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Economía

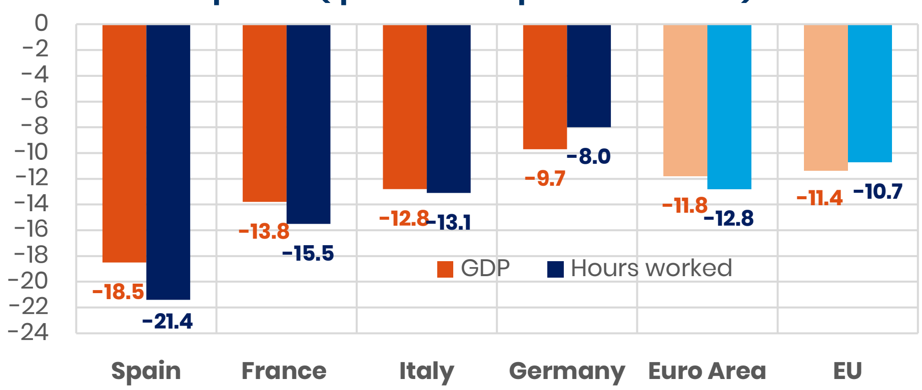
Economic Outlook

September 2020

Overview

- The world economy has shown signs of improvement in recent months after the collapse in Q2, which was unprecedented in recent history.
- The Spanish economy showed a partial recovery during the summer months, but approaches the autumn with considerable uncertainty.
- After the severe decline in Q2, the indicators for Q3 show greater momentum, although emerging from the crisis is being done quite heterogeneously across the different sectors.
- CEOE has lowered its forecasts for the Spanish economy, anticipating a fall in GDP of -11.5% in 2020.
- Employment is still below pre-crisis levels, despite recent increases in the number of people registered with the Social Security. CEOE estimates that, in Q3, this number (excluding ERTE-furloughs -Temporary Workforce Reduction Scheme-) will increase by 12% to 13% quarter-on-quarter.
- Inflation continues to be negative due to the slowdown in core inflation and the behaviour shown by oil prices.
- In 2020, we are seeing a significant deterioration in public finances. With aggregate data up to July, the State's public deficit already exceeds the figure reached by the public sector as a whole in 2019 (-2.8% of GDP)

GDP and employment (hours worked) in the second quarter (quarter-on-quarter rate in %)



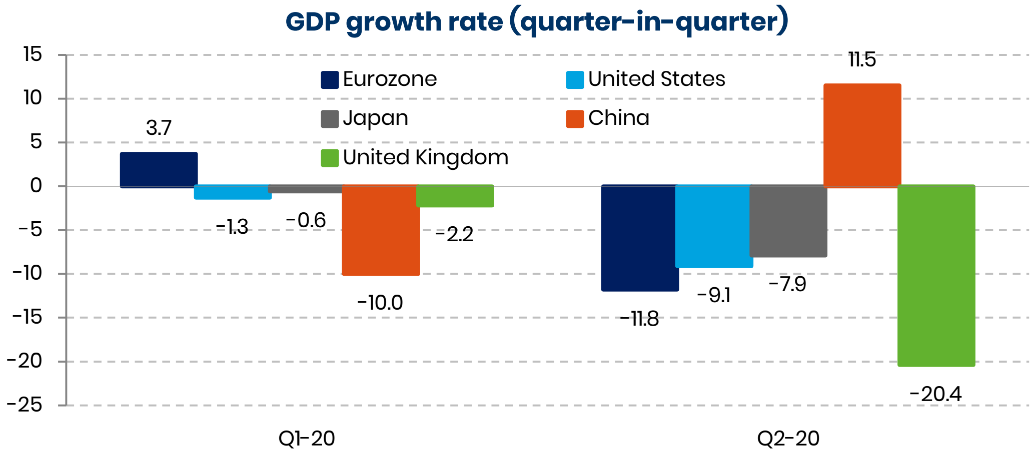
Source: Eurostat

The International Background

Signs of improvement in the global economy after the collapse in Q2

Results for Q2 reflect a collapse of the global economy of unprecedented scale in recent history. The OECD countries as a whole showed a quarterly decline in GDP of -9.8%, the largest recorded since its creation and far greater than the fall of -2.3% registered in Q1 of 2009, which followed the financial crisis. Nonetheless, performance has been rather uneven across regions.

Among the advanced economies, the United Kingdom has experienced the greatest activity drop, with a decrease of -20.4% for the quarter, followed by the Eurozone, where GDP fell by -11.8% in Q2, while in the United States and Japan the economy shrunk a little less, -9.1% and -7.9% respectively, although also a very significant figure. However, in Europe there is a wide heterogeneity in how the different countries' economies have reacted to the crisis: Spain was the worst performer within the EU, with a contraction of -18.5% in quarterly GDP, compared to -13.8% in France, -12.8% in Italy or -9.7% in Germany, while in countries such as Lithuania or Finland the decline in GDP was more contained, standing at -5.6% and -4.5% respectively. The severity of the health crisis, the weight within each country's economy of those sectors that were most affected by the restrictions implemented, the duration and intensity of the confinements, as well as the measures taken by the different governments are some of the factors that help explain these differences.



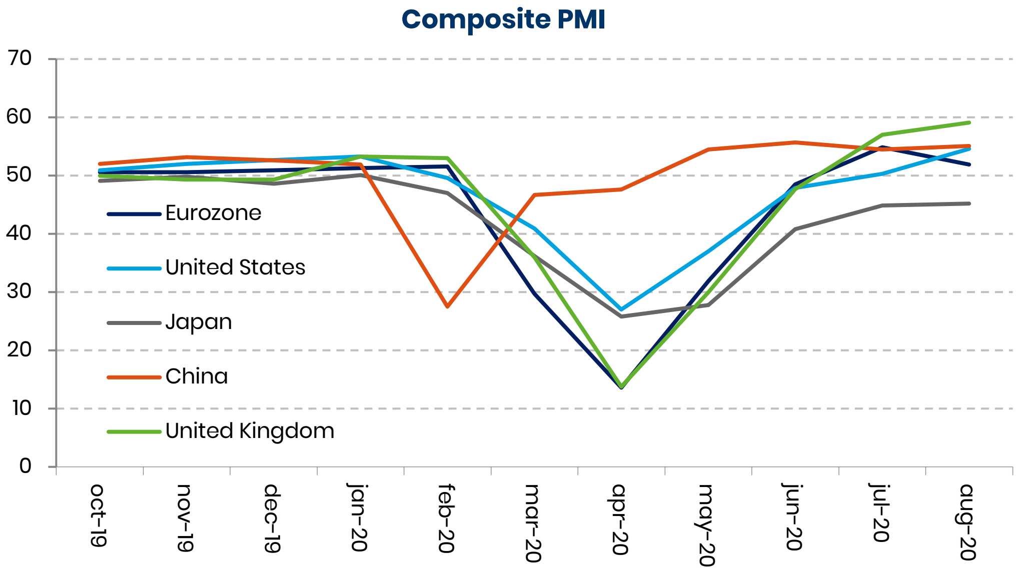
Source: Prepared-in-house based on data from the Ministry of Economic Affairs and Digital Transformation

The effects of the pandemic are also impacting the labour market, which is recording significant job losses. In the European Union, the worst performance, once again, corresponds to Spain, with a drop of -7.5% in the number of people employed in comparison to the previous quarter, vs. -2.9% in the Eurozone or -2.7% in the EU as a whole. Moreover, in terms of the number of hours worked, the results are even more substantial and in line with the activity drop, with a fall of -21.4% in Spain, almost double than the figure recorded in the Eurozone (-12.8%) or in the EU (-10.7%). In the United Kingdom, the fall in the number of hours worked (-18.4%) contrasts with the slight reduction in the number of workers(-0.7%), due to the fact that a large number of them have benefitted from the furlough measures implemented by their government.

There are also important differences between emerging economies. The ones that stand out the most are the declines of the GDP in India, a quarterly -24.8%, and Mexico, down -17.1%. In Brazil, the contraction of the economy was less intense, with a drop of -9.7%, and in Indonesia activity fell by -4.2%. Meanwhile, China, where the effects of the pandemic were felt earlier on, has already returned to positive growth rates, with an increase in GDP of 11.5% in Q2, after a fall of -10% in the first three months of the year.

For Q3, confidence indicators for July and August indicate that the recovery of the global economy continues to consolidate, after the lows seen in April. The global composite PMI indicator stood at 52.4 points in August, the highest level of the last year and a half, showing that global growth is strengthening as countries recover from the containment phase and restrictions are relaxed. In addition, this improvement is noticeable in the manufacturing as well as in the services sectors. The United Kingdom is showing the most dynamism, followed by Russia, China and the United States. Meanwhile, the Eurozone as a whole is seeing a more limited recovery. In August, it lost some momentum although it managed to stay above the 50 point-level that indicates activity growth, but there are still significant differences across countries. In contrast, Japan and India still show PMI levels that clearly place them in contractive territory.

With regard to the labour market, the indicators released also show that job destruction continues in most countries, although at a slower pace than in previous months. This is due to business expectations still being affected by the prevalence of the uncertainty on how the pandemic will evolve, a fact that is fuelled by the upsurge of new cases in several countries.



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

Meanwhile, the main central banks are still committed to their very expansive monetary policies, with low interest rates and asset purchases. The most noteworthy development is the change in the Federal Reserve's monetary policy, after having pointed out in its July meeting that the coronavirus pandemic would continue to be a drag for the economy. At the end of August, at the Jackson Hole meeting, it presented a new approach where the goal is no longer for inflation to be at 2%, but rather for average inflation to meet the 2% objective, thus being more tolerant if it goes over this 2% in the high phase of the cycle. With regard to employment, the Fed also pointed out that it will be less tolerant with underemployment situations. These announcements have been interpreted by the markets as meaning that rates will remain at low levels for longer, even if there is a certain rebound in inflation, since they will allow moderately higher levels than the 2% goal to compensate for the low CPI rates of recent years. In addition, the US currency has experienced a progressive depreciation, from 1.12 dollars per euro in June to around 1.18 dollars per euro in August.

Brent crude oil stood at $45.4/barrel in August, 3.3% more than in July, favoured by the weakness of the dollar and the strength of the Chinese economy. In year-on-year terms, the price is 23.1% lower than a year ago. For the coming months, concerns about the strength of the global economy's recovery and uncertainty about how the COVID-19 pandemic might evolve lead to the price of futures currently oscillating around $45/barrel.

The Spanish Economy

Partial recovery this summer; significant uncertainty ahead of the autumn

After the historic GDP drop in Q2 of 2020 (-18.5% quarter-on-quarter and -22.1% year-on-year), the Spanish economy has seen some recovery throughout Q3, albeit it has been partial (far from pre-crisis levels), uneven (with large differences between sectors) and gradual (slower than expected). Our estimates point to a quarterly GDP increase of between 12% and 15% for the July-September period.

This forecast for Q3 is compatible with an annual GDP growth of -11.5% for 2020, provided that the recovery continues in Q4, even though it will probably record a more modest growth rate than in Q3. It is clear that the environment of uncertainty in which the Spanish economy is immersed will be a factor to take into account for the coming months, not just internally, in terms of how the pandemic may evolve and what impact it may have on the economy, but also in terms of what events take place outside our borders. This crisis has been global and there are still many open fronts, such as the Brexit negotiations, the strength of the recovery worldwide or the evolution of the financial markets.

Looking ahead to 2021, the preparation of the General State Budget is of particular interest, given the deteriorated state of the public finances (the public deficit could be around -12.5% of GDP), the European Recovery Plan, and the combination of both. With respect to the European fund, Spain is bound to receive a total of around €140 billion, of which €72.7 billion will be in the form of aids and the rest through loans. These funds are of vital importance for achieving a more resilient and competitive economy, provided that investment is oriented towards those projects that contribute to obtaining sustained and sustainable growth in the medium and long term.

Demand and activity

Following the severe decline in Q2, the Spanish economy is starting to show some recovery

GDP figures for Q2 revealed the severe decline of the Spanish economy due to the impact of the COVID-19 crisis on activity and employment. The fall in GDP (-18.5% quarter-on-quarter) marks a historic high, although it should be noted that this is a one-off figure that reflects an atypical situation, and is, therefore, not comparable with other past crises. Moreover, the particularities of our production structure, paired with a backdrop of stronger confinement measures and restriction of activity, explain why Spain's activity decline has been greater than the one recorded in the surrounding countries: Euro Zone (-11.8%), Germany (-9.7%), France (-13.8%) or Italy (-12.8%).

The significant contraction in activity was a result of domestic demand as well as of the foreign sector, with the consumption of the Public Administrations having been the only exception. From the point of view of domestic demand, the decline in household consumption (-21.2% quarter-on-quarter) stands out. In addition, business investment behaved particularly badly (-22.3% quarter-on-quarter). With regard to the external sector, there was a strong drop in exports, mainly in the services sector, which has been greatly affected by the fall in tourist arrivals. Given this context, the recovery of confidence will be essential for the growth of activity and employment.

The first figures released for Q3 regarding confidence surveys show that the recovery started in June followed through into July, but suffered a new relapse in August, which could be related to the resurgence of cases during the summer and the tightening of measures in some municipalities or regions. Specifically, the economic sentiment indicator prepared by the European Commission for Spain reached 90.6 in July compared to 73.3 in April, although still far from 102.7 in February, but fell back slightly in August to 88.1. This is the case with most of the confidence indicators that make up this indicator, although expectations are improving faster in the industrial sector than in the remaining sectors. The consumer confidence indicator, which, in April, reached its lowest level since 2013, subsequently recorded a slight recovery that came to a halt in August. A similar evolution is seen in retail trade confidence, in line with the retail sales figures which, following a -31.6% drop in April, saw the intensity of the fall progressively curb the following months to stand at -3.7% in July.

The recovery is being very heterogeneous across the different sectors

All sectors reduced their activity intensely during Q2 due to the mandatory confinement, according to data published by the National Accounts, except for agriculture (including the food chain) and financial and insurance activities. In Q3, with still partial information, recovery is proving very heterogeneous across sectors. Thus, while agriculture and industry are very close to reaching pre-crisis levels of activity, some areas of the service sector, especially those related to restaurants, leisure and tourism, are still far from recovering their prior levels and this is not expected to change during the autumn and winter months if the health outlook does not improve substantially. Thus, the PMI index for the manufacturing sector reached 53.5 points in July, a very positive figure, but in August it worsened slightly to 49.9. Similarly, the counterpart indicator for the service sector rebounded in July to 51.9 points, above the 50-point limit for two consecutive months. However, in August, this services-PMI fell again to 47.7 points due to the difficulties that some services are still experiencing, mainly tourism and hospitality-related services, whose activity has been greatly conditioned by the anti-Covid measures and by the restrictions to travel to Spain.

Thus, after a spring without tourists, resuming activity since the end of June has been slow and very gradual, basically driven by domestic demand. In addition, in August, the resurgence of cases led to new restrictions on travel to Spain on the part of the main countries that tourists come from (quarantines, previous certificates or tests or recommendations not to travel to Spanish destinations...), making expectations worse for the rest of the year. The effect of the pandemic on tourist activity is impacting the current account balance, which registered a surplus of €300 million in the first half of the year, 96.5% below the surplus of €8.6 billion in the same period of the previous year. This was mainly as a result of the lower surplus in tourism, which in the first six months stood at €4.8 billion, compared to €21.2 billion in the previous year.

The Labour Market

Employment is still below pre-crisis levels, despite the recent increase in the number of people registered with the Social Security

In Q2, the effects of the economic crisis in the labour market as a result of COVID-19 were very intense. According to the Labour Force Survey, in this period, when measures restricting mobility and paralyzing activity were most severe, the number of effective hours worked fell by -22.6% compared to Q1. In terms of people employed, the fall was significantly more moderate (with a quarter-on-quarter rate of -5.5%), given that the people under an ERTE-furlough (a Temporary Workforce Reduction Scheme) are considered as employed for statistical purposes. In fact, the number of employed people who actually worked in Q2 was 13.9 million, which means that 25% of the people employed did not work. The unprecedented fall in employment, by more than a million people in Q2, did not transfer to the number of people unemployed and the unemployment rate rose just nine tenths, to 15.3%.

In Q3, the number of people registered with the Social Security showed a gradual and very partial recovery of the labour market and, most importantly, very much conditioned by the ERTE-furlough schemes. Despite the increase in recent months, the current number of people registered is still far from the pre-crisis levels (-457,853 since February), which is also the case in year-on-year terms (-527,851, a -2.7% year-on-year rate in August). In addition, it is worth noting the number of people registered with the Social Security who are still under an ERTE-furlough, a total of 812,438 people at the end of August. This figure is down from almost 3.4 million at the end of April, although the fall in August was less pronounced than the one recorded in June and July. According to estimates from CEOE's Economic Department, in Q3, the number of people registered with the Social Security, excluding ERTE-furlough schemes, will increase by between 12% and 13%, figures that would be in line with the quarterly growth expected in the GDP for this period.

Inflation

CPI still stands at negative rates due to the slowdown in core inflation and the evolution of oil prices

In August, the annual rate for the Consumer Price Index (CPI) increased by a tenth to -0.5%, accumulating five months in negative territory. Inflation is slowing down its rate of decrease, due to the milder fall in energy products.

Meanwhile, core inflation continued along the deceleration path that began in July and fell two tenths to 0.4%, after a long period of stability at around 1%. An analysis of its components shows that they are following a clear downward trend. Thus, the prices in Services decreased by two tenths to 0.2%, after the notable fall recorded in July, the prices in Industrial Goods, excluding energy products, went down by one tenth to 0.3%, and Processed Foods, Drinks and Tobacco decreased by two tenths y-o-y to 1.2%

Unprocessed food prices, however, increased by four tenths of a percent to 3.5% and continue to be the most inflationary component of the basket.

The rate of decrease in energy prices continues to slowdown. Specifically, the year-on-year rate in August was -9.3%, almost a point and a half higher than the previous month (-10.7%). Brent crude oil stood at $45.4/barrel in August, 3.3% more than in July, which, in year-on-year terms, represents a fall of 23.1%. For the next few months, the price is expected to oscillate around $45/barrel, which means that energy will continue to exert downward pressure on inflation.

In the coming months, inflation will continue to register negative rates, although increasingly milder, and will be conditioned by the behaviour of oil prices and the fall in the demand for certain goods and services as a result of the coronavirus crisis. For 2020 as a whole, we anticipate an average CPI rate that will be slightly negative (-0.2%).

The Public Sector

Significant deterioration of public finances in 2020

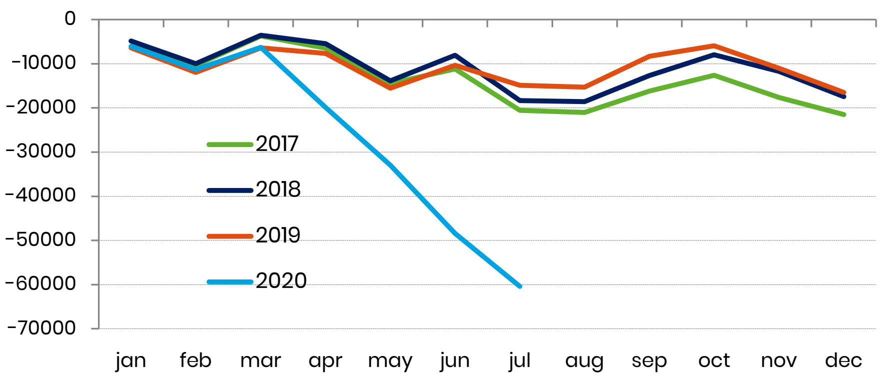
The deterioration of public finances in 2020 is severe. Presumably, there will be a record level of public debt (over 115% of GDP) and the public deficit could exceed -12% of GDP this year.

With aggregate data up to July, the State's public deficit already exceeds the figure reached by all the Public Administrations in 2019 (-2.8% of GDP). The State's deficit stood at €60.413 billion in July, representing -5.4% of GDP, due to the impact of COVID-19 on the public accounts. There has been, on the one hand, a notable fall in income due to the drop of activity and demand and, on the other hand, an increase in expenditure due to the measures adopted to mitigate the social, economic and employment-related effects of the pandemic.

Specifically, resources have decreased by -15.8% until July due to the general fall in the collection of taxes across all categories. The ones that stand out the most are, on the one hand, a -14.0% drop on production and imports taxes, including VAT, which fell by -16.4%, and on the other, current taxes on income and wealth (-25.8%). Capital taxes also fell (-78.5%), as did social contributions (-0.9%). In addition, spending increased by 21.4% up to July, largely due to the increase in transfers to the Social Security and the Autonomous Regions, with current transfers between Public Administrations having increased by 36%. Also noteworthy is the 20.1% increase in intermediate consumption, which includes the health and pharmacy benefit programs related to COVID-19.

With data for the first half of 2020, the total public deficit of the Public Administrations, excluding the Local Administrations, is equivalent to -6.12% of GDP, more than double the figure reached in the whole of 2019 by the Public Administrations as a whole (-2.8% of GDP).

State net borrowing (cumulative figures every year - EUR million)



Source: Ministry of Economic Affairs and Digital Transformation

Forecasts

Economic forecasts for Spain (last update: september 2020) — Annual rates of change, unless otherwise indicated	2015	2016	2017	2018	2019	2020	2021
GDP	3.8	3.0	2.9	2.4	2.0	-11.5	7.0
Private consumption expenditure	2.9	2.6	3.0	1.8	1.1	-13.4	7.0
Government consumption expenditure	2.0	1.0	1.0	1.9	2.3	4.3	1.0
Gross fixed capital formation	4.9	2.4	5.9	5.3	1.8	-18.8	12.6
-Tangible fixed assets	4.8	1.7	7.0	6.2	1.7	-21.8	14.8
Construction	1.5	1.6	5.9	6.6	0.9	-21.4	12.5
Equipment and cultivated assets	9.9	2.0	8.5	5.7	3.1	-22.3	18.5
-Intangible fixed assets	5.3	5.3	1.3	1.1	2.2	-4.3	4.0
Domestic demand (*)	3.9	2.0	3.0	2.6	1.5	-10.2	6.8
Exports	4.3	5.4	5.6	2.2	2.6	-24.7	7.5
Imports	5.1	2.7	6.6	3.3	1.2	-22.2	7.0
GDP current prices	4.4	3.4	4.3	3.5	3.6	-10.5	8.0
GDP deflator	0.6	0.3	1.4	1.1	1.6	1.0	1.0
CPI (average annual rate)	-0.5	-0.2	2.0	1.7	0.7	-0.2	0.9
CPI (dec/dec)	0.0	1.6	1.1	1.2	0.8	-0.2	1.1
Core CPI (average annual rate)	0.6	0.8	1.1	0.9	0.9	0.8	0.7
Employment (Quarterly National Accounts) (**)	3.2	2.8	2.8	2.5	2.3	-7.5	2.2
Employment (LFS)	3.0	2.7	2.6	2.7	2.3	-4.5	-1.1
Unemployment rate (LFS) (% of active population)	22.1	19.6	17.2	15.3	14.1	17.0	21.0
Productivity	0.6	0.2	0.0	-0.2	-0.3	-4.0	4.8
Compensation per employee	0.6	-0.6	0.7	1.0	2.0	3.0	1.0
Unit labour cost (ULC)	-0.1	-0.8	0.7	1.2	2.3	7.0	-3.7
Current Account Balance (% of GDP)	2.0	3.2	2.7	1.9	2.0	0.0	1.0
General government net lending (+) / net borrowing (-) (% of GDP) (***)	-5.1	-4.1	-3.0	-2.5	-2.8	-12.5	-7.0
Interest rates USA (dec)	0.50	0.75	1.50	2.50	1.75	0.25	0.25
Interest rates Eurozone (dec)	0.05	0.00	0.00	0.00	0.00	0.00	0.00
Brent Oil ($)	52.1	43.3	54.3	70.9	64.8	41.2	45.3

Source: CEOE, INE, Banco de España, Eurostat

(*) Contribution to GDP growth

(**) Full-time equivalent jobs

(***) Excluding aid to the financial sector