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The Spanish economy in 2022. Situation and economic policy challenges

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*English translation of the original speech in Spanish.

Minister of Foreign Affairs, European Union and Cooperation; Chair of the National Securities Market Commission; ladies and gentlemen, good afternoon.

I should like to thank the Governing Board of Spain Investors Day and its chairman, Benito Berceruelo, for their kind invitation to speak at the 12th edition of this annual international forum, which, like previous editions, will doubtless help foster international investment in Spain.

The event takes place amid more favourable circumstances than last year's edition. The vaccine roll-out and the extraordinary support provided by economic policies have significantly improved the global economic situation and outlook. However, as the emergence and rapid spread of the omicron variant remind us, the situation is far from normal and uncertainty remains high.

The latest projections serve to illustrate the improved global economic situation. For example, following a significant decline in global GDP in 2020 (down 3.1%), the most recent forecasts from the International Monetary Fund indicate robust growth in 2021 (5.9%) and 2022 (4.9%).

The euro area recorded a sharper GDP decline in 2020 (of 6.5%), but the latest Eurosystem projections likewise point to robust growth in both 2021 (5.1%) and 2022 (4.2%), which would allow pre-pandemic GDP levels to be reached around the turn of the year.

The Spanish economy has followed a similar trajectory, albeit with a sharper initial GDP impact from the crisis and a slower recovery.[1] This has largely owed to our greater reliance on the tourism sector,[2] but also to weaker household consumption and investment (the latter hit hard by the global supply crisis), particularly in the automotive industry, which accounts for a large share of the Spanish economy.

Employment developments, however, have been more favourable, both in terms of hours worked[3] and, in particular, effective social security registrations. For instance, in April 2020, nearly one in four people who were registered with social security before the outbreak of COVID-19 had either lost their job or were furloughed. The latest available figure (for December 2021) shows effective social security registrations already exceeding pre-crisis levels.[4]

The Banco de España's projections published last December envisage the recovery continuing at a good pace over the next three years. In the near term, however, the economy will remain stymied by the spread of the omicron variant. Nonetheless, stronger growth is

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[1] Following the quarter-on-quarter growth of 1.2% and 2.6% in the second and third quarters of 2021, respectively, the Spanish economy's GDP in 2021 Q3 showed a gap of 5.9 percentage points (pp) against that observed at end-2019 (0.3 pp for the euro area).

[2] The decline in foreign tourist arrivals prompted a slump in services exports, which in 2021 Q3 remained 28.7% below pre-pandemic levels; this contrasts with the performance of goods exports, which now stand 1.9% above pre-pandemic levels.

[3] In 2021 Q3, hours worked stood 3.5 pp of GDP below the level observed at end-2019 (for GDP that gap was 5.9 pp).

[4] An increase of 0.7% as compared with February 2020 in seasonally adjusted terms. Effective social security registrations are total social security registrations less furloughed workers.

expected thereafter, as the supply chain disruptions and inflationary pressures abate and tourist flows gradually normalise. This should also be supported by impetus from the projects funded through the Next Generation EU programme and by financing conditions remaining favourable.

Specifically, the projections envisaged annual GDP growth of 4.5% in 2021, picking up to 5.4% in 2022 and then standing at 3.9% in 2023. The National Statistics Institute's upward revision of GDP estimates for 2021 Q2 and Q3, published after the cut-off date of those projections, would entail a slight upward revision of these estimates for both 2021 and 2022 (assuming all other aspects of the forecast remain the same). If confirmed, this trajectory would see GDP recover its pre-pandemic level between the final stretch of 2022 and early 2023.

In any event, as I indicated earlier, these projections are still subject to **several elements of uncertainty** that will influence the speed and depth of the recovery.

Evidently, **the pandemic** remains the main source of uncertainty, although, in terms of its economic impact, we should acknowledge that economies have increasingly adapted to COVID-19 with each successive wave.

Any restrictions associated with the pandemic would have a particular bearing on **international tourism**, a key sector for Spain given its sizeable contribution to the country's economy.[5] The projections assume that non-resident tourism will return to pre-pandemic levels in 2023. However, depending on how such restrictions develop, the recovery could be hastened or delayed.

There is also uncertainty surrounding the duration of the **global supply chain bottlenecks**, which are proving more persistent than expected[6] and are significantly hampering activity.[7] These problems are expected to moderate as of 2022 H2, although, again, that assumption is subject to much uncertainty.

A further element of uncertainty is how households decide to use the savings built up during the pandemic (more than 6% of GDP), as this will shape the course of **private consumption** in the years ahead. Given that these savings are largely concentrated among relatively high-income households (whose marginal propensity to consume is lower) and that the bulk of the unrealised spending cannot be readily deferred (e.g. on restaurant and entertainment services), only a portion of the savings are expected to go towards consumption. However, that portion could prove larger than anticipated.

Given their size, one key factor that will determine economic developments in the coming years is use of the **NGEU funds**. The Banco de España's projections envisage the implementation of projects amounting to more than €60 billion in 2021-2023. However, their economic impact will depend on the pace of absorption, the design and execution of the

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[5] Tourism exports accounted for 5.7% of Spanish GDP in 2019, 3 pp above the euro area average.
[6] For instance, the latest round of the Banco de España's Business Activity Survey shows the proportion of firms reporting supply difficulties rising significantly between 2020 Q4 and 2021 Q4 (up from 13% to 31%, and reaching 51% in industry).
[7]See Box 5 "The potential impact of global supply chain bottlenecks on the Spanish economy in coming quarters", "Quarterly report on the Spanish economy", Economic Bulletin 4/2021, Banco de España.

projects undertaken and the accompanying structural reforms. Use of these funds was somewhat behind schedule in 2021, reflecting the complexity of implementing a very large volume of projects in a short period of time. The priority should be to select projects that offer high multiplier effects on potential growth and employment, and to accompany these with ambitious structural reforms.

Another element of uncertainty is the extent of the **scarring** that the crisis may have inflicted on the productive system or employment. Most sectors of activity had recovered their pre-crisis turnover levels by mid-2021, which also brought about a recovery in profitability and improved liquidity and solvency. However, the recovery remains partial in the sectors hardest hit by the pandemic, where a degree of credit quality deterioration has been observed, along with an increase in the number of firms subject to insolvency proceedings. That said, the latest data show the deterioration to be moderating, and the favourable employment developments should reduce the risks of a significant rise in structural unemployment.

Lastly, an additional element of uncertainty to have emerged in recent months, as a result of a combination of factors, is the **surge in inflation**. Prominent among these factors are the base effects stemming from the sharp drop in certain prices at the onset of the pandemic, supply difficulties, the steep rise in the prices of energy (especially electricity) and of other intermediate goods, and the impact of the recovery in demand on some services prices.

Inflationary pressures should ease over the course of 2022 thanks to the dissipation of the base effects and bottlenecks, and the partial reversal of the increase in energy prices signalled by futures markets. The forecasts suggest inflation in Spain (measured by the HICP) rising from 3% in 2021 to close to 4% in 2022, albeit with a gradual slowdown, particularly in the second half of the year, that would put inflation below 2% at end-2022 and in the years ahead.

However, two sources of risk could give rise to a more persistent inflationary process. First, a less marked energy price correction than signalled by futures markets, which might be prompted, for example, by a flare-up in geopolitical tensions. Second, a sizeable pass-through of the rise in inflation to wage demands would feed back into stronger price increases. For now, however, the growth in wage costs has been moderate.

Against this background of gradual recovery, but with various persistent uncertainties, **sound economic policies** remain crucial.

In the case of monetary policy, as I indicated earlier, recent developments continue to be consistent with a return to moderate inflationary pressures in the medium term, which is the relevant horizon for the design of European Central Bank (ECB) monetary policy. We must be on the lookout for any signs of a deanchoring of inflation expectations, which would be key to a more enduring bout of high inflation.

At the ECB Governing Council's December meeting we decided to discontinue the Pandemic Emergency Purchase Programme (PEPP) at the end of March 2022, reducing the pace of purchases in the first quarter. This decision reflects the view that the adverse impact of the health crisis on the medium-term inflation trend is behind us. At the same time, to facilitate a smooth adjustment in the flow of asset purchases, we increased the capacity of the asset purchase programmes (APP) by €20 billion in 2022 Q2 and by €10 billion in 2022 Q3.

In any event, given the current high level of uncertainty, we have maintained significant optionality and flexibility in the conduct of monetary policy. First, we have retained the option of resuming the PEPP if needed. Second, we have preserved the flexibility to adjust PEPP reinvestments across jurisdictions and extended the reinvestment period by a further year (until end-2024). Lastly, our forward guidance remains a key reference, with the first interest rate increase and the end of the purchase programme determined by inflation developments and forecasts at each point in time.[8] It is in this sense (if the current conditions for developments in underlying inflation and inflation forecasts remain unchanged) that our assertion that we do not anticipate interest rate increases in 2022 should be understood.
Turning to fiscal policy, the support should now focus on the sectors and agents still affected by the crisis (while being limited to viable firms), with temporary measures that do not further increase the structural budget deficit.

At the same time, the emphasis of budgetary policy should be on medium and long-term considerations. Now is the time to design a multi-year consolidation plan for implementation once the recovery has taken root, to allow the rebuilding of fiscal space and reduce the structural deficit and government debt. This plan must be designed to foster a greater fiscal policy contribution to the economy's potential growth, which requires an appropriately defined tax structure and expenditure efficiency improvements.

Emphasis must also be placed on identifying any crisis-induced structural changes and scarring. It should be acknowledged that factors of production need to be urgently reallocated across firms and sectors as a result of the crisis and the need to address the ecological transition and digitalisation. Economic policy should facilitate this adaptation and the efficient reallocation of resources towards the sectors with the strongest growth potential.

It would be remiss not to mention the challenges that the Spanish economy already faced prior to the pandemic, which are particularly significant in the present circumstances. These include low productivity, high structural unemployment, the fight against climate change, population ageing and inequality. These challenges should be addressed through a resolute agenda of structural reforms, underpinned by the use of the European funds.

Allow me to also explicitly mention the challenge of conducting economic policy against the backdrop of the current upturn in inflation. Providing support to the most vulnerable sections of society is clearly warranted. But firms and workers must internalise the fact that the response of economic agents will be crucial in determining the extent to which the increase in prices is temporary. Spain (and much of the rest of Europe) faces a shock to the prices of energy products that, broadly speaking, it does not produce. This involves a loss to the

[8] According to this forward guidance, the ECB Governing Council will only raise interest rates when three conditions have been satisfied: underlying inflation is compatible with convergence to the 2% target, medium-term inflation expectations reach 2% and expected inflation at the midpoint of the projection exercise (18 months) also reaches 2%. The forward guidance likewise governs the end of the purchase programmes, since these will run until shortly before we raise interest rates.

country. The priority should be to ensure that this loss is distributed equitably, thus preventing prices and costs from feeding back into each other, which would prompt additional adverse effects for competitiveness, economic activity and employment.

In short, and evidently conditional on the pandemic taking a favourable course, the growth outlook for the Spanish economy is consistent with the recovery continuing over the coming years, once the supply chain disruptions and inflationary pressures abate, tourist flows gradually normalise and use of the European funds gathers speed. That said, for this outlook ultimately to give rise to a lasting increase in economic growth and well-being hinges on the appropriate behaviour of economic agents and carefully nuanced economic policies, combining short-term support with resolute efforts to address the outstanding structural challenges.