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Economic Outlook

February 2023

Overview

- **The global economy is slowing down, but less than expected. As a result, the European Commission has revised its forecasts upwards for 2022 and 2023.**
- **Inflation continues to ease, albeit gradually, as monetary policy continues to tighten.**
- **Prices for raw materials have risen in January, reversing their downward trend of recent months.**
- **Spain: the slowdown in activity, employment and inflation in Q4 2022 is confirmed.**
- **Unit labour costs rebounded in Q4 and are almost 10% higher in comparison to the pre-pandemic levels of Q4 2019.**
- **Expectations improve in early 2023 despite high inflation and rising interest rates.**
- **Social Security registrations continued to decelerate in January, albeit more mildly than in previous months.**
- **Inflation posted a one-off rebound in January, but it is expected to continue its downward path throughout 2023.**

The International Scenario

The global economy slows down, but averts the worst-case scenario, while inflation is easing

Growth in the last quarter of 2022 reflects the slowdown in the global economy, which is already feeling the effects of monetary policy tightening across the board, although the results have been better than expected. In addition, inflation is showing signs of moderation, which means that the next central bank actions should be less severe. These factors have led to a very positive performance of the world's main stock markets at the beginning of the year.

The resilience of labour markets, coupled with the moderation in the cost of raw materials, is sustaining the different economies. In addition, there have been no energy shortages in Europe, which could have led to restrictions on activity in some sectors.

As a result, the European Commission has revised its growth estimates for the Eurozone upwards for last year and, especially, for 2023. Thus, the European economy managed to prevent a contraction of activity in the last quarter of the year, with a 0.1% increase. This leaves growth for 2022, both for the Eurozone and for the European Union as a whole, at 3.5%, three and two tenths higher, respectively, than estimated in the fall. For 2023, growth forecasts have also improved, to 0.8% in the case of the EU and 0.9% for the Eurozone, which is five and six tenths more, respectively, than the predictions released in November. Despite the improvement, they warn that the economic situation remains complicated, mostly due to the persistence of inflationary pressures and the tightening of monetary policy, which will affect business activity and weigh on investment.

European Commission forecasts (February 2023)

	GDP			Inflation		
(y-o-y rate)	2022	2023	2024	2022	2023	2024
European Union	3.5	0.8	1.6	9.2	6.4	2.8
Eurozone	3.5	0.9	1.5	8.4	5.6	2.5
Germany	1.8	0.2	1.3	8.7	6.3	2.4
France	2.6	0.6	1.4	5.9	5.2	2.5
Spain	5.5	1.4	2.0	8.3	4.4	2.3
Italy	3.9	0.8	1.0	8.7	6.1	2.6

Source: European Commission

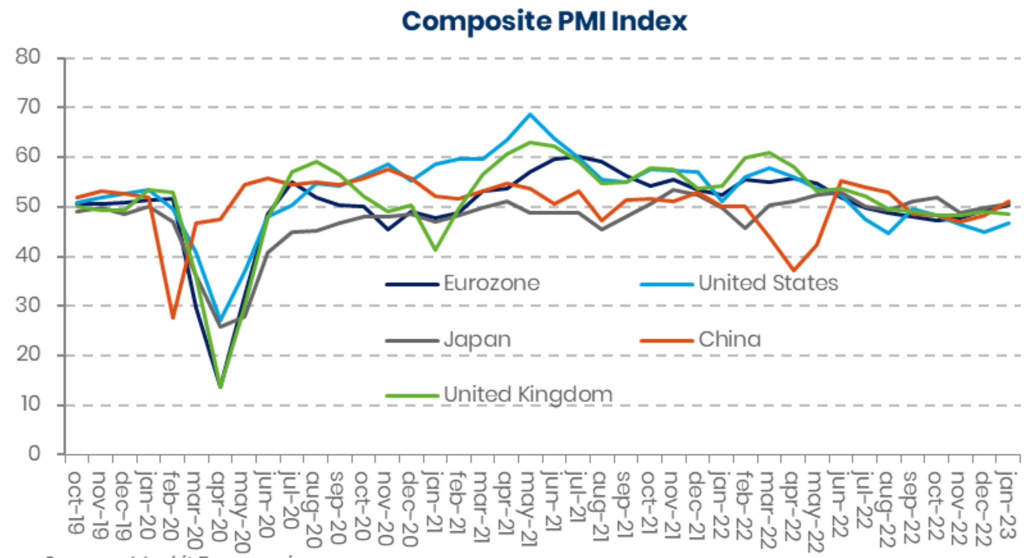
With regards to inflation, the preliminary January figure for the Eurozone was set at 8.5%, seven tenths lower than in December, thus confirming the moderation in prices. However, this figure should be viewed somewhat cautiously, as it did not include prices for Germany, which is the country with the greatest weight in the average. Nonetheless, if confirmed, it would be the third consecutive decline, after the October highs, reflecting the containment of energy prices. However, core inflation rose by one tenth to 7%, registering a new all-time high.

In the United States, GDP in Q4 increased by 0.7% quarter-on-quarter, one tenth less than in Q3. The labour market was stronger than expected in January, with 517,000 jobs created and the unemployment rate falling to 3.4%, the lowest level since 1969. The U.S. economy has now been posting twenty-five straight months of job gains, with the number of job openings nearly doubling the number of unemployed at 5.7 million. However, despite the labour shortage, wage increases have slowed slightly to 4.4%.

Inflation in January continued to fall, but very slightly, to 6.4%, one tenth less than in December, while core inflation, excluding energy and food, also fell by one tenth to 5.6%. Meanwhile, the housing market is being affected by interest rate hikes, with house prices falling and builder confidence indices at very low levels. On the other hand, the U.S. Government reached its debt ceiling. This led the Secretary of the Treasury, Janet Yellen, to announce extraordinary measures that could ease the situation until early June. Meanwhile, Republicans and Democrats continue to disagree on whether to extend this ceiling, which increases uncertainty regarding the performance of the economy.

China's activity also slowed down in Q4, with quarter-on-quarter GDP posting flat growth, once again reflecting the lockdowns on the back of new COVID outbreaks. In January, the country announced a change in its zero-tolerance policy and reopened its borders, so a rebound in activity and consumption is expected. This should revive the economy, despite the problems in its real estate sector.

Meanwhile, the PMI indices for January showed a slight improvement, with the Global Composite PMI Index standing 1.6 points above the December figure, although it remains in negative territory at 49.8 points. The Eurozone, China and Japan have returned to positive territory, above 50 points, while the United States and the United Kingdom are still at contractionary levels. Overall, there are signs of activity stabilizing, while the risks of recession seem to have diminished. The slowdown in manufacturing output has eased, while services activity has picked up again after having declined the last three months.



Source: Markit Economics

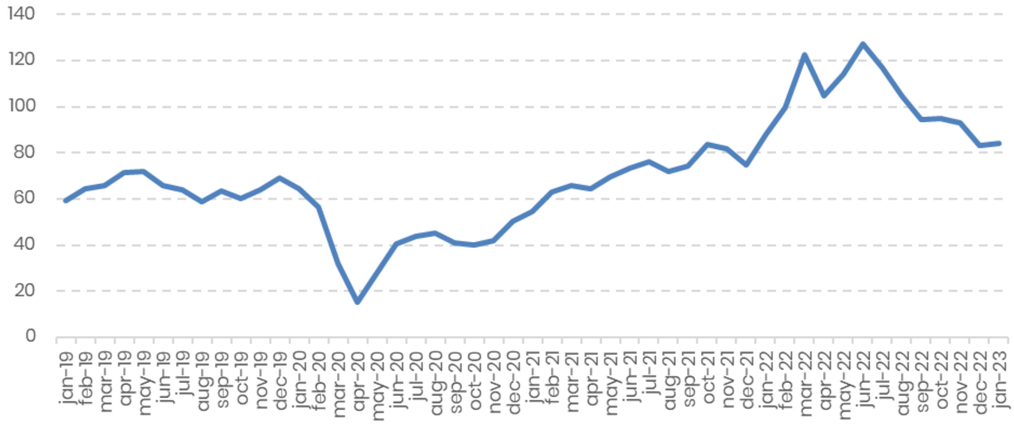
Central banks have continued to tighten their monetary policies, albeit at a slower pace than in the final months of 2022. The European Central Bank and the Bank of England raised their interest rates by half a point to 3% and 4%, respectively. The Federal Reserve raised rates by only twenty-five basis points to the 4.5%-4.75% range. However, they have all made it clear that the battle against inflation is not over and that, although the peak may be behind us, levels are still very high and far from target. This is why they have insisted that, at their next meetings, they will continue to hike interest rates, and the ECB even indicated that it will raise them again by half a point in March.

In addition, central banks are reducing their asset purchase programs, which also tightens monetary policy. The ECB will begin these cuts on March 1, at a rate of 15 billion per month and until the end of June, when they will decide on the new pace of balance sheet reduction. Meanwhile, Japan's inflation rose to 4%, the highest in four decades. In light of this, Kazuo Ueda has been appointed president of the Bank of Japan and his profile suggests that there may be a tightening in the country's monetary policy soon and that, as a result, there will be an increase in the yield of Japanese public debt.

With regards to raw material prices, their year-on-year downward trend continues, although in January the price of many of them has experienced a significant upturn compared to December's levels, mainly in the case of industrial metal products. This increase in prices is due to the improved performance of the world economy and expectations that global demand will increase, especially if the Chinese economy becomes more dynamic.

The price of Brent crude oil in January broke its downward trend and rose slightly to an average of $84.2/barrel. Meanwhile, Russia announced a decrease in its production for March in response to the cap on the price of Russian crude imposed by the West. The OPEC+ also approved leaving the agreed cuts in place. In contrast, the United States decided to reduce its strategic reserves to release more oil into the market. There is high uncertainty about the evolution of prices, which will be conditioned by the performance of the world economy. However, the OPEC estimates that world demand will increase by about 2.3 million barrels per day in 2023 so, if its forecasts prove to be correct, there may be greater pressure on prices, especially in the second half of the year and particularly if supply does not respond to this expected increase in demand.

Oil price ($ per barrel) monthly average



Source: Prepared in-house based on data from the Ministry of Economic Affairs and Digital Transformation

Thus, although the most complicated scenarios seem to have been averted, the economic context is still highly uncertain, with significant risks to growth, including inflation, geopolitical tensions and the war in Ukraine, among the most important. The evolution of the Chinese economy is also a source of uncertainty. In addition to these factors, tensions may arise in the United States in relation to how they decide to address its debt ceiling, and there may be movements in the financial markets in the face of possible changes in the Japanese monetary policy.

The Spanish Economy

A slowdown in activity, employment and inflation is confirmed with the Q4 data

Although the GDP figure published for Q4 could at first sight seem positive, posting a 0.2% increase, it indicates that domestic demand contracted significantly in said quarter, both in terms of private consumption and investment. The performance of the foreign sector was also negative, since exports and imports showed a notable reduction, which was much more intense in the case of foreign purchases. This resulted in a positive contribution from the foreign sector, which offset the decline in domestic demand.

Therefore, although the revised GDP and the Q4 estimate bring 2022 growth up to 5.5% (same rate as in 2021), the clear fall in all GDP components in Q4 (except for public consumption) casts a cautionary shadow over the evolution of economic activity going forward, and it points to the significant impact that tighter financing conditions and high inflation have on consumption and investment by businesses and households. Moreover, neither GDP nor hours worked have recovered their pre-crisis levels.

Regarding employment, it should be noted that, regardless of the statistical source used, hours worked and full-time equivalent jobs, as well as employed individuals in LFS terms, show a notable deceleration in the year-on-year rate throughout 2022, which intensified in Q4.

Inflation continued moderating through December but picked up in January (5.9% year-on-year). However, the focus is still on the core component, which already stands at 7.5% year-on-year, making it difficult to bring inflation back to stable levels.

Therefore, the economic outlook for 2023 remains highly uncertain, with clear downside risks, although the threat of a recession seems to be fading. Thus, the European Commission has revised its GDP forecast for 2023 upwards by four tenths to 1.4%, and its inflation estimation downwards to 4.4% (also four tenths lower than the previous estimate). Even so, growth is low and could affect the labour market, which, combined with high inflation, the tightening of financial conditions and lower accumulated savings, will have a major impact on household and business demand, through consumption and investment.

Demand and activity

Expectations improve at the start of 2023 despite high inflation and rising interest rates

After closing the year with 0.2% growth in Q4, indicators available for January suggest that the Spanish economy has grown at similar rates at the beginning of 2023.

With regards to expectations, after the deterioration recorded during most of last year, the last two months have seen an improvement in the household and business sentiment in general. Thus, the consumer confidence indicator in January posted its best record since the start of the war in Ukraine, driven by an improved outlook for household trends and the general economy. The retail trade indicator has also shown a significant rebound and is back to positive territory after six months in the negative, reflecting the perception of a better business climate now and for the coming months.

These improved consumer and retail expectations should lead to a favourable evolution of household consumption in the short term, despite the current high inflation rates. However, as the year progresses, there may be a slowdown as mortgage loan payments reflect interest rate hikes and the labour market loses momentum.

The industrial activity confidence indicator posted an improvement, following the recovery path shown in December. This reflects the fact that, although most industrial sectors continue to suffer from rising input prices and supply problems, the intensity of these problems has diminished. The manufacturing PMIs have also improved slightly in the last three months, being set at 48.4 in January, although they now accumulate 7 months below the 50 level.

Supply problems significantly conditioned vehicle production in our country during 2022, which, in the end and as a result of the improvement in recent months, was able to close the year 5.8% higher than in 2021. Vehicle registrations were also affected (as production was proving difficult in factories around the world). The year closed with vehicle registrations of 813,396 units, -5.4% compared to 2021. In January, registrations were up 51% compared to the same month in 2022, a result that may be due to units that had not been delivered in previous months because of transport difficulties. However, they are still far from the pre-pandemic figures. The situation is expected to improve this year in terms of both production and registrations, although high inflation and rising interest rates could hold back demand.

In the services sector, expectations also improved notably in January, following the deterioration in the confidence indicator that had been seen recent months. The services PMI, after the slump in September and October, rose above the 50 level again in the last three months and continued its path towards greater optimism in January, on the back of the total normalization of activity and the recovery of the tourism sector.

According to the Statistics on Tourist Movements at Borders (Frontur), in 2022, Spain received 71.6 million tourists, 129.5% more than in 2021, but still 14.3% below the pre-pandemic levels of 2019. The latest available data shows how the inflow of international tourists continues to recover. Thus, in December 2022, it stood at just over 4.3 million tourists, only 4.4% below December 2019. Moreover, given that average spending increased by 15.3% in 2022, total tourist spending over the past year was only 5.3% lower than that recorded in 2019.

In terms of the foreign sector, the customs information available for the first eleven months of 2022 shows a much more dynamic evolution of goods imports than exports in nominal terms, due to the greater advance in real terms as well as to the increase in import prices. Thus, exports increased by 23.6% year-on-year (4.2% in volume) and imports by 35.8% year-on-year (8.4% in volume). The result of these flows was a trade deficit in this period of -€63.6029 billion, compared to -€20.836 billion in the same period of 2021.

Similarly, according to the Balance of Payments data published by the Bank of Spain, in the first eleven months of 2022, the surplus of the current account balance reached 10.1 billion, compared to a 11.4 billion surplus in the same period for the previous year. This lower surplus is explained by 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 Labour Market

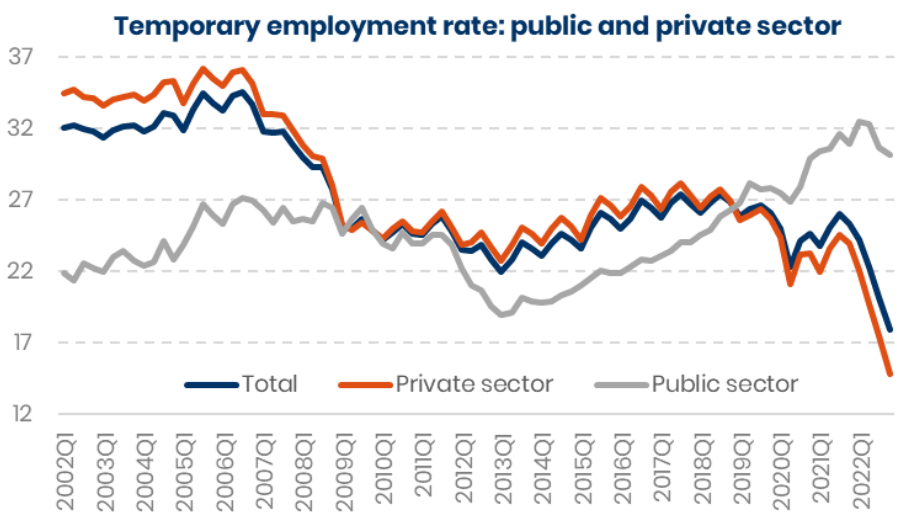
The labour market is beginning to reflect the loss of momentum in activity and the economic uncertainty.

The Labour Force Survey results for Q4 show a loss of employment, concentrated in the private sector, an increase in unemployment and a decrease in the active population.

Specifically, employment fell by 81,900 people in Q4 2022, the worst year-end figure since 2013. Moreover, its year-on-year growth rate continues to slow significantly, from 2.6% in Q3 to 1.4% in Q4. It should be noted that the deterioration in employment was concentrated in the private sector, which lost 101,900 workers in the last quarter of the year, while the public sector recorded an increase in employment of 20,000 people.

The number of unemployed individuals rose by 43,800, the most unfavourable reading since 2012. This brought the total number of unemployed to over three million people (3,024,000). The decline in the labour force has alleviated the increase in the unemployment rate, which rose two tenths, to 12.9%, in Q4 2022.

The most positive sign is still the number of permanent contracts in the private sector, whose temporary employment rate fell to 14.8%, half that of the public sector (30.2%). In the economy as a whole, the temporary employment rate continued to fall to 17.9%, the lowest in the historical series.



Source: prepared in-house based on LFS information

On the other hand, it is worth highlighting the destruction of the productive fabric as particularly unfavourable. This is reflected in the notable decrease in the number of self-employed workers by 34,700 persons in Q4, representing a 3.5% decline in year-on-year terms (-111,200 individuals).

According to the results of the Quarterly National Accounts for Q4, hours worked fell for the second consecutive quarter and, moreover, continue to be below pre-crisis levels. Specifically, they are 1.0% lower than in Q4 2019. Meanwhile, unit labour costs rebounded in the last quarter of 2022 to a year-on-year rate of 3.2% and are 9.7% higher than the pre-crisis figure recorded in Q4 2019.

The year 2023 kicked off with negative numbers for the labour market, although we should bear in mind that January is a traditionally unfavourable month due to the end of the Christmas season. Specifically, registered unemployment rose by 70,744 people, while the Social Security ended January with 215,047 fewer contributors on average than in December 2022. This decline in people registered with the Social Security is greater than the one recorded in this same month both in 2022 and in the average of the 2014-2019 period. In contrast, seasonally adjusted registrations increased by 57,726 people, a rebound in comparison to the results of the end of 2022. The preliminary data published by the Ministry of Inclusion, Social Security and Migration for the first half of February is also favourable.

The year-on-year Social Security registrations rate continues to decline, although at a slower pace than in previous months, and was set at 2.3% in January, one tenth lower than in December and less than half the rate of 5.1% reached in April. In addition, the private sector continued to lose workers in January, with 188,960 fewer than in the previous month. The public sector also recorded a loss of workers (-26,087 people), after three consecutive months of increases.

The number of furloughed workers (ERTE) fell in January to an average of 15,659 people, after having remained practically stagnant at around 20,000 people during the second half of last year. Much of this drop was due to the automotive manufacturing sector, where the number of workers under furlough schemes was below 400 people in January, down from more than 4,000 in December.

CEOE forecasts for 2023 point to a notable slowdown in job creation, whereby we expect the number of people employed in terms of LFS to grow by around 1%, after having grown by 3.1% in 2022. Meanwhile, the unemployment rate will remain at a similar level to the one recorded in 2022, 12.9%.

Inflation

Inflation posts a one-off increase in January, but is expected to follow a downward path throughout 2023

The CPI figure for January represents a change in trend compared to the deceleration of recent months, with inflation increasing by two tenths to 5.9%.

However, this information must be assessed carefully, since there have been methodological changes and economic policy measures on prices this month, making the figure not comparable to that of previous months. In particular, the elimination of the 20 cents/litre fuel subsidy for private individuals has led to an increase in general inflation of approximately three tenths, since the change in CPI excluding fuels was 5.6%, compared to 5.9% for headline inflation. Conversely, there has been a decrease in VAT on some basic products, which has led to a lower rate of change in the Food and Non-alcoholic Beverages group. This has translated in a reduction of almost three tenths in the year-on-year headline inflation rate.

On the other hand, this data also includes relevant methodological changes: the National Accounts have now become the main source used for the calculation of product weights (instead of the Household Budget Survey) and free market prices in electricity and gas are now also included (previously, only the regulated market was considered).

Energy product prices are beginning to show a significant moderation (their rate of decline intensified to -8.3% year-on-year) and Non-processed food prices also continue to decelerate (they fell by seven tenths year-on-year to 10.7%), which is due to lower tensions on raw material prices in international markets.

However, the increase in core inflation, which accelerated by 5 tenths to 7.5%, is worrying. Within the core component, Services prices increased their year-on-year rate by one tenth to 4.1%; Industrial Goods prices, excluding energy, increased by 1.3 p.p. to 6.5%; and Processed Food, beverages and tobacco accelerated their year-on-year rate by one tenth to 16.5% (without the tax changes, this rate would have been 17,3%).

The Public Sector

Notable reduction in the central government deficit in 2022

Up to September 2022, the overall Government deficit stood at 22.164 billion, 59.8% lower than in the same period of 2021. As a percentage of nominal GDP, the ratio stands at -1.7%, vs. -4.6% of GDP recorded in the first three quarters of 2021. If we deduct interest expenditure from the deficit, we get a primary surplus of 15 million, while in the same period of 2021 the primary deficit was 36.182 billion.

The Government level that has reduced its deficit the most was the Central Administration. Thus, up to September, the balance stood at -1.1% of GDP, which contrasts with almost -5% of GDP in the same period of 2021. Furthermore, based on the information released by the State up to November, its balance is equivalent to -2.0% of GDP, compared to -5.8% of GDP in the same period of 2021. Regional and local governments recorded a deficit, following the surplus accumulated up to September 2021, and the Social Security Funds reduced their negative balance

As has been the case in previous reports, non-financial resources were particularly strong, with an increase of 10.8% for the Government as a whole, driven mainly by direct and indirect tax collections (14.5%). Social security contributions increased by 4.7% and the rest of the resources by 9.8%, with capital taxes being the only component posting a decrease.

Uses up to September remained contained (+1.8%), although with significant differences in behaviour across the different items. Up to September and for the Government as a whole, there was a notable increase in interest expenses (+22.5%) due to the tightening of the ECB's monetary policy, and in subsidies (58.3%) as a result of the measures adopted to alleviate the high electricity costs for companies and families. On the other hand, the decrease in expenses was concentrated on the item "Other uses", down -27.4%. Within this item, it is worth mentioning the drop in “Other capital transfers” of -87.2%. Among other reasons, the latter is due to the fact that, in 2021, there were around 4 billion corresponding to the allowance for bad debt related to the standardized guarantees linked to the lines of credit granted by the State during 2020.

Forecasts

Economic forecasts for Spain (last update: February 2023)						
Annual rates of change, unless otherwise indicated						
	2018	2019	2020	2021	2022	2023
GDP	2.3	2.0	-11.3	5.5	5.5	1.3
Private consumption expenditure	1.8	0.9	-12.4	6.0	4.4	0.9
Government consumption expenditure	2.3	1.9	3.5	2.9	-0.9	0.0
Gross fixed capital formation	6.3	4.5	-9.7	0.9	4.3	2.0
-Tangible fixed assets	7.5	5.3	-11.1	0.1	4.1	2.1
Construction	9.5	7.2	-10.2	-3.7	4.2	2.4
Equipment and cultivated assets	4.6	2.4	-12.6	6.5	3.9	1.8
-Intangible fixed assets	1.1	0.6	-2.5	4.7	5.0	0.9
Domestic demand (*)	2.9	1.6	-9.1	5.3	2.9	1.6
Exports	1.7	2.2	-19.9	14.4	14.9	3.7
Imports	3.9	1.3	-14.9	13.9	7.7	4.6
External demand (*)	-0.6	0.4	-2.2	0.3	2.6	-0.3
GDP current prices	3.5	3.4	-10.1	7.8	10.1	4.8
GDP deflator	1.2	1.4	1.2	2.3	4.6	3.5
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	5.7	5.0
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	1.1
Employment (LFS)	2.7	2.3	-2.9	3.0	3.1	1.0
Unemployment rate (LFS) (% active population)	15.3	14.1	15.5	14.8	12.9	12.9
Productivity	0.1	-1.3	-4.8	-1.0	1.6	0.2
Compensation per employee	1.8	2.4	2.5	-0.8	2.0	2.9
Unit labour cost (ULC)	1.7	3.8	7.7	0.2	0.4	2.7
Current Account Balance (% of GDP)	1.9	2.1	0.8	0.9	0.8	0.5
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	5.25
Interest rates Eurozone (Dec)	0.00	0.00	0.00	0.00	2.50	3.75
Brent Oil ($)	70.9	64.8	41.5	71.1	103.7	80.7

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

(*) Contribution to GDP growth

(**) Full-time equivalent jobs