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Economic Outlook

September 2022

Overview

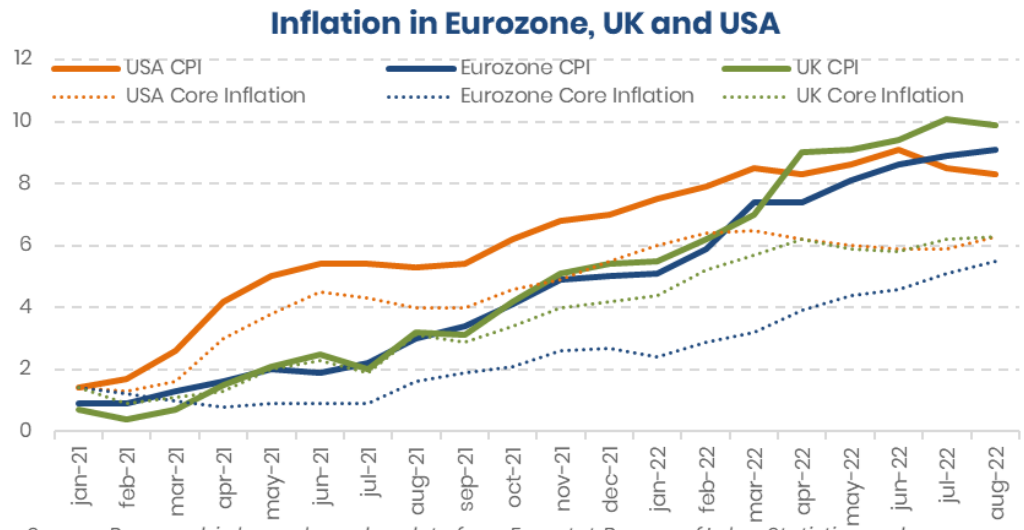
- Persistently high inflation accelerates interest rate hikes by central banks.
- PMI indices in different countries point to a marked slowdown in activity in Q3.
- The price of oil and other commodities is easing due to fears of a slowdown in the world economy.
- Autumn is expected to be a complicated season and with greater uncertainty for the Spanish economy, a scenario shared with Europe and the global economy.
- 2022 could close with growth at around 4%, while a significant downward revision is being made for 2023. In fact, at CEOE, we believe it will be difficult to reach 2% GDP growth next year.
- Job creation has been losing momentum in recent months and will continue to do so in the final stretch of 2022. CEOE estimates that seasonally adjusted effective registrations with the Social Security will increase by 0.7% quarter-on-quarter in Q3, compared to 1.0% in Q2.
- The strong tax revenues continued to drive the decline in the public deficit in the first part of 2022.

The International Scenario

Acceleration in the tightening of monetary policy and slowdown in the global economy

The persistence of high inflation and the acceleration in the monetary policy tightening by the main central banks are the most relevant issues in the international context. On top of this, we must also consider the tensions arising from the war in Ukraine, with the closure of the Russian gas supply through Nord Stream, for the time being indefinitely, which will put additional pressure on gas prices in Europe. These factors, together with other factors such as problems in supply chains, which are still ongoing, are leading to a significant slowdown in the global economy, as the PMI indices for the months of July and August already indicated.

Inflation continues to be very high in both Europe and the United States. In the United Kingdom, the August CPI fell by a couple of tenths to 9.9%, after having reached in July its highest level since 1982. However, food prices continue to rise and core inflation stood at 6.3%. In addition, the Bank of England has said that headline inflation could close the year above 13% and remain in double-digit rates for much of 2023. In the Eurozone, the CPI for August set a new high at 9.1%, two tenths higher than in July, reflecting pressures from energy prices. Inflation is increasingly more generalized, with core inflation standing at 5.5% and notable increases in food prices, among other goods.



Source: Prepared-in house based on data from Eurostat, Bureau of Labor Statistics and Office for National Statistic

In contrast, in the United States, a certain moderation in inflation seems to have been confirmed in August, when it stood at 8.3%, the second decline since the 40-year-highs reached in June. However, the CPI excluding energy and food rebounded four tenths to 6.3% and, although it remains below March's figures, it still records very high levels.

The existing high inflation rates, together with the risk that these could be prolonged over time and affect agents' expectations, have led the main central banks to intensify the pace at which they are tightening their monetary policy. In July, the Federal Reserve raised the interest rate by 75 basis points for the second consecutive meeting to bring the benchmark rate to between 2.25% and 2.5%. Hikes of this magnitude had not taken place since 1994, and it is very likely that they will be repeated at the meeting on September 20 and 21, before the pace is subsequently eased if the slowdown in prices is confirmed. Thus, the year will end with interest rates between 3.5% and 4.0%, depending on the extent of the hikes, and well above what was estimated a few months ago.

This action by the Federal Reserve is favoured by the continued good performance of the US labour market, whose number of employed workers has already clearly surpassed pre-pandemic figures. Despite the remarkable job creation, 315,000 new jobs in August, the unemployment rate rose by two tenths to 3.7%, due to the significant increase of 786,000 in the labour force. Nonetheless, Fed Chairman Jerome Powell, has warned that curbing inflation to the 2% target will cause some pain for households and businesses.

Meanwhile, the Bank of England raised interest rates in August, for the sixth consecutive meeting, to 1.75%. On this occasion, the rise was half a percentage point, the largest increase since 1995, in view of the increase in prices and expectations that they will continue to rise in the coming months, despite the fact that growth has already turned negative, with a decline of -0.1% in Q2. Moreover, the institution's outlook points to a significant recession by the end of this year and in 2023, when GDP is expected to contract by around -1.5%. The new prime minister, Liz Truss, faces a complicated scenario, with very high inflation, a foreseeable recession in the economy and high currency volatility, with the pound showing marked weakness and trading at its lowest level since 1985 against the dollar, which will make imports more expensive and will continue to put pressure on prices.

The European Central Bank also implemented an unprecedented rate hike in September of 0.75 points in the three key rates in the Eurozone, the sharpest in its history, which followed the increase of half a point in July. Thus, the main refinancing rate stood at 1.25%, the marginal lending facility at 1.5% and the deposit facility at 0.75%. For the two meetings remaining this year, it is expected that the tightening will continue and there will be further rate hikes, with the aim of restraining demand and averting a persistent rise in inflation expectations. The reference rate could end the year at around 2.25%, although the extent of the hikes will depend on the evolution of prices.

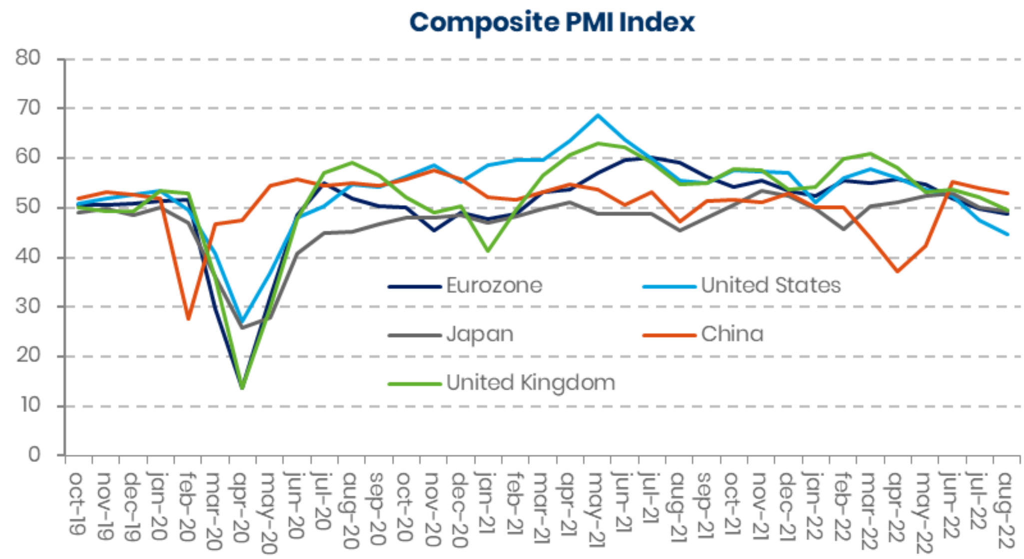
On the other hand, the ECB will continue to reinvest the maturing payments of its Asset Purchase Programmes (APP) for as long as necessary as well as those of the pandemic Emergency Purchase Programme (PEPP) until, at least, the end of 2024, in order to ensure liquidity in the markets. In addition, at its meeting at the end of July, it approved the Transmission Protection Instrument (TPI) to ensure that the monetary policy stance is seamlessly passed on to all eurozone countries, with the aim of preventing risk premia from soaring.

The ECB also revised upwards its inflation forecast, estimating the Eurozone average at 8.1% in 2022 and easing to 5.5% in 2023 and 2.3% in 2024. As for growth, it was revised downward to 3.1% this year, 0.9% in 2023 and a subsequent recovery up to 1.9% in 2024.

The performance of the global economy in Q2 has left mixed results. Noteworthy among the large economies was the decline in Chinese GDP, -2.6% quarter-on-quarter, the worst result since the first months of 2020, reflecting the effects of the lockdown and additional restrictions implemented to combat COVID-19, as well as the problems affecting its real estate sector. In the UK, activity also contracted by -0.1%, reflecting weakness in private consumption, as well as supply problems and labour shortages in some sectors. In the United States, growth in Q2 was also negative, entering a technical recession, although the contraction in activity was less than in Q1, despite the rise in interest rates. The increase in private consumption and exports was offset by a deterioration in investment in view of the prevailing uncertainty.

In contrast, GDP in the Eurozone increased by 0.8%, one tenth higher than in Q1, on the back of the easing of restrictions and the dynamism of services, and all this despite the negative effects of the war in Ukraine. Japan also showed increased activity between April and June, with GDP growth of 0.9%, compared to 0.1% in Q1, supported by a rebound in consumption of face-to-face services after the lifting of restrictions due to the pandemic, and by public aid plans to compensate for the rise in raw materials.

However, looking ahead at Q3, the slowdown in activity is more generalized, as indicated by the PMI indices, which fell in July and even more sharply in August. The Global Composite Index for August fell to 49.3 points, the worst reading since June 2020, below 50 points and pointing to a possible growth contraction, with decreases in new orders and declines in international trade. The possible contraction would be in both, the manufacturing and the services sectors. Among the major economies, only China is above 50 points, supported by the rebound after the relaxation of the restrictions implemented to combat COVID-19. The contraction of the most advanced economies contrasts with some emerging economies, such as China, India, or Brazil, where the indices still show solid signs.



Source: Markit Economics

Raw material prices continue to soften after the peaks reached in March and April, although food still shows positive year-on-year growth of 10% in dollar terms. In euros, the increase is higher, 28%, due to the strength of the dollar. The exception is gas in Europe, which reached a record high at the end of August due to the cut in Russian supplies via Nord Stream. As for oil, Brent crude averaged $104.9/barrel in August, falling for the second consecutive month due to fears of a slowdown in the world economy. However, on a year-on-year basis, it still showed a 46% increase in price, which in euro terms was almost 70%. Futures suggest that the price will continue to fall in the coming months.

The Spanish Economy

Increased uncertainty and economic slowdown in the latter part of 2022

It looks like it will be a complicated autumn and with greater uncertainty for the Spanish economy, a scenario shared with Europe and the global economy. The increase in GDP in Q2 2022 (1.1% quarter on quarter) and the good performance of the labour market (although on a decelerating path) are not enough to prevent the end of the year and the beginning of 2023 from being viewed with a certain pessimism due to several factors.

The first is the persistence of certain variables that limit activity, such as problems in the supply of some intermediate goods and the increase in the cost of production factors. At the same time, inflation remains very high, although it is beginning to show signs of slowing its upward climb. An additional factor is the intensity of the change in monetary policy, which casts a note of caution on how the incipient slowdown in production and inflation will unfold, although it is still impossible to predict its intensity. What is certain is that it will have a negative impact on household disposable income and corporate financing and investment, reducing domestic demand.

Thus, and despite the economic slowdown shown by July indicators (retail trade, industrial production index), except for the tourism indicators, 2022 could close with a growth rate of around 4%, while 2023 is undergoing a significant downward revision. In fact, at CEOE, we see a 2% GDP growth next year as complicated if there is a strong slowdown in activity in Q4 2022 and Q1 2023. We must stress the degree of uncertainty that these forecasts represent, which is very high, due to the possible impact of the energy restrictions in Europe and their consequences in Spain.

At the same time as the GDP forecast for 2023 is revised downwards, so is employment (which will increase by less than 2%), which is already beginning to reflect the lower dynamism of activity, albeit to a lesser degree. As a result, the unemployment rate is unlikely to fall below 12% on annual average next year. On the other hand, inflation continues to be revised upwards, with the average for 2022 very likely to stand at close to 9%, while next year's inflation could exceed 3% on average for the year.

Demand and activity

After the notable rebound in Q2, activity is beginning to decelerate significantly

After the notable slowdown in activity recorded during Q1 (0.2% quarter-on-quarter), the Quarterly Accounts preview indicated a certain rebound for the Spanish economy in Q2 (1.1%). This upturn in GDP is partly due to a normalization of activity, especially visible in the tourism sector, after the notable slowdown in Q1 (especially in March) due to the impact of the outbreak of the war in Ukraine. Thus, for the first two quarters as a whole, GDP is estimated to have been growing at an average rate of 0.6%.

The most positive aspect of GDP in Q2 is the recovery in private consumption (3.2% in quarterly terms), despite the very high inflation recorded this quarter. The 3.4% increase in investment is sustained by the dynamism of construction, which grew by 7.8% in quarterly terms, while investment in capital goods fell by -2.3% quarter on quarter, after several quarters showing notable strength.

In Q3, the evolution is also expected to be positive, given the favourable performance of tourist flows, among other factors, and then it will slow down in the last part of the year. Nevertheless, growth will still be quite subdued, with notable differences across sectors.

The increase in the prices of raw materials, both energy and non-energy, together with the problems in supply chains are having a major impact on industrial activity. In this regard, manufacturing PMIs have shown a clear downward trend over the last few months and have stood below the 50-point mark since July, far from the 60-point level reached in mid-2021. The companies surveyed report a drop in incoming orders, which is associated with a loss of purchasing power among customers due to rising inflation and is leading to a reduction in their workforces. Delays in delivery times continue to be a concern, although they are less intense. In addition, rising production costs remain a cause for concern, and their impact on final prices is being limited by lower demand.

Bottlenecks in the distribution of raw materials and components are also affecting the automotive industry, in addition to the low demand for vehicles in our main markets, factors that have conditioned the evolution of production and exports during 2022 so far. Thus, during the first six months of the year, vehicle production shows a drop of -5.8% compared to 2021. As for exports, up to June, automobile exports show a -7.7% drop compared to 2021. According to the sector, the shortage of components, both in Spain and in Europe, will not return to normal until the early months of 2023.

The services PMIs, on the other hand, continue to show expansionary levels of activity and employment, but have slowed considerably in recent months to almost 50 in July. Companies are suffering from higher operating costs (supplies, transport, and labour costs), which are only partially being passed on to their final prices, and their activity is also being affected by delays in supplies. Nonetheless, a somewhat more modest increase in prices has been observed recently. In addition, the persistence of inflation, which is weighing on the purchasing power of families and companies, is a cause for concern.

The latest available data regarding the tourism sector shows how the inflow of international tourists continues to recover, having exceeded 9 million tourists in July, only 8% below the pre-pandemic July-2019 figure. This represents a significant improvement over the first months of the year, when the number of tourists barely reached 70% of the pre-COVID data. Moreover, the total expenditure made by international tourists from April until today already practically equals the 2019 figures. August's figures could even surpass those of 2019.

In terms of the foreign sector, the customs information available for the first half of the year shows a much more dynamic evolution in imports of goods than in exports, in nominal terms, due to the greater advance in real terms as well as to the price increase of imports. The result of these flows was a trade deficit six times higher than in the first half of 2021. Along the same lines, the Balance of Payments data shows that, up to June, the current account deficit reached 1.2 billion, compared to a surplus of 2.1 billion in the same period of the previous year. This was due to the notable deterioration in the balance of non-tourist goods and services, which was offset by the notable increase in the surplus in the balance of tourist services.

The Labour Market

Job creation slows down in the summer and will continue to decelerate in the final stretch of 2022

The behaviour of the labour market is returning to normal in 2022, with month-to-month patterns more similar to those observed in the years prior to the pandemic, following the strong job creation recorded in 2021. In addition, the favourable results of the Labour Force Survey (LFS) in Q2 were supported by the recovery of domestic and international tourism, on the back of the lack of mobility restrictions and the good weather.

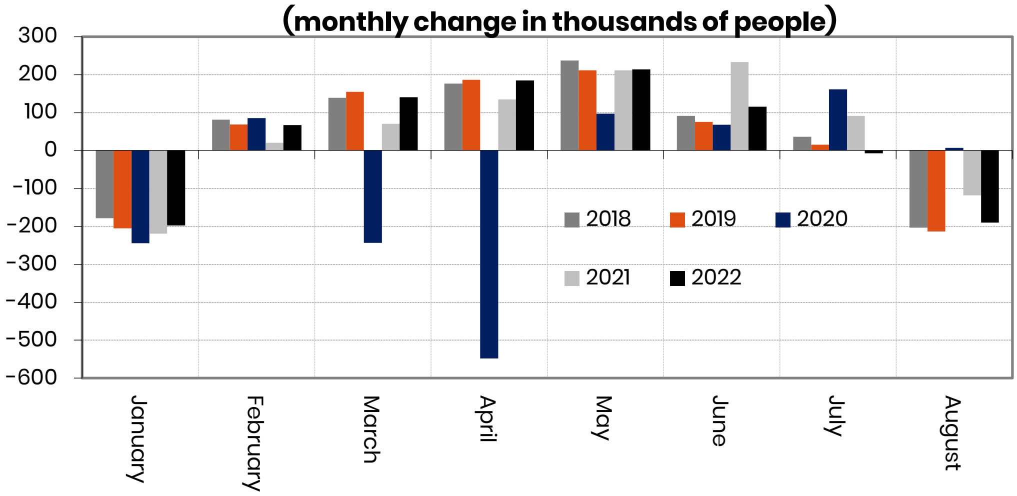
In recent months, employment, according to the number of Social Security registrations, has shown a slowdown in its year-on-year growth rate. This trend will continue in the final stretch of the year. Greater uncertainty will play a part in this, together with the existence of other factors that hinder the activity of companies, slow economic growth and, therefore, slow down job creation. These factors include continuing supply problems, high inflation, and rising interest rates.

The outlook for the labour market in 2022 and 2023 will be conditioned by the evolution of GDP. Thus, CEOE expects employment to grow by 3.0% in 2022 in terms of LFS workers, the same rate as in 2021, as a result of the dynamism of the labour market in the first part of the year, while, in the final part of the year, the labour force growth rate will ease considerably. In 2023, on the other hand, job creation will slow down to 1.1%. Meanwhile, the unemployment rate, after having reached 14.8% in 2021, will continue to fall in 2022 to 13.0%. In 2023, the rate of decline in the unemployment rate will slow down, given the expected lower creation of jobs, and should fall by three tenths to 12.7%.

According to the LFS results for Q2, which are usually favourable, the number of workers employed increased by 383,300, a figure that is in line with the average for this period over the 2014-2019 stretch. This job creation was exclusively due to the boost in the private sector, as the public sector lost workers over these months. Meanwhile, the labour force increased by 128,000 people and slowed the reduction in unemployment, which fell by 255,300. Thus, the total number of unemployed stood at 2,919,400 people and the unemployment rate fell to 12.5%, in both cases the lowest figures since 2008. In addition, it is worth highlighting the drop to 22.3%, in the temporary employment rate, thanks to the dynamism of permanent employment as a result of the labour reform. It should also be noted that the temporary employment rate in the private sector is at an all-time low, at 19.8%, which contrasts with the 32.4% rate in the public sector.

With regard to the most recent evolution of the labour market, it is worth noting that the Social Security lost contributors in both July (-7,366) and August (-189,963). It should be borne in mind that, while August is usually marked by decreases in employment, July is traditionally a month of increases. In fact, this is the first time in the historical series that there has been a decrease during this month. Thus, July and August accumulated a fall in registrations of some 197,300 people, a figure that represents the third largest decline in these two months in the historical series (behind those recorded in 2008 and 2019). Meanwhile, the number of workers on furloughs (ERTE) continues to fall and stood at 18,830 people on a monthly average in August.

Workers registered with the Social Security (monthly change in thousands of people)



Source: Ministry of Inclusion, Social Security and Migrations and CEOE Economic Department

The worse performance of employment in recent months has led to an increase in registered unemployment in July (+3,230) and August (+40,428), which interrupts the downward trend it had been showing since last February. Even so, registered unemployment remains below the 3 million level, standing at 2,924,240 people last August.

According to estimates from CEOE's Department of Economic Affairs, the balance of the labour market in Q3 will be positive, although employment will continue to lose dynamism in this period. Specifically, it is estimated that seasonally-adjusted effective registrations (discounting furloughs) will increase by around 0.7% quarter-on-quarter in Q3, three tenths lower than the 1.0% recorded in Q2.

Inflation

Inflation remains high due to higher energy and food prices

In August, inflation eased slightly to 10.5%, following 10.8% in July. Higher energy prices continue to be the main inflationary element due to the increase in raw materials on international markets. In addition, food, both unprocessed and processed, is also putting upward pressure on inflation.

Core CPI increased by three tenths, bringing its variation rate to 6.4% year-on-year in August, 4.1 points below the headline CPI. Within the core component, Services prices increased their year-on-year rate by two tenths to 4.1%; Industrial Goods prices excluding energy products increased by three tenths to 5.6%; and Processed Food, beverages and tobacco accelerated their year-on-year rate by six tenths to 12.5%.

Non-processed food prices decreased slightly by five tenths to 12.9% year on year. It is worth highlighting the increase in the prices of basic products such as cereals, milk, or eggs, all of them with growth rates above 20%, or of bread, beef and veal, lamb, poultry, fruits, or vegetables, above 10%.

Energy product prices posted a slightly lower year-on-year rate of 37.4%, compared to 41.4% in August, due to the lower increase in the price of energy raw materials. In August, oil prices continued to slow down, averaging $104.9/barrel and up 46% year-on-year in dollar terms, and almost 70% in euros. The decline in oil prices continued in September amid fears of a further slowdown in the global economy. In the first days of September, the price of Brent, on average, has been set at $95.9/barrel, which still represents a year-on-year increase of 29% in dollars and an almost 52% in euros.

It should be borne in mind that a large part of the price increase observed in many CPI components is due to factors external to the Spanish economy, such as the consequences of the war and supply problems. The weakness of the euro is an additional factor that makes imported goods more expensive. These factors may continue to condition the evolution of certain raw material prices. Thus, even though inflation is expected to ease somewhat, it will remain high in the short term.

The Public Sector

The strength of tax revenues continued to drive the decline in the public deficit in the first part of 2022

In the first half of the year, the fiscal imbalance continued to narrow on the back of recovering activity and employment and a notable increase in inflation. Thus, the overall Public Administrations, excluding Local bodies, recorded a deficit of -2.3% of GDP up to the end of June 2022, lower than that figure recorded for same period of the previous year (-4.5% of GDP). However, this improvement may be less intense in the final months of the year, given the anticipated economic slowdown.

As for the State, with information also covering the first half of the year, the deficit in national accounting terms has fallen by -41.3% due to a 20.4% increase in revenues, in clear contrast with the 2.0% increase in expenditures. In terms of GDP, the balance is equivalent to -1.8%, which contrasts with -3.3% in the same period of the previous year. The State's primary deficit at the end of June (discounting interest) is equivalent to -0.8% of GDP, well below the -2.4% of GDP in the first half of 2021.

Tax revenues continue to show a remarkable dynamism, with a growth of 20.2% up to June 2022 (and up to 18% in July, according to the Tax Agency). This strength continues to be supported by VAT revenues, which recorded an increase of 22.8%, and by Personal Income Tax, with revenues increasing by 28.2% up to June. In turn, Corporate Income Tax shows a more moderate performance, with an increase of 7.4% compared to the first half of 2021.

It is also worth noting the higher revenues from some excise taxes, such as the Tax on Hydrocarbons (13.0%); the Tax on Alcohol and Derived Beverages (53.6%); and the Tax on Tobacco Products (7.8%). On the contrary, the main decreases are related to the Special Tax on Electricity due to the reduction of the tax rate from 5.1% to 0.5% as of September 2021, and to the suspension of the Tax on the Value of Electricity Production as of Q4 2021.

Regarding the evolution of expenditures in the first half of the year, what stands out the most is the increase in financial expenses, up 16%, and intermediate consumption, up 32.7% compared to the first half of 2021. On the other hand, the increase in social benefits other than social transfers in kind stood at 6.2% and current transfers between public administrations grew by 3.0%.

Forecasts

Economic forecasts for Spain (last update: September 2022)						
Annual rates of change, unless otherwise indicated						
	2018	2019	2020	2021	2022	2023
GDP	2.3	2.1	-10.8	5.1	4.3	1.5
Private consumption expenditure	1.8	0.9	-12.2	4.7	2.9	1.9
Government consumption expenditure	2.3	2.0	3.3	3.1	-0.8	-0.1
Gross fixed capital formation	6.3	4.5	-9.5	4.3	9.3	4.9
-Tangible fixed assets	7.5	5.8	-10.5	4.1	9.3	5.2
Construction	9.5	7.1	-9.6	-2.8	6.1	4.6
Equipment and cultivated assets	4.6	3.7	-12.1	15.7	14.0	6.0
-Intangible fixed assets	1.1	-1.5	-4.3	5.5	9.2	3.1
Domestic demand (*)	2.9	1.6	-8.6	4.7	2.8	1.6
Exports	1.7	2.5	-20.1	14.7	13.6	5.3
Imports	3.9	1.2	-15.2	13.9	9.7	5.8
External demand (*)	-0.6	0.5	-2.2	0.4	1.4	-0.1
GDP current prices	3.5	3.4	-9.7	7.3	7.8	2.5
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	8.8	3.5
CPI (Dec/Dec)	1.2	0.8	-0.5	6.5	7.1	2.4
Core CPI (average annual rate)	0.9	0.9	0.7	0.8	5.0	3.5
Employment (Quarterly National Accounts)(**)	2.2	2.6	-7.6	6.6	2.9	1.4
Employment (LFS)	2.7	2.3	-2.9	3.0	3.0	1.1
Unemployment rate (LFS) (% active population)	15.3	14.1	15.5	14.8	13.0	12.7
Productivity	0.1	-0.5	-3.5	-1.4	1.4	0.1
Compensation per employee	1.8	2.6	1.3	-0.7	2.1	2.3
Unit labour cost (ULC)	1.7	3.1	5.0	0.7	0.7	2.3
Current Account Balance (% of GDP)	1.9	2.1	0.8	0.9	0.2	0.8
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	3.50	4.50
Interest rates Eurozone (Dec)	0.00	0.00	0.00	0.00	1.50	2.50
Brent Oil ($)	70.9	64.8	41.5	71.1	105.5	90.3

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

(*) Contribution to GDP growth

(**) Full-time equivalent jobs