SPAIN

THE ECONOMY IS HOLDING UP WELL, PEDRO SANCHEZ TOO

Until this summer, the Spanish economy had proved resilient to the interest rate shock. Private consumption and investment were up respectively, 2.7% y/y and 2.0% in Q2 2023. The positive trend in the labour market and the savings accumulated during the pandemic supported household spending, along with the decline in inflation, which allowed purchasing power to stabilise. However, these supports are falling off. Economic activity will slow in H2 2023 but will not come to a standstill. However, with growth now forecast at 2.2% in 2023 as a whole, Spain will remain one of the drivers of the euro zone this year.

The end of the year will continue to be driven by political developments, with the attempt to form a new coalition government. Leader of the People's Party (PP), Alberto Núñez Feijóo, whose party won the general election on 23 July (137 seats), failed to obtain the required majority of 176 seats during the voting on 26 and 27 September in Parliament. The ball is now in the court of the Socialist Party (PSOE) and the current Prime Minister, Pedro Sánchez, who has until 27 November to secure a majority, before a new vote in Parliament. While an agreement between the PSOE (121 seats) and Yolanda Díaz's new Sumar party (31 seats) has been secured, the mustering of the independent parties (ERC, Junts, Catalan European Democratic Party, DeCat), which had joined forces with the PSOE to form a coalition in 2019, is proving problematic: it would imply that Pedro Sánchez is making a move and deciding to grant amnesty to several senior Catalan independence politicians. The Spanish left is divided on this matter. If this fails, new parliamentary elections will be held on 14 January 2024.

Should a new vote take place, it would occur in a less buoyant economic context than in July. Job creations have started to stall, with a gain of just 0.1% between May and August[1], following a very strong increase in H1. The deterioration in the economic situation in Europe along with the rise in labour costs (estimated by the INE at 5.7% y/y in Q2), are beginning to impact companies' recruitment decisions. However, some industries are still hiring, thanks to structurally-rising demand. This is the case for information and communication (+5.8% y/y), healthcare (+3.2% y/y) and transport and logistics (+4.3% y/y).

After reaching a low of 1.9% in June, inflation is heading higher again, driven in particular by the increase in oil prices. The latter is being quickly passed on to fuel prices, which jumped by 5.7% m/m in August. Unfavourable base effects are also playing a role. The rate of disinflation in energy prices is expected to slow sharply in the second half of the year. Furthermore, inflation in services is not slowing down (4.7% y/y in August, excluding rents), and growth in base wages, although relatively contained, has now overtaken inflation. The increase in wages negotiated in sector agreement was 3.4% y/y in August.

The housing market is proving more resilient than expected to the rise in interest rates, and prices are still rising at a sustained pace (+5.3% y/y in August, according to Tinsa). Mortgage rates have continued to rise, reaching an average of 4% this summer. This remains much lower than the level reached during the last phase of interest rate hikes in 2006-2008, when rates topped 6% (INE). However, household borrowing has been steadily contracting for almost a year, though non-performing loans and even more so foreclosures, have remained at historically low levels. Although slow to materialise, a sharper deterioration in the housing market is a concern, because of the delay in the effect of monetary tightening on the economy.

GROWTH & INFLATION

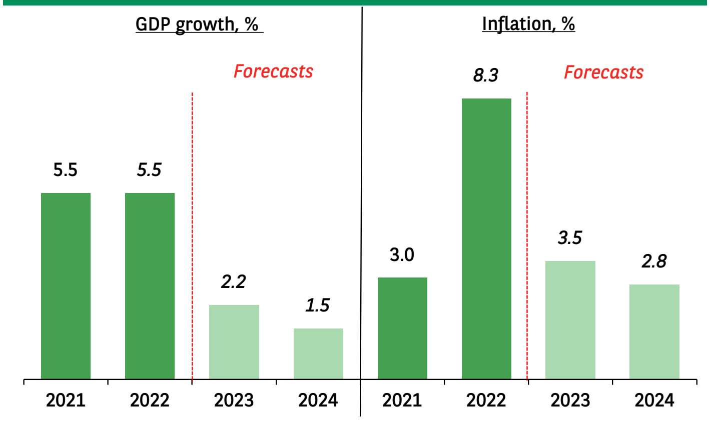

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

Nevertheless, the economy is looking more resilient to the interest rate shock today than it was fifteen years ago. Household debt has fallen sharply since then, even after an upturn observed during the health crisis: at 83.4% of disposable income in Q1 2023, household debt was at its lowest level in ten years and more than 50 percentage points below the 2008 peak (135.5%).

As a result, the slowdown in Spanish growth should be moderate in H2 2023, with an expected increase in Q3 and Q4 of 0.3% q/q and 0.2% q/q respectively. Furthermore, in mid-September, the INE revised the GDP data for the period 2020-2022. Real GDP growth has been revised to 6.4% in 2021 and 5.8% in 2022, compared to an increase of 5.5% initially reported for both years. While not significant, these adjustments indicate that the post-Covid upturn in activity has been more pronounced, which is more in line with the positive trend in the employment data.

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1 Source: Spanish State Public Employment Service (SEPE).