A RECOVERY SLOW IN THE MAKING

Economic growth remains extremely fragile in early 2021. In addition to the Covid-19 pandemic, Spain was hit by Storm Filomena in early January, which has had a direct negative impact, notably on consumption: both automobile and retail sales plummeted this winter. We now expect GDP growth to be flat in Q1. Even so, the economy could rebound strongly either this spring or more certainly by summer, although we cannot completely rule out the downside risks associated with the UK variant and a possible fourth wave of the coronavirus in Spain. We are forecasting real GDP growth of 5.9% in 2021 and 5.6% in 2022, following a record contraction of 10.8% in 2020.

To face up to the protracted health crisis, the government has extended most of the emergency measures launched in 2020, including a moratorium on corporate bankruptcies (which was extended through to 31 December 2021) and the ERTE short-time working scheme (which currently expires on 31 May). On 12 March, the government also approved a new fiscal stimulus package totalling EUR 11 bn. It comprises EUR 7 bn in direct aid for companies operating in the hardest hit sectors and regions[1], EUR 3 bn for corporate debt restructuring, and EUR 1 bn for any capital injections that might be needed. The ongoing pandemic – and its economic consequences – will certainly drive public spending above the government's initial targets. The government has formalised a record-high budget of EUR 239.8 bn for 2021. According to the Bank of Spain's central scenario, the public deficit is estimated at 7.7% of GDP this year, after peaking at an all-time high of 10.1% of GDP in 2020.

LIMITED HOPES

There are nonetheless good reasons to hope for a more significant rebound in economic growth this spring or more certainly by this summer. The number of new Covid-19 cases in Spain has dropped sharply, even though the pandemic's curve has begun to rise slightly again since the end of March. The vaccination campaign is progressing, albeit at a sluggish pace. On 29 March, nearly 16% of the population had received their first dose of the vaccine. As a result, Spain ranks among the European countries with the highest vaccine coverage, even though it remains far below the vaccination rates reported in the United States and the United Kingdom. Nonetheless, Prime Minister Pedro Sanchez announced that the number of doses would quadruple in Q2, which should in theory lead to a rapid acceleration of vaccinations. For the moment, the government is maintaining its target of vaccinating 70% of population by the end of summer, even though vaccine supply may remain a major obstacle in the months ahead.

The gradual easing of restrictive measures should trigger a significant rebound in economic activity. In any case, this is what some confidence indicators are suggesting, notably the PMIs for the services sector, which have improved sharply this winter (see chart 2). During the first reopening phase in May 2020, economic activity recovered rapidly, with real GDP growing 16.4% q/q in Q3. The global economic environment is also more promising than it was last summer, particularly in the United States and Asia. This should bolster Spanish merchandise exports to these regions, although Spain does not stand to benefit as much from this trade as its European neighbours (see box, next page).

As we explained in a previous EcoFlash[2], Spain's economic structure (with a focus on services and tourism) and an industrial fabric composed mainly of SMEs and precarious job contracts) suggests that the Covid-19 pandemic could have a bigger impact on growth in the medium term compared to the three other big European countries.

GROWTH AND INFLATION (%)

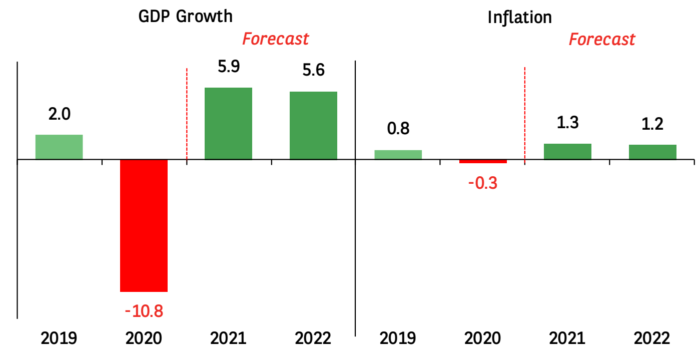

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

SERVICES PMI

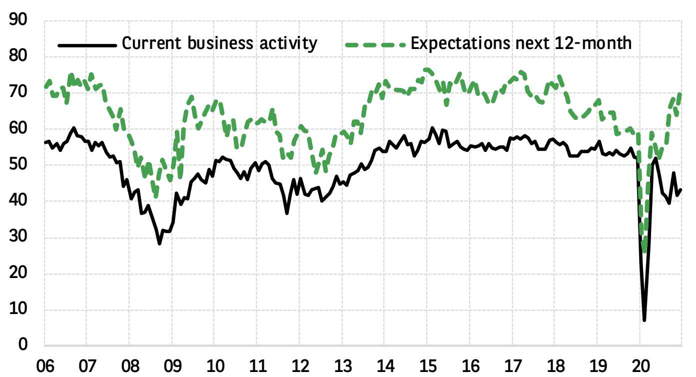

CHART 2 SOURCE: MARKIT, REFINITIV

Equity market trends seem to confirm this sentiment. At the end of March, Ibex, the Spanish equity market index, was still fluctuating about 15% below pre-crisis levels. In contrast, France's CAC 40 and Italy's FTSE MIB had made much more progress in closing the gap, while Germany's Dax had already reached new record highs as of mid March.

1 Aid will be available in 95 sectors. Moreover, EUR 2 bn will be allocated exclusively to the Balearic and Canary Islands, two regions hard hit economically by the Covid-19 crisis.
2 See BNP Paribas *EcoFlash, Eurozone: Four countries, four ways to recover*, 20 May 2020

WILL INFLATION REBOUND THIS SPRING?

Sluggish growth in the early part of 2021 has limited the rebound in consumer prices, unlike the situation in most of the other major European countries. In the Eurozone, the harmonised index of consumer prices (HICP) rebounded 0.7% between December and February, but in Spain it declined 0.8% over the same period (Eurostat). On a year-on-year basis, Spanish HICP even slipped back into negative territory in February. The only notable rebound was for energy prices, and by extension, transport prices, which followed the rise in commodity prices during the winter. Yet we cannot rule out the possibility of an upturn in inflation this spring. Bottlenecks in global supply chains (visible notably in PMI surveys) could eventually trigger an acceleration in Spanish inflation. Another upside risk factor for inflation is a strong rebound in economic activity from Q2 onwards.

RECOVERY PLAN: MADRID STEPS UP THE PACE

In the weeks ahead, the government will finalise and deliver its national recovery plan ('The Recovery, Transformation and Resilience Plan') to the European Commission. Spain's executive branch intends to submit its plan to Brussels by mid-April, two weeks ahead of the deadline imposed by the European Commission. Yet the first allocations via the Next Generation EU funds are unlikely to occur before the second half of 2021. To accelerate the process, the Spanish government plans to issue government bonds that will be reimbursed once the EU transfers have been completed. Spain's recovery plan, which must comply with the European Commission's guidelines, will have nearly two thirds of investments geared towards the ecological and digital transitions.

Yet one of the major challenges facing the Spanish authorities is to transform these "theoretical" allocations into concrete investments. Indeed, Spain has a poor track record when it comes to the utilisation of European structural funds. Under the previous European multi-year budget for the period 2014-2020 (ESIF), Spain used only 40% of the allocated funds, which was the second lowest absorption rate after Croatia.

Lastly, against the backdrop of the health crisis, this spring's main political event will be the early regional elections to be held in Madrid on 4 May. Pablo Iglesias, Deputy Prime Minister of Spain and leader of the Podemos party, has announced his candidature to be the region's president. To run for this election, he resigned as Deputy Prime Minister and was replaced by the Minister of Economic Affairs Nadia Calviño. The leader of Podemos will be facing Isabel Diaz Ayuso, the incumbent president and member of the People's Party. Madrid's election follows on the heels of February's regional election in Catalonia, which ended up strengthening the region's separatist parties. As has been the case for several years, Spain's political situation is an underlying risk that only compounds the country's currently severe economic difficulties, which are bound to worsen with the Covid-19 crisis.

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WILL SPAIN'S DEPENDENCE ON THE EUROPEAN COMMON MARKET HAMPER ITS RECOVERY?

Although tourism accounts for a major part of Spain's "external" revenue, merchandise exports are still a very important sector and its economic weight has continued to increase over the years. Goods exports as a share of GDP have gradually increased, to 24.1% in 2020, compared to only 18.5% in 2007, just before the global financial crisis (IMF data). Note that the pandemic did not have a notable impact on the share of exports compared to 2019.

This trend was accompanied by a greater concentration of Spanish exports on EU destinations, and France in particular. Inversely, for Germany, France and Italy, the share of exports to the EU has remained generally stable, and historically it has been much lower than in Spain (see table below). As a result, Spain should benefit relatively less from the rebound in activity and stronger demand from the United States and China. By extension, Spain risks being hit economically harder by the delayed rollout of vaccination campaigns, which means a belated lifting of business restrictions within the EU.

	Spain	**Germany**	**France**	**Italy**
Share of world exports in 2020 (%):	**1.8**	7.9	2.9	2.9
Share of national exports towards:				
United States	**4.6**	8.8	8.0	9.6
China	**2.7**	7.6	4.1	2.8
Japan	**0.9**	1.5	1.4	1.6
EU	**59.7**	52.5	52.4	50.8
Eurozone	**52.6**	36.8	45.6	41.0
United Kingdom	**6.7**	5.7	6.6	5.2
Asia (ex-China and "advanced" countries*)	**1.4**	2.5	3.0	2.3
Middle-East	**2.6**	2.0	3.5	3.7
Africa	**5.4**	1.4	4.7	2.7
Other destinations	**16.1**	17.9	16.2	21.1

* Advanced Asian countries (IMF classification): Australia, Hong Kong SAR, Japan, Korea, New Zealand, Singapore, and Taiwan

SOURCE: IMF DIRECTION OF TRADE STATISTICS