NEW RISKS ARE EMERGING

After the disappointing economic growth reported in H1 2021, Spain should record a robust rebound in activity in H2, assuming the health situation does not deteriorate. The inflow of tourists has picked up (but remains historically low) and employment has recovered. Yet inflationary risks are intensifying. With the surge in energy prices, the government was forced to take drastic measures to reduce the energy bill for households, which will weigh on public finances. Faced with a persistently uncertain environment, the government is bound to maintain an expansionist policy when it unveils its 2022 budget this fall, even though the health situation is more favourable for the moment thanks to the high level of vaccinations. The socialist government's top priority will be to consolidate the economic recovery, notably by protecting household purchasing power in the face of rising energy costs.

Growth figures were undoubtedly disappointing in Q2 2021. After contracting 0.2% q/q in Q1, real GDP rose only 1.1% q/q, which is a much smaller rebound than the INE's preliminary estimate of 2.7% q/q. Household consumption did not bounce back as strongly as expected. Moreover, the economy still has a long way to go before vast segments of activity return to normal. Several factors could hamper private consumption in the months ahead. In addition to rising inflation (see below), supply-chain disruptions are hurting industry, especially the automobile sector. New car sales in Spain fell by half between April and August 2021. Lastly, uncertainty looms over the evolution of savings accumulated by households during the pandemic – which the Bank of Spain estimates at nearly EUR 117 bn – since it could take a while to unblock them.

Yet the net turnaround in the job market since last spring creates encouraging prospects. More than 400,000 jobs have been filled since April[1], and employment is now only slightly below the pre-pandemic level. The jobless rate is still higher than in early 2020 (14.3% in July, compared to 13.7% in February 2020), but this partly reflects an increase in the active population. That said, given that a large portion of new hiring was seasonal, we must wait to see how employment is trending this fall to get a more precise idea of the vigour of the recovery. With numerous people returning to work, the number of individuals covered by the ERTE temporary unemployment scheme declined in August to the lowest level since the pandemic began (272,190).

The improvement in the job market also provides public finances with a little more leeway, especially for the central government accounts, which are still highly deteriorated. Spain is expected to report another substantial deficit in 2021, estimated at more than 7% of GDP according to the Bank of Spain, after reaching a record high deficit of 11% of GDP in 2020 (see box 1). The Spanish central bank is also forecasting another large deficit in 2022 (-4.3% of GDP) and 2023 (-3.5%). Assuming the health situation remains stable, growth should nonetheless accelerate in the second half of this year. Spain is one of the European countries with the highest vaccination rates, with nearly 80% of the population fully vaccinated at the end of September. The inflow of tourists continues to be hampered by the global health environment, although the level of activity in August is closing in on the pre-pandemic level observed in 2019. Indeed, the hotel occupancy rate rose to 65% in August, around 10 points below the 2019 level but significantly above that of 2020 (44%). Moreover, opinion surveys are still looking upbeat. The composite Purchasing Managers Index (PMI) is still historically high (60.6 in August). The survey highlights a particularly strong demand for consumer goods (see chart 2). According to the European Commission survey, household confidence has also returned to a level comparable with pre-pandemic levels.

GROWTH AND INFLATION (%)

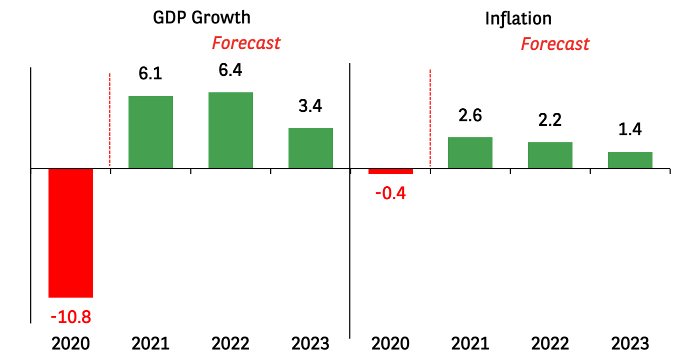

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

MANUFACTURING PMI, CONSUMER GOODS SECTORS

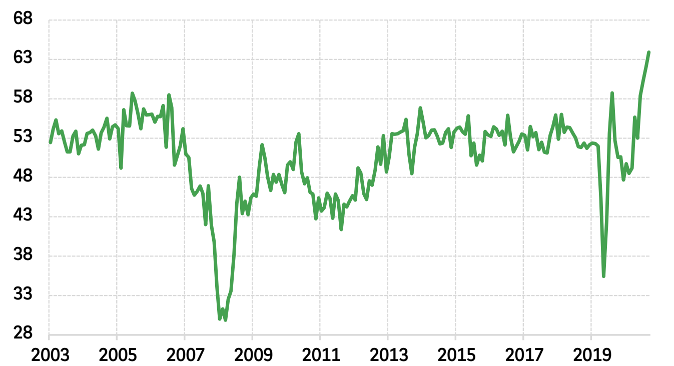

CHART 2 SOURCE: MARKIT

Another positive trend is the rebound in the real estate market, which is regaining colour after bottoming out in 2020. Several factors have come together, including historically-low interest rates[2], large household savings, and the democratisation of remote working. This has resulted in an increase in residential building permits and higher real estate prices in 2021 (prices rose 5.2% y/y in August, according to the TINSA index). Although the level of real estate activity is still far below that obser-

1 The number of payroll employees registered with Social Security rose by 412,447 over the past three months (source: SEPE).
2 The average borrowing rate fell below 1.6% for the first time in June (source: Bank of Spain).

ved during the speculative bubble of the 2000s, residential investment could provide a welcome boost to growth in the short to medium term. In August, construction sector employment, which was much more resilient to the health crisis than most other sectors, was already nearly 2% above the winter 2020 level.[3]

INFLATION SURGES: THE GOVERNMENT INTERVENES

Strong demand for natural gas coupled with supply-side disruptions triggered a surge in electricity and gas prices in Europe. Spain was one of the countries hit earliest and hardest by the price spike. Electricity prices in Spain soared 35% y/y in August, while natural gas prices rose 8.2% y/y. Higher energy costs had a significant impact on headline inflation and accounted for half of August's annual increase in the CPI. Moreover, it is unclear whether energy prices will level off or decline in the months ahead given the risk that natural gas supply problems could persist this winter.[4] The increase in energy prices could feed through to higher prices for other spending categories, notably food, which accounts for nearly a quarter of the consumer basket of Spanish households. Some components of the CPI, however, were still in deflationary territory in August, including communications (mainly telephone services), education, leisure and culture.

The surge in energy prices hits low income households hardest, as they devote a bigger share of their budget to these fixed costs. To preserve private consumption as best as possible and to avoid crimping the recovery, the government announced a series of measures. In early July the VAT rate on electricity was temporarily reduced (from 21% to 10%) through the end of 2021, and the tax on electricity production, which hurts companies, was suspended for three months. With electricity prices continuing to rise over the summer, the government announced new measures in early September that aim in particular at taking off electricity companies from part of their profits generated by the rise in gas prices on international markets market.[5] The reduced VAT rate on electricity might also be extended beyond December 2021.[6]

Completed on 23 September 2021

Guillaume Derrien
guillaume.a.derrien@bnpparibas.com

PRELIMINARY RESULTS OF PUBLIC ACCOUNTS IN 2020

Public finances (EUR bn)	2020 (a)	2019 (b)	(a) - (b)	% of total (2020)
Total revenue	463.3	487.8	-24.5	-
Value added tax and import duties	129.6	147.5	-17.9	30.2
VAT	70.6	80.9	-10.3	16.6
Other	59.0	66.6	-7.6	13.7
Income and wealth taxes	125.3	129.2	-3.9	26.5
Income tax	121.0	124.8	-3.8	25.6
Other	4.3	4.4	-0.1	0.9
Capital gains tax	4.6	5.5	-0.9	1.1
Social welfare contributions	161.9	160.7	1.2	32.9
Employers	112.3	112.3	0.0	23.0
Households	42.4	41.2	1.2	8.5
Imputed contributions	7.1	7.2	0.0	1.5
Corporate taxes	6.7	8.8	-2.0	1.8
Dividends	4.7	6.2	-1.5	1.3
Interest	2.1	2.6	-0.6	0.5
Other revenue	26.7	26.9	-0.2	5.5
Total spending	586.4	523.4	62.9	-
Intermediate consumption	66.0	64.0	2.0	11.3
Employee compensations	140.5	134.5	6.0	24.0
Interest	25.2	28.3	-3.2	4.3
Subsidies	21.4	12.5	8.9	3.7
Social transfers (excluding cash)	228.1	196.8	31.3	38.9
Cash transfers	33.6	32.8	0.8	5.7
European Union-related expenditure	11.0	10.2	0.8	1.9
Fixed capital formation (public investment)	28.2	26.0	2.2	4.8
Other spending	32.3	18.2	14.1	5.5
Fiscal balance	-123.1	(% GDP: 11.0)		
Primary balance	-97.9	(% GDP: -8.7)		

The deterioration in Spain's public finances was sharp in 2020. The fiscal deficit widened by EUR 87.4 bn to reach EUR 123.1 bn, beating the dismal record of EUR 120.6 bn in 2009. Lower revenues and higher spending created a major scissors effect. Three quarters of the decline in revenue was due to the drop in tax collection on production and imports. This reflects the slowdown or halting of numerous activities during the various lockdowns. The remainder of the fall in fiscal revenues can be attributed to the drop in resources generated by corporate taxes as well as personal income and wealth taxes. Revenue from social welfare contributions increased since wages were maintained for most workers thanks to extended furlough (ERTE) schemes. These exceptional measures nonetheless led to a spectacular rebound in social transfers, which rose by more than EUR 30 bn in 2020. Note that the cost of debt narrowed again in 2020 as interest rates continued to fall.

BOX 1

SOURCE: SPANISH MINISTRY OF FINANCES, BNP PARIBAS

3 Source: Spanish employment office (SEPE).
4 Tagliapietra & Zachmann, *Is Europe's gas and electricity price surge a one-off?*, Bruegel
5 *El Gobierno recorta 2.600 millones a las eléctricas para contener el recibo de la luz, El Economista*, 13 septembre 2021.
6 *El Gobierno estudiará ampliar la rebaja del IVA a la luz más allá del 31 de diciembre, El Economista*, 21 septembre 2021