FACING THE SECOND WAVE OF INFLATION

The Spanish economy held up better than expected in 2022 (+5.5%), but a slowdown in activity is expected this year. Industrial production is declining, hindered by the energy sector and intermediate goods and services. Investment and private consumption fell significantly in Q4 2022 and will remain under pressure in 2023 from rising interest rates and high inflation. Excluding energy, the rise in consumer prices accelerated further to 8.2% in February. The reduction in the public deficit – greater than expected in 2022 – is making it easier to continue budgetary support in 2023. However, while measures to counter the rise in energy costs have been effective, measures targeting other consumer items are more mixed: the removal of VAT on basic products, introduced in January, is still not curbing the rise in food prices.

In Spain, business surveys seem to rule out the risk of a recession in the short term. The Composite PMI rebounded sharply in February (+4.1 points to 55.7), driven by services (+4.0 points to 56.7), while the manufacturing index (+4.6 points to 52.1) rose above the contraction threshold for the first time since June 2022. Given its close correlation with inflation, which is falling, household confidence has risen in recent months. However, it remains well below the level reached before the outbreak of the war in Ukraine in February 2022. In addition, consumer purchase intention has been at its lowest since December 2020, evidence of the financial difficulties consumers are experiencing.

However, erosion of the purchasing power of the most vulnerable households will be limited by the government's decision to increase the minimum wage by 8% in January 2023, which will offset inflation, which stood at 5.9% for this month. This is the fifth increase in the minimum wage since the left-wing coalition came into power in 2018. At EUR 1,080 per month, the minimum wage now represents 60% of the national median income, which is in line with the target announced by the government at its inauguration.

Inflation has fallen from the peak of 10.8% y/y reached last July, thanks to measures to freeze energy prices, most of which are being continued in 2023. Nevertheless, the more widespread and persistent current price increases would keep inflation above 3% between now and the end of the year. In February, food prices saw a record increase of 16.6% y/y, followed by prices in the hotel and catering sector (+7.9%), while prices of household goods stabilised at a sustained rate of growth (+7.6%). As a result, core inflation (excluding energy and fresh products) rose to 7.0% y/y in February.

In addition, financing costs in Spain will continue to rise this year, fuelling the slowdown in money supply and credit. Year-on-year, housing credit flows had already fallen into negative territory last December and the contraction is expected to intensify, although effects on property prices do need to be put into perspective. Property prices also depend a great deal on the balance between supply and demand, and this balance remains a support factor for prices, supply being limited. Although the pace of increase in real estate prices has slowed in recent months, it remained dynamic in February, at +6.4% y/y.

Despite government actions to curb the energy shock, the public deficit fell significantly in 2022 and the primary deficit was halved, from EUR 60.8 bn 2021 (5.0% of GDP) to EUR 31 bn (2.3%), according to preliminary figures from the Spanish Ministry of Finance (CIGAE). Along with consumer price inflation and, to a lesser extent, wage inflation, job creation - still very dynamic this winter - is contributing to an increase in government tax revenue, which was up 9% in 2022. Public spending rose significantly, to 3% over the year, but less than income.

GROWTH & INFLATION

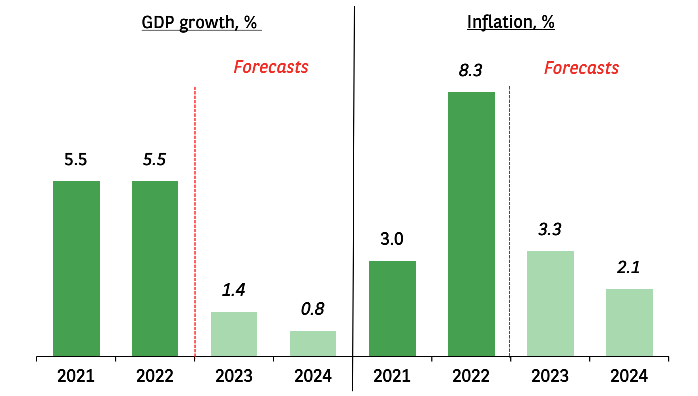

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

In fact, the good news for the Spanish economy is that net job creation is continuing. The number of employees affiliated to the social security system rose by 0.7% cumulatively over the January-February period, continuing the momentum of 2022 (+4.7%). Although the unemployment rate rose slightly in Q4 2022, to 12.9%, the labour market is resilient. Roll-out of the national recovery and resilience plan will also support new hires in the medium term. In this regard, the Bank of Spain believes that job creation will be concentrated within the digital sectors (information and communication, professional and technical services) as well as in construction, where new infrastructures linked to the green transition will require a surplus of labour[1]. Although the stimulus package should also help boost more investment momentum in the long term, its effects to date seem limited, judging by the current level of gross fixed capital formation[2].

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1 See The Recovery, Transformation and Resilience Plan and its macroeconomic impact from a sectoral standpoint, Bank of Spain Economic Bulletin, February 2023.
2 See BNP Paribas Eco Conjuncture, Productivity, an endemic weakness of the Spanish economic model, 8 February 2023