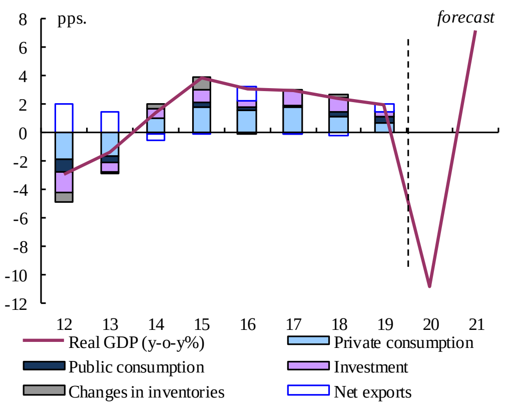
2.6. SPAIN

The severe outbreak of the COVID-19 pandemic in Spain and the confinement measures taken in response since mid-March have resulted in an unprecedented contraction of activity in the first half of the year, with the service sector being the most affected. Sentiment and economic indicators bottomed out in April and improved in May, when restrictions started to be lifted in a gradual and differentiated way across sectors and regions. The country entered a ‘new normality’ in late June, during which social distancing measures will remain in place until further notice. These measures, together with changes in consumer behaviour, are expected to have a long-lasting impact on activities in which personal interaction is intrinsic to the provision of the service, such as food and accommodation, retail trade, personal services, and arts and entertainment. In the case of international tourism, the impact will be aggravated by reduced flight connectivity, despite the gradual opening of borders. Activity in the manufacturing sector is expected to resume more quickly than in the services sector. Still, disruptions in global value chains and weak demand may impede a normalisation of industrial activity before the end of the year.

The economic impact of the confinement in the first half of 2020 looks likely to turn out worse than expected in the spring forecast. This will not be fully offset by the rebound expected in the second half of 2020 as most restrictions to activity are lifted. As a consequence, annual GDP growth in 2020 is now forecast at almost -11%, about 1½ pps. lower than projected in spring. Activity should continue recovering during the first half of 2021 and then moderate gradually in the second half. This, together with a strong positive carryover from the last quarters of 2020, would bring annual GDP growth to about 7% in 2021 (broadly unchanged since spring), leaving the volume of output in 2021 about 4½ % below its 2019 level.

Short-time work schemes (‘ERTEs’) have helped to limit large-scale job losses so far. Still, the disproportionate impact of the crisis on labour intensive sectors will result in a significant rise in the unemployment rate, and further increases are likely once ERTEs are phased out. Although private consumption is not expected to recover its pre-crisis level over the forecast horizon, it should bounce back more quickly than other demand components, as the forced increase in savings imposed by the lockdown is partly reversed. Investment is expected to rebound more slowly due to weak demand, high uncertainty, liquidity shortages, and impaired profitability. Net exports are expected to detract from growth this year due to weak receipts from international tourism, and become positive again next year as the sector starts to recover.

Graph 2.6: **Spain - Real GDP growth and contributions**



Owing to the marked drop in oil prices, headline inflation is expected to decline from 0.7% in 2019 to -0.1% this year, before picking up to 0.9% in 2021, as base effects fade away.