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Challenges for the new economic chapter

The beginning of a new economic chapter is marked by the sensation that we may be approaching a turning point in the behaviour of the economy. The information published in recent weeks has confirmed a much better performance of the global economy in the first half of the year than had been anticipated a few quarters ago, with annualised growth of almost 3% up to June, further improvements in the deflation process and the continued strength of labour markets. In addition, the summer passed without any major upsets, and this was in spite of new focal points of geopolitical instability emerging (Sahel, etc.) and the sensation that China will have major difficulties in overcoming the middle income trap, which will have significant medium-term consequences for global growth and for the reorganisation of value chains and trade flows.

But a mill cannot grind with water that is past and that window of hope provided by the behaviour of the business cycle at the beginning of the year is already narrowing due to a confluence of factors: the dilution of tail winds (positive base effects in energy, the reopening of big economies such as China, the normalisation of the bottlenecks and of excess savings following the pandemic), the restrictive effects on demand of the monetary tightening accumulated over the past year and a half, the more than 20% increase in the price of oil in the last two months, the sharp deterioration of business expectations – especially in the industrial sector – and the difficulties experienced by China and Germany in getting to grips with this new post-COVID world. Therefore, with domestic demand weakening and with little hope of greater contribution from foreign demand (judging by the weak signals from global trade), we are heading towards a new phase of growth marked by a weakening of global economic activity. This weakening will not occur evenly, however, with a sharper slowdown anticipated in Europe than in the US, as the recent appreciation of the dollar indicates. If such a temporary bump in growth allows a new balance to be reached that helps to bring down inflation, then central banks could begin to take the pressure off after months of trying to make up for lost time. All this would translate into global growth in 2024 being around 0.3-0.4 pps below that of this year, albeit with a different profile, as the economy would pick up speed during the course of the year, unlike in the current one.

The problem is that the much-sought-after soft landing, especially when it comes to taming an inflationary process, is an unstable equilibrium situation in the face of any new negative shock. We cannot, therefore, rule out the possibility of scares along the way as we lay the foundations for growth in the second half of 2024, at which point central banks could begin to relax the tone of their monetary policy. On the supply side, it seems unlikely that there will be much positive news in the short term, judging by the pattern of energy prices this summer or the situation in China or Germany, which serve as the main barometers for industries that are adapting to the shifting patterns in demand and the rebalancing of geopolitics. The fall in inflation will certainly provide a respite for households' purchasing power in much of the OECD, but in any case this will only be a mitigating factor in the face of the weakening economic activity we can expect to see in the coming months.

In short, ahead of us lies a period of economic slowdown which should help the underlying measures of inflation to begin to consolidate in the 3%-3.5% range. This period with very weak growth – almost stagnation – and with inflation still at levels that are uncomfortable for central banks will pose a challenge for the coordination of economic policy, especially given the need for a new fiscal strategy in Europe, the costs that the war will continue to entail and the demanding electoral calendar on both sides of the Atlantic. Therefore, we are entering a new chapter in which the global economy will have to grapple with a combination of contextual and structural challenges – a situation not unlike that of the past few years.

José Ramón Díez
September 2023

Chronology

AUGUST 2023

14 The United Nations declares July 2023 the hottest month since records began (174 years ago).

JULY 2023

26 The Fed raises rates by 25 bps, placing the target rate in the 5.25%-5.50% range.
27 The ECB raises rates by 25 bps, placing the depo rate at 3.75% and the refi rate at 4.25%.

JUNE 2023

13 The People's Bank of China cuts rates by 10 bps.
15 The ECB raises rates by 25 bps, placing the depo rate at 3.50% and the refi rate at 4.00%.

MAY 2023

3 The Fed raises rates 25 bps, to the 5.00%-5.25% range.
4 The ECB raises rates 25 bp and places the depot rate at 3.25% and the refi rate at 3.75%.
5 The WHO declares the global COVID-19 health emergency over.

APRIL 2023

2 OPEC+ announces an additional production cut of 1.15 million barrels per day (bpd), bringing the total reduction to 3.66 bpd.
9 Kazuo Ueda becomes the new governor of the Bank of Japan.
19 The United Nations estimates that in 2023 India will overtake China to become the country with the biggest population in the world.

MARCH 2023

16 The ECB raises rates by 50 bps and places the depo rate at 3.00% and the refi rate at 3.50%.
18 Russia and Ukraine extend the deal allowing the export of grain and related foodstuffs and fertilisers via the Black Sea.
22 The Fed raises rates by 25 bps, placing them in the 4.75%-5.00% range.

Agenda

SEPTEMBER 2023

1 Portugal: new lending (July).
4 Spain: registration with Social Security and registered unemployment (August).
8 Portugal: S&P rating.
14 Governing Council of the European Central Bank meeting.
15 Spain: quarterly labour cost survey (Q2).
Spain: S&P rating.
19-20 Federal Open Market Committee meeting.
21 Portugal: home prices (Q2).
22 Spain: GDP breakdown (Q2).
Spain: balance of payments and NIIP (Q2).
Portugal: GDP breakdown (Q2).
25 Spain: loans, deposits and NPL ratio (August).
28 Spain: CPI flash estimate (September).
Euro area: economic sentiment index (September).
29 Spain: household savings rate (Q2).
Portugal: CPI flash estimate (September).
Portugal: tourism activity (August).
Portugal: Fitch rating.
Euro area: CPI flash estimate (September).

OCTOBER 2023

3 Spain: registration with Social Security and registered unemployment (September).
Portugal: industrial production (August).
10 Spain: financial accounts (Q2).
17 China: GDP (Q3).
19 Portugal: industrial production prices (September).
23 Spain: loans, deposits and NPL ratio (August).
26 Spain: labour force survey (Q3).
Governing Council of the European Central Bank meeting.
US: GDP (Q3).
26-27 European Council meeting.
27 Spain: GDP flash estimate (Q3).
30 Spain: CPI flash estimate (October).
Portugal: business and consumer confidence indicator (October).
Euro area: economic sentiment index (October).
31 Portugal: GDP flash estimate (Q3).
Portugal: CPI flash estimate (October).
Euro area: GDP (Q3).
Euro area: CPI flash estimate (October).
31-1 Federal Open Market Committee meeting.

The post-pandemic Spanish economy

The Spanish economy of today is very different from that of late 2019, prior to the outbreak of the pandemic. Three and a half years later, GDP has now recovered the level it had then. The latest estimates by the National Statistics Institute suggest that it surpassed this threshold in Q2 2023, finally standing 0.4% higher. But the recovery has not occurred in unison. Some aspects have recovered more quickly and are now in a much better position than before. Others, on the other hand, are lagging further behind. Today the Spanish economy is more competitive and internationalised, and there is less wage inequality between citizens. However, Spaniards as a whole have not yet recovered pre-pandemic consumption levels, while investment has performed rather poorly.

The excellent state of exports of goods and services is clearly a positive development. The figures speak for themselves. Despite registering a sharp decline in Q2 due to the difficult international context, they remain 8.2% above pre-pandemic levels. The strength of the foreign sector is the result of a pattern of improvement that goes back many years, which began after the global financial crisis of 2008 and took hold during the subsequent recovery. But the resistance it has exhibited during the pandemic, first in the face of the collapse of one of the country's main export sectors – tourism – and later amid the energy crisis, has surprised everyone.

This is largely a result of the continued gains in international competitiveness, which are reflected, for example, in the increase in the country's share of exports relative to direct competitors such as France, Germany and Italy. These figures could be better still if investment in R&D&i were increased or if the obstacles that limit the growth of the most productive companies were removed. Despite the improvement of recent years, there is still some way to go.

Investment and household consumption, meanwhile, are still lagging below their pre-pandemic levels. In the case of investment, the trajectory of recent years does not invite optimism. After all, the economy's medium and long-term growth capacity depends largely on its evolution. But at times like the present, when technological change – as well as climate change – requires us to galvanise a profound transformation of the economy, its weak trajectory is even more alarming. Although we did see a notable increase in investment in Q2 2023 – specifically, up 4.6% compared to Q1 2023 – it still lies 0.8% below the pre-pandemic level, with investment in equipment standing 3.5% below. These figures stand in contrast with those of the US, where investment is already 3.5% higher, or France, up 4.5% versus 2019. On the other hand, in Germany, where the industrial sector has been hit hard by the energy and automotive crises, investment has also remained weak and is still 2.0% below pre-pandemic levels.

As for consumption, it is 3.4% below the level of late 2019. The loss of purchasing power caused by the inflation rally in 2022 stopped its recovery in its tracks, and it even fell more than 3% between the end of 2022 and the beginning of 2023. In recent months, inflation has fallen back below the rate of wage growth, allowing a certain recovery in workers' purchasing power, and in Q2 consumption resumed positive growth rates, registering a 1.6% quarter-on-quarter increase. In any case, the loss of purchasing power that has accumulated over the last few years remains all too noticeable. Since the end of 2019, the consumer price index has increased by just over 15% and that of food, by 27%, while wage income has grown by 8.1%, according to CaixaBank Research's real-time wage indicator. Over the coming years, wage rises are likely to remain somewhat above inflation, which should enable a recovery of purchasing power without eroding the gains in competitiveness.

Despite this difficult context, one encouraging development is the notable reduction in wage inequality that has taken place in recent years. According to CaixaBank Research's real-time indicator, the Gini index, which measures wage income inequality, in July of this year it stood more than 2 points below the level of 2019. In addition, the improvement is widespread across the board, both by region and by workers' age, gender and origin. Undoubtedly, the good performance of the labour market in recent quarters has played a key role in reducing inequality. But the slowdown it has recently suffered, with a quarterly growth rate in the number of registered workers that has gone from 1.4% in Q2 to just 0.1% in Q3 to date, will have to be closely monitored over the coming months in order, among other things, to assess how it impacts inequality.

Oriol Aspachs

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	5.75	4.25
3-month Libor	3.62	1.01	0.23	0.21	4.74	5.80	4.00
12-month Libor	3.86	1.48	0.34	0.52	5.47	5.60	3.40
2-year government bonds	3.70	1.04	0.13	0.62	4.41	4.20	2.80
10-year government bonds	4.70	2.57	0.93	1.45	3.62	3.60	3.10
Euro							
ECB depo	2.05	0.20	–0.50	–0.50	1.77	4.00	3.50
ECB refi	3.05	0.75	0.00	0.00	2.27	4.50	4.00
€STR	–	–0.54	–0.56	–0.58	1.57	3.91	3.48
1-month Euribor	3.18	0.50	–0.56	–0.60	1.72	3.87	3.21
3-month Euribor	3.24	0.65	–0.54	–0.58	2.06	3.82	2.94
6-month Euribor	3.29	0.78	–0.52	–0.55	2.56	3.95	3.00
12-month Euribor	3.40	0.96	–0.50	–0.50	3.02	4.08	3.06
Germany							
2-year government bonds	3.41	0.35	–0.73	–0.69	2.37	3.30	2.50
10-year government bonds	4.30	1.54	–0.57	–0.31	2.13	2.80	2.60
Spain							
3-year government bonds	3.62	1.69	–0.57	–0.45	2.66	3.15	2.82
5-year government bonds	3.91	2.19	–0.41	–0.25	2.73	3.23	2.99
10-year government bonds	4.42	3.17	0.05	0.42	3.18	3.90	3.60
Risk premium	11	164	62	73	105	110	100
Portugal							
3-year government bonds	3.68	3.33	–0.61	–0.64	2.45	3.32	3.07
5-year government bonds	3.96	3.94	–0.45	–0.35	2.53	3.33	3.20
10-year government bonds	4.49	4.67	0.02	0.34	3.10	3.70	3.60
Risk premium	19	314	60	65	97	90	100
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.26	1.22	1.13	1.06	1.12	1.15
EUR/GBP (pounds per euro)	0.66	0.84	0.90	0.85	0.87	0.87	0.89
OIL PRICE							
Brent ($/barrel)	42.3	80.1	50.2	74.8	81.3	79.5	79.0
Brent (euros/barrel)	36.4	62.5	41.3	66.2	76.8	71.2	68.8

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	–2.8	6.3	3.4	2.8	3.0
Developed countries	*2.7*	*1.4*	*–4.2*	*5.4*	*2.7*	*1.2*	*1.2*
United States	2.7	1.7	–2.8	5.9	2.1	1.7	0.5
Euro area	2.2	0.8	–6.2	5.3	3.5	0.7	1.0
Germany	1.6	1.2	–4.1	2.6	1.9	–0.3	0.7
France	2.2	1.0	–7.7	6.4	2.5	0.6	0.8
Italy	1.5	–0.3	–9.0	7.0	3.8	1.1	0.8
Portugal	1.5	0.5	–8.3	5.5	6.7	2.6	1.8
Spain	3.7	0.6	–11.3	5.5	5.5	2.3	1.7
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	4.1	0.4	0.6
Emerging and developing countries	*6.5*	*4.9*	*–1.8*	*6.9*	*4.0*	*4.0*	*4.3*
China	10.6	8.0	2.2	8.5	3.0	5.7	4.9
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	1.9
Russia	7.2	1.3	–2.7	5.6	–2.1	–0.5	1.3
Türkiye	5.5	4.5	1.9	11.4	5.6	2.4	3.2
Poland	4.2	3.7	–2.0	6.9	4.9	0.7	2.7
INFLATION							
Global	4.1	3.7	3.2	4.7	8.7	6.6	4.8
Developed countries	*2.1*	*1.6*	*0.7*	*3.1*	*7.3*	*4.6*	*2.4*
United States	2.8	1.8	1.3	4.7	8.0	4.0	2.1
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	5.8	2.9
France	1.9	1.3	0.5	2.1	5.9	4.9	2.5
Italy	2.4	1.4	–0.1	1.9	8.7	6.3	2.6
Portugal	3.1	1.1	0.0	1.3	7.8	4.7	2.6
Spain	3.2	1.3	–0.3	3.1	8.4	3.4	3.4
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	7.3	3.3
Emerging countries	*6.7*	*5.6*	*5.2*	*5.9*	*9.8*	*8.1*	*6.4*
China	1.7	2.6	2.5	0.9	2.0	0.9	2.0
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	5.3	4.5
Mexico	5.2	4.2	3.4	5.7	7.9	6.5	4.6
Russia	14.2	7.9	3.4	6.7	13.8	6.7	5.2
Türkiye	22.6	9.6	12.3	19.6	72.3	46.4	34.9
Poland	3.5	2.0	3.7	5.2	14.3	11.7	6.7

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	4.5	0.5	2.0
Government consumption	5.0	1.1	3.5	2.9	–0.7	1.9	1.3
Gross fixed capital formation	5.6	–1.4	–9.7	0.9	4.6	3.3	3.5
Capital goods	4.9	0.1	–13.3	6.3	4.0	–0.7	4.8
Construction	5.7	–2.9	–10.2	–3.7	4.7	5.9	2.9
Domestic demand (vs. GDP Δ)	4.6	–0.2	–6.4	4.5	3.2	1.3	2.0
Exports of goods and services	4.7	2.9	–19.9	14.4	14.4	3.1	0.3
Imports of goods and services	7.0	0.2	–14.9	13.9	7.9	0.9	1.4
Gross domestic product	**3.7**	**0.6**	**–11.3**	**5.5**	**5.5**	**2.3**	**1.7**
Other variables							
Employment	3.2	–0.4	–6.8	6.6	3.8	1.6	1.3
Unemployment rate (% of labour force)	10.5	19.5	15.5	14.8	12.9	12.3	11.8
Consumer price index	3.2	1.3	–0.3	3.1	8.4	3.4	3.4
Unit labour costs	3.0	0.6	7.7	0.3	0.4	2.6	3.0
Current account balance (% GDP)	–5.9	–0.3	0.6	1.0	0.6	1.0	0.7
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	–10.1	–6.9	–4.8	–4.3	–3.5

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	1.6	1.4
Government consumption	2.3	–0.3	0.4	4.6	2.4	1.2	1.2
Gross fixed capital formation	–0.4	–0.7	–2.2	8.7	2.7	3.2	5.8
Capital goods	3.2	2.6	–5.4	13.9	5.9	–	–
Construction	–1.5	–2.6	1.0	5.5	1.0	–	–
Domestic demand (vs. GDP Δ)	1.3	0.1	–5.3	5.7	4.8	0.9	2.2
Exports of goods and services	5.3	4.0	–18.8	13.4	16.7	7.9	4.5
Imports of goods and services	3.6	2.7	–11.8	13.2	11.0	4.0	5.6
Gross domestic product	**1.5**	**0.5**	**–8.3**	**5.5**	**6.7**	**2.6**	**1.8**
Other variables							
Employment	0.4	–0.5	–1.9	2.7	2.0	0.9	0.4
Unemployment rate (% of labour force)	6.1	11.4	7.0	6.6	6.0	6.6	6.5
Consumer price index	3.1	1.1	0.0	1.3	7.8	4.7	2.6
Current account balance (% GDP)	–9.2	–2.9	–1.2	–0.8	–1.4	0.8	0.7
External funding capacity/needs (% GDP)	–7.7	–1.6	0.1	1.0	–0.4	1.9	2.0
Fiscal balance (% GDP)	–4.6	–5.1	–5.8	–2.9	–0.4	–0.3	–0.1

Forecasts

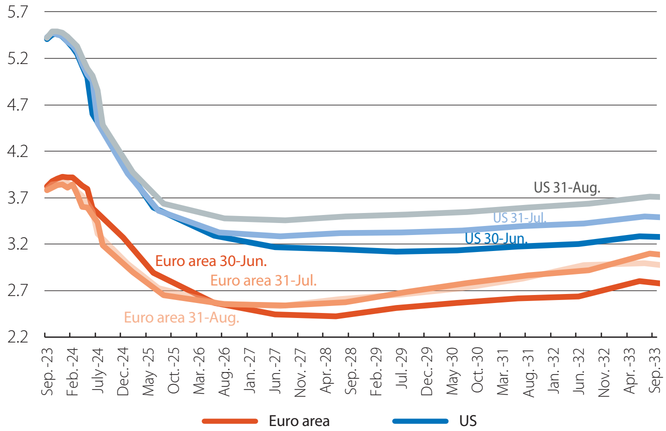
A poor August in the international stock markets sours the return from the holidays

Investors once again expect higher rates for longer. One of the top stories of the summer has been the resilience that the US business cycle continues to show to the interest rate hikes of the last year and a half. This strength has once again fuelled the narrative that the economy could make a soft landing and that interest rates will remain high for longer. As a result, expectations for long-term rates rallied, as did those for sovereign debt yields. The other major story has been the state of the Chinese economy. Together with the rate hikes, this dampened investor sentiment for much of August, and amid the usual low trading volume the world's major stock markets registered falls. On this side of the Atlantic, the weakness of the euro area economy, in contrast to the US, has slowed the rise in European sovereign yields in the last two months.

The Fed and the ECB left their options open ahead of the summer break. Both central banks rose rates in July by 25 bps, with the Fed placing them in the 5.25-5.50% range and the ECB in the 3.75-4.25% range (the depo and refi rates, respectively), underscoring their commitment to bringing inflation under control. However, they left their options open in order to assess the economic data due to be released during the numerous weeks before the next meeting. In other developed countries, the Bank of Canada also raised rates in July by 25 bp, as did the Bank of England in August; only Australia and New Zealand chose not to continue their recent cycle of rate hikes. On the other hand, the Bank of Japan took a small step towards easing its yield curve control policy, with no change to its objectives (official rate of –0.1% and a 10-year sovereign rate that fluctuates, ideally, 50 bps around 0%) but introducing greater flexibility in terms of their implementation (it will be more tolerant of sovereign rate fluctuations, allowing it to reach 1.0%). This first step in the monetary normalisation process has raised investors' expectations of a gradual tightening of Japanese monetary policy in the face of the resilience of the economy, the persistence of inflation and the weakness of the yen in recent months.

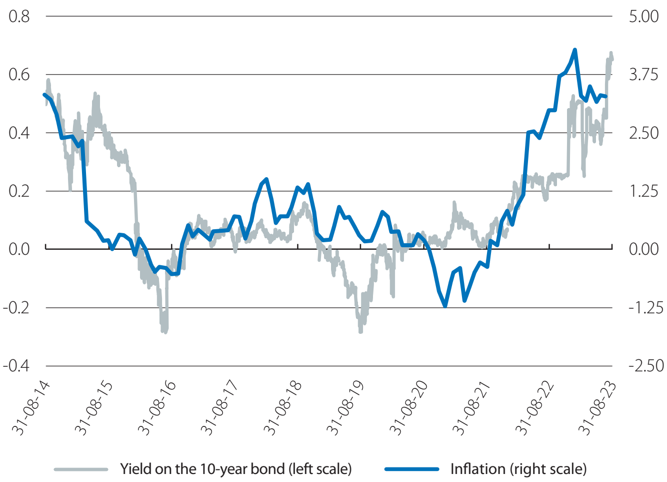
The macroeconomic data drove sovereign rates. In the US, the yield on the 10-year sovereign bond experienced a sharp rally beginning in mid-July, prolonged by Fitch's downgrade of US debt in early August (from AAA to AA+, due to the deterioration of the fiscal accounts). By mid-August it had reached a high for the year of 4.34%, while the 10-2-year slope steepened by more than 40 bps. Towards the end of the month, and despite Powell's relatively hawkish statements at Jackson Hole, US rates fell (particularly the 2-year benchmark rate, which closed August almost flat compared to the end of June) in the face of the release of macroeconomic data which, while still good, fell somewhat short of expectations. In the euro area, short-term sovereign bond yields declined slightly, with the 2-year German benchmark rate ceding more than 20 bps since June. Also in Europe, expectations that ECB interest rates are approaching their peak kept interbank rates flat, with the 12-month Euribor

Expectations for Fed and ECB reference interest rates
(%)



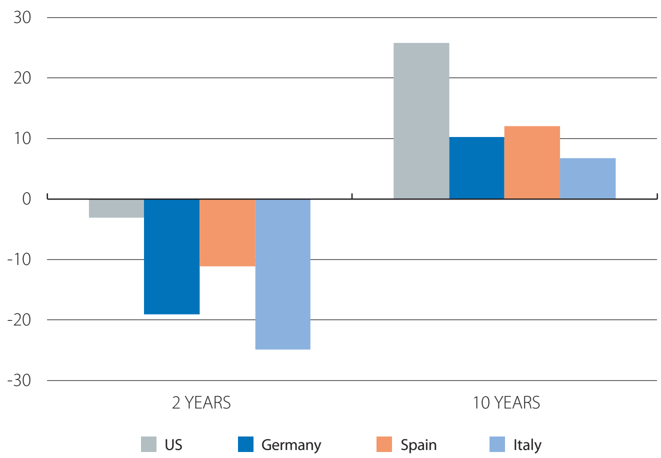
Note: *Forwards on the EFFR and the OIS of the euro area based on market yield curves.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Japan: sovereign rates and inflation
(%) *(%)*



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

*Evolution of sovereign debt by country and term **
(bps)



Note: ** From 30 June.*
Source: *CaixaBank Research, based on data from Bloomberg.*

stable at around 4.1% since June, following its upward march which began at the start of 2022.

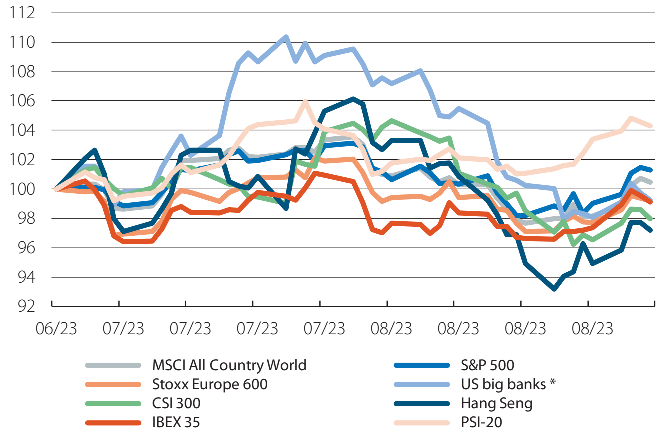
International stock markets suffer a bad month in August. Whereas the major international stock markets saw widespread gains in July, this trend reversed in August, with the MSCI All Country World index registering a 3.0% setback in the month. This performance is explained, on the one hand, by the weakness of the S&P500: after reaching 12-month highs and recording gains for five consecutive months at the close of July, it closed the month of August down 1.8%, weighed down by the poor performance of blue chip companies such as Apple and Tesla and the larger financial institutions. On the other hand, Chinese stocks also suffered losses in August, penalised by difficulties in the real estate sector (Country Garden, one of the country's biggest developers, failed to pay coupons on some of its debt issues) as well as by investors who were sceptical of the public stimulus announced in July, when the authorities promised to shore up the real estate sector's liquidity problems and boost consumer confidence. Shanghai's CSI 300 index and Hong Kong's Hang Seng closed the month down 6.2% and 8.5%, respectively. The European indices registered declines too, especially after the weakness of the business cycle became apparent in the closing weeks of the month. In this respect, the Iberian indices have performed somewhat better than their peers.

The dollar moves back and forth. Investor expectations in early July regarding the Fed's course of action – anticipating one additional rate hike followed by sharp rate cuts in 2024 – weighed heavily on the dollar in the first two weeks of that month, when the US currency depreciated by 3.1% globally according to the DXY index (–3.0% also against the euro). However, the narrative of higher rates for longer has led to a gradual appreciation of the dollar since then, in parallel with long-term rates. This allowed the US currency not to lose its footing over the summer and to close August slightly up versus the levels of June, both globally (+0.7% per the DXY index) and against the euro (+0.6%). As for the rest of the world's currencies, the yen showed particular weakness in August, suffering a depreciation of 2.2% against the dollar in the month.

Big swing in energy prices. Following the sharp rally in June in the European benchmark gas price, the Dutch TTF, as the summer heat arrived and supply pressures emerged, in July the steady progress in the filling of EU deposits calmed investor nerves and led to the price falling 23%. However, this trend was reversed with equal intensity in August with the emergence of new supply-side risks (in particular, the threat of strikes in a major Australian producer) looking ahead to the autumn coinciding with the fall in temperatures. Nevertheless, at the close of August the TTF stood close to 35 euros – the level it had ended the month of June on. As for oil, the Brent barrel price rallied more than 14% in July, driven by announcements of production and export cuts by Saudi Arabia and Russia, and it remained virtually flat in August due to doubts surrounding Chinese demand. These doubts have also weighed on industrial metals in August, which reversed most of the gains they had registered in July. On the other hand, and in spite of Russia's withdrawal from the UN deal on Ukrainian grain exports via the Black Sea, the prices of both wheat and corn have fallen since June by around 17% and 10%, respectively.

Evolution of the main international stock market indices

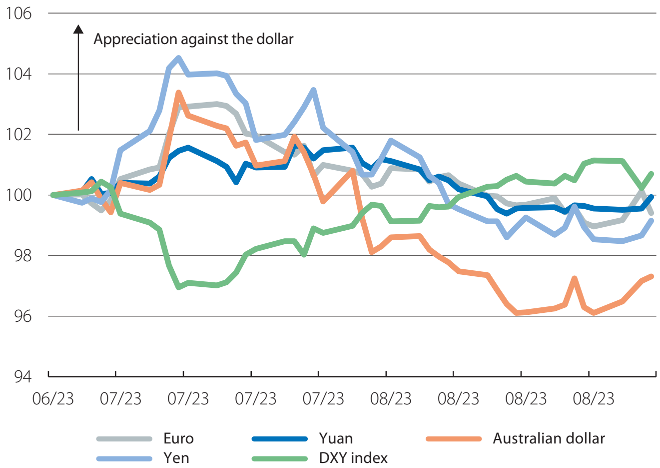
Index (100 = 30 June 2023)



Note: ** BlueStar Top10 US Banks Index (BUBNK).*
Source: *CaixaBank Research, based on data from Bloomberg.*

Currencies: evolution against the dollar

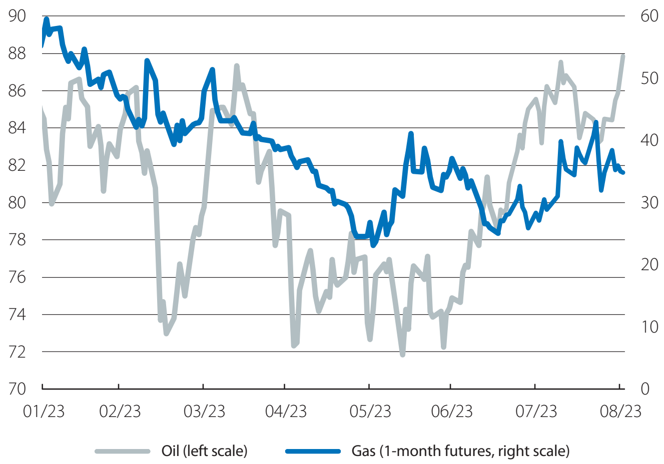
Index (100 = 30 June 2023)



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

Oil and gas prices

(Dollars/barrel) *(Euros/MWh)*



Note: *Brent oil and TTF natural gas.*
Source: *CaixaBank Research, based on data from Bloomberg.*

The importance of rents in US inflation

Inflation is on the decline in most advanced economies, although the core indices are falling at a slower rate. The pace at which they converge to the 2% target will be key in determining the future course of the major central banks' monetary policy. In the case of the US and the Federal Reserve, one important factor will be the component related to housing costs (shelter), which accounts for 34% of the CPI consumption basket (43% if we exclude food and energy).

What does shelter include and how has it evolved since the pandemic?

In the case of the US CPI, the shelter component includes housing expenses. It consists of four subcomponents: rent of primary residence, attributed rents for homeowners, non-primary-residence accommodation and certain types of insurance, which make up 22%, 75%, 3% and 1% of the total component, respectively. The bulk of the shelter component is, therefore, rents, including both those paid by tenants and those attributed to homeowners. Both price changes are obtained through the tenant survey, specifically from the answers they provide about how much rent they pay.[1] Thus, shelter mostly reflects the dynamics of the rental market which in recent years has been quite stressed. As can be seen in the first chart, shelter inflation began to rise rapidly during the second half of 2021 and peaked between late 2022 and early 2023. Since March, however, this rally has moderated, although the year-on-year growth remains well above of the Federal Reserve's target.

Going forward, we can expect a further slowdown in rental prices

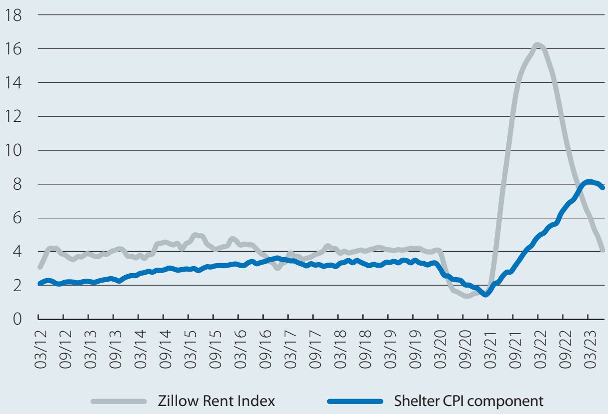
For several months we have been stating that the early indicators in the rental market suggest that this moderation in the shelter component ought to continue and could even be accentuated over the coming months. Moreover, given the significant weight of this component in the CPI basket, this is expected to drive down inflation as a whole. The indicators we refer to are indices such as that produced by Zillow, which shows the evolution of the prices of new rentals (i.e. how the rental price of the same home varies with a change of tenants). The Zillow Rent Index is indicative of the direction that the shelter component will follow in the CPI. That said, its synchrony is imperfect, since the Bureau of Labor Statistics (BLS, the

1. Buying a home is considered an investment rather than a form of consumption, so the purchase price does not figure in the CPI. However, households residing in a property which they own still have a level of consumption that is equivalent to that of households residing in a rented home. For this reason, for a primary residence under ownership, a cost is apportioned equivalent to what the owner would pay if they lived in their home but rented it.

US: inflation of CPI's shelter component
(%)

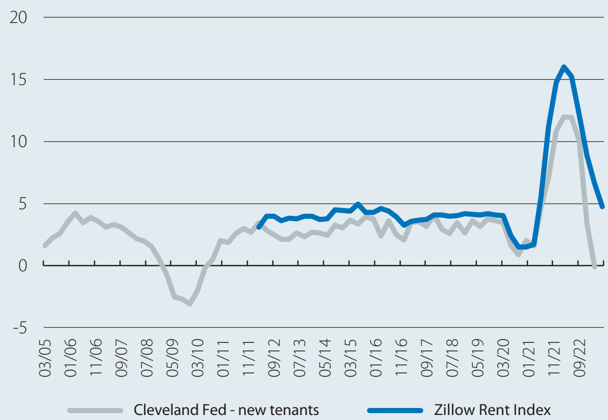
Note: ** Three-month average of the annualised and seasonally adjusted month-on-month inflation.*
Source: *CaixaBank Research, based on data from the BLS.*

US: rental prices per Zillow and shelter
Year-on-year change (%)



Source: *CaixaBank Research, based on data from the BLS and Zillow.*

US: rental prices, different indices
Year-on-year change (%)



Source: *CaixaBank Research, based on data from the BLS and Zillow.*

agency in charge of collecting and publishing CPI data) calculates the variation in rental prices based on a sample of rentals which also includes the rental prices of tenants who continue to live in the same property. In fact, lease contracts with new tenants account for just 13% to 25% of the total CPI rental sample, according to a study by the Federal Reserve Bank of Cleveland.[2] Thus, the rent component of the CPI tends to move in the same direction as the Zillow index, but more slowly and with a time lag.

To try to better understand the BLS's sample and minimise the discrepancy with the early indicators produced by private entities, this study by the Cleveland Fed has used micro-data within the BLS sample to separate rental contracts where there has been no change of tenant and those where there has. As can be seen in the third chart, the Cleveland Fed index for new tenants shows a close correlation with the Zillow index.

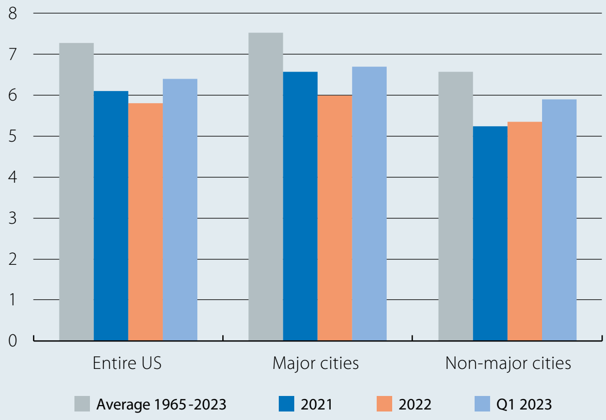
This means that, looking ahead to the next few months, the moderation observed in the Zillow index should translate to the evolution of CPI rents, with some degree of time lag. In particular, based on the historical correlations between a 12-month lag of the Zillow index and the shelter component, we can expect this component to stand at around 4.5% by the end of the year and slightly above 3% by mid-2024. Thus, solely as a result of the direct effect of the year-on-year drop in the Zillow index, headline inflation in the US could decrease by 1.0 pp by the year end and by 1.5 pps by mid-next year. In addition, there are some signs of easing of tensions in the US rental market. For instance, the percentage of homes available for rent compared to the total number of homes being rented in Q1 2023 was above the 2021 and 2022 averages, although it is still below the average since 1965 (see fourth chart).

That said, the situation is not homogeneous across US cities or regions. Differences in rental prices are substantial and, as can be seen in the last chart, so is their year-on-year rate of change. While rents have gone down in some cities (e.g. Las Vegas), in others (e.g. Boston) the year-on-year increases in the price of new rentals according to Zillow are substantial (+7%).

However, as shelter inflation continues to fall, given its significant relative weight in the consumer basket, headline and core inflation as a whole will also continue to come down. Moreover, with disinflation also visible in many other components of the consumer basket, the Federal Reserve has reason to bring its cycle of interest rate hikes to an end soon. Nevertheless, the rate at which inflation will return to 2% is uncertain and, in the absence of an economic downturn, the Federal Reserve will likely be inclined to maintain the environment of high interest rates for several quarters to come.

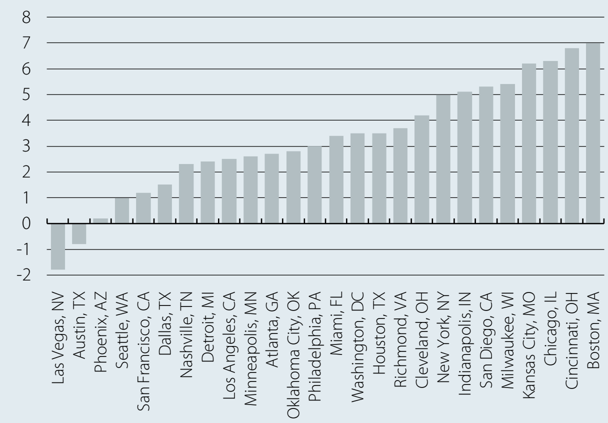
Ricard Murillo Gili

US: homes available for rent
(% of the total stock of rental housing)



Source: *CaixaBank Research, based on data from the US Census Bureau.*

US: rental prices
Year-on-year change (%)



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

2. See B. Adams *et al.* (2022). «Disentangling Rent Index Differences: Data, Methods, and Scope». Working Paper nº 22-38. Federal Reserve Bank of Cleveland.

Interest rates (%)

	31-August	30-June	Change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	4.25	4.00	25	175.0	375.0
3-month Euribor	3.80	3.58	22	166.3	303.2
1-year Euribor	4.10	4.13	–3	81.1	220.6
1-year government bonds (Germany)	3.54	3.59	–5	93.7	284.9
2-year government bonds (Germany)	2.98	3.20	–22	21.4	187.7
10-year government bonds (Germany)	2.47	2.39	7	–10.5	94.1
10-year government bonds (Spain)	3.48	3.39	10	–18.1	76.8
10-year government bonds (Portugal)	3.19	3.13	7	–39.2	58.8
US					
Fed funds (upper limit)	5.50	5.25	25	100.0	300.0
3-month Libor	5.66	5.55	12	89.6	250.5
1-year government bonds	5.38	5.39	–1	69.8	197.2
2-year government bonds	4.86	4.90	–3	43.7	147.6
10-year government bonds	4.11	3.84	27	23.3	91.9

Spreads corporate bonds (bps)

	31-August	30-June	Change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	70	74	–4	–20.5	–44.2
Itraxx Financials Senior	81	85	–4	–18.1	–43.5
Itraxx Subordinated Financials	148	160	–12	–24.1	–82.4

Exchange rates

	31-August	30-June	Change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.084	1.091	–0.6	1.3	8.9
EUR/JPY (yen per euro)	157.820	157.440	0.2	12.4	13.1
EUR/GBP (pounds per euro)	0.856	0.859	–0.4	–3.4	–1.1
USD/JPY (yen per dollar)	145.540	144.310	0.9	11.0	3.8

Commodities

	31-August	30-June	Change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	552.8	547.8	0.9	–0.3	–3.6
Brent ($/barrel)	86.9	74.9	16.0	1.1	–6.6
Gold ($/ounce)	1,940.2	1,919.4	1.1	6.4	13.3

Equity

	31-August	30-June	Change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	4,507.7	4,450.4	1.3	17.4	14.9
Eurostoxx 50 (euro area)	4,297.1	4,399.1	–2.3	13.3	21.2
Ibex 35 (Spain)	9,505.9	9,593.0	–0.9	15.5	19.8
PSI 20 (Portugal)	6,174.0	5,920.3	4.3	7.8	2.8
Nikkei 225 (Japan)	32,619.3	33,189.0	–1.7	25.0	18.0
MSCI Emerging	980.3	989.5	–0.9	2.5	0.9

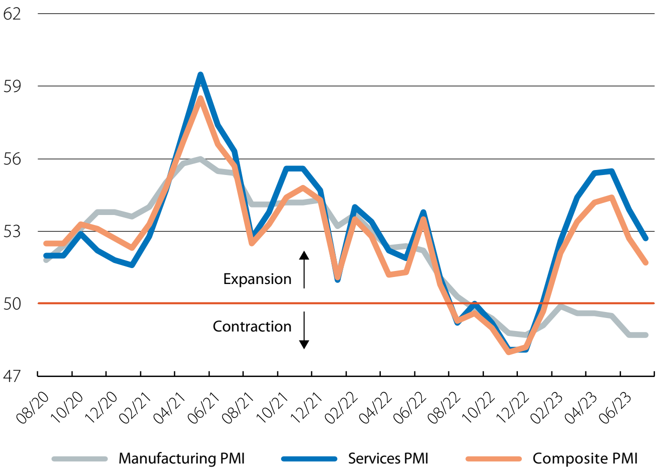
Deteriorating expectations for the global economy

The world economy will slow in the closing stages of the year. There are several factors that justify this hypothesis. China's revival following its reopening has been weaker than expected and the problems in its real estate sector are affecting its financial system. Global interest rates remain in contractionary territory (although some emerging economies have begun to cut rates), and the central banks of the major developed economies have already stated that rates will remain high for longer. In addition, after several years of highly expansionary fiscal policies, especially in Europe and the US, a certain correction is anticipated for 2024. Specifically, the deterioration in the public accounts gave the ratings agency Fitch justification to downgrade the credit rating of the United States (to AA+, from AAA).

The US is beginning to show signs of exhaustion. GDP grew by 0.5% quarter-on-quarter in Q2 (0.5% in Q1), thanks to the revival of non-residential investment (1.5% vs. 0.2%) and the restraint of public spending (0.8% vs. 1.2%). Despite the encouraging figure, some evidence of the impact of the accumulated rise in interest rates since the beginning of 2022 is beginning to become apparent. Household consumption slowed to 0.4% (1.0% previously) in the face of a practical stagnation in spending on durable goods, while residential investment recorded its ninth consecutive quarter in decline (–0.9% vs. –1.0%). Several indicators improved in July (retail sales grew by 0.7% on a monthly basis and industrial production increased by 1.0%, after falling for two months), but a cooling is expected in the coming months. In fact, the composite PMI fell in August for the third consecutive month and stood at 50.4, hinting at a stagnation in economic activity. On the other hand, the labour market remains very robust, but there are certain signs of normalisation: some 170,000 new jobs were created monthly on average in July and August, down from the 200,000 average of the previous three months (substantially revised downwards) and the ratio of job vacancies per unemployed person continues to fall from its 2022 highs. On balance, we can expect a certain moderation in the pace of growth, especially in the closing months of the year, although the resilience shown by the economy has reduced the likelihood of a recession in the coming months (even the Fed has removed this option from the scenarios considered at its last meeting).

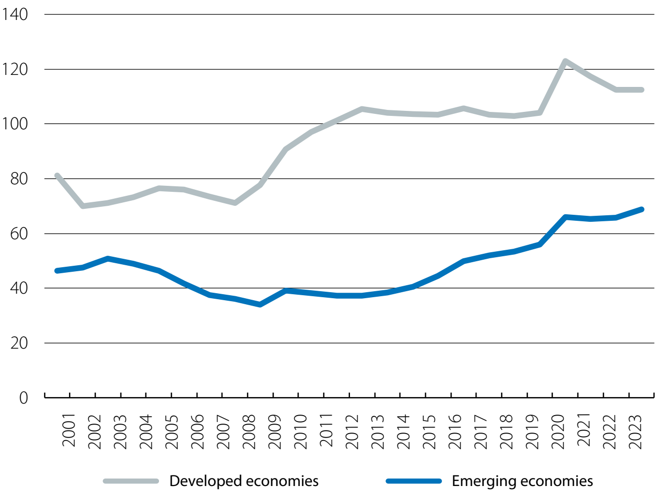
Inflationary pressures in the US remain high but are moderating. Nominal wages show little correction: on average in July and August they maintained a year-on-year increase of 4.4%, similar to the average growth in the rest of the year. This wage performance could limit the intensity of the correction shown by underlying price measures: in July, core inflation fell 0.2 pps to 4.7%, while headline inflation rose 0.2 pps to 3.2%. As for inflation in services excluding housing (a key indicator for the Fed), it has been falling since the end of last year and in July it remained practically unchanged (4.0% vs. 3.9%).

Global: PMI
Index



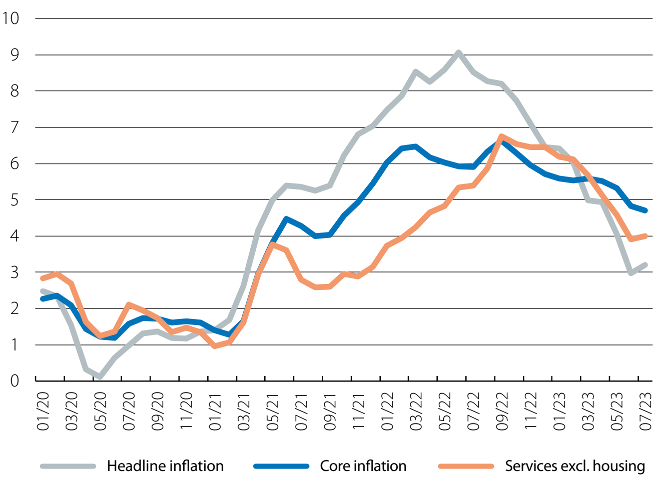
Source: *CaixaBank Research, based on data from S&P Global, via Refinitiv.*

Global: public debt
(% of GDP)



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

US: CPI
Year-on-year change (%)



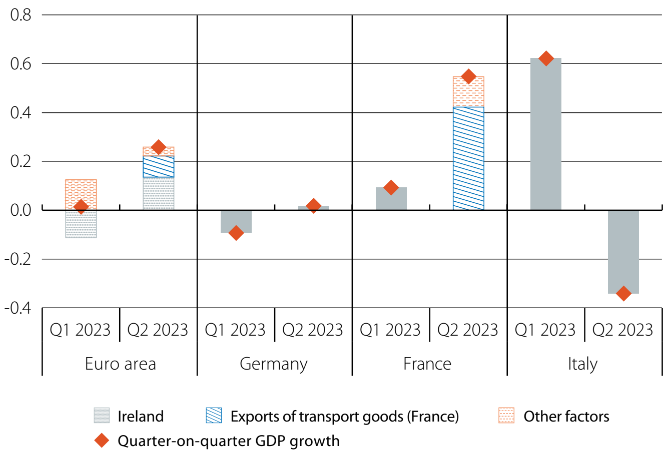
Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics.*

The euro area's resilience falters in Q2 2023. The euro area grew 0.3% quarter-on-quarter in Q2, after stagnating in Q1. However, most of this growth is explained by exceptional factors: France's strong growth (0.5% vs. 0.1% in Q1) was the result of the delivery of a cruise ship, while Ireland's growth remains characterised by its volatility (+3.3% vs. –2.8%). Excluding both of these elements, the euro area barely grew at all, as Italy shrank by 0.3% (+0.6% previously) and Germany stagnated, following two quarters of decline. These figures reveal the weakness of the euro area, which stands in contrast with the buoyancy of the labour market: employment in the euro area in the first half of 2023 grew by 0.8% compared to the first half of 2022, while the unemployment rate in June remained at a low of 6.4%. Moreover, the job vacancy rate in Q2 remains close to its high point (3.1%) and 25% of manufacturing firms and 33% of those in services acknowledge being affected by the labour shortage. This tightening of the labour market is largely determining wage growth: in nominal terms, wages negotiated in collective agreements grew in Q2 at a year-on-year rate of 4.3% (4.4% previously). This is close to the 30-year high, although still significantly below inflation, which is nevertheless falling (in July and August, headline inflation stood at 5.3%, 0.2 pps less than in June, while the core indicator remained at 5.3% in August, still supported by base effects).

Uncertainty in the euro area remains very high. The PMI fell again in August (composite indicator at 46.7 vs. 48.6 in July), affected by declining activity in the services sector (47.9 vs. 50.9), while the weakness of manufacturing persists (43.5 vs. 42.7). Furthermore, the revival of the fiscal rules within the Stability and Growth Pact in 2024 is likely to result in weaker tailwinds going forward. Germany, despite the weakness of its economy, has already cut spending by 6.4% for 2024 (only defence spending increases). On the other hand, the impact of the rate hikes (425 bps since June 2022) has not yet been fully transferred to economic activity and, in fact, Lagarde's statements suggest that monetary conditions will remain tense for some time to come. Consequently, further downward revisions to our forecast scenario cannot be ruled out, especially for 2024 (0.7% in 2023 and 1.0% in 2024, currently).

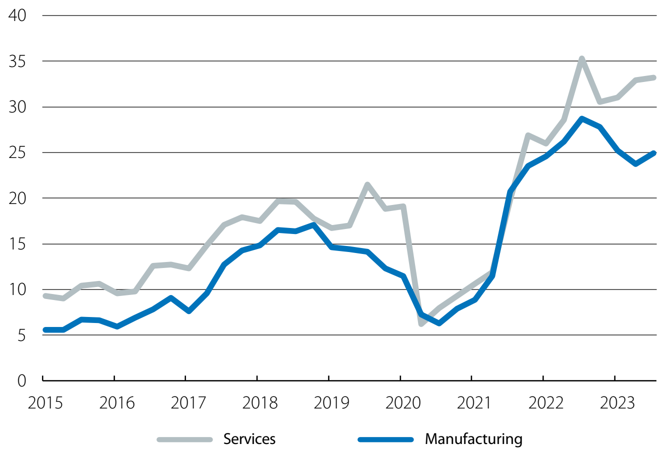
China continues to disappoint. GDP grew in Q2 2023 by just 0.8% quarter-on-quarter, after 2.2% growth in Q1 2023, due to the problems of its real estate sector, among other factors. In fact, over the summer those real estate problems triggered new episodes of financial stress. Country Garden, the biggest private developer in the country, was unable to pay interest on two international bonds; while the Chinese asset management giant, Zhongzhi Enterprise Group, announced that its high exposure to the real estate sector had forced it to suspend payments on its savings products and to restructure its debt. Further evidence of the economy's weakness can be found in prices: in July, inflation stood at –0.3% year-on-year, with production prices registering negative year-on-year change (–4.4%) for the tenth consecutive month. In this context, the fiscal and monetary policy response has been rather gradual.

Euro area: GDP *
Contribution to growth of exceptional factors (pps)



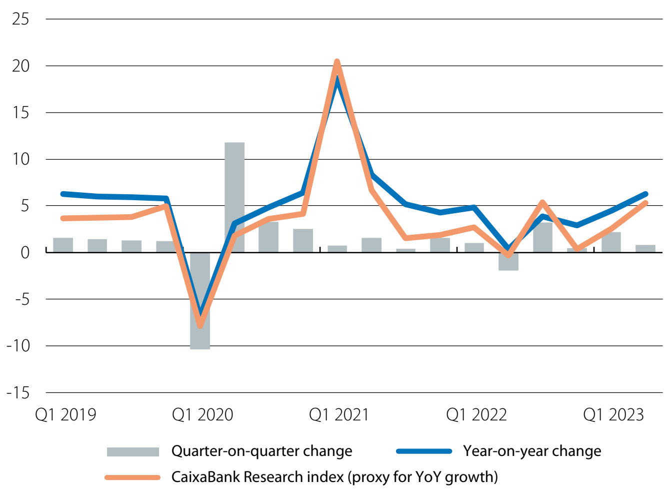
Note: ** Quarter-on-quarter growth.*
Source: *CaixaBank Research, based on data from S&P Global, via Refinitiv.*

Euro area: companies struggling to find labour
(% of respondents)



Source: *CaixaBank Research, based on data from S&P Global, via Refinitiv.*

China: GDP
Changes (%)



Source: *CaixaBank Research, based on data from the National Statistics Office of China, via Refinitiv.*

European inflation: united in diversity

The 20 economies that make up the euro area have a single currency, the euro, with a common monetary policy and, implicitly, a fixed exchange rate. However, in the last two years the euro area has suffered significant discrepancies in the inflation rates of its member countries (see first chart). This dispersion is significant: *de facto*, it leads to differences in the transmission of monetary policy and the terms of trade, because it affects the «real» (i.e. inflation-adjusted) interest rate and exchange rate: 1 euro is 1 euro in both Vienna and Paris, but the purchasing power of that euro depends on the cost of living in each city; similarly, an ECB interest rate of 4% does not have the same effect in an economy where inflation is running at 10% (real interest rate of –6%) as it does in another where it is 2% (real rate of +2%). Thus, the inflation gaps that have opened up in the last two years impact the ECB's decision-making process (see second chart) and pose a challenge for the euro area as a whole. But what is behind this dispersion?

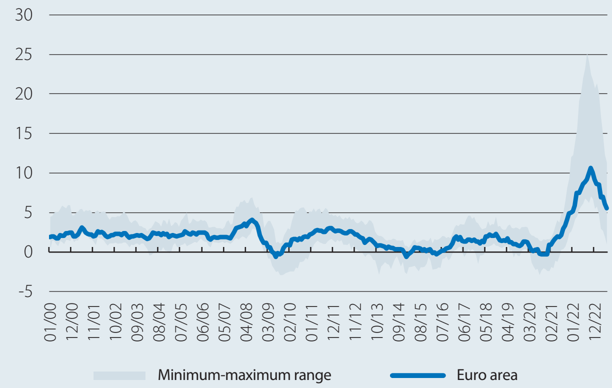
Dispersion: size of inflation matters

In more ordinary times, the range of inflation rates within the euro area spanned from a low of 0% to a high of 3%; in 2022, this range widened to 7%-25%. Some of this dispersion was due to small economies that have suffered very high inflation rates (especially the Baltic countries, with a peak of 25% in Estonia and 22% in Latvia and Lithuania). Yet, the dispersion metrics are not so high if we take into account the relative weight of each economy in the consumer price basket of the euro area as a whole (see third chart).[1]

On the other hand, part of the dispersion between countries reflects a unit effect: if the level of inflation is multiplied by 5 (as was the case of the European average), the value of dispersion metrics such as the standard deviation is also multiplied by 5. For this reason we must also analyse the current situation using relative dispersion metrics, such as the coefficient of variation, which normalises the standard deviation against the mean average level of inflation. As can be seen in the third chart, this indicator is at more normal levels, suggesting that the dispersion between countries is not so abnormal when viewed in the context of widespread high inflation across the euro area.[2]

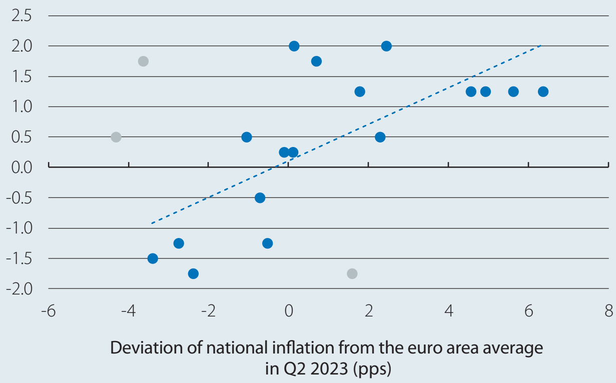
1. Formally, the standard deviation of inflation rates when weighted by the size of each economy is less than the unweighted standard deviation (i.e. when assigning the same weight to all euro area economies).
2. The observation that the dispersion between economies increases with the level of inflation can also be interpreted as evidence of differences in the degree of nominal rigidities between euro area countries.

Euro area: headline inflation
(%)



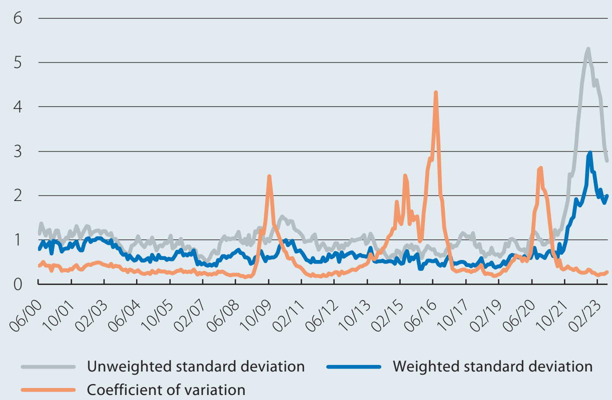
Note: *The chart shows the minimum and maximum headline inflation rate (in year-on-year terms) among euro area member countries, as well as that of the bloc as a whole.*
Source: *CaixaBank Research, based on data from Eurostat.*

Euro area: inflation and tone of national central banks
Tone of the national central bank (Hawk-Dove ranking)



Notes: *Econostream's Hawk-Dove ranking lists national central bank chairs from most «dovish» (negative index) to most «hawkish» (positive index). The grey dots represent three «atypical» cases that do not fit well with the relationship: Belgium, Italy and Luxembourg.*
Source: *CaixaBank Research, based on data from Eurostat and www.econostream-media.com.*

Euro area: dispersion of headline inflation
Index



Notes: *The unweighted standard deviation assigns the same weight to all euro area countries while the weighted standard deviation takes into account the relative weight of each country in the HICP basket of the euro area as a whole. The coefficient of variation corresponds to the weighted standard deviation divided by the mean average inflation of the euro area in a 6-month moving average.*
Source: *CaixaBank Research, based on data from Eurostat.*

Causes of the dispersion...

Context is key, and this is also shown by the fact that the bulk of the dispersion is explained by differences in energy inflation (see fourth chart), although recently there has been somewhat more dispersion in inflation relating to services.[3]

The importance of energy and the inflation «unit effect» are consistent with the idea that behind the dispersion between countries lies the same origin: a common and major shock – namely, the war in Ukraine and its impact on energy and food prices – being transmitted to each country to differing degrees, depending on their exposure to the crisis unleashed by the war and to the various different economic policy responses. Thus, countries with a lower dependence on Russian gas and/or a higher production of renewable energy have, generally speaking, seen their prices less stressed. In the same vein, there has been significant disparity in the policies implemented to tackle the crisis, in terms of both their cost[4] and their design, ranging from incentives for energy saving, to interventions (or lack thereof) in the price system,[5] to direct support for households and businesses.

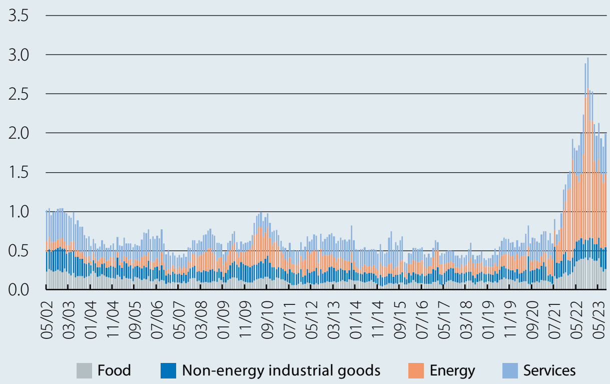
Another way to verify the common origin of this inflation disparity is to analyse the synchrony between inflation in the various countries of the euro area. There are statistical techniques which, taking advantage of the correlation between inflation rates across European economies, allow us to extract a common factor between those national inflation rates. As the last chart shows, the evolution of this common factor explains a large part of the individual dynamics of each country. Indeed, this has intensified in the last two years and it is not just limited to energy prices: with data up to June 2023, the common factor behind the inflation of industrial goods, services and food across euro area countries has also been reinforced.

... and consequences

If the dispersion between countries has its origins in a common shock, which is not only related to energy but also translates into strong common dynamics among the underlying prices of each country, then the differences ought to normalise as inflation itself declines across the euro area as a whole. However, this does not mean there will be a normalisation of the differences between countries' price levels. Indeed, there are indications that the dispersion in inflation rates has led to greater convergence in price levels across euro area countries, and this convergence could accentuate inequalities if it is not accompanied by a convergence in income and productivity.[6]

Euro area: contributions to the standard deviation of inflation

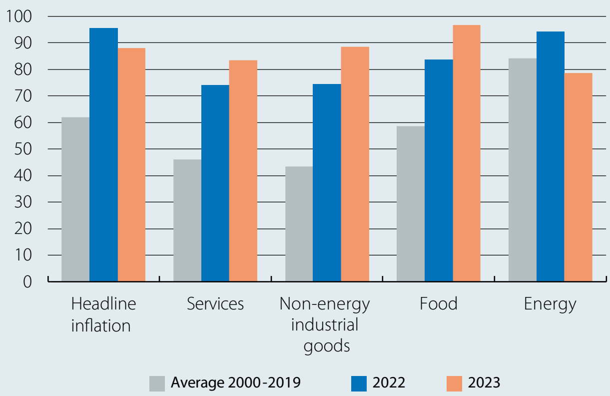
(pps)



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

Euro area: variance in countries' inflation explained by common factors *

(%)



Notes: ** We perform a principal component analysis for inflation (headline inflation and by component) for Germany, Austria, Belgium, Spain, Finland, France, Greece, Ireland, Italy, the Netherlands and Portugal. The chart presents the variance between the countries that is explained by the first principal component, calculated in 24-month rolling windows.*
Source: *CaixaBank Research, based on data from Eurostat.*

3. The recent greater contribution from services is also apparent in the breakdown of the coefficient of variation.
4. According to Bruegel, public support packages range from over 7% of GDP in Germany to less than 1% in Finland.
5. For instance, France opted for direct interventions in gas prices. Thus, the country initially experienced a less pronounced rally in energy prices in the short term, but they are now taking longer to fall back down again in the medium term: at the peak of the crisis, the energy CPI of the euro area was 30% higher than in early 2022, compared to «only» 15% higher in the case of France; today, the euro area figure has eased to 10%, but remains at around 15% in France.
6. See C. Buelens (2023). «The great dispersion: euro area inflation differentials on the aftermath of the pandemic and the war». QREA, vol. 23, nº 2.

The Middle Kingdom and its neighbours (part I): a geo-economic perspective

The meaning and use of the name of the country we know today as China evolved over time. Its most common name, used for the past few centuries and which today is the country's official name in Mandarin, *Zhongguo*, means Middle Kingdom.[1] In addition, China's economic relations with the outside world have also changed over the centuries, going through periods of practical isolation from the outside, periods of high tensions, such as during the Opium Wars, and a period of reopening, since the 1970s. In previous Focuses[2] we have seen how the Asian giant has gained importance in global value chains, surpassing for the first time in 2021 the figure of 3 trillion dollars in exports of goods. The same happened in the opposite direction: the Chinese market has gained importance for most of its trading partners and neighbours. Focusing on Asia, China is the destination for a quarter of South Korea's exports, a fifth of Japan's exports and a sixth of those of ASEAN countries.[3] Two major trends have also emerged in this century: the decline of Japan's manufacturing sector and the growing central role of China in Asian value chains.

Recent developments in Asian value chains: the case of ASEAN countries

In 2021, exports of goods from ASEAN countries to the rest of the world reached 1.4 trillion dollars (compared to 1.3 trillion for USMCA countries and 2.5 trillion dollars for EU countries, to cite other major trading blocs of a continental scope).[4] Globally, including intra-bloc trade flows, the ASEAN region accounts for 8% of global trade, compared to almost 30% in the case of the EU or 12% for USMCA. Looking at the breakdown by sector, almost 40% of ASEAN exports to the rest of the world today correspond to electronics and machinery. A decade earlier, exports from these countries to the rest of the world amounted to 900 billion, with 30% of the total corresponding to these high-tech sectors (at that time, mining and derivative products occupied a prominent second place, with 17% of total exports, compared to 8% today). The Economic Complexity Index (ECI) developed by the Observatory of Economic Complexity (OEC) measures the «technological intensity» of each economy according to the profile of its exports, and it places Singapore in 6th position in global terms, Malaysia in 24th

Value added in exports of third countries originating in ASEAN countries

(% of the VA in the exports of each sector-country)

	EU-27			US			China			Japan			South Korea			Taiwan	Hong Kong	India
	1995-2000	2002-2007	**2015-2018**	1995-2000	2002-2007	**2015-2018**	1995-2000	2002-2007	**2015-2018**	1995-2000	2002-2007	**2015-2018**	1995-2000	2002-2007	**2015-2018**	**2015-2018**	**2015-2018**	**2015-2018**
TOTAL	0.4	0.4	0.7	0.5	0.4	0.4	1.2	1.9	1.6	0.8	1.1	1.7	2.5	2.6	2.4	3.5	2.6	0.8
Agriculture	0.3	0.4	0.6	0.4	0.3	0.6	0.3	0.7	0.8	0.6	0.9	1.3	1.3	1.4	1.7	2.4	2.3	0.1
Mining	0.2	0.2	0.4	0.2	0.2	0.3	0.6	0.8	1.1	0.7	1.1	1.5	1.4	2.0	1.3	2.9	2.9	0.5
Manufacturing	0.5	0.5	0.7	0.7	0.6	0.7	1.4	2.1	1.8	0.9	1.3	2.0	2.7	2.9	2.6	4.0	3.5	0.9
Food	0.4	0.5	0.8	0.6	0.6	0.8	0.7	1.0	1.0	0.8	0.9	1.5	1.4	1.8	2.5	2.4	2.1	0.2
Textiles and clothing	0.7	0.6	0.8	0.8	0.8	0.8	1.2	1.4	1.4	0.7	1.0	1.9	2.2	2.6	3.6	3.6	3.0	0.5
Wood and paper	0.3	0.3	0.5	0.4	0.4	0.6	2.1	2.0	1.4	0.7	1.1	1.6	1.9	2.5	2.4	3.5	3.3	0.4
Chemicals and pharmaceuticals	0.4	0.4	0.7	0.4	0.4	0.5	1.5	1.9	1.6	1.3	1.9	2.4	6.4	5.5	3.1	4.6	4.9	1.5
Metals	0.5	0.4	0.5	0.4	0.4	0.5	1.1	1.4	1.1	1.3	1.9	2.2	3.5	3.1	2.7	3.1	3.8	1.0
Electronics *	0.9	1.0	1.2	1.4	1.1	0.6	1.6	3.2	2.6	0.9	1.2	2.0	2.2	2.6	2.7	4.3	4.2	1.1
Machinery	0.3	0.4	0.6	0.5	0.5	0.7	1.0	1.4	1.3	0.6	1.0	1.5	1.7	1.7	2.0	3.0	3.9	0.9
Transport equipment *	0.4	0.5	0.7	0.6	0.6	0.9	0.9	1.2	1.2	0.7	1.2	2.1	1.5	1.8	2.1	2.2	3.4	1.1
Other manufacturing	0.4	0.4	0.6	0.5	0.4	0.6	1.5	1.7	1.4	0.7	1.3	1.8	2.1	2.2	2.6	2.8	2.6	0.7
Services	0.2	0.3	0.6	0.1	0.1	0.2	0.7	0.9	0.7	0.4	0.6	0.9	2.0	1.3	1.7	1.8	2.2	0.6

Notes: *This table shows the sectoral destination of the value added of the final exports of each country. E.g. Between 2015 and 2018, ASEAN countries accounted for 1.2% of the value added of the electronics exports of the EU-27, 2.6% of China's electronics exports and 4.3% of Taiwan's electronics exports. The data refer to the average for the years 1995-2000 (before China joined the WTO in 2001), 2002-2007 (after China joined the WTO, pre-financial crisis) and 2015-2018 (the most recent years). Based on data from the most recent update of the OECD TiVA database (November 2021).*

Source: *CaixaBank Research, based on data from OECD TiVA.*

1. The western name China (or *Sinae* in Latin) originates from the name Qin (pronounced «chin»), the state which expanded in the upper Yellow River region beginning in the 7th century BC and then emerged as one of the dominant powers of the Seven Warring States, unifying them and establishing the first empire of unified China, under the Qin dynasty, in the 3rd century B.C. See, for example, L.S.K. Kwong (2015) «What's in a name: Zhongguo (or 'Middle Kingdom') reconsidered», The Historical Journal, 58, 3, pages 781-804. Cambridge University Press.
2. See the Focuses «EU and China: mapping out a strategic interdependence (I and II)» in the MR05/2022 and the MR01/2023.
3. The ASEAN countries include Brunei, Cambodia, the Philippines, Indonesia, Laos, Malaysia, Myanmar, Singapore, Thailand and Vietnam. Among these, the largest exporters are Vietnam, Singapore, Malaysia, Thailand and Indonesia.
4. The United States-Mexico-Canada Agreement (USMCA), which substituted the North American Free Trade Agreement (NAFTA), governs a free trade zone encompassing these three countries. If we add trade between countries of the same bloc, then ASEAN countries export a total of around 1.7 trillion dollars, USMCA countries around 2.6 trillion dollars and the EU, some 6.2 trillion.

and Vietnam in 58th (in 2010, Singapore was in 11th place, Malaysia in 29th and Vietnam in 78th).[5] Trade flows in the ASEAN bloc have also been changing course, with greater concentration in China and the US and a loss of importance on the part of Japan. Thus, China and the US each account for around 20% of ASEAN exports (around 15% in 2010), while Japan's share went from 13% in 2010 to 8%.

The first table represents the map of ASEAN countries' integration into global value chains, measuring the value added that originates in these countries as a proportion of the total exports of each sector-country. For instance, for every 100 euros of exports of the European electronics sector, 1.2 euros originates in ASEAN countries (compared to 81 euros produced in the EU itself, 4.1 euros in China and 3.4 euros in the US). On the other hand, 1.8 euros out of every 100 of China's manufacturing exports originates in ASEAN countries (compared to around 82 euros in China, 2.3 euros in South Korea and in the EU, 2 euros in the US and 1.8 euros in Japan).[6] Also, we can see how ASEAN countries have gained prominence in the global manufacturing sector, particularly in more cutting-edge sectors. Moreover, not only has the ASEAN bloc exported more abroad directly (as we can see by analysing the gross export data), but also, through its greater integration into the Asian and European value chains, it has benefited from its pull effect and has exported more indirectly to third countries.

On the other hand, ASEAN countries have also adjusted their production chains. Most notably, Japan has been displaced by China in the regional value chain (see first chart), a «stylised fact» that extends to other Asian economies.[7] In fact, there is a general shift in the «centre of gravity» of value chains towards China, and this also affects other trading partners, such as the US. Finally, it should be stressed that there are important differences between ASEAN countries. In the Focus «The Middle Kingdom and its neighbours: two case studies», in this same report, we analyse the recent experiences of Vietnam and Malaysia in greater detail.

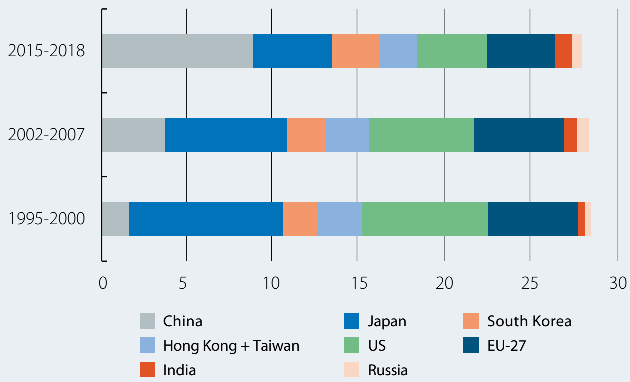
What does the future hold for Asian value chains?

In recent decades, China has acquired an indisputable economic role, which in turn has benefited many Asian economies. However, as it has claimed a geopolitical role proportional to its economic might, tensions have increased with some of its most important trading partners, and this could lead to significant side effects for its economic relations. Will China remain the Middle Kingdom in global value chains? How will its neighbours

5. For reference, Japan ranks first, Germany fifth, the US is in tenth position and China is 25th.
6. At the turn of the century, ASEAN countries accounted for 2% of the VA of China's manufacturing exports, compared to 75% in China, 3% in the EU, in the US and in South Korea, and around 5% in Japan.
7. Not only has Japan lost market share in the region, but manufacturing exports to ASEAN countries, China, South Korea, Taiwan and even the US have fallen in absolute terms. At the same time, there has been a decrease in the percentage of the «domestic» VA (i.e. produced in Japan) in the country's gross exports. However, we cannot talk of Japan decoupling from Asian (or global) value chains, given that other countries (or groups of countries) have increased their presence in Japanese value chains.

Geographical origin of the gross value added (GVA) of ASEAN countries' manufacturing exports

(% of the total GVA)



Source: *CaixaBank Research, based on data from OECD TiVA.*

manage to position themselves in the new geopolitical environment?

While Asia has taken on a crucial role in global value chains, the continent (and, in particular, the Pacific region) is becoming the epicentre of the geopolitical dispute between blocs. The fragmentation of global trade, coupled with China's economic slowdown, will thus bring major challenges to the entire region and, in particular, to the ASEAN countries. Still, there are grounds for optimism. We have seen, for example, how, although China has become the centre of the Asian value chain, ASEAN countries have maintained (and even strengthened) their economic relations with the rest of Asia and with other regions of the world. On the other hand, it should be recalled that, among these countries, some assume geopolitical positions that are closer to China, while others are closer to the US and others maintain a certain «strategic» ambiguity. It is feasible, therefore, that new de-risking strategies on the part of the emerging geopolitical blocs (potentially one that is closer to the US and another to China) could end up generating winners, in particular countries that are geographically located closer to both blocs and those which have certain essential resources (whether natural or technical).[8] Greater economic fragmentation could thus materialise in the form of longer value chains, in which parts of the production process (such as assembly or the production of certain intermediate goods) have to be relocated to regions considered «neutral» with certain competitive advantages. ASEAN countries are among those which, due to their geography and comparative advantages, could even end up benefiting from a more uncertain environment. On the other hand, other countries, such as India, are positioning themselves so as to «hedge their bets» in this geopolitical context, with the possibility of becoming an important trading partner for the region. But of course, no kingdom in the middle will be able to thrive on its own.

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8. See, for example, R. Campos, J. Estefania-Flores, D. Furceri and J. Timini (2023). «Geopolitical fragmentation and trade». Journal of Comparative Economics (published).

The Middle Kingdom and its neighbours (part II): two case studies

In the Focus «The Middle Kingdom and its neighbours (part I): a geo-economic perspective», in this same report, we can see how China has become the centre of gravity of Asian value chains in recent decades and also how this has affected the trade flows of the countries around it. Focusing on the ASEAN bloc, its exports to the rest of the world increased by 50% in the last decade, accompanied by increasing technological specialisation, and its trade flows have been changing course, resulting in greater concentration in China and the US and a loss of importance on the part of Japan. However, there are important nuances between countries, as the cases of Vietnam and Malaysia illustrate well. Vietnam has seen its exports of goods to the rest of the world multiply 19-fold over the past two decades (versus an average 4-fold increase for ASEAN as a whole, and 10-fold for China), transforming it into the largest exporter in the ASEAN bloc. Meanwhile, Malaysia's exports of goods have tripled over the same period.

Recent developments in Asian value chains: lessons from ASEAN

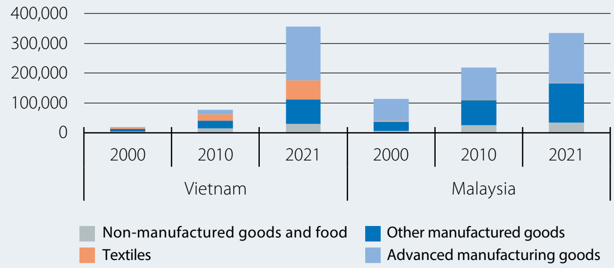
The destination and composition of trade flows from Vietnam and Malaysia have been transformed since the beginning of the century. Vietnam previously exported mostly mining products, refined products and textiles to Asia (over 50% of its exports went to Asian countries, particularly Japan, which accounted for almost 20%). In contrast, in 2021 30% of Vietnamese exports went to the US and more than half are electronics and machinery products.[1] On the other hand, 60% of Malaysia's exports at the turn of the century were electronics and machinery products, especially to the US (21%), and half also went to Asia (especially Singapore and Japan). In 2021, less than half of exports were electronics and machinery products, and they were mainly concentrated in Asia (accounting for two-thirds of Malaysia's exports, with Singapore and China as the top destinations).[2]

The value chains of these two countries have also diverged over time. In the second chart, we can see how Vietnam has become increasingly open to the outside, accompanied by greater integration into the entire Asian value chain, in particular with China and South Korea, while the weight of other advanced economies (such as Japan, the US and the EU) has remained relatively stable. On the other hand, in Malaysia there has been a gradual decrease in the foreign value added in its exports, with the likes of Japan, the US and the EU losing a notable share (see third chart).[3] One notable exception to this trend is the growing integration of Malaysian manufacturing with China, particularly in sectors such as electronics or machinery, which accounts for 10% of the GVA of exports (in Vietnam, this figure stands at 16% in electronics and 21% in machinery).

The evolution of trade with China (the second biggest trading partner for both countries) is particularly interesting. Exports of goods from Vietnam to China have gone from around 7 billion dollars in 2010 (30% mining and refined oil products) to 58 billion in 2021 (60% electronics and machinery). On the other hand,

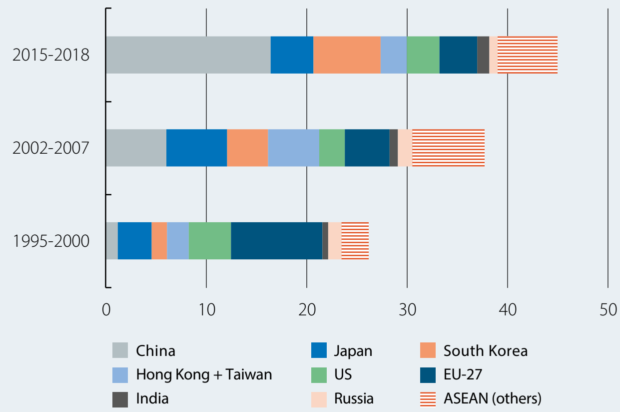
1. Asia still accounts for 50% of Vietnam's gross exports, with China as the main destination accounting for 16% of the total, while exports to Japan account for less than 6%.
2. According to the Observatory of Economic Complexity, the three most exported products by Vietnam in 2010 were crude oil (7%), rice and leather footwear (4% each). In 2021, the sum of these products accounted for less than 3% of the total, and the most exported items were transmission equipment (14%), telephones (7%) and integrated circuits (5%). In the case of Malaysia, in 2010 its most exported products included integrated circuits (12%), gas and palm oil (6% each), while in 2021 the country's top three exports were integrated circuits (21%), refined oil (9%) and palm oil (5%).
3. In fact, in the last decade there has been a decrease in the absolute value of the value added in exports of Malaysian manufacturing products originating in these three markets and in ASEAN countries.

Vietnam and Malaysia: annual exports of goods
(USD millions)



Notes: *Other manufactured goods include wood and paper products, chemicals and pharmaceutical products (including mineral products, such as refined oil) and metals. Advanced manufacturing products include electronics, machinery and transportation equipment. Methodological note: the data reported by the OEC are based on the BACI database (Base pour L'Analyse du Commerce International) of the CEPII research centre (Centre d'Études Prospectives et d'Informations Internationales), which harmonises annual international trade data from the United Nations Statistics Division (UN Comtrade) for more than 150 countries, disaggregated at t he level of more than 5,000 products. For further details on these data sources, see G. Gaulier and S. Zignago (2010): «BACI: International Trade Database at the Product-Level. The 1994-2007 Version», CEPII Working Paper, 2010-2023.*
Source: *CaixaBank Research, based on data from the Observatory of Economic Complexity (OEC) and UN Comtrade.*

Vietnam: geographical origin of the gross value added (GVA) of manufacturing exports
(% of the total GVA)



Source: *CaixaBank Research, based on data from OECD TiVA.*

Malaysia exported 27 billion dollars to China in 2010 (over 50% of which was machinery and electronics), while in 2021 it exported around 48 billion, with a lower proportion of advanced manufacturing (less than 40% corresponds to machinery and electronics) and a greater proportion of mining and refined products (mainly oil and gas) and metals, which went from less than 3% to 15%. The data for China's imports of electronics (one-sixth of the total, on par with mining and refined products) confirm the structural transformation of Vietnam's trade pattern: today, 10% of these imports come from Vietnam (a figure similar to that of Japan or the EU, and only surpassed by South Korea and Taiwan), compared to 5% in the case of Malaysia. A decade earlier, 7% came from Malaysia and less than 1% from Vietnam.[4]

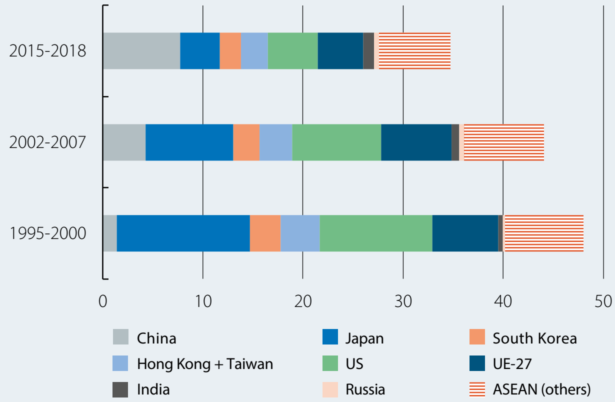
Where are ASEAN countries headed?

Behind these differences in the recent patterns of international trade, it is important to underscore the differing economic, geographical and political conditions among ASEAN countries.[5] In the case of Vietnam, we see a period of economic boom and increasing specialisation, accompanied by a diversification of trade flows. Malaysia, which at the outset was already one of the most developed economies in the region, saw a concentration of its value chain in Asia, particularly in China, whose strong demand for commodities and metals has gained prominence in the country's trade flows. On the other hand, although China's rise in the global market has served to hoist up the export sectors of some of these countries (such as Vietnam or Thailand), which has generated benefits throughout the value chain, it has also resulted in greater competition in the more cutting-edge sectors, and this has a greater impact on the more advanced economies of the region (such as Malaysia, Singapore and Japan).

But the case of Vietnam is not just one of economic convergence and positive side effects from the economic development of China. Vietnam is often cited for the quality of its education system, which has generated a supply of labour that is able to meet the country's growing demand for more specialised skills and has contributed to the rapid expansion of sectors such as electronics. Added to this is the demographic factor, with a growing and young labour force, at a time when other Asian neighbours are facing a population decline. Investment in infrastructure has also helped, as has geography: its capital, Hanoi, is now less than 17 hours' drive from China's leading technology cluster, Shenzhen, and the country's 3,000 kilometres of coastline facilitate global maritime connections.[6] The ingredients behind Vietnam's success, which replicate the experience of the «Asian tigers», thus offer several lessons in development for other countries in the region. Finally, Vietnam may already have been one of the first winners of the US-China trade tensions. Between 2018 and 2021, its exports of electronics to the US have tripled, while China's have practically stagnated.

Malaysia: geographical origin of the gross value added (GVA) of manufacturing exports

(% of the total GVA)



Source: *CaixaBank Research, based on data from OECD TiVA.*

Vietnam is now among the most open economies in the world and is a member of more than a dozen trade agreements, including the RCEP, considered to be the largest regional trade agreement in the world,[7] and, since 1995, the ASEAN group. Despite their dissimilarities, perhaps the greatest achievement of the ASEAN countries has been to bring peace and dialogue to a region devastated by conflicts just a few decades ago. But the bloc could still be more ambitious. Intra-regional trade still accounts for only 20% of total trade in the region (compared to more than 60% in the case of the EU, or 40% for the USMCA, the successor to NAFTA), a rather modest figure considering the high level of tariff-free trade barriers in the region. On the other hand, in a context of growing geopolitical tensions, the virtual non-existence of common institutions makes it difficult to take advantage of the favourable geo-economic environment and threatens the defence of regional priorities, such as the stability of the South China Sea. Like Vietnam in the 1980s, in order for the ASEAN bloc to continue to drive development in the region, it needs a *doi moi* reform plan.

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4. Vietnam has also become the third largest exporter of electronics to the US (accounting for 8% of total imports, behind only China, with 33%, and Mexico with 19%, and above the EU as a whole), compared to 5% for Malaysia. A decade earlier, it accounted for less than 1% of total US imports of electronics.
5. Vietnam had a GDP per capita of approximately 500 dollars in the year 2000 (considered a low-income country, according to World Bank indicators) and since then it has grown annually by 7% on average. Malaysia, meanwhile, had a GDP per capita at 4,500 dollars in 2000 and maintained a growth rate at 5% in the period. Currently, Vietnam has a GDP per capita of 4,500 dollars and Malaysia, 13,000 dollars, placing both countries in the high-middle income range.
6. According to data from the World Bank, foreign direct investment in Vietnam has reached 5% of GDP between 2000 and 2021. This figure is higher than most of its Asian neighbours, such as Malaysia (at 3%), as well as the average for high-middle-income countries (also at 3%).
7. The RCEP (Regional Comprehensive Economic Partnership) was established in 2022 and includes all 10 ASEAN countries, as well as China, South Korea, Japan, India, Australia and New Zealand. Together, it accounts for 30% of global GDP and has a population of over 3 billion people.

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

UNITED STATES

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Activity									
Real GDP	5.9	2.1	1.9	0.9	1.8	2.5	–	–	–
Retail sales (excluding cars and petrol)	15.8	9.3	9.3	7.5	5.9	3.3	4.0	5.3	...
Consumer confidence *(value)*	112.7	104.5	102.2	104.2	105.5	106.1	110.1	114.0	106.1
Industrial production	4.4	3.4	3.5	1.8	1.3	1.0	–0.8	–0.2	...
Manufacturing activity index (ISM) *(value)*	60.7	53.5	52.2	49.1	48.3	47.8	46.0	46.4	47.6
Housing starts *(thousands)*	1,606	1,551	1,446	1,405	1,375	1,378	1,398	1,452	...
Case-Shiller home price index *(value)*	267	306	310	304	302	301	310.9	...	...
Unemployment rate *(% lab. force)*	5.4	3.6	3.6	3.6	3.5	3.5	3.6	3.5	3.8
Employment-population ratio *(% pop. > 16 years)*	58.4	60.0	60.0	60.0	60.1	60.2	60.3	60.4	60.4
Trade balance [1] *(% GDP)*	–3.6	–3.7	–3.9	–3.7	–3.6	–3.5	–3.2	...	...
Prices									
Headline inflation	4.7	8.0	8.3	7.1	6.7	6.3	3.0	3.2	...
Core inflation	3.6	6.2	6.3	6.0	5.7	5.6	4.8	4.7	...

JAPAN

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Activity									
Real GDP	2.2	1.0	1.5	0.4	2.0	2.0	–	–	–
Consumer confidence *(value)*	36.3	32.2	31.0	30.4	30.7	31.2	36.2	37.1	36.2
Industrial production	5.8	0.0	3.7	0.7	–1.8	–1.8	0.0	–2.5	...
Business activity index (Tankan) *(value)*	13.8	9.5	8.0	7.0	1.0	5.0	–	–	–
Unemployment rate *(% lab. force)*	2.8	2.6	2.6	2.5	2.5	2.5	2.5	2.7	...
Trade balance [1] *(% GDP)*	–0.3	–3.7	–3.0	–3.8	–4.0	–4.0	–3.3	–3.0	...
Prices									
Headline inflation	–0.2	2.5	2.9	3.9	4.1	3.9	3.3	3.3	...
Core inflation	–0.5	1.1	1.5	2.8	3.0	3.2	4.2	4.3	...

CHINA

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Activity									
Real GDP	8.4	3.0	3.9	2.9	4.5	6.3	–	–	...
Retail sales	12.4	–0.8	3.5	–2.7	5.8	...	3.1	2.5	...
Industrial production	9.3	3.4	4.8	2.8	3.2	4.5	4.4	3.7	...
PMI manufacturing *(value)*	50.5	49.1	49.5	48.1	51.5	49.0	49.0	49.3	49.7
Foreign sector									
Trade balance [1,2]	681	893	912	893	940	...	935.8	913.0	...
Exports	30.0	7.1	10.0	–6.8	0.1	...	–13.9	–15.4	...
Imports	30.0	0.9	0.2	–6.6	–6.9	...	–6.9	–12.4	...
Prices									
Headline inflation	0.9	2.0	2.7	1.8	1.3	0.1	0.0	–0.3	...
Official interest rate [3]	3.8	3.7	3.7	3.7	3.7	3.6	3.6	3.6	3.5
Renminbi per dollar	6.5	6.7	6.9	7.1	6.8	7.2	7.2	7.2	7.3

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	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Retail sales *(year-on-year change)*	5.4	1.0	–0.5	–2.5	–2.5	–2.2	–1.4	...	...
Industrial production *(year-on-year change)*	9.9	2.3	3.5	2.1	0.4	–1.2	–1.3	...	...
Consumer confidence	–7.5	–21.9	–26.9	–26.9	–26.9	–26.9	–16.1	–15.1	–16.0
Economic sentiment	110.7	101.9	96.5	96.5	96.5	96.5	95.2	94.5	93.3
Manufacturing PMI	60.2	52.1	49.3	47.1	48.2	44.7	43.4	42.7	43.5
Services PMI	53.6	52.1	49.9	49.0	52.8	54.4	52.0	50.9	47.9
Labour market									
Employment (people) *(year-on-year change)*	1.5	...	1.8	1.6	1.6	1.4	–	–	–
Unemployment rate *(% labour force)*	7.7	6.7	6.7	6.7	6.6	6.5	6.4	6.4	...
Germany *(% labour force)*	3.6	3.1	3.1	3.1	3.0	2.9	2.9	2.9	...
France *(% labour force)*	7.9	7.3	7.2	7.2	7.1	7.3	7.3	7.4	...
Italy *(% labour force)*	9.5	8.1	8.0	7.9	7.9	7.7	7.5	7.6	...
Real GDP *(year-on-year change)*	5.7	3.4	2.4	1.8	1.1	0.6	–	–	–
Germany *(year-on-year change)*	3.3	1.9	1.2	0.8	–0.3	–0.1	–	–	–
France *(year-on-year change)*	6.8	2.6	1.2	0.7	0.8	1.0	–	–	–
Italy *(year-on-year change)*	7.3	3.9	2.5	1.5	2.0	0.4	–	–	–

Prices

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
General	2.6	8.4	9.3	10.0	8.0	6.2	5.5	5.3	5.3
Core	1.5	3.9	4.4	5.1	5.5	5.5	5.5	5.5	5.3

Foreign sector

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Current balance	3.1	–0.9	–0.4	–0.9	–0.6	0.0	0.0	...	...
Germany	7.7	4.2	4.7	4.2	4.4	5.1	5.1	...	...
France	0.4	–2.0	–1.2	–2.0	–1.9	–1.8	–1.8	...	...
Italy	3.1	–1.2	–1.1	–1.2	–1.0	–0.4	–0.4	...	...
Nominal effective exchange rate [1] *(value)*	**94.3**	**90.8**	**88.9**	**91.7**	**93.1**	**94.2**	**94.4**	**95.8**	**...**

Credit and deposits of non-financial sectors

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Private sector financing									
Credit to non-financial firms [2]	3.5	6.7	8.4	7.9	5.7	3.9	3.0	2.2	...
Credit to households [2,3]	3.8	4.4	4.5	4.0	3.2	2.1	1.7	1.3	...
Interest rate on loans to non-financial firms [4] *(%)*	1.2	1.8	1.8	2.9	3.8	4.5	4.8	4.9	...
Interest rate on loans to households for house purchases [5] *(%)*	1.3	2.0	2.1	2.9	3.7	4.2	4.4	4.5	...
Deposits									
On demand deposits	12.8	6.3	6.3	1.4	–3.9	–8.0	–9.2	–10.5	...
Other short-term deposits	–0.8	4.5	5.3	12.0	17.6	22.5	24.0	23.9	...
Marketable instruments	11.6	3.6	4.1	7.5	19.4	22.0	22.8	20.6	...
Interest rate on deposits up to 1 year from households *(%)*	0.2	0.5	0.4	1.1	1.9	2.5	2.7	2.8	...

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.*

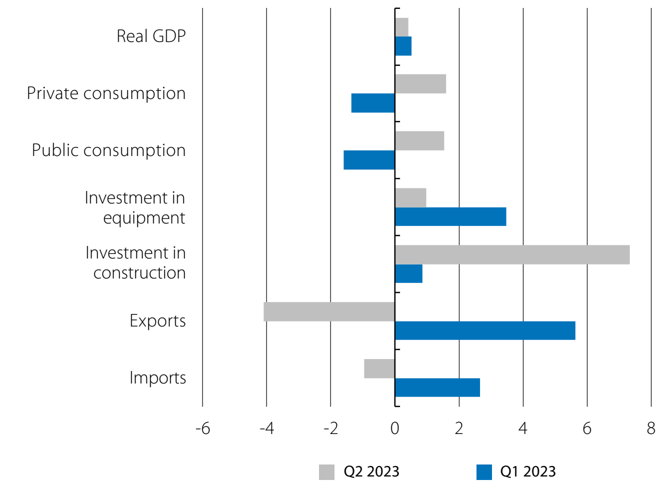
The Spanish economy remained resilient in the first half of 2023, but challenges dominate the second half

We revise the growth forecast for the Spanish economy in 2023 due to the strength of the economy during the first half of the year. GDP recorded notable growth during the first half of the year, with quarter-on-quarter rates of 0.5% and 0.4% in Q1 and Q2, respectively. In contrast, the first indicators available for Q3 show that the pace of growth is moderating. This slowdown corresponds to an environment in which the growth of our main trading partners is cooling, the tourism sector is moderating its growth rate due to having already recovered its pre-pandemic levels of activity and in which the tightening of monetary policy is taking its toll. Overall, the impact of the good data for the first half of the year overrides the slowdown we project for the second half, leading us to revise the GDP growth forecast for 2023 as a whole up by 0.3 pps, to 2.3%. Nevertheless, we do not rule out revising this forecast to the downside in the coming months if the signals from the indicators continue to deteriorate.

GDP grew in Q2, spurred by domestic demand. In Q2 2023, GDP grew by 0.4% quarter-on-quarter (1.8% year-on-year) thanks to the strength of domestic demand, as private consumption truncated its downward trend and rose a significant 1.6% quarter-on-quarter, driven by the moderation of inflation rates. Investment also registered significant growth of 4.6%, driven by increases in investment in capital goods (1.0% quarter-on-quarter) and, above all, in construction (7.3%). On the side of the foreign sector, exports fell more sharply than imports (–4.1% and –1.0% quarter-on-quarter, respectively). The reduction in exports was the result of a sharp contraction in exports of goods (–5.9%), while those relating to tourism services grew by 1.5%. Thus, in quarter-on-quarter terms, domestic demand contributed 1.8 pps to GDP growth, while foreign demand contributed 1.4 pps.

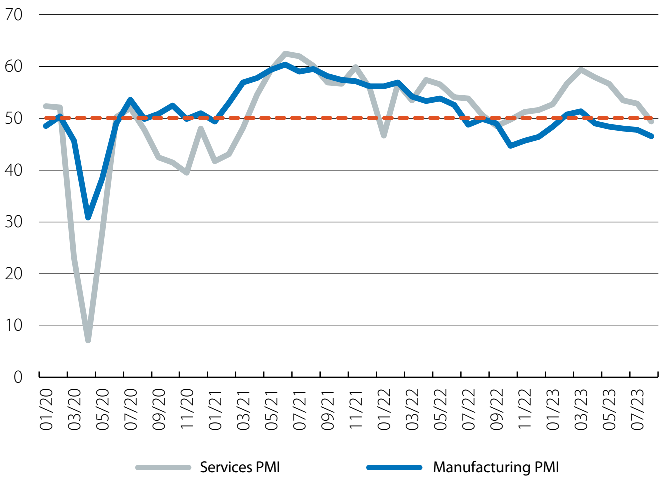
The first available indicators for Q3 point to a slowdown in growth. In August, the Purchasing Managers' Index (PMI) for the manufacturing sector suffered a significant deterioration due to a contraction in order book volumes, bringing it down to 46.5 points. This is 1.3 points below the July reading and well below the threshold that delimits growth (50 points). This reading suggests that the rate of contraction in industrial activity has accelerated compared to previous months. The PMI for the services sector also fell sharply, by 3.5 points, placing it at 49.3, also in contractionary territory. Also, in August, the number of registered workers affiliated with Social Security increased by some 18,000 people in seasonally adjusted terms, which is below the average monthly growth rate of around 52,000 affiliates in Q2. With the data for July and August, the number of registered workers grew at a rate

Spain: GDP and components of demand
Quarter-on-quarter change (%)



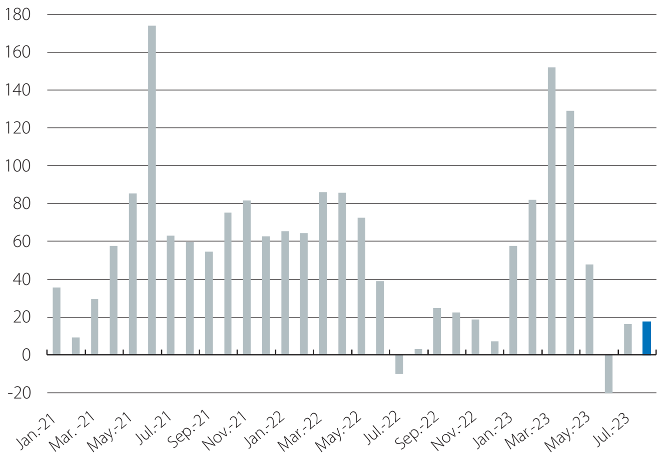
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: PMI
Level



Source: *CaixaBank Research, based on data from S&P Global.*

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



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

of 0.1% relative to the Q2 average, compared to the 1.4% quarter-on-quarter increase recorded in Q2.

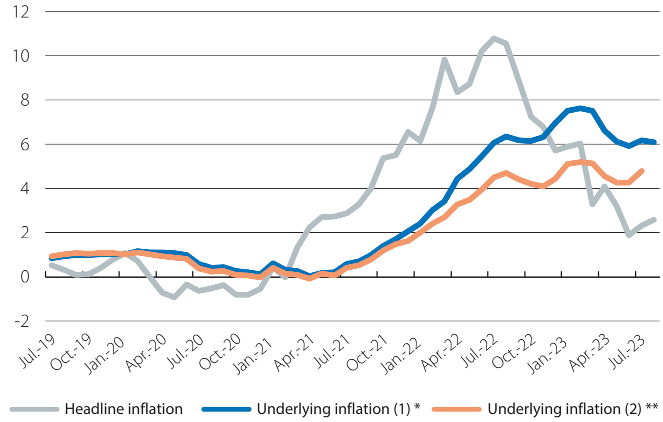
The Spanish labour market recorded excellent results in Q2. According to the LFS, employment increased in Q2 2023 by 604,000 people, marking the biggest quarterly increase in the series and far exceeding the usual growth for that quarter (+377,000 on average in 2014-2019). In seasonally adjusted terms, employment grew by 1.4% quarter-on-quarter (1.2% in Q1), the highest rate since Q3 2021 when the state of emergency due to the COVID-19 pandemic came to an end. In addition, the unemployment rate fell from 13.3% to 11.6%, its lowest level since 2008.

Inflation in Spain rallied in August due to the rise in fuel prices. Headline inflation rose in August to 2.6% (2.3% in July), according to the National Statistics Institute's flash indicator, while underlying inflation (excluding energy and unprocessed food) moderated to 6.1% (6.2% in July). The NSI has not published the breakdown by component, but stressed that the rise in headline inflation was mainly driven by the increase in fuel prices. In July, the month for which we do have the breakdown by component, headline inflation stood at 2.3% (1.9% in June). That increase was due to several factors. Firstly, it was driven by the increase in fuel prices, up 1.7% month-on-month, in contrast to the decrease observed a year earlier, of –2.1% month-on-month. Secondly, core inflation rose to 4.8% (4.3% in June), driven by a lower monthly decline in clothing and footwear prices than in July 2022 and a higher rise in tourist package tour prices than a year ago. Thirdly, the increase in unprocessed food prices rallied from 6.3% to 8.9%. It should also be noted that the base effects, which during the first half of the year have contributed substantially to reducing inflation, will be much more moderate in the second half of 2023 and could even slightly counteract its reduction.

The current account balance remained in a healthy position in the first half of the year and posted a surplus of 18,981 million euros, contrasting with the cumulative deficit in the first six months of 2022 (–2,021 million). On the one hand, the tourism sector exhibited very strong data with a surplus of 27,426 million, an all-time high in the first half of the year. On the other hand, the trade deficit moderated to 16,420 million (–31,963 million a year ago). This was thanks to the reduction of the energy deficit to 16,705 million, compared to 25,896 million in the same period of 2022, as well as the improvement in the balance of non-energy goods, which posted a surplus of 285 million compared to last year's deficit of 6,069 million.

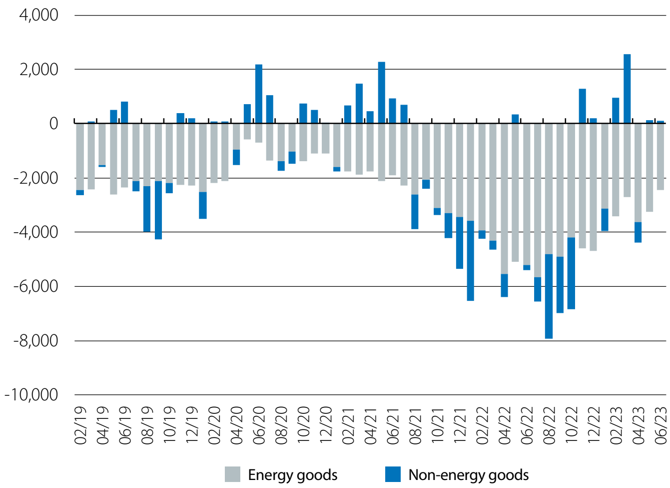
Tax revenues are growing at a steady pace, albeit slower than in 2022. Consolidated tax revenues (excluding local government corporations) to May grew by 7.8% year-on-year, down from 12.0% in the same period of 2022. While direct taxes and social security contributions are growing at a steady rate due to the growth of employment, indirect taxes are slowing down due to the VAT cuts and the moderation of inflation.

Spain: CPI
Year-on-year change (%)



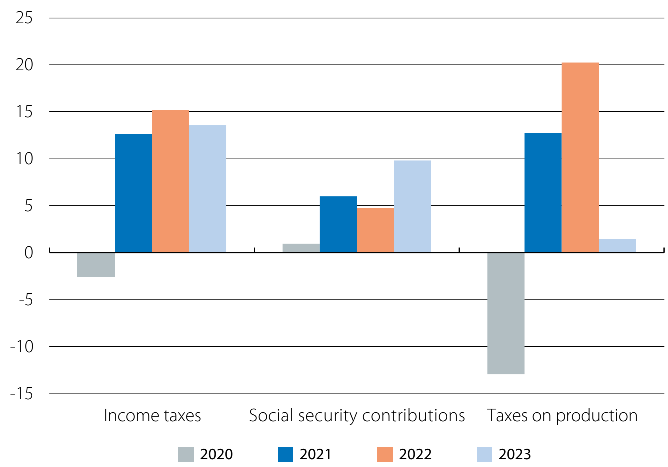
Notes: ** Underlying inflation (1) excludes unprocessed food and energy.*
*** Underlying inflation (2) excludes food and energy.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: trade balance of goods
Monthly data (EUR millions)



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

Spain: consolidated general government revenues *
Year-on-year change in the cumulative balance to May (%)



Note: ** Excluding local government corporations.*
Source: *CaixaBank Research, based on data from the General Comptroller of the State Administration (IGAE).*

The rebound in Spanish households' savings and the buoyancy of gross disposable income: what is going on?

In Q1 2023, there has been a change of trend in the savings rate of Spanish households. After peaking at 18.9% in Q1 2021[1] due to the drop in consumption during the now distant lockdowns, we witnessed how this rate fell steadily to 7.2% by the end of 2022 as the restrictions were lifted and inflation rallied. This downward trajectory in the savings rate was truncated in Q1 2023, with the cumulative savings rate for the past year climbing to 7.5%, well above the pre-pandemic average (6.7% on average in 2015-2019). The savings rate according to the static figure registered in Q1 of this year was the highest in a first quarter since 2004, excluding the exceptional years of the pandemic.[2]

What is behind this rebound in the savings rate? As we will see, there are two main factors that explain this shift: on the one hand, the rise in gross disposable income, which has been particularly notable for some segments of the population; on the other, the fall in inflation, which has naturally led to a moderation in the growth of nominal household expenditure.

Let us begin with the trend in disposable income – in other words, Spanish households' income after taxes. This variable grew by a remarkable 10.1% year-on-year in Q1 2023 (statics figure), the highest growth rate since Q2 2001. The main factors driving this growth are: the growth in the volume of total wages (+7.8% year-on-year), reflecting the increase in employment and greater wage buoyancy,[3] social benefits (+8.5% year-on-year, driven by the inflationary update to pensions), self-employed workers' income and asset income thanks to increased dividend payments and other types of investment income. All this has offset the increase in net interest payments, which amounted to over 4.1 billion euros (up almost 1.8 billion versus the stagnant figure for Q1 2022).

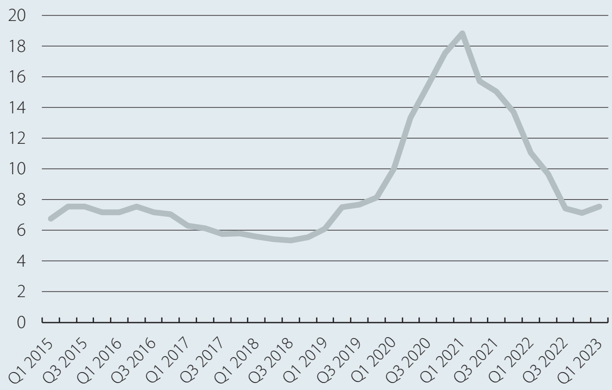
If we look at disposable income per household, it should be taken into account that in the last year, in net terms, 241,000 households were created (+1.3% year-on-year), largely due to migratory flows. Thus, income per household grew by 8.7% year-on-year in Q1, below the increase in aggregate disposable income (10.1%). If we look at the growth of disposable income per household in real terms, we see that the growth rate is just 3.5%.

In spite of the surge in nominal income, households' disposable income in real terms over the cumulative period of the last four quarters is still 5% below pre-pandemic levels. Despite this, the moderation in inflation is allowing disposable income in real terms to recover lost ground and to gradually converge on pre-pandemic levels.

In contrast, household consumption has been losing steam: it rose by 7.4% year-on-year in Q1, well below the 11.6% registered for 2022 as a whole. The moderation of

Spain: household savings rate

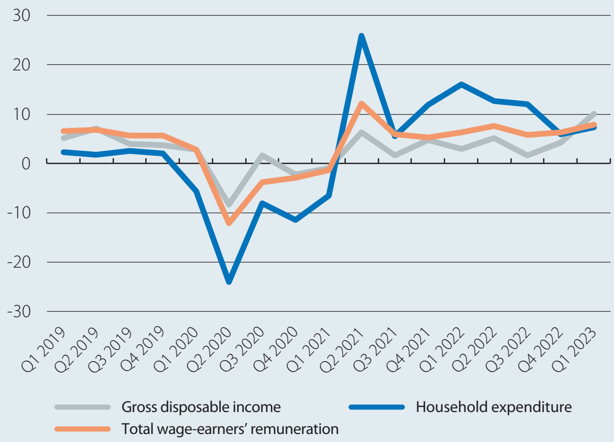
(% of gross disposable income)



Note: *Cumulative trailing 4 quarters.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: gross disposable income and household consumption

Year-on-year change (%)



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

1. Savings as a percentage of disposable income in the trailing four quarters.
2. If it is not seasonally adjusted, the savings rate in Q1 (static figure) tends to be low or negative due to the high consumption around Epiphany. In Q1 2023, gross savings amounted to 1.9 billion euros, well above the level traditionally registered in Q1 2015-2019, when it was negative.
3. In Q1 2023, the increase in the number of full-time wage-earners was 2.6% year-on-year, representing a rise in remuneration per employee of over 4.0%.

inflation, combined with the interest rate hikes, explain the weaker consumption. At the same time, expectations of a moderation in economic activity linked to the tightening of monetary policy may also be influencing households' spending decisions.

Of course, although the savings rate has increased on aggregate, there are notable differences between households. Unsurprisingly, the year-on-year growth of the volume of total wages in Q1 (7.8% year-on-year) was very much in line with that of consumption (7.4%). In contrast, pensioners have seen their pensions increase by 8.5% year-on-year, while the rise in net asset incomes is likely to have benefited high-income households with a lower marginal propensity to consume.

For the year as a whole, we expect gross disposable income growth to be around 5.0%. On aggregate, this should allow household consumption in real terms to end the year at a level very similar to that of 2022, despite the challenging context marked by the rise in interest rates and still high inflation.

Javier Garcia-Arenas

Non-financial accounts of households

	Q1 2022 (€ millions)	Q1 2023 (€ millions)	Change (%)
Total wage-earners' remuneration (+)	147,026	158,507	7.8
Self-employed workers' income (+)	47,886	52,966	10.6
Net property income (+)	3,863	4,017	4.0
*Net interest payments * (–)*	*–2,363*	*–4,118*	*74.3*
Other (dividends, other investment income, etc.) (+)	*6,226*	*8,135*	*30.7*
Income taxes (–)	–28,909	–32,137	11.2
Net social sec. contributions (–)	–46,939	–50,170	6.9
Social benefits (+)	55,258	59,943	8.5
Other (+)	5,632	9,221	96.1
Final GDI ** (National Accounting)	183,817	202,347	10.1

Notes: ** Before the allocation of financial brokerage services.*
*** GDI refers to gross disposable income.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: households' disposable income and total volume of wages in real terms *
Index (100 = Q4 2019)

Note: ** Cumulative trailing 4 quarters.*
Source: *CaixaBank Research.*

Spanish households and businesses continue to deleverage

Having overcome the crisis triggered by the pandemic, which caused debt-to-GDP levels to skyrocket, debt ratios have now resumed the downward trajectory they were on prior to COVID. In particular, in the private sector, both businesses and households already have lower levels of debt than before the pandemic and much lower than they had during the financial crisis of 2008. All this, together with the greater weight of fixed-rate debt, puts them in a less vulnerable position to cope with the rise in interest rates.

The total debt of the Spanish economy[1] increased by 0.6% quarter-on-quarter (21.5 billion euros) in Q1 2023 to 3.71 billion, although relative to GDP it fell by 5.3 points to 272.8%, the lowest ratio since Q1 2009, due to the significant increase in nominal GDP. This decrease in overall levels of debt has been driven exclusively by the non-financial private sector (households and businesses), since general government debt[2] rose slightly to 131.9% of GDP, although it is still close to its lowest levels since 2013.

In the case of households and businesses, their debt fell by 28.4 billion euros to a total of 1.92 billion, equivalent to 140.9% of GDP (146.6% at the close of 2022); in consolidated terms (excluding debt between companies, since in many cases this corresponds to holdings between parent and subsidiary companies), private debt stood at 121.1% (125.4% previously), so it remains below the threshold set by the European Commission in the Macroeconomic Imbalance Procedure (MIP).[3] Indeed, we have to go back almost 20 years (to Q2 2003) to find a lower ratio.

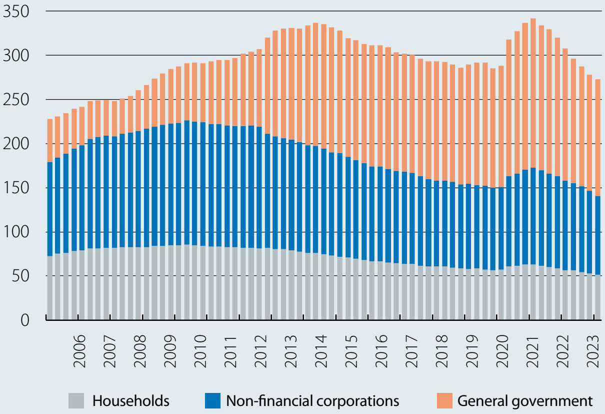
Next, we will analyse the financial flows and balances of households and businesses in more detail.

Households are allocating their higher savings to paying off debt

Households continued to deleverage in Q1 2023, reducing their debt by 7,866 million euros (–1.1%), placing it at 694,938 million. This amount represents 51.1% of

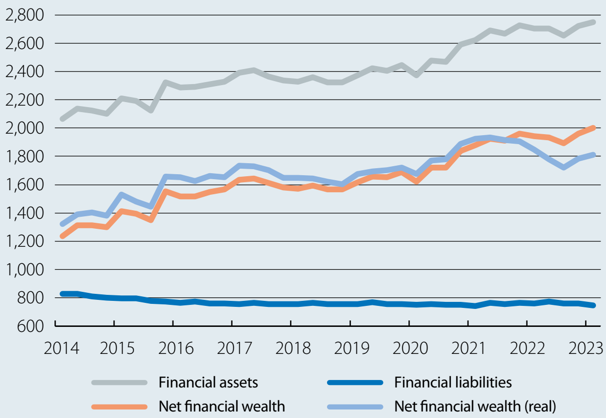
1. Debt in the form of debt securities and loans. Also, the debt of the economy as a whole does not include financial institutions in order to avoid double counting.
2. The concept of general government debt used in the Financial Accounts is broader than that used by the European Commission for the purposes of the Excessive Deficit Procedure (EDP): the latter, which stood at 113.0% of GDP in Q1 2023, includes the gross obligations of general government institutions in the form of cash and deposits, debt securities (at face value, not market value) and loans; it does not include the liabilities of general government institutions that are held by other such institutions, trade payables or other amounts payable.
3. A supervision mechanisms intended to prevent and correct macroeconomic imbalances in EU countries by monitoring 14 different indicators which trigger a warning when certain thresholds are surpassed; in the case of consolidated private debt, this threshold is set at 133% of GDP.

Spain: non-financial sector debt
(% of GDP)



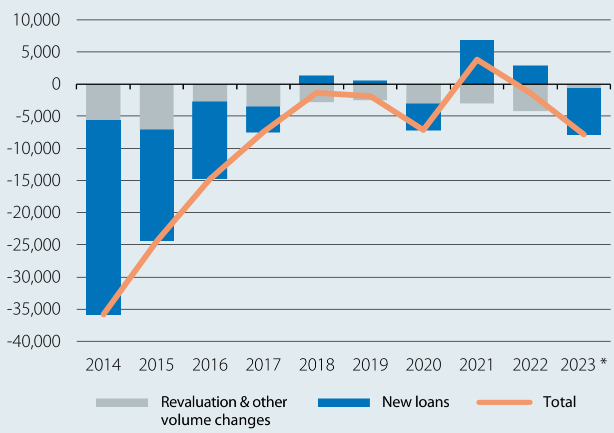
Note: *Unconsolidated debt.*
Source: *CaixaBank Research, based on data from the Bank of Spain (Financial Accounts).*

Spain: financial balance sheet of households
(EUR billions)



Source: *CaixaBank Research, based on data from the Bank of Spain (Financial Accounts).*

Spain: household debt
Change (EUR millions)



Notes: *Debt in the form of loans. * Q1.*
Source: *CaixaBank Research, based on data from the Bank of Spain (Financial Accounts).*

GDP, 2 points less than in the previous quarter and the best figure since 2002. Due to the rise in interest rates, households continued the trend initiated in the second half of 2022 and used their pent-up savings to make net payments on their bank loans of 7,268 million euros: this is the most negative flow in Q1 since 2014, which contrasts with the net increase in lending in Q1 2022 (443 million) and exceeds the average for the same period in 2014-2019 (–4,956 million).[4]

As for the households' net acquisition of financial assets, in Q1 2023 it was negative (–5,468 million euros), something not seen in a first quarter since 2017. Essentially, households reduced their cash holdings (–1,442 million euros vs. –2,719 million on average in 2014-2019) and, above all, their bank deposits (–20,776 million vs. –941 million); on the other hand, they invested 9,534 million euros in debt securities and 9,518 million in equities and investment funds.

The negative acquisition of assets was largely offset by their strong appreciation (34,897 million euros), mainly due to improvements in the valuations of equities and investment fund holdings. Thus, the stock of households' gross financial assets grew by 29,357 million euros to a total of 2.75 billion.

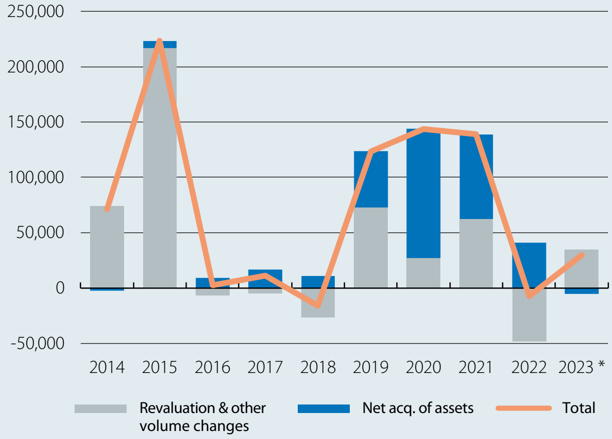
With regard to the composition of household financial wealth, we are witnessing a restructuring, as the relative weight of cash and deposits is reduced and instruments with a higher expected return, such as Treasury bills and investment funds, gain prominence. Thus, equities and investment funds accounted for 45.4% of households' total financial assets, the highest percentage since 2017 (43.0% in 2014-2019), while the role of cash fell to an all-time low (2.0% vs. 3.1% before the pandemic). Insurance policies and pension funds, meanwhile, are making a timid recovery after a long decline, although they remain close to their lowest levels since 1999 (12.5%).

As a result of the increase in financial assets discussed above, together with the fall in total liabilities[5] (–11,380 million euros), the net financial wealth of households has increased by over 40,736 million compared to the previous quarter, bringing the overall figure to just over 2 trillion euros, a new all-time high.

The fact that, at the aggregate level, households are improving their equity position is not incompatible with

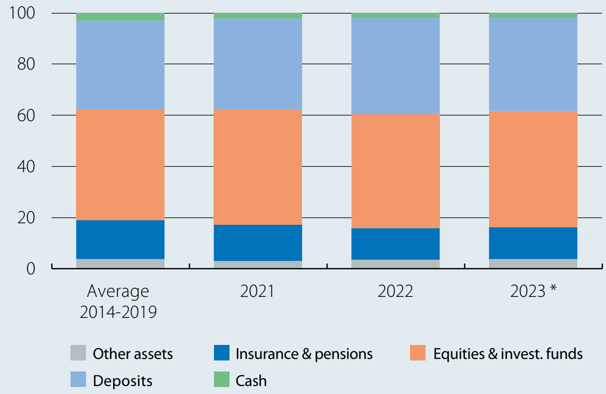
4. In addition to the decline in new lending observed since last summer, especially in the home acquisition loan segment, there has been an increase in the repayment of mortgages, essentially driven by variable-rate loans, the cost of which has risen sharply. See Bank of Spain (2023). «Report on the Financial Situation of Households and Firms. First half of 2023».
5. In addition to the balance of outstanding bank loans, this includes trade payables and other amounts payable (accrued interest on loans, taxes payable and outstanding social security contributions).

Spain: financial assets of households
Change (EUR millions)



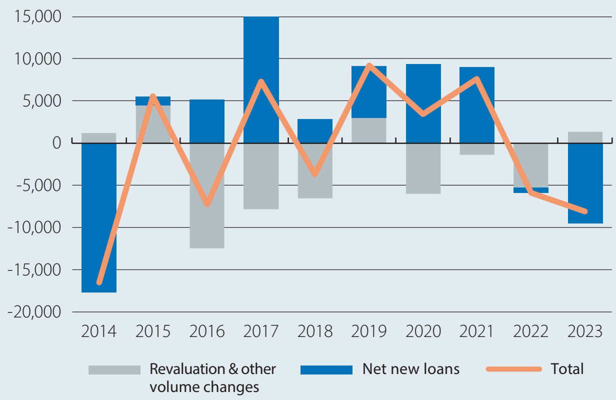
Note: ** Q1.*
Source: *CaixaBank Research, based on data from the Bank of Spain (Financial Accounts).*

Spain: composition of the financial wealth of households
(% of the total)



Note: ** Q1.*
Source: *CaixaBank Research, based on data from the Bank of Spain (Financial Accounts).*

Spain: consolidated debt of non-financial corporations in Q1
Quarter-on-quarter change (EUR millions)



Note: *Debt in the form of loans and debt securities, excluding debt with the same sector.*
Source: *CaixaBank Research, based on data from the Bank of Spain (Financial Accounts).*

the difficulties that some segments are experiencing, such as households with variable-interest-rate debts or those with lower incomes.[6]

Corporate debt, at a 20-year low

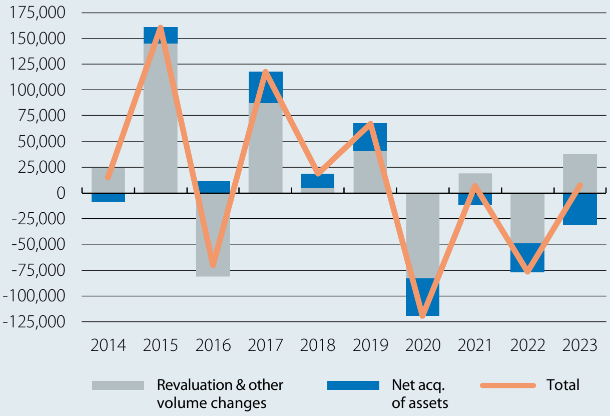
The net debt contracted by non-financial corporations (in consolidated terms) fell in the first three months of the year by 9,468 million euros, marking the biggest repayment in a first quarter since 2014 (–603 million in Q1 2022 and +2,121 million on average in 2014-2019). If we deduct a slight increase in the prices of fixed-income securities, along with other changes in volume, then the balance of consolidated corporate debt contracted by 8,116 million euros (–0.8%) to a total of 952,696 million; in terms of GDP, this is equivalent to 70%, the lowest ratio since Q3 2003.

As for corporations' financial assets, they increased slightly in Q1, by just 7,181 million euros (up to 3.03 billion). This marks an improvement on the figure of a year earlier (–76,766 million), but it is well below the 2014-2019 average (51,565 million). This increase in the asset balance is explained entirely by the significant appreciation in their value (37,600 million), especially in the case of equities and investment funds, since the net acquisition of assets was negative (–30,724 million), as has been frequently the case in the first quarter of recent years: firms reduced their assets held in the form of trade receivables, loans and, above all, cash and deposits.

Sergio Díaz Valverde

Spain: financial assets of non-financial corporations in Q1

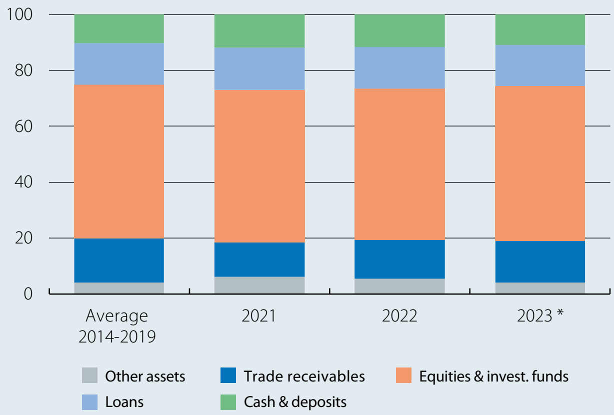
Quarter-on-quarter change (EUR millions)



Source: *CaixaBank Research, based on data from the Bank of Spain (Financial Accounts).*

Spain: composition of the financial wealth of non-financial corporations

(% of the total)



Note: ** Q1.*
Source: *CaixaBank Research, based on data from the Bank of Spain (Financial Accounts).*

6. See Bank of Spain (2023). «Report on the Financial Situation of Households and Firms. First half of 2023».

New outlook for Spain's tourism sector: strength and moderation

The Spanish tourism sector has got off to a good start in 2023. In the first half of the year, tourism has consolidated its status as one of the driving forces of the Spanish economy, completing its recovery following the complete shutdown in 2020, the insufficient improvement in 2021, and the boost it experienced in 2022. The National Statistics Institute's activity indicators show that, in 2023, real tourism output – without the effect of prices – exceeded that of 2019, driven by the boom in international tourism. Overnight stays in hotel and non-hotel accommodation establishments in the first seven months of 2023 exceeded those of the same dates in 2019 by 1.6%. This excellent figure is supported by the strength of domestic tourism, which exceeded the 2019 figure by 6.7%, as well as the strong recovery of international tourism, which stood just 1.6% behind its 2019 levels.

The figures for international tourist arrivals are showing an improvement across the board. We observe a dramatic recovery in the number of tourists coming from the Americas: according to data for the month of June, they were 27% above the level of May 2019. In contrast, more traditional markets are showing a more modest recovery. In particular, tourism from the UK is showing signs of weakness, still 6.9% below 2019 levels in the first six months of 2023.

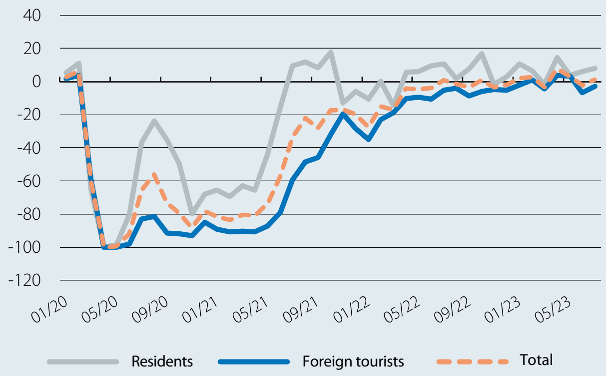
These good real demand figures have also occurred in an environment of sharp price rises. According to the CPI data for July, the hotel and tourism price component had amassed a 17.8% increase between July 2019 and July 2023. Tourism spending has thus received a double boost, with spending by international tourists in the first six months of the year surging 14.2% ahead of the same period in 2019.

The short-term outlook for the 2023 high season

The indicators for the public's interest in travelling to Spain, which help us anticipate trends during the high season, are reflecting the complexity of the international macroeconomic situation. Interest in travelling to Spain fell sharply in the United Kingdom in June, standing 12.5% below its benchmark level. The country's poor macroeconomic performance, the sharp interest rate hike and weak sterling are proving to be a significant barrier for British tourism. In addition, data relating to other competing destinations such as Türkiye, Greece, and Portugal suggest that they are managing to be more competitive when it comes to capturing British demand, and this is acting as an additional restriction for Spain.

Spain: tourist overnight stays

Change versus the same month of 2019 (%)



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

In contrast to British tourism, the interest of tourists from the EU in travelling to Spain is holding up rather well, and in the first seven months of 2023 it was 6.7% above its benchmark level. Looking at the EU figures broken down by country, of particular note is the strong interest in travelling to Spain among Germans and the Dutch, standing 9.5% and 8.4% above the benchmark, respectively. The indicators relating to France and, above all, Italy show greater weakness and reflect a fragile macroeconomic situation.

In the case of tourists from the US, we see a normalisation of the level of interest in travelling to Spain to pre-pandemic levels, suggesting that we will see very good figures for arrivals over the summer. This indicator also points to strong growth in the level of interest in travelling to Spain in Japan, standing 16.7% above the level seen in the benchmark period. These figures are consistent with the sharp increases in tourism from America and Asia observed in recent months.

Deceleration in late 2023 and throughout 2024

Although tourism is currently one of the driving forces of the Spanish economy, over the coming quarters we are likely to see several factors that will significantly moderate the growth of the tourism sector:

- The challenging macroeconomic landscape in the source countries of international tourists: despite the strong inertia of tourism demand, we expect the cumulative fall in real wages in 2022 and the tightening of financial conditions to limit the growth capacity of European tourism for 2024, something we are already seeing in the case of British tourism.

- The revival of more distant destinations for European and Spanish tourists: according to data on CaixaBank card payments made abroad, tourism spending by Spaniards abroad is still far from 2019 levels (especially in distant destinations) and we expect to see a recovery in the coming quarters, given that the international mobility of Spaniards ought to normalise over time.
- Competition from cheaper destinations: Spain's main competitors markets in the Mediterranean are delivering sharp competition in the current environment of high inflation and real wage declines. Prime examples include Türkiye and Morocco, two countries with very competitive prices.

CaixaBank Research forecasts for Spain's tourism sector

Despite the slower growth rate, after reviewing the key indicators of the sector we are left with a relatively positive outlook for 2023, for which we predict considerable growth. We expect the headwinds will begin to take effect especially towards the end of 2023 and during 2024, hence we expect to see more moderate growth in tourism GDP in the latter year. Even so, the tourism sector will continue to be supported by certain growth drivers, such as the recovery of long-haul markets (we expect very good figures from America and a recovery of the Asian market) and the resilience of European tourism demand in Spain thanks to the country's competitiveness as a destination.

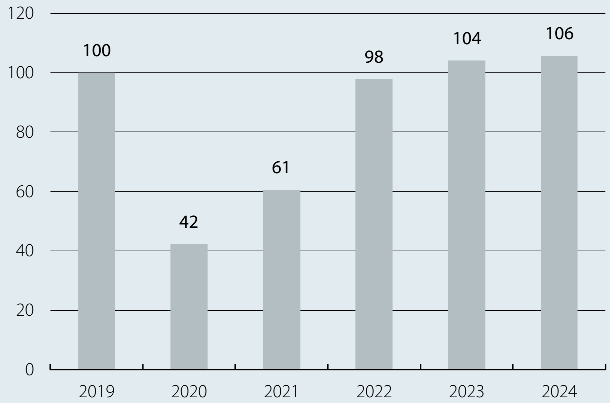
Taking into account the strong current situation, the headwinds mentioned above, and the growth drivers still available, our forecasts remain positive for 2023. We predict that real tourism GDP will achieve an annual growth of 6.5%, placing it 4.1% above the level of 2019. For 2024, we expect more moderate growth of 1.5%, which will place tourism GDP 5.7% above the 2019 level.

By country of origin, we expect domestic demand to grow by 0.4% in 2023, with a lower margin for growth compared to 2022 – when it already recovered to 2019 levels. As for international arrivals, we forecast that they will grow by 11% and that they will recover 2019 levels for the year as a whole for the first time since the outbreak of the pandemic. Looking ahead to 2024, we expect that international tourism will be the main driver of growth in the sector, supported by the recovery of long-haul tourism.

David Cesar Heymann and Javier Ibáñez de Aldecoa

Spain: real tourism GDP

Index (100 = 2019)



Note: *Forecasts from 2023 onwards.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Activity and employment indicators

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Industry									
Industrial production index	8.8	2.8	4.7	0.8	1.4	–1.6	–3.0	...	...
Indicator of confidence in industry *(value)*	0.6	–0.9	–5.1	–5.3	–4.4	–5.3	–8.7	–9.6	–6.5
Manufacturing PMI *(value)*	57.0	51.0	49.2	45.6	50.1	48.5	48.0	47.8	46.5
Construction									
Building permits *(cumulative over 12 months)*	4.7	15.4	8.8	2.6	–1.8	–	...	...	...
House sales *(cumulative over 12 months)*	9.6	28.9	22.9	17.2	10.0	3.3	1.0	...	...
House prices	3.7	7.4	7.6	5.5	3.5	...	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	64.7	129.8	208.8	129.8	90.7	40.6	40.6	31.5	...
Services PMI *(value)*	55.0	52.5	51.0	50.8	56.3	56.0	53.4	52.8	...
Consumption									
Retail sales	5.1	0.9	0.2	1.9	6.7	6.1	6.5	7.3	...
Car registrations	158.0	–3.0	3.1	2.6	45.5	9.9	13.3	10.7	7.8
Consumer confidence index *(value)*	–12.9	–26.5	–32.9	–28.1	–22.7	–18.9	–16.2	–11.6	–14.8
Labour market									
Employment [1]	3.0	3.1	2.6	1.4	1.8	2.9	–	–	–
Unemployment rate (% labour force)	14.8	12.9	12.7	12.9	13.3	11.6	–	–	–
Registered as employed with Social Security [2]	2.5	3.9	3.5	2.7	2.5	2.8	2.6	2.7	...
GDP	**5.5**	**5.5**	**4.9**	**3.0**	**4.2**	**1.8**	–	–	–

Prices

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
General	3.1	8.4	10.1	6.6	5.1	3.1	1.9	2.3	2.6
Core	0.8	5.1	6.2	6.5	7.6	6.2	5.9	6.2	6.1

Foreign sector

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	21.2	22.9	23.3	22.9	20.5	12.3	12.3	...	...
Imports *(year-on-year change, cumulative over 12 months)*	24.8	33.4	38.1	33.4	24.0	10.7	10.7	...	...
Current balance	**11.5**	**7.3**	**6.1**	**7.3**	**21.5**	**28.3**	**28.3**	**...**	**...**
Goods and services	17.9	18.5	14.4	18.5	34.1	44.6	44.6	...	...
Primary and secondary income	–6.4	–11.2	–8.3	–11.2	–12.6	–16.4	–16.4	...	...
Net lending (+) / borrowing (–) capacity	**22.4**	**19.2**	**18.0**	**19.2**	**35.1**	**41.9**	**41.9**	**...**	**...**

Credit and deposits in non-financial sectors [3]

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Deposits									
Household and company deposits	6.1	4.9	5.3	3.8	1.7	0.4	0.3	...	...
Sight and savings	10.3	7.9	8.2	5.0	0.3	–4.0	–5.1	–6.6	...
Term and notice	–24.4	–19.7	–19.2	–7.3	7.7	40.1	53.2	63.4	...
General government deposits	15.5	9.6	6.6	–3.2	7.4	6.8	6.0	12.3	...
TOTAL	**6.7**	**5.2**	**5.4**	**3.2**	**2.1**	**0.8**	**0.7**	**...**	**...**
Outstanding balance of credit									
Private sector	0.3	0.7	1.3	0.5	–0.9	–2.2	–2.4	–3.0	...
Non-financial firms	1.1	0.9	2.4	0.9	–1.0	–2.7	–3.1	–3.9	...
Households - housing	0.2	1.0	1.1	0.2	–1.2	–2.4	–2.7	–3.3	...
Households - other purposes	–1.2	–0.6	–0.9	–0.1	–0.1	–0.4	0.2	0.1	...
General government	15.3	0.2	–3.5	–1.1	–0.2	–3.3	–2.1	–5.1	...
TOTAL	**1.1**	**0.7**	**1.0**	**0.4**	**–0.9**	**–2.3**	**–2.4**	**–3.2**	**...**
NPL ratio (%) [4]	**4.3**	**3.5**	**3.8**	**3.7**	**3.5**	**3.5**	**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.*

After a strong start to the year, the Portuguese economy is losing steam

GDP stagnated in Q2, reflecting a deterioration in foreign demand following strong growth in the previous quarter, while domestic demand performed better, especially thanks to the improved tone in household consumption.

The latest data for Q3 offer mixed signals, albeit with signs of a slowdown. On the one hand, retail sales and vehicle sales remain strong, with growth of 3.6% and 9.6% year-on-year in July, respectively. Overnight stays by tourists are also encouraging and continue to exceed those of 2022. On the other hand, the daily economic activity indicator suggests a very modest year-on-year growth in August, while the economic climate indicator fell by 0.1 percent compared to July. As for prices, the preliminary inflation figure for August shows a new rally to 3.7% (driven by the rise in energy and unprocessed food prices), although the core component continues to decline.

The labour market remains steady in Q2, but the latest data reveal risks. The unemployment rate fell from 7.2% to 6.1% and the employed population reached the highest level since Q2 2009 (+1.6% year-on-year). Nevertheless, there are some warning signs, such as the rise in precarious employment, which accounts for almost 80% of the year-on-year increase in wage-earning employment, and registered unemployment, which grew by 2.5% year-on-year in July. In addition, there was an historically high number of workers made redundant, as well as an increase in mass redundancies and in unemployment benefit claims in July.

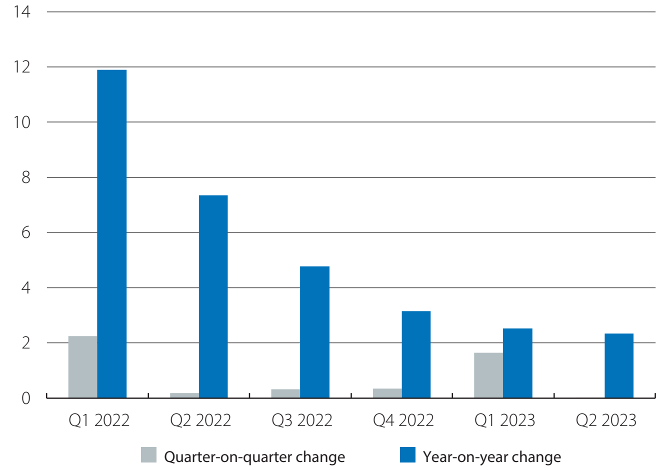
The public accounts remain in the black for the seventh consecutive month. The cumulative budget surplus up to July was 1.4% of GDP, with revenues increasing by 8.6% year-on-year and expenditure up 5.9%. The main drivers of these increases were the growth in tax revenues in the former case, and the rise in current transfers (as a result of the inflationary update to pensions and the growth in the number of pensioners) and staff costs in the latter.

Trade surplus in the first half of the year. Up to June, the trade surplus stood at just over 2.1 billion euros, in contrast with the deficit of just over 2.9 billion in 2022. This improvement is due to several factors: (i) the significant reduction in the energy deficit, thanks to both the normalisation of prices and the reduction in the volume of fuel imports, (ii) the marked improvement in the surplus of the tourism balance and (iii) the increase in the capital account surplus compared to 2022, thanks to EU funds to support investment.

The real estate sector shows a moderate slowdown. Prices are rising, but without the exuberance of the past, and the slowdown in the market is becoming apparent on the demand side. Home prices climbed 1.8% in Q2 2023, marking the lowest quarterly increase in two years. We continue to anticipate a soft landing for prices in 2023, supported by the encouraging Q1 data, the strength of the labour market and the limited real estate supply.

Portugal: real GDP

Change (%)



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

Portugal: labour market indicators

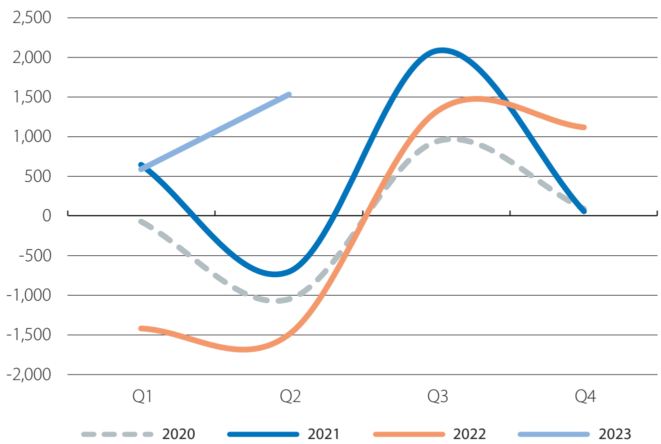
(Thousands of people, unless otherwise stated)

	Average in the month of July of the 5 years prior to the pandemic	July 2023	July 2022	Year-on-year change (%/pp)
Employment (NSI)	4,570	4,933	4,882	1.0
Unemployment (NSI)	469	330	310	6.4
Unemployment rate (%)	9.4	6.3	6.0	0.3
Registered unemployment	415	284	277	2.5
Job vacancies (thousands)	21.0	16.6	21.4	–22.7
Registered employment per S.S.	3,378	4,136	3,993	3.6
Redundancies (number of people)	609	4,031	2,981	35.2
Recipients of unemployment benefit	206	168	160	4.9
Mass redundancies *	2.1	1.9	1.5	22.6

Note: ** The data for mass redundancies refer to the cumulative result for the year up to June.*
Source: *CaixaBank Research, based on data from the National Statistics Institute (NSI), the Bank of Portugal, the IEFP and the Social Security Institute of Portugal.*

Portugal: quarterly current and capital account balance

(EUR millions)



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

Portuguese real estate sector: gentle deceleration

The Portuguese real estate market began to slow in the second half of 2022 as monetary policy shifted gear. Although the ECB has raised benchmark rates by 425 bps between July 2022 and July 2023, the slowdown in the Portuguese real estate sector is proving less pronounced than expected, at least in terms of housing prices, and this has led us to improve the growth forecast for 2023. However, looking ahead to the coming quarters, we continue to anticipate a significant slowdown in the Portuguese property market.

Home sales have declined significantly

The number home sales fell by 9% year-on-year in the cumulative trailing four quarters to Q1 2023, with a greater decrease in existing homes (–10.9%) compared to new-builds (+0.1%). Although sales have fallen from the record levels registered in 2022 (167,900), they are still 3% higher than those of 2019 (154,800). However, if we look exclusively at the figures for Q1 2023, sales during that period (34,400) were down 20.8% compared to the same period in 2022, with declines in both existing and new homes (–23.4% and –8.3%, respectively). In fact, we have to go back to a period heavily affected by the pandemic (Q2 2020) to find a quarterly sales figure lower than that of Q1 this year: 26,300.

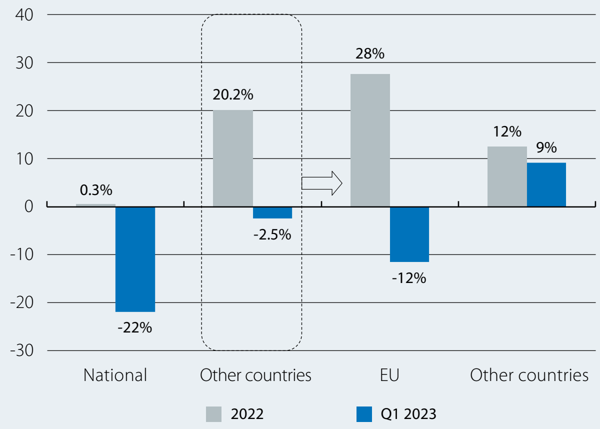
As for where buyers are coming from, purchases made by people who are tax resident outside the country (mostly foreigners) are holding up considerably better than acquisitions made by those with tax residency inside the country (mostly Portuguese nationals). Specifically, the number of purchases by foreigners only decreased by 2.5% year-on-year in Q1 2023, compared to a 22% drop in home purchases by Portuguese nationals. Importantly, this resilient performance of sales to foreigners is occurring even after the strong growth of 2022 (20.2%) and after the heightened restrictions on access to golden visas through the purchase of residential properties. Even among acquisitions made by foreigners, those made by non-EU citizens continued to climb in Q1 2023 (+9% year-on-year). Despite this pattern, home purchases by people who are tax resident outside Portugal represent just 7.2% of the total transactions (i.e. 2,492 units in Q1 2023).

Housing supply

The housing supply remains limited to meet residency needs, taking into account demographic trends. The

Portugal: home purchases by buyer's tax residence

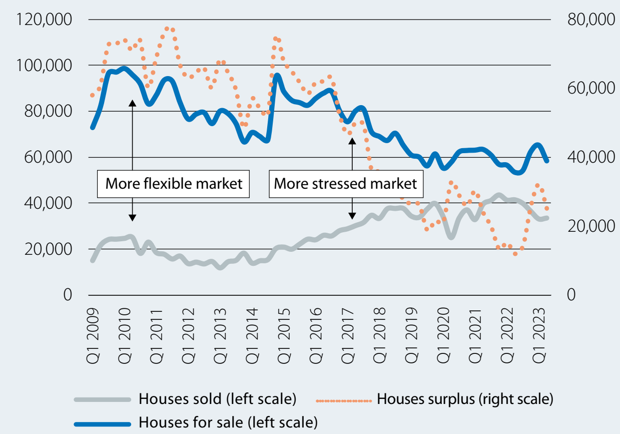
Year-on-year change (%)



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

Portugal: house sales vs. houses for sale and surplus

(Number of homes) *(Number of homes)*



Source: *CaixaBank Research, based on data from Confidencial Imobiliário.*

number of planning permissions granted for the construction of new housing in 2022 was 15,207, well below the average annual net household creation in 2021-2022 (34,000).[1] This buoyancy in household formation also reflects significant migratory flows; since 2017 there has been a positive migratory balance, which reached 86,900 people in 2022. Indeed, the foreign population residing in Portugal increased in 2022 for the seventh consecutive year and reached 757,000 people. Another way to reflect this lack of housing

1. In comparison, net household creation prior to the pandemic was around 17,000 households per year on average in the period 2015-2019.

supply is through the relationship between homes sold and homes for sale at any given time (see second chart, which includes both new and existing homes). The surplus of homes refers to the difference between the number of homes for sale and those sold: the lower the surplus, the fewer housing options are available to those wishing to buy, and this puts greater upward pressure on property prices. As is clearly apparent from the chart, this surplus has been decreasing over time – a trend which has intensified since 2015. Another factor limiting supply is the high residential construction costs. Although there has been a gradual moderation in construction costs in 2023 to date, in the trailing 12 months to May costs increased by 9.6%.

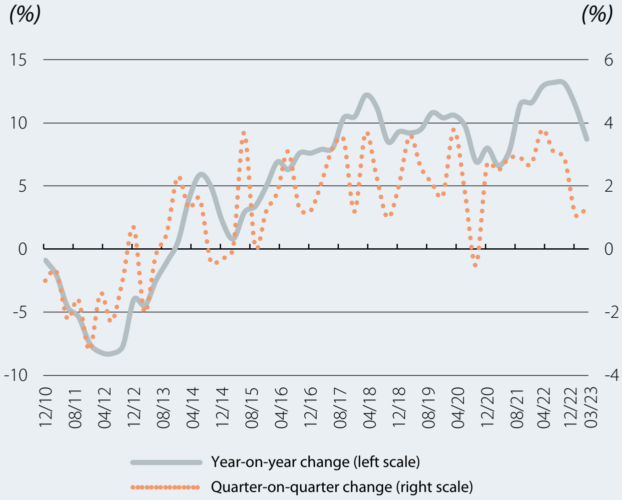
Home prices are holding up in a difficult environment

In 2023, we have seen a slowdown in the pace of house price increases. According to the index produced by the National Statistics Institute (see third chart), the year-on-year growth rate was above 10% for six consecutive quarters, before moderating to 8.7% in Q1 2023. From a more regional perspective, we see that the Lisbon metropolitan area and the Algarve were where the median sales value increased the most in Q1 2023 compared to the end of 2022 (+5.5% and +7.1%, respectively). This is partly because these regions have a higher proportion of foreign buyers. In the index produced by Confidencial Imobiliário (which has monthly data), a slowdown in the growth of prices is also evident and is more pronounced in Q2 of the year. In fact, in this index, home sale prices rose by 1.8% in that quarter compared to the previous quarter and registered the lowest quarter-on-quarter change in two years. We have to go back to Q1 2021 in order to find weaker quarter-on-quarter growth.

Update of the house price forecast

It is important to recall that there is a time lag between monetary policy action and its impact on the economy. In the case of the real estate market, this impact occurs through two channels. On the one hand, the higher cost of financing discourages a portion of potential buyers with less capacity to access credit, which leads them to seek necessarily cheaper homes. On the other hand, the update of indices for variable-rate loans occurs gradually over time, so the effort perceived by borrowers (as well as a potential decision to sell up) is also gradual. The second half of the year will be important for assessing the impact of the rise in interest rates in this market.

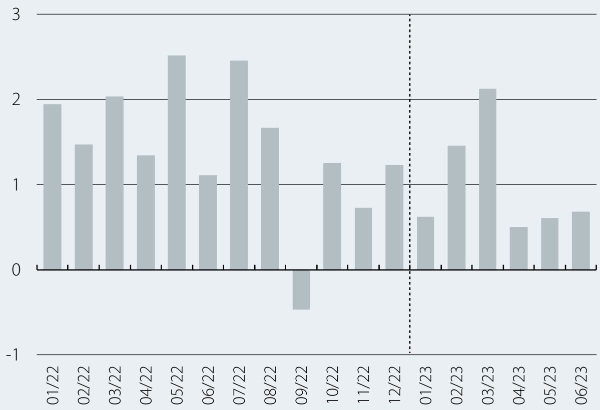
Portugal: house price index



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

Portugal: residential price index

Monthly change (%)



Source: *CaixaBank Research, based on data from Confidencial Imobiliário.*

Despite this, in July we revised our 2023 house price growth forecast up to 4%.[2] In this revision, we have taken into account the strength seen in price growth in Q1 (+1.3%). The resilience of demand, the short supply of new homes and the high construction costs will continue to support home prices, even in a context of sharp interest rate rises. Moreover, the labour market, with its low unemployment rate, is acting as a safety net for mortgages by limiting defaults, forced sales and price reductions.

2. Our forecast is produced for the National Statistics Institute's index, the Home Price Index.

For 2024, our outlook is not so optimistic: we anticipate a 2.1% decline in prices. One of the main factors behind this forecast is related to the sharp slowdown in demand. This year we expect that the number of sales will fall more than 20% short of the 2022 figure and that this low level will persist into 2024. Double-digit declines in demand for prolonged periods of time are compatible with price reductions, as we have observed in other developed-country markets.[3]

The particularities of the Portuguese market, as set out in this article, lead us to anticipate a more moderate reduction. Therefore, we consider it unlikely that we will see a significant correction in prices like that of 2011-2013, when the country was receiving financial aid and household debt was higher.

Tiago Belejo Correia

3. See parts I and II of the Focus «Advanced economy housing markets in a scenario of tighter monetary policy» in the MR04/2023.

Activity and employment indicators

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Coincident economic activity index	3.4	5.8	5.2	4.4	4.5	5.0	5.2	...	...
Industry									
Industrial production index	4.5	0.4	1.8	–0.3	1.0	–5.2	–3.7	...	...
Confidence indicator in industry *(value)*	–5.3	–3.4	–4.8	–6.3	–5.0	–5.6	–7.7	–8.9	–9.6
Construction									
Building permits - new housing (number of homes)	13.5	6.2	–3.2	13.5	8.7	–70.4	0.7	...	...
House sales	20.5	1.3	–2.8	–16.0	–20.8	...	–	–	–
House prices *(euro / m² - valuation)*	8.6	13.8	15.8	13.6	12.9	9.1	7.9	7.6	...
Services									
Foreign tourists *(cumulative over 12 months)*	51.5	158.9	244.8	158.9	117.2	52.6	52.6	38.5	...
Confidence indicator in services *(value)*	0.1	15.1	16.9	9.9	11.1	13.4	11.7	8.2	6.3
Consumption									
Retail sales	4.9	4.8	3.3	0.0	1.7	3.0	3.8	3.4	...
Coincident indicator for private consumption	4.9	4.1	2.9	2.2	3.0	4.4	4.9	...	...
Consumer confidence index *(value)*	–17.2	–29.7	–31.8	–37.0	–35.1	–29.4	–26.8	–23.7	–21.9
Labour market									
Employment	2.8	2.0	1.1	0.5	0.5	1.6	1.3	1.0	...
Unemployment rate (*% labour force*)	6.6	6.0	5.8	6.5	7.2	6.1	6.3	6.3	...
GDP	**5.5**	**6.7**	**4.8**	**3.2**	**2.5**	**2.3**	–	–	–

Prices

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
General	1.3	7.8	9.1	9.9	8.0	4.4	3.4	3.1	3.7
Core	0.8	5.6	6.5	7.2	7.1	5.7	5.3	4.7	4.5

Foreign sector

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	18.3	23.2	23.0	23.2	21.6	11.7	11.7	...	...
Imports *(year-on-year change, cumulative over 12 months)*	22.0	31.7	35.5	31.7	24.4	12.6	12.6	...	...
Current balance	**–1.6**	**–2.8**	**–3.8**	**–2.8**	**–1.2**	**1.5**	**1.5**	**...**	**...**
Goods and services	–5.5	–4.7	–5.0	–4.7	–2.8	–0.3	–0.3	...	...
Primary and secondary income	3.9	1.9	1.3	1.9	1.6	1.9	1.9	...	...
Net lending (+) / borrowing (–) capacity	**2.1**	**–0.5**	**–1.5**	**–0.5**	**1.5**	**4.5**	**4.5**	**...**	**...**

Credit and deposits in non-financial sectors

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	06/23	07/23	08/23
Deposits [1]									
Household and company deposits	9.3	6.4	7.8	6.4	0.5	–2.1	–2.1	–2.3	...
Sight and savings	16.3	7.3	11.2	7.3	–3.1	–9.0	–9.0	–9.6	...
Term and notice	1.2	5.2	3.3	5.2	5.4	7.5	7.5	8.0	...
General government deposits	–4.1	12.4	–0.1	12.4	11.1	1.4	1.4	6.5	...
TOTAL	**9.0**	**6.5**	**7.5**	**6.5**	**0.8**	**–2.0**	**–2.0**	**–2.0**	**...**
Outstanding balance of credit [1]									
Private sector	2.9	1.8	2.3	1.8	0.0	–1.2	–1.2	–1.4	...
Non-financial firms	2.2	–0.4	0.1	–0.4	–2.1	–3.6	–3.6	–3.6	...
Households - housing	3.3	3.2	3.8	3.2	1.5	0.1	0.1	–0.3	...
Households - other purposes	3.0	2.9	3.3	2.9	0.0	0.4	0.4	0.4	...
General government	3.8	–2.7	–1.5	–2.7	–2.0	0.6	0.6	–3.0	...
TOTAL	**2.9**	**1.7**	**2.2**	**1.7**	**–0.1**	**–1.2**	**–1.2**	**–1.5**	**...**
NPL ratio *(%)* [2]	**3.7**	**3.0**	**3.2**	**3.0**	**3.1**	**...**	–	–	–

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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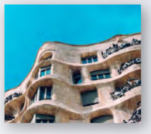

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