Box 1

THE SPANISH ECONOMY BEFORE THE SPREAD OF THE CORONAVIRUS EPIDEMIC

The spread of the coronavirus health crisis outside Asia, which has ultimately led to the confinement of the population in Spain and in many other European countries, is an unusually virulent shock. It has sharply altered the trajectory of our economy. This box describes the main features of the developments observed prior to this shock.

The analysis of short-term economic developments is usually based on the assessment of various monthly indicators, which are released with a certain time lag with respect to the period to which they refer. Given this lag, the latest data currently available in the indicators of Spanish economic activity refer to January and February; accordingly, they do not capture the latest adverse developments.

Overall, the conjunctural indicators most representative of the behaviour of activity suggest that GDP had followed a similar trajectory in the two opening months of the year to that observed in late 2019. Indeed, the Banco de España's models for short-term GDP forecasting had projected growth of around 0.4% for the current quarter.[1] Along these same lines, the latest Social Security registration figures, which showed a notable improvement in monthly employment creation in February, had suggested - if we ignore the foreseeably much less favourable path in March - quarterly growth in employment similar to that observed in late 2019 (see Chart 1).

The somewhat better than expected behaviour of employment in February, the improvement in confidence in the first two months of the year and the stabilisation around the turn of the year in the year-on-year rate of increase in the outstanding balance of consumer credit, following the slowdown seen since mid-2018 (see Chart 2), suggested that household spending would foreseeably post positive growth in these months, following a zero increase in 2019 Q4. Conversely, new private car registrations held on a clearly negative trend in the first two months of the year, while January retail sales proved somewhat weaker than expected.

As to residential investment, the latest indicators relating to supply, which anticipate trends in activity in the sector in the coming months, such as building permits and construction material production indices, evidenced moderately negative signs for the start of the year. On the contrary, the data for the demand-related indicators, such as sales and mortgages on residential assets, were somewhat more buoyant. Finally, house prices, on figures to 2019 Q4, also pointed to an easing in residential activity, both in the second-hand property and new dwellings segments. And this especially in those regions where prices had been more expansionary since the start of the recovery.

After turning down heavily in Q4, the business investment outlook had improved somewhat in the opening months of the year. Indeed, to February, some qualitative indicators such as the manufacturing PMI and the European Commission's business climate survey, had shown something of a pick-up in business sentiment (see Chart 3). Moreover, financial conditions for non-financial corporations remained easy.

The scant information available for the start of the year suggested a reduction in the contribution of external demand to GDP growth in Q1, following the significant upward surprise in 2019 Q4, due essentially to the slowdown in goods and services exports. In the case of inbound tourism, the latest information on non-resident spending, which covers only January, showed a continuation of its expansionary trajectory. This was thanks to the increase in average spending per tourist, which offset the slowdown in total inflows prompted by the reduction in the main European outbound-tourist markets (see Chart 4).

Turning to public finances, in February the Spanish Parliament approved a revaluation of pensions and a rise in civil servants' remuneration which, so far, have not been accompanied by additional increases in revenue, against the background of the extension, for the second year running, of the 2018 State Budget. The latest information would suggest that headway had not been made in 2019 in correcting the public finances imbalances, and a budget deficit/GDP ratio similar to that of the previous year was expected to be recorded. That would entail a structural deficit in line with that of 2015, leading to the conclusion that the expansionary phase was not harnessed to build up a budgetary buffer that would have allowed the current health crisis to be tackled from a sounder position. The mildly declining path of the public

1 See A. Arencibia Pareja, A. Gómez Loscos, M. de Luis López and G. Pérez Quirós (2018), A short-term forecasting model for the Spanish economy: GDP and its demand components, Documentos Ocasionales 1801, Banco de España; and Álvarez, Cabrero and Urtasun (2014), A procedure for short-term GDP forecasting, *Economic Bulletin,* Banco de España, October.

Box 1

THE SPANISH ECONOMY BEFORE THE SPREAD OF THE CORONAVIRUS EPIDEMIC (cont'd)

Chart 1
SOCIAL SECURITY REGISTRATIONS (EXCL. CARERS) (a)

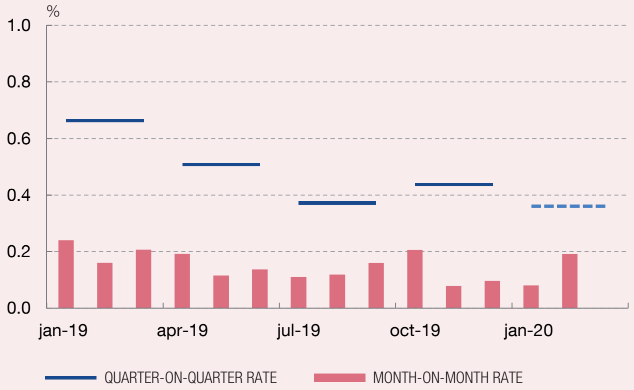


Chart 2
BANK LENDING TO HOUSEHOLDS

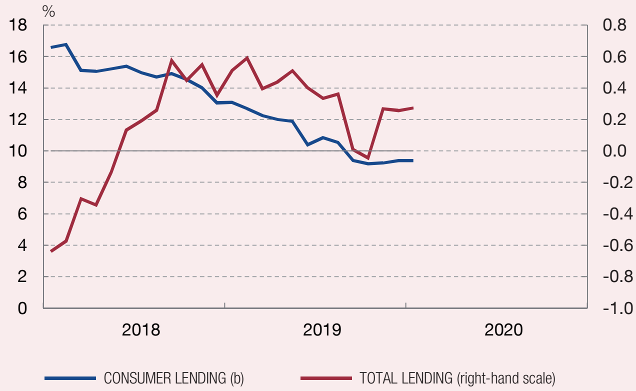


Chart 3
BUSINESS CONFIDENCE INDICATORS

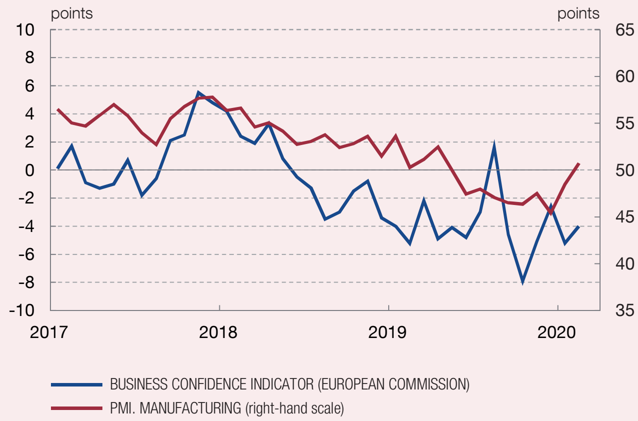


Chart 4
FOREIGN TOURISM INDICATORS

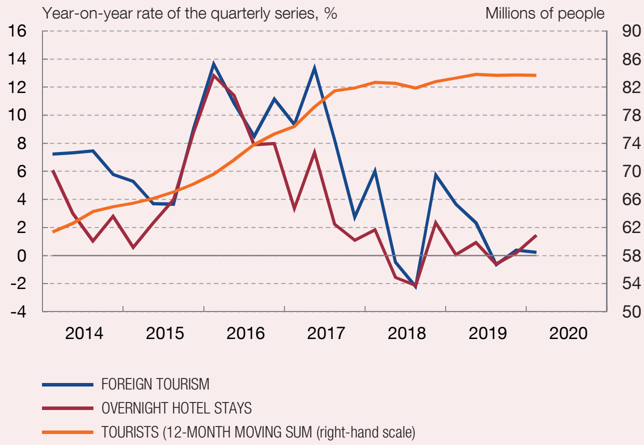


Chart 5
HICP. OVERALL INDEX

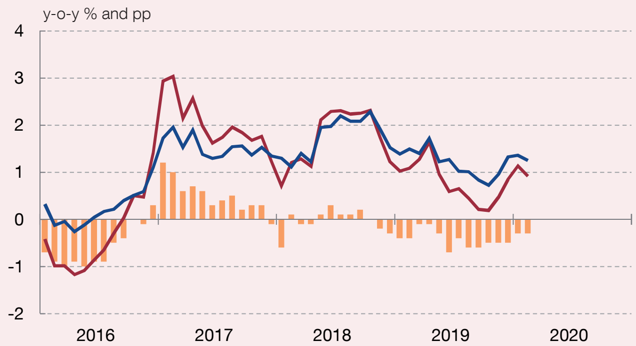
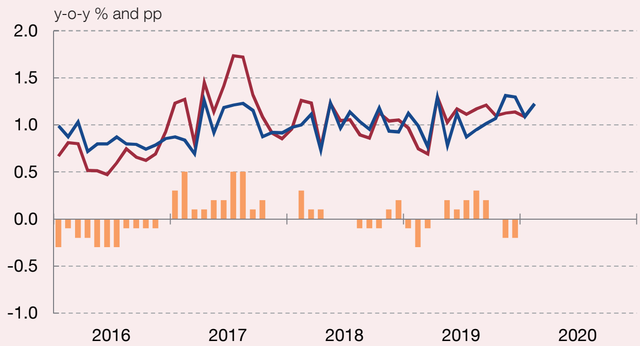


Chart 6
HICP. OVERALL INDEX EXCLUDING ENERGY AND FOOD



SPAIN EURO AREA DIFFERENTIAL

SOURCES: INE, Ministerio de Trabajo, Migraciones y Seguridad Social, European Commission, Markit Economics and Banco de España.

a Royal Decree-Law 6/2019 of 1 March 2019 restored the right of non-professional carers of dependents to enter into a special agreement with the Social Security authorities. Under the agreement, the State bears the cost of their Social Security contributions. This legal amendment has increased the number of non-professional carers from 7,300 (as observed in March 2019) to 57,600 (February 2020).

b Securitised lending not included in this segment.

debt/GDP ratio is expected to have continued in 2019, ending the year at 95.5% of GDP.

Inflation, measured by the Harmonised Index of Consumer Prices (HICP), has continued to post very moderate rates in recent months, standing at 0.9% in February (see Chart 5). Influencing these dynamics were, mainly, the year-on-year declines observed in energy prices. Core inflation grew in February by 1.3%, a rate slightly up on that observed over the past two years (see Chart 6). In terms of components, services inflation stood at 1.7%, while non-energy industrial goods prices held at a more moderate year-on-year growth rate (0.6% in February). Inflation in Spain has continued to stand marginally below that recorded in the euro area.

On the costs side, the latest available information on collective bargaining agreements, to February, suggested somewhat more moderate wage increases in 2020 (2%) than in 2019 (2.3%), affecting a higher number of workers (6.2 million). However, these wage rises solely reflect agreements signed in prior years.

In short, the information available for the first two months of the year pointed to a continuation of the expansionary phase, underpinned by some reduction in external uncertainties. Although there are still no monthly indicators that reflect the fact, the previous trajectory has been dramatically dislocated as from the last week of February, further to the outbreak of the coronavirus epidemic in Europe and, in particular, in Spain. The increase in uncertainty, the confinement at home of the population and the closedown of trade not involving the sale of staple goods is estimated to have translated into a notable reduction in private consumption. The contraction in demand and uncertainty are expected to have brought private investment decisions to a standstill. As regards external trade in goods and services, the impact of the heightening health crisis is estimated to have been particularly severe in the tourism sector, as the sharp recent decline in new hotel bookings and the widespread cancellation of those made earlier suggest. In terms of prices, the fall-off in demand and the strong reduction in oil prices will foreseeably lead to a decline in the inflation rate.