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Economic Outlook

February 2021

Overview

- The recovery is expected to gain momentum from the second half of the year onwards, as the number of vaccinated people increases and restrictions are eased.

- In January, PMI confidence indices declined in most countries, mainly in the majority of the services sectors.

- Oil prices continue their upward trend, favoured by expectations of a global recovery and the production limitations agreed by the OPEC+ countries.

- The greater restrictions on mobility and activity at the beginning of the year and the uncertainty associated with the recovery process have led us to revise our Spanish GDP growth forecast for 2021 down to 5.4%. The European Commission's forecast stands at 5.6%.

- If the health situation improves and a certain degree of group immunity is achieved, investment is reactivated with the help of European funds and retained consumption begins to emerge, 2022 will be more positive, with growth that could exceed 6%.

- The recovery of the labour market stalled in January, given the increased restrictions on activity in an attempt to contain the third wave of the pandemic. Within this context, CEOE forecasts that the unemployment rate will rise to 16.9% in 2021.

- Inflation picked up in January due to the lower decrease in energy prices and the increase in core CPI, although it continues to be very moderate (0.5%). Inflation is expected to be around 1% in 2021.

- The lower economic and employment growth forecast for 2021 jeopardises the achievement of the government's public deficit goal (-7.7% of GDP).

The International Scenario

The recovery will be more robust from the second half of 2021 onwards.

In January, the IMF reviewed its growth forecasts and now sets the decline in global GDP for 2020 at -3.5%, a nine-tenths improvement over its previous estimate, due to the greater dynamism of the economy in the second half of last year. For 2021, it points to an increase in global GDP of 5.5%, three tenths higher than the estimate it released a few months ago, as activity is expected to strengthen more than initially foreseen, favoured by vaccinations and fiscal policy support in certain large economies, as well as by very lax monetary policies from the main central banks. In this regard, the IMF recommends that policies should continue to support the recovery until it is firmly on track.

The strength of the recovery in 2021 will vary significantly from country to country, depending on factors such as the effectiveness of the measures and policies adopted, the structural characteristics of each economy and the development of the health situation, among others. Advanced economies, as a whole, will end 2021 at slightly lower activity levels than in 2019, and should surpass said levels throughout 2022, albeit unevenly.

IMF (January 2021) **and European Commission** (February 2021) **growth forecasts**

	IMF			**European Commission**		
	2020	**2021**	**2022**	**2020**	**2021**	**2022**
World growth	-3.5	5.5	4.2			
United States	-3.4	5.1	2.5			
Japan	-5.1	3.1	2.4			
Eurozone	-7.2	4.2	3.6	-6.8	3.8	3.8
Germany	-5.4	3.5	3.1	-5.0	3.2	3.1
France	-9.0	5.5	4.1	-8.3	5.5	4.4
Italy	-9.2	3.0	3.6	-8.8	3.4	3.5
Spain	-11.1	5.9	4.7	-11.0	5.6	5.3
United Kingdom	-10.0	4.5	5.0			
China	2.3	8.1	5.6			
India	-8.0	11.5	6.8			
Brazil	-4.5	3.6	2.6			
Mexico	-8.5	4.3	2.5			
Advanced economies	-4.9	4.3	3.1			
Emerging economies	-2.4	6.3	5.0			
World trade	-9.6	8.1	6.3			

Source: European Commissión, European Economic Forecast - Winter 2021, Feb. 2021, and IMF, World Economic Outlook Update, Jan. 2021

A more dynamic recovery is expected for the United States, with growth of 5.1% in 2021, significantly higher than the -3.4% decline in 2020. The $0.9 trillion economic stimulus plan approved in December, together with a new fiscal package worth another $1.9 trillion, which the new Biden administration is working on, will be crucial to keep the recovery on track. The chairman of the Federal Reserve, Jerome Powell, has also insisted on the importance of the stimuli, pointing out that there has been certain weakness in household demand and considering that growth in both activity and employment are slowing down. Thus, at its January meeting, the Fed kept rates unchanged between 0.0% and 0.25% and continued with its asset purchase programme, stressing the importance of applying a "patiently adaptable" monetary policy to favour the recovery of the labour market. As for the rise in inflation foreseen for 2021, the Fed believes it will be transitory and not very relevant, so it will not affect interest rates, which will remain low for quite some time.

Meanwhile, the Eurozone, as well as Japan and the United Kingdom, will show much more modest recoveries, and the return to GDP levels comparable to those of 2019 is not expected until the end of 2022. Along these lines, the European Commission has also reviewed its forecasts for the EU, improving the results for 2020 due to the better performance of the European economy in the second half of last year. However, it has lowered estimated growth for 2021 by four tenths, both in the Eurozone and in the EU as a whole, due to the new restrictions that have been implemented at the beginning of this year. It is expected that, in the second half, as vaccination progresses and the measures are eased, the recovery will gain momentum. This improvement will presumably continue into 2022, with forecasts for the Eurozone and the EU improving by eight and nine tenths, respectively, in comparison to the estimations released this past fall, although with very unequal results among the Member states. Inflation is expected to remain subdued, although it will rise gently in 2021 due mainly to the energy component. This situation will encourage the ECB to continue applying a very expansionary monetary policy, with rates at minimum levels and its asset purchase programme active at least until March 2022. Its president stressed that ample monetary stimulus remains essential to preserve favourable financing conditions for the economy, which will increase confidence and, in turn, encourage spending and business investment. In addition, she stressed the importance of the implementation of the Next Generation EU plan, which she expects will contribute to a faster and stronger recovery.

Among the emerging economies, China stands out with positive growth in 2020, and is expected to exceed 8% in 2021. Also very noteworthy is India's growth forecast for 2021, which is set over 11%, albeit after a notable decline of around -8% in 2020. Moreover, there is a significant contrast between the Asian economies, which in general will show a dynamic recovery, and those of Latin America, where the crisis has been felt more intensely and for which more modest rates of growth are foreseen in 2021, despite having been revised upwards by five tenths of a percentage point, substantially lower than what was lost in 2020. For Latin America as a whole, GDP is projected to return to pre-pandemic levels by 2023. To support growth in 2021, the IMF believes that some countries still have some fiscal room, as their increase in debt has been offset by a significant decline in interest rates. In addition, it also warns of the uncertainty that the region will experience this year due to the various elections scheduled. With respect to the main economies, it highlights that the GDP decrease in Brazil in 2020, -4.5%, was significantly lower than that of Mexico, -8.5%, partly due to the different dynamics of the economies prior to the crisis, more vigorous in the case of Brazil, but also due to the higher levels of aid given to activities and households, which in Brazil has been close to 8% of GDP while in Mexico is stood at 1.7%.

As for the current situation, the Global Composite PMI index fell for the third consecutive month in January to 52.3 points, the lowest level since last July, although it still shows that the global economy keeps growing. However, the new mobility restrictions implemented in several countries in the face of new waves of the pandemic are affecting demand as well as supply capacity in many activities, mainly in the services sectors, while industrial sectors are holding up better. Worldwide, the worst affected sectors are those linked to tourism, travel and leisure activities, while banking and real estate services have shown significant improvements, leading the global recovery. Among the manufacturing sectors, the best performers were machinery and equipment, the automobile sector, and technological equipment. By country, the United States showed an increase in confidence levels, including services, influenced by the plans to boost its economy. The remaining major economies showed declines in their PMIs, with the United Kingdom's sharp drop to 41.2 points standing out, as a result of the mobility restrictions.

Oil prices kept rising in January, with Brent crude oil monthly average standing at $54.6/barrel, the highest since February 2020. The price increase is due to improved expectations of a recovery in the world economy, together with the cut in oil production still being implemented by the OPEC countries and their allies. In this regard, the announcement of a new stimulus package in the United States has also had an effect on the rise in prices.

The Spanish Economy

Downward revision of growth projections for 2021

The second and third waves of the pandemic have had a significant impact on activity and employment in the latter part of 2020 and the beginning of 2021. Thus, GDP practically plateaued in Q4-2020, as we had estimated. This stagnation of the economy is expected to continue in Q1 of 2021, given the more restrictive measures on mobility and activity in some productive sectors.

These circumstances and the uncertainty surrounding the recovery process, not only in Spain but also in the rest of the world, mainly in Europe, explain the downward revision of the Spanish economic growth forecast in 2021. Even anticipating a change in trend towards greater economic dynamism from spring onwards, the weakness of these initial months of the year has led us to revise our GDP growth forecast down to around 5.4%, an estimate very similar to the European Commission's forecast (5.6%).

If the health situation improves, achieving certain immunity in some groups by year-end, and, from an economic point of view, European funds are incorporated into investment and retained consumption begins to flow through, 2022 will be more positive, with growth that could exceed 6%. By 2022, the foreign environment will also be somewhat more favourable for the Spanish economy and could contribute to an increase in our exports of goods and services. Thus, if all these conditions are met, the Spanish economy would recover pre-crisis activity levels by the end of 2022.

Within this context, risks are clearly on the downside, unless there are some positive surprises linked to the early arrival of recovery funds or a faster than expected return to normality due to the acceleration of the vaccination process. The situation of our main trading partners and of the global economy is, in general, one of containment or even reversal of the recovery, with a clear weakness in some segments of the services sector at an international scale that will negatively affect the Spanish economy this year. From a domestic point of view, the duration of the crisis is taking its toll on a large part of the business fabric of the most affected sectors, which may give rise to solvency problems in these companies. We should also bear in mind the compromised situation of our public finances, which leaves less margin for action if the expected recovery is not achieved.

Demand and Activity

The first estimate published by the INE (National Statistics Institute) for GDP in Q4 2020 shows a virtual plateauing of economic growth at levels reached in Q3 (0.4% quarter-on-quarter), slowing down the recovery. In year-on-year terms, the fall in GDP stands at -9.1%, compared to -9.0% in Q3. With this result, the fall for 2020 as a whole is set at -11.0%, in line with CEOE's forecasts.

From the point of view of domestic demand, it is worth highlighting the increase in household consumption (2.5% quarter-on-quarter) and in government spending (4.0% quarter-on-quarter). However, there was a fall in investment, both in its construction component (-6.3% quarter-on-quarter) and in machinery and capital goods (-1.5% quarter-on-quarter), reflecting a loss of confidence in the short term as a consequence of the delay in activity recovering normal levels, the increase in uncertainty and the decline in business results. On the external sector side, there was a greater decline in exports of goods and services, compared to the less negative performance of imports of goods and services, with respect to the previous quarter. All this has worsened the balance of external trade, intensifying its negative contribution to GDP.

In general, economic sectors have shown much more modest rates than in Q3 2020, albeit with very heterogeneous behaviour. Particularly noteworthy is the deterioration suffered by construction (-8.1% quarter-on-quarter) and some service activities, such as artistic and recreational activities. Only three sectors have recovered or exceeded 2019 year-end levels: Agriculture, livestock, forestry and fishing, Financial and insurance activities, and Public administration, education and health. At the other extreme, the following have experienced very notable declines in the last year: Arts, entertainment and other service activities, Trade, transportation and accommodation and food service activities and Construction.

With regard to Q1, there is hardly any information available on some indicators for January. The worsening of the health situation, the increase in restrictions, the slow pace of the vaccination process and other factors, such as the snow-storm Filomena, had a negative impact on the beginning of the year. All this has led to a deterioration in consumer expectations and in sentiment in certain sectors, mainly retail trade and services, which were already at pessimistic levels. As a result of all these factors, activity is estimated to continue stagnated in Q1.

With information related to Q4 and considering the events of the beginning of the year, at CEOE we have revised our forecasts for 2021 downward and made a preliminary estimate for 2022, setting GDP growth at 5.4% and 6.2%, respectively.

With regard to domestic demand, household consumption will still show little dynamism in the first half of 2021 but will start to pick up strongly from the second half of the year, when we expect the vaccination process to allow for unrestricted "normality" and for activity to resume in some sectors that are now practically at a standstill. In 2022, it will continue to show a high level of dynamism on the basis of the consumption that was backed up during the crisis and an improvement in expectations, in line with an improvement in the labour market. Meanwhile, public spending will continue to register notable increases during 2021 but will moderate its growth significantly in 2022. On the other hand, the high uncertainty still present at the beginning of 2021 is slowing down investment in both construction and capital goods, so its growth will be limited until the second half of 2021, when the improved outlook on the health situation and on the economy, together with the arrival of European funds and the implementation of projects, will boost investment.

From the point of view of the external sector, according to National Accounts data, exports fell by -20.8% and imports by -16.8% in 2020, with intense declines in the trade of goods and services, but especially intense with regard to tourism services, which were still posting falls of close to 100% in Q4 2020 in comparison to 2019. Both exports and imports of goods have been recovering ground over the past year after the plunge in Q2, with energy goods suffering the greatest decline over the year as a whole, while food products were the best performers, in terms of exports as well as imports. As a result, the current account balance has continued to show a surplus, although much lower than in 2019. In 12-month cumulative terms up to November, the net lending position was 14.1 billion, compared to 31.8 billion accumulated up to the same month of the previous year. For the same period, the current account balance was 9.5 billion, down from 26 billion a year earlier. According to our forecast, in 2021 and 2022 the economy will continue to record an external surplus, and this will increase with respect to 2020 as the tourism balance recovers, to stand a few tenths above 1% of GDP.

The Labour Market

Labour market recovery stalls, with an increase in ERTE-furlough schemes in January, as restrictions tighten in response to the third wave of the pandemic

The Q4 2020 LFS shows that the Spanish economy continued its normalization process during this period, although at a slower pace than in the previous quarter. The number of people employed increased by 167,400 compared to Q3, which in seasonally adjusted terms meant a quarter-on-quarter rate of 1.3%, compared to the 3.0% recorded in the previous quarter. Thus, employment (which in LFS terms includes people affected by furloughs) ended 2020 with 622,600 fewer people employed than a year earlier, representing a year-on-year fall of -3.1%. Meanwhile, the number of people unemployed increased by 527,900, to over 3.7 million at the end of the year, although the existence of the furlough schemes has prevented a greater increase in unemployment. In turn, the unemployment rate stood at 16.1% in Q4 2020, up from 13.8% at the end of 2019.

With regard to the outlook for 2021, the expected improvement in economic activity will lead to a certain recovery in the labour market, although this will not be reflected in the official LFS figures due to the gradual return to normality of workers affected by furloughs, who are considered as employed for statistical purposes. Thus, CEOE expects employment in LFS terms to fall by a yearly average of -0.5% in 2021, and to grow by 3.0% in 2022. Meanwhile, the unemployment rate, after reaching an average of 15.5% in 2020, will continue to rise in 2021 to 16.9% and fall to 14.8% in 2022.

The stalling of the labour market improvement shown by the LFS for Q4 continued in January, as indicated by the number of people registered with the Social Security and the registered unemployment figures. This reflects the difficulty of returning to normal job creation rates within a context of increased restrictions on activity as a result of the third wave of the pandemic. January, which is traditionally unfavourable for the labour market due to the end of the Christmas season, finished with 218,953 fewer people registered with the Social Security (monthly average) and an increase of 76,216 registered unemployed, to a total of 3.9 million unemployed. Meanwhile, the daily number of people under ERTE-furlough schemes began to rise after the end of the Christmas campaign, reaching 738,969 people on January 30, which is 35,625 more than at the end of the previous month. In addition, the number of self-employed individuals receiving extraordinary benefits also increased in January, by almost 35,000 people, reaching a total of 384,000 people.

Inflation

A slower decrease in energy prices and a higher core inflation rate push headline inflation up to 0.5%

In January, the Consumer Price Index (CPI) year-on-year rate increased by one percentage point to 0.5%, after accumulating nine months in the negative. Despite this increase, inflation remains at very subdued rates, both in terms of the headline rate as well as core inflation, reflecting the weakness of private consumption and the absence of external inflationary pressures.

Core inflation increased by five tenths, to 0.6%. An analysis of the different components shows that they remain at very low rates. Thus, Services prices increased by six tenths, to 0.5%. Industrial Goods prices excluding energy products increased by two tenths, to 0.3%, and Processed foods, beverages and tobacco increased by two tenths in year-on-year terms, to 1.1%. The rise in the latter group of Processed foods, beverages and tobacco was largely determined by the tax increase on sugar-sweetened beverages, which, if excluded, would leave the price increase at 0.6%, three tenths less than in the previous month.

Non-processed food prices showed higher growth, rising by more than one point to stand at 2.5%, and they continue to be the most inflationary component of the basket, with increases concentrated in vegetables, fresh fruit and sheep meat.

Energy prices continued to slow their rate of decline in January. Specifically, the year-on-year rate this month was -1.8%, compared to -6.2% the previous month, and this trend of a slower fall is expected to continue in the coming months, given that in the first days of February the price was around $60/barrel.

Over the coming months, inflation will be conditioned by the behaviour of oil prices and the decline in the demand for some goods and services caused by the coronavirus crisis. In any case, we can confirm that we are experiencing a period of price stability without inflationary pressures. Our forecasts point to yearly average inflation at 1.2% in 2021 and 0.5% in 2022.

The Public Sector

The extraordinary situation of the pandemic takes its toll on the public accounts in 2020 and foreseeably in 2021 if the economy's recovery is lower than expected

With information up to November 2020 on budget execution for the all the Public Administrations with the exception of Local Governments, the budget balance stands at -7.8% of GDP, compared to -1.6% of GDP in the same period of 2019. These results highlight the very sharp deterioration of public finances in 2020, whose deficit will exceed -11% of GDP.

As has become the norm this year, the Central Government is the one with the largest deficit, with -6.5% of GDP, as it has borne the cost of the measures implemented to deal with the pandemic. This result contrasts with the surplus of +0.3% of GDP of the Autonomous Regions up to November, due to the financing received from the Central Government. In fact, regional revenues grew by 8.5% up to November, due to a 14.5% increase in transfers received from the State and a 4.2% increase in tax resources. Within the expenditure of the Autonomous Regions, the greatest increase is centred on intermediate consumption (9.4%), due to higher healthcare spending, and on subsidies (13.9%).

Meanwhile, the Social Security posted a negative balance of -1.7% of GDP, due to the higher amount allocated to social benefit programs. Resources increased by 14.1%, especially due to the transfers received from the State, but non-financial expenses increased even further by 22.1%.

Looking ahead to 2021, the Government anticipates an adjustment of the deficit, which it estimates could reach -7.7% of GDP, compared to -11.3% in 2020. This target is based on GDP growth forecasts ranging from 7.2% in the inertial scenario to 9.8% in the best-case scenario for 2021. The optimism of the macroeconomic scenario conditions the revenue forecast, which is overestimated, and partly supports the high growth in expenditure (20%). All this in a context of very high uncertainty due to the outbreaks of the pandemic after Christmas and their impact on activity, which jeopardizes compliance with the goals set for this year. In fact, the Funcas panel points to a budget balance forecast of -8.4% of GDP, somewhat above our estimates (-9.0% of GDP).

CEOE Empresas Españolas

Informe Economía

Forecasts

Economic forecasts for Spain (last update: February 2021) Annual rates of change, unless otherwise indicated	2016	2017	2018	2019	2020	2021	2022
GDP	3.0	3.0	2.4	2.0	-11.0	5.4	6.2
Private consumption expenditure	2.6	3.0	1.8	0.9	-12.6	6.8	7.5
Government consumption expenditure	1.0	1.0	2.6	2.3	4.5	3.7	0.6
Gross fixed capital formation	2.4	6.8	6.1	2.7	-12.4	4.8	11.0
-Tangible fixed assets	1.7	7.7	7.6	2.7	-14.5	5.1	11.7
Construction	1.6	6.7	9.3	1.6	-15.8	3.0	11.9
Equipment and cultivated assets	1.9	9.2	5.2	4.3	-12.6	8.2	11.3
-Intangible fixed assets	5.2	2.9	-0.7	2.6	-1.5	3.2	7.5
Domestic demand (*)	2.0	3.1	3.0	1.4	-9.0	5.0	5.5
Exports	5.4	5.5	2.3	2.3	-20.9	6.6	9.4
Imports	2.6	6.8	4.2	0.7	-16.8	5.0	6.7
GDP current prices	3.4	4.3	3.6	3.4	-10.0	6.9	7.2
GDP deflator	0.3	1.3	1.2	1.4	0.9	1.5	1.0
CPI (average annual rate)	-0.2	2.0	1.7	0.7	-0.3	1.2	0.5
CPI (dec/dec)	1.6	1.1	1.2	0.8	-0.5	1.4	0.5
Core CPI (average annual rate)	0.8	1.1	0.9	0.9	0.7	0.5	0.6
Employment (Quarterly National Accounts) (**)	2.8	2.9	2.6	2.3	-7.5	2.1	4.5
Employment (LFS)	2.7	2.6	2.7	2.3	-2.9	-0.5	3.0
Unemployment rate (LFS) (% of active population)	19.6	17.2	15.3	14.1	15.5	16.9	14.8
Productivity	0.2	0.1	-0.2	-0.3	-3.8	3.3	1.8
Compensation per employee	-0.6	0.7	1.0	2.1	1.8	0.6	1.1
Unit labour cost (ULC)	-0.8	0.6	1.2	2.4	5.8	-2.7	-0.7
Current Account Balance (% of GDP)	3.2	2.8	1.9	2.0	0.5	1.2	1.5
General government net lending (+) / net borrowing (–) (% of GDP) (***)	-4.1	-3.0	-2.5	-2.8	-11.5	-9.0	-6.0
Interest rates USA (dec)	0.75	1.50	2.50	1.75	0.25	0.25	0.25
Interest rates Eurozone (dec)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Brent Oil ($)	43.3	54.3	70.9	64.8	41.5	57.9	54.3

Source: CEOE, INE (National Statistics Institute), Banco de España, Eurostat

(*) Contribution to GDP growth

(**) Full-time equivalent jobs

(***) Excluding aid to the financial sector