DYNAMIC GROWTH, BUT FOR HOW LONG?

Over the next two years, Spanish growth should be stronger than anticipated in our last issue of EcoPerspectives. Continued disinflation and the good performance of the labour market should continue to drive domestic demand, at the expense of foreign trade. Despite expectations of higher defence spending, strong nominal growth should continue to facilitate the rebalancing of public finances. However, Spain's structural vulnerabilities threaten its continued outperformance in the longer term.

ECONOMIC ACTIVITY: FORECASTS REMAIN POSITIVE

After rebounding in 2024 (+3.2%), Spanish growth will decline very slightly over the next two years. Nevertheless, it will remain well above the Eurozone average (+2.6% and +2.1% in 2025 and 2026, compared to 1.0% and 1.3%).

Private consumption should continue to underpin economic activity. The robustness of the labour market, wage growth and the slowdown of inflation will boost household purchasing power. The disbursement of funds from the European Union's recovery plan (NGEU) and the easing of monetary policy by the ECB will benefit investment, which should rebound. However, foreign trade is no longer expected to contribute positively to growth, as rising domestic demand will support imports more than has been the case in recent years.

Lastly, the increase in US tariffs announced by Donald Trump raises major uncertainties about growth forecasts in the Eurozone, starting as early as 2025. Although the consequences for Spain are likely to be limited—due to its heavy reliance on the services sector and its low exposure to the US (the share of total Spanish goods exports to the US amounting to just 1.2% of GDP in 2023)— the country is likely to suffer from the slower growth of its main European trading partners (Germany, France and Italy), which are more affected. According to our forecasts, it is only from 2026 onwards that the positive effect on growth of European fiscal policy reorientation will dominate, via an expected defence spending increase, and should ultimately have a positive effect on Spanish growth.

LABOUR MARKET: BOOSTED BY IMMIGRATION

The labour market remains buoyant: the number of unemployed fell again in February (-0.4% m/m[1]), while the number of people in work continued to rise (+0.3% m/m). The proportion of foreign workers in the workforce continues to rise (15.2% in Q4 2024; +0.6 pp over one year). Employment growth is set to continue, driven mainly by these migratory flows. This positive outlook, combined with continued strong wage growth (negotiated wages up 3% y/y in February, and minimum wage raised to EUR 1184 gross in 14 instalments [+4.4%]) and disinflation, will continue to support private consumption. However, real income gains will moderate over time, as growth in negotiated wages has already begun to slow.

INFLATION: DRIVEN BY RISING ELECTRICITY PRICES

After remaining at a high level in February (+2.9% y/y), due to the abolition of the reduced VAT rate on basic foodstuffs and the rise in electricity prices (itself linked to the abolition of tax cuts at the start of the year), harmonised inflation slowed sharply in March (+2.2% according to the INE's estimate). Inflation is likely to remain close to this level over the coming months due to the anticipated slowdown in energy prices. Core inflation, meanwhile, is slowing (2.0% y/y) and is close to the ECB's target.

1 Seasonally adjusted data

GROWTH AND INFLATION

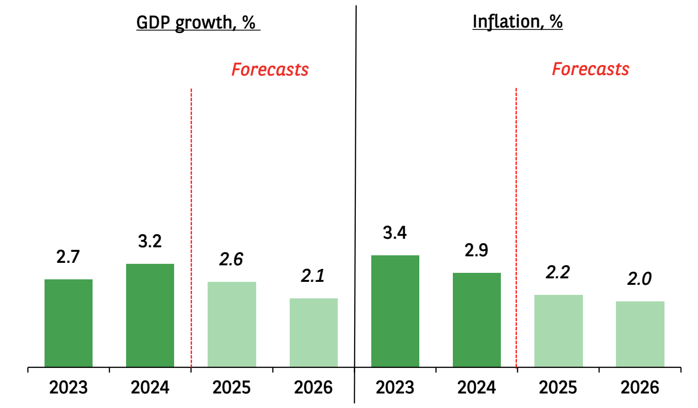

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

PUBLIC FINANCES: NOMINAL GROWTH TO SUPPORT BUDGET RATIOS

Despite political fragmentation and the expected rise in defence spending, the dynamics of public finances should remain positive as long as nominal growth remains high. This will enable the public debt/GDP ratio to continue to fall (see *Chart 2*). In 2024, it had already fallen by more than initially expected (101.8% compared with 102.5% estimated by the Bank of Spain). It is therefore possible that it will approach the 100% mark or even pass it by 2026 (100.6% in 2025 and 99.6% in 2026 according to our forecasts), notwithstanding the increase in defence spending (*see our box*).

FOREIGN TRADE: SERVICES SURPLUS HITS AN ALL-TIME HIGH

Spain's external accounts remain solid. In Q4 2024, the current account reached its best level since 2018 (cumulative surplus of EUR 92.7 bn over twelve months). This remains underpinned by the services surplus, which reached an all-time high (EUR 266 bn), boosted by the record tourism figures for 2024 (93.8 million visitor arrivals, +10.1% y/y).

STRUCTURAL CHALLENGES: BETWEEN LOW PRODUCTIVITY AND THE HOUSING CRISIS

The low level of productivity observed in Spain threatens its continued outperformance in the medium term. Over the last decade, productivity trends (measured by the ratio of GDP to hours worked) show that the country still lags behind the Eurozone average. Between 1995 and 2022, productivity increased by 18.7% in Spain, compared to an average of +29.1% in the Eurozone. This weakness is explained by a larger proportion of the economy being reliant on sectors with lower productivity, such as tourism services. However, once the positive cyclical trends have dissipated, this lack of productivity could act as a brake on the country's growth.

Housing activity rebounded in 2024. Over the year, demand for housing has picked up, with transactions recording their best figures since 2008 (with a total of 642,208 homes sold [+10% y/y]). However, the housing supply is still not keeping pace, pushing up prices (+7.7% y/y in February). The regions most affected by these shortages are those with the highest levels of economic activity and tourism, such as Catalonia, the Madrid region and Andalusia. Furthermore, according to the Bank of Spain[2], the housing deficit could rise to 600,000 units this year.

Article completed on 17 April 2025

Lucie Barette
lucie.barette@bnpparibas.com

BUDGET BALANCE AND PUBLIC DEBT OF SPAIN

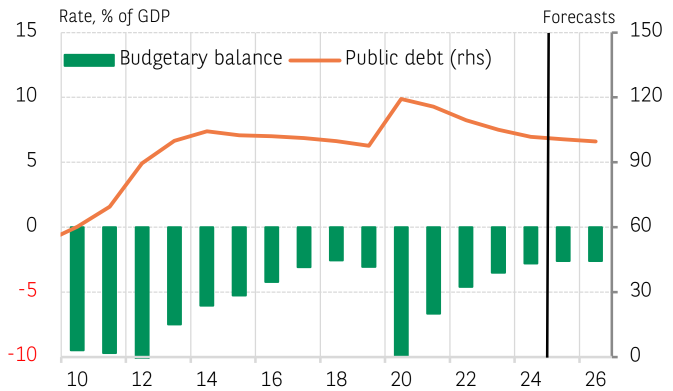

CHART 2 SOURCE: EUROSTAT, DG ECFIN AMECO, MACROBOND, BNP PARIBAS

2 April 2024 note: The Spanish Housing Market, Bank of Spain

Focus: The increase in defence investment should not threaten Spain's public finances

Spain's public finances are on a fairly favourable path. Strong nominal growth has enabled the ratios of public debt and budget deficit to GDP to fall. The latter has actually fallen by more than expected in 2024 (-2.8%), as has the debt ratio (see above).

The country is benefiting from nominal growth (6.2% in 2024) that is higher than the average cost of debt (2.5% of GDP), allowing it to be reduced. This gives the government significant room for manoeuvre to increase spending without worsening the public debt ratio.

In 2024, Spain's defence spending will represent just 1.28% of GDP, one of the lowest levels among NATO countries. The prime minister recently pledged to increase public investment in defence to 2% by 2029. However, political fragmentation may make his task more difficult. Without a budget bill, the government plans to deploy this spending without a parliamentary vote, by playing on budget lines through extraordinary credits.

Over the next two years, despite the end of support to the private sector in response to rising energy prices, public spending is set to rise as a result of increased defence spending. However, rising revenues could offset this trend. Revenues are set to rise as a result of an increase in social security contributions, due to the rise in the number of workers, and the abolition of the VAT reduction on basic foodstuffs. As a result, the budget deficit/GDP ratio should fall to -2.6% in 2025, and then remain at this level in 2026.