

## Spanish economy picks up sharply in February

In February, Spain's service sector experienced a significant pick-up in activity, while the manufacturing sector recorded growth for the first time since June 2022. However, the downside of this is that inflation will remain high for longer



Spain's service sector saw increased activity in February

### Spanish economy shows surprising growth in both services and manufacturing sectors

In February, the Spanish economy surprised to the upside with stronger-than-expected growth in both the services and manufacturing sectors. The Services PMI, which was announced today, reached 56.7, the highest level since April last year, with increased activity, new business, and a pick-up in employment compared to January.

Earlier this week, the manufacturing PMI also climbed to 50.7 from 48.8 in January, indicating the first growth since June last year and exceeding expectations. However, underlying demand is still weak as order books shrank, although at a slower pace thanks to a cautious pick-up in demand.

## Pick-up in Spanish economy raises inflationary concerns

However, the pick-up in the Spanish economy comes with the downside of inflationary pressures accelerating again in February. Input and sales prices increased compared to January, indicating that underlying price pressures are still very high. The sharp rise in energy prices and input costs last year is still being passed on to sales prices, and with demand and activity picking up, it becomes easier for companies to implement new price increases. The increase in employment in both manufacturing and services sectors, due to the tight labour market, could also lead to stronger wage growth and thereby fuel inflation. As a result, core inflation might still rise further in the coming months.

## Despite the rebound, interest rate hikes will further slow growth

While the Spanish economy has shown a strong rebound in activity, it is still too early to conclude that this recovery will be sustained throughout the year. While supply issues and falling energy prices may provide a boost to activity, the ECB's interest rate policy is expected to constrain economic growth. The ECB is set to increase interest rates above its neutral level of 2% in the near future, pushing rates further into restrictive territory. This is likely to impact interest rate-sensitive sectors like the real estate market and business investment. This year, Spanish GDP growth is projected to reach 1.3%, but with the full impact of the interest rate hikes expected only next year, the expansion is expected to slow down to 0.8% in 2024.