

Spain: leads the pack for European growth in 2023

We expect Spain's economy to grow by 0.9% this year, considerably less than in 2022, but better than most other eurozone countries. Headline inflation will fall further thanks to favourable energy effects but underlying inflationary pressures will remain high for some time



Thanks to a relatively more service-oriented economy and a positive contribution from tourism, Spain is likely to outperform the eurozone average

The strong reopening effect completely faded away in the second half of 2022

The Spanish economy cooled sharply in the second half of last year. Although the big drop in energy prices and cooling inflation have led to cautious optimism among companies and households, we expect the recovery to be very slow this year. Financial conditions will tighten further in 2023. The European Central Bank announced at the last policy meeting in December that interest rates still need to go significantly higher, and further 50bp rate hikes will follow. The ECB's deposit rate now sits at 2%, the level considered the neutral level where the economy is neither stimulated nor restricted. Thus, additional interest rate hikes will certainly dampen economic activity in 2023.

Consumption will also remain under pressure as inflationary pressures will further erode

purchasing power in 2023. Households are also very cautious about tapping into the savings accumulated during the Covid-19 pandemic to maintain consumption. The current energy crisis is just prompting more precautionary savings and, moreover, the value of these savings has already been eroded by the sharp price increases. In addition, rising mortgage rates will take an extra bite out of the budget of Spanish borrowers with variable interest rates, which are the majority in Spain. On the other hand, the tight labour market will support consumption.

Spain likely to outperform other eurozone countries in 2023

We expect the Spanish economy to do slightly better than the eurozone average. Spain is less dependent on gas and the economy is relatively more reliant on the service sector. A further recovery in the tourism sector will also contribute positively to growth rates. In the first 11 months of 2022, the number of international visitors was still 15% lower than in the same period in 2019. We expect the number of international visitors to continue to rise gradually and exceed pre-crisis levels by summer. Finally, the roll-out of Next Generation EU (NGEU) funds will make a positive contribution to growth rates in 2023.

In addition, the housing market is also much healthier than during the financial crisis. The high number of households with variable interest rates is a risk, but for now, there are no worrying signs that the number of households unable to repay their loans is rising sharply, helped by some government measures introduced last year. A scenario similar to what was seen during the financial crisis will not be repeated. The sharp rise in interest rates and the energy crisis will likely put an end to the sharp price increases of recent years, but we expect this to be very gradual. For this year, we expect house prices to grow by about 1%.

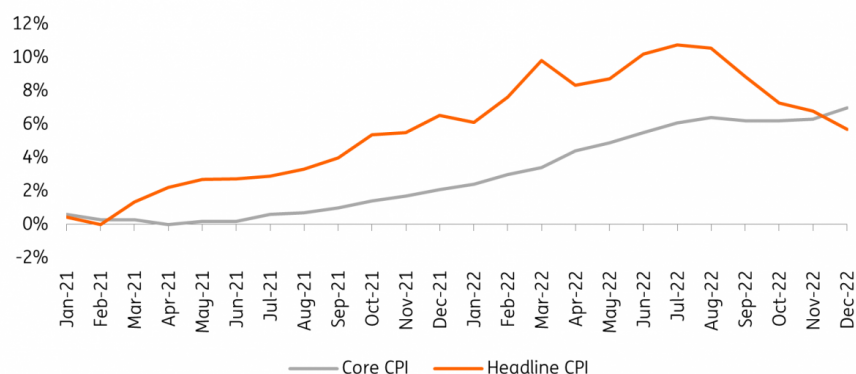
Underlying inflationary pressures remain high

Spanish inflation has cooled solidly since its peak. Harmonised inflation fell to 5.5% in December from 6.7% the month before, significantly below the eurozone average of 9.2%. The fall in Spanish inflation has started much earlier and more firmly than in other eurozone countries, thanks to a host of government measures and a greater cooling of energy inflation. Electricity inflation already turned negative in October and gas inflation is also falling sharply. In late December, Spain's Sanchez government announced a new €10bn package to address the cost-of-living crisis. The new package includes a VAT cut on essential food items and a six-month rent freeze, which will further reduce inflation in the coming months. Although lower energy prices and government measures have brought some temporary relief to headline inflation, the inflationary pressures in the rest of the economy are still very high. Core inflation, excluding the more volatile food and energy prices, reached a record high of 7% in December, a strong acceleration from 6.3% in November. As a result, core inflation is now above headline inflation for the first time since the start of 2021.

For 2023, we project average inflation at 3.7%. Although the headline inflation will fall further thanks to these favourable base effects for energy, it will take somewhat longer for the pace of the food price increases to moderate and for underlying inflation to resume a downward trajectory. Food inflation reached a new record high of 15.7% year-on-year in December and the feed-through of higher labour and energy costs to final food prices is likely to continue in 2023. Moreover, fertiliser exports were severely disrupted last year, which might also affect global food production in 2023 and push food prices up. Moreover, fertiliser exports were severely disrupted last year by the war in Ukraine, which could also affect global food production in 2023 and cause

higher food prices. Moreover, the Iberian gas price cap also expires at the end of May, meaning gas-fired power plants will have to pay more for their gas again. This will also put upward pressure on the inflation rate.

Spanish core inflation above headline inflation for the first time



Source: INE

Modest growth rate in 2023

Spain experienced a very strong reopening effect after the pandemic, but this effect faded away in the second half of 2022. Tightened financial conditions and an ongoing cost of living crisis will weigh on the growth outlook in 2023. Thanks to a relatively more service-oriented economy and a positive contribution from tourism, Spain is likely to outperform the eurozone average. For 2023, we expect growth of 0.9%.

The Spanish economy in a nutshell (% YOY)

	2021	2022F	2023F	2024F
GDP	5.5	4.3	0.9	1.9
Private consumption	6.0	1.8	0.4	2.0
Investment	0.9	4.9	1.8	2.2
Government consumption	2.9	-1.4	0.1	0.1
Net trade contribution	0.3	3.3	-0.3	-0.5
Headline CPI	3.0	8.5	3.7	2.6
Unemployment rate (%)	14.8	12.8	12.9	13.4
Budget balance as % of GDP	-6.9	-4.3	-4.7	-4.3
Government debt as % of GDP	118.3	113.9	113.2	112.6

Source: Thomson Reuters, all forecasts ING estimates