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Economic Outlook

May 2023

Overview

- **The European Commission raised growth forecasts for the EU and the Eurozone, although it also slightly increased its inflation expectations.**
- **The main Western central banks implemented further tightening of their monetary policies in May.**
- **Commodity prices continued their downward trend in April, although oil prices rebounded on the announcement of OPEC+ production cuts.**
- **The Spanish economy gained momentum in Q1 and growth forecasts were revised upwards to around 2% for 2023. However, the degree of uncertainty remains very high.**
- **GDP continued to show a significant improvement at the start of 2023 supported by strong exports and weak imports.**
- **Unit labour costs continued to rise in Q1 and are almost 9% higher in comparison to Q4 2019.**
- **Good labour market performance in Q1, with job creation accelerating, although there was also an increase in the unemployment rate. In April, Social Security registrations recorded the largest increase in the historical series for this month.**
- **Core inflation decelerated in April on the back of slower increases in food prices.**
- **Within this context of decelerating inflation, the agreement reached by the social agents for the signing of the Fifth Collective Bargaining and Employment Agreement (AENC), which establishes a framework for determining wage increases during the 2023-2025 period, is particularly relevant.**
- **The Government's Stability Programme for 2023-2026 postpones the reduction of the deficit under -3% of GDP until 2024. Public debt remains above 105% of GDP throughout the estimation period.**

The International Scenario

Interest rates continue to rise as inflation slowly eases

At the beginning of May, the main central banks of the Western world continued to tighten their monetary policy in response to persistent inflation and the resilience of the world economy. However, the subtle moderation in prices and the lower turbulence in the banking markets suggest that interest rate hikes may be close to an end, especially in the United States.

Amid this context, the European Commission has revised its 2023 growth forecasts upwards for the EU and the Eurozone to 1.0% and 1.1% respectively, which is two tenths higher than in its February estimates. By 2024, GDP will gain momentum, with growth of 1.7% in the EU and 1.6% in the Eurozone, also one tenth higher than the previous forecast. They highlight the fall in energy prices and the strength of the labour market, with the unemployment rate at historic lows, as factors that have favoured higher growth in Q1 and that will provide a boost to activity. However, on the other hand, the increase in the cost of financing could act as a restraining factor, slowing down consumption and investment.

European Commission Forecast (May 2023)

	GDP			Inflation		
(y-o-y rate)	**2022**	**2023**	**2024**	**2022**	**2023**	**2024**
World	3.3	2.8	3.1			
European Union	3.5	1.0	1.7	9.2	6.7	3.1
Eurozone	3.5	1.1	1.6	8.4	5.8	2.8
Germany	1.8	0.2	1.4	8.7	6.8	2.6
France	2.6	0.7	1.4	5.9	5.5	2.5
Spain	5.5	1.9	2.0	8.3	4.0	2.7
Italy	3.7	1.2	1.1	8.7	6.1	2.9
United States	2.1	1.4	1.0	8.0	4.3	2.6
Japan	1.0	1.1	1.0	2.5	3.2	1.8
United Kingdom	4.1	-0.2	1.0	7.9	6.7	2.4
China	3.0	5.5	4.7			

Source: European Commission

The more persistent underlying inflation has also led to an upward revision of the forecast for price increases to 6.7% for the EU and 5.8% for the Eurozone on average in 2023, two and three tenths higher than previously estimated. Prices are expected to continue their downward trend and average 3.1% in the EU and 2.8% in the Eurozone in 2024, also three tenths higher than the February estimate.

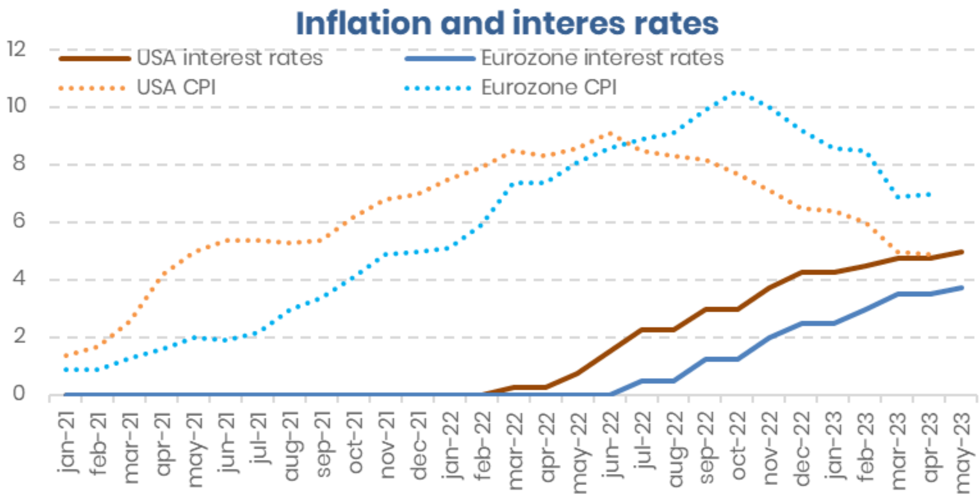
The global economy performed better than expected in Q1. Activity picked up notably in China, where GDP grew by 2.2% quarter-on-quarter, benefiting from the reopening of the economy and following stagnation in Q4. However, there are still concerns about the problems in its real estate sector. Meanwhile, the Eurozone economy has shown a more modest performance, with growth of 0.1% quarter-on-quarter, albeit still positive and averting recession, after the zero growth recorded in the final months of 2022.

On the other hand, the United States is showing signs of a slowdown, with quarterly growth of 0.3%, half that of the previous quarter. Along the same line, even though the labour market continues to generate employment at a good pace, it is doing so with less intensity than at the end of 2022. Nevertheless, in April, the unemployment rate fell to 3.4%, the same as in January, which is the lowest rate since 1969. However, rising interest rates are taking their toll on the housing sector, which is suffering a notable contraction. There are also concerns about the tensions that the difficulties in raising the country's debt ceiling could lead to.

In addition, the PMI indices for April continue to show a world economy displaying positive signs. The Global Composite Index is at 54.2 points, the highest level since December 2021, with the labour market performing well and the services sectors showing considerable strength, while the manufacturing sector is less buoyant.

Meanwhile, inflation in the United States fell by one tenth in April to 4.9%, while in the Eurozone it rebounded by the same magnitude to be set at 7.0%. Core inflation also remains high: it dropped one tenth to 5.5% in the United States, excluding energy and food and, in the Eurozone, it declined for the first time since July 2021 to 5.6%, down one tenth in comparison to March.

Despite these signs of a certain moderation in prices and a somewhat calmer banking sector, the monetary authorities in the United States and the Eurozone, as well as the Bank of England, raised their interest rates by a quarter point. The Federal Reserve implemented the tenth hike since March 2022, raising interest rates to the range between 5.0% and 5.25%. And although its chairman, Jerome Powell, denied that this might have been the last hike, the markets believe that there could be a pause after this May hike or after the one that might take place in June. Meanwhile, the Bank of England raised interest rates for the 12th consecutive time, bringing them to 4.5%, their highest level since 2008. Meanwhile, the European Central Bank raised its benchmark rate to 3.75%, the lending facility to 4% and the deposit facility to 3.25%. In this case, experts believe that there may be a couple of additional hikes, although it will depend on how inflation evolves. In addition, the institution has indicated that, as of July, it will stop reinvesting the asset purchase programme (APP) maturities.



Source: Prepared-in house based on data from Eurostat, ECB, Federal Reserve and Bureau of Labor Statistics.

With regard to commodities, it is worth noting that, in April, prices continued to fall pretty much across the board, in some cases returning to levels similar to those prior to the Russian invasion of Ukraine. However, oil was an exception, with Brent crude prices rising almost 10% compared to March, to $86/barrel on average, as a result of OPEC+'s announcement to cut production from May onwards. Nonetheless, at the end of April and throughout the first days of May, oil prices resumed their downward trend due to the uncertainty over the strength of world demand. The situation in the United States is a cause for concern, with speculation over whether the debt ceiling will be raised, and Chinese demand has also turned to be weaker than expected. On the other hand, the International Energy Agency estimates that, in the second half of the year, prices could again come under pressure with demand expected to exceed supply by two million barrels per day.

The Spanish Economy

LFS and GDP data show that the Spanish economy has gained momentum in the first quarter

The Spanish economy gained momentum in Q1 2023, albeit at a modest pace. Starting with GDP, it increased by 0.5% quarter-on-quarter, one tenth higher than in the second half of 2022. This higher-than-expected GDP growth has led to an upward revision of the outlook for 2023 to around 2%. This is reflected both in the new forecast from the European Commission and also in the one released by CEOE's Economic Research Department, both of which estimate that GDP will grow 1.9% in 2023, somewhat lower than the rate included in the Government's 2023-2026 Stability Programme (2.1%).

However, given the existing uncertainty, which increases after the summer, the estimated growth for 2024 ranges from 1% to 2.5%, depending on the different national and international institutions' forecasts. Although there are elements that affect activity positively, such as the labour market or the European funds, the balance of risks remains skewed to the downside due to the global geopolitical tensions and their effect on world trade, the degree to which inflation seems deadlocked and the impact of the monetary policy on the real economy.

It is clear that employment performance was the positive surprise in 2022 and continues to be so at the start of 2023. Figures for Social Security registrations had already shown an increase in the job creation rate in Q1, and the LFS confirmed the good evolution of employment and permanent contracts during this period. According to this source, employment fell by 11,100 people, a figure well below the average for the same period in the years prior to the pandemic, and the rate of temporary employment in the private sector fell to 13.7%, an all-time low. The negative note came from unemployment, which rose more than in other first quarters and pushed the unemployment rate up four tenths to 13.3%. Our forecasts point to a stable unemployment rate in 2023 and 2024 at around 12.7%.

Inflation is starting to stabilise at more modest rates, around 4% in April, although the most notable feature is the downward turn in core inflation in April, led by food prices. Over the coming months, CPI is expected to remain at these rates and the decelerating trend in prices is expected to continue in 2024. The European Commission forecasts a HICP for Spain of 4% in 2023 (somewhat lower than CEOE) and 2.7% in 2024 (the same rate as CEOE).

Demand and Activity

GDP growth continued to post strong figures at the start of 2023, driven by the external sector

The preliminary Quarterly National Accounts data for Q1 2023 shows a slight acceleration in GDP growth, which rose to 0.5%, while the rate for Q3 and Q4 2022 was revised to 0.4%. The breakdown continues to show a marked weakness in domestic demand, detracting 0.8 points from quarterly growth, and a strong external sector, which more than offsets the fall in domestic demand. In year-on-year terms, the pace of growth accelerated more sharply to 3.8%, compared with 2.9% in Q4.

It is worth highlighting the notable decline in private consumption in Q1, which contradicts the evolution of the available indicators. However, it should be borne in mind that this is still a preliminary estimate and may be subject to significant revisions.

In contrast with the National Accounting figures, there has been a notable improvement in the outlook for households and other sectors in general, with information up to April, with the exception of construction. In particular, both the retail trade confidence indicator and the services sector confidence indicator have shown a significant rebound with respect to the last months of 2022.

Household consumption indicators continue to show a favourable evolution, supported by these improved consumer expectations for the short term, despite the fact that inflation remains high and interest rates continue to rise. However, a slowdown in consumption is likely to begin, due to accumulated inflation and the impact of rising interest rates on the financial costs of indebted households. Moreover, in a context of rising interest rates, part of the savings will be used to repay debt or invest in savings products.

With regard to the real estate sector, the intense and rapid rises in interest rates are making existing loans as well as new loan applications more expensive. Thus, the theoretical housing affordability indicator has risen to 36.1% of the average household income in Q4 2022, the number of purchase and sale transactions has fallen by -10.0% over the same period and house prices are already showing a containment.

With regard to industrial activity, there has also been an improvement in confidence indicators and manufacturing PMIs, which were once again above the

50 level in February and March, although in April they returned to contractionary levels. This improvement in expectations is due to the fall in energy prices, the gradual return to normality of supply problems and the good performance of exports.

In the first four months of 2023, vehicle registrations have increased by 33.7% compared to the same period in 2022, although they are still 28.4% below pre-pandemic figures. This rebound may be due to an improvement in vehicle supply and undelivered units in the final months of last year.

There has also been a significant improvement in expectations in the services sector in the first few months of 2023, both in the confidence indicator and in the services PMI, which stands at levels close to 60. According to the latest data available from the Statistics on Tourist Movements at Borders (Frontur), the inflow of international tourists continues to recover, albeit with less intensity. Thus, in March 2023, it stood at just over 5.3 million tourists, 300,000 fewer than in March 2019, before the pandemic. However, as the average expenditure per visitor has been increasing, total tourist expenditure during March was 10% higher than in the same month of 2019.

In terms of the foreign sector, both exports and imports have shown a notable upturn in Q1, according to the preliminary data from the Quarterly National Accounts. The stronger growth of exports compared to imports in Q1 has led to a positive contribution from the foreign sector.

In this regard, the customs information available for 2023 shows a greater dynamism of exports, which is leading to a correction of the non-energy as well as the energy trade deficits. Over the January-March period, the increase in exports was 14.6% (3.5% in volume), compared to 4.0% in imports (-3.2% in volume). Similarly, according to the Balance of Payments data published by the Bank of Spain, in the first two months of 2023, the current account surplus reached 5.6 billion, compared to a deficit of -3.9 billion in the same period of 2022. This more positive result is explained by the improvement in the balance in goods and non-tourist services (which went from a deficit of -6.3 billion to a surplus of 1.3 billion) and a slight increase in the tourism balance, while primary and secondary income posted deficits.

The Labour Market

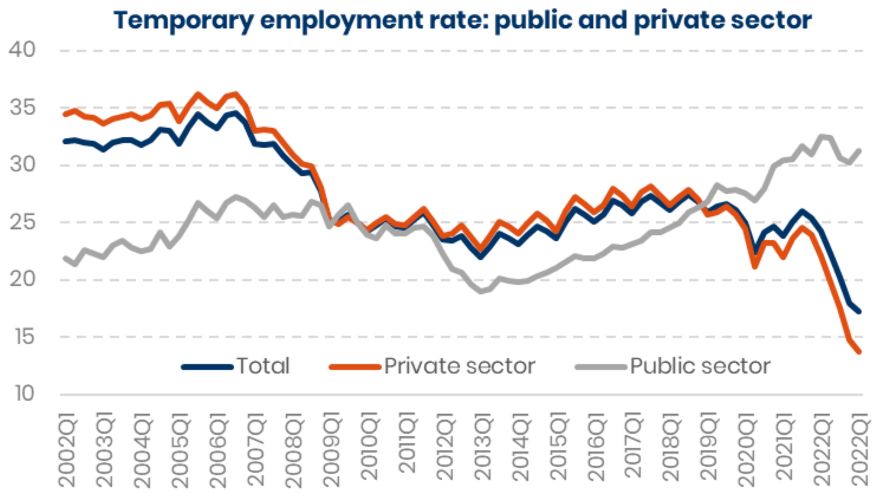
Labour market buoyancy in Q1, despite the rise in the unemployment rate

The LFS results for Q1 show the labour market performing well, with only a slight fall in employment in quarterly terms during a period that is traditionally unfavourable. However, the number of people unemployed rose, largely due to the notable increase in the labour force, and this led to a rebound in the unemployment rate.

Specifically, employment fell by 11,100, the smallest drop in employment in a first quarter since 2007. In seasonally adjusted terms, the quarter-on-quarter employment rate rebounded notably, to 1.2%, the highest figure since the end of 2021.

Going back to the gross figures, the private sector lost 8,800 jobs in Q1, the best performance for this period since 2007, reflecting the efforts made by companies to maintain employment. In the public sector, employment also fell, by 2,300 people. In year-on-year terms, both the public sector and the private sector showed an acceleration in employment, which has allowed the total number of people employed to post a rebound in its year-on-year rate, to 1.8% in Q1.

On a positive note, it is also worth highlighting the number of permanent contracts signed in the private sector, with the temporary employment rate falling to 13.7%, less than half that of the public sector (which rose to 31.3%). In the economy as a whole, the temporary employment rate continued to fall to 17.3%, the lowest in the historical series.



Source: prepared in-house based on data from the LFS

The significant increase of the labour force by 103,800, a much higher figure than is typical for a first quarter, contributed notably to the rise in the number of people unemployed. This brings the total number of unemployed to 3,127,800. Meanwhile, the unemployment rate rose for the third consecutive month, up four tenths to stand at 13.3%.

Among the results from the Quarterly National Accounts for Q1, it should be noted that, in contrast to the greater dynamism of employment in terms of employed individuals, hours worked showed a slowdown in their year-on-year growth, while they remain below the year-end 2019 levels. Unit labour costs continue to rise and, in comparison to pre-pandemic levels, are 8.8% higher than in Q4 2019.

The initial indicators for Q2 pertaining to the month of April show that job creation continues to intensify. Thus, Social Security registrations behaved very positively and went up by 238,436 workers in April, the largest increase in the historical series for this month. Moreover, it should be noted that the private sector generated 230,169 jobs, meaning that 97% of the increase in Social Security registrations was due to the private business sector.

In April, registrations with the Social Security rose for the third consecutive month. The year-on-year rate was up by three tenths to stand at 3.0%. Both the public and private sectors intensified their growth rates in April, to 2.9% and 3.0%, respectively. By economic sectors, it is worth highlighting the notable momentum of construction, which reached a year-on-year rate of 5.2%, and services, with 3.3%. This was also the case in the industrial sector, where the rate also improved to 1.8% while in agriculture, the rate of decline continued to ease to -2.1%.

The number of workers under furloughs (ERTE) fell in April for the fifth consecutive month, to a monthly average of 13,660. The trend in registered unemployment was not as favourable as that in employment. Specifically, registered unemployment fell in April by 73,890 people, a lower figure than is typical for this month (the yearly average for the 2014-2019 period was a drop of 103,595 people). This brings the total number of unemployed to 2,788,370 people.

After the positive evolution of the labour market in Q1, CEOE has revised upwards its forecasts for job creation in 2023. In this way, we predict that the number of people employed, in LFS terms, will increase by around 1.5% this year (a slowdown compared to the 3.1% recorded in 2022) and that the unemployment rate will fall slightly to 12.7%.

Inflation

Core inflation slows in April on the back of lower food price rises

In April, headline inflation rose to 4.1%, eight tenths higher than in March, while core inflation finally seems to have reached a turning point and decelerated by nine tenths to 6.6%.

In addition to the fall in energy product prices and the moderation in industrial goods prices, which had already started in recent months, this month has seen lower inflation in the CPI's food components, a trend that is expected to continue in the coming months. Forecasts suggest that inflation will continue to ease, although there could be an occasional upturn. Moreover, the average inflation rate in 2023 is expected to be much lower than in 2022.

In this context of decelerating inflation, the agreement reached by the social partners to sign the Fifth Collective Bargaining and Employment Agreement, which establishes a framework for determining wage increases during the 2023-2025 period, is of particular relevance, as it generates confidence and helps to avoid an inflationary spiral.

Within the core component, Services prices decreased by one tenth to 4.3% year-on-year; Industrial Goods, excluding energy, fell by 1.1 p.p. to 4.8%; and Processed Food, beverages and tobacco dropped by more than two points to 14.2%.

Unprocessed food prices showed a notable moderation, decreasing by almost 5 p.p. to 8.8% year on year. Nevertheless, many food items still recorded rates above 10%.

Energy product prices slowed their decline to -15.6% year-on-year, compared with -25.6% the previous month, due both to the lower fall in the price of energy commodities this month and to the step effect of the 20-cents-per-litre reduction in fuel prices which was introduced in April last year. Thus, although energy product prices are expected to fall significantly throughout the remainder of the year, these will be slightly tempered by the withdrawal of this discount when compared with 2022.

The Public Sector

The Government's Stability Programme 2023-2026 is somewhat more optimistic in terms of deficit reduction than the European Commission

The government has unveiled its medium-term fiscal strategy through the 2023-2026 Stability Programme. It plans a gradual fiscal adjustment based on a containment of spending as a percentage of GDP (anchored at 46.3% from 2024), while the revenue ratio rises (to 43.8% of GDP from 43% in 2022). With regard to public debt, a very gradual declining trend is foreseen over this period, even though it will remain above 105% of GDP throughout the entire projection horizon. Thus, the public deficit would stand at -2.5% of GDP and public debt at 106.8% of GDP in 2026.

Regarding the structural deficit, an adjustment from -3.6% of GDP in 2022 to -2.5% of GDP in 2026 is also targeted. According to the government, this will be achieved through the withdrawal of the extraordinary measures adopted in response to the war in Ukraine and the improvement in tax revenues and social security contributions, following the structural measures adopted in pensions and taxation.

Public and structural deficit /Public debt (% GDP)

	Government (Stability Programme)					European Commision		
	2022	2023	2024	2025	2026	2022	2023	2024
Public deficit (General Government)	-4.8	-3.9	-3.0	-2.7	-2.5	-4.8	-4.1	-3.3
Public debt	113.2	111.9	109.1	107.9	106.8	113.2	110.6	109.1
Structural deficit	-3.6	-3.4	-2.9	-2.7	-2.5	-4.0	-3.7	-3.2

Source: European Commission and Ministry of Finance and Public Administration

The European Commission, meanwhile, points out that Spain, with one of the highest public deficits in the Eurozone in 2022, behind Italy and Malta, will be slower in reducing it in 2023 and 2024 than the government estimates. Thus, it will have a deficit of more than -3% of GDP in 2024 and will continue to record a fiscal imbalance above the Eurozone average (-2.4% of GDP). The structural deficit is expected to remain above -3% of GDP until 2024 and, on the other hand, its public debt forecasts are in line with that of the Spanish Government.

The government deficit up to March is close to budgetary stability

With data for Q1 2023, the State's net borrowing declined considerably, to -0.04% of GDP, compared with -0.44% of GDP in the same period of 2022. Also on a positive note, there has been a primary surplus (0.34% of GDP), which contrasts with the negative, albeit low, balance achieved in the first three months of last year.

The good results in terms of the budget balance up to March can be explained by the strength of non-financial resources, which increased by 9.7%, compared with the slight decline in non-financial uses (-0.2%).

Within resources, tax revenue stands out, with growth of 6.2% up to March. Regarding this figure, it should be noted that half of the increase in revenue is due to the three new taxes for 2023: the Special Tax on Non-Reusable Plastic Packaging, the Temporary Tax on Energy and the Temporary Tax on Credit Institutions and Financial Credit Entities. These three taxes have raised €1.537 billion (the increase in revenue in Q1 was €2.932 billion).

Revenues from current taxes on income, wealth, etc., are 3.4% higher than in Q1 2022. Within this component, personal income tax is the item that shows the strongest revenue growth (7.6%).

On the uses side, one of the items experiencing the greatest increase is subsidies (45.9%), due both to the greater financing of the electricity system and to different aids aimed at transport or gas-intensive companies. There has also been an increase in social benefits other than social transfers in kind, which include pensions, which have appreciated by 8.5% this year. The rest of the expenditure items recorded a subdued increase.

On the other hand, expenditure on accrued interest (-6.4%), miscellaneous current transfers (-23.2%), resources to the EU (-27.3%) and gross fixed capital formation (-13.5%) fell.

Forecasts

Economic forecasts for Spain (last update: May 2023)						
Annual rates of change, unless otherwise indicated						
	2019	2020	2021	2022	2023	2024
GDP	2.0	-11.3	5.5	5.5	1.9	1.4
Private consumption expenditure	0.9	-12.4	6.0	4.5	-0.1	0.9
Government consumption expenditure	1.9	3.5	2.9	-0.7	1.2	0.9
Gross fixed capital formation	4.5	-9.7	0.9	4.6	1.9	2.5
-Tangible fixed assets	5.3	-11.1	0.1	4.4	1.8	1.9
Construction	7.2	-10.2	-3.7	4.7	4.3	2.3
Equipment and cultivated assets	2.4	-12.6	6.5	4.1	-2.1	1.2
-Intangible fixed assets	0.6	-2.5	4.7	5.5	2.4	5.3
Domestic demand (*)	1.6	-9.1	5.3	3.1	0.8	1.2
Exports	2.2	-19.9	14.4	14.4	6.4	3.3
Imports	1.3	-14.9	13.9	7.9	3.5	3.0
External demand (*)	0.4	-2.2	0.3	2.4	1.1	0.2
GDP current prices	3.5	-10.2	7.9	10.0	5.4	4.4
GDP deflator	1.5	1.1	2.4	4.5	3.5	3.0
CPI (average annual rate)	0.7	-0.3	3.1	8.4	4.5	2.7
CPI (Dec/Dec)	0.8	-0.5	6.5	5.7	4.9	2.5
Core CPI (average annual rate)	0.9	0.7	0.8	5.2	6.7	2.8
Employment (Quarterly National Accounts)(**)	3.3	-6.8	6.6	3.8	1.6	1.0
Employment (LFS)	2.3	-2.9	3.0	3.1	1.5	1.0
Unemployment rate (LFS) (% active population)	14.1	15.5	14.8	12.9	12.7	12.6
Productivity	-1.3	-4.8	-1.0	1.6	0.3	0.4
Compensation per employee	2.4	2.5	-0.8	2.0	3.7	2.9
Unit labour cost (ULC)	3.8	7.7	0.2	0.4	3.4	2.4
Current Account Balance (% of GDP)	2.1	0.6	1.0	0.6	1.0	0.8
General government net lending (+) / net borrowing (–) (% of GDP)	-3.1	-10.1	-6.9	-4.8	-4.2	-3.8
Interest rates USA (Dec)	1.75	0.25	0.25	4.50	5.25	4.25
Interest rates Eurozone (Dec)	0.00	0.00	0.00	2.50	4.25	3.75
Brent Oil ($)	64.8	41.5	71.1	103.7	84.2	79.6

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

(*) Contribution to GDP growth

(**) Full-time equivalent jobs