SPAIN
2023-2024 SCENARIO

MODERATE SLOWDOWN ON THE HORIZON

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WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

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SUMMARY

BUSINESS IS RESILIENT IN ADVERSE CONDITIONS

Spanish GDP rose 0.4% in Q2 on the back of strong growth in private consumption (+1.6%) and investment (+4.6%), while the contribution of foreign demand was negative, by -1.3pp. Activity was primarily driven by services in spring, including artistic, recreational and other services, information and communications as well as non-market services. Conversely, the primary sector and, to a lesser extent, the industrial, energy and real estate services sectors recorded declines in activity. **Spain's GDP has proved more dynamic than the Eurozone average, largely owing to differences in the sector composition of the economy, notably the greater weight of hotel and tourism-related services, which have benefited from strong demand since the spring. The weight of manufacturing industries, which are less dynamic than services, is comparatively lower in the Spanish economy, however.**

Against this backdrop, we expect the Spanish economy to experience a period of **positive but modest growth over the next two quarters, with GDP growth rates approaching 0.3% quarter-on-quarter**, mainly impacted by the impact of the rise in interest rates that has occurred since July 2022 and due to the **sharp downturn on major export markets. Although the tourism sector will continue to be a growth driver, it is set to make a weaker contribution than in recent quarters**, given that the level of activity is already much higher compared to 2019.

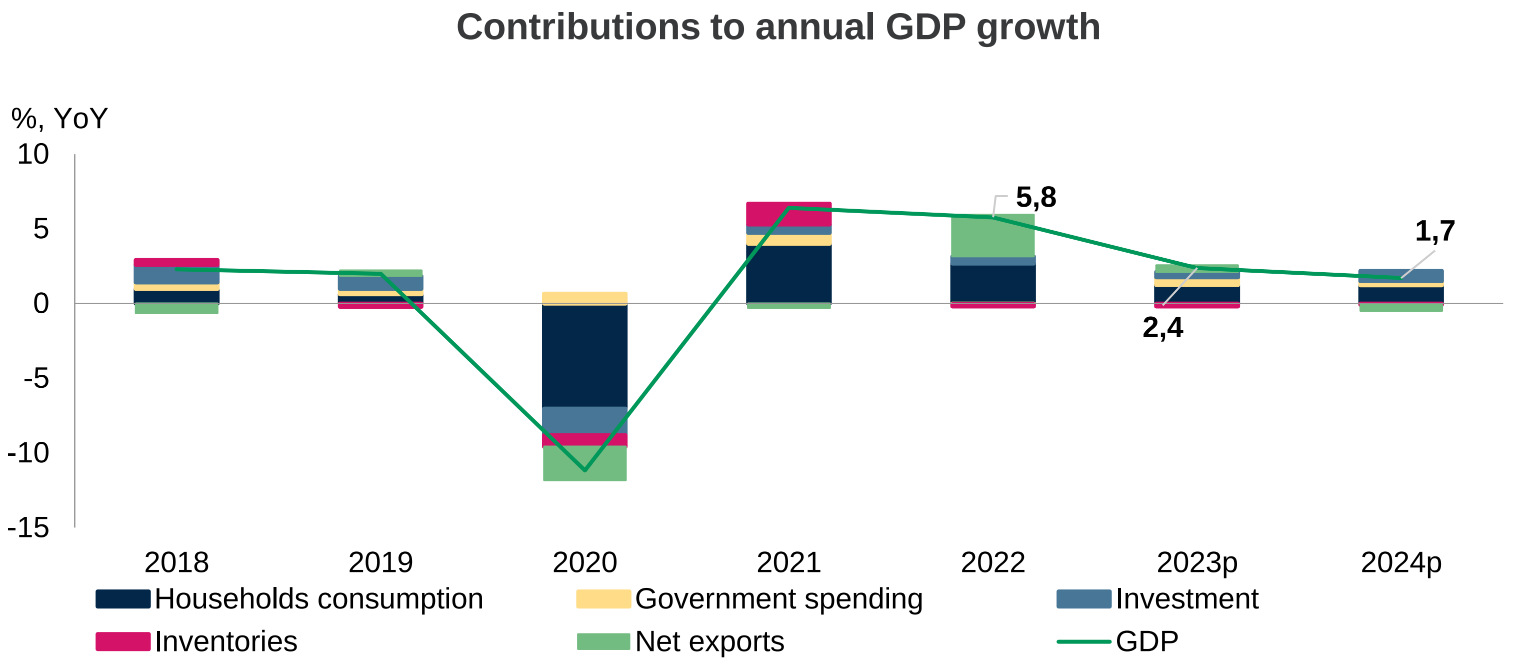
Domestic demand, though negatively impacted by the impact of rising interest rates, will receive some support. First, with wage growth ranging from 3% to 3.5%, in line with collective bargaining guidelines, we expect **growth in gross disposable household income to exceed inflation, despite the gradual increase in net interest payments. Second, European NGEU funds should continue shoring up growth, and in particular investment, assuming some acceleration in the rate of implementation.** Domestic demand is thus expected to make the greatest contribution to growth in the coming quarters. Our growth forecasts for private consumption are 2.2% for 2023 and 2.2% for 2024, while investment should climb 1.9% and 3.7%, respectively.

Activity should gather pace starting in early 2024 thanks to the recovery in global demand, the improvement in real household incomes and the projected acceleration in the deployment of investment projects associated with the Recovery Plan programme. However, the gain in economic momentum may be hampered, to some extent, as monetary tightening moves reflect in financial conditions, support measures deployed by the authorities in response to the energy crisis are withdrawn, and growth of tourism becomes more moderate once pre-pandemic levels are restored. **According to our forecasts, after rising 2.4% this year, Spanish GDP is expected to grow 1.7% in 2024.**

The 2024 budget plan presented to the European Commission calls for the public deficit to be reduced to 3.9% in 2023 and to reach the 3% target in 2024. The budget plan provides for an adjustment of around €12bn, which could be achieved simply by not extending the energy support measures still in force in 2023.

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	5,8	2,4	1,7	0,6	0,4	0,3	0,3	0,5	0,6	0,4	0,3
Households consumption	4,7	2,2	2,2	0,3	1,0	1,4	0,3	0,3	0,5	0,4	0,6
Investment	2,4	1,9	3,7	2,9	1,9	-0,4	1,0	1,3	1,0	0,8	0,7
Change in inventories*	-0,1	-0,2	-0,1	-0,4	-0,2	0,1	0,0	0,0	0,0	0,0	0,0
Net export*	2,8	0,4	-0,4	0,3	-0,6	-0,4	-0,1	0,0	0,1	0,0	-0,2
Unemployment	13,0	12,3	11,8	12,8	11,9	12,0	12,4	12,2	11,9	11,4	11,7
Inflation	8,3	3,2	2,8								
Government net lending	-4,7	-4,1	-3,2								

* Contributions to GDP growth

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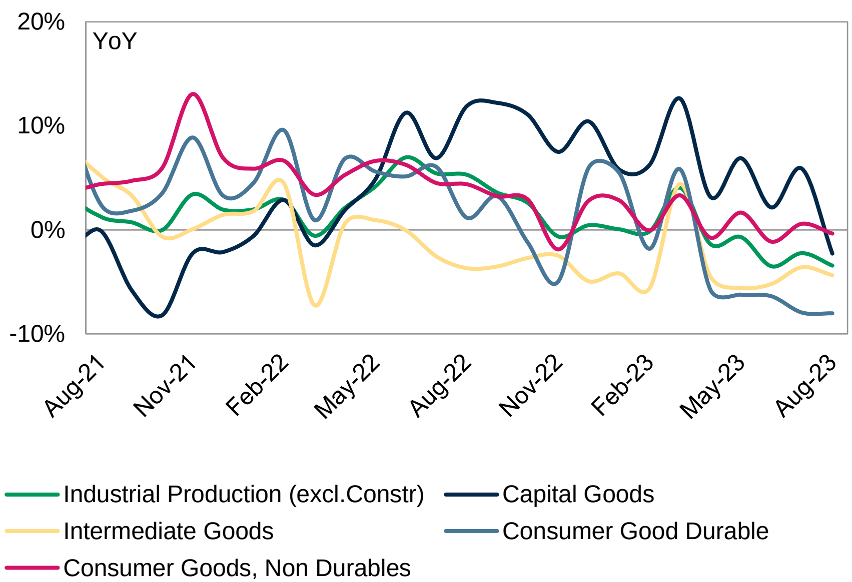
RECENT ECONOMIC TRENDS

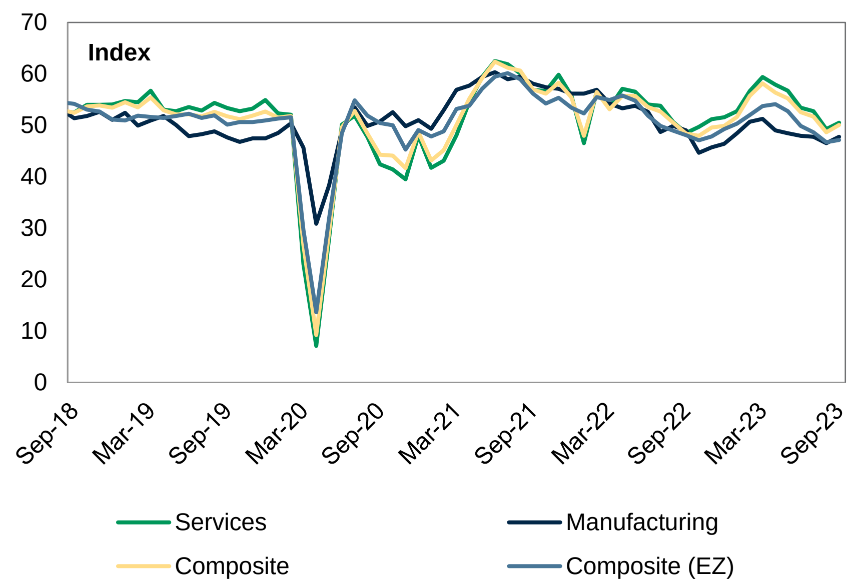
MORE MODERATE GROWTH IN Q2

Industrial output



Sources: Eurostat, Crédit Agricole SA/ECO

Purchasing Managers Index (PMI)



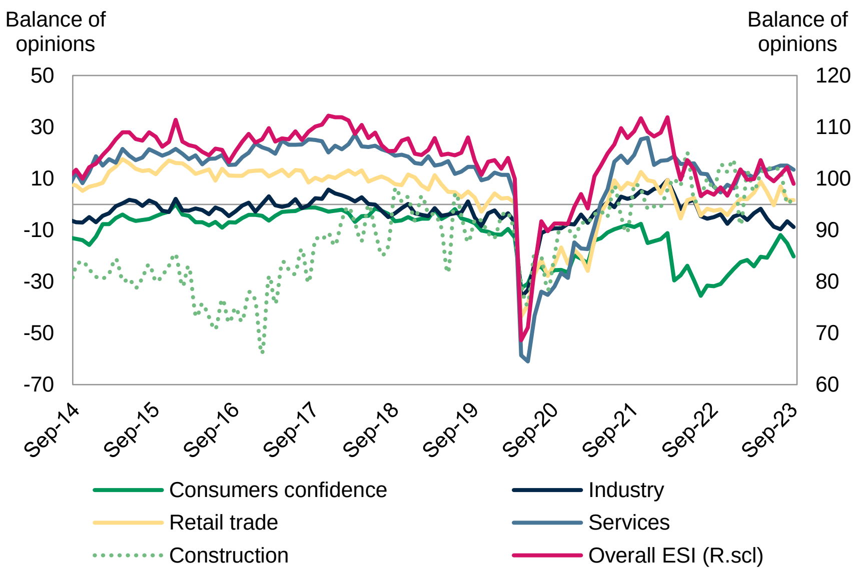
Sources: Markit, Crédit Agricole SA/ECO

With the summer over, the Spanish economy is showing clear signs of deceleration from the strong growth rate seen in H1 2023. Job creation, though still positive, rose from growth rates of close to 1% quarter-on-quarter in H1 2023 to a much more modest 0.2% in Q3. Similarly, survey-based leading indicators, such as PMIs, show that the weakness seen in the manufacturing sector in recent quarters is ongoing and that the outlook for activity in the services sector is deteriorating. In September, the PMI rebounded slightly but remained below the growth threshold, while the services and composite indices were barely above the threshold..

RECENT ECONOMIC TRENDS

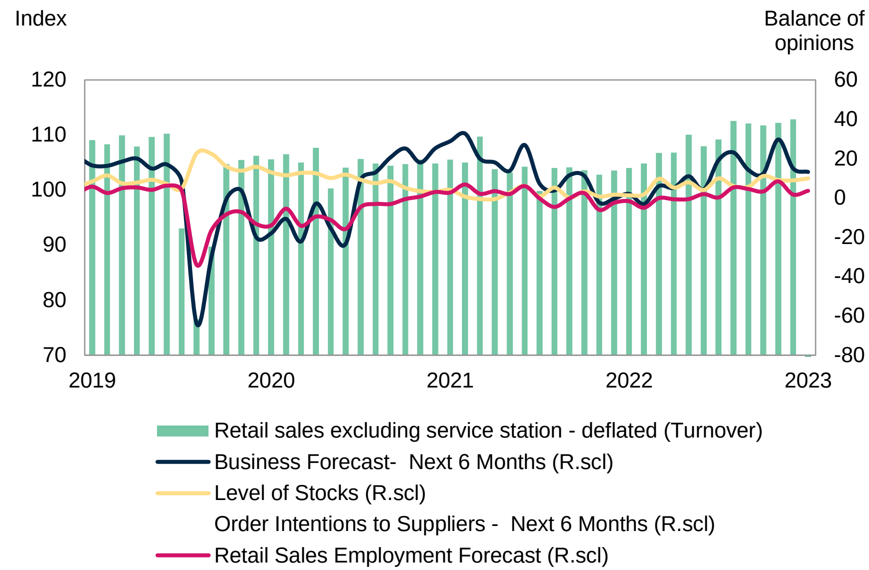
MORE MODERATE GROWTH IN Q3 2023

ESI and its components



Sources: Eurostat, Crédit Agricole SA/ECO

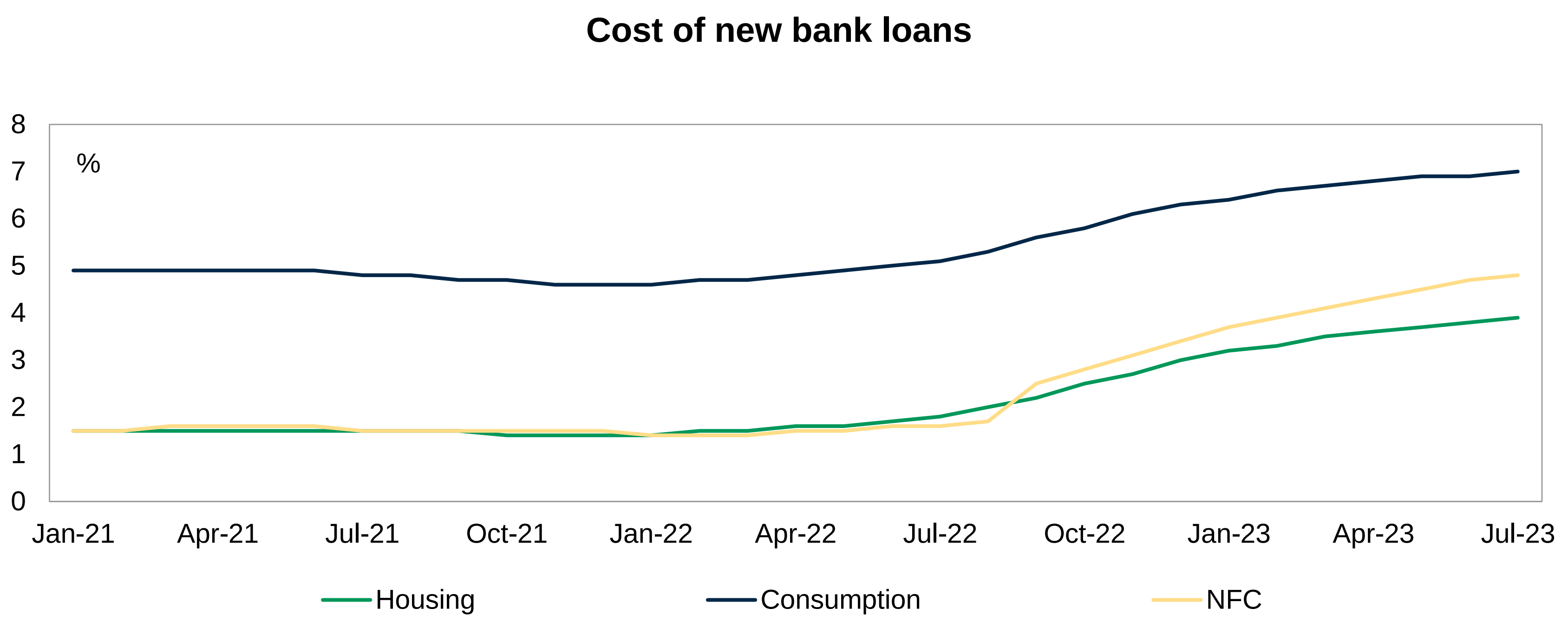
Retail sales



Sources: ICI, Crédit Agricole SA/ECO

The European Commission's September economic climate surveys for the Spanish economy reveal a further deterioration not only in consumer and industry sentiment, but also in services and retail. The results of the Bank of Spain's business activity survey, which showed a decline in Spanish corporate revenues for the entire third quarter, are also consistent with more moderate GDP growth in Q3. Tourist demand nevertheless remains strong. International arrivals in August were 0.45% lower than in the same month of 2019, while international tourist spending was 15.6% higher compared to August 2019. Demand for tourism services is holding up despite the sharp increase in tourism-related prices: according to the CPI in August hotel prices rose 6.9% over a year, ending up 25.5% higher than in the same month of 2019. In the medium term, growth in tourism activity will become more moderate but the level of activity will remain high.

FINANCING CONDITIONS CONTINUE TO TIGHTEN



Sources: Bank of Spain, Crédit Agricole SA/ECO

The cost of new financing transactions for households and businesses has continued to rise in recent months, with the exception of short-term corporate bond issuance, the cost of which decreased in August. In contrast, according to the Bank Lending Survey (conducted by the Bank of Spain), credit demand and supply continued to decline in the second quarter. Although the decline was less pronounced than in Q1, this most recent survey sees credit supply and demand contracting further in Q3. Against this backdrop, data on new funding flows showed that new bank loans to businesses lost momentum in July, while new home purchase loans continued to contract (a trend that began mid-2022). In contrast, both new consumer credit and loans to businesses obtained by issuing fixed-income securities increased in July.

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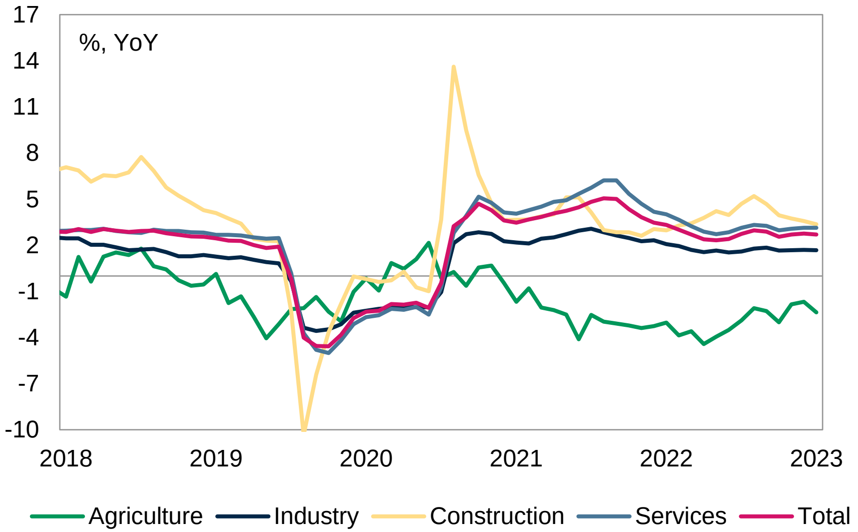
OUTLINE OF OUR SCENARIO

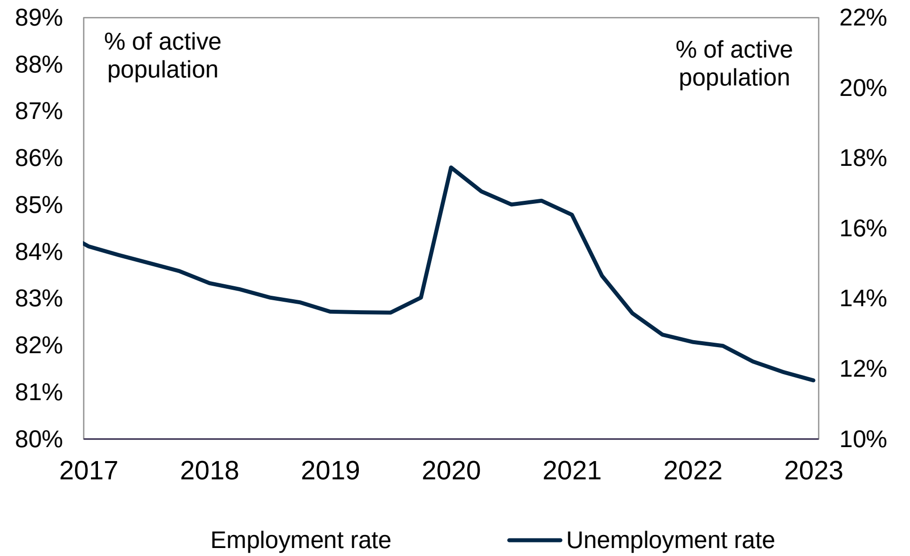
EMPLOYMENT SLOWS SHARPLY

Employment: Social Security enrolment



Sources: Ministry of Labour, Crédit Agricole SA/ECO

Unemployment rate



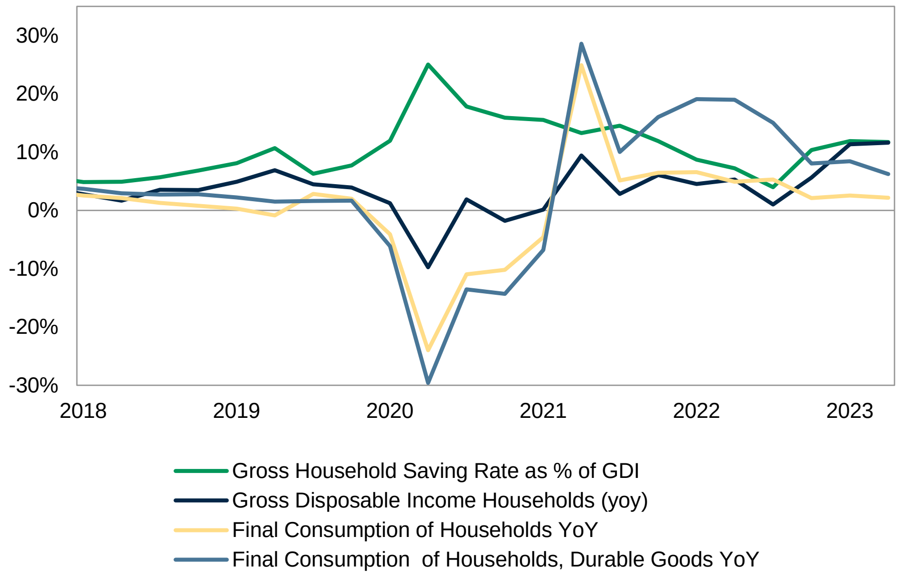
Sources: Ministry of Labour, Crédit Agricole SA/ECO

The workforce increased by 15,700 workers on a monthly average in Q3 (data adjusted for seasonal variations), i.e. less than the monthly average of 52,000 recorded in Q2. Employment thus increased by only 0.2% over the quarter in Q3, compared with 1.4% in Q2 2023. Over Q3 as a whole, the worst sector performance was seen in agriculture, with a fall of 0.4% over the quarter, followed by construction (0%). The services sector, which was the main driver of job creation in Q2 (+1.6%), posted moderate growth of 0.2% in Q3. The labour market was showing signs of a marked slowdown after a surprisingly strong performance in the first half of the year. With the supply of services running out of steam, we still expect to see weaker employment growth in the second half of the year as the unemployment rate approaches its all-time low. Inflationary pressure and the drop in activity driven by weaker domestic demand point to moderation in the unemployment rate going forward. Our forecasts show the unemployment rate falling further to 12.3% in 2023 and 11.8% in 2024.

OUTLINE OF OUR SCENARIO

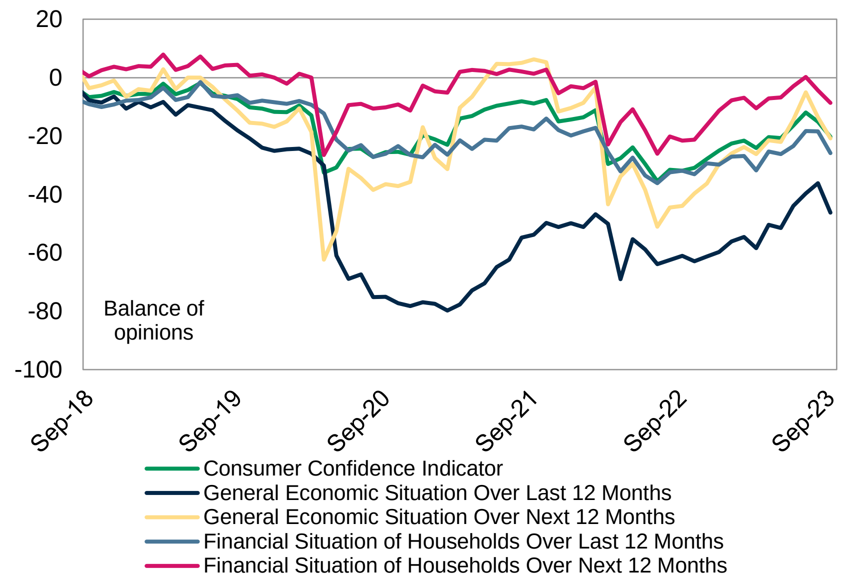
PRIVATE-SECTOR CONSUMPTION REBOUNDS SHARPLY IN Q1 2023

Change in gross disposable household income and its components



Sources: Eurostat, Crédit Agricole SA/ECO

Household survey

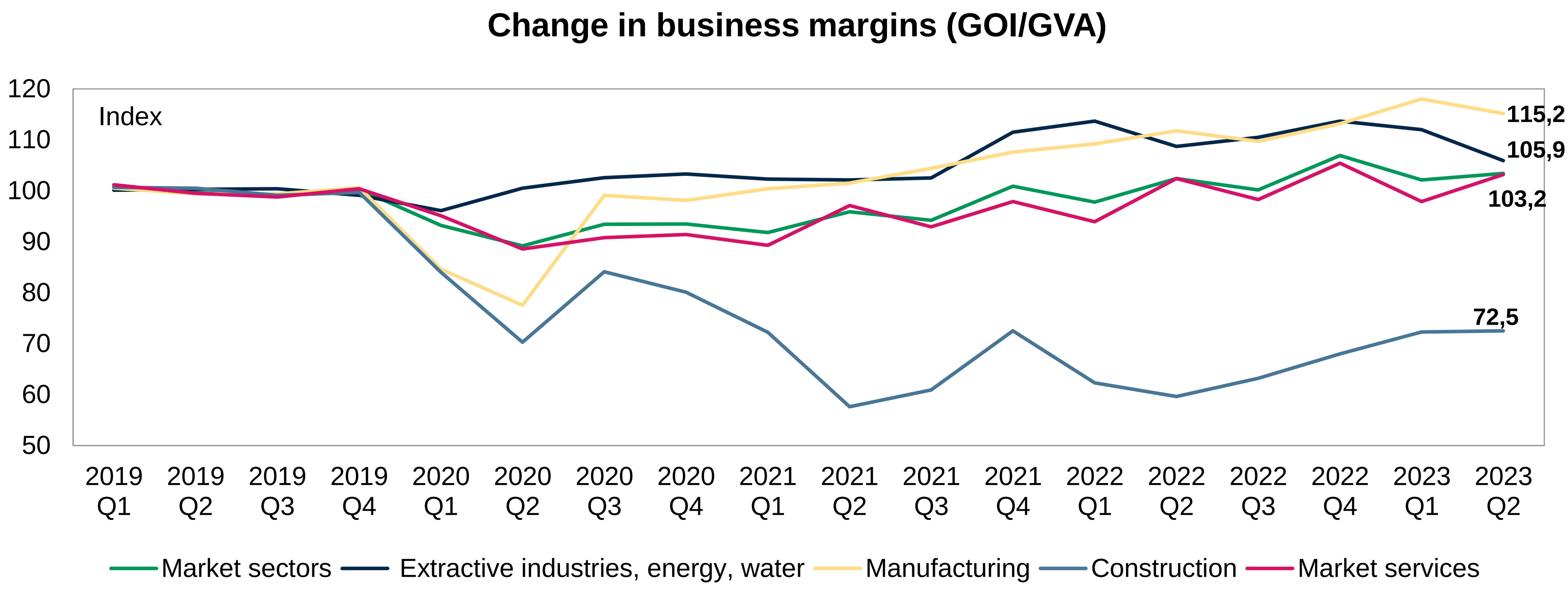


Sources: European Commission, Crédit Agricole SA/ECO

After a significant two-quarter contraction, private consumption rebounded by 1.6% over the second quarter, driven by purchases of durable goods (+6.2%). However, growth in consumer spending is expected to slow in the coming quarters due to tighter financial conditions and the loss of purchasing power that households have accumulated with the past rise in inflation. On the other hand, although private spending is lagging behind the economy's overall post-pandemic recovery, the sharp drop in inflation and recent increase in wage growth should drive real incomes higher, helping to boost confidence and stimulate spending. Furthermore, although momentum on the labour market is still the main support factor for consumer spending, households have also built up substantial savings (estimated at €100bn at end-2022 by the Bank of Spain). However, if economic activity slows more than expected and the labour market deteriorates significantly, household spending could fall sharply as a result. Based on our forecasts, private consumption should climb 2.2% in 2023 and 2024.

OUTLINE OF OUR SCENARIO

CORPORATE MARGINS ARE IMPROVING



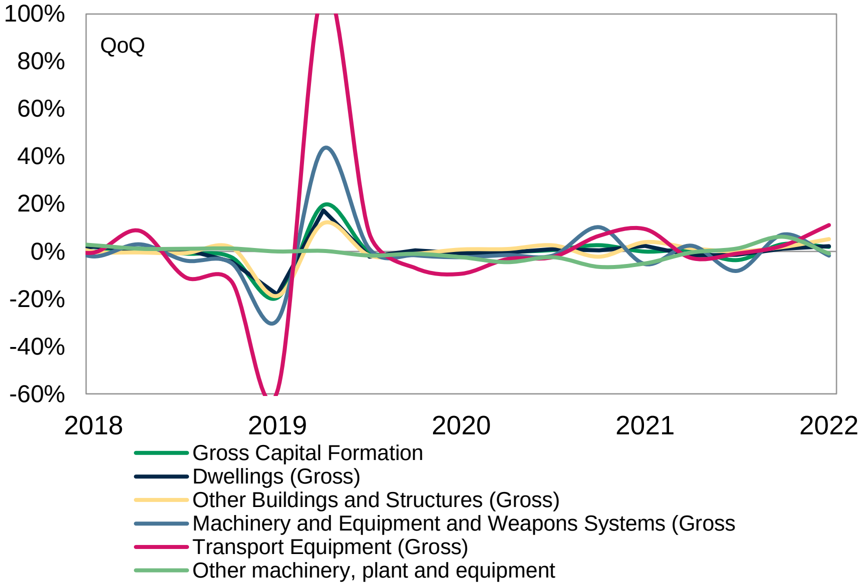
Sources: INE, Crédit Agricole SA/ECO.

Based on provisional national accounts data for the second quarter of 2023, the ratio of gross operating income (GOI) to gross value added (GVA) in the market economy is thought to have decreased slightly in the first half of the year, following the increase observed at the end of 2022. In any event, these combined changes mask a significant disparity between sectors, due not only to differences in the momentum of demand but above all to the changes in costs confronting each business sector. For example, the manufacturing sector exceeded pre-pandemic levels in Q1 2019 (115%), while construction still lagged far behind (72.5%).

OUTLINE OF OUR SCENARIO

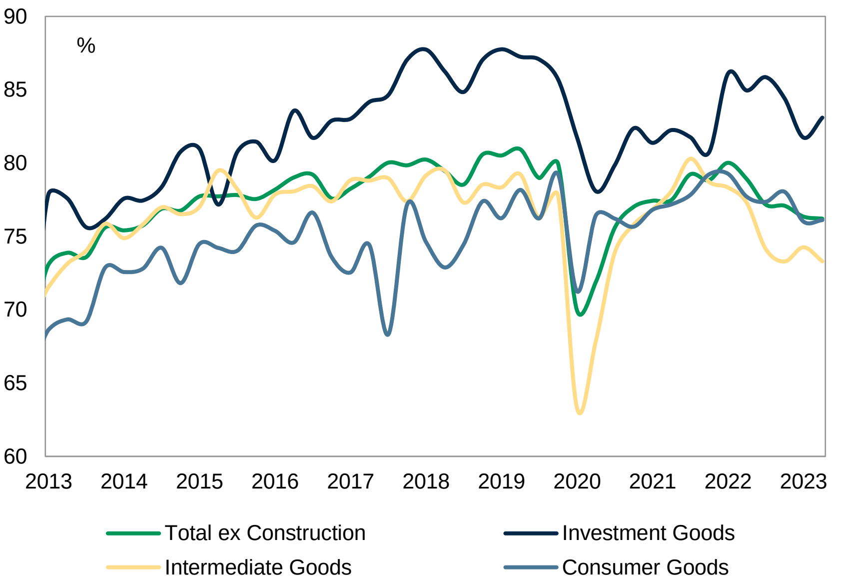
INVESTMENT: THE OUTLOOK IS IMPROVING

Components of investment



Sources: INE, Crédit Agricole SA/ECO.

Capacity utilisation rate



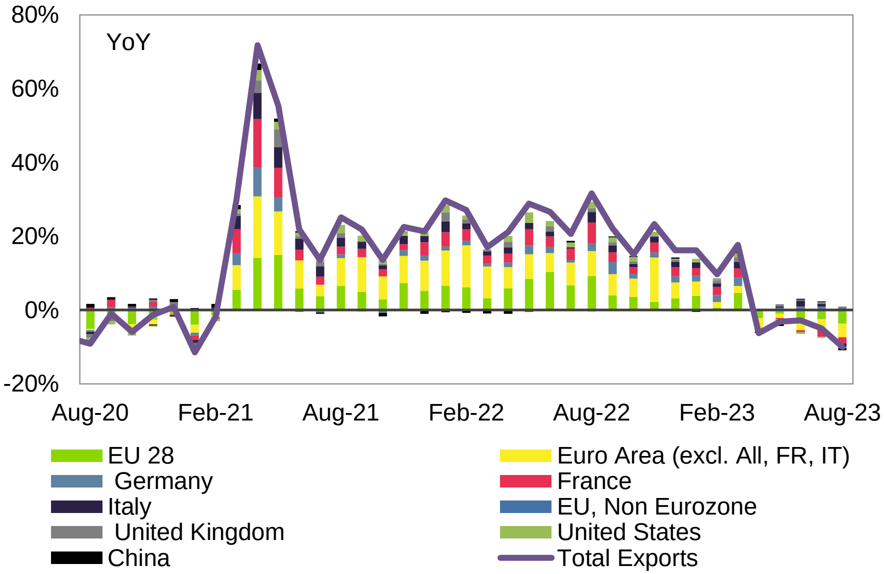
Sources: Ministry of Industry and Commerce, Crédit Agricole SA/ECO.

Investment rose sharply (4.6%) in Q2, driven by construction but also by investment in transport goods. Investment is expected to continue recovering in the coming quarters, albeit at a slower pace than in Q2. For example, although business investment momentum could get support from the deployment of NGEU-related projects as well as the capital available to companies, the tightening of financial conditions in recent quarters and the slowdown in activity will make it harder for companies to build up their resources. In light of these factors and the recent slowdown in residential investment, housing growth is expected to be modest in the coming quarters. We now estimate investment growth to come out at 1.9% in 2023 and 3.7% in 2024.

OUTLINE OF OUR SCENARIO

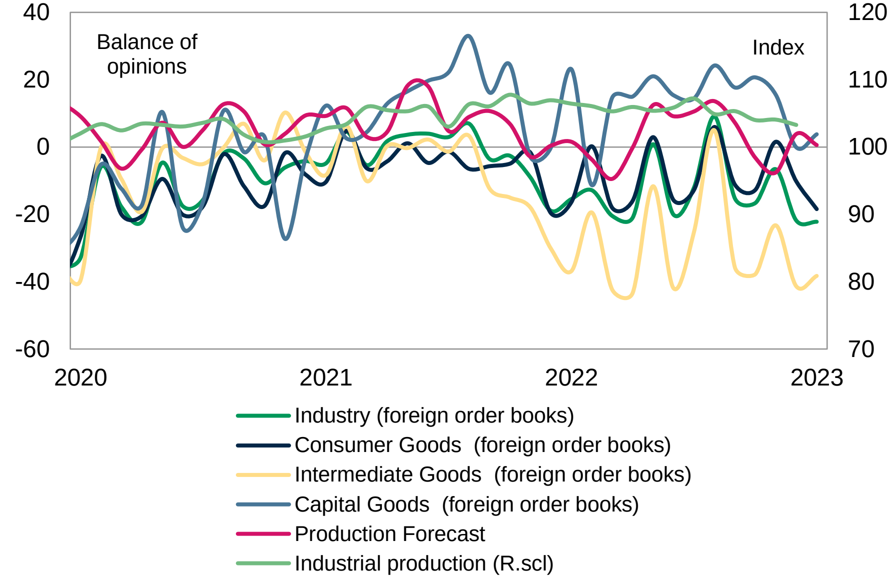
FOREIGN TRADE EXPECTED TO CONTRIBUTE LESS

Exports by destination



Sources: Bank of Spain, Crédit Agricole SA/ECO

Export order books



Sources: Business sentiment survey, Min. of Industry & Commerce, CA SA/ECO

Net foreign demand made a very negative contribution to GDP growth (-1.4 pp) in Q2, amid a sharp contraction in exports of goods (down 5.9% over the quarter) and an increase in imports of services (+12.3%). In the third quarter, however, the contribution of net foreign demand to economic growth is likely to have increased, especially given the strength of foreign tourism over the summer. In July, tourist arrivals were 2.6% higher than in the same month of 2019, while non-resident tourist spending exceeded July 2019 levels by 16% in nominal terms and 7.3% in real terms.

This increase in spending may have been partly due to the arrival of visitors with greater purchasing power. Conversely, amid slowing global economic activity (particularly evident in the manufacturing sector), and given the contraction of PMIs, goods traded with the rest of the world are thought to have posted weaker growth in Q3. According to our forecasts, external demand will continue to make a positive but very low contribution in the coming quarters, given that tourism appears to be running out of steam as a driving factor. We expect exports to make a net contribution of 0.4 points in 2023 and -0.4 points in 2024.

OUTLINE OF OUR SCENARIO

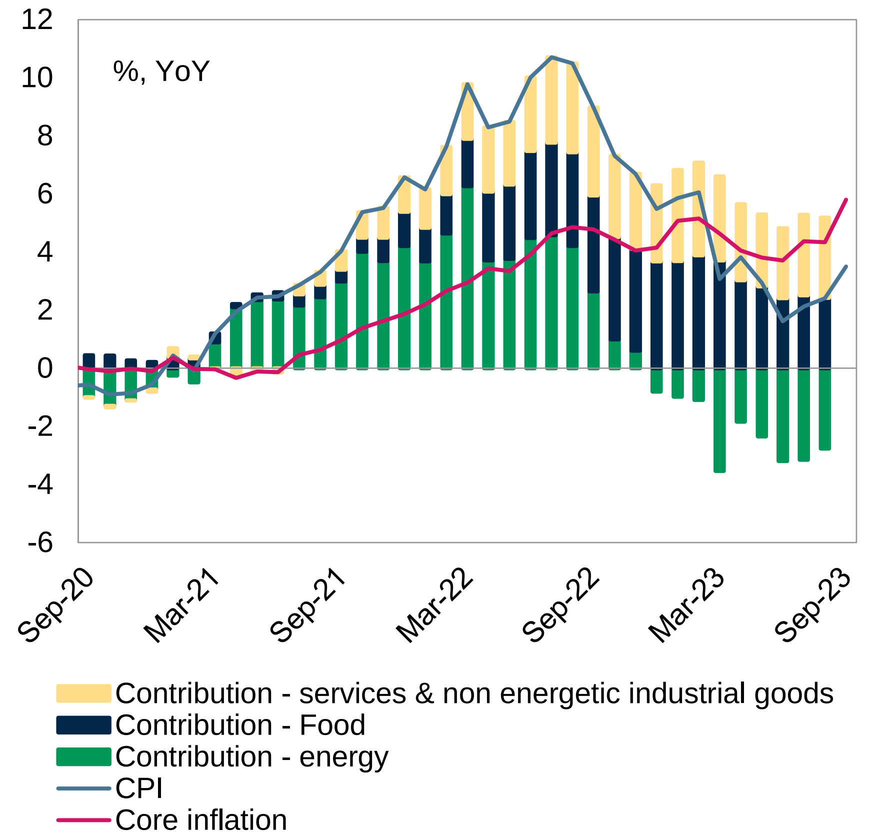
HEADLINE INFLATION REBOUNDS SLIGHTLY OVER THE SUMMER

Inflation in Spain stood at 3.5% year-on-year in September, after reaching 1.6% in June, its lowest level since April 2021. This rebound reflects a moderation in the pace of the year-on-year energy price drop triggered by the recent rise in crude oil prices in international markets and the comparison base effects derived from price declines in energy products in Q3 2022.

In the short term, the trajectory of the general HICP in Spain will be fundamentally determined by the energy component. The recent rise in oil prices, the upward comparison base effects of lower fuel prices in the latter part of 2022 and the 2024 expiration of government measures to mitigate the consequences of the energy crisis will lead to a rebound in headline inflation until the middle of next year.

Non-energy inflation is expected to undergo a gradual slowdown, however. Projected disinflation would result, fundamentally, from past increases in the cost of intermediate goods no longer being passed on to consumer prices and from monetary policy actions depressing demand. This would be happening in a context where it is assumed, in line with developments observed thus far, that there will be no significant second-round effects liable to cause current inflationary pressures to have retroactive impacts. Our annual average inflation forecasts are 3.6% in 2023 and 3.5% in 2024.

Inflation and contributions



Sources: INE, Crédit Agricole SA

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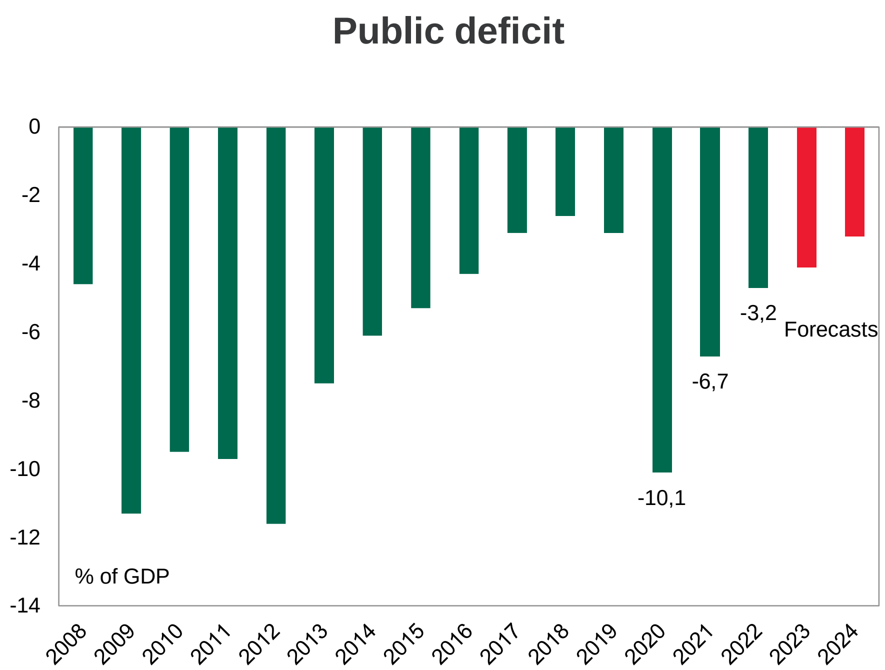
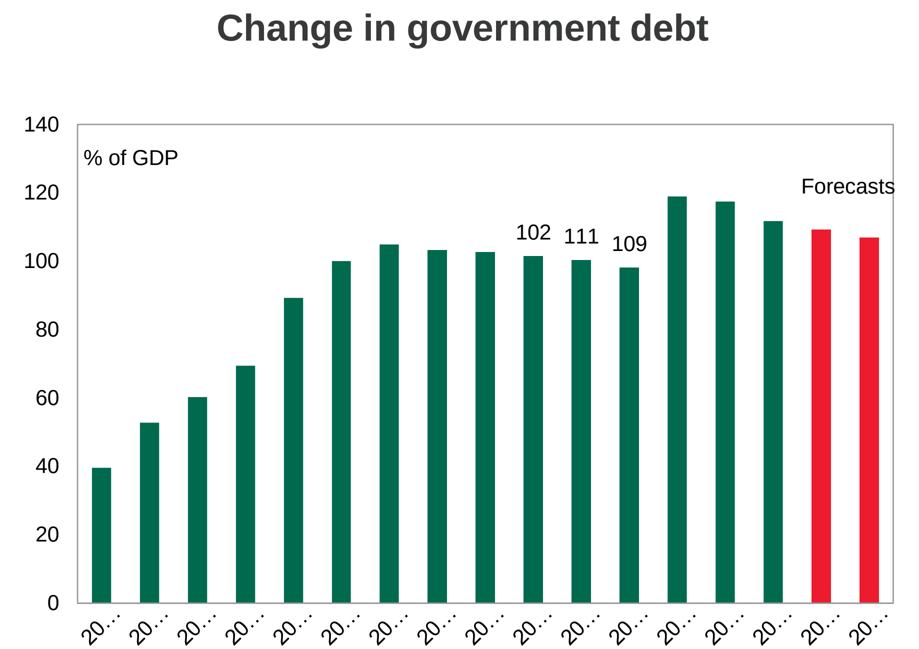
FOCUS – PUBLIC FINANCES

DEFICIT REDUCTION IN Q1



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



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

After the slowdown in the final months of 2022, government revenues made significant progress in the first half of 2023. This momentum can primarily be attributed to the nominal increase in income, which would have boosted the collection of direct taxes and social security contributions. For its part, spending accelerated in H1 2023 compared to the 2022 average, due to the sharp increase in social benefits caused by pension increases and, to a lesser extent, the increase in public consumption. Accordingly, in June, the general government balance over twelve months stood at –4.4% of GDP, down 0.4 pp compared to end-2022. On 16 October, the Spanish government presented the 2024 Budget Plan to the European Commission. The document reported an improvement in growth forecasts for 2023 compared to the projections contained in the April Stability Programme. Growth is expected to be 2.4% in 2023, compared with 2.1% initially forecast, while growth in 2024 has been revised downwards (from 2.4% to 2%). The public deficit is forecast at 3.9% this year and 3% in 2024 and the public debt ratio at 108.1% and 106.3% respectively.

FOCUS – PUBLIC FINANCES

2024 BUDGET PLAN: HEADED FOR A 3% DEFICIT

The 2024 Budget Plan calls for a slight increase in government revenues, from 41.9% of GDP in 2023 to 42% in 2024. Taxes are expected to rise 7.5% in 2024, versus 7.6% in 2023, thanks to strong income tax revenues for individuals linked to improved employment and higher pensions, as well as the increased tax rate for income above €300,000. Corporate tax revenues have also increased. For next year, social security contributions are expected to climb 6.4%, fuelled by labour market momentum and the implementation of the pension reform. Meanwhile, the Finance Bill calls for spending to fall from 45% of GDP to 45.8% in 2023. According to the government, this is compatible with the pension increase and the 2% rise in civil servants salaries in 2024.

In order to reduce the deficit to 3% of GDP by 2024, the Budget Plan provides for an adjustment of around €12bn. In principle, not extending the energy support measures still in force in 2023 would likely be sufficient to meet this objective. However, the executive branch has still made no clear statement on what it plans to do about the measures still in force and has not ruled out extending some of them. It should be noted that measures such as the reduction of taxes on electricity and gas bills expires on 31 December, as does the reduction in VAT on certain basic foodstuffs or reductions on fuel, which are currently reserved for the road transport sector.

Brussels recommended last May that Spain withdraw the energy support measures in force by the end of 2023 and use savings to reduce the deficit. Spain must address this recommendation in the budget plan and the Commission will assess its compliance at the end of November. In any event, government figures seem a little optimistic about growth in 2024 (2% vs. 1.7% according to our forecasts), which constitutes the biggest risk for the 3% deficit target. We see a less ambitious trajectory for the budget balance, at -4.1% this year and -3.2% in 2024.

Fonction	2023	2024
	% GDP	% GDP
1. General public services	5,7	5,6
2. Defense	1,2	1,3
3. Public order and security	1,9	1,7
4. Economic issues	5,0	4,6
5. Environmental protection	1,0	1,0
6. Housing and community services	0,5	0,5
7. Health	6,7	6,7
8. Recreational activities, culture and religion	1,1	1,0
9. Education	4,3	4,3
10. Social protection	18,7	18,3
11. Total expenditure	45,8	45,0

Sources : Ministry of Finance, Crédit Agricole S.A.

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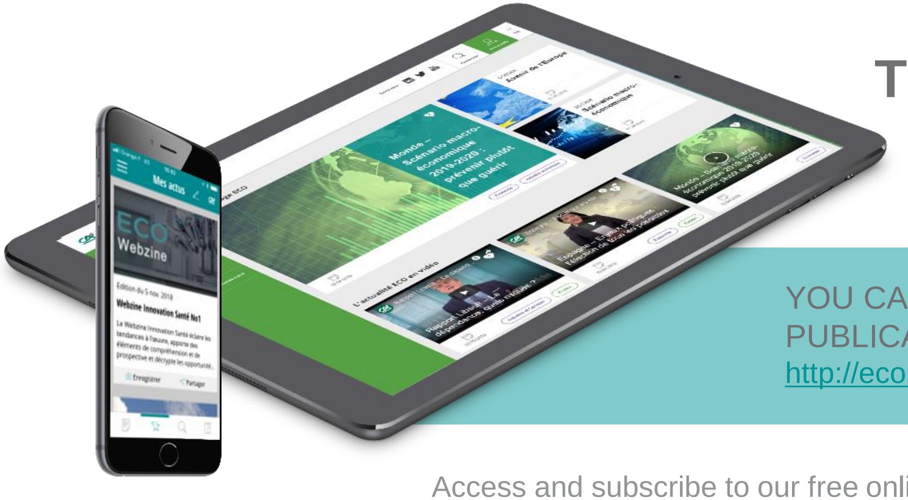

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