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Economía

Economic Outlook

July 2023

Overview

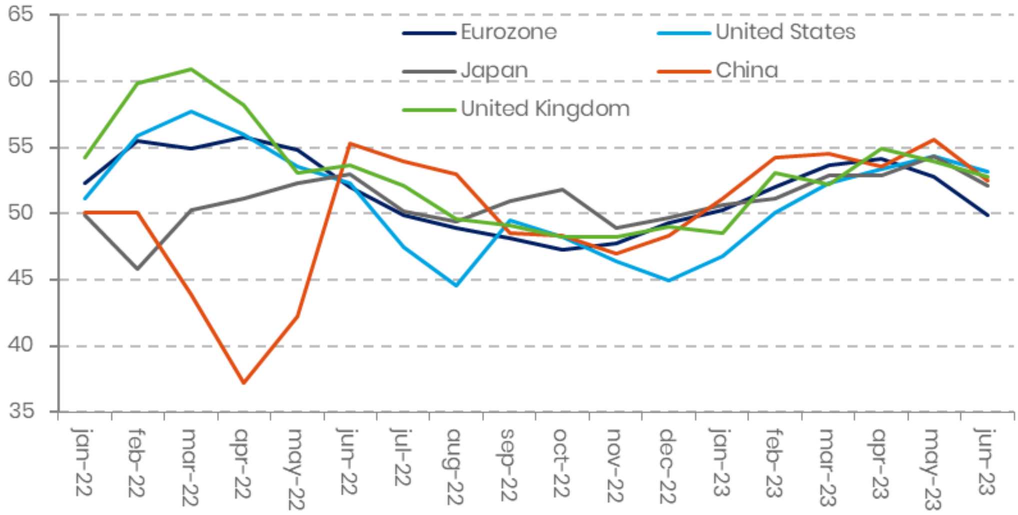
- PMIs show signs of a slowdown in the world's major economies.
- Although inflation continues to slow down, core inflation is doing so quite slowly, and, therefore, western central banks keep tightening their monetary policies.
- Commodity prices show a downward trend due to lower activity dynamism.
- The growth outlook for the Spanish economy for 2023 is revised upwards to around 2%, although there are two distinct stages: a first half of the year of notable momentum and, foreseeably, a second half of the year of clear slowdown.
- The Spanish economy could record solid growth in Q2, although signs of a slowdown are beginning to be observed.
- Social Security registrations increased moderately in June and the year-on-year job creation rate slowed. All in all, Q2 may be considered positive in terms of labour market performance.
- Inflation continues to decelerate on the back of lower energy prices and the moderation of unprocessed food prices.
- The public deficit continued to shrink in May, although the adjustment pace slowed.

The International Scenario

Signs of economic slowdown in light of the gradual tightening of monetary policy

The PMIs for June have shown signs of a slowdown in the global economy, with all major economies having posted declines. The Global Composite PMI stands at 52.7 points, the lowest reading since February. In addition, the Eurozone Composite PMI has fallen back to 49.9 points, returning to negative territory for the first time since December 2022. The weakness in demand is most notable in the manufacturing sectors, with PMIs clearly below 50 points in the Eurozone, as well as in the UK, the US and Japan. In fact, in the Eurozone, the June manufacturing reading of 43.4 points is the lowest in 37 months, since May 2020. The manufacturing indices continuously posting contractionary figures (twelve consecutive months in the Eurozone, eleven in the United Kingdom, and seven of the last eight months in both the United States and Japan) may be evidence of the difficulties that industrial sectors, affected by the higher cost of financing as a result of the increase in interest rates, are having in boosting their investments. In June, the services PMIs also fell, although they clearly remain in expansionary territory.

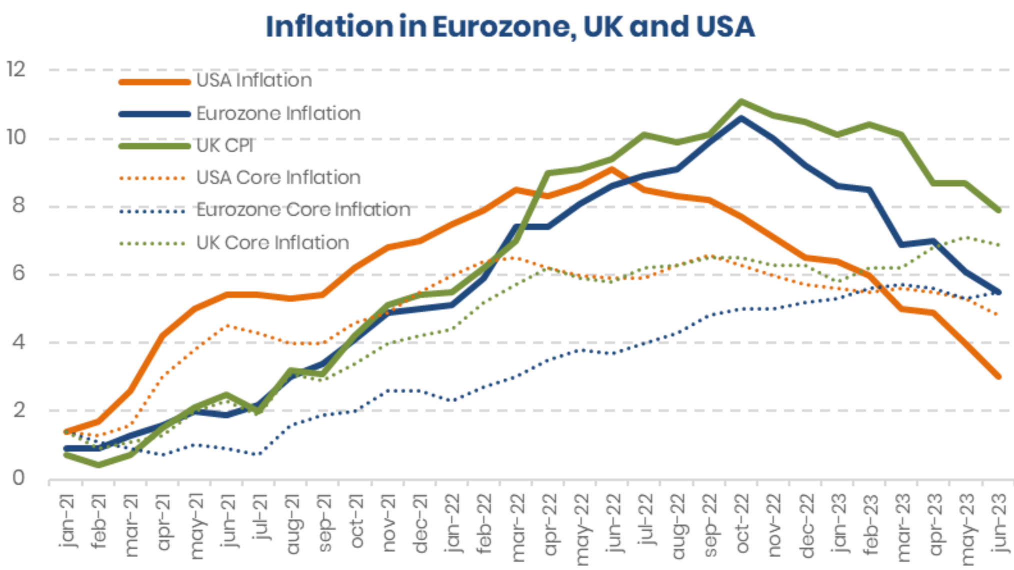
Composite PMI Index



Source: Prepared-in house based on data from Markit Economics

Meanwhile, it looks as if the main central banks in western countries will continue to raise interest rates at their meetings in late July and early August, although, in most cases, the highs of the current upward cycle are likely approaching. The ECB is expected to raise interest rates by a quarter point in July, while the markets expect a further increase in September, bringing overall rates up to half a point above their current levels (4% for the main refinancing rate, 3.5% for the deposit rate and 4.25% for the marginal lending facility). The Federal Reserve is also expected to resume its rate hike in July after it left its rates unchanged in June in the 5% to 5.25% range, but it is uncertain whether there will be any subsequent rate hikes after that one. As for the Bank of England, the end of rate hikes may be further away, given the UK's difficulties in containing inflation, especially core inflation. In June, the Bank of England raised rates by half a point, to the current 5%, and in August rate hikes will most likely continue, given that the market expects an upper limit of around 6.5%.

The progressive monetary policy tightening, combined with other factors such as lower energy prices, improvements in supply chains, and base effects, are slowing inflation trends. In June, the United States' headline CPI fell to 3%, versus 9.1% a year earlier, when record highs were seen. In Europe, prices are a few months behind the US. In the Eurozone, preliminary data for June set inflation at 5.5%, also significantly below the high of 10.6% seen in October, although still showing elevated rates. Meanwhile, in the United Kingdom, price moderation is proving to be considerably more complex, with rates in May of 8.7%, still very high, versus the peak of 11.1% also seen in October.



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

However, core inflation (excluding food and energy) is showing greater downward resistance across the board. In the United States, it fell to 4.8% in June, while in the Eurozone it increased by one tenth month-on-month to 5.4%, which is close to the highs of 5.7% reached in March. The situation is worse in the United Kingdom, where core inflation continues to increase, with rates set at 7.1% in May, the highest since 1992.

In terms of activity, there are also signs of a slowdown. In the United States, where the economy remains remarkably buoyant with Q1 growth having been revised to 0.5%, there was a slowdown in job creation, which increased 209,000 in June but is significantly lower than in previous months. In addition, the effects of rising interest rates are also being felt in the residential market and in the deterioration of the manufacturing PMIs.

The Eurozone entered a technical recession in Q1, with 0.1% growth for the second consecutive quarter. The labour market remains robust, with unemployment rates at an all-time low of 6.5%, but the manufacturing PMIs are clearly in contractionary territory, and the residential market is showing signs of stagnation. However, the situation is very heterogeneous across countries.

Meanwhile, in China, after the notable upturn in Q1, when GDP grew by 2.2% quarter-on-quarter, there was slowdown in activity in Q2, with GDP growth of 0.8% quarter-on-quarter. In addition, in May there was a decline in exports and a slowdown in investment, industrial production and retail sales. The residential market also showed weaknesses, which is why the Bank of China has lowered its interest rates by 10 basis points to stimulate economic activity.

Commodity prices in June were slightly higher than in May but remain well below the levels seen in previous months, reflecting the weak outlook for the global economy in the second half of the year. Oil prices in June fell to $75.5/barrel, 40.8% lower than a year earlier. However, in the first days of July, the price is rising in reaction to the commitment of Saudi Arabia and Russia to further reduce crude oil production. In this regard, the U.S. Energy Information Administration believes that OPEC+ production cuts will reduce oil inventories over the next few quarters, which will boost the price in late 2023 and early 2024. However, there is uncertainty about how oil prices will evolve in the coming months, as they will also be closely linked to the intensity of the economic slowdown.

The Spanish Economy

Spanish economic forecasts are raised to 2% in 2023 and lowered to 1.4% in 2024

The upward revision of GDP in the second half of 2022 by the National Statistics Institute (INE) and the better-than-expected performance of activity in Q1 2023, with a quarterly increase of 0.6%, have led CEOE to raise its growth outlook for the Spanish economy to 2% this year. However, this rate hides a differing performance between the first and second halves of the year. Specifically, the first half will be more dynamic (including growth of around 0.5% in Q2), while the second half is expected to show a notable moderation in activity rates and could even lead to a certain stagnation. This fact conditions the outlook for 2024, with GDP growth set at 1.4%.

The Funcas panel published in July also points to 2.1% growth for 2023. It should be noted that the majority of the panellists raised the growth forecast, while most estimate GDP in 2024 at 1.8%.

Under this scenario, employment slows down substantially, growing below GDP both years, which will allow for a certain recovery in productivity. Thus, CEOE estimates an increase in employment of 1.7% and 1%, respectively.

As for inflation, in June it continued its downward trend and stood at 1.9%, while the underlying rate showed more resistance to easing, posting 5.9% year-on-year. All in all, the average CPI rate will be below 4% in 2023. With regard to other macroeconomic variables, the current account surplus will stabilize at below 1% of GDP, while public deficit levels will remain at around -4% of GDP (-4.2% in 2023 and -3.8% in 2024), provided there is no change in budgetary and fiscal policy.

There is still high uncertainty in this scenario for the remainder of 2023, due to continuing geopolitical tensions stemming from Russia's invasion of Ukraine and its negative effects on Europe. This external factor is compounded by the impact of a restrictive monetary policy and the high inflation on household consumption and business investment in Spain, which is difficult to quantify, but will continue to detract from the buoyancy of domestic demand.

Demand and Activity

Signs of a slowdown in Q2 are beginning to emerge

The Spanish economy seems to have maintained a remarkable pace of growth in Q2 and could, therefore, post a growth rate similar to the 0.6% recorded in Q1. This growth would have been based, primarily, on the favourable performance of the foreign sector, while domestic demand would have continued to register a certain stagnation. However, some signs of a slowdown are beginning to show.

With regard to expectations, the consumer confidence indicator and the retail trade indicator have shown a rebound with respect to the Q1 average, in line with the continued dynamism of employment and the moderation in inflation in recent months. However, both the retail trade index at constant prices as well as the domestic sales of large companies showed somewhat more contained growth in May. In addition, part of the improvement in household disposable income is expected to be held back in the coming months by rising financial costs, as loans at current interest rates are reviewed. On the other hand, the increase in interest rates is also making new credit more expensive and creating tougher lending conditions, which, together with lower demand, is leading to a decline in new financing.

With regard to industrial activity, there was a slight deterioration in confidence indicators and manufacturing PMIs in Q2, which returned to negative levels, after having been above the 50 level in Q1. This worsening of expectations is due to weak demand, which is reflected in a decrease in new orders, both domestic and foreign, in a context of weakening industrial activity at a global level. This weaker demand has also brought some relief on input costs and a slowdown in sales price increases.

In the first six months of 2023, vehicle registrations were up 24% compared to the same period in 2022, to over half a million units, but still 27% below pre-pandemic figures. In June, 100,000 units were reached due to an increase in rent-a-car sales, while demand from private individuals remains very subdued.

Expectations in the services sector also deteriorated somewhat in Q2, both the confidence indicator and the services PMI, which, although still at expansionary levels, declined to around 53 in June after having stood at close to 60 in Q1. Activity levels remain high, but the pace of growth is slowing, which is reflected in new orders. Operating costs for companies continue to rise, especially those related to wage costs, albeit at a slower pace.

The inflow of international tourists continues to recover and forecasts for the sector point to a record summer. Thus, according to the latest data available from the Statistics on Tourist Movements at Borders (Frontur), April exceeded the pre-pandemic equivalent figures for 2019 for the first time and, in May, the latest figures available, the inflow of visitors stood at just over 8.2 million tourists, compared to 8.0 million in the same month of 2019. In addition, as average spending has been increasing, total tourist spending during May was nearly 20% higher than that recorded in the same month of 2019.

From the point of view of the external sector, the information available for Q2 seems to indicate that exports will continue to be more dynamic than imports, meaning that the contribution of the external sector will continue to play a key role in growth during this period. Thus, the customs information available for the first four months of 2023 shows a notably better performance of exports, which is leading to a correction of the trade deficit, both non-energy and energy. In the January-April period, the increase in exports was 9.2% (0.0% in volume), compared to 0.2% in imports (-4.4% in volume). The trade balance recorded a deficit of €10.9537 billion, compared to a deficit of €21.8109 billion in the same period of 2022.

Similarly, according to the Balance of Payments data published by the Bank of Spain, in the first four months of 2023 the current account balance surplus reached 15.7 billion, compared to a deficit of -2.8 billion in the same period of the previous year. This positive evolution of the balance was due to the significant improvement in the balance of goods and non-tourist services (with a surplus of 1.6 billion, compared to the deficit of -12.7 billion in the same period of 2022), in addition to the surplus in the balance of tourist services (16.1 billion, compared to 11.9 billion in the same period of the previous year), which is in line with the favourable evolution of visitor inflows this year and the increase in tourist spending.

The Labour Market

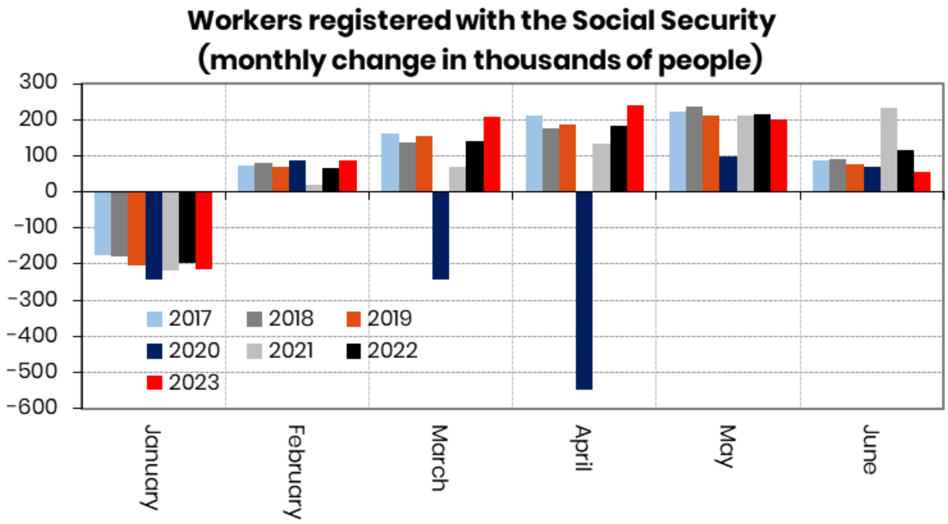
Social Security registrations increase moderately in June and the year-on-year rate loses momentum

The labour market closed Q2 with a favourable balance, although the number of people registered with the Social Security has slowed down in the last two months, most sharply in June. This could foreseeably be the prelude to a deceleration in job creation in the second half of the year, as GDP growth slows down.

In June, the labour market left behind the positive job creation surprises observed in previous months. Thus, Social Security registrations increased modestly, by 54,541 people, which is the smallest increase for this month since 2015. In seasonally adjusted terms, according to the Ministry of Inclusion, Social Security and Migration, the evolution was more unfavourable, given that a decrease of 20,119 registrations was recorded, which contrasts with the notable increases posted in the preceding months of 2023 and represents the first drop since July of last year.

Going back to the raw data, it should be noted that the slowdown in the monthly growth of Social Security registrations was due to the private sector, where 38,615 jobs were generated, the lowest figure for a month of June in the historical series (which begins at the end of 2013). Even so, the private business fabric accounts for 71% of the June increase in registrations. Meanwhile, the public sector incorporated 15,926 workers, a slightly higher figure than the one recorded in May.

In year-on-year terms, in June, the number of people registered with the Social Security slowed down for the second consecutive month, although more sharply than in May, falling by three tenths to 2.6%. Thus, job creation came to a halt after the upward trend seen between February and April of this year. Both the private and public sectors showed a slowdown in registrations, with June's year-on-year rates standing at 2.5% and 3.2%, respectively. In addition, all economic sectors posted a less favourable performance in June, with a loss of momentum in growth rates, although the figures differed markedly. Construction is the most dynamic sector, with a year-on-year rate of 3.9%, followed by services, with 3.0%, while industry recorded a more contained growth of 1.7%. On the other hand, jobs continue to be lost in agriculture, where the year-on-year rate stands at -3.0%



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

The dynamism recorded by the number of companies registered with the Social Security during a good part of 2022 has given way to more discrete growth this year, below 1% year-on-year, which is making it difficult for the business fabric to recover 2019 levels. In June, the number of companies registered with the Social Security grew by 0.3% year-on-year to 1,331,470 companies, which means that there are 17,855 fewer companies than four years ago. By size, the number of small companies (between 1 and 5 workers) is the one that has not managed to recover pre-crisis levels. And by economic sector, only construction has more companies than in 2019, while in agriculture, industry, and services there are still fewer companies than before the crisis.

Workers under furlough schemes (ERTE) fell in June, to stand at 12,054 people on average for the month, which is less than half of the more than 26,000 furloughed workers recorded in this same month in 2022. Meanwhile, registered unemployment fell in June by 50,268 people, a figure well below what is typical for this month (the average in 2014-2019 was a drop of 98,974 people). Thus, the total number of unemployed stands at 2,688,842 people, the lowest level since September 2008.

Despite the less favourable tone of the labour market in June, the balance for Q2 can be considered positive. Social Security registrations grew by 2.8% year-on-year in Q2, three tenths more than in Q1. In addition, according to the series published by the Ministry of Inclusion, Social Security and Migration, seasonally adjusted effective registrations (discounting furloughed workers) are estimated to have increased by 1.4% quarter-on-quarter in Q2, compared to 0.9% in Q1.

Inflation

Inflation continues to decelerate on the back of lower energy prices and moderation in unprocessed food prices

In June, headline inflation fell by 1.3 points to 1.9% and core inflation continued its deceleration, although much more gradually, falling 2 tenths vs. May and currently standing at 5.9%. Energy product prices have accelerated their fall and industrial goods and unprocessed food prices have shown a further deceleration. This trend is expected to continue in the coming months, as lower inflationary pressures are observed in international markets. However, in the case of services, there is greater resistance to deceleration due to the strength of their demand.

Within the underlying component, Services prices increased their year-on-year rate by one tenth to 4.3%; Industrial Goods prices excluding energy products fell by two tenths to 4.0%; and Processed Food, beverages and tobacco decreased by nine tenths to 12.0%.

The prices of unprocessed foods also decelerated notably, by 2.6 points, to 6.3%. However, many products with an important weight in the household shopping basket still show double-digit changes, such as cereals, pork, milk, or eggs.

Energy product prices intensified their rate of fall to -24.9% year-on-year, compared to -19.6% in the previous month, due to the greater decline in energy raw material prices this month. Although for the remainder of the year, energy prices are expected to show significant declines, these will be slightly tempered by the withdrawal of the 20 cents per litre discount when compared to 2022.

Forecasts suggest that inflation will remain subdued in the coming months, but there could be an occasional spike in the latter part of the year. As a result, the average inflation rate in 2023 is expected to be much lower than in 2022, below 4%.

In comparison to Europe, the HICP in June reached 1.6%, while in the Monetary Union this rate stood at 5.5%, bringing the negative differential to 3.9 p.p.

The Public Sector

The reduction in the State's public deficit lost momentum in May

The accumulated State public deficit through May has continued to narrow, although with less intensity in comparison to the first months of 2023. Thus, the financing requirement reached -0.9% of GDP, compared to -1.4% of GDP in the same period of the previous year. Meanwhile, the primary balance (discounting interest) remains negative, at -0.1% of GDP, versus -0.5% accumulated up to May 2022.

The dynamism of resources continues to be the most outstanding feature, with growth of 9.7% in the first five months of 2023. Around 50% of the growth in revenues is due to newly created taxes in 2023, such as the Special Tax on Plastic Containers, the Temporary Energy Levy and the Temporary Levy on Credit Institutions and Financial Credit Establishments. Between the three of them, total collection amounts to €1.639 billion up to May. This is compounded with the increase in the collection of the first Corporate Income Tax instalment payment (232 million euros). Another factor that has had a positive influence on resources is capital gains, mainly interest and dividends.

With regard to tax collection, there is a notable difference in trend. Thus, while VAT fell by -0.7%, other taxes related to production and imports increased by 9.9%. It is also worth noting the strength of taxes on income, wealth, etc., although this is largely due to the early payment of the first Corporate Income Tax instalment, as mentioned above.

As for uses, there was a slight increase of 2.2% at the end of May. The evolution by items is also uneven. Among the items that have increased the most, transfers between public administrations and social benefits stand out. Other increases in spending, although smaller, were recorded in compensation of employees, up 3.7%, and in intermediate consumption, up 11.6%, in this latter case due to the 204 million for the elections and the political parties' programs.

In contrast, the item relating to the European Union's own resources based on VAT and GNI fell by 20.5% due to lower contributions in both the VAT and GNI resources. Subsidies also decreased, as well as investment and investment aid.

Forecasts

Economic forecasts for Spain (last update: July 2023)						
Annual rates of change, unless otherwise indicated						
	2019	2020	2021	2022	2023	2024
GDP	2.0	-11.3	5.5	5.5	2.0	1.4
Private consumption expenditure	0.9	-12.4	6.0	4.5	0.0	0.8
Government consumption expenditure	1.9	3.5	2.9	-0.7	1.3	0.9
Gross fixed capital formation	4.5	-9.7	0.9	4.6	2.0	2.5
-Tangible fixed assets	5.3	-11.1	0.1	4.4	1.9	2.0
Construction	7.2	-10.2	-3.7	4.7	4.0	2.1
Equipment and cultivated assets	2.4	-12.6	6.5	4.1	-1.6	1.9
-Intangible fixed assets	0.6	-2.5	4.7	5.5	2.5	4.5
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	3.4	3.0
External demand (*)	0.4	-2.2	0.3	2.4	1.2	0.2
GDP current prices	3.5	-10.2	7.9	10.0	5.5	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	3.5	2.8
CPI (Dec/Dec)	0.8	-0.5	6.5	5.7	4.2	2.3
Core CPI (average annual rate)	0.9	0.7	0.8	5.2	6.2	3.1
Employment (Quarterly National Accounts)(**)	3.3	-6.8	6.6	3.8	1.7	1.0
Employment (LFS)	2.3	-2.9	3.0	3.1	1.6	1.0
Unemployment rate (LFS) (% active population)	14.1	15.5	14.8	12.9	12.5	12.4
Productivity	-1.3	-4.8	-1.0	1.6	0.3	0.4
Compensation per employee	2.4	2.5	-0.8	2.0	4.0	2.9
Unit labour cost (ULC)	3.8	7.7	0.2	0.4	3.7	2.5
Current Account Balance (% of GDP)	2.1	0.6	1.0	0.6	1.2	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	5.50	4.50
Interest rates Eurozone (Dec)	0.00	0.00	0.00	2.50	4.50	4.00
Brent Oil ($)	64.8	41.5	71.1	103.7	77.7	72.8

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

(*) Contribution to GDP growth

(**) Full-time equivalent jobs