

# SPAIN

20

## JOB CREATION CONTINUES TO UNDERPIN GROWTH

After a strong first half of the year, Spanish growth should remain higher than that of its European neighbours in 2025 and 2026. Domestic demand is likely to remain the main driver, primarily supported by job creation, while the contribution of foreign trade is expected to become slightly negative. The budget deficit and the debt-to-GDP ratio should continue to benefit from significant nominal growth, which is nevertheless expected to slow gradually. Weak productivity could, however, hold back potential growth in the longer term, particularly as the available labour force begins to shrink.

### ECONOMIC ACTIVITY: DOMESTIC DEMAND, THE MAIN DRIVER OF GROWTH

Spanish growth averaged +0.7% q/q in H1 2025, driven mainly by private consumption and a rebound in investment in machinery and equipment. It should remain robust in the second half of the year (+0.6% on average), bringing the annual average to +2.7% in 2025.

Next year, economic activity is expected to slow slightly, with GDP growth at +2.3%. The contribution of foreign trade is likely to become negative. On the one hand, geopolitical and trade uncertainty, caused by the rise in US tariffs and its impact on Spain's main European trading partners, should push exports down (more details below). On the other hand, imports will be further stimulated by strong growth in domestic demand.

Household consumption should remain the main driver of growth. Retail sales volumes continue to rise steadily (+1.9% q/q in Q2), household confidence is high by historical standards (47.8 versus 42.3 on average over 2015-2019 according to the Ipsos survey), and the savings rate is gradually declining (12.8% of disposable income in Q1 2025, versus 14% in Q1 2024). Investment, meanwhile, should continue to rebound. Although the recovery has been particularly slow since Covid, investment in machinery and equipment has recently shown signs of recovery. Since Q4 2024, it has returned to its pre-Covid level, supported by aid for flood victims in the Valencia region and by investment associated with the disbursement of funds from the recovery and resilience plan.

In addition, like other eurozone countries, Spain should benefit from the positive effects of the roll-out of the German infrastructure plan (leading to an increase in German demand) and the rise in defence spending over the next two years (generating more industrial opportunities at European level).

### LABOUR MARKET: FURTHER STRENGTHENING

In terms of production factors, Spanish growth is driven by the availability of abundant, skilled and inexpensive labour. The strong contribution to growth from household consumption stems from the income generated by this large workforce, which is then spent. This performance of the labour market is reflected in the latest figures: the unemployment rate has fallen to its lowest level since May 2008 (10.4% in July) and employment, measured by the number of people registered with the social security system, has reached a historic high (21.6 million in July). Slight tensions persist, however. According to the Bank of Spain, the proportion of companies reporting labour availability problems decreased in Q2 compared with Q1 (-3pp) but remains at a high level (42.9% compared with an average of 30.2% in the same quarter over the last four years). These issues are particularly marked in agriculture, hospitality and construction. Nevertheless, it is in tourism-related sectors that employment continues to grow the most (services up 2.4% y/y in July).

### GROWTH AND INFLATION (YEARLY AVERAGE)

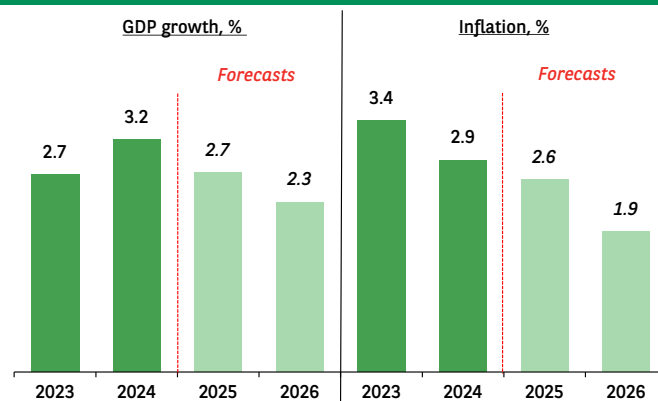


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

### INFLATION: TOWARDS A REDUCTION IN THE MEDIUM TERM

Strong tourist demand is having a positive impact on activity, but also on prices. The rise in services inflation (+3.6% y/y in July, +0.2pp m/m) reflects in particular the passing on of costs by businesses to their customers, as confirmed by the PMI services survey. This phenomenon, driven by the continued growth in nominal wages (+3.5% y/y in July), remains the main contributor to headline inflation (+2.7% y/y; +0.4pp m/m and -0.3pp compared with July 2024). Despite nominal wage growth now outstripping inflation, real wages remain around eight percentage points below their pre-inflationary crisis level.

Two forces will be at play over the coming quarters. On the one hand, energy prices should continue to fall, which will act as a brake on price rises. On the other hand, continued strong wage growth and the housing shortage will exacerbate inflationary pressures. The housing shortage is due to demand still far outstripping supply. Demand is benefiting from the improvement in financial conditions, and a construction deficit explains the low level of supply. To ease these pressures, the government has introduced measures to regulate tourist rentals. It has also rolled out a national housing plan, including increased public investment to speed up construction. However, these tensions are likely to persist, pushing up property prices and rents over the next two quarters. We therefore anticipate inflation to remain relatively high in 2025 (+2.6%), before easing to +1.9% in 2026.


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## PUBLIC FINANCES: FAVOURABLE TRENDS IN BUDGET RATIOS

Despite the absence of a budget for 2025, measures approved in November 2024 have increased public revenue. These include the introduction of a minimum 15% corporate income tax for multinationals, an increase in the top bracket on personal capital income, and an increase in taxes on tobacco and electronic cigarettes. These measures, combined with higher social security contributions (driven by growth in the number of workers) and the removal of VAT reductions introduced during the inflationary period, should give the government significant leeway to increase its spending, particularly on defence (from 1.3% of GDP in 2024 to 2.1% from this year<sup>1</sup>). However, this should not prevent the public debt ratio from falling, as it has done in recent years (from 109.5% in 2022 to 101.8% in 2024). Spanish nominal growth is expected to remain high (5.1% in 2025 and 4.4% in 2026) and above the apparent interest rate on the debt (2.6% of GDP and then 2.7%), which would allow for a reduction in the public debt-to-GDP ratio (see chart 2).

## FOREIGN TRADE: BETWEEN TRADE SLOWDOWN AND RENEWED ATTRACTIVENESS OF FDI FLOWS

The surplus on the balance of goods and services is set to decline over the next two years. On the one hand, the services surplus is likely to shrink, due to the marked slowdown in tourism revenue growth<sup>2</sup> (the main source of the services surplus). On the other hand, the goods deficit is set to widen, with goods exports having already begun to slow in Q2 (EUR 101.3 bn; -0.4% y/y) due to the direct and indirect impacts of higher US tariffs. Exports of goods to the United States fell sharply (-11.7% y/y), as did those to the EU (Spain's main trading partner), which fell by 1.2%. These declines were offset by a rise in exports outside the EU (+1.5%), notably to China (+4.6%).

Although foreign direct investment (FDI) flows to Spain have slowed, as in most developed economies in 2024 (-35% y/y), they remain significant for the country (EUR 31 bn). Spain remains second in Europe in terms of attracting the most investment, after France<sup>3</sup>. This inflow of FDI supports the development of Spain's productive potential and improves the country's export capacity.

## LACK OF PRODUCTIVITY REMAINS THE MAIN STRUCTURAL PROBLEM

The persistent gap in the GDP per capita ratio between Spain and the other three major countries in the Eurozone (Germany, France and Italy) is mainly due to its low productivity<sup>4</sup>. The Spanish economy is based on sectors with lower productivity (such as tourism services). This handicap can also be explained by the small size of its companies, their difficulty in expanding, and their low level of investment in research and development. In Spain, gross domestic expenditure on R&D reached 1.5% of GDP in 2023, compared with 2.2% in France. Despite GDP growth above the eurozone average, this lack of productivity could become more damaging in the medium to long term. In addition, the potential slowdown in net immigration and the burden of population ageing will weigh on human capital, the main strength of the Spanish economy.

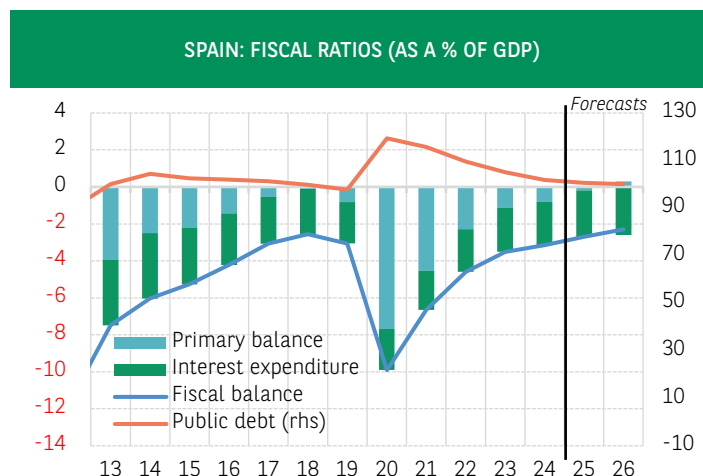


CHART 2

SOURCE: DG ECFIN AMECO, EUROSTAT, BNP PARIBAS FORECASTS

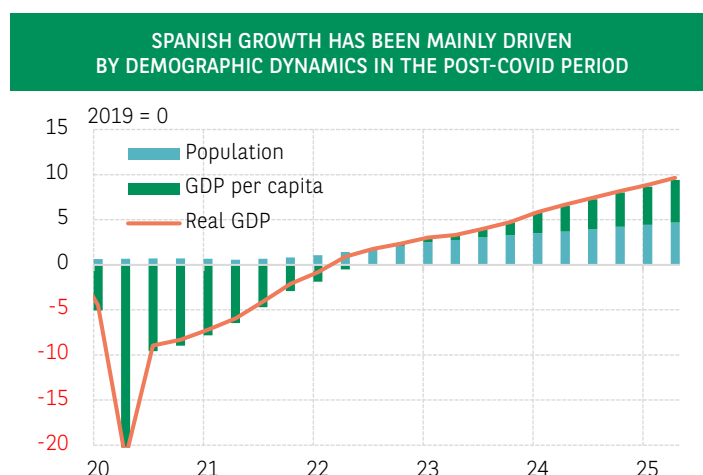


CHART 3

SOURCE: EUROSTAT, BNP PARIBAS

According to the OECD<sup>5</sup>, if productivity levels remain unchanged, Spain's real GDP per capita will grow by just 1.0% per year between now and 2040 due to population ageing (compared with an average of 1.5% between 2000 and 2024<sup>6</sup>).

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<sup>1</sup> However, Prime Minister Pedro Sanchez has announced his refusal to comply with the 5% military spending threshold required by NATO in the long term.

<sup>2</sup> Tourist arrivals rose by 1.4% y/y in June 2025, compared with +13.2% a year earlier.

<sup>3</sup> World Investment Report 2025 «World Investment Report 2025: International investment in the digital economy», UNCTAD.

<sup>4</sup> June 2025 Note «Spain's Productivity Gap Vis-à-vis Europe and the United States: Diagnosis and Remedies», IMF.

<sup>5</sup> July 2025 Note «OECD Employment Outlook 2025: Spain», OECD.

<sup>6</sup> Excluding 2020, due to the Covid period.



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