New economic scenario: the outlook improves for Spain

It has been almost four months since our last update to the macroeconomic scenario. During these months, the Spanish economy has shown a more resilient tone than expected. Furthermore, the normalisation of gas prices, although incomplete, has been confirmed and the peak in reference interest rates is now in sight. Faced with all these changes, we have updated our macro forecast scenario.

A better-than-expected starting point

Despite the current economic environment being fraught with challenges, the performance of the Spanish economy has been sustained by three key elements: a strong labour market, the marked correction in gas prices and a highly buoyant foreign sector.

Employment, far from slowing down, has stepped on the gas in the early stages of 2023. According to the LFS, employment grew by 1.2% quarter-on-quarter in Q1 2023 in seasonally adjusted terms, which is well above the 0.2% registered in the previous quarter. Looking at the Social Security affiliation data, this positive trend appears to be continuing in Q2 2023. The strong performance of the labour market is giving households greater solvency to cope with the inflationary pressures. It is also supporting the demand outlook for businesses and is creating an effective barrier to the rise of inequality, a crucial factor amid the current cost of living crisis.

At the same time, economic activity has benefited from the fall in the price of natural gas. Following fears that the energy crisis would intensify over the winter, in the end they were alleviated by a more temperate winter than usual, as well as by a marked reduction in consumption and high levels of gas reserves. Whereas the Mibgas benchmark gas price registered an average of around €100/MWh in 2022, during Q1 2023 the average price has stood at around €50/MWh, and so far in Q2 it has fallen to €35/MWh, thus approaching the €20/MWh average for the period 2017-2019.

As for the foreign sector, it has been highly buoyant, driven largely by tourism. To illustrate this, despite international tourist arrivals in Q1 2023 still lying 3.5% below the same quarter of 2019, their expenditure in real terms was 12.1% higher. While tourism has been the primary driver of foreign demand, it has not been the only one. The trade balance of non-energy goods registered a surplus of 1,639 million euros in the quarter, thanks to the increase in exports (15.1% year-on-year) exceeding that of imports (7.3%). This balance is the best Q1 record since 2014, and it stands in contrast with the deficit of 4,364 million registered in Q1 2022. Also, not all the improvement in the balance is attributable to price effects. In terms of volume, exports grew by 3.6% year-on-year compared to a fall in imports of 2.2%. In addition, the pattern of exports of non-tourism services has been highly favourable. The trade balance of non-tourism services reached a surplus of 10,460 million euros, well above the balance of Q1 2022, when it stood at 5,892 million euros. This improvement has been driven by a combination of strong export growth (18% year-on-year) and a fall in imports (–6%).

In short, all these factors have led to GDP exceeding expectations during Q1, alleviating fears of a recession in the short term.[1]

Key assumptions of the scenario: inflation and interest rates

However, the outlook is not without its obstacles. High inflation and interest rates are leaving their mark on the economy. Fortunately, those shocks that triggered the inflation rally are beginning to fade. As we mentioned earlier, energy prices have experienced a significant decline and are now close to their historical average levels. In addition, the famous bottlenecks, a legacy of the process of economies reopening in the late stages of the pandemic, are also beginning to dissipate and this is alleviating pressures in the early stages of the price formation chain.

The recent correction in energy prices has given way to a substantial moderation in headline inflation. With data up to April, it has already dropped to 4.1%, compared to the 8.4% average registered in 2022, and this is despite food prices still rising by 12.4%.[2] Core inflation, which excludes food and energy, is slightly higher than the headline inflation rate, at 4.6%. This is due to the delayed effects of the transmission of the cost increases that businesses have been facing since last year (contagion effect).

For 2023, we project that headline inflation will be 3.9% on average. This forecast incorporates the substantial fall in energy prices, but also the greater persistence of core inflation and that of food. However, we expect that these pressures will gradually ease and that by 2024 inflation will be below 3% in annual average terms.

These projections are based on the assumption that there will not be significant second-round effects. While wages are gradually incorporating the impact of inflation,

1. See the Brief Note for further information on the reported GDP figure.
2. The May inflation flash indicator shows a continuation of the trend of slowing inflation, standing at 3.2%. However, we will have to await the definitive announcement to find out the breakdown by component.

there are incipient signs that wage growth could stabilise at around 4%-4.5% this year. Wage growth of this magnitude should not pose an upward risk for inflation. In this regard, the recent wage agreement reached between the various social agents should be viewed positively, because it helps to reduce uncertainty and limit the occurrence of second-round effects.

With regards to interest rates, the ECB remains concerned about the lack of obvious signs of moderation in core inflation in the euro area and it has signalled its intention to raise interest rates a little further. But it is also true that the cumulative increase of almost 4 pps (from –0.50% to +3.25%) is very substantial and that its effects are already beginning to be felt, for example, in the demand for credit. Therefore, we expect the ECB to raise the depo rate to a peak of 3.75% (which is in line with market expectations) and to keep it there until mid-2024. This reflects a more gradual path towards monetary policy normalisation than we were previously expecting. Nevertheless, based on its recent communications, we believe that the ECB will opt to keep rates higher for longer in order to ensure that inflation falls to 2% in the medium term.

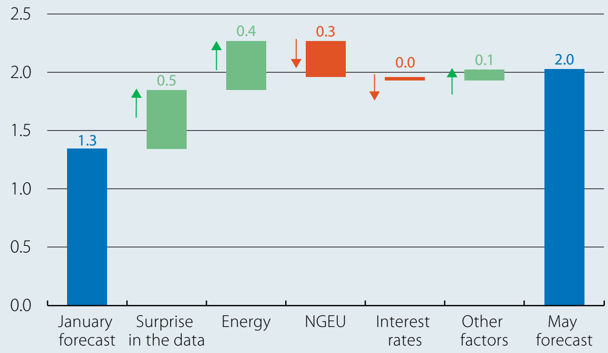
However, the high inflation and interest rates are leaving clear traces in their wake. Private consumption has been declining for two consecutive quarters, while higher frequency indicators, such as our internal indicator based on card spending, are showing no signs of any clear improvement in the immediate future. In 2022, rising prices led to a sharp increase in spending. Private consumption in nominal terms grew by over 10%, compared to a more moderate growth of 3.6% in gross disposable income. Consequently, the savings rate decreased from 13.7% in 2021 to 7.2% in 2022. Given that the savings rate is approaching its historical average (6.7% between 2014 and 2019), consumption in 2023 could be more closely linked to the growth of disposable income. However, while we expect disposable income to grow at a higher rate – specifically at around 4.5%, thanks to the rebound in wage growth and the expected good performance of employment – we also project that inflation will remain high, at 3.9%. This will limit the growth of consumption in real terms. Similarly, investment is also reflecting the effects of the higher cost of credit and has been showing signs of weakness since the spring of 2022. While the European funds will continue to provide support, we expect investment will continue to experience only moderate growth during the remainder of 2023.

Outlook

All in all, 2023 looks set to continue to be a year full of challenges. This is a year in which the economy will continue to endure high inflation and the impact of the interest rate hikes, but it will also be able to enjoy some support factors. In particular, it will receive a boost from the almost complete fading of the energy shock, the good performance of the foreign sector thanks to the margin for recovery which the sectors hardest hit by the pandemic still have, and the contribution from the European funds. After incorporating all the information, we expect GDP to grow by 2.0% in 2023 as a whole, representing a 0.7-pp upward revision compared to our previous forecast. As the chart shows, this revision is largely explained by the improvement of the economic data in the latter part of 2022 and by the fall in energy prices that has been reflected in a good performance of the economy in Q1 2023. The assumption regarding the execution of European funds has limited the scale of the revision, as the forecasts now incorporate a somewhat more conservative degree of execution. Nevertheless, the effect of the NGEU funds will remain very significant, contributing 0.7 pps to annual GDP growth. As for the higher-for-longer interest rates, we expect this factor will still have only a moderate impact in 2023, becoming more pronounced in 2024.

Oriol Carreras

Spain: breakdown of the revision of the 2023 GDP growth forecast
(pps)



Source: *CaixaBank Research.*