The Spanish economy in the face of the war in Ukraine

The outbreak of war in Ukraine has occurred at a time when things were looking favourable for the Spanish economy. Economic activity gained traction during the course of the past year and in Q4 it grew by a significant 5.2% in year-on-year terms. In addition, the impact of the new wave of infections caused by the Omicron variant was lower than feared. The high proportion of the population that had been vaccinated allowed the pressure on hospitals to remain contained, and that finally allowed us to look to the future with some optimism. It seemed as though we would enter a new phase of the pandemic in the coming months, in which we could recover a more normal life and in which the economic recovery would be consolidated.

In addition to these encouraging prospects was the deployment of NGEU funds, which is set to gather pace in the coming months, providing a boost to growth of well over 1 pp this year. The savings accumulated at the height of the pandemic were expected to continue to drive consumption. International tourism, which held up much better than expected during the months of December and January, was already showing signs of recovery. Internet searches for holidays to Spain were showing significant growth and suggested a very good summer season was ahead. And the bottlenecks, which were limiting the recovery of international trade flows, were expected to gradually moderate. Given these prospects, few doubted that growth this year could well exceed 5%.

However, the war that has broken out in Ukraine makes it now very difficult to predict the course of economic activity, but with every day that passes it seems increasingly unlikely that growth will reach 5%. Given the high uncertainty, it is still premature to sketch out a new macroeconomic scenario. The severity of the conflict's impact will depend on its duration, its geographical scope, and the sanctions and counter-sanctions that are imposed. What we can do is identify the main channels through which it will affect the Spanish economy and offer some metrics that will allow us to assess its sensitivity.

The main impact will undoubtedly come from the sharp rise in energy prices. Net imports of gas and oil amounted to almost 25 billion euros last year. Although the bulk of these imports does not come from Russia, given that prices are set internationally the sharp rise that has occurred will have a direct impact, which could prove significant if this price rise persists over time. As a benchmark, if the price of oil and gas close the year with an average price similar to that which the futures markets have been suggesting in late February and early March (with oil at around 105 dollars per barrel and gas at around 120 euros/MWh), then GDP growth would likely end up just over 1 point below what we were anticipating before the outbreak of the conflict. The impact may be significant, but fortunately the starting point for the growth rate was relatively high.

Also of concern is the rise in inflation that could occur as a result of the rising energy prices. In recent months, we have witnessed how the upward pressures resulting, above all, from the rise in the price of oil, gas and electricity were being translated to the rest of the basket of consumer goods. In January, more than 60% of the goods that make up the consumer price index were already registering price increases in excess of 2% year-on-year. If energy prices end up remaining around the high levels indicated by the futures markets, then inflation could reach around 7% this year on average.

Beyond the aggregate impact on growth and inflation, there are some sub-sectors that will be hit particularly hard by the current circumstances. On the one hand are those which consume significant amounts of energy in their production processes and which, therefore, will be significantly affected by the increase in its price. Examples in the manufacturing sector include the auxiliary construction, metallurgy and timber industries. The agrifood sector will also suffer. It will suffer directly, due to the high imports from Russia and Ukraine of cereals (especially corn), sunflower oil (used, for instance, in tinned food and in all kinds of processed foods, with Russia and Ukraine accounting for 80% of the world's exports) and mineral fertilisers. In addition, the war in Ukraine is triggering a sharp rise in the price of agricultural commodities, and this will also have a major impact on the agrifood sector.

Faced with this situation, a coordinated fiscal response at the European level must once again play a key role. It is important to support those sectors most affected by the high energy and other commodity prices. In addition to trying to minimise the impact on employment, this will also help to prevent the rise in their inputs from being translated to final prices, thus moderating inflationary pressures. Faced with a shock of such a nature and magnitude, it is also imperative to act decisively in order to protect the most vulnerable households. Finally, the urgent transition of the energy model towards one that is more sustainable, from both an environmental and a geopolitical point of view, must be accelerated.

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