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Economic Outlook

November 2020

Summary

- The recovery of the global economy will show a slowdown in Q4 due to the resurgence of the pandemic, mainly in Europe.

- Announcements of progress in vaccine developments, the monetary policies undertaken by central banks and Joe Biden's victory in the United States are boosting global stock markets.

- The latest European Commission forecasts are less optimistic than those of the Government for 2020 and 2021.

- The Budget presented by the Government is marked by a growth in spending that could jeopardize the sustainability of public finances in the future, and it calls for the need for a medium-term fiscal strategy.

- Following the significant upturn in activity in Q3, the ongoing pandemic is holding back the pace of recovery ahead of Q4. The high uncertainty about the intensity of progress in activity and employment makes it difficult for businesses and families to make decisions about consumption and investment.

- In October, the labour market posted a slowdown in the recovery path and the number of workers in the private sector registered with the Social Security saw a steeper rate of decline, which stands at -3.4%.

- Inflation is still negative due to the fall in energy prices and in the core rate, on the back of sluggish demand.

- In 2020, public finances are suffering a notable deterioration. With accumulated data up to September, the State's public deficit stands at -5.09% of GDP, as a result of a decrease in revenues of -12.3% and an increase in spending of 18.5%.

The International Scenario

The second pandemic wave threatens the intensity of the global economic recovery

The advanced economies posted significant growth rates in Q3, outperforming expectations from a few months ago, on the back of the progressive recovery of activity that followed the abrupt collapse experienced in Q2. However, in year-on-year terms, growth is still negative, with significant differences among regions. The best results are seen in the United States, where the GDP showed a year-on-year variation of -2.9% in Q3, supported by the good performance of investment in capital goods and consumption of durable goods. Meanwhile, the European Union's growth stands at -4.3% compared to a year ago, while Japan's GDP is -5.9% lower than in Q3 of 2019, and the worst result among the large economies corresponds to the United Kingdom, where the year-on-year GDP for Q3 stands at -9.6%. Within the EU, there are also significant differences between the largest countries, with Germany turning a year-on-year GDP decline of -4.2% compared to the -8.7% recorded in Spain.

A notable improvement is also expected in Q3 among emerging economies, with China's performance, with a GDP growth of 4.9% year-on-year, standing out, after having returned to positive rates in Q2, when it posted 3.2%. China's growth is supported by good figures in consumption and exports, especially in materials for remote work and distance learning and medical equipment sales.

The recovery seen in Q3 is being undermined in many countries by a new worldwide increase in the number of people affected by Covid-19, which is leading to restrictions that condition mobility and economic activity. For the time being, these restrictions are most severe in European countries.

Within this context and on the back of the good results for Q3, the European Commission has revised its growth forecasts slightly upwards for the year, both for the EU as a whole and for the Eurozone, in relation to the estimates it published last July. However, for 2021 the revision has been downwards due to loss of dynamism expected for Q4, which could return to negative quarterly rates, and the expectation that this slowdown will extend to the first part of next year. Its forecasts highlight a significant increase in the public deficit for 2020 and 2021 as well as in public debt. This will be a consequence of the fiscal policy measures that have been and will continue to be adopted by the various governments and the European Union as a whole, which aim to alleviate the damage caused by the pandemic in the health, social and economic fields, and to contribute to the recovery of the economy and the employment. Meanwhile, inflation is expected to remain very subdued, with the Eurozone estimate set at an average of 0.3% this year and 1.1% next year.

Another concern in the European Union is the struggle that has arisen in regard to the approval of the European Relief Fund, following the recent blocking by Hungary and Poland. This could delay the arrival of money to member countries at least until the middle of next year, and it is added to the already existing concern regarding the continued stagnation in the negotiation for a trade agreement with the United Kingdom after Brexit. Failure to reach an agreement would mean that, from January 1, 2021, trade relations between the two blocs would be marked by WTO rules, which would involve significant tariff increases.

European Commission (November 2020) **and IMF** (October 2020) **growth forecasts**

	European Commission			IMF		
	2019	2020	2021	2019	2020	2021
World growth	2.7	-4.3	4.6	2.8	-4.4	5.2
United States	2.3	-4.6	3.7	2.2	-4.3	3.1
Japan	0.7	-5.5	2.7	0.7	-5.3	2.3
Eurozone	1.3	-7.8	4.2	1.3	-8.3	5.2
Germany	0.6	-5.6	3.5	0.6	-6.0	4.2
France	1.5	-9.4	5.8	1.5	-9.8	6.0
Italy	0.3	-9.9	4.1	0.3	-10.6	5.2
Spain	2.0	-12.4	5.4	2.0	-12.8	7.2
United Kingdom	1.3	-10.3	3.3	1.5	-9.8	5.9
China	6.1	2.1	7.3	6.1	1.9	8.2
India	4.9	-8.3	7.6	4.2	-10.3	8.8
Advanced economies	1.8	-5.6	3.7	1.7	-5.8	3.9
Emerging economies	3.6	-3.2	5.3	3.7	-3.3	6.0
World trade	1.0	-10.8	6.1	1.0	-10.4	8.3

Source: European Commissión, European Economic Forecast - Autumn 2020, Nov. 2020, and IMF, World Economic Outlook, Oct. 2020

For Q4, global PMI confidence indices continue to perform well, with October at its highest level since August 2018. However, there are significant differences between the manufacturing indices, which are leading the recovery (with the automotive sector outperforming all others), and the services indices, which are suffering from the restrictions in place, and where the tourism and leisure sectors are showing the worst data. There is also considerable regional heterogeneity, with China and the United States seeing an ongoing rise in their PMI indices, while the European Union is stagnant and growth in the United Kingdom is losing momentum. Meanwhile, Japan's economy is still contracting, although at a lower rate than in previous months. Among the emerging economies it is also worth noting the good performance of the manufacturing indices of India and Brazil, in contrast to Mexico´s, where levels are still well below 50 points.

The greatest sign of optimism comes from the announced progress made in the development of vaccines against Covid. In addition to being good news for the fight against the pandemic, this contributes to prevent a worsening of expectations from economic agents by bringing forward the date in which, after a generalized distribution of these vaccines, the recovery would not be affected by new outbreaks of the virus.

The news about the vaccines, which limit the duration of the crisis, together with the signs from the main central banks indicating that they will maintain their expansionary policies for a long time and Joe Biden's victory in the US elections have strongly boosted the world's stock markets, with US indices trading at historic highs.

Meanwhile, the major central banks have said that interest rates will remain at their current levels for the foreseeable future, at least for the next three years according to the Federal Reserve, and that subsequent increases will be very gradual. The ECB, in its October meeting, indicated that its monetary policy will continue to be very accommodative and suggested that in December it might adopt new measures, without specifying what these would entail. However, they could probably lead to an extension of its asset and sovereign bond purchase program and an extension of the liquidity lines for banks, which is enabling sovereign debt rates to be at their lowest levels.

With regard to the U.S., no great changes in U.S. policy are expected beyond some tax increases and a slightly greener agenda, as a consequence of the change of administration. As for the relationship with China, tensions will continue in both the trade and the technological fields, although the confrontation will not be as direct as it was during the Trump administration.

In October, oil prices fell slightly compared to September, with Brent crude standing at $39.8/barrel on a monthly average, which is -2.3% lower than the previous month and -34.0% lower in year-on-year terms. New restrictions on mobility, mainly in some European countries, and worries about the recovery of the world economy, together with the decrease in OPEC forecasts for global oil demand, kept crude oil prices very contained.

The Spanish Economy

Pandemic outbreaks lower growth prospects

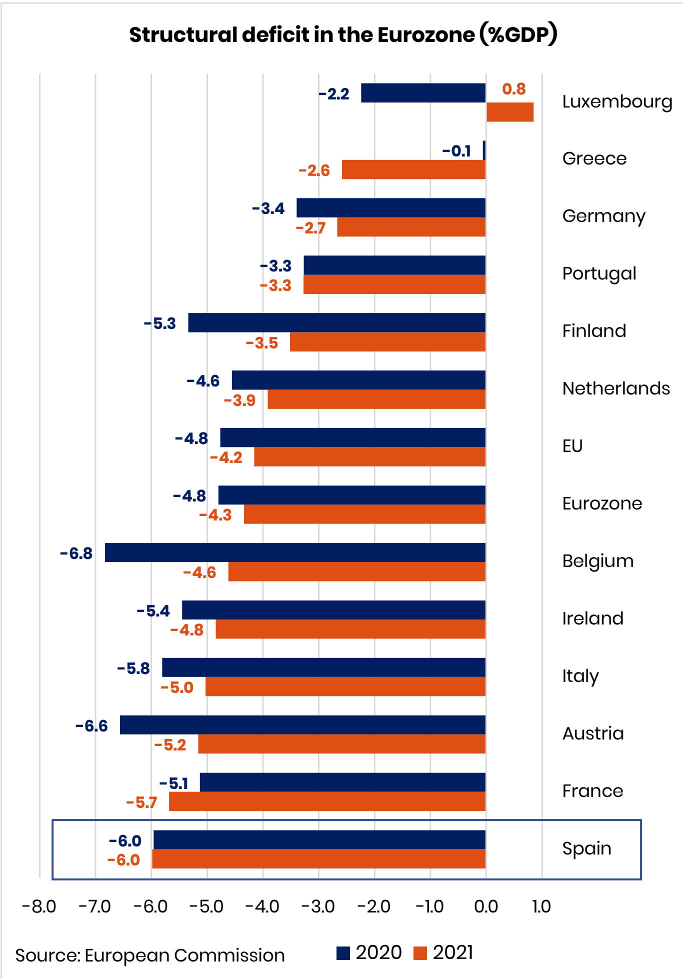
The European Commission is less optimistic than the Government in its forecasts, increasing the drop in GDP for 2020 to -12.4% and pointing to a milder recovery in 2021 (5.4%). These figures contrast with the macroeconomic framework on which the General State Budget for 2021 is based, which foresees a fall in GDP of -11.2% for this year and growth of 9.8% for 2021, thanks to the boost to activity and employment driven by European funds and the expansionary social spending policy.

This very different growth scenario between the two institutions is also reflected in the projections for the labour market and the public deficit. Thus, the Government estimates an unemployment rate of 16.3% in 2021, compared to 17.9% estimated by the European Commission, while the Government's public deficit figure is set at -7.7% of GDP, almost two points below what the European institution foresees (-9.6% of GDP).

Spain will continue to be one of the countries most affected by the pandemic due to the resurgence of outbreaks experienced since the summer which have slowed down the strong recovery process seen in Q3, both in terms of activity (when a quarterly GDP growth of +16.7% was recorded) and employment (with an increase in the number of people employed of 569,600). Therefore, uncertainty is increasing, and a slower recovery scenario seems increasingly more likely both for the end of the year and for the beginning of 2021.

This is also clear from the conclusions of the IMF's Article IV Consultation Mission to Spain, which states that the second wave of infections is jeopardizing recovery and that the evolution of the pandemic and the corresponding public measures will determine economic developments. In particular, it stresses that economic policy measures should be aimed at limiting the damage to the economy in the long term and facilitating the reallocation of resources to growing sectors, as well as providing a robust social safety net. In the medium term, once the recovery is on track, it will also be necessary to ensure a sustainable downward path for public debt, while supporting greater social inclusion and resilient growth. In this respect, the European Recovery and Resilience Mechanism may provide an important stimulus for demand, support job creation and encourage greener and more digitalized activities. Efficiency in the coordination, implementation and monitoring of the plans will be crucial.

With this backdrop, the budgetary policy takes advantage of the arrival of European funds and the suspension of fiscal rules to introduce a record increase in consolidated spending, around 20%. The exceptional and transitory nature of this situation should be born in mind and the Government should not commit to a level of spending that will be difficult to maintain when things go back to normal. In Spain, the structural deficit in 2020 was already high before the crisis (-4.0% of GDP in 2019) and will increase even more in 2021 and 2022 (to around -5/-6% of GDP). In addition, public debt levels may also exceed 120% of GDP. Therefore, returning to the fiscal consolidation process that Europe will require, once the pandemic is overcome, will involve a great effort, hence the need and urgency for a reliable, specific and responsible medium-term fiscal strategy that should be more aimed at controlling and improving the efficiency of spending than at raising taxes.



Demand and activity

GDP growth in Q3, released at the end of October, shows a significant recovery in activity compared to Q2 thanks to the gradual return to normalcy and the lifting of confinement measures. The increase in GDP (16.7% quarter-on-quarter) compensates for part of the fall recorded in Q2 (-17.8%) and is compatible with CEOE's forecast for the year as a whole, set at -11.5%, since there are clear signs of a loss of activity momentum in Q4.

In year-on-year terms, the fall in GDP is set at -8.7%, compared to -21.5% in Q2. Both domestic and external demands are improving significantly, although their contribution are still negative. Specifically, the contribution of domestic demand is -7.8 percentage points, 11.0 points higher than in Q2, while external demand makes a contribution of -0.9 points, 1.8 points higher than in the last quarter.

Strong recovery in private consumption and investment in Q3, although a worsening is foreseen in Q4

From the point of view of domestic demand, it is worth noting the increase in household consumption (20.7% quarter-on-quarter), driven by retained demand following the confinements, and the notable improvement in business investment, up 37.4% quarter-on-quarter, which reached pre-crisis levels once again.

However, after the significant improvement in consumer and business expectations up until July, in recent months this progression has stagnated as a result of the return to more restrictive measures of mobility and capacity in certain activities, given the increase in the number of infections in some municipalities and regions. In fact, consumer confidence is the one that has shown the slowest and most limited improvement, unlike retail trade confidence, which in October registered a significant rebound.

In this regard, the latest available data from the retail trade index, corresponding to September, once deflated, is at a higher level than the one recorded in February, although it is still -3.6% lower than the figure recorded a year earlier. Meanwhile, domestic sales of consumer goods and services by large companies, with data up to August, also showed a notable recovery compared to Q2, but still recorded a -6.0% drop year-on-year, with sales of goods almost recovered, but sales in services still 20% below pre-crisis levels.

The persistence of the pandemic, awaiting effective vaccine or treatment, makes it very difficult to return to pre-crisis levels in many sectors, so recovery remains incomplete. In addition, the high degree of uncertainty makes it very difficult for families and businesses to make purchase and investment decisions. Therefore, it is foreseeable that in the coming quarters activity and employment will slow down.

Despite the drop in tourist arrivals, the contribution of the foreign sector to growth is improving

With regard to the foreign sector, with the information from the National Accounts for Q3, it is worth mentioning the significant increase in exports, mainly in the goods component, since the services component continued to be greatly affected by the collapse of tourist entries and stands at levels that are almost 75% lower than those in the previous year. As a result, external demand made a contribution of -0.9 points, 1.8 points higher than the previous quarter. Thus, according to the preliminary monthly data on the Balance of Payments published by the Bank of Spain, in the first eight months there was a surplus on the current account of €3.5 billion, compared with the surplus of €17.1 billion the previous year, due to the less positive result of the balance of goods and services, within which the positive balance of the Tourism and Travel balance suffered a drastic decrease. The net lending position of the economy was positive in this period by €5.1 billion, compared to €19.0 billion in 2019.

All sectors post a better performance in Q3, although in uneven intensities

Most of the sectors have normalised their activity intensely with respect to the previous quarter, although only agriculture, Public Administration, financial and insurance activities, education and health, which had suffered less in Q2, are back to recording positive year-on-year rates.

The Labour Market

After the recovery of the labour market in Q3, the number of people registered with the Social Security from the private sector drops even faster in October

The LFS results for Q3 were a positive surprise, even taking into account that many companies returned to activity in this period after a Q2 of partial or total shutdown of many economic activities. The number of people employed increased by 569,600, offsetting part of the loss of almost 1.1 million jobs in Q2. However, the number of people employed in Q3 (which includes those affected by the ERTE furlough schemes) is 697,500 lower than a year ago (a -3.5% change). In this regard, the sharpest drop is seen in private sector employment (-4.8% year-on-year), while public sector employees increased by 3.4%.

The resumption of economic activity in Q3 is clearly reflected in the hours per week actually worked, which grew by 15.1% quarter-on-quarter (despite the fact that they traditionally fall in the summer period), following a -22.6% decline in the previous quarter. In year-on-year terms, hours worked are -7.2% lower than a year ago, demonstrating that effective employment levels, measured by hours worked, are still below pre-crisis levels.

The good performance of employment in Q3 has not stopped the unemployment rate from continuing to rise, currently standing at 16.3%, almost one point more than in the previous quarter and 2.3 points more than a year ago. This increase in the unemployment rate is due to the increase in the number of unemployed people, up 355,000 compared to Q2, bringing the total number of unemployed people to more than 3.7 million, a year-on-year increase of 15.8%.

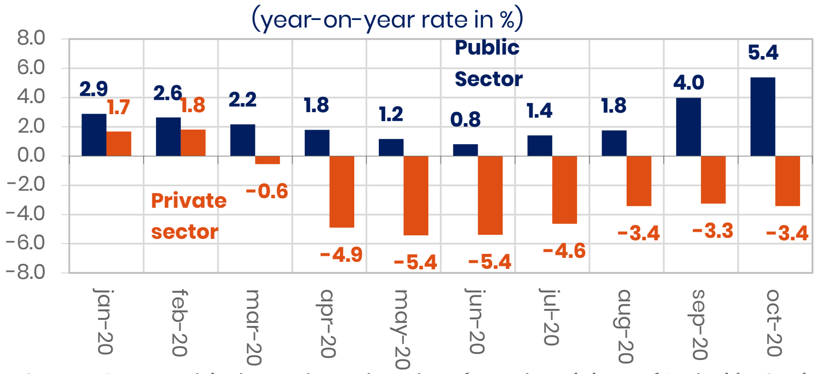
The increase in the number of employed and unemployed people corresponds to a surge in the working population of 924,600 people, which compensates for much of the decline in Q2 (1,019,000 people). In this regard, it is worth recalling that, in Q2, a considerable number of those who lost their job went into inactivity because they were unable to meet the job-seeking or work availability requirements established for being considered unemployed.

For Q4, the evolution of the economy and the labour market will be conditioned by the second Covid-19 wave sweeping the country and the resulting adoption of various restrictive measures to try to combat it. Thus, the recovery of the economy and employment in Q3 may suffer in the final stretch of the year.

For the time being, in October, the number of people registered with the Social Security increased for the sixth consecutive month, by a monthly average of 113,974. However, in seasonally adjusted terms, the increase was set at 45,365 people, significantly less than the average for the last three months (almost 170,000 people). Going back to the gross figures, despite the recovery in employment in recent months, the current number of contributors (almost 19 million people) is still far from the pre-crisis situation (-259,866 fewer people registered than in February) and, in fact, only two out of every three jobs lost in March and April have been recovered. Meanwhile, the year-on-year rate remained at -2.3% in October (-439,628 people), the same as in September, thus slowing down the progressive reduction in the year-on-year rate of decline (the highest drop took place in May and June, with -4.6%).

The evolution of the number of people registered with the Social Security broken up by public and private sector has been very uneven. In the public sector, the number of contributors has increased in year-on-year terms throughout 2020 and, since July, there has been an acceleration in the rate of growth, reaching 5.4% in October. In contrast, the number of contributors in the private sector is falling in year-on-year terms since March and, although the rate of decline had become less intense in recent months, this trend came to a halt in October, when the year-on-year rate reached -3.4% (-3.3% in September).

Workers registered with the Social Security
(year-on-year rate in %)



Source: Prepared-in-house based on data from the Ministry of Inclusión, Social Security and Migrations

In recent months, as activity has recovered, the number of workers who are still in an ERTE furlough scheme decreased to a total of 633,192 people on average in October (almost 120,000 people less than in September). If we add the nearly 260,000 fewer people registered with the Social Security in October than in February, it turns out that there are almost 900,000 people whose employment status is affected by the Covid-19 crisis, either because they have lost their jobs or because they are still under a furlough scheme.

Inflation

The drop in energy prices and core inflation intensifies the fall in headline inflation

In October, the annual Consumer Price Index (CPI) decreased four tenths to -0.8%, accumulating seven months in negative rates. Inflation fell at a greater pace due to the larger drop in energy product prices and the deceleration in core inflation.

Thus, core inflation continues its downward trend and stands at 0.3%, one tenth less than the previous month. In terms of its components, they keep posting very low rates or even practically zero. Thus, Services decreased by two tenths to 0.1%, Industrial goods excluding energy products decreased by two tenths to 0.0%, and Processed foods, beverages and tobacco decreased by one tenth to 1.0%

Non-processed foods also saw lower prices, down a tenth to 4.1%, although they continue to be the most inflationary component in the basket, with the strongest increases concentrated in fresh fruit, ovine meat, vegetables and pulses.

Energy prices in October fell at a higher rate. Specifically, the year-on-year rate for energy product prices was -11.1%, compared with -8.5% in the previous month. After the notable fall in September, oil prices continued easing, although at a slower rate. Concerns about the strength of the economy's recovery are leading to lower forecasts for global oil demand, so prices are expected to remain stable at around $40/barrel in the coming months, which in turn would mean that energy prices would continue to put downward pressure on inflation.

Over the coming months, inflation will continue to register negative rates and will be conditioned by the behaviour of oil prices and the drop in demand for some goods and services due to the coronavirus crisis. For 2020 as a whole, we anticipate an average CPI rate that will be slightly negative (-0.3%).

The Public Sector

The Government presents a General State Budget for 2021 based on a notable increase in spending and an overestimated increase in revenues

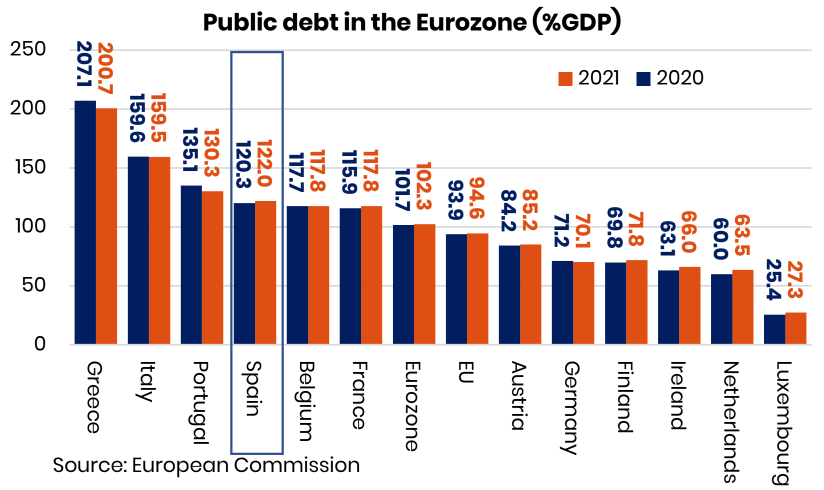
At the end of October, the Government presented the Bill for the General State Budget for 2021. This budget is extremely important for our country for several reasons. Firstly, because they are brought forward within the framework of overcoming an unprecedented economic crisis that has had as its main consequence a notable deterioration of public finances. Secondly, because a historical increase in spending is foreseen which, if not coupled with an equally significant increase in revenues, could jeopardize the sustainability of public finances for a long time. Thirdly, because this budget includes European funds (€27 billion in 2021). The short-term recovery of the economy, its competitiveness and its resilience in the future will depend on the effectiveness of how they are applied.

The government expects the public deficit to pull back from the -11.3% of GDP it estimates for 2020 to -7.7% in 2021. However, both figures are optimistic in comparison with other forecasts, such as those recently published by the European Commission, which point to a public deficit of -12.2% in 2020 and -9.6% next year.

In the General State Budget, consolidated spending increases by 20.1% (chapters I to VIII). It is true that this increase in spending is conditioned, in part, by the arrival of European funds. But even discounting the European funds, spending will grow significantly in 2021, by 13.1%. Meanwhile, the Government expects tax revenues to increase by 4.3% over those recorded in 2019 and by 13% in comparison to 2020. This increase is not entirely explained by the measures adopted, since, excluding the €6.085 billion estimated to be collected as a result of these fiscal measures, the estimated revenues for 2021 would still be 1.5% higher than the ones recorded in 2019, while the nominal GDP in 2021, even if we take as reference the Government's forecast, would be lower than the one recorded in 2019.

The transfer of the resulting deficit flows to the outstanding public debt balance, together with the notable decrease in nominal GDP, would raise the public debt ratio to 118.8% of GDP in 2020 (23 points more than in 2019), figure that would drop very slightly in 2021 (117.4% of GDP), according to the Government's forecasts. In contrast, the European Commission raises this ratio to over 120% in the 2020-2023 period and, moreover, with a slightly increasing trend in this forecast horizon.

Thus, Spain joins the group of Eurozone countries with the highest public debt since 2020, exceeding the Eurozone and the EU average by almost 20 points and by around 30 points, respectively.



Source: European Commission

For the time being, the budget execution so far in 2020 reflects the impact of Covid-19 on public finances. With accumulated data up to September, the State's public deficit already far exceeds the figure reached by all the Public Administrations in 2019 (-2.8% of GDP). The State's deficit in September stood at €56.291 billion, -5.09% of GDP. There has been, on the one hand, a notable fall in revenues due to the drop in activity and demand, and, on the other, an increase in spending, due to the measures adopted in the health field and to mitigate the social, economic and employment effects derived from the pandemic.

Resources decreased by -12.3% until September due to the overall drop in collection in most of the tax figures. The ones that stand out the most are, on the one hand, the -12.7% decrease in taxes on production and imports, including a -14.3% drop in VAT, and, on the other, current taxes on income and wealth (-16.1%). Taxes on capital (-56.1%) and social contributions (-1.0%) also fell. Meanwhile, spending rose by 18.5% up to September, largely due to the increase in transfers to the Social Security and the Autonomous Regions (current transfers between Public Administrations rose by 31.6%). Also noteworthy is the increase in intermediate consumption (16.7%), which includes health benefits and pharmacy expenditure related to Covid-19.

With data up to August, the total public deficit of the General Government, excluding the Local Administrations, is equivalent to -7.07% of GDP, more than double the figure reached in 2019 by all the Public Administrations (-2.8% of the GDP).

Forecasts

Economic forecasts for Spain (last update: november 2020)							
Annual rates of change, unless otherwise indicated							
	2015	2016	2017	2018	2019	2020	2021
GDP	3.8	3.0	2.9	2.4	2.0	-11.5	7.0
Private consumption expenditure	2.9	2.6	3.0	1.8	1.1	-13.4	7.0
Government consumption expenditure	2.0	1.0	1.0	1.9	2.3	4.3	1.0
Gross fixed capital formation	4.9	2.4	5.9	5.3	1.8	-18.8	12.6
-Tangible fixed assets	4.8	1.7	7.0	6.2	1.7	-21.8	14.8
Construction	1.5	1.6	5.9	6.6	0.9	-21.4	12.5
Equipment and cultivated assets	9.9	2.0	8.5	5.7	3.1	-22.3	18.5
-Intangible fixed assets	5.3	5.3	1.3	1.1	2.2	-4.3	4.0
Domestic demand (*)	3.9	2.0	3.0	2.6	1.5	-10.2	6.8
Exports	4.3	5.4	5.6	2.2	2.6	-24.7	7.5
Imports	5.1	2.7	6.6	3.3	1.2	-22.2	7.0
GDP current prices	4.4	3.4	4.3	3.5	3.6	-10.5	8.0
GDP deflator	0.6	0.3	1.4	1.1	1.6	1.0	1.0
CPI (average annual rate)	-0.5	-0.2	2.0	1.7	0.7	-0.3	0.9
CPI (dec/dec)	0.0	1.6	1.1	1.2	0.8	-0.2	1.1
Core CPI (average annual rate)	0.6	0.8	1.1	0.9	0.9	0.8	0.8
Employment (Quarterly National Accounts) (**)	3.2	2.8	2.9	2.6	2.3	-7.6	3.6
Employment (LFS)	3.0	2.7	2.6	2.7	2.3	-2.9	-0.8
Unemployment rate (LFS) (% of active population)	22.1	19.6	17.2	15.3	14.1	15.8	18.2
Productivity	0.6	0.2	0.1	-0.2	-0.3	-3.9	3.4
Compensation per employee	0.6	-0.6	0.7	1.0	2.1	1.6	0.5
Unit labour cost (ULC)	-0.1	-0.8	0.6	1.2	2.4	5.4	-2.9
Current Account Balance (% of GDP)	2.0	3.2	2.7	1.9	2.0	0.0	1.0
General government net lending (+) / net borrowing (–) (% of GDP) (***)	-5.1	-4.1	-3.0	-2.5	-2.8	-12.5	-9.0
Interest rates USA (dec)	0.50	0.75	1.50	2.50	1.75	0.25	0.25
Interest rates Eurozone (dec)	0.05	0.00	0.00	0.00	0.00	0.00	0.00
Brent Oil ($)	52.1	43.3	54.3	70.9	64.8	41.2	45.3

Source: CEOE, INE, Banco de España, Eurostat

(*) Contribution to GDP growth

(**) Full-time equivalent jobs

(***) Excluding aid to the financial sector