Spain:
Macroeconomic and financial outlook

CaixaBank Research

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www.caixabankresearch.com

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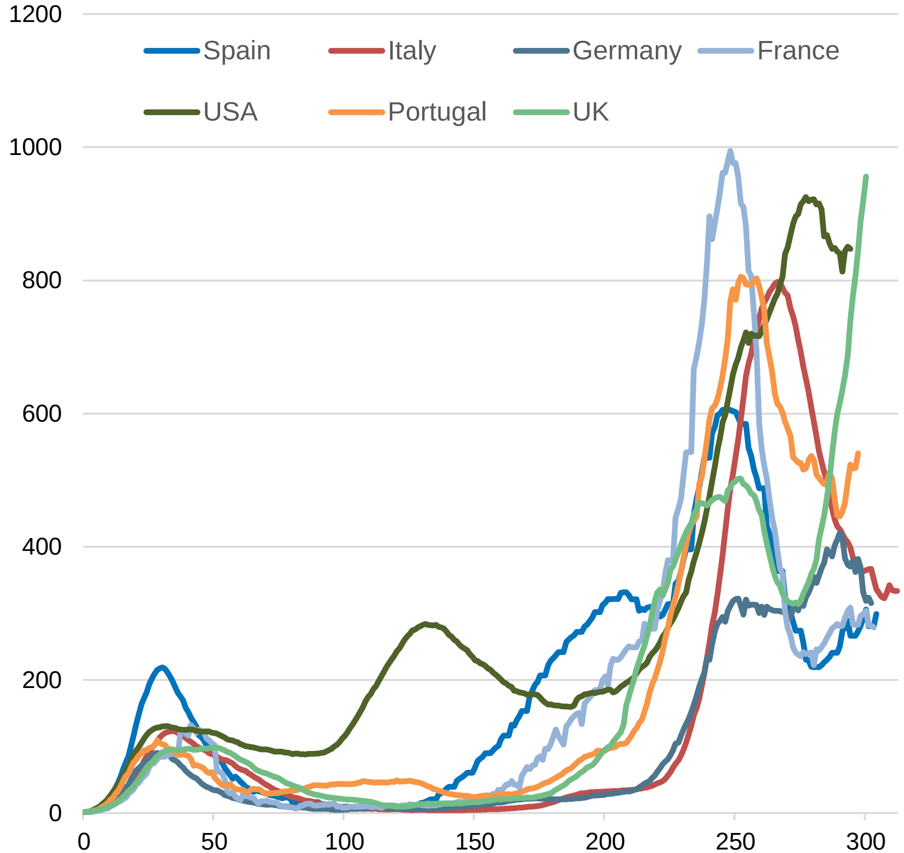
Main messages

Activity	▶ **Restrictions have been more targeted and mobility declined more modestly in the second COVID-19 wave**. The latest indicators for Q4 are mixed. Some suggest that GDP may have grown in the quarter, other suggest a small decline. All in all, there appear to be upside risks for our projections (which assumed a decline of 1.7% qoq). ▶ **Rising infections are likely to dampen activity at the start of 2021, but growth is forecasted to pick up substantially thereafter**. The recovery will be more sustained in 2021 –supported by the widespread use of rapid tests and the distribution of the vaccine. Economic activity will also be supported by fiscal policy and, in particular, the execution of the European recovery plan (which we conservatively estimate could boost growth next year by more than 1pp based on an execution rate of c.50% of the government's plan). ▶ **GDP is not expected to reach pre-crisis levels until 2023** –slightly later than the main European partners, given the prominent weight of the tourism sector (which will continue to operate well below potential throughout 2021).
Banking sector	▶ **The Spanish banking system has a relatively strong financial position to face the crisis and contribute to the recovery**. Credit quality constitutes a major challenge going forward, specially if debt moratoria expire and guaranteed loans start falling due before a strong recovery has taken hold (the possibility to extend grace periods and maturities will be helpful). So far NPLs remain quite stable and banks are building reserves to face future losses.
Policy	▶ **Spain maintains the state of alarm with a night curfew**. Regional governments are responsible for tightening or easing restrictions, and several of them have started to tighten them after the holiday period. ▶ **The policy response is offering significant support to the economy** with a portfolio of direct measures, tax deferrals and public guarantees. Furlough schemes (which have been extended until the end of January) are proving very effective in cushioning the shock and may be extended further if necessary. ▶ **The government funding needs are well covered**, helped by ECB purchases, plenty of liquidity available and low interest rates. Public debt is estimated to stand at 120% of GDP (30pp in the hands of the ECB). ▶ **The 2021 government budget envisages a decline in the fiscal deficit from 11.3% in 2020 to 7.7% in 2021** and the execution of NGEU projects for 27bn (c.2.2% of GDP). Revenue estimates, based on real GDP growth of 9.8% next year, appear optimistic. The goal for NGEU spending is very ambitious as well.

Infections start to trend up again

COVID-19 cumulative incidence

Infections per 100k inhabitants accumulated in 14-day



Days since the first case per 100k inhabitants was recorded

	14 days cumulative incidence*		% positive tests in 7 days		Hospital occupancy rates (COVID)		ICU occupancy rates (COVID)	
	04-ene	30-dic	04-ene	30-dic	29-dic	22-dic	04-ene	22-dic
Andalusia	143	135	9%	8%	6%	7%	13%	15%
Aragon	257	217	11%	12%	8%	9%	18%	20%
Asturias	122	113	4%	3%	8%	10%	20%	21%
Balearic Islands	530	528	11%	10%	13%	11%	32%	21%
Canary Islands	127	130	6%	5%	6%	5%	12%	10%
Cantabria	193	162	7%	6%	5%	7%	18%	18%
Castilla La Mancha	356	309	14%	15%	12%	11%	26%	23%
Castilla Leon	182	147	7%	7%	8%	9%	26%	26%
Catalonia	337	350	8%	7%	13%	11%	34%	30%
C. Valenciana	323	378	20%	18%	16%	13%	29%	26%
Extremadura	603	459	14%	15%	7%	6%	16%	13%
Galicia	202	186	7%	5%	4%	4%	7%	7%
Madrid	375	371	10%	11%	12%	11%	25%	25%
Murcia	238	177	9%	11%	6%	6%	15%	15%
Navarre	215	192	6%	6%	6%	6%	16%	14%
Basque Country	203	204	7%	7%	11%	11%	19%	19%
La Rioja	331	255	7%	7%	8%	7%	22%	30%
Spain	**272**	**265**	**10%**	**9%**	**10%**	**9%**	**21%**	**20%**

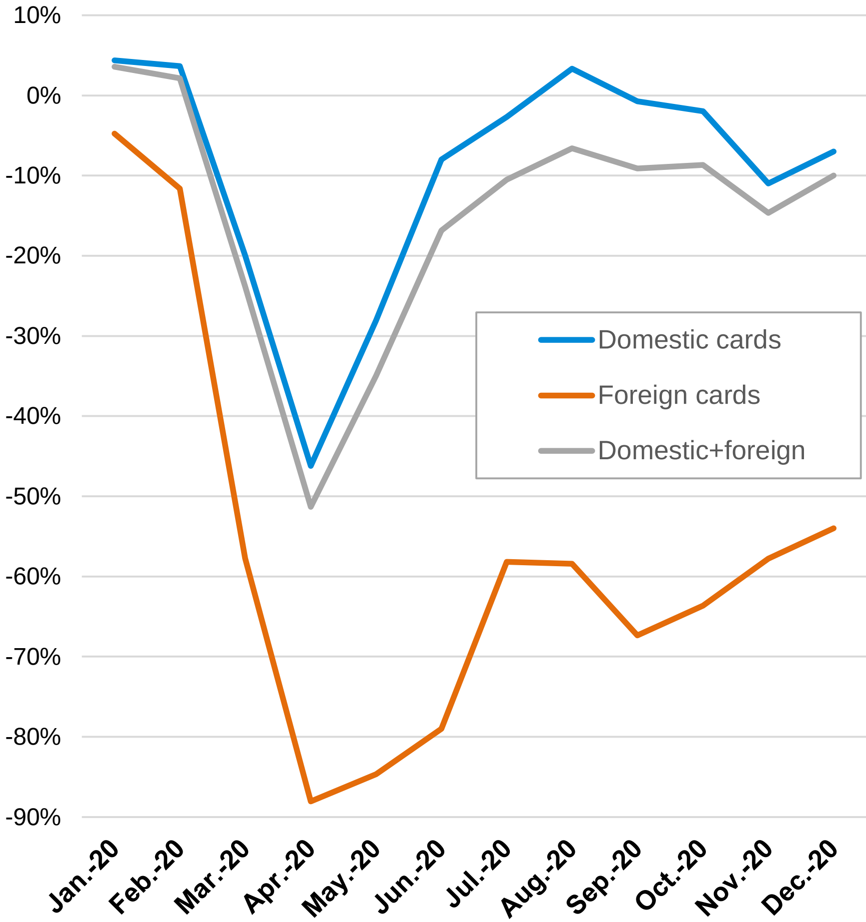
*Notes: * COVID-19 infections per 100k inhabitants accumulated in 14 days.*

- **14-day cumulative incidence in Spain increased to 272 cases per 100k inhabitants** on January 4th, remaining above the extreme-risk threshold of 250 cases per 100k set by the Government. Severe cases are increasing at a slower rate and stand significantly below those of the spring wave, but pressure on the health system remains high in the majority of Spain. Vaccinations started in end-December (~80,000 doses in the first week).
- **The second wave of restrictions has not implied strict lockdowns**. Under the state of alarm, a night curfew has been imposed and regional governments (CC. AA.) are responsible for additional restrictions –such as on mobility across regions, social gatherings, restaurants and leisure. Teleworking is being encouraged everywhere.

New restrictions drag on mobility and consumption indicators

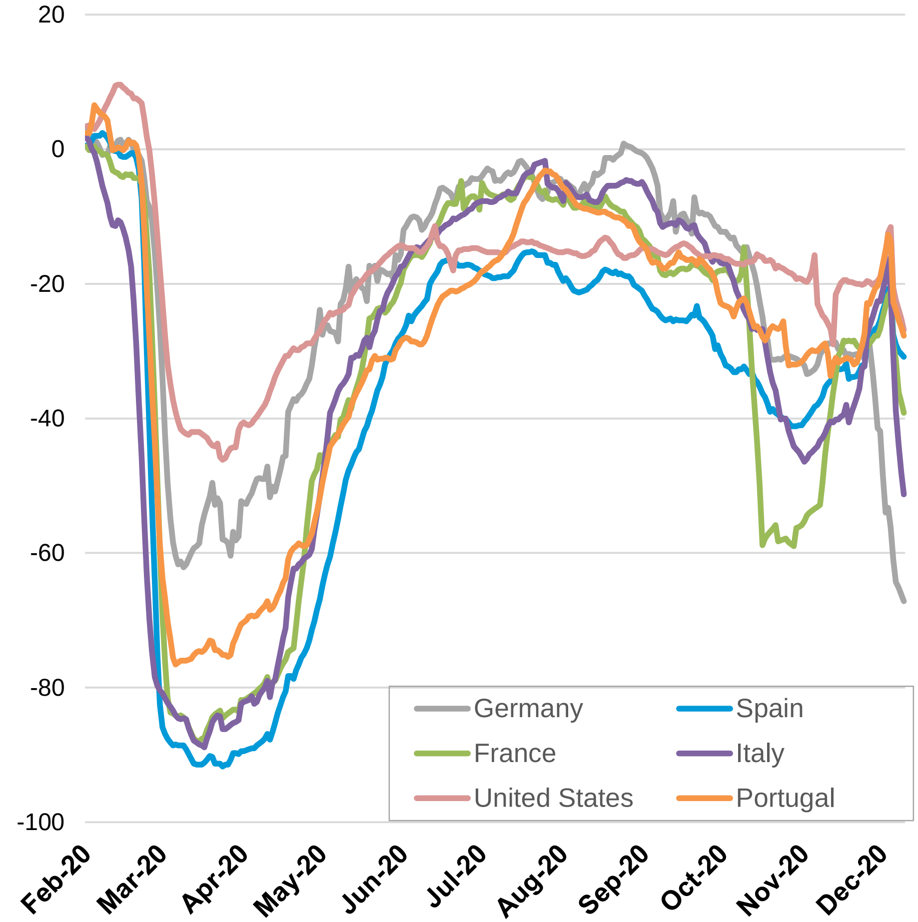
Card activity (point of sale + e-commerce + ATMs)

Year-on-year change (%)



Population mobility: visits to retail and recreation

Deviation from base level (%)



- **The latest wave of coronavirus infections weighs on mobility and activity**. Yet, their decline has been milder (in fact, mobility around workplaces was little affected) and indicators in the labor market and the manufacturing sector remain resilient.
- **CaixaBank card data show that consumption remained subdued in Q4 2020**. Yet, consumption recovered some ground in December and e-commerce spending (+14% yoy in December and +11% in November) is cushioning the impact of mobility restrictions on retail consumption. Spending by foreigners remains very weak.

Industrial activity and the labor market exhibit greater resilience than services and consumption

Year-on-year change (%)	Domestic cards activity	Foreign cards activity	Goods exports	Cement	New registrations of passenger cars	Electricity consumption	Industrial production	Retail sales	Registered employment *
2019	**7.4**	**-4.1**	**1.8**	**9.2**	**-4.8**	**-2.9**	**0.7**	**2.3**	**2.6**
Q1 2020	**-4.2**	**-26.3**	**-3.0**	**-13.5**	**-31.0**	**-2.6**	**-6.5**	**-3.9**	**-1.6**
Q2 2020	**-26.8**	**-83.8**	**-27.7**	**-22.8**	**-67.7**	**-12.8**	**-24.2**	**-18.4**	**-18.9**
Q3 2020	**-0.4**	**-60.6**	**-5.7**	**-1.8**	**-6.3**	**-4.0**	**-5.2**	**-3.4**	**-7.1**
October	**-1.9**	**-63.6**	**-5.9**	**-9.6**	**-21.0**	**-0.7**	**-1.2**	**-3.0**	**-5.8**
November	**-11.0**	**-57.8**		**3.9**	**-18.7**	**-2.9**		**-4.3**	**-6.3**
December	**-7.0**	**-54.2**			**0.0**	**0.4**			**-5.9**

Note: (*) End-of-month figures. It does not include workers affected by a furlough scheme.

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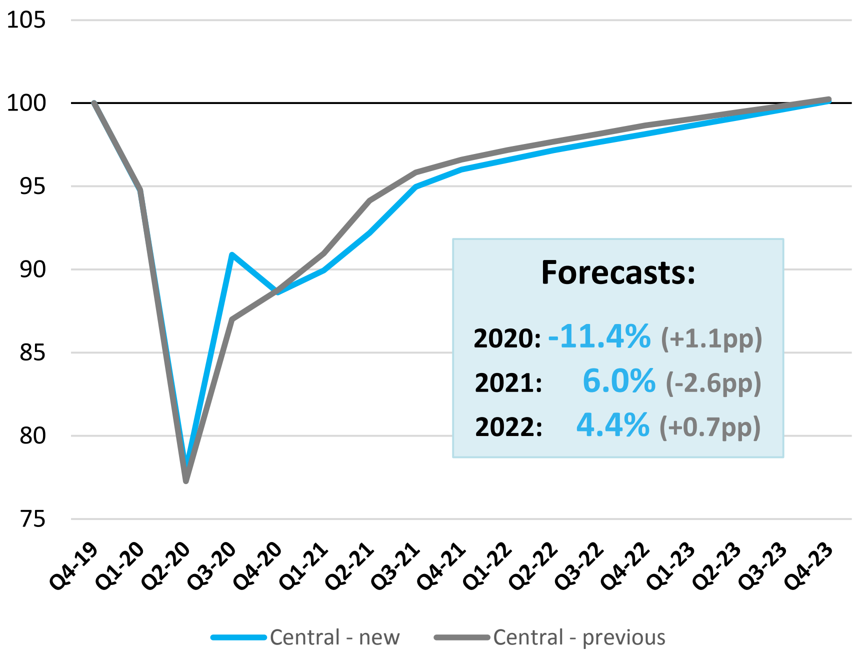
GDP is likely to decline in Q4 2020, but growth will pick up substantially in 2021

GDP projections

Index (Q4 2019 = 100)



Analysts' forecasts

GDP (Δ %)	2020	2021	Cum. 20-21
Government (October 6) – incl. NGEU	**-11.2**	**9.8**	**-2.5**
Santander (October 12)	**-10.0**	**7.9**	**-2.9**
Government (October 6) – excl. NGEU	**-11.2**	**7.2**	**-4.8**
Bank of Spain (December 11) – Central	**-11.1**	**6.8**	**-5.1**
AFI (November 9)	**-11.7**	**6.4**	**-6.0**
Funcas (November 23)	**-12.0**	**6.7**	**-6.1**
CaixaBank Research (November 12)	**-11.4**	**6.0**	**-6.2**
BBVA (October 21)	**-11.5**	**6.0**	**-6.2**
Consensus Bloomberg (November 9)	**-11.7**	**5.9**	**-6.5**
IMF (October 7)	**-12.8**	**7.2**	**-6.6**
OECD (December 1)	**-11.6**	**5.0**	**-7.2**
Morgan Stanley (November 9)	**-12.1**	**4.9**	**-7.8**
Bank of Spain (December 11) – Risk	**-11.6**	**4.2**	**-7.9**

Central Scenario - Update

- Our forecasts assume that **new bouts of contagion continue to take place before a treatment/vaccine is widely distributed**. In order to tackle these outbreaks, measures that reduce mobility continue to be necessary through early-2021. However, **generalized lockdowns are expected to be avoided and the measures considered will not be as disruptive to economic activity** as the ones implemented during Q2 2020.
- By spring 2021, supported by the widespread use of rapid tests and the distribution of the vaccine, we expect growth to pick up. In addition to medical advances, economic activity will also be supported by fiscal policy and, in particular, the execution of the European recovery plan (which we conservatively estimate could boost growth next year by more than 1pp based on an execution rate of c.50% of the government's plan).
- **GDP is not expected to reach pre-crisis levels until 2023** –slightly later than the main European partners, given the prominent weight of the tourism sector (which will continue to operate well below potential throughout the coming year).

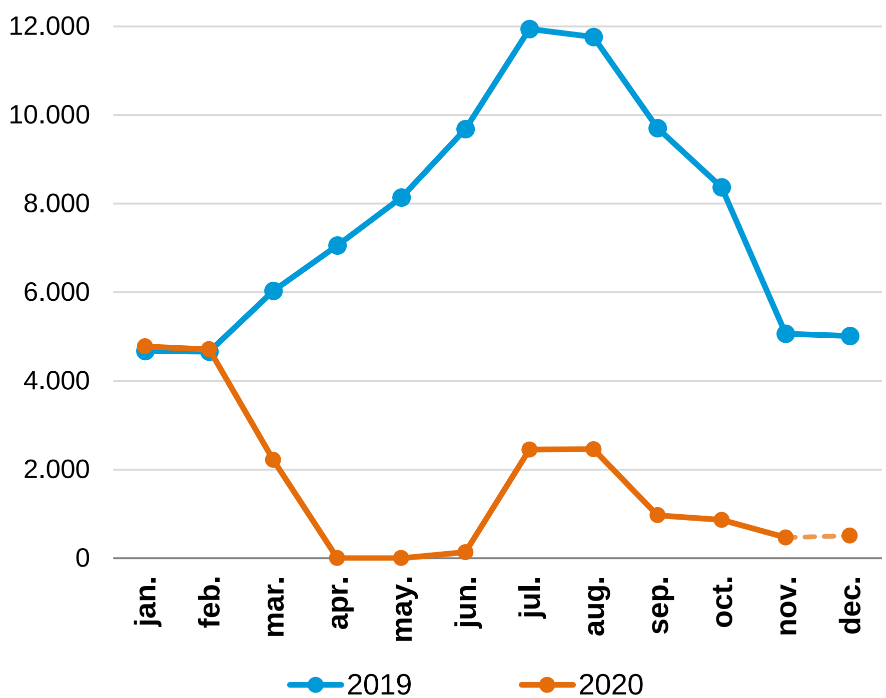
Latest data developments

- **The latest indicators for Q4 are mixed**. Some suggest that GDP may have grown in the quarter, other suggest a small decline. All in all, there appear to be upside risks for our projections (which assumed a decline of 1.7% qoq). With a zero growth rate in Q4 2020, GDP would have declined by 10.9% in 2020 (0.5 p.p. less than in our projection).

Tourism collapsed due to COVID-19 but could recover swiftly once the crisis is over

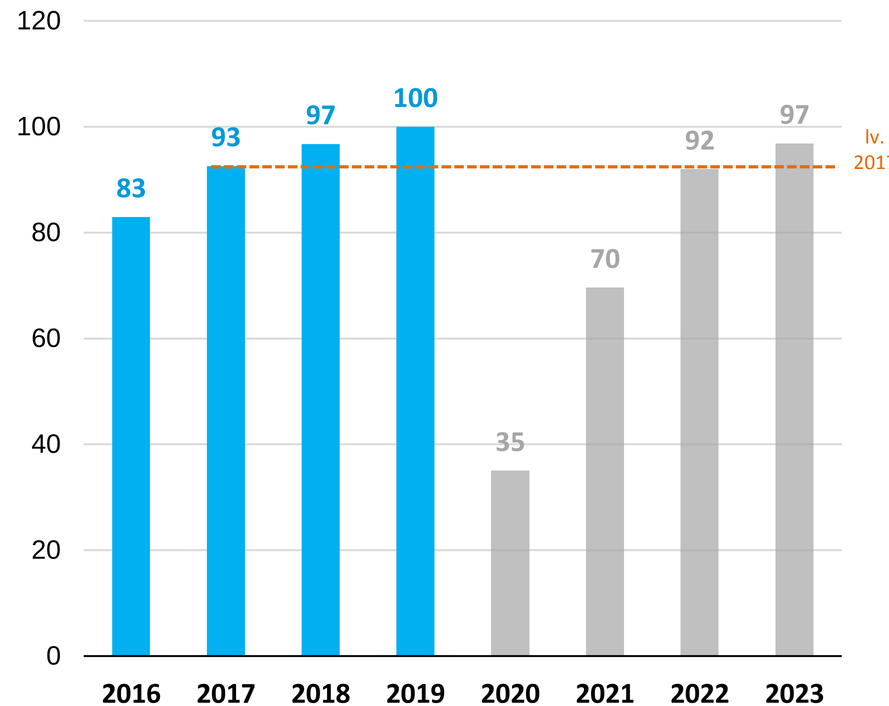
Expenditure of international tourists

€ million



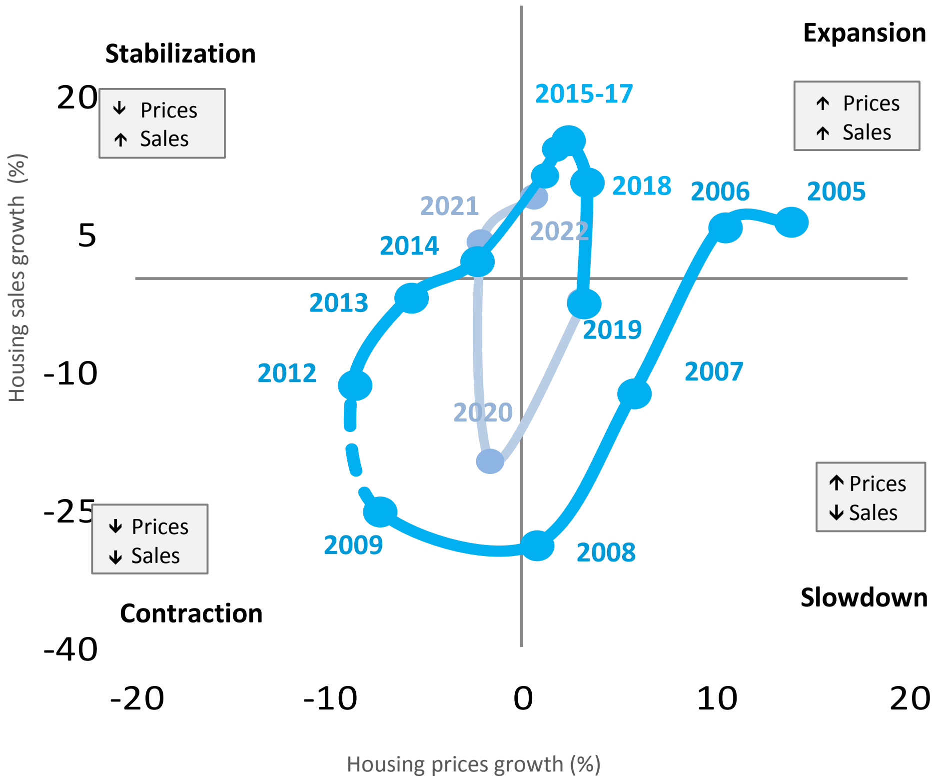
Tourism GDP forecasts

Index (2019 = 100)



- **Tourism has been the hardest hit sector by the pandemic:** In November, only 460k international tourists came to Spain (-90% with respect to Nov-19). Domestic tourism (30% of total tourism demand) was more resilient during 2020. In the coming months it will also remain subdued as a result of the measures taken to fight the latest wave of contagions, although the tourism activity should start to improve in Q2 2021.
- **Tourism GDP is expected to have declined by around 65% in 2020.** Around 60% of the decline in total GDP will be explained by the collapse of tourism.
- **Fundamentals remain strong in spite of the current shock.** The Spanish tourism industry is one of the most competitive worldwide and its recovery may be swift once vaccines are distributed and quick tests widespread –although it will take time to return to pre-pandemic levels.

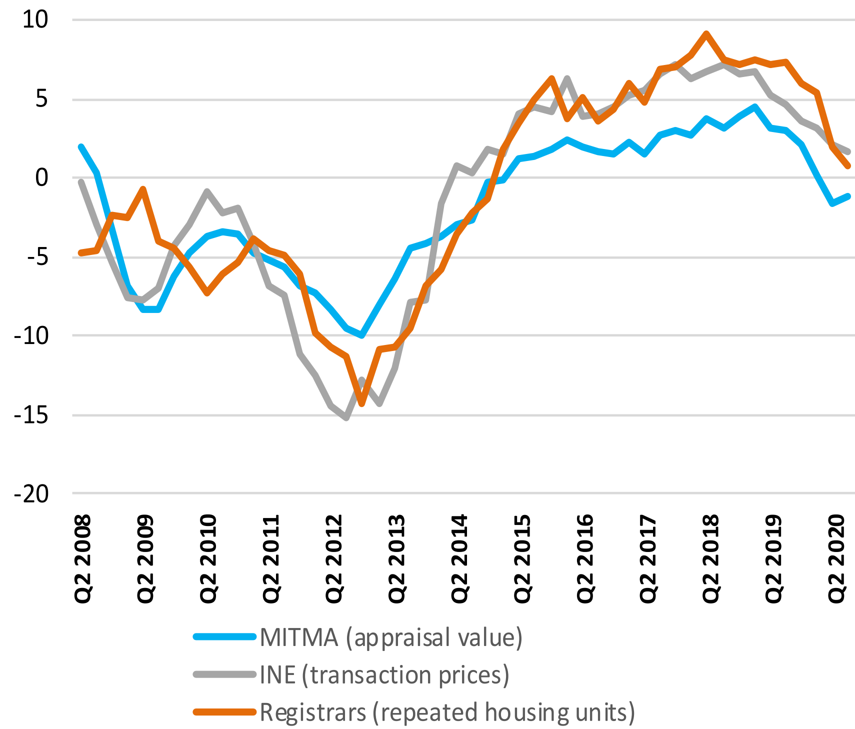
Real estate clock



Source: Fomento, INE and CaixaBank Research forecasts.

Housing prices

Year on year (%)

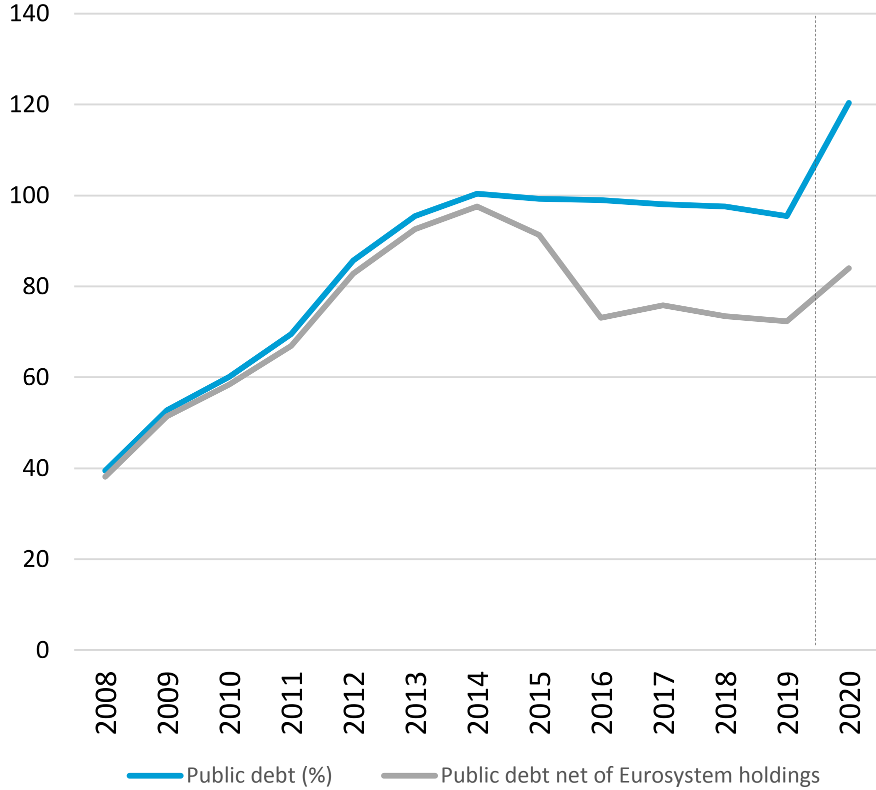


Source: INE, Ministry of Public Works, Association of Registrars.

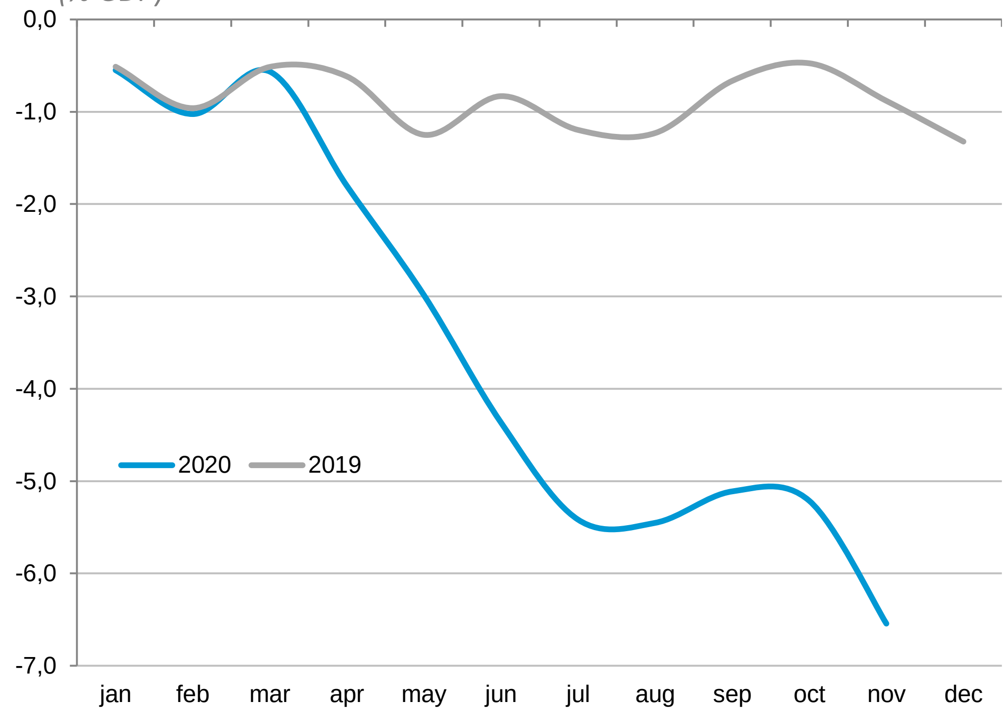
- **The housing sector will experience a temporary contraction in 2020/21**, but the fundamentals remain solid: no excess indebtedness of families and real estate companies, and no excess capacity on the supply side.
- **Housing sales are recovering quite swiftly after their significant drop in Q2 (-43%):** the cumulative drop from January to October is -21.2% yoy. New housing sales are recovering faster (-14.3% yoy cum. Jan-Oct) than sales of second hand housing (-22.8% yoy cum. Jan-Oct).
- Building permits declined sharply in Q2 (-37.2%). Despite their gradual recovery, in October they remained down by -24.0% yoy on a ytd-basis.
- **Housing prices significantly decelerated in Q3 but their decline is limited so far** (-1.1% yoy appraisal value, +1.7% yoy transaction prices, +0.8% registrars' index based on transactions on the same housing units). We expect housing prices to decrease by about 4% in 2020-2021 (cumulative).

In spite of a strong increase in public debt, funding needs are well covered

Public debt
(% GDP)



Central Government net lending needs (-) or capacity (+)
(% GDP)



Note: The graph does not include the net lending needs of Regional Governments and Social Security since their data is only available until October

- **The 2021 government budget envisages a decline in the fiscal deficit from 11.3% in 2020 to 7.7%** in 2021 and the execution of NGEU projects for 26.6bn (c.2.2% of GDP). Revenue estimates, based on real GDP growth of 9.8% next year, appear optimistic and the goal for NGEU spending is very ambitious. On the political side, the new budget was approved without major changes and it came into force on January 1.
- **The European Commission gave the go-ahead to the 2021 budget**. Overall, the EC welcomed measures to support economic activity, but it also underscored the need to preserve fiscal sustainability over the medium term (given high debt levels).
- **The government funding needs for 2021 are well covered**, helped by ECB purchases, plenty of liquidity available and low interest rates.

The Government budget: a strong increase in revenues and spending

Government's budgetary plan 2021

Key elements	% GDP 2019	% GDP 2020	% GDP 2021	2019-2021 change (EUR millions)	2019-2021 growth rate (%)
Total revenue	**39.2**	**41.7**	**40.3**	**5,592**	**1.1**
Indirect taxes (VAT,...)	11.5	11.5	12.0	3,812	2.7
Taxes on income and wealth	10.4	11.3	11.2	7,707	6.0
Social contributions	12.9	14.2	13.0	-1,368	-0.9
Total spending	**42.1**	**53.0**	**48.0**	**63,795**	**12.2**
Worker salaries	10.8	12.9	12.0	12,526	9.3
Social transfers (excl. unemployment)	16.9	20.5	19.6	29,670	14.1
Unemployment schemes	1.5	3.7	1.8	3,373	18.1
Interest payments	2.3	2.3	2.2	-1,687	-5.9
Balance	**-2.8**	**-11.3**	**-7.7**	**-58,203**	**...**

Note: Projections incorporating the macroeconomic impact of the NGEU plan.

Revenue

- Likely overestimation due to optimistic base effect in 2020, high GDP growth forecast in 2021 and not too realistic impact of new tax measures (digital and financial transaction taxes, increase in income and corporate taxes...) on revenues.

Spending (excl. NGEU)

- Strong increase in structural spending.
- Stability in interest payments (thanks to the reduction of interest rates).

Highlighted measures

- New digital, financial and green taxes (0.15% of GDP), higher tax rates on top incomes (0.01% of GDP), caps on corporate tax exemptions (0.04%), and a sugar tax.
- Higher spending on pensions (+3%).

Assessment

- **The Government public deficit target of 7.7% in 2021 is reasonable but may be difficult to attain with the measures in the current budgetary plan and in light of the optimistic forecast at the end of 2020.**

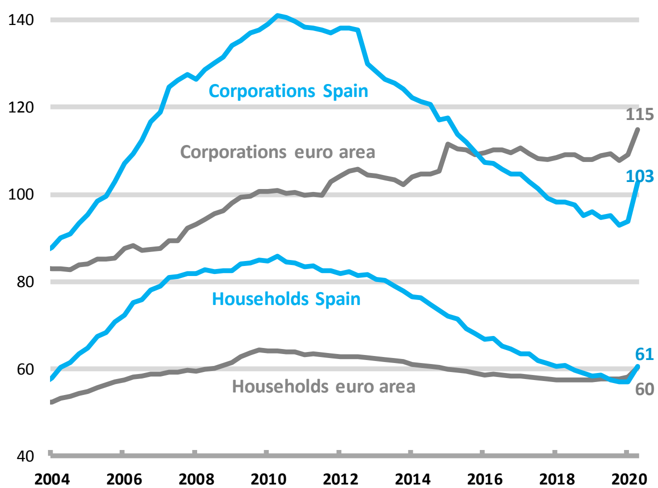
Key fiscal and quasi-fiscal measures

	Amount (% GDP)	Main measures
Direct fiscal measures	4.5%	• Benefits for workers affected by temporary lay-offs (ERTEs) and for the self-employed affected by the hiatus in activity (now: ≈747k in ERTES; Spring: 3.4million). Good measure to alleviate pressure on labour market. About to be extended until May 2021. • COVID-19 Fund for regional government (will help finance mostly health and education). • Lacking: more direct support measures to SMEs and most hit sectors.
Deferrals	1.1%	• Deferral of tax payments for six months (from March to October) in 2021 for SMEs and self-employed (estimated amount:€2.6bn) • Utility bills moratorium and eviction ban for vulnerable families until May 9.
Credit guarantees and capital injections	12.9%	• €100bn on credit guarantees for companies and self-employed to guarantee liquidity wit State guarantee between 70 and 80%. Level of use: €84.3bn of guarantees (end of November) • €40bn on credit guarantees for companies and self-employed to boost investment activity (but also guarantee liquidity). • The concession of these guarantees has been extended until June 2021 and the repayment period extended in 3 years (up to a maximum of 8 years).

The Spanish banking system: supporting an economy hit by covid-19 (1)

Gross private debt

% of GDP, non consolidated debt.



Source: ECB, Eurostat.

Private domestic credit

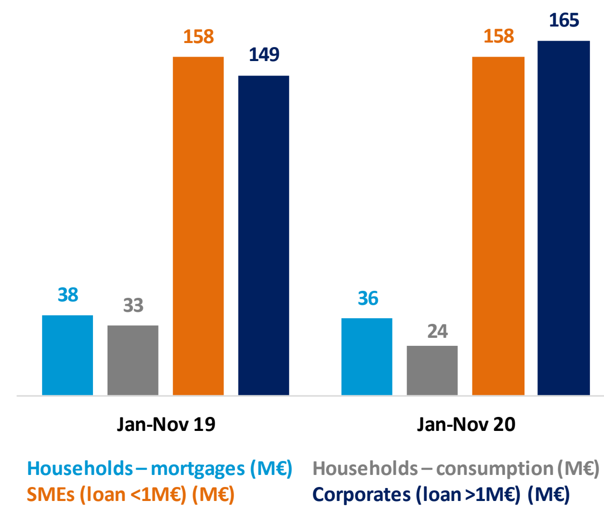
Year on year (%)

	Dec-19	Nov-20 (latest)	2021 (forecast)
	% yoy	% yoy	% yoy
Total credit	**-1,2%**	**2,1%**	**-1,9%**
Households	-0,5%	-1,3%	-1,8%
Housing mortgages	-1,5%	-1,6%	-1,6%
Other purposes	2,6%	-0,5%	-2,5%
Of which consumption	8,8%	-2,2%	-2,5%
Businesses	-2,3%	7,5%	-1,9%
Non-real estate developers[1]	-1,4%	11,7%	-
Real estate developers[1]	-5,4%	-5,8%	-

Note: (1) latest available data Sep-20
Source: Bank of Spain.

New lending activity by sector

Bn euros

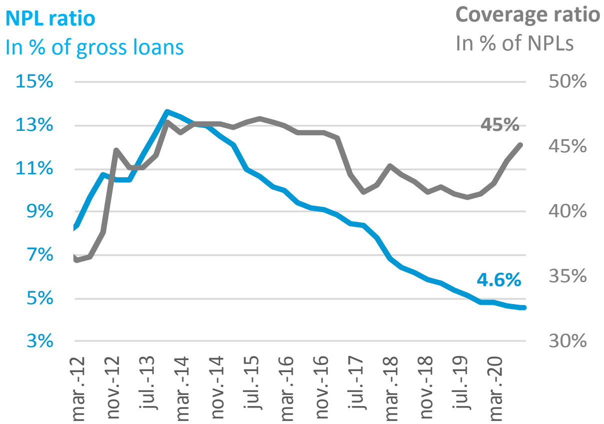


Source: Bank of Spain.

- **Corporate debt levels** remain below euro area averages despite the recent strong pick-up in credit. **Household debt** has increased more modestly reflecting some debt moratoria and higher debt for the self-employed. We expect a protracted period of deleveraging after the covid crisis.
- **New mortgage production** suffered a sharp contraction in March-May due to the sudden stop of housing transactions but has rebounded helped by pent-up demand.
- **New lending for consumption** remains well below pre-covid levels and is expected to show a more subdued recovery.
- **New lending to corporates spiked in March-June** (about 55% of it with government guarantees) but demand has now declined. After the decree law on the extension of ICO guarantees, we expect that there will be a high demand to extend grace periods and maturities.

The Spanish banking system: supporting an economy hit by covid-19 (2)

NPLs and coverage ratios



Moratoria[2]	**Cost of risk[1]**
12% of loans to households 5% of loans to NFC	0.3% in 2019 0.8% in 3Q 2020

Note: (1) Spanish business. Accumulated 12 months based on the average of the 5 largest institutions. (2) Based on EBA data as of Jun20. Source: Bank of Spain and Bank's financial statements.

Banks' profitability

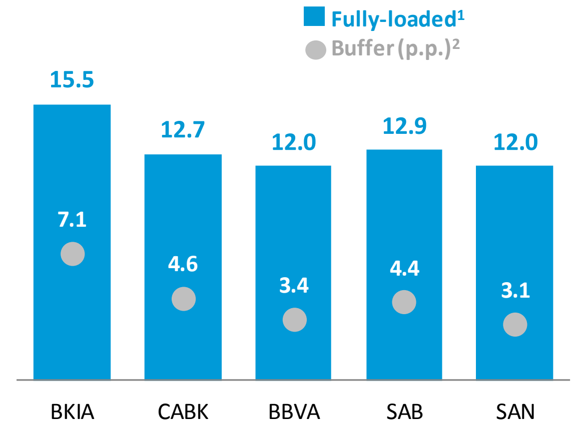
In % of average total assets (Q3 20; trailing 12M)

	CABK	BBVA	SAN	BKIA	SAB
Net interest income	**1.1%**	**0.9%**	**1.1%**	**0.9%**	**1.4%**
Net fees	0.6%	0.5%	0.7%	0.5%	0.7%
Gains on financial assets/liab. and	0.1%	0.1%	0.3%	0.1%	0.1%
Other operating income	0.1%	0.0%	-0.1%	-0.1%	-0.1%
Gross income	**1.9%**	**1.5%**	**2.0%**	**1.5%**	**2.0%**
Operating expenses	-1.1%	-0.8%	-1.2%	-0.8%	-1.2%
Impairment losses, tax and others	-0.6%	-0.5%	-1.4%	-0.5%	-0.6%
Profit	**0.2%**	**0.2%**	**-0.5%**	**0.1%**	**0.2%**
ROTE (%)[1]	5.0	1.5	n.d.	0.7	1.3

Note: Domestic businesses. ROTE based on internal calculations. (1) Group ROTEs for CABK and SAB. BBVA include Corporate Centre (only proportion applicable to business in Spain). SAN not available because DTAs impairment generates significant losses. Source: Bank's financial statements.

Banks' solvency and liquidity position

In % (Q3 20)



	BKIA	CABK	BBVA	SAB	SAN
LCR[3]	**191%**	**280%**	**159%**	**206%**	**171%**

Note: (1) CET1 FL transitional IFRS9. (2) Difference between CET1 ratio fully-loaded and SREP requirement 2019. (3) LCR = liquidity coverage ratio. Source: bank's financial statements.

- After declining below 5%, NPL ratios have roughly stabilized. The stock of NPLs has only increased marginally thus far helped by debt moratoria and loan guarantees. However, **NPLs will inevitably increase** as debt moratoria expire and companies start facing repayments of guaranteed loans.
- **Covid adds even more pressure to banking profitability and the need for further consolidation:**
  - Interest rates are now expected to remain lower for longer.
  - After a temporary pick-up in loan demand, businesses and households are expected to focus on balance sheet repair.
  - The cost of risk has risen. Banks have already booked a significant amount of provisions in the first half of 2020.
- **The capital position of Spanish banks provides buffers to weather the COVID-19 shock.** A recent Bank of Spain top-down analysis estimates a CET1 erosion of 1.6 percentage points in aggregate (to 10.8%) under the central scenario and a decline of 3.9 p.p. in an adverse scenario (to 8.5%).

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Main economic forecasts

%, YoY, unless otherwise specified	2012	2013	2014	2015	2016	2017	2018	2019	Forecast 2020	Forecast 2021	Forecast 2022
GDP	-3.0	-1.4	1.4	3.8	3.0	3.0	2.4	2.0	-11.4	6.0	4.4
Private Consumption	-3.4	-3.0	1.7	2.9	2.6	3.0	1.8	0.9	-13.6	6.6	4.0
Public Consumption	-4.2	-2.1	-0.7	2.0	1.0	1.0	2.6	2.3	3.6	3.3	2.2
Gross Fixed Capital Formation (GFCF)	-7.4	-3.8	4.1	4.9	2.4	6.8	6.1	2.7	-12.4	8.6	7.7
GFCF - equipment	-7.1	2.4	5.6	9.1	1.8	9.2	5.4	4.4	-13.8	16.1	8.5
GFCF - construction	-10.4	-8.2	3.0	1.5	1.6	6.7	9.3	1.6	-15.1	5.5	7.2
Exports	0.9	4.4	4.5	4.3	5.4	5.5	2.3	2.3	-21.1	8.3	7.4
Imports	-5.8	-0.2	6.8	5.1	2.6	6.8	4.2	0.7	-17.3	9.0	7.4
Unemployment rate	24.8	26.1	24.4	22.1	19.6	17.2	15.3	14.1	16.0	17.9	16.5
CPI (average)	2.4	1.4	-0.2	-0.5	-0.2	2.0	1.7	0.7	-0.3	1.0	1.7
External current account balance (% GDP)	0.1	2.0	1.7	2.0	3.2	2.8	1.9	2.1	1.1	1.6	2.0
General Government Balance (% GDP) [1]	-7.0	-6.7	-5.8	-5.1	-4.1	-3.0	-2.5	-2.8	-12.4	-9.2	-6.6
General government debt (% GDP) [2]	85.7	95.5	100.4	99.3	99.0	98.1	97.6	95.5	120.4	119.3	118.6
Housing prices	-8.7	-5.8	-2.4	1.1	1.9	2.4	3.4	3.2	-1.5	-2.0	0.8
Risk premium (vs. 10Y Bund, bps, Dec.)	429	295	149	120	124	120	97	88	86.3	66.4	67.3
Bank credit (to the private domestic sector)	-9.9	-9.4	-7.1	-4.3	-2.9	-1.9	-2.6	-1.2	2.3	-1.9	-0.9

Notes: All GDP figures are based on ESA-2010 methodology.

1/ The general government deficit excludes one-off bank restructuring costs of 3.7% of GDP in 2012, 0.3% of GDP in 2013, 0.1% in 2014, 0.05% in 2015, 0.2% in 2016, 0.04% in 2017 and 0.01% in 2018.
2/ General government debt includes ESM/FROB related borrowings equivalent to 3.9% of GDP in 2012.

Source: CaixaBank Research.