Spain: In a bad place

Spain is hit hard by Covid-19, with latest figures showing about 14,000 infections and over 600 deaths. It is the second most-affected European country after Italy. While the government already announced fiscal policy action, we expect the economic impact to be large

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Lockdown

The Covid-19 outbreak started on 1 February and the number of infections started to rise fast by the beginning of March. Since last Saturday the country is in lockdown. People need to stay home until 28 March, unless they have to buy food or medicine or go to work or the hospital. Shops, except food shops and pharmacies, schools, museums, libraries, hotels and restaurants are closed and sporting and cultural events are prohibited. These measures can be extended with parliamentary approval, which is likely given the high number of infections. Spanish minister for transport, José Luis Ábalos, already warned last Monday that the lockdown will last longer.

Spanish economy sensitive to such a shock

As with every economy that is affected by the spreading of Covid-19, output will contract due to a negative labour supply shock (e.g. as schools close parents cannot go to work), a negative labour demand shock (e.g. firms need to close due to lockdown measures) and a demand shock (less consumption and investment). The importance of the tourism and travel sector – it account for 15% of Spanish GDP – make the Spanish economy particularly sensitive to a pandemic. And it looks like this sector will be hard hit. We already see that prices for flights to Spain and hotel prices for the Easter period drop significantly, implying a sharp fall in demand.

The economic crisis can be amplified by stress in financial markets. The 10Y government bond spread with Germany already more than doubled. Today it equals about 150 basis points, whereas it was only 60 basis points in the beginning of the year. We observe similar movements in other government bond markets, such as the Italian, Portuguese and Greek markets. The higher interest rate can make it harder for business to obtain a loan, making liquidity problems more likely and in the worst case bankruptcy.

Government action

In this crisis it is crucial that business are provided with liquidity to weather the storm and that employees with an income loss are assisted so that consumption is supported. The national government yesterday announced a relief package of €200 billion, 20% of GDP, to do just that. The measures include: public guarantees to ensure liquidity for businesses (half of the relief package), some mortgage and utility payments will be delayed, and some social security contributions will be suspended. It will also become easier to temporarily suspend work, instead of being fired, and retain all the benefits. Employees who need to take care of dependent relatives may reduce their workday by as much as 100%.

Last week, the ECB also announced some measures. We expect, however, that the ECB will announce more in the coming weeks, such as a deposit rate cut with enforced measures to combat the negative side effects and an extra €100 billion of quantitative easing.

Conclusion

This crisis will have a large effect on economic activity in Spain, even though the government took some unseen measures to combat it. If the spreading of the virus can be stopped soon, then the economy could bounce back sharply in the second quarter already. If it lasts longer, then a prolonged crisis is possible.

For now, we hypothesize that the measures taken to combat the virus will be effective and that the spreading of the virus will ultimately follow a similar path as in China. This implies that the spreading will be managed by mid-April. The second quarter could therefore see a less negative year-on-year growth figure compared to the first quarter. There is a risk, however, that tourists cancel their summer holidays and that the third quarter is still negatively affected. We downgrade our GDP growth forecast to -2.8% in 2020. Earlier this year we expected a growth rate of 1.3%.

Spanish GDP contracted by 3.8% in 2009 due to the financial crisis and by 3.0% in 2012 due to the Eurozone crisis. We are close to these dramatic figures, but for now we think that they will not be crossed during this current crisis. If, however, the spread of Covid-19 is not halted by mid-April, then things could get worse.

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