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# **Economic Outlook**

January 2021

## Overview

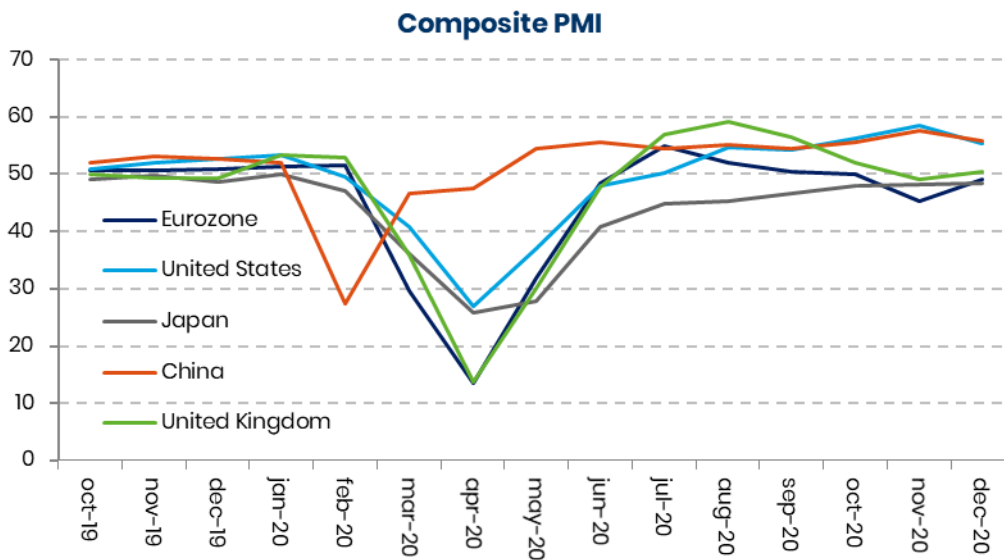
- Worldwide pandemic outbreaks weaken the recovery of the economy in the short term.
- Significant growth is expected worldwide for 2021, supported by expansionary fiscal and monetary policies. However, it will be uneven across regions.
- In December, oil prices rose, encouraged by positive news about vaccines and the associated expectations of a recovery in oil demand.
- 2020 closes with a clearly negative balance for the Spanish economy, with record falls of economic activity of around -11% and an unprecedented deterioration of public accounts.
- 2021 begins with considerable uncertainty about the continuity of the recovery process, given the intensity of the third wave and its possible effect on activity and employment in the short term.
- December marks a slowdown in the employment recovery that started in May. 2020 ends with 360,000 fewer people registered with the Social Security than at the end of 2019, around 783,000 people under furlough schemes and around 725,000 more people unemployed.
- The slower decline in energy prices and the slowdown in core CPI cause inflation to slow down its decrease to -0.5% in December. There are no signs of inflationary pressures in the near term.

# The International Scenario

## New outbreaks weaken global recovery

The start of vaccinations in several countries positively influences expectations of a sustained recovery, especially from the second half of this year. However, the intensity of the pandemic's third wave, together with the emergence of new strains, has led to new restrictions that are once again weakening activity in many economies in the short term.

This loss of momentum in activity can be seen in the fall of the global PMI indices, which in December pulled back for the second consecutive month, although they remained in expansionary territory for the world economy as a whole. The services sectors are the most affected by the new containment measures, mainly in activities related to tourism, recreational activities and transport services. Manufacturing is showing more resilience and the sectors related to technological equipment, car production and machinery & equipment producers continue to record a significant growth trend.



Source: Markit Economics

By country, the evolution is also uneven, with China and the United States having the highest PMI rates, followed by India and Brazil. Meanwhile, the Eurozone remains below 50 points, in contractionary territory, although the December figure improved in comparison to that of November. Within Europe there are also significant differences among countries, with Ireland and Germany still presenting good figures while Italy is pointing to a severe contraction, mainly due to the service sectors.

For 2021, forecasts from the main international institutions point to a notable rebound in the global economy, which will grow between the 4.2% estimated by the OECD and the 5.2% by the IMF. This follows the collapse seen in 2020, when global GDP contracted between -4.2% and -4.4% according to these institutions. Thus expectations point to a return to pre-pandemic levels by the end of the year.

As the virus becomes increasingly under control, it is expected that restrictions on mobility will be removed and uncertainty will be reduced, which will favour consumption and investment and will lead to a more dynamic world trade. Moreover, this foreseeable improvement will be supported by monetary and fiscal policies, which are expected to keep being expansionary and will be key factors in driving the recovery, albeit a recovery that is not exempt from challenges. Among the challenges, it is worth pointing out the financial weakness of many companies, especially in the sectors most affected by the crisis. This could jeopardise the productive fabric of countries if the situation deteriorates further.

The recovery will be uneven across regions, and among the advanced economies the strength of the United States stands out, since it should gain back in 2021 almost everything lost in 2020. Following the change of government, an ambitious new stimulus plan is expected to be approved to reinforce the measures passed at the end of December and help relaunch activity. In the European Union, 2021 recovery estimates are more modest in comparison to the deterioration in GDP experienced in 2020, although the EU's Next Generation plan is also expected to boost growth in 2021 as well as in the following years. Furthermore, the trade agreement reached with the United Kingdom, although very basic, prevents a situation that could have complicated recovery for both regions. Among the emerging economies, China stands out as one of the few countries that will post positive growth in 2020 and its growth rate in 2021 could reach 8%. On the other hand, the developing countries that are more dependent on tourism and some other service sectors, whose activity is more conditioned by greater physical interaction, will take longer to notice the improvement in their economies, and in some cases certain sectors will have to adjust to new demand levels.

In December, the price of Brent crude oil continued to rise to an average of \$50.2/barrel, driven by the OPEC+ production agreements and the good prospects for recovery in demand generated by news about vaccines. Even so, the price was -27.3% lower than a year earlier, measured in dollars, and -33.6% lower in euros, due to the appreciation of the European currency over the last year. The futures markets are quoting a crude oil price of around \$55/barrel for 2021.

## The Spanish Economy

After a very negative balance in 2020, the intensity of the recovery will be key for 2021

2020 will be remembered as the year of the Spanish economy's most intense crisis, with historical registers of falling activity and fiscal imbalance increases and, to a lesser extent, of unemployment. Furthermore, it has been one of the countries in the Eurozone whose economy has been most affected by the pandemic.

GDP will close 2020 with a decline of around -11%, given its near-stabilisation in Q4. The weakness of domestic and external demand has put downward pressure on prices, which remained negative practically throughout the year, with an average CPI rate of -0.3%. With regard to macroeconomic imbalances, it should be noted that there will still be an external surplus, although it will be lower than in 2019<sup>1</sup>, while the public deficit and debt will be very high, with the former exceeding -11% of GDP and the latter reaching a ratio of close to 120% of GDP. With regard to the labour market, the implementation of the furlough schemes (ERTE) cushioned the increase in unemployment and the fall in the number of people employed, and employment will therefore only fall to rates of around -3%, according to the LFS. However, if we take into account actual employment (number of people registered with the Social Security and not under a ERTE), it should be noted that in December 2020 there were 1.1 million fewer people registered than a year ago.

After a very negative balance of the Spanish economy in 2020, 2021 begins with considerable uncertainty about the intensity of the recovery. Despite the hope afforded by the immunity of the population as a result of the vaccine and its implications for a return to normalcy being closer, the evolution of the pandemic at the beginning of the year has dampened optimism due to the increasingly more real possibility of having to maintain and even increase restrictions on mobility and activity in some economic sectors. Forecasts from the November Funcas Panel point to a 6.5% growth in GDP for this year, slightly below the 7% estimated by the CEOE.

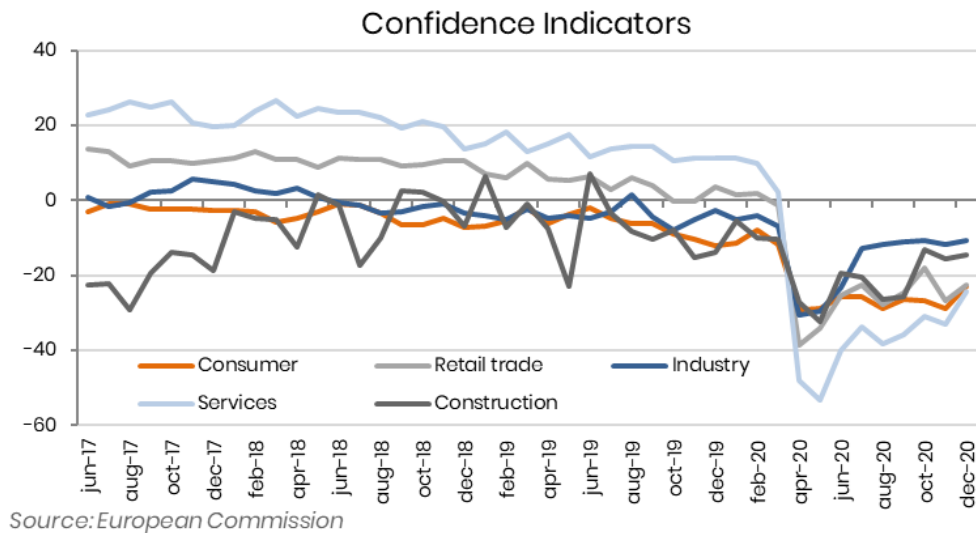
The factors which will condition the performance of the economy in the short term are the evolution of the health situation and whether or not the measures to support employment and companies are kept in place. In the medium term, to consolidate the recovery, the most relevant aspects are the effectiveness of European funds; the implementation of structural reforms; the solvency level of economic agents; the confidence of families and their predisposition to consumption; and whether imbalance corrections start to be undertaken.

<sup>1</sup> On a 12-month cumulative basis, the financing capacity stood at 13.9 billion in October 2020, vs. 30.8 billion recorded on the same month of the previous year.

## Demand and activity

At the end of December, the National Statistics Institute (INE) published revised data for Q3-2020 (16.4% quarter-on-quarter), which is only three tenths lower than the preliminary number released. This revision is mainly due to a more negative contribution from external demand, mainly exports, while there was an increase in domestic demand, especially investment. The Quarterly Non-Financial Accounts of the Institutional Sectors were also published, showing that the financing capacity of the Spanish economy declined in Q3-2020 to 1% of GDP, two points lower than a year earlier (3%). This result was due to the lower financing capacity of non-financial corporations and financial institutions, in comparison to the same period in 2019, together with the general government starting to post financing needs, compared with the positive balance in 2019. This was partly offset by the lower financing needs of households and NPISHs due to higher savings as a result of lower consumption expenditure.

With respect to Q4, information available still gives mixed signals that make estimations difficult. However, GDP is expected to show some stabilisation, which, any case, was clearly lower than in Q3, given the mobility and activity restrictions caused by the second wave of the pandemic.



The deterioration of confidence indicators from past months was even more acute in November, but the December figure was much less negative. This improvement is seen in almost all indices, but more intensely in the ones related to consumers, retail trade and services. The effect of the third wave of the pandemic in January still remains to be seen.

With regard to household consumption, the Christmas season has been much slower than in previous years in terms of consumption of goods as well as of services, due to restrictions on mobility and the limited number of people allowed at gatherings. There is still no information available for December as a whole, but it's a fact that the gap between digital and physical purchases continues to increase sharply and that consumer preferences when it comes to purchases and gifts have changed. The latest retail trade index available, corresponding to November, sets the annual rate at -5.1%, mainly due to non-food products. On the other hand, registrations of cars and SUVs in December recorded an inter-annual rate of zero compared to the falls of the previous four months (-18.7% in November), with increases in the distribution channels for individuals (3.5%) and companies (18.1%), while those for rental companies continued to fall sharply (-54.6%). However, last year as a whole, the average annual decline was -32.3%, much higher than in 2019 (-4.8%).

The lower dynamism of domestic demand also shows in new financing operations, which in October and November continued to fall by around -20% year on year, with a significant decline in both of their components: credit to non-financial corporations fell by -22.5% and credit to households by -6.8%. Home mortgages fell by -5.9% year-on-year in October, after having rebounded by 18.4% in September.

The restrictions resulting from the second and third waves are having a very uneven impact on different sectors. Thus, while the recovery in activity is now almost complete in both industry and construction, in the case of the services sector it is proving very difficult and it will probably not fully recover until the disease is no longer a threat. The tourism sector, in particular, continues to be practically at a standstill. Overnight stays in hotels slightly increased their year-on-year fall in November, to -84.5%, and the entry of international tourists to -90.2%. In the first 11 months of 2020, 18.3 million tourists visited Spain, compared to 79.2 million in 2019. At the same time, tourism expenditure fell by an additional 1.1 points to -90.8%.

The balance of payments in October 2020 recorded a financing capacity of 1.9 billion, compared with 3.1 billion in the previous year. The worsening is mainly due to the tourism and travel item, with a balance of 0.4 billion, compared with 3.9 billion in the same period in 2019. On a 12-month cumulative basis, in October 2020 the financing capacity stood at 13.9 billion, down from 30.8 billion in the same month of the previous year. On the same basis, the current account balance was 9.5 billion, down from 24.9 billion a year earlier.

## The Labour Market

### The recovery of the labour market slows down in December

December is usually a favourable month for employment because of the Christmas campaign, but this season's figures in 2020 are not positive and reflect the impact of the second wave of the pandemic on our country's labour market. Thus, the number of people registered with the Social Security points to a slowdown in the labour market recovery process started in June. This can be seen both in the monthly average, with an increase of 26,432 people compared to the previous month, much lower than in previous years, and in the end of month figure, which shows a decrease in 69,600 people compared to the last day of November. There is also a halt in the improvement in registered unemployment, which increased by 36,825 people, which contrasts with the decreases in December of previous years.

This is in addition to the number of people that were still under a furlough scheme on December 31, of which almost half are in the hospitality sector (accommodation and food and drink services), with around 353,000 workers on temporary leave from their contracts or having had their working hours reduced. Hence the concern about the uneven recovery of the different sectors of activity and the critical situation that some sectors are going through. There are also almost 350,000 self-employed workers who still receive benefits.

In Q4 as a whole, effective social security registration corrected for seasonal variations continued to increase (1.7% quarter on quarter) but was well below the rate observed in the previous quarter (15.2%).

The balance for 2020 is clearly negative for the labour market despite the fact that the furlough schemes were able to mitigate the impact of the initial activity decline on employment and subsequently eased the de-escalation process in the most affected sectors. Thus, last year ended with 360,000 fewer people registered than at the end of 2019, around 783,000 people under furlough schemes (both figures on a monthly average) and around 725,000 more people unemployed. This means that, in December 2020, there were approximately 1.1 million fewer people effectively registered with the Social Security system than a year ago (total registered minus those affected by furloughs), which shows the severity of the effects of the pandemic on employment.



## Inflation

The lower decrease of energy prices led to a slower decline in inflation, which stood at -0.5% in December

In December, the Consumer Price Index (CPI) reduced its decline by three tenths to -0.5% in year-on-year rate, accumulating nine months of negative figures.

Core inflation continued to decelerate and stood at 0.1%, one tenth lower than the previous month. An analysis of its components shows that they remain at very low rates, some even close to 0%. Thus, services prices decreased by two tenths to -0.1%, industrial goods prices (excluding energy products) increased by one tenth to 0.1%, and processed foods, beverages and tobacco went up by one tenth to 0.9% in year-on-year rate.

Non-processed foods also slowed down, dropping by six tenths to 1.4%, although they continue to be the most inflationary component of the basket.

Energy prices fell to -6.2%, compared with -9.5% the previous month, and this trend is expected to continue in the coming months. In December, the price of Brent crude oil continued to rise to an average of \$50.2/barrel, 19.5% higher than the previous month, although -27.3% lower than a year earlier. In euros, the monthly increase was slightly lower, at 16.2%, and in year-on-year terms the price of Brent is -33.6% lower. The forecasts for 2021 estimate that the price will oscillate around \$55/barrel, compared to \$41.5/barrel in 2020, and will therefore no longer have a downward effect on inflation.

Looking at the coming months, inflation will slow down its falling rate and gradually return to positive rates, conditioned by the behaviour of oil prices and the evolution of the coronavirus crisis. In 2020, the average CPI rate was -0.3% and in 2021 it is expected to return to positive values, although very subdued.

## The Public Sector

The public deficit in 2020 will be set at around -11.5% of GDP, in line with our forecasts

The years 2020 and 2021 are marked by extraordinary milestones such as the suspension of fiscal rules at European level and the remarkable fiscal boost, both at national level, through the measures adopted by the government, and at European level, where the approval of the recovery plan takes on special importance ahead of the year that has just begun. In fact, the Ministry of Finance, within the State Secretariat for Budgets and Expenditure, has created a General Secretariat for European Funds in order to establish better communication with European institutions and coordinate the actions implemented with the other ministries. It is also worth highlighting the approval of the General State Budget for 2021 after two years of budget extensions.

The crisis generated by the pandemic has had a very negative impact on public accounts in 2020. At the end of October, the general government deficit, excluding local authorities, had risen to -7.1% of GDP. The central government is the level with the highest negative balance (-5.3% of GDP), followed by the Social Security (-2% of GDP), while regional governments are practically in balance due to State transfers (+0.1% of GDP).

The latest information released by the government, up to November, reflects a further increase in its fiscal imbalance, which in terms of national accounts stands at -6.5% of GDP. All this means that the public deficit in 2020 is expected to be around -11.5% of GDP, in line with our forecasts. Public expenditure is 19.1% higher than the accumulated figure up to November 2019, due to a large extent to the necessary measures to combat the pandemic. According to the Ministry of Finance, of the nominal increase in expenditure of 37.694 billion, 33 billion is related to the pandemic. Of these, a little over 18 billion were transferred to the Social Security system, 2.3 billion to the SEPE (Public Employment Service) to finance contributory pensions and unemployment benefits and 11 billion (corresponding to three tranches of the COVID-19 Fund) to be distributed between the regional and local governments. On the other hand, resources have reduced by -12.8% with respect to 2019. Revenues collected from taxes on production and imports fell by -12.3%, with VAT standing out (-14.0%). Income and wealth taxes fell more sharply, especially those corresponding to income taxes (-16.8%) and corporate taxes (-15.9%).

## Forecasts

<b>Economic forecasts for Spain</b>							
(last update: January 2021)							
Annual rates of change, unless otherwise indicated							
	2015	2016	2017	2018	2019	2020	2021
<b>GDP</b>	3,8	3,0	3,0	2,4	2,0	-10,7	7,0
<i>Private consumption expenditure</i>	2,9	2,6	3,0	1,8	0,9	-12,5	7,0
<i>Government consumption expenditure</i>	2,0	1,0	1,0	2,6	2,3	4,0	1,0
<b>Gross fixed capital formation</b>	4,9	2,4	6,8	6,1	2,7	-14,2	12,9
- <i>Tangible fixed assets</i>	4,8	1,7	7,7	7,6	2,7	-16,6	15,0
<i>Construction</i>	1,5	1,6	6,7	9,3	1,7	-16,5	12,7
<i>Equipment and cultivated assets</i>	9,9	2,0	9,2	5,2	4,4	-16,8	18,5
- <i>Intangible fixed assets</i>	5,3	5,3	2,9	-0,7	2,6	-2,5	4,0
<b>Domestic demand (*)</b>	3,9	2,0	3,1	3,0	1,4	-9,2	6,8
<b>Exports</b>	4,3	5,4	5,5	2,3	2,3	-21,6	7,3
<b>Imports</b>	5,1	2,7	6,8	4,2	0,7	-18,9	7,3
<b>GDP current prices</b>	4,4	3,4	4,3	3,6	3,4	-9,7	8,0
<b>GDP deflator</b>	0,6	0,3	1,3	1,2	1,4	1,0	1,0
<b>CPI (average annual rate)</b>	-0,5	-0,2	2,0	1,7	0,7	-0,3	1,0
<b>CPI (dec/dec)</b>	0,0	1,6	1,1	1,2	0,8	-0,5	1,1
<b>Core CPI (average annual rate)</b>	0,6	0,8	1,1	0,9	0,9	0,8	0,8
<b>Employment (Quarterly National Accounts) (**)</b>	3,2	2,8	2,9	2,6	2,3	-7,6	3,6
<b>Employment (LFS)</b>	3,0	2,7	2,6	2,7	2,3	-2,9	-0,8
<b>Unemployment rate (LFS) (% of active population)</b>	22,1	19,6	17,2	15,3	14,1	15,8	18,2
<b>Productivity</b>	0,6	0,2	0,1	-0,2	-0,3	-3,9	3,4
<b>Compensation per employee</b>	0,6	-0,6	0,7	1,0	2,1	1,6	0,5
<b>Unit labour cost (ULC)</b>	-0,1	-0,8	0,6	1,2	2,4	5,4	-2,9
<b>Current Account Balance (% of GDP)</b>	2,0	3,2	2,7	1,9	2,0	0,5	1,0
<b>General government net lending (+) / net borrowing (-) (% of GDP) (***)</b>	-5,1	-4,1	-3,0	-2,5	-2,8	-11,5	-9,0
<b>Interest rates USA (dec)</b>	0,50	0,75	1,50	2,50	1,75	0,25	0,25
<b>Interest rates Eurozone (dec)</b>	0,05	0,00	0,00	0,00	0,00	0,00	0,00
<b>Brent Oil (\$)</b>	52,1	43,3	54,3	70,9	64,8	41,5	55,0

Source: CEOE, INE, Banco de España, Eurostat

(\*) Contribution to GDP growth

(\*\*) Full-time equivalent jobs

(\*\*\*) Excluding aid to the financial sector