SPAIN

A FISCAL STIMULUS MONITORED CLOSELY BY BRUSSELS

Forecasts made at the start of the year will probably turn out to be accurate. Spain is set to be the Eurozone's economy hardest hit by the Covid-19 epidemic. We forecast GDP to shrink by 11.8% in 2020 before rebounding by 7.0% in 2021. The social situation has worsened again this year, forcing the government to introduce new large-scale welfare benefits (e.g. minimum living income), which will be reinforced in 2021. Spain's huge EUR 140 billion stimulus plan will support the recovery, should raise the country's potential growth and create jobs. But the structural budget deficit is widening. Once the Covid-19 crisis is over and the recovery underway, Brussels will intensify the pressure on the Government to speed up certain key reforms, and in particular regarding the country's pension system.

In all likelihood, the Spanish economy will contract again in the fourth quarter of 2020. Although the second wave of Covid-19 has been receding rapidly since its peak in mid-November, restrictions on activity have remained – until mid-December at least – severe and among the most stringent in Europe. Despite the sizeable rebound in activity in Q3 (+16.7% q/q, non-annualised), Spanish GDP was still 9% below its end-2019 level, a recovery comparatively smaller than in other European countries.[1] Breaking down the figures by expenditures, the recovery in service exports had unsurprisingly been the weakest (43.6% below the Q4 2019 level) – pulled down by the slump in tourism activity. Gross fixed capital formation and households spending were down 11.1% and 10.5%, respectively. However, within household consumption, spending on durable goods had rebounded rapidly, rising above its Q4 2019 level.[2]

For sure, job-protection measures – mainly the ERTE temporary unemployment scheme – have significantly cushioned the shock on the labour market, particularly in the service sector. According to the Spanish Employment Office (SEPE)[3], the number of workers affiliated to the social security system was 2.2% lower in November than in February in the industry, and 2.6% lower in services.[4] Comparing these figures with the larger declines in GDP, we see that the government's measures to protect jobs are having a positive effect, although this comes at a high cost for the public finances. According to the labour ministry, 746,900 workers were covered by a ERTE in November. The ERTE scheme has been extended until 31 January, which should limit the increase in unemployment until then. The unemployment rate was 16.2% in October.

FISCAL CONSOLIDATION PUSHED BACK UNTIL 2022 AT THE EARLIEST

Spain's fiscal policy will therefore remain highly expansionary in 2021. The 2021 budget, which was approved by parliament in late November, will amount to a record of EUR239 billion. Key welfare measures put forward by coalition partner Podemos will be reinforced; this is the case of the minimum living income (IMV), for which a further EUR3 bn will be allocated (see box). However, investment accounts for the largest increase in the budget, with significantly greater spending on R&D, apprenticeships and vocational training, as well as the modernisation of public infrastructure. On the revenue side, new taxes on high-earners will be introduced. The budget will also be partly funded by EUR 27 billion of subsidies granted by the European Commission to Spain in 2021 as part of the EU recovery fund (Next Generation EU).

GROWTH AND INFLATION (%)

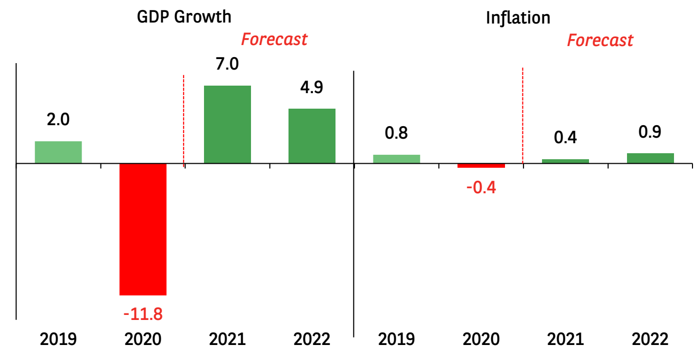

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

GOVERNMENT PRIMARY STRUCTURAL BALANCE (% GDP)

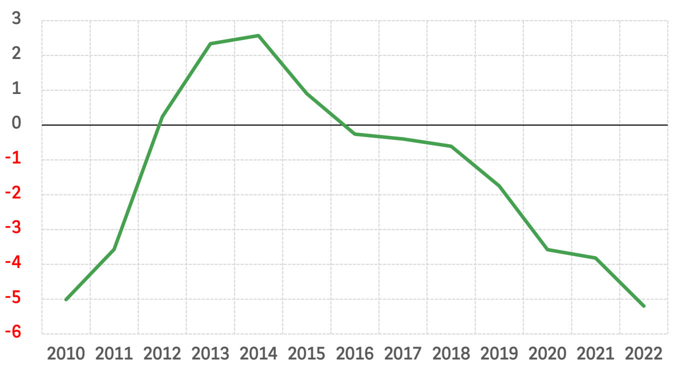

CHART 2 SOURCE: AMECO

This record budget has been built in line with the rapid implementation of Spain's large-scale EUR 140 billion national recovery plan (the "Recovery, Transformation and Resilience plan") for 2021-2026. With this plan, the government is hoping to generate around 800,000 jobs by 2023 and boost GDP growth by 2.5 percentage points over the same period, by investing massively in the ecological and digital transitions. Half of the spending (EUR 72 bn) is due to take place in the next three years.

1 For a comparison of recovery rates, see H. Baudchon and L. Boisset, Eurozone: from rebound to relapse, BNP Paribas Ecoflash, 4 November 2020.
2 A large part of the increase can be traced to automobile sales, which bounced back thanks to the government's decision in June to offer subsidies for the purchase of cleaner vehicles (Renove 2020 programme).
3 Seasonally-adjusted figures.
4 Employment in the construction industry was only 1.1% lower than the February level.

However, the public-sector deficit is expected to jump to around 120% of GDP at the end of 2020, an increase of 20 percentage points year-on-year. Against these circumstances, and once the Covid-19 crisis is over, Spain's government will be under pressure from Brussels again to address certain major structural issues that represent a long-term drag on Spain's budget balance. In particular, the European Commission wants the Spanish government to commit to ensuring the future viability of its pension system, and to introduce new measures to reduce the proportion of people with temporary jobs[5].

Based on its November forecasts, the European Commission estimates that Spain's structural primary deficit (i.e. the deficit excluding changes in income/expenditure related to the economic cycle and excluding interest payments on debt) will widen further in the next two years, reaching 5.2% of GDP in 2022 (see chart 2). This is by far the largest deficit in the Eurozone, and more than twice the Euro-area average (-2.3%).

NFCS AND THE COVID-19 SHOCK

At this stage, it remains difficult to quantify precisely the impact of the Covid-19 crisis on the liquidity and solvency of the non-financial corporation (NFC) sector. A Bank of Spain study[6] estimates that between April and December, demand for liquidity from non-financial corporations could exceed EUR 230 billion, although almost three quarters of that would be covered by state-guaranteed loans. Unsurprisingly, the sectors struggling the most are tourism and leisure, transport and automotive. However, it is worth bearing in mind that non-financial corporations went into the Covid-19 crisis with a more solid financial position than in the past. In particular the debt-to-GDP ratio had dropped steadily between 2010 and 2019, falling to levels unseen since the early 2000s.[7]

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THE IMPACT OF COVID-19 ON INEQUALITY IN SPAIN

Without doubt, rising inequality is one of the main social risks emerging from the Covid-19 crisis in Spain. In its annual report on wages development[1] the International Labour Organization shows that the ratio between wage earners belonging to the 9th-decile and those belonging to the 1st-decile increased substantially in the first wave of the pandemic, i.e. between Q1 and Q2 2020 (see chart 3). At the end of Q2, Spain's ratio was by far the worst in the EU. Part of that sharp increase in disparities was due to the fact that a high proportion of jobs in Spain are precarious, in sectors hard-hit by Covid-19 restrictions and unsuited to remote working. To address these growing difficulties, the government introduced in emergency a minimum living income (IMV) in June. The IMV is a subsistence income of up to EUR 462 per month for a single person, rising to a maximum of EUR 1,015 for larger households. The IMV budget will be increased by EUR 3 bn in 2021, as recommended by the 2021 budget approved by parliament in November. A second significant welfare measure will be the 5% increase in the IPREM index used to calculate most welfare benefits. In addition, when the current government came to power it promised to raise progressively the minimum wage to 60% of Spain's median wage by the end of the current parliament in 2023, i.e. to around EUR 1,200 per month. The minimum wage is currently EUR 950 per month.

1 Global Wage Report 2020-21: Wages and minimum wages in the time of Covid-19, International Labour Organization, December 2020

RATIO OF 90TH PERCENTILE OF THE WAGE DISTRIBUTION TO 10TH PERCENTILE

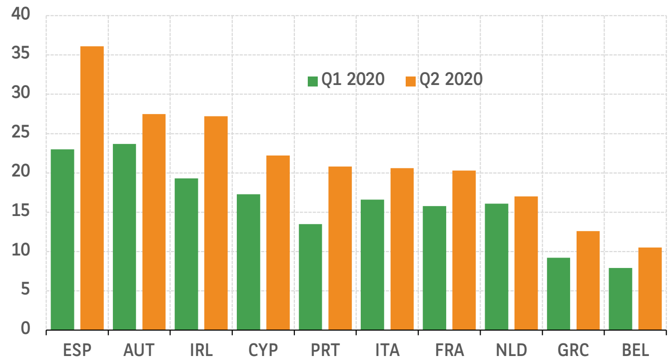

CHART 3 SOURCE: : INTERNATIONAL LABOUR ORGANIZATION, BNP PARIBAS

5 *Bruselas apremia a España a reformar las pensiones y el mercado laboral*, El País, 7 December 2020.
6 Blanco et al. (2020), Spanish non-financial corporations' liquidity needs and solvency after the Covid-19 shock, occasional paper, Banco de España.
7 As a proportion of GDP, the consolidated debts of non-financial corporations fell from 108.2% in Q2 2010 to 61.0% in Q4 2019 (Bank of France data).