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Briefing note
Macroeconomic projections for the Spanish economy (2020-2022)

This note describes the key features of the macroeconomic scenarios for the Spanish economy for the period 2020-2022, which the Banco de España has published today on its website (available at this link). Compared with the scenarios of last June, the current projections incorporate the new information that has since become available; among other elements, this includes the preliminary estimates of the Quarterly National Accounts (QNA) for 2020 Q2 and the changes observed in the technical assumptions underlying the construction of the scenarios.

In recent months, the COVID-19 pandemic has led to unprecedented disruption of economic activity, both at global level and in Spain. **The short and medium-term economic outlook continues to be highly dependent on epidemiological developments, in respect of which there remains a high degree of uncertainty.** The limited information available as at the cut-off date for this projections exercise as to the precise magnitude of the impact that the rise in COVID-19 cases observed in Spain in recent weeks may already have had on the buoyancy of activity, as well as the uncertainty regarding the epidemiological developments in late September, have made it advisable to formulate two alternative scenarios for Q3 (each constituting the starting point for a distinct scenario over the whole projection horizon).

The main difference between these two scenarios stems from the assumptions regarding the course of the pandemic over the coming quarters, which, in turn, determines the degree of severity of the containment measures that may be necessary and their consequent impact on economic activity. Both scenarios assume that the availability of an effective medical solution for COVID-19 after 2021 Q2 will enable any containment measures in force at that time to be lifted.

Scenario 1 envisages the emergence of outbreaks that would only require containment measures of limited scope, both from a geographical standpoint and in terms of the sectors affected. These measures would cause relatively limited additional disruption to economic activity, their impact being more severe in sectors linked to leisure and accommodation and food service activities (and, on the demand side, tourism), while activity in other sectors would only be affected indirectly through spillover effects.

Scenario 2, in contrast, envisages more intense outbreaks of the pandemic in the short term. It is assumed that the containment of these outbreaks would not require the application of such strict and widespread social distancing measures as those that were in force before lockdown began to be eased, but it is envisaged that the restrictions required, apart from having a greater impact on the activity of services sectors, may also have a direct impact (not only through spillover effects) on the buoyancy of other productive sectors.

Under these considerations, **the economy's output would fall by 10.5% on average in 2020 in scenario 1, and by up to 12.6% in the event that the less favourable epidemiological situation underlying the construction of scenario 2 were to materialise.** That said, the pickup in activity projected for the second half of this year, following the historic collapse recorded in the first half, would have a positive carry-over effect on the average GDP growth rate in 2021, which would reach 7.3% in scenario 1, while remaining at 4.1% in scenario 2, as a consequence, in this second case, of the greater incidence of the pandemic until the middle of next year. The prolonging of the recovery would give rise to more modest growth in activity in 2022. In any event, **at the end of 2022, GDP would stand some 2 percentage points (pp) below its pre-crisis level in scenario 1, a gap that would widen to somewhat more than 6 pp in scenario 2.**

The impact of the health crisis on the labour market and on public finances will be relatively long-lasting. Total hours worked would fall very sharply on average in 2020: by 11.9% in scenario 1 and 14.1% in scenario 2. Although the rise in this variable, which began with the easing of lockdown, would continue over the rest of the projection horizon, the total number of hours worked at the end of 2022 would still be 4.5% and 8.3% lower than before the COVID-19 crisis under scenarios 1 and 2, respectively. As regards public finances, it is estimated that the general government deficit will increase sharply in 2020, to stand at 10.8% and 12.1% of GDP in each of the two scenarios considered. Although these ratios would fall over the projection horizon, the budget deficit would remain very high in 2022. Public debt, meanwhile, would increase in 2020 by more than 20 pp in scenario 1 and by some 25 pp in scenario 2, to stand at 116.8% and 120.6% of GDP, respectively. This ratio would continue to increase in the next two years, to a greater extent, in cumulative terms, under scenario 2.

Turning to consumer prices, following the notable slowdown in recent months, both the overall and the core inflation rates are expected to stabilise at close to their current levels over the rest of the year. Accordingly, on average in 2020, the annual change in the overall HICP would stand at -0.2% in scenario 1 and -0.3% in scenario 2, while the HICP excluding food and energy would be 0.7% and 0.6% in each of the scenarios. Over the rest of the projection horizon, prices are expected to continue to record very moderate, albeit gradually rising, rates of change, against a background of gradual recovery in demand and a certain acceleration in energy prices.

In the scenarios described, **the risks to economic growth lie on the downside over the whole of the projection horizon**. Specifically, it cannot be ruled out that, in the coming quarters, more unfavourable epidemiological developments than those considered in scenario 2 may materialise, entailing the need for more stringent restrictions on movement or activity, or that obstacles may arise that lead to delay in the timeframe for developing and distributing an effective COVID-19 remedy. Neither can it be ruled out that, despite the economic policy measures deployed in response to the current health crisis, the deterioration in the potential growth of the economy may be more acute than envisaged in the scenarios described. Beyond the possible additional implications of the pandemic, other relevant risks persist in relation to the external environment, such as the possibility of no agreement being reached when the Brexit transition period ends, and trade tensions between the United States and China could intensify.

By contrast, a very important upside risk derives from the various pan-European initiatives launched in response to the crisis, most notably the Next Generation EU recovery programme approved at the end of July. The scenarios designed in this projections exercise do not incorporate the effect of this programme as the precise details regarding its scale, use and the timing of distribution of the funds that may be channelled through it are still unknown. However, the estimates of the Banco de España suggest that, under certain assumptions, the macroeconomic effects of this programme may be potentially significant.