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Economic Outlook

March 2023

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Overview

- **The banking system in the eye of global financial instability.**
- **The financial turmoil has not altered the ECB's roadmap, who raised its benchmark interest rate to 3.5%. Nonetheless, it underlined its commitment to providing the necessary liquidity and highlighted the good position of the European financial system.**
- **The ECB and the OECD revised their growth forecasts upwards and inflation estimations downwards. The start of 2023 has been better than expected in terms of activity and confidence, but the balance of risks is still tilted to the downside.**
- **The Spanish economy starts 2023 with a more positive tone than anticipated, but at a modest pace. The factors that slowed growth in the second half of 2022 are still present and their impact is expected to be greater this year.**
- **The first Q1 indicators for Spain's economic activity show a favourable evolution and an improvement in expectations.**
- **Employment surprised positively in February, with a rebound in the Social Security registrations' year-on-year rate, thus breaking the slowdown it had been showing since May 2022.**
- **Inflation showed a slight upturn in January and February but, in March, it is expected to decelerate significantly and continue a downward trend throughout 2023.**
- **The public deficit for the general government sector as a whole, excluding local governments, stood at -1.9% of GDP up to November 2022, lower than in the same period in 2021 (-5.1% of GDP).**

The International Scenario

The banking system in the eye of global financial instability

The collapse of Silicon Valley Bank and Signature Bank caused an episode of financial upheaval in international markets in March. The lack of liquidity and the economic insolvency of these entities led to the quick intervention by the US financial regulator, in order to avoid heavy losses to their clients and a greater spillover to the rest of the sector. We should also mention First Republic Bank's problems, which was finally rescued by a pool of 11 large banks.

The financial markets reacted strongly, with widespread falls in the stock markets and, most of all, in the share prices of banks around the world. These strains intensified with the Credit Suisse crisis, which significantly affected European and Spanish banks. In the case of Spain, the share price of some financial institutions fell by as much as 10% in a single day, despite the fact that the Spanish financial system has a very residual position in this bank.

Following these losses, the Swiss National Bank's backing of Credit Suisse with €50 billion and the subsequent purchase of this bank by UBS reduced the stress level, although concern remains about the degree of financial stability worldwide. The euro and the Swiss franc were affected, with significant falls that have gradually recovered. On the other hand, dollar and gold prices strengthened.

This tense climate could have conditioned the ECB's policy, but this was not the case. At its meeting on March 16, the ECB followed the planned roadmap with an interest rate hike of 50 basis points for the Eurozone, setting the key interest rate at 3.5%. This sends a clear message that inflation control is the priority.

In addition, the monetary agency stated that, from now on, it will not provide signals on the future direction of interest rates. They stressed the importance of following the economic and financial indicators, in light of the high degree of uncertainty currently present. With regard to the recent financial turmoil, which is having a greater impact on the banking sector, they expressed the agency's commitment to providing the necessary liquidity and highlighted the good position of the European financial system, both in terms of capital and liquidity.

However, on March 19, several central banks (the ECB, the Bank of Canada, the Bank of England, the Bank of Japan, the Federal Reserve and the Swiss National Bank) announced a coordinated action to improve liquidity availability through U.S. dollar swap line agreements. Initially, this joint central bank action is expected to take place at least until the end of April.

At the same time, the ECB updated its growth and inflation forecasts for the 2023-2025 period. In the case of inflation, it has revised downward the estimates for the headline CPI, with a projected trend of 5.3%, 2.9% and 2.1% over the three years. However, it raised forecasts for core CPI over this period to 4.6% this year, 2.5% in 2024 and 2.2% in 2025. This forecast scenario implies delaying price stability until 2025. Regarding growth projections, they have been revised upward in 2023 to 1.0% (prior forecast was 0.5%), but downward in 2024 (1.6%) and in 2025 (1.6%). These forecasts do not take into account the impact of recent tensions in the financial markets.

In its March Interim Economic Outlook, the OECD points in the same direction and has revised its growth forecasts upwards and its inflation forecasts downwards. In its report, it notes that factors contributing to the improved outlook include stronger business and consumer confidence, falling energy and food prices and the reopening of the Chinese economy.

Thus, the OECD now estimates that the global economy will grow by 2.6% in 2023 and speed up to 2.9% in 2024, which is four and two tenths higher, respectively, than previous forecasts. For the United States, they estimate that GDP will increase by 1.5% in 2023 and 0.9% in 2024, as monetary policy eases the demand pressures. In contrast, in the Eurozone, economic growth is expected to be 0.8% in 2023 and rebound to 1.5% the following year, supported by lower energy prices.

As for inflation, the OECD estimates that it will gradually decline over 2023 and 2024, as a result of the monetary policy tightening implemented by central banks, lower energy prices following a mild winter in Europe, and falling global food prices. However, the OECD also warns about the persistence of core inflation. Thus, average inflation in the United States is expected to stand at 3.7% in 2023, before slowing to 2.5% in 2024. Meanwhile, in the Eurozone, inflation will fall to 6.2% in 2023 and 3.0% in 2024.

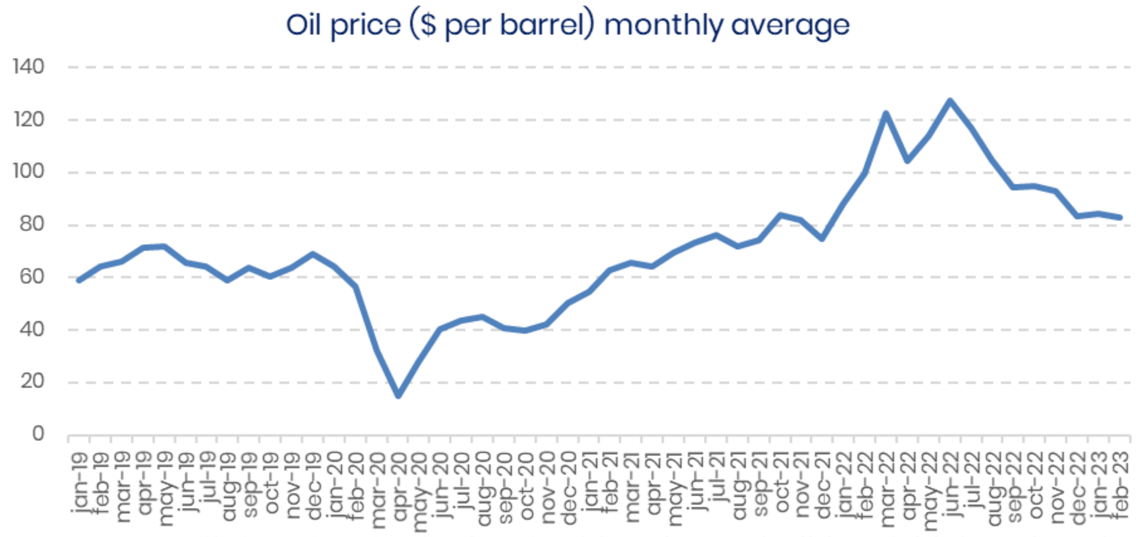
According to the OECD, the economic outlook is now slightly more optimistic than a few months ago, but the global economy still remains fragile, and risks remain skewed to the downside. These include the ongoing war in Ukraine and its consequences, as well as the impact of monetary policy tightening, which is difficult to quantify and could cause the surfacing of a number of vulnerabilities related to high debt levels and asset valuations. Similarly, some energy sector pressures are still present and could, once again, have an impact on inflation, which is still very high.

OECD forecasts (March 2023)						
	GDP			**Inflation**		
(y-o-y rate)	**2022**	**2023**	**2024**	**2022**	**2023**	**2024**
World	3,2	2,6	2,9			
United States	2,1	1,5	0,9	6,3	3,7	2,5
Japan	1,0	1,4	1,1	2,5	2,5	1,8
United Kingdom	4,0	-0,2	0,9	9,1	6,7	2,8
Eurozone	3,5	0,8	1,5	8,4	6,2	3,0
Germany	1,9	0,3	1,7	8,7	6,7	3,1
France	2,6	0,7	1,3	5,9	5,5	2,5
Spain	5,5	1,7	1,7	8,3	4,2	4,0
Italy	3,8	0,6	1,0	8,7	6,7	2,5
China	3,0	5,3	4,9	1,9	2,2	2,0
India	6,9	5,9	7,1	6,6	5,8	4,2
Brazil	3,0	1,0	1,1	9,3	5,4	4,3
Mexico	3,0	1,8	2,1	7,9	5,9	3,4

Source: OECD

This is why the OECD insists on monetary policy remaining restrictive until core inflation is reduced consistently. As for fiscal policy, the OECD points out that the impact of reducing high food and energy prices must be more targeted and focused on those most in need. Likewise, fiscal sustainability must be guaranteed, and structural reforms must be resumed to increase competitiveness and, at the same time, mitigate supply restrictions.

In the United States, according to the Fed's Beige Book, the economy grew mildly at the start of 2023. Some cooling of the labour market is observed, with an increase in layoffs. However, it remains very tight, with the unemployment rate set at 3.6%, which means that the inflation risk is still high. In this regard, although inflation softened in February for the eighth consecutive month, the CPI still rose by 6.0% year-on-year and core inflation stood at 5.5%. These still high levels pointed to a further rate hike by the Federal Reserve at its next meeting, although last week's financial turmoil has made this decision more complicated.



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

In February, the price of Brent crude oil fell slightly compared to January, to $82.8/barrel. In year-on-year terms, this represented a decline of -17.0%, while in euros it was down by -12.2%. So far in March, the average price stands at around $80.1/barrel, after last week's sharpest weekly decline since December due to the financial failures (below $72/barrel). Prices are expected to stabilize again above $80 and their evolution in the coming months will continue to be strongly conditioned by China's recovery and possible additional OPEC+ cuts.

The Spanish economy

Slightly more positive start of the year, but downside risks persist

The year 2023 begins on a more positive note than expected. Confidence continues to improve, as does foreign trade, with exports of goods and services continuing to perform favourably. The labour market is still surprisingly buoyant, with the number of registered workers growing by around 2.4% year-on-year. This is supporting a large part of household consumption together with accumulated savings, although the latter is on the decline. The household savings rate continues its downward trend and stood at 5.7% in Q3 2022. GDP growth is, therefore, expected to be positive in Q1 and could even exceed the 0.2% quarter-on-quarter rate recorded in Q4 2022. Once the recession scenario has been ruled out, the outlook for 2023 is being revised upwards. Thus, the OECD estimates that GDP in Spain will increase by 1.7% in 2023 and 2024.

Nevertheless, moderate growth is still the prevailing forecast, since the factors that slowed down the intensity of the recovery in the second half of 2022 are still present and their impact is likely to be greater in 2023. Thus, the monetary policy tightening has pushed the daily Euribor close to 4% in the first weeks of March, although it then eased to around 3.4% after the bout of turmoil. This is starting to affect the flow of credit to companies and households, especially when it comes to house purchases. In fact, in January, new lending to households for this purpose fell by -8.2% year-on-year.

On the corporate side, new credit is increasing at a more measured pace, but the most relevant development is the significant rise in insolvency proceedings in the last quarter of 2022, up 86% year-on-year. The end of the bankruptcy moratorium (in effect until June 30, 2022), the withdrawal of the stimuli implemented during the pandemic and higher business costs may explain these figures.

Meanwhile, inflation, remains high despite the moderation of the last few months, especially the core component (7.6% year-on-year in February). However, from March onwards, a notable slowdown is expected, largely due to the base effect (in March 2022, the CPI rebounded more than 2 points to 9.8%) and also to the slowdown in commodity prices in international markets.

Finally, in the coming months we will have to monitor the effects of the financial turmoil in the banking sector, to see if there is a possible contagion to the European and Spanish economy through the credit channel.

Demand and Activity

Improved expectations and lower energy prices support growth at the start of 2023

The indicators available for the Spanish economy for the first months of 2023 show a better performance than initially expected, even exceeding the previous quarter's figures (0.2% quarter-on-quarter).

With regard to expectations, with the data available for January and February, there is a notable improvement in the outlook for households and sectors in general. Thus, the consumer confidence indicator in January and February reached its best reading since the start of the war in Ukraine, on the back of a better outlook for household trends and the general economy. The retail trade indicator has also shown a significant upturn and is back in positive territory in these first two months of the year, after six months in the negative, due to the perception of a better business situation now and in the future.

Household consumption continues to show a favourable evolution and may be driven by these improved consumer expectations in the short term, despite the fact that inflation remains high and interest rates continue to rise. However, household savings accumulated during the pandemic appear to be running out and the savings rate is already below that recorded at the end of 2019, so a slowdown in consumption may now be starting, as mortgage loan repayments are brought up to current rates.

With regard to industrial activity, there has also been an improvement in confidence indicators, which continue the recovery shown in December, and in manufacturing PMIs, which, after seven months of contraction, once again rose above the 50 level in February. This improvement in expectations is due to the fall in energy prices, the gradual return to normality in supply conditions and the good performance of exports.

This improvement in supply chains is being reflected in many sectors that were suffering delays and is enabling production and sales levels to increase. This was the case for the automotive sector, for example, where, in the first two months of 2023, registrations increased by 32.1% compared to the same period in 2022, even though they are still 24% below pre-pandemic figures. These increases may be due to undelivered units in the final months of last year.

In the services sector, after the deterioration of the last few months of last year, there has also been a significant improvement in expectations in the first two months of 2023, both in the confidence indicator and in the services PMI, which not only continues to rise, but did so more sharply in February.

The latest data from the Statistics on Tourist Movements at Borders (Frontur), referring to the month of January show how the inflow of international tourists continues to recover. Specifically, in January, 4.1 million international tourists visited Spain, which is 65.8% more than in January 2022, and practically the same as in January 2020, just before the pandemic hit. Moreover, as average daily expenditure increased by 19.3% year-on-year, the total expenditure by international tourists in January was 9.2% higher than in the same period in 2020.

Looking at the external sector, the customs information available for 2022 shows a much more dynamic evolution of goods imports than exports in nominal terms, due to the greater advance in real terms and to the increase in import prices. Thus, exports increased by 22.9% year-on-year (3.9% in volume terms) and imports by 33.4% year-on-year (7.4% in volume terms). The result of these flows was a trade deficit this year of -€68.1222 billion, compared to -€26.1779 billion in 2021. Since November 2022, there has been a greater momentum in exports, which is leading to a correction of the trade deficit for both, the non-energy and the energy segments. In January, the latest figure available, exports increased by 16.2%, compared to a rise of 5.3% in imports.

Similarly, according to the Balance of Payments data published by the Bank of Spain, in 2022 as a whole, the current account surplus reached 11.8 billion, compared to a surplus of 11.5 billion in 2021. This slight improvement is explained by the increase in the tourism balance (of 30.7 billion), which was offset by decreases in the balance of non-tourism goods and services (of 26.2 billion) and in primary and secondary income (of 4.3 billion).

With regard to the real estate sector, the sharp and rapid rate hikes by the ECB are pushing up the Euribor, making loans already granted as well as new applications more expensive. This is dampening the number of housing market transactions and containing prices.

The Labour Market

Employment surprises positively in February and the year-on-year rate of Social Security registrations rebounds

The labour market surprised positively in February, at least in terms of employment. Social Security registrations grew more in than previous years for this same month and the slowdown in employment in year-on-year terms in the first few months of 2023 is less pronounced. Moreover, the number of workers under furloughs has fallen again for the third consecutive month. In contrast, the results for registered unemployment in February are not as favourable. Unemployment rose moderately, though this month tends to post declines. All in all, pending the figure for Social Security registrations in March, it is likely that Q1 will close with a more favourable performance in employment than expected a few months ago, similarly to economic activity.

In February, the number of workers registered with the Social Security increased by 88,918, the highest increase since 2015. The private sector acquired 76,575 new workers, while the public sector added 12,343 employees, meaning that 86% of the increase in Social Security registrations in February was due to the private sector.

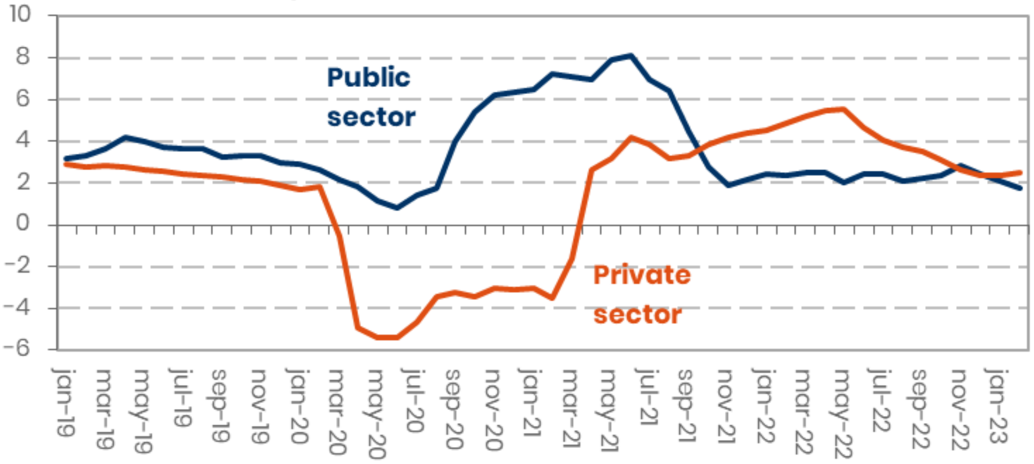
Broken down by economic sector, a large part of this growth in employment came from services, where new registrations increased by more than 66,000 people, with the good performance of the hospitality and education segments being particularly noteworthy. In addition, industry and construction also added new workers, while in agriculture there was a decline in Social Security registrations for the second consecutive month.

In year-on-year terms, registrations with the Social Security rose by one-tenth to 2.4%, thus interrupting the decelerating trend followed since May 2022. This dynamism was due to the private sector, whose year-on-year rate also increased by one-tenth to 2.5%. By contrast, the number of new workers in the public sector continued to moderate their year-on-year rate, which stood at 1.7% in February.

The negative element in employment so far in 2023 is the unfavourable performance of the self-employed individuals' segment. In January and February, in terms of Social Security registrations, this segment recorded a fall compared to the same months in the previous year, which represents a negative development for our country's productive fabric.

Along the same line, the number of companies registered with the Social Security has been posting a slowing trend in its year-on-year rate since mid-2022. It stood at 0.2% in February, although this figure represents a slight upswing with respect to the zero growth in January. It is worth highlighting that the number of smaller firms (with fewer than five workers) is declining in comparison to the figure from a year ago. Moreover, the pre-pandemic number of firms has still not been reached. Specifically, there are 7,900 fewer firms than three years ago.

Workers registered with the Social Security (y-o-y rate in %)



Source: prepared in-house based on data from the Ministry of Inclusion, Social Security and Migrations

The number of furloughed workers fell in February for the third consecutive month, to a monthly average of 15,369. This is a positive result, taking into account that the number of furloughed workers remained at around 20,000 during the second half of 2022. Meanwhile, registered unemployment rose moderately in February, by 2,618 people, even though this month usually sees declines (the average for the period 2014-2020 is a fall of 4,772 people). This brings the current total number of unemployed to 2,911,015.

The slight upturn in Social Security registrations in February suggests that the balance of the labour market in Q1 could be more favourable than expected a few months ago. According to estimates by CEOE's Department of Economics Affairs, on the basis of the seasonally adjusted series released by the Ministry of Inclusion, Social Security and Migration, effective Social Security registrations (discounting furloughed workers) corrected for seasonal effects will increase by 0.8% quarter-on-quarter in Q1, which is higher than the 0.3% recorded in Q3 and Q4 of 2022. However, we will have to wait for the LFS results, which will be released next April, to confirm whether the labour market is performing better than expected in Q1.

Inflation

Inflation rises by one tenth in February, but it is expected to continue on a downward path throughout 2023

In February, headline inflation rose one tenth to 6.0% and core inflation also rose one tenth to 7.6%, lower than the preliminary data released at the end of the month. This figure could represent a turning point, leading to some moderation in the coming months.

We should bear in mind that these figures should be assessed with caution, as this year has seen significant methodological changes and economic policy measures that mean that the data is not homogeneous with respect to 2022.

A significant fall in energy product prices is beginning to materialise and industrial goods' prices are stabilising as a result of reduced pressures on the prices of raw materials on international markets. Inflation is expected to decelerate significantly in March and to slow further in the coming months. The average rate in 2023 is expected to be much lower than in 2022, at around 4%.

Within the core component, Services prices increased their year-on-year rate by one tenth to 4.2%; prices of Industrial goods excluding energy products stood at 6.5%; and Processed foods, beverages and tobacco accelerated their year-on-year rate by three tenths to 16.8% (on a constant tax basis, this rate would have been 17.6%).

Non-processed food prices increased by 2.7 percentage points year-on-year to 13.4% (on a constant tax basis, this rate would have been 15.4%). Virtually all food items recorded rates above 10%.

Energy product prices intensified their downward trend to -8.9% year-on-year, in line with recent months, driven by the fall in the price of energy raw materials, and in spite of the withdrawal of the subsidy on fuels for private individuals. In February, the price of Brent crude oil fell slightly versus January to $82.8/barrel. On a year-on-year basis, this was a decline of -17.0%, while in euro terms it represented a fall of -12.2%. In the first days of March, the average price is around $80/barrel.

The Public Sector

The public deficit could close 2022 at around -4.5% of GDP

Up to the end of November, the general government's aggregate deficit, excluding local governments, was 58.3% lower than in the same period of 2021. In terms of the deficit-to-GDP ratio, it stands at -1.9%, significantly lower than in the same period of the previous year (-5.1% of GDP). In 2022, the public deficit could close at around -4.5% of GDP.

The different government tiers have performed unevenly, although it is worth highlighting the reduction in the deficit at central government level. This may be explained by the lower transfers made by the State to the regional governments as a result of the return to normality after the pandemic, and also by the larger transfers received as a result of the settlement of the 2020 regional financing system, which was favourable to the State. Thus, the central government deficit stood at -1.8% of GDP at the end of November 2022, compared with -5.9% of GDP in the same period of 2021.

In contrast, the Regional Governments have gone from a surplus to a deficit, posting a balance of -0.6% of GDP up to November 2022, while the Social Security funds have increased their surplus to 0.4% of GDP in the same period.

Expenditure as a whole shows some containment, with growth of 2.7%, despite a surge in interest expenditure in 2022, which in the first eleven months of the year was 19.3% higher than in 2021. The subsidies item also increased, by 26.3%, reflecting the programmes implemented to alleviate higher inflation. The rest of the items show a more contained behaviour, with the fall in investment standing out.

This partly explains the fiscal imbalance reduction during this period, although it is also important to note the dynamism of revenues. In fact, at all government tiers, it is worth noting the strength of revenues linked to factors such as economic activity, the increase in funds from the EU, taxes, and also to contributions in the case of the Social Security. Of total non-financial resources, tax revenues increased by 15.1%, with current taxes on income and wealth rising by 30.6%.

Forecasts

Economic forecasts for Spain (last update: March 2023)						
Annual rates of change, unless otherwise indicated						
	2019	2020	2021	2022	2023	2024
GDP	2,0	-11,3	5,5	5,5	1,3	2,0
Private consumption expenditure	0,9	-12,4	6,0	4,4	0,9	2,0
Government consumption expenditure	1,9	3,5	2,9	-0,9	0,0	1,0
Gross fixed capital formation	4,5	-9,7	0,9	4,3	2,0	2,4
-Tangible fixed assets	5,3	-11,1	0,1	4,1	2,1	2,5
Construction	7,2	-10,2	-3,7	4,2	2,4	1,8
Equipment and cultivated assets	2,4	-12,6	6,5	3,9	1,8	3,5
-Intangible fixed assets	0,6	-2,5	4,7	5,0	0,9	2,0
Domestic demand (*)	1,6	-9,1	5,3	2,9	1,6	1,8
Exports	2,2	-19,9	14,4	14,9	3,7	3,5
Imports	1,3	-14,9	13,9	7,7	4,6	3,0
External demand (*)	0,4	-2,2	0,3	2,6	-0,3	0,2
GDP current prices	3,4	-10,1	7,8	10,1	4,8	5,5
GDP deflator	1,4	1,2	2,3	4,6	3,5	3,5
CPI (average annual rate)	0,7	-0,3	3,1	8,4	4,2	2,3
CPI (Dec/Dec)	0,8	-0,5	6,5	5,7	5,0	2,1
Core CPI (average annual rate)	0,9	0,7	0,8	5,1	5,4	2,2
Employment (Quarterly National Accounts)(**)	3,3	-6,8	6,6	3,8	1,1	1,5
Employment (LFS)	2,3	-2,9	3,0	3,1	1,0	1,5
Unemployment rate (LFS) (% active population)	14,1	15,5	14,8	12,9	12,9	12,4
Productivity	-1,3	-4,8	-1,0	1,6	0,2	0,5
Compensation per employee	2,4	2,5	-0,8	2,0	2,9	2,7
Unit labour cost (ULC)	3,8	7,7	0,2	0,4	2,7	2,2
Current Account Balance (% of GDP)	2,1	0,8	0,9	0,8	0,5	1,0
General government net lending (+) / net borrowing (–) (% of GDP)	-2,9	-10,3	-6,9	-4,8	-4,0	-3,5
Interest rates USA (Dec)	1,75	0,25	0,25	4,50	5,25	4,00
Interest rates Eurozone (Dec)	0,00	0,00	0,00	2,50	4,00	3,75
Brent Oil ($)	64,8	41,5	71,1	103,7	80,7	75,8

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

(*) Contribution to GDP growth

(**) Full-time equivalent jobs