

## RECOVERY MEASURES MEET FISCAL REALITY

The unprecedented economic contraction in H1 2020 raises serious doubts about the upcoming recovery. Although the reopening phase has proceeded smoothly so far, the recovery in employment was very small in June. Tourism remains under the threat of a resurgence of the Covid-19 epidemics in Europe. The swelling public deficit will force Prime Minister Pedro Sanchez to design a tight recovery package that balances between short-term emergency measures and long-term investments. This difficult equilibrium is likely to heighten the tensions in the governing coalition between Podemos and the socialist party. Subsidies allocated as part of the European Recovery Plan would give Spain some fiscal leeway, but the final terms and amount of the funds are yet to be finalised.

The Covid-19 crisis has erased the economic momentum that Spain has enjoyed in recent years. The 5.2% q/q contraction in Q1 GDP will be followed by an even sharper decline in Q2, probably above 10%. The successful reopening process and the mechanical rebound in activity observed since late May must be kept in perspective. Spain enters the summer season with a job market that has sharply deteriorated since February. The number of workers affiliated to the social security system increased slightly in June (+0.16%), but the contraction in Q2 was a record 4.9% (-947,514, see chart 2)<sup>1</sup>. The number of jobseekers rose above 4 million in June<sup>2</sup>.

On 17 March, the Spanish government implemented an emergency plan worth EUR 117 bn in public funds (EUR 200 bn including the private sector's contribution). The programme included EUR 100 bn in state-backed corporate loans and EUR 17 bn in direct aid, mainly for healthcare spending, job retention schemes and deferred tax and social security charges for companies and individuals.

Pedro Sanchez, Spanish Prime minister, subsequently announced a recovery plan for the tourism and automobile sectors, two sectors hardly hit by the crisis. The automobile sector will receive EUR 3.75 bn in support, including a relatively small portion of subsidies (EUR 1.1 bn). The tourism industry will receive EUR 4.26 bn in aid, including a large amount of state-backed loans (EUR 2.5 bn), EUR 850 million for companies to facilitate digitalisation, and EUR 300 million in subsidies<sup>3</sup>. A solidarity fund for autonomous community worth EUR 16 bn will also be deployed to help local communities meet their financial obligations.

The government must carefully calibrate corporate subsidies – especially the temporary unemployment scheme (ERTE) – to prevent a wave of layoffs while encouraging a maximum of companies to restart their activities as soon as feasible. The ERTE scheme was extended until 30 September, and will probably be prolonged again next fall (under different conditions that are less advantageous for employers). According to the Ministry of Labour, 1.83 million employees, or nearly 1 in 10 workers, were still under ERTE at the end of June.

## DIFFICULTIES PALPABLE BEFORE THE COVID-19 CRISIS

The Covid-19 health crisis occurred in the midst of an already tense economic environment, with companies in many sectors facing deep structural mutations and a loss of competitiveness (automobiles, aeronautics, telecommunications). The Covid-19 pandemic has exacerbated these difficulties, but it is not the main cause, which is mainly structural. Nissan announced the closing of its Barcelona plant with more than 2500 job losses, and Airbus is now planning to reduce its personnel by 900 workers in the civil aviation division. A handful of major corporations have already announced a total of more than 5,000 layoffs in Spain<sup>4</sup>. The weight of the industrial sector has constantly

<sup>1</sup> Spanish employment agency (SEPE). Seasonally-adjusted data.

<sup>2</sup> 4,014,011 in June (SEPE, seasonally-adjusted data)

<sup>3</sup> These subsidies will cover the creation of a tourism observatory as well as marketing and promotional activities

<sup>4</sup> El Economista "La industria anuncia 5.140 despidos en España en el año del covid-19", 2 July 2020

<sup>5</sup> The peak was 20.5% in Q1 2000 (Eurostat data)

### GROWTH AND INFLATION (%)

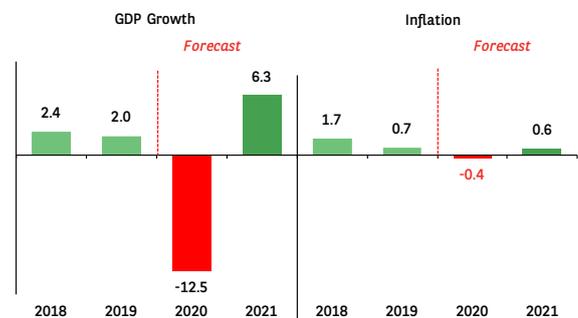


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

### EMPLOYMENT

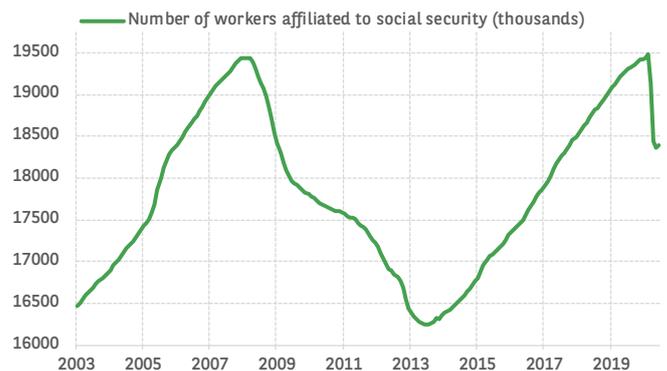


CHART 2

SOURCE: SPANISH EMPLOYMENT AGENCY (SEPE)

fallen over the past twenty years. Its share of total value added slipped to an all-time low of 15.5% in Q4 2019 (see chart 3). In the early 2000s, this share was above 20%<sup>5</sup>.

The rebound in tourism activity is also very uncertain. The reinstatement of lockdown measures in Leida (Catalonia) and A Mariña (Galicia) highlights the clouds looming over the economic recovery.



Arancha Gonzalez Laya, the Minister of Foreign Affairs, warned that new restrictive measures could be imposed locally again if the weekly contamination rate were to rise above the threshold of 50 cases per 100,000 inhabitants.

## ECONOMIC STIMULUS AND FISCAL CONSTRAINTS

The months ahead will be crucial for Spain. The government must elaborate an ambitious recovery plan, while dealing with a tight budget. New growth opportunities are arising in Spain, notably in the renewable energy sector<sup>6</sup>. Brussels is likely to scrutinise Spain's recovery plan, the latter having to follow closely the targets defined in the European Green Deal. As it stands, Spain, along with Italy, is the biggest beneficiary of the European Recovery Fund announced by the European Commission at the end of May. Spain will receive EUR 77.3 bn, the equivalent of 6.2% of GDP. The terms and size of the European Recovery Fund will be discussed at the next European Summit on 17 July.

The government seems willing to align Spain with Brussel's targets. At the end of May, it unveiled the National Energy and Climate Plan which sets an objective of carbon neutrality by 2050. Parliament still needs to approve the plan, which will ban all new fossil fuel projects and will aim to achieve 100% electrical power generation from renewable energy sources by 2050. Building on this plan, seven of the remaining fifteen coal-fired power plants were shut down on 30 June. Coal accounted for nearly 15% of Spain's CO2 emissions in 2018, but had already fallen to 1.4% last May. Spain is one of the European countries that has made the most progress towards a cleaner energy mix.

The health crisis has heightened tensions within the governing coalition. The radical left wing led by Podemos is pressuring the Socialist Party of Pedro Sanchez to introduce strong social measures to support the most vulnerable populations. The so-called vital minimum wage – introduced in June – is an emergency measure pushed through by Pablo Iglesias, head of Podemos and the Minister of Social Rights. For the moment, the Socialist Party is ruling out the idea of a new tax on high-income earners, as proposed by Podemos. The Prime Minister admits, however, that a major fiscal reform will be necessary, given the fiscal situation<sup>7</sup>.

Meanwhile, the government has yet to reach a trans-party consensus on the outline of the recovery plan. It faces fierce opposition from the conservative party, the Partido Popular.

In the Stability Plan submitted to the European Commission, the government is now forecasting an increase in the public deficit from 2.8% of GDP in 2019 to 10.3% in 2020. Central government debt has risen sharply since the beginning of the crisis (see chart 4). According to the same government outlook, public debt to GDP ratio will hit 115.5% this year. Under these conditions, the European Recovery Fund would offer some policy leeway for the Spanish administration to reconcile social emergency needs with investments in the future.

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### INDUSTRY (EXCLUDING CONSTRUCTION)



CHART 3

SOURCE: EUROSTAT, BNP PARIBAS

### CENTRAL GOVERNMENT NET FUNDING REQUIREMENT

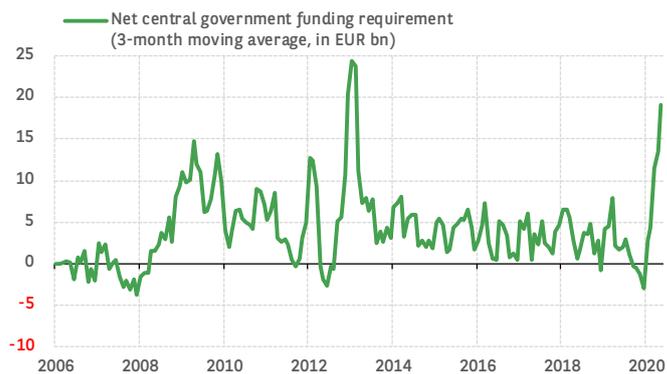


CHART 4

SOURCE: SPAIN MINISTRY OF FINANCE, BNP PARIBAS

<sup>6</sup> See BNP Paribas Ecoflash "Spain: hopes of a green recovery", 9 June 2020

<sup>7</sup> El Economista, "Sánchez anuncia que subirá impuestos, mantendrá las pensiones y el sueldo de los funcionarios", 2 July 2020

