Spain's service sector goes from strength to strength

Activity in both the services and manufacturing sectors improved further in March and came in above expectations once again. Nevertheless, we expect the Spanish economy to lose momentum in the second half of the year as interest rate hikes will increasingly weigh on economic activity

Spain's services PMI rose again in March

Spanish services sector strengthened again in March

Spain's services PMI experienced another sharp increase in March, surpassing market expectations once again. The PMI rose from 56.7 in February to 59.4 in March, reaching its highest level since November 2021. Demand for services rose significantly, including both domestic and foreign demand. The downside is that core inflation is likely to remain stubbornly high in the coming months as well. The strength of the services sector makes it easier for service companies to pass on new price increases which is unlikely to change soon.

Spanish manufacturing sector recovers further thanks to strong growth in new domestic orders

The manufacturing PMI for Spain, which was released on Monday, increased to 51.3 in March from 50.7 in February. The rise was primarily attributed to an increase in new domestic orders, reflecting stronger underlying demand. However, the number of foreign orders saw a sharp decline. In terms of inflation, input costs for manufacturers decreased in March for the first time in 32 months, owing to a reduction in energy and raw material prices.

Official data released by Spain's statistical office INE this morning also showed that the industrial production index rose 0.6% month-on-month in February. However, growth in February was mainly driven by the energy component which recorded 3.2% month-on-month growth, while production of consumer durables fell 3.5%. Overall, the figures show that while the manufacturing sector is starting to recover, it remains highly vulnerable as the recovery is mainly fueled by the energy sector. Moreover, weak external demand will also continue to hamper the sector's recovery, as we expect growth in both Europe and the US to slow later this year.

We still expect tighter monetary conditions to dampen growth

Thanks to a significant fall in energy prices and continued improvement in supply chain disruptions, the first and second quarters are likely to be better than previously expected. We now pencil in growth of 0.3% quarter-on-quarter in the first quarter of this year. However, the momentum of the Spanish economy is expected to slow down in the second half of the year. This is mainly due to interest rate hikes and the tightening of financial conditions that will have an increasing impact on the economy.

It usually takes several months before the economic effects of ECB interest rate hikes become noticeable, and the full effect is not expected to be felt until the second half of 2023 and early 2024. Moreover, we expect the ECB to raise interest rates again by 25 basis points in May and June, pushing it deeper into restrictive territory. We see the Spanish economy growing by 1.5% in 2023 and 1% in 2024.

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