SPAIN

FISCAL COMPROMISES ARE INEVITABLE

The Spanish economy registered a record contraction of 22.7% in the first half of 2020. With the public deficit likely to rise above 10% of GDP this year, the government faces some difficult decisions, notably on the terms and conditions of its temporary layoff scheme (ERTE). The recovery in industrial production since the easing in lockdown restrictions in May is encouraging. However, this only partially compensate for the slow pick-up in activity in other sectors. The final quarter of 2020 will be a pivotal moment. A substantial programme of support for employment and investment (under the recovery package announced this autumn) is needed, while narrowing down support more specifically towards the sectors lastingly affected by the crisis.

Spain has been Eurozone's hardest hit economy by the Covid-19 crisis. Real GDP plunged by 18.5% in the second quarter of 2020. There were significant declines in all components of demand (consumption, investment and exports). We now expect GDP to shrink by 13.0% in 2020, before growing by 5.0% in 2021.

Local lockdowns have been introduced in several areas - and in particular in Madrid – in an attempt to halt a surge in new cases in the country. The worsening situation could hold back the economic recovery over the coming months, although the current situation is, for now, not as bad as in February-March. The Purchasing Managers index (PMI) slipped back into contractionary territory in August (composite index of 48.4).

INDUSTRY 'DRIVING' THE RECOVERY

Nevertheless, the industrial sector has turned higher over the summer, led by a rebound in consumer goods and more particularly durable goods. In July, car sales climbed back above their level at the start of the year, before dipping in August. The introduction of the government's Renove 2020 scheme – a programme offering subsidies for the purchase of cleaner vehicles – has stimulated demand. By July, industrial production was only 3.5% below its pre-crisis levels.

This recovery in consumer goods has occurred elsewhere in Europe (France and Italy for example). This resulted in a stronger demand for Spanish exporters. The trade balance improved significantly as a result, posting a surplus in June (EUR 746.9 million), for the first time since the current data series began[1]. However, this increase only partially compensate for the loss in revenue from tourism activity, which caused a sharp deterioration in the balance on services. The current account thus deteriorated this summer.

The Spanish economy remains more structurally exposed to the current crisis than its European neighbours, as it is more dependent on non-tradable services (retail, construction, hotels and restaurants) and SMEs[2]. These activities have been hit harder by public health restrictions and the fall in tourism. The latter struggled to recover over the summer. In July, the hotel occupancy rate was 35.6%, half of July's 2019 level (71.7%).

It is still too early to assess the full impact of the crisis on the labour market. The unemployment rate climbed to 15.8% in July and employment in August remained 3.5% below February's level[3]. However, we have seen a gradual, albeit modest, pick up in employment growth since the easing in lockdown restrictions in May. The PMI data suggest that the recovery in employment will continue in the coming months (see Chart 2). This trend is of course fragile and dependent on the evolution of the epidemic over the coming weeks and months.

GROWTH AND INFLATION (%)

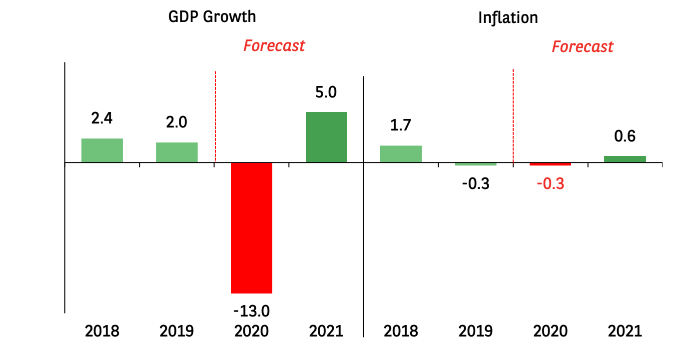

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

PMI INDEX AND EMPLOYMENT

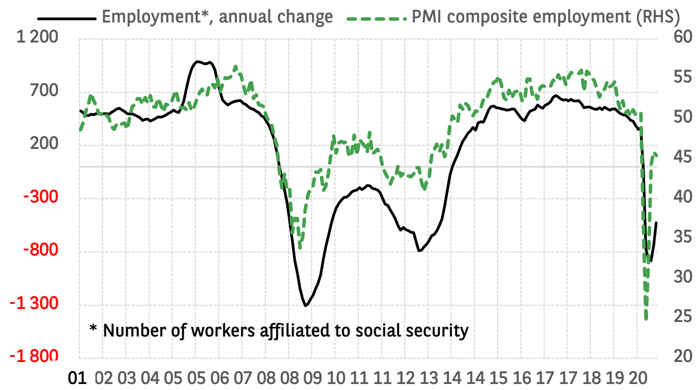

CHART 2 SOURCE: MARKIT, BNP PARIBAS

Young workers have been heavily impacted by the crisis, due to the more precarious nature of their employment status (short-term, seasonal, temporary work). The jobless rate for the 15-24 age group has increased by more than 10 points this year, reaching 41.7% in July. Youth unemployment remains nearly fifteen points below its 2013 peak[4]. Nevertheless, the reincorporation of this category into the labour market will remain a key challenge for the Spanish authorities going forward.

1 January 1985 Seasonally-adjusted data
2 For more details, please see BNP Paribas EcoFlash Euro zone: Four countries, four ways to recover, 20 May 2020.
3 Spanish employment agency (SEPE). More precisely, this figure represents the number of workers affiliated with the social security system.
4 55.9% in July 2013

A FISCAL PUZZLE

The Spanish government must find the right balance over the recalibration of its temporary layoff scheme (ERTE). The current scheme, which is due to expire on 30 September, will be extended, but it is likely to become more selective and further limited to the sectors the most heavily impacted by health restrictions or those facing a longer recovery period (aeronautics, automotive industries). In return, the Labour Ministry has extended the tightening of redundancy conditions to 2021, which operates mainly via an increase in redundancy payments. According to the Ministry, there were 813,000 employees under the ERTE scheme at the end of August, down from around 3.4 million during the peak in May.

These adjustments to employment support measures come against a difficult backdrop in public finances. In its September forecast, the Bank of Spain estimates that the budget deficit will widen between 10.8% and 12.1% of GDP in 2020 depending on the scenario considered[5]. Under both scenarios the debt-to-GDP ratio will climb by more than 20 points (to between 116.8% and 120.6%).

However, the funds allocated to Spain under the European Recovery Plan (Next Generation EU) should allow Pedro Sanchez's government to introduce a substantial recovery package. Under the 21 July agreement, Spain will receive EUR 72.7 billion, or 5.8% of its GDP, in subsidies spread over the period from 2021 to 2026.

The national recovery plan must be approved by the European Commission in order for these funds to be released. The government has already unveiled a major investment programme in the digital sector – España 2025. This programme, run jointly by the public and private sectors, will last through to 2025 and will be worth a total of EUR 140 billion, EUR 70 billion of which will be allocated between 2020 and 2023. After the emergency measures taken this summer –particularly to support the automotive and tourism sectors– the government will, in the coming months, set an agenda that focuses more on competitiveness and the transformation of the Spanish economy.

TOWARDS SERVICES DEFLATION?

The fall in economic activity during the first half of 2020 is causing downward pressures on consumer prices. The consumer price index (CPI) dipped 0.52% year-on-year (y/y) in August. The underlying CPI (excluding energy and perishable food) rose by only 0.43% y/y in August, its lowest annual increase since April 2015. This was partly due to lower services prices, a sector that is suffering more from the restrictions measures. The fall in the services CPI (excluding rents) over the past six months has been the biggest since the current data series began in January 2002. The last six months have seen major falls in the leisure, restaurant and hotel sectors, which follow price declines in transport, gas and electricity (Table 1).

This downward pressure on prices is also visible in the real estate market. Despite historically-low interest rates[6], property prices fell by 2.3% between May and August (TINSA index)[7]. That said, inflation could pick up in 2021, as the effect of falling energy prices at the beginning of this year recedes.

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CHANGE IN CPI

CPI (August 2020)	Weight in CPI	Annual growth rate	Contribution to annual growth rate	% change 6-months	Contribution to % change 6-months
Total CPI	100.0	-0.52	-0.52	-0.79	-0.79
Core CPI (excluding fresh foods & energy)	80.5	0.43	0.34	-0.13	-0.11
Food & non-alcoholic beverages	19.5	2.20	0.43	0.81	0.16
Alcoholic beverages & tobacco	2.9	0.50	0.01	0.23	0.01
Clothing & footwear	6.5	1.04	0.06	0.46	0.03
Housing, water, electricity, gas & fuel	13.4	-2.74	-0.37	-0.95	-0.12
Furniture & household equipment	5.8	0.44	0.02	0.39	0.02
Health	3.9	0.50	0.02	0.37	0.01
Transport	15.4	-4.40	-0.71	-4.45	-0.72
Communication	3.8	-1.22	-0.05	-0.57	-0.02
Recreation & culture	8.4	-2.06	-0.17	-1.92	-0.15
Education	1.6	0.82	0.01	0.39	0.01
Restaurants & hotels	12.1	0.47	0.06	-0.59	-0.07
Other goods & services	6.8	1.51	0.10	0.70	0.05

TABLE

SOURCE: INE, BNP PARIBAS

5 https://www.bde.es/bde/en/secciones/informes/boletines/relac/Boletin_Economic/Informes_de_proy/
6 According to the Bank of Spain, the average mortgage rate was 1.92% in July.
7 The average price per square meter of land fell by 15.2% y/y in Q2. See El precio del suelo urbano se hunde un 15% y cae por debajo de los minimos de 2013, El Economista, 16 September 2020.