SPAIN

ECONOMIC ACCELERATION IN SIGHT

Just when the lights seemed to be turning green on the health front, the spread of the Delta variant in Spain, as elsewhere in Europe, is a cause of concern. The risks remain currently under control and economic activity should record a significant upturn this summer. The easing of travel restrictions and the introduction of the European health pass since 25 June should allow the Spanish tourist industry to lift itself back up, which would have positive knock-on effects on consumption and employment. Even so, and despite the fact that growth is expected to bounce back strongly, to 6.0% in 2021, the Covid-19 will continue to leave its mark on Spain's public finances. After a record year in 2020, the government deficit could remain at over 8% of GDP this year and stay elevated until 2022 at least. The European Commission's approval of Spain's recovery plan will, however, allow Madrid to receive the first round of European subsidies. Thus EUR 9 billion in grants could be allocated in July, with a further EUR 10 billion unlocked by the end of 2021.

THE PANDEMIC EMERGES AGAIN

Although our central scenario remains one of a solid economic recovery in Q3, the risks of a new wave of the pandemic caused by the Delta variant cannot be totally excluded. This is particularly true because the vaccination campaign seems to be levelling off in Spain[1], with just half of the country's population having received at least one vaccine dose by the end of June. The government's goal of vaccinating 70% of the population by the end of the summer nevertheless remains within reach according to the health ministry.

The tourist season would suffer from any worsening of the health situation in Spain and elsewhere in Europe if this leads to a renewed tightening of travel conditions between countries. Control measures (PCR tests, vaccination certificates) have already been reintroduced for British travellers coming to Spain. Before the pandemic, the tourism sector generated nearly 2.6 million jobs (direct and indirect) or just under 15% of total employment in Spain[2]. The figures related to the tourism activity that we have so far still bear the marks of lockdown measures and reflect the long road still ahead for a recovery. The number of overnight stays in May was still only around a quarter of the level seen in the same month in 2019. Even though these figures will improve significantly, a return to 2019 levels is unrealistic this year, and will still be a challenging target in 2022.

At this stage, we are still expecting economic activity to accelerate in the second half of this year – with growth of around 5.5% – after a timid recovery in the first semester. This represents a slight upward revision of our March forecast estimate for the full year 2021, up from 5.9% to 6.0%. Economic activity in Spain was hit this winter not only by another wave of infections – which caused the authorities to tighten again health protection measures – but also by winter storm Filomena in January. This paralysed large parts of the country for several days, further impacting economic activity in Q1, particularly in construction. This sector recorded the biggest contraction in activity in Q1 2021, at -4.3%, whilst real GDP fell 0.4% q/q. It is worth noting, however, that some components of demand held up really well. On the investment side, spending on machinery and equipment and on intangibles continued to grow over the winter, with the latter reaching record levels. But the most pronounced growth came from exports of goods. Exports by value grew by more than 8% in the first four months of the year, climbing well above the levels seen at the end of 2019 (see Chart 2). The recovery in capital goods exports was particularly strong (13.8% over the first four months of the year), but there was also significant increases in consumer goods (8.5%) and intermediate goods (7.0%). By country of destination, and over the same period, the biggest growth came from the eurozone (28.2%), most notably Portugal (30.7%), Italy (28.7%) and France (27.6%).

GROWTH AND INFLATION (%)

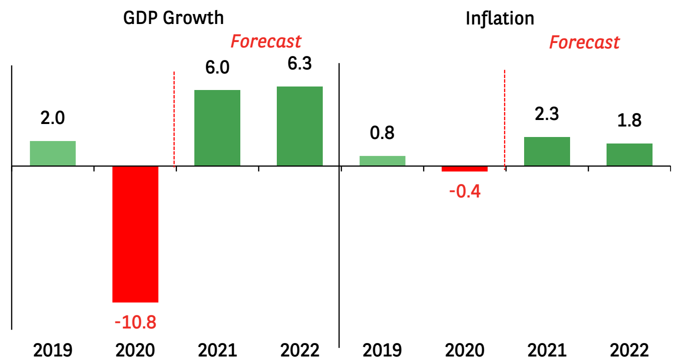

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

GOODS EXPORTS HAVE UNDERPINNED GROWTH THIS SPRING

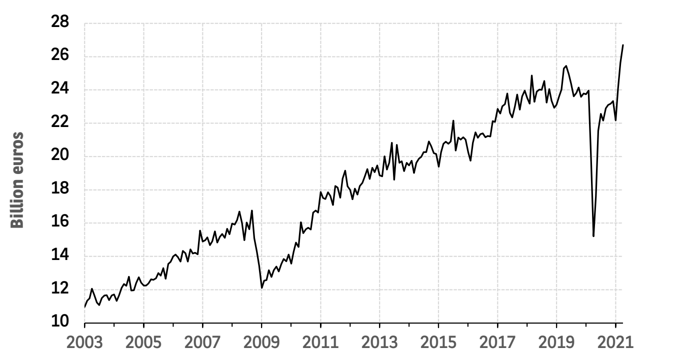

CHART 2 SOURCE: SPAIN FINANCE MINISTRY

1 *Spain misses June vaccination target with nearly three million doses still in storage, El Pais*, 22 June 2021.
2 Source: Eurostat.

CONSUMPTION AND EMPLOYMENT STILL CONVALESCING

The recent evolutions in surveys (PMI, European Commission) clearly point to an acceleration in activity over the summer. For example, the composite PMI hit its highest level for 20 years in May, at 59.2. Although the upturn in optimism was already visible in the manufacturing sector over the winter, the improvement in confidence in services occurred more lately, on the back of the gradual loosening of lockdown measures that still weighed on this sector last spring. However, so far there has been a significant lag between these (optimistic) survey data and more tangible data, for which a noticeable improvement is yet to materialise. This is particularly the case for the consumption (retail and car sales) and employment data. Nearly 4 of every 10 jobs lost during the first lockdown had still not been replaced by May.[3] This said, the construction sector is performing well, with employment in the sector already back above 2019 levels. National employment data nevertheless need to be viewed with some caution; workers on the ERTE short-time working scheme are considered as employed, although not all of them will return to employment. Despite a significant fall, nearly 500,000 workers were still covered by the ERTE scheme at the end of May.

Given these circumstances, and even though the process of scaling back the government's exceptional support measures is now under way, a large chunk of the support measures is likely to remain in place for several months yet, and will only be withdrawn very gradually. This is particularly true of the "widened" form of the short-time working scheme (ERTE) introduced at the onset of the pandemic, which has been extended to the end of September. The Spanish public finances will thus remain deeply in the red in 2021. The Bank of Spain (BdE) is now predicting a General government deficit of around 8% of GDP (8.2%)[4] for the year; the bank expects the deficit to remain high in 2022 (4.9%) and 2023 (4.3%). This is not solely due to the exceptional support measures the government has adopted to limit the shock of the pandemic, but it is also the consequence of a large underlying 'structural' deficit that predated the coronavirus crisis[5]. The ratio of government debt to GDP will therefore benefit only very slightly from the growth expected in 2021 and 2022, and will remain close to the threshold of 120% (118.0% in 2022 according to the BdE; from 119.9% in 2020).

Spain should nevertheless benefit in July from the first payments (EUR 9 billion) under the European recovery fund, following the European Commission's approval of its recovery programme. EUR 10 billion in additional grants should be released by the end of this year. However, this total of EUR 19 billion for 2021 falls short of the EUR 27 billion that the Spanish government initially expected to receive.

INFLATIONARY PRESSURES NOT AS STRONG AS IT SEEMS

As in other parts of Europe, inflation in Spain has climbed steeply over recent months, reaching 2.7% in May. However, underlying pressures remain contained. The overall increase in the CPI was almost entirely due to increases in energy prices, with two main contributors: first, the rise in petrol and diesel prices – CPI for petrol jumped 24.2% in May – and secondly the spectacular leap in electricity prices (36.3%). Removing the energy component from CPI gives a level of inflation much more benign, at just 0.3% in May (Chart 3). Indeed, some CPI components were even in deflation. This was the case, for example, in communications (-4.5% y/y), hotels and restaurants (-0.6% y/y) and alcohol & tobacco (-0.3% y/y). The gap between headline and underlying inflation (excluding energy and fresh food) has been the widest since the current data series began (January 2002).

RECORD GAP BETWEEN OVERALL AND CORE INFLATION

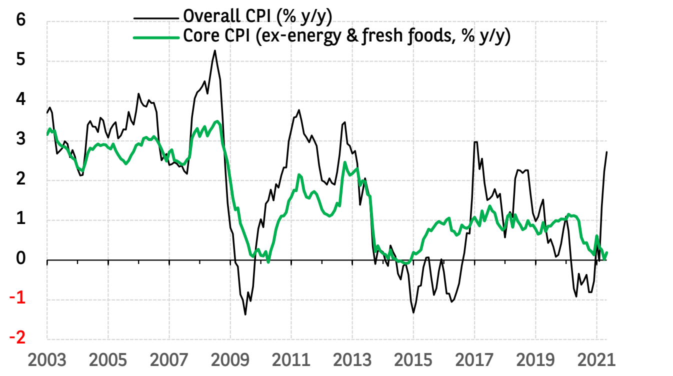

CHART 3 SOURCE: INE

In order to reduce the weight of electricity in household living costs, the government decided to cut on June 26 the rate of VAT on electricity from 21% to 10% until the end of the year. It also suspended the 7.0% tax on electricity paid by companies. The shortfall in tax revenue will be important, at nearly EUR 1.2 billion according to the government. This will further increase the budget deficit in 2021.

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3 Data from the Spanish employment agency (SEPE).
4 Banco de España macroeconomic forecasts, June 2021.
5 See BNP Paribas EcoFlash *Spain: Towards a protracted increase in the public deficit?,* 21 January 2021.