

DOMESTIC DEMAND IS EXPECTED TO CONTINUE TO DRIVE GROWTH

The Spanish economy is in a favourable long-term cycle, characterised by strong growth, underpinned by domestic demand. In 2026, outperformance relative to the eurozone is expected to continue, but growth is projected to decelerate due to the weakening of its structural foundations (available labour), a lack of momentum (low productivity) and the inflationary shock. It is projected to reach 2.3% in 2026 (revised downwards by 0.2pp). Inflation is expected to rise to 3.3% (revised upwards by 1pp), which will impact household purchasing power. However, public finances are expected to have the capacity to mitigate this impact without jeopardising the trajectory of public debt ratio reduction.

GROWTH: MOMENTUM EXPECTED TO REMAIN STRONG

In 2025, Spanish GDP growth outpaced that of the Eurozone for the fifth consecutive year (+2.8% versus +1.5%, with an average gap of +1.8 pp over the five-year period). However, it is expected to slowdown in 2026. This slowdown is partly attributed to structural factors: growth relies heavily on job creation, which is expected to decline as full employment is approached, while productivity fails to pick up the slack (see below).

Spain is vulnerable to the consequences of the conflict in the Middle East, albeit to a lesser extent than other countries. In particular, its energy mix is more favourable: gas accounts for only around 21% of it (compared with 39.8% in Italy, 27.5% in Germany and 12.1% in France), while the share of renewable energy exceeds 58% of electricity generation¹. Industry also accounts for a significantly smaller share of economic activity (15% of Spanish value added, compared with 23% in Germany, 19% in Italy and 14% in France), which effectively limits this exposure. On the other hand, rising oil prices will, as elsewhere, weigh on household purchasing power, while inflation is already above the European average. The economic climate remains relatively favourable, however, with the composite and services PMIs in expansionary territory for nearly two and a half years. The manufacturing PMI, meanwhile, has been at or below 50 since December (48.7 in March).

Spain is therefore expected to continue posting growth above the Eurozone average. Pressures on purchasing power are unlikely to prevent domestic demand from remaining a driver of economic activity, buoyed by the strength of the labour market, although this strength is expected to gradually diminish. Investment is also expected to continue supporting growth, with 2026 being the final year for the disbursement of NGEU funds (with EUR 23 billion in grants and EUR 7 billion in loans still to be mobilised), before a likely slowdown in 2027. Conversely, foreign trade could be adversely affected by a decline in tourist flows.

LABOUR MARKET: A DRIVER NEARING ITS LIMITS

Household consumption remains strong due to a tight labour market. Job creation remains robust (22 million people in work in March, up 523,000 y/y), while the unemployment rate continues to fall (down 1.1 pp y/y to 9.8% in January, below the 10% mark for the first time since March 2008), underpinning wage growth. The services sector accounts for the bulk of this growth (79% of job creation). Furthermore, immigration continues to play a key role: the share of the foreign labour force stabilised at 17.7% in Q4 2025, helping to mitigate the effects of demographic ageing. At the same time, the government has launched a large-scale migrant regularisation process, which will affect around 500,000 people. This is expected to bolster the labour supply in the short term.

However, structural weaknesses remain. The unemployment rate remains above the Eurozone average (6.2%), particularly affecting young

¹ Compared with 58% in Germany, 51% in Italy and 22% in France.

² A temporary mechanism adopted in 2022 by Spain and Portugal, which allows for a cap on the price of gas used to generate electricity, in derogation from the European market regulations. This has helped to limit inflation during the energy crisis.

Growth and inflation

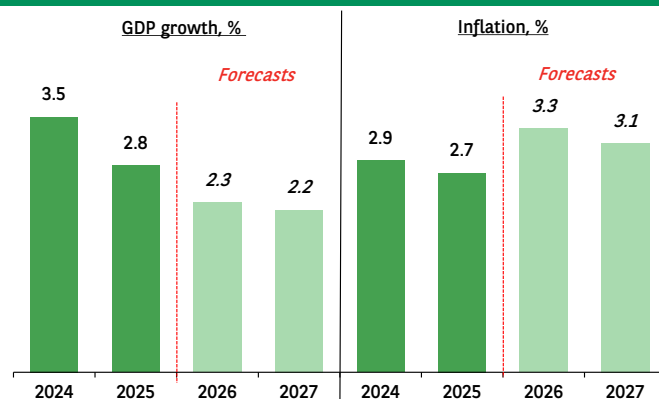


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

people (23.8% compared with 14.9%). Furthermore, business surveys indicate that labour shortages continue to hold back output, in both construction and services, at levels significantly above the historical average.

Against this backdrop, the Spanish labour market is gradually nearing its structural limits. Although unemployment is decreasing, it is projected to remain higher than in other major European economies (9.6% in 2027 according to the European Commission, compared with 6.2% in the Eurozone). As these gaps close, the contribution of employment to economic growth is expected to diminish, while wage pressures are likely to intensify. This trend suggests a gradual decline in the labour market's capacity to support economic activity, alongside an increase in wage and inflationary pressures in the medium term.

INFLATION WILL WEIGH ON PURCHASING POWER

Spain is facing an energy crisis with inflation exceeding the European average (3.3% y/y in March, compared with 2.5% in the Eurozone), indicating an economy under pressure. The rise in energy prices (+7.6% y/y in March) has not yet been reflected in core inflation. Nevertheless, the latter remains relatively high (2.9% in March).

Supply pressures in Spain, as in other countries, are less severe than in 2022. Demand, which was robust following Covid, is also more moderate now. However, unlike during that period, Spain no longer benefits from the Iberian exception². Nevertheless, its energy mix still provides some insulation against the pass-through of gas prices to electricity prices, due to the significant proportion of renewables in its energy mix.



Wage growth is slowing (+2.9% y/y in nominal terms in January–February, down from an average of +3.4% in 2025). Inflation is therefore already outpacing nominal wage growth, leading to an erosion of real wages. As a result, real wages are unlikely to recover the losses incurred since the inflationary crisis, remaining around 7 pp below the Q1 2020 level. However, growth in real gross disposable income is expected to be more resilient, as it is based on a consumption deflator that is less sensitive to imported energy prices, and is bolstered by public finances (see below). This resilience will help sustain household consumption, albeit at a more moderate pace.

A SOMEWHAT IMPACTED BUT STILL FAVOURABLE FISCAL TRAJECTORY

The government has swiftly introduced support measures to address the energy crisis, amounting to nearly EUR 5 billion (0.3% of GDP). These measures include energy tax relief (VAT reductions), targeted aid for the most vulnerable sectors, and support measures for households. These exceptional measures are temporary in nature and supplementary to the budget; they will weigh on public finances in the short term, while having a limited impact on the medium-term trajectory.

Spain is therefore making use of the fiscal leeway at its disposal, which is greater than that of other European countries. Its fiscal trajectory is indeed favourable, characterised by gradual consolidation facilitated by nominal GDP growth and the rollover of the state budget since 2023. Consequently, the public deficit fell to -2.2% of GDP in 2025 (-1.1 pp over three years), while debt stood at 100.7% (close to a return to its pre-Covid level).

Against this backdrop, the support measures are expected to result in a slight deterioration in the budget balance, due to a fall in revenue and a rise in expenditure. Nevertheless, the expected nominal growth (5.7% in 2026 and 4.9% in 2027) should enable the debt-to-GDP ratio to continue its downward trend. Consolidation is expected to continue, albeit at a slightly slower pace than anticipated. The deficit is projected to rise to -2.5% of GDP in 2026 before falling to -2.3% in 2027, while the primary balance is expected to return to surplus (+0.1% then +0.3%). Against a backdrop where the effective interest rate on debt (2.6%) is expected to remain below nominal growth, debt dynamics would remain favourable. The public debt ratio is projected to fall below the 100% threshold in 2026 (98.1%), with a continued decline anticipated in 2027 (96.5%). This favourable trend should help maintain a moderate spread against the German 10-year rate (around 50 bp since the outbreak of the conflict in Iran, compared with an average of 59 bp in 2025).

A NARROWING EXTERNAL SURPLUS

Spain's external accounts remain strong. Despite a decline, the current account surplus remained high at +2.3% of GDP in Q4 2025. It is expected to erode in the coming months, driven by an anticipated decline in the services surplus, particularly in tourism. Indeed, growth in tourist arrivals has slowed (+2.3% y/y in February 2026 compared with +6.1% a year earlier).

At the same time, the goods trade deficit is expected to widen due to the pressures of rising oil prices. Exports are expected to further decelerate, hampered by the impact of US tariffs. Indeed, although Spain's

Growth driven by employment and held back by productivity

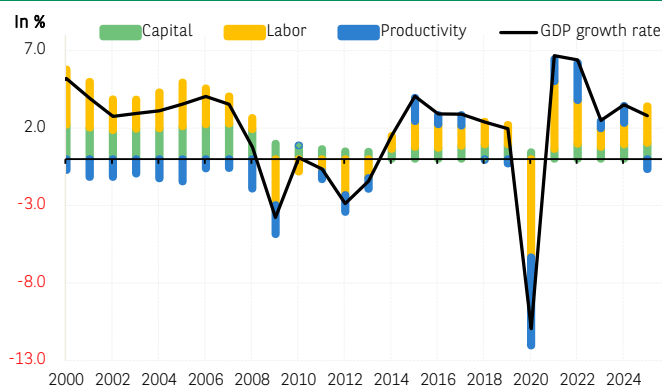


CHART 2

SOURCE: BNP PARIBAS, TOTAL ECONOMIC DATABASE

direct exposure to the United States remains limited (less than 5% of total goods exports and 1.3% of GDP), the indirect effects through its main European trading partners are considerable. However, in the medium term, an improvement in the growth outlook for the Eurozone could bolster exports.

Moreover, Spain continues to attract significant inflows of foreign direct investment (FDI), ranking as the second-largest recipient in Europe, after France. These investments help to strengthen the country's export capacity and, to some extent, mitigate the deterioration of the trade balance.

LOW PRODUCTIVITY HAMPERS GROWTH POTENTIAL

Spain's GDP per capita (EUR 26,740) is considerably lower than that of its Eurozone counterparts (EUR 32,850 on average), largely due to a structural productivity deficit. Data from the Conference Board indicates that one hour of work in Germany generates, on average, 30% more value added than in Spain (compared with an average of 28% over the period 2010–2019).

This disparity arises from the composition of Spain's economy, which is still dominated by low-value-added sectors, particularly tourism, despite the advancements in the renewable energy sector. Furthermore, the prevalence of small and medium-sized enterprises in the country restricts economies of scale and hampers innovation capacity. Finally, R&D expenditure in Spain stood at 1.5% of GDP in 2024, compared with 2.2% in France and 3.1% in Germany.

Against this backdrop, Spanish growth continues to rely heavily on an expanding labour force. In the long term, low productivity could become a major constraint on growth. This risk is exacerbated by an ageing population and a potential slowdown in migration flows – two factors likely to further reduce the available labour supply.

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