Spain:
Macroeconomic and financial outlook

CaixaBank Research

October 2021

CaixaBank

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Main messages

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Activity

- **The national statistical office (INE) revised quarterly GDP growth downwards both in Q1 and Q2 2021** to -0.6% (-0.2 p. p.) and to 1.1% (-1.7 p. p.) respectively -a revision of a magnitude rarely seen before.
- **Sustained recovery.** Following a bout of growth during the summer season, the pace of recovery moderated somewhat in September, but remains elevated. Employment, net of furloughed workers, is close to pre-crisis levels and confidence indicators remain at historical highs.
- **The latest wave of contagions has receded.** 14-day cumulative incidence in Spain fell below 50 cases per 100k inhabitants at the beginning of October for the first time since July-20. Pressure on the health system is low and over 75% of the population has been fully vaccinated (98% for those aged 65 and above).
- **Inflation has increased with a significant contribution from electricity prices**. While inflation is poised to post high readings in the coming months, inflationary pressures are likely to prove temporary, as these are largely due to a combination of factors that will fade away in 2022
- **We recalibrate our GDP forecasts following the downward GDP revision implemented by INE but do not modify our view regarding the ongoing recovery.** Growth in 2021 is now forecast at 5.0% and increases to 6.2% in 2022. GDP reaches pre-crisis levels in Q4 2022, one quarter later than envisaged previously.

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.** Most of loan moratoria have expired 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. There has been a strong rebound of activity in mortgages (exceeding pre-covid levels) while consumer loans are lagging due to the strong savings generated during the pandemic.

Policy

- **Domestic restrictions have mostly been removed.** Regional governments are responsible for tightening or easing restrictions.
- **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, under different conditions, until the 28th of February) have been 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 started delivering on the measures contemplated in the Recovery and Resilience plan**. It includes a broad array of investments in areas such as digitalisation of SMEs, green transition, education, real estate and mobility, the latter including a large-scale public-private collaboration (PERTE) to bolster the fabrication of electric vehicles. The upcoming labor market and pension reforms are critical milestones ahead.

The latest wave of contagions in Spain has receded

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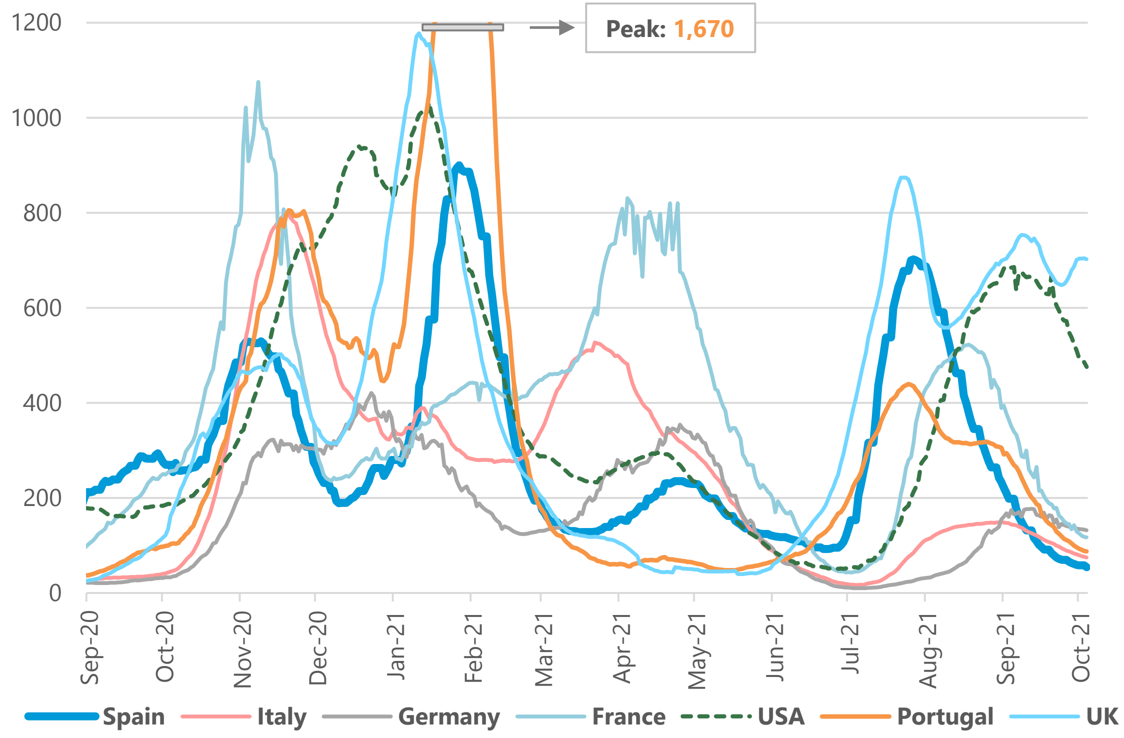
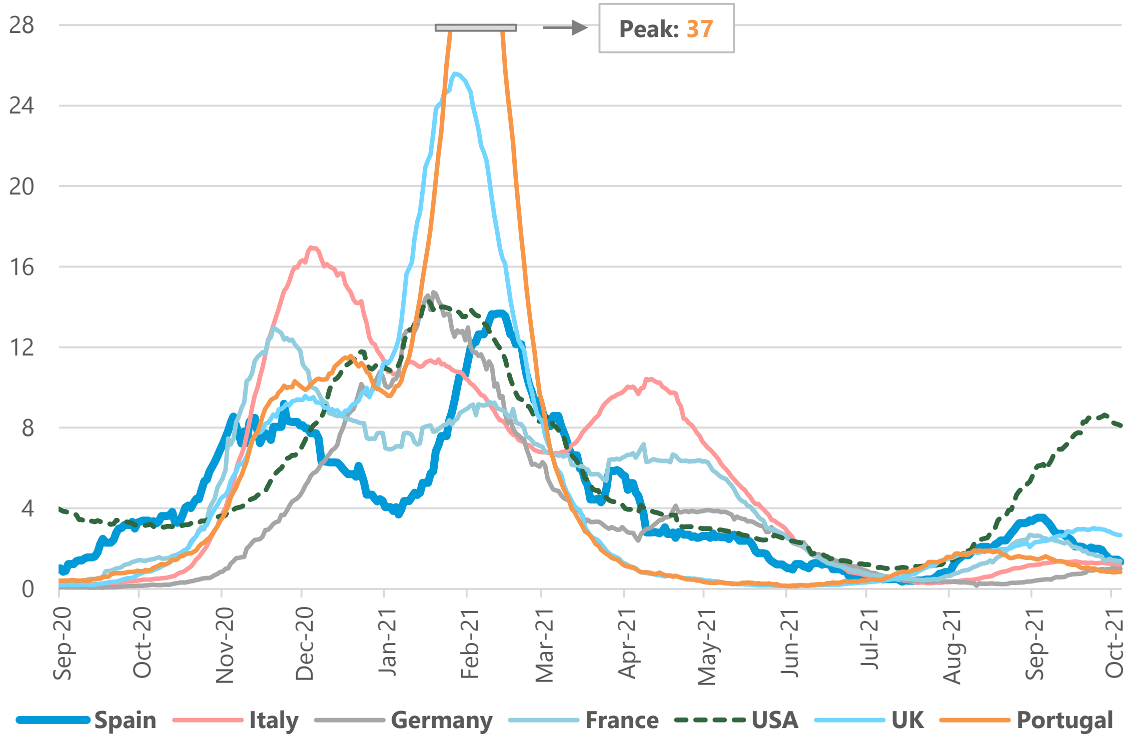
COVID-19 cumulative incidence

Infections per 100k inhabitants accumulated in 14-day



Deaths caused by COVID-19

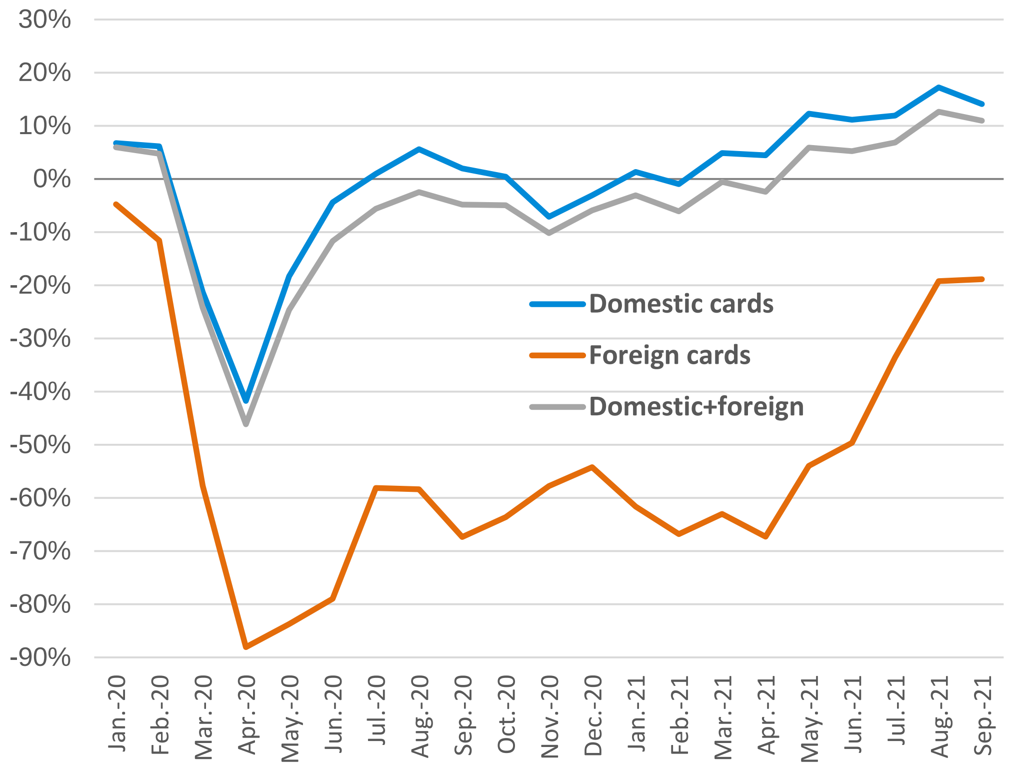
Deaths per 100k inhabitants accumulated in 14-day



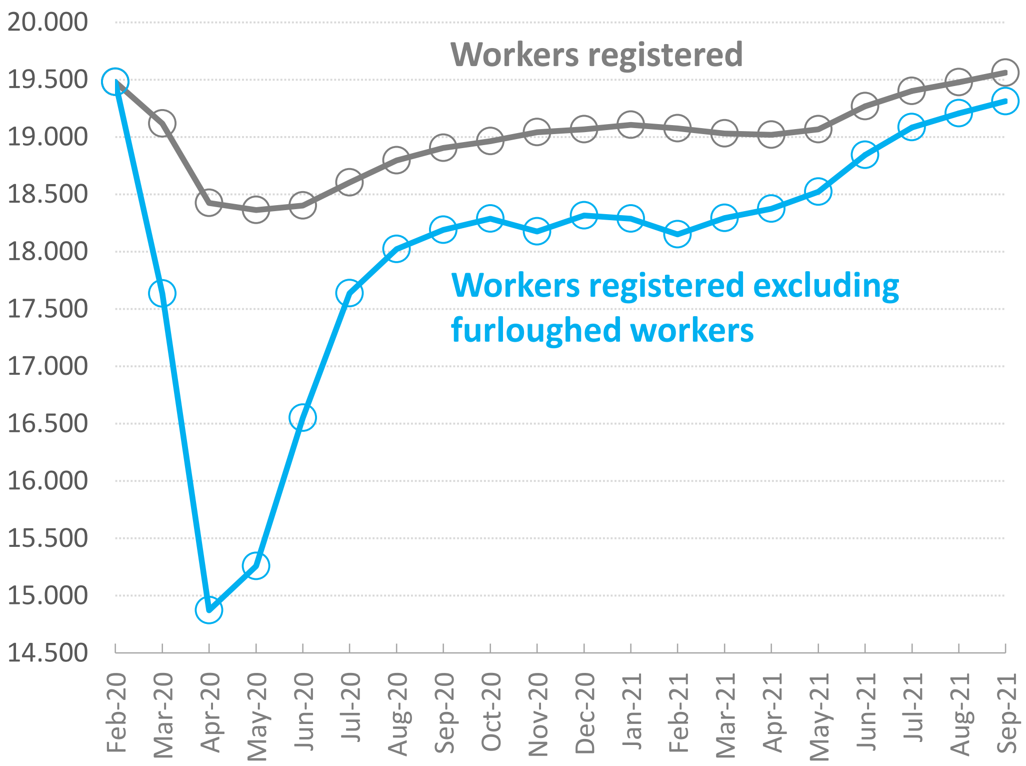
- **The Delta variant caused a new wave of contagions in western countries despite having a large share of their population vaccinated**. The Delta variant is very contagious among partially vaccinated people (effectiveness against contagion of AstraZeneca's first dose is 33% and Pfizer's is 50%) and relatively contagious even 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 below 50 cases per 100k inhabitants** at the beginning of October, the minimum level since July 2020 and well below the 250 extreme risk threshold. Pressure on the health system is moderating in almost all regions (7% of ICU beds are occupied by COVID-19 patients in Spain).
- In Spain, **77% of the total population and 98% of the population over 65 are fully vaccinated**. The Government approved a third dose of the vaccine (Pfizer and Moderna) to population over 70, which will start by the end of October.

Economic activity strengthens during the summer

Card activity (point of sale + e-commerce + ATMs)
Change with respect to same period 2019 (%)



Workers registered to Social Security System
Thousands



- **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 August and September (+17% and +14% 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.
- **Sustained recovery.** Indicators of economic activity show strong growth in Q3 although the pace of recovery seems to have moderated somewhat in September. On the labor market front, in September employment added 82k workers in seasonally adjusted terms and workers in a furlough scheme declined by 22k (249k left). As a result, employment, net of furloughed workers is just 0.9% below the pre-crisis levels. Confidence indicators remain at historical highs, the manufacturing and services PMI both sitting in September at 58.1 and 56.9 points, respectively, well above the no-change threshold (50 points).

INE's downward GDP revision prompts a recalibration of GDP projections

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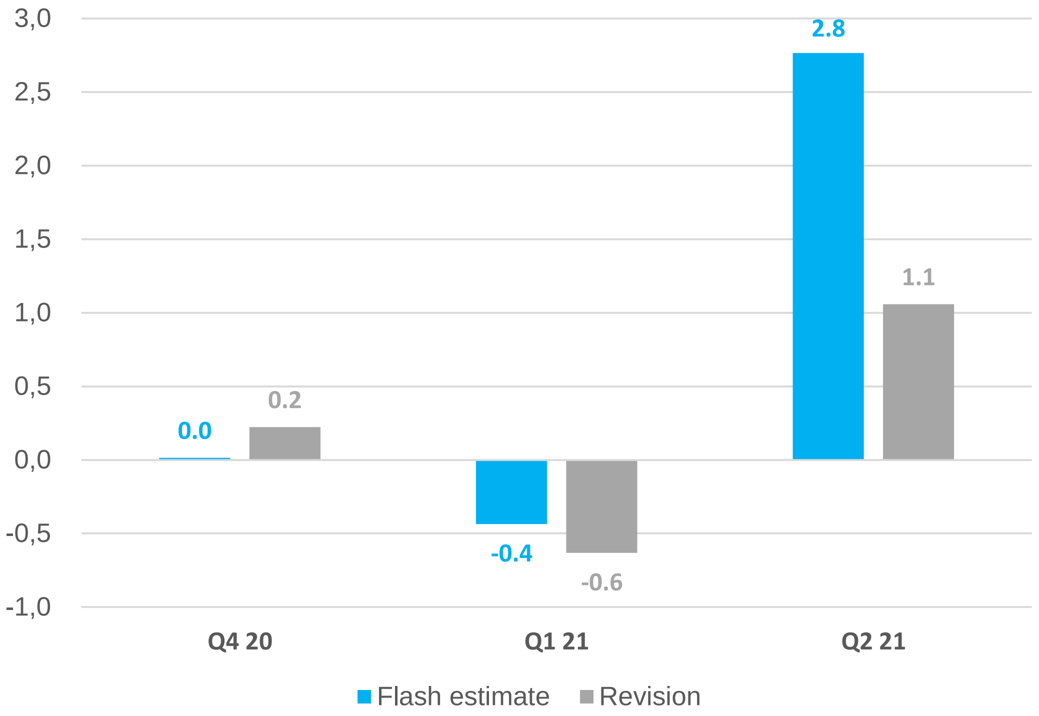
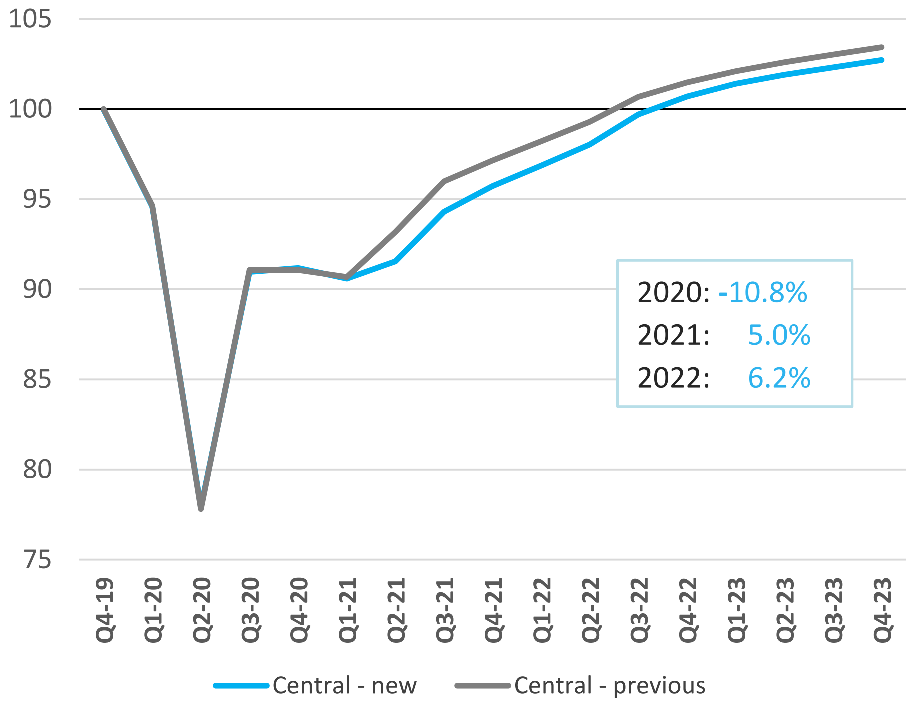
Quarterly GDP growth

Percentage change (%)



GDP projections

Index (Q4 2019 = 100)

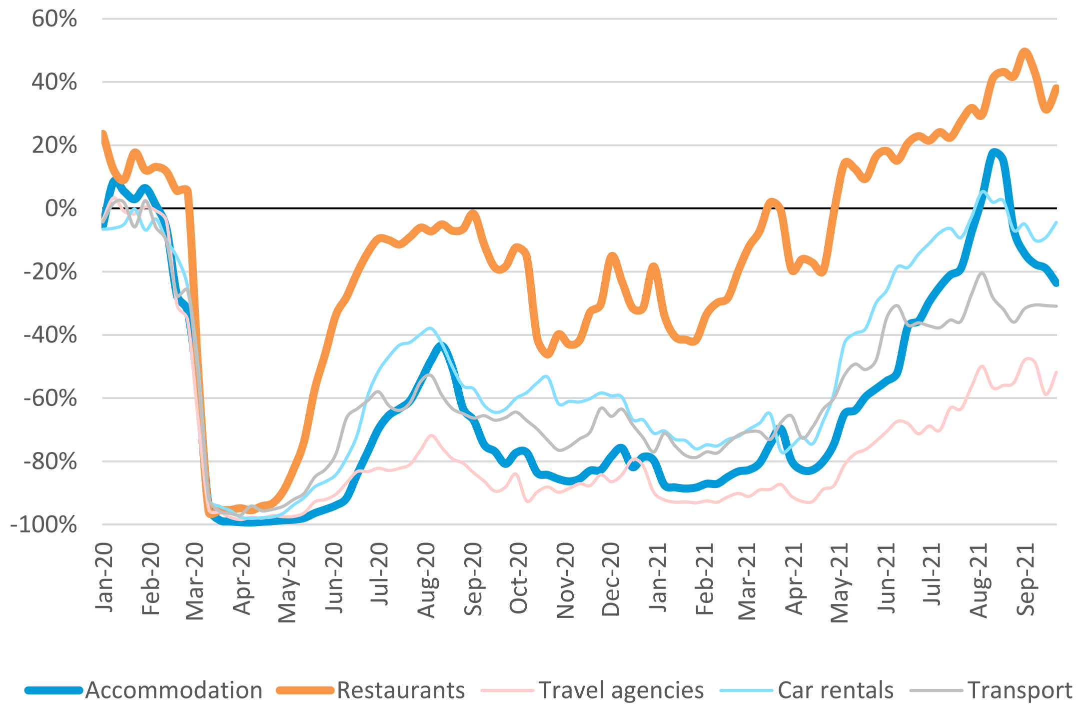


- **GDP growth estimates have been slashed.** The national statistical office (INE) revised quarterly GDP growth downwards both in Q1 and Q2 2021 to -0.6% (-0.2 p. p.) and to 1.1% (-1.7 p. p.), respectively. Zooming into the Q2 revision, private consumption growth took a hit of -1.9 p. p. to 4.7%, while imports growth has been revised upwards by 1.3 p. p. to 4.2%. Overall, it was a revision of a magnitude rarely seen before.
- **The recovery consolidated during the summer despite the spread of the Delta variant**. The new wave of contagions did not forfeit the economic recovery during the summer 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.
- **Following the downward revision of GDP growth in Q2, we lower our growth forecast for 2021 to 5.0%.** The downward GDP revision implemented by INE has more than offset the positive news coming from the growth surprise in Q3 2021 (we estimat growth of c.3.0% qoq). A more muted recovery in 2021 allows for a stronger rebound in 2022. Accordingly, we increased our forecast for 2022 by 0.2 p. p. to 6.2%. Under the new scenario, GDP reaches pre-crisis levels in Q4 2022, one quarter later than envisaged in our previous scenario.

The tourist sector springs back to life during the summer season

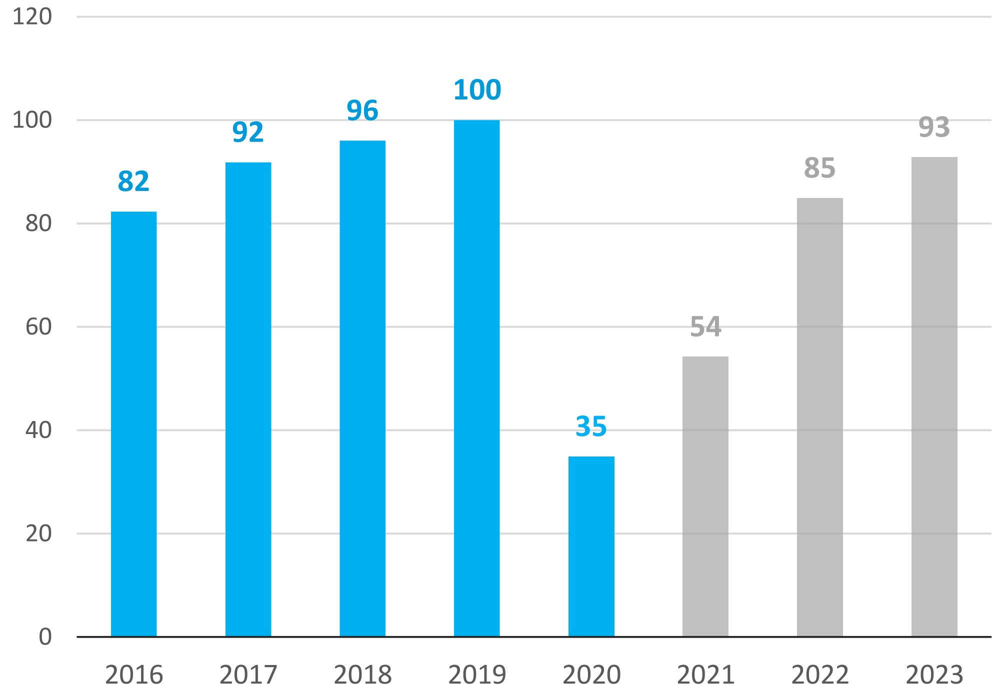
Card activity (point of sale) in tourism related businesses

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



Tourism GDP forecasts

Index (2019 = 100)



- **Tourism activity cools down in September, but the recovery is still ongoing:** CaixaBank internal data shows that expenditure on tourism related activities moderated in September, after the extraordinary rebound observed in August. At the end of September, credit card expenditure in accommodation (hotels and similar) was 24% below the same period of 2019 (way above the -81% figure recorded in September 2020). Foreign card expenditure decreased 36% with respect to the same period of 2019, while Spanish credit card payments were 11% above the 2019 reference. In the coming months, tourism activity is expected to improve 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 will continue as vaccines become more widespread and international mobility flows normalize–although it will take time to return to pre-pandemic levels.

The real estate sector: recovery underway

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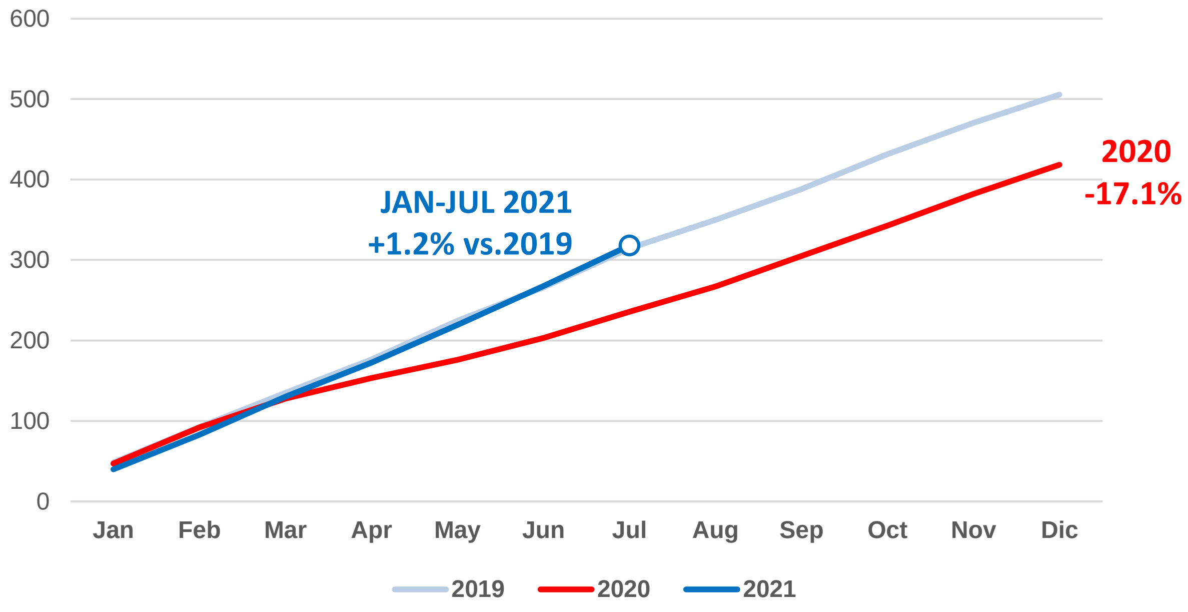
Housing sales

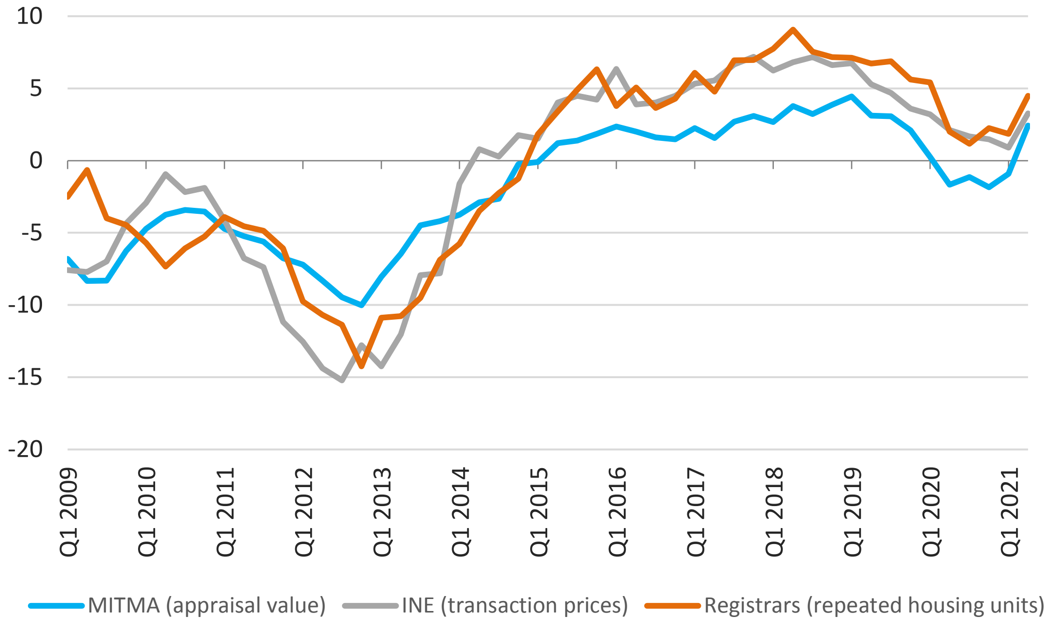
(Thousand, cumulative over the year)



Source: Eurostat.

Housing prices

Year on year (%)

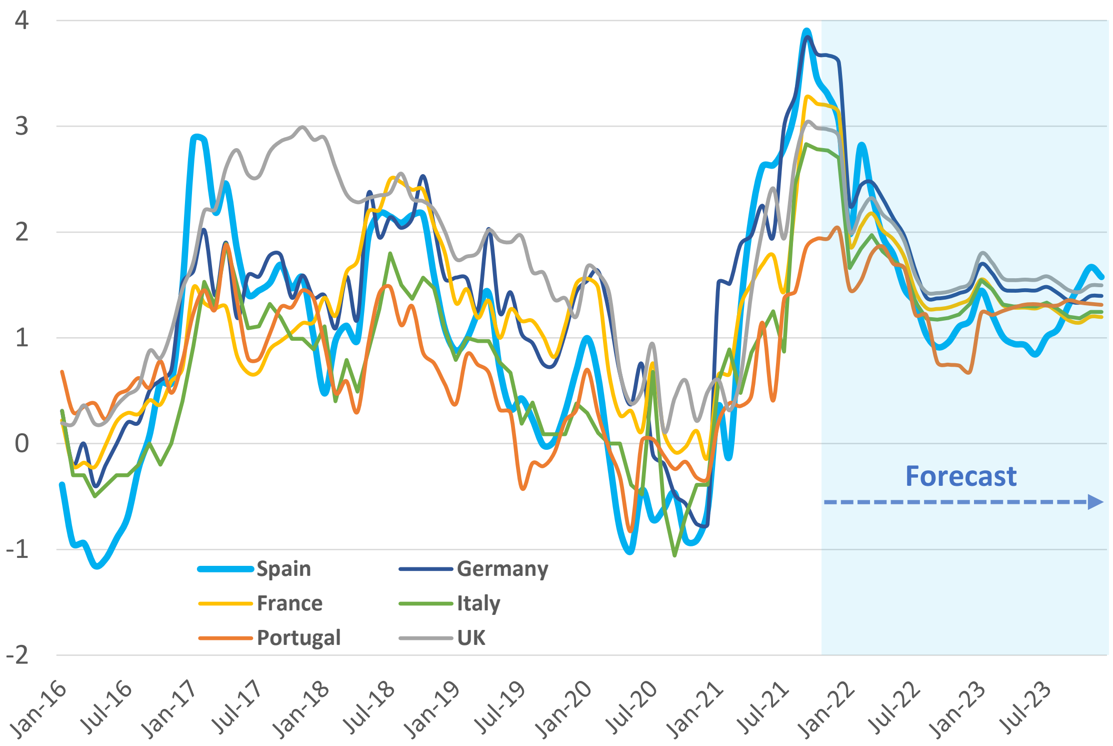


Source: INE, Ministry of Public Works, Association of Registrars.

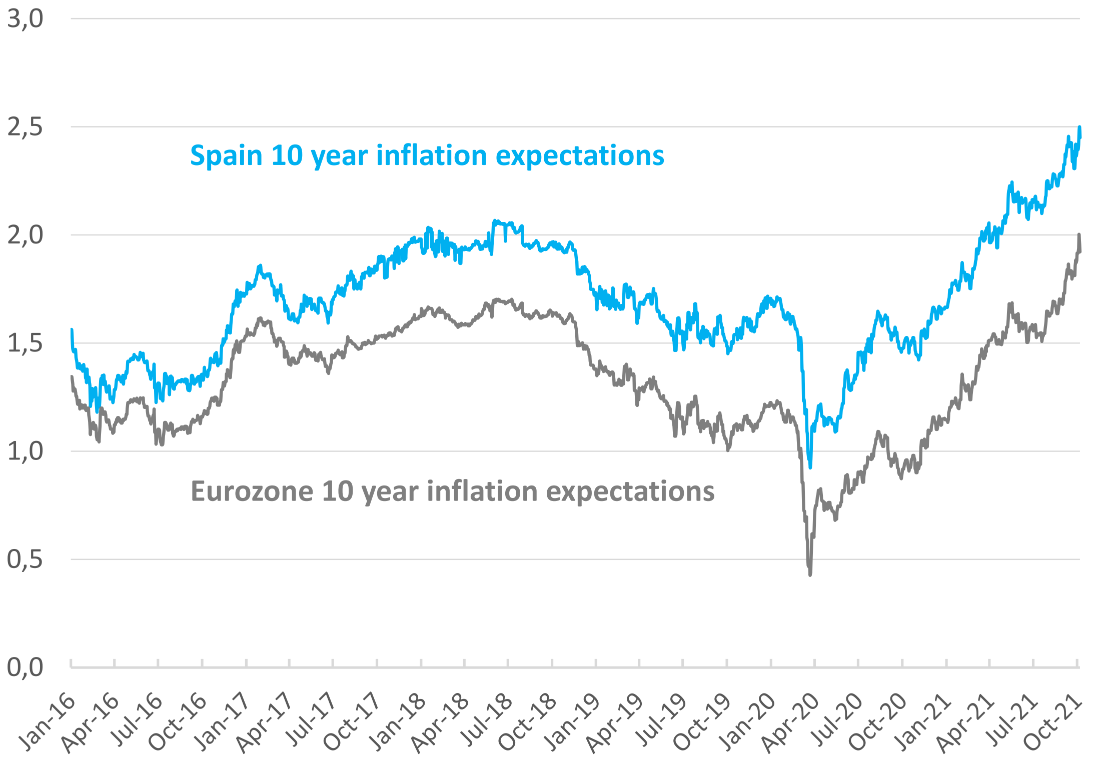
- **The steady performance of the real estate market has been a surprise during the COVID-19 crisis.**
- Real estate prices experienced a mild downward adjustment in 2020 but are currently exhibiting an upward trend (Q2 2021: +2.4% yoy appraisal value, +3.3% yoy transaction prices, +4.5% yoy registrars' index based on transactions on the same housing units). We project an **uptick on real estate prices in the next few quarters** because of a temporary decoupling of demand (fast recovery) and supply (slowly catching-up):
    - **On the one hand, housing sales have recovered quite swiftly**, after experiencing a sharp decline in 2020 (-17.1%). In Jan.-Jul. 2021, housing sales increased by 1.2% compared to Jan.-Jul. 2019. New housing sales are increasing at a faster pace (+13.1% in Jan-Jul. 2021 vs. Jan.-Jul. 2019) than sales of existing housing (-1.5%). We expect housing demand to remain strong in the coming months, although it may decelerate slightly because of the vanishing effect of pent-up demand.
    - **On the other hand, building permits are recovering at a slow pace** due to the presence of bottlenecks (labor shortage in several specialized jobs, price increase of raw materials) and uncertainty (evolution of the pandemic, speed of economic recovery, regulatory changes). We project building permits to reach ~90k and ~95k in 2021 and 2022, respectively, compared with 86k in 2020 and 106k in 2019.
- **The fundamentals of the Spanish real estate market are solid** (no excess supply or indebtedness from households or real estate developers) and residential investment as a percentage of GDP is well below the previous cycle (5.6% of GDP in Q2 2021 compared to 11.8% of GDP in 2006).

Inflation is on the rise on the back of electricity prices

Inflation: general CPI
(%)

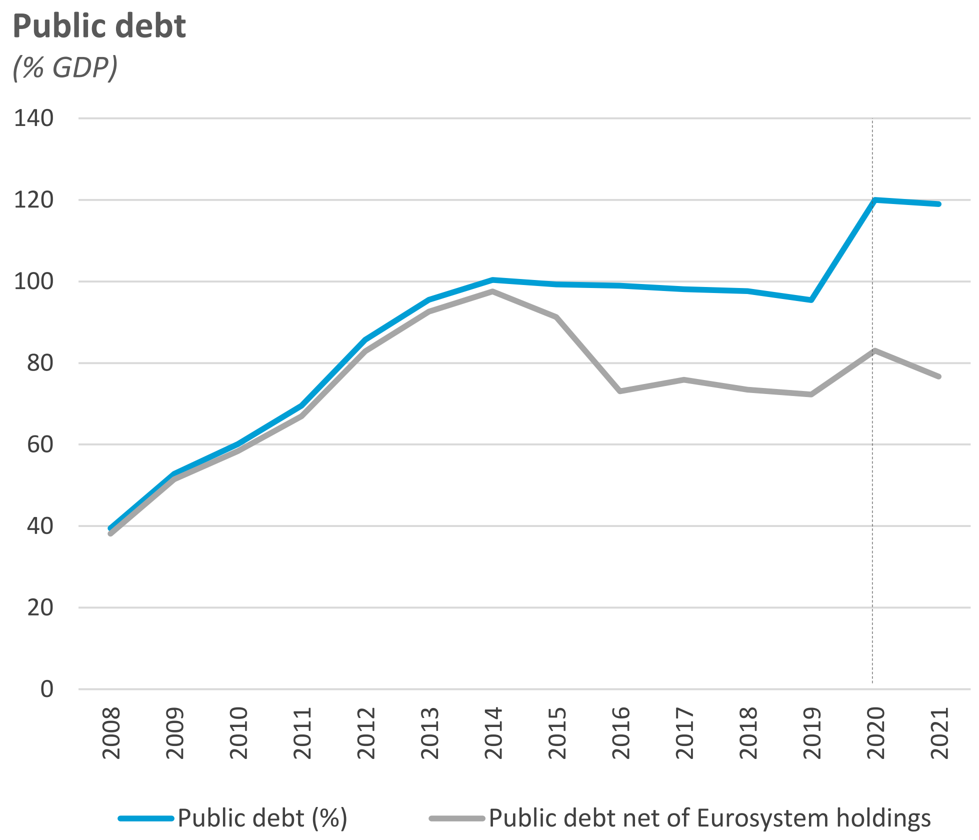


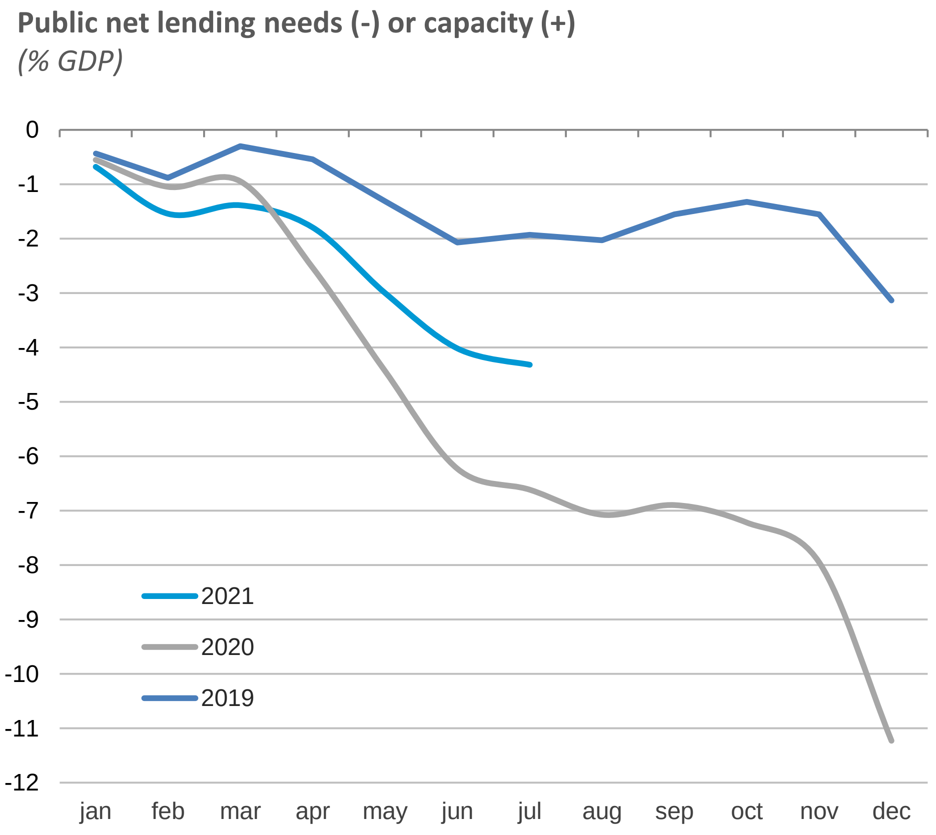
Long-term inflation expectations
(%)



- **Inflation dynamics in Spain have been mainly driven by energy prices over 2021**, an effect likely to be sustained into the first quarter of 2022. This particularly reflects the strong pressure exerted by electricity prices since March (wholesale prices reached past 150€/MWh in September, vs. a pre-pandemic price at around 50€/MWh). This trend has been partly offset by a set of measures approved by the government since June aimed at containing electricity prices. Despite the strong uptick of headline inflation, core inflation remains at 1%, 3 p. p. below the headline rate.
- **Inflationary pressures are likely to prove temporary**. The increase in energy prices is largely due to a combination of factors, among others, production disruptions, ongoing geopolitical tensions with Russia and low level of reserves of natural gas in Europe with the winter season soon approaching, that are likely to fade away in 2022. Other factors may prove of a more structural nature, such as increased competition for U.S. liquefied gas from Asian countries or increased cost of CO_2 emissions, but these latter factors are not likely to induce further significant increases in the near future.
- **Inflation expectations remain anchored around target.** Despite the strong upswing in inflation in 2021, ten-year ahead inflation expectations remain close to their long-term 2% target both in Europe and Spain.

Increase in public revenues and spending in 2022



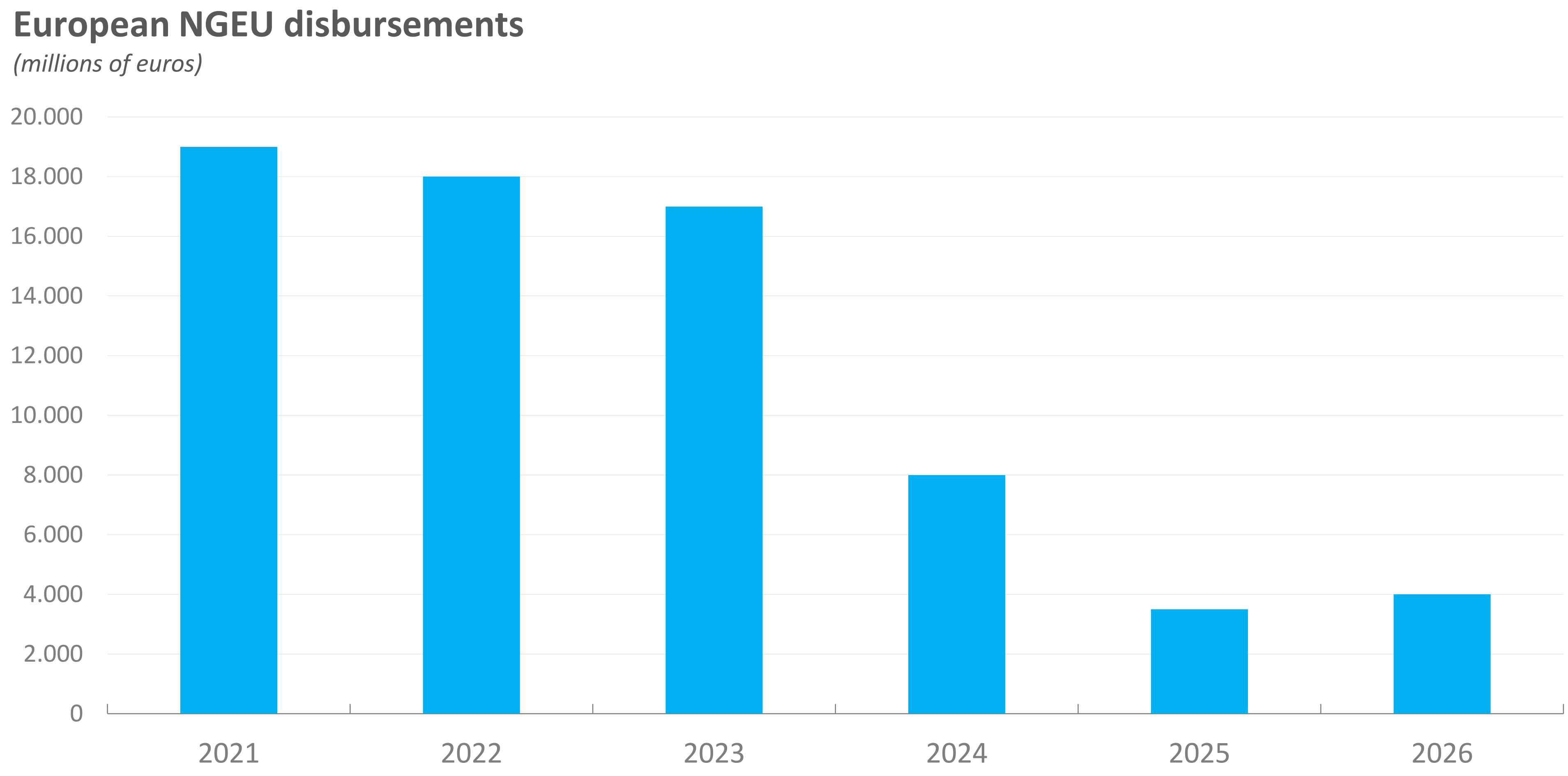


- The **2022 State Budget Project** in Spain foresees a notable increase in revenues and expenditure.
- **Spending**: growth of 2.3% year-on-year in consolidated state non-financial spending, with the inclusion of more than €26bn of NGEU funds. Strong increase in structural spending with pensions total expenditure increase of €7.9bn w.r.t. 2021 (+4.8%) and 2% increase of civil servant salaries, while budgeted unemployment benefits decrease by €2.5bn (-10.2%).
- **Revenues**: strong rebound (+8.1% year-on-year) thanks to the economic recovery but likely overestimation due to optimistic Government macroeconomic outlook (cumulative growth 2019-2022: +1.6%).
- The Government public deficit target of 5.0% in 2022 appears difficult to attain considering the measures in the current budgetary plan and the optimistic macroeconomic forecasts.

NGEU funds: updates and what is in the pipeline for Spain

Running projects	▸ **Mobility**: Low emissions zones and renovation urban transport (€1bn). PERTE to produce a 100% Spanish connected electric vehicle (€4.3bn public spending, €24bn in total). ▸ **Real estate:** Housing renovations 510,000 homes (2021-23 €3.4bn) with subsidies between 40% and 80% of total renovation costs conditional on the energy savings of the renovation. ▸ **Digitalisation:** Next Tech Fund (€2bn) to increase start-up size in disruptive technologies. ▸ **Education:** Digitalisation of education and universities (€1bn) and Strategic Plan to foster vocational training (€0.3bn). ▸ **Social policies:** transfer of €1bn to CCAA to bolster social services and reinforce care assistance.
Investments at initial stages	▸ **PERTES:** 1) modernisation of agro-food sector (€1bn) and 2) Spanish language in AI. ▸ **Digitalisation:** digital kit (€0.5bn) to help small companies invest in their digitalisation. ▸ **Green transition:** renewable energy deployment, renewable hydrogen and sustainable transportation.
Recent reforms (anteproyectos de ley)	▸ **Pensions:** Pension annual increase linked to CPI and incentives to delay retirement age. ▸ **Business creation:** Possibility of forming a Limited Liability Company with a social capital of just €1, eliminating the former legal minimum of €3,000. ▸ **Insolvency law:** debt relief is facilitated and transposition of the European normative. ▸ **Education:** University and vocational training laws.
Key reforms on the horizon	▸ **Labour market:** Simplification of labour contracts and how to finance a a new permanent mechanism of labor adjustment (structural ERTE) to reduce duality (both in **Q4 2021**). ▸ **Pensions:** Promotion of workplace pension schemes through the creation by the Administration of pension funds open to all companies and workers **(Q2 2022).**

Expected calendar of European NGEU disbursements



Total: €69.5bn (≈5.6 of 2019 GDP) of non-refundable transfers.

Already received **€9.0bn.**

Next disbursement: **€10bn. expected dec-21**

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

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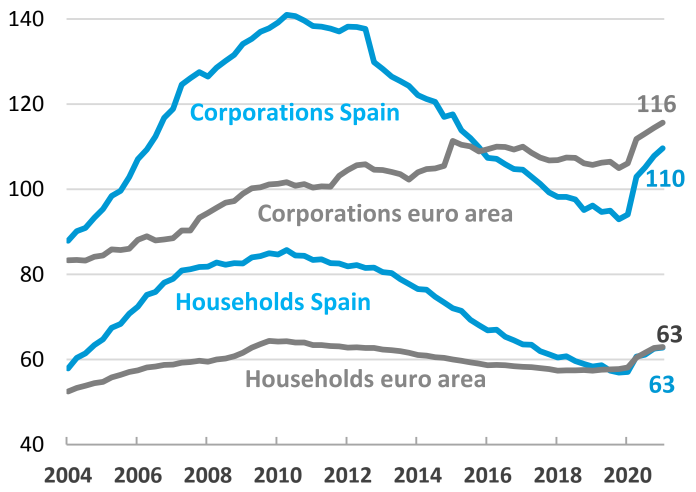
Gross private debt

% of GDP, non consolidated debt.



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

Private domestic credit

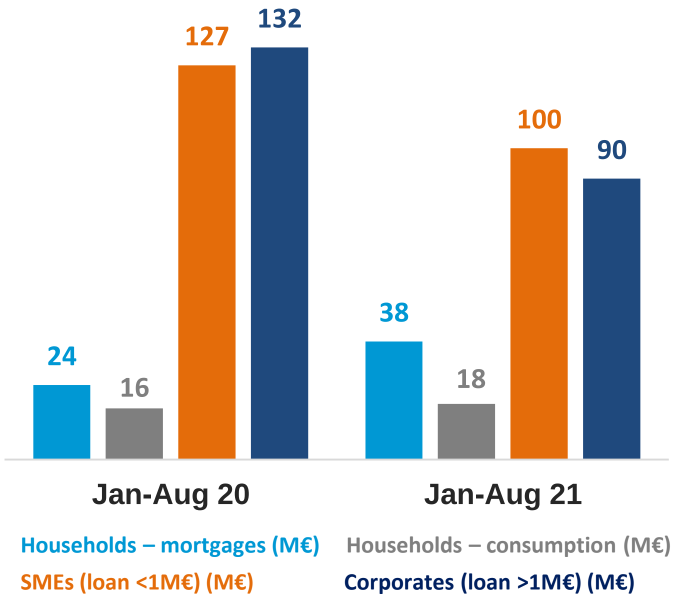
Year on year (%)

	Dec-20	Aug-21 (latest)	2021 (forecast)
	% yoy	% yoy	% yoy
Total credit	**2.5%**	**-0.9%**	0.4%
Households	-1.2%	0.0%	0.6%
Housing mortgages	-1.3%	0.5%	0.8%
Other purposes	-0.8%	-1.6%	-0.1%
Of which consumption	-2.6%	0.4%	0.5%
Businesses	8.2%	-2.2%	0.0%
Non-real estate developers[1]	12.2%	-0.8%	-
Real estate developers[1]	-5.3%	-4.3%	-

Note: (1) latest available data Jun-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** remains below pre-covid levels due to the high savings generated during the pandemic and the postponement of some consumption decisions until the availability of NGEU funds
- **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 sustain the stock of loans.

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

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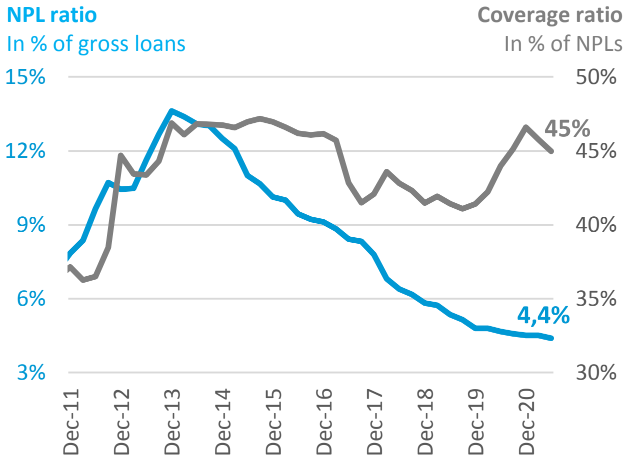
NPLs and coverage ratios[1]

%



Non expired moratoria[2]
1.1% of loans to households
1.3% of loans to NFC

Cost of risk[3]
0.9% in 2020
0.6% in 2Q21

Note: (1) latest available data Jun-21. (2) Based on EBA data as of Jun-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

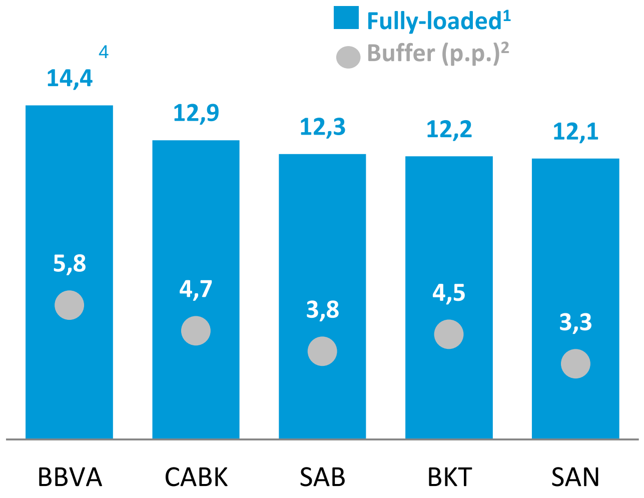
In % of average total assets (Q2 21; trailing 12M)

	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%,** despite the fact that most debt moratoria have expired in the 2Q (non-expired moratoria decreased to 1.2% of household and NFC loans in 2Q21 vs a peak of 7.8% in 2Q20). Although the NPL ratio is expected to worsen somewhat as all debt moratoria expire and companies start facing repayments of guaranteed loans, the increase will be limited 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 deleverage so business volumes will not grow as fast as GDP.
  - 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.
- **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

%, 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	2,3	2,1	-10,8	5,0	6,2
Private Consumption	-3,4	-3,0	1,7	2,9	2,6	3,0	1,8	0,9	-12,2	6,0	5,3
Public Consumption	-4,2	-2,1	-0,7	2,0	1,0	1,0	2,3	2,0	3,3	3,2	1,0
Gross Fixed Capital Formation (GFCF)	-7,4	-3,8	4,1	4,9	2,4	6,8	6,3	4,5	-9,5	4,4	10,0
GFCF - equipment	-7,1	2,4	5,6	9,1	1,8	9,2	4,7	3,2	-12,9	13,4	8,0
GFCF - construction	-10,4	-8,2	3,0	1,5	1,6	6,7	9,5	7,1	-9,6	-1,0	11,0
Exports	0,9	4,4	4,5	4,3	5,4	5,5	1,7	2,5	-20,1	11,3	9,9
Imports	-5,8	-0,2	6,8	5,1	2,6	6,8	3,9	1,2	-15,2	12,4	7,0
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	-8,2	-5,6
General government debt (% GDP) [2]	85,7	95,5	100,4	99,3	99,0	98,1	97,6	95,5	120,0	120,2	116,4
Housing prices	-8,7	-5,8	-2,4	1,1	1,9	2,4	3,4	3,2	-1,1	1,6	3,0
Risk premium (vs. 10Y Bund, bps, Dec.)	429	295	149	120	124	120	97	88	86,3	64,7	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.