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SPAIN 2024-2025 SCENARIO

ACTIVITY REMAINS ROBUST

January 2024

**WORKING EVERY DAY
IN YOUR INTEREST**



GROUP ECONOMIC RESEARCH

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SUMMARY

BUSINESS HOLDS UP IN ADVERSE CONDITIONS

The Spanish economy ended 2023 on a better note than expected at the beginning of the year. The pace of growth slowed in the second half of the year but less significantly and at a later stage than expected. In the second estimate of GDP for the third quarter, the INE confirmed the growth rate at 0.3% quarter-on-quarter (0.4% in Q2). GDP was thus 2.1% higher than in fourth-quarter 2019, before the pandemic. The pace of growth in household consumption and public consumption stands apart from other GDP components, both exceeding 1% quarter-on-quarter. However, investment fell by 1%, and exports of goods and services reflected the weakness of the main trading partners, dipping 4.1%.

The indicators available for the fourth quarter suggest that the momentum of economic activity is similar to that in the previous quarter, consistent with growth of around 0.3%. Growth in activity is expected to stabilise in the next few quarters, coming out slightly higher than in H2 2023. But the strong economic momentum in the latter part of 2022 and early 2023 implies that on an average annual basis GDP growth will slow between 2023 and

2024 from 2.4% to 1.6%. The main support for activity will be domestic demand. Household consumption will be boosted by the rise in real incomes as inflation and wage increases moderate in a relatively dynamic labour market. Investment will also be a key growth driver, largely thanks to the boost lent by investment projects linked to the NGEU programme, the implementation of which is set to pick up speed in 2024 and 2025. Our growth forecasts for private consumption are 1.9% for 2024 and 1.5% for 2025, while investment should climb 2.7% and 2.4%, respectively.

The contribution of net foreign demand will recover in the coming quarters after a considerably negative contribution in spring and summer 2023. Yet net exports are not expected to boost GDP growth as much as they did in 2023. This is due to the increased momentum expected in exports of non-tourist goods and services (thanks to a gradual improvement in the external environment), which will be offset by a recovery in imports, in part stemming from improved investment, with high import content. Exports of tourist services, already higher than before the pandemic, are expected to slow. According to our forecasts, the

contribution of net exports to growth will be barely negative in 2024 (-0.2%) and zero in 2025.

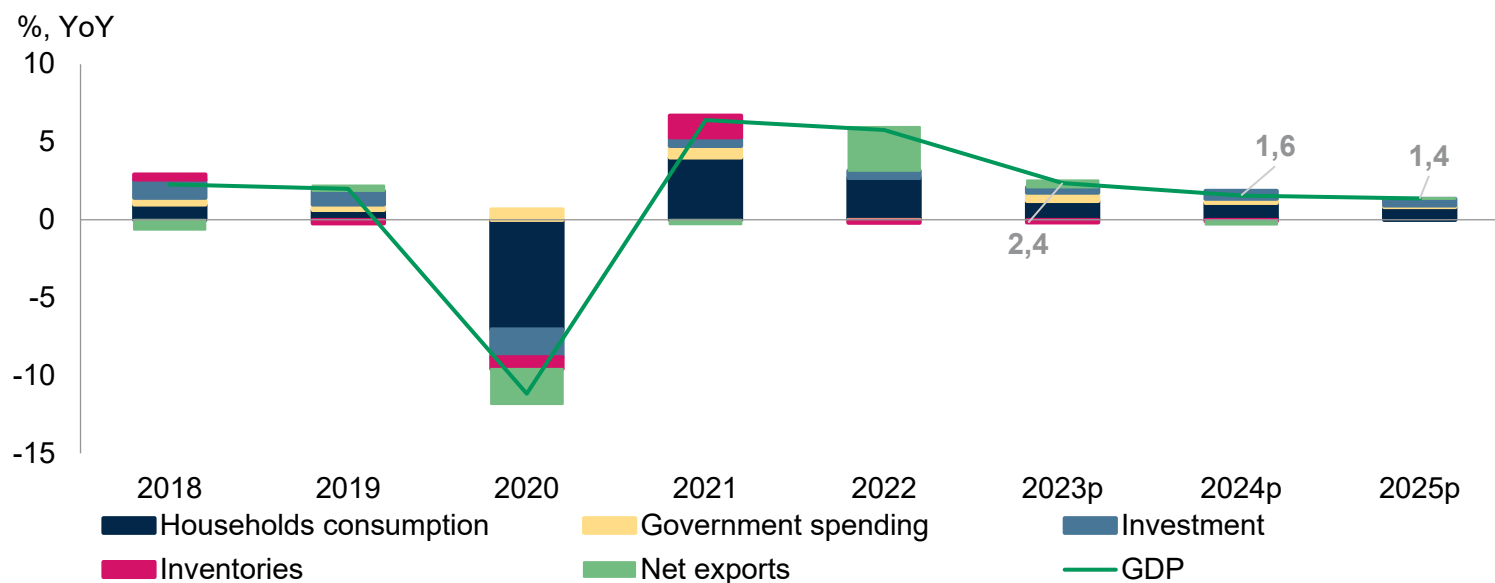
Regarding the labour market, employment momentum will moderate throughout the forecast horizon in line with the expected trend in activity and assuming a certain recovery in productivity. The unemployment rate will continue to trend downwards, albeit at a slower pace than in recent years. Both the moderation in the pace of job creation and the expected growth in the working population, which will be driven by strong momentum in immigration flows, will contribute to this slowdown in the reduction of the unemployment rate. As a result, unemployment is expected to come out at 11.8% in 2024, lower than the historical average of the last four decades (16.8%) but higher than the low reached in 2007 (8.2%).

In the twelve months to date, the general government deficit stood at 4.2% of GDP at the end of the third quarter (4.5% in June). This figure is still higher than the government's 3.9% target for full-year 2023. We expect a public deficit of -4.1% in 2023 and -3.6% in 2024.

SUMMARY

OUR GROWTH FORECASTS

Contributions to annual GDP growth



Sources: Eurostat, Crédit Agricole S.A./ECO.

Spain	2023	2024	2025	2024				2025			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	2,4	1,6	1,4	0,4	0,4	0,5	0,3	0,4	0,2	0,2	0,1
Households consumption	2,1	1,9	1,5	0,3	0,3	0,4	0,5	0,5	0,2	0,2	0,2
Investment	1,8	2,7	2,4	0,8	0,9	0,7	0,7	0,6	0,4	0,4	0,4
Change in inventories*	-0,2	-0,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Net export*	0,5	-0,2	0,0	0,1	0,1	0,1	-0,1	0,0	0,0	0,0	-0,1
Unemployment	12,3	11,8	11,4	12,2	12,0	11,3	11,6	11,8	11,6	11,1	11,3
Inflation	3,3	2,6	2,0								
Government net lending	-4,1	-3,6	-3,8								

* Contributions to GDP growth

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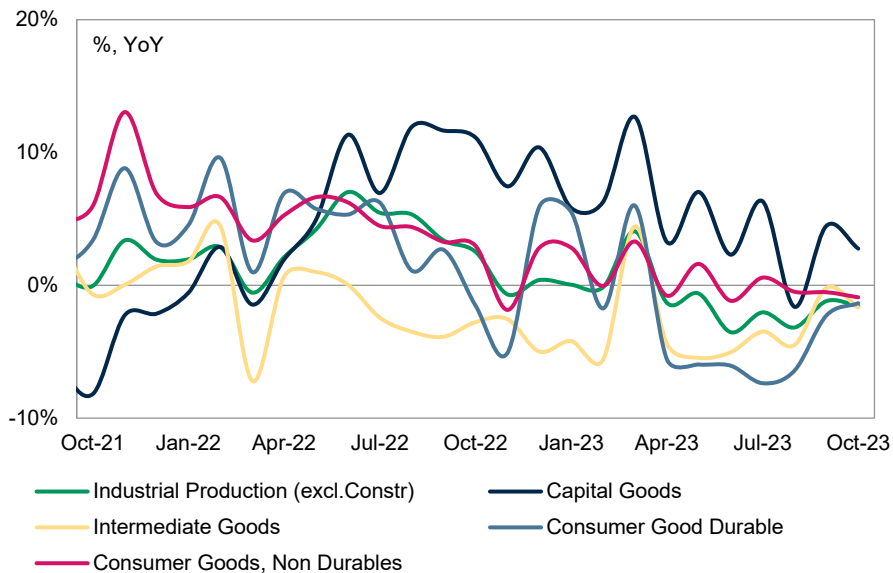
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RECENT ECONOMIC TRENDS

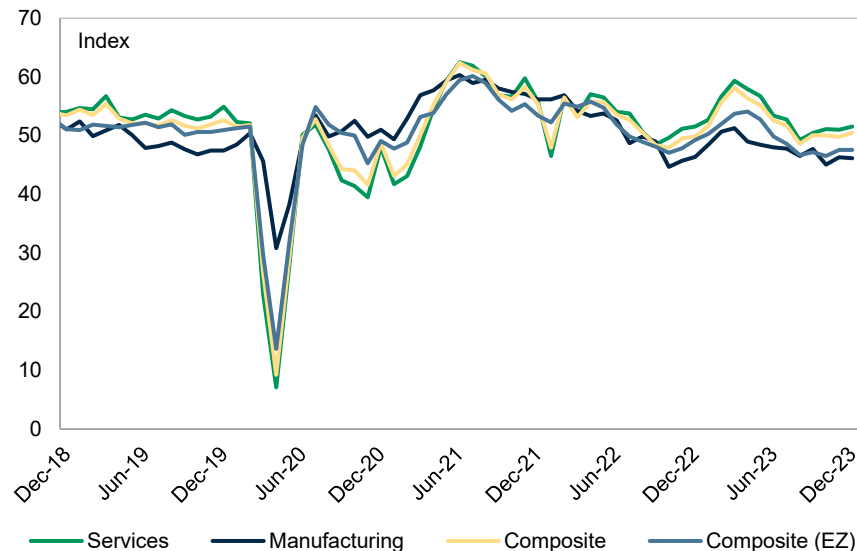
VERY MODEST GROWTH IN Q4

Industrial output



Sources: Eurostat, Crédit Agricole S.A./ECO.

Purchasing Managers Index (PMI)



Sources: Markit, Crédit Agricole S.A./ECO.

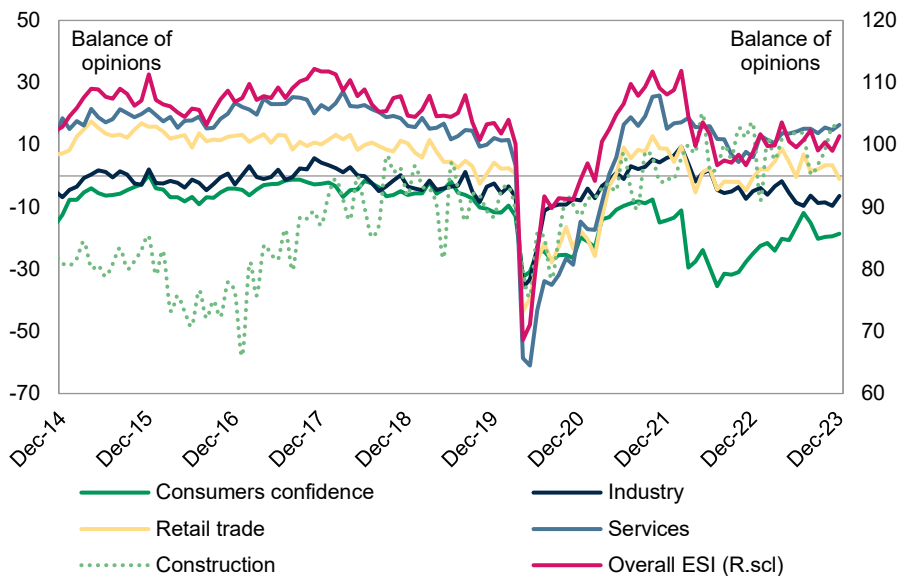
The indicators available for Q4 2023 suggest that activity momentum is likely to be similar to that in the last few months of 2022. Among the available indicators, purchasing managers' indices (PMIs) trended similarly to the third quarter and continue to point to stronger momentum in services than in industry. Likewise, the Bank of Spain's

EBAE survey on business activity suggests that corporate revenues have remained virtually stable compared with the previous quarter, with significant differences between sectors. Industrial production continued to trend negatively until October.

RECENT ECONOMIC TRENDS

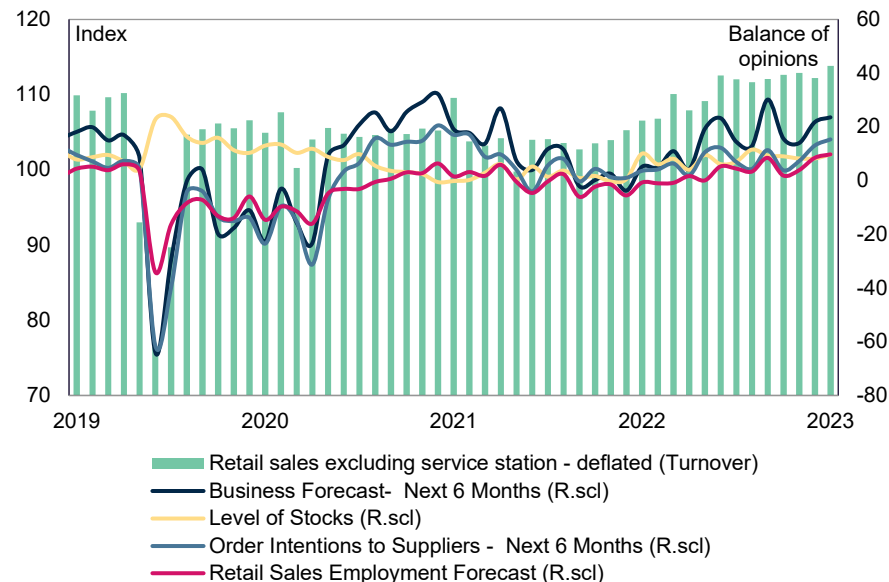
VERY SLIGHT GROWTH IN Q4 2023

ESI survey and components



Sources: Eurostat, Crédit Agricole S.A./ECO.

Retail sales



Sources: ICI, Crédit Agricole S.A./ECO

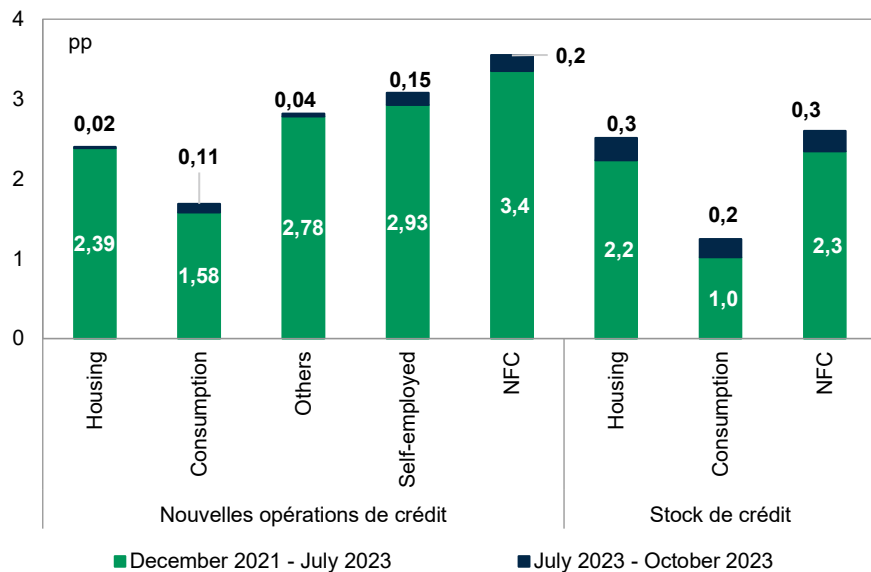
The European Commission's Q4 economic climate surveys for the Spanish economy reveal a slight improvement in consumer and industry sentiment, as well as in services and retail. Deflated retail sales accelerated to 0.9% month-on-month, after the zero change in October, the sharpest growth coming in personal equipment (2%) and the lowest in household equipment (0.2%). Spain welcomed 5.1 million foreign tourists in November, down 37.1% over the month and

down 40.6% compared with the same period from 2015 to 2019. Tourist flows increased 18.6% year on year. Significant contributions to growth in this demand component are not to be expected once tourism returns to normal after the post-pandemic rebound. We are forecasting GDP growth of 0.2% in Q4 2023, for annual growth of 2.4% in 2023.

RECENT ECONOMIC TRENDS

FINANCING CONDITIONS CONTINUE TO TIGHTEN

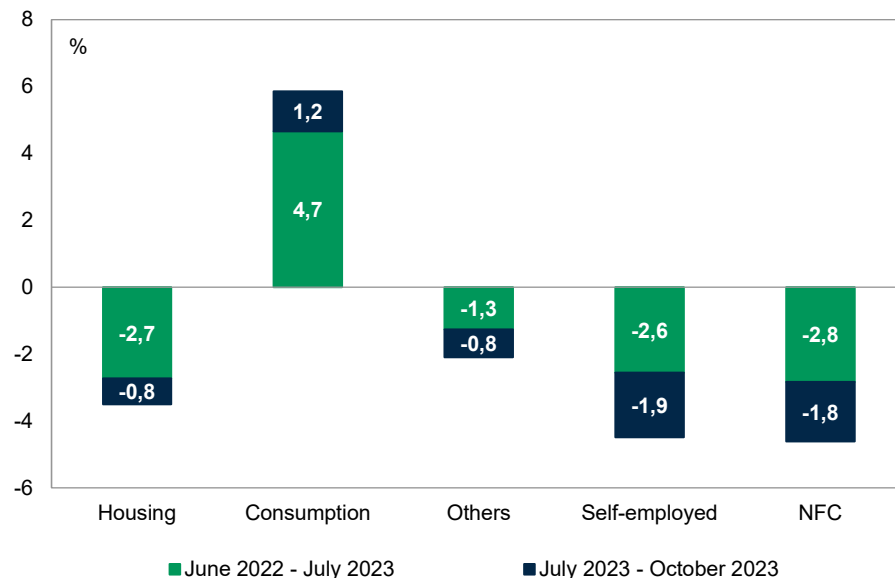
Increase in the cost of credit since the inception of the monetary tightening cycle



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

The cost of new bank financing transactions with households and businesses has continued to rise in recent months. The latest survey on bank lending shows a further reduction in demand and a general tightening of credit criteria across the credit market. In Q4 2023, the entities surveyed expect a further reduction in both credit supply and demand, though less emphatic than between July and September.

Trend in lending to households and businesses since mid-2022



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

Against this backdrop, the contraction in private sector financing has intensified in recent months, particularly in loans to businesses and individual entrepreneurs. But growth in consumer loans remained positive and stable at around 4% year on year, bolstered recently by the financing of consumption of durable goods.

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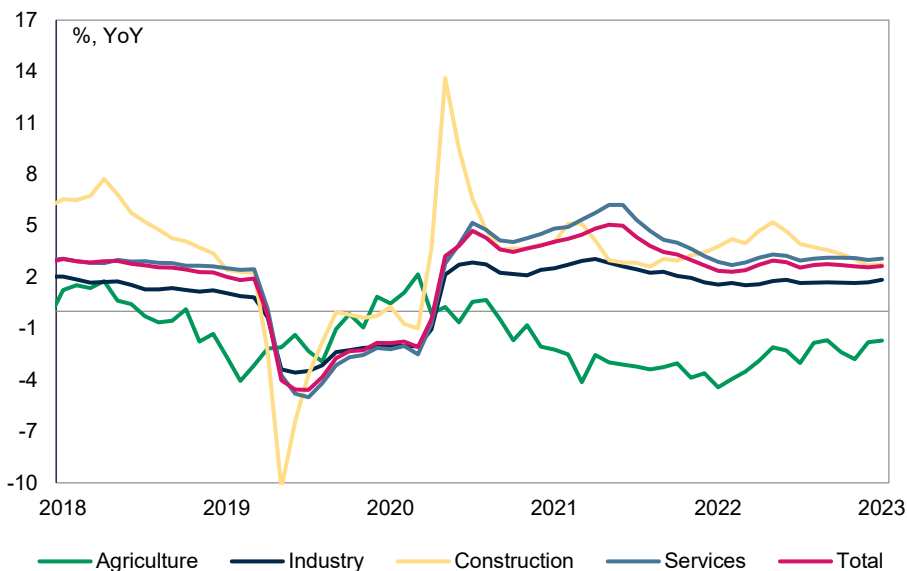
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OUTLINE OF OUR SCENARIO

EMPLOYMENT RESILIENT IN Q4 2023

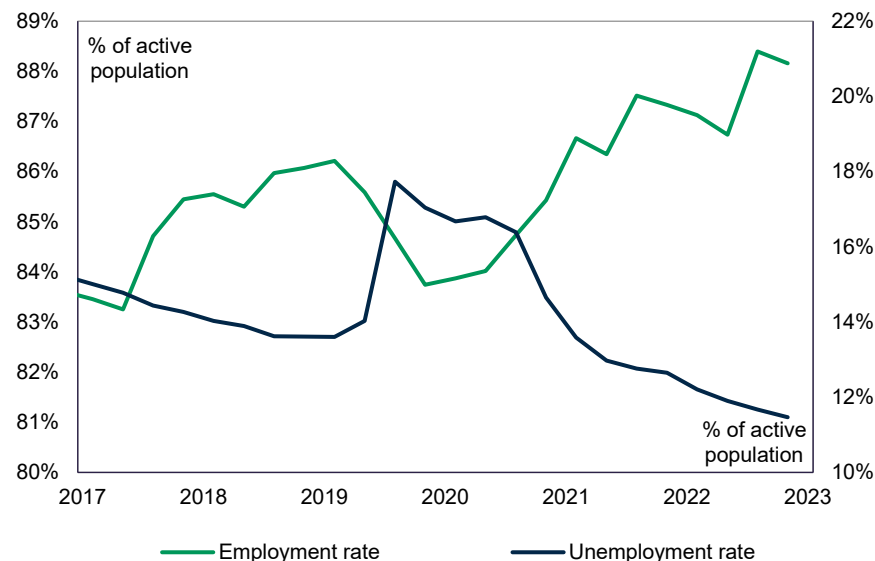
Employment: Social Security enrolment



Sources: Ministry of Labour, Crédit Agricole S.A./ECO.

Social Security enrolment increased 0.4% in Q4 (0.3% in Q3). All non-agricultural sectors contributed positively, notably construction (0.7%) and services (0.5%). The robust performance of employment in recent quarters has been closely linked to strong momentum in foreign workers, the number of whom increased 8.6% in November, compared with an increase of 1.7% for Spanish workers. Foreign workers accounted for just over 40% of the total increase in enrolment, after increasing their weight to 12.8% of total contributors, compared

Unemployment rate



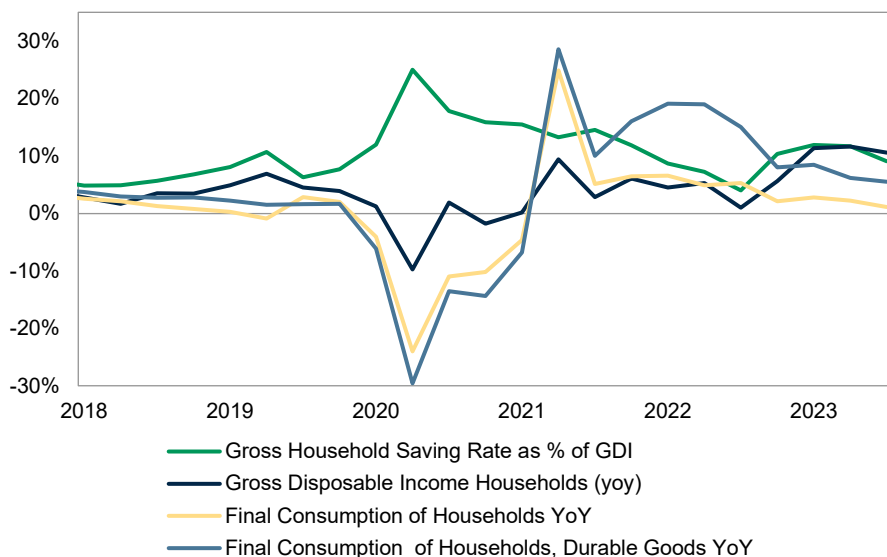
Sources: Ministry of Labour, Crédit Agricole S.A./ECO.

with around 11% at the end of 2019. The labour market proved resilient in the last quarter of the year. However, with the contribution of services running out of steam, we still expect to see weaker employment growth in 2024 as the unemployment rate approaches an all-time low. The decline in activity driven by weakening domestic demand owing to past inflation points to a slowdown in the reduction in the unemployment rate. Our forecasts show the unemployment rate falling further to 11.8% in 2024 and 11.4% in 2025.

OUTLINE OF OUR SCENARIO

CONSUMPTION STILL ROBUST IN Q3 2023

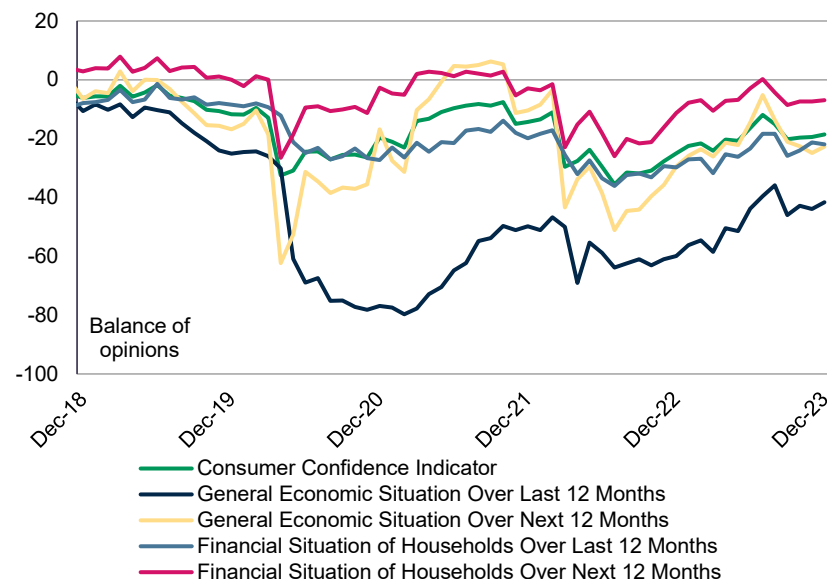
Change in gross disposable household Income and its components



Sources: Eurostat, Crédit Agricole S.A./ECO.

Household gross disposable income (GDI) dipped 0.5% in Q3 2023, after more than a year of uninterrupted growth (+1% in Q2). This resulted primarily from an increase in income and wealth taxes (+24.8%) while employee remuneration increased at a slightly higher pace (2.3% vs. 2% in Q2). Household consumption rose 2.6% in value terms (1% in Q2) and is 13.8% higher than before COVID. The slight fall in gross disposable income in Q3 relative to the sharper increase

Household survey



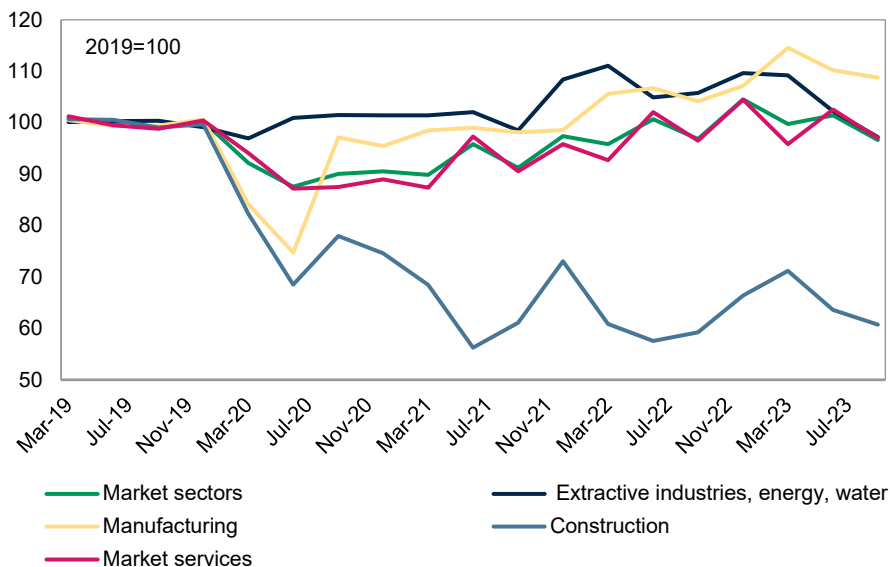
Sources: European Commission, Crédit Agricole S.A./ECO.

in consumption explains the decline in the household savings rate, which stood at 9.1% in Q3 (after 11.9% in Q2). The savings rate continues to exceed its average in 2022 (7.6%) and is also higher than before the pandemic (8.2% in 2019). However, consumption growth is expected to slow in the coming quarters on tighter financial conditions and the erosion in purchasing power. We expect consumption to increase 1.9% in 2024 and 1.5% in 2025.

OUTLINE OF OUR SCENARIO

CORPORATE MARGINS MODERATE IN Q3 2023

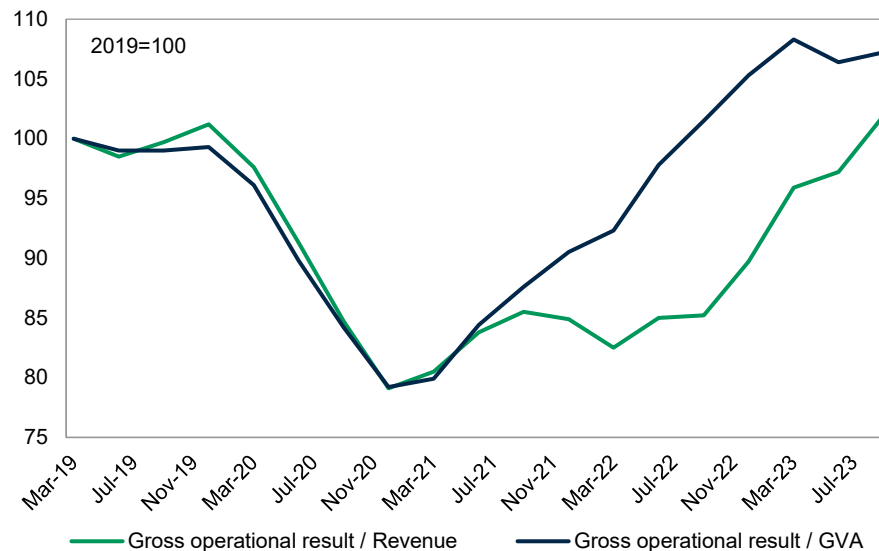
Trend in business margins (GOI/GVA)



Sources: INE, Crédit Agricole S.A./ECO.

According to national accounting data for Q3, the ratio between gross operating income (GOI) and gross value added (GVA), i.e. the margin rate of the market sectors, has continued the trend of moderation initiated at the beginning of the year, after the rebound in 2022. These trends are in line with that in the ratio between gross economic income and gross value added observed in the sample of companies of the Bank of Spain's quarterly Central Balance Sheet (CBT). According to the CBT, the estimated trade margin and the ratio between gross

Trend in activity margins according to the Bank of Spain



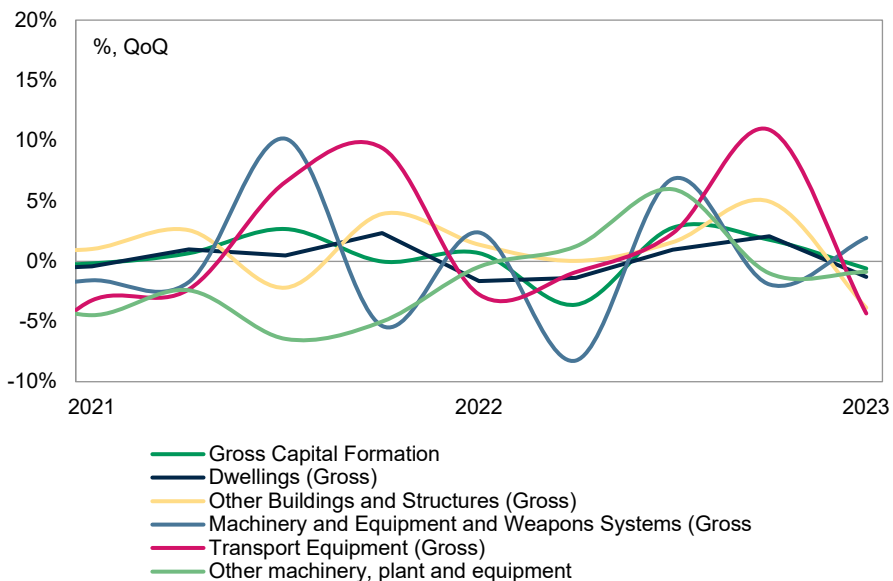
Sources: Bank of Spain, Crédit Agricole S.A./ECO.

economic income and revenue continued to recover in Q3, reaching pre-pandemic levels. However, these combined changes mask a significant disparity between sectors, due not only to differences in the momentum of demand but above all to changes in the costs borne by each business sector. For example, the manufacturing sector exceeded pre-pandemic levels in Q1 2019 (108%), while construction still lagged far behind (60.7%).

OUTLINE OF OUR SCENARIO

INVESTMENT: OUTLOOK STILL OPTIMISTIC

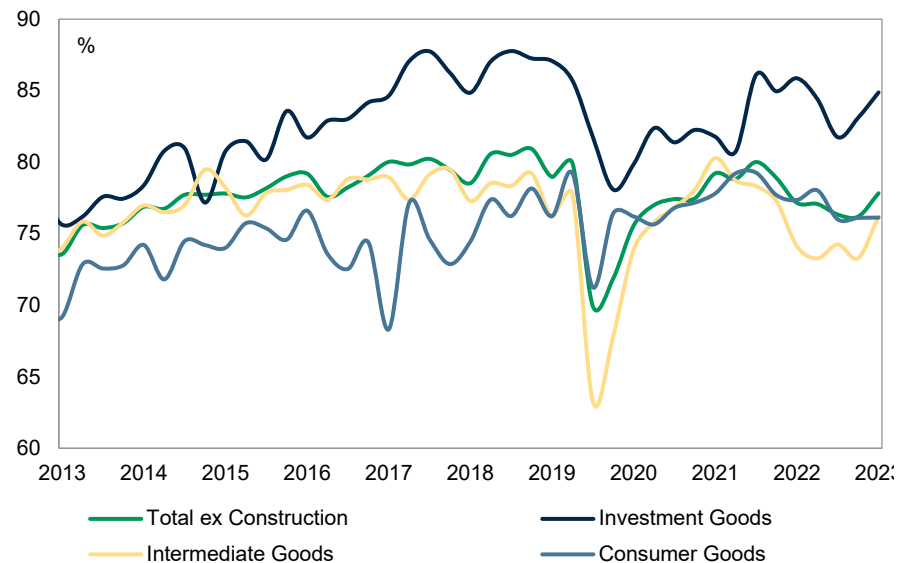
Components of investment



Sources: INE, Crédit Agricole S.A./ECO.

After the strong rebound in Q2, investment contracted 1% in Q3 on a decline in construction (-2.5%), which was not offset by increased investments in machinery and equipment (+1.8%). The increase in investments is expected to continue in the coming quarters, moderated by weaker activity. Although business investment momentum could be bolstered by the implementation of NGEU-related projects as well as the capital available to companies, the tightening of

Capacity utilisation rate



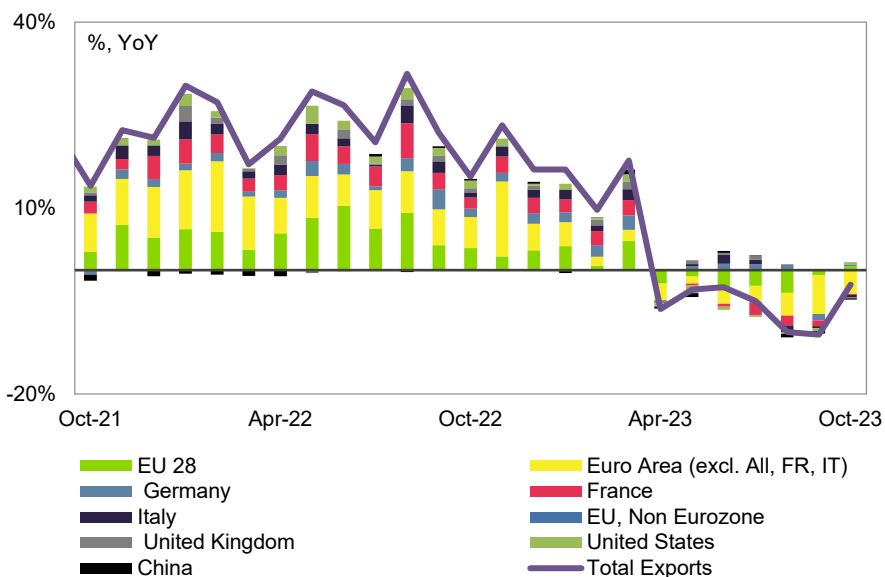
Sources: Ministry of Industry and Commerce, Crédit Agricole S.A./ECO.

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 2.7% in 2024 and 2.4% in 2025.

OUTLINE OF OUR SCENARIO

FOREIGN TRADE: ZERO CONTRIBUTION EXPECTED

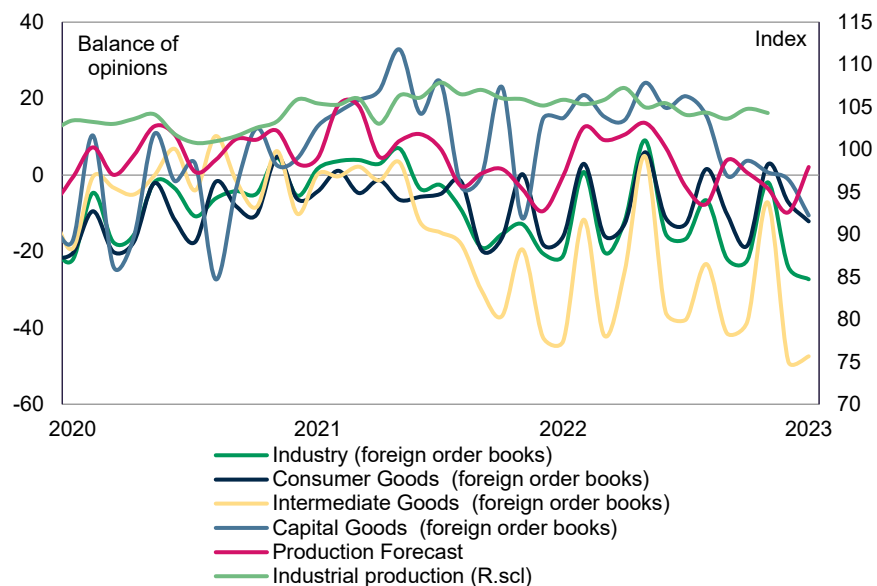
Exports by destination



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

Foreign trade continued to slow GDP growth in Q3 2023 owing to a sharp drop in exports (-4% qoq), against the backdrop of a slowdown in external markets, particularly among the main trading partners. As in previous quarters, the reduction in imports (-3.1%) appears to be related to the post-pandemic boom in the consumption of services, less intensive in imports. It is also linked to the deterioration in household purchasing power, which has shifted consumption towards products with lower import content (particularly in food and textiles,

Export order books



Sources: Business sentiment survey, Ministry of Industry and Commerce, Crédit Agricole S.A./ECO.

where imports are trending more negatively than domestic sales). The expected gradual recovery in the eurozone should support Spanish exports in the coming quarters. Conversely, tourist flow momentum is also expected to moderate, as foreign tourist arrivals were already 0.2% higher from January to October 2023 than in 2019. We expect exports to make a net contribution of -0.2 points in 2024 and zero points in 2025.

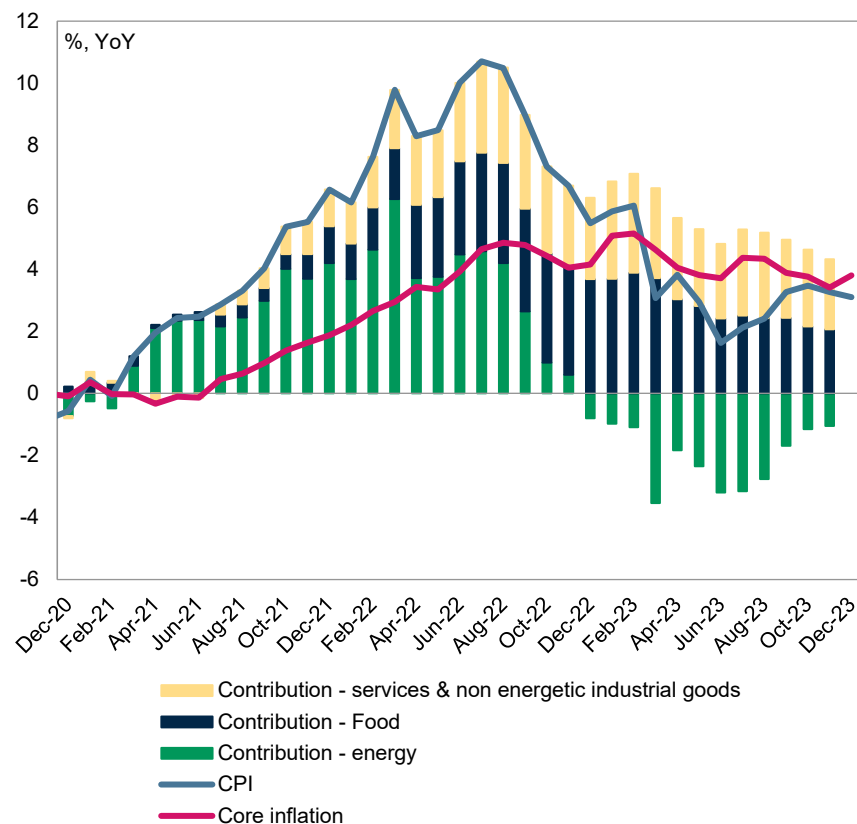
OUTLINE OF OUR SCENARIO

HEADLINE INFLATION IS MODERATING

From the low recorded in June (1.6% year-on-year), headline inflation increased persistently until October, owing primarily to a sharp moderation in the pace of the decrease in energy prices. In November, the decline in headline inflation (to 3.3%) was driven mainly by the slowdown in core inflation. Core inflation has decelerated gradually since July, reaching 3.4% in November. This decline has mainly been underpinned by the decline in items related to leisure, catering and tourism activities – from 6.6% in July to 5.4% in November – and by those related to housing equipment and conservation – from 4.5% to 2.8% over the same period. The deceleration in food inflation came to a halt in the summer but has resumed in the last two months, reaching 8.6% in November. The prices of cereals, milk and derivatives have contributed the most to the recent slowdown in food inflation, although the phenomenon is fairly widespread. In December, the leading indicator pointed to a moderation in the general index to 3.1% year-on-year.

However, non-energy inflation is expected to slow gradually. Projected disinflation results mainly 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 is 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 3.3% in 2023 and 2.6% in 2024.

Inflation and contributions

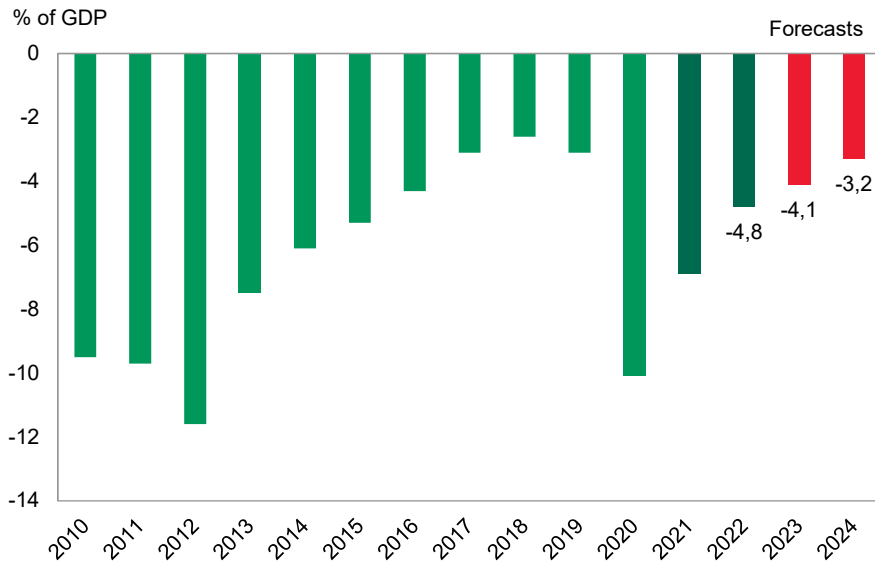


Sources: INE, Crédit Agricole S.A.

PUBLIC FINANCES

DEFICIT REDUCTION IN Q3 2023

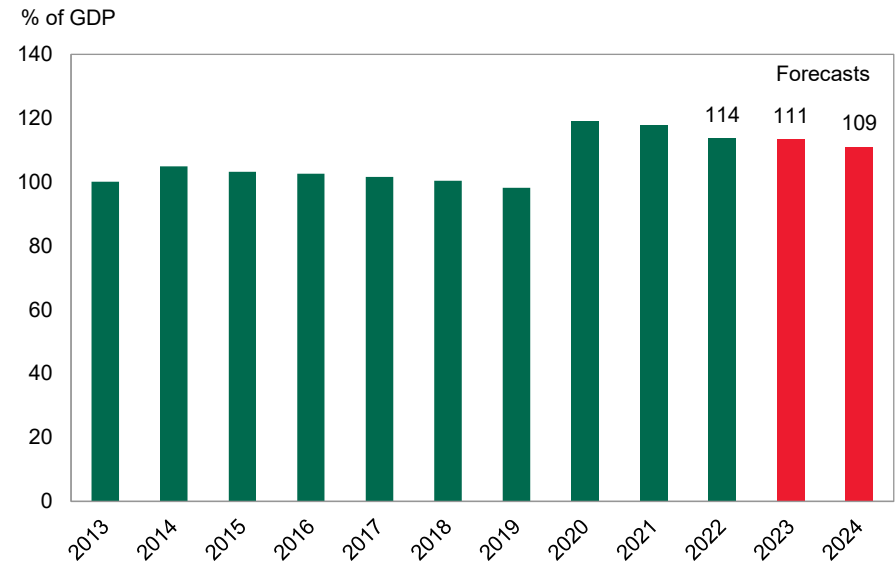
Public deficit



Sources: Stability and Growth Programme, Crédit Agricole S.A./ECO.

In the twelve months to date, the government deficit stood at 4.2% of GDP at the end of Q3 (4.5% in June). This figure continues to exceed the Government's 3.9% target for full-year 2023. In total since January, the annual growth rate in spending stood at 6.2% in September, slightly lower than in June. Social benefits rose year on year (9.8%), driven by the increase in pensions and also by the growth in unemployment expenditure (5.2%). Cumulative revenue growth

Change in government debt



Sources: Stability and Growth Programme, Crédit Agricole S.A./ECO.

over the last twelve months was 8.1% in September, a little lower than that recorded until June. This trend is characterised by the increase in the collection of direct taxes (11.1%) and social security contributions (9.2%), driven by the rebound in nominal incomes, the recent increase in social security contributions and the introduction of transitional taxes on corporate profits and assets. We expect the deficit to continue to fall, to 4.1% in 2023 and 3.6% in 2024.

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SHARP SLOWDOWN IN 2023

The latest housing market data point to a slowdown due to rising interest rates. According to MITMA records, based **on notarised sales, more than 470,500 transactions were completed in the first nine months of 2023, down 13.5% from 2022. But the number of transactions remains above the average level of the last five years.** INE data, based on recorded sales, confirm an 8% annual contraction. With transactions by domestic buyers decreasing (-14.5%) more than those of foreign buyers (just under 9% in the first nine months of the year), **the weight of foreign capital in the Spanish residential market is gradually increasing. The latter currently accounts for one in five transactions concluded in the country, but in major tourist regions such as Alicante it can account for up to half of all transactions.**

The rise in interest rates has not significantly affected the key market player, the higher middle-income segment, which is less reliant on financing. However, it has impacted first-time buyers, generally young people with lower-middle incomes. This population is affected not just by rising interest rates but by rising prices, which have continued to increase throughout the year, particularly in areas with the greatest mismatch between supply and demand. **According to INE data, housing prices were up 4.2% year on year in Q3 2023.**

Some 81,000 building permits were granted year to date through September 2023. If these levels continue, roughly 110,000 permits could be delivered by the end of the year, similar to the total in 2021 and 2022. However, according to INE data, the formation of new households by the end of the year is estimated at around 220,000, constituting **a significant gap between supply and demand.** In addition, although a stock of nearly 450,000 unsold housing units has accumulated since the housing boom, it should be kept in mind that, given the characteristics of the residential market, **excess supply in one geographical area cannot be absorbed by the residential needs that may arise in another geographical area.** As a result, some relevant markets with high demand are more affected by the problem of access to housing, with the ratio of housing access to household creations totalling 0.3 in Catalonia, the Valencian Community, Galicia, Murcia and Aragon. The ratio is even lower in the Canary Islands and stands at 0.5 in Madrid and Andalusia.

As factors contributing to the decline in activity, including inflationary pressures and high interest rates, cease to present upside risks, the trend in residential demand in Spain could improve in 2024.

CONSULT OUR LAST PUBLICATIONS

Date	Title	Theme
24/01/2024	France – 2024-2025 Scenario: economy recovering as shocks dissipate	France
18/01/2024	The Critical Raw Materials Act: Europe's metals sector expresses its desire for independence	Mines & metals
16/01/2024	United Kingdom – 2024-2025 Scenario: a fragile recovery expected later in the year	United Kingdom
22/12/2023	World – Macro-economic Scenario 2024-2025: Fluctuat nec mergitur	World
14/12/2023	Sub-Saharan Africa: how is climate change affecting the region's economies?	Africa
07/12/2023	Between China and the US, South Korea still needs the benefits of globalisation	Asia
30/11/2023	En route to Dubai: let's talk about COP28	Climate challenge
23/11/2023	Xi Jinping's visit to San Francisco is both politically and economically important	USA/China
21/11/2023	China – The long road to transition	Asia
17/11/2023	Geopolitics – The brick wall of reality	Geopolitics
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06/11/2023	France – 2023-2024 Scenario: a smooth recovery despite headwinds	France
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