

## Spain: A resilient service sector

In the midst of higher inflation and somewhat weaker than expected overall growth numbers, the Spanish services sector remains in good shape



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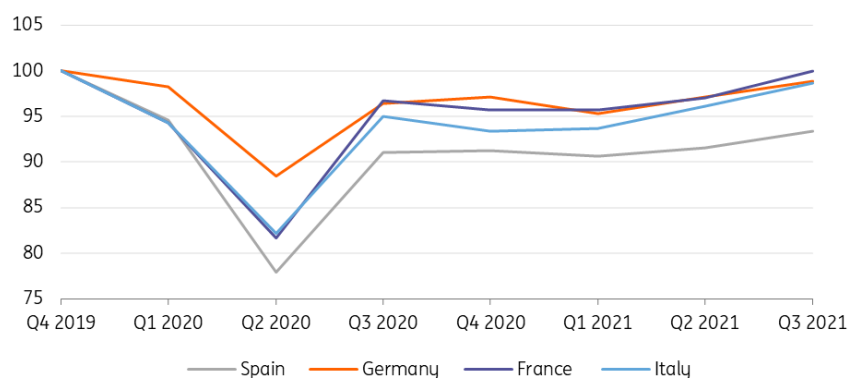
### Disappointing GDP figures

Last week, the GDP growth number for the third quarter came in at 2.0% quarter-on-quarter, close to the eurozone average, but the consensus was closer to 3%. Given these figures, economic activity in Spain is still 6.6% below pre-pandemic levels, a much larger gap compared to other eurozone countries.

The weaker than expected growth was mainly due a contraction in household consumption of 0.5% quarter-on-quarter. This is indeed surprising as consumer confidence continued to improve over recent months and is now even above the five-year average. INE, the Spanish statistical office, warned that the flash estimates is based on less information than usual. We therefore do not rule out an upward revision to the data.

## Spain's recovery is slower compared to other European countries

GDP level Q4 2019 = 100



Source: Refinitiv Datastream

## High inflation

Another reason for caution: the inflation figures. Headline inflation increased from 4.0% in September to 5.5% in October. Just as in the rest of Europe, the sharp increase is mainly due to higher energy costs. But the recent closing of the Maghreb-Europe pipeline - which is responsible for 20% of Spanish natural gas imports - due to tensions between Algeria and Morocco, intensified the energy crisis. Spain will now get its gas via a pipeline that connects Algeria directly with Spain. Unfortunately, this set up will be more expensive.

Higher energy prices are not, however, the only reason for higher headline inflation. Core inflation (CPI) also continued to rise from 1.0% in September to 1.4% in October. Though still low, this is now a higher level than before the pandemic. This shows that companies are starting to pass higher input prices on to consumers. Earlier this week, the PMI for the manufacturing sector showed that supply-side challenges and rising prices are a serious concern and have started to harm production as well as demand. The indicator dropped from 58.1 in September to 57.4 in October. Indeed, sustained supply-side challenges are leading to rising prices, which in turn weakens demand. According to a survey from the European Commission, 27% of Spanish industrial firms claim that a shortage of material and/or equipment is limiting production. This is the highest level ever recorded.

## A resilient service sector

The PMI for the services sector, however, was better than expected. Indeed, activity growth slowed much less than expected. The purchasing manager's index dropped from 56.9 in September to 56.6 in October, a level still firmly above the 50.0 no-change mark. Business in the service sector reported a sharp increase in incoming business and this also led to a pick up in job growth. Service businesses are, however, not immune to the rising input cost and they also report input price increases. These businesses also increased their own prices as a result.

## Conclusion

For the coming quarters, we continue to believe that the recovery will continue, but at a slowing pace. The weaker than expected growth figures in the third quarter mechanically push down our growth forecasts for 2021 and 2022. We do not rule out an upward revision to the GDP figures for 3Q but coupled with the higher inflation and an easing of the bounce back effect, we have downgraded our growth forecast for 2021 to 4.3%, and for 2022 to 4.0%. These figures would imply that the pre-pandemic activity level will still not be reached by the end of 2022.