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Economic Outlook

October 2022

Overview

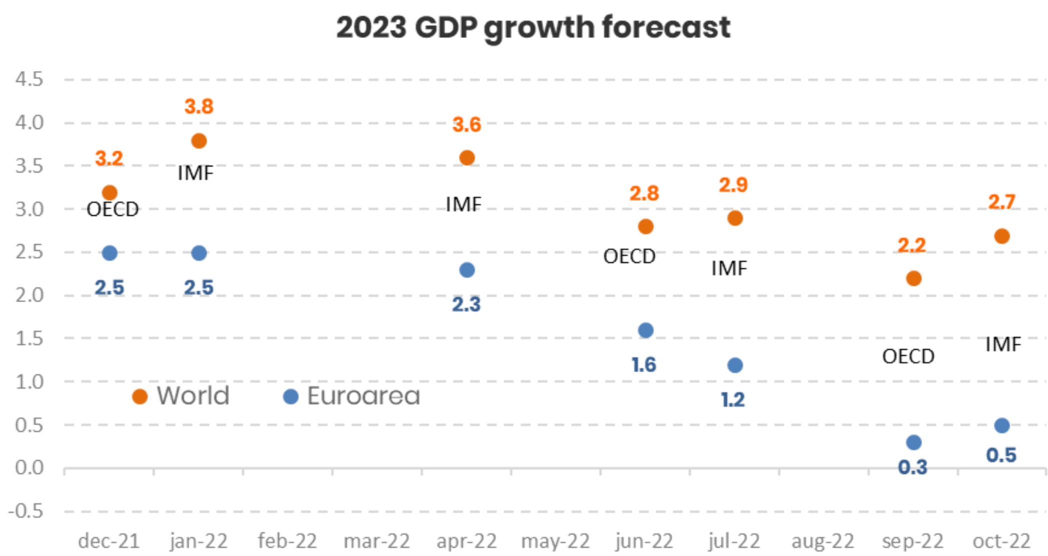
- **Inflation continues to become more widespread and major central banks will continue to tighten their monetary policies.**
- **The OECD and the IMF have revised their 2023 growth forecasts downward and their inflation forecasts upward.**
- **The strength of the dollar dampens the decline in commodity prices.**
- **The growth forecasts for the Spanish economy for 2023 are set at around 1% and move away from the macroeconomic scenario envisioned by the 2023 General State Budget.**
- **The indicators available for Q3 show a clear deceleration of the Spanish economy, which could register practically zero quarter-on-quarter growth for this period.**
- **Job creation continues to weaken, a trend that will follow through into the final stretch of 2022. CEOE estimates that seasonally adjusted effective Social Security registrations increased by 0.7% quarter-on-quarter in Q3, vs. 1.0% in Q2.**
- **Inflation eases slightly to 8.9%, although it is still very high, fuelled by the increase in energy and food prices.**
- **The presentation of the General State Budget for 2023 shows an expansionary budgetary policy in terms of spending, supported by strong revenues that continue to set record highs.**

The International Scenario

International organizations revise 2023 growth downward, especially in Europe

Persistent high inflation rates are the greatest concern for the global economy. The spread of this inflation to more and more products has accelerated the tightening of monetary policies by most of the major central banks, with interest rate hikes that had not been seen in decades. Inflation itself, the higher cost of financing, the bottlenecks that are still present, as well as geopolitical tensions and the exhaustion of the momentum that followed the end of the restrictive measures are leading to a clear slowdown in the global economy, especially in Europe.

This slowdown context, which is already reflected in the PMI indices for August and September, together with the enormous uncertainty about multiple factors, among which it is worth highlighting the duration of the war in Ukraine and its economic consequences, the possible evolution of the pandemic or the effects of the monetary policy tightening, are driving the main international institutions to revise their growth forecasts downwards and their inflation forecasts upwards, mainly for 2023.



Source: Prepared-in house based on OECD and IMF Economic Outlook.

Both the OECD, at the end of September, and the IMF, in October, maintained their global growth estimates for the current year at 3.0% and 3.2%, respectively. Both organizations point out that the war in Ukraine is putting additional pressure on food and energy prices and will keep inflation high for longer than expected. In addition, they point out that growth will remain very modest in the second half of the year and that it will decelerate further throughout 2023. In this regard, they have significantly cut their global growth estimates for next year, to 2.2% and 2.7% respectively, a reduction of six tenths in the case of the OECD vs. its previous June forecast, while for the IMF this is two tenths lower than its July interim forecasts and nine tenths lower that its April report. The adjustment has been particularly marked in the case of the Eurozone, which will be more affected by the consequences of the Russian invasion of Ukraine. Specifically, the OECD reduces Eurozone growth in 2023 to 0.3%, which is 1.3 points less than in the June estimate, while the IMF places growth at 0.5%, seven tenths less than its July forecast and almost two points lower than April's. Both institutions point to a contraction of the German economy, which in the case of the IMF would also reach Italy, while France and Spain will show moderate growth.

OECD (September 2022) **and IMF forecast** (October 2022)

	OECD			IMF		
(y-o-y rate)	**2021**	**2022**	**2023**	**2021**	**2022**	**2023**
World growth	5.8	3.0	2.2	6.0	3.2	2.7
United States	5.7	1.5	0.5	5.7	1.6	1.0
Japan	1.7	1.6	1.4	1.7	1.7	1.6
Euroarea	5.2	3.1	0.3	5.2	3.1	0.5
Germany	2.6	1.2	-0.7	2.6	1.5	-0.3
France	6.8	2.6	0.6	6.8	2.5	0.7
Spain	5.5	4.4	1.5	5.1	4.3	1.2
Italy	6.6	3.4	0.4	6.6	3.2	-0.2
United Kingdom	7.4	3.4	0.0	7.4	3.6	0.3
China	8.1	3.2	4.7	8.1	3.2	4.4
India	8.7	6.9	5.7	8.7	6.8	6.1
Brazil	4.9	2.5	0.8	4.6	2.8	1.0
Mexico	4.8	2.1	1.5	4.8	2.1	1.2
World trade	0.0	0.0	0.0	10.1	4.3	2.5

Source: OECD and IMF

As for inflation, it is expected to reach peak levels at the end of the current year, followed by a progressive moderation throughout 2023, although it will remain at high rates that are well above central banks' targets. For the Eurozone, inflation is estimated to average 8.1% in 2022 according to the OECD, and 8.3% according to the IMF, and then fall on average in 2023 to 6.2% and 5.7%, respectively, according to the estimates of the aforementioned organizations.

All these forecasts are subject to high uncertainties and risks, most of them on the downside, such as a total shutdown of Russian gas supplies to Europe, which would lead to a contraction in most European Union countries as well as higher inflation. There is also the risk that the strong appreciation of the dollar will hinder financial flows to emerging countries, complicating their financing and increasing their debt levels. On the other hand, we must remember that the pandemic is still an issue and there is the risk that new outbreaks could lead to restrictions on activity, mainly in China. If this were to happen, it would have negative effects on global production chains and add additional pressures on prices. It would also lead to the risk of a sharp slowdown in the Chinese real estate market, which could be passed on to the economy, given that the weight of the construction sector in China is around 20% of GDP.

Therefore, both the OECD and the IMF have proposed alternative, more negative scenarios, which take into account the effects that could derive from these situations. Thus, the OECD estimates that with the total shutdown of Russian gas or if there is a particularly cold winter, energy shortages could lead to an additional price increase -over the base scenario- of 1.5 points in Europe in 2023 and half a point worldwide. Meanwhile, GDP growth next year could fall by around 1.3 points in the Eurozone -relative to the baseline scenario- with many countries in the region experiencing a contraction, while, at a worldwide scale, the effect would be a half-a-point reduction in comparison to the central scenario.

In more immediate terms, inflation in September continued to rise. In the Eurozone, it rose to 9.9%, marking a new all-time high, while in the United Kingdom it increased to 10.1%, returning to the highest levels in more than 40 years, which had already been recorded this past July. In contrast, in the United States, it continued to ease slightly to 8.2%, the third consecutive decline, following a 40-year-high last June. Nevertheless, price pressures are becoming more widespread across economies, with core inflation rising to 6.6% in the United States and to 6.5% and 6.0% in the United Kingdom and the Eurozone, respectively.

In light of this situation, central banks will continue to tighten monetary policy. In the United States, the rise in core inflation and the labour market figures, with 263,000 jobs created in September and the unemployment rate having fallen to 3.5%, will enable a further increase of interest rates in November. Expectations point to a hike of 75 basis points, which would be the fourth such consecutive hike. As for the ECB, it is also expected to continue with significant interest rate hikes in October, foreseeably also by 75 basis points, thus repeating the highest increase that already took place at the last meeting in September. With these measures, central banks are prioritizing inflation control, even if this means less dynamism in economic activity or even mild growth declines in the short term.

The aggressive rate hikes in the United States are resulting in a significant appreciation of the dollar against other currencies. This situation is contributing to imported inflation in countries whose currencies are depreciating, given that this loss in the value of their currencies is pushing up the prices of many raw materials, or offsetting the lower prices that may be occurring in dollars. Particularly noteworthy was the collapse of the pound at the end of September, following the announcement in the United Kingdom of heavy tax cuts and significant increases in public spending, which forced the Bank of England to intervene to support its currency. Subsequently, the British government has withdrawn its plan and Liz Truss has resigned as Prime Minister.

In terms of activity, the PMI indices are already showing clear signs of a global slowdown. The Global Composite PMI stood at 49.7 points in September, and although it improved slightly compared to August, it is the second consecutive month in which it remains below 50 points, in contractionary territory. Among the main economies, Japan returned to expansionary territory, while the United States, although showing recovery in comparison to August, continues to point to a decline in activity. In addition, the results of the Eurozone, China and the United Kingdom worsened, all of them at contractionary levels.

On the other hand, commodity prices are beginning to show some signs of a slowdown, after the highs reached between April and May. Some are even recording year-on-year declines, mainly in industrial metal products, while food and non-metallic industrial products are still showing positive year-on-year rates. As for oil, the price of Brent crude continued its downward trend in September, to $95/barrel on average. However, in year-on-year terms, this accounted for a 27.6% increase, which in euros was 51.7% due to the weakness of the euro against the dollar. In the first weeks of October, the average price will remain at similar levels to those of September, although it will be less expensive year-on-year, so the pressure on inflation will be lower. Meanwhile, futures point to a progressive softening of oil prices due to fears of a slowdown in the world economy.

The Spanish Economy

Growth forecasts for 2023 are set at around 1% and diverge from the macroeconomic scenario envisioned by the 2023 General State Budget

Domestic analysts and international organizations are revising significantly downwards the growth of the Spanish economy for 2023. Specifically, the OECD forecasts a GDP growth of 1.5%, the same rate as the AIReF, while the IMF sets its estimate at 1.2%. At CEOE, we anticipate GDP growth of 1.5% for next year, with clear downside risks. In contrast to this consensus, the Government has presented its budget for 2023 based on economic forecasts of a 2.1% rise in GDP for 2023.

The growth gap in these estimates issued by the Government vs. those of other institutions lies mainly on the impact of the Recovery, Transformation and Resilience Plan (PRTR, for its acronym in Spanish), which, according to the former, will offset all the other external challenges to be faced by the Spanish economy, allowing for a positive differential in comparison to the performance expected for the Eurozone. Thus, the Government estimates an increase in GDP of 0.7 points in 2021, 1.9 points in 2022 and 2.8 points in 2023, in comparison to a scenario without the Plan. On the other hand, AIReF states that, in 2021, the impact was practically nil due to the delay in the actual materialization of investments, and it estimates a much more limited effect on GDP in 2022 and 2023 (0.8 points and 2 points, respectively) in comparison to a scenario without the Plan.

Despite the uncertainties and downside risks that loom over the Spanish economy, in a context of tighter financial conditions, the budget for 2023 reflects revenues and expenditures at record highs. Inflation and the announced measures to increase corporate taxes (social security contributions, banking and energy, plastic) explain the buoyancy of revenues and are a clear sign that the tax burden is increasing, given that nominal GDP has advanced at a slower pace.

Spending measures should have been more restrained, considering the deficit and public debt levels we are starting from in 2022 (-5% of GDP and 115.2% of GDP respectively) and our structural deficit, anchored at -4% of GDP in recent years. The budgetary policy is clearly expansionary, especially in discretionary current spending, further consolidating and compromising the sustainability of public finances. As for spending aimed at more productive activities, the improvement is due to the PRTR, considering that there is no increase in the weight of these policies if European funds are not taken into account.

Demand and activity

Activity slows down significantly in Q3

As we have seen above, the international context is marked by high inflation and the tightening of monetary policy, which, together with the supply problems that are still present, are weighing very significantly on the global economic recovery.

The Spanish economy is no exception to this slowdown. After the rebound in activity recorded in Q2 (1.5% quarter-on-quarter), GDP growth is expected to be practically nil in Q3 and even decline in Q4.

In this regard, there is a clear deterioration of expectations in the confidence indicators of most sectors and in consumers. Industrial activity is being further impacted by the increase in the prices of raw materials, both energy and non-energy, together with problems in the supply chains and the decline in new orders. As a result, manufacturing PMIs have been in contractionary territory since July. Services PMIs also fell below the 50 level in September. Sales are declining as a result of increased uncertainty and persistent inflation, which is negatively affecting the purchasing power of households and companies.

The latest available data regarding the tourism sector show how the inflow of international tourists already started to slow down its recovery in August, standing at around 87% of the 2019 figures, when in July it had reached 92%.

From the point of view of the foreign sector, the Customs information available for the first eight months of the year shows a much more dynamic evolution of imports than exports, resulting in a trade deficit that is 4.5 times higher than in the same period of 2021. Along the same lines, the Balance of Payments data show that, in the first seven months of 2022, the current account balance surplus reached 1.1 billion, compared to a surplus of 4.2 billion in the same period of the previous year. This balance was due to the notable deterioration in the balance of non-tourist goods and services, which has been offset by the notable increase in the tourist services surplus.

The Labour Market

Employment growth continues to slow down, although with a more favourable evolution than GDP growth

The labour market continues its return to normalcy in 2022, with month-to-month behaviour similar to the one observed in the years prior to the pandemic, following the remarkable dynamism of employment in 2021. The number of jobs continues to grow, despite economic uncertainty and the downward revision of economic forecasts. This reflects the efforts of companies to maintain employment levels, even in a less favourable environment than the one prevailing a few months ago. Even so, Social Security registrations have been showing a decelerating trend in recent months, which will continue in the final stretch of this year.

September registered an increase of 29,286 in the number of people registered with the Social Security, lower than the increase recorded for this month in 2020 and 2021, but higher than the average for the 2017-2019 period. By sector, it is worth highlighting the employment increase in agriculture, with almost 24,000 new jobs. Within services, it is worth noting the notable boost in jobs related to education, on the back of the start of the school year, in contrast to the declines in retail and hotels and restaurants, linked to the end of the summer tourism season. Meanwhile, in September, registered unemployment rose for the third consecutive month, this time by 17,679 people, lower than the average for the months preceding the pandemic. Thus, the total number of unemployed stands at 2,941,919 people.

The Ministry of Inclusion, Social Security and Migration estimates that October could see an increase of some 102,000 Social Security registrations, which would be somewhat lower than the average for the 2017-2019 period. In seasonally adjusted terms, the Ministry forecasts an increase of some 15,000 registrations, which would imply a notable slow down compared to the evolution of recent months, with the exception of July. If these estimates are met, the year-on-year rate of Social Security registrations would continue to slow, as it has been doing since May, to be set at 3.0% in October, following September's 3.3%.

The employment balance in Q3 was positive, although the rate of growth was less intense than in Q2. Specifically, according to estimates by CEOE's Economics Department, seasonally adjusted effective registrations (discounting furloughs) increased by 0.7% quarter-on-quarter in Q3, three tenths lower than in the previous quarter. This employment performance contrasts with the practically zero growth expected for GDP in Q3.

Inflation

Inflation remains high due to higher energy and food prices

In September, inflation softened to 8.9%, after the 10.5% recorded in August, thanks to the lower increase in energy prices. Nevertheless, energy products continue to be the main inflationary element, together with food, both non-processed and processed, due to the increase in raw materials on international markets.

Core CPI decreased by two tenths to 6.2% year-on-year in September. Within the underlying component, Services prices decreased year-on-year by three tenths to 3.8%; Industrial Goods prices (excluding energy products) decreased by three tenths to 5.3%; and Processed foods, beverages and tobacco increased by three tenths to 12.8% year-on-year.

Non-processed food prices increased by 9 tenths to 13.8% year-on-year. It is worth mentioning the price increase of basic products such as cereals, milk, or eggs, all of them with growth rates above 20%. Practically all food items recorded rates above 10%.

Energy product prices significantly eased their year-on-year rate to 22.4%, vs. 37.4% in August, due to the lower increase in the price of energy raw materials. Oil prices declined in September on fears of a slowdown in global growth. Brent crude oil stood at $95/barrel, a decline of 9.4% compared to August, although in year-on-year terms it is up 27.6%. This increase was more significant in the Eurozone, up 51.7% compared to one year ago, due to the weakness of the euro against the dollar. For the time being, the average Brent price in October is around $95/barrel, which means that it will continue to put upward pressure on inflation, although to a lesser extent than in previous months.

The ongoing war in Ukraine and the economic sanctions imposed on Russia may continue to affect the evolution of the prices of certain raw materials, such as gas, fuels, cereals, and oils, which in turn affect the price composition of many other products. As a result, inflation will remain high in the short term, although it will continue to slow down.

The Public Sector

Notable reduction in the State government deficit through August on the back of strong tax revenues

As previously mentioned, the presentation of the General State Budget for 2023 shows an expansive budgetary policy in terms of expenditure on the back of a robust revenue base that continues to set record highs. According to the Government's forecasts, the Spanish economy will end 2022 with a public deficit to GDP ratio of -5% and public debt of 115.2%. Next year, the fiscal balance will stand at -3.9% of GDP and public debt at -112.4%. Therefore, the fiscal imbalance is still very large, far from European budgetary stability standards, and it makes the Spanish public sector one of the most indebted in Europe.

In terms of budget execution up to August, the State deficit in national accounting terms has decreased by 57.0% compared to the same period of 2021. In GDP terms, this balance stood at -1.8%, which contrasts with -4.6% in the same period of 2021. The key to this decline in the State's fiscal imbalance continues to be the good performance of revenues, which have increased by 32.3% up to August, above the 5.0% increase in expenditure.

Within non-financial resources, of particular note is the increase in taxes and social contributions, which rose by 23%. Among the main taxes, VAT stands out, with an increase of 20.8%. Personal income tax is the fastest-growing tax, with a 44.7% increase in revenues up to August. Also noteworthy is the increase in Corporate Income Tax (22.2%). Of the remaining taxes, the Tax on Hydrocarbons and Tobacco Products and the auctioning of greenhouse gas emission rights also deserve a special mention.

Despite the improved situation in terms of the pandemic and the economic recovery, spending continues to increase due to measures aimed at fuelling subsidies and specific aid to the transport sector and gas-intensive companies. Also noteworthy is the increase in interest expenses, which rose by 18.7% up to August, followed by other items such as transfers to other public administrations[1], subsidies, and pensions for civil servants.

[1] Transfers were mainly to Local Bodies and Autonomous Communities. For the latter, the settlement of the 2020 funding system resulted in a positive balance of €6.376 billion.

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