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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

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CaixaBank Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
March 2023

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Growth of the Spanish economy: quantity and quality?

To take the pulse of the economy, we usually look at GDP growth. From this perspective, the latest dynamics in the Spanish economy are turning out to be somewhat better than expected. Furthermore, if we expand the perspective to cover the last few decades and look at how Spain's economy has evolved compared with the biggest European economies, the message is also a positive one. However, an analysis of the factors that have driven growth offers a more nuanced view of this apparent strong performance.

Let us put some figures to these claims. The Spanish economy ended 2022 with a growth rate of 5.5%. This is a significant rate and very similar to what was envisaged at the beginning of last year, prior to the outbreak of the war in Ukraine. It is also well above the expectations of mid-2022, when it was feared that the impact of the conflict could be substantial. Thus, for the time being, the Spanish economy is managing to evade the impact of the energy crisis better than the major European countries. Those countries ended last year with growth rates between 1.5 and 2.5 pps lower than that recorded in Spain. In any case, it should also be noted that part of this difference is due to the greater cyclical momentum of the Spanish economy, as it is still recovering the ground lost during the pandemic.

Spain's advantage over the main European countries also continues to apply if we take a longer reference period into account. For instance, since the year 2000 the Spanish economy has grown at an average rate of 1.6%, well above that of Germany or France (specifically, 0.4 and 0.3 pps higher, respectively). As for Italy, the advantage in terms of growth is even greater, at 1.2 pps. These are not insignificant figures, especially when maintained for so long.

However, the factors on which the growth is supported are just as important, if not more so. In other words, quality is just as or more important than quantity. In the case of the Spanish economy, GDP growth has been accompanied by a significant increase in the population. Specifically, since 2000, the country's population has grown at an average rate of 0.7% per year. The populations of Germany, France and Italy, in contrast, have grown at an average annual rate of just 0.1%, 0.5% and 0.2%, respectively.

Thus, Spain's GDP per capita in 2022 was 14% higher than it was in 2000, but it should be noted that the bulk of the progress was concentrated in the years prior to the financial and real estate crisis. In fact, it was only last year that the GDP per capita previously reached in 2007 was recovered.

Germany stands out in terms of GDP per capita growth, substantially widening the gap versus Spain over the last two decades. Although Germany's GDP growth is lower than Spain's, it is supported by higher productivity growth. This more solid base is what ultimately allows for a bigger improvement in the quality of life of the population as a whole. In France, the increase in GDP per capita since 2000 has been similar to that of Spain. On the other hand, the Italian economy is at the opposite end of the spectrum: it has been stagnant for two decades, with virtually no growth either in absolute terms or relative to its population. Thus, Italy's GDP per capita in 2022 was very similar to where it stood in the year 2000.

The path an economy takes is not written; rather, it depends on the public policies that are implemented and on the entrepreneurial and innovative capacity of its population. Relative to the major European countries, the Spanish economy lies somewhere in the middle. It could have taken a worse path, but also a much better one.

Oriol Aspachs
March 2023

Chronology

JANUARY 2023

1 Croatia joins the euro area and the Schengen Area.
8 China reopens its borders to foreign travellers after three years.

FEBRUARY 2023

1 The Fed raises rates by 25 bps up to the 4.50%-4.75% range.
2 The ECB raises rates by 50 bps, placing the depo rate at 2.50% and the refi rate at 3.00%.
6 A magnitude 7.8 earthquake strikes Türkiye and Syria, with the highest death toll since 2010 and the fifth highest this century.

NOVEMBER 2022

2 The Fed raises official interest rates by 75 bps.
15 The world's population reaches 8 billion people.

DECEMBER 2022

14 The Fed raises official interest rates by 50 bps.
15 The ECB raises official interest rates by 50 bps and announces that it will reduce reinvestments under the APP.

SEPTEMBER 2022

8 Queen Elizabeth II dies after a 70-year reign.
16 The death of Mahsa Amini sparks a wave of mass protests in Iran.
27 Sabotage on the Nord Stream 1 and 2 gas pipelines.
30 The European Council approves measures to reduce energy demand.

OCTOBER 2022

5 OPEC agrees to cut crude oil production by 2 million barrels a day compared to August 2022 levels.
23 Xi Jinping receives a third term as general secretary of the Chinese Communist Party.
27 The ECB raises official interest rates by 75 bps.

Agenda

MARCH 2023

2 Spain: registration with Social Security and registered unemployment (February).
Euro area: CPI flash estimate (February).
10 Portugal: S&P rating.
16 Spain: quarterly labour cost survey (Q4).
Portugal: industrial production prices (February).
Governing Council of the European Central Bank meeting.
17 Spain: S&P rating.
21-22 Federal Open Market Committee meeting.
22 Portugal: home prices (Q4).
23 Spain: loans, deposits and NPL ratio (Q4).
23-24 European Council meeting.
24 Spain: Q4 GDP (2nd estimate).
Spain: balance of payments and NIIP (Q4).
Portugal: general government key figures (2022).
30 Spain: CPI flash estimate (March).
Euro area: economic sentiment index (March).
Portugal: NPL ratio.
31 Spain: household savings rate (Q4).
Spain: state budget execution (February).
Portugal: CPI flash estimate (March).

APRIL 2023

3 Portugal: industrial production (February).
4 Spain: registration with Social Security and registered unemployment (March).
12 Spain: financial accounts (Q4).
Portugal: services sector turnover (February).
14 China: GDP (Q1).
24 Spain: loans, deposits and NPL ratio (February).
27 Spain: labour force survey (Q1).
Portugal: business and consumer confidence indicator (April).
Euro area: economic sentiment index (April).
US: GDP (Q1).
28 Spain: GDP flash estimate (Q1).
Spain: CPI flash estimate (April).
Spain: state budget execution (March).
Euro area: GDP (Q1).
Portugal: GDP flash estimate (Q1).
Portugal: CPI flash estimate (April).

From soft landing to no landing: interest rates higher for longer

On the catwalk of trendy economic jargon, the latest buzzword that has gained popularity in recent weeks is «higher for longer», referring to interest rates. This is a reflection of the string of positive surprises in the economic activity data, as well as the resistance to downward movements which key components of the consumer price index basket, such as food or services, continue to show. With the threat of recession diluted in the short term in the strength of the labour market, concerns are once again focused on inflation, and the financial markets are now anticipating further official rate hikes up to the 4% mark in the euro area and up to 5.5% in the US. The additional 75 bps relative to the terminal rate anticipated at the beginning of the year have had an immediate impact across the entire yield curve. This is particularly the case in the shorter sections, with the yield on 2-year bonds in the US and Germany climbing to a 15-year high.

Thus, the umpteenth change in the economic narrative in recent months – this time going from soft landing to no landing – appears to work in favour of the central banks' intention to stay on the current course, to continue to raise rates and, once the peak is reached, to remain in restrictive territory for longer than previously expected. The negative effects of this new round of monetary tightening on growth can be expected to be felt next winter, as the steepening of the downward slopes of the yield curves on both sides of the Atlantic appear to be anticipating. In other words, we have saved match point in the energy sphere, but the game is still at stake, given the complexity of assessing the potential effects of the sharpest monetary tightening cycle in the last four decades on a world that has not ceased to accumulate debt.

According to data from the IIF, despite the slight decline in 2022 (4 trillion dollars), total global debt stands at 299 trillion dollars (338% of GDP), doubling the levels of 2006 in nominal terms (+50 pps as a percentage of GDP). In addition to the well-known high leverage of Chinese firms (160% of GDP), the group that is most vulnerable to this latest tightening of the monetary environment is emerging countries. They are vulnerable both because of the increase in their total debt since the beginning of the pandemic (+20 trillion, bringing the sum to 95 trillion dollars) and due to the high volume of maturities falling due in 2023 (7 trillion dollars), just at a time when the dollar is appreciating against the major currencies. Let us remember that, since 2020, three emerging countries (Zambia, Sri Lanka and Ghana) have defaulted on their debts.

The truth is that in a world as complex as today's, with different shocks interacting at the same time, it is difficult to gauge the effects of the interest rate hikes on economic activity and inflation, taking into account the variety of distortions that are affecting the monetary policy transmission channels. The exercises recently published by the ECB show significant dispersion in their conclusions, depending on the model selected to assess the impact. The average result of all the estimates is that for every 100-bp rise in interest rates, growth would be reduced by 0.7 pps and inflation by 3 pps. Taking into account that by the end of the journey the cumulative rise will amount to between 400 and 450 bps, the price to be paid in terms of growth in order to try and bring inflation back to the target rate will be significant.

Therefore, the central banks are navigating this most complex of times with little certainty about what effects their decisions will have, while also having to show a high degree of flexibility in the event of possible surprises along the way. Above all, it is unclear whether the issue we are really facing could be a structural insufficiency of supply, as a result of a decade and a half of low levels of public and private investment and the changes that are beginning to emerge in the labour market in OECD countries (retirement of baby boomers, smaller cohorts of young workers, and quiet quitting). This would limit their ability to correct the current «sticky» inflation (another buzzword referring to the inertia in prices) through demand-side policies. In any case, as background currents such as the energy transition (or deglobalisation) gradually settle, in the short term we will have to get used to a world with higher interest rates. For now, the implicit 10-year rates of the deposit facility in Europe are at an average of around 3%, well above the levels we have lived with in the last decade and which we considered neutral up until a couple of quarters ago. This is a major shift, and its effects are not to be underestimated.

José Ramón Díez

Average for the last month in the period, unless otherwise specified

Financial markets

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
INTEREST RATES							
Dollar							
Fed funds (upper limit)	3.43	0.81	0.25	0.25	4.50	5.00	3.75
3-month Libor	3.62	1.01	0.23	0.21	4.74	4.75	3.50
12-month Libor	3.86	1.48	0.34	0.52	5.47	4.50	3.50
2-year government bonds	3.70	1.04	0.13	0.62	4.41	4.00	2.80
10-year government bonds	4.70	2.57	0.93	1.45	3.62	3.20	2.80
Euro							
ECB depo	2.05	0.20	–0.50	–0.50	1.77	3.50	2.50
ECB refi	3.05	0.75	0.00	0.00	2.27	4.00	3.00
€STR	–	–0.54	–0.56	–0.58	1.57	3.41	2.48
1-month Euribor	3.18	0.50	–0.56	–0.60	1.72	3.36	2.42
3-month Euribor	3.24	0.65	–0.54	–0.58	2.06	3.31	2.35
6-month Euribor	3.29	0.78	–0.52	–0.55	2.56	3.38	2.46
12-month Euribor	3.40	0.96	–0.50	–0.50	3.02	3.44	2.56
Germany							
2-year government bonds	3.41	0.35	–0.73	–0.69	2.37	3.20	2.50
10-year government bonds	4.31	1.54	–0.57	–0.31	2.13	3.00	2.80
Spain							
3-year government bonds	3.62	1.69	–0.57	–0.45	2.66	3.23	2.93
5-year government bonds	3.91	2.19	–0.41	–0.25	2.73	3.38	3.15
10-year government bonds	4.42	3.17	0.05	0.42	3.18	4.10	3.80
Risk premium	11	164	62	73	105	110	100
Portugal							
3-year government bonds	3.68	3.33	–0.61	–0.64	2.45	3.46	3.20
5-year government bonds	3.96	3.94	–0.45	–0.35	2.53	3.57	3.38
10-year government bonds	4.49	4.68	0.02	0.34	3.10	4.05	3.80
Risk premium	19	314	60	65	97	105	100
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.26	1.22	1.13	1.06	1.10	1.15
EUR/GBP (pounds per euro)	0.66	0.84	0.90	0.85	0.87	0.86	0.85
OIL PRICE							
Brent ($/barrel)	42.3	80.1	50.2	74.8	81.3	93.0	80.0
Brent (euros/barrel)	36.4	62.5	41.3	66.2	76.8	85.1	69.8

Forecasts

Change in the average for the year versus the prior year average (%), unless otherwise indicated

International economy

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
GDP GROWTH							
Global	4.5	3.3	–3.0	6.0	3.1	2.7	3.4
Developed countries	*2.6*	*1.4*	*–4.4*	*5.2*	*2.6*	*1.0*	*1.7*
United States	2.7	1.7	–2.8	5.9	2.1	0.9	1.4
Euro area	2.2	0.8	–6.3	5.3	3.5	0.5	1.6
Germany	1.6	1.2	–4.1	2.6	1.9	0.0	1.4
France	2.2	1.0	–7.9	6.8	2.6	0.3	1.4
Italy	1.5	–0.3	–9.1	6.7	3.9	0.5	1.1
Portugal	1.5	0.5	–8.3	5.5	6.7	1.0	2.1
Spain	3.7	0.6	–11.3	5.5	5.5	1.3	1.9
Japan	1.4	0.4	–4.3	2.3	1.1	1.3	1.1
United Kingdom	2.6	1.3	–11.0	7.6	4.0	–1.7	–0.9
Emerging and developing countries	*6.5*	*4.9*	*–1.9*	*6.6*	*3.5*	*3.9*	*4.5*
China	10.6	8.0	2.2	8.4	3.0	5.2	5.1
India	7.2	6.8	–6.7	9.0	7.3	6.0	6.7
Brazil	3.6	1.6	–3.3	5.0	2.9	0.9	1.8
Mexico	2.4	1.9	–8.0	4.7	3.1	1.4	2.5
Russia	7.2	1.3	–2.7	4.8	–2.1	–3.2	3.0
Türkiye	5.5	4.5	1.9	11.4	5.6	3.0	3.2
Poland	4.2	3.7	–2.0	6.9	4.9	0.7	3.2
INFLATION							
Global	4.1	3.7	3.2	4.7	8.6	6.0	4.1
Developed countries	*2.1*	*1.6*	*0.7*	*3.1*	*7.2*	*4.0*	*2.0*
United States	2.8	1.8	1.2	4.7	8.0	4.1	2.7
Euro area	2.2	1.4	0.3	2.6	8.4	5.3	2.7
Germany	1.7	1.4	0.4	3.2	8.6	5.9	3.0
France	1.9	1.3	0.5	2.1	5.9	4.3	2.6
Italy	2.4	1.4	–0.1	1.9	8.7	5.9	2.6
Portugal	3.1	1.1	0.0	1.3	7.8	5.5	2.8
Spain	3.2	1.3	–0.3	3.1	8.4	4.2	2.6
Japan	–0.3	0.4	0.0	–0.2	2.5	2.5	1.5
United Kingdom	1.6	2.3	0.9	2.6	9.0	5.7	2.9
Emerging countries	*6.7*	*5.6*	*5.1*	*5.9*	*9.7*	*7.4*	*5.6*
China	1.7	2.6	2.5	0.9	2.0	1.5	1.6
India	4.5	7.3	6.6	5.1	6.7	5.3	5.0
Brazil	7.3	5.7	3.2	8.3	9.3	5.1	4.0
Mexico	5.2	4.2	3.4	5.7	7.9	4.7	3.8
Russia	14.2	7.9	3.4	6.7	13.8	7.5	6.8
Türkiye	22.6	9.6	12.3	19.6	72.3	36.4	29.0
Poland	3.5	1.9	3.7	5.2	14.9	7.0	3.7

Forecasts

Change in the average for the year versus the prior year average (%), unless otherwise indicated

Spanish economy

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
Macroeconomic aggregates							
Household consumption	3.6	0.0	–12.4	6.0	4.4	0.7	2.3
Government consumption	5.0	1.1	3.5	2.9	–0.9	2.1	0.5
Gross fixed capital formation	5.6	–1.4	–9.7	0.9	4.3	–1.8	2.6
Capital goods	4.9	0.1	–13.3	6.3	3.8	–4.6	3.4
Construction	5.7	–2.9	–10.2	–3.7	4.2	–0.5	2.2
Domestic demand (vs. GDP Δ)	5.8	–0.3	7.6	6.5	2.6	1.0	1.9
Exports of goods and services	4.7	2.9	–19.9	14.4	14.9	1.1	2.0
Imports of goods and services	7.0	0.2	–14.9	13.9	7.7	–0.6	2.0
Gross domestic product	**3.7**	**0.6**	**–11.3**	**5.5**	**5.5**	**1.3**	**1.9**
Other variables							
Employment	3.2	–0.4	–6.8	6.6	3.8	1.1	1.4
Unemployment rate (% of labour force)	10.5	19.5	15.5	14.8	12.9	12.8	12.4
Consumer price index	3.2	1.3	–0.3	3.1	8.4	4.2	2.6
Unit labour costs	3.0	0.6	7.7	0.3	0.4	3.5	2.4
Current account balance (% GDP)	–5.9	–0.3	0.6	1.0	0.9	0.3	1.0
External funding capacity/needs (% GDP)	–5.2	0.1	1.1	1.9	1.5	1.5	2.0
Fiscal balance (% GDP)[1]	0.4	–6.5	–10.3	–6.9	–4.0	–4.0	–3.3

Note: *1. Excludes losses for assistance provided to financial institutions.*

Forecasts

Portuguese economy

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
Macroeconomic aggregates							
Household consumption	1.7	0.5	–7.0	4.7	5.7	0.9	0.9
Government consumption	2.3	–0.3	0.3	4.6	2.4	1.0	1.0
Gross fixed capital formation	–0.4	–0.7	–2.2	8.7	2.7	2.5	8.2
Capital goods	3.2	2.6	–5.4	13.9	–	–	–
Construction	–1.5	–2.6	1.0	5.5	–	–	–
Domestic demand (vs. GDP Δ)	1.3	0.1	–5.3	5.8	4.7	1.1	2.3
Exports of goods and services	5.3	4.0	–18.6	13.4	16.7	4.3	6.1
Imports of goods and services	3.6	2.7	–11.8	13.2	11.0	4.5	6.3
Gross domestic product	**1.5**	**0.5**	**–8.3**	**5.5**	**6.7**	**1.0**	**2.1**
Other variables							
Employment	0.4	–0.5	–1.9	2.7	2.0	0.1	0.4
Unemployment rate (% of labour force)	6.1	11.4	7.0	6.6	6.0	6.4	6.1
Consumer price index	3.1	1.1	0.0	1.3	7.8	5.5	2.8
Current account balance (% GDP)	–9.2	–2.9	–1.2	–1.1	–1.4	–1.0	–0.3
External funding capacity/needs (% GDP)	–7.7	–1.6	0.1	0.6	–0.5	1.3	1.6
Fiscal balance (% GDP)	–4.6	–5.1	–5.8	–2.9	–1.1	–0.9	–0.8

Forecasts

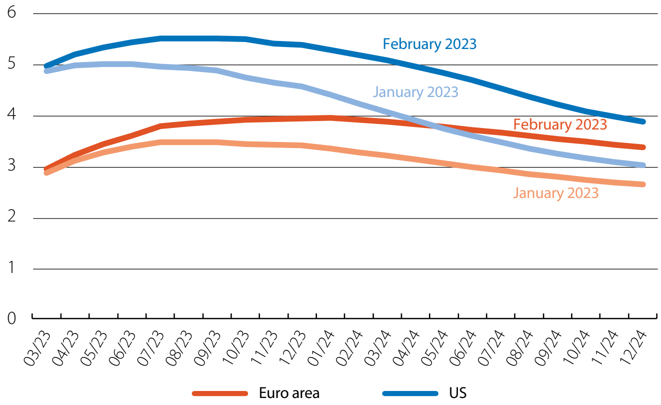
The markets anticipate further interest rate hikes

The strength of the economic data stirs the debate over whether there will be a hard or a soft landing. After a buoyant and upbeat January, the financial markets resumed the tone of volatility and reduced risk appetite throughout February, in a context in which positive surprises in the economic data failed to translate into good news for risky assets. Investors thus interpreted the strength in the macro indicators as fuel for inflation, which in turn would justify a more restrictive monetary policy on the part of the central banks. Thus, the debate on whether the global economy is facing a hard or a soft landing was overshadowed by the possibility of no landing at all, that is, a situation in which, despite the headwinds, global economic activity and inflation show resistance to moderating. In the financial markets, this change in tone resulted in a notable revision in investors' expectations regarding the future path of official interest rates, which led to further tightening of financial conditions around the world and truncated the gains that had been registered in fixed-income assets, equities and emerging currencies.

Higher rates and for longer. The publication in February of better-than-expected economic activity and employment data, both in the euro area and especially in the US, highlighted the blocs' economic resilience at the beginning of the year despite the tightening of financial conditions. However, the optimism, which had brushed aside the threats of economic recession, soon faded as it became apparent that this buoyancy was accompanied by the persistence of inflationary tensions. This situation triggered a restrictive bias in the discourse of the members of the Fed and the ECB. The shift was particularly pronounced in the case of the US monetary authority, going from Jerome Powell's comment on the beginning of the disinflation process at the start of February, to ending the month with most members indicating the need to raise reference rates more quickly and for longer in order to curb the price rally. Meanwhile, the ECB expressed its intention to raise interest rates by another 50 bps in March (to 3.00%), as it anticipated at its last meeting, and left the door open for further increases in the coming months. Investors, meanwhile, quickly revised upwards their expectations regarding the short- and medium-term monetary scenario, having previously anticipated the end of the cycle of interest rate hikes sometime around the summer. Thus, the money markets reflected expectations that Fed rates would peak at 5.50% before the summer and that ECB rates would do so in the autumn at around 4.00%, pushing back the prospect of any downward adjustments well into 2024 in both cases.

Expectations for Fed and ECB reference interest rates

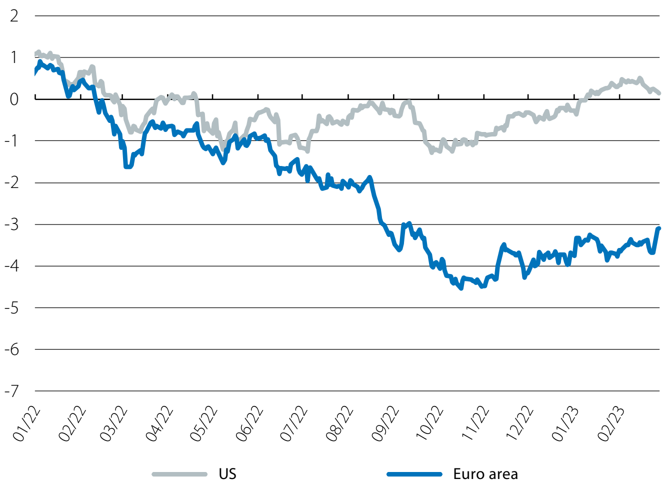
(%)



Note: *Forwards on the EFFR and the OIS of the euro area derived with the NSS model using market yield curves.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Financial conditions

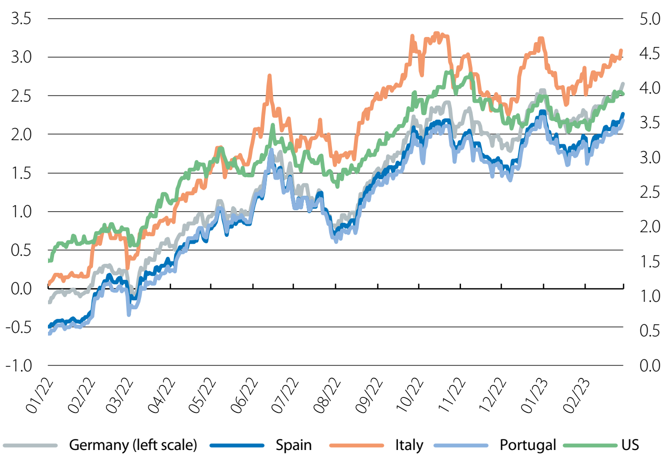
Index (0 = historical average)



Note: *A positive value indicates accommodative conditions, while a negative value indicates more restrictive financial conditions. The historical average benchmark corresponds to the period 1994-2008.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Interest rates on 10-year sovereign debt

(%) *(%)*



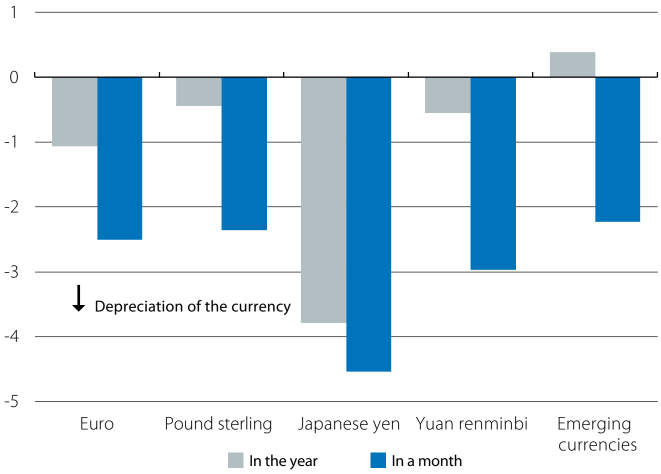
Note: *US, Spain, Italy and Portugal (right scale).*
Source: *CaixaBank Research, based on data from Bloomberg.*

Sovereign debt yields spike. Within this new episode of volatility, the shift in the markets towards a scenario in which interest rates are expected to remain at restrictive levels for longer was reflected in the rise in interest rates throughout the sovereign yield curves on both sides of the Atlantic. In the US, the 2-year rate reached 4.8%, its highest level in 15 years, while the yield on 10-year treasuries ended up at the 4% mark. The euro area saw a similar movement in its yield curves, with the yield on the 10-year *bund* reaching 2.65%, its highest level since 2011. In both cases, the movements in the short section of the curve were more pronounced than in the long section. Despite the rise in yields, risk premiums in the peripheral countries remained favourable, with the Spanish spread remaining below 100 bps. On the other hand, the dollar capitalised on the upward shift in the US yield curve, as well as the increase in volatility in the money markets, appreciating against other major currencies. In particular, against the euro it appreciated around 3% in the month, although this trend could be reversed over the coming quarters (see the Focus «On the round trip movement of the (king) dollar» in this same report).

The price of energy products drops. The price of Brent oil closed February slightly down (–0.7% monthly), making it the fourth consecutive month of declines. Its price was affected by the increase in inventories in the US and by fears that the tightening of US monetary policy could cool global demand. However, the incipient improvement in the economic activity data in China and the scant prospect of an increase in supply from OPEC offset the downward pressures on oil. Similarly, the price of European natural gas (the Dutch TTF benchmark) fell by 19% in February, accumulating an 86% decline since the peaks of last August (although it is still 250% above its pre-crisis average). The price was below €50/MWh thanks to the high level of gas reserves in the EU, the surge in imports of liquefied natural gas and the mild weather.

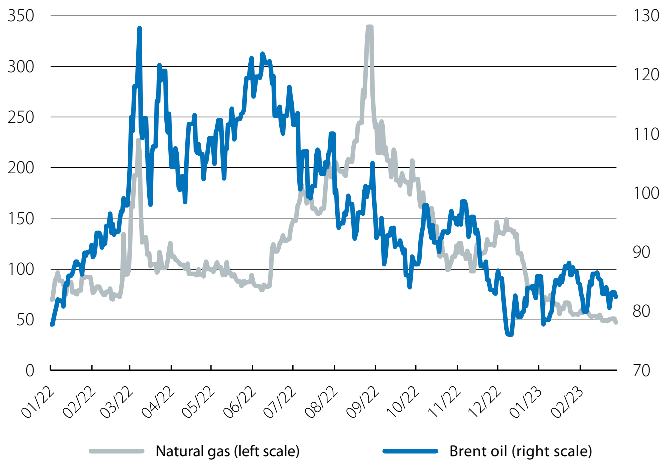
The shift in interest rate expectations reins in the stock market rally. The prospect of a scenario with higher interest rates for longer put a damper on investor sentiment regarding the state of the business cycle. This was particularly noticeable in the performance of the US stock indices, which ended the month down by more than 2%. The European indices performed somewhat better (Eurostoxx 50 +2%), especially the IBEX 35 which registered the highest gains (+4%), favoured by the composition of the indices and specifically the greater presence of sectors with a defensive bias compared to in the US. In emerging markets, on the other hand, price movements were dominated by profit-taking, with setbacks approaching 20% in year-on-year terms in view of the continued restrictive financial environment worldwide.

Currencies against the dollar
(%)



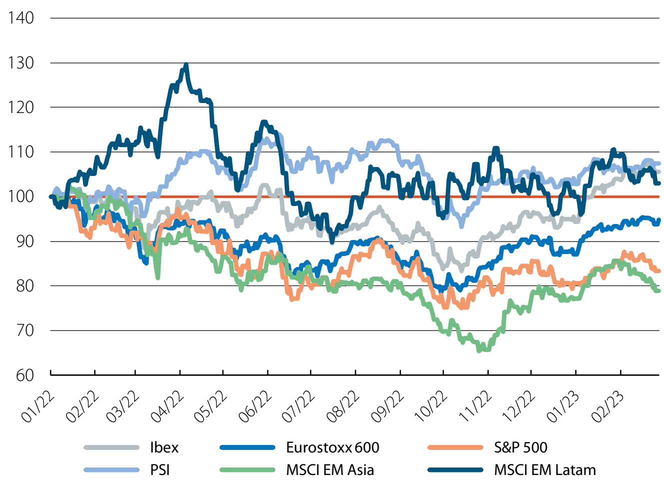
Source: *CaixaBank Research, based on data from Bloomberg.*

Oil and gas prices
(€/MWh) *($/barrel)*



Note: *The natural gas price corresponds to the Dutch TTF.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Main international stock markets
Index (100 = January 2022)



Source: *CaixaBank Research, based on data from Bloomberg.*

On the round trip movement of the (king) dollar

In a year of widespread losses in the financial markets, if there is any asset that stood out for its positive performance during much of 2022, it was the US dollar. Its appreciation, in effective nominal terms, amounted to 16% in the first nine months of the year, marking the biggest advance since 2015 when the Federal Reserve ceased net bond purchases following the stormy taper tantrum episode.

The strength of the dollar last year was particularly pronounced against the euro. It closed below parity with the European single currency in 46 sessions of the year, reaching a low of 0.959 at the end of September, the lowest level since the euro's introduction two decades ago.

However, more than this appreciation, perhaps what has surprised analysts the most is how quickly it has reversed. Between the end of September and the end of February, the dollar depreciated by 6% in effective nominal terms and by 10% against the euro, trading at close to 1.07, a level not seen for almost a year.

Given how sharp this movement has been, in this Focus we explore what lay behind the change in trend and to what extent it could continue.

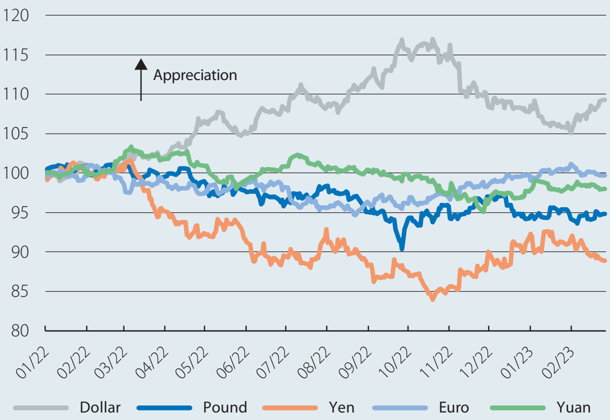
A green safe haven in a financial storm

To answer these questions, we begin by analysing the factors behind the appreciation of the dollar up until October 2022.

Firstly, we highlight the demand for the dollar as a safe-haven asset. In a year overshadowed by the final throes of the pandemic, and above all by Russia's invasion of Ukraine, it is no surprise that investors, as is typical during episodes of uncertainty and volatility, opted to hedge some of the risk by increasing their «long» positions in the US currency (i.e. buying assets denominated in dollars). This factor is particularly relevant in the current context of inflationary tensions, disruptions in the commodity markets and, in particular, uncertainty regarding the energy supply.

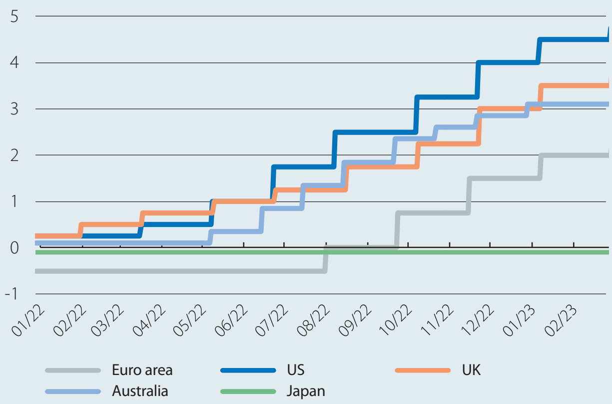
On this latter point, the terms of external trade improved in the US, which is a net exporter of energy, compared to other major economic blocs, especially the EU. In fact, according to data from the balance of payments, the euro area closed 2022 with a negative current account balance (–0.8% of GDP versus +2.3% in 2021), making it the first year with an external deficit since 2011, at the height of the sovereign debt crisis. These factors exerted downward pressure on the euro's exchange rate with the dollar.

Currencies: nominal effective exchange rates
Index (100 = January 2022)



Source: *CaixaBank Research, based on data from Bloomberg and the Bank for International Settlements.*

Official interest rates of major central banks
(%)



Source: *CaixaBank Research, based on data from Bloomberg.*

The US Federal Reserve, meanwhile, has been at the forefront of the monetary tightening process among advanced economies, with cumulative official rate rises of 450 bps and with the onset of quantitative tightening even before this summer. This decisive response widened the gap between US interest rates and those of other economic blocs, both in the money markets and in the sovereign debt markets, which favoured capital inflows into this country (see second chart).

Finally, the economic recovery in the US in the post-pandemic period has been faster and stronger than in other developed countries, due to the vast rounds of fiscal stimulus approved in recent years. In the euro area, by contrast, the strong growth in 2022 as a whole reflects, on the one hand, the rebound associated with the reopening process in the first half of the year, but also, on the other hand, the slowdown and virtual stagnation seen in the second half of the year, which was dominated by the energy crisis.

Euro/dollar exchange rate: a return to equilibrium?

Generally speaking, while still tangibly on the table, many of these factors have lost steam since November. Despite the extension of the war in Ukraine, the energy markets have stabilised, and with it the improvement in the terms of trade in the US has faded. Symmetrically, the terms of trade and the economic outlook for Europe have improved. The Fed, meanwhile, appears to be signalling that the end of monetary tightening is approaching, whereas for the ECB this seems like a somewhat more distant prospect.

Taken together, these factors help us to understand the unwinding of the dollar's rally, beginning in the autumn, particularly against the euro, which has recovered almost all of the ground lost since May last year, despite the volatility of recent weeks. Nevertheless, the single currency closed February still trading at historically low levels against the dollar, 6% below the average of the previous five years and 12% below the average of the last two decades. This suggests that, at least *a priori*, the trend of the last few months may still have some way to go.

Indeed, according to conventional econometric models, the euro/dollar (EUR/USD) exchange rate still lies below most estimates of the so-called «equilibrium» exchange rate. These estimates involve trying to determine the exchange rate of two economies based on their macroeconomic fundamentals, including both those which measure internal imbalances (related to potential growth, its components and its relationship with the business cycle) and those measuring external imbalances (such as the current account deficit or the international investment position), as well as variables which measure the gap in benchmark interest rates.[1]

According to some estimates, for example, the EUR/USD equilibrium exchange rate could lie at around 1.20, that is, around 10% higher than the rate at the end of February.[2] On the other hand, estimates based on the purchasing power parity (PPP) theory result in an exchange rate of between 1.20 (using the Big Mac index) and 1.30 (using the CPI).[3]

Despite the gap with the current EUR/USD rate, what is clear is that a hypothetical return to these equilibrium levels is unlikely to occur without volatility or periods with new ups and downs, fluctuations that are linked to a set of cyclical, contextual and structural factors. At CaixaBank Research, our baseline scenario projects that the euro is likely to appreciate against the dollar in the coming quarters, albeit very moderately, reaching 1.10 by the end of the year. In the medium term, we project that it could return to a level of around 1.25. The path we anticipate over the next two years is fairly in line with that expected by the consensus of analysts (1.11 in Q4 2023 and 1.14 in Q4 2024, according to Bloomberg).

Balance of risks

Our forecast scenario that the dollar could continue along a path of moderate depreciation in the medium term is based on a view of relative economic stability, with assumptions that (i) a recession in the world economy (both in the euro area and in the US) is avoided, (ii) inflation gradually returns to the 2% target rate, and (iii) central banks are able to bring the cycle of rate hikes to and end in the coming months and to begin bringing rates back down to neutral territory over the next year. Ultimately, this scenario depends on the central banks on both sides of the Atlantic being successful in their fight against inflation. Needless to say, the probability of these assumptions coming to fruition is closely tied to a set of imponderables linked to the impact of pre-existing shocks (e.g. greater persistence in the inflationary pressures or a larger effect of the monetary tightening process), as well as possible new unforeseen events (e.g. geopolitical conflicts, natural or health disasters, as well as other external factors, such as a possible change in the direction of monetary policy in Japan).

Antonio Montilla

1. The economic literature groups the equilibrium models of the real exchange rate into two main blocks: (i) estimates based on internal and external balances (fundamental equilibrium exchange rates, or FEER) and (ii) estimates based on a set of reduced general equilibrium equations (behavioural equilibrium exchange rates, or BEER). The more traditional approach of purchasing power parity, meanwhile, is based on the notion that, in the long run, a currency should be able to buy the same basket of goods and services in different places.
2. See William Cline (2017, 2018). «Estimates of Fundamental Equilibrium Exchange Rates». Peterson Institute for International Economics.

3. According to the IMF, the implicit exchange rate according to PPP theory is around 1.30 for the main euro area countries.

The appreciation of the dollar and American and European interest rates

Since the outbreak of the war in Ukraine and the intensification of inflationary pressures, US interest rates have risen steadily and significantly, galvanised by the Federal Reserve's rapid and aggressive monetary tightening policies. However, this does not necessarily mean that US bonds are more attractive than their European counterparts.

A key factor in the comparison is the exchange rate. Specifically, exchange rate movements between the moment when an investor sends capital abroad and when they repatriate that capital or the associated interest payments are another factor which determines the return on investment, in addition to being a source of uncertainty. In order to eliminate or «sterilise» the risk of exchange rate fluctuations, one possibility is to secure a future exchange rate at the same time that currencies are exchanged in the spot market.

As a result of the interest rate hikes in the US, in 2022 the dollar registered a significant appreciation. However, the appreciation was more intense in the spot market than it was in the futures market. The gap that opened up between the two implicitly generated an appreciation of the euro. For instance, at the beginning of 2022 the spot rate was 1.13 dollars per euro while the three-month future rate was 1.14, assigning the euro an implicit increase in value of 0.7%. In the autumn, however, the euro/dollar exchange rate fell below 1 in the spot market and was above parity in the futures market, so the implicit appreciation of the euro reached over 3%.

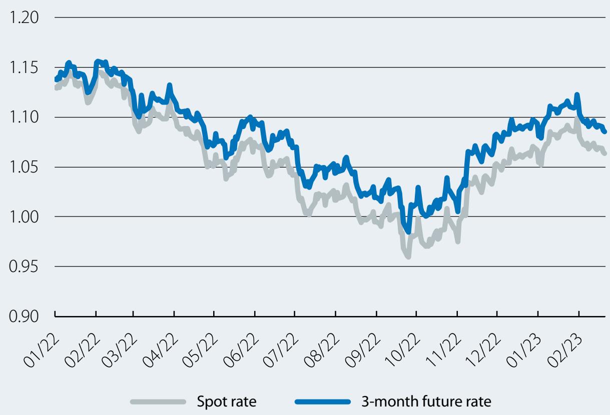
The opening up of this gap and the greater implicit appreciation of the euro tended to reduce the effective interest received by a European investor holding US bonds: for example, when the spot exchange rate was virtually 1 dollar per euro, a European investor could get 100 dollars in exchange for 100 euros; but as the future exchange rate was greater than 1, when exchanging those 100 dollars back into euros they would become less than 100 euros.

Looking at the overall picture, we are faced with two forces. On the one hand, rising US interest rates increased the appeal of the dollar. On the other hand, the exchange rate movements in 2022 gradually dampened this appeal factor.[1] To see which force was more dominant, in the second chart we compare the German sovereign interest rate with its US counterpart «sterilised» against foreign exchange risk.[2] This shows how, apparently, despite lower interest rates, German rates were found to be higher from the point of view of a European investor once the foreign exchange risk is factored in.

In short, the rise in US interest rates is a factor which causes the dollar to appreciate. However, the appreciation of the US currency in 2022 went well beyond this, reinforcing the view, as set out in this same report,[3] that the appreciation of the dollar was supported by other forces, such as its position as a safe-haven asset in a highly uncertain environment.

Euro-dollar exchange rate

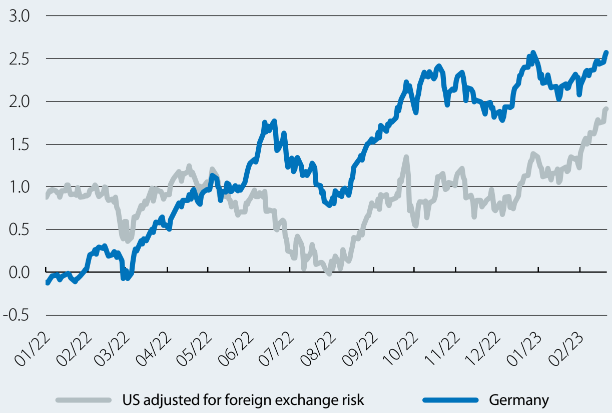
(Dollars per euro)



Source: *CaixaBank Research, based on data from Bloomberg.*

10-year sovereign interest rates

(%)



Source: *CaixaBank Research, based on data from Bloomberg.*

1. Assuming that investments are «sterilised» against foreign exchange risk. An investor choosing to assume this risk and opting to repatriate the interest income at the spot exchange rate, rather than securing a future exchange rate, would have benefited *ex post* due to the fact that the dollar steadily appreciated between January and October 2022.

2. The relationship between the domestic interest rate and a foreign interest rate adjusted for the foreign exchange risk between the foreign and domestic currencies is known as Covered Interest Parity (CIP). See the Focus «Why do similar assets have differing yields?» in the MR03/2019.
3. See the Focus «On the round trip movement of the (king) dollar» in this same *Monthly Report*.

Interest rates (%)

	28-February	31-January	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	3.00	2.50	50	50.0	300.0
3-month Euribor	2.74	2.51	23	61.2	327.8
1-year Euribor	3.73	3.41	31	43.4	408.8
1-year government bonds (Germany)	3.21	2.78	43	61.0	390.0
2-year government bonds (Germany)	3.14	2.65	49	37.3	387.4
10-year government bonds (Germany)	2.65	2.29	37	8.0	272.3
10-year government bonds (Spain)	3.60	3.28	32	–6.2	274.2
10-year government bonds (Portugal)	3.51	3.19	32	–7.3	278.3
US					
Fed funds (upper limit)	4.75	4.50	25	25.0	450.0
3-month Libor	4.96	4.81	15	19.5	445.2
12-month Libor	5.69	5.34	35	20.9	451.5
1-year government bonds	4.98	4.65	32	29.1	410.0
2-year government bonds	4.82	4.20	61	39.0	347.5
10-year government bonds	3.92	3.51	41	4.5	219.3

Spreads corporate bonds (bps)

	28-February	31-January	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	79	79	0	–11.1	3.2
Itraxx Financials Senior	88	88	0	–10.8	0.1
Itraxx Subordinated Financials	154	156	–2	–17.8	–9.5

Exchange rates

	28-February	31-January	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.058	1.086	–2.6	–1.2	–4.9
EUR/JPY (yen per euro)	143.990	141.320	1.9	2.5	12.6
EUR/GBP (pounds per euro)	0.880	0.882	–0.2	–0.6	5.4
USD/JPY (yen per dollar)	136.170	130.090	4.7	3.9	18.5

Commodities

	28-February	31-January	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	548.5	557.0	–1.5	–1.1	–10.8
Brent ($/barrel)	83.9	84.5	–0.7	–2.4	–20.1
Gold ($/ounce)	1,826.9	1,928.4	–5.3	0.2	–6.1

Equity

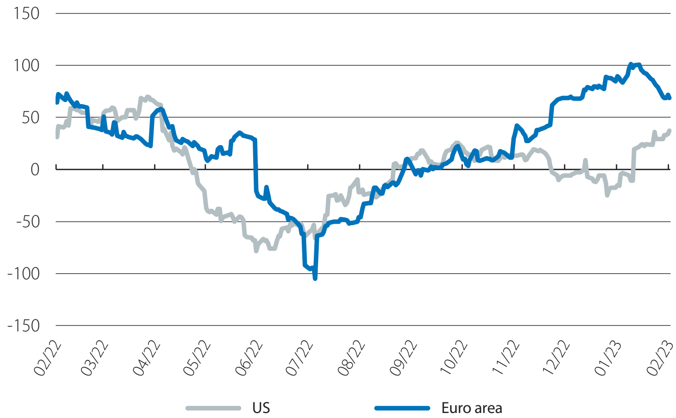
	28-February	31-January	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	3,970.2	4,076.6	–2.6	3.4	–7.8
Eurostoxx 50 (euro area)	4,238.4	4,163.5	1.8	11.7	12.5
Ibex 35 (Spain)	9,394.6	9,034.0	4.0	14.2	14.7
PSI 20 (Portugal)	6,057.2	5,886.3	2.9	5.8	10.2
Nikkei 225 (Japan)	27,445.6	27,327.1	0.4	5.2	2.2
MSCI Emerging	964.0	1,031.5	–6.5	0.8	–18.1

Cautiously optimistic about the international economy

The macroeconomic outlook continues to show encouraging signs in a challenging environment. Economic activity has been performing better during the winter than had been feared back in the summer. Notably, confidence continues to improve and headline inflation may have already peaked, thanks to the substantial reduction in energy prices (85% in the case of gas, versus the August highs) and the normalisation of global supply chains. Overall, the latest signs suggest that economic activity in the major developed economies and in China is holding up better during Q1 than had been anticipated a few months ago. This is obviously good news, but we should not indulge in excessive optimism. Firstly, the geopolitical risk, far from subsiding, remains ever present a year into the war in Ukraine. Moreover, the impact of the rate hikes approved by most central banks has not yet fully translated to economic activity and monetary policy will remain restrictive, given the persistence of the core inflation indices. Indeed, the strength of the latest economic activity data and the persistence of inflation in the major economies has raised the risk that interest rates could climb even higher and that they could also remain high for longer, as reflected in the change in market expectations, which we set out in the financial markets economic outlook section.

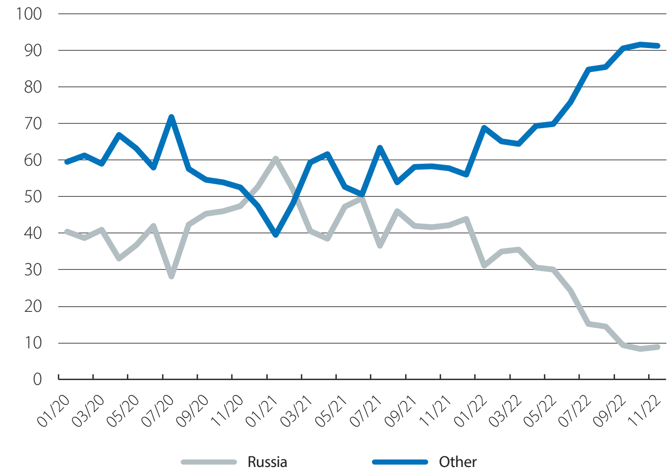
The euro area begins the year with an encouraging outlook for Q1 2023. In fact, in February the PMIs exceeded the critical 50-point threshold in the major economies (Germany, 50.7; France, 51.7; and the euro area, 52.0). This development was driven by the marked improvement in confidence in the services sector (clearly in expansionary territory), given that confidence in manufacturing fell yet again (the eighth consecutive month at contractionary levels). The PMI price component in the euro area, meanwhile, fell yet again and reached 16-month lows, although it remains very high. This reinforces the view there will be greater inertia in inflationary pressures than had been hoped for, and the data corroborate this outlook: euro area headline inflation has been falling from its October highs (10.6% vs. 8.5% in February) thanks to the decline in the energy component, while the pressures in the core components continue their slow but steady upward trickle, with core inflation (excluding energy and all food) peaking in February at 5.6%. In this context of high inflation, the growth in wage demands has stabilised at around 4.0% year-on-year at the end of last year, according to the indicator produced by the ECB. Despite the good performance of the economy in Q1 2023, it is premature to assume we will see a significant rebound in economic activity after the spring, given the major challenges the region still faces. Although gas prices have fallen substantially, they are still double their pre-war value. In addition, the ECB has made it clear that it will

*Economic Surprise Index **
Level



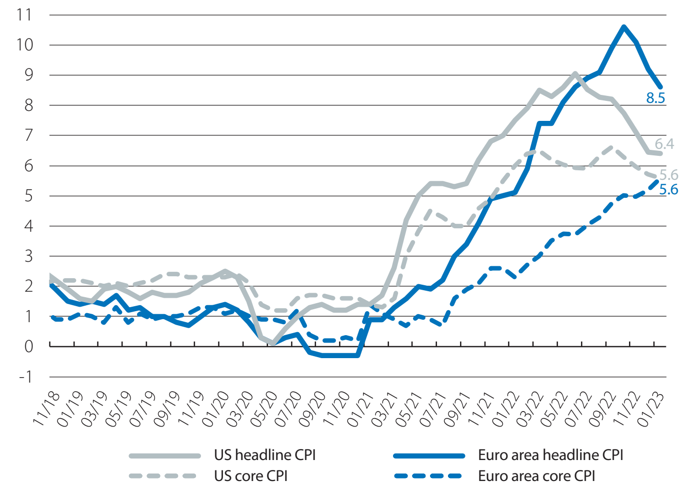
Notes: *Defined as the weighted historical standard deviations of the differences between the published data and analysts' expectations. A positive value indicates that the published data was better than expected, while a negative value suggests that the release disappointed.*
Source: *CaixaBank Research, based on data from Citigroup, via Refinitiv.*

EU: gas imports
(% of the total)



Source: *CaixaBank Research, based on data from Eurostat.*

US and euro area: CPI
Year-on-year change (%)



Source: *CaixaBank Research, based on data from Eurostat and the Bureau of Labor Statistics.*

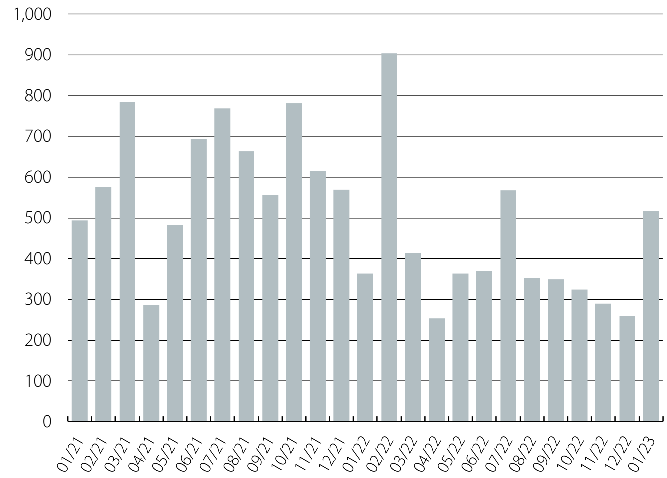
continue to raise interest rates, with the consequent restriction on activity this entails.

A surprisingly buoyant start to the year in the US. After registering a far from negligible annualised growth rate of 2.7% in Q4 2022, the latest indicators have shown significant strength at the beginning of 2023: retail sales growth in January (3.0% month-on-month) offset the cumulative decline in the previous two months; manufacturing output managed to grow by 1.0% on a monthly basis in January; the same month also saw the creation of more than 500,000 jobs, and the PMI surpassed the critical 50-point threshold in February for the first time in eight months. In this context, inflation continued to fall in January, in both the headline index (6.4%) and the core index (5.6%), albeit at a slower pace than in previous months. This scenario of positive surprises in economic activity, with inflation still at relatively high levels, helps to explain the recent messages from the Fed emphasising that interest rates will continue to rise.

Russia performs better than expected in 2022, despite the sanctions. The Russian statistics office announced that the economy contracted by 2.1% in 2022, which is compatible with a growth of 0.5% quarter-on-quarter in Q4 2022. However, the start of 2023 is unlikely to be so rosy as the impact of two of the sanctions imposed in December will begin to be felt, namely: the EU ban on imports of Russian oil and the cap on oil prices imposed by the G7. In order to counter these measures, Russia has significantly increased its sales of crude oil to China and, above all, to India, while announcing that it will cut production by around 500,000 barrels a day.

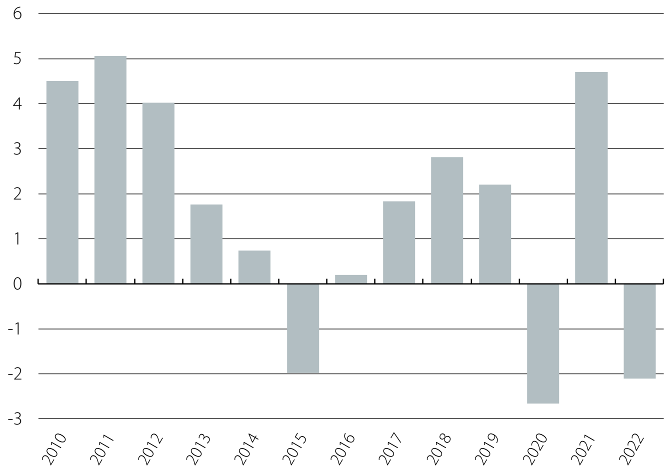
Türkiye faces the consequences of the earthquake. The recent buoyancy of the Turkish economy (it grew by 0.9% quarter-on-quarter in Q4 2022) has been abruptly interrupted by the devastating earthquake that has ravaged the south-east of the country, along the border with Syria. In addition to the irreparable cost in human lives, it has also dealt a heavy blow to economic activity, given that the area affected accounts for around 10% of Türkiye's GDP. The good news is that the damage to key infrastructure appears to be limited, and this could make it easier for the economy to make a quick and strong recovery after an initial shutdown, thanks to the reconstruction works which will cost between an estimated 6% and 10% of GDP. However, the earthquake could also have political consequences: the elections on 14 May will be held under the shadow of the earthquake's impact and the social discontent over what many consider to be a slow and inadequate reaction from Erdoğan's government. In addition, given the high number of people who have been displaced following the earthquake (some 13 million people), the feasibility of holding the elections on the planned date is beginning to be questioned.

US: non-farm payrolls
(Thousands of people)



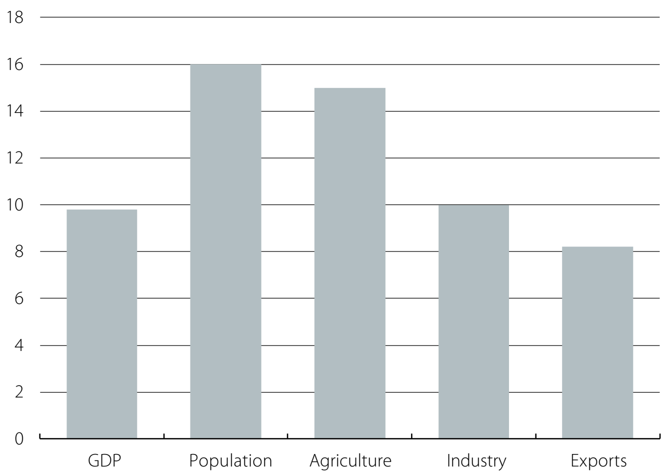
Source: *CaixaBank Research, based on data from the BLS, via Refinitiv.*

Russia: GDP
Annual change (%)



Source: *CaixaBank Research, based on data from the IMF.*

Türkiye: area affected by the earthquake
(% of country total)



Source: *CaixaBank Research, based on data published by Capital Economics.*

Analysing the tightness in the US labour market

The unemployment rate in the US stood at 3.4% in January, a level not seen since the 1960s, while job creation in the same month reached more than 500,000 jobs, a rate twice the average observed between 2015 and early 2020. Moreover, based on the data available up to December, in the US there are 1.9 job vacancies for every unemployed person. This is well above the historical average of 0.65 and demonstrates just how tight the world's largest economy's labour market is.

Supply shock or demand shock in the labour market?

When we say there is stress in the labour market, we are referring to the fact that there are many more companies seeking to hire workers than there are people looking for jobs. The first question we must ask ourselves is thus whether this post-pandemic tightness is the result of higher job demand (more companies wanting to hire) or a fall in supply (fewer workers). The sum of the total number of employees plus the unfilled job vacancies, which serves as an indicator for total job demand, is not far from its historical trend, suggesting that we are not facing a demand shock. On the other hand, if we perform a similar calculation for the supply of jobs,[1] we see that the pandemic did indeed trigger a major supply shock, as there are now around 4.5 million fewer workers than would be expected.

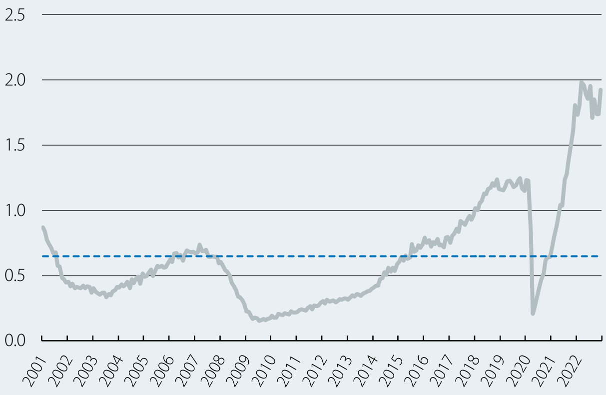
There are two factors that can explain most of this lower job supply: lower immigration and a reduction in the labour participation rate. The first factor explains approximately 1.2 of the 4.5 million fewer workers, as since the beginning of 2019 a change is apparent in the data regarding the number of people born outside the US who are seeking work in the country. If the growth trend of this population segment observed between 2015 and 2019 had continued, then by the end of 2022 there would have been just over 47 million people born outside the US over 16 years of age, rather than the 45.9 million reported by the BLS in January. The second factor is the fall in the labour participation rate – i.e. the number of people over the age of 16 who either work or would like to work – from 63.3% before the pandemic to the 62.4% registered in January, which equates to some 2.7 million fewer workers.

At the height of the pandemic, the decline in this rate was particularly pronounced and was attributed, in part,

1. In order to forecast the level of employment which we would "expect" to see, we use the latest US population estimates (2017) to predict the population over 16 years of age and assume constant unemployment and labour participation rates (3.5% and 63.3%, respectively) since the beginning of the pandemic.

US: job vacancies per unemployed person

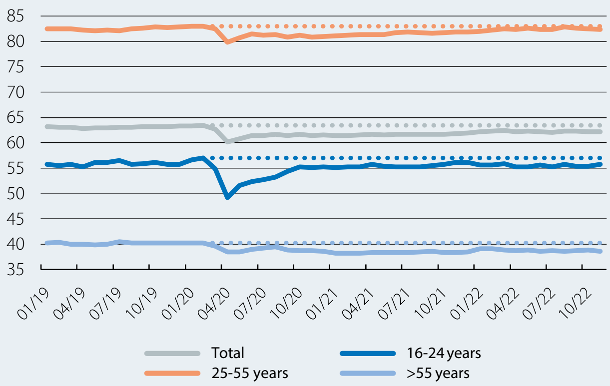
Ratio



Note: *The dashed line indicates the historical average.*
Source: *CaixaBank Research, based on data from the BLS.*

US: labour participation rate by age group

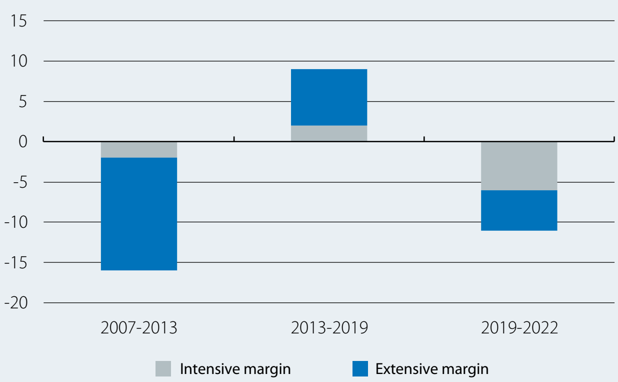
(%)



Note: *The dashed line marks the level of February 2020.*
Source: *CaixaBank Research, based on data from the BLS.*

US: breakdown of the change in total hours worked

Annual change (%)



Source: *CaixaBank Research, based on data from D. Lee et al. (2023). «Where Are the Workers? From Great Resignation to Quiet Quitting». National Bureau of Economic Research, No. w30833.*

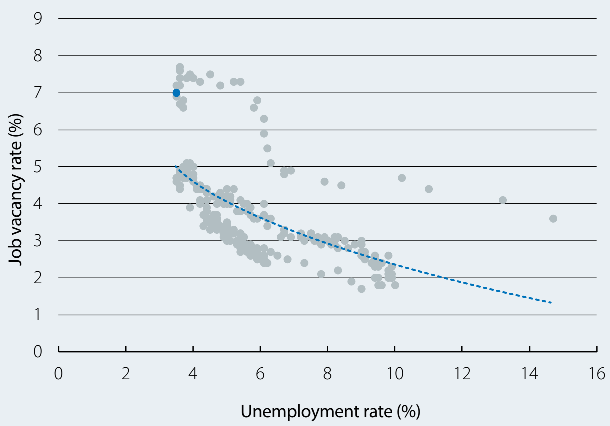
to temporary factors such as the fear of working in jobs more exposed to human contact or the fact that many people were unable to combine work with caring for minors or elderly people.[2] Nevertheless, these factors should no longer play a significant role. In fact, the factor that is now driving this lower rate is, above all, the departure of the population over 55 years of age from the labour market. The changes in composition within this (large) age range have been particularly pronounced between 2016 and 2022, as the relative weight in the labour market of the population between 55 and 59 years of age (whose labour participation rate is much higher than that of the population over 60) has fallen.[3]

On the other hand, it is important to note that this fall in the number of workers has occurred in the extensive margin of the labour supply, that is, the number of people who work. But at the same time as the number of people who are in the labour market is falling, those who remain active in it are working fewer hours, thus reducing the intensive margin. This phenomenon has been named quiet quitting and is due to the desire of many workers to strike a better work-life balance. Thus, as can be seen in the third chart, according to the data from a recent investigation, the reduction in the hours worked between 2019 and 2022 in the US is explained by a reduction in both the extensive and the intensive margin, with the intensive reduction being most notable among men with university studies and between the ages of 25 and 39.[4]

Will the Fed manage to balance job supply and demand?

This mismatch between the supply and demand for jobs is leading to wage dynamics which are not exactly helping the Federal Reserve to bring inflation back down to its 2% target. In order to fill their vacancies and attract workers, businesses must offer higher wages, which in turn drives up inflation. For this reason, through its rate hikes, the Fed is trying to rebalance the supply and demand for jobs and hopes to do so without triggering an unemployment rally: monetary tightening alone will not encourage workers who are outside the labour market to join it, but it should discourage businesses from hiring more people, thereby reducing the number of job vacancies.

US: Beveridge curve



Note: *In blue we mark the latest available data*
Source: *CaixaBank Research, based on data from the BLS.*

So will the Fed manage to reduce the job vacancy rate without necessarily increasing unemployment? The answer is not clear, and the conclusion of the debate over whether there will be a recession in the US will largely depend on how this episode unfolds. There are arguments in favour of both outcomes: on the one hand, the Beveridge curve, which links the vacancy rate to that of unemployment, is not linear and, provided the historical relationships are maintained, at the point at which it currently lies there should be some scope to reduce the number of job vacancies without an excessive rise in unemployment.[5] In addition, given the difficulties in filling vacancies in recent years, many firms may choose not to destroy jobs if they fear that they will find it difficult to find replacement workers later on.[6] On the other hand, job vacancies are not evenly distributed across the different US economic sectors. In fact, vacancies are highly concentrated in accomodation and food services sector (precisely where the hourly wage is lower). Thus, if we assume that the Fed's rate hikes will cool demand (and thus destroy job vacancies) to a relatively similar extent across all sectors, then it could lead to job destruction in the rest of the sectors and thus increase the unemployment rate.

Ricard Murillo Gili

2. This phenomenon, which was particularly intense in 2021, was named the great resignation. For further details, see «US: (in)complete recovery of the labour market» in the MR07/2021.
3. In fact, the change in composition within the population over 55 accounts for 2.4 million of the 2.7 million fewer workers discussed above.
4. See D. Lee *et al.* (2023). «Where Are the Workers? From Great Resignation to Quiet Quitting». National Bureau of Economic Research, No. w30833.
5. See B. Bok *et al.* (2022). «Finding a Soft Landing along the Beveridge Curve». FRBSF Economic Letter, 24.
6. In fact, the employment report for January documented fewer redundancies than usual for this month of the year, which could be explained by companies' fear of difficulties in finding workers in the future.

Year-on-year (%) change, unless otherwise specified

UNITED STATES

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Activity									
Real GDP	5.9	2.1	3.7	1.8	1.9	0.9	–	–	–
Retail sales (excluding cars and petrol)	17.5	8.7	11.5	7.8	8.5	7.0	7.3	7.4	...
Consumer confidence *(value)*	112.7	104.5	108.1	103.4	102.2	104.2	109.0	106.0	102.9
Industrial production	4.9	3.8	4.8	4.5	3.9	2.1	1.1	0.8	...
Manufacturing activity index (ISM) *(value)*	60.7	53.5	57.7	55.0	52.2	49.1	48.4	47.4	47.7
Housing starts *(thousands)*	1,605	1,556	1,720	1,647	1,450	1,405	1,371	1,309	...
Case-Shiller home price index *(value)*	267	306	299	313	310	303	302	...	...
Unemployment rate *(% lab. force)*	5.4	3.6	3.8	3.6	3.6	3.6	3.5	3.4	...
Employment-population ratio *(% pop. > 16 years)*	58.4	60.0	59.9	59.9	60.0	60.0	60.1	60.2	...
Trade balance [1] *(% GDP)*	–3.6	–3.7	–3.9	–4.0	–3.9	–3.7	–3.7	...	...
Prices									
Headline inflation	4.7	8.0	8.0	8.6	8.3	7.1	6.5	6.4	...
Core inflation	3.6	6.2	6.3	6.0	6.3	6.0	5.7	5.6	...

JAPAN

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Activity									
Real GDP	4.1	0.0	0.5	1.7	1.5	0.6	–	–	–
Consumer confidence *(value)*	41.4	37.7	34.8	33.1	31.2	29.6	30.3	31.0	31.1
Industrial production	15.6	–2.6	–0.6	–3.6	4.0	0.6	–0.8	–3.1	...
Business activity index (Tankan) *(value)*	0.0	–1.3	14.0	9.0	8.0	7.0	–	–	–
Unemployment rate *(% lab. force)*	5.1	4.6	2.7	2.6	2.6	2.5	2.5	2.4	...
Trade balance [1] *(% GDP)*	1.4	–0.6	–1.0	–1.9	–3.0	–3.8	–3.7	–5.1	...
Prices									
Headline inflation	–0.7	–0.3	0.9	2.4	2.9	3.9	4.0	4.4	...
Core inflation	–1.4	–0.8	–0.9	0.8	1.5	2.8	3.0	3.2	...

CHINA

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Activity									
Real GDP	8.4	3.0	4.8	0.4	3.9	2.9	–	–	–
Retail sales	12.4	–0.8	1.6	–4.9	3.5	–2.7	–1.8	...	...
Industrial production	9.3	3.4	6.3	0.6	4.8	2.8	1.3	...	...
PMI manufacturing *(value)*	50.5	49.1	49.9	49.1	49.5	48.1	47.0	50.1	52.6
Foreign sector									
Trade balance [1,2]	681	889	728	824	908	889	905.1	...	...
Exports	30.0	7.1	15.7	12.9	10.0	–6.8	–9.9	...	...
Imports	30.0	1.1	10.6	1.2	0.6	–6.5	–7.5	...	...
Prices									
Headline inflation	0.9	2.0	1.1	2.2	2.7	1.8	1.8	2.1	...
Official interest rate [3]	3.8	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Renminbi per dollar	6.5	6.7	6.3	6.6	6.9	7.1	7.0	6.8	6.9

Notes: *1. Cumulative figure over last 12 months. 2. Billion dollars. 3. End of period.*
Source: *CaixaBank Research, based on data from the Department of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Standard & Poor's, ISM, National Bureau of Statistics of Japan, Bank of Japan, National Bureau of Statistics of China and Refinitiv.*

EURO AREA

Activity and employment indicators

Values, unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Retail sales *(year-on-year change)*	5.4	...	6.1	1.1	–0.6	–2.6	–2.8	...	...
Industrial production *(year-on-year change)*	9.0	...	–0.2	0.4	1.7	1.5	–1.7	...	...
Consumer confidence	–7.5	...	–13.7	–22.6	–26.9	–26.9	–22.0	–20.7	–19.0
Economic sentiment	110.7	...	111.2	103.8	96.5	96.5	97.1	99.8	99.7
Manufacturing PMI	60.2	...	57.8	54.1	49.3	49.3	47.8	48.8	48.5
Services PMI	53.6	...	54.1	55.6	49.9	49.9	49.8	50.8	52.7
Labour market									
Employment (people) *(year-on-year change)*	1.4	...	3.0	2.6	1.7	1.5	–	–	–
Unemployment rate *(% labour force)*	7.7	6.7	6.8	6.7	6.7	6.7	6.7	6.7	...
Germany *(% labour force)*	3.6	3.1	3.1	3.0	3.1	3.0	3.0	3.0	...
France *(% labour force)*	7.9	7.3	7.3	7.5	7.2	7.2	7.2	7.1	...
Italy *(% labour force)*	9.5	8.1	8.5	8.1	8.0	7.8	7.8	7.9	...
Real GDP *(year-on-year change)*	5.5	3.5	5.5	4.3	2.3	1.9	–	–	–
Germany *(year-on-year change)*	2.8	1.9	3.5	1.7	1.4	0.9	–	–	–
France *(year-on-year change)*	7.2	2.6	4.8	4.2	1.0	0.5	–	–	–
Italy *(year-on-year change)*	7.3	3.9	6.5	5.1	2.5	1.4	–	–	–

Prices

Year-on-year change (%), unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
General	2.6	8.4	6.1	8.0	9.3	10.0	9.2	8.6	8.5
Core	1.5	3.9	2.7	3.7	4.4	5.1	5.2	5.3	5.6

Foreign sector

Cumulative balance over the last 12 months as % of GDP of the last 4 quarters, unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Current balance	2.6	–0.8	1.8	0.7	–0.8	–0.8	–0.8	...	...
Germany	7.4	3.8	6.6	5.4	4.2	3.8	3.8	...	...
France	0.4	–2.0	0.1	–0.4	–1.3	–2.0	–2.0	...	...
Italy	3.0	–0.7	2.1	1.0	–0.6	–0.7	–0.7	...	...
Nominal effective exchange rate [1] *(value)*	**94.3**	**90.8**	**92.5**	**90.2**	**88.9**	**91.6**	**92.6**	**93.0**	**93.0**

Credit and deposits of non-financial sectors

Year-on-year change (%), unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Private sector financing									
Credit to non-financial firms [2]	3.5	6.7	4.4	6.1	8.4	7.8	6.3	6.1	...
Credit to households [2,3]	3.8	4.4	4.4	4.6	4.5	4.0	3.8	3.6	...
Interest rate on loans to non-financial firms [4] *(%)*	1.2	1.8	1.2	1.4	1.8	2.9	3.4	3.5	...
Interest rate on loans to households for house purchases [5] *(%)*	1.3	2.0	1.4	1.5	2.1	2.9	3.1	3.5	...
Deposits									
On demand deposits	12.6	6.2	9.1	7.7	6.3	1.8	0.0	–1.3	...
Other short-term deposits	–0.8	4.5	–0.3	0.9	5.3	12.0	14.0	15.1	...
Marketable instruments	11.6	3.7	0.7	2.0	4.2	7.7	11.3	13.3	...
Interest rate on deposits up to 1 year from households *(%)*	0.2	0.5	0.2	0.2	0.4	1.1	1.4	1.5	...

Notes: *1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated. 2. Data adjusted for sales and securitization. 3. Including NPISH. 4. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 5. Loans with a floating rate and an initial rate fixation period of up to one year.*

Source: *CaixaBank Research, based on data from the Eurostat, European Central Bank, European Commission, national statistics institutes and Markit.*

The Spanish economy, off to a good start to the year

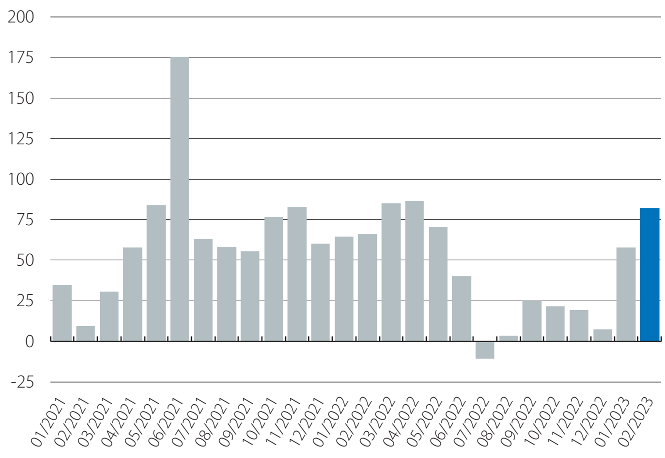
The reading that emerges from the behaviour of the economic indicators suggests that the Spanish economy is gaining strength in these first few months of the year. Employment, consumption, activity in industry and services, as well as the foreign sector are all showing encouraging figures. There is just one big but: inflation, which in February continued to reflect major price tensions. Despite this, the conclusion of the analysis of the current situation is that the Spanish economy continues to withstand the challenging economic environment better than expected.

Employment once again provides a positive surprise. The February data for Social Security affiliation show that the labour market has got off to a strong start to the year. The average number of registered workers increased in February by 88,918 people, which is higher than a typical month of February (+71,000 on average in the period 2014-2019). Indeed, this is the best result in a month of February in eight years. After correcting for seasonality, the monthly growth stands at 81,808 people, the biggest increase since April last year. On the other hand, we continue to see the effects of the labour reform on the temporary employment rate, which fell to 14.2% (27.2% in December 2021).

The economic activity indicators kick off the year on a good footing. The manufacturing PMI returned to expansionary territory in February, rising above 50 points for the first time since June 2022 and reaching 50.7 points (48.4 in January). Furthermore, the counterpart indicator for the services sector advanced 4 points, to 56.7 points, placing it firmly within the expansionary zone. On the consumer side, CaixaBank Research's consumption tracker shows that activity registered with Spanish bank cards moderated its pace of growth in February, with a year-on-year growth rate of 7% compared to 10% in January, although this is still above the rate registered in Q4 2022 (6%).

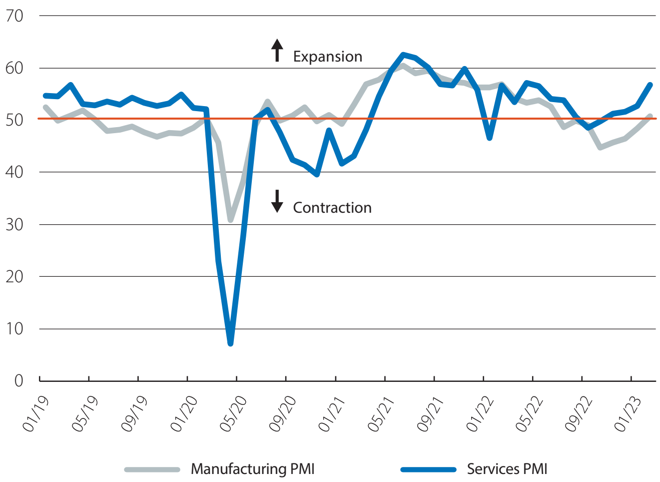
The foreign sector continues to bring good news. The current account balance ended 2022 with a surplus of 0.9% of GDP, just 1 percentage point below the level of 2021. This impressive figure was achieved despite the trade deficit of energy goods standing at 4.3%, 2.2 pps more than in 2021, weighed down by the sharp rise in gas and crude oil prices during the course of the year. The trade balance of non-energy goods, meanwhile, also closed the year with a deficit (–0.9%), although in the closing months of the year it registered a surplus thanks to the recovery in exports in real terms and the containment of imports. On the services side, the balance of non-tourism services reached a surplus of 3.1% of GDP (1.6% in 2021), the highest in the historical series. Finally, the balance of tourism services registered a surplus of 3.7% of

Spain: registered workers affiliated with Social Security *
Month-on-month change (thousands of people)



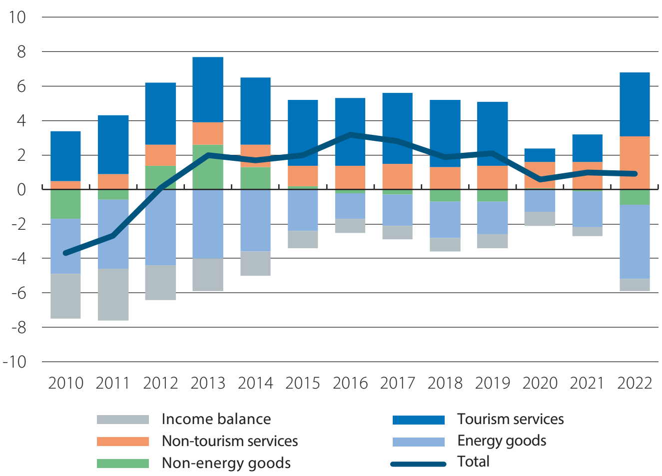
Note: ** Seasonally adjusted series.*
Source: *CaixaBank Research, based on data from the Ministry of Inclusion, Social Security and Migration (MISSM).*

Spain: PMI
Level



Source: *CaixaBank Research, based on data from Markit.*

Spain: balance of current account payments
(% of GDP)



Source: *CaixaBank Research, based on data from the Bank of Spain.*

GDP, thus recovering the levels of 2019. This figure was reached thanks to the lower spending of Spaniards abroad (1.4% of GDP in 2022 vs. 2.0% in 2019), which offset the fact that the income generated by international tourists in Spain was still below pre-COVID levels (5.3% of GDP in 2022 vs. 5.7% in 2019).

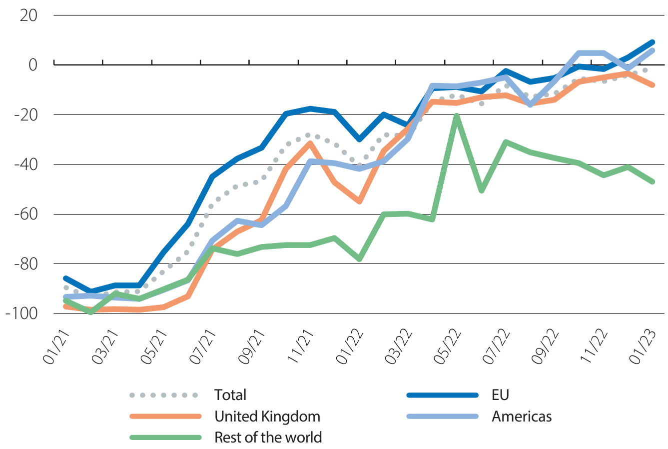
However, the latest data on international tourist arrivals confirm that tourism activity improved over the course of last year and that the start of 2023 is looking highly buoyant. The number of international tourists visiting Spain reached 4.1 million in January, which is just 1.2% below the figure for January 2019 and represents a year-on-year increase of 66.8%. By country of origin, tourists from the EU stand out, registering an all-time high for a month of January with 2.7 million tourist arrivals, 9.1% more than in January 2019. Also, the number of arrivals of American tourists has been very high, reaching 6.0% above the figure for January 2019. In contrast, British tourism remains relatively weak, with 8.1% fewer arrivals than in the same month of 2019.

The inflation rally continued in February. According to the CPI flash indicator, headline inflation rose in February for the second consecutive month, standing at 6.1%, 2 percentage points above the previous month. On the other hand, core inflation (which excludes energy and unprocessed food) rose once again, reaching 7.7%, also 2 percentage points above the figure for the month of January. That said, the monthly change reflected a significant growth rate for a month of February (+0.7% in February 2023 vs. 0.0% on average in the same month during the period 2017-2019), signalling that price tensions remain considerably high. In the absence of the breakdown by component, the National Statistics Institute noted that the main drivers of inflation were the increase in electricity prices, although they most likely continued to register a significant drop in year-on-year terms (–40.8% in January), and a new rise in food and beverage prices (+14.6% in January); while the moderation in the price of fuels helped to contain the advance of the CPI.

Home prices closed 2022 up, although their growth rate continues to moderate. The price of housing grew by 0.5% quarter-on-quarter in the final quarter of last year, thus overcoming the stagnation of Q3 (+0.0%). With this figure, the year-on-year rate stood at 3.3% at the year end, albeit with a declining trend over the course of the year (in Q1 it stood at 6.7%). In terms of housing demand, the signs of cooling are increasingly evident. In December, the first year-on-year decrease in the number of sales was recorded, according to the National Statistics Institute (–10.2%). Nevertheless, in 2022 as a whole there were some 650,000 sales (+14.7%), the highest figure since 2007. Thus, last year was one of significant growth in activity in the real estate market, but in recent months it has begun to show signs of slowing down.

Spain: international tourist arrivals by country of origin

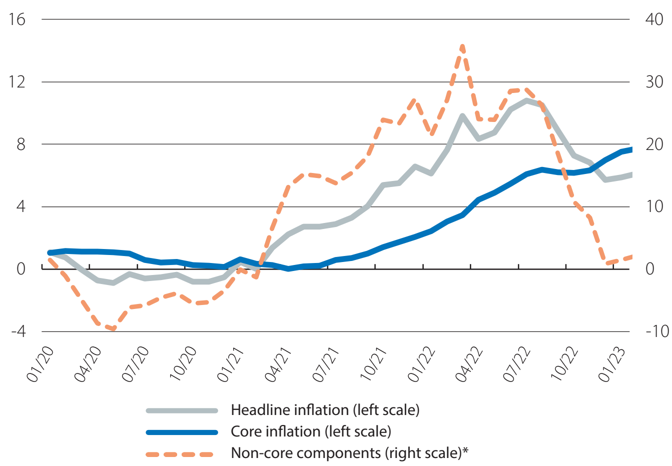
Change versus the same month of 2019 (%)



Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: CPI

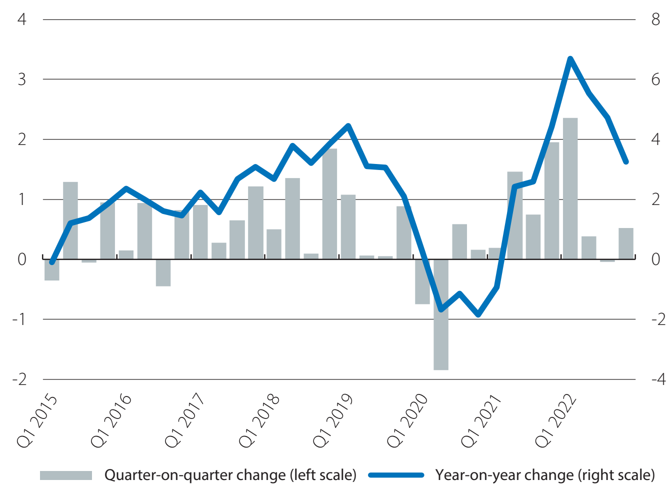
Year-on-year change (%) *Year-on-year change (%)*



Note: ** Aggregate of unprocessed food and energy products.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: home prices

QoQ rate of change (%) *YoY rate of change (%)*



Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Next Generation EU funds: current status and how they affect you

After the second year of disbursements of the European Next Generation EU (NGEU) funds, it is time to take stock. Spain included 28.4 billion euros from the Recovery and Resilience Mechanism, NGEU's main instrument, in the 2022 General Government Budget. Have expectations been met? Are the investments and reforms being implemented as planned?

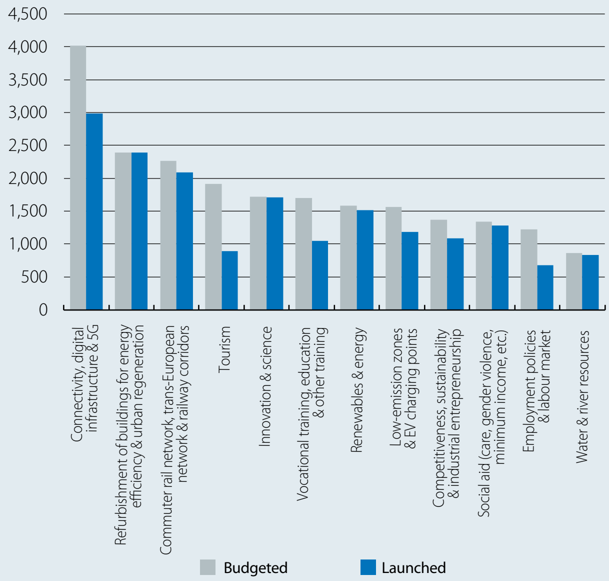
Investments: many projects launched and a *crescendo* in the pace of execution

Many projects were launched in 2022 (see first chart), amounting to around 25.1 billion euros (88% of the total amount budgeted) according to budget execution data. This includes calls to apply for financial support and competitive tenders, as well as areas where funds have begun to be distributed to the regional, local and public institutions that are executing the investment programmes. However, when analysing the execution of funds, this estimate is too broad, as it includes projects in which the funds are available to the public sector (or will be imminently) but where the beneficiaries of the associated aid have not yet been selected. In other words, the money is still «in the pipeline». If we look at the projects that have been launched in 2021-2022 since the NGEU programme was kick-started, they come to over 47 billion euros, or 90% of the total budget.

However, if, rather than looking at the funds that have been budgeted for, we stick to the funds which have been allocated (or committed, in budgetary jargon), then we will get a slightly more precise idea of the rate at which the investments are reaching the real economy. Using this criterion, we find that the central government allocated funds worth 21.9 billion euros out of the 2022 budget (42.9 billion in 2021-2022).[1] This represents 77% of the total budget, although a portion of this amount was allocated to the autonomous community regional governments, local government corporations and public entities and companies in order for them, in turn, to launch the corresponding tender processes or calls for applications for the final recipients of the funding. In particular, of this sum of 21.9 billion that has been allocated, we estimate that around 6.2 billion (28%) has been awarded to private companies through calls for applications. Of this 6.2 billion, 2.2 billion was awarded in the first half of the year and 4.0 billion in the second half, suggesting an acceleration in the rounds of funding being granted to the private sector in the second half of the year.

1. The funds committed in 2021-2022 accounted for 81.5% of the total funds budgeted for in the two years as a whole.

Spain: NGEU funds, 2022 investments
(EUR millions)



Note: *The investments launched include funds that have already been transferred (and those which have not yet been transferred but are about to be) to autonomous community regional governments, local government corporations and public bodies, even if they have not yet published the associated funding programme.*
Source: *CaixaBank Research, based on data from the General Comptroller of the State Administration (IGAE) up to November 2022.*

In the second chart, we can distinguish the main allocations of NGEU funds by the central government in 2021 and 2022.[2] Some of the biggest allocations include projects in railway infrastructure, the programme for funding SMEs and self-employed workers through loan guarantees, the Digital Kit programme to fund the digitalisation of self-employed workers and SMEs, and programmes in sustainable mobility and urban transformation, as well as energy projects with a clear commitment to sustainability (building refurbishments to improve energy efficiency).

If we want to be even more precise and drill down to the final layer, that is, the amount of funds that has reached the productive fabric of the economy, then the figure will be less than the funds allocated, since the beneficiaries have to present documentation before the payment is executed. If we focus on disbursements from the central government to the final recipients (i.e. payments to the private sector and payments of direct aid to other public entities, but excluding transfers to other public entities where they in turn must publish a call for funding

2. In total, the central government awarded calls for funding in 2021-2022 amounting to 19.2 billion euros (including funds awarded to private companies, as well as direct aid awarded to other public entities where they are the final recipients and are not required to open a call for applications to subsequently pass on the funding). In addition to this, we must add 4.1 billion of funds awarded by the autonomous community regional governments to the final recipients.

applications in order to subsequently allocate the funds, and aid for technological, university and educational centres) in terms of what was budgeted for in 2022, we find that the central government disbursed 8.2 billion euros, or 30% of the amount budgeted in that year.[3] However, the acceleration in the second half of last year was palpable: the central government disbursed funds amounting to almost 6.0 billion euros, tripling the amount disbursed in the first half of the year.

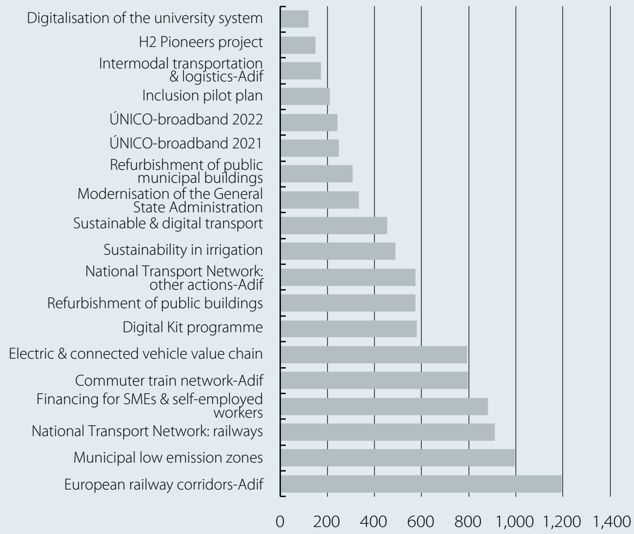
As for the so-called PERTE projects (Strategic Projects for Economic Recovery and Transformation), which have a high potential to drive the transformation of the economy and involve significant public-private collaboration, the calls for applications launched in 2021-2022 (i.e. the sum of the calls opened and those awarded) totalled 12.3 billion euros (almost 30% of the total of 47.0 billion euros in projects launched in 2021-2022). This sum included 4.9 billion allocated to the renewable energies PERTE project, 2.0 billion for the electric and connected vehicle PERTE project and 1.84 billion for the PERTE project related to the aerospace sector. It should be noted that, taking into account the reinforcement of the 18 billion in loans that are due to be channelled into the PERTE projects, the total public investment in these projects between 2022 and 2026 will exceed 40 billion euros.

As for 2023, the European funds are expected to play a greater role in the economy: there are many projects that have already been launched and that should crystallise by reaching the productive fabric of the economy, and a steady cruising speed is expected to be maintained in the rhythm of calls for applications and disbursements, as was observed in the second half of 2022. In addition, the figures announced for calls for funding applications in the first half of 2023 demonstrate how the budget is concentrated in just a handful of large-scale awards[4] and it should be the year in which major funding application processes are opened for some of the larger PERTE projects, such as the one related to renewable energies and green hydrogen, as well as the second round for the PERTE project related to the industrial chain of the electric and connected vehicle (in the first round, projects amounting to 793 million were awarded funding, representing only a portion of the almost 3 billion budgeted).

If everything that was anticipated in 2022 and a portion of what is budgeted for in 2023 is finally executed (the total figure could exceed 20 billion euros in execution),[5]

3. Data up to November 2022.
4. The five biggest calls for funding applications in the spheres of the green transition, digitalisation, trade and tourism, education and employment account for at least 70% of the total aid available in each of these sectors. Some 11.6 billion euros have been budgeted for in calls for funding in the first half of 2023.
5. By execution, we mean that the funds have been disbursed and the productive economic agents have access to them.

Main NGEU calls for funding applications awarded by the central government in 2021-2022
(EUR millions)



***Source:** CaixaBank Research, based on data from the Recovery, Transformation and Resilience Plan portal.*

then the macroeconomic impact on growth in 2023 would be substantial, potentially amounting to 1.0 pp. Ensuring that the funds are executed quickly in 2023 will also be key in order for the disbursement of the European funds to continue: the first disbursements depended primarily on reforms being carried out, but as we move forward the importance of meeting quantifiable targets related to the investments will gain weight. Even this year, in 2023, there will be quantitative targets to be met based on measurements since the Plan began. Among others, these targets will include: 231,000 refurbishment works carried out on at least 160,000 homes, a minimum fleet of 238,000 vehicles and charging points, 800,000 SMEs benefited from the Digital Kit, and an 8,500-MW increase in the installed capacity of renewables.

The reforms in 2022: the schedule has been met, pending finalisation of the second pensions reform

The schedule of reforms agreed upon by Brussels in the first half of 2022 was met, and this has allowed the European Commission to give the green light in February to the disbursement of European funds worth 6.0 billion euros, with Spain due to receive the full sum shortly once the European Council has given its final approval. Some of the key reforms that are planned include the law aimed at promoting company pension plans which will increase the maximum tax-deductible joint contribution of worker and company to 10,000 euros,[6] as well as the

6. However, a plan with tax incentives to facilitate mobility between alternative plans has not been established.

new system for self-employed workers' social security contributions based on a set of standardised criteria known as «modules».

In the second half of the year there was an acceleration in the passing of laws aimed at modernising general government administrations, such as the approval of the bill for a reform of public sector workers which, among other elements, introduces a component of their remuneration linked to annual performance reviews. In addition, Congress passed the Public Policy Assessment Act to evaluate, both *ex ante* and *ex post*, the results of public policies with the creation of a Public Policy Assessment Agency. According to the schedule of the Recovery Plan, we should learn more about how this agency will function in Q3 2023, and it would be desirable for the assessments to be conducted by independent and external evaluators. The Employment Act also came into force, which gives job seekers a maximum period of one month following their initial assessment to establish a tailored plan to find work, as well as boosting the use of digital tools and assessment mechanisms in how the state employment service (SEPE) operates.

However, in the sphere of pensions, the second part of the reform, focused on changes in how the number of years of social security contributions affects the calculation of a person's pension as well as an increase in the maximum contribution base and the maximum pension amount, is not yet finalised. It would be desirable for this reform to ensure the sustainability of the system by balancing the interests of all generations; this reform is the only milestone left to go in order for funds amounting to 10 billion euros, linked to the progress made in the second half of 2022, to be disbursed in mid-2023.

Javier Garcia-Arenas

Execution status of the PERTE projects *
(EUR millions, as of 14/12/2022)

PERTE project	Public funds	Awarded and open calls
Microelectronics	12,250	–
Renewable energies, hydrogen and storage	10,475	4,957
Electric and connected vehicle	4,295	2,018
Decarbonisation	3,100	–
Digitalisation of the water cycle	2,790	425
Aerospace	2,126	1,844
Social and care economy	1,808	380
State-of-the-art health	1,650	912
Agrifood industry	1,450	1,063
New language economy	1,101	298
Circular economy	792	192
Marine sector	310	250
Total	42,146	12,339

Note: ** Strategic Projects for Economic Recovery and Transformation.*
Source: *Portal of the Recovery, Transformation and Resilience Plan.*

The Spanish tourism sector, off to a strong start in 2023

Tourism activity continues to advance at a steady pace. In the midst of the low season for much of the sector, the figures published month by month continue to confirm strong demand despite the challenging economic environment that is affecting the global economy, particularly the European one. Will this dynamic continue in the coming months?

Encouraging pattern in tourism demand

The indicators for tourism activity continued to show signs of significant strength at the end of 2022. In December, the number of international tourist arrivals in Spain reached 4.1 million, just 4.4% below the figure for December 2019. This recovery in the volume of international tourists has occurred in an environment of rising prices in the sector. According to the January CPI data, accommodation prices were 18.6% above those of the same month of 2019, while leisure and catering prices were 14.9% higher. The combination of the recovery in volume and the price increases has led to tourism revenues already exceeding pre-pandemic levels. Specifically, the expenditure of international tourists in December was 4.5% above the same month of 2019.

Domestic tourism also performed well at the end of 2022, although by then it had already been above 2019 activity levels for the past three quarters. In December, the number of overnight stays by residents in tourist accommodation establishments was 2.9% higher than in the same month of 2019. One of the key drivers of this excellent performance is the slow recovery of residents travelling abroad. According to CaixaBank card data, card payments abroad in January this year were still 16.8% below the level of January 2019.

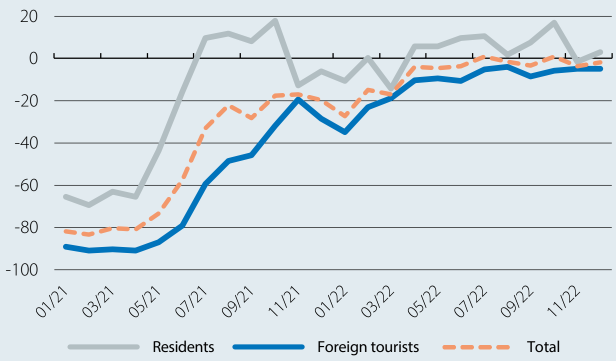
How will the high season begin?

While the figures are very encouraging, it can be risky to judge tourism demand on the basis of low season performance. In this case, it is common practice to analyse the state of demand in the Canary Islands during the winter months – as it is high season there – in order to better understand the strength of tourism demand and anticipate the trend that we could observe when the high season begins on the mainland and in the Balearic Islands.[1]

If we stop to analyse the indicators of international tourism volumes in December in the Canary Islands, the conclusion we reach is that tourism demand is indeed showing great strength, even surpassing the levels of last

Spain: overnight stays in tourist accommodation establishments

Change versus the same month of 2019 (%)



Note: *Overnight stays in hotel establishments, tourist apartments, agritourism locations and campsites.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

summer. International tourist arrivals were 1.6% above the level of December 2019 and improved on the already good records registered in the summer (–1.0% vs. the summer of 2019). By country of origin, the strength of British tourism stood out, standing above the level of the same month in 2019 (+3.4%) and clearly on an upward path. On the downside, meanwhile, tourism from Germany and Norway remained weak, being the only source countries still below 2019 levels. It is also interesting to note that other European countries with a smaller share in Canary Island tourism are showing significant growth: the Netherlands, France, Ireland and Belgium registered double-digit growth compared to December 2019.

In addition to the good data from the Canary Islands, our indicator of interest in travelling to Spain, developed based on Google searches conducted in tourist source countries, continues to emit positive signals. Specifically, the interest indicator among EU tourists stood in positive territory in February (+4%), mainly due to the strong levels registered in the Netherlands, which rose +10%, and in Germany, which reached +7%, thus reversing the very poor figure noted in January (–17%). As for British tourists, the indicator is in negative territory, which contradicts the trend observed in the Canary Islands, although it is coherent with the difficult economic situation that the United Kingdom is currently going through. Finally, the strength of interest in countries such as the US and Japan could be an indication of a recovery in long-haul tourism, which remains very much incomplete in the case of Asian tourists.

In conclusion, the data from the Canary Islands indicate that tourism demand remains strong, confirming the readings we receive from the indicators for Spain as a whole. On the other hand, the Google search data lead

1. In December 2019, Spain as a whole registered 4.9% of the entire year's international tourist arrivals, whereas in the Canary Islands this percentage stood at 9.1%.

us to anticipate the continued strength of EU tourist arrivals in the short term, to raise some doubts about the strength of British demand and to foresee a buoyant recovery in long-haul tourism.

Margin for growth in a context of eroded purchasing power

The encouraging figures and good outlook for tourism demand are occurring in an adverse macroeconomic environment in which households are seeing their purchasing power eroded by the inflation rally and the tightening of financial conditions. Thus, one would expect to see some degree of containment in tourism spending, being a non-essential form of consumption. However, given that we are emerging from a period with unusually high savings rates, we estimate that some European households still have room to adjust their savings rates, bringing them back down to around pre-pandemic levels, and thus to maintain their consumption levels.

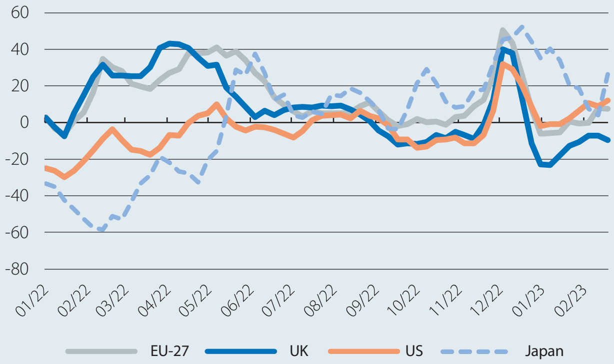
If we analyse the evolution of household savings rates between Q3 2022 (the latest available data) and the same period in 2019 in the main source countries for tourists visiting Spain, only in the cases of Italy and Spain do we observe a lower savings rate in 2022. As can be seen in the second chart, in the United Kingdom the household savings rate stood at 9.0% in Q3 2022, considerably above the pre-pandemic level (5.2%). We observe a similar phenomenon in the cases of Germany, France and the Netherlands, with savings rates still 1.4 and 1.7 pps above 2019 levels.

We expect that this process of normalisation of savings rates will continue to contribute to the recovery of tourism consumption in the coming quarters, along with other growth drivers such as the expected recovery in long-haul tourism (from the US, Latin America and Asia), the higher propensity for domestic travel within the EU and the decongestion of airspace. For all these reasons, we expect that tourism sector activity levels in 2023 will exceed the 2019 benchmark and that the sector will thus definitively consolidate its recovery.

Javier Ibáñez de Aldecoa

Weekly Google searches about travel to Spain

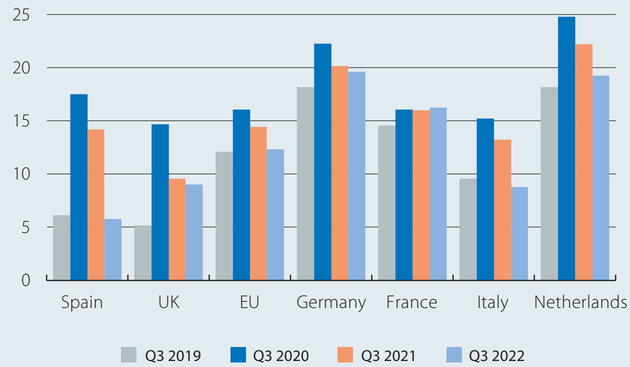
*Change versus the benchmark level (%) **



Notes: *We use search data for the word «Spain» in the United Kingdom, Germany, France, Italy, the Netherlands and the US in the official language of each country within the travel category.*
** The benchmark level is built using the weekly searches conducted between 2017 and 2019.*
Source: *CaixaBank Research, based on Google Trends.*

Household savings rate in Q3 of each year

(% of gross disposable income)



Note: *Data corrected for seasonality and calendar effects.*
Source: *CaixaBank Research, based on data from the National Statistics Institute, Eurostat and the ONS.*

Electricity and gas in 2022: the impact of energy bills on Spanish households

The energy crisis has had a major impact on how much of their income Spanish households have to allocate to paying their energy bills.[1] In order to quantify this, we have examined fully anonymised employment-related income data (i.e. payrolls and unemployment benefits) and direct debits for electricity and gas bills charged to bank accounts held with CaixaBank. By having access to both pieces of information for the same household, we can estimate what percentage of their income was allocated to paying for electricity and gas.[2] Furthermore, we can estimate how this percentage changed depending on households' income level.

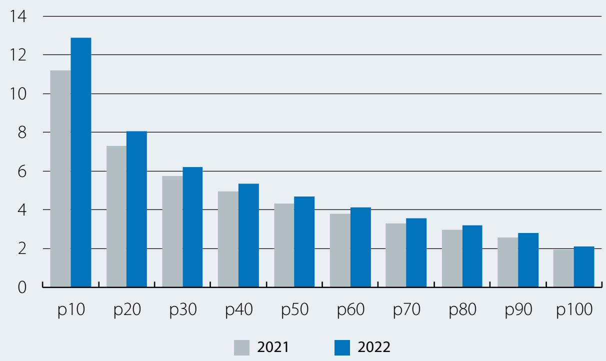
Clearly, in 2022 all households had to allocate a greater percentage of their income to paying their electricity and gas bills compared to the previous year, as shown in the first chart. A middle-income household dedicated 4.7% of their employment-related income to paying their electricity and gas bills, a 0.4-pp increase over the previous year.[3]

However, the additional effort required to pay for energy consumption was not the same for all households: those with lower incomes had to allocate a greater proportion of their income to paying their electricity and gas bills compared to those with higher incomes. Specifically, low-income households (20th percentile) allocated 8.1% of their income to this purpose (+0.7 pps more than in 2021), while high-income households (80th percentile) allocated 3.2% (+0.3 pps more than in 2021). This additional effort would have been even greater without the support measures introduced to tackle the energy crisis, which have benefited all households, but especially those on the lowest incomes.[4]

Energy expenditure was substantially higher in 2022 than in 2021 at two specific times of the year: in March and April, just after the outbreak of the war in Ukraine, and between August and October (see third chart). This was an anomaly in the usual pattern of household spending, as bills tend to be highest in January and February (the coldest months) and lowest in October and November (see second chart).

Spain: decile distribution of electricity and gas expenditure

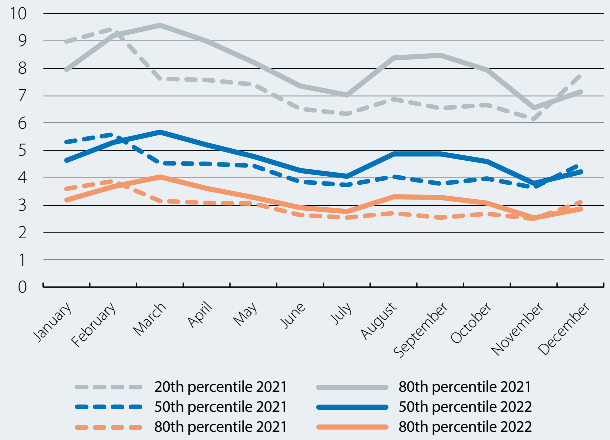
(% of income)



Notes: *(p) Percentile. Median monthly expenditure on electricity and gas in each decile, calculated as a percentage of total annual income converted into monthly income (including wages paid through payrolls and unemployment subsidies or benefits).*
Source: *CaixaBank Research, based on internal CaixaBank data.*

Spain: monthly evolution of energy expenditure

(% of income)



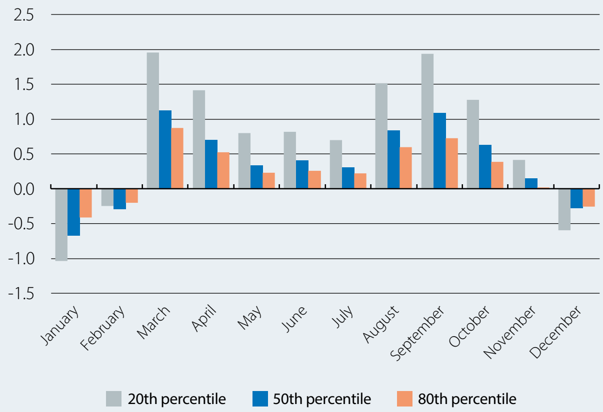
Note: *Median monthly expenditure on electricity and gas in each decile, calculated as a percentage of total annual income converted into monthly income (including wages paid through payrolls and unemployment subsidies or benefits).*
Source: *CaixaBank Research, based on internal CaixaBank data.*

1. In previous articles we analysed the evolution of household electricity bills in these turbulent times following the outbreak of the war in Ukraine. See the Focus «The evolution of Spanish households' electricity bills in 2022» in the MR12/2022 and «Electricity prices are sky high, but what about household bills?» in the MR01/2022.
2. To do this, we add together the monthly expenditure on electricity and gas of each customer aged between 16 and 65 who pays these bills by direct debit. In addition, we calculate the total annual employment-related income – whether wages or unemployment subsidies or benefits – paid into bank accounts that are in the same individual's name. This encompasses the income of all holders of these accounts in order to approximate household income. However, a household's employment income could be underestimated if some wages or unemployment benefits are paid into accounts held with other banks. Moreover, we do not include the income of other members of the same household who are not named as account holders in the account taken into consideration. We then calculate the equivalent monthly income in order to determine the proportion that is allocated to paying these bills.
3. For reference, Spanish households allocated 4.1% of their total expenditure in 2021 to household energy bills (primarily electricity and gas, which is expenditure subgroup 4.5) according to the Household Budget Survey (National Statistics Institute).
4. For further details on the measures taken and their impact on income distribution, see E. García Miralles (2023), «Support measures in the face of the energy crisis and the rise in inflation: an analysis of the cost and distributional effects of some of the measures rolled out based on their degree of targeting». Economic Bulletin, 2023/Q1, Bank of Spain.

The more positive news, however, came at the end of the year. The situation was turned on its head and households across all income deciles allocated a smaller proportion of their income to paying for electricity and gas than they had 12 months earlier. This reduction was particularly pronounced among lower-income households. Moreover, this situation looks set to continue in 2023, given the easing of energy prices observed since the beginning of the year.

Josep Mestres Domènech

Spain: difference in energy expenditure as a percentage of income in 2022 *
(pps)



Notes: ** Difference versus 2021. Median monthly expenditure on electricity and gas in each decile, calculated as a percentage of total annual income converted into monthly income (including wages paid through payrolls and unemployment subsidies or benefits).*
Source: *CaixaBank Research, based on internal CaixaBank data.*

Inflation base effects in 2023: are they important?

Inflation can be measured in many ways, but the most commonly used method is by calculating the year-on-year change in the Consumer Price Index (CPI).[1] By definition, inflation depends on the value of the CPI in the month in question, but also on the value of the CPI 12 months earlier, which is the starting point or «base» value. This reference to past CPI values is what gives rise to the so-called «base effect». In this article, we go over this concept and analyse how it could impact the course of inflation in 2023.

An example is worth a thousand words

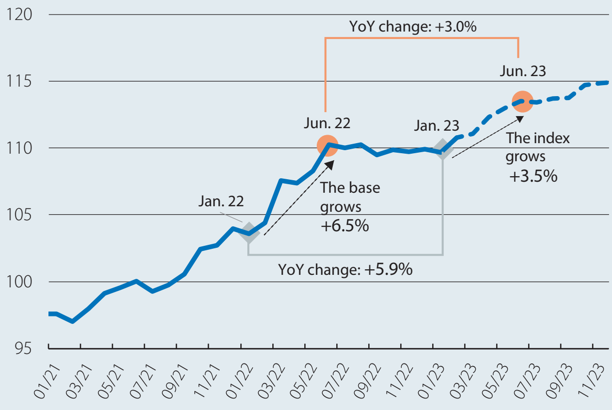
The first chart provides a visual example of the base effect. We show the evolution of the level of the CPI between January 2021 and December 2023, a series which includes our forecasts for the months of March to December this year. Here, we focus on the comparison between inflation in January and that which is expected in June 2023. As can be seen, inflation (remember, the year-on-year rate of change in the CPI) in January 2023 stood at 5.9%. We also expect inflation to fall to 3.0% in June, even though the level of the CPI is expected to climb by 3.5% between January and June 2023. If the index climbs between January and June, how can inflation fall? This fall in inflation (from 5.9% to 3.0%) is explained by the fact that, between January and June of the previous year (the base), the CPI grew at an even higher rate of 6.5%. Put more precisely, the difference in inflation between January and June 2023, of –2.9 pps (3.0%-5.9%), is due to the sum of the positive contribution of the CPI figures between January and June 2023 (of 3.5 pps) and the negative contribution of the CPI between January and June 2022 (of –6.5 pps).[2]

The base effect in 2023

The second chart shows the month-by-month change in inflation throughout 2023, according to our forecast scenario, and the breakdown of this change between the contribution of the impact of the CPI figure for each month and the base effect.

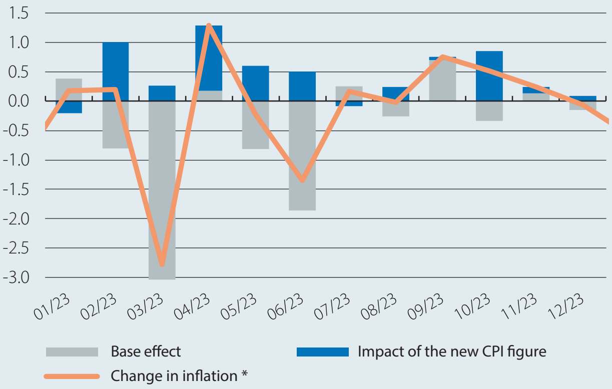
We can extract several messages from this chart. Firstly, it is apparent that the base effect will apply significant downward pressure on inflation throughout the first half of 2023. For instance, we expect inflation to fall by 2.8 pps in March 2023 compared to the previous month. This fall is explained by a monthly increase of 0.3% in the CPI, on the one hand, and a negative base effect of 3 pps, on the other, because the CPI recorded a much higher monthly growth in March 2022 (specifically, 3.0%).

Spain: headline CPI
Index (100 = 2021)



***Note:** Up to February 2023 we show historical data; from March onwards, we show the forecast.*
***Source:** CaixaBank Research, based on data from the National Statistics Institute.*

Spain: contribution to the change in inflation
(pps)



***Note:** * We show the actual change in inflation up until February 2023; from March onwards, we show the forecast.*
***Source:** CaixaBank Research, based on data from the National Statistics Institute.*

Secondly, we can see that the base effects will subside during the second half of 2023, even changing sign in several months. This is because, as can be seen in the first chart of the article, the significant growth in the CPI was concentrated in the first half of 2022, while during the second half of 2022 the CPI remained rather stable.

To sum up, over the coming months we are likely to see inflation levels moderate. This moderation will be driven by the base effects of the previous year, rather than a substantial moderation in the CPI's monthly growth rate during 2023.

Oriol Carreras and Javier Ibáñez

1. The year-on-year change is the percentage change in the value of a variable in a given month compared to 12 months earlier.
2. Figures rounded to one decimal place.

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Industry									
Industrial production index	8.8	2.9	1.6	4.6	4.6	0.8	0.6	...	...
Indicator of confidence in industry *(value)*	0.6	–0.9	6.8	0.4	–5.2	–5.4	–4.8	–3.8	–6.0
Manufacturing PMI *(value)*	57.0	51.0	55.8	53.2	49.2	45.6	46.4	48.4	50.7
Construction									
Building permits *(cumulative over 12 months)*	4.7	–	31.6	18.8	8.8	–	...	...	...
House sales *(cumulative over 12 months)*	9.6	28.9	41.8	33.6	23.0	17.3	14.7	...	...
House prices	3.7	8.1	8.5	8.0	7.6	...	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	64.7	129.5	313.4	311.7	208.4	129.5	129.5	...	...
Services PMI *(value)*	55.0	52.5	52.2	55.9	51.0	50.8	51.6	52.7	56.7
Consumption									
Retail sales	5.1	0.8	0.3	1.2	0.1	1.7	4.0	...	...
Car registrations	158.0	–3.0	–7.5	–10.3	3.1	2.6	–14.1	51.4	19.2
Consumer confidence index *(value)*	–12.9	–26.5	–18.2	–26.9	–32.5	–28.2	–25.3	–22.9	–22.1
Labour market									
Employment [1]	3.0	3.1	4.6	4.0	2.6	1.4	–	–	–
Unemployment rate (% labour force)	14.8	12.9	13.6	12.5	12.7	12.9	–	–	–
Registered as employed with Social Security [2]	2.5	3.9	4.5	4.8	3.5	2.7	2.4	2.3	2.4
GDP	**5.5**	**5.5**	**6.9**	**7.8**	**4.8**	**2.7**	–	–	–

Prices

Year-on-year change (%), unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
General	3.1	8.4	7.9	9.1	10.1	6.6	5.7	5.9	6.1
Core	0.8	5.1	3.0	4.9	6.2	6.5	7.0	7.5	7.7

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	21.2	22.9	26.2	22.2	23.3	22.9	22.9	...	...
Imports *(year-on-year change, cumulative over 12 months)*	24.8	33.4	36.1	35.2	38.1	33.4	33.4	...	...
Current balance	**11.5**	**11.8**	**8.5**	**8.5**	**7.0**	**11.8**	**11.8**	...	...
Goods and services	17.9	22.4	14.2	15.3	15.7	22.4	22.4	...	...
Primary and secondary income	–6.4	–10.7	–5.7	–6.8	–8.7	–10.7	–10.7	...	...
Net lending (+) / borrowing (–) capacity	**22.4**	**25.0**	**19.8**	**21.5**	**19.8**	**25.0**	**25.0**	**...**	**...**

Credit and deposits in non-financial sectors [3]

Year-on-year change (%), unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Deposits									
Household and company deposits	6.1	4.9	5.2	5.4	5.3	3.7	3.2	2.9	...
Sight and savings	10.3	7.9	9.3	9.2	8.2	5.0	3.6	2.3	...
Term and notice	–24.4	–19.7	–26.8	–25.4	–19.2	–7.4	–3.4	0.2	...
General government deposits	15.5	9.6	19.3	15.6	6.6	–3.1	–0.8	5.8	...
TOTAL	**6.7**	**5.2**	**6.0**	**6.0**	**5.4**	**3.2**	**2.9**	**3.1**	**...**
Outstanding balance of credit									
Private sector	0.3	0.7	0.2	0.8	1.3	0.5	–0.4	–0.5	...
Non-financial firms	1.1	0.9	–0.5	0.7	2.4	0.9	–0.7	–0.5	...
Households - housing	0.2	1.0	1.3	1.4	1.1	0.2	–0.2	–0.8	...
Households - other purposes	–1.2	–0.6	–1.1	–0.5	–0.9	–0.1	–0.1	0.2	...
General government	15.3	0.2	3.4	1.9	–3.5	–1.1	0.6	–4.5	...
TOTAL	**1.1**	**0.7**	**0.4**	**0.9**	**1.0**	**0.4**	**–0.3**	**–0.8**	**...**
NPL ratio (%) [4]	**4.3**	**3.5**	**4.3**	**4.1**	**3.8**	**3.7**	**3.5**	**...**	**...**

Notes: *1. Estimate based on the Active Population Survey. 2. Average monthly figures. 3. Aggregate figures for the Spanish banking sector and residents in Spain. 4. Period-end figure.*
Source: *CaixaBank Research, based on data from the Ministry of Economy, the Ministry of Public Works, the Ministry of Employment and Social Security, the National Statistics Institute, the State Employment Service, Markit, the European Commission, the Department of Customs and Special Taxes and the Bank of Spain.*

Tourism, the driving force of the Portuguese economy

Confirmed GDP growth of 6.7% in 2022. Exports and consumption were the components that contributed the most to this result, reflecting the sharp increase in tourism activity and the recovery in the consumption of durable goods, especially cars, thanks to the savings accumulated during the pandemic. The indicators available for the beginning of the year, still scarce, show a more positive pattern than expected in our forecast scenario. The confidence indicators improved in January and February, while the consumer indicators – car sales and card payments – are growing at a steady pace and tourism remains highly buoyant. For now, we keep the 2023 GDP growth forecast at 1%, but the risks are skewed slightly to the upside.

Mixed news on inflation in February. On the positive side, headline inflation fell for the fourth consecutive month, to 8.2%, according to the flash indicator (8.4% in January), thanks to the easing of inflation in energy products. On the negative side, after January brought the first drop in core inflation in 15 months, in February it resumed its rally, climbing 2 percentage points to 7.2%. In addition, unprocessed food registered inflation of 20.1%, a rate not seen since the country joined the euro.

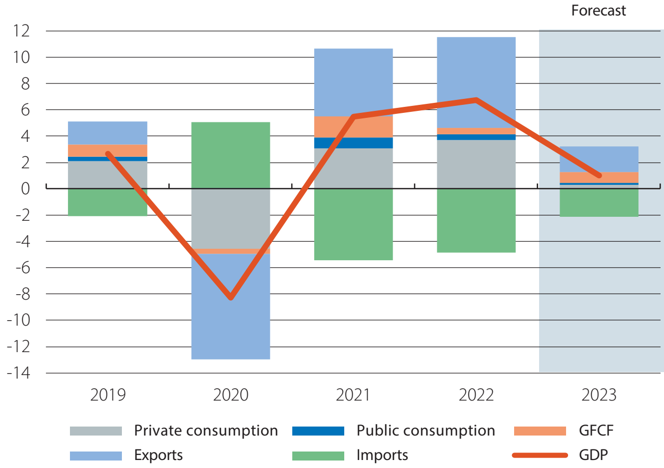
Signs of deterioration in the labour market. The unemployment rate increased to 6.5% in Q4 2022, up 0.7 pps compared to Q3. Moreover, employment fell for the first time since Q1 2021 (–0.5% quarterly, –26,200 jobs), although it is still above pre-pandemic levels (+2.4%, +117,000 jobs). The normalisation of post-COVID activity in some sectors, such as health and social services, may at least partly explain this destruction of jobs. Registered unemployment, meanwhile, continued to climb in January by 4.9% (–9.5% year-on-year), driven by the increase in construction and trade.

Tourism gets off to a good start to the year, with around 1.5 million guests in January. This figure represents growth of 72.5% year-on-year and of 3.2% with respect to January 2020. The overall picture in 2022 was very positive, with total revenues of tourist establishments reaching 16.5% above the level of 2019, despite a slightly lower number of guests (–2%). For 2023 we expect the positive trend to continue, supported by (i) lower energy prices, which will be reflected in air fares, (ii) some specific events, such as the World Youth Days, and (iii) the recovery of Asian tourists.

In 2022 Portugal registered net borrowing of 0.4% of GDP, versus net lending of 1.0% of GDP the previous year. This deterioration mainly resulted from the worsening of the current account balance, which posted a deficit of 0.8% of GDP, due to the increase in the energy and income deficit, which could not be offset by the improvement in the tourism surplus. We expect a return to a surplus in 2023 thanks to a reduction in the current account deficit and an improvement in the capital balance, which will benefit from the receipt of the NGEU funds. The lower current account deficit will be driven by the correction of the energy deficit and the good outlook for the tourism sector.

Portugal: contribution to GDP growth by component

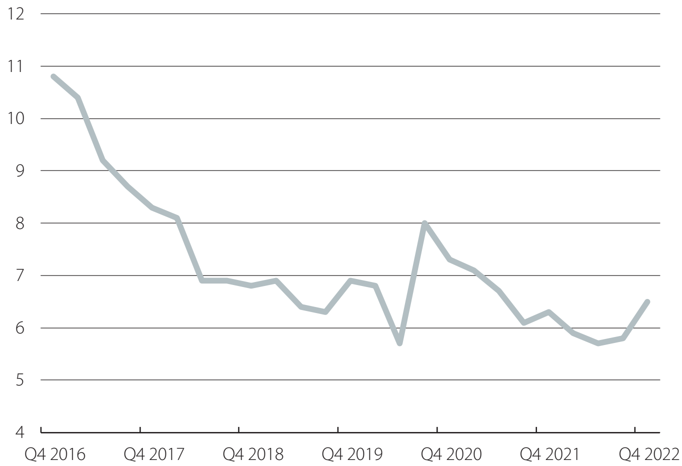
(%)



Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Portugal: unemployment rate

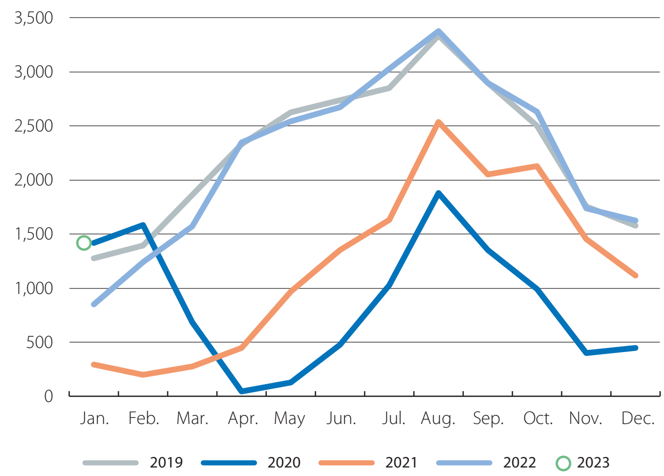
(%)



Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Portugal: number of guests

(Thousands)



Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Coincident economic activity index	3.4	6.0	7.1	6.7	5.4	4.7	4.7	4.7	...
Industry									
Industrial production index	4.5	0.5	–2.1	2.0	1.8	0.1	2.5	...	...
Confidence indicator in industry *(value)*	–5.3	–3.4	–0.1	–2.3	–4.7	–6.6	–6.9	–6.3	–5.0
Construction									
Building permits - new housing (number of homes)	13.5	...	46.0	–22.6	4.3	...	...	...	...
House sales	20.5	...	25.8	4.5	–2.8	...	–	–	–
House prices *(euro / m^2 - valuation)*	8.6	13.8	11.5	14.2	15.8	13.6	13.5	14.9	...
Services									
Foreign tourists *(cumulative over 12 months)*	51.5	158.6	259.9	298.1	244.4	158.6	158.6	154.0	...
Confidence indicator in services *(value)*	0.1	15.0	13.0	21.1	17.9	8.1	5.8	6.1	10.2
Consumption									
Retail sales	4.9	4.8	12.7	3.1	3.3	0.0	0.5	3.7	...
Coincident indicator for private consumption	5.0	4.4	6.9	5.2	3.2	2.3	2.3	2.4	...
Consumer confidence index *(value)*	–17.2	–29.7	–19.3	–30.5	–31.8	–37.0	–38.1	–37.0	–35.0
Labour market									
Employment	2.8	2.0	4.7	1.9	1.1	0.5	–0.5	...	...
Unemployment rate (*% labour force*)	6.6	6.0	5.9	5.7	5.8	6.5	6.7	...	...
GDP	**5.5**	**6.7**	**11.9**	**7.4**	**4.8**	**3.2**	**–**	**–**	**–**

Prices

Year-on-year change (%), unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
General	1.3	7.8	4.3	8.0	9.1	9.9	9.6	8.4	8.2
Core	0.8	5.6	3.1	5.5	6.5	7.2	7.3	7.0	7.2

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	18.3	23.1	21.2	18.9	22.7	23.1	23.1	...	...
Imports *(year-on-year change, cumulative over 12 months)*	22.0	31.2	33.3	31.5	35.2	31.2	31.2	...	...
Current balance	**–1.6**	**–3.2**	**–3.5**	**–4.4**	**–4.2**	**–3.2**	**–3.2**	**...**	**...**
Goods and services	–5.5	–4.9	–6.8	–6.4	–5.3	–4.9	–4.9	...	...
Primary and secondary income	3.9	1.7	3.3	2.0	1.1	1.7	1.7	...	...
Net lending (+) / borrowing (–) capacity	**2.1**	**–1.1**	**–0.1**	**–1.0**	**–1.9**	**–1.1**	**–1.1**	**...**	**...**

Credit and deposits in non-financial sectors

Year-on-year change (%), unless otherwise specified

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Deposits [1]									
Household and company deposits	9.3	6.4	8.9	8.2	7.8	6.4	6.4	5.1	...
Sight and savings	16.3	7.3	15.3	12.9	11.2	7.3	7.3	5.3	...
Term and notice	1.2	5.2	1.1	2.3	3.3	5.2	5.2	4.7	...
General government deposits	–4.1	12.4	9.8	8.5	–0.1	12.4	12.4	22.3	...
TOTAL	**9.0**	**6.5**	**8.9**	**8.2**	**7.5**	**6.5**	**6.5**	**5.5**	**...**
Outstanding balance of credit [1]									
Private sector	2.9	1.3	2.8	2.5	1.9	1.3	1.3	0.9	...
Non-financial firms	2.2	–1.0	1.2	0.7	–0.5	–1.0	–1.0	–1.5	...
Households - housing	3.3	2.7	3.0	3.8	3.3	2.7	2.7	2.6	...
Households - other purposes	3.1	2.9	6.4	3.3	3.2	2.9	2.9	1.4	...
General government	3.8	–2.7	5.3	–1.3	–1.5	–2.7	–2.7	–2.9	...
TOTAL	**2.9**	**1.2**	**2.8**	**2.4**	**1.7**	**1.2**	**1.2**	**0.8**	**...**
NPL ratio *(%)* [2]	**3.7**	**...**	**3.6**	**3.4**	**3.2**	**...**	**–**	**–**	**–**

Notes: *1. Residents in Portugal. The credit variables exclude securitisations. 2. Period-end figure.*
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal, Bank of Portugal and Refinitiv.*

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