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# Economic Outlook

December 2022

# Outlook

- **Inflation is showing signs of having reached its peak, more so in the United States than in Europe.**
- **The main central banks are easing the pace of their interest rate hikes, having raised them by 50 basis points in their most recent meetings.**
- **The global PMI indices show signs of activity losing momentum.**
- **The final stretch of 2022 for the Spanish economy is marked by the ongoing slowdown in activity, inflation and employment, albeit at different speeds.**
- **The labour market has behaved favourably in recent months, with employment performing better than expected, although the year-on-year growth rate is slowing down.**
- **Inflation in Spain continued to ease and stood at 6.8% in November, although underlying inflation is resisting to turn downwards.**
- **State resources collected through VAT, personal income tax and corporate income tax are showing a remarkable dynamism, increasing by between 18% and 38%**
- **The Spanish economy approaches 2023 amidst great uncertainty, although the slowdown will intensify, with growth of around 1%, while inflation will continue to post high levels (between 4% and 5%).**

# The International Scenario

## Lower intensity of interest rate hikes in response to signs of price easing

Inflation, which is still very high and constitutes the main concern in the international front, is beginning to show signs of having reached peak levels. This is more evident in the United States, where the CPI has softened to 7.1% in November, accumulating five consecutive declines. In the Eurozone, it has eased in November for the first time after seventeen months of increases, although it still stands at 10%. Underlying inflation remains high, with price increases spreading to more and more sectors.

Meanwhile, PMI indicators point to an increasingly widespread economic slowdown, although for the time being it is less intense than expected. Both factors, a loss of dynamism in activity and declines in inflation, have weighed on the decisions of the main Western central banks, which have eased the pace at which they continue to tighten their monetary policies. The latest interest rate hikes, by 50 basis points, have been somewhat less aggressive than those of previous meetings.

At the end of November, the OECD revised its forecasts and, in line with other international organizations, estimated lower growth for 2023 as well as higher and more persistent inflation. In its report, it notes that global growth stagnated in Q2, with contractions in output in both the United States and China, while Q3 saw a modest pickup in activity. However, they believe that the tightening of monetary policies, as well as high inflation, will affect the consumption and investment decisions of economic agents, which, together with the decline in confidence levels, will lead to a slowdown in growth, especially over the coming year. Thus, for 2022, they forecast a 3.1% increase in global GDP, which will drop to 2.2% in 2023, and recover slightly in 2024, when they expect growth of 2.7%. These ratios are still far from the average recorded in the years prior to the pandemic (2013-2019), when the world economy grew at annual rates of 3.4%.

As for inflation, the OECD has revised its estimates upwards, both for the present and the coming years, forecasting average inflation in 2022 at 8.3% in the Eurozone and 6.2% in the United States. Prices are expected to moderate throughout 2023, more rapidly in the United States, where they will grow by an annual average of 3.5%, and much more slowly in the Eurozone, which will still show an average inflation rate of 6.8% next year.

| OECD forecasts (November 2022) | | | | | | |
|---|---|---|---|---|---|---|
| | GDP | | | Inflation | | |
| (y-o-y rate) | 2022 | 2023 | 2024 | 2022 | 2023 | 2024 |
| **World** | 3.1 | 2.2 | 2.7 | | | |
| **United States** | 1.8 | 0.5 | 1.0 | 6.2 | 3.5 | 2.6 |
| **Japan** | 1.6 | 1.8 | 0.9 | 2.3 | 2.0 | 1.7 |
| **United Kingdom** | 4.4 | -0.4 | 0.2 | 8.9 | 6.6 | 3.3 |
| **Eurozone** | 3.3 | 0.5 | 1.4 | 8.3 | 6.8 | 3.4 |
| **Germany** | 1.8 | -0.3 | 1.5 | 8.5 | 8.0 | 3.3 |
| **France** | 2.6 | 0.6 | 1.2 | 5.9 | 5.7 | 2.7 |
| **Spain** | 4.7 | 1.3 | 1.7 | 8.6 | 4.8 | 4.8 |
| **Italy** | 3.7 | 0.2 | 1.0 | 8.1 | 6.5 | 3.0 |
| **China** | 3.3 | 4.6 | 4.1 | 2.0 | 2.2 | 2.0 |
| **India** | 6.6 | 5.7 | 6.9 | 6.8 | 5.0 | 4.3 |
| **Brazil** | 2.8 | 1.2 | 1.4 | 8.9 | 4.2 | 4.5 |
| **Mexico** | 2.5 | 1.6 | 2.1 | 8.0 | 5.7 | 3.3 |

*Source: OECD*

With regard to recent economic performance, the data for Q3 presented mixed results, although, in general, they surprised on the upside, with GDP rebounding in the United States (+0.7% quarter-on-quarter), and in China, which also returned to positive figures. In the Eurozone, meanwhile, there was a slowdown to 0.3% quarter-on-quarter, although the negative rates anticipated a few months ago were avoided. In contrast, the United Kingdom and Japan returned to negative growth rates of -0.2% and -0.3%, respectively.

In the United States, the labour market is still performing well, with employment continuing to grow, albeit at a slower pace. On the other hand, the household savings rate is falling sharply and has reached its lowest level since 2005, which could slow consumption in the coming months. In the Eurozone, consumption and investment sustained growth, while the foreign sector made a negative contribution, reflecting the energy tensions resulting from the Russian invasion of Ukraine. Meanwhile, in China, concerns are focused on the restrictions on activity that continue to be imposed as a result of its policy to contain the pandemic. This is coupled with the problems in its real estate sector, which run the risk of eventually affecting the financial sector.

In Q4, the slowdown in activity appears to be intensifying, albeit to a lesser extent than expected a few months ago. The global composite PMI index declined again in November to 48 points, the lowest level since June 2020. Moreover, it is the fourth consecutive month that posts levels below 50 points, pointing to a contraction in growth. In fact, in November, the composite PMI indices of the world's major economies were in contractionary territory, showing that the loss of dynamism in the economy is becoming more widespread.

Amid this context of slower economic activity and a certain moderation in prices, the main central banks hiked their interest rates in December at a slower rate than in previous meetings, raising them by 50 basis points vs. the prior 75 basis points. Thus, following these latest hikes, the Federal Reserve has set its interest rates within the 4.25% to 4.5% range, the Bank of England at 3.5% and the European Central Bank's main refinancing rate stands at 2.5%. The ECB has also announced that it will begin reducing its balance sheet, at a rate of €15 billion per month, from March 2023.

Monetary authorities continue to insist that their priority is still to rein in inflation, so they will continue to raise rates in the coming meetings. Markets are pricing in that rates will reach around 5.0% in the United States, close to 5.0% in the United Kingdom and slightly above 3.0% in the Eurozone.

On the other hand, the weakening of the world economy is contributing to a moderation in many commodity prices. Nonetheless, price levels remain significantly higher than before the outbreak of the war in Ukraine.

With regard to gas, it is worth noting that the risk of supply problems in Europe has been significantly reduced, mainly due to savings in consumption and the existing good level of reserves, partly thanks to the favourable autumn weather. However, gas prices in Europe, although significantly reduced from the highs of late August, are still almost double than at the end of 2021.

Meanwhile, oil prices also continued their downward trend, averaging $92.9/barrel in November. In the first days of December, they have continued to fall, following the entry into force of the European embargo on Russian oil and the cap on the price of crude oil from Russia, at a maximum of $60/barrel. However, prices are still 13.4% higher than a year ago, and in euros this difference widens to almost 27%.

# The Spanish Economy

## A year-end marked by a lower impact of the energy crisis than was expected a few months ago

For the Spanish economy, the final stretch of 2022 is marked by the ongoing slowdown in activity, inflation, and employment, albeit at different speeds. Demand and activity figures for Q4 are still scarce, but they are consistent in indicating a moderation in sales and production variables, while most economic sentiment indicators are experiencing a setback as a result of rising costs and uncertainty. Nevertheless, there are no signs of an abrupt slowdown, so GDP in Q4 is expected to be around 0% and could even be slightly positive.

Despite the loss of dynamism in activity, the labour market performance in October and November has been relatively favourable. Registrations with the Social Security posted positive figures compared to the average of the 2014-2019 period for these months. In addition, registered unemployment continues to fall, which contrasts with the seasonal increase typical in this period.

Inflation in November stood at 6.8% (vs. 7.3% in October), although the underlying CPI continues its upward trend to 6.3%, albeit at a slower pace than in previous months. In this regard, the key to controlling inflation in 2023 lies in not initiating (or mitigating) second-round effects.

The Spanish economy approaches 2023 amidst great uncertainty, although the slowdown will intensify with growth of around 1%, while inflation will continue to post high levels (between 4% and 5%), although the figures seen in 2022 (an average of 8.5%) will not be reached. Even though we are aware that Spain continues to lag behind in GDP recovery, our economy could show greater resilience than the Eurozone due to a series of factors. These include the lower impact of the energy shock compared to other European countries, a less stressed real estate market and the resilience of the labour market.

Nevertheless, there are still downside risks. The impact of rising interest rates on household and business consumption and investment, high inflation, and the state of public finances, together with the geopolitical context, among other factors, are creating conditions that will likely have a negative impact on both activity and employment in 2023.

# Demand and Activity

## Persistent inflation and rising interest rates are undermining demand

After the significant deceleration of the Spanish economy in Q3, with 0.2% quarter-on-quarter growth, activity could show a similar or slightly more unfavourable performance in Q4, in line with a more deteriorated international context. Thus, persistently high inflation, the slowdown of the European economies and monetary policy tightening, with the Euribor already above 2.8% and likely to rise further, could hinder the growth of consumption, investment, and exports.

In this context, there is a significant deterioration in the expectations of both consumers and sectors, especially in industry and services. The exception is construction, where the outlook is, in fact, improving. Nonetheless, the real economy indicators still show some resistance to a slowdown.

With regard to the evolution of consumption, the rise in inflation and the rise in interest rates have increased uncertainty and deteriorated consumer confidence, reducing households' intention to make major purchases. In addition, these factors have led to a decline in household purchasing power, which is not being offset by increased job creation. This will slow down private consumption in the coming quarters. On the other hand, the savings accumulated by households since the beginning of the Covid-19 crisis may partially cushion the effect of the rise in prices and interest rates, although part of these savings will be used for other purposes, such as reducing debt or investing in housing.

The increase in energy prices and the ongoing supply problems are having a more intense impact on industrial activity, although services are also beginning to show some deceleration due to the loss of household purchasing power.

Thus, manufacturing PMIs have stood at contractionary levels since July and, in October, they posted their lowest level since 2020. However, in November, they improved slightly, although they remain at contractionary levels. The companies surveyed report a fall in incoming orders, which is associated with lower consumption due to rising inflation. Delivery delays continued, albeit with less intensity, and raw material prices decelerated slightly, although energy and transport prices remained high.

The automotive industry is also being affected by the lack of certain supplies, especially microchips and semiconductors, coupled with falling demand due to rising inflation and uncertainty about the economic context, which is conditioning the evolution of production and exports in 2022. Thus, despite the increases in vehicle registrations recorded in the last four months to November, the market could close the year at around 820,000 new registrations, the lowest level since the 2008 crisis.

The services sector continues to recover after the lifting of the restrictions associated with the pandemic. However, the sector's expectations have deteriorated in recent months, with its PMIs recording contractionary levels in September and October due to the persistent inflation as well as the rise in interest rates. This will likely lead to the weakening of household consumption capacity and, thus, a certain slowdown in spending on services is expected in the coming months.

From the point of view of the foreign sector, the customs information available for the first nine months of the year shows a much more dynamic evolution in imports over exports of goods in nominal terms, due both to the greater advance in real terms and to the increase in import prices. Thus, exports increased by 24.7% year-on-year (4.8% in volume terms) and imports by 39.8% year-on-year (10.6% in volume terms). The result of these flows was a trade deficit in this period of -€53.4371 billion, compared to -€13.2674 billion in the same period of 2021. Along the same lines, according to the Balance of Payments data published by the Bank of Spain, in the first nine months of 2022 the current account balance surplus reached 1.4 billion, compared to a surplus of 6.2 billion for the same period in the previous year. This balance was due to the notable deterioration in the balance of goods and non-tourist services, which was offset by the surplus in the balance of tourist services, in line with the better evolution of tourist flows this year.

The latest available data regarding the tourism sector show that the inflow of international tourists continues to recover, standing at around 7.2 million in October, only 5% below the tourists reported in October 2019, before the start of the pandemic, and significantly better than in August and September, when the number of tourists stood at just 88% of the pre-covid figures.

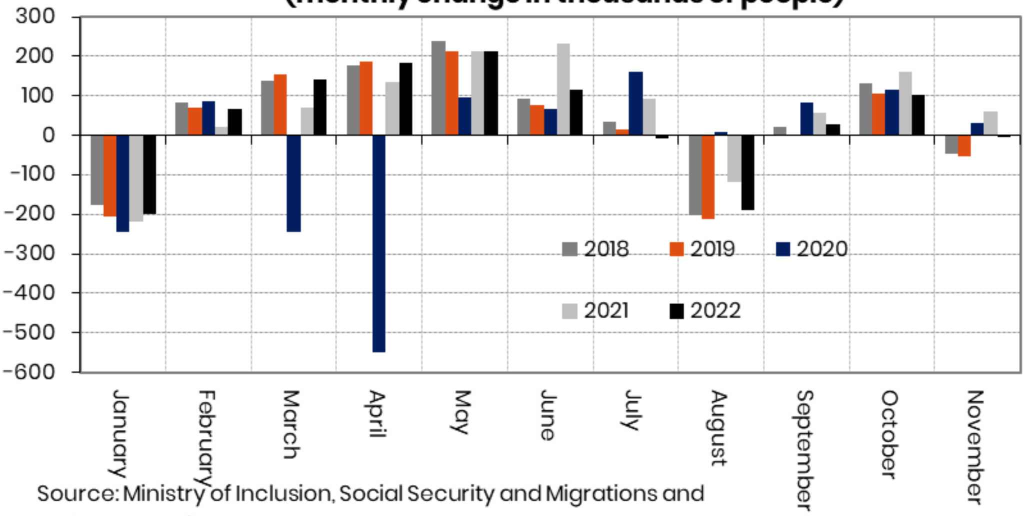
# The Labour Market

## Job creation loses momentum in recent months, but performs better than expected

In recent months, the labour market has shown a favourable behaviour, with employment performing better than expected despite the high level of uncertainty. Even though the labour market is highly resilient, employment growth has slowed down since the middle of the year, although not as strongly as expected a few months ago. This evolution of the labour market reflects the fact that companies are making every effort to maintain their workforces, despite rising production costs, deteriorating confidence levels and an economic environment marked by a slowdown in activity.

In November, Social Security registrations remained practically stable in comparison to the previous month, with a slight decline of 155 people. This result may be considered favourable relative to the same month in the years prior to the pandemic when a decline was the norm (the average decrease for the period 2014-2019 is set at -23,219 persons). In seasonally adjusted terms, the number of workers registered with the Social Security has accumulated 19 consecutive months of increases, and the rise recorded in November, up by 78,695 people, is the highest this year.

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




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

Turning to the gross figures by sector, it should be noted that services was the only sector where the number of new registrations fell in month-on-month terms, with accommodation and food and beverage services being the areas that recorded the largest fall in terms of persons, as a result of the end of the summer season. The year-on-year rate of total Social Security registrations continued to moderate, standing at 2.7% in November, three tenths lower than in October, and almost half the rate reached in April (5.1%). On a negative note, the private sector lost 21,372 workers in November, which was offset by the addition of 21,216 new employees in the public sector.

The number of workers under furloughs has stabilised at just over 20,000 since last July, reaching 23,108 in November, of which almost a quarter are in the automotive sector.

As in October, registered unemployment posted a positive surprise again in November, falling by 33,512 people, which contrasts with the usual seasonal increases during this month. Thus, registered unemployment fell below 2.9 million to 2,881,380 persons. By sector, it should be noted that unemployment fell in November in all sectors, especially in services, with 25,083 fewer unemployed, while it increased in the category of those without previous employment.

Year-on-year, hiring has been falling in recent months, with November posting 29.5% fewer contracts than a year earlier, due to the 53.5% decline in temporary contracts. Meanwhile, as a result of the changes implemented in the labour market regulations, permanent contracts continue to grow at a remarkable pace, although the growth rate is slowing. Permanent contracts account for 43.2% of the total number of registered contracts, whereas in the past this figure was usually around 10%.

According to estimates by CEOE's Economics Department, the balance of the labour market in Q4 will be positive considering the unfavourable economic context, although employment will continue to lose dynamism in terms of year-on-year rates. Specifically, seasonally adjusted effective registrations (excluding furloughed workers) are estimated to increase by around 0.7% quarter-on-quarter in Q4 this year, the same rate as in Q3.

# Inflation

## Inflation in Spain continued to ease in November, although underlying inflation is resisting a downward turn

Prices in November continued to moderate. Specifically, the year-on-year rate stood at 6.8%, compared with 7.3% in October, thanks to the slower rise in energy prices. However, food prices are the main inflationary element since, in addition to their notable increase, they represent a significant weight in the CPI basket of products.

An analysis by component reveals that a significant slowdown is taking place in the rate of increase of energy product prices (now at 4.5% year-on-year compared with 37.4% in August) and, in November, there has also been a turn in the rate of growth of unprocessed food prices (2.7 points to set the year-on-year rate at 12.6%), which is due to less pressure on commodity prices in international markets. However, the ongoing war with Ukraine and other supply problems may continue to weigh on the evolution of commodity prices.

Meanwhile, the underlying CPI rose by one tenth to 6.3% year-on-year in November, resisting to resume the decelerating trend. Within this component, Services prices decreased their year-on-year rate by one tenth to 3.8%; Industrial Goods prices excluding energy products decreased by two tenths to 4.6%; and Processed food, beverages and tobacco prices accelerated their year-on-year rate by 1.4 p.p. to 14.7%.

Inflation is expected to continue moderating over the coming year. This year could end with inflation at around 6% in December, bringing the average to around 8.5%. A much more moderate average rate of close to 4% is expected in 2023. In this context, it is particularly important to avoid a scenario in which price and wage increases feed off each other, so as not to lead to second-round effects that could cause an inflationary spiral.

When compared to Europe, the HICP in November reached 6.7%, while in the Monetary Union this rate stood at 10.0%, which means that the negative differential remains at 3.3 p.p., with lower inflation in Spain.

# The Public Sector

## The State's public deficit stands at -1.4% of GDP up to October

The accumulated State deficit in national accounting terms up to the end of October narrowed to -1.4% of GDP from -4.9% of GDP in 2021. Over this same period, the government posted a primary surplus (net of interest) of 0.34% of GDP, versus a primary deficit of -3.4% in the same period of the previous year.

Non-financial resources continued to set record highs, with revenues from personal income tax up by 38.0% and from corporate income tax by 25.2%. VAT revenues grew 18.0%, despite the measures adopted to mitigate the impact of electricity prices. As for other revenues, there was a 6.6% increase in collections from the tax on hydrocarbons, a 6.1% increase from the tax on tobacco products and a 42.0% increase from the auctioning of greenhouse gas emission allowances.

In addition to taxes, another important source of revenue for the State is transfers received from other public administrations, with an increase of 113.1% with respect to 2021. This is due to the fact that the final settlement of the resources in the financing system for Autonomous Communities and Local Corporations in 2020 has been favourable to the State to a much larger degree than in 2019.

As for non-financial uses, these have increased by 1.8% up to October. In the breakdown by expenditure items, it is worth highlighting the evolution of interest (+18.6%) and subsidies. The latter item is part of "other current expenditure", which increased by 91.5%. This includes subsidies and discounts on the retail price of certain energy products, which are subsidised by 15 cents per litre/kg fuelled and to which companies, self-employed workers and private individuals are entitled. It also includes 419 million in aid to the transport sector and 61 million to gas-intensive companies. In total, this expenditure amounts to some 5 billion up to October.

As for the remaining items, the higher amounts allocated to the Social Security System and the lower allocation to the National Employment Service (SEPE) stand out, mainly due to the end of the COVID-related furlough schemes.

# Forecasts

| Economic forecasts for Spain (last update: December 2022) | | | | | | |
|---|---|---|---|---|---|---|
| Annual rates of change, unless otherwise indicated | | | | | | |
| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| GDP | 2.3 | 2.0 | -11.3 | 5.5 | 4.6 | 0.8 |
| *Private consumption expenditure* | 1.8 | 0.9 | -12.4 | 6.0 | 2.1 | 0.8 |
| *Government consumption expenditure* | 2.3 | 1.9 | 3.5 | 2.9 | -1.6 | 0.5 |
| *Gross fixed capital formation* | 6.3 | 4.5 | -9.7 | 0.9 | 5.7 | 4.8 |
| *-Tangible fixed assets* | 7.5 | 5.3 | -11.1 | 0.1 | 5.4 | 5.1 |
| *Construction* | 9.5 | 7.2 | -10.2 | -3.7 | 4.4 | 4.6 |
| *Equipment and cultivated assets* | 4.6 | 2.4 | -12.6 | 6.5 | 7.0 | 5.9 |
| *-Intangible fixed assets* | 1.1 | 0.6 | -2.5 | 4.7 | 6.9 | 3.5 |
| *Domestic demand (*)* | 2.9 | 1.6 | -9.1 | 5.3 | 1.5 | 1.0 |
| *Exports* | 1.7 | 2.2 | -19.9 | 14.4 | 17.8 | 4.3 |
| *Imports* | 3.9 | 1.3 | -14.9 | 13.9 | 9.2 | 4.5 |
| *External demand (*)* | -0.6 | 0.4 | -2.2 | 0.3 | 3.1 | -0.2 |
| GDP current prices | 3.5 | 3.4 | -10.1 | 7.8 | 8.1 | 2.0 |
| GDP deflator | 1.2 | 1.4 | 1.2 | 2.3 | 3.5 | 1.2 |
| CPI (average annual rate) | 1.7 | 0.7 | -0.3 | 3.1 | 8.5 | 4.3 |
| CPI (Dec/Dec) | 1.2 | 0.8 | -0.5 | 6.5 | 6.1 | 4.6 |
| Core CPI (average annual rate) | 0.9 | 0.9 | 0.7 | 0.8 | 5.1 | 4.5 |
| Employment (Quarterly National Accounts)(**) | 2.2 | 3.3 | -6.8 | 6.6 | 3.5 | 0.5 |
| Employment (LFS) | 2.7 | 2.3 | -2.9 | 3.0 | 3.1 | 0.6 |
| Unemployment rate (LFS) (% active population) | 15.3 | 14.1 | 15.5 | 14.8 | 12.9 | 13.0 |
| Productivity | 0.1 | -1.3 | -4.8 | -1.0 | 1.1 | 0.3 |
| Compensation per employee | 1.8 | 2.4 | 2.5 | -0.8 | 1.5 | 2.8 |
| Unit labour cost (ULC) | 1.7 | 3.8 | 7.7 | 0.2 | 0.5 | 2.6 |
| Current Account Balance (% of GDP) | 1.9 | 2.1 | 0.8 | 0.9 | 0.7 | 0.0 |
| General government net lending (+) / net borrowing (–) (% of GDP) | -2.5 | -2.9 | -10.3 | -6.9 | -4.8 | -4.4 |
| Interest rates USA (Dec) | 2.50 | 1.75 | 0.25 | 0.25 | 4.50 | 5.00 |
| Interest rates Eurozone (Dec) | 0.00 | 0.00 | 0.00 | 0.00 | 2.75 | 3.50 |
| Brent Oil ($) | 70.9 | 64.8 | 41.5 | 71.1 | 104.9 | 88.1 |

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

*(*) Contribution to GDP growth*

*(**) Full-time equivalent jobs*