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Economic Outlook

May 2022

Overview

- The European Commission follows other international organizations and revises growth forecasts downwards and inflation forecasts upwards.

- The main central banks expedite the tightening of their monetary policies, given the persistence of high inflation rates and the risk of expectations becoming de-anchored.

- The Spanish economy's growth outlook for 2022 suffers a notable downward revision by the Government (4.3%) and the European Commission (4.0%).

- After the disappointing growth rate posted by Spain in Q1, the start of Q2 is marked by rising inflation and supply problems in the industrial sector.

- The labour market returns to normal in 2022 while, for the time being, it is weathering the unfavourable external context better than activity. Even so, CEOE forecasts indicate that this year's job creation will be more modest than the GDP growth rate.

- Inflation slowed down slightly in April but is still very high. It is expected to continue on a downward path in the coming months on the back of lower inflationary pressure from the energy component.

- The Stability Program still lacks a fiscal strategy, revealing the main vulnerabilities of our public finances: the high public debt (above 100% of GDP until 2025) and the structural deficit (around -4% of GDP).

The International Scenario

Tightening of monetary policy in the face of persistently high inflation rates

The persistence of inflation at historically high rates is prompting the main central banks to tighten monetary policy, while economic activity is showing signs of deceleration. The first quarter of the year showed negative growth in the United States (-0.4% quarter-on-quarter) and moderate growth in the Eurozone (0.3% quarter-on-quarter), influenced by the impact of the war in Ukraine, which is putting upward pressure on prices and complicating the normalization of global production chains. In addition, China's zero-tolerance policy on COVID has slowed activity and also hindered exports and trade with other countries, increasing risks to global growth.

Inflation continues to be the strongest concern. In the Eurozone, it again posted a record high of 7.4% in April, the same as in March, while in the United Kingdom it continued to rise to 9.0%, the highest in forty years, with its central bank estimating that it might exceed 10%. In the United States, on the other hand, it fell by a couple of tenths to 8.3%, although it also remains at very high levels. Aside from the price pressures derived from the energy and other raw materials components, the difference between the United States and the United Kingdom vs. the Eurozone is that the increase in prices is more generalized in the former two, with core inflation in the United States at 6.2% and strong strains in the labour market. A similar situation exists in the UK, with widespread inflation and labour shortages putting upward pressure on wages. In addition, recent Brexit tensions and the threat to unilaterally break Ireland's protocol could lead to a trade war with the EU, adding further pressure to rising inflation. In contrast, in the Eurozone, the increase in non-energy prices, although still rising, is still contained, with core inflation at 3.9%, and lower wage pressures. These factors explain the different pace of response from central banks.

In terms of activity, PMI indices for April show a global economy that continues to grow, although it is losing momentum. The Global Composite PMI stood at 51 points, its lowest value in 22 months, reflecting rising costs and trade flow problems. Performance was mixed, with services growing at a slower pace and manufacturing production falling for the first time since June 2020. There were also significant differences across countries, with the Eurozone and Japan showing some improvement, while the United States and the United Kingdom lost some dynamism, although the most significant change is the sharp decline posted by China, whose composite PMI fell to 37.2 points, the lowest since February

2020. The country was hit by the restrictions on activity that persist in many cities due to its policy to curb COVID, and the decline in PMIs anticipates a possible contraction in growth for Q2. The Chinese economy must also address the problems affecting its real estate sector and prevent them from spreading to other activities. Therefore, and although its public sector and central bank have some room to stimulate activity, growth forecasts for the current year have been reduced to around 4.5%, the lowest since 1990 (without taking 2020 into account).

Meanwhile, the European Commission has revised downwards its growth forecasts for Europe and for the world as a whole as a result of the war in Ukraine and the derived increase in inflation. Nevertheless, growth will remain positive, with GDP in the EU and the Eurozone expected to stand at 2.7% for the current year, which is 1.3 points lower than estimations released in February, and at 2.3% for 2023, half a point less than the February forecast. Global growth is lowered to 3.2%, also 1.3 points less than in last autumn's forecast. On a positive note, they point to the recovery of the services sector following the lifting of restrictions on activity and mobility, the good performance of the labour market, and the support to be provided by the Next Generation funds. As for inflation, they estimate that this year it will average 6.8% in the EU and 6.1% in the Eurozone.

European Commission forecast (May 2022)

	GDP			Inflation			Unemployment rate		
	2021	2022	2023	2021	2022	2023	2021	2022	2023
EU-27	5.4	2.7	2.3	2.9	6.8	3.2	7.0	6.7	6.5
Eurozone	5.4	2.7	2.3	2.6	6.1	2.7	7.7	7.3	7.0
Spain	5.1	4.0	3.4	3.0	6.3	1.8	14.8	13.4	13.0
Germany	2.9	1.6	2.4	3.2	7.8	1.9	3.6	3.3	3.2
France	7.0	3.1	1.8	2.1	4.9	3.1	7.9	7.6	7.6
Italy	6.6	2.4	1.9	1.9	5.9	2.3	9.5	9.5	8.9
United Kingdom	7.4	3.4	1.6	2.5	7.0	3.6	4.5	4.0	4.0
United States	5.7	2.9	2.3	4.7	7.3	3.1	5.4	3.6	3.5
Japan	1.7	1.9	1.8	-0.2	1.6	1.5	2.8	2.7	2.6
China	8.1	4.6	5.0						
World	5.8	3.2	3.5						

Source: European Commission

In light of the huge uncertainty that exists right now, the Commission has also considered other, more adverse scenarios, in which the war is prolonged and the impact of high commodity prices, mainly energy, is extended. In the most unfavourable scenario, growth in the Eurozone would be reduced by up to 2.5

points over the base scenario in 2022 and by one point in 2023, while inflation would increase by up to 3 additional points this year and by one point next year.

In the United States, the labour market continues to show remarkable dynamism, with 428,000 jobs created in April, just 1.2 million short of the February 2020 figure, while the unemployment rate remained at 3.6%. High levels of inflation and supply problems have weighed on growth in Q1. However, a recovery is expected for Q2. Annual growth will be around 3% according to the Commission's latest forecast, 1.6 points lower than estimated in the fall.

The good performance of the US labour market and high inflation have led the Federal Reserve to intensify the process of normalizing its monetary policy. At its May meeting, it raised interest rates by half a point for the first time in 22 years, bringing them to between 0.75% and 1.0%. In addition, its chairman, Jerome Powell, has indicated that similar increases could be made at future meetings in order to end the year with rates close to 3.0%. Moreover, starting in June, they will begin to reduce their balance sheet by 30 billion dollars per month, and starting in September by 60 billion dollars per month. The Bank of England also increased its interest rates in May by a quarter of a point to 1.0%, its highest level in thirteen years, due to concerns about inflation, which they estimate could exceed 10% in the coming months as a result of the impact of the war in Ukraine. On the other hand, the president of the ECB, Christine Lagarde, indicated that there could be a rate hike in just a few weeks, the first in a decade, and that it could take place in July, after the asset purchase program comes to an end.

In April, crude oil stood at 104.7 $/barrel, significantly lower than in March, although in year-on-year terms it continues to show high increases: 63% in dollars and 80% in euros due to the strength of the US currency, which has appreciated against the main international currencies. In May, the price of crude oil recovered a certain upward trend and high volatility, in contrast to the weakness of activity in China and the geopolitical uncertainty due to the war in Ukraine. In the coming months, futures prices point to a smooth and gradual decline in oil prices

The Spanish Economy

The European Commission and the government have revised growth forecasts significantly downward

In the presentation of the Stability Program[1] for the 2022-2025 period, the Government has substantially lowered the growth forecast for the Spanish economy to 4.3% in 2022 from the 7.0% reflected in the General State Budget for 2022. The 7.0% rate was clearly difficult to achieve, given the negative impact on the recovery process of high inflation, supply shortages, the weak recovery of international tourism and the reduced materialization of European funds. This Government forecast is in line with the estimates of most national and international institutions. The European Commission, in its latest spring forecast report, estimates a GDP growth of 4.0%, somewhat below estimations from the Government, the Funcas Consensus (4.3%) and CEOE (4.2%).

The beginning of 2022 is being marked by a slowdown in the recovery process, with a quarterly GDP growth of 0.3%, which contrasts with rates of more than 2% in the second part of 2021. Moreover, the composition of growth introduces certain elements of concern, such as the decline in household consumption, the increase in public spending, the notable accumulated fall in productivity and the increase in business costs, which mean that margins will continue to shrink this year, as inferred from the Bank of Spain's Business Activity Survey for the first quarter of the year.

In contrast, employment is performing better in the first months of 2022, both in terms of new job creation and the increase in the number of permanent contracts. However, given the current uncertainty and the particularly complex scenario domestically as well as internationally, we should remain cautious about the future evolution of the labour market.

Inflation forecasts point to a strong rebound in 2022, with a greater divergence across different organizations: 5.3% according to the IMF, 6.3% in the case of the European Commission and 7.5% in the opinion of the Bank of Spain. All of this reflects the high degree of uncertainty in the estimation of this variable.

For 2023, the different organizations and institutions expect economic recovery to continue, but with lower GDP rates, which are estimated at around 3% (3.2% according to CEOE and 3.4% according to the European Commission), while the rates expected for employment (below 2%) and inflation (around 2%) are more modest.

[1] More detailed information about this program may be found in the "Public Sector" section below

Demand and activity

Rising inflation and supply problems mark the start of Q2

The first quarter of 2022 was initially impacted by the sixth wave of the pandemic and, although from February onwards the economic situation seemed to be on a rebound, the outbreak of the war at the end of February exacerbated some risk factors that were already weighing on the economy, such as the increase in raw material and transportation prices or the difficulties in the supply of materials and components. This has led to a deterioration in expectations for this year, especially with regard to inflation and the current account balance, which is already being reflected in real indicators, and to a downward revision of growth forecasts, as mentioned in the previous section.

Even though the combination of all these factors already foreshadowed a slowdown in growth during Q1, the preliminary Quarterly National Accounts data for Q1 2022 still came as a negative surprise, since the 0.3% quarter-on-quarter rate represents a significant slowdown in recovery, given that the economy had ended 2021 at more than 2% growth. It is important to bear in mind that this data is preliminary and is based on information from indicators that don't cover the entire quarter and could, therefore, be subject to significant revisions.

According to the National Statistics Institute (INE), domestic demand is reported to have suffered a setback mainly due to the fall in household consumption. As we already mentioned in last month's outlook report, although this indicator is still showing notable momentum in nominal terms, it has been affected by the significant increase in inflation and the corresponding decrease in the purchasing power of households, and by the deterioration of expectations. Looking ahead to the coming months, the evolution of this component, which was expected to be one of the driving forces of the economy this year, is a cause for concern.

The worsening of expectations seen in March has continued into April, with a significant deterioration in consumer, retail and industrial confidence, while expectations for the services and construction sectors have barely been affected. Moreover, the services PMIs, which had suffered somewhat of a decline in March, have rebounded in April and are well above the 50 level, indicating a favourable outlook for this sector. The manufacturing PMIs, however, although still in the positive range, do point to a worse outlook.

A large part of the deterioration observed in the industrial sector's expectations is due to production difficulties caused by the shortage of components. In this regard, China's ongoing "zero covid" policy will continue to cause bottlenecks in global value chains, so the situation is not expected to return to normal in the coming months. This is coupled with rising energy and transportation costs, which is jeopardizing the activity of many sectors, leading to significant delays, creating uncertainty about the evolution of prices and, in some cases, even causing shutdowns due to the impossibility of continuing production without supplies or without incurring losses.

Indicators related to the housing market show a remarkable dynamism of demand, posting increases of almost 20% in 2021 compared to 2019, while supply is barely increasing, which is producing a tightening of prices.

From the point of view of the foreign sector, the available Customs information for Q1 shows a much more dynamic evolution of imports over exports in nominal terms, due to the greater advance in real terms as well as to the increase in import prices. Thus, exports increased by 23.9% year-on-year (6.2% in volume) and imports by 39.0% year-on-year (14.7% in volume). The result of these flows was a trade deficit in this period of -€15.4165 billion, compared to -€3.2628 billion in the same period of 2021. According to the Bank of Spain's Balance of Payments data, in the first two months of 2022, the current account deficit was -2.4 billion, compared to -1.7 billion in the same period of the previous year. This balance was due to the deterioration to non-tourism goods and services (-5.0 billion, compared to a 0.7 billion surplus in the same period of 2021), partly offset by the surplus in the tourism services balance (4.6 billion, compared to 0.3 billion in the same period of the previous year).

The latest available data regarding the tourism sector shows that international tourist inflows, which started to recover in February, continue on an uptrend and stood at nearly 4.0 million tourists in March, 10 times the previous year's figure, although still almost 30% below the tourists in March 2019, before the pandemic. Similarly, total spending by international tourists still stands at levels of around 70% compared to the same month in 2019.

The Labour Market

The labour market returns to normal in 2022 as it resists the unfavourable external context better than activity

In 2022, the evolution of the labour market is returning to normal and behaving similarly to the years prior to the pandemic, after the remarkable dynamism of employment seen in 2021. In addition, it should be noted that Q1 results confirm that employment, although having suffered a slowdown, has held up better than economic activity despite the deterioration of the international context in recent months, which has been affected by the war in Ukraine, the difficulties in the supply of raw materials and the increase in energy prices.

The labour market should be regarded with caution over the next few months. The evolution of employment in 2022 will be conditioned by the great uncertainty that prevails and the downside risks to economic growth within an unfavourable external environment. In fact, in recent months, there has been a succession of downward revisions to growth forecasts by various national and international organizations and institutions, which will ultimately be reflected in job creation.

With regard to the outlook for 2022 and 2023, the labour market will continue to recover, although job creation will be less intense than in 2021, and also lower than GDP growth. CEOE forecasts that employment in LFS terms will increase by an annual average of 2.5% in 2022 and by 1.7% in 2023, in both cases rates lower than the 3.0% recorded in 2021. Meanwhile, the unemployment rate, after having reached an average of 14.8% in 2021, will continue to fall to 13.7% in 2022 and 12.9% in 2023.

The LFS results for Q1 2022 show that the labour market is now in a process of normalization, with a performance that has not been affected by the sixth COVID wave or by the war in Ukraine. In a quarter that is traditionally unfavourable for the labour market, 100,200 jobs were lost compared to the fourth quarter of 2021, in line with the average for the first quarters of the 2014-2019 period, while the seasonally adjusted quarter-on-quarter rate eased by one tenth to 1.1%. Meanwhile, the labour force decreased by 29,400 people, which enabled the increase in unemployment, up by 70,900 people, to be lower than the decline in employment. Meanwhile, the unemployment rate increased by three tenths, to 13.65%.

Certain aspects of the LFS results are worth noting. Firstly, more than 90% of the fall in employment in Q1 is due to the private sector, which has not yet recovered pre-pandemic (end of 2019) employment levels. Secondly, the evolution by sector has been uneven. Thus, although it's true that employment fell in all sectors, with the exception of construction, it is worth highlighting that industry is the sector that lost the most workers, specifically 68,000 people, the largest drop in a first quarter since 2012. This sector is being affected more than others by supply problems and the rise in energy prices and other raw materials. And thirdly, on a positive note, it is worth highlighting the dynamism of permanent contracts, aided by the entry into force of the labour reform, in contrasts to the decline in temporary jobs. This has allowed the temporary employment rate to fall by more than one percentage point, to 24.2%, driven by the private sector, where the temporary employment rate fell to 22.1%, while in the public sector it rose to 32.5%.

The increase in Social Security registrations in April reflects the favourable effect of the start of the tourist season, with a strong boost in employment in the hotel and catering industry, higher than usual for this month than in previous years. However, other sectors, such as industry and construction, have performed worse than in previous years. Thus, in April, overall Social Security registrations increased by 184,577 people on a monthly average, a figure very similar to the increase recorded in this month in 2019, before the pandemic. The increase in the number of people registered in April was almost entirely due to the private sector, with only 150 new contributors in the public sector. In addition, it is worth noting that April marked the record figure of over 20 million registered workers for the first time since the historical series begun in 2001.

In seasonally adjusted terms, the number of people registered with the Social Security accumulates twelve months of increases, and in April it grew by 33,244 workers. Estimates by the Ministry of Inclusion, Social Security and Migration point to an increase in May of 36,626 contributors, in line with the average of the previous months during 2022, although below the average monthly growth in the second half of 2021.

Registered unemployment fell in April by 86,260 people, a figure similar to the average fall in 2018-2019, although the total figure is still over 3 million unemployed people. Meanwhile, it is worth highlighting the notable increase in registered permanent contracts as a result of recent changes in the labour market regulation. Specifically, they grew by more than 300% year-on-year in April, so that their weight in total hiring rose to 48.2%, when the norm has been around 10%. In addition, there was a notable upturn in permanent seasonal contracts, which accounted for 34.2% of the permanent contracts, compared to the 10.6% they represented a year ago.

Inflation

April CPI falls slightly to 8.3%, due to the lower rise in energy prices

In April, inflation fell by one and a half points to 8.3%, although it continues to be at very high rates. Higher energy prices are still the main inflationary factor.

The evolution of core inflation, which increased by one point in April to 4.4% year-on-year, is a cause for concern. Nonetheless, it is almost 4 points below the headline CPI, reflecting the efforts of the productive fabric to not pass all the cost increases onto the final prices of goods and services.

Within the underlying component, the prices of Services increased by nine tenths to 3.3% year-on-year.; the prices of Industrial Goods without energy products increased by one tenth to 3.3%; and Processed Foods, beverages and tobacco increased by 2.5 points to 8.7% year-on-year, with the increase in oils and fats (48.4%) standing out.

Non-processed food prices increased by almost 4 points to 10.5% year-on-year. The increase in the price of products as basic as cereals, bread, milk, lamb, beef or poultry, all of them with growth slightly above 10%, or eggs (21.6%), is worth noting.

The prices of energy products slowed their year-on-year rate in April to 33.7%, after the 60.9% recorded in March, as a result of a certain decrease in the price of energy commodities and the subsidy approved by the Government on fuels.

Over the coming months, inflation will be strongly conditioned by the evolution and duration of the conflict between Russia and Ukraine and the economic sanctions imposed by the European Union on Russia, which may have significant repercussions on the price of some raw materials, including gas, fuel, cereals, and oils. Moreover, this will be coupled with other factors that were already driving inflation, such as the base effects caused by the pandemic, supply difficulties or the strong rise in the price of some intermediate goods. All this means inflation will continue to post high rates in the short term, although it is already showing some slowdown.

The Public Sector

Projected budget consolidation postponed to 2025

The government has updated Spain's Stability Program for the 2022-2025 period. This program is marked by a more moderate recovery scenario and by the Recovery, Transformation and Resilience Plan (PRTR). In this context, the public deficit will be reduced from -6.9% of GDP in 2021 to -5.0% of GDP in 2022. In line with previous years, the largest imbalance corresponds to the Central Administration (-3.8% of GDP), while the deficit of the Social Security and the Autonomous Regions will not exceed -1% of GDP. The Autonomous Regions will continue to show a balanced budget.

The Independent Authority for Fiscal Responsibility (AIReF) has reviewed the program and believes that it presents feasible scenarios in both macroeconomic and fiscal terms. However, it detects vulnerabilities, such as the high public debt and the structural deficit (around -4% of GDP), and, once again, it stresses the need to establish a credible and realistic medium-term fiscal strategy that should integrate the PRTR and other measures.

In 2022, the Government still contemplates maintaining some measures linked to the pandemic and that are aimed at mitigating the drop in income for workers, the self-employed and companies. It also takes into account the cost of those actions aimed at lowering inflation (reduction of the electricity bill and fuel prices, support for the transport sector and, in general, for the most affected economic sectors), amounting to a total of 16 billion.

This fiscal consolidation path extends into the following years, although the effort to reduce the public deficit is much smaller. Thus, for the 2023-2025 period, targets of -3.9%, -3.3% and -2.9% of GDP, respectively, are foreseen.

It is estimated that public revenues, mainly taxes, will continue to be highly dynamic, although lower than nominal GDP, which will entail a slight loss in the weight of this variable in GDP. Thus, from the 43.7% reached in 2021, this ratio will decline to stabilize at around 41.3% in 2025. In the disaggregated analysis, direct taxes are increasing in weight, while indirect taxes are decreasing. Following the tax increase in 2021, they are expected to remain at 38.3% from 2022 onwards. Spending, which reached record highs in 2020 and 2021 and exceeded 50% of GDP, will decrease to 44.3% of GDP in 2025. The weight of all expenditure items is expected to fall, albeit very slightly.

Forecasts

Economic forecasts for Spain (last update: May 2022)						
Annual rates of change, unless otherwise indicated						
	2018	2019	2020	2021	2022	2023
GDP	2.3	2.1	-10.8	5.1	4.2	3.2
Private consumption expenditure	1.8	0.9	-12.2	4.7	3.1	2.7
Government consumption expenditure	2.3	2.0	3.3	3.1	2.2	1.3
Gross fixed capital formation	6.3	4.5	-9.5	4.3	7.4	5.4
-Tangible fixed assets	7.5	5.8	-10.5	4.1	7.1	5.7
Construction	9.5	7.1	-9.6	-2.8	3.3	4.7
Equipment and cultivated assets	4.6	3.7	-12.1	15.7	12.2	6.8
-Intangible fixed assets	1.1	-1.5	-4.3	5.5	8.9	3.9
Domestic demand (*)	2.9	1.6	-8.6	4.7	3.1	2.7
Exports	1.7	2.5	-20.1	14.7	11.3	6.9
Imports	3.9	1.2	-15.2	13.9	8.3	6.0
External demand (*)	-0.6	0.5	-2.2	0.4	1.1	0.4
GDP current prices	3.5	3.4	-9.7	7.3	7.7	4.2
GDP deflator	1.2	1.3	1.1	2.2	3.5	1.0
CPI (average annual rate)	1.7	0.7	-0.3	3.1	7.0	1.9
CPI (Dec/Dec)	1.2	0.8	-0.5	6.5	4.5	1.5
Core CPI (average annual rate)	0.9	0.9	0.7	0.8	3.9	2.1
Employment (Quarterly National Accounts)(**)	2.2	2.6	-7.6	6.6	3.1	2.8
Employment (LFS)	2.7	2.3	-2.9	3.0	2.5	1.7
Unemployment rate (LFS) (% active population)	15.3	14.1	15.5	14.8	13.7	12.9
Productivity	0.1	-0.5	-3.5	-1.4	1.1	0.4
Compensation per employee	1.8	2.6	1.3	-0.7	2.0	1.8
Unit labour cost (ULC)	1.7	3.1	5.0	0.7	0.9	1.4
Current Account Balance (% of GDP)	1.9	2.1	0.8	0.9	0.0	0.5
General government net lending (+) / net borrowing (–) (% of GDP)	-2.5	-2.9	-10.3	-6.9	-5.2	-4.5
Interest rates USA (Dec)	2.50	1.75	0.25	0.25	2.75	3.50
Interest rates Eurozone (Dec)	0.00	0.00	0.00	0.00	0.50	1.00
Brent Oil ($)	70.9	64.8	41.5	71.1	107.2	95.1

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

(*) Contribution to GDP growth

(**) Full-time equivalent jobs