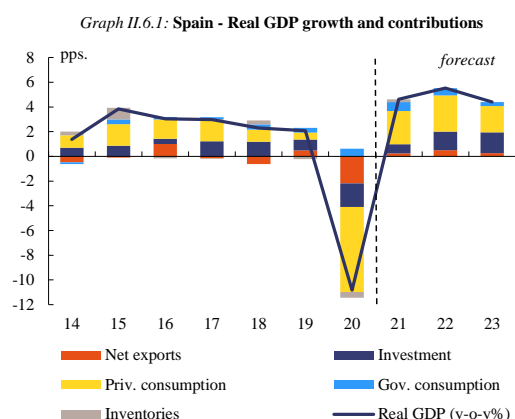


6. SPAIN

After recording the deepest contraction in the EU in 2020, the economic recovery is gaining traction in Spain. The implementation of the Recovery and Resilience Plan will sustain the economic momentum over the forecast horizon and spur public and private investment. The labour market has shown remarkable resilience compared to previous crises and the unemployment rate is expected to fall below its pre-crisis level by 2023. Inflation has risen in 2021 and is projected to remain high until mid-2022. The general government deficit is set to improve to 5.2% in 2022 and 4.2% in 2023 due to a good revenue performance and the supportive macroeconomic scenario.

Recovery is gaining traction in the second half of 2021

The containment measures still in force dragged down economic activity in the first half of 2021, with a moderate GDP contraction in the first quarter (-0.6%) followed by a softer-than-expected rebound in the second quarter (1.1%). Since the lifting of the state of emergency in mid-May, backed by the success of the vaccination campaign, the Spanish economy has entered into a steady recovery. The service sector, including leisure and tourism-related activities, is finally supporting the recovery. Job creation has accelerated in recent months and confidence indicators remain very high for both manufacturing and services. In this context, real GDP is set to speed up in the second half of the year and achieve an annual growth rate of 4.6% in 2021, with private consumption as its main driver.



The RRP will boost economic growth over the forecast horizon

Following the rebound in the second half of 2021, the Spanish economy is set to continue to grow in 2022 and close the gap with its pre-pandemic level of GDP by 2023-Q1. Private consumption growth is projected to remain strong with the impulse of

savings accumulated during the pandemic and the recovery of employment. Meanwhile, the implementation of the Recovery and Resilience Plan (RRP) will gain traction, thereby spurring public and private investment. The forecast incorporates expenditures financed by RRF grants for a cumulative amount of 5.0% of 2019 GDP over the forecast horizon. The external sector is also expected to contribute positively to GDP growth throughout the forecast horizon, thanks to the gradual normalisation of international tourism. Economic activity is forecast to continue to expand in 2023, still under the impulse of the RRF-financed expenditure and reforms, although quarterly growth rates are set to moderate as the output gap turns positive.

Overall, real GDP is projected to grow by 5.5% in 2022 and by 4.4% in 2023. While uncertainty has decreased significantly thanks to the control of the health situation at national level, there are still several risks to the outlook. The persistence or resurgence of the pandemic in other countries could weigh on economic growth, notably by delaying a full recovery in the tourism sector. Supply-side bottlenecks and energy and transport prices could delay the recovery in the short-term, while labour market mismatches could affect the implementation of green and digital investments connected to the RRP. By contrast, the implementation of the RRP could lead to more powerful crowding-in effects and a stronger impact of key reforms on potential growth.

Inflation to remain high in the short term

Headline inflation reached 2% in April and 4% in September, due to the surge of gas and electricity prices. These are expected to remain at record levels until 2022-Q2, despite some measures adopted by the government to contain them, including reduced VAT rates. In addition, pensions' indexation will put some upward pressure on core inflation. However, the remaining

large slack in the Spanish labour market should help to contain wages and limit second round effects. As a result, current inflationary pressures are expected to start to fade in the second half of 2022. Overall, HICP inflation is forecast to reach 2.8% in 2021, moderate to 2.1% in 2022 and abate to 0.7% in 2023 due to strong (negative) base effects in energy prices. In turn, core inflation is projected to increase from 0.6% in 2021 to 1.5% in 2022 and ease to 1.3% in 2023.

The labour market is recovering fast, upheld by policy measures

Short-term work schemes (so-called 'ERTEs') remarkably mitigated job destruction during the initial stages of the COVID-19 crisis and have paved the way for a quick recovery of the labour market. Both the number of workers and the unemployment rate have roughly recovered to their pre-pandemic levels, although around 200 000 employees remain subject to ERTEs (1% of total employment). The Spanish government plans to replace the current extraordinary scheme with a new one of structural nature, with a greater focus on reskilling and up-skilling of workers. The unemployment rate is expected to decline throughout the forecast horizon, from 15.2% in 2021 to 13.9% in 2023.

Government deficit decreasing but still high

The COVID-19 pandemic and the necessary measures taken by the government to overcome the crisis caused an exceptional deterioration in Spain's public finances. The general government deficit reached 11% of GDP in 2020 and the gross debt-to-GDP ratio rose by almost 25pps. With economic growth resuming in 2021-Q2, the government deficit started to decrease thanks in particular to higher income tax and VAT revenues. The phasing out of several measures introduced to contain the impact of the pandemic and the solid performance from the revenue side are set to reduce the deficit to 8.1% of GDP in 2021. The debt, marginally increasing to at 120.6% of GDP in 2021, is expected to gradually come down from 2022. A supportive macroeconomic scenario, partly due to the implementation of the RRP, and the action of automatic stabilisers are set to help the debt-to-GDP ratio decrease to 118.2% and keep improving the general government balance, with the deficit at 5.2% in 2022. Sustained economic growth in 2023 and the containment of total current expenditure will be the main drivers of further public deficit reduction, to 4.2%, and of the debt ratio to 116.9%.

Table II.6.1:

Main features of country forecast - SPAIN

	2020			Annual percentage change						
	bn EUR	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP	1121.9		100.0	1.4	2.3	2.1	-10.8	4.6	5.5	4.4
Private Consumption	628.0		56.0	1.1	1.7	1.0	-12.0	4.8	5.2	3.8
Public Consumption	245.3		21.9	2.5	2.3	2.0	3.3	3.3	2.7	1.5
Gross fixed capital formation	227.6		20.3	0.1	6.3	4.5	-9.5	3.7	7.4	8.1
of which: equipment	67.0		6.0	1.3	4.7	3.2	-12.9	15.0	8.0	7.5
Exports (goods and services)	343.6		30.6	3.3	1.7	2.5	-20.1	12.1	10.4	7.1
Imports (goods and services)	327.0		29.1	2.2	3.9	1.2	-15.2	11.9	9.2	6.6
GNI (GDP deflator)	1128.5		100.6	1.5	2.4	2.2	-10.5	4.2	5.5	4.4
Contribution to GDP growth:										
Domestic demand				1.2	2.6	1.8	-8.2	4.2	5.0	4.1
Inventories				0.0	0.3	-0.2	-0.5	0.2	0.0	0.0
Net exports				0.3	-0.6	0.5	-2.2	0.2	0.5	0.3
Employment				0.4	2.5	2.3	-7.6	4.5	2.8	2.3
Unemployment rate (a)				16.5	15.3	14.1	15.5	15.2	14.3	13.9
Compensation of employees / head				2.3	1.2	2.8	1.3	-0.3	2.1	1.7
Unit labour costs whole economy				1.2	1.4	3.0	5.0	-0.4	-0.5	-0.4
Real unit labour cost				-0.5	0.2	1.6	3.8	-1.9	-2.0	-1.3
Saving rate of households (b)				8.2	5.6	8.3	15.0	11.7	8.3	6.1
GDP deflator				1.7	1.2	1.3	1.1	1.5	1.6	0.9
Harmonised index of consumer prices				2.1	1.7	0.8	-0.3	2.8	2.1	0.7
Terms of trade goods				0.0	-0.7	-0.5	2.8	-0.9	-0.1	-0.1
Trade balance (goods) (c)				-4.6	-2.4	-2.2	-0.8	-1.5	-2.2	-2.5
Current-account balance (c)				-2.9	1.9	2.1	0.8	0.3	0.8	1.0
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-2.4	2.4	2.4	1.2	1.5	2.3	2.6
General government balance (c)				-4.2	-2.5	-2.9	-11.0	-8.1	-5.2	-4.2
Cyclically-adjusted budget balance (d)				-3.2	-3.3	-4.3	-5.7	-4.7	-4.1	-4.6
Structural budget balance (d)				-2.2	-3.0	-4.1	-4.5	-4.7	-4.1	-4.6
General government gross debt (c)				66.5	97.5	95.5	120.0	120.6	118.2	116.9

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.