Outlook for the Spanish economy in 2024: a year full of challenges

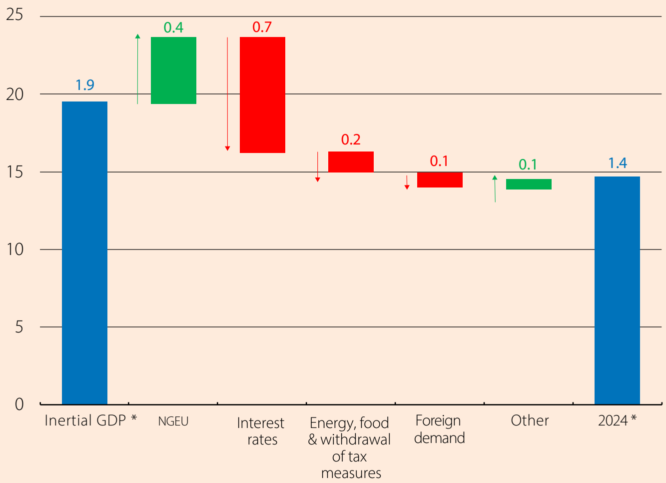
Starting point

The consequences of the war between Russia and Ukraine have continued to dominate the dynamics of the economy throughout 2023. The war sparked an energy crisis which triggered a sharp rebound in inflation and led the ECB to embark on an aggressive cycle of interest rate hikes. The energy crisis had its maximum impact in 2022, but it quickly faded in the closing weeks of 2022 and the beginning of 2023. Along with the recovery of tourism, the rapid moderation of energy prices allowed for an improvement in consumption and the Spanish economy grew at significant rates during the first half of 2023. However, with the energy channel exhausted, the second half of 2023 has seen a moderation in the economy's growth rate, as it also confronts a series of headwinds. These factors include inflation, driven by rising food prices and the rebound in the oil price since July 2023, the impact of the higher interest rates and the sharp slowdown in growth in the euro area. Thus, whereas GDP grew by an average of 0.5% quarter-on-quarter in the first half of 2023, in Q3 the economy grew by a more modest 0.3% quarter-on-quarter. All in all, within the context of this slowdown we expect the economy to grow by 2.4% in 2023 as a whole.

2024 outlook

For 2024, we expect the economy's growth rate to moderate to 1.4%. In the first chart we show the breakdown of this forecast according to its main determining factors.[1] As can be seen, in the absence of external shocks we could have expected a growth rate of almost 2.5%, thanks in part to the support of European funds.

Spain: breakdown of 2024 GDP growth
(pps)



Note: ** Annual change (%).*
Source: *CaixaBank Research.*

However, we expect the economy to be weighed down by a series of factors. The first one is the impact of the interest rate hikes. The ECB began raising rates in July 2022 and has since increased them by 450 bps. Our forecast is that this cycle of rate hikes has already reached its peak in September (with the depo rate at 4.0% and the refi rate at 4.5%) and that the ECB will keep rates at their current levels until the second half of 2024, at which point it would begin to gradually lower them.[2] According to these forecasts, the 12-month Euribor would be close to 3.6% on average during 2024, after averaging around 3.9% in 2023. Although rates may be lower in 2024 than in 2023, it should be recalled that the impact of a rate hike takes a long time to filter through to the economy. Typically, the maximum impact occurs between one and two years after the rate rise.[3] These delays explain why, although we expect lower rates in 2024 on average than in 2023, the impact of interest rates on GDP growth is substantially negative in 2024.[4]

Secondly, we expect that inflation will continue to weigh down economic activity, albeit to a lesser extent than in the last two years. On the positive side, we expect that the underlying inflation dynamics are likely to moderate during the course of 2024. This moderation will come about thanks to the gradual depletion of the contagion effect (the impact that the sharp rise in energy and food prices has on the prices of other products in the CPI basket) and the absence of significant second-round effects. Thus, we expect core inflation (excluding energy and food) to go from 4.6% in 2023 to 3.0% in 2024. In contrast, the withdrawal in early 2024 of the main tax cuts that were introduced in response to the war in Ukraine are expected to add around 1 pp to inflation in

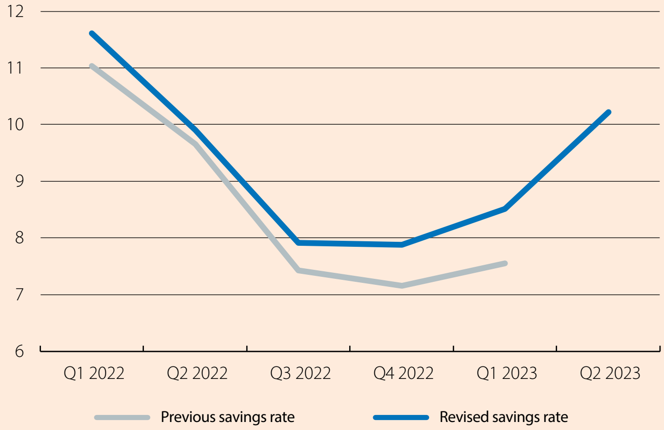
1. We begin with inertial GDP growth, which is calculated using a regression of the annual change in GDP on the first lag of this variable and the output gap of the previous year. The delay captures the ordinary inertia of GDP, while the output gap captures the momentum of the economy according to where it is in the business cycle.
2. For further information on the interest rate forecast, see the Focus «New scenario: international economy and market outlook» in the MR10/2023.
3. See ECB. «A model-based assessment of the macroeconomic impact of the ECB's monetary policy tightening since December 2021». Economic Bulletin 3/2023.
4. The impact of interest rates is calculated using CaixaBank Research's semi-structural model for Spain. We introduced into the model the difference between the rates that we were forecasting for the period Q1 2022 to Q4 2024 as of December 2021 (prior to the outbreak of the war between Russia and Ukraine) and those in our current forecast for the same period (together with the actual figures to date) in order to obtain the impact in each year of the rate hike cycle. The entire cycle between 2022 and 2024 is evaluated so that the model captures the typical delays of the impact of rate rises.

2024, mainly through the energy and food components.[5] On the whole, we expect average headline inflation to barely moderate in 2024 compared to 2023 (3.6% compared to 3.7%), so it will continue to make a negative contribution to growth.[6]

Finally, the low economic growth that is forecast for the euro area (0.7% in 2024 according to CaixaBank Research, compared to potential growth of 1.4% according to the IMF) will also have an adverse effect on our economy.[7]

Spain: savings rate

Gross disposable income (%)



Note: *4-quarter cumulative rate.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

A scenario immersed in risks

This scenario, however, could change depending on whether some of the risks surrounding it materialise. In particular, there is a risk that the current geopolitical conflicts could further strain energy and commodity markets and/or global supply chains. Also, the impact of the cycle of interest rate hikes could be greater than anticipated, impacting our economy not only directly but also through slower growth in the euro area. As an illustration, the table offers the reader a set of sensitivities of GDP growth to changes in some of the key assumptions underlying our scenario.[8]

However, not all are downside risks, as there are also upside risks. The good pattern in disposable income is one of them.[9] In the first half of 2023, household gross disposable income grew by 11.5% year-on-year, a figure that is both significant and well above average inflation in the same period, which was around 4%. This growth was largely due to the 8.5% year-on-year increase in wage earners' remuneration (the most important component of disposable income), as a result of both the strong pace of employment growth in the period, at around 3% year-on-year, and higher wage growth. The strength shown by the labour market has more than offset the increase in net interest payments resulting from the higher rates. Specifically, in absolute terms, the increase in wage earners' remuneration between the first half of 2022 and 2023 amounted to around 47 billion euros, which far exceeds the increase in net interest payments of around 2.4 billion.[10]

Spain: average for the year (2024)

	Impact on GDP growth (in pps)
Inflation (+1 pp)	–0.1
Oil price (+20 dollars)	–0.3
12-month Euribor (+1 pp)	–0.1
Euro area GDP growth (–1 pp)	–0.2
Savings rate (–1 pp)	0.4

Source: *CaixaBank Research.*

Beyond the recent strength shown by disposable income, also of note is the upward revision of the historical series carried out by the National Statistics in its last publication. The greater buoyancy of disposable income has been reflected in the savings rate: according to the new data, the household savings rate in Q1 2023 was around 1 pp higher than previously reported (see second chart).

The upward revision of the savings rate in Q1 2023, together with the high level of savings in Q2 2023, could lead to more buoyant private consumption in 2024. As an illustration, if the savings rate in 2023 closes 1 pp above our current macroeconomic forecast scenario (1 point is precisely the magnitude of the aforementioned upward revision), this would mean households would have a larger savings buffer heading into 2024. Assuming they used that savings buffer in full in 2024, we estimate an impact on GDP of around 0.4 pps (see the sensitivities table).

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5. Primarily, the withdrawal of the VAT reduction on electricity, gas and food, as well as the reduction of excise duty on electricity.
6. To calculate the impact of the inflation of non-core elements (energy and unprocessed food) we introduced into the semi-structural model shocks in the non-core components in order to model the direct and indirect impact of these shocks (the latter captured by the inertia presented by the price equation in the model).
7. The foreign demand shock measures the difference between the GDP growth that is forecast for the euro area for 2024 and its potential GDP (obtained from the IMF), and it translates this difference in growth to export flows net of the import content of those exports.
8. These figures are not alternative scenarios that we consider more or less likely; rather, they offer an illustrative sensitivity analysis to changes in some of the assumptions used in our scenario.
9. For more information on the evolution of gross disposable income in Q2 2023, see the Focus «Spanish households' finances improve thanks to job creation and a reduction of debt» in this same *Monthly Report*.
10. Data on interest payments per the National Statistics Institute's non-financial accounts.