SPAIN: MANAGING NEW RISKS

Spain is now the eurozone country with the lowest inflation rate, standing at 6.7% in November. Government measures to curb the rise in energy prices are paying off, although the underlying CPI is still rising significantly. The slowdown in inflation is expected to continue in 2023, but the government will keep on providing significant support to the economy. The 2023 budget, discussed in parliament, extends most of the support measures until the end of next year. Faced with the rise in mortgage rates, Madrid eased repayment conditions for households via loan restructuring facilities while allowing for a temporary freeze on monthly payments. In addition to the energy crisis, the government will have to manage credit risk, in a country still marked by the banking and real estate crisis of the past decade, but with households generally less indebted than in the past.

After reaching 10.7% in July, consumer price inflation fell sharply to 6.7% in November. The Spanish economy, which suffered from the surge in energy prices and, as a result, a rise in inflation, earlier than its European neighbours – the 2% threshold had been crossed in April 2021, three months before the eurozone average – recorded the weakest rate within the monetary union in November. The Iberian exception, which has been in place since spring 2022 and which consists of limiting the price of gas so that it is not the most expensive energy that sets the price of electricity, has paid off. The cap on regulated gas prices and the decline in the global price of energy commodities also provided some breathing space.

In addition, the government extended the cap on regulated gas tariffs, until the end of 2023, to 5% for households and public authorities eligible for the so-called last resort gas tariff (TUR), for which the majority of consumers are eligible. Until the end of next year, the authorities also increased the social bonus, which reduces electricity bills by up to 80% for the more vulnerable households. Combined with significant base effects, energy prices could fall into deflation this winter. That said, core inflationary pressures remain high and did not fade until October (6.2% y/y). Business confidence surveys, particularly PMIs for services, do not yet indicate a turnaround in sales price dynamics, which remain at a historically high level (the PMI price charged index for services rose to 60 in November). We now expect activity to contract over the next two quarters. Real GDP grew slightly in the third quarter (+0.2% q/q) but remained 2% above its level at the end of 2019. Consumption, the country's main driver of growth, shows little sign of a tangible recovery.

Despite the lack of growth in activity, the labour market is more than resilient. According to the Spanish employment agency (SEPE), after a stabilisation since the beginning of the year, unemployment fell significantly in October-November (-166,500 over the two months as a whole) to reach its lowest level in fourteen years. The number of people employed increased in November (+79,000 jobs, seasonally adjusted figures), for the seventeenth consecutive month. If employment remains unchanged in December, recruitment will end 2022 up 2.4%, a very solid figure given the economic shock experienced by European economies this year.

At the same time, the number of permanent contracts (part-time and full-time contracts combined) increased by 103,000 and now accounts for more than 70% of total jobs. The equivalent percentage was only 62% at the end of 2021, a few weeks before the new labour law came into effect in February, the main purpose of which was to tighten the conditions to encourage employers to hire full-time employees.

The increased release of funds for the National Recovery and Resilience Plan (PRR) will further support activity in 2023. The volume of funding for this programme already expanded significantly in 2022, with EUR 19 billion unblocked during the first nine months of the year, i.e. EUR 7 billion more than at the same time last year. These funds are fully financed by European subsidies from the "Facility for Recovery and Resilience" plan, the payments of which (EUR 69 billion in total) are mainly concentrated in 2022 and 2023. Minister of Economy Nadia Calviño formalised Spain's request at the end of November to obtain a new tranche of subsidies, the third of which, EUR 6 billion, should be paid before the end of the year.

GROWTH & INFLATION

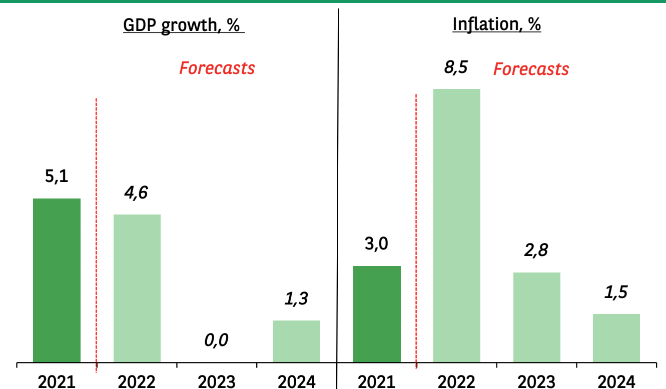

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

REAL ESTATE AS A NEW SOURCE OF FRAGILITY

With the rise in refinancing rates in the eurozone, the conditions and costs of mortgages in Spain increased, with rates going from an average rate of 1.5% at the end of 2021 to 2.4% in September 2022. This rise, which was still modest but will increase as the ECB continues to raise its policy rates, has already led to a drop in new bank loans (-0.4% between August and October, the sharpest drop in three months since June 2020). As a result of a tight market due to supply constraints, the rise in real estate prices in the country is not slowing: they jumped 1.7% m/m and 9.1% y/y in October, the highest annual rate for more than 15 years (see chart 2). While a decline in the volume of real estate activity is expected in 2023, price trends, which depend on the balance between supply and demand, remain more difficult to assess.

In addition to the energy issue, households will therefore be faced with the increase in the costs of loans. The mortgages market has certainly undergone a profound change of structure over the past few years, with a significant shift from variable-rate to fixed rates. These, which represented less than 5% of new mortgages in 2011, now account for two-thirds of the originations in September 2022 (This trend has however

begun to reverse once again with the rise in credit costs making variable rate loans attractive). For these households having taken advantage of the period of low interest rates to obtain and sustain more favourable and stable borrowing conditions, the tightening of credit conditions will have a logically low impact. However, the share of variable rates in the total outstanding credit remains a minority. Payment difficulties should therefore increase in 2023, although the improvement in the labour market is somewhat limiting these risks. In addition, Spanish household debt remains well below its level at the threshold of the 2008 financial crisis. As a share of gross disposable income, household debt stood at 89.3% in Q2 2022, compared with 136% at the peak recorded in Q2 2008 (see chart 3).

Nevertheless, in view of the impact of this rise in interest rates on the financial situation of more vulnerable homeowners, the government integrated targeted protection measures into the 2023 budget: ease of restructuring mortgage loans, freezing monthly repayments for 12 months and extending the term of the loan up to 7 years. At the same time, the annual rent capping measure of 2%, first introduced in March 2022, was extended in 2023.

On the corporate side, the increase in refinancing costs should be more severe in Spain than in France or Germany in particular, due to the use of more variable rates and shorter maturities[1].

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SPAIN: HOUSE PRICE GROWTH

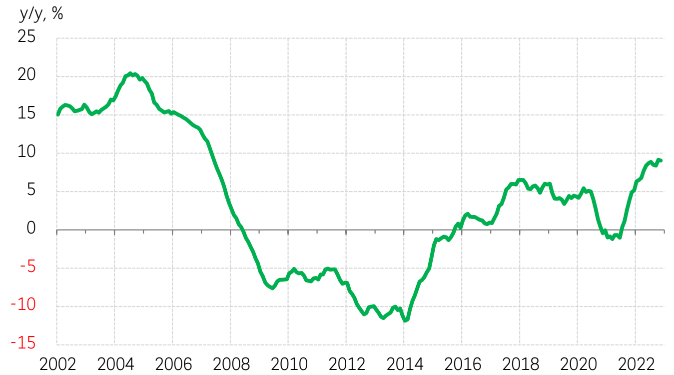

CHART 2 SOURCE: TINSA, BNP PARIBAS CALCULATIONS

SPAIN: HOUSEHOLD DEBT TO GROSS DISPOSABLE INCOME RATIO

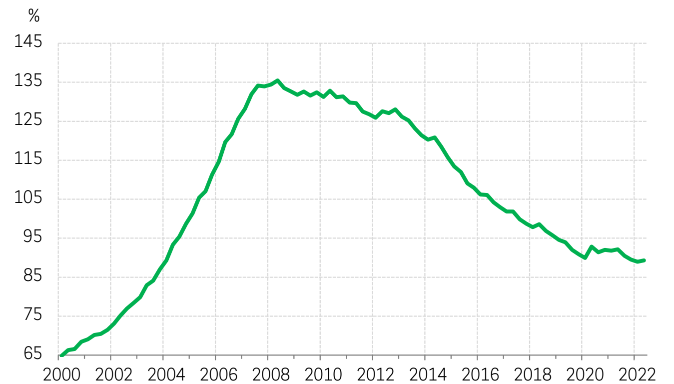

CHART 3 SOURCE: ECB, BNP PARIBAS

1 See M. Gueuder and S. Ray. Rising interest rates: European companies will not be affected at the same rate, Banque de France Bulletin, December 2022. In this study, the share of variable rate loans from Spanish companies is estimated at 38%, compared with 20% in Germany and 17% in France.