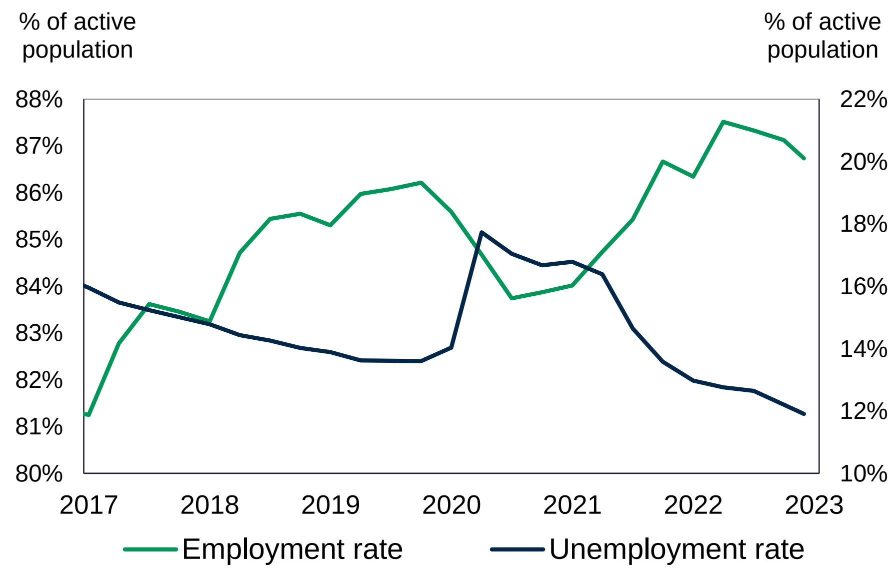
EMPLOYMENT HELD UP IN Q1

Employment: Social Security enrolment



Sources: Ministry of Labour, Crédit Agricole SA/ECO

Unemployment rate



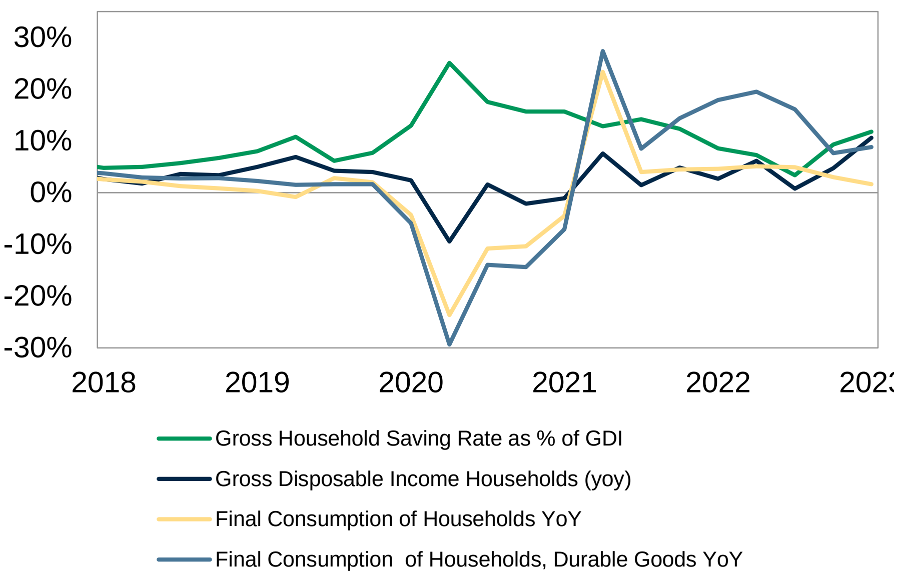
Sources: Ministry of Labour, Crédit Agricole SA/ECO

In June, the average number of Social Security registrations increased by 54,541, the lowest June figure since 2015 and in contrast to 115,000 in June 2022 and an average of 74,000 in June 2014-2019. In seasonally adjusted terms, employment fell by 20,119, the first decline since July last year; however, across Q2, employment rose 1.4%, compared to 0.9% in Q1. This positive labour market performance is broad-based across all sectors. However, employment has recently been particularly robust in sectors related to tourism, information and communication activities and specialised, scientific and technical activities. Labour shortages are already being seen in some of these sectors, which could explain, at least in part, sector disparities in terms of the wage increases negotiated in 2023. Inflationary pressure and the drop in activity driven by weaker domestic demand suggest that the decline in the unemployment rate will moderate in the future. Our forecasts are 12.6% in 2023 and 12.2% in 2024.

OUTLINE OF OUR SCENARIO

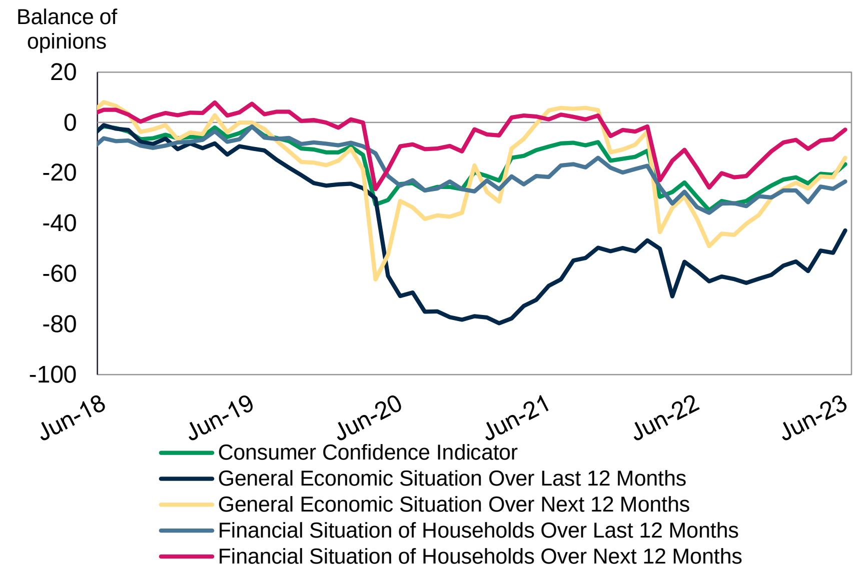
PRIVATE CONSUMPTION PLUMMETED IN Q1

Change in gross disposable income



Sources: Eurostat, Crédit Agricole SA/ECO

Household survey



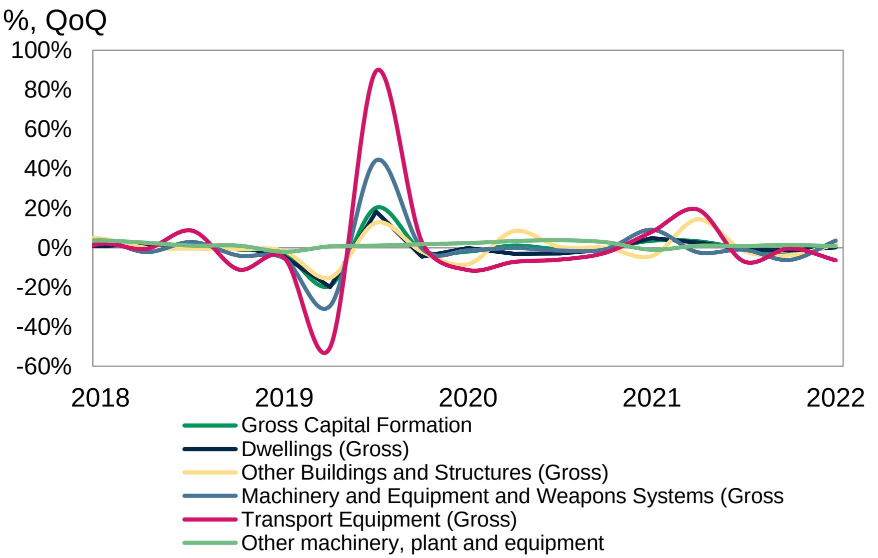
Sources: European Commission, Crédit Agricole SA/ECO

Private consumption contracted in Q1 2023 (-1.3% quarter-on-quarter), dragged down by the cumulative loss of purchasing power amid high inflation and the negative effects on their purchasing capacity (particularly in the case of the most indebted households) and tighter financing conditions. However, at the end of Q2, various factors, including strong employment, progressive improvement in confidence indicators and the prospect of a gradual easing of inflationary pressures, point to stronger – albeit still rather sluggish – household consumption. In any event, in the coming quarters, household spending growth will remain curbed by tightening financial conditions and by still high prices. In addition, rising interest rates and debt costs could push households to allocate more of their income and excess savings accumulated during the pandemic to loan repayment. Due to a very negative growth overhang in Q1, our consumption forecast stands at -0.7% in 2023 and 1.3% in 2024, with improved momentum as of Q2 next year.

OUTLINE OF OUR SCENARIO

INVESTMENT: THE OUTLOOK IS IMPROVING

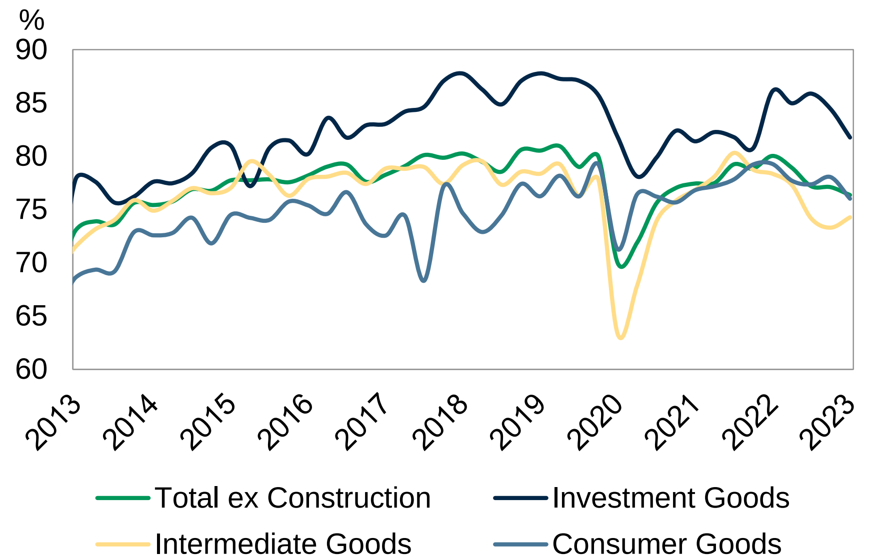
Components of investment



Sources: INE, Crédit Agricole SA/ECO.

Investment rose 1.9% in Q1 2023, following the sharp decline in Q4 2022 (-3.7%). All components posted gains with the exception of investments in transport (-6.3%): construction increased 0.9% (including 0.1% for housing) and investment in machinery and equipment rose 3.7%. This is partly due to the moderation in energy prices and, more generally, intermediate goods – implying lower production costs – and reduced delivery times (due to improved supply chain bottlenecks).

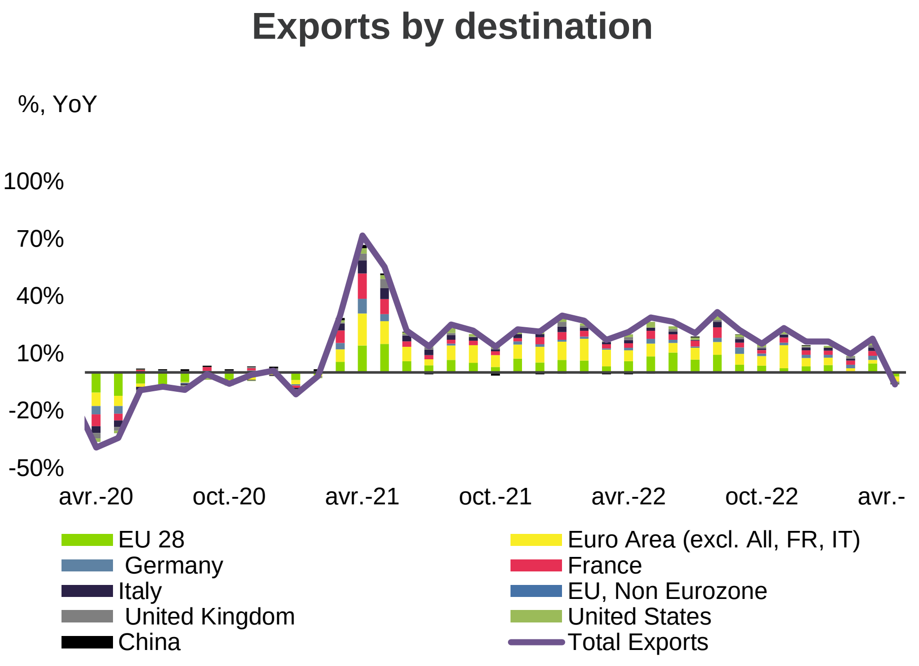
Capacity utilisation rate



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

The continuation of this momentum in recent months as well as the gradual roll-out of projects related to the NGEU programme suggest that the recovery in business investment continued in the second quarter of the year. However, as with household consumption, the gradual tightening of monetary policy and its effect on corporate financing conditions, as well as persistent high uncertainty, will likely continue to curb business investment this year. Our forecasts are 0.6% in 2023 and 3.8% in 2024.

TRADE IS EXPECTED TO CONTRIBUTE LESS



Sources: Bank of Spain, Crédit Agricole SA/ECO

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

During Q1, the notable strength in exports of tourism and non-tourism services contrasted with the slowdown in goods exports. These trends probably continued throughout the second quarter, in line with PMI indicators for new orders abroad in May and June. Moreover, Spain has seen wages moderate and inflation decline faster than the rest of the eurozone, making its economy more competitive compared to its main trading partners, as shown by the competitiveness indicators based on unit labour costs and relative consumer prices versus the eurozone. In any case, imports (which have been very volatile in previous quarters) are likely to be underpinned to some extent in Q2 by solid investment in capital goods. This would mean that the positive contribution of net external demand to GDP growth in the second quarter would moderate compared to the first. The contribution of net exports to GDP growth is expected to drop from 1.7% in 2023 to -0.1% in 2024, due to the slowdown in growth in tourism services.

OUTLINE OF OUR SCENARIO

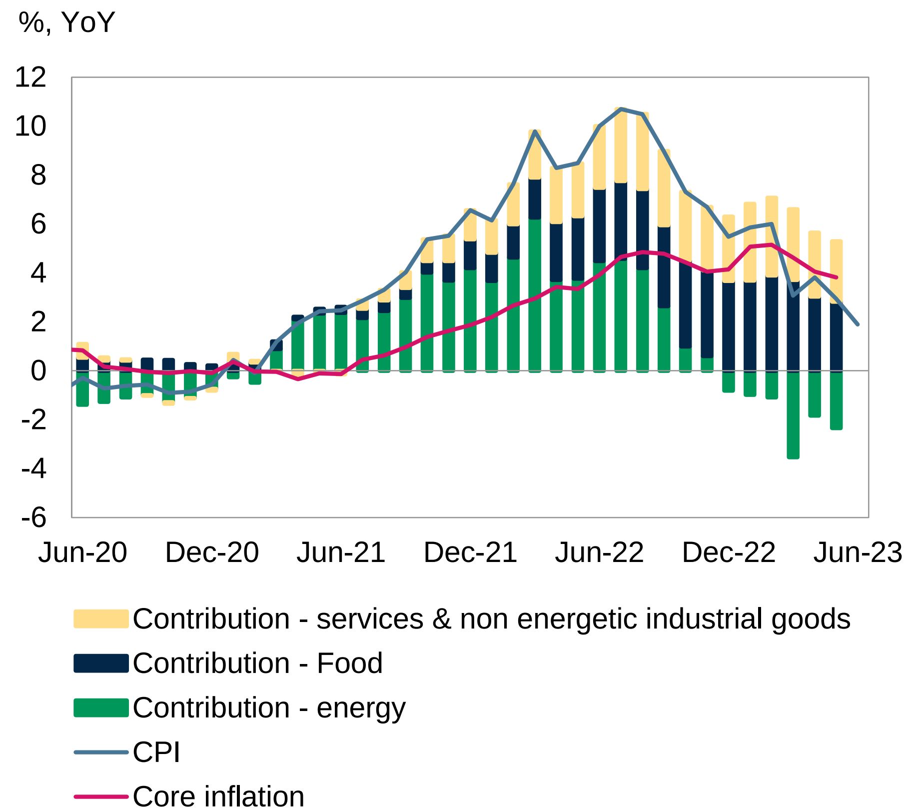
INFLATION CONTINUES TO TREND LOWER

- Inflation in Spain stood at 1.9% in June, down from 2.9% in May and 8.8pp lower than the peak of 10.7% in July 2022. So far, this correction has come mainly on the back of the decline in energy prices.

- However, during Q2, food prices (particularly oils, bread and grains, and dairy products) and service inflation (including transport and, more recently, housing, leisure, restaurants and tourism related items) also seem to have started to moderate.

- Going forward, a number of factors could provide some downside resilience to current inflationary pressures: possible asymmetry in the pass-through to consumer prices of changes in energy prices (energy cost reductions may be passed on more slowly than increases); drought, which poses an upside risk to the future price of certain food products; the possibility of second-round effects on inflation through corporate wages and/or margins. Our forecasts are for an annual average of 3% in 2023 and 2.5% in 2024.

Inflation and contributions



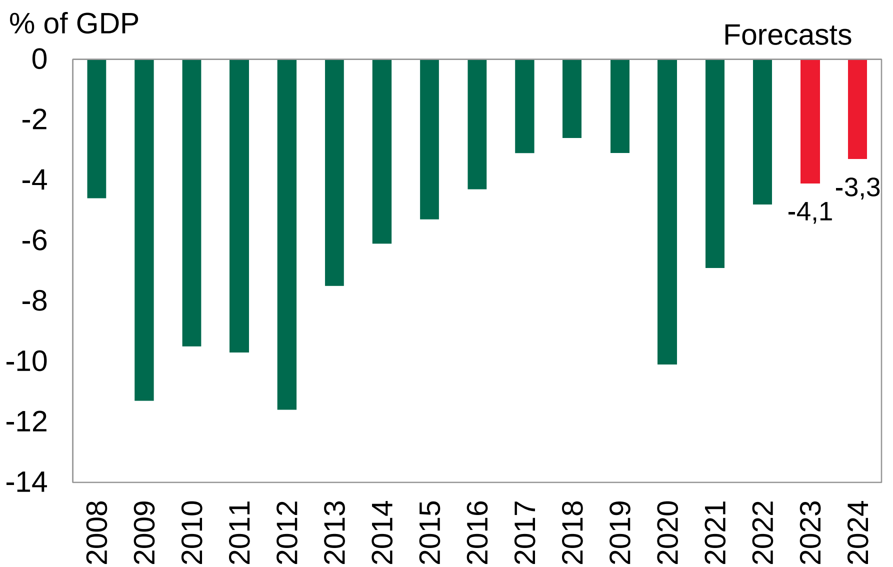
Sources: INE, Crédit Agricole SA/ECO

CONTENTS

FOCUS: PUBLIC FINANCES

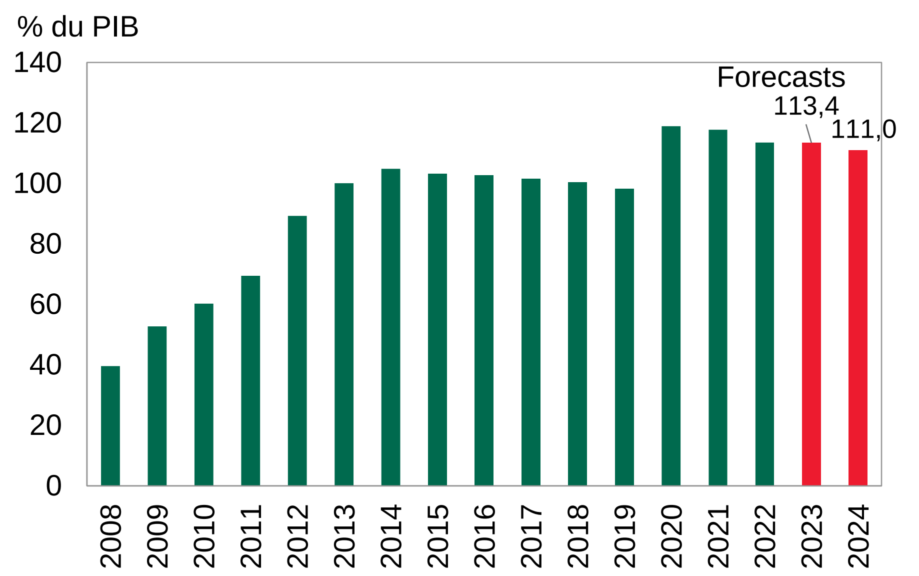
DEFICIT REDUCTION IN Q1

Government deficit



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

Government debt



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

The extension until 2023 of many of the support measures deployed in response to the energy crisis, the approved increases for salaries and pensions of civil servants and the increase in spending financed by the NGEU programme, is expected to have led to an increase in public spending in Q2, which would have more than offset the increase in revenues from the new approved taxes. All this would imply a boost to activity recently. However, given that the stimulus derived from the NGEU programme has no effect on the general government balance, this boost would only be partially reflected in the public accounts. As such, in Q1, the 12-month cumulative government balance improved by 0.4pp (from -4.8% of GDP at the end of 2022 to -4.4% in March). The recovery in revenues, due to both robust activity and new taxes introduced, as well as growth in other revenues (mainly interest and dividends) contributed to this improvement. On the expenditure side, it is worth pointing out the increase in social security benefits, which were up 8.5% year-on-year.

FOCUS: PUBLIC FINANCES

THE 2023-2026 STABILITY PROGRAMME, A VERY GRADUAL ADJUSTMENT TO THE GOVERNMENT DEFICIT

- The government's 2023-2026 stability programme proposes a gradual adjustment to the government deficit – justified by the recovery in activity – to 3.9% in 2023 (after 4.8% in 2022) and 2.5% in 2026.

- In terms of revenue, the programme takes into account the measures voted for in the 2023 budget (increase in personal income tax on capital income, tax on banks and energy companies, solidarity tax on high-net worth individuals in 2023-2024) and an increase in social security contributions provided for in the pension reform. As such, revenues are expected to increase to 43.4% of GDP in 2023 (43% in 2022) and will continue to rise until 2026 thanks to direct taxes and social security contributions, which will increase more quickly than nominal GDP.

- Public spending is expected to gradually decrease as a percentage of GDP, due to the sharp increase in nominal GDP and better control of spending (excluding pensions and interest). As such, primary public spending (excluding interest payments) is expected to fall from 45.4% of GDP in 2022 to 43.4% in 2026. The adjustment in employees' wages is expected to decline from 11.6% in 2022 to 11.2% in 2026, and subsidies from 2.0% in 2022 (very high due to the 20 cent per litre fuel discount, which has already been eliminated in 2023) to 1.4% in 2026. On the other hand, pension spending, which by law is indexed to inflation, is expected to increase at a rate higher than that of nominal GDP in 2023 and at a similar pace in 2024-2026.

Forecasts	% of GDP 2022	% of GDP 2023	% of GDP 2024	% of GDP 2026
Revenue	43	43,4	43,3	43,8
Indirect taxes	12,1	11,9	12	11,8
Direct taxes	12,4	13,2	13,5	14,3
Capital taxes	0,4	0,4	0,3	0,3
Social security contributions	13,6	13,9	14	14
Other revenues	4,6	4	3,5	3,4
Public expenditure	47,8	47,3	46,3	46,3
Employee compensation	11,6	11,3	11,2	11,2
Social benefits	17,2	17,7	17,6	17,7
Gross capital formation	2,8	2,7	2,6	2,4
Interest expenses	2,4	2,4	2,6	2,9
Subsidies	2	1,8	1,3	1,4
Public balance	–4,8	–3,9	–3,0	–2,5
Primary balance	–2,4	–1,5	–0,4	0,4

Sources: Stability Programme, Crédit Agricole SA/ECO

- The macroeconomic framework on which the stability programme is based takes into account the following forecasts: combined GDP growth of 8.2% between 2023 and 2026, with a very important role played by investment in 2024 thanks to the NGEU programme. According to our current growth forecasts, which are slightly lower than the government's, the public deficit is expected to be slightly below official figures, at 4.1% in 2023 and -3.3% in 2024. Government debt is likely to be gradually reduced as a percentage of GDP, but will remain at high levels. It is expected to fall from 113.2% of GDP in 2022 to 106.8% in 2026. Most of this decline is expected to be driven by nominal GDP growth.

CONSULT OUR LAST PUBLICATIONS

Date	Title	Theme
19/07/2023	Europe – Financing the reconstruction of Ukraine in the context of the European recovery plan	Europe, PECO
19/07/2023	Oil – 2023-2024 Scenario: the price recovery is playing hard to get	Oil
17/07/2023	Eurozone – Scenario 2023-2024 : the bumpy road back to normal	Eurozone
13/07/2023	United Kingdom – 2023-2024 Scenario: persistent inflation and resilient demand defy the BoE	United-Kingdom
12/07/2023	France – 2023-2024 Scenario: growth wobbles despite dipping inflation	France
30/06/2023	World – Macro-economic Scenario 2023-2024: normalisation plays hard to get	World
03/05/2023	Italy – 2023-2024 Scenario: 2023, the year of slowdown	Italy
02/05/2023	Spain – 2023-2024 Scenario: Sluggish growth returns	Eurozone
28/04/2023	United-Kingdom –2023-2024 Scenario: recession avoided, inflation persists	United-Kingdom
24/04/2023	Eurozone – 2023-2024 scenario: an unusual mix of powerful supportive and detrimental factors	Eurozone
24/04/2023	Germany – 2023-2024 Scenario: the winding path of the recovery	Eurozone
24/04/2023	France – 2023-2024 Scenario: activity buckles but does not break	France
07/04/2023	World – Macro-economic Scenario 2023-2024: a peculiar slowdown	World
01/02/2023	Eurozone – 2023-2024 Scenario: shock behind, shock ahead	Eurozone
30/01/2023	Italy – 2023-2024 Scenario: a year of growth despite the shock	Italy
18/01/2023	Spain – 2023-2024 Scenario: The end of the rebound	Eurozone
17/01/2023	United Kingdom – 2023-2024 Scenario: from stagnation to recession	United-Kingdom
12/01/2023	France – 2023-2024 Scenario: the economy and the challenges of inflation	France
10/01/2023	Germany – 2023-2024 scenario: towards a brief and limited recession!	Eurozone
19/12/2022	World – Macro-economic Scenario 2023-2024 : an unprecedented reversal	World
19/12/2022	Geo-economics – The new role of second-tier powers	Geo-economics
13/12/2022	France – Investment and financial health of companies	France
01/12/2022	COP27: a first step towards climate justice	Sub-Saharan Africa

Ticiano BRUNELLO

ticiano.brunello@credit-agricole-sa.fr

THANKS FOR YOUR ATTENTION

YOU CAN SUBSCRIBE TO OUR PUBLICATIONS ON OUR WEBSITE :
http://economic-research.credit-agricole.com/

Access and subscribe to our free online publications:
application available in App Store and in Google Play

Crédit Agricole S.A. — Group Economic Research
12 place des Etats-Unis – 92127 Montrouge Cedex

Publication Manager: Isabelle Job-Bazille - **Chief Editor:** Armelle Sarda
Information centre: Elisabeth Serreau - **Statistics:** DataLab ECO
Editor: Véronique Champion
Contact: *publication.eco@credit-agricole-sa.fr*