

Sustaining Spain's competitiveness gains in a higher-inflation environment

Spain's export performance has outpaced that of its major eurozone peers, driven particularly by business services. However, a persistent inflation differential and rising relative labour costs are putting these gains to the test, underscoring the importance of boosting productivity growth.

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Abstract [1]: Spanish competitiveness has improved in recent years, primarily driven by services: Spain's share of global exports of non-travel services rose by 12% between 2023 and 2025, while Germany, France, and Italy lost share. Business services accounted for most of that increase, led by technical and trade-related services and consultancy. Non-price factors appear to support these gains, as knowledge-intensive activities now represent 35.6% of inbound foreign direct investment, almost double their share a decade ago. Spain's competitive position could, nonetheless, come under pressure from a positive inflation differential with the eurozone that has persisted since 2024. Cumulative losses in price competitiveness since 2023 remain limited and uneven across indicators, but unit labour costs have risen faster than in the eurozone since 2025, driven by stronger nominal wage growth and weaker growth in hourly productivity. Consolidating these gains would require strengthening the capabilities that produced them and raising hourly productivity.

Foreword

Competitiveness is the ability of the firms in a given geographic area to sustain and expand their presence in the markets in which they operate. Its study therefore requires combining analysis of their export performance with the trends in relevant prices, costs and other driving forces.

In recent years, Spain has outperformed the eurozone in terms of GDP growth, while headline inflation has been tracking above the eurozone since 2024. This combination of factors creates an interesting case for analysing the Spanish economy's competitive dynamics, as the export sector has played a meaningful role in lifting growth and the inflation differential could hold it back.

The relatively higher growth does not, however, necessarily imply enhanced competitiveness. The growth period prior to the financial crisis is an illustrative case in point as it was marked by a loss of price competitiveness, combined with a build-up of imbalances, specifically including a concentration of resources in less productive sectors.

The current period shares with that period relatively higher growth and inflation but differs in other key aspects, including global market share gains in non-travel services and a bigger share of inbound foreign direct investment flowing into knowledge-intensive activities. However, the stubbornness of the inflation differential requires detailed analysis of its origin and of its impact on the prices and costs of relevance for firms, as it could become a constraint for Spanish competitiveness.

This paper analyses Spain's recent competitiveness gains, whether they rest on a level advantage that is holding up or on a cost trend that has already begun to turn. We also discuss the conditions needed to lock the gains in.

Spanish competitiveness: Recent performance

The Spanish economy has been outgrowing the eurozone as a whole in recent years, specifically by an average of 1.8 percentage points in year-on-year terms since 2023. That momentum has been accompanied by strong exports: despite the various different shocks, the balance of trade in goods and services has averaged 3.7% of GDP during that same period.

However, neither the economic growth nor the trade balance can tell us by themselves if the country's competitiveness has improved. To do that, it is necessary to directly observe the Spanish firms' ability to maintain or increase their presence in the international markets.

A first approach to sizing up the Spanish economy's performance in terms of competitiveness is to look at the trend in its global export shares. This is an *ex-post* indicator insofar as it captures an economy's ability to adapt in response to overseas demand and competition from other countries.

Exhibit 1 provides the percentage changes in the shares of Spain, France, Italy and Germany in global exports of goods, travel services and non-travel services between 2023 and 2025.

During that period, the four largest eurozone economies all lost share in global goods exports, although Spain's decline (3.6%) was smaller than that of the other three, which ranged from 4.8% to 7.9%. In contrast, Spain gained market share in both travel services (4.6%) and, more notably, non-travel

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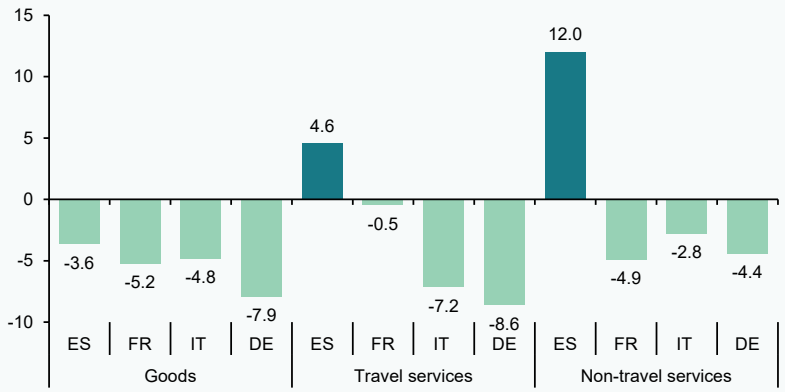
Exhibit 1

Change in share of global exports by category between 2023 and 2025

Percentage



Note: The bars represent the relative change in the share of global exports for each category and country between 2023 and 2025.

Sources: Author's own elaboration based on Eurostat and UNCTAD.

services (12.0%), compared to a contraction in the other three countries' market shares.

The widespread drop in the share of goods exports reflects the difficulties being encountered by manufacturing firms in competing in third markets in a context of heightened competition, particularly from China. This would reinforce the China Shock 2.0 hypothesis, which holds that manufacturing exports from the Asian giant are competing directly with advanced European manufactured goods, making considerable inroads into the global markets in recent years (Amicucci et al., 2026).

Although the growth in exports of Spanish non-travel services has been widespread, it has been spearheaded by certain sectors. Notably, business services contributed 53.6% of the increase between 2023 and 2025. Within this category, technical, trade-related services and professional and management consultancy services explain 41.2% and 16.4% of the growth in non-travel services, respectively, while R&D services detracted from growth, reflecting weakness in this segment, as analysed further on. Growth in charges for the use of intellectual property also made a notable contribution (21.9%).

The momentum in non-travel service exports is an international phenomenon on display in recent decades (Minondo, 2015). Key enabling factors include the development of information and communication technologies and the fact that goods exports increasingly embody foreign digital services (Martín Machuca & García, 2023).

> "Since the COVID-19 pandemic, the main driving force behind increasing non-travel service exports has been the growth in services provided digitally, expanding the market for Spanish businesses."

Since the COVID-19 pandemic, the main driving force has been the growth in services provided digitally, expanding the market for Spanish businesses (Bank of Spain, 2026). Spain has benefitted from the fact of offering these services primarily to the European Union, where barriers to trade in non-travel services have been falling.

The increased complexity of the global economy has highlighted the importance of monitoring competitiveness indicators other than price. According to Crespo et al. (2011), price competitiveness explains around 10% of the change in exports, indicating the relevance of other factors, such as the variety and quality of the goods and services exported. One of the factors that may have contributed to Spain's recent competitiveness gains is the composition of the foreign direct investment (FDI) received, whose impact on recipient firms is greater in activities with more of a technological component (Rodríguez & Tello, 2014).

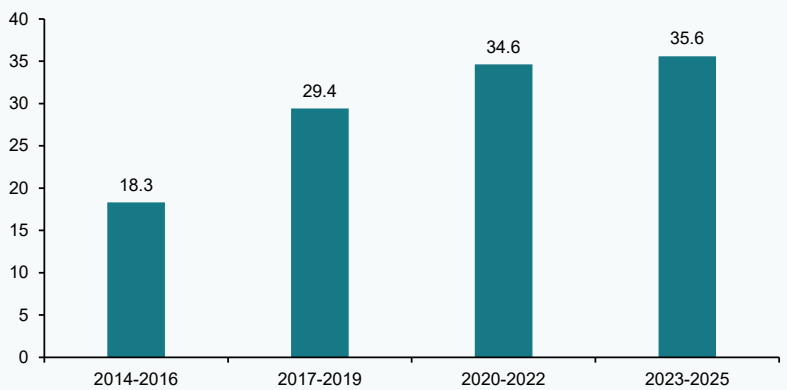
Exhibit 2 represents the share of gross FDI received by Spain in the last decade by knowledge-intensive activities.

That share has been rising steadily over the last decade, almost doubling, from 18.3% in 2014-2016 to 35.6% in 2023-2025. The biggest jump, however, materialised in the period right before the pandemic, increasing by around 11 points in 2017-2019, followed by a further 5.2-point gain in 2020-2022. In the last three years (2023-2025), that share has continued to increase, albeit at a slower pace (one point), suggesting that these activities are consolidating their position in the mix of inbound FDI.

Inbound FDI tends to increase business productivity with somewhat of a lag. Accordingly, the gains in the share of exports of non-travel services will have been driven by an FDI structure that had shifted towards knowledge-intensive activities in previous years. The nature of the companies that have spearheaded the growth in these exports since

Exhibit 2

Share of knowledge-intensive activities in the foreign direct investment received by Spain, expressed as a percentage of total FDI received for each period



Note: The bars show the share of the gross FDI received by Spain (excluding transactions channelled through foreign security holding companies, or ETVEs for their acronym in Spanish) garnered by knowledge-intensive activities. That share is calculated as the total funds received by those activities over the total received in each period. Knowledge-intensive activities are defined following the Eurostat definition: activities in which employed tertiary educated persons represent more than 33% of the total employment in that activity.

Source: Author's own elaboration based on DataInvex statistics.

the pandemic fits with this reading. Martín Machuca and García (2023) partially attribute the dynamism in these exports to a universe of large enterprises that usually belong to multinational groups, including subsidiaries of foreign groups that are recipients of FDI.

In short, the recent competitiveness gains shown by the Spanish economy have been driven by market share growth in global services exports, especially non-travel exports, spearheaded by business services, coupled with narrower market share losses in global goods exports compared to the other main European economies. The gains have also been underpinned by non-price factors, such as a steady shift in the FDI mix towards knowledge-intensive activities.

Their scope is nonetheless still limited, although a comparison with France and Germany suggests room for further gains. Between 2023 and 2025, non-travel services exports accounted for 6.7% of GDP in Spain, on average, compared to 10.2% in France and 9.3% in Germany. The distance, moreover, is concentrated in the higher-tech segments, such as intellectual property and R&D services, which account for a scant 0.5% of GDP, compared to 1.2% in France and 1.6% in Germany. Whether this upside materialises or not will also depend on the trend in relative prices and costs, a factor we analyse next.

Challenges for Spanish competitiveness

The improvements notched up by the export sector are no guarantee that Spain will preserve its competitive positioning in the years to come. Since 2024, inflation in Spain has been running above the eurozone average, raising questions about the extent to which it could end up affecting the prices and costs of relevance for Spanish firms, endangering the gains accumulated.

Analysis of these factors is important in a monetary union like the eurozone where the national authorities cannot use the exchange rate as an adjustment tool. What counts for competitiveness is the relative trend in prices and costs compared to the firms' competitors. In normal conditions, these inflation differentials are commonplace and reflect price adjustments in response to shocks. Their persistence, however, unless it reflects convergence in price levels, could signal diverging costs and foster external imbalances (Filip et al., 2023).

Exhibit 3 depicts the inflation differential between Spain and the eurozone since 2023, measured using the average year-on-year rate for each month based on the headline and core harmonised indices of consumer prices (HICP).

In 2023, Spain's headline and core HICP rates were, on average, 2.0 and 0.8 percentage points below the eurozone average, respectively. Since 2024, however, Spanish inflation has been tracking above the eurozone average, and the gap has been widening to reach, according to the data available for 2026, 0.8 and 1.0 percentage points above the eurozone headline and core averages, respectively. The tighter gap in core inflation in 2023 suggests that the advantage that year was due, at least in part, to the more volatile components of the index, like energy. In contrast, the increase observed ever since suggests that the positive inflation differential is spreading to the more stable components of the composite, which could make it more persistent.

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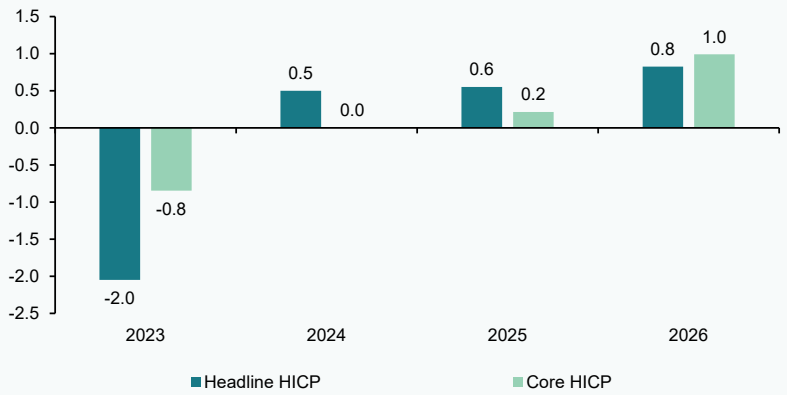
Exhibit 3

Inflation differential between Spain and the eurozone

Percentage



Note: The bars indicate the annual average differential in the year-on-year rates of the headline and core harmonised indices of consumer prices (HICP). The 2026 figures run to September. Core HICP is defined following European Central Bank methodology, i.e., *the headline rate excluding energy, food, alcohol and tobacco. Positive values denote higher inflation in Spain relative to the eurozone average.*

Source: Author's own elaboration based on Eurostat statistics.

The pattern is unchanged if we isolate the effect of changes in indirect taxation by using Eurostat's harmonised index of consumer prices at constant taxes (HICP-CT). By that measure, the gap in headline inflation increases from 0.6 percentage points in 2024 to 1.3 in 2026: half a point more than observed using the main index. This suggests that the tax policy changes introduced had the effect of dampening the increase in the gap in 2026.

The differential relative to the eurozone is attributable initially to the trend in energy prices in Spain and subsequently to stickier inflation in services (Bank of Spain, 2026).

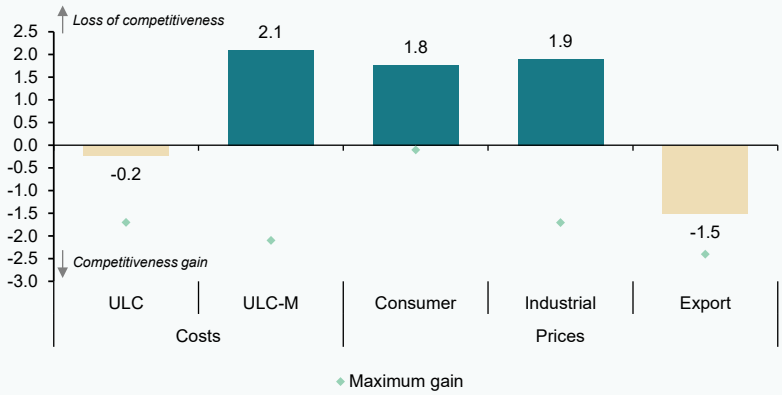
That being said, an inflation differential does not automatically imply a loss of competitiveness, as the consumer price comparison includes non-tradable goods and services with different weights in each geography's consumer basket. By the same token, the decrease in the differential associated with the tax changes does not imply a gain, because indirect taxes, as a general rule, do not apply to exports. Therefore, the competitiveness assessment requires comparing the trend in comparable cost and price aggregates for Spain and the eurozone, such as those gleaned from the different real effective exchange rate indicators.

Exhibit 4 shows the cumulative rate of change since 2023 in the real effective exchange rate relative to the eurozone, deflated by different indicators selected to capture the trend in costs and prices from a number of angles.

The competitiveness indicators signal that, according to the latest data available, the Spanish economy's competitive positioning has deteriorated relative to the maximum gains achieved since 2023, currently standing, according to most of the indicators, at levels close to the least favourable readings for the period. The intensity of the deterioration differs, however, depending on the deflator used. The indicator built around unit labour costs (ULC) for the economy as a whole is very close to its 2023 average (-0.2%), having at one point accumulated a gain of around 1.7%. Using manufacturing ULCs, the loss of competitiveness is higher: a loss of 2.1% relative to the 2023 average, marking a reversal of around four points from its best reading.

Exhibit 4

Real effective exchange rate of Spain compared to the EMU by deflator, cumulative change relative to the 2023 average in percent



Note: The bars depict the change up until the last piece of data available, while the rhombuses show the biggest competitiveness gain recorded since 2023. Negative values denote a competitiveness gain. The most recent reading dates to August 2026 in the case of consumer prices; July 2026 for industrial prices; June 2026 in the case of the EUVI and the second quarter for the ULC and ULC-M deflators. ULC indicates the overall economy's unit labour cost; ULC-M indicates the manufacturers' unit labour cost. Exports are measured using the exports unit value index (EUVI).

Source: Author's own elaboration based on Bank of Spain data.

The price measures also indicate a loss of competitiveness in terms of both consumer (1.8%) and industrial prices (1.9%). In contrast, the indicator calculated using export prices [2] continues to show a gain relative to 2023 (-1.5%) and a deterioration of less than one point from its best reading.

This variability of results using different indicators shows that the assessment of recent trends in price competitiveness depends to a large extent on the variable under consideration, as they encompass different groups of goods and services; it is therefore advisable to interpret them as a whole.

The next step in our analysis is to compare the recent trend in ULCs in Spain with that of the eurozone. Exhibit 4 shows the cumulative trend in the real effective exchange rate, while Exhibit 5 depicts the differential in annual growth in ULCs and the breakdown by component. This rounds out the picture of their performance and allows us to quantify and explain the change since 2023.

In 2023 and 2024, unit labour costs increased at a slower pace in Spain than in the eurozone (-0.5 and -1.2 percentage points, respectively) but in 2025 grew 1.1 percentage points faster than the eurozone rate, a gap that has persisted so far in 2026 (0.7 percentage points).

Their breakdown reveals a change of composition in 2025 and 2026 relative to 2023 and 2024. The growth in ULCs was contained in 2023 and 2024 by higher growth in hourly productivity, which detracted, as a whole, two percentage points, and, to a lesser degree, by relative moderation in wage growth, which contributed a one-point decrease. The two factors combined more than offset the positive contribution by hours worked per employee, whose lower relative growth in Spain decreased the gain in productivity per person employed, curbing the growth in ULCs relative to the eurozone.

In 2025 and 2026, in contrast, all components, except for hours worked per person employed in 2026, have contributed to the relative increase in ULCs in Spain. Compensation per

person employed stands out, contributing 0.6 percentage points in annual terms, as does the loss of momentum in productivity per hour worked. These shifts point to an increase in the cost pressures facing Spanish firms in the prevailing context of relatively higher inflation, which could weigh on their price competitiveness.

Higher inflation tends to translate into higher compensation through collective bargaining. Between 2023 and the second quarter of 2026, real compensation per person employed, adjusted by the GDP deflator, increased at a similar pace in Spain as in the eurozone (almost 4% on a cumulative basis). If that correlation holds, the contribution of compensation to the ULC differential would ease in tandem with the inflation differential, assuming the collective bargaining mechanisms work as intended.

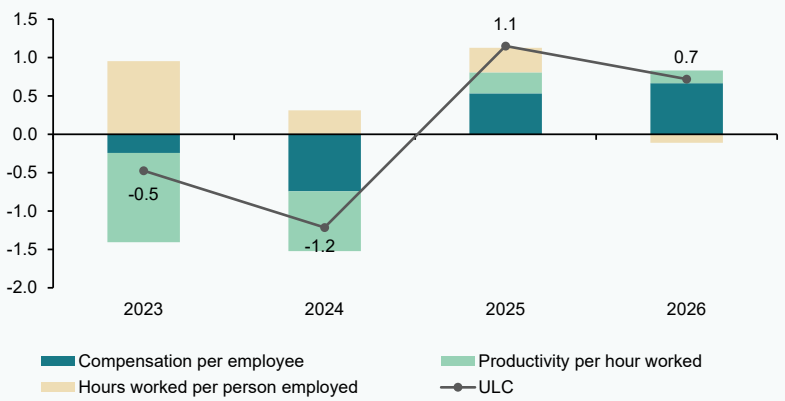
However, Exhibit 4 shows that relative ULCs, in cumulative terms, are still close to the average 2023 level. In that case, only if relative unit labour costs continue to rise will firms have to respond either by increasing their prices so as to preserve profit margins, at the cost of their price competitiveness, or by absorbing the increases, eroding margins, which could also hurt their competitiveness by limiting their ability to generate funds internally and, ultimately, hurting their capacity to invest.

In this context, for faster growth in employee compensation not to translate into a loss of price competitiveness or excessive margin compression, it is vital that productivity per person employed grow faster than in the eurozone. Given that the number of hours worked per person employed has tended to grow by less than in the eurozone, such an outcome would need to come, above all, from productivity per hour worked. One way to lift aggregate productivity would be to favour the reallocation of resources to more productive firms, which would in turn help increase the export pool.

On balance, the positive differential in inflation relative to the eurozone since 2024,

Exhibit 5

Breakdown of the differential in the year-on-year rate of change in unit labour costs in Spain relative to the eurozone, percentage points



Note: The line depicts the differential in the year-on-year rate of change in unit labour costs (ULC), while the bars show the contribution of each component, the sum of which equals the figure depicted on the line. Positive values indicate higher growth in ULCs in Spain or components pushing ULCs higher in Spain. Higher growth in productivity per hour worked or in hours worked per person employed in Spain reduce the country's ULCs and therefore display as negative values. The 2026 figures run to the second quarter.

Source: Author's own elaboration based on Eurostat statistics.

> "The challenge is to prevent the annual differential in costs and margins from translating into a cumulative loss of price competitiveness."

and in ULCs since 2025, point to an erosion of price competitiveness, which, nevertheless, remains limited in cumulative terms and uneven depending on the indicator used. Containing these differentials will shape Spanish firms' ability to hold onto the gains recorded in recent years and will depend, in the near term, on wage negotiations not perpetuating the price gap, and, in the medium term, on hourly productivity. These two factors lie at the core of the economic policy recommendations outlined next.

Economic policy recommendations

The Spanish economy has gained market share in global services exports since 2023, particularly in knowledge-intensive, non-travel services. Since 2025, however, unit labour costs have been rising faster in Spain than in the eurozone and the trend in its price competitiveness has reversed course, albeit remaining close to 2023 levels, measured using the real effective exchange rate deflated by ULCs.

These developments do not justify an internal devaluation to maintain the accumulated gains. Unlike in the growth period prior to the financial crisis (Gopinath et al., 2017), in the recent period there appears to have been no cumulative misalignment in need of correction.

The challenge, therefore, is to prevent the annual differential in costs and margins from translating into a cumulative loss of price competitiveness.

Policy should focus on adding capabilities and lifting productivity. The distance from France and Germany in exports of non-travel services is concentrated in intellectual property and R&D services, where the advantage depends more on intangible assets than the cost of its skilled labour. In parallel, FDI policies should prioritise linkages between foreign investors and domestic firms and the diffusion of knowledge to them.

In goods, the loss of market share is common to the main eurozone economies, reinforcing the need to complement national initiatives with a European-level trade and industrial response to heightened competition from China.

Productivity per hour worked in the economy as a whole could be leveraged via two different mechanisms. The first would be to reassign resources among firms to the more productive enterprises, allowing them to gain scale and absorb resources, giving them the ability to sustain higher compensation without losing competitiveness. One avenue would be to replace the step changes in regulatory and fiscal thresholds associated with size, which may have the effect of discouraging business growth (Garicano et al., 2016), with sliding scales. Another would be to increase sources of financing for young firms with growth potential to encourage them to pursue riskier projects and grow faster (Ando, 2026).

The second mechanism would be to boost productivity within each firm by investing more in technology. Investment in technology would not suffice, however: an artificial intelligence system would increase productivity per hour worked if the hours it frees up are devoted to more value-adding tasks, which requires reorganising processes and ensuring employees have the skills needed to use the new technology. That is why public support should consider these interrelated effects and also address training and restructuring.

In sum, Spain's competitiveness has improved, particularly in services. The deterioration in relative costs observed since 2025 has not yet erased those gains on a cumulative basis. The challenge is therefore to add to the capabilities

that explain the competitiveness gains made and to increase hourly productivity so that higher compensation does not translate into a loss of competitiveness.

Notes

[1] The author would like to thank Raymond Torres for his input. Any error or omission, however, is the sole responsibility of the author.

[2] The export price index is built using unit value indices for goods exports, so that its performance also reflects changes in its composition.

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