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Economic Outlook

July 2022

Overview

- **Persistently high inflation and the likelihood of a recession at the end of the summer are the biggest concerns for the global economy.**
- **Central banks are tightening their monetary policy more rapidly despite signs of a slowdown in activity.**
- **The Federal Reserve's increased aggressiveness and the risks to global growth are causing the dollar to trade at its highest levels in more than 20 years against the euro and also against the yen.**
- **The growth outlook for the Spanish economy for 2023 worsens significantly (growth around 2%), while it remains stable for 2022 (growth around 4%).**
- **In Q2, the Spanish economy seems to have performed more dynamically than in Q1 as a result of the good behaviour of the services sector.**
- **Social Security registrations in June closed a favourable quarter for employment, although a certain loss of intensity was observed.**
- **Inflation in Spain is not relenting in the short term, and the forecasts for 2022 continue to be revised upwards.**

The International Scenario

Rising inflation prompts tougher response from central banks

Persistently high inflation is the biggest concern for the global economy. As a result, central banks are intensifying the tightening of their monetary policy, despite increasing signs of a clear slowdown in the growth rate and even the risk of a recession by year-end or at the beginning of next year hovering over several countries.

Uncertainty about the duration of the war in Ukraine, intense geopolitical tensions, raw material prices and problems in supply chains, impacted by the effects of the war and also by the measures implemented as a result of the pandemic, are factors driving the main international organizations to revise their growth forecasts downwards. In addition, monetary policy will not be as lax as it has been in recent years, and this will also dampen the dynamism of activity as it will increase the cost of financing for governments, families, and companies, especially given the high level of indebtedness in the world economy.

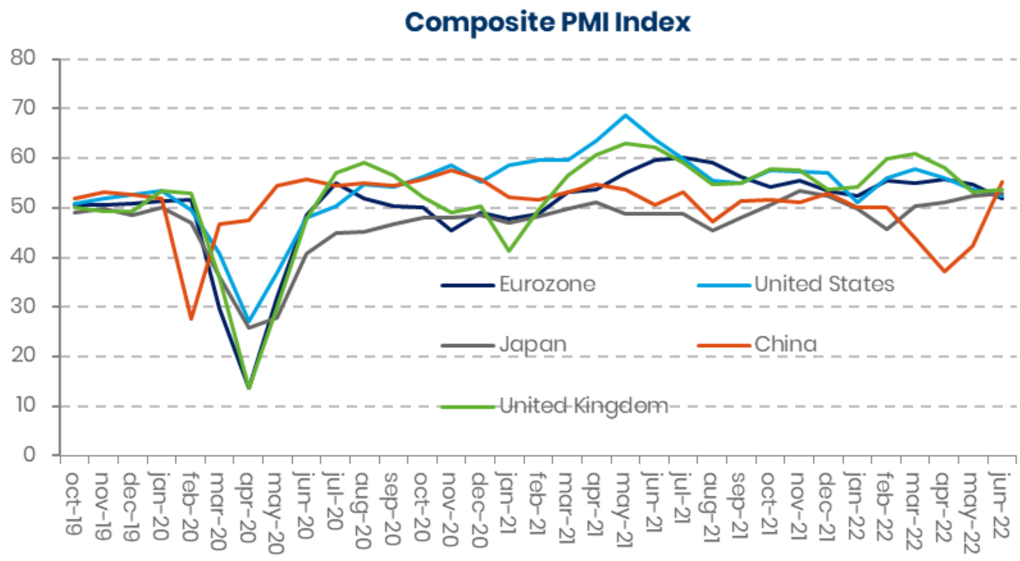
Within this context, the European Commission updated its forecasts in July, cutting Eurozone growth expectations by one tenth for this year, to 2.6%, and by nine tenths for next year, to 1.4%. On the other hand, inflation is revised upwards once again, by a point and a half for 2022, to 7.6%, and by a point and three tenths for 2023, to 4.0% on average, still well above the ECB's targets.

European Commission forecasts (July 2022)

	GDP			Inflation		
(y-o-y rate)	**2021**	**2022**	**2023**	**2021**	**2022**	**2023**
European Union	5.4	2.7	1.5	2.9	8.3	4.6
Eurozone	5.3	2.6	1.4	2.6	7.6	4.0
Germany	2.9	1.4	1.3	3.2	7.9	4.8
France	6.8	2.4	1.4	2.1	5.9	4.1
Spain	5.1	4.0	2.1	3.0	8.1	3.4
Italy	6.6	2.9	0.9	1.9	7.4	3.4

Source: European Commission

In terms of activity, the global composite PMI index for June showed some improvement with respect to previous months, supported by the improved performance of the manufacturing sector, which benefited from the easing of restrictions in China. In fact, the Asian country returned to a level above 50 points, after having been clearly below this figure for three months. PMI indices in both the Eurozone and the United States showed signs of a slowdown, although they remain in positive territory. However, despite the improvement in the June PMIs, if we consider Q2 as a whole, it is easier to see the weakness of the global economy, with the worst results since Q3 2020.



Source: Markit Economics

Forecasts by the main international organizations indicate that this loss of momentum in the economy is likely to intensify in the latter part of the year and at the beginning of 2023: negative growth is expected to occur in several countries during several quarters, followed by an improvement that will become more marked in the second half of next year, as inflationary pressures ease.

Inflation continues to be the main source of concern right now, with many economies at more than forty-year highs, and with the perspective that it will not return to levels seen as reasonable by central banks until the end of 2023 or even 2024. In the United Kingdom, inflation continued to rise in May, to 9.1%, and is expected to keep rising in the coming months. In the United States, inflation also continued to climb, reaching 9.1% in June, the highest since the end of 1981. However, core inflation does seem to be moderating and, in June, it fell by one tenth to 5.9%, although it is still at very high rates. Meanwhile, the Eurozone continues to post record high inflation, with a rate of 8.6% in June. In addition, it is also worth highlighting the increase in core inflation, which reached 4.6% in June, the highest rate in its historical series.

Persistently high inflation is prompting central banks to accelerate their reaction by tightening their monetary policies more intensely than announced a few months ago. The Federal Reserve is proving to be one of the most aggressive and, following the 75-basis point increase in June, a similar rise is expected at its next meeting at the end of July and, most probably, also in September, to close the year above 3% and set rates close to 4% throughout 2023. The Bank of England is also raising its interest rates, with five consecutive hikes having brought them to 1.25% in June, the highest level in thirteen years. Meanwhile, the ECB plans to start raising interest rates at its July meeting, after having completed its bond-buying program. It will be the first interest rate hike since 2011, and more will follow in the latter part of the year: the benchmark rate is expected to close the year at 1%, or even above, and be close to 2% by the end of 2023. It is also expected that, at the July meeting, they will provide more information on the mechanism announced to prevent the widening of risk premia among countries, mainly peripheral southern countries, that do not respond to fundamentals.

The greater aggressiveness on the part of the Federal Reserve and the risks to global growth are causing the dollar to strengthen its role as a safe-haven currency. Thus, it is trading at more than 24-year highs against the yen and also at 20-year highs against the euro, reaching almost parity levels.

As for oil, the price of Brent crude in June stood at $127.4/barrel on a monthly average, the highest since July 2008. However, due to the weakness of the euro, the price of crude oil in the Eurozone currency reached an all-time high since the existence of the single currency. In the first days of July, oil prices began to moderate somewhat on fears of a further slowdown in global activity, although uncertainty is very high and there are also forces pushing in the opposite direction, such as supply shortages or reduced restrictions on activity in China. Again, in euros, this price containment will be lower due to the strength of the dollar against the European currency, which will lead to an additional price increase for Eurozone countries. On the other hand, oil futures point to a gradual decline in prices during the latter part of the year, which should continue throughout 2023.

The Spanish Economy

Notable downward revision of growth forecasts for 2023

The recovery outlook for the Spanish economy is becoming more complicated, not just because of the slowdown in economic activity and the increase in inflation, but also because of many other unresolved issues, which could continue to worsen and intensify the imbalances and, in turn, deteriorate the situation even further.

Inflationary pressures are one of the main threats in the short term, due to their impact on consumption, which is falling, and because of the increase in interest rates, which clearly affects savings and investment decisions and increases the financing costs of the public sector (18.3% up to May, according to data from the IGAE on budget execution in the National Accounts). On the other hand, supply difficulties and transport problems are generating bottlenecks in many industrial sectors (automotive, aeronautics, construction), causing delays, and even halting activity, something that could extend into the beginning of 2023. In addition, it is worth mentioning the delay in the execution of European funds, which could affect company investment. The greatest danger from abroad comes from the reduction of the gas supply to Europe and the economic consequences on our main trading partners, something that will, in turn, impact our exports.

For 2022, most international and national agencies estimate GDP growth for Spain at around 4%, although more and more institutions are revising the forecast for the coming year significantly downwards. This is the case of the European Commission, which, in its July 14 forecasts, maintains the 4% growth in GDP for this year, but lowers it to 2.1% in 2023. In fact, the possibility of a quarter with a decrease in GDP at the end of 2022 or at the beginning of 2023 has not been ruled out.

In contrast, inflation is being revised steadily upward for both 2022 and 2023. This year' average will be above 7.5%, while the lower dynamism of activity in 2023 together any measures implemented are factors likely to slow the price rise towards the 3% level in the coming year. However, the risks are on the upside, and it is possible that it could exceed 8% on average in 2022, as indicated by the European Commission.

Demand and Activity

The economy is expected to perform better in Q2, although with notable differences across sectors

Pending the publication at the end of the month of the preliminary data for Q2, the Spanish economy is expected to have performed more favourably than in Q1 (quarter-on-quarter growth of 0.2%), partly due to a rebound effect after the deterioration seen in March and also as a result of the favourable evolution of tourist flows. Nevertheless, growth will still be fairly contained, with notable differences across sectors.

The increase in the price of raw materials, both energy and non-energy, together with supply chain difficulties, are having a major impact on industrial activity. All of this is reflected in a deterioration of expectations, which can be seen in both the confidence indicator published by the European Commission and the manufacturing PMI. In this regard, the manufacturing PMI, although still above the 50 level, has shown a clear downward trend over the past few months and is far from the levels of around 60 points reached in mid-2021. The companies surveyed report a decline in new orders, due to rising inflation. In addition, delays in delivery times, albeit to a lesser extent, and rising production costs remain a cause for concern.

The automotive industry continues to be affected by supply problems and very limited domestic and international demand. Thus, during the first five months of the year, vehicle production shows a drop of -12.6% compared to 2021 and -30% compared to 2019. With regard to exports, up to May, car sales abroad recorded a -13.4% drop compared to what was recorded in 2021, also reflecting the decline in demand in the main destination countries. According to the sector, the shortage of components, both in Spain and in Europe, will not be reverted until the first months of 2023.

The services sector continues to show a favourable evolution in terms of activity and employment. Expectations for the sector continue to improve, following the slump at the end of 2021 and beginning of 2022, and the outlook for the coming months is positive, especially for tourism and hospitality. However, the persistence of inflation, which weighs on the purchasing power of families and companies, is a cause for concern.

The latest available data from the tourism sector indicate that international tourist arrivals continue to recover: there were nearly 7 million tourists in May, which is 5 times the figure for the same month last year, and only 12% below the tourists in May 2019 (before the start of the pandemic). This is a significant improvement over previous months, when tourist numbers barely reached 70% of pre-covid figures. Moreover, total spending by international tourists in April and May is already practically the same as the 2019 figures. According to Turespaña, in June, air passenger arrivals already reached 8.2 million passengers. The sector's outlook for the summer, based on the bookings being made, is very positive and it could be a record season, surpassing the 2019 figures. Spain continues to be the preferred destination for many Europeans and, in addition, it benefits from its population's high rate of vaccination against covid-19 in comparison to other destinations.

In terms of the foreign sector, the customs information available for the first five months of the year shows a much more dynamic evolution in the import than in the export of goods in nominal terms, due both to the greater advance in real terms and to the increase in import prices. Thus, exports increased by 24.4% year-on-year (6.1% in terms of volume) and imports by 40.7% year-on-year (17.4% in terms of volume). The result of these flows was a trade deficit in this period of -€26.5697 billion, compared to -€4.4196 billion in the same period of 2021. Along the same lines, according to the Balance of Payments data published by the Bank of Spain, in the first four months of 2022 the current account deficit reached -4.1 billion, compared to a surplus of 0.5 billion in the same period of the previous year. This balance was due to the notable deterioration in the balance of non-tourist goods and services (with a deficit of 12.1 billion, compared to a surplus of 3.2 billion in the same period of 2021), which has been offset by the surplus in the balance of tourist services (12.4 billion, compared to 0.7 billion in the same period of the previous year), reflecting the better evolution of tourist flows this year.

Looking ahead to the coming quarters, persistently high inflation, together with the increase in the Euribor, will reduce the purchasing power of households and may limit the investment decisions of companies, and thus the contribution to consumption and investment growth could be lower than initially expected.

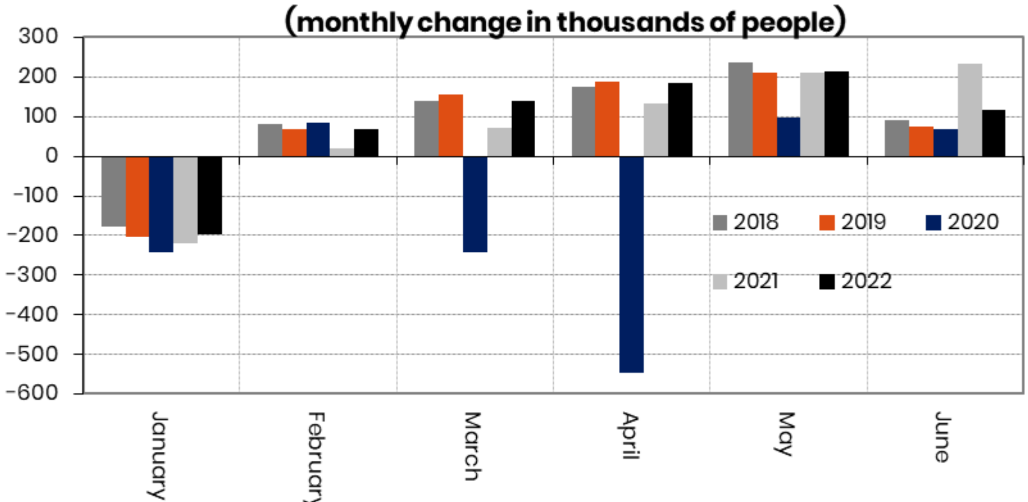
The Labour Market

The number of people registered with the Social Security in June closes a favourable quarter for employment, although there was a slight loss of intensity

The labour market continued to evolve favourably in June, driven by seasonality and the improvement in the tourism sectors. It is worth highlighting the behaviour of Social Security registrations, with the total number of people registered still above 20 million in June (on a monthly average basis).

Specifically, June recorded an increase of 115,607 Social Security registrations (on a monthly average), a lower figure than the same month in 2021 (which was particularly high due to the start of the return to normality), but higher than the average increase recorded in the 2014-2019 period. All in all, the year-on-year rate of Social Security registrations in June slowed down with respect to May and stood at 4.35%. On the other hand, the number of workers under furlough-ERTE continues to fall (8,323 people in June) and is set at a total of 22,769 people on a monthly average.

Workers registered with the Social Security (monthly change in thousands of people)



Source: Ministry of Inclusion, Social Security and Migrations and CEOE Economic Department

In the disaggregated analysis by sector, Social Security registrations increased in all activity areas, except in agriculture, which lost 24,508 contributors. The largest volume of growth was concentrated in the services sector, with 112,553 new workers, with hotel and catering-related activities standing out as a result of the good weather in June and the boost in tourism. Within services, it is also worth highlighting the strength of new registrations in retail, administrative activities and auxiliary services, and health and social services. On the other hand, education lost 49,206 workers as the school year came to an end. Industry and construction recorded increases of 15,062 and 12,499, respectively.

The good performance of employment in recent months has allowed unemployment to continue declining, with the number of registered unemployed now standing below 3 million. Specifically, registered unemployment stood at 2,880,582 people in June, the lowest level since October 2008. Nonetheless, there is a noticeable slowdown in the rate of decline, given that the 42,409 fewer registered unemployed represent a much more moderate fall than that observed, on average, in the month of June over the 2014-2019 period (-98,974 people).

It is worth noting the boost in permanent contracts and the drop in temporary contracts as a result of recent changes in labour market regulations. This has allowed this type of contract to account for close to 50% of total registered new jobs, when previously the usual rate was around 10%. In addition, there has been a particular increase in the number of permanent contracts in sectors such as agriculture and construction.

In short, employment growth in Q2 was positive, although the pace was somewhat slower than in Q1. Specifically, according to estimates from CEOE's Research Department, effective registrations (excluding furloughs) will increase by around 1.0% quarter-on-quarter, one tenth less than in Q1. Therefore, the divergence between the positive employment performance and the lower dynamism of economic activity continues in Q2.

Over the coming months, the labour market is expected to continue to follow a positive trend, favoured by the seasonal nature of the summer season. However, we should bear in mind that employment figures will also be conditioned by the difficulties that companies are facing, in a context of great uncertainty, with supply shortages and higher prices in the inputs necessary for their activity. All in all, the unemployment rate is expected to fall in 2022 (to 13.7% on average) and to continue dropping in 2023, albeit less sharply (12,9%).

Inflation

Inflation rebounds to 10.2% due to higher energy and food prices

In June, inflation picked up again by one and a half points to 10.2%, the highest rate since April 1985. Higher energy prices continue to be the main inflationary element due to the increase in raw materials on international markets, although other components are beginning to show notable price increases.

Core inflation increased by six tenths, taking the year-on-year rate to 5.5% in June, almost 5 points below the headline CPI. Within the core component, Services prices increased by four tenths to 3.8% year-on-year; Industrial Goods prices excluding energy products increased by six tenths to 4.2%; and Processed Food, beverages and tobacco grew by 1.1 points to 11.1% year-on-year.

Unprocessed food prices also increased year-on-year by 3.5 points, to 13.6%. It is worth highlighting the increase in the prices of products such as cereals, bread, lamb, beef or poultry, all of them above 10%, or eggs or milk, above 20%.

Energy product prices increased to 40.8% year-on-year, compared to 34.2% in May, due to the increase in the price of energy raw materials. Oil prices in June stood at $127.4/barrel on average, the highest since 2008, and up 73.8% year-on-year in dollars and 98.3% in euros, due to the strength of the U.S. currency. In the first days of July, the price of crude oil has moderated somewhat, although the average price so far this month is $112.4/barrel, representing year-on-year increases of 48% in dollars and 73% in euros due to the weakness of the European currency, which is trading at a low against the dollar.

We should bear in mind that a large part of the price increase seen in many CPI components is due to factors external to the Spanish economy, such as the consequences of the war and supply problems. These factors may continue to condition the evolution of the prices of some raw materials, such as gas, fuels, cereals, and oils, which in turn have an impact on the price composition of many other products. As a result, inflation will remain high in the short term.

The Public Sector

Increased public deficit reduction up to May, due to strong revenues

With budget execution data up to May, the State deficit in national accounting terms has decreased by -48.5% due to robust resources, which are up by 19.2%, while expenditures have decreased by -3.3%. In terms of GDP, the balance is equivalent to -1.4%, compared to -2.9% in the same period of 2021. As for the primary deficit, it stood at -0.5% of GDP over this period, compared to -2.1% of GDP in the previous year.

State resources have increased significantly in the first five months of 2022, having even risen at a faster rate than in the first five months of April (16.7%). Tax revenues continue to benefit from high inflation and the favourable evolution of employment, as reflected in VAT revenues, which rose by 22.8%, and direct taxes (personal income tax and wealth tax), which increased by 22.2%.

On the other hand, the recovery of tourism, the increase in the price of energy raw materials and the lifting of restrictions are also boosting the collection of excise taxes. It is worth noting the growth in revenues from the tax on hydrocarbons (+15%), alcohol and beverages (+63%) and tobacco (+9.2%).

The decrease in expenditure up to May is explained, in general terms, by the lower transfers made to other units of the Government, to the lower contribution of our country to the European Union by GNI resource and, most of all, to the recording in 2021 of the expenditure for the standardized guarantees, an item that has no correspondence this year.

Considering the rest of the expenditure components, it is worth highlighting the impact that the increase in interest rates has had on the financial expenditure item, up by 18.3%, intermediate consumption, up by 34.5%, and employee wages and salaries, up by 3.0% in 2021.

For the Public Administrations as a whole and with data only up to March, the deficit was 76.6% lower than in the same period of the previous year. In relative terms, the ratio over GDP stood at -0.4%, compared to -1.7% in the Q1 2021.

Forecasts

Economic forecasts for Spain (last update: July 2022)						
Annual rates of change, unless otherwise indicated						
	2018	2019	2020	2021	2022	2023
GDP	2.3	2.1	-10.8	5.1	4.2	3.2
Private consumption expenditure	1.8	0.9	-12.2	4.7	3.1	2.7
Government consumption expenditure	2.3	2.0	3.3	3.1	2.2	1.3
Gross fixed capital formation	6.3	4.5	-9.5	4.3	7.4	5.4
-Tangible fixed assets	7.5	5.8	-10.5	4.1	7.1	5.7
Construction	9.5	7.1	-9.6	-2.8	3.3	4.7
Equipment and cultivated assets	4.6	3.7	-12.1	15.7	12.2	6.8
-Intangible fixed assets	1.1	-1.5	-4.3	5.5	8.9	3.9
Domestic demand (*)	2.9	1.6	-8.6	4.7	3.1	2.7
Exports	1.7	2.5	-20.1	14.7	11.3	6.9
Imports	3.9	1.2	-15.2	13.9	8.3	6.0
External demand (*)	-0.6	0.5	-2.2	0.4	1.1	0.4
GDP current prices	3.5	3.4	-9.7	7.3	7.7	4.2
GDP deflator	1.2	1.3	1.1	2.2	3.5	1.0
CPI (average annual rate)	1.7	0.7	-0.3	3.1	7.8	3.0
CPI (Dec/Dec)	1.2	0.8	-0.5	6.5	6.0	2.3
Core CPI (average annual rate)	0.9	0.9	0.7	0.8	4.5	3.0
Employment (Quarterly National Accounts)(**)	2.2	2.6	-7.6	6.6	3.1	2.8
Employment (LFS)	2.7	2.3	-2.9	3.0	2.5	1.7
Unemployment rate (LFS) (% active population)	15.3	14.1	15.5	14.8	13.7	12.9
Productivity	0.1	-0.5	-3.5	-1.4	1.1	0.4
Compensation per employee	1.8	2.6	1.3	-0.7	2.0	1.8
Unit labour cost (ULC)	1.7	3.1	5.0	0.7	0.9	1.4
Current Account Balance (% of GDP)	1.9	2.1	0.8	0.9	0.0	0.5
General government net lending (+) / net borrowing (–) (% of GDP)	-2.5	-2.9	-10.3	-6.9	-5.2	-4.5
Interest rates USA (Dec)	2.50	1.75	0.25	0.25	3.25	4.00
Interest rates Eurozone (Dec)	0.00	0.00	0.00	0.00	1.00	1.75
Brent Oil ($)	70.9	64.8	41.5	71.1	113.1	104.2

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

(*) Contribution to GDP growth

(**) Full-time equivalent jobs