

Spain: Tourism and employment boom puts economy back on track

The first quarter of 2022 will be impacted by the Omicron wave, but from the second quarter onwards we expect the economy to grow faster again. A strong labour market, an uplift in public investment, and a further recovery of the tourism sector will boost economic activity. Inflation is high, but we expect it to come down this year



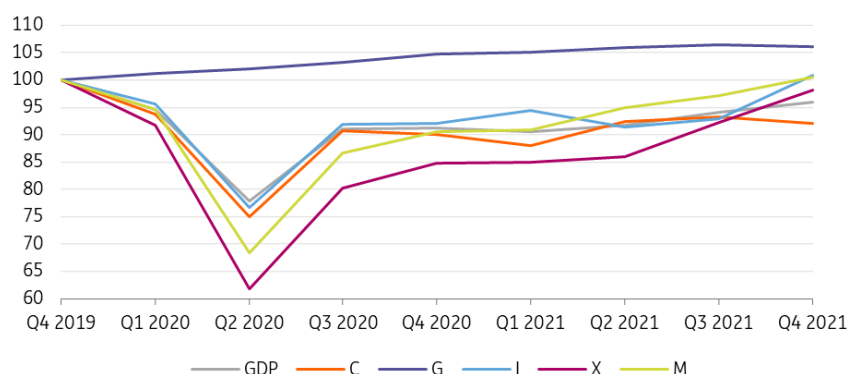
Spain's tourism sector has not yet fully recovered from the Covid-19 pandemic, but this gives more potential to support growth in the years to come

Stronger growth from 2Q onwards

The Spanish economy ended 2021 on a strong note. GDP growth came in at 2% quarter-on-quarter, which was higher than expectations. Due to the Covid-19 Omicron wave consumption contracted, but investment and exports grew sharply. The economy is now about 4% smaller than pre-pandemic levels. This is in contrast to the eurozone as a whole, which reached its pre-pandemic level in 4Q21.

Survey data, however, points to a weakening in the first quarter of this year caused by Omicron. But from the second quarter onwards we expect the economy to grow faster again. The main reasons for this are a vibrant labour market, a boost to public investment, and a continued recovery of the tourism sector. High inflation, however, is currently a threat, even though we think it will come down over the year.

Evolution of GDP and components during the pandemic (4Q 2019 = 100)

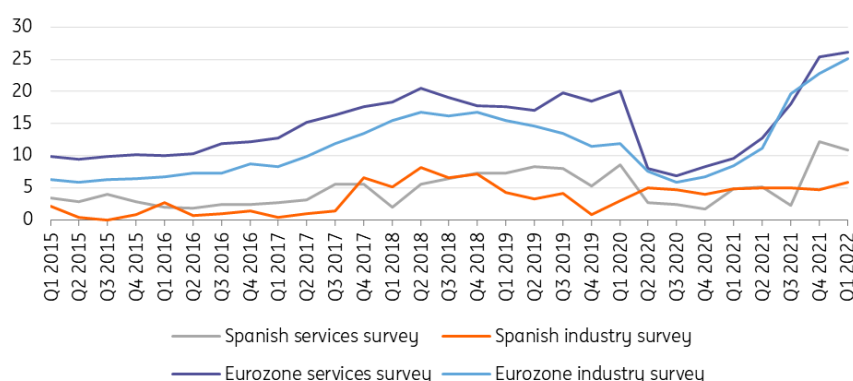


Source: Refinitiv

A very strong labour market will support consumption

Historically, the negative impact of a recession on the Spanish labour market is quite extreme and long-lasting. But the impact of the pandemic is already digested. Indeed, there are currently more people registered with the social security system and fewer people are jobless than before the pandemic. The unemployment rate was 13.3% in the final quarter of 2021, which is lower than before the pandemic. Looking ahead, it is likely that the unemployment rate will continue to fall. Demand remains strong as industrial companies indicate that their order books are richly filled, even more so than before the pandemic. And the number of businesses that report labour shortages is still limited, certainly compared to the eurozone.

Figure 2: Spanish companies are less labour strapped (% of businesses saying that labour limits their production)



Source: Refinitiv

Structural problems in the labour market are still with us

All this is obviously good news for short-term economic activity, but that does not mean the structural problems in the labour market are history. Indeed, the Spanish unemployment rate is still almost double the rate of the eurozone, youth unemployment is very high, and almost one in four Spanish workers is on a temporary contract.

The latest labour market reform, which tweaks the 2012 measures and focuses on limiting the use of temporary contracts, caused a lot of discussion on the political front. It is backed by businesses and unions, but initially it did not have sufficient support in parliament. Surprisingly, it did pass recently... by [accident](#). This could obviously cause some political tension.

Rise in public investment will support growth

The labour reform is also important for short-to-medium term activity as it would help to secure new NextGenerationEU (NGEU) funds which should boost public investment. The Spanish government wants to frontload the EU money and spend 77% of the €70bn in grants (about 4.5% of 2021 GDP) over the period 2021-23. The next instalment of €14bn should be requested before April. Even though we think this rate of absorption is very ambitious, the NGEU will still have a positive impact on growth in 2022 and 2023.

Another issue that will support public investment is the budget for 2022, the largest in Spanish history. It was approved at the end of last year, which lowered political uncertainty and includes €40bn of investments (including NGEU funds).

Tourism sector will further recover

During the first quarter of this year, the tourism sector will still be affected by the Omicron wave, but we think that from the second quarter onwards the sector will be able to continue its recovery. In 2021 the tourism sector was able to recuperate but less than expected due to travel restrictions and new Covid waves. The number of international tourists grew from about 19 million in 2020 to about 31 million in 2021, but this is still about 52 million (!) less than in 2019. Since this sector has not yet fully recovered, this of course gives more potential to support growth in the years to come.

Inflation should come down during 2022

As for the whole of Europe, rising inflation is a threat to the Spanish economy. Headline inflation was about 0% at the beginning of 2021, but in January 2022 it equalled about 6%. Core inflation started to rise in the middle of 2021 from about 0.2% to 2.4% in January 2022. The biggest contributor to the rise was higher energy prices, and this item has a larger weight in Spain than the eurozone as a whole. But the sharp rise of core inflation warrants caution. Indeed, higher energy prices can feed into other consumer prices and on top of that more and more companies are saying that they will increase their selling prices. We nevertheless expect that inflation will come down during 2022 as we do not expect energy prices to rise as much in 2022 as they did in 2021. They might even come down. However, due to second-round effects, we expect about 2.5% headline inflation at the end of 2022, which is higher than pre-pandemic levels of about 1.0%.

Conclusion

All in all, the economic outlook is good for Spain. We expect the economy to grow by about 5.0% in 2022, matching the 5.0% growth in 2021. For 2023 we expect about 3% growth. In this scenario the Spanish economy would reach its pre-pandemic level in the first half of 2023. Indeed, the firm labour market, a push of public investment, a further recovery of the tourism sector and declining inflation should all help to push the economy further.

The Spanish economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-10.8	5.0	5.0	3.0
Private Consumption	-12.0	4.6	5.0	3.2
Investment	-11.4	6.6	9.0	4.4
Government Consumption	3.3	3.0	1.6	1.4
Net trade contribution	-1.7	0.5	0.7	0.2
Headline CPI	-0.3	3.0	4.0	2.2
Unemployment rate (%)	15.6	14.8	12.0	9.5
Budget balance in % of GDP	-11.0	-8.2	-4.7	-3.0
Government debt in % of GDP	120	120	115	113

Source: Refinitiv Datastream, all forecasts ING estimates

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