4

THE IMPACT OF THE PANDEMIC IN SPAIN AND THE ECONOMIC POLICY RESPONSE

4.1 The health crisis in Spain

In recent months the COVID-19 pandemic has posed a major public health challenge in Spain. The first case of COVID-19 infection in the country was diagnosed on 31 January 2020, but the incidence of the disease, both in terms of daily infection rates and deaths, peaked in March and April (see Chart 4.1.1). In light of the need to curb the rate of infection and prevent a collapse of the healthcare system, and as in the majority of countries affected by the pandemic, severe restrictions were imposed on people's movements and economic activity, and extraordinary measures were urgently adopted for the management of healthcare resources. Many of these measures were adopted in the framework of the state of alert, imposed with effect throughout the country on 14 March.

In practice, the state of alert involved confining people to their places of residence and shutting down almost all economic activity across a wide range of sectors. Specifically, people were only allowed to leave their homes to carry out a very limited number of essential activities.[1] Accommodation and food service activities were all shut down (the latter, save for home delivery services), along with face-to-face teaching at all levels of education and all cultural, artistic and sporting activities. As a result of these restrictions, which were intensified with the suspension of all non-essential economic activity between 30 March and 9 April, people's movements decreased dramatically in the second half of March and throughout April. Thus, for example, some road traffic indicators fell by almost 80% in year-on-year terms (see Chart 4.1.2), while mobility indicators based on information provided by several technology companies using mobile phone location records showed similar declines across a wide range of activities. In many cases the falls were more pronounced than those observed in other countries affected by the pandemic (see Chart 4.1.3).

Since early May, as the pandemic came more under control, some restrictions have been eased as part of a gradual process of lifting the lockdown measures adopted. On 28 April, the Spanish government announced its lockdown easing plan, in four phases, running from 4 May to the end of June. The plan established that each province could progress through the different phases at its own pace, according to the capacity of its healthcare system, its epidemiological situation, the

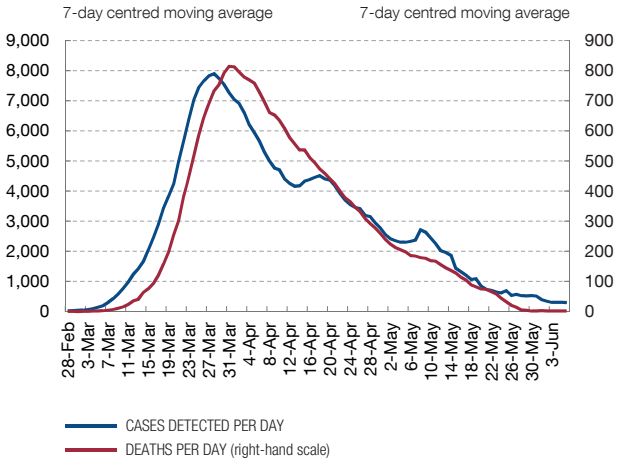
1 The activities permitted included among others, shopping for food, pharmaceutical products and other essentials, attending health centres and health services, travelling to work, returning to one's main residence and attending to dependent or especially vulnerable persons (see Royal Decree 463/2020 of 14 March 2020).

Chart 4.1

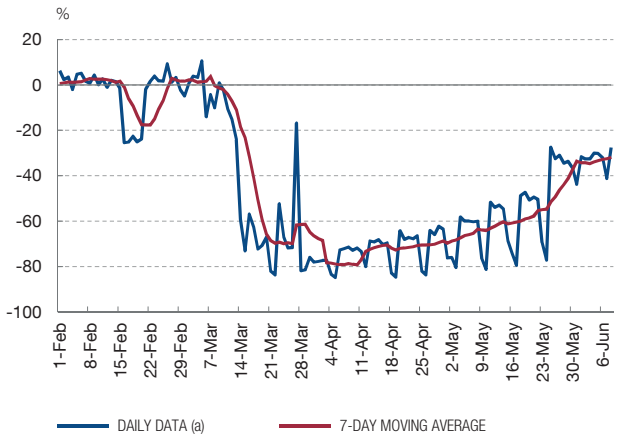
THE CORONAVIRUS PANDEMIC HAS POSED A MAJOR PUBLIC HEALTH CHALLENGE IN SPAIN IN RECENT MONTHS

The first case of COVID-19 infection in Spain was diagnosed on 31 January 2020, but March and April saw the highest incidence of the disease. To curb the rate of infection, severe restrictions were imposed on people's movements and economic activity. Since early May, as the pandemic came more under control, some restrictions have been lifted as part of a gradual process of easing the lockdown.

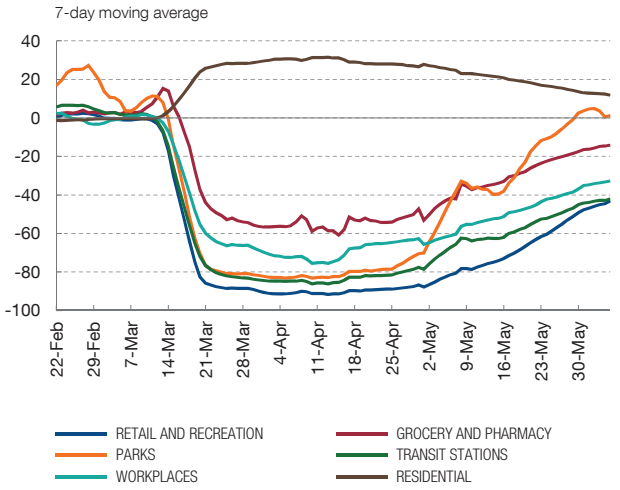
1 COVID-19 PANDEMIC IN SPAIN



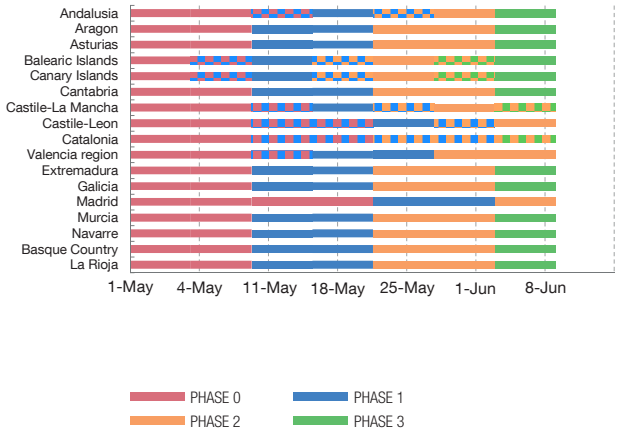
2 TRAFFIC ON M-30 (MADRID INNER RING ROAD) (VEHICLES PER KM TRAVELLED, Y-o-Y CHANGE)



3 GOOGLE MOBILITY INDICATORS



4 LOCKDOWN EASING PHASES (b)



SOURCES: Ministerio de Sanidad, Ayuntamiento de Madrid, Google and Banco de España.

a The year-on-year change of the daily data is in respect of the equivalent day of the week in the previous year (e.g. 29.03.2020 vs 31.03.2019).

b Andalusia: all provinces moved to Phase 1 on 11 May, except Malaga and Granada which did so on 18 May; all provinces progressed to Phase 2 on 25 May, except Malaga and Granada which did so on 1 June; the entire region entered Phase 3 on 8 June. Islands: Formentera (Balearics) and El Hierro, La Gomera and La Graciosa (Canaries) moved to Phase 1 on 4 May, to Phase 2 on 18 May and to Phase 3 on 1 June; all the other islands progressed to Phase 3 on 8 June. Castile-La Mancha: only Cuenca and Guadalajara entered Phase 1 on 11 May, followed by the other provinces on 18 May; Cuenca and Guadalajara progressed to Phase 2 on 25 May, and to Phase 3 on 8 June. Castile-Leon: 26 basic health areas moved to Phase 1 on 11 May, followed by a further 42 on 18 May, and the entire region was in Phase 1 by 25 May; the area of El Bierzo entered Phase 2 on 1 June; the rest of the region changed phase on 8 June. Catalonia: only three health areas moved to Phase 1 on 11 May, two in the province of Tarragona and one in Lleida; the rest of the region entered Phase 1 on 18 May, except Barcelona and its metropolitan area which did so on 25 May, when the more advanced health areas progressed to Phase 2; on 8 June the three most advanced health areas in exit from lockdown moved to Phase 3. Valencia region: only ten health departments moved to Phase 1 on 11 May, one in Castellón, three in Valencia and six in Alicante; the rest of the region entered Phase 1 on 18 May, and then all provinces progressed to Phase 2 on 1 June.

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protective measures adopted in public spaces and how the mobility and socioeconomic data evolve.[2] In any event, it was established that, in general, each province would remain in each of the four phases for at least two weeks.

The first phase of the lockdown easing plan – Phase 0 or the Preparatory phase – included, among other measures, allowing certain establishments to open for individual customers on an appointments-only basis. In particular, small local retailers, hairdressing salons and restaurant takeaway services were allowed to open. In the second phase – Phase 1 or the Initial phase – most retail outlets that were still closed were allowed to open (except for shopping malls), as well as accommodation and food services, but with strict safety regulations and very limited capacity. Thus, for example, restaurants and bars were allowed to open outdoors, but limited to 50% of their capacity, and in the case of hotels and tourist accommodation all communal areas had to remain closed as this is where agglomerations of people are most likely. In the third phase of the plan – Phase 2 or the Intermediate phase – shopping malls and cultural premises opened, although still with significant restrictions. Restaurants were allowed to open for indoor dining, with limited capacity. The restrictions on people's movements and on social contact were also eased. The last phase of the plan – Phase 3 or the Advanced phase – was essentially managed by Spain's regional governments. In this phase, almost all activity was allowed to reopen, public transport was able to operate virtually without restriction and some of the limitations still in place were eased even further, although not completely removed (for example, restrictions on mobility or on the use of communal areas in certain establishments). When the state of alert ended on 21 June, Spain entered the "new normal" phase. All restrictions on movements within the country have been removed, but various hygiene and prevention measures affecting both individuals and economic activity remain. In particular, the use of face masks remains mandatory outdoors and in enclosed public spaces, unless minimum social distancing can be guaranteed (a rule in force since 21 May).[3]

In recent weeks, the gradual easing of the lockdown measures adopted when the pandemic was at its peak has been reflected in mobility indicators. The pace of progress through the different phases of easing of lockdown varied by region, province and, in some cases, even by health area (see Chart 4.1.4). In any event, the process has entailed a relatively gradual increase in mobility in recent weeks (see Charts 4.1.2 and 4.1.3).

Although the worst of the pandemic may appear to be behind us, the cost has already been extraordinarily high in all spheres and further outbreaks of the disease cannot be ruled out. According to the latest official data available, more

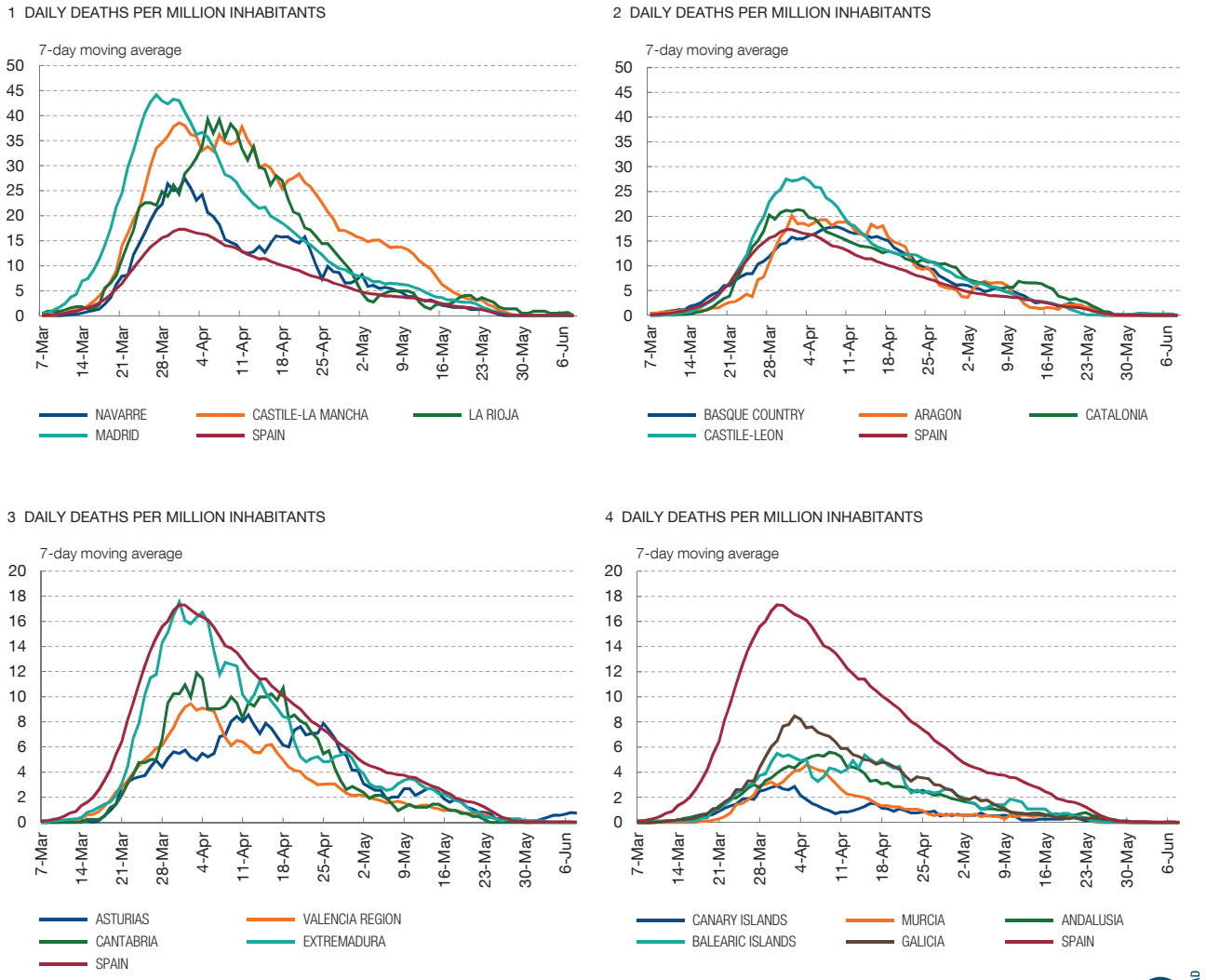
2 As the implementation of the lockdown easing plan has progressed, some intra-provincial geographical areas have been considered separately and have been granted differential treatment (for example, some of the Spanish islands and some health areas).

3 See Royal Decree-Law (RDL) 21/2020 of 9 June 2020.

Chart 4.2

WITHIN SPAIN, THE INCIDENCE OF THE PANDEMIC HAS BEEN VERY UNEVEN ACROSS REGIONS

There are significant regional differences both in the timeline of the disease and in the mortality rate per capita. A broad range of factors could be behind these differences, including environmental factors, demographics, socioeconomic factors and others relating to the lockdown measures adopted. In the future, a detailed analysis will be required in order to assess the role that each of these factors may have played in the incidence of the disease in each region or country. Such an analysis must take account of possible methodological differences in the recording of the data.



SOURCE: Ministerio de Sanidad.

than 28,000 people will have lost their lives to COVID-19 in Spain since the start of the pandemic. Although comparisons between countries must be made with extreme caution, as the criteria used may vary, this is one of the highest mortality rates per capita worldwide. In addition, according to the first results of a seroepidemiological study carried out by the Instituto de Salud Carlos III, the estimated prevalence of COVID-19 antibodies is only approximately 5% in Spain.[4] In this setting, and while there is no vaccine or effective treatment for the virus, Spain remains very vulnerable

4 See Estudio ENE-COVID19: Primera ronda and Estudio ENE-COVID19: Segunda ronda.

to a further outbreak. To reduce this vulnerability, a programme of rigorous protocols should be rolled out, as has been done in other countries affected by the pandemic, to achieve a significant increase in the number of tests performed, identify and isolate persons infected, and closely monitor all those persons who may have been in contact with the positive cases detected.

Within Spain, the incidence of the pandemic has been very uneven across regions. In particular, there are marked regional differences both in the timeline of the disease and in the mortality rate per capita (see Chart 4.2). Thus, at the peak of the pandemic, Madrid, Castile-La Mancha and La Rioja all presented mortality rates per capita much higher than the national average, while the Balearic Islands, Andalusia, Murcia and the Canary Islands recorded much lower rates. In addition, the peak mortality rates were recorded at different moments in time, such that, for example, Madrid reached its peak approximately two weeks before the Basque Country, Asturias and Andalusia reached theirs.

A broad range of factors could be behind the differences in the incidence of COVID-19 in certain regions or countries. These would include environmental factors (such as temperature or pollution levels), demographics (such as population density or the percentage of population groups at risk), socioeconomic factors (such as the volume of healthcare resources, the degree of social and international contact among the population, or the sectoral structure of the economy) and other factors relating to the lockdown measures adopted (such as the type, timing and severity of the measures).[5] In any event, it is important to note that some of these international or inter-regional comparisons could be affected by significant methodological differences in the recording of the data, so the findings should be analysed with due caution.

4.2 The initial economic impact

The measures adopted to contain the pandemic have had a very marked impact on economic activity in Spain. According to the activity indicators for January and February 2020, the Spanish economy was growing at a similar rate in this period to that recorded in late 2019.[6] This dynamic was suddenly interrupted in March, as the health crisis intensified and it became necessary to adopt extraordinary containment measures.

In 2020 Q1, Spanish GDP suffered its largest quarter-on-quarter contraction ever. With the declaration of the state of alert on 14 March, the mobility of the population was drastically restricted and activity was suspended in a large number

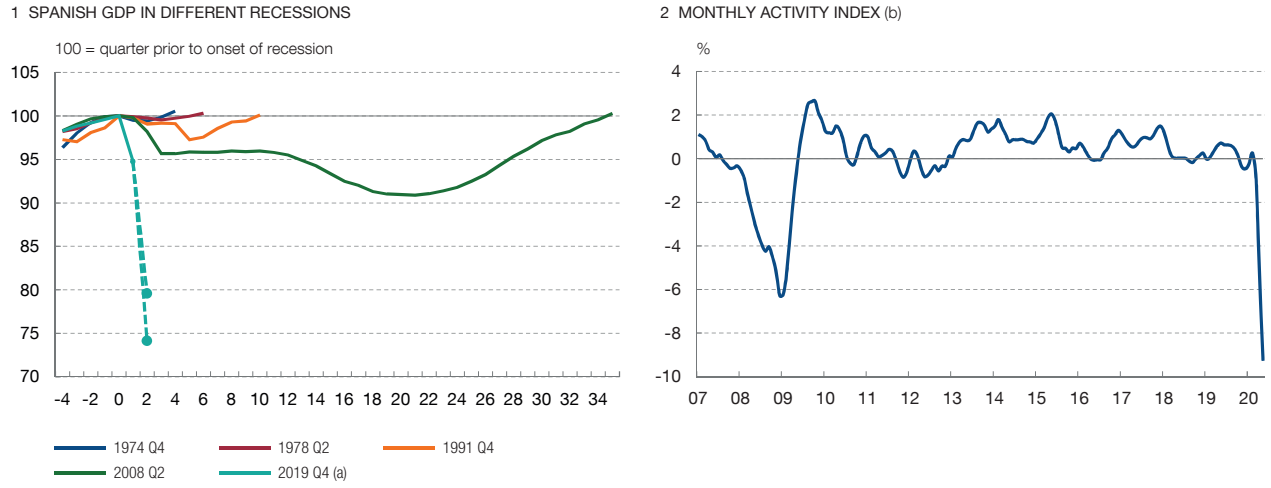
5 Several, essentially preliminary, studies have explored the possible relationship between the incidence of the disease in the different regions of Spain and some of these factors. See, for example, Orea and Álvarez (2020), and the joint work of the Agencia Estatal de Meteorología and Instituto de Salud del Carlos III.

6 See Banco de España (2020c).

Chart 4.3

SPANISH GDP IS ESTIMATED TO HAVE SUFFERED AN UNPRECEDENTED CONTRACTION IN THE FIRST HALF OF THE YEAR

In 2020 Q1, Spanish GDP suffered its largest quarter-on-quarter contraction ever. The most recent activity indicators suggest that the fall in GDP will be significantly steeper in Q2. The magnitude of the negative shock of the COVID-19 pandemic on the Spanish economy can also be seen in a monthly activity index which summarises in real time the information contained in a broad set of indicators.



SOURCES: INE and Banco de España.

a The data for 2020 Q2 are consistent with the Banco de España's latest forecasts under the early recovery and gradual recovery scenarios (June Quarterly Report).

b Rate of change on the basis of three-month moving averages. The latest data available correspond to May. The monthly activity index, which summarises the information contained in a broad set of activity indicators, is governed by non-linear dynamics that adapt to the presence of phase changes in economic cycles and is constructed following the methodology proposed in Leiva-León et al. (2020).

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of sectors, especially in the retail, recreation, and accommodation and food services industries. Activity was also affected in some manufacturing industries (in particular, the car industry), initially by distortions in global supply chains caused by the pandemic, and subsequently by the collapse in demand. Although the impact of all these negative shocks was from mid-March onwards, it was so strong that GDP contracted by 5.2% in the first quarter as a whole. This was the largest fall in quarter-on-quarter terms recorded by the Spanish economy since data first became available and marked the end of an uninterrupted growth phase dating back to late 2013.

The most recent activity indicators suggest that the decline in GDP will be significantly steeper in Q2. Practically all the restrictions initially linked to the state of alert, which were tightened between 30 March and 9 April when all non-essential economic activity was suspended, have remained in force during most of Q2. This means that activity will suffer even more in this period than in Q1. Indeed, in line with the information supplied by the latest activity indicators available, the Banco de España's most recent estimates point to a GDP contraction in the current quarter in the range of 16% to 21.8% quarter-on-quarter.[7] Thus, it is estimated that Spanish GDP will have fallen in the first half of the year by a significantly larger amount than in previous

7 See Banco de España (2020a).

recessions (see Chart 4.3.1). This impression is consistent with the evidence of a monthly activity index, which summarises in real time the information on the Spanish economy contained in a broad set of indicators (see Chart 4.3.2).[8]

In any event, output appears to have recovered some strength in recent weeks, as the restrictions initially imposed on mobility and on the activity of certain sectors have been gradually eased. In Q2, the negative impact of all these restrictions on economic activity was at its height in the month of April; since then it has been gradually declining, in line with implementation of the Government's lockdown easing plan. This easing of restrictions has already been reflected in certain high-frequency activity indicators, in addition to those relating to mobility mentioned in Section 4.1 (see Charts 4.1.2 and 4.1.3). Thus, for example, electricity consumption (see Chart 4.4.1) and credit card spending[9] have picked up somewhat in recent weeks. Some of the intraday indicators normally used to monitor activity are also consistent with this gradual improvement over the quarter; these are mentioned in the following paragraphs.

On the demand side, all private spending items appear to have fallen very considerably in the first half of the year. In this period, Spanish household and business spending and investment decisions appear to have been very adversely affected, not only by the restrictions on mobility and activity already mentioned, but also by the deterioration in the macroeconomic outlook and in agents' confidence, due to the increase in uncertainty and the tightening of financial conditions. Indeed, the outbreak of the health crisis led to a collapse by historical standards in confidence indicators (see Chart 4.4.2) and equally unprecedented climbs in economic uncertainty indices (see Chart 4.4.3), which have only been partially reversed in recent weeks. Also, at the global level, the pandemic has caused a notable increase in the volatility of asset prices on financial markets, sharp falls in stock market indices and very significant increases in credit risk premia in some segments. All this has entailed a tightening of financial conditions, to which the Spanish economy has not been immune. In particular, the IBEX-35 fell by 39.4% between 19 February (when it recorded its high prior to the COVID-19 crisis) and 16 March (when it reached its low); as at the cut-off date of this Report, it has since recovered by 26.9% (see Chart 4.4.4). Likewise, the Spanish 10-year sovereign debt spread over the German Bund has widened from 66 bp on 21 February to 95 bp as at the cut-off date of this Report, after peaking at 157 bp on 22 April. Meanwhile, the average cost of long-term corporate debt issues rose by 75 bp between February and May, to 2.1%, thus reversing a large part of the decline since the beginning of 2019. In contrast, on data to April, no appreciable tightening of financial conditions was observed in the bank funding market. This was largely a result of the measures adopted by the ECB and of the Government's public guarantee scheme (see Sections 3.4 and 4.3 of this

8 For further details of this index, see Leiva-León et al. (2020).

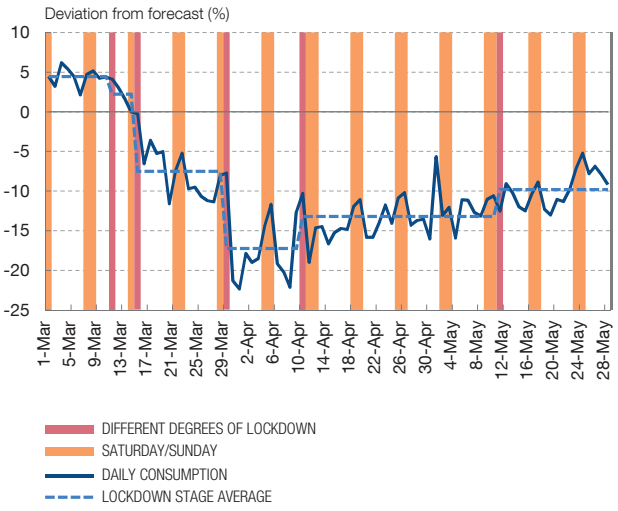
9 For further details of the recent behaviour of credit card spending, see Banco de España (2020a) and BBVA Research (2020).

Chart 4.4

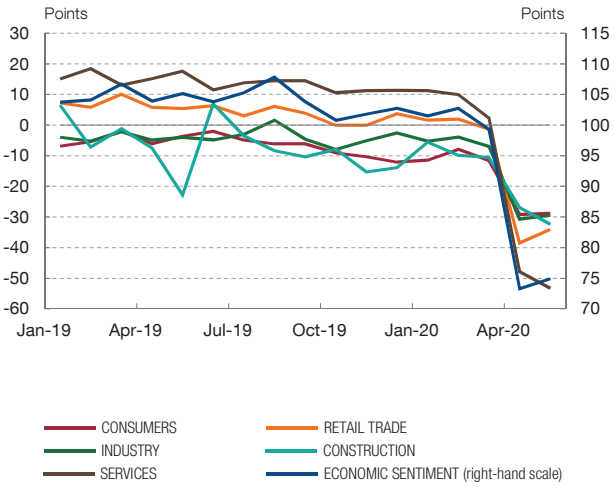
THE HEALTH CRISIS HAS LED TO SEVERE ADJUSTMENTS IN BOTH REAL AND FINANCIAL QUANTITATIVE AND QUALITATIVE INDICATORS

The outbreak of the health crisis and the lockdown measures adopted to curb its spread led to historic corrections in numerous indicators, such as electricity consumption, confidence and economic uncertainty, in March and April. These dynamics have only been partially reversed in recent weeks. On the Spanish and global financial markets, the pandemic has also caused sharp falls in stock market indices and significant increases in credit risk premia.

1 ESTIMATION OF IMPACT OF DIFFERENT LOCKDOWN MEASURES ON ELECTRICITY CONSUMPTION (a)

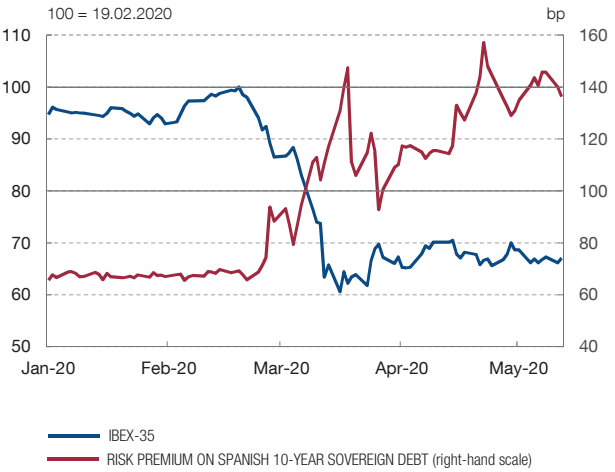


2 ECONOMIC SENTIMENT INDICATOR (LEVELS)



3 ECONOMIC POLICY UNCERTAINTY INDICATOR (b)

4 CHANGES IN THE FINANCIAL MARKETS



SOURCES: Red Eléctrica de España, European Commission, INE, Thomson Reuters Datastream and Banco de España.

a The estimation period runs from 1 January 2019 to 28 May 2020. The dependent variable for the regression is the logarithm of hourly electricity consumption, based on indicators of year, month, day of the week and time of the day, distinguishing three time bands (super-off-peak, from 01:00 to 07:00; off-peak, from 07:00 to 13:00; and peak, from 13:00 to 01:00). Also included are maximum temperature, maximum temperature squared and dummy variables for national and regional holidays, weighted by electricity consumption per region.

b The indicator is constructed on the basis of the number of articles published in leading Spanish newspapers containing a set of terms referring to the concept of economic policy uncertainty. See Ghirelli et al. (2019).

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Report, respectively). In particular, the latest data (for April) on interest rates on new loans show declines in most segments since the outbreak of the health crisis, that have been especially sharp in the case of financing for the self-employed.

The preliminary Quarterly National Accounts (QNA) data for Q1 show very sharp falls in domestic demand and exports. As a result of the impact of the factors described above, the preliminary QNA data for the period January-March point to quarterly declines of 7.5% in household consumption and 5.3% in gross capital formation, particularly in residential investment (-12.3%), but also in investment in capital goods (-3.5%). Government consumption was the only relevant item to increase in this period, by 1.8%, which is consistent with the need to provide greater funds to the national health system to address the pandemic. For its part, external demand made a slightly negative contribution to output growth (-0.2 pp), the result of an 8.4% contraction in imports and a fall of the same magnitude in exports. This fall was especially sharp in the case of exports of tourist services (18.6%) (see Box 4.1 for further details on the recent performance and future outlook for tourism in Spain). The fact that the restrictions on activity and mobility were in force for a longer period in Q2 than in Q1 can be expected to result in an acceleration of the decline in the private domestic demand components. Also, the spread of the disease to practically all the world's economies and the widespread imposition of lockdown measures have led to a synchronised global slowdown, which would also point to an acceleration of the decline in exports.

Since the start of the crisis, certain notable changes have been observed in the composition of household spending. The lockdown measures and the suspension of activity in certain sectors have forced households to change their consumption patterns significantly. Notable among the most adversely affected items of spending are those relating to accommodation and food services, but sales of cars, personal equipment (a category that includes, inter alia, clothing and footwear) and household equipment (which includes, inter alia, furniture, lighting and domestic appliances) have also suffered a collapse by historical standards.[10] Conversely, as expected, the lockdown has favoured spending on food products.[11] However, the positive impact on this item was not sufficient to offset the decline in the other categories included in the overall retail sales index, which has fallen sharply since the beginning of the crisis (see Chart 4.5.1). In any case, besides the changes in the composition of consumption caused by the restrictions in force during the state of alert, it should be taken into account that during periods of recession and heightened uncertainty, such as the present one, it is normal to see changes in the

10 According to the services sector activity indicator, turnover in the accommodation and food services sector contracted by 59.1% in March (in terms of the seasonally- and calendar-adjusted monthly rate) and by 87.0% in April. Likewise, new private car registrations fell very sharply in March (-67.5% year-on-year), April (-98.2%) and May (-66.0%). According to the retail trade index, sales of personal equipment fell by more than 50% month-on-month, both in March and in April, while sales of household equipment declined by more than 30% in each of these months.

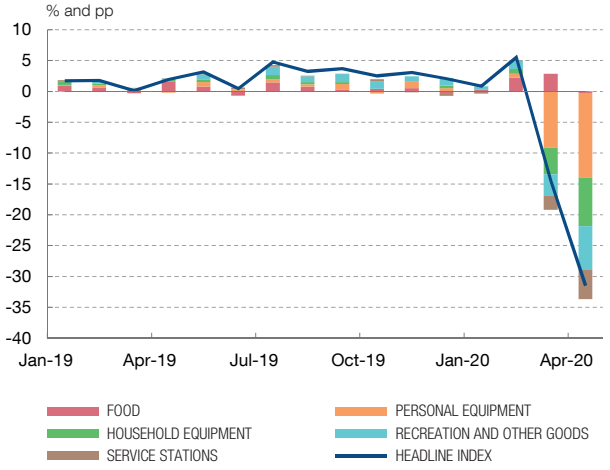
11 For further details of the changes in the consumption pattern of Spanish households in recent months, see Carvalho et al. (2020), based on the data for credit card transactions (including point-of-sale terminals) of a Spanish credit institution.

Chart 4.5

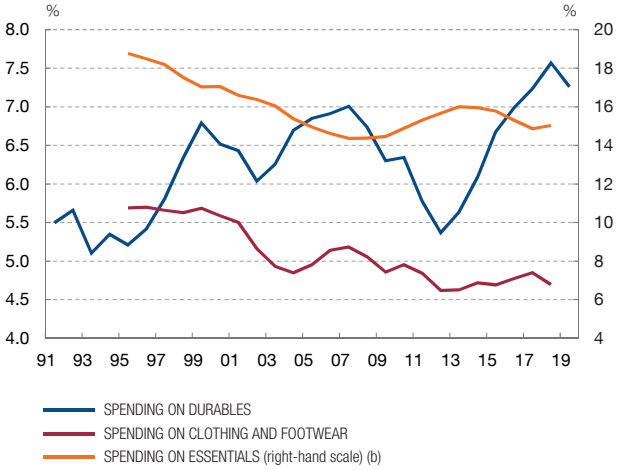
THE LOCKDOWN MEASURES HAVE FORCED A DRASTIC CHANGE IN HOUSEHOLD CONSUMPTION PATTERNS, WHICH HAS BEEN REFLECTED IN INFLATION

The lockdown measures have favoured spending on food products. Notable among the most adversely affected items of spending are those relating to accomodation and food services, but there has also been a collapse by historical standards in sales of cars and personal and household equipment. Within the subset of goods and services that households have continued to consume during lockdown, broadly speaking the prices of goods have increased while those of services have fallen.

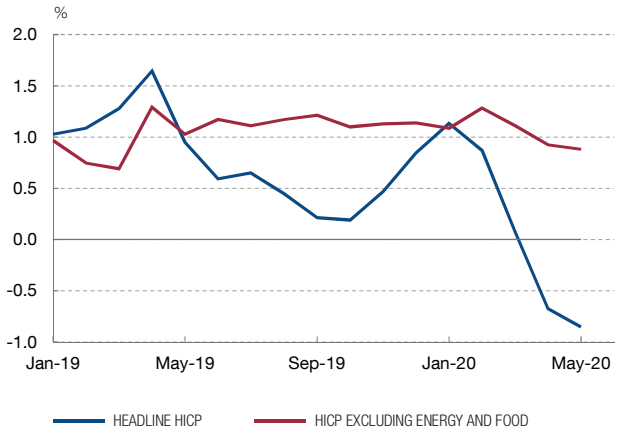
1 RETAIL TRADE INDEX
Year-on-year change and contributions



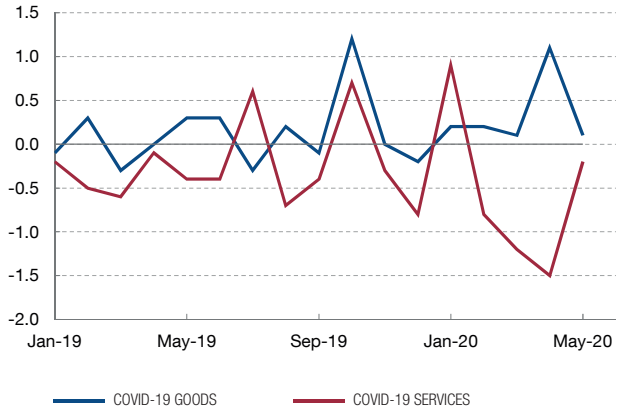
2 WEIGHT OF DIFFERENT ITEMS OF SPENDING IN CONSUMPTION OF HOUSEHOLDS AND NPISHs IN REAL TERMS (a)



3 HEADLINE AND CORE INFLATION



4 INFLATION: SPECIAL COVID-19 GROUPS (c)



SOURCE: INE.

a Base year: 2015.
b Food and non-alcoholic beverages, and pharmaceutical and medical products.
c Special groups, calculated by the INE, of the goods and services that most households have continued to consume during lockdown.

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structure of household spending, as households reduce the weight of durables in their consumption.[12] This happened, for example, between 2007 and 2012 when the share of durables in household consumption spending fell by more than 1.5 pp to around 5.5% (see Chart 4.5.2).

12 See, for example, Martínez-Matute and Urtasun (2017), and Arce et al. (2013).

The adjustments observed in the composition of the household consumption basket have also been reflected in inflation dynamics. In recent months, the behaviour of inflation, both in Spain and at the global level, has basically been driven by the slump in the price of oil (see Chart 4.5.3 and Section 2.2 of Chapter 2 for further details of recent oil and other commodity price developments). However, the measures to contain the pandemic and the consequent changes in household consumption patterns have also had a direct impact on the prices of certain goods and services. In this respect, in order to provide more details of the effect that the COVID-19 pandemic is having on prices, the INE has created two specific aggregates of basic consumer products for households in lockdown: the *Special COVID-19 goods group* and the *Special COVID-19 services group.*[13,14] In line with the discussion in the preceding paragraphs, the behaviour of the prices of these goods and services has been very dissimilar in recent months, as the prices of goods have increased while the prices of services have fallen, partly due to oil price developments (see Chart 4.5.4). The behaviour of fresh food prices, which surged in April (by 2.6% month-on-month) and barely corrected in May, is noteworthy. These developments may have been influenced not only by demand-side factors, but also by supply-side issues relating, for example, to greater difficulty hiring labour and certain transport restrictions.

The impact of this crisis on employment is proving to be particularly acute. According to social security registrations data, between mid-March and the end of May almost 752,000 jobs (3.9% of the total) were destroyed in Spain. However, these figures do not include furloughed workers (subject to temporary layoffs or short-time work arrangements, ERTEs by their Spanish initials) or the self-employed who have temporarily ceased their activity. In fact, the bulk of the labour market correction in Spain in recent months has been precisely through these two temporary employment adjustment instruments – the ERTEs and discontinuation of activity for the self-employed – promoted by the Government in its economic policy response to the crisis (see Section 4.3). In particular, according to the latest information published by the Ministry of Inclusion, Social Security and Migration, at the end of May almost 3,000,000 workers were furloughed and somewhat more than 1.4 million self-employed workers had temporarily ceased their activity.[15]

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13 Lockdown measures have also had a notable impact on the compilation of inflation statistics. For example, in April, a considerable number of consumer goods and services were not available for purchase, or were only available online. Although the situation improved in May, when calculating the measures of inflation for that month the INE still had to estimate 18.6% of prices, which correspond to 21% of the index weighting. For further details, see the INE's Technical note on the influence of COVID-19 (Spanish version only).

14 According to the information provided by the INE, the Special COVID-19 goods group, which represents 27% of the overall index, includes food, beverages, tobacco, pet food, and household cleaning and personal care products. The Special COVID-19 services group, which accounts for 18% of the overall index, includes housing and garage rentals, water distribution, sewerage, refuse collection, maintenance charges in multi-occupied buildings, electricity, gas, heating oil, telephone, music and television streaming services, insurance, bank charges and funeral services.

15 At the end of May, 87.2% of furloughed workers had been furloughed due to force majeure, while the rest had been furloughed for other economic reasons. This percentage was lower than at the end of April (91%), since the number of workers furloughed due to force majeure decreased by 14.9% in May, while the number of workers furloughed for other reasons increased by 22.4%.

The destruction of employment was concentrated in the second half of March. In that 15-day period alone, which followed the declaration of the state of alert, social security registrations decreased by more than 890,000. In April and May, the labour market showed some signs of stabilising (see Chart 4.6.1). In particular, social security registrations fell much less significantly in April (with a 0.3% contraction, as compared to a 4.3% decrease in March)[16] and increased slightly in May (by 1%). Also that month, the number of furloughed workers fell by 11.5%. As discussed below, these dynamics partly reflect the recovery in employment in certain sectors and provinces that were further ahead in the lockdown easing process in May.

As in other episodes of major job destruction in the Spanish economy, in this crisis temporary workers are bearing the brunt of the adjustment. As seen in Chart 4.6.2, the destruction of employment in recent months has basically been concentrated among temporary workers, whether with part-time or full-time contracts, while the fall in social security registrations among workers with permanent contracts has been relatively low. Thus, temporary employees account for 77.2% of the total decline in social security registrations since the start of the crisis. The fact that this percentage is so high is nothing new for the Spanish economy, but rather a normal phenomenon that repeats itself at times of job destruction. For example, between July 2008 and May 2009, in the initial phase of the global financial crisis, 92% of the workers who lost their jobs in Spain were on temporary contracts. In the current context, this situation appears to have been exacerbated, possibly by the fact that the sectors most affected by the health crisis are also those that have a higher rate of temporary employment. In addition, an analysis of social security registration inflows and outflows shows that the decline in registered workers in March was basically the result of an increase in outflows, which were 36% higher than in March 2019, and, to a lesser extent, to a decline in inflows, which fell by 19.2% from the same period a year earlier. In contrast, in April and May, the flows of employment creation (inflows) and destruction (outflows) were both 60% smaller than in 2019.

The impact of employment adjustment is highly heterogeneous across sectors. The fact that the measures adopted to slow the rate of infection have restricted the activity of services (especially retail trade, recreation, accommodation and food services) more severely than that of other sectors of the economy is reflected in employment.[17] Thus, between the end of February and the end of May, the most marked falls in social security registrations were concentrated in certain non-essential services (for example, –12.5% in the arts and –7.8% in accommodation and food services), while job destruction was lower in the manufacturing industries (for example, –2.6% in the food industry) (see Chart 4.6.3). These same sectoral differences

16 Month-end month-on-month data.

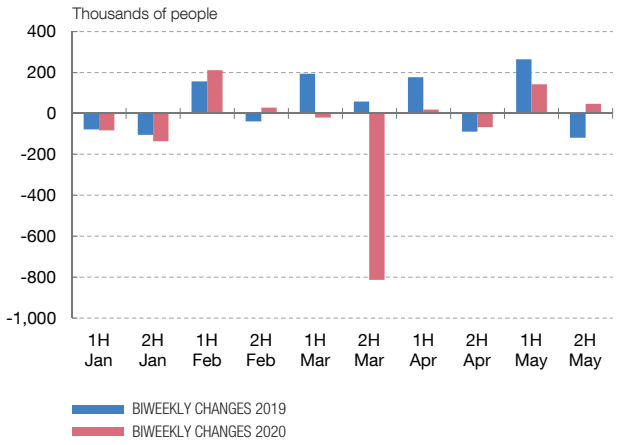
17 The greater direct impact of the lockdown measures on services is consistent with the fact that, according to different metrics (see, for example, Koren and Peto (2020)), services industries generally involve more intensive social interaction than other activities and, therefore, tend to be more conducive to the spread of the virus.

Chart 4.6

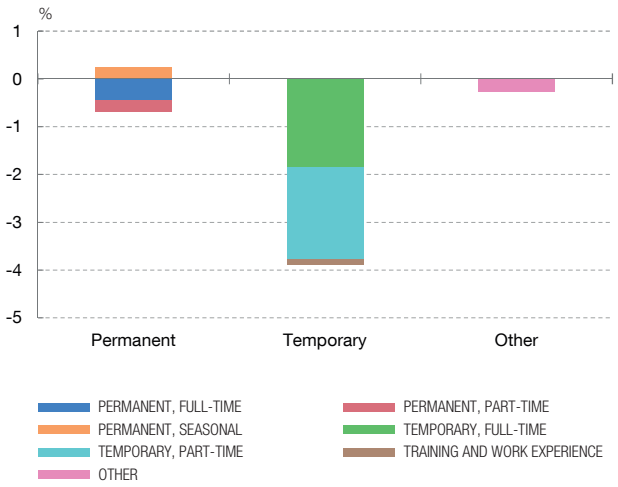
THE IMPACT OF THIS CRISIS ON EMPLOYMENT IS PROVING PARTICULARLY SEVERE

The impact of the crisis on employment was concentrated in the second half of March; the labour market showed signs of stabilising in April and May. Temporary workers are bearing the brunt of the adjustment in this crisis, which at the sector level is affecting services (especially retail trade, recreation, accommodation and food services) far more severely than manufacturing.

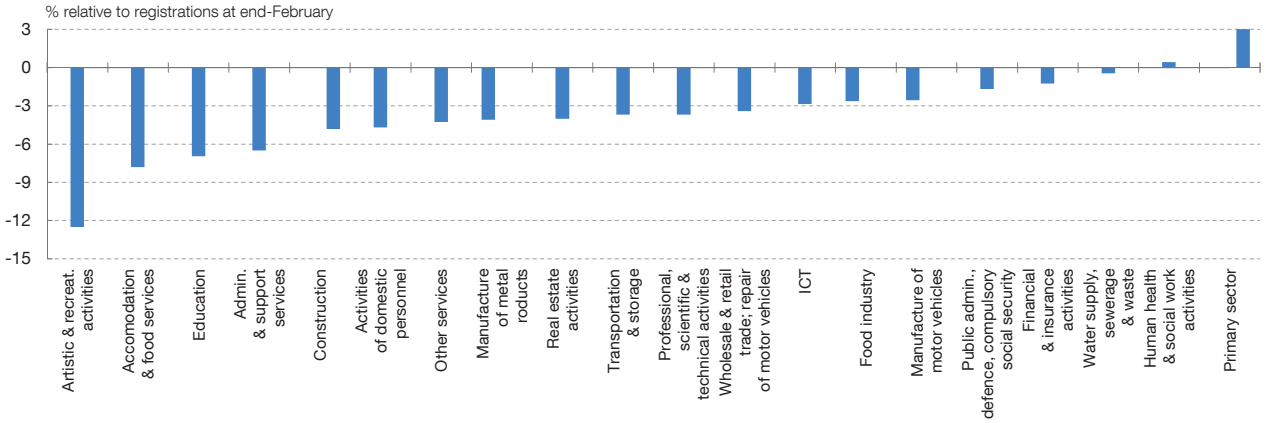
1 BIWEEKLY CHANGES IN SOCIAL SECURITY REGISTRATIONS



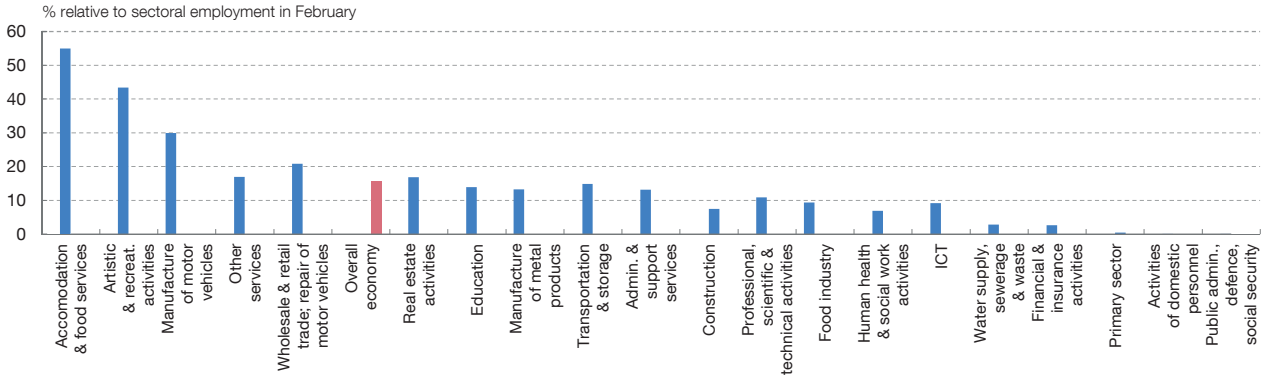
2 DROP IN SOCIAL SECURITY REGISTRATIONS BY CONTRACT TYPE BETWEEN FEBRUARY AND MAY 2020



3 CHANGE IN SOCIAL SECURITY REGISTRATIONS AT END-MAY BY SECTOR OF ACTIVITY



4 INCIDENCE OF FURLOUGHS (ERTEs) IN MAY BY SECTOR OF ACTIVITY



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SOURCE: Ministerio de Inclusión, Seguridad Social y Migraciones.

are also observed when the use that the different industries have made of furloughs (ERTEs) as an employment adjustment mechanism is considered (see Chart 4.6.4). In addition to these cumulative impacts, it should be noted that, within the framework of the gradual lockdown easing plan established by the Government, employment in some of the sectors that have benefited most from the easing of certain restrictions on their activity was relatively more dynamic in May. In fact, when the sectoral breakdown of the increase in social security registrations in May (almost 188,000 more jobs) and of the decrease in the number of furloughed workers in the same month (almost 390,000 fewer workers) is considered, the recovery in effective employment in accommodation and food services and wholesale and retail trade (19.3% and 7.5%, respectively) is seen to have been well above that recorded for the economy as a whole (4.1%) and, for example, for manufacturing (4.5%).

A broad set of additional information indicates that services activity has suffered more than manufacturing activity since the beginning of this crisis. A case in point are the results of the Banco de España survey of a sample of Spanish non-financial corporations to obtain information on the impact of the COVID-19 crisis on their business (see Chart 4.7.1).[18] Other indicators of different kinds are also consistent with a larger decline in the activity of services than manufacturing. One example, among qualitative indicators, is the purchasing managers' index (PMI) (see Chart 4.7.2). Other quantitative indicators pointing in the same direction include the latest industrial production (IPI) and services activity (IASS) data. All this information is in line with the behaviour of value-added by industry inferred from the preliminary National Accounts data for 2020 Q1. In particular, according to these data, activity in the services sector contracted by 5.6% in the first three months of the year, with especially sharp falls in retail and wholesale trade, transport and accommodation and food services (10.9%), as well as in artistic and recreational activities (11.2%). Industry, by contrast, suffered a significantly smaller decline, of 2.7%. In the same period, activity in the primary sector, which has been practically unaffected directly by the measures applied to contain the pandemic, fell by only 1.4%. Finally, there was a notable contraction, of 8.1%, in construction, which would be consistent with the collapse in some of the most relevant activity indicators for this sector (for example, those for property sales, cement consumption and confidence).

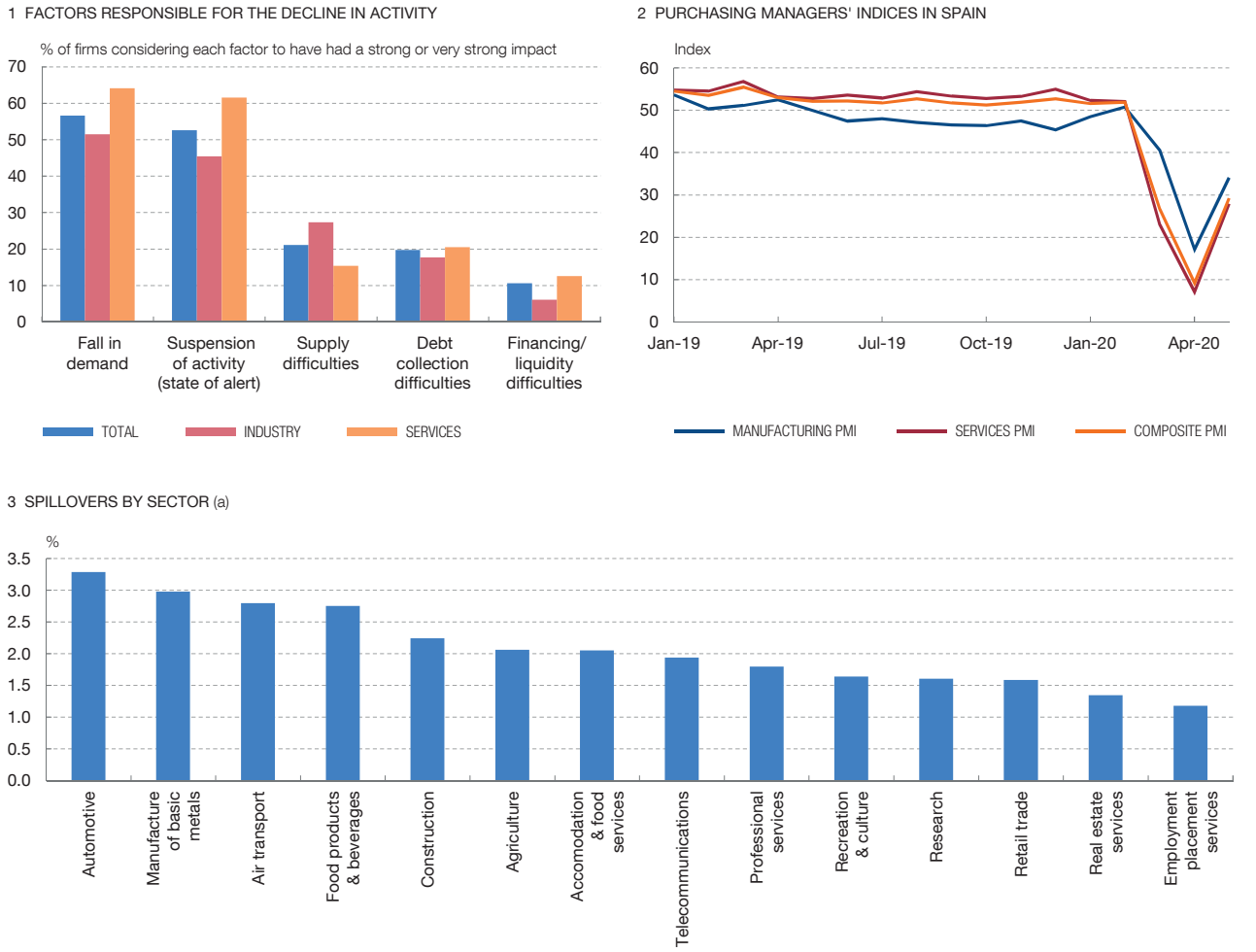
Apart from the direct impact of the measures to contain the pandemic, all industries appear to have been affected indirectly by the fall in demand and the spillovers between the different sectors. As already mentioned, although some sectors were barely affected by the restrictions imposed on activity during the management of the health crisis, their level of employment and activity also appears to have declined in recent months. This is the case, for example, of the primary and energy sectors. It is important to remember in this respect that the activity of a particular sector may be affected not only directly by the measures to contain the

18 For further details of this survey, see Banco de España (2020b).

Chart 4.7

SERVICES ACTIVITY APPEARS TO HAVE SUFFERED MORE THAN MANUFACTURING ACTIVITY SINCE THE BEGINNING OF THIS CRISIS

Different pieces of information are consistent with a larger decline in services activity than in manufacturing. For example, the PMIs and the results of the Banco de España's survey of a sample of Spanish non-financial corporations in early April point in this direction. However, apart from the direct impact of the measures to contain the pandemic, all industries appear to have been affected indirectly by the fall in demand and by the spillovers among the different sectors.



SOURCES: IHS Markit, INE and Banco de España.

a See Acemoglu et al. (2016).

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pandemic, but also indirectly by the spillover effects arising from the input-output links that such sector has with the rest of the economy's industries. Chart 4.7.3 shows, for a selection of sectors, the total spillover effect that each has on the economy as a whole.[19] A notable example is the car industry, whose activity was significantly affected in March and April by the fall in demand and by global supply chain disruptions and which, in addition to being one of the sectors of the Spanish

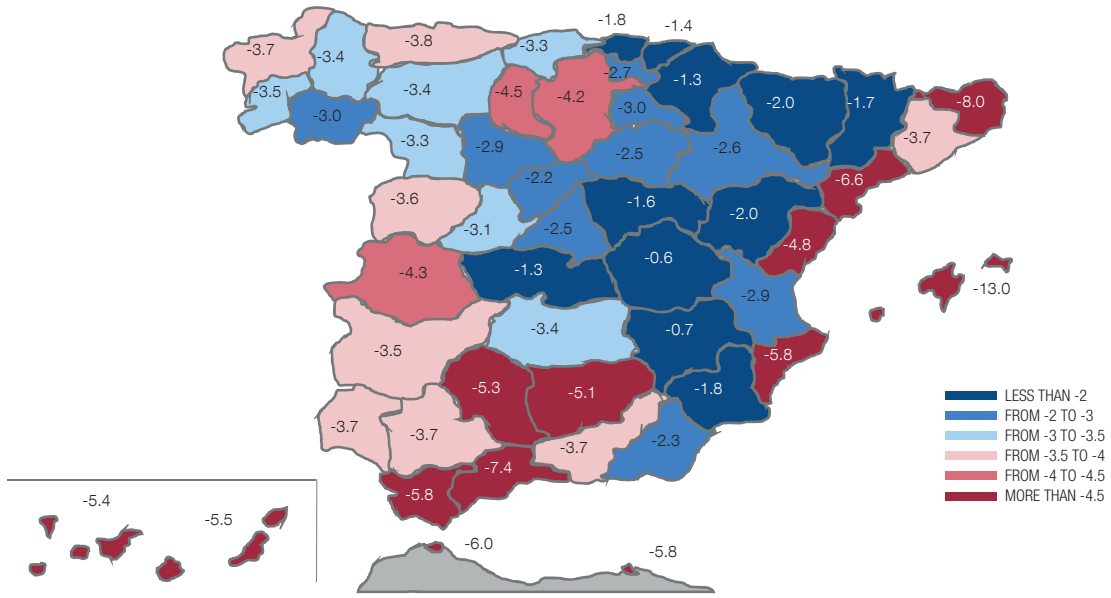
19 For further details of the methodology used to calculate these spillover effects, see, for example, Izquierdo et al. (2019) and Acemoglu et al. (2016).

Chart 4.8

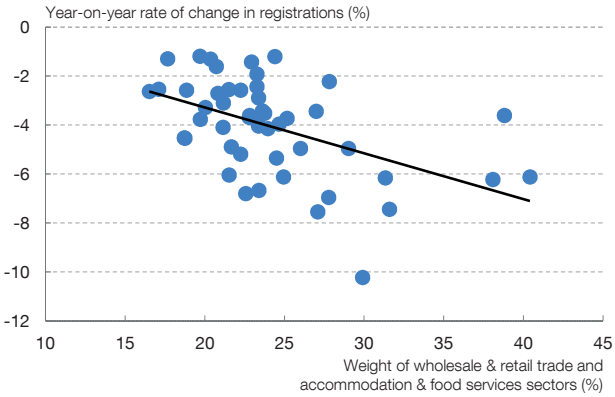
THE HEALTH CRISIS IS HAVING A VERY UNEVEN IMPACT ON THE ECONOMIC ACTIVITY OF SPAIN'S PROVINCES

The impact of this crisis on employment is proving to be highly uneven at the provincial level. A significant part of this heterogeneity can be explained by the differences in sectoral structures and temporary employment rates across provinces. In May, social security registrations and furloughs were also affected by the different rates of progress in the easing of lockdown among provinces.

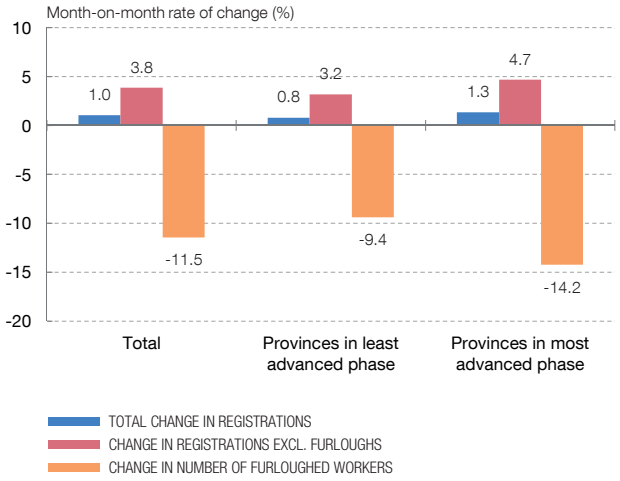
1 YEAR-ON-YEAR CHANGES IN SOCIAL SECURITY REGISTRATIONS IN MAY 2020 BY PROVINCE (%)



2 DROP IN SOCIAL SECURITY REGISTRATIONS IN APRIL 2020 AND WEIGHT OF WHOLESALE & RETAIL TRADE AND ACCOMODATION & FOOD SERVICES SECTORS BY PROVINCE



3 CHANGES IN SOCIAL SECURITY REGISTRATIONS IN MAY



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SOURCES: Ministerio de Inclusión, Seguridad Social y Migraciones, INE and Banco de España.

economy with the highest productivity,[20] also has a very high spillover effect. Also, the multiplier or spillover effect of accommodation and food services and travel agencies, the sectors that have perhaps suffered most from the impact of the

20 See Cuadrado et al. (2020).

lockdown measures, is quantitatively highly relevant; each additional euro of turnover in these sectors is linked to somewhat more than two euro of additional production in the rest of the economy.

The health crisis is having a heterogeneous impact on the economic activity of Spain's provinces. Even though sufficiently detailed information is still not available on developments in activity at a geographically disaggregated level, the impact of this crisis on employment is proving to be highly uneven across provinces (see Chart 4.8.1). For example, while social security registrations in May fell by more than 7% year-on-year in the Balearic Islands, Girona and Málaga, the decline was less than 2% in provinces such as Navarre, Guipúzcoa, Cuenca and Toledo. A significant part of these differences can be explained by the heterogeneity of the sectoral structures and temporary employment rates at provincial level.[21] In this respect, Chart 4.8.2 shows that provinces with a high proportion of their productive activity in the wholesale and retail trade and accommodation and food services sectors recorded much sharper falls in employment between the end of February and the end of April. The behaviour of social security registrations and furloughs in May also suggests that differences in the rate of progress in the lockdown easing are an additional factor that has driven provincial heterogeneity in the recent behaviour of employment (see Chart 4.8.3). The increase in social security registrations in May was greater in those provinces that moved into the second stage of the lockdown easing plan on 11 May than in other provinces (1.3%, as against 0.8%) and the decline in the number of workers affected by furloughs was steeper (14.2%, as against 9.4%). The fact that this health crisis is having an asymmetric impact across Spain, mainly as a result of differences in sectoral structure and in the pace of easing of lockdown, is consistent with the estimates made by the Banco de España on the basis of sectoral input-output links broken down by region.[22]

4.3 Economic policies adopted in Spain

Economic policy measures in response to the COVID-19 crisis have been taken in several areas and in different phases. Akin to other countries, Spain has responded to the COVID-19 pandemic on various fronts, implementing measures as the economic impact of the health crisis has intensified.[23] The measures approved have chiefly focused on strengthening the healthcare system, protecting employment and supporting vulnerable households, and providing liquidity to firms and the self-employed.[24] The main aim has been to ease the pressure on the healthcare system

21 See Pérez and Izquierdo (2020).

22 See Prades Illanes and Tello Casas (2020).

23 The main measures adopted are set out in four Royal Decree-Laws (RDL 7/2020, RDL 8/2020, RDL 11/2020 and RDL 15/2020), approved between 12 March and 21 April.

24 Measures have also been taken in many other spheres. For example, a degree of flexibility was introduced in certain obligations on companies during the state of alert, and in some cases for longer. In particular, more flexible arrangements have been set in place for the way in which meetings of governing and management bodies may be held and resolutions adopted, and various timelines have been suspended. For more details, see RDL 8/2020.

in the short term and protect households' and firms' income. It has also been to prevent this eminently temporary health crisis from causing significant damage to the economy's growth potential that would limit its capacity for subsequent recovery, if viable firms were to close or jobs were to be permanently lost.

The budgetary resources assigned to healthcare have been increased to withstand the pandemic. To this end, the central government has provided €2.8 billion to the regional governments and has assigned an extra €1 billion to the Ministry of Health. Moreover, €30 million has been earmarked for funding research into the virus, and €600 million has been assigned to regional and local governments to ensure that healthcare services reach the most vulnerable. The Government has also approved the creation of a special non-repayable fund – the COVID-19 Fund – through which the State will pay regional governments €16 billion, €9 billion of which will be earmarked for healthcare expenditure.[25] Moreover, on 21 April, a zero VAT rate was set for purchases of healthcare equipment for public sector entities, clinics, hospitals or private charitable entities, which will be in force until 31 July 2020.

Important measures have also been deployed to protect jobs and support the most vulnerable households. These measures notably include greater flexibility in layoffs and short-time work arrangements and waiver of employer social security contributions (100% in the case of SMEs and 75% for all other firms). The term of these measures was initially linked to the duration of the state of alert. It was subsequently extended, first to the end of June and then to the end of September, albeit with lower rebate rates in order to encourage the return to work as firms' activity recovered. Further, an extraordinary unemployment assistance benefit has been introduced for various groups, such as temporary workers with an insufficient previous contribution period and domestic service workers. The conditions for drawing the discontinuation of activity benefit for the self-employed have been relaxed, removing certain eligibility requirements, and greater unemployment protection has been afforded to permanent seasonal workers, expanding coverage to those who have been unable to start work and were not entitled to claim the benefit. Among other measures for the most vulnerable households, supplies of essential utilities have been guaranteed and moratoria have been established for rent payments and mortgage and non-mortgage loan repayments. Although not directly linked to the present health crisis, a permanent minimum living income has also been approved.[26, 27] This new

25 Of the remainder of this fund, €5 billion will be used to offset the fall in revenues of regional governments (i.e. from regional taxes and other revenues), which particularly affects specific-status regional and provincial governments, and €2 billion will be earmarked for education. For more details on this fund and its distribution among the regions, see RDL 22/2020.

26 See RDL 20/2020.

27 The minimum living income eligibility requirements are generally defined on the basis of the prior year's income. However, in order to reach the groups that have been hardest hit by the ongoing health crisis, it has been established that households whose income was particularly low in the early months of 2020 may benefit from this assistance, under certain conditions, during the second half of 2020.

benefit is intended to reduce extreme poverty and will supplement the income of eligible households so as to guarantee a minimum annual income of €5,538 per person. According to information provided by Social Security, this scheme could benefit around 850,000 households, with a cost of approximately €3 billion per annum.

A third set of measures is aimed at providing liquidity to firms, specifically SMEs and the self-employed. First, a public guarantee facility of €100 billion has been made available for loans to non-financial corporations, and another of €2 billion specifically for SMEs and export firms. The Official Credit Institute (ICO) has also set up a credit facility of €400 million for the tourism industry. Second, a series of legislative moratoria on mortgage and non-mortgage debts, similar to those introduced for households, was also approved for sole proprietors who are economically vulnerable as a consequence of the crisis. Subsequently, the banking sector established a special additional regime for moratoria agreements for these vulnerable groups. Third, a six-month moratorium on tax debts was agreed for SMEs and the self-employed, and also the deferral of all tax payments by firms until 20 May. Along the same lines, a six-month moratorium on social security contributions was granted, running from April to June for firms and from May to July for the self-employed in certain sectors. Lastly, it has also been agreed that SMEs and the self-employed registered under the objective estimate scheme may declare their taxes based on an estimate of their current levels of activity, rather than on their volume of business in 2019.

The estimates of the budgetary cost of the set of discretionary measures approved by the Government to tackle this crisis are subject to an extraordinary level of uncertainty. First, in some cases the number of households or firms that will benefit from the measures adopted cannot be accurately determined, nor is the term of the measures always clear. Second, the final cost of the measures will ultimately depend on their ability to prevent long-lasting deterioration in economic growth potential, an aspect that is also subject to considerable uncertainty. In particular, how successfully these measures foster a swift and sharp economic recovery in the near term will have a direct impact on the solvency and liquidity of the Spanish business sector and, therefore, on the final cost for the public sector of the guarantee facilities established for lending to business. In addition, the total cost of this crisis for public finances will depend not only on the expenditure associated with the discretionary measures approved, but also on the functioning of the automatic stabilisers. In this regard, as detailed in Section 4.4.3, this crisis is expected to trigger a highly substantial increase in the general government deficit in coming quarters, largely owing to a very significant decline in public sector tax revenues and a rise in unemployment benefit expenditure.

4.4 Economic outlook for the coming quarters

4.4.1 The starting point

The Spanish economy faces the economic crisis stemming from the COVID-19 pandemic after a long upturn that showed a more balanced growth pattern than in the past. Until the outbreak of the COVID-19 crisis, the Spanish economy had been in a phase of uninterrupted growth since end-2013. During this period, Spanish GDP increased by 16% in cumulative real terms, a markedly steeper growth rate than that observed in the euro area on average (11.5%),[28] and at end-2019 it was more than 6% higher than the peak GDP recorded in the previous upward cycle (in 2008). This growth phase was underpinned by the introduction of various reforms at the European and national level, and by the expansionary stance of demand-side policies. A number of elements distinguished this period of growth from previous expansionary cycles and broadly contributed to a notable reduction in the main macrofinancial imbalances of the economy.

External surpluses, private sector deleveraging and the transformation of the productive structure were all distinctive elements of the last growth phase. The expansionary cycle that came to an end in 2008 was characterised, among other factors, by burgeoning current account deficits, large-scale private sector borrowing and an extraordinary prominence of the construction sector in the productive structure. These dynamics, which were a source of considerable vulnerability for the economy as a whole and for the financial sector, saw highly significant adjustments in the growth phase that began towards the end of 2013, as described below.

The Spanish economy has continuously posted surpluses on current account in recent years (see Chart 4.9).[29] At end-2019, this surplus stood at 2% of GDP, in contrast to the deficits of around 9% of GDP observed in the period 2006-2008. This improvement in the external balance of the Spanish economy was explained by a series of interrelated factors, including the competitiveness gains built up over the last decade, the geographical diversification of Spanish exports to markets with greater growth potential, and the increase in the number of regular exporting firms. As a result, the weight of Spanish exports in GDP rose significantly (35% in 2019, compared with 26% in 2007) and the negative international investment position declined, although it is still very sizeable, both in historical terms and compared with other European economies (see Chart 4.9.1).

Households and firms deleveraged, while the construction sector and the financial sector undertook extensive restructuring, leading to a very marked

28 In per capita terms, real GDP growth in Spain between 2013 and 2019 also exceeded the euro area average (15.2% in Spain, compared with 10% in the euro area).

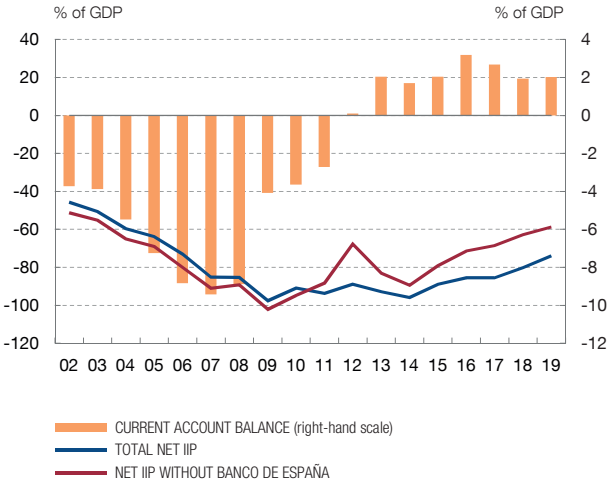
29 For more details on the adjustment of the Spanish current account balance during these years, see Banco de España (2017a).

Chart 4.9

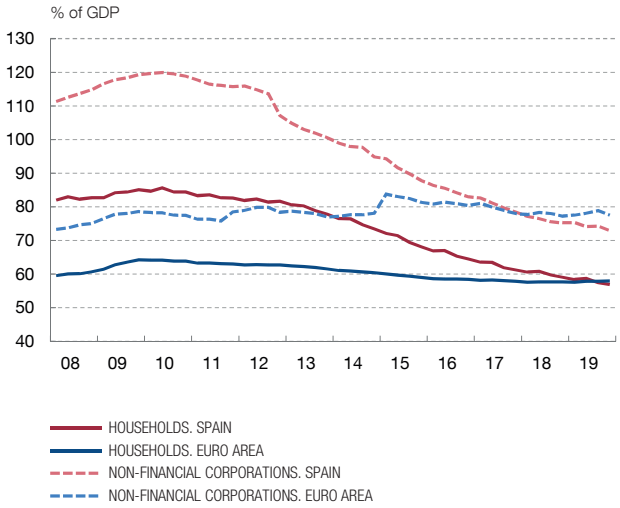
EXTERNAL SURPLUSES, PRIVATE SECTOR DELEVERAGING AND THE TRANSFORMATION OF THE PRODUCTIVE STRUCTURE WERE ALL DISTINCTIVE ELEMENTS OF THE LAST GROWTH PHASE IN SPAIN

The Spanish economy has continuously posted surpluses on current account in recent years, in contrast to the deficits of around 9% of GDP observed in 2006-2008. Growth in recent years was also compatible with intensive deleveraging by Spanish households and non-financial corporations, whose debt-to-GDP ratios were lower than the euro area average at end-2019.

1 CURRENT ACCOUNT BALANCE AND NET INTERNATIONAL INVESTMENT POSITION (IIP)



2 DEBT OF THE PRIVATE NON-FINANCIAL SECTOR



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SOURCES: Banco de España, ECB and INE.

reduction in their size. The growth in recent years was compatible with an intensive process of deleveraging by the private non-financial sector. Thus, at end-2019, the debt-to-GDP ratios of Spanish households and non-financial corporations stood at 57% and 74%, respectively (28 pp and 46 pp below their post-crisis peaks), in both cases lower than the euro area average (see Chart 4.9.2). At the same time, the weight of construction investment in Spanish GDP fell very significantly (from nearly 21% in 2006 to 9% on average in 2013-2019), drawing it closer to the euro area average.[30] In contrast to the relative sluggishness seen in the construction sector in recent years, investment in capital goods was clearly more buoyant in Spain than in other European countries after 2013 (with average annual growth of 5.1% in Spain, compared with 3.2% in the euro area).[31] This occurred against a backdrop of considerable rationalisation, recapitalisation and restructuring by the financial sector, which contributed to a more efficient

30 This same dynamic is also observed in terms of the weight of the GVA of the construction sector in the total GVA of the economy. In real terms, this ratio fell from 10.3% in 2006 to 5.9% on average in 2013-2019, only 1 pp above the euro area average in this period. For further details of the adjustment process in the Spanish construction sector in recent years see, for example, García-Montalvo (2013) and Banco de España (2020d).

31 For a more detailed description of the behaviour of investment in the last Spanish expansionary cycle see, for example, Banco de España (2018).

allocation of credit to businesses, with lending being more concentrated on more productive firms.[32]

Despite the progress made in recent years, the Spanish economy still presented some significant sources of vulnerability at end-2019, shaping the response to the COVID-19 crisis and the scale of the current downturn. In particular, after years of robust and uninterrupted growth, the Spanish economy has not managed to correct the imbalance in its public finances, the labour market continues to be characterised by high unemployment rates and excessive duality, and productivity growth remains low. Not only have these aspects already had some influence on the initial impact of the COVID-19 pandemic on the Spanish economy (see Section 4.2), but looking forward they will also have a bearing on its behaviour and its responsiveness (see Section 5.1 of this Report).

4.4.2 The main sources of uncertainty

Extraordinary uncertainty surrounds the three keys aspects that shape the medium-term outlook for the Spanish economy. First, the economic performance over the coming quarters will hinge on how the pandemic develops from a healthcare perspective, on how the plans for the gradual easing of lockdown implemented in recent weeks unfold, and on the extent to which the different sectors of economic activity can recover a certain level of normality. In the context of a highly integrated global economy, all of these matters must be assessed from both a domestic and an international standpoint. Second, the momentum of the Spanish economy over the medium term will depend on the degree to which the health crisis has damaged the growth potential of the economy, despite the measures deployed to avert such damage. In this regard, there is considerable uncertainty as to how persistent the damage to the labour market and the business sector may be. Lastly, the medium-term outlook for the Spanish and global economy will be influenced by developments in the financial system and, in particular, by the possibility of disruptive episodes in this area, with potentially adverse implications for the real economy.

As regards the first source of uncertainty, although the pandemic appears to be relatively under control in most European countries in late June, new outbreaks of the disease in the future cannot be ruled out. Indeed, experience of other epidemics throughout history and the evidence analysed in various scientific studies suggest that there is a not insignificant probability of new outbreaks of COVID-19 in the future. Naturally, it is not possible to determine when any such new outbreak would occur, nor how severe it would be. Further, it is not

32 See Banco de España (2017b) for a detailed description of the transformation process undertaken by the financial sector in recent years, and Jiménez, Moral-Benito and Vega (2018) for an analysis of the changes that took place in the credit allocation process in this period. For a description of the challenges facing the financial sector in the coming years, see Section 5.3 of this Report.

certain when a vaccine or effective anti-viral treatment for COVID-19 could become widely available. There is, however, broad consensus that, until such a vaccine or treatment is available, any possible new outbreak of the disease will require renewed lockdown measures, with the consequent economic cost.[33] Such a possibility means that uncertainty will remain at relatively high levels over the coming months, adversely affecting agents' spending and investment decisions. In this regard, the Banco de España's estimates suggest that, if economic uncertainty were to remain at current levels (following the increase recorded in the second half of March; see Chart 4.4.3), household consumption in mid-2021 would be 3.5% less than it would be under a scenario in which uncertainty fell swiftly back to pre-COVID-19 levels. There would be an even more significant adverse impact, of around 27%, on business investment.

Nor is it certain how households and firms will adapt to the lockdown easing plans implemented in Spain and other countries in recent weeks, nor what the new normal will be. Despite the major differences among them, most plans still maintain different forms of restrictions on activity in some sectors (for example, in terms of capacity in certain public spaces)[34] and on international movement. So it is not yet a case of a full return to normal. How long these restrictions will last is uncertain, and they will undoubtedly place constraints on the profitability of the sectors and businesses affected, potentially leading to changes in their business models in the short term. It is also possible that this crisis may ultimately trigger relatively persistent changes in some countries' industrial policies, in the functioning of global value chains, and in households' consumption and work habits, all of which are surrounded by a high level of uncertainty (see Section 5.2 of this Report). For example, it is difficult to determine the extent to which there will be permanent changes in the percentage of households' online consumption expenditure (with implications for the retail trade sector) or in demand for services linked to international travel or mass gatherings (with implications for sectors such as transport, tourism and leisure).

The sectors most affected by the restrictions to contain the pandemic account for a large share of the Spanish economy, which amplifies the adverse impact of the crisis in the short term and will foreseeably affect the momentum of the subsequent recovery.[35] In comparison with other economies, the weight of the

33 Broadly speaking, the incipient academic literature analysing the economic implications of the COVID-19 pandemic suggests that, although the social distancing measures implemented to curb the spread of infection have an immediate, high economic cost, they are optimal from an economic standpoint when a longer-term perspective is taken or when the different channels through which the pandemic could affect activity are internalised. See Bodenstein et al. (2020) and Farboodi et al. (2020).

34 See Section 4.1 for more details on the lockdown easing plan in Spain.

35 As detailed in other sections of this Report, in addition to the sectoral structure of the Spanish economy, the high percentage of temporary employment and the relatively large weight of small and medium-sized enterprises in the national productive system will also exert significant influence on the outlook of the Spanish economy in the short and medium term.

sectors most affected by the initial restrictions on movement and activity (those connected with passenger transport, retail trade, leisure, restaurants and, more generally, with tourism) is relatively high in Spain (see Chart 2.8.2). This pattern of productive specialisation explains, in part, why the Spanish economy is being harder hit than other European economies by the present crisis (see Section 2.3 of this Report). Indeed, it is estimated that, even in a hypothetical exercise in which the four large countries in the euro area applied exactly the same restrictions to activity in the different sectors of the economy, there would be a more acute contraction in activity in Spain than in Germany, France or Italy, as a result of its specific sectoral composition.[36] Insofar as the restrictions that are currently in force, and will foreseeably remain in place over the coming months, continue to have a greater direct impact on the services sectors mentioned above, the sectoral structure of the Spanish economy could continue to have an adverse influence on the momentum of the recovery in the medium term. This channel is illustrated from the perspective of the tourism sector in Box 4.1, which describes the collapse of this sector in Spain in recent months and assesses its possible performance in coming quarters, as well as the impact that this performance may ultimately have on the recovery of the whole Spanish economy in the medium term.

The make-up of the workforce of these sectors, with a relatively high share of women, young adults and low-income workers, will also influence the spending recovery path and how inequality evolves in the future. Box 4.2 highlights that the sectors of activity bearing the brunt of this health crisis – also known as "social industries" insofar as they entail a larger proportion of tasks requiring a high degree of social interaction – have a much higher percentage of female, young and low-income employees than other sectors of the economy. The fact that the workers most affected by the crisis are precisely those who were more vulnerable at the outset and have more limited resources with which to maintain their spending levels could undoubtedly influence the momentum of the recovery in aggregate demand and changes in inequality, not only during the coming months, but also over the longer term. Thus, for example, it has been documented that greater instability in young adults' income leads them to delay buying durable goods (such as housing)[37] and that young adults affected by bouts of high unemployment have a lower propensity to spend, both in the short term and over their life cycle.[38] Moreover, in terms of vulnerability, the latest data from the Banco de España's Survey of Household Finances (EFF) suggest that a relatively significant percentage of workers in the "social industries" (12%) are women who also provide more than 50% of their household income. Furthermore, one in five women in this cohort (22%) live in a household with assets of less than one month's income. Importantly, however, in comparison with the global financial crisis, the workers most affected by the present

36 See Prades Illanes and Tello Casas (2020).
37 See Paz-Pardo (2020).
38 See Malmendier and Sheng Shen (2019).

crisis are relatively more protected. Their households are in better financial health (in terms of lower debt payments relative to their income) and, in general terms, these workers are not the principal source of the household's income, which is usually salaried income from a sector other than the "social industries".[39]

The specific degree to which the economic policy measures will be effective in preventing long-lasting damage to the labour market is as yet unknown. As discussed in Section 4.2, in recent months Spanish firms have made large-scale use of furlough schemes (ERTEs). Although this has also been observed in other countries during the crisis, the use of this mechanism is new in the Spanish labour market compared with the dynamics observed in previous downturns. In addition to the design of this tool making it particularly suitable for responding to short-lived episodes such as the COVID-19 health shock, its current use has also been driven by the incentives approved by the Government at the outbreak of the crisis. In any event, given the relative novelty of furloughs due to force majeure as a tool for employment adjustment in the Spanish economy, there is notable uncertainty as to how the employment relationships concerned will be affected. Clearly this will also depend on how the crisis unfolds over the coming months. In this regard, it should be noted that the number of workers furloughed due to force majeure fell by nearly 460,000 between April and May, while the number of those furloughed due to other reasons increased by 70,000 in the same period. This could reflect a gradual shift from the initial furloughs due to force majeure, which were directly related to the COVID-19 pandemic, to other mechanisms (in this case, furloughs due to other reasons) that are better aligned with the specific situation of each firm. In any event, this evidence suggests that the transition from furloughs due to force majeure to employment does not necessarily have to be direct or immediate.

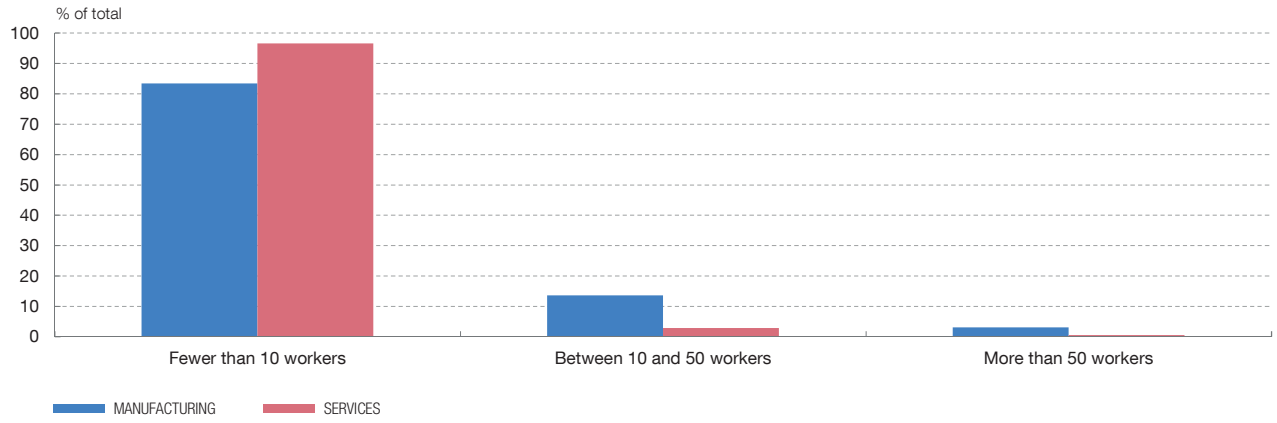
The percentage of workers on furlough who will recover their jobs will depend, among other factors, on the growth capacity of each sector and firm. As mentioned, the recovery in the manufacturing sector may be expected to be more robust than the recovery in retail trade, leisure, restaurant and tourism services, at least while uncertainty persists as to a possible new outbreak of the disease. However, it is precisely these services sectors that have most resorted to furlough schemes and that concentrate the bulk of the workers affected. As discussed below, the future of furloughs in each sector will also hinge on firms' capacity to adapt to the new environment, which usually presents a positive correlation with their size.[40] In this respect, notable sectoral heterogeneity is once again observed, which suggests that firms in the manufacturing sector are significantly larger than services sector firms (see Chart 4.10). Lastly, how the layoffs and short-time work arrangements evolve over the coming quarters will undoubtedly be influenced by the conditions applied to them. The economic benefits and advantageous conditions approved for requesting furloughs were, in principle,

39 See Alvargonzález et al. (2020).
40 See, for example, Bartik et al. (2020).

Chart 4.10

FIRMS BY SIZE AND SECTOR IN 2019

In comparison with other economies, Spain has a relatively high share of small and medium-sized enterprises in its productive system. Although this is true both of manufacturing and services, the prominence of SMEs is particularly pronounced in the services sector.



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SOURCE: Directorio Central de Empresas 2019 (DIRCE) (INE).

linked to the duration of the state of alert. These conditions were subsequently extended, albeit with lower rebate rates, first to the end of June and then to the end of September. In any event, any further adjustment made in this area should take account of the extraordinary heterogeneity among sectors and firms as regards their capacity to recover over the coming quarters.

The empirical evidence available suggests that temporary layoff or short-time work schemes, such as the ERTEs in Spain, would have a relatively limited ability to protect employment in the medium term should there be structural changes in economic activity momentum. In particular, the international economic literature generally finds that the ability of schemes of this kind to safeguard employment is lower the longer the crisis persists.[41] This suggests that, at least in part, some such schemes may delay rather than prevent job destruction in certain cases where restructuring is inevitable. In any event, this empirical evidence should be interpreted with due caution, as it focuses on crisis episodes that are very different from the present one. In particular, much of the existing analysis focuses on the downturn that Spain and other European countries suffered from 2008, when employment cuts in certain sectors were unavoidable, as they were oversized following a long previous expansionary phase. By contrast, in the present episode, the risk of future job destruction would be more closely linked to the potential long-lasting effects of the crisis on the sectors of activity most affected by the measures taken to mitigate the spread of the disease, rather than to previous structural imbalances.

41 For evidence relating to Spain, see Arranz et al. (2018); for evidence relating to Germany, see Boeri et al. (2011).

A relatively prolonged period of job losses affecting a large number of workers would have an adverse impact on human capital and economic growth potential in the medium term. In this respect, it seems unlikely that workers with either permanent or temporary contracts who have lost jobs in the sectors worst hit by the crisis will be able to quickly find new employment in other sectors where activity may be more dynamic in coming quarters. In particular, it has been documented that the potential mobility of the workers most affected by the crisis is generally limited. This is especially the case in accommodation and food services and in wholesale and retail trade, partly owing to the low level of use in these sectors of tasks associated with information and communication technology and with reading, writing and numeracy skills.[42] On the basis of this evidence, it may be appropriate, so as not to delay the possible reallocation of workers in the labour market, for the economic policy response to the current crisis to encourage training of workers affected by temporary layoffs and, in some cases and under certain conditions, to allow them to combine this with the possibility of working in other sectors or firms. Following the 2008 crisis, the effects on the employability of workers who had been employed in the construction sector were very negative: by 2013, more than half were still jobless, and only 23% had obtained employment in a different sector of activity. In that period, the likelihood of finding employment in another sector was especially low in the case of older workers, with greater work experience and lower skill levels.[43]

There is also considerable uncertainty regarding the permanent damage that this crisis may have on the Spanish business sector. As a result of the severe contraction in activity in some industries in recent months, businesses and the self-employed have seen their liquidity needs climb sharply. The fall in sales has meant that many have insufficient income to pay utility bills, rents or wages (despite the measures approved by the Government, which have helped to reduce some of these expenses in the short term and to defer the payment of others, such as taxes or rents). In this respect, the Banco de España's estimates suggest that a signification proportion of Spanish non-financial corporations would need additional liquidity to meet these payments and repay their financial debts in the last three quarters of the year.[44]

Businesses may meet some of these liquidity needs by having recourse to their liquid assets and to undrawn credit facilities. Smaller firms in particular have been building up liquid assets since the crisis that began in 2008. Accordingly, they come into the present crisis with a high liquidity ratio by historical standards. In addition, some companies, especially larger ones, have credit facilities open with financial institutions. Indeed, the information on banks' balance sheets available to April 2020 shows that, at end Q1, these companies had significantly increased drawdowns on these credit facilities.

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42 See Anghel et al. (2020).

43 See Banco de España (2015).

44 For more details, see Blanco et al. (2020).

The bulk of the liquidity needs of businesses and the self-employed will have to be met through recourse either to the markets or to financial intermediaries. As only companies of a certain size have access to the capital markets, and as such access is more complicated at times of financial stress, most of the funds needed may be expected to be channelled through banks. In this respect, the existence of close previous relationships with their customers should make it easier for banks to fund the liquidity needs of businesses and the self-employed. These relationships enable banks to obtain information on the financial situation of their customers, including important qualitative aspects, so as to be able to identify those borrowers that have liquidity needs in the short term but that present a solvent position in the medium term.

In addition, the measures adopted by the economic authorities will also facilitate the provision of bank financing to the private sector. The Eurosystem's liquidity support measures help to ensure that banks have the funds needed to finance this lending. Moreover, some of these measures, such as the targeted longer-term refinancing operations (TLTRO-IIIs) in particular, contain explicit incentives for financial institutions to continue to provide financing[45] (see Section 3.4.2 in Chapter 3). At the national level, the Government's guarantee programme will also help stimulate lending to the private sector, reducing any reluctance on the part of banks to assume new risks in a highly uncertain environment. The data on new lending to business in March and April point in that direction (see Box 4.3), as does the latest information on the volume of lending to resident non-financial corporations, which rose again in year-on-year terms in May after accelerating sharply in April. On the data published at 14 June, the guarantees requested totalled almost €52.8 billion. This has enabled slightly more than €69 billion to be mobilised through new loans and other funding facilities, of which almost €48.8 billion has been granted to SMEs and the self-employed. In addition, at 16 June, credit institutions had granted, to vulnerable households and sole proprietors, more than 1 million moratoria on mortgage and non-mortgage loans, amounting to an outstanding credit balance of more than €37.7 billion.

Both the ECB and the Basel Committee on Banking Supervision have adopted measures to allow a significant volume of capital buffers to be used to absorb possible losses and thus encourage banks to continue lending. The Banco de España has committed to the ECB's decision and has extended it to all the financial institutions under its direct supervision. The combined size of all these buffers – including the voluntary, countercyclical, systemic, capital conservation and P2G buffers – amounted to 6% of the risk-weighted assets of the Spanish banking system at end-2019 (see Chart 4.11).[46] It is estimated that these buffers would be able

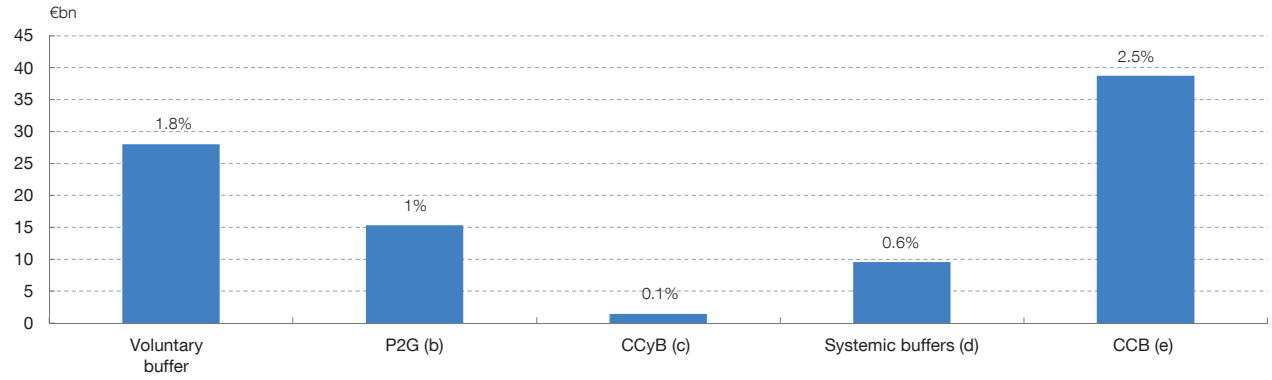
45 In particular, these refinancing operations have a lower cost if the bank's credit balance increases during the reference period.

46 According to the current supervisory guides of the ECB and the national authorities, the voluntary, countercyclical, systemic and capital conservation buffers, and capital linked to P2G, may be drawn down to absorb losses, while the P2R requirements are maintained, although the rules on their composition are relaxed, with a lower weight of CET1 capital required. An easing of the rule on P2R composition would provide a minimum additional release of CET1 capital at significant institutions that is not considered in this analysis.

Chart 4.11

VOLUME AND RELATIVE WEIGHT OF BUFFERS WITH RESPECT TO RISK-WEIGHTED ASSETS (RWAs) (a)
December 2019

The capital conservation buffer is by far the most important of the capital buffers, while the countercyclical buffer represents a minimal percentage of RWAs. The joint release of these buffers, which is permitted as part of the prudential response to the crisis, could cover a significant volume (relative to the RWAs) of impairment losses on banks' balance sheets.



SOURCE: Banco de España.

a The figure above each bar is the percentage of total risk-weighted assets the buffer represents.
b Pillar 2 Guidance.
c Includes the countercyclical capital buffer.
d Includes both the buffer for global systemically important institutions and the buffer for other systemically important institutions.
e Includes the capital conservation buffer.

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to absorb an increase of some 8.2 pp in the non-performing loan (NPL) ratio, albeit with a certain degree of heterogeneity across institutions as they do not all have the same margin for recording impairment provisions. In any event, the loan moratoria and the Government's programme of guarantees for loans to businesses and the self-employed will further increase loss-absorption capacity, without institutions being required to reduce their assets in order to comply with capital requirements.[47] All the foregoing will help sustain the flow of credit, reducing the risk of amplification of the effects of the shock associated with the pandemic through the financial channel.[48]

In any event, despite this wide range of measures, there has already been a very considerable drop in the number of firms registered with Social Security.[49]

47 The loans guaranteed have a risk weight of 0%, which is the Spanish sovereign risk weight. In consequence, the increase in these loans on the balance sheet does not consume own funds.

48 Past experience suggests that making use of capital buffers during periods of crisis may play a significant role in sustaining the flow of credit. This was, in particular, the evidence gained from Spain's dynamic provisions, which were in force from 2000 to 2006, and their release during the 2008 financial crisis. Although these dynamic provisions are not fully comparable with the capital buffers, and were subject to different regulatory frameworks, they were a sufficiently similar mechanism for building up and releasing funds so as to be used as a benchmark for the effects of the use of these buffers.

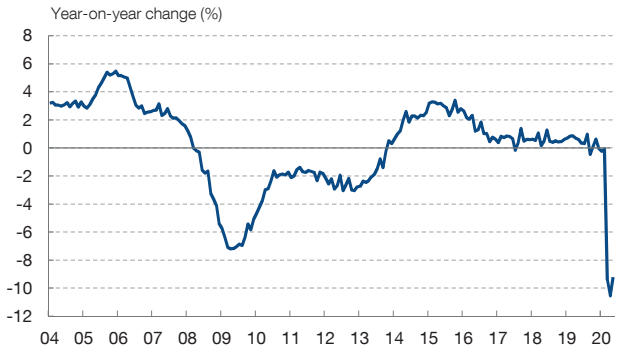
49 The fact that a firm ceases to be registered with Social Security does not necessarily mean its definitive closure or disappearance. Firms cease to be registered if they have no workers registered with Social Security in a specific month, but they may resume their activity at a later date. However, the longer this situation lasts, the more likely it is that a firm that has no workers registered will ultimately close. The empirical evidence presented here points in this direction.

Chart 4.12

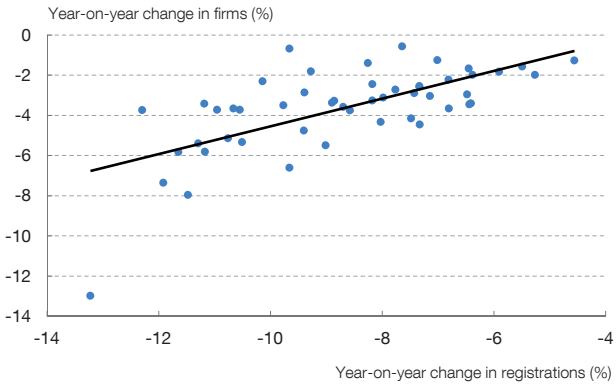
THERE HAS ALREADY BEEN A VERY CONSIDERABLE DROP IN THE NUMBER OF FIRMS REGISTERED WITH SOCIAL SECURITY

Since the start of the crisis, the number of firms registered with Social Security has fallen very significantly. This decrease is closely related to the intensity of the fall-off in employment, both by province and by sector of activity. In the past, a relatively high correlation is observed between a decrease in the number of firms registered with Social Security and an increase in the number of firms subject to insolvency proceedings.

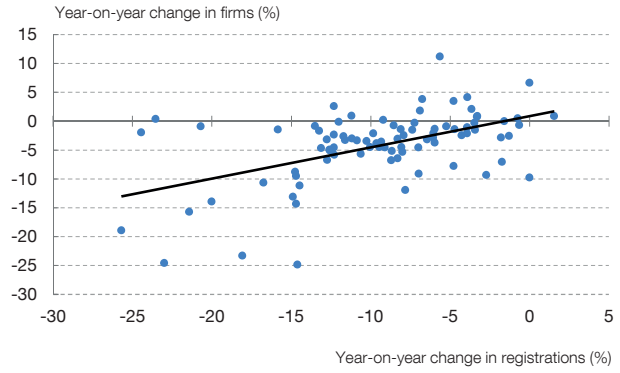
1 FIRMS REGISTERED WITH SOCIAL SECURITY



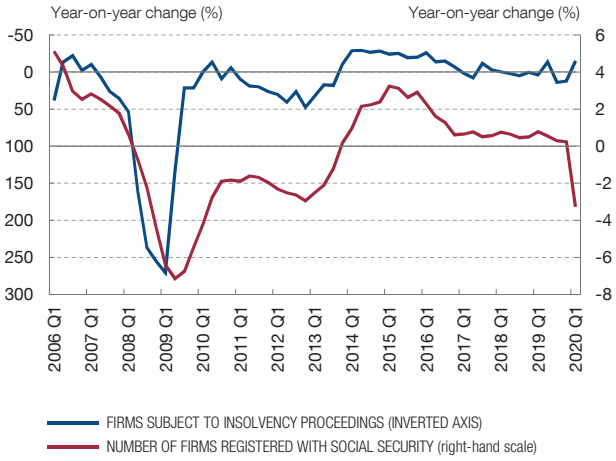
2 CHANGE IN REGISTRATIONS AND IN FIRMS REGISTERED WITH SOCIAL SECURITY BY PROVINCE IN MAY 2020



3 CHANGE IN REGISTRATIONS AND IN FIRMS REGISTERED WITH SOCIAL SECURITY BY SECTOR OF ACTIVITY IN MAY 2020



4 FIRMS SUBJECT TO INSOLVENCY PROCEEDINGS AND FIRMS REGISTERED WITH SOCIAL SECURITY



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SOURCES: Ministerio de Inclusión, Seguridad Social y Migraciones and INE.

Indeed, since the start of the crisis the number has fallen very significantly, with a loss of almost 108,000 firms from social security records between end-February and end-May, giving a drop of 9.2% in year-on-year terms in May (see Chart 4.12.1). This decrease is closely related to the intensity of the fall-off in employment, both by province and by sector of activity (see Charts 4.12.2 and 4.12.3). There is great uncertainty about the extent to which this dynamic may reverse or intensify in coming quarters, and about its possible impact on the growth potential of the economy in the medium term. In any event, the evidence from previous crisis episodes, which must be interpreted with caution as those were downturns with very different characteristics

from the present crisis, suggests that there is an appreciable risk of the decrease in the number of businesses registered in recent months ultimately resulting in permanent damage to the Spanish productive system. In particular, in the past, a relatively high correlation is observed between a decrease in the number of firms registered with Social Security and an increase in the number of firms subject to insolvency proceedings (see Chart 4.12.4), and also between a decrease in the number of firms registered with Social Security and the number of active firms in the Spanish Central Companies Directory (DIRCE).

This evidence points to the need to ensure that the Spanish insolvency process works swiftly and effectively. Specifically in the case of insolvency processes, despite a series of partial reforms adopted in recent years, the Spanish system is much less efficient than those of our peers.[50] It would, therefore, be advisable to consider the appropriate transposition of the regulations included in the European Directive on restructuring and insolvency.[51] This would provide for rapid and simplified administrative procedures that would grant debtors in financial difficulties access to a preventive restructuring framework that would allow them to continue to pursue their business activity while it is still viable. It would thus enhance the efficiency of the restructuring and insolvency procedures and ease the financial burden. This reform is especially important in the present circumstances, in which there will foreseeably be an increase in personal and business insolvency procedures in the coming quarters. Speed of resolution is paramount in these procedures so as to minimise the losses in asset value that would materialise if they were to drag on. And all the more so in a situation in which the economic policy response in the short term makes it very likely that the liabilities of ailing businesses to general government will be much higher than in previous crisis periods. The introduction of more appropriate procedures and incentives would also avoid excessively high levels of business liquidations and destruction of the productive system that would weaken the long-term economic growth and recovery potential.

A third source of uncertainty affecting the growth outlook for the Spanish economy in the medium term relates to the response of the financial markets in coming quarters. Looking ahead, one of the possible financial risks is that, as a result of a change in investor sentiment in the markets, the cost of financing for public and private sector resident issuers may rise, prompting a tightening of financing conditions for businesses and households. In any event, in this case, by contrast to the episodes during the European sovereign debt crisis of 2010-2012, the likelihood of this risk materialising, and its incidence, would be mitigated by the ECB's asset purchase programmes (APP and PEPP) and the extraordinary measures it has adopted to facilitate bank financing, and by the State guarantee programme rolled out by the Spanish government to encourage bank lending to business.

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50 See Indicators of Product Market Regulation.

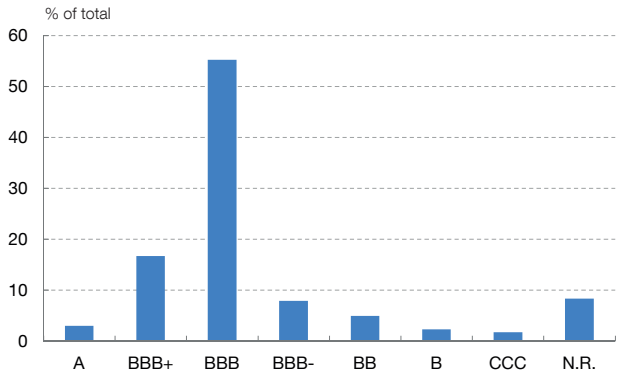
51 See García-Posada and Vegas (2018).

Chart 4.13

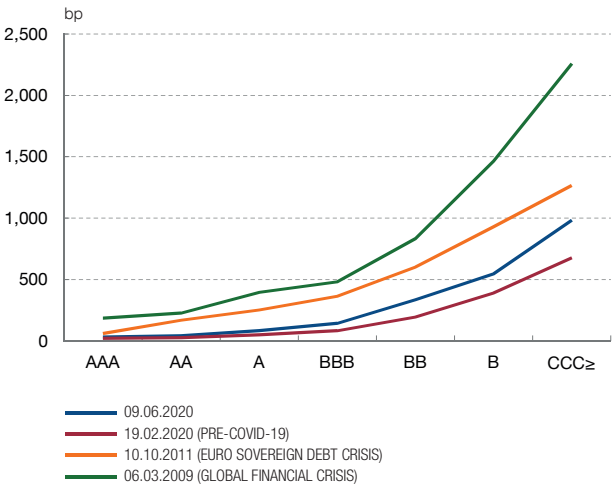
SOME FINANCIAL RISKS WILL PLACE CONSTRAINTS ON THE OUTLOOK FOR THE SPANISH ECONOMY IN COMING QUARTERS

Spanish issuers of debt securities are highly exposed to a possible downgrade of credit ratings, as a large share of their issuances are rated at the low end of investment grade. During financial stress episodes, the cost of issuing securities with a credit rating below BBB increases significantly, hindering new placements.

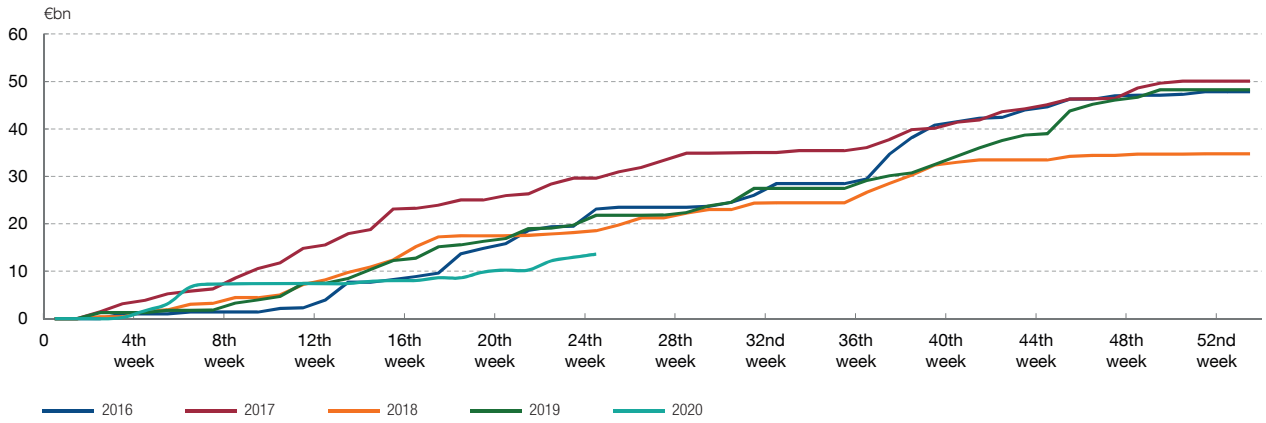
1 DISTRIBUTION OF DEBT OF SPANISH NON-FINANCIAL CORPORATIONS BY RATING



2 CORPORATE CREDIT RISK PREMIA IN THE EURO AREA



3 CUMULATIVE ISSUANCE OF HIGH-YIELD BONDS IN THE EURO AREA



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SOURCES: Thomson Reuters Datastream, Dealogic and Banco de España.

Another financial risk is the possibility of significant downgrades of credit ratings of securities issued both by financial and non-financial corporations. This could occur if, for example, the deterioration of the macroeconomic outlook proves to be greater than expected. A good many Spanish financial and non-financial corporations that issue securities could be particularly affected by this shock, since a high proportion of their securities are currently rated at the low end of investment grade (see Chart 4.13.1). A downgrade that takes them below investment grade (down to high yield) would likely have a potentially significant

adverse impact on their financing conditions in the wholesale markets (see Charts 4.13.2 and 4.13.3).[52]

A further source of uncertainty is the lack of clarity on the future trade agreement between the United Kingdom and the European Union, once the transition period agreed by the two parties in the framework of the Brexit negotiations comes to an end on 31 December 2020 (see Section 2.3 of this Report). At the aggregate level, the Spanish economy's exposure to the British economy is relatively similar to the average euro area exposure. However, in the services sector – tourism and non-tourism services – Spain is more highly exposed than its main euro area partners.[53] The vulnerability of Spanish export firms with a strong presence in the United Kingdom could be mitigated, however, by their higher productivity and greater geographical diversification compared with the average of Spanish companies with no presence in the British market.[54] In any event, an outcome of no agreement on future trade relations between the United Kingdom and the European Union and, therefore, with trade subject to WTO tariffs from 1 January 2021, would be an added source of uncertainty that would have an adverse impact on the Spanish economy. Accordingly, it is highly desirable that a trade agreement be reached between the parties before year-end, even if it is only an agreement on minimums and is thus susceptible to subsequent review and extension.

4.4.3 Macroeconomic scenarios for the medium term

In such an uncertain healthcare and macro-financial setting, the Banco de España's latest projections,[55] published on 8 June, envisage three scenarios drawing on different assumptions as to the rate at which a certain degree of normality may be restored both from the healthcare and the economic standpoint. Under the "early recovery" scenario, it is assumed that the improvement in economic activity observed from the last stretch of Q2 continues, with no new major healthcare, economic or financial obstacles. By contrast, the "gradual recovery" scenario does not rule out the possibility of fresh future outbreaks of the epidemic, but it assumes they would be less virulent than the recent episode and, therefore, that the economic cost would be lower. This scenario also factors in rather more persistent damage to the productive system than the early recovery scenario.

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52 As Chart 4.13.2 shows, the cost of issuing securities with a credit rating below BBB (the lowest end of investment grade) increases significantly compared with the cost of issuing securities that have a higher credit rating during financial stress episodes. In the same vein, Chart 4.13.3 shows that the debt securities market for securities with a credit rating below investment grade has been practically closed since the COVID-19 epidemic spread to Europe at the end of February.

53 For more details on the Spanish economy's exposure to Brexit, see Vega (2019) and the section of the Banco de España's website dedicated to this issue.

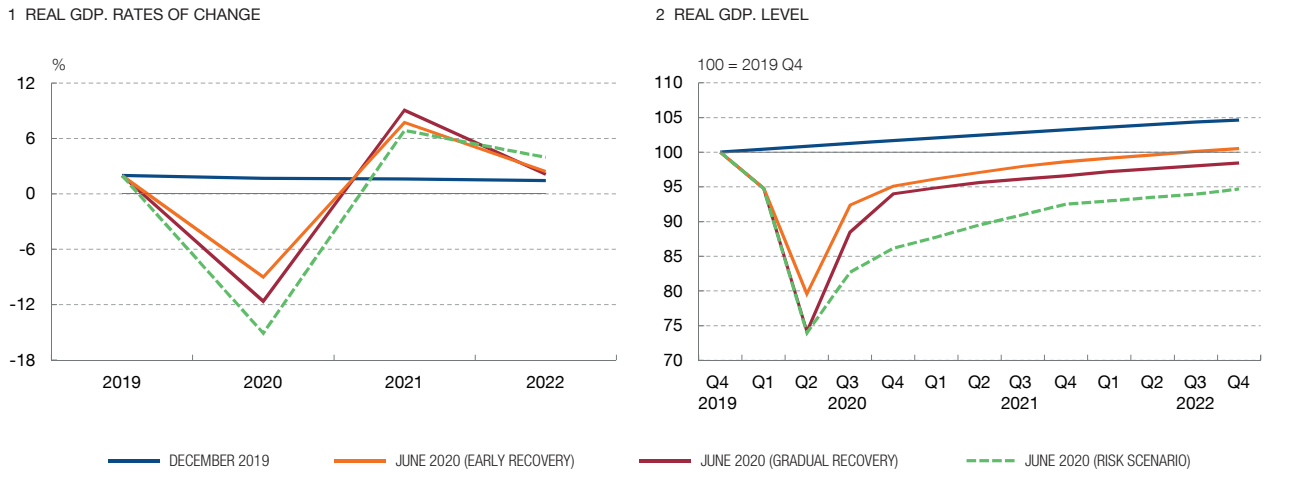
54 See Gutiérrez-Chacón and Martín-Machuca (2020).

55 See Macroeconomic projections for the Spanish economy (2020-2022): the Banco de España's contribution to the Eurosystem's June 2020 joint forecasting exercise. These projections form part of the Eurosystem's June 2020 joint forecasting exercise (see Eurosystem staff macroeconomic projections for the euro area June 2020).

Chart 4.14

A SEVERE CONTRACTION IN SPANISH GDP IS ENVISAGED IN 2020

Under the three scenarios envisaged in the Banco de España's latest projection exercise, Spanish GDP is expected to contract severely in 2020, by between 9% (early recovery scenario) and 15.1% (very slow recovery scenario). The subsequent economic recovery would only entail a return to levels close to those recorded pre-crisis towards the end of 2022.



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SOURCES: Banco de España and INE.

The deterioration would be concentrated in the sectors most exposed to social interaction, where it will take longer for the pre-crisis levels of activity to be fully restored. Lastly, a "very slow recovery risk" scenario is considered, which includes the possibility of more adverse epidemiological developments in coming months, with significant increases in the number of new infections, requiring further strict lockdown measures, with the consequent adverse economic impact. This scenario also considers the presence of financial channels that amplify the real shock and cause it to have notably more persistent effects than in the other two scenarios.

All three scenarios envisage a severe contraction in Spanish GDP in 2020, followed by a substantial rebound in 2021 (see Chart 4.14.1 and Table 4.1). GDP would shrink by 9% this year under the early recovery scenario, and by 11.6% under the gradual recovery scenario. In the hypothetical case of the very slow recovery risk scenario materialising, the downturn this year could be significantly deeper, with a fall of around 15% in GDP. The subsequent economic recovery, which in the most favourable scenarios would be compatible with relatively high quarter-on-quarter growth rates in 2020 H2, would translate into growth of between 6.9% and 9.1% in 2021, followed by slightly more moderate rates in 2022. However, this recovery would only entail a return to levels close to those recorded pre-crisis towards the end of 2022 (see Chart 4.14.2). Specifically, at the end of the projection period, it is estimated that GDP will be approximately 0.5 pp above the pre-crisis level under the early recovery scenario, whereas under the gradual recovery

Table 4.1
PROJECTIONS OF THE MAIN MACROECONOMIC VARIABLES OF THE SPANISH ECONOMY (a)

Annual rates of change

		June 2020 projections								
		Early recovery			Gradual recovery			Risk scenario		
	2019	2020	2021	2022	2020	2021	2022	2020	2021	2022
GDP	2.0	-9.0	7.7	2.4	-11.6	9.1	2.1	-15.1	6.9	4.0
Harmonised index of consumer prices (HICP)	0.8	-0.1	1.3	1.6	-0.2	1.2	1.5	-0.3	0.9	1.2
HICP excluding energy and food	1.1	0.9	1.1	1.3	0.8	1.0	1.1	0.6	0.5	0.7
Unemployment rate (% of labour force) (b)	14.1	18.1	18.4	17.1	19.6	18.8	17.4	23.6	24.7	22.2
General government net lending (+)/net borrowing (-) (% of GDP)	-2.8	-9.5	-5.8	-4.8	-11.2	-6.8	-6.1	-14.0	-10.5	-8.7
General government debt (% of GDP)	95.5	114.5	111.7	112.5	119.3	115.9	118.7	126.7	129.0	131.8

SOURCES: Banco de España and INE.
NOTE: Latest QNA figures published: 2020 Q1.

a Cut-off date for the projections: 25 May 2020.
b Annual average.

scenario and the very slow recovery risk scenario it would remain 1.6 pp and 4.7 pp, respectively, below that level.

In addition to the impact of the crisis on GDP, the projections also point to a very significant and persistent increase in public debt and the budget deficit, and in the unemployment rate (see Table 4.1). Specifically, the unemployment rate is expected to climb sharply this year, up to 18.1% of the labour force under the early recovery scenario and to 19.6% under the gradual recovery scenario, remaining above 17% in 2022 in both cases. Under the very slow recovery risk scenario, the increase in the unemployment rate would be considerably higher and longer lasting. For its part, the general government deficit is expected to rise very sharply this year, to 9.5% under the early recovery scenario, 11.2% under the gradual recovery scenario and 14% under the risk scenario. The rebound forecast in economic activity in 2021 and 2022, together with the gradual disappearance of the impact of the temporary measures adopted in response to the pandemic, would give rise to a lower deficit in those two years, but it would still stand at between 4.8% (early recovery) and 8.7% (very slow recovery) in 2022. Similarly, the government debt-to-GDP ratio is expected to increase by 20 pp to 30 pp in 2020, to between 115% and 125% approximately across the three scenarios envisaged, and to continue at very high levels in 2021 and 2022.

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Box 4.1

THE SPANISH TOURISM SECTOR: RECENT PERFORMANCE, OUTLOOK AND IMPLICATIONS FOR THE ECONOMY

As evidenced by a wide range of indicators, activity in the Spanish tourism sector has been brought to a standstill since the outbreak of the COVID-19 health crisis. For instance, overnight stays at hotels – which had grown year-on-year by 2.9% and 6.8% in January and February, respectively – fell by more than 60% in March, while in April there were none. This dynamic was common to both resident and non-resident travellers (see Chart 1).[1] Along the same lines, foreign tourist arrivals and inbound tourism expenditure also fell sharply in March and disappeared completely in April. This brought the momentum demonstrated by these variables in the preceding months to a sudden halt (see Chart 2). In employment terms, the adjustment in the domestic tourism sector has been equally pronounced. For example, at end-May, 7.8% of the employees of the accommodation and food service activities sector — one of the sectors most closely linked to tourism — were no longer registered for social security, and 55% of the total were subject to short-time working arrangements. Furthermore, according to data at end-April, 15% of the sector's workers were receiving the benefit for cessation of activity.

This box first analyses the outlook for the Spanish tourism sector in the coming quarters. The outlook is of course contingent on how the virus evolves, which is extraordinarily uncertain and will be key to determining the pace at which this sector's activity could return to a certain level of normality. This box then studies the extent to which the Spanish tourism sector's performance in the medium term could affect the recovery of the economy as a whole. This is a matter of particular importance considering that tourism accounts for a relatively high percentage of Spanish GDP and employment in the Spanish economy.

It is foreseeable that the uncertainty surrounding further possible outbreaks of the virus will continue to adversely affect the sector's activity until a vaccine or effective treatment for COVID-19 is widely available. First, this uncertainty, along with a downturn in household income and in the macroeconomic outlook, will clearly hinder the recovery in domestic and inbound tourism demand in the medium term. Further, in order to minimise the risk of a second outbreak of the virus, the leisure, accommodation and food services, restaurant and transportation sectors of activity are still subject to significant capacity restrictions and must adopt various hygiene and safety measures that place constraints on the normal performance of their activity.

These factors may also delay the recovery from a supply-side perspective. In particular, it is likely that some of the restrictions in force significantly limit in the short term the profitability of many tourism-related firms and their ability to resume business, following sizeable revenue losses during the months when the measures to contain the pandemic were at their strictest and amid high levels of uncertainty surrounding the future outlook for their businesses.[2]

The various scenarios envisaged in the tourism sector point in the same direction. Broadly speaking, they all suggest – even in a context in which a second wave of infections of the virus is avoided and the authorities of the various countries can continue with the lockdown easing plans – that activity in this sector will plummet in 2020 by around 60% both in Spain and globally, and that the recovery will be very gradual. Accordingly, at present, it does not seem feasible that pre-health crisis levels of activity will be achieved before 2021 H2.[3]

In any event, tourism activity will foreseeably recover at different speeds. In particular, one could expect domestic tourism to recover before inbound tourism and a portion of Spanish residents' usual outbound tourism expenditure to be redeployed in the domestic market.[4] Nevertheless,

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1 Data on overnight stays in February were already evidencing some of the pandemic's effects on the sector's activity. Specifically, overnight stays by Chinese residents, the country initially hardest hit by the virus, fell by 54% between January and February. Further, coinciding with the cancellation of the Mobile World Congress in Barcelona in February, overnight stays by foreign tourists in Catalonia performed considerably worse than the national average and declined 6% year-on-year.

2 The vulnerability of the business model or the financial position of certain key firms in this sector, such as airlines, tour operators, hotels and restaurants, has been highlighted, inter alia, in various reports by the Alliance for Excellency in Tourism (Exceltur), the International Air Transport Association (IATA) or the consultancy firm Ernst and Young. For the specific case of accommodation and food services activities, see, for example, Ernst and Young (2020). *Impacto de Covid-19 en hostelería en España,* April.

3 See, for example, UNWTO (2020). *World Tourism Barometer May 2020, Impact assessment of the COVID-19 outbreak on international tourism;* and Exceltur (2020). *Plan "Renacer del Turismo Español" 2020-2023* (June).

4 Some EU countries have adopted economic incentives to boost domestic tourism. The cases of Italy and France stand out because of their significance. In Italy, the incentive consists of a "holiday voucher" of up to €500 per family to be redeemed at Italian hotels and hostels this summer. Households whose income does not exceed €40,000 per year will benefit from this voucher. In turn, France will provide tourism cheques to its underprivileged citizens and to the cohorts that have battled COVID-19 on the front line, such as healthcare workers and cleaning, transport and food services.

Box 4.1

THE SPANISH TOURISM SECTOR: RECENT PERFORMANCE, OUTLOOK AND IMPLICATIONS FOR THE ECONOMY (cont'd.)

Chart 1
OVERNIGHT HOTEL STAYS

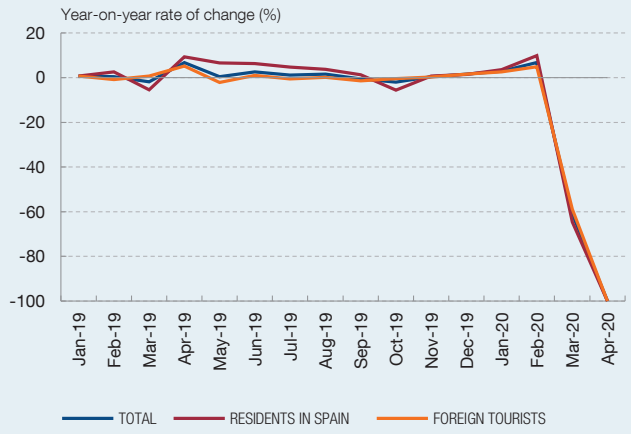


Chart 2
ARRIVALS OF FOREIGN TOURISTS AND TOURISM EXPENDITURE

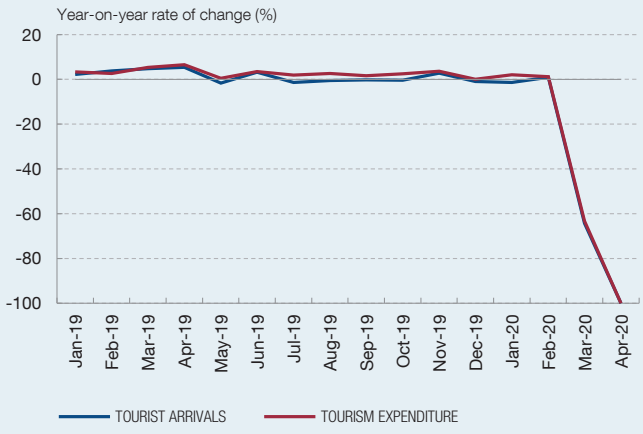


Chart 3
ARRIVALS OF FOREIGN TOURISTS AND TOURISM EXPENDITURE BY MONTH

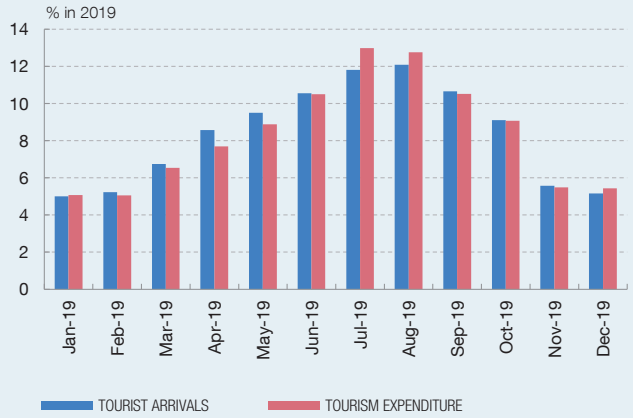


Chart 4
SPILLOVER EFFECT AMONG THE MAIN SECTORS ENGAGED IN TOURISM ACTIVITIES

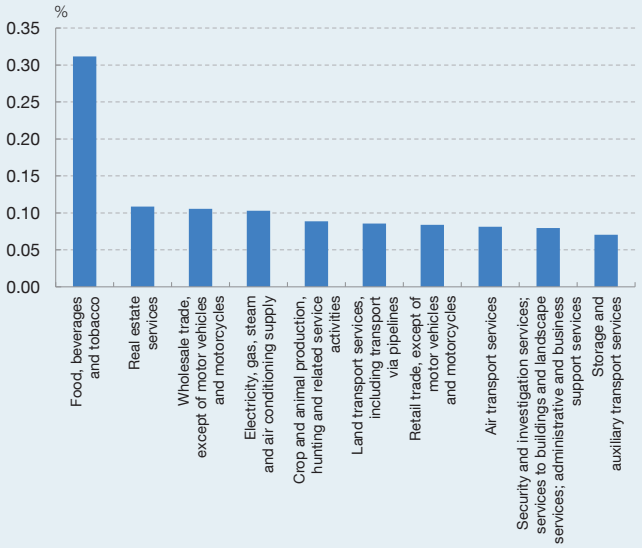


Chart 5
INTERNAL TOURISM EXPENDITURE BY REGION IN 2019

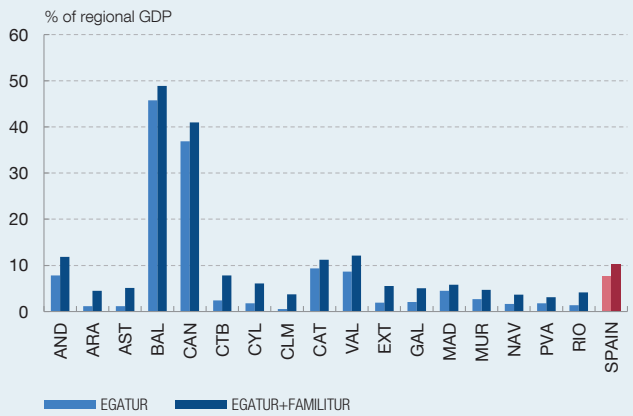
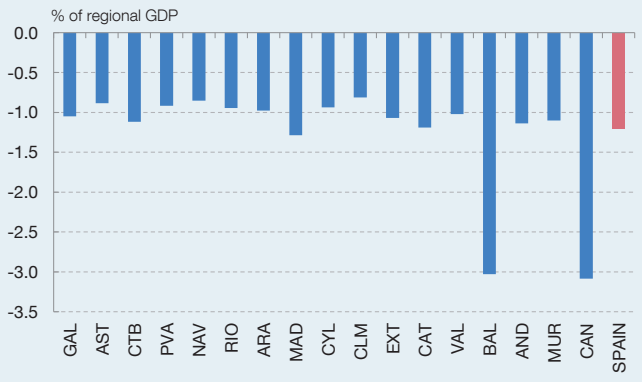


Chart 6
IMPACT ON ANNUAL REGIONAL GDP OF A DOWNTURN IN INTERNAL TOURISM EXPENDITURE OF 1% OF GDP



SOURCES: INE, AENA, EUREGIO 2018 input-output table and own calculations (based on Google).

the ability of these channels to mitigate the sharper and more protracted reduction that will probably be recorded in inbound tourism to Spain would be relatively limited. For instance, the latest data from the Tourism Satellite Account in Spain show that, in 2018, domestic tourism only accounted for 41% of total internal tourism expenditure. In turn, drawing on data from the Balance of Payments, outbound tourism expenditure by Spanish residents in 2019 only accounted for 33% of inbound tourism expenditure in Spain, resulting in the large travel surplus consistently recorded by the Spanish economy in recent decades.

As regards inbound tourism, some sources in the sector suggest that it seems likely that the flows of visitors from relatively nearby countries, some of whom could enter the country by road (without needing to use shared means of transport for their journey), and of visitors with their own residence in Spain or, more generally, who do not require market accommodation for their stay, will recover first. Table 1 details the make-up of inbound visitors to Spain in 2019, based on data provided by the Inbound Tourism Survey (FRONTUR, by its Spanish abbreviation). As can be observed in the table, most inbound visitors to Spain last year were tourists (66%), while the remainder were same-day visitors whose trips did not include overnight stays. Most tourists come by plane (more than 80%), for leisure or holidays (almost 90%) and stay at a hotel (around 65%). Drawing on the Tourism Expenditure Survey (EGATUR, by its Spanish abbreviation), most inbound tourism expenditure in Spain is by these specific profiles. By contrast, some of the visitor flows that could recover with more momentum in the short and medium term account for a relatively small weight of the sector's total activity. For instance, in 2019, same-day visitors only accounted for 5% of inbound tourism expenditure, whereas, when focusing solely on tourists, those who accessed the country by road or who stayed in non-market accommodation only accounted for 8% and 16%, respectively, of inbound tourism expenditure.

In terms of inbound tourism markets, a significant portion of inbound tourists visiting Spain comes from relatively nearby countries, such as the United Kingdom (almost 22%), Germany and France (in both cases 13% of total tourists). Overall, the British, Germans and French account for just over 40% of inbound tourism expenditure. Nonetheless, it should be highlighted that, as part of the growing globalisation of tourism flows, in recent years the weight of tourism expenditure in Spain by tourists from countries further afield (such as Scandinavian countries, the United States, Russia or China, which, overall, accounted for 13% of the inflows of foreign tourists to Spain in 2019) was on the rise. Furthermore, their average expenditure during their stays in Spain is, broadly speaking, higher. There is a high level of uncertainty surrounding how this momentum will be affected in the medium term, which will hinge on, among other aspects, macroeconomic and health developments in both the countries that provide tourists for Spain and in our main market competitors. In this regard, there is considerable uncertainty over not only the varying impact of the pandemic on these two groups of countries, but also its effect on the Spanish tourism sector.

In Spain, the tourism sector accounts for 12.3% of GDP and 12.7% of employment, according to the latest information available for 2018. The intensity of its recovery will therefore have a significant bearing on the pace of the overall economy's recovery. Furthermore, insofar as the sectoral and regional exposure to tourism varies considerably, the tourism sector's momentum in the coming quarters will also notably influence the economic outlook for certain sectors of activity and regions. To illustrate these channels, different findings are presented below obtained from several approaches and alternative models.

First, the Quarterly Macroeconometric Model of the Banco de España (MTBE, by its Spanish abbreviation)[5] shows the importance of inbound tourism to the Spanish economy as a whole. The simulations performed using this model suggest that, if international tourism flows (i.e. both imports and exports of tourism) disappeared completely in an "average" month, GDP and annual exports would fall by 0.4% and 1%, respectively. However, as can be seen in Chart 3, inbound tourism expenditure in Spain is highly seasonal. Hence, were international tourism flows to disappear completely in August, the decline in GDP and annual exports would rise to 0.6% and 1.6%, respectively. These estimates highlight the

5 The MTBE is a large-scale macroeconometric model used for medium-term macroeconomic forecasting of the Spanish economy and for simulating counterfactual scenarios. The model is specified as a large set of error correction equations and, especially in the short run, is mostly demand driven. See A. Arencibia, S. Hurtado, M. de Luis and E. Ortega (2017). *New Version of the Quarterly Model of Banco de España (MTBE)*, Occasional Paper No 1709, Banco de España.

extraordinary importance of the exact point when activity in the sector returns to a certain level of normality.

Second, analysis of global input-output tables with regional detail[6] demonstrates the important differences in the sector's impact on the activity of other productive sectors in the Spanish economy and of certain regions. For example, Chart 4 shows the ten main sectors acting as suppliers of firms engaging in tourism activities in Spain.[7] Based on that information, each €1 of tourism turnover would generate €0.3 of demand in the food and beverage sector and €0.1 of demand in the real estate services sector. Through these spillover effects, wholesale and retail trade services would also be relatively exposed to the greater or lesser momentum exhibited by tourism activities in the coming quarters.[8]

Table 1
FOREIGN VISITORS: TOURISTS AND SAME-DAY VISITORS

	Characteristics of foreign tourists			
	2019		2019	
	Millions of people	%		%
Foreign visitors	126.1	100.0	Tourists by country of residence	100.0
Tourists	83.7	66.4	Germany	13.3
1 night	4.2	3.3	Belgium	3.0
2 to 3 nights	15.5	12.3	France	13.3
4 to 7 nights	39.7	31.5	Ireland	2.6
8 to 15 nights	18.9	15.0	Italy	5.4
More than 15 nights	5.4	4.3	The Netherlands	4.4
Same-day visitors (0 nights)	42.4	33.6	Scandinavian countries	6.6
Tourists by mode of transport		100.0	Portugal	2.9
Air		82.1	United Kingdom	21.6
Road		15.2	Russia	1.6
Sea		2.3	Switzerland	2.2
Rail		0.4	Rest of Europe	7.7
Tourists by accommodation type		100.0	United States of America	4.0
Market		81.6	Rest of America	4.5
Hotel		65.4	Rest of the world	6.8
Other non-hotel market accommodation		16.2	Tourists by purpose of trip	100.0
Rented accommodation		11.2	Leisure, recreation and holidays	87.4
Other		5.0	Business or professional purposes	6.4
Non-market		18.4	Other	6.2
Own dwelling		5.9	Tourists by organisation of trip	100.0
Dwelling owned by relatives or friends		11.3	Non-package holiday	71.9
Other		1.2	Package holiday	28.1

SOURCE: INE.

6 The EUREGIO database includes, in the global input-output table, regional detail for EU countries at the NUTS2 level. For further information, see E. Prades-Illanes and P. Tello-Casas (2020). *Spanish regions in Global Value Chains: How important? How different?,* Working paper, Banco de España, forthcoming.

7 According to the INE's Tourism Satellite Account, tourism activities include, inter alia, accommodation, food and beverage, travel agency, tour operator and transport services.

8 As detailed in Section 4.2, the spillover effect on the overall economy of each additional €1 of tourism turnover is just over €2.

From a regional standpoint, Spain's regions are clearly heterogeneous, not only as regards the weight of the tourism sector in terms of expenditure (see Chart 5), but also the type and seasonality of these flows.[9] In any event, through the various sectoral and interregional input-output relationships, all regions have a relatively high sensitivity to the sector. The foregoing is demonstrated by Chart 6, which illustrates the drop in the regions' GDP that would result from a reduction (equal to 1% of domestic GDP) in the activity of tourism-related services. Naturally, given their greater direct exposure, the impact on the Canary Islands and the Balearic Islands would be greater. Nevertheless, other regions that are less directly exposed would also suffer a relatively significant impact, owing to the aforementioned spillover effects.

In sum, this box has highlighted that the collapse of the tourism sector in recent months – mainly the result of the measures adopted to contain the spread of the COVID-19 pandemic – will not, foreseeably, be accompanied by a swift recovery in the short and medium term. There are several contributing factors, among which mention should be made of the need to keep in place, for an additional period, certain restrictions on people's movement and on the activity of certain sectors in order to minimise the risk of a second wave of the pandemic. This – relatively negative – outlook for a sector of such importance to the Spanish economy points to the need to deploy an economic policy measure specific to this sector that aims to avoid the destruction of a significant part of its productive system. In this regard, on 18 June the government announced a plan to support tourism, based on providing liquidity to the sector's firms in the form of ICO loans and mortgage moratoria, and creating a credit line to fund firms' transition to a more digital, sustainable and competitive model. Here, like in other areas of the economy, it is necessary to be flexible enough to adapt the measures applied depending on how the situation evolves. In particular, two aspects, among others, that should probably be taken into account when designing future measures are the sector's high seasonality and the heterogeneous regional exposure to it.

9 See, for example, A. Gómez and M. J. González (2014). "La evolución reciente del turismo no residente en España", *Economic Bulletin,* April, Banco de España.

Box 4.2

THE EMPLOYMENT INCOME AND FINANCIAL SITUATION OF THE WORKERS MOST AFFECTED BY COVID-19

The most recent economic crises have had asymmetric impacts across different groups of the population. Between 1978 and 2013 a decline in GDP of 1% had a proportionally larger negative impact on the income of men than that of women among US workers earning median salaries. By age group, the same 1% contraction in GDP reduced the annual employment income of workers under the age of 35 by 2.5%, of those aged between 36 and 55 by 1% and of those aged between 55 and 65 by less than 1%. Lastly, in past crises the workers hit by the deepest declines in employment income when GDP shrank were employed in the manufacturing sector and construction.[1]

This box sets out preliminary evidence for the potential effects of the current economic crisis, prompted by the COVID-19 pandemic, on different groups of workers and sectors in the Spanish economy.[2] The analysis focuses on two specific aspects that have had a notable bearing on the extent to which levels of economic activity have been maintained during the crisis: the feasibility of performing the work from home and the degree of physical proximity to others required by each task.

Specifically, this box describes the characteristics of workers in the so-called "social industries", which bore the brunt of the confinement measures implemented by most countries in response to the pandemic, using data from the Spanish Survey of Household Finances. In particular, the analysis focuses on the financial position of those workers and their households.

The financial position of households is a key factor when studying how loss of employment might affect their demand for goods. The lower the levels of disposable savings held by the affected individuals' households, the lower their capacity to maintain spending when employment is lost, resulting in a deeper drop in expenditure. It has been documented in the United States that households with members less able to work from home and employed in the industries hardest hit by the confinement measures also tend to have fewer financial assets (liquid savings) than other households. At the aggregate level, the fact that these workers, who are more at risk of losing their employment, hold lower levels of financial assets is likely to accentuate the drop in total expenditure in the economy during a pandemic.[3]

For the purposes of this analysis, the "social industries" are: retail trade, accommodation and food services, education, arts and entertainment, and other personal services.[4] As described in Chapter 4.2 of this report, employment and activity levels in those sectors have been particularly dented by the confinement measures implemented by most countries to contain the pandemic. Conversely, the relatively less affected or "regular" industries include agriculture; manufacturing; construction; real estate and financial services; clerical, professional and specialist services and public administration. In addition to these two industry groups, this analysis also examines two essential sectors – healthcare and transport – on a separate basis, owing to their particular importance during this crisis.

Given that a substantial proportion of young Spanish people live with their parents and bearing in mind the varying frequency with which men and women may work in the different sectors, the analysis in this box is conducted at the individual level.

Charts 1 to 3 show the proportion of workers – both employed and self-employed – in the various industries in 2014 on the basis of various characteristics.[5] Chart 1 illustrates how women are overrepresented in the social industries. While Chart 2 shows that practically half of all workers in Spain under the age of 35 are employed in the social industries. The evidence available for other countries

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1 F. Guvenen, S. Schulhofer-Wohl, J. Song and M. Yogo (2017): "Worker betas: Five Facts About Systematic Worker Risk", *American Economic Review,* Vol. 107 No 5; B. Bell , N. Bloom, J. Blundell and L. Pistaferri (2020): *Prepare for Large Wage Cuts if you are Younger*, VOX CEPR Policy Portal.

2 For an analysis of the heterogeneous impact of the COVID-19 crisis based on the productive structure of the economy and sectoral interconnections, see E. Prades-Illana and P. Tello-Casas (2020), "The heterogeneous economic impact of COVID-19 among euro area regions and countries", *Analytical Articles,* Economic Bulletin, 2/2020. Banco de España.

3 G. Kaplan, B. Moll and G. Violante 2020 *Pandemics according to HANK*, mimeo, Stockholm University; S. Mongey, L. Pilossoph and A. Weinberg (2020) *Which workers bear the burden of social distancing policy?*, BFI Working Paper 2020-51.

4 This classification of regular and social industries is an adaptation of the classification used by G. Kaplan, B. Moll and G. Violante (2020), op. cit., but here healthcare and transport are separated from the others. In the Spanish Survey of Household Finances, "Transport" encompasses both regular and social modes in the classification by G. Kaplan, B. Moll and G. Violante (2020). The same applies to "Healthcare", which is considered social but has been maintained as an essential industry.

5 This box takes data from the 2014 Spanish Survey of Household Finances, which is the most recent with full available data. The analytical article *"La situación financiera de los trabajadores afectados por la pandemia"* argues that the main qualitative results are unchanged when examining the preliminary data from the 2017 Spanish Survey of Household Finances.

Box 4.2

THE EMPLOYMENT INCOME AND FINANCIAL SITUATION OF THE WORKERS MOST AFFECTED BY COVID-19 (cont'd.)

Chart 1
PROPORTION OF MALE AND FEMALE WORKERS, BY SECTOR OF ACTIVITY

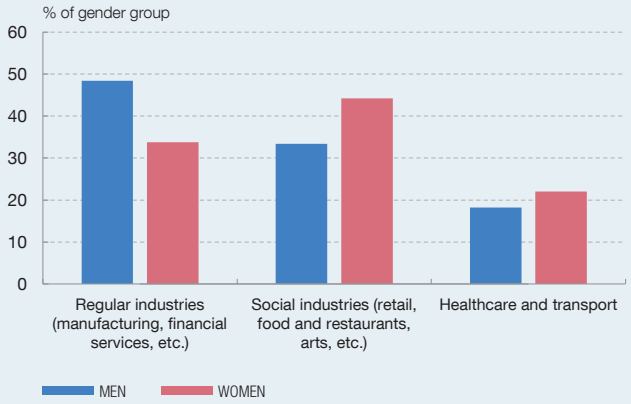


Chart 2
PERCENTAGE OF WORKERS, BY SECTOR OF ACTIVITY AND AGE GROUP

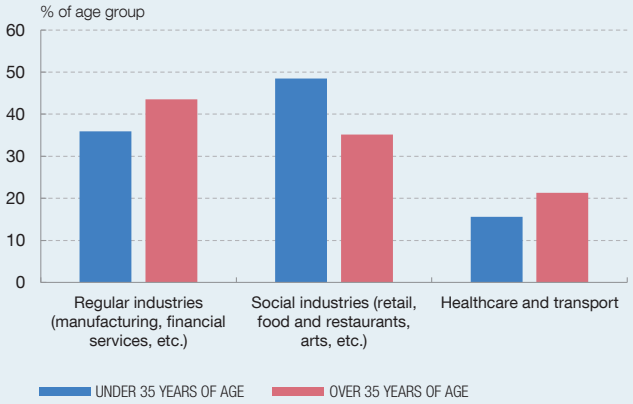


Chart 3
PERCENTAGE OF WORKERS IN THE BOTTOM QUARTILE OF THE INCOME DISTRIBUTION

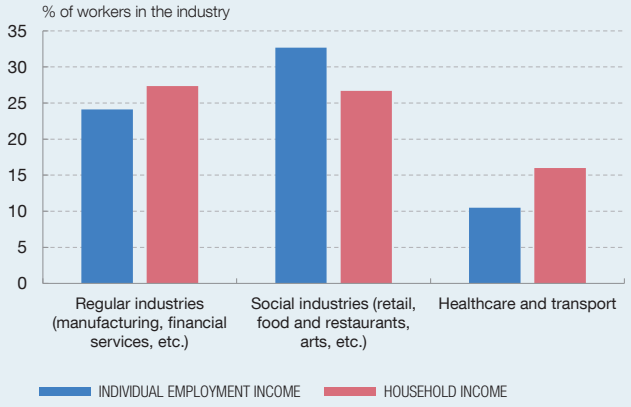


Chart 4
RELEVANCE OF INCOME SOURCES TO THE HOUSEHOLDS OF WORKERS IN DIFFERENT SECTORS OF ACTIVITY

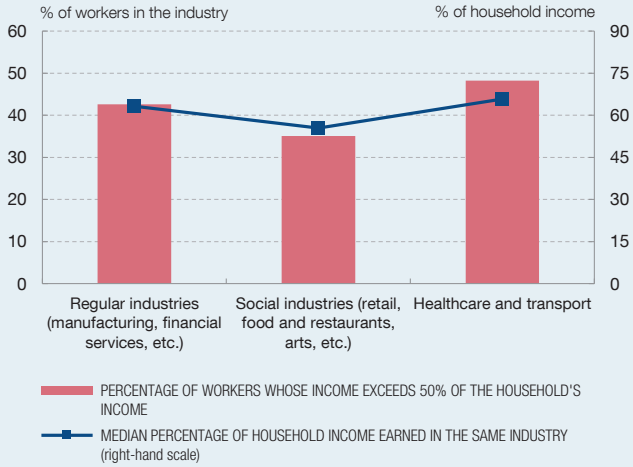


Chart 5
FINANCIAL SITUATION OF THE HOUSEHOLDS OF WORKERS IN DIFFERENT SECTORS OF ACTIVITY

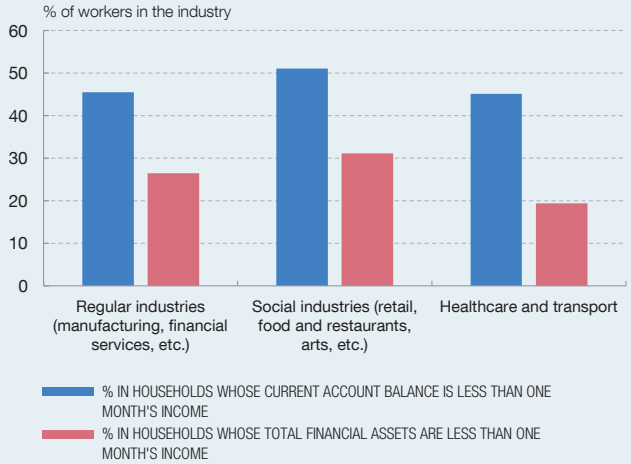
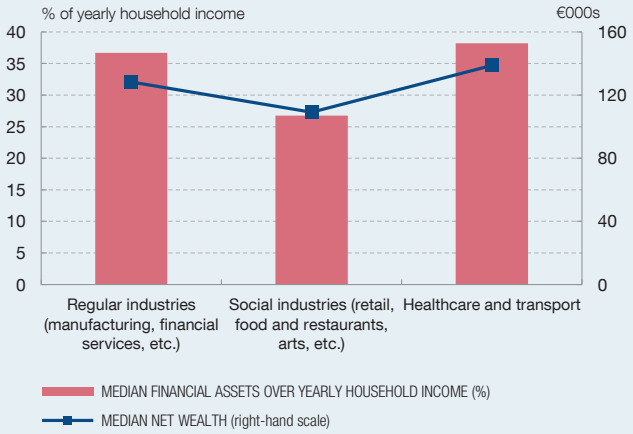


Chart 6
FINANCIAL ASSETS AND NET WEALTH OF THE HOUSEHOLDS OF WORKERS IN DIFFERENT SECTORS OF ACTIVITY



SOURCE: Banco de España, based on the Survey of Household Finances (EFF) 2014.

likewise indicates that social industries employ proportionally more young workers.[6] Further, 33% of those employed in the "social industries" have lower employment income than 75% of all workers (see Chart 3). In the remaining sectors the percentage of employees in the bottom quartile of salary income is substantially smaller, which suggests that the workers hardest hit by social distancing measures earn less than the rest.

However, it is important to take into account the composition of the households where each of these workers resides. Although nearly a third of employees in the social industries earn less than 75% of the population, they are not necessarily members of households in the lowest income groups. As Chart 3 likewise illustrates, just a quarter of workers in the "social industries" live in households in the bottom quartile of the income distribution. This ratio is very similar to that observed for the regular industries. The reason for this is a higher proportion, on average, of young people being employed in social industries than regular industries.[7] As a proportion of young Spanish people live with their parents and given that salaries tend to rise with age, the total income of the households of workers hardest hit by the pandemic may be greater than their individual income would suggest.

Taking this into account, Chart 4 shows that 35% of workers in the "social industries" are the primary breadwinners for their homes, i.e. their earnings account for more than half of the household's income. This percentage stands at 43% for employees in the regular industries. Further, the impact of the potential loss of employment in social industries on a household will be smaller if other members of the family unit draw salaries in other sectors. In fact, half of all affected employees reside in households that earn less than 55% of their income from the social industries (see Chart 4). By contrast, half of the workers in regular industries live in households where more than 63% of total income is earned from regular industries. Therefore, the earnings of other members of the household provide something of a safety net, albeit limited, when employment is lost in the sectors worst hit by the pandemic.[8]

Chart 5 suggests that the households of workers in "social industries" generally have more limited access to resources to maintain their expenditure. Half of the workers in the industries worst affected by the crisis live in homes whose current account savings represent less than one month of the household's income (see Chart 5). If less liquid financial assets (such as pension funds) and higher risk assets (such as shares) are included, 31% of those workers live in homes whose financial assets amount to less than one month's income. The median ratio of financial assets to annual household income for workers in social industries stands at 0.27 (see Chart 6). This means that for 50% of these individuals the household's savings represent less than 3.3 months of their total income. The financial position of employees in regular industries is somewhat better: 26% live in a home with financial assets amounting to less than one month's income and 50% hold assets representing more than four and a half months' income (the ratio of financial assets to annual income is 0.37). Lastly, the net median wealth of households with members employed in the "social industries" stands at €109,000, 17% lower than that of other workers' households (see Chart 6).

In short, a high percentage of women and young people are employed in the sectors bearing the brunt of the confinement ("social industries"). Further, a higher proportion of employees in these sectors are low-income earners and live in households with few financial assets to help withstand a reduction in employment income. This evidence suggests that the measures aimed at supporting income and employment should be targeted to take into account the asymmetric impact that the current crisis is having on certain groups of particularly vulnerable workers.

Notable among these measures, given the more physical and interactive tasks performed by the groups of workers most closely associated with the social industries, would be support for training in new skills that may be in demand in other sectors with robust growth potential, thus enhancing the employability of these workers.

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6 R. Joyce and X. Xu (2020), in *Sector shutdowns during the coronavirus crisis: which workers are most exposed?*, IFS Briefing Note BN278, documented a high percentage of workers in the United Kingdom under the age of 25 in industries affected by the quarantine. S. Mongey, L. Pilossoph and A. Weinberg (2020) showed that, in the United States, there are more employees under the age of 50 in occupations that require close physical contact with other people.

7 The bottom quartiles of the distribution of salary income and total household income are calculated based on the population of employed individuals to ensure that 25% of workers are at the lower end of the distribution in both cases.

8 In 2008 the employment income of one in two workers in construction – which bore the brunt of that crisis – accounted for at least 50% of their household income. In this recession, the employment income of one in every three workers affected exceeds the 50% level.

Box 4.3

DEVELOPMENTS IN BANK FINANCE FOR PRODUCTIVE ACTIVITIES IN THE CONTEXT OF THE COVID-19 CRISIS

The liquidity needs of Spanish non-financial corporations (hereinafter NFCs) have grown significantly since the outbreak of the health crisis, owing to income from ordinary activities declining sharply for most firms as activity ground to a halt during the state of alert and demand fell. Many of these firms have resorted to bank finance to cover their liquidity needs, in some cases benefiting from the State guarantees approved by Royal Decree-Law 8/2020 of 17 March 2020, via the COVID-19 ICO Guarantee Facility (hereinafter, ICO facility). The facility will guarantee up to a maximum of €100 billion, covering up to 80% of the potential losses on finance extended to the self-employed and SMEs, and up to 70% or 60% of financing extended to firms that do not satisfy the European Commission's definition of a SME (hereinafter, large enterprises), depending on whether they are new loans or rollovers.

This Box describes the developments in new loans extended to finance productive activities during March and April 2020, distinguishing between loans implemented through the ICO facility and other lending. It further analyses the extent to which the funds obtained by NFCs through these transactions have helped to address their liquidity needs. Also examined are the terms and conditions of the loans extended under the ICO facility.

Chart 1 shows data for new credit drawn and undrawn to finance productive activities during March and April 2020, both with and without State guarantees.[1] The first two tranches of the guarantee programme, amounting to €40 billion – of which €30 billion was earmarked for SMEs and the self-employed, and the rest for large enterprises – were approved during this period and a total of nearly €26.5 billion was disbursed. For the purposes of comparing new lending in the most recent period against the pre-crisis situation, the amount of new loans arranged during the same period in 2019 is also presented. The chart shows that lending to finance productive activities, extended mainly to NFCs, grew significantly in March and April 2020 as compared with the previous year, reaching €98.3 billion. Although the amount of bank finance not guaranteed by the ICO facility (€63.8 billion) amply exceeded total new lending in March and April 2019 (€48.3 billion), the bulk of the increase was attributable to the sizeable borrowing under the ICO facility (€34.6 billion).

Credit guaranteed by the ICO facility centred on the SME segment (€22.9 billion), while most of the bank finance extended to large enterprises was not guaranteed by the facility (€39 billion out of a total of €48.5 billion). Also noteworthy is the €9.1 billion increase in finance available to large enterprises through credit lines that do not benefit from the State guarantee. The bulk of this credit was extended in April, as large corporations to a significant extent resorted to their existing lines of credit at the onset of the health crisis. In finance provided to the self-employed, the ICO facility made a notably large contribution (€2.2 billion) to the overall credit obtained in March and April 2020 (€4 billion), slightly up on the financing obtained in the same period of the previous year.

Chart 2 illustrates how the new credit was distributed based on the NFCs' estimated liquidity needs. These have been calculated using company information in the Integrated Central Balance Sheet Data Office Survey (CBI)[2] and include both potential deficits (payments minus receipts) from the firms' ordinary activities this year and the outlays associated with debt repayments between March and December 2020.[3] The first bar in Chart 2 shows that 92% of the new bank credit originated in March and April 2020 was provided to firms with liquidity needs. These firms represent 67% of Spanish NFCs and employ 73% of the workers in the sector. The subsequent bars in Chart 2 refer to these firms and depict the distribution of the two credit types (ICO facility and other) in different categories of firms. Around 35% of the finance received by the NFCs needing liquidity was

1 The data for the ICO facility are provided by the ICO itself, while the figures for other lending are obtained from the Banco de España Central Credit Register (CCR).

2 The CBI includes information on some 500,000 non-financial corporations and represents, in GVA terms, around 42% of the overall NFC sector (according to National Accounts). Given that these firms represent a sub-sample of the universe of companies in the Spanish economy, the results are adjusted using weights to estimate a representative figure for the overall NFC sector.

3 The needs stemming from the firms' ordinary activities are obtained through a simulation, which assumes a severe contraction of their activity in 2020 as compared with 2018 (the latest available CBI data), distinguishing between sectors based on the extent to which they are affected by the pandemic. The outlays associated with debt repayments are estimated based on data from the CCR and the firms' balance sheet information. It should be borne in mind that the firms' liquidity needs may include measurement errors since they are identified through simulation. For further details, see R. Blanco, A. Menéndez and M. Mulino (2020): *Las necesidades de liquidez y la solvencia de las empresas no financieras españolas tras la perturbación del Covid-19*, Occasional Papers, Banco de España, forthcoming.

accounted for by the ICO facility loans. However, this proportion is not consistent across all of the different company types. As might be expected, the ICO's weight is comparatively greater in the segments with the worst conditions of access to credit: SMEs (57%), firms operating in the sectors most affected by the health crisis (47%) and riskier firms (56%).[4] Conversely, the ICO guarantee facility was used to a lesser extent in lending to large enterprises

Chart 1
NEW CREDIT TRANSACTIONS TO FINANCE PRODUCTIVE ACTIVITIES (a)

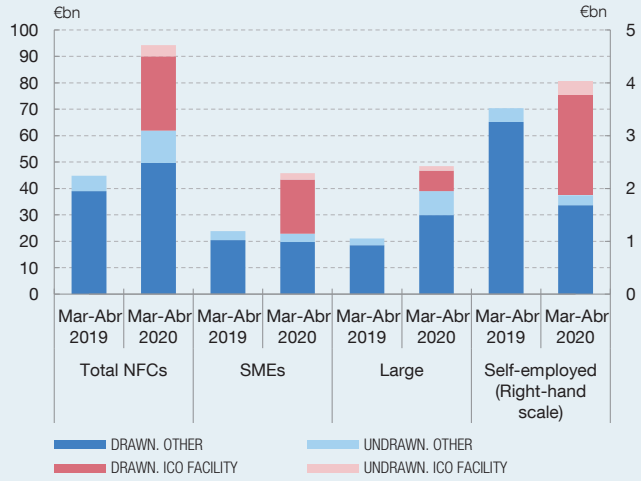


Chart 2
DISTRIBUTION OF NEW CREDIT TRANSACTIONS BY NFCs' LIQUIDITY NEEDS. MARCH-APRIL 2020 (a) (b)

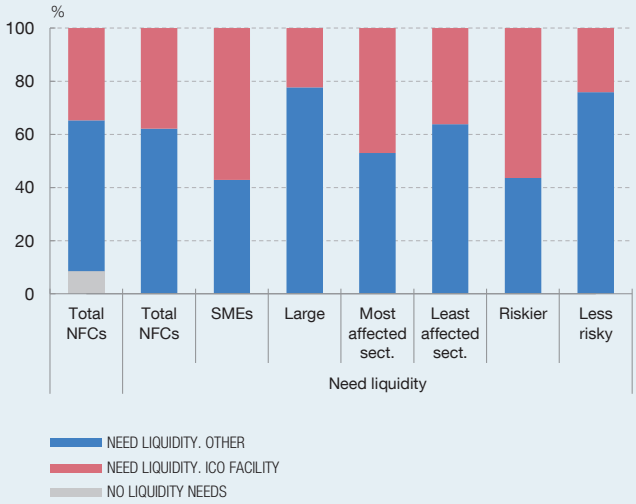


Chart 3
COVERAGE OF LIQUIDITY NEEDS BY NFCs' SIZE AND RISK. MARCH-APRIL 2020 (a) (b)

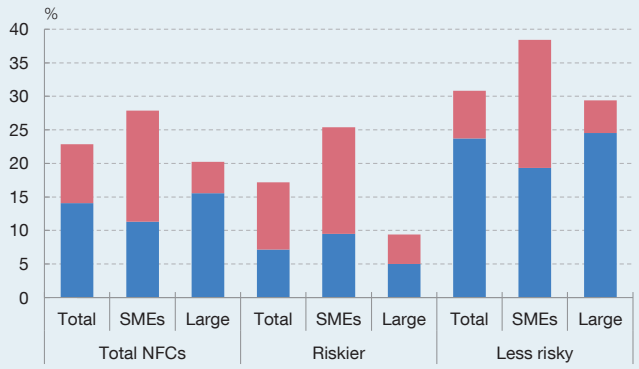
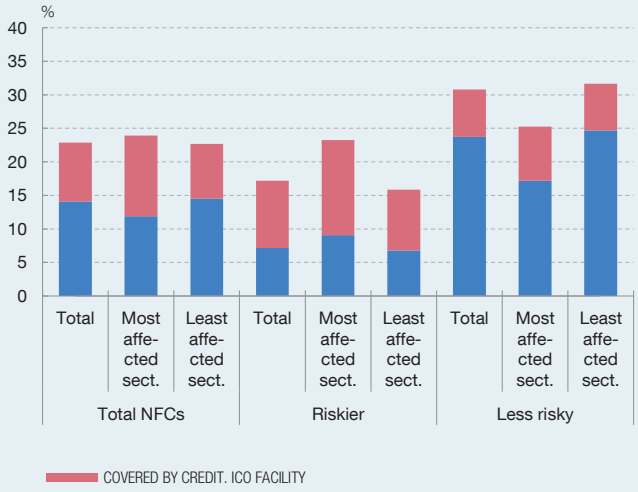


Chart 4
COVERAGE OF LIQUIDITY NEEDS BY NFCs' SECTOR AND RISK. MARCH-APRIL 2020 (a) (b)



SOURCE: Banco de España.

a Includes credit drawn and undrawn. The firms are classified based on their size, risk and sector. Size is defined in line with the European Commission Recommendation. Small firms forming part of a business group are not classified as SMEs. Riskier firms are those with credit quality steps (CQS) of 6, 7 or 8, meaning a probability of default of over 2%. Lastly, the sectors most affected by the health crisis are transport, hospitality, catering, entertainment and motor vehicles.
b The firms' liquidity needs are identified based on a simulation of their ordinary activities during 2020 and debt repayments between March and December 2020.

4 The sectors most affected by the health crisis are: transport, hospitality, catering, entertainment and motor vehicles. Riskier companies are those with a credit quality step (CQS) of 6, 7 or 8, meaning a probability of default of over 2%.

and less risky firms, where its weight stood at 22% and 24%, respectively.

Chart 3 shows that, on average, new credit covered around 23% of the firms' estimated liquidity needs between March and December 2020. Further, the chart demonstrates that loans arranged through the ICO facility played a particularly important role in addressing the liquidity needs of SMEs, covering close to 17% (compared with around 11% covered by credit not linked to the facility). Whereas loans extended to large enterprises under the guarantee programme covered just 5% of their liquidity needs, while other credit accounted for more than 16%.

Admittedly, the ICO facility has helped significantly to address the liquidity needs of riskier firms. But to date these companies have not been able to cover their needs to the same extent as less risky companies, particularly in the case of large enterprises, which may reflect greater restrictions in terms of their access to bank finance.

Chart 4 shows that the credit needs of NFCs operating in the sectors most affected by the health crisis and with a higher probability of default on their debts have been considerably alleviated by the credit originated under the guarantee programme.

Finally, Charts 5, 6 and 7 show the terms and conditions (interest rates, maturities and amounts) of the loans extended through the guarantee programme as compared with the terms and conditions of other bank finance before and during the pandemic. Chart 5 shows that the average interest rate of loans under the guarantee programme stood at 2.1% in the SME segment and 2.2% for large enterprises. These are significantly lower than the interest rates on loans not linked to the ICO facility and arranged during the same period or in the weeks prior to the state of alert, which range from 2.6% to 2.8%.[5] Likewise, the ICO facility credit has considerably longer maturities in both company segments, exceeding the maturities of other loans extended before and during the pandemic by more than three years (see Chart 6). Lastly, the loan amounts under the guarantee programme are likewise clearly larger than those of the other loans (see Chart 7). Given that the borrowers in transactions benefiting from State guarantees may not be exactly comparable with the borrowers in the other two types of credit, a regression analysis has been conducted comparing the terms and conditions of the loans guaranteed by the programme against the loans with no guarantee that are extended by the same bank and to the same company, while controlling for other characteristics of the loans. The results confirm the differences described above.

Chart 5
NEW CREDIT TRANSACTION INTEREST RATES (c)

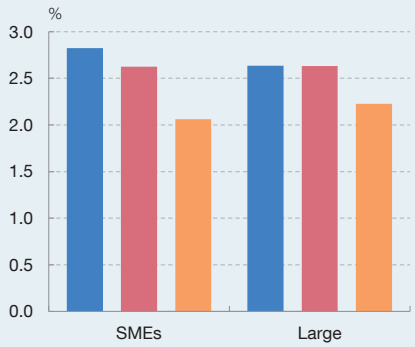


Chart 6
NEW CREDIT TRANSACTION MATURITIES (c)

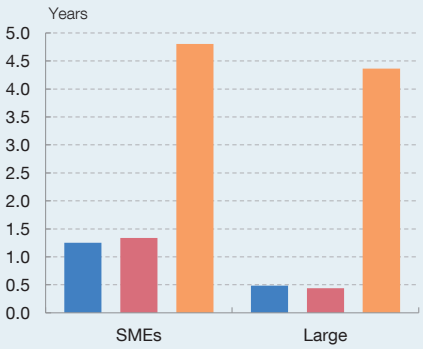
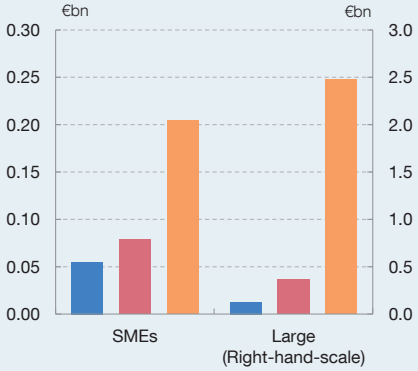
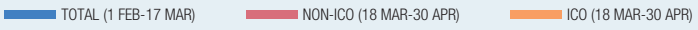


Chart 7
NEW CREDIT TRANSACTION AMOUNTS (c)





SOURCE: Banco de España.

c ICO indicates credit implemented through the ICO facility and non-ICO indicates all other credit transactions. The credit includes the amount drawn and undrawn. Excluded are transactions with maturities of less than one month. Size (SME and large) is defined in line with the European Commission Recommendation. In accordance with the European Commission, small firms forming part of a business group are not classified as SMEs.

5 Although these interest rates do not include fees, the differences are likely to be almost the same given that the average front-end fee for ICO facility transactions stands at 0.2%.

In short, the evidence presented in this Box, based on data at end-April, indicates that the State guarantee facility is contributing significantly to covering the liquidity needs of the companies hardest hit by the pandemic and that face the greatest difficulties in terms of access to credit. Further, the terms and conditions associated with these credit transactions, in terms of interest rates and in particular loan amounts and maturities, are more favourable than would be applied in the programme's absence. The lengthy average term to maturity of lending under the ICO programme (more than four years) will help to extend the average life of the firms' debt, which will mitigate potential short-term rollover risk. Meanwhile, those companies less affected by the pandemic and with better access to credit have been able to increase their bank finance without resorting to the ICO facility.