The outlook for the Spanish economy improves

The current economic context, marked by the EU energy crisis and the geopolitical conflict between Russia and Ukraine, magnifies the difficulties of making forecasts. The environment is uncertain and changing, and there are different factors that are pushing the Spanish economy in opposite directions. These difficulties, however, must not prevent us from outlining the main factors that we believe will dominate the economy and how it will evolve in the coming months.

All forecasts require us to first understand the starting point. The recent performance of the Spanish economy has been somewhat better than expected. Whereas in late Q3 2022 the consensus of analysts was predicting that economic activity – beset with inflation, uncertainty and rising interest rates – would experience a slight decline in the closing stages of the year, the figure published at the end of January for GDP in Q4 2022 shows that the economy actually managed to dodge this decline and grew by 0.2% quarter-on-quarter. Although modest, this figure highlights the resilience the Spanish economy has shown throughout 2022 to the impact of the energy crisis. However, it was not all good news. The weakness shown by consumption and investment (both fell in quarter-on-quarter terms) is a wake-up call and reflects the fact that the economy is not immune to the current challenging context.

Besides the somewhat better than expected starting point, in 2023 we expect growth to be driven by two major sources. First of all, during 2023 we can expect the European NGEU funds to gain traction. To date, their execution has been somewhat slower than expected (with data between January and November 2022, the aid disbursed in the period reached 29% of the total budgeted for the year). However, the data show that in the second half of 2022 the pace of execution accelerated: whereas between January and June only around 2.6 billion euros were disbursed, the figure for the period between July and November was almost 5.6 billion, more than double. In this regard, if the rate reached during the second half of 2022 is maintained, then the NGEU funds could contribute around 1 pp to GDP growth in 2023.

Secondly, the sectors that were hardest hit by the restrictions on mobility and activity during the pandemic are also likely to continue to gain traction during 2023, particularly the tourism sector. Although in 2022 the sector experienced a strong recovery, it still has some way to go. In particular, European tourism has a significant capacity to recover, as during the 2022 summer season it still remained between 10% and 15% below the levels of 2019 in terms of flights, largely due to the bottlenecks at European airports which are not expected to be repeated in 2023. In addition, long-haul tourism also has a significant margin for recovery: flights from North America, or from the rest of the world excluding the American and European continents, were still some 20% below pre-pandemic levels during the summer. In this regard, the figures for the tourist season in the Canary Islands, which can be taken as a leading indicator since it is now high season there, point to a good year: in terms of hotel overnight stays, in late 2022 the Canary Islands reached the pre-pandemic figures of 2019.

Macroeconomic forecast table

Annual change (%), unless otherwise stated

	2022	2023	2024
GDP	5.5	1.3	1.9
Inflation (level, annual average)	8.4	4.2	2.6
Unemployment rate (% labour force, annual av.)	12.9	12.8	12.4
Home prices	4.9	0.2	1.5
Budget deficit (% of GDP)	4.0	4.0	3.3

Note: *The blank figures are those already confirmed.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

However, there are other factors pushing the economy in the opposite direction, which will limit the pace of growth. These include the cycle of interest rate rises being implemented by the ECB, which is occurring faster than expected and also looks set to go further than foreseen. In September 2022 it was anticipated that the ECB would bring the benchmark rate for the deposit facility up to 2.5%, whereas today the expectation is that it could reach 3.5% by mid-2023. As a benchmark, we estimate that for every 100-bp increase in interest rates, growth tends to slow by 0.4 pps, but estimating its impact in the current context is especially difficult. For instance, the sudden and unexpected change in the pattern of interest rates could make the impact somewhat greater this time around. On the other hand, the high proportion of fixed rate mortgages that have been granted in recent years (66% in 2022) could help mitigate the impact at the aggregate level.

Finally, another element that will continue to limit the Spanish economy's capacity to recover, and that of household consumption in particular, is the increase in prices. After surpassing the 10% barrier in July and August 2022, headline inflation has gradually moderated back down to 5.8% in January 2023. This downward trend has been driven by the fall in energy prices (gas prices, in particular), which has been sharper than anticipated and is explained by a diverse set of factors: a milder than usual winter, the EU's high levels of gas reserves and the reduced demand for gas in European economies, among other factors. The impact of this moderation in energy prices is substantial: in August, the energy component grew by around 40% year-on-year and contributed some 4 pps to headline inflation, but in December, energy fell by around 7% year-on-year, making a negative contribution of 0.7 pps to headline inflation. Looking ahead to 2023, we have incorporated this recent moderation in energy prices into our forecasts (although not entirely, to be prudent), and this should allow inflation to continue to moderate over the coming months.

However, the latest data also show that the rising inflation in the non-energy components is proving more pronounced and persistent than previously anticipated. Particularly noteworthy is the case of food, which since September has outrun the energy component and is now the component contributing the most to inflation (3.9 pps in December). Overall, the inflation rate looks set to remain high this year, with an annual average of 4.2%, and it will therefore continue to limit the growth of household consumption.

In all, the factors mentioned above suggest that growth will be moderate this year, although probably somewhat higher than was expected a few months ago. More specifically, we expect GDP to grow by 1.3% in 2023, up from the 1.0% previously anticipated.

In this context, employment can be expected to continue to grow, albeit at more modest rates than those observed in 2022. Thus, for the year as a whole, we expect employment to grow at rates close to, but slightly below, 1%. This, together with the maintenance of the growth of the labour force at a similar rate to that observed in recent quarters, should allow the unemployment rate to remain quite stable in 2023, with a slight fall of 0.1 pp compared to 2022, placing it at 12.8%.

In addition, the housing market is expected to slow during the year, driven by declining household purchasing power and rising interest rates. In this context, we expect home prices to grow by just 0.2% in 2023. However, insofar as the fundamentals of the property market are strong (no oversupply, households and businesses with debt levels below the euro area average, while credit standards have not been relaxed during the cycle's expansionary period), we do not foresee any sharp corrections in the levels of construction of new housing or prices in nominal terms.

Finally, on the public finances side, our estimates suggest that after taking into account the impact of the recently announced action plan to tackle rising inflation (with a budget of 10 billion euros), the rise in pensions in line with the CPI and the higher costs of debt servicing, the growth rate of expenditure will be similar to that of income. As such, we expect the budget deficit to remain at around 4% of GDP, the same level as we project for 2022.

Oriol Carreras Baquer