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Economic Outlook

January 2023

Overview

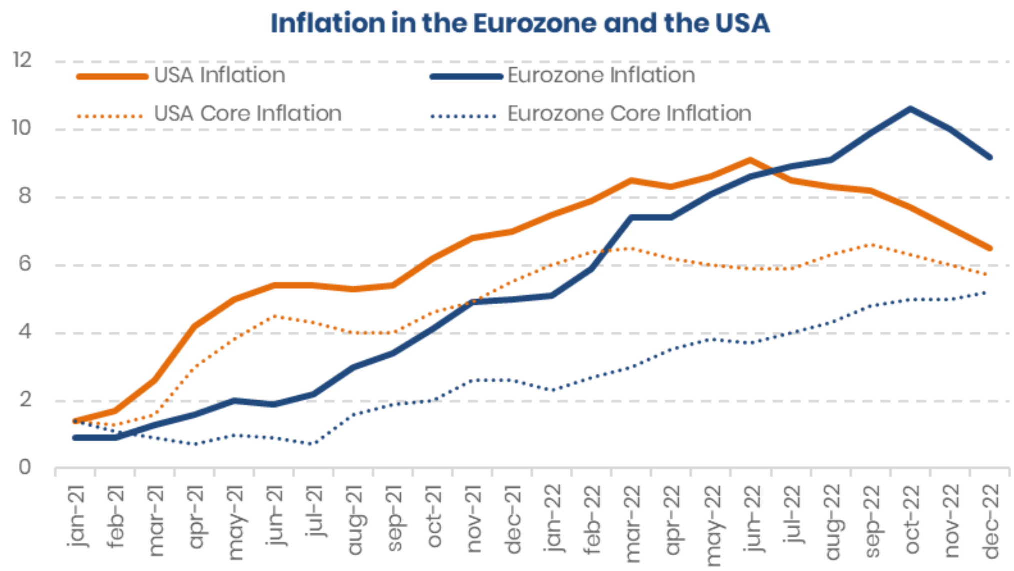
- **December inflation confirms that the peak has already been reached in both the United States and the Eurozone, although it still remains at high rates.**
- **PMI indices, despite the slight improvement in December, remain in contractionary territory, pointing to a generalized slowdown in the world economy.**
- **Oil prices continued to fall in December, as signs of a loss of dynamism in activity persist.**
- **Following the significant upward revision in GDP for the first half of 2022 released by the National Statistics Institute (INE), the year's average growth rate for the Spanish economy is expected to be around 5.2%, an improvement in comparison to the previous forecast of 4.8%.**
- **The beginning of 2023 is still marked by great uncertainty regarding the intensity of the slowdown and when the turning point for a more sustained and robust recovery will occur. Growth forecasts are around 1%.**
- **As for Q4 2022, the Spanish economy is expected to post similar growth to that recorded in Q3, despite the deterioration of the international context and the increase in uncertainty.**
- **Job creation eased in the second half of 2022 compared to the good performance shown in the first half. CEOE estimates that seasonally adjusted effective registrations with the Social Security increased by 0.3% in the last quarter of 2022, the same rate as in Q3.**
- **Inflation continued its slowdown to close 2022 at 5.7% in December, although core inflation is still on the rise.**
- **The public deficit for 2022 will close at around -4.5% of GDP.**

The International Scenario

Inflation starts to soften as global economy loses momentum

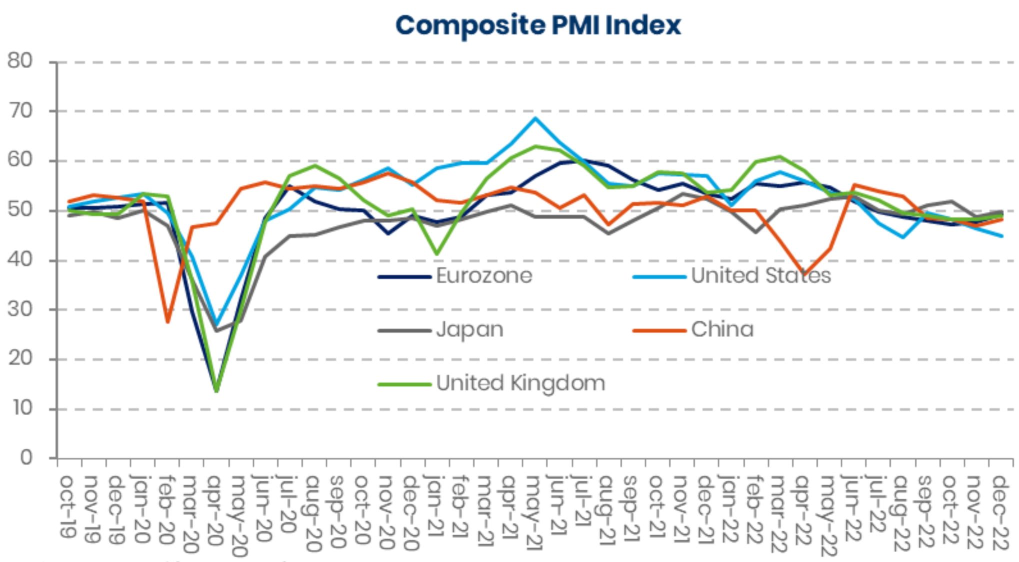
The world economy continues to show signs of slowing down, with PMI indices in negative territory. However, the loss of dynamism seems to be less intense than expected a few months ago, albeit with significant differences across regions. At the same time, inflation seems to have moved away from its peak levels, both in the United States and in Europe, although it still remains at very high levels.

In December, inflation in the United States fell for the sixth consecutive month to 6.5%, while core inflation, excluding energy, food, alcohol and tobacco, declined for the fourth consecutive month to 5.7%. The rates are still high, but considerably more moderate than the highs in June for headline inflation (9.1%) and September for core inflation (6.6%). The Eurozone is lagging somewhat behind in price trends, and December saw the second consecutive decline in headline inflation to 9.2%, after the October peak (10.6%). However, core inflation, again excluding energy, food, alcohol and tobacco, still continues its upward trend and climbed to 5.2%, marking a new high in the historical series. If it follows a path similar to the one seen in the U.S., the highs for core CPI could be reached between January and February, provided there are no significant second-round effects.



Source: Prepared-in house based on data from Eurostat and Bureau of Labor Statistics

As for the evolution of activity, the Global Composite PMI Index has improved two tenths in December, to 48.2 points, even though it remains in contractionary territory for the fifth consecutive month. Moreover, these results are the worst since June 2020, with the exception of last November. The weakness of the world economy is evidenced by the fact that the composite indicators are below 50 points in all the main economies, although in December there was some improvement in the Eurozone, China, Japan and the United Kingdom, which contrasts with the greater deterioration of the indices in the United States.



Source: Markit Economics

The main international agencies estimate that there may be a technical contraction in several economies between the end of 2022 and the first quarter of 2023, or even in the first half of the year, before the world economy resumes its recovery path. On a positive note, however, it should be noted that the loss of dynamism in the latter part of 2022 appears to have been less intense than expected. Meanwhile, in addition to the uncertainty still associated with the possible evolution of the war in Ukraine and the pandemic, concerns about the recovery focus on the effects of tighter monetary conditions on growth, both in Europe and in the United States. In China, the main concerns are related to the problems in its real estate sector.

Moreover, amid this context of generalized slowdown, the Managing Director of the IMF, Kristalina Georgieva, has highlighted the risk that geopolitical tensions could lead to a fragmentation of trade in economic blocs. In this sense, they estimate that the effects on world production in the long term would range from 0.2% in the best-case scenario to 7% in the most adverse one. If the effects of this fragmentation, in addition to trade, also entail technological decoupling, the losses could reach up to 12% of GDP. The impact would be even greater if the restrictions were to extend to cross-border migration, capital flows and a decline in international cooperation.

Given such fragmentation risks, the IMF underlines that pragmatism must prevail and points out areas where international collaboration is essential, such as trade, debt and climate action. To this end, they call for the need to strengthen world international trade, help the most vulnerable countries to deal with their debt and intensify actions to address the climate crisis.

In the United States, Q3 GDP was revised upward to 0.8% quarter-on-quarter, after two quarters of negative growth. Growth was supported by the strength of the external sector, driven by an increase in exports, particularly oil exports. Non-residential investment also performed well. In contrast, private consumption slowed, while residential investment and imports declined, with domestic demand suffering from the effects of inflation and tighter monetary conditions. In Q4, the economy is expected to slow down again, as anticipated by the PMI indices, and in 2023 as a whole, growth is expected to be very modest, below 1%, in a context of higher financial costs and a reduction in the savings accumulated during the pandemic.

Meanwhile, the US labour market remains robust, although job creation is slowing down. In December, employment rose by 223,000 and the unemployment rate fell by two tenths to 3.5%. These good employment and growth figures may encourage the Federal Reserve, after having set interest rates in the 4.25% to 4.5% range in December, to continue tightening monetary policy at its next meetings. However, rate hikes may be milder, given that inflation is already showing signs of moderation.

In the euro zone, there was already a significant slowdown in Q3, with GDP rising 0.3%, vs. 0.8% in Q2, and in Q4 the loss of dynamism is expected to worsen. However, favourable weather and savings in energy consumption are preventing the most adverse scenarios, with the PMI indices having improved in December, even though they remain below the 50 point mark. Q4 could post virtually zero growth, clearly better than anticipated a few months ago. For 2023, a slight contraction could be seen in Q1, but the main international agencies expect annual growth to be positive, albeit very moderate, between 0.3% and 0.5%. Inflation and higher financing costs will weigh on private consumption and also on investment, although the latter will benefit from the boost provided by European funds.

Meanwhile, the Eurozone labour market continues to show remarkable resilience, with the unemployment rate in November standing at 6.5%, the same as in October, repeating its historical lows. On the other hand, the ECB raised its rates in

December by half a point, bringing the interest rate on the main refinancing operations to 2.5%, while the interest rates on the marginal lending facility and the deposit facility stood at 2.75% and 2.0% respectively. The institution also stated that rates will continue to be raised at future meetings and that its asset purchase programme (APP) will reduce reinvestments from March, at a rate of 15 billion euros per month, until the end of Q2. Its forecasts point to inflation levels that will gradually ease, but still average 6.3% in 2023. Inflation is not expected to approach the institution's target until 2025, when the average rate for the euro area is estimated at 2.3%.

In China, after the improvement recorded in Q3, where GDP rose to 3.9% year-on-year, Q4 again showed flat growth, reflecting the resurgence of the pandemic. Thus, 2022 has seen an average growth of 3.0%, the lowest since 1976, with the exception of 2020, and far short from the official target of 5.5%. Moreover, the country has experienced a decline in its population for the first time since 1961, which may also detract from its growth potential. The outlook for 2023 suggests a modest recovery, with growth of around 4.5%. However, its economy has weaknesses, such as the problems in its real estate sector, which are already being felt in the decline in house prices in recent months, and the risk that tensions could spill over to the financial sector. This is compounded by the country's difficulties in dealing with COVID, despite having announced a relaxation of its zero-tolerance policy.

As for raw materials, the prices of food and non-metallic industrial products continued to ease, while those of metallic products rebounded. Oil prices also continued their downward trend, averaging $83.3/barrel in December, while in the first half of January they averaged close to $82/barrel. However, in the last few days they have followed an upward trend due to increased demand from China, following the reopening of its economy, and the restrictions on supply resulting from the embargo on Russia. These situations could put pressure on prices again in 2023, especially if the global slowdown is milder than anticipated a few months ago.

The Spanish Economy

2022: a difficult year marked by high inflation and the tightening of monetary policy;
2023: uncertain start due to the intensity of the slowdown

Following the significant upward revision that the National Statistics Institute (INE) published for the GDP corresponding to the first half of 2022, the average growth of the Spanish economy is expected to be around 5.2%, an improvement on the previous forecast of 4.8%. Last year was marked by a strong recovery until Q2 and a very pronounced slowdown since the summer, due to the effect of the war in Ukraine on the rise in the prices of raw materials, and their subsequent impact on inflation and on the cost of doing business in our country. Together with these parameters, the persistence of certain bottlenecks, the uncertainty linked to the international context and the monetary policy tightening have interrupted the recovery process that had been underway since the pandemic restrictions were lifted.

Inflation levels and the derived consequences on the change in the monetary policy stance have undoubtedly been the key issues in 2022. December's year-on-year CPI came in at 5.7% (after peaking at 10.8% in July) and the average for the year was 8.4%, rates not reported since the 1980s. Such high and widespread inflation in all European countries has led the ECB to raise interest rates to 2.5%. The Euribor is already around 3.3%, which is tensing the financing conditions for families and companies. On the other hand, the positive surprise in 2022 was both the good performance of employment, despite the weakening seen in the second half of the year, and the continuation of the external surplus, although it will be lower than in previous years.

The beginning of 2023 is still immersed in great uncertainty regarding the intensity of the slowdown and when the turning point for a more sustained and robust recovery will occur. The focus will remain on core inflation (7% in December) and how high interest rates will be set by the ECB, as both will determine the behaviour of consumption and private investment, as well as their impact on public finances. GDP could be around 1% (recently, AIReF even pointed to 1.6% and the Funcas panel to 1.3%), amid a context of clear downside risks. Spain also has some elements to make it more resilient, such as the European funds, a greater energy autonomy and the labour market. What is relevant is that, for now, a recession in Spain seems to be ruled out for 2023, mainly due to a better outlook in the energy sector.

Demand and Activity

The Spanish economy sustains its activity in Q4 despite the deterioration of the economic environment

Pending the publication at the end of this week of the advanced Quarterly National Accounts figures for Q4 2022, with the information currently available, we believe that the Spanish economy could post a similar performance to the one recorded in Q3 (0.1% quarter-on-quarter). Despite the deterioration of the international context and the monetary policy tightening, real economy indicators are still displaying some resistance to a downturn.

Thus, after a deterioration in both consumer and business expectations over most of last year, the last two months have seen a slight improvement in the outlook for households and for retail trade and services.

With regard to the evolution of consumption, despite the rise in inflation and the increase in interest rates, it has continued to show a positive behaviour in recent months. However, a slowdown is likely over the coming quarters, as mortgage payments continue to reflect interest rate rises and the labour market becomes less buoyant.

Industrial activity continues to be affected by an economic climate of high uncertainty, rising energy prices and supply problems. This is reflected in the evolution of the sector's confidence indicators, which have shown a clear worsening for practically the entire 2022 year, implying that the sector is undergoing a contraction. However, there are signs of this deterioration slowing down to give way to a certain stabilisation. Thus, although the manufacturing PMIs have accumulated six months of contractionary levels and continue to be below the 50 mark, in November and December they improved slightly. The companies surveyed report a slower fall in new orders, a stabilization in employment and less pressure on the prices of their raw materials, together with a slight reduction in delivery delays.

This certain improvement in international trade supply chains has also improved the supply of materials for the automotive industry in the last part of the year, resulting in an improvement in vehicle production in the last months of 2022 compared to the same period of the previous year, which was particularly affected by the lack of microchips. According to the industry, 2022 will close the year at around 2.2 million units produced. Despite this context, domestic manufacturing is still 23% below the pre-pandemic production rate, with around 600,000 fewer units.

The services sector continues to show a fairly solid performance, although expectations have deteriorated in recent months due to persistent inflation and rising interest rates, both of which will erode household spending power. Thus, the services PMI, after the slump in September and October, was once again above the 50 level in November and December.

From the point of view of the foreign sector, the customs information available for the first eleven months of 2022 shows a much more dynamic trend in imports than in exports of goods, in nominal terms, due to the greater increase in real terms as well as to the rise in import prices. Thus, exports increased by 23.6% year-on-year (4.2% in volume terms) and imports by 35.8% year-on-year (8.4% in volume terms). The result of these flows was a trade deficit in this period of €-63.6029 billion euros, compared with €-20.836 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 ten months of 2022 the current account surplus reached 4.4 billion, compared with a surplus of 9.8 billion in the same period of 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, reflecting the improved performance of tourist flows this year.

In this respect, the latest data available for the tourism sector show that the inflow of international tourists continues to recover, although there are signs of a certain slowdown. Thus, in November 2022, it stood at around 4.3 million tourists, almost 9% below the number of tourists in November 2019, whereas in October we had already reached 95% of the pre-pandemic figure. However, as average spending has increased, total tourist expenditure is 6% above that recorded in November 2019. Looking ahead to 2023, the sector's expectations are favourable within a scenario of a return to normality and a reactivation of Asian tourist flows.

The Labour Market

Job creation slows down in the final stretch of 2022 and will continue to do so in 2023

The labour market's balance for 2022 is positive, with job creation of 3.9% on average per year, in terms of registrations with the Social Security, which means some 750,000 more contributors than in 2021, of which almost 685,000 (more than 90%) are private sector workers. However, there are two phases in the evolution of employment over the course of 2022. In the first half of the year, Social Security registrations showed a remarkable dynamism, as opposed to the slowdown observed in the second half of the year.

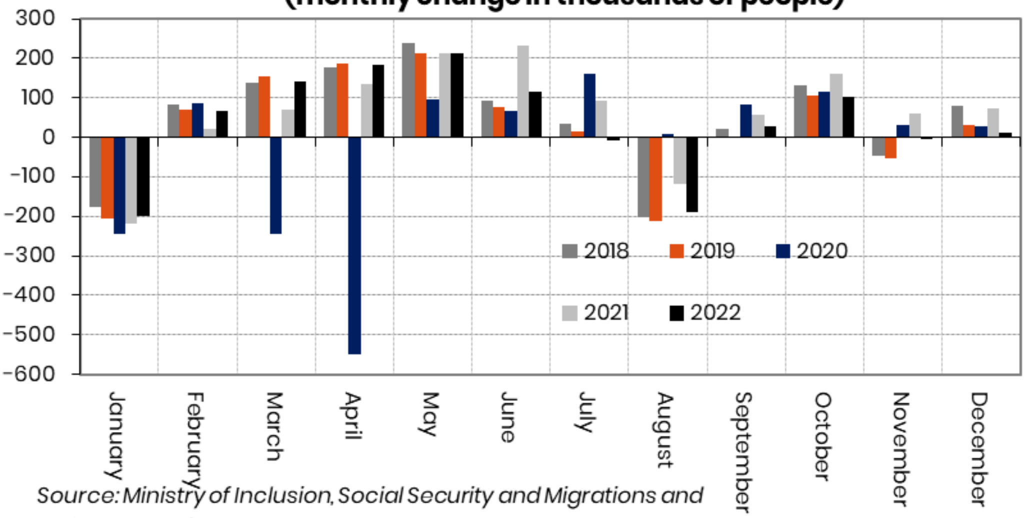
Looking ahead to 2023, great caution should be exercised, given the economic uncertainty due to the consequences of the war in Ukraine on inflation, energy supply and, broadly speaking, the generalised rise in production costs, which are affecting economic activity and, consequently, the labour market. Thus, CEOE estimates that employment in LFS terms will grow by 3.3% in 2022. In contrast, job creation will slow down notably in 2023, to 0.8%, as a result of the lower GDP growth forecast. Meanwhile, the unemployment rate, after having reached 14.8% in 2021, is estimated to fall in 2022 to 12.8%. In 2023 it will remain at a similar level to the previous year.

In December, Social Security registrations performed less favourably than in previous months. Specifically, they registered an increase of 12,640 contributors, which is lower than the average increase observed in the period 2014-2019 (+64,327 workers). In fact, this is the worst figure for a month of December since 2012. By sector, the increases in registrations recorded in agriculture and services are noteworthy, although they were more moderate than those recorded in the same month in the years prior to the pandemic. Meanwhile, there were declines in industry and construction, but not very different to what is typical for this month.

The year-on-year rate of Social Security registrations continued to decrease and stood at 2.4% in December, three tenths lower than in November, and half the rate of 5.1% reached in April. It should also be noted that the private sector continued to lose workers in December. Specifically, it lost 10,687 workers compared with the previous month, which was more than offset by the incorporation of 23,327 new employees in the public sector.

The Ministry of Inclusion, Social Security and Migration has recently published a new seasonally adjusted Social Security registrations series, which incorporates methodological changes. With the new results, seasonally adjusted registrations show a favourable performance in the first half of 2022, with an average month-on-month increase of close to 70,000 people, while in the second half of the year this dynamism slowed notably and the month-on-month average was around 11,000 workers, with an increase of 7,357 workers in December vs. November. Moreover, on the basis of the information published by the Ministry, it is estimated that gross registrations in January, typically an unfavourable month, will fall considerably, with a decline that could exceed 200,000 workers in comparison to December.

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 number of workers under furlough (ERTE) has stabilised at just over 20,000 since last July. Specifically, it reached 21,326 people in December, of which one fifth are in the automotive sector. Registered unemployment fell in December for the third consecutive month. Specifically, it fell by 43,727 workers in the last month of the year, although this figure is lower than the average for this month in the period 2014-2019. Registered unemployment closed 2022 at 2,837,653 persons, which is 268,252 fewer unemployed than at the end of 2021.

The balance of the labour market in Q4 was positive, although much of the dynamism shown in the first half of 2022 has been lost. In fact, according to estimates by CEOE's Economics Department, seasonally adjusted effective registrations (excluding furloughed workers) rose by 0.3% quarter-on-quarter in Q4, the same rate as in Q3, but much lower than the rates of 1.2% and 1.6% recorded in Q1 and Q2 2022, respectively.

Inflation

Inflation slows substantially in the last months of 2022 and closes the year at 5.7%.

In December, inflation declined to 5.7%, down from November's 6.8%, on the back of lower energy prices. Inflation has shown a significant decline from the double-digit rates recorded in the middle months to post the lowest rate of the year in December. This brings average annual inflation to 8.4% in 2022 and average core inflation to 5.2%.

In December, core CPI rose by seven tenths to 7.0% year-on-year. Within the core component, Services prices increased their year-on-year rate by two tenths to 4.0%; Industrial goods prices (excluding energy products) increased by six tenths to 5.2%; and Processed food, beverages and tobacco accelerated their year-on-year rate by 1.7 points to 16.4%.

Unprocessed food prices decreased year-on-year by 1.2 points to 11.4%. Practically all food items recorded rates above 10%.

Energy product prices recorded a significant fall to -6.9% year-on-year, which constitutes a sharp deceleration in recent months from the 37.4% recorded in August, due to the lower increase in the price of energy raw materials. Thus, in December, oil prices continued to decelerate amid signs of a loss of dynamism in the global economy, standing at an average of $83.3/barrel, 10.3% lower than in the previous month. Year-on-year rates also eased to 11.5% in dollar terms and 18.1% in euros. In the first days of January, the price is hovering around $82/barrel, which, if sustained, would result in negative year-on-year rates this month of -6.8% in dollar terms and -1.2% in euros. These rates are expected to be significantly more negative in the coming months.

Energy prices are starting to moderate significantly and unprocessed food prices are also continuing to fall, reflecting lower commodity price pressures in international markets. Inflation is expected to ease further in the coming months and over the course of next year. A much more moderate average rate of around 4% is expected in 2023.

The Public Sector

The public deficit will close at around -4.5% of GDP in 2022.

The Independent Authority for Fiscal Responsibility (AIReF) has updated its public deficit forecasts, worsening its estimate of the budget balance for the general government sector for 2022 by two tenths to -4.5% of GDP. It forecasts an increase in the weight of revenues to 43.9% of GDP, while uses would be set at 48.3% of GDP, due to the implementation of the different measures and the Recovery, Transformation and Resilience Plan.

In the breakdown by level of government, and according to the same source, the Social Security Funds will reach a negative balance of -0.5% of GDP in 2022. The Autonomous Communities will close the year with a deficit of -1.1% of GDP and local entities will post a surplus of 0.2% of GDP. Thus, the central government will account for the largest negative balance, with -3.1% of GDP.

Based on the National Accounts data up to November for the Central Government, its balance is equivalent to -2.0% of GDP, much lower than the -5.8% of GDP in the same period of 2021. The primary balance has turned negative (-0.1% of GDP), although this is much lower than the -4.1% of GDP accumulated up to November 2021.

As has become the norm throughout 2022, it is worth highlighting the strength of non-financial resources, which grew by 23.5%, driven mainly by personal income taxes, VAT and corporate income taxes. Social security contributions also performed well. And all this despite the drop in revenue resulting from the various measures adopted to reduce electricity prices (-7.466 billion up to November, according to AIReF).

On the other hand, uses continue to grow, albeit at a slower pace (0.5%). It is worth noting the different evolution in spending items. Thus, transfers to other Public Administrations and to the National Employment Service (SEPE) decreased as a result of the termination of COVID and furlough-related allowances. On the other hand, there was a sharp increase in interest expenses (20.5%) and subsidies for transport, which are included under the heading of other current expenditure, up by 90.8%.

Forecasts

Economic forecasts for Spain (last update: January 2023) — Annual rates of change, unless otherwise indicated	2018	2019	2020	2021	2022	2023
GDP	2.3	2.0	-11.3	5.5	5.2	0.8
Private consumption expenditure	1.8	0.9	-12.4	6.0	2.5	0.8
Government consumption expenditure	2.3	1.9	3.5	2.9	-1.6	-0.2
Gross fixed capital formation	6.3	4.5	-9.7	0.9	5.0	2.8
-Tangible fixed assets	7.5	5.3	-11.1	0.1	4.7	2.7
Construction	9.5	7.2	-10.2	-3.7	4.3	2.7
Equipment and cultivated assets	4.6	2.4	-12.6	6.5	5.3	2.8
-Intangible fixed assets	1.1	0.6	-2.5	4.7	6.2	2.8
Domestic demand (*)	2.9	1.6	-9.1	5.3	1.9	1.3
Exports	1.7	2.2	-19.9	14.4	18.4	3.9
Imports	3.9	1.3	-14.9	13.9	9.0	4.8
External demand (*)	-0.6	0.4	-2.2	0.3	3.3	-0.4
GDP current prices	3.5	3.4	-10.1	7.8	8.7	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	8.4	4.2
CPI (Dec/Dec)	1.2	0.8	-0.5	6.5	5.8	4.9
Core CPI (average annual rate)	0.9	0.9	0.7	0.8	5.1	5.4
Employment (Quarterly National Accounts)(**)	2.2	3.3	-6.8	6.6	3.8	0.7
Employment (LFS)	2.7	2.3	-2.9	3.0	3.3	0.8
Unemployment rate (LFS) (% active population)	15.3	14.1	15.5	14.8	12.8	12.8
Productivity	0.1	-1.3	-4.8	-1.0	1.4	0.1
Compensation per employee	1.8	2.4	2.5	-0.8	1.7	2.9
Unit labour cost (ULC)	1.7	3.8	7.7	0.2	0.3	2.8
Current Account Balance (% of GDP)	1.9	2.1	0.8	0.9	0.6	0.0
General government net lending (+) / net borrowing (–) (% of GDP)	-2.5	-2.9	-10.3	-6.9	-4.5	-4.0
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	2.50	3.50
Brent Oil ($)	70.9	64.8	41.5	71.1	103.7	80.3

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

(*) Contribution to GDP growth

(**) Full-time equivalent jobs