# SPAIN



## ECONOMIC SUPPORT ABOVE ALL ELSE

**Despite a rather weak recovery in GDP, the Spanish economy has been much more resilient on the labour market front in 2021. Employment (November) and the participation rate (Q3) are at record levels. Inflation will be one of the biggest obstacles in 2022, the increase in production prices having accelerated markedly this autumn. Support for growth will remain a government priority in 2022. The country will benefit from a larger transfer of European funds that will help finance a record budget of EUR196 billion. The reduction in the government deficit will be again pushed into the background, the authorities mainly betting on economic growth to reduce the deficit-to-GDP ratio.**

Our growth forecasts for 2021 have been downgraded since our last publication, due to the smaller-than-expected increase in real GDP in Q3 2021 (2.0% q/q). Up until this autumn, the recovery in Spanish GDP had been the weakest among eurozone countries. Significant revisions are possible, with the INE stressing that "*the volume of information available in this advance report [for Q3] is less than in previous [reports]*." Indeed, the change in GDP was in marked contrast with the much better performance of the labour market. The increase in employment[1] has shown no sign of slowing down this autumn, and reached a record level at the end of November. It will be hard to match 2021's pace of hiring in 2022, but job creation should continue to increase. The unemployment rate is still high (14.5% in October 2021) and thus Spain has a substantial pool of available workers. Opinion surveys have shown a deterioration of confidence (and of hiring intentions) in industry, due to the factors currently holding back activity in the sector (rising production costs, shortage of inputs and so on). Conversely, hiring trends in the service sector remain encouraging. Employment in sectors hit hard by the health crisis (accommodation and food services, retail trade, artistic and leisure activities) are still well below their end-2019 levels and thus have significant room for improvement.

Inflation will remain as one of the biggest obstacles in 2022. The sharp increase in consumer prices (5.6% y/y in November) could persist this winter, as the rise in production input prices and transport costs showed few signs of slowing. The combined 11.7% jump in production prices in September and October was, by far, a new record. All of this will clearly hurt margins at companies, which could then seek to pass on these increases in the selling prices of their products. On the health front, the risks from the spread of new variants and their impact on economic activity will remain present in 2022. The success of the initial vaccination campaigns in Spain nevertheless reduces concerns of a wave of infection that would be as 'dangerous' as that in 2020, and would therefore result in restrictions affecting economic activity.

Against this still unstable situation, a better balancing of public finances is not a priority for the Spanish government, which should continue to benefit from very favourable borrowing conditions in 2022. The government will also have to maintain high levels of social spending (VAT reductions on energy products, increases in pensions and the minimum wage, support for access to housing, etc.) in the face of the energy crisis and rising consumer prices and rents. The government expects the deficit to be large again in 2021 (8.4%) and to drop back below the 3% of GDP mark in 2024 at the earliest. Indeed a record budget of EUR196 billion is planned for 2022. Pedro Sanchez's coalition managed to get this budget approved by parliament thanks to the support of two nationalist parties (ERC and EH Bildu). This budget, which includes a big increase in social spending (+3.9% on 2021) will be partly financed, via EUR27.6 billion coming from the European

GROWTH AND INFLATION

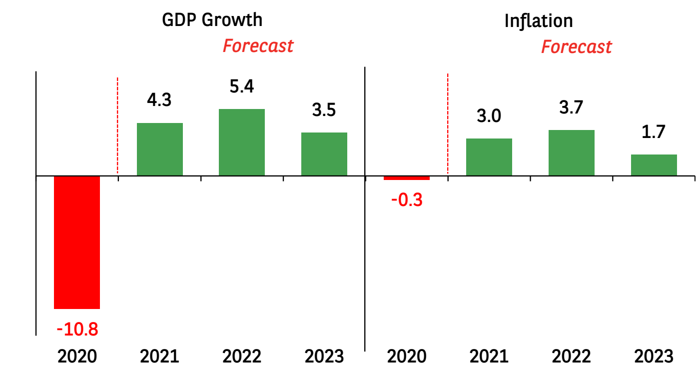


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

Recovery Fund. This financing will be used, amongst other things, for strengthening industrial policies, supporting SMEs and energy efficiency upgrades to buildings.

Meanwhile the banking sector, on the whole, resisted well to the recession of 2020, thanks in particular to the extension of government measures introduced at the beginning of the pandemic (short-time working, moratoria on loans and social security contributions, government guaranteed loans (GGL), etc.). These measures have cushioned the economic shock and limited companies' loan books from deteriorating too significantly The non-performing loans (NPLs) ratio continued to fall throughout 2021, reaching 4.35% of total loans outstanding in September 2021, its lowest level since the spring of 2009. The level of NPLs is likely to increase in 2022, due in particular to the end of the postponement period for the repayment of certain GGLs, (the payment holiday was extended, at the end of 2020, from 12 to 24 months). This said, the risks are likely to remain contained in 2022: the volume of loans covered by a moratorium represented less than 6% of total loans to the non-financial private sector at the end of 2020, whilst GGLs accounted for a relatively small share (14.5%) of the total stock of loans in June 2021 (EBA data).

**Guillaume Derrien**
guillaume.a.derrien@bnpparibas.com

1 More precisely, the data given corresponds to the number of active workers registered with the social security system (source: Spanish employment agency).