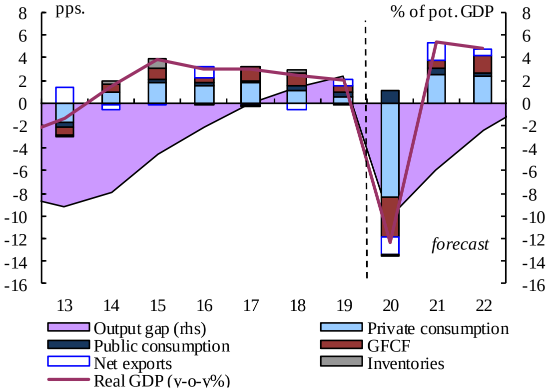
6. SPAIN

The COVID-19 pandemic and the strict confinement measures put in place in Spain to contain it have led to an unprecedented downturn in economic activity this year. Measures to limit job losses and support the corporate sector have cushioned the impact. Output is forecast to rebound strongly in the second half of the year, but the recovery will be uneven across sectors and the significant increase in the unemployment rate this year will be only partly reversed over the next two years. The economic downturn is set to worsen the general government balance, which will decrease gradually from 2021 onwards.

An unprecedented decline followed by a strong rebound in the third quarter

The severe outbreak of the COVID-19 pandemic in Spain and the strict confinement measures taken in response resulted in an unprecedented decline in GDP in the first half of the year (22.1% compared to the end of 2019). The end of the lockdown and the easing of containment measures allowed economic activity to resume over the second quarter, as shown by the strong rebound in manufacturing and service sector indicators in May and June. Following the reopening of borders at the end of the second quarter, airline flights and tourist arrivals increased quickly in July, supporting economic activity in the leisure sector. The resurgence of numerous outbreaks over the summer prompted some European countries to request quarantines for travellers returning from some Spanish regions, and the progressive adoption by Spanish authorities of social distancing measures. As a result, rebound of activity is expected to peter out over the last quarter of this year.

Graph II.6.1: **Spain - Real GDP growth and contributions, output gap**



Overall, real GDP is expected to contract 12½% in 2020, as a whole, and expand by 5½% in 2021. As a result, output at the end of 2022, is projected to remain about 3% below its pre-pandemic 2019 level. After the sharp drop in private consumption and investment in 2020, consumer spending is expected to be supported by pent-up demand unleashed progressively throughout 2021. The household savings rate is forecast to decrease, after having peaked in 2020 due to the forced savings accumulated during the confinement period. However, uncertainty regarding the dynamics of the pandemic and its potential impact on employment are likely to keep precautionary savings above pre-crisis levels in 2021 and 2022, and will also weigh on investment decisions in early 2021. Exports are forecast to shrink strongly in 2020, in the context of declining global growth and a severe impact of the crisis on the tourism sector. Though imports will also contract in 2020, the contribution of net exports to growth is expected to be negative this year but should turn positive in 2021, as trade flows recover and inbound tourism rebounds.

Inflation is forecast to remain very low in the second half of 2020, dominated by the fall in energy prices and the appreciation of the euro. In 2021, headline inflation is expected to increase to 0.9%, and should remain at that level in 2022 as core inflation increases gently.

Policy measures have cushioned the impact of the COVID crisis

Existing short-time work schemes (‘ERTEs’) were made more generous at the outset of the crisis so as to mitigate job losses. They have been extended several times and are currently legislated to remain in place until the end of January 2021, though more targeted to those firms or sectors most affected by the containment measures. In addition, several measures were taken to protect the self-employed by means of benefits for suspension of activity, which have also been extended until January 2021. These schemes have done much to contain job losses but could not avoid them altogether. Hence, the fall in employment is projected to push the unemployment rate up to 16.7% in 2020, and is forecast to increase further in 2021 when ERTEs are scheduled to be phased out. In 2022, job creation is expected to reduce the unemployment rate to around 17%. Corporate liquidity was enhanced by the programme of public guarantees for new bank loans and payment moratoria, among other measures. The take-up of liquidity loans backed by public guarantees has been high (about 80%), which has helped to cushion firms from the fall in revenues while demand is gradually strengthening. Nevertheless, impaired profitability could lead to the materialisation of corporate insolvencies and downside risks for productive capacity and employment. The Spanish authorities have announced the main elements of a policy package for 2021 to be funded by the Recovery and Resilience Facility. The Commission forecast does not incorporate its potentially significant positive impact on economic growth in 2021 and beyond. According to government estimates, based on full and swift absorption and high multipliers, it would increase real GDP growth by about 2.5 pps in 2021.

Government debt to reach record levels

After widening to a revised 2.9% of GDP in 2019, the general government deficit has increased substantially in 2020 as a result of the COVID-19 crisis. This is due both to the contraction of tax bases affecting revenues as well as to policy measures to counteract the impact of the pandemic costing about 1.3% of GDP. These factors are likely to widen the deficit to around 12% of GDP in 2020. In 2021, the deficit should narrow to around 9½% of GDP, as economic activity rebounds and with most of the measures put in place to respond to the COVID-19 crisis expected to have been phased out and some revenue-increasing measures introduced. Based on a no-policy change assumption, the deficit is forecast to narrow to 8½% in 2022. Public guarantees equivalent to 14% of GDP provide crucial support, but also constitute a risk to the fiscal outlook. Due to the large government deficit and the severe contraction in GDP, the general government debt-to-GDP ratio is expected to rise by almost 25 pps., from 95.5% of GDP in 2019 to around 120% by 2020, a level that is expected to increase somewhat in following years. Higher GDP growth generated by the implementation of the investment and reform package announced in the Draft Budgetary Plan would help the debt-to-GDP to evolve more favourably.

Table II.6.1:

Main features of country forecast - SPAIN

	2019			Annual percentage change						
	bn EUR	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP		1244.8	100.0	1.5	3.0	2.4	2.0	**-12.4**	**5.4**	**4.8**
Private Consumption		713.8	57.3	1.2	3.0	1.8	0.9	**-14.6**	**4.5**	**4.2**
Public Consumption		234.9	18.9	2.6	1.0	2.6	2.3	**6.0**	**2.1**	**1.7**
Gross fixed capital formation		247.3	19.9	0.0	6.8	6.1	2.7	**-17.3**	**3.8**	**8.5**
of which: equipment		79.8	6.4	0.7	9.2	5.4	4.4	**-23.4**	**5.8**	**10.2**
Exports (goods and services)		434.3	34.9	3.2	5.5	2.3	2.3	**-22.1**	**14.2**	**7.8**
Imports (goods and services)		396.9	31.9	2.0	6.8	4.2	0.7	**-18.9**	**9.4**	**7.0**
GNI (GDP deflator)		1246.6	100.1	1.6	2.8	2.6	1.9	**-11.7**	**4.7**	**4.7**
Contribution to GDP growth:	Domestic demand			1.2	3.2	2.7	1.5	**-10.7**	**3.7**	**4.2**
	Inventories			0.0	0.0	0.3	-0.1	**-0.1**	**0.0**	**0.0**
	Net exports			0.3	-0.2	-0.5	0.6	**-1.7**	**1.6**	**0.5**
Employment				0.4	2.8	2.5	2.3	**-8.7**	**3.5**	**2.0**
Unemployment rate (a)				16.1	17.2	15.3	14.1	**16.7**	**17.9**	**17.3**
Compensation of employees / f.t.e.				2.4	0.7	1.0	2.1	**1.9**	**0.0**	**0.8**
Unit labour costs whole economy				1.3	0.6	1.1	2.4	**6.2**	**-1.8**	**-1.9**
Real unit labour cost				-0.5	-0.7	-0.1	1.0	**5.5**	**-2.8**	**-2.8**
Saving rate of households (b)				8.4	5.8	5.6	6.3	**18.2**	**15.3**	**13.3**
GDP deflator				1.9	1.3	1.2	1.4	**0.7**	**1.1**	**1.0**
Harmonised index of consumer prices				2.1	2.0	1.7	0.8	**-0.2**	**0.9**	**1.0**
Terms of trade goods				0.1	-0.4	-1.4	-0.5	**2.4**	**-0.2**	**-0.2**
Trade balance (goods) (c)				-4.8	-1.9	-2.5	-2.1	**-0.2**	**-0.1**	**-0.8**
Current-account balance (c)				-3.3	2.8	1.9	2.1	**1.8**	**2.5**	**2.8**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-2.8	3.0	2.4	2.5	**2.2**	**2.9**	**3.1**
General government balance (c)				-4.0	-3.0	-2.5	-2.9	**-12.2**	**-9.6**	**-8.6**
Cyclically-adjusted budget balance (d)				-3.3	-3.0	-3.3	-4.2	**-6.2**	**-6.0**	**-7.2**
Structural budget balance (d)				-	-2.9	-3.0	-4.0	**-6.0**	**-6.0**	**-7.2**
General government gross debt (c)				63.8	98.6	97.4	95.5	**120.3**	**122.0**	**123.9**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.