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Economic Outlook

November 2021

Overview

- **Slowdown in the recovery of the global economy due to the inflation impact and the problems in global supply chains.**
- **The transitory nature of most of the factors that are pushing up prices is not deterring some central banks from starting to tighten their monetary policy.**
- **Oil prices continued to rise in October following the OPEC+ agreement to continue to increase production very gently.**
- **The Spanish economy heads into the final stretch of the year with slower activity growth, greater dynamism in employment and high inflation.**
- **CEOE revises downwards the growth outlook for Spain in 2021 and 2022 to 4.8% and 5.0%, respectively, in line with the European Commission (4.6% and 5.5%). This revision is mainly due to the lack of supplies and the rise in the prices of raw material, together with the delay in the application of European funds and the regulatory uncertainty.**
- **Activity will continue its recovery during Q4 driven by household consumption, but the contribution of the foreign sector and the recovery in tourism may be lower than initially expected.**
- **Job creation has been notable in recent months, more intense than the GDP recovery. However, the effective number of workers registered with the Social Security in the private sector is still around 150,000 below pre-crisis levels.**
- **Inflation reached 5.4%, driven by the rise in energy prices. Core inflation is also rising, although it still remains very subdued at 1.4%.**

The International Scenario

High inflation slows down global growth and portends the tightening of monetary policies

The recovery of the world economy is still underway, although at a slower pace of growth than in the first half of the year and with greater disparities between regions. The vaccination rollout and the evolution of the pandemic variants, mainly the delta variant, are still factors that condition activity in many countries. In addition, the persistence of bottlenecks in the global production and distribution of certain goods also limits activity, which, together with the increase in energy prices, puts pressure on global inflation. Both of these factors are contributing to the slowdown in growth. Although many of the mismatches between supply and demand are believed to be transitory in nature, inflationary pressures are not expected to ease significantly in the short term, given that the coming months are traditionally characterized by high consumption and strong energy demand; therefore, price moderation will be more evident from next spring onwards. The greatest risks could arise from possible second-round effects, which would make inflation more persistent and could de-anchor the long-term inflationary expectations of economic agents, which would bring about a tightening of central banks' monetary policies. The latter is already beginning to occur in certain countries.

In the European Union, after an uncertain start to the year, activity gained momentum in Q2 and Q3, supported by a swift vaccination rollout and the lifting of restrictions. As a result, in Q3, GDP rates reached pre-pandemic levels again, posting a quarterly growth of 2.1% for the EU and 2.2% for the Eurozone, albeit with significant differences from one country to another. However, in recent months, several European countries have seen rebounds in the number of people infected, especially in Central Europe, while several industries (mainly manufacturing), are suffering from bottlenecks arising from global supply chains, with delays in production and limitations in activity. This is putting upward pressure on prices and negatively affecting consumption and investment. In addition, we have to take into account the increase in energy prices, most notably in gas, which have pushed inflation in October to 4.1% in the Eurozone, the highest levels since 2008.

In this context, the European Commission has revised upwards its growth forecasts for the current year by two tenths to 5.0% for both, the EU as a whole and the Eurozone, due to the better performance of the previous quarters. On the other hand, it has revised its forecast for 2022 down by two tenths to 4.3%, due to the temporary effects of high inflation and production constraints. For 2023, it forecasts a slowdown in the growth rate to 2.4% for the EU and 2.5% for the

Eurozone, as the effects of the Next Generation Plan fade away and fiscal and monetary policies become less expansionary.

European Commission forecast (November 2021)									
	GDP			**Inflation**			**Unemployment rate**		
	2021	**2022**	**2023**	**2021**	**2022**	**2023**	**2021**	**2022**	**2023**
EU-27	5.0	4.3	2.5	2.6	2.5	1.6	7.1	6.7	6.5
Eurozone	5.0	4.3	2.4	2.4	2.2	1.4	7.9	7.5	7.3
Spain	4.6	5.5	4.4	2.8	2.1	0.7	15.2	14.3	13.9
Germany	2.7	4.6	1.7	3.1	2.2	1.7	3.6	3.4	3.2
France	6.5	3.8	2.3	1.9	2.1	1.4	8.0	8.0	7.9
Italy	6.2	4.3	2.3	1.8	2.1	1.4	9.8	9.3	9.2
United Kingdom	6.9	4.8	1.7	2.4	3.2	2.2	4.9	4.7	4.4
United States	5.8	4.5	2.4	4.3	3.3	2.2	5.5	4.2	4.0
Japan	2.4	2.3	1.1	-0.5	0.2	0.4	2.8	2.6	2.4
China	7.9	5.3	5.3						
World	5.7	4.5	3.5						

Source: European Commission

In the United States, the slowdown in growth already took place in Q3, when GDP posted a rate of 0.5% quarter-on-quarter, well below the quarterly 1.6% recorded, on average, in for the first half of the year. A lower vaccination pace and supply problems and delays, along with rising energy prices, pushed CPI up to 6.2% in October, which is the highest reading since November 1990, while core inflation stands at 4.6%, the highest since 1991. The higher prices are also reflecting in the labour market, with upward pressures on wages. For Q4, PMI indicators point to slightly better growth than in Q3, but below the rates of the first part of the year. The notable increase in employment in October, with the creation of 531,000 new jobs, pushed the unemployment rate down by two tenths to 4.6%. Meanwhile, the Federal Reserve, faced with rising prices and a reduction in the unemployment rate, decided at its November meeting to start cutting its bond-purchasing program by 15 billion a month as of this month, and aiming to end said program by mid-2022, while the markets are starting to contemplate possible rate hikes over the course of next year.

In China, activity also decelerated significantly in Q3, with growth standing at 0.2% quarter-on-quarter, the lowest rate since the start of the pandemic. It has been affected by the delta variant of the coronavirus, bottlenecks in the supply of certain goods and energy supply problems, together with the restrictions adopted to limit pollutant emissions. In Q4, indicators are giving mixed signals, with retail sales and exports performing better and industrial production still decelerating.

The real estate market is also struggling with some concerning problems, such as the Evergrande developer crisis, together with the government's intention to progressively reduce the weight of construction in GDP. Thus, the country's growth is expected to slow down in the short and medium term.

In October, the global composite PMI improved slightly to 54.5 points. This underpins the expansion of the world economy mainly as a result of the good performance of the services sector, while manufacturing continues to suffer from supply chain problems. Growth improved in the United States, the United Kingdom and India, among other countries, and very mildly in China. There was also a better performance in Japan, which posted positive growth again after five decreasing months. In the Eurozone, on the other hand, there was less dynamism, although the indicators continue to show a clearly expanding economy. By sector, the strongest performers are health services, followed by financial services, pharmaceuticals and biotechnology, while the automotive sector is the worst performer worldwide.

Rising inflation is capturing the attention of the financial markets, as some central banks are beginning to tighten monetary policy in response to rising prices. Since last summer there have been rate hikes in Norway, South Korea, several South American countries including Chile, Brazil, and Mexico, as well as in Russia and the Czech Republic, and more recently in Poland, Peru and New Zealand. In addition, the Bank of England, Canada and Australia may join in the coming months and have already expressed their intention to do so. The United States has also begun to cut back on its bond purchasing program, while the ECB, for the time being, insists on the temporary nature of the increase in prices as a reason for keeping its monetary policy unchanged.

As for oil, the price of Brent crude rose again to an average of $83.8/barrel, more than double than a year ago and the highest price since October 2014. Rapid growth in global demand, coupled with weak supply in the wake of the pandemic, are pushing crude oil prices higher. In addition, the decision of the OPEC+ countries to maintain their pace and quotas of production increases, despite the difficulties of some of their partners, such as Angola or Nigeria, complicate the closing of the supply deficit.

The Spanish Economy

Slower recovery in activity, but not in employment. Inflation at high levels

The published GDP, employment and inflation figures show a recovery of the Spanish economy characterized by less intense activity, a surprising dynamism in employment and worrying levels of inflation.

After the downward revision of GDP in Q2, which lowered growth expectations for 2021, Q3 figures have confirmed this trend in an even more pronounced way. With a 2% quarterly rate in this last period, the Government's estimations of 6.5% in 2021 are going to be very difficult to achieve, and even those that pointed to an increase of over 5% seem challenging. In fact, at CEOE we have revised growth downwards to 4.8% for 2021 and 5.0% for 2022, in line with the European Commission (4.6% and 5.5%, respectively).

Furthermore, the GDP composition reflects some worrying elements with regard to the recovery process, such as the fall in household consumption. Also noteworthy is the situation of the business sector, which trying its best to hire workers (employment is close to pre-crisis levels) and invest within a context of rising costs (not just labour costs, but also raw material costs) and notable bottlenecks in production. As a result, the Gross Operating Surplus continues to decline and is currently -9.9% below pre-crisis levels.

The short-term employment outlook is positive, but there are shadows in the future if the recovery slows down or if there are regulatory changes that imply more barriers to the hiring process or an increase in costs. In addition to the good LFS figures for Q3, there has been an exceptional rise in employment in National Accounting terms (700,000 more jobs in just one quarter). These results bring employment data closer to pre-crisis levels, although not the unemployment rate (14.6% today, compared to 13.8% at the end of 2019).

Rising prices for energy and raw materials, together with production bottlenecks, are causing a supply shock that is triggering a higher-than-expected increase in inflation. In Spain, the October CPI reached 5.4% and is expected to remain around 5% until the end of the year. Although core inflation remains subdued, the repercussions are manifold: higher pension expenditures, loss of purchasing power in household income and negative real interest rates, which are detrimental to savers.

Demand and Activity

The recovery of activity will continue in Q4 driven by household consumption

In Q3, the economy continued to register an improvement in activity, albeit at a modest pace (2% quarter-on-quarter, according to INE's first estimate), lower than analysts' expectations. This figure, together with the downward revision of the figure for Q2, cools growth expectations for this year, which is estimated to close at around 5%.

Now that the risks associated with the pandemic are not having as much impact on economic activity, other factors are beginning to weigh negatively on growth (raw material prices, difficulties in the supply of materials and components, higher transport costs, etc.). In addition, as far as Spain is concerned, the recovery of international tourism, which, as we shall see below, is progressing slowly, and the implementation of European funds will be fundamental.

The first figures for Q4 point to a continuation of the recovery. Thus, in October, consumer expectations in all sectors continued to improve with respect to the average for Q3, with a particularly strong improvement in the case of services and retail trade. In the case of consumer confidence, both the present situation of households and the trend of the economy in general are seen with greater optimism. Also, PMIs in October continue to be well above the 50 level (indicating activity growth) for both manufacturing and the service sector, although somewhat lower than the levels reached in Q3, when they stood at close to 60 points.

Available indicators on household consumption in recent months show an acceleration, mainly spending on services, while those on goods indicate lower momentum. Households are reported to have increased their spending on accommodation, restaurants and leisure considerably during the October 12 and November 1 bank holidays. However, consumption of durable goods, especially automobiles, was not as robust. Production difficulties due to the shortage of microchips, coupled with very subdued demand, are causing registrations to accumulate further declines. For the year as a whole, car sales could register slightly more than a 5% increase compared to 2020, but a drop of more than 30% compared to 2019 levels, even taking into account a possible increase in sales in the final stretch of the year in the face of the registration tax hike that will take place in January 2022. With respect to household consumption in the coming months, the persistence of high inflation levels could lead to a decline in purchasing power. Moreover, the savings accumulated during the pandemic are mainly concentrated in higher-income families and could be used for investments (financial or real estate assets).

Supply problems and the rising costs of certain raw materials are affecting the activity in part of the industrial sector, which is reflected in a decline in the industrial production index in its capital goods component and a slowdown in the growth rates of consumer durables and intermediate goods.

From the point of view of the foreign sector, with information up to August, there was a slightly better evolution of exports than imports. Thus, in the first eight months of the year and in terms of volume, exports increased by 15.5% year-on-year and imports grew by 14% year-on-year. The result of these flows was an accumulated trade deficit in this period of -€10.8712 billion, 13.1% higher than the figure for 2020 and 52.7% lower the one for 2019. According to the Balance of Payments data published by the Bank of Spain, the accumulated figure for the 12 months up to August 2021 shows that the Spanish economy recorded a foreign financing capacity of 17.4 billion, similar to figures for the same period in the previous year. The worse performance of the tourism and travel balance (10.1 billion, compared to 19.9 billion a year earlier), even though it was partly offset by the improvement in the balance of goods, could not prevent a worsening of the current account balance (10.3 billion, compared to 13.2 billion a year earlier).

The latest available data for the tourism sector show that tourist arrivals continue to recover, although they are still far below pre-pandemic levels. In September, international tourist inflows stood at 4.7 million tourists, 312% higher than in the previous year, although still -47% below the September 2019 figure. Similarly, total spending by international tourists in September reached €5.041 billion, down -48% from 2019. These rates barely represent an improvement over those recorded in August, which means a flattening of growth rates and could lead to a slowdown in the pace of recovery.

The Labour Market

Remarkable boost in job creation in October

The results of the LFS show that the labour market has continued to improve in Q3. In a period traditionally marked by positive seasonality, the gradual lifting of restrictions and the progressive return to normality brought about by the progress in the vaccination rollout have boosted job creation, with a quarter-on-quarter increase of 359,300 jobs, higher than in previous years except for 2020's figure. In addition, the dynamism in the private sector, which has generated 314,800 jobs, is particularly noteworthy. Due to the improvement of the economic outlook, there have been more people re-entering the labour market, which has led to an increase in the active population of 232,200 people. In turn, this has slowed down the decrease in the number of employed individuals, which fell by 127,100 people, while the unemployment rate dropped to 14.57%.

The October results for Social Security registrations and registered unemployment are favourable, even better than expected. Registered unemployment fell by 734 people in October, as opposed to the typical increase at this time of year following the end of the summer season for some activities. The number of people registered with the Social Security increased by 159,478, the largest increase in the historical series for this month. In the private sector, 129,630 new workers were registered, while the public sector added 29,848 workers. In seasonally adjusted terms, registrations grew for the sixth month in a row, specifically by 102,474 people, which is a higher increase than in August and September, and the Ministry of Inclusion, Social Security and Migration estimates that November will close with around 90,000 more registered workers. Meanwhile, the number of workers under furlough schemes-ERTE fell again in October by 48,029 people, to stand at 198,041 people (monthly average).

Following the October results, the number of Social Security registrations exceeds the number recorded in October 2019 by 260,597 workers. Discounting ERTEs, the effective registrations figure is 0.3% higher than in October 2019, i.e., 62,556 workers. However, the situation differs from the public to the private sector. In the public sector, the current level of workers registered with the Social Security is higher than in October 2019 by 212,570 people. In the private sector, registrations exceed those of two years ago by 48,027 people, although actual employment is still below pre-crisis levels, at 150,014 workers.

Job creation is outpacing the economic recovery. However, the more than 3.2 million unemployed, the almost 200,000 people in ERTE and a lower GDP growth than estimated a few months ago, together with the existing uncertainty and downside risks, make it necessary to exert some caution about the future evolution of the labour market.

Inflation

Inflation rises 1.4 points to 5.4% due to higher energy prices

In October, inflation increased by 1.4 points to 5.4% year-on-year, with higher energy prices being the main inflationary component. It should be noted that current inflation reflects a strong "base effect", since in 2020 prices fell until December.

Core inflation also increased, albeit more moderately, by four tenths, bringing its rate of change to 1.4% year-on-year due to the higher increases in all its components. Thus, Services increased by five tenths to 1.4%, Industrial Goods without energy products went up by two tenths to 0.9%, and Processed foods, beverages and tobacco rose by five tenths to 2.0%.

Non-processed food prices dropped by seven tenths to 0.9% year-on-year.

Energy prices are the most inflationary component of the CPI, with a year-on-year rate of 39.5% (28.8% in September). In fact, the October CPI rate excluding energy products was set at 1.4%. In particular, motor fuel prices, together with electricity and liquid fuels, continued to grow at very high rates. In October, crude oil stood at $83.9/barrel (a year-on-year increase of 114% in euros), and at the beginning of November it reached almost $85/barrel. Over the past week it has started to fall and is now trading at around $82/barrel, which, if continued, would represent an increase of 99% in year-on-year terms. Forecasts suggest that the price will remain relatively stable over the next few months, which will continue to put upward pressure on inflation. The latter should start to decrease from December onwards.

Despite the upward trend in raw material prices, their effect on inflation is expected to be transitory and should gradually diminish over the coming months. This, coupled with the fact that core inflation is expected to remain at subdued levels, will be factors that should help to bring back the inflation rate.

The Public Sector

Remarkably strong tax revenues in 2021, but still below the expected level

With three months of information still pending until the closing of the 2021 fiscal year, the accumulated State public deficit up to September 2021 narrowed to -4.5% of GDP, vs. -5.1% of GDP for the same period of 2020. In terms of the primary balance, this is also less negative than in 2020, standing at -3.1% of GDP (-3.6% previously).

It is worth highlighting that non-financial resources have increased by 16.2%, with tax revenues standing out with a 17.6% rise in comparison to 2020. Despite these strong revenues, the final figure for the year is expected to be lower than the estimation included in the General State Budget for 2021. Thus, there will once again be a negative gap between actual and expected revenues, with a deficit that could vary between €7 billion and 9 billion.

In cumulative terms up to the end of September, VAT revenue has grown at a good pace (+16.4%), as has Personal Income Tax (+28.3%). Other items showing strong collection rates are the Insurance Premium Tax, with an increase of 32.1%, and the auctioning of greenhouse gas emission rights, with a year-on-year increase of 29.4%.

As for non-financial uses, they continued to increase at a good pace up to September (9.6%), even though the impact of COVID-related expenditure was down 23.7% compared to 2020. It is worth noting that during the present year there has been a significant expenditure on vaccines, as well as transfers to the regional administrations amounting to a total of 16,314 million, of which 6.765 billion correspond to the COVID line of direct aid to self-employed workers and companies, and 9.426 billion to the additional allocation of resources delivered in September.

Among the rest of the expenditures not related to the pandemic, the most noteworthy are the increases made to finance expenditures on Dependency and the Minimum Vital Income, the transfers to the Public Employment Agency (SEPE), the higher contribution per GNI resource and the increase in the financing cost of the electricity deficit.

Forecasts

Economic forecasts for Spain (last update: November 2021)						
Annual rates of change, unless otherwise indicated						
	2017	2018	2019	2020	2021	2022
GDP	3.0	2.3	2.1	-10.8	4.8	5.0
Private consumption expenditure	3.0	1.8	0.9	-12.2	4.4	5.9
Government consumption expenditure	1.0	2.3	2.0	3.3	3.1	2.2
Gross fixed capital formation	6.8	6.3	4.5	-9.5	3.7	4.5
-Tangible fixed assets	7.7	7.5	5.8	-10.5	3.6	4.8
Construction	6.7	9.5	7.1	-9.6	-3.1	2.4
Equipment and cultivated assets	9.2	4.6	3.7	-12.1	14.8	8.1
-Intangible fixed assets	2.9	1.1	-1.5	-4.3	3.9	3.3
Domestic demand (*)	3.1	2.9	1.6	-8.6	4.3	3.8
Exports	5.5	1.7	2.5	-20.1	12.9	11.2
Imports	6.8	3.9	1.2	-15.2	11.6	7.9
External demand (*)	-0.2	-0.6	0.5	-2.2	0.5	1.2
GDP current prices	4.3	3.6	3.4	-9.8	6.3	6.0
GDP deflator	1.3	1.3	1.3	1.0	1.5	1.0
CPI (average annual rate)	2.0	1.7	0.7	-0.3	3.0	2.3
CPI (dec/dec)	1.1	1.2	0.8	-0.5	5.1	0.2
Core CPI (average annual rate)	1.1	0.9	0.9	0.7	0.7	1.3
Employment (Quarterly National Accounts)(**)	2.9	2.2	2.6	-7.6	5.9	2.5
Employment (LFS)	2.6	2.7	2.3	-2.9	2.9	2.7
Unemployment rate (LFS) (% active population)	17.2	15.3	14.1	15.5	15.1	14.2
Productivity	0.1	0.1	-0.5	-3.5	-1.1	2.6
Compensation per employee	0.7	1.8	2.6	1.3	-0.3	2.0
Unit labour cost (ULC)	0.6	1.7	3.1	5.0	0.9	-0.6
Current Account Balance (% of GDP)	2.8	1.9	2.0	0.7	1.2	1.5
General government net lending (+) / net borrowing (–) (% of GDP)	-3.0	-2.5	-2.9	-11.0	-8.0	-6.2
Interest rates USA (dec)	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
Brent Oil ($)	54.3	70.9	64.8	41.5	72.1	79.7

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

(*) Contribution to GDP growth

(**) Full-time equivalent jobs