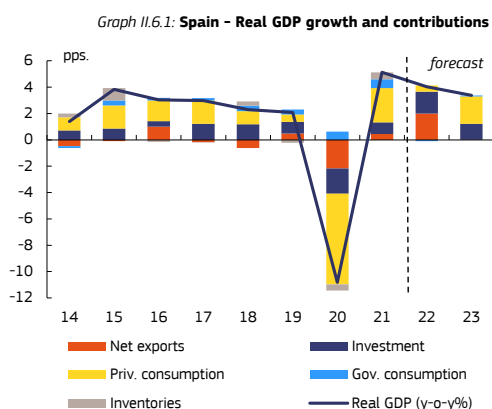


6. SPAIN

The economic recovery is expected to continue in Spain despite the disruptions created by Russia's war of aggression against Ukraine. Investments under the RRP and the recovery of the tourism sector are set to underpin economic growth over the forecast horizon. Real GDP is set to expand by 4.0% in 2022 and 3.4% in 2023. Headline inflation is projected to peak by mid-2022 and average 6.3% in 2022. The labour market is expected to remain strong, with the unemployment rate at its lowest level since 2008. The general government balance is set to improve, helped by strong revenues.

Economic growth to slow down in 2022-H1

Spain's real GDP grew by 5.1% in 2021, partly recovering from the unprecedented decline in 2020 (-10.8%). Economic growth accelerated in the second half of the year thanks to the COVID-19 vaccination campaign and the gradual relaxation of pandemic-related containment measures, the revival of international tourism and the strength of domestic demand. The Spanish economy was keeping momentum at the beginning of 2022, but supply disruptions and escalation of inflationary pressures in the context of the war have slowed down economic activity since the end of February. As a result, real GDP grew by 0.3% q-o-q in 2022-Q1 (compared to 2.2% in 2021-Q4), restrained by the strong contraction of private consumption. Further deceleration is expected in the second quarter (0.1%) due to the persistence of headwinds to growth.



Positive prospects despite deterioration of the balance of risks

Overall, real GDP is projected to grow by 4.0% in 2022 and by 3.4% in 2023, delaying the closure of the gap with the pre-crisis GDP level until mid-2023. Revived tourism activity has been the main driver of economic growth since

the summer of 2021 and is expected to keep momentum in 2022, allowing for a large contribution of net exports to GDP growth. Economic growth is set to accelerate as from 2022-Q3 thanks to the faster implementation of investments under the RRP and some reactivation of private consumption. The latter is expected to be supported by the strong labour market and the savings accumulated during the pandemic. However, the deterioration of households' purchasing power in a context of high inflation and declining real wages is expected to weigh as a drag. Private consumption is projected to remain below its pre-pandemic level over the forecast horizon.

Downside risks are predominant in a context of large global uncertainty. Energy prices have increased in Spain faster than in most of the euro area countries. Further price escalation may hit particularly hard activity in sectors such as transport, construction and electro-intensive industry. Consumption and investment decisions could be postponed until current disruptions fade away. Private consumption could be further affected by the persisting impact of inflation on households' purchasing power, particularly on those at the bottom of the income distribution. In addition, shortages of inputs in sectors receiving a large share of RRP funds (e.g. construction) could affect the delivery of green and digital investments envisaged in the plan. Conversely, RRP investments could lead to wider crowding-in effects than projected and a stronger-than-assumed impact on potential growth could materialise from key RRP reforms.

Inflation to remain high in the medium-term

Energy prices have been the main driver of the steep increase in the HICP rate since the spring of 2021 (7.9% y-o-y in 2022-Q1), although the pass-through effect into the prices of other

goods and services is becoming more and more evident. HICP inflation is expected to slowly start to ease by mid-year, helped by governmental measures such as fuel discounts and the cap on wholesale gas prices. Still, annual HICP inflation is forecast to increase from 3.0% in 2021 to 6.3% in 2022. In 2023, the reversal of base effects of energy prices is expected to reduce annual HICP inflation to 1.8%. Core inflation is projected to remain high over the forecast period, reaching 3.9% in 2022 and easing to 2.7% in 2023.

Strong labour market amid wage pressures

The labour market gained resilience during the pandemic thanks to the short-term work schemes (so-called 'ERTEs') put in place. As a result, at the end of 2021 the unemployment rate was at its lowest level since 2008. Further decreases are expected over the forecast horizon (from 14.8% in 2021 to 13.0% in 2023), on the back of continued job creation and the availability of the newly created 'RED mechanism' to support firms and workers in transition. Wage growth is set to accelerate but at a slower pace than prices, resulting in losses in households' purchasing power and a decline in households' savings ratio going forward.

Strong revenues drive the improvement of the government balance

Spain ended 2021 with a better than expected general government balance. The recovery of economic activity and a strong revenue performance drove the reduction of the public deficit from 10.3% of GDP to 6.9%. In addition, most COVID-19-related measures became more targeted and created space for the measures to cushion the impact of the rising energy prices.

In 2022, the government deficit is set to narrow further on the back of sustained economic growth and the continued strength of revenues, particularly from taxes on production and imports. On the expenditure side, the measures to ease the consequences of Russia's war of aggression against Ukraine will weigh on the deficit that is projected at 4.9% of GDP.

In 2023, the government deficit is set to continue decreasing (4.4% of GDP), reflecting dynamic economic growth and expenditure moderation that compensate the gradual return of revenues to their traditional elasticities. However, the indexation of pensions may result in higher than envisaged expenditure if inflationary pressures remain.

Public debt is projected to gradually decrease to 113.7% of GDP in 2023 mostly driven by nominal GDP growth.

Table II.6.1:

Main features of country forecast - SPAIN

| | 2021 | | Annual percentage change | | | | | | | |
|-------------------------------------|--------|--------------|--------------------------|-------|-------|------|-------|-------|-------|-------|
| | bn EUR | Curr. prices | % GDP | 02-17 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| GDP | 1205.1 | | 100.0 | 1.4 | 2.3 | 2.1 | -10.8 | 5.1 | 4.0 | 3.4 |
| Private Consumption | 669.7 | | 55.6 | 1.1 | 1.7 | 1.0 | -12.0 | 4.6 | 0.8 | 3.8 |
| Public Consumption | 258.1 | | 21.4 | 2.5 | 2.3 | 2.0 | 3.3 | 3.1 | -0.5 | 0.4 |
| Gross fixed capital formation | 242.0 | | 20.1 | 0.1 | 6.3 | 4.5 | -9.5 | 4.3 | 8.3 | 5.8 |
| Exports (goods and services) | 420.8 | | 34.9 | 3.3 | 1.7 | 2.5 | -20.1 | 14.7 | 13.6 | 4.6 |
| Imports (goods and services) | 402.6 | | 33.4 | 2.2 | 3.9 | 1.2 | -15.2 | 13.9 | 8.3 | 4.8 |
| GNI (GDP deflator) | 1211.3 | | 100.5 | 1.5 | 2.4 | 2.2 | -10.5 | 5.1 | 4.2 | 3.3 |
| Contribution to GDP growth: | | | | | | | | | | |
| Domestic demand | | | | 1.2 | 2.6 | 1.8 | -8.2 | 4.1 | 2.0 | 3.4 |
| Inventories | | | | 0.0 | 0.3 | -0.2 | -0.5 | 0.5 | 0.0 | 0.0 |
| Net exports | | | | 0.3 | -0.6 | 0.5 | -2.2 | 0.5 | 2.0 | 0.0 |
| Employment | | | | 0.4 | 2.2 | 2.6 | -7.6 | 6.6 | 3.3 | 1.6 |
| Unemployment rate (a) | | | | 16.5 | 15.3 | 14.1 | 15.5 | 14.8 | 13.4 | 13.0 |
| Compensation of employees / head | | | | 2.3 | 1.8 | 2.5 | 1.3 | -0.6 | 2.8 | 3.0 |
| Unit labour costs whole economy | | | | 1.2 | 1.7 | 3.1 | 5.0 | 0.8 | 2.1 | 1.2 |
| Saving rate of households (b) | | | | 8.2 | 5.6 | 8.3 | 15.0 | 11.4 | 9.7 | 8.8 |
| GDP deflator | | | | 1.7 | 1.2 | 1.3 | 1.1 | 2.2 | 3.7 | 2.4 |
| Harmonised index of consumer prices | | | | 2.1 | 1.7 | 0.8 | -0.3 | 3.0 | 6.3 | 1.8 |
| Terms of trade goods | | | | 0.0 | -0.7 | -0.5 | 2.8 | -0.2 | -2.8 | 1.1 |
| Trade balance (goods) (c) | | | | -4.6 | -2.4 | -2.2 | -0.8 | -1.7 | -4.4 | -4.1 |
| Current-account balance (c) | | | | -2.9 | 1.9 | 2.1 | 0.8 | 1.0 | 1.8 | 2.1 |
| General government balance (c) | | | | -4.3 | -2.6 | -3.1 | -10.3 | -6.9 | -4.9 | -4.4 |
| Structural budget balance (d) | | | | -1.9 | -2.8 | -3.9 | -4.3 | -3.8 | -3.5 | -4.3 |
| General government gross debt (c) | | | | 66.5 | 100.5 | 98.3 | 120.0 | 118.4 | 115.1 | 113.7 |

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