Spain:
Macroeconomic and financial outlook

CaixaBank Research

September 2021

CaixaBank

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Main messages

Activity

- **GDP surprised on the upside in Q2 2021** (+2.8% qoq and +19.8% yoy) but still remains 6.8% below its pre-crisis levels (9.3% in the previous quarter). The strong recovery of private consumption (+6.6% qoq), fueled by pent-up demand, explains the bulk of the increase in GDP.
- **The recovery consolidated during the summer despite the spread of the Delta variant.** The new wave of contagions did not prevent a continuation of the economic recovery in July and August as high vaccination rates kept in check the impact on the health system. Internal data points to a substantial recovery of the tourist sector driven by domestic and European tourists.
- **The latest wave of contagions is receding.** 14-day cumulative incidence in Spain decreased below the 250 cases per 100k inhabitants extreme risk threshold on September 1st. Pressure on the health system is moderating and over 70% of the population has been fully vaccinated (the percentage increases to almost 95% for those aged 50 and above).
- **We revise our GDP growth forecasts upwards** considering the positive growth surprise in Q2 2021 and the strength of the recovery during the summer season. GDP is forecast to grow 6.3% in 2021 and reach pre-crisis levels in 2022. The recovery plan financed with European funds should boost growth by c.1pp in 2021.

Banking sector

- **The banking system is facing the crisis from a solid financial position, with enough reserves to cover risk and contribute to the recovery.** Loan moratoria are expiring without a significant increase in NPLs, while stage 2 exposures of guaranteed loans remain contained. Grace periods of guaranteed loans will expire in 2022, once the economic recovery is well under way. A strong rebound of activity in mortgages (exceeding pre-covid levels) and greater dynamism in consumption loans is taking place.

Policy

- **Domestic restrictions have mostly been removed.** Regional governments are responsible for tightening or easing restrictions. Restrictions to international mobility are the main hurdle that prevent full normalization of economic activity.
- **The policy response is offering significant support to the economy** with a portfolio of direct measures, tax deferrals and public guarantees. Furlough schemes (which have been extended until the 30th of September) are proving very effective in cushioning the shock. The government also approved last March an aid package of c.1.0% of GDP for the most affected sectors encompassing direct transfers and other solvency support mechanisms (debt restructuring and capital injections).
- **The government funding needs should be covered without difficulties**, helped by ECB purchases, plenty of liquidity available and low interest rates. Public debt stands at c.122% of GDP (30pp in the hands of the ECB).
- **The Government has revised its projections and now envisages a decline in the fiscal deficit to 8.4% in 2021** (2020: 10.1% excluding Sareb one-offs). For next year, the Stability Plan forecasts a deficit of 5.0% without measures (which have not been specified yet), which appears slightly optimistic (GDP growth of 7% seems high). NGEU spending targets are ambitious: above 2% of GDP in 2021 and 2022.

The latest wave of contagions is receding

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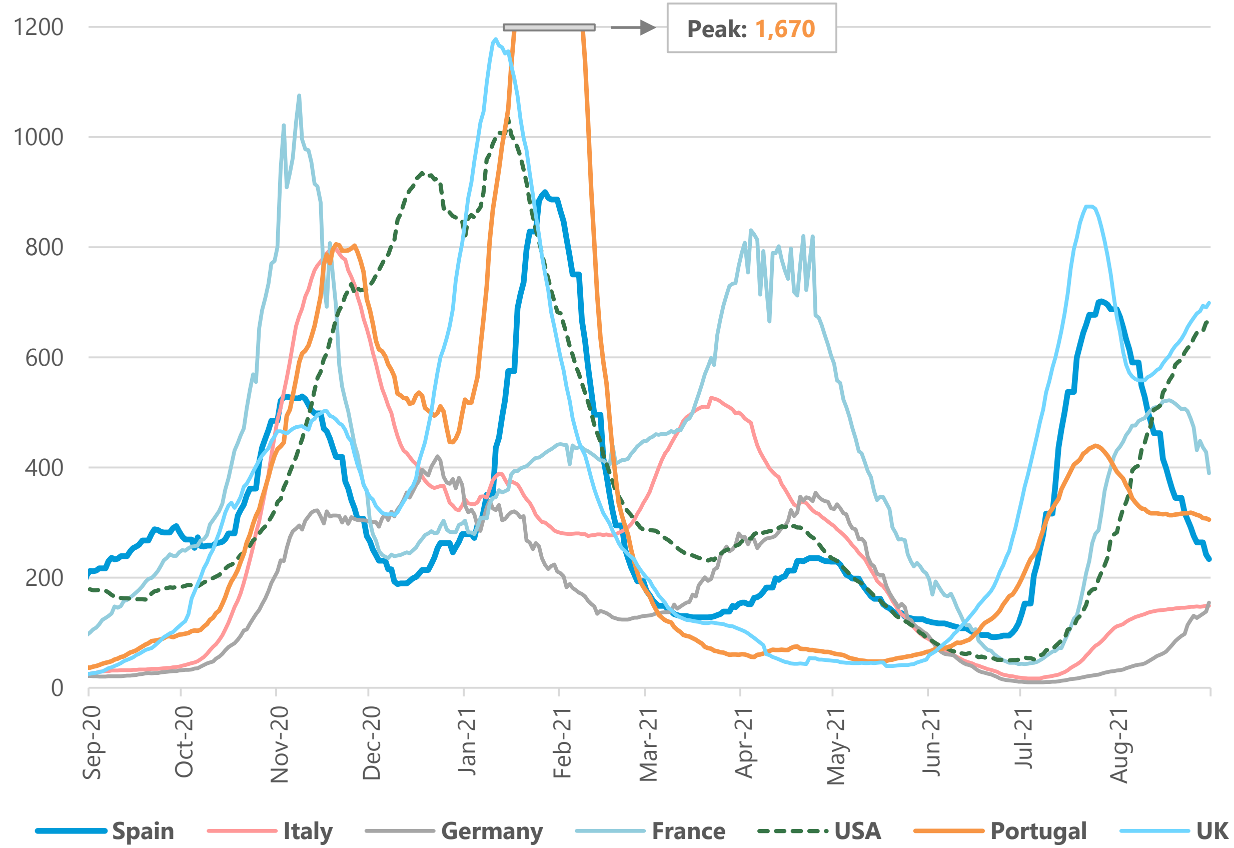
COVID-19 cumulative incidence

Infections per 100k inhabitants accumulated in 14-day



	14 days cumulative incidence*			ICU occupancy rates (COVID)		
	01-sep	25-ago		31-ago	24-ago	
Andalusia	227	303	↓	10%	12%	↓
Aragon	247	294	↓	22%	22%	=
Asturias	90	130	↓	7%	8%	↓
Balearic Islands	271	361	↓	21%	22%	↓
Canary Islands	138	196	↓	16%	19%	↓
Cantabria	286	369	↓	12%	16%	↓
Castilla La Mancha	274	322	↓	14%	13%	↑
Castilla Leon	233	300	↓	14%	18%	↓
Catalonia	172	252	↓	31%	37%	↓
C. Valenciana	173	232	↓	13%	13%	=
Extremadura	444	498	↓	13%	11%	↑
Galicia	249	315	↓	7%	9%	↓
Madrid	238	304	↓	29%	33%	↓
Murcia	229	303	↓	6%	7%	↓
Navarre	225	314	↓	21%	22%	↓
Basque Country	291	380	↓	19%	21%	↓
La Rioja	287	375	↓	11%	13%	↓
Spain	**222**	**291**	↓	**17%**	**19%**	↓

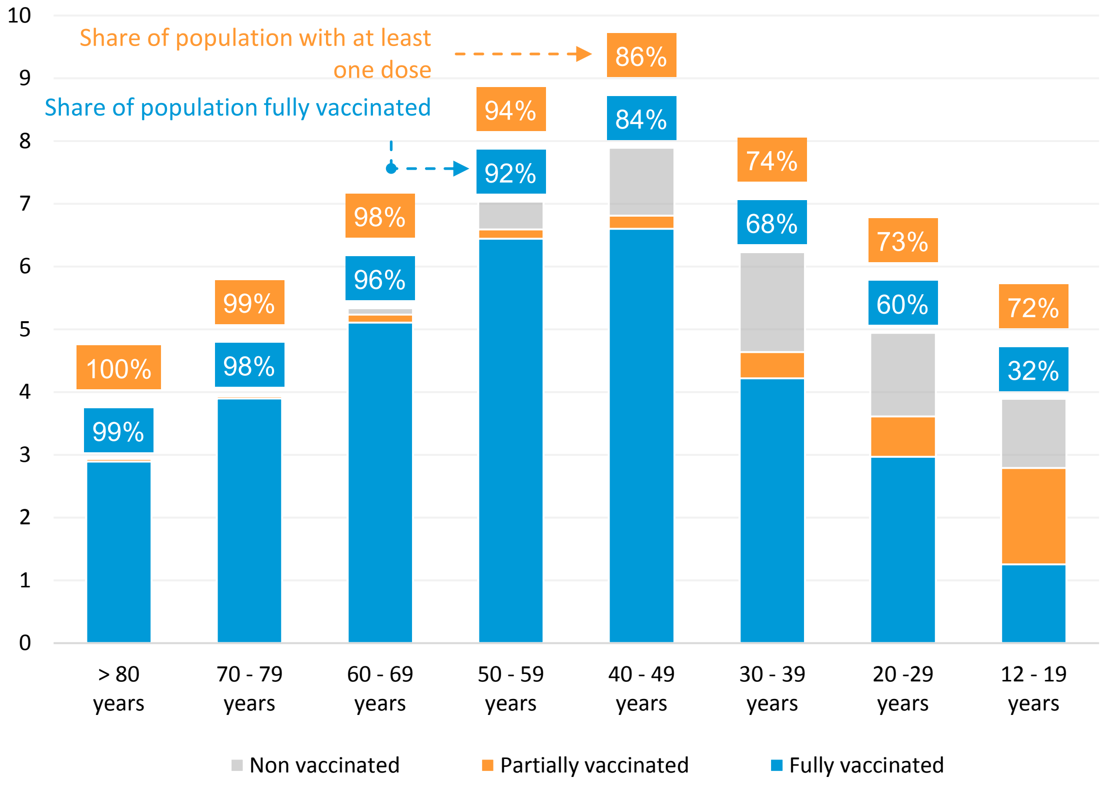
Notes: ** COVID-19 infections per 100k inhabitants accumulated in 14 days.*

- **The Delta variant caused a new wave of contagions in western countries despite having a large share of their population vaccinated**. The Delta variant is very contagious among partially vaccinated people (effectiveness against contagion of AstraZeneca’s first dose is 33% and Pfizer’s is 50%) and relatively contagious among fully vaccinated people. On the plus side, the vaccine is still very effective to prevent severe cases even after only one dose (AstraZeneca’s first dose avoids 71% of severe cases and Pfizer’s 94%).
- **14-day cumulative incidence in Spain decreased to 222 cases per 100k inhabitants** on September 1st, below the 250 extreme risk mark. Pressure on the health system is moderating in almost all regions (17% of ICU beds are occupied by COVID-19 patients in Spain). Vaccination proceeds rapidly and over 70% of the population have already been fully vaccinated.

Vaccination of the risk population is maintaining the number of severe cases under control

Vaccinated population by age

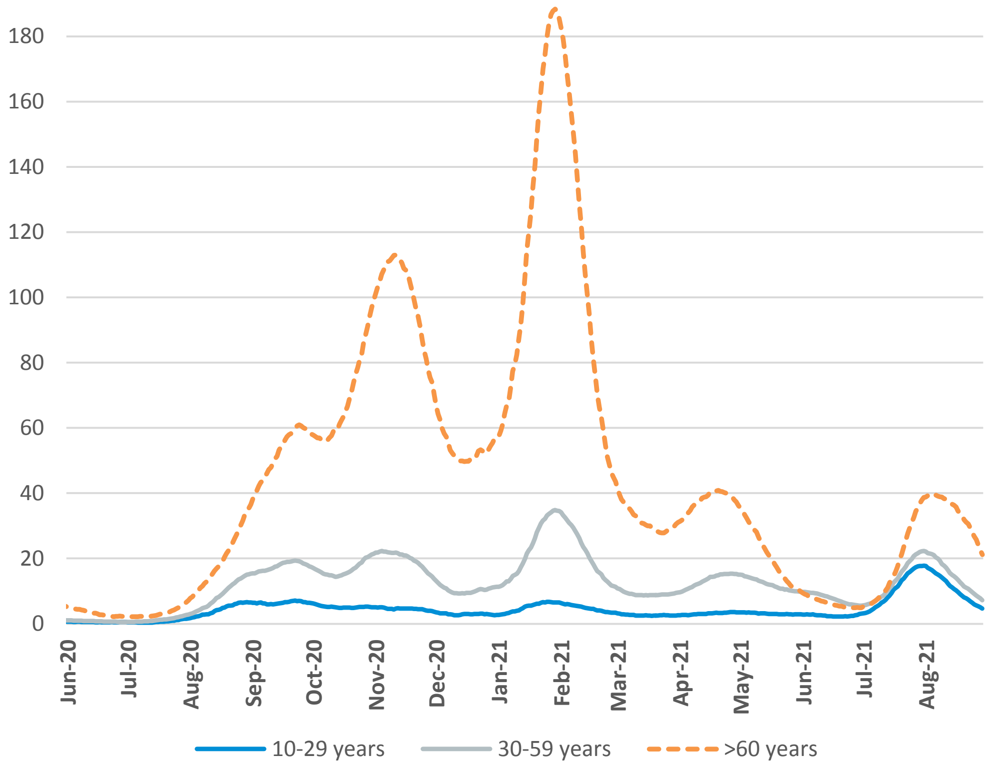
Million of inhabitants



Key take-away: More than 70% of the total population have been vaccinated. Risk groups have already been fully vaccinated, and inoculations are progressing fast among younger age groups.

Hospitalizations by age group

Hospitalizations per 100k age group inhabitants accumulated in 14-day

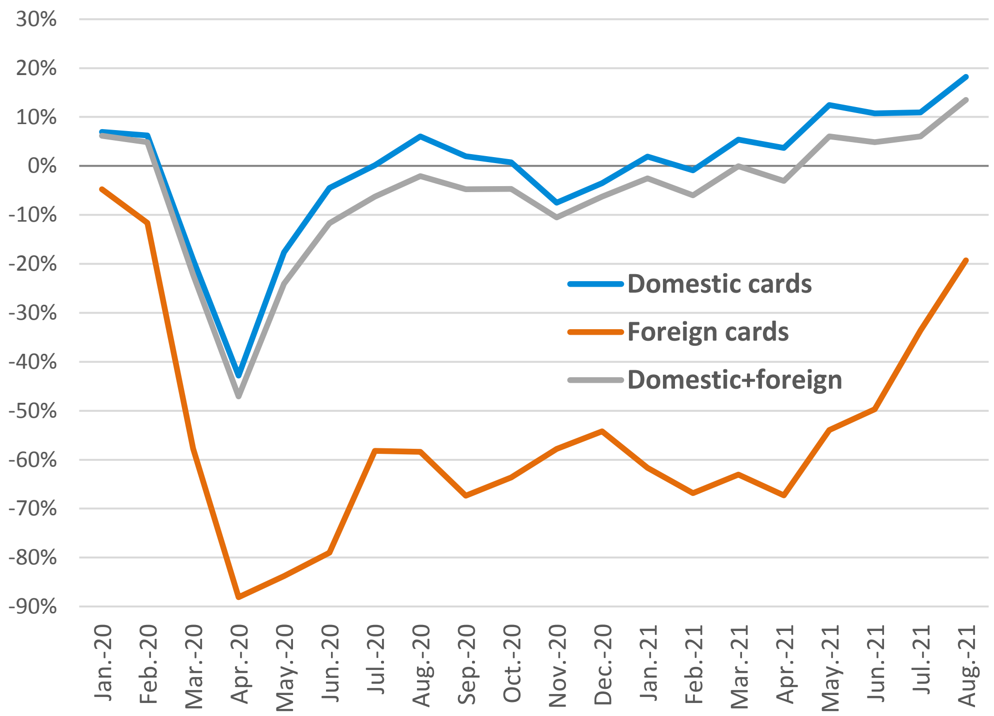


Key take-away: Despite the marked increase of contagions in July, severe cases remained contained among people over 60 years thanks to the widespread vaccination of this age group.

Economic activity strengthens during the summer

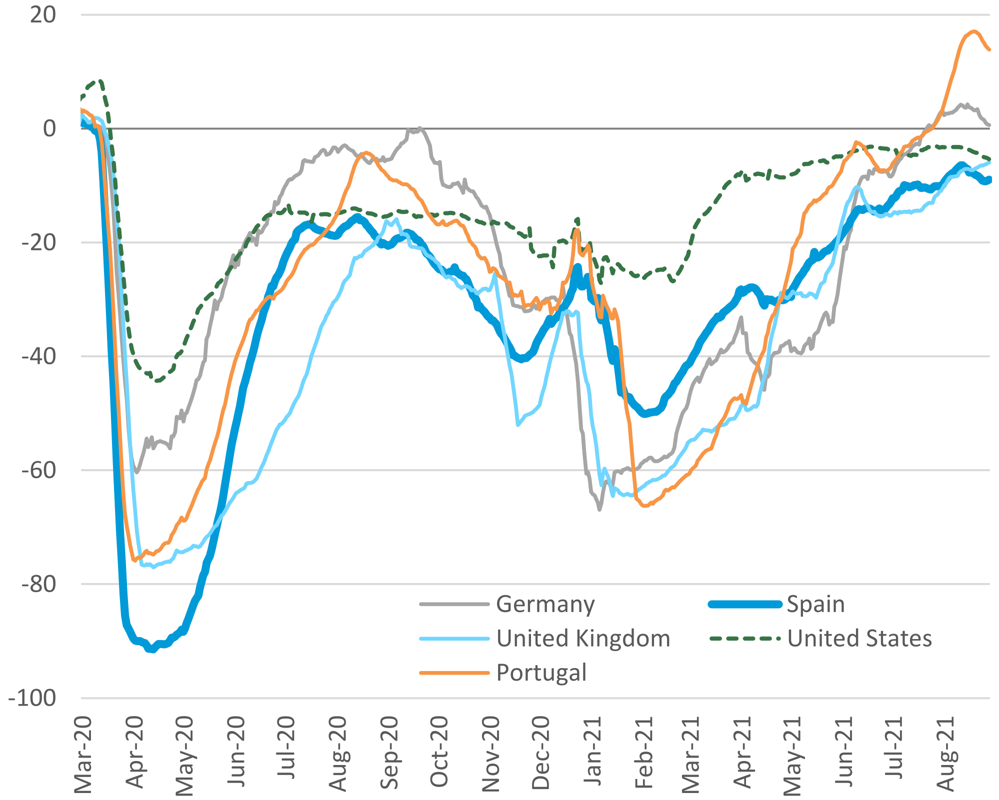
Card activity (point of sale + e-commerce + ATMs)

Change with respect to same period 2019 (%)



Population mobility: retail and recreation places

Deviation from base level (%)



- **CaixaBank card data points to a rapid recovery of consumption.** Domestic expenditure has been recovering at a high pace, reaching remarkably high growth rates in July and August (+11% and +18% with respect to 2019) and foreign expenditure, following a flat performance in Q2, also recovered most of the ground lost to the crisis during the summer season. Along the same line, mobility indicators are at their highest level since the pandemic began.
- **Broad-based recovery**. The recovery strengthened during the summer and has been broad-based, taking place both in the service and industrial sector alike. As will be seen later, indicators point to a vigorous recovery of the tourist sector during the summer season. On the labor market front, employment growth remained strong, adding 133k workers in seasonally adjusted terms in July and 77k in August. In addition, since the end of June, workers in a furlough scheme have decreased by a third (278k left). In year-on-year terms, correcting for base effects and excluding furloughed workers, employment declined 0.6% in August, substantially below June's rate (-2.3%). Finally, confidence indicators remained at historical highs, the manufacturing and services PMI both sitting in August at historically high levels (59.5 and 60.1 points, respectively).

Activity monitor

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Year-on-year change (%)	Domestic cards activity	Foreign cards activity	Goods Exports	Cement	New registrations of passenger cars	Electricity consumption	Industrial production	Retail Sales	Registered employment [1]
Q1 2020	-2.2	-26.3	-3.0	-13.3	-31.0	-2.6	-6.5	-3.7	-1.4
Q2 2020	-22.8	-83.8	-27.7	-21.4	-67.7	-12.7	-23.5	-18.3	-19.0
Q3 2020	2.4	-60.6	-5.7	-1.8	-6.3	-3.8	-5.4	-3.5	-7.2
Q4 2020	-3.3	-59.2	-2.3	-0.5	-12.7	-1.1	-2.3	-3.0	-5.9
Q1 2021	2.2	-63.9	1.8	-7.1	-41.3	-2.4	-4.0	-4.9	-4.6
Q2 2021	8.6	-57.5	5.6	0.5	-27.9	-3.1	-3.4	-3.3	-3.4
July	11.0	-33.6			-28.1	-3.0		-3.6	-1.3
August	18.2	-19.3			-36.1				-0.6

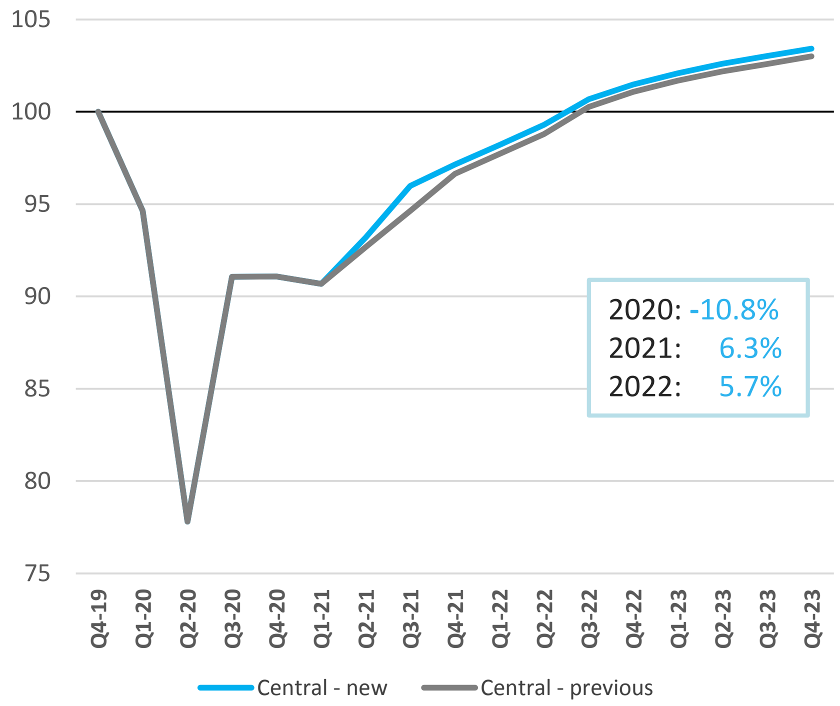
Note: Yoy rates in 2021 are computed relative to 2019 values. (1) Monthly average figures. It does not include workers affected by a furlough scheme.

Rate >= avg. prev. quarter **Rate < avg. prev. quarter**

GDP pre-crisis levels forecast to be reached in 2022

GDP projections

Index (Q4 2019 = 100)



Analysts' forecasts

GDP (Δ %)

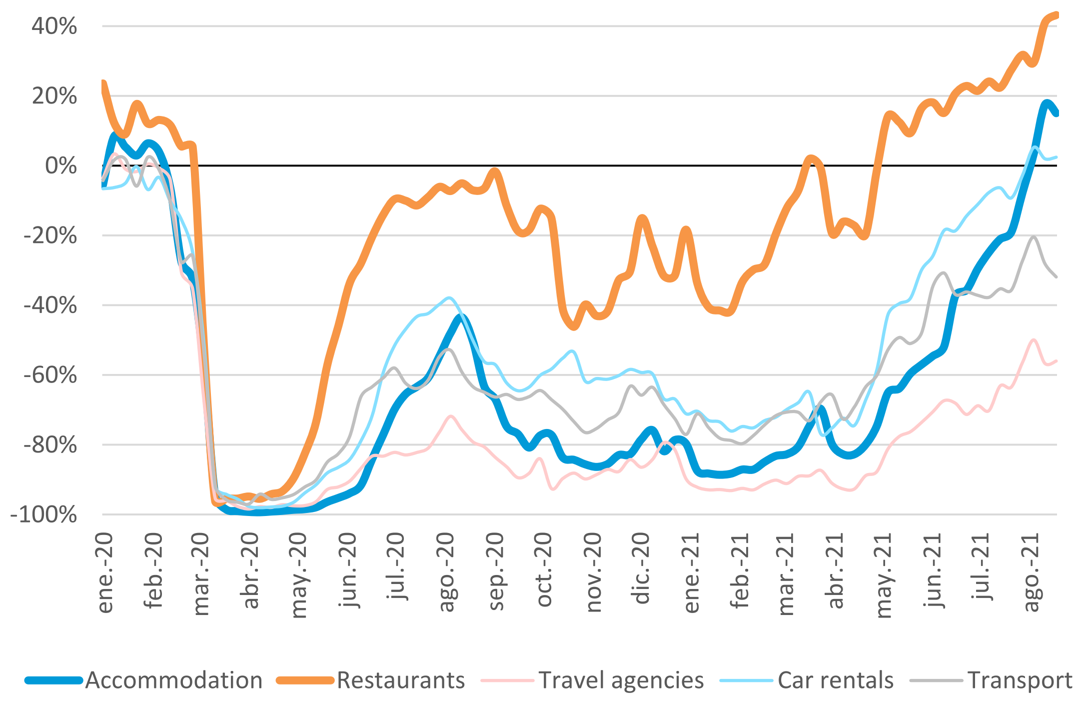
	2020	2021	2022	Cum. 20-22
Government (July 27)	-10.8	6.5	7.0	1.6
European Commission (July 7)	-10.8	6.2	6.3	0.7
CaixaBank Research (September)	-10.8	6.3	6.0	0.5
AFI (as of July)	-10.8	6.4	5.8	0.4
OECD (May 27)	-10.8	5.9	6.3	0.4
Panel de Funcas (July 20)	-10.8	6.1	6.1	0.4
Funcas (July 13)	-10.8	6.3	5.8	0.3
IMF (July 27)	-10.8	6.2	5.8	0.2
Bank of Spain (June 14) - central	-10.8	6.2	5.8	0.2
Consensus forecast (August 9)	-10.8	6.0	5.9	0.1
Bank of Spain (June 14) – risk	-10.8	4.6	6.2	-1.9

- **GDP surprised on the upside in Q2 2021 (+2.8% qoq and +19.8% yoy)**. Despite the rapid bounce-back of activity from the first quarter, the economy remains 6.8% below its pre-crisis levels (from 9.3% in the previous quarter). The strong recovery of private consumption (+6.6% qoq), fueled by pent-up demand, explains the bulk of the increase in GDP.
- **The recovery consolidated during the summer despite the spread of the Delta variant**. The new wave of contagions did not forfeit the economic recovery in July and August as the rapid deployment and the effectiveness of vaccines kept in check the impact on the health system. Our forecasts assume that new bouts of contagion may continue to take place in the coming months as new variants may appear, but the stress induced on the health system will be greatly diminished as a high share of the population is already vaccinated and vaccines remain effective against new strains of the virus.
- **We revise our GDP growth forecasts upwards** considering the positive growth surprise in Q2 2021 and the strength of the recovery during the summer season. GDP is forecast to grow 6.3% in 2021 and reach pre-crisis levels in 2022. We have also revised downwards the projection for the unemployment rate in 2021 by 0.5 p. p. to 15.1%, and upwards that of house prices in 2021 to 1.3% (prev. 1.1%), both as a result of stronger than expected data.

The tourist sector springs back to life during the summer season

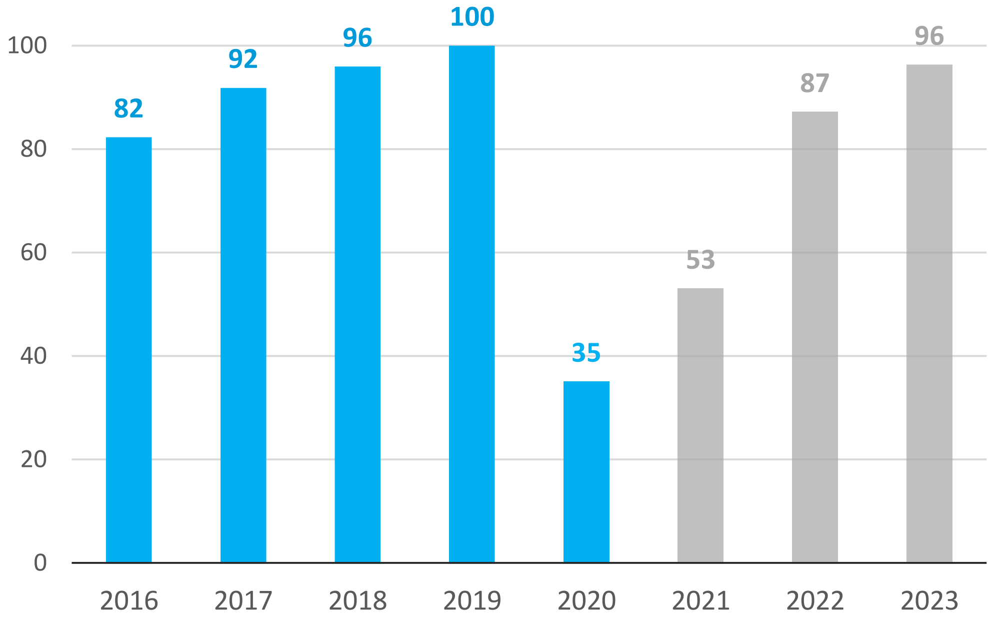
Card activity (point of sale) in tourism related businesses

Change with respect to the same week of 2019 (%)



Tourism GDP forecasts

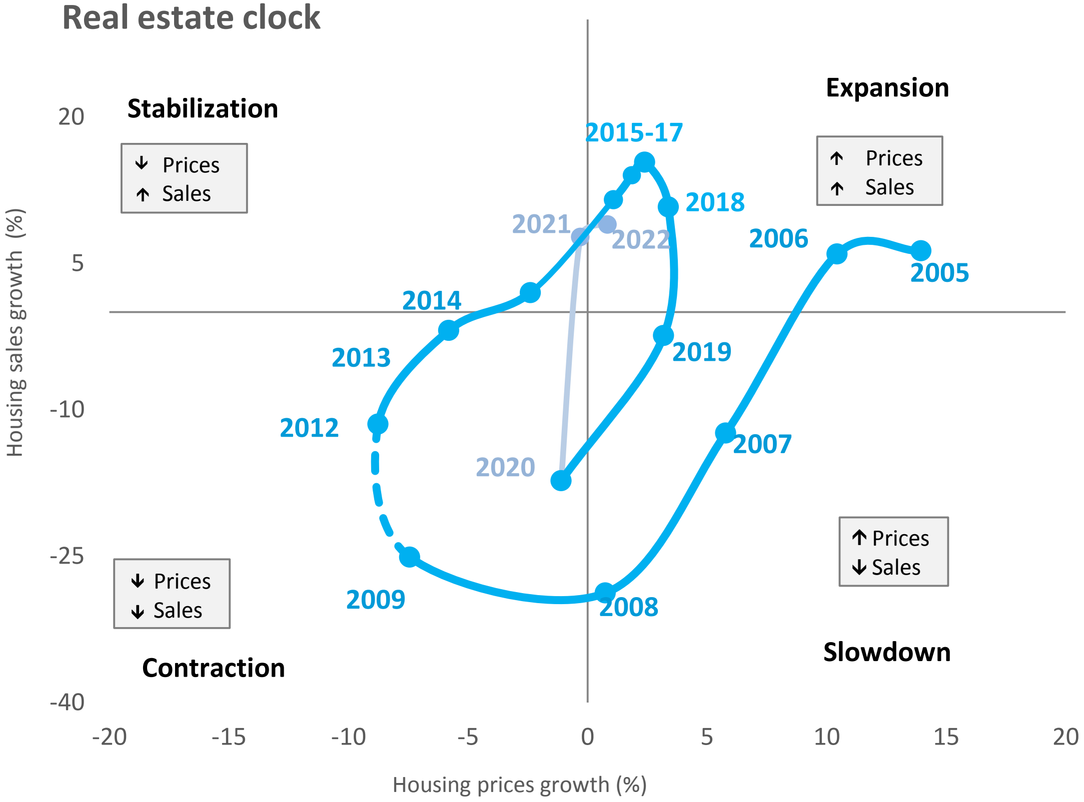
Index (2019 = 100)



- **Tourism activity is recovering at a fast pace:** CaixaBank internal data shows that expenditure on tourism related activities improved significantly in the last two months. At the end of August, credit card expenditure in accommodation (hotels and similar) was already +15% above the 2019 reference, thanks to a remarkable increase in domestic tourism compared to 2019. In the coming months, tourist activity is expected to keep gradually improving, as international mobility recovers.
- **Tourism GDP is expected to increase by around 50% in 2021** as a result of a significant improvement in tourism activity in the second half of the year.
- **Fundamentals remain strong in spite of the current shock.** The Spanish tourism industry is one of the most competitive worldwide and its recovery ought to be swift once vaccines are widely distributed and international mobility flows normalize–although it will take time to return to pre-pandemic levels.

The real estate sector: recovery underway

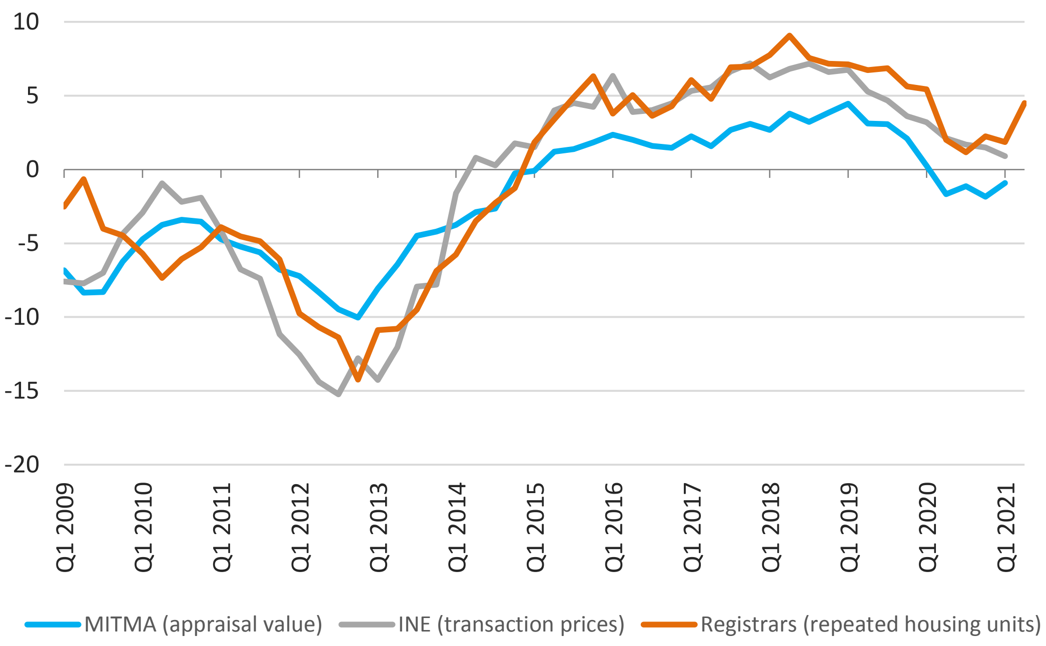
Real estate clock



Source: Mitma, INE and CaixaBank Research forecasts.

Housing prices

Year on year (%)



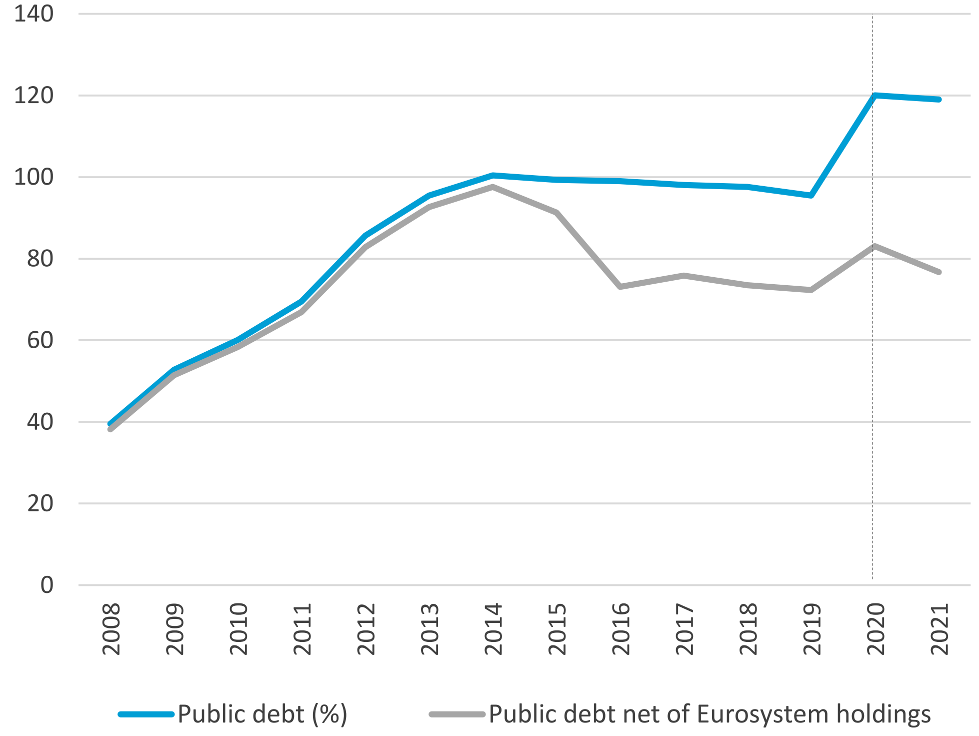
Source: INE, Ministry of Public Works, Association of Registrars.

- **The housing sector experienced a sharp contraction in activity in 2020** (housing sales declined by 17.3% and building permits by 19.5% in 2020)**,** but it is recovering quite swiftly thanks to (1) its solid fundamentals (no excess indebtedness of families and real estate companies, and no excess capacity on the supply side), and (2) policy support (fiscal and monetary policy measures).
- **Housing sales picked up in H1 2021** (+0.6% compared to H1 2019). New housing sales are increasing at a faster pace (+13.5% in H1 2021 vs. H1 2019) than sales of second-hand housing (-2.3%). We expect that housing demand will remain robust in the coming months.
- The recovery of building permits has been fairly muted so far (-11.0% cum. Jan-May 2021 compared to Jan-May 2019) and we expect this trend will continue in 2021 (~90k building permits compared with 86k in 2020 and 106k in 2019).
- **Housing prices have decelerated significantly but the adjustment has been limited** (Q1 2021: -0.9% yoy appraisal value, +0.9% yoy transaction prices; Q2 2021: +4.5% yoy registrars' index based on transactions on the same housing units). We expect house prices to increase gradually starting in H2 2021.

In spite of a strong increase in public debt, funding needs are well covered

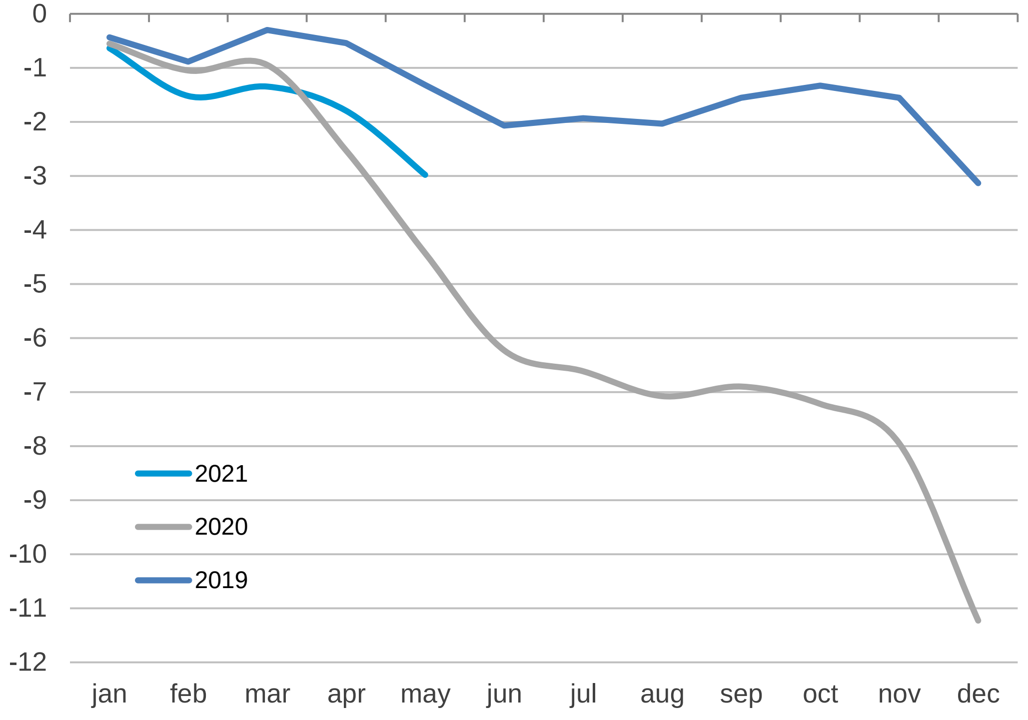
Public debt

(% GDP)



Public net lending needs (-) or capacity (+)

(% GDP)



- **The government budgetary scenario envisages a decline in the public deficit to 8.4% in 2021 (previously 7.7%)** with much higher public spending than in 2019. The 11bn€ package for companies that was approved last March will have an impact on the 2021 deficit of almost 1 p. p. The projected decline in deficit in 2022 (up to 5% of GDP), appears slightly optimistic.
- **The public debt amounted to 122% of GDP in Q2 2021** (120% at the end of 2020 and 95.5% at the end of 2019). **The government funding needs for 2021 are well covered**, helped by ECB purchases, plenty of liquidity available and low interest rates.

Assessment of Spain's Recovery Plan

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Content	▸ The 2021-2023 ≈€70bn in non-refundable transfers of the Recovery Mechanism will be **invested in key sectors**. ▸ **Reforms touch on the most relevant domains** (pensions, labor market, modernization of public administrations, education, business creation…).
Priorities	▸ **Frontloading of projects with a fast implementation and significant knock-on effects** (housing refurbishment, electrical vehicles, energy, infrastructures…). ▸ In parallel, medium-run projects will be started (5G, renewable hydrogen…)
Reforms	▸ **The plan lacks important details (pending negotiations).** ▸ Labour market: Simplification of labour contracts and a new mechanism of labor adjustment (structural ERTE) to reduce duality. ▸ Pensions: Raise retiring age, workplace pension schemes (but no detail on incentives and no NGEU investments in sight), raise maximum SS contributions, incorporation of life expectancy in the sustainability analysis. ▸ Fiscal reform: Tax hikes once the recovery is well on track.
Governance	▸ **Little participation of external experts**. ▸ A thorough mechanism of monitoring and assessment of the projects would be helpful.

The European Commission endorsed the Recovery Plan in June with a positive assessment and the European Council gave the final approval in mid-July. Spain received a first payment of €9bn in August as pre-financing and subsequent disbursements (the following one expected at the end of the year) will depend on the completion of intermediate targets and milestones (investments, reforms…).

Key fiscal and quasi-fiscal measures

	Amount (% GDP 2020)	Main policy measures
Direct fiscal measures (2020 and committed in 2021)	**6.0%**	▸ Benefits for workers affected by temporary lay-offs (ERTEs) and for the self-employed affected by the hiatus in activity (August avg.: 278k in ERTES; Spring 2020: 3.4million). Good measure to alleviate pressure on the labor market. Extended until September 2021. ▸ Approved the first phase of the pension reform in Spain, which should enter into force in January 2022. Return to the indexation of pensions with inflation and more incentives to delay retirement (4% increase in the pension per extra year worked, a fixed amount to be received in the time of retirement, or a combination of both). ▸ VAT reduction from 21% to 10% until December 31 2021 to consumers with a contracted power lower than 10 kW, provided that the arithmetic average price of the wholesale electricity market corresponding to the month prior to the last day of the billing period has exceeded 45 euros per MWh. Estimated impact: 566 million of foregone revenues. ▸ 11bn€ package to support SMEs and most hit sectors in March 2021. Partially disbursed.
Deferrals and moratoria	Deferrals: **1.1%** Moratoria: **5.2%**	▸ Legislative moratoria on mortgages and consumer loans complemented by sectoral moratoria for households (the outstanding balance of loan payments suspended amounted to €57.6bn at the end of April). The majority have expired. ▸ Legislative moratoria on loan repayments for tourism and transport sector (€2.8bn). ▸ Deferral of tax payments for six months (from March to October) in 2021 for SMEs and self-employed (estimated amount:€2.6bn). ▸ Utility bills moratorium and eviction ban for vulnerable families until October 31.
Credit guarantees	**8.9%** (considering the level of use until July 2021)	▸ €100bn on credit guarantees for companies and self-employed to guarantee liquidity with State guarantees between 70 and 80%. Level of use: €92.0bn of guarantees (end of July 2021) ▸ €40bn on credit guarantees for companies and self-employed to boost investment activity (but also guarantee liquidity). Level of use: €7.7bn of guarantees (end of July 2021). ▸ The concession of these guarantees has been extended until December 2021, grace periods may be extended 12 more months and the repayment period may be extended 3 years (up to a maximum of 8 years; further extensions could be granted in the package for firms).

The Spanish banking system:
Economic recovery softens Covid-related concerns (1)

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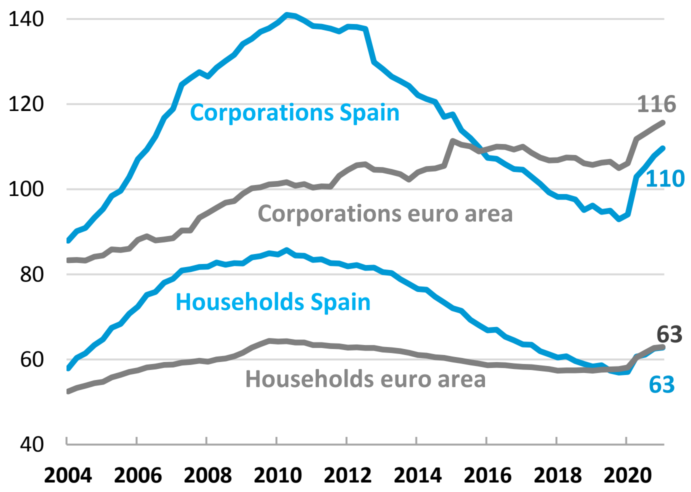
Gross private debt

% of GDP, non consolidated debt.



Note: latest available data Mar-21
Source: ECB, Eurostat

Private domestic credit

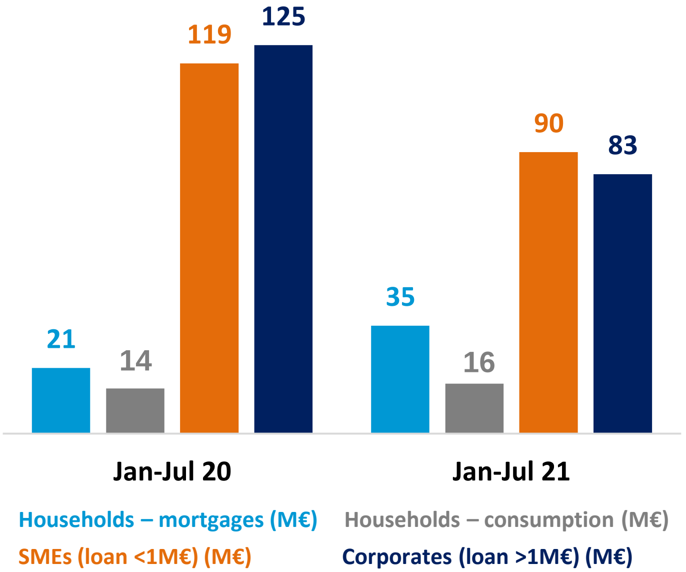
Year on year (%)

	Dec-20	Jul-21 (latest)	2021 (forecast)
	% yoy	% yoy	% yoy
Total credit	**2,5%**	**-0,5%**	**0,4%**
Households	-1,2%	0,1%	0,6%
Housing mortgages	-1,3%	0,7%	0,8%
Other purposes	-0,8%	-1,4%	-0,1%
Of which consumption	-2,6%	0,4%	0,5%
Businesses	8,2%	-1,4%	0,0%
Non-real estate developers[1]	12,2%	9,8%	-
Real estate developers[1]	-5,3%	-6,0%	-

Note: (1) latest available data Mar-21
Source: Bank of Spain

New lending activity by sector

Bn euros



Source: Bank of Spain

- **Corporate debt levels** remain below euro area averages despite the strong pick-up in credit in 2020. **Household debt** has also increased as a percentage of GDP but this is due to denominator effects (debt moratoria and higher indebtedness of the self-employed have not offset headwinds from lower demand for consumption loans and continued deleveraging of housing credit). We expect a process of gradual deleveraging after the covid crisis.
- **New mortgage production** suffered a sharp contraction during the lockdowns of March-May 2020 but has rebounded strongly since and surpassed pre-covid levels, helped by pent-up demand.
- **New lending for consumption** has behaved more dynamically in recent months although remains below pre-covid levels.
- **New lending to corporates spiked in March-June 2020** but demand has now declined. We expect it to recover during 2H21 due to the impact of NGEU funds and the amount still available of the ICO lines. The extension of grace periods and maturities for existing ICO loans will also help to maintain the stock of loans.

The Spanish banking system:
Economic recovery softens Covid-related concerns (2)

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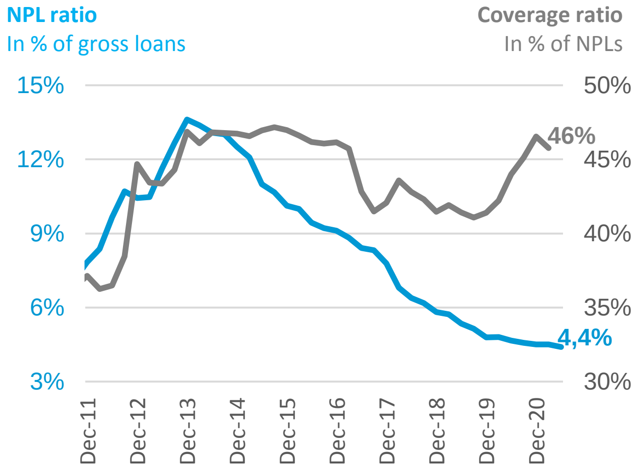
NPLs and coverage ratios[1]

%



Non expired moratoria[2]	Cost of risk[3]
3,1% of loans to households 1,7% of loans to NFC	0.9% in 2020 0.6% in 2Q21

Note: (1) latest available data Jun-21. (2) Based on EBA data as of Mar-21. (3) Spanish business. Accumulated 12 months based on the average of the 5 largest institutions.
Source: Bank of Spain and Bank's financial statements.

Banks' profitability

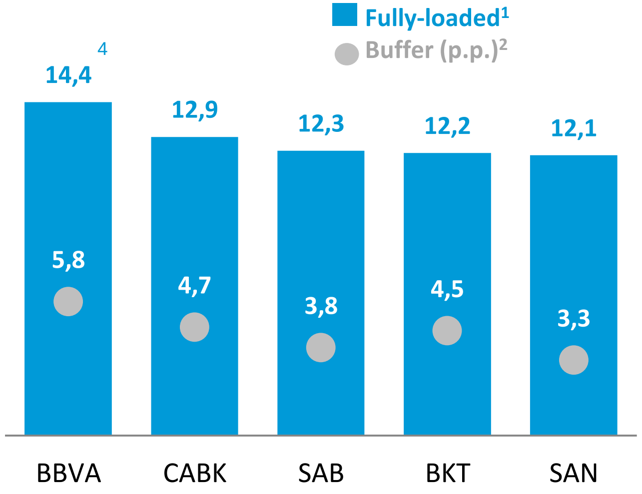
In % of average total assets (Q2 21; trailing 12M)

	CABK	BBVA	SAN	SAB	BKT
Net interest income	**1,0%**	**0,9%**	**1,2%**	**1,3%**	**1,3%**
Net fees	0,6%	0,5%	0,7%	0,7%	0,5%
Gains on financial assets/liab. and others	0,0%	0,1%	0,2%	0,3%	0,1%
Other operating income	0,1%	0,0%	-0,1%	-0,1%	-0,1%
Gross income	**1,7%**	**1,4%**	**1,9%**	**2,1%**	**1,8%**
Operating expenses	-1,3%	-0,9%	-1,0%	-1,1%	-0,9%
Impairment losses, tax and others	0,6%	-0,3%	-1,0%	-0,8%	0,7%
Profit	**1,1%**	**0,2%**	**-0,1%**	**0,1%**	**1,4%**
Ex M&A impacts	**0,4%**				
ROTE (%)[1]	9,8	4,4	4,0	2,3	9,4

Note: Domestic businesses. ROTE based on internal calculations. (1) Group ROTEs for CABK ex M&A impacts. BBVA include Corporate Centre (only proportion applicable to business in Spain). The same happens in SAN.
Source: Bank's financial statements.

Banks' solvency and liquidity position

In % (Q2 21)



LCR[3]	179%	333%	220%	n.d.	164%

Note: (1) CET1 FL transitional IFRS9. (2) Difference between CET1 ratio fully-loaded and SREP requirement. (3) LCR = liquidity coverage ratio. (4) 12.9% after targeted 10% share buyback.
Source: Bank's financial statements.

- **NPLs remain below 5%,** helped by debt moratoria and the extension of maturities and grace periods for guaranteed loans. Non-expired moratoria decreased to 2.6% of household and NFC loans in Q121 (vs a peak of 7.8% in 2Q20). Although the NPL ratio is expected to worsen as debt moratoria expire and companies start facing repayments of guaranteed loans, the increase will be limited and manageable as suggested by NPL ratios of expired moratoria (slightly above average levels).
- **Nevertheless, banking profitability remains under pressure and the need for further consolidation still exists despite the two mergers recently approved:**
  - Interest rates are now expected to remain lower for longer.
  - After a temporary pick-up in loan demand, businesses and households are expected to focus on balance sheet repair.
  - Banks booked a significant amount of provisions in 2020. Although the cost of risk already improved in H121, it may take some time to reach pre-covid levels depending on the evolution of the pandemic.
- **The capital position of Spanish banks provides buffers to weather the COVID-19 shock.** A Bank of Spain top-down analysis estimates a CET1 erosion of 1.6 percentage points in aggregate under the central scenario and a decline of 3.9 p.p. in an adverse scenario.

Main economic forecasts

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%, YoY, unless otherwise specified	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
GDP	-3,0	-1,4	1,4	3,8	3,0	3,0	2,4	2,0	-10,8	6,3	6,0
Private Consumption	-3,4	-3,0	1,7	2,9	2,6	3,0	1,8	0,9	-12,4	9,6	4,6
Public Consumption	-4,2	-2,1	-0,7	2,0	1,0	1,0	2,6	2,3	3,8	2,5	1,0
Gross Fixed Capital Formation (GFCF)	-7,4	-3,8	4,1	4,9	2,4	6,8	6,1	2,7	-11,4	4,8	10,4
GFCF - equipment	-7,1	2,4	5,6	9,1	1,8	9,2	5,4	4,4	-13,0	11,7	9,0
GFCF - construction	-10,4	-8,2	3,0	1,5	1,6	6,7	9,3	1,6	-14,0	-0,5	11,3
Exports	0,9	4,4	4,5	4,3	5,4	5,5	2,3	2,3	-20,2	8,4	10,0
Imports	-5,8	-0,2	6,8	5,1	2,6	6,8	4,2	0,7	-15,8	10,3	6,7
Unemployment rate	24,8	26,1	24,4	22,1	19,6	17,2	15,3	14,1	15,5	15,1	14,0
CPI (average)	2,4	1,4	-0,2	-0,5	-0,2	2,0	1,7	0,7	-0,3	2,4	1,7
External current account balance (% GDP)	0,1	2,0	1,7	2,0	3,2	2,8	1,9	2,1	0,7	1,5	1,6
General Government Balance (% GDP) [1]	-7,0	-6,7	-5,8	-5,1	-4,3	-3,0	-2,5	-2,9	-11,0	-7,9	-5,4
General government debt (% GDP) [2]	85,7	95,5	100,4	99,3	99,0	98,1	97,6	95,5	120,0	118,4	114,8
Housing prices	-8,7	-5,8	-2,4	1,1	1,9	2,4	3,4	3,2	-1,1	1,3	2,1
Risk premium (vs. 10Y Bund, bps, Dec.)	429	295	149	120	124	120	97	88	86,3	63,9	60,0
Bank credit (to the private domestic sector)	-9,9	-9,4	-7,1	-4,3	-2,9	-1,9	-2,6	-1,2	2,5	0,4	1,7

Notes: All GDP figures are based on ESA-2010 methodology.

1/ The general government deficit excludes one-off bank restructuring costs of 3.7% of GDP in 2012, 0.3% of GDP in 2013, 0.1% in 2014, 0.05% in 2015, 0.2% in 2016, 0.04% in 2017 and 0.01% in 2018.
2/ General government debt includes ESM/FROB related borrowings equivalent to 3.9% of GDP in 2012.

Source: CaixaBank Research.