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THE ECONOMIC IMPACT OF THE PANDEMIC

1 Introduction

The COVID-19 pandemic has caused a global health, social and economic crisis, unprecedented in modern times. Since the crisis broke, and over the course of several waves, the pandemic has cost the lives of over 3 million people worldwide – over 78,000 in Spain – and has posed an extraordinarily deep-seated challenge for most countries' health systems. Moreover, it has necessitated social distancing measures which, under different formulations and degrees of stringency, have led to restrictions never before witnessed in peacetime on people's mobility and on activity in specific sectors. The crisis prompted by this exogenous shock resulted in a very deep contraction in global economic activity in the first half of 2020 from which most economies worldwide have not yet emerged, despite the fragile recovery path initiated in the second half of last year.

Along with its considerable scale, the economic impact of the pandemic has been characterised by its extraordinary heterogeneity in several dimensions. The social distancing measures set in place in many countries for much of the recent quarters have had a far greater effect on activity in those services requiring a high degree of personal interaction – retail, hospitality, transport and leisure – than in manufacturing, the primary sector or areas linked to the public sector. The impact of the crisis has also been very asymmetrical across countries and the major geographical areas, mainly as a result of differences in the productive structure of each economy, in the epidemiological course of the pandemic and in the type of measures implemented to contain it. Often, moreover, the current crisis has exerted more of a negative influence precisely on the more vulnerable groups of firms and workers, posing an additional challenge in economic and social terms.

The economic policy response to the health crisis has generally been swift and resolute, which has contributed to mitigating its adverse economic effects. Indeed, since the start of the pandemic, economic policymakers' response has been most extensive, both domestically and supranationally, and in the fiscal, monetary, prudential and regulatory spheres. This has made it possible to partially protect households' and firms' incomes and liquidity, to stabilise the markets in the financial system and to lessen the potentially adverse effects of this crisis on economies' medium-term growth capacity. In the case of monetary policy, some of the main measures adopted, such as the large-scale purchase of government bonds, has contributed to broadening the fiscal authorities' leeway to implement measures supporting the economy.

The notable adaptability of households and firms to the new economic and health circumstances is estimated to have also helped progressively reduce the impact of the pandemic on activity. Since the outbreak of the health crisis, there have been very significant changes in households' consumption, working and leisure habits. And firms, meanwhile, have established new ways of organising their productive activities and have, in some cases, set up alternative sales channels. These changes, largely related to a greater digitalisation of economic activity, have helped mitigate the negative impact of the crisis in the short term and may possibly have accelerated a structural transformation of the economy, which will foreseeably continue to unfold in the coming years and whose overall consequences cannot yet accurately be known.

In recent months, the successful development of effective vaccines against COVID-19 and their ongoing roll-out to immunise the world population have reduced the risks to global economic activity. The pandemic evolved relatively unfavourably in the final stretch of 2020 and in early 2021, with the virus causing more deaths than during its initial phase. But the proven effectiveness of the various vaccines developed against COVID-19 in a very short space of time and the progress in vaccination have helped brighten the global economic outlook in the short term, especially as from the second half of 2021. The IMF's latest April forecasts testify to this.¹ Among other aspects that have contributed to this improvement are the fiscal stimuli approved in the United States in late 2020 and early 2021, and the lesser risks to activity as a result of the United Kingdom-EU Withdrawal Agreement.

In any event, recovery in the world economy remains subject to high uncertainty. That advises retaining the support measures, albeit in a more focused fashion and bearing in mind their potential implications in the medium term. In a setting in which the global economic recovery is still fragile and very asymmetrical (across sectors, countries, households and firms), we cannot rule out the possibility of new strains of the virus emerging and setting back the time at which the health crisis will be overcome. It is also difficult to accurately gauge the durable damage the pandemic has already inflicted on employment and the productive system. Accordingly, a premature withdrawal of the support measures would be ill-advised. However, it would be worth adapting these measures to the changing economic circumstances – as has largely been the case in recent quarters – so that they are more targeted and are not, in themselves, an obstacle to a sustainable recovery.

The pandemic has had an extraordinarily high impact on the Spanish economy, both from a historical standpoint and in comparative terms internationally. All the previously described developments and conditioning factors are perfectly valid for describing the impact of the current crisis on the Spanish economy. Thus, Spanish GDP shrank most sharply in the first half of 2020 – far more than output in

¹ See IMF (2021).

the euro area as a whole did – and, thereafter, it moved onto what has been a fragile path of recovery. In particular, following very sharp growth in Q3, output in the Spanish economy flattened out in the final stretch of 2020 and even fell back slightly in Q1 this year. In fact, Spanish GDP is still 9.4% below its pre-crisis level, a gap clearly wider than that in the euro area as a whole and in other advanced economies. There are several reasons for this greater adverse impact of the pandemic in Spain. Some of these factors concern the course of the pandemic in our country. But others are more structural in nature and related to the particularities of the Spanish productive structure, in which the sectors, firms and workers with a high relative share are, precisely, those that have been most affected by the pandemic.

The short-term outlook is for the Spanish economy to recover relatively vigorously as from the second half of this year, although the adverse effects of the pandemic on the level of GDP, employment and public finances will persist for several years. As from the second half of 2021, the recovery of the Spanish economy is expected to be especially assisted by progress in the vaccination campaign and the gradual return to normality health wise. The start of the implementation in Spain of the European NGEU programme will also help. However, the intensity of the recovery might vary considerably depending on several factors, over which there is considerable uncertainty. These factors include most notably the speed at which international tourist flows pick up and the intensity with which Spanish households resort, in the coming quarters, to the reservoir of saving they have built up since the onset of the pandemic. The degree of momentum of Spanish economic activity in the short term will also depend on how the main economic policy instruments deployed in Spain to counter the pandemic – namely, furlough schemes and the liquidity and business solvency support measures – adjust to a continuously changing economic situation. Further, avoiding a persistent reduction in our growth capacity will hinge on the effectiveness of these instruments.

Over a longer time horizon, the outlook for the Spanish economy will be conditional upon a series of structural challenges and on how economic policy addresses them. As Chapter 2 of this Report sets out, the economic policy response to the extraordinarily deep-seated challenges Spain must unavoidably address in the coming years will determine the robustness and sustainability of our growth path in the medium and long term.

2 The behaviour of global and euro area activity

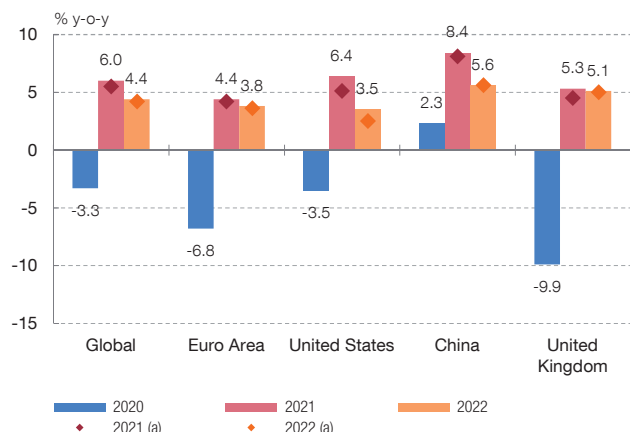
Global economic activity contracted abruptly in the first half of 2020 and has since been recovering, with a profile characterised by high volatility. Global GDP fell by 3.3% in 2020 as a whole (see Chart 1.1.1), in contrast to the increase of the same order that the IMF had forecast for this period in January that same year, just before the international spread of the virus. This decline in output was

Chart 1.1

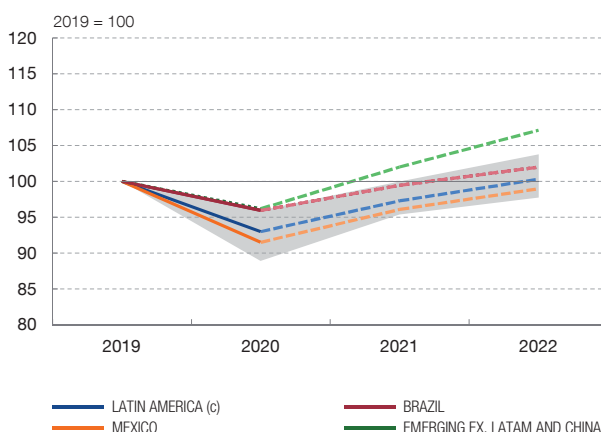
RECOVERY IN THE WORLD ECONOMY IS GAINING TRACTION, AT A RATE GOVERNED BY THE PERSISTENCE OF THE PANDEMIC AND UNEVENLY ACROSS COUNTRIES

Pandemic-related developments and the lockdown measures to check it influenced global economic activity in 2020, with a decline in aggregate GDP of 3.3%. However, the economic impact of the pandemic has been uneven across economies. Thus, the intensity of the fall in the euro area was greater than in the world economy as a whole or in the United States, and its recovery less robust. Within the euro area, the divergences are on account both of the different cross-country incidence of the pandemic and various structural factors. Among the emerging economies, Latin America is the region most affected by the pandemic.

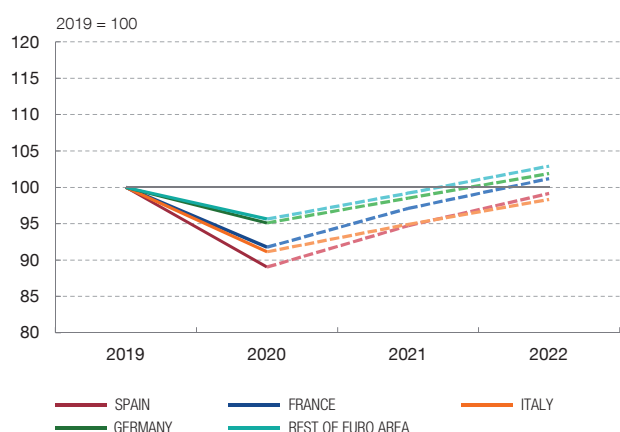
1 GDP GROWTH AND FORECASTS (IMF, APRIL)



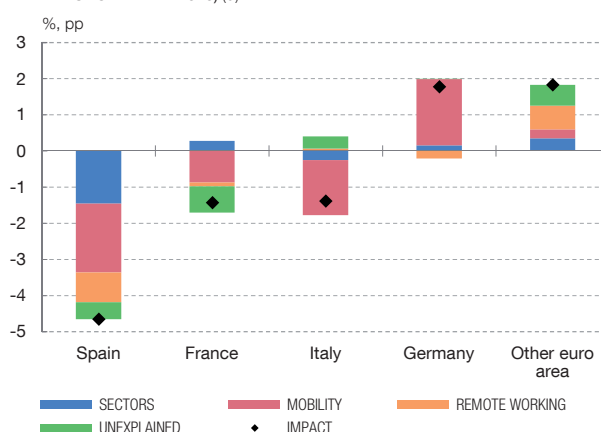
2 GDP LEVELS IN LATIN AMERICA (b)



3 GDP LEVELS IN THE EURO AREA



4 ECONOMIC IMPACT AND CONTRIBUTIONS (DIFFERENCES VIS-À-VIS THE EURO AREA IN 2020) (d)



SOURCES: Banco de España, national statistics, Eurostat, IMF (WEO, April 2021) and Refinitiv.

- a IMF January 2021 forecast.
- b The shaded area covers the range between the maximum and the minimum value for each year, among the six main Latin American economies (Argentina, Brazil, Chile, Colombia, Mexico and Peru).
- c Aggregate for Latin America and the Caribbean (according to the IMF definition).
- d The economic impact is measured as the difference between the change observed in GDP in 2020 and that forecast before the health crisis. See Gómez and Del Río (2021).



predominantly in the first half of the year, when activity contracted across the board globally, mainly as a result of the strict lockdown that the vast majority of national authorities imposed in the spring in an attempt to contain the spread of the pandemic. Activity has since progressively recovered, with a profile much influenced by the emergence of new strains of the virus and by the containment measures adopted

(see Box 1.1). This has resulted in high volatility in global economic dynamics in the second half of 2020 and in early 2021.

The forceful economic policy response globally has helped mitigate the adverse impact of the crisis and support the recovery. The various national and supranational authorities reacted to the economic crisis prompted by the pandemic by adopting extraordinary monetary, fiscal and financial support measures. These have been broadened and adapted to the changing health situation, as described in Section 1.4. Their deployment has mitigated the incidence of the crisis at the business activity and employment levels. A further contributing factor here is the fact that, after the first wave of the pandemic, the authorities adopted more targeted measures to contain the spread of the virus, and households and firms began to prove notably adaptable to the new health, social and economic situation prevailing.

The pandemic and the lockdown measures have borne down particularly on the economic sectors most dependent on personal interaction and on private spending decisions (see Chart 1.2.1). The impact of the pandemic is proving very uneven across sectors of activity, and the intensity and persistence of the decline in services contrast with the brisker recovery in the manufacturing sector. In services, the sectors most affected are those that entail a greater degree of personal interaction – such as retail, transport and hospitality – and, therefore, they have been more influenced by the social distancing measures set in place (see Chart 1.2.2). Turning to the demand components, the sluggishness of activity has mainly been reflected in private consumption (see Chart 1.2.3). Some of the fall-off in consumption would have been due to households' difficulty in undertaking some of their usual spending because of the pandemic-associated restrictions (“forced” saving), while a further portion could be explained by the increase in precautionary saving, given the uncertain health and macrofinancial situation (see Chart 1.2.4). Both factors led to the build-up of a substantial reservoir of saving by households in the main advanced economies in 2020.² As the course of the pandemic improves and uncertainty abates, households will foreseeably use these savings, at least in part, thereby boosting the recovery in consumption and activity. In this respect, it has been seen how, in those countries such as China where the health situation has normalised, household consumption has already recouped its pre-pandemic levels.

Economic developments over the past 18 months have also been uneven across countries and geographical areas. And the future prospects of recovery mirror this unevenness (see Chart 1.1.1). Among other aspects, this unevenness reflects differences in the epidemiological incidence of the pandemic, in the public (health and economic) policy response and in the productive structure of each economy (mainly in terms of the weight of the sectors most exposed to social

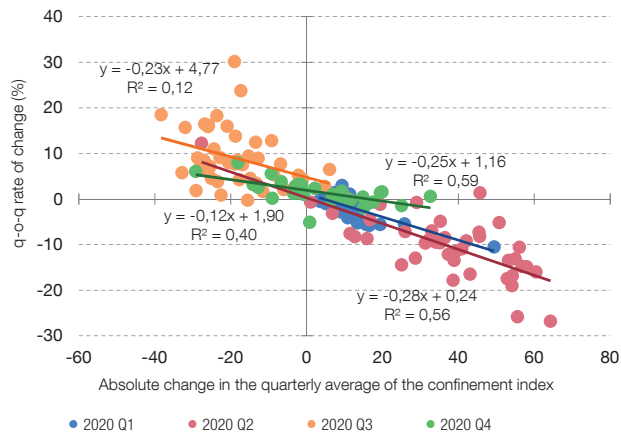
2 For more information, see [Cuenca y del Río \(2020\)](#).

Chart 1.2

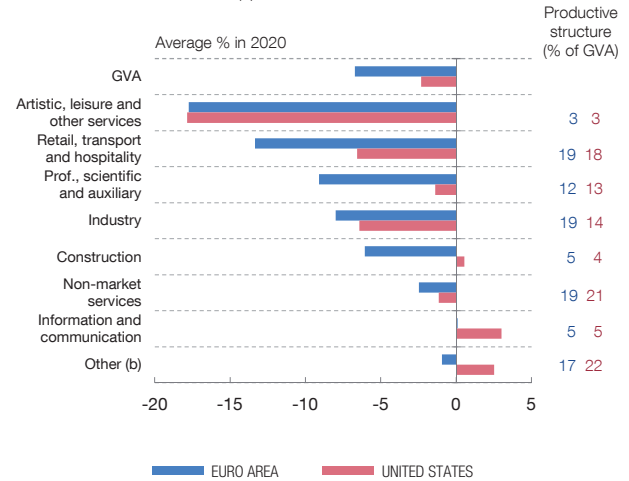
THE SPEED OF THE EXIT FROM THE CRISIS DEPENDS ON HOW NORMALISED AGENTS' SPENDING PATTERNS ARE AND ON THE RECOVERY OF THE MOST AFFECTED SECTORS

GDP dynamics in 2020 were largely determined by the strong fall in private consumption, owing both to precautionary reasons and to the difficulty of undertaking the usual expenditure as a result of the restrictions imposed on mobility and on the activity of specific sectors to curb the pandemic. By productive sector, services were more affected than manufacturing. Within services, the sectors most affected are those most exposed to the lockdown measures.

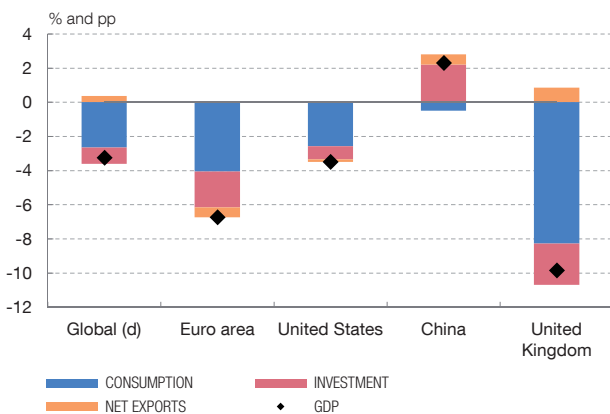
1 GDP GROWTH AND CHANGES IN THE LOCKDOWN INDEX (a)



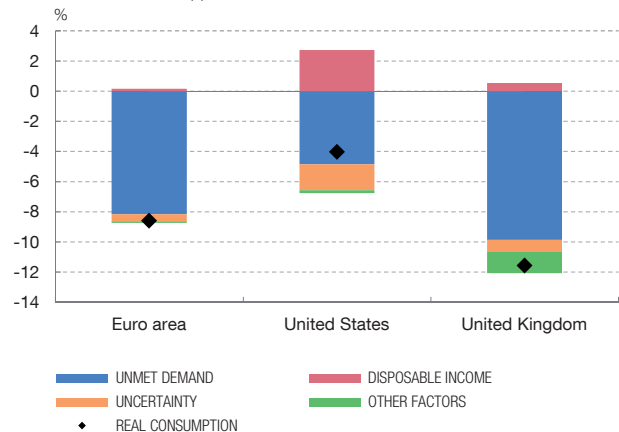
2 GVA GROWTH BY SECTOR (b)



3 BREAKDOWN OF GROWTH IN 2020 (c)



4 HOUSEHOLD CONSUMPTION. CUMULATIVE CHANGE IN THE FIRST THREE QUARTERS OF 2020 (e)



SOURCES: Banco de España, BEA, Eurostat, IHS Markit, ONS and University of Oxford.

- a Countries with quarterly accounts, a total of 44 (33 for 2020 Q4). The Goldman Sachs lockdown index, which combines mobility indicators, and the Oxford stringency index are used.
- b The category "Other" includes the primary sector and other market services (financial activities, insurance and real estate activities).
- c Provisional data.
- d Aggregate constructed on the basis of 56 economies accounting for 83% of global GDP.
- e Drawn from a quarterly error correction model for household consumption based on Cuenca and Del Río (2020). The explanatory variables in the long-term equation are income, wealth and the interest rate. Uncertainty comes into the short term contemporaneously and in levels. "Other factors" include wealth, the interest rate and the residual.



interaction). Hence, among the main world economies, the decline in output in 2020 was 3.5% in the United States, 6.7% in the euro area, 4.8% in Japan and 9.8% in the United Kingdom, while GDP expanded by 2.3% in China. Among the emerging economies, the impact was especially acute in Latin America, where GDP declined

by 7% in the region as a whole. As to the economic outlook, on available forecasts,³ subject to the still-uncertain course of the health situation, the expectation is that the recovery of pre-pandemic levels of activity will take place very unevenly across the main world economies. Thus, whereas China had already recouped these levels at end-2020, the United States and the euro area as a whole are forecast to do so in 2021 and 2022, respectively. For Latin America as a whole, the pre-crisis level of activity is expected to be reached in 2022 (see Chart 1.1.2). However, there is notable heterogeneity in Latin America, with economies – such as Brazil and Chile – that will practically attain their previous level in 2021 already and others – such as Argentina and Mexico – that will still have not done so in 2022.

The asymmetry of economic developments is also discernible in the euro area.

In the main economies in the area, the contraction in GDP in 2020 was slightly higher than 5% in Germany, at around 8% in France and 9% in Italy, and up to 10.8% in Spain (see Chart 1.1.3). On the evidence available,⁴ the more unfavourable course of the pandemic in France, Italy and Spain, and the relatively more stringent containment measures, would contribute to accounting for the bigger fall in output in these countries than in the euro area as a whole (see Chart 1.1.4). Moreover, productive specialisation would lie behind the relatively greater impact of the crisis in economies such as Spain and Greece. The sectors of hospitality, artistic and recreational activities, and other services activities account in these two countries for over 10% of GVA, compared with 6% in the euro area. The heterogeneity across the euro area economies likewise reflects the different speed of the expected recovery of pre-pandemic output levels. Thus, on the latest IMF forecasts, in April this year, whereas German GDP is expected to be above its pre-crisis level next year already, this will foreseeably not be the case for output in Spain until 2023.

Among the emerging economies, certain structural characteristics might explain why Latin America has been more affected than other areas.⁵ Health wise, the greater incidence of the pandemic in this region has come about despite the fact that, in several Latin American countries, more restrictive and earlier measures on people's mobility and on the shutdown of activity were adopted than in other emerging economies.⁶ Some of the structural characteristics of Latin America that might be behind this greater health and economic vulnerability in the face of the pandemic are high poverty levels, lower institutional quality, the high rate of labour market informality, the weakness of health systems and the large proportion of the population residing in urban areas.

Maintaining appropriate financial conditions and the normal flow of capital between economies is crucial for global economic recovery. Financial markets

3 See IMF (2021).

4 See Gómez and del Río (2021), forthcoming.

5 Véase Banco de España (2020a).

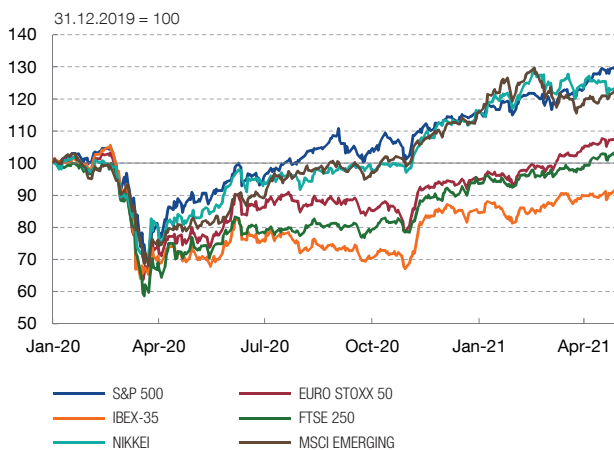
6 See Banco de España (2020f).

Chart 1.3

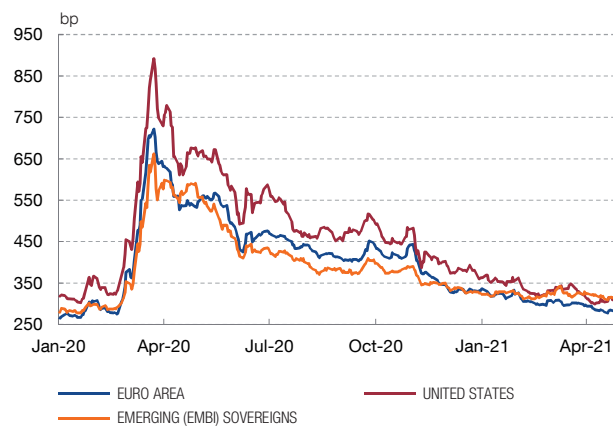
RECOVERY ON INTERNATIONAL FINANCIAL MARKETS

Public policies and the development of effective vaccines against COVID-19 have allowed for the recovery of financial markets. In recent months there have been across-the-board gains on stock markets and higher yields on higher-graded long-term sovereign debt. Moreover, sovereign risk premia in the euro area have declined, as have corporate credit risk spreads and sovereign spreads in the emerging economies.

1 STOCK MARKET INDICES



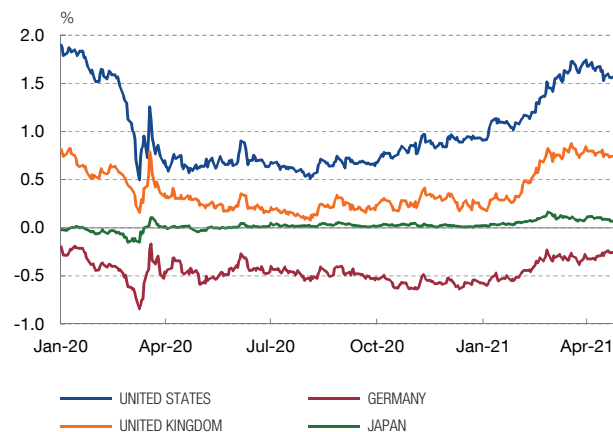
2 HIGH-YIELD BOND SPREADS RELATIVE TO THE SWAP CURVE AND EMERGING (EMBI) SOVEREIGN SPREADS (a)



3 10-YEAR GOVERNMENT BOND SPREADS VIS-À-VIS GERMANY



4 10-YEAR GOVERNMENT BOND YIELDS



SOURCE: Thomson Reuters Datastream.

a Bank of America Merrill Lynch Single-B High Yield ICE Index.



have trended positively in recent quarters, in the advanced and emerging economies alike. Stock market prices have risen across the board and record highs were recently posted on the S&P 500 and MSCI emerging markets indices (see Chart 1.3.1). On the fixed-income markets, corporate spreads have narrowed, both in the high-yield and the investment-grade segments, supported by central banks' asset purchase programmes and by the progressive reduction in uncertainty (see Chart 1.3.2). These factors have also been conducive to the reduction in sovereign risk premia in the euro area (see Chart 1.3.3) and in the emerging economies. Investors' lower risk aversion and the improvement in growth and inflation expectations have

contributed to an increase in the long-term yields on higher-rated sovereign debt, especially since early 2021 (see Chart 1.3.4). Moreover, in this favourable financial setting, the dollar has held over the course of the year on a depreciating path against the euro and sterling, which has been partly reversed at the start of 2021. Portfolio capital flows, for their part, have progressively returned to the emerging economies, following the heavy outflows witnessed in March and April 2020.

However, in some markets financial asset prices are relatively high which, further ahead, could pose a price-adjustment risk. Against this backdrop of relatively high prices, sharp corrections might be triggered in the prices of some financial assets, adversely impacting global financial conditions and real activity. Some such potential triggers might, for example, be a sharp, across-the-board rise in global interest rates or revised investor expectations about future economic developments, the corporate sector's debt repayment capacity and the duration of public support programmes.⁷

The buoyancy of international trade is another key lever for the global recovery. Unlike events in the wake of the 2008 financial crisis, in the present COVID-19 crisis world trade in goods has recovered swiftly from the disruption to trade flows in the first half of 2020, thanks largely to the buoyancy of the Chinese economy (see Chart 1.4.1). In this respect, the resilience of the global value chains has allowed much of the initial decline to be recovered, ensuring the supply of certain goods of critical importance. And this despite the fact that, at some junctures of the pandemic, trade in medical products was hampered by protectionist-like measures (see Box 2.2 of Chapter 2 of this Report). Trade in services is also picking up, albeit with less intensity, as it is weighed down by the restrictions on people's movement, which particularly affect international tourism.

Euro area exports have nevertheless shown less relative momentum in recent quarters. In December 2020, goods exports from the euro area countries had not recovered the level recorded in the same month a year earlier, whereas in the advanced economies as a whole and in China, these exports had grown by 1.6% and 8.3%, respectively (see Chart 1.4.2). Some particular factors have contributed to this relative lesser momentum of euro area exports. First, the greater intensity of the health crisis and the lesser impetus of the economic recovery in the region have borne adversely on intra-euro area trade, which gained in weight in the past decade (see Chart 1.4.3). Further, the sectoral structure of extra-euro area exports shows a significant share – especially in some of the euro area countries – of certain goods and services that have performed relatively more negatively in this crisis, such as transport machinery and tourist services (see Charts 1.4.3 and 1.4.4). In any event, set against the adverse scenarios prevailing in late 2020, the United Kingdom-EU Withdrawal Agreement has helped significantly reduce trade uncertainty in relation

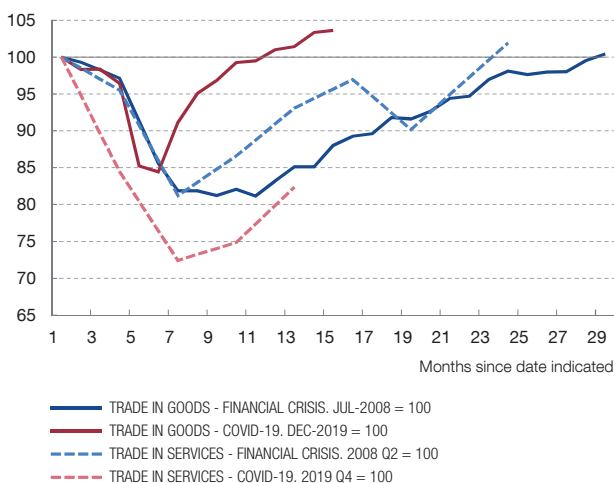
⁷ See Banco de España (2021a). Forthcoming.

Chart 1.4

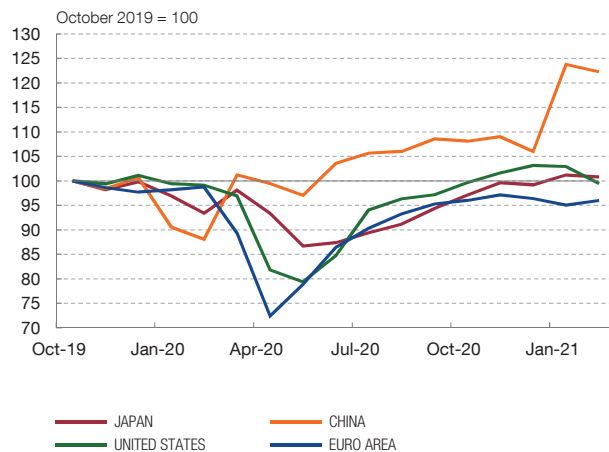
GLOBAL TRADE IS PICKING UP FORCEFULLY, EXCEPT FOR SERVICES, WHICH EXERTS A GREATER ADVERSE IMPACT ON EURO AREA EXPORTS

Trade in goods has shown a greater capacity for recovery in this crisis than that observed after the global financial crisis. Marking developments has been China's swift recovery. The recovery in trade flows has been slower in the euro area, owing to the greater relative share in these flows of specific goods and services, such as tourism, which have been more adversely affected in this crisis.

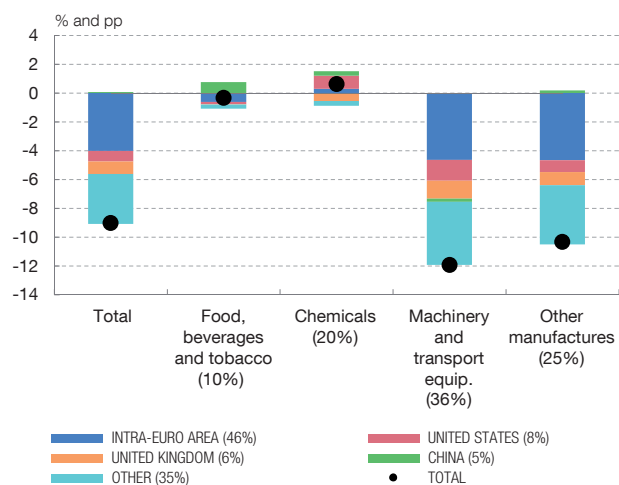
1 INTERNATIONAL TRADE COMPARED (a)



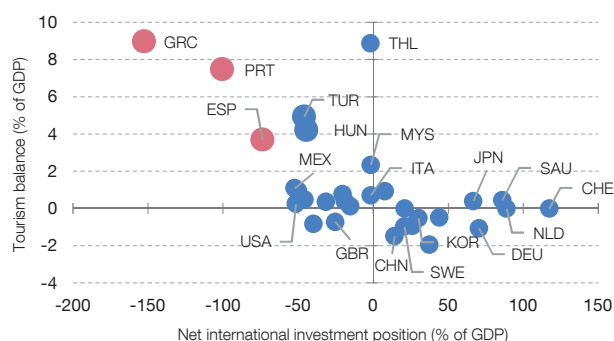
2 TRADE IN GOODS BY AREA



3 EURO AREA GOODS EXPORTS BY PRODUCT AND AREA (b). NOMINAL CHANGE IN 2020 AND CONTRIBUTIONS



4 TOURISM BALANCE AND NET INTERNATIONAL INVESTMENT POSITION IN 2019



SOURCES: CPB, Eurostat, IMF, UNWTO and OECD.

a Services trade data are quarterly. The weighted average for countries with available data is reported.
 b In brackets is the share of each product and destination for total euro area goods exports in 2020.



to the UK. Though some doubts persist as to what will happen once the transition period envisaged in this agreement concludes,⁸ the reduction in uncertainty should contribute to trade flows between both areas recovering in the coming quarters.⁹

8 See Buesa et al. (2021).

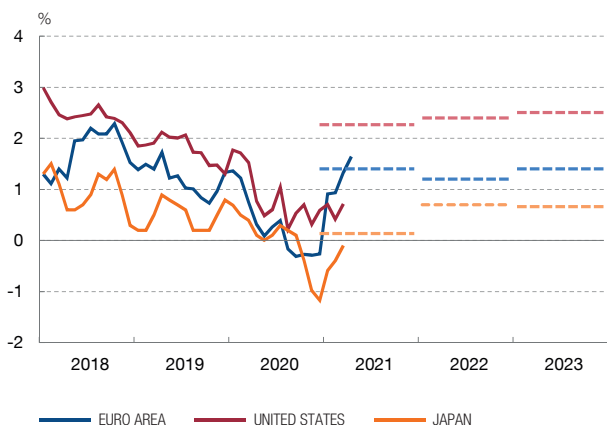
9 On the adverse economic effects of trade uncertainty, see Albrizio et al. (2021), forthcoming.

Chart 1.5

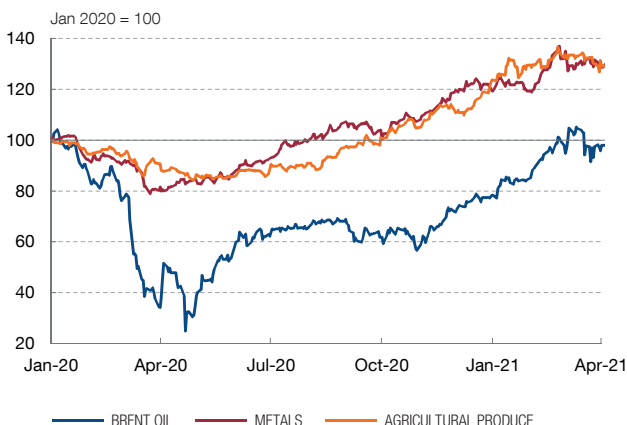
THE CRISIS HAS ACCENTUATED DISINFLATIONARY TRENDS

The increase in commodities prices and the closing of the output and unemployment gaps as the economic recovery progresses will provide for a gradual increase in inflation.

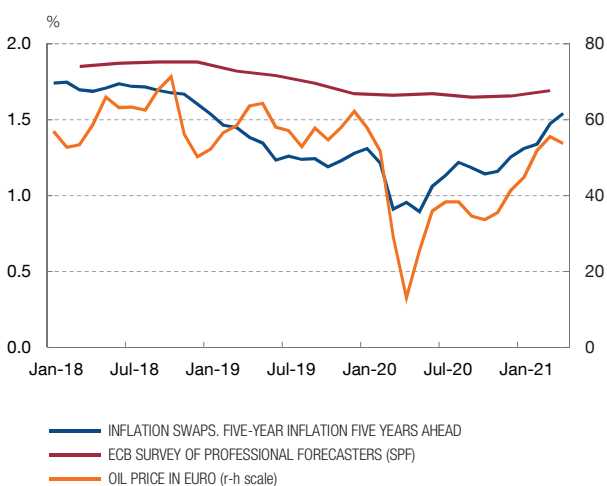
1 INFLATION IN ADVANCED ECONOMIES
Monthly developments and annual forecasts (a)



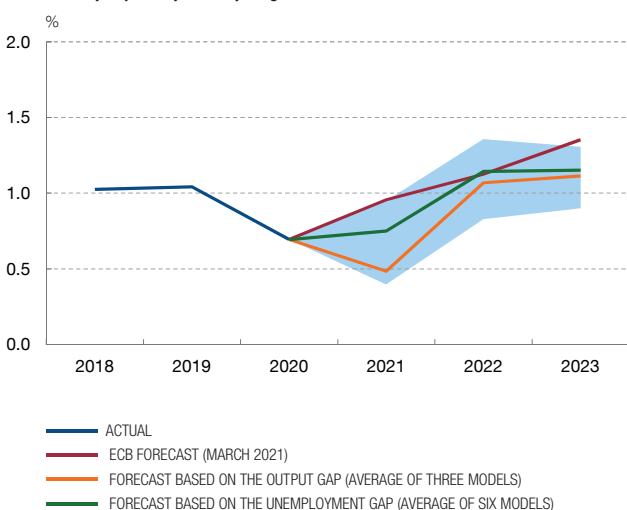
2 COMMODITIES PRICES



3 LONG-TERM INFLATION EXPECTATIONS IN THE EURO AREA



4 CORE INFLATION OUTLOOK IN THE EURO AREA (b)
Seasonally adjusted year-on-year growth



SOURCES: ECB, Eurostat, IMF and Thomson Reuters

- a IMF forecasts (*WEO*, April 2021).
- b Forecasts drawing on nine Phillips curve models for the HICP, excluding energy and food, which consider different inflation expectations measures, with the range between the maximum and minimum value shaded. See Álvarez and Correa-López (2020).



As to inflation, the weakness of aggregate demand pushed prices downwards across the board for most of last year. Inflation rates globally in 2020 were down on 2019, both in the advanced and emerging economies, against a backdrop of very negative output gaps and declines in commodity prices (see Chart 1.5.1). Both factors more than offset the upward pressures on the prices of some goods and services – such as unprocessed food – stemming from specific one-off disruptions on the supply side. In the OECD countries as a whole, annual rates of overall and

core inflation, the latter excluding energy and food prices, stood at end-2020 at 1.2% and 1.6%, respectively. In the euro area, which before the pandemic broke already had a persistent negative difference in relation to the rates observed in the other advanced economies, inflation fell to even lower rates of 0.3% and 0.7%, respectively. Some specific factors contributed to these low rates, such as the appreciation of the euro against the basket of currencies of its main trading partners and the temporary cut in indirect taxes in Germany.

The improved outlook for recovery has been reflected in the increase in some inflation expectations indicators since late 2020. Progress in the vaccination roll-out and new fiscal stimuli have entailed an upward revision in the global growth and inflation outlook. In the case of the latter, this perception, visible above all in the financial indicators of inflation expectations (see Chart 1.5.2), has been amplified by certain conjunctural factors. First, the circumstantial mismatches between supply and demand have given rise to certain cost pressures, owing to the increase in the prices of food, commodities and other inputs, such as semiconductors and maritime freight (see Chart 1.5.3). Moreover, in the case of consumer prices, the rapid rise in crude oil to levels close to those prevailing pre-crisis in the opening months of the year led to increases in inflation rates, which in principle should be fundamentally temporary. So too did various idiosyncratic factors, such as those arising from the changes in early 2021 to HICP weights to align them to the new household spending patterns. Lastly, some analyses have warned of the danger of the US economy overheating further to the two fiscal policy packages adopted since end-2020, which could have significant effects in terms of US growth, employment and inflation.¹⁰ However, under the assumption that inflation expectations remain properly anchored, these effects would be transitory and progressively fade as from 2022.

In the medium term, the persistence of negative output gaps and relatively high unemployment rates in most of the main economies does not augur significant underlying inflationary tensions. The forecasts available point to moderate and gradual increases in inflation rates in the coming years in the developed countries. In the case of the euro area, the latest Eurosystem projections¹¹ are for a temporary rise this year to a rate of 2% in 2021 Q4. In 2023, at the end of the projection period, inflation would stand at 1.4%, slightly down on the same three-year horizon forecast made before the pandemic broke, and still some way off the ECB's monetary policy objective (see Chart 1.5.4).

The outlook for the global and the euro area economy is subject to major factors of uncertainty. In the short term, the vaccination roll-out in the opening months of 2021 has helped largely dispel doubts over the course of the pandemic, especially in the developed countries. However, downside risks persist owing to the

¹⁰ See [Párraga and Roth \(2021\)](#).

¹¹ See [European Central Bank \(2021\)](#).

uneven pace of the vaccination campaign globally and to how this may condition the future course of the pandemic if new strains of the virus potentially more resistant to the current vaccines were to emerge. It is essential in this connection to reinforce multilateral collaborative initiatives, such as COVAX,¹² whose aim is to accelerate the development and manufacture of vaccines and to ensure fair and equitable access to all countries. Health matters aside, there is also high uncertainty over how households and firms will adapt their spending and output patterns once the pandemic is behind us. Also very uncertain is the scale of the scarring the current, profound economic crisis may leave in the form of damage to economies' productive capacity and macroeconomic imbalances, in both the public and private sectors. Against this background, Section 1.4 and, more extensively, Chapter 2 analyse economic policies, which are playing an essential role in the stabilisation phase of the crisis. These policies must also be to the fore in the recovery phase and in absorbing the imbalances generated by the pandemic.

3 The behaviour of economic activity in Spain

Since breaking, the COVID-19 pandemic has prompted the biggest health crisis in Spain's recent history. Over the course of several waves, of differing intensity and duration, the pandemic has posed a deep-seated challenge for the Spanish health system and has exacted an extraordinarily high cost in terms of human lives (see Chart 1.6.1).¹³ Thus, on the latest official data available, more than 78,000 people have died in Spain from COVID-19 since the start of the pandemic. That would place Spain among the countries with the highest per capita death rate for this cause.¹⁴

The pandemic has also meant unprecedented disruption to economic activity in Spain (see Section 1.3.1). The scale of this impact has been extraordinary in at least three respects. First, because of its magnitude. Hence, most macroeconomic aggregates underwent a historical downturn in the first half of 2020. The ensuing recovery in Q3 last year has so far only allowed a part of this initial deterioration to be corrected. Second, the economic impact of the pandemic has been notably and markedly uneven. In particular, the crisis has affected the various productive sectors, provinces, firms, households and groups of workers most asymmetrically, which requires an assessment of the economic context that goes beyond an analysis of the major activity aggregates. Lastly, the extraordinarily disruptive nature of the COVID-19 crisis is also discernible in the highly

12 COVAX is the vaccines pillar of the Access to COVID-19 Tools (ACT) Accelerator, a global collaboration initiative promoted by the World Health Organization to accelerate the development, production and equitable access to COVID-19 tests, treatments and vaccines.

13 When analysing the course of the virus in Spain, it should be borne in mind that, in the first wave, contagion figures were underestimated compared with subsequent outbreaks, owing to the lack of available tests and to the collapse of the health system that came about in this episode in the areas most afflicted by the pandemic.

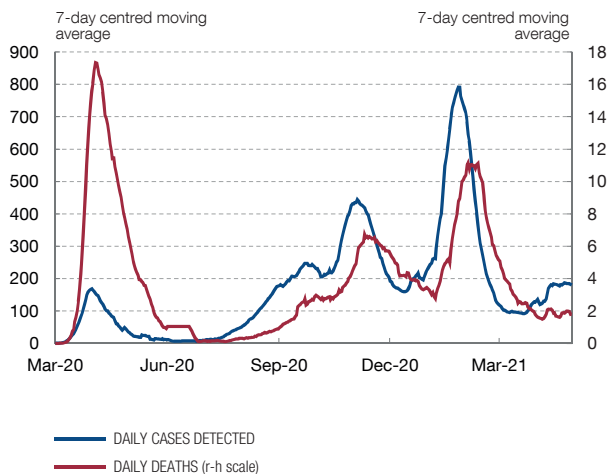
14 Other sources that estimate excess mortality, such as INE, would have higher figures for deaths. Comparisons of international data should be made with caution, owing to the differences there may be regarding, inter alia, diagnostic capacity, recording criteria, data quality and data coverage.

Chart 1.6

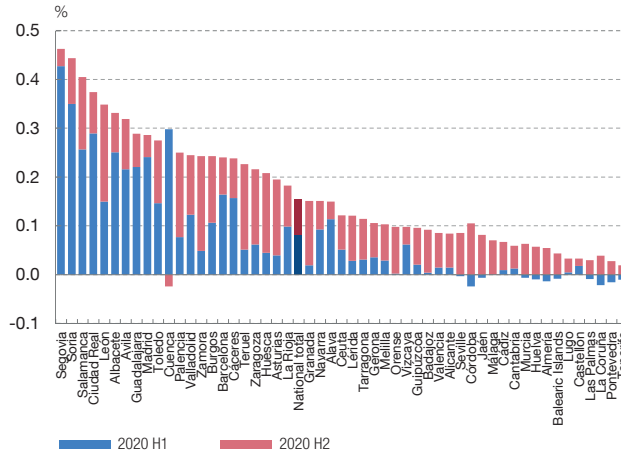
THE COVID-19 PANDEMIC HAS POSED AN EXTRAORDINARY PUBLIC HEALTH CHALLENGE IN SPAIN

Over the course of several waves, of differing intensity and duration, the COVID-19 pandemic has posed a deep-seated challenge to the Spanish health system and exacted an extraordinarily high cost in terms of human lives, unevenly distributed across Spain.

1 THE COVID-19 PANDEMIC IN SPAIN
Daily cases per million inhabitants



2 EXCESS MORTALITY
(DEATHS IN 2020 - AVERAGE DEATHS IN 2019 AND 2018) /
POPULATION



SOURCES: INE and Ministerio de Sanidad.



significant changes it has caused in the behaviour of economic agents, who have attempted to adapt to the pandemic and its consequences in a short space of time. For example, very notable changes have been seen in people’s mobility patterns, in household consumption habits and in the provision and organisation of work, whose implications and persistence can still not be accurately assessed. The economic authorities have also been obliged to react resolutely to the challenges posed by the health crisis – in many cases deploying measures of an unprecedented nature and scale – and to progressively recalibrate their actions in the face of the changing nature of the crisis.

As the vaccination process progresses, the outlook for the Spanish economy will be increasingly conditional upon essentially economic factors. Since the onset of the pandemic, the health situation and the tightening or easing of the measures deployed to contain the virus have been the main conditioning factors of Spain’s economic dynamics. In the coming months, however, the vaccination roll-out will foreseeably mean that other, genuinely economic factors will take on greater importance in determining how buoyant economic activity is in the short and medium term. These factors, all of which are interrelated and shrouded in considerable uncertainty, include most notably: the pace, scope and effectiveness of the implementation of the NGEU programme; the stance of the main economic policies; and the scale of the lasting damage the pandemic may have caused to employment and the productive system. More particularly, the outlook for the Spanish economy in the coming quarters will also depend on three elements: the intensity and pace at which households reduce the saving they have built

up since the start of the crisis; the capacity for recovery of business investment; and the contribution of external demand – in particular tourism exports – to growth.

3.1 The impact of the crisis: scale and heterogeneity

After plummeting by 13.8% in the first half of 2020, Spanish GDP was, at the end of 2021 Q1, still 9.4% below its pre-pandemic level (see Chart 1.7.1). The outbreak of the COVID-19 crisis in our country, in March 2020, and the major restrictions on people's mobility and on activity in specific sectors led GDP to shrink by 5.4% and 17.8% quarter-on-quarter in the first two quarters of last year. Thereafter, GDP embarked on a path of recovery – thanks to the improvement in the epidemiological situation in the spring and gradual lockdown-easing – which soon began to show signs of fragility. Indeed, the worsening of the health crisis in autumn 2020 and in early 2021, and the tightening or reintroduction of some of the lockdown measures led activity to stagnate in 2020 Q4 and, subsequently, to a slight contraction in 2021 Q1. As a result, Spanish GDP, which shrank by 10.8% in the course of 2020, was still 9.4% below its end-2019 level in 2021 Q1.

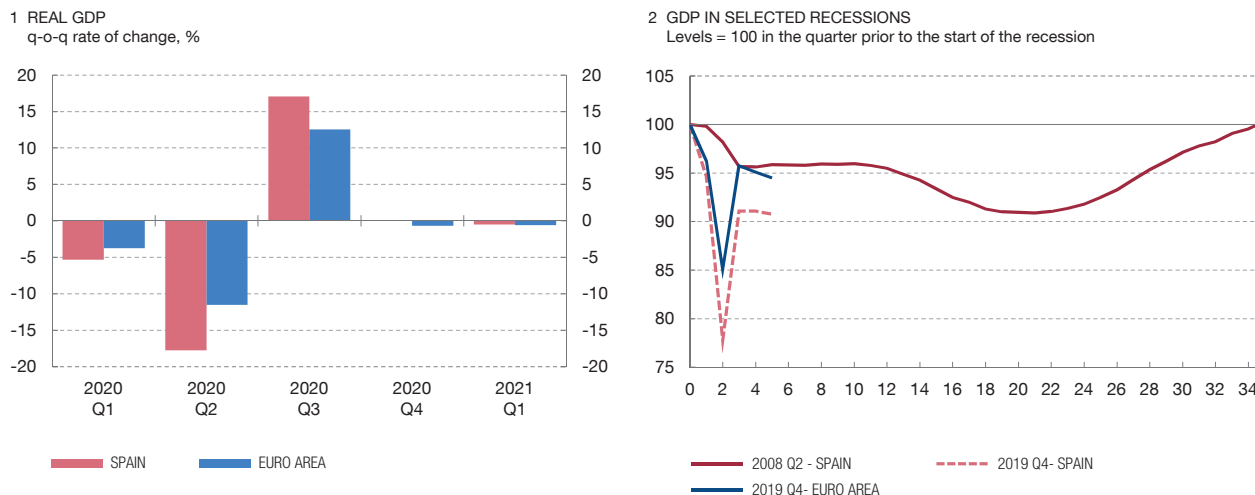
This downturn in activity is unprecedented in the Spanish economy's recent history. From a historical standpoint, the current crisis is notable for the intensity with which economic activity has contracted in a short space of time. Thus, for example, the downturn in Spanish GDP since the onset of the pandemic is practically the same as the cumulative reduction it underwent over more than five years from 2008 Q2 to 2013 Q3. The decline in this latter period came about against a domestic background marked by the correction of deep-seated macrofinancial imbalances and a very complex international scenario which saw the global financial and European sovereign debt crises (see Chart 1.7.2 and Table 1.1).

The contraction in Spanish GDP since end-2019 is among the biggest declines recorded in the advanced economies. In particular, this decrease is bigger than that observed in the euro area as a whole – whose GDP in 2021 Q1 was 5.5% below its pre-pandemic level – and in the region's main economies. Significantly, though, the Spanish economy's relatively worse performance is estimated to have been essentially in the first half of 2020 when, in comparative terms, the incidence of the pandemic was greater in our country and more stringent lockdown measures were implemented. Conversely, in recent quarters, the behaviour of Spain's GDP, despite showing clear weakness, is expected to have been somewhat more favourable than that in the euro area as a whole (see Chart 1.7.1). In any event, a series of structural factors in the Spanish economy would suggest that the continuing gap between levels of activity in Spain and in other European economies will still take some time to close. These factors fundamentally include the greater weight in Spain of the sectors, companies and groups of workers most affected by the pandemic, i.e. social interaction sectors, small firms and temporary workers.

Chart 1.7

THE ECONOMIC IMPACT OF THE COVID-19 CRISIS HAS BEEN ON A SCALE UNPRECEDENTED IN PEACETIME

The outbreak of the pandemic in Spain in March 2020 and the setting of severe restrictions on personal mobility and on the activity of specific sectors saw Spanish GDP undergo an extraordinary decline, both in historical terms and on international comparisons, in the first two quarters of the year. Economic activity picked up sharply in Q3, but in the final stretch of last year the recovery came to a halt. In 2021 Q1, GDP was still 9.4% below its end-2019 level, a gap almost 4 pp higher than that observed in the euro area as a whole.



SOURCES: Eurostat and INE.



The economic impact of the pandemic might have been even greater without the economic policy response (see Section 1.4). Notable among the range of measures at the domestic level are, in terms of their importance, the advantages offered to firms to launch furlough schemes (ERTE by their Spanish name) and the suspension of activity in the case of the self-employed, and the various credit facilities with ICO public guarantees that were created to foment lending to firms. These measures, along with those taken in the monetary policy and financial regulation spheres, have been instrumental in mitigating the impact of the pandemic on households' and firms' incomes and liquidity in the short term. Consequently, the macroeconomic effect of the crisis would have been significantly more adverse than has been the case since March 2020 had this package of economic policy measures not been activated.

Economic policy responses have been progressively adjusted as the crisis has evolved. Most of the measures in the fiscal, monetary, regulatory and prudential policy spheres adopted by other national and supranational authorities have had to be gradually adjusted to the course of the pandemic. Thus, for instance, as the health crisis has proven more persistent than initially envisaged, it has been necessary to extend and recalibrate the furlough schemes and ICO-backed credit facilities on several occasions. This is not only to avoid a premature withdrawal of these support measures, but also to ensure that these instruments are better attuned to the needs arising in a changing economic and health situation. Also part of this setting is the new package of extraordinary measures approved by the Government

Table 1.1

MAIN MACROMAGNITUDES OF THE SPANISH ECONOMY

Annual rate of change in volume terms and % of GDP

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
GDP	3.6	0.9	-3.8	0.2	-0.8	-3.0	-1.4	1.4	3.8	3.0	3.0	2.4	2.0	-10.8
Private consumption	3.4	-0.7	-3.6	0.4	-2.5	-3.3	-2.9	1.7	2.9	2.7	3.0	1.8	0.9	-12.1
Government consumption	6.2	6.0	4.2	1.5	0.0	-4.2	-2.1	-0.7	2.0	1.0	1.0	2.6	2.3	3.8
Gross fixed capital formation	3.9	-4.3	-17.3	-5.4	-7.6	-7.4	-3.8	4.1	4.9	2.4	6.8	6.1	2.7	-11.4
Investment in equipment, intangibles and other (a)	8.9	-1.0	-19.1	5.7	0.0	-3.4	1.3	5.2	8.2	3.1	6.9	3.1	3.7	-8.8
Investment in construction	1.7	-5.9	-16.3	-11.1	-12.3	-10.4	-8.2	3.0	1.5	1.6	6.7	9.3	1.6	-14.0
Exports of goods and services	7.6	-0.9	-10.8	9.1	8.2	0.9	4.4	4.5	4.3	5.4	5.5	2.3	2.3	-20.2
Imports of goods and services	8.2	-5.5	-18.3	6.2	-0.6	-5.8	-0.2	6.8	5.1	2.7	6.8	4.2	0.7	-15.8
National demand (b)	4.2	-0.6	-6.6	-0.4	-3.1	-5.0	-2.8	1.9	3.9	2.0	3.2	2.9	1.4	-8.8
Net external demand (b)	-0.6	1.5	2.8	0.6	2.3	2.0	1.4	-0.5	-0.1	1.0	-0.2	-0.5	0.6	-2.0
Nominal GDP	7.1	3.2	-3.6	0.3	-0.8	-3.1	-1.0	1.2	4.4	3.4	4.3	3.6	3.4	-9.9
GDP deflator	3.4	2.3	0.1	0.2	0.0	-0.1	0.4	-0.2	0.5	0.3	1.3	1.2	1.4	1.1
Harmonised index of consumer prices (HICP)	2.8	4.1	-0.2	2.0	3.1	2.4	1.5	-0.2	-0.6	-0.3	2.0	1.7	0.8	-0.3
HICP excluding energy and food	2.5	2.4	0.9	0.8	1.2	1.3	1.3	-0.1	0.3	0.7	1.2	1.0	1.1	0.5
Employment (hours)	2.5	0.6	-6.0	-2.3	-2.3	-4.8	-2.8	1.1	3.0	2.6	2.1	2.7	1.5	-10.4
Unemployment rate (% of labour force). Annual average	8.2	11.3	17.9	19.9	21.4	24.8	26.1	24.4	22.1	19.6	17.2	15.3	14.1	15.5
Household saving rate and NPIs (c)	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8
Net lending (+)/net borrowing (-) of the nation (% of GDP)	-9.1	-8.6	-3.7	-3.3	-2.4	0.6	2.6	2.1	2.7	3.4	3.0	2.4	2.5	1.1
General government net lending (+)/net borrowing (-) (% of GDP)	1.9	-4.6	-11.3	-9.5	-9.7	-10.7	-7.0	-5.9	-5.2	-4.3	-3.0	-2.5	-2.9	-11.0
General government debt (% of GDP)	35.8	39.7	53.3	60.5	69.9	86.3	95.8	100.7	99.3	99.2	98.6	97.4	95.5	120.0
Household debt ratio (% of GDP)	81.8	82.6	85.0	84.4	82.5	81.6	77.8	73.4	68.0	64.5	61.2	58.9	56.9	61.8
Non-financial corporations' debt ratio (% of GDP)	111.5	114.9	119.3	118.8	115.7	107.1	100.5	94.8	87.8	83.3	78.7	74.4	72.6	84.6

SOURCES: Banco de España and INE.**a** Includes machinery, capital goods, weapons systems, cultivated biological resources and intellectual property products.**b** Contribution to growth.**c** As a percentage of gross disposable income.

in March this year to support the viability and shore up the financial solvency of companies most affected by the crisis.

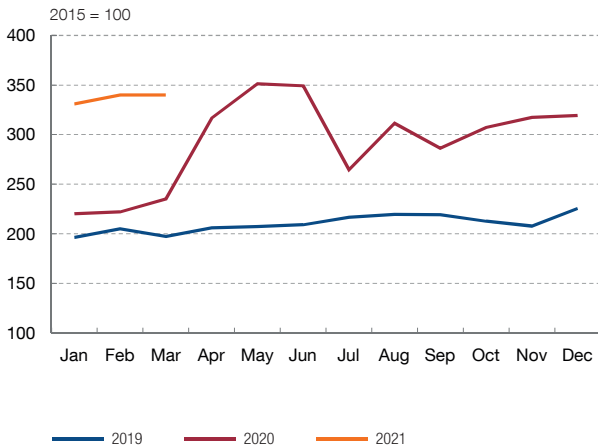
Economic agents' adaptability to the pandemic and its associated restrictions have also helped mitigate its adverse economic impact. Indeed, since the start of the pandemic there have been very significant changes in the behaviour of households and firms along lines that traditionally evolve relatively parsimoniously. Thus, for instance, in a setting in which the restrictions on mobility and consumer caution over

Chart 1.8

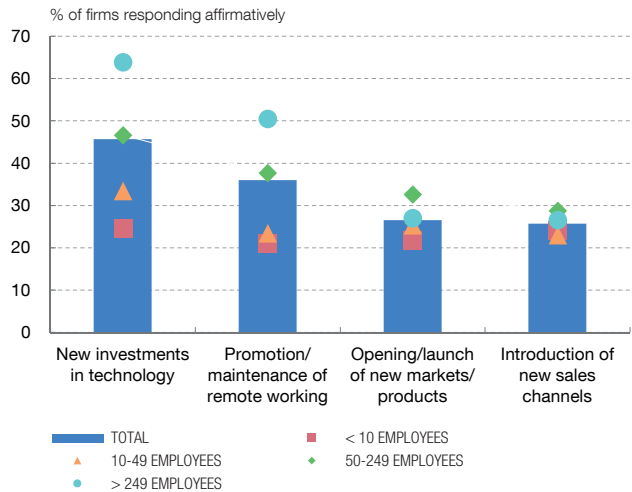
ECONOMIC AGENTS' NOTABLE ADAPTABILITY TO THE PANDEMIC IS ESTIMATED TO HAVE HELPED MITIGATE ITS ADVERSE ECONOMIC IMPACT

Since the start of the pandemic there have been very significant changes in the behaviour of households and firms in dimensions that traditionally move relatively parsimoniously. Thus, for example, households have notably increased their online purchases and firms have made substantial organisational changes, especially towards a greater digitalisation of activity and more remote working. This learning curve or adaptation by economic agents is estimated to have mitigated the adverse economic impact of the pandemic and to have infused activity with greater dynamism in recent quarters.

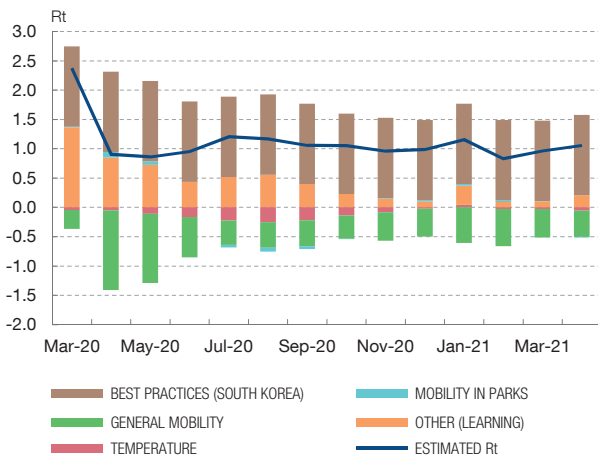
1 E-COMMERCE IN SPAIN (a)



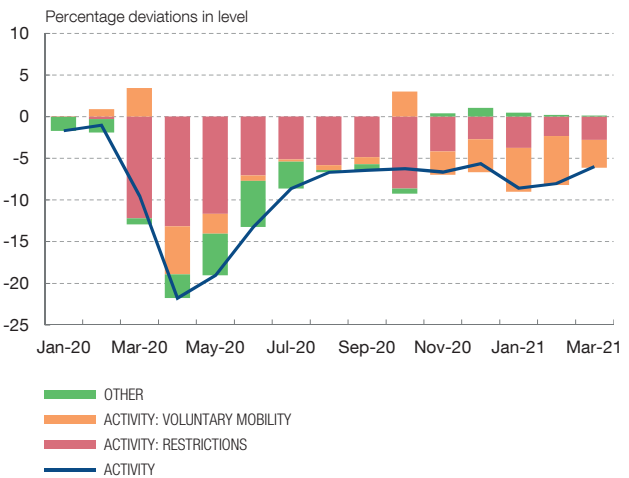
2 MEASURES ENVISAGED FOR 2021 H1 BY FIRM SIZE



3 DETERMINANTS OF Rt IN SPAIN (b)



4 MONTHLY INDICATOR OF ACTIVITY (c)



SOURCES: Banco de España and INE.

- a Postal and internet retailing (INE).
- b Ghirelli et al. (2021). The effective reproduction number (Rt) measures the number of infectious cases generated on average by each infected person.
- c Ghirelli et al. (2021). The relationship between pandemic containment measures, mobility and economic activity. Occasional Paper no. 2109, Banco de España.



contagion might have been expected to influence the volume of face-to-face sales most adversely, Spanish households' resort to e-commerce, especially in goods, has contributed to keeping private consumption relatively buoyant (see Chart 1.8.1). Also, a high proportion of Spanish firms have made substantial organisational changes in

response to the pandemic (particularly to increase the digitalisation of activity and to set greater store by working from home), which will have allowed them to cushion the adverse impact of the crisis on their levels of activity. Testifying to this is the Banco de España survey on business activity (EBAE). It points out, for example, that almost half of Spanish firms planned to undertake new investment in technology in the first half of this year and more than one-third of them would promote the use of working from home (see Chart 1.8.2). These percentages are higher for larger corporations, suggesting their greater capacity to adapt to the new economic conditions. This ongoing learning curve or adaptation by economic agents to the pandemic and to the various restrictions applied to contain it – which, in turn, have also evolved and become more targeted – will have been conducive to the greater dynamism of activity in recent quarters.

The evidence available highlights the importance of economic agents' gradual adaptation to the pandemic. A recent Banco de España study establishes a relationship between temperature, mobility and the path of the pandemic.¹⁵ The findings of this analysis note how, over time, efforts to curb the pandemic in Spain have entailed reductions in mobility which, comparatively, have been increasingly less acute (see Chart 1.8.3). A second study analyses the relationship between restrictions, mobility and economic activity, and also finds evidence of some learning over the course of the year. This is because the impact of the restrictions on mobility (reflected in an increasingly smaller contribution of voluntary reductions in mobility, which are those not related to the level of restrictions in force at each point in time) and of mobility on economic activity progressively diminishes (see Chart 1.8.4).¹⁶

The impact of the pandemic on economic activity in Spain is proving very uneven across sectors, different types of firms and groups of workers, and also regionally. From a sectoral standpoint, the pandemic has influenced more negatively those productive sectors, especially in services, whose activity requires a relatively high degree of social interaction. These include most notably retail, hospitality and artistic activities. By type of firm, several studies by the Banco de España suggest that the current crisis has caused a bigger increase in the financial vulnerability of small and medium-sized firms (see Chapter 3 of this Report).^{17, 18} Moreover, the fall in turnover and employment has been more marked in small, young and less productive firms, and in those located in urban areas (see Charts 1.9.1 and 1.9.2).¹⁹ As analysed in depth in Chapter 2 of this Report, among employees, those on temporary contracts along with the youngest and low-income workers will have

15 See [Guirelli et al. \(2021\)](#).

16 See [Guirelli et al. \(2021\)](#).

17 See, for example, [Blanco et al. \(2020b\)](#); [Blanco et al. \(2020a\)](#); and R. Blanco, S. Mayordomo, Á. Menéndez and M. Mulino (2021). Documento Occasional, Banco de España, “El impacto de la crisis del COVID-19 sobre la vulnerabilidad financiera de las empresas españolas”, forthcoming.

18 These findings are consistent with the information available for 2020 as a whole in the CBSO Quarterly Report. See [Menéndez and Mulino \(2021b\)](#).

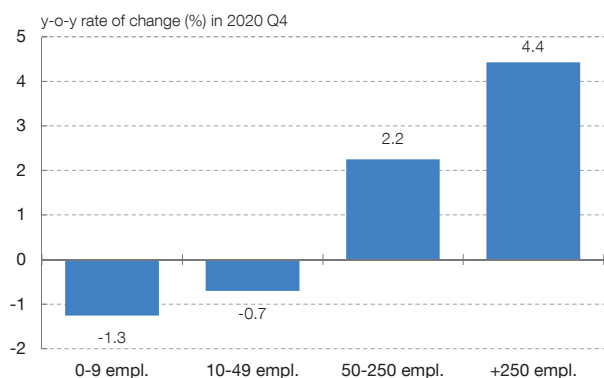
19 See [Fernández-Cerezo et al. \(2021\)](#).

Chart 1.9

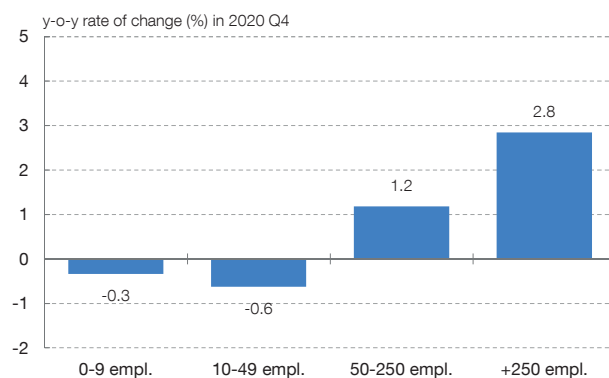
THE COVID-19 CRISIS IS HAVING A VERY UNEVEN EFFECT SECTORALLY AND REGIONALLY, AND ACROSS DIFFERENT TYPES OF FIRMS AND CATEGORIES OF WORKERS

The pandemic has more adversely influenced those productive sectors, essentially services, whose activity requires a relatively high degree of social interaction. The impact of the crisis has also been more marked on small firms and on temporary, younger and lower-income employees. Geographically speaking, GDP in 2020 is estimated to have worsened more acutely in the island and Mediterranean coast provinces.

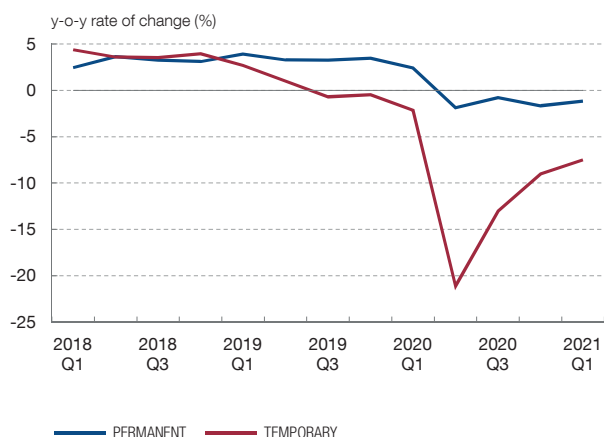
1 TURNOVER (DISCOUNTING THE AVERAGE FOR THE SECTOR) BY FIRM SIZE



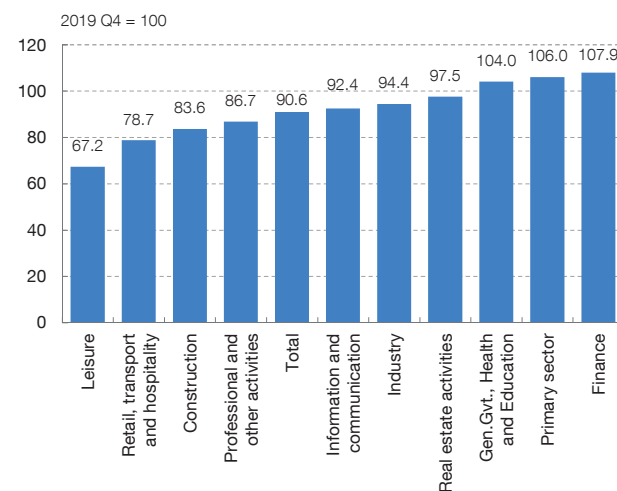
2 EMPLOYMENT (DISCOUNTING THE AVERAGE FOR THE SECTOR) BY FIRM SIZE



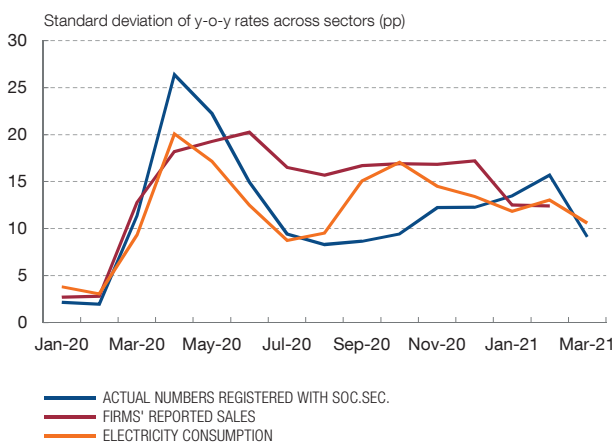
3 EMPLOYMENT BY TYPE OF CONTRACT



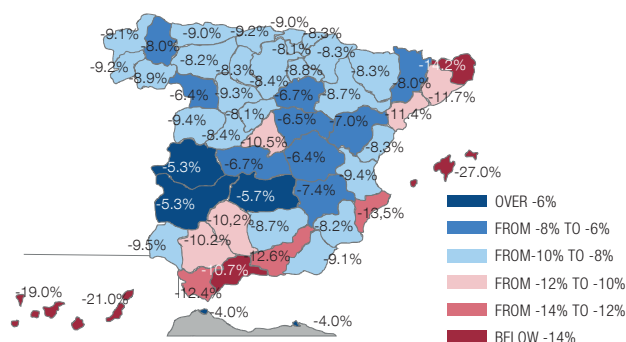
4 GVA IN 2021 Q1



5 SECTORAL DISPERSION



6 ESTIMATED DECLINE IN GDP IN 2020, BY PROVINCE



SOURCES: Banco de España, INE, Ministerio de Hacienda, Ministerio de Trabajo y Economía Social, and Red Eléctrica de España.



been particularly affected by the labour market downturn prompted by the pandemic (see Chart 1.9.3).²⁰

Gross value added in the retail, transport and hospitality, and artistic and recreational activities sectors still stood, in 2021 Q1, at 21.3% and 32.8% below their pre-crisis levels, respectively (see Chart 1.9.4). Set against these sectors – those most affected by the economic crisis caused by the pandemic – the levels of the primary sector, financial and insurance activities, and general government, health and education services have scarcely fallen back in recent quarters and, at the start of 2021, their gross value added was higher than at end-2019. As regards sectoral heterogeneity, it is worth highlighting two aspects. First, this disparity is evident not only in terms of gross value added, but also in the behaviour of employment, sales and electricity consumption, inter alia. Second, although the scale of sectoral asymmetry relative to the impact of the pandemic peaked in spring 2020, in the final stretch of last year and in early 2021 this heterogeneity increased again, in some cases significantly, further to the worsening of the health crisis and the tightening of the lockdown measures following the summer (see Chart 1.9.5). In this respect, the sectoral gap that has opened up as a result of this crisis will, foreseeably, gradually close in the coming quarters as the epidemiological situation improves and the vaccination roll-out in Spain progresses.

The impact of this crisis also evidences high regional heterogeneity. Cross-provincial GDP growth in the course of 2020 was deeply uneven, with the Canary and Balearic Islands and the Mediterranean coast those most affected by the crisis (see Chart 1.9.6).²¹ Among the factors that would account for a more adverse economic impact of the pandemic are the greater share of tourism, foreign tourism especially, in provincial activity, the high proportion of temporary employment, the lower weight of the public sector and lower levels of personal mobility.²²

Aside from GDP, the extraordinary adverse impact of the pandemic on activity can also be seen in employment and in the various macroeconomic variables. Broadly, since the start of the pandemic, employment in the Spanish economy has followed a very similar path to that of GDP. There was a marked downturn in the first half of 2020, a relatively sharp recovery in Q3 and a flattening out, with some decline, since then. This is highlighted by the various indicators of employment in effective terms, which consider the total number of hours worked and take into account the employment status of workers under furlough schemes and of the self-employed whose activity has been suspended (see Chart 1.10.1).

20 See Banco de España (2020e) and Alvargónzalez, Pidkuyko and Villanueva (2020).

21 See Fernández-Cerezo (2021).

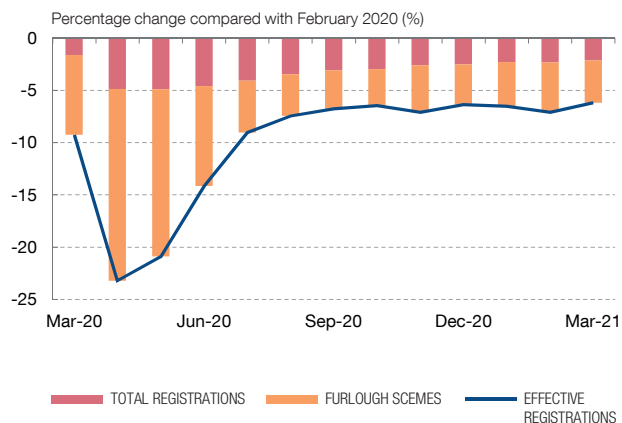
22 Once these factors are taken into account, the impact of the pandemic on death rates at the provincial level (see Chart 1.6.2) does not seem to be a relevant variable for explaining the heterogeneity observed across Spanish provinces as regards the path of GDP in 2020.

Chart 1.10

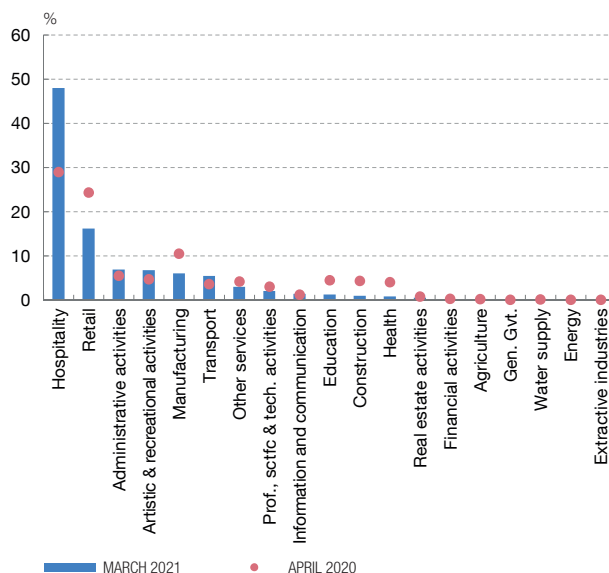
IMPACT OF THE COVID-19 CRISIS ON THE LABOUR MARKET

Since the start of the pandemic, employment in the Spanish economy has trended very similarly to GDP, with a marked deterioration in 2020 H1, a relatively sharp recovery in Q3 and a flattening out, even with some decline, thereafter. Throughout this period, the key factor in the behaviour of the labour market has been the extensive resort by firms to furlough schemes, which has helped significantly mitigate the increase in unemployment.

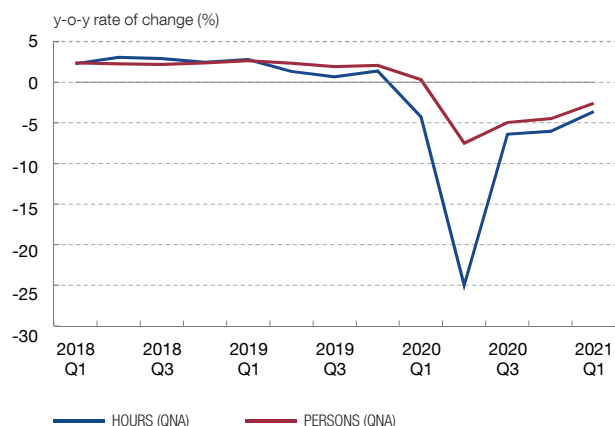
1 TOTAL REGISTRATIONS, FURLOUGHED WORKERS AND EFFECTIVE REGISTRATIONS



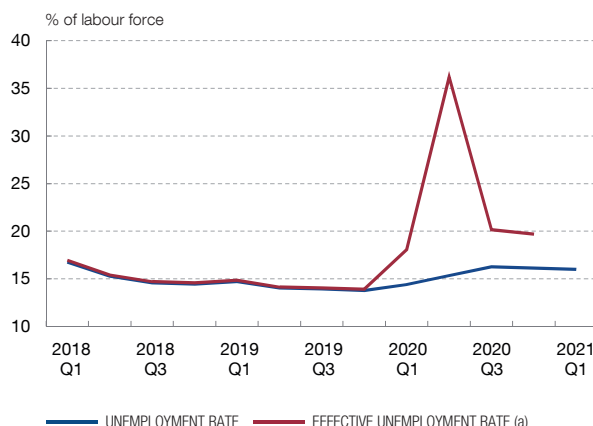
2 SECTORAL DISTRIBUTION OF FURLOUGHED WORKERS



3 EMPLOYMENT INDICATORS



4 UNEMPLOYMENT RATE



SOURCES: Banco de España, Quarterly National Accounts and Labour Force Survey (INE), and Ministerio de Trabajo y Economía Social.

a Effective rate of unemployment calculated as the unemployed plus furloughed employees plus the self-employed whose activity has been suspended divided by the labour force. As from 2021 Q1 it is not possible to calculate this rate because the EPA has ceased to provide information on furloughed (short-time work) workers.



Firms' large-scale use of furlough schemes has been the most notable feature of the behaviour of the Spanish labour market since the COVID-19 crisis broke. Indeed, when employment was at its trough, in April 2020, more than 3.5 million workers had been furloughed in Spain (more than 20% of the total). Despite the path of recovery embarked upon since, in March 2021 slightly more than 740,000 workers were still furloughed, most of them in the hospitality sectors (see Chart 1.10.2). The resort to this temporary employment adjustment mechanism meant that, although

hours worked declined by 10.4% in 2020 as a whole (in line with the observed historical relationship between this measure of the labour factor and GDP), the employment adjustment in terms of numbers of people was much lower than had habitually been the case (a decline of 4.2%; see Chart 1.10.3). This helped alleviate the increase in the unemployment rate in 2020 which, in any event, rose to 16.1% of the labour force, 2.3 pp above its end-2019 level. In this respect, it should be noted that, when considering alternative measures of labour market slack that take into account furloughed workers and the self-employed whose activity has been suspended, the decline in effective labour activity in 2020 would be notably sharper – above 23% of the labour force for the year on average – than that denoted by the unemployment rate (see Chart 1.10.4).

All the domestic demand components, except government consumption, have declined strongly since the pandemic began. In 2020 as a whole, domestic demand subtracted 8.8 pp from the increase in output as a result of the deep declines in all its components, except government consumption. In fact, this latter variable behaved differently from the rest of the main domestic demand items and increased by 3.8% in 2020, its highest growth rate since 2009. This increase was essentially due to the higher general government spending needs in order to address the health area. On information provided by the Quarterly National Accounts flash estimate for 2021 Q1, this divergence between the path of government consumption and the other domestic demand components is expected to have held in place at the start of this year.

There was a 12.4% collapse in household consumption in 2020, with widely differing behaviour across the various spending items. The available indicators show that, over the course of 2020, household spending on leisure and hospitality declined most significantly – e.g. restaurants and accommodation services fell off by more than 40% and almost 65%, respectively – as a result, above all, of the pandemic-containment restrictions imposed (see Chart 1.11.1). Spending on personal appliances and new private car registrations also fell strongly, by more than 25% year-on-year. Conversely, food expenditure increased slightly, by 0.4% in real terms. Unlike in other recent recessionary bouts, the decline in spending on non-durable goods and services since the start of the pandemic has been somewhat sharper than that observed in spending on durable goods (see Chart 1.11.2). Partly accounting for this behaviour would be the increase in spending on goods related to remote working, such as PCs, furniture and fittings, and office supplies.²³

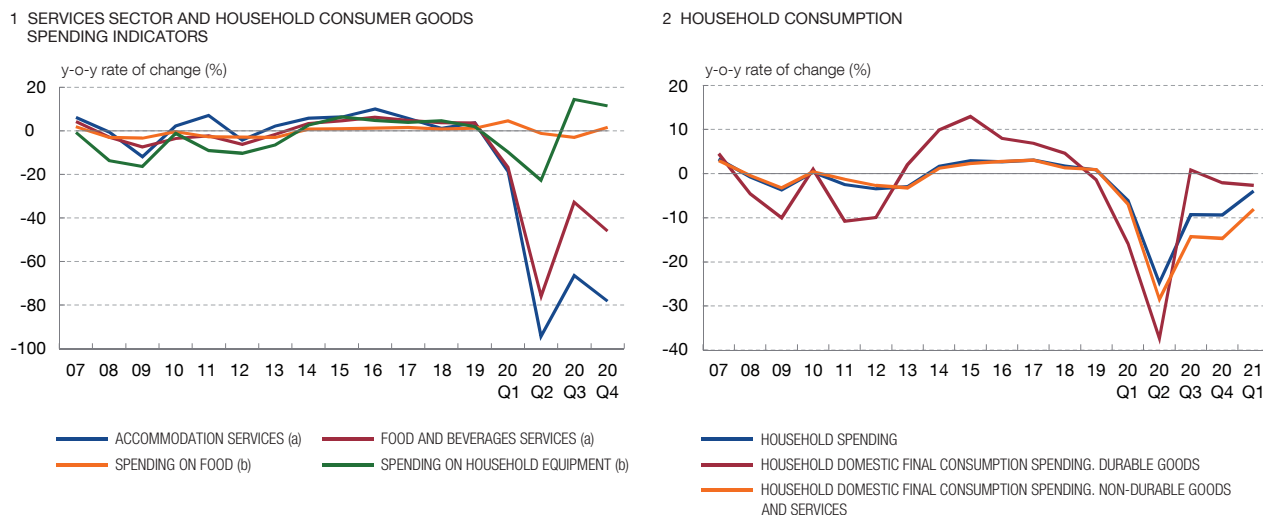
Residential investment declined by 16.6% in 2020, more sharply than other investment components, while there were some changes in the types of housing demanded. Housing starts and house sales declined sharply in the opening months

23 According to data from the INE Retail Trade Index, sales of household appliances (including PCs) fell by 2.8% in 2020 and those of other goods (under which office supplies and equipment, including furniture, are recorded) declined by 5.6%, compared with the 28% fall in sales of personal appliances.

Chart 1.11

THE IMPACT OF THE PANDEMIC ON HOUSEHOLD CONSUMPTION

Household consumption underwent an unprecedented fall in 2020, although there was considerable heterogeneity across the main expenditure components. In particular, the decline was particularly marked in the services items most affected by the restrictions to contain the pandemic (leisure and hospitality), while spending on food increased slightly. Unlike other recent recessionary episodes, the decline in spending on non-durable goods and services since the start of the pandemic has been somewhat sharper than that observed in spending on durable goods.



SOURCE: INE.

a Turnover of firms operating in this sector. Seasonally and calendar-adjusted time series.
 b Real terms series.



of the COVID-19 crisis, greatly influenced by the stringent restrictions on mobility and activity in that period. Thereafter, activity in this market moved onto a gradually recovering path, whereby building permits and registered sales stood, for 2020 as a whole, almost 20% down on 2019 levels. The latest available information would point, however, to more sluggish residential investment in early 2021, as suggested by the slight decline observed in the main indicators of activity in the sector. Notably, in recent months, there has been a greater relative preference for new, bigger, single-family homes outside large cities (see Box 2.1). These dynamics would partly reflect changes in household demand for housing induced by the pandemic, e.g. as a result of the search for larger spaces outside the major cities owing to more time spent at home in light of the restrictions on mobility and the increase in remote working. In the case of new housing, the fact that many of these transactions are the result of decisions formalised prior to the outbreak of the health crisis is significant.

Despite contracting sharply, business investment in 2020 was not strongly procyclical as it had been in other, previous recessionary episodes (see Chart 1.12.1).²⁴ This behaviour might first be indicative of the fact that firms'

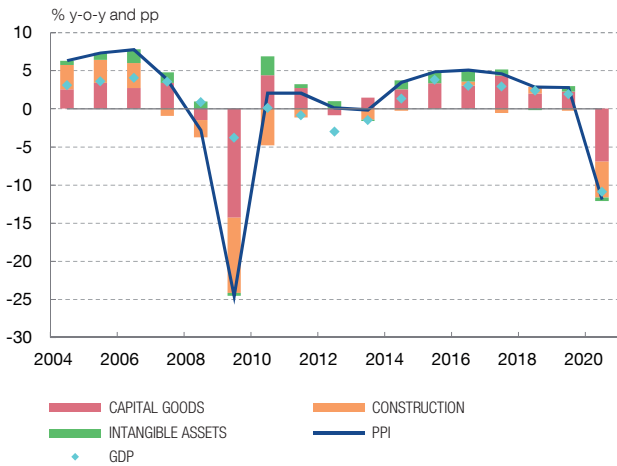
²⁴ In 2009, for example, the decline in business investment was fivefold that in GDP. For greater details on the procyclicality of investment in Spain and in other European countries, see *Álvarez, Gadea and Gómez-Loscós (2021)*.

Chart 1.12

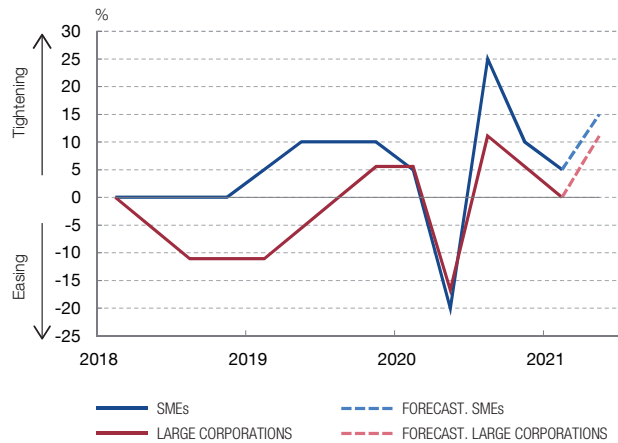
THE DECLINE IN BUSINESS INVESTMENT HAS BEEN CUSHIONED BY THE MAINTENANCE OF RELATIVELY EASY FINANCING CONDITIONS

Business investment in 2020 was not as strongly procyclical as it had been in previous recessionary episodes. This was partly on account of the fact that, although lending standards have tightened in recent quarters, firms' financing conditions have remained relatively easy during this crisis. Contributing to these favourable developments were the various ICO-administered public guarantee facilities established by the Government in response to the pandemic and also the numerous measures deployed by the monetary, regulatory and prudential authorities to promote bank lending to the private sector and financial market stability.

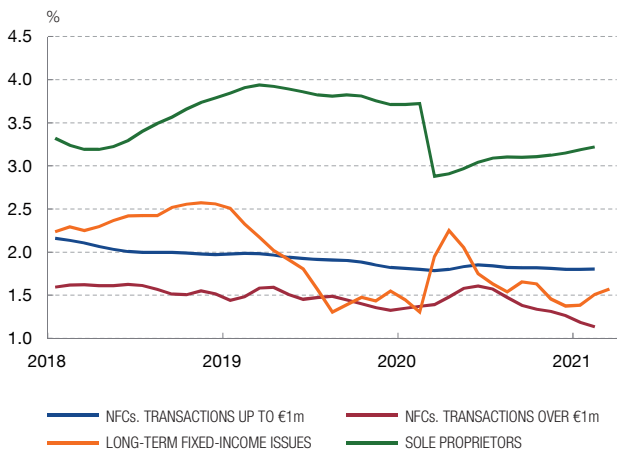
1 PRIVATE PRODUCTIVE INVESTMENT (PPI) AND GDP



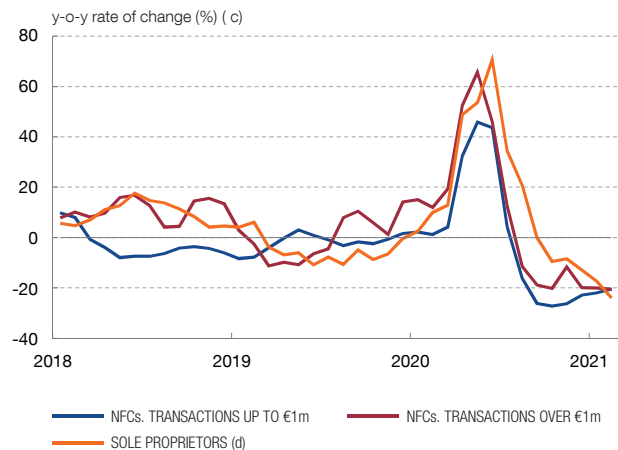
2 BLS: CHANGE IN LENDING STANDARDS (a)



3 FINANCING COSTS (b)



4 NEW LENDING BUSINESS



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

- a BLS. Indicator = percentage of banks that have tightened their credit standards considerably × 1 + percentage of banks that have tightened their credit standards somewhat × 1/2 – percentage of banks that have eased their credit standards considerably × 1/2 – percentage of banks that have eased their credit standards considerably × 1.
- b The interest rates on bank loans are narrowly defined effective rates (NDER), i.e. they do not include related charges and fees, and are adjusted seasonally and for the irregular components.
- c Cumulative three-month flow.
- d Includes new business consisting of previous, renegotiated loan transactions.



interpretation of the pandemic-associated shock was that it would be essentially temporary. Further, firms' need to adapt to the new circumstances arising from the COVID-19 crisis might have given momentum to business investment to move forward in digitalising activity, to boost remote working and to promote online

sales. The INE report on the Business Confidence Indicator (“Yearly module on the impact of COVID-19”) spanning the second half of 2020 and the first half of 2021 is along these lines. It notes that these three formulas were those most used by Spanish firms to attempt to maintain or recover their pre-crisis level of activity.²⁵ In this same vein, too, it is investment in intangible assets – which partly comprises investment in the information and communication technologies needed to boost the digitalisation of productive activities – that has so far felt less sharply the effects of the pandemic.²⁶

The fact that financing conditions for firms have not worsened significantly in this crisis is also expected to have contributed to cushioning the decline in business investment. Indeed, unlike what has traditionally occurred in previous contractionary phases, in the current crisis firms’ financing conditions have continued to be relatively easy. Hence, although lending standards have tightened in recent quarters, they have done so relatively moderately and the cost of financing has remained low (see Charts 1.12.2-1.12.4). These favourable dynamics will have been assisted by the various ICO-administered public guarantee lines established by the Government in response to the pandemic, and also by the numerous measures deployed by the monetary, regulatory and supervisory authorities to promote bank lending to the private sector and the stability of financial markets.

The contribution of net external demand to GDP growth in 2020 was also negative (2.0 pp). This negative contribution is due to a sharper fall in exports (20.2%) than in imports (15.8%). The decline in exports reflected, first, the strong contraction in export markets in 2020. This was more markedly the case for Spain’s markets than it was for trade worldwide, since the EU and Latin America, whose share in Spanish exports is very significant, were among the world regions where the incidence of the pandemic was higher (see Chart 1.13.1). Second, the sizeable share in the Spanish export structure of tourism, one of the sectors most affected by the pandemic-containment measures deployed internationally, was an additional drag on the buoyancy of Spanish sales abroad. As to imports, their performance in 2020 was against a background of substantial and across-the-board adjustment in final demand, which affected those components with a greater import content – such as automobiles, investment in equipment and exports – more adversely (see Chart 1.13.2 and 1.13.3). Conversely, the health crisis boosted purchases of drugs and medical products, which performed most dynamically.²⁷

25 See the INE press release, “[Indicador de Confianza Empresarial, Módulo de Opinión sobre el Impacto de la COVID-19](#)”, published on 21 January 2021.

26 This greater resilience of investment in intangible assets might partly be the result of the uneven impact of the crisis on firms since, in general, companies that invest more in intangible assets tend to be bigger, more productive and more innovative. It is precisely these firms that would have been less affected by the economic crisis caused by the pandemic and, therefore, those that would have least had to scale back their investment plans. See [European Investment Bank](#) (2021).

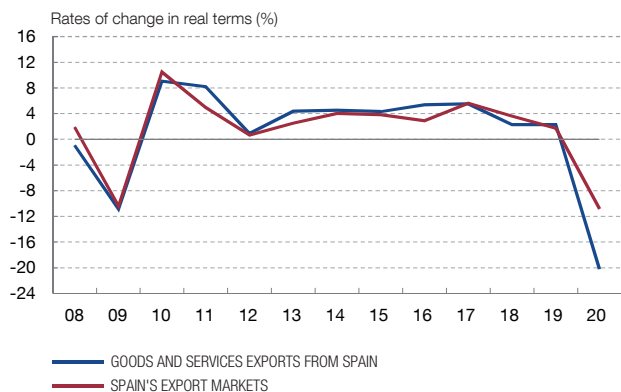
27 See [García, Martín and Viani](#) (2020).

Chart 1.13

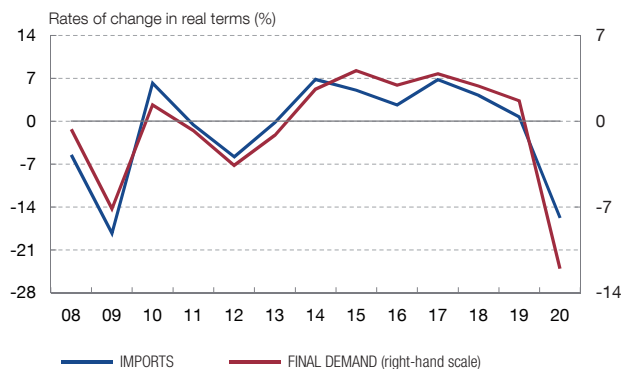
THE CONTRIBUTION OF NET EXTERNAL DEMAND TO GDP IN 2020 WAS NEGATIVE

This negative contribution is due to the sharp fall in Spanish exports, essentially as a result of the collapse in tourism exports, which exceeded the fall-off in imports, affected by the sluggishness of final demand. These dynamics partly contributed to the reduction in 2020 in the Spanish economy's financing capacity, against a background in which the net debtor position vis-à-vis the rest of the world remains at a high level.

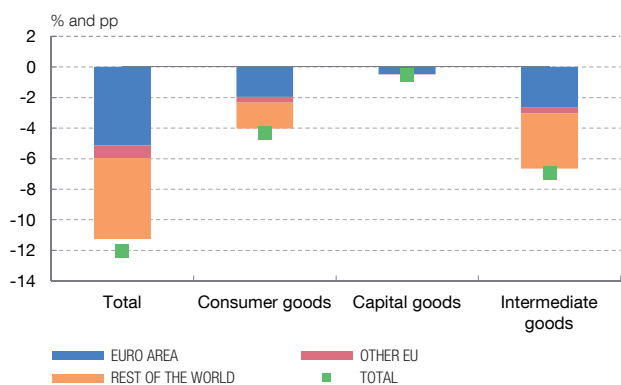
1 EXPORTS



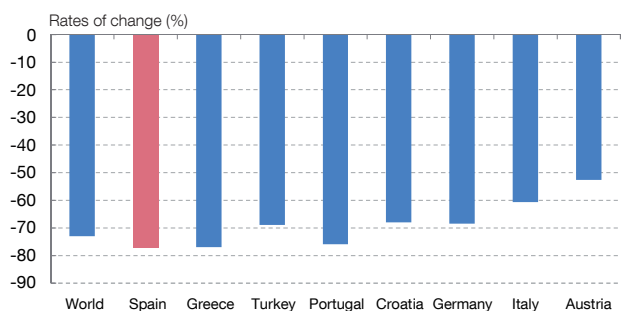
2 IMPORTS AND FINAL DEMAND



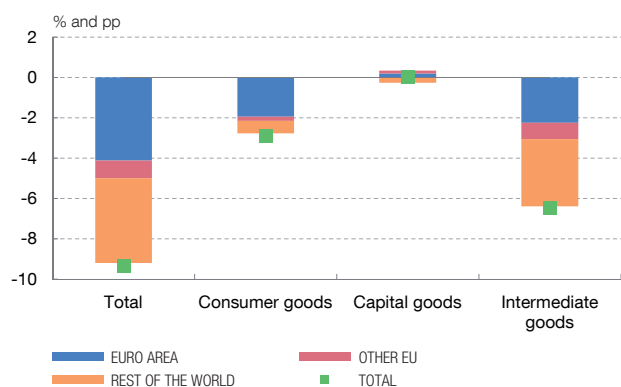
3 REAL GOODS IMPORTS. 2020



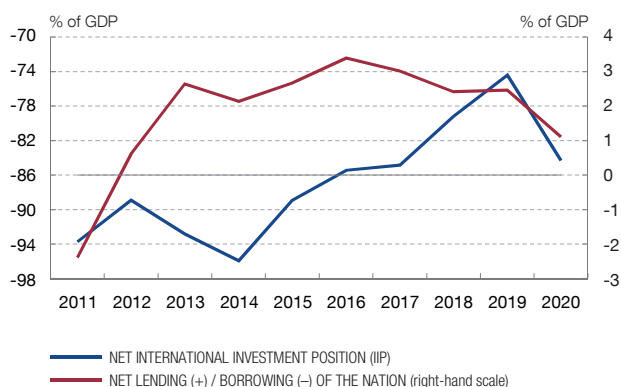
4 INTERNATIONAL TOURIST ARRIVALS. 2020



5 REAL GOODS EXPORTS. 2020



6 NET LENDING (+) / BORROWING (-) OF THE NATION AND NET IIP



SOURCES: ECB, Banco de España, Departamento de Aduanas, Ministerio de Asuntos Económicos y Transformación Digital, INE and UNWTO.



Foreign tourism receipts fell by 75.9% in 2020 in real terms. Directly contributing to this slump were the restrictions on international travel (set by Spain and by the main countries of origin of foreign tourists visiting our country), and on the hospitality industry, which were in force for much of that year. Potential tourists' health concerns about travelling might further have borne down on the demand for tourist services. Thus, foreign tourist inflows and spending in Spain saw an unprecedented contraction – of around 80% – in 2020, and this dynamic has continued in 2021 to date. It should moreover be highlighted that the decline in tourist inflows into Spain last year was sharper than that seen globally and in the main European destinations (see Chart 1.13.4). This was the result, at least in part, of the more unfavourable epidemiological situation in Spain compared with our peer countries, and precisely during the summer season, which is the most important in terms of annual tourist activity.

Despite shrinking by 8.9% last year, goods exports have performed relatively better since the start of the pandemic. The lesser influence of the pandemic lockdown measures on global manufacturing activity, compared with their impact on services, is estimated to have mitigated the adverse effects of the COVID-19 crisis on international trade in goods. In any event, there was an appreciable decline in Spanish goods exports in 2020. By geographical region, the fall was across the board – although somewhat more acute in exports intended for non-Community markets – and particularly affected the goods most integrated into the global production chains (see Chart 1.13.5). In this respect, the decline in goods exports was particularly pronounced in intermediate industrial products and automobiles, while exports of capital goods (largely sustained by computer and medical-surgical equipment), food and, above all, drugs and medical products were more robust.

The outlook is for a gradual recovery in goods exports during the first half of 2021, following their decline at the start of the year. On the latest Customs data, real goods exports fell by 1.9% year-on-year in February (evidencing a generalised fall-off by type of good and by market), affected by the worsening of the health crisis in Europe. In the case of exports to the United Kingdom, which fell significantly, other temporary factors came into play. These included adapting to new customs procedures following Brexit, the strong rise in British imports in the final stretch of 2020 to avoid potential supply problems and the controls on hauliers crossing the English Channel to prevent the spread of the British COVID-19 strain. However, the latest indicators point to a recovery in Spanish goods exports in the coming months, more markedly so in non-Community markets. This is in line with the expansionary behaviour of new export orders in the Spanish manufacturing PMI, which improved appreciably in February and March, against the backdrop of the gradual recovery in global trade.

The Spanish economy's financing capacity has declined as a result of the crisis, in a setting in which the net debtor position vis-à-vis the rest of the world remains at a high level (84.3% of GDP at end-2020). In 2020, the Spanish

economy's financing capacity stood at 1.1% of GDP, 1.4 pp down on 2019 according to the National Accounts Rest of the World Account (see Chart 1.13.6). This reduction is mainly due to the decline in the tourism surplus, which shrank by 2.4 pp, to 0.7% of GDP. On a lesser scale was the 0.4 pp worsening in the other services surplus, taking it to 1.6% of GDP. This development was only partly offset thanks to the significant 1.3 pp reduction in the goods deficit, to 0.8% of GDP. The improvement in the goods balance was both in net energy imports (against the background of the reduction in the amount of imported oil and of its price in euro) and in the non-energy balance (which went into surplus owing to a more marked adjustment in goods imports than in exports). The aggregate deficit of the primary and secondary income balances fell by 0.4 pp to 0.4% of GDP, driven by transfers from the EU, while the capital account surplus fell slightly (by 0.2 pp to 0.2% of GDP).

The public finances worsened most significantly in 2020. In particular, the general government deficit rose to 11% of GDP, 8.1 pp up on 2019, and the public debt/GDP ratio ended the year at 120%, 24.5 pp up on its end-2019 level (see Charts 1.14.1 and 1.14.2). A proportion of the 2020 deficit (0.9 pp) can be accounted for by the reclassification of Sareb as part of general government.²⁸ Stripping out this effect, the increase in the budget deficit last year was in response, above all, to the strong growth in expenditure, which increased by 10.1%, although revenue also worsened appreciably and fell by 5% (see Chart 1.14.3). The increase in the public debt ratio was the outcome both of greater general government financing needs in 2020 and of the strong decline in nominal GDP. Moreover, the reclassification of Sareb involved the reconsideration of its debt (at 3% of GDP) as public debt. In any event, the public finances would have worsened more seriously and persistently in the medium term had the policies to sustain household and business incomes since the start of the pandemic not been set in place.

Around 85% of the increase in public spending recorded last year (excluding the effect of the reclassification of Sareb debt) is related to the pandemic. In particular, this spending is estimated to have taken the form of higher social benefits for employees and the self-employed, subsidised social security contributions for firms and higher social and health spending by general government. In terms of budgetary items, almost half the increase observed in public spending was due to social benefits, including most notably those for unemployment and the suspension of activity for the self-employed. These benefits rose from accounting for 1.5% of GDP in 2019 to 3.7% in 2020. General government consumption demand continued to be notably buoyant (although it grew at rates more similar to those for 2019), and

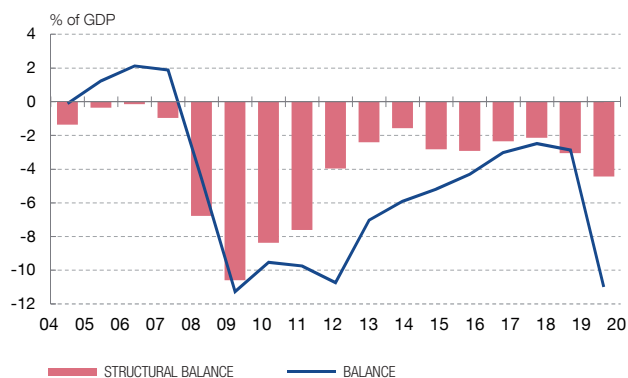
28 The negative performance of Sareb's financial accounts led Eurostat to decide on their inclusion as part of general government, which meant the absorption by the latter of Sareb's negative net value at end-2020. Accounting wise, this reclassification operation is recorded in two ways. On one hand, it is recorded as a capital transfer from general government to the other resident agents, which entails an increase in expenditure. On the other, it is assumed that the financial institution's debt is part of general government debt, which entails an increase in this latter debt.

Chart 1.14

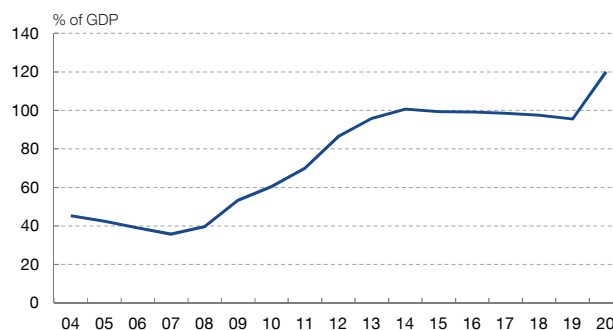
THE PUBLIC FINANCES WORSENE MOST SIGNIFICANTLY IN 2020

The general government deficit rose to 11% of GDP in 2020, 8.1 pp up on 2019, owing to the strong growth of expenditure, the reclassification of Sareb under general government and a less sharp but equally significant downturn in revenues. The public debt/GDP ratio ended the year at 120%, 24.5 pp above the end-2019 level. Looking ahead, that entails a considerable source of vulnerability for the Spanish economy.

1 GENERAL GOVERNMENT TOTAL AND STRUCTURAL BALANCE



2 PUBLIC DEBT



3 GENERAL GOVERNMENT REVENUE AND EXPENDITURE

Percentages of GDP	2019	2020	2020-2019	Year-on-year rate (%)
Revenue	39.2	41.3	2.1	-5.0
Indirect taxes	11.5	11.2	-0.2	-11.8
Direct taxes	10.4	11.2	0.8	-3.0
Social security contributions	12.9	14.4	1.5	0.8
Other revenue (a)	4.4	4.5	0.0	-9.0
Expenditure	42.1	52.3	10.2	12.0
Remuneration	10.8	12.5	1.7	4.5
Other final consumption expenditure	7.8	8.9	1.1	2.9
Social benefits	15.8	20.3	4.5	15.9
Effective interest paid	2.3	2.2	0.0	-11.1
Gross fixed capital formation (a)	2.1	2.5	0.4	8.4
Other (b)	3.2	5.7	2.5	58.9
Balance	-2.9	-11.0	-8.1	
Debt	95.5	120.0	24.5	

SOURCES: Banco de España, IGAE and Ministerio de Hacienda.

- a In 2020 this includes €1.75 billion (0.16% of GDP) relating to the return to State management of several motorway concessions, with a zero impact on the balance.
- b In 2020 this includes 0.7% of GDP in subsidies intended to cover social security contributions by firms and the self-employed, and 0.9% in capital transfers relating to the negative net value of Sareb. Stripping out this latter effect, expenditure grew by 10.1% year-on-year in 2020.



public investment – adjusted for the extraordinary impact of several toll motorway concessions being returned to State management – grew moderately. Conversely, despite the highly significant increase observed in public debt, interest expenditure declined once more.

The decline in revenues was due mainly to indirect taxes, the take for which shrank by 11.8%, in line with the behaviour of activity. By contrast, direct tax

takings (down only 3%) and social security contributions (up 0.8%) proved resilient. These items were assisted by the positive effect on the bases that determine these revenues of some of the Government's measures to address the pandemic. Particular cases in point here were the increases in social benefits for – and the payment by general government of the social security contributions of – furloughed workers and the self-employed whose activity was suspended. As a result, the share of public revenue in GDP rose by 2.1 pp last year.

The impact of the pandemic on consumer prices has so far been clearly disinflationary. In 2020 as a whole, both overall inflation – measured as the rate of change of the harmonised index of consumer prices (HICP) – and core inflation – the HICP excluding energy and food – fell very sharply to -0.3% and 0.5%, respectively (1.1 pp and 0.6 pp below their rates in 2019). Although most items moved on a clearly slowing path from the start of the pandemic, the inflation performance in 2020 was essentially linked to the sharp decline in energy prices – of both oil and of electricity and gas – and the marked slowdown in services prices (see Chart 1.15.1). Conversely, food prices quickened in the first half of that year – due partly to increased household demand, but also to certain supply-side factors – and, thereafter, the pace of their year-on-year growth progressively eased, ultimately posting a rate similar to that seen before the pandemic.

Almost 80% of the HICP items were affected significantly as a result of the health crisis. On the latest Banco de España estimates for core inflation, 33% of the items reflecting the course of non-energy industrial goods prices and 46% of those doing so for services (whose weights account for 16% and 32% of the index, respectively) have seen their trajectory significantly disrupted since the start of the pandemic.²⁹ Most of these COVID-sensitive items are estimated to have contributed to the decline in core inflation last year (see Chart 1.15.2). Indeed, these items would account for a portion (0.8 pp) of the decline (1.2 pp) observed in core inflation from January to December 2020. Conversely, some of the items whose prices were distorted by the outbreak of the pandemic will, in recent months, have shown abnormally high price growth. This would be the case, for example, of the electronic equipment item.

There has been a notably sharp slowdown, and even decline, in the prices of tourist packages, accommodation services and air transport. The prices of these items contributed 1.3 pp to the reduction observed in the rate of change of the services aggregate in 2020. However, the measurement of some of these prices in the first state of alert in Spain posed evident complications (due essentially to the closure of most of the establishments providing these services), which required indirect estimates be made of such prices.³⁰ That entails further difficulty when

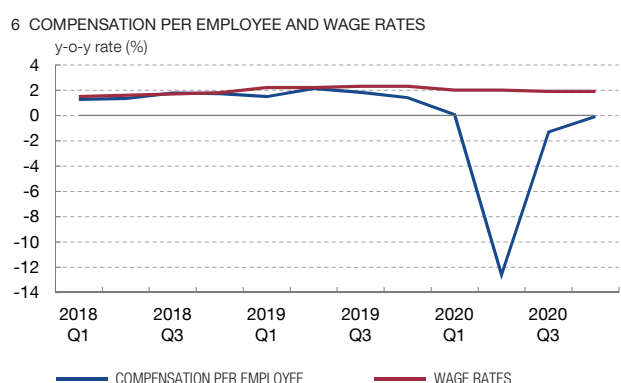
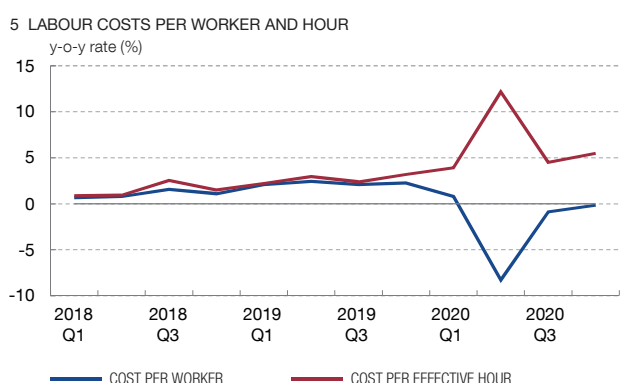
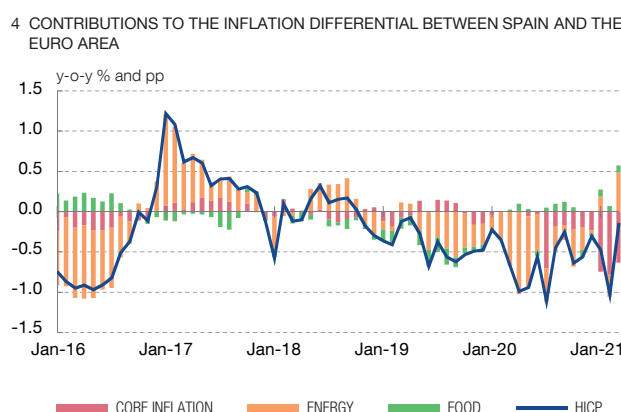
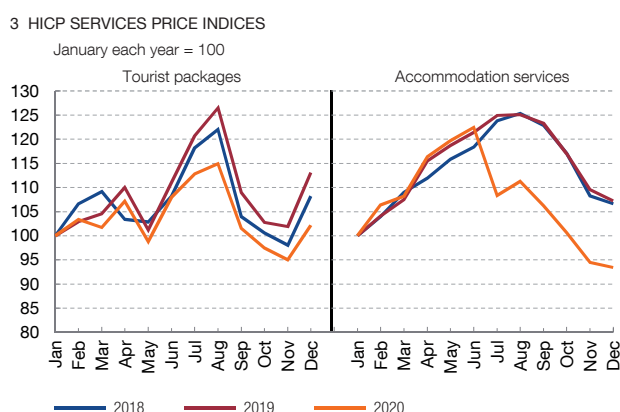
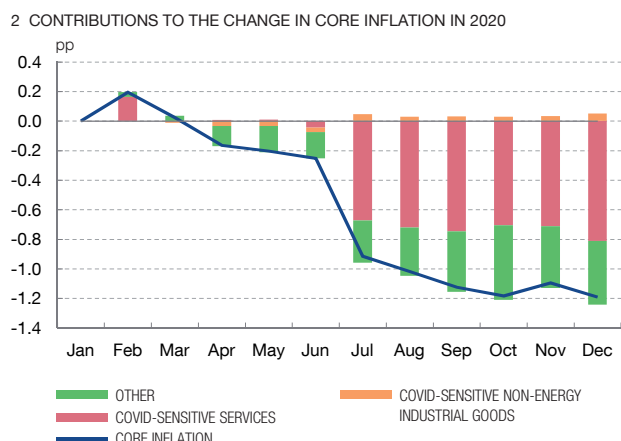
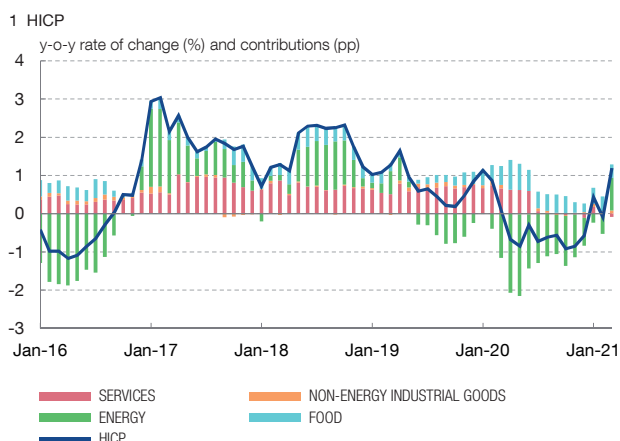
29 To identify these COVID-sensitive items, regressions are estimated for the year-on-year rates of the HICP item classes, with a dummy taking the value of 1 as from March 2020. COVID-sensitive classes are considered to be those for which the coefficient of this dummy is significantly different from zero at a 95% confidence level.

30 See Sánchez (2020).

Chart 1.15

THE IMPACT OF THE PANDEMIC ON CONSUMER PRICES HAS SO FAR BEEN DISINFLATIONARY

Although most of the HICP items have moved on a clearly slowing path since the start of the pandemic, the behaviour of inflation in 2020 was essentially linked to the steep decline in energy prices, oil and electricity and gas alike, and to the marked slowdown in services prices. Of particular note was the sharp slowdown, and even decline, in tourist package prices, accommodation services and air transport. Inflation has shown considerable volatility in early 2021, though a very gradual rise in core inflation continues to be expected in the coming quarters, against a background in which the increase in wage costs will probably be limited.



SOURCES: Banco de España, Eurostat, INE and Ministerio de Trabajo y Economía Social.

a Items whose coefficient is significant at the 95% confidence level in the regressions of the year-on-year rates with a dummy that takes a value of 1 as from March 2020.



assessing the anomalies observed in the monthly course of these prices (see Chart 1.15.3).

In 2020, the inflation differential between Spain and the euro area (-0.6 pp) was slightly wider than that of the previous year (-0.4 pp). Nonetheless, the slowdown in energy prices was somewhat sharper in Spain than in the euro area as a whole, whereas food prices grew at a swifter pace in our country in the second half of the year (see Chart 1.15.4). Core inflation trended similarly in both areas in the first half of the year and, subsequently, posted a steeper decline in Spain.

Inflation has been considerably volatile in early 2021, although a very gradual increase in core inflation in the medium term is still expected. The volatility of inflation in the opening months of this year has essentially been due to the oscillations in the year-on-year growth rates of energy prices – electricity in particular – and, to a lesser extent, of food and tourism-related items. In the absence of further shocks, the inflation rate can be expected in the coming months to increase to around 2%. This rise will initially be the outcome, first, of a bigger contribution of energy prices (75% of the increase in the year-on-year rate of the energy component from February to April would be due to base effects and the remaining 25% to the recent rise in prices), which turned positive in March; and further, as from the summer, of the correction of the base effects associated with the marked declines observed in the prices of many items over the course of 2020. The advancing vaccination campaign – in Spain and globally – and the foreseeable gradual recovery in aggregate demand will likewise contribute positively to the future behaviour of prices. In any event, it should be stressed that, technical aspects aside, short and medium-term inflationary pressures are proving relatively contained given the high degree of slack in the economy. In particular, the information available on recent wage cost trends in Spain, though they are partly distorted by the recording of furloughed workers and by the practical halt in collective bargaining since March 2020, would suggest wage increases in the coming months will be relatively muted (see Charts 1.15.5 and 1.15.6).

3.2 The main sources of uncertainty

Some risk factors conditioning the outlook for the Spanish economy have recently been mitigated. In recent months, confirmation of the effectiveness of vaccines against COVID-19 and the headway in the vaccination process are notably restricting the possibilities of highly adverse epidemiological scenarios materialising that may abruptly affect the behaviour of economic activity. Also, on the external front, the EU-UK withdrawal agreement reached in late 2020 and the US fiscal stimulus plans approved in December 2020 and in March 2021 have notably lessened the downside risks in place late last year to global economic activity in the short term.

Despite these developments, the Spanish economic outlook remains subject to much uncertainty. Among the different factors conditioning this outlook, the course of the pandemic and the speed of the vaccination campaign remain key, until a high degree of immunisation of the population against COVID-19 has been attained. However, health aspects aside, other more economic factors have recently taken on greater importance when it comes to determining the dynamism of the Spanish economy in the future. These factors include most notably: the degree of implementation and effectiveness of the NGEU programme in Spain (see Chapter 2); the adaptability of economic policies to the changing circumstances of the crisis (see Section 1.4); the scale of the scarring the pandemic may have left on the productive system and the Spanish labour market; and the speed at which certain crisis-induced changes in agents' behaviour (in particular, the sharp rise in the household saving rate and the steep decline in tourism exports) are reversed. This section addresses some of these sources of uncertainty (see Figure 1.1), while the rest are subject to more detailed analysis elsewhere in this Report.

Spanish households have built up a considerable reservoir of saving since the start of the pandemic. In 2020 as a whole, Spanish household saving was almost 6 pp of GDP higher than the average for the previous five years. In a setting in which household incomes have been sustained, in part, by the public aid granted to mitigate the effects of the health crisis, this accumulation of saving was mainly through two channels. First, saving will have been built up for precautionary reasons, given the highly uncertain health and economic situation. A second factor that will have boosted the increase in saving would be the difficulties faced by Spanish households in recent quarters in attaining their desired level of consumption of specific goods and services, owing to the pandemic lockdown measures. On Banco de España estimates, this forced saving would account for most of the total built up since the start of the COVID-19 crisis (see Chart 1.16.1).³¹

It is difficult to specify at what pace this reservoir of saving will be released in the future, which will be a key determinant of how private consumption evolves. In the coming months, as the epidemiological situation improves and uncertainty abates, it is to be expected that a portion of the reservoir of saving built up since the start of the pandemic – essentially in the form of bank deposits – will be earmarked for consumption, lending greater momentum to the recovery of this demand component. The intensity with which this channel will operate is, however, very uncertain. In particular, it will depend on the extent to which this crisis will entail a persistent increase in the precautionary component of household saving. It will also depend on how present and relevant the Ricardian channel will prove to be, whereunder households might maintain a relatively high level of saving in the short

³¹ See [Cuenca, Martínez y del Río \(2021\)](#).

Figure 1.1

MAIN FACTORS OF UNCERTAINTY OVER THE FORECASTING HORIZON



SOURCE: Banco de España.

term in anticipation of future tax rises. Further, the fact it is higher-income households, which tend to consume a lower proportion of their income, that have most contributed to this reservoir of forced saving also poses added uncertainty about the speed at which it might be released in the future.

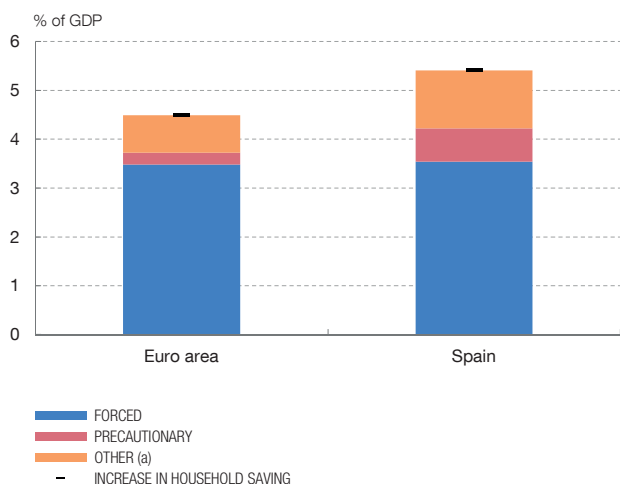
Household consumption will also be greatly influenced by the path of recovery of hours worked. As mentioned in the previous section, the number of hours worked in Spain fell very sharply in the first half of 2020 and has only recovered partly since. The gradient of this path of recovery in the coming quarters – which is conditional, in turn, upon the behaviour of furlough schemes – will undoubtedly influence how dynamic private consumption will be in the future. Indeed, estimates drawing on the Survey of Household Finances (EFF) and the Labour Force Survey (EPA) suggest that the pick-up in hours worked between Q2 and Q3 in 2020 would

Chart 1.16

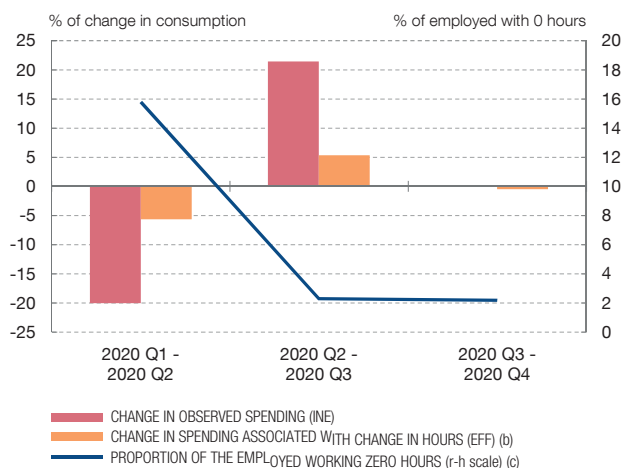
FACTORS THAT WILL CONDITION THE PATH OF RECOVERY OF HOUSEHOLD CONSUMPTION IN THE COMING QUARTERS

Spanish households have built up a significant reservoir of saving since the start of the crisis, largely as a result of the difficulties encountered in attaining their desired level of consumption of certain goods and services owing to the pandemic lockdown measures. Foreseeably, as the epidemiological situation improves and uncertainty abates, a portion of this reservoir of saving may be targeted on consumption, which will add greater momentum to the ongoing economic recovery. Household consumption will also be greatly influenced by the path of recovery hours worked may follow.

1 DETERMINANTS OF THE INCREASE IN HOUSEHOLD SAVING
Cumulative increase in 2020



2 CHANGE IN OBSERVED SPENDING ASSOCIATED WITH THE CHANGE IN THE DISTRIBUTION OF HOURS WORKED



SOURCES: Spanish Survey of Household Finances (EFF), INE, Cuenca, Martínez-Carrascal and Del Río (2021), and Alvargonzález, *et al.* (2021).

- a Includes the contribution of the other determinants of consumption (inter alia, income, wealth and interest rates).
- b Spending reported in the 2017 EFF in a situation where the distribution of individuals working a limited number of hours would have been that observed in each quarter of 2020 in the Labour Force Survey (EPA).
- c Relates to the last quarter considered. Thus, in 2020 Q1 and Q2 it is the proportion of the employed population working zero hours in 2020 Q2.



account for 20% of the observed increase in spending in that same period (see Chart 1.16.2).³²

High uncertainty prevails over the future course of business investment, which is affected by various factors. In this crisis business investment, despite having contracted significantly, has performed better than in other, previous recessionary episodes. It has also trended less negatively than other demand components. In the coming quarters, business investment, like the rest of aggregate demand, will foreseeably experience an improvement driven by the normalisation of the health situation and the reduction in uncertainty. Several factors suggest that the recovery of this investment component might be relatively robust. First, the launch – as from the second half of this year in particular – of investment

32 The impact of the reduction in working hours on consumption in 2020 Q2 can be approximated by analysing the spending of similar workers' households in the 2017 EFF. Hence, spending by employees or the self-employed working zero hours in 2020 is assimilated to that of workers in similar industries that had recently lost their job or business in 2017 (given that the unemployment subsidy accounts for 70% of labour income, a similar percentage to that replaced by furlough schemes). Likewise, spending by those who worked fewer hours in 2020 than normal can be assimilated to that of those who worked fewer hours in 2017. For further details, see Alvargonzález *et al.* (2021), mimeo.

projects linked to the NGEU programme should provide a significant boost to business investment. The effect could be both direct, through the financing of non-financial corporations' investment projects, and indirect, via the impulse stemming from the financing of public investment projects. Second, it is true that there has recently been some weakness in bank financing flows to firms and that banks have tightened their lending standards in this segment; but financing conditions for the business sector generally remain easy in historical terms, which should not pose an obstacle to the execution of new investment projects by firms. Lastly, as mentioned in the previous section, the COVID-19 crisis appears to have significantly and durably accelerated the ongoing digitalisation of economic activity, giving rise to new investment needs on the part of firms to adapt to this structural change.

The increase in firms' financial vulnerability and the reduction in the degree of capacity utilisation in some sectors might dent the robustness of the short-term recovery in business investment. Set against the arguments in the previous paragraph, other factors might adversely influence the future course of business investment in Spain. In particular, as set out in detail in Chapter 3 of this Report, the economic crisis caused by the pandemic has entailed an appreciable downturn in Spanish firms' financial position and an increase in their financial vulnerability, restricting their capacity to undertake new investment projects. Indeed, the crisis is already estimated to have caused a significant reduction in the number of firms and to have negatively affected their investment plans. Specifically, according to the figures on Social Security-registered firms, the number of active companies in Spain fell by almost 50,000 in the period from February 2020 to March 2021. That represents a fall of 3.7% (see Chart 1.17.1), although this decline is essentially due to fewer new firms entering the market and not to the increase in existing firms shutting down. Moreover, according to the annual European Investment Bank Investment Survey³³, the crisis will not only have adversely affected business investment levels in 2020, but also those planned for the future (see Charts 1.17.2 and 1.17.3). In particular, the number of companies without investment plans for the coming years is expected to have increased notably in Spain, more steeply than in other euro area economies, especially in the construction and services sectors, and in the case of SMEs. Lastly, the fact that the pandemic has entailed a significant reduction in capacity utilisation in most sectors of activity – above all in the services sector – might also bear down on the recovery of business investment in Spain in the coming quarters (see Chart 1.17.4).

The outlook for the Spanish economy also hinges on the path of recovery of international tourism, which is shrouded in considerable uncertainty. According to the INE Tourism Satellite Account, in 2019 the tourist sector accounted for 12.4% of GDP and 12.9% of employment in the Spanish economy. In turn, international

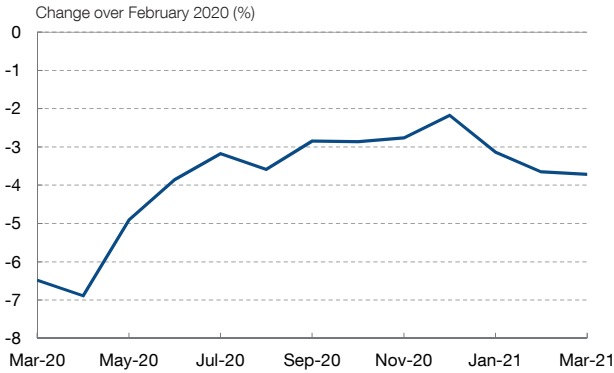
33 See [European Investment Bank](#) (2020).

Chart 1.17

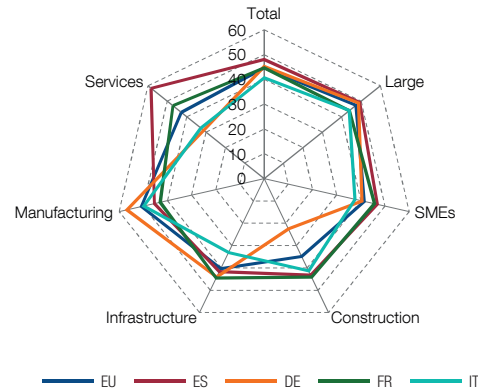
THE IMPACT OF THE CRISIS ON THE BUSINESS SECTOR AND SCANT CAPACITY UTILISATION MIGHT RESTRICT THE RECOVERY IN BUSINESS INVESTMENT IN THE SHORT AND MEDIUM TERM

The economic crisis caused by the COVID-19 pandemic has prompted a significant reduction in the number of active firms in Spain and has adversely affected their investment plans. These factors, along with the fact that capacity utilisation has fallen appreciably in most sectors of activity (especially in the services sector), might weigh down on the recovery of business investment in Spain in the coming quarters.

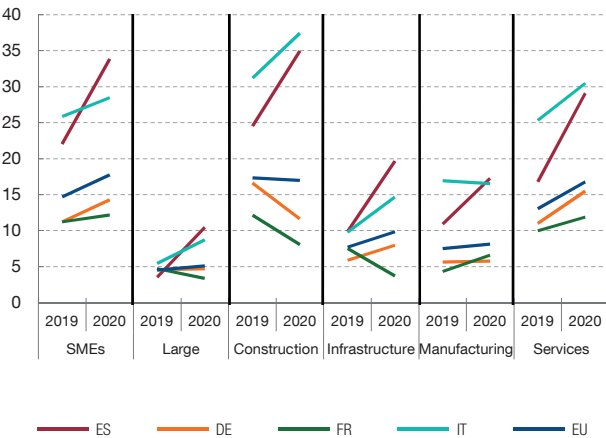
1 SOCIAL SECURITY-REGISTERED FIRMS



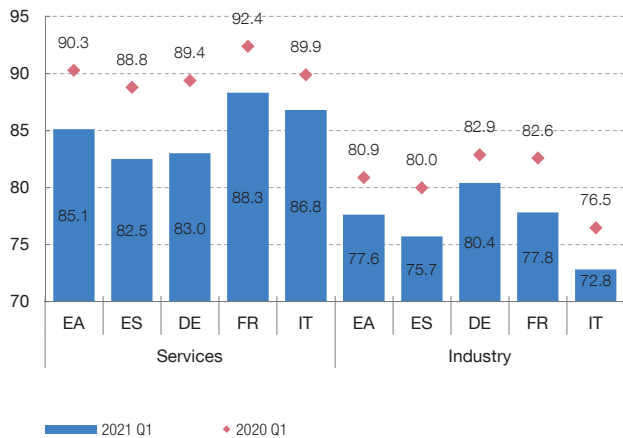
2 EIB INVESTMENT SURVEY. LOWER INVESTMENT THAN THAT PLANNED IN 2020 OWING TO COVID (a)
% of firms in each sector or type of firm



3 EIB INVESTMENT SURVEY. FIRMS WITH NO INVESTMENT PLANS FOR THE NEXT THREE YEARS
% of firms in each sector or type of firm



4 CAPACITY UTILISATION
% in each sector and country



SOURCES: EIB, European Commission and Ministerio de Trabajo y Economía Social.

a The results show the percentage of firms in each sector or type of firm that reported having scaled back investment from initial 2020 plans owing to COVID-19.



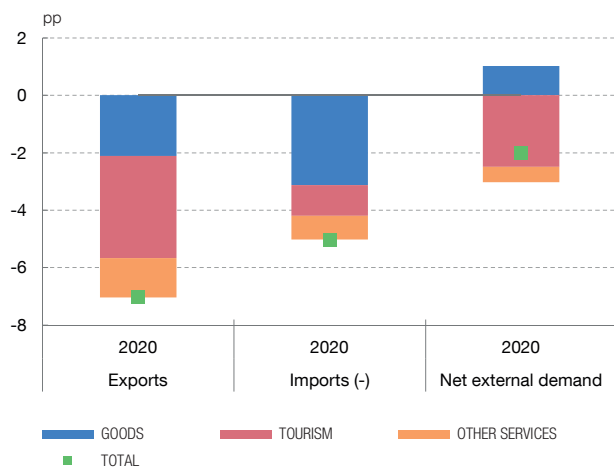
tourism represented 60.2% of total tourist spending in our country. Given the most sizeable share of the tourist sector in general, and of international tourism in particular, it is not surprising that the extraordinary collapse of this sector and international tourism flows since the start of the pandemic have contributed so notably to the decline in Spanish GDP. Indeed, a portion (3.5 pp) of the decline in Spanish GDP in 2020 is in response to the poor performance of tourism exports (see Chart 1.18.1).

Chart 1.18

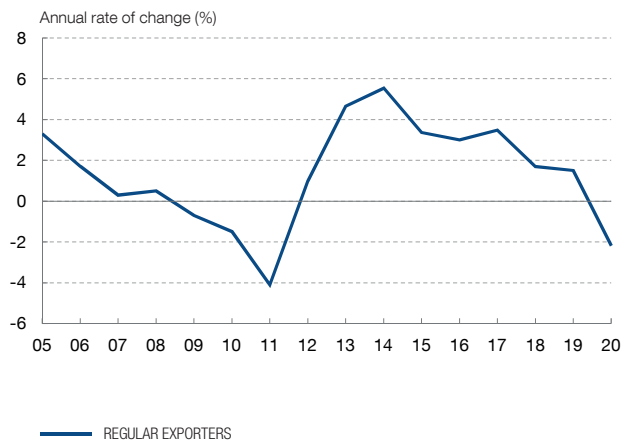
UNCERTAINTY OVER THE PATH OF RECOVERY OF INTERNATIONAL TOURISM AND THE EXPORT BASE

The collapse in international tourist flows since the start of the COVID-19 crisis has contributed most notably to the fall in Spain's GDP. How sharply these flows pick up in the coming quarters will depend not only on the course of the pandemic and the pace of progress in the vaccination process, but also on the scale of the persistent changes the crisis appears to have prompted in global tourism demand. The contribution of the external sector to Spanish economic growth in the future will be influenced by developments in the export base, which has fallen back in this crisis.

1 CONTRIBUTION OF THE EXTERNAL SECTOR TO THE CHANGE IN REAL GDP IN 2020



2 REGULAR EXPORTING FIRMS (a)



SOURCES: INE and Ministerio de Industria, Comercio y Turismo (ICEX).

a Exporters whose exports do not exceed €5,000 are excluded. Regular exporters are those that have exported in the year of reference and in each three immediately preceding years.



Looking ahead, there is notable uncertainty over the speed at which the tourist sector might recover. This will depend not only on how the health crisis unfolds and on the pace of the vaccination process (both in Spain and globally), but also on the scale of the lasting changes the pandemic may have caused regarding the demand for these types of services among the population. The results of the latest World Tourism Organization (WTO) expert panel are consistent with this high uncertainty and show sizeable dispersion as regards the expectations of recovery in the sector.³⁴ Thus, whereas 51% of the experts consulted expect tourist flows in Europe to regain their pre-pandemic levels in 2022, a very significant percentage of them (35%) puts back that date to 2023. In Spain's case, tourist sector expectations predominantly place the recovery of pre-crisis levels beyond 2022, and according to Exceltur, 67% of managers in the sector opt for this possibility.³⁵ Conversely, the percentage of those bringing forward this recovery to 2021 is a minority view (5%), while 28% consider that the gap will close in 2022.

The contribution of the external sector to Spanish economic growth in the future will be conditional upon the performance of the export base. With

34 See UNWTO (2021).

35 See Exceltur (2021).

regard to the export base, the year 2020 saw the interruption of the ongoing intensification of the Spanish productive system's degree of exposure to international markets. Also, the number of stable exporting firms – which had grown by 1.5% in 2019 – fell by 2.2% (see Chart 1.18.2).³⁶ The information available indicates this contraction fell mainly on SMEs. In this respect, there is much uncertainty as to whether these firms will be able to resume their export activity in the coming quarters (given the costs this activity entails and the observed increase in these companies' financial vulnerability), even if the recovery in international trade takes root.

3.3 Outlook for the Spanish economy in the short and medium term

The last Banco de España projections exercise envisaged three alternative scenarios to describe the possible course of the Spanish economy in the 2021-2023 period. The considerable uncertainty still clouding the health and macrofinancial situation of the Spanish economy made it advisable – as in other forecasting exercises conducted since the outbreak of the pandemic – for the latest macroeconomic projections of the Banco de España, published on 23 March,³⁷ to consider several alternative scenarios. These scenarios – dubbed *mild*, *baseline* and *severe* – differed essentially in their assumptions as to how the pandemic and the vaccination process were unfolding in the short term, and as to the impact the pandemic might have in the medium term on the productive system and agents' behaviour.

Despite their differences, the various scenarios point to a relatively robust recovery in economic activity as from the second half of 2021 (see Table 1.2). This recovery, which would also run into 2022, would essentially be underpinned by the gradual normalisation of the health situation (albeit at different speeds according to the scenario), the maintenance of a very accommodative economic policy (both fiscal and monetary wise) and the beginning of the launch of the NGEU programme in Spain. The three scenarios also envisage a progressive pick-up in international tourist flows and a gradual release of the reservoir of saving built up by households in recent quarters. These latter processes are expected to be less intense, especially in the short run, under the *severe* scenario (see Charts 1.19.1 and 1.19.2).

In any event, the three scenarios coincide in signalling that the impact of the current health crisis on the level of GDP, employment and the public finances will be relatively persistent. Thus, for example, under the *baseline* scenario, Spanish GDP would not regain its end-2019 level until 2023 (see Chart 1.19.3). As to

³⁶ A "stable exporting firm" is defined as one that exports for at least four consecutive years. Exporters with sales of less than €5,000 are excluded.

³⁷ See [Banco de España \(2021b\)](#).

Table 1.2

PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES OF THE SPANISH ECONOMY (a)

Annual rate of change in volume terms and % of GDP

	2020	March 2021 projections								
		Mild scenario			Baseline scenario			Severe scenario		
		2021	2022	2023	2021	2022	2023	2021	2022	2023
GDP	-10.8	7.5	5.5	1.6	6.0	5.3	1.7	3.2	4.6	2.2
Harmonised index of consumer prices (HICP)	-0.3	1.4	0.9	1.3	1.4	0.8	1.2	1.3	0.6	1.0
Unemployment rate (% of labour force). Annual average	15.5	15.9	13.9	12.8	17.0	15.1	14.1	18.3	17.2	16.1
General government net lending (+)/net borrowing (-) (% of GDP)	-11.0	-6.8	-3.9	-3.4	-7.7	-4.8	-4.4	-9.1	-6.5	-5.8
General government debt (% of GDP)	120.0	115.4	112.7	112.8	117.9	116.4	117.6	122.6	123.6	125.5

SOURCES: Banco de España and INE.

a Projections cut-off date: 16 March 2021. As at the projections cut-off date the 2020 budget deficit, public debt and definitive GDP figures were not available. The projections are made on the basis of an 11% decline in GDP in 2020, a budget deficit of 10.5% of GDP and a public debt of 117.1% of GDP.

employment, the three scenarios expect a further increase in the unemployment rate in 2021 – after that observed in 2020 – and only under the *mild* scenario would this rate stand below pre-pandemic figures in 2022 (see Chart 1.19.4). As to the public finances, the general government deficit is expected to decline gradually over the course of the projection horizon. However, under all the scenarios considered, the budgetary imbalance in 2023 would still be higher than that observed in 2019.

The developments in recent weeks, since the publication date of this projections exercise, do not substantially alter its forecasts. According to the Quarterly National Accounts flash estimate for 2021 Q1, released after the publication date of the Banco de España's latest macroeconomic projections, the Spanish economy's GDP is estimated to have fallen by 0.5% quarter-on-quarter, a figure very close to that of 0.4% projected under the baseline scenario. Domestic demand made a negative contribution to growth of 0.9 pp, which was partly offset by the positive 0.4 pp contribution by the external sector.

4 Economic policies in the short term

4.1 From a very resolute initial response to a more focused strategy

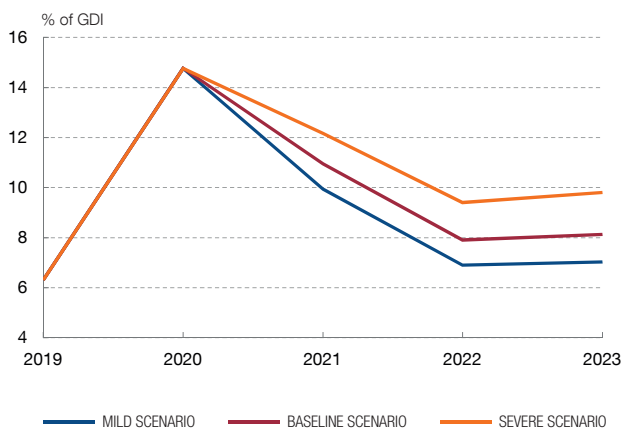
The swift response by economic policies worldwide has helped mitigate the strong adverse impact of the pandemic on economic activity. As noted in the

Chart 1.19

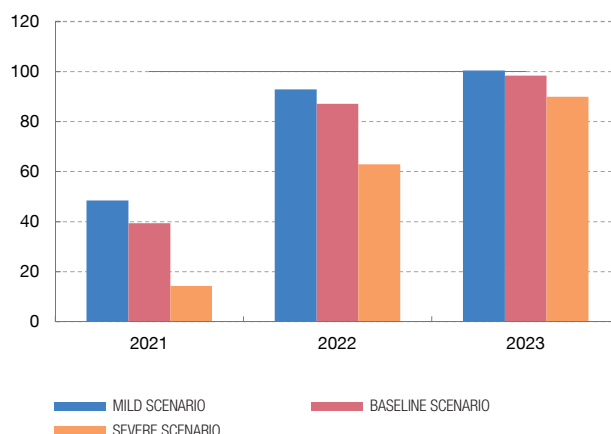
MACROECONOMIC SCENARIOS FOR THE SPANISH ECONOMY (2021-2023) (a)

The latest Banco de España projections envisaged three alternative scenarios to describe the possible course of the Spanish economy in the 2021-2023 period. Among other aspects, these three scenarios differ in terms of the paths international tourism flows and the household saving rate might follow in the coming quarters. The three scenarios concur in indicating that the impact of the current crisis on the level of GDP, employment and the public finances will be relatively persistent. Under the baseline scenario, Spain's GDP would not recoup its end-2019 level until 2023.

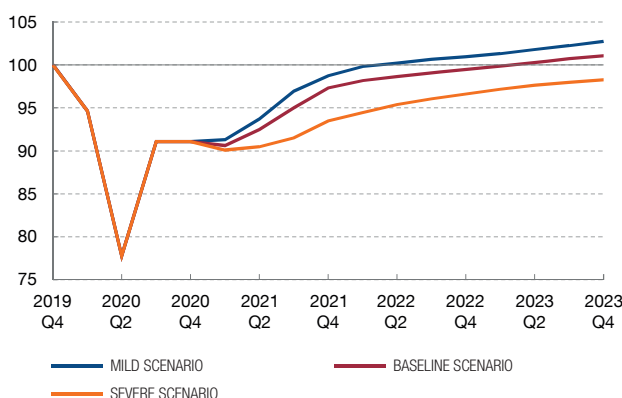
1 HOUSEHOLD AND NPISH SAVING RATES



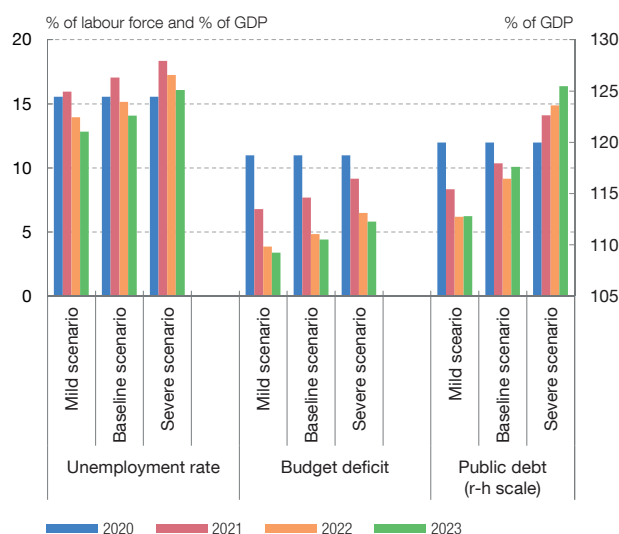
2 TOURISM EXPORTS (2019 = 100)



3 REAL GDP. LEVEL (2019 Q4 = 100)



4 UNEMPLOYMENT RATE, DEFICIT AND PUBLIC DEBT



SOURCES: Banco de España and INE.

a Banco de España March 2021 macroeconomic projections for the Spanish economy. Definitive data for 2020 are depicted, having been released after the projections cut-off date (except for the unemployment rate for that year, which was published beforehand).



previous sections, the economic crisis caused by the COVID-19 pandemic may be considered extraordinary in many respects, including the nature of the shock at its origin and the scale and unevenness of its impact. Another facet characterising the current health crisis is the swift and resolute response of economic policies, globally, in attempting to tackle the adverse economic effects of this extraordinary shock. Indeed, since the start of the pandemic, the reaction of fiscal, monetary, regulatory

and prudential policies have been notably ambitious, from a historical perspective, and have evidenced a high degree of synchronisation at the international level.³⁸ In combination, they will have helped cushion, to some extent, the impact of the crisis on households' and firms' employment, incomes and liquidity, credit flows, and the stability of financial markets and institutions. In doing so, these policies will not only have headed off the materialisation of highly disruptive macrofinancial scenarios in the short term, but will also have limited the lasting damage this crisis might entail for the growth potential of economies in the medium and long term.

The persistence of the crisis is leading to the maintenance or extension of the economic measures initially deployed, thereby avoiding a premature withdrawal of support. While the COVID-19 pandemic may be considered an eminently transitory shock, it is proving more persistent than initially envisaged. This has meant that the vast majority of the (markedly temporary) economic policy initiatives deployed nationally and supranationally in the initial phases of the health crisis have had to be extended in time or broadened in recent quarters. Thus, for example, in the fiscal policy realm, new, highly significant stimulus packages were rolled out in the United States in late 2020 and early 2021.³⁹ Moreover, in recent quarters, international financial institutions have continued supporting the low-income countries through extending the official debt moratorium agreed by the G-20 and via the emergency aid granted by the IMF. Also notable in the case of the IMF has been its use of precautionary lending, especially in the Latin American countries. The IMF is also likely to shortly approve a new general allocation of Special Drawing Rights (SDRs) for an amount of around \$650 billion, which will act as a supplement to all the member countries' international currency reserves. The persistence of the negative effects of the pandemic has also led to the maintenance, with some adjustments, of the regulatory measures approved in spring 2020.⁴⁰ Generally, the authorities have retained the recommendations on the use of capital and liquidity buffers,⁴¹ while progressively adjusting the recommendations on the distribution of profits.⁴² Likewise, in Europe, the European Banking Authority decided to extend the term of application of the guidelines governing the favourable prudential treatment of the moratoria on loan repayments, although it added safeguards and additional limitations.

However, as the recovery takes root, the approach of some of these policies is also being re-oriented, setting greater store by medium and long-term issues. In particular, in accordance with different national circumstances, the emphasis of

38 For a more detailed description of the specific measures deployed in these areas, see, for example, [Cuadro et al. \(2020\)](#) and [Alonso et al. \(2021\)](#).

39 See [Párraga and Roth \(2021\)](#).

40 See [Anguren et al. \(2020\)](#).

41 See [BIS \(2020\)](#).

42 In this connection, see the 15 December 2020 updates of the [ECB Recommendation](#) and the [Federal Reserve Recommendation](#).

fiscal policy has gradually changed from widespread support to firms' liquidity and the preservation of employment towards measures more targeted on the productive sectors most affected by the crisis and more geared to backing firms' solvency and the financial situation of the most vulnerable households. Further, fiscal policy is increasingly focusing on certain long-term challenges, such as climate change and digital transformation. This re-orientation of fiscal policy is especially evident in the case of the EU and the United States.⁴³ In fact, in the EU, where national fiscal policies are being complemented by a broad range of supranational measures (see Box 1.2), the funds linked to the NGEU recovery programme – which is analysed in greater detail in Box 2.3 and in Section 2.3.3 of Chapter 2 – are essentially aimed at boosting European economies' ongoing digitalisation and ecological transition. In the United States, the American Jobs Plan, included in the current Administration's plans,⁴⁴ is playing a similar role. Overall, these programmes should contribute to the composition of public finances proving more conducive to long-term economic growth and to redressing the declining trend of public and private investment observed in recent decades in the advanced economies.⁴⁵

The regulatory and supervisory authorities are also paying greater heed to the medium-term challenges in this area. The full implementation of Basel III remains a priority in the medium term to ensure sustainable recovery and the appropriate coverage of the risk measurement shortcomings identified in the wake of the 2008 crisis. Moreover, the regulatory focus is also shifting towards new risks, including those arising from the impact of digitalisation, climate change and the growth of non-bank financing. These are the main areas of concern and interest for the international financial authorities.

At the same time, some medium-term challenges associated with maintaining crisis lockdown policies for a prolonged period are becoming discernible. For example, as a result of the resolute fiscal policy response to this crisis, budget deficit and public debt levels have increased very significantly in practically all countries. In particular, in 2020, the budget deficit at the global level is estimated to have risen to 12.1% of GDP (2.9% in 2019), whereas public debt will have increased to around 100% of GDP, i.e. 14 pp up on 2019 (see Chart 1.20). These developments mean maintaining fiscal policy support to the recovery in the short term must be combined with restructuring plans in the medium and long term that allow room for manoeuvre to be restored ahead of potential new shocks in the future. From the regulatory and supervisory standpoint, it remains a priority to ensure that the measures adopted carry on offering continuity to the correct measurement and recognition of credit risk by banks, including appropriate classification of loans and of the level of provisions and capital. The supervisory and regulatory authorities are closely monitoring

43 On the fiscal policy response in the euro area and the United States, see also [Guirola, Kataryniuk and Moreno \(2020\)](#).

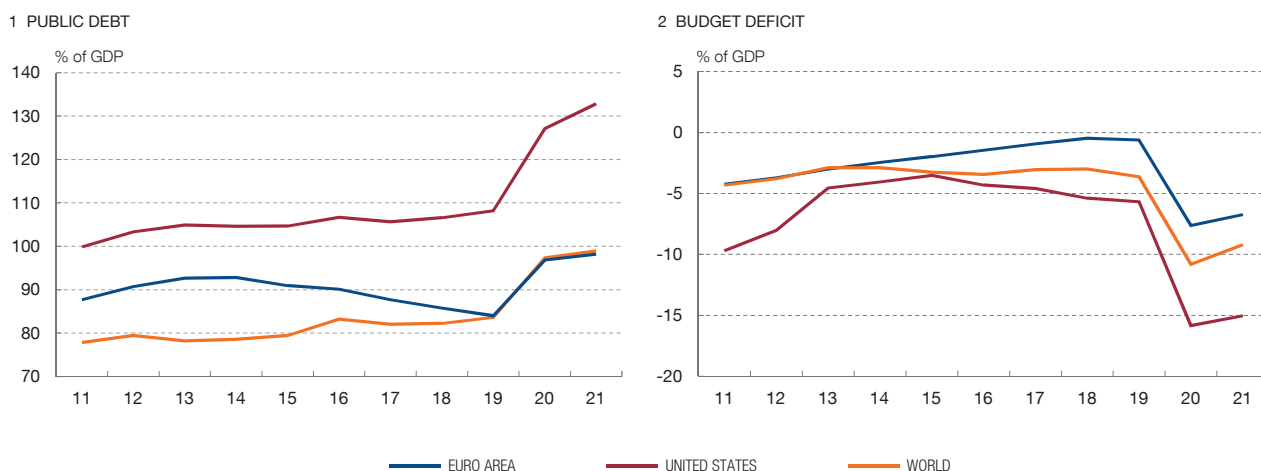
44 See [Arce et al. \(2020\)](#).

45 See [Banco de España \(2020c\)](#) and [Delgado-Téllez et al. \(2020\)](#).

Chart 1.20

THE GLOBAL ROLE OF FISCAL POLICY IN THE CRISIS AND IN THE RECOVERY IS PROVING CONSIDERABLE

The crisis has notably raised public debt and budget deficits in the euro area and in the United States. In the United States, the fiscal impulse has been particularly based on discretionary measures. In any event, the start-up of the NGEU programme will provide an additional fiscal boost in the EU.



SOURCE: IMF (WEO, April 2021).



developments in this area and the possible effects of the withdrawal of the support measures, which might result in significant distortions were it withdrawn prematurely.

The crisis has also highlighted the need to continue strengthening economic governance in Europe. As mentioned, at the supranational level, the EU has managed to forge a common, swift and extensive response to the economic crisis generated by the pandemic. This decision-making capacity and joint action has contributed to boosting European integration and has played a key role in preventing any further financial fragmentation in the euro area,⁴⁶ thus complementing the work of the ECB’s common monetary policy. Nonetheless, as set out in Box 1.2, it remains necessary to strengthen the European economic and financial architecture in different areas, including, for example, the reform of fiscal rules, the creation of a common and permanent fiscal capacity, the protection of the single market and the completion of the Banking Union.

4.2 The role of the European Central Bank’s monetary policy

At the onset of the pandemic, the ECB deployed a package of measures, which were subsequently extended and reinforced. Notable among these measures were the targeted longer-term term refinancing operations (TLTROs) and

⁴⁶ See Kataryniuk et al. (2021).

the pandemic emergency purchase programme (PEPP). Through the TLTROs, the ECB provides banks with financing under particularly advantageous conditions, provided they meet specific lending targets in respect of households and firms.⁴⁷ Through the PEPP, the ECB purchases sizeable volumes of public and private financial assets, and the purchases are distributed more flexibly over time and across issuers.

The ECB's response has been pivotal in maintaining favourable financing conditions in the euro area and preventing financial fragmentation in the region. Despite the recent tightening of bank lending standards in recent quarters, bank financing conditions have remained relatively easy and the cost of new lending has held at low levels in historical terms (see Chart 1.21 for the euro area as a whole and Chart 1.12 for Spain). The scope of the measures deployed by the ECB to mitigate the adverse effects of the health crisis on the supply of bank lending has also been highlighted in the Bank Lending Survey (BLS). This survey suggests that banks participating in TLTRO-III operations have already allocated a portion of the financing received to lending to households and firms.⁴⁸ The ECB's monetary policy response has also contributed to firms and euro area Governments being able currently to finance themselves under historically very favourable conditions on the capital markets (see Chart 1.3). In this respect, a detailed analysis of the behaviour of financial markets around the launch date of the PEPP highlights the fact that, in that period, this decision had a positive effect on the main euro area stock markets and prompted strong declines in sovereign debt yields (especially those of Italy and Spain). That duly checked capital market dynamics which, at the start of the crisis, had looked to be leading to growing financial fragmentation in the region.⁴⁹ Aside from these financial effects, Banco de España estimates indicate that the PEPP would also be having a significant positive impact on euro area GDP growth and inflation.⁵⁰

The flexibility provided by the PEPP is a key factor in the effectiveness of the ECB's monetary policy in this crisis. As earlier mentioned, the PEPP is one of the main tools of the ECB's response to this health crisis. This is not only because of its capacity to act on governments' and corporate issuers' yield curves, but also because of the operational flexibility that distinguishes this asset purchase programme from that in place before the pandemic (the APP). This flexibility has enabled the ECB to concentrate asset purchases at those junctures in the pandemic crisis – in particular, between April and July 2020 – and in those jurisdictions when and in which financing conditions were tightest, thereby increasing the PEPP's

47 To increase banks' capacity to obtain funds in the Eurosystem's TLTROs and other refinancing operations, at the start of the pandemic the ECB also made its collateral framework more flexible (i.e. the rules governing the eligibility and valuation of the collateral used in these operations), through measures such as valuation haircuts and the increase in Eurosystem national central banks' additional credit claim (ACC) frameworks.

48 See [Menéndez and Mulino \(2020\)](#). For greater details on financing to households and firms against the background of the COVID-19 crisis, see [Alves et al. \(2020\)](#) and [Alves et al. \(2021\)](#).

49 See [Banco de España \(2020b\)](#).

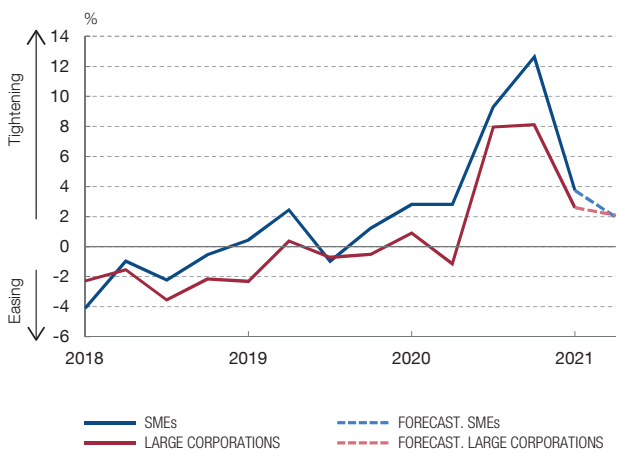
50 See [Aguilar et al. \(2020\)](#).

Chart 1.21

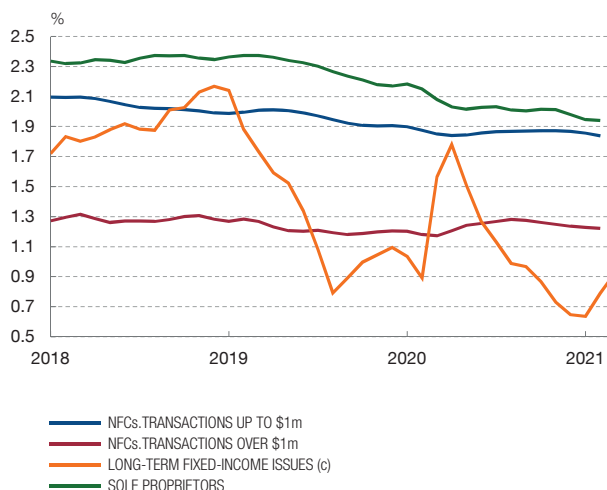
FIRMS' FINANCING CONDITIONS ARE HOLDING EASY IN THE EURO AREA, THOUGH THERE HAS BEEN A TIGHTENING OF LENDING STANDARDS

According to the BLS, lending standards have tightened recently. This trend might extend over 2021 Q2, both in the SMEs and large corporations segments. However, the financing costs of non-financial corporations in the euro area have held at low levels, assisted by the measures implemented by the ECB in response to the COVID-19 crisis.

1 BLS: CHANGE IN LENDING STANDARDS IN THE EURO AREA (a)



2 FINANCING COSTS IN THE EURO AREA (b)



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

- a BLS. Indicator = percentage of institutions that have tightened credit standards considerably × 1 + percentage of institutions that have tightened credit standards somewhat × 1/2 – percentage of institutions that have eased credit standards somewhat × 1/2 – percentage of institutions that have eased credit standards considerably × 1.
- b Bank lending rates are NDER (narrowly defined effective rate), i.e. excluding the related charges and fees, and are adjusted seasonally and for the irregular component.
- c Issues with a maturity of over ten years.



effectiveness. A recent Banco de España paper shows that the PEPP’s flexibility was particularly telling when it came to reducing the financing costs of the countries most affected by the crisis, such as Italy and Spain, as it significantly reduced the term and risk premia on their government bonds (see Chart 1.22).⁵¹

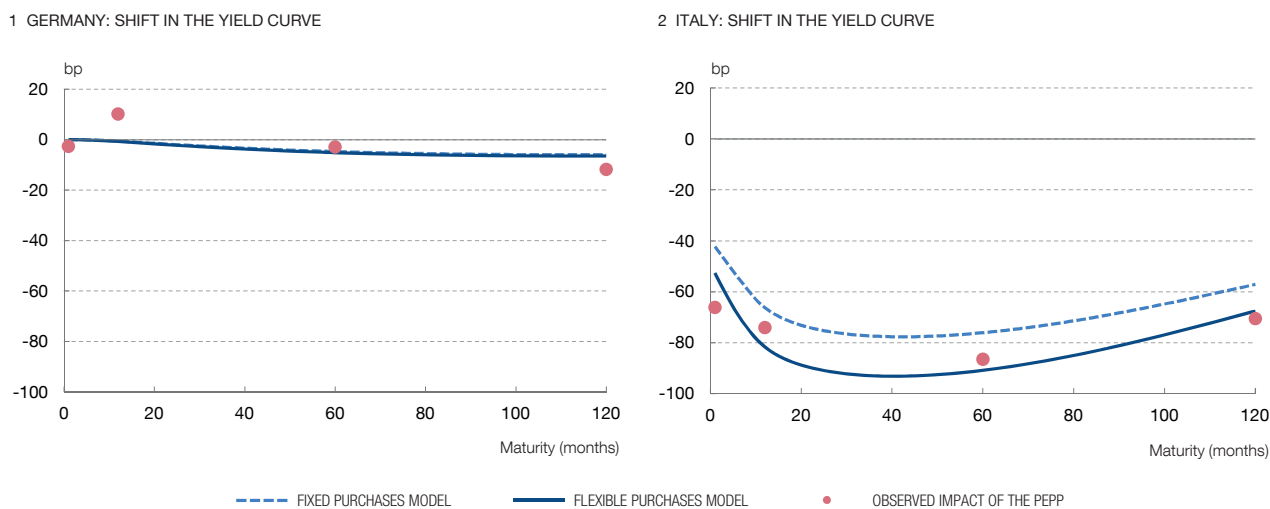
The PEPP has afforded fiscal authorities leeway to extend and maintain the measures supporting the economy. By way of illustration, net asset purchases under the PEPP in 2020 rose to an amount equivalent to over 90% of the euro area countries’ net public financing needs that same year (and almost 30% of gross needs), on preliminary estimates. This is particularly significant in countries such as Spain, whose pre-crisis deficit and public debt levels were already high. Hence, the ECB’s actions are preventing a potential significant increase in financing costs. Had such an increase arisen, it would have restricted national fiscal authorities’ capacity to support the economy.

51 See Costain, Nuño and Thomas (2021) for a more detailed discussion of the effects of the purchase programmes on a heterogeneous monetary union.

Chart 1.22

IMPACT OF THE ANNOUNCEMENT OF THE PEPP IN MARCH 2020 (a)

The PEPP has enabled the financing costs of households, firms and governments to be substantially reduced. One of its key characteristics is that it allows asset purchases to be distributed flexibly over time, across asset classes and jurisdictions. Without this flexibility, the impact of the programme would have been lower, especially in the countries most affected by the crisis, such as Italy and Spain.



SOURCES: Banco de España and Bloomberg.

a Observed impact of the announcement of the PEPP (18-20 March 2020). The impact on the data is calculated as the difference between the zero-coupon yield curve as at the close on 20 March less as at the close on 18 March. The theoretical impact is calculated using the Costain, Nuño and Thomas (2021) model, assuming that, at the time of the announcement, investors know the volume and time-distribution of the purchases. Flexible purchases replicate observed ones, while fixed purchases analyse the counterfactual case of a distribution of the purchases across countries according to the capital key and uniformity over time.



The fragility still characterising the ongoing economic recovery and price dynamics in the euro area advises maintaining a very accommodative monetary policy in the coming quarters. The ECB Governing Council has reiterated that it remains essential to maintain favourable financing conditions for households, firms and governments during the pandemic. In this connection, it announced last December that purchases under the PEPP programme would be made flexibly to prevent a tightening of financing conditions incompatible with the objective of countering the downward impact of the pandemic on the projected inflation path. Thus, in response to the increase in long-term interest rates observed since late 2020, the ECB announced in March that it expected a significant increase in the pace of PEPP purchases in the following quarter.

In any event, the euro area inflation outlook remains some distance off its medium-term objective. The latest ECB staff projections, published in March, place average inflation in 2023 at 1.4%, far removed from the objective of an inflation rate below, but close to, 2%. In this respect, the ECB has reiterated that it stands ready to adjust all its instruments to ensure inflation moves in a sustained fashion towards its objective.

4.3 The economic policy response in Spain

Domestically, the health crisis was also accompanied by a forceful economic policy response. The Spanish authorities adopted a wide range of measures, which have been analysed in various Banco de España reports.⁵² Their main aims were to provide greater resources to the health system, to protect employment (especially through the advantages of using furlough schemes), to support the most vulnerable households (e.g. with different types of moratoria and increased benefits in some cases) and to provide liquidity to firms (essentially by activating various public guarantee lines to promote lending to non-financial corporations – see Box 1.3).

As in other countries, this initial response has since been adjusted to changing economic circumstances. In particular, many of the measures deployed at the onset of the pandemic, with a temporary lifespan or with relatively limited pre-set amounts, have been extended over time on several occasions as the health and economic crisis has run for longer than first forecast. In this process of adaptation, the specific details of these economic policy measures have been recalibrated in order to target the measures more closely on the groups most affected by the pandemic.

One of the main instruments to mitigate the economic effects of the pandemic on firms' liquidity has been the ICO-administered public guarantee programmes. Since the start of the crisis, these programmes have contributed decisively to financing the liquidity needs of sole proprietors and firms, especially smaller ones.⁵³ Up to 31 March 2021, new credit generated thanks to these programmes has totalled €124 billion, of which €87 billion has been for SMEs and sole proprietors. Moreover, these programmes have progressively adapted over time, among other aspects, regarding the lines available, the total amount the guarantees could involve and the conditions of the loans granted under these programmes.⁵⁴

More recently, the main source of concern has shifted towards aspects linked to firms' over-indebtedness and solvency problems. The increase in indebtedness and the decline in firms' expected cash flows that has arisen as a result of the crisis have raised some companies' financial vulnerability, with potential adverse implications for economic recovery. Part of this changed setting is a new package of business support measures, for a total amount of €11 billion. The package was approved last March and has been revised in April so that the regional governments

52 See, for example, [Banco de España \(2020d\)](#) and [Hernández de Cos \(2020\)](#).

53 For an analysis of the impact of these business liquidity support measures, see Box 1 of [Alves et al. \(2021\)](#).

54 Thus, for example, [Decree-Law 34/2020](#) extended the maximum maturity of loans to 8 years (from 5 initially), and the maximum grace period to 24 months (initially 12 months). Likewise, the term for the granting of guarantees has been extended to 30 June 2021, as opposed to 31 December 2020 previously.

may have more flexibility in its application.⁵⁵ This package includes a framework of direct aid to the firms most affected by the crisis. The allocation of funds from this programme is based on straightforward criteria, which should provide for their implementation in a setting of some urgency, although their design might lessen the effectiveness in meeting the objectives pursued, as analysed in detail in Chapter 3 of this Report. The ultimate effectiveness of these measures will depend, in any event, on their swift and effective application and on their adaptability, in terms of size and design, to the course of the pandemic in relation to firms' economic and financial position.

Furlough schemes have also been a fundamental mechanism for protecting labour income and mitigating the rise in the unemployment rate.

As mentioned in Section 1.3, one of the differentiating aspects of this economic crisis has been the intensive use Spanish firms have made of furlough schemes as a temporary employment adjustment mechanism. At the trough of the downturn in activity, in 2020 Q2, furlough schemes covered more than 20% of employees in Spain compared with a percentage of less than 1% in the 2008 crisis. Since initially being established, the favourable conditions set for the treatment of furlough schemes, in force until late May 2021, have been subject to successive extensions and various amendments, in particular regarding arrangements for the exemption of social security contributions. These changes initially sought to encourage the resumption of work, in summer 2020, of furloughed workers. Subsequently, in the face of fresh waves of the pandemic, they sought to concentrate protection in those sectors and activities most affected.

Looking ahead, the design of furlough schemes must continue adapting to the changing economic and health situation. They must be increasingly targeted so as to provide for the necessary reallocation of employment to more productive firms and sectors.

Given the uncertainty still marking the current epidemiological and economic setting, furlough schemes should necessarily continue acting in the coming months as a basic support of employee-employer relations in those sectors where the pandemic and the measures deployed to contain it are prompting a sharp downturn or a slower recovery. At the same time, the design of this mechanism should continue pursuing a twofold objective: first, to maintain a relatively generalised level of protection; and second, to foment the future reallocation of productive resources across sectors and firms further to potentially structural changes in the relative demand of different sectors as a result of the pandemic. It should be stressed here that there are significant differences in the productivity levels of the different types of firms and sectors availing themselves of furlough schemes, which in many cases were already present before the pandemic broke. Thus, for example, the sectors with higher levels of protection as from the October 2020 extension of furlough schemes are characterised, on the whole, by a negative wage premium of around 10% compared with the other sectors in the economy (see Chart

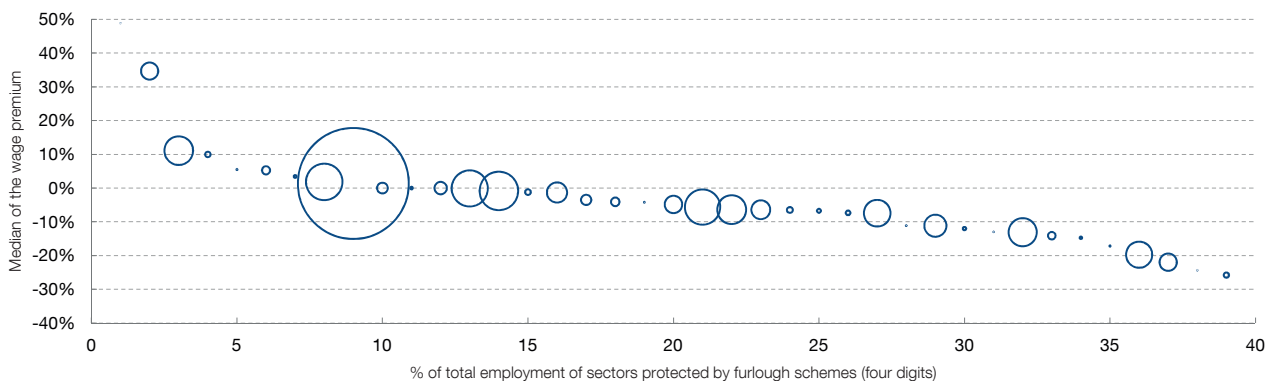
⁵⁵ See [RDL 5/2021](#).

Chart 1.23

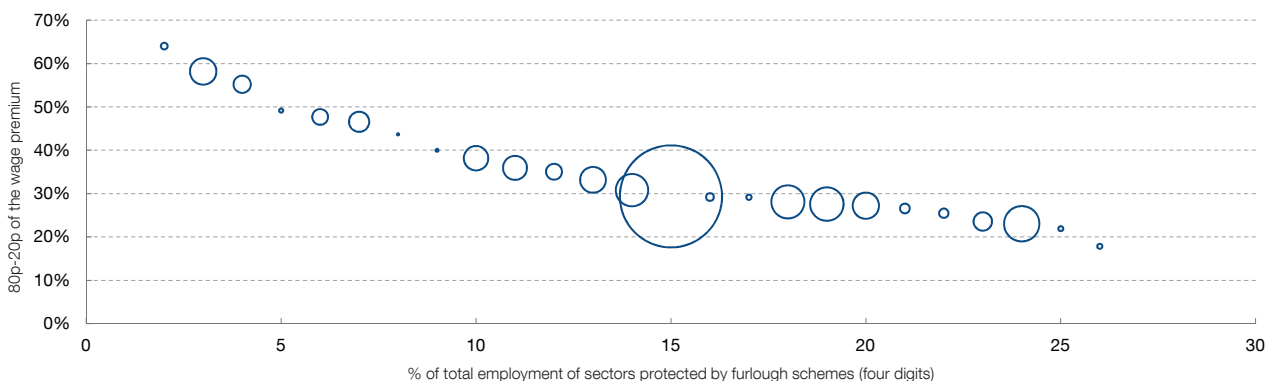
SIGNIFICANT PRODUCTIVITY DIFFERENCES AT FIRMS FROM SECTORS ESPECIALLY PROTECTED BY FURLOUGH SCHEMES

In some of the sectors with a higher level of protection under the current furlough scheme arrangements, a negative wage premium of over 15% can be seen. That would denote a negative productivity differential in these sectors of activity. High heterogeneity among the firms in these sectors can also be observed.

1 MEDIAN WAGE PREMIUM OF FIRMS IN SECTORS AFFECTED BY FURLOUGH SCHEMES, ACCORDING TO THE SHARE OF EACH SECTOR IN THE TOTAL EMPLOYMENT OF FURLOUGH SCHEME-AFFECTED SECTORS (a)



2 DIFFERENCE BETWEEN 80th AND 20th PERCENTILES OF THE WAGE PREMIUM OF FIRMS IN FURLOUGH SCHEME-AFFECTED SECTORS, ACCORDING TO THE SHARE OF EACH SECTOR IN THE TOTAL EMPLOYMENT OF FURLOUGH SCHEME-AFFECTED SECTORS (a)



SOURCE: Social Security General Treasury (Firm and Employee Data Panel, 2013-2016).

a A firm's wage premium is equal to the fixed effect of that firm when a regression is estimated of the logarithm of the wage on firm fixed effects, worker fixed effects, age dummies and year dummies. A sample of workers with full-time contracts and aged 25-55 is used. See Abowd, Kramarz and Margolis (1999) and Carneiro, Guimarães and Portugal (2012).



1.23). The heterogeneity within these sectors is also very high, and wage differences of over 40% between firms are observed.⁵⁶ Under normal conditions, these productivity differences should give rise to natural processes of cross-sectoral and cross-firm resource reallocation, resulting in aggregate efficiency improvements. Hence, in the current circumstances, given the high heterogeneity of the impact of

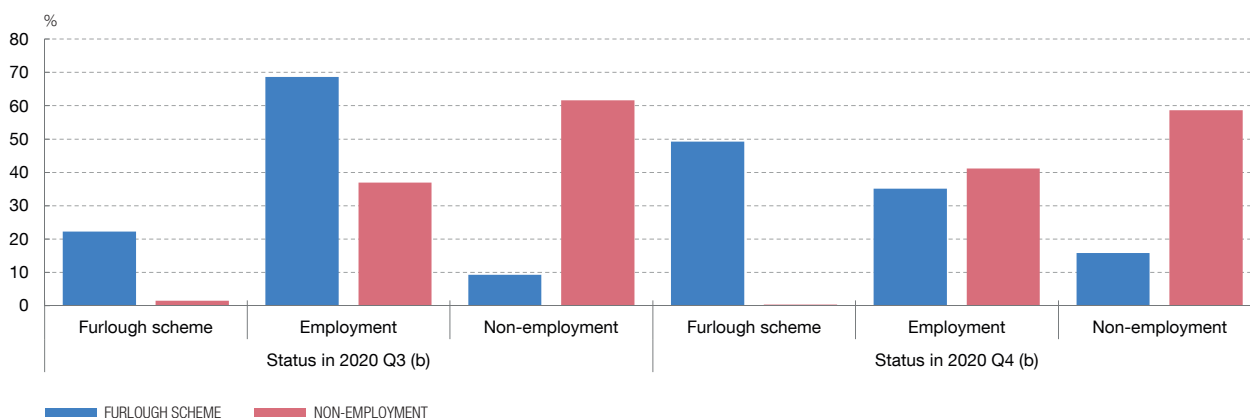
⁵⁶ Drawing on what is observed in the ratio of the 80th percentile to the 20th percentile of firms according to their average wage within each sector.

Chart 1.24

LABOUR FLOWS IN 2020 FOLLOWING A QUARTER WITHOUT WORKING OWING TO BEING FURLOUGHED, UNEMPLOYED OR INACTIVE

In 2020 Q3, the return to work of furloughed workers during the previous quarter was much greater than that observed among those who lost their jobs in that same period and became unemployed or inactive. However, this gap narrowed considerably in the final stretch of the year.

EMPLOYMENT STATUS AFTER HAVING SPENT A QUARTER BEING FURLOUGHED (SUSPENSION OF ACTIVITY) OR WITHOUT EMPLOYMENT (a)



SOURCES: Banco de España, drawing on EPA flows microdata.

- a Individuals who did not work in 2020 Q2 or Q3, either because they were furloughed or their activity had been suspended, or because they are unemployed or inactive (but not furloughed).
- b Individuals subject to short-time work schemes are classified as furloughed, and only those who have returned to work on normal working hours are considered as being employed.



the crisis, it is important that the various labour flexibility mechanisms, including those approved in response to the previous crisis, play a key role. They should provide for the adaptation of the productive system to the scenario generated by the pandemic and accommodate those reallocation processes that are structural in nature.

Given that the return to work by some groups of employees is hampered, it would be advisable to complement furlough schemes with other measures as the crisis stretches out. Between 2020 Q2 and Q3, furlough schemes proved to be an effective instrument for smoothing workers' re-incorporation into the labour market. In fact, almost 70% of furloughed workers in 2020 Q2 resumed effective employment in Q3, a percentage that was 30 pp higher than that observed for workers who lost their jobs in the same quarter and were not furloughed (see Chart 1.24).⁵⁷ However, the pace of affected workers returning to work falls appreciably when analysing the employment flows of those furloughed in Q3 or the employment status at end-2020 of those workers who had been furloughed for a longer time. For these workers, the probability of returning to work was closer to that observed among those not furloughed. In light of this evidence, it might be appropriate to complement this mechanism with other measures and review some of the aspects of its design. In particular, the exemptions from social security contributions applied

57 See Izquierdo, Puente and Regil (2021).

to firms might best be more closely linked to the participation of furloughed workers in training programmes that mitigate the human capital losses associated with long periods of inactivity and, potentially, allow for reallocation to other jobs. In this respect, as the crisis stretches out, it would be worth assessing whether the restrictions on dismissal for economic causes and the commitment to maintain employment in the six months following the return to work by furloughed employees might bear down negatively on the viability of some firms resuming their activity or hinder the aforementioned resource reallocation process. As detailed in Chapter 2 of this Report, the resort to furlough schemes will need to be accompanied by a review of active employment policies so as to reduce possible increases in the structural component of unemployment.

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GLOBAL EPIDEMIOLOGICAL DEVELOPMENTS

The COVID-19 pandemic has entailed a world health emergency, without precedent in the past century, that has already cost more than three million lives.¹ This box briefly describes how the disease has developed since its beginnings, the international differences observed in its incidence and the outlook for its future course.

The origin of the disease is still uncertain, but the first cases were documented in the Chinese city of Wuhan in mid-December 2019. During the first two months of 2020, when China was already tackling a first-order health crisis, the virus spread progressively through the rest of the northern hemisphere. Infections having surpassed 100,000 in more than 100 countries, the World Health Organisation declared the disease a pandemic on 11 March 2020 (see Chart 1.1).

In March and April, its rapid spread posed a huge challenge to highly saturated health systems, leading to the introduction of stringent containment measures, practically unprecedented in peacetime, such as home confinement (see Chart 1.2).² As a consequence, the spread of the virus slowed progressively, leading to a gradual easing of restrictions in most advanced economies from the second half of the second quarter. Meanwhile, the virus was spreading through the emerging economies, with particular virulence in Latin America.

In the summer, the incidence of the pandemic was relatively limited in the northern hemisphere, but infections and deaths rose progressively from September with much greater geographical heterogeneity than in the first wave. At global level, this new wave, which has cost many more lives than the first one, peaked in February 2021 (see Chart 1.3). Since then, the pandemic containment measures, which had been strengthened again during the autumn, have been intermittently eased, as progress has

been made with vaccination. In recent weeks there has been a rise in fatalities in the emerging economies, especially in India, where vaccination is lagging.

Against a background of notably heterogeneous containment measures, the incidence of the pandemic across geographical areas, as regards its timing, magnitude and persistence, has been very uneven, as can be seen, for example, in deaths per capita (see Chart 2). In the first few months, given the initial experience of China,³ the most widespread approach in the advanced economies was to impose general lockdowns and severe restrictions on personal mobility and on activity in certain sectors.⁴ However, some countries, such as South Korea, decided to focus their efforts on mass testing and thorough contact tracing.⁵ Subsequently, other countries (such as Japan, New Zealand and Australia) have followed a similar strategy and, with very strict controls on spread in the community, have managed to recover some degree of normal social activity. By contrast, certain other economies (such as Sweden, the United States and Brazil) opted for less restrictive containment measures from a normative perspective.⁶

Generally speaking, after the experience of the first wave, a broader range of measures was used to address the health crisis, and these tended to be more focused on specific areas or activities to try to minimise social and economic disruption. In any event, even in the most extreme episodes, the tightening of the pandemic containment measures during the second wave did not reach the level of stringency seen in the first phase. At the same time, regardless of the reaction of the authorities, there was also notable adaptation by households and firms. Indeed, the general public have been adapting their habits; for example, there has been a voluntary reduction

1 The number of deaths in other recent respiratory disease epidemics, such as SARS (2002-2004) and MERS (2012), did not reach even 0.1% of those caused by COVID-19 as at the cut-off date of this report.

2 See N. Haug, L. Geyrhofer, A. Londei, E. Dervic, A. Desvars-Larrive, V. Loreto, B. Piniór, S. Thurner and P. Klimekg (2020), "Ranking the effectiveness of worldwide COVID-19 government interventions", *Nature Human Behaviour*; and J. Dehning, J. Zierenberg, P. Spitzner, M. Wibral, J. Pinheiro, M. Wilczek and V. Priesemann (2020), "Inferring change points in the spread of COVID-19 reveals the effectiveness of interventions", *Science*, vol. 10. The Oxford Stringency Index, shown in the chart, has certain limitations. For example, the way that provincial and municipal measures are included in the index means that they have a considerable effect on its level, causing very marked rises that may not reflect the situation at national level.

3 China applied stringent localised lockdowns, which, at their peak, affected 10% of the population. See A. Buesa (2020), "China: Impact of the pandemic and economic recovery", Analytical Articles, *Economic Bulletin*, 4/2020, Banco de España.

4 See S. Flaxman, S. Mishra, A. Gandy, H. Juliette T. Unwin, T. A. Mellan, H. Coupland, C. Whittaker, H. Zhu, T. Berah, J. W. Eaton, M. Monod, A.C. Ghani, C. A. Donnelly, S. Riley, M. A. C. Vollmer, N. M. Ferguson, L. C. Okell and S. Bhatt (2020), "Estimating the effects of non-pharmaceutical interventions on COVID-19 in Europe", *Nature*, 257-261.

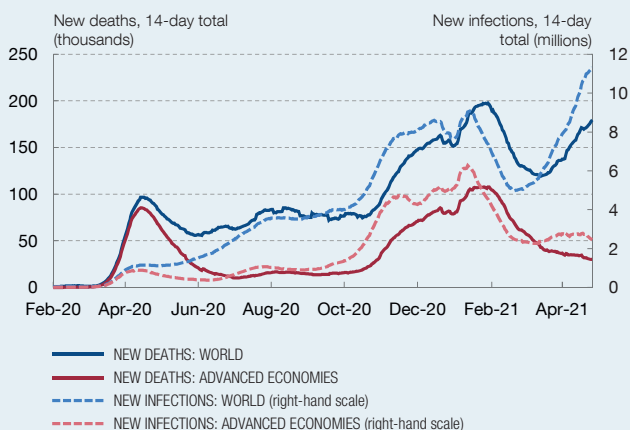
5 See B. Égert, Y. Guillemette, F. Murtin and D. Turner (2020), *Walking the tightrope: avoiding a lockdown while containing the virus*, OECD Economics Department Working Papers, No 1633.

6 See I. A. Moosa (2020), "The effectiveness of social distancing in containing Covid-19", *Applied Economics*, 52:58, pp. 6292-6305.

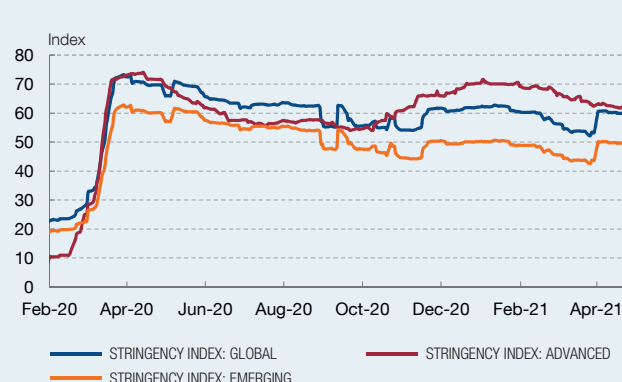
GLOBAL EPIDEMIOLOGICAL DEVELOPMENTS (cont'd)

Chart 1
COURSE OF COVID-19, VACCINATION AND EPIDEMIOLOGICAL PROSPECTS

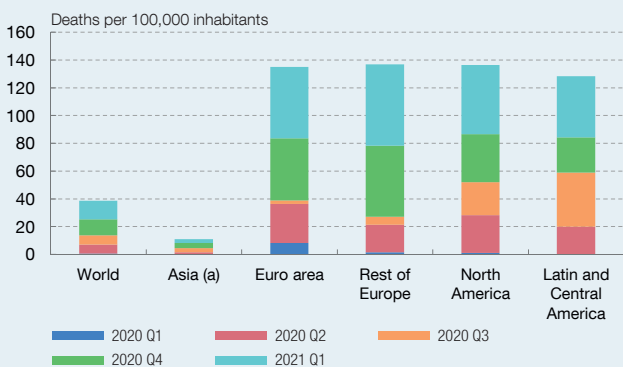
1 DEATHS AND INFECTIONS SINCE THE START OF THE PANDEMIC



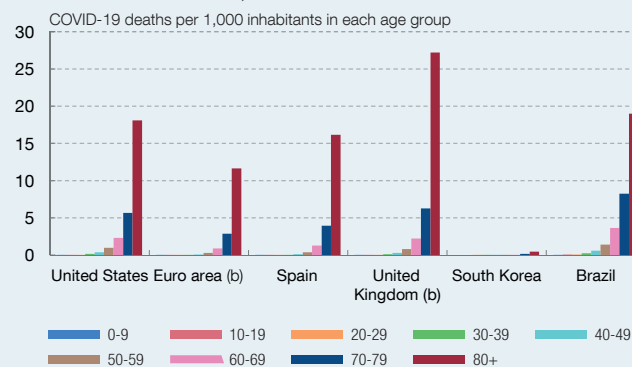
2 STRINGENCY OF CONTAINMENT MEASURES



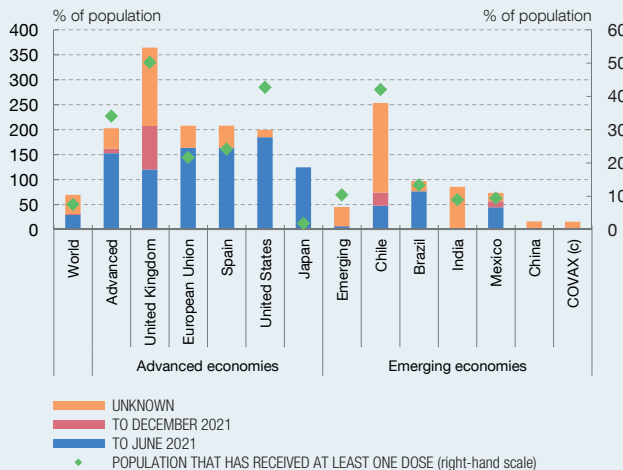
3 DEATHS IN THE DIFFERENT WAVES



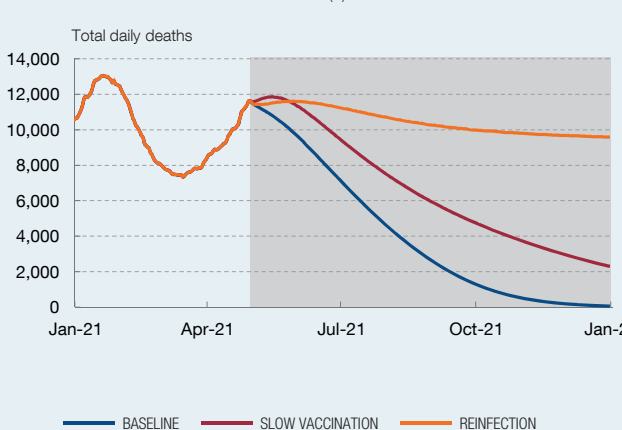
4 DEATH RATE FOR INFECTED, BY AGE GROUP



5 VACCINES ORDERED FROM PHARMACEUTICAL COMPANIES AND VACCINES ADMINISTERED



6 PANDEMIC DEVELOPMENT SCENARIOS (d)



SOURCES: World Bank, Bloomberg, Duke Global Health Innovation Center, Johns Hopkins University - Coronavirus Resource Center, Our World in Data, COVID-19 INED, COVerAGE-DB, Reuters, Oxford COVID-19 Government Response Tracker and Rungcharoenkitkul (2021).

- a Asia includes Russia.
- b The United Kingdom data are for England and Wales; the euro area data are for Germany, Spain, France and Italy.
- c Vaccines acquired under the COVAX initiative as a percentage of the population of emerging countries.
- d Scenarios considered by Rungcharoenkitkul (2021). The "baseline" scenario assumes linear progress in the rate of vaccination until all the doses ordered have been exhausted at the end of 2021. Under the "slow vaccination" scenario vaccination proceeds at a third of the rate under the "baseline" scenario. The "reinfection" scenario assumes that people lose their immunity 60 days after infection or vaccination.

Box 1.1

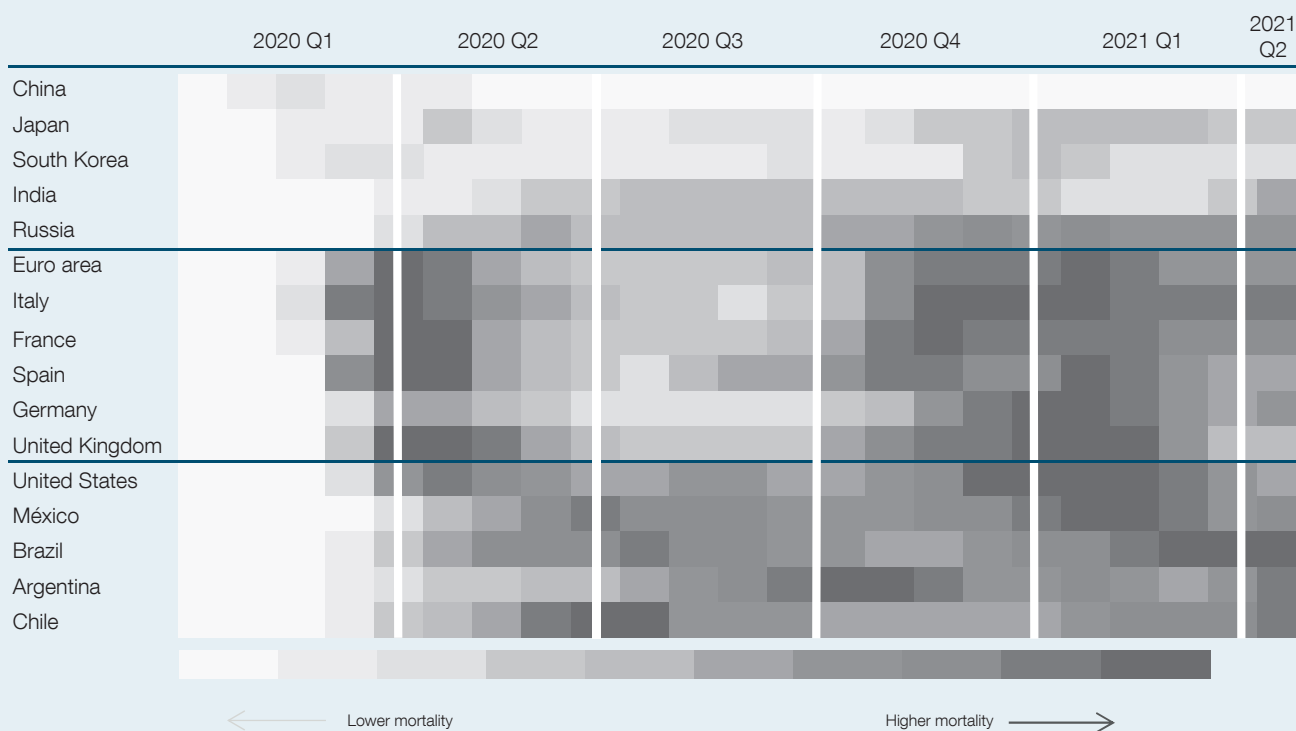
GLOBAL EPIDEMIOLOGICAL DEVELOPMENTS (cont'd)

in social interaction and mobility,⁷ in some economies with the support of firms, through their expansion of teleworking, digitalisation and e-commerce.

The determinants of the heterogeneity in the incidence of the virus and mortality across countries and geographical areas remain uncertain. The literature points to a set of factors that may partly account for it. For example, some studies associate greater spread of the disease with certain structural characteristics linked to personal interaction patterns, climate,⁸ population concentration and the productive system (the latter on account of the different importance of the activities that can benefit from teleworking and of those that involve a high degree of human contact). Other possible reasons for the

asymmetric impact of the pandemic by country include the demographic structure of the population, given the higher mortality in older age groups (see Chart 1.4), the quality of health systems⁹ and the proportion of the population that has acquired immunity having recovered from the illness or been vaccinated. A second group of factors is more related to sociological characteristics. For example, societies with customs involving more physical contact can be expected to have greater difficulty containing the spread of the virus, while those with prior experience of this type of disease should be better prepared.¹⁰ As already mentioned, the selection of the health strategy in each country may also have affected the heterogeneity observed in the incidence of the pandemic.

Chart 2
DEATHS PER CAPITA, BY COUNTRY (a)



SOURCE: WHO.

a Each shaded area corresponds to a 21-day interval.

7 See W. Maloney and T. Taskin (2020), "Determinants of Social Distancing and Economic Activity during COVID-19: A Global View", Policy Research Working Paper Series 9242, World Bank.

8 See C. Ghirelli, A. González, J. L. Herrera, and S. Hurtado (2021), *Weather, mobility and the evolution of the Covid-19 pandemic*, Working Papers, No 2109, Banco de España.

9 See Sussman (2020), "Time for Bed(s): Hospital Capacity and Mortality from COVID-19", *Covid Economics*, 11.

10 See A. Buesa, J. J. Pérez and D. Santabárbara (2021), "Awareness of pandemics and the impact of COVID-19", *Economics Letters*, forthcoming and Working Papers, Banco de España, forthcoming.

GLOBAL EPIDEMIOLOGICAL DEVELOPMENTS (cont'd)

The availability of various effective vaccines for COVID-19, within months of the pandemic emerging, is considered a medical milestone and key to overcoming the health crisis.¹¹ In particular, gradual immunisation of the population is expected to be accompanied by a reduction in mortality, the lifting of containment measures and a gradual return to normal of social and economic activity. The worldwide vaccination campaign was launched in December 2020 and, so far, 2% of the global population has been immunised. In addition, there are those who have some natural immunity as a result of having had the disease. Also, medical treatments have been developed that are reducing mortality and the after effects of the disease. Countries have already acquired sufficient vaccines to vaccinate more than 60% of the world population, which could be compatible with control over the disease this year, as long as they do not lose their effectiveness.¹² However, access to vaccines in advanced economies is much greater than in other countries despite the initiatives taken to boost the supplies to developing countries¹³ (see Chart 1.5). Vaccine roll-out at global level is highly uneven across countries, owing to the supply contracts with pharmaceutical companies, the logistical challenges of the different types of vaccines acquired and the capacity of health systems to administer them to the most vulnerable groups.

This baseline scenario, under which the disease is controlled this year, is uncertain, however, and a global medical solution may be delayed (see Chart 1.6). Thus, on one hand, it is possible that the vaccination plans are optimistic and may not be fulfilled. On the other hand, of particular concern is a possible loss of immunity due to the emergence of new variants of the virus – some of which may be more contagious or lethal – that reduce the effectiveness of the current vaccines and naturally acquired immunity. In this respect, virus mutations that result in a loss of immunity may be encouraged by excessively cautious vaccination strategies that delay complete immunity or that cover only part of the world population.¹⁴ This scenario of heightened persistence of the pandemic may entail the need for intermittent containment measures.¹⁵ Finally, when the pandemic is over, the disease could become seasonal, requiring regular prevention and vaccination drives.

Against this background, it is crucial that the authorities continue to strengthen health systems, in particular their preventive and rapid response capabilities, as well as the supply of vaccines and other medical equipment. In a global setting, for personal mobility to return to normal, international cooperation is also required, to ensure universal access to vaccines and the medical treatments available.

11 Several effective COVID-19 vaccines have been developed and clinically tested in record time (less than a year). This rapidity, facilitated by the financing available and the speeding up of approval processes, has also been a consequence of past experience in the development of vaccines against other recent diseases (e.g. SARS and MERS). For further information, see S. Su, L. Du and S. Jiang (2020), “Learning from the past: development of safe and effective COVID-19 vaccines”, *Nature Reviews Microbiology*, 19, 211–219.

12 See Rungcharoenkitkul (2021), “Macroeconomic consequences of pandexit”, Working Papers, No 932, BIS.

13 Notably, the *COVAX (Covid-19 Vaccines Global Access)* initiative, which aims for fair access to vaccines through a joint purchase mechanism for distribution among the emerging countries.

14 See O. J. Wouters, K. C. Shadlen, M. Salcher-Konrad, A. J. Pollard, H. J. Larson, Y. Teerawattananon and M. Jit (2021), “Challenges in ensuring global access to COVID-19 vaccines: production, affordability, allocation, and deployment”, *The Lancet*.

15 Experience with other diseases suggests there is a risk it will become chronic. See D. Morens and A. Fauci (2020), “Emerging Pandemic Diseases: How We Got to COVID-19”, *Cell* 182(5).

THE EU RESPONSE TO THE COVID-19 ECONOMIC CRISIS AND ITS NEW GOVERNANCE CHALLENGES

The European Union (EU) has forged consensus around a common response to the economic crisis caused by the COVID-19 pandemic (see Figure 1).¹ This response has significantly complemented the likewise resolute reaction of monetary policy. Particularly notable among the various initiatives approved is the creation of the *Next Generation EU* (NGEU) recovery tool, set out in greater detail in Chapter 2 of this Report. Though temporary, this programme is an unquestionable milestone in the Union's integration project, as it contains unprecedented elements of pooled solidarity and accountability.²

This ambitious response – reflecting partly the lessons learned in previous crises – has evidenced the EU's capacity for resolve and joint action. But it has also highlighted the need to continue strengthening its economic governance. This box sets out some of the main courses of future action needed to reinforce the European economic and financial architecture.

One such area for action of particular significance is the reform of European fiscal rules. In February 2020, the European Commission (EC) launched a review of fiscal governance, which was interrupted by the COVID-19 crisis and by the activation of the General Escape Clause (GEC).³ Adding to the reasons then identified for this review⁴ – among which were the excessive complexity of fiscal rules, which has led to a lack of transparency and predictability, and their inability to prevent fiscal policy procyclicality – is the strong worsening of national public

finances as a result of the pandemic and the need to safeguard public investment.⁵ According to the EC's proposal, and in order to preserve the fiscal impulse needed to entrench the recovery from the current crisis, the GEC will not be deactivated until the EU attains its pre-pandemic level of economic activity.⁶ However, the review of the fiscal rules should be resumed as soon as possible.

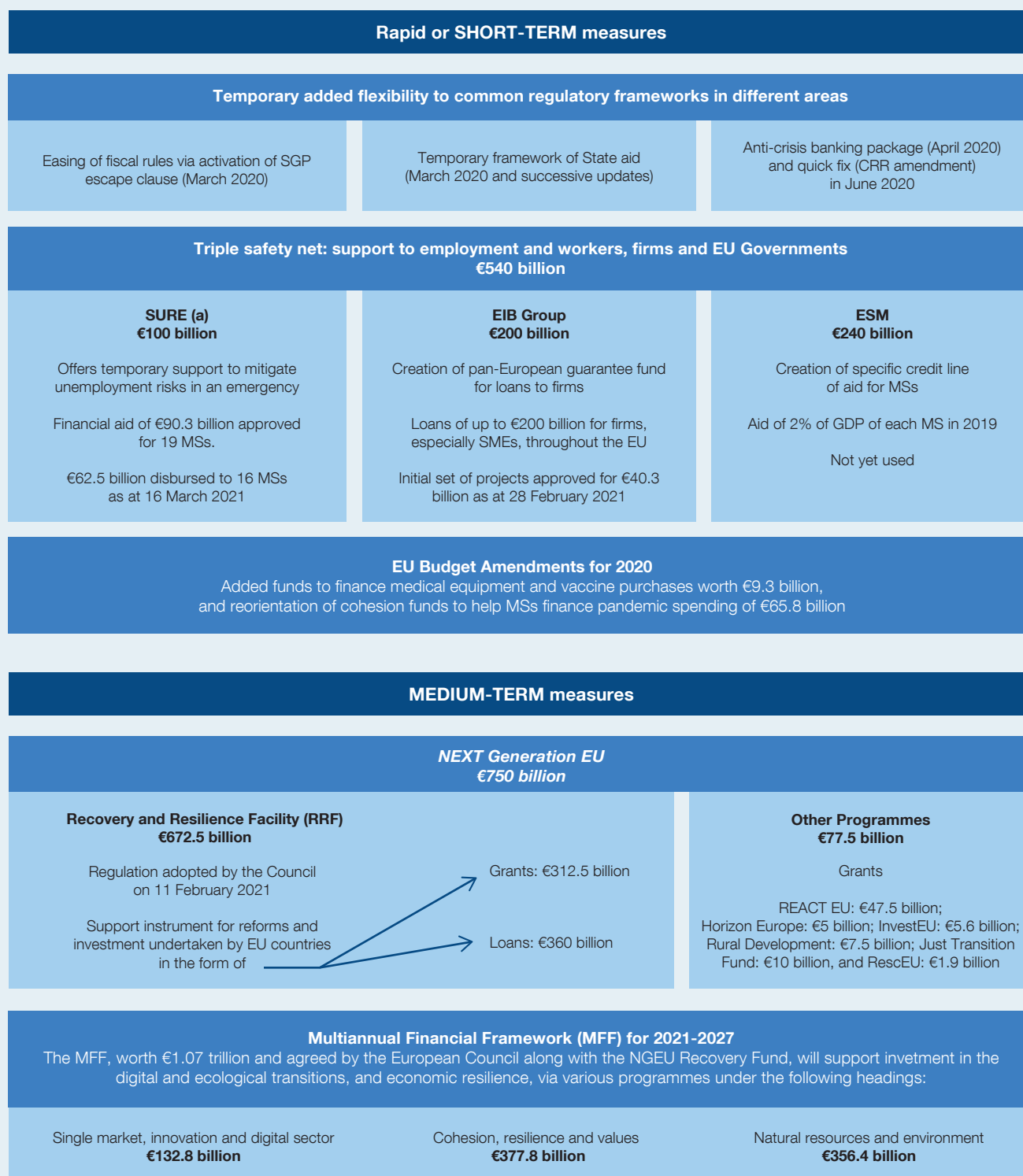
Another key component of the reform agenda is the creation of a common and permanent fiscal capacity in the euro area to address serious adverse shocks. That would prevent the European economic policy response in these episodes from having to depend essentially on ad hoc political agreements.⁷ This macroeconomic stabilisation mechanism would allow a common response to both systemic and idiosyncratic shocks, ensuring fiscal policy countercyclicality.⁸ This fiscal capacity might consist of an investment support instrument (which would contribute to raising the region's potential growth), the funding of common European projects (e.g. in the environmental and digital realm) or European unemployment insurance.⁹ Undoubtedly, with a view to establishing a permanent instrument of this type, at least for the euro area, it will be crucial to take in and draw inspiration from the lessons that may be learned from the design and implementation of the temporary programmes NGEU and SURE (Support to mitigate Unemployment Risks in an Emergency).

- 1 For a more detailed description of the various elements of the EU response to the pandemic, see, for example, Banco de España (2020), Chapter 3, *Annual Report 2019* and L. Guirola, I. Kataryniuk and C. Moreno (2020), "Fiscal policy response to the crisis in the euro area and the United States", Box 2, *Economic Bulletin*, 4/2020, Banco de España.
- 2 Chapter 2 of this Report analyses in depth the characteristics and implications of this programme. In addition, see Banco de España (2020), "Next Generation EU: main characteristics and impact of its announcement on financial conditions", and J. J. Pérez (2020), Thoughts on the design of a European Recovery Fund, Occasional Paper, no. 2014, Banco de España.
- 3 See European Commission (2020), "Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions. Economic governance review", COM(2020) 55 final and "Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact", COM(2020) 123 final.
- 4 See Box 4 "The reform of the fiscal surveillance framework in Europe", *Economic Bulletin*, 1/2020, Banco de España.
- 5 See Box 3.4 "The importance of an internationally coordinated fiscal policy response and its interaction with monetary policy", *Annual Report 2019*, Banco de España, and M. Delgado-Téllez, E. Gordo, I. Kataryniuk and J.J. Pérez (2020), *The decline in public investment: «social dominance»' or too-rigid fiscal rules?*, Working Paper no. 2025, Banco de España.
- 6 On current forecasts, this criterion would entail the deactivation of the GEC in 2023. However, once the GEC is deactivated, it may be necessary to resort to flexibility in the application of the Stability and Growth Pact (SGP) in those Member States that have not yet recovered the pre-crisis level of economic activity. See European Commission (2021), "Communication from the Commission to the Council. One year since the outbreak of COVID-19: fiscal policy response", COM(2021)105 final.
- 7 See European Fiscal Board (2020), *Annual Report 2020*.
- 8 For an analysis of the stabilisation capacity of a centralised fiscal capacity, see P. Burriel, P. Chronis, M. Freier, S. Hauptmeier, L. Reiss, D. Stegarescu and S. Van Parys (2020) *A fiscal capacity for the euro area, lessons from existing fiscal-federal systems*, Occasional Paper no. 2009, Banco de España.
- 9 For an analysis of the macroeconomic consequences of these instruments, see Chapter 4, "Fiscal policy in the euro area", *Annual Report 2016*, Banco de España.

THE EU RESPONSE TO THE COVID-19 ECONOMIC CRISIS AND ITS NEW GOVERNANCE CHALLENGES (cont'd)

Figure 1

THE EUROPEAN RESPONSE TO THE COVID-19 CRISIS. REGULATORY AND FISCAL MEASURES APPROVED BY THE EU



SOURCE: Banco de España, based on EU.

a SURE stands for *Support to mitigate Unemployment Risks in an Emergency*, and MSs for "Member States".

Fiscal matters aside, the financing of the NGEU and SURE programmes will involve the issuance of a very significant volume of euro-denominated pan-European bonds.¹⁰ These issues mark a major step on the road towards a European safe asset, although additional measures will be required in the coming years for its full development and consolidation. In this respect, a European safe asset would play a decisive role in weakening the link between bank and sovereign risk, promoting the international role of the euro¹¹ and fomenting the Capital Markets Union.^{12,13} Indeed, the latter is a fundamental project – all the more so following the United Kingdom's withdrawal from the EU – for increasing the integration of European capital markets and promoting private risk-sharing channels.

Along with the need to further financial integration in the EU is that of preserving its most valuable economic integration mechanism, namely the single market. During the COVID-19 crisis, the flexibility of its regulatory framework was used to ensure the support of the Member States to their economies, e.g. through State aid. However, any such national measures must be prevented from potentially fragmenting the internal market or undermining the level playing field.¹³ Looking ahead, the internal market must adapt to the changing circumstances of international competition, so as to preserve its external openness, but also to eliminate vulnerabilities. The design of an open strategic autonomy strategy seeks to strike this balance between the commitment to multilateralism and openness, and the goal of making European value chains more sustainable and resilient. To prevent certain aspects of this strategy from hampering convergence among the Member States and distorting the workings of the single

market, these measures should be accompanied by mutual insurance mechanisms guaranteeing the necessary internal cohesion.¹⁴

The euro area's financial architecture and crisis-management framework must also be strengthened. To complete the Banking Union requires setting in place a European Deposit Insurance Scheme (EDIS) with a risk-pooling component that is as extensive as possible. A credible political commitment here would represent a decisive contribution to ensuring financial stability in the euro area in the short and medium term.¹⁵

As regards the crisis-management and bank resolution framework, the approved amendment to the Treaty establishing the European Stability Mechanism (ESM) is a positive achievement in itself as it will be conducive, *inter alia*, to this mechanism becoming the financial backstop to the Single Resolution Fund in the resolution of significant institutions. However, outstanding issues remain, such as the provision of liquidity to institutions in resolution, a common regulatory framework for resolution in the face of systemic crises and a common European procedure for the administrative winding up of credit institutions.

Finally, in the current circumstances, inter-governmental responses (as in the case of the ESM), which require unanimity for their approval, have been relegated in favour of responses firmly anchored in the EU framework.¹⁶ It might be appropriate here to move forward with the EC proposal, backed by the ECB in 2018, to integrate the ESM as an EU body, so as to strengthen and cement its role in the management of future crises.¹⁷

10 See M. Delgado-Téllez, I. Kataryniuk, F. López-Vicente, and J.J. Pérez (2020), *Supranational debt and financing needs in the European Union*, Occasional Paper no. 2021, Banco de España.

11 See P. Hernández de Cos (2019), "The EMU at 20: from divergence to resilience", opening remarks at the Banco de España *Third Annual Research Conference*.

12 See Box 4, "The Capital Markets Union: New developments", *Economic Bulletin*, 3/2020, Banco de España.

13 To achieve a sound and resilient recovery in the EU economy calls for a fully operational and more integrated single market that can redress the weaknesses identified during the crisis. See the Conclusions of the Council of the European Union (2020), "A deepened Single Market for a strong recovery and a competitive, sustainable Europe", 11 September.

14 See P. L'Hotellerie, M. Manrique and A. Millaruelo (2021), "Open strategic autonomy in the EU", Box 5, *Economic Bulletin*, 1/2021, Banco de España.

15 See P. Hernández de Cos (2020), *The European response to the COVID-19 crisis*, opening address at the Fundación Internacional Olof Palme Conference.

16 See A. Westerhof (2021), *Reform of the European Stability Mechanism signed: a landmark achievement fully respectful of EU constitutional and institutional limits*, EULawLive, Weekend Edition no 50.

17 See European Central Bank (2018), *Opinion CON/2018/20*, general observations.

ECONOMIC POLICIES DEPLOYED TO MITIGATE THE LIQUIDITY RISKS OF FIRMS AND SOLE PROPRIETORS IN SPAIN AND THEIR INTERNATIONAL COMPARISON

The containment measures adopted in response to the health crisis have had a major impact on business activity, as reflected in a significant increase in firms' and sole proprietors' liquidity needs. At the same time, the increase in lenders perception of risk in debt markets prompted expectations of a tightening of financing conditions. In order to mitigate these liquidity risks, policymakers rapidly deployed economic policies in various areas, at both national and supranational level, the main features of which are described in this box.

In the area of fiscal policy in Spain, mention should be made of the public guarantee schemes managed through the ICO. The first guarantee scheme, for up to €100 billion, was aimed at financing the liquidity needs of firms and the self-employed. The second scheme, for up to €40 billion, was mainly targeted at financing fixed-asset investment, although its aims also include coverage of liquidity needs. Under these guarantee schemes, the government covers up to 80% of the potential losses on loans granted by financial institutions, thus supporting the supply of credit.¹ As at 31 March 2021, these two schemes had jointly provided loan guarantees for a total amount of €93.9 billion, representing total lending of €123.6 billion.² Furthermore, €4 billion of the envelope of the first scheme were used as a guarantee for commercial paper issued in the alternative fixed-income market (MARF by its Spanish abbreviation), €600 million of which have been taken up, and €500 million to back the counter-guarantees granted by Compañía Española de Reafianzamiento (CERSA). These amounts were reinforced through the second guarantee scheme.³

Furthermore, compared with other forms of bank lending, loans under the guarantee scheme are granted under

favourable conditions in terms of both interest rate and maturity.⁴ Following approval of the resolution of the Council of Ministers of 24 November 2020, the maximum term of loans granted was extended to eight years (from the initial five years in the guarantees provided under the first facility).⁵ In addition, pursuant to Royal Decree-Law 5/2021, the deadline for granting of guarantees was extended to 31 December 2021. This Royal Decree-Law also extended to year-end the insolvency moratorium, which had been previously extended to 14 March 2021,⁶ with the aim of preventing firms that continue to experience temporary, pandemic-related financial difficulties from having to file for insolvency and being eventually wound up.

In the other large European economies, public guarantee schemes for business loans were widespread and a high volume of funds was used, although with notable differences in terms of their specific features and take-up.⁷ Among the largest euro area countries, France, Italy and Spain granted guarantees for a significant share of their GDP in early 2021, whereas Germany used these schemes to a lesser extent (see Chart 1). In particular, funds taken up in Spain reached 8.4% of GDP in 2020, 2.4 pp less than in Italy, but 6.5 pp more than in Germany. However, the take-up of guarantee schemes decreased in all these countries in the last few months of 2020 and at the beginning of 2021.

In the fiscal policy area, the various income support policies deployed have contributed to alleviating the financial position of firms. Noteworthy in this connection are furlough schemes (ERTE, by their Spanish abbreviation), under which companies whose business activity was affected by the COVID-19 crisis were allowed

- 1 These guarantees generally cover up to 80% of potential losses on bank loans to the self-employed and to SMEs, and up to 70% on bank loans to companies that do not meet the European Commission's definition of SME.
- 2 Of the total amount guaranteed, €90.1 billion relate to the facility approved by Royal Decree-Law 8/2020 of 17 March 2020, and €3.8 billion to the facility approved by Royal Decree-Law 25/2020 of 3 July 2020.
- 3 At the cut-off date of this Report, €50 million of the second ICO guarantee facility had been used to secure commercial paper issued on the MARF by firms under arrangement with creditors, €250 million to secure commercial paper issued on the MARF by companies which could not benefit from the tranche of the first facility since they were in the roll-over phase of their commercial paper programme, and €500 million to reinforce the counter-guarantees provided by CERSA.
- 4 For further details, see Banco de España (2020), "Developments in bank finance for productive activities in the context of the COVID-19 crisis", Box 4.3, Annual Report 2019.
- 5 For transactions arranged prior to 18 November 2020, Royal Decree-Law 34/2020 made it possible to request from banks an extension of up to three years of the maturity of loans guaranteed under Royal Decree-Law 8/2020, and an additional extension of up to 12 months of the grace period of loans granted pursuant to Royal Decree-Law 8/2020 and Royal Decree-Law 25/2020, with respect to initially agreed maturities and grace periods.
- 6 Royal Decree-Law 34/2020 of 17 November 2020.
- 7 For further details on the policies applied in other countries, see Cuadro Sáez, L., F. López Vicente, S. Párraga Rodríguez and F. Viani (2020), *Fiscal policy measures in response to the health crisis in the main euro area economies, the United States and the United Kingdom*, Occasional Papers, No. 2019, Banco de España.

ECONOMIC POLICIES DEPLOYED TO MITIGATE THE LIQUIDITY RISKS OF FIRMS AND SOLE PROPRIETORS IN SPAIN AND THEIR INTERNATIONAL COMPARISON (cont'd)

to suspend employment contracts for a specific period of time, thus reducing their staff costs, while maintaining the labour relationship with their workers (see Chart 2). In particular, in Spain the number of workers covered by these schemes, which exceeded 3.5 million in April last year, was around 740,000 at end-March 2021. This instrument, which, as at the cut-off date of this Report, had been extended to 31 May 2021,⁸ also partly exempts companies from social security contributions according to their size and situation. In addition, an extraordinary discontinuation of activity benefit was established for the self-employed affected by the health crisis. Altogether, these income support measures amounted to 2.5% of GDP in 2020.

Like Spain, France and Italy strengthened their partial and temporary unemployment regimes. Additionally, Germany made its existing short-time work compensation mechanism more flexible, whereas the United Kingdom and the United States opted to support employee retention through loans and grants. Furthermore, since the onset of the crisis, European countries also resorted

to tax deferrals, tax exemptions or direct transfers. In view of the persistence of the pandemic, many of the measures adopted in the main euro area economies have been extended since their initial implementation and will be in force at least until the end of 2021.

To protect the business sector, liquidity support measures were also implemented in Spain through the deferral of loan instalments, of tax payments and of other charges. These measures allowed companies and sole proprietors to apply for a moratorium or deferral of social security contributions, and individuals to benefit from moratoria on mortgage and non-mortgage loans. Furthermore, moratoria were established for mortgage loans on property used for business activities in the tourism sector, and for payments under agreements to lend, lease or rent vehicles in the public transport of goods and the charter bus sector.⁹ Based on the information available to end-March, the outstanding amount of loan payments suspended under these two types of moratoria for the tourism and transport sectors exceeded €2,495 million. Further measures were approved, such as the possibility

Chart 1
TAKE-UP OF PUBLIC GUARANTEE SCHEMES IN THE EURO AREA
Cumulative data from March 2020

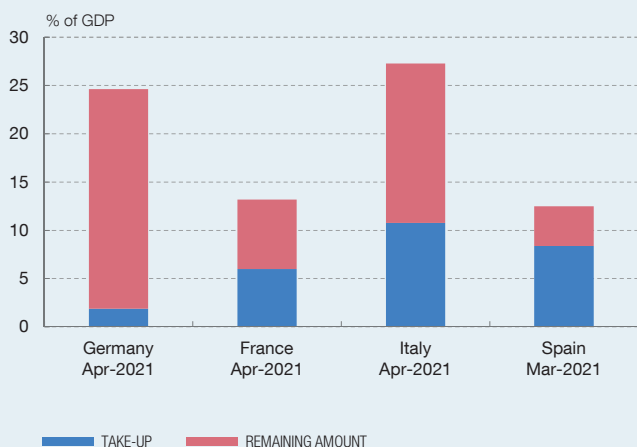
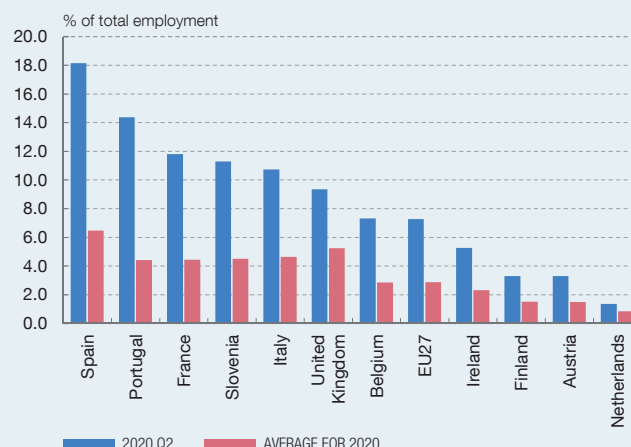


Chart 2
FURLOUGHED WORKERS



SOURCES: Banco de España, Bruegel, Eurostat, ICO, INE, KfW, Ministère de l'Économie, des Finances et de la Relance and Sace Simest.

8 Royal Decree-Law 2/2021 of 26 January 2021.

9 By Royal Decree-Law 3/2021 of 2 February 2021, which extended the deadline for application for these moratoria and adapted their maximum term, and under legislative and banking sector moratoria applicable to individuals, in accordance with the European Banking Authority guidelines in this connection.

ECONOMIC POLICIES DEPLOYED TO MITIGATE THE LIQUIDITY RISKS OF FIRMS AND SOLE PROPRIETORS IN SPAIN AND THEIR INTERNATIONAL COMPARISON (cont'd)

of applying for moratoria on rental payments or for tax deferrals,¹⁰ as well as measures adapting the calculation of taxes payable to the exceptional economic situation.

Since the outbreak of the pandemic, several industrialisation support measures were also implemented, some of which were subsequently reinforced. In Spain, the deadlines for repayment of the public loans managed by the General Secretariat for Industry and SMEs and the suspension of interest and principal payments on *Emprendetur* loans in the tourism sector were extended in March 2021. Moreover, international firms, or firms in the process of internationalisation, benefited, among other things, from expense refunds and grants as a result of the cancellation of international trade promotion activities, and from liquidity support for export companies through CESCE (the Spanish export credit agency).

In the monetary policy area, the ECB adopted several measures to support lending to the non-financial private sector by providing funding to banks on very favourable conditions.¹¹ In particular, the ECB introduced new longer-term refinancing operations (LTROs), improved conditions for targeted longer-term refinancing operations (TLTRO III operations, specifically designed to encourage lending to businesses and households) and eased its collateral

framework to increase the amount of funds that banks can borrow in these operations.

Furthermore, the ECB introduced the Pandemic Emergency Purchase Programme (PEPP) to ease financing conditions in the euro area and to address the emerging financial fragmentation across jurisdictions. The maximum purchase amount is currently €1.85 trillion.¹² The design of the PEPP allows for great flexibility in the distribution of asset purchases over time and across jurisdictions to achieve its objectives more effectively.

Finally, financial policies have also played a role in supporting bank lending to businesses. Specifically, both macroprudential and microprudential capital and liquidity requirements for European banks were eased. In addition, European regulations on capital requirements were amended by modifying rules affecting sovereign exposures, impairments on non-defaulted exposures, SME support factors and software development deductions, among other elements of bank capital calculation. In general, these regulatory amendments involve an increase in capital ratios, leaving banks with larger buffers to absorb potential losses on their loan portfolios and to increase their capacity to provide new lending.

¹⁰ Royal Decree-Law 5/2021 of 12 March 2021 extended to four months the period in which no late-payment interest is accrued on tax payment deferrals that had already been established in Royal Decree-Law 35/2020 of 22 December 2020.

¹¹ For further details on the monetary policies implemented, see Aguilar, P., Ó. Arce, S. Hurtado, J. Martínez-Martín, G. Nuño and C. Thomas (2020), *The ECB monetary policy response to the COVID-19 crisis*, Occasional Papers, No 2026, Banco de España.

¹² For more details on the impact of this measure on the financial conditions in the euro area, see Banco de España (2020), *Box 3.3, Annual Report 2019*.

