SPAIN

THE INFLATIONARY SHOCK IS SEVERE

Spain is unlikely to avoid a difficult winter. Although its economy is structurally less vulnerable to energy shortages, the inflationary shock is severe and is not slowing down, with an inflation rate of over 10% in August. The rise in non-energy prices is amplifying relentlessly. Despite government action, the decline in purchasing power for Spanish households will be among the biggest in the Eurozone. Although tourism is likely to have helped business to cope with the third quarter, we are expecting a contraction in the fourth quarter of 2022, which is likely to continue through the winter. Job creation was strong again this summer, but opinion surveys are also pointing to a downturn on the way.

Spanish inflation shows no signs of easing. The rise in consumer prices remained above 10% in August, at 10.5% y/y. However, it fell slightly compared to July (10.8% y/y), due to the decline in private transport prices (-3.5% over one month), which itself was fuelled by the drop in prices at the pump. Conversely, underlying inflation (excluding energy and perishable foods) continued to rise, to 6.4% y/y in August. The government is struggling to contain the general rise in inflation. While most measures so far have been aimed at reducing the energy bill, a broader range of actions will gradually be implemented. For example, the government is aiming to reach an agreement with major distribution companies on a cap on the prices of essential products[1].

Economic activity in Spain has so far remained on track. Real GDP rose by 1.3% in the first half of the year, slightly above the Eurozone average (1.1%). However, these good figures need to be tempered by the catch-up effect enjoyed by the economy, whose recovery post-lockdown is less substantial than its European neighbours. At the end of the first half-year, Spanish GDP was still 2.5% below its Q4 2019 pre-pandemic level, while the Italian and French GDPs had already more than covered this deficit and German GDP had just caught up with it. Although it recovered sharply in Q2 (+3.2 q/q), private consumption is likely to suffer over time from the drop in household purchasing power, which is particularly significant due to the high level of inflation. According to our estimates (May 2022[2]), the fall in purchasing power may exceed 4% in 2022 as an annual average, one of the largest losses in the Eurozone. Despite a strengthening of support measures this summer (reduction in VAT on gas from 21% to 5% effective from 1 October to 31 December 2022, subsidies for rail transport) and the extension of those already in place (reduction of 20 cents on a litre of petrol extended until the end of 2022), we now expect a contraction in activity of 0.4% q/q in the last quarter of the year.

However, employment has continued to surprise positively, accentuating the lag with the evolution of GDP. According to the Spanish employment agency (SEPE), the number of workers registered with social security system rose again in August (+62,136), with gains generalised across all three major sectors: services, industry and construction. In the first eight months of the year compared to the same period a year ago, employment rose by 1.7% (+334,000), bringing the unemployment rate down to 12.6%, its lowest level since September 2008. However, this momentum could stall. Opinion surveys are becoming less positive, both the European Commission survey (the consumer survey unemployment index for the 12-month ahead was the worst in 18 months) and PMI surveys (the composite employment index was at its lowest since the first quarter of 2021, at 50.4 in August).

GROWTH & INFLATION

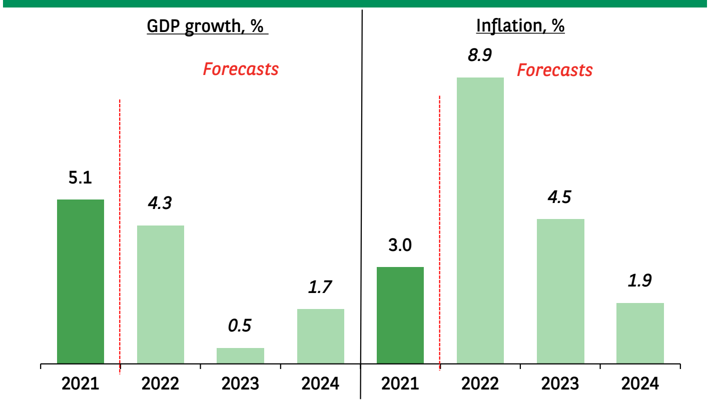

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

Structurally, Spain is better placed to cope with a total breakdown in Russian gas supplies. Compared to other European countries gas imports from Russia make up a small part of Spain's total gas imports (around 13% in 2021). Diplomatic tensions with Algeria have undoubtedly led to a drop in gas deliveries from this country, but Spain seems capable of replacing these shortfalls by using other suppliers, including by liquefied natural gas from the United States[3]. Spain also has the most developed LNG infrastructure in Europe (a third of the infrastructure in Europe is located in the country)[4], even though a large part of it is currently not used. To this end, the government has announced its intention to reopen the El Musel re-gasification site (in the north-west of the country) from next January, ten years after its closure.

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1 See *"Díaz y Garzón contactan con la distribución para intentar poner tope al precio de 20 o 30 productos básicos"*, (Díaz and Garzón talk to the distribution sector in an attempt to cap the prices of 20 or 30 basic products) *El País*, 5 September 2022.
2 See BNP Paribas Ecoflash, *Energy price inflation in the Eurozone: government responses and impact on household purchasing power,* 20 May 2022.
3 See "Spain Not at Risk If Russia Cuts Gas Flow, Network Operator Says", Bloomberg, 12 July 2022
4 See Natural Gas in Europe, The Potential Impact of Disruptions to Supply, IMF Working Paper, July 2022, table page 9.