

## Spain: Getting more confident about the recovery

After a difficult period around the turn of the year, the manufacturing sector continues to boom. The PMI for the manufacturing sector rose for the third consecutive month to 57.7, the highest level in more than 21 years



### Strong activity ahead

Demand was strong, both from at home and abroad, and companies said that clients were confident about the future. Firms wanted to raise production volumes, and they did, but supply side issues (high demand and shortages of certain inputs) limited this. Vendor delivery times lengthened sharply and the backlog of work grew as a result. To manage the extra workload companies also increased employment at the highest degree since early 2018.

This is obviously good news for economic activity in the next few months. After the 0.5% contraction in the first quarter, we expect growth to be positive again in 2Q. For now, we expect GDP growth to be 1% quarter-on-quarter with risks to the upside. One sector to keep an eye on, however, is the construction sector. This sector contracted by 4.2% quarter-on-quarter in 1Q, after another contraction of 2.8% in 4Q of 2020.

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Spain also submitted its recovery plan to the EU in order to receive money from Next Generation EU. The European Commission now has two months to evaluate the plan. The Spanish plan is worth about €70bn of grants to be spent between 2021 and 2023. At first sight it complies with the spending limits concerning sustainability (45% of the plan while the limit is 37%) and digitalization (23% while the limit is 20%) The government anticipates to take up a similar amount in loans for the period 2024 and 2026.

The Spanish government recently revised down its growth forecast for 2021 from a 7.2% - 9.8% range to 6.5%, giving the later than expected use of EU funds as an explanation. This lower forecast seems still optimistic to us. We continue to believe that Spain will grow by about 5% this year.

## Price pressures

An important side effect of the strong demand and shortages of certain inputs is upward pressure on input prices, while firms have a stronger desire to pass these on to clients. Output charges actually rose at the fastest pace since mid-2002, when these data were available. We expect that this will push up core inflation in the coming months.

All in all, this report supports our optimism for a recovery in 2Q and 3Q. If the service sector was able to grow in April, after an eight-month long contraction, then we will be even more confident about the economic recovery. We will know more about this on Wednesday, when the PMI for the services sector will be published.

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