Spain

Badly hit by the Covid-19

Spain is Europe's second hardest-hit country by the coronavirus pandemic, and is likely to suffer a sharp economic contraction this year. The economic impact remains hard to quantify. GDP is nonetheless likely to fall by more than 3% in 2020, before a recovery in 2021. The structure of the Spanish economy – turned heavily towards services and with a high proportion of SMEs – suggests that the economic shock could be greater than in other industrialised countries. Endemic unemployment could intensify, leaving a lasting mark on growth over the medium term. However, the improvement in public finances before the virus outbreak and a more stable political situation gives the government some leeway to face the crisis.

Spain has been heavily hit by the Covid-19 epidemic. At the end of March, the country had the second highest number of reported cases in Europe, after Italy. Prime Minister Pedro Sanchez has announced a substantial fiscal package. EUR 200 bn (16.6% of current GDP[1]) will be provided primarily via bank guarantees and deferred social security contributions for companies.[2] A postponement in loan repayments has also been introduced for the most vulnerable households. The Spanish economy should contract by at least 3.3% in 2020 before a recovery in 2021. GDP growth was strong in 2019 (+2.0%), although both the economy and the labour market began to lose steam in the summer of last year.

Spain: particularly vulnerable to the Covid-19 shock...

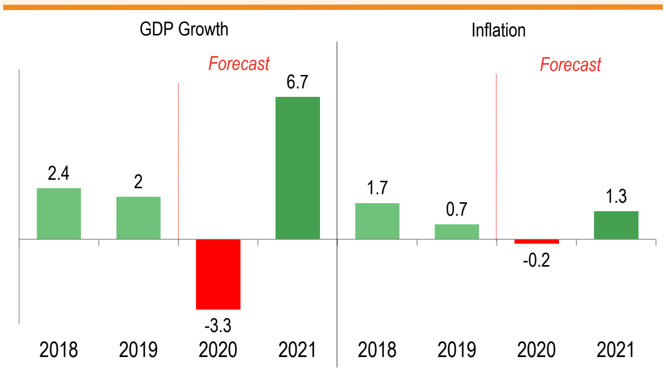
The structure of the Spanish economy renders the country particularly fragile against the coronavirus shock. First, the Spanish economy is composed largely of SMEs, whose cash positions are by nature less robust than major companies. Nearly one-third (32.1%) of gross value added in the non-financial sector is generated by companies with fewer than 20 employees. This is well above the EU27 average of 27.2%.[3]

Furthermore, the Spanish economy has a strong focus on the service sector. This sector consists in large part of businesses that are considered as 'non-essential' (tourism, leisure) and which are currently closed down. On this metric, Spain ranks highly within the EU: its service sector accounts for 74.2% of total value added, compared with an EU average of 73.0%.[4]

Lastly, Spain continues to face mass unemployment. Although the jobless rate has fallen significantly since its peak of 26.1% in Q2 2013, it was still 13.6% in February. Even if economic activity restarts in the second half of 2020, job offers will, in all likelihood, take much longer to recover as companies needs to first ensure their financial viability before recruiting. Long-term unemployment – which has a much greater impact on individuals than short-term unemployment – could thus increase sharply.

[1] Based on 2018 GDP.
[2] EUR117 billion will be provided by the government and EUR83 billion by the private sector, primarily the banks. The plan, announced on 24 March, stipulates that the government will guarantee 80% of bank loans taken out by SMEs and the self-employed. This guarantee is reduced to 70% for companies with more than 50 employees.
[3] Eurostat figures for 2017
[4] Eurostat figures for 2017

1- GDP Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

... but debt levels are lower than in 2009-2011

Nevertheless, it is worth noting that the coronavirus crisis has emerged at a time when the government's fiscal position had improved significantly. Indeed, the government deficit has shrunk considerably since Spain came out of recession in 2013: the Spanish primary balance recorded then a deficit of 3.6% of GDP.[5]

The public accounts for 2019 – published on 31 March – showed a primary deficit of 0.36% of GDP, a slight increase on the 0.10% of GDP in 2018. Spain's structural primary balance is estimated at a deficit of 0.8% of GDP in 2019.[6] Thus before the announcement of its emergency plan, the government had some fiscal leeway to 'cushion' the slump in economic activity.

The Spanish economy was also in a less 'perilous' financial position than during the 2008 financial crisis or during the European sovereign debt crisis in 2011. Although the ratio of total debt to GDP remains high, it has fallen by nearly 30 points of GDP since the peak in Q3 2014, reaching 267.3% in Q3 2019. Private sector debt (non-financial companies and households combined) was at its lowest since Q3 2004 (Figure 2). Part of the fall in private debt has, however, been transferred to the public sector. Government debt stood at 97.9% of GDP in Q3 2019.[7]

[5] The primary balance excludes debt interest payments. INE data.
[6] The structural primary balance excludes the impact of the economic cycle, one-off spending and debt interest payments from the calculation of the budget balance. See https://ec.europa.eu/economyfinance/ameco/user/serie/SelectSerie.cfm
[7] Bank for International Settlements data.

Towards a return of public investment?

With government spending set to rise sharply in 2020, the role of government investment as a support for economic growth could come back at the top of the political agenda. Government investment in Spain has stalled in recent years, even after the recession ended in 2013. The share of public investment in GDP has thus fallen from a peak of 5.2% in 2009, to 2.0% in 2019 (Figure 3). This decline is the result of the fiscal consolidation pursued by the former government of Mariano Rajoy, which followed a period of over-investment, particularly in the real estate sector.

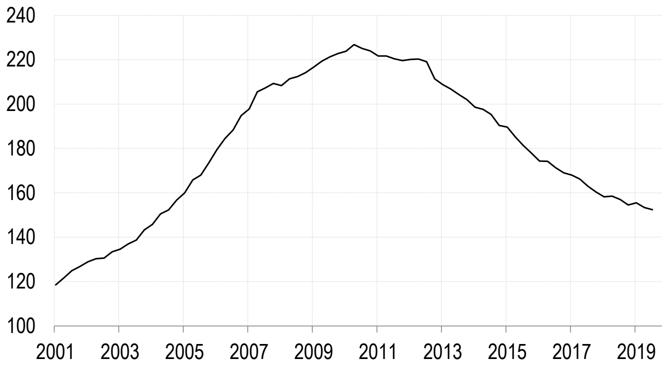
Once the health crisis finishes, there will be legitimate questions to be asked about the pursuit of low public-sector investment. This is true in healthcare, where GFCF was 0.8% of GDP in 2017.[8] More broadly, targeted public sector investment that supports innovation and boost productivity remains a significant driver of economic growth.

Political tensions have eased, for now

The coronavirus crisis has eased the political divisions that have shaken Spain for several years. The government received quasi unanimously the congressional support to extend the state of emergency until 12 April. It is nevertheless worth noting that the coalition government secured some notable successes prior to the crisis: the initial budget for 2020 was approved by the Congress at the end of February (although the budget has of course been substantially revised since then). This budget included, amongst other things, a 5.5% increase in the monthly minimum wage – to EUR950 – which follows a substantial 22% hike in 2019. The government objective is to raise the minimum wage to 60% of average wages by the end of the current parliamentary term in 2023.

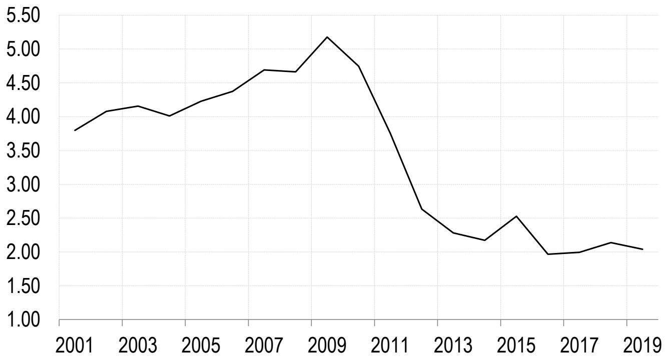
However, once the crisis finishes, Prime Minister Pedro Sanchez will remain under pressure. The socialist party (PSOE) has 120 seats in Congress. To maintain a congressional majority he will need to negotiate with the Catalan Separatist Party (ERC, 13 seats) and keep the unity with its coalition partner, Podemos, which has 35 seats. Podemos urgently wants to revisit some labour law reforms introduced by the Rajoy government. In particular, Podemos wants to restore branch-level agreements and move away from intra-company agreements that have been preferred in recent years. Meanwhile, the ERC is asking a referendum on Catalonia independence and amnesties for a number of separatist leaders.

2- Private debt
Private non-financial sector debt (% of GDP)



Source: BIS

3- Public investment
GFCF (% of GDP)



Source: Spanish Ministry of Finance

Some political opponents (the Partido Popular), and indeed even the Bank of Spain[9], fear that the labour law reforms could ultimately have a negative impact on business competitiveness and hold back the country's economic growth.

Guillaume Derrien
guillaume.a.derrien@bnpparibas.com

[8] This figure is above the OECD average of 0.5%, but below those of other European nations such as Germany (1.1%), Belgium (0.9%) and the Netherlands (0.9%). OECD data.

[9] Spain's central bank urges government to stick with labour reform, *Financial Times*, 4 February 2020.