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Muted growth of Spanish service sector in July

KEY FINDINGS

Activity gains restricted by weakness in demand
Job losses recorded again
Margins under pressure as charges cut further

Spain’s service sector grew for a second successive month during July, but only modestly as levels of incoming new business disappointed and firms continued to operate below capacity. Jobs were again cut, whilst expectations remained historically subdued. Operating expenses rose further, but profitability was again under pressure as firms enacted another round of output price discounting.

July’s headline Business Activity Index, which is based on a single question asking firms to comment on developments in their activity since the previous month, posted above the 50.0 no-change mark for a second successive survey period. At 51.9, the index was also up on June’s 50.2, and its best level for five months.

However, the rate of growth signalled by the index was modest and well below its historical average. Despite reports of the further reopening of the economy, levels of new business placed with service providers failed to ignite. According to July’s survey, new work returned to contraction territory (albeit marginally). Panellists commented that market activity was struggling to regain traction despite the easing of lockdown measures related to the global coronavirus disease (COVID-19) pandemic.

With activity up and new business down, firms were able to comfortably keep on top of existing workloads, as evidenced by a drop in work outstanding for a fifth successive month. Job losses were also recorded despite reports of some staff being brought back from furlough. Evidence from the survey panel suggested that disappointing and insufficient sales volumes had led to forced redundancies and layoffs.

Nonetheless, there were again reports from firms of higher employee expenses during the month. Allied with an increase in fuel prices, plus increased costs related to enacting COVID-19 precautions, overall operating expenses rose for a second successive month in July. The rate of inflation was however noticeably slower than June’s recent high.

Margins came under pressure as firms continued to struggle to pass on higher costs to their clients. Latest data showed that discounting of output charges was recorded for a fourth successive month in July. Deflation was also firmer than in June, with firms signalling a need to offer lower prices in a bid to retain and stimulate sales.

Finally, confidence remained inside positive territory during July but was well below its historical trend with many firms signalling considerable uncertainty about the future. Panellists indicated that activity levels over the coming months will be determined by the evolution of COVID-19, with several panellists indicating worries over a ‘second wave’ and the potentially damaging impact on their businesses.
Spain’s private sector economy returned to growth during July, expanding for the first time in five months as both manufacturing and service sector activity increased. After accounting for seasonal factors, the Composite Output Index* recorded 52.8, up from 49.7 in the previous month, to signal a solid rate of growth that was the best since April 2019.

It was manufacturers that were the primary drivers of growth, with output in the sector rising to the strongest degree for nearly two-and-a-half years. Solid expansion was seen in services but gains here were restricted by a slight fall in new orders. In contrast, manufacturing order books rose at the fastest pace since March 2018.

Private sector job losses were recorded for a fifth successive month, although rates of decline across the manufacturing and service sectors eased in each instance. Job losses were again driven by a general lack of overall workloads, as backlogs of outstanding business declined again in July.

Meanwhile, operating expenses increased modestly (despite a fall in manufacturing input costs), but output price discounting continued to indicate some margin pressure across the private sector.

*Composite PMI indices are weighted averages of comparable manufacturing and services PMI indices. Weights reflect the relative size of the manufacturing and service sectors according to official GDP data. The Spain Composite Output Index is a weighted average of the Spain Manufacturing Output Index and the Spain Services Business Activity Index.

Commenting on the PMI data, Paul Smith, Economics Director at IHS Markit said:

“The latest services data proved to be somewhat disappointing, with only muted growth of the service sector recorded and, most worrying of all, incoming new business failing to regain meaningful traction as the economy opened up.

“Hesitancy amongst businesses and households in committing to sales, plus the challenges related to operating in the current COVID-19 environment, had restricted new work in July. Panellists indicated that sub-par demand performance, plus ongoing reductions in outstanding business subsequently led to redundancies and layoffs.

“Service providers are acutely aware that their business performance in the coming months will be primarily determined by the evolution of COVID-19. With recent reports of a spike in cases, plus some countries changing advice for citizens travelling to Spain likely to weigh heavily on the country’s key tourism sector, uncertainty over the shape and speed of the recovery from the pandemic has inevitably increased.”