New macroeconomic outlook: Spain's economic growth moderates

In the last year and a half, our economy has been besieged by a three-headed hydra. The hydra is the outbreak of the war between Russia and Ukraine, and the three heads are the different manifestations of this shock: an energy crisis, a strong inflationary episode and the consequent tightening of monetary policy. The first, besides the recent rally in oil prices, is now behind us. The second is what we are still going through. And the third is now beginning to rear its head. Over the next 12 months we will see whether the dose of monetary policy that has been administered will be sufficient to tame inflation, as well as what damage it will have done to economic activity. In this article we present our outlook.

Brief overview of recent dynamics

As we emerged from the summer, we found an economy in the midst of a slowdown compared to the significant growth rates recorded in the first half of 2023. Job creation, while still positive, has gone from growing at quarter-on-quarter rates of around 1% in the first half of the year to more moderate rates of 0.1% in Q3 to date (adjusting, of course, for seasonal effects). In addition, the early indicators based on surveys, such as the Purchasing Managers' Indices (PMIs), reveal that in addition to the weakness shown by the manufacturing sector in recent quarters there is now a loss of momentum in the services sector. In August, both the manufacturing and services PMIs stood below the growth threshold. While we should not draw hasty conclusions from such readings, they are a clear indication of a slowdown. Based on these indicators, our estimates suggest that GDP could grow by around 0.2% quarter-on-quarter in Q3 2023, compared to rates of 0.5%-0.6% observed in the first half of the year.

The international context is not helping matters either. Our main trading partners in the euro area are also showing signs of slowing down, and since mid-July a combination of demand and supply factors have been driving the oil price back up again. Whereas in June the average price of a barrel of Brent stood at 75 dollars, in the first two weeks of September it recorded an average price of 91 dollars – an increase of just over 20%. This increase in the oil price has been reflected in inflation, which since June has been back on the rise, partly due to the strong momentum of the fuel component.

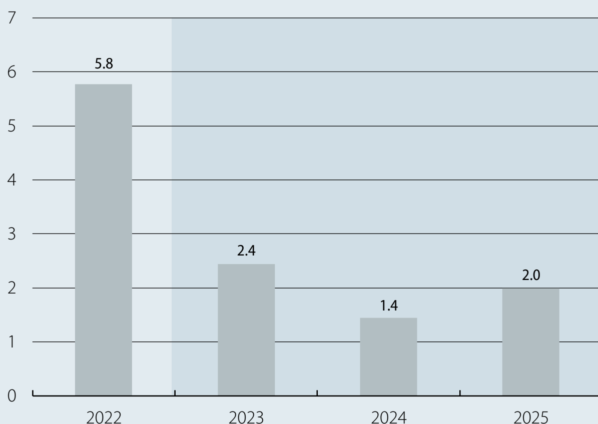
Changes in the underlying assumptions behind the forecast scenario: energy and interest rates

Against a backdrop of slowing economic activity, assumptions about the evolution of oil prices and interest rates which underlie the forecast scenarios have also tightened.

The recent dynamics in the oil market have led us to revise our projection for the Brent barrel price higher. Whereas in our July forecast we expected to see an oil price of around 80 dollars a barrel at the end of 2023 and an average price of 78 dollars in 2024, in our current forecast scenario we expect the current year to close with the oil price at 85 dollars and the 2024 average to stand at 81 dollars. However, with the Brent oil price recently hovering around the 95-dollar mark, the risks surrounding the forecast are skewed to the upside.

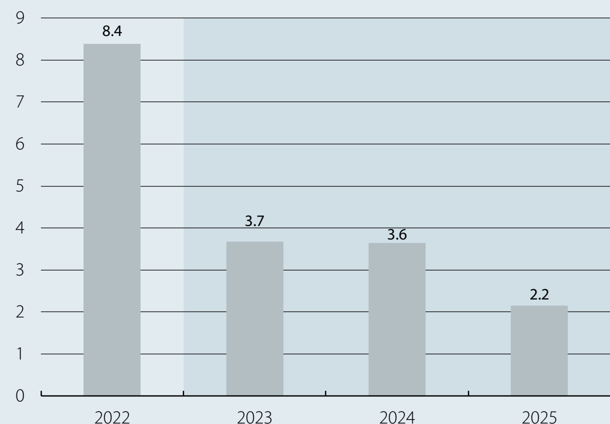
In the case of the euro area's core inflation (which excludes energy and food), this is the key variable that the ECB is monitoring and it is still too high (5.3%). Moreover, the rate at which it is descending is insufficient, in the opinion of the top European

Spain: GDP growth forecast
Annual change (%)



Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: inflation forecast
Annual change (%)



Source: *CaixaBank Research, based on data from the National Statistics Institute.*

authority. Thus, at its last meeting in September, the ECB raised the depo rate to 4.0% (and the refi rate to 4.5%), noting that, although it probably would not continue to raise rates, it would maintain them at their current levels for an extended period of time in order to ensure inflation converges towards its medium-term target of 2%. Market expectations are therefore that the ECB will not begin to lower rates until the second half of 2024 and that, when it eventually does, it will do so gradually. Our own forecast is that the central bank's reference rates will remain at their current levels until the end of next summer. Anticipating this turning point, it is logical to expect market rates such as the 12-month Euribor to fall below their current levels by early 2024, after which they will follow a downward trend.

Future outlook

Against this backdrop, we expect that the Spanish economy will experience a period of modest growth during the next two quarters, with GDP growth rates of around 0.3% quarter-on-quarter, mainly affected by the impact of the cycle of interest rate hikes which began in July 2022 and by the marked weakness of our main export markets.[1] Although the tourism sector will continue to act as a driving force for growth, its contribution will no longer be as high as in recent quarters, since activity levels equal to or higher than those of 2019 have already been reached. As such, domestic demand is expected to provide the biggest contribution to growth in these coming quarters.

In particularly, although it is also affected by the higher interest rates, domestic demand will enjoy certain supporting factors. Firstly, with an assumed growth rate in employment of around 1.5% in 2024 and with wages growing in the 3%-3.5% range, in line with the guidelines recommended by the agreement between unions and business associations, we expect household gross disposable income to grow above inflation (forecast average growth of 3.6% in the year), despite the gradual increase in net interest payments.[2] It should be recalled that, in the midst of a cost-of-living crisis, the fact that the economy continues to generate jobs is in itself a major source of support for economic activity, insofar as it gives households a degree of certainty. Secondly, the European NGEU funds are expected to continue to support growth and, in particular, investment. Specifically, we expect these funds could contribute around 0.4 pps to GDP growth in 2024, assuming a slight acceleration in the pace of execution.

Inflation dynamics, meanwhile, should follow a pattern of moderation. To understand this moderation process, it is useful to divide the inflationary episode of the last two years into three phases. The first phase saw the materialisation of the direct impact of the sharp rise in energy and food prices. This shock, although not completely behind us – particularly on the food side and, more recently, with the rise in oil prices – has already run much of its course. In the second phase, which was more predominant in the closing stages of 2022 and in 2023, we saw the materialisation of the contagion effect of the higher costs of energy inputs and food on other products. While we believe these indirect effects have not yet run their course entirely, there cannot be much life left in them. Thirdly and finally are the dreaded second-round effects, which could lead to even more persistent inflation. These effects capture the impact of a possible decoupling of medium-term inflation expectations and the vicious circle of price increases that could be triggered by sharp rises in wages or corporate margins. Since the data available to date do not show any signs of concern in these regards, our forecast scenario assumes a limited impact from second-round effects. Thus, to the extent that the direct impact has already largely faded, that the contagion effect is gradually exhausted in the remainder of 2023 and in 2024 and that few second-round effects are expected, we should see a moderation in inflation rates during the course of 2024.

That said, our forecast is that average annual inflation in 2024 will be similar to that of 2023 (3.7% in 2023 and 3.6% in 2024). This is due to the impact of the withdrawal – expected in early 2024 – of the fiscal measures that were implemented to tackle the rise in energy and food prices (the VAT cut on electricity and food and the public transport subsidy). We estimate that the withdrawal of these measures will add around 1 pp to headline inflation during 2024. However, if we look at the forecast for core inflation (i.e. that which excludes energy and unprocessed foods), the forecast is one of gradual moderation: from 6.1% on average in 2023 to 3.1% in 2024.

Overall, we expect the economy, after growing 2.4% in 2023, to moderate its growth rate to 1.4% in 2024, albeit with a gently accelerating profile throughout the year. This forecast for 2024 is 0.3 pps lower than that contemplated in our previous scenario, due to the impact of the change in the underlying assumptions. Looking ahead to 2025, thanks to the anticipated gradual decline in interest rates and the convergence of inflation towards its 2% target, the Spanish economy ought to follow a growth path that is more in line with its potential growth rate, placing the growth forecast at 2%.

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1. We expect euro area GDP to grow by just 0.7% in 2024.
2. We expect gross disposable income, including the impact of higher interest payments, to grow by 5.3% in 2024.